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Macro Research

Weekly update 34/2019

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Highlights

The world around us

The Norwegian economy

Market charts & comments

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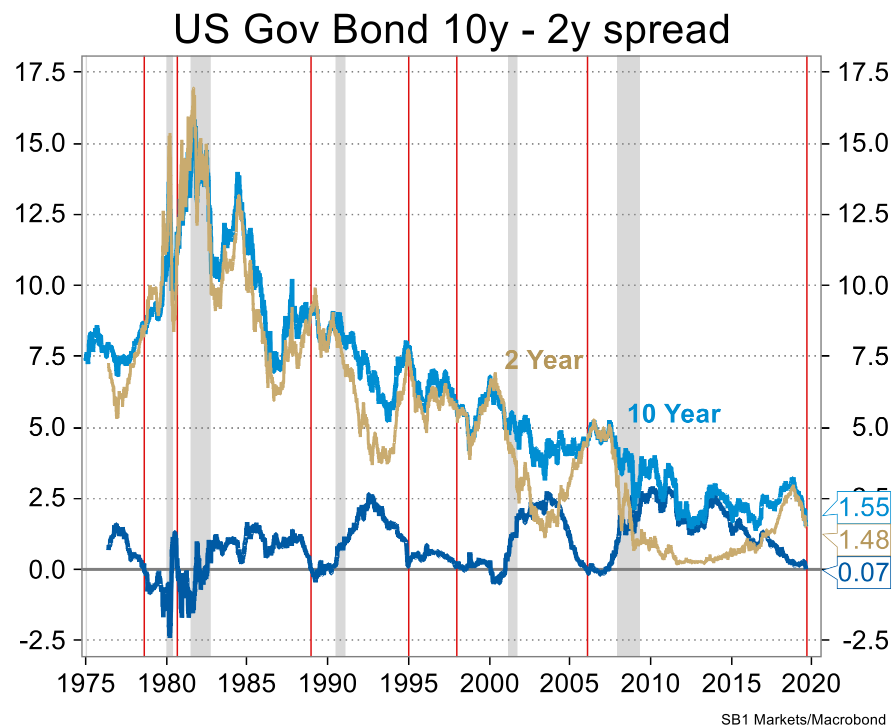
Last week – the main takes

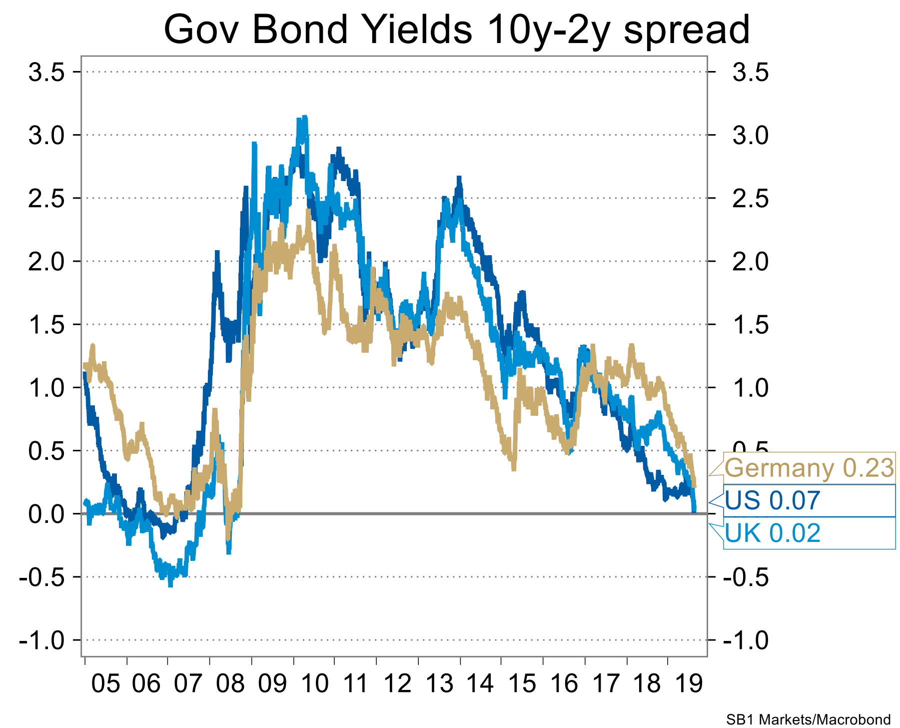
- **Politics:** Even if the Chinese 'of course are paying the US tariffs' (and not US importers or consumers), Trump decided to **postpone tariffs** on Chinese phones, PCs and toys until Dec 15 to be sure that Christmas presents did not become more expensive. China announced that it will take necessary measures to retaliate to the (remaining) tariffs (no election there next year, or later). **Argentinian markets** collapsed as the populist party won a huge victory in the primary election
- **Chinese data** were flatly on the weak side in July, and since everybody seemed to have forgotten that June data were surprisingly strong, consensus concluded that China has serious problems. It may have, but July data alone cannot tell that. PBoC will lower lending rates, at least for companies
- **US manufacturing production** fell in July but the speed into Q3 is not that weak. However, surveys do not signal any upswing even if the first Aug surveys, from NY Fed and Phil Fed, were stable, both better than expected. **Core CPI inflation** rose to 2.2%, not an argument for cutting rates (although the PCE deflator, Fed's preferred is a few tenths below the target). **Retail sales** are booming, core sales volume up 9% measures 3m/3m. **Housing permits** recovered strongly in July, after a weak June, confirming a stable housing market (although starts came down). **Productivity growth** was stronger than expected in Q2 and is trending up but less than previously reported, and cost inflation has been revised steeply up! **UoM consumer sentiment** nosedived in early August, we assume due to the stock market setback and rising recession worries. An **inverted yield curve** did not calm markets last week
- **The ECB** is planning a new, big bazooka in September, both in rates and a substantial QE, according to a leading board member (Olli Rehn), and before Legarde arrives the Bank later in September. **Eurozone employment** rose 0.8% in Q2, thus, zero productivity growth. **Industrial production** plunged 1.6% m/m in June, as expected, with Germany in the 'lead'. **German GDP** fell by 0.3% q/q in Q2, sparking fears of a deeper contraction (and the sudden drop in the **ZEW survey** did not help)
- **UK wage inflation** accelerated to 3.9% as the labour market tightens. Retail sales still going strong
- **The Swedish labour market** may be softening. **Core CPI inflation** is not far below target but the Riksbank is stuck in negative
- **Norges Bank's** ambiguous press release was enough to cast some doubt on the September hike, and the NOK initially weakened some 0.9% against EUR, before reversing half of it. As the Bank stated that the outlook for the policy rate is little changed for the period ahead, we still expect a Sept hike, but then NoBa might signal that a pause is warranted. Data the coming weeks will be crucial. **Consumer confidence** recovered in Q3 but is still below an long term average, and weaker than most other places

SpareBank 1 MARKETS

Yield curves are sending an SOS. Is this time different??

The US (and UK) 10y-2y spread briefly inverted on Wednesday, sparking fears of a coming recession





- An inverted yield curve has been a good recession warning. As many economists have stressed, the yield curve inversion now may be distorted by the sharp decline in term premiums driven at least partly by central banks' quantitative easing programmes
- Usually (4 of past 5), the inversions takes place as long bond yields increase slower than short rates in the last stage of a Fed tightening campaign, when the economy is strong - and not because the market 'expects' a recession. The present inversion (at least the latter part of it) is due to a faster decline in long yields than in short rates, on fears of weaker growth. The implications of the inversion cannot be the same?? Probably not, but the implications seems to be mixed, here is two alternatives
  1) The inversion is not due to an aggressive Fed tightening that usually takes place before recessions, at least not the past 10 months of the flattening
  2) The inversion is caused by a rapidly deteriorating economic outlook. Bad news! Still, in 1998 the same happened, and a recession was avoided

July on the weak side following a strong June

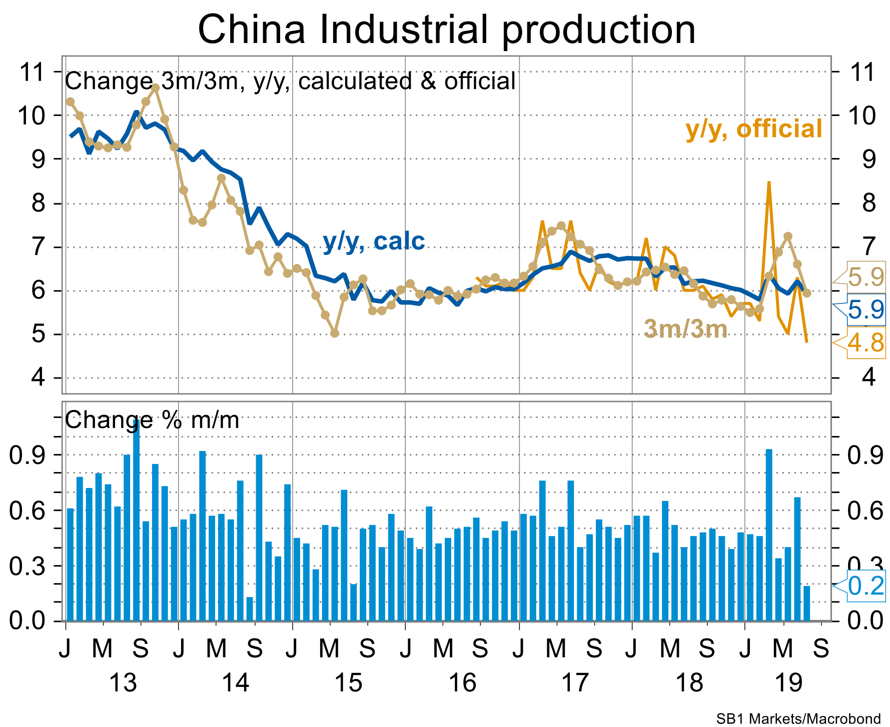
July data broadly weaker than expected but still no signs of a sharp slowdown

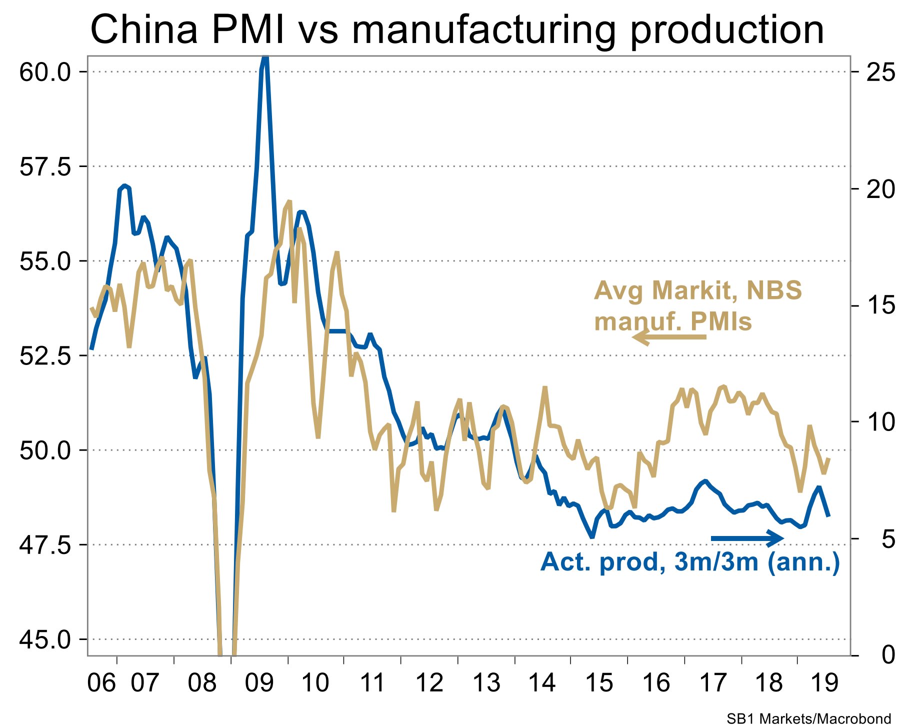
The most important message: We still do not find indications of a steep slowdown in China amid the escalating trade war

- **Industrial production** slowed to 4.8% from 6.3% in June, to the lowest level since 1990 (according to the 'useless' official annual growth rate). Even if production rose just 0.2% m/m, down from 0.7%, underlying growth past months is still at 5.9%. Surveys do not signal any slowdown from this level
- **Retail sales** growth nosedived to 7.6% from 9.7% in June, expected 8.6%. Sales were flat m/m, following the 0.8% hike in June. Last month, data were revised sharply up, followed by a substantial downward revision this month. Underlying volume growth has fallen below 6% but not slowing further recent months
- **Investment** growth softened marginally to 5.3% y/y in July, and the trend is flat. The official YTD rate fell 0.2 pp to 5.7%, weaker than exp. Construction starts are still trending up, but slower
- **Credit growth** was weaker than expected in July and the annual rate declined. However, total credit has accelerated somewhat recent quarters as higher lending from the shadow banking market is compensating for a slowdown in bank lending. The credit impulse has turned neutral, from a contraction
- **House prices** are still increasing but a tad slower
- Both **exports and imports** were close to flat in July and exports are trending up
- Chinas' central bank announced measures to **lower lending rates**

Oops, just 0.2% growth in industrial production in July. Annual growth at 29y low

The official y/y 'collapsed' to 4.8%, lowest since 1990. Our calculation yields 5.9%, down from 6.2%

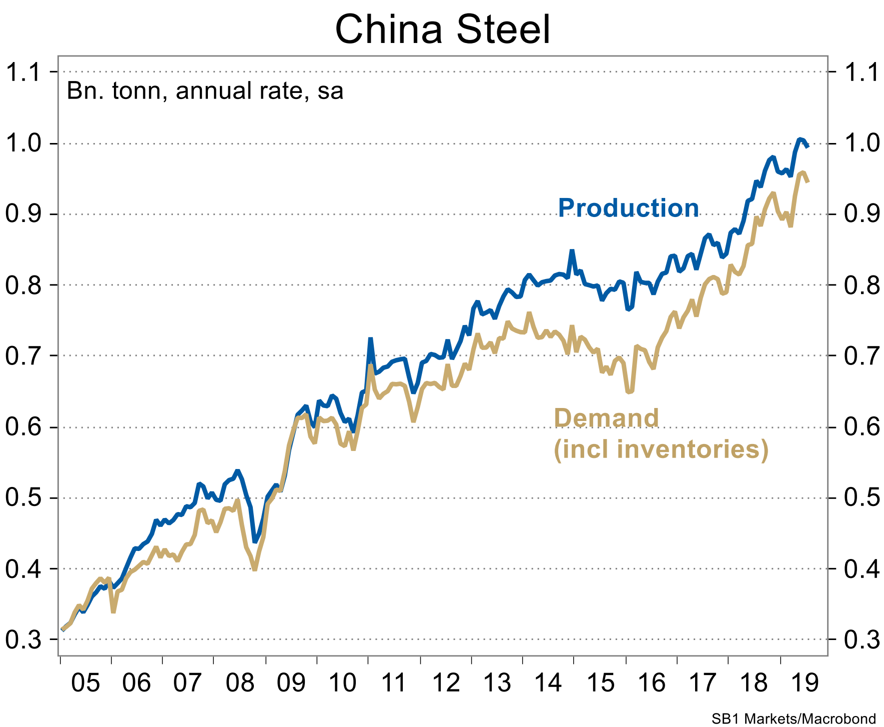




- Production rose just 0.2% m/m in July, down from a strong 0.7% print in June. Measured 3m/3m the decline was much less dramatic; growth slowed to 5.9%, the same annual rate as our monthly seasonally figures add up to
  - » The official y/y growth rate is 'useless', far too volatile as it is not adjusted for holidays or working days. Even so, the 4.8% growth rate was the lowest since 2002, but that was one month exception, like 4 times in the years before that. A 'real' 4.8% has not been seen since 1990. (But the 'real' annual rate is not 4.8% but rather 5.9%, which is not dramatic!)
- PMIs or other surveys are not signalling an abrupt halt in manufacturing. Export volumes are back to peak levels. China has most likely not been brought to a halt – but **the unusual 0.2% m/m growth is a warning sign**

Steel production (and demand) marginally down in June/July, trend strong

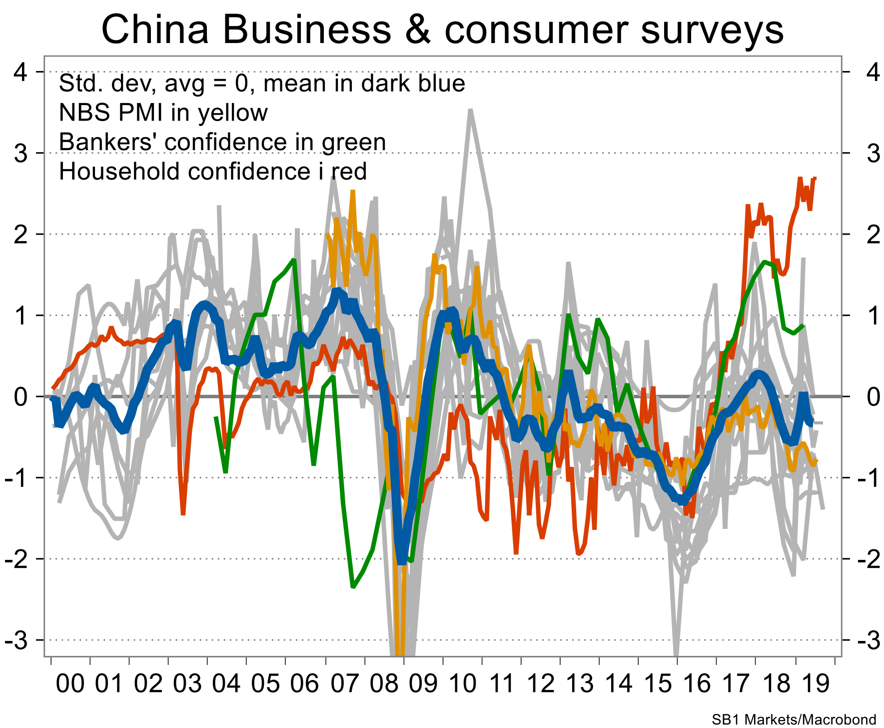
Upward trend intact, after both demand and production softened last winter. Reduced overcapacity

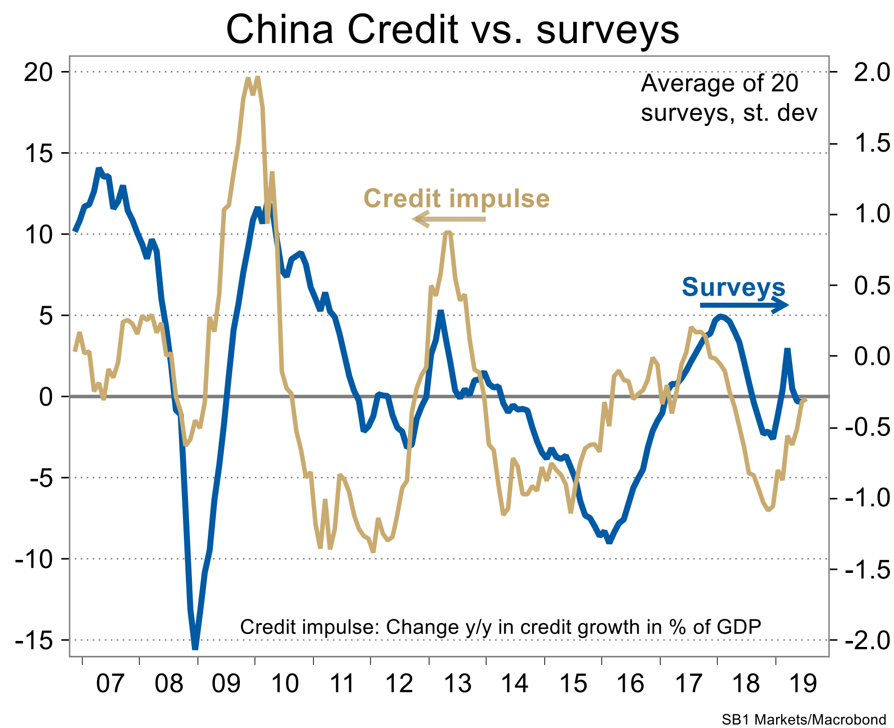


- Production is up some 8% y/y (smoothed, 5% in July, from 12% in June) and demand is expanding a tad faster, (almost) well explained by the strong growth in construction starts. On the other hand, slowing auto production signals softening steel demand from that sector
- China is still a net steel exporter, 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

Credit has been tightened, usually dampens growth

Now, credit has turned neutral and can't be blamed if growth should slow further

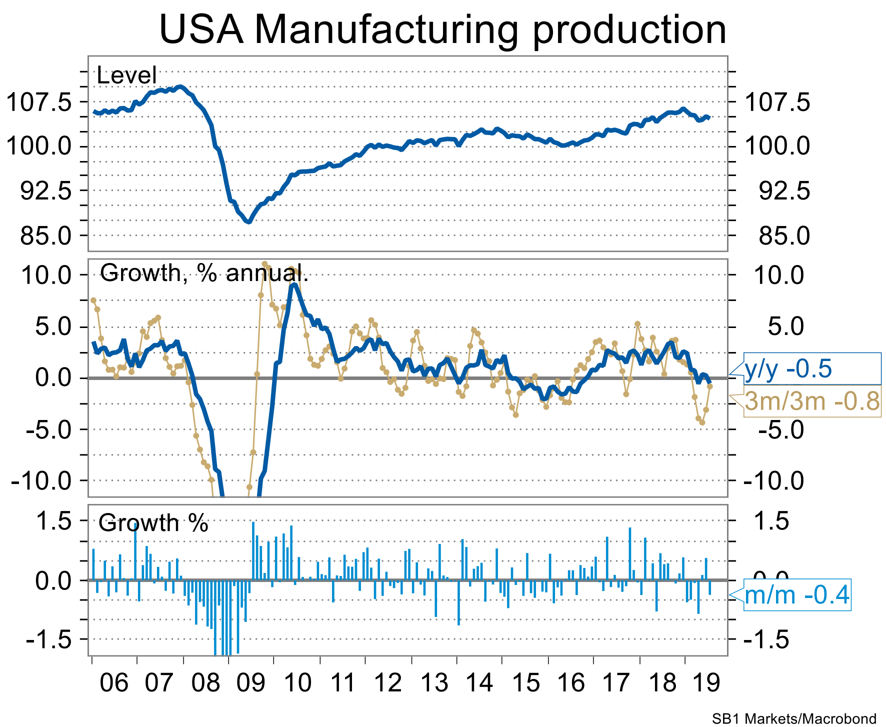


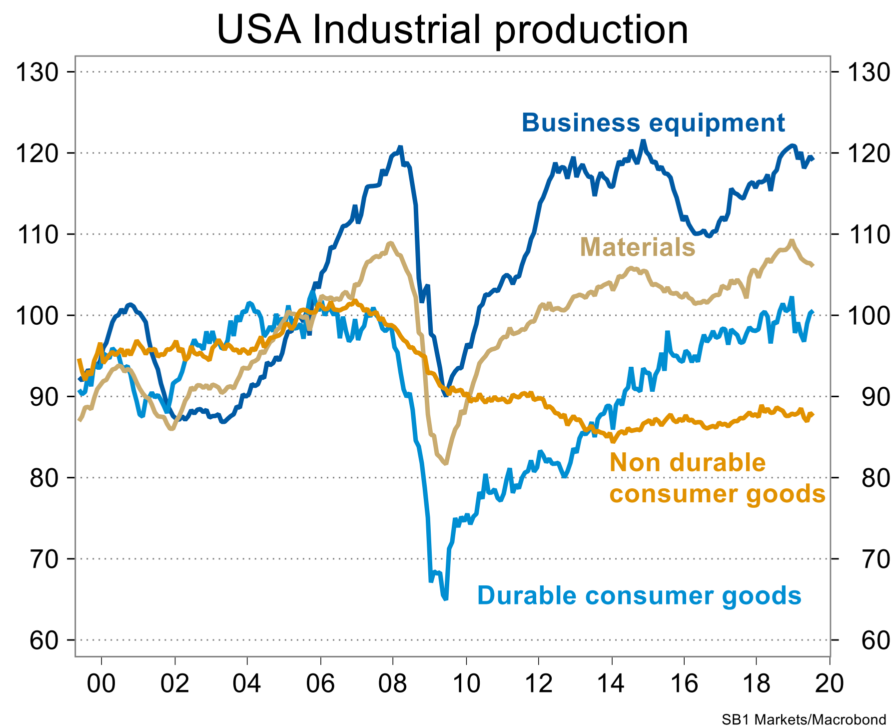


- An avg of Chinese business & consumer surveys indicates that growth has slowed, however, the level is still at an historical average and above the 2018 level (and it was weaker in 2014-2016 and 2012)

Manufacturing production down again in July

Production down 0.4% m/m, 0.1 pp more than expected, but recent months not a disaster

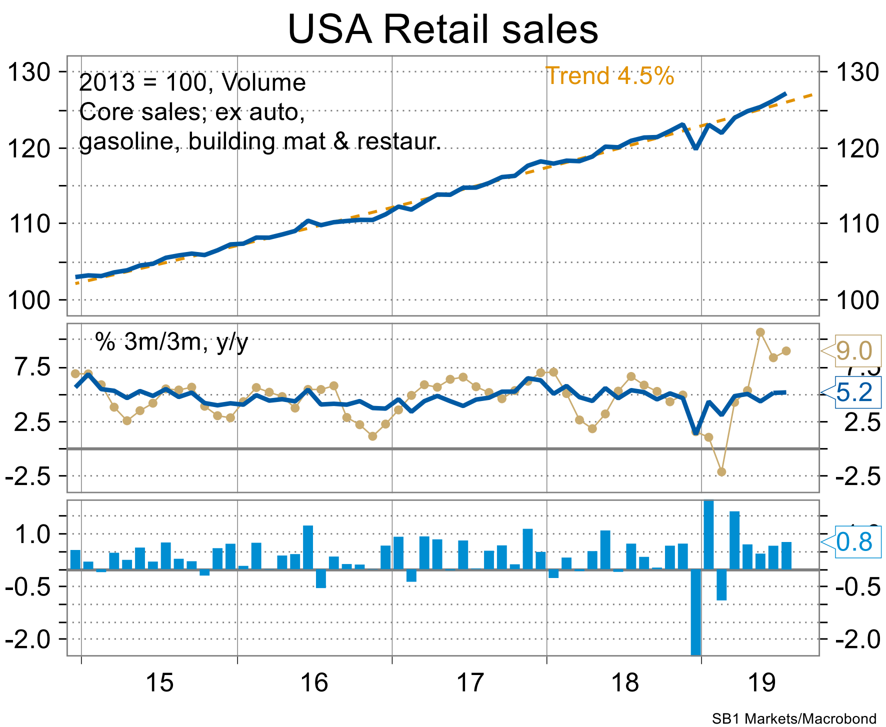


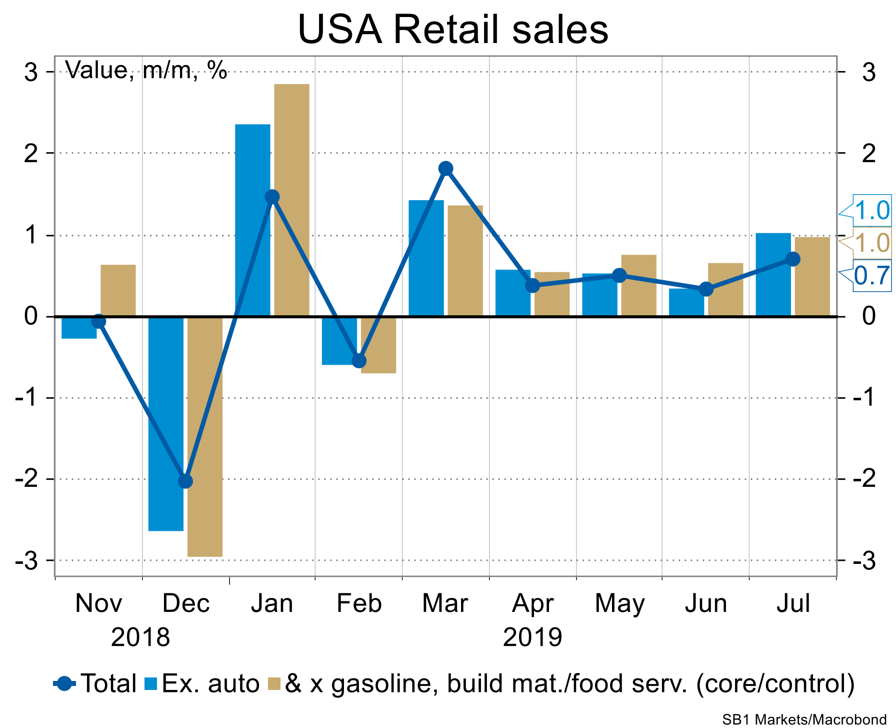


- Manufacturing production fell 0.4% m/m in July, following the 0.5% lift in June (revised from 0.4%). Production fell by a 3.1% pace in Q2 but even if production fell in July, Q3 is heading for a far better print. Still, production has fallen 1.6% from the peak in Dec '18
  - Total industrial production including energy & mining fell 0.2%
  - Production of business equipment has fallen, but durable consumer goods have also been weaker (however, recovering this summer)
  - Materials fell further in July and the slowdown has just slowed marginally
- The first August surveys? Check two pages forward!

Full speed ahead, retail sales are really strong!

Core sales volume rose 0.8% in July, and are up 9% 3m/3m

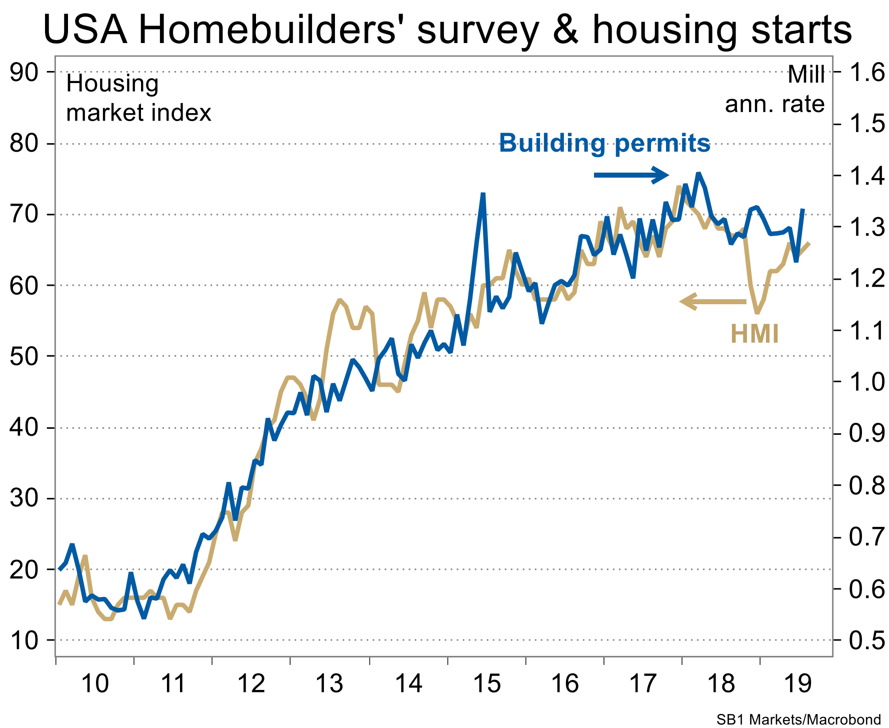


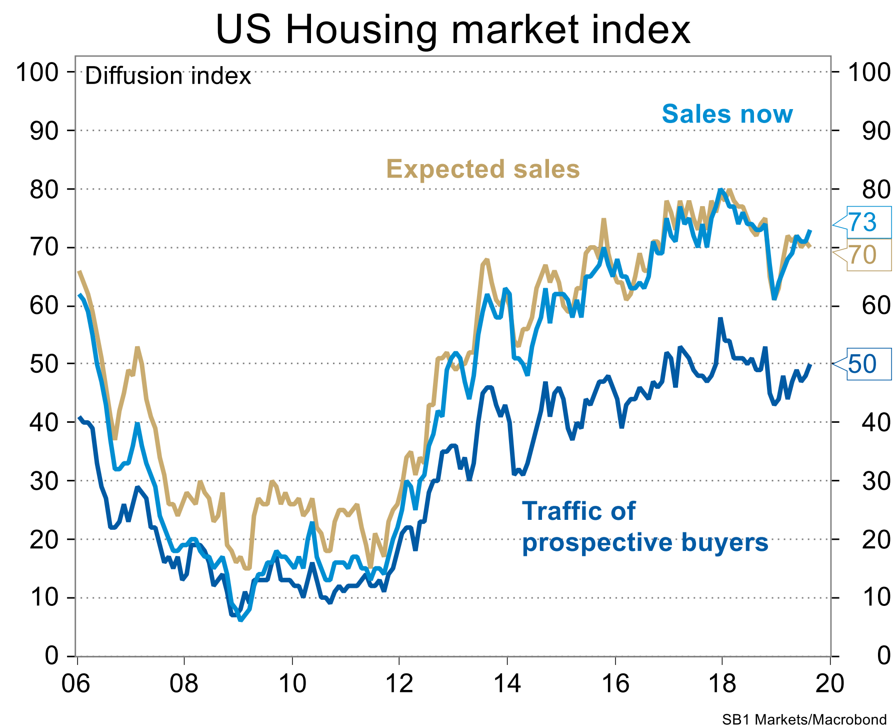


- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by 1% m/m in nominal terms in July, 0.5 pp above expectations, following the 0.7% growth in June, remarkably strong
- We estimate a 0.8% m/m volume growth in core sales, up from the 0.7% lift in June. Growth recent months have been strong, up 9% measured 3m/3m annualized (with a weak February included in the calculus, but impressive without too, 8% 2m/2m)
  - » Consumer confidence is still strong while income growth has slowed somewhat but not much

Homebuilders' confidence further up in August, still below the 2017 peak

The HMI rose another tick in Aug but is not signaling higher building activity



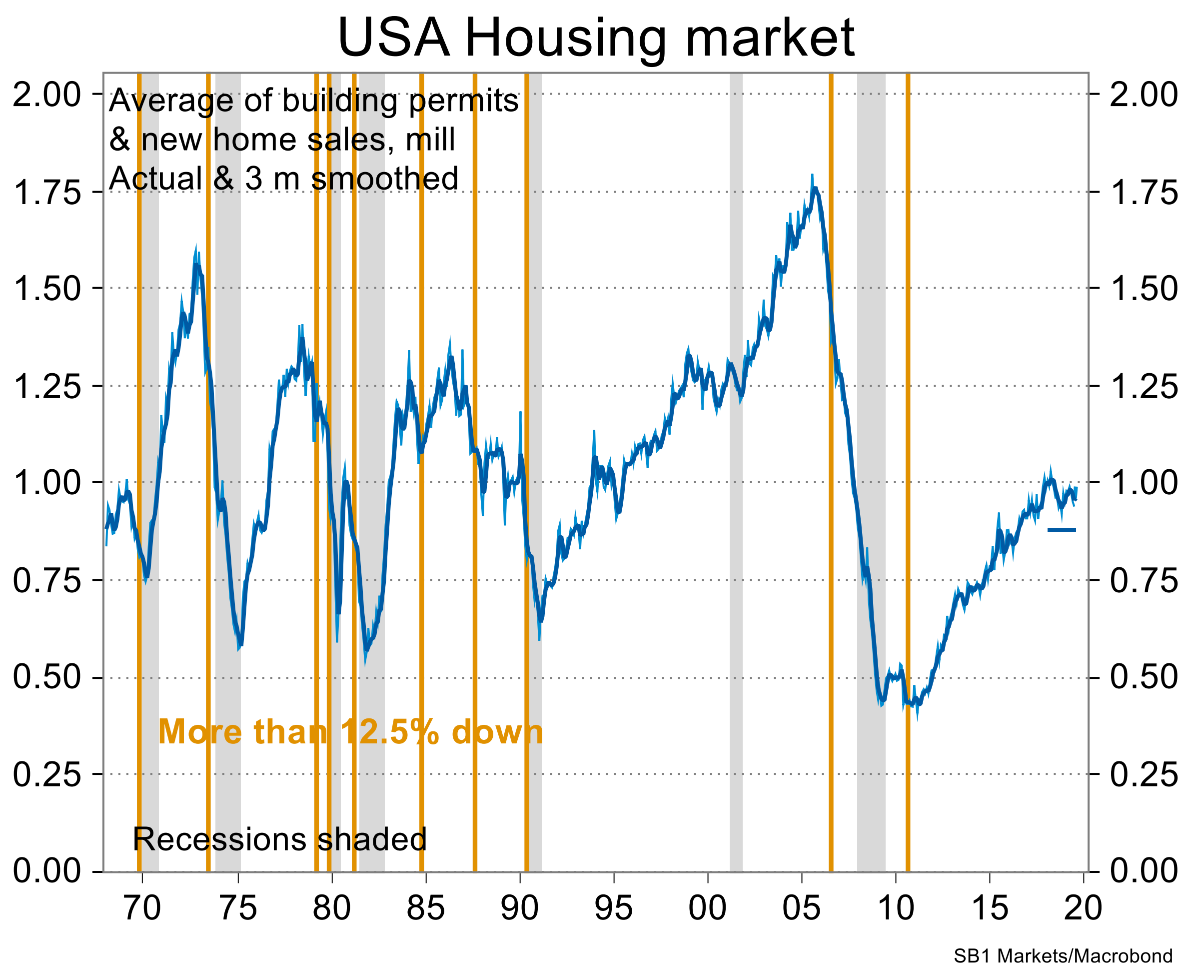


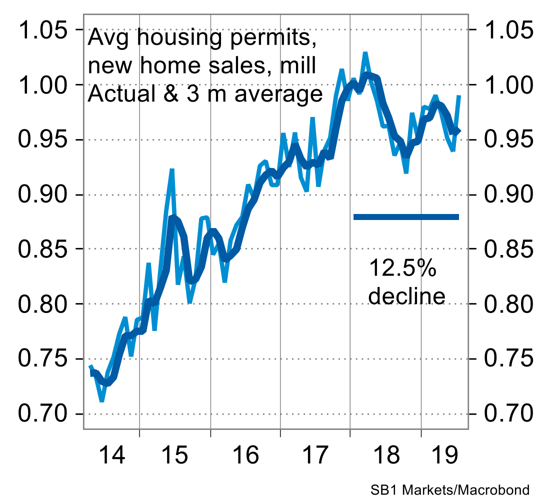
- The housing market index (HMI) rose 1 p to 66 in Aug, as expected. The homebuilders have been reporting improved market conditions since January. The index is still 2 p below the Dec 18 level and 7 p below the local peak in Dec 17. HMI still does not suggest any increase in housing starts, the survey is pointing to a stabilization
- The homebuilders are reporting that the decline in mortgage rates has not stimulated demand by much because rates have fallen due to higher economic uncertainty. This rising uncertainty is due to the trade war, of course. Since the survey was conducted, rates have fallen further, down to record low levels (30y)
- The homebuilders are still complaining about lack of labour, construction costs due to regulations, and lack of building lots

HMI is a based on a sentiment survey of US homebuilders, in which the respondents rate housing market conditions at the present time and the next six months. The index ranges from 0 to 100

Housing vs recession: Safe, for now (at least in this sector)

Building permits/new home sales in avg down just above 2% from peak

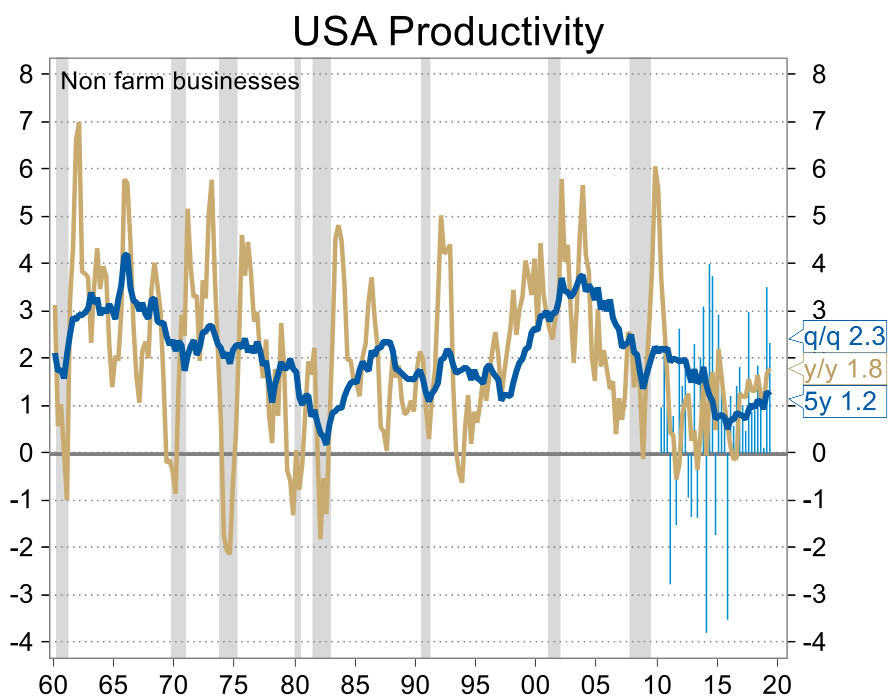


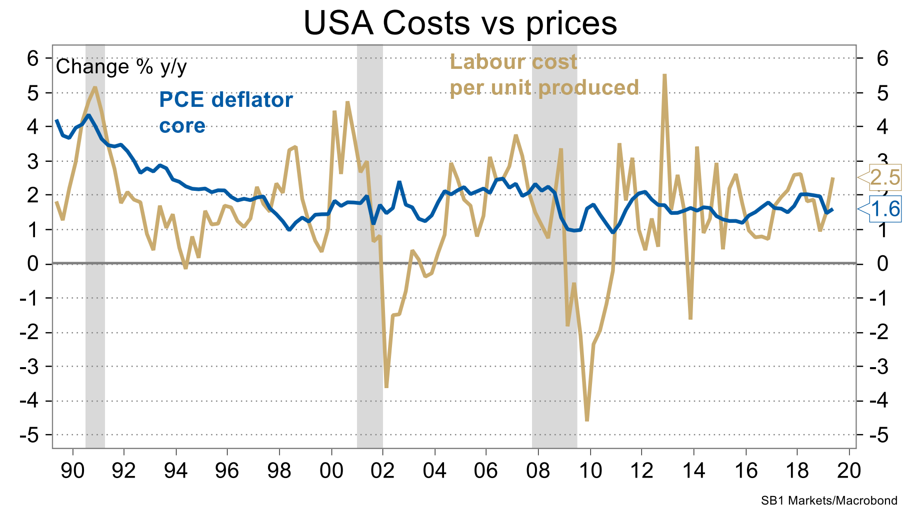


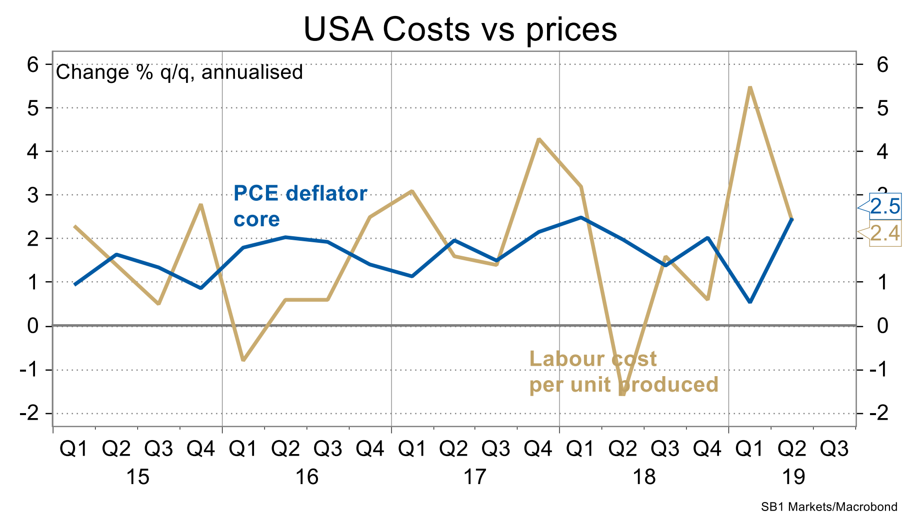
Memo: New Home sales are assumed unchanged at 645 in July, in line with consensus f'cast

Productivity growth not that bad in Q2 but cost inflation SHARPLY revised up

Productivity up 2.3% q/q in Q2, annual growth at 1.8% - revised down but still trending up



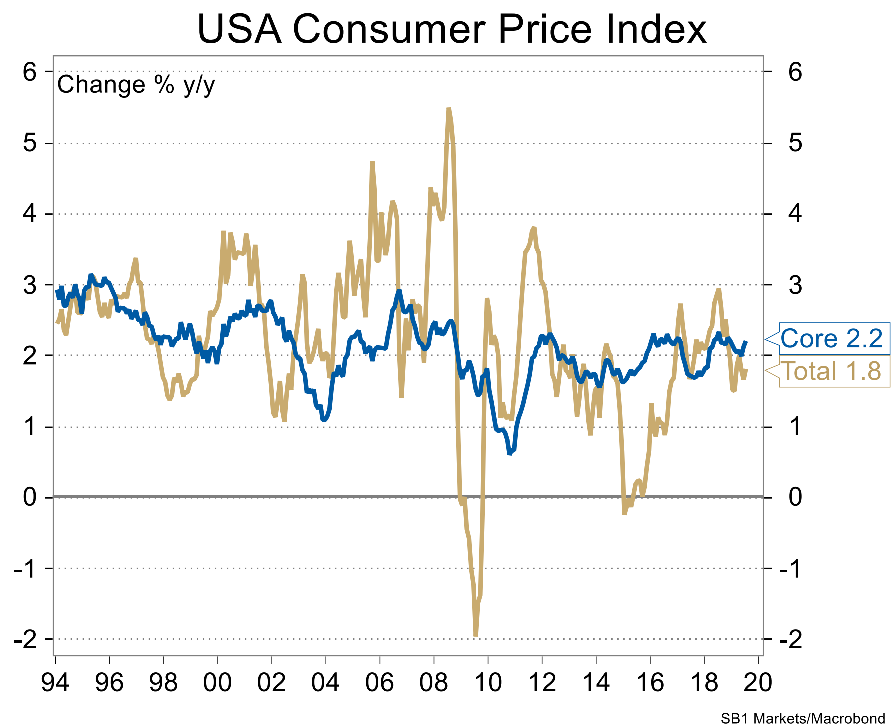


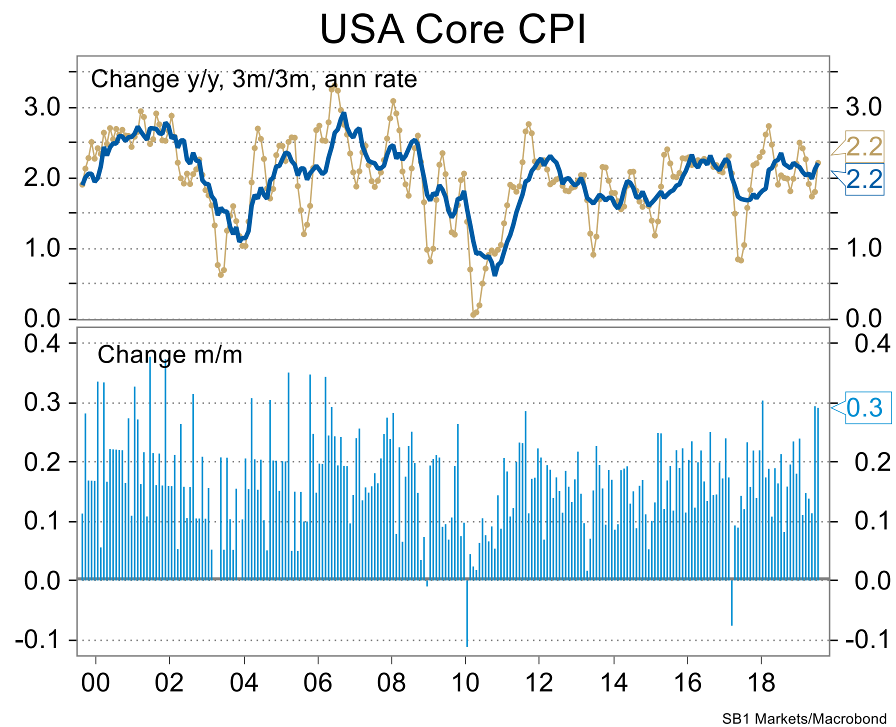


- Productivity rose by 2.3% q/q in Q2, far better than the expected 1.4%. The annual rate rose to 1.8% still trending up (but slower than pre. Reported, Q1 revised to 1.7% from 2.4 % y/y). The 5 y average is inching up too. **The best news so far in 2019?**
- On the other hand: **Labour cost inflation has been much higher than previously reported**, explaining the deep downward revision in corporate profits. Hourly labour cost rose 9.0% in Q1, not 1.8% (figures are correct!!). Unit labour cost rose is up 2.5% y/y in Q2, up from prev. reported 0.1% in Q1, a data point we doubted was correct (now revised to 1.5% y/)
- **Underlying wage inflation is approx. 3%, and underlying productivity growth is well below 2.4%. Underlying ULC inflation is probably approx 2%, like we have assumed for a while. Not an obvious cut argument for Federal Reserve**

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

Core CPI rose 0.3 % in July too, the annual rate up 0.1 pp to 2.2%

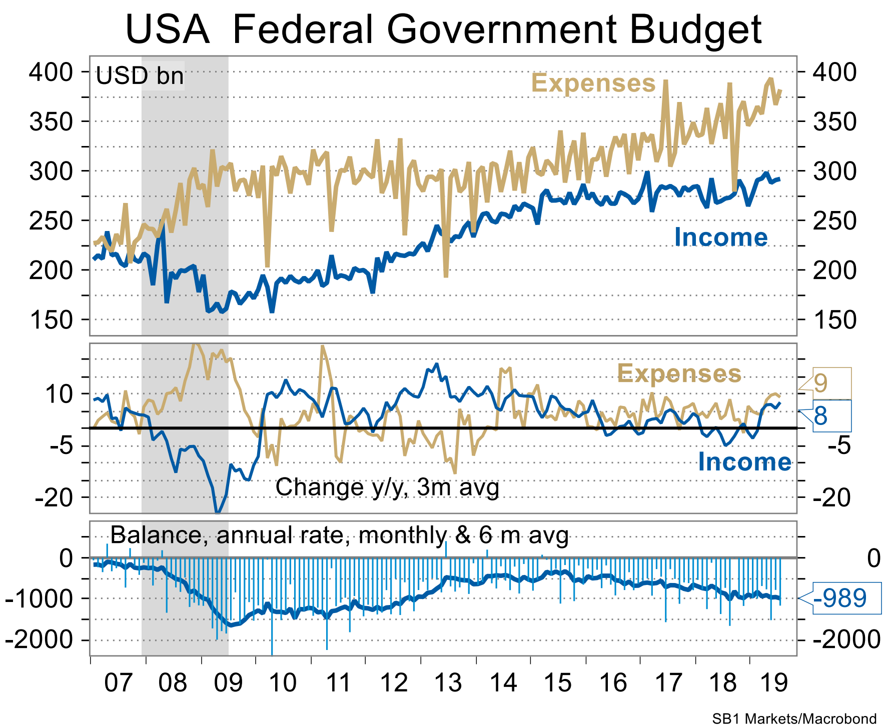


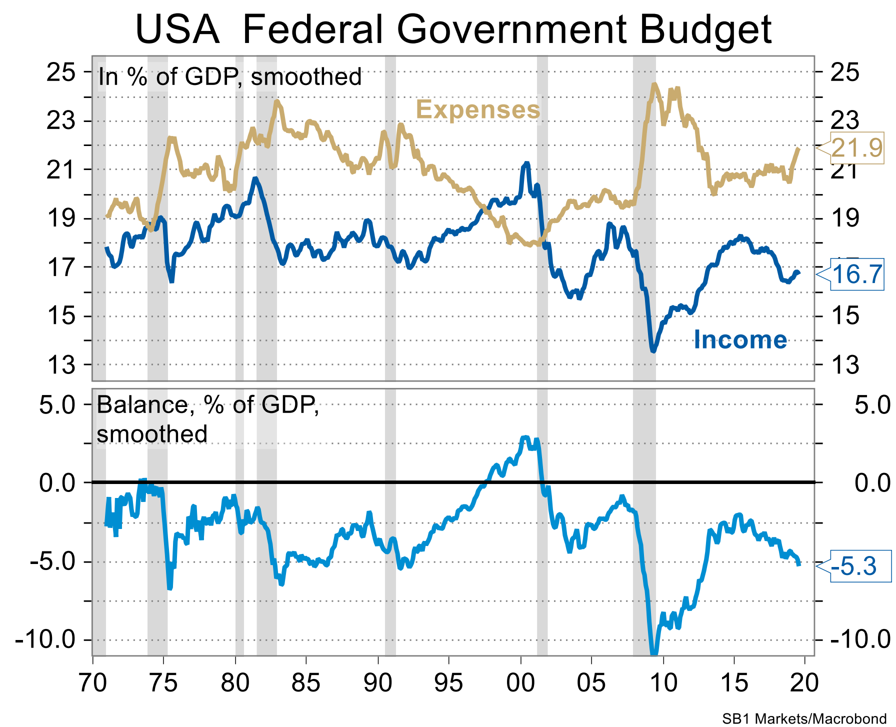


- 'We all know' that inflation has surprised on the downside and is below target – and that the Fed has to cut rates. Fed preferred price measure, the core PCE (the consumption deflator in the Nat. Accounts) was up 1.6% y/y in June, and is below Fed's 2 % price target
- However, the core CPI accelerated further to 2.2% in July (expected unch) after a 0.3% lift m/m. The PCE deflator probably accelerated to 1.7% in July, still below Fed's target. The shortfall vs the target is not large
- Headline inflation ticked up 0.1 pp to 1.8%

The federal budget deficit is widening amid soaring spending

The federal deficit at 5.3% of GDP, and the total public sector deficit at 6.9% of GDP in Q1!

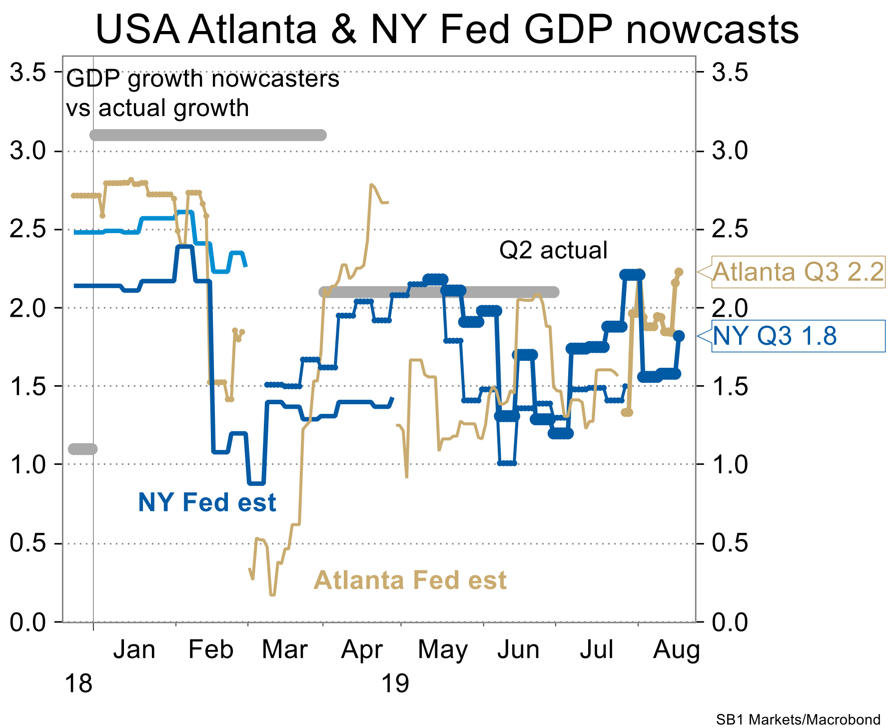


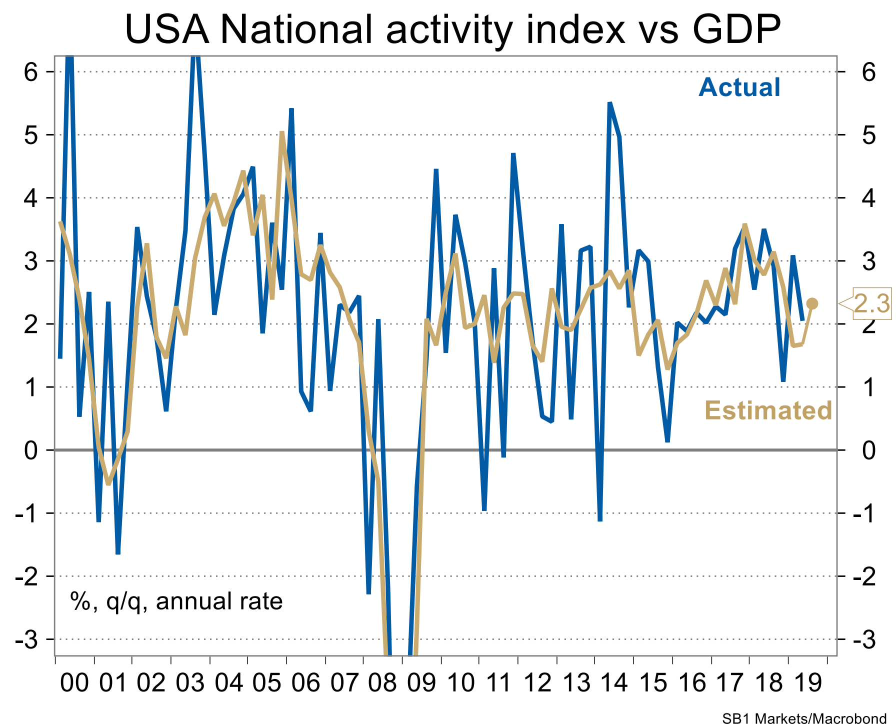


- The budget deficit fell to USD 1180 bn in annual rate in July (seas. adj), and the 6 m avg is approaching USD 1.000 bn. Including local government etc, the US is running full employment, peacetime deficit at 6.9% in Q1 (from 6.7% in Q4); totally unprecedented!
- Federal spending inched down m/m in June but is up 10% y/y (smoothed), way above growth in nominal GDP. Income is up 8% y/y (but the underlying trend for income growth is far slower)
- 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 (in a boom ☺)
- A divided Congress has agreed upon a modest further increase in the deficit but no more than some 0.2 pp of GDP

Q3 growth accelerating? The nowcasters are suggesting, 1.8 – 2.2%

Higher retail sales are lifting consumption nowcasts



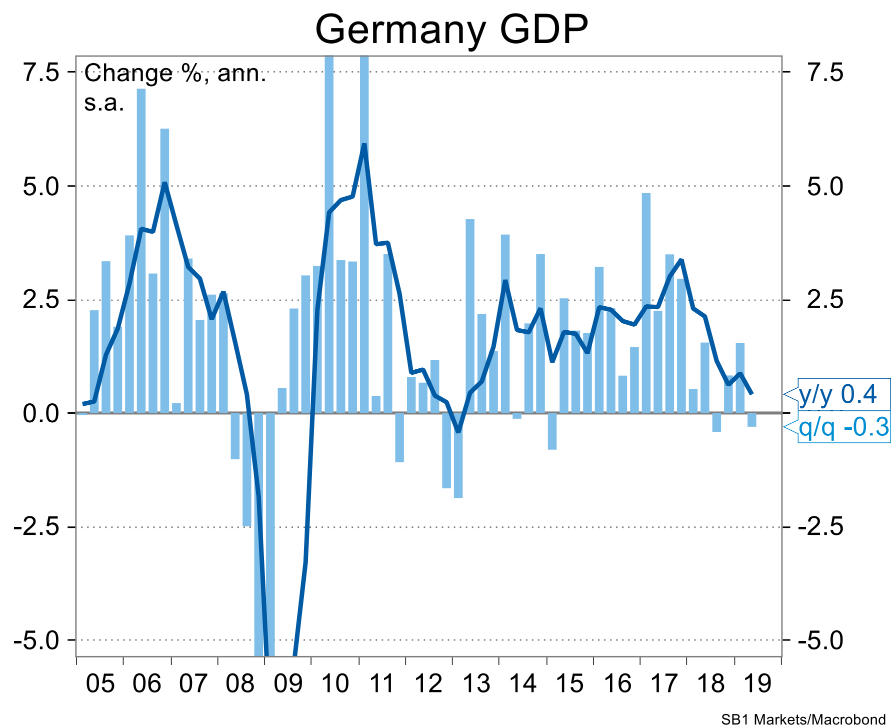


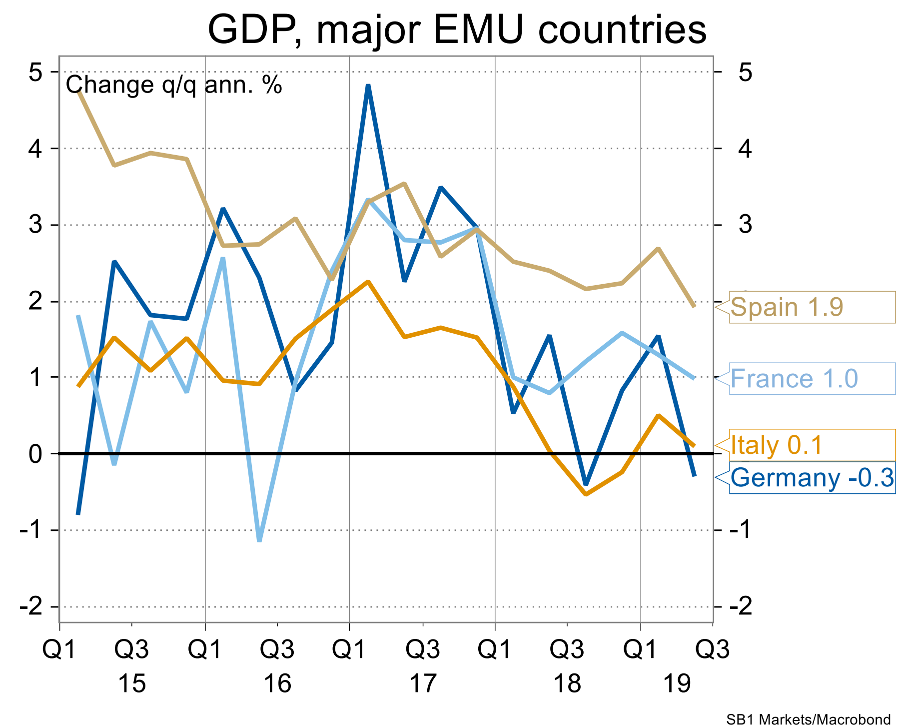
- The National activity reported 1.7% growth in Q2, and a 2.3% speed into Q3 (June level)

dd

GDP contracted in Q2, annual growth down to 0.4%. Fiscal policy to the rescue?

GDP fell 0.3% q/q (0.1% not annualised), down from 1.5%. All EMU big 4 weaker in Q2

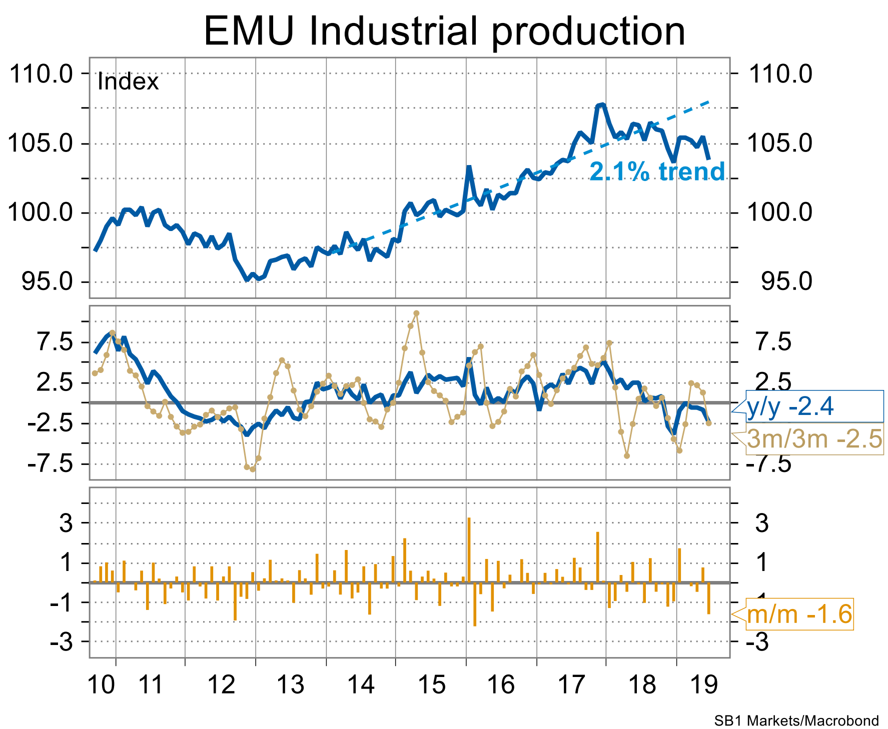


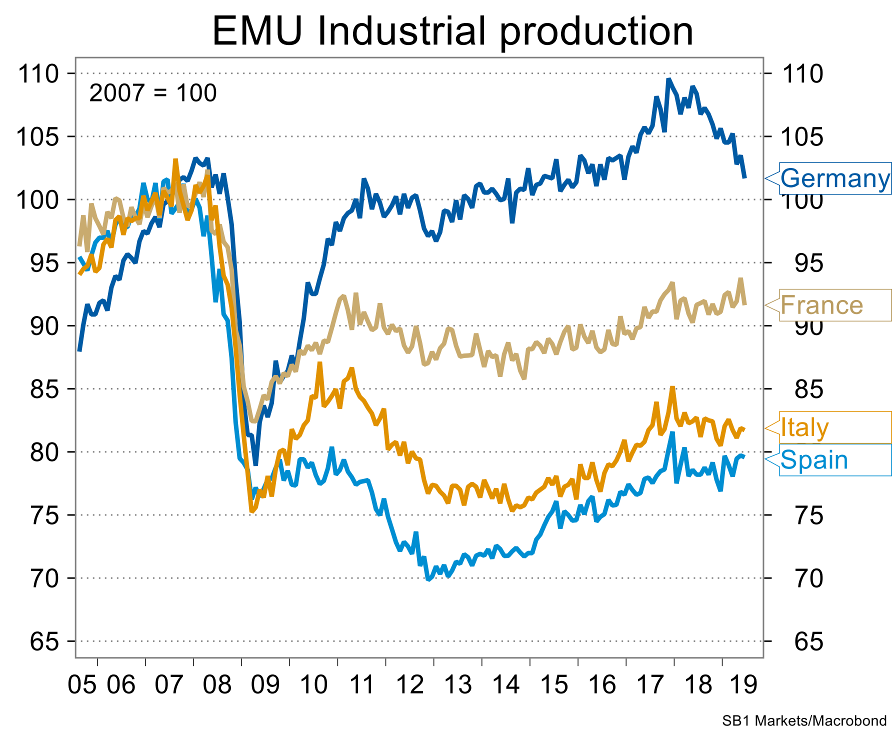


- Germany GDP declined by 0.3% q/q annualized, as expected. Growth in Q1 was revised down to 1.5%, from 1.8%. Growth in EMU was 0.8%, unch from the first estimate
  - » Meagre Q2 GDP growth EMU strengthens the case for the ECB to loosen monetary policy at the September meeting
  - » In addition, the rapid deteriorating conditions in Germany will no doubt increase the possibility for fiscal stimulus – from a Government that is running a budget surplus

Industrial production sharply down in June, as expected

Production down 1.6% m/m, with Germany in the lead, down 5% y/y!



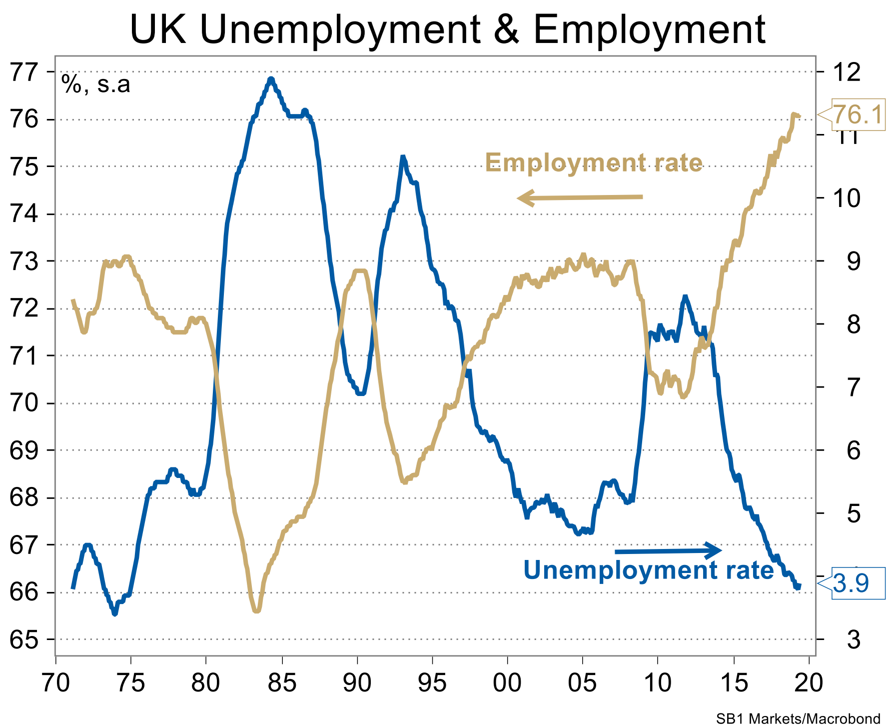


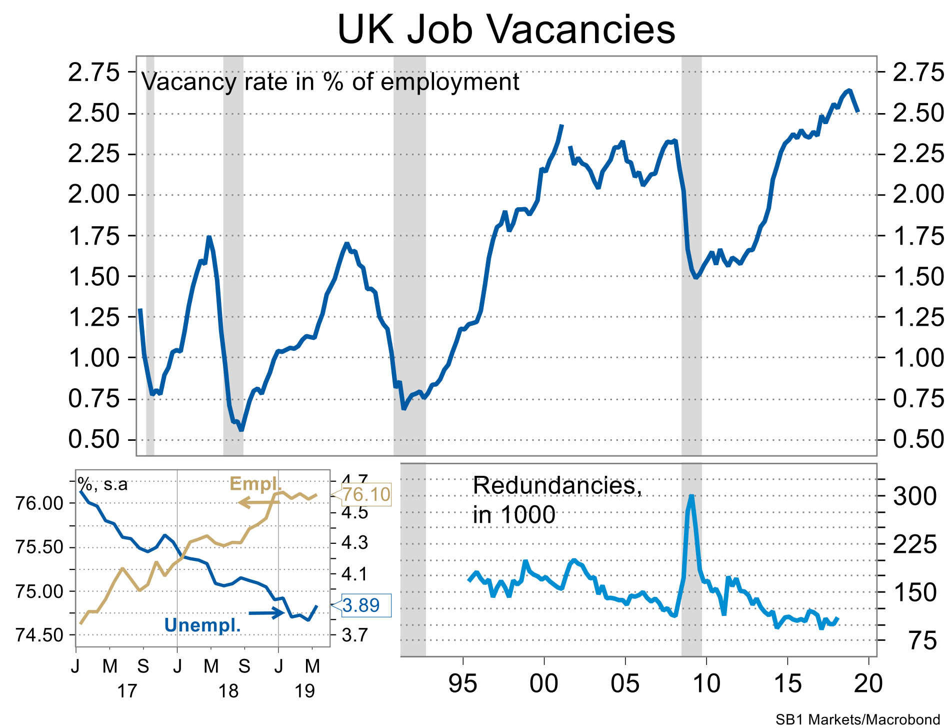
- Industrial production in the Eurozone declined by 1,6% in June, and by 2.5% in Q2 (almost as bad as in the US). Over the last year production has fallen 2.4%, and by 3.7% from the late 2017 peak
- Germany is down 5% y/y, and by 7% from the peak
- France is trending up, Spain too, with a narrow margin. Italy is slowly trending down
- **The manufacturing PMI and orders remain weak, no signs of recovery**

SpareBank 1 MARKETS

Unemployment up 0.1 p to 3.9%, wage inflation accelerating to 3.9%

Employment growth has slowed to below popul. growth, some fewer vacancies (but still many)

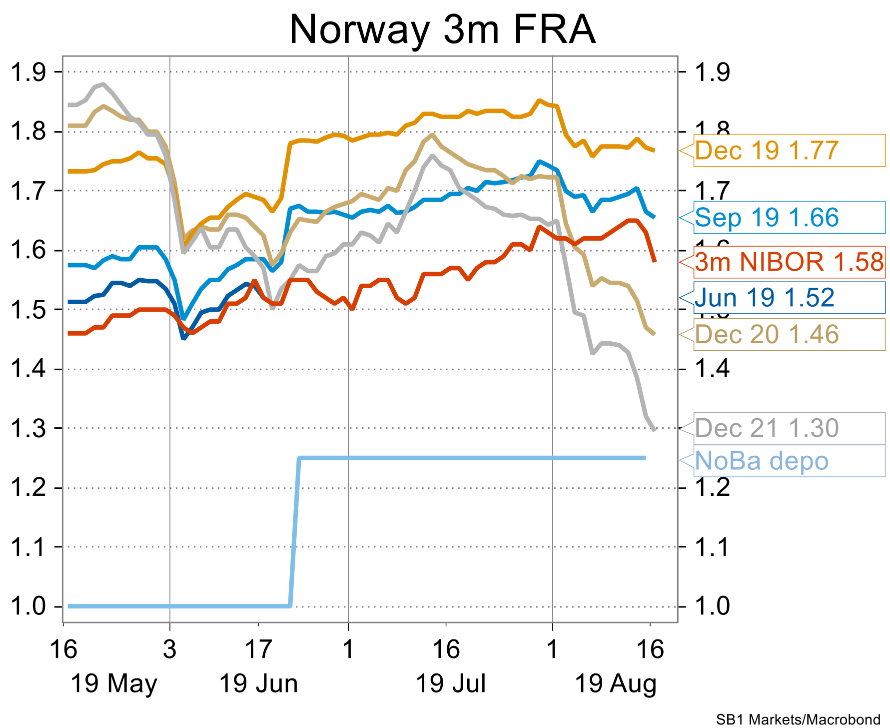




- Unemployment (LFS/ILO) rose marginally to 3.9% in May (avg April-June), up 0.1 pp, from the lowest level since 1974
- The employment rate rose 0.1 pp to 76.1%. The rate is marginally down since January, signalling some weakness in the UK labour market
- The number of job vacancies has fallen marginally recent months but is still close to a record-high level
- No surprise, wage inflation is trending up, and is approaching 4%. Wages are outpacing CPI inflation at 2%

Policy rate outlook for the period ahead is little changed. A Sept hike?

The upturn in the Norwegian economy is still on track but trade tensions, Brexit may slow Norway too



The two key sentences from Norges Bank's August meeting, with our comments:

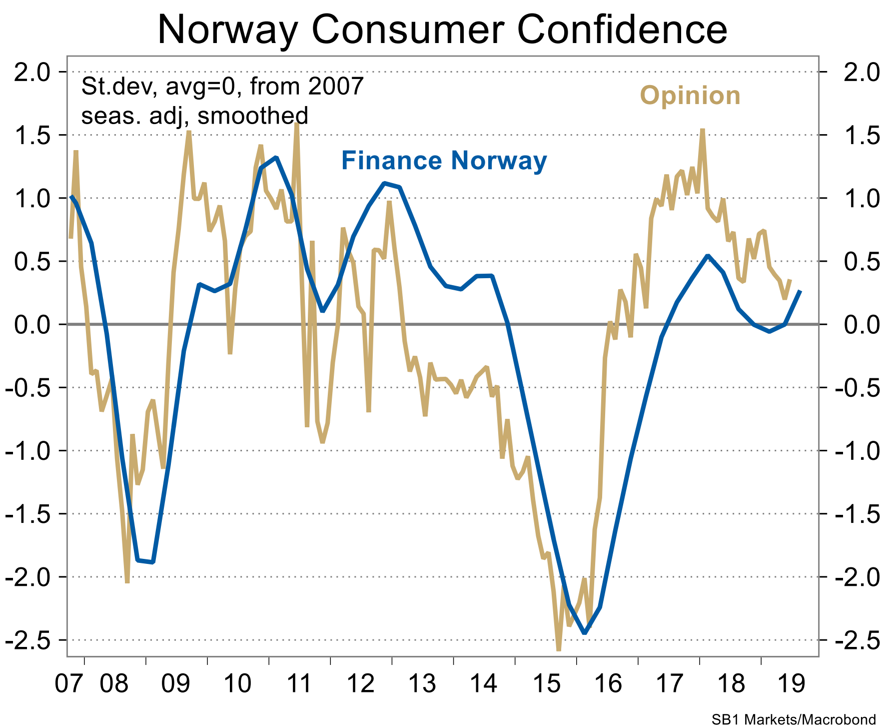
1) New information indicates that the outlook for the policy rate for the period ahead is little changed since the June Report (*which implied another hike in H2, so let's go in September*)

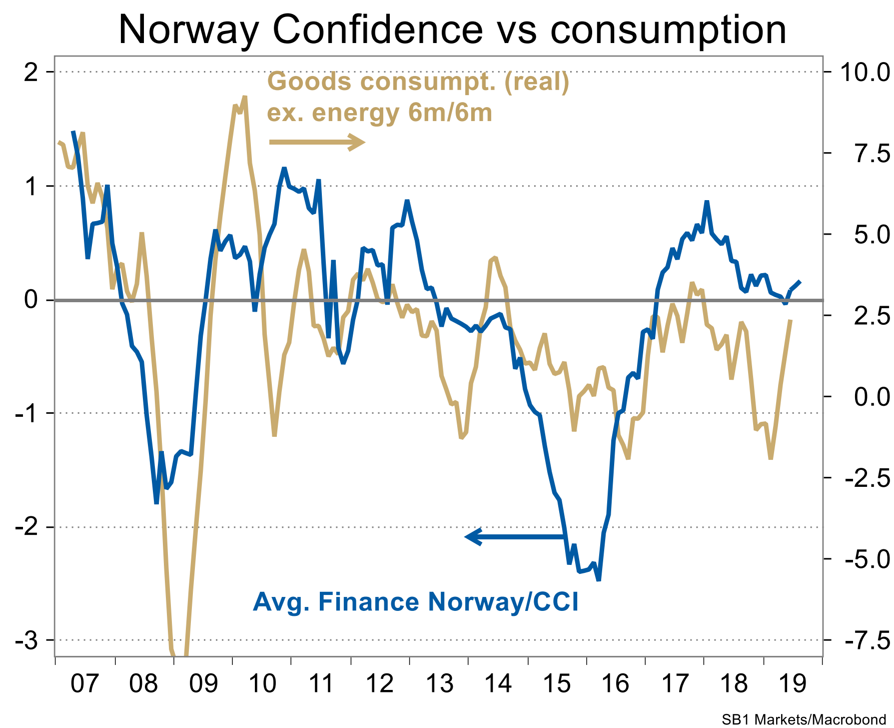
2) The global risk outlook entails greater uncertainty about policy rates going forward (*a signalled second hike in 2020 seems less likely for the Bank, now*)

- The bank also notes that growth is on track, and that the NOK depreciation may contribute to higher inflation
- We think the bank is still seriously contemplating an interest rate hike in September – as long as incoming data are not much weaker than those so far received, or global risk markets fall apart
  - » Most likely, the Bank will then lower the interest rate path in the Sept MPR, in order to take increased uncertainty into account by removing the 2020 (partly) hike from the path
- Market rates fell Thursday and Friday, which (probably) implies market pricing a lower probability for a Sept hike (check more here)

Consumer confidence surprisingly up in Q3, still not strong

Finance Norway's CCI rose further in Q3. Mixed spending plans

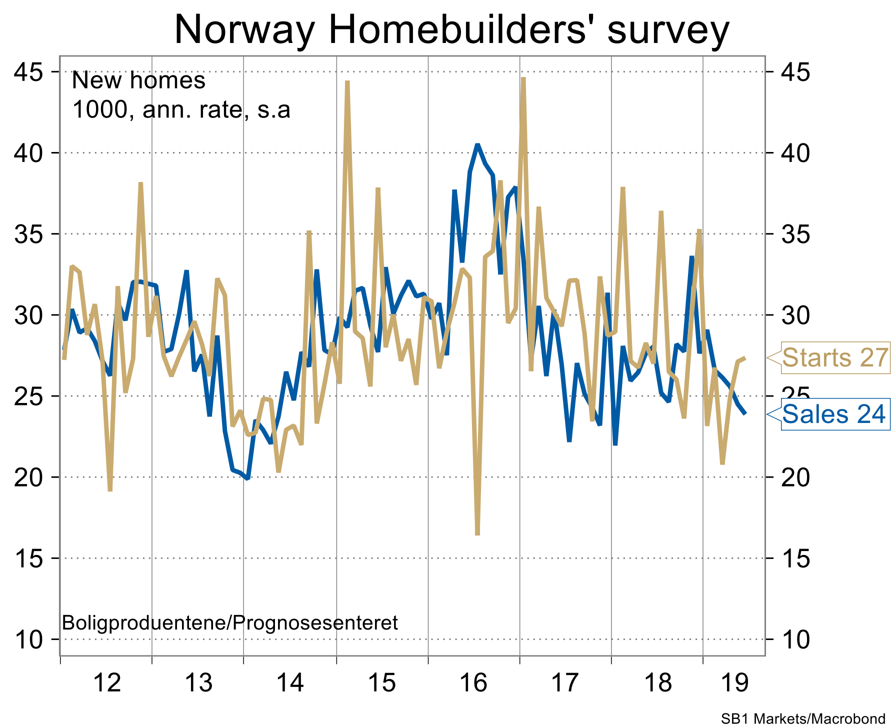


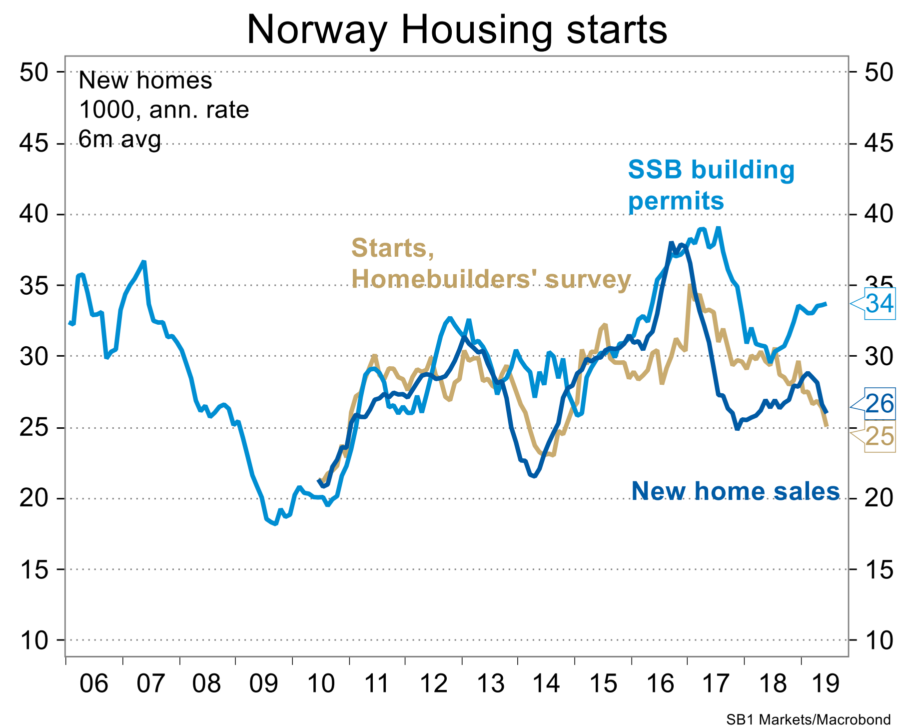


- Finance Norway's consumer conf. index rose 17 in Q3 from 14 in Q2 (revised from 12). Confidence weakened through 2018 but has recovered in Q2 and Q3. Consumers are far more optimistic than during the oil downturn (2015-2017), but less than in average (since 1994, but above the avg since 2007, shown on the chart above)
  - » The sentiment in Norway is well below levels in US and EMU but in line with sentiment in Sweden and UK (measured vs. long term avgs)
  - » Opinion's monthly CCI has not yet turned up (but no data since June)
- Growth in consumption of goods has been far softer than indicated by the sentiment surveys (and the correlation is anyway not that strong). Slow growth in nominal and even more in real income, and low population growth may explain some of the gap

Homebuilders report softer new home sales & starts

SSB housing permits still kept well up but may be lagging the Homebuilders' survey





- The Homebuilders reported **new home sales** at an annual rate of 24' in June (seas. adj.), down 1' from May. The 6m average has fallen to 26', edging down the past 5 months
- **Housing starts** rose marginally to 7' but are no doubt trending down, according to the Homebuilders, the 6 m avg has fallen to 25'.
  - » SSB reports building permits at a 34' level, and the gap to the homebuilders' report is substantial (9' measured 6 m smoothed, vs avg at 2').
- Recent data from homebuilders are not consistent with our view that housing starts and investments would be kept up for a while, following the recovery in sales through 2018. The risk is now on the downside – and the upside was anyway limited, given meagre existing house price growth!

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 recovered modestly in July, up 0.5 p. The PMI points to stable GDP growth at just above 3% growth
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 trade/tech war will be bad, a deal with US is important	July data were weaker than expected on almost all fronts. However, following an upbeat June, we do not find evidence of any rapid slowdown. Industrial production, retail sales are slowing, investments and credit stable. Surveys are not weak
USA	Growth has slowed, from well above trend. Employment growth has come down too but is still not too low, and unemployment is trending down while inflation is just marg. below target. No serious overinvestments but most sectors at/above trend. Business investments has weakened amid trade war uncertainty. Recent consumption data are solid, housing mixed. Another substantial upward revision of household savings, limited consumption risk. Fiscal stimulus continues 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 more support. **Risks: Trump/trade/bus investments** (we told you so ☺)	Core CPI inflation is gaining some steam, up to 2.2%. Retail sales are accelerating. Productivity growth trending up, labour cost inflation revised up. Housing starts/permits have been trending more or less flat recent months. The nowcasters do not suggest any collapse in Q3 either, 1.8-2.2% growth.
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	GDP growth confirmed at 0.8% in Q2, employment increased at the same speed. GDP contracted marginally in Germany and the ZEW survey signals a deterioration. EMU industrial production fell 1.6% in June
Norway	Growth may soon be peaking but it still above trend – and unemployment declines further (some soft unempl. data recently, though!). 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 accelerating. Electr. prices have taken the headline CPI. Credit growth almost kept at bay just due to regulations. **Risks: Debt, housing.**	Norges Bank expressed uncertainties about further interest rate hikes. Consumer confidence improved in Q3, the level is not upbeat

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

The Calendar

In focus: The first Aug PMIs, Fed meeting minutes, Norway oil & gas investments, LFS unemploym.

Time	Country	Indicator	Period	Forecast	Prior
Monday Aug 19					
06:00	SW	House Prices MoM SA	Jul		0.2%
11:00	EC	CPI Core YoY	Jul F	0.9%	0.9%
Tuesday Aug 20					
08:00	NO	Population Growth	2Q		0.6%
08:00	NO	Housing Starts	July		33'
12:00	UK	CBI Trends Total Orders	Aug	-25	-34
Wednesday Aug 21					
08:00	NO	Unemployment Rate LFS	Jun	3.4%	3.4%
16:00	US	Existing Home Sales	Jul	5.40m	5.27m
20:00	US	FOMC Meeting Minutes	Jul-31	--	--
Thursday Aug 22					
02:30	JN	PMI Composite	Aug P	--	51.2
06:30	JN	All Industry Activity Index	Jun	-0.8%	0.3%
08:00	NO	Oil & Gas Investm. Survey, '20	3Q	180 bn	172 bn
09:30	SW	Unemployment Rate LFS	Jul	6.5%	6.6%
10:00	NO	Norges Bank Expectations Survey	3Q		
10:00	EC	Eurozone Manufacturing PMI	Aug P	46.3	46.5
10:00	EC	Eurozone Services PMI	Aug P	53	53.2
10:00	EC	Eurozone Composite PMI	Aug P	51.2	51.5
14:30	US	Initial Jobless Claims	Aug-17	216k	220k
15:45	US	Markit Manufacturing PMI	Aug P	50.5	50.4
15:45	US	Markit Services PMI	Aug P	52.8	53
15:45	US	Markit Composite PMI	Aug P	--	52.6
16:00	US	Leading Index	Jul	0.2%	-0.3%
16:00	EC	Consumer Confidence	Aug A	-7	-6.6
Friday Aug 23					
01:30	JN	CPI Ex Fresh Food, Energy YoY	Jul	0.5%	0.5%
08:00	NO	Labour Costs	2Q		
16:00	US	New Home Sales	Jul	645k	646k

- **Preliminary August PMIs**
  - » The global composite PMI may have stabilised, at least that's what businesses have been reporting the two past months. Manufacturing is weakening swiftly in both the US and EMU, stable in China and Japan. Output in the service sector still expanding in all major countries
- **US**
  - » **At the July meeting**, Fed's Powell disappointed markets by striking a cautious approach with regards to further interest rate cuts. We expect mixed signals from the Committee's members, in the minutes
  - » **New home sales** have softened recent months but **existing home sales** are still climbing
  - » **The leading index** is sliding down, like most other surveys/nowcasters. However, the index does not signal any recession now
- **Norway**
  - » In Q2, **oil & gas companies** nudged up their investment f'casts significantly. A few more PDO's are expected submitted this year (according to SSB), we expect a small upward adjustment in Q3 survey both for 2019 and 2020. Still, the broad picture remains, the upside is not that large. Manufacturing & power supply will also report their investment plans
  - » Will **LFS unemployment** follow registered unemployment up? The participation rate is retreating, pointing to a tight labour market
  - » **Population growth** may have bottomed out, 'labour' immigration ticked up to a marginally positive rate in in Q1

Source: Bloomberg. SB1M est. in brackets

In this report

Global

- US data less disappointing, EMU deteriorates, China back in neutral
- Retail sales still strong, manufacturing production is stagnating

China

- July on the weak side following a strong June
- Oops, just 0.2% growth in industrial production in July. Annual growth at 29y low
- Retail sales volume flat in July – and the history revised down
- Nominal investments are growing steadily
- Credit growth cooled in July, trending flat the past year (but no more tightening)

USA

- Manufacturing production down again in July
- The first August manuf. surveys close to stable
- Oh shit, core inflation further up above target
- Full speed ahead, retail sales are really strong!
- Univ. of Michigan consumer sentiment fell sharply in August
- Housing permits spiked in July, more than reversing the June slip
- Homebuilders' confidence further up in August
- Productivity growth revised down but trends up. Cost inflation sharply revised up
- The federal budget deficit is widening amid soaring spending
- Jobless claims remain very low
- Q3 growth accelerating?

EMU

- German GDP contracted in Q2, annual growth down to 0.4%. Fiscal policy to the rescue?
- Employment growth = GDP growth -> no productivity growth
- Industrial production sharply down in June, as expected
- German ZEW survey expectations further down, current situation weaker too

UK

- Core CPI inflation ticked up to 2.0%, total inflation has probably bottomed
- Unemployment up 0.1 p to 3.9%, wage inflation accelerating to 3.9%
- Retail sales are still strong

Sweden

- Unemployment turns up?
- Core inflation a tad down in July, to 1.7%, not far below the inflation target

Norway

- Norges Bank still want to hike in Sept? Probably
- Consumer confidence surprisingly up in Q3, still not strong
- The Financial News Index has rebounded
- Exports still not impressive, imports are on the way up
- Homebuilders report softer new home sales & starts
- Register data may signal slower employment growth

Highlights

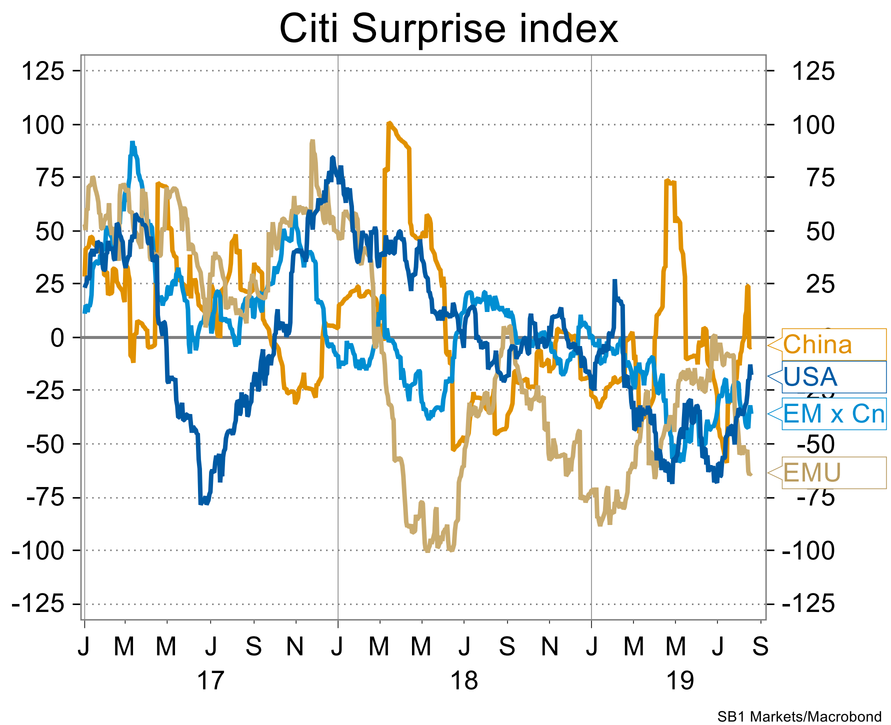
The world around us

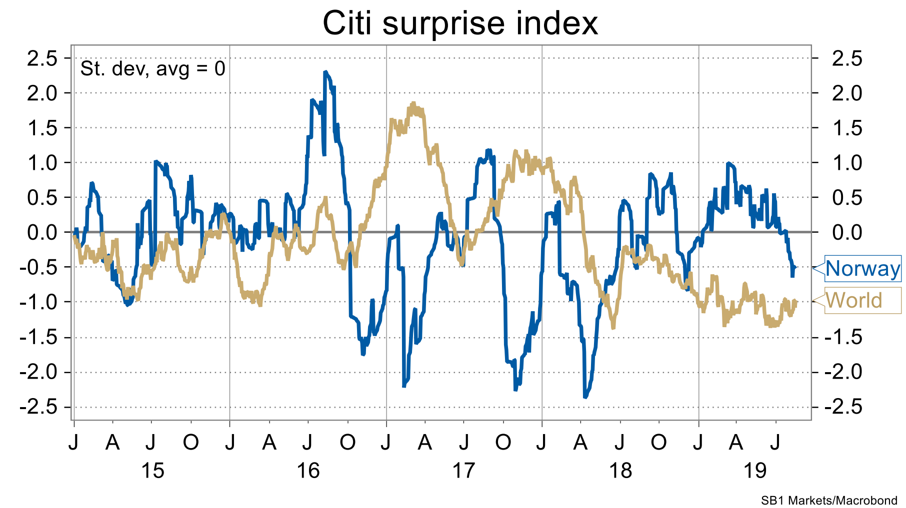
The Norwegian economy

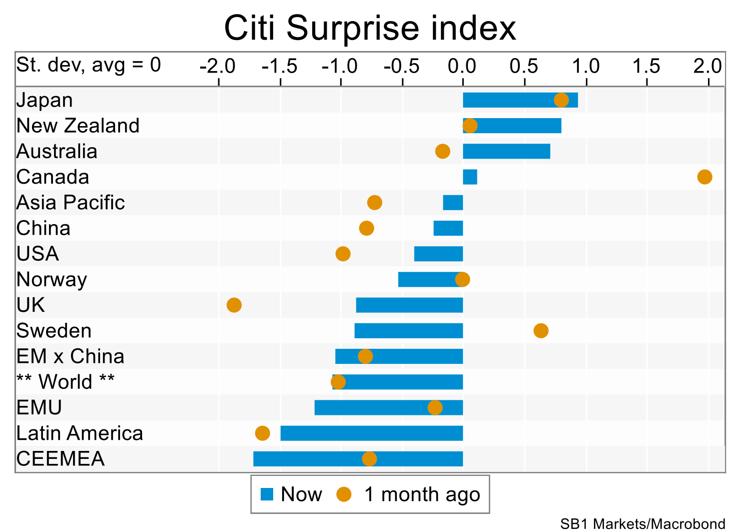
Market charts & comments

US data less disappointing, EMU deteriorates further, China back in neutral

All major regions ex China are reporting data below par, world index stable last week





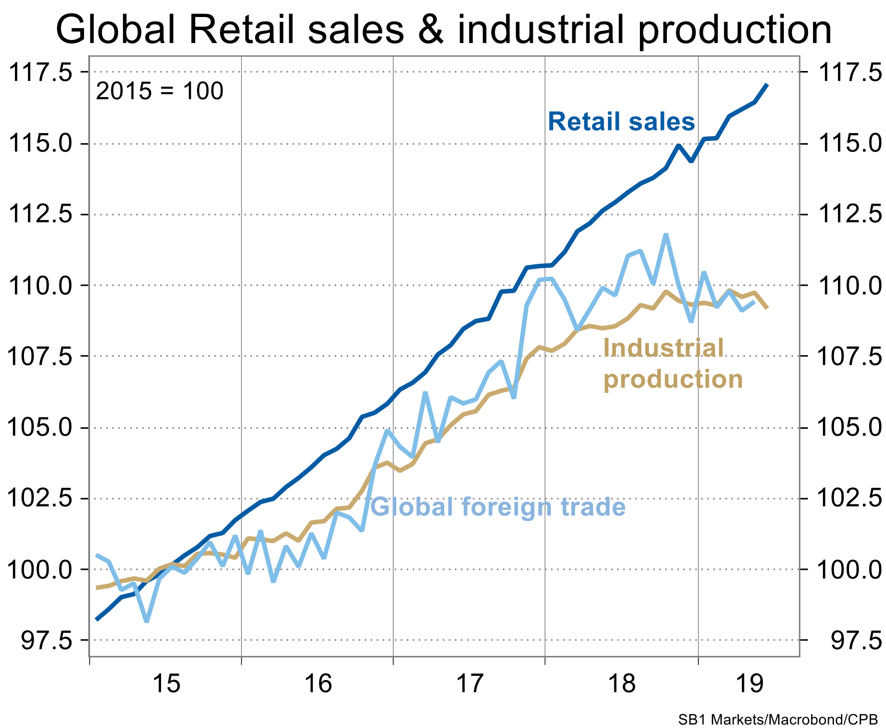


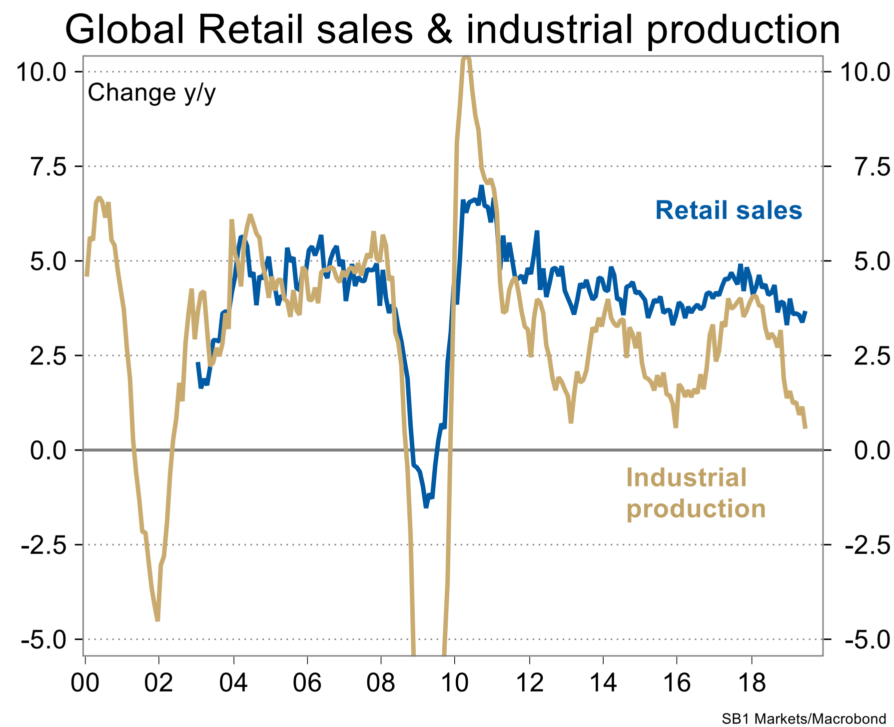
- The global surprise index has been in negative territory since last spring
- The EMU surprise index is falling steeply, dragged down by weak PMIs, manufacturing
- US data still negative over the 4 last months period, but less so in July & August
- Chinese July data came in below expectations, surprise index fell back to neutral
- Norwegian data have been disappointing vs expectations the past weeks (we agree with this view, which we don't always do ☺). New Zealand, Canada at the top, UK & LatAm at the bottom

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

Retail sales still strong, manufacturing production stagnates

Global foreign trade rose in May but has been trending down since Q3 last year

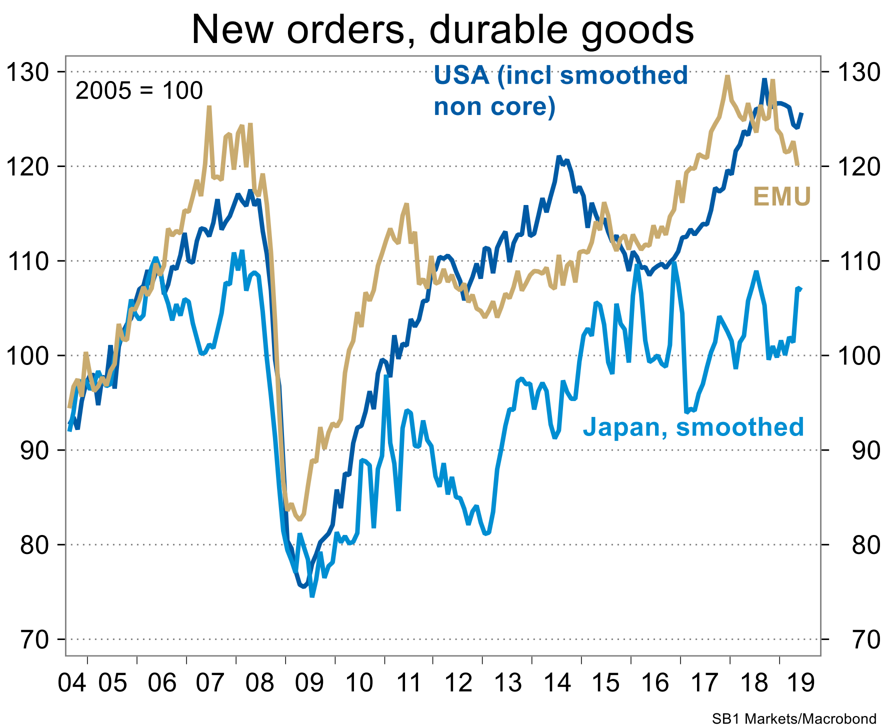


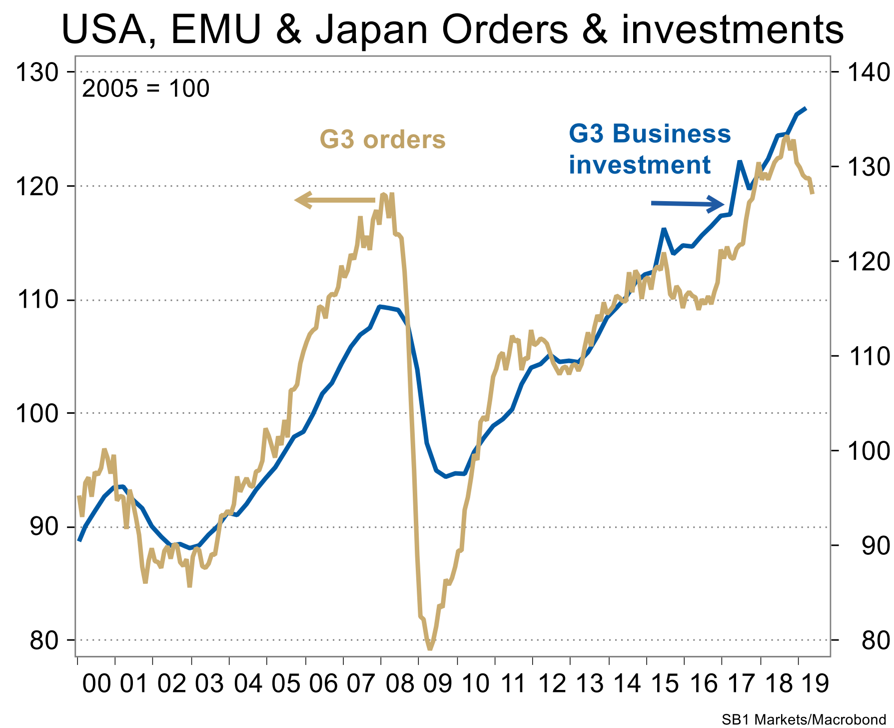


- Our f'cast on June global industrial production has been nudged down as more countries are reporting data. Production probably fell some 0.5% m/m in June and the trend is not more than flat recent months.
  - » The first July data are on the weak side too (but some countries like Indonesia and Turkey reported 'too low' production data and will likely recover in July)
- Retail sales accelerated in June, and signal that consumption is still supporting the global economy – even if it has slowed somewhat. However, the first July data are on the weak side

DM orders: The downswing in orders signal weaker investments

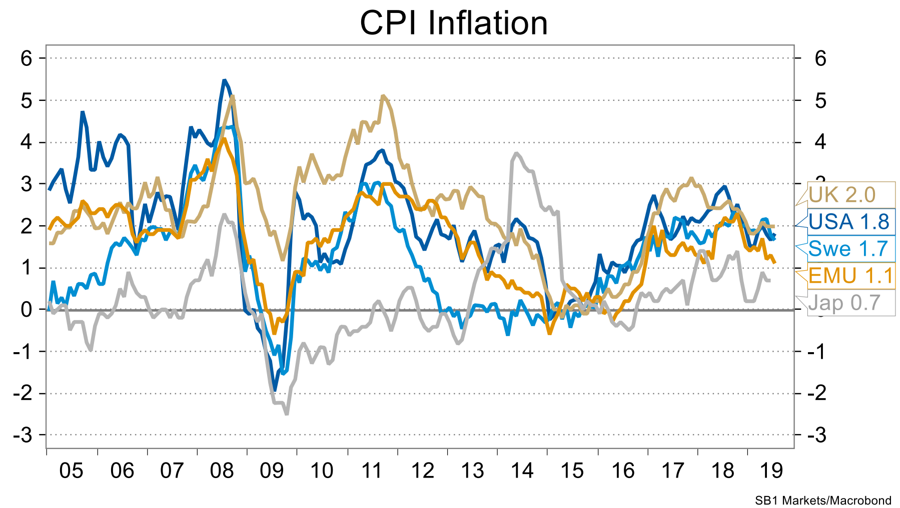
Something must be happening with investments, somewhere

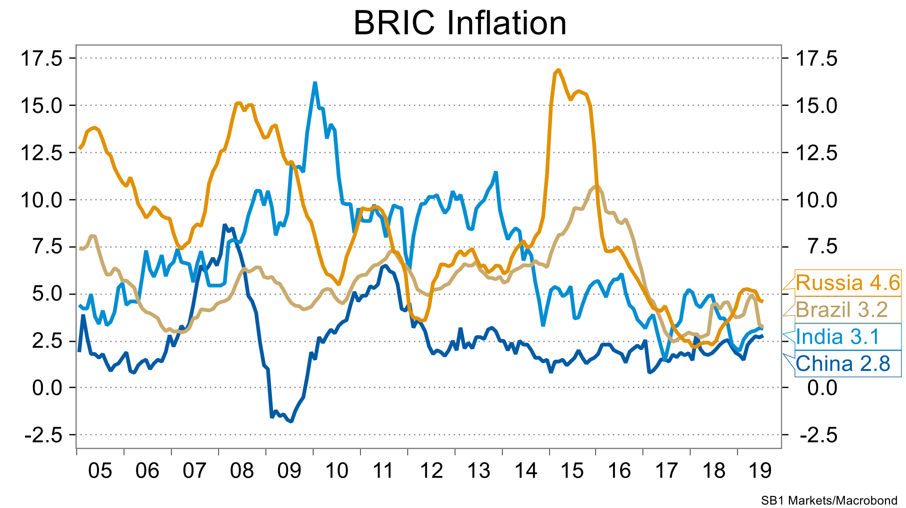


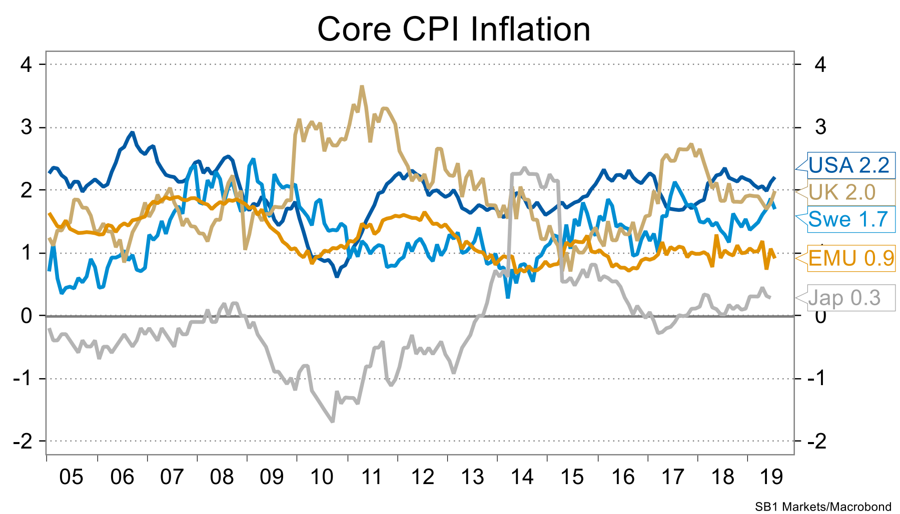


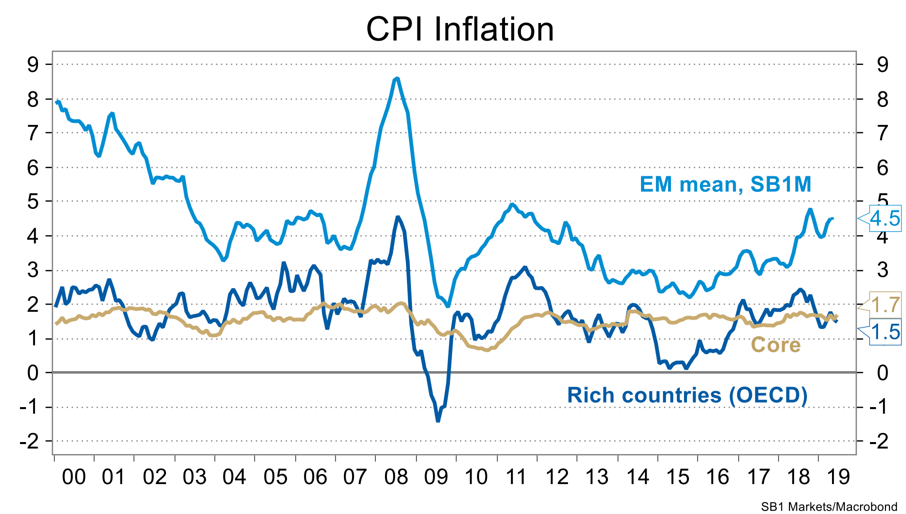
DM CPI has turned south, with the oil price. Core is sum flattish

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









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

July on the weak side following a strong June

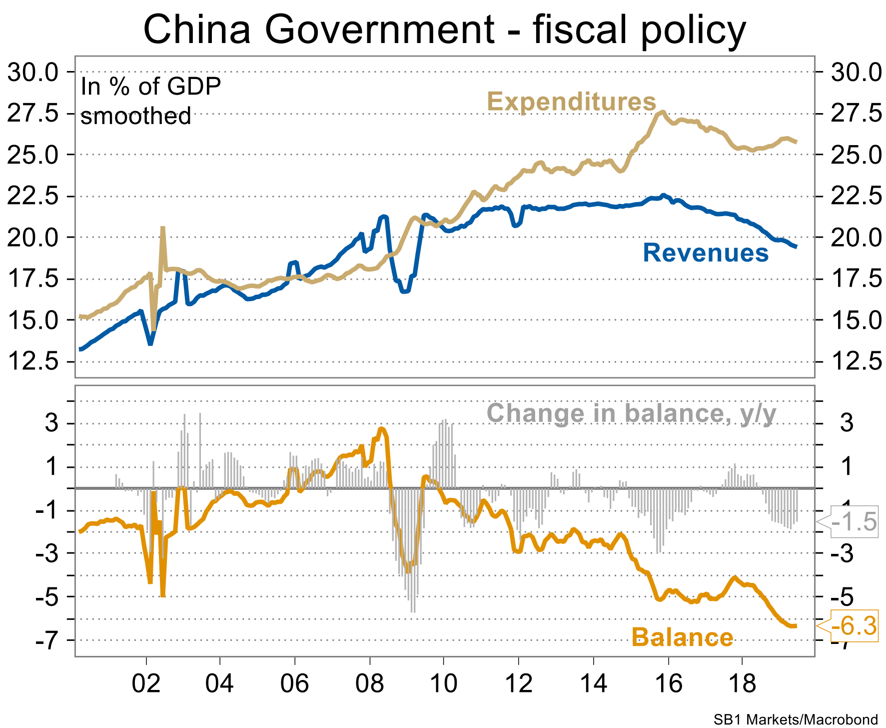
July data broadly weaker than expected but still no signs of a sharp slowdown

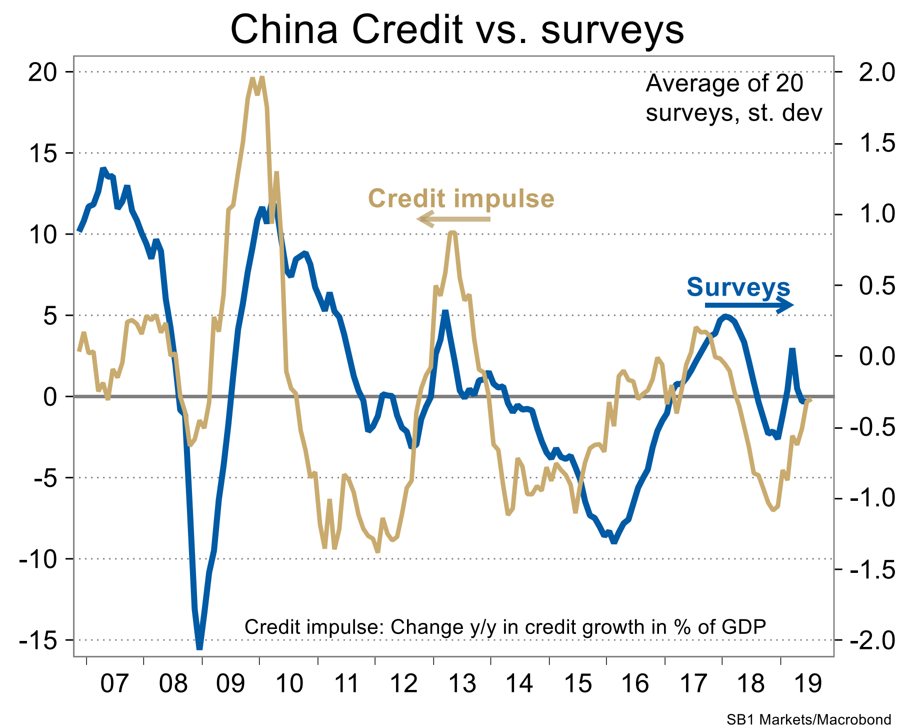
The most important message: We still do not find indications of a steep slowdown in China amid the escalating trade war

- **Industrial production** slowed to 4.8% from 6.3% in June, to the lowest level since 1990 (according to the 'useless' official annual growth rate). Even if production rose just 0.2% m/m, down from 0.7%, underlying growth past months is still at 5.9%. Surveys do not signal any slowdown from this level
- **Retail sales** growth nosedived to 7.6% from 9.7% in June, expected 8.6%. Sales were flat m/m, following the 0.8% hike in June. Last month, data were revised sharply up, followed by a substantial downward revision this month. Underlying volume growth has fallen below 6% but not slowing further recent months
- **Investment** growth softened marginally to 5.3% y/y in July, and the trend is flat. The official YTD rate fell 0.2 pp to 5.7%, weaker than exp. Construction starts are still trending up, but slower
- **Credit growth** was weaker than expected in July and the annual rate declined. However, total credit has accelerated somewhat recent quarters as higher lending from the shadow banking market is compensating for a slowdown in bank lending. The credit impulse has turned neutral, from a contraction
- **House prices** are still increasing but a tad slower
- Both **exports and imports** were close to flat in July and exports are trending up
- Chinas' central bank announced measures to **lower lending rates**

Growth is gradually slowing even if policies try to stimulate

Record high budget at 6.3% of GDP, +1.5 pp last year! In addition: A modest credit turnaround

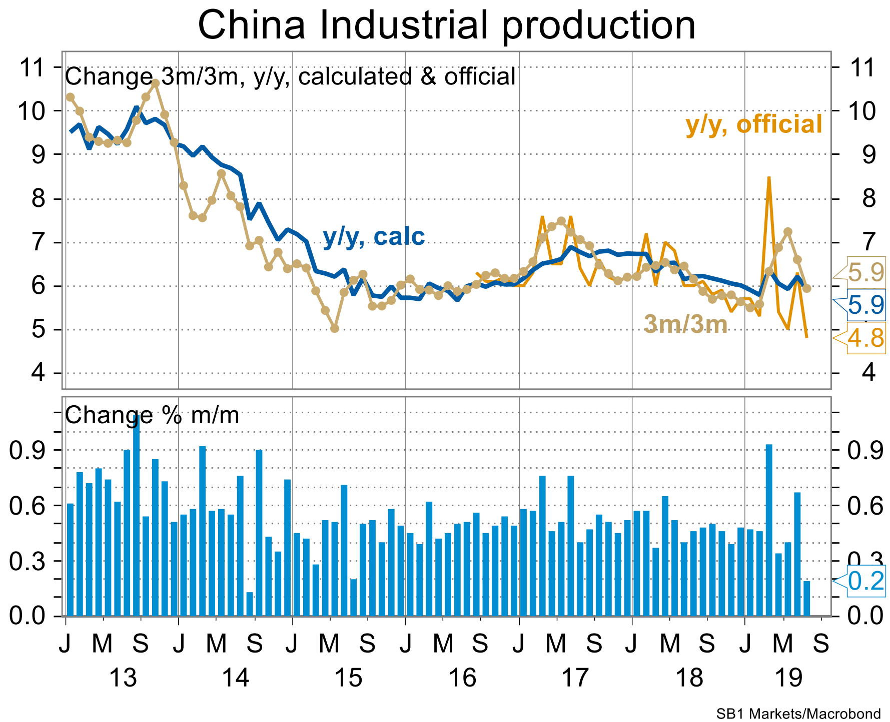


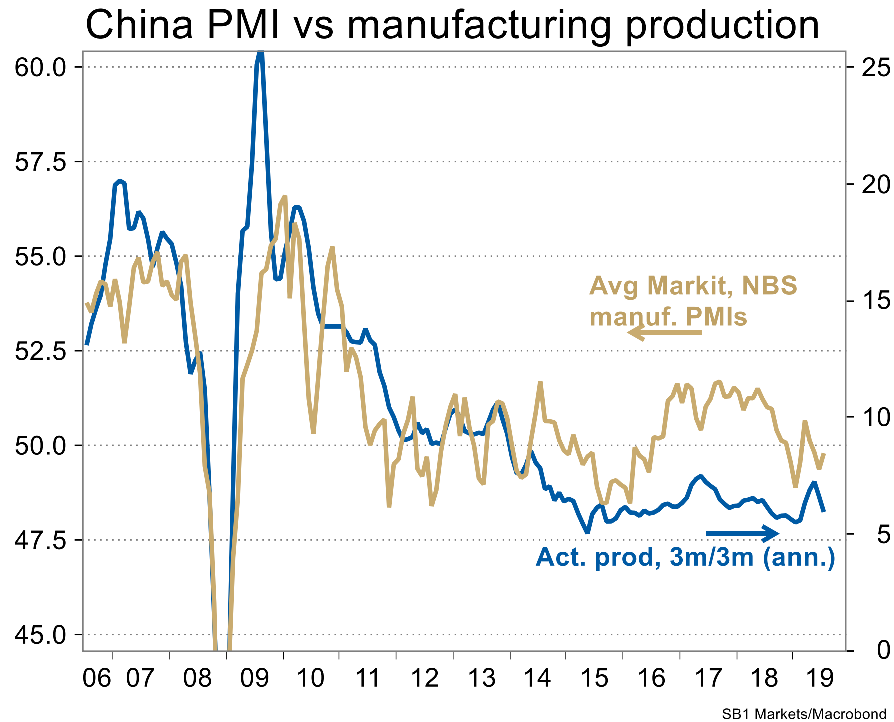


- Fiscal policy: Taxes are cut, spending programs decided. Over the past year, the deficit has increased by 1.5% of GDP, a substantial fiscal expansion. The deficit has increased to 6.3% of GDP, according to our calculations
- During the weekend, the PBoC announced measures to lower borrowing rates for the corporate sector, and more news are expected today. During the past year banks’ reserve requirements have been cut 4 times, by 4.5 pp to 13.5%, freeing up lending capacity equalling some 6½ of GDP. Credit growth has stabilised, thus the credit impulse has turned neutral, from sharply negative
- CNY has depreciated almost 10% since 2015, of which 4% since May (and 1.5% in August)

Oops, just 0.2% growth in industrial production in July. Annual growth at 29y low

The official y/y 'collapsed' to 4.8%, lowest since 1990. Our calculation yields 5.9%, down from 6.2%

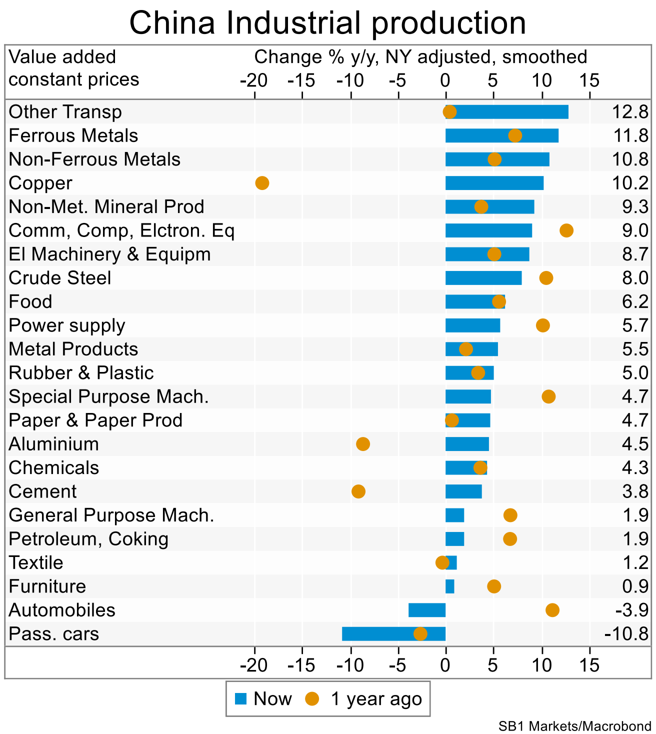




- Production rose just 0.2% m/m in July, down from a strong 0.7% print in June. Measured 3m/3m the decline was much less dramatic; growth slowed to 5.9%, the same annual rate as our monthly seasonally figures add up to
  - » The official y/y growth rate is 'useless', far too volatile as it is not adjusted for holidays or working days. Even so, the 4.8% growth rate was the lowest since 2002, but that was one month exception, like 4 times in the years before that. A 'real' 4.8% has not been seen since 1990. (But the 'real' annual rate is not 4.8% but rather 5.9%, which is not dramatic!)
- PMIs or other surveys are not signalling an abrupt halt in manufacturing. Export volumes are back to peak levels. China has most likely not been brought to a halt – but **the unusual 0.2% m/m growth is a warning sign**

Still broad based growth, just autos are down y/y

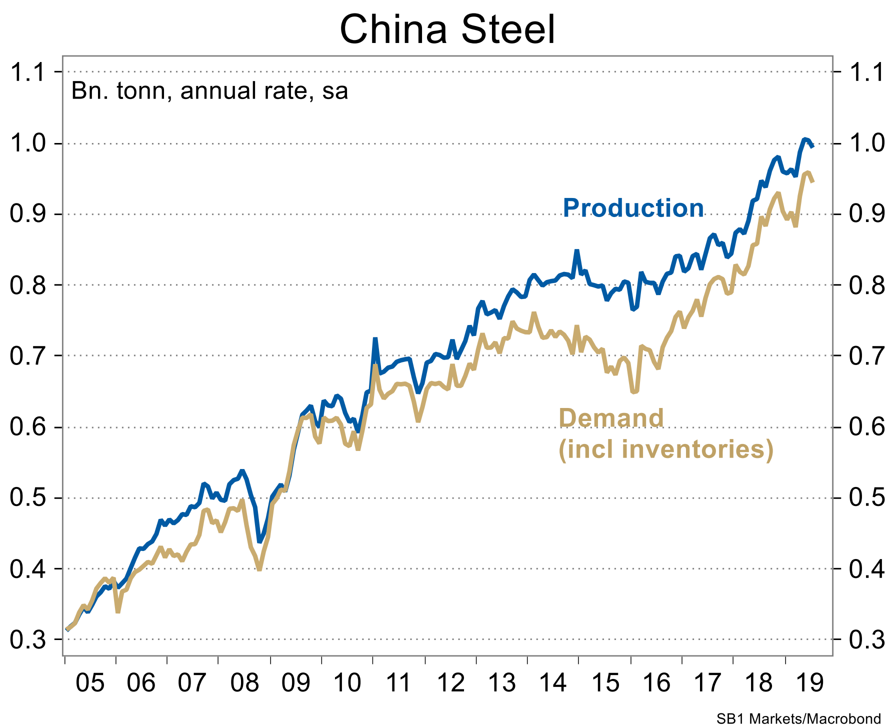
10 sectors are accelerating (vs. 1 y ago), 8 are slowing. Auto production falling



- Crude steel production has fallen marginally in June/July but is still on an upward trend, up 8% 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, up just 5% y/y
- Copper production rose sharply in both May and June (no July data yet), and has stabilised following an almost 20% decline from late '17 to '18
- Auto production (valued added) has been hurt by weaker sales but has kept (unbelievable?) stable, down just 4% y/y, while production of passenger cars are down 11% - more in line with the decline in auto sales

Steel production (and demand) marginally down in June/July, trend strong

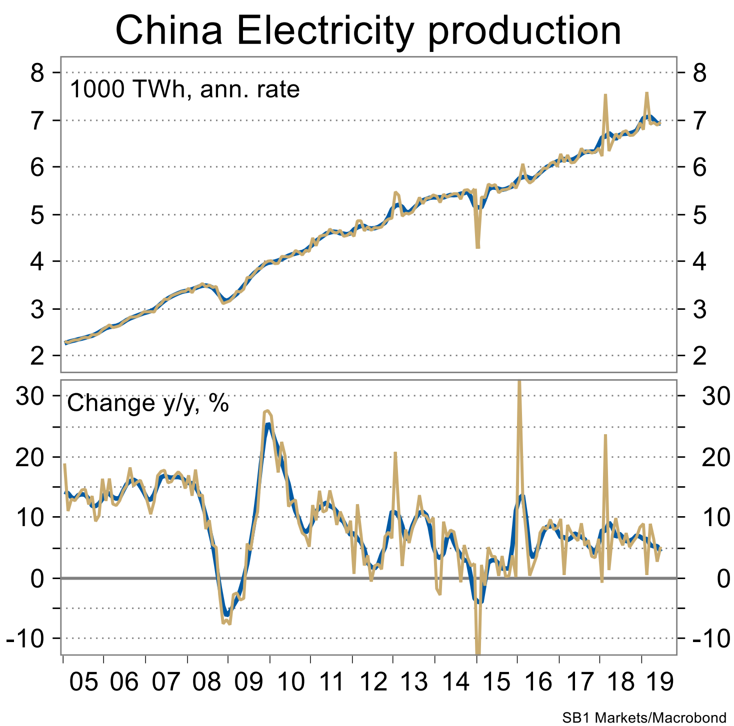
Upward trend intact, after both demand and production softened last winter. Reduced overcapacity

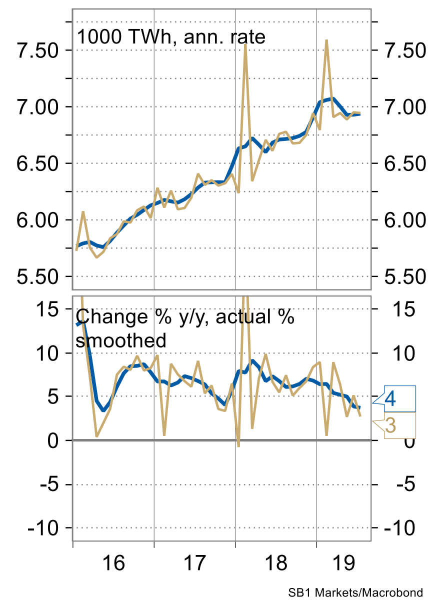


- Production is up some 8% y/y (smoothed, 5% in July, from 12% in June) and demand is expanding a tad faster, (almost) well explained by the strong growth in construction starts. On the other hand, slowing auto production signals softening steel demand from that sector
- China is still a net steel exporter, 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 is slowing?

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

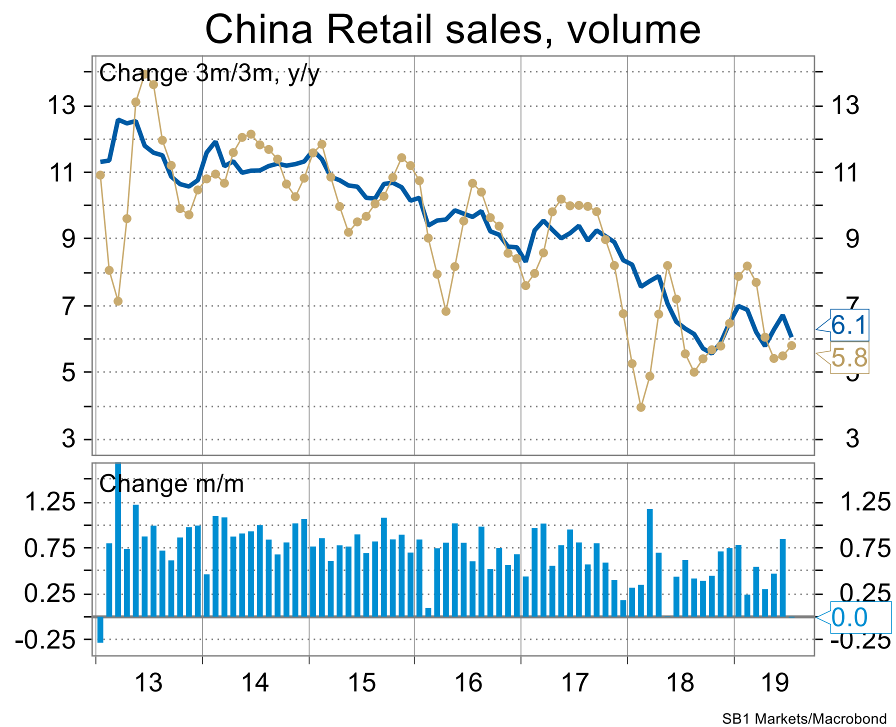




- Transport growth (seaports & railway) has recovered past two months, following a setback earlier in 2019
- The Li Keqiang index, which includes some few real data (among them, electricity production and freight volumes) as a proxy for GDP is reporting 10% growth in July, as in June (and up from 8% in May), well above the 6.2% 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 volume flat in July – and the history revised down

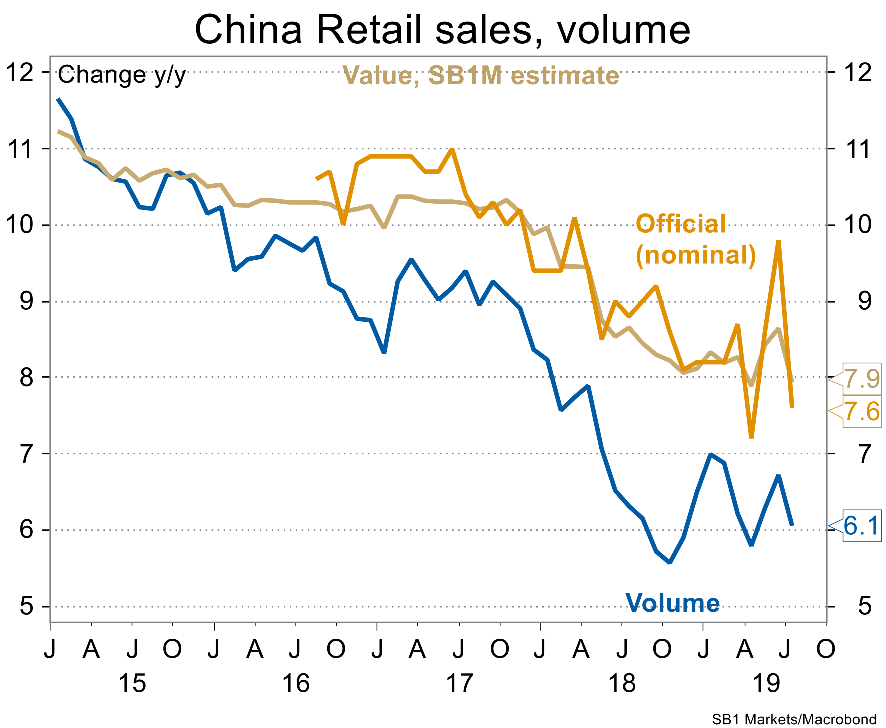
Growth has slowed but not collapsed

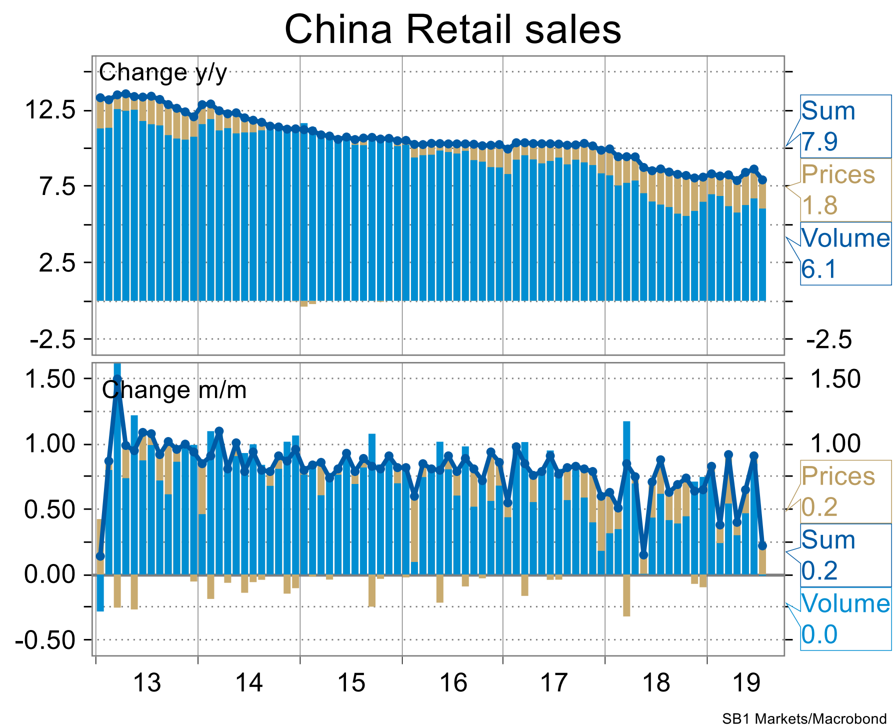


- The official value growth rate fell to 7.6% from in July from 9.8% in June, and well below expectations at 8.6%. Auto sales explained much of the swing from June to July. Our (normally) less volatile value growth estimate (based on monthly seas adj. data) yields 7.9%, from 8.6% in June, revised down from 9.4%! (Last month we had a substantial upward revision – these data are not reliable!)
- Sales rose 0.2% m/m (NBS estimate) and we assume zero volume growth, like in May last year, down from a 0.8% gain in June
  - » The annual volume rate fell to 6.0% from 6.7% in June (revised from 7.7%!). 3m/3m growth has been stable at marginally below 6% recent month, just marginally below the average since early 2018
- Consumer confidence surveys is very high and do not point to any demand weakness. 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

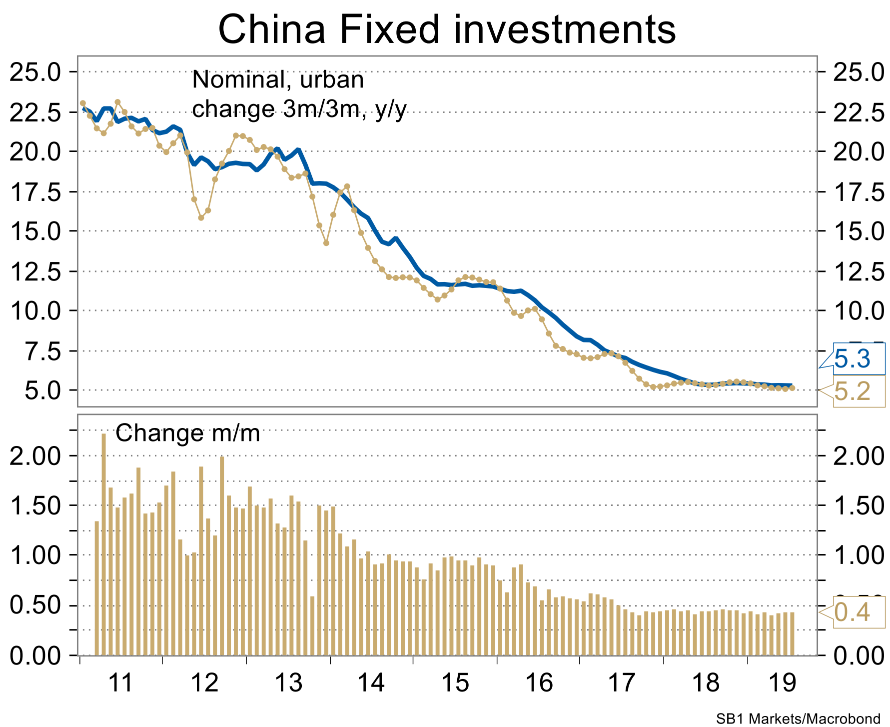




- Retail prices are up just 1.8% y/y, while the total CPI is up 2.7%. The discrepancy is not due to services, and the low retail price inflation does not seem that reasonable as foods prices are soaring. Thus, the ‘real’ real growth may be lower than our estimate

Nominal investments are growing steadily, according to monthly stats

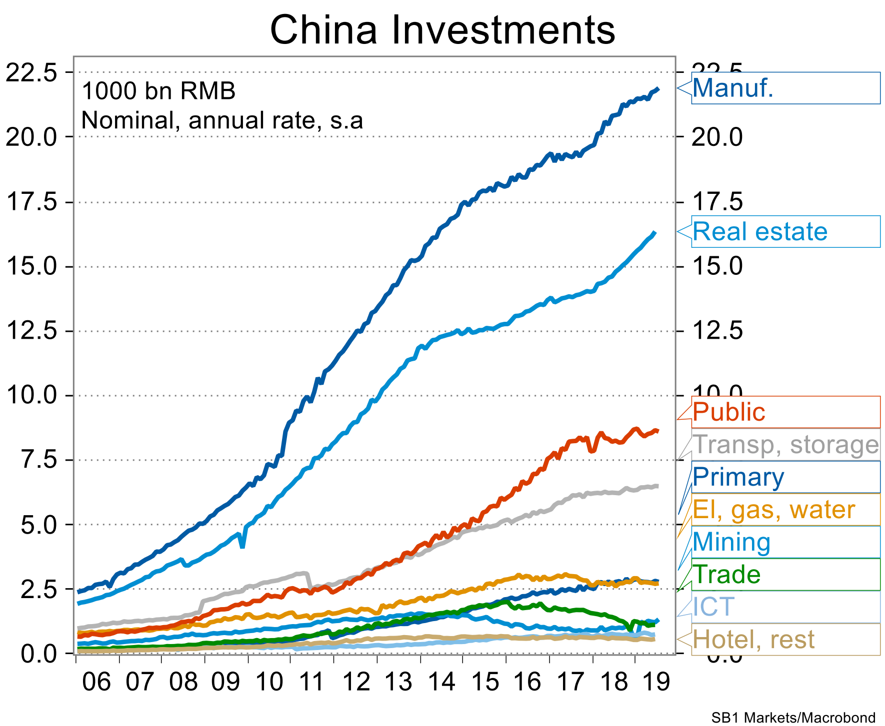
The long term decline in investment growth has halted, at a comfortable, low level

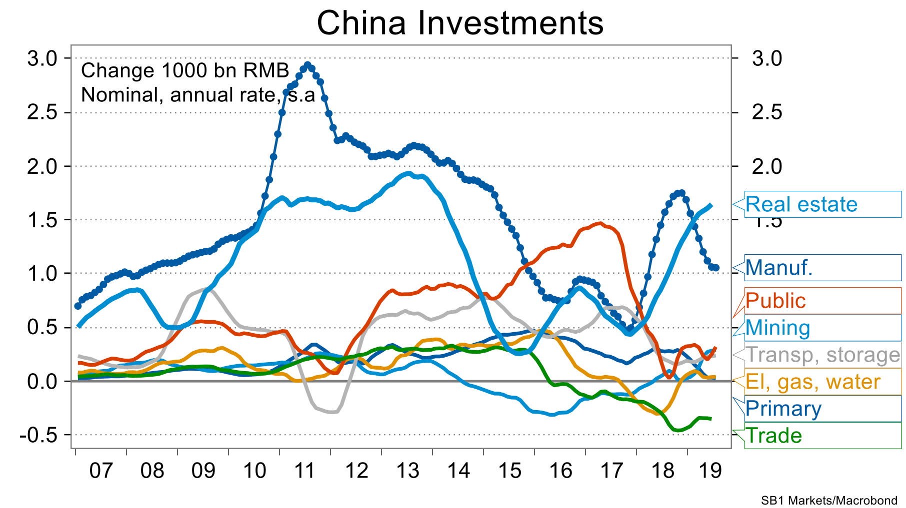


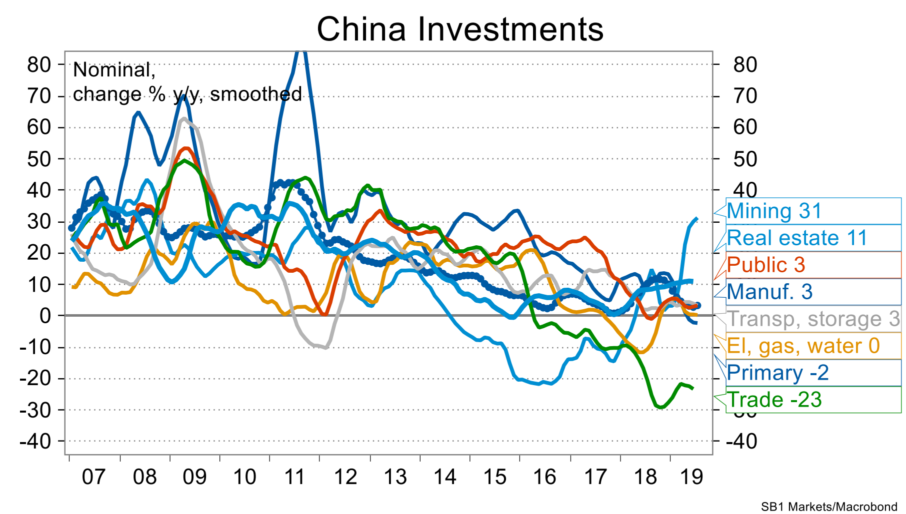
- Urban investments rose 5.7% y/y ytd in June, according to the official data, down from 5.8% in May, expected up to 5.9%. Our calculation yields a 5.3% y/y growth, stable recent months. The m/m rate was stable at 0.4%. Growth has been stable since late 2017. In real terms, we assume growth has accelerated, to 4% from 2% (as our aggregate of Chinese price indices have slowed somewhat)
- 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 (measured this way) has been on a steady downward path, from 25-30% before 2009 – but it has now stabilised, well below nominal GDP or income growth

Investments are still expanding in most sectors in spite of trade war concerns

Retail trade inv. down 23%, may have bottomed, primary flat. Others as still growing





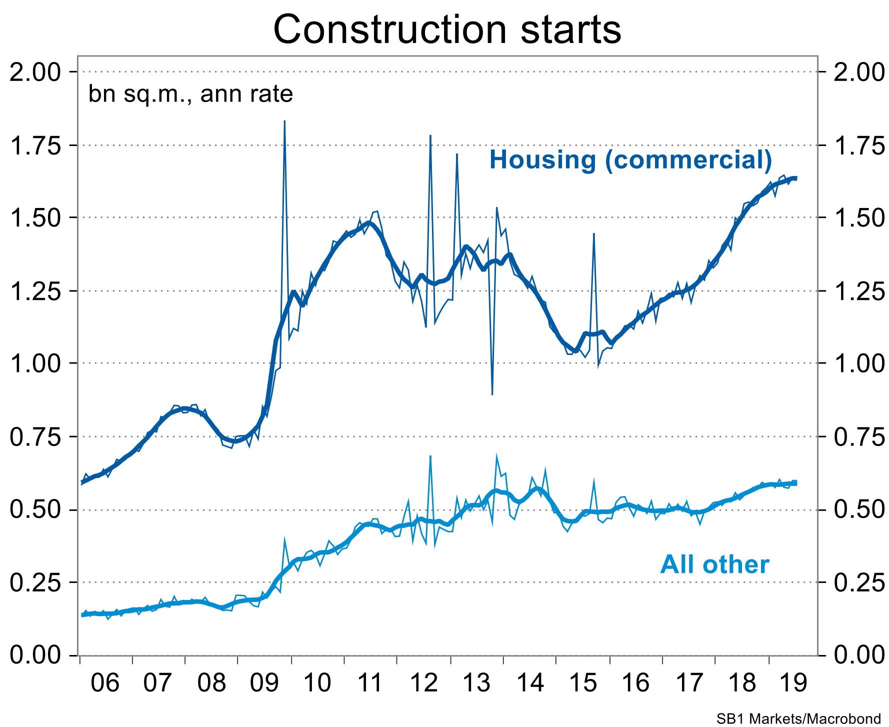


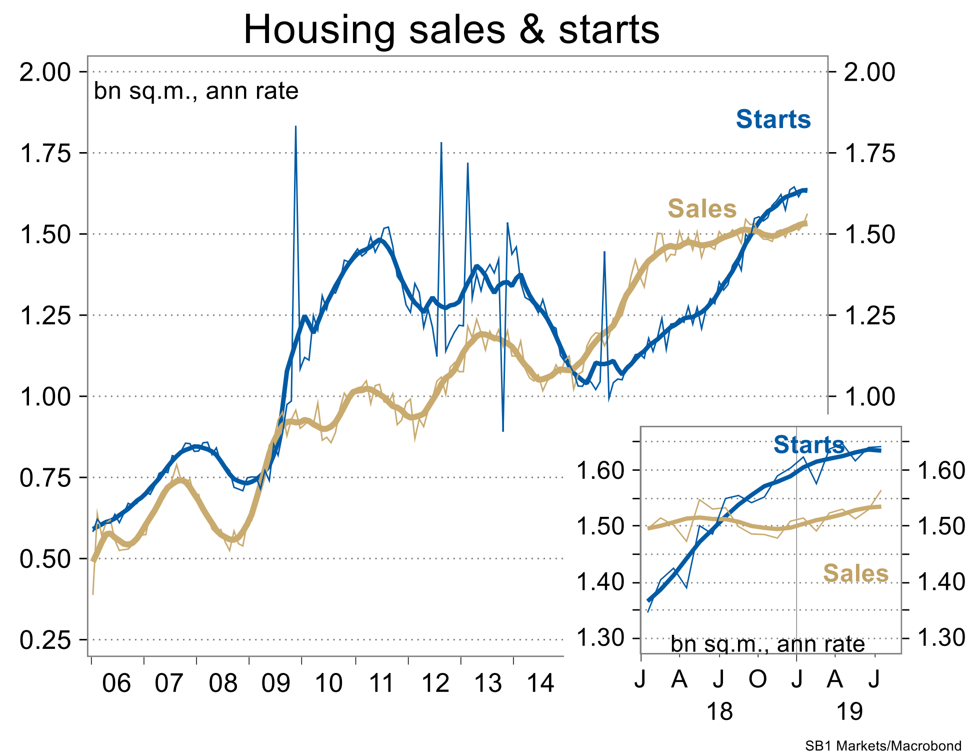
- Manufacturing investments are still on the way up but just 3% y/y
- Weak retail sales through 2018 probably brought investments in trade sharply down. Signs of stabilising now
- Real estate investments are now the main growth engine, up 11% y/y
- Public sector investments have slowed past 2 years, as have investments in transport. **No signs yet of the great fiscal stimulus**

Not all sectors have reported data for the last month

New home sales up in July; starts are flattening out

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

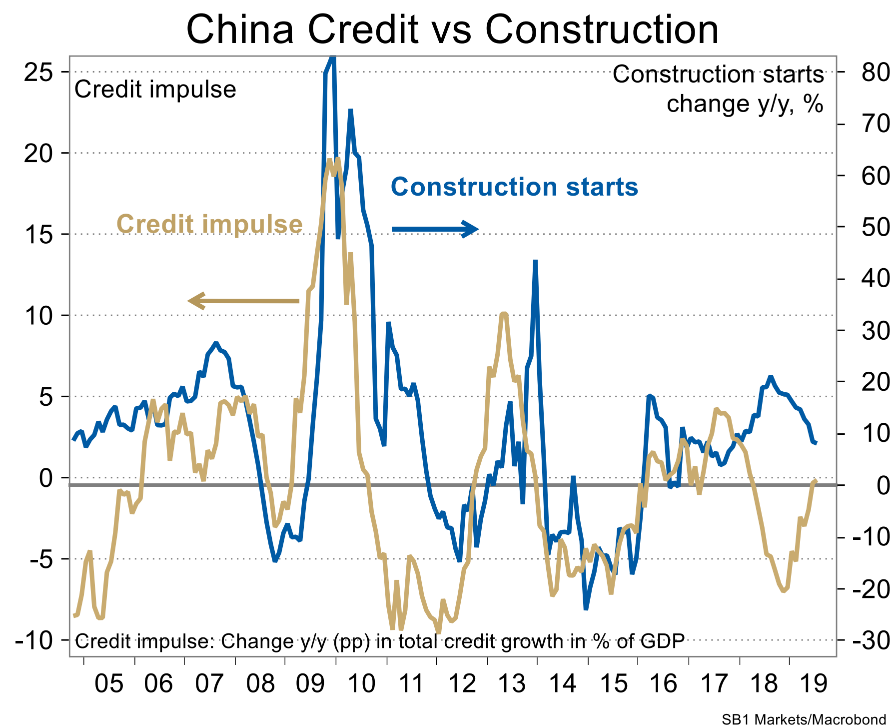




- Sales of new homes have flattened out over the past couple of years, at a record high level. Sales rose in July, to the highest level ever
- Housings starts are running higher than sales, still trending up but slower and starts were flat in July. Even if sales are below starts – implying an increasing inventory – we are not that worried, given the large inventory drawdown from 2014 – 2018. Still starts are record high, are up more than 50% from the 2015 trough, and are up 8% y/y (smoothed) – and are now slowing. The downside risk is still there
- Other construction starts have been flattening since late 2018 but rose in July, and are still up 10% y/y (down from 20% in late 2018). These starts have reached a new ATH too, although the level is not that much higher than 5 years ago. The cycles in non residential construction have been and still is very close to the cycle in housing construction

Credit and construction usually correlated but not recently

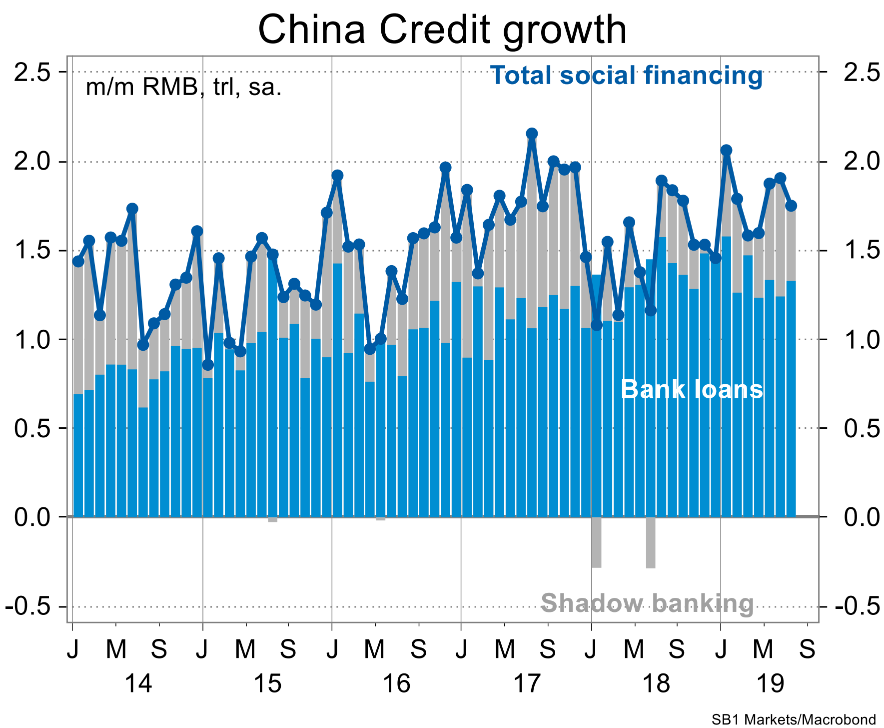
Credit is not contracting anymore but growth in construction is slowing

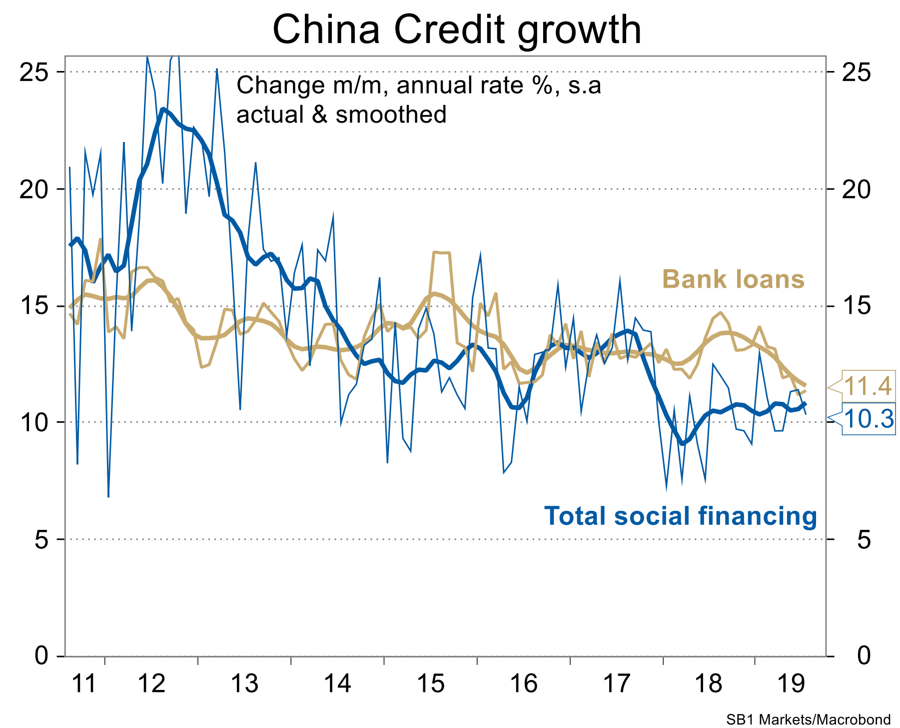


- During 2017/18 credit was tightened but construction activity accelerated – not the usual response

Credit growth cooled in July, trending flat the past year (but no more tightening)

Credit growth through banks is slowing visibly, shadow banking has picked up the slack (fell in July)

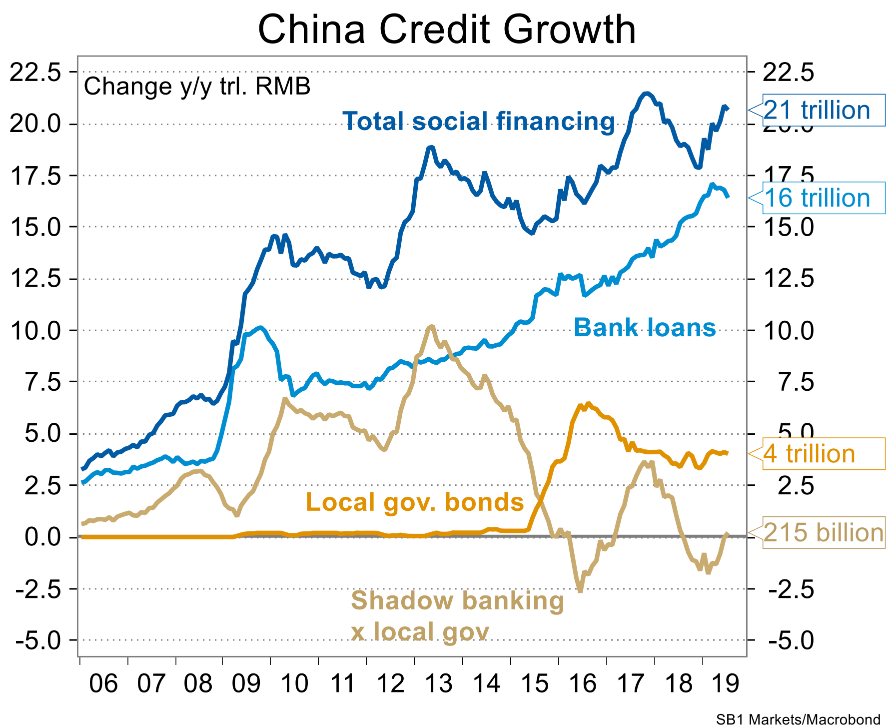


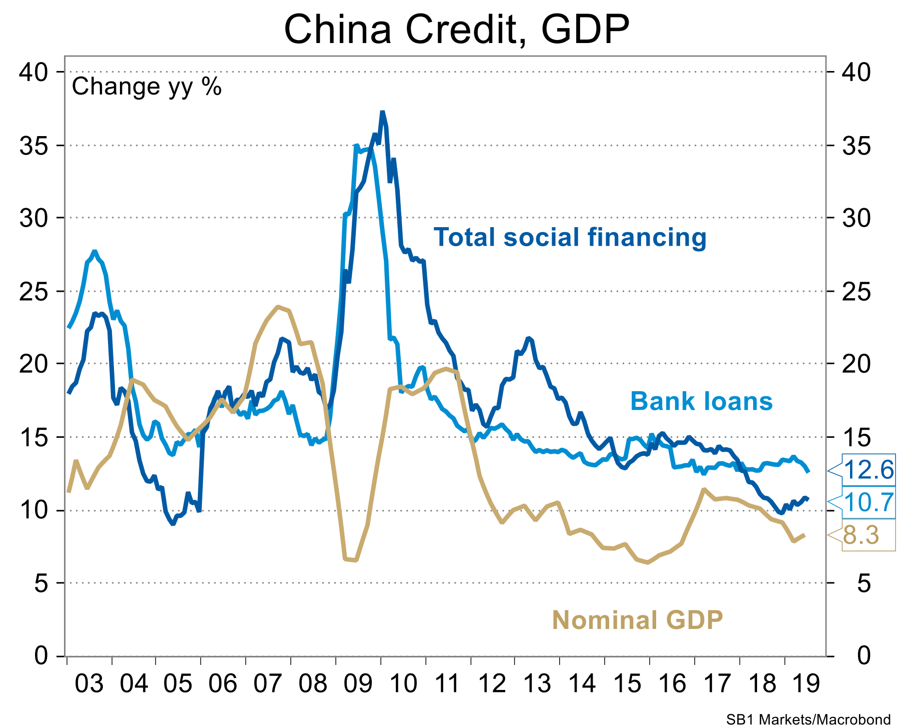


- Total credit rose by 10.3% m/m annualised in July, down from 11.4% in June. However, media reported a more dramatic slowdown as the unadjusted (thus, more or less useless) total credit m/m growth was weaker than expected, at RMB 0.9 trl vs. expectations of 1.6 trl. The underlying growth trend over the past year is flat to up. Total credit is up 10.7% y/y (from 10.9% in June) climbing slowly since January 2018. Credit growth is above the reported 8% nominal GDP growth
- In 2017, 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, and the credit impulse is finally neutral – even if banks are slowing down
- 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

Banks are slowing somewhat, while the shadow banking market fills the void

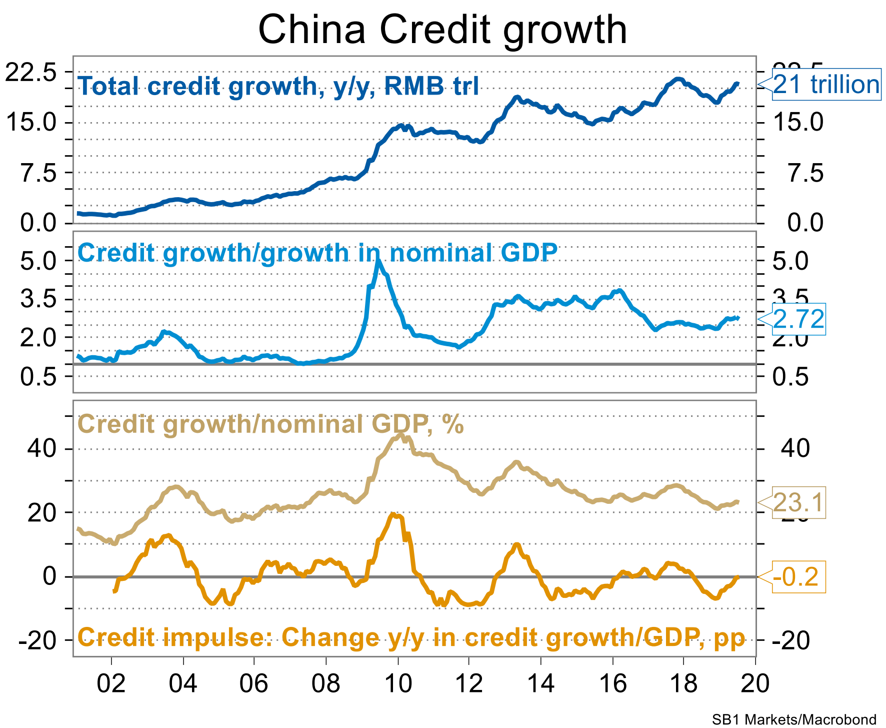


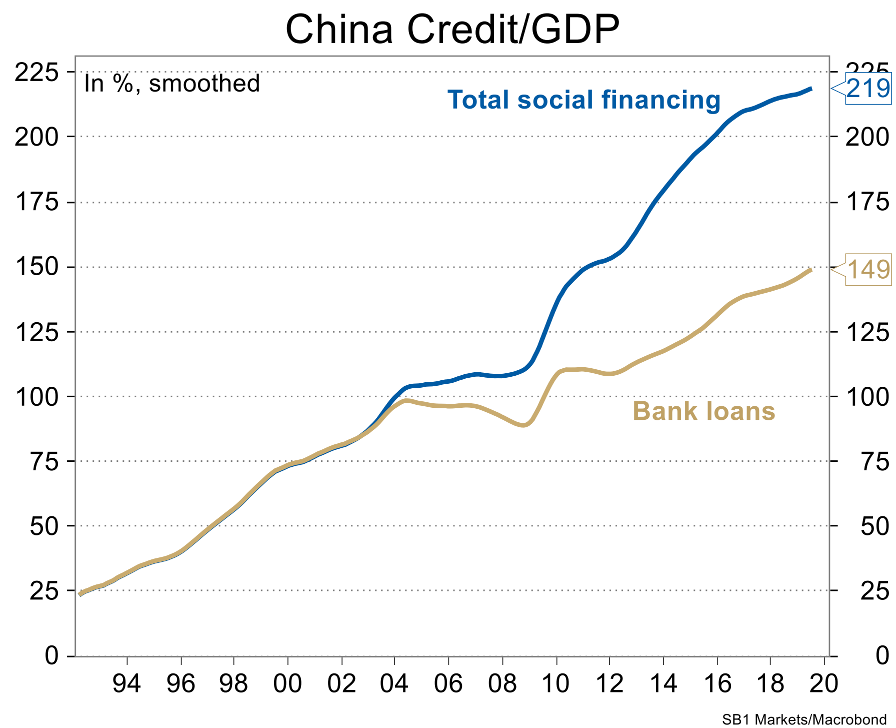


- Over the past 12 months, total credit has grown by CNY 21 trl, equalling 23% of GDP. The annual rate bottomed out in Dec
- Banks supplied CNY 16 trl, 80% of the increased credit volume
- Local governments borrowed CNY 4 trl in the bond market
- Other credit – via the shadow credit market x gov bonds – are flat y/y, from a negative drag over the previous year
- Total credit growth at 10.7% is well above growth in nominal GDP growth at 8.3%, and debt/income is still on the way up

Credit impulse back to neutral, from negative

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

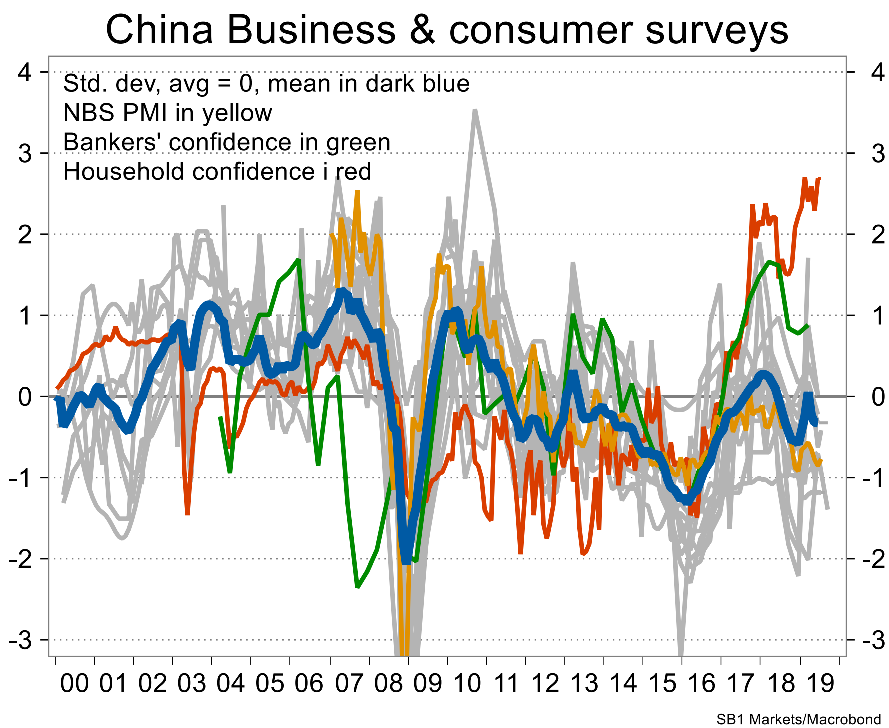


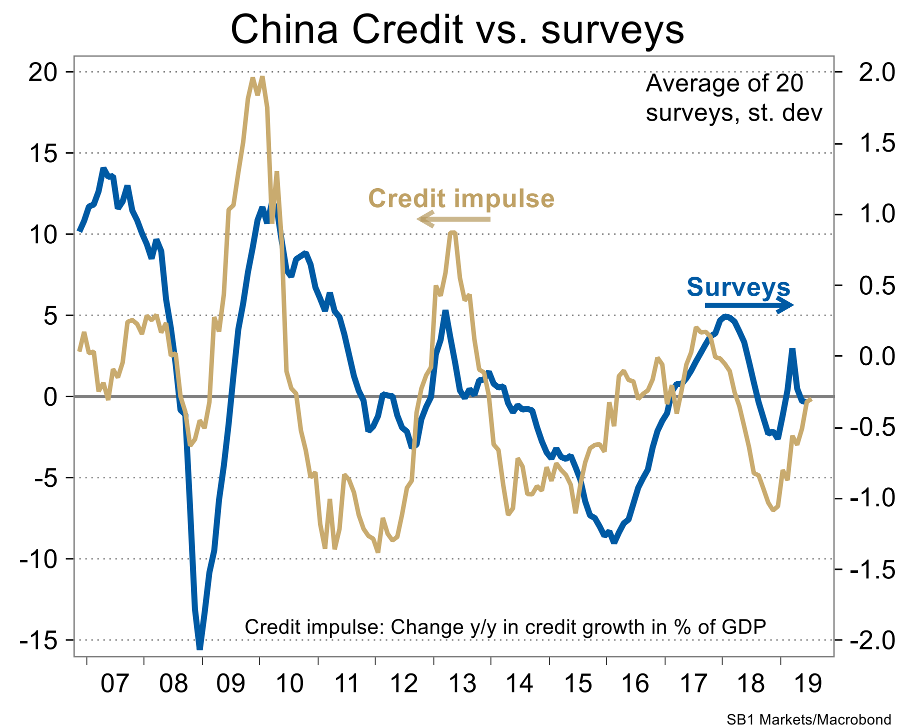


- A negative credit impulse implies that the credit growth/GDP ratio is declining (the 2nd derivative)
  - » Indicates credit tightening (or weaker demand)
  - » Has been associated with slowdowns in the Chinese economy
  - » Now, the credit impulse is has risen to neutral measured y/y (the 3rd derivative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

Now, credit has turned neutral and can't be blamed if growth should slow further

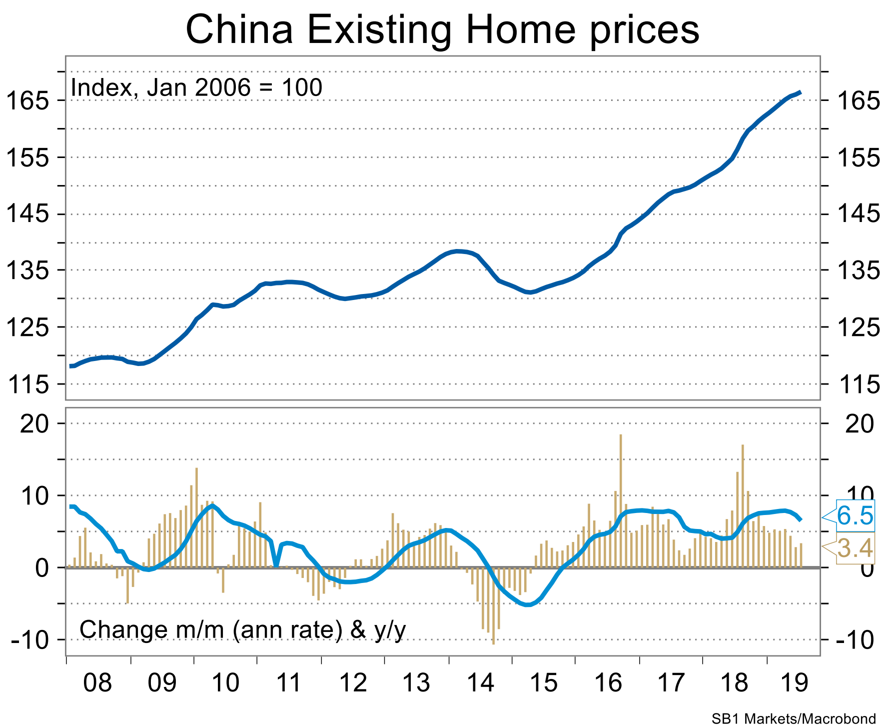


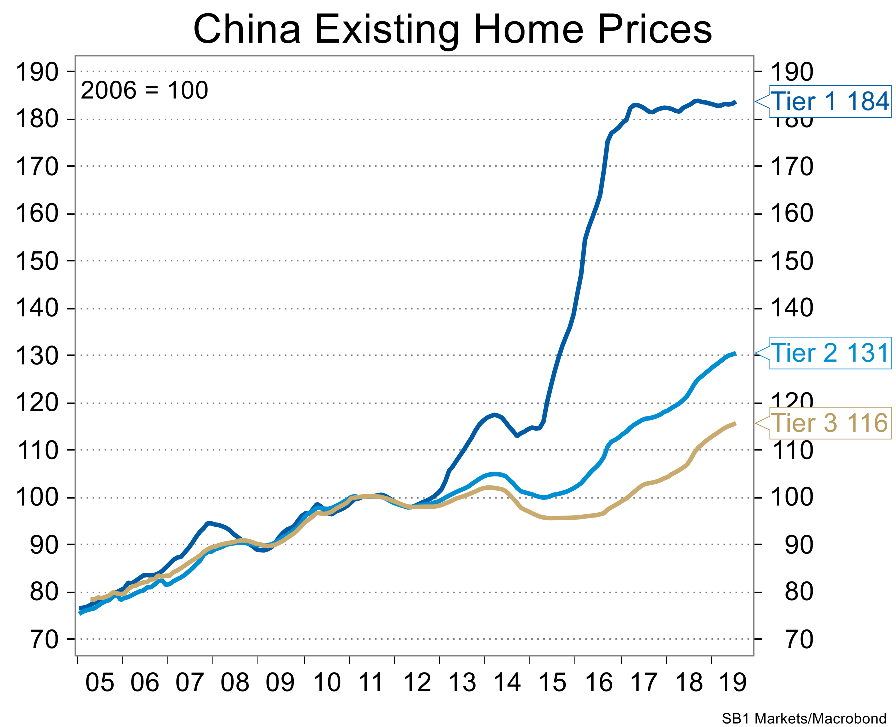


- An avg of Chinese business & consumer surveys indicates that growth has slowed, however, the level is still at an historical average and above the 2018 level (and it was weaker in 2014-2016 and 2012)

House price inflation slowing but not further in July

The annualised m/m rate up to 3.4% in July, the annual rate ticked down to 6.5%

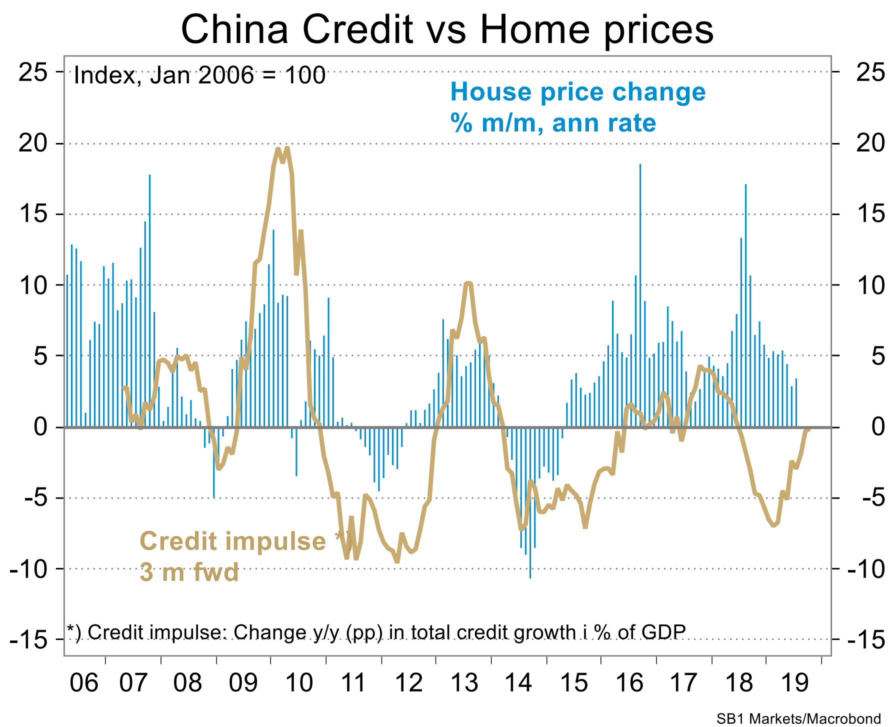


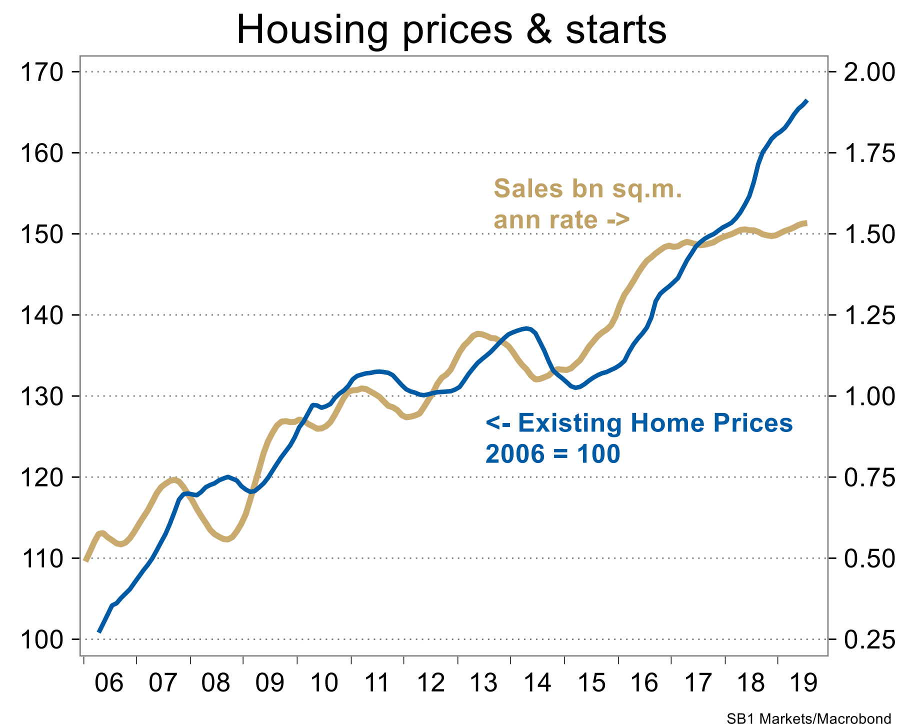


- The annual growth rate came down 0.8 pp to 6.5% in July. Monthly price inflation was 3.4% annualised, and has slowed gradually since last summer. The decline in the annual rate is due to high monthly price increases last summer, and has been 'announced' long time ago, as monthly growth rates have slowed ever since. In July, prices rose a tad faster than in June, at 3.4% (annualised). No doubt, the annual growth rate will fall sharply the coming months
  - » Prices in the four tier 1 cites have remained more or less flat since early 2017 (following a 60% lift past 2 years), prices in the 'smaller' cities are still on the way up, but at a slower pace
  - » SouFun has reported an uptick in m/m rate to some 4% in July
- The credit (impulse) contraction in 2017 and into 2018 was most likely the main reason for the mild downshift in late 2018. Now, the authorities are (trying to) stimulate credit growth, will support price growth?

The 2018 credit slowdown did not take house prices down, just slowed them…

… and house prices do not signal lower new home sales/starts

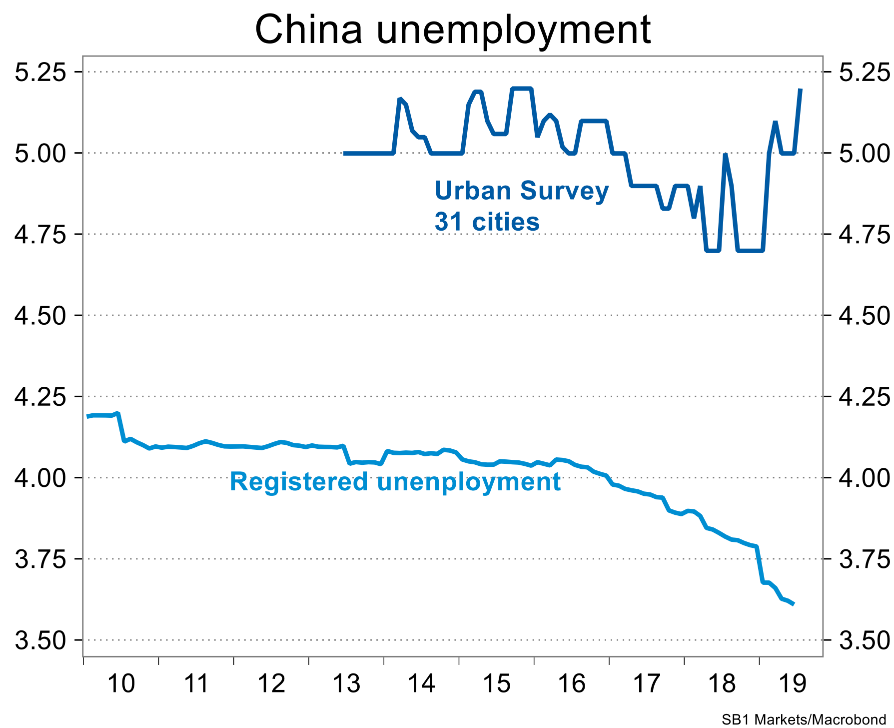




- So far, prices have kept up better than usual, even as the credit impulse has been negative since early 2018
- That's the case with new homes sales too – sales are still trending slowly up
- Now, the authorities are pushing the credit accelerator again – and they may succeed, as many times before, at least the credit impulse have turned neutral

Is the labour market slowing? Unemployment up 0.5 pp past 6 months

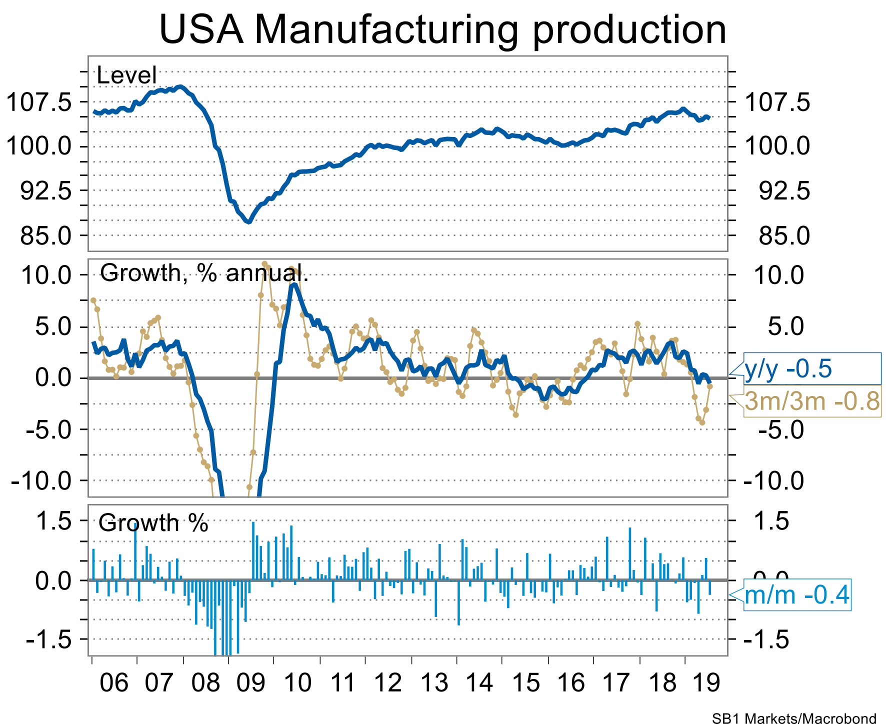
Employment growth may be slowing somewhat but just slowly. Unempl. 0.2 pp to 5.2% in July

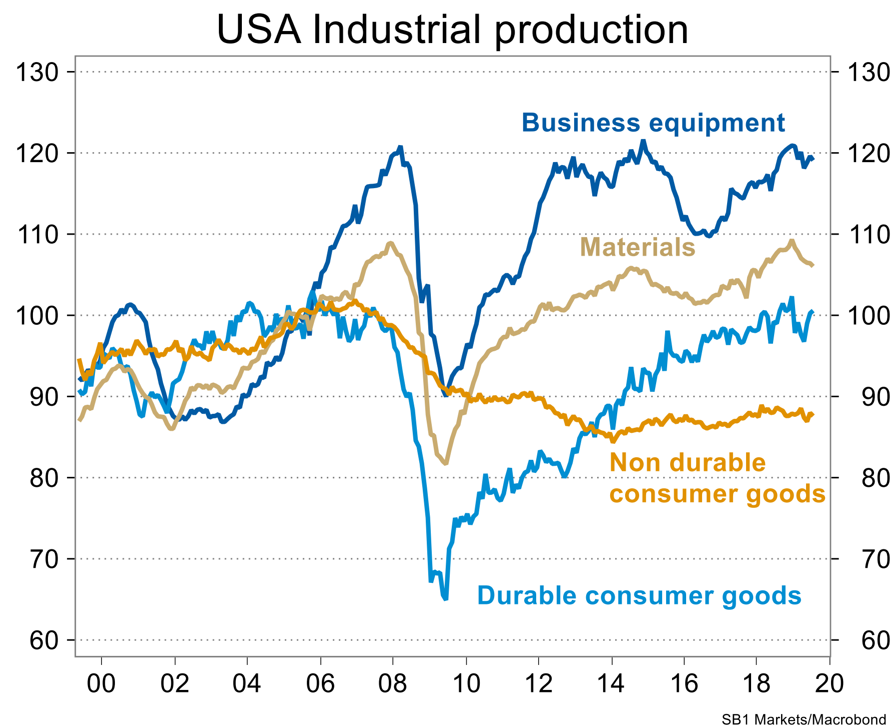


- Chinese labour market data are perhaps even less reliable than other statistics – but we present them here
  - » Monthly employment growth data are strangely stable, check the narrow scale

Manufacturing production down again in July

Production down 0.4% m/m, 0.1 pp more than expected, but recent months not a disaster

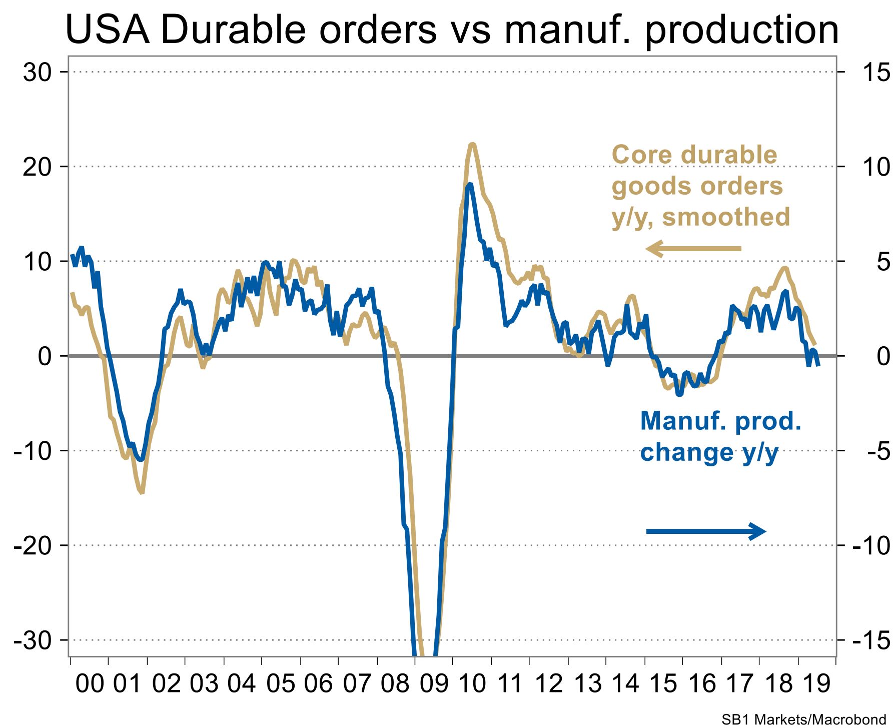


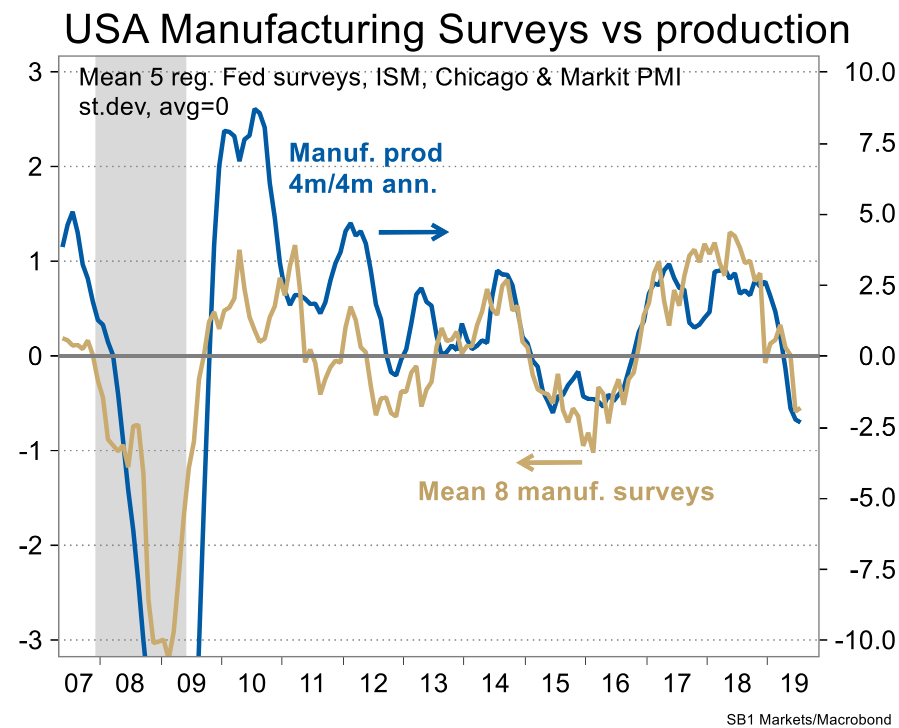


- Manufacturing production fell 0.4% m/m in July, following the 0.5% lift in June (revised from 0.4%). Production fell by a 3.1% pace in Q2 but even if production fell in July, Q3 is heading for a far better print. Still, production has fallen 1.6% from the peak in Dec '18
  - » Total industrial production including energy & mining fell 0.2%
  - » Production of business equipment has fallen, but durable consumer goods have also been weaker (however, recovering this summer)
  - » Materials fell further in July and the slowdown has just slowed marginally
- The first August surveys? Check two pages forward!

Orders, surveys have told you so

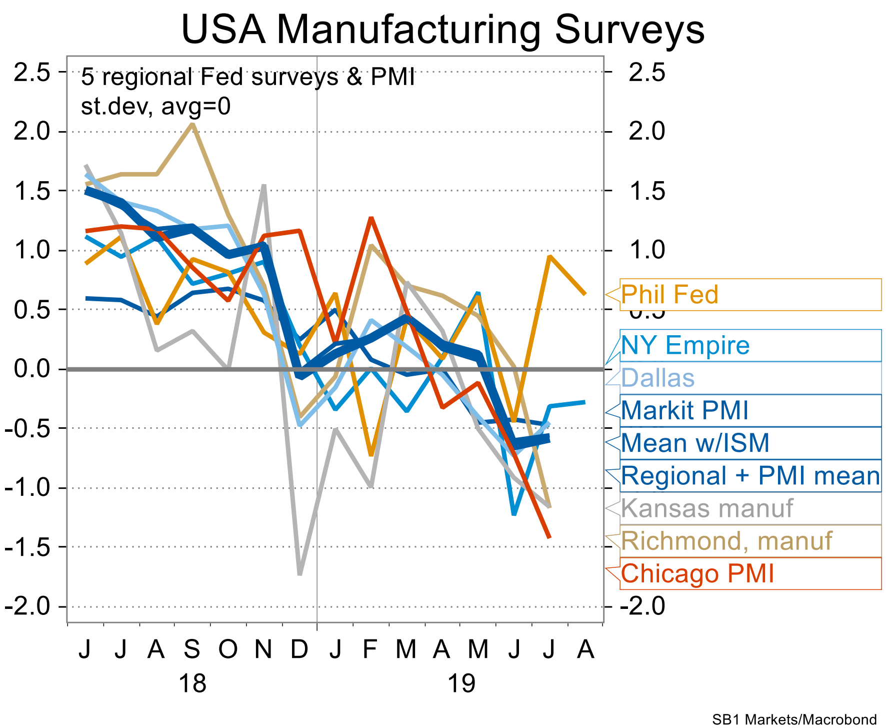
An average of surveys signals a continued decline in production

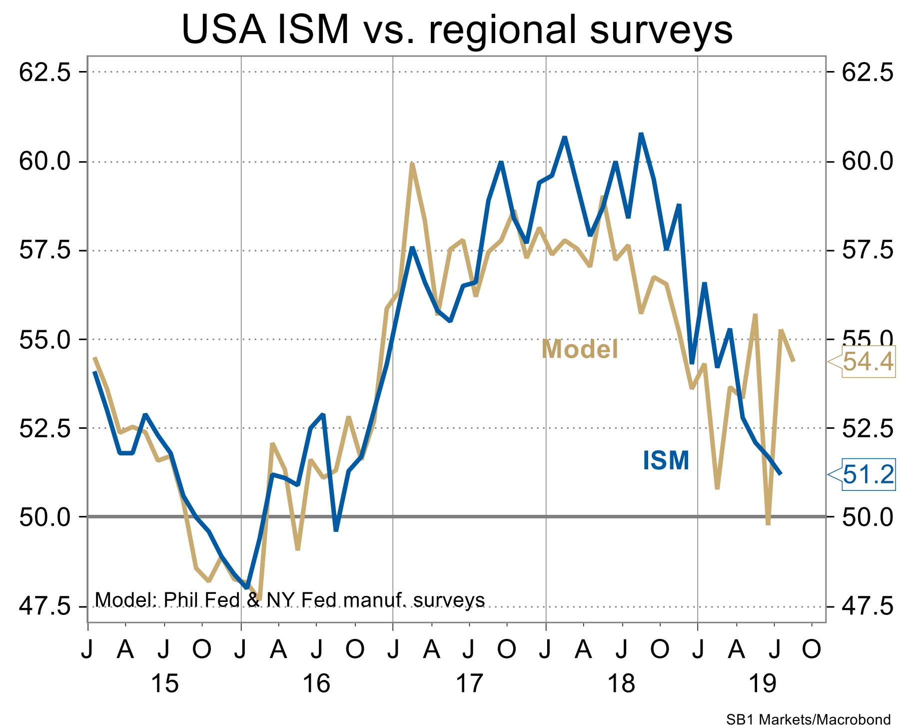




The first August manufacturing surveys close to stable, better than expected

Phil Fed did not lose too much after the (strange) July hike, and NY Fed survey marginally up

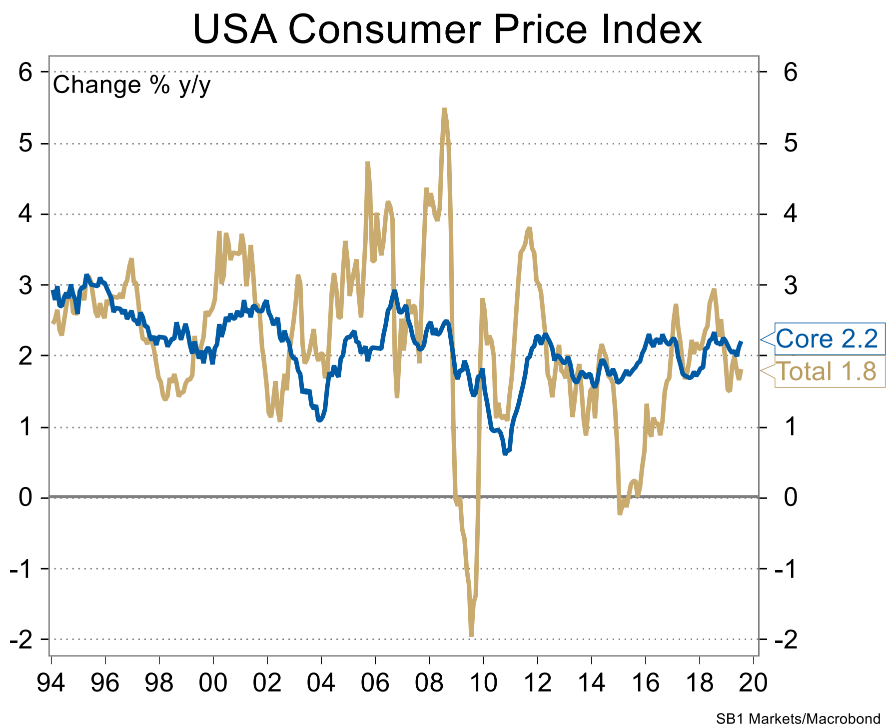


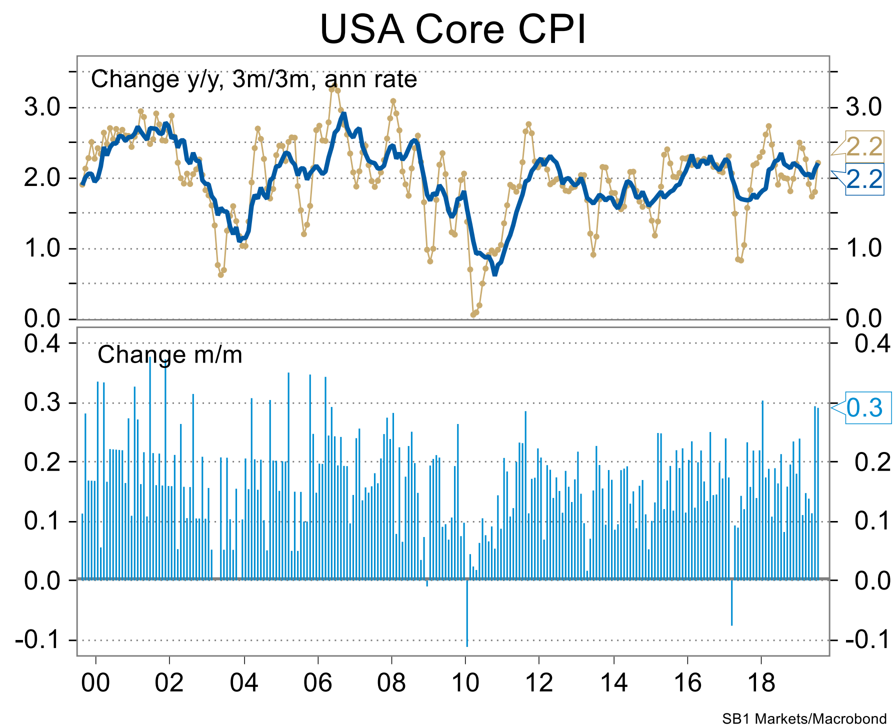


- Both indices were expected down in August, probably partly because were stronger than other surveys in July
- The regional manufacturing surveys from NY & Phil Fed have been rather volatile recently and they have correlated less with other surveys (like the ISM) than normal. In July the two surveys surged but nobody else did. Thus, these August data points have limited value

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

Core CPI rose 0.3 % in July too, the annual rate up 0.1 pp to 2.2%

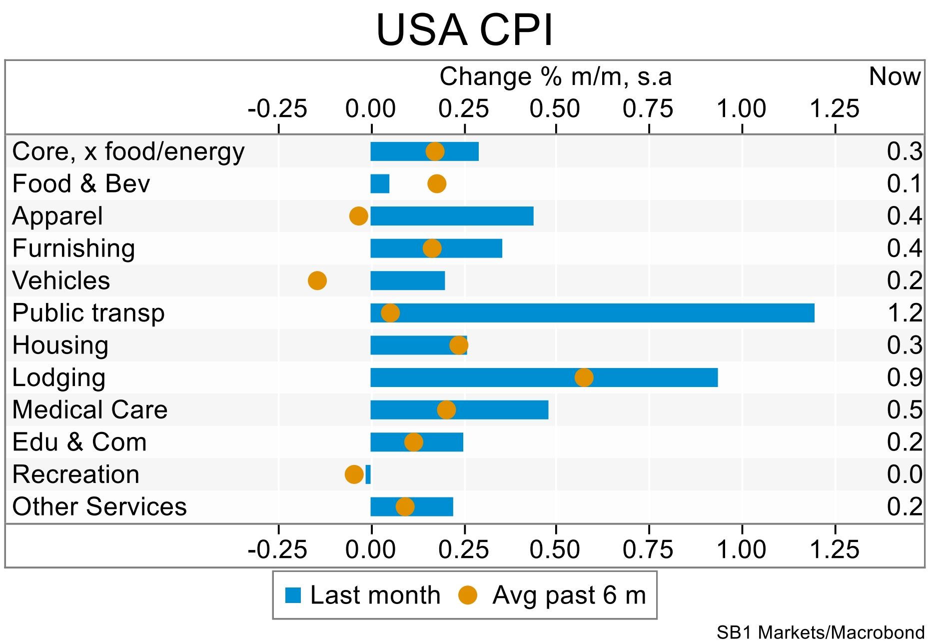


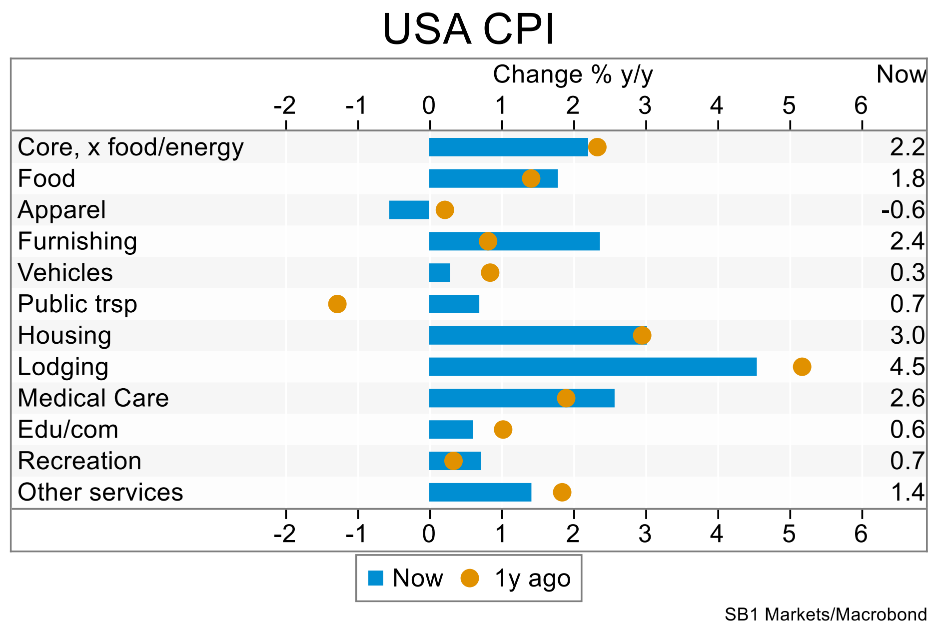


- 'We all know' that inflation has surprised on the downside and is below target – and that the Fed has to cut rates. Fed preferred price measure, the core PCE (the consumption deflator in the Nat. Accounts) was up 1.6% y/y in June, and is below Fed's 2 % price target
- However, the core CPI accelerated further to 2.2% in July (expected unch) after a 0.3% lift m/m. The PCE deflator probably accelerated to 1.7% in July, still below Fed's target. The shortfall vs the target is not large
- Headline inflation ticked up 0.1 pp to 1.8%

Public transport, lodging contributed most on the upside in July

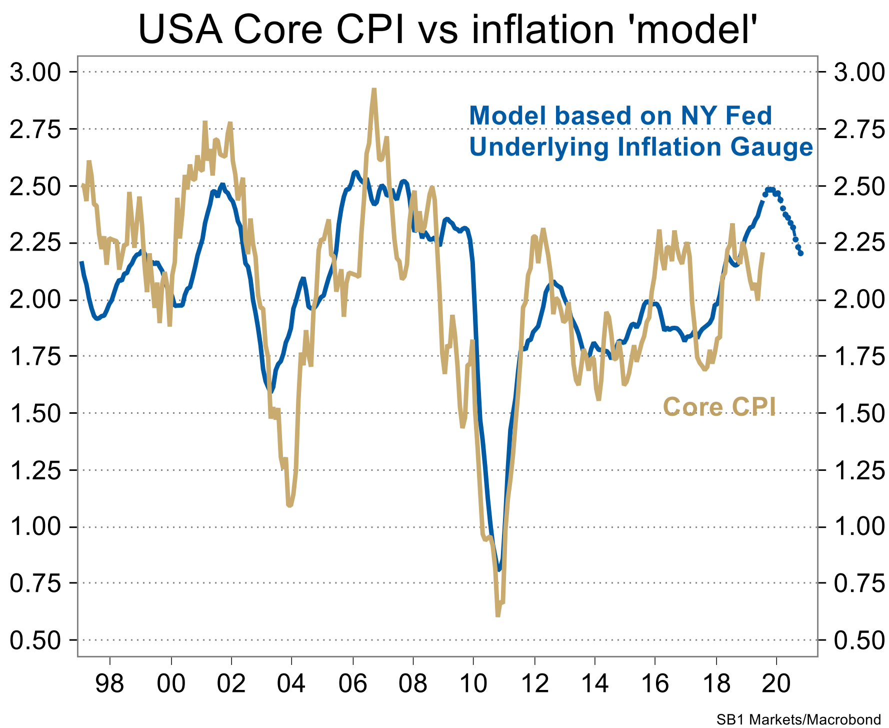
Just apparel prices are down y/y

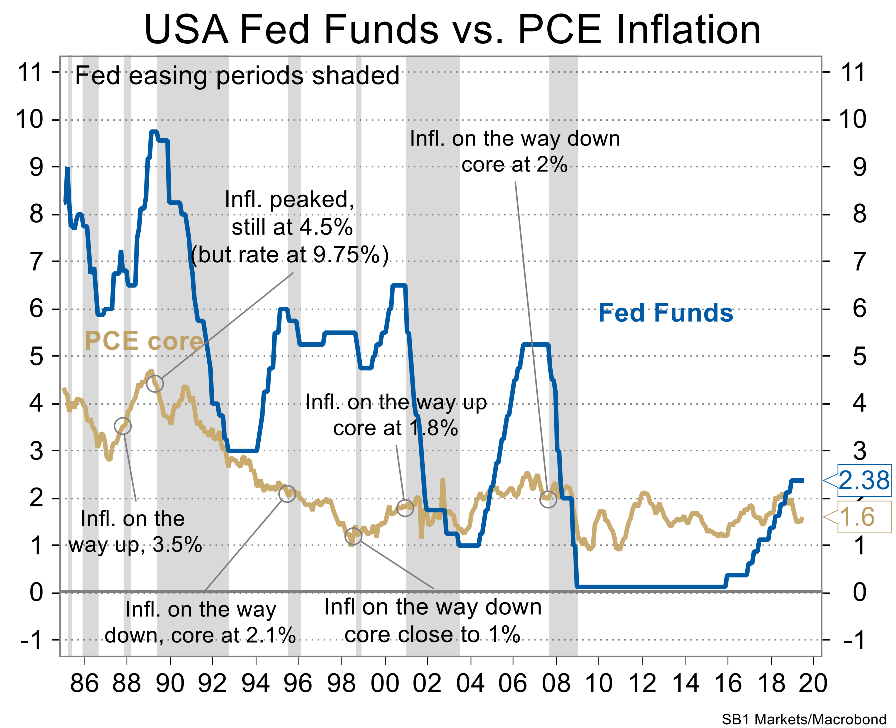




- Higher prices in housing (rents & services), food and medical care are boosting annual inflation

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

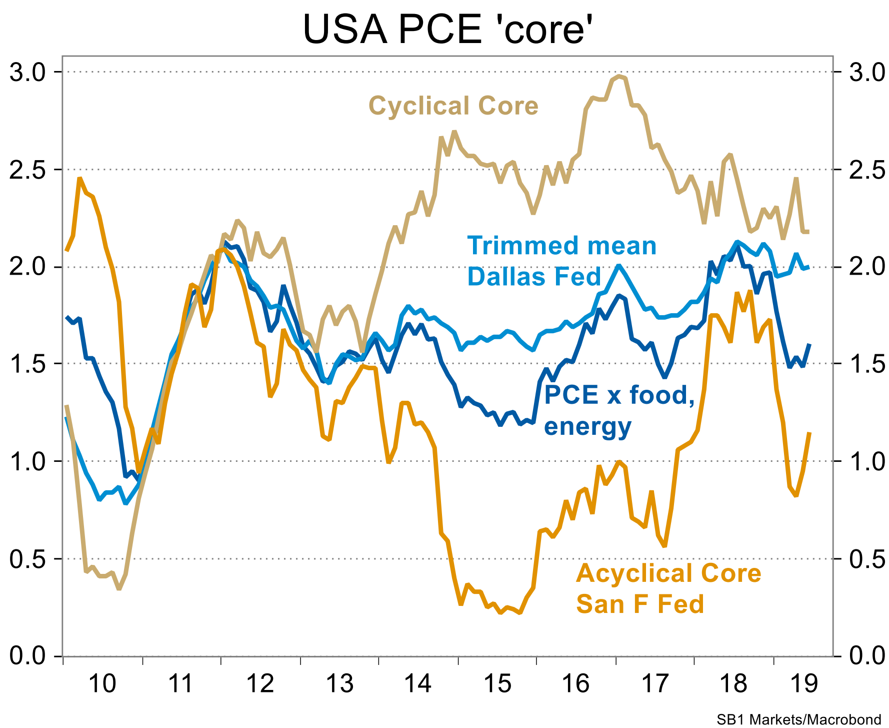


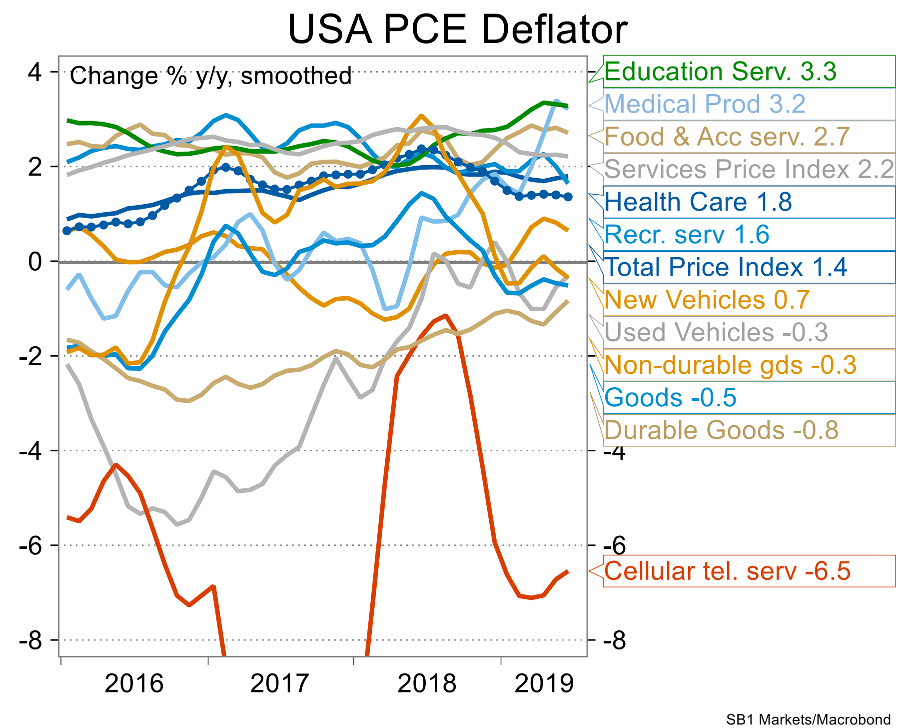


- The NY Fed's Underlying Inflation Gauge model includes a wide range of macroeconomic and financial components in addition to some CPI components. The UIG model leads the actual inflation rate by some 15 – 20 months. The model now signals somewhat lower inflation than it did some months ago (lower energy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

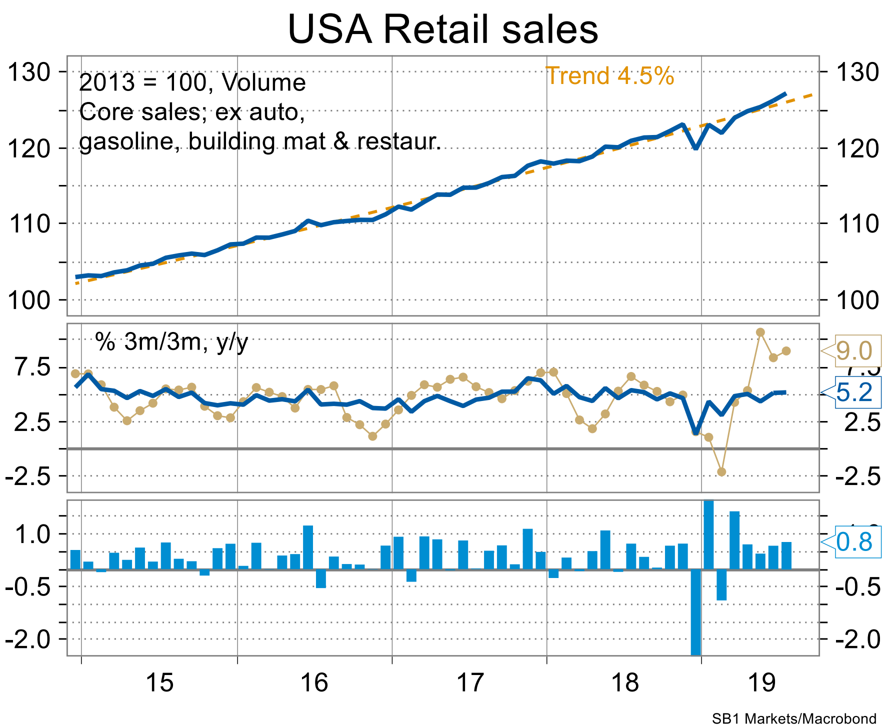


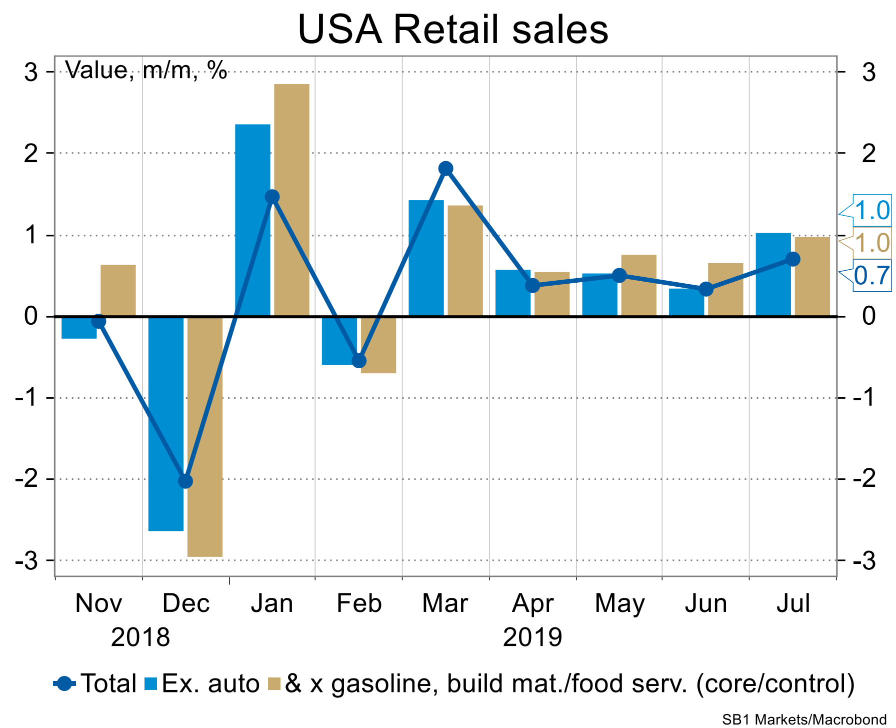


- Cell phone services are dragging prices down
- However, price pressure in production chains are easing somewhat, check the next slide

Full speed ahead, retail sales are really strong!

Core sales volume rose 0.8% in July, and are up 9% 3m/3m

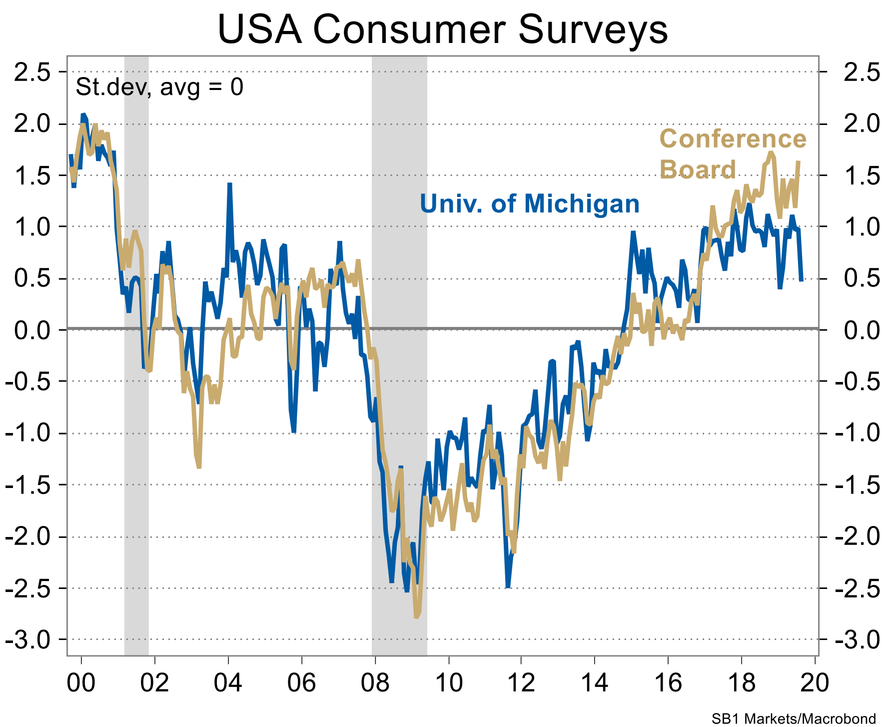


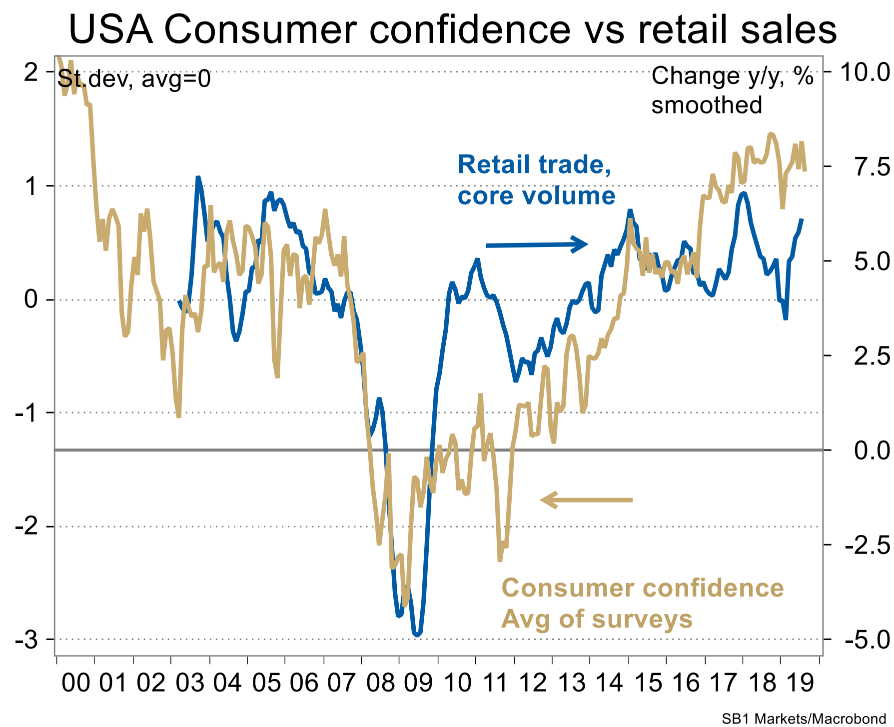


- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by 1% m/m in nominal terms in July, 0.5 pp above expectations, following the 0.7% growth in June, remarkably strong
- We estimate a 0.8% m/m volume growth in core sales, up from the 0.7% lift in June. Growth recent months have been strong, up 9% measured 3m/3m annualized (with a weak February included in the calculus, but impressive without too, 8% 2m/2m)
  - » Consumer confidence is still strong while income growth has slowed somewhat but not much

Univ. of Michigan consumer sentiment dived in early August

The trade war escalation, recession worries and stock market turbulence sent confidence down

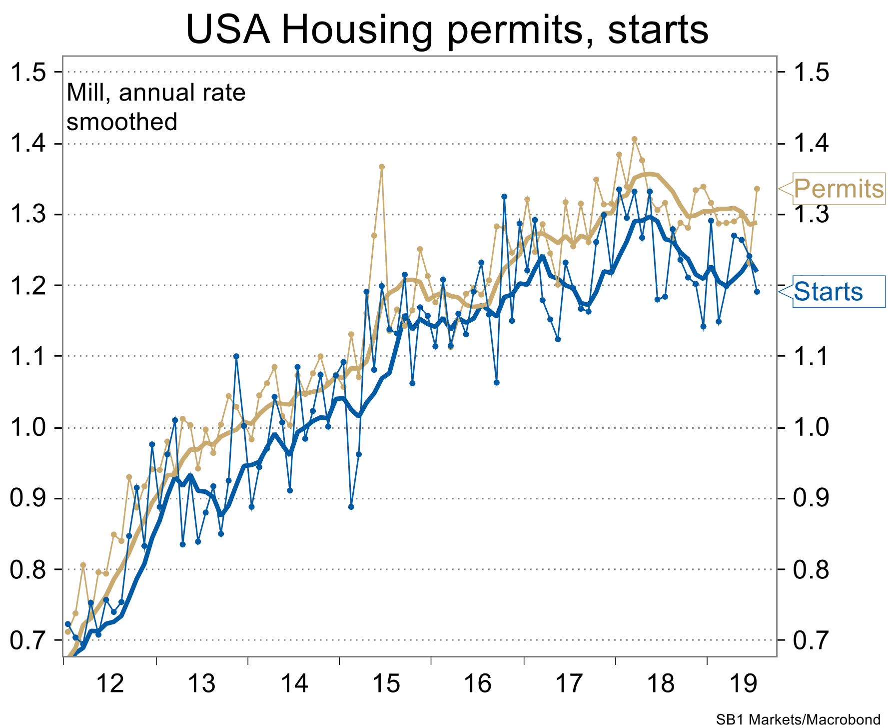


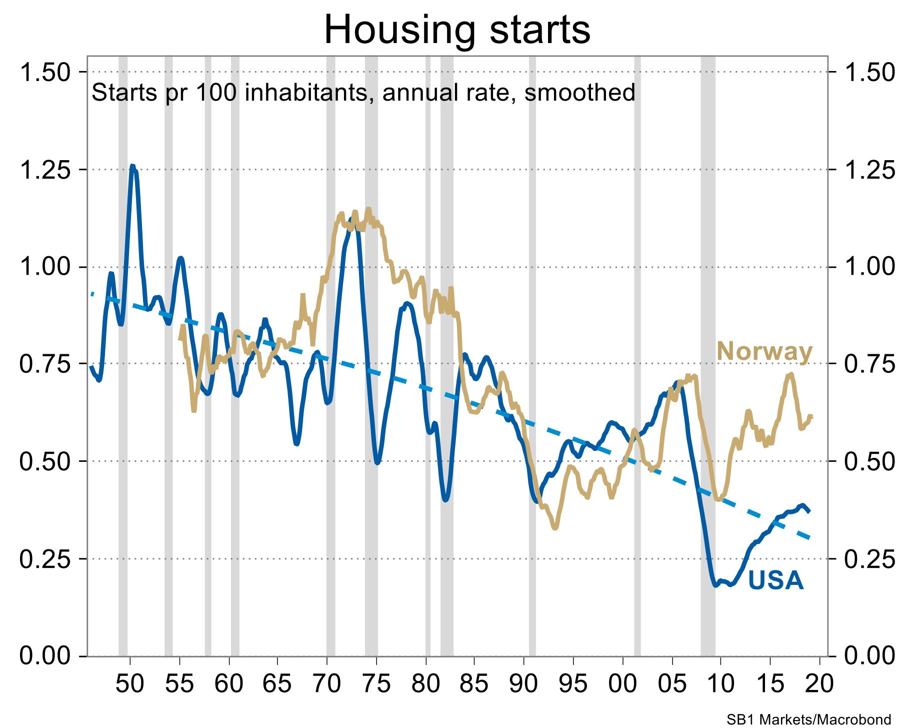


- The sentiment index delivered the steepest monthly drop since January. The 6 p decline was much weaker than the modest 1 p decline which was expected. The level is marginally higher than the local January bottom
  - » The expectations index fell much more than the view of the current situation, understandably. Respondents highlighted the escalating trade dispute and fears of a potential US recession. Turbulence in financial markets probably did not help, either
  - » At least we cannot say that the first Fed cut in late July lifted the sentiment more than other things that has happened the past two weeks

Housing permits spiked in July, reversing the June slip

The June weakness probably a one-off, permits jumped in July. Still, trend not more than flat

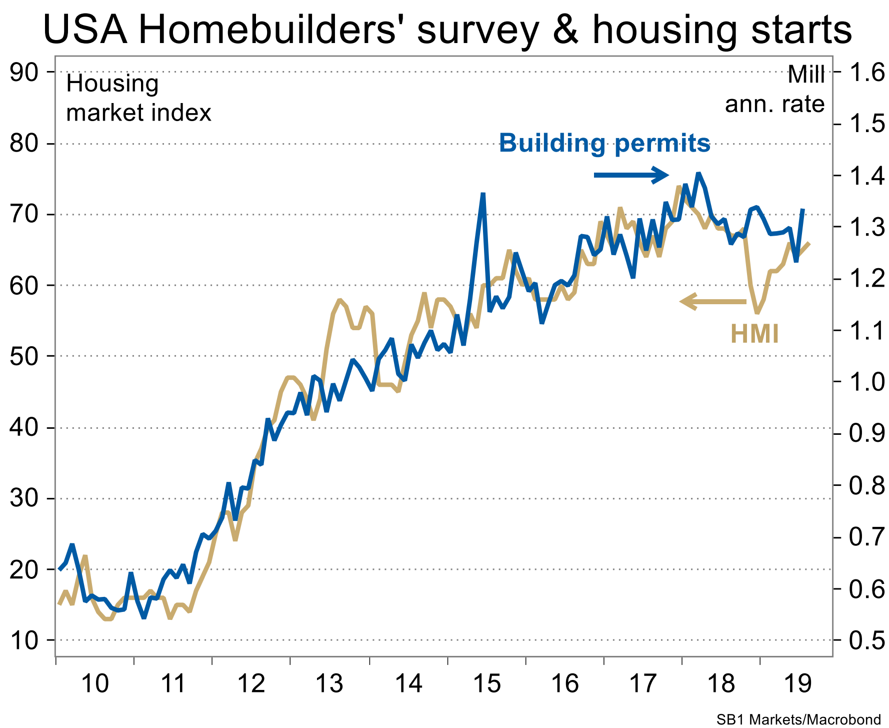


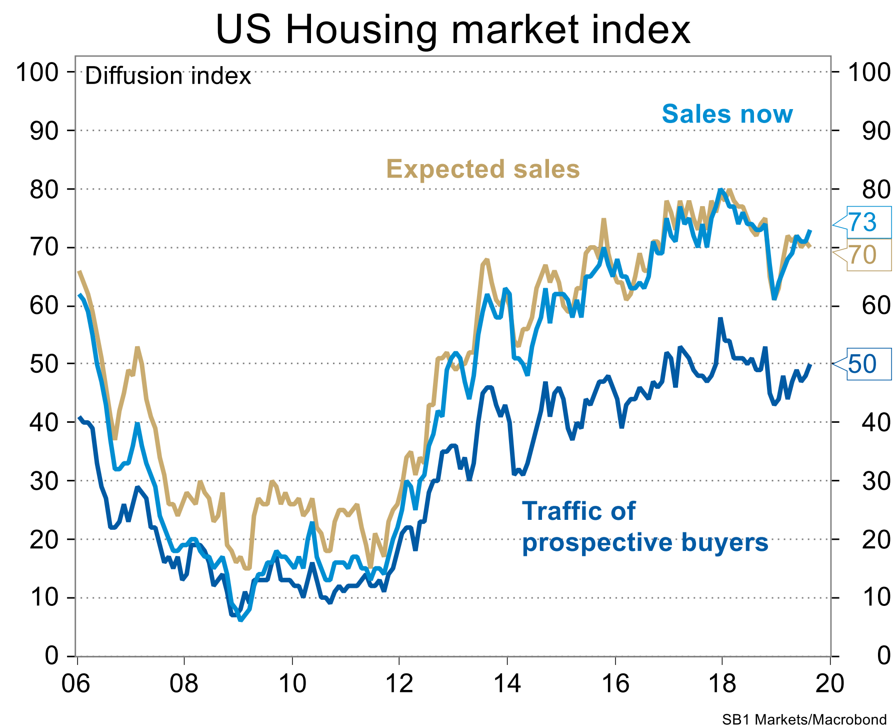


- Housing starts fell 4% m/m in July, to 1.191 mill (annual rate) vs expectations at 1.260 mill
- Housing permits jumped 8.4% m/m, the highest monthly rise in 2 years, following a 5% dip in June. The annual rate at 1.336 mill is the highest in 6 months. Strange, housing permits are usually less volatile than actual starts, thus, a more useful gauge of the activity in the sector than actual starts. Regardless, the July print signals that the weakness in June was a one off, and that permits have stabilised at some 1.3 mill since late '18
- Housing starts/permits are trending flat since last autumn, coincident with the soft recovery the homebuilders' sentiment have been reporting. Moreover, the level of housing starts is quite low, and the home construction downside is not large compared to the fall in 2006-09

Homebuilders' confidence further up in August, still below the 2017 peak

The HMI rose another tick in Aug but is not signaling higher building activity



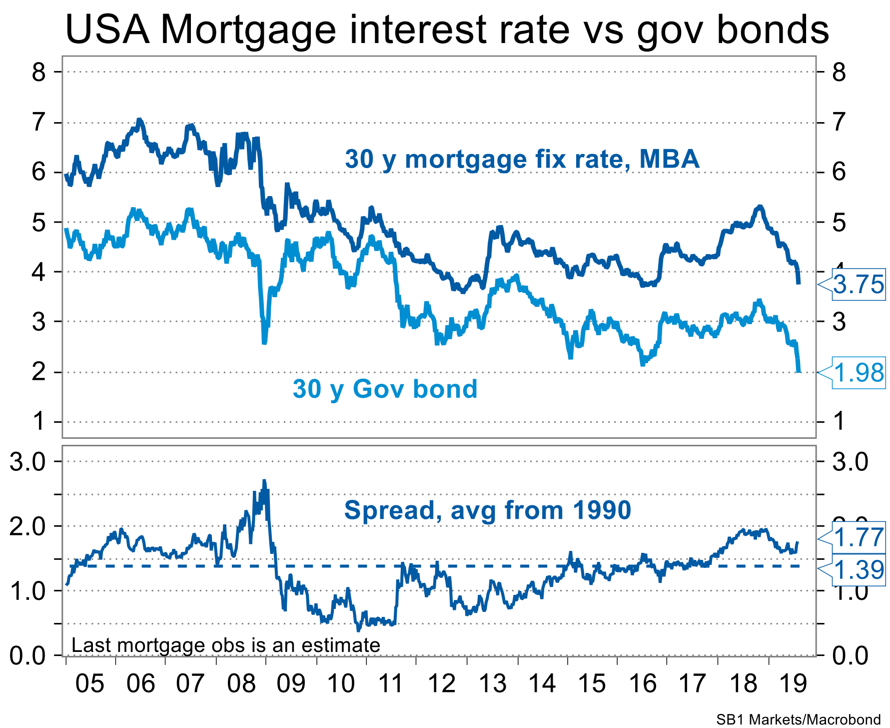


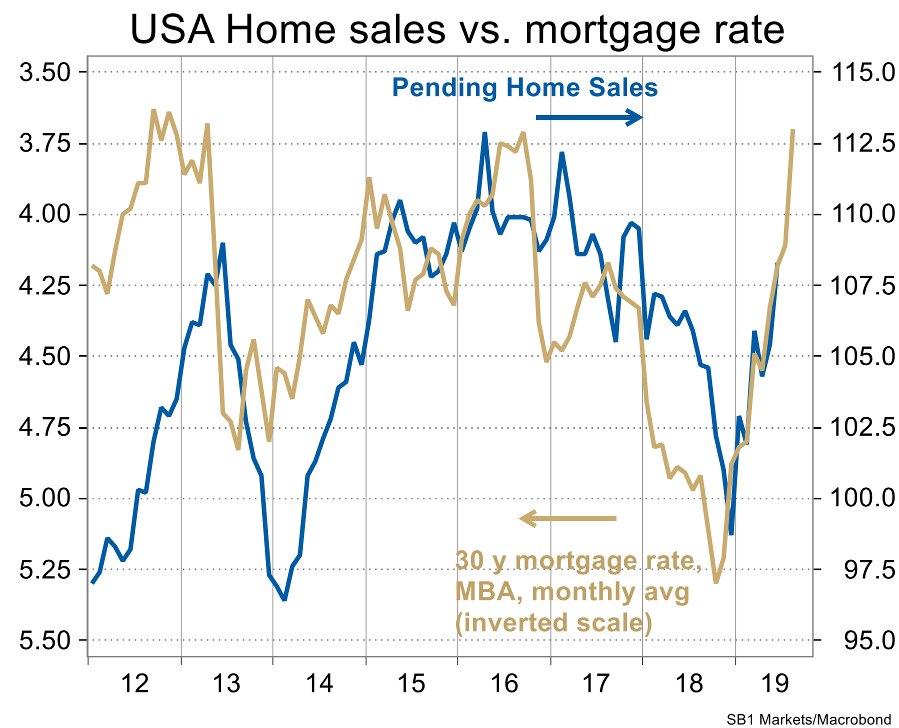
- The housing market index (HMI) rose 1 p to 66 in Aug, as expected. The homebuilders have been reporting improved market conditions since January. The index is still 2 p below the Dec 18 level and 7 p below the local peak in Dec 17. HMI still does not suggest any increase in housing starts, the survey is pointing to a stabilization
- The homebuilders are reporting that the decline in mortgage rates has not stimulated demand by much because rates have fallen due to higher economic uncertainty. This rising uncertainty is due to the trade war, of course. Since the survey was conducted, rates have fallen further, down to record low levels (30y)
- The homebuilders are still complaining about lack of labour, construction costs due to regulations, and lack of building lots

HMI is a based on a sentiment survey of US homebuilders, in which the respondents rate housing market conditions at the present time and the next six months. The index ranges from 0 to 100

30 y treasury at ATL, below 3%. Fixed mortgage rates approaching ATL too

Still US households are paying just below 4% at their mortgages, was 5.25% last autumn

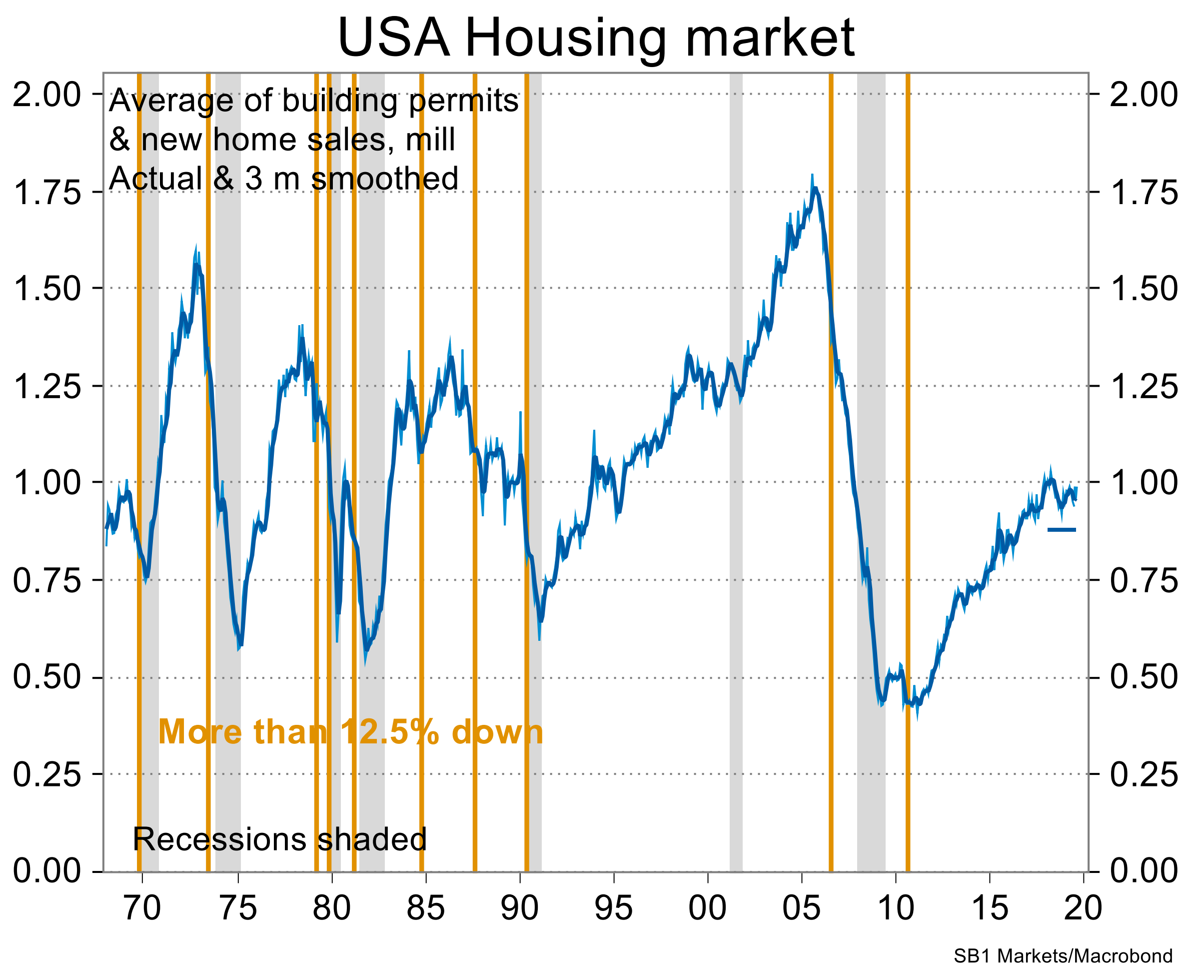


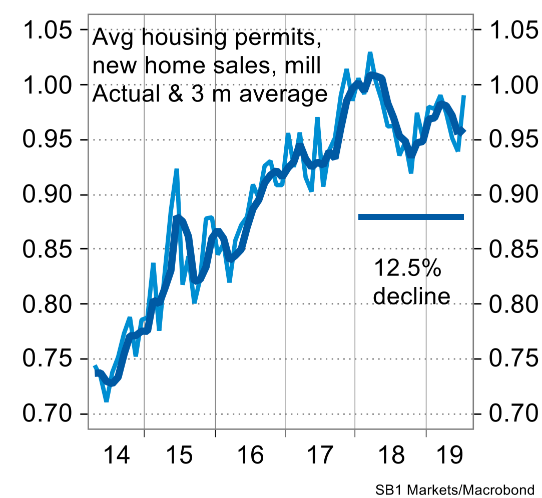


- Will the decline in mortgage rates initiate the animal spirit at the housing market when the labour market is strong at the same time?
  - » Pending home sales have – up to June - recovered most of the 2017/18 losses so far in 2019. The 30 y mortgage rate has fallen by 50 bps

Housing vs recession: Safe, for now (at least in this sector)

Building permits/new home sales in avg down just above 2% from peak

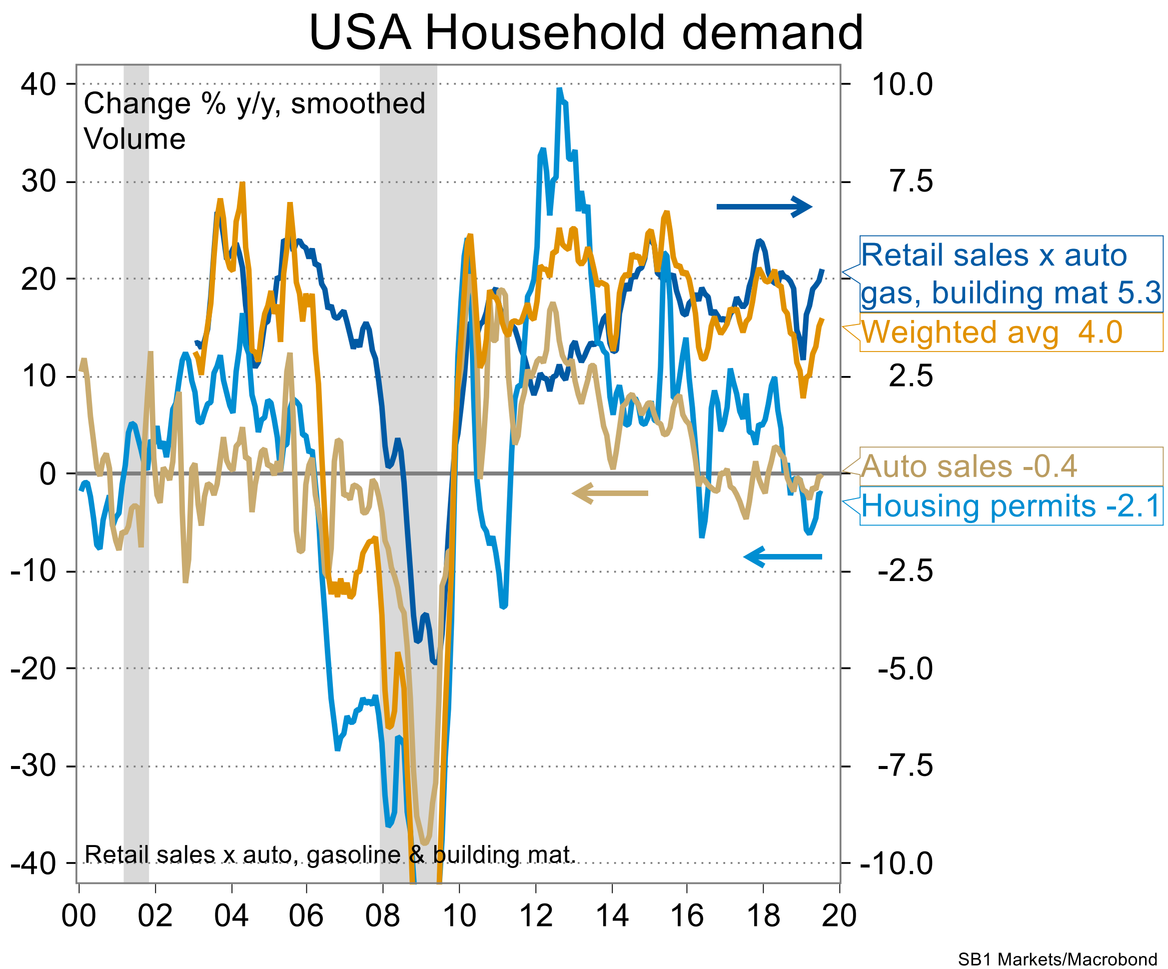




Memo: New Home sales are assumed unchanged at 645 in July, in line with consensus f'cast

Household demand is rising, at least retail sales (ex autos)

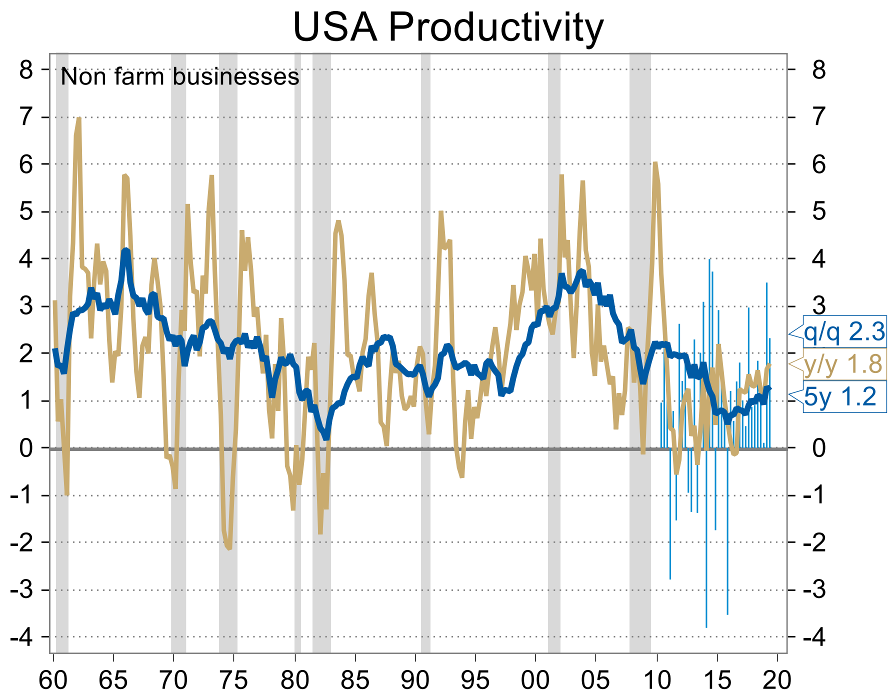
Auto sales have stagnated, housing is flattish – but retail sales are soaring – and save the day?



- Total household demand is not on the brink of sending the US into recession

Productivity growth not that bad in Q2 but cost inflation SHARPLY revised up

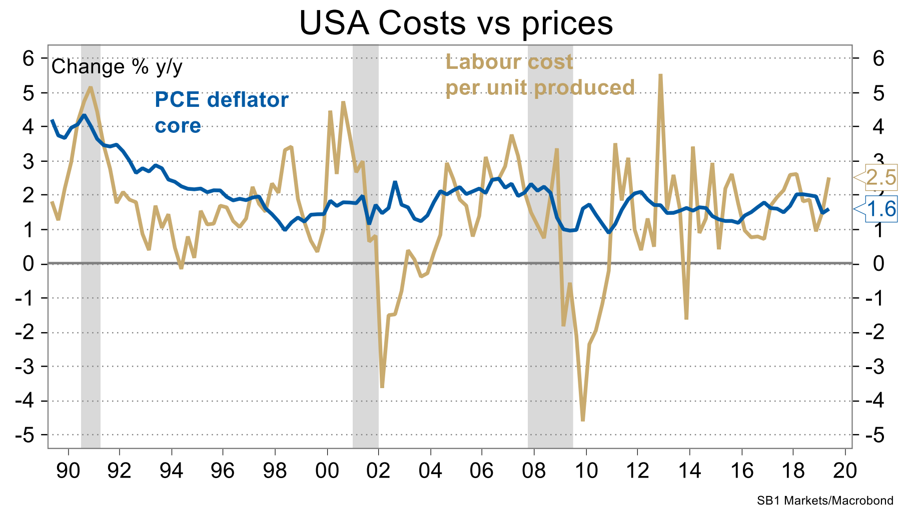
Productivity up 2.3% q/q in Q2, annual growth at 1.8% - revised down but still trending up

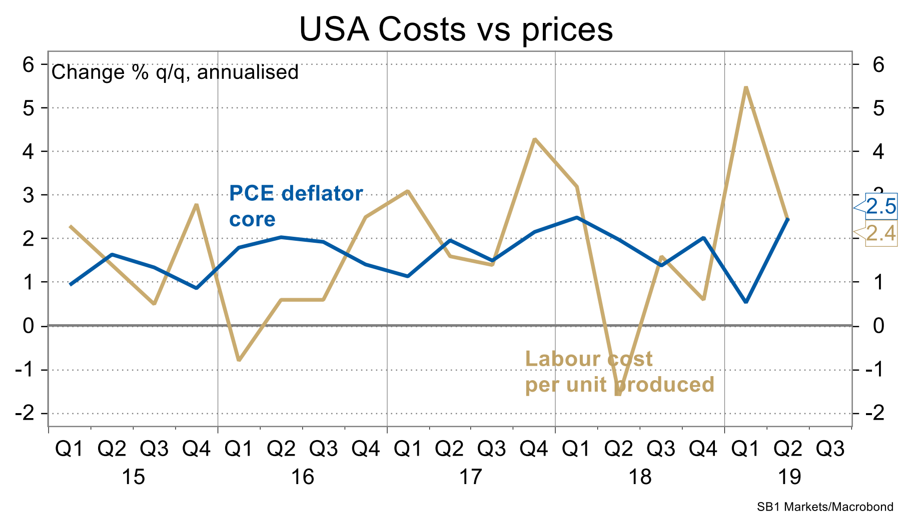


- Productivity rose by 2.3% q/q in Q2, far better than the expected 1.4%. The annual rate rose to 1.8% still trending up (but slower than pre. Reported, Q1 revised to 1.7% from 2.4 % y/y). The 5 y average is inching up too. **The best news so far in 2019?**

- On the other hand: **Labour cost inflation has been much higher than previously reported**, explaining the deep downward revision in corporate profits. Hourly labour cost rose 9.0% in Q1, not 1.8% (figures are correct!!). Unit labour cost rose is up 2.5% y/y in Q2, up from prev. reported 0.1% in Q1, a data point we doubted was correct (now revised to 1.5% y/)

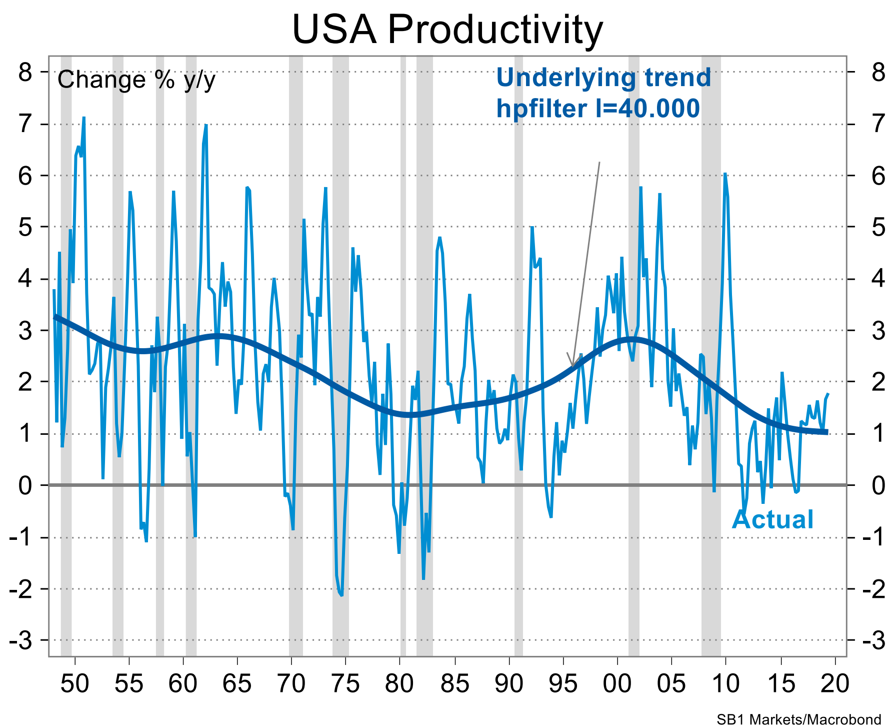
- **Underlying wage inflation is approx. 3%, and underlying productivity growth is well below 2.4%. <u>Underlying ULC inflation is probably approx 2%, like we have assumed for a while. Not an obvious cut argument for Federal Reserve</u>**

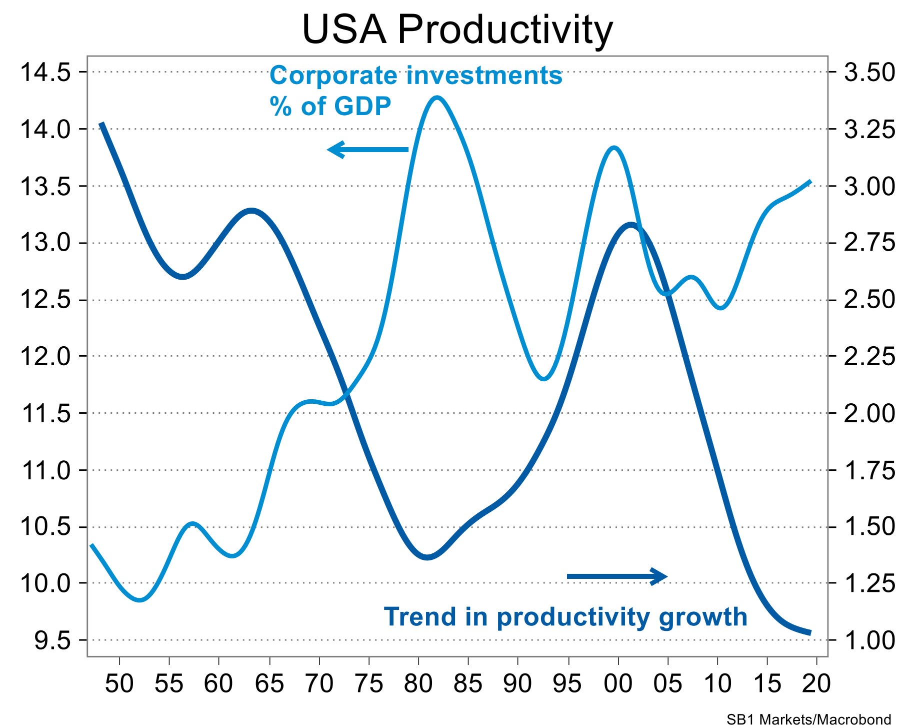




Where is the trend productivity growth? The most important figure…

It is, per definition, impossible to know in real time where the long term trend is





What sort of an increase in productivity growth are we now observing? We do not for sure know before well after the fact. We (always) have three alternatives:

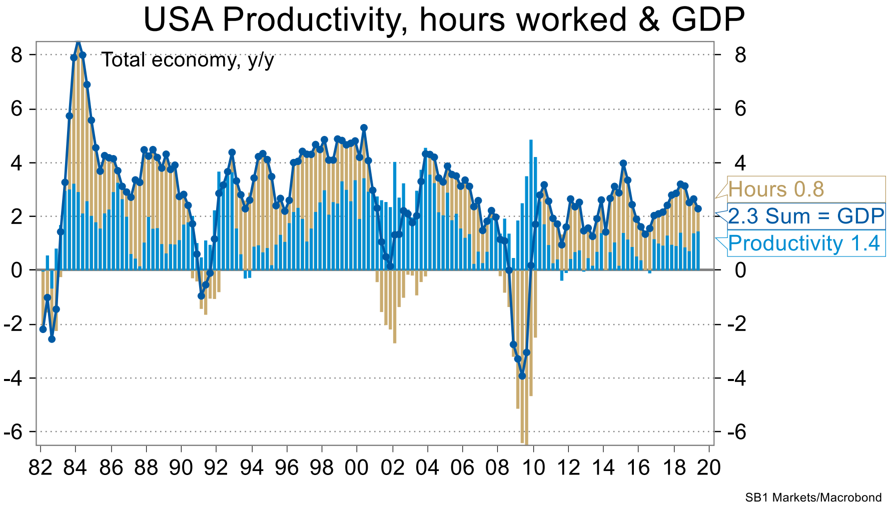
1) A normal short term impact due to a faster GDP-growth (hours worked is adjusted over time), see also next page

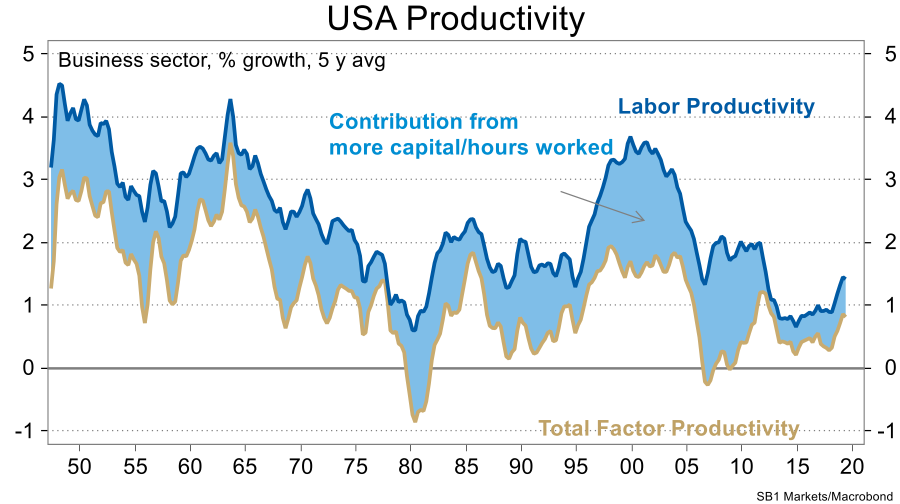
2) A medium term increase in productivity due to lack of labour and higher wages that incentivise companies to rationalise by utilising and investing in known technology, methods

3) A longer term in productivity growth due to a structural recovery and implementation of new and more efficient technologies, possibly embedded in investments. However there is no close correlation between investment ratio and trend in productivity growth

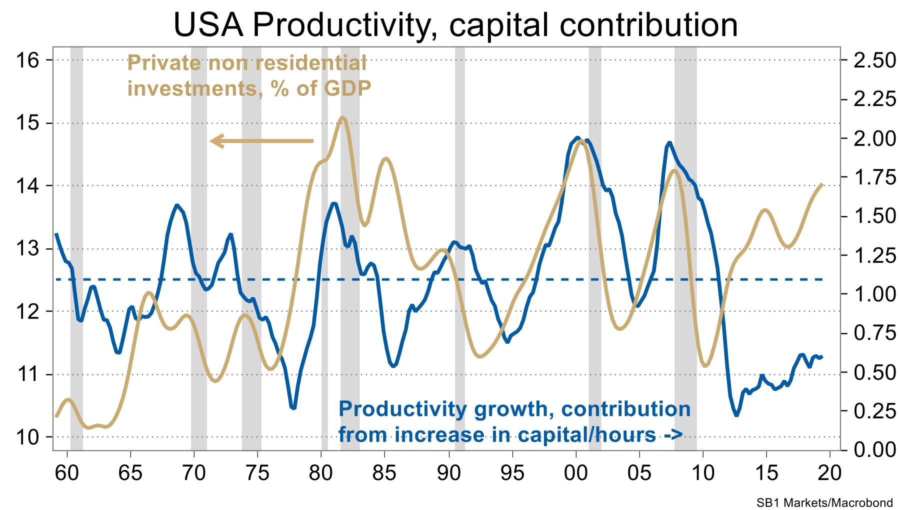
Total economy labour productivity growth at 1.4%, growth hours worked slows

Total factor productivity is not accelerating much, even if investments are high



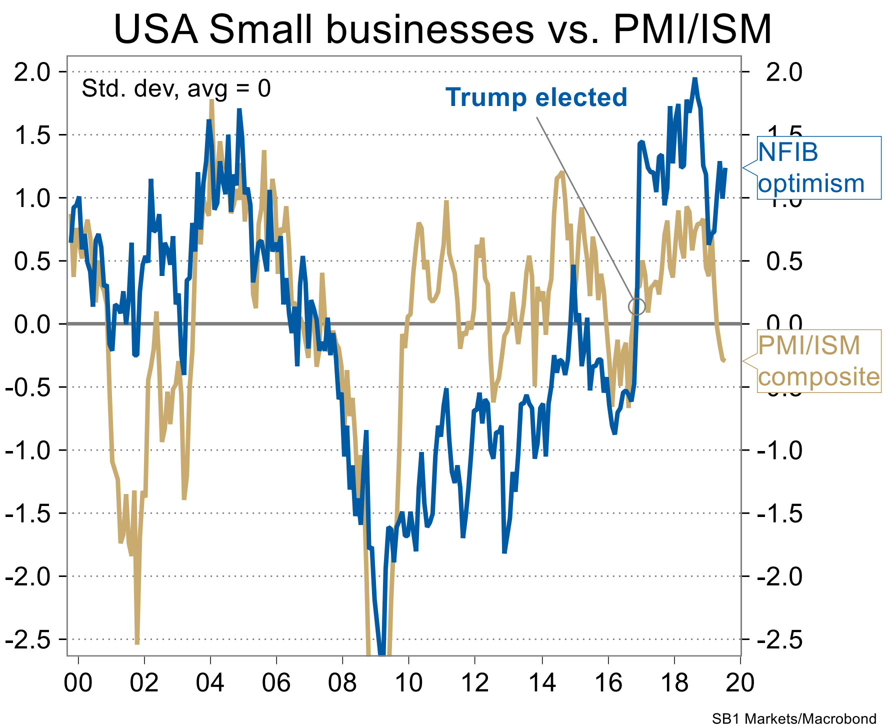


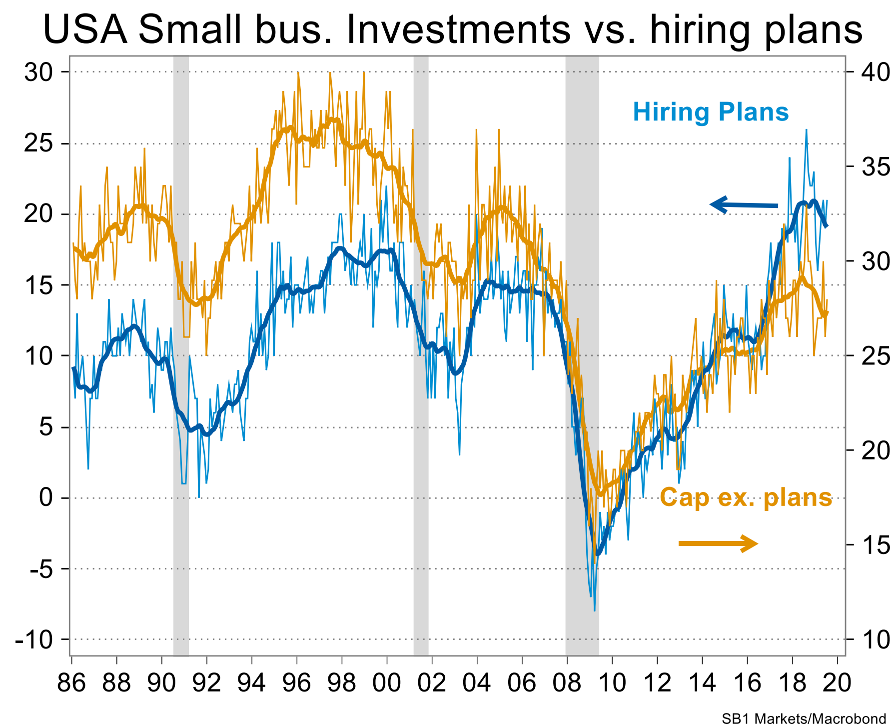
- Total economy 1.4% productivity growth + 0.8% hours worked = 2.3% growth in GDP y/y in Q2
  - » Growth in hours worked has been higher than likely over time (which is normal boom periods) – but has slowed recently, mostly due to weakness in overall demand
  - » Productivity growth has recovered somewhat but it is still not impressive
- A substantial decline in productivity growth since 2005 is due to a slowdown in capital deepening, leading to a much slower growth in capital/hours worked (the workers are not supplied with more capital to make them more productive). <u>Growth in capital/hours worked remains low even if business investments are at a high level somewhat strange, are the investments not productive anymore?</u>



Small businesses more optimistic, and miles above PMI/ISM (activity) reports

The NFIB optimism index rose in July and is still strong – although well below the 2018 peak

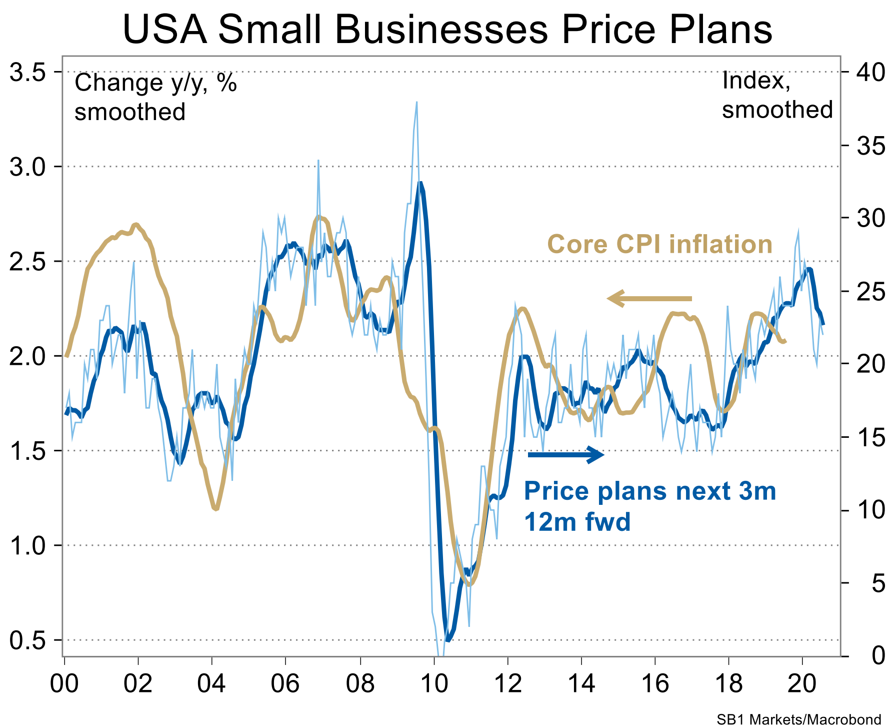


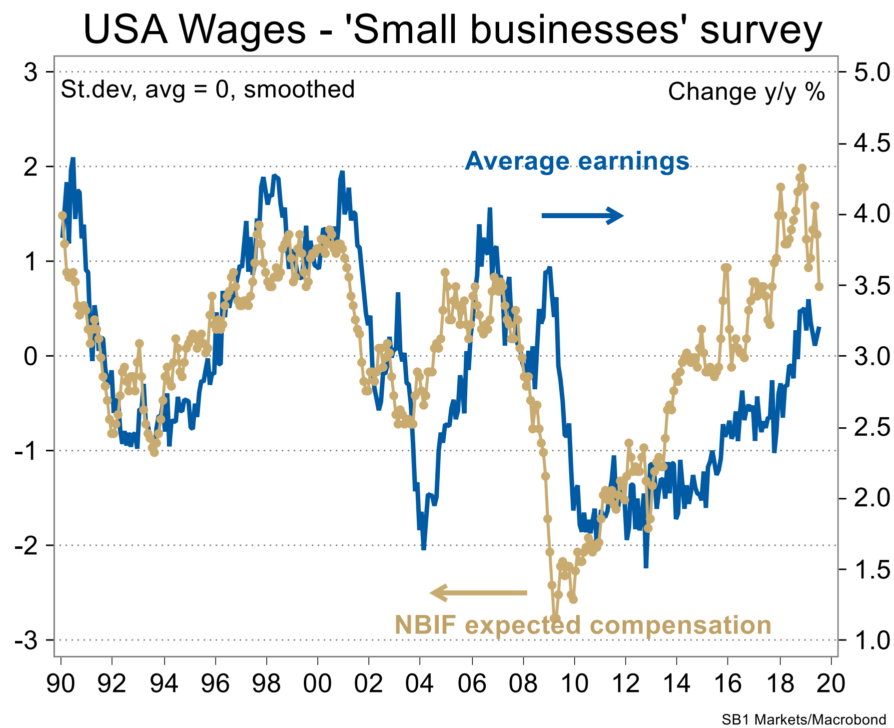


- The NFIB optimism index, measuring small businesses' expectations on business conditions, rose in July, as expected. However, the level is well down (almost -1 std. dev, ¼ of a normal cycle) from the peak last autumn
  - » The NFIB optimism index is still 1.2 st.dev above average. The surveys from ISM/Markit PMI (and most others) reports actual growth rates (not optimism/sentiment!) below average levels. These different measures 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. Wage infl. moderates

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

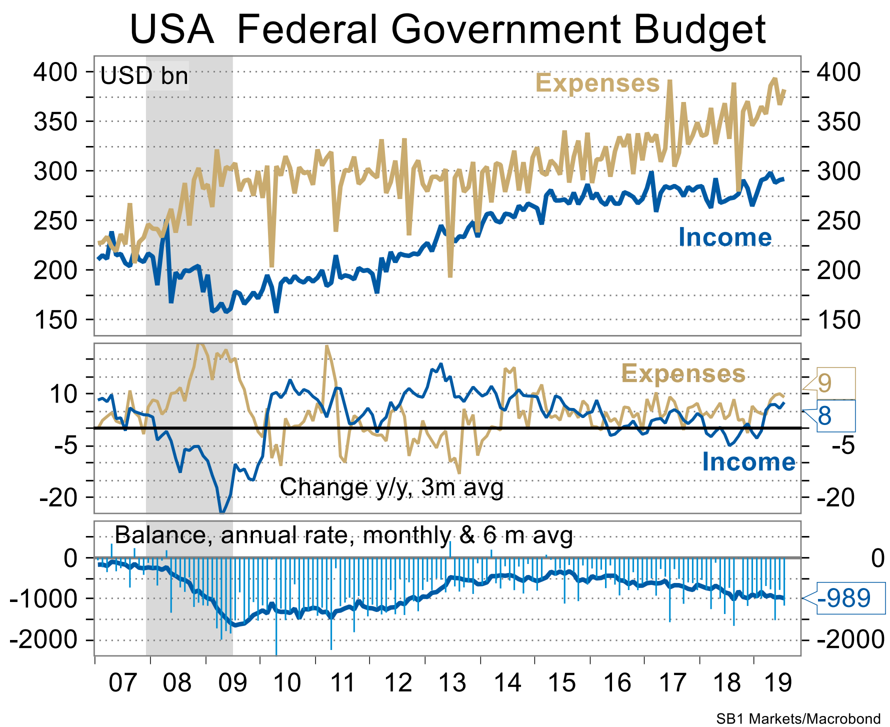


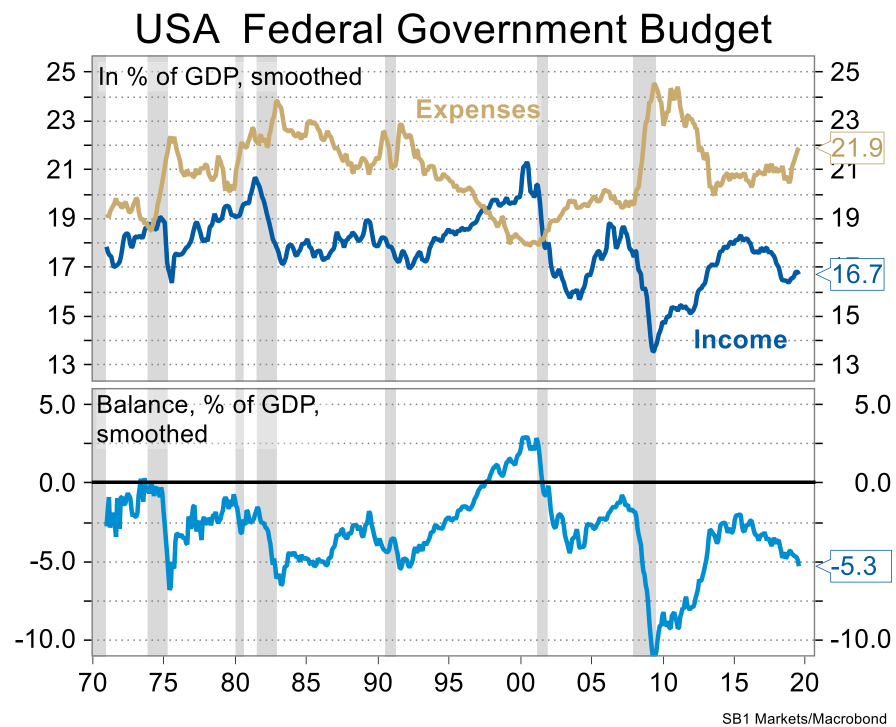


- 22% of small businesses are planning to hike prices, down from a peak at 29% in November last year (27% reasonably smoothed), still somewhat above the average 'normal' share! Are companies witnessing slower demand growth?
- Businesses are still reporting quite aggressive plans to raise compensation, but substantially less than some months ago. Actual wage growth has cooled somewhat, the survey does not signal any further slowing - but probably not an acceleration either

The federal budget deficit is widening amid soaring spending

The federal deficit at 5.3% of GDP, and the total public sector deficit at 6.9% of GDP in Q1!

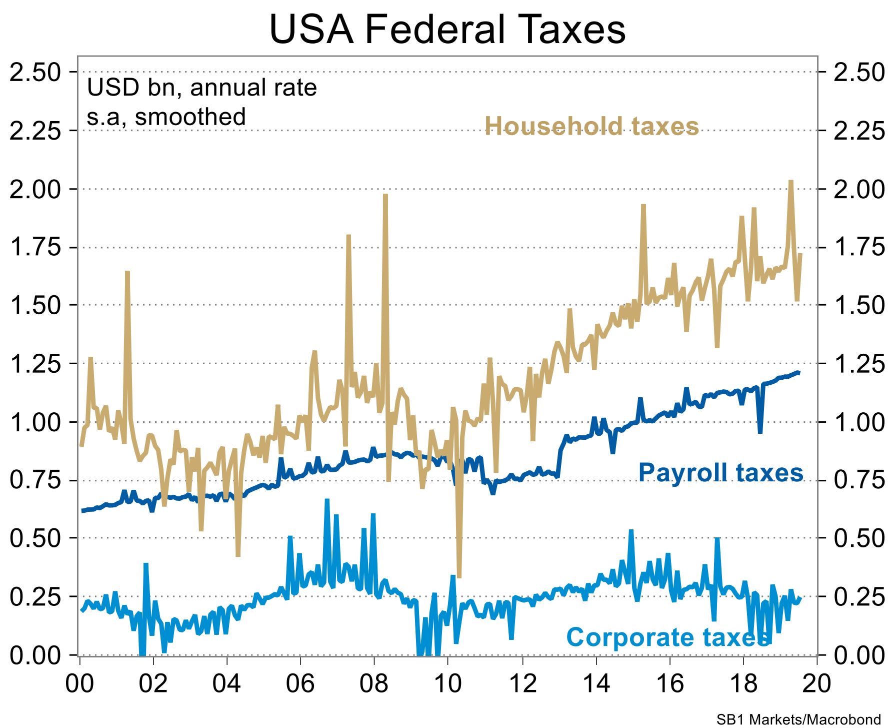


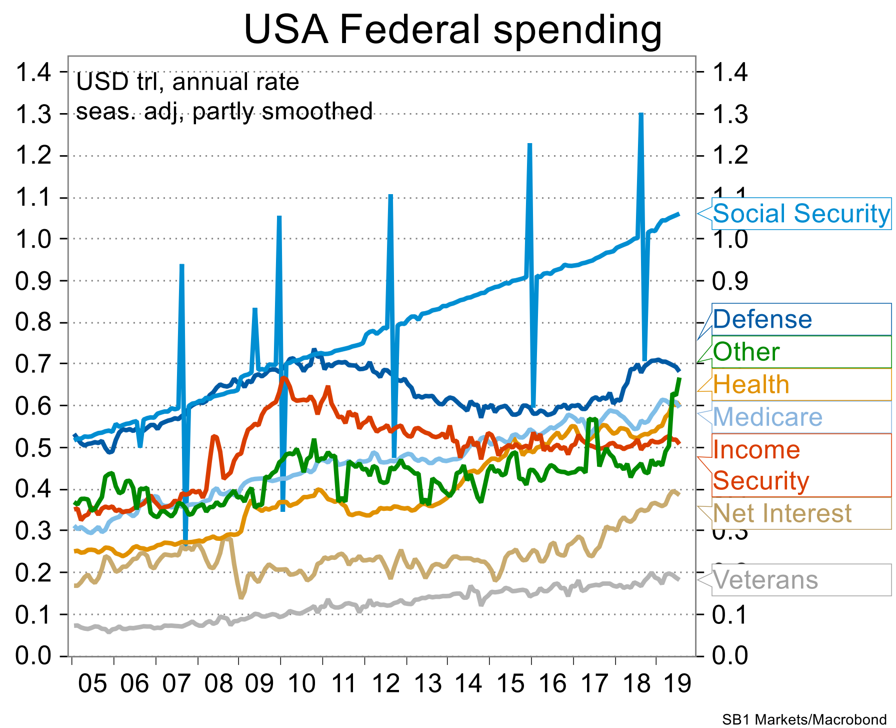


- The budget deficit fell to USD 1180 bn in annual rate in July (seas. adj), and the 6 m avg is approaching USD 1.000 bn. Including local government etc, the US is running full employment, peacetime deficit at 6.9% in Q1 (from 6.7% in Q4); totally unprecedented!
- Federal spending inched down m/m in June but is up 10% y/y (smoothed), way above growth in nominal GDP. Income is up 8% y/y (but the underlying trend for income growth is far slower)
- 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 (in a boom ☺)
- A divided Congress has agreed upon a modest further increase in the deficit but no more than some 0.2 pp of GDP

Corporate taxes zigzag upwards but remain low, household taxes growing slower

More money spent on… everything?

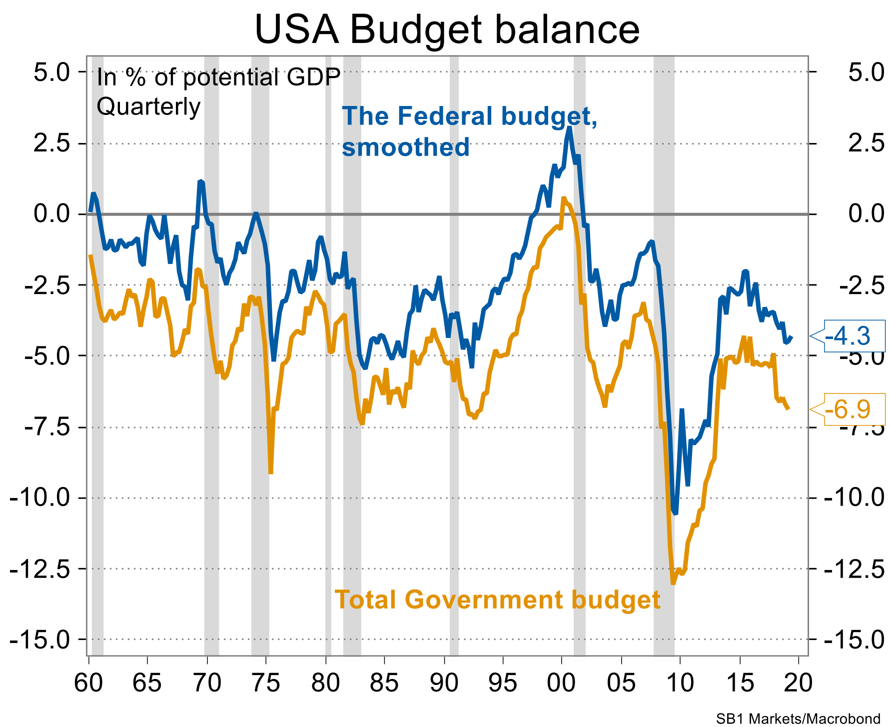


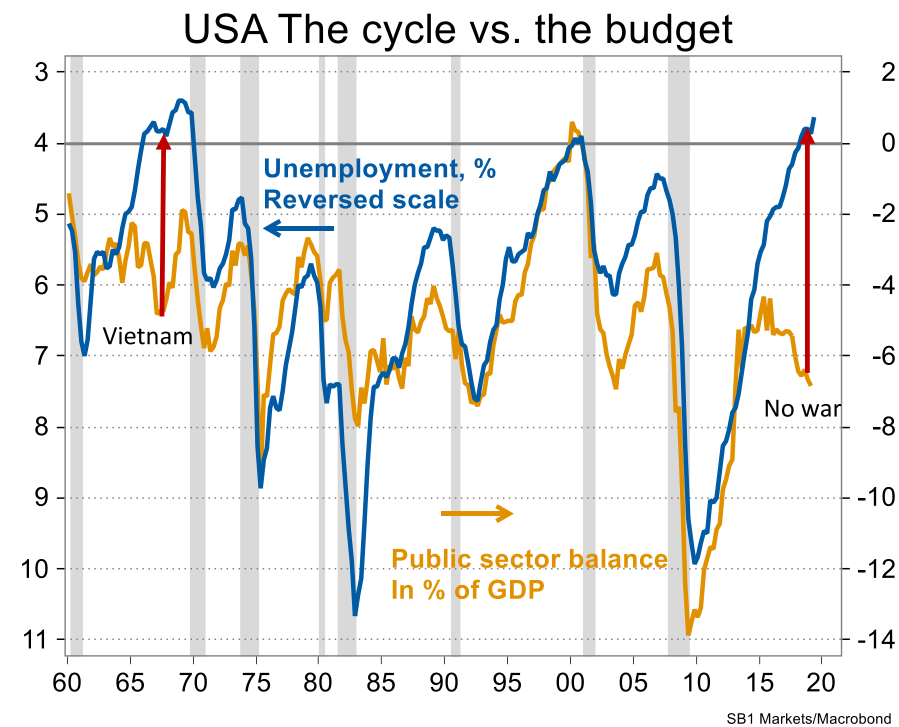


- The biggest spending changes the past year: medicare, health, net interest payments (highest ever, even if interest rates are rather low…)
- A huge hike in “others” recent months must be temporary (we assume) lift in spending on education, employment & social services (but it has now lasted for three months, is it immigration costs?)

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

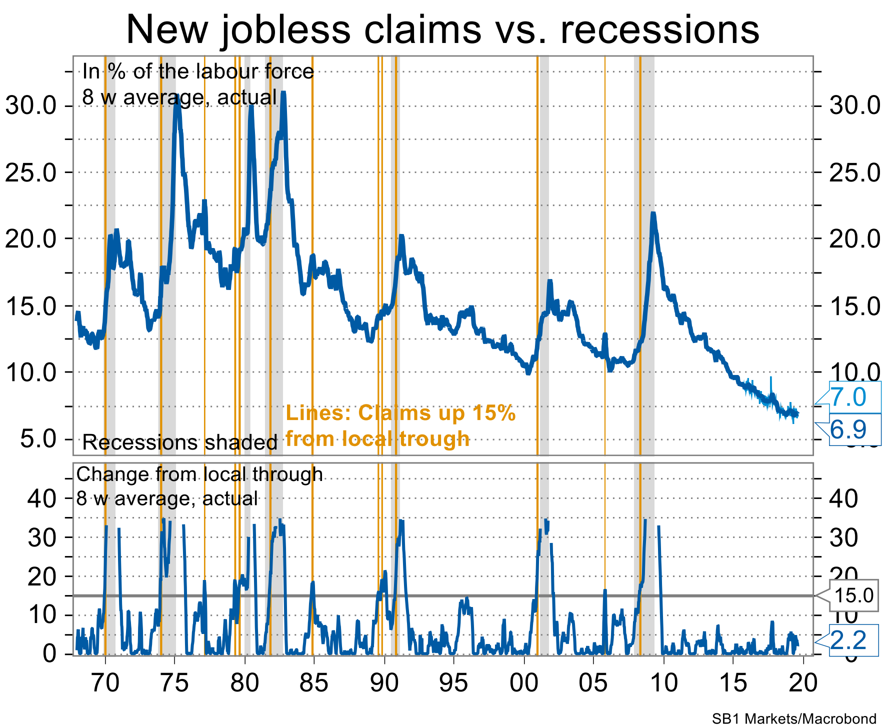


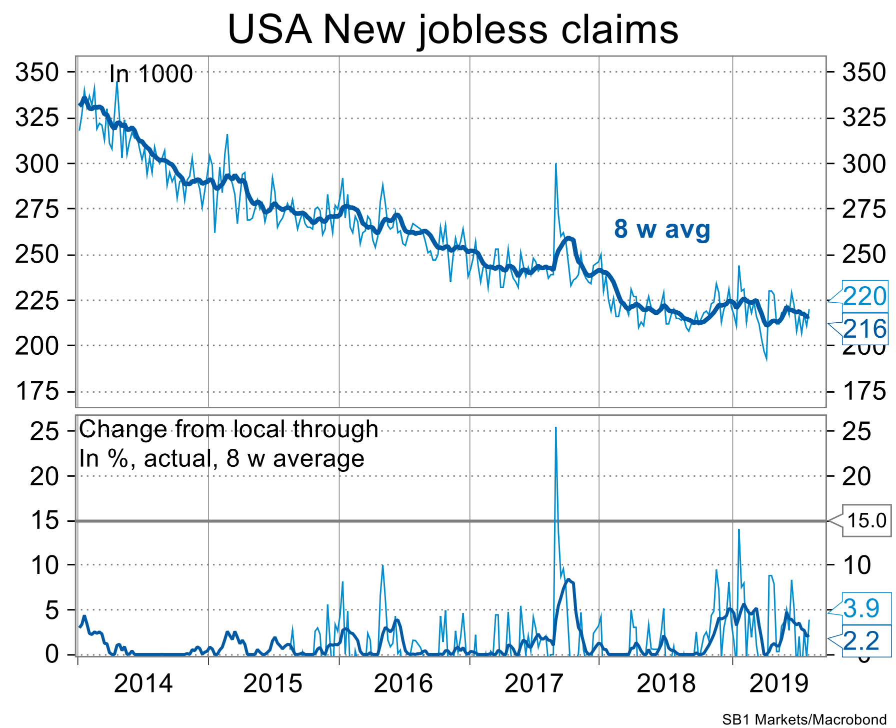


- The deficit has never been anywhere close to the present level in peace time when unemployment is as low as now – and it will most likely become even worse as all of the tax cuts and increased expenditures kick in
  - » We have not seen anything like this in the US or elsewhere before (except Greece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

Jobless claims remain very low, no signs of weakness

Jobless claims up 9’ to 220’, the 8 w average is very low, at 216’. The labour market is tight

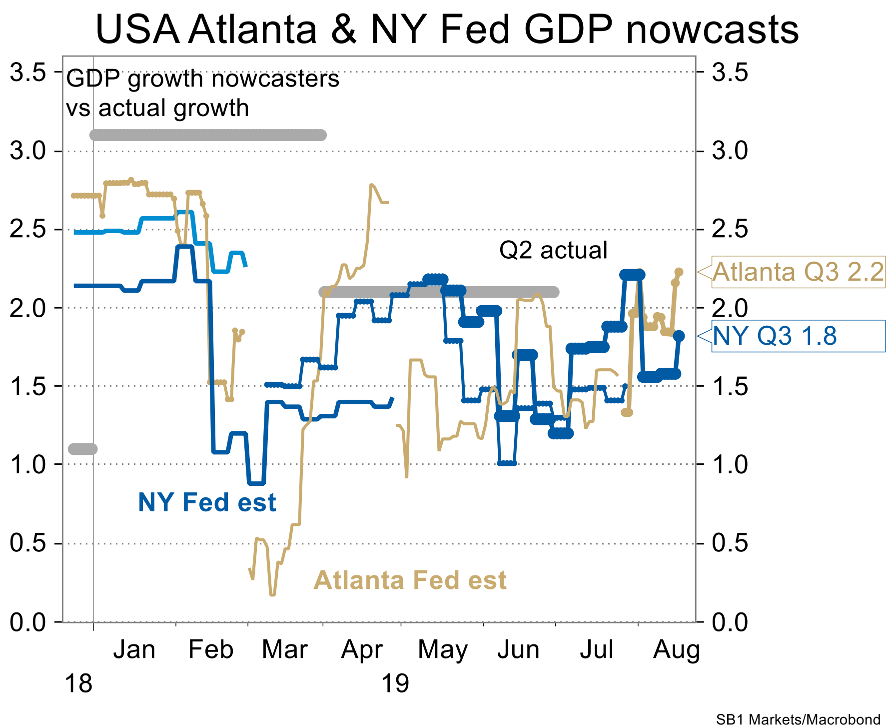


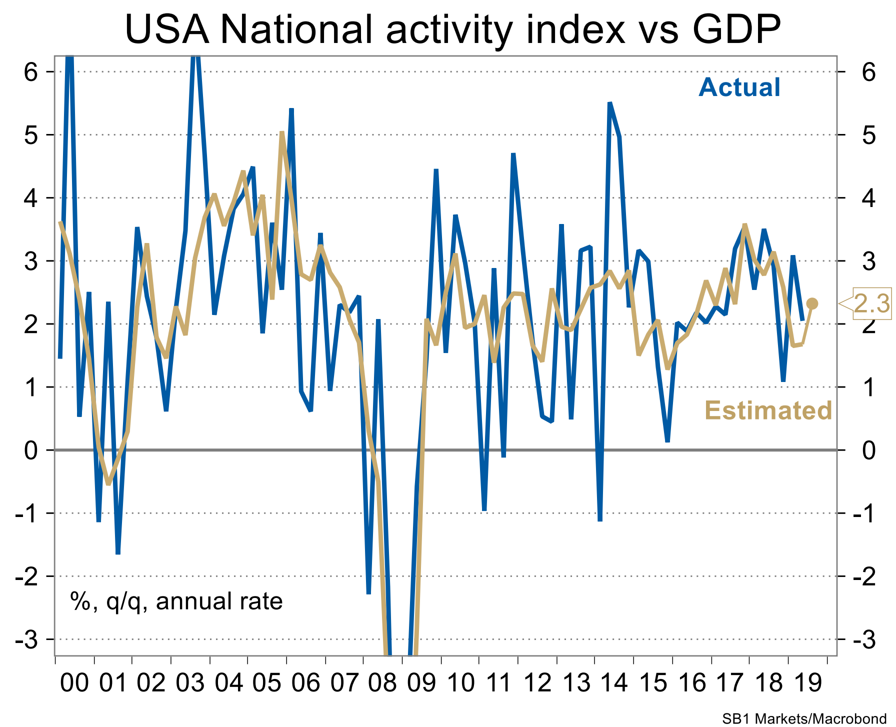


- A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow ‘recession’ warning line is to be drawn, check the chart to the left. So, no reason to worry now?

Q3 growth accelerating? The nowcasters are suggesting, 1.8 – 2.2%

Higher retail sales are lifting consumption nowcasts



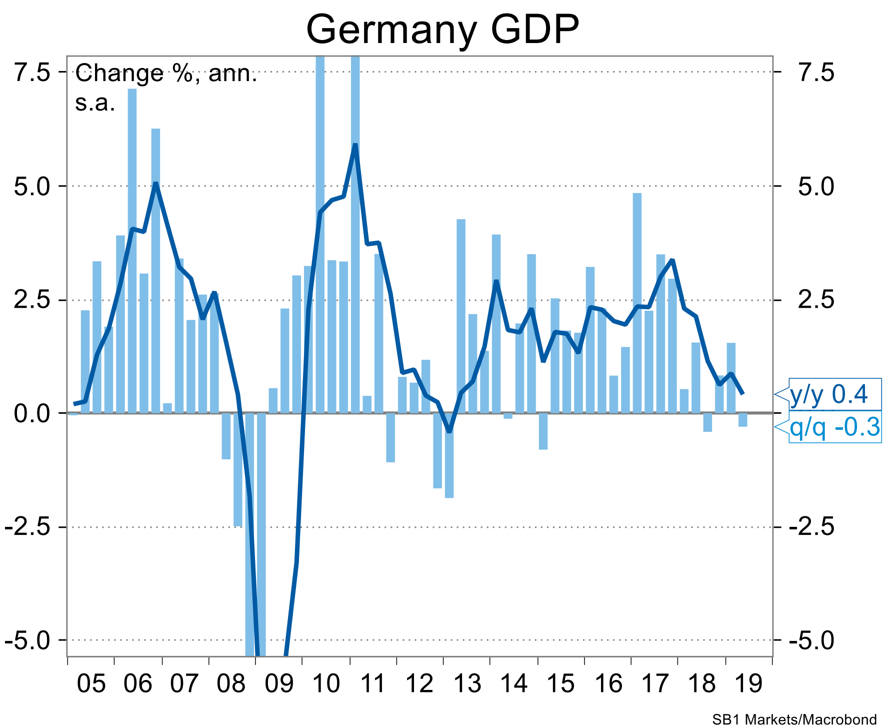


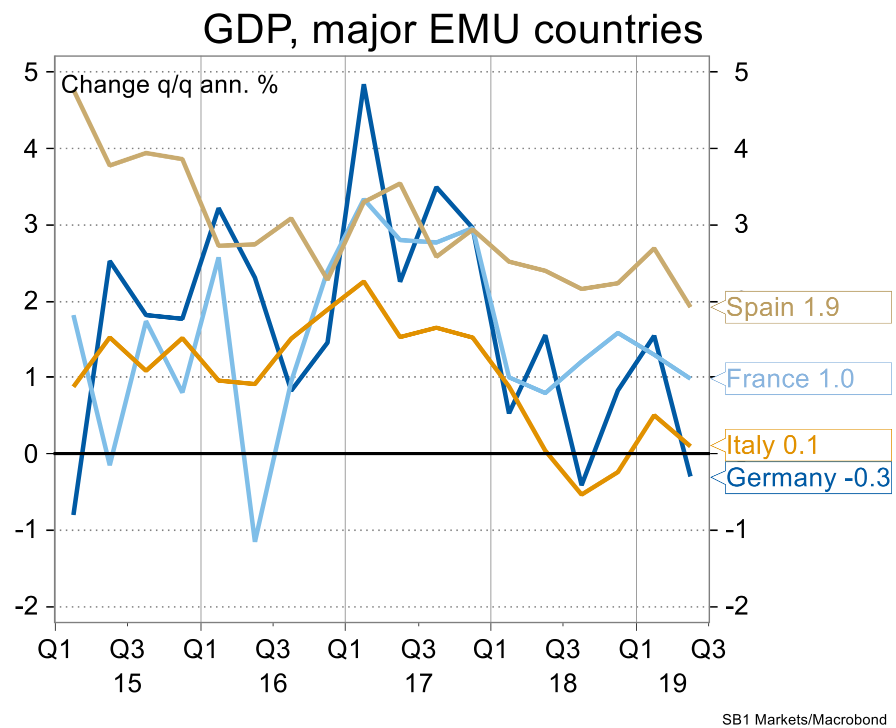
- The National activity reported 1.7% growth in Q2, and a 2.3% speed into Q3 (June level)

dd

GDP contracted in Q2, annual growth down to 0.4%. Fiscal policy to the rescue?

GDP fell 0.3% q/q (0.1% not annualised), down from 1.5%. All EMU big 4 weaker in Q2



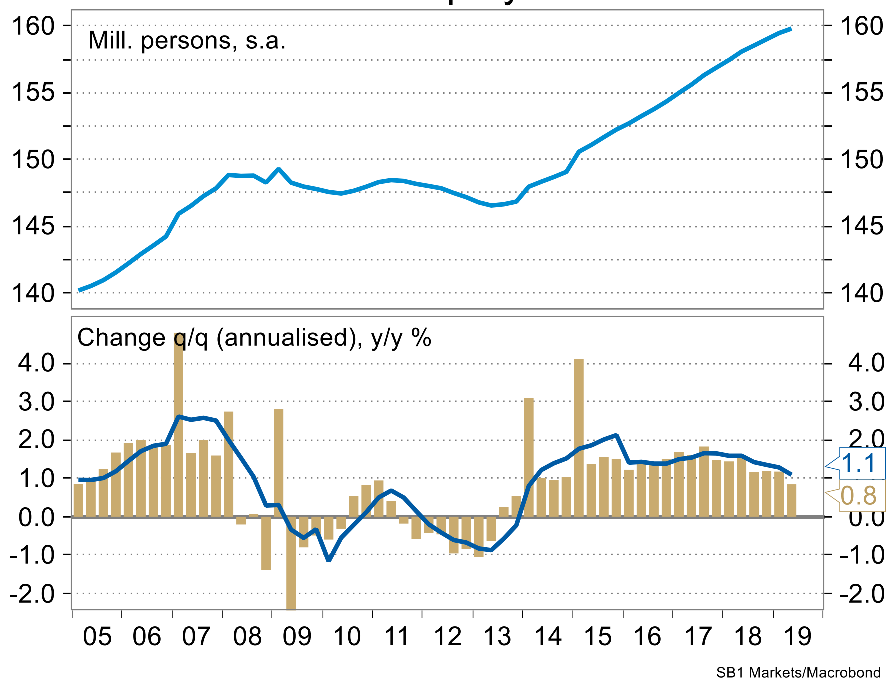


- Germany GDP declined by 0.3% q/q annualized, as expected. Growth in Q1 was revised down to 1.5%, from 1.8%. Growth in EMU was 0.8%, unch from the first estimate
  - » Meagre Q2 GDP growth EMU strengthens the case for the ECB to loosen monetary policy at the September meeting
  - » In addition, the rapid deteriorating conditions in Germany will no doubt increase the possibility for fiscal stimulus – from a Government that is running a budget surplus

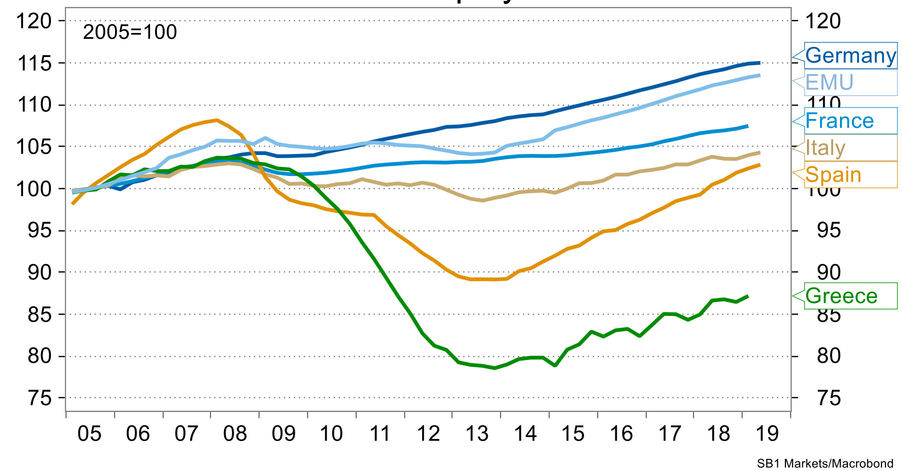
Employment growth = GDP growth -> no productivity growth

Employment rose 0.8% in Q2, down from 1.1% in Q1. Growth still above population growth

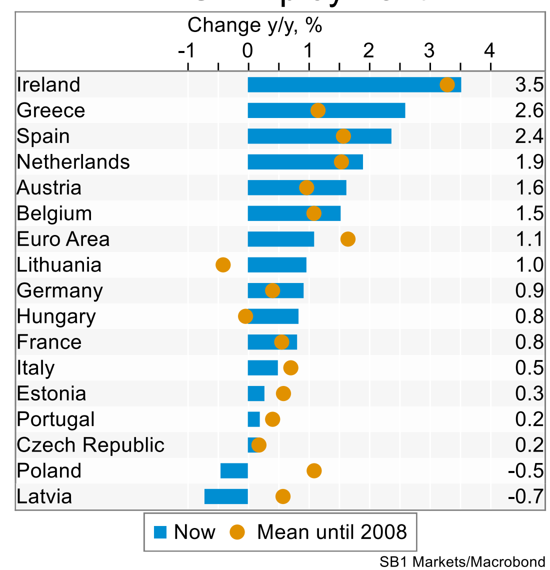
EMU Employment



EMU Employment



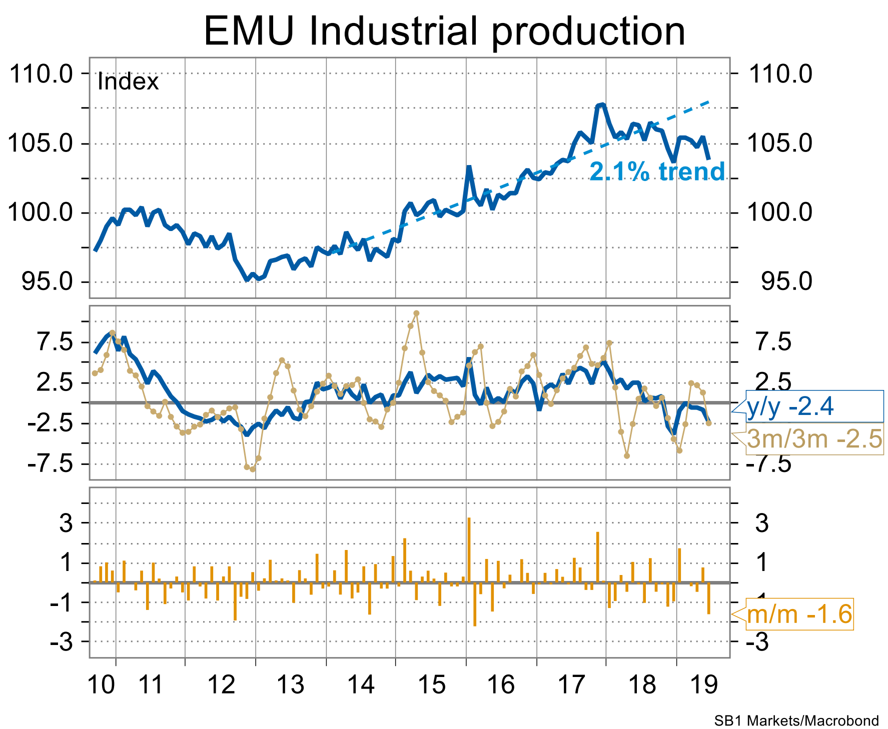
EMU Employment

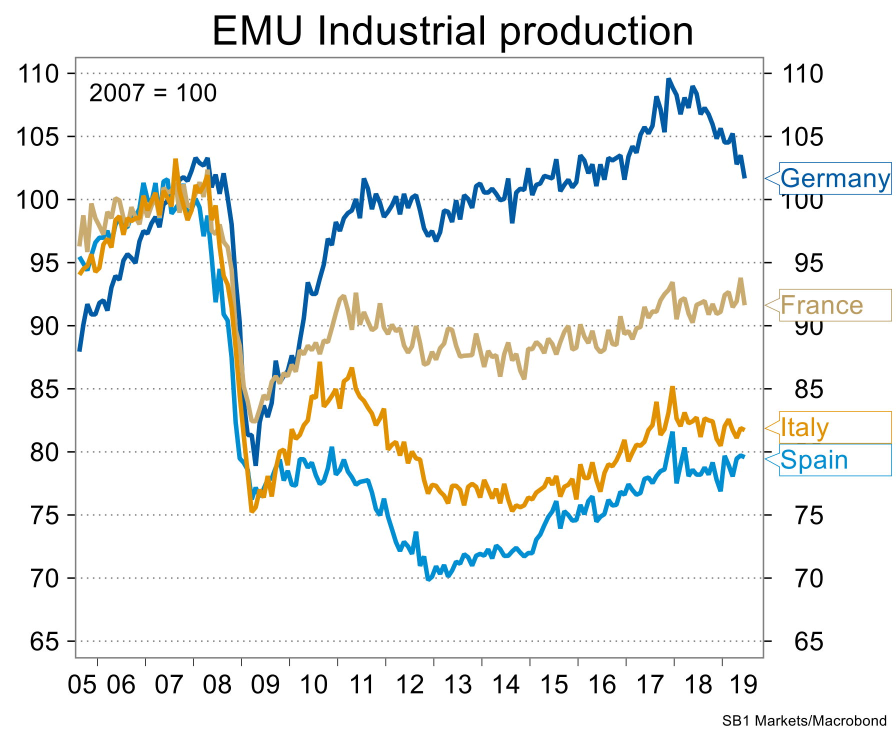


- Employment has been growing at just above 1% since Q3 ‘18, down from some 1.5%, along with slower GDP growth – and now down to 0.8. Productivity growth is still dismal
- Employment is growing in all but two countries and faster than before ‘08 in most of them
- Productivity was probably close to flat in Q2 (hours worked not yet published but GDP grew 0.8%)

Industrial production sharply down in June, as expected

Production down 1.6% m/m, with Germany in the lead, down 5% y/y!



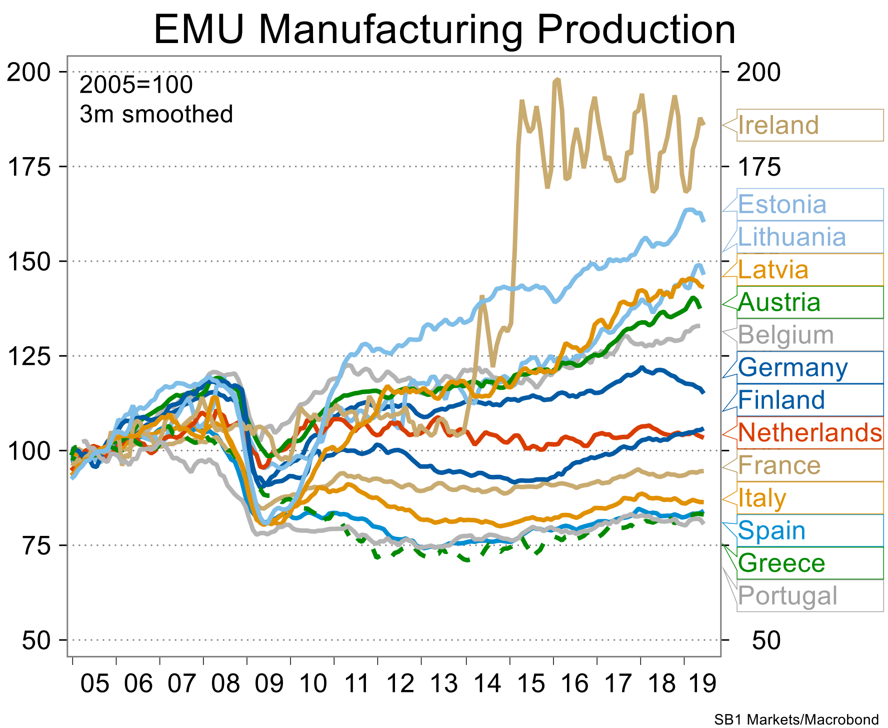


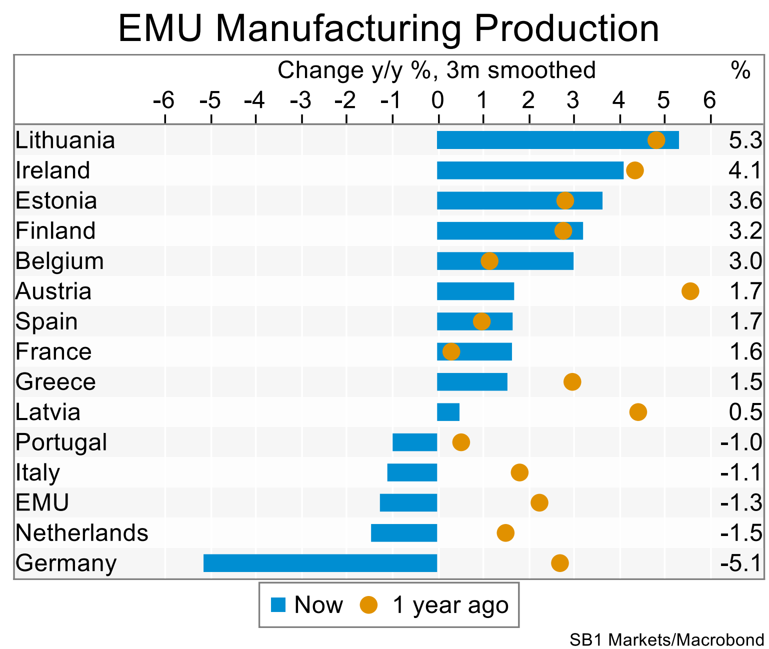
- Industrial production in the Eurozone declined by 1,6% in June, and by 2.5% in Q2 (almost as bad as in the US). Over the last year production has fallen 2.4%, and by 3.7% from the late 2017 peak
- Germany is down 5% y/y, and by 7% from the peak
- France is trending up, Spain too, with a narrow margin. Italy is slowly trending down
- **The manufacturing PMI and orders remain weak, no signs of recovery**

SpareBank 1 MARKETS

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

Production is falling in Germany, Netherlands and Italy

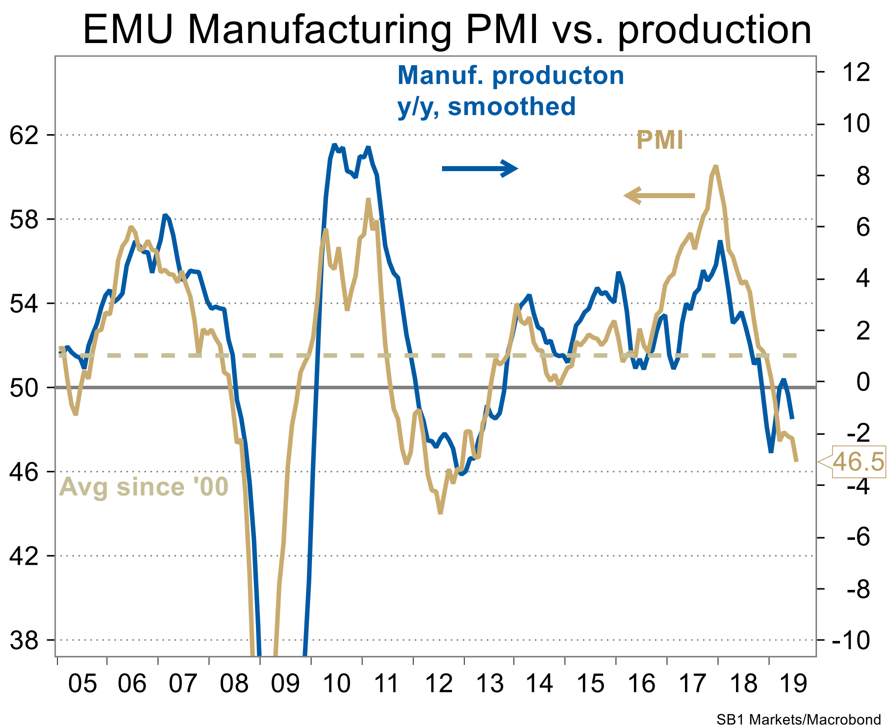


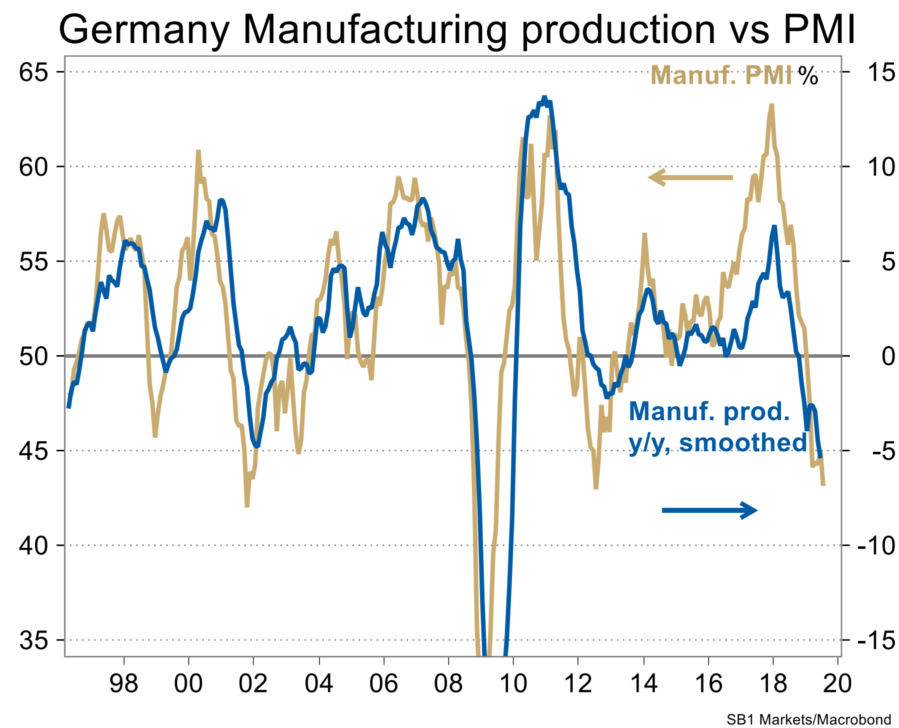


SpareBank 1 MARKETS

The PMIs told you so…

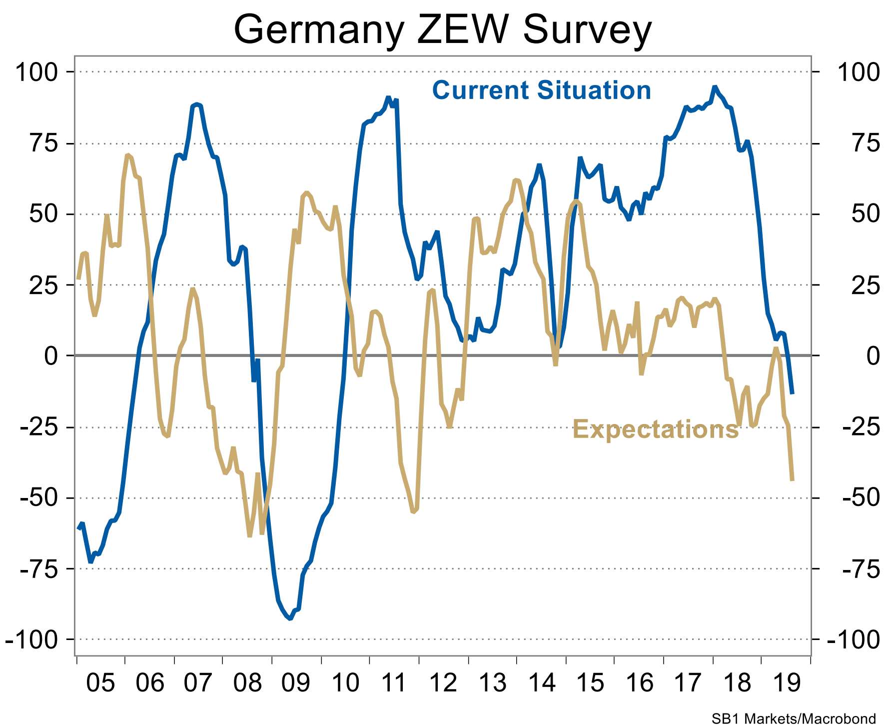
.. and the outlook is not bright, the PMIs are reporting a deterioration

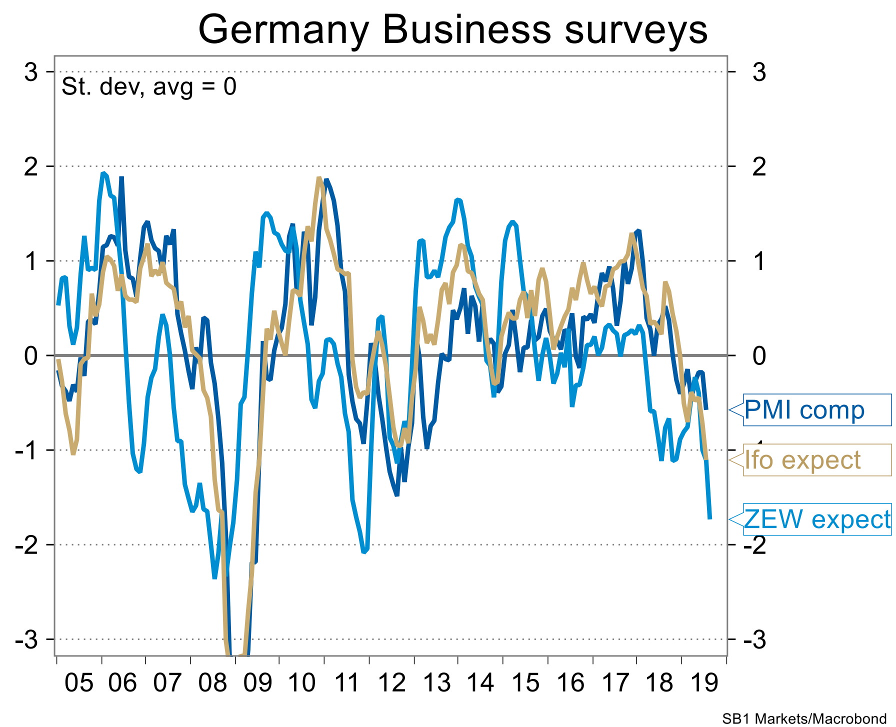




ZEW survey expectations further down, current situation weaker too

The subpar domestic data flow and the intensified trade dispute darken the economic outlook

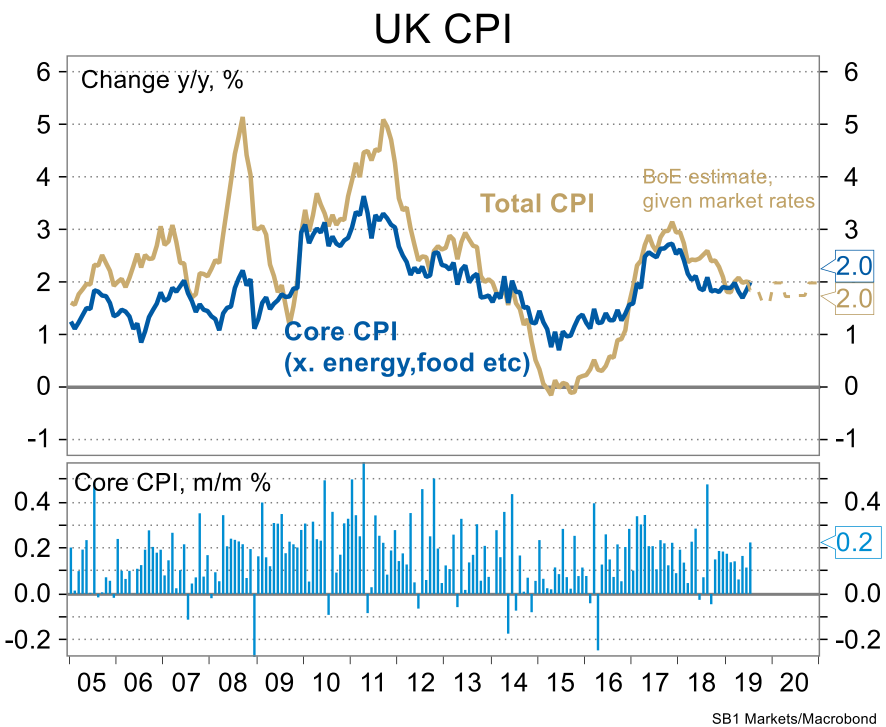


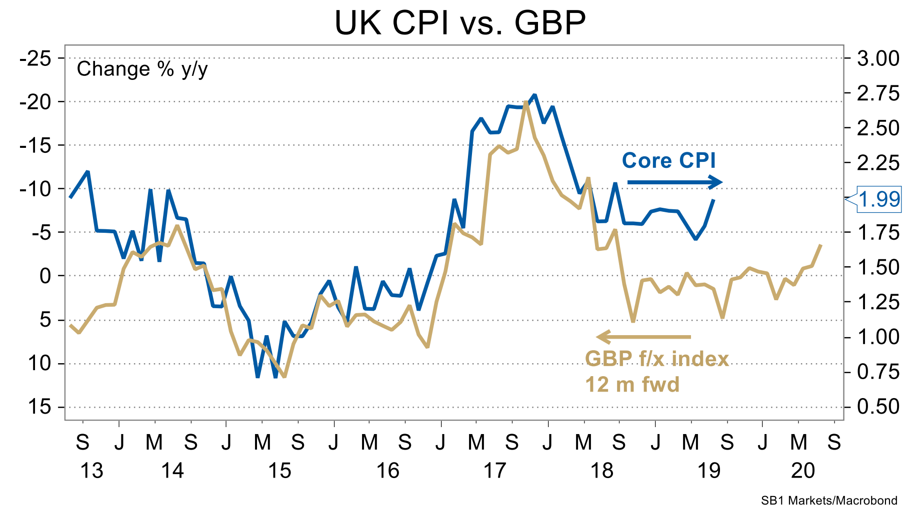


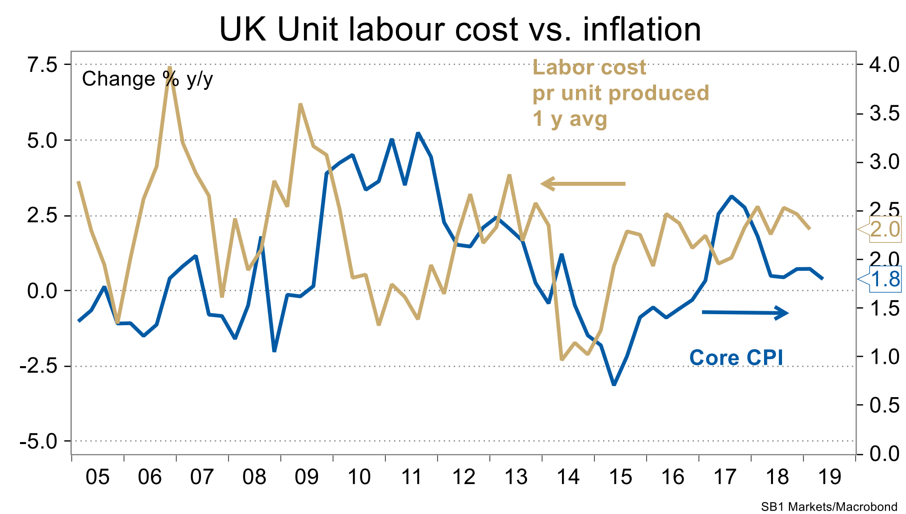
- Expectations in the German ZEW survey fell by an unusual 20 p in August, and the level is far below average, the lowest since 2011. The assessment of the current situation fell too, down to below an average level
  - » The ZEW survey points to grim Q3 growth. The ZEW is a sentiment survey among economists and analysts, not a business survey, and is usually leading the Ifo and PMI – however with a rather weak correlation
- Other German surveys are pointing to a rather bleak outlook. The ZEW sentiment survey has been the weakest recently, we prefer the PMI and Ifo, as these are business surveys and better correlated to actual growth

Core CPI inflation ticked up to 2.0%, total inflation has probably bottomed

The GBP impact is probably soon taken out, core inflation close to target





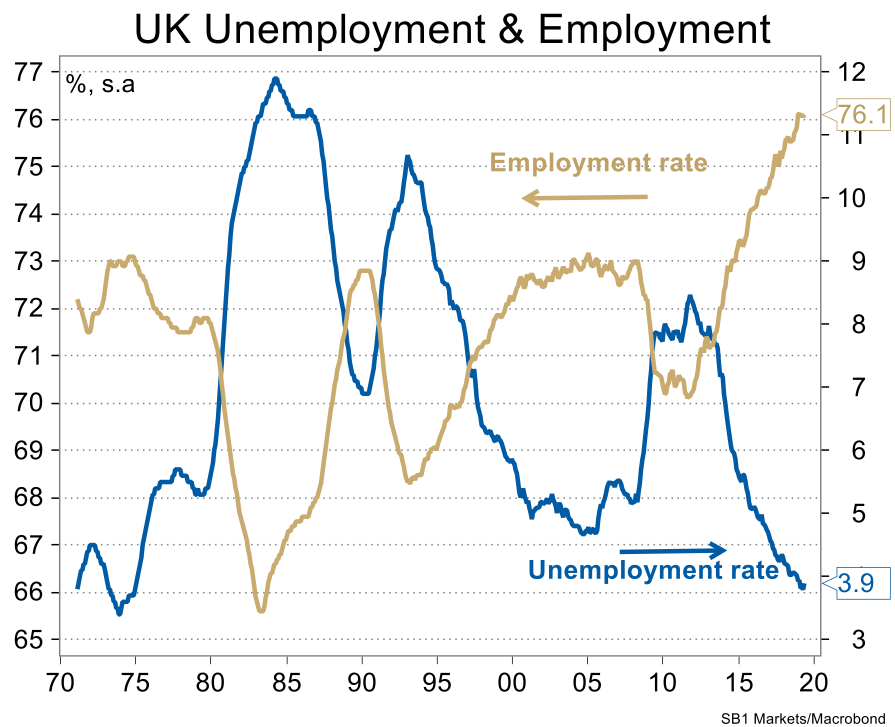


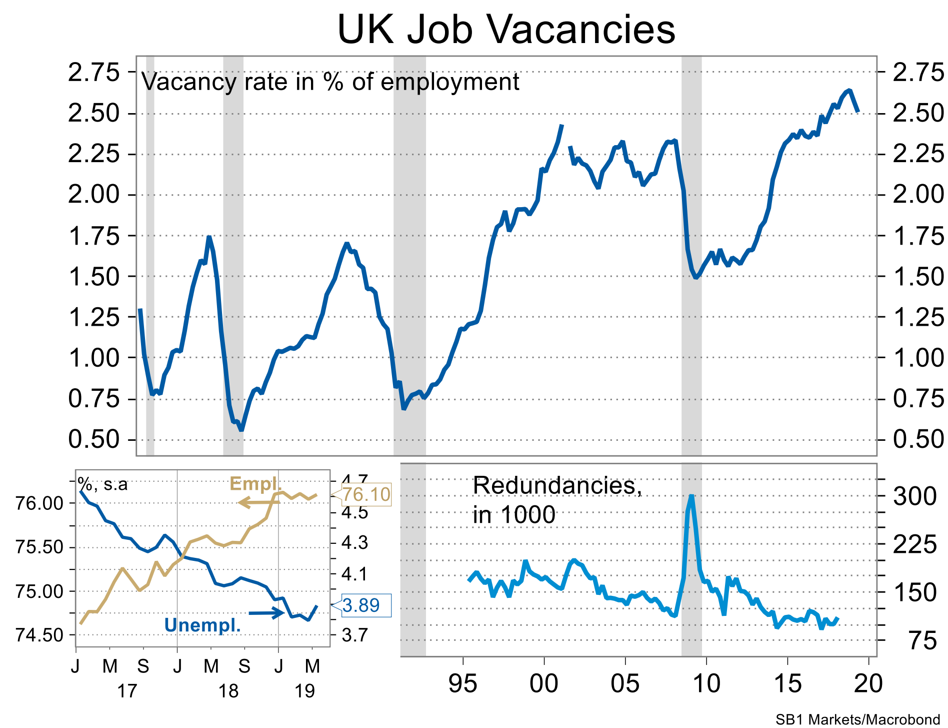
- Core CPI inflation +0.2 pp up to 2.0% in July. Core inflation may still be trending slowly down but is now back at BoE's price target. Total inflation flat at 2.0%, stabilising the past 4 months
- Inflation came down through 2018, as the upward pressure from the GBP depreciation in 2016 changed sign. Our simple f/x based model still may still point to lower CPI inflation, even if GBP has fallen recently. However, domestic costs are not low, and wage inflation has climbed to 4% XXXX

SpareBank 1 MARKETS

Unemployment up 0.1 p to 3.9%, wage inflation accelerating to 3.9%

Employment growth has slowed to below popul. growth, some fewer vacancies (but still many)

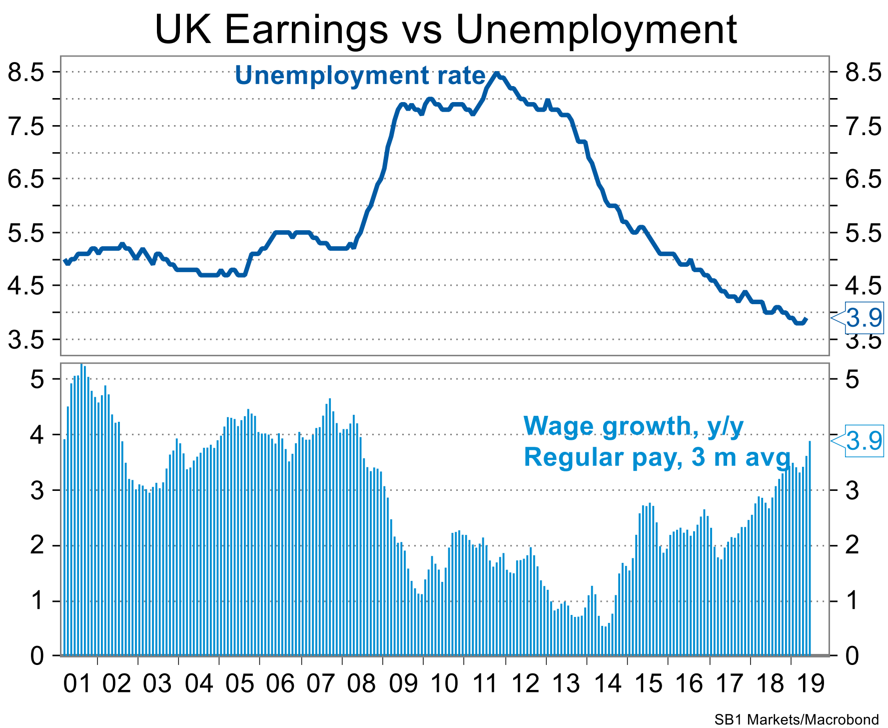


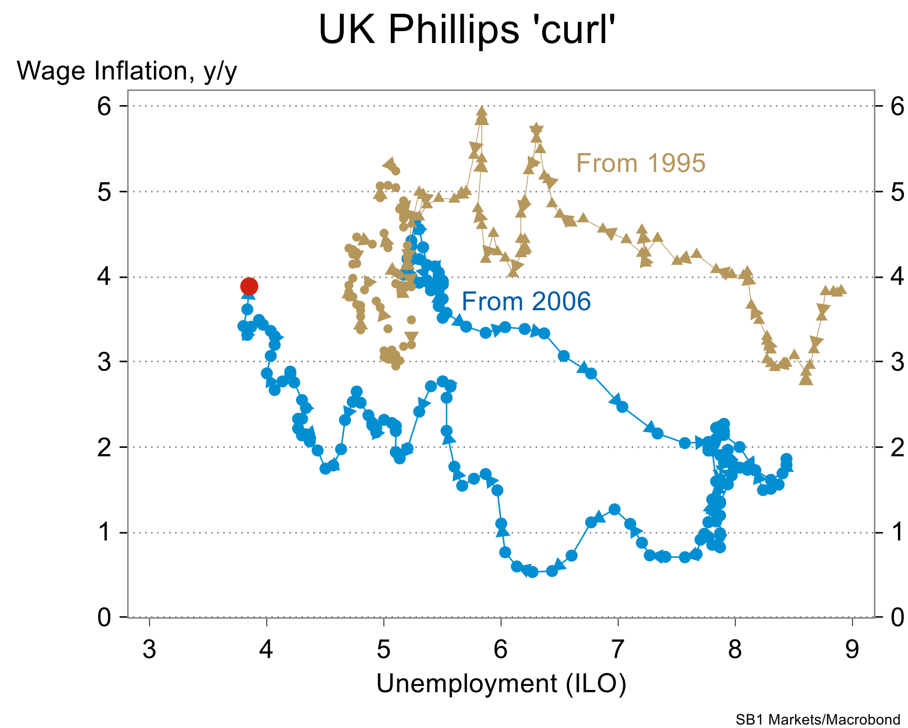


- Unemployment (LFS/ILO) rose marginally to 3.9% in May (avg April-June), up 0.1 pp, from the lowest level since 1974
- The employment rate rose 0.1 pp to 76.1%. The rate is marginally down since January, signalling some weakness in the UK labour market
- The number of job vacancies has fallen marginally recent months but is still close to a record-high level
- No surprise, wage inflation is trending up, and is approaching 4%. Wages are outpacing CPI inflation at 2%

A tight labour market is boosting wage inflation, now close to 4%, highest in 11y

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

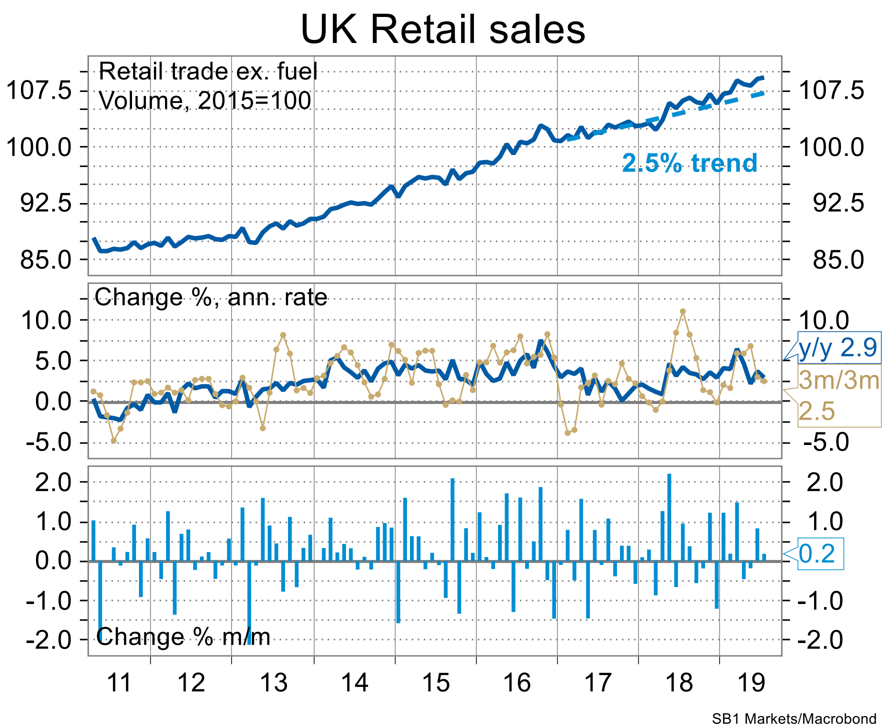


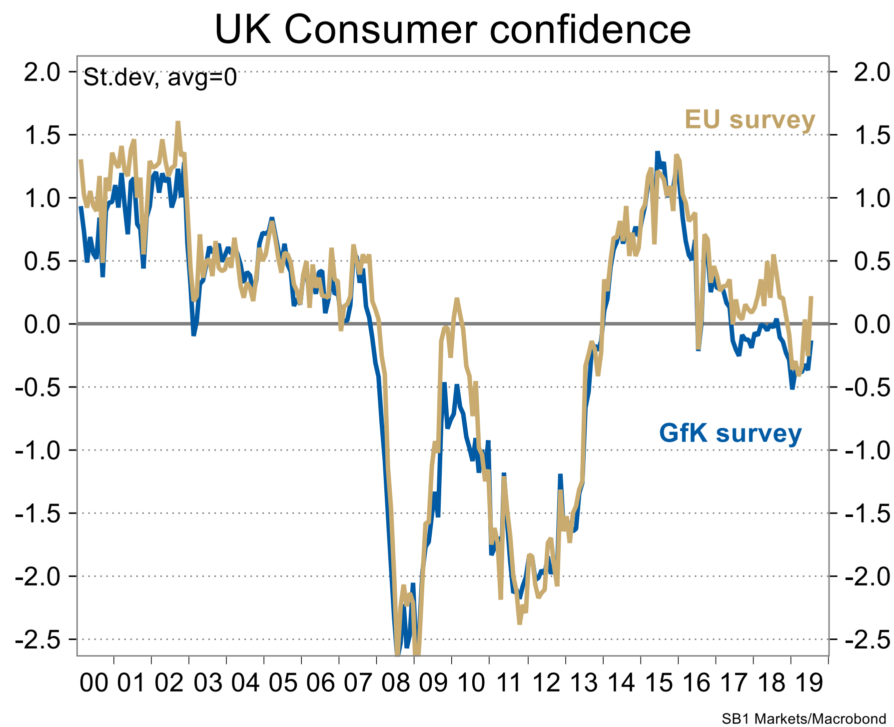


- Wage growth rose marginally 3.9% y/y in July (regular pay) but the the 3 m average accelerated 0.3 pp, to the same speed, the highest since 2008
- UK productivity growth is very low, still well below 1%, and unit labour cost inflation is running far above the inflation target. Either will inflation become too high or corporate profits will take a hit

Retail sales are still strong

Sales up 0.2% in July, expected down 0.2%, following the 0.9% lift in June. Confidence up too

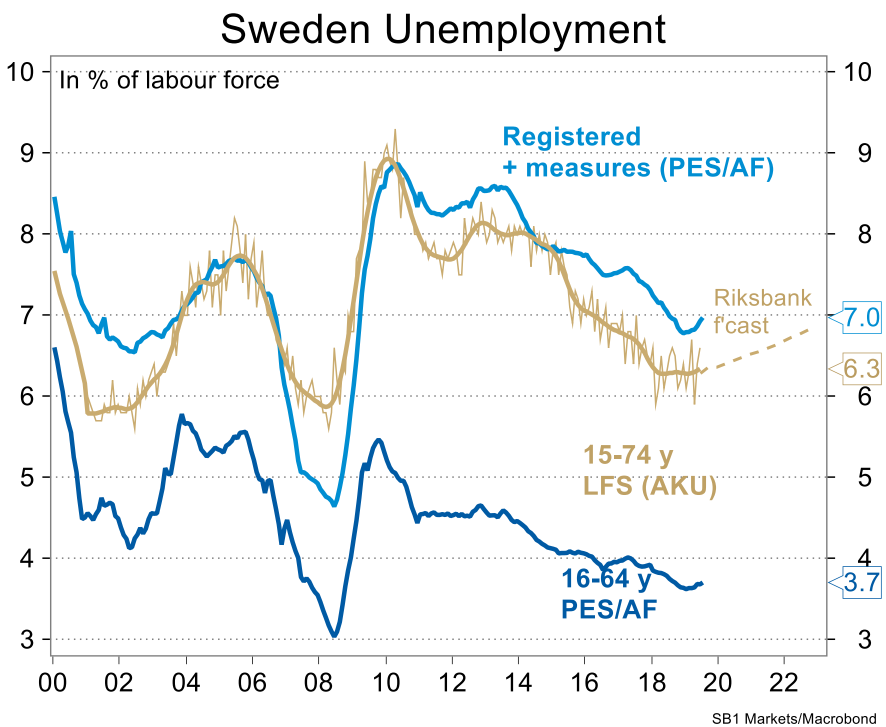


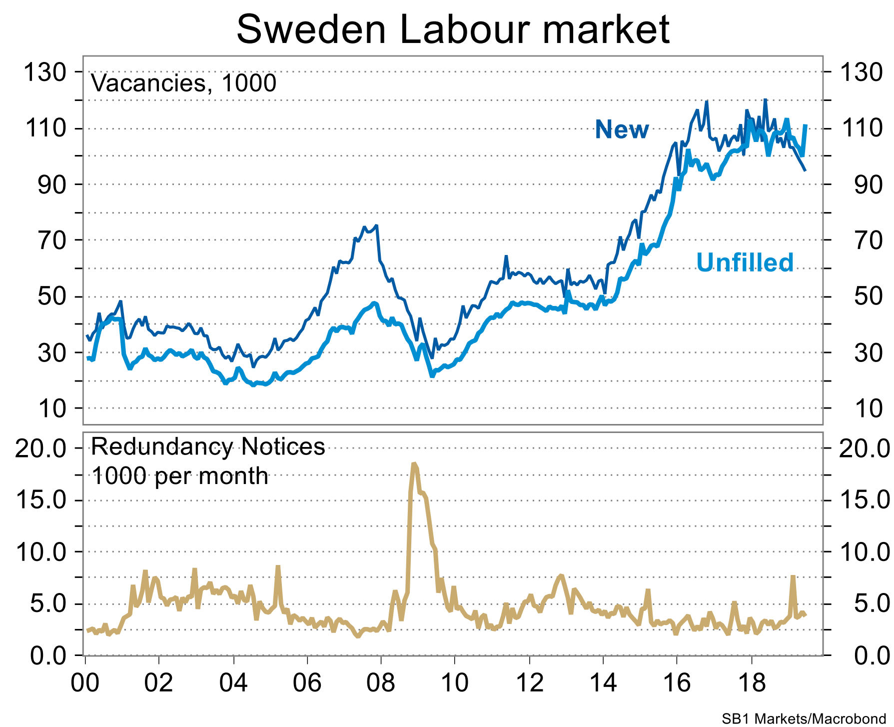


- Sales rose 3% in Q2, and the speed into Q3 is high – <u>the best data point from the UK?</u>
- High employment and rising real wages are helpful. However, over the recent years, consumption has also been fuelled by a sharp decline in household savings. Given the drop in savings, the risk is on the downside
- However, consumer confidence has recovered somewhat recent months, and sentiment is now close to average

Unemployment turns up?

Both registered and LFS unemployment up but more unfilled vacancies

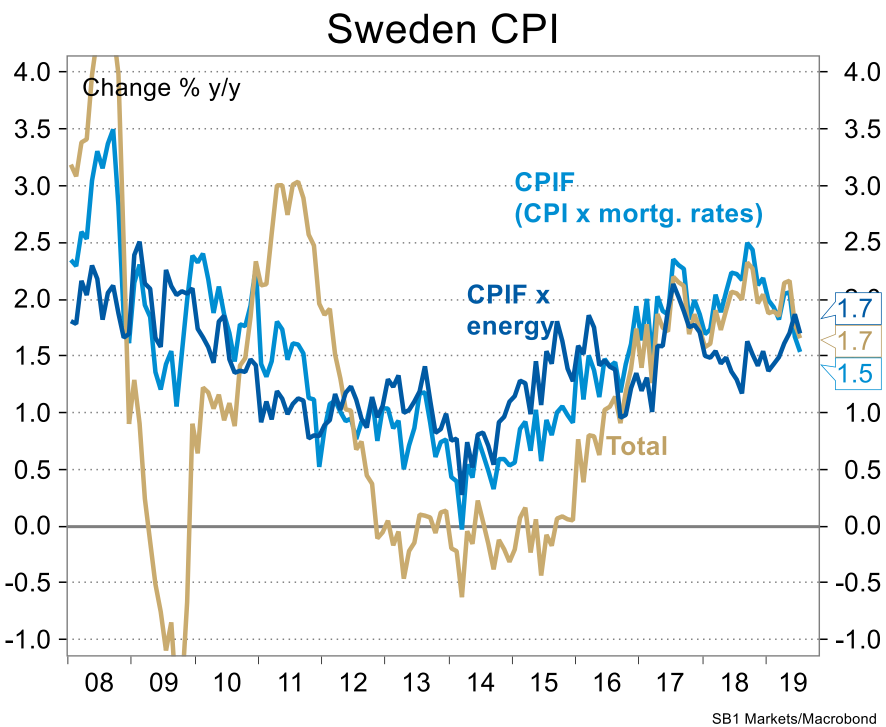


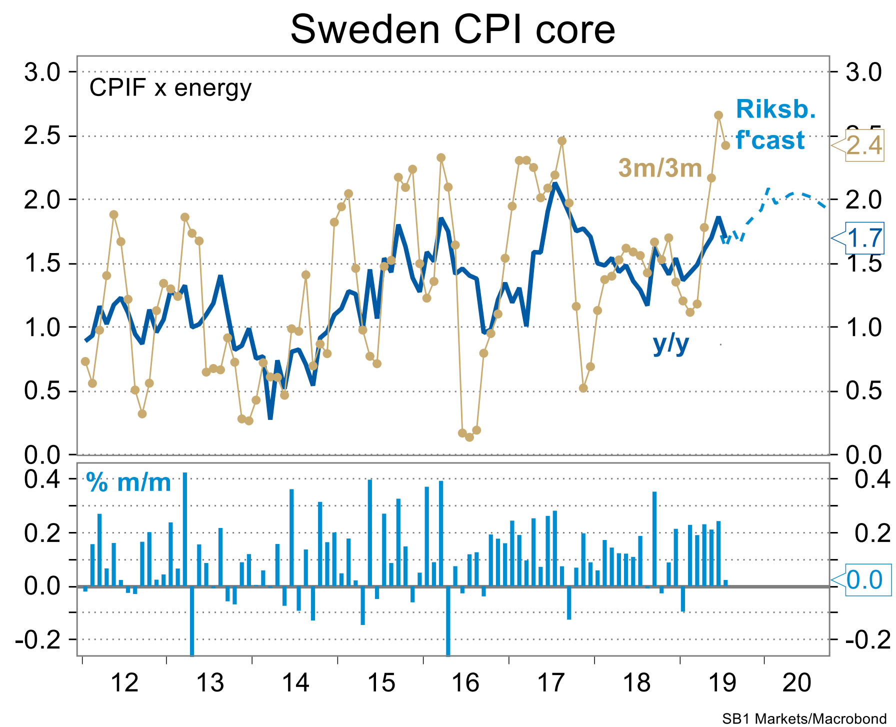


- The LFS unemployment rate rose 0.2 pp to 6.6% in June. The smoothed rate, which we prefer, was unch at 6.3%, but it rose slightly at the 2. dec.
- Employment rose in June but less than the decline previous months, and it is barely up y/y
- PES/AF open (registered) unemployment rate is confirming a weakening labour market; it has turned (very) marginally up recent months
- The number of unfilled vacancies rose sharply in June, while the number of new vacancies continued downwards. We assume the trend is down for both, but levels are still very high. The number of redundancies has fallen back after a temporary spike but may be trending slowly up

Core inflation a tad down in July, to 1.7%, not far below the inflation target

Core CPIF down 0.2 pp to 1.7%. Total CPIF inflation down to 1.7% too, both 0.1 below expect.

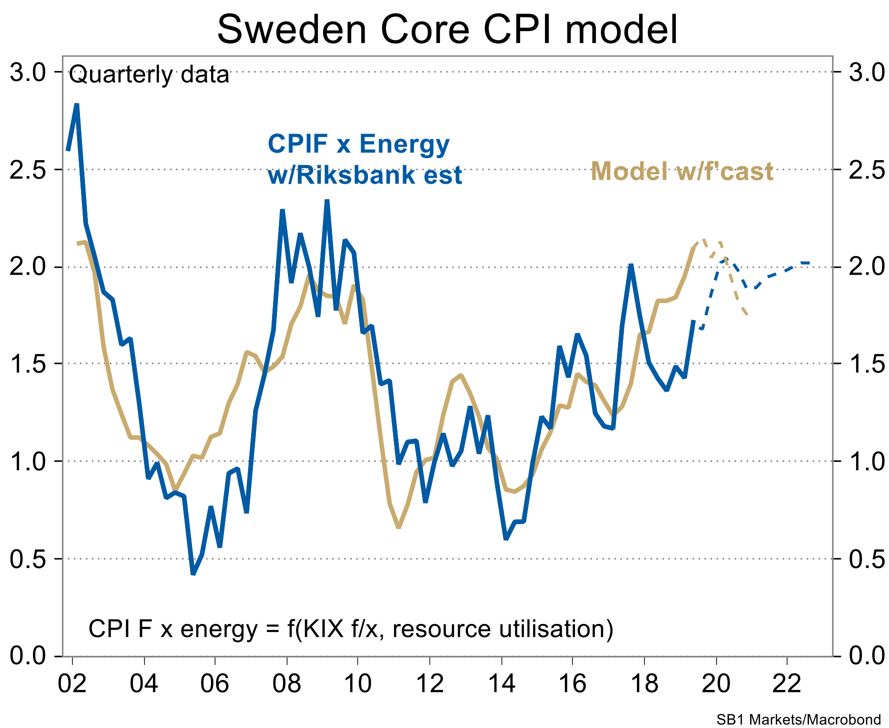


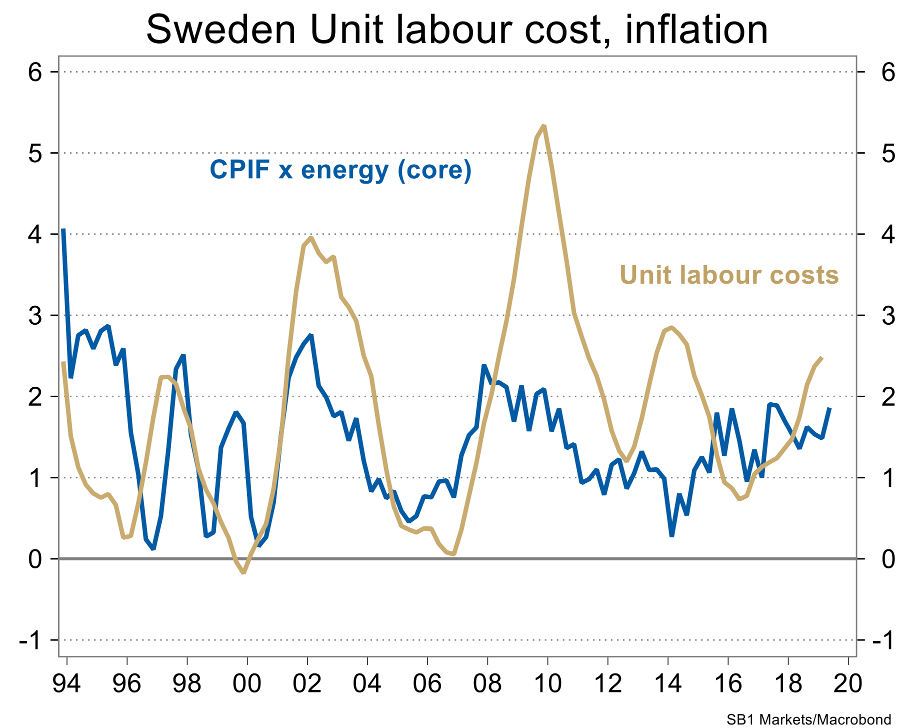


- The 'real' core (CPIF ex energy) was unch m/m and the annual rate inched up to 1.9%, 0.1 pp above consensus f'casts and Riksbank 1.8% estimates. Core inflation has moved upwards over the past year, from 1.2%. Measured 3m/3m, the rate is 2.4%
  - » CPIF (ex mortgage rates) fell 0.2 pp to 1.5% y/y - due to lower energy prices
  - » Our simple inflation model signals 2% core inflation. Domestic cost inflation is accelerating due to falling productivity
- 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

Highlights

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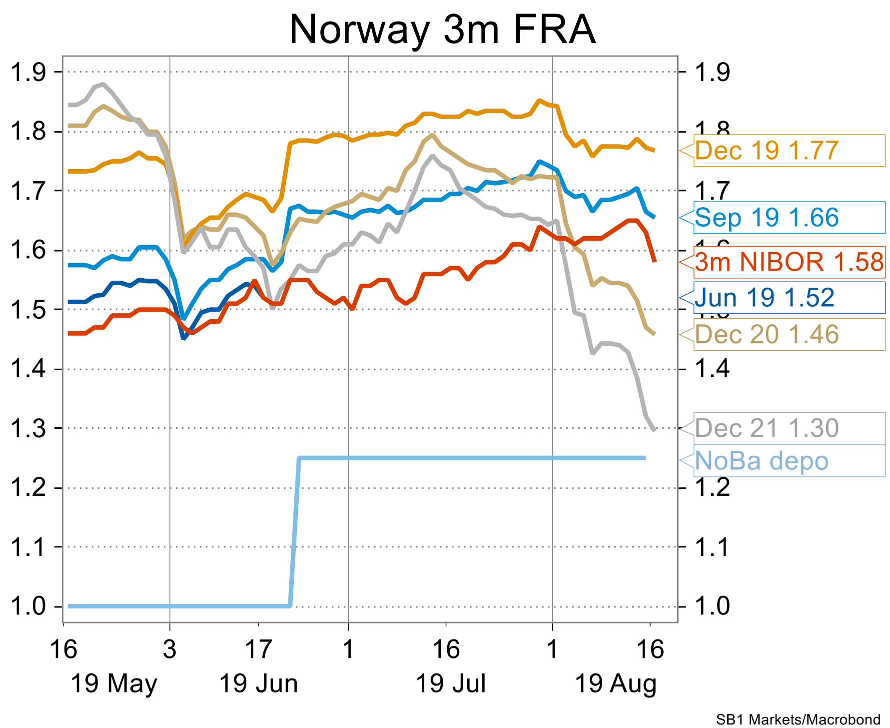
Policy rate outlook for the period ahead is little changed. A Sept hike?

The upturn in the Norwegian economy is still on track but trade tensions, Brexit may slow Norway too



The two key sentences from Norges Bank's August meeting, with our comments:

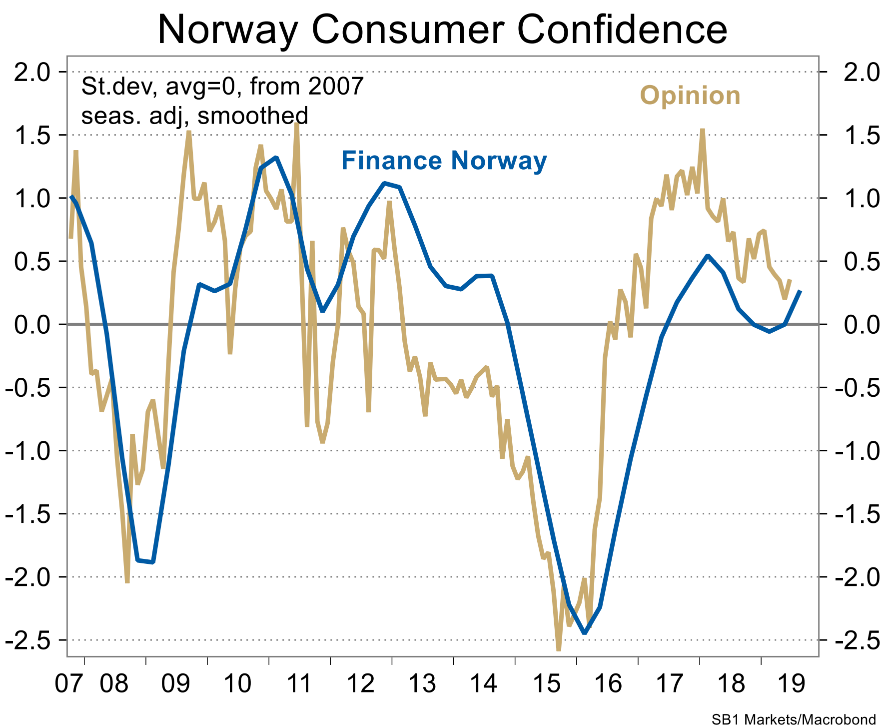
1) New information indicates that the outlook for the policy rate for the period ahead is little changed since the June Report (*which implied another hike in H2, so let's go in September*)

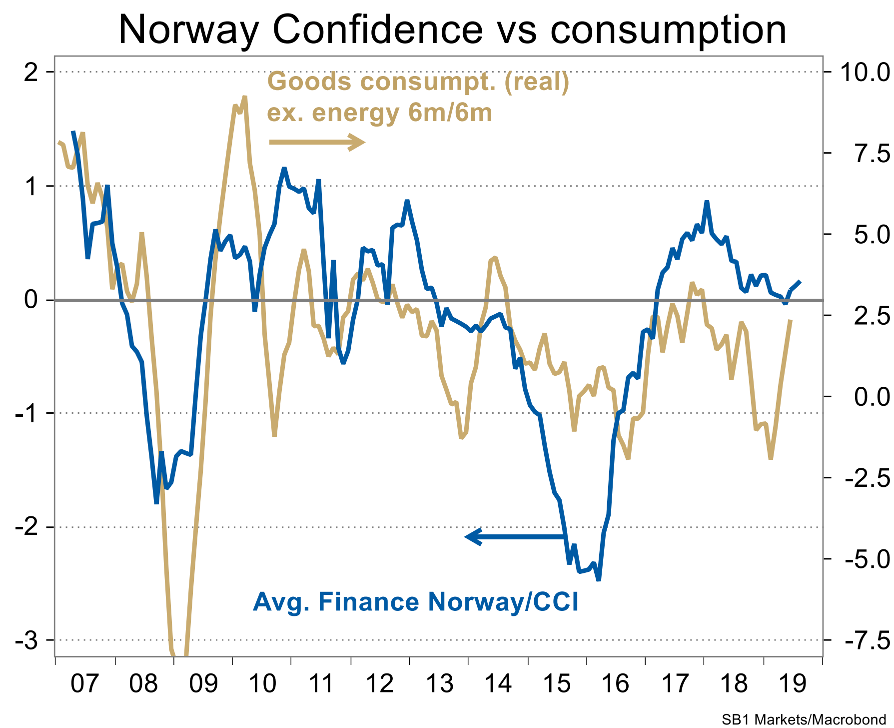
2) The global risk outlook entails greater uncertainty about policy rates going forward (*a signalled second hike in 2020 seems less likely for the Bank, now*)

- The bank also notes that growth is on track, and that the NOK depreciation may contribute to higher inflation
- We think the bank is still seriously contemplating an interest rate hike in September – as long as incoming data are not much weaker than those so far received, or global risk markets fall apart
  - » Most likely, the Bank will then lower the interest rate path in the Sept MPR, in order to take increased uncertainty into account by removing the 2020 (partly) hike from the path
- Market rates fell Thursday and Friday, which (probably) implies market pricing a lower probability for a Sept hike (check more here)

Consumer confidence surprisingly up in Q3, still not strong

Finance Norway's CCI rose further in Q3. Mixed spending plans

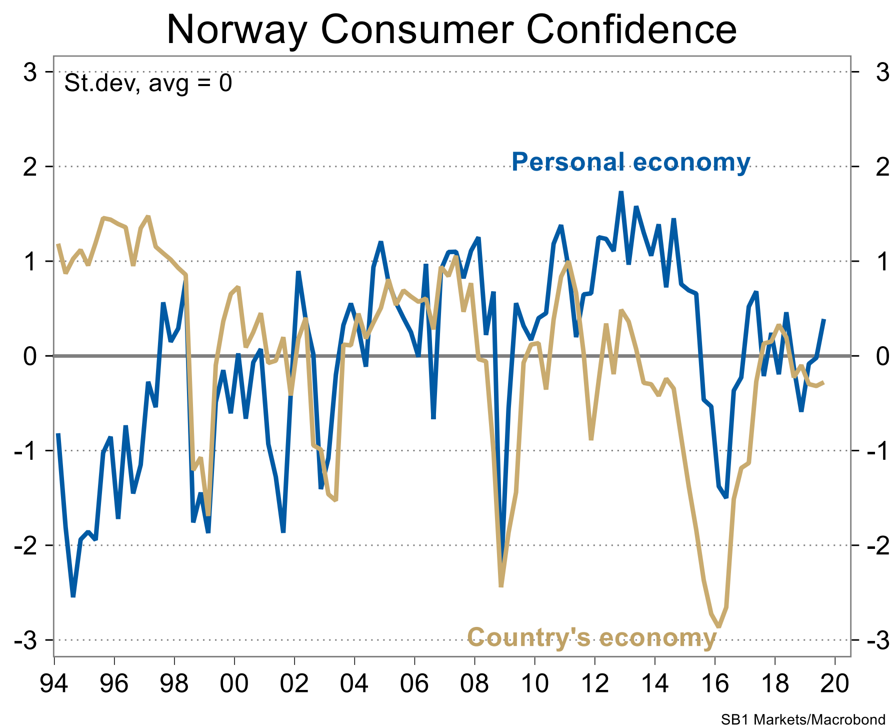


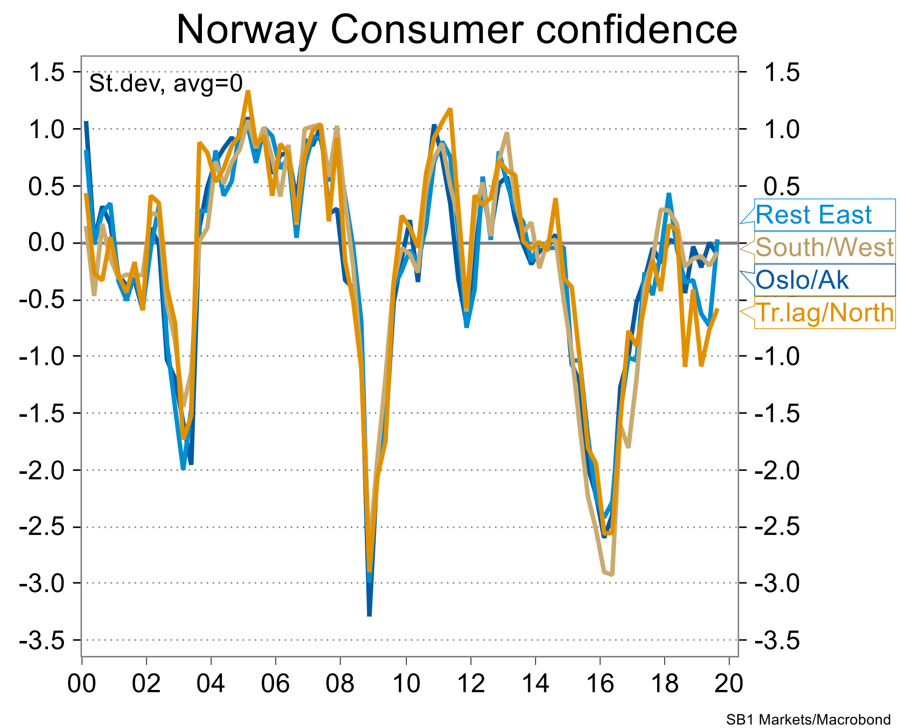


- Finance Norway's consumer conf. index rose 17 in Q3 from 14 in Q2 (revised from 12). Confidence weakened through 2018 but has recovered in Q2 and Q3. Consumers are far more optimistic than during the oil downturn (2015-2017), but less than in average (since 1994, but above the avg since 2007, shown on the chart above)
  - » The sentiment in Norway is well below levels in US and EMU but in line with sentiment in Sweden and UK (measured vs. long term avgs)
  - » Opinion's monthly CCI has not yet turned up (but no data since June)
- Growth in consumption of goods has been far softer than indicated by the sentiment surveys (and the correlation is anyway not that strong). Slow growth in nominal and even more in real income, and low population growth may explain some of the gap

It's my economy stupid, not the country's

The assessment of the personal economy rose, confidence in the country's economy flat

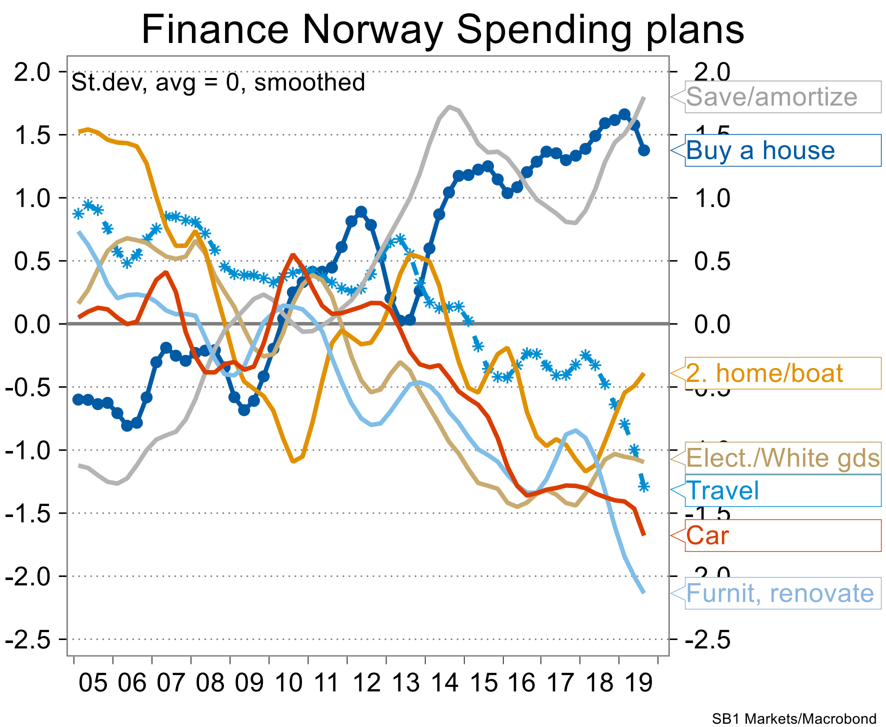


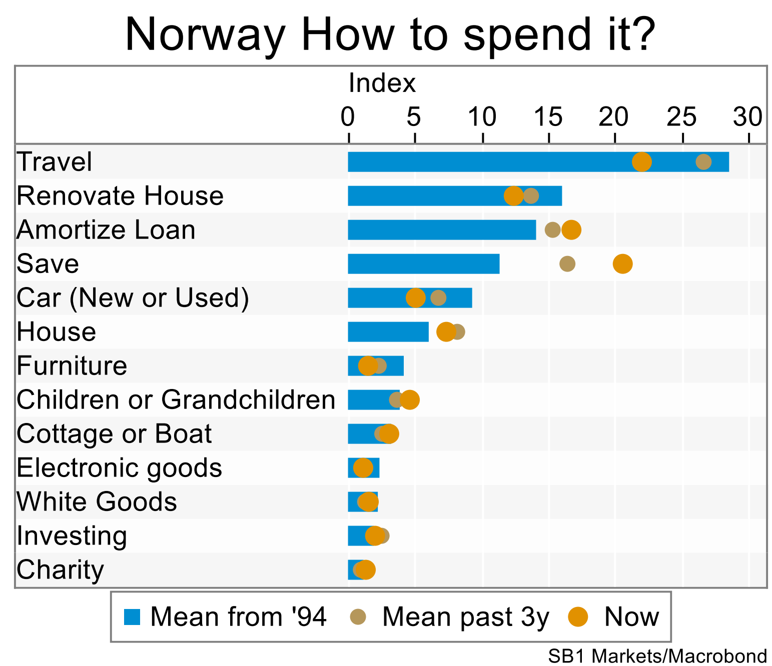


- Confidence in the Norwegian economy has not recovered and is weaker than the micro index but still close to an average level
- Regions are usually moving in tandem, and they did even during the oil downturn. Now, Trøndelag/North are lagging the others. Confidence in the South/West (oil heavy) region is back to the same level as in Norway ex. Trøndelag/North

They want to save more/pay down their debt, they say

House buying plans down in Q3 but level remains high. Plans for a 2nd home/boat up, others down



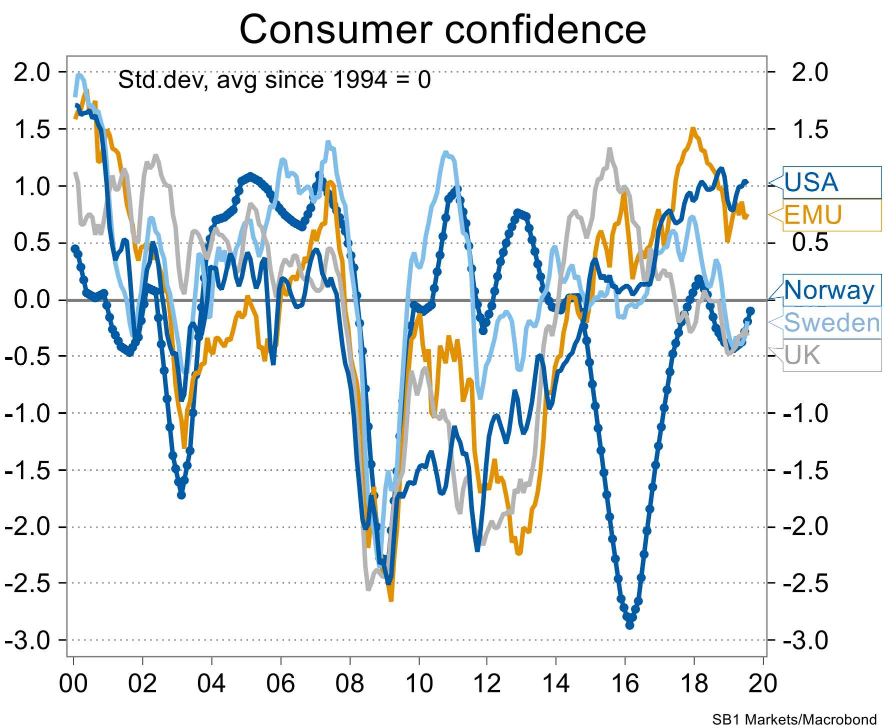


- The Finans Norge survey indicates that neither higher interest rates nor modest house price increases past two years have dented households appetite for buying a house. Plans for buying a 2nd home or a boat are still below par but have strengthened over the past year
- Savings/amortize plans have trended up since 2017
- Then there is less to spend? Plans for spending on furniture/renovate has never been lower, plans for buying a car has never been lower since 1992, travel plans not since 1997. Electronics/white goods are not in vogue either

SpareBank 1 MARKETS

Little mirror on the wall… No, the Norwegians are not the most optimistic

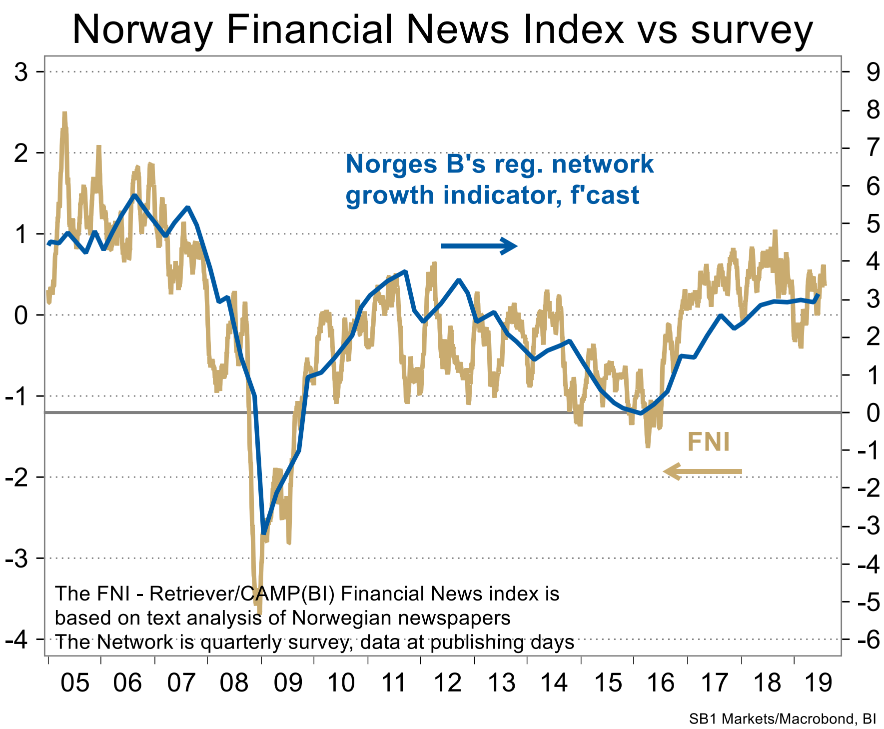
At least not compared to what people usually are reporting. US and EMU at the top

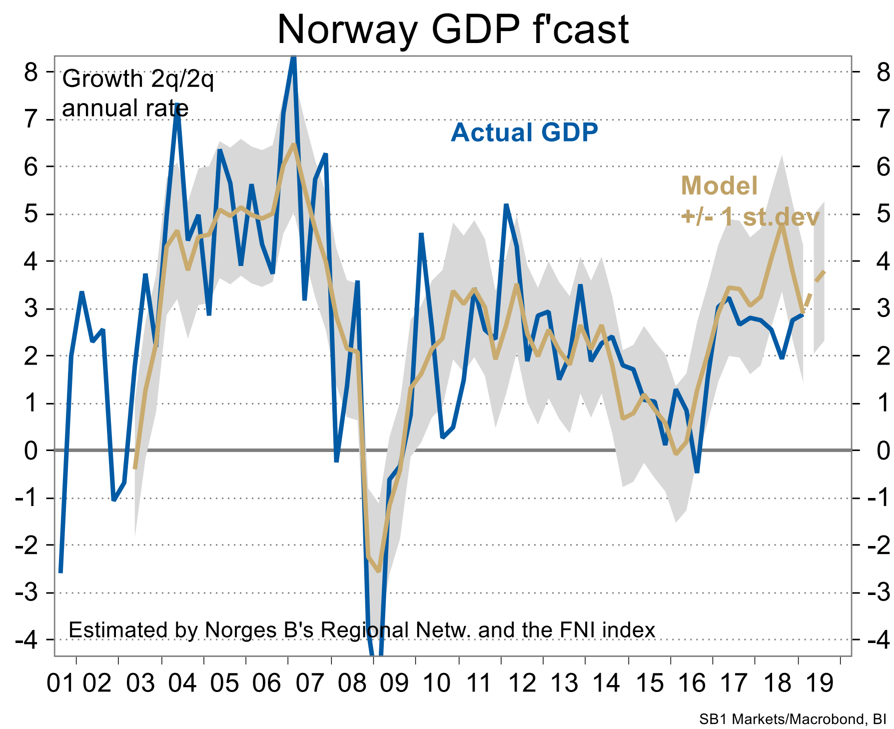


- (Well, the Chinese are even more optimistic, according to the NBS survey there)
- Consumer confidence in Norway is in line with levels in Sweden and UK

The Financial News Index has rebounded

The FNI is back at strong 2017/18 level, signals still decent growth



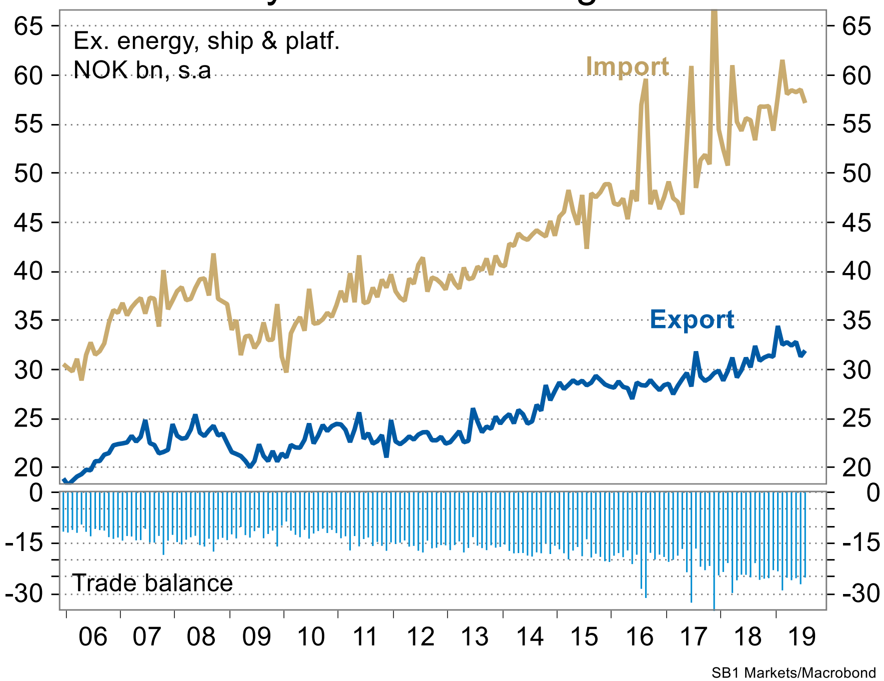


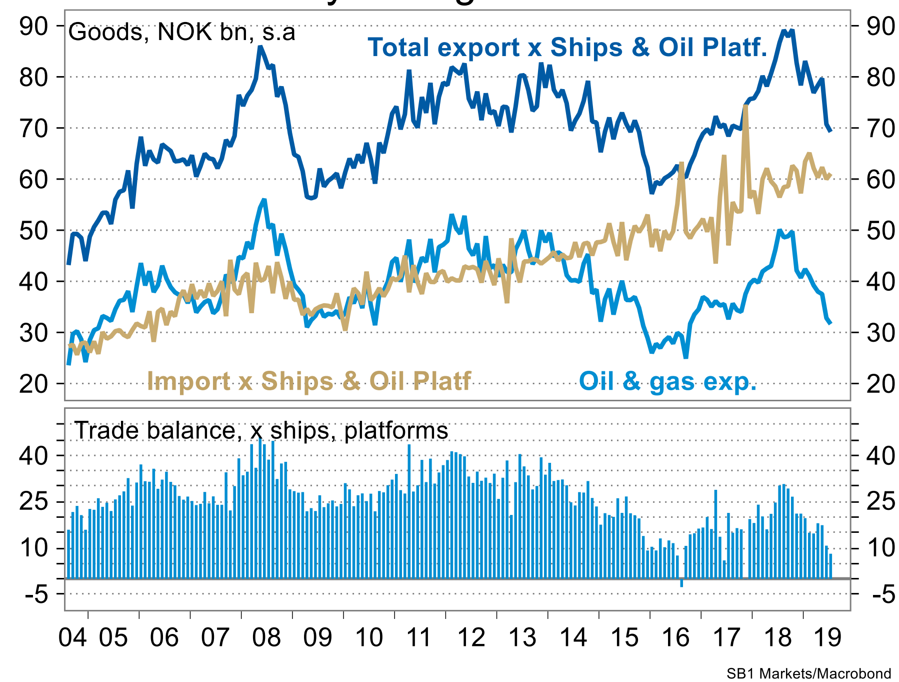
- Late last autumn, media started talking/writing about the downside, amid the turmoil at the financial markets, sending the index down from the level last summer. The index fell until the end of last year, and since then the index has recovered and in July the index signalled strong growth again

Financial News Index is based on an analysis of text in Norwegian newspapers covering the economy, tracing 'economic' world and assessments. The index follows the cycle well but is rather volatile, short term. The FNI is published by Retriever/CAMP(BI)

Exports still not impressive, imports are on the way up

Mainland trade deficit narrowed in July but trend is flat, at best. Petroleum exports down in July too

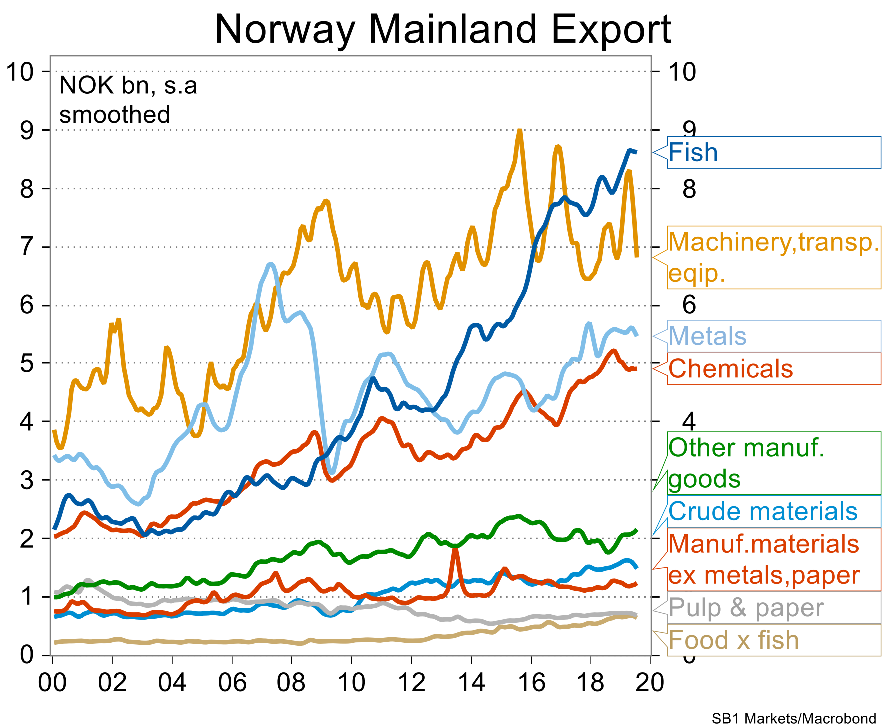


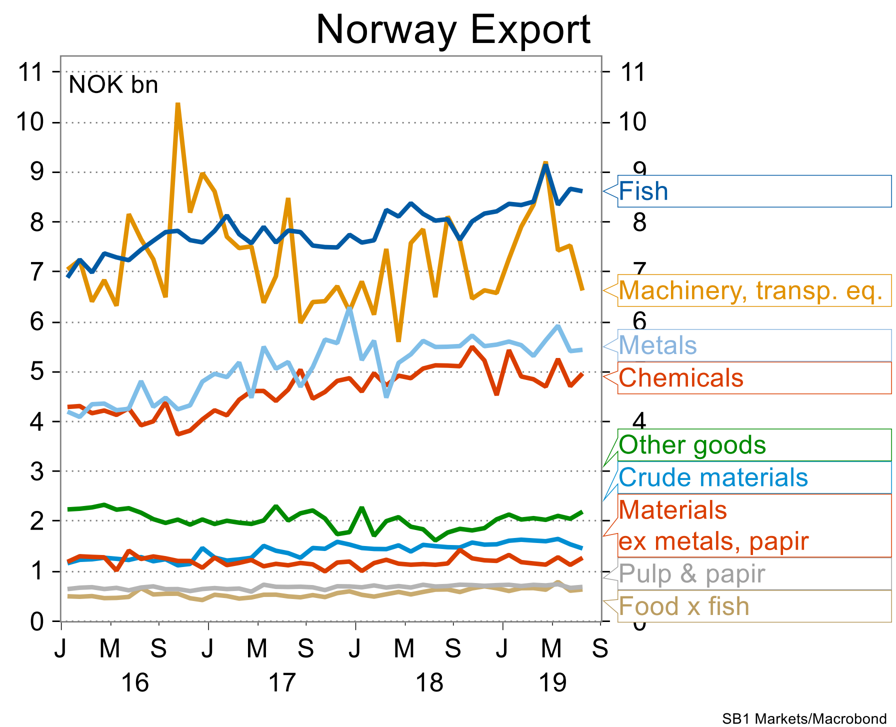


- The Mainland (non energy) trade deficit declined almost NOK 2 bn to 25 bn in July. The deficit has been more or less stable since early 2018, following a significant widening the previous 7 years – and the long term trend is flat, at best
  - » Imports are up (in value) 6% y/y (smoothed), primarily due to soaring imports of machinery & equipment + vehicles
  - » Mainland exports value fell sharply in June and did not recover much in July. The underlying trend is still up, but at a marginally slower pace than imports (in %), even if the NOK is weak. Machinery and fishing contributes on the upside
- The overall trade surplus (incl oil & gas, ex ships & platforms) fell to NOK 8 bn from 10 bn in June. Oil/gas exports fell sharply due to reduced volumes. The total trade surplus equalled some 3% of total GDP in July, but level over the previous months are some 6%

Most sectors reported lower exports in June/July – but most are trending up

Fish exports are trending steeply up, most others heading slowly upwards

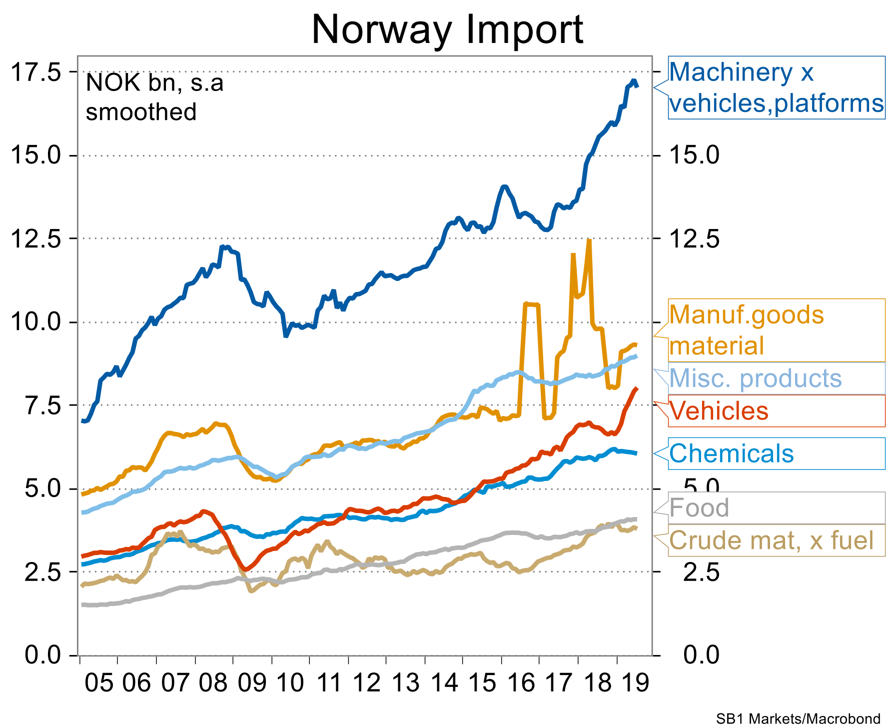


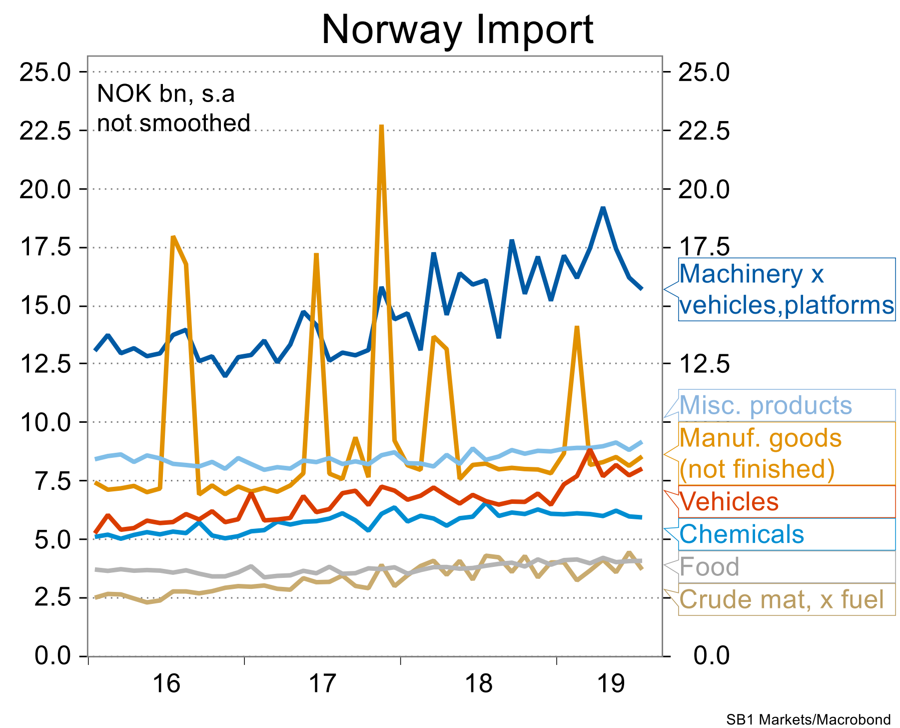


- Fish exports have been soaring both in value and volume recent years
- Exports of machinery and transport equipment (probably related to oil activities abroad) accelerated during the spring and has been decreasing since.. Exports are well below the 2015 and 2016 peaks

Imports of machinery equipment are soaring, vehicles up too

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

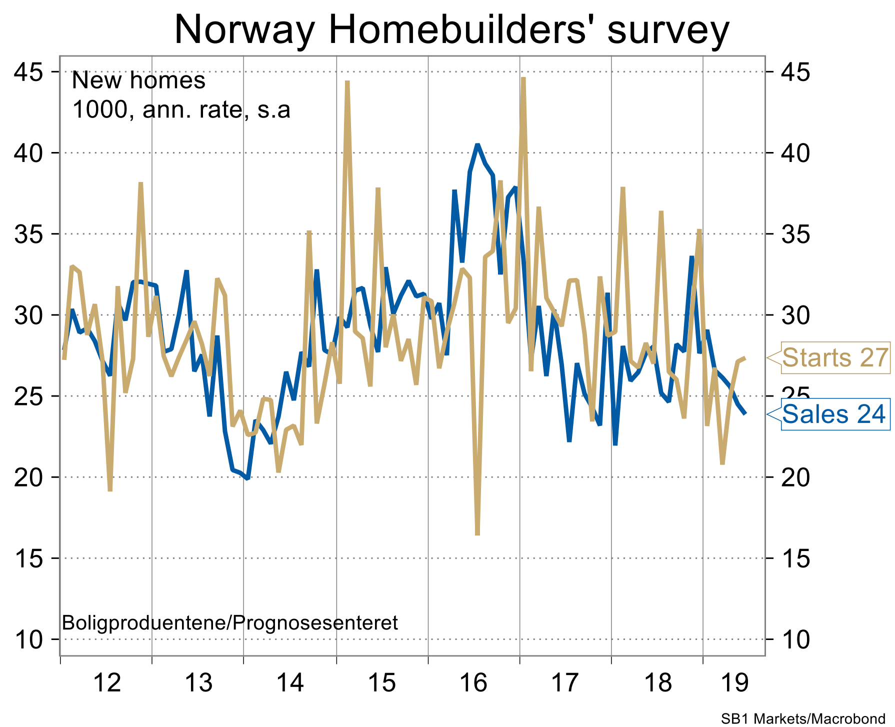


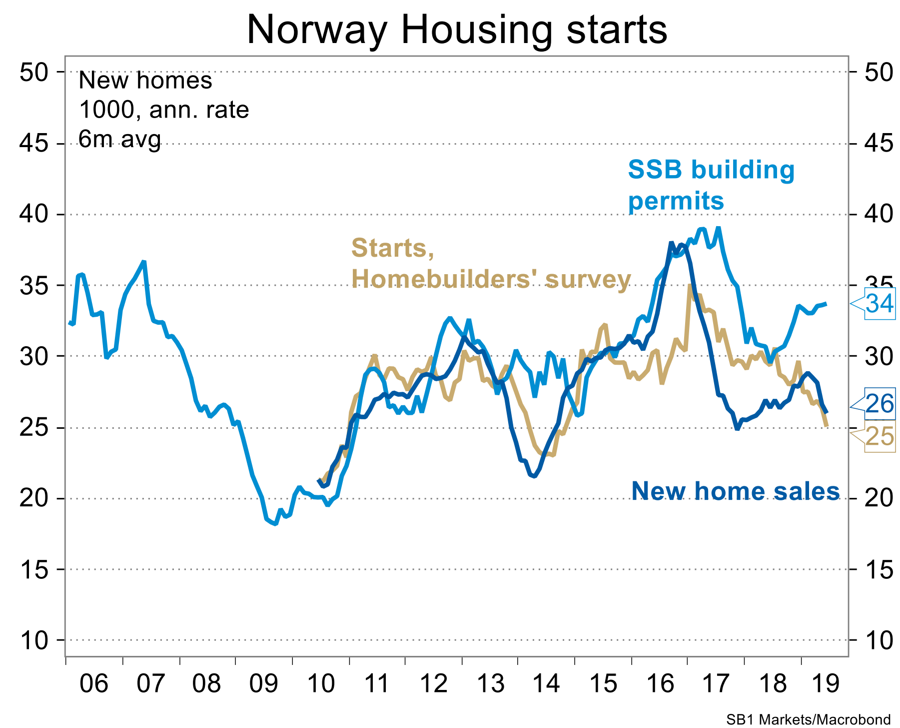


- Imports of manufacturing materials have had some huge spikes, due to some massive transactions; of oil platforms, wind mills and combat airplanes. Regardless, the trend is steeply up. Machinery ex vehicles and platforms, much oil related, are rising steeply too
- Chemicals, food and crude materials 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

Homebuilders report softer new home sales & starts

SSB housing permits still kept well up but may be lagging the Homebuilders' survey



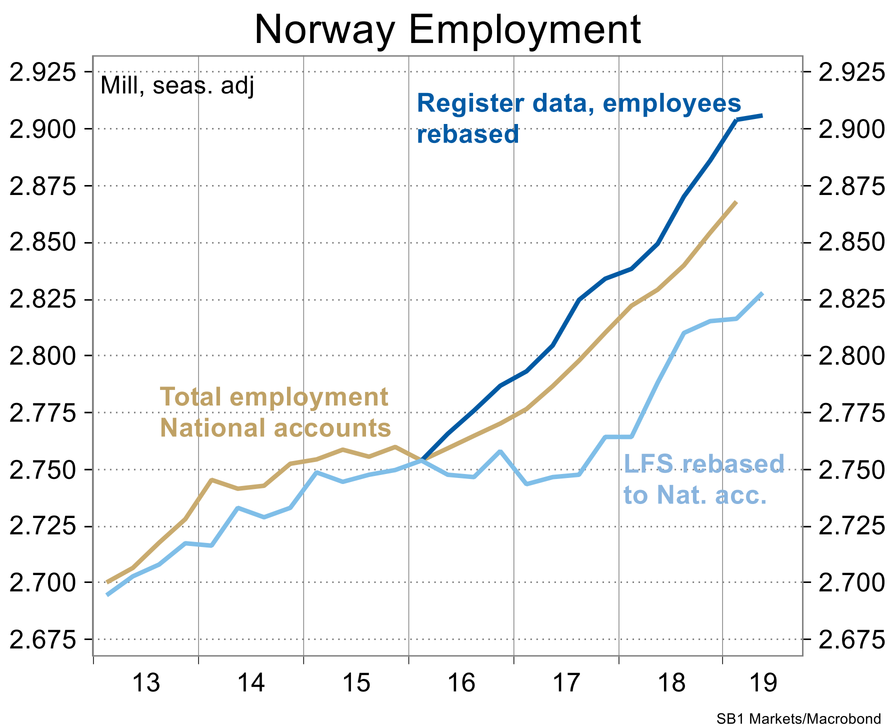


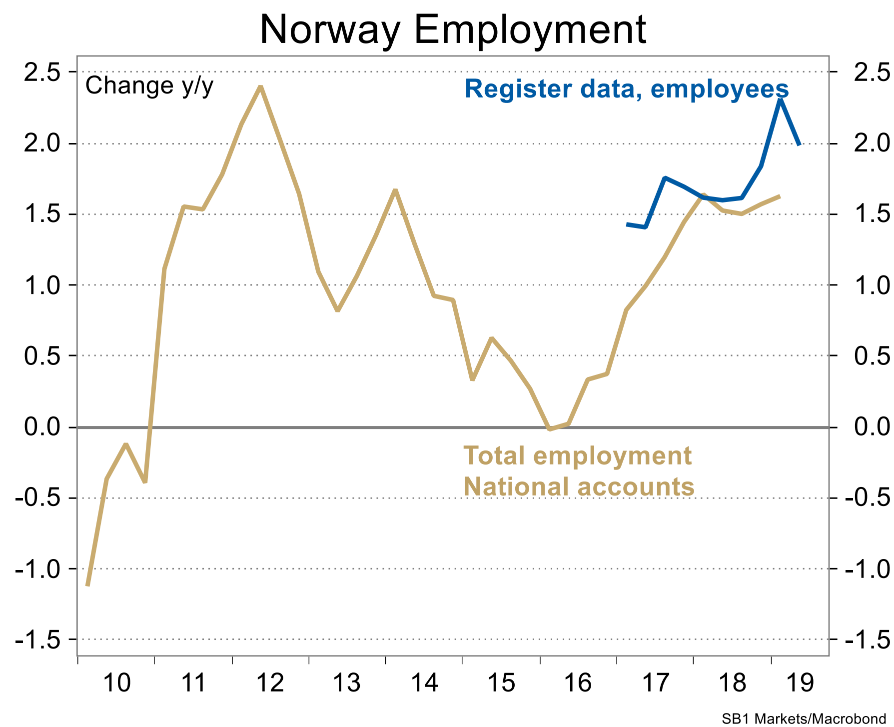
- The Homebuilders reported **new home sales** at an annual rate of 24' in June (seas. adj.), down 1' from May. The 6m average has fallen to 26', edging down the past 5 months
- **Housing starts** rose marginally to 7' but are no doubt trending down, according to the Homebuilders, the 6 m avg has fallen to 25'.
  - » SSB reports building permits at a 34' level, and the gap to the homebuilders' report is substantial (9' measured 6 m smoothed, vs avg at 2').
- Recent data from homebuilders are <u>not</u> consistent with our view that housing starts and investments would be kept up for a while, following the recovery in sales through 2018. The risk is now on the downside – and the upside was anyway limited, given meagre existing house price growth!

SpareBank 1 MARKETS

Register data may signal slower employment growth

The number of employees rose 2.0% y/y in Q2 down from 2.3%, and q/q growth probably slowed too





- The register data history is too short to make a decent seasonal adjustment, we present a preliminary estimate above
  - » These quarterly employment data are based on the new register based on 'a-ordningen', covering all businesses paying wages or social contributions. The national accounts' employment data are now heavily based on this data source. The register data have been running somewhat higher than total employment measured by the Nat. Acc
- The LFS (survey) employment data are more volatile than other measures. LFS has reported slower employment growth past three quarters

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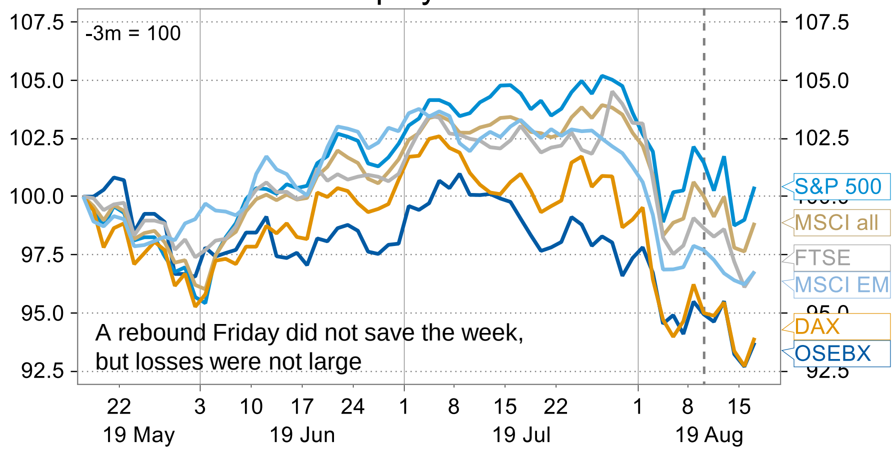
Another volatile week, stock, bond yields down. Oil, metals up, currencies stab.

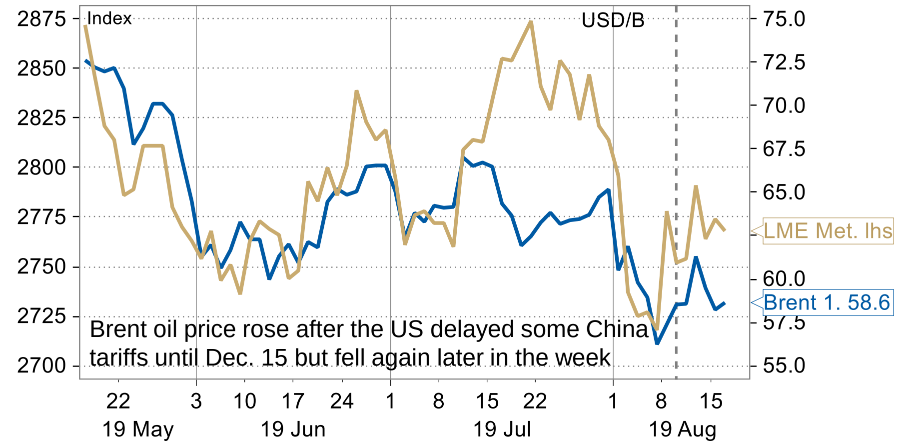
(x the Argentinian peso). Economic outlook uncertain amid mixed trade war signals, mixed data

Equity Indices



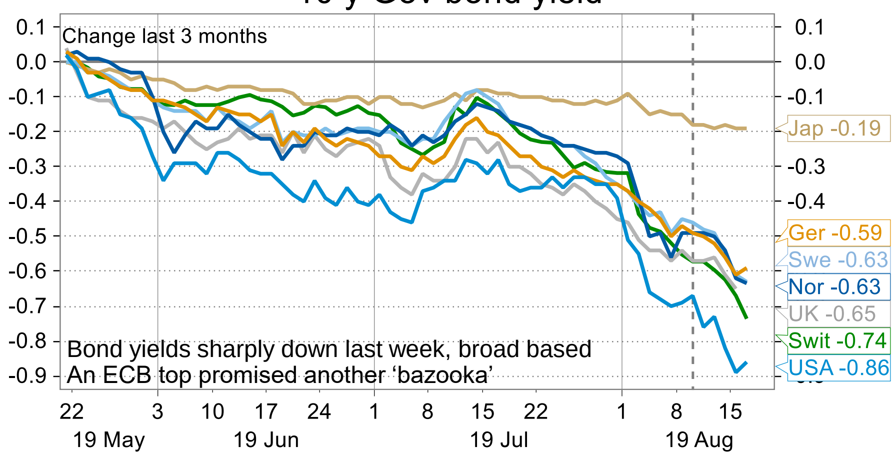
SB1 Markets/Macrobond

Oil vs. metals



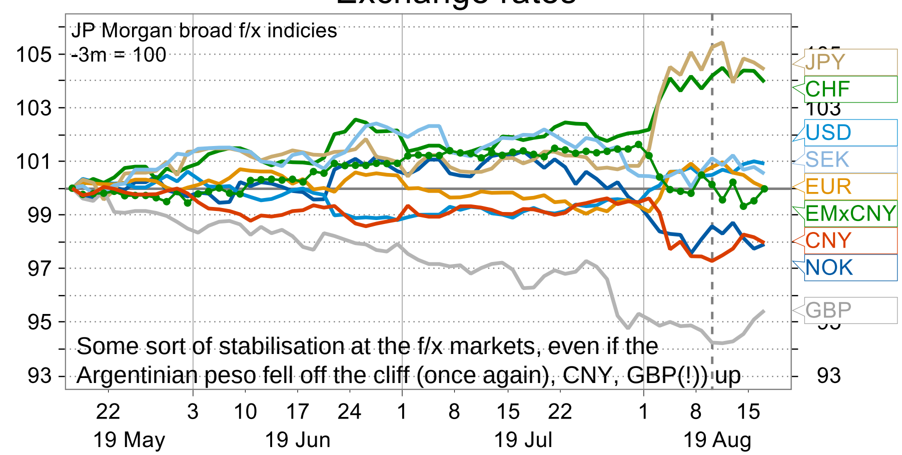
SB1 Markets/Macrobond

10 y Gov bond yield



SB1 Markets/Macrobond

Exchange rates



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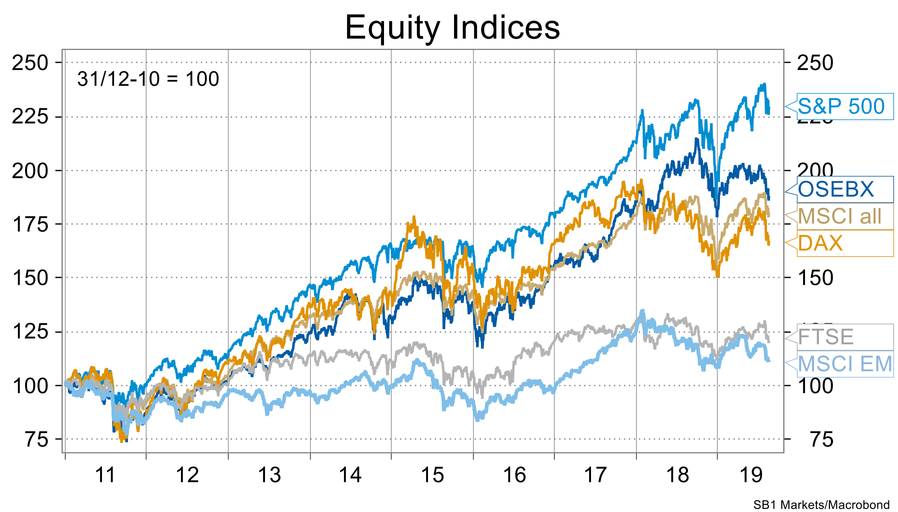
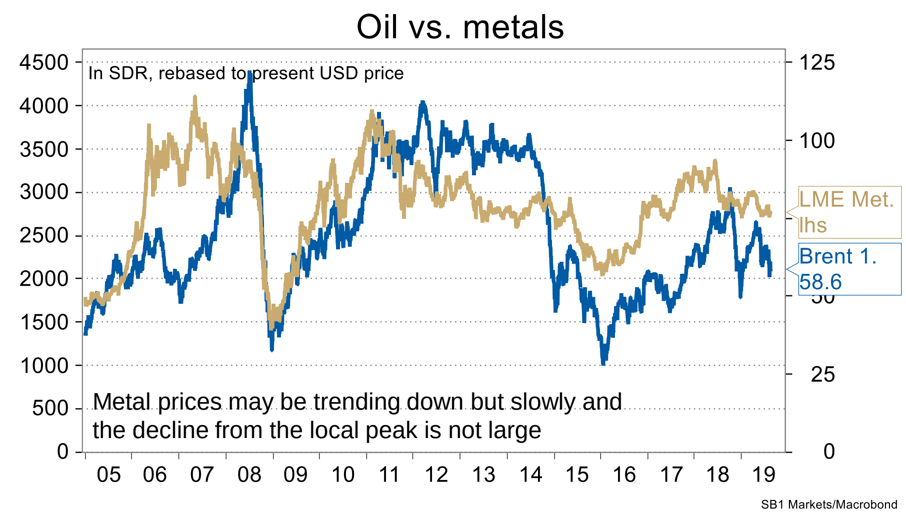
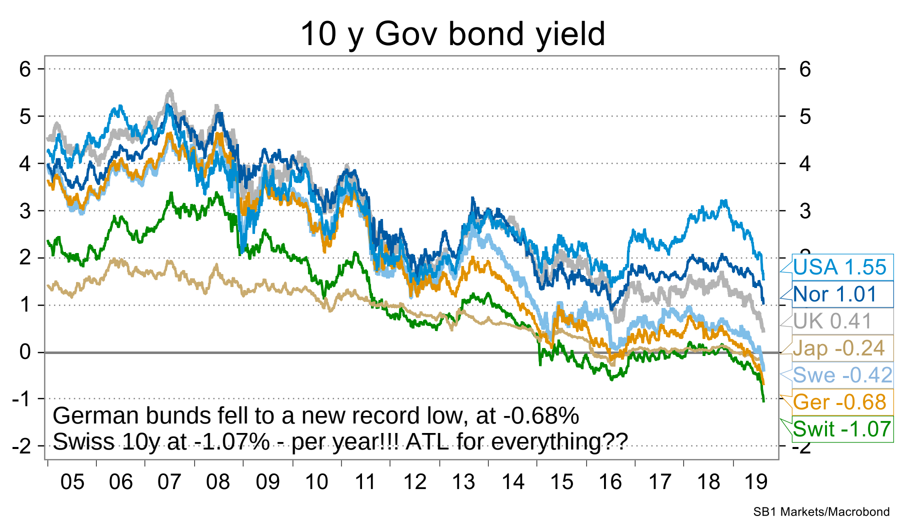
SpareBank 1 MARKETS

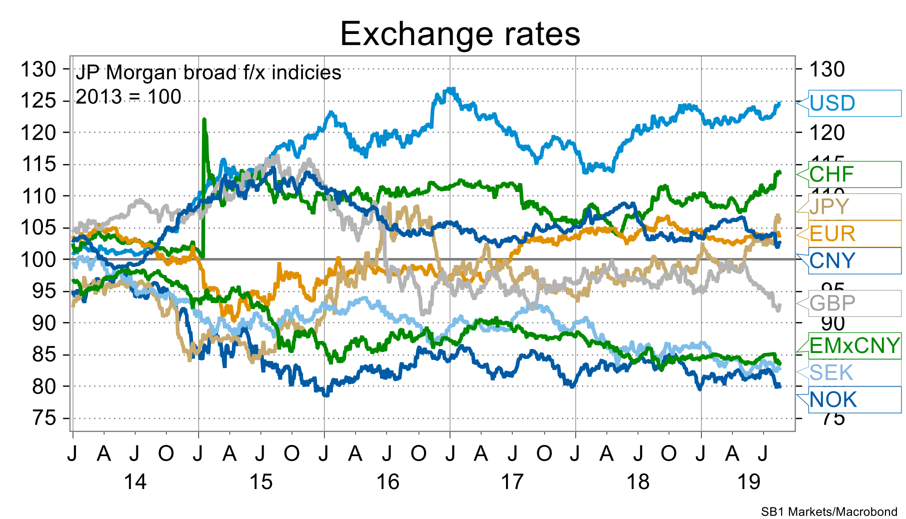
German bunds to a new ATL at -0.58%, S&P down some 4% from peak

The trade war rules. And then some economic data





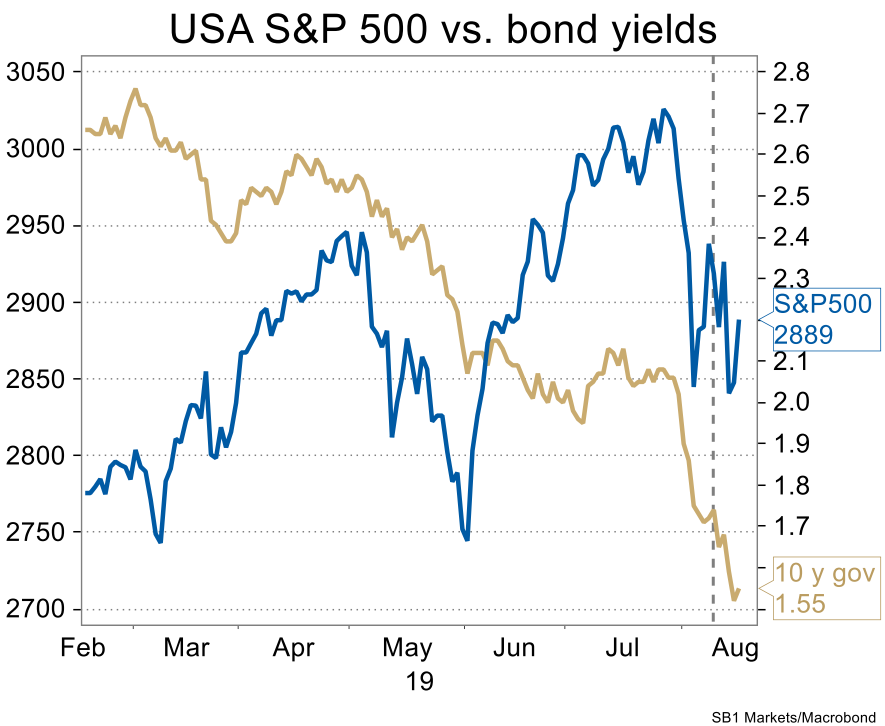


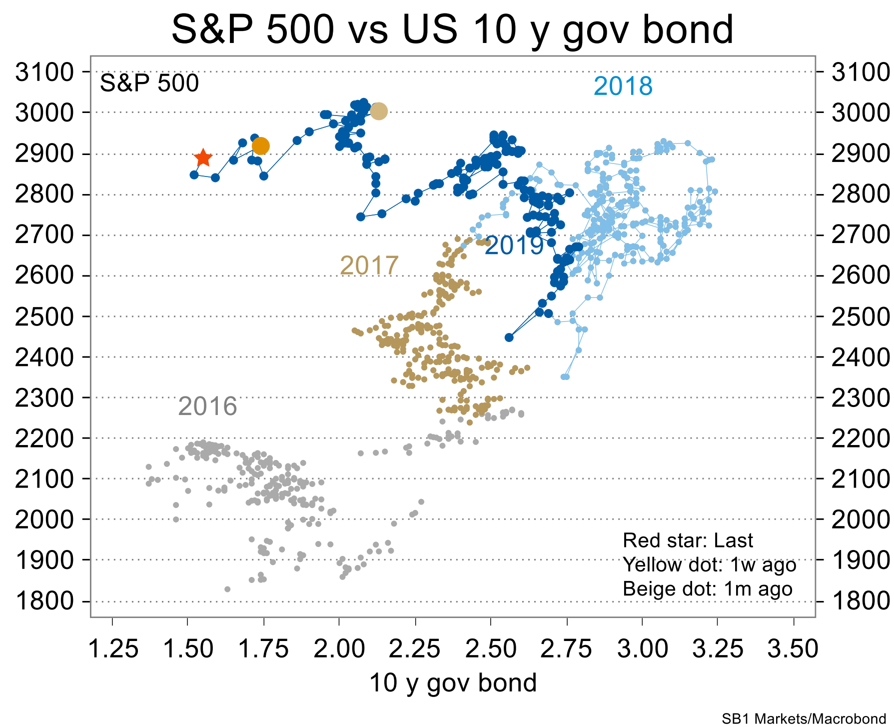


SpareBank 1 MARKETS

US: A turbulent week ended with a stock market rebound but still low yields

Global growth/trade concerns and dovish central banks sent yields further down, 10 y down 15 bps

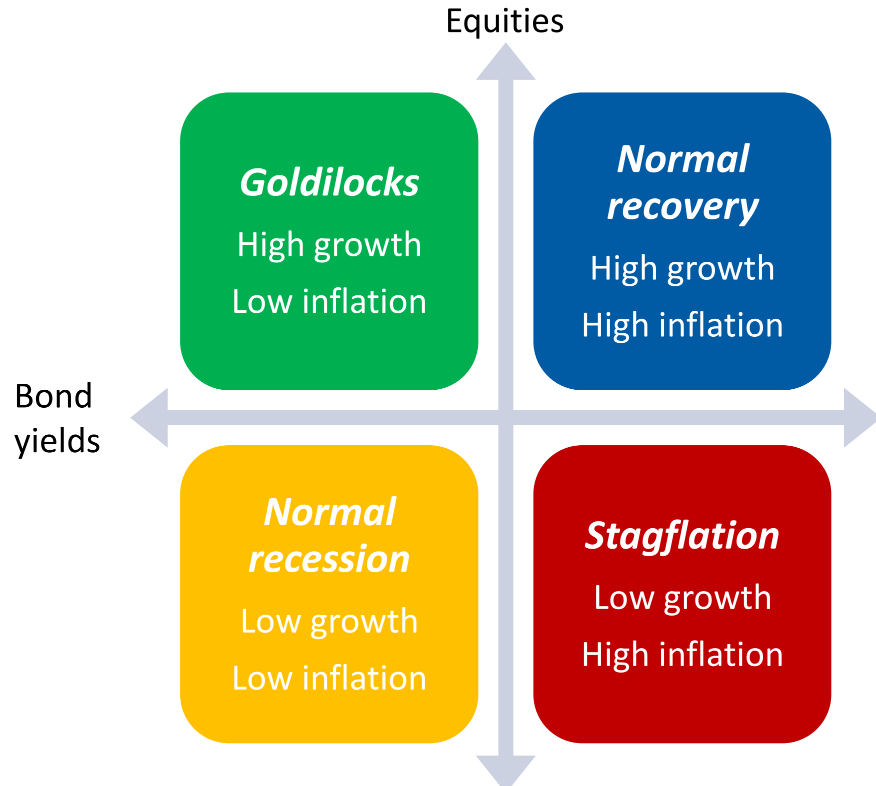


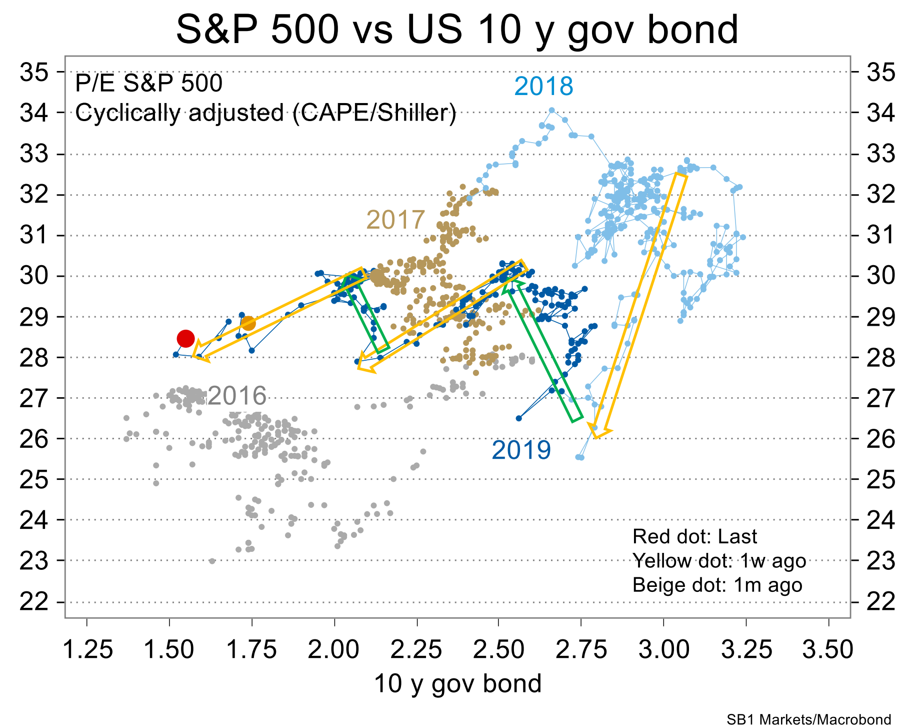


- The government bond rally regained speed last week, and stocks fell more than they rose
  - » ECB ‘promises’ to take action in Sept, contributing to the bullish bond market sentiment everywhere
- For more on the relation between stocks and bonds, check next page

US markets are moving towards the recession corner

The yield curve down, due to lower growth expectations – and stocks have fallen for the same reason

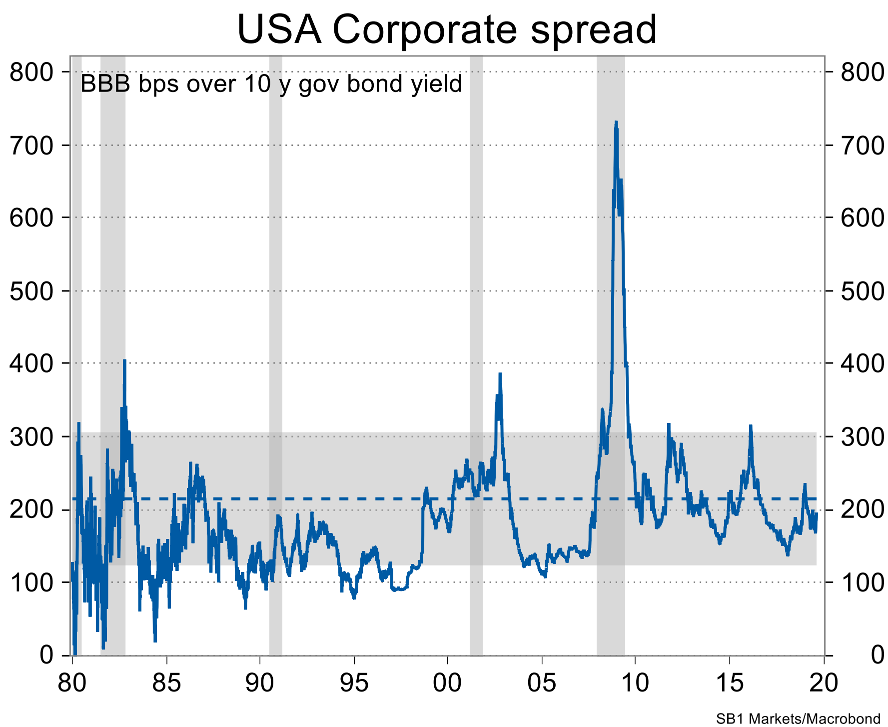


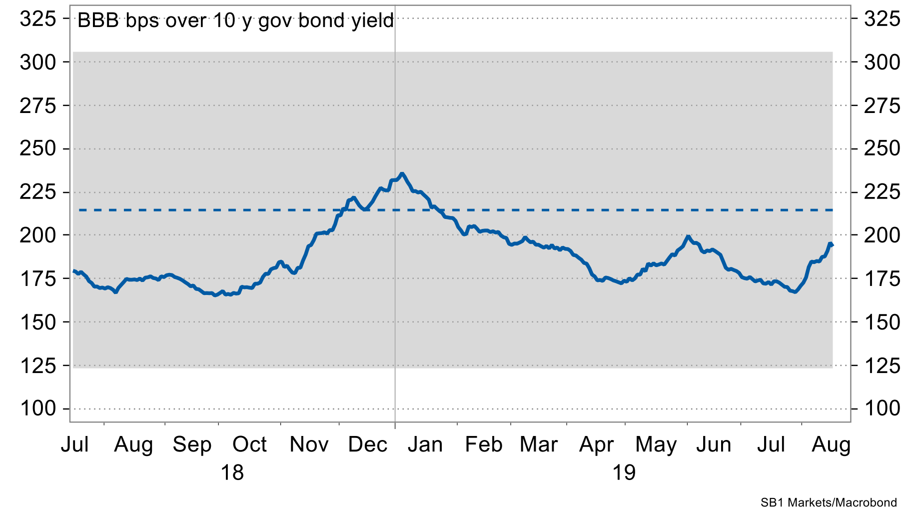


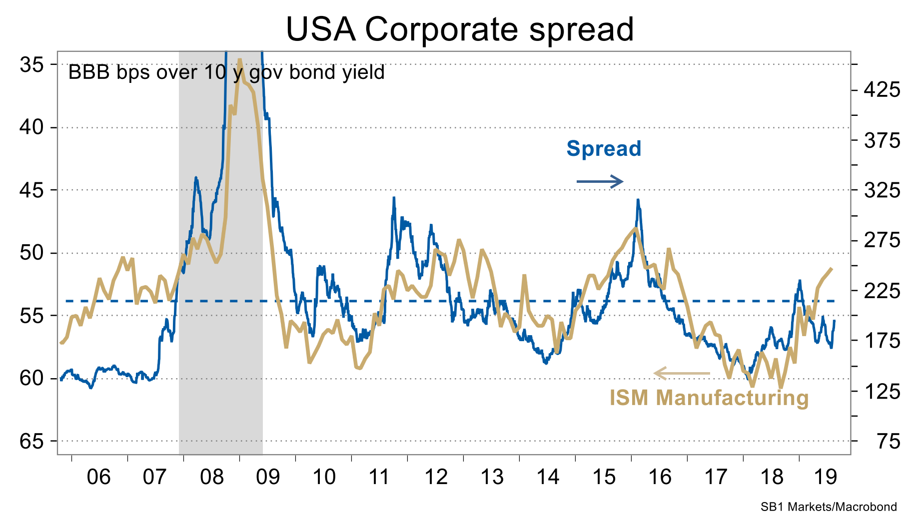
- During May, both stocks and bond yields fell sharply, towards the 'normal recession' (yellow) corner. The 'yielding' signals from the Fed (and other central banks) during June then pushed bond yields further down, and stock markets up – in the Goldilocks direction. In July, the market fluctuated mostly along the normal recession/normal recovery axis.
- So far in August, markets have moved towards the recession corner following the bad trade policy news.
- We still do not think the 'Goldilocks' scenario is likely. If yields decline substantially form here, it will be due to really weak economic news, which will not be good news for the equity markets. We are not that worried for the 'Stagflation' corner either; a take off in inflation will happen only if central banks make serious policy mistakes, over time. Trump wants the Fed to do just that but we doubt he will succeed. So, the normal recession/recovery axis is the most likely – and now we are heading towards the recession corner

Credit spreads have widened past three weeks but remain (too?) low?

Spreads are too low if the ISM and (most) other surveys are correct; <u>if growth is slowing</u>

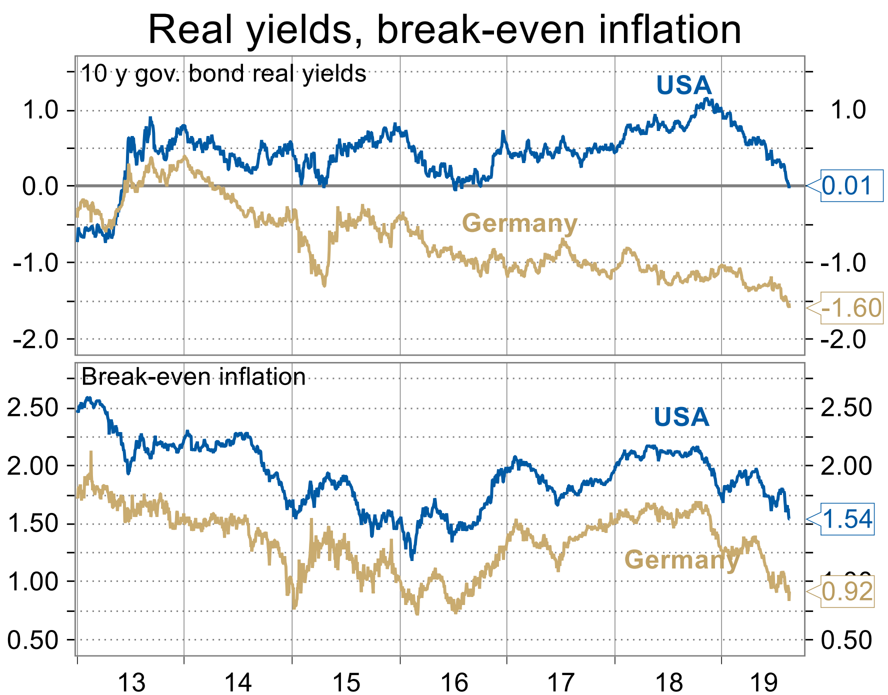


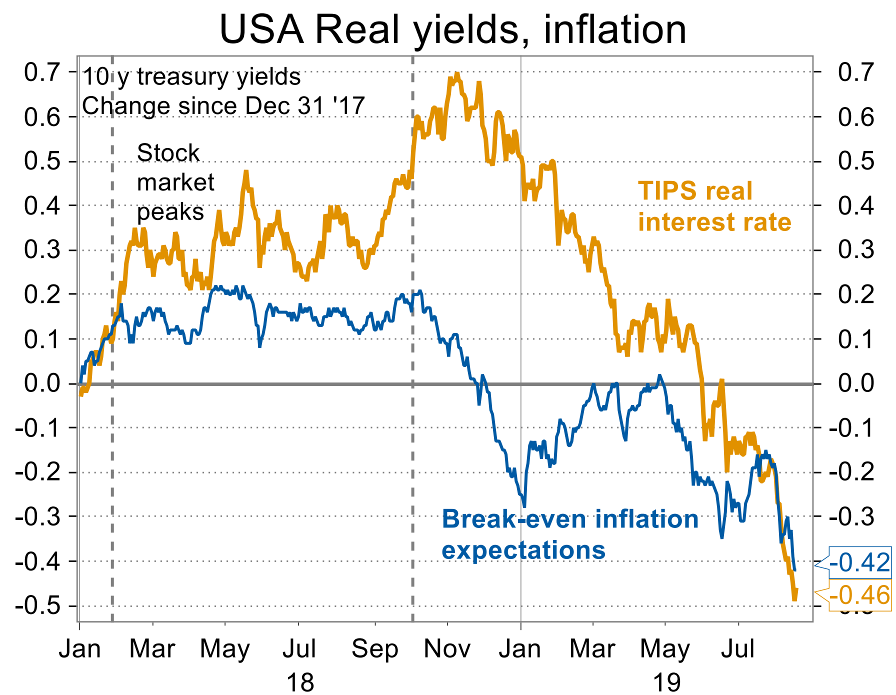




Real rates, inflation expectations, term premiums, have all tumbled

... German 10 y real rate at -1.6%, inflation expectations below 1%. US real rate at 0.01%

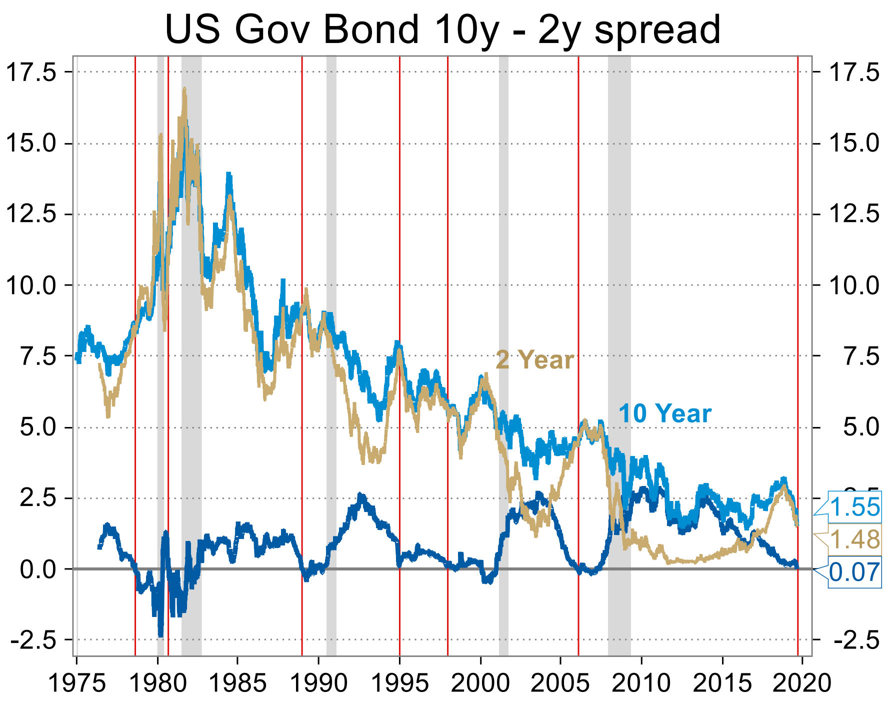




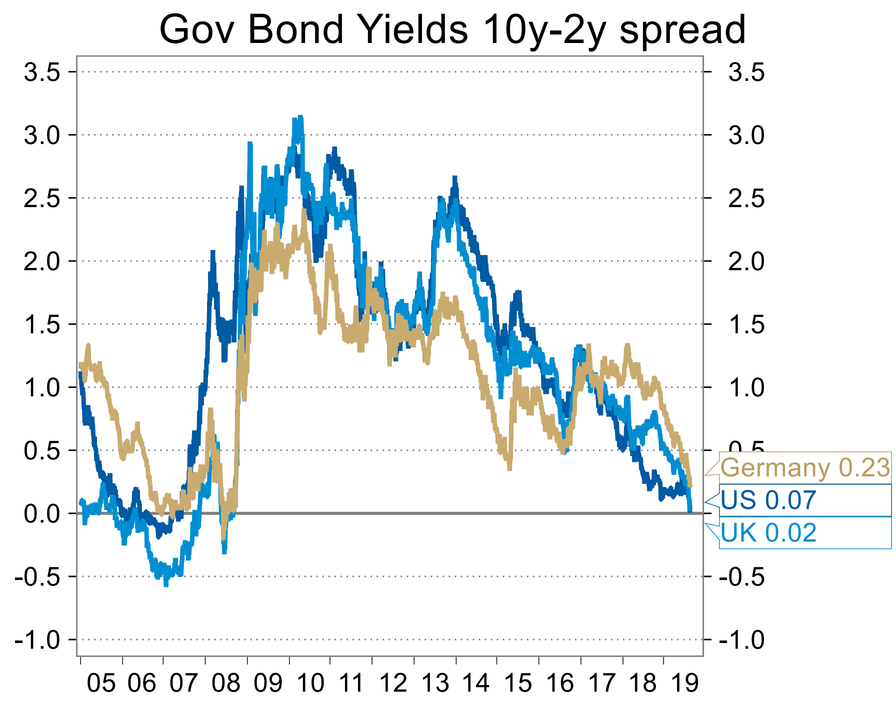
- German real rates record low, US the lowest in three years

Yield curves are sending an SOS. Is this time different??

The US (and UK) 10y-2y spread briefly inverted on Wednesday, sparking fears of a coming recession



SB1 Markets/Macrobond



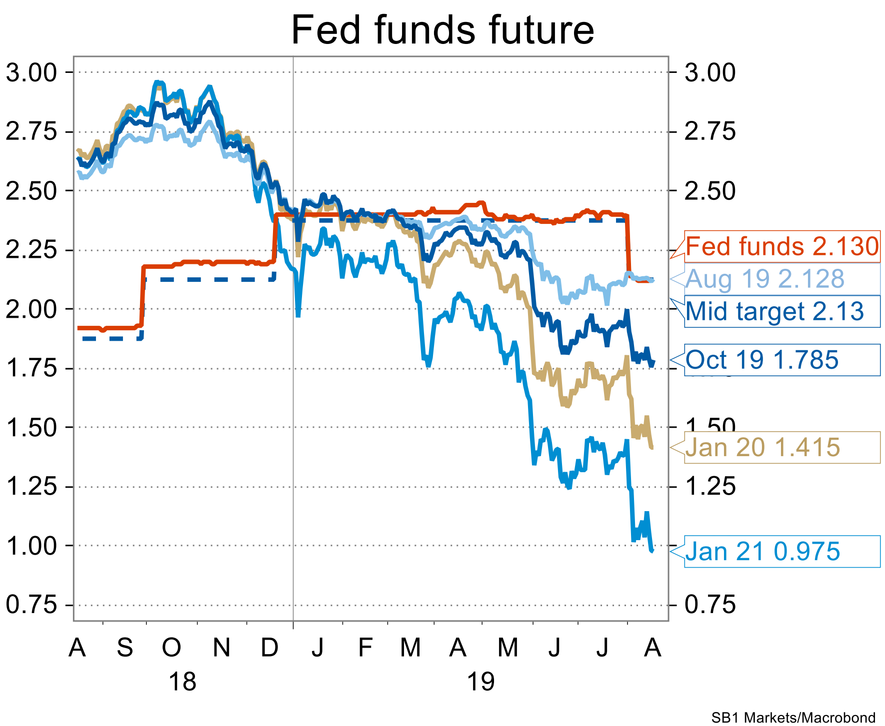
SB1 Markets/Macrobond

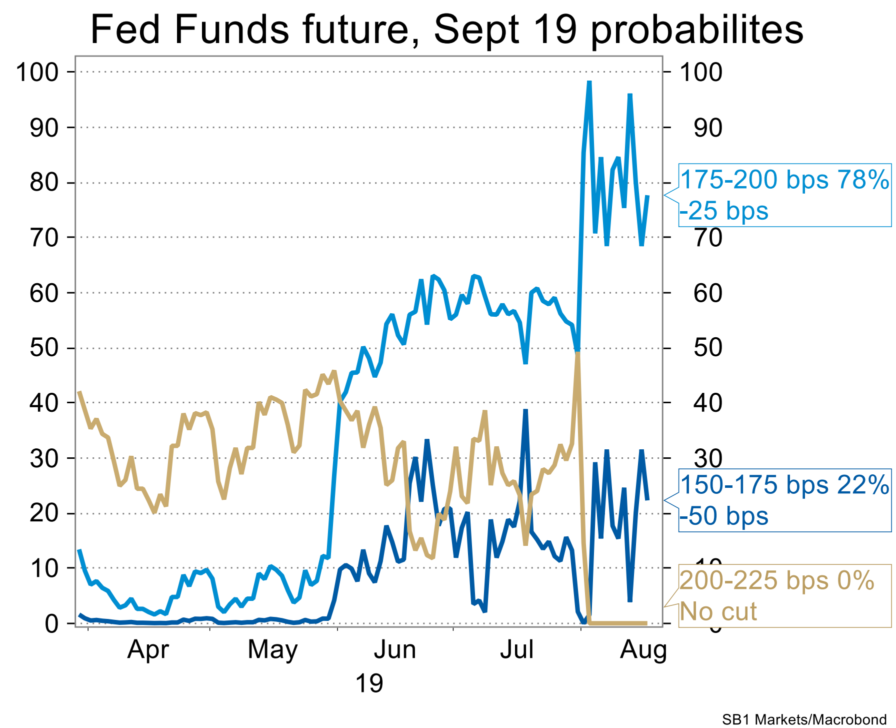
- An inverted yield curve has been a good recession warning. As many economists have stressed, the yield curve inversion now may be distorted by the sharp decline in term premiums driven at least partly by central banks' quantitative easing programmes
- Usually (4 of past 5), the inversions takes place as long bond yields increase slower than short rates in the last stage of a Fed tightening campaign, when the economy is strong - and not because the market 'expects' a recession. The present inversion (at least the latter part of it) is due to a faster decline in long yields than in short rates, on fears of weaker growth. The implications of the inversion cannot be the same?? Probably not, but the implications seems to be mixed, here is two alternatives
  1) The inversion is not due to an aggressive Fed tightening that usually takes place before recessions, at least not the past 10 months of the flattening
  2) The inversion is caused by a rapidly deteriorating economic outlook. Bad news! Still, in 1998 the same happened, and a recession was avoided

SpareBank 1 MARKETS

Another 25 bps cut in September is a done deal, markets are considering a 50 bps

The trade war cleared the deck. A Sept cut is fully priced in, and some 20% prob. of a 50 bps cut

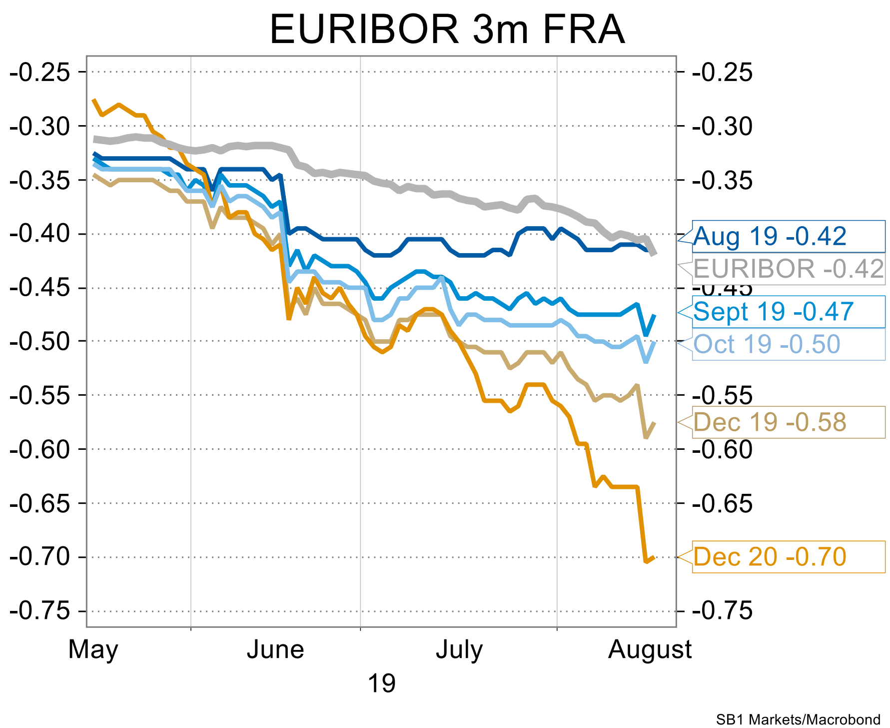


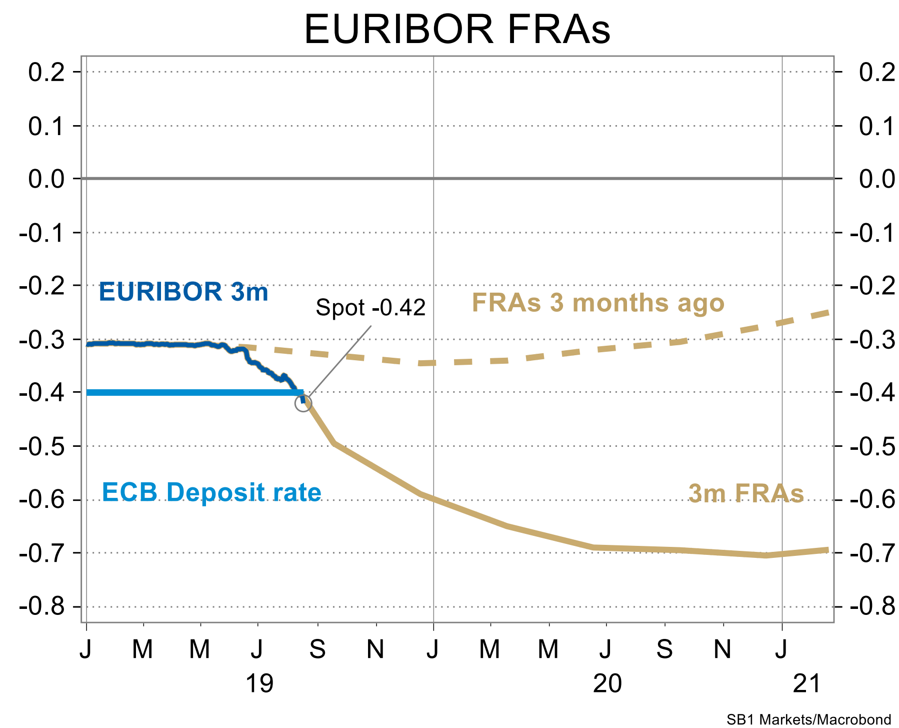


- The trade war escalation has taken Fed fund futures steeply down, and rates fell further last week. The bottom of the curve has fallen below 1%, down 50 bps since before Trump's announcements. Market is pricing in close to 3 cuts before Christmas
- US growth has slowed slightly but it is still above or at trend. Inflation is not far below the target. The real Fed funds rate is just above zero. Yes, there are clouds at the horizon but is still not raining. The USD is stronger than normal but not by that much. <u>The economy is not justifying another interest rate cut in Sept, but another 'precautionary' 25 bps cut is very likely to be delivered</u>

Another drop in the EUR curve. Olli Rehn promises aggressive measures

The market is pricing in almost 40 bps cut from the ECB before mid 2020

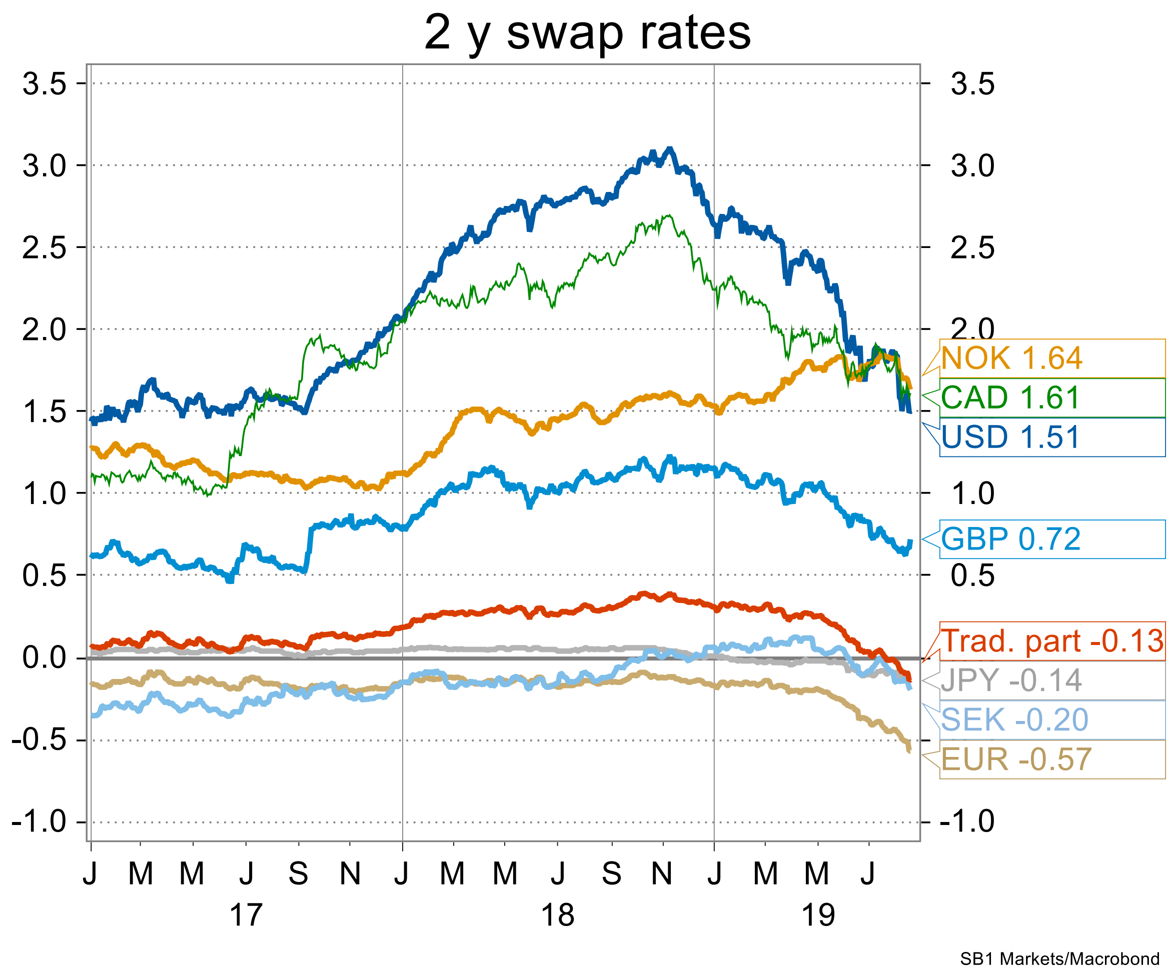


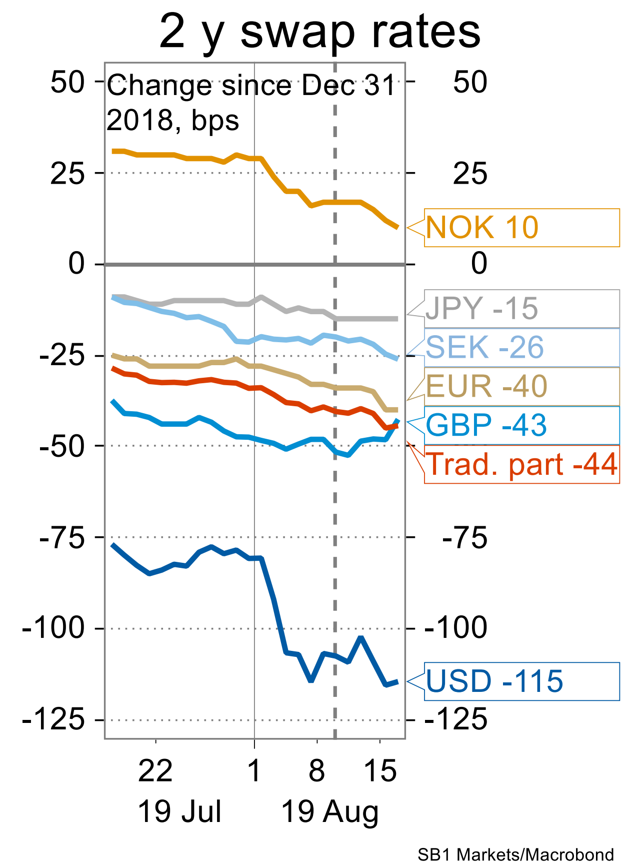


- At the July meeting, the ECB hinted of a more accommodative monetary policy, if the economic/inflation outlook did not strengthen.
- Last week, board member Olli Rehn said that bank was prepared to cut rates and introduce aggressive QE measures
- The market is pricing 100% probability for a cut at the September meeting, and 20 bps is now most likely (80% probability)
- Unlike in the US, a more expansive monetary stance can be justified by weak data and muted inflation

Even Norwegian short term rates down – but at the top last week too

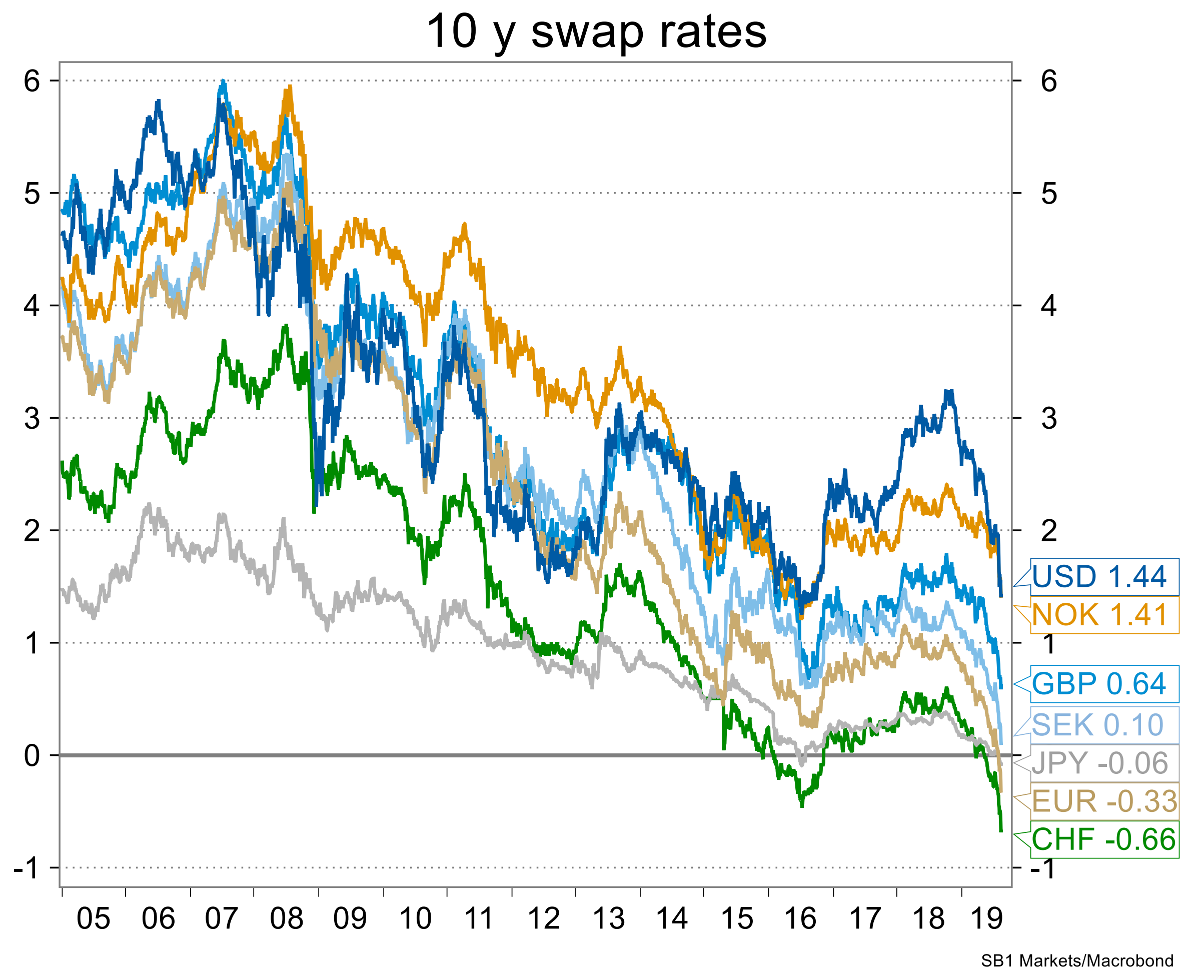
Short term rates everywhere (-UK) have followed the US down after the tariff announcement

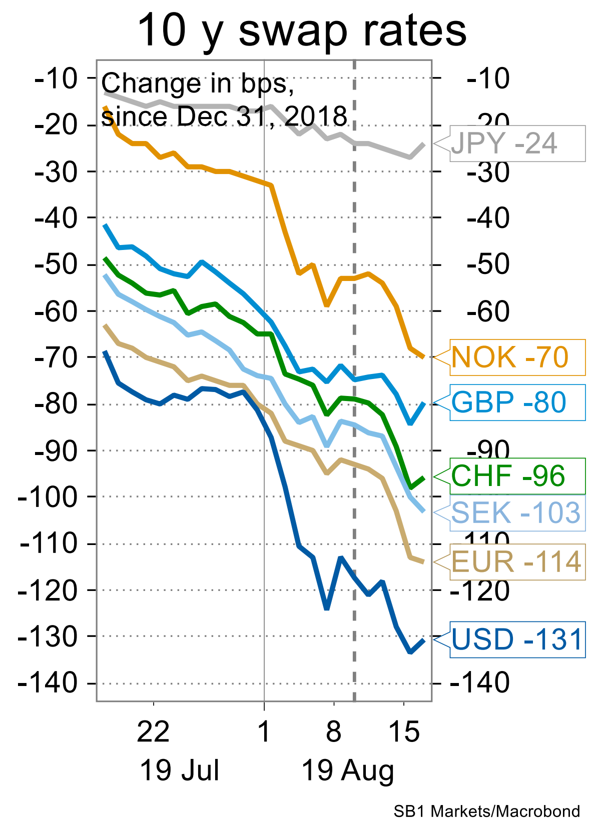




Long term swap rates down everywhere

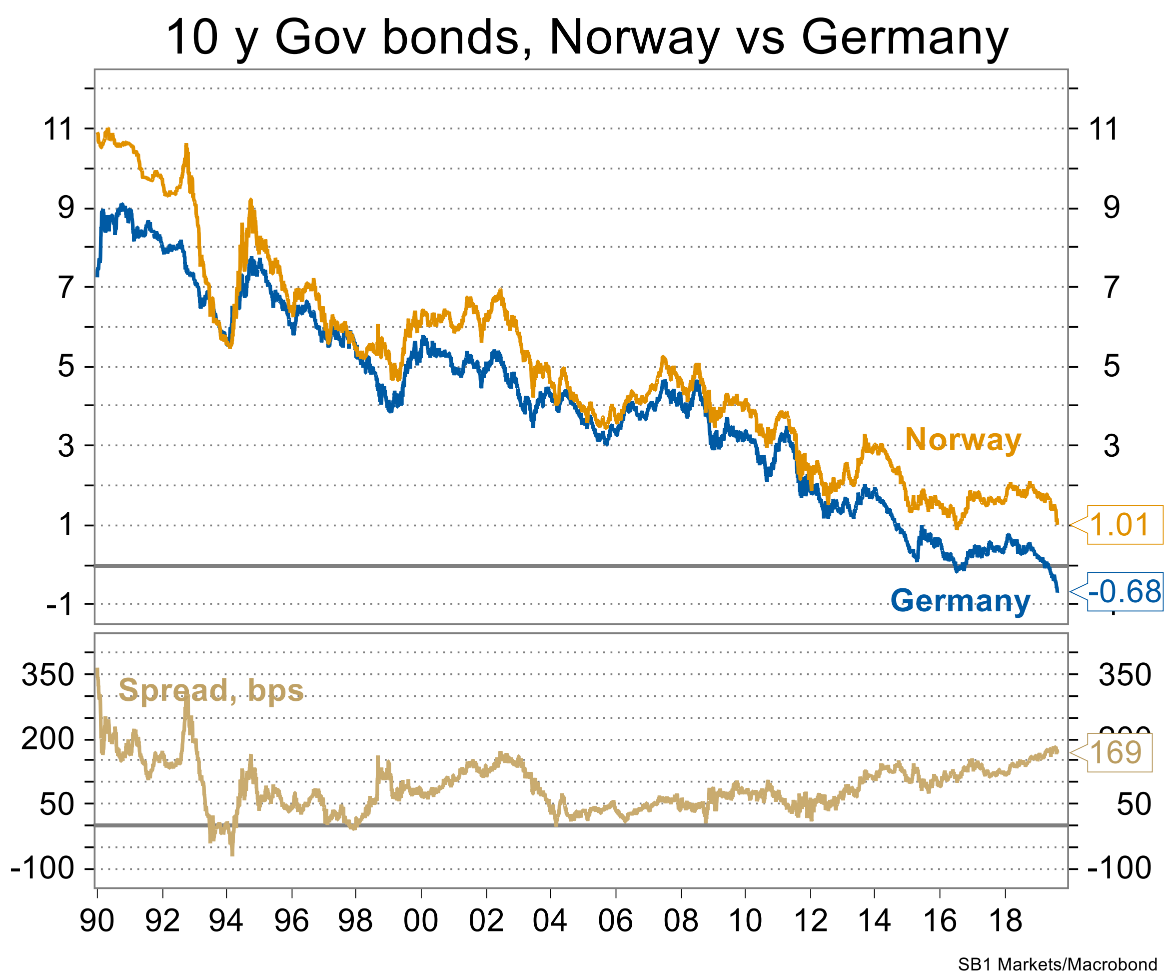
NOK rates fell below US rates last week

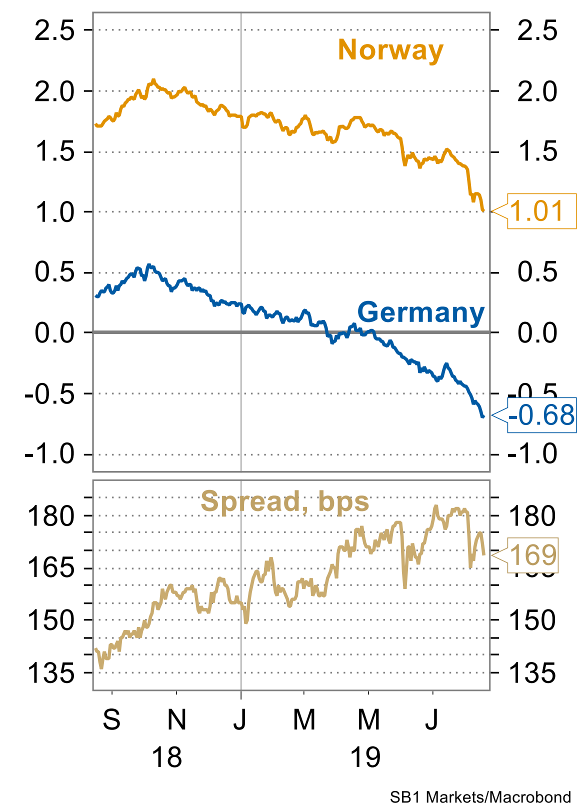




NOK 10 y gov rapidly down, even faster than the German bund

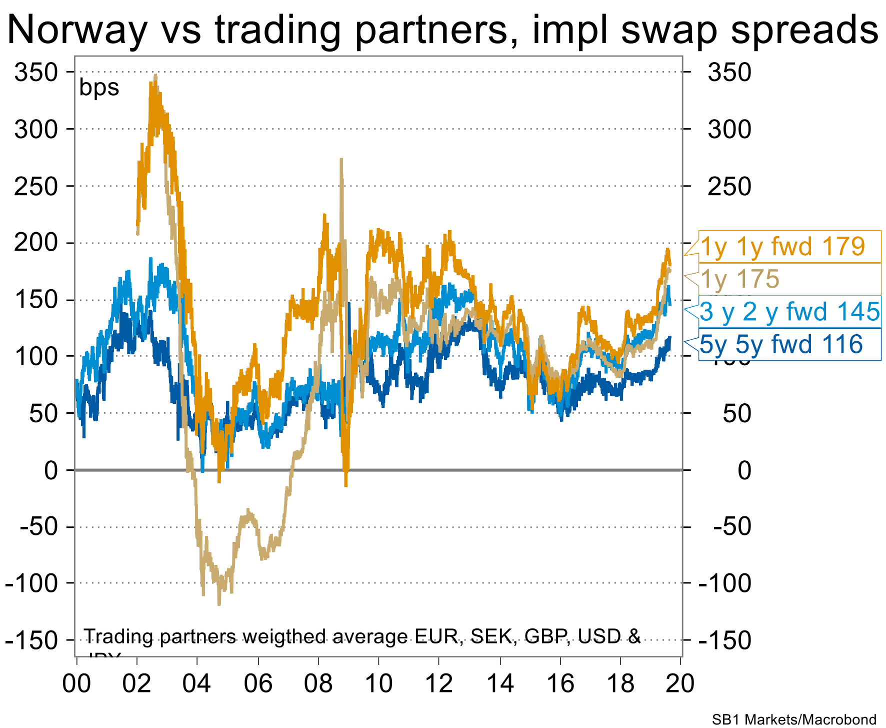
NOK 10 y gov down 14 bps to 1.01% close to ATL), the German bund down 10 bps to -0.68, a new ATL

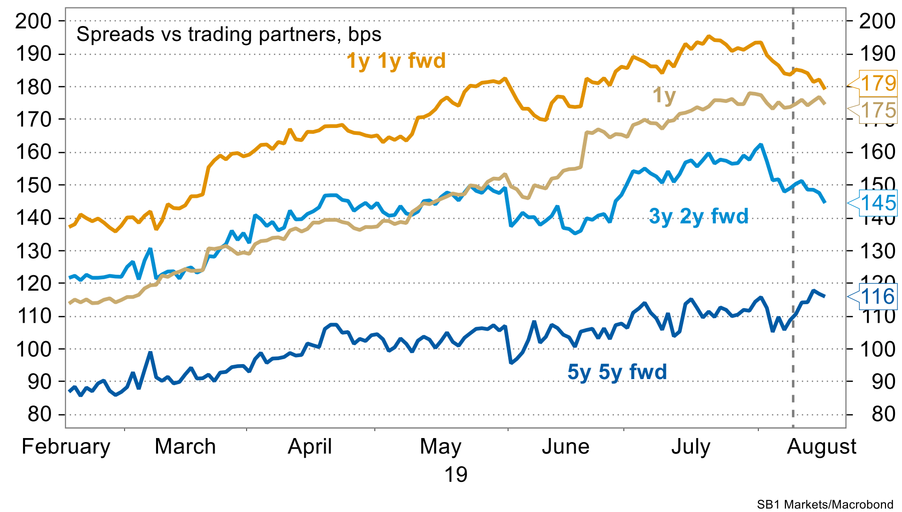


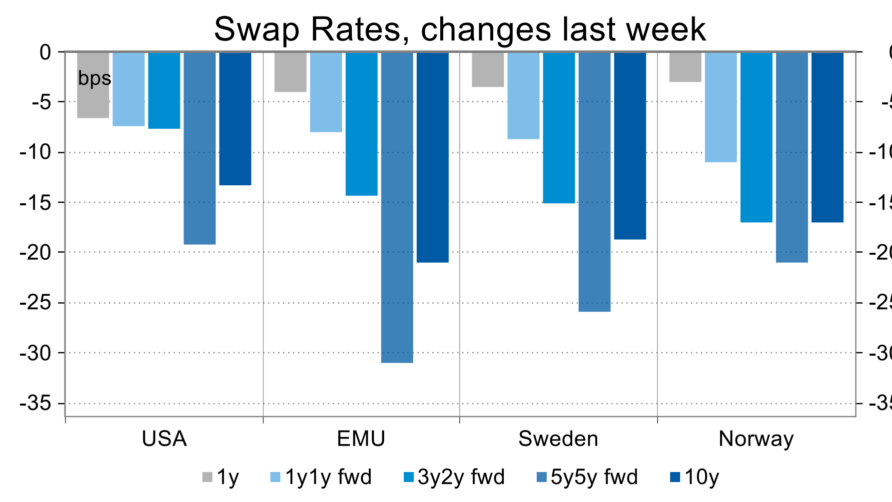


Finally, some narrowing of the spread between NOK and trading partners’ swaps

Still, the spread is widening in the long end of the curve, strange







- No narrowing in the very short end either – if Norges Bank yielded last week (we are not so sure about that), rates fell at the same speed abroad. The bazooka statement from ECB did not have much impact on the EUR short end
- 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. Still much more to go on the downside!

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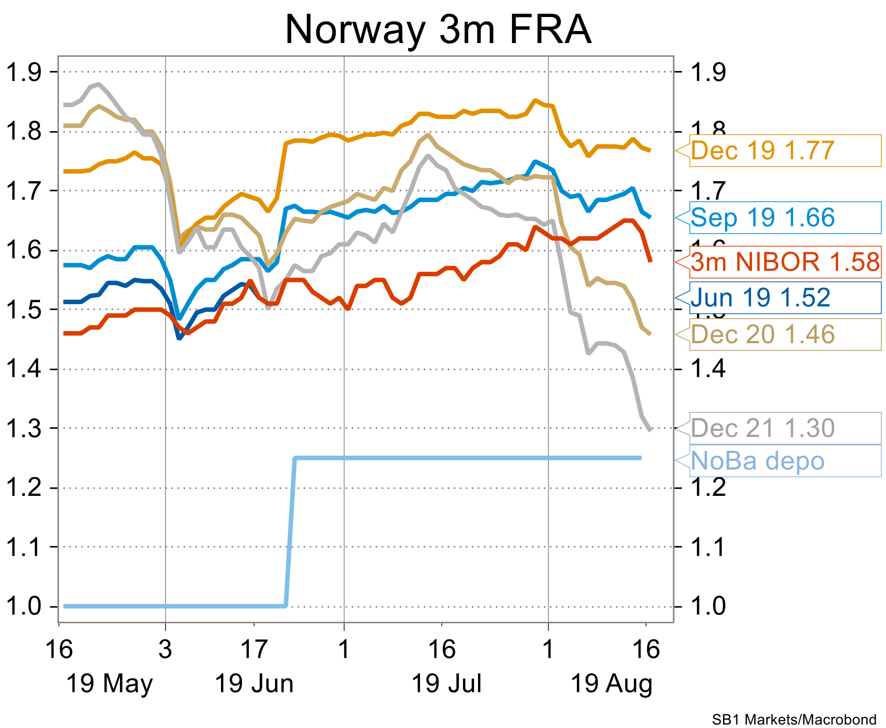
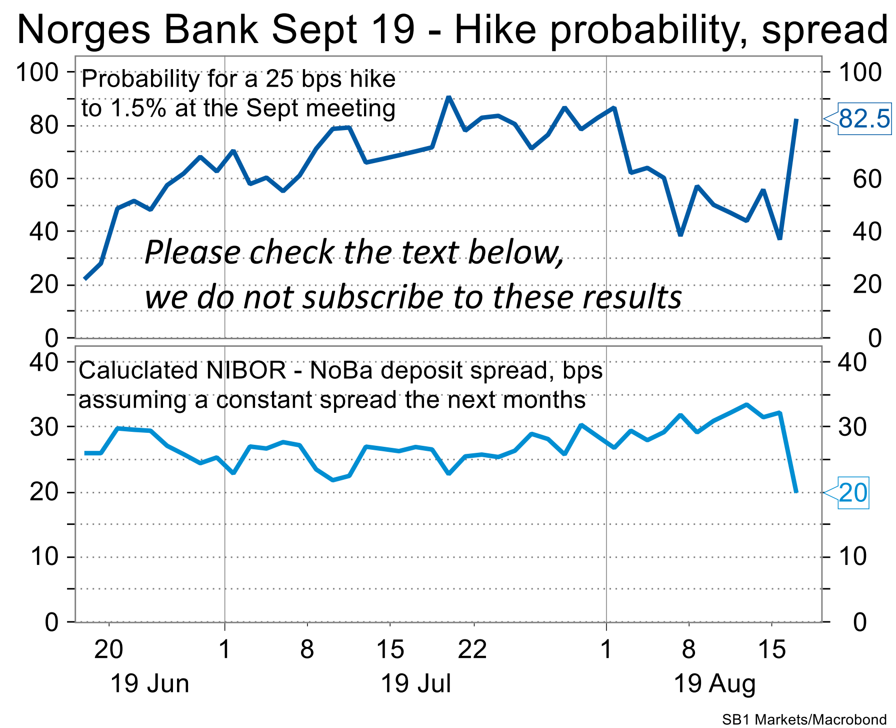
3m NIBOR sharply down, and more than short FRAs. Strange

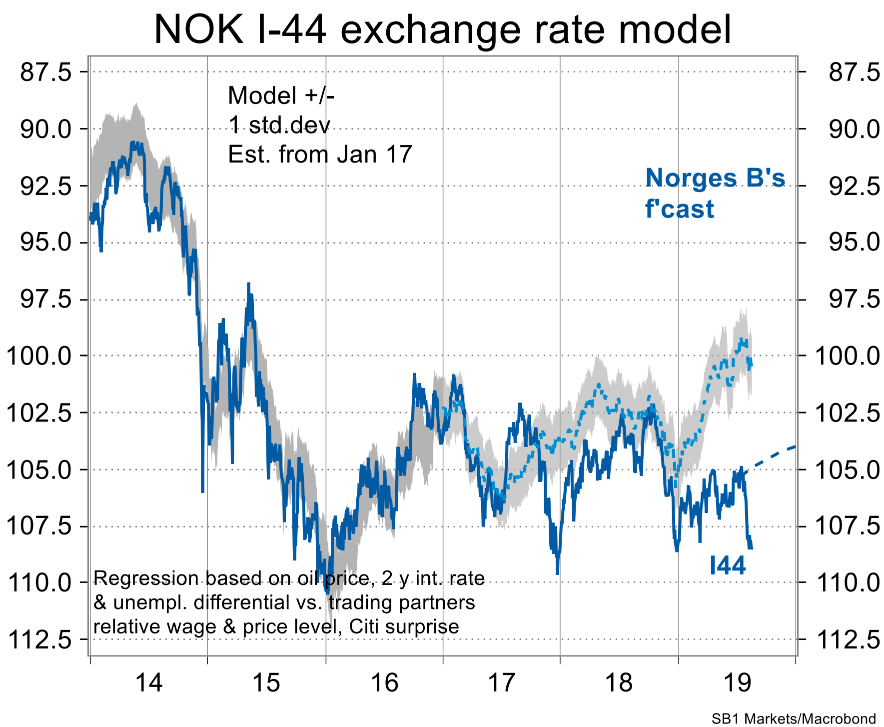


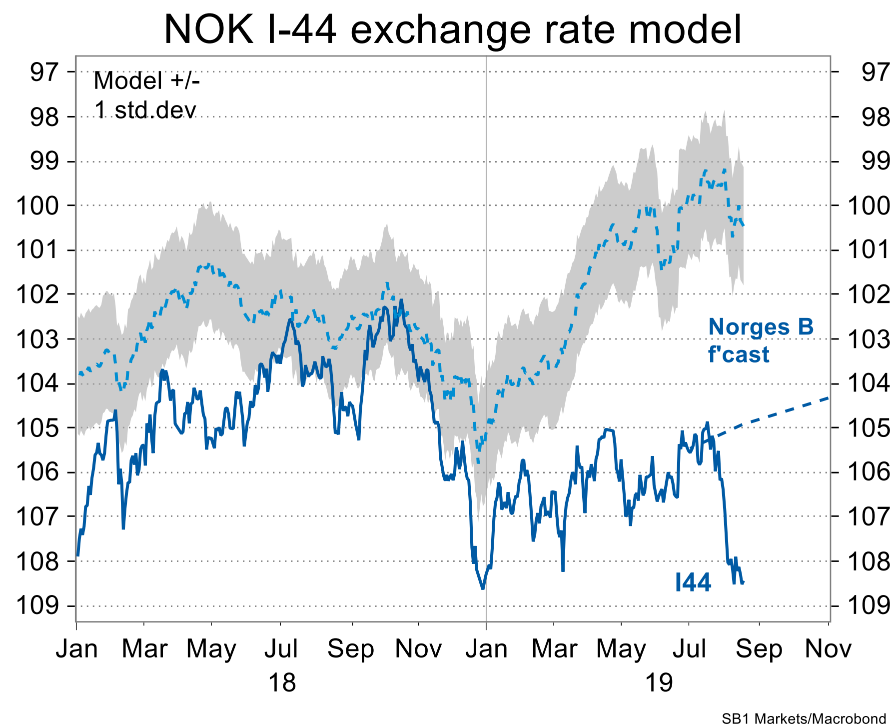


- The Sept 3 m FRA fell 4 bps Thursday and 1 more point Friday (sum 5 bps) to 1.66%, implying a 20% reduction in the likelihood for a Sept hike – if the expected NIBOR spread remained unchanged – to some 44% given a 30 bps spread or 24% given a 30 bps spread
  - » The 3 m NIBOR lost 7 bps to 1.58%. The implied NIBOR rate before the Sept meeting (and before the Sept FRA contract starts), has fallen by 11 bps, to 1.45%. Formally, that implies a similar decline in the NIBOR spread by 11 bps to 20 bps, and a sharp increase in the likelihood for a Sept hike. Does this seem reasonable? At least not the sudden spread collapse. Either is the 3m NIBOR fixing some 4 bps too low, or the Sept 3m FRA 4 bps too high. Given the changes in 2 &6 m NIBOR rates, the decline in 3m seems too aggressive
- The FRA curve is inverted from Dec 19 onwards, the market expects a Norges Bank cut in 2020 (In June, NoBa planned (almost) one more hike in ‘20)

NOK down 0.5%, by itself, without help from our f/x model

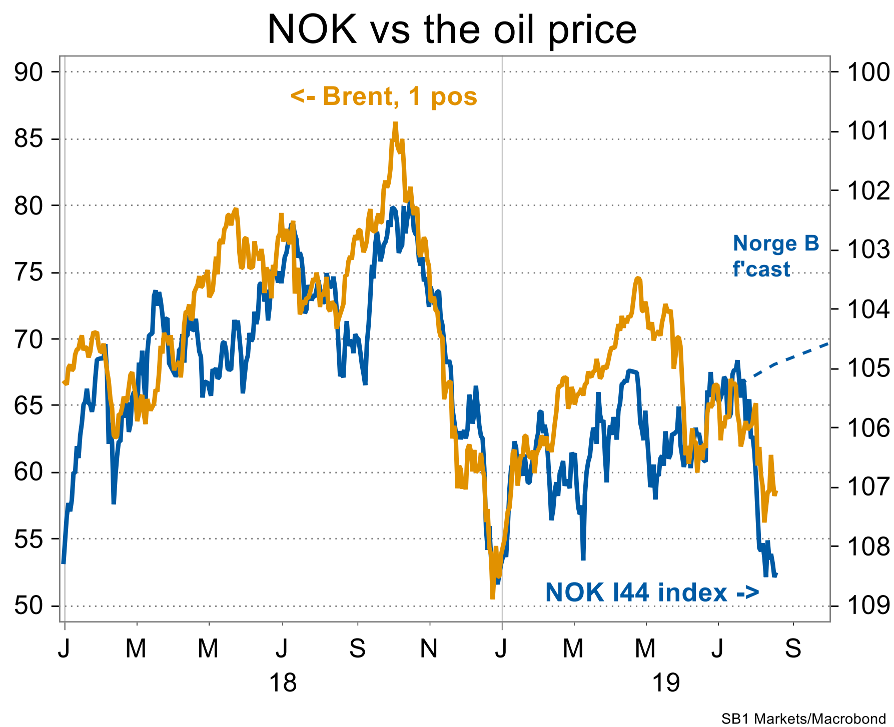
The gap between the two widened further, now at 8%, a record high residual

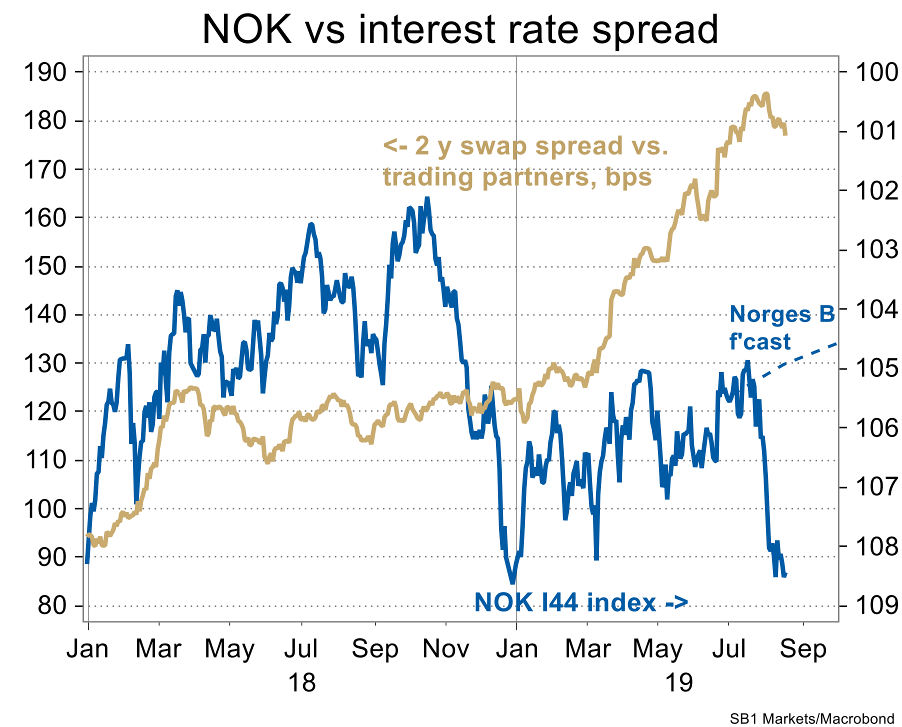




- Even our super-cycle f/x model has not explained the NOK decline the previous weeks
  - We have tested our models with global risk etc., without success
- We do not have any other recommendation than **Buy NOK**

The NOK weak vs. oil & the interest rate spread





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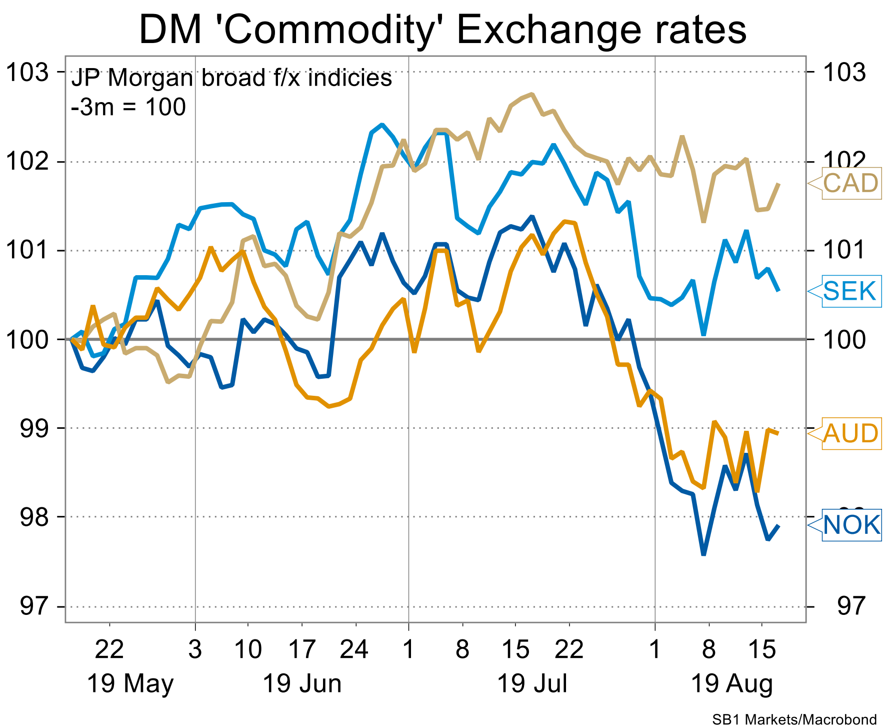
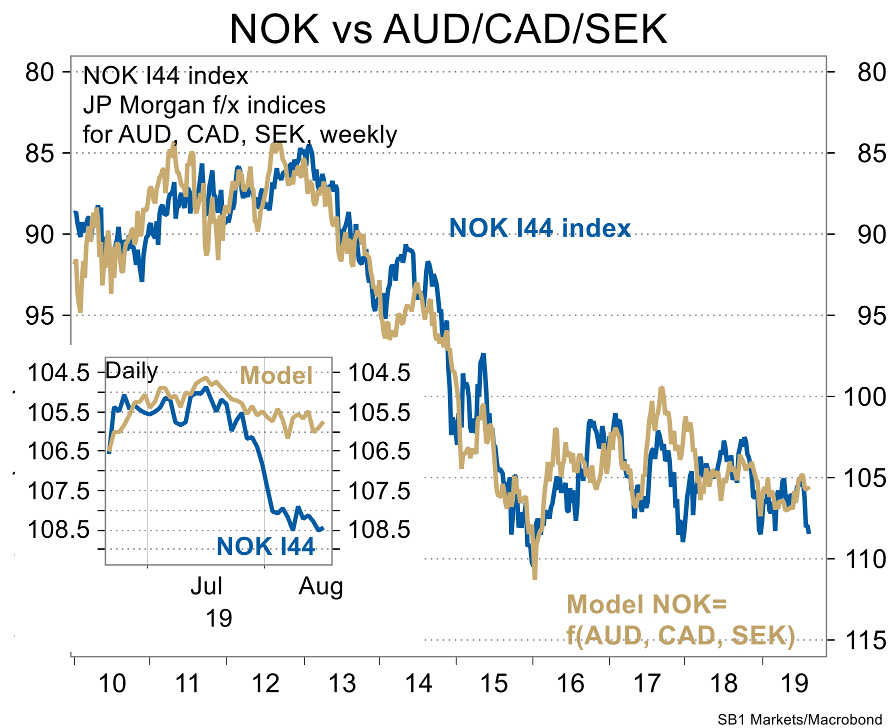
The CAD has not followed NOK down; AUD, SEK just partly

Together, the other supercyclicals have not followed NOK down recently

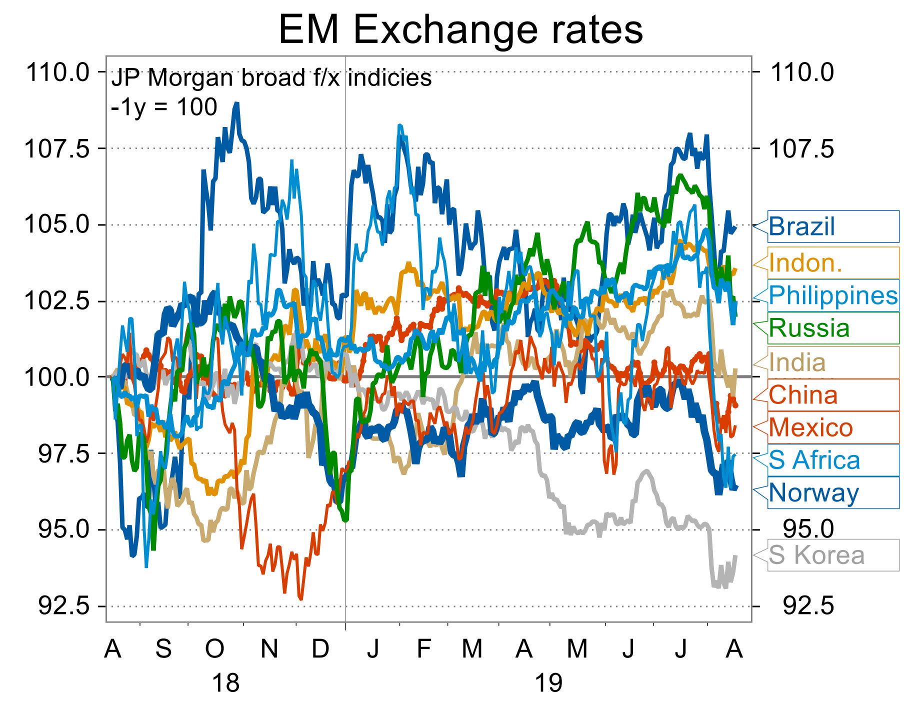


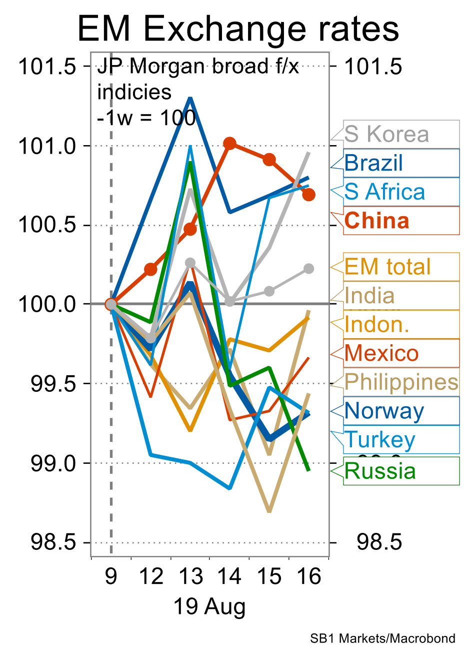


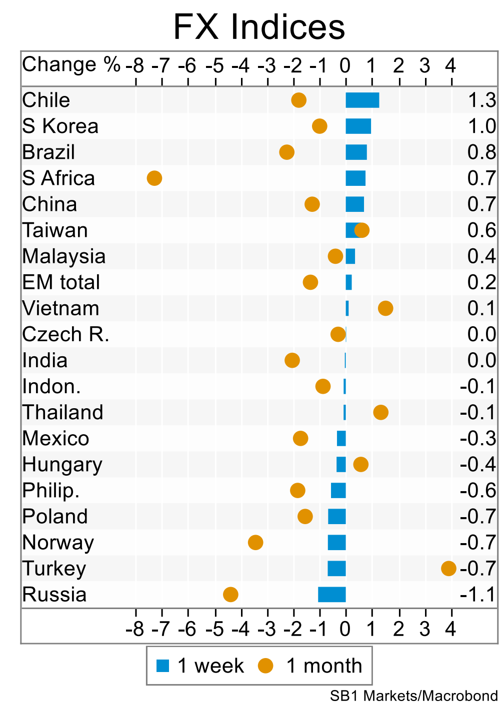
- The NOK has lost 2% vs. the the supercycle f/x model estimate over the two past weeks. That’s not unusual but not something that happens often either

EM f/x: Broad stabilisation last week (x Argentina)

The CNY up 0.7% and is down just some 1.7% since before the new tariffs were announced







- Most EM currencies are down last month (2 out of 3) but balanced last week
- Argentina is not included in the charts above, the scales became so strange.. Check next page

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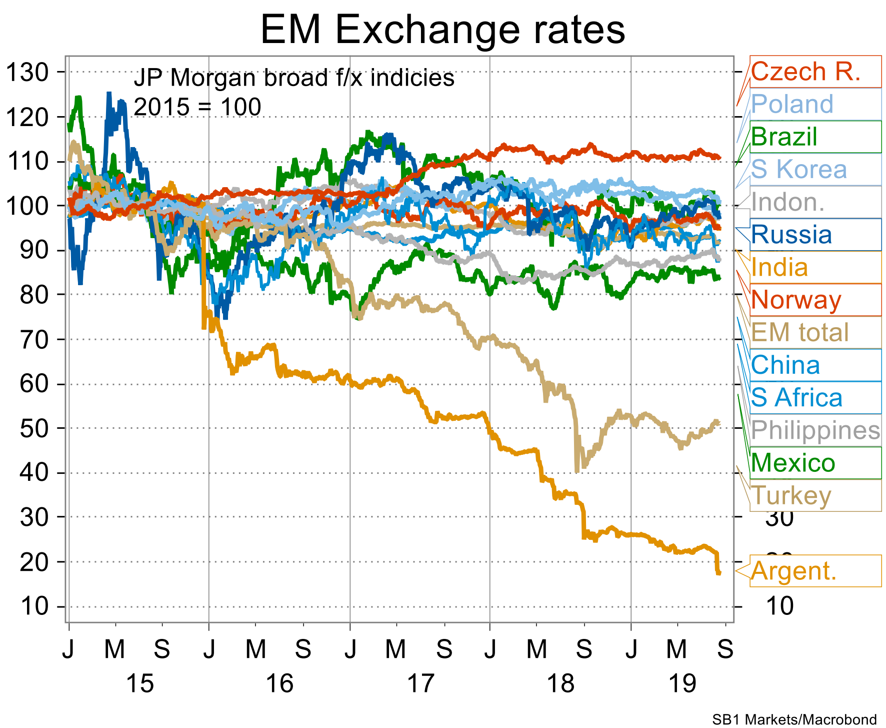
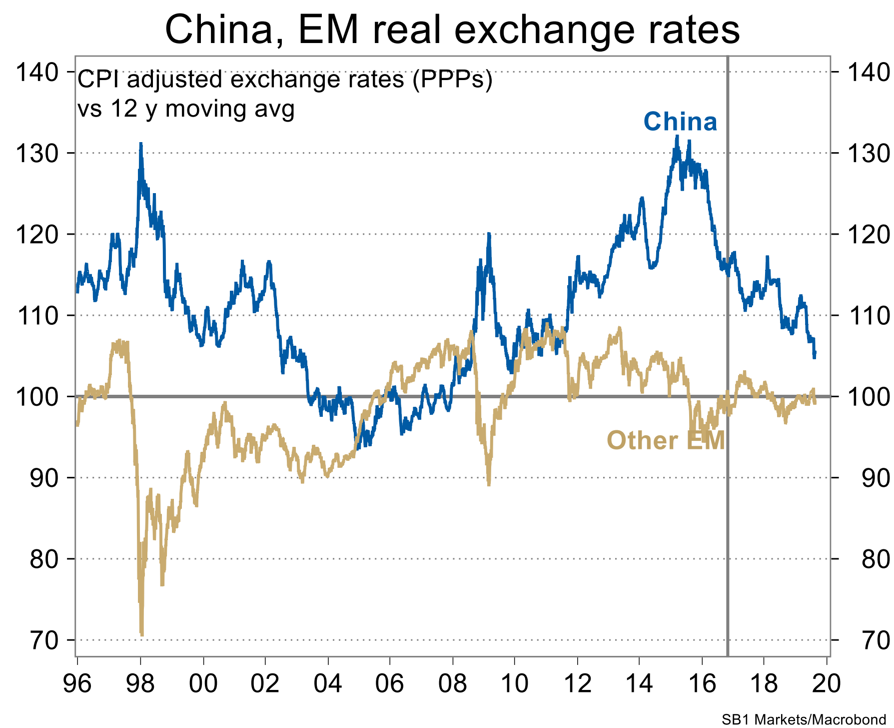
EM f/x, a long term view: Not that exciting, now

With a (normal) couple of notable exceptions, EM currencies have been unusual stable recent years





- The real CNY exchange rate was (too) strong in 2015/16, most likely contributing to the slowdown in the Chinese economy. China had a huge surplus at the current account 10 years ago (10%+). Now, the C/A is close to balance; goods are still in surplus, countered by a deficit at the service balance. The CNY real exchange rate has fallen by 10% since 2015 (of which 3% since early 2019) but is still 5% above its 12 y average
- Other EM currencies have in average been quite stable the recent years, even if some have run into problems, like always. Argentina and Turkey struggled last year, and Argentina once more now, for good reasons. The lira is down 50%, Argentina 83% (from 2015, and by 18% last week)

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