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# Macro Research

## Weekly update 25/2019


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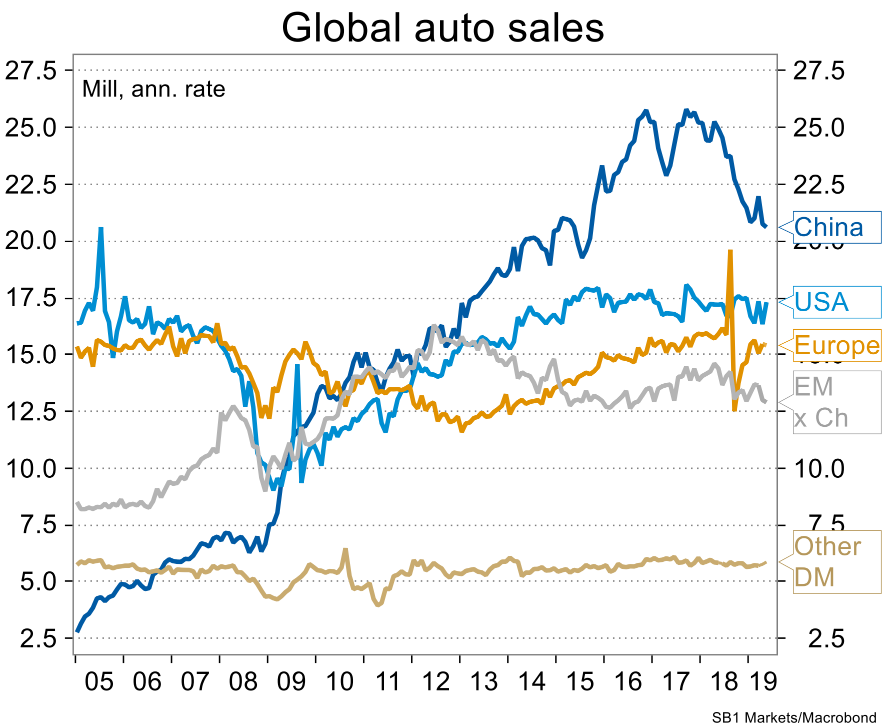
*The headlines are linked to the relevant section in the report*
*The elements on the the page "In this report" are linked*
*A top right button will bring you back to the content page*

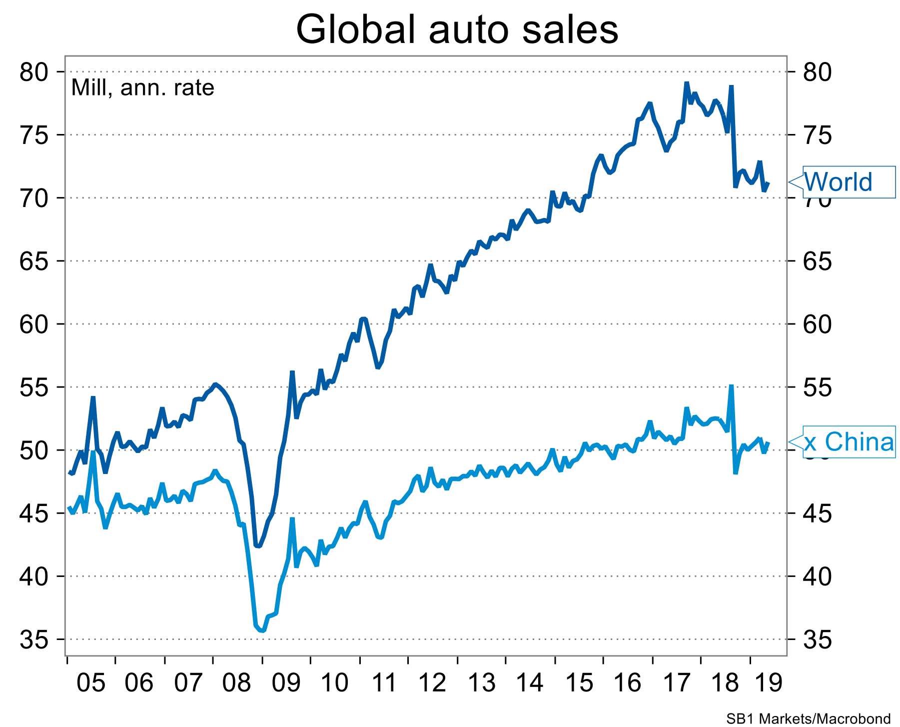
# Last week – the main takes

- Increased tensions in the **Persian Gulf** as two more ships were attacked (by Iran, according to the US) but markets did not panic. No major news on the **China/US** conflict
- **Global auto sales** rose marginally in May but sales are still down 8% y/y, driven by weaker sales in China and other Emerging Markets. China is down 17% y/y, a rapid slowdown. The US is probably heading slowly down too. EMU sales marginally down
- **China May data** were not weak, in our view, reflecting a stabilized economy (for now, at least). **Industrial production** slowed, according to both the official figure and our calculation. However, production has stabilized recent months, after sliding down through 2018. **Retail sales surprised** on the upside; noting brisk growth in May and a considerable upward revision of the previous months, may be reflecting a rebound in demand. **Investments** are growing steadily, although the speed has slowed marginally recently. **Credit growth** turned up in May, more or less flat the past year
- **US core CPI inflation** is easing; the annual rate came down to 2.0% in May, the 4$^{th}$ decline in a row. Cooling inflation is surely bolstering expectations of a Fed cut this summer. **Producer price inflation** is not implying much pressure on the consumer level either, and **small businesses** are nudging down their plans to raise prices. On the other hand; details on CPI suggests that the downswing is not driven by 'cyclical' sectors – and prices are accelerating in most sectors. The federal budget widened in May and the total government deficit equaled 6.9% of GDP in Q1! Quite extraordinary. **Retail sales** are gaining steam; core sales rose 0.5% m/m in value terms in May and April was revised up by 0.4 pp, pointing to a consumption rebound in Q2, and Q2 GDP forecasts were lifted by some ½ pp! Still, **manufacturing production** has fallen so far in 2019. Unfortunately, neither surveys nor order inflow point to any rebound
- **Eurozone industrial production** fell 0.5% m/m in April, less than we expected but the trend is sharply down. PMIs indicate that manufacturing will remain in the doldrums in Q2. Germany continues to struggle, down some 2.5% y/y
- **Norges Bank's Q2 Regional Network** was more upbeat than expected. Companies reported 3.0% growth the past months and expects 3.1% the coming 6 months, the highest since 2012 and well above Norges Bank's GDP growth f'casts (at 2.3% in Q3 and 1.9% in Q4). An important argument for a steeper interest rate path! The upswing is driven by oil services & related businesses but most sectors are slowly accelerating. Wage growth expectations nudged up 0.2 pp to 3.2%. **CPI inflation** fell short of expectations in May, core CPI rose 2.3%, down 0.3 pp and 0.3/0.2 pp below f'casts. Still, inflation remains well above the price target. With regards to Norges Bank, we expect a neutral CPI impact on the interest rate path, as inflation has been beating the f'cast in 2 of the 3 months since March

# Auto sales up in May, still weak; down 8% y/y

## Chines sales continues down, down 20% from the peak - but higher US sales saved the month

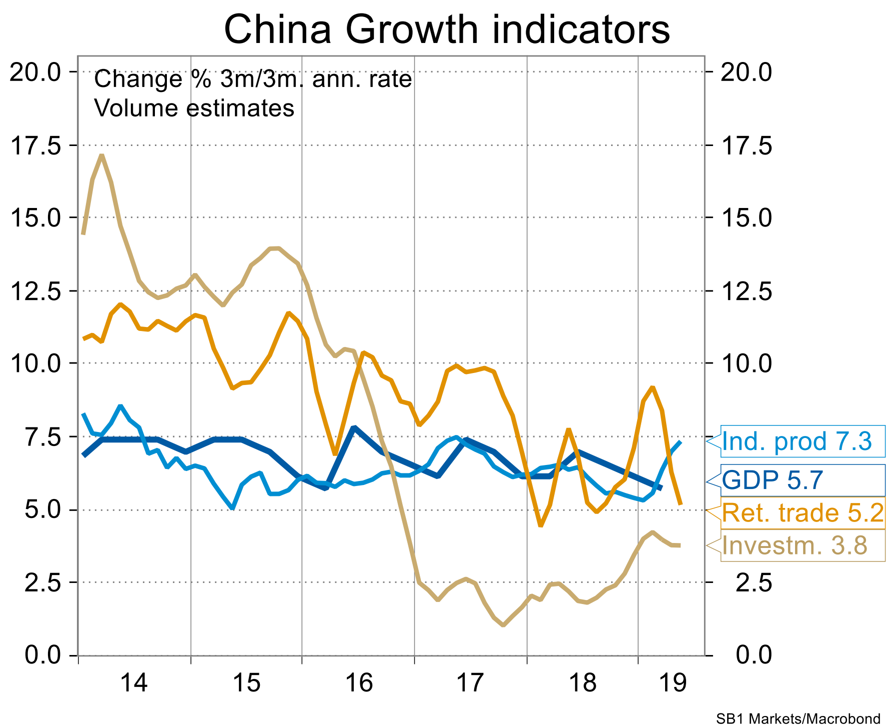



- Global auto sales grew 1% m/m in May following the 3% decline in April. Sales are down 8% y/y
- Sales in China fell 1% m/m, after the 6% drop in April. Sales are down 17% y/y and down 20% from the peak in Sept 17 - and the trend is surely still down. Sales are at the same level at 4 years ago! A huge shift in the Chinese economy!
- US sales recovered the April loss, but the average of the recent zigzag 5 months is below the level over the previous quarters, the trend is now slowly down
- Sales EMU fell marginally in May, and sales are still somewhat below the pre emission regulation level. Other DM pushed a tad harder on the accelerator in May
- Auto sales in EM ex. China is heading down again; mostly due to lower sales in India, Argentina and Turkey – and Indonesia and Mexico

# May data in sum upbeat, in spite some disappointing headline figures

## Industrial prod. stabilised, retail sales rebounding following revisions, investments grow steadily




GDP growth has been seriously overstated by National accounts since 2007, according to a Brookings Inst research paper, see some comment next page

**May data were mixed but in sum below expectations, at least the official data. However, the official data are volatile and not always useful, our calculations note a more upbeat outlook. <u>The most important message: We find no indications of a steep slowdown in China amid the escalating trade war</u>**

- **Manufacturing production** slipped to 5.0% y/y, according to the official data. However, our less volatile calculations yields a 5.8% speed, still above the Jan/Feb slump, indicating that growth has stabilised. Underlying growth has accelerated to 7.3% and the monthly rate was stable at 0.4%
- **The biggest surprise this month was retail sales,** which bounced back up in May, after a dip the prior month. Moreover, recent months have been revised up significantly (following a downward revision in April…), our volume estimate yields 6.6%, vs 5.3% one month ago! If correct, sales have improved since late 2018, in volume and value
- **Investment** growth was steady at 5.3% y/y in May, recent months were revised down somewhat, but not dramatically. The official YTD rate fell 0.3 pp to 5.6%, the same pace as in late 2018. In real terms, investments has most likely turned up the past years
- **Credit growth** picked up in May, after slowing in Q1. Growth has more or less flattened out, at some 11% y/y

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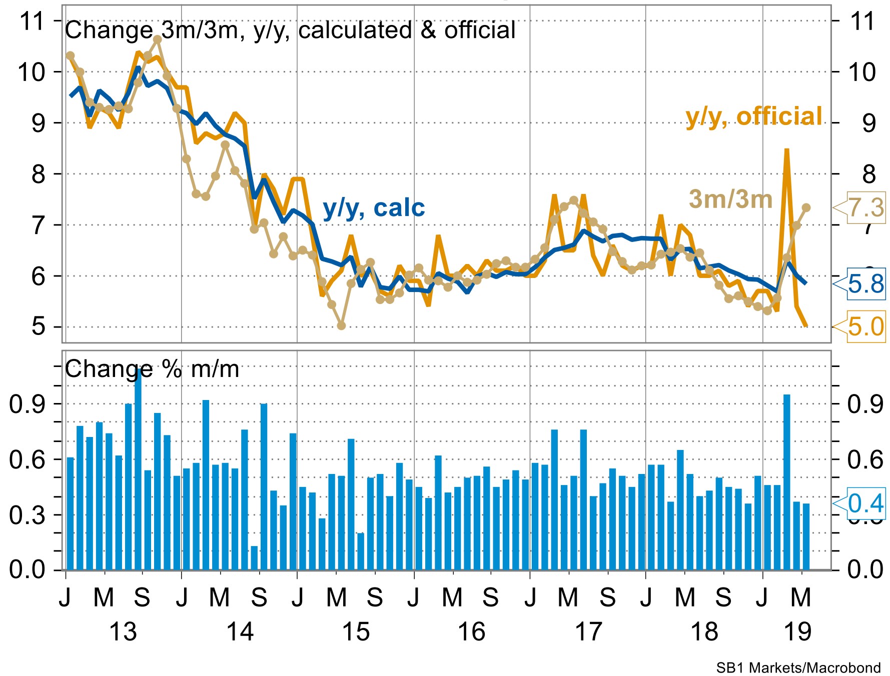
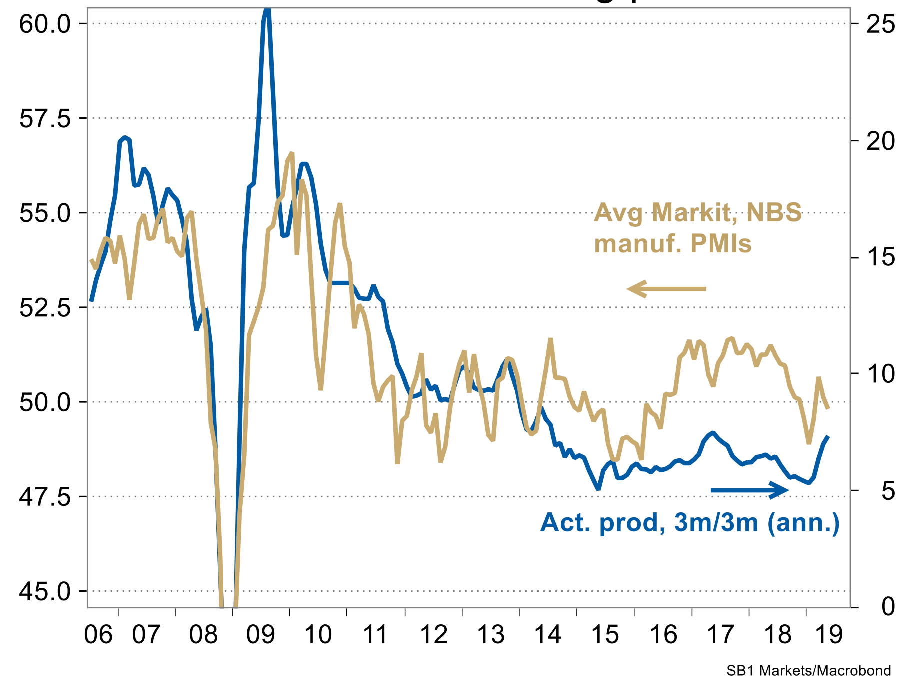
# Slower industrial production growth in May but is it that weak??

## The official y/y rate is rather grim – our less volatile calculation finds a stabilisation recent months

China Industrial production




China PMI vs manufacturing production

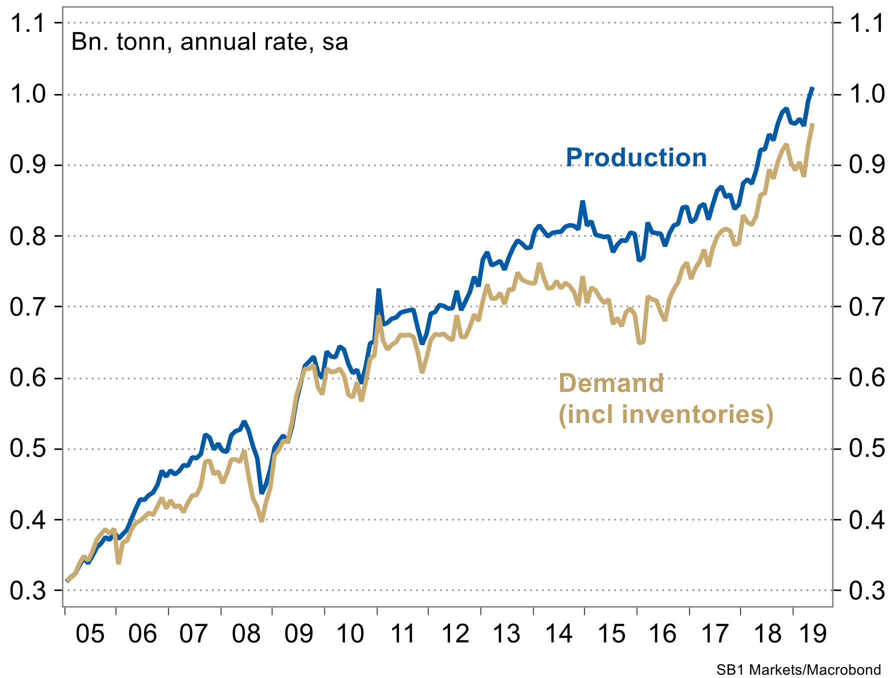



- Production rose 0.4% m/m in May, the same pace as in April. Growth the past two months is the slowest since the brief setback in July 2015 (just one month), and before that the 'shutdown' in Q4 2008. However, the unusual 0.95% hike in March of course complicate the analysis. Taken face value, growth the recent 3 months is higher than normal.
- The longer trend is anyway down, but most likely not as dramatic as indicated by the official annual growth rate at 5%, unexpectedly down 0.5 pp from April. The official rate is the lowest since 1991, barring some volatile single month prints 1997 – 2002. Our far less adjusted annual growth rate, based on official monthly seasonally adjusted data, ticked down to 5.8%, still 0.1 pp above the speed before the March hike – and it has not trended down recent months (though assuming the March hike is for real!).
- PMIs or other surveys are not signalling an abrupt halt in the manufacturing sector either. Export volumes are back to peak levels. <u>China has not been brought to a halt</u>

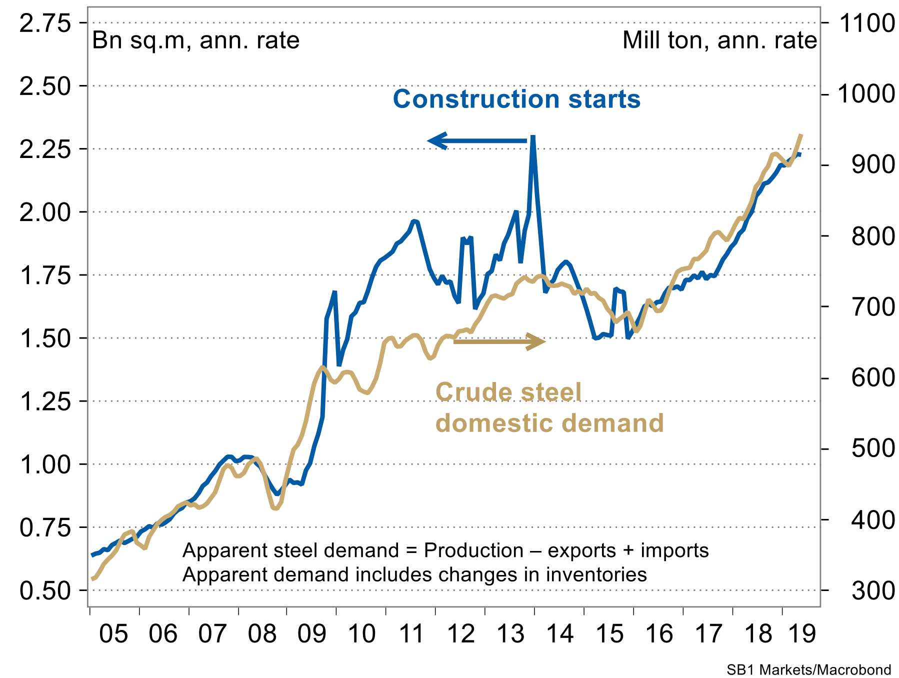
# Steel production (and demand) spikes, following a slowdown

Upward trend intact, after both demand and production softened last winter. Reduced overcapacity

China Steel



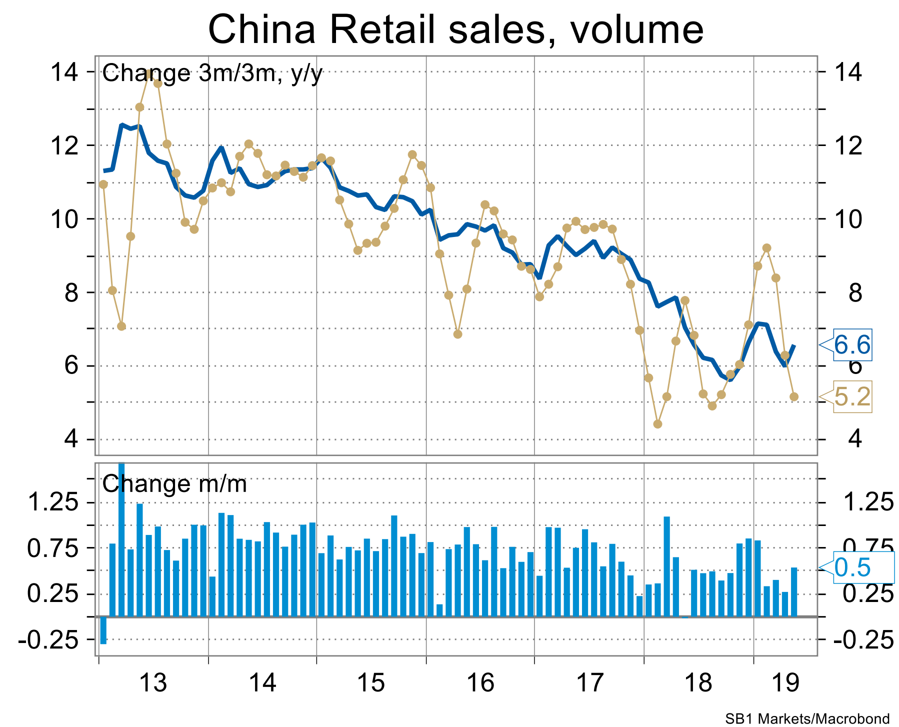

China Construction vs steel




- Production is up some 10% y/y and demand is expanding at a 12% speed, pretty well explained by the strong growth in construction starts. On the other hand, slowing auto production signals softening steel demand from that sector
- China is still a net steel exporter, but far less than during the 2015-16 setback in domestic demand. Back then, production was cut by far less than domestic demand and net exports soared. Now, net exports are far lower (and domestic demand closer to production.

# Retail sales rebounded after significant upward revisions

## Sales volume growth at 6.6% in May, vs 5.3% in April, indicating that growth has stabilised


- The official value growth rate bounced back up to 8.6% in May, from 7.2% the prior month, and well above expectations. Our less volatile value growth estimate (based on monthly seas adj. data) yields 8.7%, from 8.1% in April (revised up from 7.3%!). In April, the prior months were revised down significantly (so some cautiousness is needed)
- Our volume estimate rose 0.5% m/m in May (retail prices rose 0.2% m/m), and the annual rate came up to 6.6%, from 6% the previous month, which has been revised up from 5.3%. Thus, growth has recovered somewhat since late 2018 (if we believe these revisions). The May upswing in volume growth is surprising, as retail price inflation has been boosted by soaring pork prices (swine flue)
- Consumer confidence surveys have strengthened recent months, at very high levels. Even so, consumption is not thriving, even larger tax cuts may be needed to bring consumption up?

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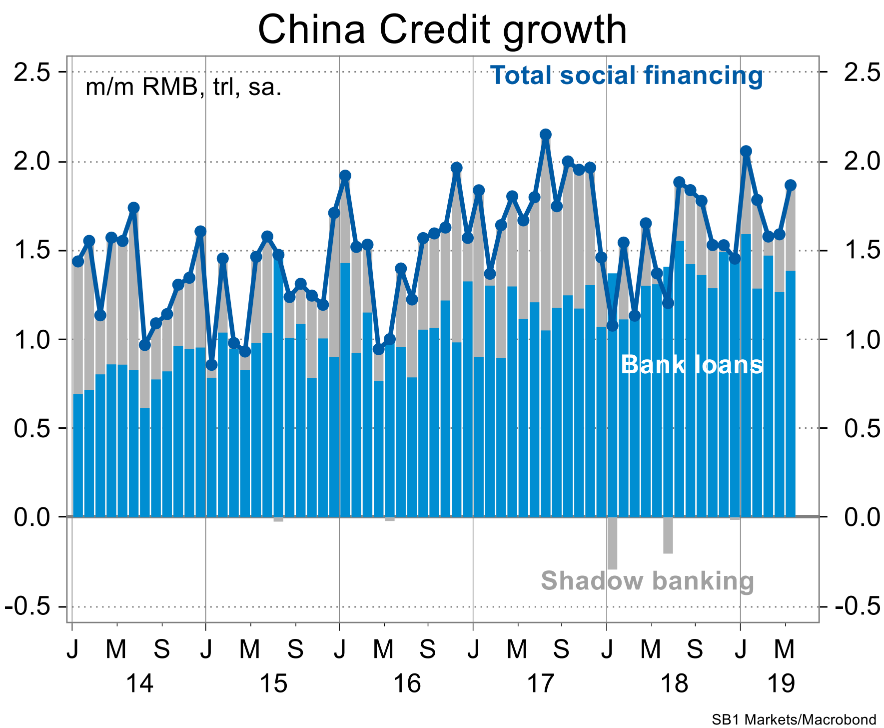
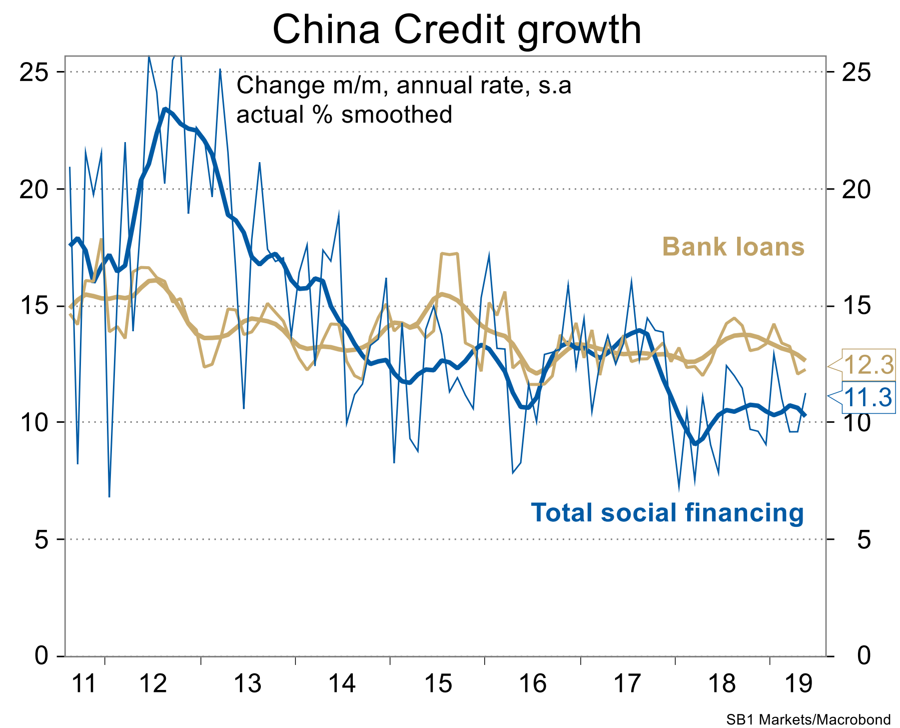
# Credit growth accelerated in May, trend not more than flat

## Credit growth through banks is slowing, shadow banking up, total credit growth flattening out



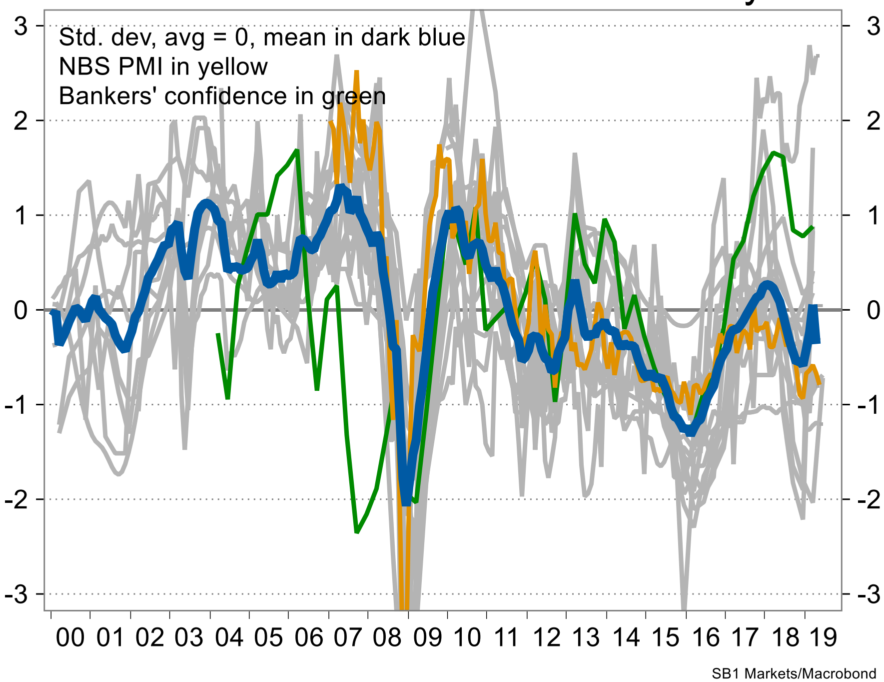




- Total credit rose by 11.3% m/m annualised in May, the highest in 4 months, and the recent trend is flat – and not accelerating. Total credit is up 10.5% y/y (from 10.3% in April, but lower than expected) – and above the reported 8% nominal GDP growth
  - » Both credit through banks and shadow banking accelerated in May. Still, during the recent months, lending through banks have slowed – even if authorities have tried to stimulate bank lending. The slowdown is not yet visible in the annual growth rate (see next page). Shadow banking lending is turning slowly up, after being curbed into 2018
- Total credit growth slowed substantially in early 2018, by some 5 pp, a substantial credit tightening. This credit contraction no doubt contributed to the slowdown in the Chinese economy last year, as several times before, and probably more than trade war/uncertainty. The authorities have implemented several measures to stimulate credit growth – at the same time as they do not want ignite another credit boom. Underlying Credit growth us up from the early 2018 slump but just marginally

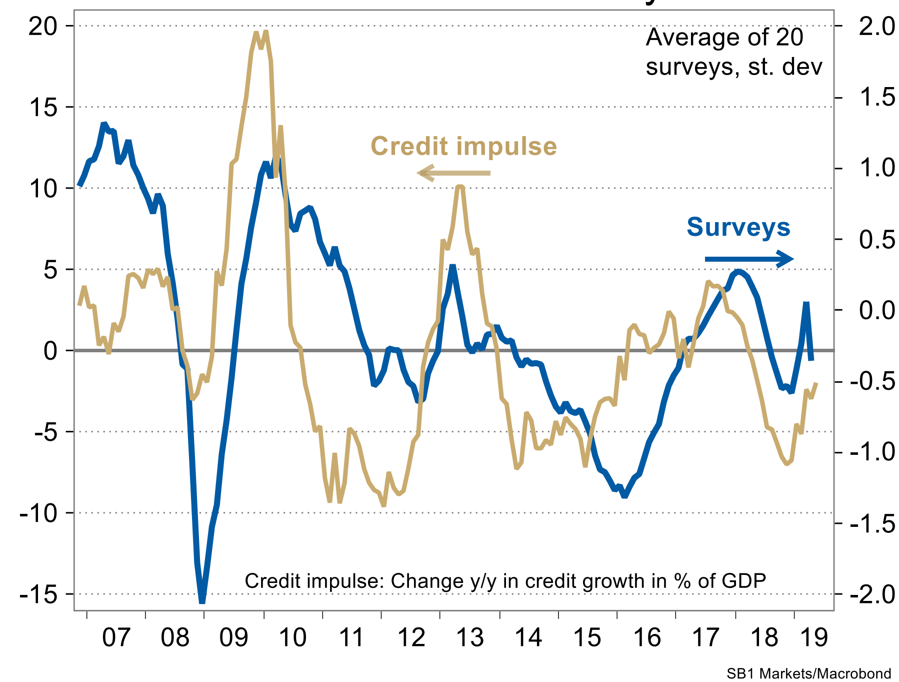
# Credit has been tightened, usually dampens growth

## We are most likely witnessing a growth slowdown but not a rapid one

China Business & consumer surveys



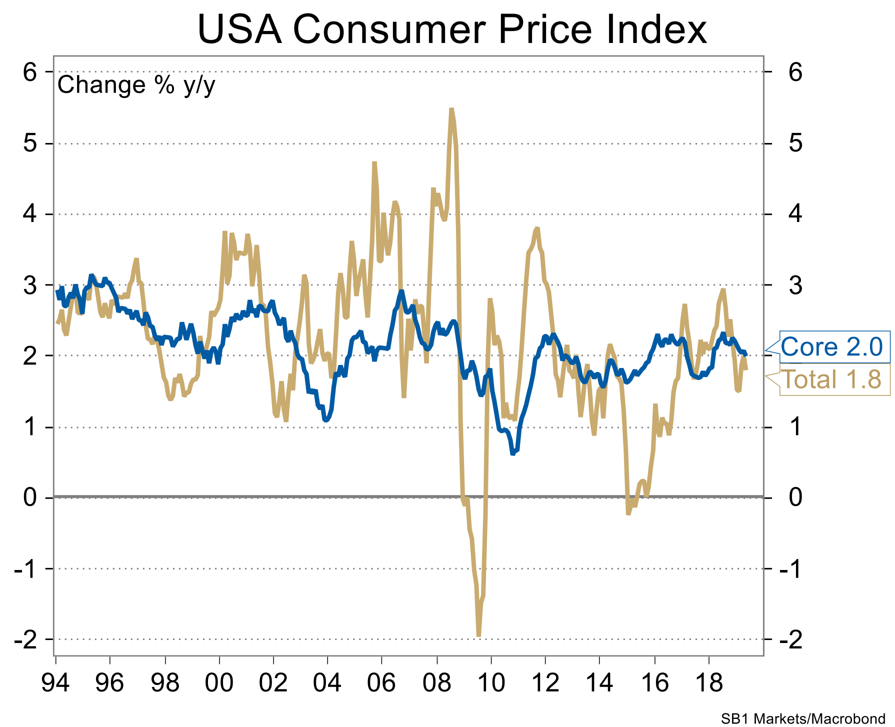

China Credit vs. surveys

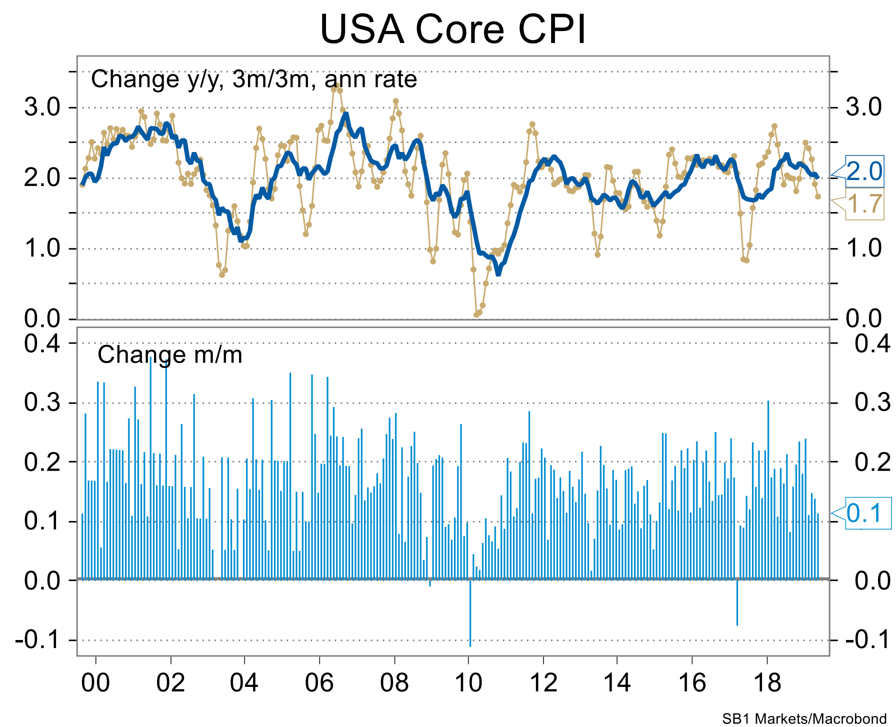



- An avg of Chinese business & consumer surveys indicates that growth has slowed significantly. However, the level is still not very weak, neither are the PMIs

# CPI core inflation eases, bolstering expectations of a Fed cut this summer

Core CPI rose just 0.1 % in May, for the 4th month in a row, exp. 0.2%, annual rate slides down to 2%

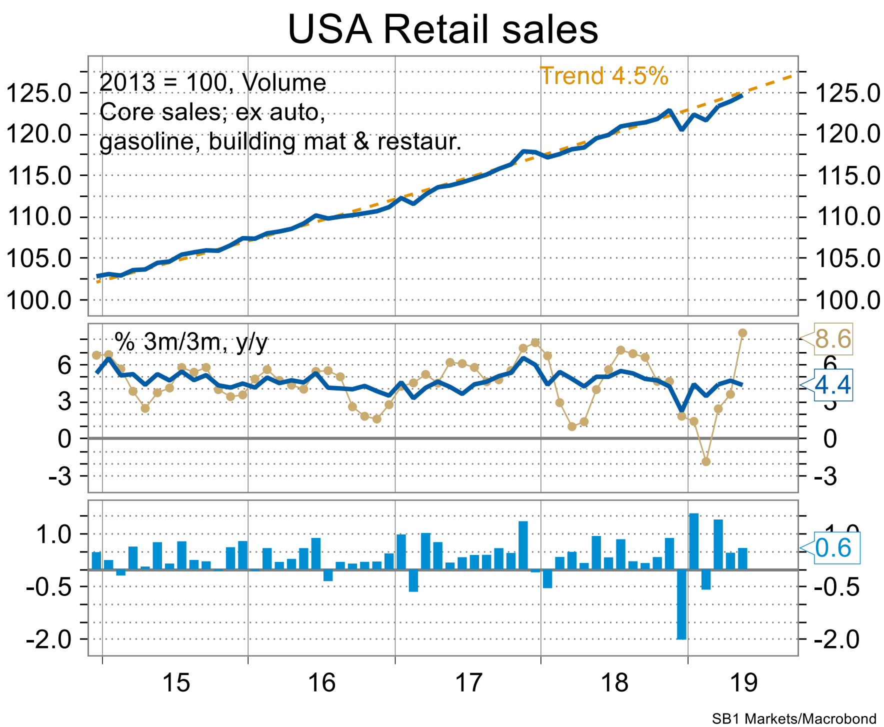


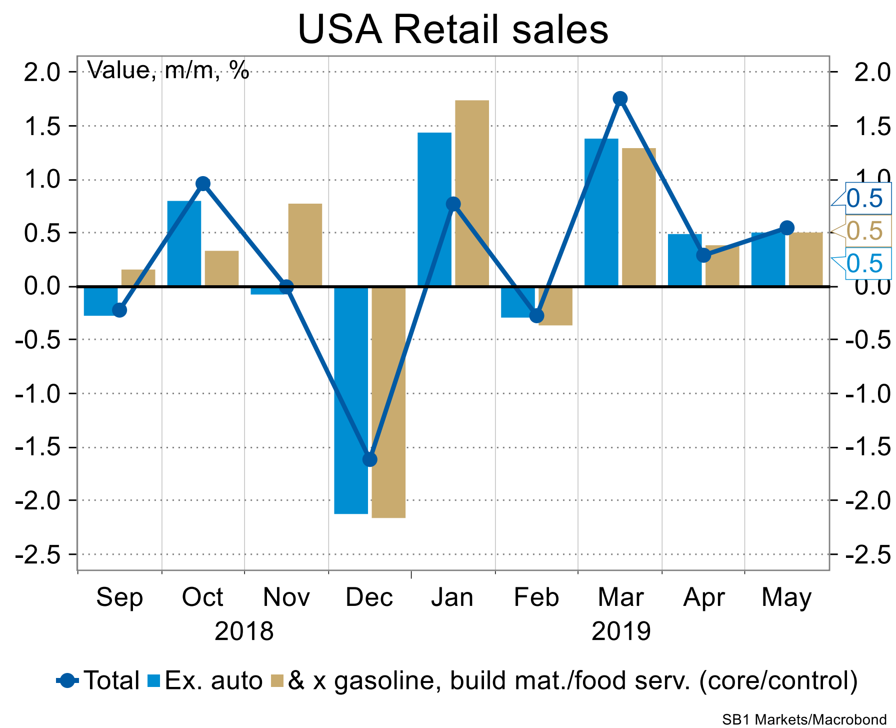




- Core CPI rose by 0.1% m/m in May, once more missing expectations by 0.1 pp. The annual rate inched down to 2.0%. Core inflation has no doubt moderated recent months, underlying growth down to 1.7%, from 2.5% in January
- Headline inflation ticked down 0.2 pp to 1.8%, as the impact from energy prices changed sign and was trimming inflation this month. The oil price fell significantly through May and will no longer boost inflation
- Core CPI inflation is down 0.4 pp from the local peak, an argument for a soft Federal Reserve. However, inflation is still close to the target (the core PCE deflator is 0.4 pp below the target) and the Fed has so far not expressed concerns about the cooling inflation. Rather, transitory factors have been highlighted

# Retail sales are recovering, came back to the old growth path in May

## Sales rose 0.5% in May and April was revised up by 0.4 pp to 0.5%; implying a strong rebound in Q2

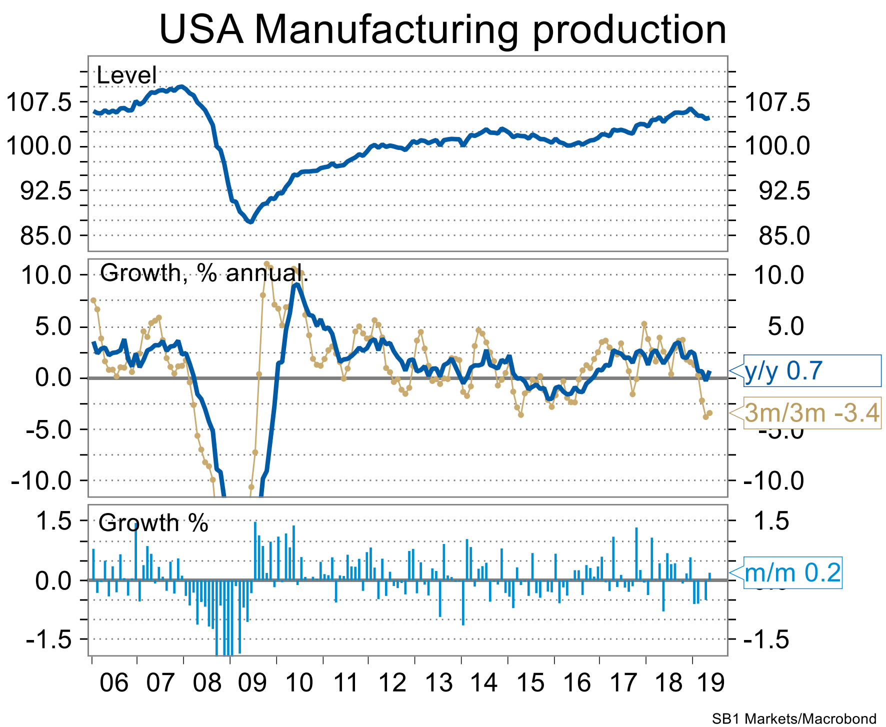


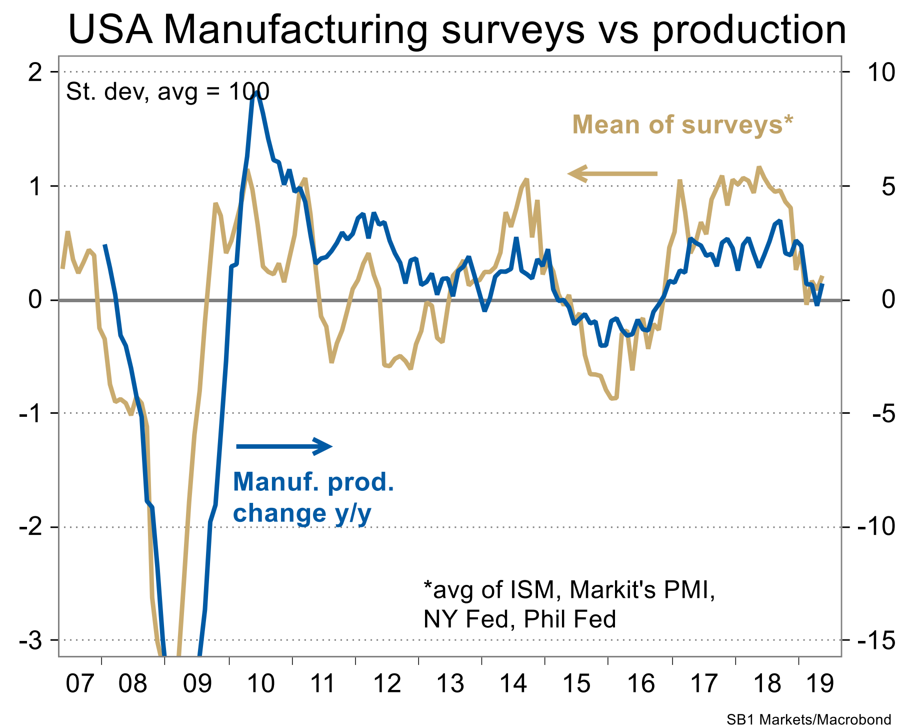




- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by 0.5% m/m in nominal terms in May, 0.1 pp above expectations. Moreover, April was revised up to 0.4%, from zero. Total sales up 0.5% too
- We estimate a 0.6% m/m volume growth in core sales, a marginal increase from the upwardly revised 0.5% in April. Given unch sales in June, core sales will have accelerated 6.6% in Q2, much better than the two previous quarters and total consumption may increase some 3%, contributing significantly to Q2 GDP growth (estimates were revised up by these figures)
  - » Consumer confidence is very strong and income and employment growth is supporting real income (and inflation subsides), and stock markets are recovering. No indications of a sudden slowdown in consumption at this point

# Manufacturing production is sagging, heading for a decline in Q2 too

## Production rose 0.2% m/m, as expected. Underlying growth down 3.4%, surveys are not promising




- Manufacturing production increased just 0.2% m/m in May, after the 0.5% drop in April. The slight increase was in line with expectations (which are dragged down by weak surveys). Production has slowed significantly and the 3m/3m speed has fallen to -3.4%. Production is still up y/y but just 0.7% and this rate will soon turn negative if production does not turn up
  - » Output has generally not been very impressive recent years (and remains below the 2008 peak) but rose slowly through 2017/18
- The manuf. data confirm the slowdown that surveys have been suggesting. Both the ISM and the PMI have softened rapidly, while the regional surveys are somewhat stronger. In average, the surveys are pointing to a stalling production

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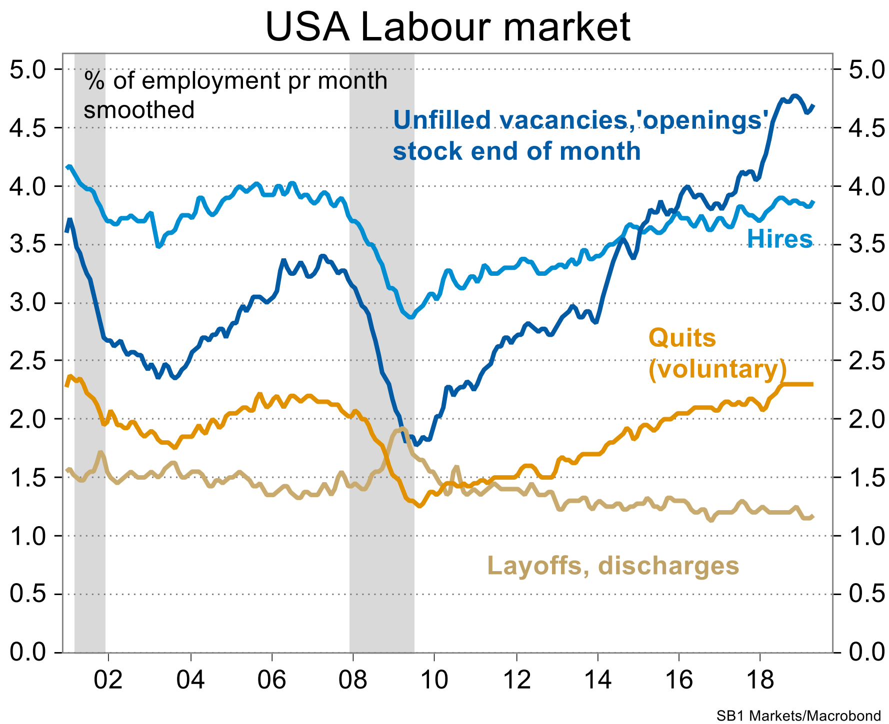
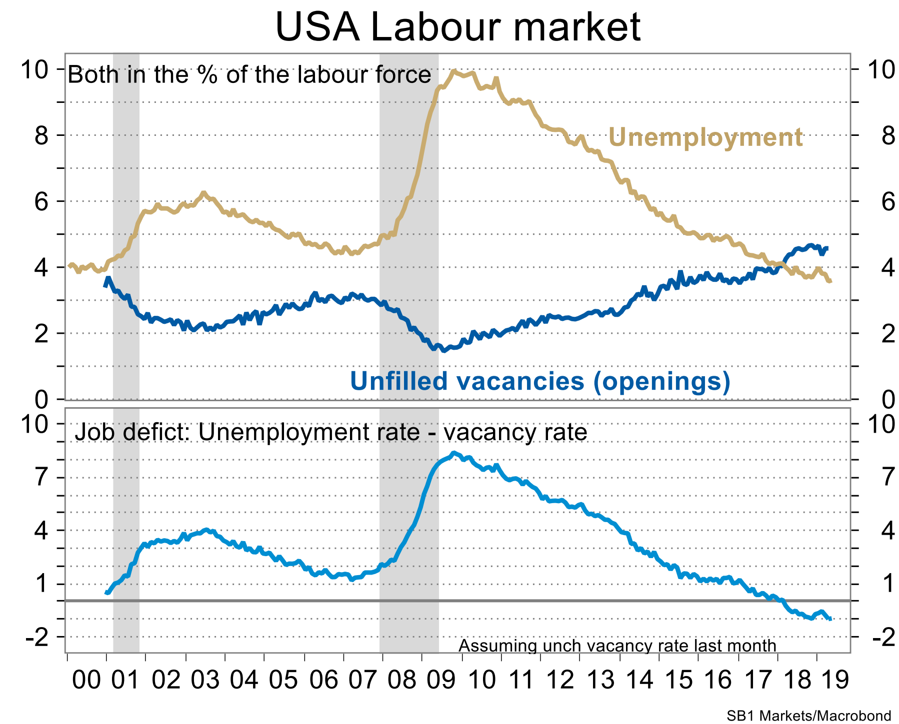
# Job openings, hiring have just flattened, at very high level

More hires in April (not May), openings stable after the March hike – and both at high levels

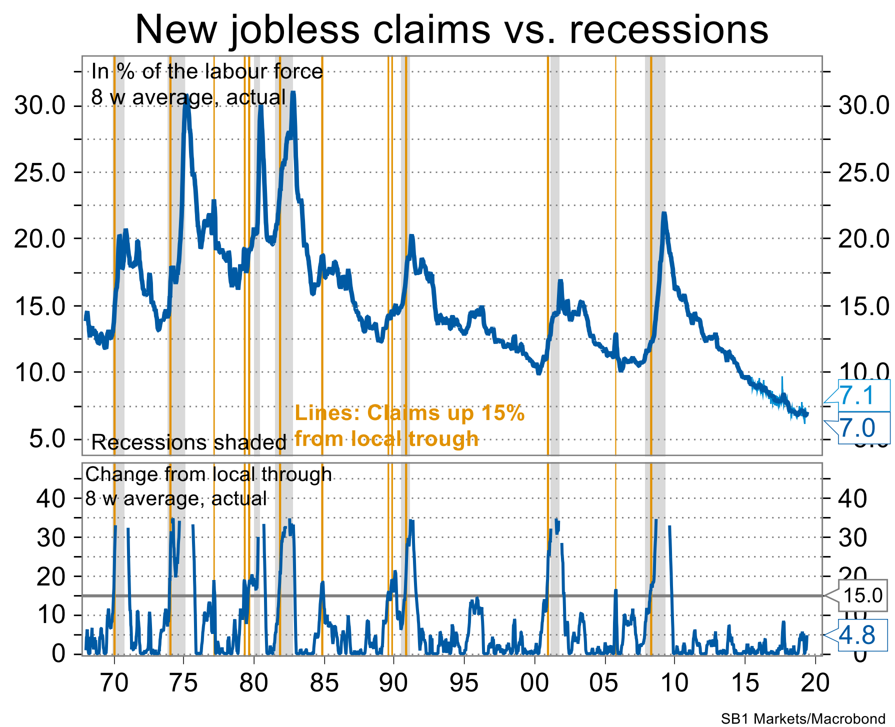


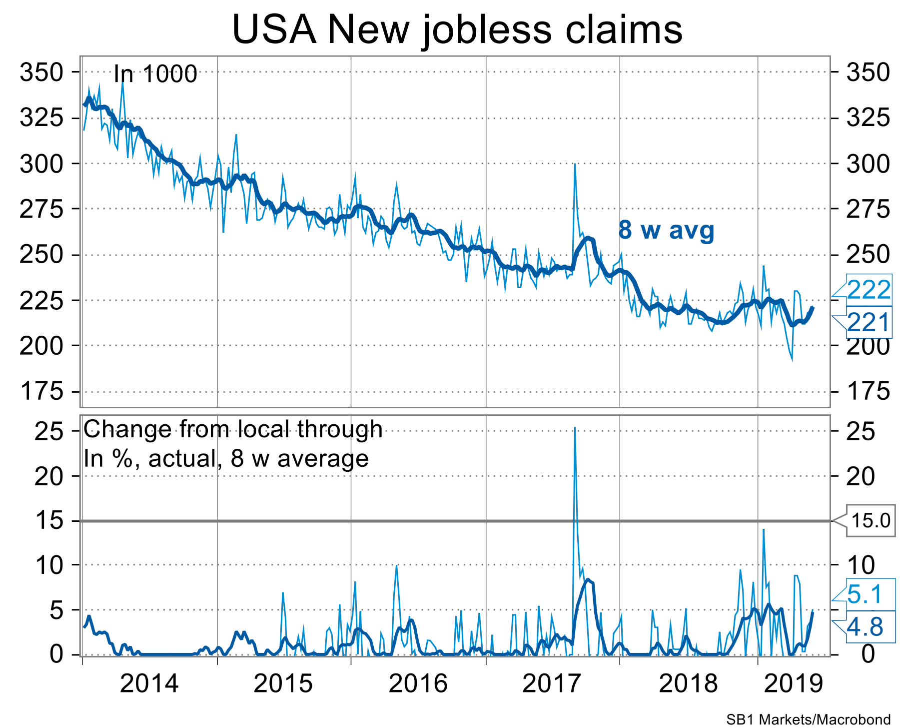




- The unfilled job openings rate was unch in April, following the March hike. The level is slightly down from the peak, still very high
- The hiring rate rose and is not far from the peak last year – and the level is high (3.8% per month)
- The no of unfilled vacancies are record high vs the no of unemployed; openings equal 4.7% of the labour force, above the unemployment rate at 3.6%, the labour market is very tight
- The number of voluntary quits has flattened recent months but remains at a very high level – as many employees leave for better (paid) jobs. Layoffs are trending down and is very low

# Jobless claims a tad up, no signs of labour market weakness

## Jobless claims (2 m avg) have been very low lately, reflecting a tight labour market




- Last week, jobless claims rose to 222', from 218' the prior week. Claims have inched up recent week, yet the level is still very low, the 8 week average is 221', up from  and up just slightly from the bottom at 193'in mid-April (the lowest since 1969!) The 8 week average is still very low, at 218', up from 211', the lowest since 1969
- A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow 'recession' warning line is to be drawn, check the chart to the left. So, no reason to worry now?

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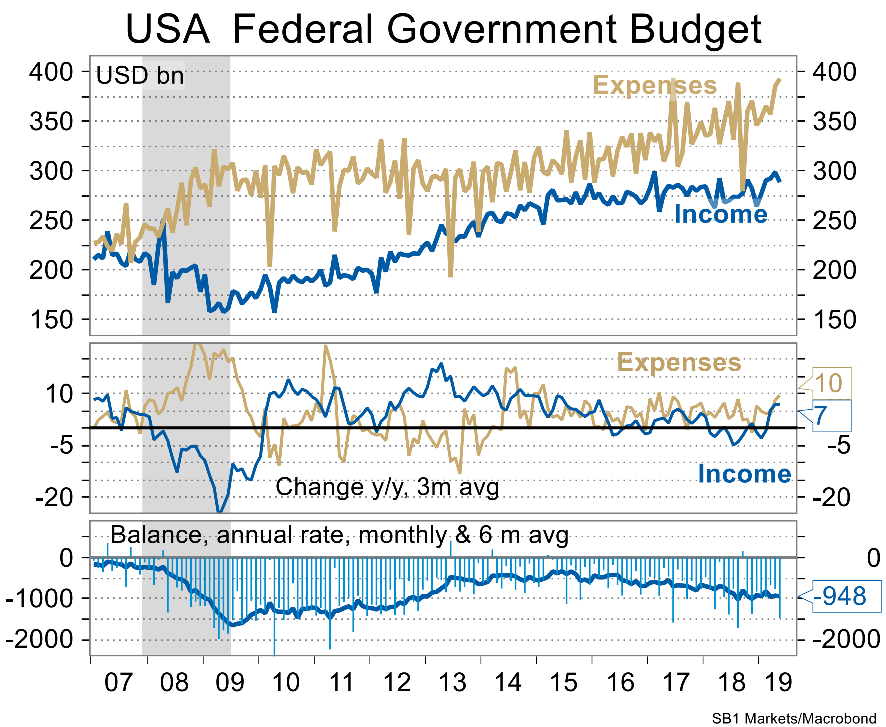
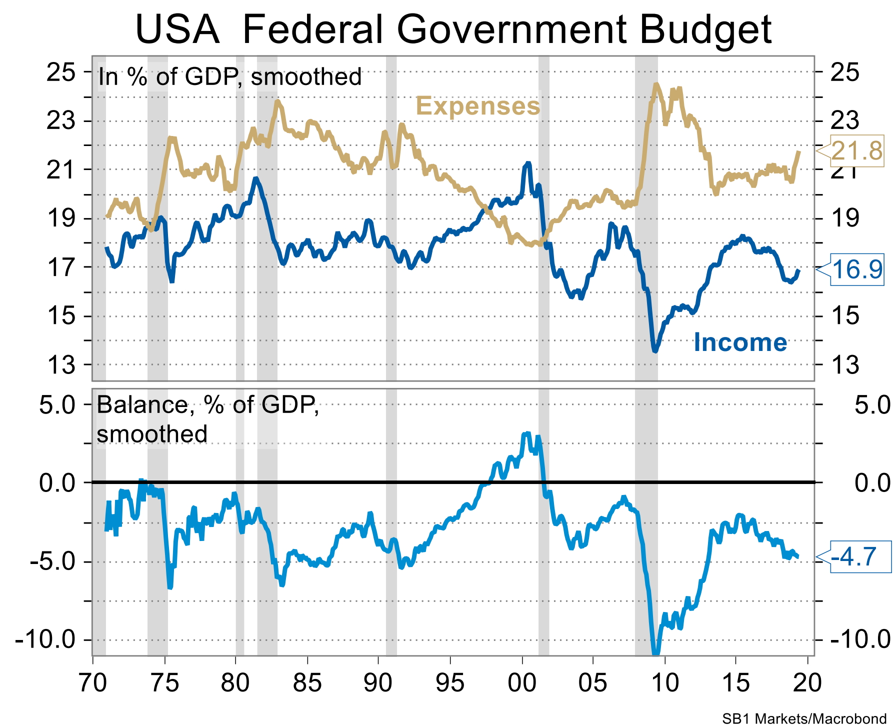
# The federal budget deficit is widening amid soaring spending

The federal deficit up to 4.7% of GDP in May and the total public sector deficit at 6.9% of GDP in Q1!

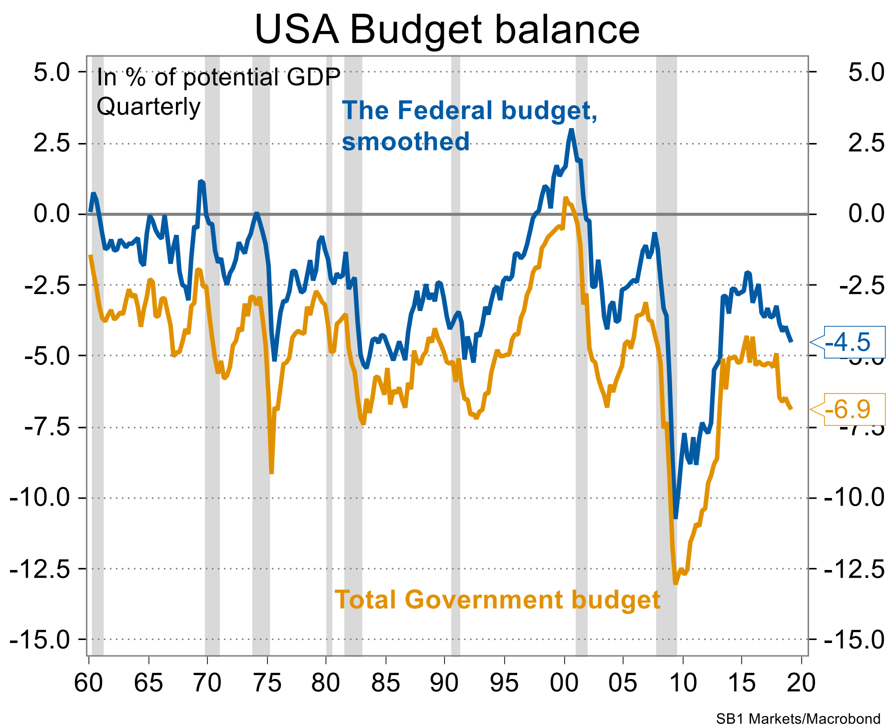


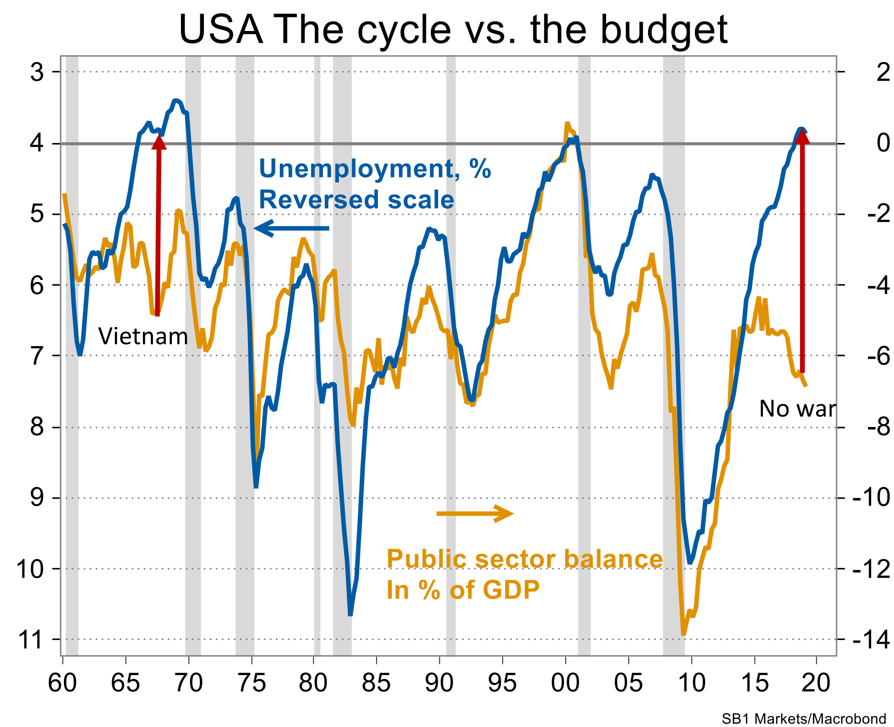




- The budget deficit spiked to USD 1.480 bn in annual rate in May, the highest in almost a year and not far below 5% of GDP. Including local government etc, the US is running full employment, peacetime deficit at 6.9% in Q1 (from 6.7% in Q4); totally unprecedented!
- Federal revenues inched down in May but are up 7% y/y (smoothed), the best in a long while, though the trend vs GDP has been very weak. Expenditures spiked in May and are up 10% y/y, equalling 22% of GDP, the highest since 2012
- A divided Congress will probably not agree upon much more fiscal stimulus. But with 1 ½ y to the next election, any tightening is totally unlikely too

# The public sector deficit up to 6.9% of GDP in Q1

With an unemployment rate below 4%! We have NEVER seen something like this before

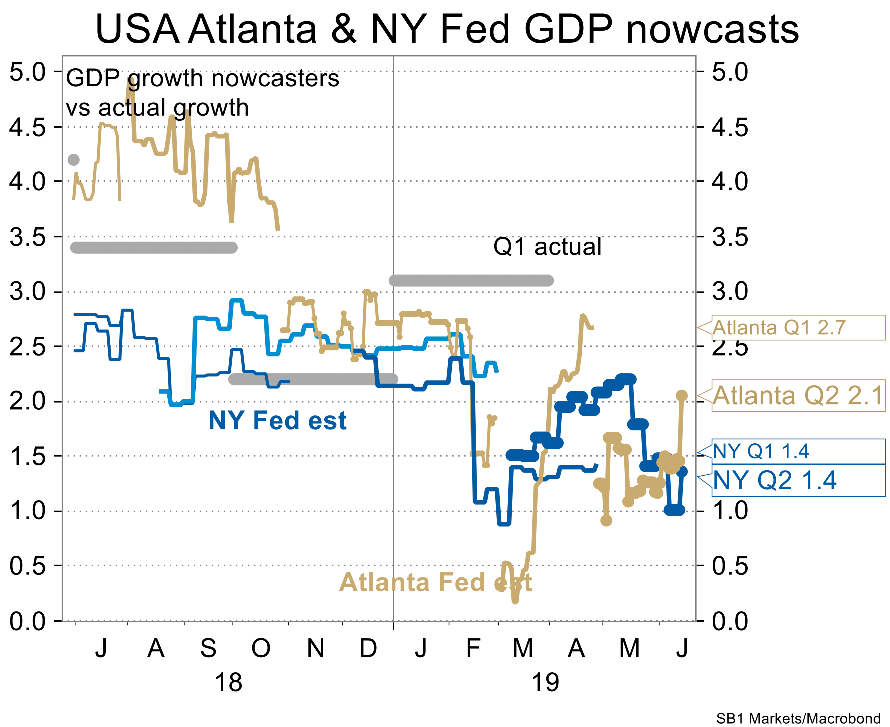


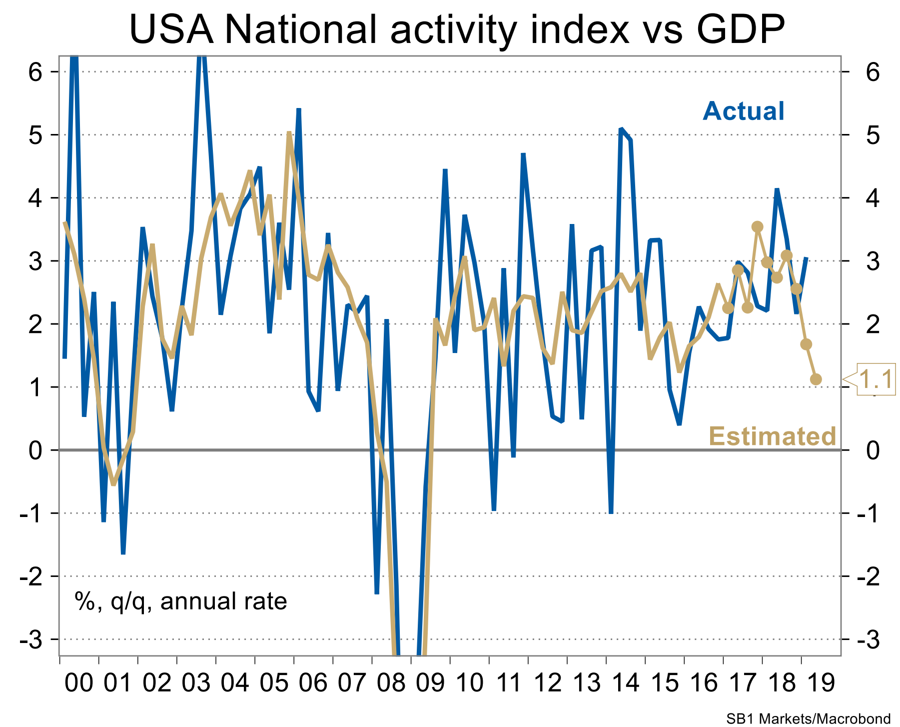




- The deficit has never been anywhere close to the present level in peace time when unemployment is as low as now – and it will most likely become even worse as all of the tax cuts and increased expenditures kick in
  - » We have not seen anything like this in the US or elsewhere before (except Greece in 2007, partly Japan)
  - » The deficit at 5% was large vs the unemployment rate in 1967 too, when the Vietnam war was fought. Btw, afterwards, inflation and a lot of other problems turned up
- *The total public sector deficit is larger than the Federal Government's, as local gov. & social security are included*

# Strong retail sales lifted Q2 estimates by 0.4 – 0.6 pp, to 1.4 – 2.1%

One number (including revisions) made the (Fri)day. Still, no signals of strong growth in Q2



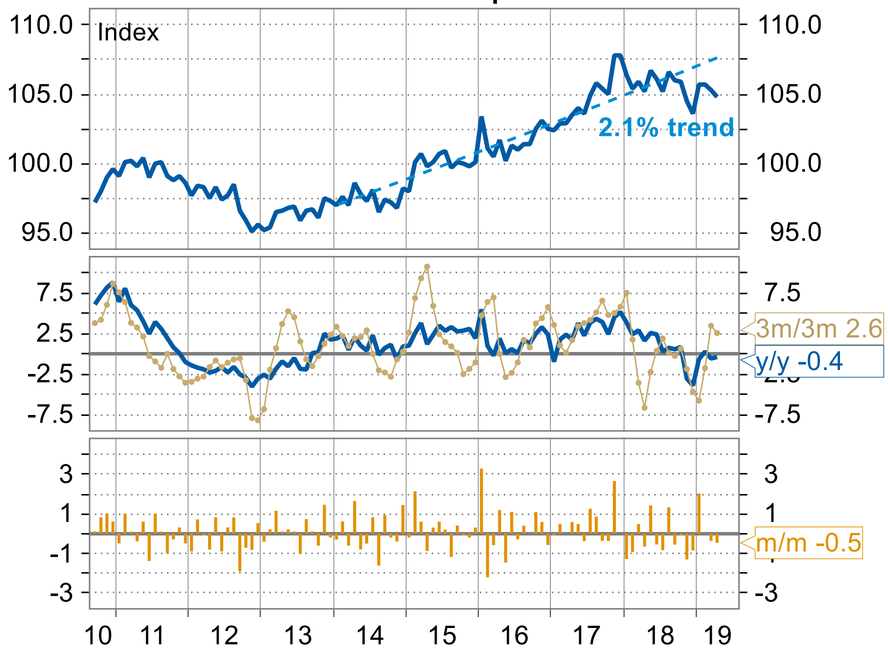




- However, a lot of data has still to be reported – and the nowcasters often miss the target (as they change their mind through to the quarter

# Industrial production falls again, down 0.5% in April

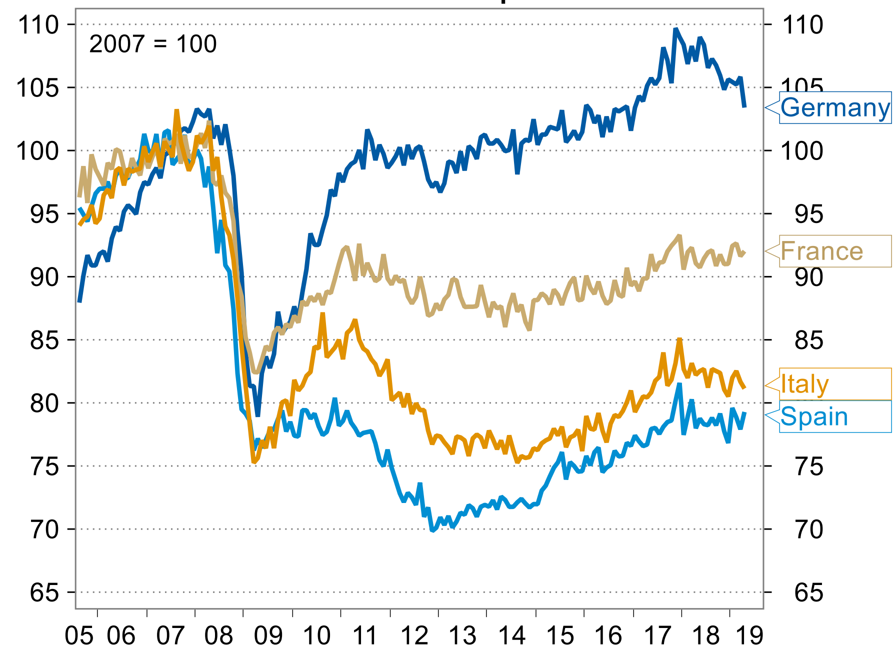
## April data (and PMIs) suggests industries remain in the doldrums in Q2, dragged down by Germany

EMU Industrial production




SB1 Markets/Macrobond

EMU Industrial production

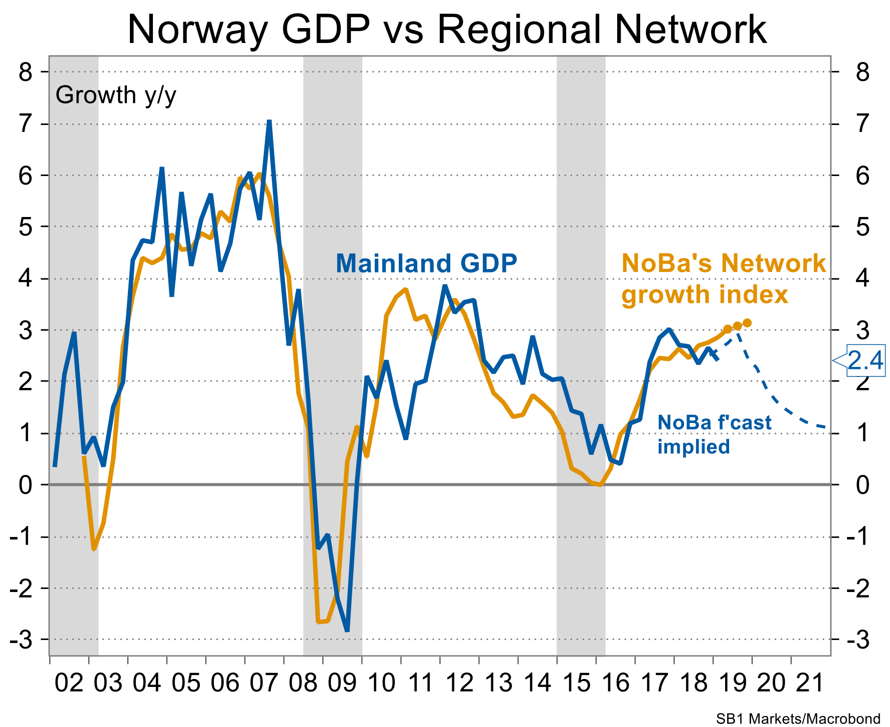



SB1 Markets/Macrobond

- Industrial production in the Eurozone dropped 0.5% m/m in April, we f'casted -0.7% (based on the first country releases). No specific sector problem; the decline was broad among sectors. Industrial production has improved somewhat from the Dec slump, underlying growth is up 2.6%, yet the level is miles below the old 2% trend path. The annual rate is -0.4%
- The decline was driven by a 2.3% plunge in German production. However, the German downswing is spilling over to other countries, production is falling y/y in both the Netherlands, Italy and Spain as well
- **Unfortunately, the manufacturing PMI and orders remain weak, no signs of recovery**

# A much more upbeat Norges Bank's Network than expected, best since 2012

Businesses report 3% growth and expects 3.1% the coming 6 months, far above NoBa's f'cast

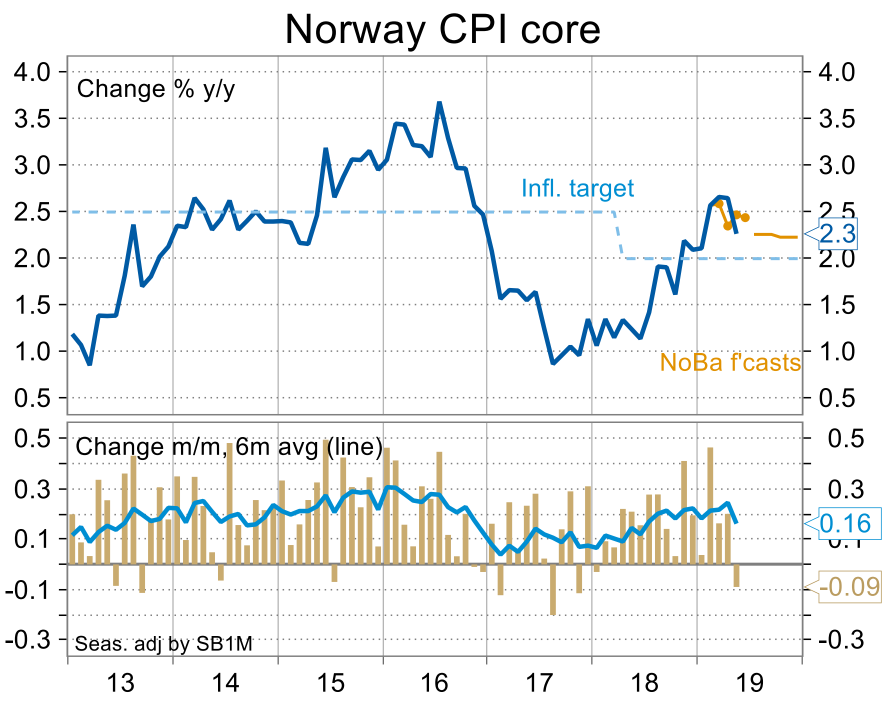



## Summary of the Q2 report

- **Growth indications**
  - » Norges Bank's Regional Network reports 3.0% growth the past 3 months, up from 2.9% in the previous report (and expectations on the coming 6 m). The report is 0.15 pp below NoBa's Q2 q/q f'cast from the March PPR
  - » Businesses expect 3.1% growth the coming 6 months, 0.2 pp higher than in the Q1 survey. A 3.1% speed is much higher than we expected (2.7%) and the highest since 2012. In contradiction, Norges Bank expects (implicitly) a steep slowdown in H2, to 2.3% in Q3 and 1.9% in Q4. Thus, the Bank will have to nudge up it's f'casts significantly
- **Capacity utilisation/investments**
  - » The Network reports rising capacity constraints, well above Norges Bank's f'cast. Capacity utilisation is back at the same level as the 2012 peak. Still, the share of businesses reporting labour shortages is low vs the unemployment rate, while more companies are reporting lack of qualified labour
  - » Businesses expect stable employment growth, at some 1.5%
  - » 2019 wage expectations were nudged up to 3.2%, from 3.0%,
- **Sectors**
  - » Growth outlook up everywhere, led by oil related sectors
- **Implications**
  - » The Q2 report came in above expectations, reflecting a bright outlook and accelerating growth, well above capacity growth
  - » An upbeat Network is yet another argument for an interest rate on Thursday. Moreover, Norges Bank will have to raise its H2 growth f'cast, pushing the interest rate path up. We expect the interest rate path to be nudged up by 20-25 bp, more our Norges Bank expectations here

# Core CPI inflation edged down to 2.3% in May, below all f'casts (for once)

## Core CPI inflation ticked down 0.3 pp, dragged down by volatile airline tickets and food prices



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- CPI-ATE (ex. energy and taxes) rose 2.3% y/y in May, from 2.6% the prior month. We f'casted unchanged growth, so did consensus. Norges Bank expected 2.5% back in March
  - » CPI-ATE fell 0.1% m/m (seas adj), as it usually does once or twice a year. The 3m/3m growth rate has come down to 2.4%
  - » Lower prices on airline tickets and food were the major culprits in May, both noting a steep decline m/m
  - » Total CPI growth came down 0.4 pp to 2.5% y/y. Electricity prices are heading down and will most likely bring total inflation further down. Good for real income growth, thus, consumption!
- **Implications**
  - » One months' downtick does not spark concerns that inflation is losing steam. Core inflation is above the 2% target
  - » Inflation has surprised in the upside vs NoBa's f'cast in 2 of the 3 months since the past MPR, we assume a neutral impact on the interest rate path on Thursday
  - » NOK depreciated after the release but was saved by an upbeat Norges Bank Network later on the day and ended up some 0.2% (import weighted index)

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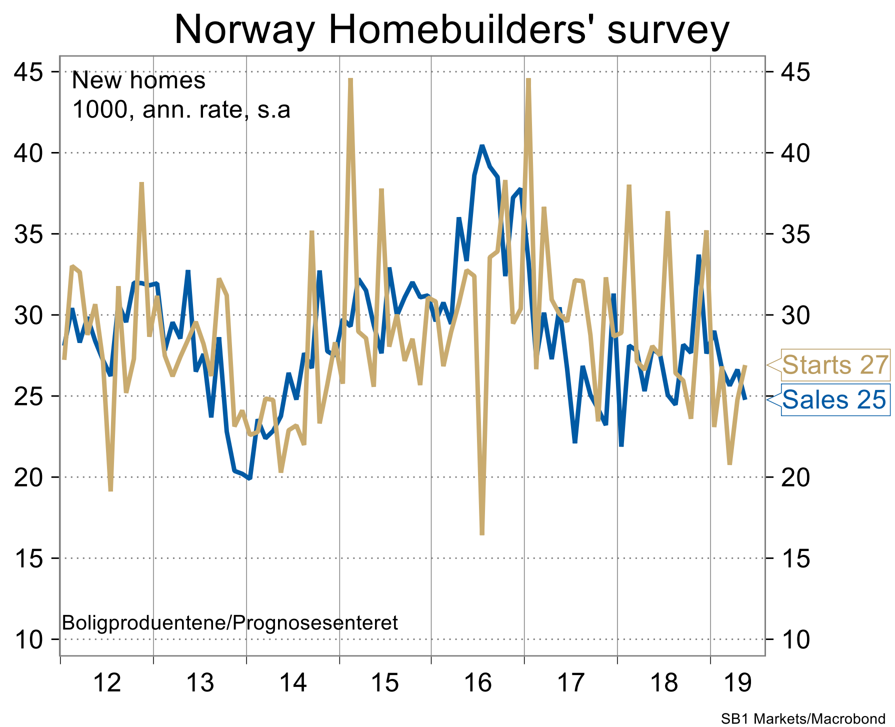
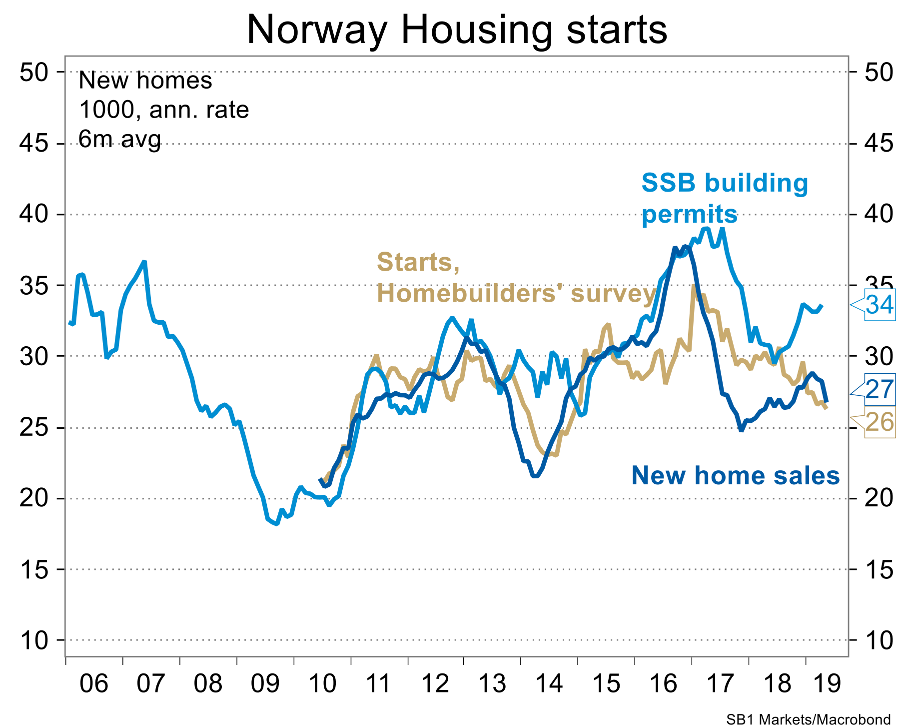
# Homebuilders report somewhat softer new home sales, suggests stalling starts

## Starts increased in May but are still trending down, in contradiction to SSB's data

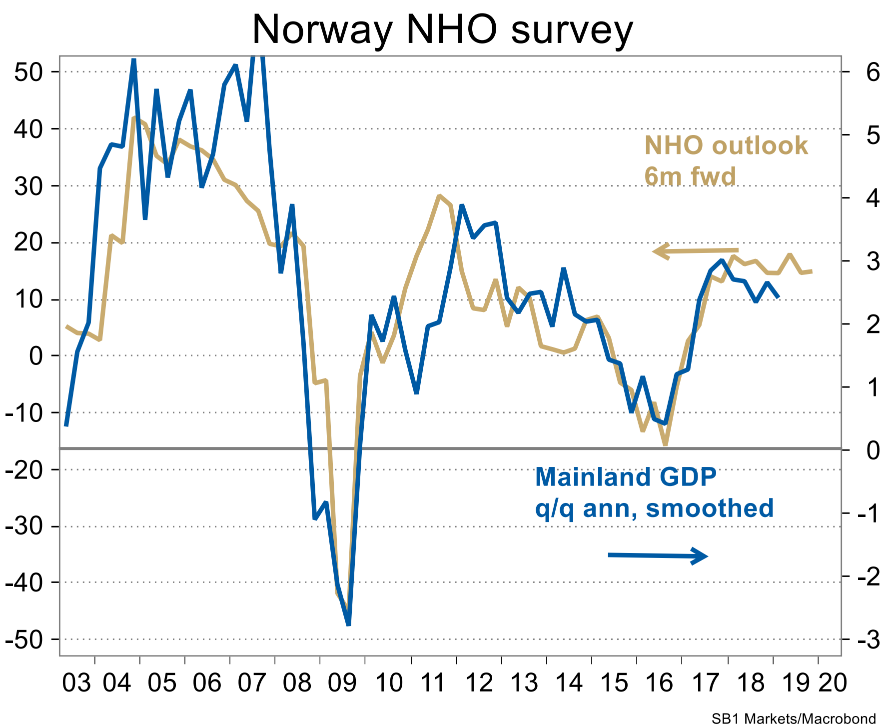


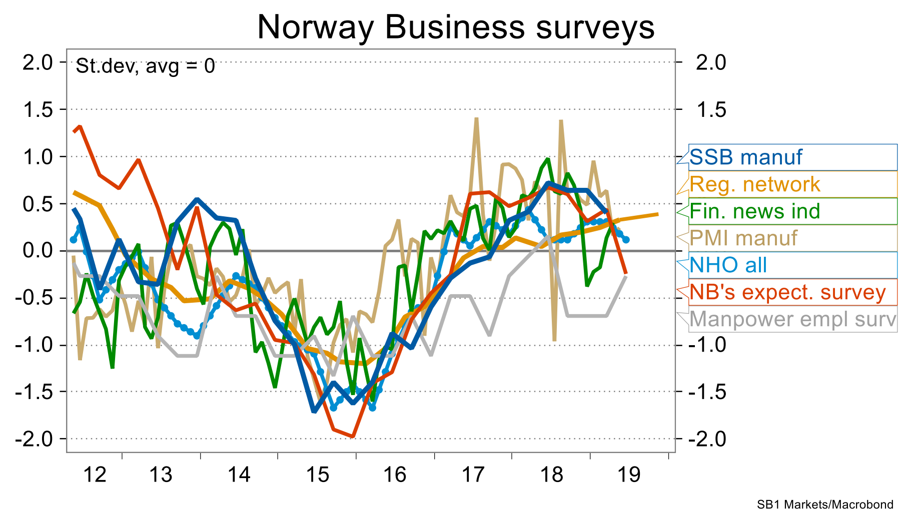



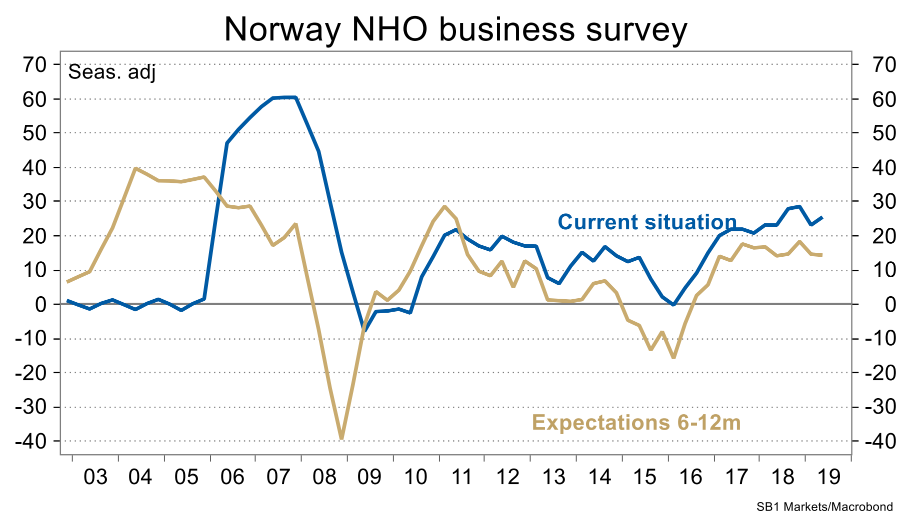

- The Homebuilders reported **new home sales** at an annual rate of 25' in May (seas. adj.), down 2' from April. The 6m average has fallen to 27', edging down the past 4 months
- **Housing starts** climbed to 27' but are no doubt trending down, according to the Homebuilders. There may be an inventory overhang from the previous two years' 'overbuilding'. If so, there is still a way to go before starts should pick up due to stronger sales
  - » SSB reports building permits at a 34' level, and the gap to the homebuilders' report is substantial (8' measured 6 m smoothed, vs avg at 2').
- We still assume that housing starts and investments are slowly recovering but recent data indicate that starts may be stalling. Limited upside, given meagre house price growth! Businesses in NoBa's Network are reporting saturated demand in most of Norway

# NHO business survey still upbeat, signals well above 3% GDP growth

## NHO economic outlook indicator slightly down in Q1, stable the past year




- The NHO (Confederation of Norwegian Enterprise) Q1 survey is pointing to some 3.5% GDP growth, we assume too optimistic, even as the survey is usually quite well correlated to GDP growth
- NHO is in the mid-range of surveys, in line with Norges Bank's Q4 Regional Network (Q1 released this week!)

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# The Calendar

## In focus: An important central bank week; Fed, NoBa, BoE. US & EMU June PMIs, US housing market

| Time | Country | Indicator | Period | Forecast | Prior |
|---|---|---|---|---|---|
| **Monday June 17** | | | | | |
| 08:00 | NO | Trade Balance NOK | May | -- | 17.6b |
| 11:00 | EC | Labour Costs YoY | 1Q | -- | 2.3% |
| 14:30 | US | NY Empire Manufacturing Survey | Jun | 12 | 17.8 |
| 16:00 | US | NAHB Housing Market Index | Jun | 67 | 66 |
| **Tuesday June 18** | | | | | |
| 03:30 | CH | New Home Prices MoM | May | -- | 0.6% |
| 11:00 | EC | CPI Core YoY | May F | 0.8% | 0.8% |
| 11:00 | GE | ZEW Survey Expectations | Jun | -5.8 | -2.1 |
| 14:30 | US | Housing Starts | May | 1240k | 1235k |
| 14:30 | US | Building Permits | May | 1300k | 1296k |
| **Wednesday June 19** | | | | | |
| 06:00 | SW | Valueguard House Prices | May | | 0.3% |
| 09:00 | SW | Economic Tendency Survey | Jun | -- | 99.8 |
| 09:00 | SW | Consumer Confidence | Jun | -- | 91 |
| 09:30 | SW | Unemployment Rate LFS | May | 6.2% | 5.9% |
| 10:30 | UK | CPI Core YoY | May | 1.6% | 1.8% |
| 12:00 | UK | CBI Trends Total Orders | Jun | -12 | -10 |
| 20:00 | US | FOMC Rate Decision | Jun-19 | 2.25-2.5% | 2.25-2.5% |
| **Thursday June 20** | | | | | |
| 07:30 | JN | All Industry Activity Index MoM | Apr | 0.7% | -0.4% |
| 10:00 | NO | Norges Bank Deposit Rate + MPR | Jun-20 | 1.25% | 1.00% |
| 10:30 | UK | Retail Sales Ex Auto Fuel MoM | May | -0.6% | -0.2% |
| 13:00 | UK | Bank of England Bank Rate | Jun-20 | 0.75% | 0.75% |
| 14:30 | US | Current Account Balance | 1Q | -$125.0b | -$134.4b |
| 14:30 | US | Initial Jobless Claims | Jun-15 | 220k | 222k |
| 14:30 | US | Phil Fed Business Outlook | Jun | 10.5 | 16.6 |
| 16:00 | US | Leading Index | May | 0.1% | 0.2% |
| 16:00 | EC | Consumer Confidence | Jun A | 0.1% | -6.5 |
| | JN | BOJ Policy Rate | Jun-20 | -- | -0.1% |
| **Friday June 21** | | | | | |
| 01:30 | JN | CPI Ex Food, Energy YoY | May | 0.5% | 0.6% |
| 02:30 | JN | Markit Japan PMI Mfg | Jun P | -- | 49.8 |
| 08:00 | NO | Housing Starts | May | | 37' |
| 10:00 | EC | Markit Eurozone Composite PMI | Jun P | 52 | 51.8 |
| 15:45 | US | Markit US Composite PMI | Jun P | -- | 50.9 |
| 16:00 | US | Existing Home Sales | May | 5.30m | 5.19m |

Source: Bloomberg, SB1M

- **Preliminary June PMI**
  - » In May, the global composite PMI slipped to 51.2, signaling a slowdown in global GDP growth (from 3.3% in Q1 too below 3%). Any further decline will spark fears of a more abrupt slowdown. The first June PMIs from EMU, US and Japan are released this week
- **USA**
  - » The market's expectations of a **Fed interest rate cut** this month remain subdued, some 20% prob. A cut at the July meeting is fully priced – and the Fed will publish its economic and rate projections (the dot plot). It is completely unlike the Fed will fully accommodate to market expectations of at least 3 cuts in 2019. A dovish stance could still be sufficient to keep these expectations intact – but not to push them further down
  - » **Both housing starts & permits, existing home sales** as well as **the housing market index** have recovered this year, supported by a steep drop in interest rates. The recent slump in bond yields suggests a prolonged upswing on the housing market
- **Eurozone**
  - » **Consumer confidence** is improving and does not indicate that the manufacturing contraction is spreading to consumer sectors
  - » All business surveys from Germany are heading down, no reason to expect a rebound in the **ZEW survey**, a survey among economists
- **Sweden**
  - » **House price** inflation is subdued, although prices rose 0.3% in April
  - » An increase in the **LFS unemployment rate** will add to signs of a softening labour market, as registered unempl. indicates
- **Norway**
  - » **Norges Bank** will no doubt deliver the 25 bps hike. Moreover, summing up data since March suggests that the Bank will nudge up the interest rate path by some 20-25 bps. Our take is that this implies one additional hike in 2020. Higher capacity utilization and an overall stronger domestic outlook than projected, a much weaker NOK and lower money market spreads will bring the path up. On the downside; a significantly weaker global outlook due to increased uncertainties, and a somewhat lower oil price than f'casted, and we expect the path to be lowered at the far end. The market will not be impressed by the 2020 outlook (one extra hike) but may increase the probability for a Dec hike somewhat. *Check our calculations next page*

# Norges Bank will hike – and lift the interest rate path in the short end

## Lower growth and rates abroad will lower the long end of the path

| Factor | Norges Banks' scenario | What's new since December? | Impact | Next? |
|---|---|---|---|---|
| **Foreign factors** | | | **-23** | |
| | Growth: Slowly decreasing | PMIs down, TP GDP 'official' f'casts down 0.3 from Mar | -15 | Neutr |
| | Short term rates: Slowly up | Trading part. 1y swap -12 bps, 1y1y fwd -28 bps, 1y2y fwd -32 | -8 | |
| **Oil price** | 62 in March | Prices recovering, futures 0-2 y +USD 5/b | **-5** | Down |
| **Domestic demand** | | | **6** | Neutr |
| | Consump. 1.9% in '19 | Mixed, but April strong - sum neutral | 0 | Neutr |
| | Investments | | | |
| | .. Housing: 0% in '19 | Housing starts have turned up, we expect +1% in '19 | 2 | Neutr |
| | .. Mainl bus. 4.1% in '19 | F'cast still too high | -8 | Neutr |
| | .. Oil 12.5% in '19 | Survey indicates higher growth | 4 | Neutr |
| | Public demand 1.4 '19 | No news | 0 | Neutr |
| | Fiscal policy indic.: +0.1% per year | Fiscal policy more expansionary | 8 | Neutr |
| **Money market, lending spreads** | | | **15** | |
| | MM: 40 bps | Money marked: (3m-depo) probably down to 30 bps | 10 | Up |
| | | Lending margin: Mortg. rates up less than expected | 5 | Down |
| **NOK** | Index 104.5 in Q1, 103.7 in Q2 | More than 3% below path | **15** | Down |
| **Prices, wages** | | | **0** | |
| | CPI-ATE at 2.4 % in Q2 | ATE below f'cast in May, after two above, sum neutral | 0 | Neutr |
| | Wages 3.2% in '19 | Spot on outcome of wage negotiations | 0 | Up |
| **Capacity utilisation** | | | **9** | |
| | NAV unempl 2.3% in Q2, LFS 3.6% | Both 0.1 pp below f'cast | 5 | Up |
| | Outp. gap slowly closing, then posit. | Netw: Incr. cap. util in Q2, even if GDP will not be revised up | 4 | Up |
| **Judgement/ corrections** | | | **5** | |
| | Financial imbalances | Household credit has stabilised | 0 | |
| | Housing prices | Prices have inched up, marginally above March f'cast | 5 | |
| | Consumer confidence | Surveys flat to down in Q2 | 0 | |
| | Financial conditions | Finacial markets volatile, up, then down | 0 | |
| | Caution?? | No reason as NOK is weak, unempl. down, house prices up | | |
| **Sum changes** | Growth above trend, CPI above target | Global growth, foregin rates, oil all down, but growth is above trend, money market spreads down | **22** | **Neutr** |
| **Memo: Market** | Changes in NOK int. rate expect. | 3 m FRA Dec 19 +4 bps, Dec 20 -7 bps, Dec 21 -16 bps, avg | -5 | |
| | | 1 y swap 1 y fwd | -2 | |

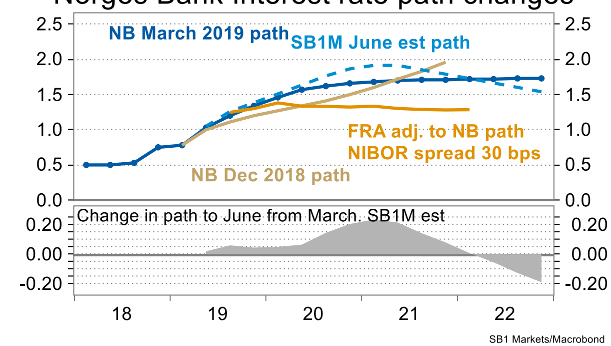
Impact: Contribution to change in the interest rate path 1 - 1 1/2 y ahead

Next change: Impact on the interest rate path due to 'next news', based on SB1M outlook

| Changes in the interest rate path from the March meeting | Impact bps |
|---|---|
| Domestic demand (incl oil price), capacity util. | 10 |
| Money Market (money market, lending spreads) | 15 |
| Prices, wages | 0 |
| Foreign factors | -23 |
| NOK | 15 |
| Judgement (credit, housing, fin. stab etc) | 5 |
| **Sum** | **22** |

- A stronger domestic economic outlook, the weak NOK, and lower NIBOR margins lift the path
- Slower growth, lower rates contributes on the downside
- And extra hike should be put into the curve in 2000, then a lowering due the foreign factors

Norges Bank Interest rate path changes



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# Our main views

| | Main scenario | Recent key data points |
|---|---|---|
| Global growth cycle | The cycle is maturing, in the real economy, markets. Rich countries (DM) in the lead, more to go in most EM. Unemployment is low, wage inflation on the way up, not low vs. productivity. Most emerging countries (EM) x China are in recovery mode. Some hotspots EM will get burned, as usual – but there are fewer EM imbalances than normal. Barring policy mistakes, the global economy is not yet rigged for a *hard* downturn | Global composite PMI fell 0.9 p to 51.2 in May, 0.3 p weaker than we expected. Signals below 3% growth. The US-China trade negotiations will be in focus the coming weeks too |
| China | The governments' stimulus measures may have turned the growth momentum, at least that's what some of the data indicate. The invest/GDP ratio is declining rapidly. Debt growth has slowed, and will not accelerate much even if authorities are now, probably successfully, stimulating to counter negative impacts from the trade war/prev. tightening. Fiscal policy is also activated. Exports to US (net of interm. imp) approx 2% of GDP, and a 10% decline here is manageable. However, a full scale tech/trade war will be bad, a deal with US is important | Mixed May data but mostly upbeat. Growth in industrial production eased slightly but has stabilized recent months. Retail sales are stronger than assumed after a rise in May and an upward revision. Investment growth a tad weaker but stable over the past year |
| USA | Growth is now slowing substantially, from an above trend level. Employment growth has come down too but is still not too low, and unemployment is trending down while wage inflation has slowed. CPI inflation is showing signs of easing as well. No serious overinvestments but most sectors at/above trend, and housing is still exposed but recent data have been OK. Household debt 'low' – and the savings rate is OK, limited consumption risk. Corporate debt might become a challenge. Fiscal stimulus continues into '19, but not by much. The deficit is far, far too high, given the low unemployment rate. Recession risk is increasing, but still not overwhelming, short term, and a dovish Fed may give some support. **Risk: Trump/trade/bus investments** | Core CPI inflation once again came in below expectations and the annual rate fell 0.1 pp to 2.0%, adding to signs of cooling inflation. Small businesses are more upbeat, yet fewer are planning to raise prices. Retail sales are recovering, sales rose 0.5% in May and April revised up. Industrial production is weakening, as surveys have been telling |
| EMU | Growth has slowed and recent manufacturing data are worrying. The labour market is still tightening, and labour cost infl. back to a normal level. Investment ratios on the way up but are not too high. Credit growth still muted. Household savings are high, and consumption has kept up well. Policy risk: Trade war, populist revolt. Italy 'saved' now, not forever. Even without obvious recession triggers, weak short term data signals a substantial risk for a downturn | Industrial production fell 0.5% m/m, indicates that the sector will remain in stagnation. Broad decline among sectors. Germany is struggling the most |
| Norway | Growth is and will remain above trend – and unemployment declines further. Oil investments have more to go (we have revised our f'cast up). Mainland business inv. not low anymore, risks balanced. Housing investments have bottomed, for now. The labour market is not tight yet, but wage inflation is accelerating, no reason to expect much lower core CPI infl. Electr. prices will stabilise (at least), headline CPI will come down. Credit growth almost kept at bay just due to regulations. | Norges Bank's Network reports accelerating growth, up to 3.1% the next 6 m, suggesting that NoBa will revise up its growth f'cast. Core CPI inflation fell to 2.3%, below 'all' f'casts, we assume a temporary dip |

Colour codes: Green=more to go. Yellow=the cycle is maturing, close to peak. Orange=at peak, downside risk. Red=recession level

# In this report

## Global + Auto sales

- The world remains in the doldrums, according to the surprise index
- Retail sales still growing but slower, manuf. prod gained speed in March/April
- DM inflation is bottoming now? No more oil contribution. Core inflation stable
- Auto sales up in May, still weak; down 8% y/y
- German auto sector outlook remains gloomy

## China

- May data in sum upbeat, in spite some disappointing headline figures
- Slower industrial production growth in May, stabilised the past 3 months
- Retail sales rebounding after significant upward revisions
- Nominal investments are growing steadily, most likely accelerating in real terms
- Housing starts are still climbing, sales a tad better too. Other constr. slowly up
- Credit growth accelerated in May, trend not more than flat
- The swine flue pushes CPI inflation sharply up

## USA

- CPI core inflation eases, bolstering expectations of a Fed cut this summer
- Small businesses nudged up hiring & capex plans in May but both are ebbing
- Retail sales are recovering, almost back on the old growth path
- UoM consumer sentiment still strong in June
- Manufacturing production is sagging
- Job openings, hiring have flattened, at high level. New jobless claims remain low
- The federal budget deficit is widening amid soaring spending
- US Indicators: Not a recession warning, now

## EMU

- Industrial production falls again, -0.5% in April

## UK

- Unemployment flat at 3.8%, employment has been soaring, rising wage growth

## Sweden

- Registered unemployment is flattening out
- Inflation is finally turning up, beating expectations in May

## Norway

- A much more upbeat Norges Bank's Network than expected, best since 2012
- Core inflation edged down to 2.3% in May, below all f'casts (for once)
- Homebuilders report somewhat softer new home sales, suggests stalling starts

Highlights

The world around us

The Norwegian economy

Market charts & comments

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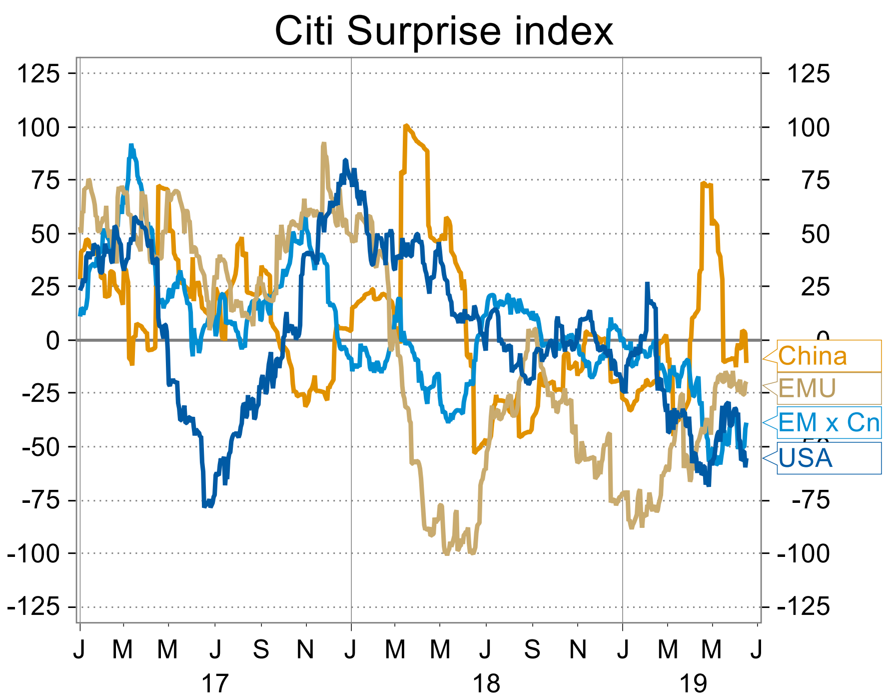
# The world remains in the doldrums, according to the surprise index

## China a tad weaker, EMU stable and not too weak, the US somewhat more disappointing, EM less

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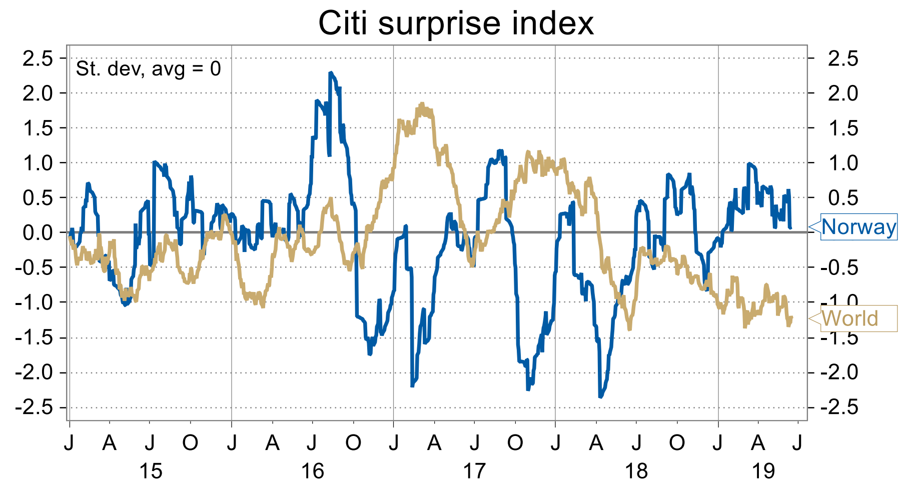


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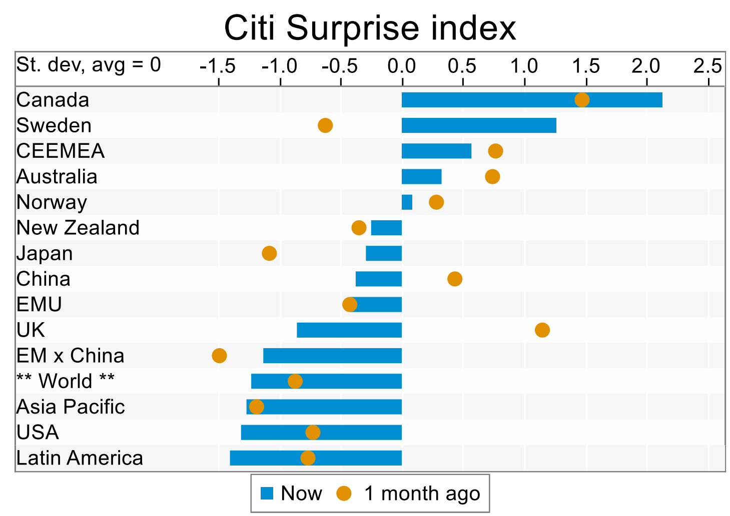


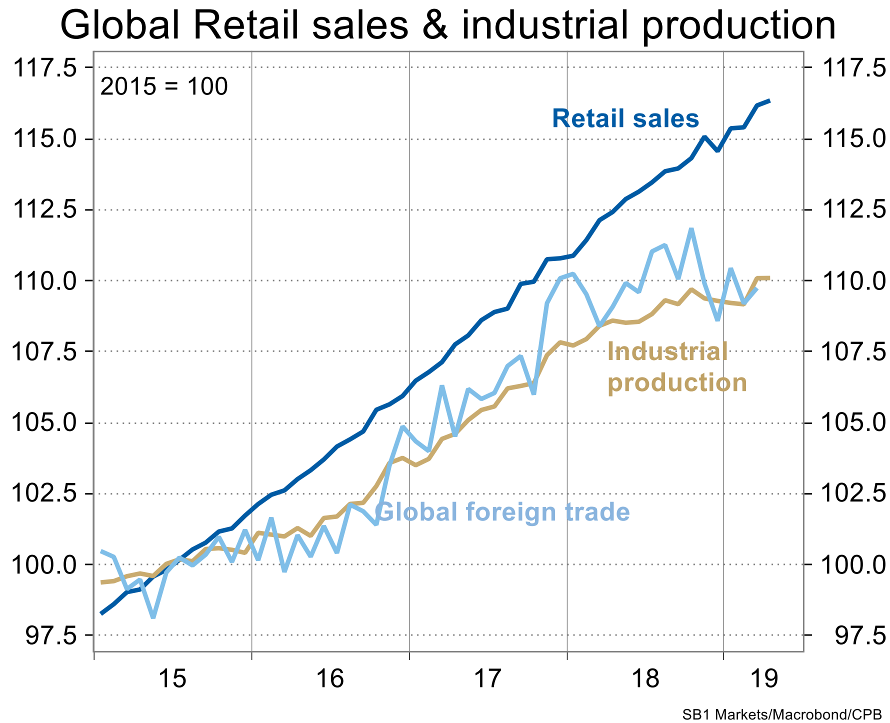

SB1 Markets/Macrobond

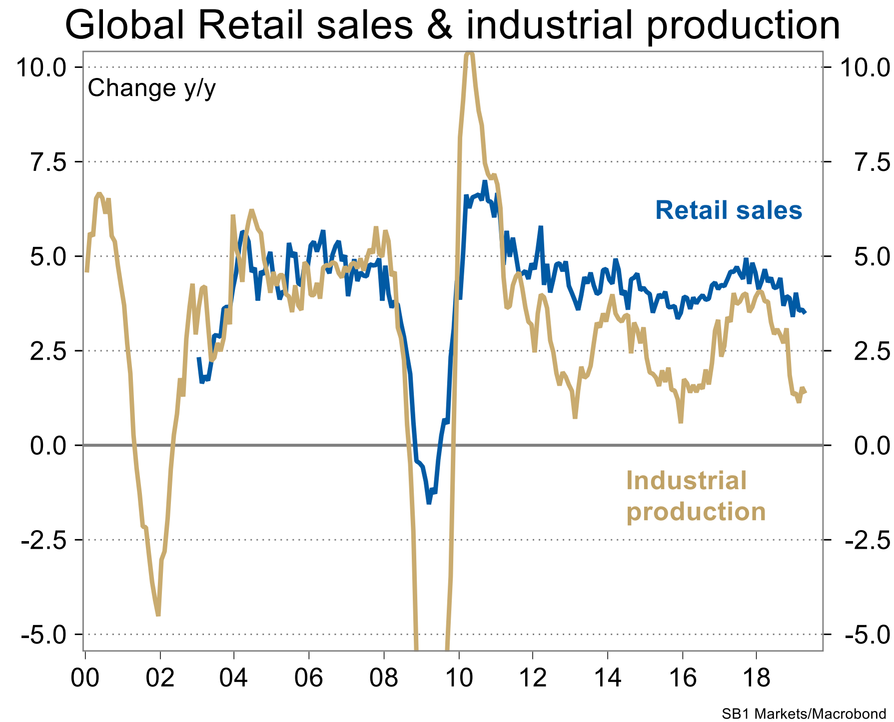
- The global surprise index has been in negative territory since last spring
- The US and EM x China are the most disappointing. Last week, soft inflation data pulled the index further down, the US now at the bottom! EM x China slightly less disappointing
- Chinese data are close to neutral territory, following some extreme volatility
- EMU stable vs expectations, data have not deteriorated much lately
- Norwegian data down to neutral (due to the low CPI). Canada, Sweden and Australia in the lead

Surprise-indices measure the difference between economists' expectations and the actual outcome over a 3 month rolling window

# Retail sales still growing but slower, manuf. prod gained speed in March/April

Still, manufacturing production has been flat the previous months. Foreign trade weak too




- Manufacturing production has stagnated since last autumn. However, the slowdown has not accelerated recent months, production probably grew marginally in April, after a lift in March. The downturn the past 6 months is due to lower investments and probably destocking following an unwarranted inventory build-up during 2018, stabilising now?
- Global retail sales increased in April and is still tending up, but at a somewhat slower pace
- Global trade volumes improved in March, recovering just slightly the past 3 months. Foreign trade has no doubt slowed, however, the change of pace is so far not dramatic and volumes are up 1.1% y/y (from -1.4% in Dec)

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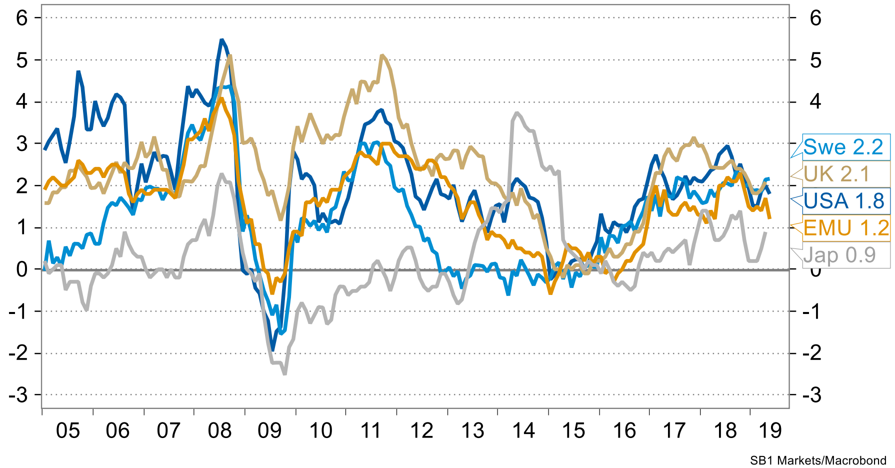
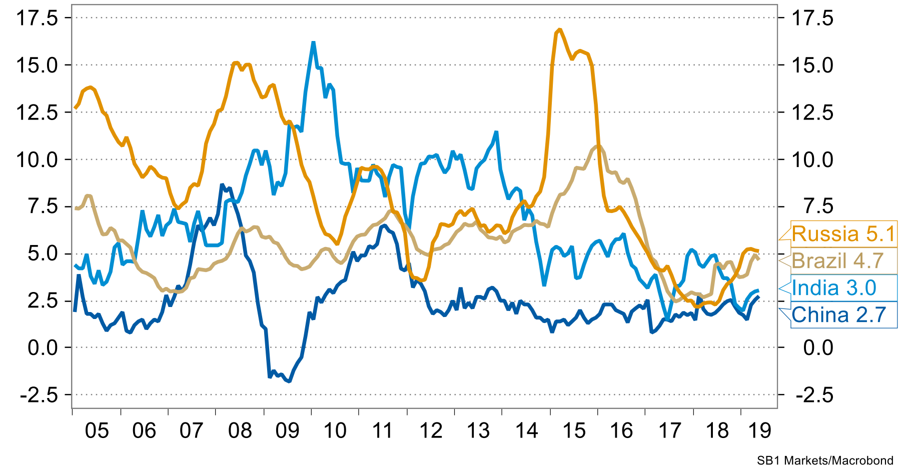
# DM inflation is bottoming now? No more oil contribution. Core inflation stable

Core inflation at target in US, UK, not far below in Sweden. EMU still muted. EM inflation will pick up

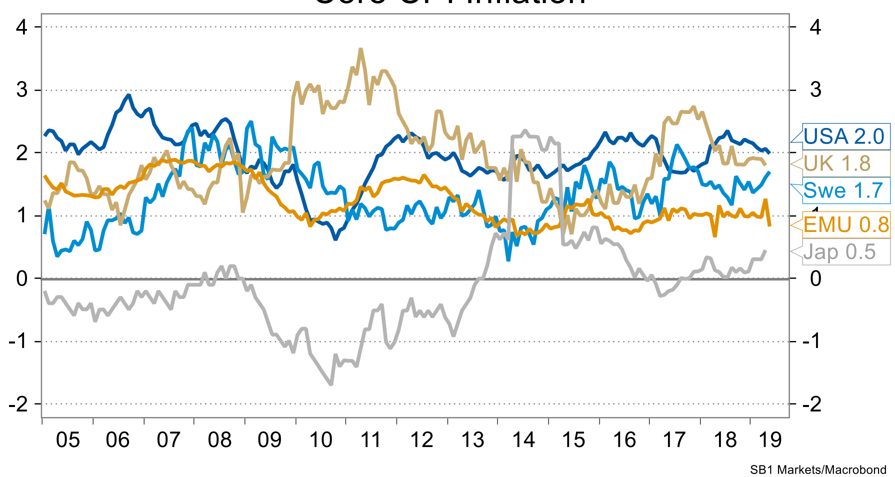
CPI Inflation



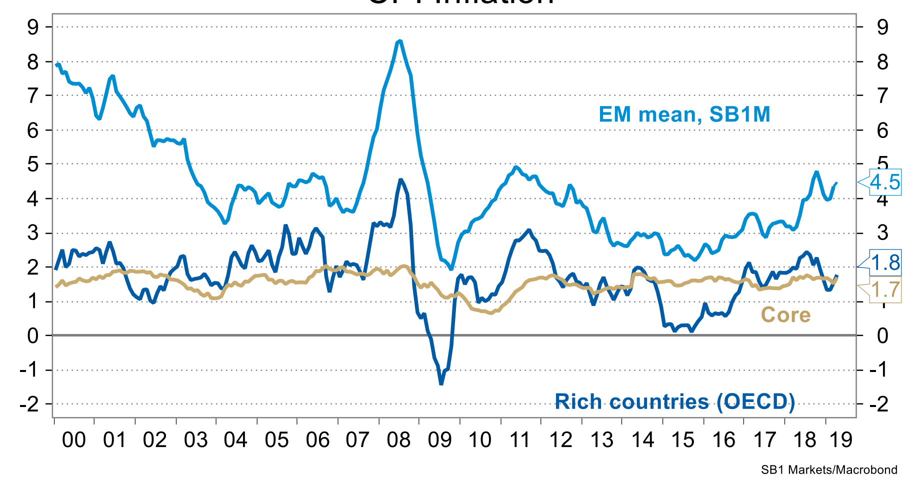

BRIC Inflation




Core CPI Inflation



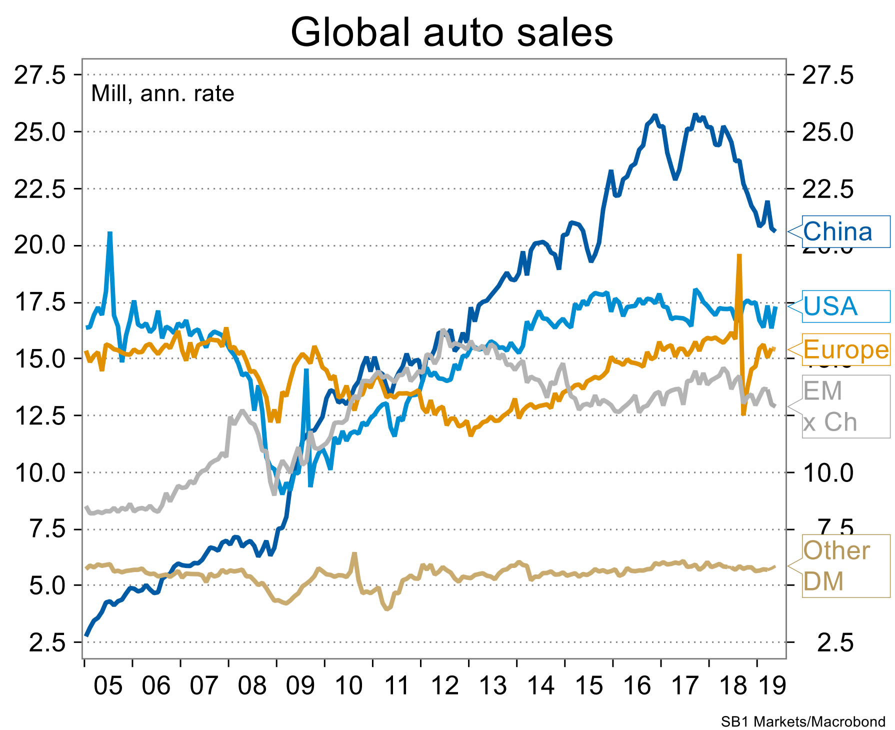

CPI Inflation

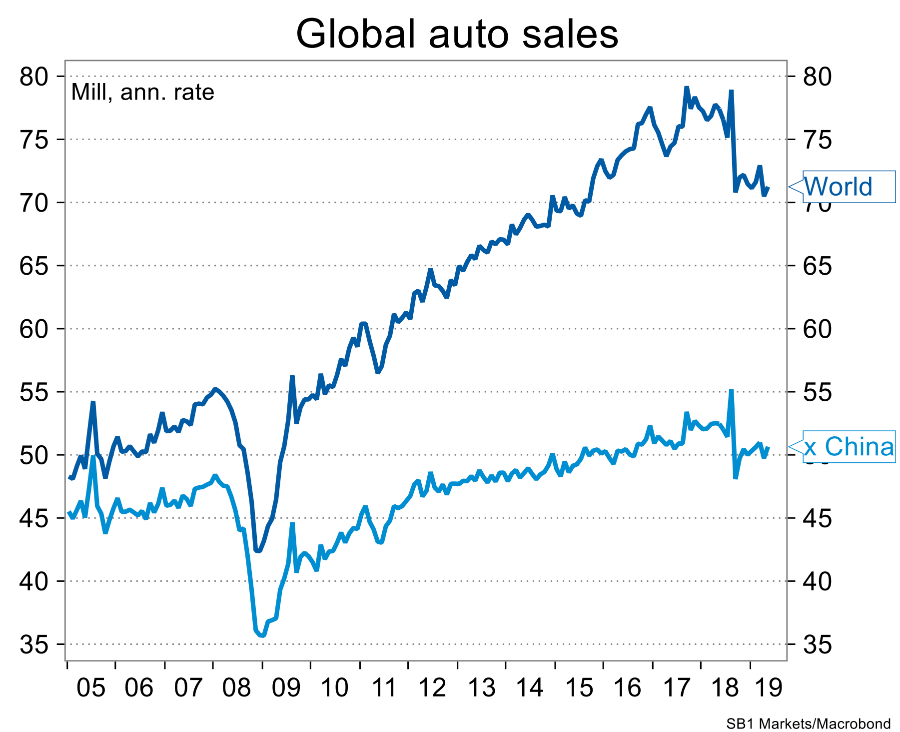



Change in % y/y in all charts. EMU core based on a seasonally adjusted price index

# Auto sales up in May, still weak; down 8% y/y

## Chines sales continues down, down 20% from the peak - but higher US sales saved the month

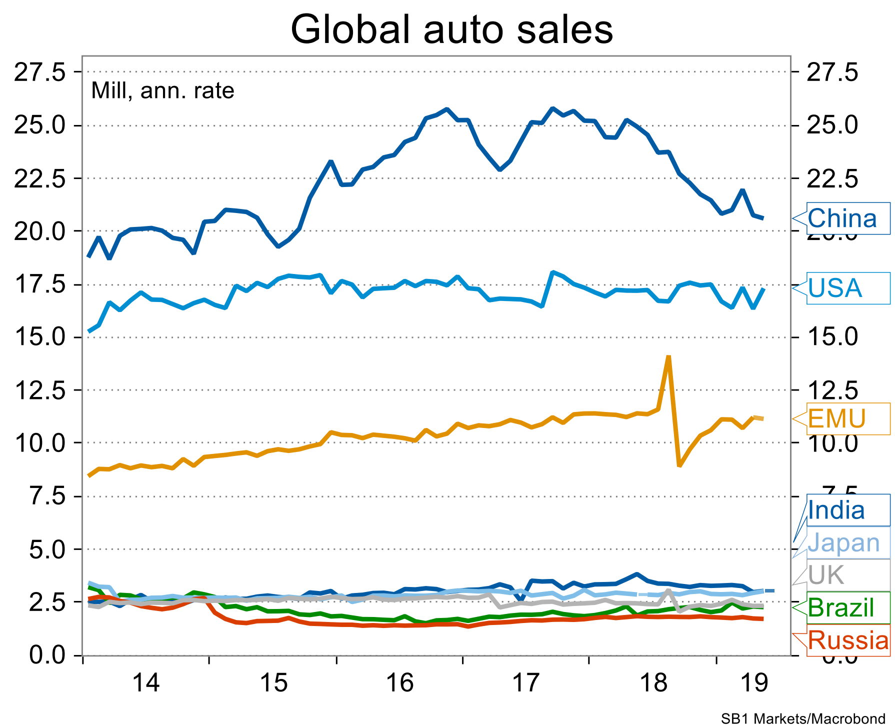


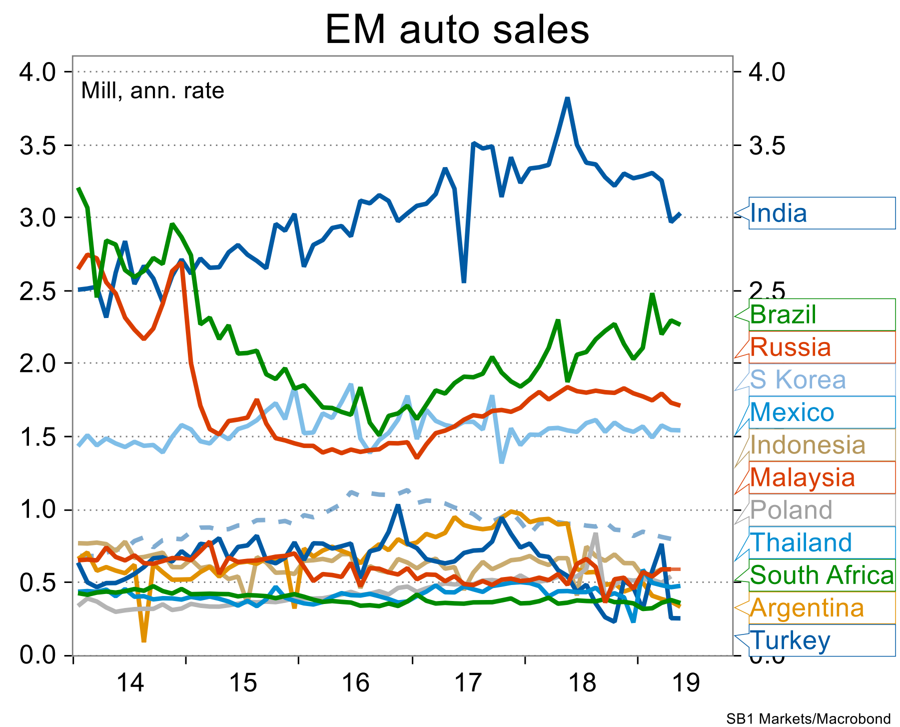




- Global auto sales grew 1% m/m in May following the 3% decline in April. Sales are down 8% y/y
- Sales in China fell 1% m/m, after the 6% drop in April. Sales are down 17% y/y and down 20% from the peak in Sept 17 - and the trend is surely still down. Sales are at the same level at 4 years ago! A huge shift in the Chinese economy!
- US sales recovered the April loss, but the average of the recent zigzag 5 months is below the level over the previous quarters, the trend is now slowly down
- Sales EMU fell marginally in May, and sales are still somewhat below the pre emission regulation level. Other DM pushed a tad harder on the accelerator in May
- Auto sales in EM ex. China is heading down again; mostly due to lower sales in India, Argentina and Turkey – and Indonesia and Mexico

# EM x China more down than up in May too

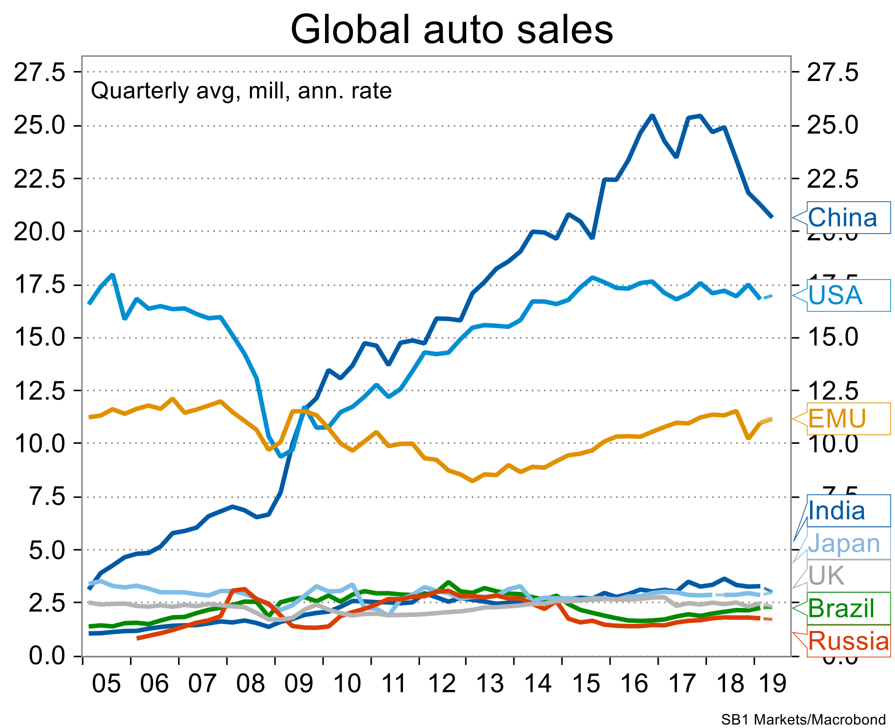
India is sharply down recent two months, Turkey & Argentina too. Trend down in Russia & Mexico too

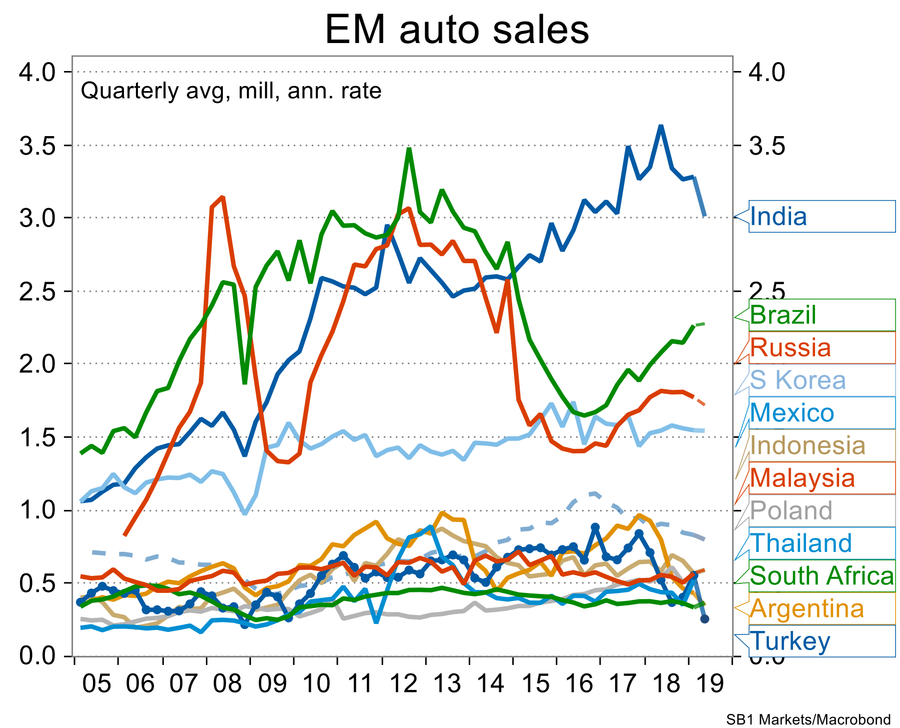



- Sales in Brazil are still heading up
- Monthly data are volatile, check the quarterly average (including Q2, assuming unch sales in June)

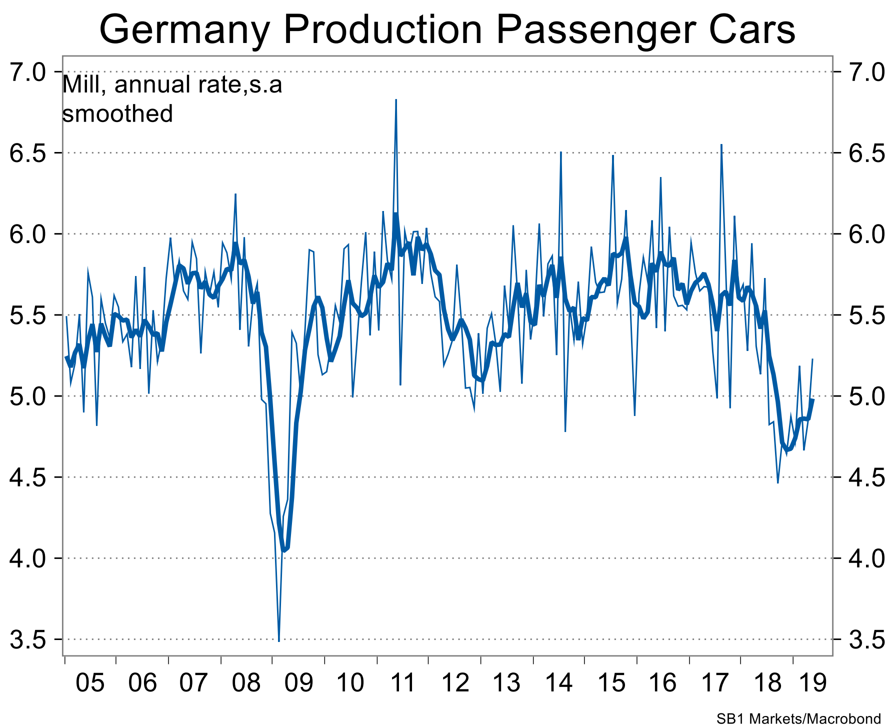
# Not many countries/regions on the way up. It's only Brazil?

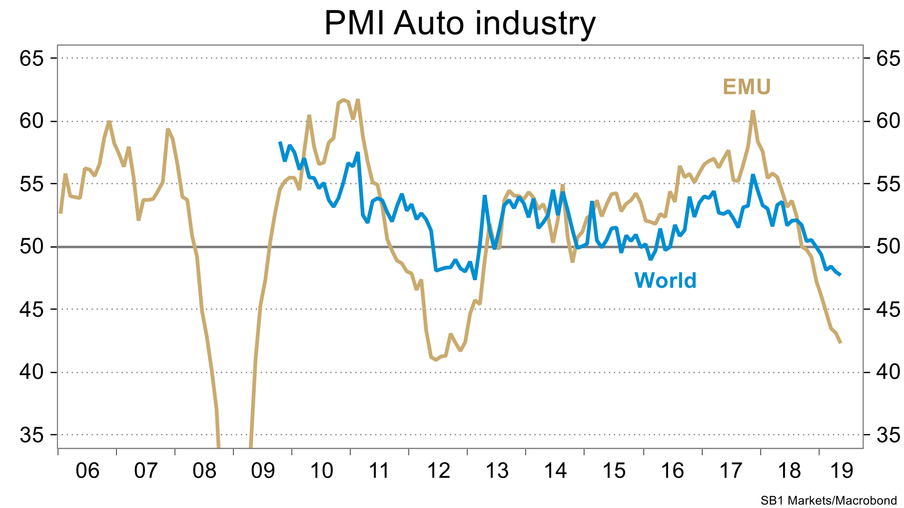


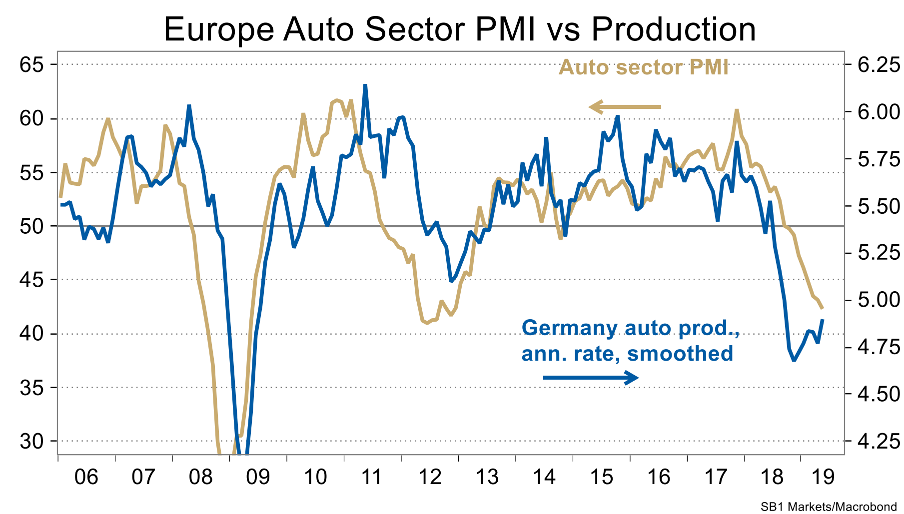



# The auto sector outlook remains gloomy

German auto production is slowly picking up, the auto sector PMIs do not signal any upswing




- German auto production is down some 12% from the level from the pre emission regulation change level
- German and European sales are almost back to the pre regulation levels, while global sales are down some 8% from the level last year. Some upside for German auto production soon?

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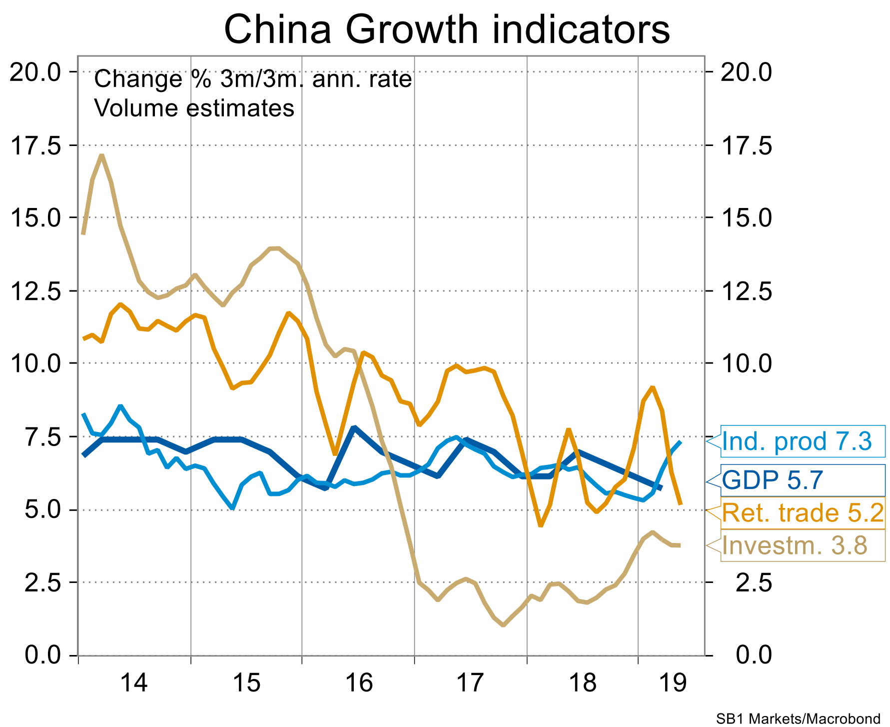
# May data in sum upbeat, in spite some disappointing headline figures

## Industrial prod. stabilised, retail sales rebounding following revisions, investments grow steadily



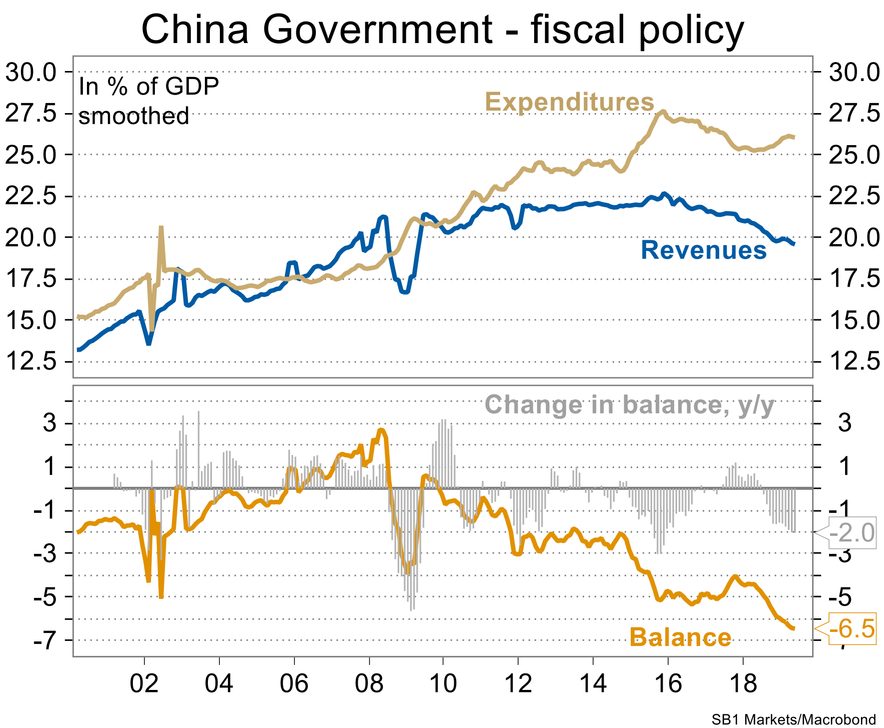

GDP growth has been seriously overstated by National accounts since 2007, according to a Brookings Inst research paper, see some comment next page

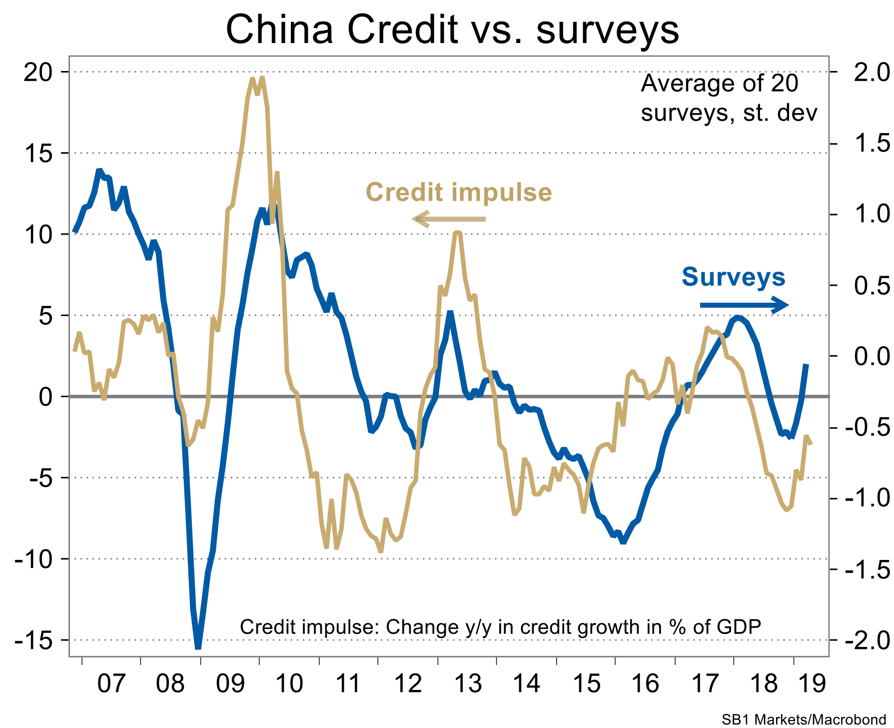
**May data were mixed but in sum below expectations, at least the official data. However, the official data are volatile and not always useful, our calculations note a more upbeat outlook. <u>The most important message: We find no indications of a steep slowdown in China amid the escalating trade war</u>**

- **Manufacturing production** slipped to 5.0% y/y, according to the official data. However, our less volatile calculations yields a 5.8% speed, still above the Jan/Feb slump, indicating that growth has stabilised. Underlying growth has accelerated to 7.3% and the monthly rate was stable at 0.4%
- **The biggest surprise this month was retail sales,** which bounced back up in May, after a dip the prior month. Moreover, recent months have been revised up significantly (following a downward revision in April…), our volume estimate yields 6.6%, vs 5.3% one month ago! If correct, sales have improved since late 2018, in volume and value
- **Investment** growth was steady at 5.3% y/y in May, recent months were revised down somewhat, but not dramatically. The official YTD rate fell 0.3 pp to 5.6%, the same pace as in late 2018. In real terms, investments has most likely turned up the past years
- **Credit growth** picked up in May, after slowing in Q1. Growth has more or less flattened out, at some 11% y/y

# The policy responses: MUCH more expansionary fiscal & credit policy

## Record high budget at 6.5% of GDP, +2 pp last year!! In addition: A substantial credit stimulus




- Fiscal policy: Taxes are cut, spending programs decided. Over the past year, the deficit has increased by 2.0%, a substantial fiscal expansion. The deficit has increase to 6.5% of GDP, according to our calculations
- Banks's reserve requirements have been cut 4 times, by 4.5 pp to 13.5%, freeing up lending capacity equalling some 6½ of GDP! The increase in total credit growth has still been muted, check here for May data
  - » The 3 m SHIBOR at 2.82% has not been lower since 2010 . In addition, the CNY exchange rate is down from the peak. Actual credit supply has slowed somewhat in March & April, and credit growth vs. GDP is still lower than

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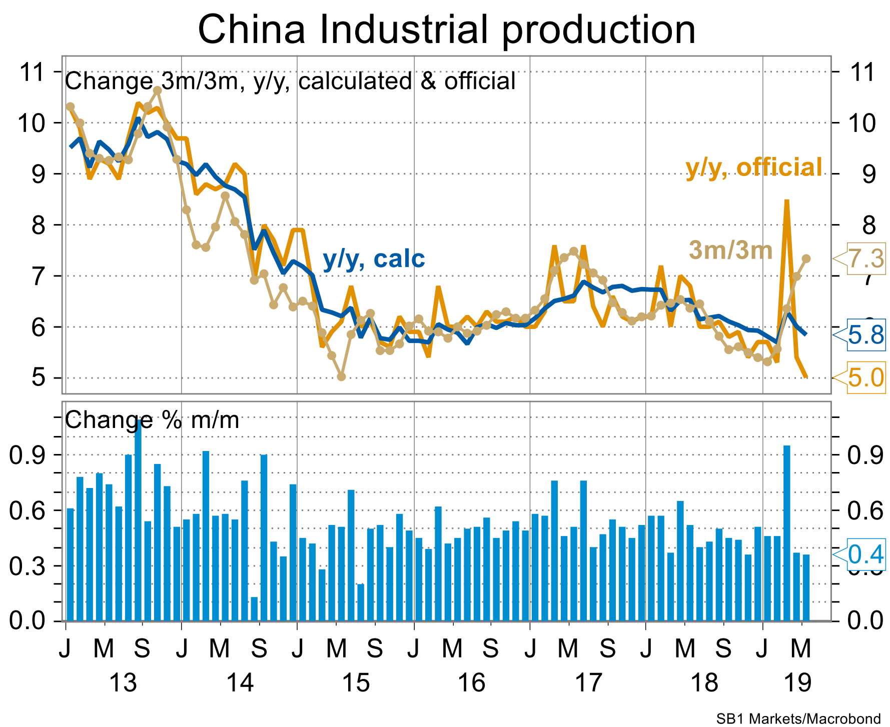
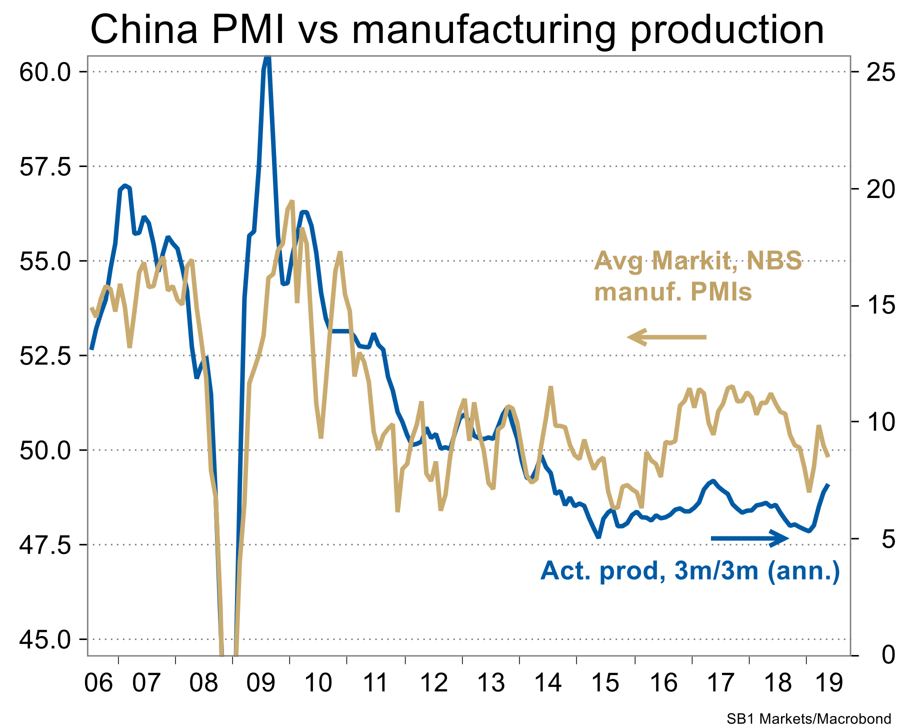
# Slower industrial production growth in May but is it that weak??

## The official y/y rate is rather grim – our less volatile calculation finds a stabilisation recent months



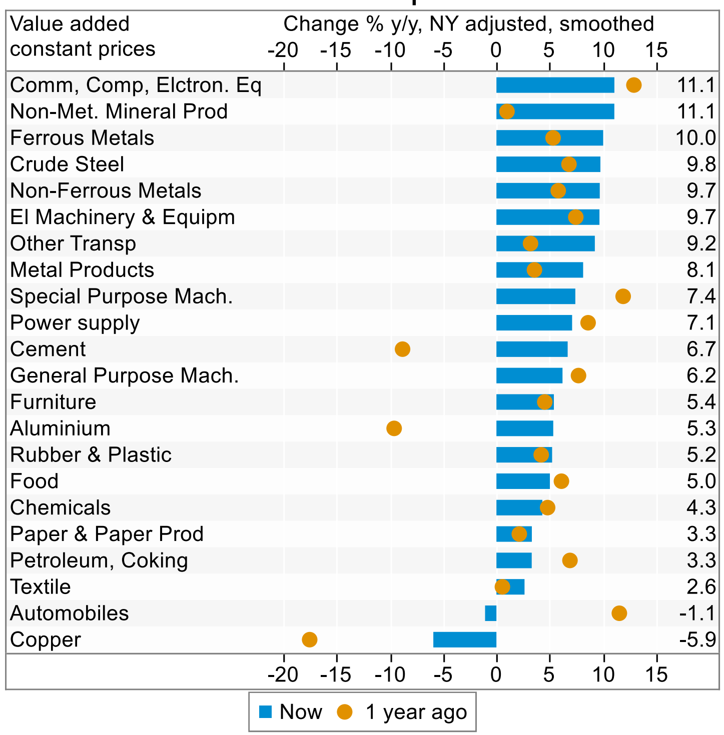




- Production rose 0.4% m/m in May, the same pace as in April. Growth the past two months is the slowest since the brief setback in July 2015 (just one month), and before that the 'shutdown' in Q4 2008. However, the unusual 0.95% hike in March of course complicate the analysis. Taken face value, growth the recent 3 months is higher than normal.
- The longer trend is anyway down, but most likely not as dramatic as indicated by the official annual growth rate at 5%, unexpectedly down 0.5 pp from April. The official rate is the lowest since 1991, barring some volatile single month prints 1997 – 2002. Our far less adjusted annual growth rate, based on official monthly seasonally adjusted data, ticked down to 5.8%, still 0.1 pp above the speed before the March hike – and it has not trended down recent months (though assuming the March hike is for real!).
- PMIs or other surveys are not signalling an abrupt halt in the manufacturing sector either. Export volumes are back to peak levels. <u>China has not been brought to a halt</u>

# A broad upswing among sectors, just copper & autos are down y/y

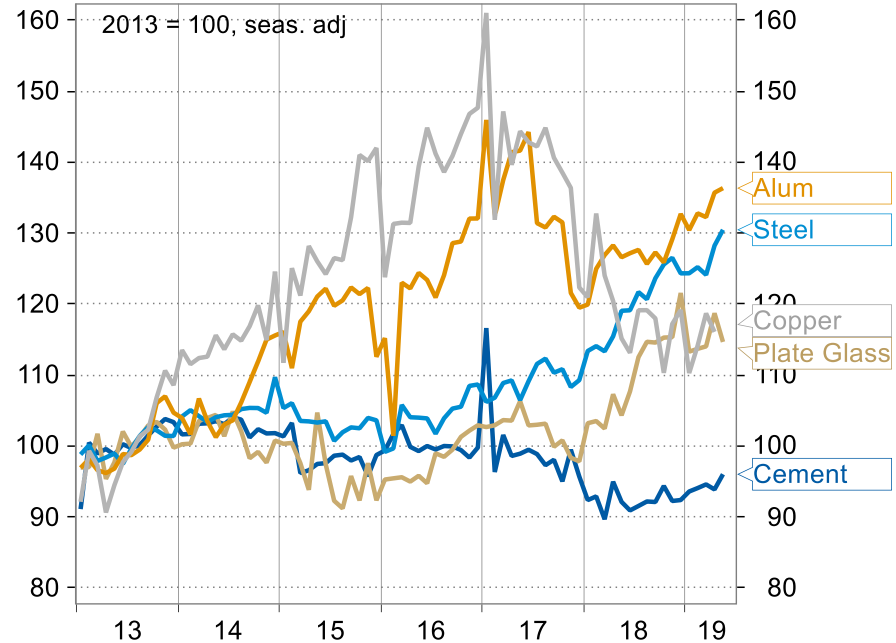
## 13 sectors are accelerating, 6 are slowing. Auto production is stalling, downside risk

China Industrial production




SB1 Markets/Macrobond

China 'Building' material production

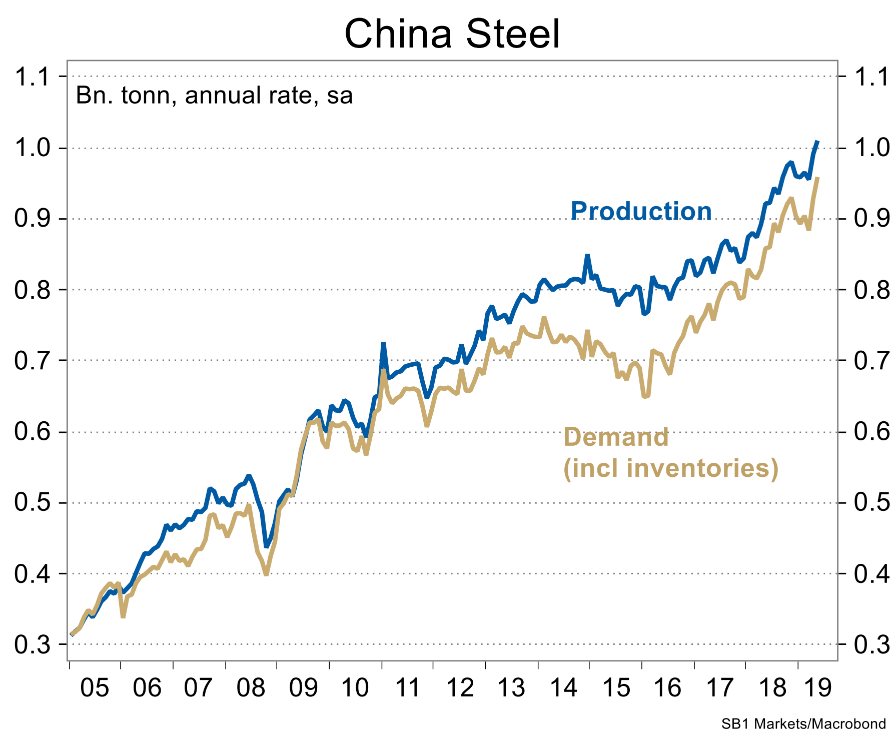



SB1 Markets/Macrobond

- Crude steel production is gaining steam, after a stagnation in early 2019, up 9.8% y/y
- Aluminium production is recovering from the downturn in 2017 and is increasing by 5% y/y (smoothed)
- Cement production is slowly climbing, up just 6.7% y/y
- Copper production inched down in May and is not more than flat recently, after a downturn in 2017 and 2018. Still down 6% y/y
- Auto production (valued added) has been hurt by weaker sales but has kept (unbelievable?) stable, down just 1.1% y/y, while sales are down 17% y/y. Does not seem reasonable, given the low import share

# Steel production (and demand) spikes, following a slowdown

## Upward trend intact, after both demand and production softened last winter. Reduced overcapacity



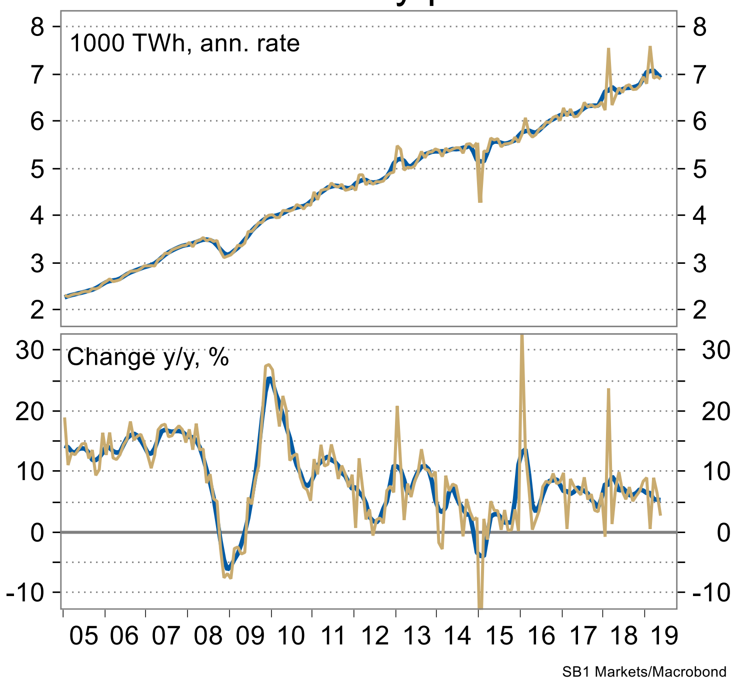


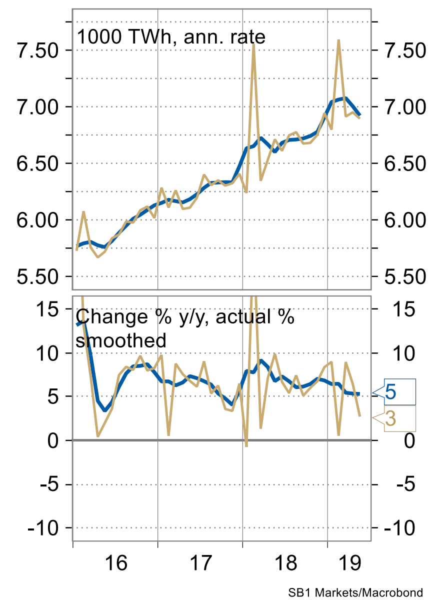
- Production is up some 10% y/y and demand is expanding at a 12% speed, pretty well explained by the strong growth in construction starts. On the other hand, slowing auto production signals softening steel demand from that sector
- China is still a net steel exporter, but far less than during the 2015-16 setback in domestic demand. Back then, production was cut by far less than domestic demand and net exports soared. Now, net exports are far lower (and domestic demand closer to production.

# Electricity production trending up, but weakness in seaport activity

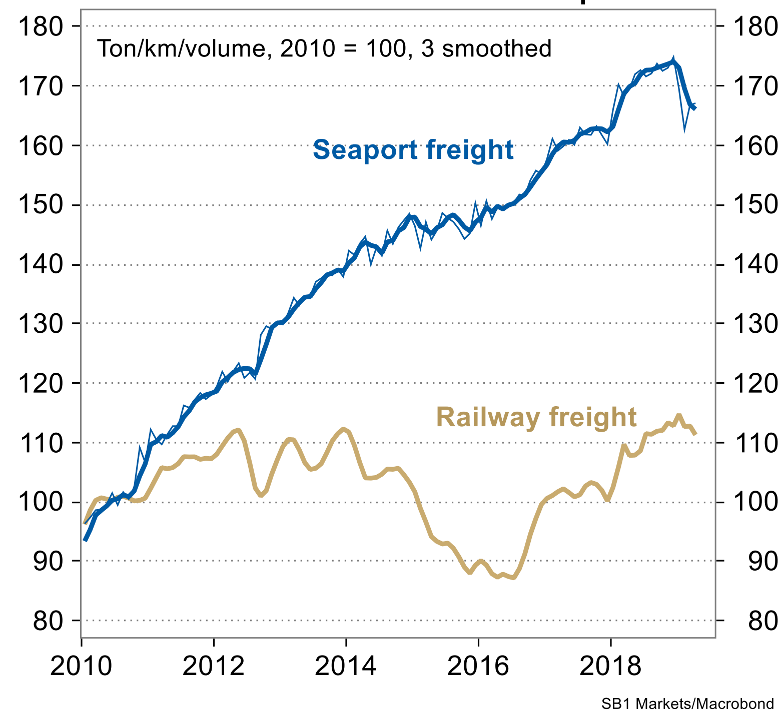
## Electricity production has slowed somewhat recent months, trend still up, at a 5% y/y speed

China Electricity production



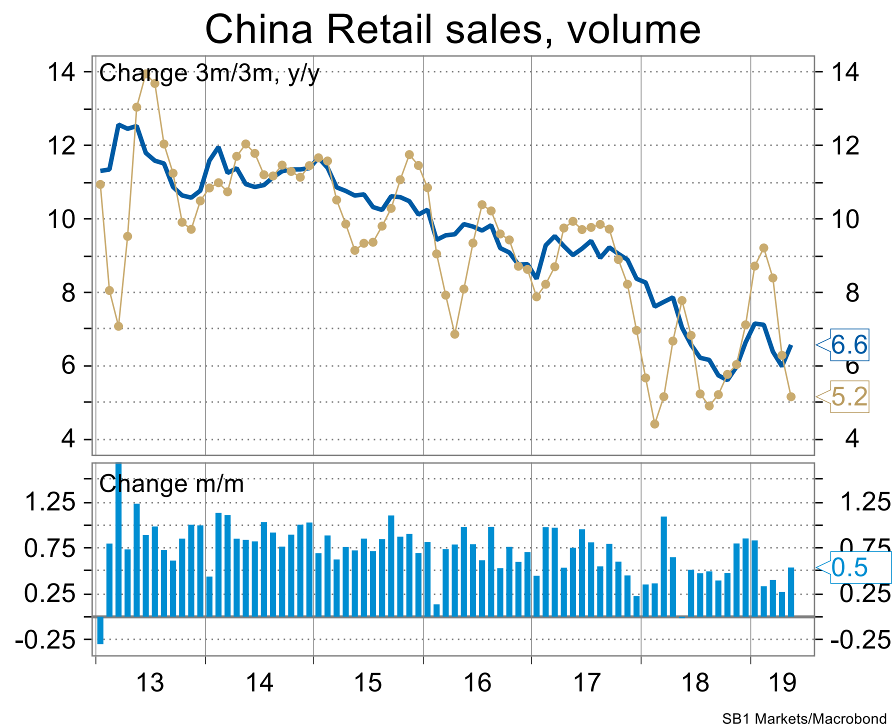

China Trade and transport




- Transport growth (seaports & railway) has softened, seaport freight fell steeply in Feb/March, stable since then. Railways have weakened less than seaport, fell marginally in May
- The Li Keqiang index, which includes some few real data (among them, electricity production and freight volumes) as a proxy for GDP is reporting 8% growth in May, down from 12% in April yet well above the 6.4% official y/y GDP rate. Our view is that the index is not a relevant gauge of the Chinese economy anyway. In fact, (quite impressive) new research argues that growth is much lower than the official accounts reports

# Retail sales rebounded after significant upward revisions

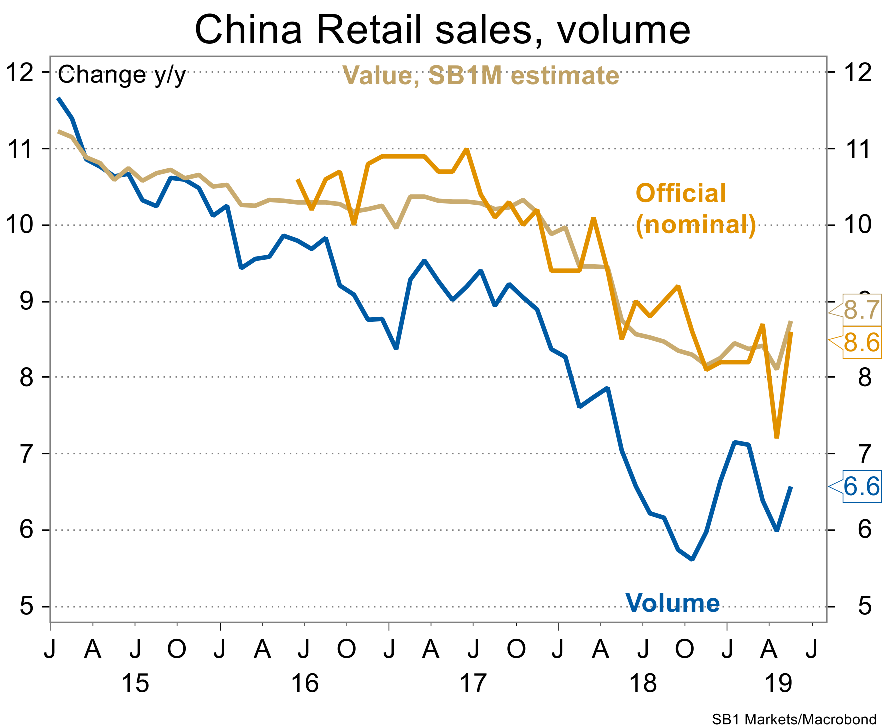
## Sales volume growth at 6.6% in May, vs 5.3% in April, indicating that growth has stabilised

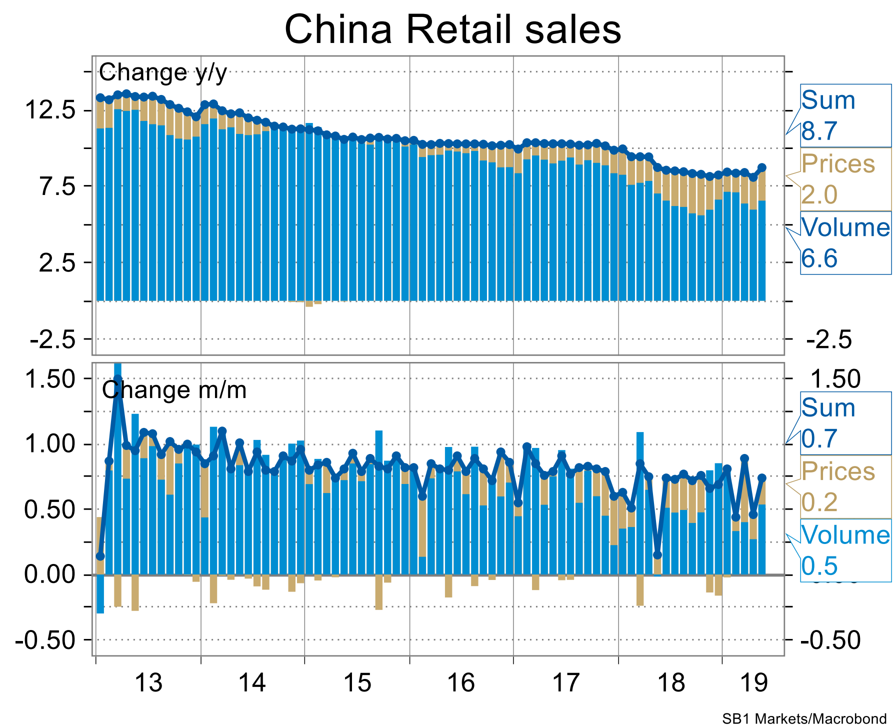




- The official value growth rate bounced back up to 8.6% in May, from 7.2% the prior month, and well above expectations. Our less volatile value growth estimate (based on monthly seas adj. data) yields 8.7%, from 8.1% in April (revised up from 7.3%!). In April, the prior months were revised down significantly (so some cautiousness is needed)
- Our volume estimate rose 0.5% m/m in May (retail prices rose 0.2% m/m), and the annual rate came up to 6.6%, from 6% the previous month, which has been revised up from 5.3%. Thus, growth has recovered somewhat since late 2018 (if we believe these revisions). The May upswing in volume growth is surprising, as retail price inflation has been boosted by soaring pork prices (swine flue)
- Consumer confidence surveys have strengthened recent months, at very high levels. Even so, consumption is not thriving, even larger tax cuts may be needed to bring consumption up?

# Retail sales: A closer look

## Sales have stabilised in nominal terms and prices have come up but not by that much yet

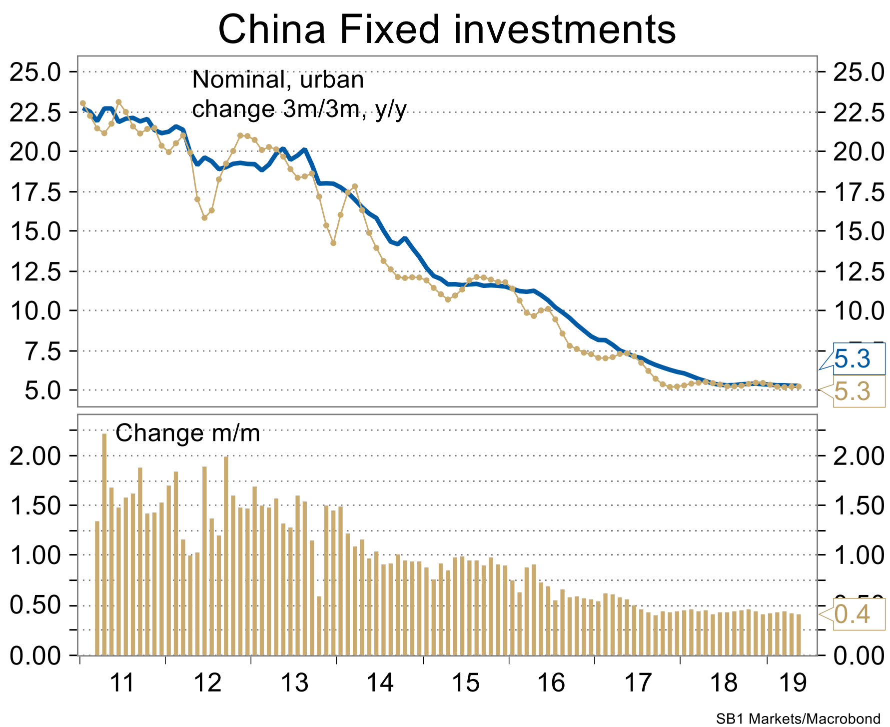



- Retail prices are up just 2% y/y, while the total CPI is up 2.7%. The discrepancy is not due to services, and the low retail price inflation does not seem that reasonable as foods prices are soaring. The 'real' real growth may be lower than our estimate

# Nominal investments are growing steadily, most likely accelerating in real terms

## The long term decline in investment growth has halted, at a comfortable, low level





- Urban investments rose 5.6% y/y ytd in May according to the official data, down from 6.1% the prior month. Our calculation yields a 5.3% y/y growth, unchanged from April after a small downward revision of the previous months. The m/m rate slowed just marginally to 0.4%. Growth has been quite stable since late 2017. In real terms, we assume growth has accelerated, to 4% from 2% (as our aggregate of Chinese price indices have slowed somewhat (and pork meat prices do not influence investment goods prices)
- State controlled investments have slowed recent months, whereas private sector investments have picked up. Strange, given that the government is taking huge steps to stimulate growth, we are not sure that we trust these data (and there are huge revisions)
- Long term, investment growth has been on a steady downward path, from 25-30% before 2009 – but it has now stabilised, well below nominal GDP/income growth –and may have fallen much more than official accounts have reported

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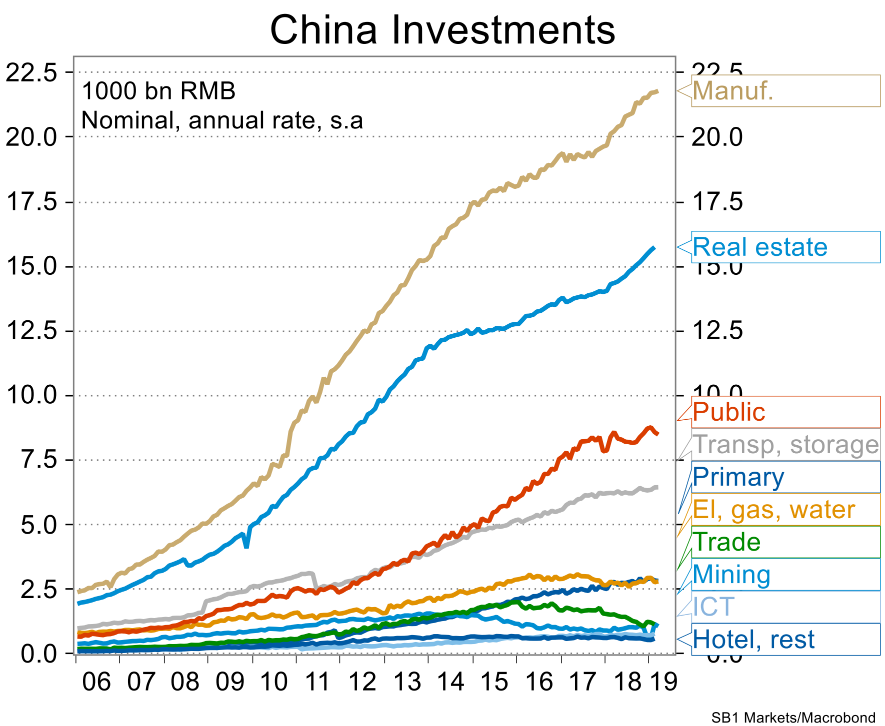
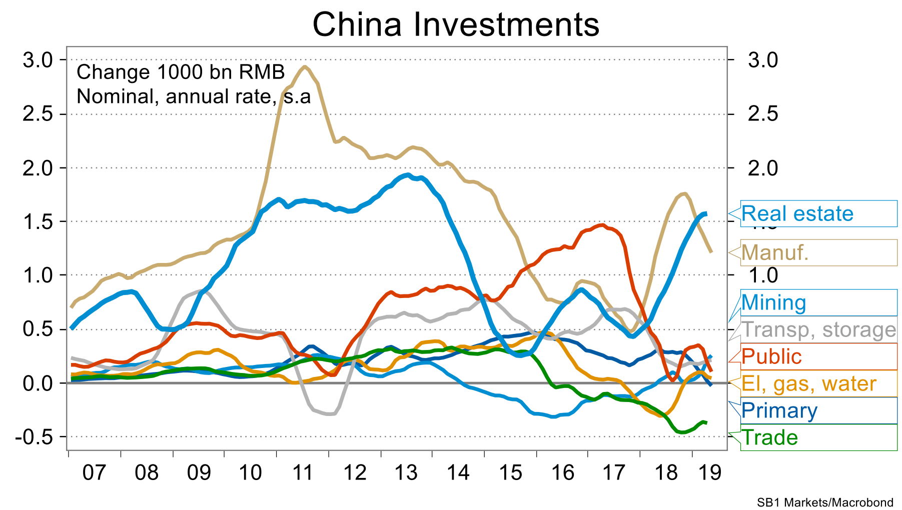
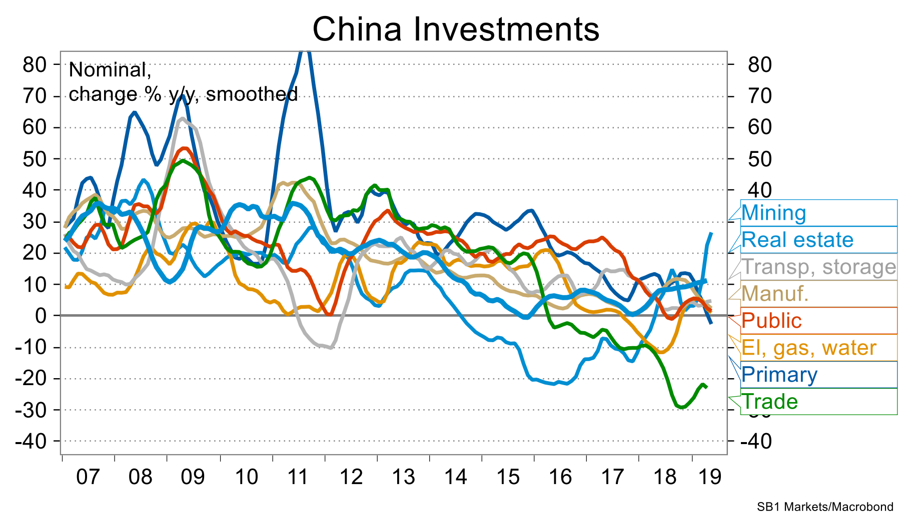
# Investments are still expanding in all sectors barring trade

## Retail trade down 23%, may have bottomed. Manufacturing is slowing, mining soars



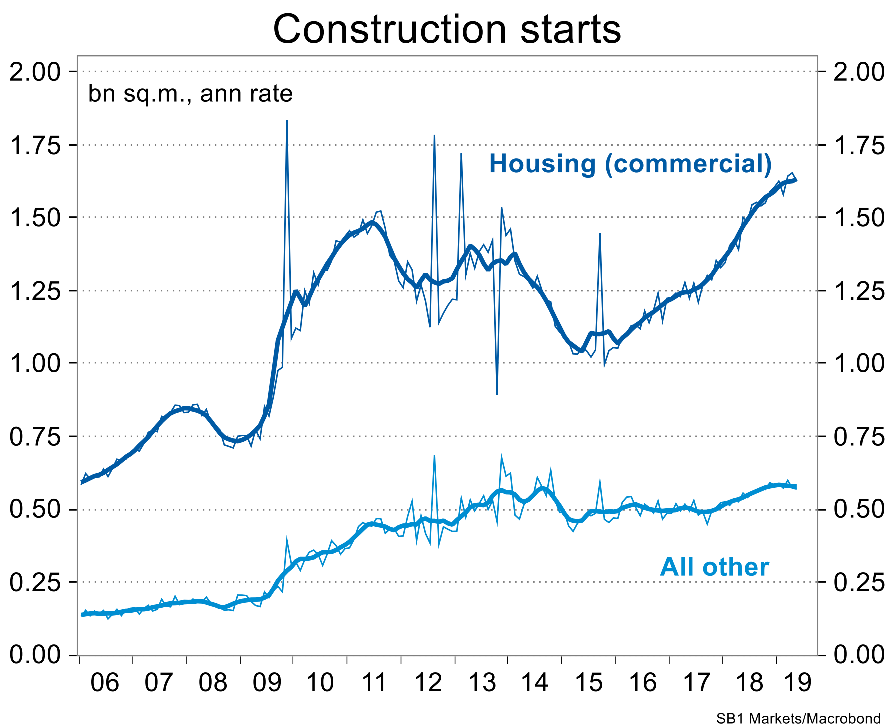



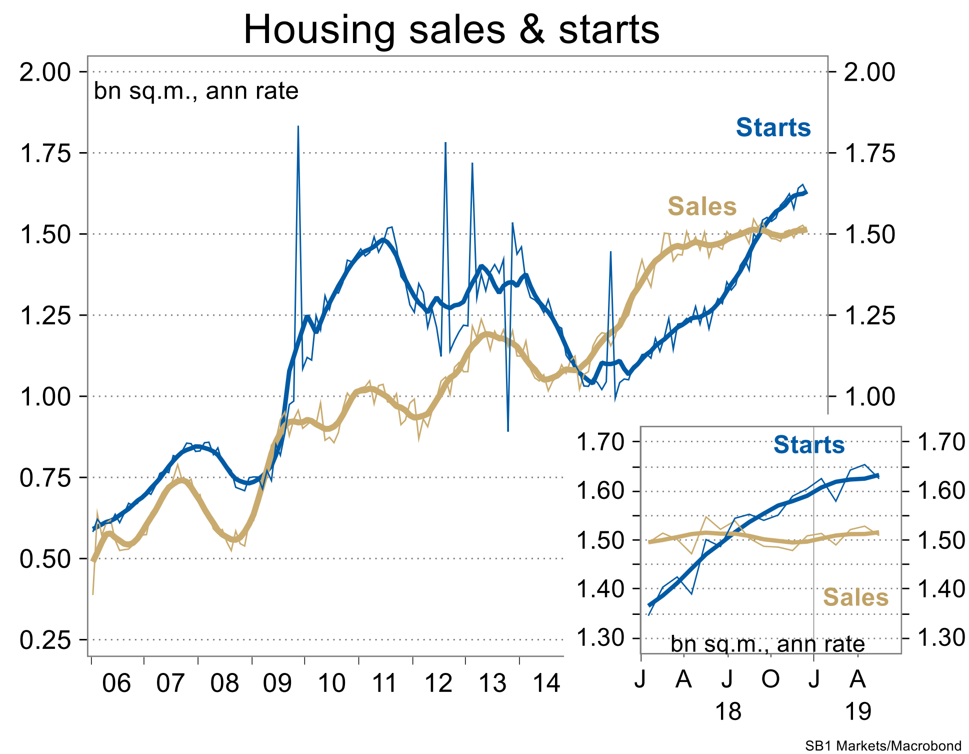

- The steep increase in investment in manufacturing through does not signal trade war worries. The recent slowdown is so far mild. Real estate investments are still strong and accelerating
- Investments in retail and wholesale trade have been declining rapidly, may have bottomed out. Weak retail sales through 2018 probably brought investments down, should stabilise now?
- Public sector investments have slowed the past 3 months and are up just 1.5% y/y, seems strange

*Not all sectors have reported data for the last month*

# Home sales, starts down in May; starts trend still strong, sales flattish

Both housing starts and other construction are at record high levels, close to peak?

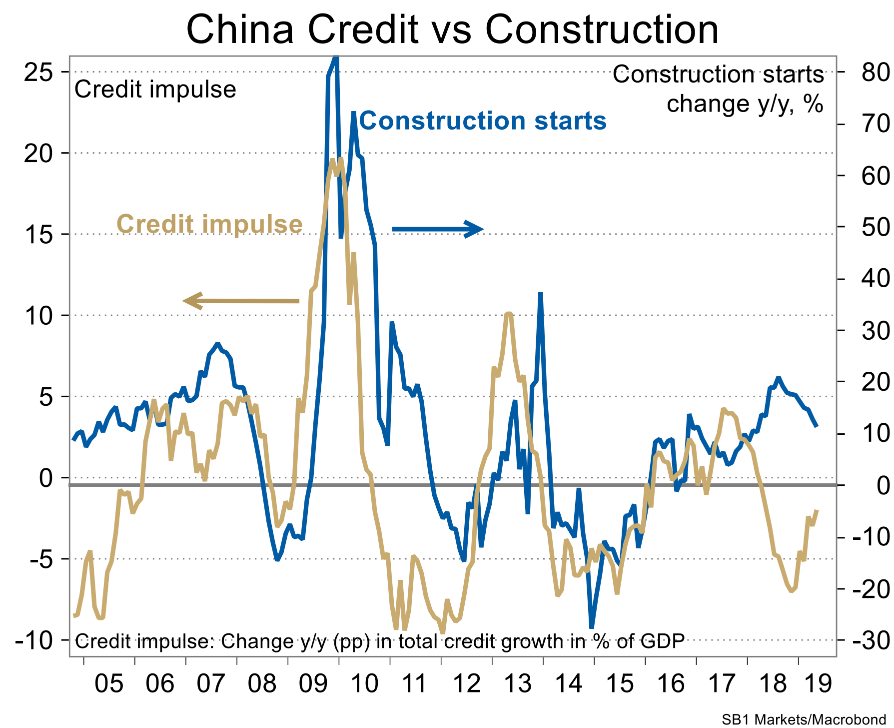



- Sales of new homes have flattened out over the past couple of years, at a record high level
- Housings starts are running higher than sales, trending straight up. However, sales fell marginally in May and recent months were revised down marginally, indicates that the upswing has slowed somewhat. Given the large inventory drawdown from 2014 – 2018 (starts were below sales), the increase in inventories are now is very limited. Starts are up more than 50% from the 2015 trough, and are up 14% y/y (smoothed)
- Other construction starts have been trending upwards since late 2017, may be peaking now? Annual growth down to 6%, from 20% in late 2020. These starts have reached a new ATH too, although the level is not that much higher than 4 years ago

# Credit and construction usually correlated but not recently

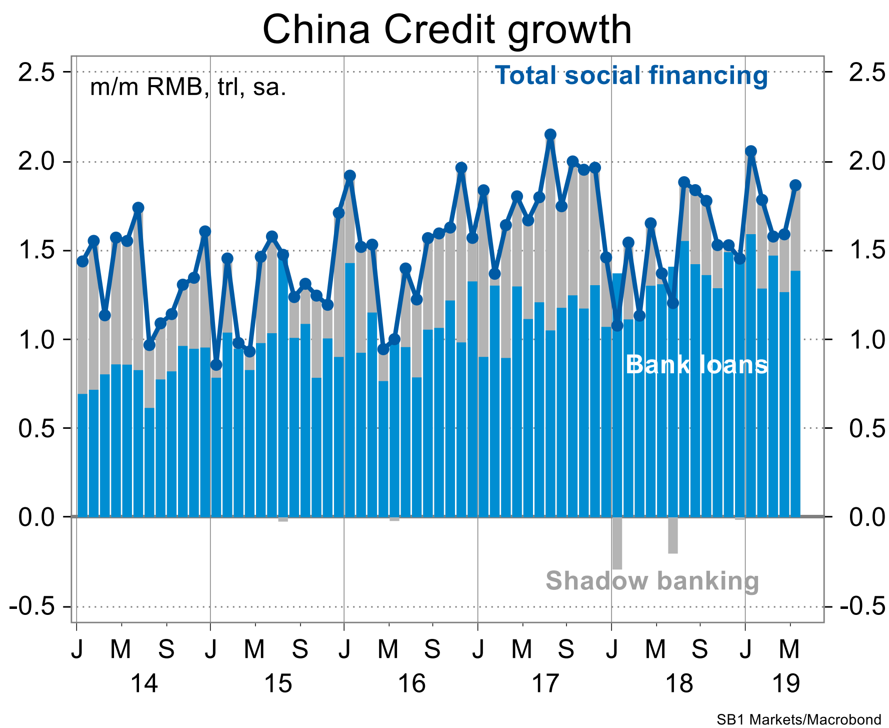
## The 2017/18 credit tightening did not dampen construction

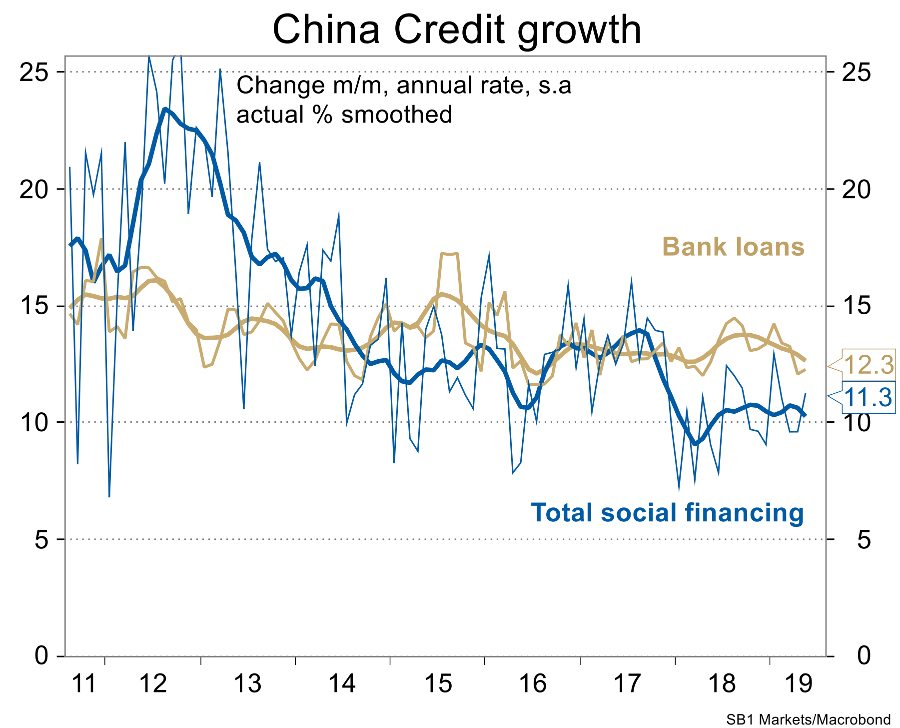




- Now, the credit impulse has turned upwards and the authorities might be able to accelerate credit
  - » However, would that be sufficient to ignite a faster (or even further) lift in construction activity?

# Credit growth accelerated in May, trend not more than flat

## Credit growth through banks is slowing, shadow banking up, total credit growth flattening out




- Total credit rose by 11.3% m/m annualised in May, the highest in 4 months, and the recent trend is flat – and not accelerating. Total credit is up 10.5% y/y (from 10.3% in April, but lower than expected) – and above the reported 8% nominal GDP growth
  - » Both credit through banks and shadow banking accelerated in May. Still, during the recent months, lending through banks have slowed – even if authorities have tried to stimulate bank lending. The slowdown is not yet visible in the annual growth rate (see next page). Shadow banking lending is turning slowly up, after being curbed into 2018
- Total credit growth slowed substantially in early 2018, by some 5 pp, a substantial credit tightening. This credit contraction no doubt contributed to the slowdown in the Chinese economy last year, as several times before, and probably more than trade war/uncertainty. The authorities have implemented several measures to stimulate credit growth – at the same time as they do not want ignite another credit boom. Underlying Credit growth us up from the early 2018 slump but just marginally

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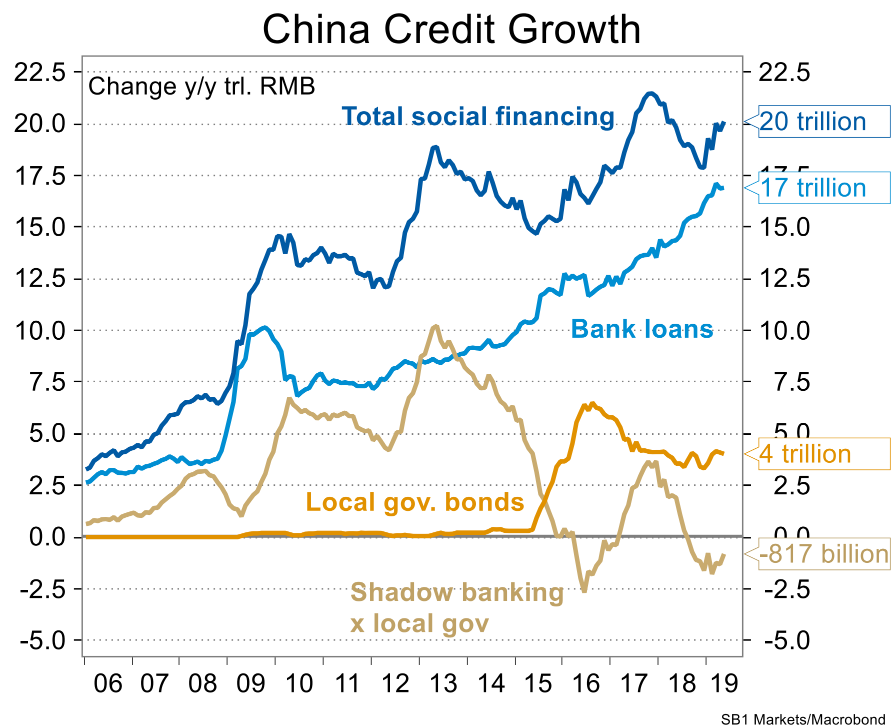
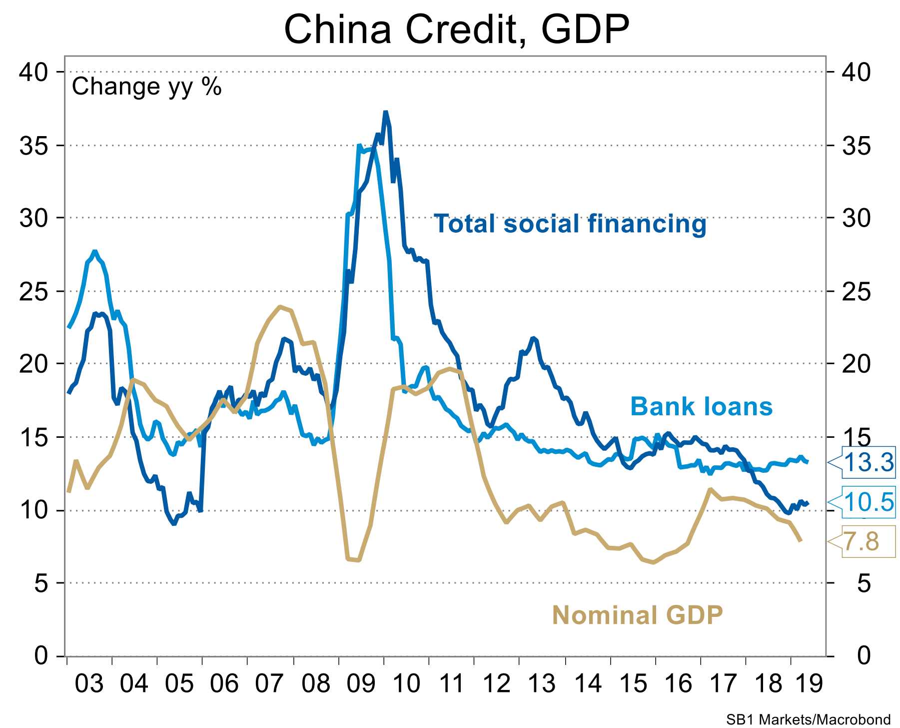
# Credit growth has accelerated slowly over the past year (if not further now)

Banks have until now compensated for slower growth in other parts of the credit market

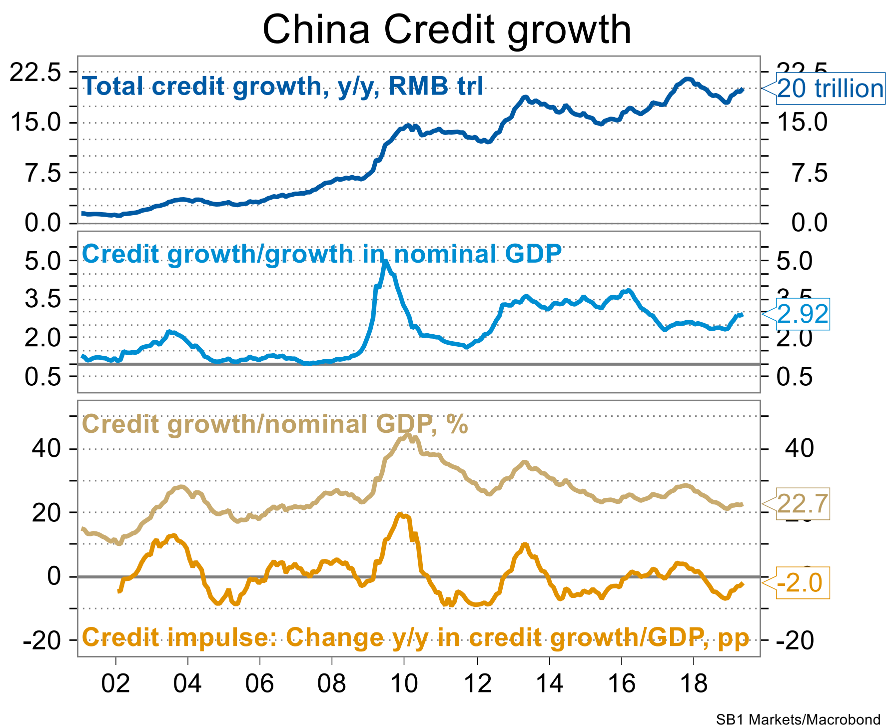


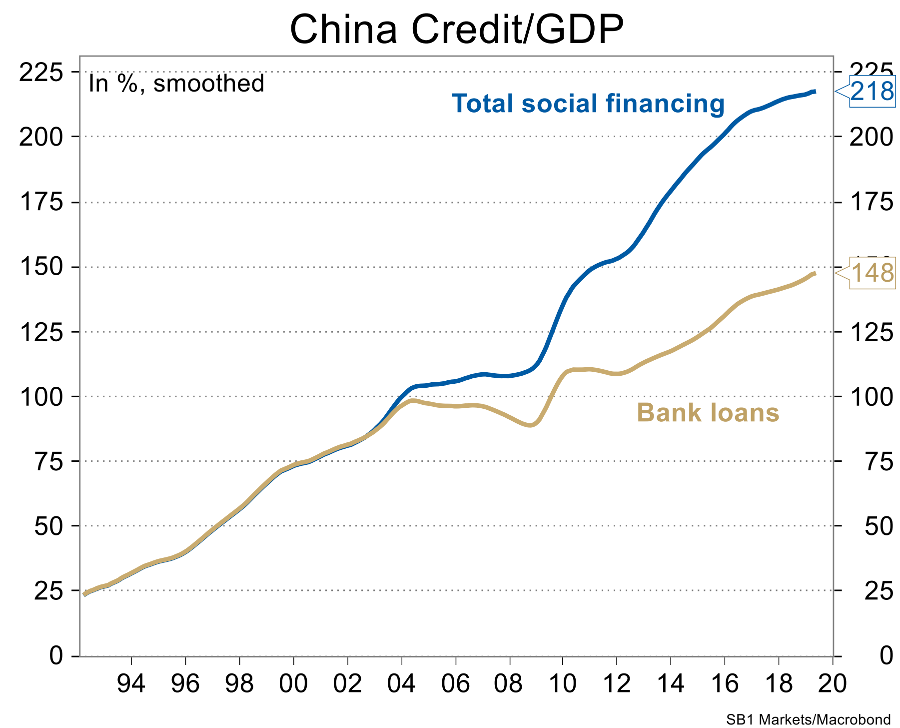




- Over the past 12 months, total credit has grown by CNY 20 trl, equalling 23% of GDP. The annual rate bottomed out in Dec
- Banks supplied CNY 17 trl (85%) of the increased credit volume
- Local governments borrowed CNY 4 trl in the bond market
- Other credit – via the shadow credit market x gov bonds – are down by almost1 bn, mostly because authorities tried to calm down this credit channel, and succeeded
- Total credit growth at 10.5% is still well above growth in nominal GDP

# Credit at a turning point? Quite likely. At least something has happened

Anyway, the credit impulse is clearly less negative, authorities' stimulus dampens the slowdown?

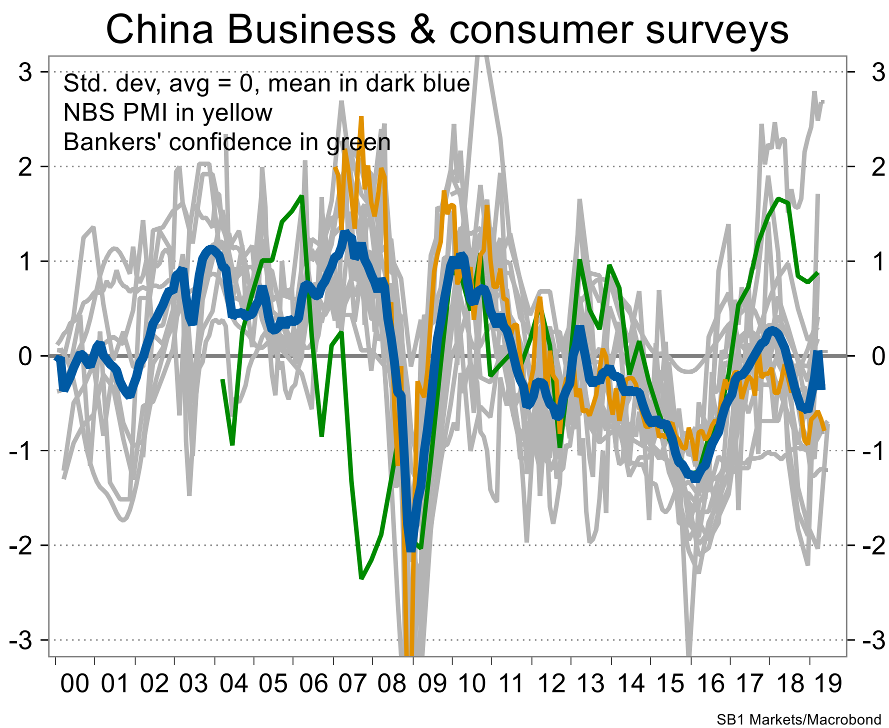


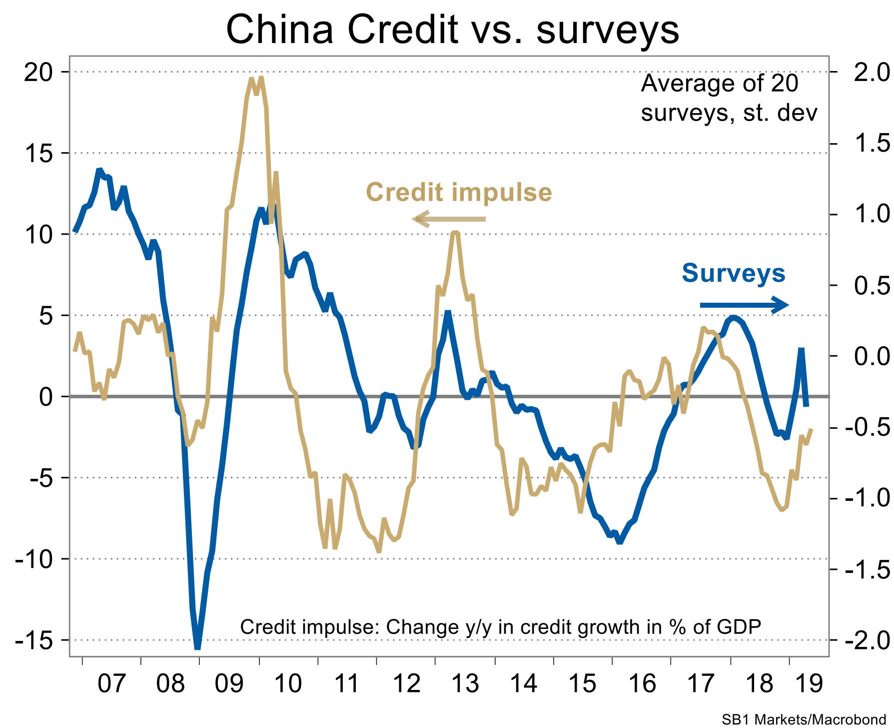




- A negative credit impulse implies that the credit growth/GDP ratio is declining (the 2nd derivative)
  - » Indicates credit tightening (or weaker demand)
  - » Has been associated with slowdowns in the Chinese economy
  - » Now, the credit impulse is less negative measured y/y (the 3rd derivative ☺ is positive)
- We are uncertain how far the authorities are able (or willing) to bring credit growth back up. The credit/income level is high – and may be even higher than so far reported (as GDP might be significantly lower than officially reported. Thus, the problem may turn out to be demand for credit, rather than supply, even if supply has been the limiting factor from time to time recent years as authorities (successfully) have clamped down on credit growth primarily through the shadow banking market but also through banks.

# Credit has been tightened, usually dampens growth

## We are most likely witnessing a growth slowdown but not a rapid one

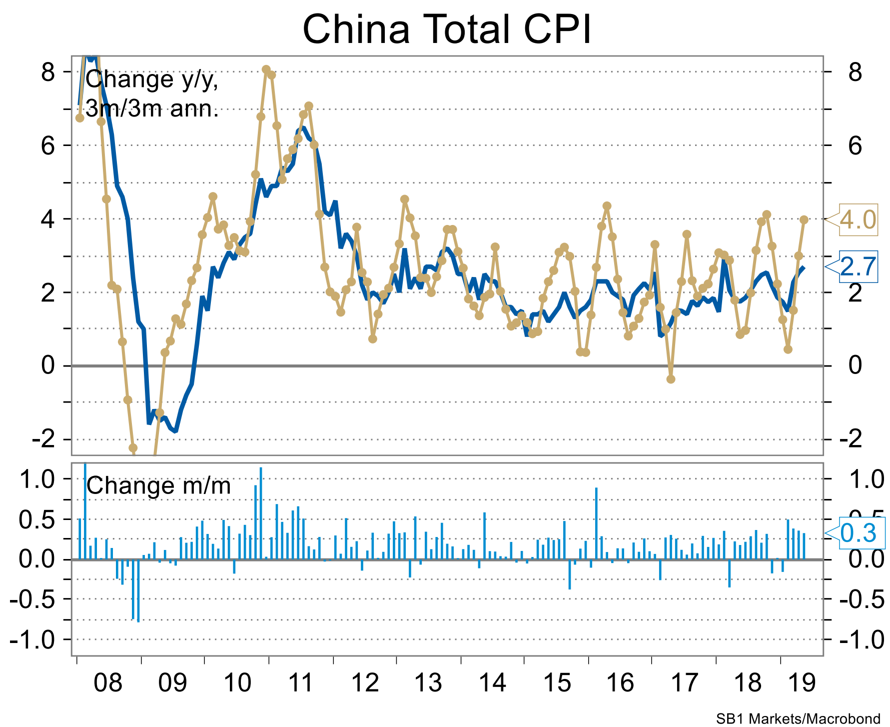


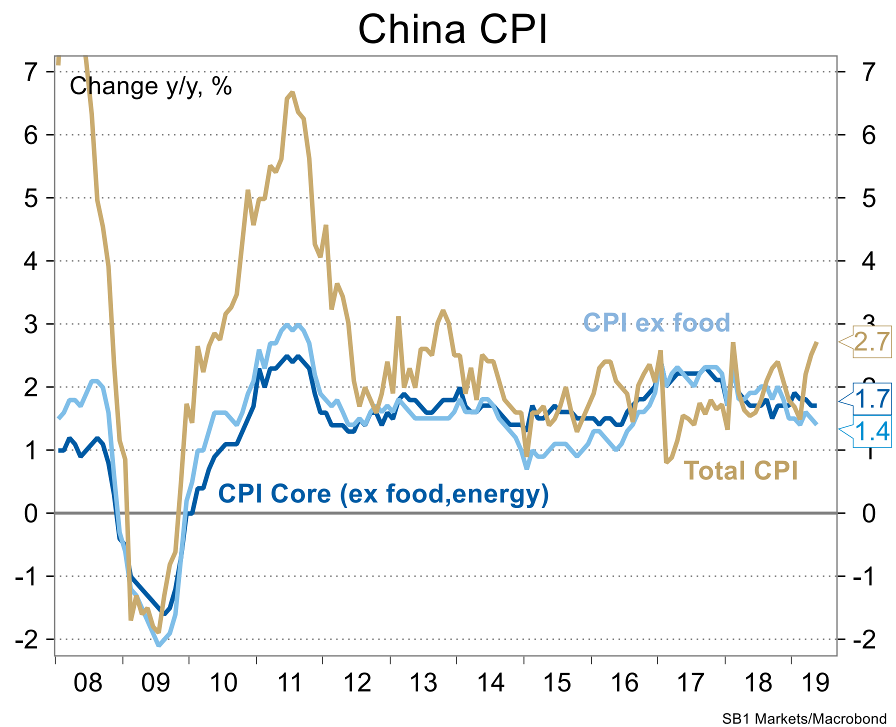




- An avg of Chinese business & consumer surveys indicates that growth has slowed significantly. However, the level is still not very weak, neither are the PMIs

# The swine flue pushes CPI inflation sharply up, real disposable down

Total CPI growth is climbing on soaring food (pork) prices, core inflation unchanged at 1.7% in May

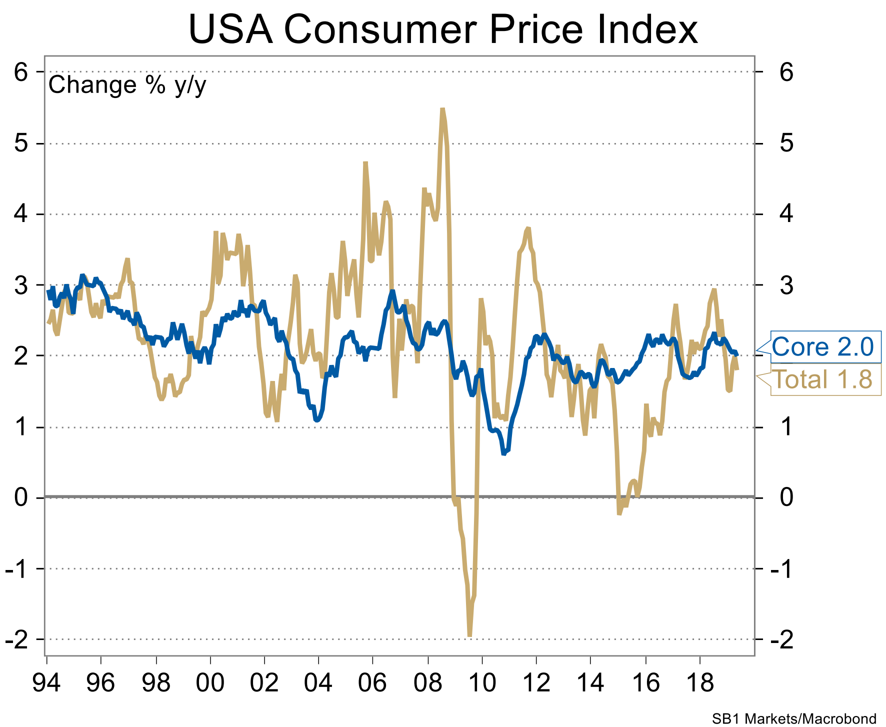


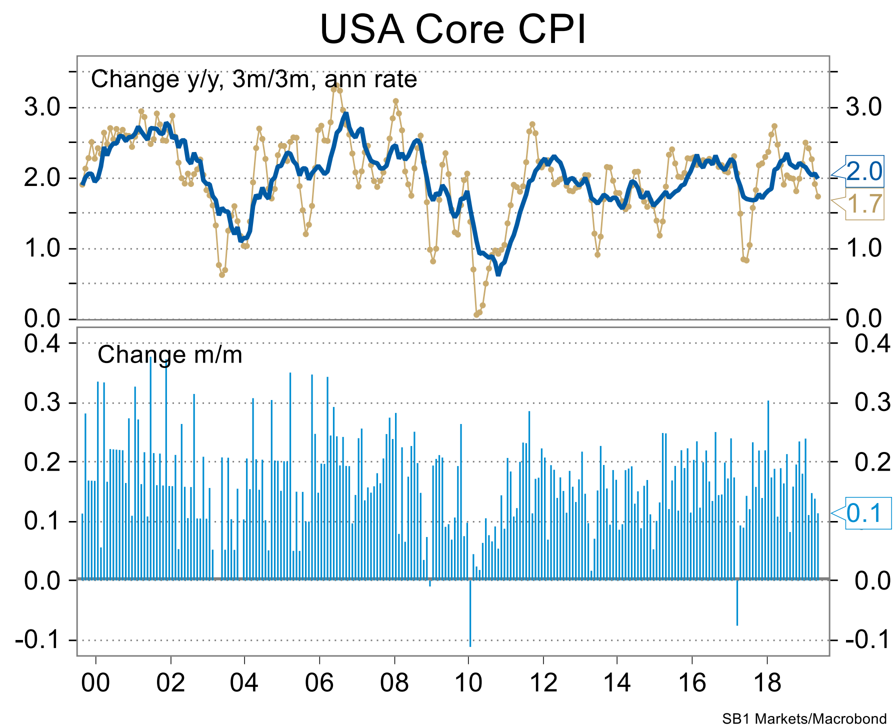




- Headline inflation accelerated 0.2 pp to 2.7% in May, following a 1 p accumulated lift in March & April. Prices rose 0.3% m/m, slowly decelerating
- Food prices have increased more than 1% m/m the past 4 months and the annual rate shot up to 7.7% in May, up from 6.1% in April (and 0.7% in Feb!) The main reason is a 18% hike in pork meat prices y/y due to the serious outbreak of the swine flue, and a sharp drop in pork meat production, perhaps as much as 30%
- CPI ex food has been almost stable at 1.5% (and fell by 0.1 pp to 1.4% in May). Thus, of the 1 pp increase in total inflation past two months is entirely due to higher food/pork prices
- The 'real' core, excluding food and energy, was flat at 1.7% in May. Core CPI has been growing at a stable rate since early 2018. Oil/energy prices have contributed on the downside to the CPI, now the sign has changed, and energy is now lifting annual headline CPI by 0.2 pp

# CPI core inflation eases, bolstering expectations of a Fed cut this summer

## Core CPI rose just 0.1 % in May, for the 4th month in a row, exp. 0.2%, annual rate slides down to 2%

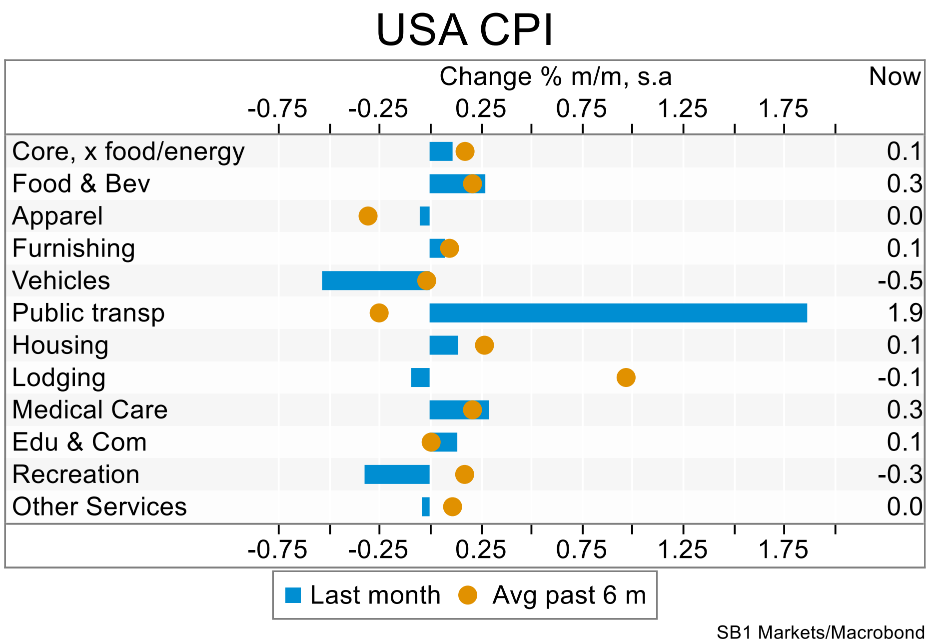


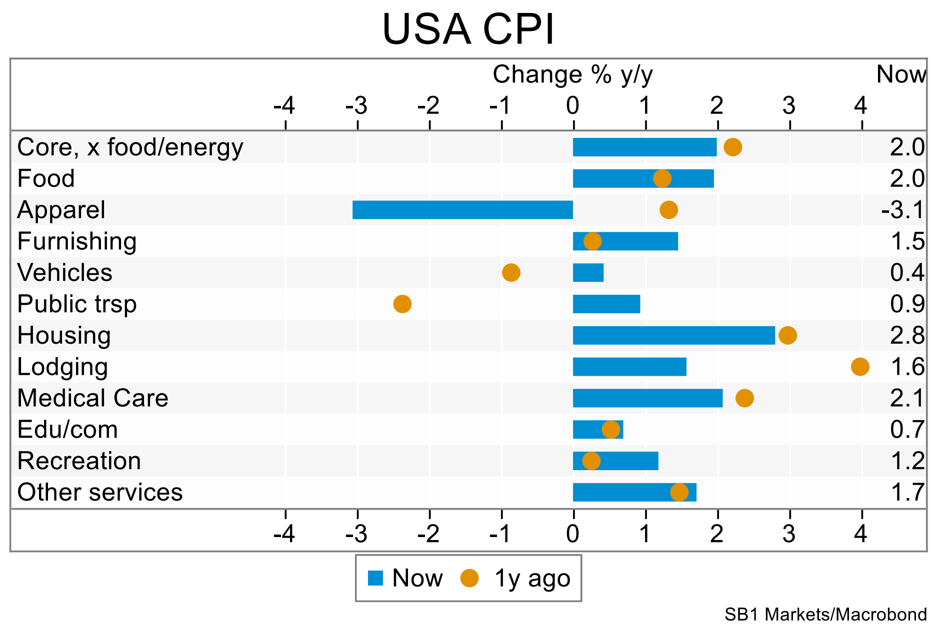




- Core CPI rose by 0.1% m/m in May, once more missing expectations by 0.1 pp. The annual rate inched down to 2.0%. Core inflation has no doubt moderated recent months, underlying growth down to 1.7%, from 2.5% in January
- Headline inflation ticked down 0.2 pp to 1.8%, as the impact from energy prices changed sign and was trimming inflation this month. The oil price fell significantly through May and will no longer boost inflation
- Core CPI inflation is down 0.4 pp from the local peak, an argument for a soft Federal Reserve. However, inflation is still close to the target (the core PCE deflator is 0.4 pp below the target) and the Fed has so far not expressed concerns about the cooling inflation. Rather, transitory factors have been highlighted

# Vehicle prices fell in May and are rising just marginally y/y

Just apparel prices are pulling annual inflation down, most other sectors rising moderately

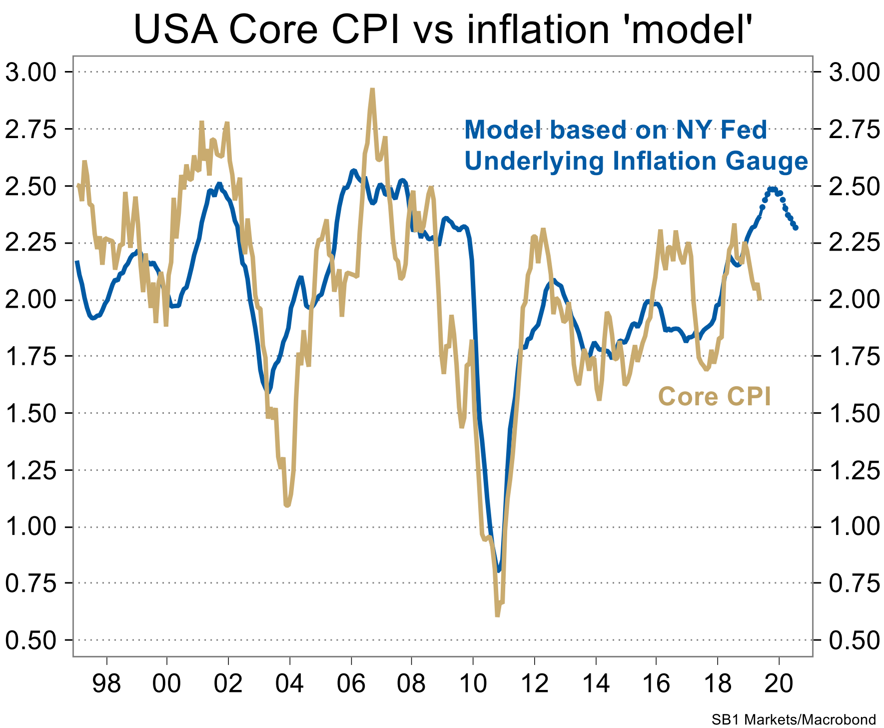


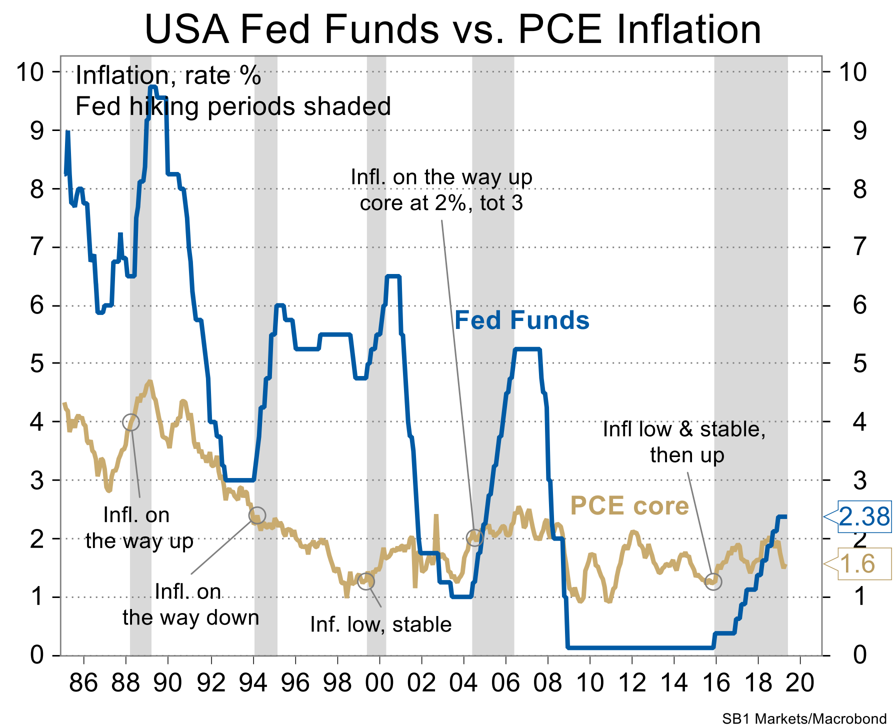




- Higher prices housing (rents & services), food and medical care are boosting annual inflation
- Vehicle prices fell m/m in May and are growing just 0.4% annually, does not imply brisk demand

# NY Fed's inflation model suggests that inflation is soon peaking

... or has it peaked already?

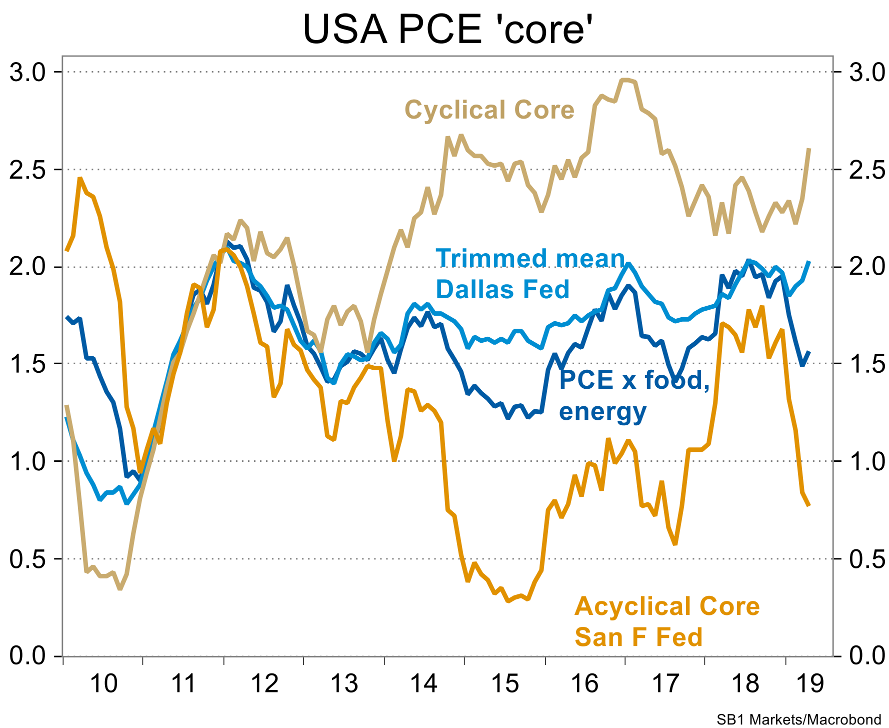


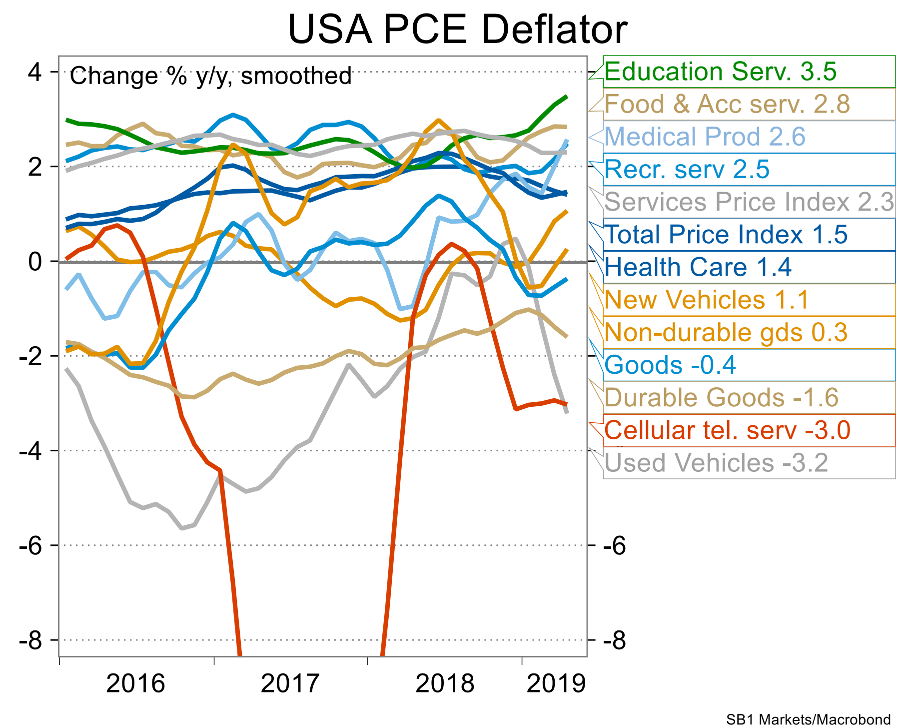




- The NY Fed's Underlying Inflation Gauge model includes a wide range of macroeconomic and financial components in addition to some CPI components. The UIG model leads the actual inflation rate by some 15 – 20 months. The model now signals somewhat lower inflation than some months ago (lower energy prices is probably one element) but it is still indicating higher inflation than today
- The personal consumption expenditure price deflator (PCE deflator) is the Fed's preferred inflation measure, not the CPI. The core PCE (ex food, energy) was up 1.6% y/y in April, below Feds inflation target at 2% - and it may slow to 1.4 – 1.5% in May
- Fed's actual rate setting has not been well explained by actual inflation during the past two decades. The present inflation rate does not prevent the Fed from further hiking – or cutting. The economy – taking care of the 'dual mandate', full employment - will decide Feds action from here

# Is the decline in consumer inflation ‘for real’? Not necessarily

## More sectors up than down and details do not suggest a ‘cyclical’ inflation decline



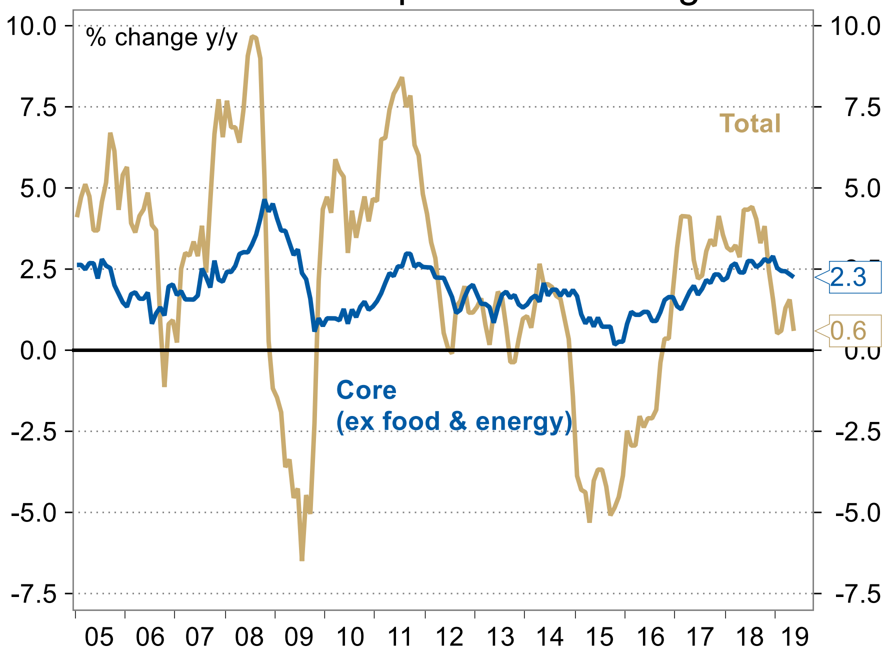




- Used vehicles and cell phones are dragging prices down
- However, prise pressure in production chains are easing somewhat, check the next slide

# Producer price inflation slows, does not imply upward pressure on final prices?

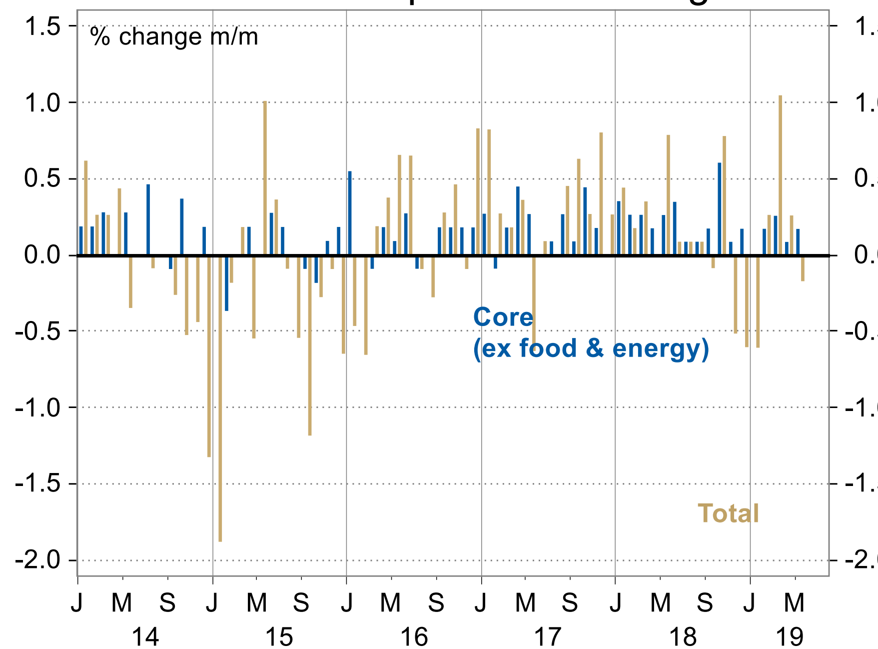
## Core finished goods one tick down to 2.3% y/y in May; total PPI down with lower energy prices

USA - Producer prices finished goods




SB1 Markets/Macrobond

USA - Producer prices finished goods




SB1 Markets/Macrobond

- Core finished goods x food & energy PPI rose by 0.2% m/m in May, as expected. Monthly growth has been muted recent months and the annual rate fell to 2.3% in May (down 0.1pp), from 2.9% at the local Dec peak
- Headline PPI fell 0.2% m/m, 0.3 pp below expectations, as energy prices are heading down again. The annual rate fell back down and is very low, at 0.6%. Declining energy prices dragged total PPI down last autumn/winter

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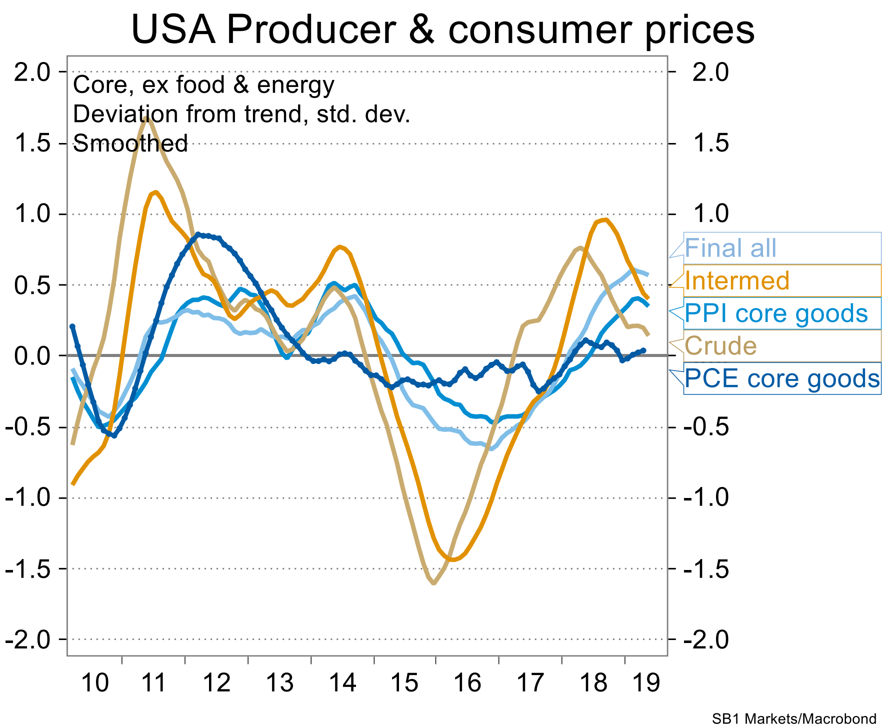
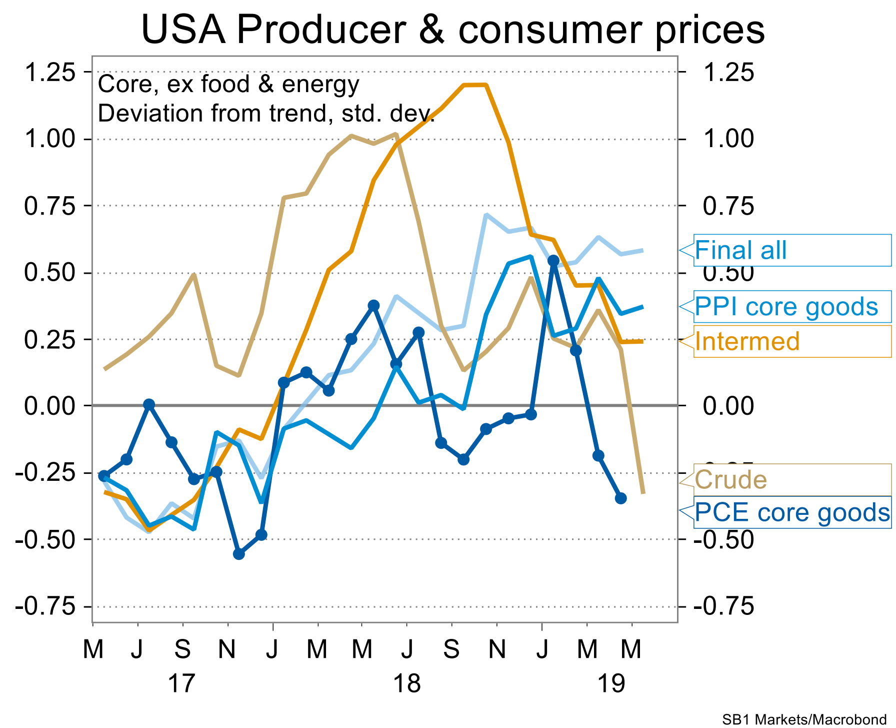
# Prices have eased at early production stages

## Even so, core goods PPI-prices signal higher consumer prices the coming months

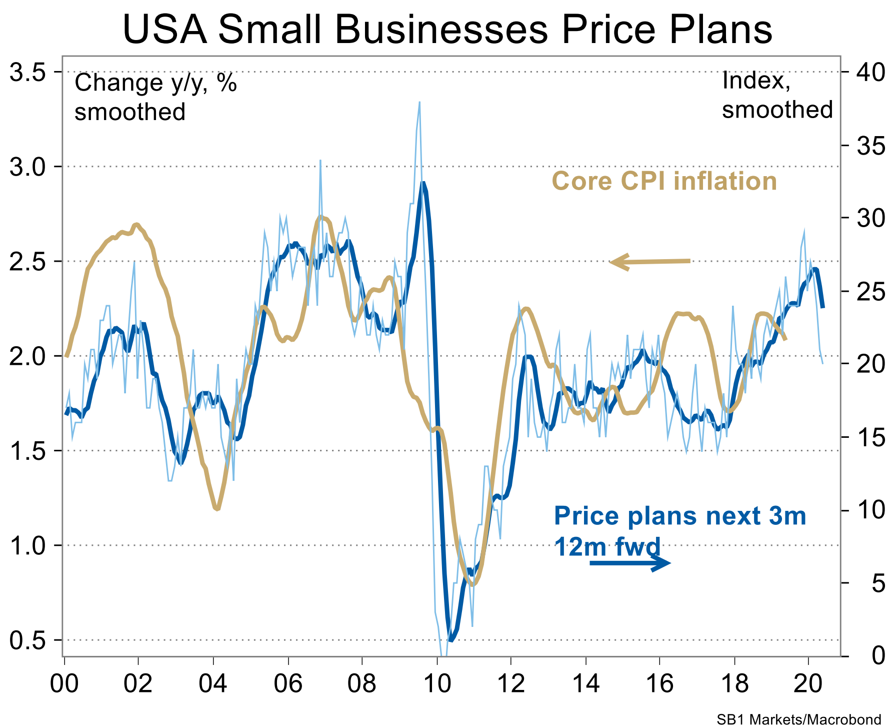


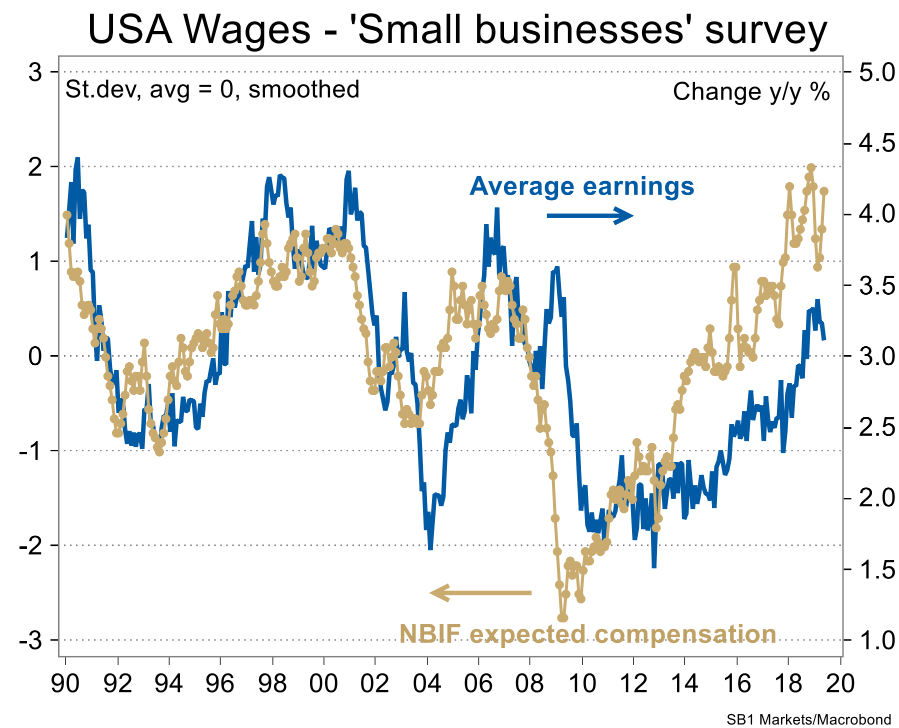




- Crude (core) PPI prices plunged in May. Intermediate goods prices were flat but is trending down. Core consumer goods prices (at the producer level) may have flattened out, a normal response to the slowdown in core/intermediate goods prices - and there might be some downside pressure the coming months
  - » However, the important price index, the personal consumption deflator (here the goods segment). These prices have fallen sharply in Feb-Apr. However, do not expect core PCE goods prices to fall further as they were surprisingly weak through last year as price increases at the producer level were not pushed forward to the consumer level
- The NY Fed's inflation model is still suggesting higher consumer inflation (before coming down at a later stage, like the PPI data indicates
- On the other hand, small businesses' price plans are falling steeply, flip to the next slide

# Businesses are nudging down their price plans significantly, pay plans not

Steep drop in share of businesses planning to raise prices, even as wage compensation plans surged



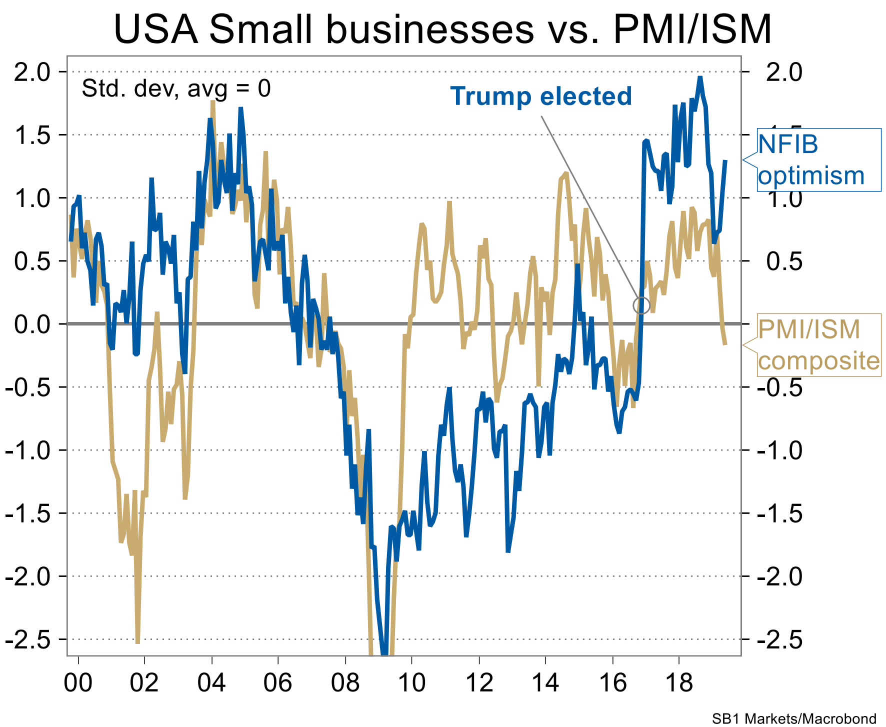



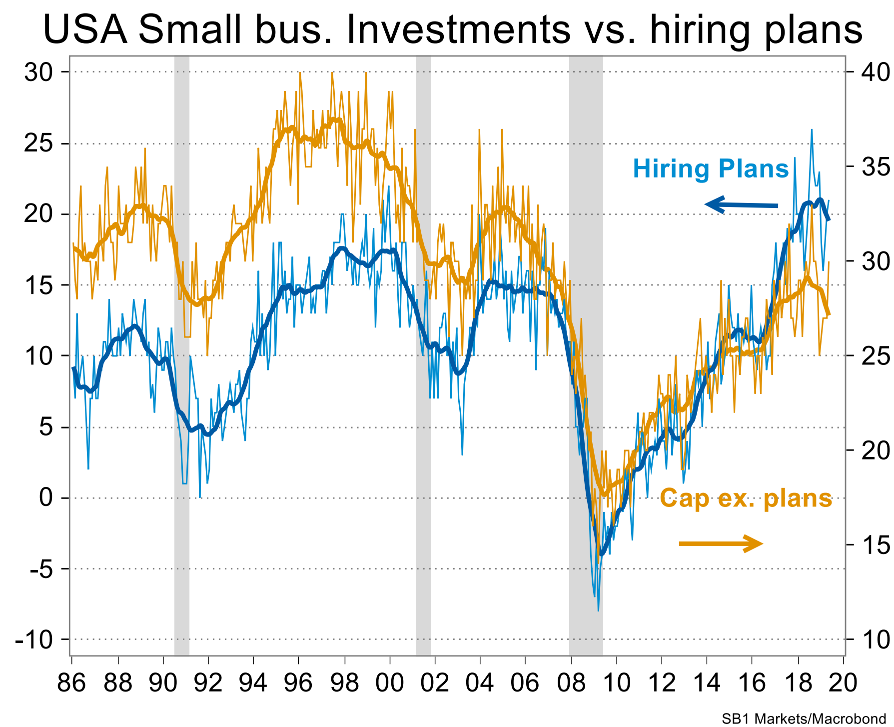

- 20% of small businesses are planning to hike prices, down from 29% in November, still somewhat above the average 'normal' share – but fewer than some months ago! This may indicate lower CPI inflation, even if the correlation is not that strong short term. Are companies witnessing slower demand growth?
- In contradiction; businesses reported aggressive plans to raise wages again in May, after easing in Q1. High compensation plans are surely due to a very tight labour market. Actual wage growth has cooled somewhat, the survey signals an upswing

USA

# Small businesses nudged up hiring & capex plans in May but both are ebbing?

## The NFIB optimism index climbed in May, half the 2018 downturn is reversed

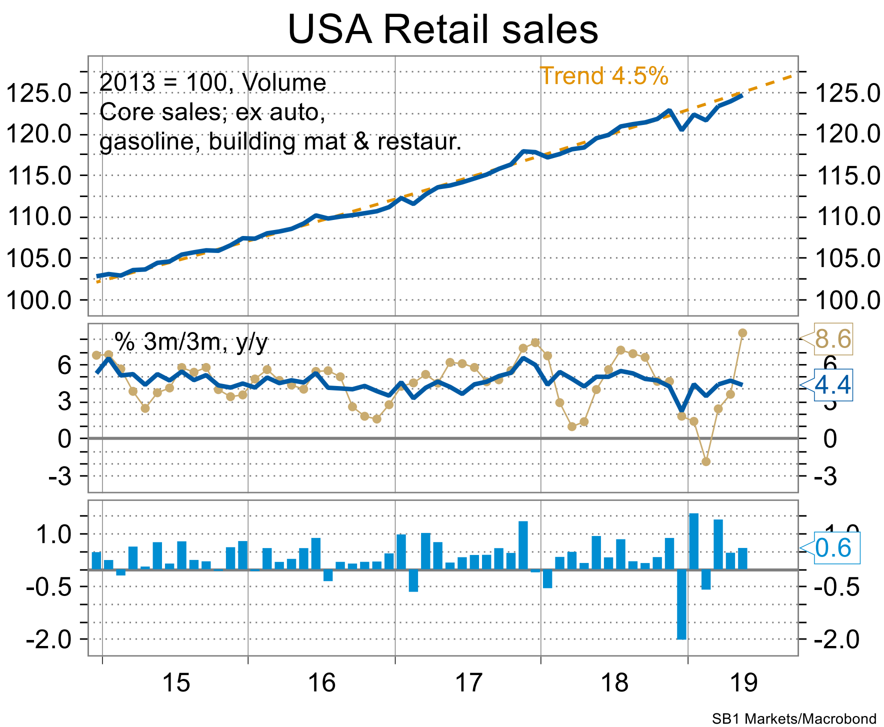


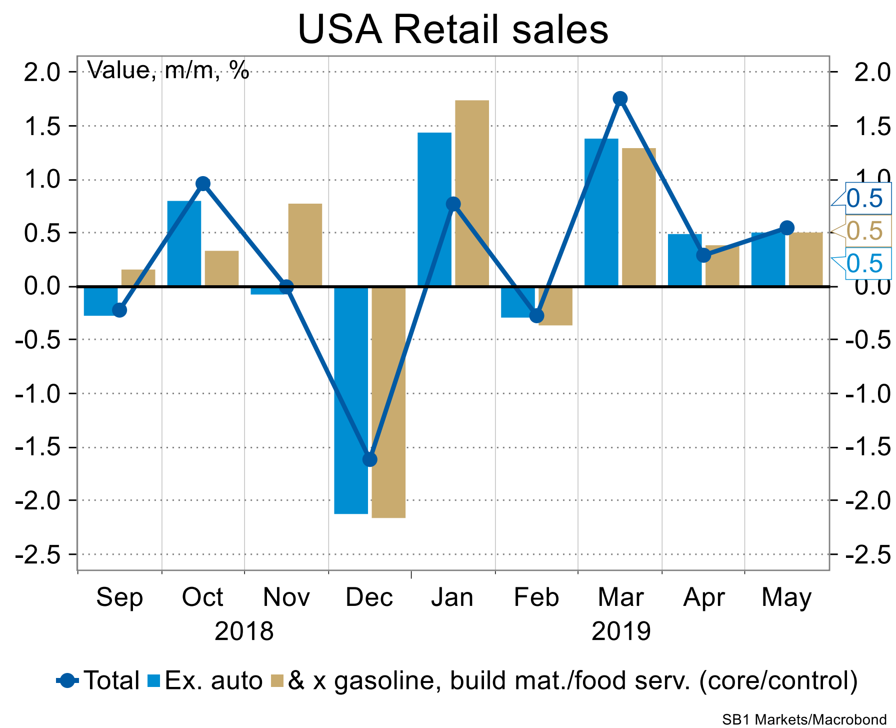




- The NFIB optimism index, measuring small businesses' expectations on business conditions, has ticked up the past 4 months. In 2018, trade war uncertainties, growth worries and financial market instability dampened expectations. Why are these concerns easing now?
  - » Other surveys have until now not found any strengthening in business activity, neither in the businesses assessment of the future in these surveys
- Investment plans were raised in May but have been trending down recently
- SME's are have revised their hiring plans somewhat down recent months, although they were nudged up in April/May. The level is still high and businesses are reporting huge (and unprecedented) problems finding enough labour, both in qualified and unqualified

# Retail sales are recovering, came back to the old growth path in May

## Sales rose 0.5% in May and April was revised up by 0.4 pp to 0.5%; implying a strong rebound in Q2

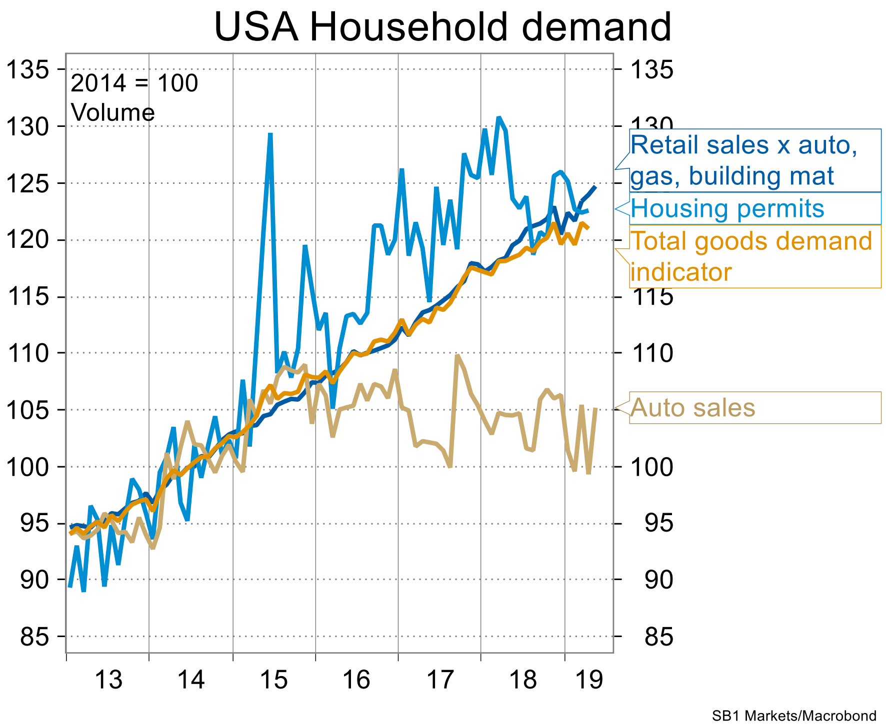


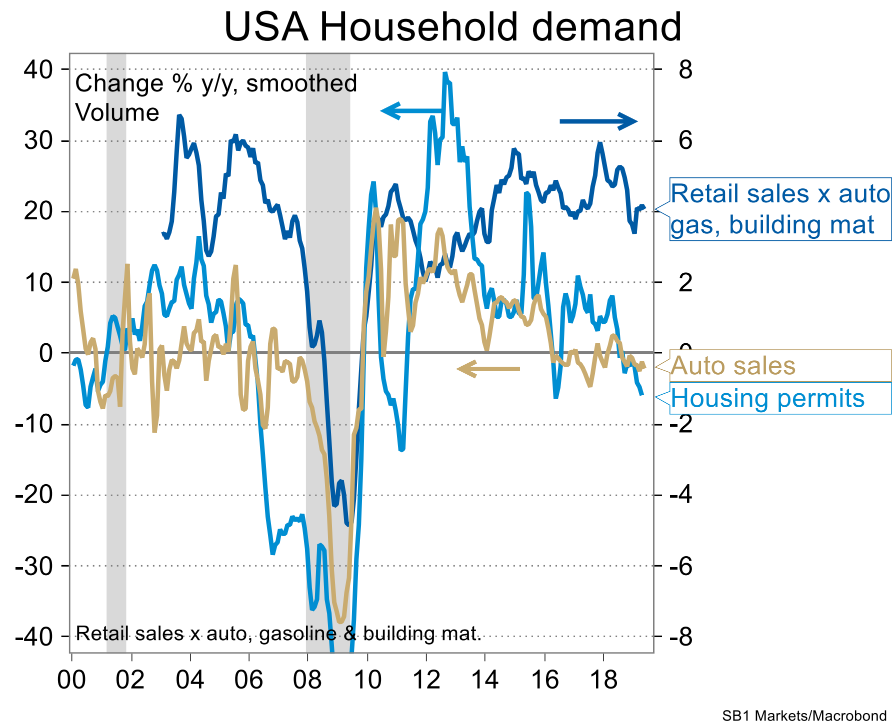




- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by 0.5% m/m in nominal terms in May, 0.1 pp above expectations. Moreover, April was revised up to 0.4%, from zero. Total sales up 0.5% too
- We estimate a 0.6% m/m volume growth in core sales, a marginal increase from the upwardly revised 0.5% in April. Given unch sales in June, core sales will have accelerated 6.6% in Q2, much better than the two previous quarters and total consumption may increase some 3%, contributing significantly to Q2 GDP growth (estimates were revised up by these figures)
  - » Consumer confidence is very strong and income and employment growth is supporting real income (and inflation subsides), and stock markets are recovering. No indications of a sudden slowdown in consumption at this point

# Housing and autos have softened, retail sales still strong?

Total household goods demand is not that strong anymore but there is no abrupt halt



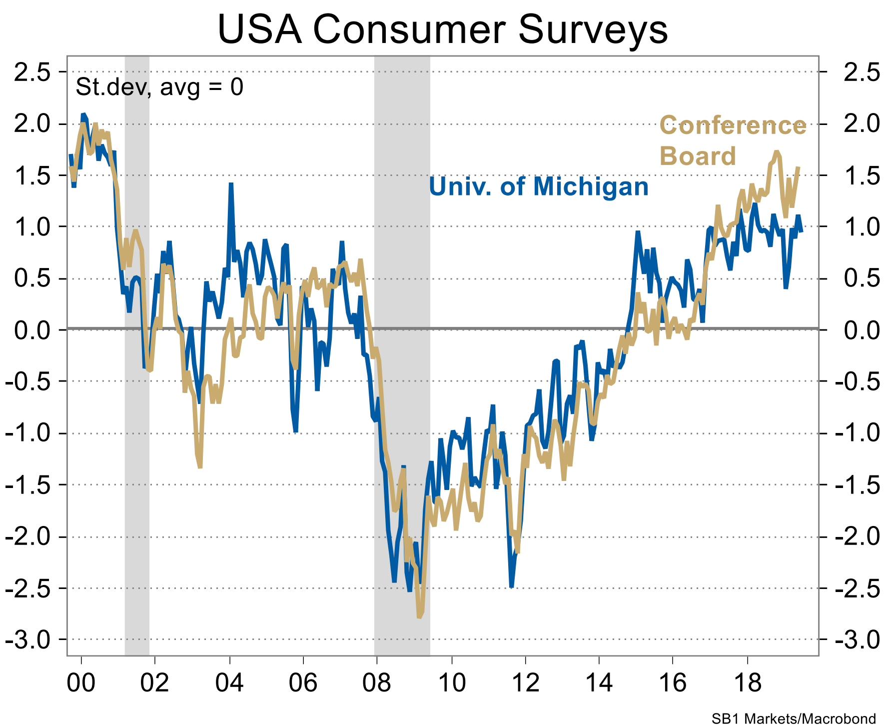



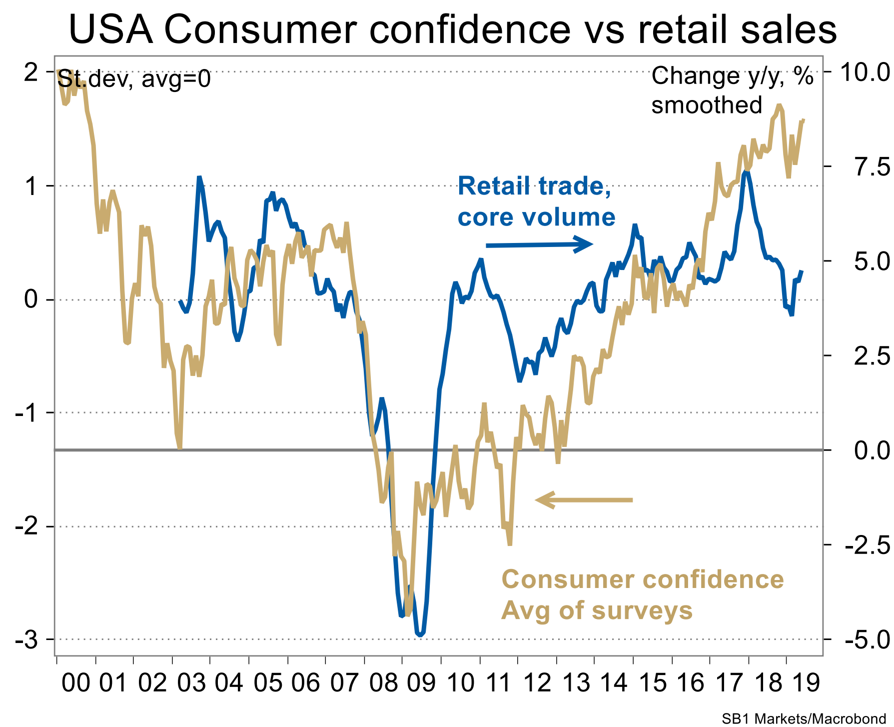

- Unemployment is very low, employment is growing (if not that much in May), and wage inflation has accelerated, and together with lower headline inflation (until recently, at least) are generating stronger real income growth. Consumer confidence is strong

The total household goods demand weights together core volume retail sales, auto sales & housing permits. Actual housing investments '(activity') are lagging permits/starts by some months

# UoM consumer sentiment marginally down in June, at an elevated level

Both consumer sentiment surveys are noting rising optimism, suggesting an upswing in consumption

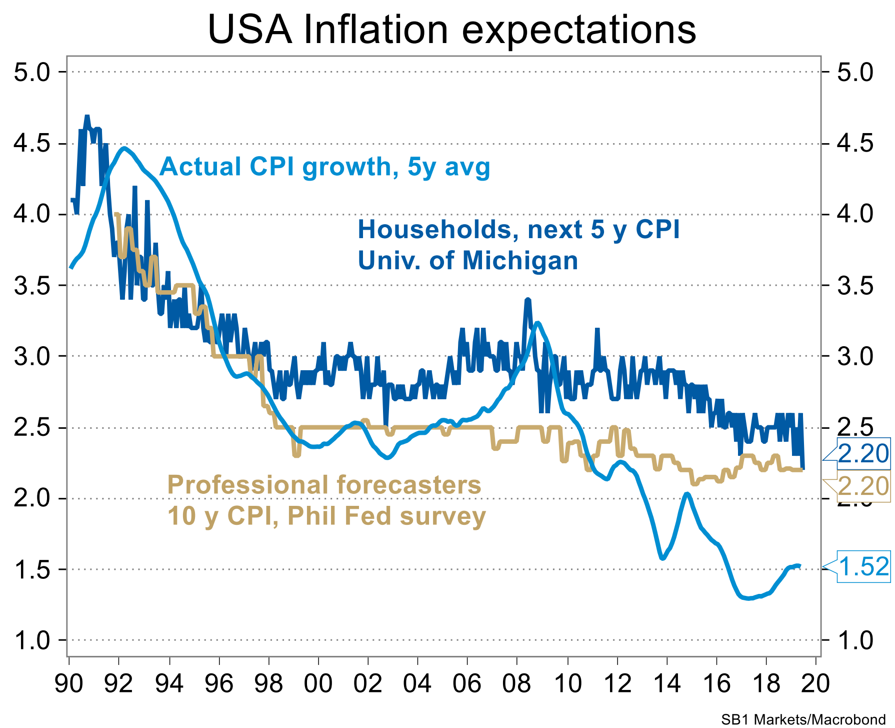


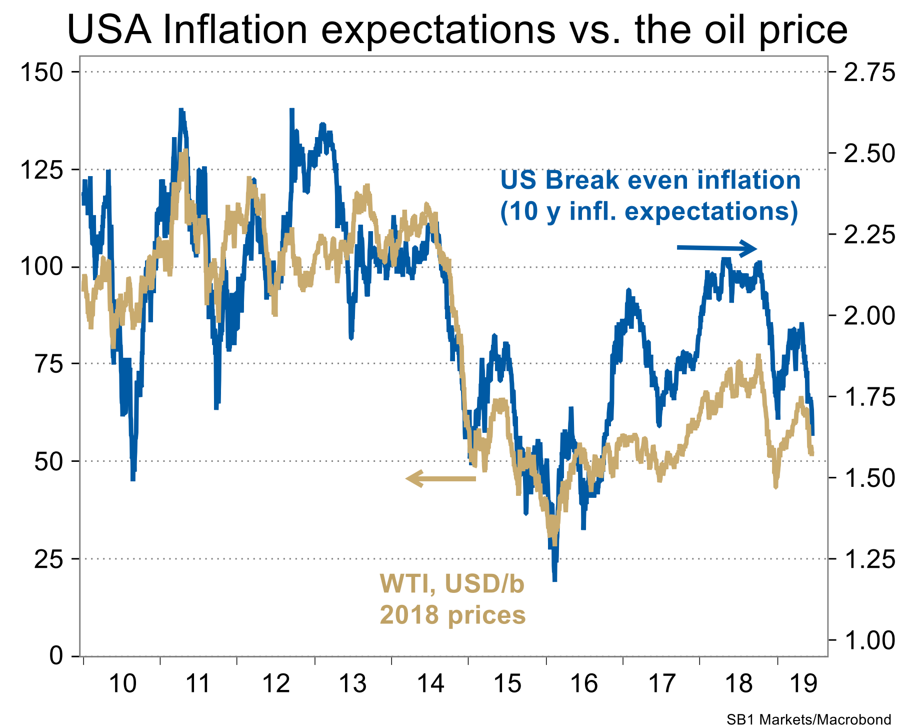




- University of Michigan's consumer sentiment came down 2 p to 98 in June, as expected, after reaching the highest level in 8 months in May. The surveys reflects upbeat consumers, no signs of a consumption slowdown!
  - » Conference Board's consumer confidence posted another gain in May, to 134.1, beating expectations and the highest level in 6 months. The level is high, not far below the 2018 peak, and is no doubt reflecting upbeat consumers
- Strong consumer confidence signals a lift in consumption (although the correlation is not strong in the short term)

# (Some) inflation expectations down

Households' 5y CPI expectations fell to 2.2 from 2.6 in one month, says the Univ. of Mich. Survey..

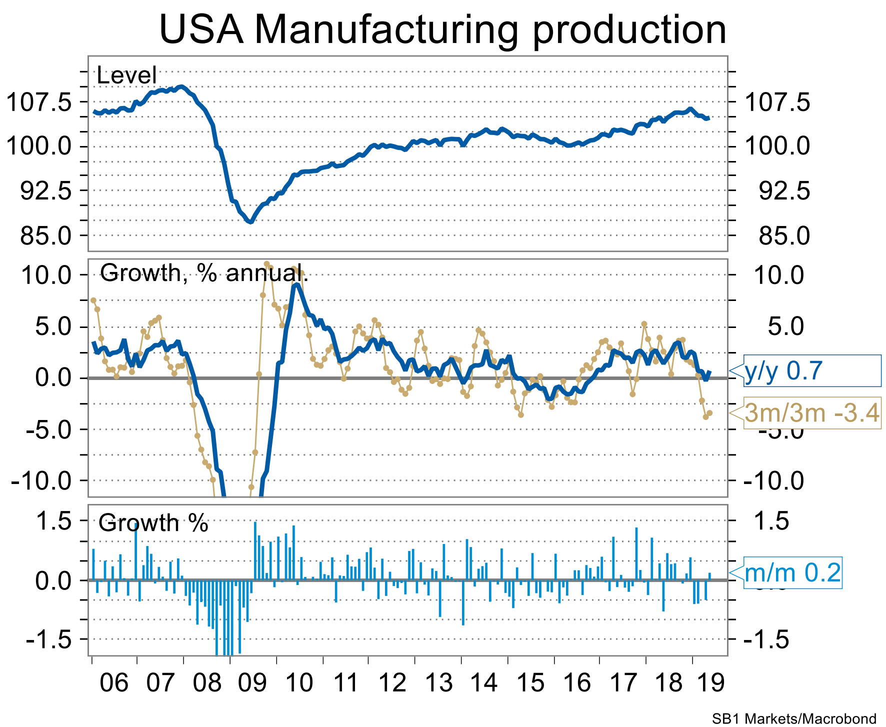


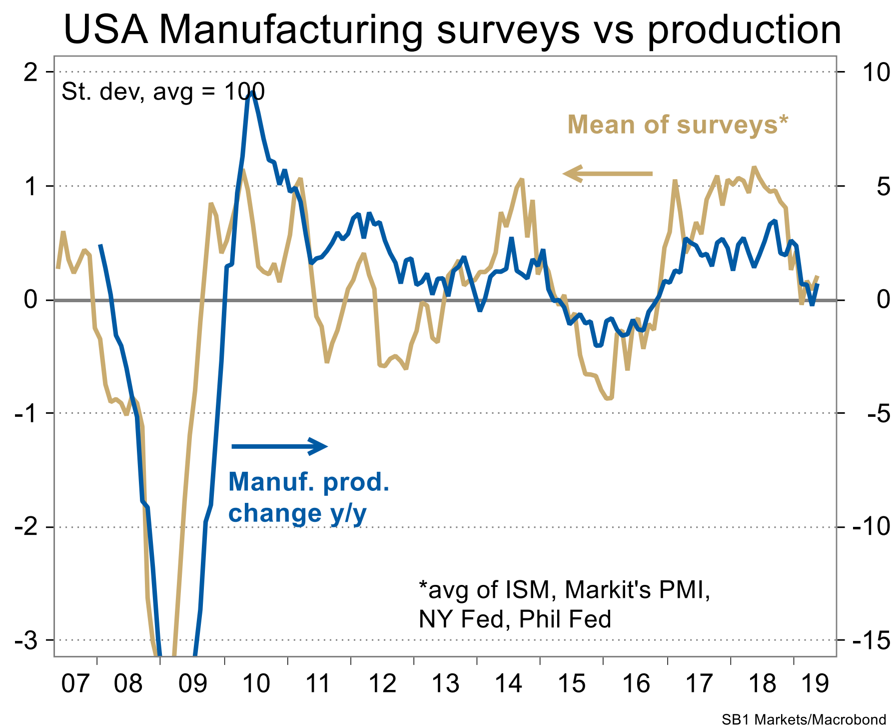




- ... a rather large adjustment you would think. However, this measure is rather volatile. Still the June 2.2% level is the lowest on record, data from 1980
  - » Households have often had too high inflation expectations but have adjusted their expectations twice last 30 years. First as inflation came down during the 90-ies, and then over the past few years, when actual inflation (in average) has been low. We do not think the Fed puts too much emphasis on this number – and their expectations are still above Fed's 2% target
- Professional forecasters have (according to Philadelphia Fed's survey) more stable expectations (but they did not catch the decline in the 90'ies before the households did). Their expectations have been rather flat since 2013, slightly above 2%, and now at 2%
- Market expectations have recently fallen alongside the decline short end of the oil price curve, as they often are closely correlated to. Now at 1.63%

# Manufacturing production is sagging, heading for a decline in Q2 too

## Production rose 0.2% m/m, as expected. Underlying growth down 3.4%, surveys are not promising

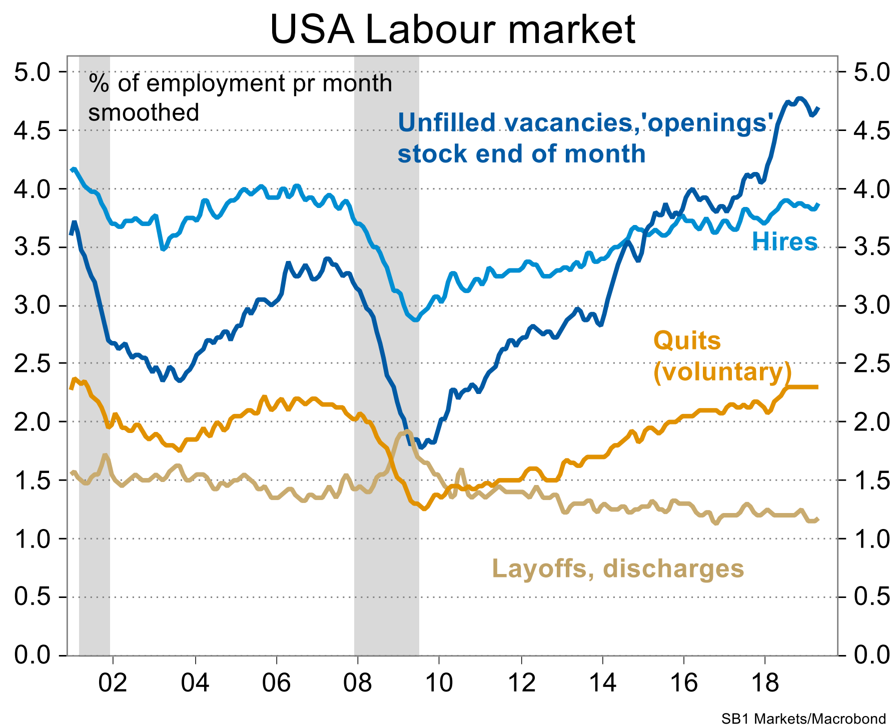


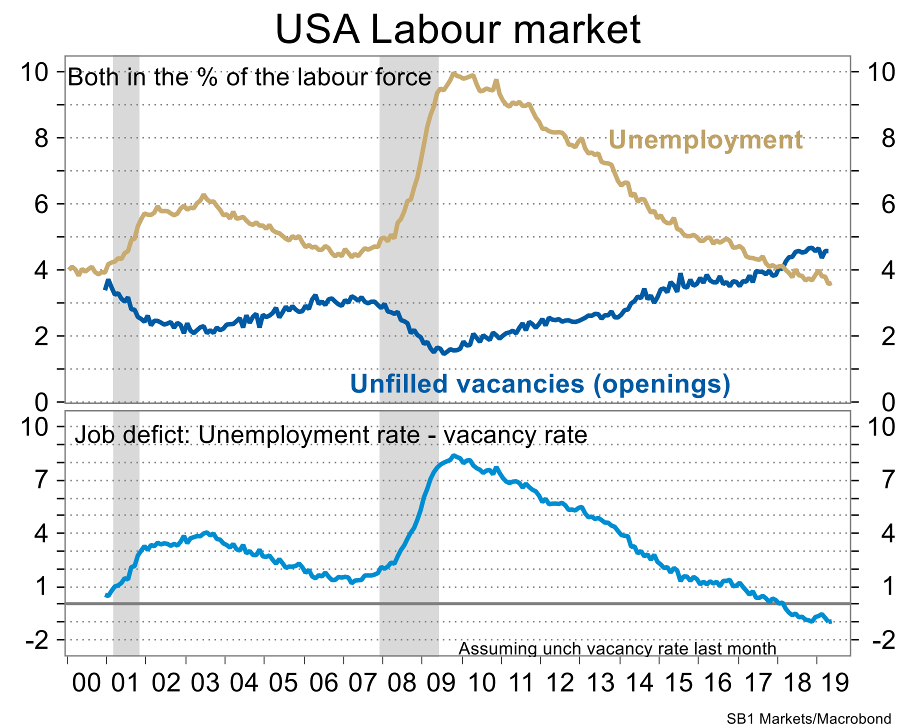




- Manufacturing production increased just 0.2% m/m in May, after the 0.5% drop in April. The slight increase was in line with expectations (which are dragged down by weak surveys). Production has slowed significantly and the 3m/3m speed has fallen to -3.4%. Production is still up y/y but just 0.7% and this rate will soon turn negative if production does not turn up
  - » Output has generally not been very impressive recent years (and remains below the 2008 peak) but rose slowly through 2017/18
- The manuf. data confirm the slowdown that surveys have been suggesting. Both the ISM and the PMI have softened rapidly, while the regional surveys are somewhat stronger. In average, the surveys are pointing to a stalling production

# Job openings, hiring have just flattened, at very high level

More hires in April (not May), openings stable after the March hike – and both at high levels

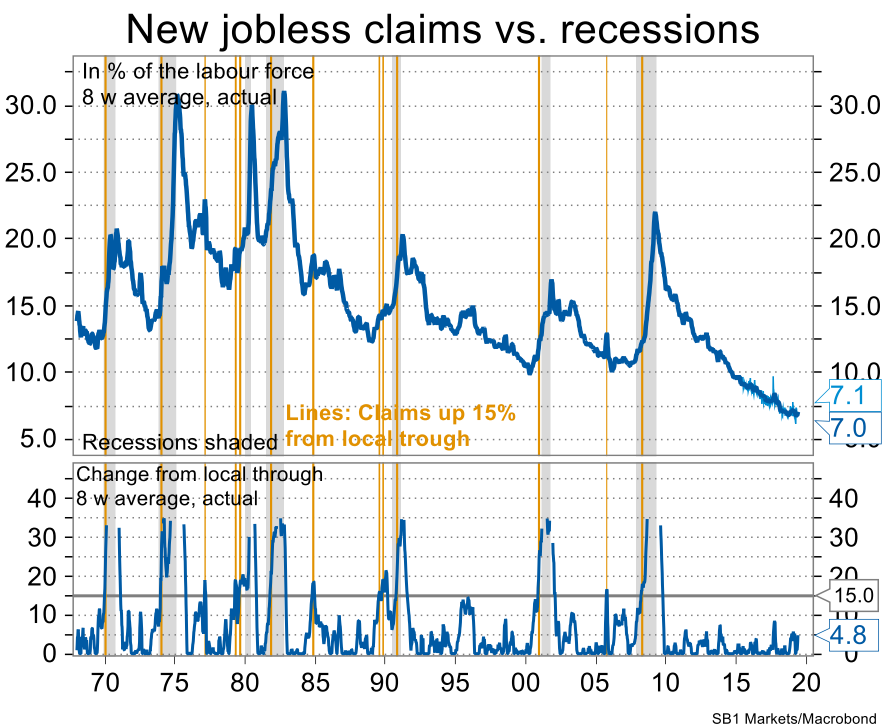


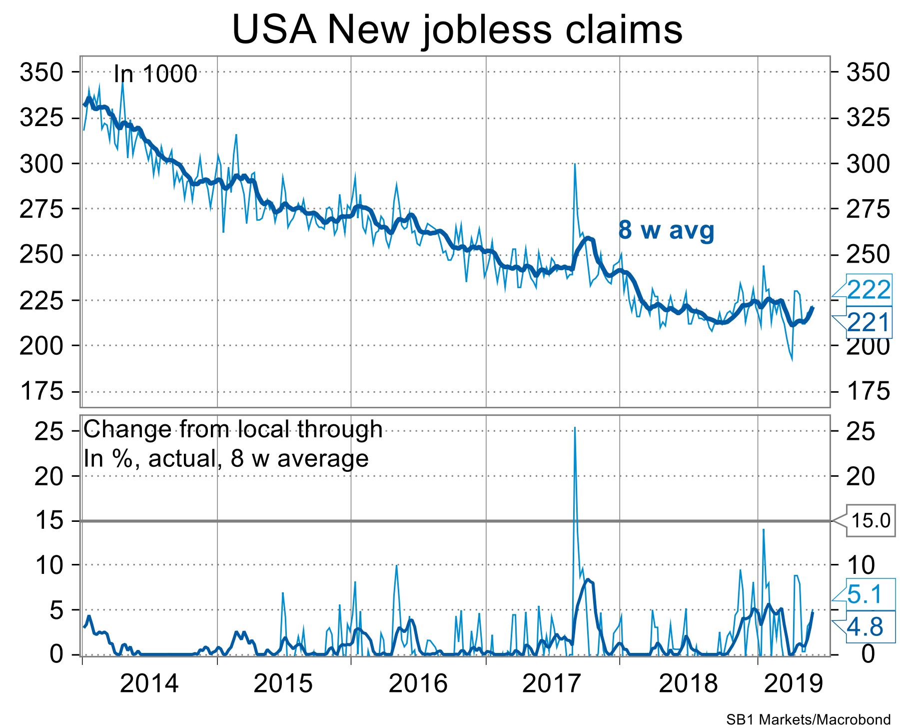




- The unfilled job openings rate was unch in April, following the March hike. The level is slightly down from the peak, still very high
- The hiring rate rose and is not far from the peak last year – and the level is high (3.8% per month)
- The no of unfilled vacancies are record high vs the no of unemployed; openings equal 4.7% of the labour force, above the unemployment rate at 3.6%, the labour market is very tight
- The number of voluntary quits has flattened recent months but remains at a very high level – as many employees leave for better (paid) jobs. Layoffs are trending down and is very low

# Jobless claims a tad up, no signs of labour market weakness

## Jobless claims (2 m avg) have been very low lately, reflecting a tight labour market

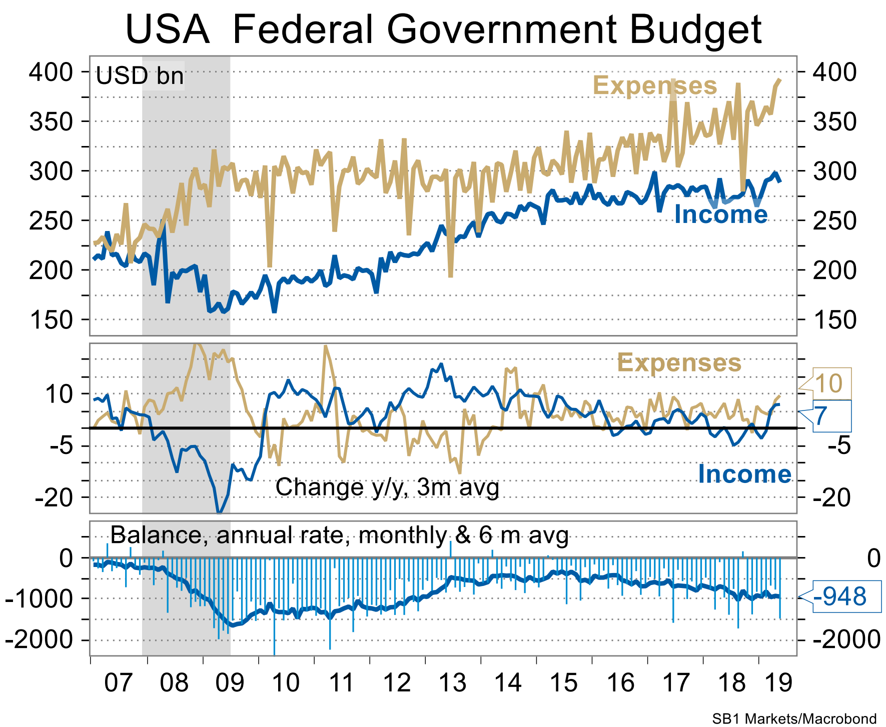


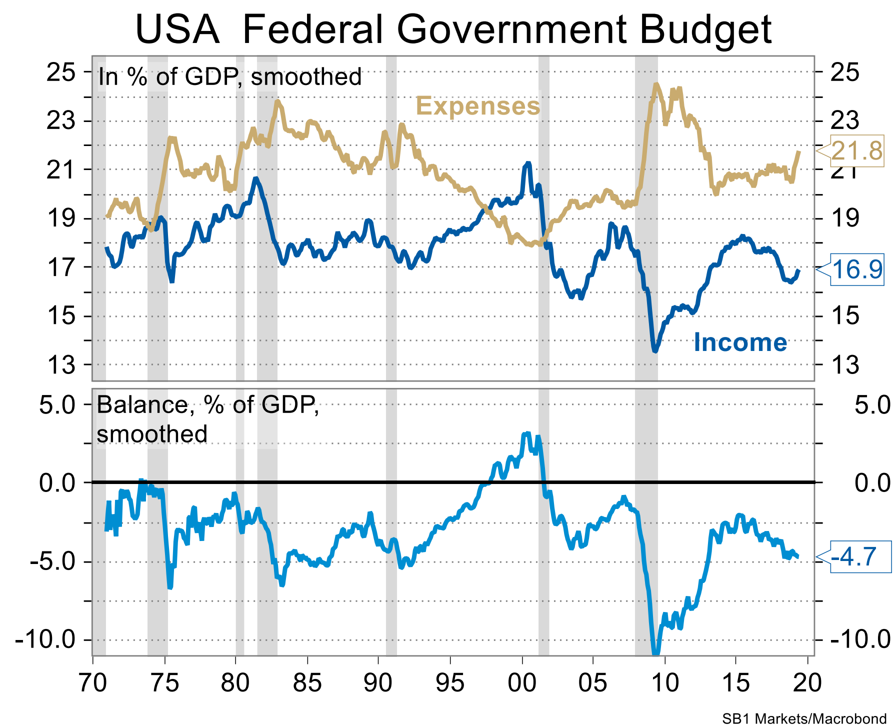




- Last week, jobless claims rose to 222', from 218' the prior week. Claims have inched up recent week, yet the level is still very low, the 8 week average is 221', up from and up just slightly from the bottom at 193'in mid-April (the lowest since 1969!) The 8 week average is still very low, at 218', up from 211', the lowest since 1969
- A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow 'recession' warning line is to be drawn, check the chart to the left. So, no reason to worry now?

# The federal budget deficit is widening amid soaring spending

The federal deficit up to 4.7% of GDP in May and the total public sector deficit at 6.9% of GDP in Q1!




- The budget deficit spiked to USD 1.480 bn in annual rate in May, the highest in almost a year and not far below 5% of GDP. Including local government etc, the US is running full employment, peacetime deficit at 6.9% in Q1 (from 6.7% in Q4); totally unprecedented!
- Federal revenues inched down in May but are up 7% y/y (smoothed), the best in a long while, though the trend vs GDP has been very weak. Expenditures spiked in May and are up 10% y/y, equalling 22% of GDP, the highest since 2012
- A divided Congress will probably not agree upon much more fiscal stimulus. But with 1 ½ y to the next election, any tightening is totally unlikely too

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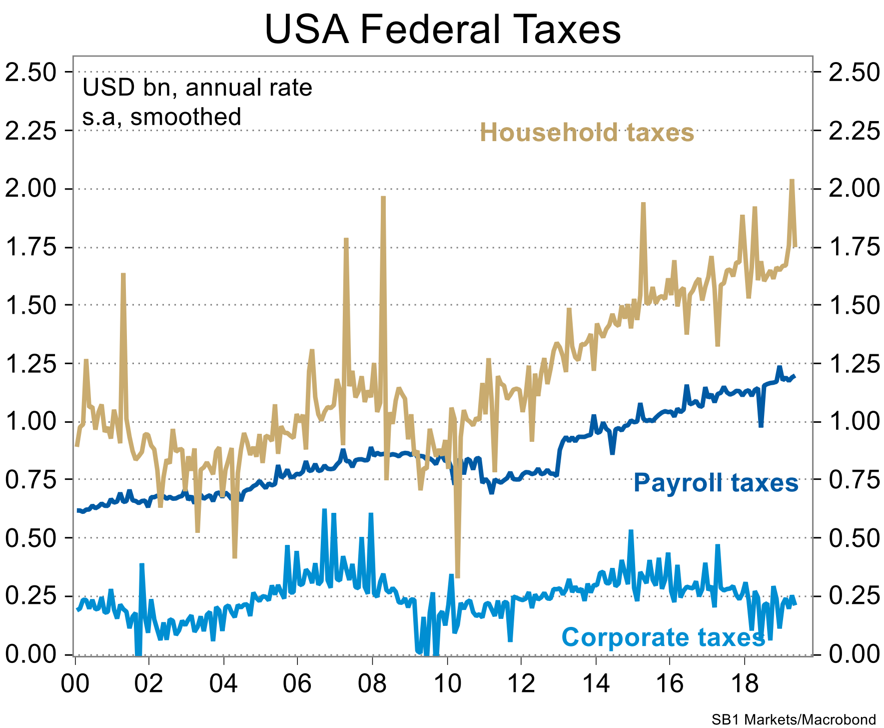
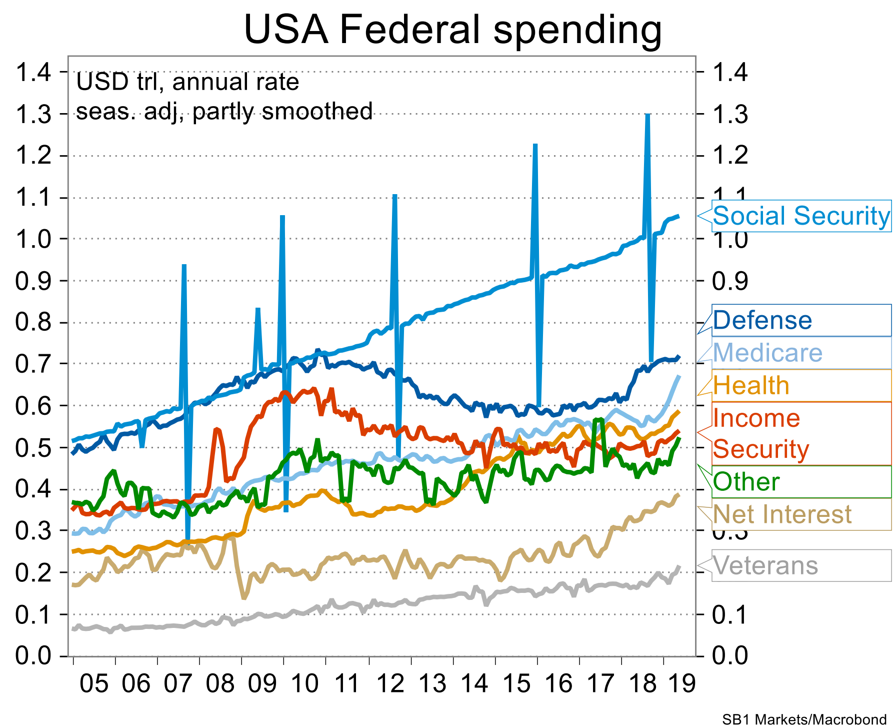
# Corporate taxes remain low, household taxes are climbing

## More money spent on… everything?

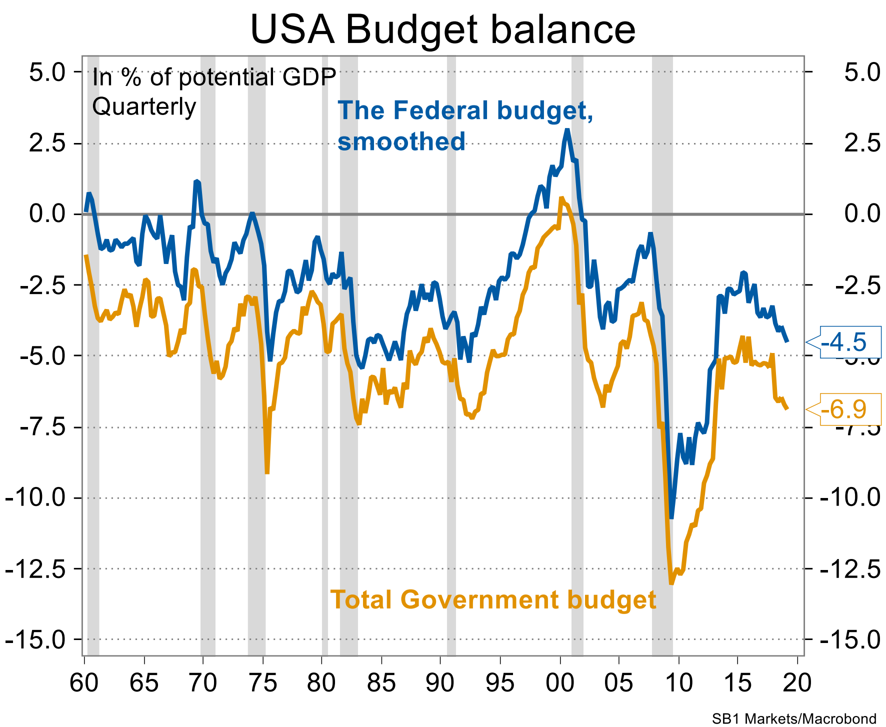


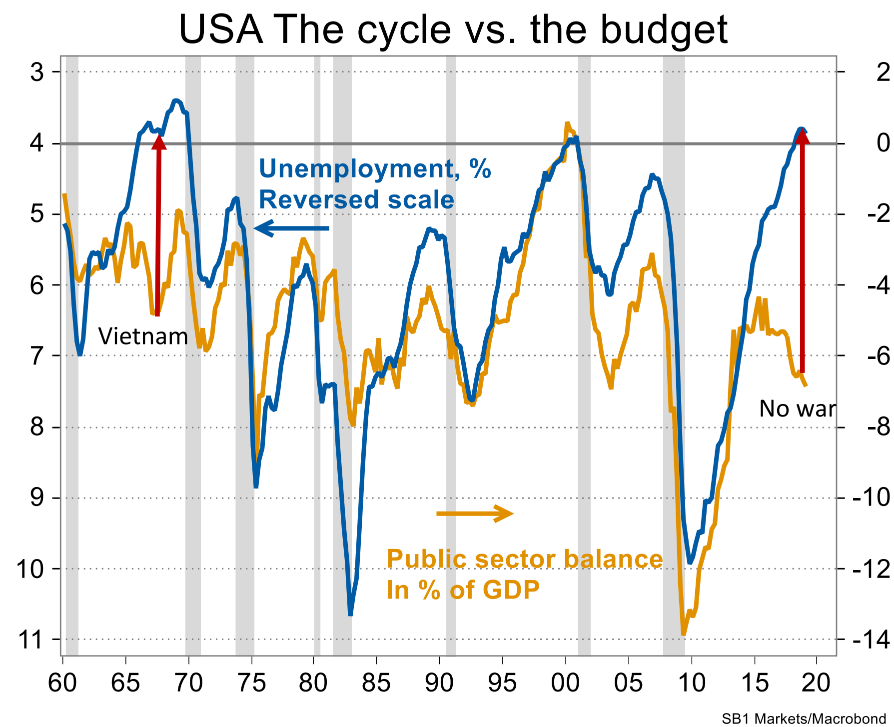




- The biggest spending changes the past year: medicare, defence, net interest, veteran benefits

# The public sector deficit up to 6.9% of GDP in Q1

## With an unemployment rate below 4%! We have NEVER seen something like this before




- The deficit has never been anywhere close to the present level in peace time when unemployment is as low as now – and it will most likely become even worse as all of the tax cuts and increased expenditures kick in
  - » We have not seen anything like this in the US or elsewhere before (except Greece in 2007, partly Japan)
  - » The deficit at 5% was large vs the unemployment rate in 1967 too, when the Vietnam war was fought. Btw, afterwards, inflation and a lot of other problems turned up
- *The total public sector deficit is larger than the Federal Government's, as local gov. & social security are included*

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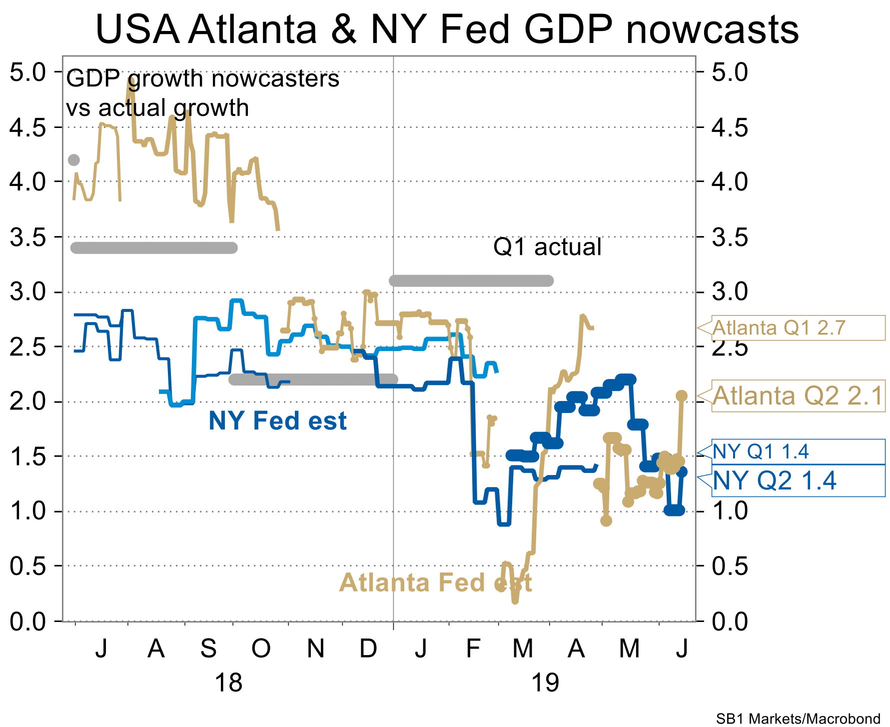
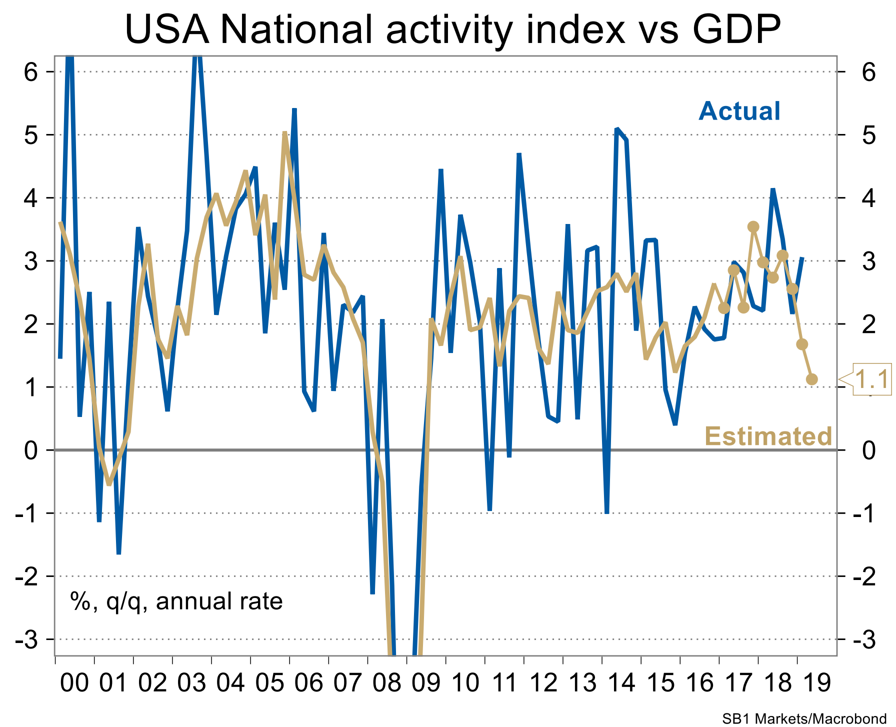
# Strong retail sales lifted Q2 estimates by 0.4 – 0.6 pp, to 1.4 – 2.1%

One number (including revisions) made the (Fri)day. Still, no signals of strong growth in Q2

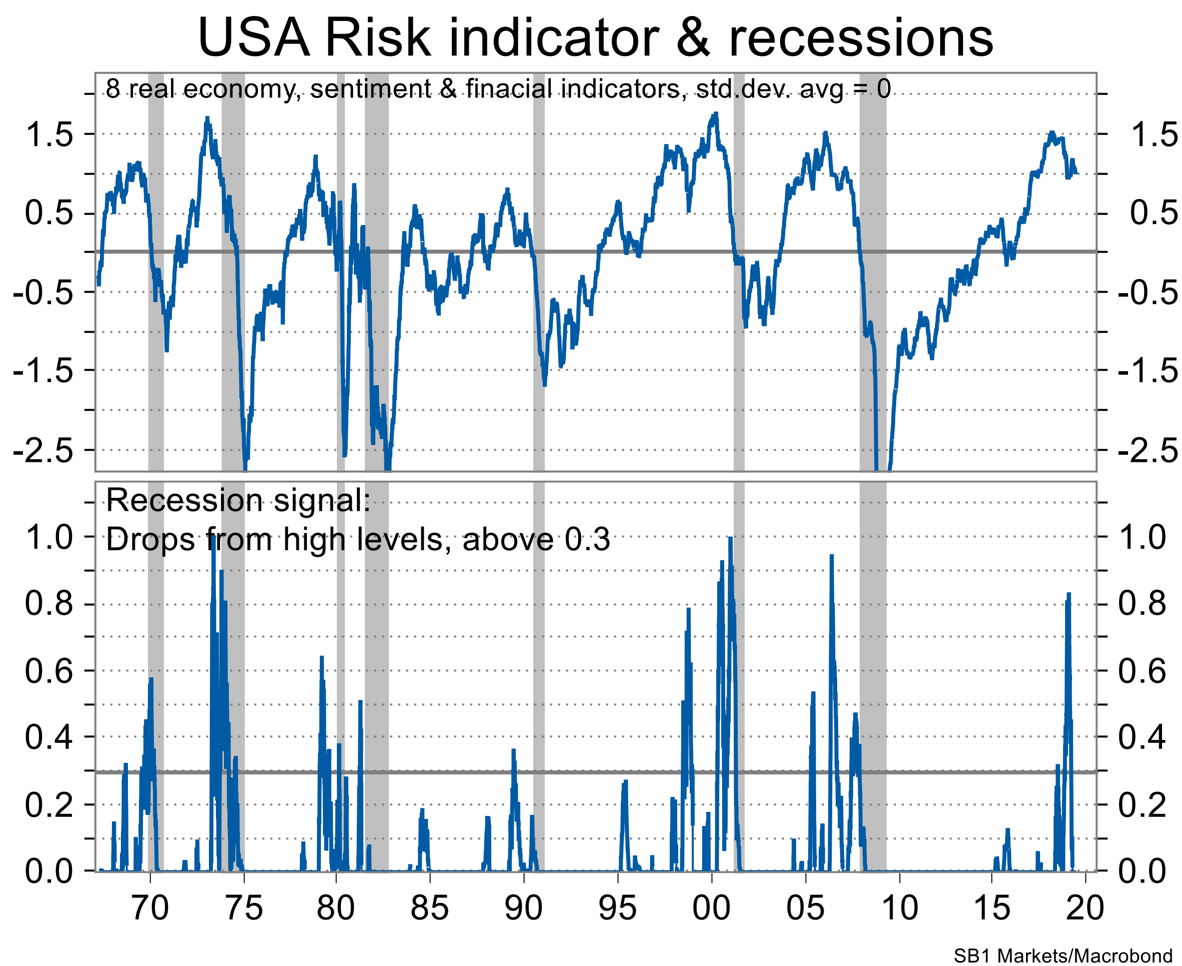


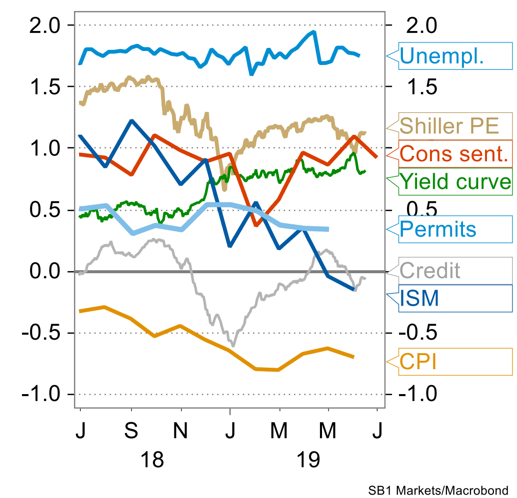

- However, a lot of data has still to be reported – and the nowcasters often miss the target (as they change their mind through to the quarter

# US Indicators: Not a recession warning, now

… but data are deteriorating, barring the labour market and housing. To be continued








Inspired by Goldman Sachs Bull/Bear indicator. We are using jobless claims instead of unemployment, and have added housing starts, consumer sentiment, and a credit spread. In average, our Risk or Good Times Indicator leads recession starts by 18 months. The lower panel above shows changes in the squared index (if index >0) to accentuate the dangerous declines from high levels

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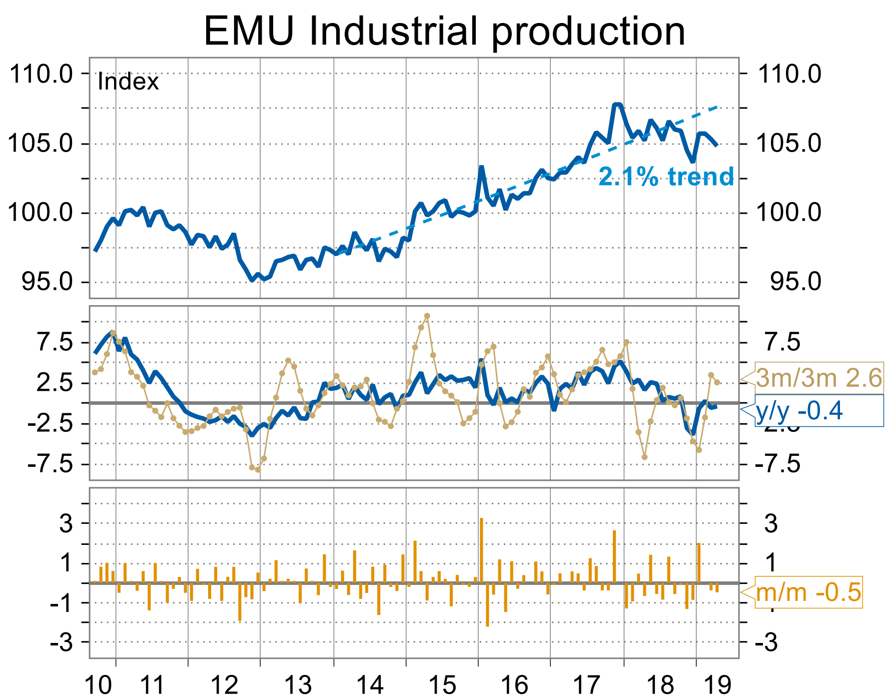
# Industrial production falls again, down 0.5% in April

## April data (and PMIs) suggests industries remain in the doldrums in Q2, dragged down by Germany



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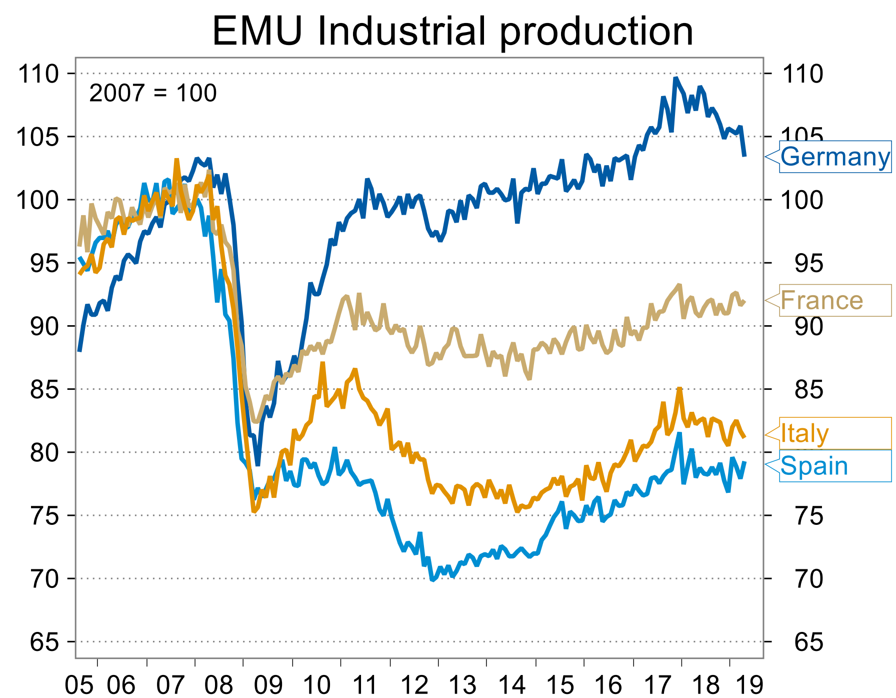

SB1 Markets/Macrobond

- Industrial production in the Eurozone dropped 0.5% m/m in April, we f'casted -0.7% (based on the first country releases). No specific sector problem; the decline was broad among sectors. Industrial production has improved somewhat from the Dec slump, underlying growth is up 2.6%, yet the level is miles below the old 2% trend path. The annual rate is -0.4%
- The decline was driven by a 2.3% plunge in German production. However, the German downswing is spilling over to other countries, production is falling y/y in both the Netherlands, Italy and Spain as well
- **Unfortunately, the manufacturing PMI and orders remain weak, no signs of recovery**

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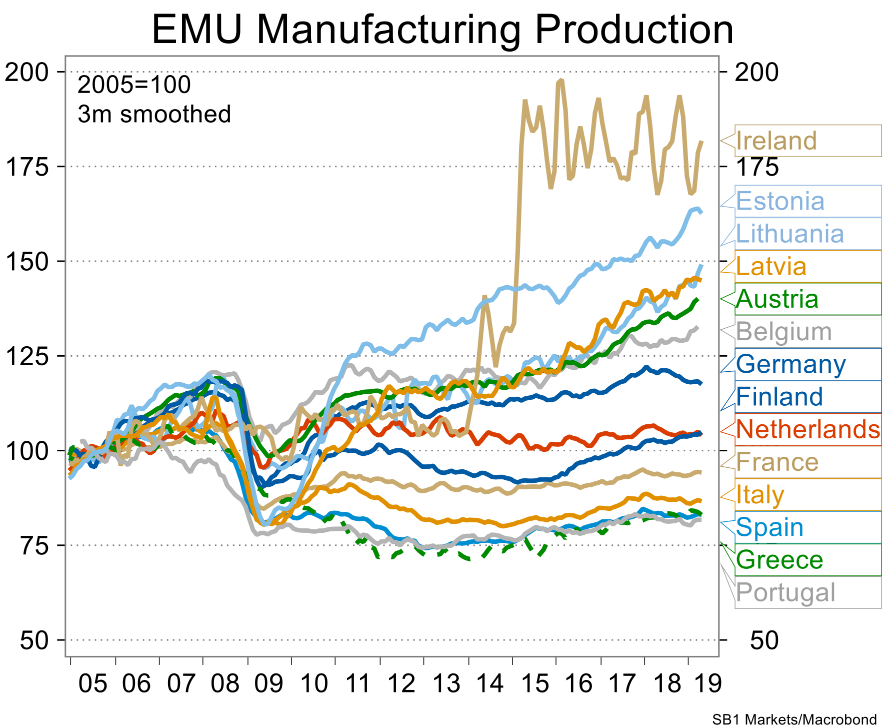
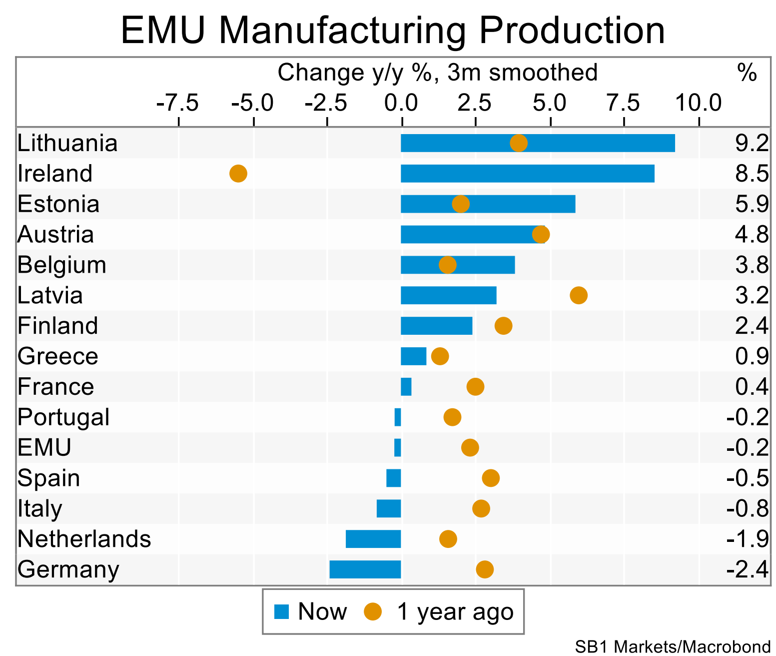
# Just Eastern Europe is thriving, Germany & Netherlands are struggling the most

## Production is falling in Germany, Netherlands, Italy and Spain



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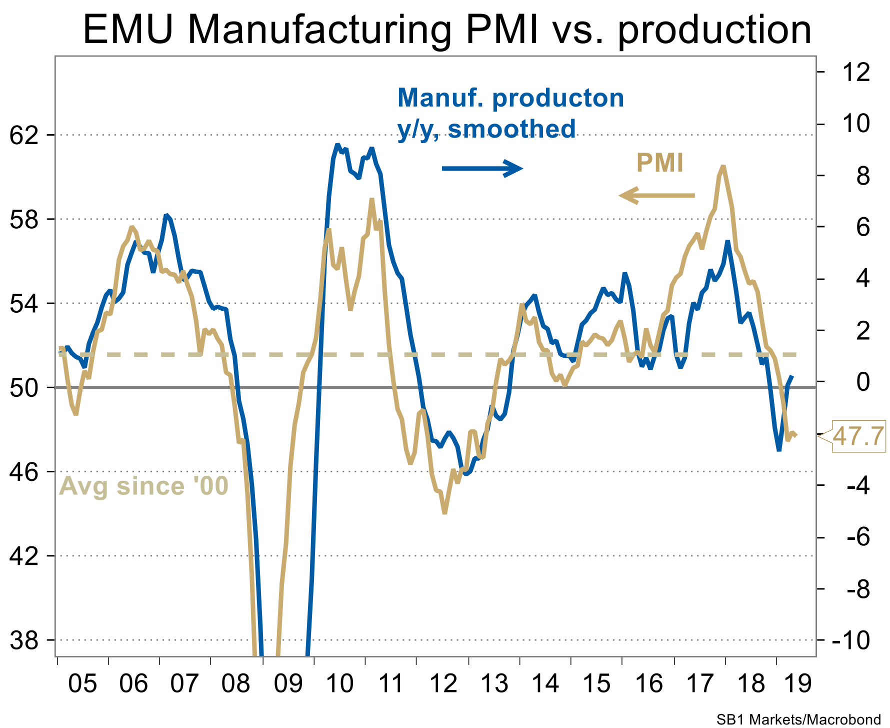
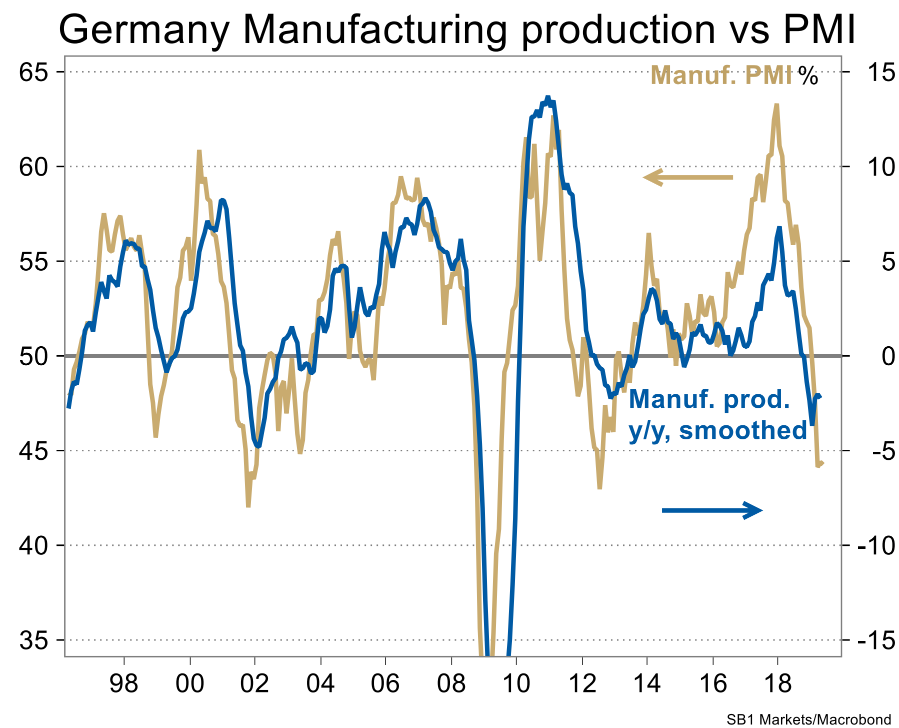
# The PMIs told you so…

.. and the outlook is not bright, the PMIs are reporting a deterioration



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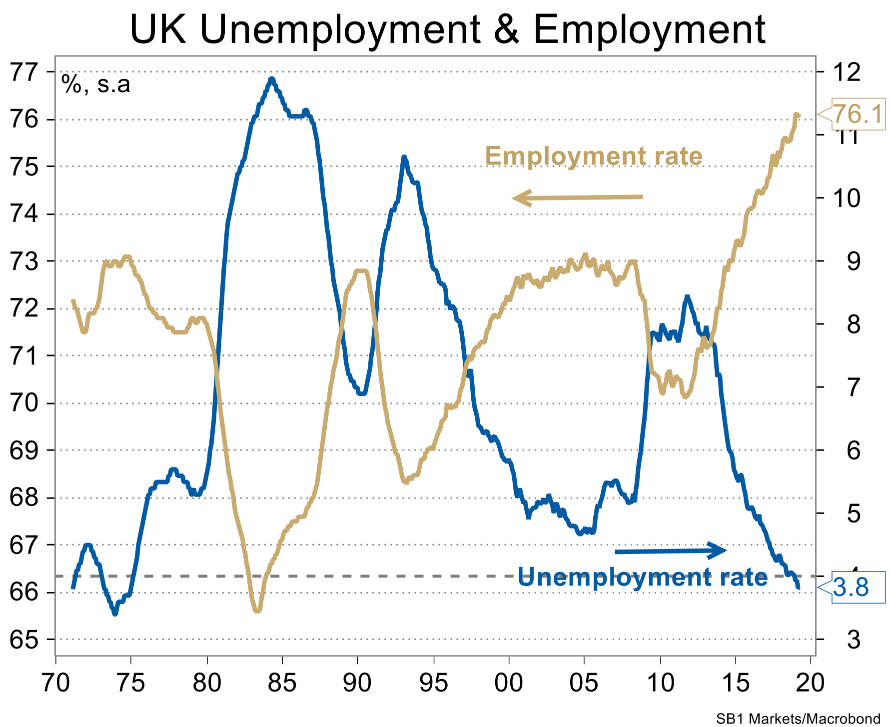
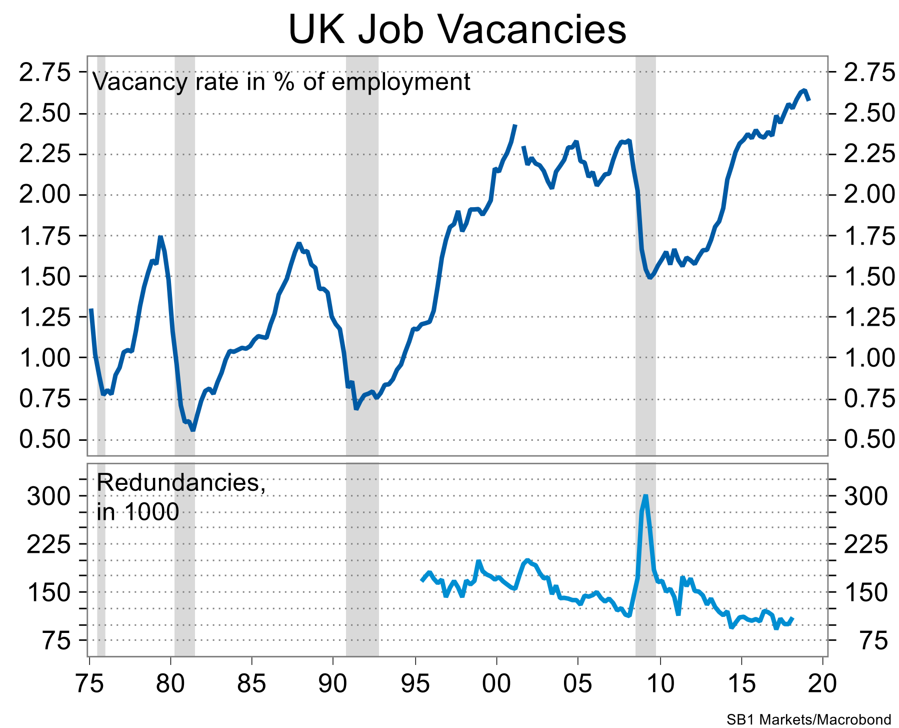
# Unemployment flat at 3.8%, employment has been soaring, rising wage growth

Tight labour market; unemployment at 44 y low, high empl. & job vacancies and wages are climbing

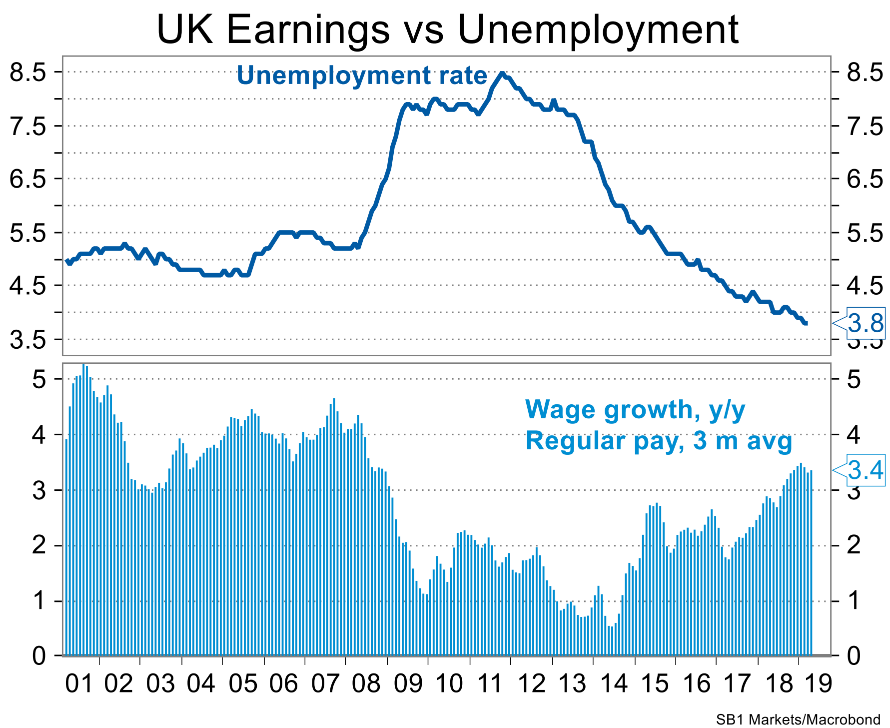


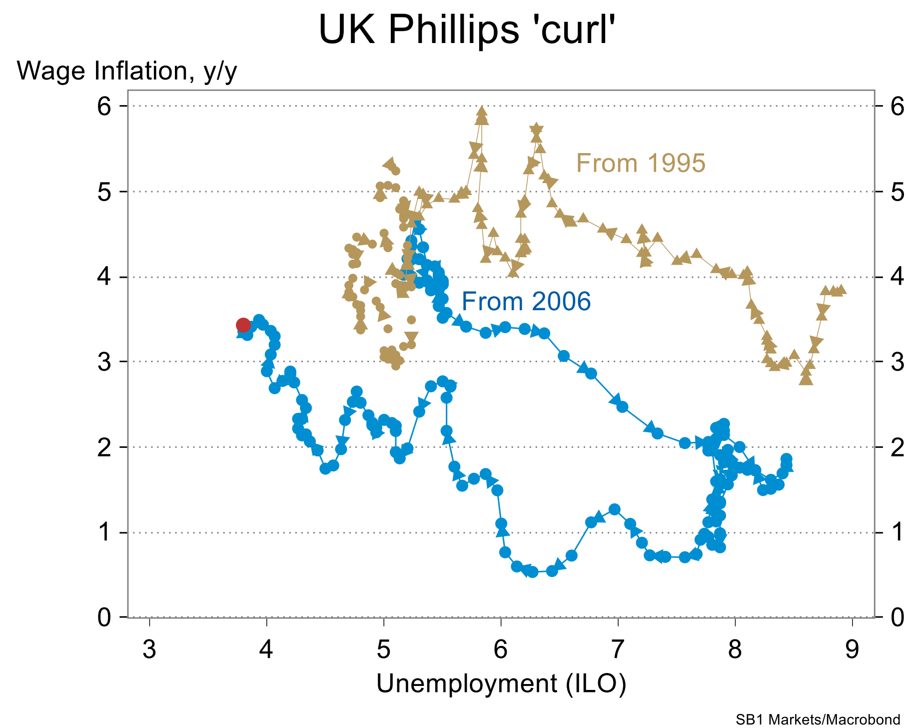




- Unemployment (LFS/ILO) was unchanged at 3.8% in Mar (avg Feb-Apr). The unemployment rate is the lowest since 1975
- The employment rate was unch at 76.1%, the highest ever (data back to 1971), trending straight up - ahead of Brexit…
- The number of job vacancies inched down in Q1, still at a record-high level. No signs of any negative impact on demand for labour due to Brexit (yet)
- No surprise, wage inflation is trending up. Wages are outpacing CPI inflation, total inflation has come down to 1.8%

# A tight labour market is boosting wage inflation

The Phillips curve is not dead, just bit lower/less steep than normal

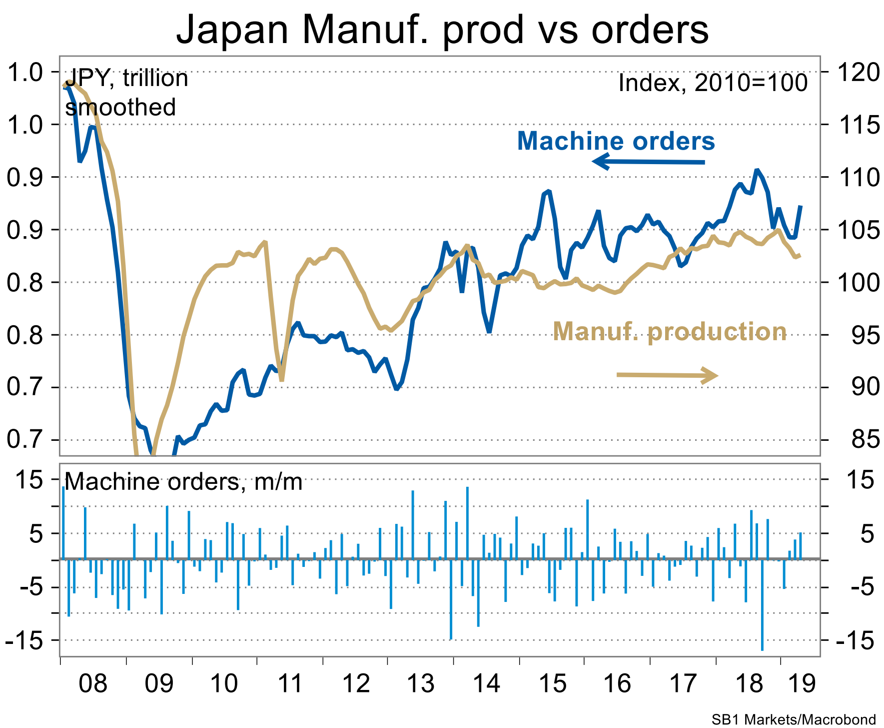


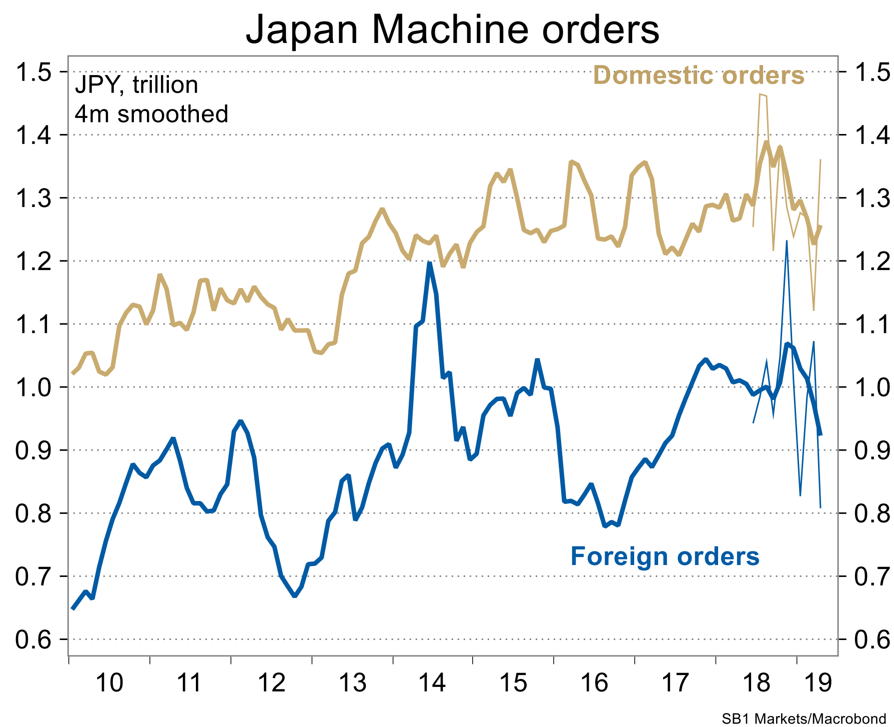




- Wage growth surprisingly surged to 3.8% y/y in April (regular pay), from 3.1% the prior month. The monthly data are too volatile to provide useful information, thus, we add a 3 month smoothing, which yields a 0.1 pp uptick to 3.4%
- Either will inflation become too high or corporate profits will take a hit

# A strong rebound in machine orders in April, driven by domestic orders

## Orders are down 1.7% y/y, do not signal deteriorating manufacturing output

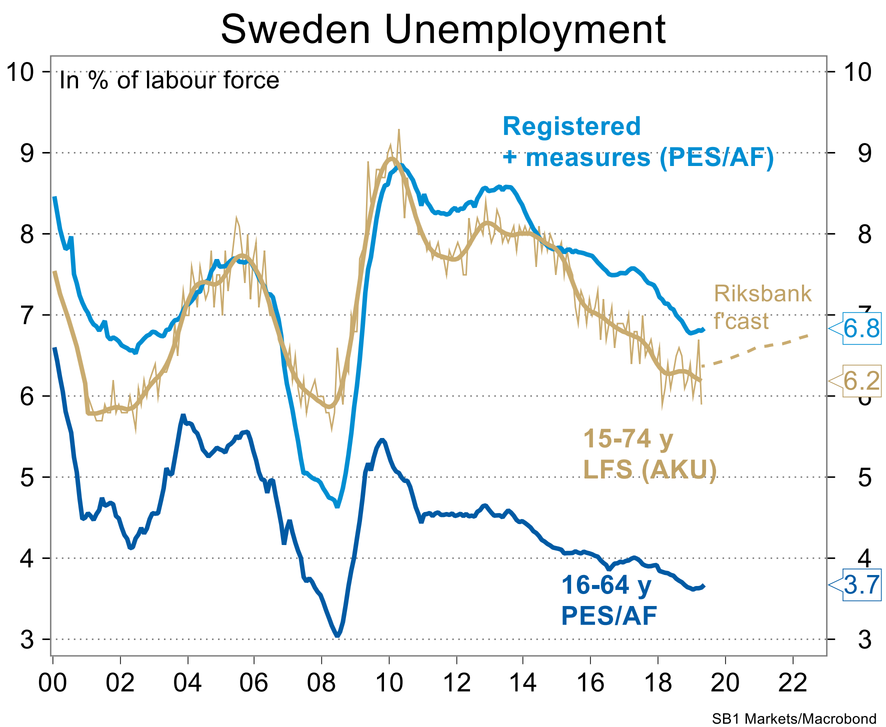


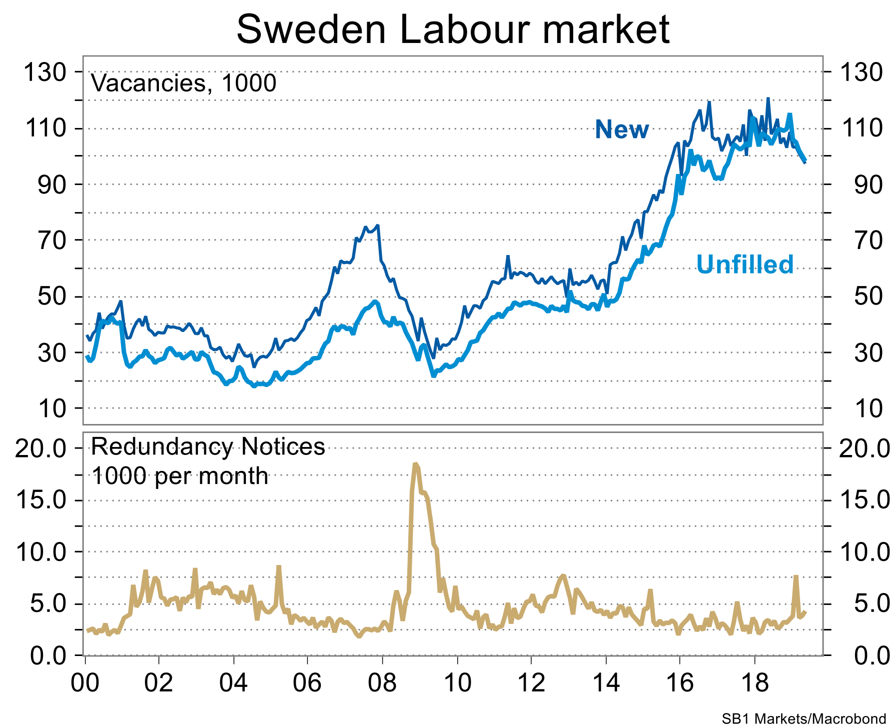




- Total machine orders spiked in April. Orders have been sliding down since last autumn, and are as the PMIs indicated. However, the recent slowdown in orders is not dramatic; it has been as low as now, or lower, several times recent years
- Both domestic orders and foreign orders are trending down, domestic orders improved significantly in April
  - » The monthly data are too volatile, we have added a 4 m smoothing at the chart to the right
  - » Both manufacturing orders and manufacturing production are now declining modestly y/y
- Manuf. inventories are quite high – not a good sign

# Registered unemployment is flattening out, new vacancies heading down

## A marginal increase in unemployment adds to early signs of a softening labour market

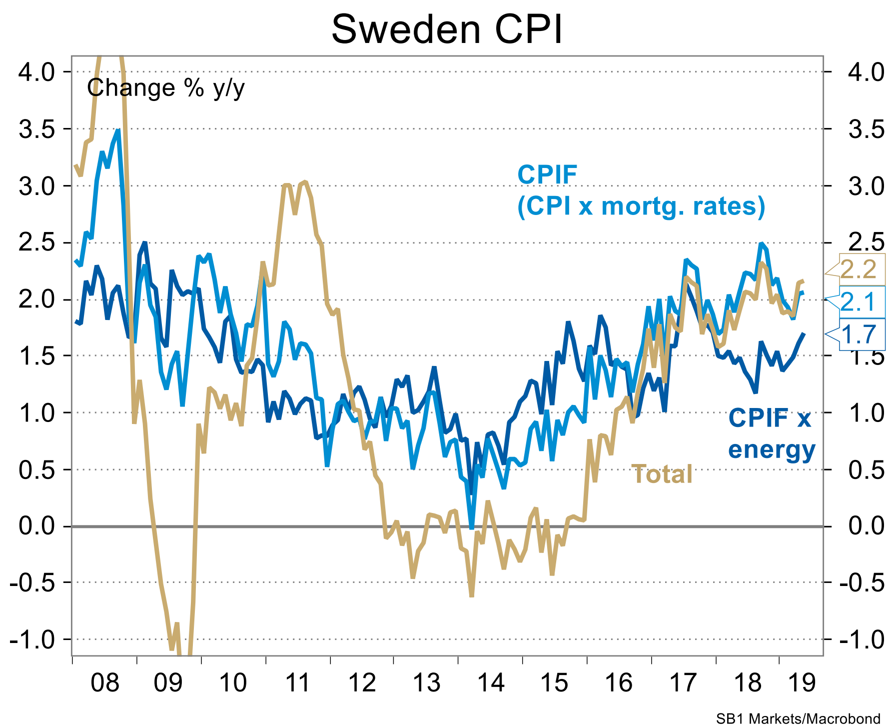


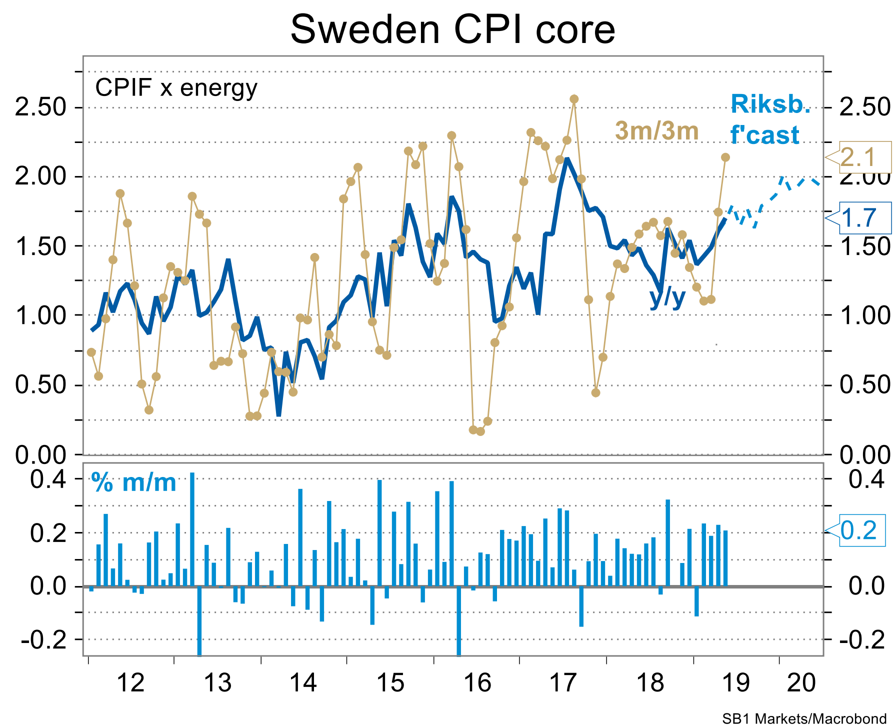




- PES open (registered) unemployment rate rose marginally to 3.7% in May (unchanged at 6.8% incl. measures). Unemployment has flattened out the past 5-6 months, may be an early indication of a weakening labour market. Even as the rates are not low compared to 2007-2008 levels
- The LFS unemployment rate (smoothed) ticked down 0.1 pp to 6.2% in April. Trend still down but the pace of decline is slowing
  - » Employment growth has eased somewhat, barring a spike in April. The employment rate is high, at 69%
- The number of unfilled vacancies and new, incoming vacancies have probably peaked – and both came further down in May. Still, the levels are very high. The number of redundancies has fallen back after a temporary spike but may be trending slowly up

# Inflation is finally turning up, beating expectations in May

Core CPIF up 1.7%, a 0.1 pp uptick and the 4th month of increase. Total CPIF inflation rose to 2.2%




- CPIF inflation (ex mortgage rates) accelerated just marginally in May, was expected one tick down, to 1.9%. **The 'real' core (CPIF ex energy)** rose by 0.2% m/m and the annual rate inched up to 1.7%, 0.1 pp above f'casts (and as the Riksbank expected in the April MPR). Core inflation is slowly moving upwards, the underlying speed jumped to 2.1%
- The dovish Riksbank has anyway postponed the next hike until late 2019 or early 2020. Inflation is now at the Riksbank's f'cast and does not imply a steeper interest rate path

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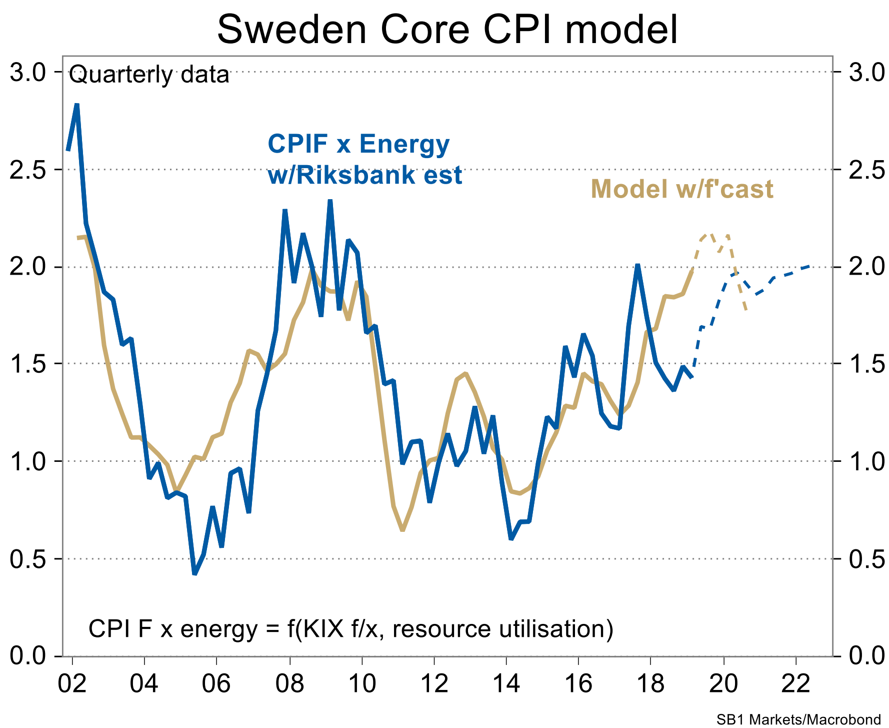
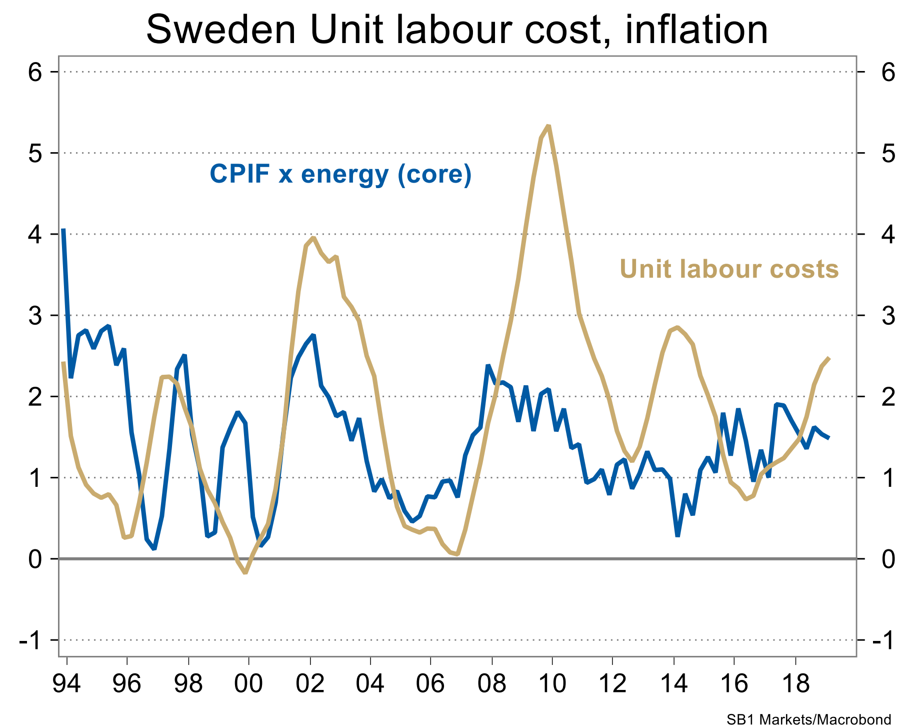
# Our model says that inflation will accelerate, temporarily

Capacity utilisation, SEK signal higher inflation the next year and unit labour costs are rising




- Our model includes SEK and the Riksbank's Resource Utilisation indicator, measuring deviation from potential GDP growth. The inflation model points to a an uptick to above 2% this year, before easing next year
- On the other hand, productivity has disappeared, down 0.3 y/y in Q1 and unit labour costs were up 2.5% y/y in Q1 (volatile data). The cost pressure is not low at all!
- The Riksbank expects inflation to accelerate this winter/spring and stabilise at approx. 2% in late 2019

Highlights

The world around us

The Norwegian economy

Market charts & comments

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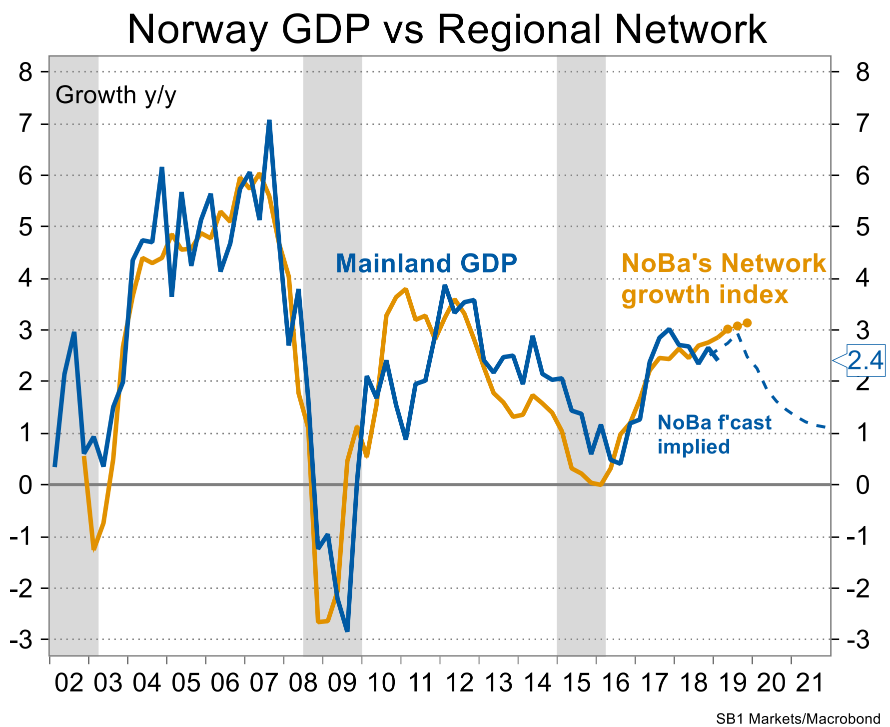
# A much more upbeat Norges Bank's Network than expected, best since 2012

Businesses report 3% growth and expects 3.1% the coming 6 months, far above NoBa's f'cast

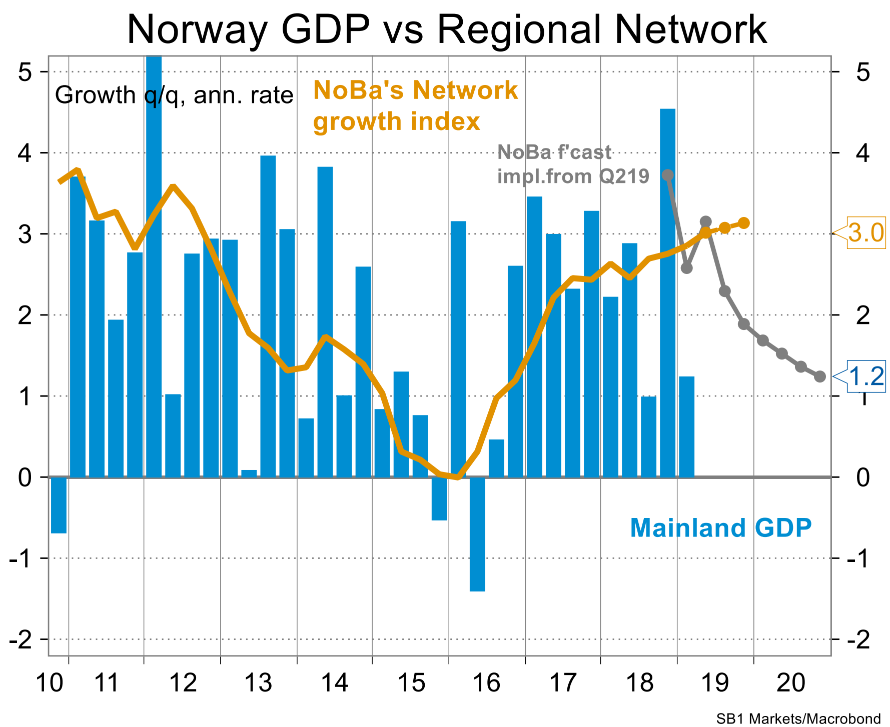


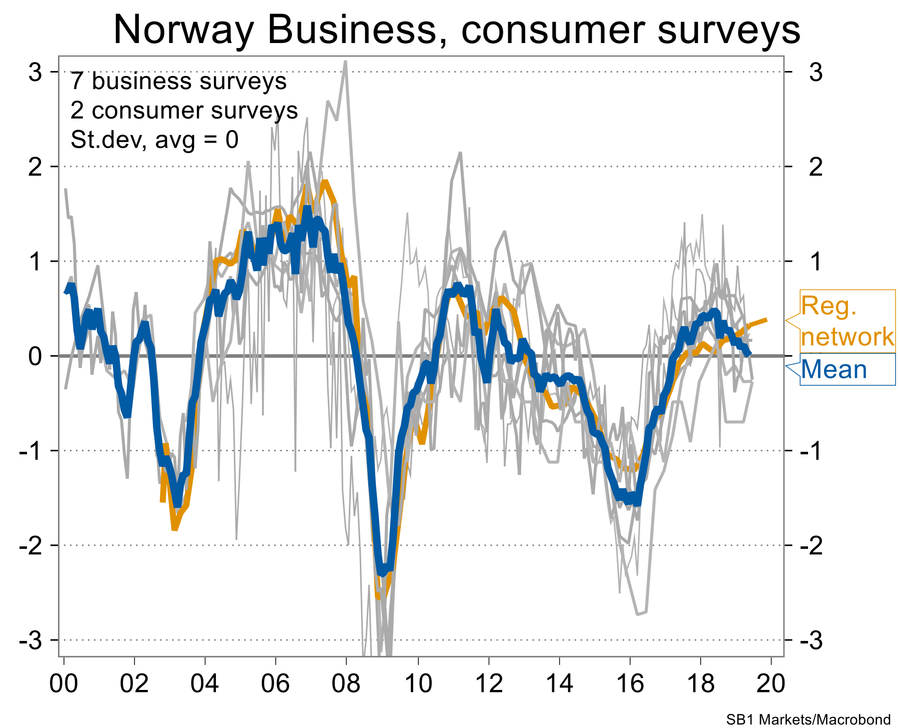

## Summary of the Q2 report

- **Growth indications**
  - » Norges Bank's Regional Network reports 3.0% growth the past 3 months, up from 2.9% in the previous report (and expectations on the coming 6 m). The report is 0.15 pp below NoBa's Q2 q/q f'cast from the March PPR
  - » Businesses expect 3.1% growth the coming 6 months, 0.2 pp higher than in the Q1 survey. A 3.1% speed is much higher than we expected (2.7%) and the highest since 2012. In contradiction, Norges Bank expects (implicitly) a steep slowdown in H2, to 2.3% in Q3 and 1.9% in Q4. Thus, the Bank will have to nudge up it's f'casts significantly
- **Capacity utilisation/investments**
  - » The Network reports rising capacity constraints, well above Norges Bank's f'cast. Capacity utilisation is back at the same level as the 2012 peak. Still, the share of businesses reporting labour shortages is low vs the unemployment rate, while more companies are reporting lack of qualified labour
  - » Businesses expect stable employment growth, at some 1.5%
  - » 2019 wage expectations were nudged up to 3.2%, from 3.0%,
- **Sectors**
  - » Growth outlook up everywhere, led by oil related sectors
- **Implications**
  - » The Q2 report came in above expectations, reflecting a bright outlook and accelerating growth, well above capacity growth
  - » An upbeat Network is yet another argument for an interest rate on Thursday. Moreover, Norges Bank will have to raise its H2 growth f'cast, pushing the interest rate path up. We expect the interest rate path to be nudged up by 20-25 bp, more our Norges Bank expectations here

# The Network signals accelerating GDP growth, NoBa expected a steep slowdown

## The Network predicts 3.1% GDP growth in H2, NoBa a rapid slowdown to below 2% by Q4




- Norges Bank's Network estimates economic activity to expand by a 3.1% speed the coming 6 months, which is well above Norges Bank's f'cast. The bank expects 3.1% in H2 and a rapid slowdown to 2.3% in Q3 and 1.9% in Q4 (implicitly, our calc), in average 2.1% in H2, 1 pp below the Network's f'cast!
- Most other surveys are somewhat weaker than the Network. Just SSB's manufacturing survey is more optimistic and 5 surveys are below (NHO survey in line with the Network)

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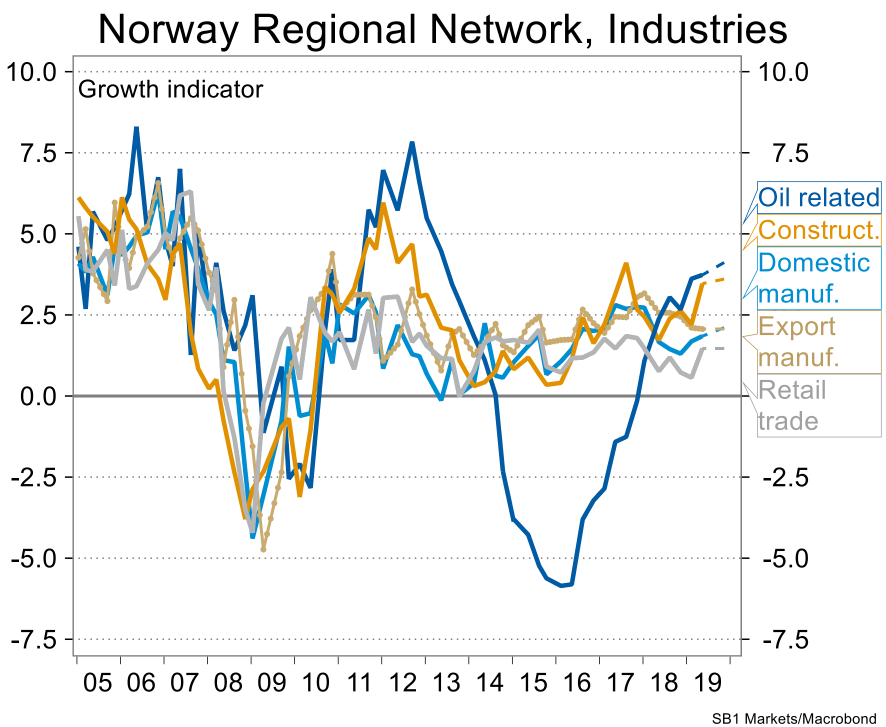
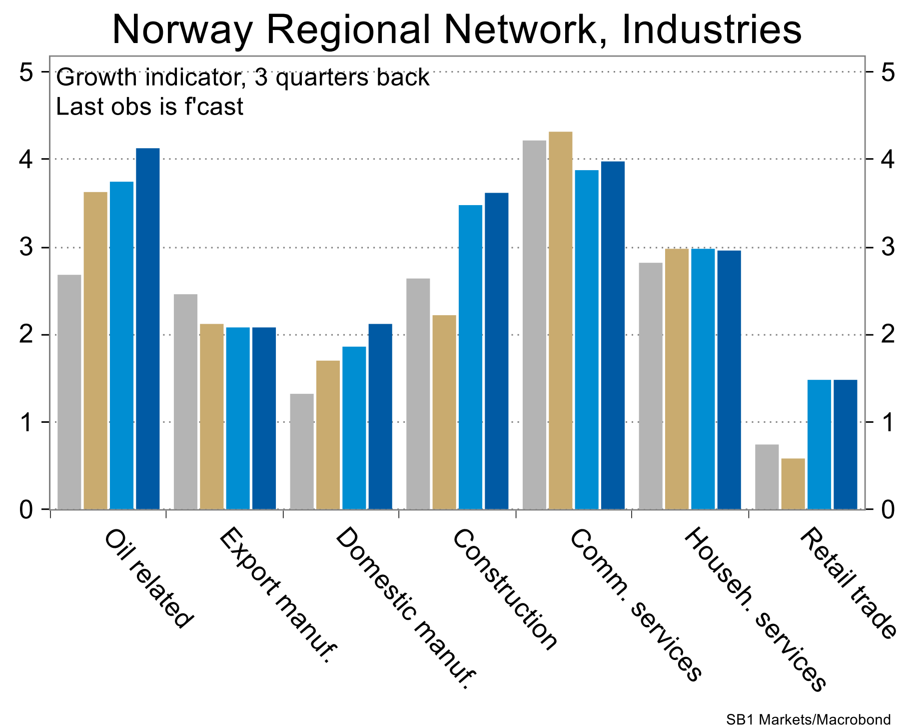
# Brighter outlook in all sectors, even retail trade (but just temporarily?)

Businesses expect accelerating growth in oil-related, construction and domestic manufacturing

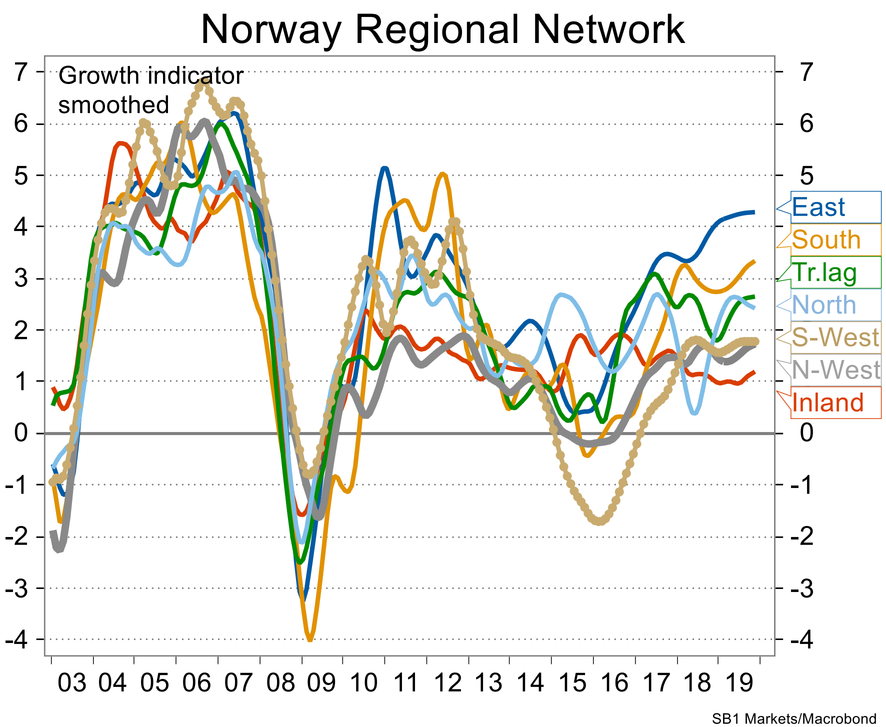


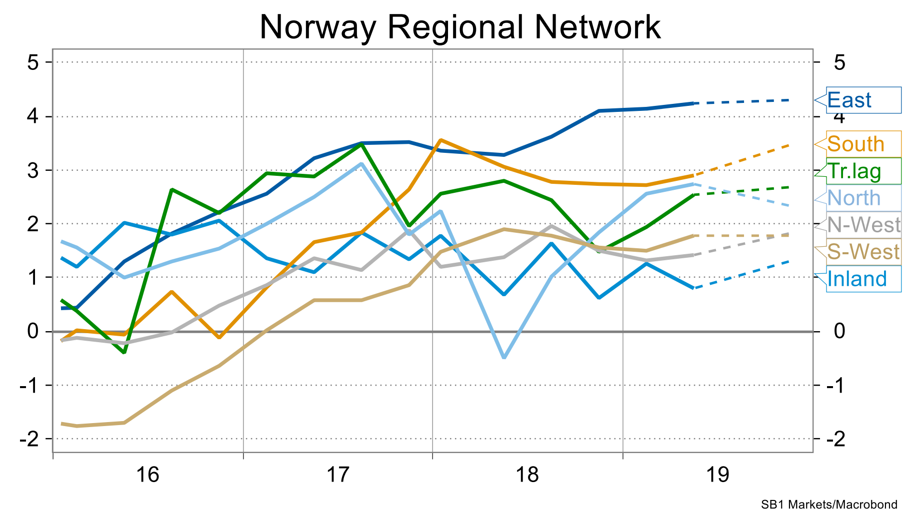



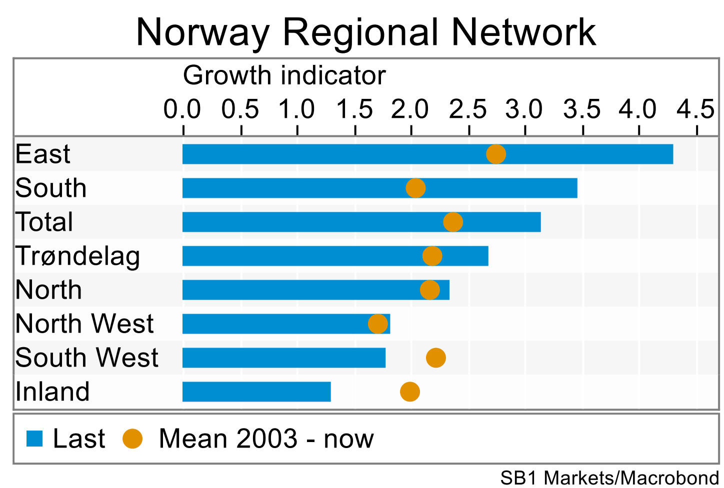

- Oil related companies (manufacturers & service providers) are reporting higher output growth the past 3 months and they are expecting just above 4% growth the coming months, the highest speed since 2013
- Export oriented manufacturing sectors are experiencing somewhat slower growth but they expect stable growth the coming months, at some 2%. Domestic manufacturing is gaining some speed, and a small uptick is expected, probably partly driven by spill overs from oil related sectors
- Construction businesses are reporting accelerating activity, the highest rates since the 2017 peak, driven by road & rail investments and rising residential construction. Limited upside on the latter?
- Growth in commercial services has slowed but is still expanding quite rapidly, household services stable at a somewhat slower. Within the retail sector, businesses are reporting a slight recovery. However, the increase is attributed to favourable weather and huge deliveries of electric cars (the new Teslas) and businesses are still noting weak growth in groceries trade, competition from online shopping and new market trends such as sustainability and recycling. Pointing to a still bleak outlook? Consumer confidence signals weakness too, and real wage growth is low

# A slow upswing in most regions, ex Inland?

## Most heading up since 2016, with the East & South in the lead – but no take-off in the oil region




- Growth in in most regions: The Network expects steady growth in the East (at a high level) and stronger growth in the South, Trøndelag
- The western regions are reporting decent growth rates but no take off, at or below the average since 2003

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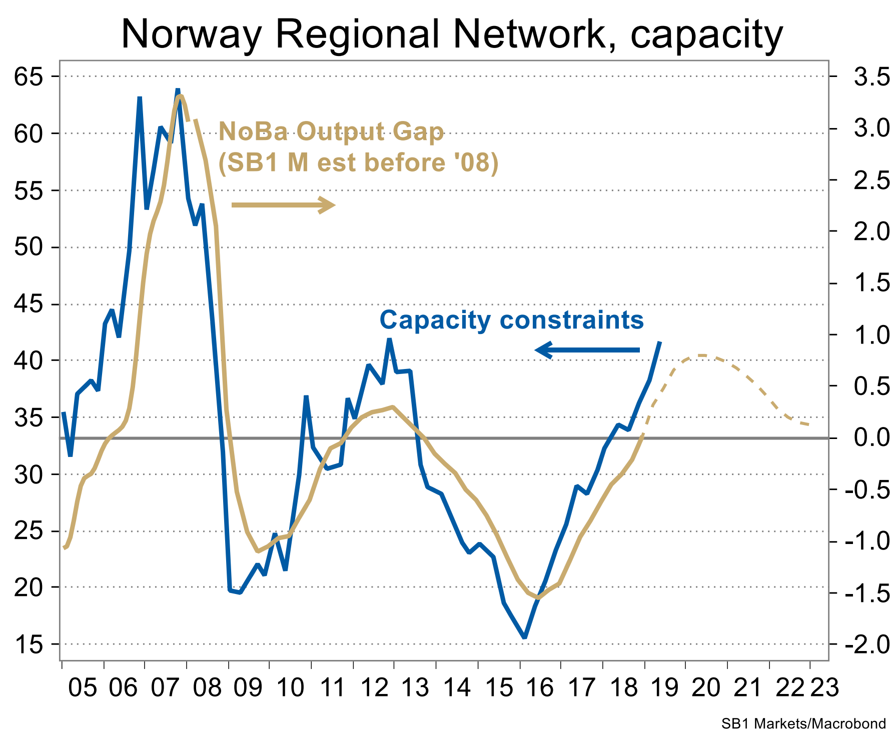
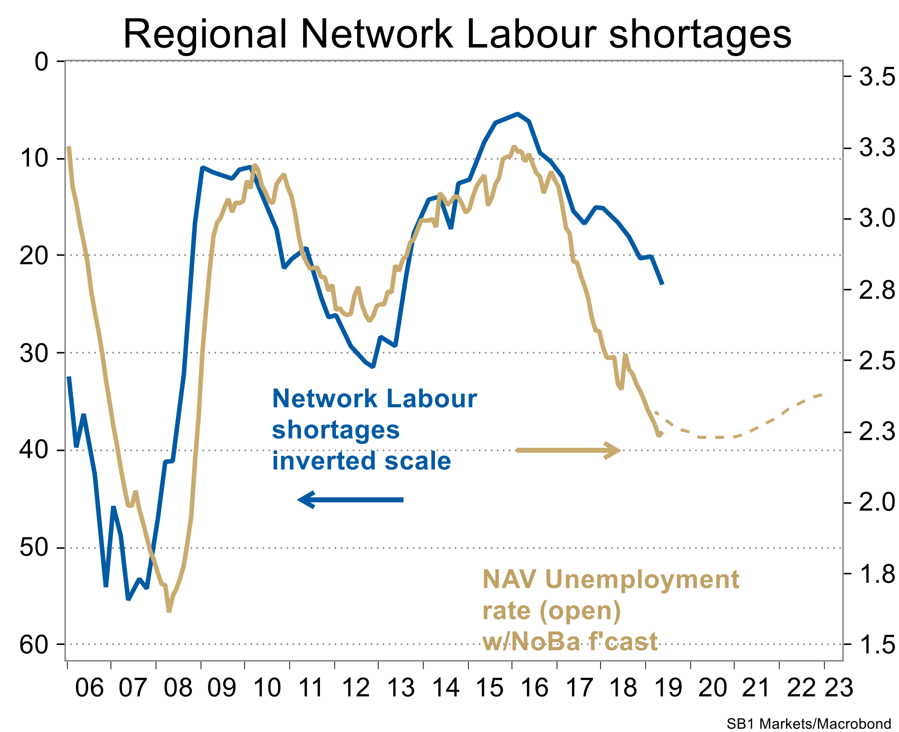
# Businesses report higher capacity utilisation – labour shortages remain modest

## Capacity utilisation is back at the 2012 peak and well ahead of Norges Bank's f'cast

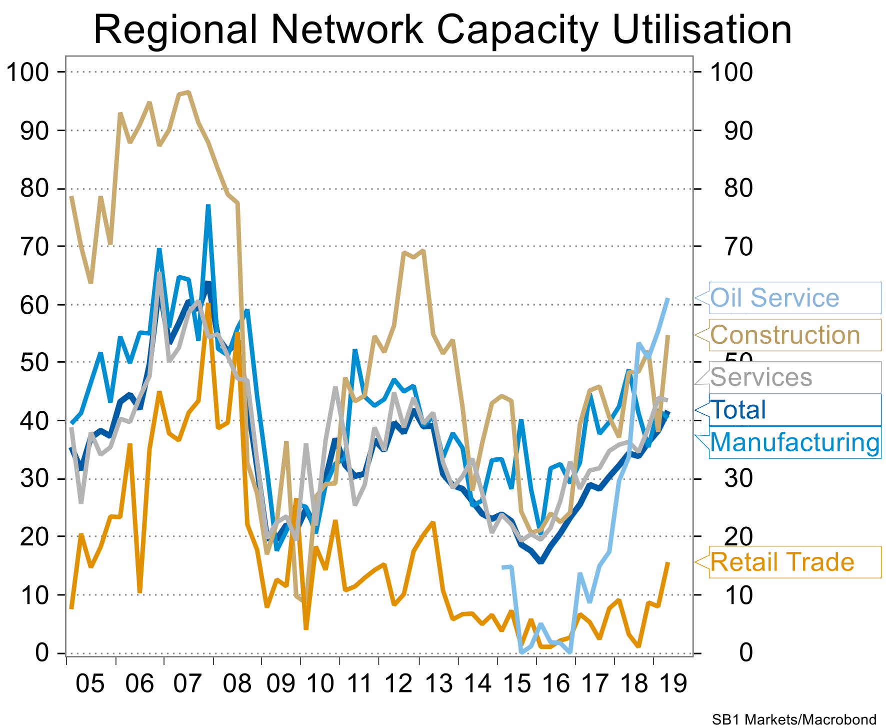


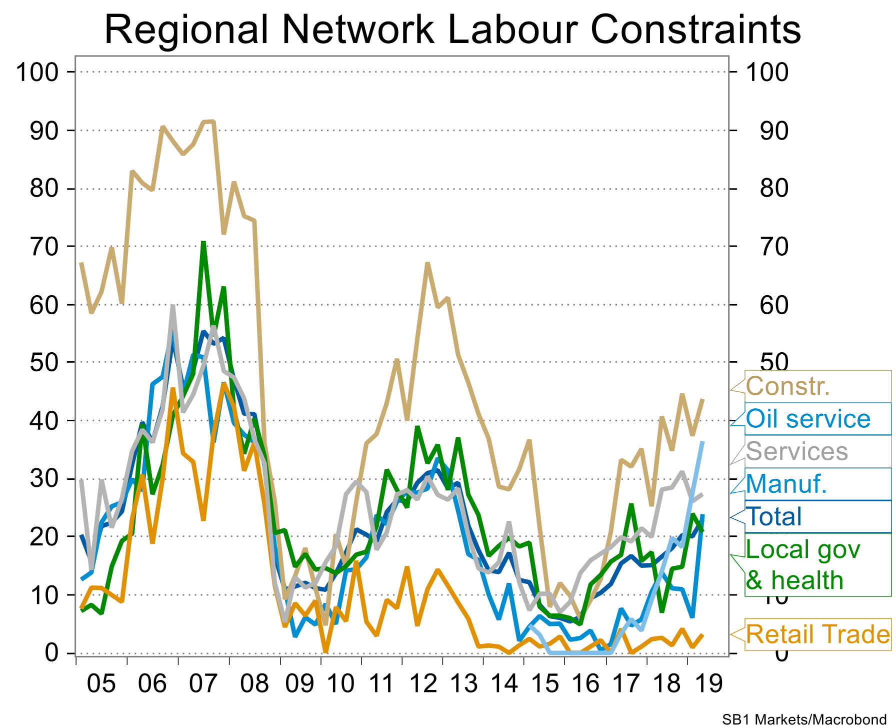




- Capacity utilisation is improving, to the highest level since 2012 (but still well below 2007!)
- In spite rising capacity utilisation and low unemployment, businesses are not reporting any substantial labour supply constraints. The share of businesses noting difficulties recruiting labour increased in Q2 but is still well below the 2012-2014 levels – and very low given the unemployment rate at 2.2%! Indicating that labour is still available. Probably the softest labour market indicator at hand today, and not an unimportant one

# Capacity utilisation is increasing in all sectors, retail may be picking up

61% of oil related businesses are reporting full capacity utilisation, retail up to 16%




- The share of oil-related businesses (not oil companies) reporting problems accommodating rising demand increased to 61%! Still, just 32% are experiencing labour supply constraints, not a very high share. Unfortunately, we only have data from 2015 for oil service companies
- The share of businesses in construction which are reporting full capacity bounced back up after a decline in Q1, to the highest level since 2013. Rising housing starts and muted labour immigration is putting pressure on the sector
- Retail trade is reporting higher capacity utilisation, after struggling with weak demand the past year. Signs of a soft recovery? Perhaps, but the uptick may as well be temporary, check the next slide. The sector still does not have any problems attracting labour
- 40% of manufacturers are reporting full capacity utilisation, a marginal decline form Q1. The share of businesses struggling to attract labour spiked, to 25%, probably due to spill overs from oil related sectors

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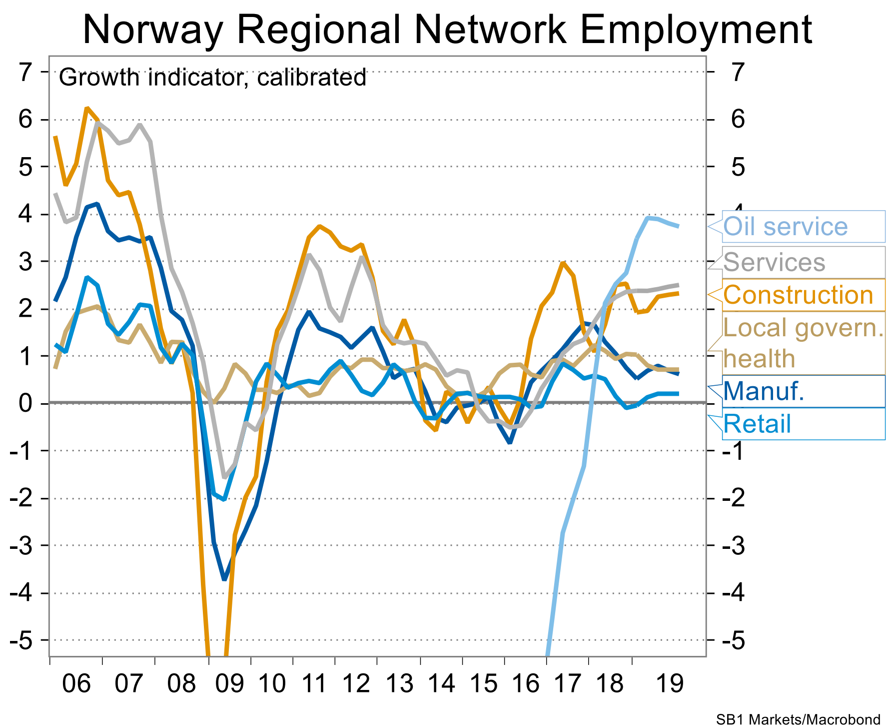
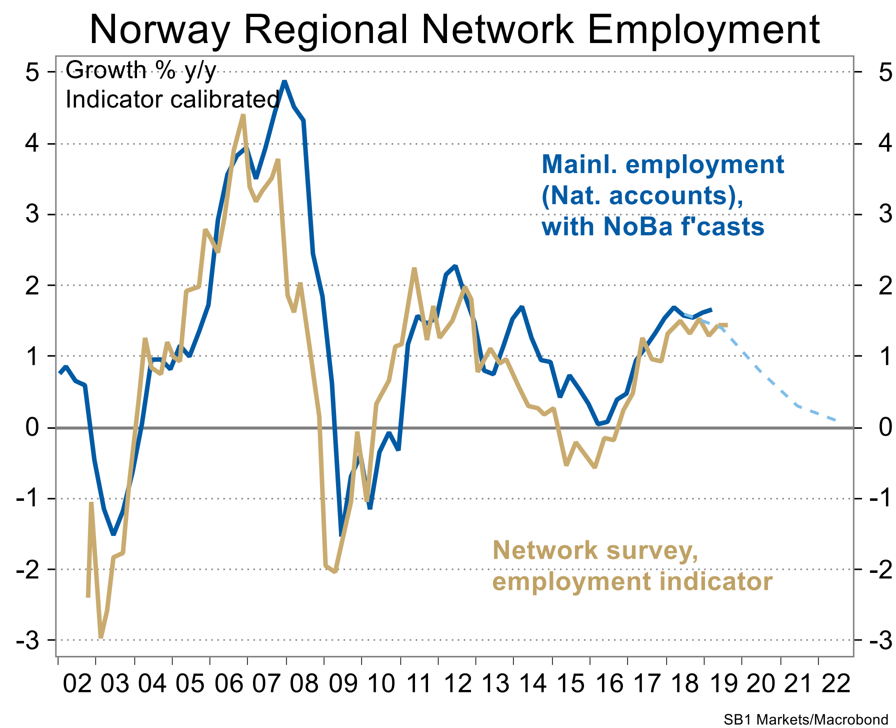
# The Network signals stable employment growth

## Businesses expects continued solid growth, at some 1.5%, in line with NoBa f'cast

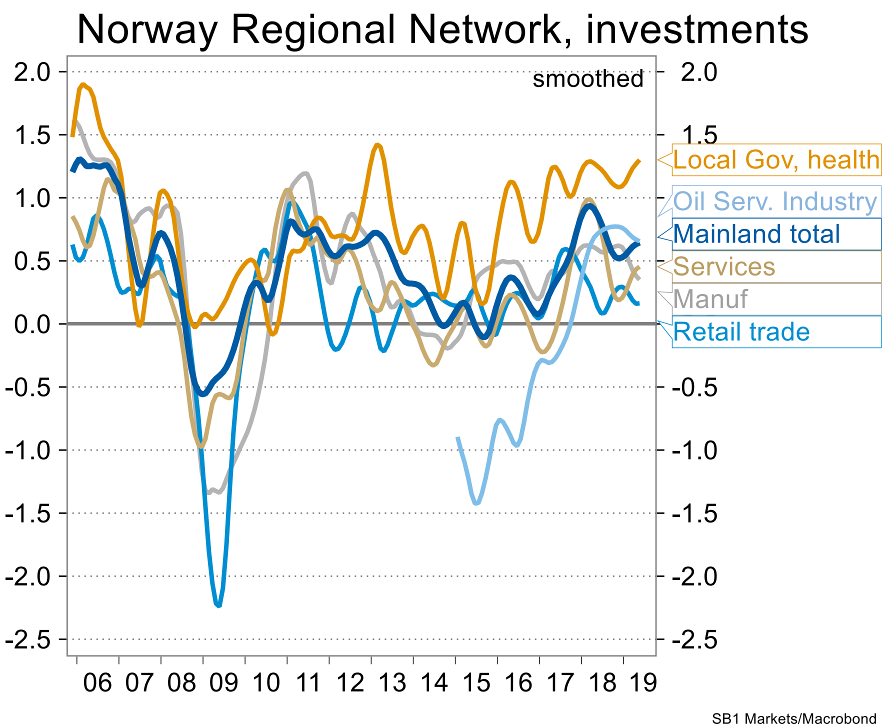


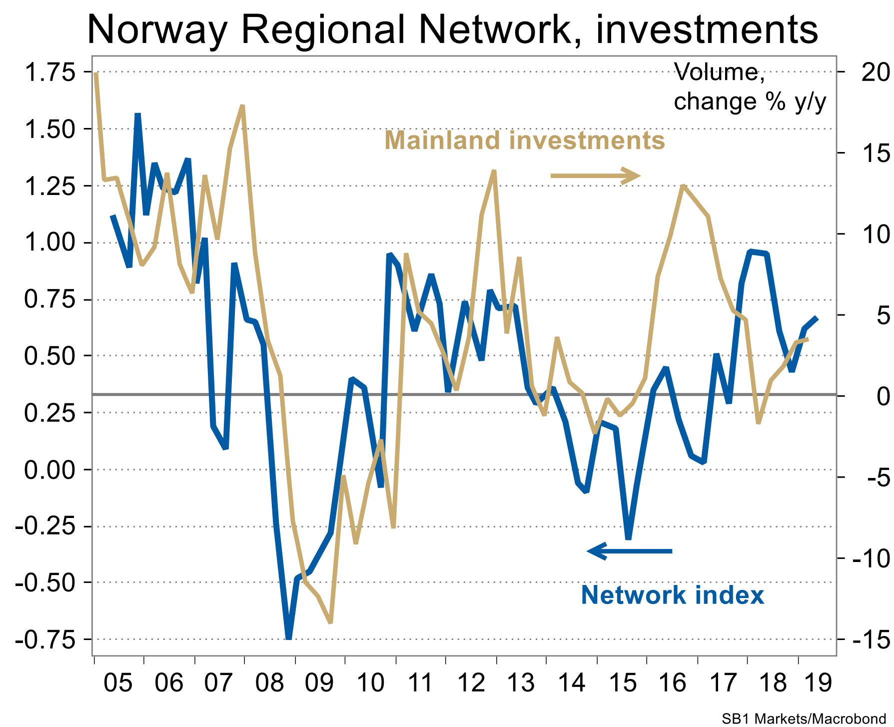




- Even if employment grows at a modest pace just above 1%, it will most likely be sufficient to pull unemployment further down
- Oil related services in the lead but businesses did not report an acceleration the past months and they do not expect one either. The sector is thriving and businesses are reporting stronger investments, lack of qualified labour is most likely holding back employment
- Construction has stabilised the past year, businesses are struggling with capacity constraints in this sector too, housing starts are heading up
- Other sectors are reporting more or less steady growth

# Business investments are rising but no take off

Investment plans signals solid investment growth, at some 5%. Oil services turning down, strange..



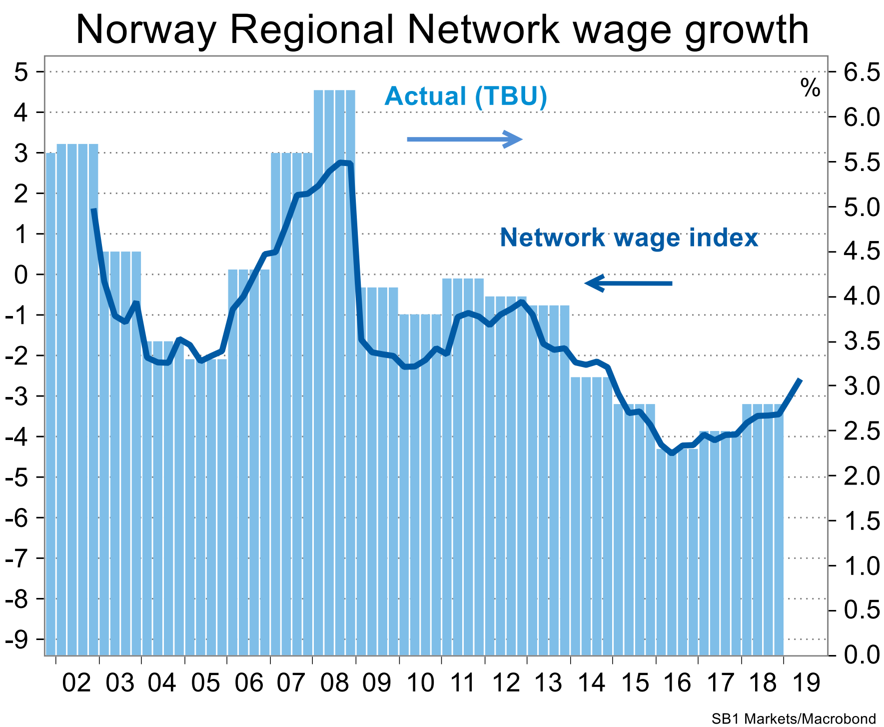



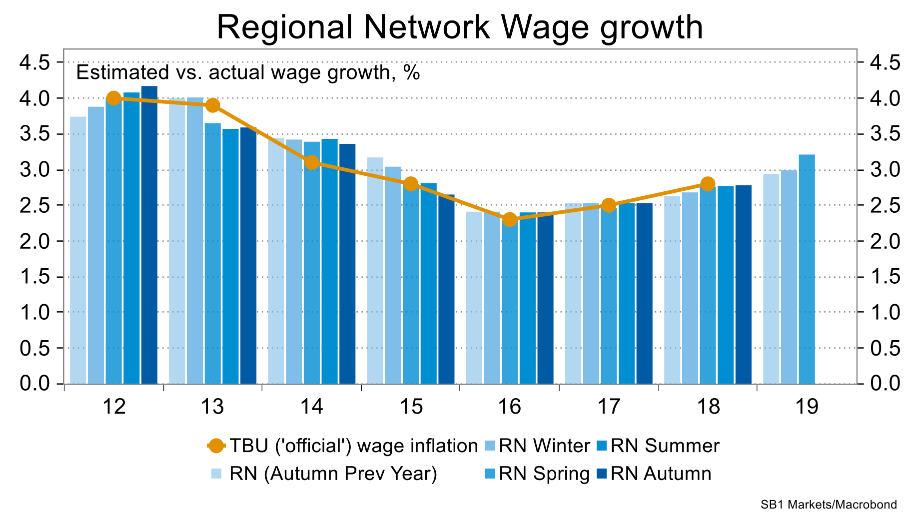

- Oil service/oil related manufacturing industries have moderated their investment plans the past quarters. Strange, as the oil companies are reporting thriving investments, should boost these sectors too
- Non-oil related manufacturing is reporting lower growth but the level is not weak
- Investments in retail sales are not impressive. Services gaining some pace. Local govt/health remains on the top
- Actual Mainland business investments rose 3.5% in Q1, the Network suggests an uptick, to some 5%. Norges Bank expects 4.1% growth in 2019, seems within reach

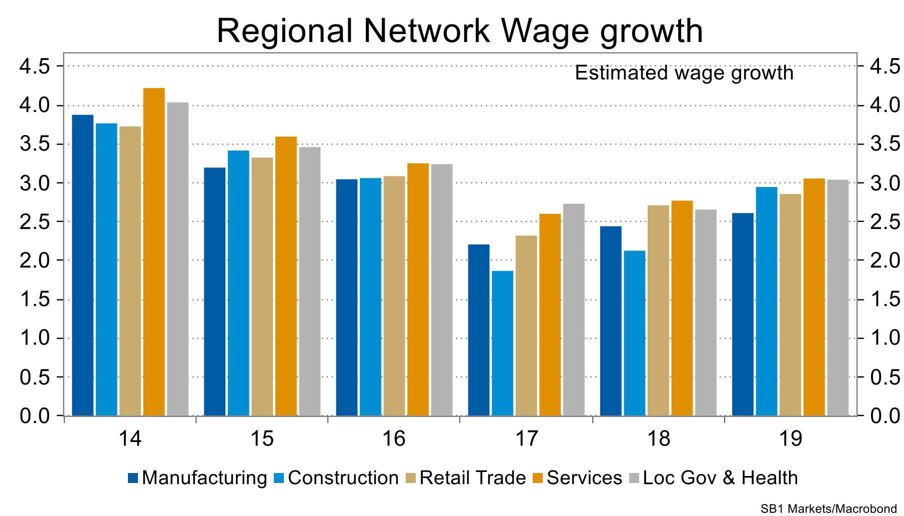
SpareBank 1 MARKETS

# Network reports accelerating wage growth, broad based

## Businesses estimate 3.3% wage growth in 2019, a 0.2 pp lift from the previous report



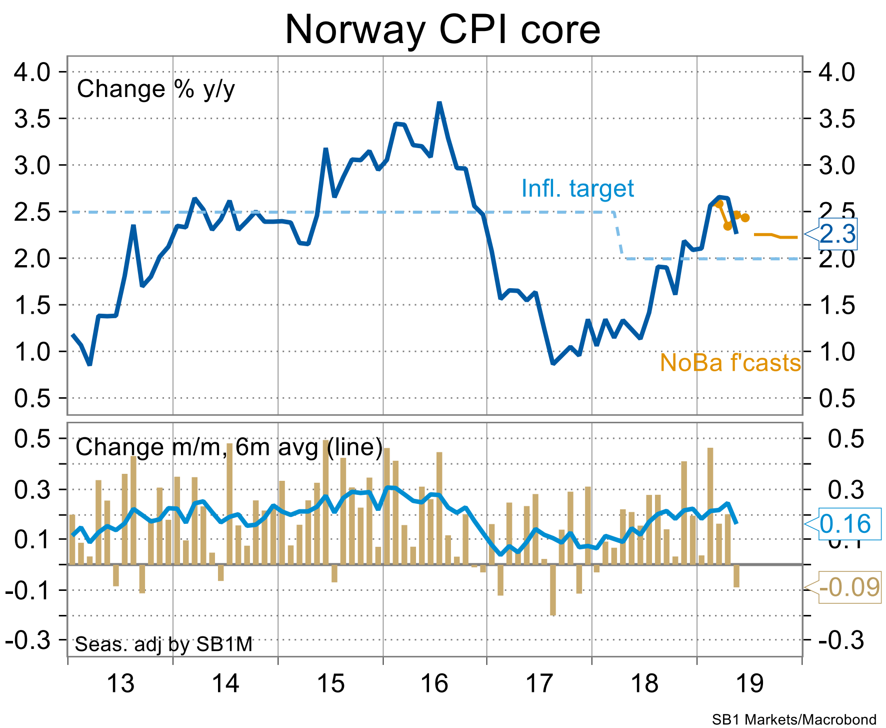




- The Network expects a broad upturn in wage inflation, higher growth in all sectors. Constriction sectors are reporting the highest wage growth plans, probably due to capacity constraints
- NoBa assumed wage growth at 3.3% in the March MPR, probably somewhat too optimistic

# Core CPI inflation edged down to 2.3% in May, below all f'casts (for once)

## Core CPI inflation ticked down 0.3 pp, dragged down by volatile airline tickets and food prices




- CPI-ATE (ex. energy and taxes) rose 2.3% y/y in May, from 2.6% the prior month. We f'casted unchanged growth, so did consensus. Norges Bank expected 2.5% back in March
  - » CPI-ATE fell 0.1% m/m (seas adj), as it usually does once or twice a year. The 3m/3m growth rate has come down to 2.4%
  - » Lower prices on airline tickets and food were the major culprits in May, both noting a steep decline m/m
  - » Total CPI growth came down 0.4 pp to 2.5% y/y. Electricity prices are heading down and will most likely bring total inflation further down. Good for real income growth, thus, consumption!
- **Implications**
  - » One months' downtick does not spark concerns that inflation is losing steam. Core inflation is above the 2% target
  - » Inflation has surprised in the upside vs NoBa's f'cast in 2 of the 3 months since the past MPR, we assume a neutral impact on the interest rate path on Thursday
  - » NOK depreciated after the release but was saved by an upbeat Norges Bank Network later on the day and ended up some  0.2% (import weighted index)

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# Arline ticket prices and food were the outliers in May… As usual..

## Airline ticket prices are volatile and difficult to predict, this time they fell 12% m/m

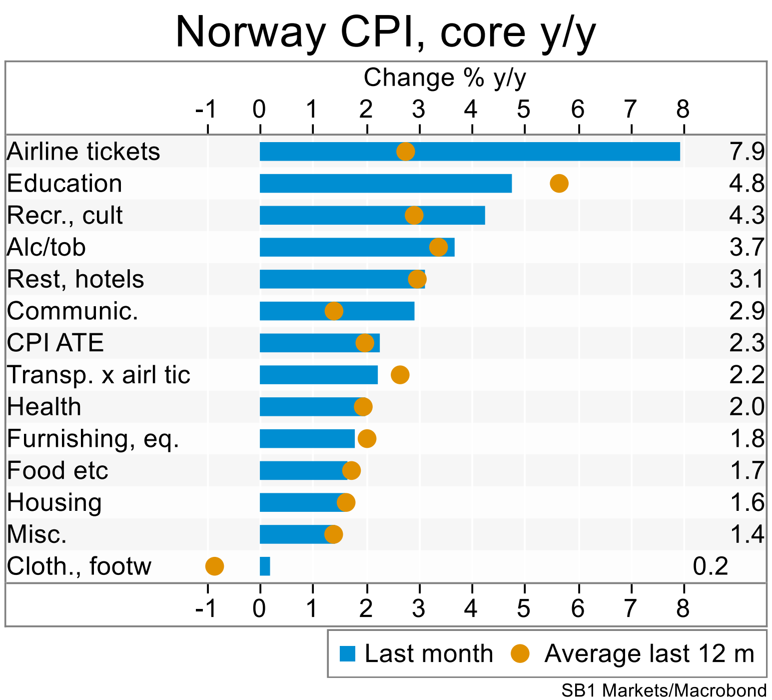
| | | Change m/m, seas. adj | | | Change y/y | | | Contribution, pp | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *May-19* | Weight | Out- | SB1M | Dev. | Last | Out- | SB1M | | | Dev. vs |
| CPI ATE | % | come | f'cast | pp | month | come | f'cast | m/m | y/y | f'cast |
| Food, non alc bev | 12.5 | -0.7 | 0.1 | -0.8 | 2.7 | 1.7 | 3.6 | -0.08 | 0.21 | -0.09 |
| Alcohol, tobacco | 3.9 | 0.1 | 0.3 | -0.1 | 3.9 | 3.7 | 3.8 | 0.01 | 0.14 | -0.00 |
| Clothing, footwear | 4.9 | 1.0 | 0.0 | 1.0 | 0.5 | 0.2 | -1.0 | 0.05 | 0.01 | 0.05 |
| Housing x. energy | 20.1 | 0.2 | 0.2 | 0.1 | 1.6 | 1.6 | 1.5 | 0.04 | 0.32 | 0.01 |
| Furnishing | 6.6 | -0.4 | 0.2 | -0.6 | 2.4 | 1.8 | 2.8 | -0.03 | 0.12 | -0.04 |
| Health | 3.2 | 0.1 | 0.2 | -0.1 | 2.1 | 2.0 | 2.1 | 0.00 | 0.06 | -0.00 |
| Transp. ex. gas, airl. tick | 12.0 | 0.1 | 0.2 | -0.1 | 2.4 | 2.3 | 2.6 | 0.01 | 0.27 | -0.02 |
| Airline tickets | 1.2 | -12.0 | -10.0 | -2.0 | 25.7 | 7.9 | 14.9 | -0.14 | 0.09 | -0.02 |
| Communication | 2.2 | 0.4 | 0.1 | 0.3 | 2.4 | 2.9 | 2.5 | 0.01 | 0.07 | 0.01 |
| Recreation, culture | 11.9 | 0.4 | 0.3 | 0.1 | 4.1 | 4.3 | 4.1 | 0.04 | 0.51 | 0.01 |
| Education | 0.5 | - | - | - | 4.8 | 4.8 | 4.8 | | 0.02 | 0.00 |
| Restaurants, hotels | 6.2 | 1.0 | 0.3 | 0.7 | 2.3 | 3.1 | 2.5 | 0.06 | 0.19 | 0.04 |
| Other | 8.8 | 0.0 | 0.2 | -0.1 | 1.5 | 1.4 | 1.6 | 0.00 | 0.12 | -0.01 |
| **CPI-ATE** | 94 | **-0.1** | **0.0** | -0.1 | **2.6** | **2.3** | **2.6** | | | |
| *Norges Bank est.* | | | *0.2* | | *2.4* | | *2.5* | | | |
| Imported | 33 | -0.0 | 0.1 | -0.1 | 1.5 | 1.3 | 1.5 | -0.01 | 0.44 | -0.05 |
| Domestic | 61 | -0.1 | 0.0 | -0.1 | 3.3 | 2.8 | 3.2 | -0.08 | 1.69 | -0.08 |
| Energy, housing | 4 | 0.4 | -2.0 | 2.4 | 8.4 | 11.1 | 10.9 | 0.02 | 0.43 | 0.09 |
| Energy, transport | 4 | 1.6 | 3.0 | -1.4 | 3.3 | 0.2 | 1.6 | 0.06 | 0.01 | -0.05 |
| **CPI Total** | 101 | **-0.1** | **0.0** | -0.1 | **2.9** | **2.5** | **2.8** | -0.09 | 2.54 | -0.13 |

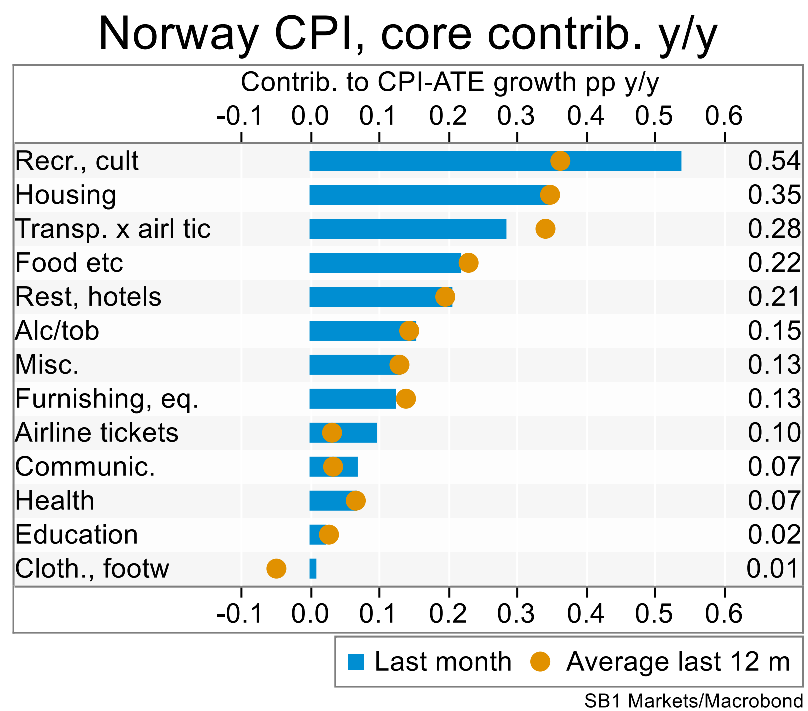
- Food prices fell 0.7% m/m, we f'casted a marginal increase. The contribution on core inflation was -0.08 pp on the m/m rate
- Furnishing prices came in on the weak side too
- Volatile airline ticket prices this time slipped 12% m/m, we expected a 10% decline. Ticket prices pulled the core m/m rate down by 0.14 pp
- **CPI-ATE up 2.3% y/y, 0.3 pp below our and consensus' expectations**
- Imported prices were unchanged m/m but is lifting the annual rate by 0.4 pp (domestic inflation by 1.7 pp)
- Housing electricity prices inched up m/m in May, we expected a drop.
- Headline inflation still came in below our expectations, at 2.5% (consensus expected 2.9%)

Monthly changes are seasonally adjusted by SB1 Markets. The weighted sum of the components does not necessarily sum exactly up to the total. Norges Bank m/m s.a. estimate is implied, calculated by us

# A broad upswing recently; prices are rising in all major sectors ex clothing

Recreation & culture, housing and transport are lifting the annual rate. Muted clothing prices

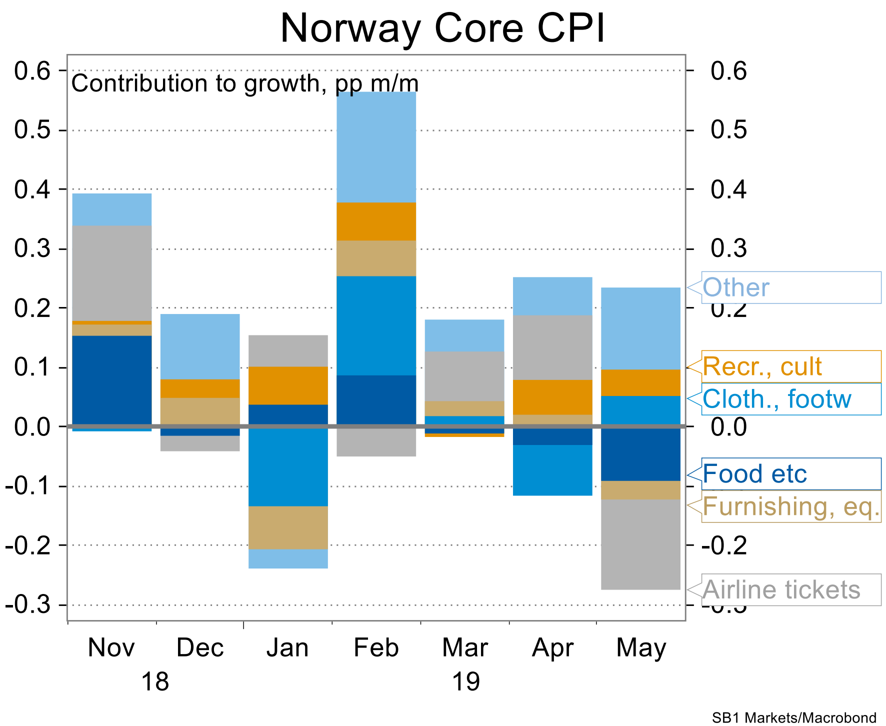


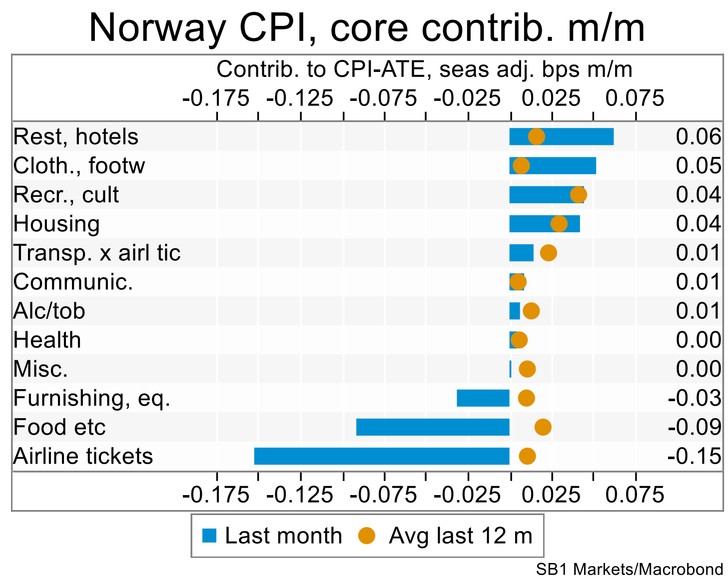




- Prices on airline tickets jumped 7.9% annually in May (and fell 12% m/m). These prices are very volatile and the seasonal adjustments are tricky

# Airline tickets and food pulled m/m growth down in May

.. While clothing prices and restaurants/hotels accelerated

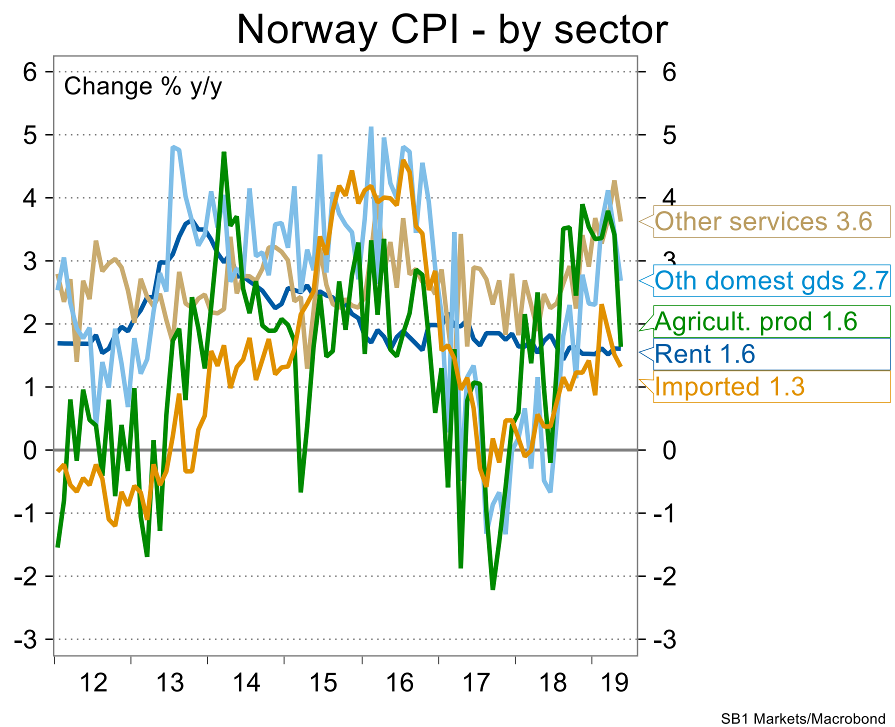


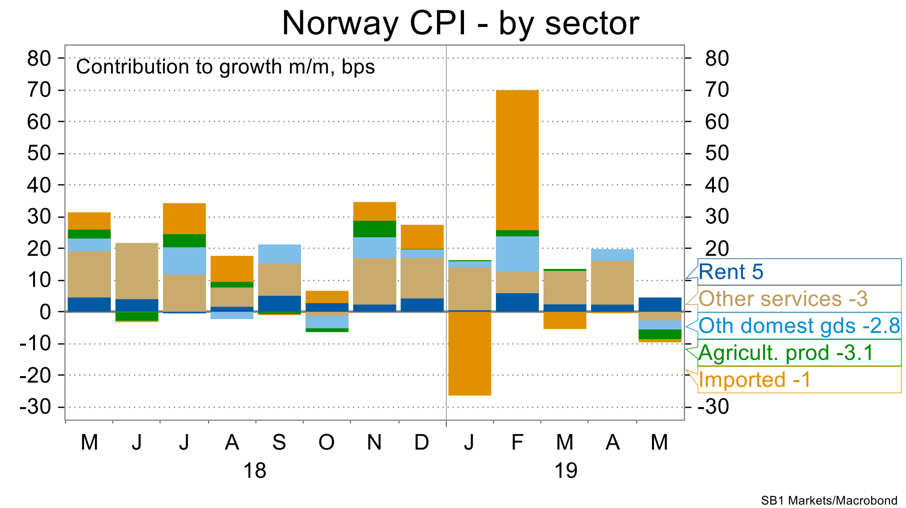



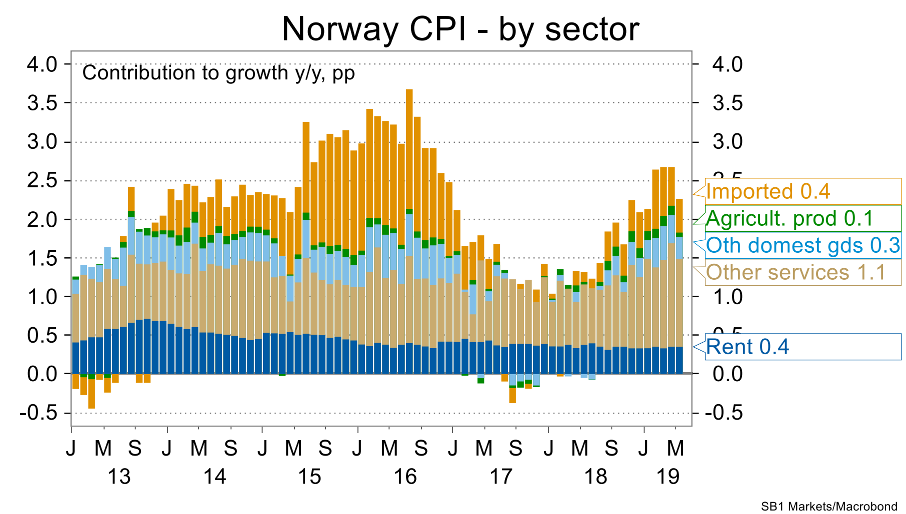

- Recreation/culture and communication, clothing & footwear and other goods drove monthly inflation up

# No NOK effects; imported inflation is retreating, just services rising recently

Both imported and domestic inflation slowed in May – and a steep decline in agriculture




- Price growth in services (such as culture, travelling etc) has been soaring the past months. Other domestic goods and imported goods have slowed the past 2-3 months, after accelerating the past year. Inflation in agriculture dropped in May. Only rent is pulling back
- The NOK depreciation has been lifting import prices but they are still modest (and we do not expect more)

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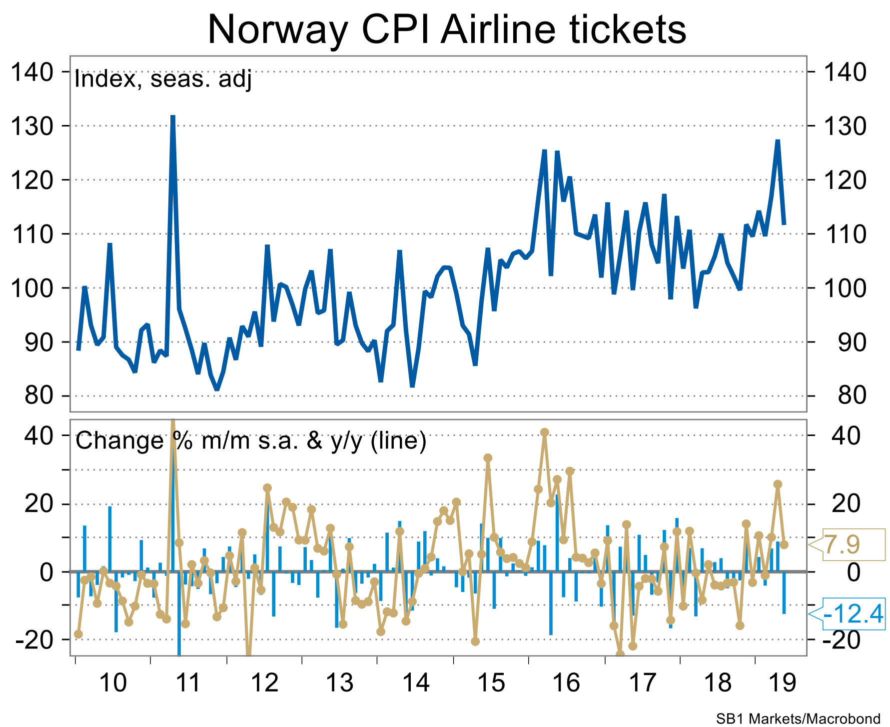
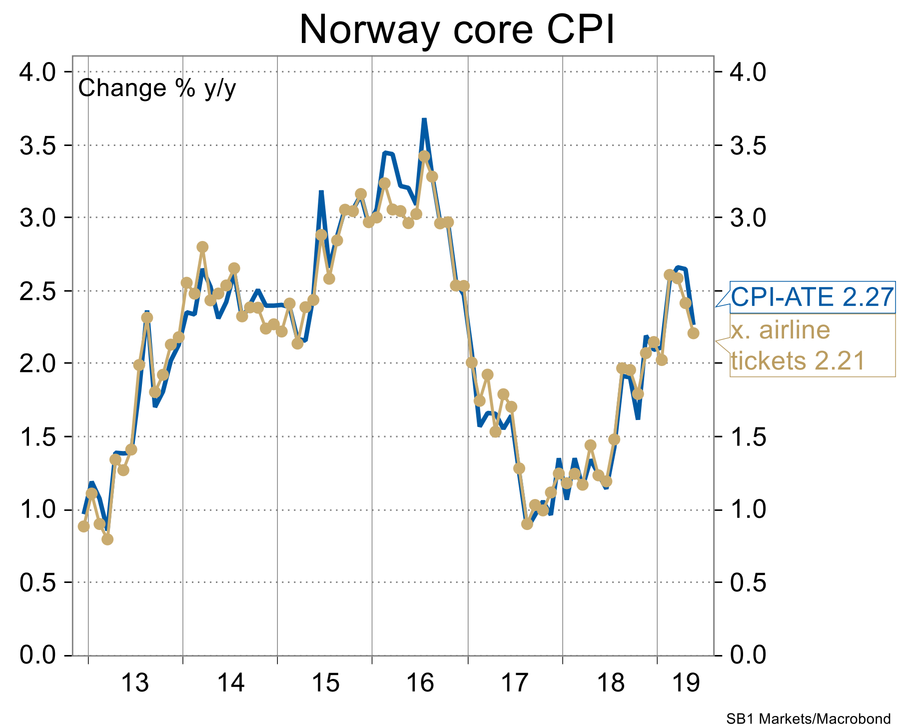
# Airline tickets prices down in May, trending up?

Airline ticket prices are still boosting inflation, capturing 0.06 pp of core annual growth in May



SB1 Markets/Macrobond



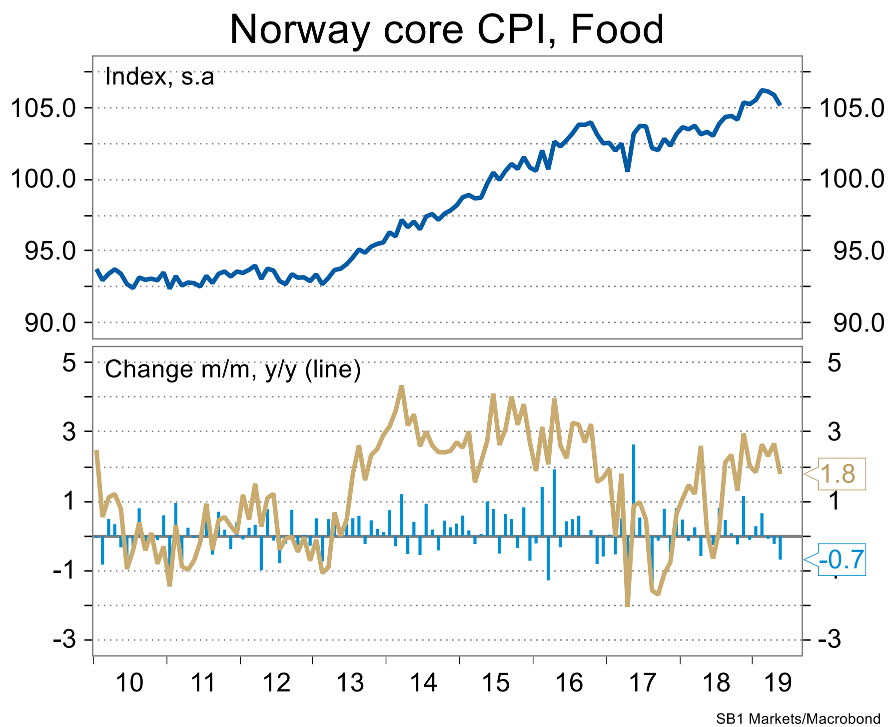
SB1 Markets/Macrobond

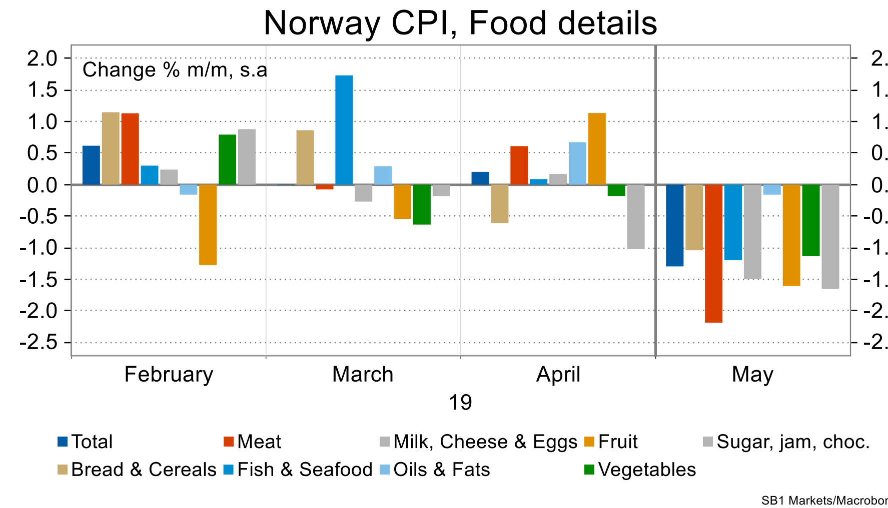
- Prices dropped 12% m/m in May (after an uncertain seasonal adjustment), following a 9% rise the prior month. The annual rate is up 7.9%, from ridiculously 25.7% in April
  - » These data are very volatile. During the spring, Easter impact are making the seasonal adjustments even more uncertain than usual. The strike in the SAS airline did not lift prices
  - » Airline ticket prices have been trending up since mid-2018, lifting inflation

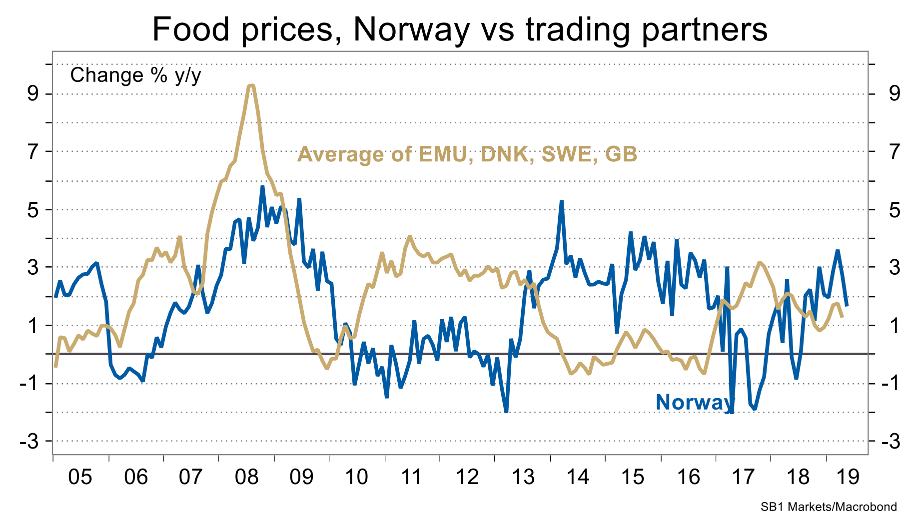
SSB is using a sophisticated net search model to calculate average prices in the relevant week. We assume that the real volatility in average monthly air ticket prices are lower than calculated

# Food price down in May, broad based

## Food prices have fallen the past 2 months, a broad downswing in May



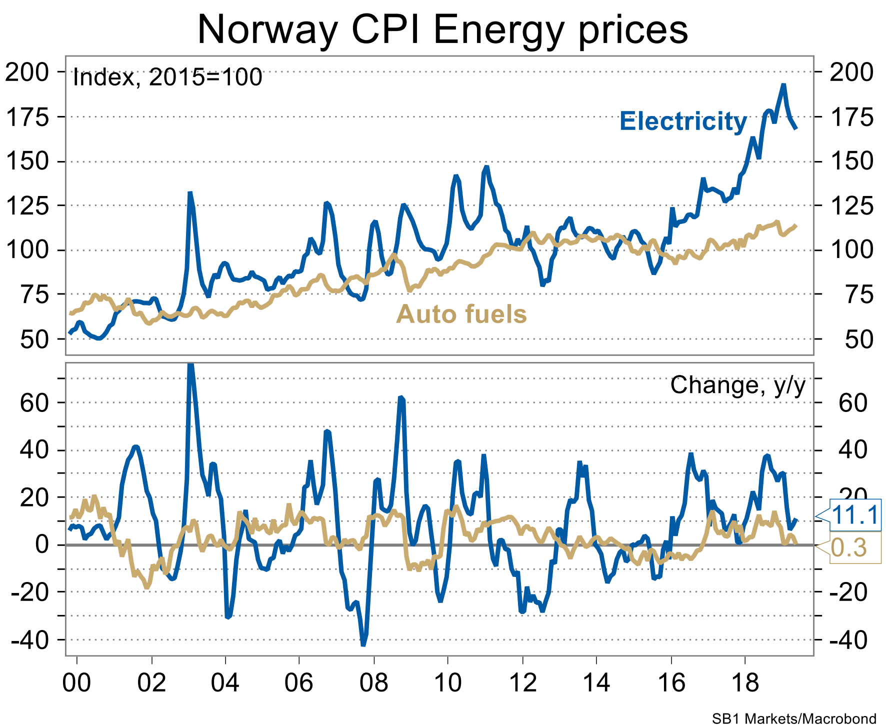



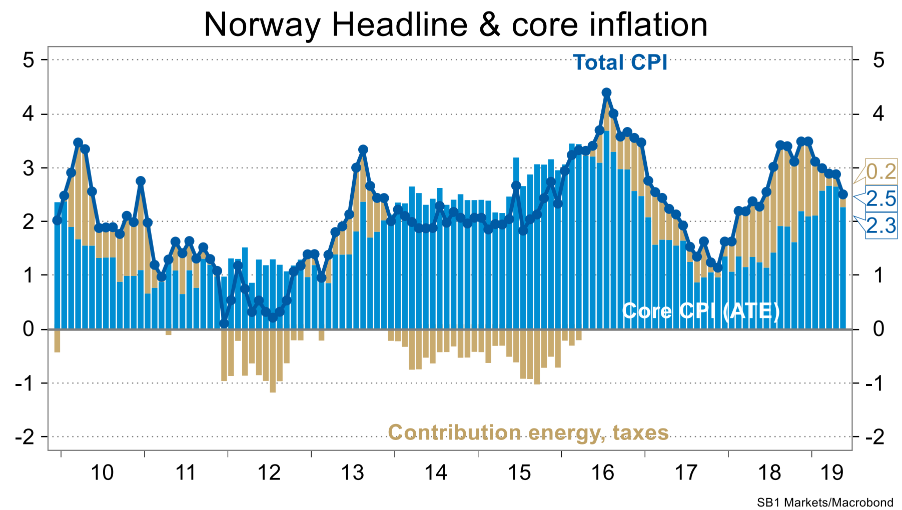



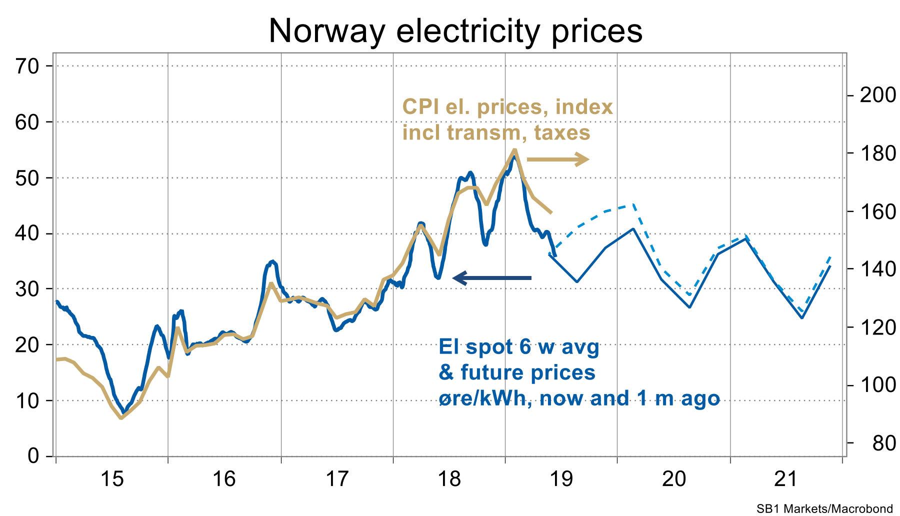

- Prices dropped 0.7% m/m, we expected a marginal uptick. Prices fell among all categories
- Food prices are now increasing at the same speed as in our neighbouring countries

# Headline inflation has come down, more to come

## Consumer prices not yet adjusted to the May/June crash in market electricity prices




- The sharp rise in electricity prices have lifting the headline CPI, reducing real disposable income significantly. Now, this effect is subsiding, as electricity prices are falling. The contribution was just 0.4 pp in May, vs 1.5 pp 6 months ago
  - » Spot & near term future prices have collapsed since mid May (Q3 19 contract down 25% in 4 weeks!). If the market is right now (and not 4 weeks ago…), el prices in CPI will decline sharply the coming months, at least 15%, taking the CPI level down 0.6%. The future market is pricing in even lower prices in 2020 and 2021 (if so, the 'net' (of carbon quota) price for fossil fuel (coal) EU producers will be really low, if the carbon prices do not collapse too, so far they have not
- Auto fuel prices are now close to neutral vs. headline CPI

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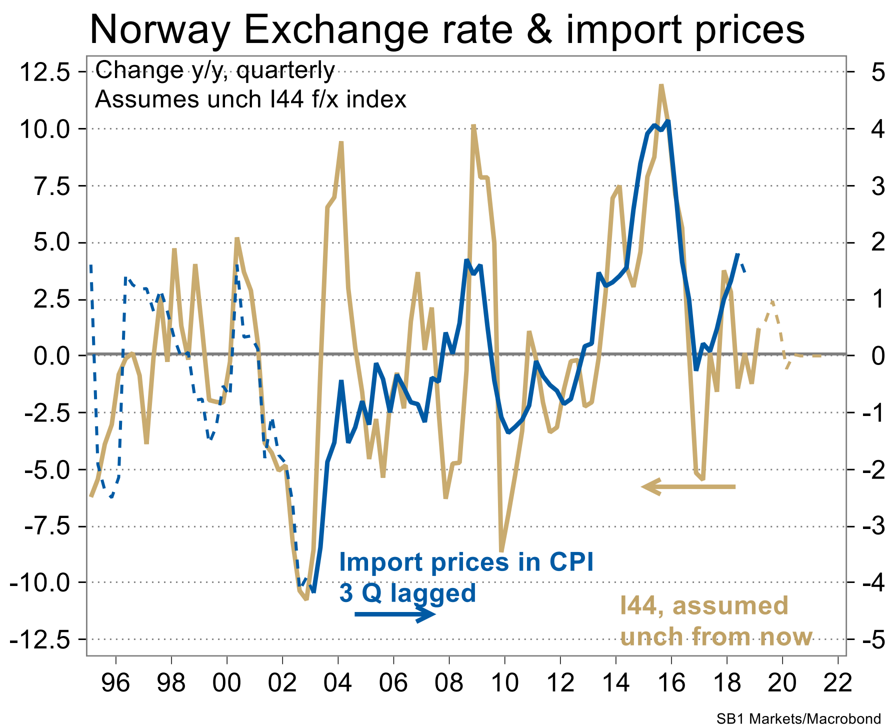
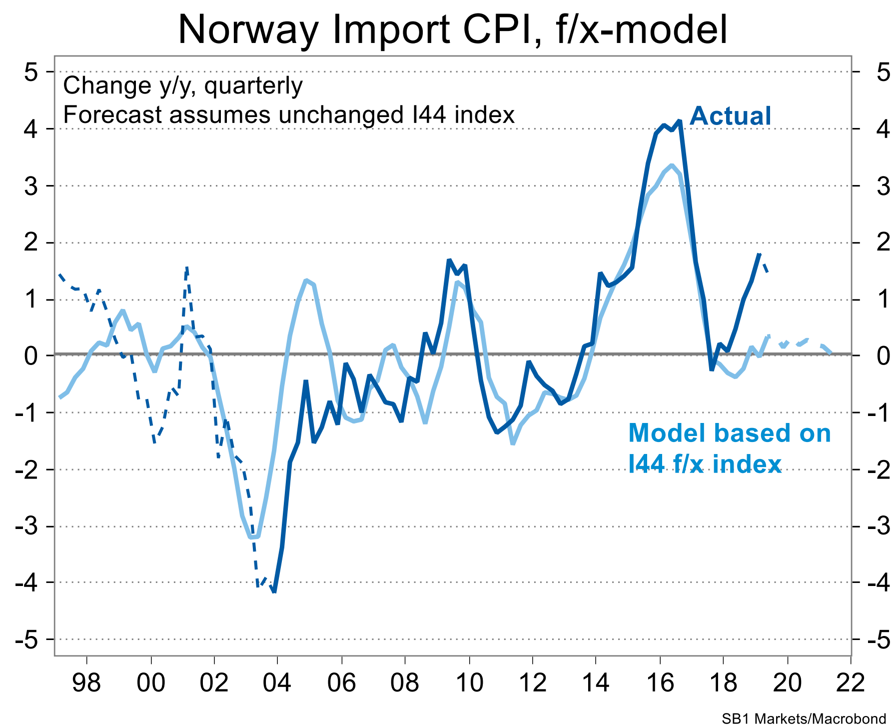
# The impact from the weak NOK will most likely subside the coming months

## Imported inflation is higher than the NOK implies




- In general, retail demand is so weak that it does not seem likely that the retailers are able to push up their margins. It does not seem likely that prices are accelerating abroad. Still, somewhere prices inflation is coming into the equation

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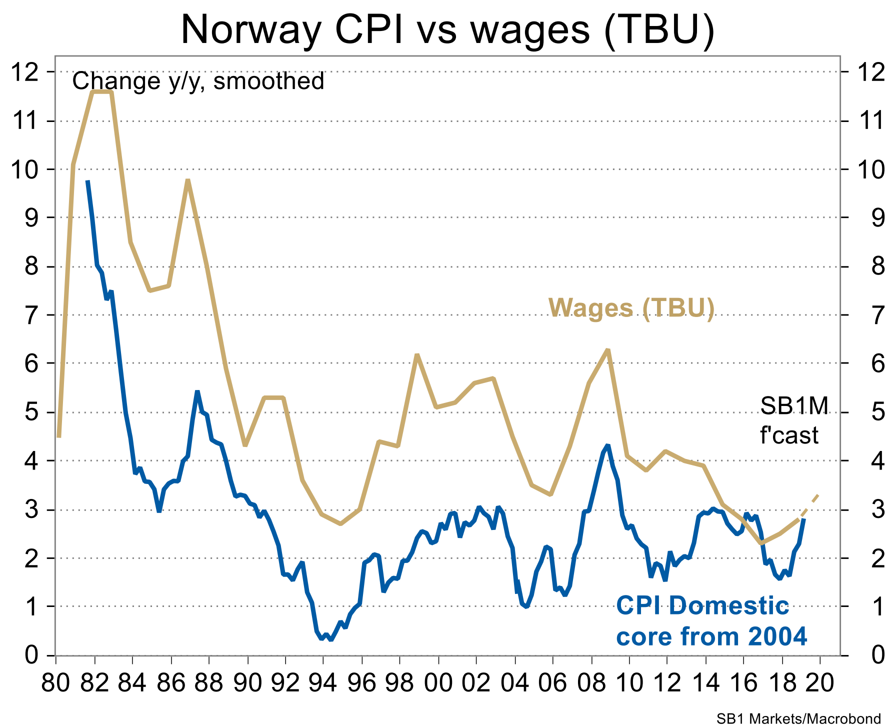
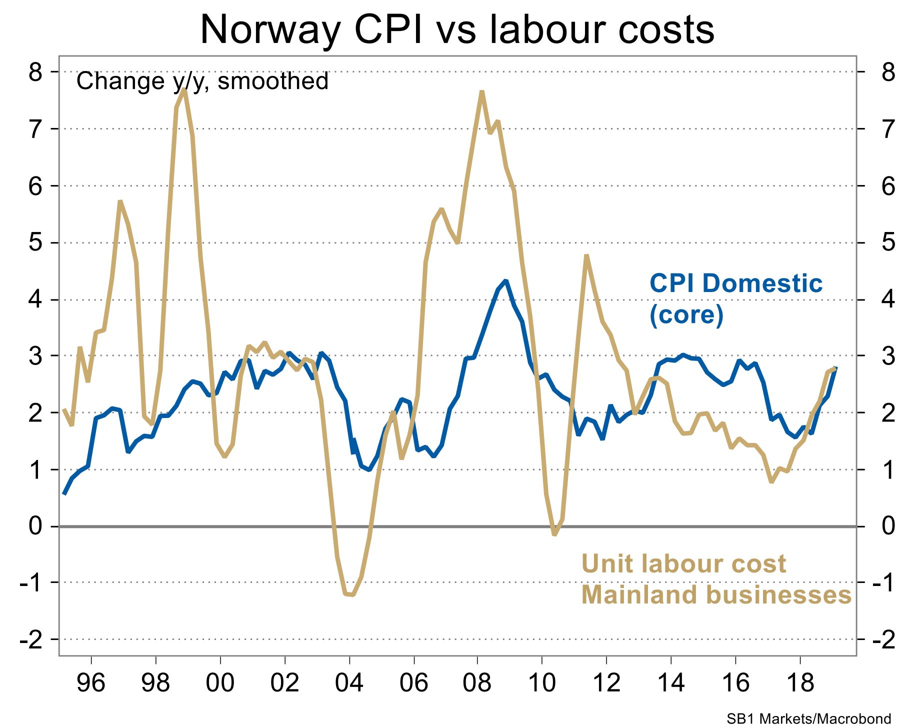
# Domestic costs: Wage inflation turning up, cost inflation above infl. target

Wage inflation is on the way up. Unit labour cost up some 2.8% in Q1

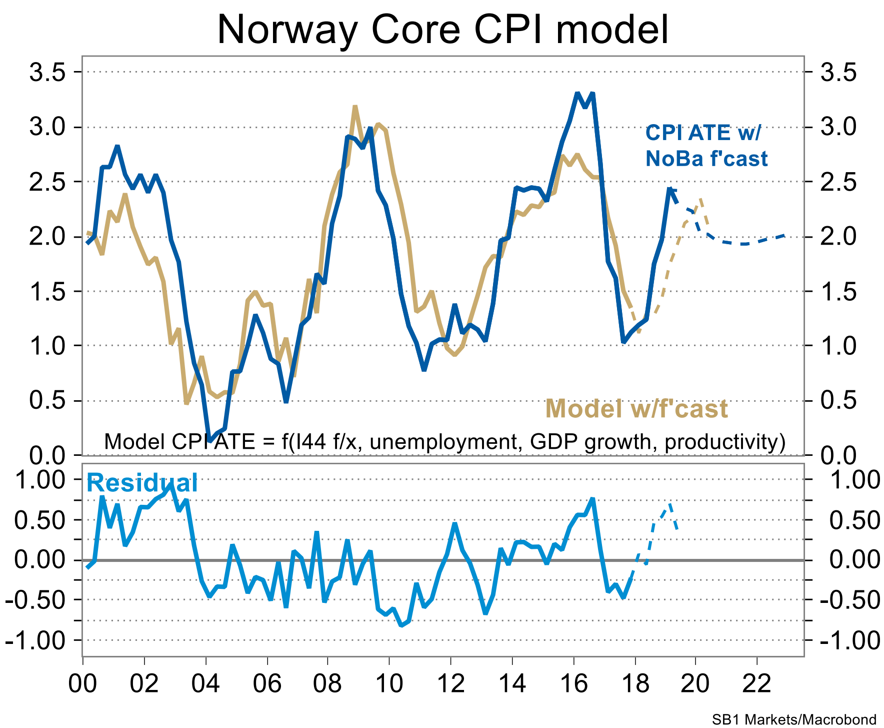



- Wage inflation is increasing and is now approaching 3%
- Productivity growth remains meagre
- Unit labour costs inflation up to 2.8% y/y in Q1, up from 2.7% in Q4 – and below 1% in 2017

# The outlook: Core CPI inflation peaking?

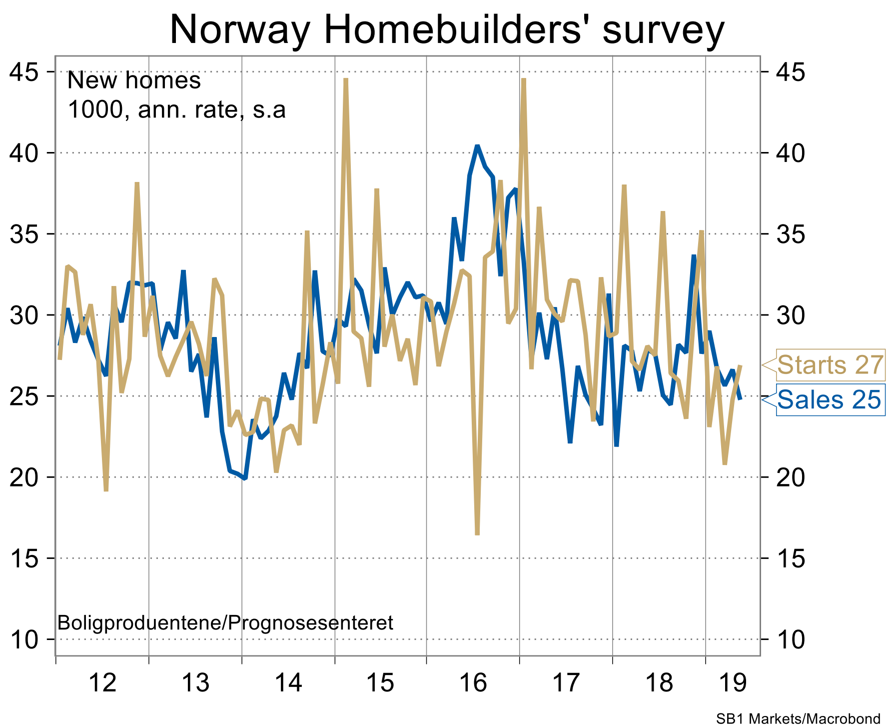
## Our simple short term model signals core inflation to peak at 2.4% - in one year's time…

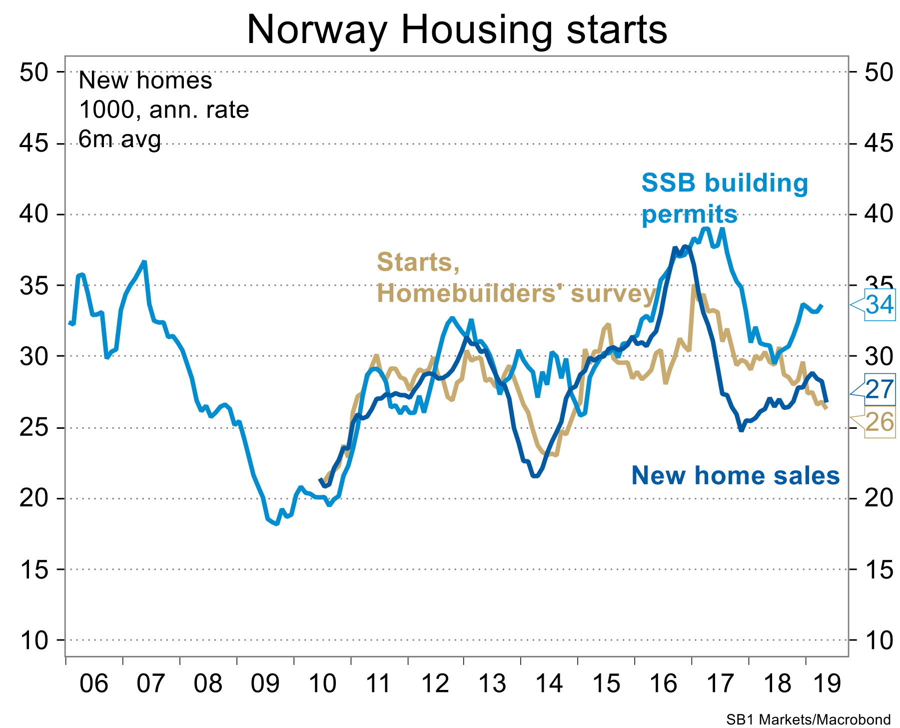



- Core CPI growth has been well above the model f'cast recent months, the 2.3% speed in May is far above our model f'cast at 1.9% in Q2
- Declining unemployment and solid GDP growth signal modest inflation the coming year, up to 2.4% in Q1 2020
- Norges Bank expects core CPI at 2.3% in 2019 (March Monetary Policy report)

# Homebuilders report somewhat softer new home sales, suggests stalling starts

## Starts increased in May but are still trending down, in contradiction to SSB's data

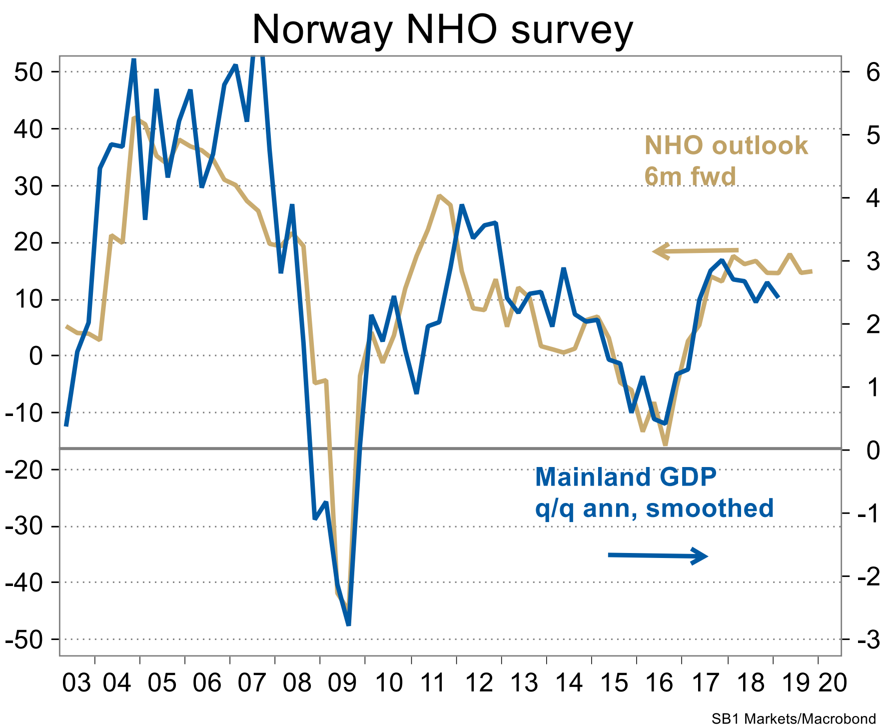


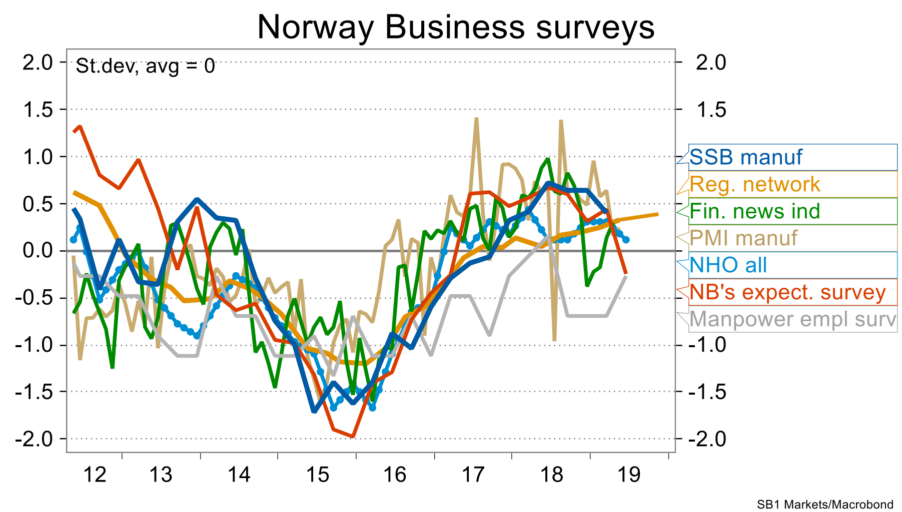



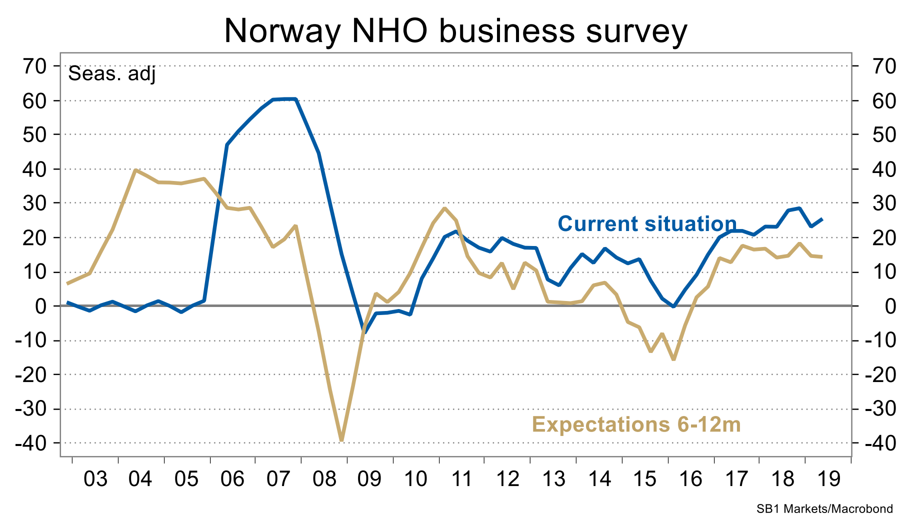

- The Homebuilders reported **new home sales** at an annual rate of 25' in May (seas. adj.), down 2' from April. The 6m average has fallen to 27', edging down the past 4 months
- **Housing starts** climbed to 27' but are no doubt trending down, according to the Homebuilders. There may be an inventory overhang from the previous two years' 'overbuilding'. If so, there is still a way to go before starts should pick up due to stronger sales
  - » SSB reports building permits at a 34' level, and the gap to the homebuilders' report is substantial (8' measured 6 m smoothed, vs avg at 2').
- We still assume that housing starts and investments are slowly recovering but recent data indicate that starts may be stalling. Limited upside, given meagre house price growth! Businesses in NoBa's Network are reporting saturated demand in most of Norway

# NHO business survey still upbeat, signals well above 3% GDP growth

## NHO economic outlook indicator slightly down in Q1, stable the past year




- The NHO (Confederation of Norwegian Enterprise) Q1 survey is pointing to some 3.5% GDP growth, we assume too optimistic, even as the survey is usually quite well correlated to GDP growth
- NHO is in the mid-range of surveys, in line with Norges Bank's Q4 Regional Network (Q1 released this week!)

Highlights

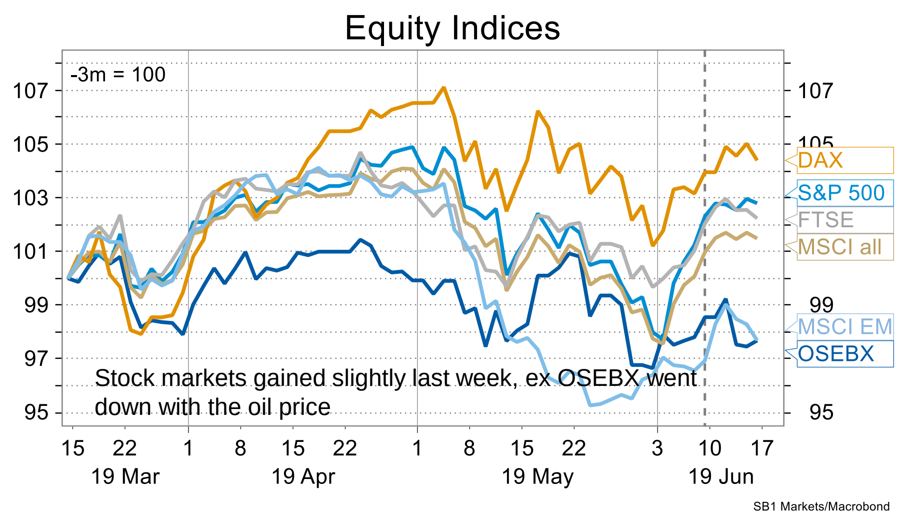
The world around us

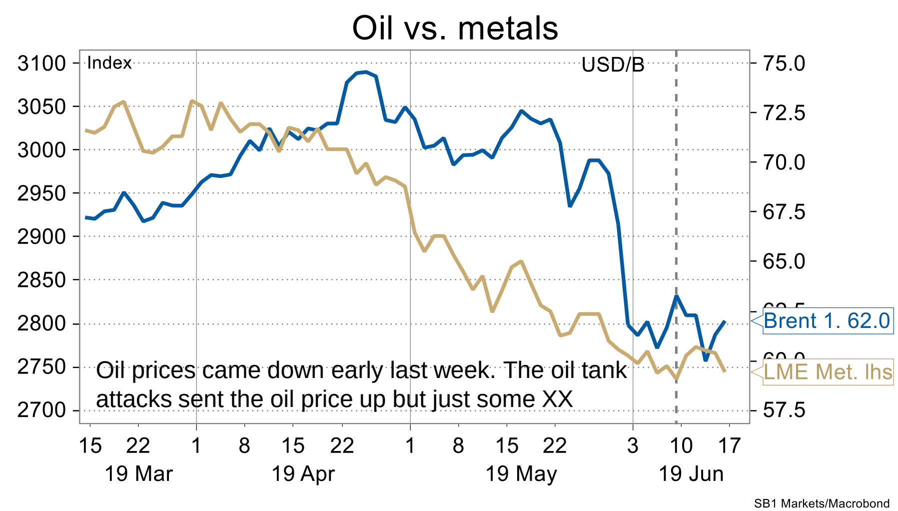
The Norwegian economy

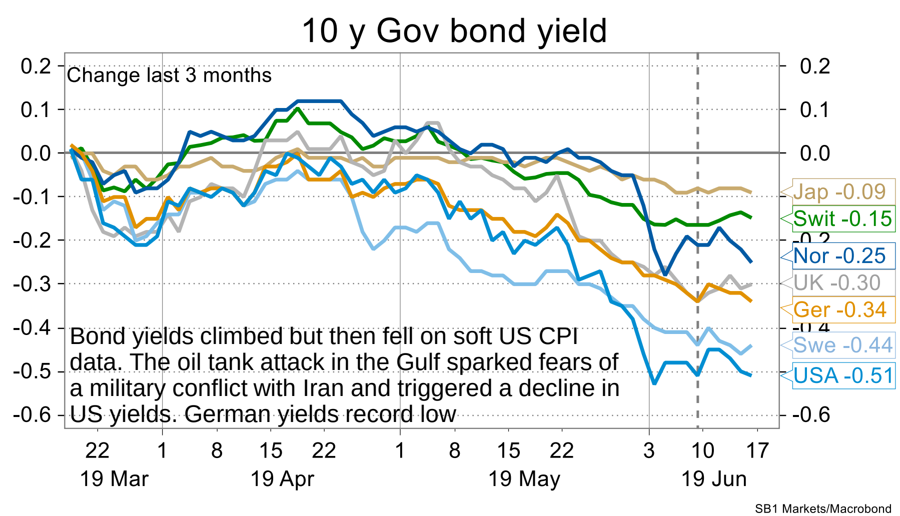
Market charts & comments

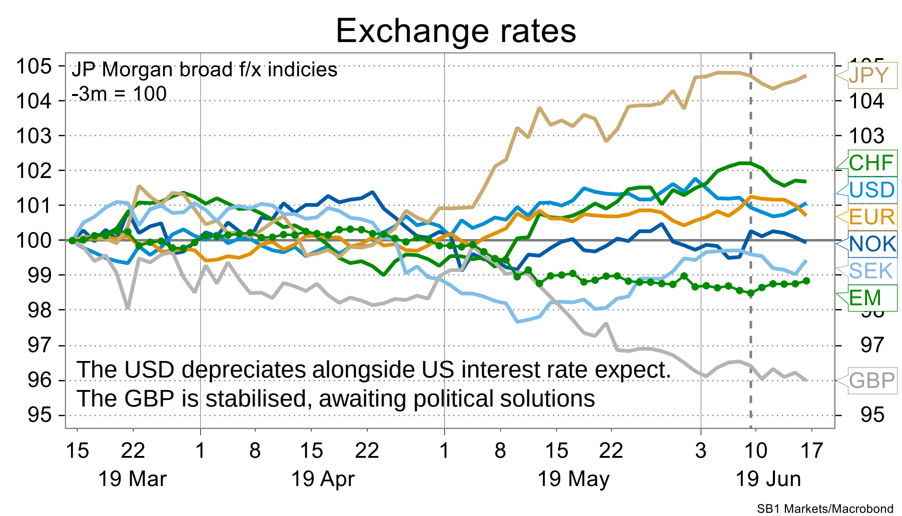
# Stock markets shrug off trade/growth fear, bond yields stabilised, for now

Bond yields climbed but then fell on geopolitical risk, triggered by oil tanker attack. OSEBX down w/oil price



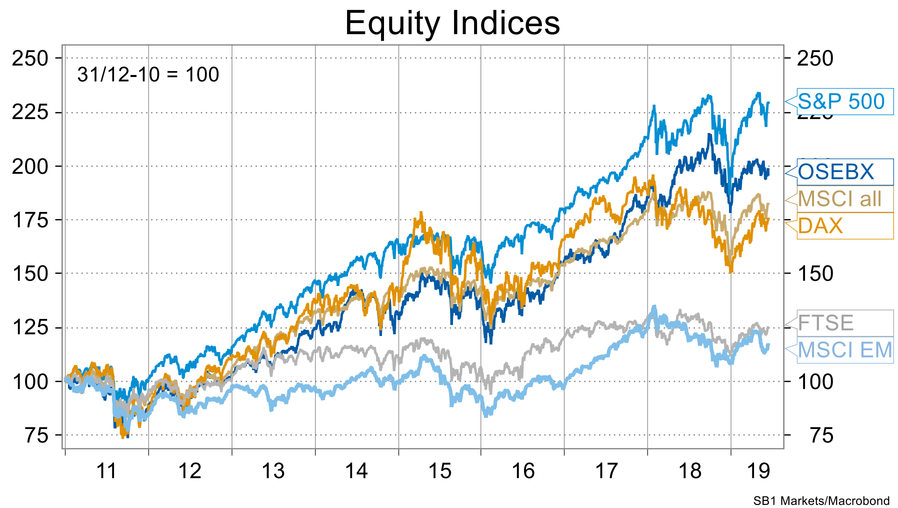



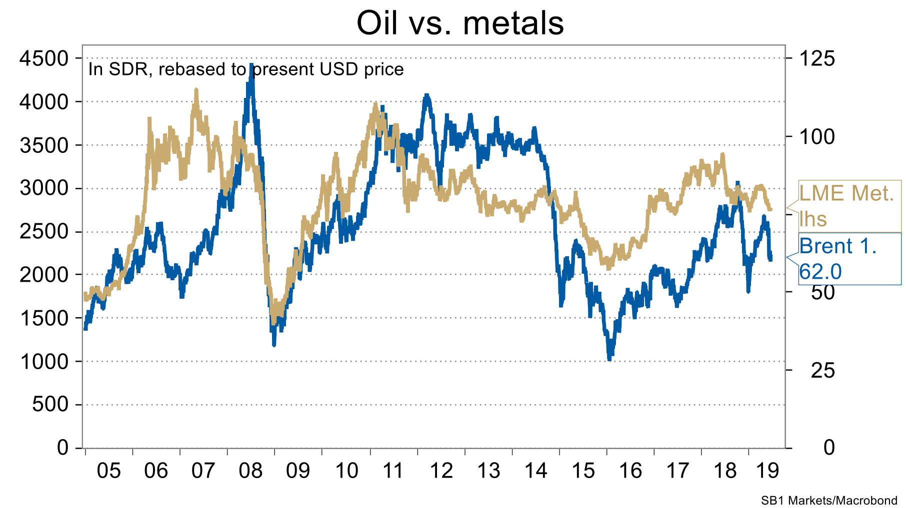



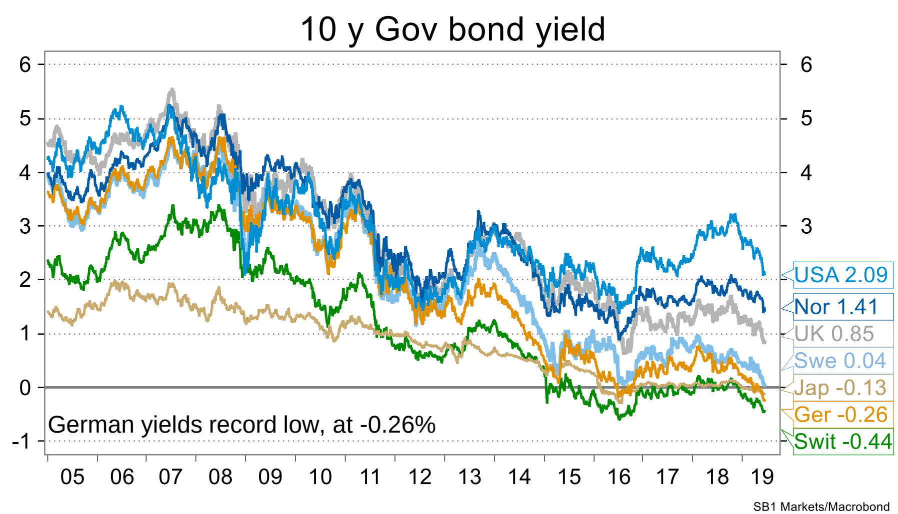



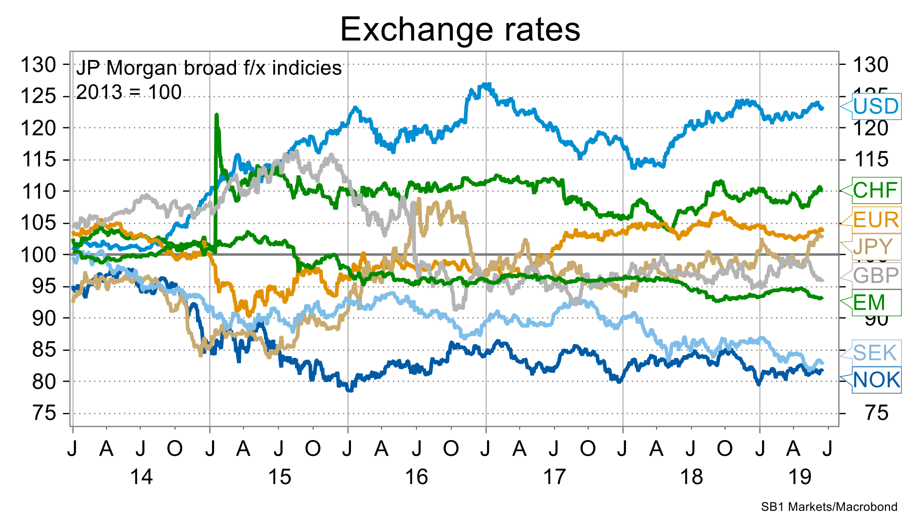
# The trade war may trigger a stock market crash. Or the economy..

Economic data are now extremely important, risk markets are vulnerable. The trade war is key



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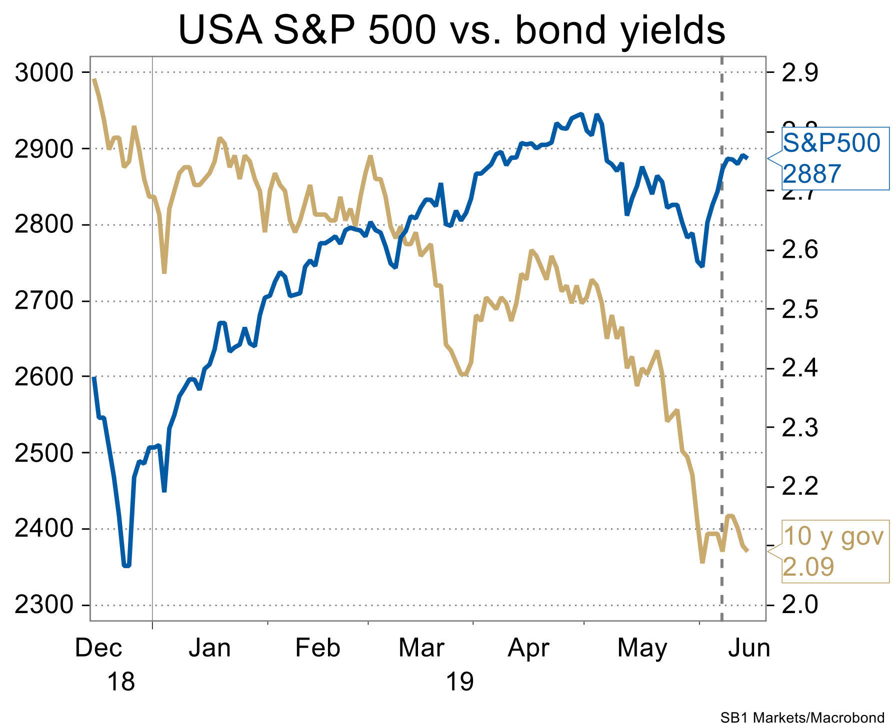
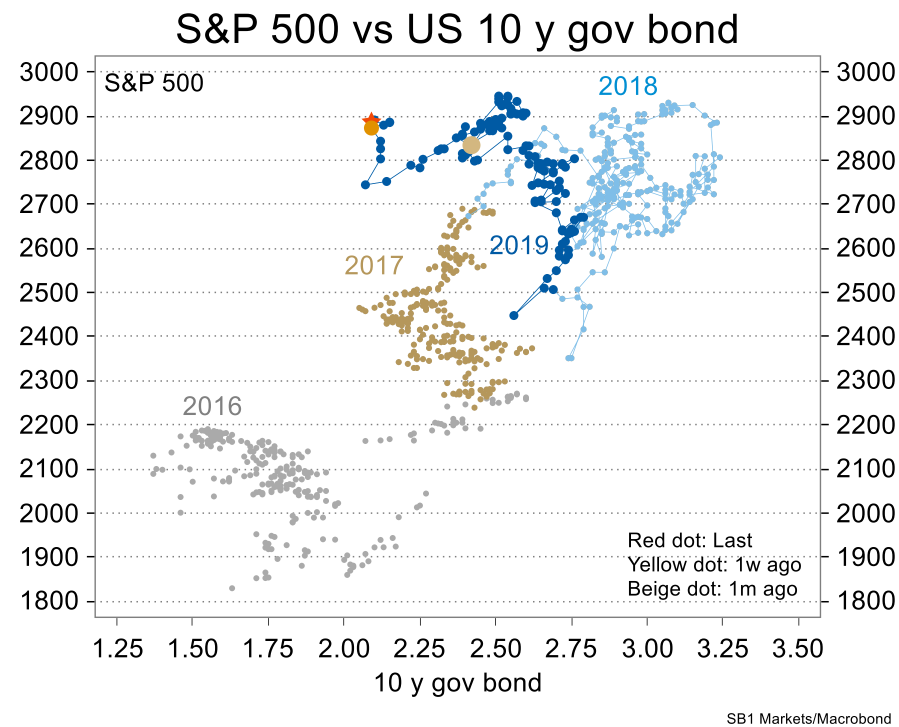
# Stock market rebounds, bond yields down on inflation and geopolitical risk

Bond yields have been stable since early June while the stock market is recovering



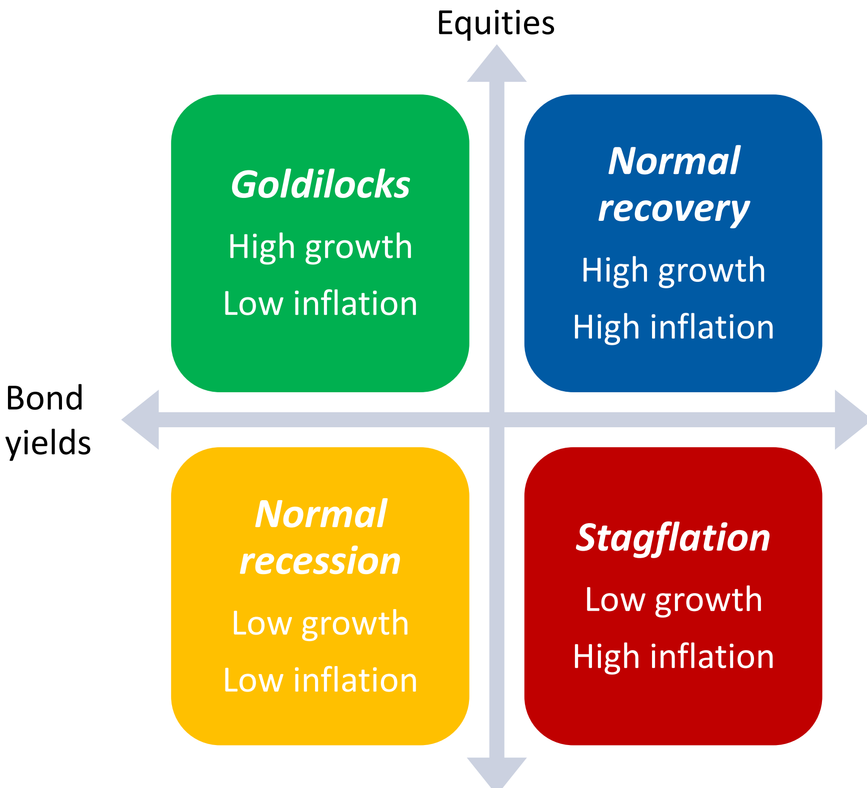



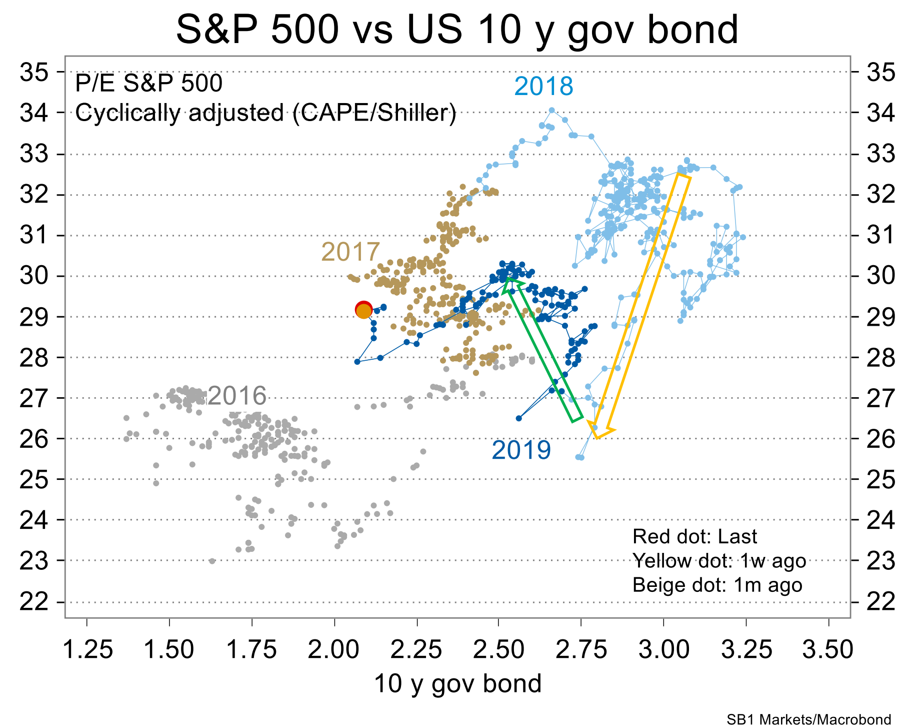

- S&P has recovered more than 5% since the local bottom on June 3rd, reversing some ¾ of the May downturn. The rebound was triggered by Fed opening the door for an interest rate cut this year. Easing trade war concerns, supported by the US Mexico deal boosted investors risk appetite
- Bond yields have recovered much less than the stock market, the 10 y gov is up just 2 bps from the local through. Yields followed the stock market up last Monday. A softer than expected US CPI inflation report sent yields down (through inflation expectations), supported by the geopolitical risks on Thursday, after the oil tanker attack in the Gulf
- For more on the relation between stocks and bonds, check next page

SpareBank 1 MARKETS

# Markets are moving rapidly towards the normal recession corner

## Last week: A step towards the 'Goldilocks' scenario

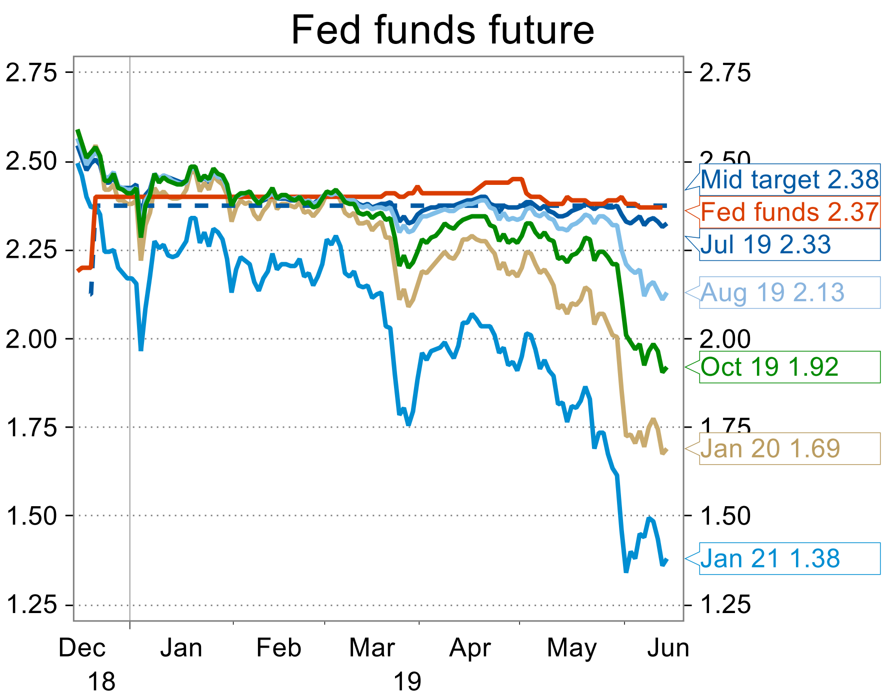


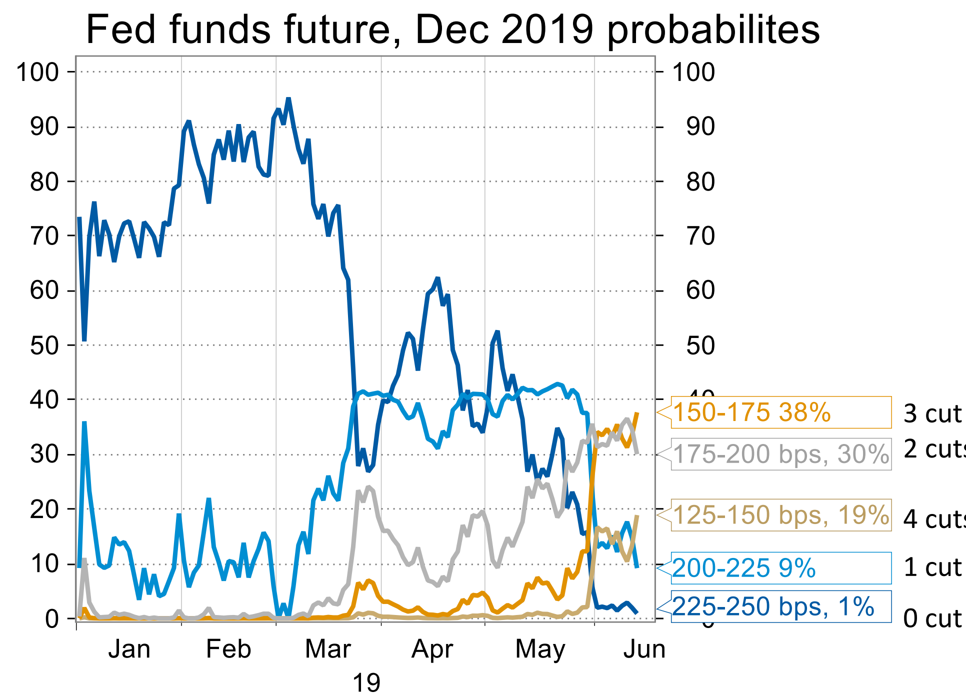

- Until two weeks ago, both stocks and bond yields fell sharply, towards the 'normal recession' corner. The past 2 weeks, stocks have increased while yields have been held down, thus, back to a 'Goldilocks' scenario, similar to the movements before the trade war escalated this spring (check the green arrow)
- We are not that worried for 'Stagflation', a take off in inflation will happen only if central banks make serious policy mistakes, over time. Trump want the Fed to do just that but we doubt he will succeed
- We stick to our 'normal' axis, driven by growth, and with inflation (or at least interest rates) over time following growth up or down. The risks of a slide in the recession direction has increased significantly past weeks, primarily due to trade war escalation

# Fed funds futures are pricing close to 60% prob. of at least 3 cuts this year

... the first in July. A cut at the Fed meeting this week is unlikely, some 20%. Just 1% for no '19 cut




SB1 Markets/Macrobond




SB1 Markets/Macrobond

- Soft signals from Powell & co lowered the curve two weeks ago. Last week, intensified geopolitical risk (due to the oil tanker attack) triggered another downward movement, even if retail sales altered the impression of the weak Q2. No cut is expected at the June meeting but a July cut is a 'done deal'
- The market now expects at least one cut in 2019 with a 99% probability; 9% for one cut, 30% for two cuts, and 38% for 3 cuts, 19% for 4 (and 3% for 5 cuts, not at the chart above), 25 bps per cut. The Aug FRA at 2.11 implies that the market is fully expecting a cut at the July meeting
- **At the June meeting, the Fed may well signal that it plans to cut the signal rate in H2 as a precautionary measure to fend off possible impacts from the trade war. However, even if employment growth has slowed, the economic situation down does not warrant any cut now**

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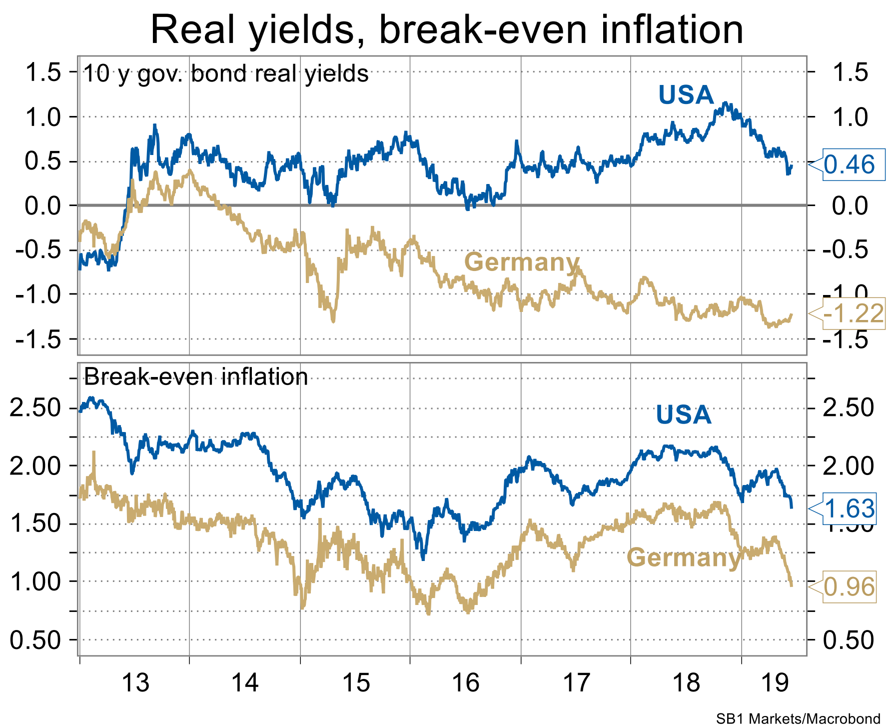
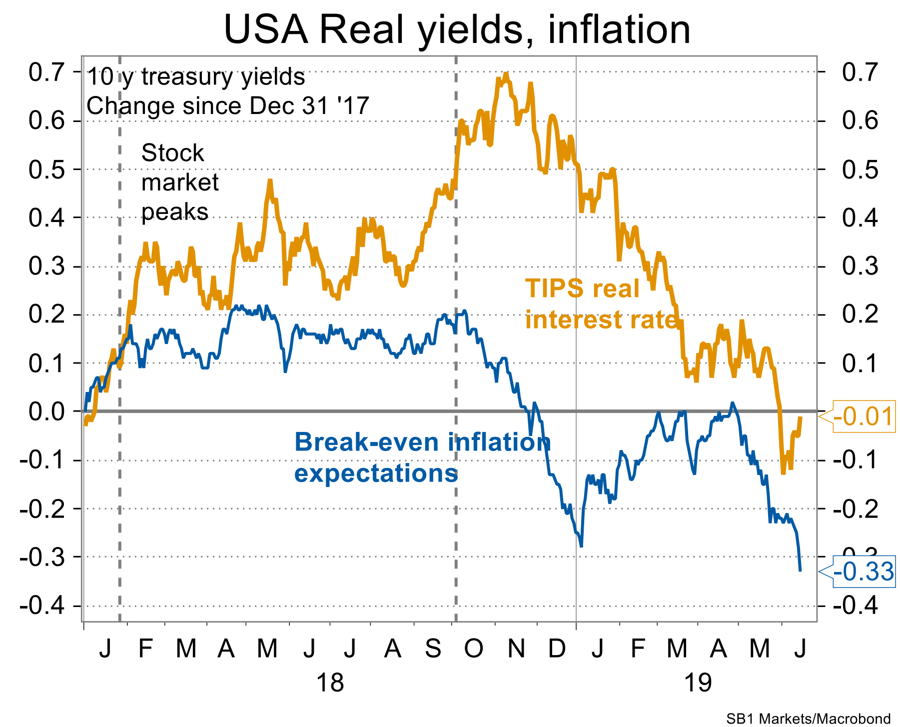
# And now it's inflation expectations that are collapsing

Infl. expectations down more than 30 bps in the US, even more in Germany, down to 0.96% there




- US inflation expectations have collapsed recent weeks – and fell 11 bp last week and has come down to 1.63%, well below Fed's inflation target at 2% (measured by the PCE deflator, usually some tenths below the CPI. Expected inflation the next 10 years has fallen more then 50 bps since last autumn, still very correlated with the spot oil price, check here
- The US 10 y real rate rose further last week, up 11 bps but the level is still low at 0.46%
- German real rates have climbed too, but are still low, -1.22%, per year the next 10 years… 10 y inflation expectations have fallen even more then in the US, and fell bellow 1% last week, far below the inflation target, of course. The nominal bond yields dropped to a record low -0.26% last week

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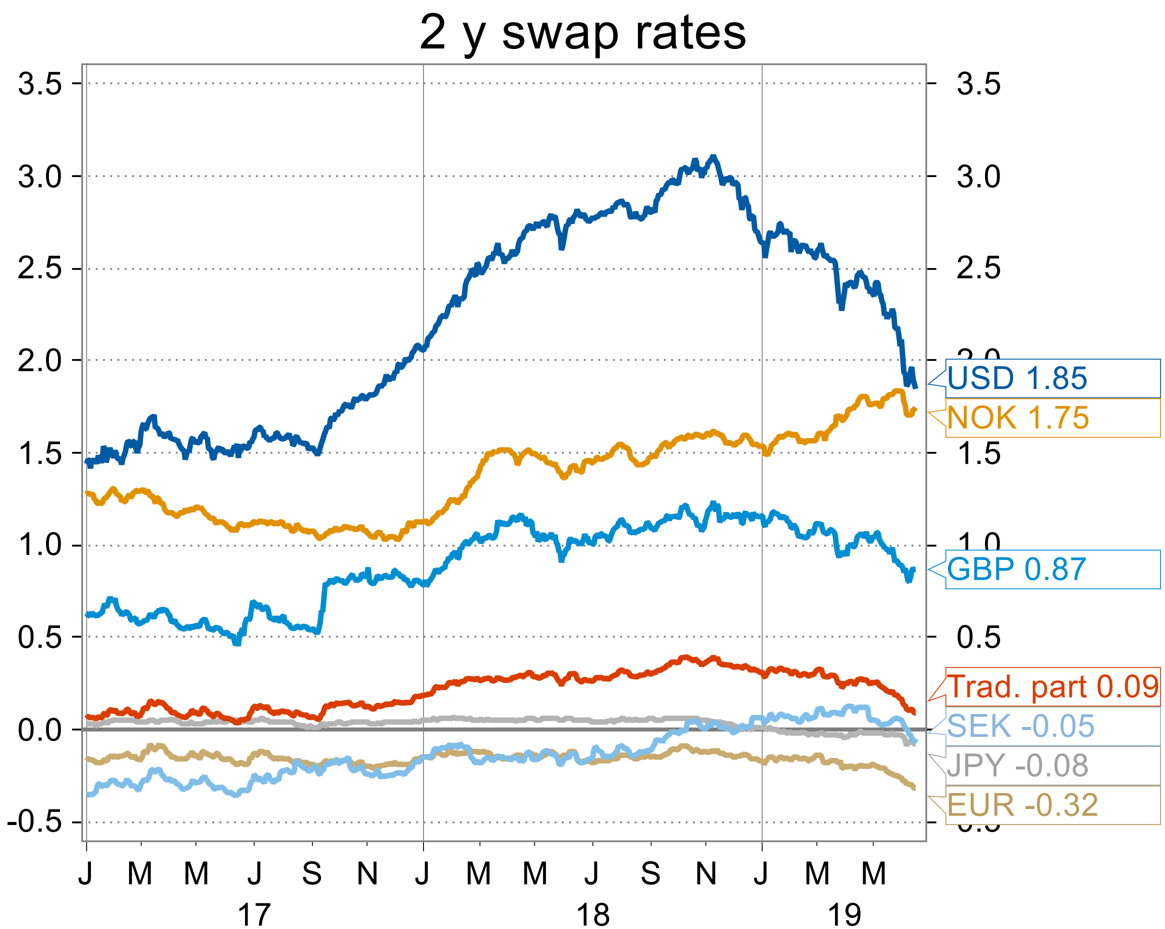
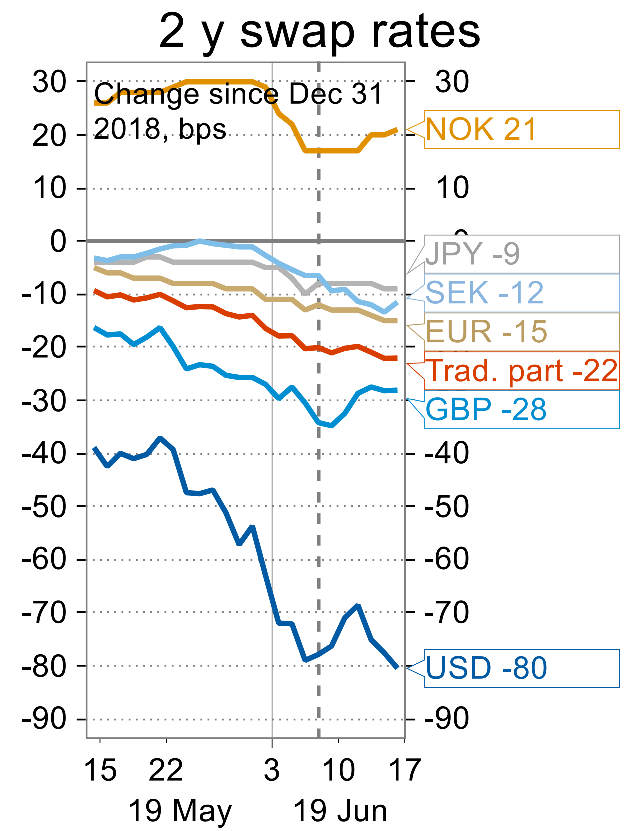
# Short term rates are plummeting all over, NOK rates have come down too

NOK rates have followed others down in June, without any weak domestic data – but rose last week




SB1 Markets/Macrobond




SB1 Markets/Macrobond

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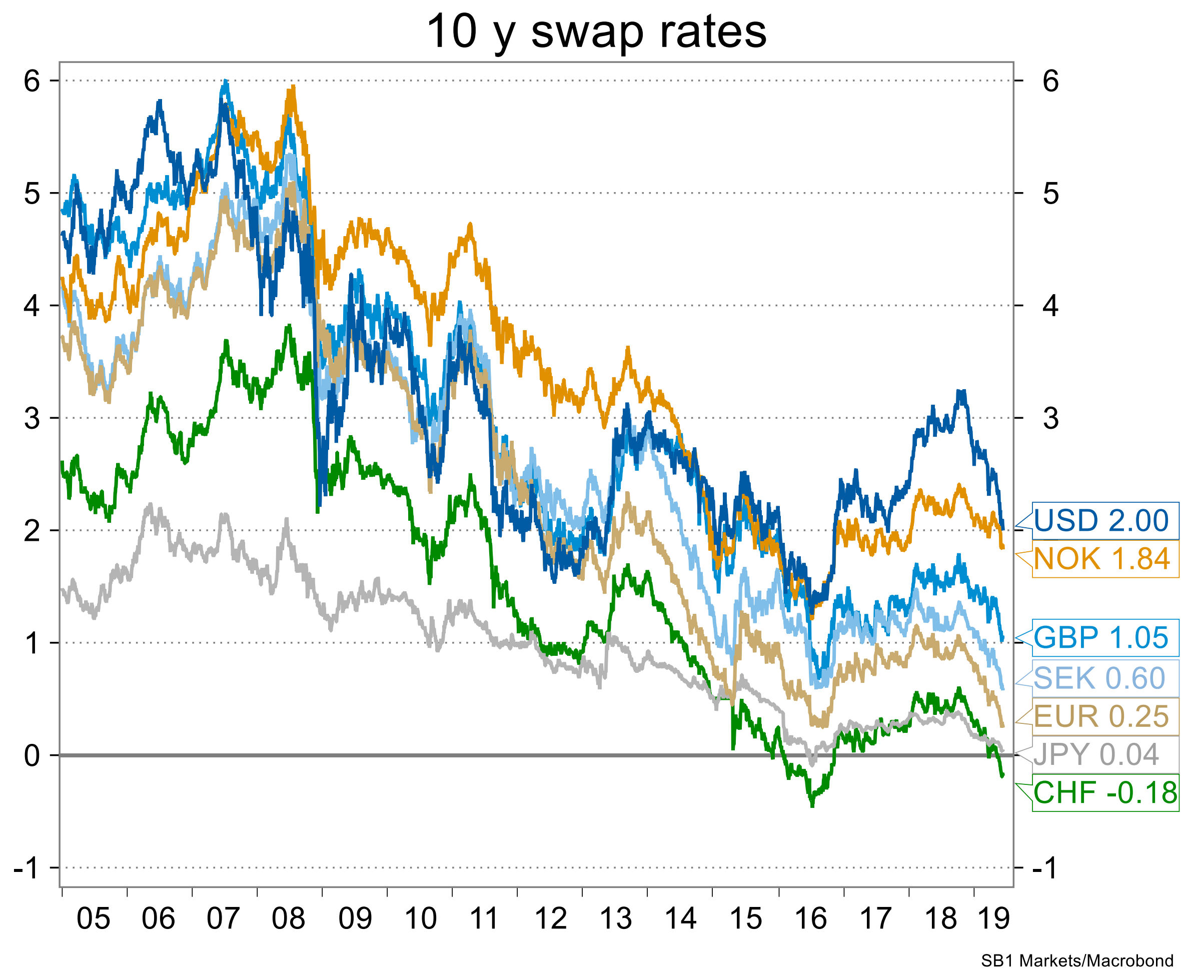
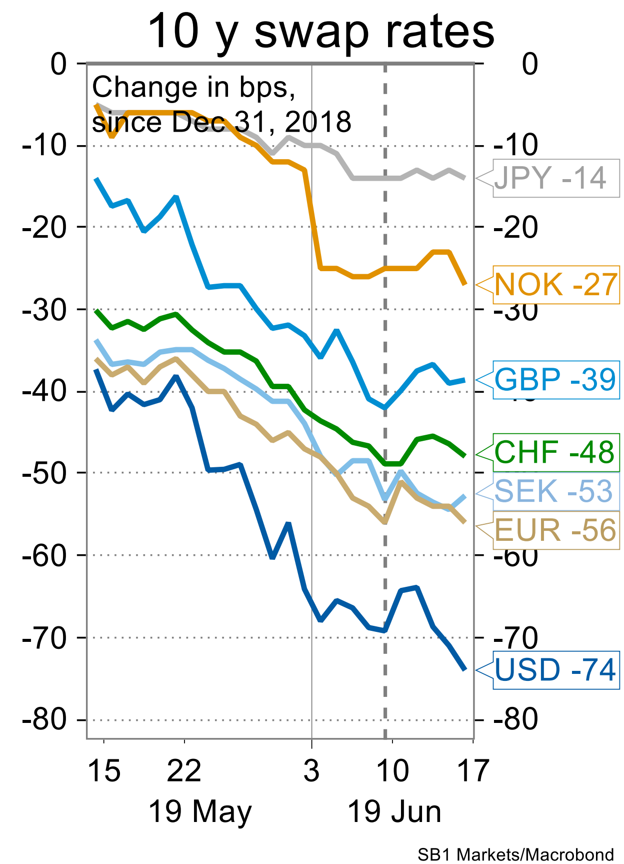
# Long term rates are falling all over, triggered by the trade wars

The fixed rate in Japan is declining the least, with the Norwegian rates



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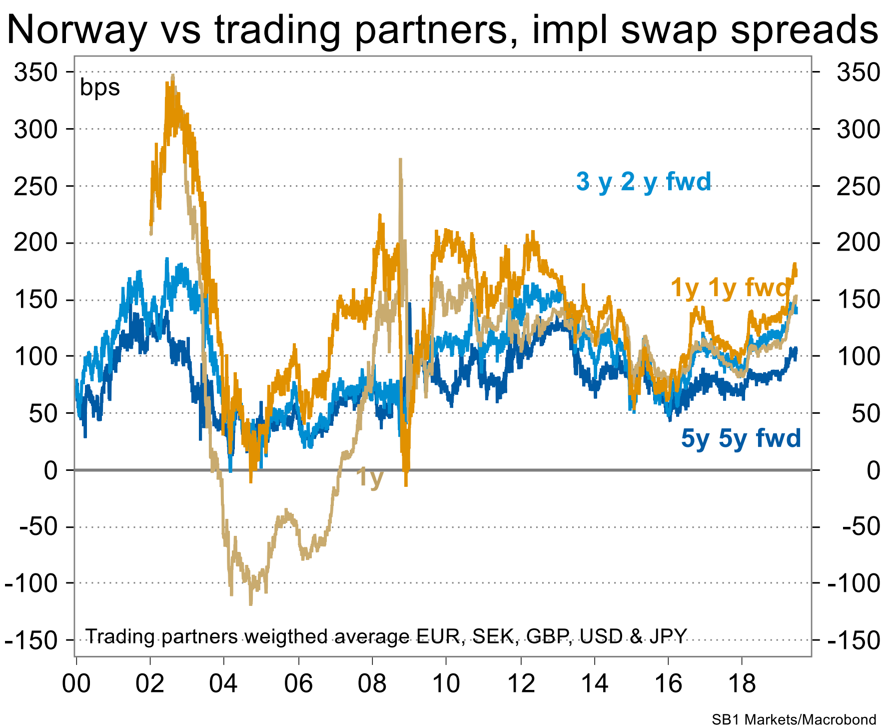
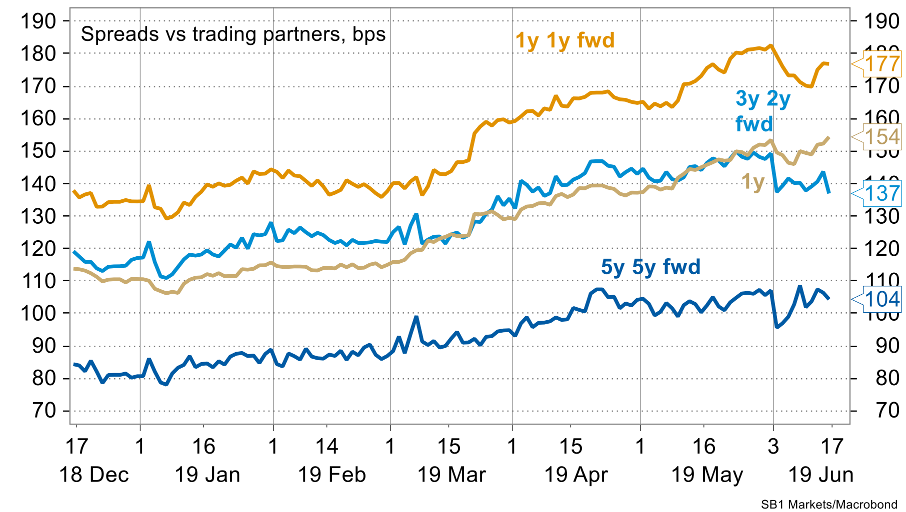
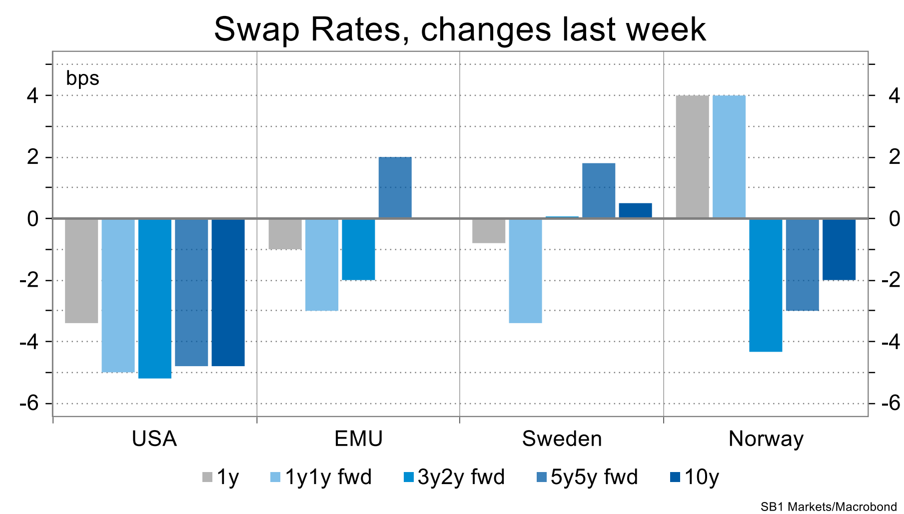
# Swap spreads vs our trading partners out again in the short end, strong Network

## Spreads have narrowed somewhat in June but rose last week on OK Norwegian data




- NOK short term spreads vs trading partners widened again last week following a visible narrowing, at least 1y 1 y fwd. A high spread is reasonable, given NoBa's stance, and solid Norwegian data.
- However, we have been surprised by the wide spread in the long end of the curve of the since March

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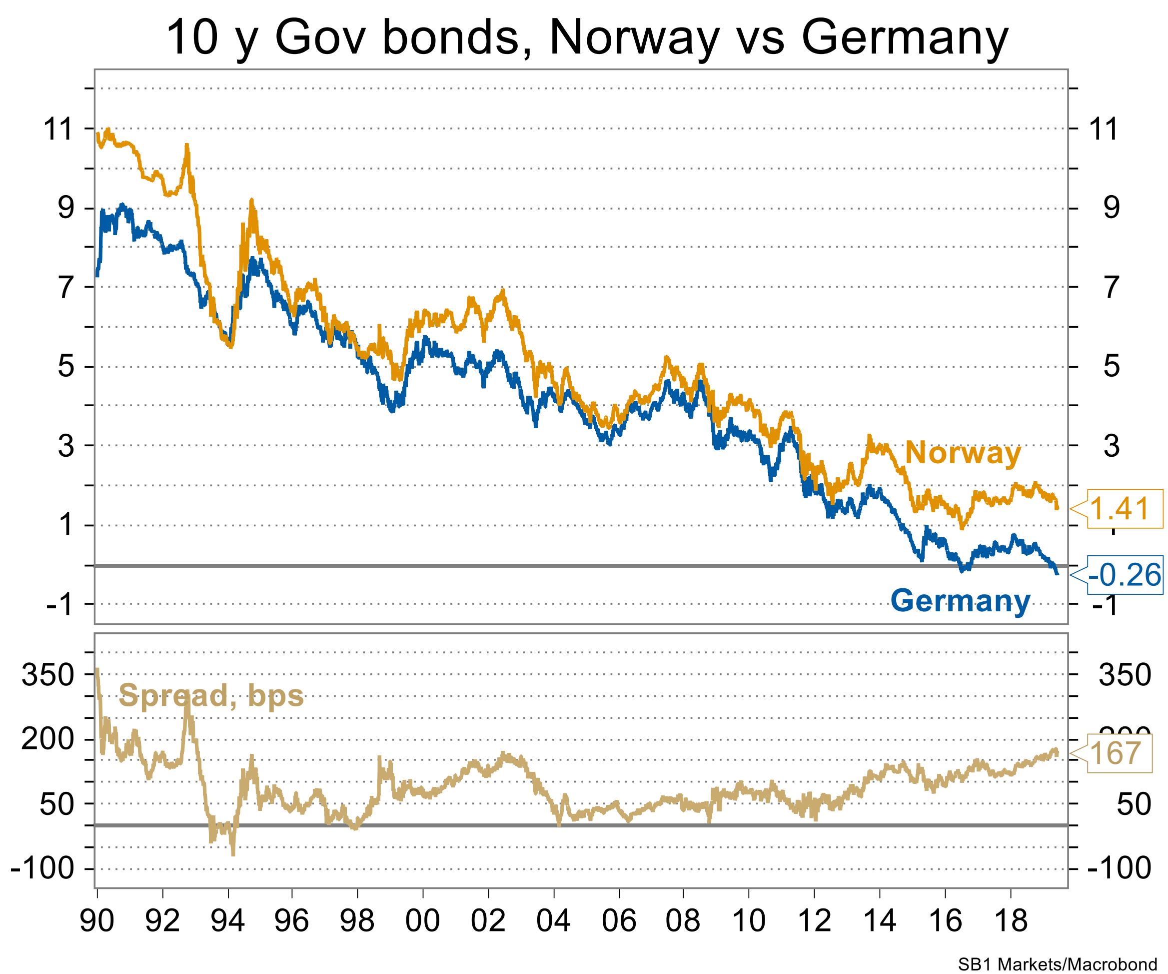
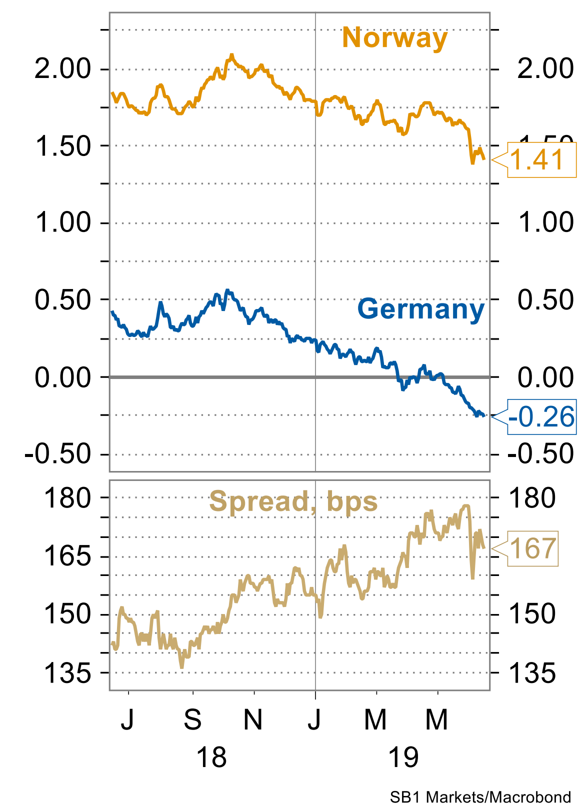
# German Bund down to -0.26% at Friday, the lowest ever

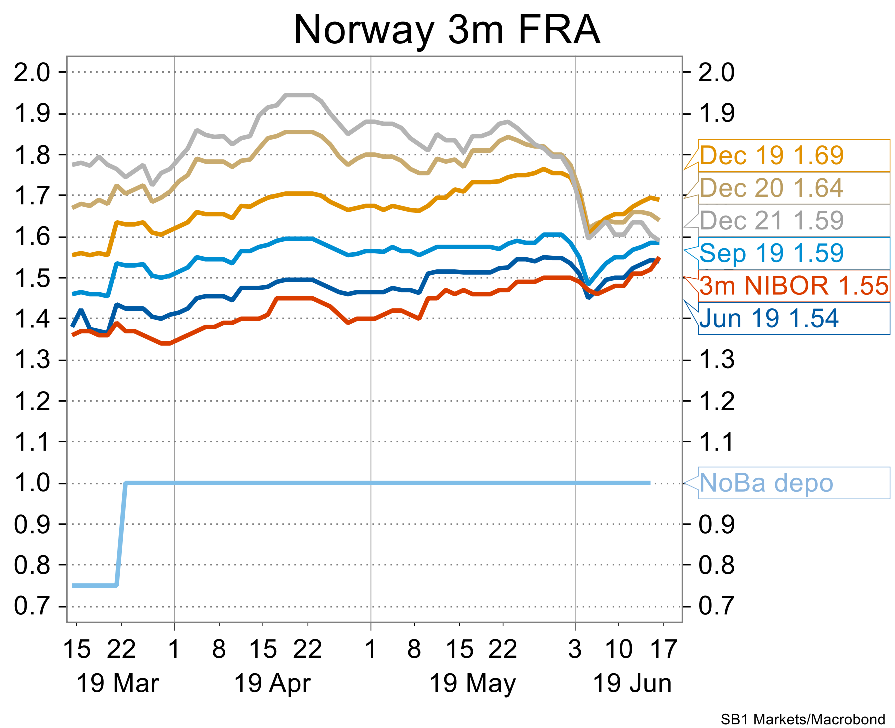
The 10 y gov spread at 167 bp is far too rich, long term

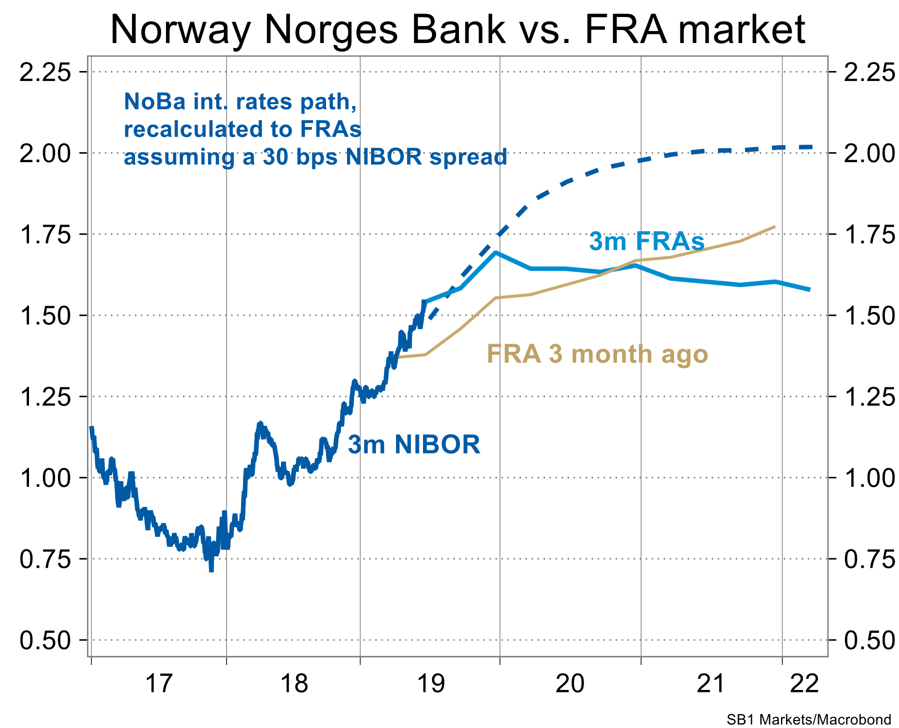


# This week's hike is now accepted, just some 50% probability for a Dec hike

## The near term NOK FRAs rose last week but the far end was stable, and the curve is tilting down




- The 3 m NIBOR rate climbed to 1.55%, the highest in 4 ½ years
- NOK FRAs rose last week, and the June contract is back to the peak level late May – a hike is now fully priced in, if we are right that the NIBOR-deposit spread is 30 bps
- The Sept contract is almost back to the peak level – while the further out FRAs are well below earlier peak, of course influenced by the steep decline in rate expectations abroad recent weeks. A Dec hike was given a 80%+ probability 3 weeks ago, now its approx 50%. The FRA curve is inverted from Dec 19 onwards, as the longer dated FRAs have fallen by up to more than 30 bps

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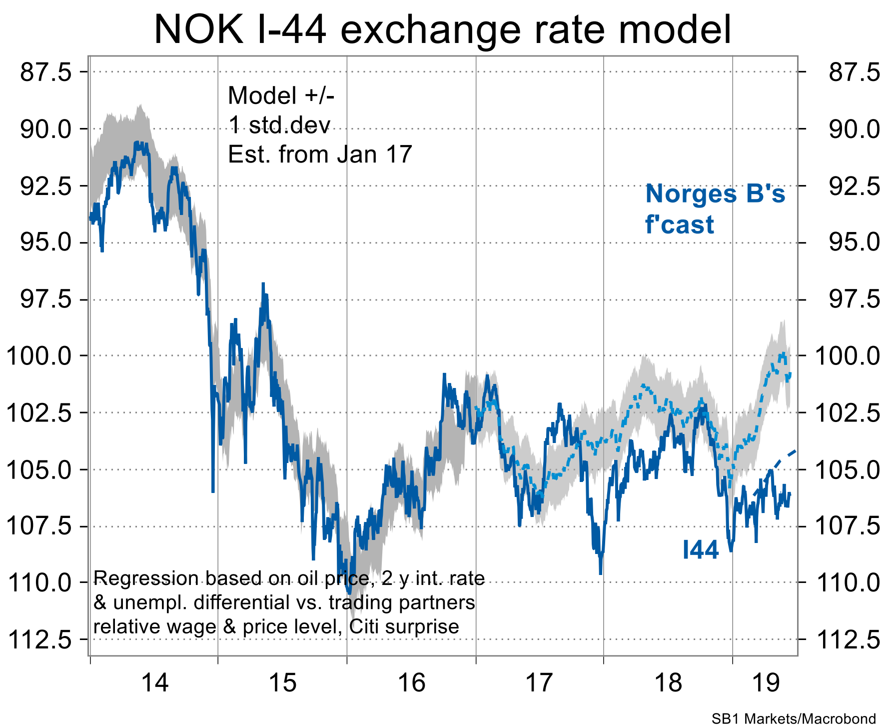
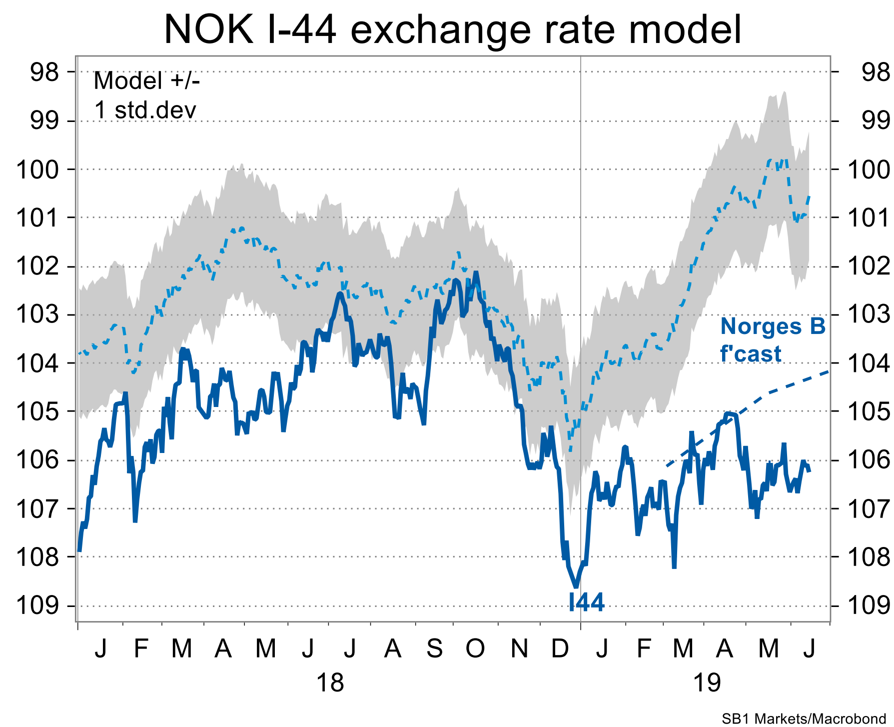
# NOK stabilized, has narrowed the gap to our market model slightly

NOK held steady last week and the gap vs the model decreased to 4.9%. Still far too wide, of course




- Our model estimate has fallen sharply since late May, due to a lower oil price. The NOK depreciated somewhat less than indicated by the model but is still more than 5% below the model f'cast (the main drivers are the oil price and the 2 interest rate swap spread), the second highest deviation since 2010. What explains the weakness?
  - » No really weak Norwegian macro data, on the contrary, most data have been upbeat
  - » Risk aversion? Perhaps, yet EM currencies have not collapsed (even as many depreciated when the trade war escalated)
  - » Weakness in other supercycle currencies may be an explanation. NOK followed the SEK down after a dovish Riksbank. The AUD has fallen, due to RBA's rate cut. The CAD fall last week too but less than the AUD, following an appreciation the previous week
- We do not have any other recommendation than **Buy NOK**

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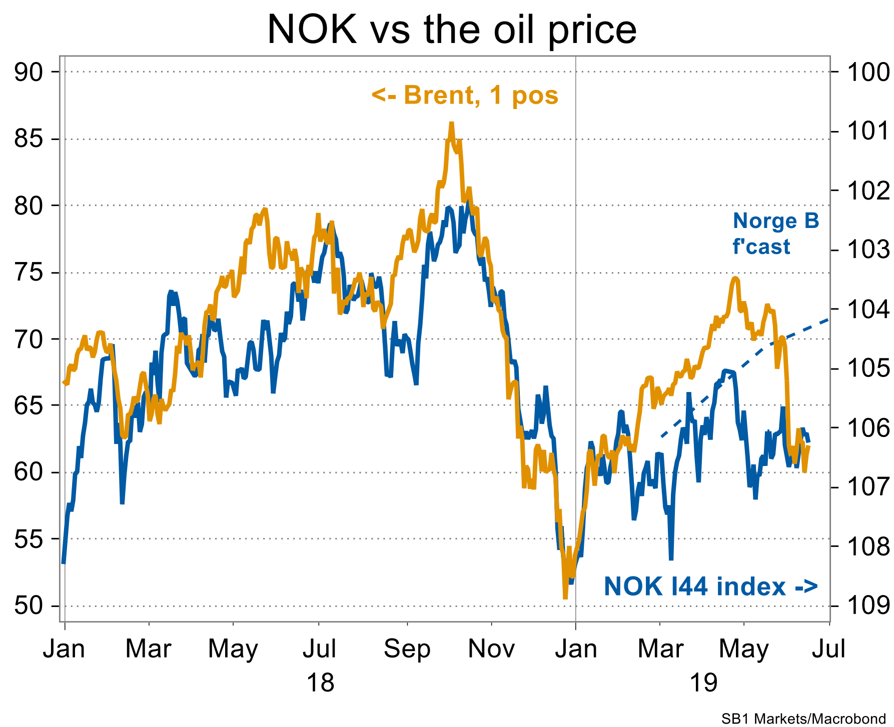
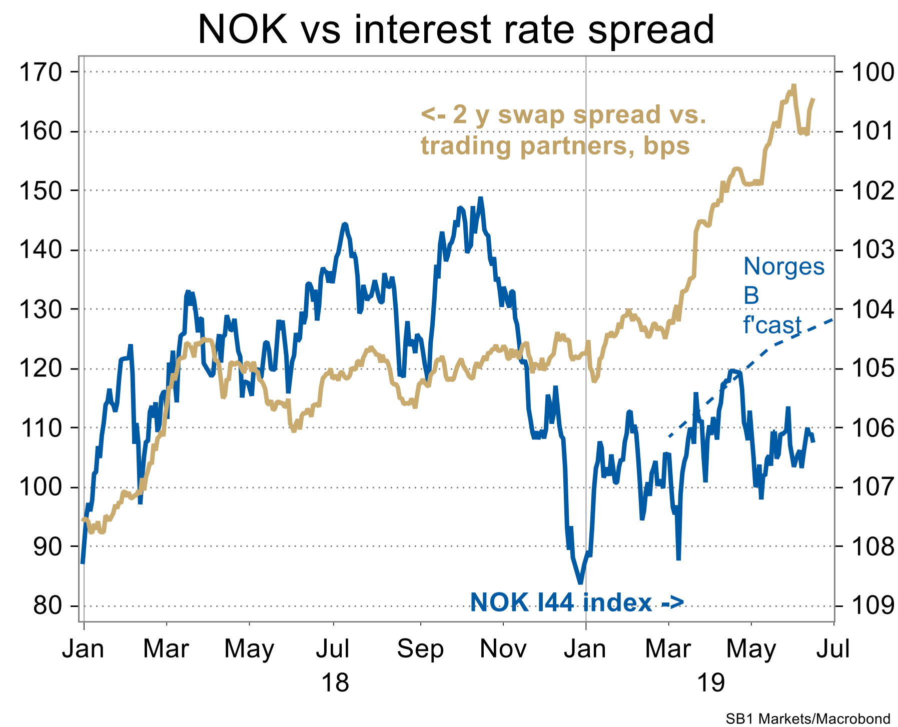
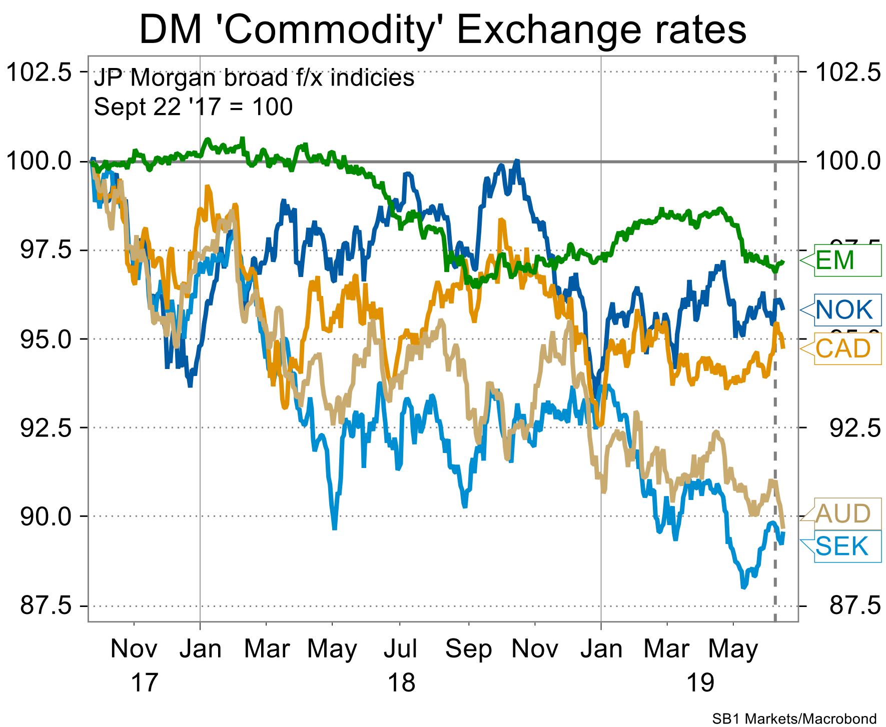
# NOK fell 'less' than the oil price, as the interest rate spreads shrank

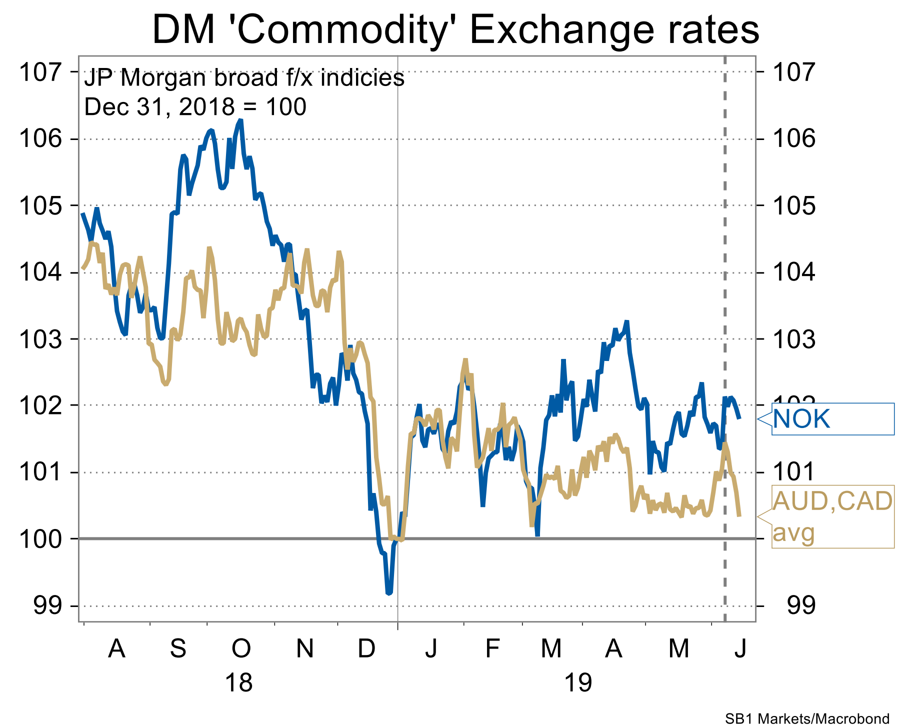


# NOK saved by the super cycle friends recently?

SEK, AUD and CAD recovered somewhat, may have supported the NOK when the oil price dropped




- NOK is more closely correlated to AUD, than to CAD and SEK, over time. Weak 'super cycle' currencies are perhaps the best explanation for the large deviation between the NOK and its fundamental drivers the past year
  - » Global risk appetite can often but not regularly explain the trajectory of these 'commodity' currencies. Some housing market trouble, debt concerns as well??

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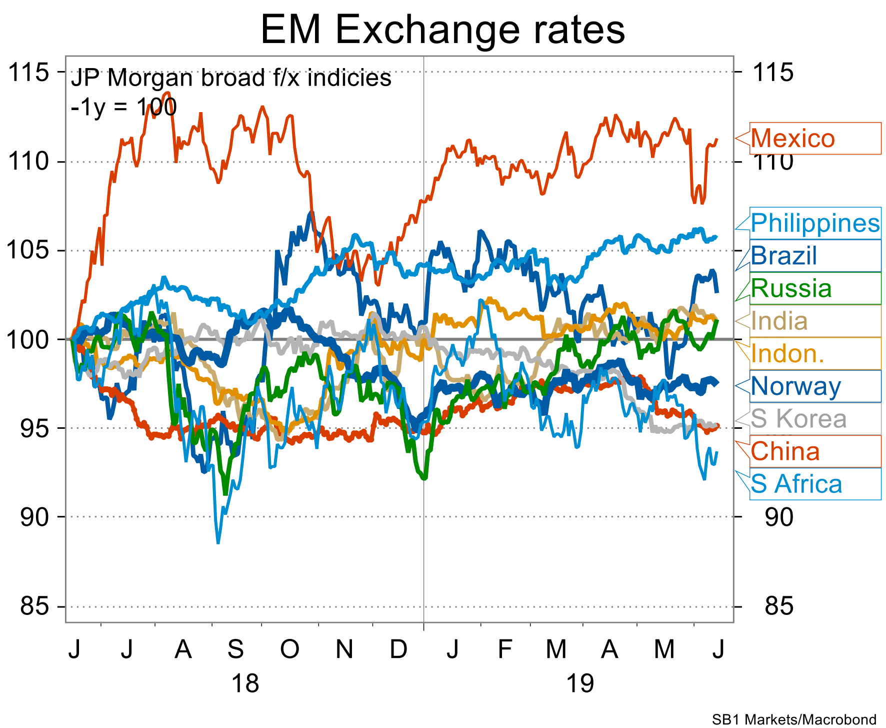
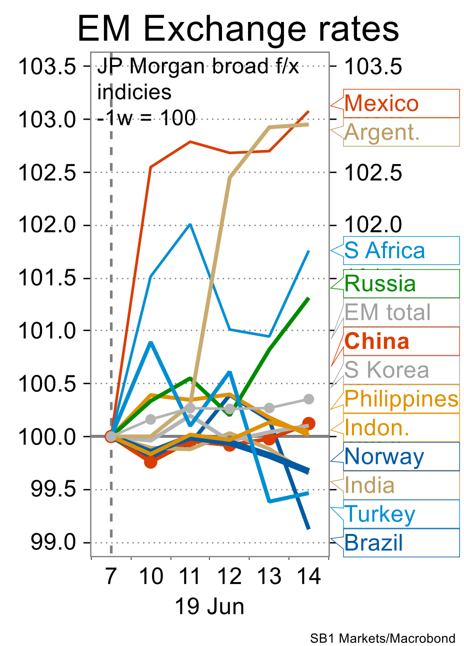
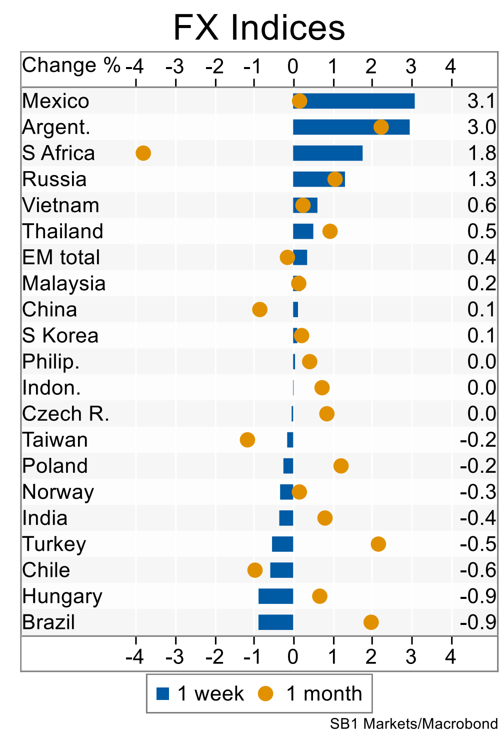
# EM f/x mostly up as US let Mexico ‘go free’ of new tariffs

## Even the CNY ended marginally up, trade weighted




- The Mexican peso depreciated after Trump’s surprising tariff threat – and bounced back up the deal between US and Mexico was reached
- The Brazilian real has been volatile recently, sharply up recent weeks
- The South African rand is tumbling amid weak macro data and a political squabble between the Central Bank and the ANC, bringing the banks independence into question. A small relief last week

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