The story of the UK’s economic resilience of 2023 is being put to the test – the impact of all those hikes in interest rates may just be beginning to more obviously weigh on growth, according to the latest PMI suveys. The situation is little better elsewhere, with the eurozone in particular exhibiting signs of weakening economic momentum.

The word or phrase backtrack in a dictionary.

Yikes! A sharp drop in August’s flash PMI suggests that high interest rates are finally taking their toll on the economy. The almost three-points drop to contractionary territory (47.9) was below consensus of a modest expansion (50.4) and broad-based. New orders dropped to a nine month low, due to a weakening of demand at home and abroad. Noting that this drop is despite companies working through order backlogs at the fastest pace since mid-2020, downward pressure is likely to mount once these backlogs are cleared.

Err on the side of caution. GfK's composite index of consumers' confidence in the UK rose to -25 in August, from -30 in July. This renewed recovery comes on the back of the fall in energy bills in July and the pullback in mortgage rates over the past few weeks. However, over half of adults reported that their cost of living had increased compared with a month ago. 51% reported having to spend more on food shopping than usual for what they normally buy, an increase from 43% in the previous period. Among renters and mortgagors, 36% reported finding it very or somewhat difficult to afford these payments.

Heating up, for some. A year ago, upward revisions to estimated UK energy bills to ever more frightening levels was causing consternation for households. This year, things are very different. Ofgem confirmed on Friday that the typical energy bill will be £1,923 for Q4: £200 less than the effective level of £2,100 last year. But that, as the Resolution Foundation points out, masks some potential divergences. Households that use relatively little energy will see their bills rise this winter. If households consume less than 80% of the average (which applies to 35% of households and close to half of those in the lowest income decile) they will see a rise. For some, it will be significant. 13% of households will see a hike of more than £100.

Mounting pressures. Higher interest rates are putting pressure on corporate debt serviceability. The proportion of UK corporations with low interest coverage ratios, indicating debt servicing difficulties, is projected to rise from 45% in 2022 to 50% by end-2023 based on market expectations for interest rates. However, current vulnerabilities remain below previous peaks during the Global Financial Crisis and Dotcom crash. It would require a further significant rise in rates beyond current expectations to reach those prior vulnerability levels. While rising rates raise near-term corporate debt risks, UK banks are better capitalised now, mitigating risks of credit supply constraints that amplified economic impacts post-GFC.

Growing pains. Often the latest signals distract from the underlying forces that shape our future. While ‘real-time’ economic indicators suggest more of the same (job adverts and card spending slightly weaker, nothing more), the UK’s working age population is probably rising quite sharpish. Immigration’s the key. Work visas rose by 208,295 (+68%) in the year to June. Study visas were up 165,968 (+34%). New arrivals are more skilled (+34%), especially in health care, up a whopping 157% to 121,290. Indian nationals are clear top country of origin. Those worried about inflation can take comfort. This definitely did not happen in the 1970s.

The Balance Sheet. The latest public sector finances are a mixed bag. Net borrowing in July reached £4.3bn, far better than the £6bn forecast by the OBR and £5bn by economists at Reuters. In addition, public sector borrowing was £56.6bn in March-July, well below the OBR’s forecast of £68bn. Central government receipts, too, increased by £3.4bn compared with July’22 , owing to higher company profits, wage growth and inflation. However, borrowing for July exceeded the year- earlier figures by £3.4bn. Additionally, public sector net debt overall grew to 98.5%—1.9 ppts higher than a year prior and reaching levels last seen in the early 1960s. 8.9% of this net debt was from the Bank of England.

Feeling the pain. Similar to the UK, the downturn in eurozone business activity is deepening. The composite EZ PMI slipped to a 33-month low of 47.0 in Aug, from 48.6 last month, with sharp falls in output and new orders. Services slid below the 50 mark for the first time in seven months while manufacturing continues to decline. Eurozone recession fears are climbing with Germany likely to be the worst performer. Across the pond, US PMIs also fell to a six-month low of 50.4 in August, from 52 suggesting the US economy is also struggling for traction. Price rises remain elevated while manufacturing is contracting, and services had the slowest growth since February. All in all, the economic pain of tighter monetary policy is coming through.**Talking tough.** Chairman of the US Federal Reserve, Jay Powell, wants you to know they might not be done yet. Speaking at the annual conference on monetary policy at Jackson Hole, he emphasised that whilst inflation might be falling, it was still too high and that more tightening may be needed to sustainably reduce it further. In the US wage pressures appear to be abating faster than in the UK, so the top of the Fed’s rate hiking cycle feels closer than the Bank of England’s.