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Macro Research

Summer update

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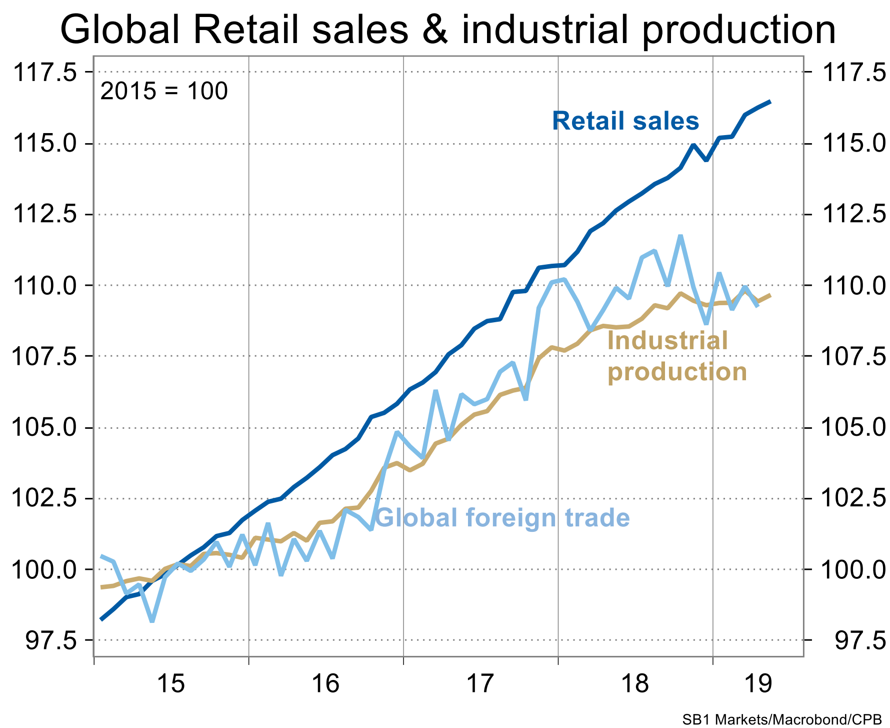
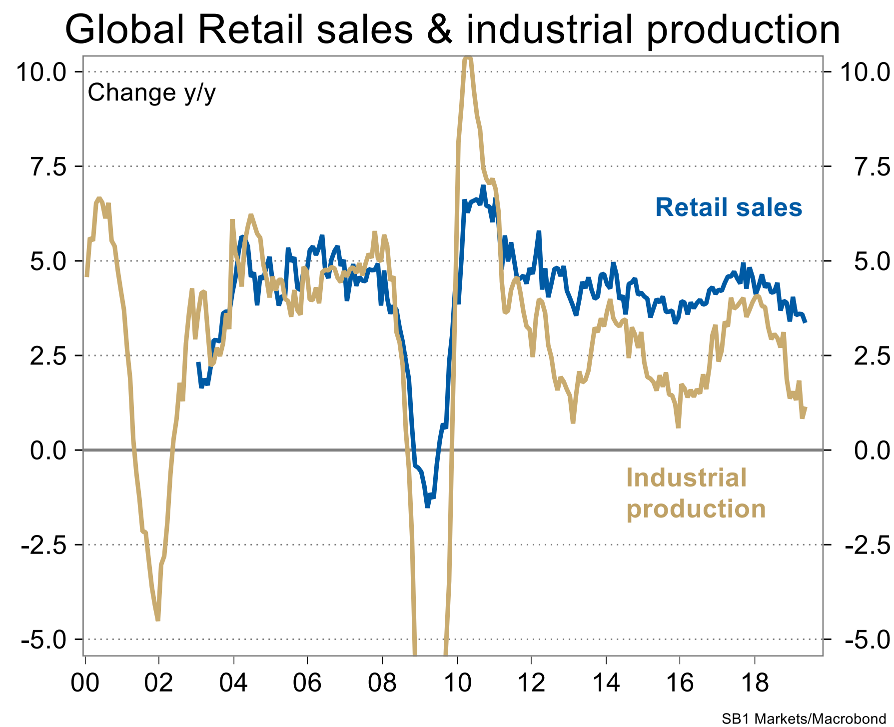
Last week – the main takes

- **Trade:** They are talking (by phone). Trump says he is not in any hurry
- **Global auto sales** rose in June, due to higher Chinese sales ahead of tighter emission rules. EMU sales are finally back to a normal level, US sales ok in May/June. Except for Brazil, most other EMs are reporting slower sales, among them India, Russia, South Korea, and Mexico
- **Chinese June & Q2 data** were in line with or above expectations. Still, GDP grew at the lowest level 'ever' in Q2, at 6.2%, due to a further but gradual decline in growth in investments. Industrial production was far better than expected, as was retail sales, albeit mostly due to the temporary lift in car sales
- **The Fed will cut in July.** Minutes from the FOMC June meeting and even more Powell's message to Congress made it clear that the Fed very likely will cut the signal rate in late July, even if the economy is in good shape now, and Fed's baseline scenario for growth is unchanged and satisfactory. However, risks are sharply tilted to the downside, due to uncertainty, uncertainty & even more uncertainty, mostly globally. So just as an insurance… **Actual core CPI inflation** rose to 2.1% in June, and inflow of **new jobless claims** was close to record low, while the fiscal budget is drifting out
- **EMU industrial production** rose more than expected in May but Q2 will anyway be weak, flat at the best
- **Swedish core inflation** is accelerating and was close to the 2% target in June
- **The Norwegian core CPI** was unchanged at 2.3% y/y in June, in line with market expectations but insignificantly 0.1 pp below Norges Bank's forecast. The core inflation rate has been above the 2% target the past 8 months but is now slowing slowly, and we expect . Headline CPI fell as we expected to 1.9%, from 2.5% in May (and 3.5% last December!) due to a rapid decline in electricity prices, and there is still somewhat more to come, at least measured by the annual CPI rate

Manuf. production & global trade have stalled, retail sales still growing (slower)

Manufacturing production weaker than previously estimated in April, foreign trade not shining either

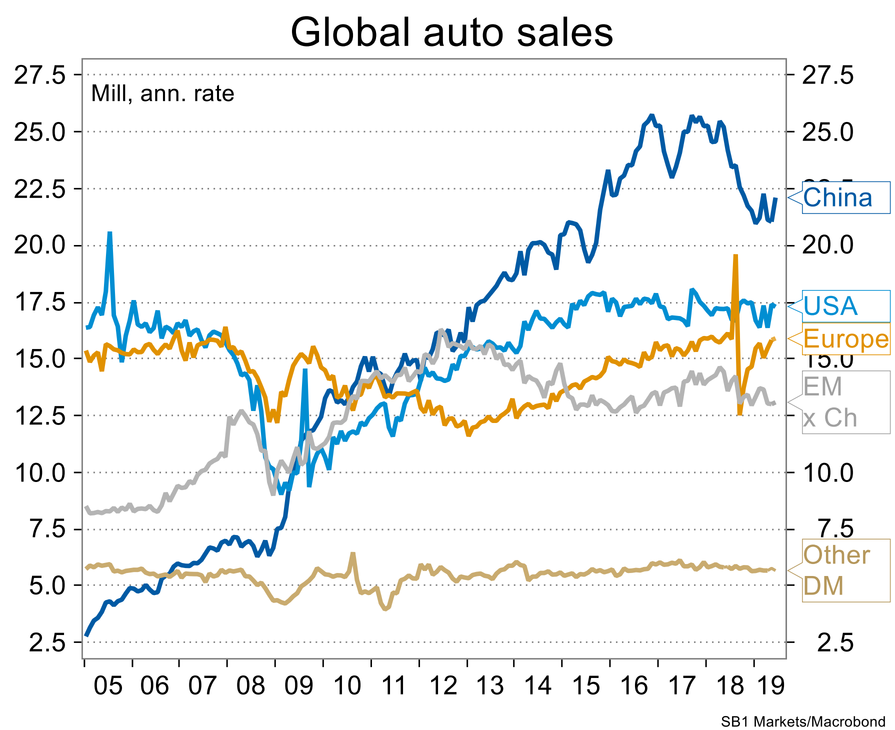


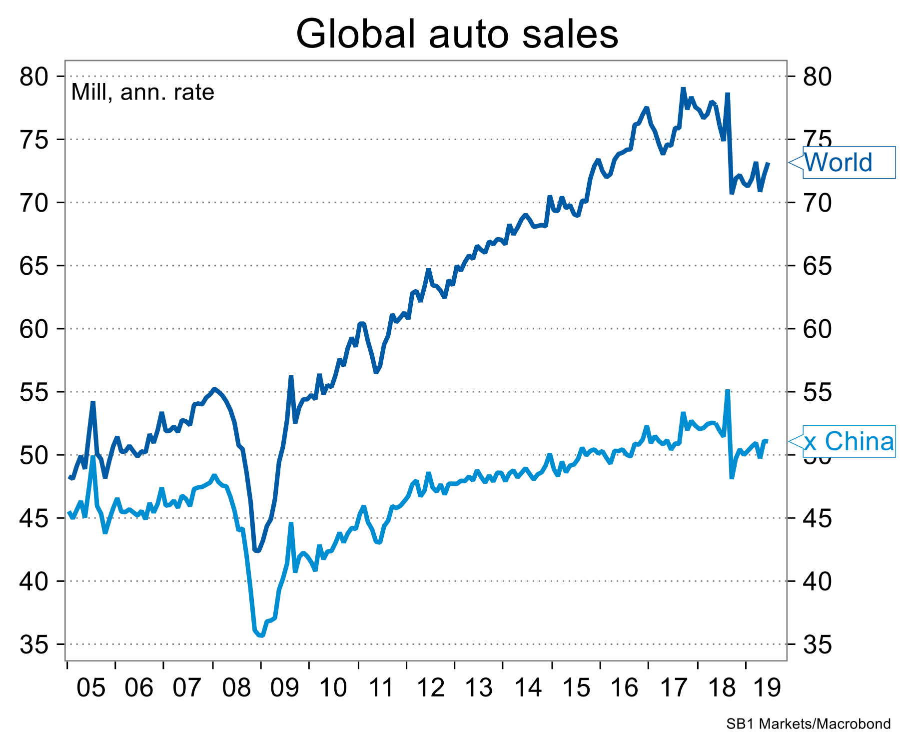


- Manufacturing production has been stagnating since last autumn. However, the slowdown has not accelerated recent months, although April came in on the weak side. The downturn the past 6 months are both due to somewhat slower growth in retail sales, a slowdown in business investments (triggered by global uncertainties?) and probably destocking following an unwarranted inventory build-up during 2018
- Global retail sales increased in April and is still trending up, at a somewhat slower pace than one year ago
- Global trade volumes fell in April and have stabilised the past 4 months, after retreating in late 2018

Sales up June - due to inventory clearance before new Chinese emission rules

Chinese sales rose 5% m/m, as retailers had to slash prices to clear the inventory of 'old' vehicles





- Global auto sales grew 1% m/m in June, as in May but sales are still down 4% y/y. Sales x China were flat m/m – and they are down less than 2% y/y
- From July, the authorities in many Chinese cities have introduced tighter emission standards and retailer – and probably some factories - had to clear the inventory of old models by giving huge discounts. Measured at the retail level sales rose 20% y/y in nominal terms. Sales will very likely fall back in July. Even so, there are signs of a stabilisation of Chinese auto sales recent months, following an unprecedented 20% decline since last spring
- US sales were stable at a 'high' level in June but the trend is most likely slowly down
- Sales EMU rose further in May, and sales are now at the same level or marginally higher the before the emissions rule turbulence
- Auto sales in EM ex. China is heading down again; mostly due to lower sales in India, Argentina and Turkey – and Indonesia and Mexico

GDP slows y/y but that's the only soft spot? Well, it's a bit more complicated

June and 2Q data were better than expected, even if the annual growth rate is the lowest 'ever'

The most important message: We still no not find indications of a steep slowdown in China amid the escalating trade war

- **GDP** growth y/y fell 0.2 pp to 6.2% in Q2, as expected, and the growth rate is trending downwards. However, the quarterly growth rate accelerated to 6.6% from 5.7% in Q1, better than expected. Investment growth is slowing but not faster than before. Net trade supports growth. Growth is gradually slowing, even if both fiscal and credit policies have turned expansionary
- **Industrial production** accelerated to 6.3% from 5.0% y/y, according to the useless, volatile, official data, far better than expected. Production rose by 0.7% m/m, up from 0.4% the two months. Underlying growth is close to 7%. Surveys do not signal any slowdown from the 6% level
- **Retail sales** growth shot up to 9.7% from 8.6% (expected down), and sales rose 0.9% m/m. The jump is mostly due to higher auto sales ahead of new emission rules from July (inventory of 'old' cars had to be cleared). Underlying volume growth is some 6%, or somewhat lower
- **Investment** growth was steady at 5.4% y/y in June. The official YTD rate rose 0.2 pp to 5.8%, better than exp. Nat. accounts are reporting a steady slowdown in investments
- **Credit growth** picked up in June too, due to higher growth in the shadow banking market, while , after slowing in Q1. Growth has more or less flattened out, at some 11% y/y
- Both **exports and imports** close to flat m/m in June. Exports are not far below ATH, even if exports to the US are down more than 10%. Imports have fallen more, but volumes are close to flat y/y in Q2. We have seen it far worse

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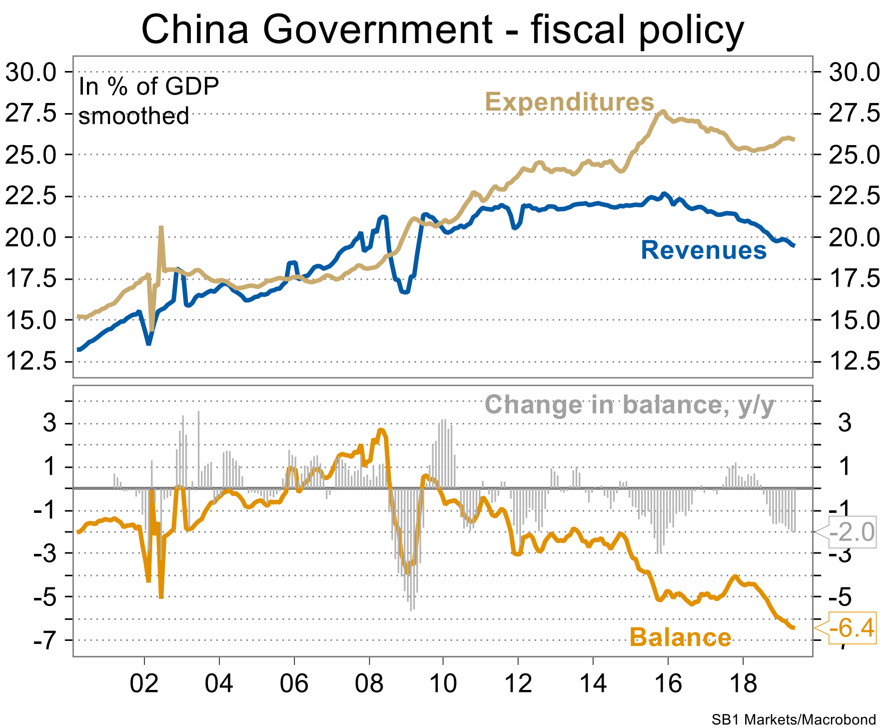
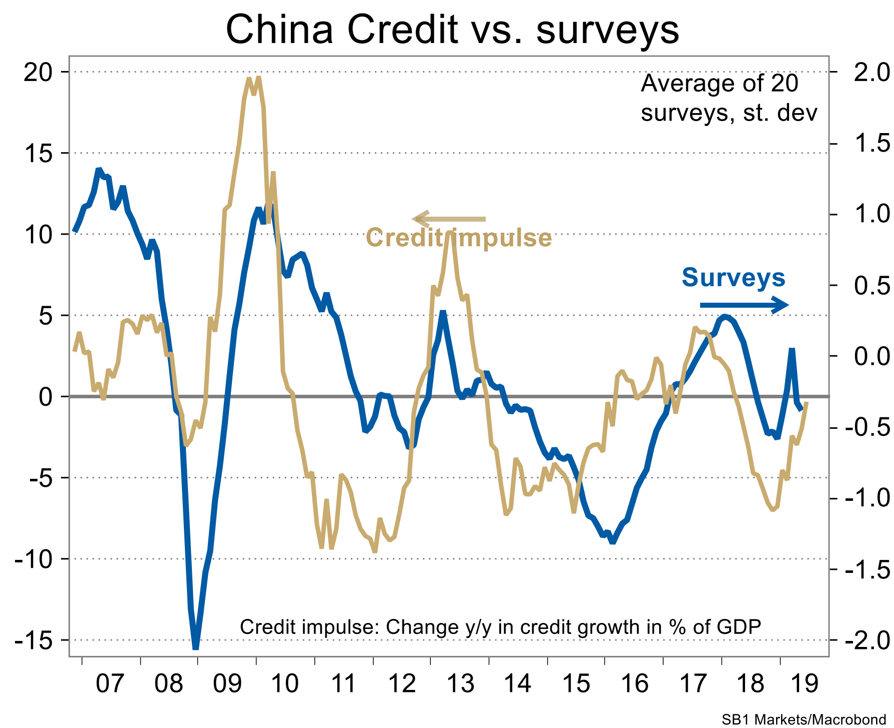
Growth is gradually slowing even if policies tries to stimulate

Record high budget at 6.4% of GDP, +2 pp last year! In addition: A credit policy turnaround

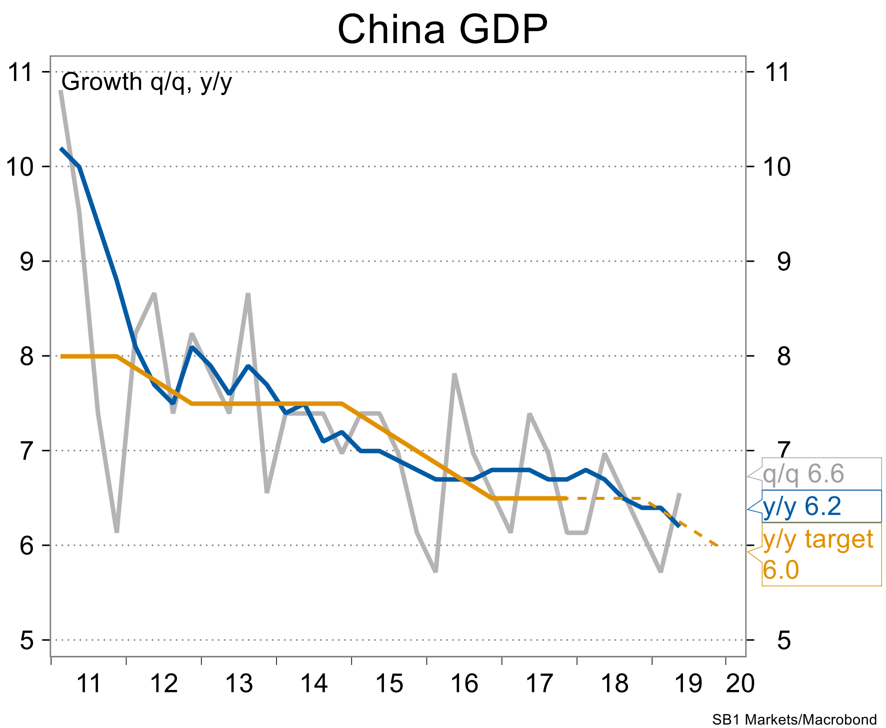


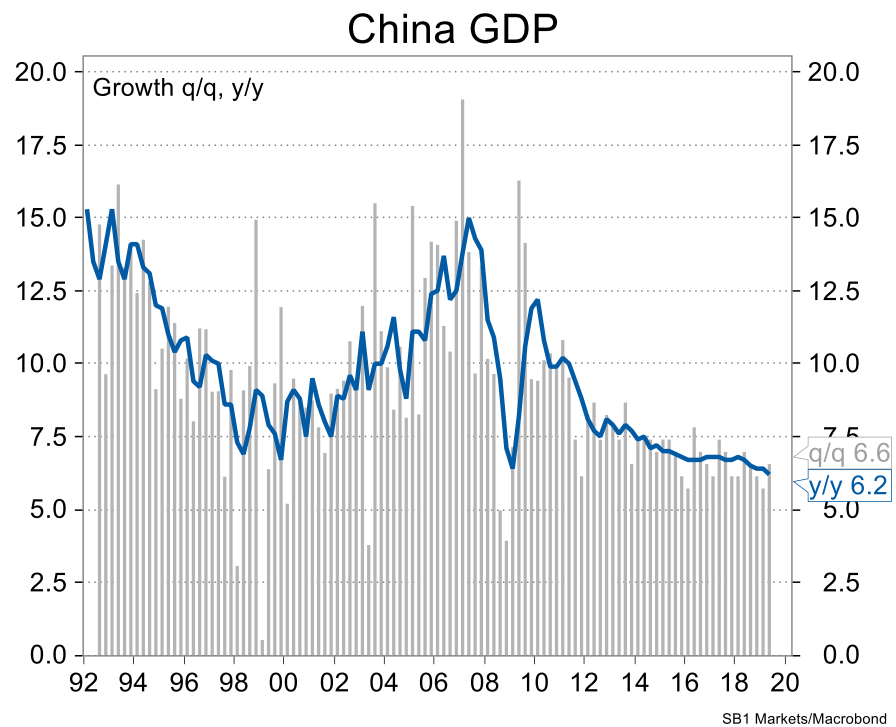


- Fiscal policy: Taxes are cut, spending programs decided. Over the past year, the deficit has increased by 2.0%, a substantial fiscal expansion. The deficit has increase to 6.4% of GDP, according to our calculations
- Banks's reserve requirements have been cut 4 times, by 4.5 pp to 13.5%, freeing up lending capacity equalling some 6½ of GDP. The increase in total credit growth has been muted but credit growth has stabilised, thus the credit impulse has turned neutral, from sharply negative
- The 3 m SHIBOR has fallen sharply to 2.6%, the lowest since 2010 and markets expect the PBOC to cut signal rates. In addition, the CNY has depreciated somewhat

Faster GDP growth in Q2, even if the annual rate surprised on the downside

Anyway: GDP growth is still trending downwards, the annual rate the lowest 'ever'

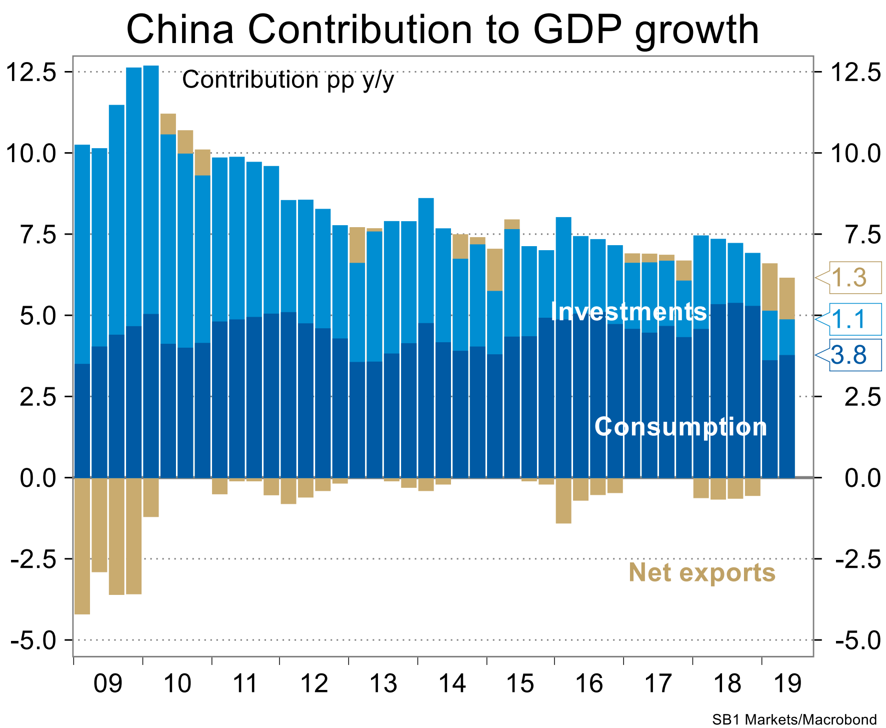




- GDP grew 6.2% y/y in Q2, down 0.2% from Q1, in line with expectations (Bloomberg) or marginally below (DJ). The annual growth rate has fallen from 6.8% in Q1 last year, and is the lowest y/y growth rate on record (quarterly data back to 1992)
- Still, measured q/q, GDP grew 1.7% (6.6% annualised) in Q2, up from 1.4% (5.7%) in Q1, 0.1 pp faster than expected (quarterly data does not add up to annual growth rates, but that's another story)
- Big picture: Growth is slowing but at a slow pace. The authorities' growth target is at 6 - 6½%. Investment growth is slowing according to GDP data
- Are the official GDP reliable? Goods research suggests that growth is some 2pp lower than reported, mostly due to a much slower growth in investments

Investment growth slows further steadily; consumption not, in Q2

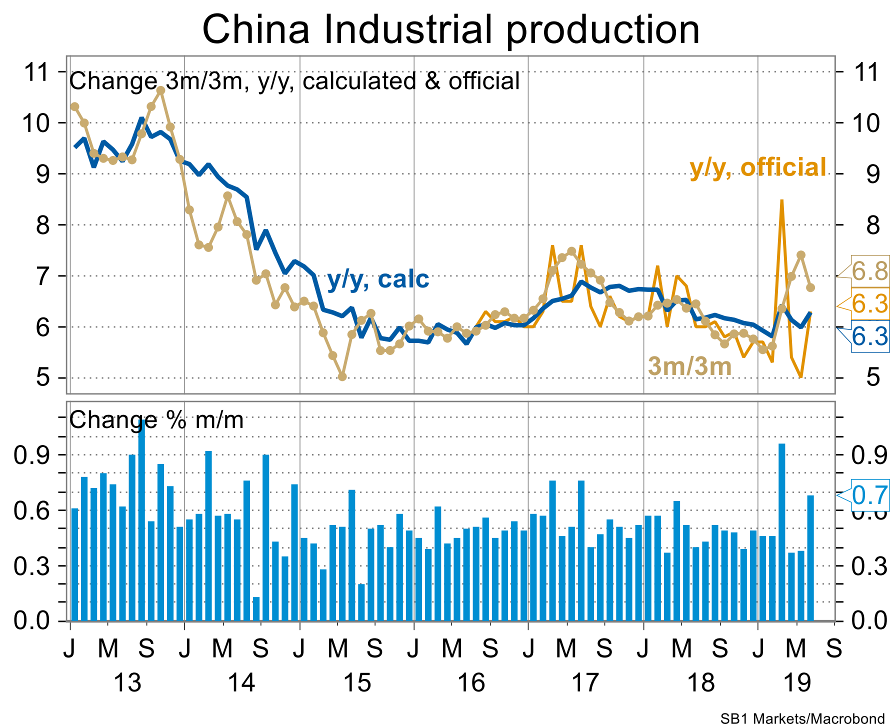
Net exports contributed positively in Q2, as in Q1

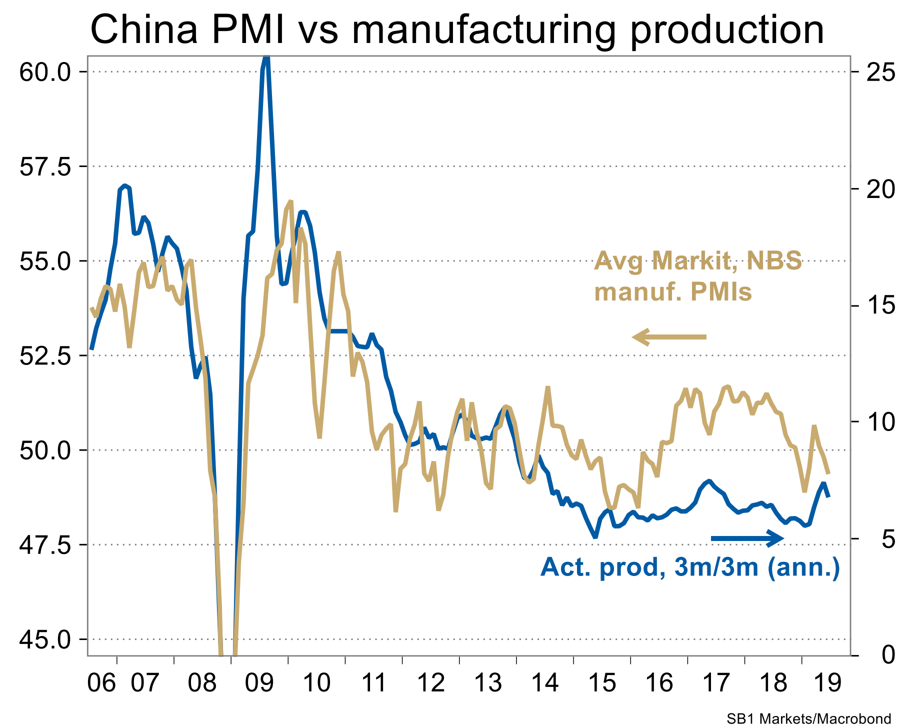


- In the Nat. accounts, net exports contributed to 1.3 pp GDP growth from Q2 last year. Net trade has in average been marginally negative since 2011. Not easy to identify any direct impact of the trade war… The slowdown in GDP growth is domestically driven
  - According to trade data (our volume calc), imports rose 6% in Q1, above the 3% growth in exports, while imports are down 2% y/y, and exports are up 1%.
- Consumption (private & public) contributed to 3.8 pp growth in Q2, a tad higher than in Q1 but sharply down from 2018 (above 5%). Consumption grew somewhat above 6% y/y
- Growth in investments (private & public) is slowing, measured as contribution to growth according to Nat. Accounts, now just supporting GDP growth by 1.1% (implying a growth rate at some 2.8%, down from 5% tow years ago – and much higher some years ago. However the slowdown is very gradual, and we assume in line with the authorities' ambitions in order to get the investment ratio further down to reduce the risk for a sudden halt due to overinvestments (which still is a substantial risk!). The continued gradual slowdown may now of course be due to the trade war reducing investment appetite

Strong growth in industrial production in June, up 0.7% m/m (vs 'normal' 0.5%)

The official y/y jump to 6.3% from 5.0%, and 1 pp higher than expected overstates the strength

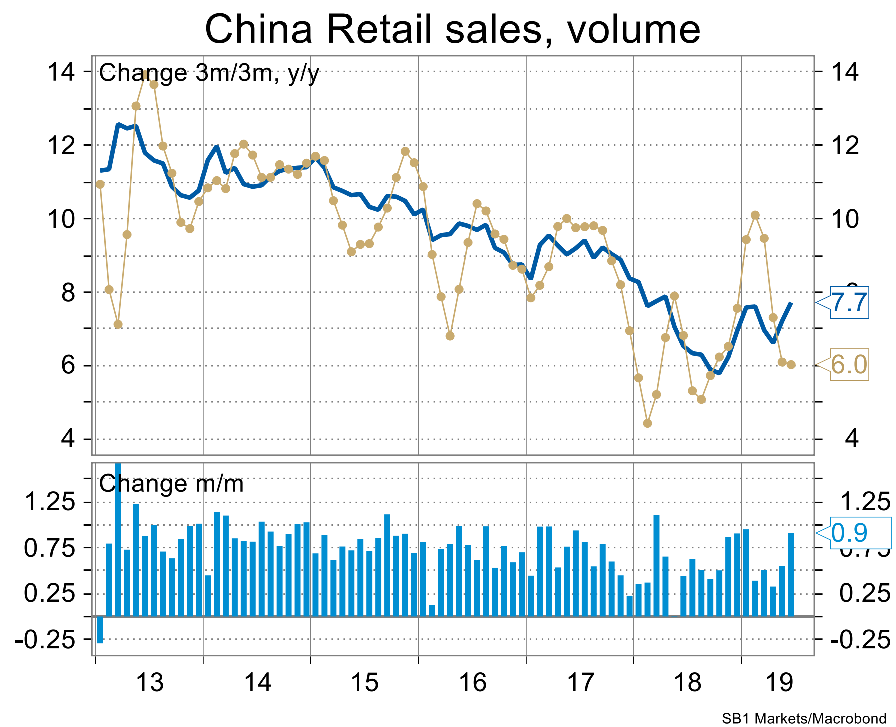




- Production rose 0.7% m/m in June, up from 0.4% in April and May. In March production rose more than 0.9%. Measured 3m/3m (now Q2 from Q1) growth is at 6.8% (and by 6.3% H1/H2), both the best in 2 years. Measured y/y, based on these official monthly seas. adj data yields a 6.3% growth rate.
  - » 'Our' y/y rate growth rate is much more stable than the useless official y/y unadjusted growth rate, now up to (a 'correct') 6.3% from a ('too low') 5% growth rate in May. The May growth rate was the lowest growth rate on record, barring some volatile single monthly prints 1997 – 2002
- PMIs or other surveys are not signalling an abrupt halt in the manufacturing sector either. Export volumes are back to peak levels. China has not been brought to a halt

Retail sales up in June, due to a temporary hike in auto sales

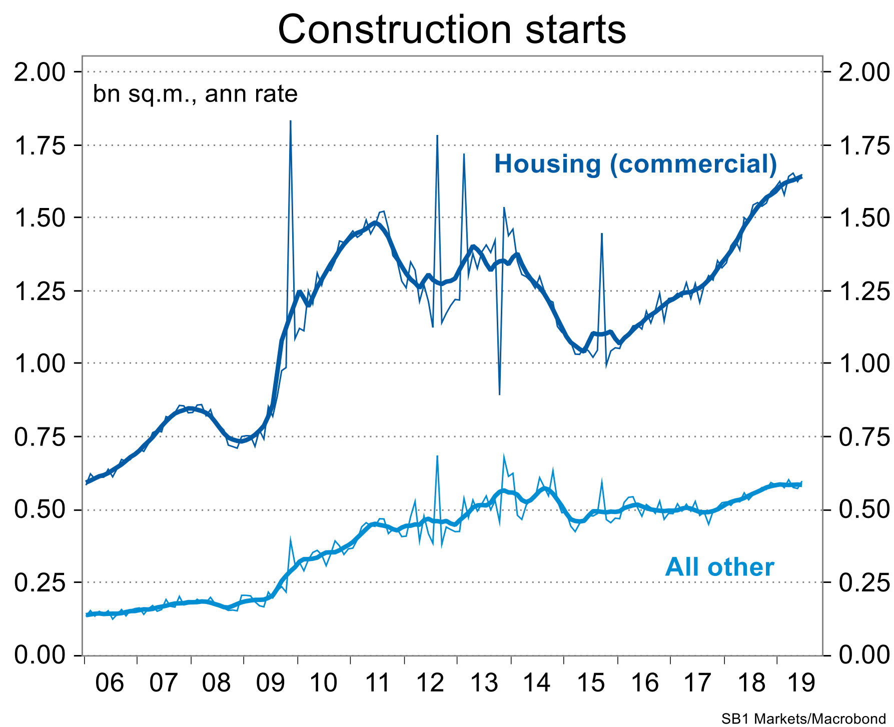
Sales up 0.9% m/m

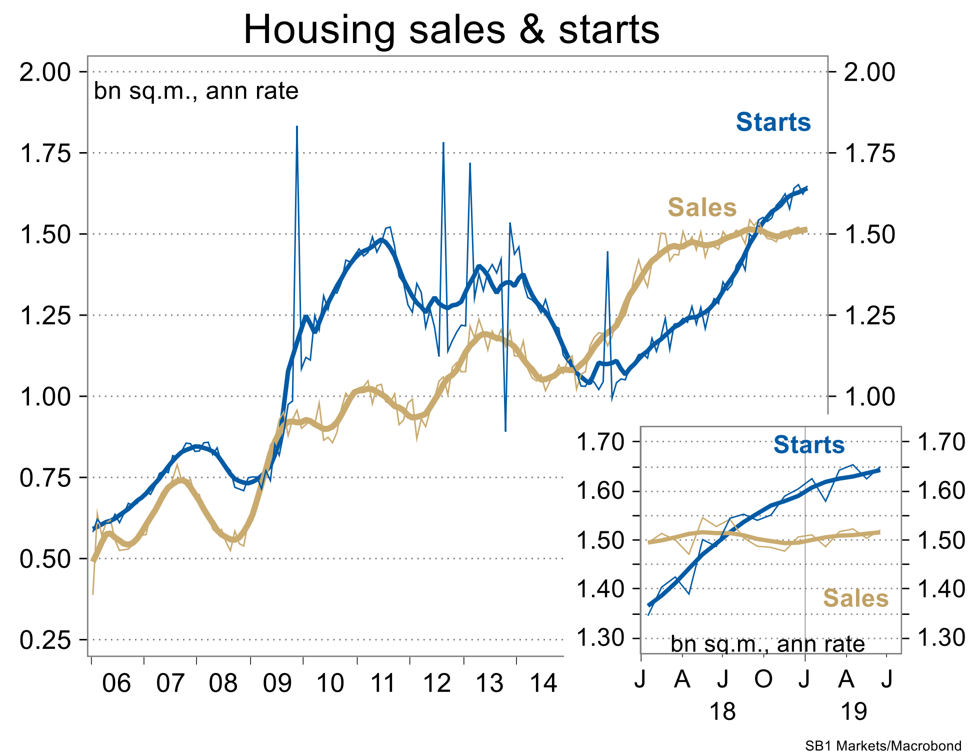


- The official value growth rate accelerated to 9.8% from 8.6% in May, and well above expectations at 8.5%. Auto sales were much stronger than assumed, up 17% y/y (nominal value of a sales), from 2% in May (and negative y/y before that). The jump is due to the introduction of new emission rules in many cities from July forcing dealer to cut prices sharply to get rid of the 'old' cars.
- Our (normally) less volatile value growth estimate (based on monthly seas adj. data) yields 9.7%, from 9.4% in May (revised up from 8.7%!)
- Our volume estimate is 0.9% m/m in June (retail prices were probably flat in m/m), and the annual volume rate rose to 7.7%, from 7.2% in May (revised from 6.6%). Even if the annual growth rate has recovered somewhat since late 2018, underlying volume growth has slowed, and now down to 6%, even with the strong June included
- 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?

Home sales, starts up in June; starts trend still upwards, sales flattish

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

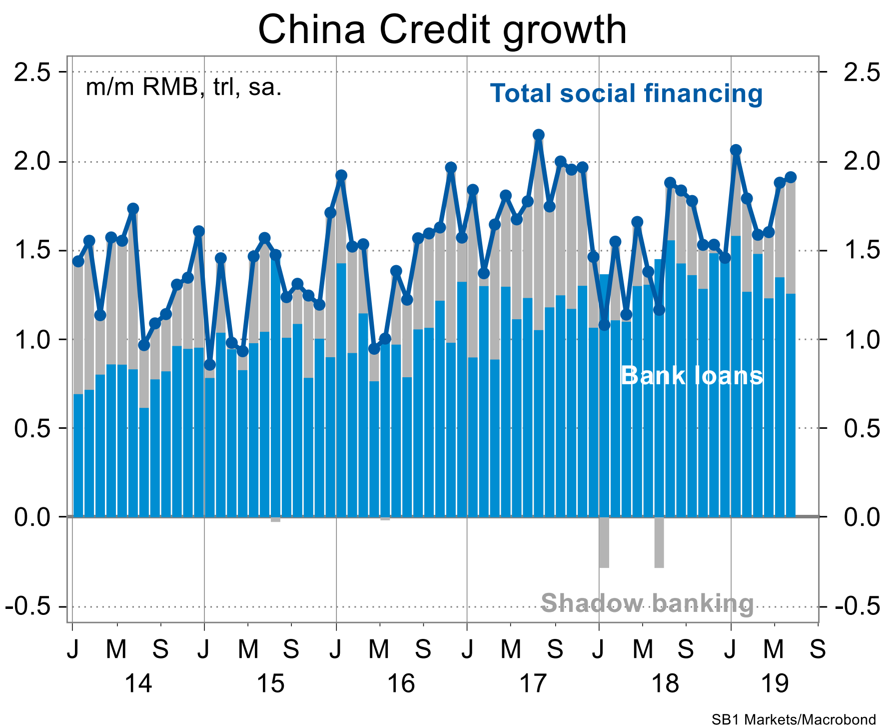


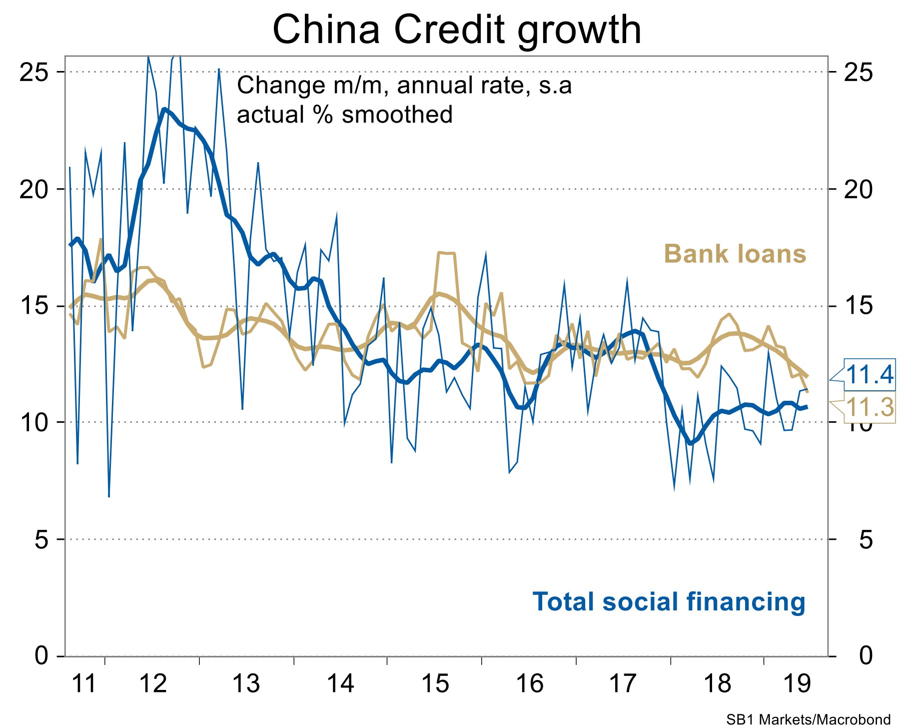


- Sales of new homes have flattened out over the past couple of years, at a record high level. Sales rose marginally in June
- Housings starts are running higher than sales, still trending up – and starts rose more than sales in June. Even so, given the large inventory drawdown from 2014 – 2018 (starts were below sales), the increase in inventories does not seem worrisome, yet Starts are up more than 50% from the 2015 trough, and are up 10% y/y (smoothed), down from more than 20% through 2018
- Other construction starts have been trending upwards since late 2017, may be peaking now? Annual growth down to 7%, from 20% in late 2020. These starts have reached a new ATH too, although the level is not that much higher than 5 years ago. The cycle in non residential construction is very close to the cycles in housing construction

Credit growth accelerated in May/June, even if bank lending is slowing

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

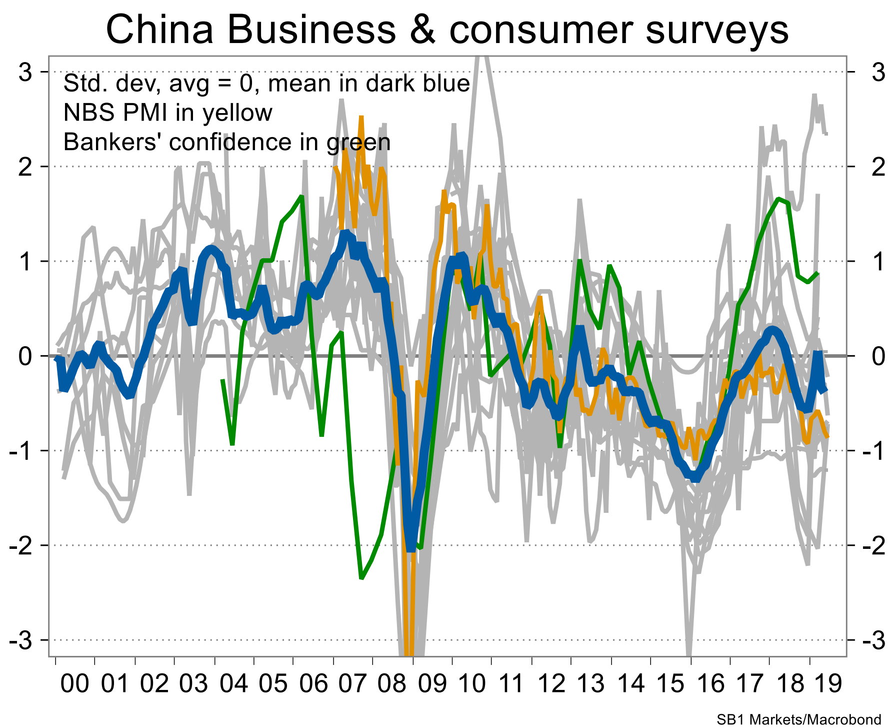


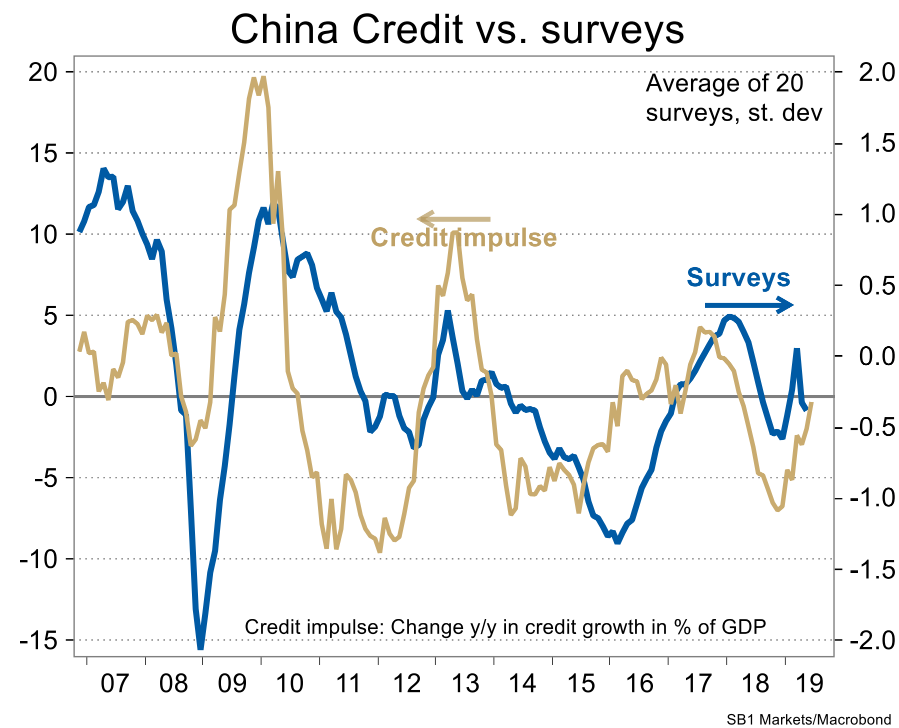


- Total credit rose by 11.4% m/m annualised in June, the highest in 5 months, and unadjusted total credit m/m growth at RMB 2.6 trl vs. expectations of 1.9 trl. Seas adj. total credit grew 1.9 bn, marginally up from May. Still, the underlying trend over the past year is flat – and not accelerating. Total credit is up 10.9% y/y (from 10.5% in May, but lower than expected) – and above the reported 8% nominal GDP growth
- In 2018, the authorities tightened credit supply through the non banking credit market and total credit growth slowed by 5 pp, a significant change. As usual following a credit tightening, GDP growth slowed. Now, following several measures to stimulate credit growth, mostly to counterweight the impact of the trade war, growth has stabilised. Thus, the credit impulse is neutral (and underlying growht it is up from the early 2018 slump)
- What's next? Many expect the PBoC to turn more expansionary. However, there are good arguments against pushing the credit accelerator even harder. Credit growth is well above growth in nominal GDP, and very high debt ratios are climbing further

Credit has been tightened, usually dampens growth

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

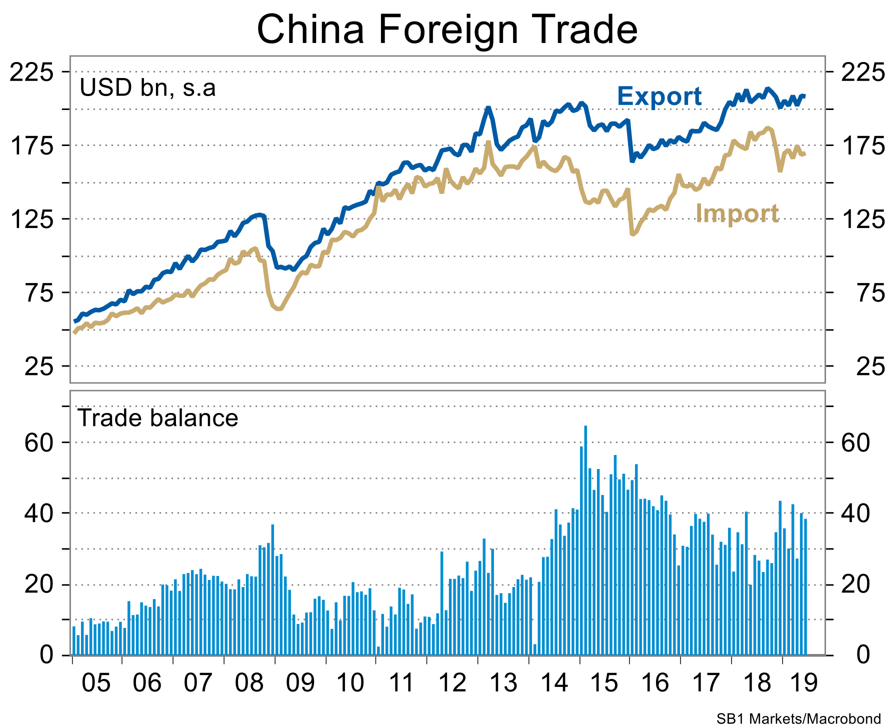




- An avg of Chinese business & consumer surveys indicates that growth has slowed significantly. However, the level is still not very weak, neither are the PMIs

Exports/imports stable in June, export volumes close to ATH, imports not weak

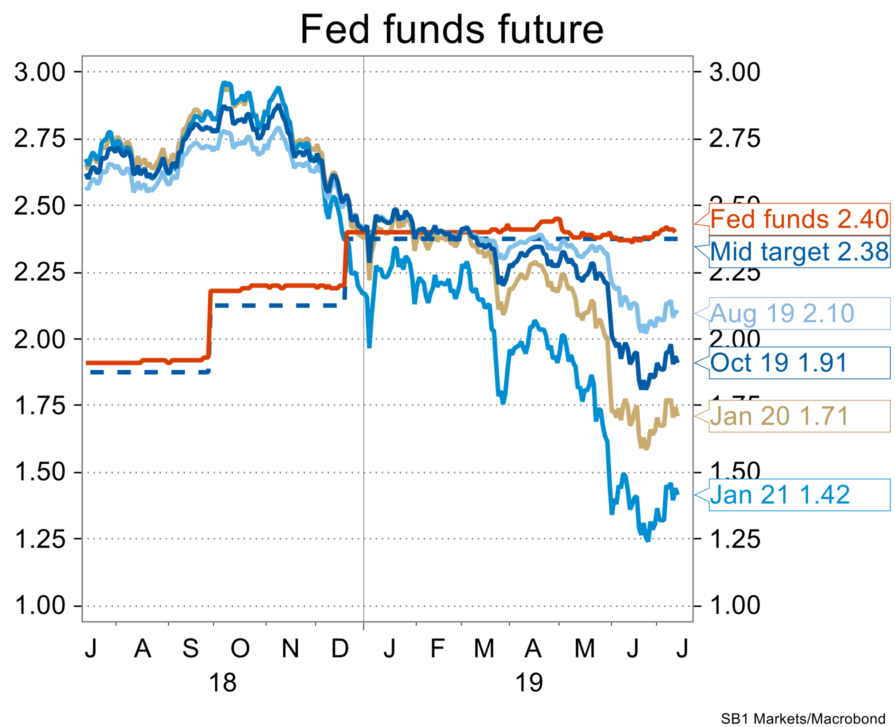
Exports & imports have recovered after the drop last fall. The trade surplus remains large

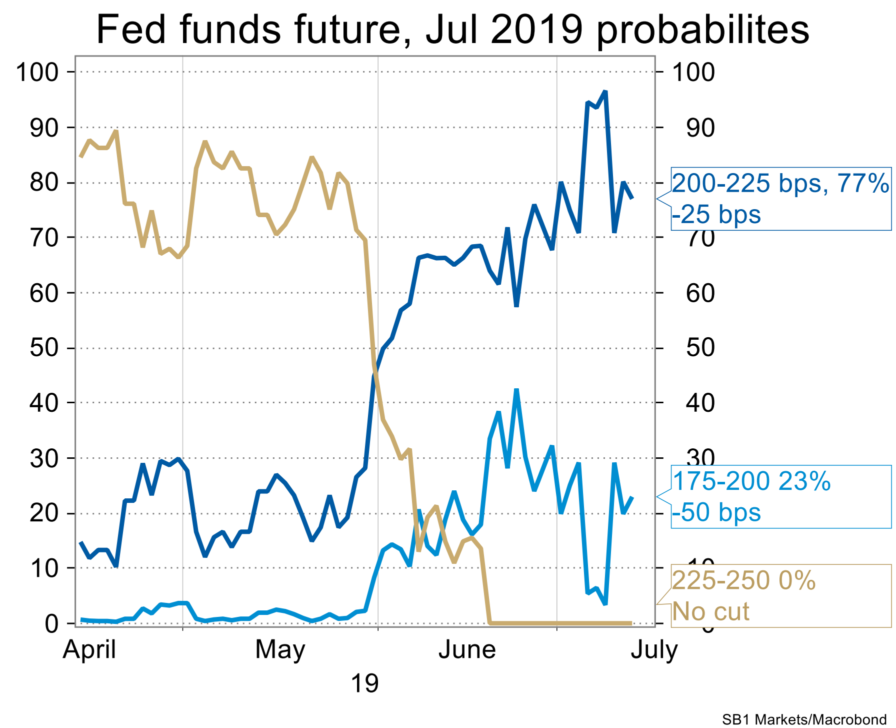


- Exports were reported down 1% y/y in May (in USD), close to expectations. Exports were flat m/m, and export volumes are close to ATH after recovering from the Q4 local trough, both in value and volume terms. The trend since early 2018 is close to flat
  - Exports to the US rose in both May and June, perhaps to avoid the announced tariffs hikes. US exports are down 10% since before the tariffs were implemented. Exports to other regions have slowed
- Imports are down 7.3% y/y in June (in USD), exp down 4% - and imports fell marginally. However the trend is slowly up from the weak Q4, and even if both value and volumes are down y/y and both are down from the Q3 peak, imports data does not signal a sharp weakening of domestic demand, check also the next page
- The trade balance was approx as expected, and at USD 40 bn, unch. from May, and remains at a higher level than over the past two years

FOMC minutes & Powell left the door for a late July cut wide open

Minutes from the June meeting more dovish than the announcement/reports. Powell confirmed





- The minutes from the June 20 meeting referred than many members expected the signal rate to be cut soon if the outlook for growth and inflation was not strengthening, and several others said that they were prepared to cut if the outlook deteriorated (further). Governor Powell strengthened the case for a cut in July at his two hearings at Capitol Hill
  - » The contrast to the dot plot from the June meeting is striking. Here, the majority of the FOMC members indicated they assumed an unchange rate through 2019. Now, with better news on the trade front, OK labour market data and a strong stock market, we all take a July cut for granted!
- The base case is still that the US economy will continue to grow at or marginally above trend but Powell/FOMC put much more emphasis on the downside risks from global uncertainty (read: trade war) through the impact on business investments especially in the manufacturing sector.
- The market increased its bet on a 50 bps cut following Powell's Congress performances

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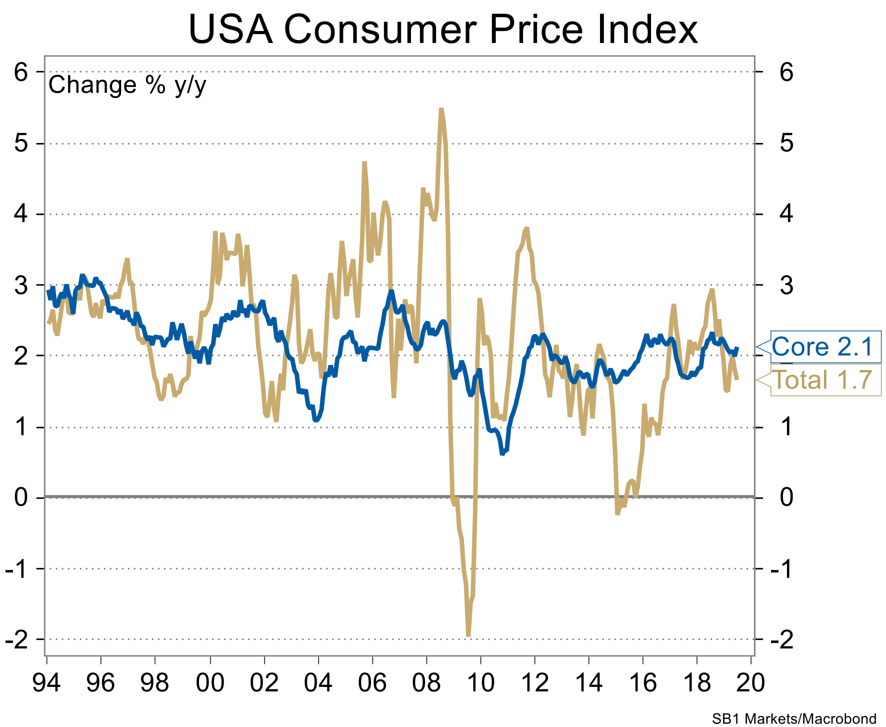
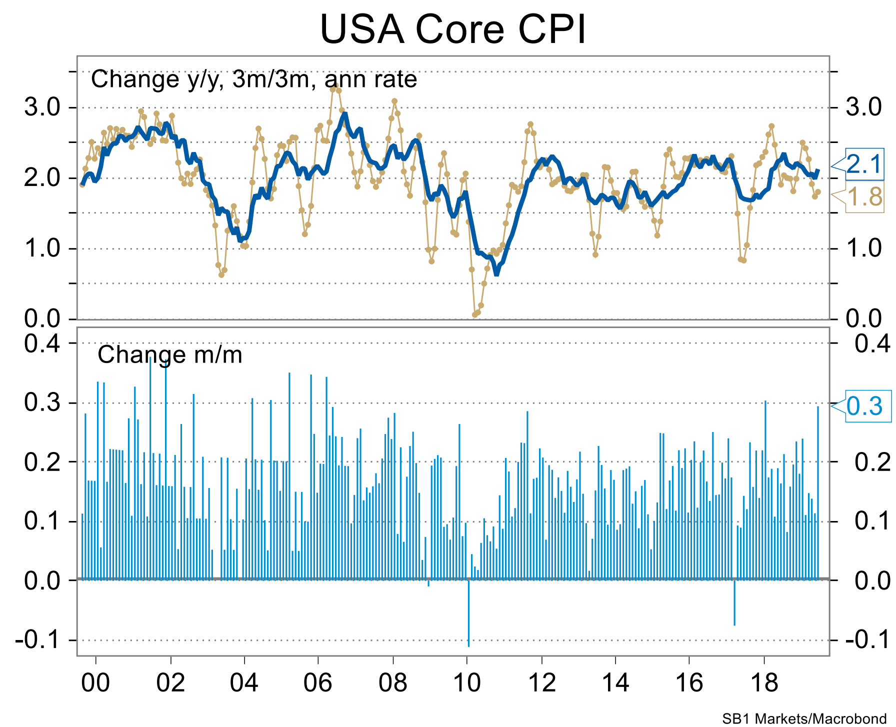
Oh shit, core inflation up to above target (well not Fed's inflation target, but still)

Core CPI rose just 0.3 % in June, following 4 x 0.1%, the annual rate up 0.1 pp to 2.1%

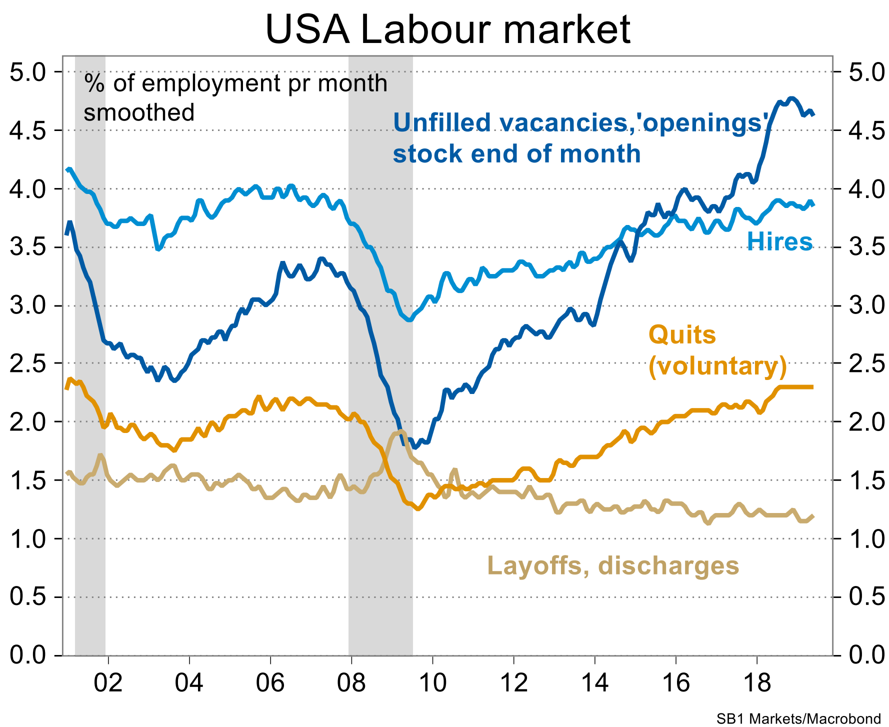


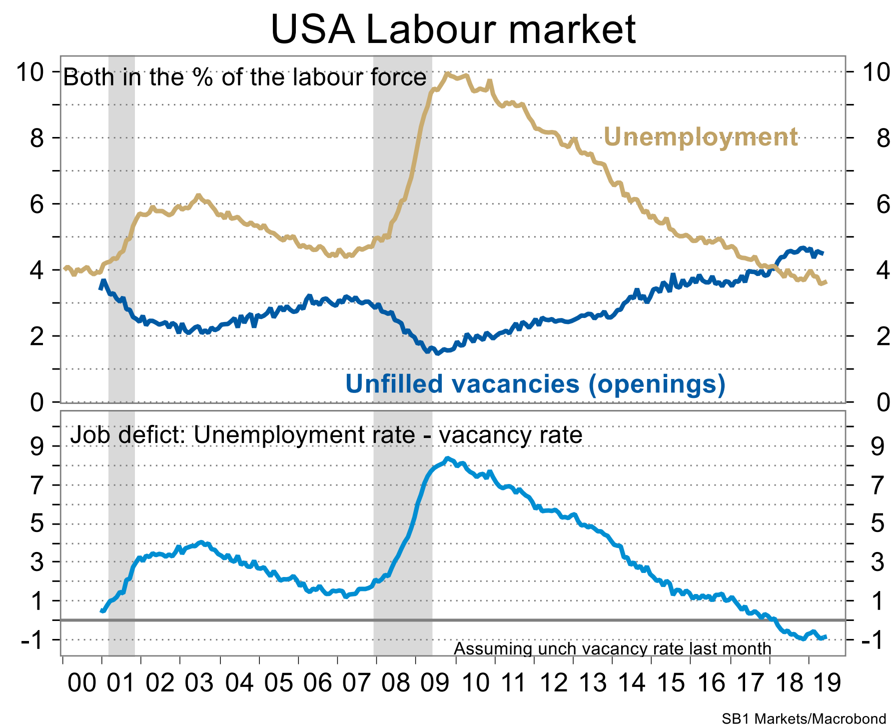


- 'We all know' that inflation has surprised on the downside and is below target – and that the Fed has to cut rates by the end of the month. Fed preferred price measure, the core PCE (the consumption deflator in the Nat. Accounts) was up 1.6% y/y in May, and is below Fed's 2 % target.
- However, the core CPI accelerated slightly to 2.1% in June (expected unch) after a 0.3% lift m/m. The PCE deflator probably accelerated to 1.7% in June, still below Fed's target. Still, the shortfall vs the target is not large
- Headline inflation ticked down 0.1 pp to 1.7%, as the impact from energy prices changed sign and was trimming inflation rate down in June, as in the previous months

Marginally fewer unfilled vacancies but still plenty. More hires, few layoffs

.. and a record number of people are leaving their job voluntary (to pick up a better)





- The JOLTS report does not signal a further tightening labour market – but still a tight market. There are still more unfilled jobs (4.7%) than unemployed people (3.7%) – and the gap is still record high (at least very close to (ATH). Monthly (gross) hiring equals 3.9% (of total employment)
- 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 at very low level

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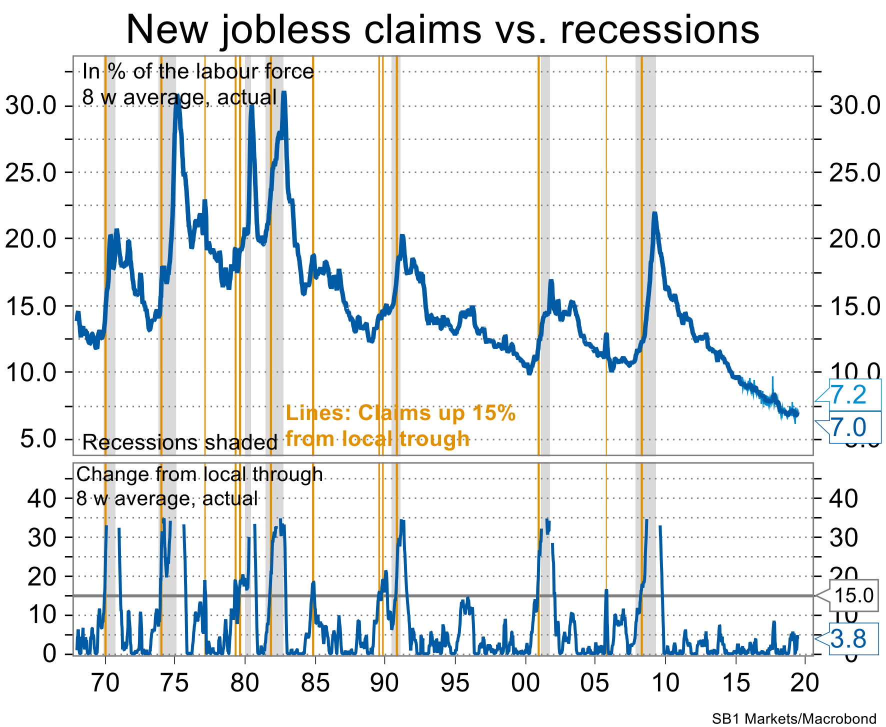
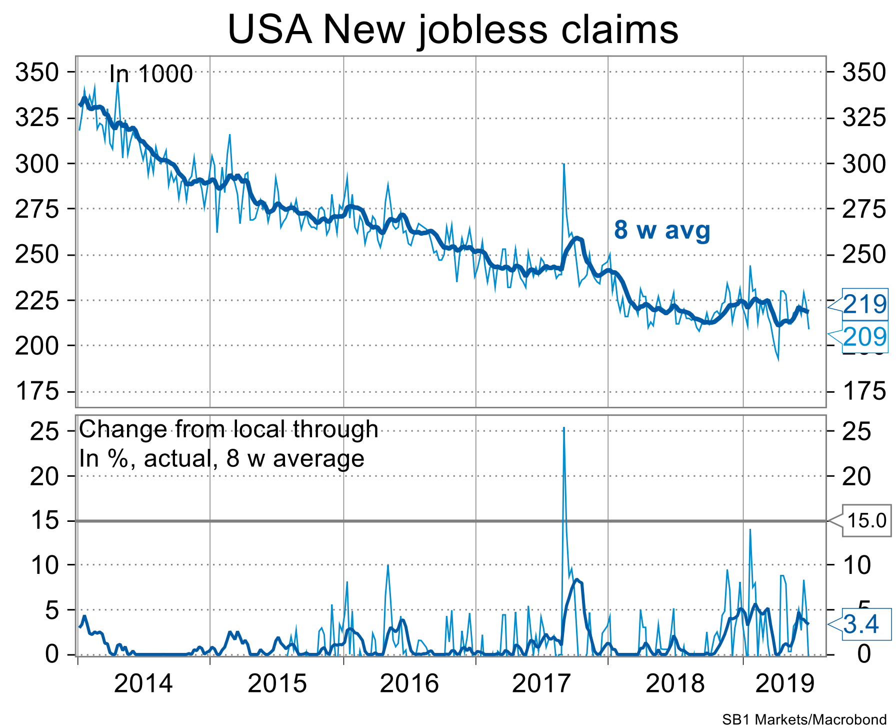
New jobless claims down to close to record low levels. And rates must be cut…

Jobless claims fell to 209' last week, just two weeks have been reported lower i recent times





- In per cent of the labour force, the inflow of new jobless claimants have never been lower than now (as it by and large has been since 2015)
- 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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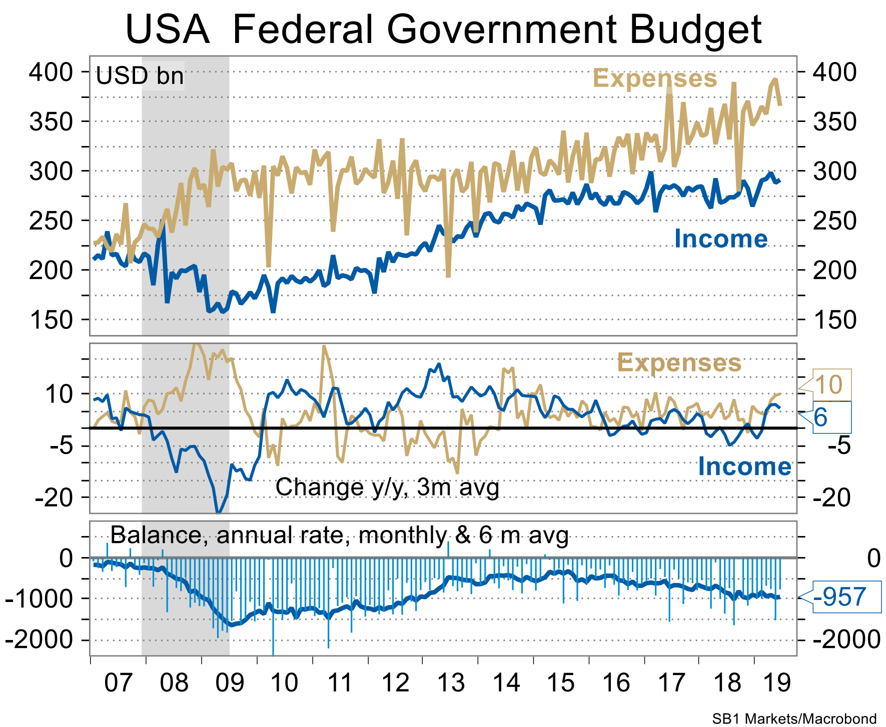
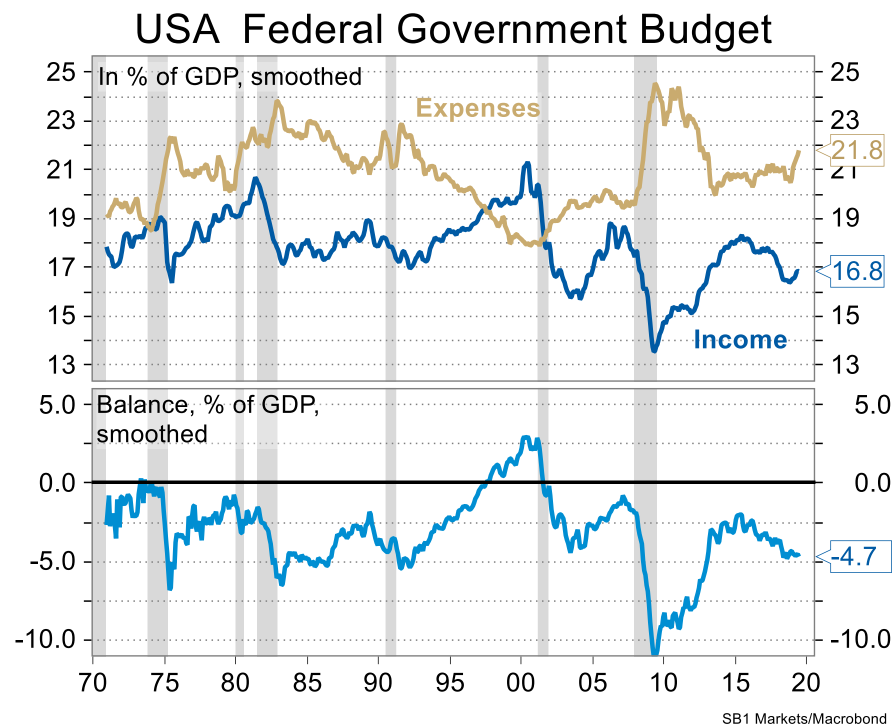
The federal budget deficit is widening amid soaring spending

The federal deficit at 4.7% of GDP in Q2, and the total public sector deficit at 6.9% of GDP in Q1!

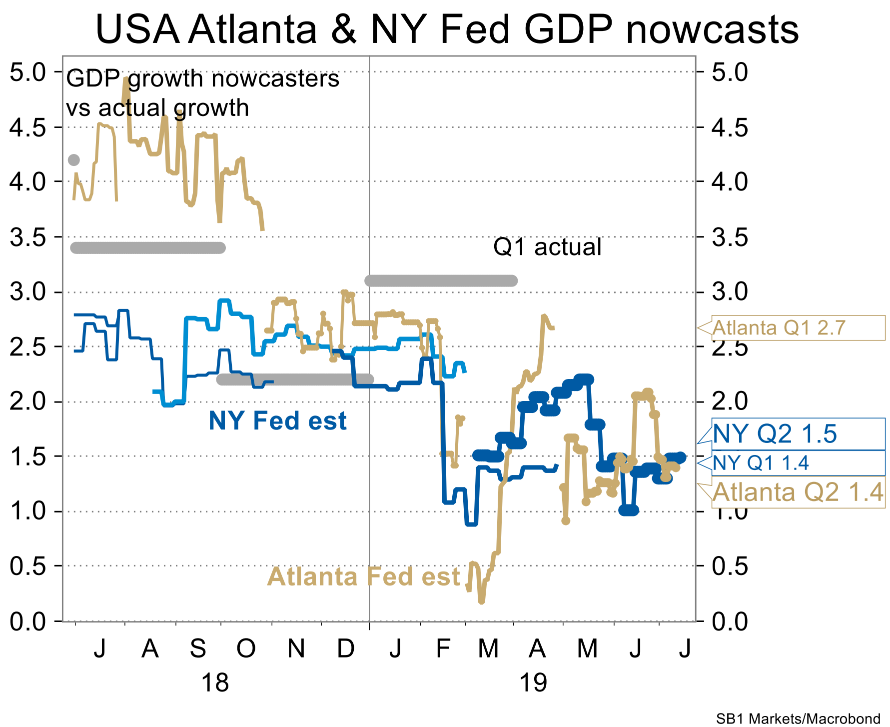


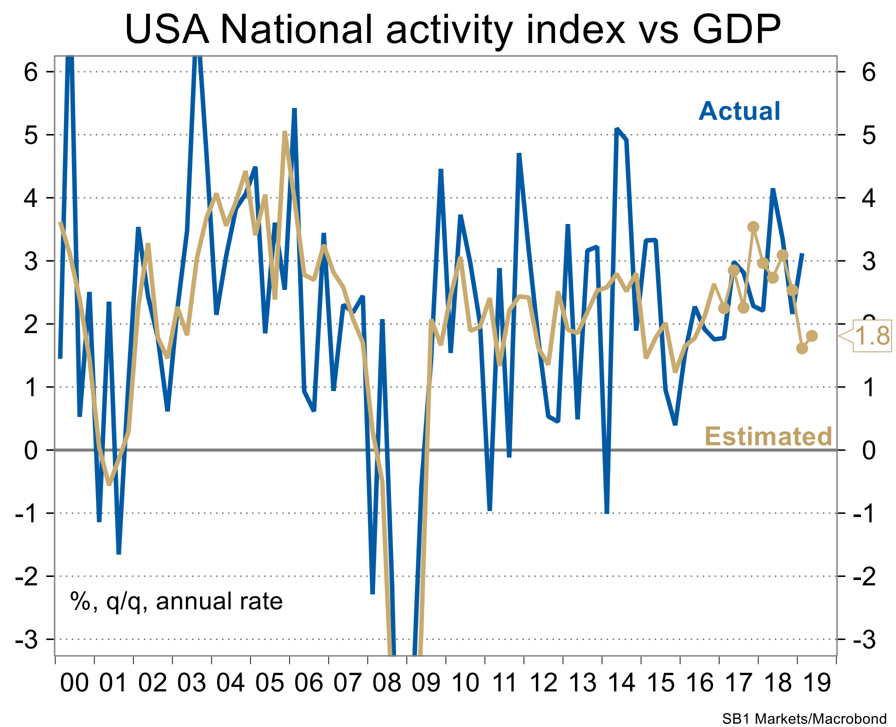


- The budget deficit fell to USD 770 bn in annual rate in June (seas. adj), less than the average over the past year – from a high level in May. Including local government etc, the US is running full employment, peacetime deficit at 6.9% in Q1 (from 6.7% in Q4); totally unprecedented!
- Federal spending inched down m/m in June but is up 10% y/y (smoothed), way above growth in nominal GDP. Income is up 5% y/y
- In % of GDP federal spending equals almost 22%, way above a normal level (except for recessions). Regrettably, federal income just equals 17% of GPD, much lower than normal in a blooming economy – of course because taxes have been cut
- 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

Fed nowcasters say 1.3 – 1.4% in Q2

The National activity index signalled 1.8% Q2 growth in May (up from the 1.1% April est)





- 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

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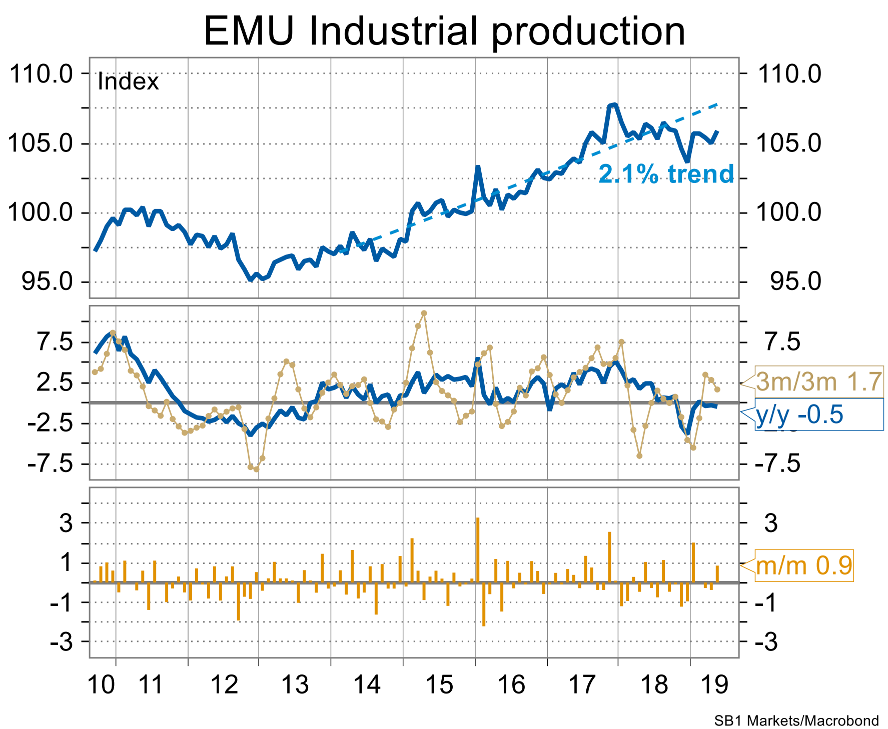
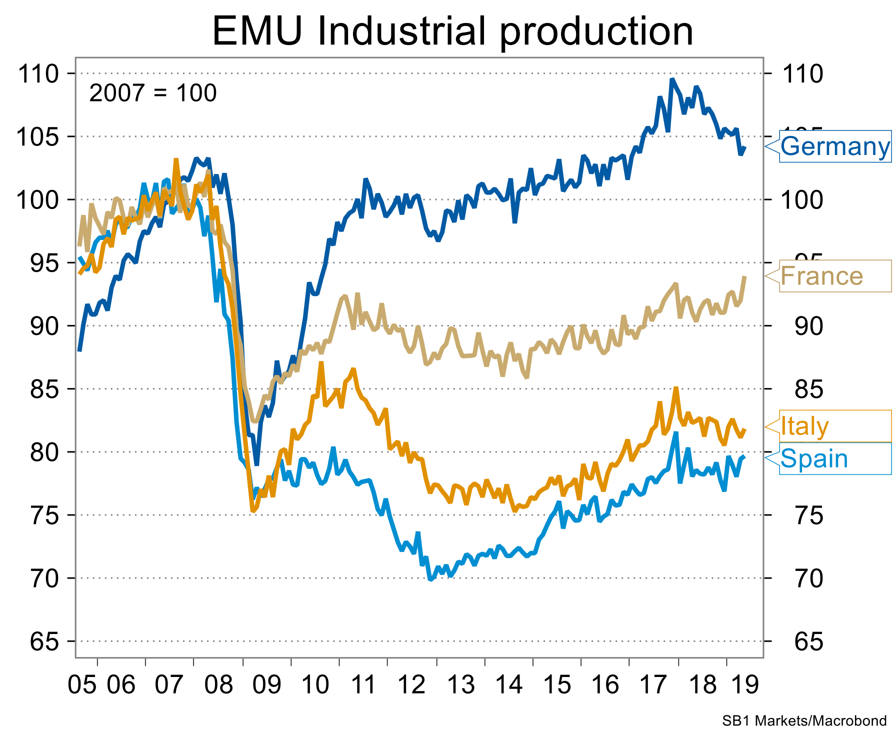
Industrial production up in May, saved by France – still far from impressive

Production rose 0.9% m/m in May, well above the originally expected 0.2%. Surveys are still weak

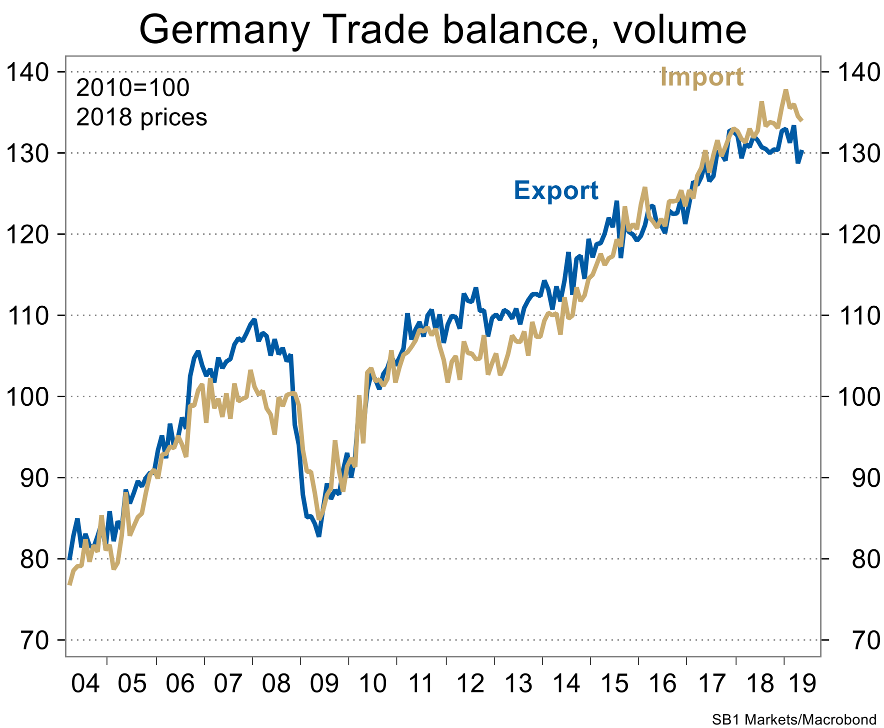


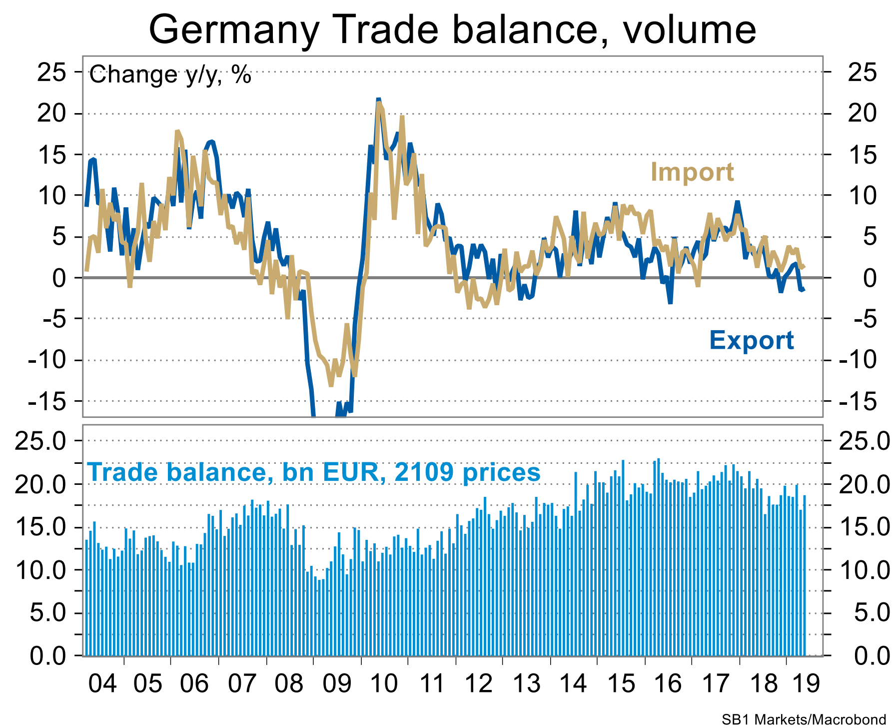


- Industrial production in the Eurozone rose 0.9% in May, following the 0.5% decline April. Production is down 0.5% y/y, and the medium term trend is down rather than up
  - » Given unch. production in June, Q2 was flat following the 3.5% growth in Q1, from the deep Q4 slump
- Production of transport equipment rose sharply, from a low level. Chemicals also up
- The uptick was driven by a 2.1% surge in French production. Germany reported +0.7% but the level is very low, even after a substantial upward revision of April. Italy is trending down, Spain marginally upwards
- **Unfortunately, the manufacturing PMI and orders remain weak, no signs of recovery**

Finally, German exports are yielding (somewhat, and not to China)

Still, exports cannot explain the weakness in German manufacturing. And imports not weak either

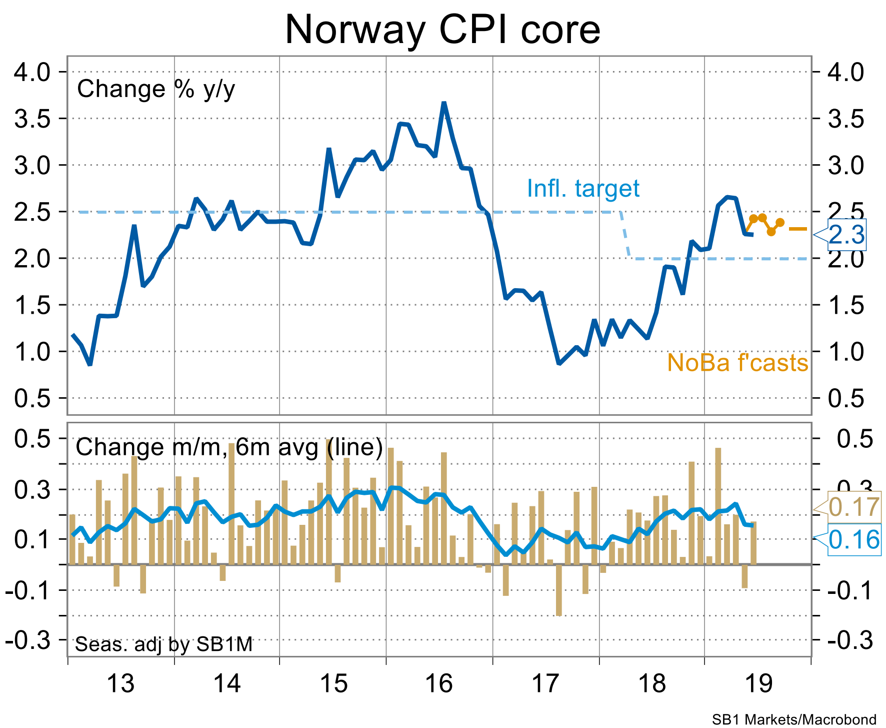




- Export volumes recovered just marginally in May, following the 1.8% drop in April. Exports have kept up far better than PMIs and export orders have been indicating recently, but the to past months signals that 'something' has turned up.
  - However, the decline is not that sharp, and exports to China are still on the way up. UK (Brexit) to blame (exports are falling sharply), and some weakness in exports to other EU countries, and to Asia ex China
  - Export orders may have stabilised following a substantial decline and PMIs or other surveys are not signalling any recovery
- Import volumes have fallen marginally but are not far below a medium term trend
- The German trade surplus is slowly shrinking, and now equals approx 6% of GDP, from 8% in 2016

Electricity prices took headline inflation below 2%, core stable at 2.3%

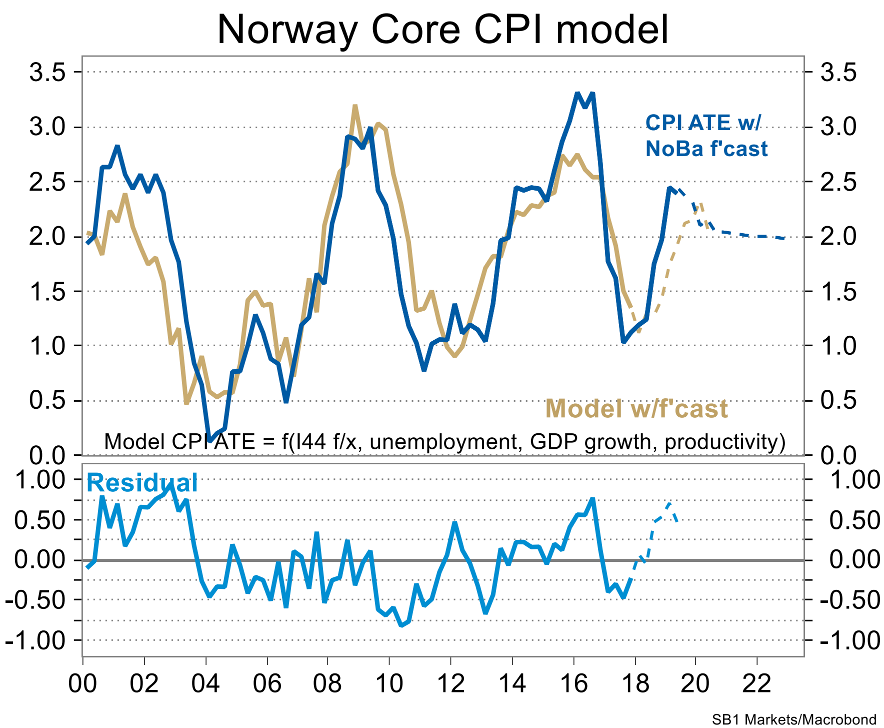
Core CPI inflation ticked down 0.3 pp, dragged down by volatile airline tickets and food prices



- CPI-ATE (ex. energy and taxes) unch at 2.3% y/y in June, in line with our and consensus f'cast. Norges Bank expected 2.4%
  - » CPI-ATE rose 0.2% m/m (seas adj), up from the surprising 0.1% drop in May
  - » Imported goods are up 1.5% y/y, domestically produced goods and services at 2.7%
  - » Total CPI growth decline further, to 1.9% from 2.4% (as we expected, consensus at 2.1%), mostly due to a steep decline in electricity prices. There is more to come. Good for real income growth, thus, consumption!
- **Implications**
  - » Core inflation remains above target, and broadly in line with NoBa's f'cast
  - » No market reaction, for good reasons

The outlook: Core CPI inflation has peaked?

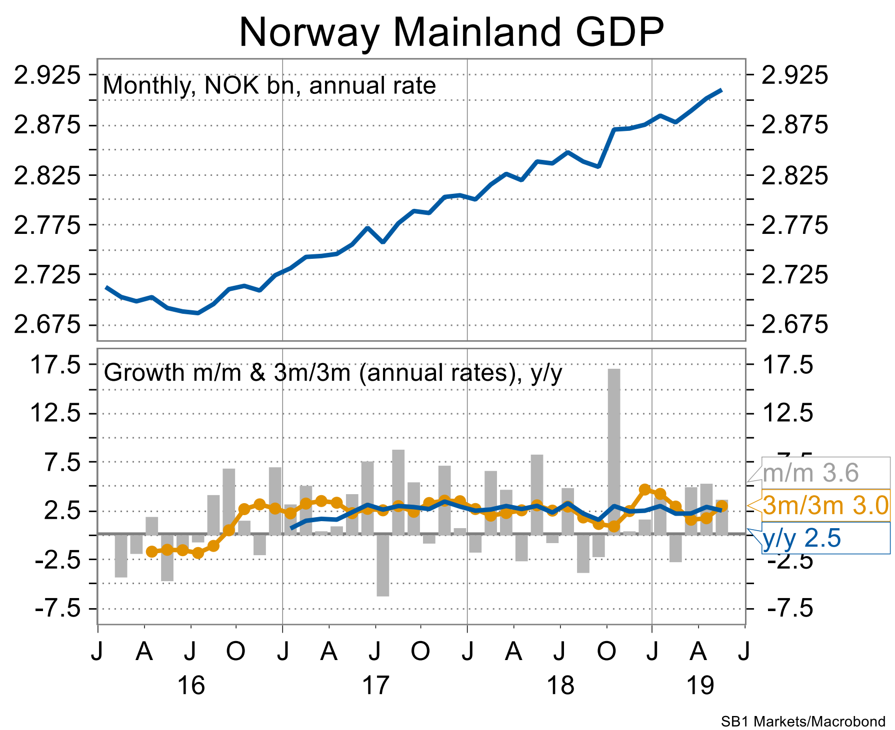
Actual inflation higher than our model forecast now – but it suggest 2.3% in a year's time



- Core CPI growth has been well above the model f'cast recent months, the 2.3% speed in June 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 2.4% in 2019, and down to 2.1% in 2020 (June Monetary Policy report). Fair estimates

GDP growth on track, Norges Bank will continue

GDP rose 3.6% annualised in May, underlying growth up to 3% following upward revisions



- Mainland GDP rose 0.3% m/m in May, 3.6% ann. rate
  - » The monthly data are too volatile to give us any useful signals, the more important 3m/3m rate accelerated to 3.0% from 1,7% (revised from 1.4%). The pace of growth in both March and April was approx 5%
  - » Norges Bank's March f'cast is 3.1% (0.8) growth in Q2, up from 0.4% in Q1 (with drag from primary and electricity production). The f'cast is still within reach (but may be a tad to optimistic)
  - » GDP is up 2.4% from May last year – close to the average growth rate recent years – and well above trend as the employment rate is increasing the unemployment rate is declining
- On the demand side:
  - » Private consumption probably slowed in Q2, partly due to lower auto sales ('technically, due to estraordinary high sales of Tesla EVs in March)
  - » Mainland business investments probably rose sharply in Q2, mostly doe to a huge lift in investments in manufacturing and other good, which cannot be replicated in Q3 (we expect a sharp contraction)
  - » Oil investments have been heavily revised recent months but is now confirmed down more than 4% in Q1 (from an increase) and data at hand now suggest a 10% increase in Q2
  - » Housing investments are growing at a modest pace
  - » Mainland net trade was probably close to neutral in Q2
- So what?
  - » Norges Bank's Q2 GDP f'cast at 0.8% q/q is still within reach, and the underlying picture is anyway that Mainland GDP is growing above trend, supporting the bank's view that the signal rate should be nudged further up. Barring a global 'disaster', we expect a Sept hike, to 1.5%

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 stabilised in June, at 51.2, we expected a 0.4 p decline. The PMI signals just below 3% GDP growth. US and Asia the weakest links now. We think we know why. Global auto sales up in June
China	The governments' stimulus measures may have stabilised the economy but surveys and data do not point to any swift turn of growth momentum. The invest/GDP ratio is declining rapidly. Debt growth has slowed, and will not accelerate much even if authorities are trying to stimulate credit in order to compensate for the negative impacts from the trade war/previous tightening. Fiscal policy is also activated, strongly. Exports to US (net of interm. imp) approx 2% of GDP, and a (so far) 10% decline here is manageable. However, a full scale tech/trade war will be bad, a deal with US is important	June/Q2 data in line or above expectations albeit partly due to temporary factors
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 some easing as well. No serious overinvestments but most sectors at/above trend. Business investments are probably slowing amid trade war uncertainty. Recent housing and consumption data are OK. Household debt 'low' – and the savings rate is OK, limited consumption risk. 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. **Risks: Trump/trade/bus investments**	Inflation higher than expected, at core CPI above 2%. No signs of weakness in the labour market
EMU	Growth has slowed and manufacturing data are worrying while services remain resilient. 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, still 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	Manufacturing production up in May but still weak
Norway	Growth is and will remain above trend – and unemployment declines further. Oil investments have more to go. 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 above target. Electr. prices have fallen sharply, will take the headline CPI further down. Credit growth almost kept at bay just due to regulations. **Risks: Debt, housing.**	Core CPI in line with expectations in June, above target. Headline CPI sharply down due to the 'crash' in electricity prices. May GDP signals OK growth in Q2, and unemployment is anyway still falling

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

The Calendar: Key macro data next two weeks

In focus: US manuf w/2 surveys, retail sales & housing+Beige book. July PMIs next week, ECB

Time	Country	Indicator	Period	Forecast	Prior
Monday July 15					
14:30	US	NY Empire Manufacturing Survey	Jul	2	-8.6
Tuesday July 16					
10:30	UK	Average Weekly Earnings YoY	May	3.1%	3.1%
11:00	GE	ZEW Survey Expectations	Jul	-22	-21.1
14:30	US	Retail Sales Core (Control Group)	Jun	0.3	0.5%
15:15	US	Manufacturing Production	Jun	0.3%	0.2%
16:00	US	NAHB Housing Market Index	Jul	64	64
Wednesday July 17					
14:30	US	Housing Starts	Jun	1260k	1269k
14:30	US	Building Permits	Jun	1300k	1294k
20:00	US	Fed's Beige Book			
Thursday July 18					
06:00	SW	House prices	Jun		
14:30	US	Phil Fed Business Outlook	Jul	5	0.3
14:30	US	Initial Jobless Claims	Jul-13	216	--
16:00	US	Leading Index	Jun	0.1	0.0%
Friday July 19					
16:00	US	U. of Mich. Sentiment	Jul P	98.6	98.2
Monday July 22					
14:30	US	Chicago Fed Nat Activity Index	Jun	--	-0.05
Tuesday July 23					
08:00	NO	SSB Industrial Confidence Survey	2Q	(3)	6.9
08:00	NO	Housing Starts	Jun		35'
16:00	EC	Consumer Confidence	Jul A	--	-7.2
16:00	US	Existing Home Sales	Jun	5.35m	5.34m
Wednesday July 24					
02:30	JN	Manufacturing PMI	Jul P	--	49.3
10:00	EC	Eurozone Composite PMI	Jul P	--	52.2
15:45	US	Markit US Composite PMI	Jul P	--	51.5
16:00	US	New Home Sales	Jun	664k	626k
Thursday July 25					
08:00	NO	Unemployment Rate LFS	May	(3.3)	3.2%
09:30	SW	Unemployment Rate LFS	Jun	--	6.4%
10:00	GE	IFO Expectations	Jul	--	94.2
13:45	EC	ECB Deposit Facility Rate	Jul-25	--	-0.4%
14:30	US	Durable Goods Orders	Jun P	--	-1.3%
14:30	US	Cap Goods Orders Nondef. Ex Air	Jun P	--	0.5%
14:30	US	Trade Balance Advance Goods	Jun	--	-$74.5b
14:30	US	Initial Jobless Claims	Jul-20	--	--
Friday July 26					
14:30	US	GDP Annualized QoQ	2Q A	(1.5)	3.1%
14:30	US	Personal Consumption	2Q A	--	0.9%

Source: Bloomberg. SB1M est. in brackets.
The most important indicators are highlighted

In this report

Global

- Negative surprises most places, less in US, EM x China. More in China, until this morning
- Manuf. production & global trade have stalled, retail sales still growing (slower)
- Auto sales up June - due to inventory clearance before new Chinese emission rules?

China

- Q2 GDP growth fell 0.2 pp to 6.2%, as expected but the q/q rate accelerated to 6.6%
- Industrial production rose substantially more than expected in June
- Retail sales rose much more than expected in June, mostly due to higher auto sales before new emission rules
- Investment growth was higher than expected in June, has stabilised (but Nat. Accounts report a steady slowdown
- Credit growth higher than expected in June, driven by the shadow banking market. The credit impulse has turned neutral, from negative
- Exports, imports close to stable in June, exports not far below ATH/old trends. Net exports up in Q1 and Q2 (due to higher imports)

USA

- Powell 'promises' to cut rates
- Inflation higher that expected
- Producer price higher than expected too but price pressures are abating
- SMEs a tad less optimistic but still optimistic
- Labour market flows still strong
- Near record low inflow of new jobless claims
- The budget balance better in June but the trend not
- Fed nowcasters say 1.3 – 1.4% in Q2

EMU

- Industrial production up in May, still weak
- German exports are finally yielding but at not that weak – and exports to China still strong

Sweden

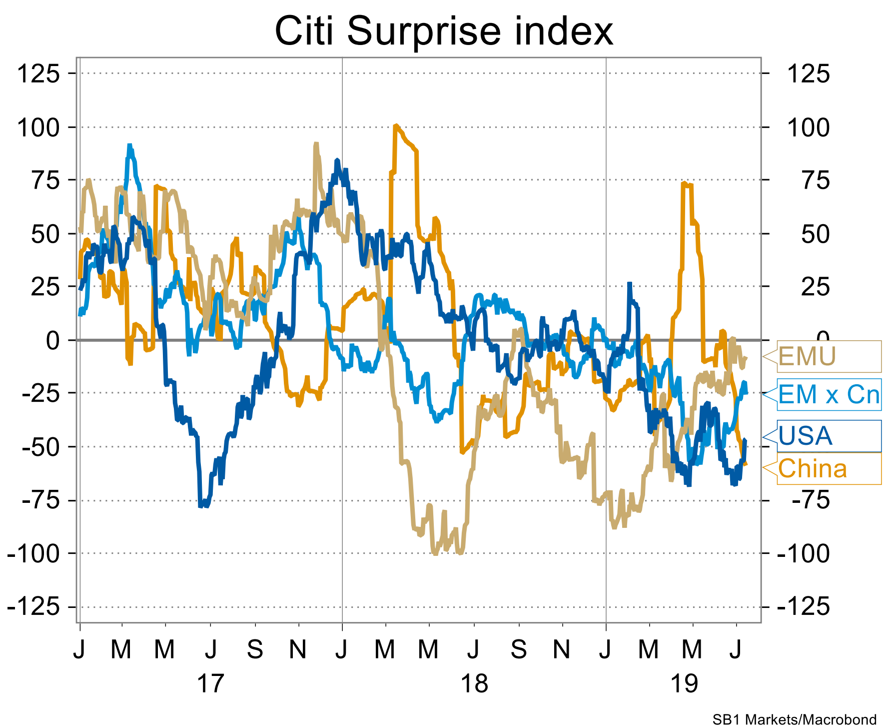
- CPI surprised on the upside, core close to target

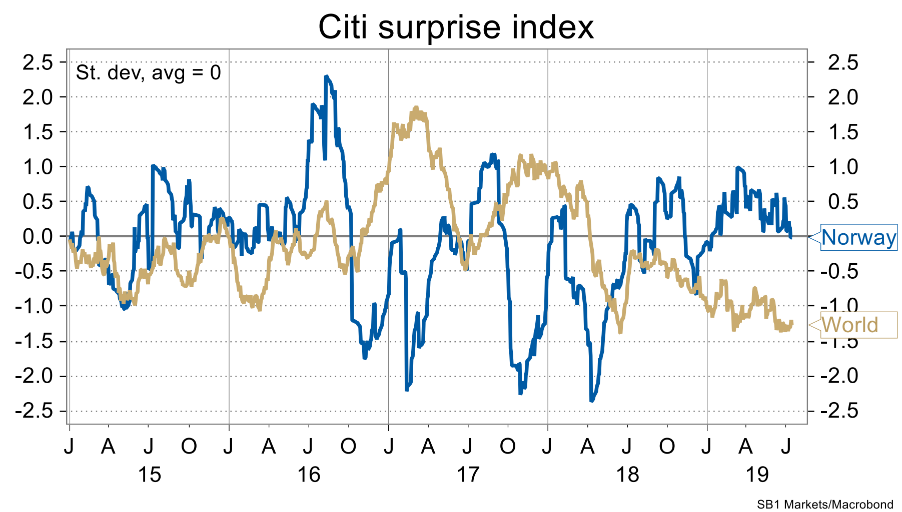
Norway

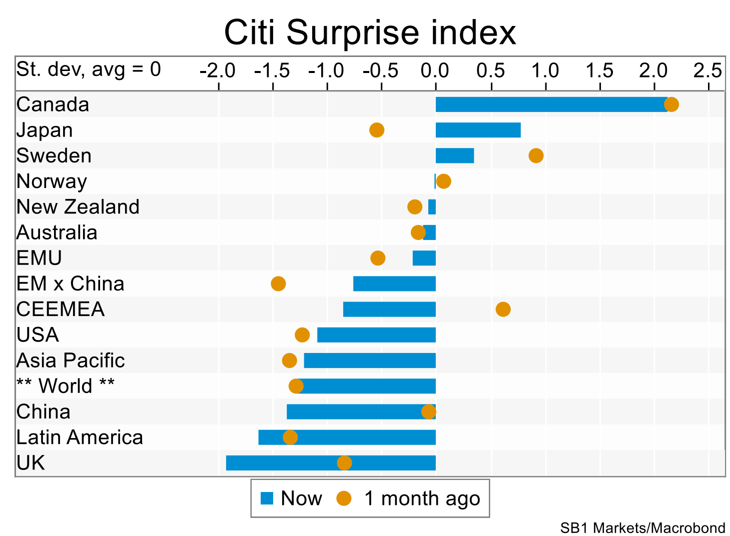
- Core CPI unchanged at 2.3%, headline sharply down with lower electricity prices, more to come
- May GDP data confirmes OK Q2 growth
- Both Mainland and oil exports down in June

Negative surprises most places, less in US, EM x China. More in China

The world is also unusually slack vs. vs expectations







- The global surprise index has been in negative territory since last spring
- EMU is not far below average vs expectations
- The US a tad less negative last week but still well below neutral
- Chinese data are weaker again (but possibly mostly due to 'old' (April) strong data moving out of the 3 m average measurement window, not that the very recent data are that weak. The June data out today will turn the surprise index up again
- EM x China less negative recent weeks
- Norwegian data close to normal

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

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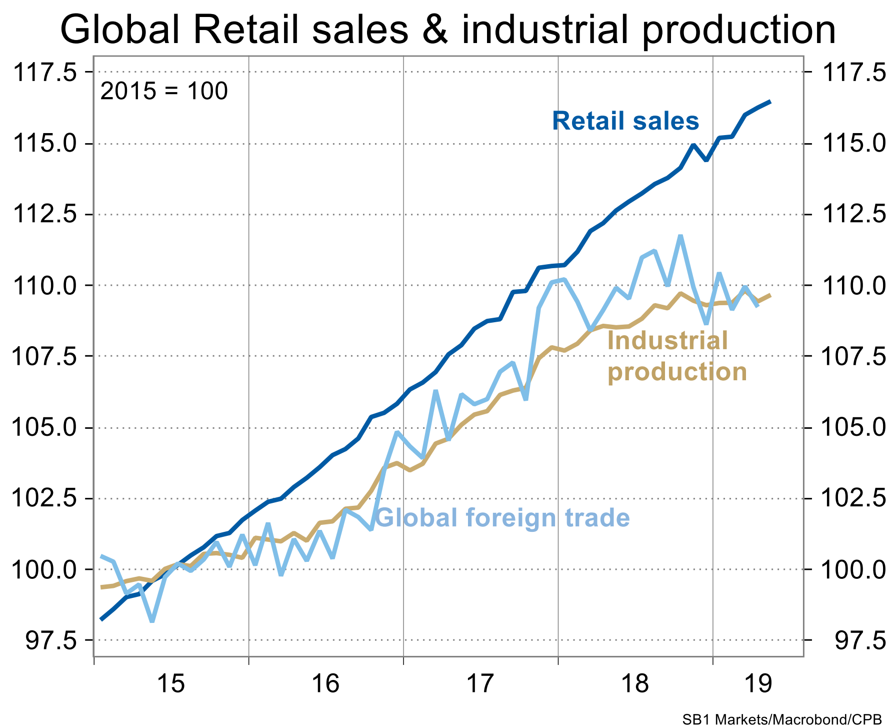
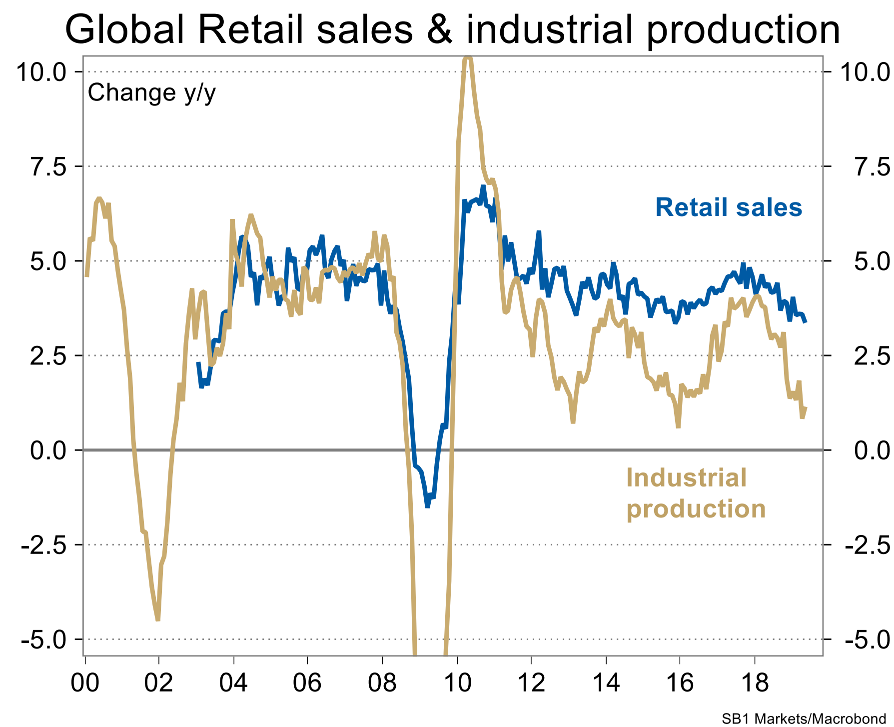
Manuf. production & global trade have stalled, retail sales still growing (slower)

Manufacturing production weaker than previously estimated in April, foreign trade not shining either





- Manufacturing production has been stagnating since last autumn. However, the slowdown has not accelerated recent months, although April came in on the weak side. The downturn the past 6 months are both due to somewhat slower growth in retail sales, a slowdown in business investments (triggered by global uncertainties?) and probably destocking following an unwarranted inventory build-up during 2018
- Global retail sales increased in April and is still trending up, at a somewhat slower pace than one year ago
- Global trade volumes fell in April and have stabilised the past 4 months, after retreating in late 2018

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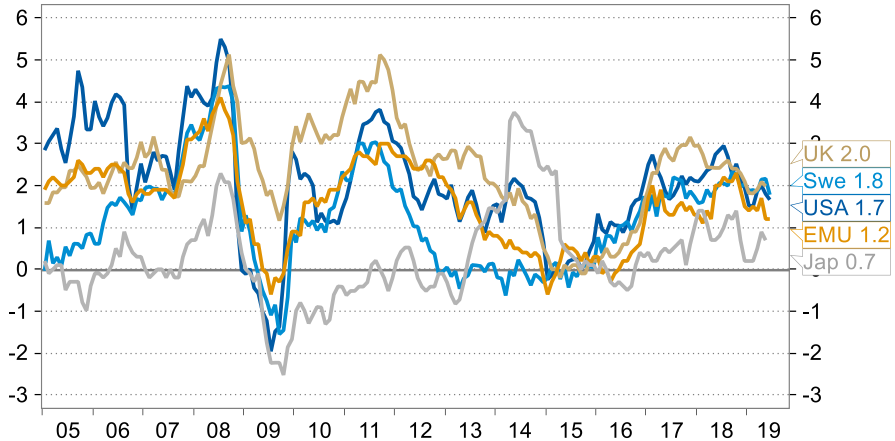
DM to turn south again, with the oil price? Core is sum flattish

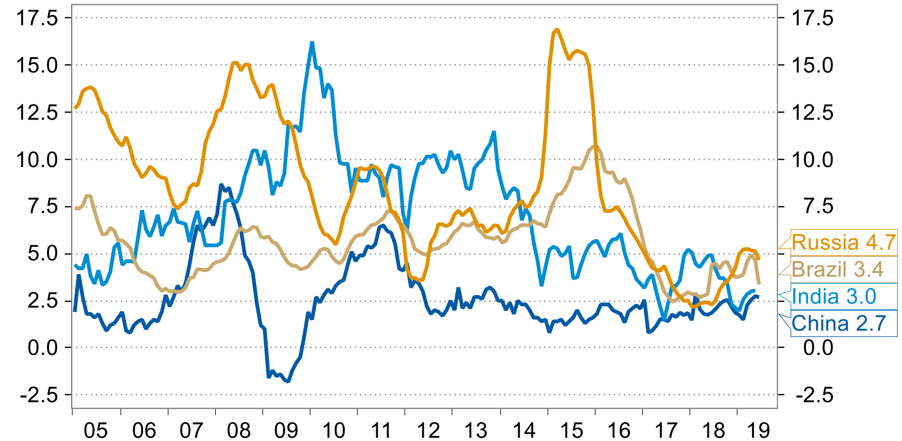
Core inflation at target in US, not far below in UK, Sweden. EMU still muted. EM inflation will pick up

CPI Inflation



SB1 Markets/Macrobond

BRIC Inflation



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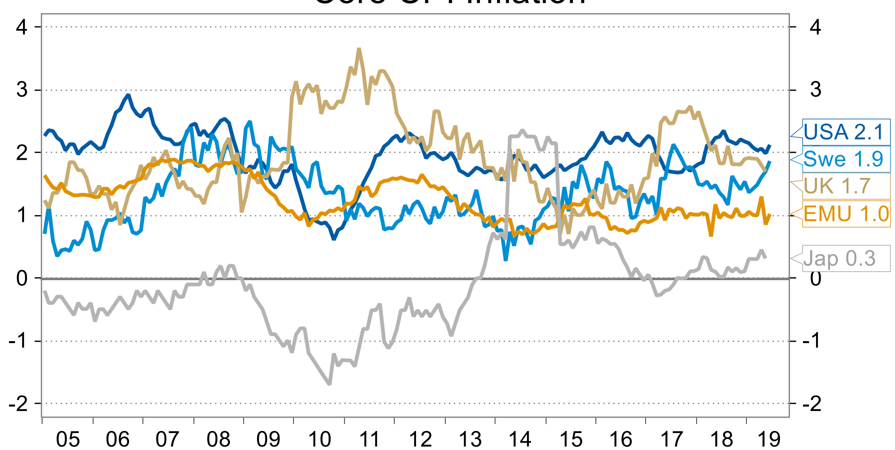
Core CPI Inflation



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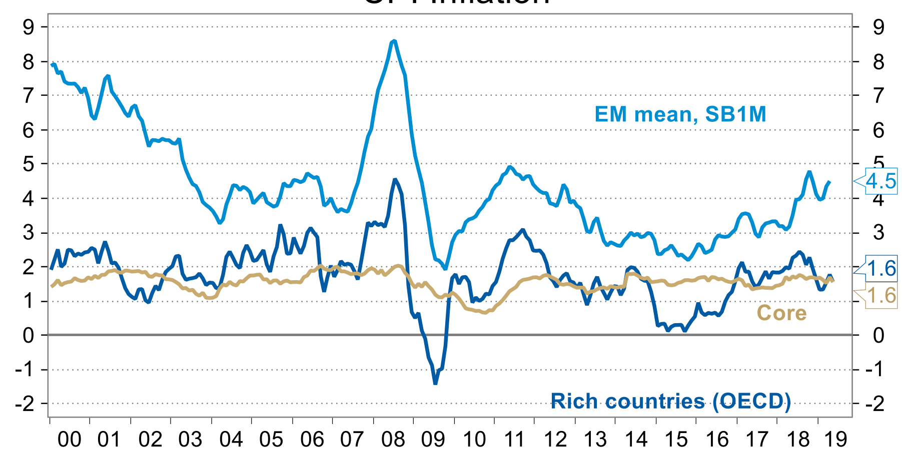
CPI Inflation



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

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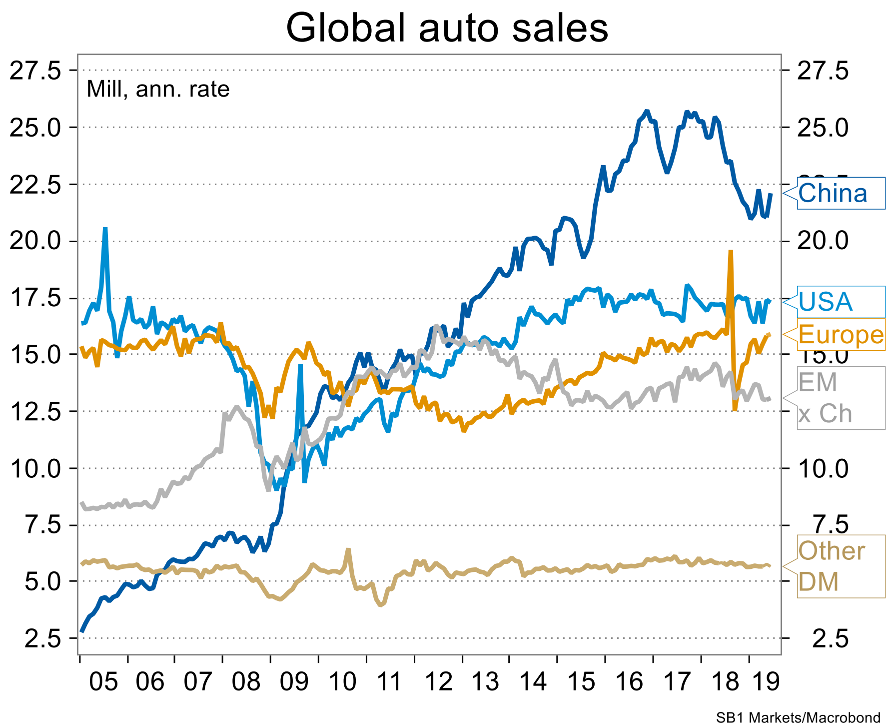
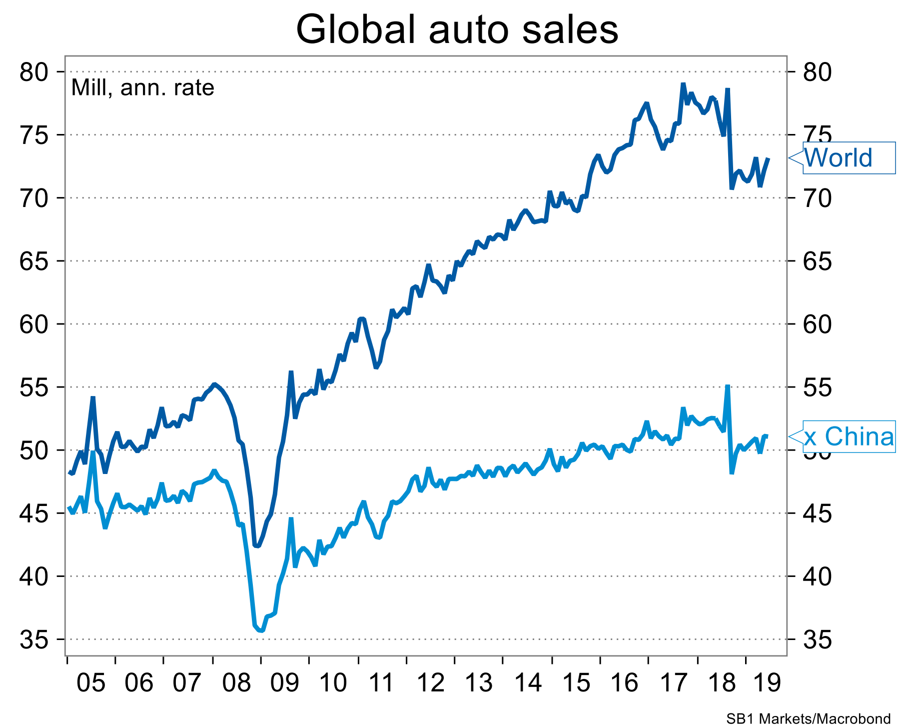
Sales up June - due to inventory clearance before new Chinese emission rules

Chinese sales rose 5% m/m, as retailers had to slash prices to clear the inventory of ‘old’ vehicles

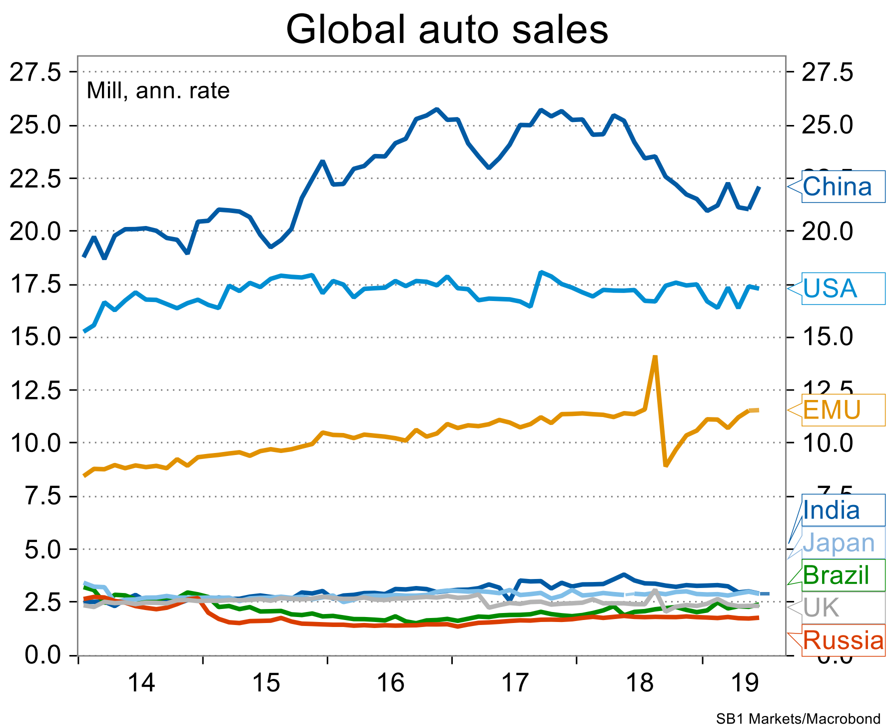


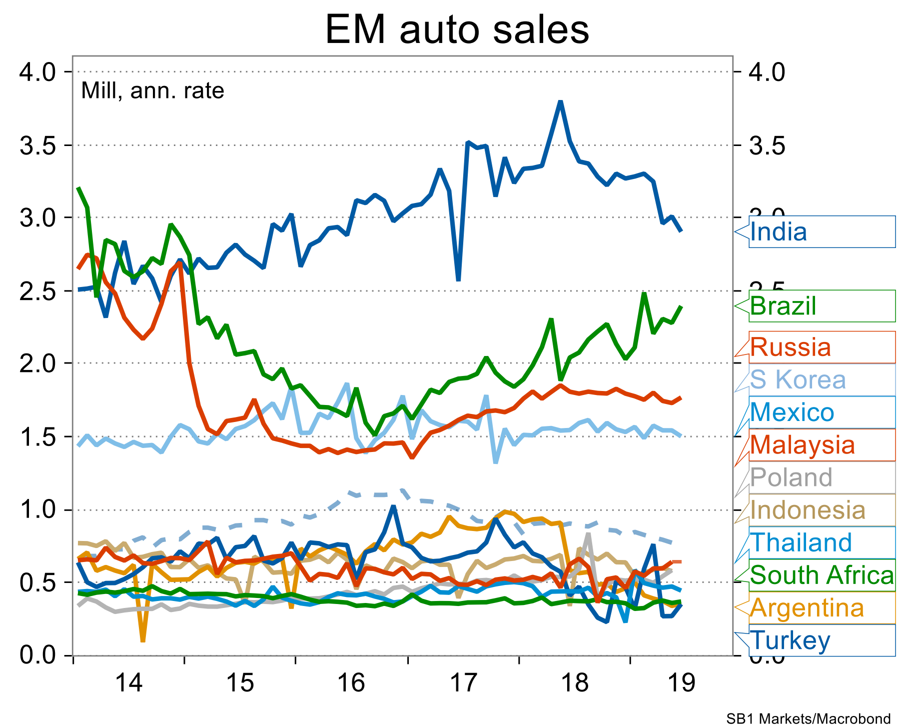


- Global auto sales grew 1% m/m in June, as in May but sales are still down 4% y/y. Sales x China were flat m/m – and they are down less than 2% y/y
- From July, the authorities in many Chinese cities have introduced tighter emission standards and retailer – and probably some factories - had to clear the inventory of old models by giving huge discounts. Measured at the retail level sales rose 20% y/y in nominal terms. Sales will very likely fall back in July. Even so, there are signs of a stabilisation of Chinese auto sales recent months, following an unprecedented 20% decline since last spring
- US sales were stable at a ‘high’ level in June but the trend is most likely slowly down
- Sales EMU rose further in May, and sales are now at the same level or marginally higher the before the emissions rule turbulence
- 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 up in June, but is trending down. India is slowing

Indian sales have fallen more than 10% past 4 months, more than 20% from last year's peak

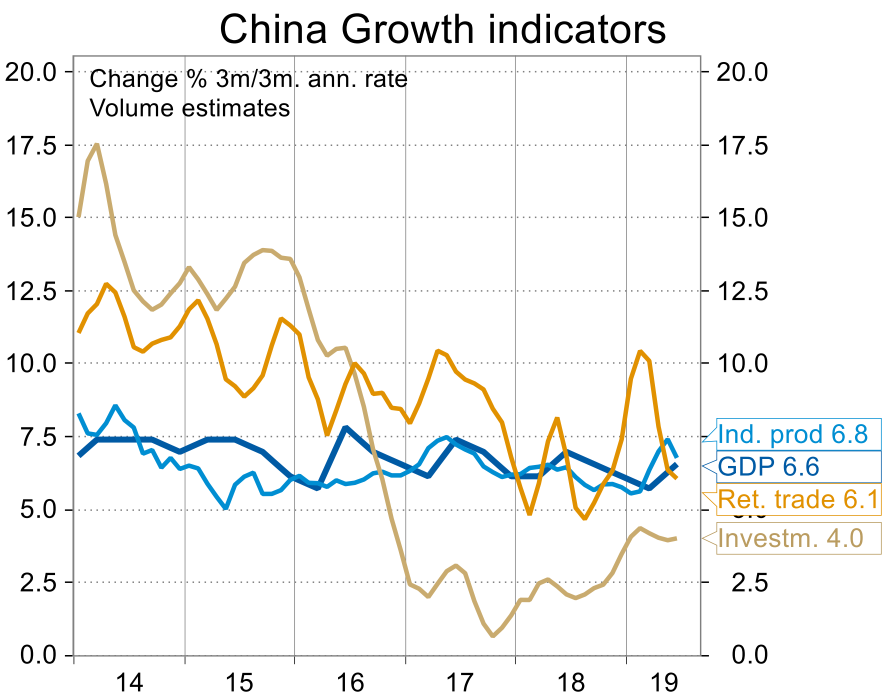




- Sales in Russia are heading slowly down too, as in South Korea & in Mexico (thus sales in 4 out of the 5 largest EM X China are slowing)
- Sales in Brazil are still heading up (and in Malaysia)
- Turkish sales have been extra volatile recently but have stayed at a low level past three months

GDP slows y/y but that's the only soft spot? Well, it's a bit more complicated

June and 2Q data were better than expected, even if the annual growth rate is the lowest 'ever'



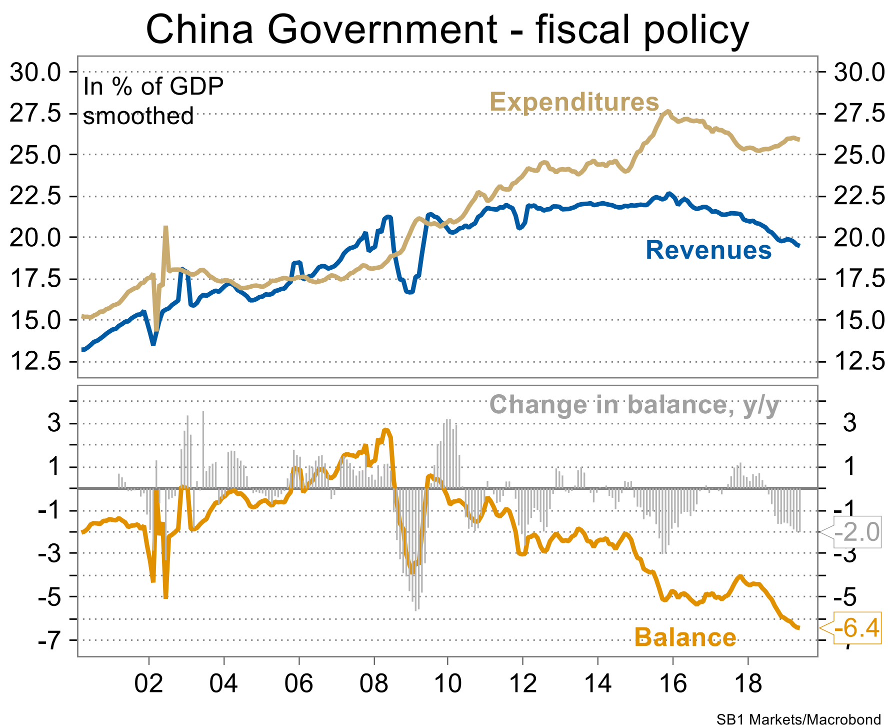
SB1 Markets/Macrobond

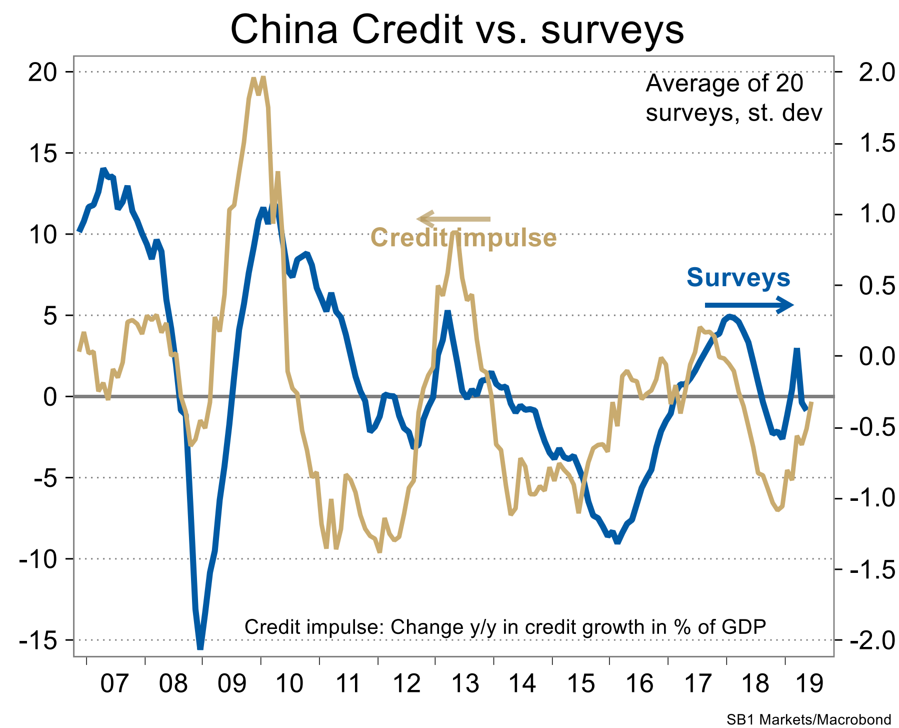
The most important message: We still no not find indications of a steep slowdown in China amid the escalating trade war

- **GDP** growth y/y fell 0.2 pp to 6.2% in Q2, as expected, and the growth rate is trending downwards. However, the quarterly growth rate accelerated to 6.6% from 5.7% in Q1, better than expected. Investment growth is slowing but not faster than before. Net trade supports growth. Growth is gradually slowing, even if both fiscal and credit policies have turned expansionary
- **Industrial production** accelerated to 6.3% from 5.0% y/y, according to the useless, volatile, official data, far better than expected. Production rose by 0.7% m/m, up from 0.4% the two months. Underlying growth is close to 7%. Surveys do not signal any slowdown from the 6% level
- **Retail sales** growth shot up to 9.7% from 8.6% (expected down), and sales rose 0.9% m/m. The jump is mostly due to higher auto sales ahead of new emission rules from July (inventory of 'old' cars had to be cleared). Underlying volume growth is some 6%, or somewhat lower
- **Investment** growth was steady at 5.4% y/y in June. The official YTD rate rose 0.2 pp to 5.8%, better than exp. Nat. accounts are reporting a steady slowdown in investments
- **Credit growth** picked up in June too, due to higher growth in the shadow banking market, while , after slowing in Q1. Growth has more or less flattened out, at some 11% y/y
- Both **exports and imports** close to flat m/m in June. Exports are not far below ATH, even if exports to the US are down more than 10%. Imports have fallen more, but volumes are close to flat y/y in Q2. We have seen it far worse

Growth is gradually slowing even if policies tries to stimulate

Record high budget at 6.4% of GDP, +2 pp last year! In addition: A credit policy turnaround





- 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 6.4% 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 been muted but credit growth has stabilised, thus the credit impulse has turned neutral, from sharply negative
- The 3 m SHIBOR has fallen sharply to 2.6%, the lowest since 2010 and markets expect the PBOC to cut signal rates. In addition, the CNY has depreciated somewhat

Faster GDP growth in Q2, even if the annual rate surprised on the downside

Anyway: GDP growth is still trending downwards, the annual rate the lowest 'ever'

- GDP grew 6.2% y/y in Q2, down 0.2% from Q1, in line with expectations (Bloomberg) or marginally below (DJ). The annual growth rate has fallen from 6.8% in Q1 last year, and is the lowest y/y growth rate on record (quarterly data back to 1992)
- Still, measured q/q, GDP grew 1.7% (6.6% annualised) in Q2, up from 1.4% (5.7%) in Q1, 0.1 pp faster than expected (quarterly data does not add up to annual growth rates, but that's another story)
- Big picture: Growth is slowing but at a slow pace. The authorities' growth target is at 6 - 6½%. Investment growth is slowing according to GDP data
- Are the official GDP reliable? Goods research suggests that growth is some 2pp lower than reported, mostly due to a much slower growth in investments

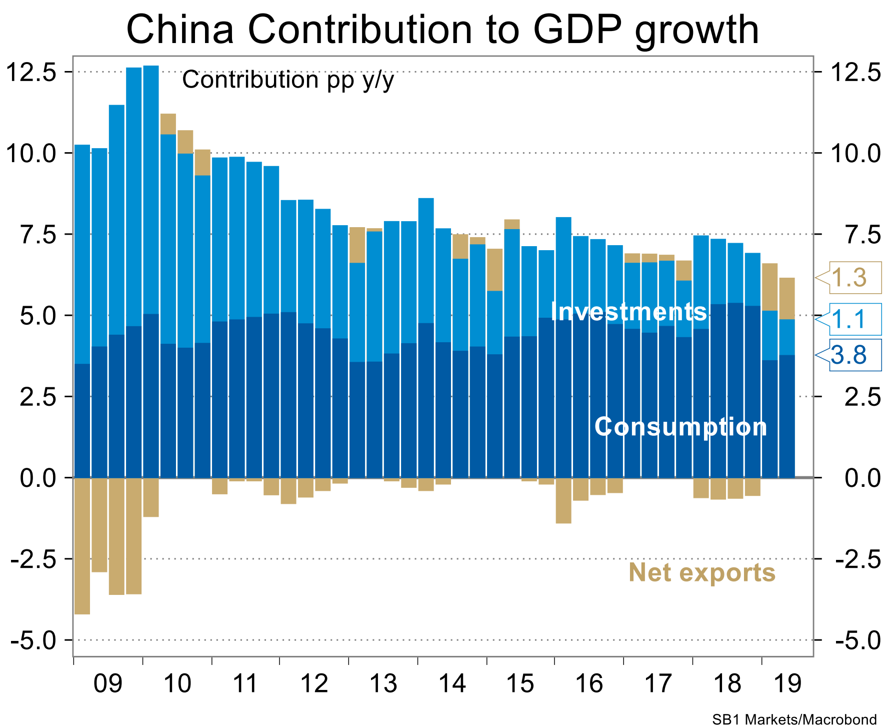
Whither GDP growth? And investment ratio?

Official GDP data have always been disputed. New research confirms reasons for scepticism

- According to research published by Brookings, real GDP growth may have been overstated by almost 2 pp per year since 2008, leaving the official GDP overstated by some 12%. By itself, probably goods news. The world has survived at an even more 'dramatic' decline in the Chinese growth rate – and the downside risk must be smaller
- Investments have been even more overstated, and the investment ratio may have fallen much more than the officially reported, it may be approaching 30% and not 40% (both starting from 42% in 2008). <u>If correct, the risk for an abrupt decline in investments is substantially lower than we have assumed</u>
  - » <u>The only negative impact of a lower GDP, debt ratios are even more crazy high!</u>

Investment growth slows further steadily; consumption not, in Q2

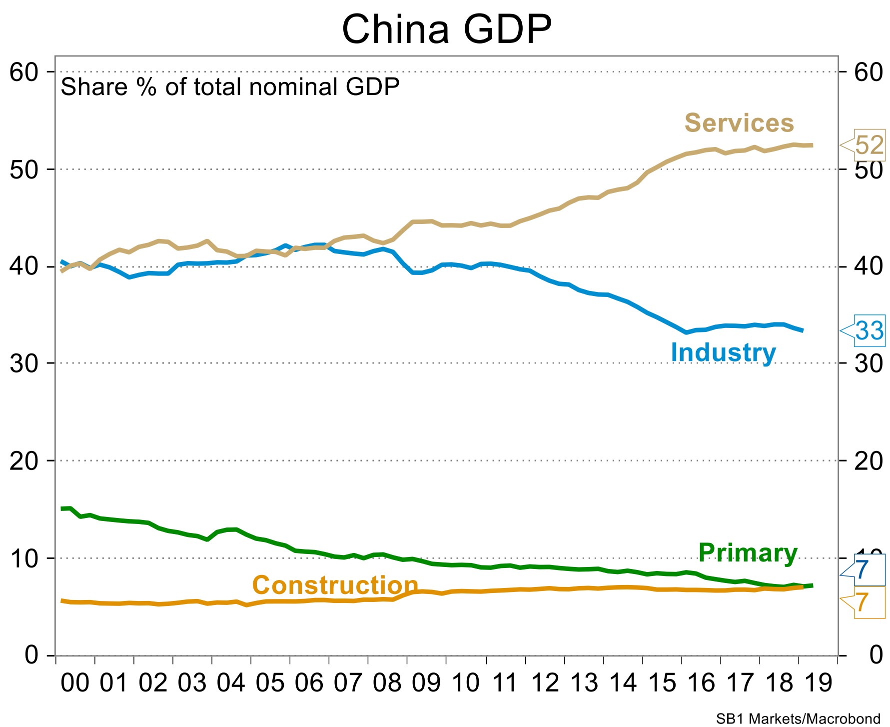
Net exports contributed positively in Q2, as in Q1



- In the Nat. accounts, net exports contributed to 1.3 pp GDP growth from Q2 last year. Net trade has in average been marginally negative since 2011. Not easy to identify any direct impact of the trade war… The slowdown in GDP growth is domestically driven
  - According to trade data (our volume calc), imports rose 6% in Q1, above the 3% growth in exports, while imports are down 2% y/y, and exports are up 1%.
- Consumption (private & public) contributed to 3.8 pp growth in Q2, a tad higher than in Q1 but sharply down from 2018 (above 5%). Consumption grew somewhat above 6% y/y
- Growth in investments (private & public) is slowing, measured as contribution to growth according to Nat. Accounts, now just supporting GDP growth by 1.1% (implying a growth rate at some 2.8%, down from 5% tow years ago – and much higher some years ago. However the slowdown is very gradual, and we assume in line with the authorities' ambitions in order to get the investment ratio further down to reduce the risk for a sudden halt due to overinvestments (which still is a substantial risk!). The continued gradual slowdown may now of course be due to the trade war reducing investment appetite

Services are slowing too but less than industry. Strong growth in construction

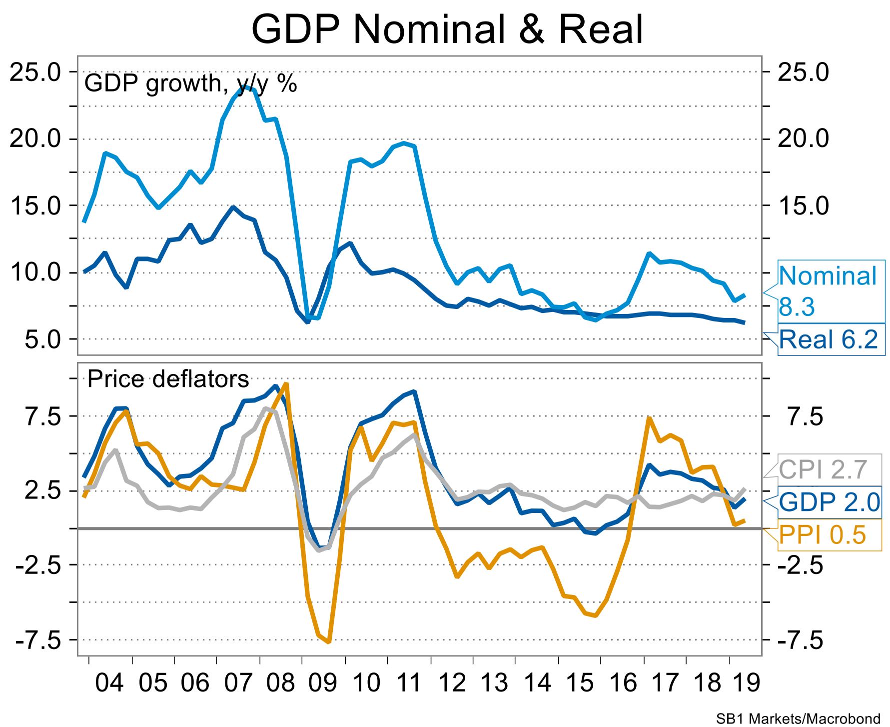
Nominal growth has slowed in the main production sectors, just construction remains above 10%



- No Q2 data for construction, industry

GDP price deflator +2.2%, nominal GDP 8.3 %, both are trending down

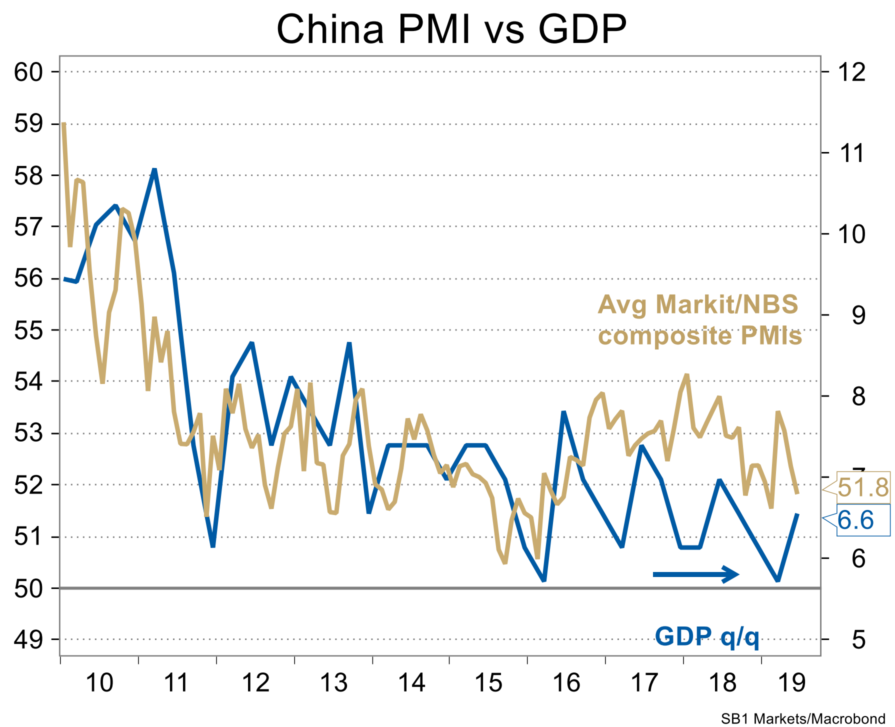
However, neither slowed further in Q2, and neither are at low levels

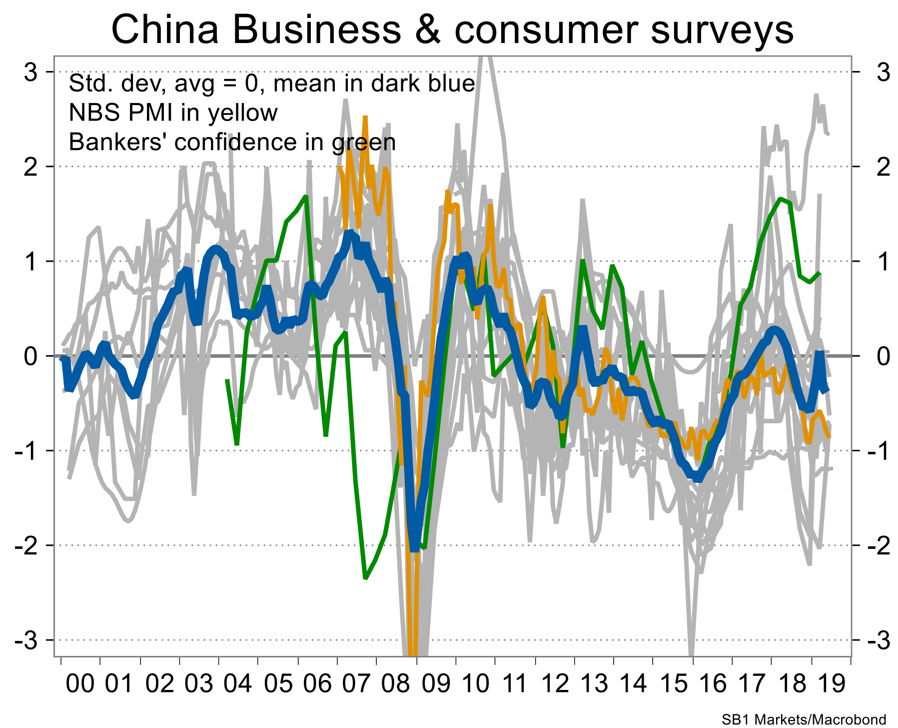


- Manufacturing producer prices (PPI) up 0.5% y/y, down from above 7% (!) less than 2 years ago. CPI up 2.7% in Q2 in average, up from 1.8% in Q1 – entirely due to higher pork meat prices caused by the serious swine flu

Surveys are not signalling a further growth slowdown

Most surveys dell last year but the average has recovered, at least until May/June

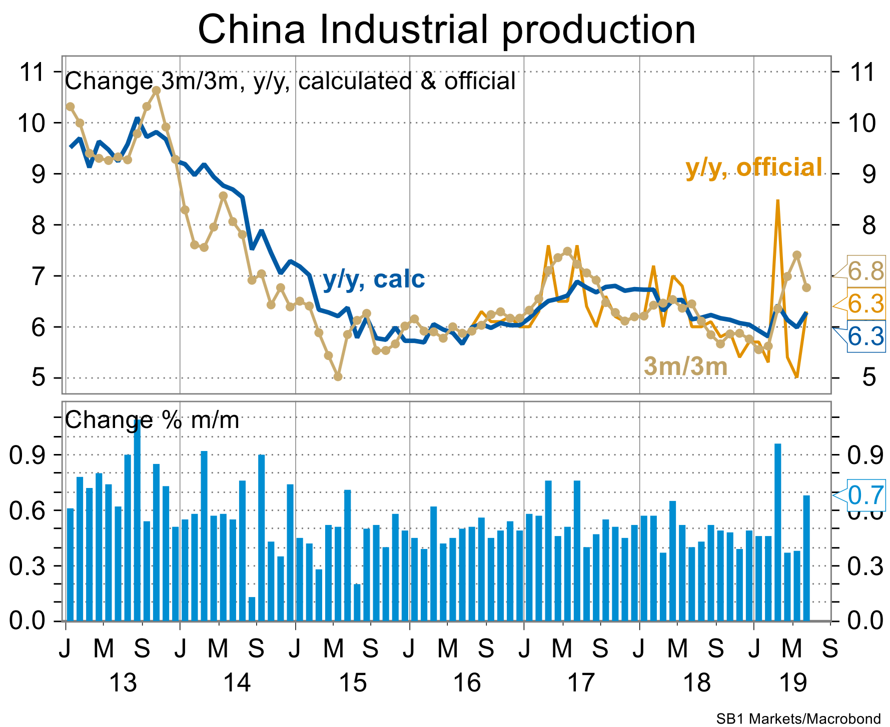


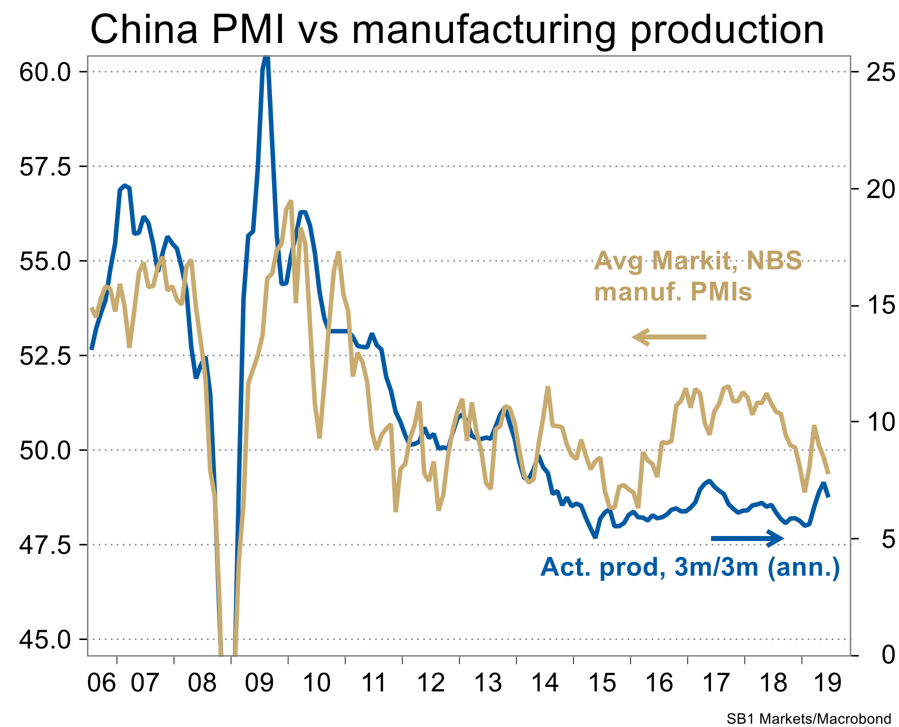


SpareBank 1 MARKETS

Strong growth in industrial production in June, up 0.7% m/m (vs 'normal' 0.5%)

The official y/y jump to 6.3% from 5.0%, and 1 pp higher than expected overstates the strength

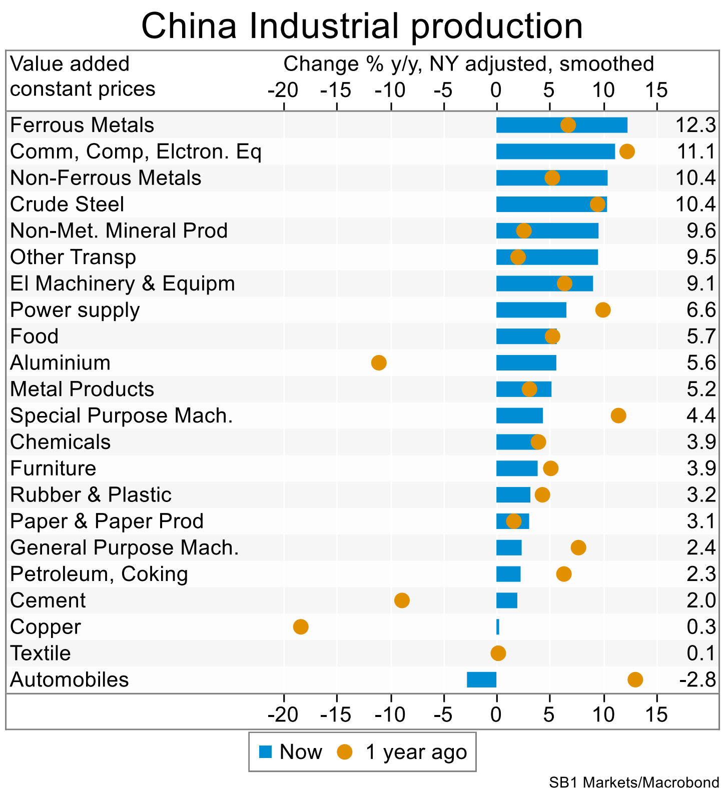




- Production rose 0.7% m/m in June, up from 0.4% in April and May. In March production rose more than 0.9%. Measured 3m/3m (now Q2 from Q1) growth is at 6.8% (and by 6.3% H1/H2), both the best in 2 years. Measured y/y, based on these official monthly seas. adj data yields a 6.3% growth rate.
  - 'Our' y/y rate growth rate is much more stable than the useless official y/y unadjusted growth rate, now up to (a 'correct') 6.3% from a ('too low') 5% growth rate in May. The May growth rate was the lowest growth rate on record, barring some volatile single monthly prints 1997 – 2002
- 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

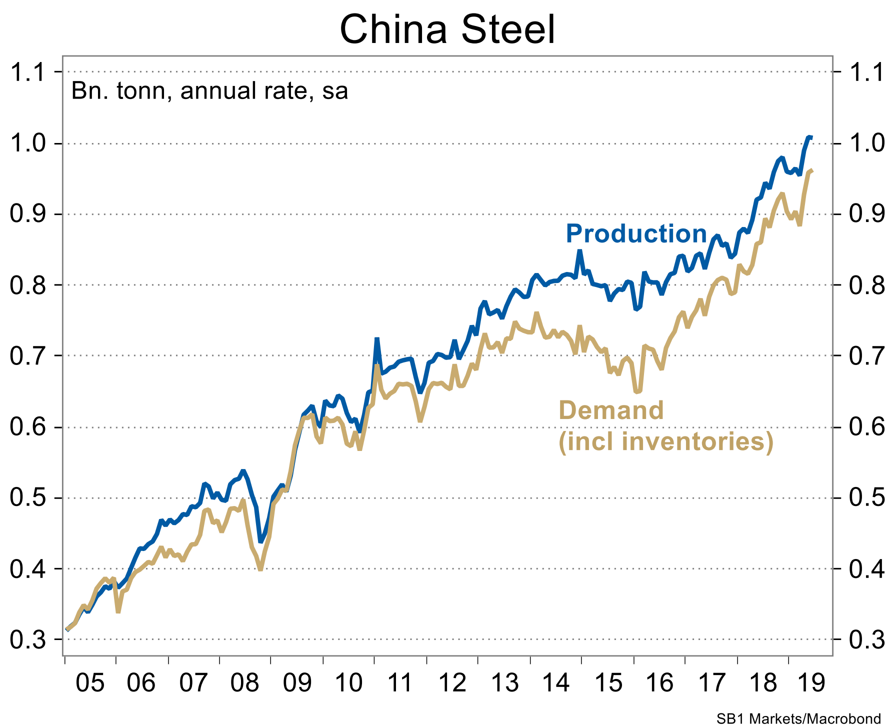
10 sectors are accelerating, 7 are slowing. Auto production is stalling, downside risk



- Crude steel production is gaining steam, after a stagnation in early 2019, up more than 10% y/y (3 m smoothed)!
- Aluminium production is recovering from the downturn in 2017 and is increasing by 5% y/y
- Cement production is slowly climbing, still up just 2%
- Copper production inched up (in May, no June data yet) and has stabilised following an almost 20% decline from late 2017 to 20018
- Auto production (valued added) has been hurt by weaker sales but has kept (unbelievable?) stable, down just 2.8% y/y, while sales are down almost 20% 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

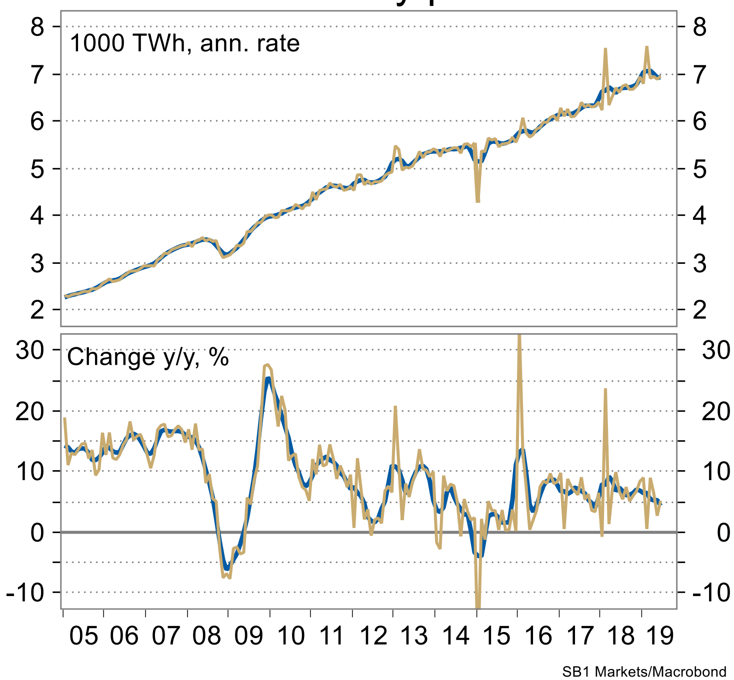


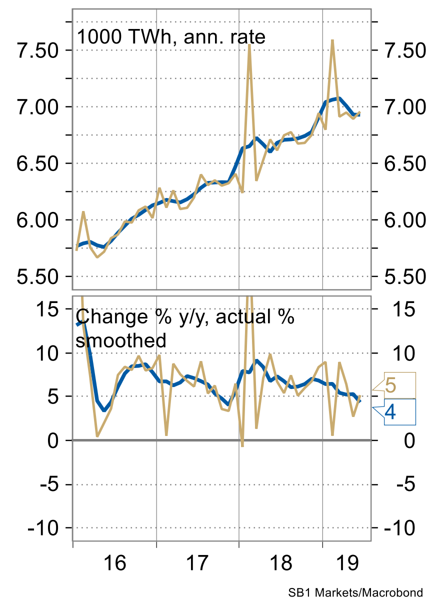
- Production is up some 10% y/y and demand is expanding at a 12% speed, pretty well explained by the strong growth in construction starts. On the other hand, slowing auto production signals softening steel demand from that sector
- China is still a net steel exporter, but far less than during the 2015-16 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 some weakness in seaport activity

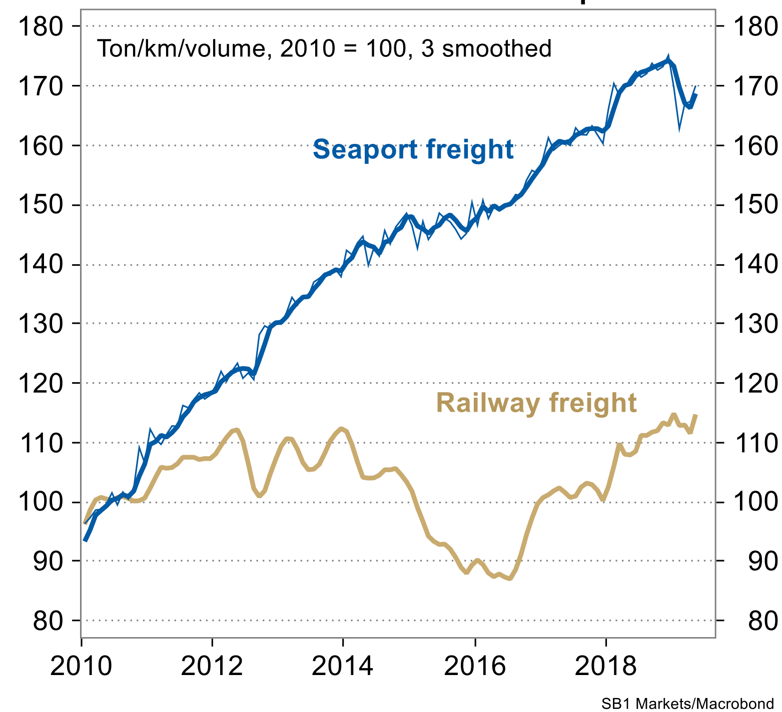
Electricity production has slowed somewhat recent months, trend still up, at a 4% y/y speed

China Electricity production





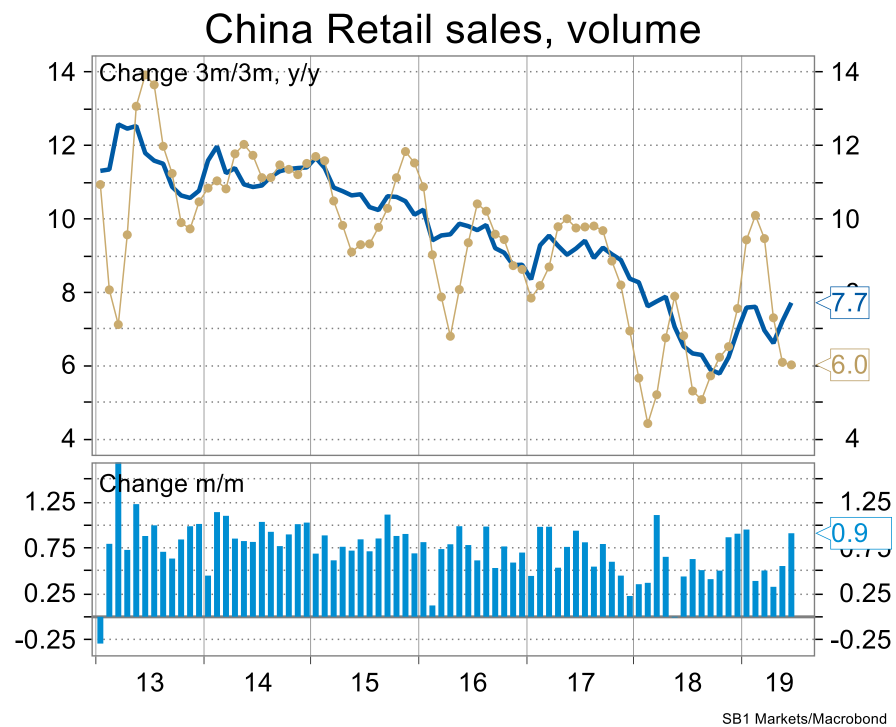
China Trade and transport



- 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 11% growth in June, up from 8% in May, 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 up in June, due to a temporary hike in auto sales

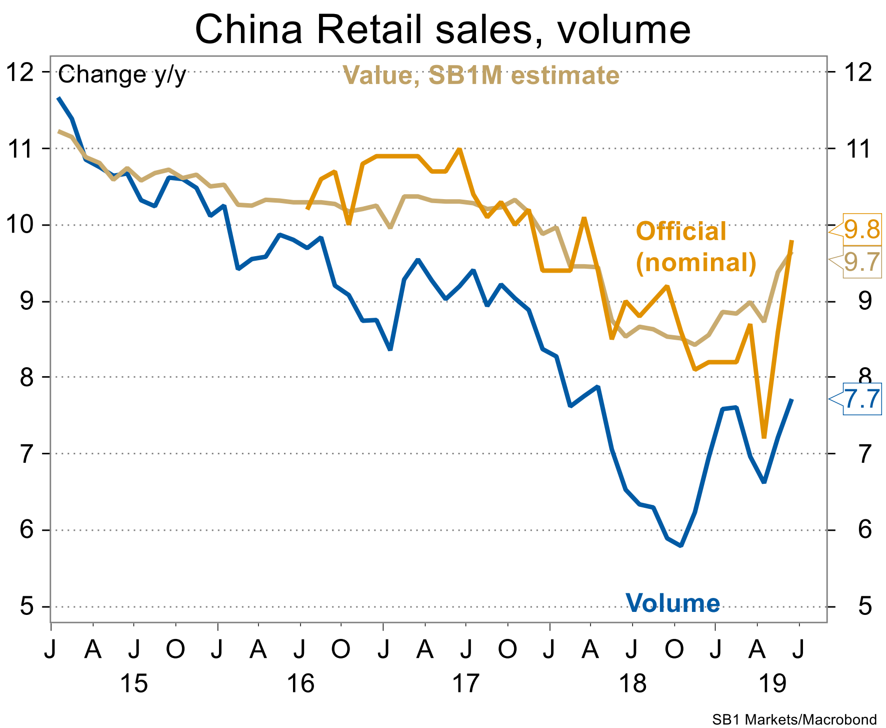
Sales up 0.9% m/m

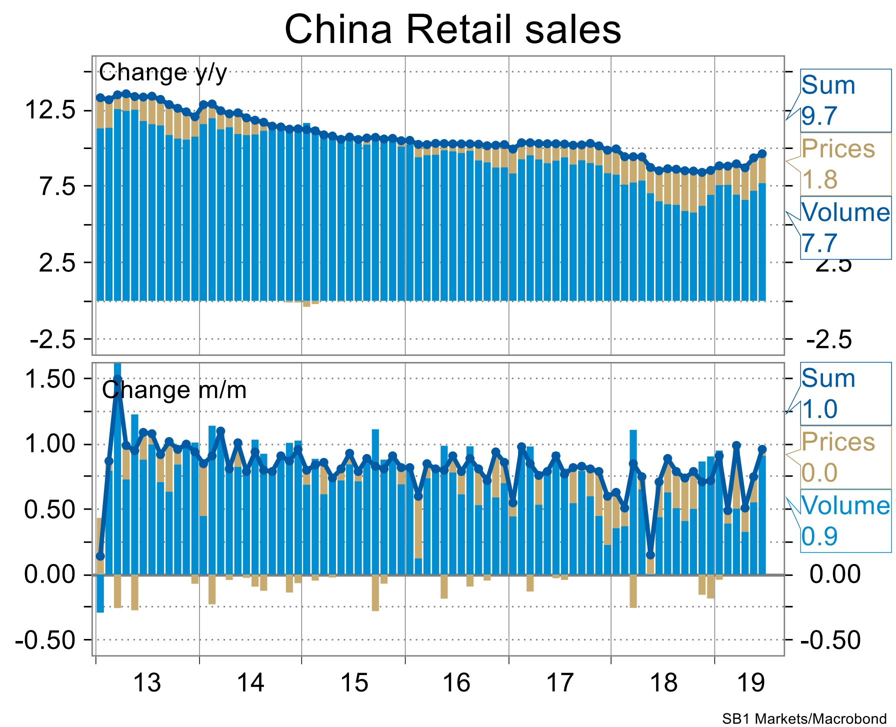


- The official value growth rate accelerated to 9.8% from 8.6% in May, and well above expectations at 8.5%. Auto sales were much stronger than assumed, up 17% y/y (nominal value of a sales), from 2% in May (and negative y/y before that). The jump is due to the introduction of new emission rules in many cities from July forcing dealer to cut prices sharply to get rid of the 'old' cars.
- Our (normally) less volatile value growth estimate (based on monthly seas adj. data) yields 9.7%, from 9.4% in May (revised up from 8.7%!)
- Our volume estimate is 0.9% m/m in June (retail prices were probably flat in m/m), and the annual volume rate rose to 7.7%, from 7.2% in May (revised from 6.6%). Even if the annual growth rate has recovered somewhat since late 2018, underlying volume growth has slowed, and now down to 6%, even with the strong June included
- 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

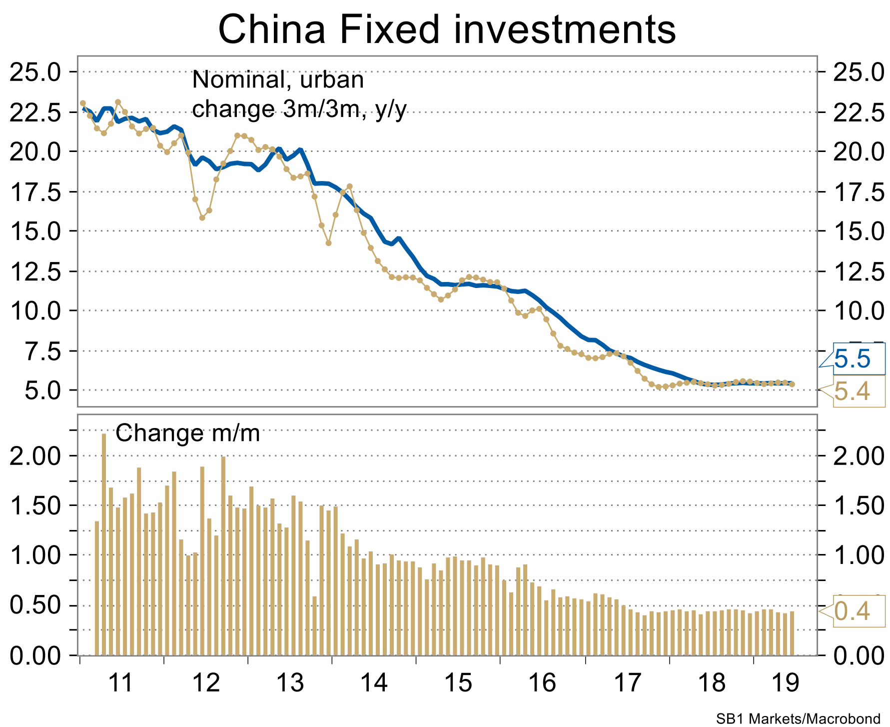




- Retail prices are up just 1.8% y/y, while the total CPI is up 2.7%. The discrepancy is not due to services, and the low retail price inflation does not seem that reasonable as foods prices are soaring. Thus, the 'real' real growth may be lower than our estimate

Nominal investments are growing steadily, according to monthly stats

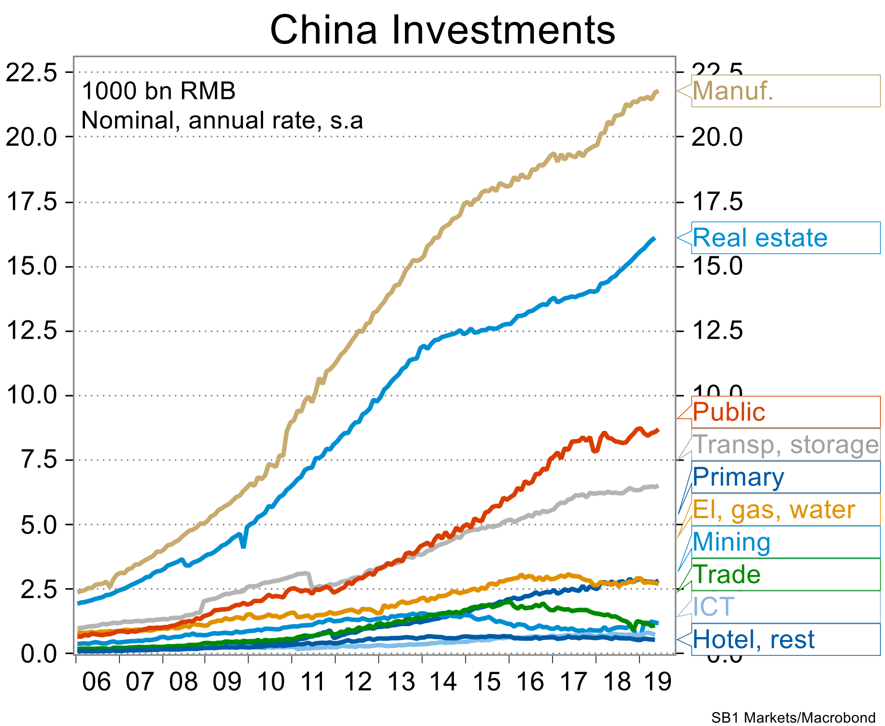
The long term decline in investment growth has halted, at a comfortable, low level

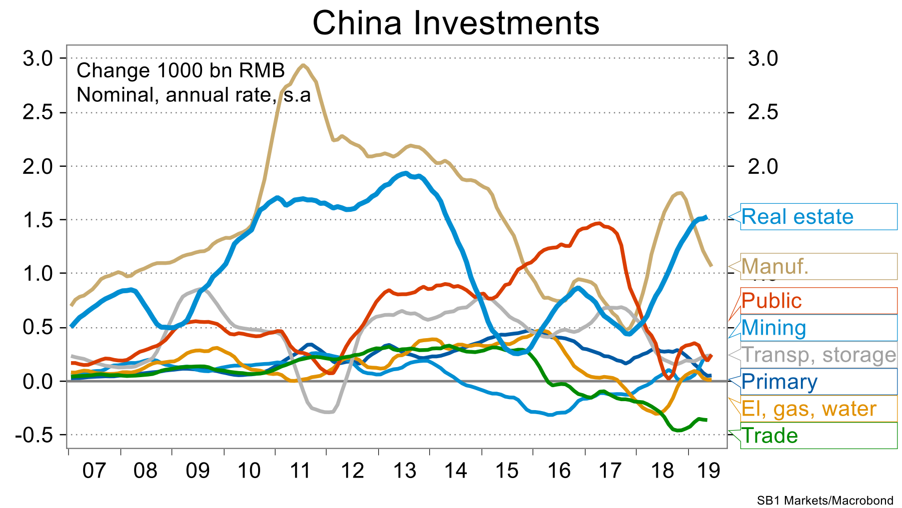


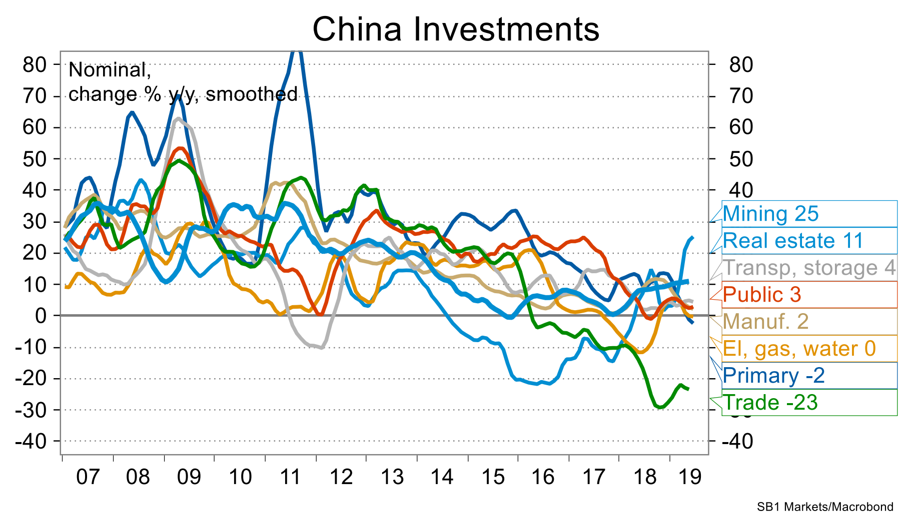
- Urban investments rose 5.8% y/y ytd in June, according to the official data, up from 5.6% in May, expected unch. Our calculation yields a 5.4% y/y growth, stable recent months. The m/m rate was stable at 0.4%. Growth has been stable since late 2017. In real terms, we assume growth has accelerated, 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. National accounts report a steady decline in growth in investments, check here

Investments are still expanding in all sectors barring trade war concerns

Retail trade inv. down 23%, may have bottomed. Manufacturing has slowed but





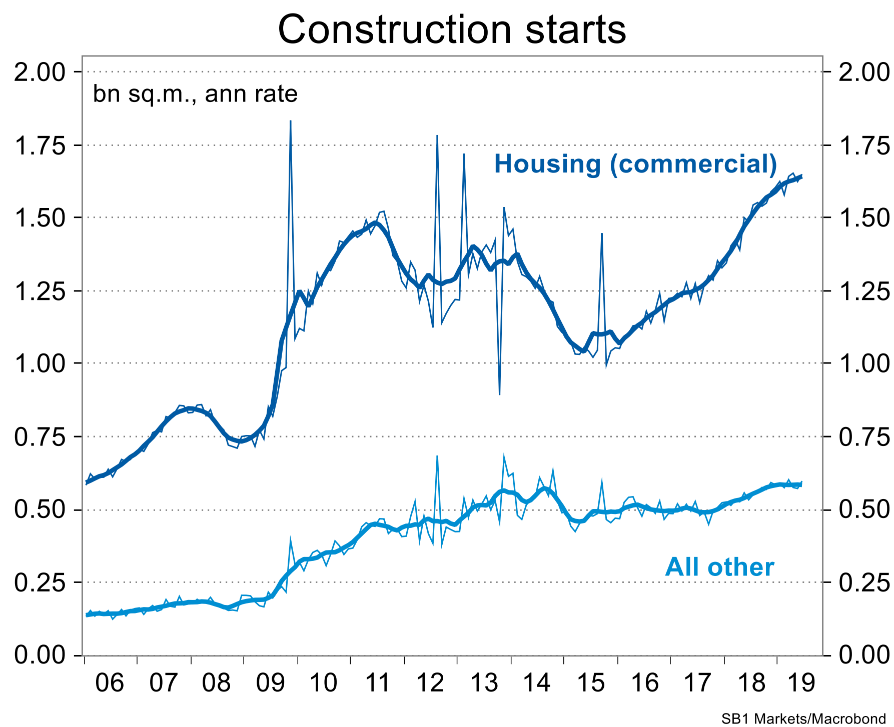


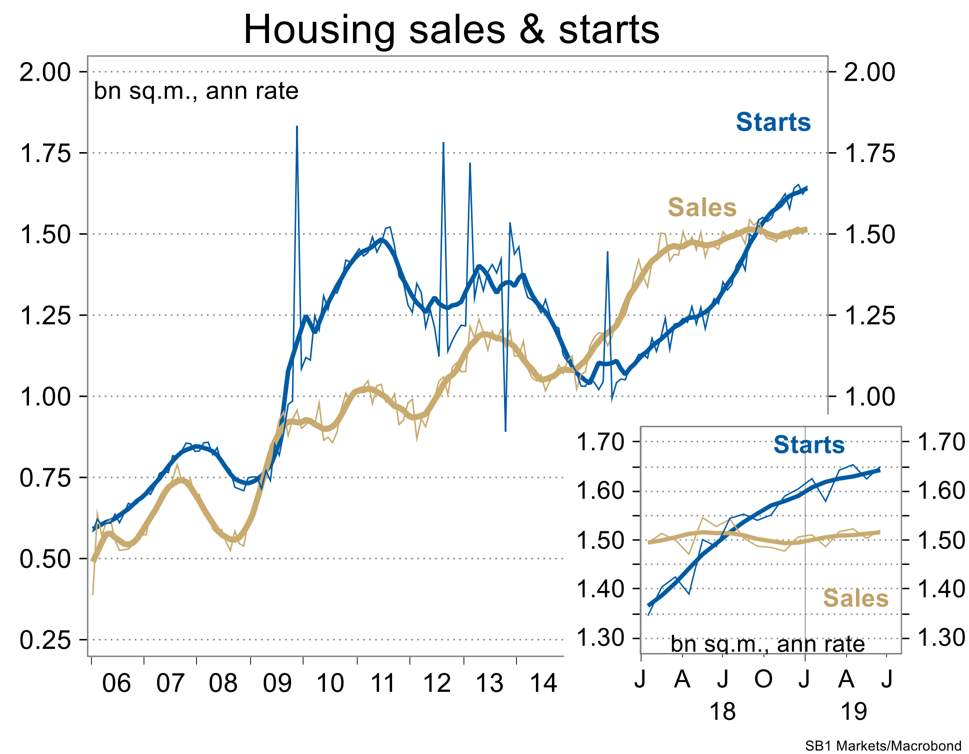
Not all sectors have reported data for the last month

- Manufacturing investments are still on the way up but just 2% y/y (but May and June a tad stronger)
- Weak retail sales through 2018 probably brought investments in trade sharply down. Signs of stabilising now
- Real estate investments are nowt the main growth engine, up 11% y/h
- Public sector investments have slowed past 2 years, has have investments in transport. No signs yet of the fiscal stimulus

Home sales, starts up in June; starts trend still upwards, sales flattish

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

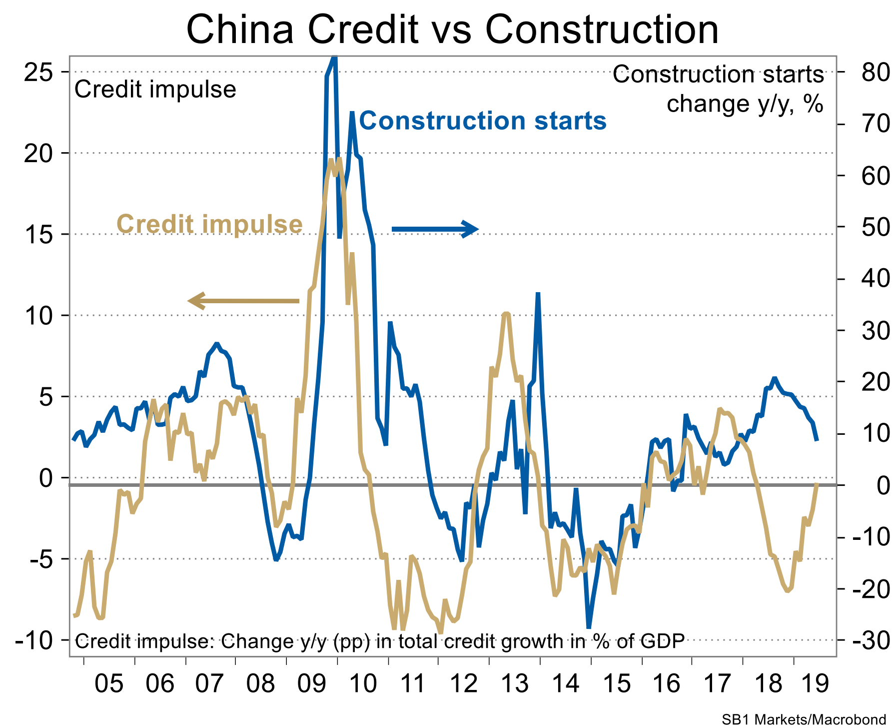




- Sales of new homes have flattened out over the past couple of years, at a record high level. Sales rose marginally in June
- Housings starts are running higher than sales, still trending up – and starts rose more than sales in June. Even so, given the large inventory drawdown from 2014 – 2018 (starts were below sales), the increase in inventories does not seem worrisome, yet Starts are up more than 50% from the 2015 trough, and are up 10% y/y (smoothed), down from more than 20% through 2018
- Other construction starts have been trending upwards since late 2017, may be peaking now? Annual growth down to 7%, from 20% in late 2020. These starts have reached a new ATH too, although the level is not that much higher than 5 years ago. The cycle in non residential construction is very close to the cycles in housing construction

Credit and construction usually correlated but not recently

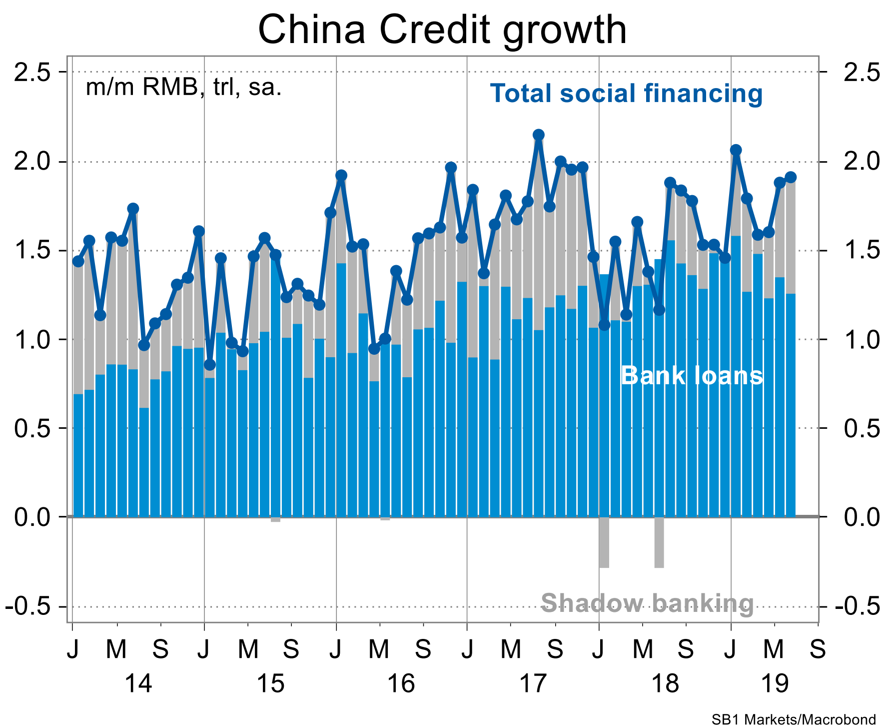
The 2017/18 credit tightening did not dampen construction

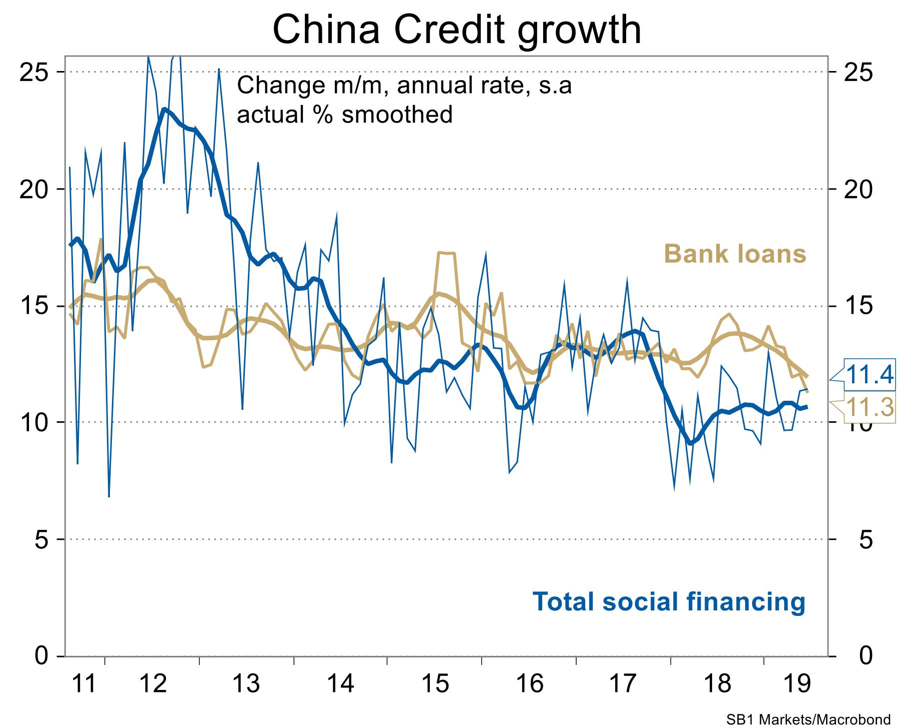


- Now, the credit impulse has turned upwards and the authorities might be able to accelerate credit
  - » However, would that be sufficient to ignite a faster (or even further) lift in construction activity?

Credit growth accelerated in May/June, even if bank lending is slowing

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

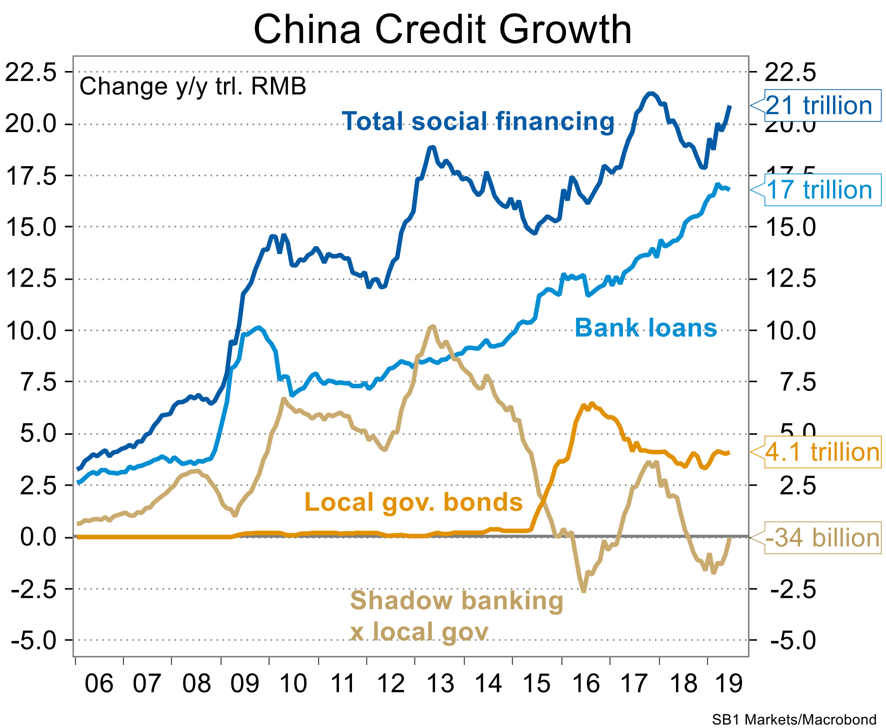


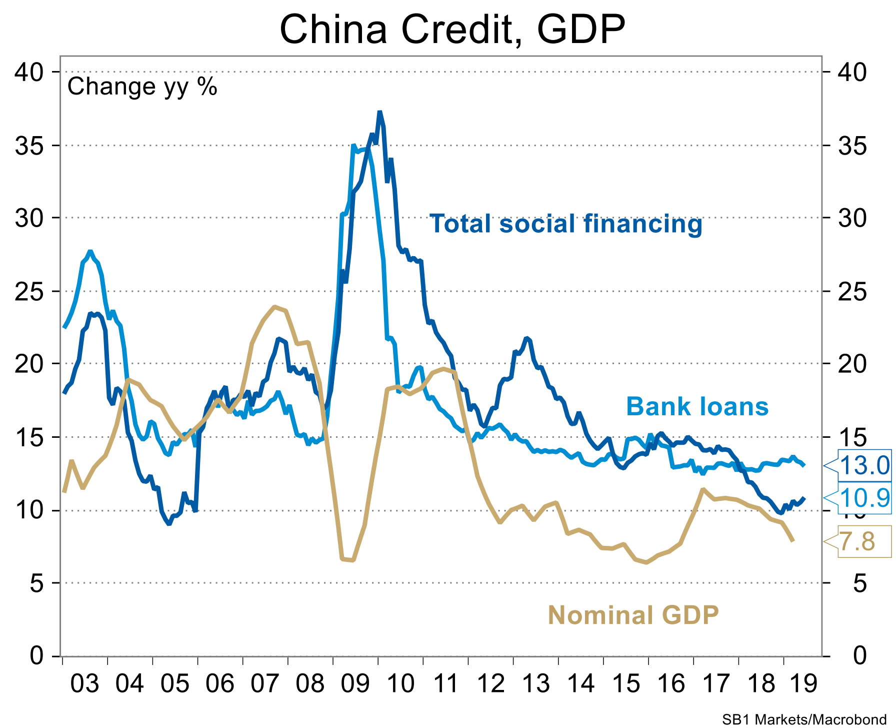


- Total credit rose by 11.4% m/m annualised in June, the highest in 5 months, and unadjusted total credit m/m growth at RMB 2.6 trl vs. expectations of 1.9 trl. Seas adj. total credit grew 1.9 bn, marginally up from May. Still, the underlying trend over the past year is flat – and not accelerating. Total credit is up 10.9% y/y (from 10.5% in May, but lower than expected) – and above the reported 8% nominal GDP growth
- In 2018, the authorities tightened credit supply through the non banking credit market and total credit growth slowed by 5 pp, a significant change. As usual following a credit tightening, GDP growth slowed. Now, following several measures to stimulate credit growth, mostly to counterweight the impact of the trade war, growth has stabilised. Thus, the credit impulse is neutral (and underlying growht it is up from the early 2018 slump)
- What's next? Many expect the PBoC to turn more expansionary. However, there are good arguments against pushing the credit accelerator even harder. Credit growth is well above growth in nominal GDP, and very high debt ratios are climbing further

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

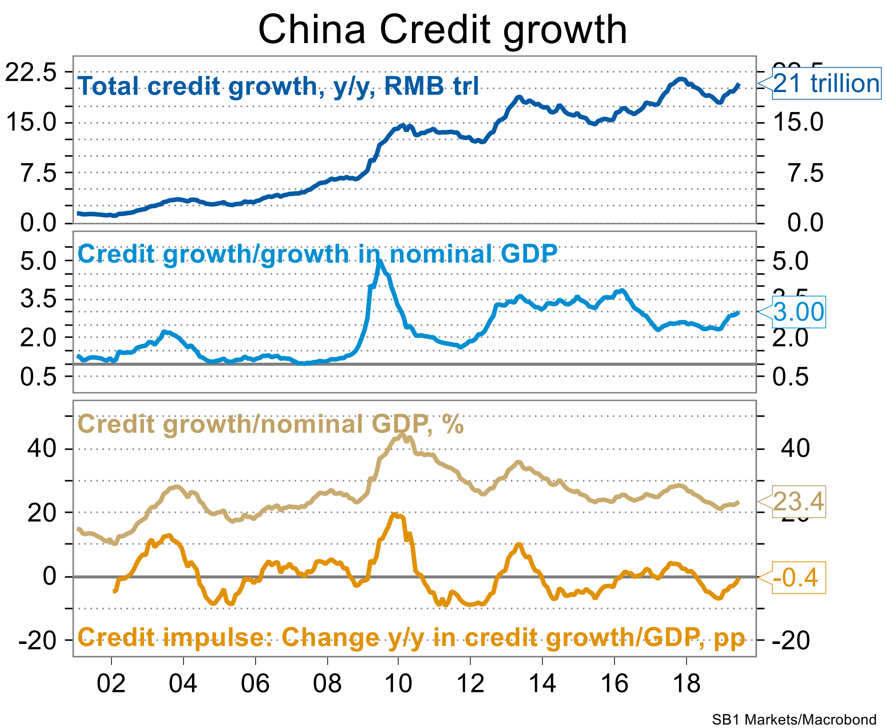


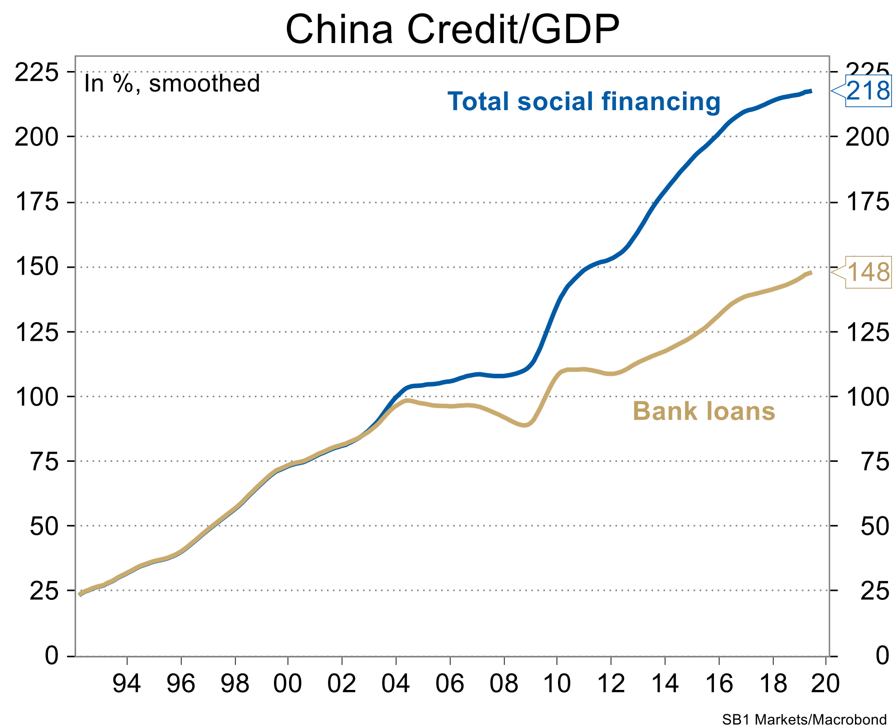


- Over the past 12 months, total credit has grown by CNY 21 trl, equalling 23% of GDP. The annual rate bottomed out in Dec
- Banks supplied CNY 17 trl (85%) of the increased credit volume
- Local governments borrowed CNY 4 trl in the bond market
- Other credit – via the shadow credit market x gov bonds – are flat y/y, from a negative drag over the previous year
- Total credit growth at 10.9% is well above growth in nominal GDP

Credit impulse back to neutral, from negative

Credit growth is slowly increasing vs GDP but still flat y/y (will probably turn positive soon)

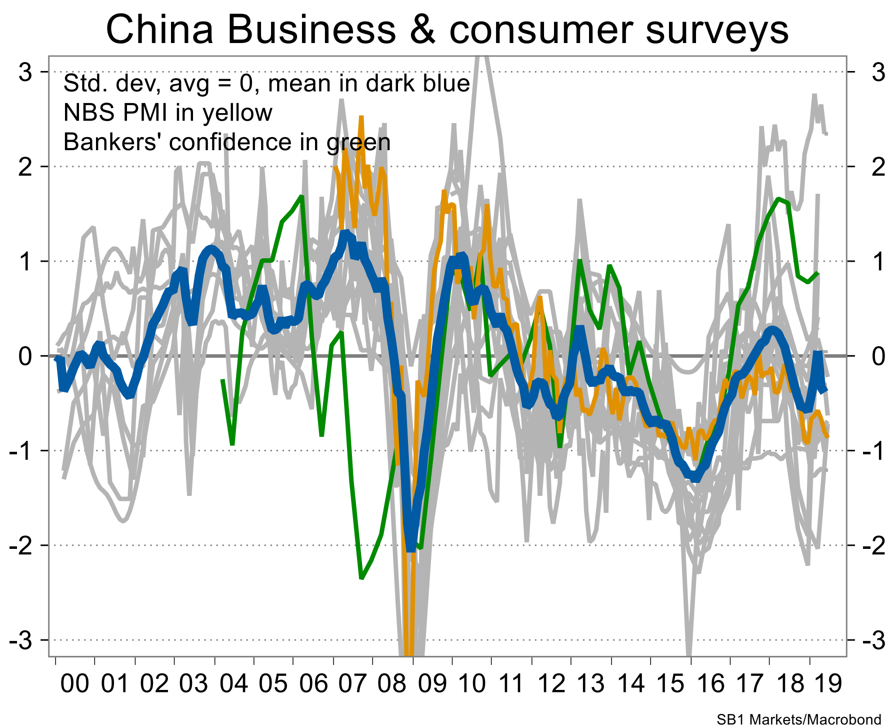


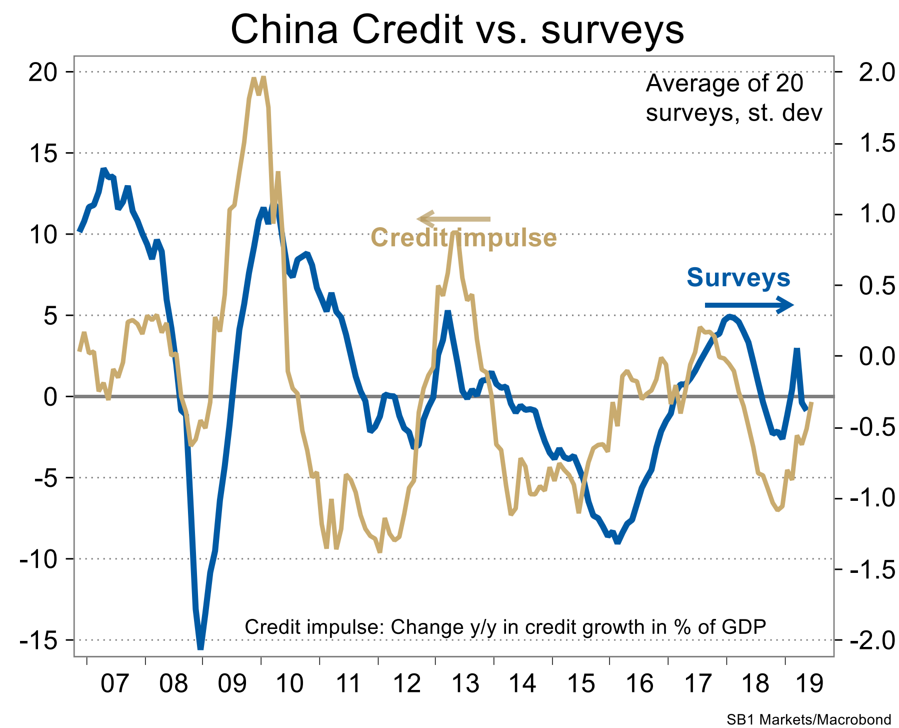


- A negative credit impulse implies that the credit growth/GDP ratio is declining (the 2nd derivative)
  - » Indicates credit tightening (or weaker demand)
  - » Has been associated with slowdowns in the Chinese economy
  - » Now, the credit impulse is has risen to neutral measured y/y (the 3rd derivative ☺ 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

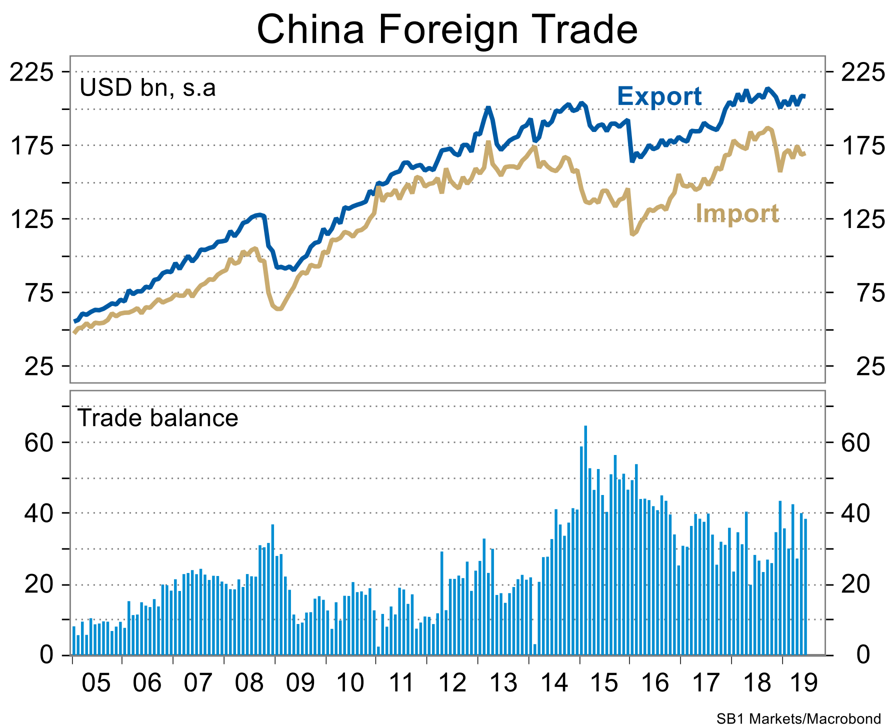




- An avg of Chinese business & consumer surveys indicates that growth has slowed significantly. However, the level is still not very weak, neither are the PMIs

Exports/imports stable in June, export volumes close to ATH, imports not weak

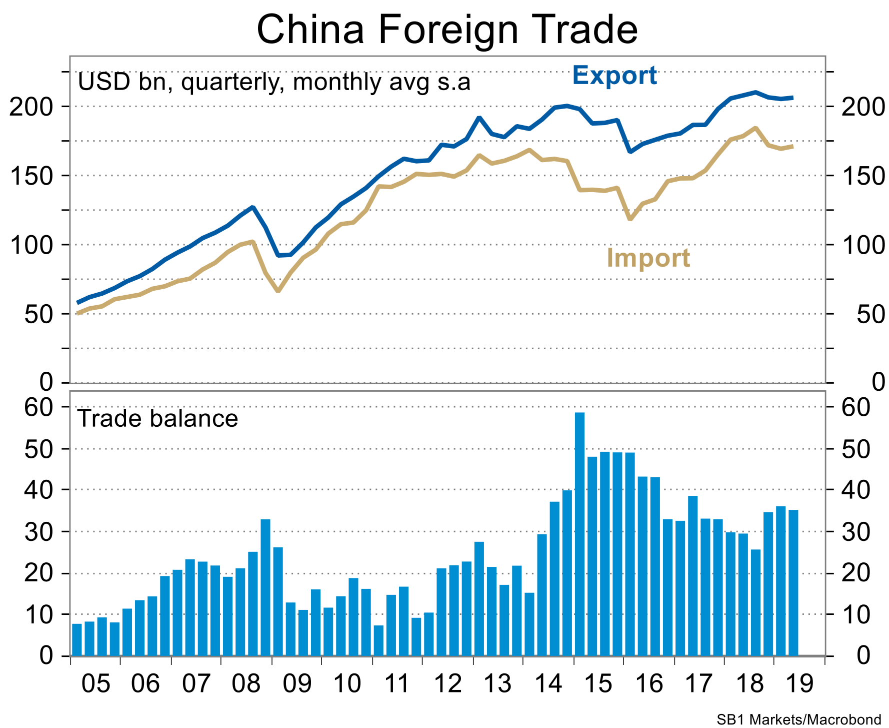
Exports & imports have recovered after the drop last fall. The trade surplus remains large



- Exports were reported down 1% y/y in May (in USD), close to expectations. Exports were flat m/m, and export volumes are close to ATH after recovering from the Q4 local trough, both in value and volume terms. The trend since early 2018 is close to flat
  - Exports to the US rose in both May and June, perhaps to avoid the announced tariffs hikes. US exports are down 10% since before the tariffs were implemented. Exports to other regions have slowed
- Imports are down 7.3% y/y in June (in USD), exp down 4% - and imports fell marginally. However the trend is slowly up from the weak Q4, and even if both value and volumes are down y/y and both are down from the Q3 peak, imports data does not signal a sharp weakening of domestic demand, check also the next page
- The trade balance was approx as expected, and at USD 40 bn, unch. from May, and remains at a higher level than over the past two years

A more smooth (quarterly) view:

Exports close to trend, imports below – but not by much, does not signal a dom. demand ‘collapse’



- Import volumes up 6% in Q2 (q/q, annual rate), from 3% in Q1, and -25% (!) in Q4
- Export volumes up 4% in Q2, from 1% in Q1 and -10% in Q4

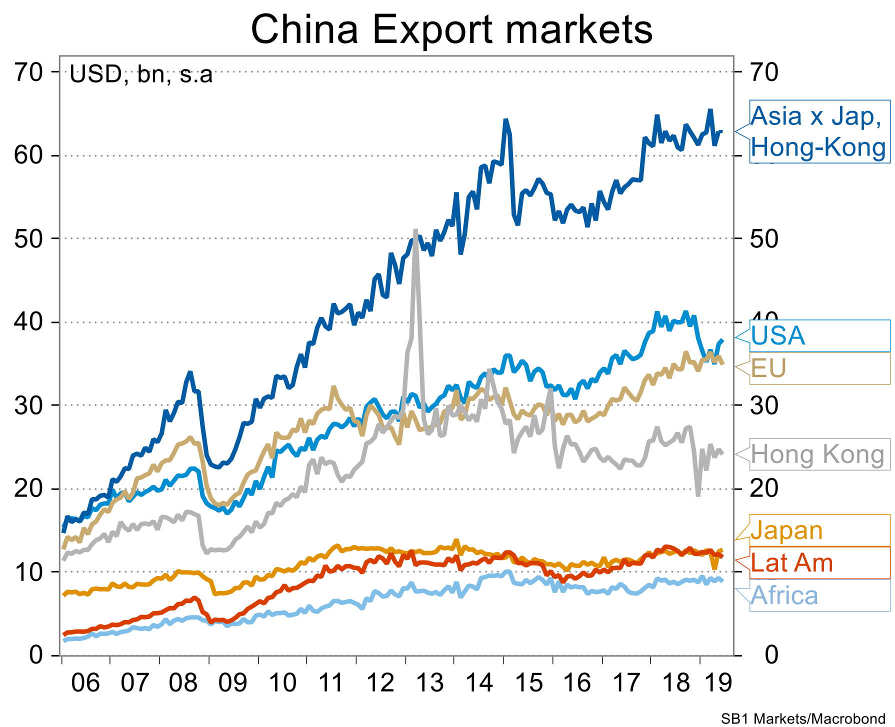
Export surveys are signalling stalling exports but no collapse

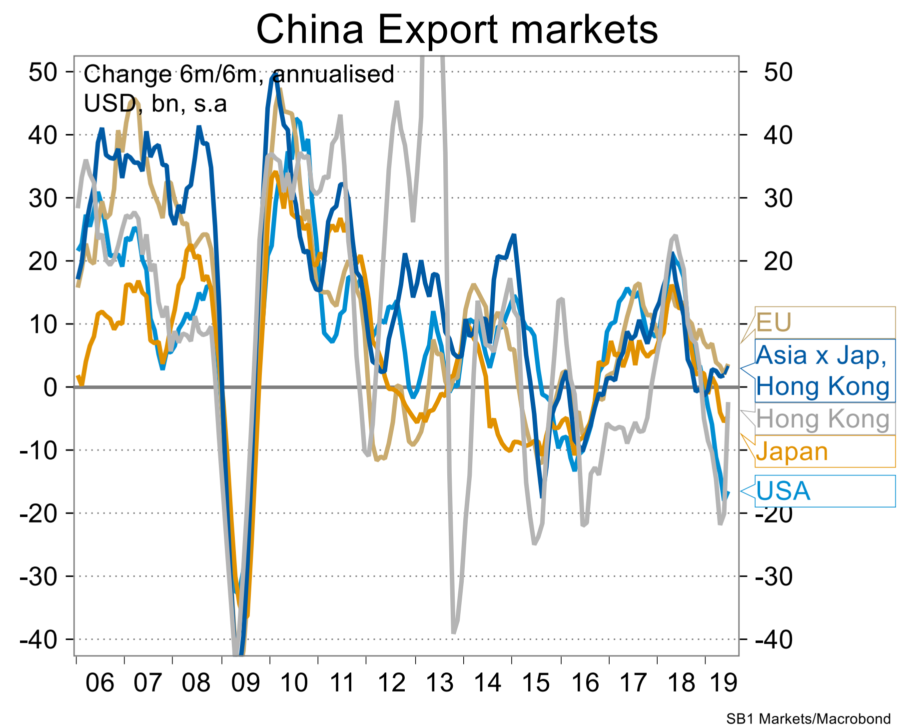
A slowdown/marginal decline has been signalled, as in 2011, ’12, ‘13, and ’15/16

- .. And actual export volumes fell in 11/12, were flat in 13 and fell in 2015 – <u>without creating huge problems in the Chinese economy</u>
- Now, exports are close to flat y/y

Exports to the US up in May/June, down 10% from the peak

Growth in exports to other regions have slowed too, contributing to the overall flattening of exports



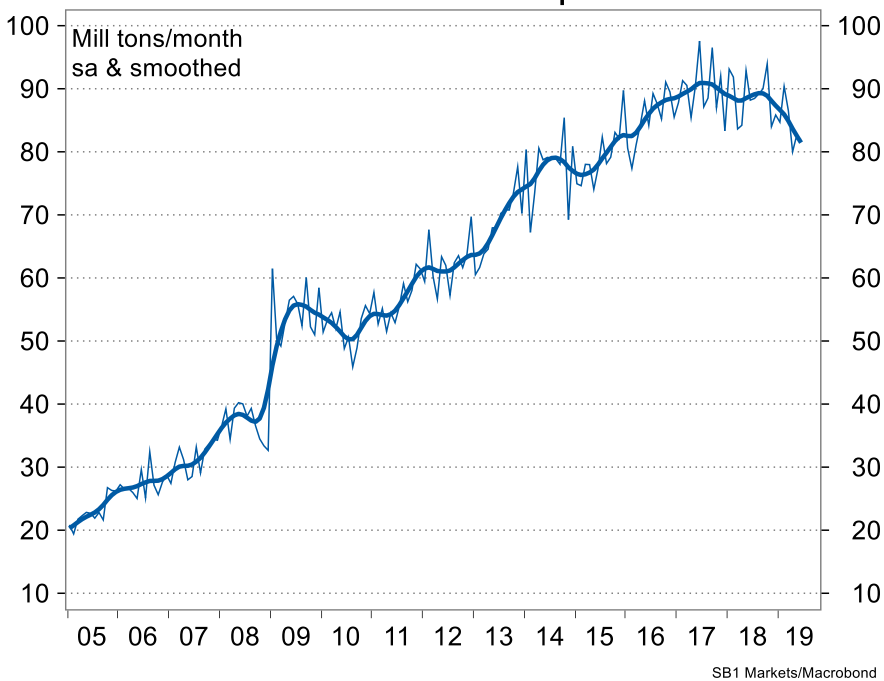


- Exports to the US is very likely hurt by the tariffs, now down some 10% since last autumn. The increase in tariffs to 25% from 10% on USD 200 bn of imports from China will no doubt lower Chines exports to the US further the coming months. The hike in exports and May and June may be caused by companies bringing exports forward ahead of the implementation of higher tariffs
  - » Exports to the US equalled 18% of total Chinese goods exports (and exports to EU 16%, rest of Asia 48%, all before US tariffs)
    - Total exports equal some 20% of GDP, exports to the US 3.6% of GDP – now down 10%, shaving a gross 0.4% from GDP growth (however, dampened by lower need for imports as inputs for these exports). The total trade surplus in volume terms is up, as imports have fallen – and net trade is supporting Chinese growth
    - The real economic risk for China & elsewhere: Trade rule uncertainty may hurt investments as companies may postpone investment decisions until the dust settles – and both Chinese and foreign company may reallocate to other countries. The tech war will of course increase the risk substantially. Some households may become worried too
- Exports to Asia ex Japan & H-K fell in April (no May data)

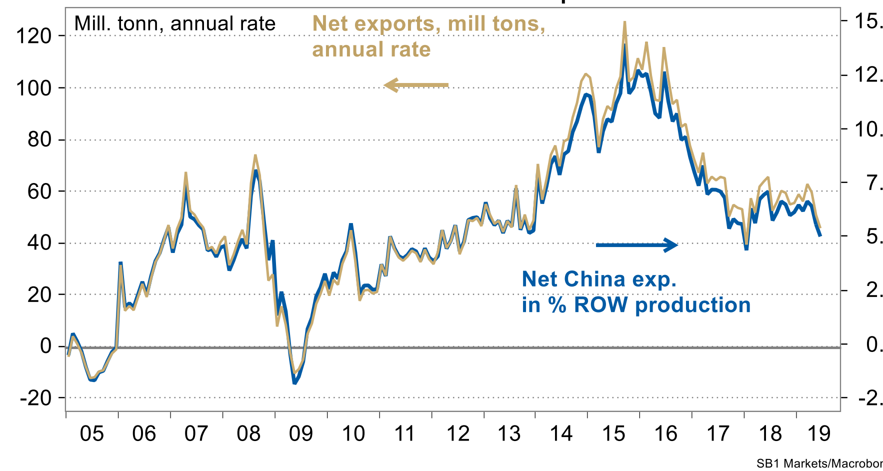
Iron ore imports are trending down, less imports from Brazil

Net steel exports further down in June, but are still too high? Domestic demand up

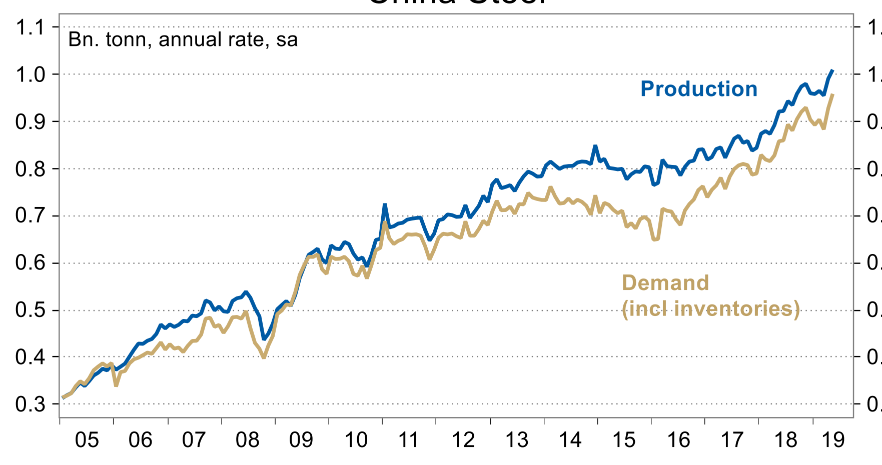
China Iron ore imports



China Net steel exports



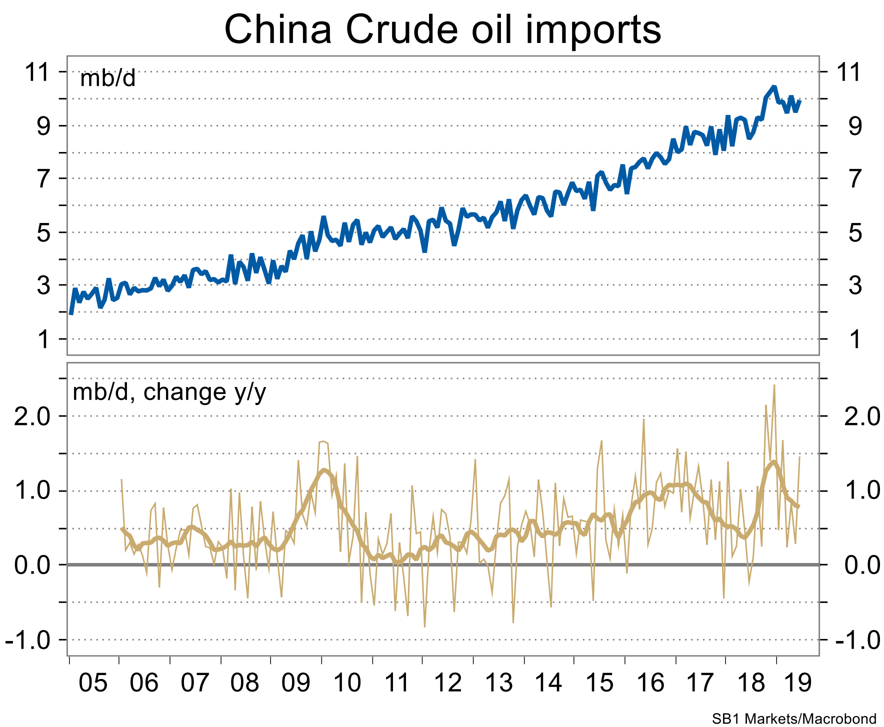
China Steel

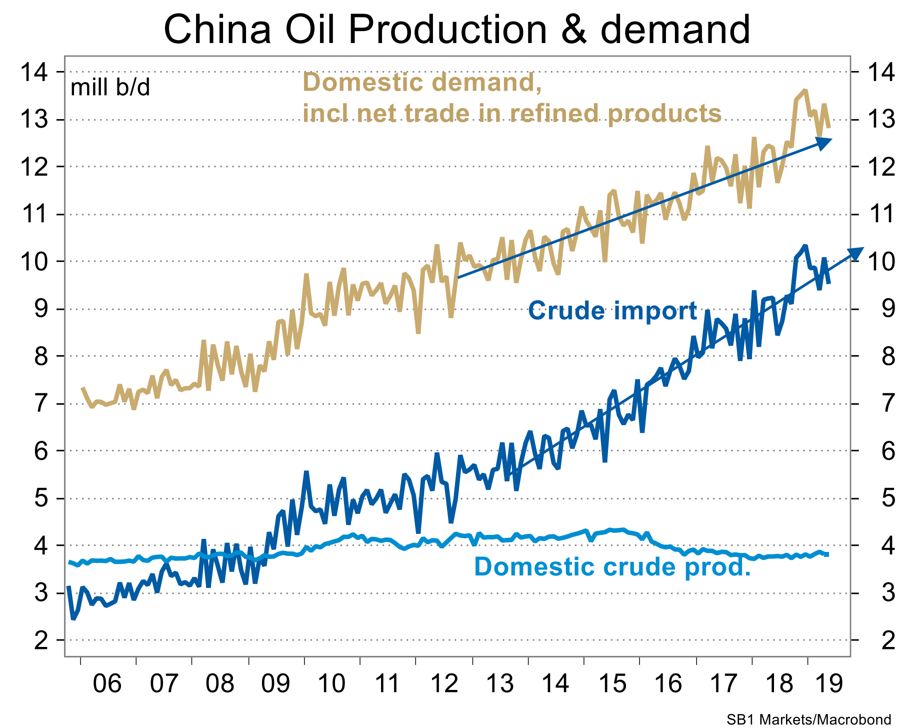


- Chinese steel production XXX rose in June, as did domestic apparent demand. Iron ore inventories in China are probably declining XXXX
- Net steel exports equals some 5% of Rest of World production, and is trending up again – most likely not sustainable. However, 3 years ago in equalled 13%!!

Oil imports (and demand) down to the old growth path

Crude imports soared last autumn, and have fallen so far in '19 – still at normal level vs trend

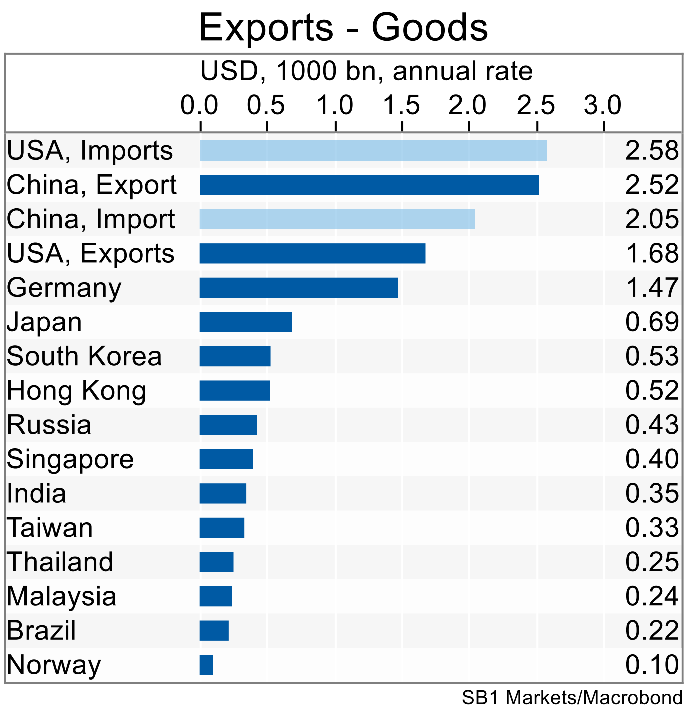


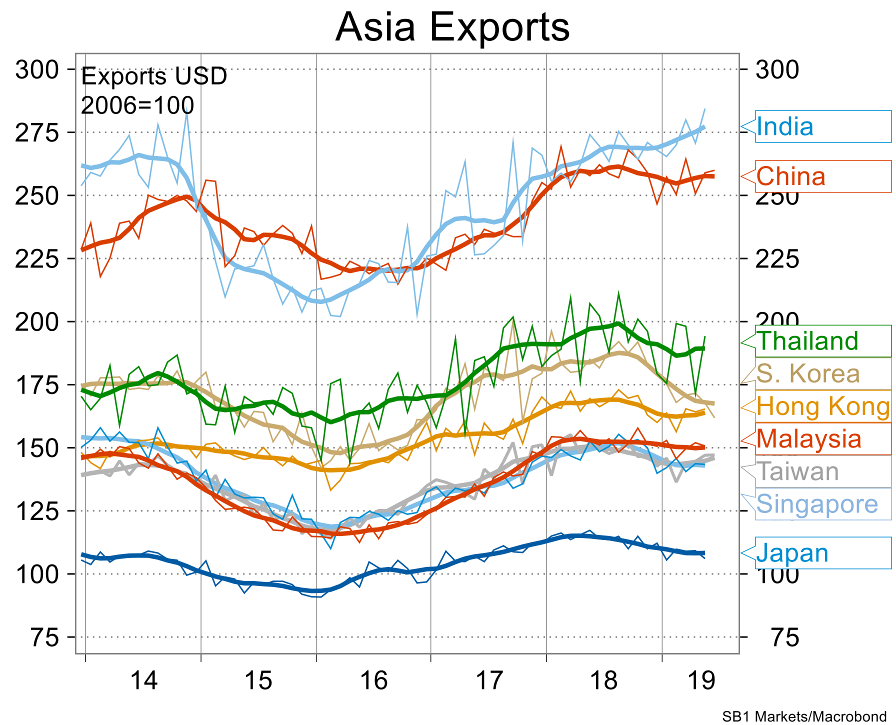


- Chinese crude oil imports were up 1.4 mill b/d y/y in June, probably an outlier at the upside. Still oil imports are trending up with no signs of abating, even if imports are down from the peak last autumn
  - » Beside reporting errors, just an aggressive stock rebuilding can explain the unprecedented increase in imports through 2018; it is highly unlikely that end-user demand could have been that strong. If so, the recent slowdown in imports does not signal a weakening of final demand for oil in China

South K. exports falling rapidly, Japanese slower. Others Asian exports not

Taiwan exports steady up, as is Indian.

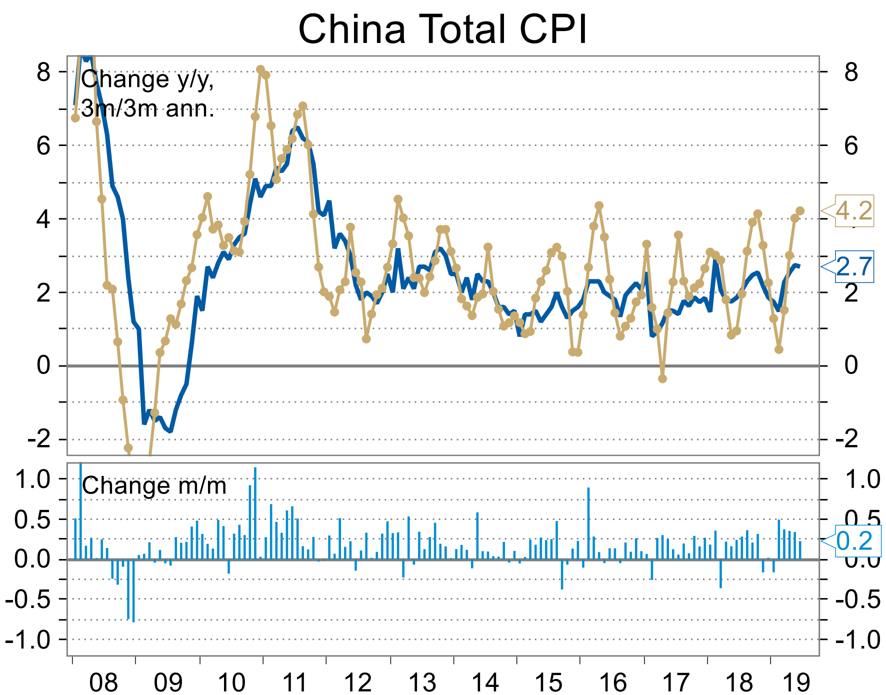


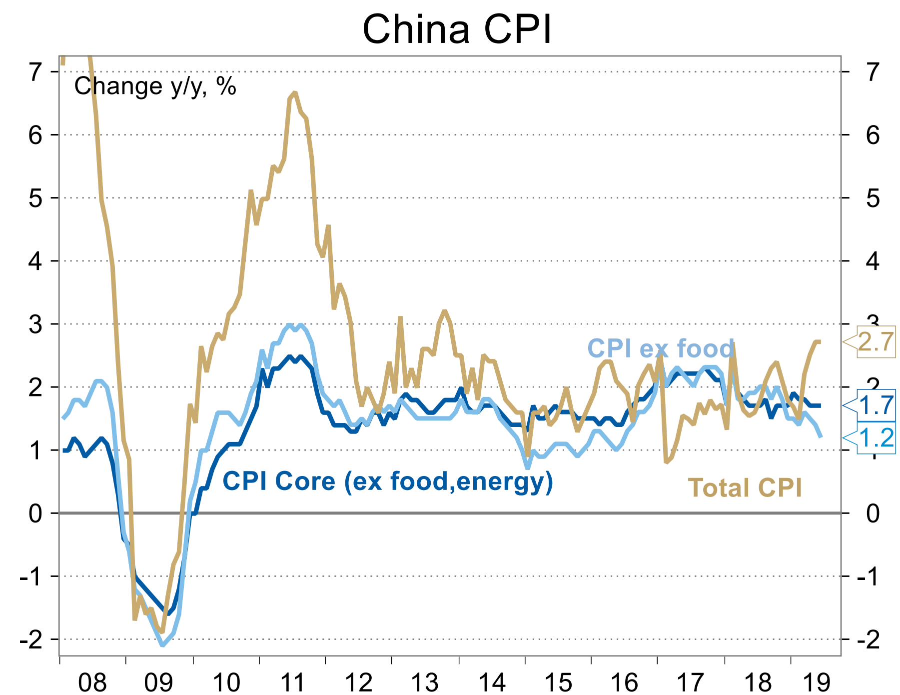


- Thai exports are volatile, so far it has kept up recent months
- hina is of course the world's biggest exporter country (50% larger than the US!) – and the 2nd biggest importer!
  - » China will probably take the pole position in imports too, in some few years time

Inflation is peaking? Core stable at 1.7% but food prices slow, energy fall

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

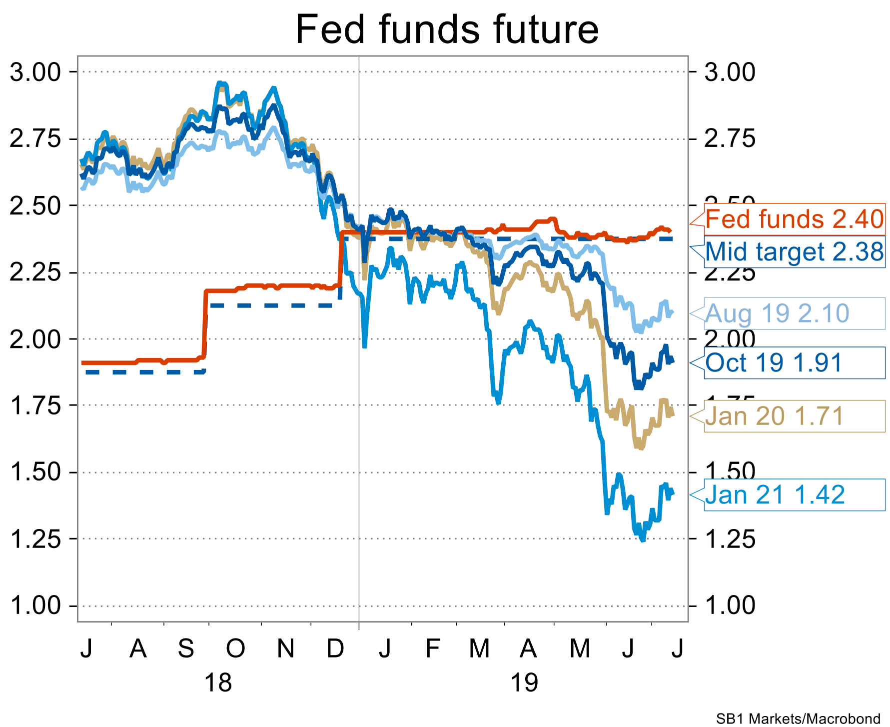


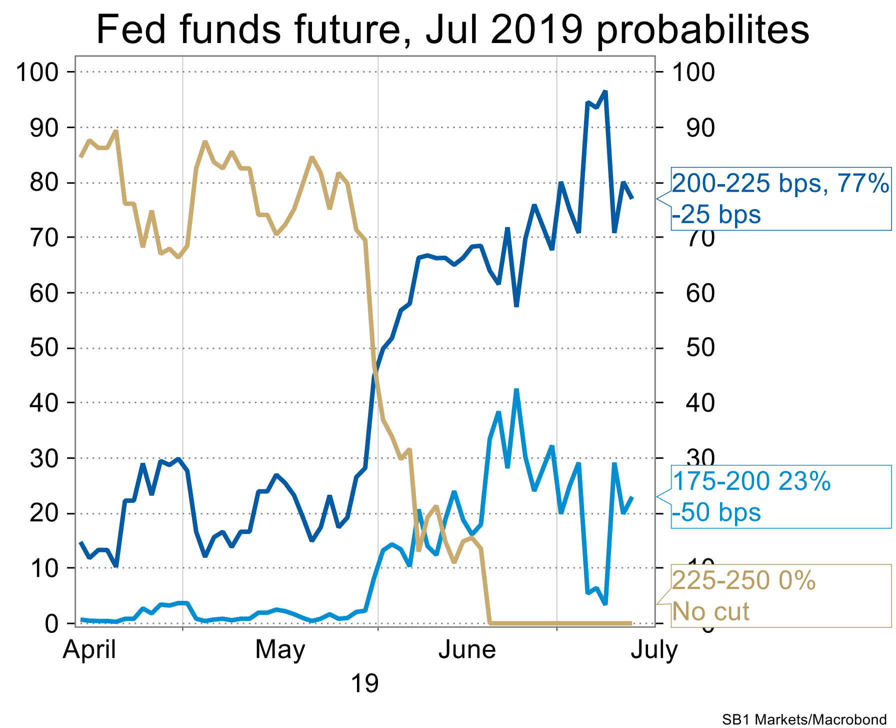


- Headline inflation was stable at 2.7% in Jun, following a 1 p accumulated lift in March & April. Prices rose 0.2% m/m, slowly decelerating
- Food prices rose 0.8% m/m in June, and the annual rate accelerated 0.5 pp to 8.3%. Still, the monthly increase is slowing. Pork prices are still increasing due to the swine flu, up more than 20% y/y.
- CPI ex food fell to 1.2% from 1.4% in May. The decline is just due to lower energy prices, the core – CPI ex food and energy – was stable at 1.7% y/y, and the trend is flat. CPI does not send a ‘China slowing’ signal

FOMC minutes & Powell left the door for a late July cut wide open

Minutes from the June meeting more dovish than the announcement/reports. Powell confirmed

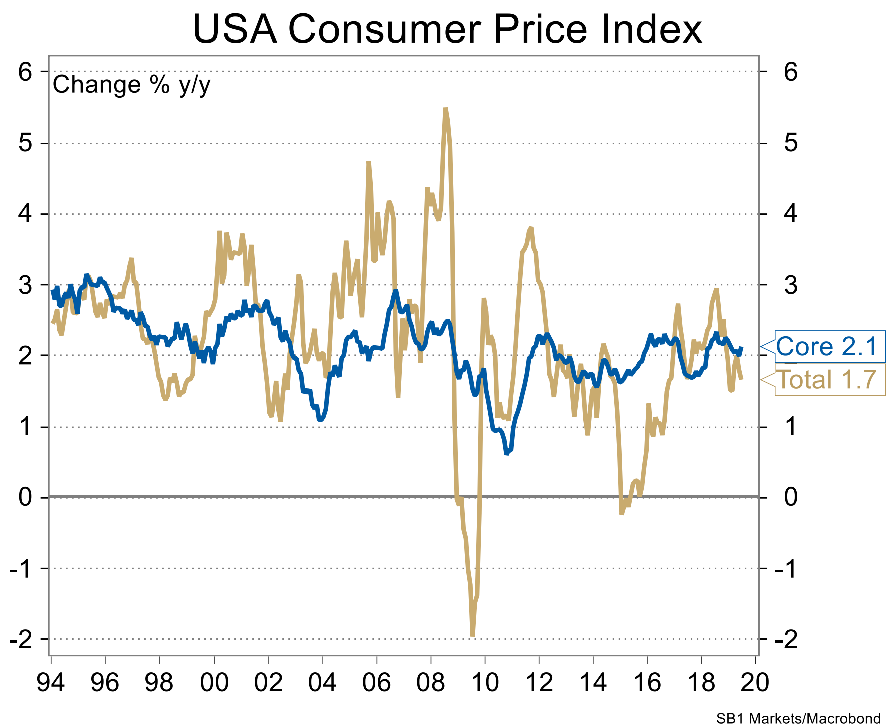


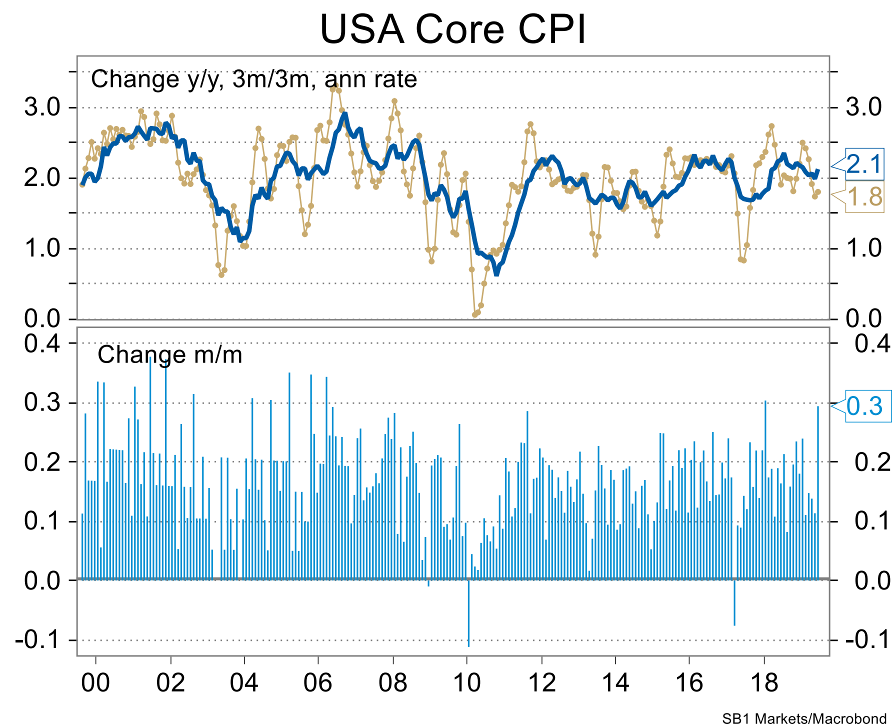


- The minutes from the June 20 meeting referred than many members expected the signal rate to be cut soon if the outlook for growth and inflation was not strengthening, and several others said that they were prepared to cut if the outlook deteriorated (further). Governor Powell strengthened the case for a cut in July at his two hearings at Capitol Hill
  - » The contrast to the dot plot from the June meeting is striking. Here, the majority of the FOMC members indicated they assumed an unchange rate through 2019. Now, with better news on the trade front, OK labour market data and a strong stock market, we all take a July cut for granted!
- The base case is still that the US economy will continue to grow at or marginally above trend but Powell/FOMC put much more emphasis on the downside risks from global uncertainty (read: trade war) through the impact on business investments especially in the manufacturing sector.
- The market increased its bet on a 50 bps cut following Powell's Congress performances

Oh shit, core inflation up to above target (well not Fed's inflation target, but still)

Core CPI rose just 0.3 % in June, following 4 x 0.1%, the annual rate up 0.1 pp to 2.1%



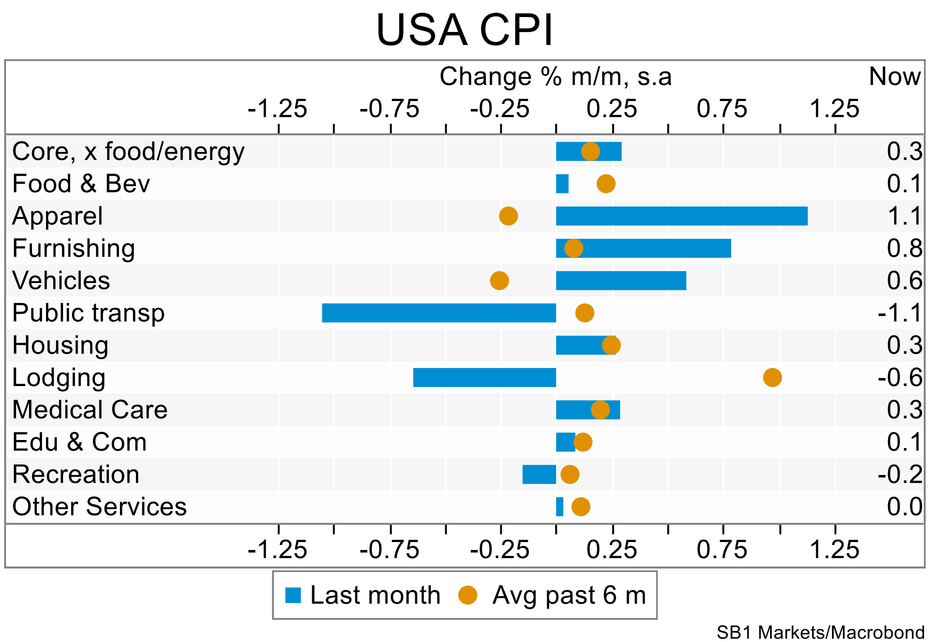


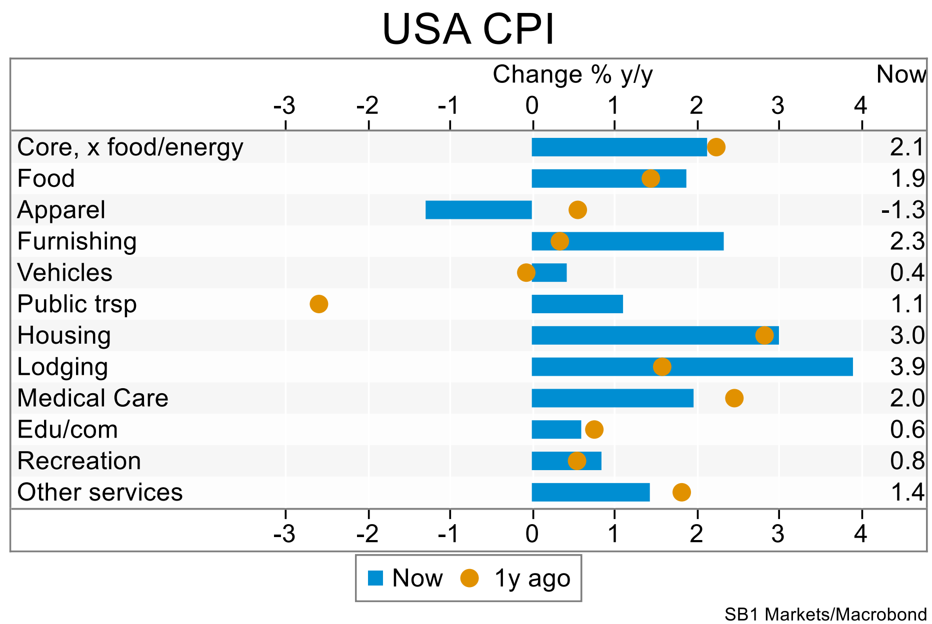
- 'We all know' that inflation has surprised on the downside and is below target – and that the Fed has to cut rates by the end of the month. Fed preferred price measure, the core PCE (the consumption deflator in the Nat. Accounts) was up 1.6% y/y in May, and is below Fed's 2 % target.
- However, the core CPI accelerated slightly to 2.1% in June (expected unch) after a 0.3% lift m/m. The PCE deflator probably accelerated to 1.7% in June, still below Fed's target. Still, the shortfall vs the target is not large
- Headline inflation ticked down 0.1 pp to 1.7%, as the impact from energy prices changed sign and was trimming inflation rate down in June, as in the previous months

SpareBank 1 MARKETS

Apparel, furnishing, vehicles contributed most on the upside in June

Just apparel prices are down y/y

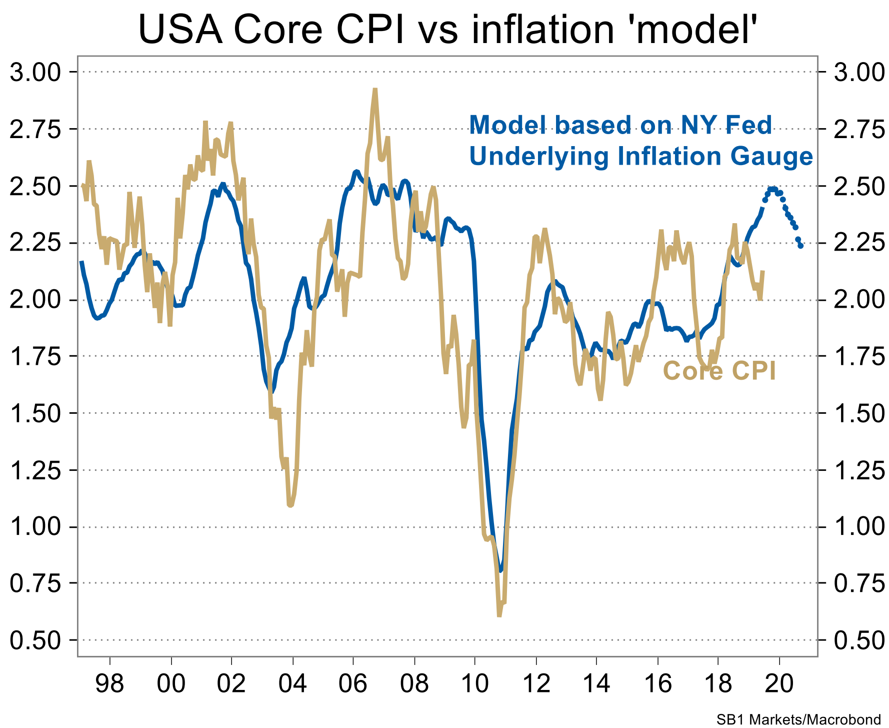


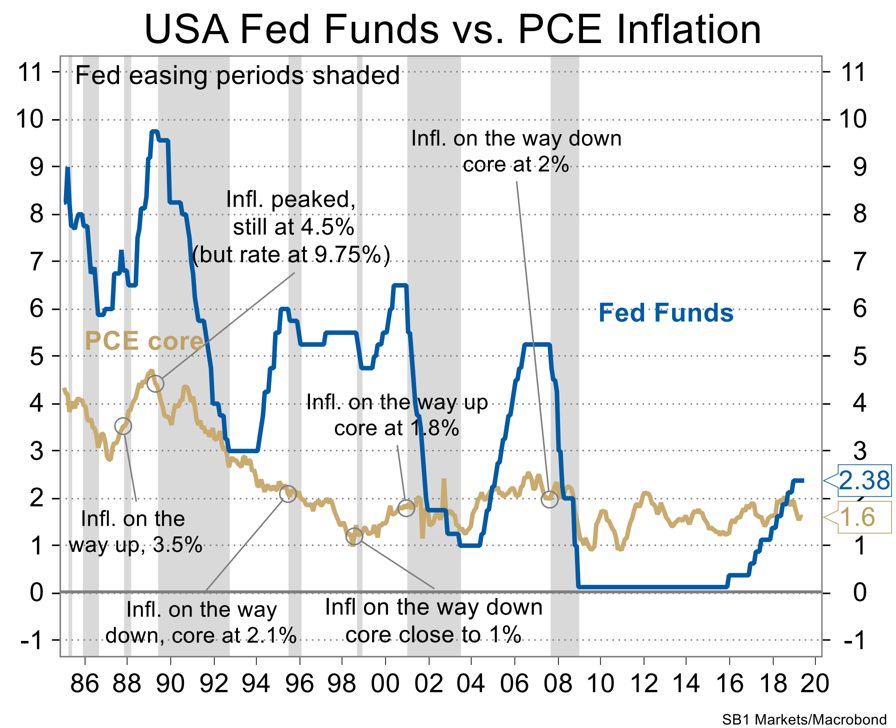


- Higher prices housing (rents & services), food and medical care are boosting annual inflation

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

… or has it peaked already?

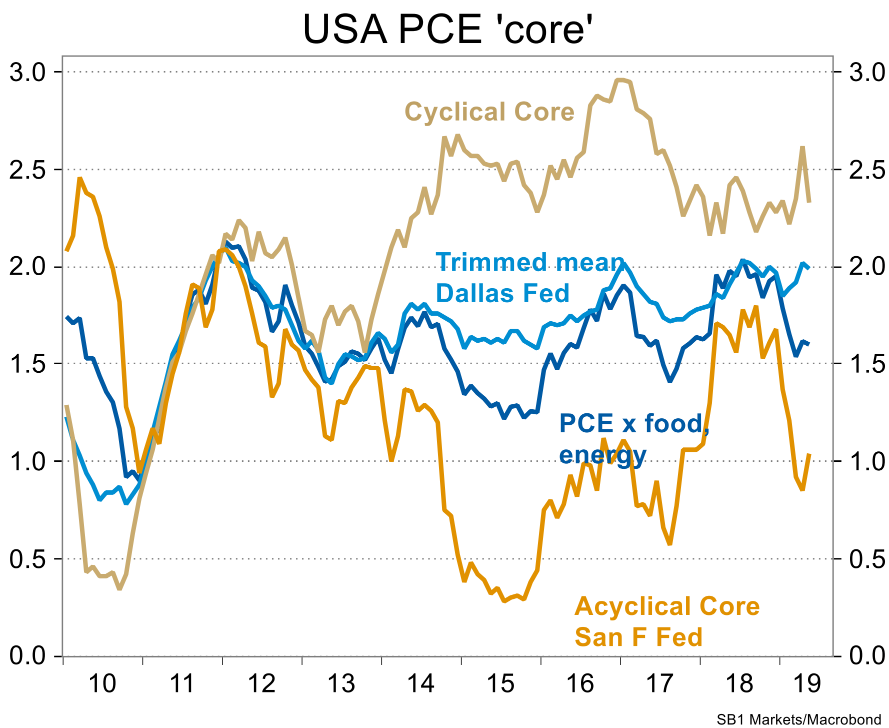


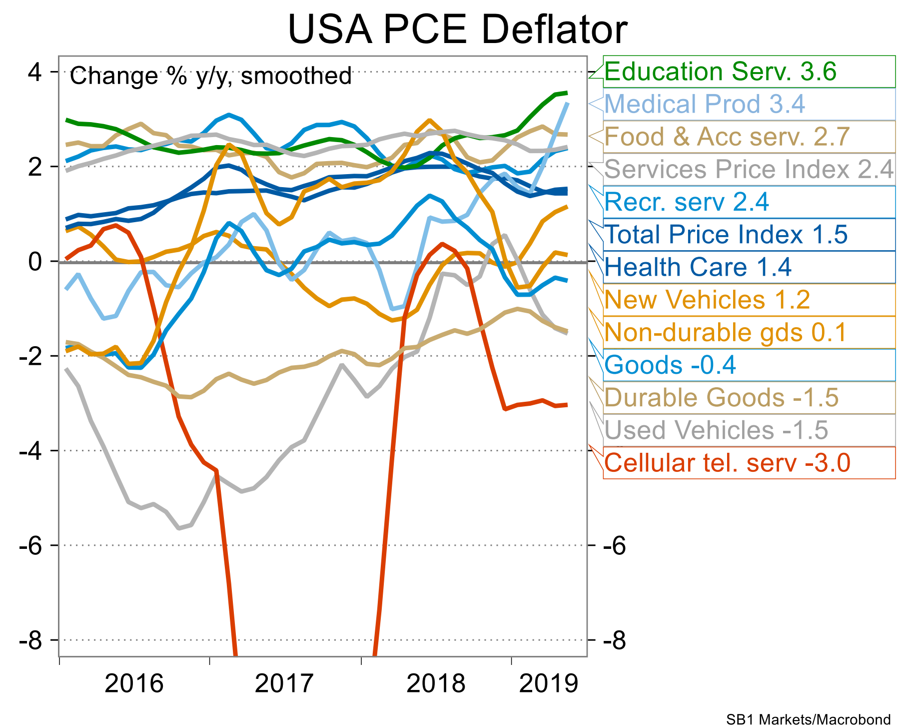


- The NY Fed's Underlying Inflation Gauge model includes a wide range of macroeconomic and financial components in addition to some CPI components. The UIG model leads the actual inflation rate by some 15 – 20 months. The model now signals somewhat lower inflation than some months ago (lower energy prices 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 May, below Feds inflation target at 2% - but it may accelerate to 1.7% in June
- 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

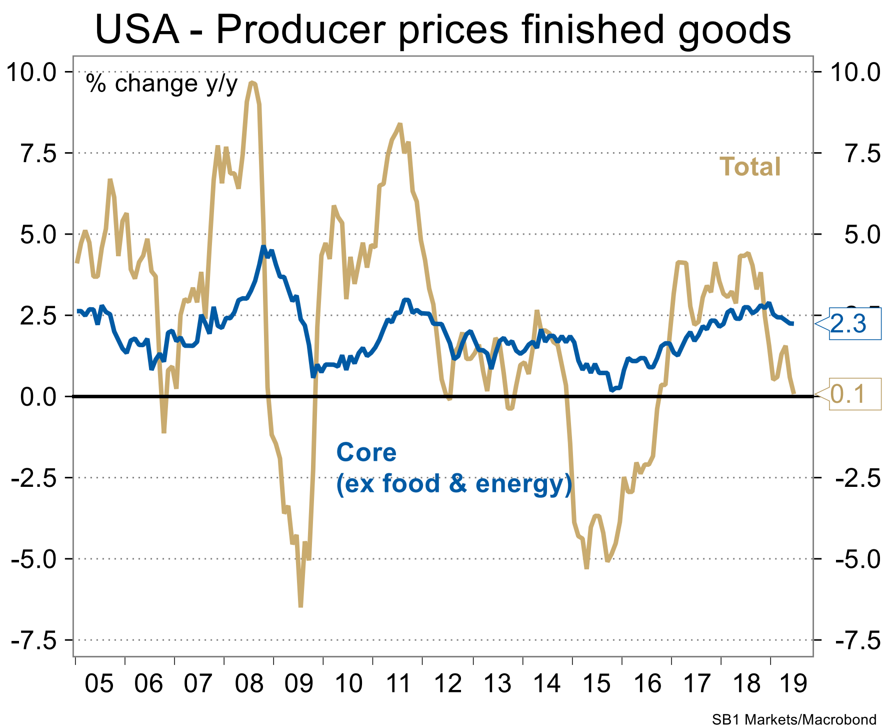


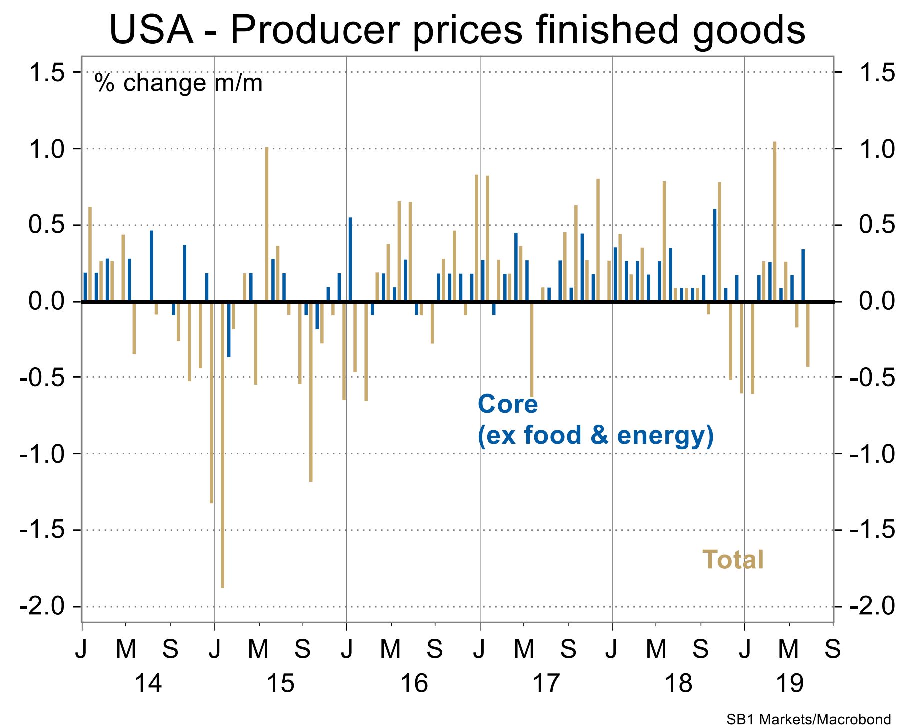


- Used vehicles and cell phones are dragging prices down
- However, price pressure in production chains are easing somewhat, check the next slide

Producer price higher than expected too but price pressures are abating

Core finished goods unch at 2.3% y/y in June; total PPI down to 0.1% with lower energy prices

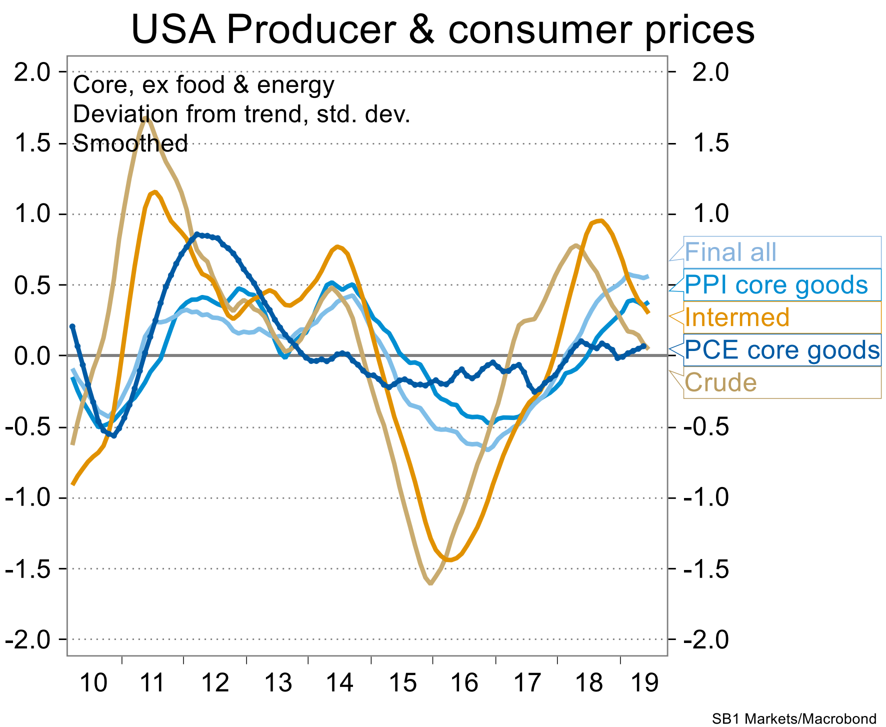


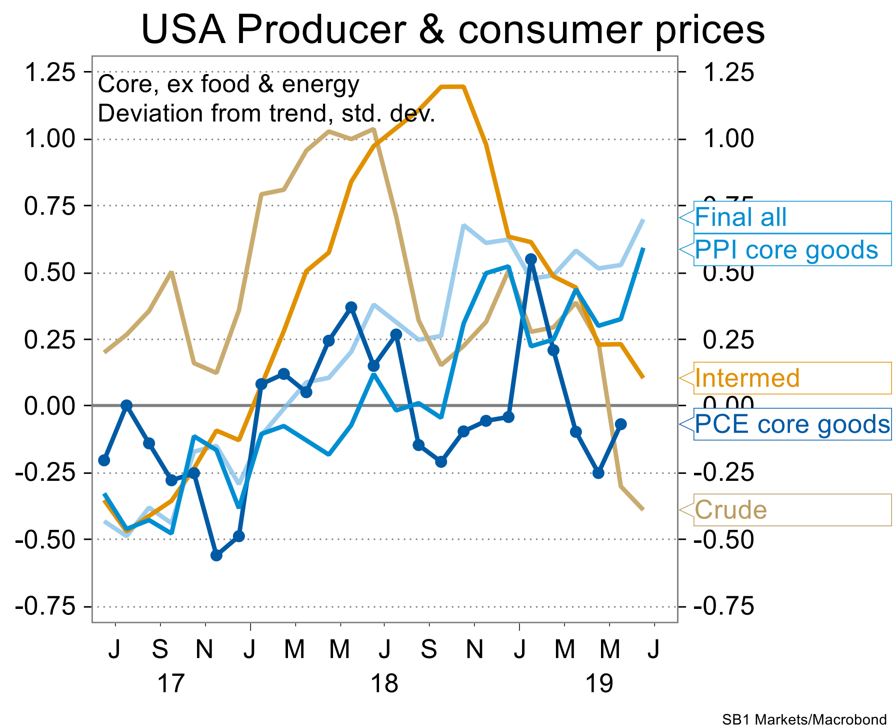


- Core finished goods x food & energy PPI rose by 0.3% m/m in June, 0.1 pp more than expected. Monthly growth has been muted recent months and the annual rate have fallen to 2.3% from 2.9% in Dec ‘18
- Headline PPI fell 0.4% m/m, as energy prices are heading down again. The annual rate fell back down and is very low, at 0.1%
- BTW, when the Fed started hiking the Fed funds rate, core PPI was 0.3%, and total PPI was down 4.5% y/y

Prices continue to ease at early production stages

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

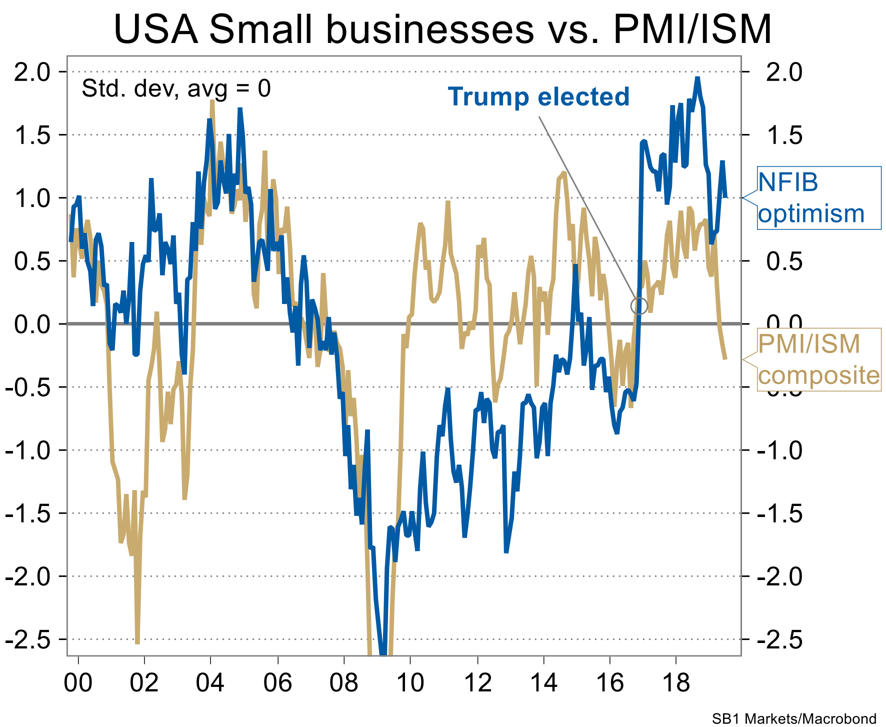


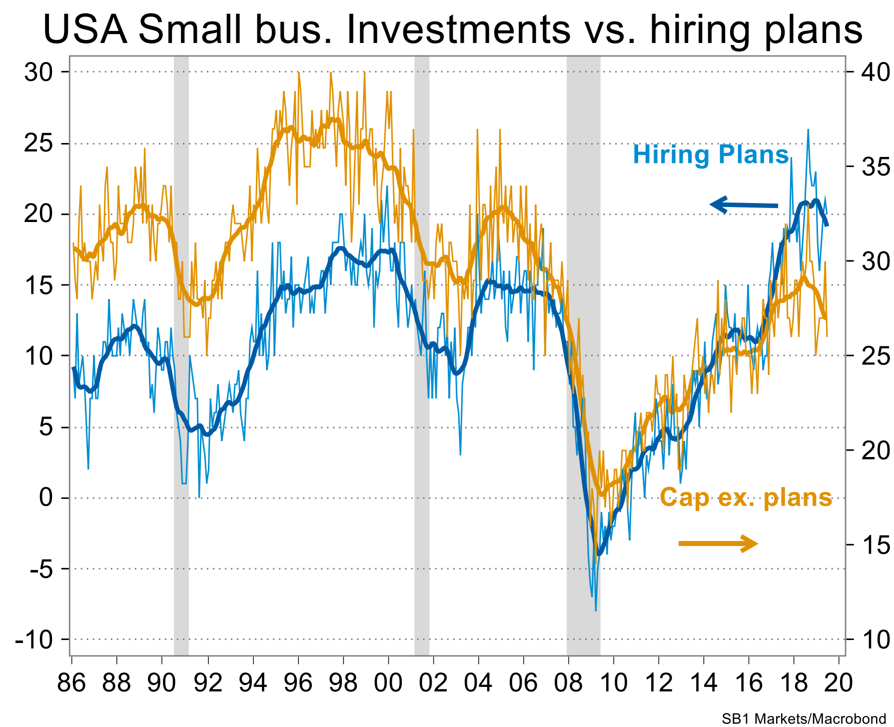


- Crude (core) PPI prices fell further in May, as did intermediate goods prices, and both is trending down. Core consumer goods prices (at the producer level) rose sharply, but will over time turn south if prices at earlier stages do not recover
  - » Short term, there might be some upside risks vs. goods prices at the consumer level as these prices have been rather muted recently. The CPI indicates an uptick in June (following the one in May, check the graph at the right hand side)

Small businesses a tad less optimistic but well above PMI/ISM (activity) reports

The NFIB optimism index fell in June at is well down from the peak but still well above average too

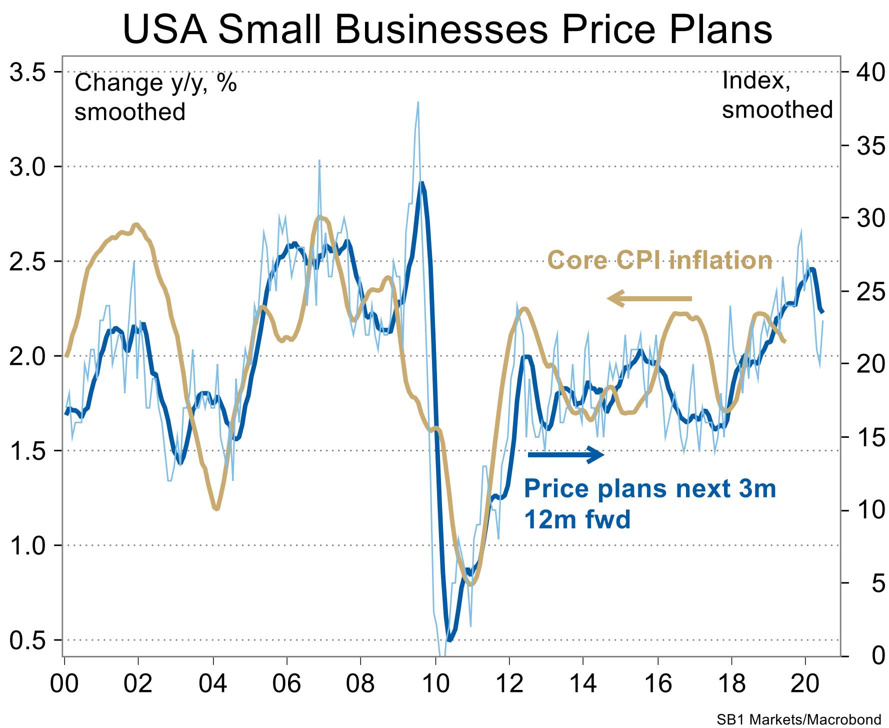


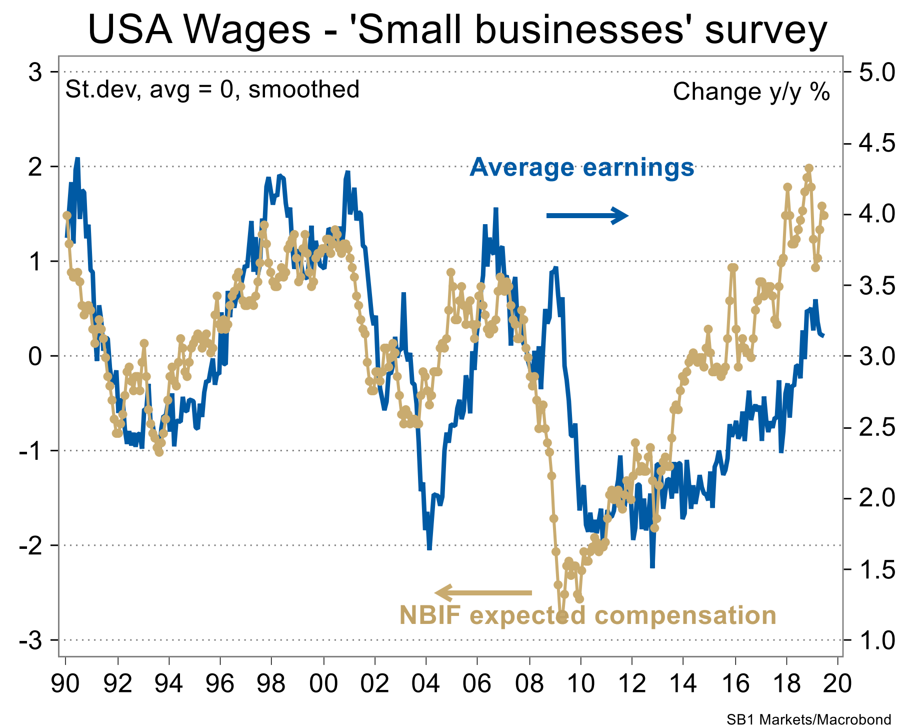


- The NFIB optimism index, measuring small businesses' expectations on business conditions, fell as expected in June, following a larger lift the two previous months. However the level is well down (-1 std. dev, ¼ of a normal cycle) from the peak last autumn
  - » The NFIB optimism index is still 1 st.dev above average. The surveys from ISM/Markit PMI (and most others) reports actual growth rates (not optimism/sentiment!) below average levels. These different measure are not very closely correlated, at least not level-wise. The difference now may be due to the SME's exposure to the domestic market, while larger companies that report to ISM/PMI are more influence by trade policy/global uncertainty
- Investment plans are slowly heading south, and are now below par
- Hiring plans har probably peaked but they are still extremely aggressive. Companies are still not able to fill vacant positions

SMEs still expect to hike prices, but somewhat slower. Wages still under pressure

Businesses do not signal lower price inflation – and definitely not lower wage inflation

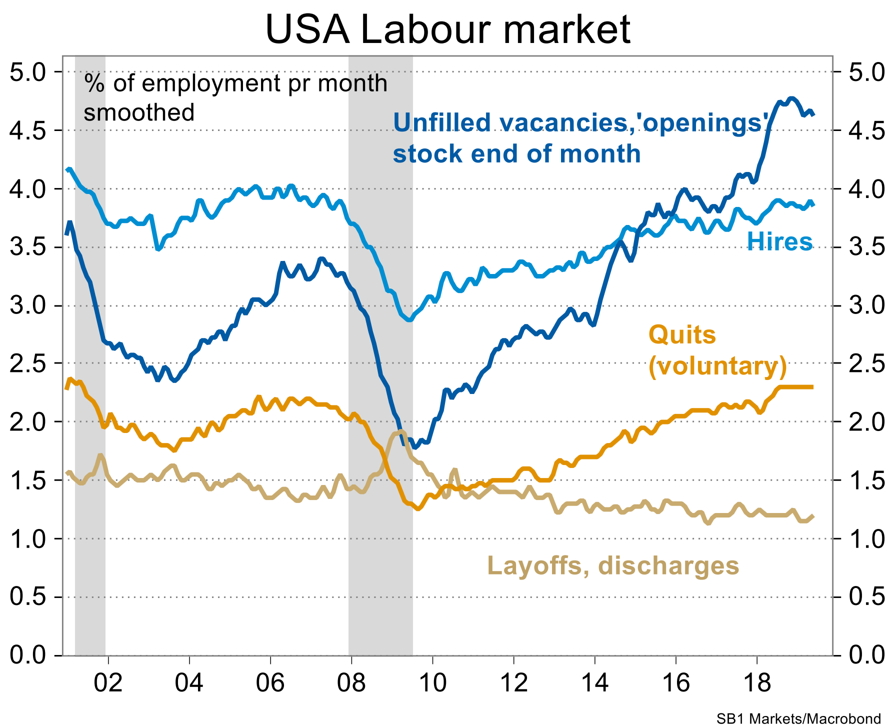


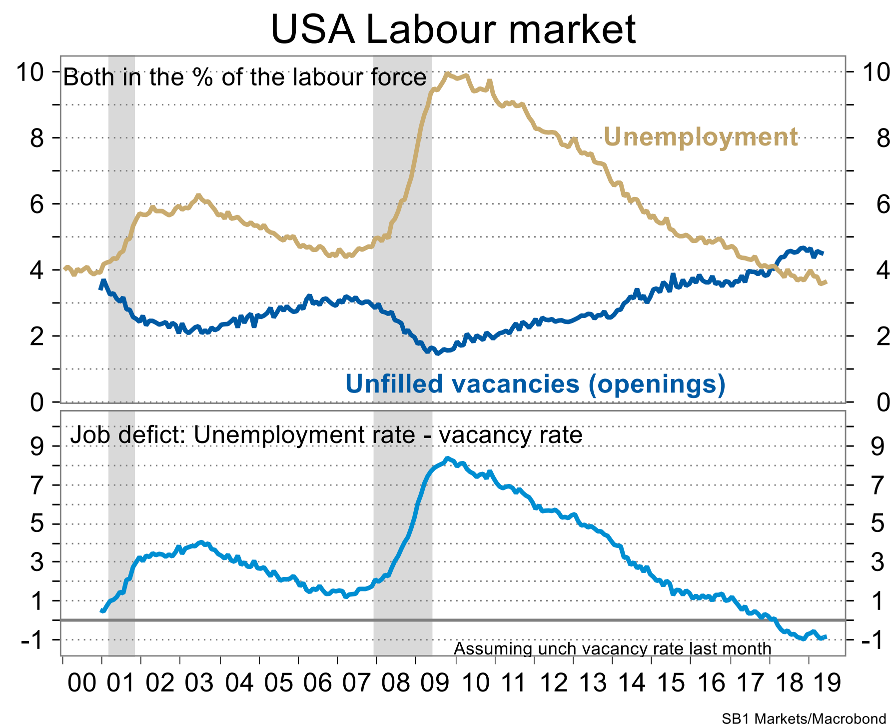


- 23% of small businesses are planning to hike prices, down from a peak at 29% in November (27% reasonably smoothed), still somewhat above the average 'normal' share! Are companies witnessing slower demand growth?
- In contradiction; businesses are still reporting aggressive plans to raise compensation, after easing somewhat 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

Marginally fewer unfilled vacancies but still plenty. More hires, few layoffs

.. and a record number of people are leaving their job voluntary (to pick up a better)



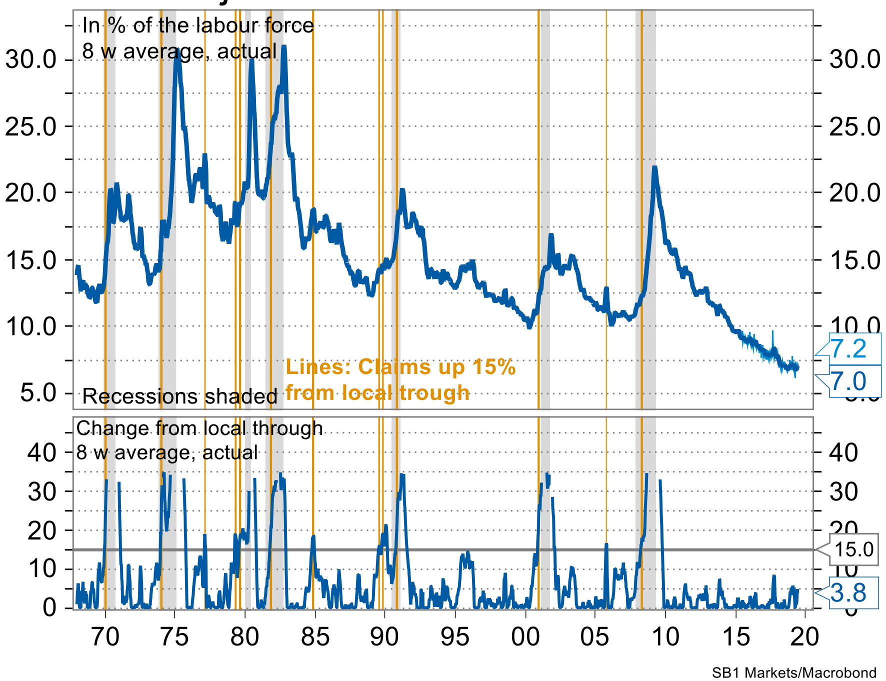


- The JOLTS report does not signal a further tightening labour market – but still a tight market. There are still more unfilled jobs (4.7%) than unemployed people (3.7%) – and the gap is still record high (at least very close to (ATH). Monthly (gross) hiring equals 3.9% (of total employment)
- The number 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 at very low level

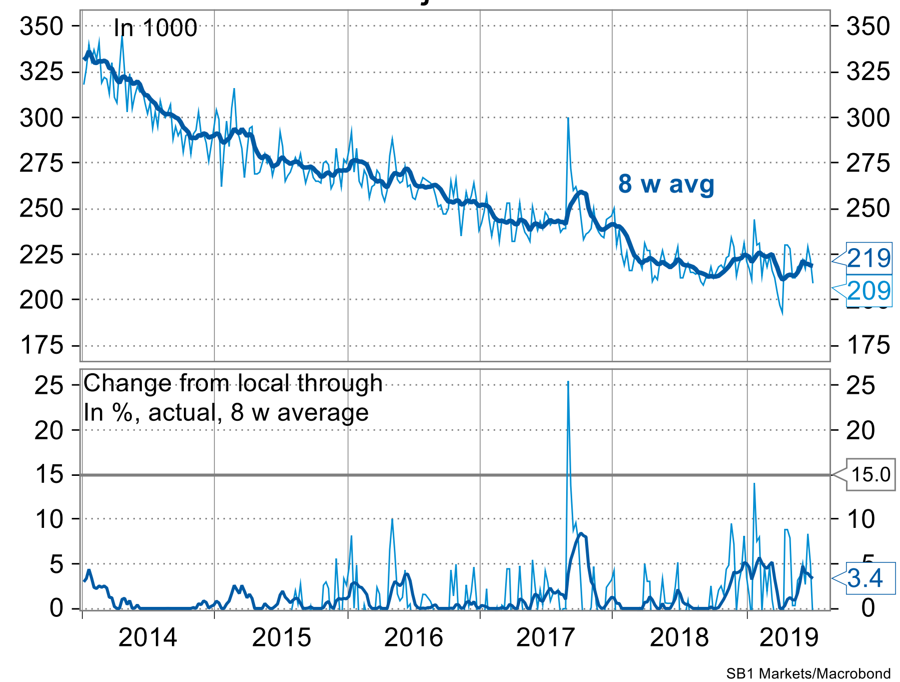
New jobless claims down to close to record low levels. And rates must be cut…

Jobless claims fell to 209’ last week, just two weeks have been reported lower i recent times

New jobless claims vs. recessions



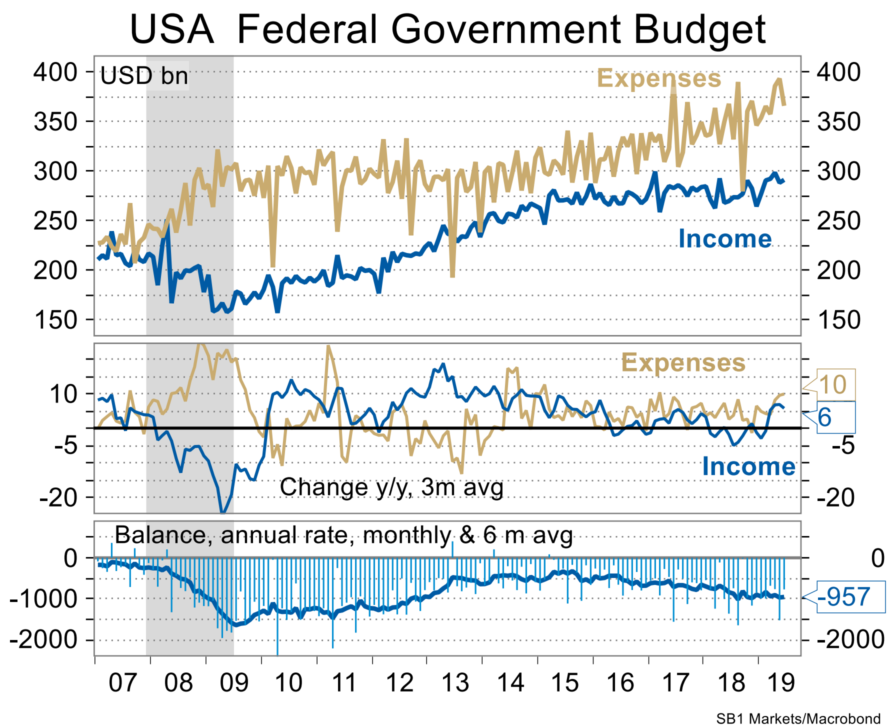
USA New jobless claims

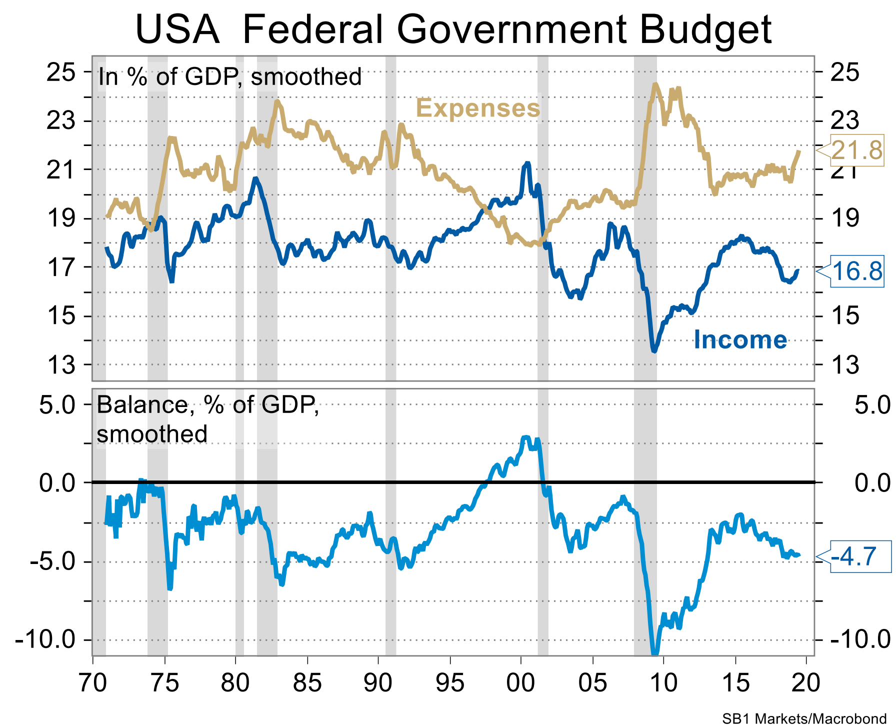


- In per cent of the labour force, the inflow of new jobless claimants have never been lower than now (as it by and large has been since 2015)
- A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow ‘recession’ warning line is 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 at 4.7% of GDP in Q2, and the total public sector deficit at 6.9% of GDP in Q1!

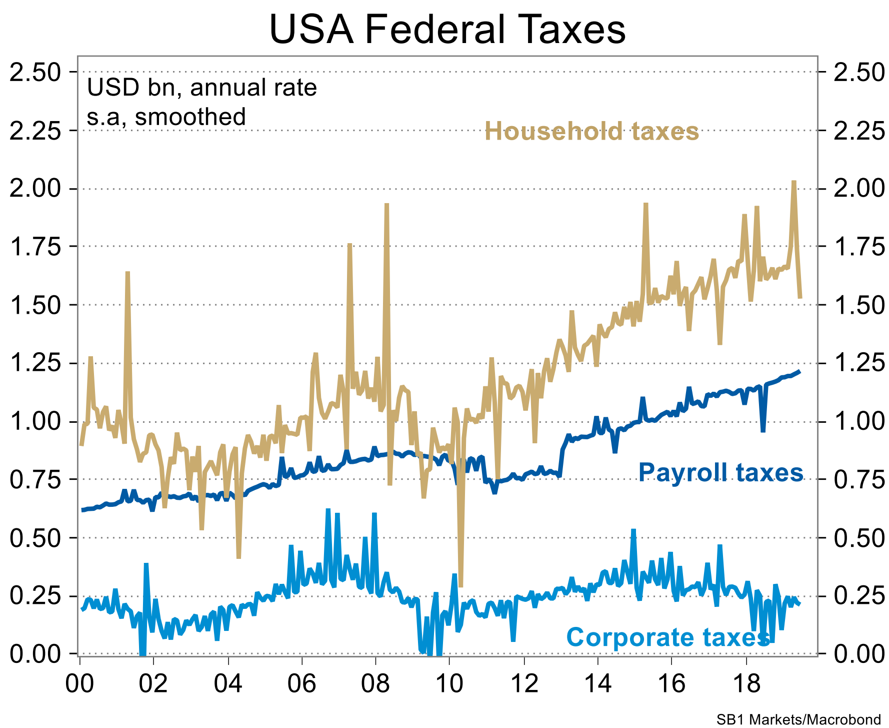


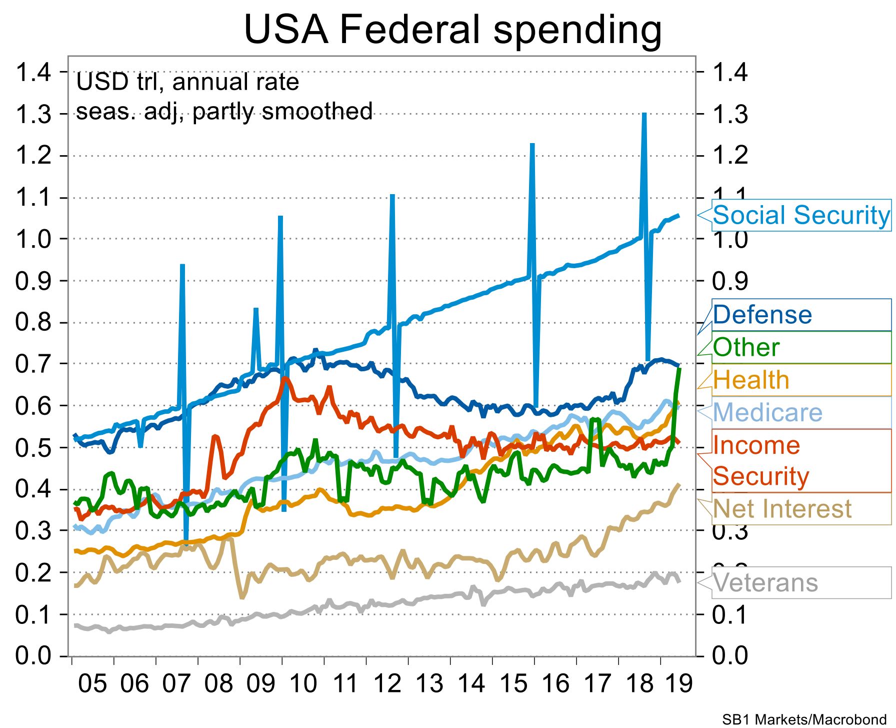


- The budget deficit fell to USD 770 bn in annual rate in June (seas. adj), less than the average over the past year – from a high level in May. Including local government etc, the US is running full employment, peacetime deficit at 6.9% in Q1 (from 6.7% in Q4); totally unprecedented!
- Federal spending inched down m/m in June but is up 10% y/y (smoothed), way above growth in nominal GDP. Income is up 5% y/y
- In % of GDP federal spending equals almost 22%, way above a normal level (except for recessions). Regrettably, federal income just equals 17% of GPD, much lower than normal in a blooming economy – of course because taxes have been cut
- 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

Corporate taxes remain low, households' have flattened

More money spent on… everything?

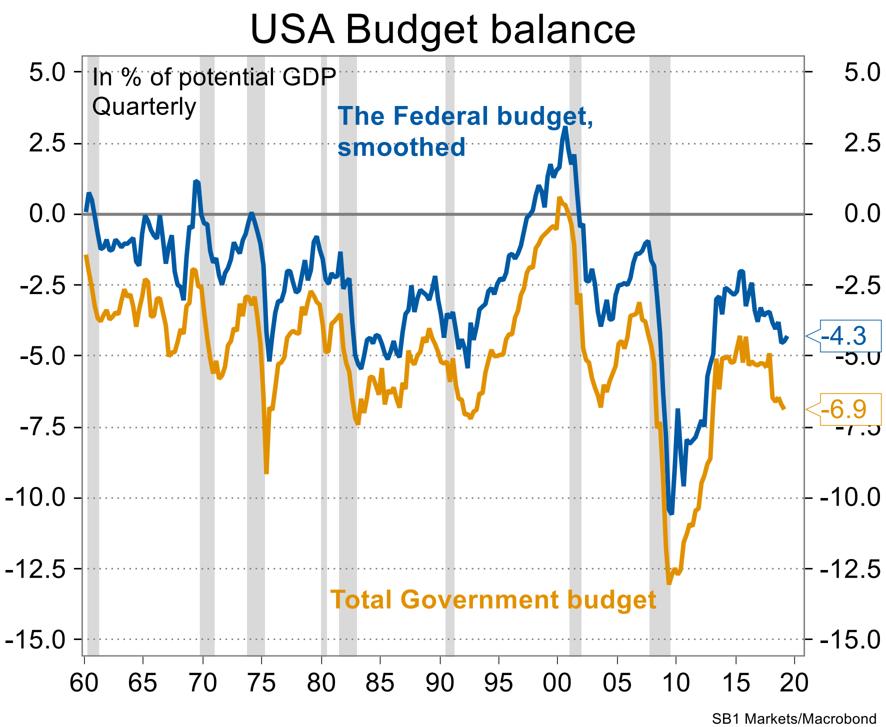


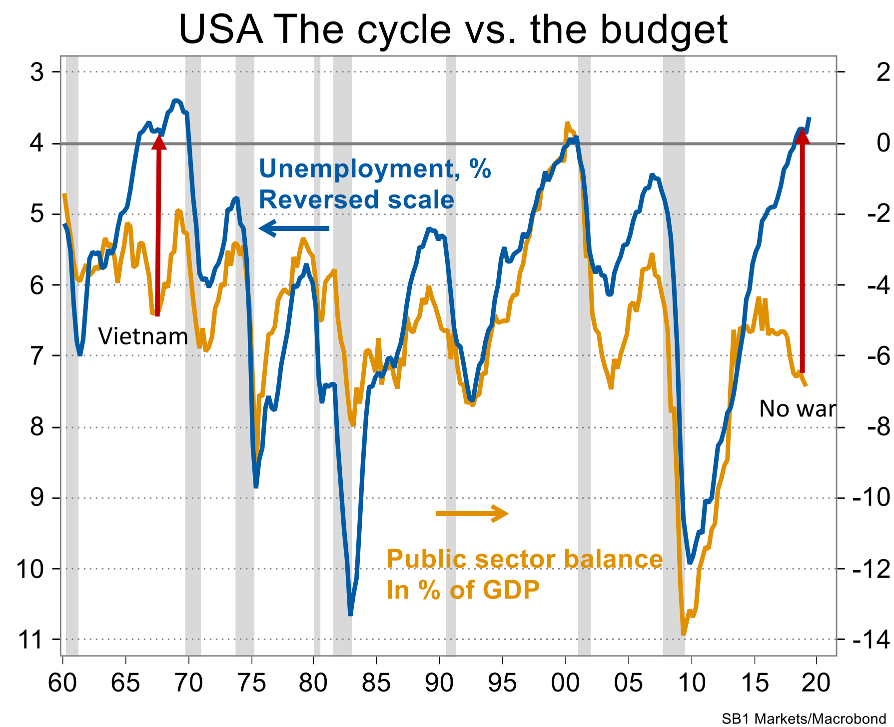


- The biggest spending changes the past year: medicare, health, net interest payments.
- A huge hike in "others" in June is due to a (temporary, we are sure) lift in spending on education, employment & social services

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

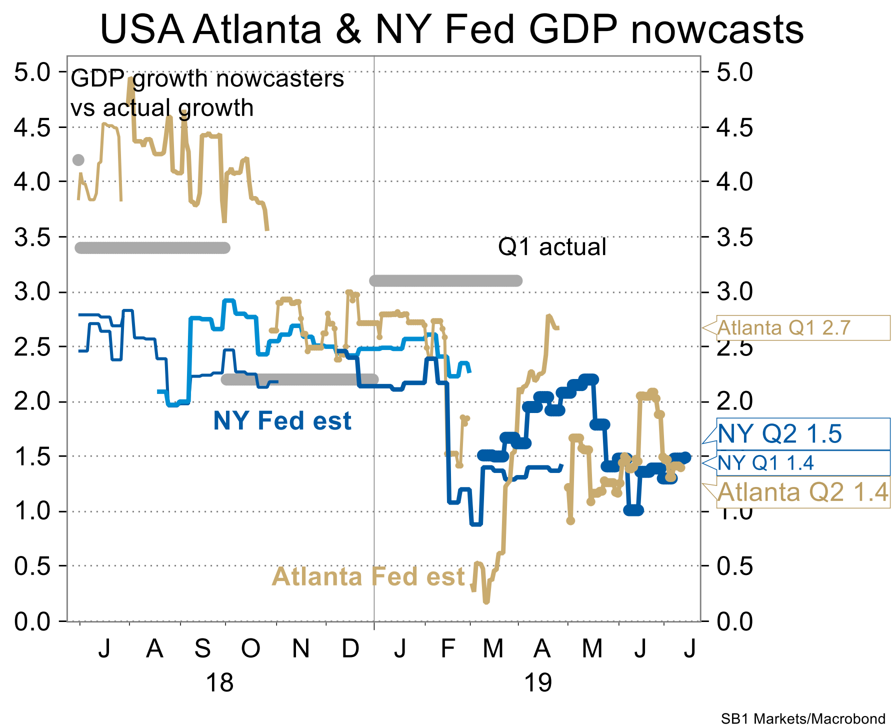


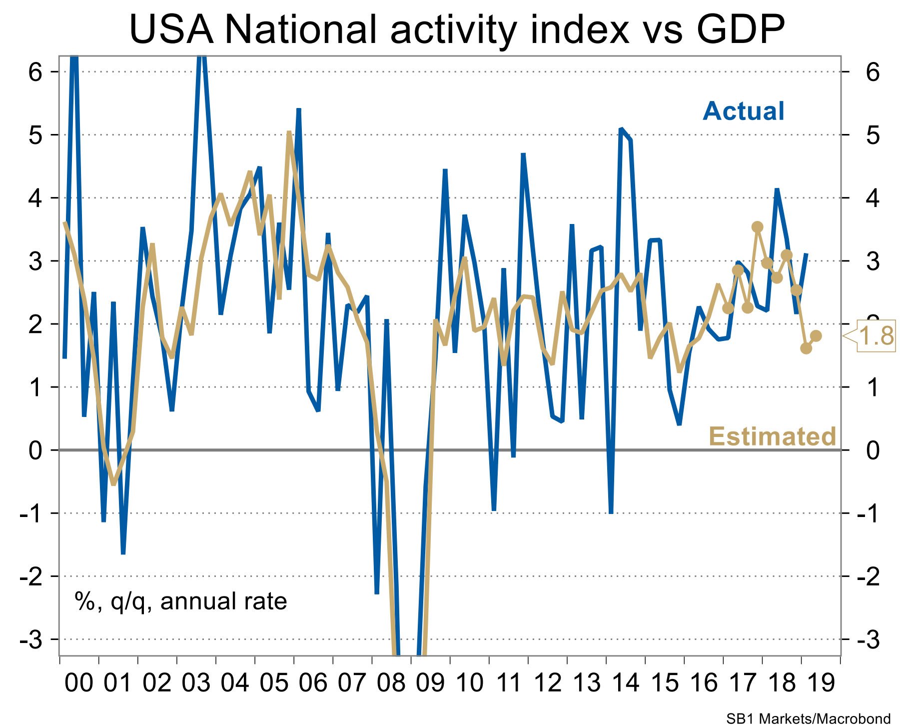


- The deficit has never been anywhere close to the present level in peace time when unemployment is as low as now – and it will most likely become even worse as all of the tax cuts and increased expenditures kick in
  - » We have not seen anything like this in the US or elsewhere before (except Greece 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*

Fed nowcasters say 1.3 – 1.4% in Q2

The National activity index signalled 1.8% Q2 growth in May (up from the 1.1% April est)



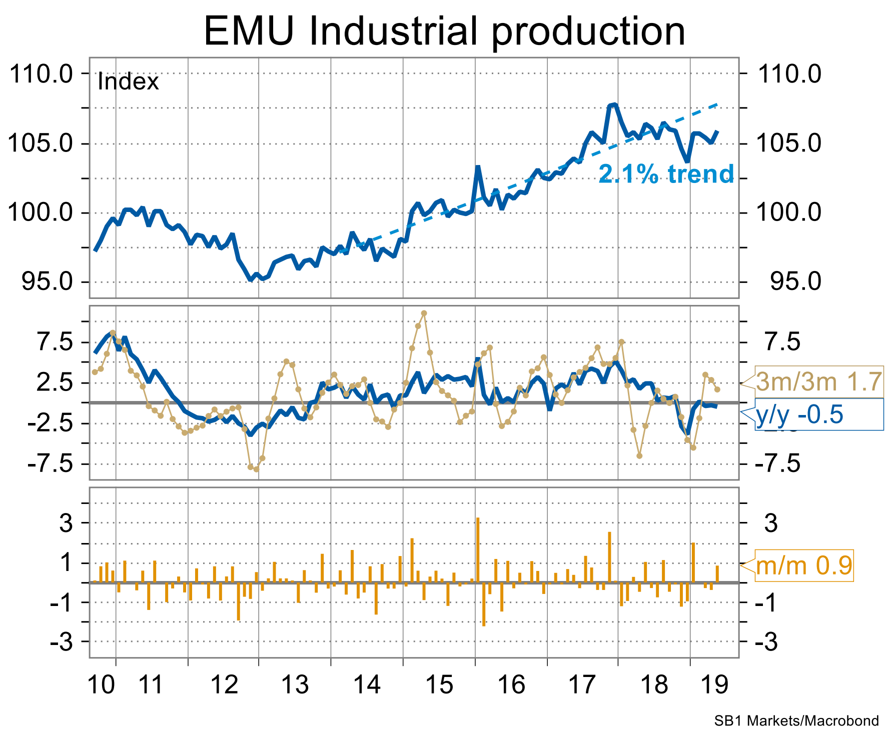


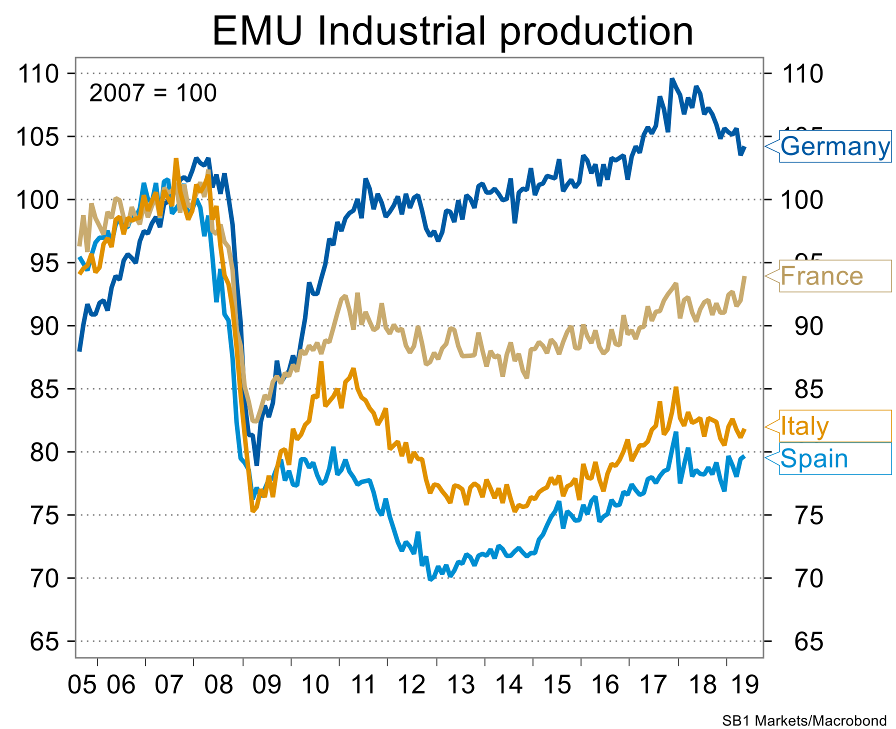
- However, a lot of data has still to be reported – and the nowcasters often miss the target (as they change their mind through to the quarter

dd

Industrial production up in May, saved by France – still far from impressive

Production rose 0.9% m/m in May, well above the originally expected 0.2%. Surveys are still weak

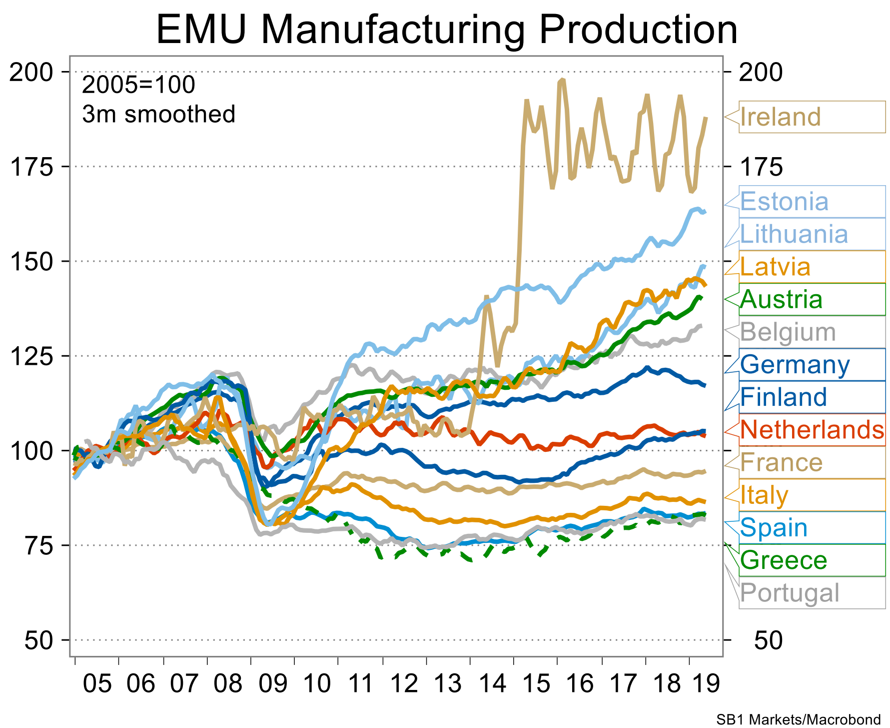


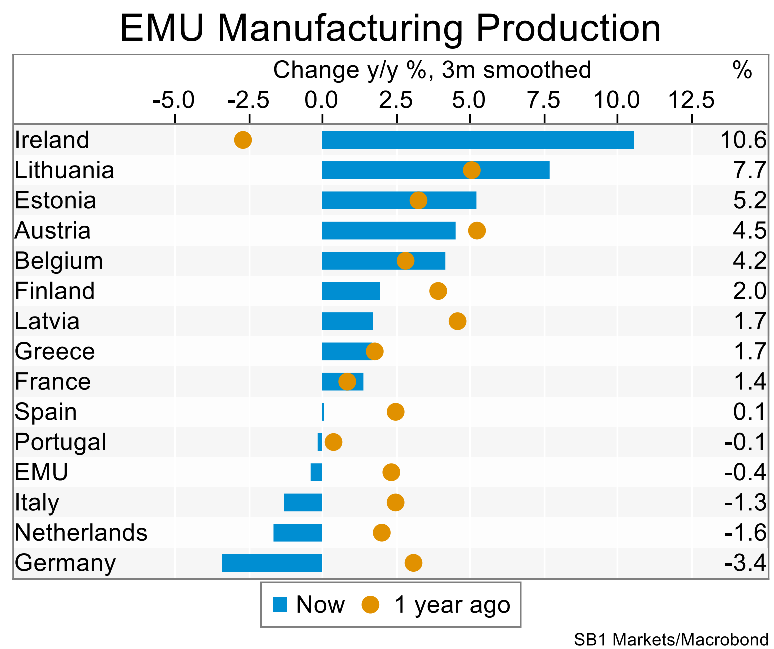


- Industrial production in the Eurozone rose 0.9% in May, following the 0.5% decline April. Production is down 0.5% y/y, and the medium term trend is down rather than up
  - » Given unch. production in June, Q2 was flat following the 3.5% growth in Q1, from the deep Q4 slump
- Production of transport equipment rose sharply, from a low level. Chemicals also up
- The uptick was driven by a 2.1% surge in French production. Germany reported +0.7% but the level is very low, even after a substantial upward revision of April. Italy is trending down, Spain marginally upwards
- **Unfortunately, the manufacturing PMI and orders remain weak, no signs of recovery**

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

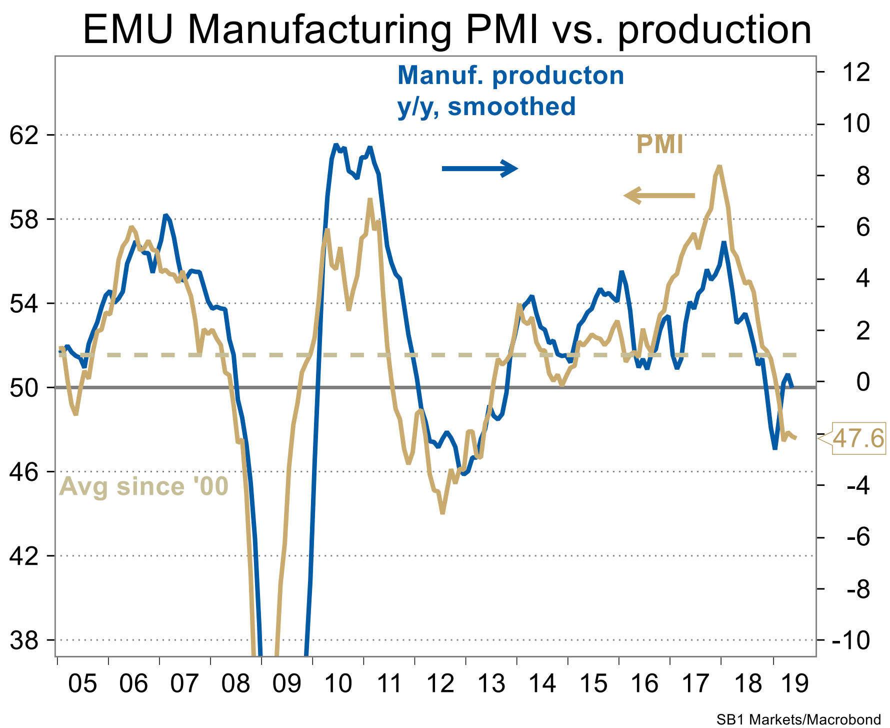
Production is falling in Germany, Netherlands and Italy

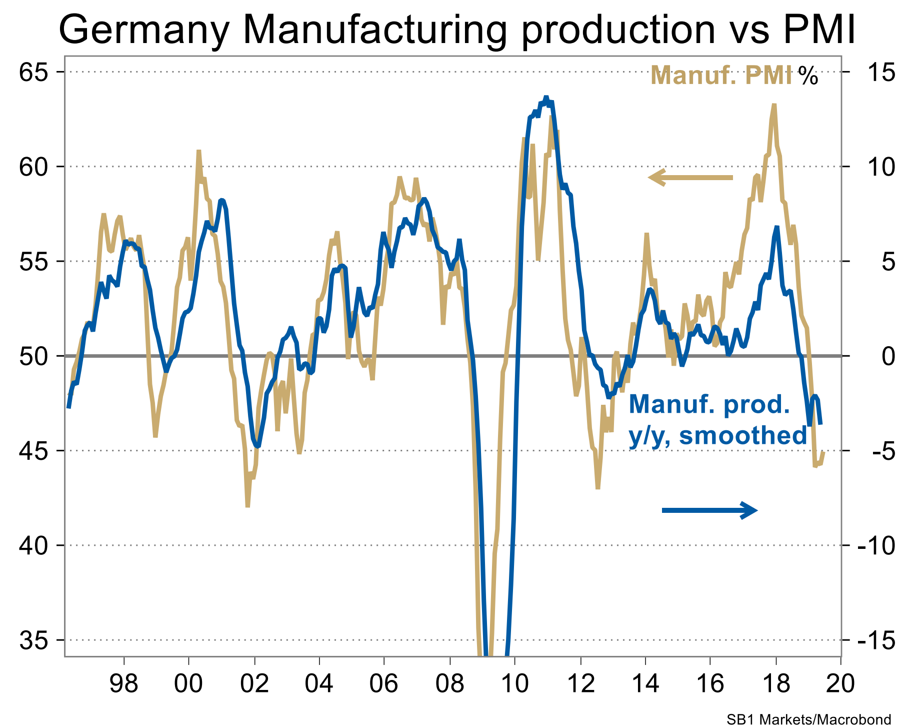




The PMIs told you so…

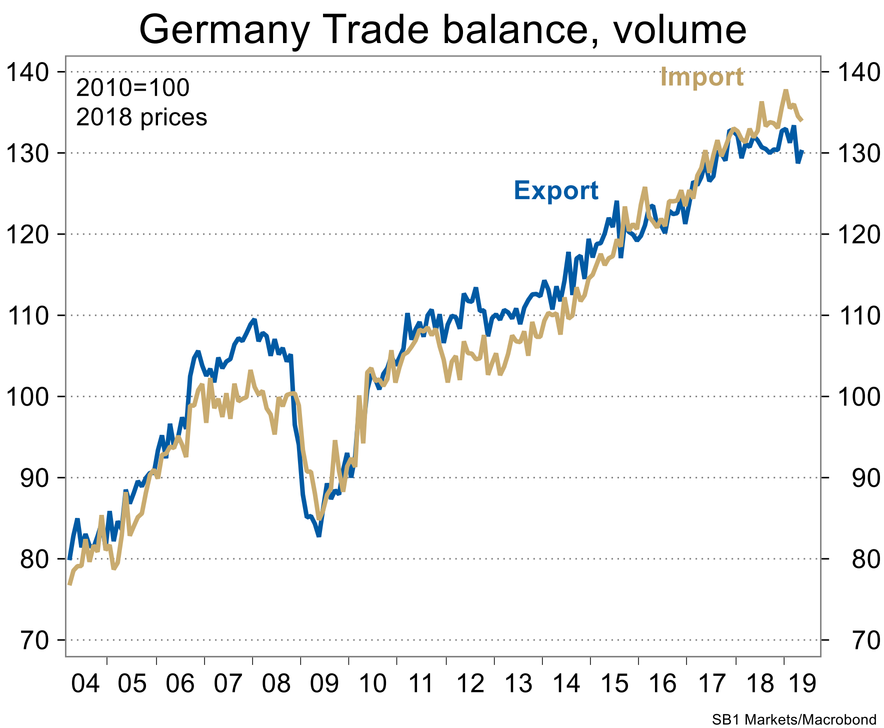
.. and the outlook is not bright, the PMIs are reporting a deterioration

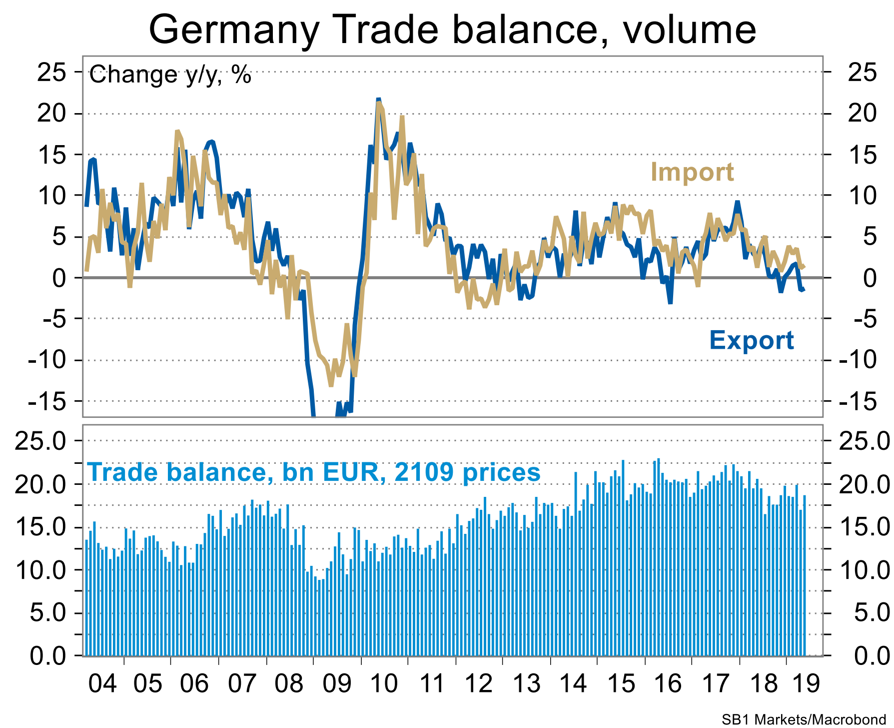




Finally, German exports are yielding (somewhat, and not to China)

Still, exports cannot explain the weakness in German manufacturing. And imports not weak either

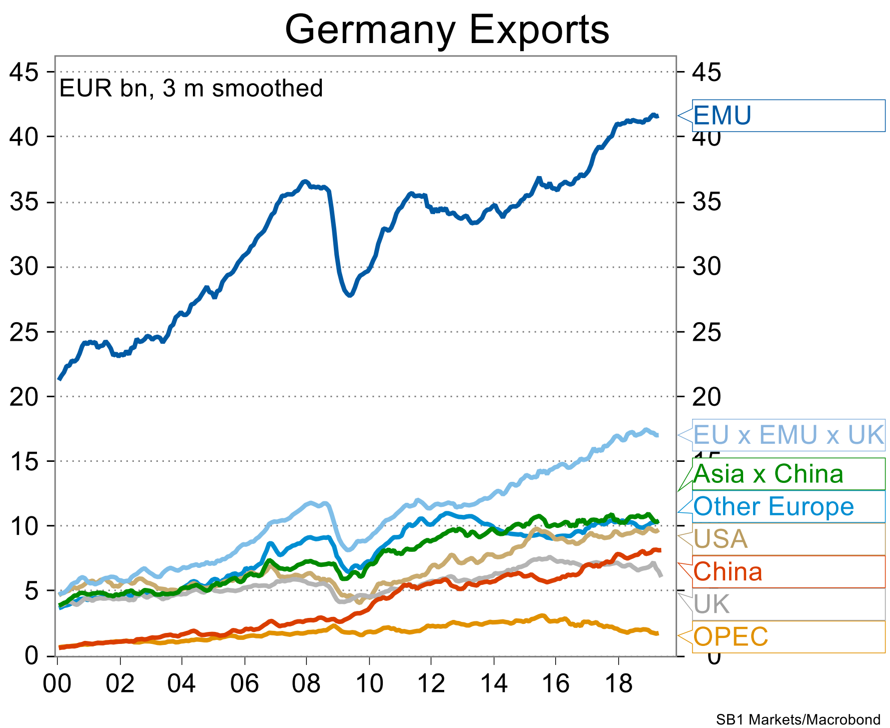


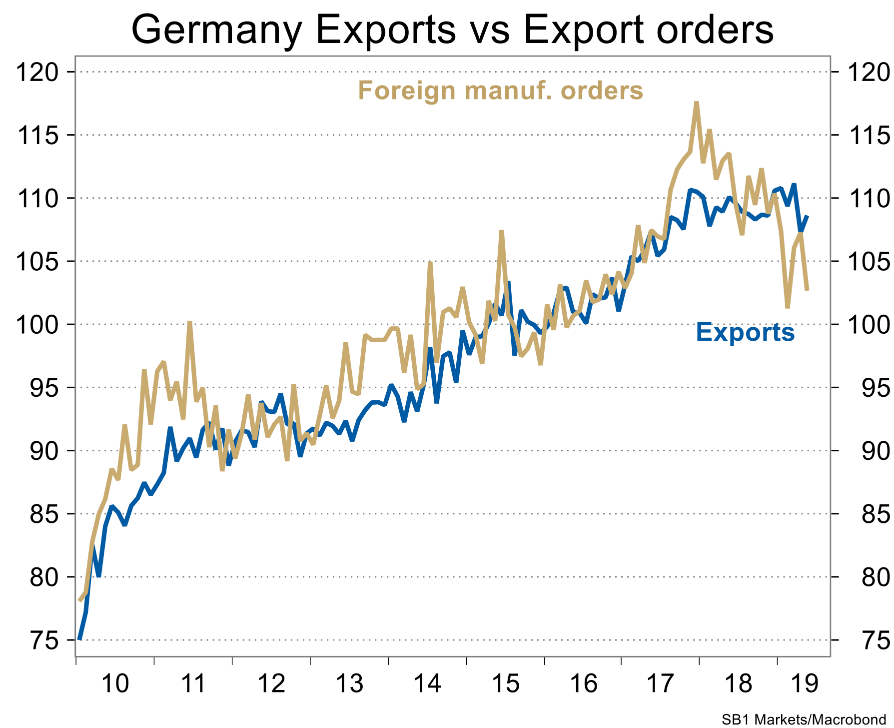


- Export volumes recovered just marginally in May, following the 1.8% drop in April. Exports have kept up far better than PMIs and export orders have been indicating recently, but the to past months signals that 'something' has turned up.
  - » However, the decline is not that sharp, and exports to China are still on the way up. UK (Brexit) to blame (exports are falling sharply), and some weakness in exports to other EU countries, and to Asia ex China
  - » Export orders may have stabilised following a substantial decline and PMIs or other surveys are not signalling any recovery
- Import volumes have fallen marginally but are not far below a medium term trend
- The German trade surplus is slowly shrinking, and now equals approx 6% of GDP, from 8% in 2016

Export data still OK in most directions; China in the lead, exports to the UK down

It can not be just exports that have halted the German manufacturing sector

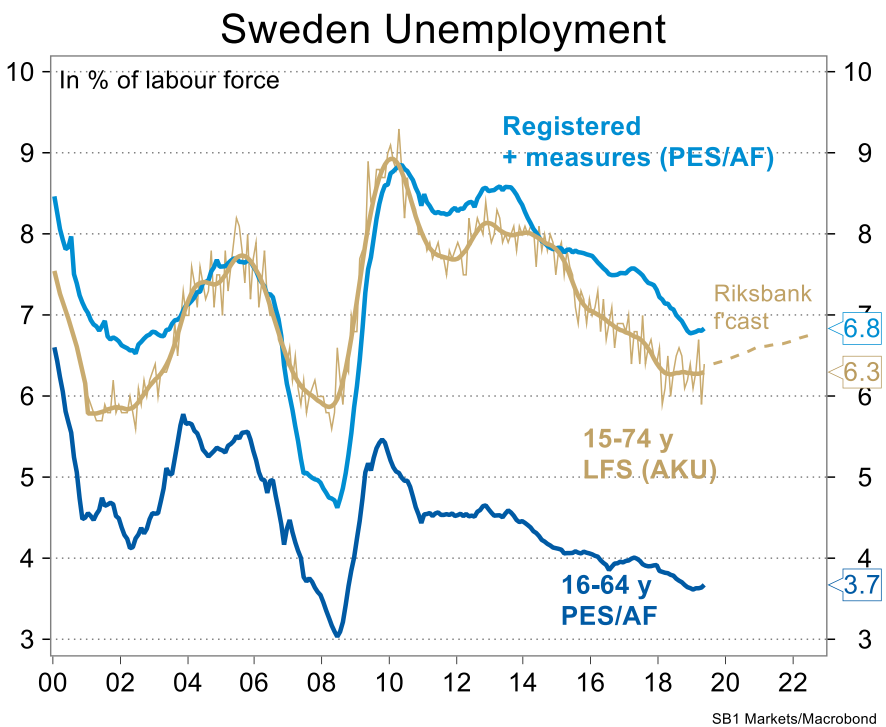


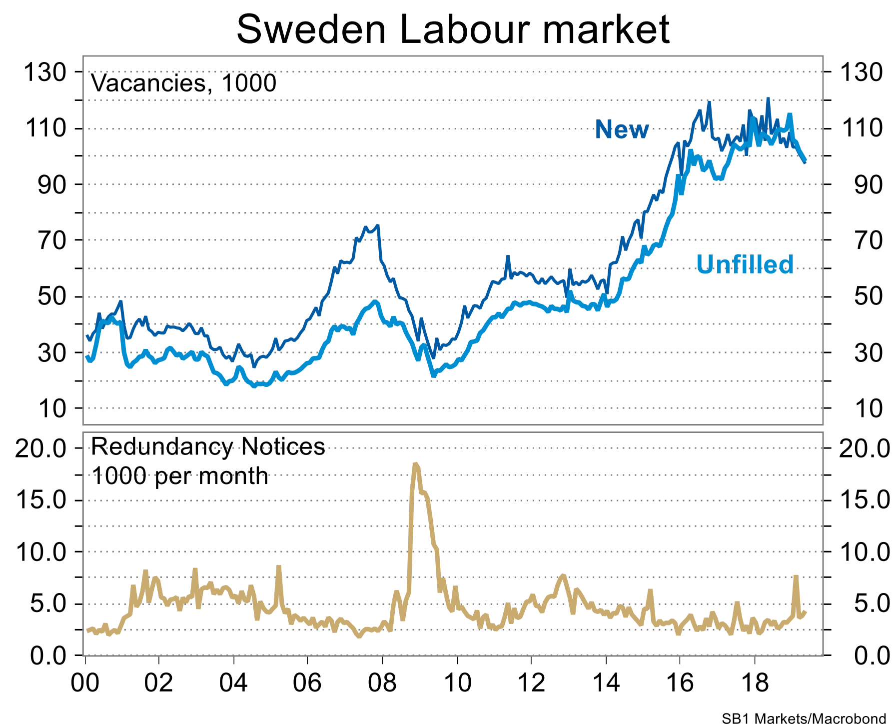


- Exports to China are still increasing rapidly (and faster than to any other regions) XXXXXX
- The direct impacts of the trade war are not easy to find; and German businesses have anyway not been much directly hurt anyway. Surveys/orders are signalling that somewhat else have been happening: A retreat in business investments, due to trade war/Brexit uncertainties and probably also a 'normal' mature cycle. Most likely, businesses are holding back their purchases due to increasing global uncertainties
- Exports to UK are falling rapidly, most likely as businesses there are cutting back purchases after a huge stockpiling ahead of the prior Brexit deadline. Exports to the US is still trending up (no June data), and exports to China are increasing at a fast pace. Exports to other EMU partners have also strengthened recently (no April data), exports to other Europe mixed. Exports to Opec have been the weak link recent two years
- Germany's main export markets: The other EMU countries (38%), other EU countries x UK (16%), Asia x China (10%), Europe x EU (9%), USA (9%), China (7%), UK (6%)

Unemployment is flattening out, employment may be slowing

Unchanged unemployment and weaker employment add to signs of a softening labour market

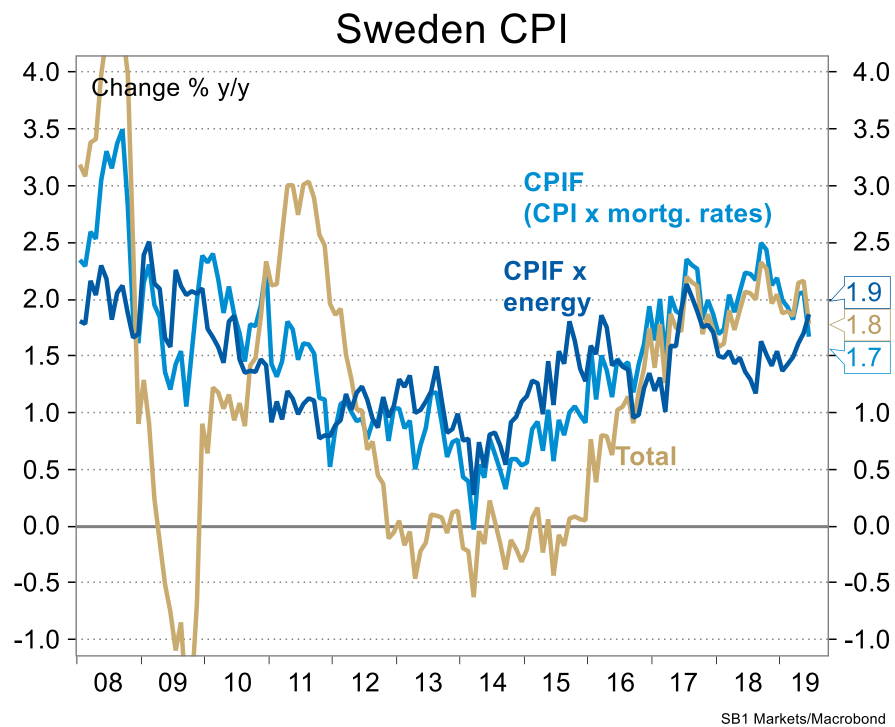


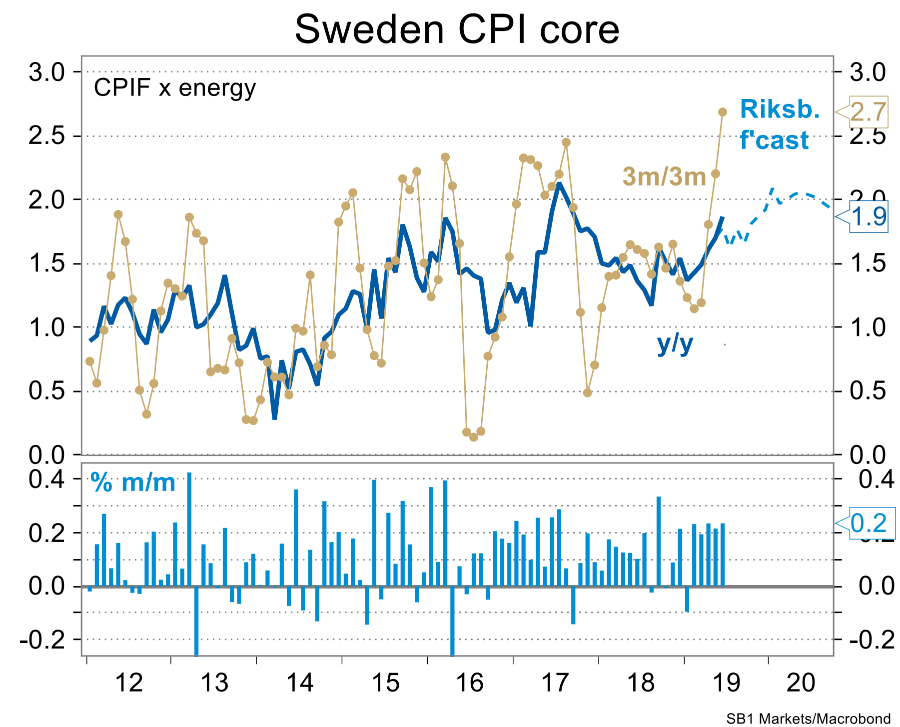


- The LFS unemployment rate rose to 6.4% in May, after a steep decline in April. The smoothed rate, which we prefer, was unchanged at 6.3%, as it has been for more than a year! Is unemployment bottoming out, some 0.5 pp above previous throughs?
- Employment fell sharply in May, the weakest month since 2015. Both the empl. rate and participation rate declined from the peak
- PES open (registered) unemployment rate is confirming a weakening labour market; unempl. rose marginally to 3.7% in May and has flattened out the past 5-6 months. Even as the rates are not low compared to 2007-2008 levels
- 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

Core inflation further up, close to target in June; energy took the headline down

Core CPIF up 0.2 pp to 1.9%M; the 5th acceleration in row. Total CPIF inflation down to 1.8%

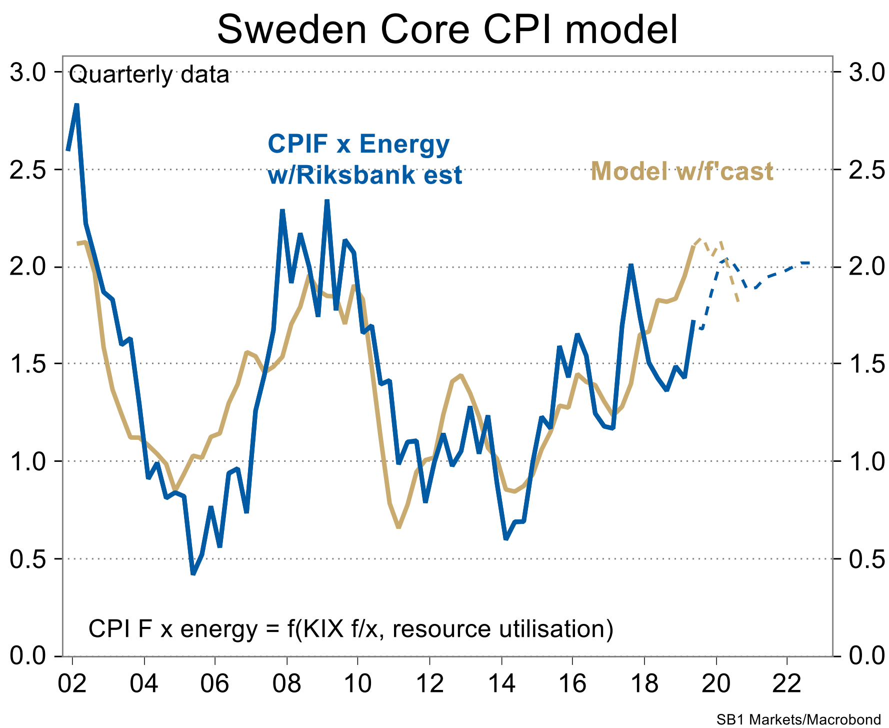


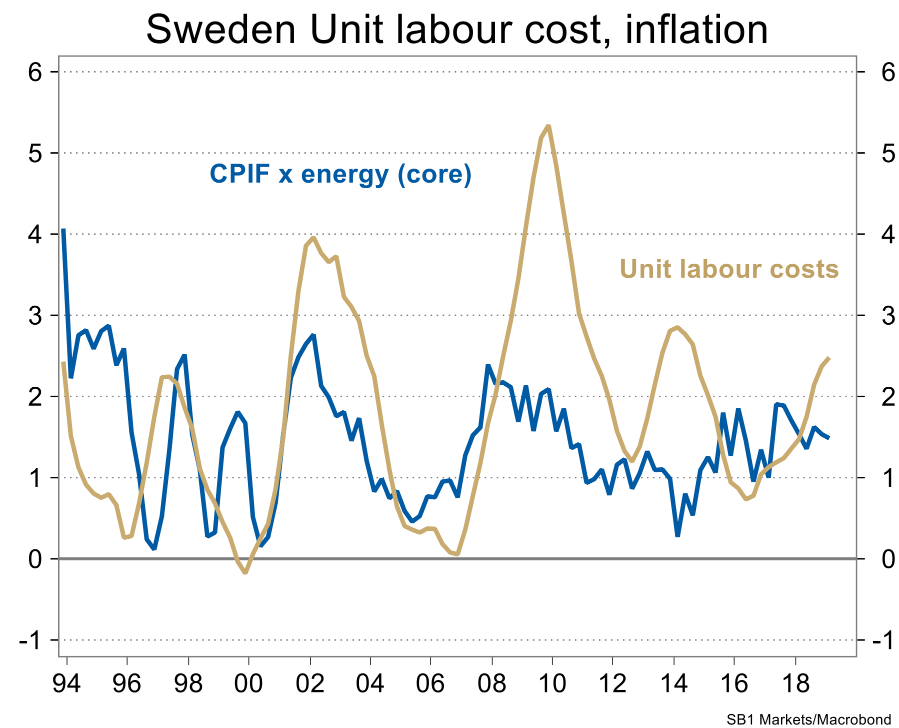


- The ‘real’ core (CPIF ex energy) rose by 0.2% m/m and the annual rate inched up to 1.9%, 0.1 pp above consensus f’casts and Riksbank 1.8% estimates. Core inflation has moved upwards over the past year, from 1.2%. Measured 3m/3m, the rate is 2.7%
  - CPIF (ex mortgage rates) fell 0.4 pp to 1.7% y/y - due to lower energy prices, which also took the headline CPI town 0.4 pp to 1.8%
  - Our simple inflation model signals 2% core inflation. Domestic cost inflation is accelerating due to falling productivity
- Earlier in July, the Riksbank surprised markets with a ‘hawkish’ stance, by stating it expected to hike the signal rate from -0.25% in Q4. The market does not believe the Bank at all

Our model says 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

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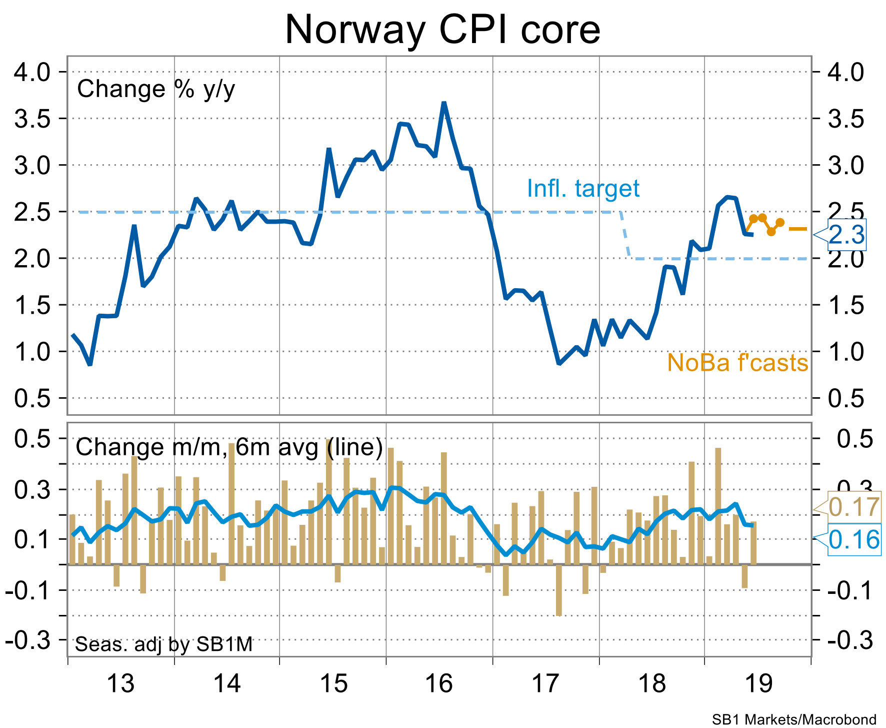
Electricity prices took headline inflation below 2%, core stable at 2.3%

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



- CPI-ATE (ex. energy and taxes) unch at 2.3% y/y in June, in line with our and consensus f'cast. Norges Bank expected 2.4%
  - » CPI-ATE rose 0.2% m/m (seas adj), up from the surprising 0.1% drop in May
  - » Imported goods are up 1.5% y/y, domestically produced goods and services at 2.7%
  - » Total CPI growth decline further, to 1.9% from 2.4% (as we expected, consensus at 2.1%), mostly due to a steep decline in electricity prices. There is more to come. Good for real income growth, thus, consumption!
- **Implications**
  - » Core inflation remains above target, and broadly in line with NoBa's f'cast
  - » No market reaction, for good reasons

Electricity prices took headline inflation below 2%, core stable at 2.3%

Core prices up 0.2% m/m, 0.1 pp below NoBa's f'cast

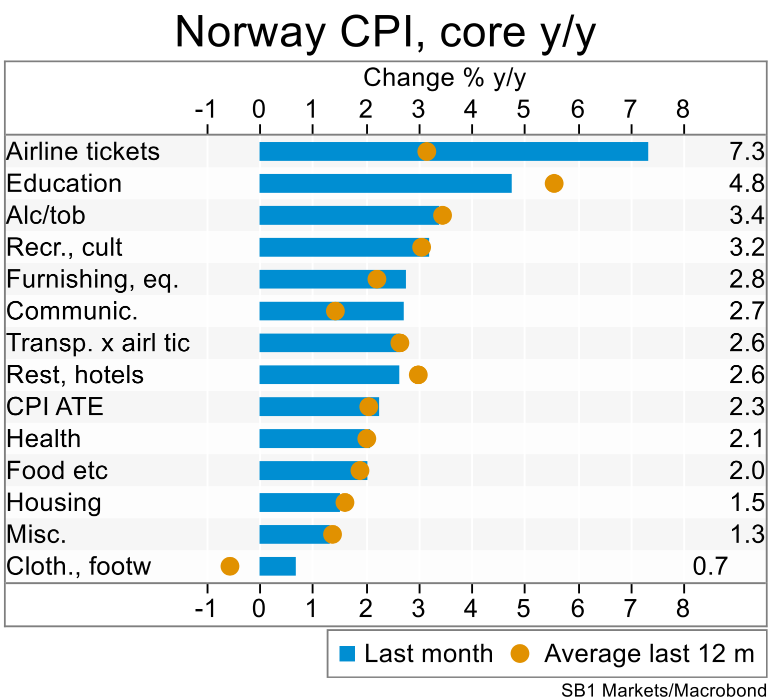
		Change m/m, seas. adj			Change y/y			Contribution, pp		
Jun-19 CPI ATE	Weight %	Out-come	SB1M f'cast	Dev. pp	Last month	Out-come	SB1M f'cast	m/m	y/y	Dev. vs f'cast
Food, non alc bev	12.5	0.2	0.3	-0.1	1.7	2.0	2.2	0.02	0.25	-0.02
Alcohol, tobacco	3.9	0.1	0.2	-0.1	3.7	3.4	3.5	0.00	0.13	-0.00
Clothing, footwear	4.9	-0.1	0.0	-0.1	0.2	0.7	0.8	-0.00	0.03	-0.00
Housing x. energy	20.1	0.0	0.1	-0.1	1.6	1.5	1.6	0.01	0.31	-0.01
Furnishing	6.6	0.9	0.1	0.8	1.8	2.8	1.6	0.06	0.18	0.05
Health	3.2	0.2	0.2	0.1	2.0	2.1	2.0	0.01	0.07	0.00
Transp. ex. gas, airl. tick	12.0	0.5	0.2	0.3	2.3	2.6	2.0	0.06	0.31	0.04
Airline tickets	1.2	2.4	0.0	2.4	7.9	7.3	5.0	0.03	0.08	0.03
Communication	2.2	-0.1	0.1	-0.2	2.9	2.7	3.0	-0.00	0.06	-0.00
Recreation, culture	11.9	-0.1	0.3	-0.4	4.3	3.2	3.9	-0.01	0.38	-0.05
Education	0.5	-	-	-	4.8	4.8	4.8		0.02	0.00
Restaurants, hotels	6.2	0.1	0.2	-0.1	3.1	2.6	2.8	0.01	0.16	-0.01
Other	8.8	0.0	0.2	-0.1	1.4	1.3	1.5	0.00	0.12	-0.01
CPI-ATE	94	**0.2**	**0.2**	0.0	**2.3**	**2.3**	**2.3**			
Norges Bank est.			***0.3***		***2.3***		***2.4***			
Imported	33	0.2	0.1	0.1	1.3	1.5	1.4	0.07	0.50	0.04
Domestic	61	0.1	0.2	-0.1	2.8	2.7	2.3	0.09	1.62	-0.03
Energy, housing	4	-7.1	-8.0	0.9	11.1	-6.6	-6.9	-0.27	-0.26	0.04
Energy, transport	4	-0.3	-2.0	1.7	0.2	1.7	-0.1	-0.01	0.06	0.06
CPI Total	101	**-0.2**	**-0.2**	0.0	**2.5**	**1.9**	**1.9**	-0.18	1.96	0.02

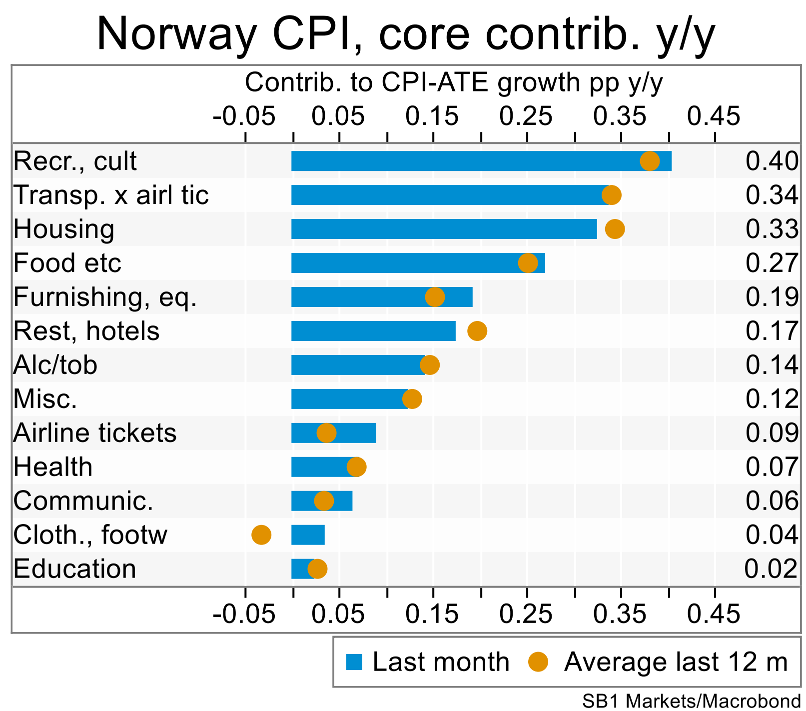
- Food prices fell 0.7% m/m, we f'casted a marginal increase. The contribution on core inflation was -0.08 pp on the m/m rate
- Furnishing prices surprised us on the upside
- Airline ticket prices marginally up
- **CPI-ATE up 0.2% m/m and 2.3% y/y, in line with our & consensus' f'cast**
- Imported prices below average inflation at 1.5%, domestic above 2.7% (both core)
- Electricity prices fell 7%, close to our f'cast and prices will continue down.
- Headline inflation fell as we assumed to 1.9% (consensus at 2.1%), down from 2.5% in May (and 3.5% in Dec). Nice for households

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

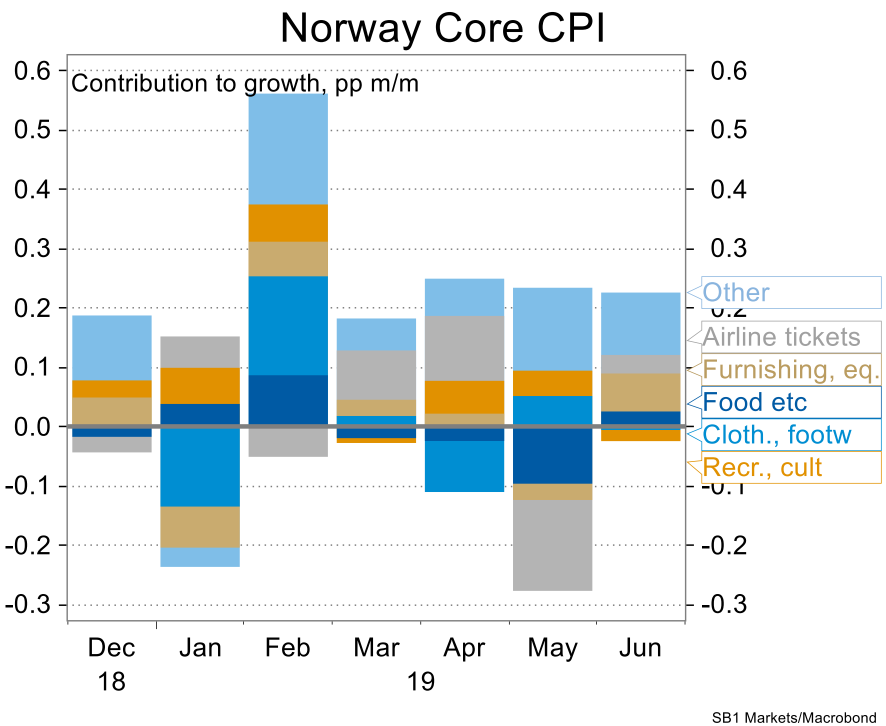
Annual inflation quite stable – domestic services are the big contributors

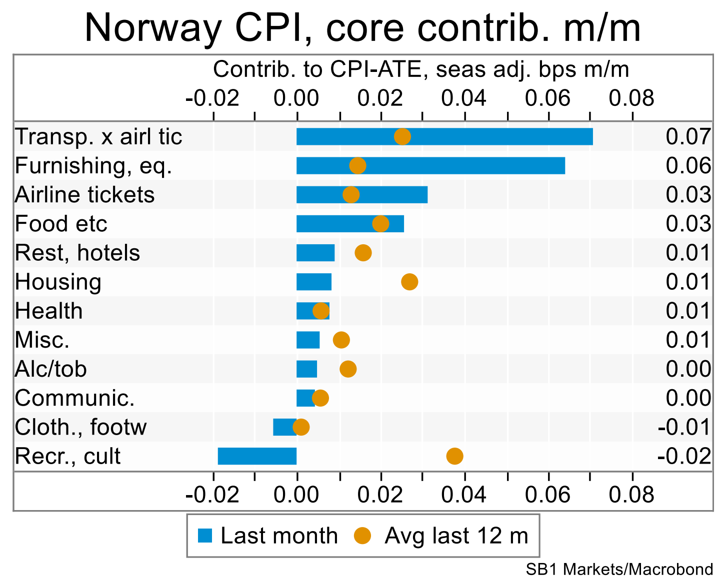
Recreation & culture, housing and transport are lifting the annual rate. Muted clothing prices





Broad but modest increases in core prices in June

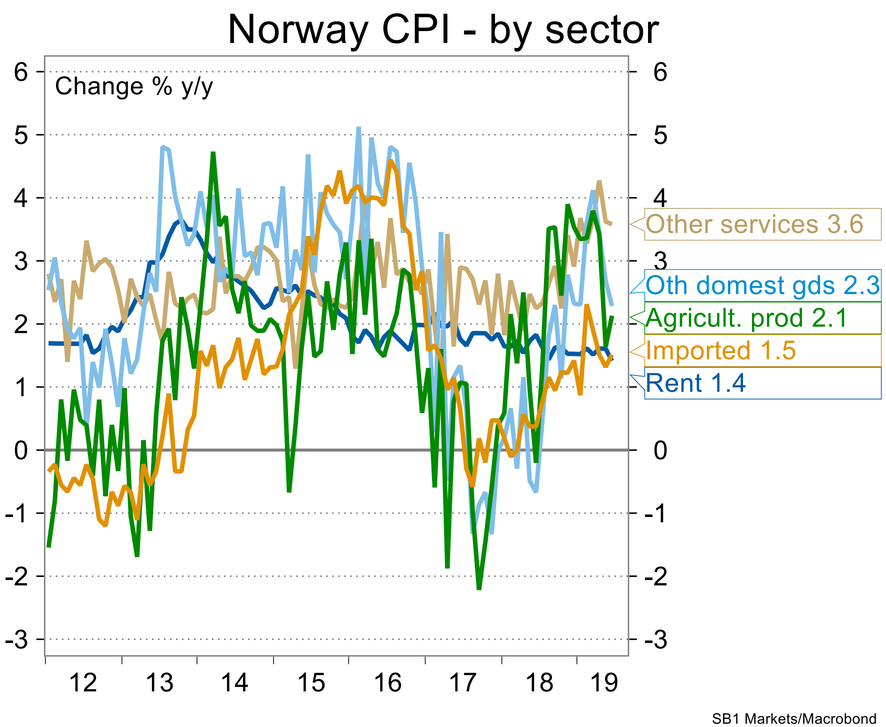


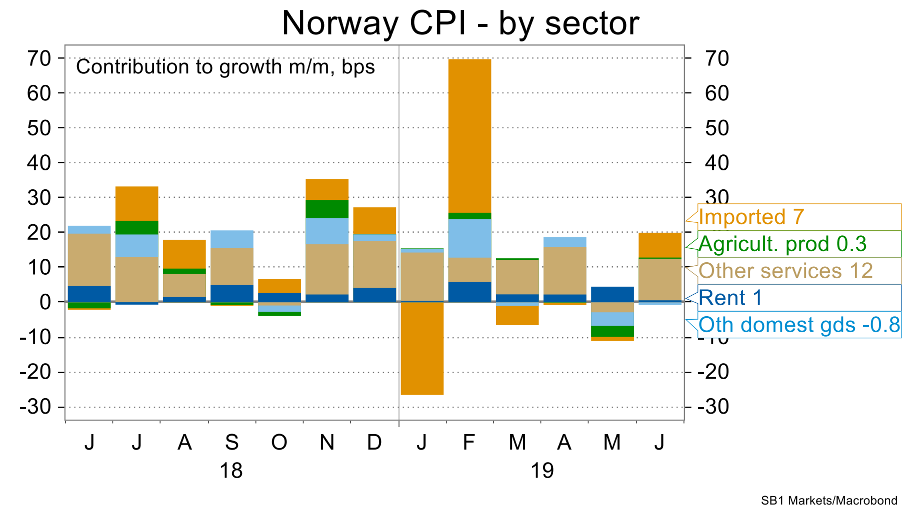


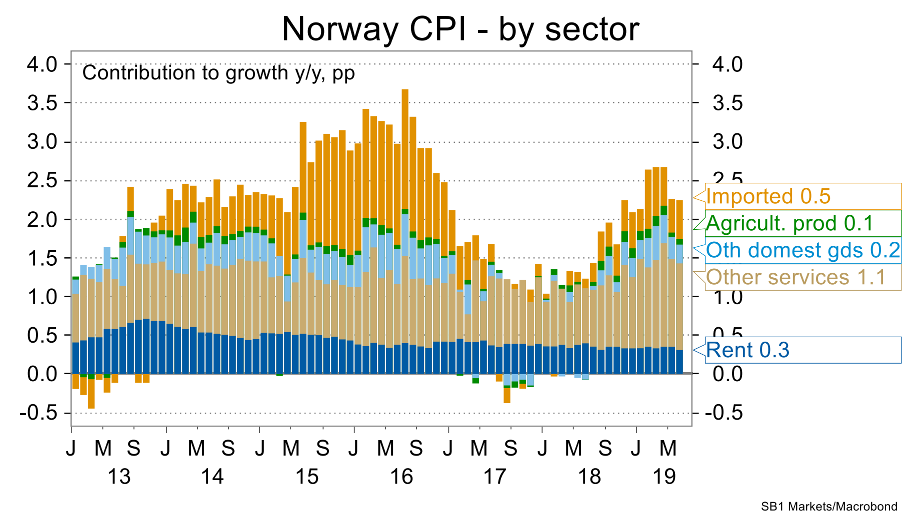
- Recreation/culture and communication, clothing & footwear and other goods drove monthly inflation up

Imported inflation is retreating, just services rising recently

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



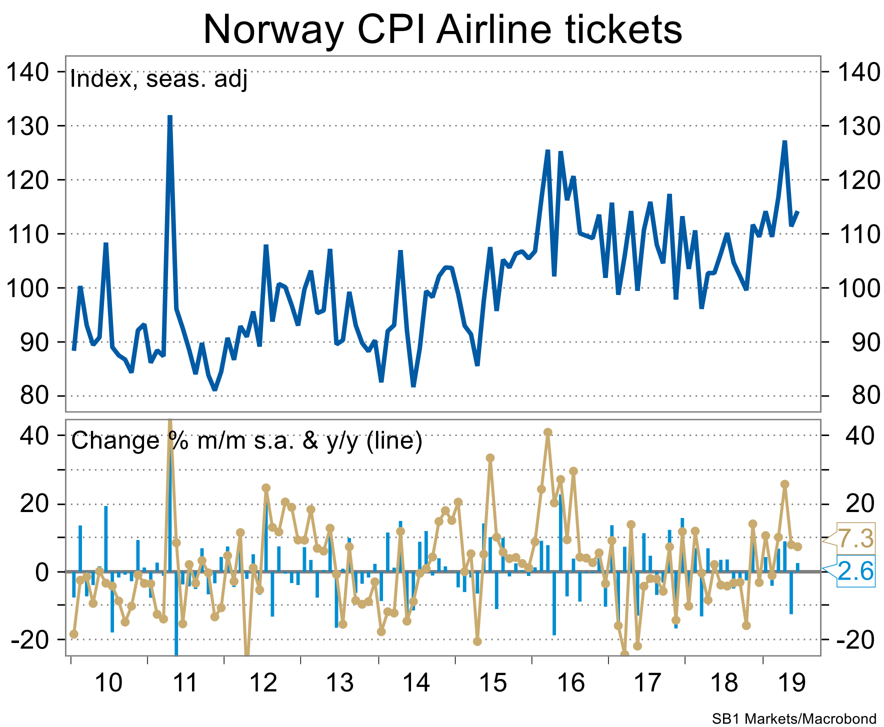


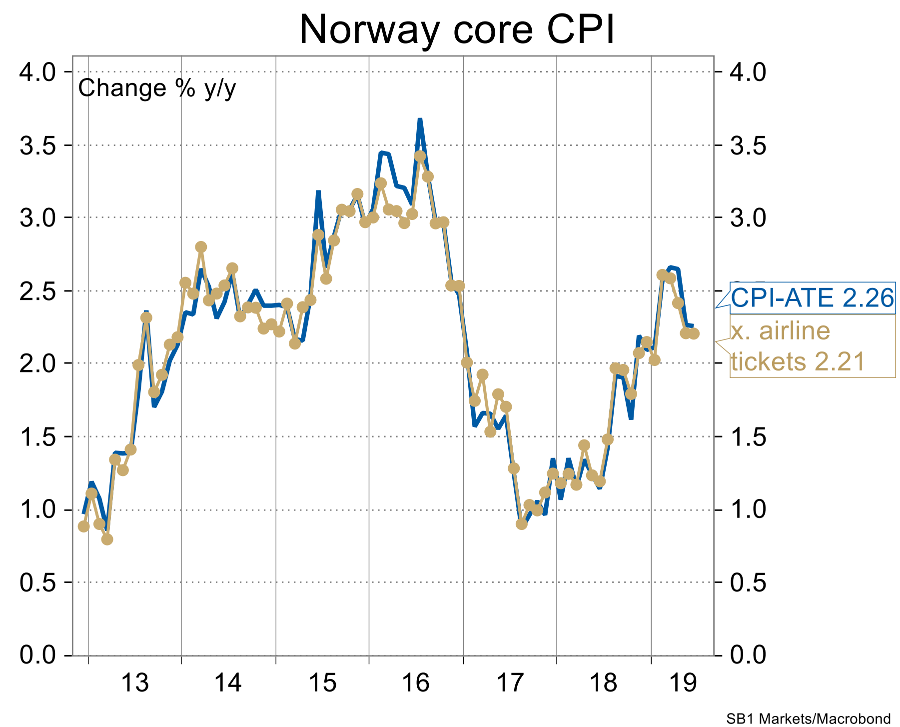


- Price growth in services (such as culture, travelling etc) has been soaring the past months, they are up 3.6% y/y! Other domestic goods and imported goods have slowed, after accelerating the past year. Rent inflation is slowly slowing, up 1.4% y/y (no lack of housing??)
- The NOK depreciation has been lifting import prices but the impact will now probably fade (check here)

Airline tickets prices marginally up in June

Airline ticket prices are still boosting inflation but not significantly



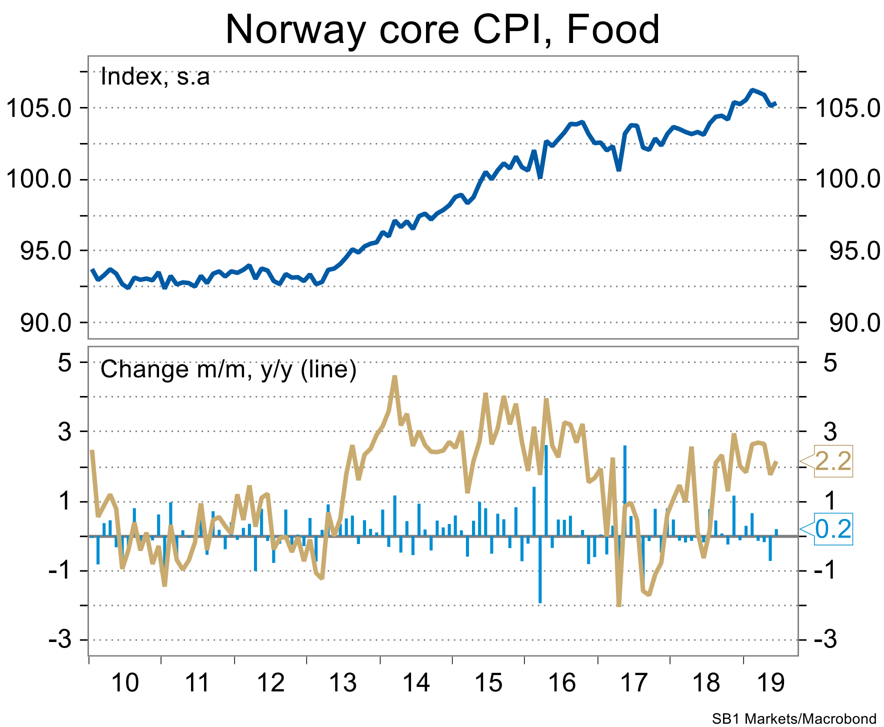


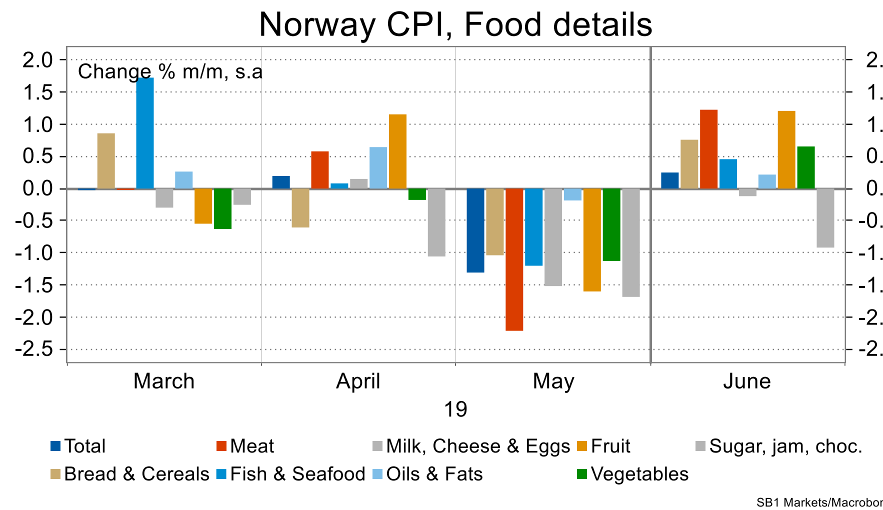
- Prices rose 2.6% (seasonally adjusted) and 7.3 y/y.
  - » These data are very volatile. During the spring, Easter impact are making the seasonal adjustments even more uncertain than usual

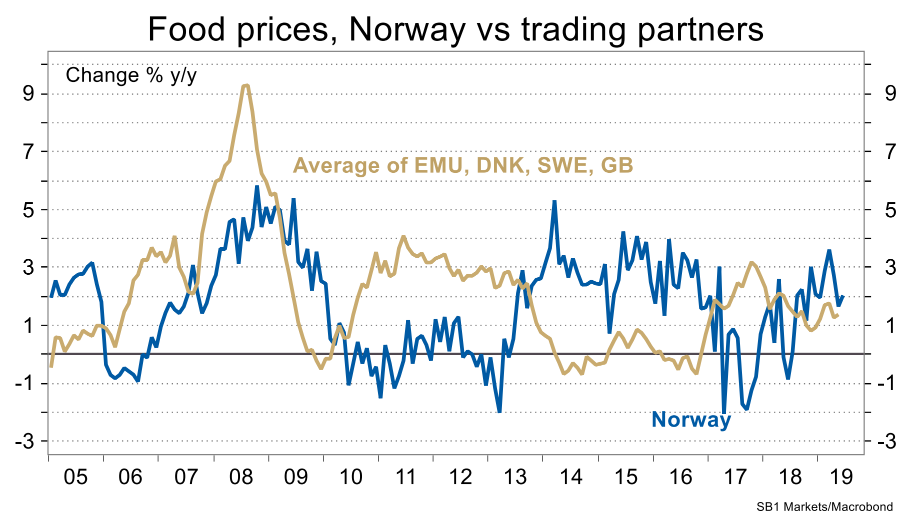
SSB is using a sophisticated net search model to calculate average prices in the relevant week. We assume that the real volatility in average monthly air ticket prices are lower than calculated

Food prices reversed some of the May decline

The annual rate is hoovering above 2%





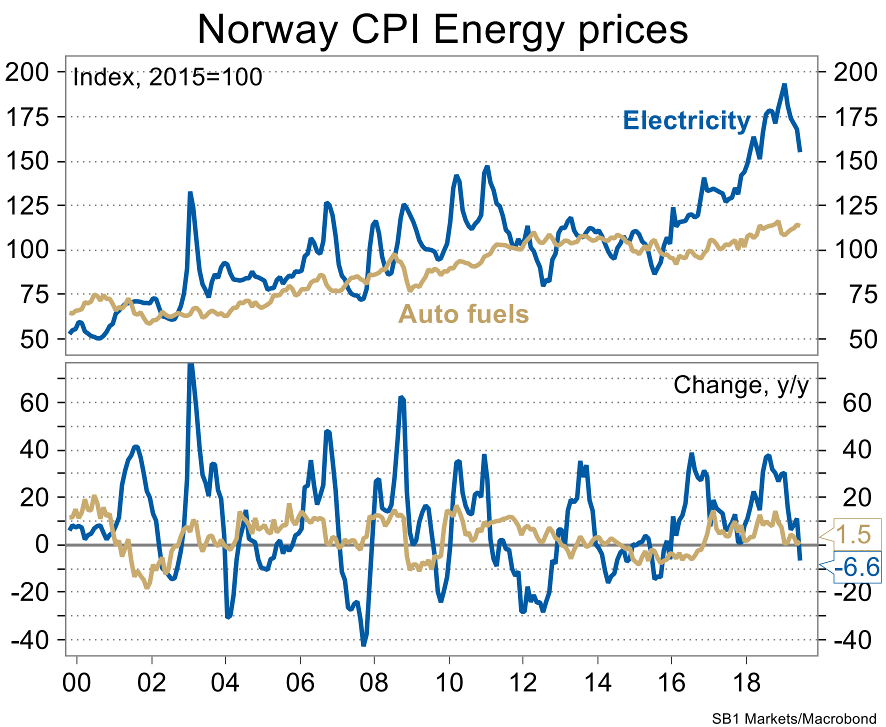


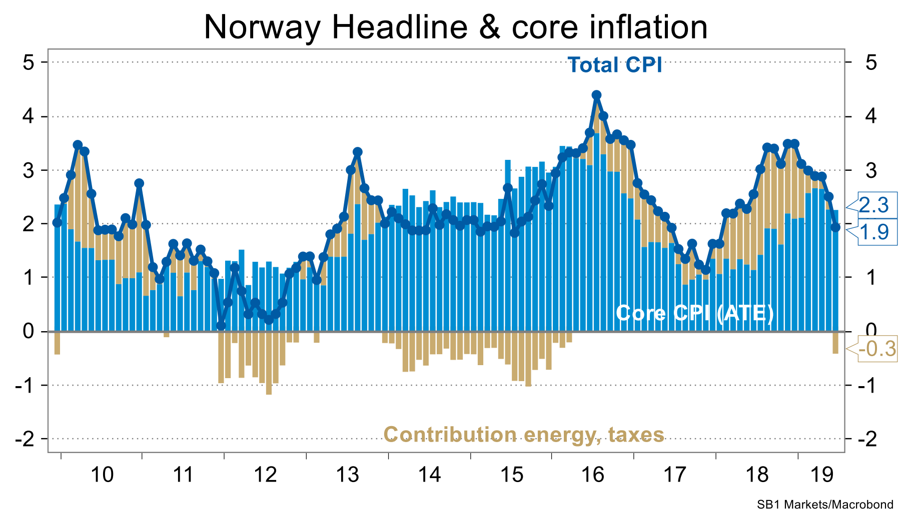
- Prices rose 0.3% m/m, slightly less than we expected
- Food prices are now increasing at the same speed as in our neighbouring countries

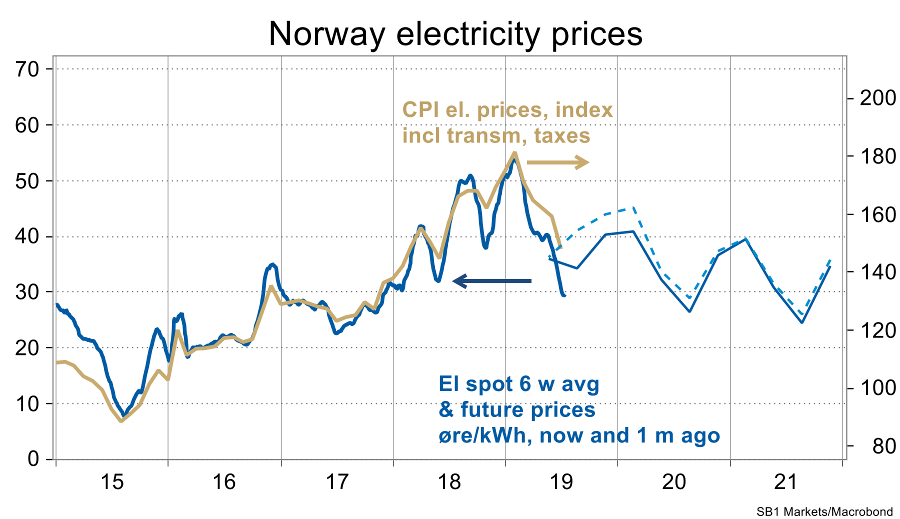
SpareBank 1 MARKETS

Electricity price a 0.3 pp drag on headline CPI, from +1.5 pp 6 months ag

And there is still more to come!



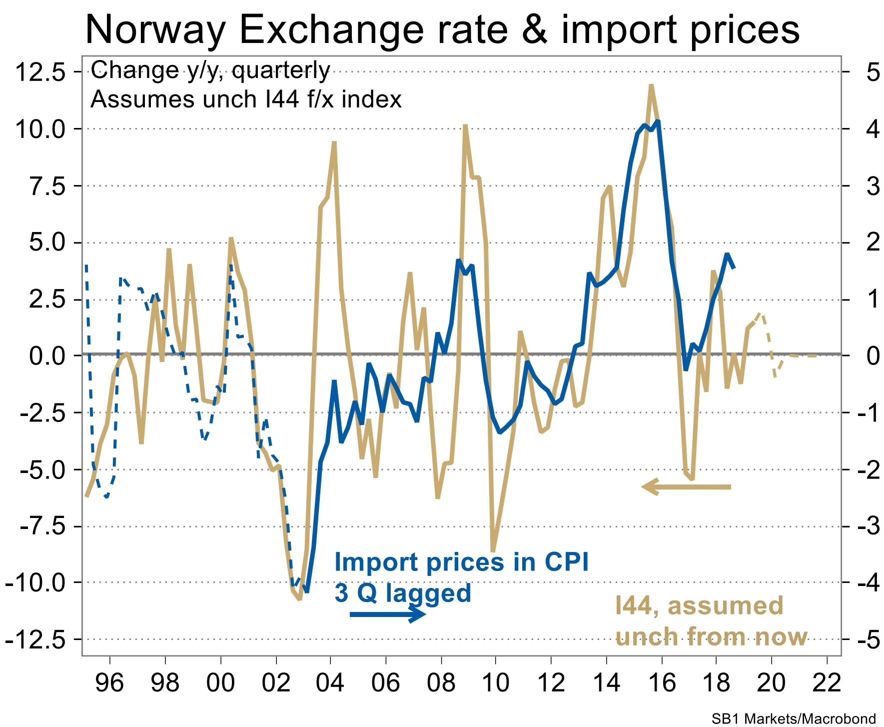


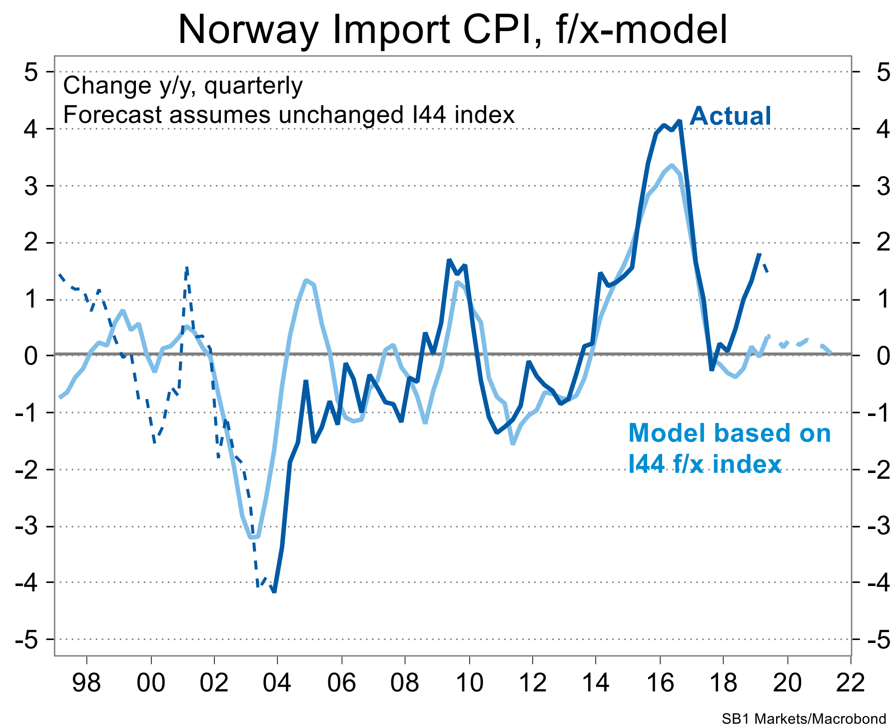


- Over the previous two years the surge in electricity prices have lifted the headline CPI, reducing real disposable income significantly. Now, this effect has gone into reverse, as electricity prices are falling sharply. The y/y contribution was -0.3 pp in June, from +0.4 pp in May, vs +1.5 pp 6 months ago!!
  - » Spot & near term future prices have collapsed since mid May. If the market is right now (and not 4 weeks ago…), el prices in CPI will decline somewhat more the coming months, taking the headline CPI further down. The future market is pricing in even lower prices in 2020 and 2021
- Auto fuel prices are close to neutral vs. headline CPI

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

Imported inflation is substantially higher than the NOK implies

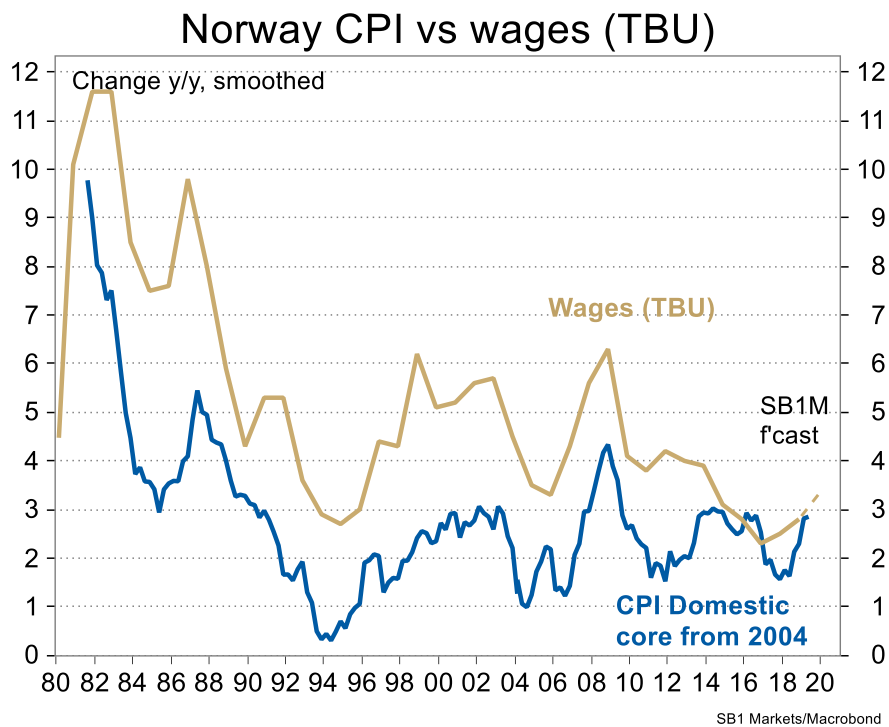


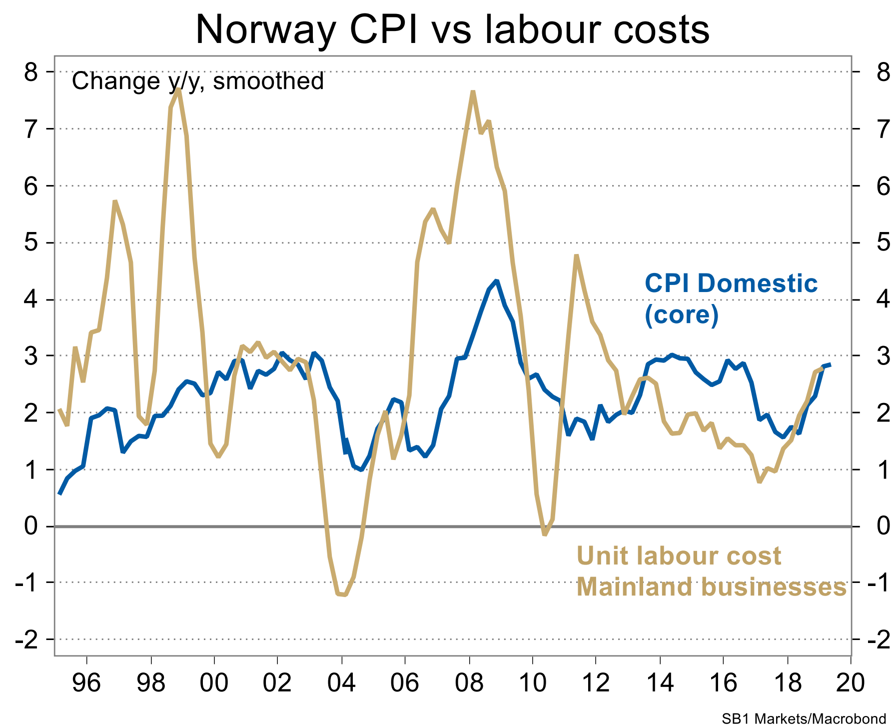


- In general, retail demand is so weak that it does not seem likely that the retailers are able to push up their margins. It does not seem likely that prices are accelerating abroad

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

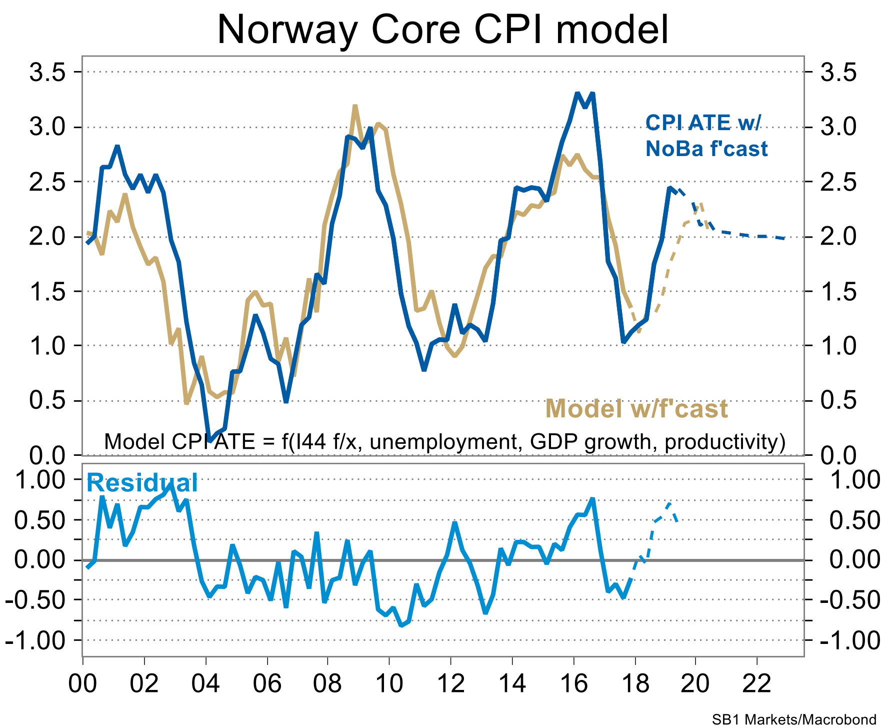




- Wage inflation is increasing and is now approaching 3%, will probably edge up to 3.2% in 2019
- Productivity growth remains meagre
- (Underlying) Unit labour costs inflation up to 2.8% y/y in Q1, up from 2.7% in Q4 – and below 1% in 2017

The outlook: Core CPI inflation has peaked?

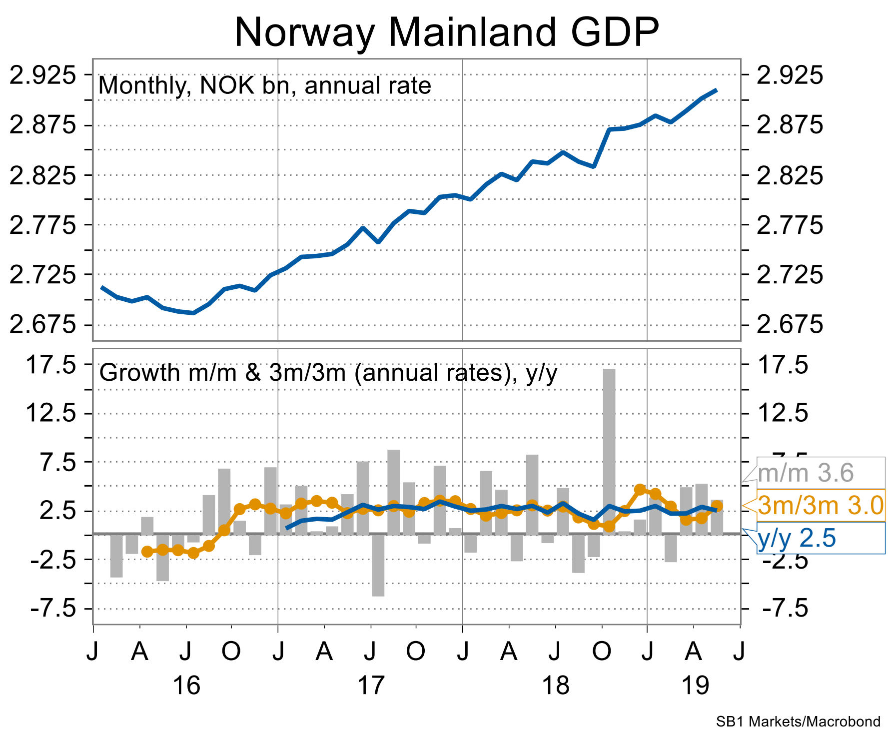
Actual inflation higher than our model forecast now – but it suggest 2.3% in a year's time



- Core CPI growth has been well above the model f'cast recent months, the 2.3% speed in June 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 2.4% in 2019, and down to 2.1% in 2020 (June Monetary Policy report). Fair estimates

GDP growth on track, Norges Bank will continue

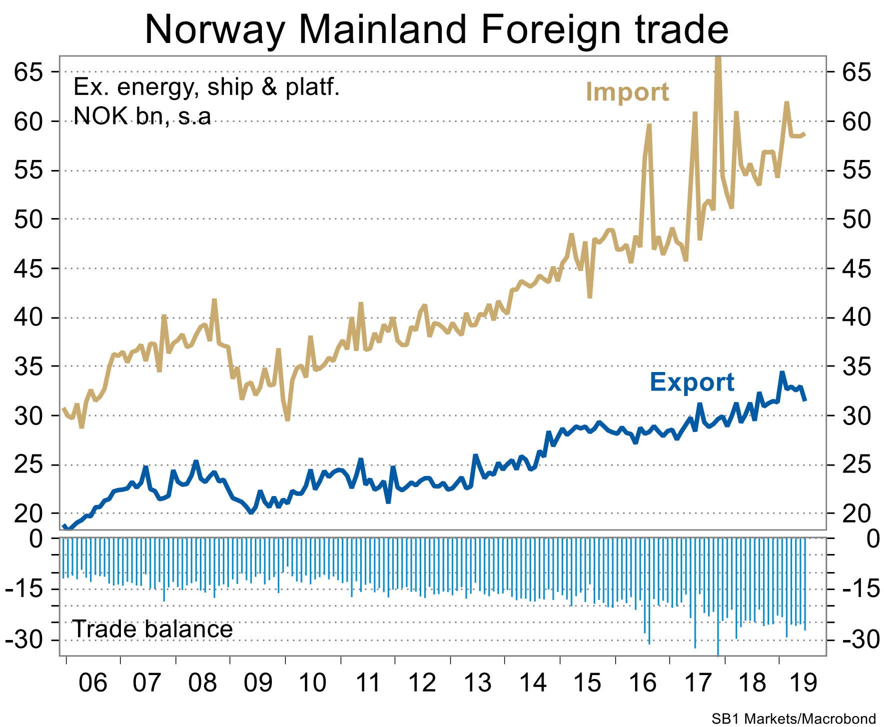
GDP rose 3.6% annualised in May, underlying growth up to 3% following upward revisions

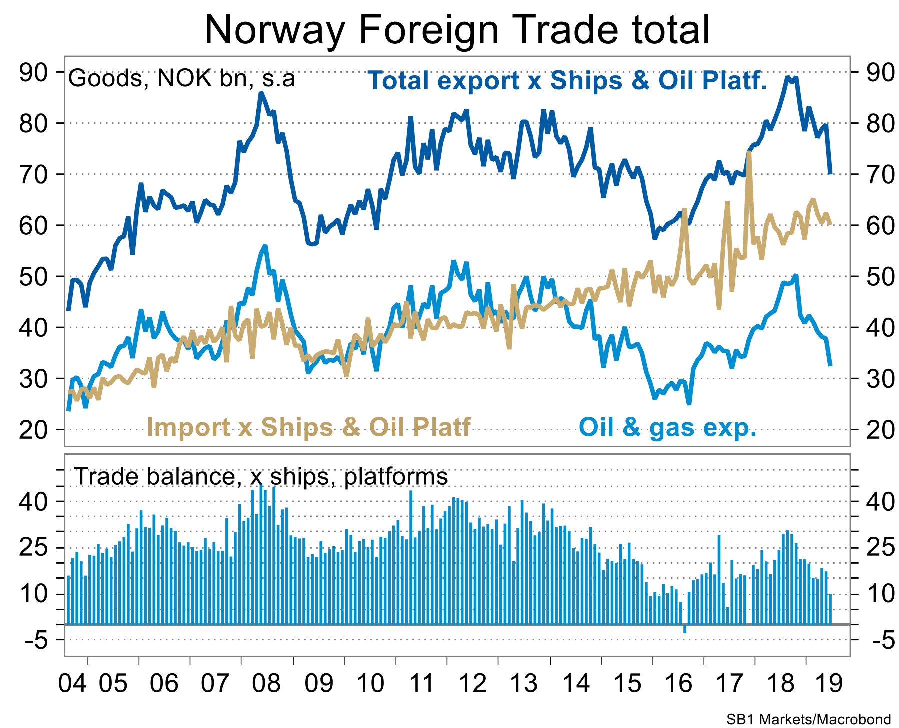


- Mainland GDP rose 0.3% m/m in May, 3.6% ann. rate
  - » The monthly data are too volatile to give us any useful signals, the more important 3m/3m rate accelerated to 3.0% from 1,7% (revised from 1.4%). The pace of growth in both March and April was approx 5%
  - » Norges Bank's March f'cast is 3.1% (0.8) growth in Q2, up from 0.4% in Q1 (with drag from primary and electricity production). The f'cast is still within reach (but may be a tad to optimistic)
  - » GDP is up 2.4% from May last year – close to the average growth rate recent years – and well above trend as the employment rate is increasing the unemployment rate is declining
- On the demand side:
  - » Private consumption probably slowed in Q2, partly due to lower auto sales ('technically, due to estraordinary high sales of Tesla EVs in March)
  - » Mainland business investments probably rose sharply in Q2, mostly doe to a huge lift in investments in manufacturing and other good, which cannot be replicated in Q3 (we expect a sharp contraction)
  - » Oil investments have been heavily revised recent months but is now confirmed down more than 4% in Q1 (from an increase) and data at hand now suggest a 10% increase in Q2
  - » Housing investments are growing at a modest pace
  - » Mainland net trade was probably close to neutral in Q2
- So what?
  - » Norges Bank's Q2 GDP f'cast at 0.8% q/q is still within reach, and the underlying picture is anyway that Mainland GDP is growing above trend, supporting the bank's view that the signal rate should be nudged further up. Barring a global 'disaster', we expect a Sept hike, to 1.5%

Broad decline in exports but just in June, imports still strong

Mainland trade deficit widened in June - and is trending out. Petroleum exports down in June

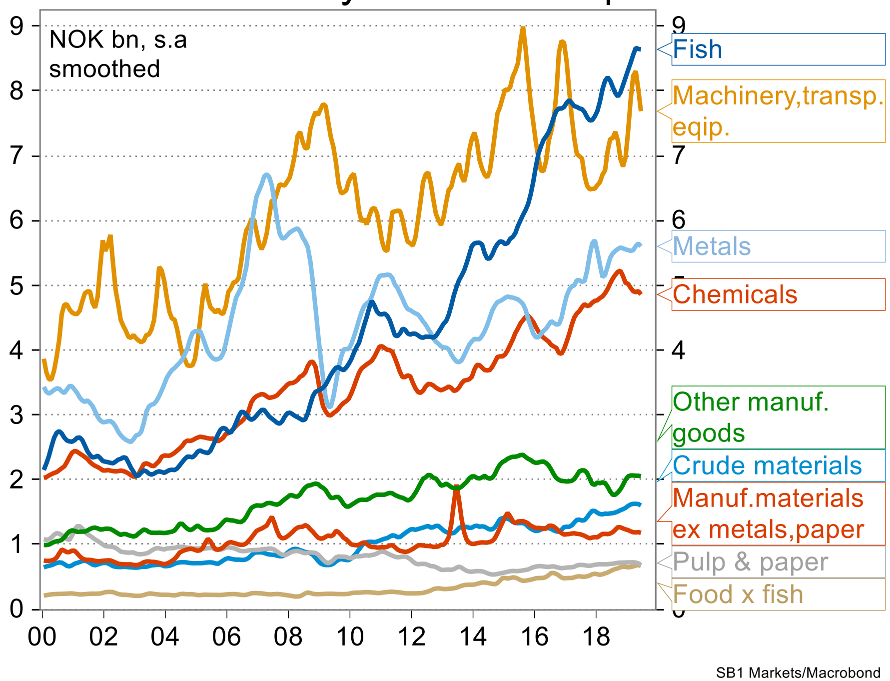


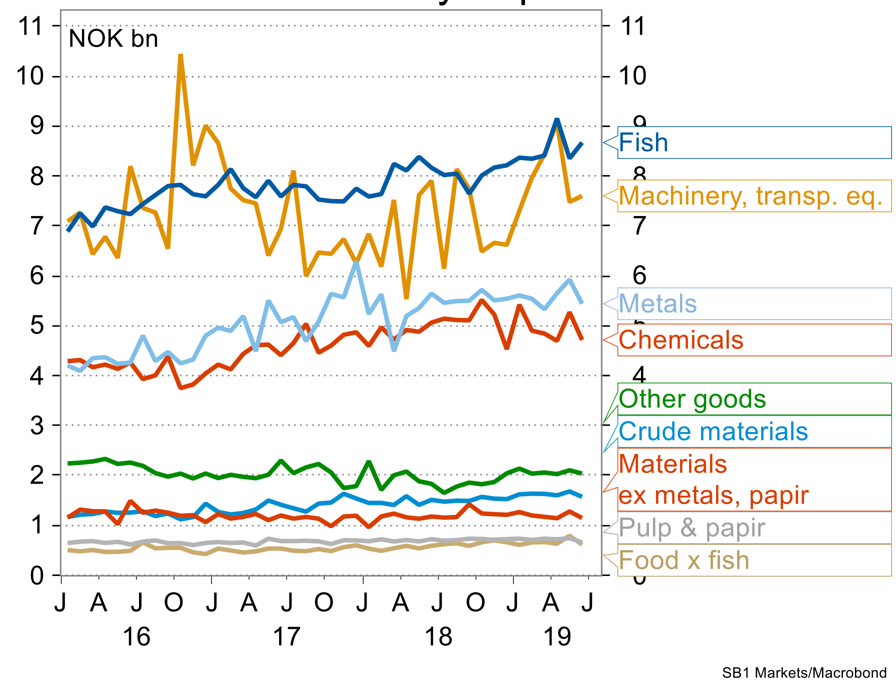


- The Mainland trade deficit rose by almost NOK 2 bn to 27.3 bn in June. The deficit has been more or less stable since early 2018, following a significant widening the previous 7 years
  - » Imports (in value) rose 0.5% m/m in June and are up 7% y/y (3m smoothed), primarily due to soaring imports of machinery & equipment + vehicles
  - » Mainland exports fell 4.6% (in value). Barring the June decline, exports have been trending up driven by machinery and fishing (sum +7% y/y smoothed)
- The overall trade surplus (incl oil & gas, ex ships & platforms) fell to NOK 10 bn from 15 bn in May. Oil/gas exports fell sharply due to reduced volumes. The total trade surplus equaled some 4% of total GDP in June, but level over the previous months are some 6%

Most sectors reported lower exports in June – but most a trending up

Metals and chemicals exports contributed most on the downside in June





- Fish exports have been soaring both in value and volume recent years
- Exports of machinery and transport equipment (probably related to oil activities abroad) have accelerated, following a downturn in late 2018. Exports are still below the 2015 and 2016 peaks

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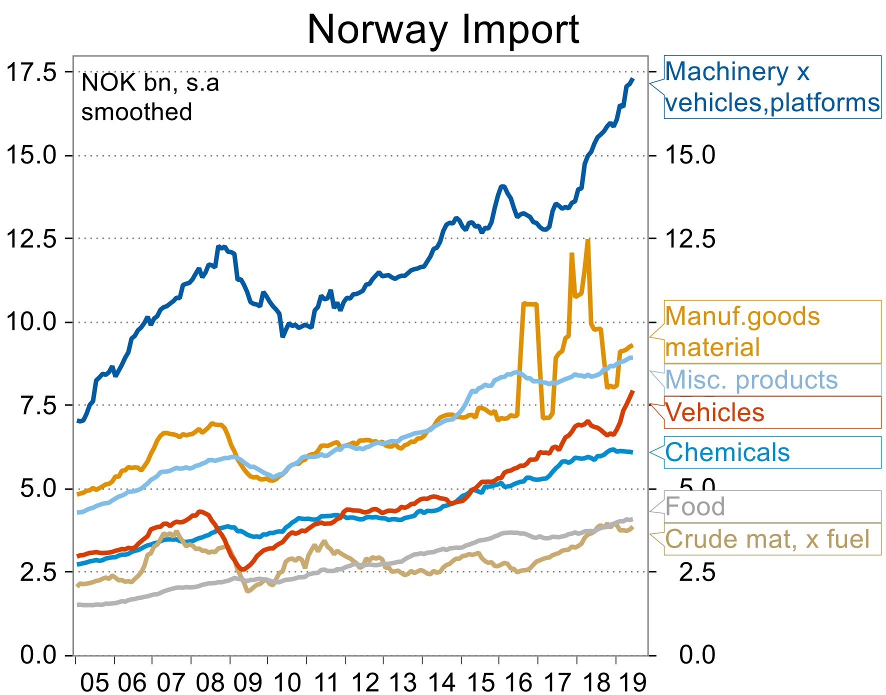
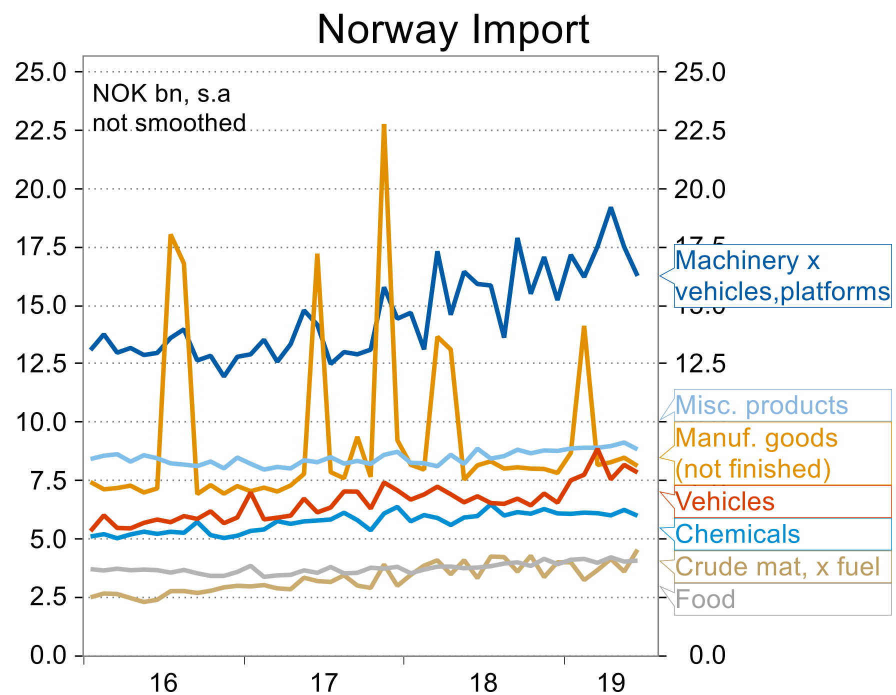
Imports of machinery equipment are soaring, vehicles up too

Imports of most goods are trending up. Vehicles have gained pace, due to electric cars



SB1 Markets/Macrobond



SB1 Markets/Macrobond

- Imports of manufacturing materials have had some huge spikes, due to some massive transactions; of oil platforms, wind mills and combat airplanes. Regardless, the trend is steeply up. Machinery ex vehicles and platforms, much oil related, are rising steeply too
- Chemicals, food and crude materials are all slowly expanding
- Vehicle imports slowed through 2018 and have been soaring since. Partly due to rising imports of electric cars, particularly the new Tesla in March, and electric busses. Imports of electric cars equalled 35% of total auto imports (in value) in May

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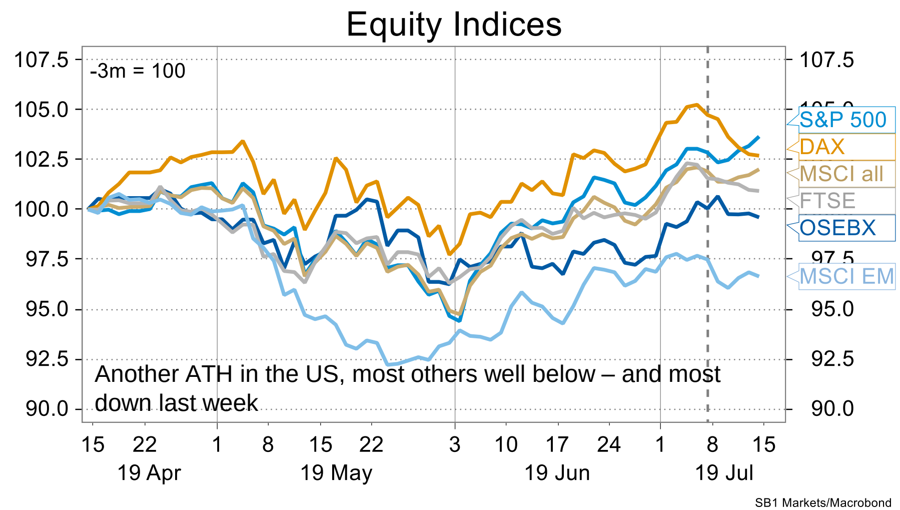
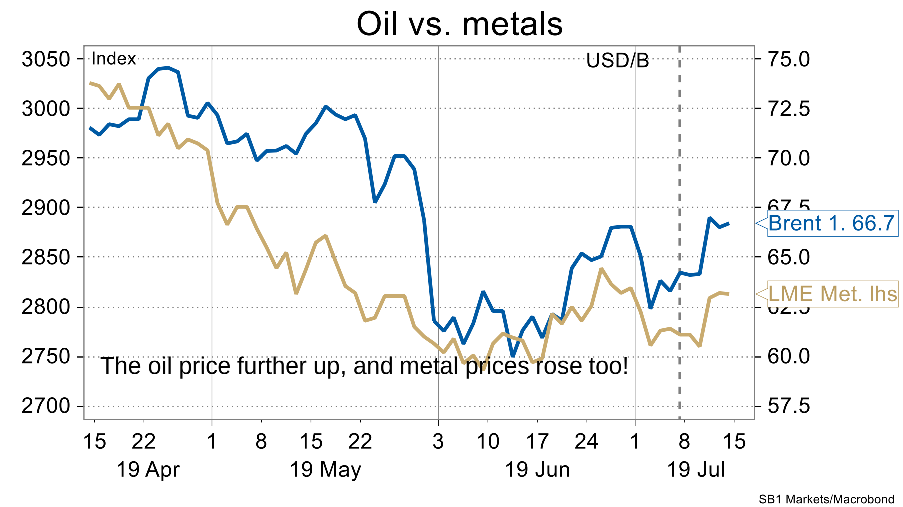
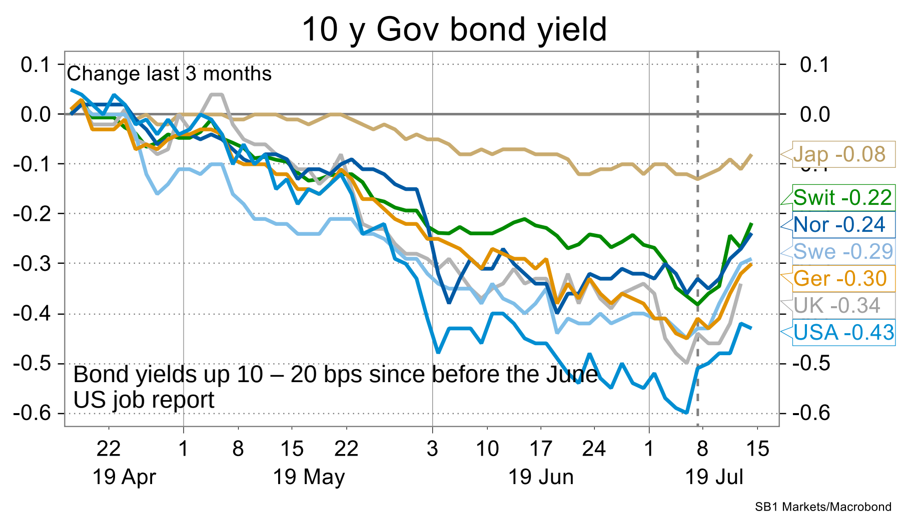
SpareBank 1 MARKETS

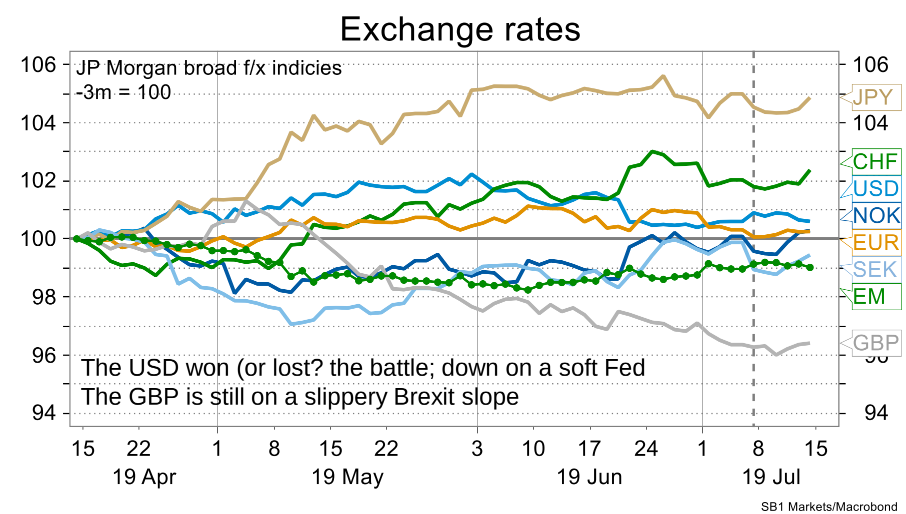
Stock markets mostly down (but ATH in the US, again); bond yields and oil up

A marginal decline in the USD cannot explain the stock market divergence.





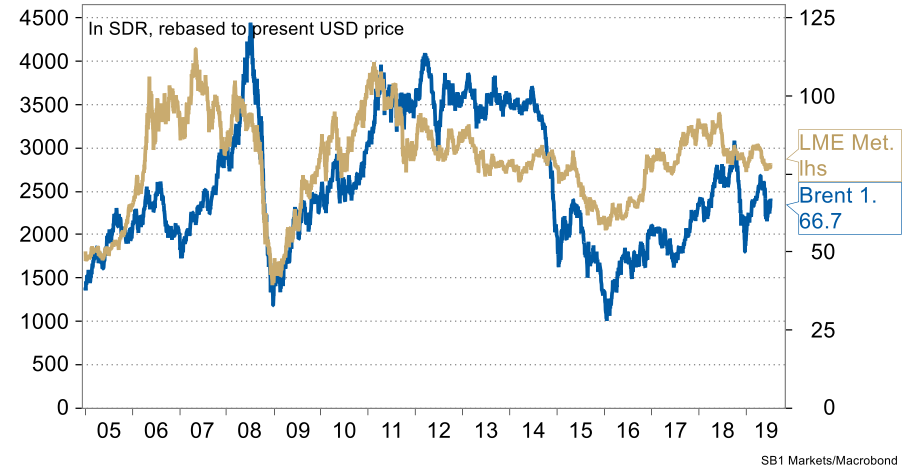




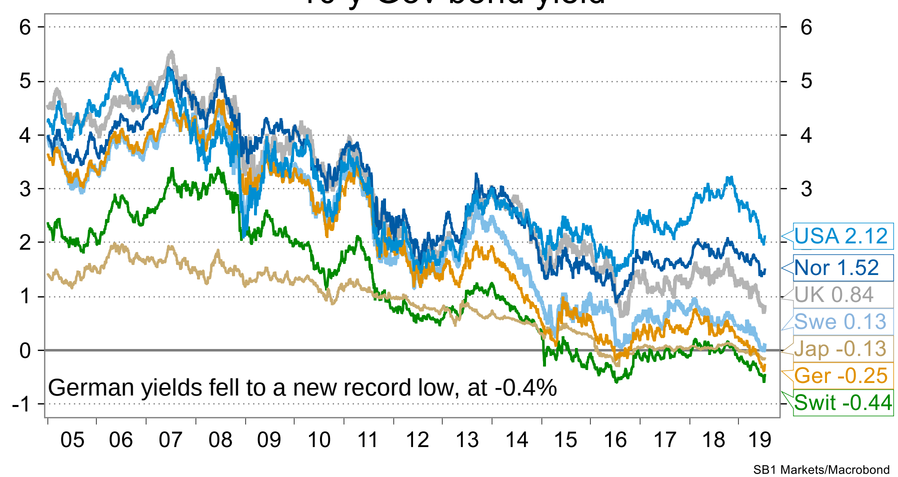
US at new ATH. It's not the economy, stupid. (It's the Fed, until further notice)

Equity Indices

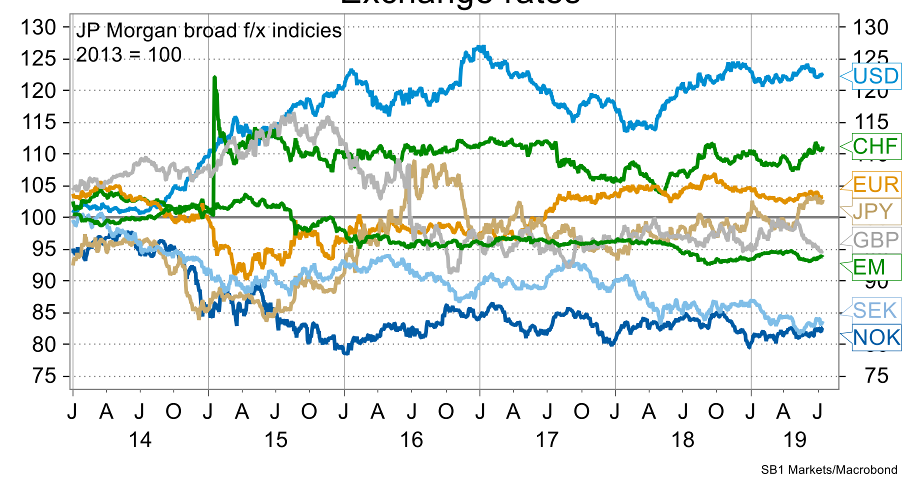
Oil vs. metals



10 y Gov bond yield



Exchange rates



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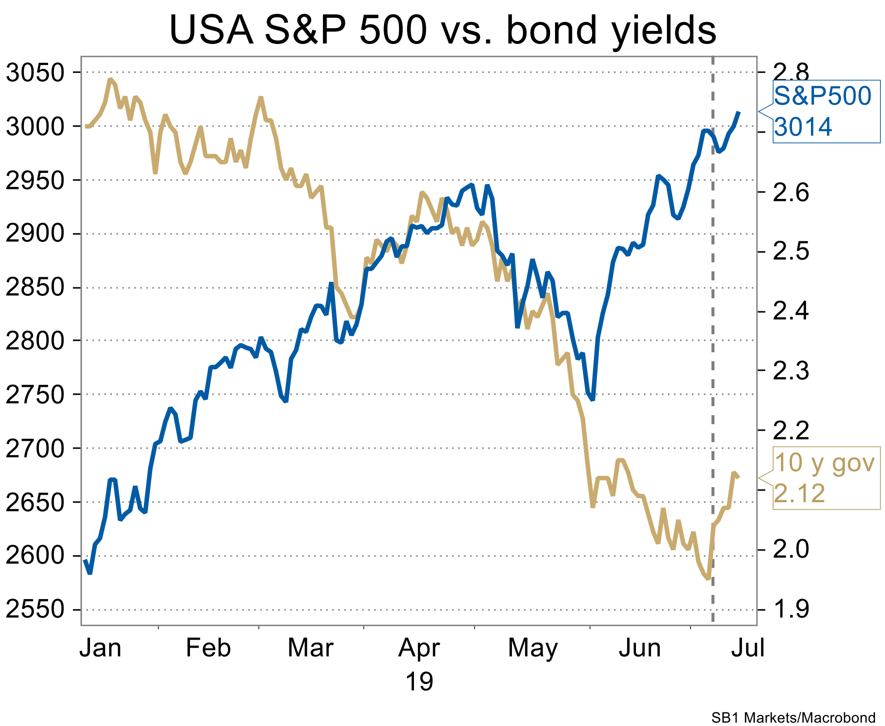
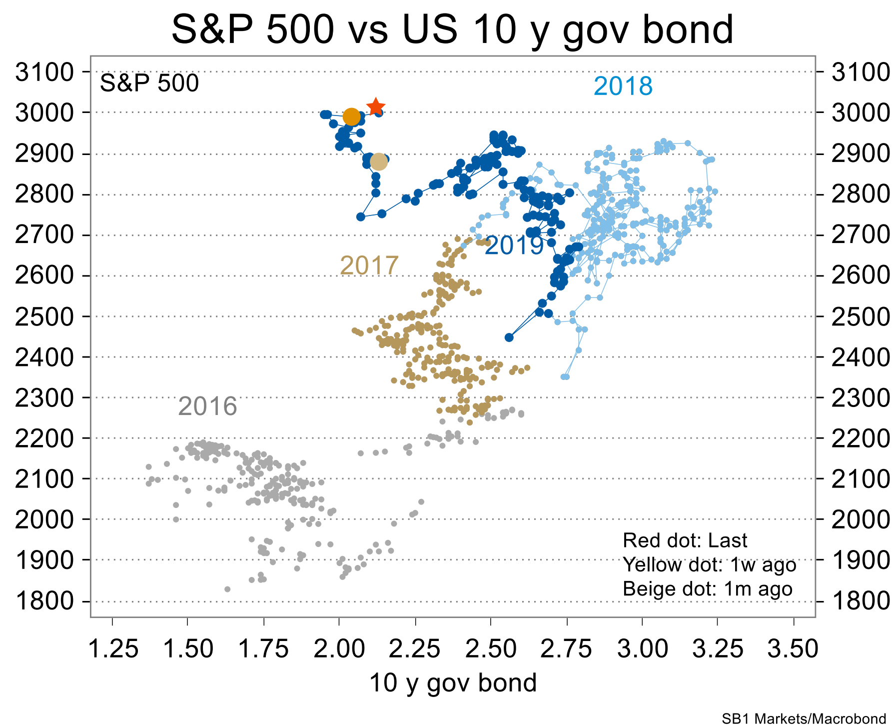
Higher bond yields, and another S&P500 ATH

Bond yields up 7 bps, to 2.12%. S&P500 up 0.8%, due to higher growth expectations

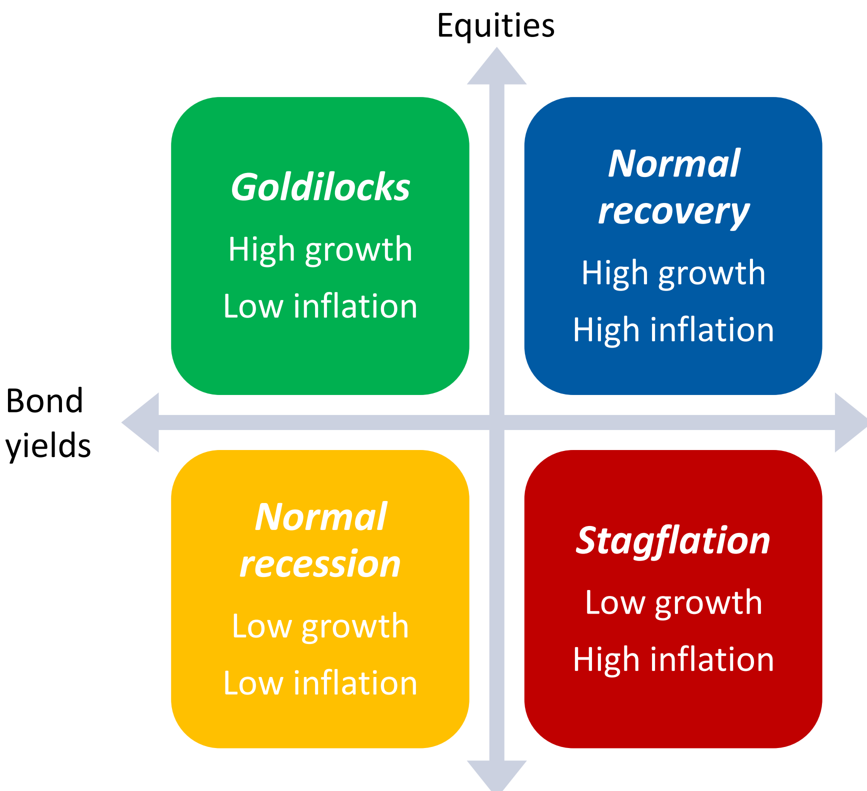


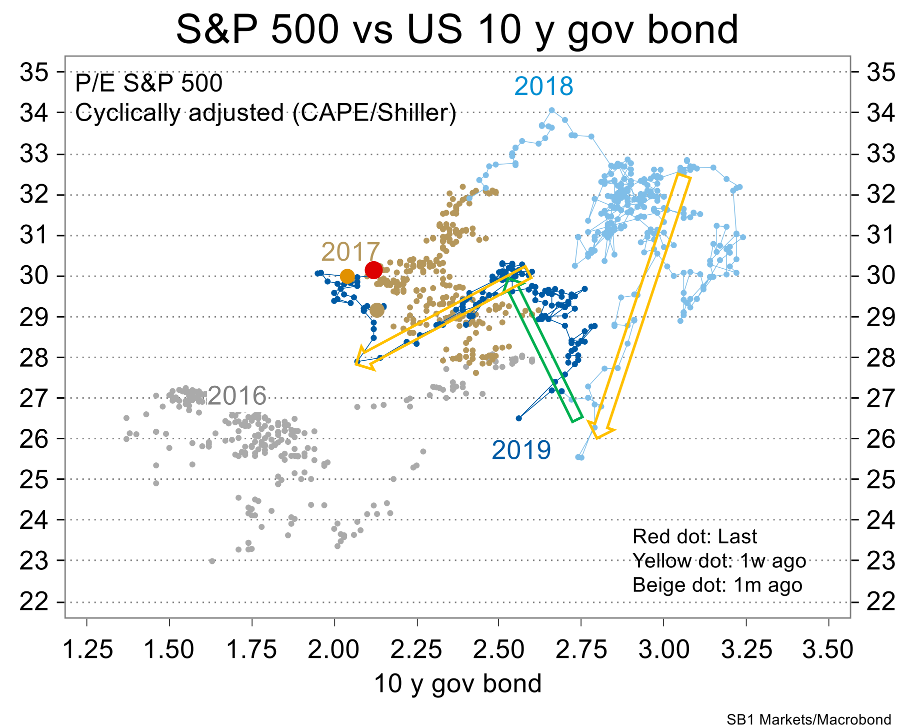


- S&P has recovered swiftly since end of May and soared to new ATHs last week, as markets are cheering prospects of a dovish central banks
- For more on the relation between stocks and bonds, check next page

Markets towards 'normal recovery' last week too: Yields, equities up

The move in the Goldilocks' direction is done for now? Only a Fed surprise can repeat the trick?

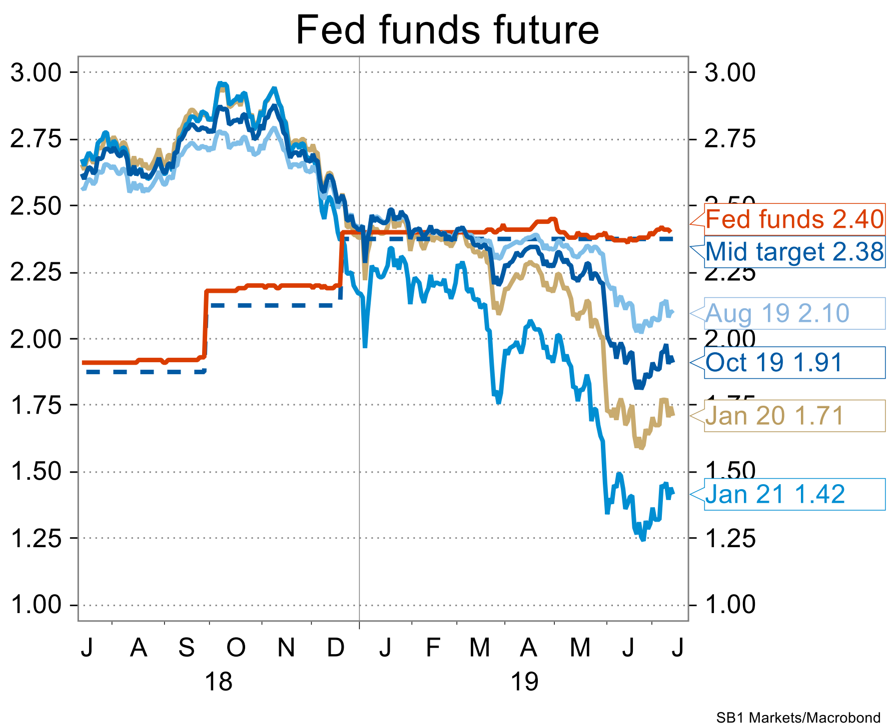


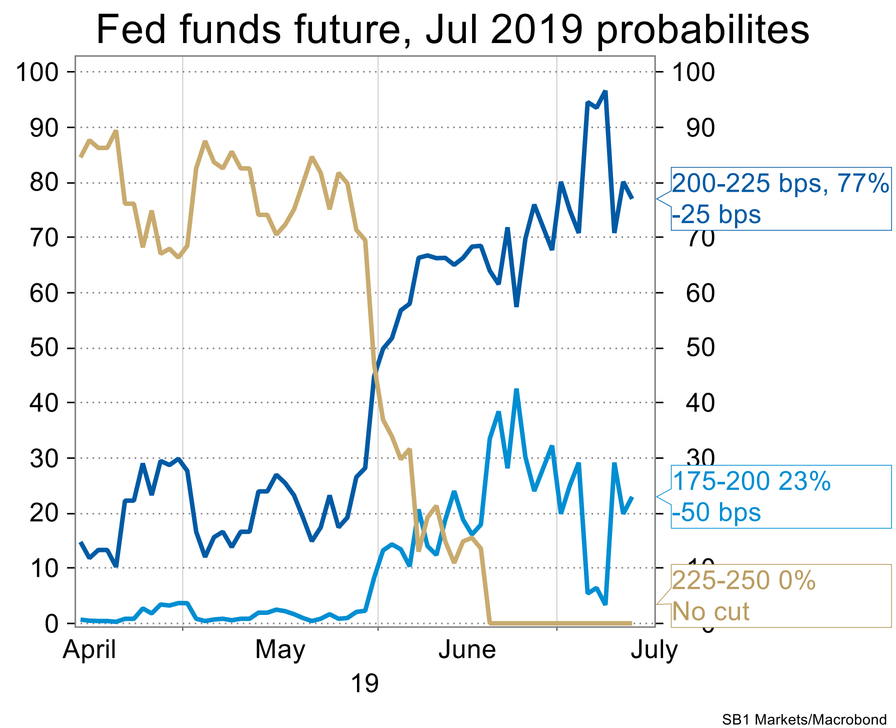


- During May, both stocks and bond yields fell sharply, towards the 'normal recession' corner. The 'yielding' signals from the Fed (and other central banks) during June then pushed bond yields further down, and stock markets up – in the Goldilocks direction.
- Last week long bond yield rose, even if Powell talked the very short end of the curve down. A a more dovish Fed will stimulate growth but at the expense of higher rates later on. Higher bond yields due to higher growth is good news for the stock market
- We still think 'normal' axis, driven by growth, and with inflation (or at least interest rates) over time following growth up or down. (the yellow/blue axis)
- We are – longer term – not that worried for the 'Stagflation' corner, 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

Powell talked down rate expectations, and a 50 bps July was put back at the table

Market had almost given up a 50 bps late July Fed cut, but Powell lifted the prob. to 30%, from 4%

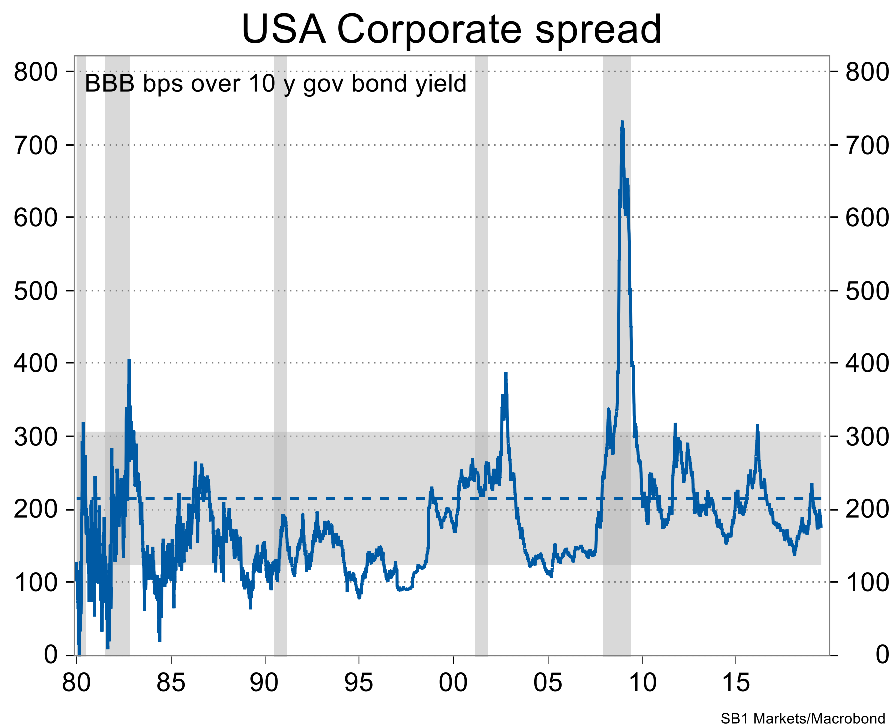


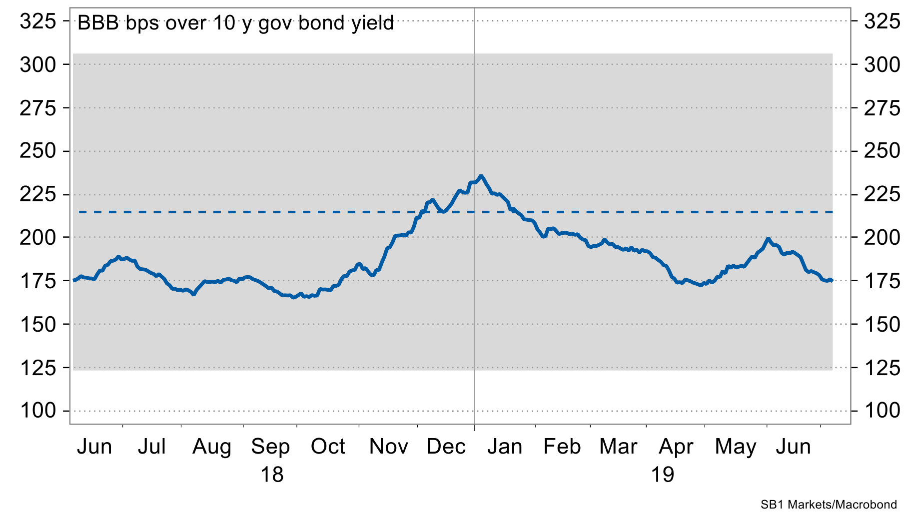


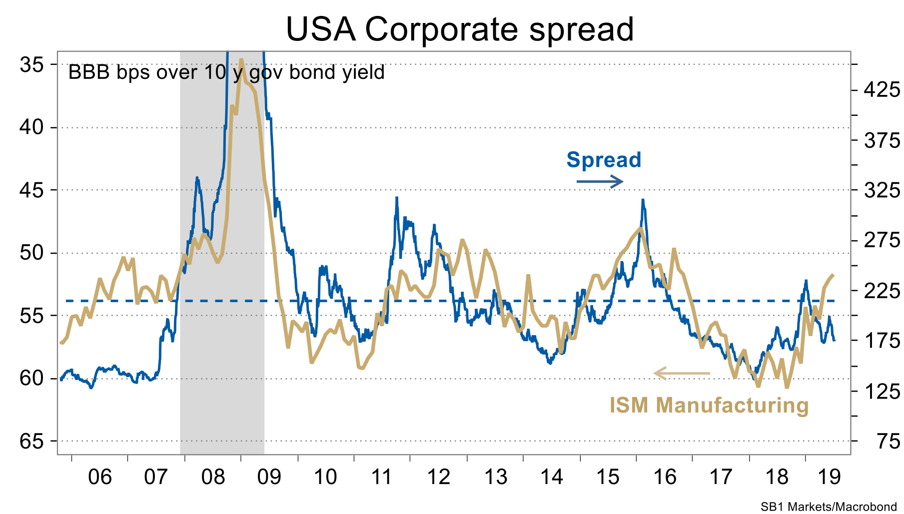
- The ‘strong’ June payroll report 2 weeks ago almost completely wiped out the possibility for a 50 bps cut in the Fed funds rate in late July. Powell managed to talk the possibility back up to 30% (23% at Friday). A cut has been taken for granted (100% probability) since mid June
- Further cuts are expected before end of year, the market puts a 56% probability for at least 3 cuts, and just 10% for 1 cut
- We still think the market is too optimistic. Sure, the Fed may cut several times – but that requires a much weaker economy

Credit spreads marginally down last week – risk is on!

However, spreads are too low if the ISM and (most) other surveys are correct; if growth is slowing

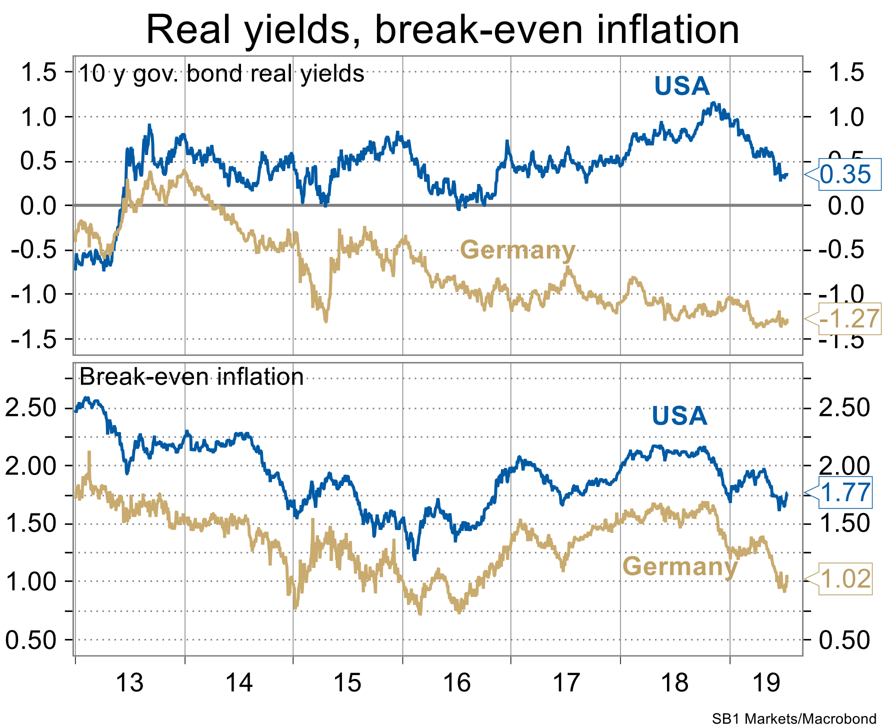


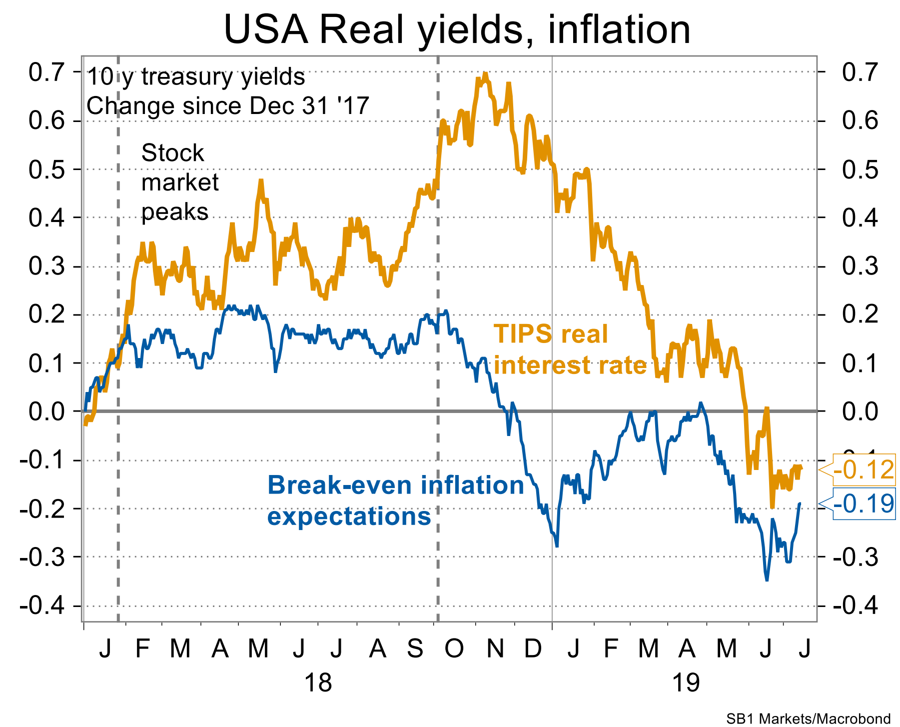




Inflation expectation up, still muted. Real rates up too, but less

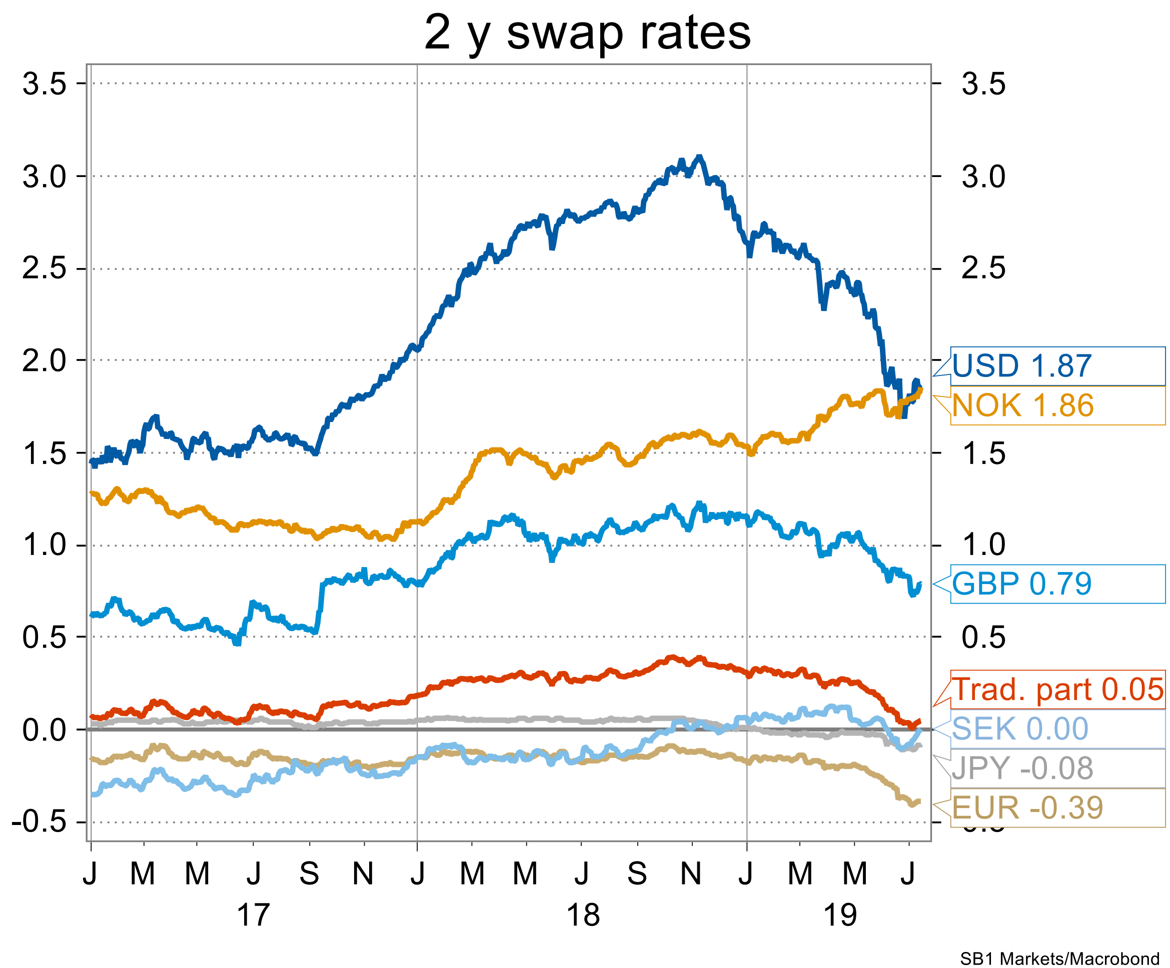
.. And very low in Germany, at -1.27%

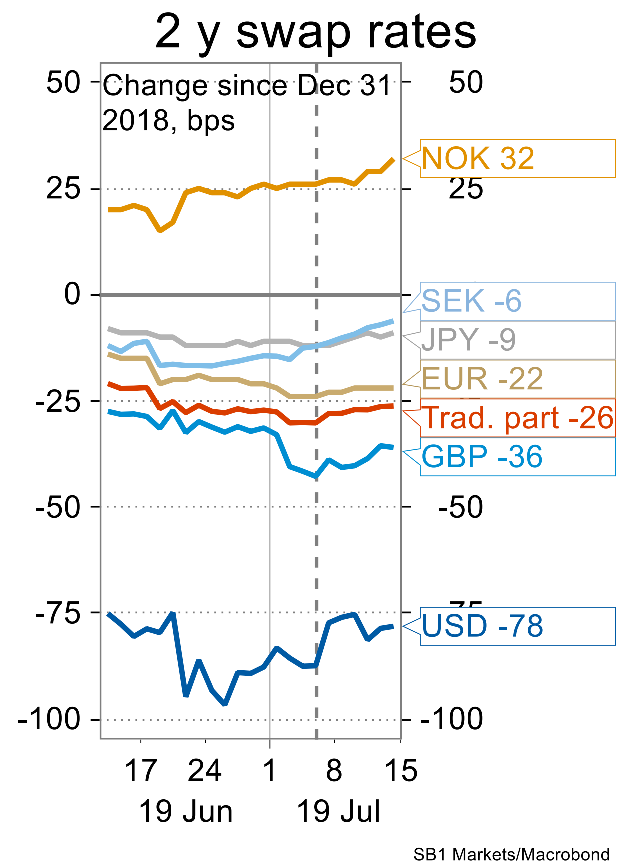




- US 10 y real rates at 0.35%, inflation expectations (measured by CPI) at 1.77%
- German real rates up but are still at -1.27%, inflation expectations at 1.02%, both very low

Short term rate up everywhere (but not the very shortest in the US)





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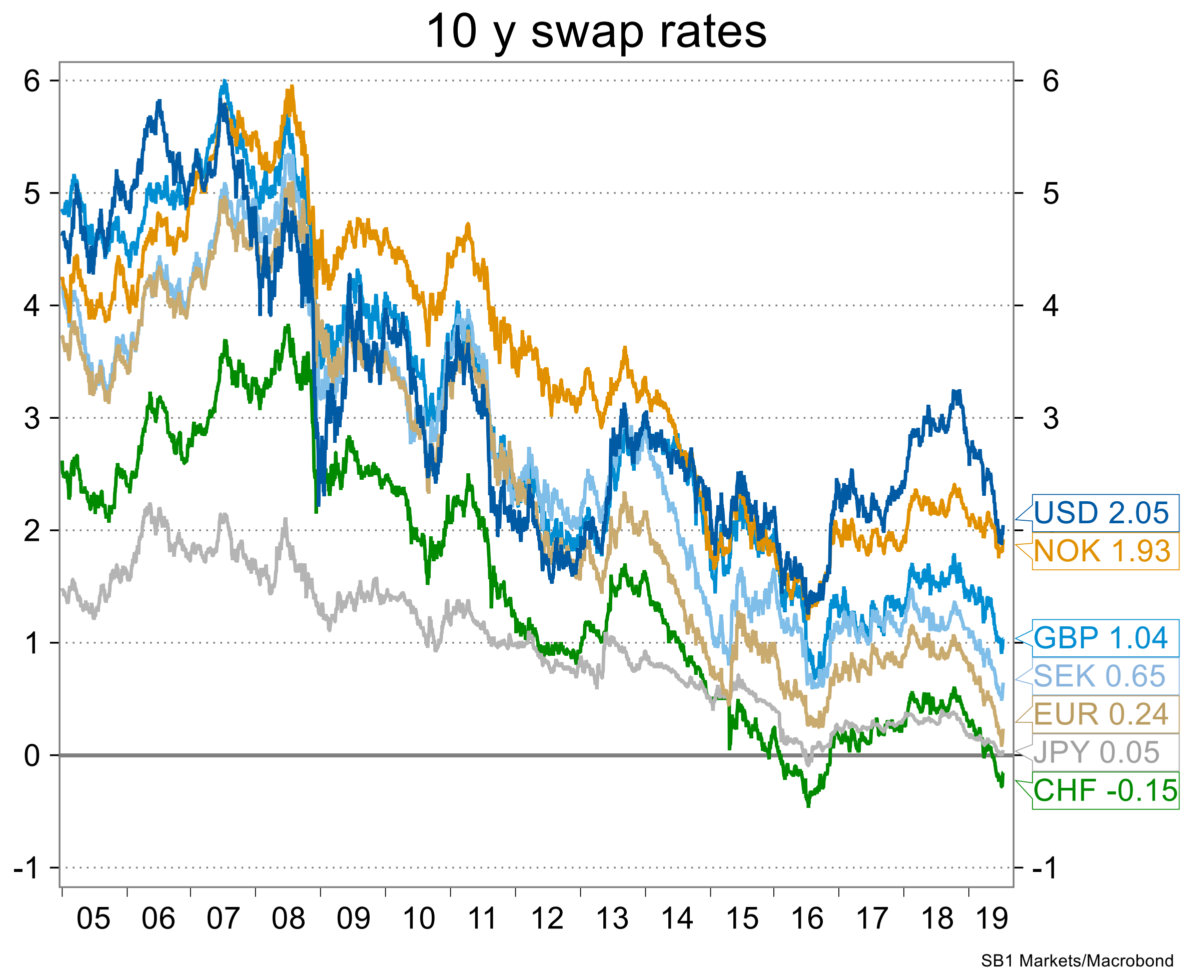
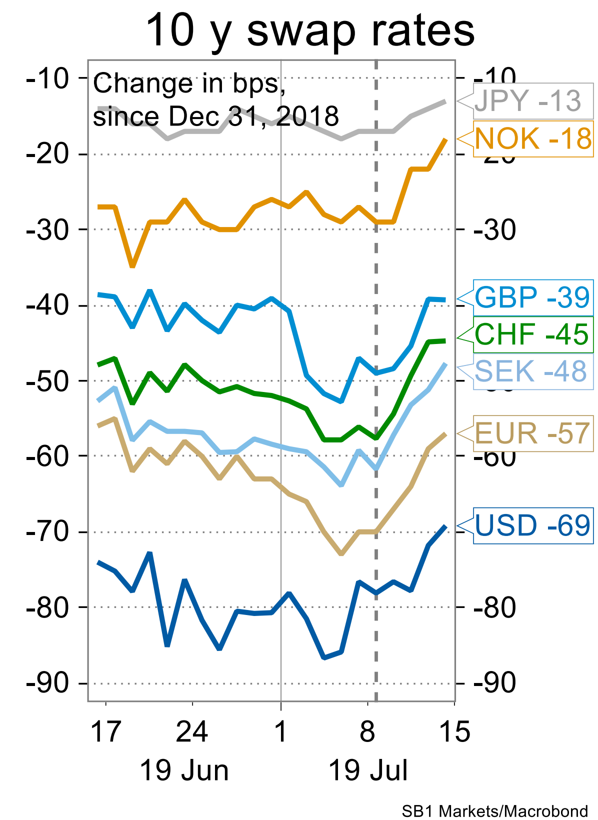
Long term swap rates up everywhere. But just the past few days

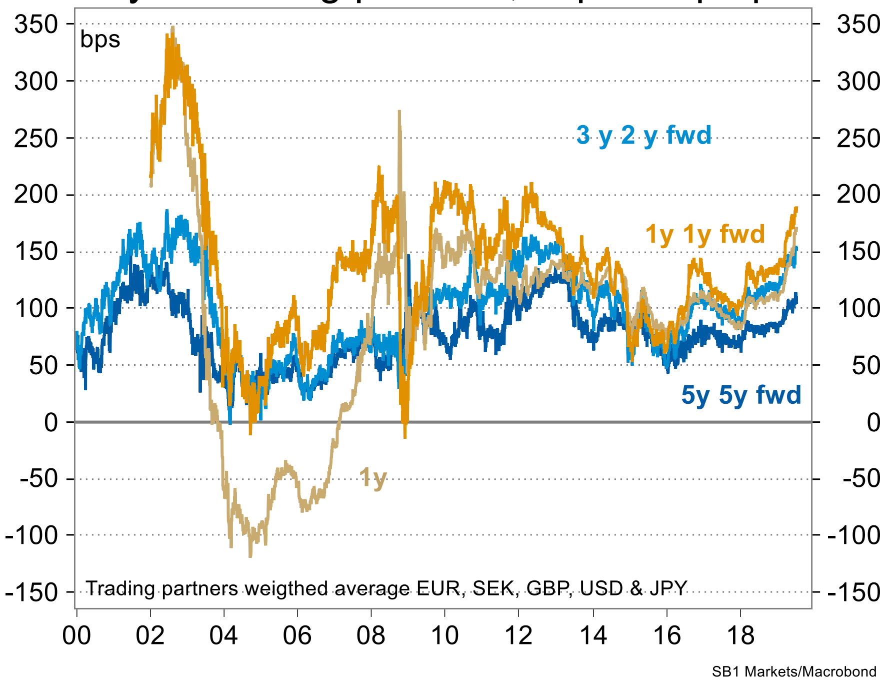


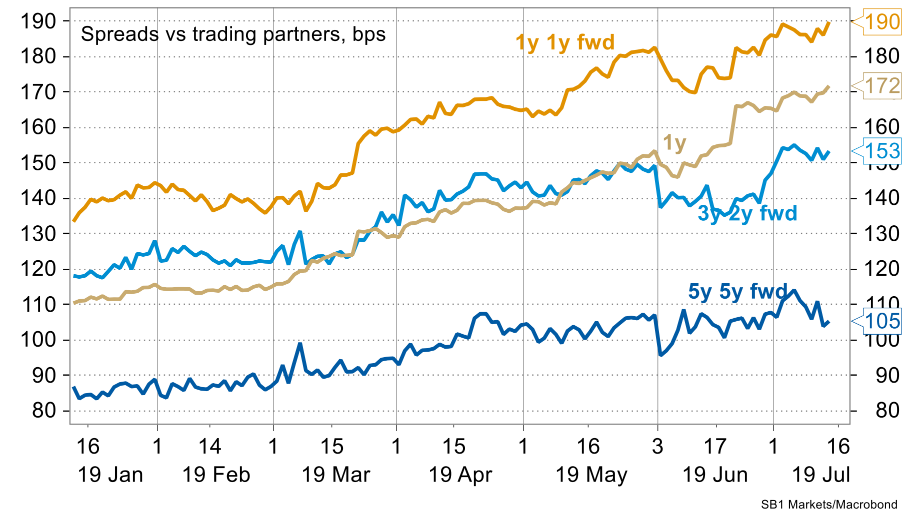


Powell sent short US rates down, all other rates (everywhere) up

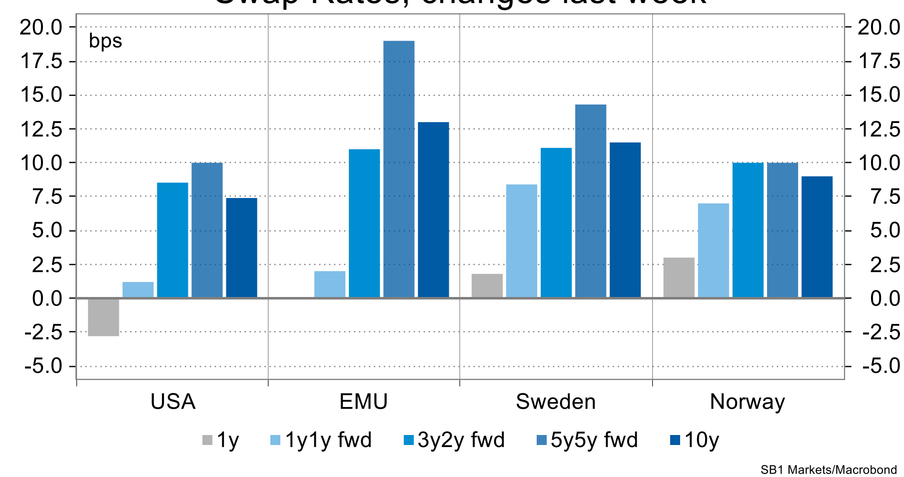
NOK rates more up in the short end than abroad – but not in the long end (finally)

Norway vs trading partners, impl swap spreads





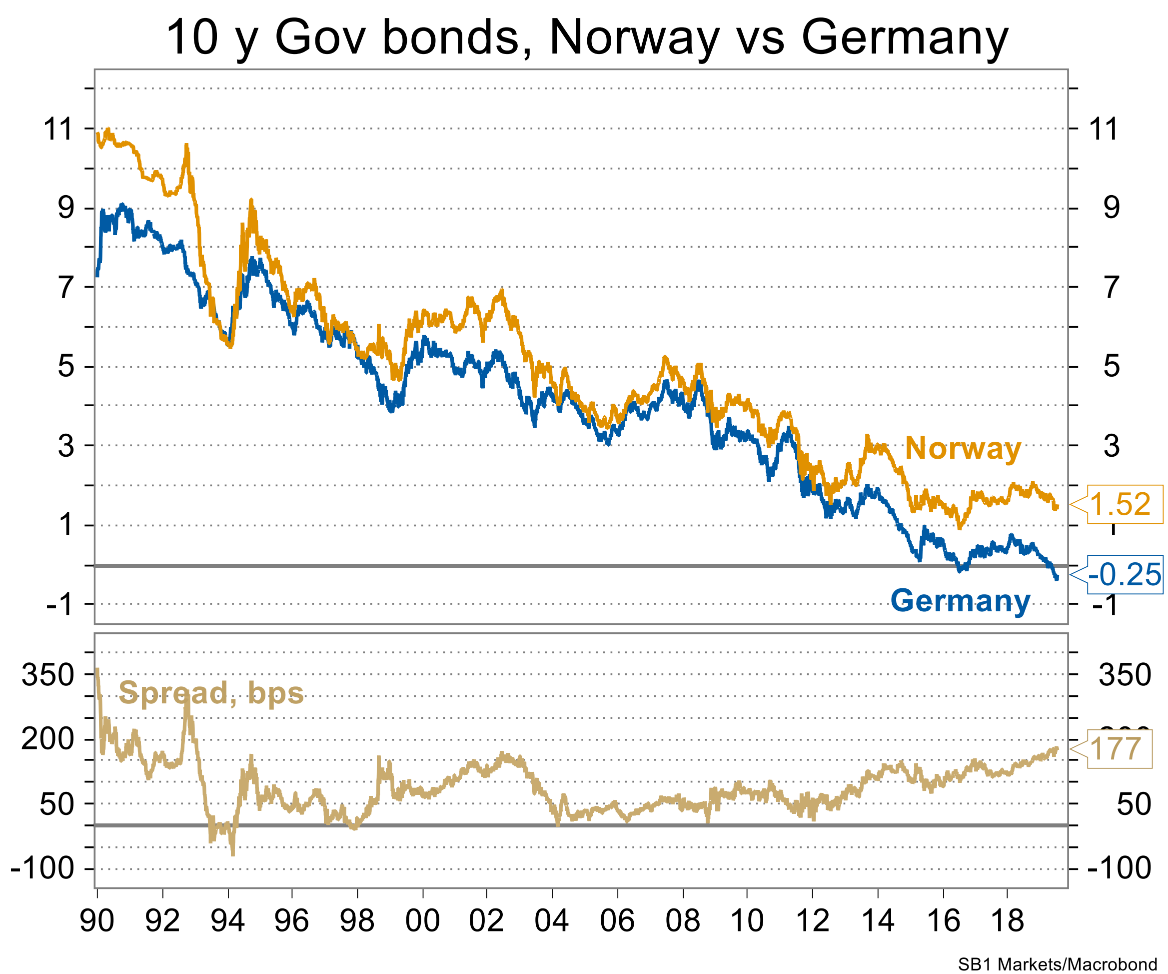
Swap Rates, changes last week

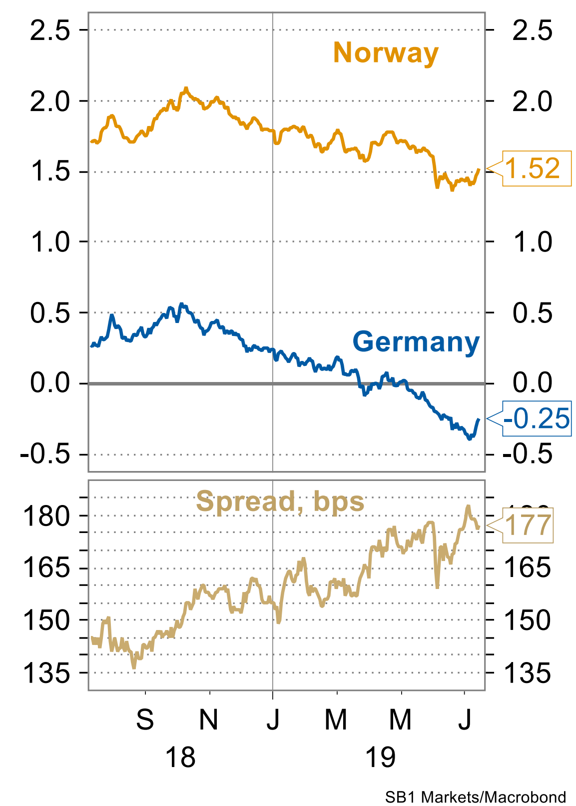


- A high spread is reasonable, given NoBa's stance vs Fed, ECB and the Riksbank (which is due to solid Norwegian data, not a really hawkish bank..)
- Although the short term spread is well explained, we have been surprised by the wide spread in the long end of the curve of the since March

Long bond yields up 10 bps, still the German bund -0.25%

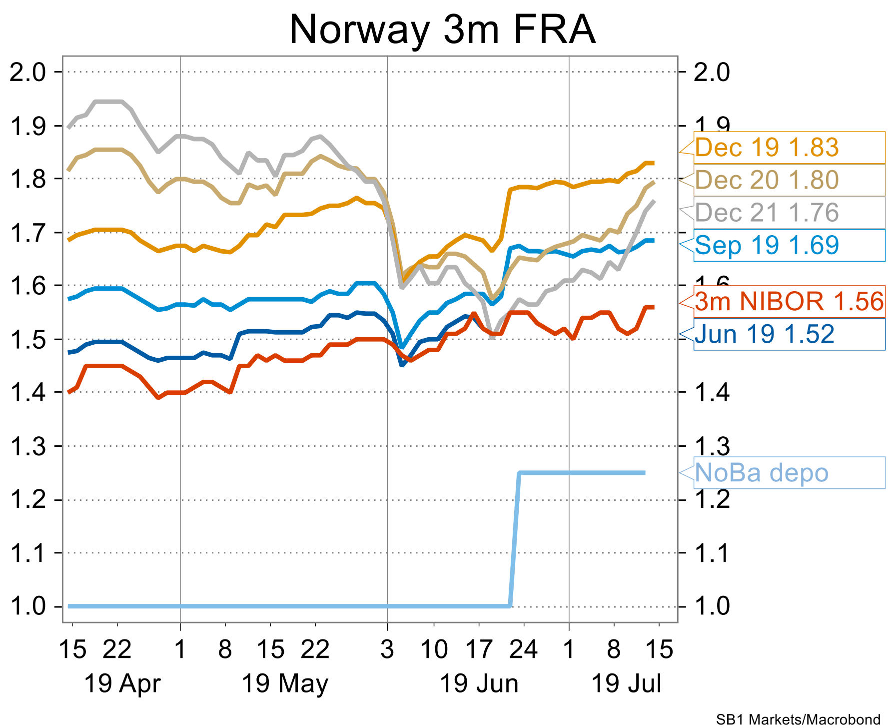
NOK 10 y gov up to 1.52 - the spread vs the German bund at 177 bp is far too rich, long term

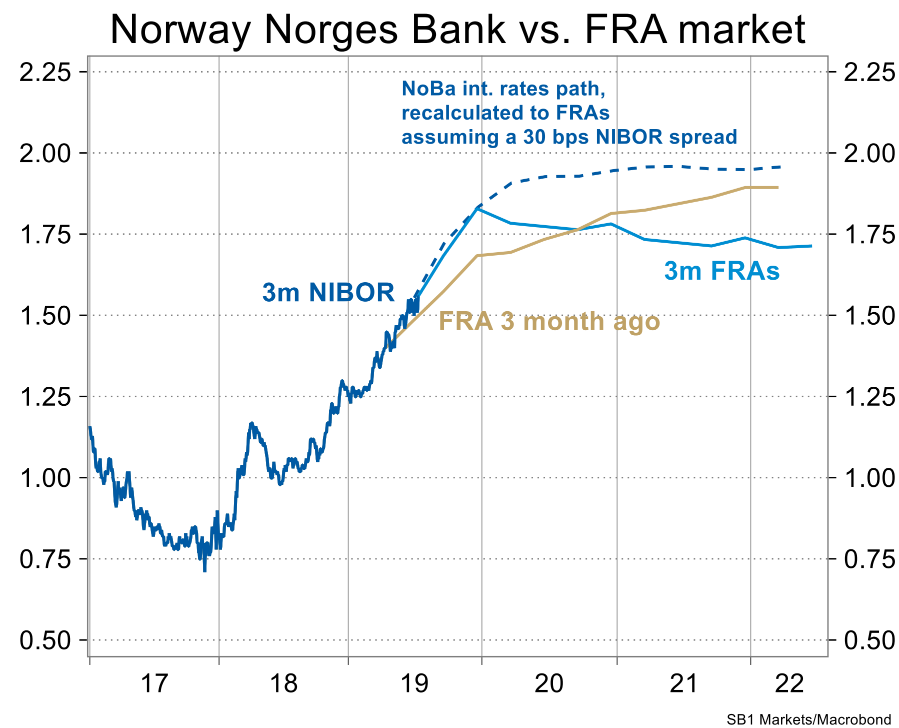




Norwegian FRAs climb, now implies 75% prob. for a Sept hike

FRA’s are edging up, the market is fully expecting another ‘19 hike (given a 30 bps NIBOR spread)

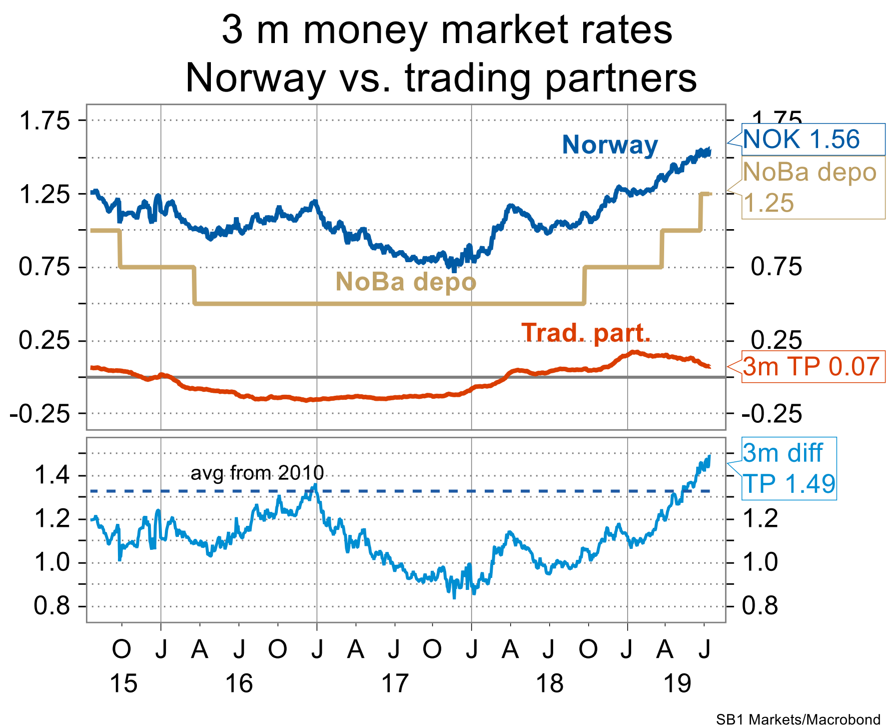


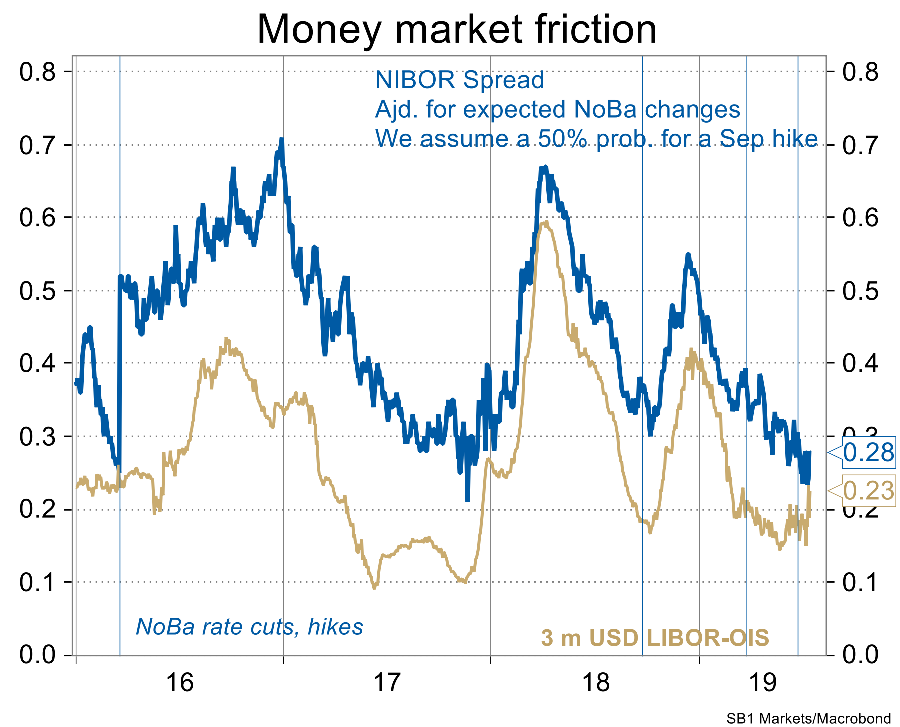


- The NIBOR Dec ‘19 FRA at 1.83%, signals either that at NIBOR spread has increased (we have until now assumed 30 bps) or that the market is puts some probability for a hike both in Sept and Dec (if so up to signal rate at 1.75, and a NIBOR at 2.05). We think a spread widening is most likely, check the US OIS spread next page
- The FRA curve is inverted from Dec 19 onwards, the market does not expect any hikes after 2019 (NoBa plans 1 in ‘20)

3m NIBOR back at 1.56%, as the market is starting to discount a Sept hike

Warning: The US 3m OIS (as the TED) spread sharply up last week. Upside risk for NIBOR?

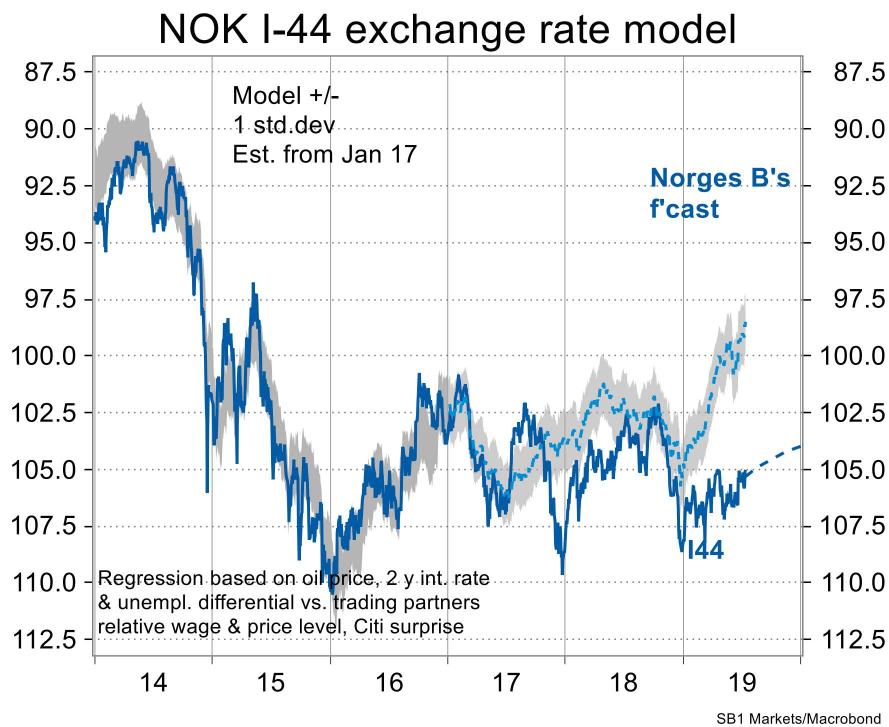


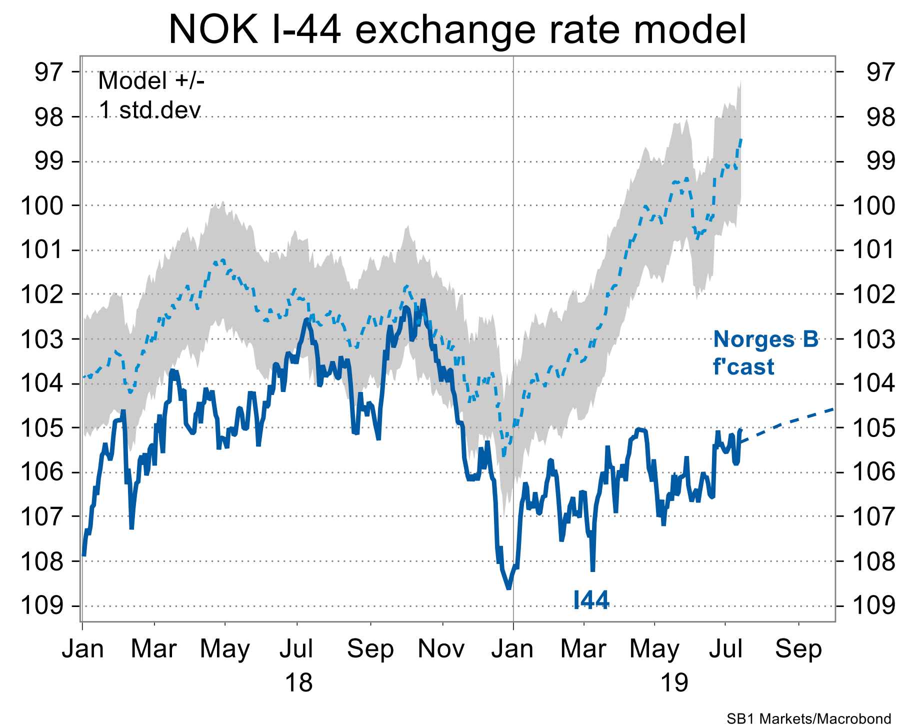


- The spread between NOK and trading partners' 3 m money market rates at 1.49 bps is up 70 bps since December 2017 and is above the 10 past year's average – without sending the NOK into the orbit

NOK up last week but the our model f'cast even more

The NOK is more than 6% below our model's f'cast





- The model forecast up 0.5% with higher interest rate differential and a rising oil price. The NOK rose 0.2%, and the gap widened
- What explains the (extra) weakness vs the model estimate since March?
  - » 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. A NOK model based on AUD, CAD & SEK, that has worked very well over time, explains the recent 'flattishness' very well – which our standard model does not
- We do not have any other recommendation than **Buy NOK**

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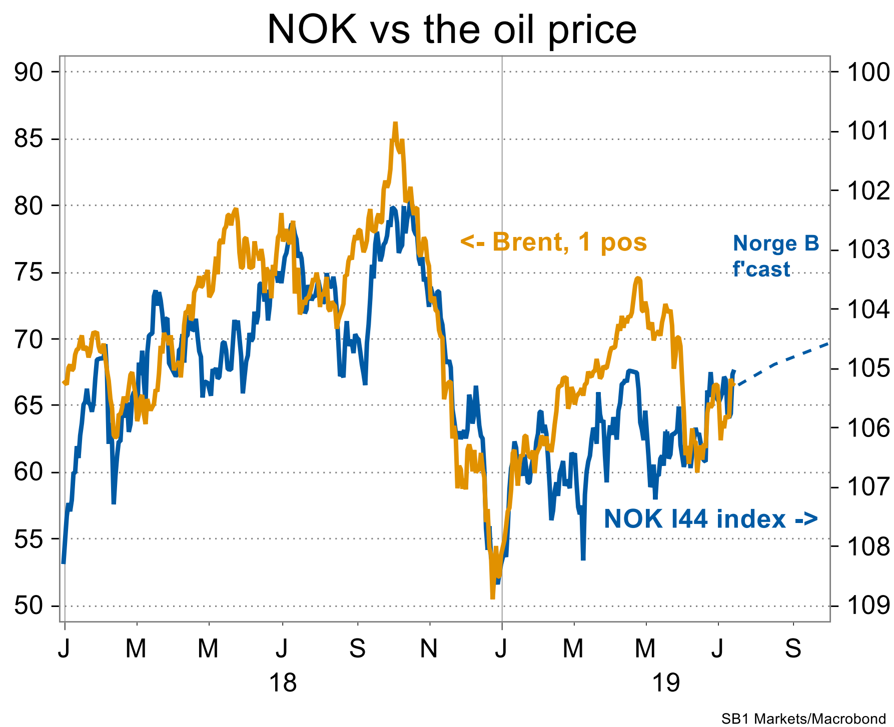
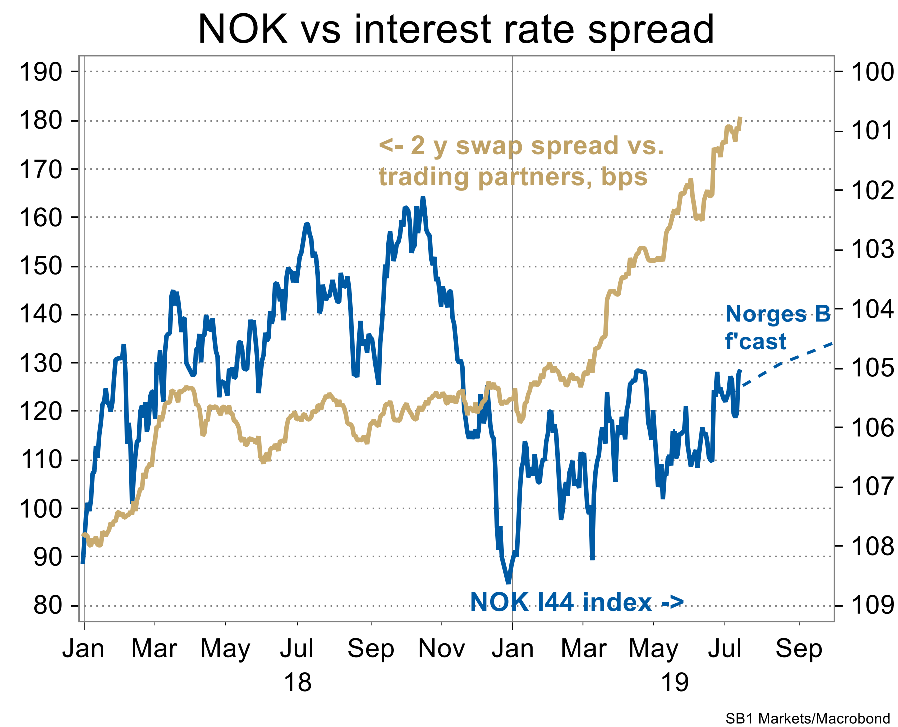
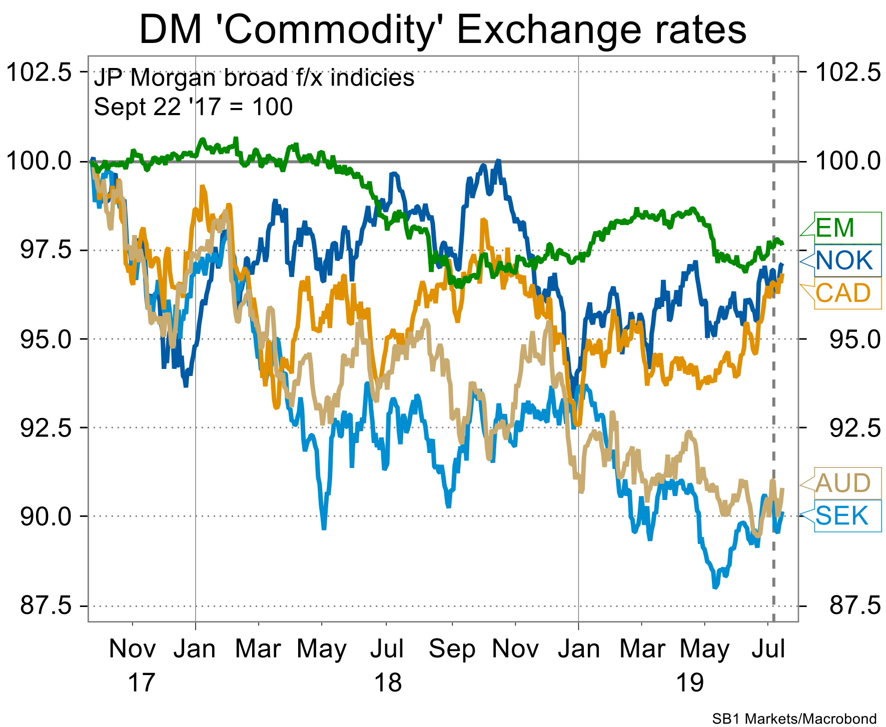
NOK marginally up last week, but less than oil, interest rate spreads suggested

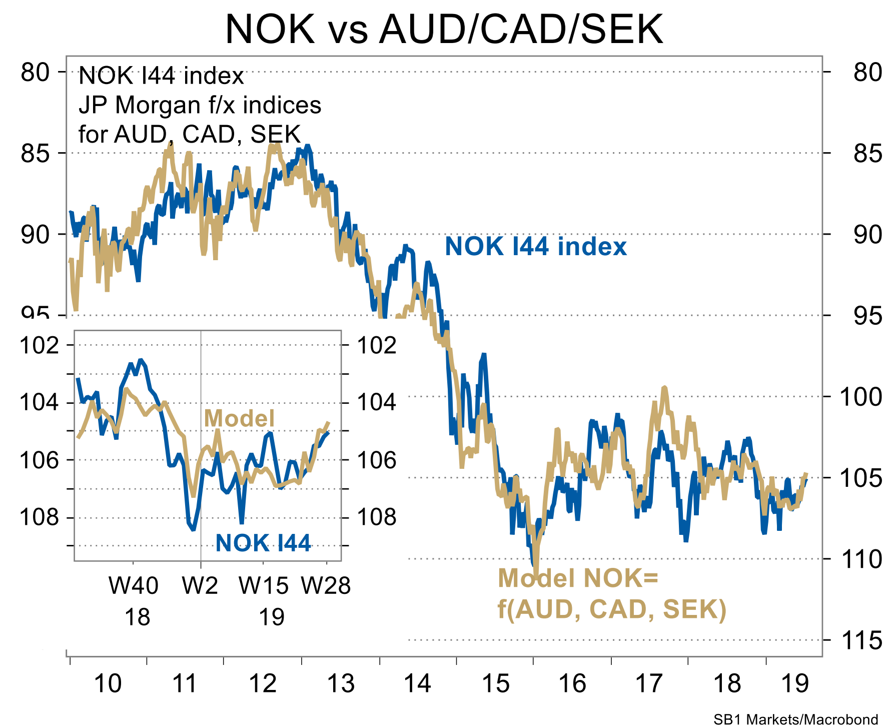




NOK follows our supercycle pals pretty well over time – and now

Forget oil, NOK interest rates and all the other factors. Just look at AUD, CAD (& SEK, but not needed)





- NOK is much weaker than our workhorse model predicts, and much lower than others' models suggests (NoBa's model miss is almost twice as large as our model's residual)
- If we just model NOK as a function of AUD, CAD and SEK indices, the 'new' NOK weakness since 2017 is much better explained. It was the supercyclicals that fell out of favour – not the NOK (except for some extra NOK weakness late 2017)
- What is the common factor for these currencies? It could be raw material prices, but they do not explain it. Quite similar bubble economies w/ debt & housing risk? China risk?

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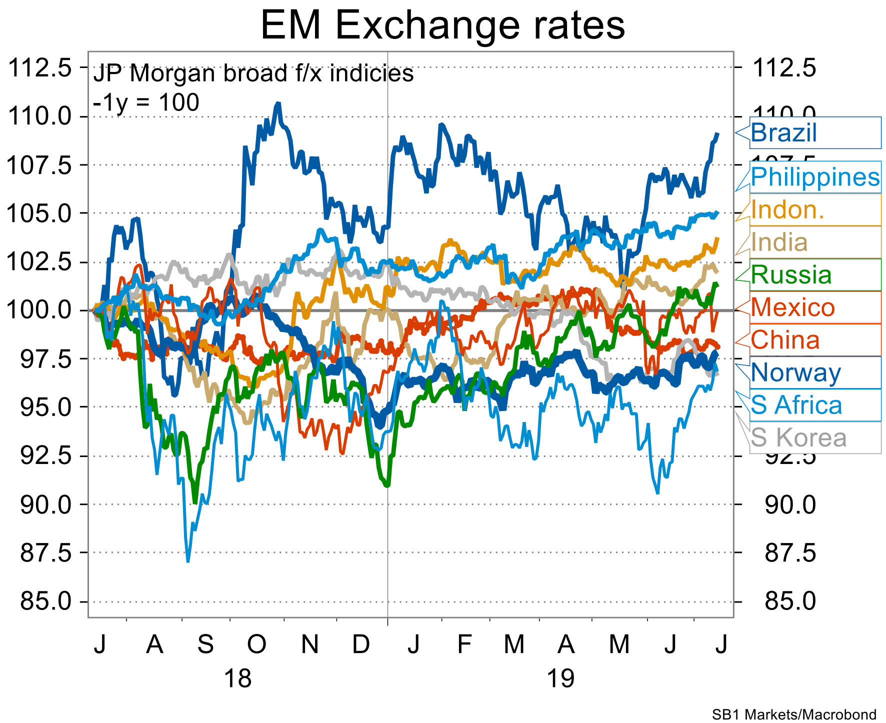
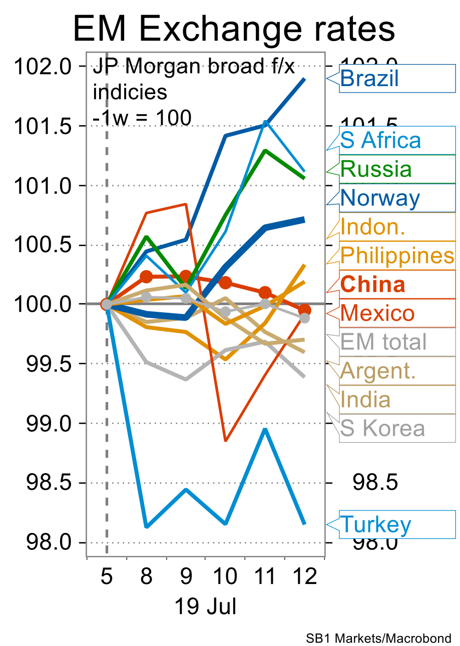
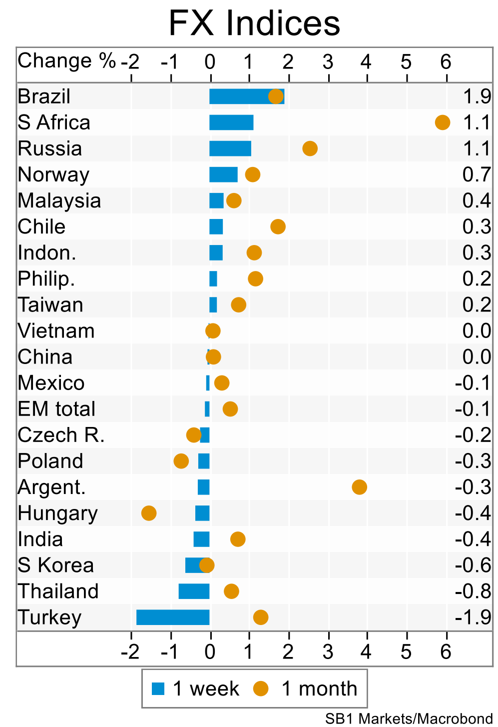
EM f/x: Brazil up, Turkey down. Most stronger last month

The CNY fell Friday, but most up on the week







- The Turkish lira fell 2% following president Erdogan's last weekend's dismissal of the central bank governor, who 'was too hawkish'

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