Financial markets globally are taking in the “higher for longer” rhetoric. But non-market sentiment on the subject, be it economists or firm owners themselves, remain diverged. Firms’ expectations of prices and wage growth are coming down steadily. Further, the impact of already-announced rate hikes is just starting to be felt. Should it become apparent that the Bank of England has done too much, rate cuts may be upon us sooner than we expect.

Falling in line. Financial market last week put a premium on the risk of ‘sticky’ inflation, raising the prospect of higher-for-longer. But a survey of UK businesses suggests that it might be an overreaction. Expected inflation over the next year is at the lowest level since the question was first asked in July last year. More importantly, wage growth expectation have also moderated since peaking last December. It made sense as employment growth is expected to slow down to 1.1%, lowest since December 2020. To boot, only one-fifth of the

firms now find it very hard to recruit, compared to nearly two-thirds in June 2022.

Exceptionalism. Drawing parallels with the US and Euro Area (where the descent of inflation began earlier than in the UK), the Resolution Foundation noted in its Macro Policy Outlook report that the Ofgem price cap delayed the impact of falling wholesale energy prices on the headline inflation rate. The UK also lacks the strong productivity growth US enjoys, which can help break the link between rising wages and prices by pushing down firms' costs. But with the labour market loosening rapidly and the majority of the impact of rate rises still to show up in the data, the report remarks that the Bank of England may have overdone its tightening. So a "higher for longer" strategy may not be as likely as what many expect.

Recovering not recovered. September was a good month for UK showrooms with a 21% y/y rise in new car registrations. Dealers recorded a similar rise year-to-date but sales volumes remain over one-fifth below pre-pandemic levels (NI = -16%). Electrified vehicle uptake continued to grow with plug-in hybrid vehicle sales up 50.9% y/y and battery electric vehicles (BEV) up 18.9% y/y. BEV sales volumes were driven entirely by fleet sales while there was a notable fall in private purchases. With fewer than 1 in 10 private new car buyers opting for electric in September, the industry needs new incentives. Pushing back the ban on petrol and diesel car sales from 2030 to 2035 isn't one of them.

Could AI Help? Businesses are showing signs of optimism, with the lowest reported business concern since Feb-22 (63% of firms). Stronger domestic supply chains and reduced industrial action are helping. Yet, global supply chain disruption continues to pose threats as does weak demand, inflation and energy prices. Firms are also experiencing worker shortages, with more than half reporting insufficient staff to meet demands. Despite this, only a small minority (16%) are using Artificial Intelligence. Still, 19% of businesses plan to adopt AI technologies in the near future, most commonly to improve business operations.

Confident, but careful. Speaking of business concerns, the global narrative is shifting on what constitutes a risk to business. According to KPMG's 2023 CEO Outlook survey, majority remain confident of the 3-year ahead global outlook, but geopolitics and political uncertainty are the leading perceived risk for CEOs globally and in the UK today (these concerns weren't even in the top 3 last year!). While we may be out of the peak of the Cost of Living squeeze, 83% of UK CEOs surveyed fear that CoL pressures will negatively impact their business over the next three years. With the "higher for longer" rhetoric gaining traction, 84% of UK CEOs say rising rates could risk or prolong the threat of a global recession.

Déjà vu. An old golfing adage goes "you drive for show and putt for dough". This neatly describes the labour market. Having a high employment rate is welcome. But what really drives productivity (and prosperity) is skills. And the UK has a worsening skills shortage. Around 10% of firms had a skills shortage in 2022, up from 6% in 2017. A record 36% of vacancies are due to the difficulty of matching skills (22% in 2017). It's most acute in construction, ICT, manufacturing and Health & Social Work. It affects all levels. An easy putt is investment in skills. A miss then, that between 2017-2022 it fell from £58.1m to £53.6m.

Mixed bag. Employers in US added 336k jobs in September, far above the consensus estimate of 170k, and sharply higher from the upwardly revised figure of 227k in August. Job gains were driven by an expansion in hospitality, education, and healthcare. A pretty strong labour market still, in other words, despite higher interest rates and tighter financial conditions. However,the Fed is mostly interested in wage growth, and not payroll growth per se at this juncture. Average hourly wages rose just 0.2% m/m (below the expected 0.3%). While the unemployment rate held steady at 3.8%, near its record low. Policy-makers' job is again complex, and debate has intensified on whether the Fed will raise rates again in early November.

Term-time. Global government bond markets have seen a big selloff (rising yields) in recent weeks. Last week the 10-year yield in the US touched the highest level since 2007. So what’s going on? Partly it’s strong economic data supporting “higher for longer” interest rates that central banks have told us all to expect. But with the selloff increasingly occurring in longer-dated debt, the term premia (or the extra compensation investors demand) has moved into focus. A lot tends to get lumped into this category. But fiscal policy (or the sheer heft of government debt supply) is looming large. The US is running fiscal deficits that are on the large side given how low unemployment is. Is it all cause for concern? First and foremost it’s an economic headwind (it tightens financial conditions) but the potential for broader financial contagion from such a sharp move in a short period deserves watching.

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