Macro Research

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Weekly update 38/2019

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Last week – the main takes

- Wow, announced **tariffs are postponed** (US) **or abolished** (China)**, and China will buy soybeans and pork** (they need it) from the US. And they will start talking, and Trump is signalling an **interim trade** deal is possible. **A soft Brexit** seems less unlikely as UK and EU is trying to find a compromise on the Irish border. **So why worry??** (Well, until Saturday and the drone attacks on the huge **Saudi oil plant** – and oil prices soaring?)
- **Global auto sales** rose August, merely due to a spike in European sales (!). Global sales are down 8% y/y but have been flat since late '18. Sales in China have stabilised but sales in other EMs are still declining, with India and Turkey in the lead
- **The Chinese economy is slowing but still just slowly. Manufacturing production, retail sales, investments** were all weaker than expected in August but underlying growth rates remain quite stable. However, the two past months have been tough for the manufacturing sector, growing just at a 3% pace. **Credit growth** was a tad higher than expected in Aug, and is slowly accelerating, and the credit impulse (y/y) has turned neutral – even if bank lending is slowing (in spite several cuts in the reserve requirements). Credit through the 'shadow' market is driving total credit up.
- **US retail sales** slowed in August, we estimate a 0.2% m/m core volume growth, as (implicitly) expected. Still, sales are trending straight up (underlying growth above 8%). Univ. of Mich sentiment recovered just a small part of large Aug setback. **No inflation?** Well, **core CPI prices** rose 0.3% m/m, for the third straight month, y/y up to 2.4% (11 y high!). On the other hand, neither inflations model nor producer prices indicate much higher inflation. The number of **unfilled vacancies** is turning slowly down, from a very high level but new jobless claims fell close to a 50 y low; the labour market is tight. **The Federal Budget** is widening as spending soars, equalling 5.3% of GDP (total public sector 6.9% in Q1). So now, **the Fed has to cut, NOW!!**
- **The ECB** delivered a sweeping stimulus package; the deposit rate was cut 10 bps to -0.5% (some 50% exp. 20 bps), the bond buying program was reintroduced by a smaller than expected EUR 20 bn per month but without any fixed time limit. Moreover, measures to smooth bank lending were announced; changes to the TLTRO and a two tier system in which parts of banks excess liquidity will be excluded from negative interest rates. **Eurozone industrial production** fell further in July, down 1.8% y/y; Germany is down more than 5%. Still, **German exports** have not collapsed. Instead, both imports and exports have flattened out; exports are up 0.6% y/y – domestic demand must slowing? **Labour costs** eased to 2.4% y/y in Q2, from 2.6% and flattening out the past year. Still, over the past years, wage growth is rising
- **Norges Bank Q3 Regional Network** reports 3% growth and expects a slowdown to 2.7% the two coming quarters, broad based – still suggesting higher growth than Norges Bank expects. Yet another argument for an interest rate hike this week. **Core CPI inflation** slowed to 2.1% in August, 0.1 pp below our f'cast and 0.2 pp below NoBa's f'cast. Still, inflation is running above target. The Homebuilders reported a steep drop in **housing starts** in August, and sales are heading down too. SSB is still reporting increasing housing starts albeit with many student homes included. Has homebuilding peaked?

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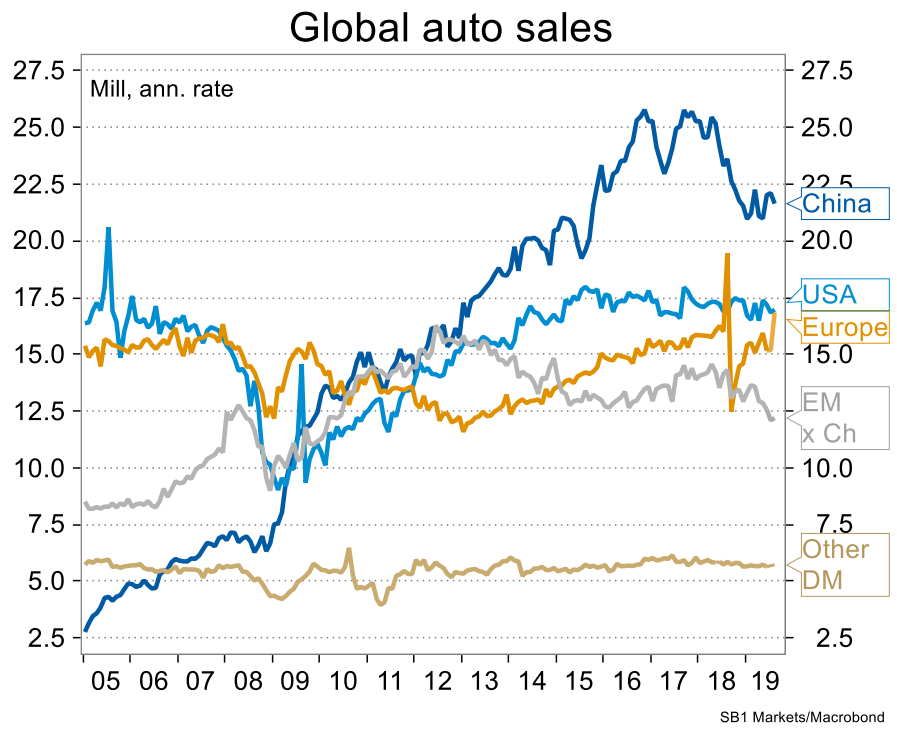
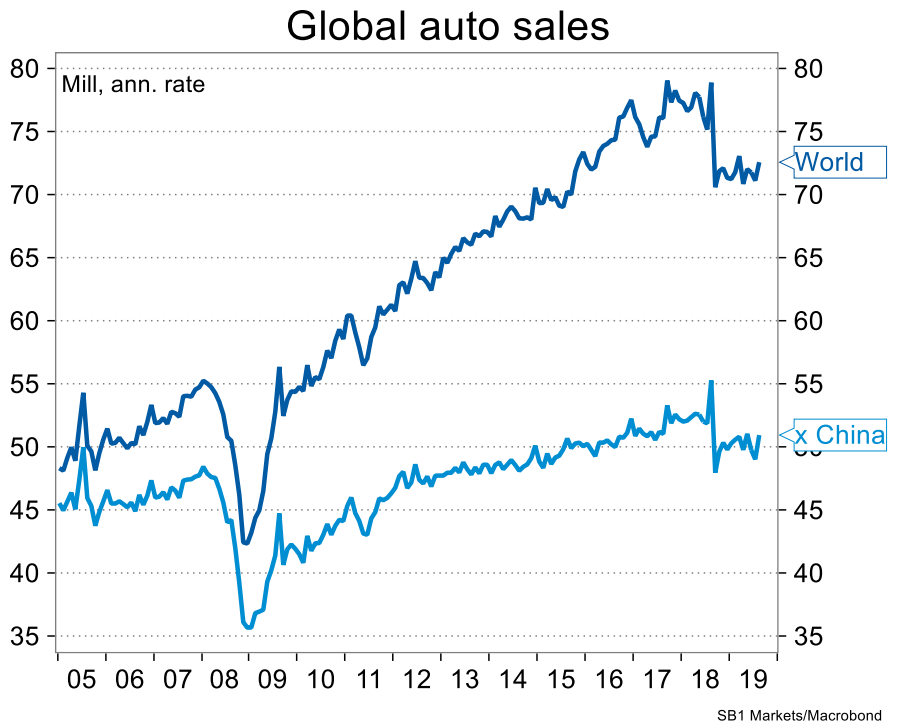
Global sales rebounded in August, thanks to the EMU (!)

Global sales have been close to flat so far in 2019, after the 8% drop last autumn

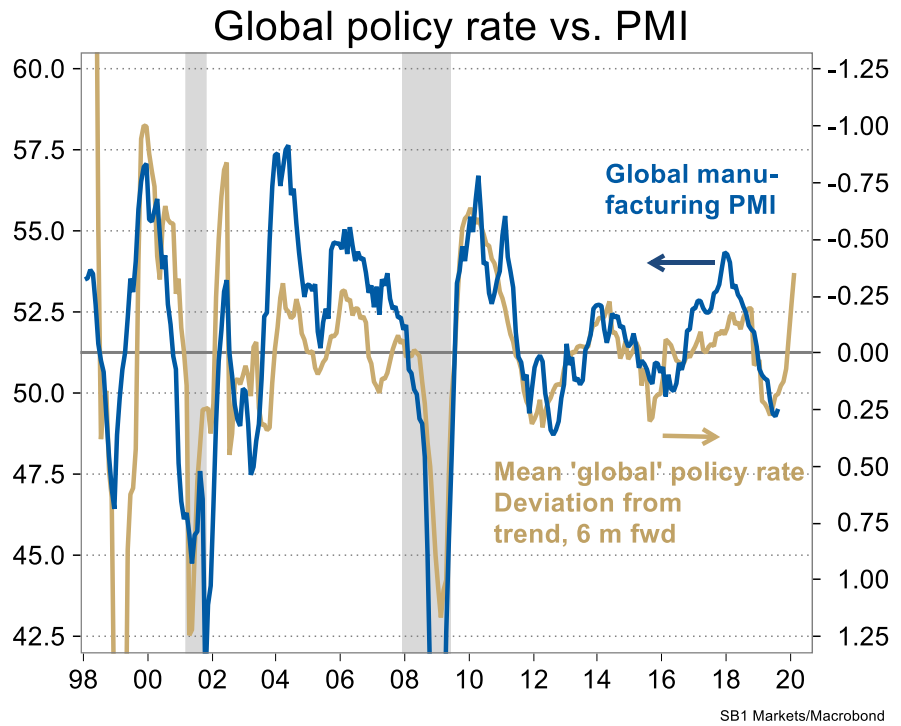


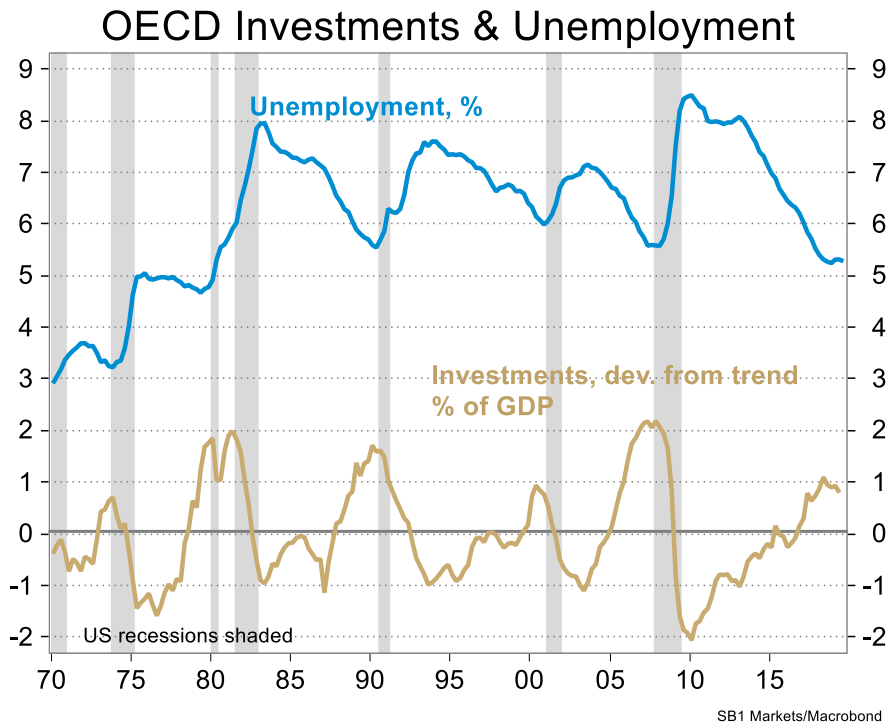


- Global auto sales rose 2% m/m in August, following a 0.9% decline in July, and they are down 8% y/y (preliminary data)
- Chinese sales fell 2.1% m/m in August. Sales have stabilised since Q4 last year but are still down some 16% from the peak
- Sales in EMU spiked in August (no official total data yet), as sales rose steeply in all four main countries. We wonder who have produced these cars, as production has dropped sharply in the EMU. US sales increased marginally in August but may be trending slowly down
- Auto sales in EM ex. China is heading down again (steady in August); mostly due to lower sales in India, Russia, Argentina and Turkey – and Indonesia and Mexico. Sales are down 15% from the local peak early 2018. Even worse, sales are down almost 25% (!!) from the 2012 ATH – equalling a close to 5% drag on global sales in the period (!!)

Central bank's are coming to the rescue. Will they succeed? In the end, yes

Often, lower interest rates quickly stimulate the economy – but capacity is now constrained





- If so, the PMIs are close to the bottom now, after a close to 50 bps cut in an unweighted global policy rate proxy (far less in DM of course, but these rates have been less volatile than EM rates recent decades)
  - » Downturns do not last forever, and monetary & fiscal policy are normally important 'helpers'. So, the sky is clear?
- Well, we do not have any guarantee that a monetary boost will save the world from a further slowdown.
  - » Unemployment is low (less capacity for growth)
  - » Investment demand is very likely above trend – and is exposed anyway

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Growth is slowing but just slowly

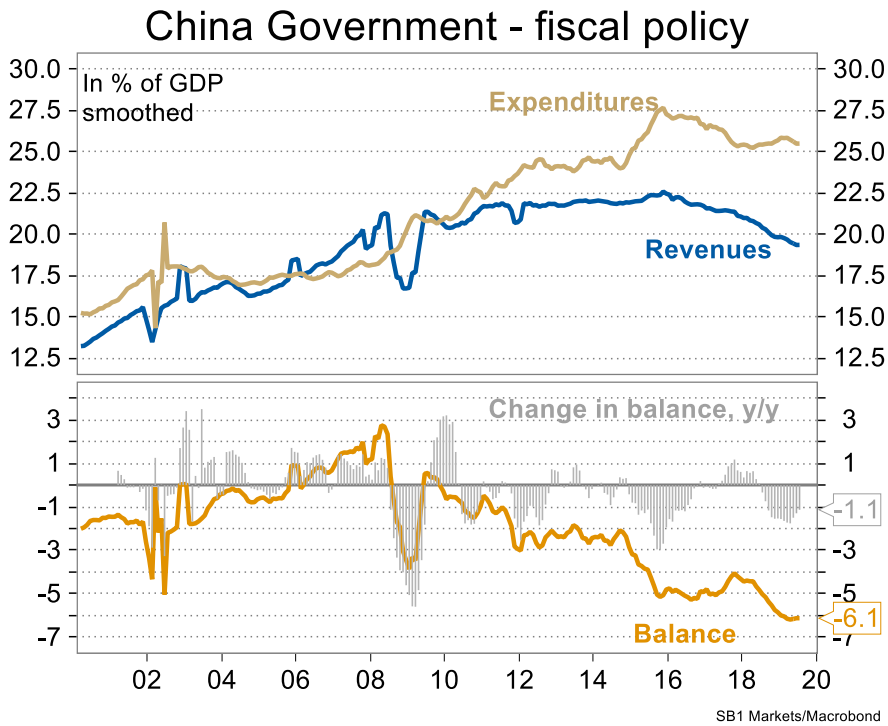
August data broadly weaker than expected but still no signs of a sharp slowdown

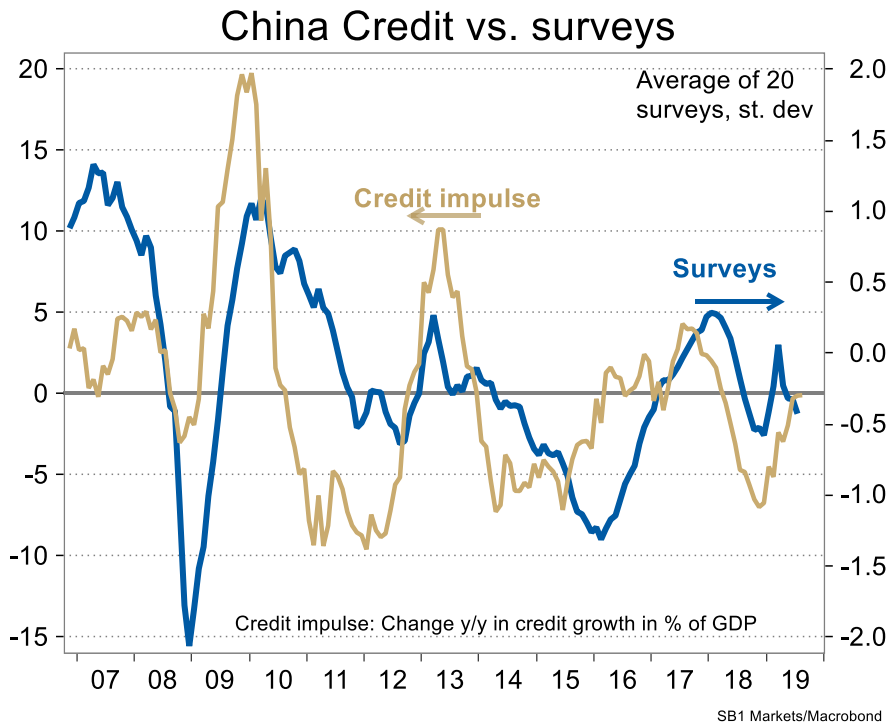
Growth is most likely slowing amid the escalating trade war, but data are not signalling an abrupt setback

- **Industrial production** slowed to 4.4% from 4.8% in June, to the lowest level since 1990 (according to the 'useless' official annual growth rate). While production rose just 0.3% m/m (following the 0.2% July growth in July), the underlying growth pace past months is still at above 5%. Surveys do not signal any slowdown from this level
- **Retail sales** growth slowed to 7.5% y/y from 7.6% in July, expected 7.9%. Sales rose 0.7%, following the 0.2% hike in June. Underlying volume growth has fallen below 6% but has not slowed further recent months
- **Investment** growth softened 0.2 pp to 5.5% y/y in July (official YTD rate), weaker than exp. Our calc yields a stable 5.2% growth pace. Real growth at some 2%. Construction starts are still trending up, but slower
- **Credit growth** was higher than expected in August, and the credit impulse is now back to neutral (measured y/y). Bank credit is slowing even if reserve requirements are cut 6 times (the last one a week ago), while 'shadow' banking credit is accelerating. Total credit growth is still well above income (GDP) growth, and the debt/income level is increasing, from an unusual high level

Growth is gradually slowing even if policies try to stimulate

Budget deficit at 6.1% of GDP, +1.1 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 1.1% of GDP, a substantial fiscal expansion – but it is slowly petering out, as spending declining marginally (in % of GDP). The deficit has increased to 6.1% of GDP, according to our calculations
- Credit growth is slowly accelerating (more here), and the credit impulse has turned neutral (measured y/y, positive 'now'), from sharply negative
- CNY has depreciated 10% since 2015, of which 5% since May (and 2 % since early August)

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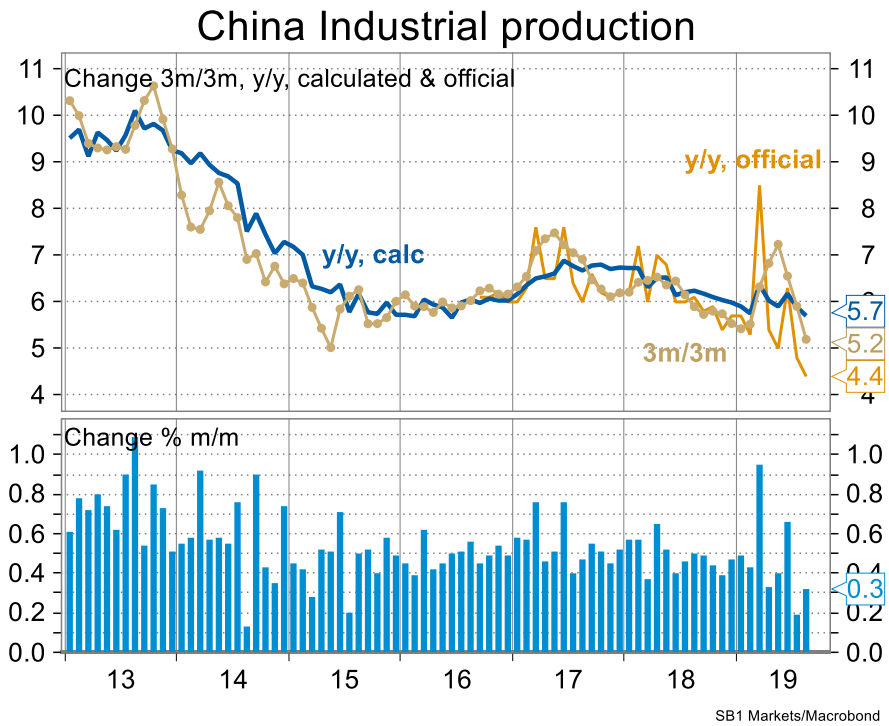
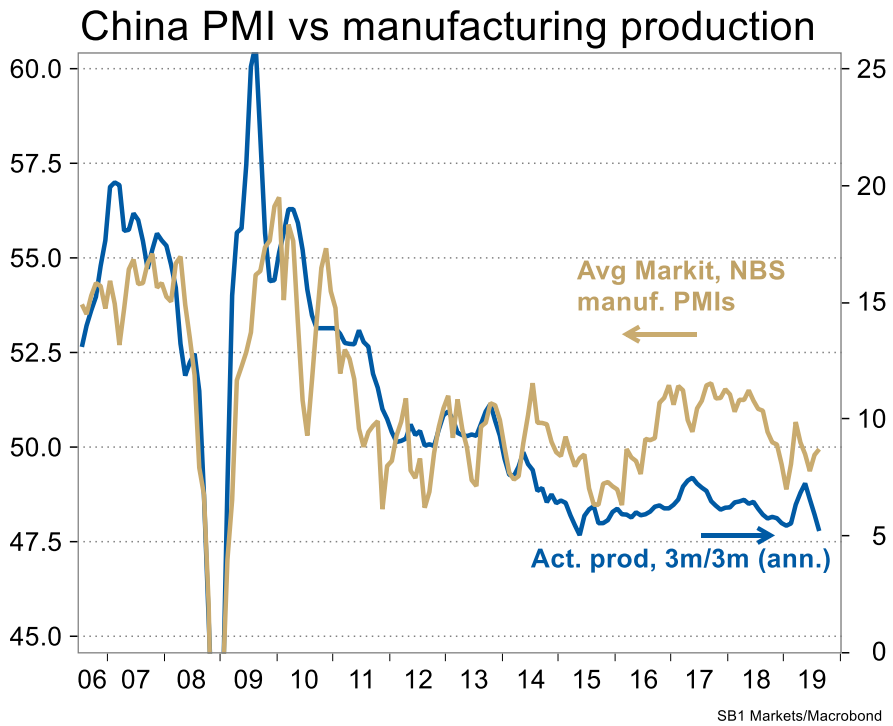
Industrial production is slowing (but not as sharply as the official y/y rate signals)

The official y/y down 0.4 pp to 4.4%, lowest since 1990. Our calculation yields 5.7%, down from 5.9%

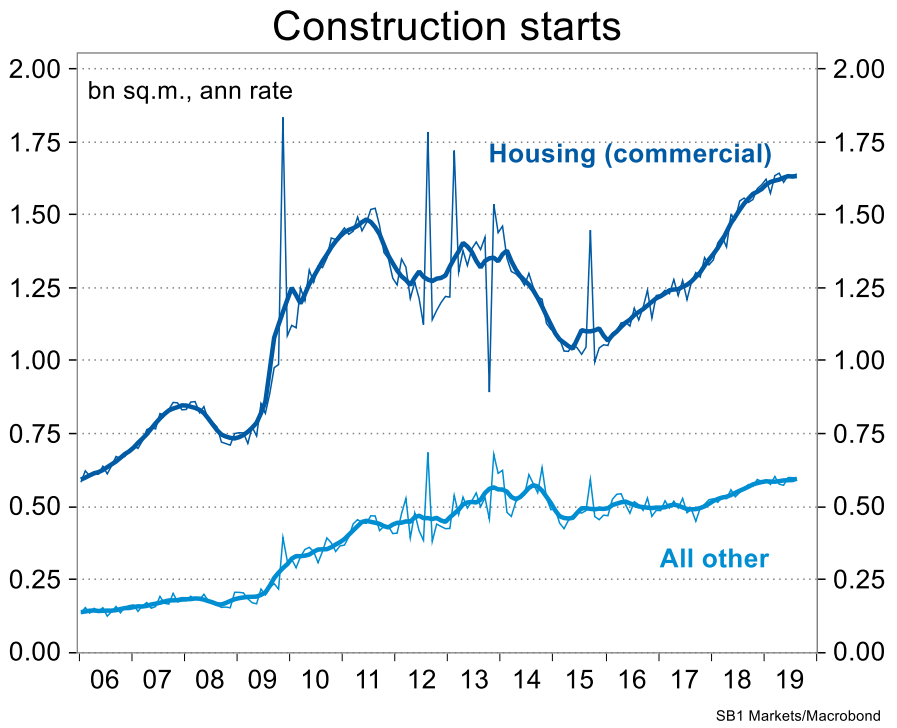


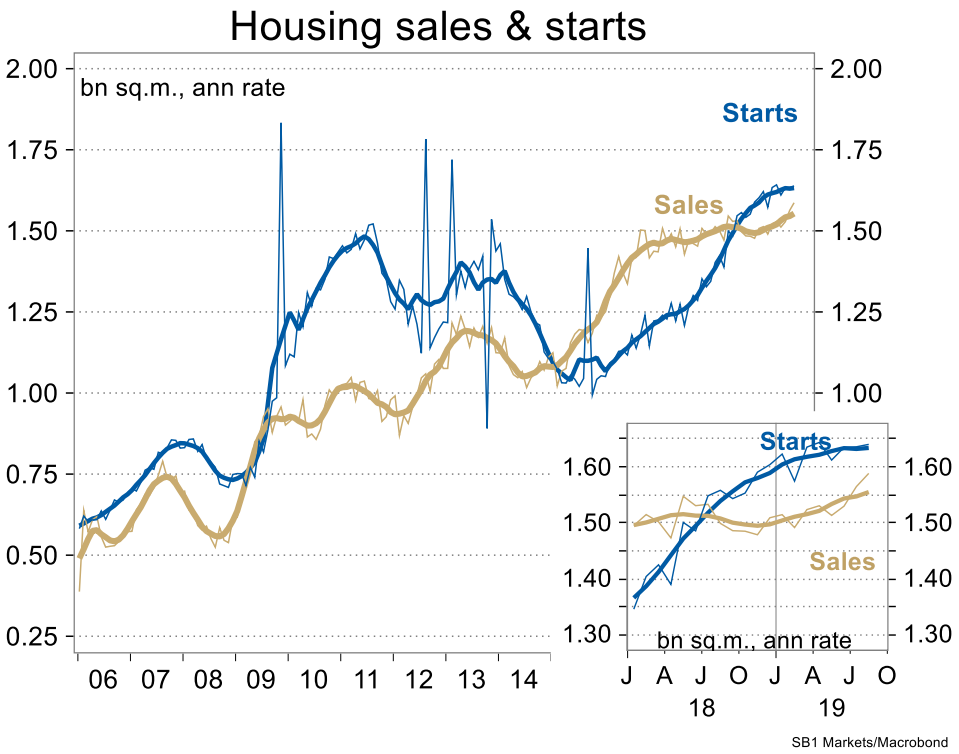


- Production rose just 0.3% m/m in August, up from the 0.2% print in July. The two past months (3% annualised growth pace) are the weakest since the setback in Oct/Nov 2008. Measured 3m/3m the decline is less dramatic; growth has just slowed to 5.2%, a tad weaker than in January
  - » The official y/y growth rate is 'useless', far too volatile as it is not adjusted for holidays or working days. Even so, the 4.4% growth rate was the lowest since 2002, but that was a one month exception, like 4 times in the years before that. A 'real' 4.4% growth (officially measured) has not been seen since 1990.
- Still, PMIs or other surveys are not signalling an abrupt halt in manufacturing. Export volumes close to peak levels. China has most likely not been brought to a halt – but **the two past months send strong warning, something may take place now**

New home sales up in August; starts have almost flattened

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

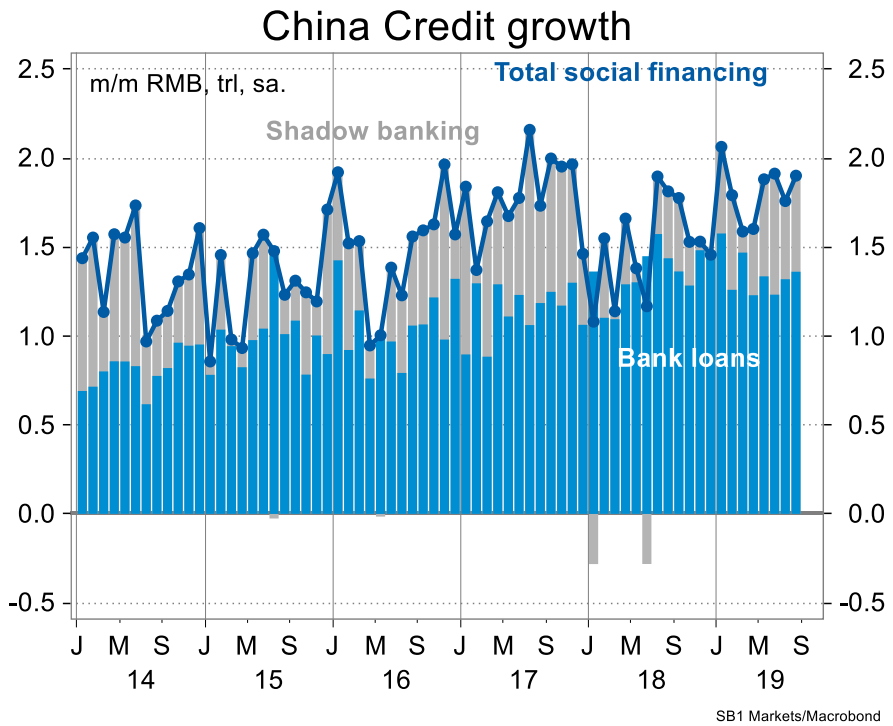


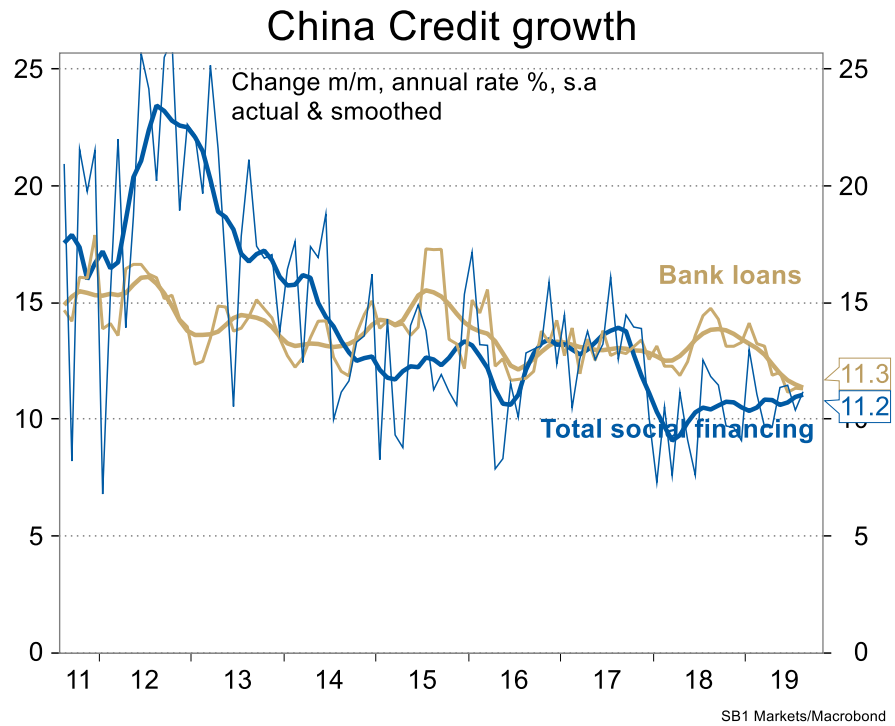


- Sales of new homes have accelerated through the summer, and is not far below housing starts
- Housings starts are running higher than sales, still trending up but slower and rose just marginally in Aug. Even if sales are below starts – implying an increasing inventory – we are not that worried, given the large inventory drawdown from 2014 – 2018. Still starts are record high, are up more than 50% from the 2015 trough, and are up 5% y/y (smoothed) – and are now slowing. The downside risk is still there
- Other construction starts have been flattening since late 2018 but are still up 8% 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 residential construction

Bank lending is slowing but the void is filled in the shadows, total is accelerating

Credit growth higher than expected in August



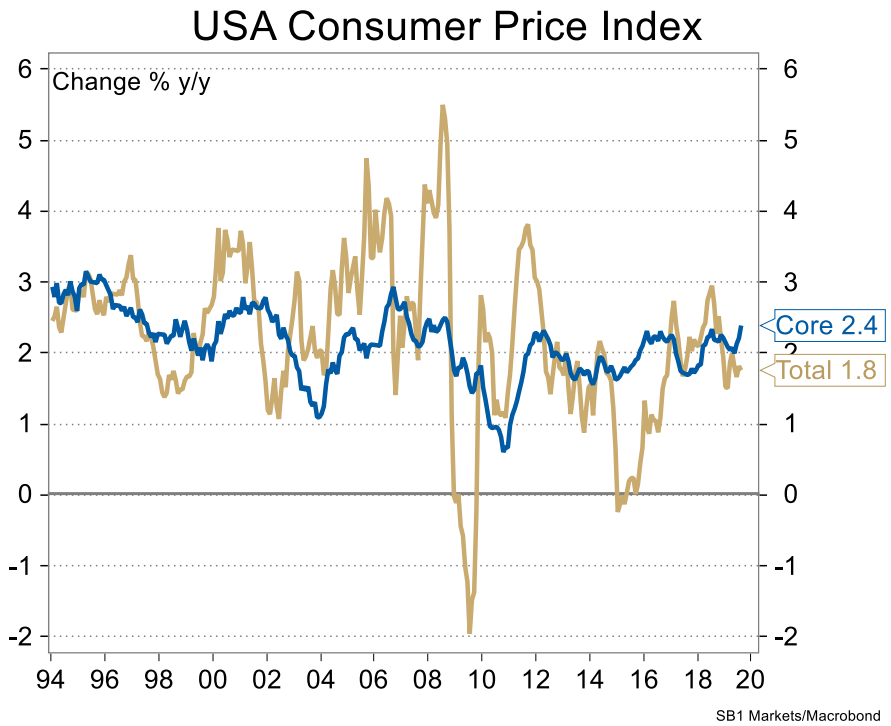


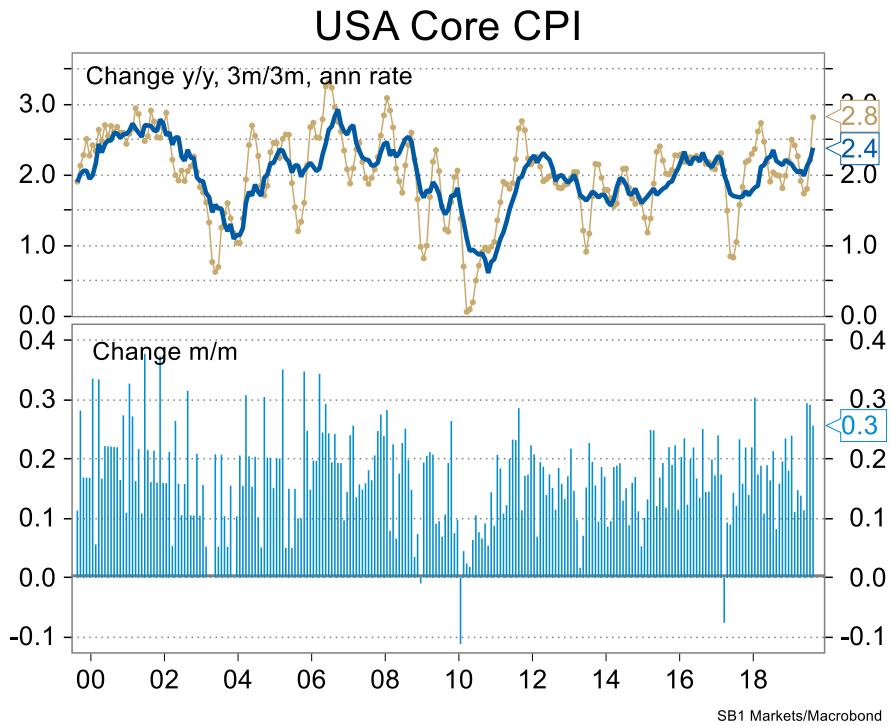
- Total credit rose by 11.2% m/m annualised in Aug, down from 10.4% in July. In RMB, total credit rose by 1.9 trl, expected 1.6 trl. The underlying trend is slowly up, since the trough in early 2018. The credit impulse (measured over 12 months) is close to neutral
  - » However, the mix has been somewhat surprising. Growth in bank loans is slowing in spite of 5 (and now 6) cuts in the reserve requirement that has released a 4% increase in lending capacity (close to 5% now). The authorities successfully clamped down on credit supply through the non bank ('shadow') credit market early 2018, but since then growth has picked up again, and now accounts for 1/3rd of total credit supply again
- What's next? Many expect the PBoC to turn more expansionary, and cuts in interest rates are quite likely. 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

(Trump's words, not ours☺)

Core inflation at 2.4% = time for the Fed 'boneheads' to slash interest rates!!

No 'no inflation', sir; Core CPI up 0.3% m/m in August, underlying growth at 2.8%

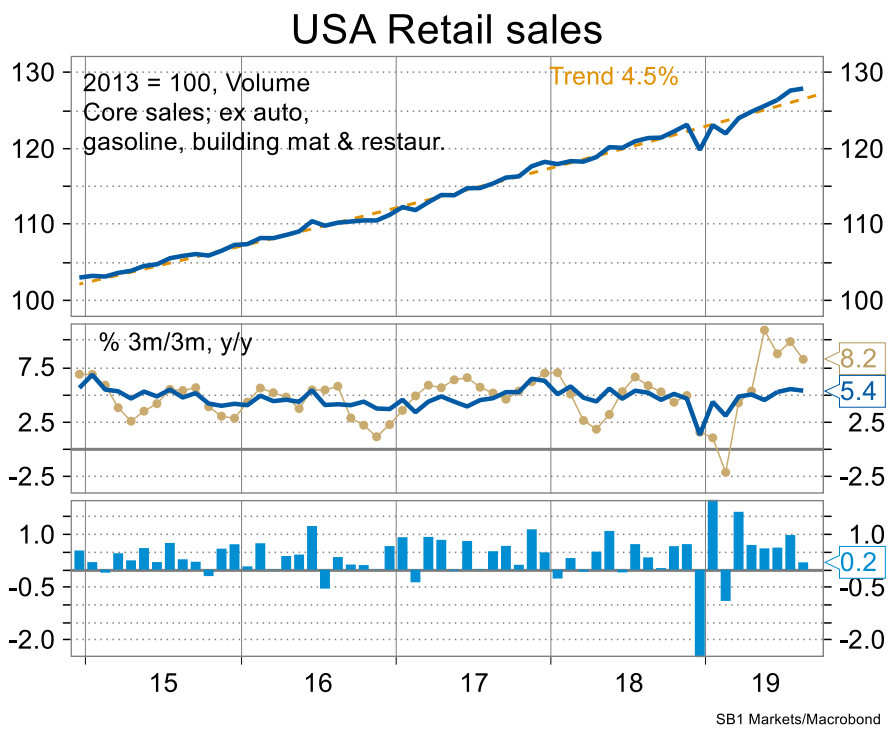


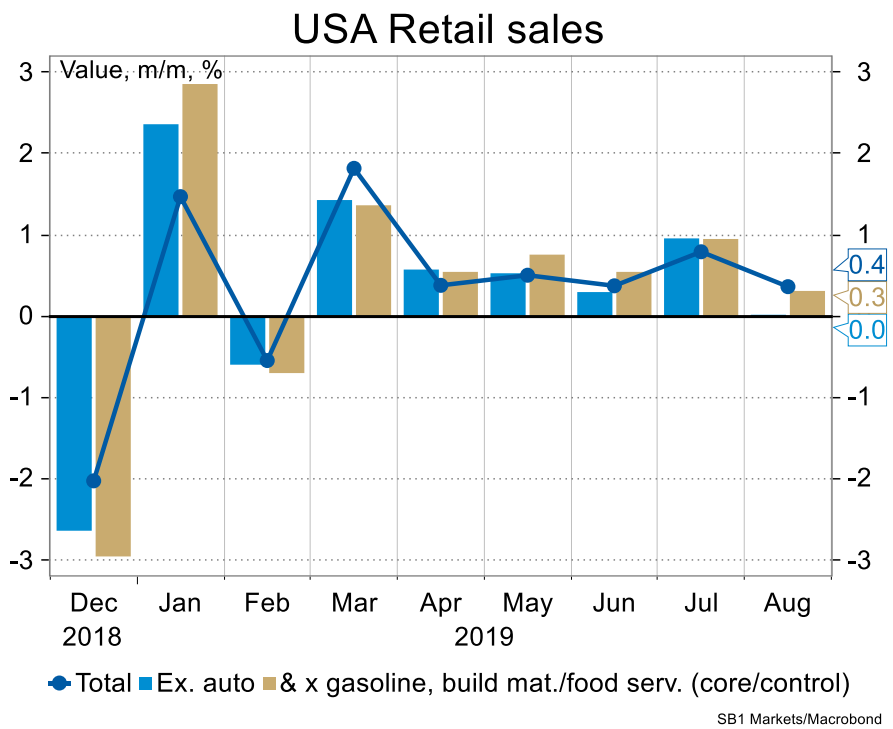


- Core CPI increased by 0.3% m/m in August, for the 3rd month in row, 0.1 pp above f'casts. The annual rate ticked up to 2.4%, from 2,2%, the highest since 2008 (partly lifted by muted m/m growth in Aug last year). Underlying growth, measured 3m/3m, soared to 2.8% (highest since 2008 too). High inflation underway? We doubt so, looking at producer prices or inflation models. Still, inflation has not disappeared!
  - » Fed preferred price measure, the core PCE (the consumption deflator) was up just 1.6% y/y in July, below Fed's 2% price target, will most likely accelerate in August
- Headline inflation was flat at 1.8%. Inflation has stabilised after being pulled down by declining energy prices in the spring

Retail sales slowed in August, the speed is still impressive

Core sales volume rose 0.2% in Aug (our est) and are up 8.2% 3m/3m





- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by 0.3% m/m in nominal terms in Aug, just in line with expectations, following a strong July (just marginally revised down). Total retail sales rose 0.4%, auto sales increased marginally
- We estimate a 0.2% m/m volume growth in core sales, after a 1.0% lift in July. Growth recent months has been very strong, up 8.3% measured 3m/3m annualized and the annual rate is 5.4%!
  - » Income growth has slowed somewhat and consumer confidence is mixed – but neither signal an abrupt slowdown in household demand (even if declining savings have been funding half of the growth in consumption so far in 2019…)

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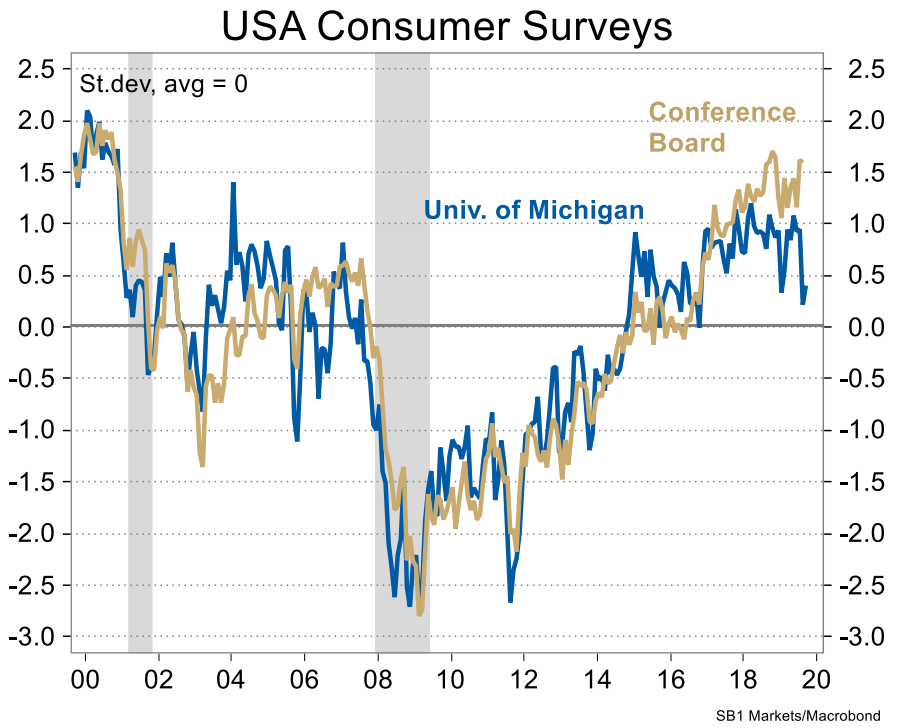
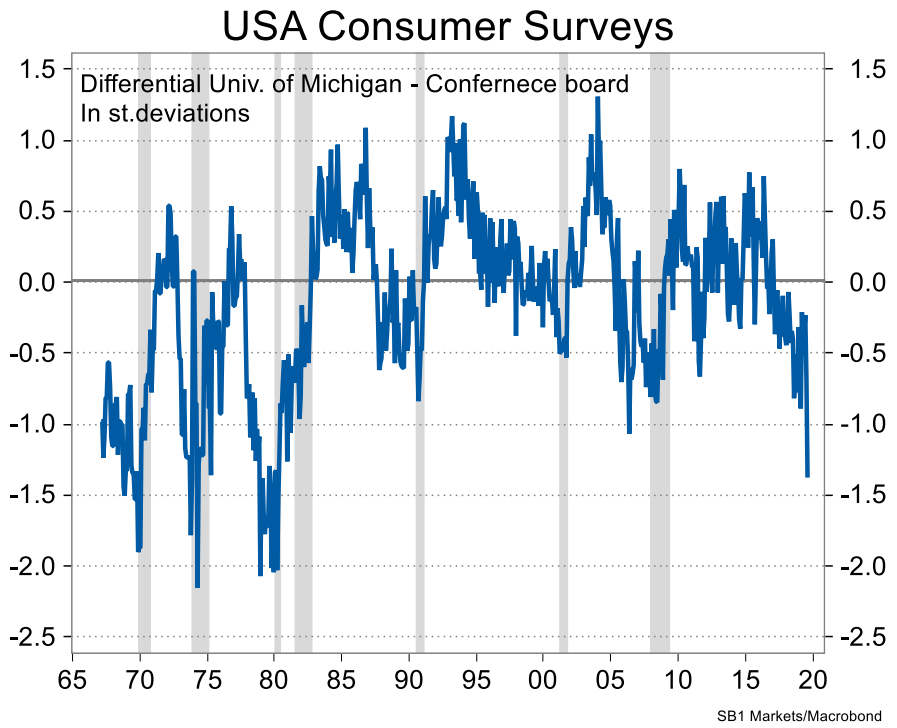
Michigan consumer sentiment a tad up in Sept, still at a 'low' level

Sentiment rose more than expected, but just a small part of the Aug decline was reversed





- University of Michigan's sentiment survey climbed to 92 in Sept from 90 – but remains well below the July level at 98. The August setback was unusual. The level is still above average for the total index (current situation well above, expectations at average).
- Conference Board's consumer confidence survey did not report any setback in August, and the difference between the two surveys suddenly became unusually large. Ahead of economic downturns, this usually happens
- Still, both surveys are above their long term averages and they do not signal a sudden halt in consumption. But…

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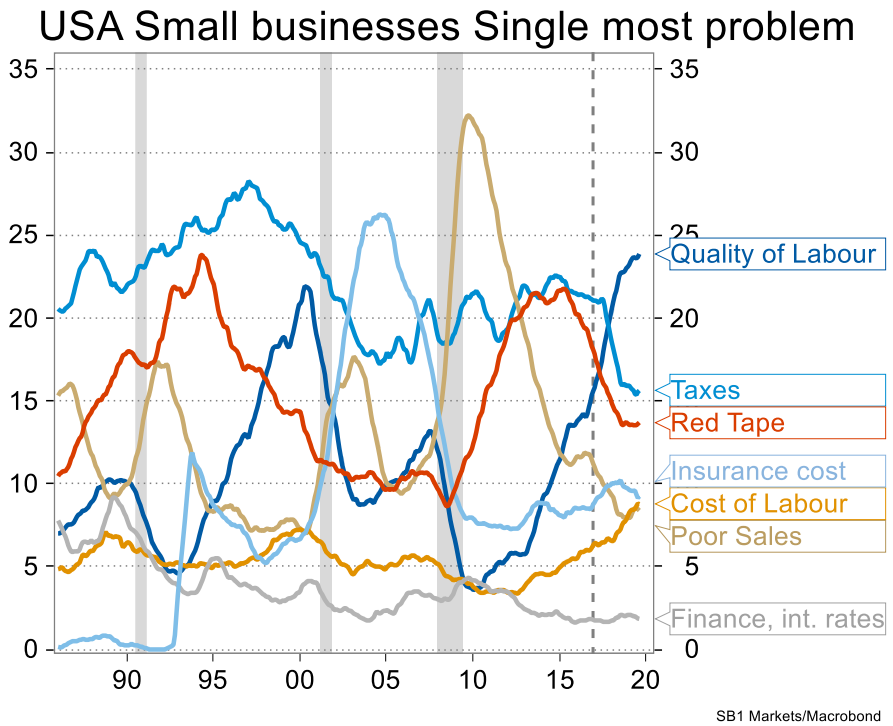
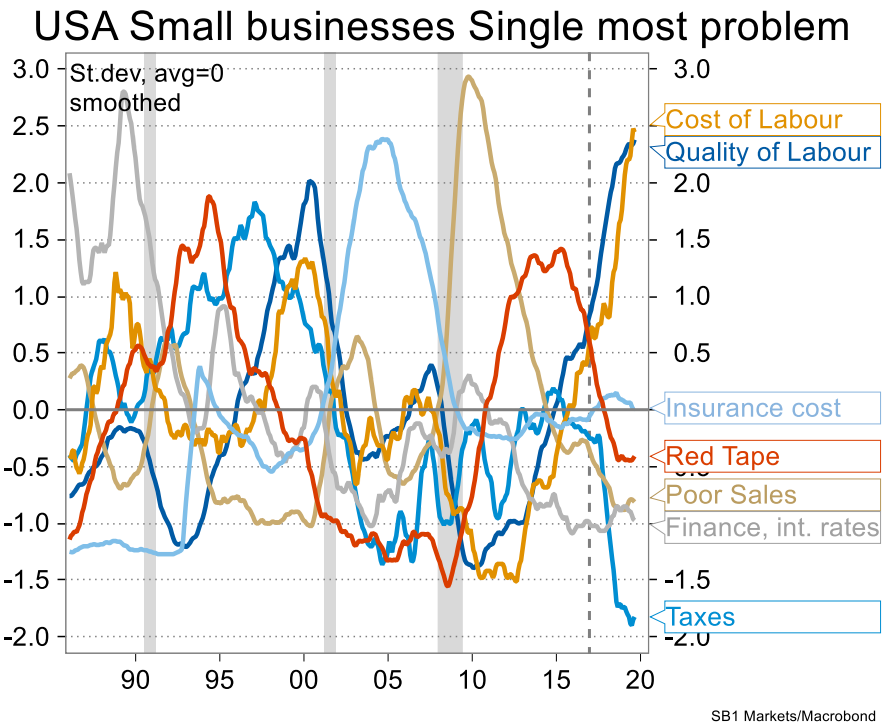
What's the problem? Cost & quality of labour, not sales, interest rates or taxes

US SMEs have never before reported more problems due to cost and quality of labour!

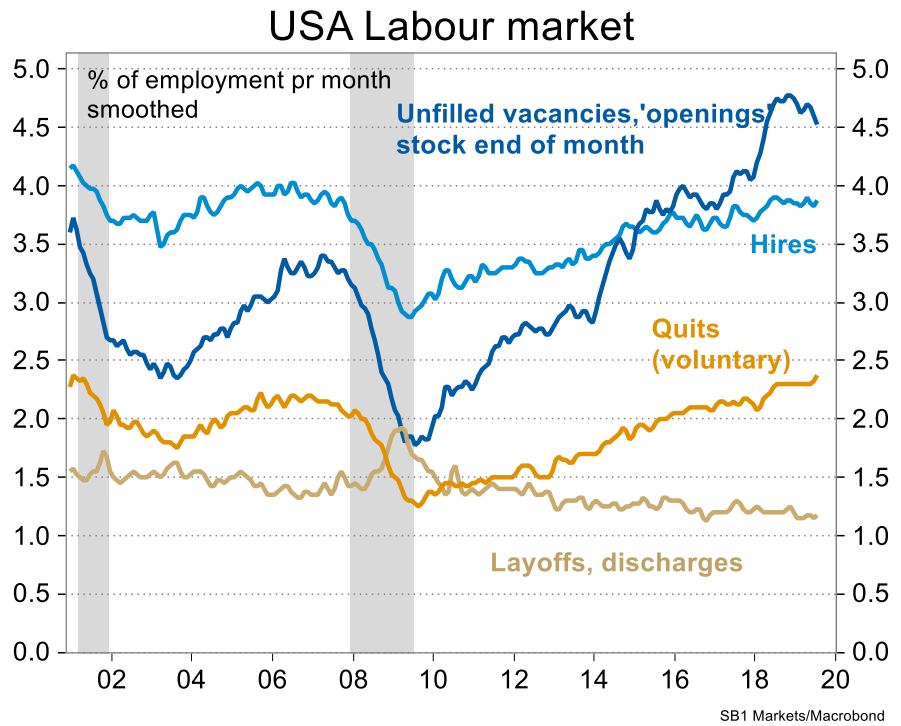


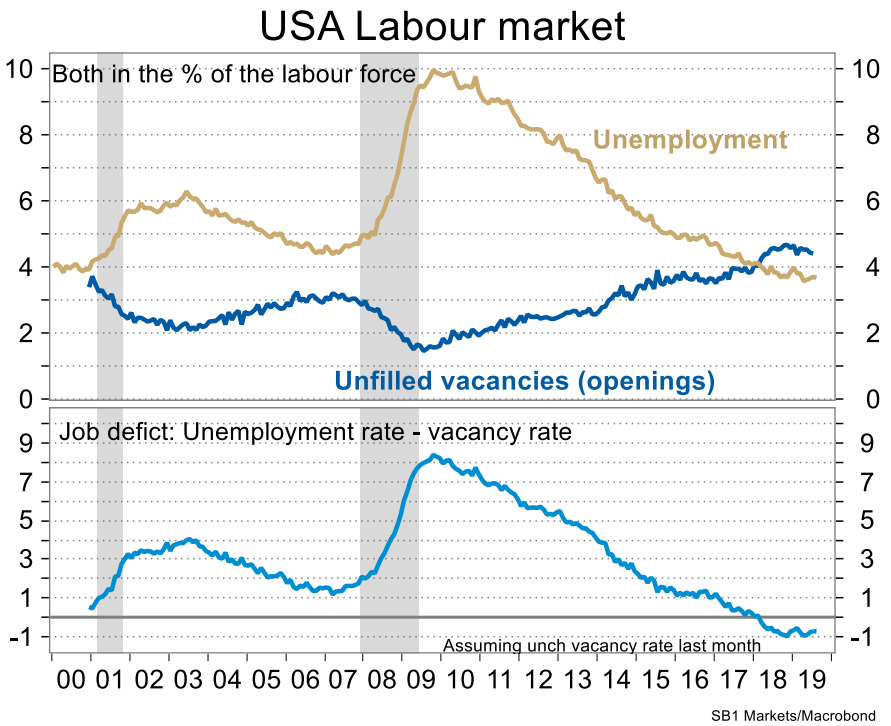


- And fewer than ever are complaining about finance/interest rates and about taxes, following last year's tax cuts
- Sales are not the problem either, almost 20 year since so few stated sales as the most important problem, constraining production.
- So the answer is obvious: The Fed must cut the fed fund to zero, or below, the USD must be taken down, as must taxes!
  - » Sure, at one stage in the economic cycle interest rate cuts will be appropriate. It's just not now!

Unfilled vacancies have probably peaked, at a very high level. Still few layoffs

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

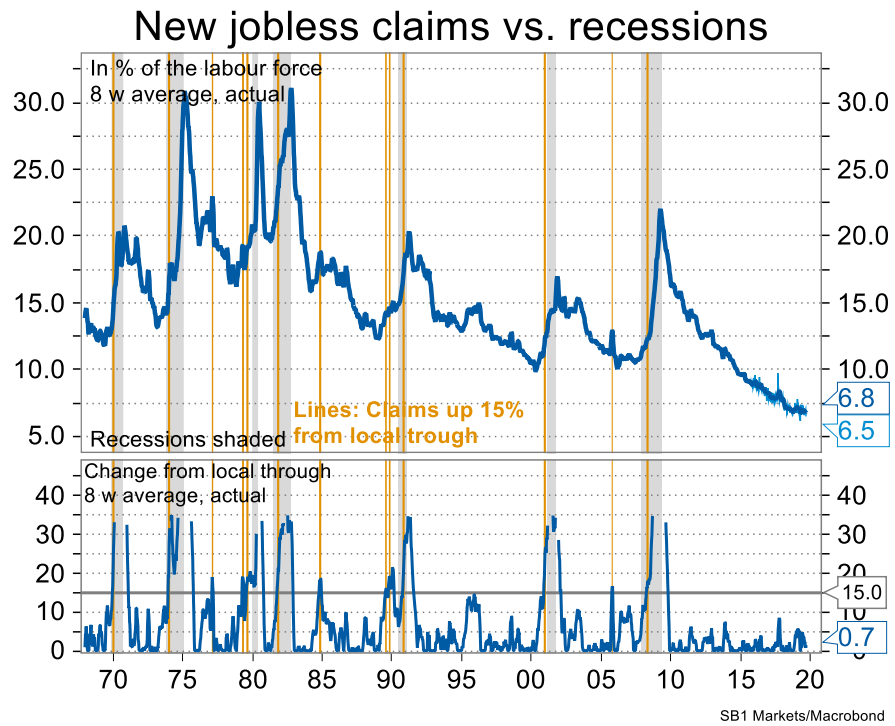


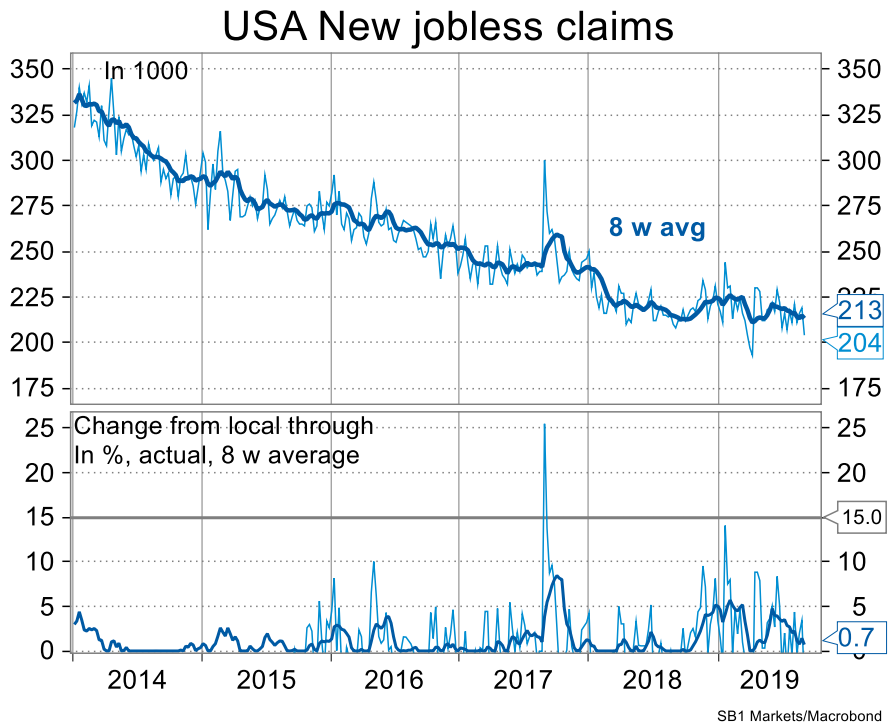


- The July JOLTS report does not signal a further tightening labour market, as 'job openings' are ticking down from the top. A turning point? Perhaps, but the labour market is no doubt tight; there are still more unfilled jobs (4.4%) than unemployed people (3.7%). Monthly (gross) hiring equals 3.9% (of total employment) and is not increasing anymore, as businesses struggle to attract labour
- The number of voluntary quits ticked up in July and is at a very high level – as many employees leave for better (paid) jobs. Not a sign of a weakening labour market! Layoffs are trending down and is at very low level

Jobless claims another tick down last week, no signs of weakness

Jobless claims fell to 204' last week, the 4th lowest in 50 years, and the 8 w avg is very low, at 213'





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

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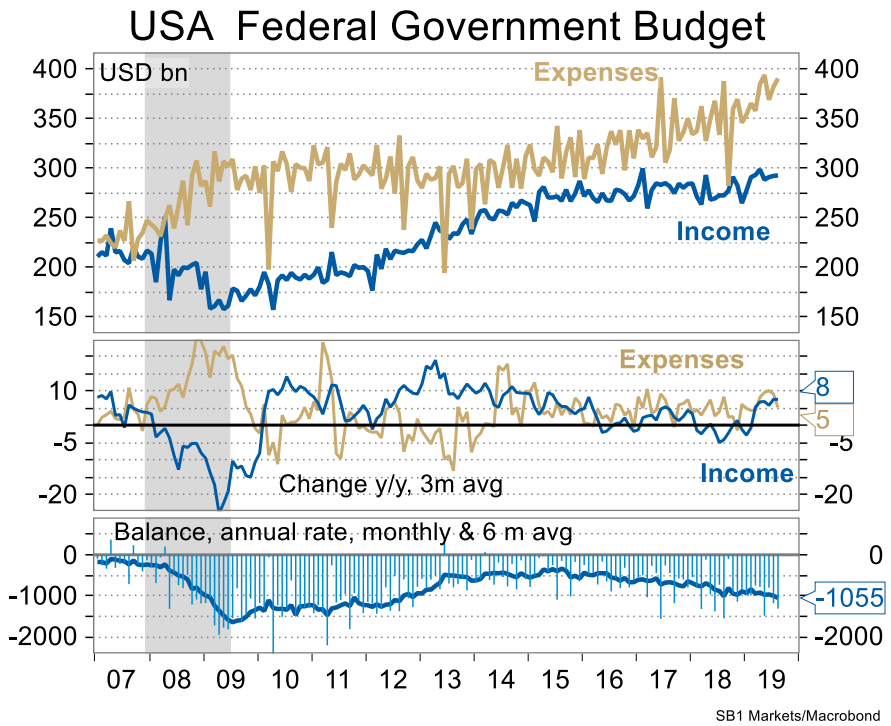
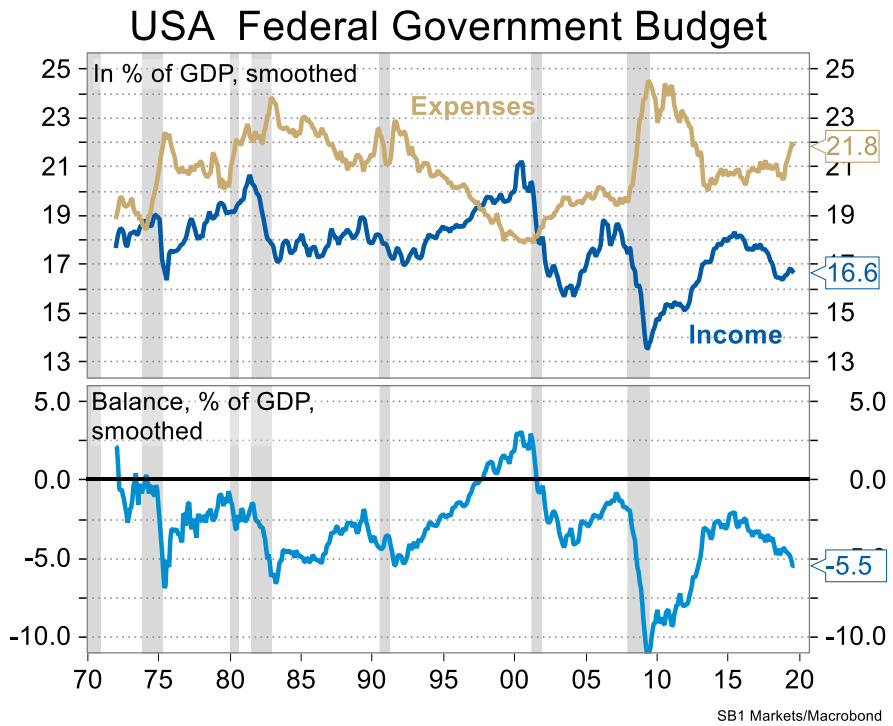
The federal budget deficit is widening amid soaring spending

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





- The budget deficit fell to USD 1360 bn in annual rate in August (seas. adj), and the 6 m avg is at USD 1.050 bn. Including local government etc, the US was running full employment, peacetime deficit at 6.9% in Q1 (from 6.7% in Q4); totally unprecedented!
- Federal spending inched is up 5% y/y (smoothed), way 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 less than 17% of GPD, much lower than normal in a blooming economy – of course because taxes have been cut
- A divided Congress has agreed upon a modest further increase for the deficit in 2019 and 2020, but no more than some 0.2 pp of GDP (extra)

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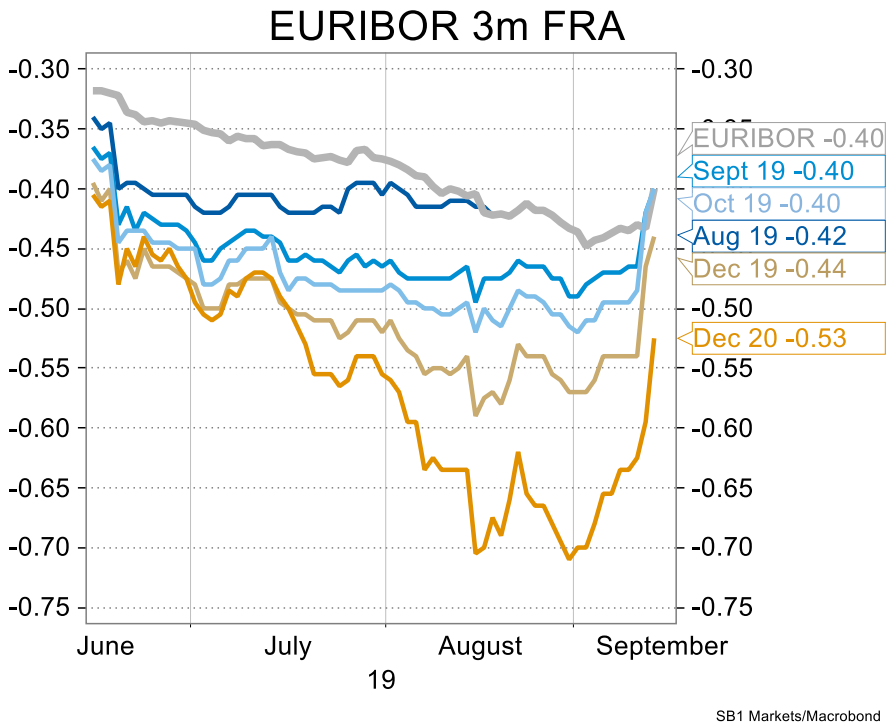
The ECB goes all in; 10 bps cut, introduces 'eternal QE', more bank support

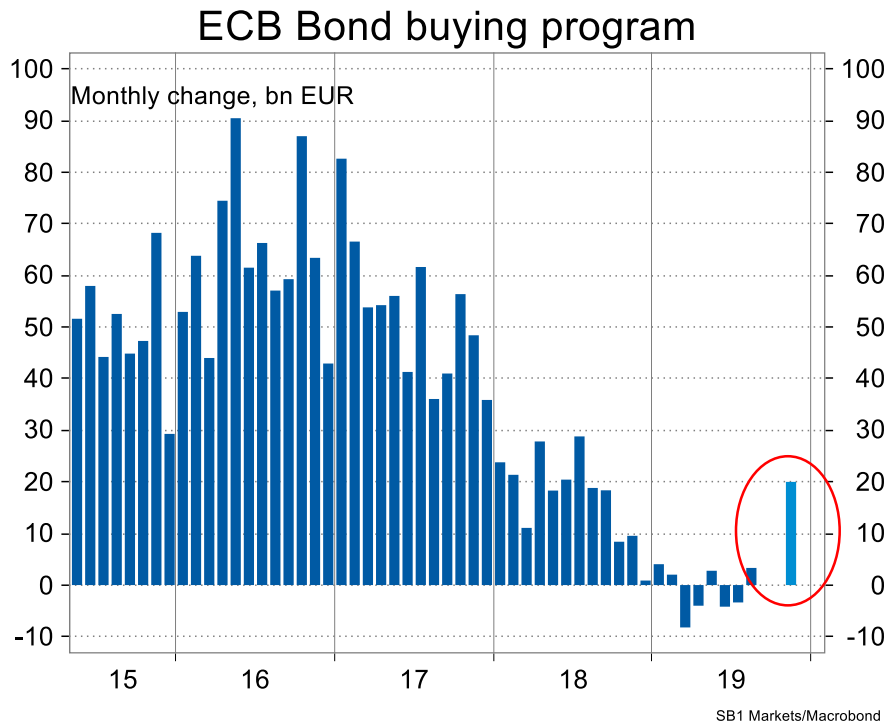
ECB delivered an extensive stimulus package, less QE than expected but no time limit

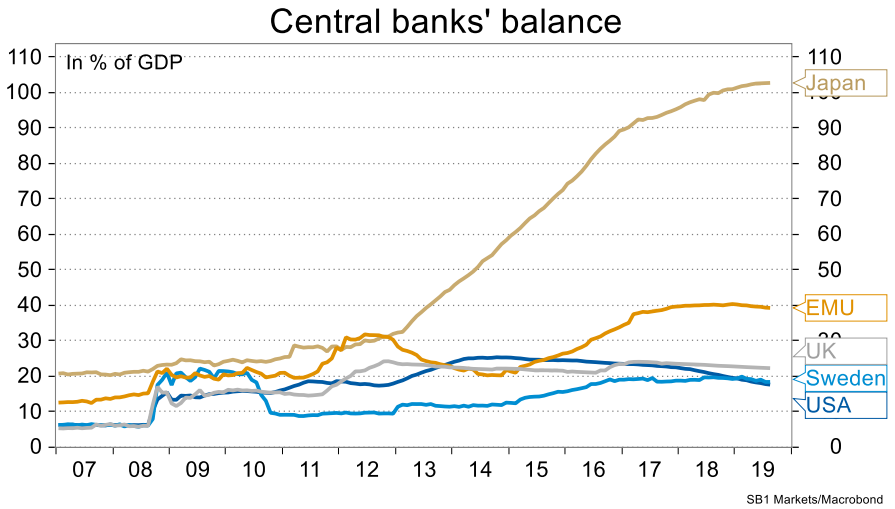


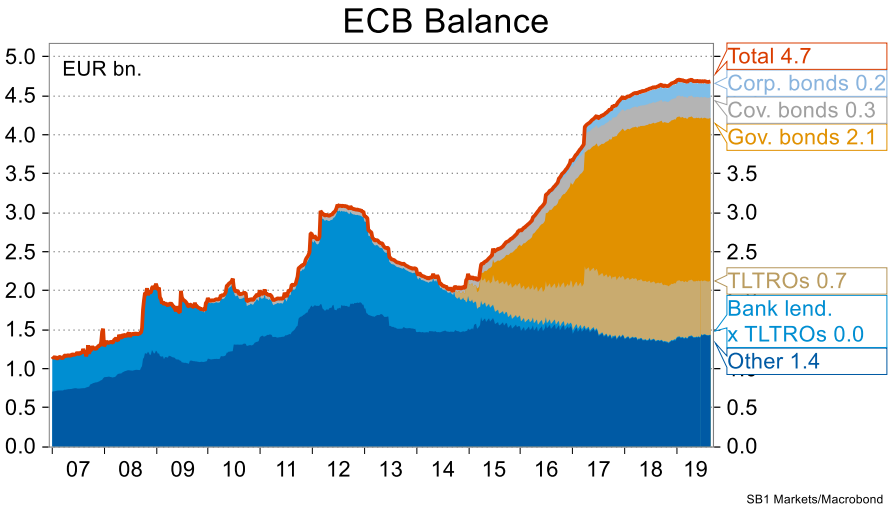
- The ECB's delivered a sweeping stimulus package but saves <u>some</u> ammunition (rightfully)
  - » The deposit rate cut by 10 bps to -0.5%, the market was even split between 10 or 20 bps. Moreover, the bank opened up for further rate cuts if the inflation outlook does not improve substantially. <u>The bank pledgedit will not hike before ECB's inflation f'cast approaches the below but close to 2% target</u>
  - » Asset purchases are reintroduced, at a monthly pace of EUR 20 bn (from Nov 1.). Less than expected (Bloomberg consensus 45 bn) but with <u>no fixed end date,</u> which was more aggressive than anticipated. <u>QE will continue until just before the first rate hike</u>
  - » In order to lessen the negative earnings impact for banks from the negative ECB deposit rate, parts of their holdings of excess liquidity will be sheltered from the negative rate (though with limited impact.) Moreover, changes were made to the TLTRO refinancing operation so that banks with loans exceeding a certain benchmark will be given an interest rate as low as the deposit rate, from +10 bps
  - » Several times during the press conference, Draghi urged for more expansionary fiscal policy measures (guess from which country!)
- The 2019 GDP f'cast was nudged down to 1.1%, from 1.2% in June, and the 2020 f'cast was lowered by 0.2 pp to 1.2%. The inflation outlook was held unchanged in 2019, 2020 revised down by 0.2 pp to 1.3%
- Volatile markets as the ECB package was digested; initially, EUR and interest rates slipped. The following hours, the mood changed and interest rates closed far above the pre-ECB levels, EUR 2 y swap up 7 bps. Because markets became concerned as to whether the ECB will add more stimulus? Positive trade war developments probably helped too, interest rates spiked all over

ECB reintroduces QE for as 'long as necessary', until ECB's infl. f'cast reach target

The EUR 20 bn per month was somewhat below expectations, however, the ECB sets no time limit



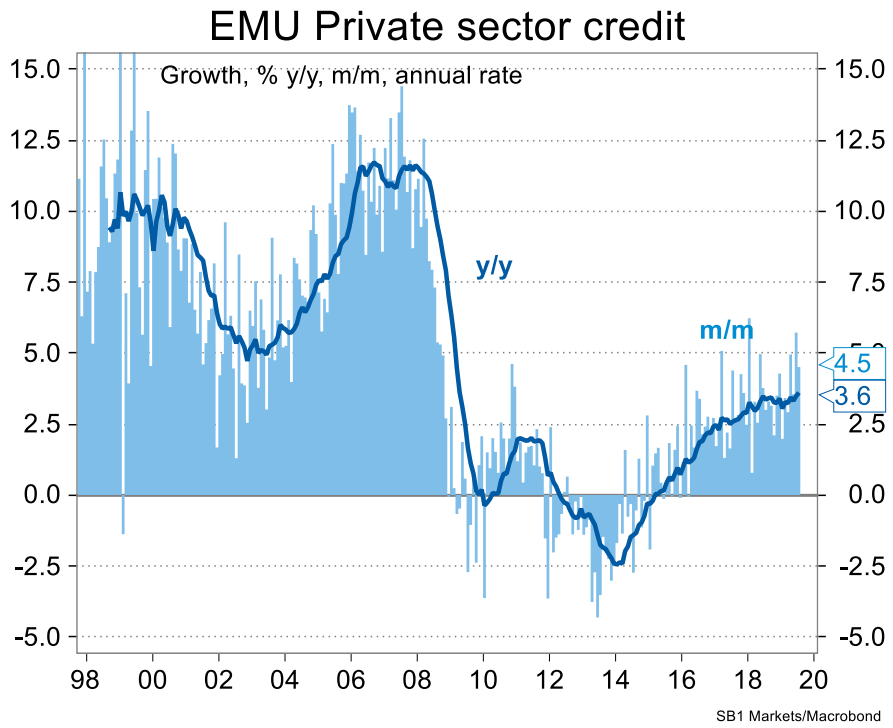


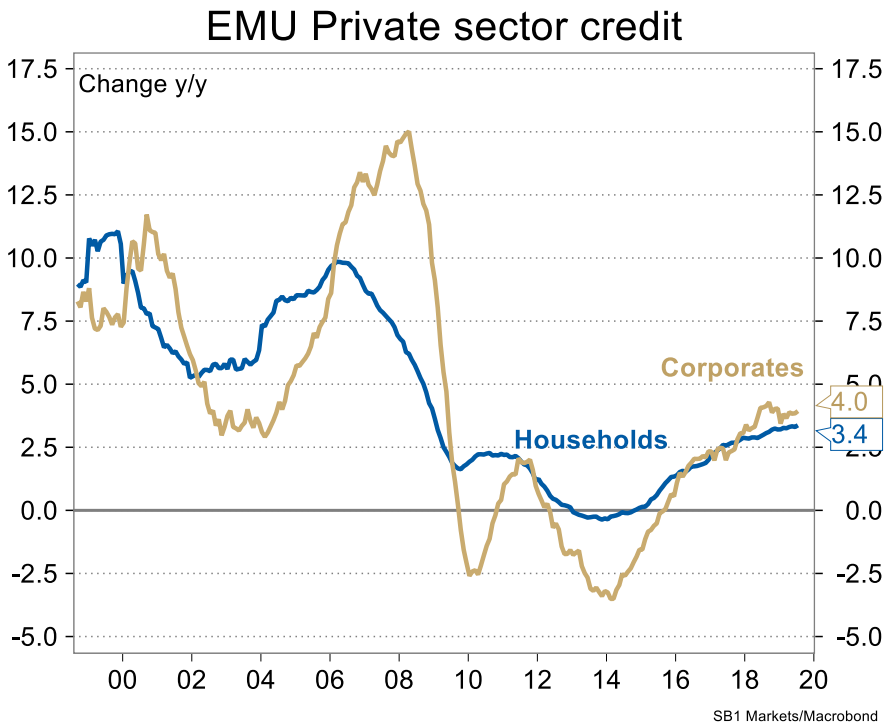


- An EUR 20 bn QE equals just 2% of GDP, and if nominal GDP increases 2% per year, ECB's QE holdings will be flat vs. GDP. A modest QE, compared to the 3 times larger buying program in 2016. A compromise??
- At the press conference, Draghi noted that the ECB has the headroom to prolong the asset purchases for 'quite a long time' without approaching the limits of holdings av government bonds (1/3 of total). However, this limit is self imposed, and may be lifted

What's the (credit) problem?

Credit is flowing just the way it should, it seems like – and definitely no signs of contraction

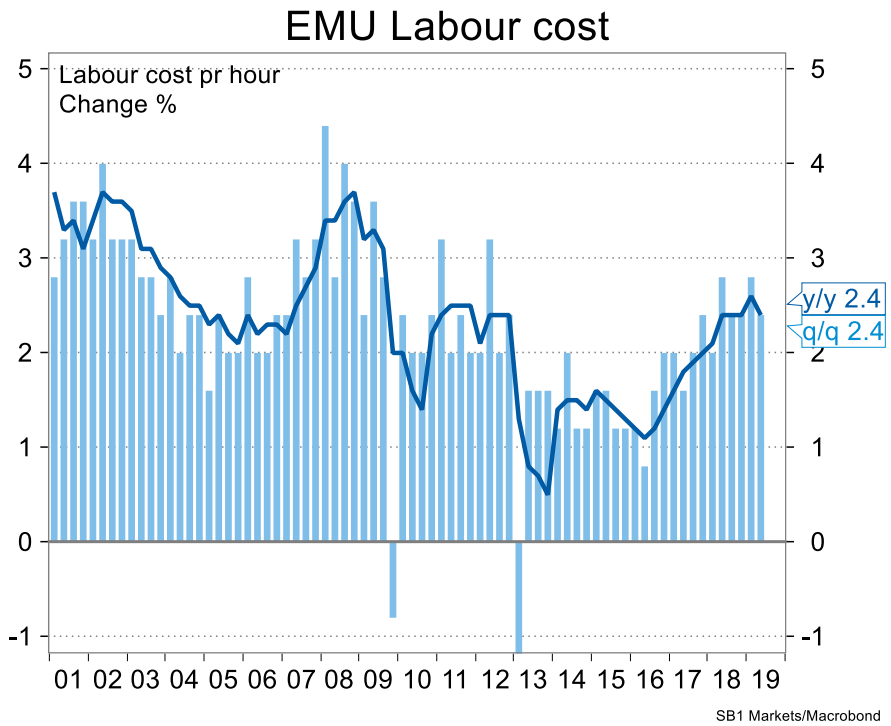


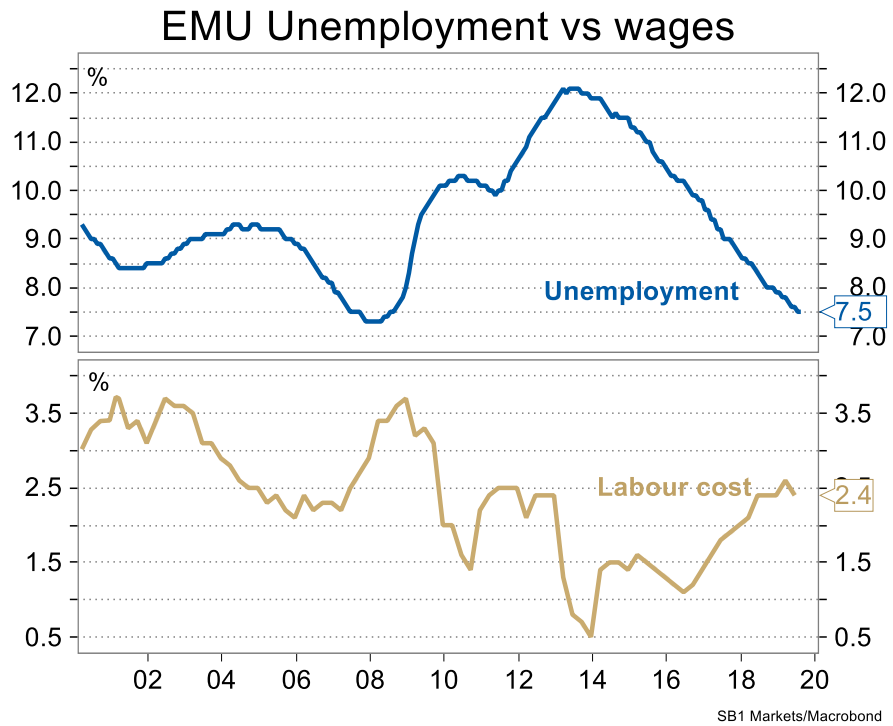


- No doubt, growth has slowed in the Euro area but is the economy in really bad shape?

Wage inflation cooled in Q2, trending up

Labour cost eased to 2.4% y/y in Q2, from 2.6% in Q1, even as unemployment is declining

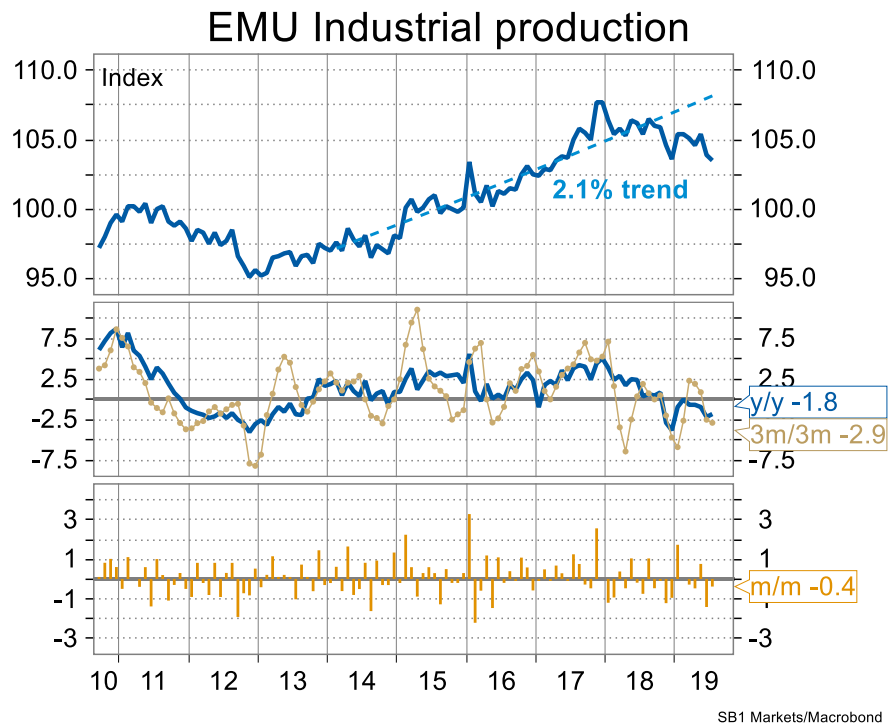


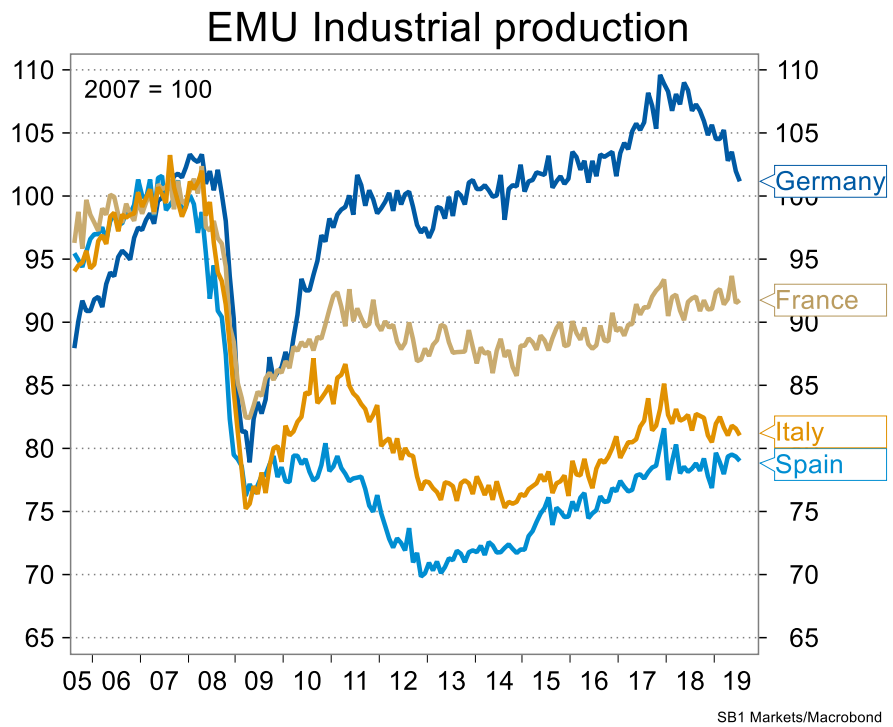


- Wage inflation slowed to 2.4% y/y in Q2, thus, flattening out the past year, after a steady upturn. Growth q/q annualised fell to 2.4% as well, from 2.8% in Q1
  - » Unemployment is still sliding steadily down and the level is not high anymore. The strengthening labour market stands in contradiction to the loss of momentum in the EMU economy, particularly within manufacturing, however, it is probably a lagging indicator
  - » In spite the Q2 slowdown, wage inflation is trending up and will have to to translate into higher CPI inflation at one point?
  - » No Q2 country details are published yet

Industrial production slides down, led by Germany

Production fell 0.4% m/m in July, Germany down 5.6% y/y, France flat, Spain still heading slowly up

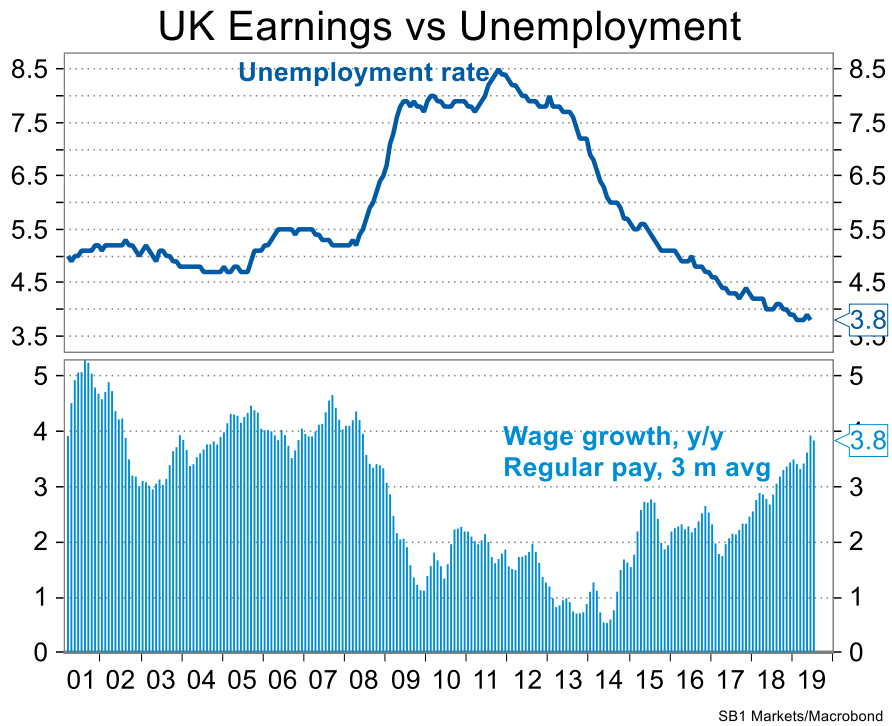


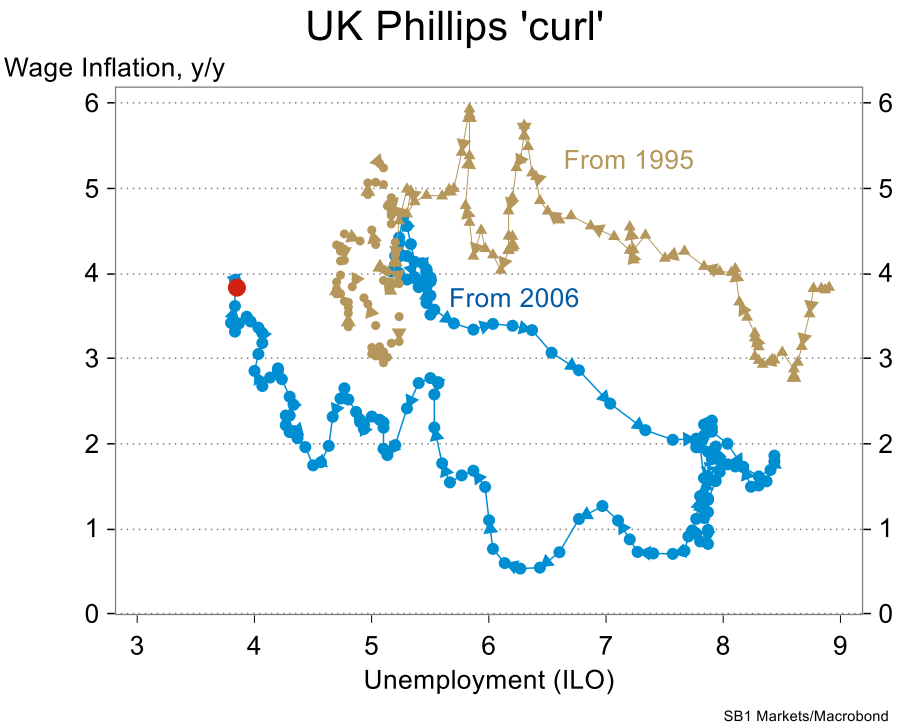


- Industrial production in the Eurozone declined by 0.4% in July, a tad more than expected, following a steep drop in June. Over the last year production has fallen 1.8% and is down 3.9% from the late 2017 peak
  - » Germany is plummeting; down 5.6% y/y (smoothed), and by 7.7% from the peak
  - » France has stagnated but is not declining, and Spain is still heading slowly up. Italy trending down, at a softer pace than Germany
- <u>The manufacturing PMI and orders remain in the doldrums, no signs of recovery</u>

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

The Phillips curve is not dead, it has just moved somewhat to the left? Rapid wage acceleration now





- Wage growth (regular pay) eased marginally to 3.8% y/y in July (regular pay), measured by the 3 m average. Wage inflation is heading straight up, to an 11 year high in June
- UK productivity growth is 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

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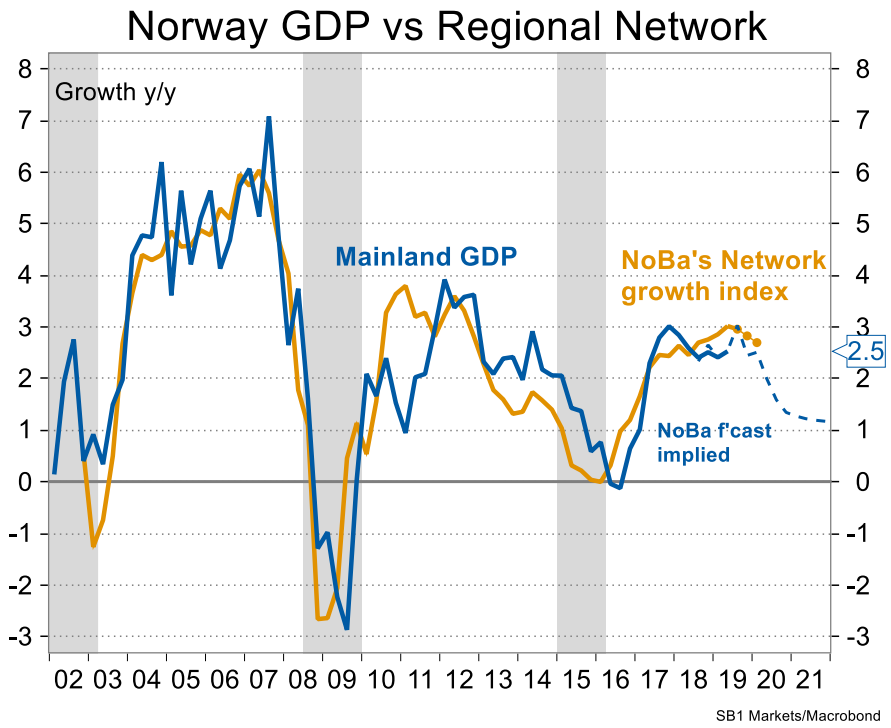
Norges Bank's Network confirms strong growth, NoBa have to revise its f'cast up?

Reported growth stable at 3%, expected growth down to 2.7% from 3.1% - but that's not slow!



Summary of the Q3 report

- **Growth**
  - » Norges Bank's Regional Network reports 3.0% growth the past 3 months, the same pace as in the Q2 survey and in line with Norges Bank's Q3 forecast
  - » Businesses expect 2.7% growth the coming 6 months, spot on our f'cast. This is 0.4 pp softer than in the Q2 survey but far above Norges Bank's Q4 2.2% and Q1 1.5% estimates (our calc, and further down through '20). Most likely, the Bank will have to nudge up its 2020 growth f'cast (which also is below SSB's and consensus)
- **Capacity utilisation/investments**
  - » The Network reports marginally higher capacity constraints, above Norges Bank's f'cast. Capacity utilisation is slightly higher than at the 2012 peak. Still, the share of businesses reporting labour shortages did not increase and remains low vs the unemployment rate
  - » Businesses expect slower employment growth, still above 1% (and faster than working age popul. Growth
  - » 2019 wage exp. were nudged down marginally to 3.2%
- **Sectors**
  - » Mixed outlook; Oil services are peaking, will slow the coming quarters. Manufacturing stable but global uncertainties are expected to act as a drag on export oriented sectors. Retail is struggling
- **Implications**
  - » The Network confirms that growth is now peaking and will decline, however, at a slower pace than Norges Bank assumes. Thus, the Network supports our view that Norges Bank will hike on Thursday

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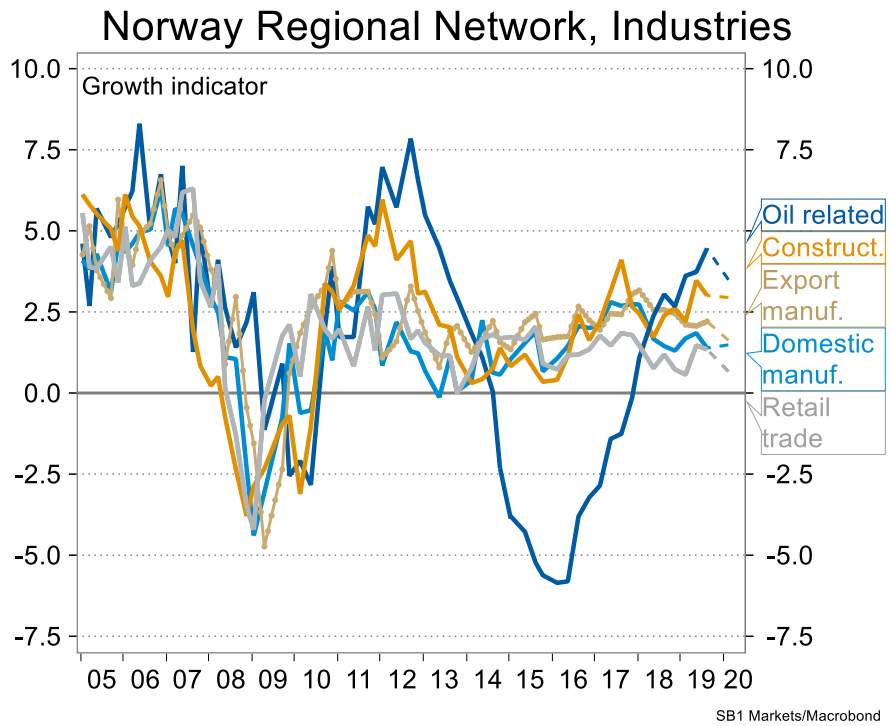
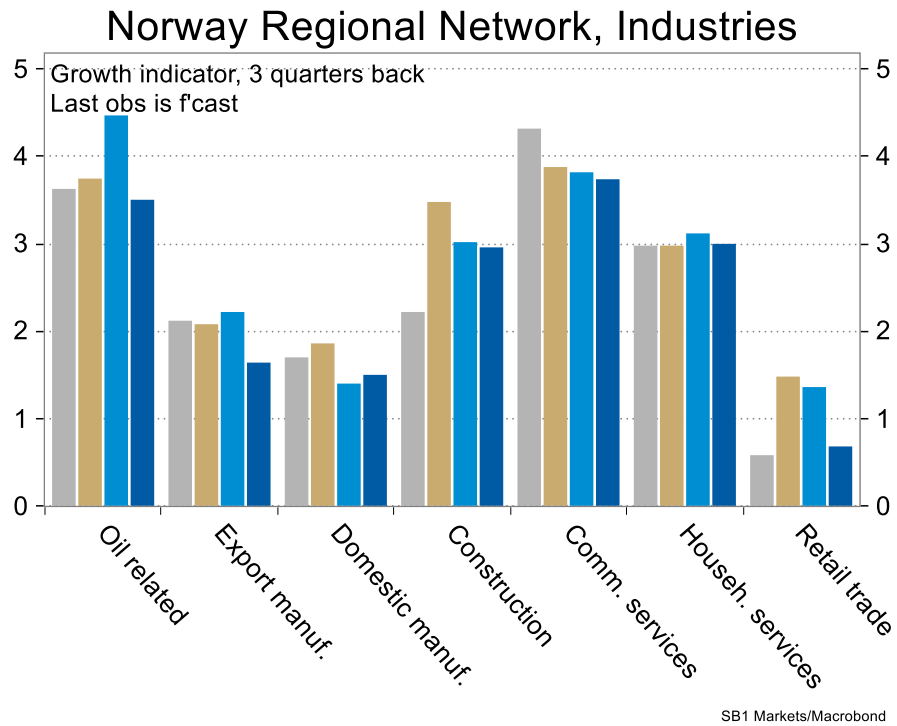
Growth is peaking in oil related, construction and manufacturing

Businesses expect a slower expansion in oil related sector, export manufacturing and retail trade

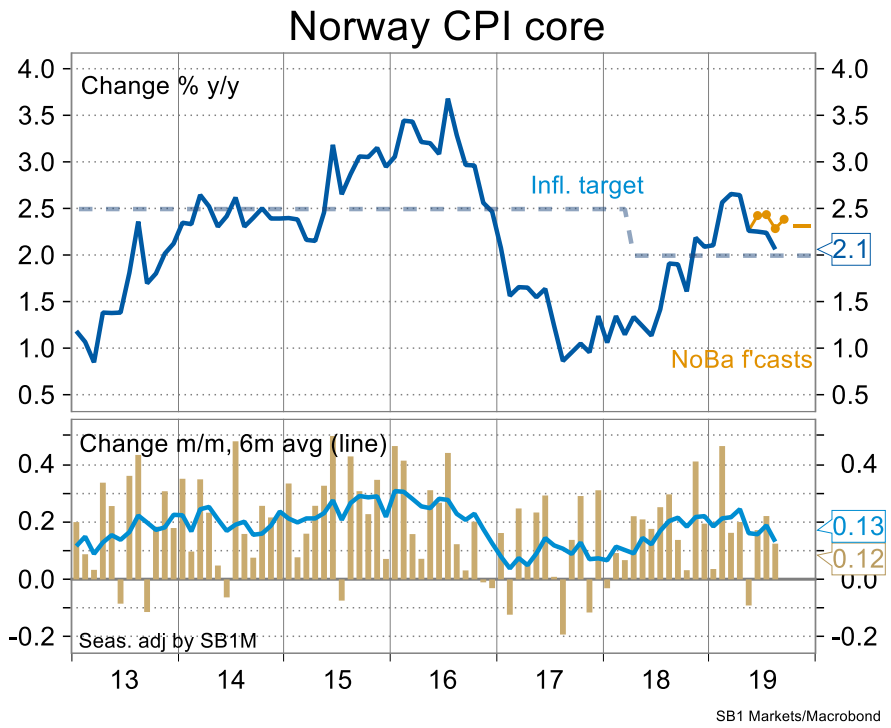




- Oil related companies (manufacturers & service providers) are reporting higher output growth the past 3 months but expect a slowdown the next 2 quarters. Hence, the Network confirms what oil companies reported in the investment survey; growth in oil related sectors will soon turn south
- Export oriented manuf. sectors experience steady demand in spite global uncertainties. Some cite that impacts from the weak NOK have offset the slowdown in global demand. However, they expect growth to moderate the coming months. Domestic manuf. slowed in Q3 and is expected steady
- Construction slowed in Q3 and activity is expected to increase at a steady pace the coming 6 months. Businesses note somewhat softer housing sales
- Growth in commercial services has slowed but is still expanding quite rapidly, household services stable at a somewhat slower pace
- The retail sector is struggling, growth slowed marginally in Q3 and the outlook is not bright, according to these businesses. Competition from online shopping and new market trends such as sustainability and recycling are cited as challenging for the sector

Core inflation inched down to 2.1%, total inflation fell to 1.6%

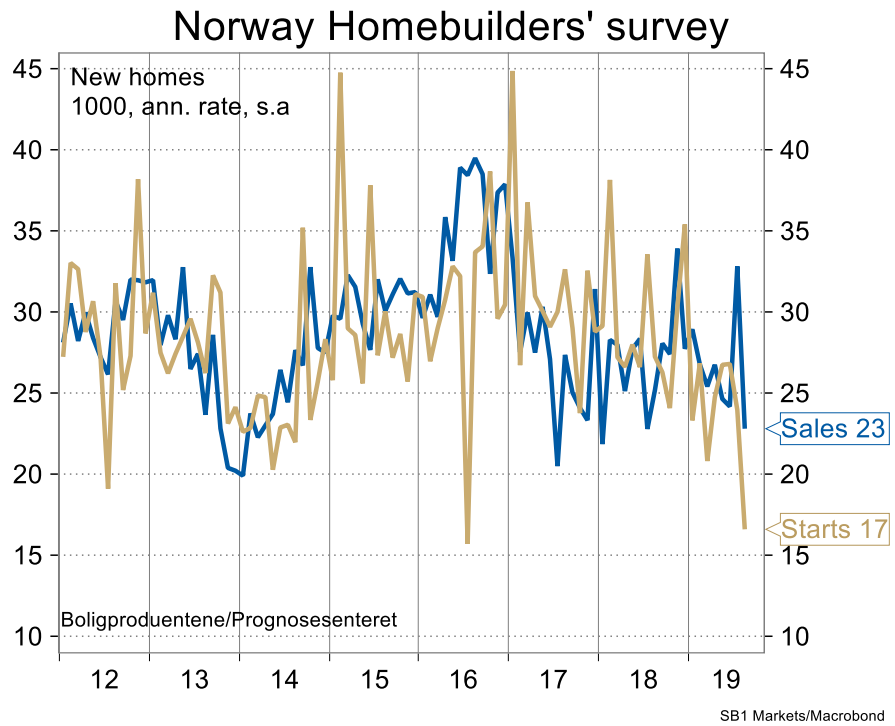
Core CPI inflation ticked down 0.1 pp in August, the 3rd month just below Norges Bank's f'cast

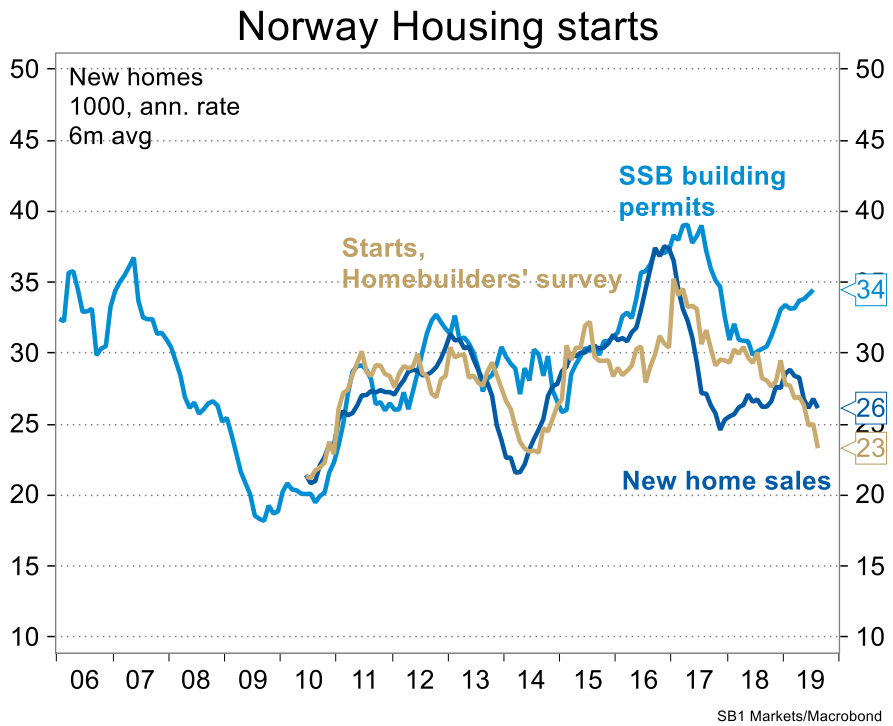


- CPI-ATE (ex. energy and taxes) slowed 0.1 pp to 2.1% y/y in August. Consensus was for an unchanged pace of inflation (like our f'cast). Core inflation has been running below Norges Bank's f'cast (from June) for 3 months now, the Bank expected a 2.3% speed in August
  - » CPI-ATE rose 0.1% m/m (seas adj), down from 0.2% in July
  - » Higher food and clothing discounts sent inflation down, while prices on health services and housing (rent) boosted price growth
  - » Imported goods are up just 1.1% y/y and we do not expect much more, even as the NOK is weak. Domestic goods & services are up 2.8%!
- Total CPI growth came in at 1.6%, a 0.3 pp decrease from July. Total inflation has been pushed down by a steep decline in electricity prices. Good for real income growth, thus, consumption!
- **Implications**
  - » Core inflation remains just above the price target, we do not expect Norges Bank to put much emphasis on a slight deviation from its forecast the past 3 months. Nonetheless, the bank will probably nudge down the inflation f'cast, contributing to a lower interest rate path
  - » No substantial market reaction, NOK depreciated marginally following the report

Homebuilders report softer sales – and a steeper decline in starts

SSB housing permits kept much better up due to a (temporary) hike in student homes starts





- The Homebuilders reported **new home sales** at an annual rate of 23' in August (seas. adj.), after soaring to 33' in July. Sales have been sliding down since early 2019 but is still slightly up from the late 2017 trough. The 6m average has fallen to 26'
- Homebuilders' **housing starts** dropped to an annual rate of 17' in August (seas. adj.), down 7' from July and the weakest month since 2016. The 6m average has fallen to 23', <u>heading steeply down the past 6-7 months</u>
  - » SSB reports building permits at 34' (6 m avg), trending up, the gap to the Homebuilders at 23' is unprecedented. We can explain part of it by a boom in student homes, check the next slide

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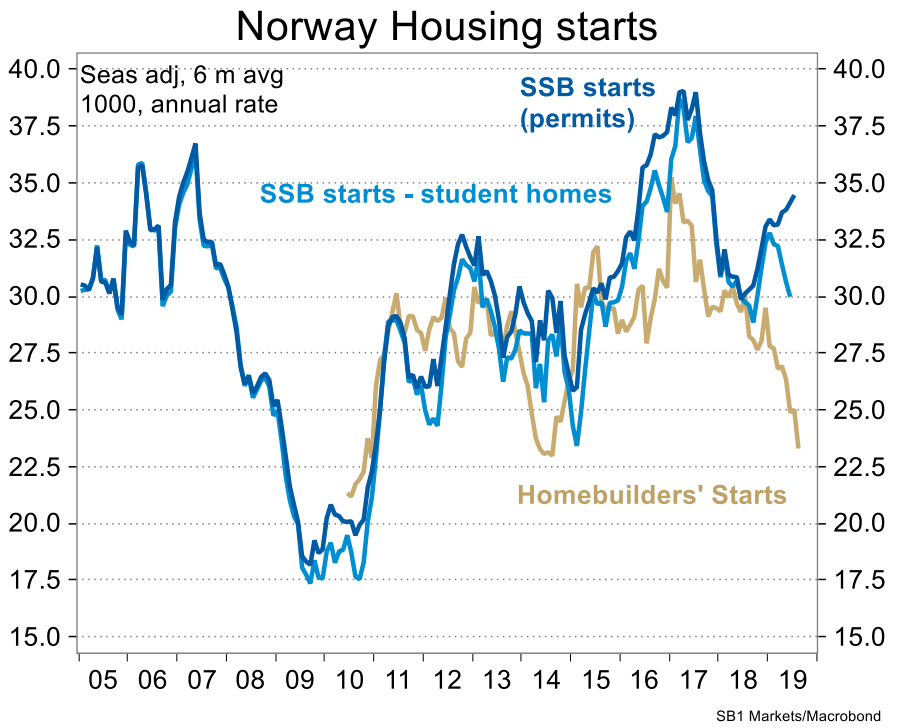
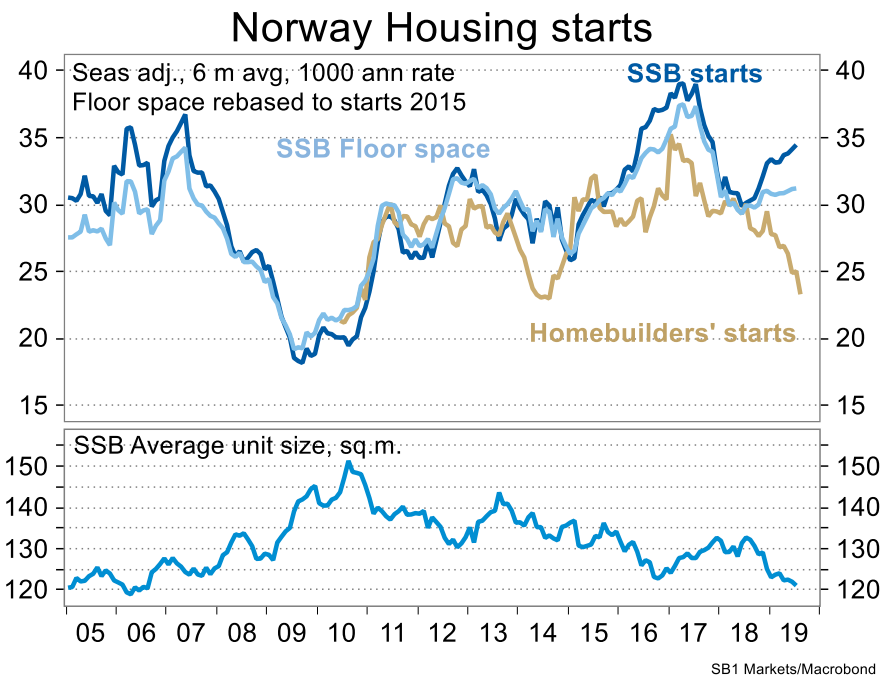
Barring student housing, housing starts have most likely peaked

… Although the downturn is much steeper according to the Homebuilders





- In Q2, student housing, which is only included in SSB's statistics, explained more than half the gap. Student home construction equalled 4' in annual rate in H1, no doubt a temporary hike. In addition, student homes are smaller than other homes, and the contribution to construction activity and to housing supply is less than for other housing (some 1/3rd per unit we guess)
  - » Measured by total sq.m., starts have not increase by much recent quarters according to SSB – <u>but it has not fallen either</u>!
- If Homebuilders' data were representative, it would have substantial impact on the assessment of the Norwegian economy. Norges Bank's regional network did not report any broad weakening in the construction sector where supply constraints were more important than demand challenges
- Still, we cannot completely disregard data from the homebuilders either, and they are supported by other reports of slower new home sales. (BTW, there are also far larger volumes of existing homes for sale in most places outside Oslo, so far without depressing existing home prices)

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Our main views

	Main scenario	Recent key data points
Global growth cycle	The cycle is maturing, in the real economy, markets. Rich countries (DM) in the lead, more to go in most EM. Unemployment is low, wage inflation on the way up, not low vs. productivity. Most emerging countries (EM) x China are in recovery mode. Some hotspots EM will get burned, as usual – but there are fewer EM imbalances than normal. Barring policy mistakes, the global economy is not yet rigged for a *hard* downturn	Global composite down 0.3 p in August, to 51.3, suggesting some 3% GDP growth. The global manuf. PMI rose marginally, after 15 months of decline. Auto sales rose in Aug, trend flat so far in '19 but are down 8% y/y
China	The governments' stimulus measures may have stabilised the economy, and surveys and data do not point to any swift turn of growth momentum. The invest/GDP ratio is still sliding down. 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. Exports to US approx 2% of GDP, and a (so far) 10 % decline here is manageable. **However, a full scale trade and even more a tech war will hurt the Chinese economy**	Aug data softer than expected but no signs of an abrupt halt. Industrial production is slowing, retail sales too, but not further recent months. Investments are growing steadily. Credit growth is heading slowly up, due to shadow banks.
USA	Growth has slowed, from well above trend. The employment rate is still trending up, and unemployment down while inflation is just marg. below target. No serious overinvestments but most sectors at/above trend and corporate debt is high. Business investments have weakened amid weaker growth in profits and trade war uncertainty. Recent consumption data are solid, halfway funded by lower (but still unusual high) savings. Housing mostly positive. Fiscal stimulus continues in '19/20 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/business investments**	Core CPI inflation accelerated more than expected, to 2.4%, 11 y high. Jobless claims close to a 50 y low. Retail sales are still going strong, no evident weakness in the consumer sector. Well, expect from UM consumer sentiment, which rose in Aug but remains 'low'
EMU	Growth has slowed and manufacturing data are worrying while services remain resilient. The labour market is still tightening, and labour cost infl. is back to a normal level. Investment ratios are above trend. Credit growth is accelerating, but still muted. Household savings are high, still consumption has kept up well. Policy: ECB has turned dovish but has not that much ammunition left, barring a huge QE. Fiscal policy debate has turned. **Risks: Trade war (but less risk for a US/EU war after G7). Italy. Weak short term data signals a substantial further slowdown risk**	ECB delivered an extensive stimulus package; a 10 bps cut, open ended QE and more support to banks. Ind. prod. slides down, led by Germany (but Germ. Exports not that weak). Labour cost inflation slower in Q2, still trending up?
Norway	Growth is still above trend but may soon be peaking. For now, unempl. declines further (some soft data recently, though!). Wage inflation is accelerating. Oil investments are peaking in H2. Mainland business inv. not low anymore, will probably slow in '20. Housing investments have bottomed, for now. Electr. prices have taken the headline CPI down but core still above target. Credit growth still above income growth, is spite of heavy regulations. **Risks: Debt, housing. A harsh global slowdown**	Norges Bank's Network report strong growth at just a mild slowdown the coming 2 quarters, above NoBa's growth estimates. CPI inflation below f'casts but still above target, at 2.1%. Housing starts are declining

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The Calendar

In focus: Fed & Norges Bank, US manufacturing prod & surveys, housing market data

Time	Country	Indicator	Period	Forecast	Prior
Monday Sept 16					
08:00	NO	Trade Balance	Aug		6.5b
14:30	US	NY Empire Manufacturing Survey	Sep	4	4.8
Tuesday Sept 17					
03:30	CH	New Home Prices MoM	Aug		0.6%
09:30	SW	Unemployment Rate, LFS	Aug	6.8%	7.1%
11:00	GE	ZEW Survey Expectations	Sep	-37.8	-44.1
15:15	US	Manufacturing Production	Aug	0.2%	-0.4%
16:00	US	NAHB Housing Market Index	Sep	66	66
Wednesday Sept 18					
10:30	UK	CPI Core YoY	Aug	1.8%	1.9%
11:00	EC	CPI Core YoY	Aug F	0.9%	0.9%
14:30	US	Building Permits	Aug	1310k	1336k
14:30	US	Housing Starts	Aug	1250k	1191k
20:00	US	FOMC Rate Decision	Sep-18	1.75-2%	2-2.25%
Thursday Sept 19					
06:00	SW	Valueguard House Prices MoM	Aug		
06:30	JN	All Industry Activity Index MoM	Jul		-0.8%
10:00	NO	Norges Bank Deposit Rate + MPR	Sep-19	1.25%(1.5)	1.25%
10:30	UK	Retail Sales Ex Auto Fuel MoM	Aug	-0.3%	0.2%
13:00	UK	Bank of England Bank Rate	Sep-19	0.75%	0.75%
14:30	US	Current Account Balance	2Q	-$126.6b	-$130.4b
14:30	US	Philadelphia Fed manuf. Survey	Sep	10.8	16.8
14:30	US	Initial Jobless Claims	Sep-14	--	204k
16:00	US	Leading Index	Aug	0.1%	0.5%
16:00	US	Existing Home Sales	Aug	5.39m	5.42m
	JN	BoJ Policy Balance Rate	Sep-19	--	-0.10%
Friday Sept 20					
01:30	JN	CPI Ex Fresh Food, Energy YoY	Aug	0.5%	0.6%
03:30	CH	1-Year Loan Prime Rate	Sep	4.2	4.25
16:00	EC	Consumer Confidence	Sep A	-7.1	-7.1
18:00	US	Flow of Funds, credit growth	2Q	--	$4691b
Monday Sept 23					
02:30	JN	PMI Composite (+manuf, serv.)	Sep P	--	51.9

- **US**
  - » **The Fed** will no doubt cut interest rates and a 25 bps cut is broadly expected (by some 90%, market pricing), zero prob. for a 50 bps hike, was 40% at the peak. All eyes on the 'dot plot', which must be nudged down as the funds rate was cut in July, but there is no chance more than a couple of the 17 FOMC members will lower their paths down to market expectations. The median path will hardly signal another (a third) cut?
  - » **Manufacturing production** is stagnating, and surveys do not point to a recovery (but not a deeper slowdown either. The first Sept manufacturing surveys are released this week; **NY Fed** & **Phil Fed**
  - » **Housing permits** spiked in July, a correction is likely in August. Permits have anyway stabilized, as the **Housing market index**
  - » **Existing home sales** are heading up, while pending home sales do not indicate a further upswing
- **EMU**
  - » **Consumer sentiment** remains upbeat, confirms a resilient service sector
  - » No signs of recovery in the **German ZEW survey** (or other bus. surveys)
- **Sweden**
  - » Will **unemployment** continue to tick up? Employment has fallen sharply, and vacancies have turned down (from a high level), obvious warning signs
- **Norway**
  - » Our take is that **Norges Bank** will deliver the 25 bps hike to 1.5% (consensus is no change). However, due to global uncertainties and lower global interest rates, we expect the Bank to nudge down the interest rate path but not more than some few basis point, signaling that (another) the fifth hike in this cycle is put on hold

Source: Bloomberg. SB1M est. in brackets. The key data points are highlighted

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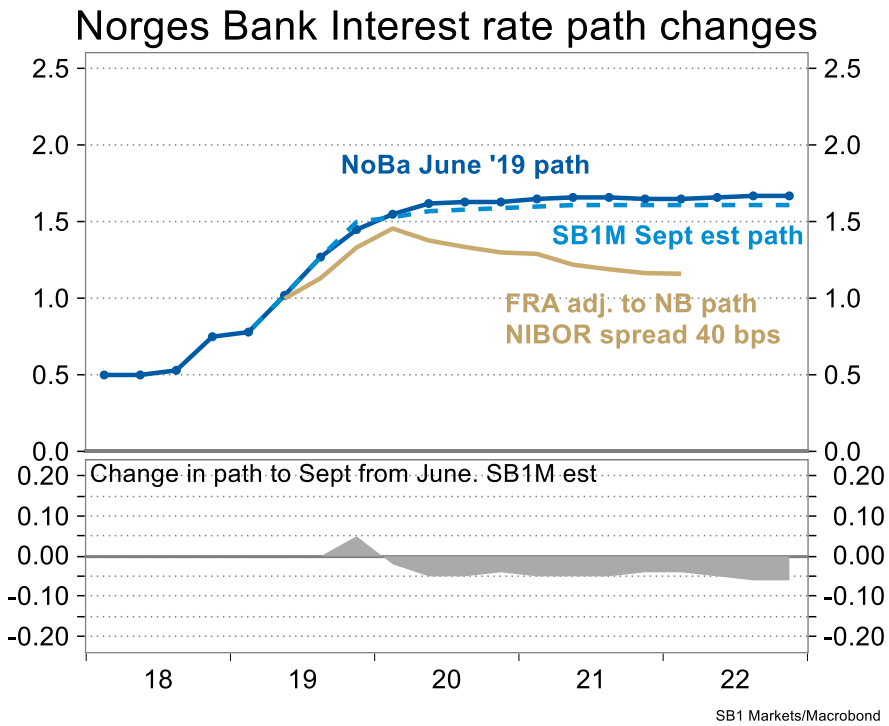
Ahead of Norges Bank: We expect a hike – but a lower interest rate path

The Bank will probably nudge down the path in the long end, signaling no additional hikes



Changes in the interest rate path from the June meeting	Impact bps
Domestic demand (incl oil price), capacity util.	-4
Money Market (money market, lending spreads)	0
Prices, wages	-8
Foreign factors	-4
NOK	15
Judgement (surveys, fin. stab, global risk etc)	-6
Sum	**-7**
Check details next page	

Source: Norges Bank MPR 2/19, SB1 estimates

- The best argument for not hiking, that the global outlook had deteriorated sharply since June – which could have a valid argument in the beginning of August – has become notably weaker recent weeks. Trade tensions have deescalated and risk markets have soared – and interest rate expectations abroad have climbed significantly
- What's left then is a sharp decline in the NOK and Norwegian data more or less in line with NoBa's expectations (which was noted at the mid Aug meeting), and a Regional network that is reporting a growth outlook above NoBa's f'cast
- Will a NoBa hike surprise markets? Partly, the short end of the FRA curve is too low – and the NOK will at least not depreciate. The FRAs are pricing some 30-50% probability of a hike (depending on the current NIBOR spread). And at least 80% probability of a hike by the end of the year. And after then, a cut??

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Foreign factors and uncertainty will send the rate path slightly down

.. And a somewhat softer inflation outlook. NOK the only substantial argument on the upside

Factor	Norges Banks' scenario	What's new since June?	Impact	Impact	Next?
Foreign factors			Down	-4	
	Growth: Steady since June	Global PMI stable to up, Q2 GDP better than Q1. Still, IMF nudged down growth f'casts marginally	Neutral	0	Down
	Short term rates: Steeply down	Trading part. 1y swap -8 bps, 1y1y fwd -7, 3y2y fwd -17	Down	-4	
Oil price	NoBa f'cast 60 late '19, 58.6 late 0	On track near term, longer contracts down, -2 USD/b	Down	-2	Neutr
Domestic demand			Down	-1	Down
	Consump. 2.0% in '19, 2.3 '20	Q2 up 1.4% (avg Q1/Q2 1.8%) but retail sales improved in July	Down	-4	Neutr
	Investments				
	.. Housing: 0.3% in '19, 1% in '20	Mixed news, Homebuildes down, SSB starts up	Neutral	0	Down
	.. Mainl bus. 4.2% in '19, 3.5% in '20	Declined in Q1 and Q2 but '19 est OK, '20 probal. too high	Down	-2	Down
	.. Oil 14% in '19, 1,0% in '20	Inv. survey indicates higher growth next year	Up	2	Down
	Public demand 1.7 in '19, 1.3% in '20	Nat accounts signal stronger growth	Up	3	Up
	Fiscal policy indic.: +0.1% per year	No news	Neutral	0	Neutr
Money market, lending spreads			Neutral	0	
	MM: 35 bps, 40 from Oct '19	Money marked: (3m-depo) has prob. increased towards 40 bps	Neutral	0	Up
	Mortgage rates: +0.9 bps in Q2	Lending margin: Mortg. rates up 18 bps in Q2	Neutral	0	Neutr
NOK	Index 106 in Aug, 104.9 in Sept	NOK 3 % below expected Sept path	Up	15	Down
Prices, wages			Down	-8	
	CPI-ATE at 2.5 % in Q2, 2.4% in Q3	CPI ATE below f'cast in June-Aug, avg 2.15% so far in Q3	Down	-8	Neutr
	Wages 3.3% in '19	Hourly wage costs 3.5% in Q2, ULC 2.7%	Neutral	0	Up
Capacity			Down	-1	
	NAV unempl 2.2% in Aug, LFS 3.5%	NAV marginally above f'cast, LFS 0.1 pp above	Down	-3	Neutr
	Outp. gap slowly closing, then posit.	Network: Incr. cap. utilisation in Q3, aboveNoBa f'cast	Up	2	Neutr
Judgement/ corrections			Down	-6	Up
	Surveys, growth signal vs. NB path	Most down, still signal above NB growth est, will rev '20 up	Up	8	
	Financial imbalances	Household credit stable (student loans adj.)	Neutral	0	
	Housing prices	Prices have inched up, marginally above June f'cast	Up	1	
	Consumer confidence	Fin. Norway up in Q2 but Opinion slipped in Aug	Neutral	0	
	Financial conditions	Finacial markets volatile, steeply down in Aug, has recovered	Neutral	0	
	Caution (uncertainties, risk)	Greater global uncertainties due to the trade war escalation	Down	-15	
Sum changes	Growth above trend, CPI above target	Global outlook not that much weaker, Norw. growth is above trend, the NOK weaker	Down	-7	Neutr
Memo: Market	Changes in NOK int. rate expect.	3 m FRA Dec 19 +7bps, Dec 20 +9 bps, Dec 21 +8 bps, avg +8	Up	8	
		1 y swap 1 y fwd	Neutral	0	

Impact: Contribution to change in the interest rate path 1 - 1 1/2 y ahead
Next change: Impact on the interest rate path due to 'next news', based on SB1M outlook

Source: Norges Bank MPR 2/19, SB1M estimates

- We expect the Bank to deliver the 25 bps interest rate hike as signaled as most likely in June. Data since then have not deteriorated, in sum
- However, sustained global risk will probably allow the bank to lower the path from Q1 '19, we project less than 10 bps, signaling an unchanged rate at 1.5% going forward but with a slight upward bias
- Factors which indicate a lower path:
  - » Foreign, chiefly lower interest rates, global PMIs/f'casts have not softened since June. Global risk markets have recovered since then. Also, the Bank will most likely emphasis sustained global uncertainties stemming from the trade war/Brexit
  - » Inflation on the soft side vs f'casts
  - » A slightly lower oil price than expected
  - » A marginally weaker growth in domestic demand now but not a rapid slowdown
- On the upside:
  - » The Regional Network signals higher growth in Q4/Q1 than Norges Bank anticipated in June
  - » Oil investments probably revised upw (2020)
  - » An even weaker NOK

In this report

Global +PMIs

- Global macro less disappointing, strongest in a year!
- Retail sales still OK, manufacturing production stagnates – exports implodes
- Global sales (probably) rebounding in August, thanks to EMU

China

- Growth is slowing but just slowly
- Industrial production is slowing (but not as sharply as the official y/y rate signals)
- Retail sales volume up in August
- Nominal investments are growing steadily, according to monthly stats
- Bank lending is slowing but the void is filled in the shadows, total is accelerating

USA

- Core inflation at 2.4%, 11 y high = time for the Fed 'boneheads' to slash interest rates!!
- Retail sales slowed in Aug, speed still impressive
- Univ. of Mich up in Sept, but still 'low'
- Small businesses' optimism down in Aug, still miles above PMI/ISM (activity)
- Unfilled vacancies have probably peaked, at a very high level. Still few layoffs
- Jobless claims another tick down last week
- The federal budget deficit is widening amid soaring spending
- Q3 GDP growth below 2%?

EMU

- The ECB goes all in; 10 bps cut, introduces 'eternal QE', more bank support
- Wage inflation cooled in Q2, trending up
- Industrial production slides down, led by Germany
- Germany: Both exports and imports have stalled but no disaster

Sweden

- Is the labour market turning sour? Probably
- Core inflation missed expectations once again in August

UK

- Unemployment still heading down, employment flattening out. 3.8% wage inflation
- Manufacturing production has cooled, still a downside risk?

Norway

- Norges Bank's Network confirms strong growth, NoBa have to revise its f'cast up?
- Core inflation inched down to 2.1%, total inflation fell to 1.6%
- GDP growth spiked July, Q3 is off to a solid start
- Homebuilders report softer sales – and a steeper decline in starts
- Current account surplus a tad down in Q2, on lower capital income & oil exports

Highlights

The world around us

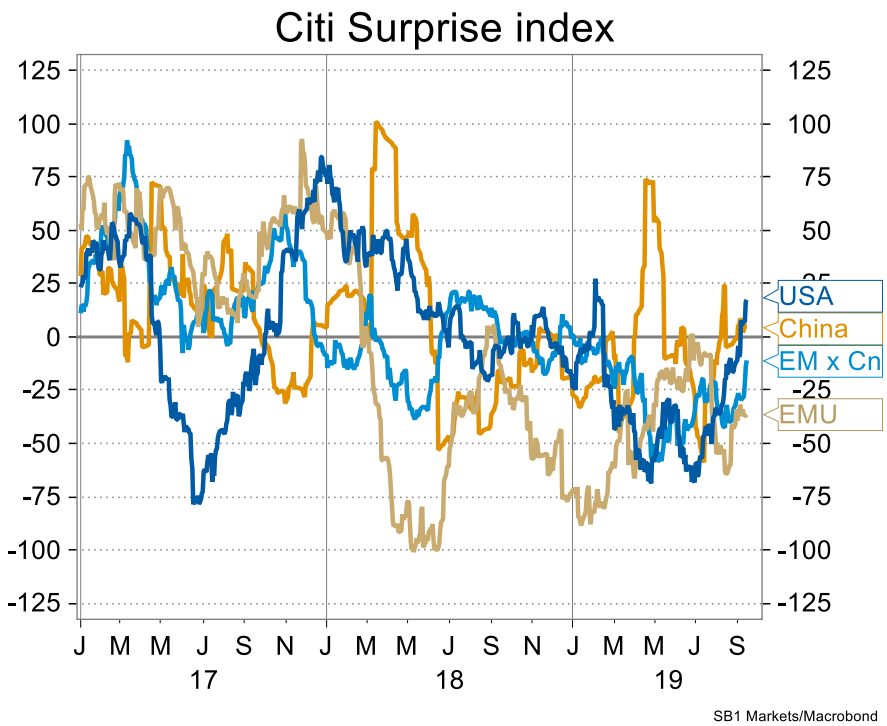
The Norwegian economy

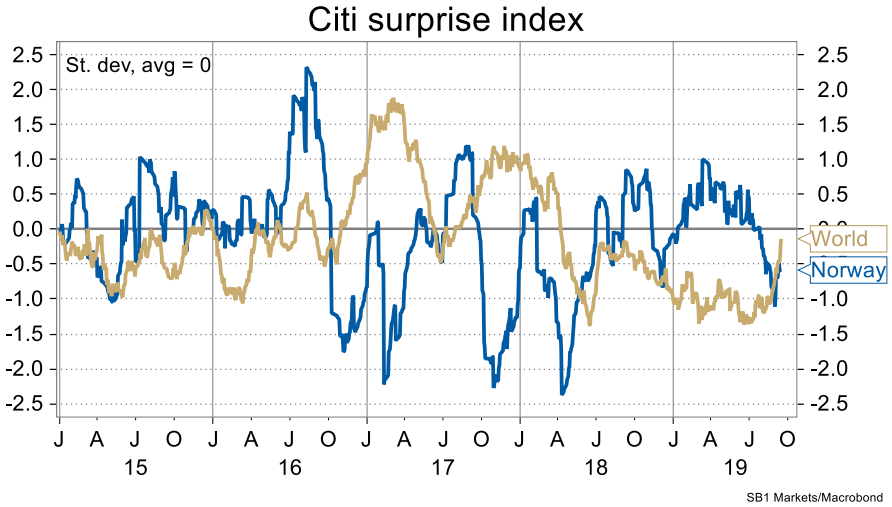
Market charts & comments

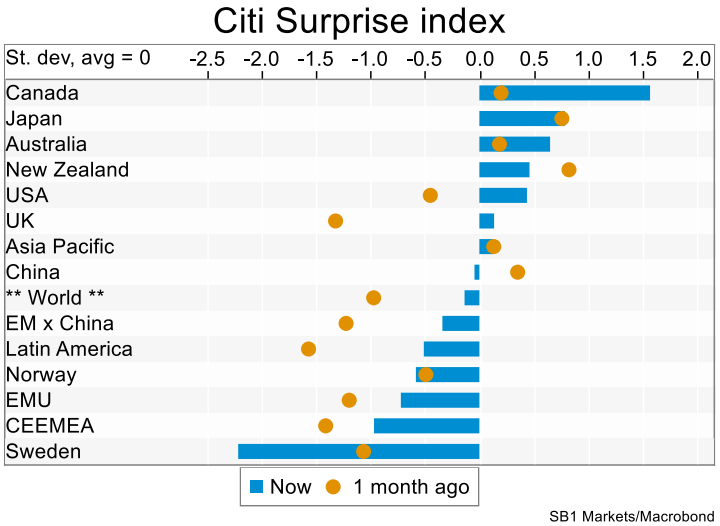
SpareBank 1 MARKETS

Global macro less disappointing, strongest in a year!

US at 7 months high, China data above par too, EMU and Emerging Markets less negative







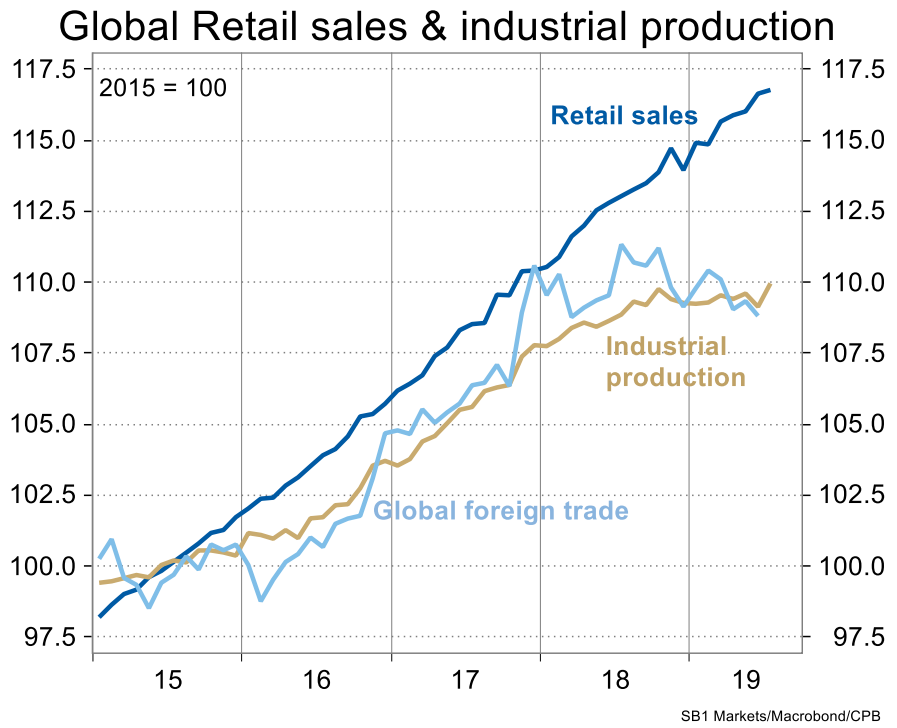
- The global surprise index has been in negative territory since last spring. The index has improved through July and August, last week it rose to the highest level since late 2018!
- US data flows are now in sum more upbeat than expected, for the fist time since Feb! Consumer data, non-manuf ISM, CPI inflation are lifting the surprise index
- The EMU surprise index is weak but less so recently, PMIs better than feared
- Chinese July data in sum slightly better than expected too. Other EM improved last week
- Norwegian data are disappointing vs expectations but less to the past 2 weeks

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

SpareBank 1 MARKETS

Retail sales still OK, manufacturing prod. up in July but trend flattish

While global trade has fallen since last summer

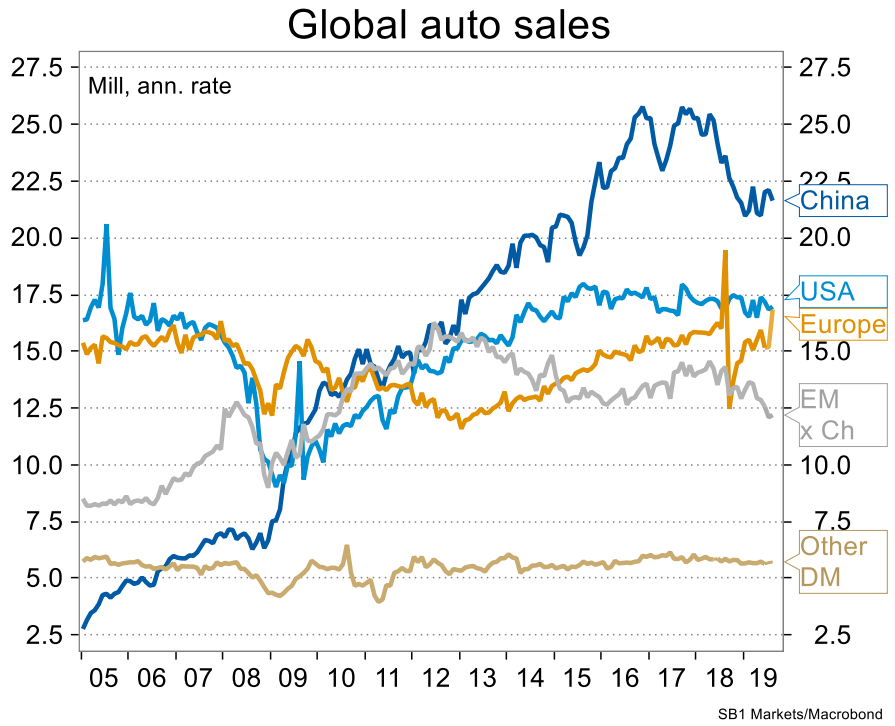


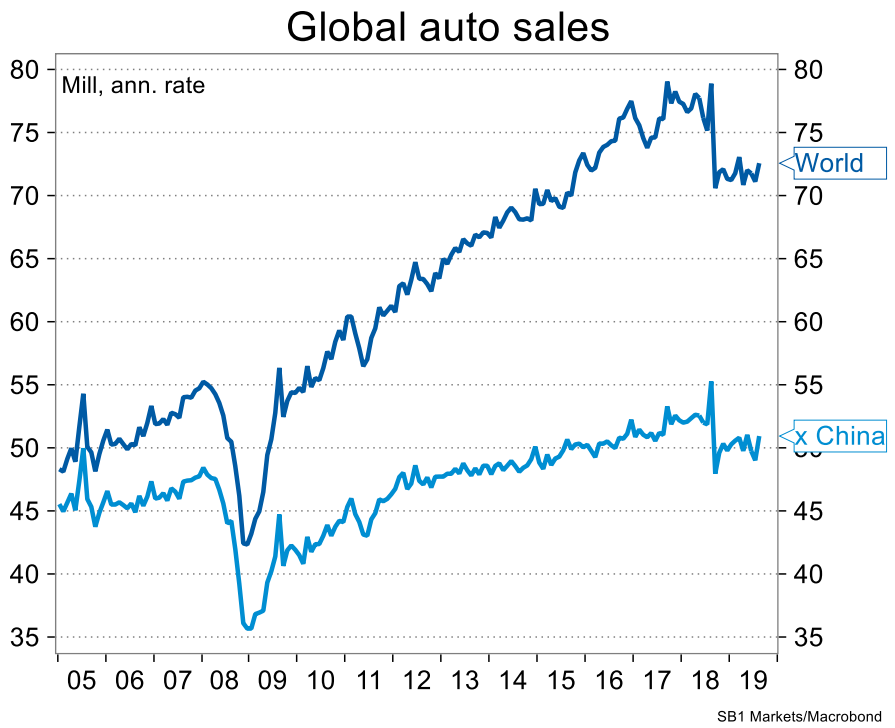
- **Global foreign trade** fell 0.5% m/m in June, and is now trending sharply down. The weakness was rather broad based but Emerging Asia ex China and Lat. Am were the weakest links in the chain
- Global **industrial production** recovered in July, from the June slump, even if both China, EMU and the US have reported weak figures but other EMs, that were weak in June recovered sharply (and even more than we assumed). Still, the overall trend is no better than just marginally upwards. Global business surveys signal a marginal decline
- **Retail sales** accelerated in June but slowed in July. Growth has come down, more or less in tandem with manufacturing production (given the normal correlation between the two, retail sales are less volatile than retail sales). Even so, consumption is still supporting the global economy

SpareBank 1 MARKETS

Global sales rebounded in August, thanks to the EMU (!)

Global sales have been close to flat so far in 2019, after the 8% drop last autumn

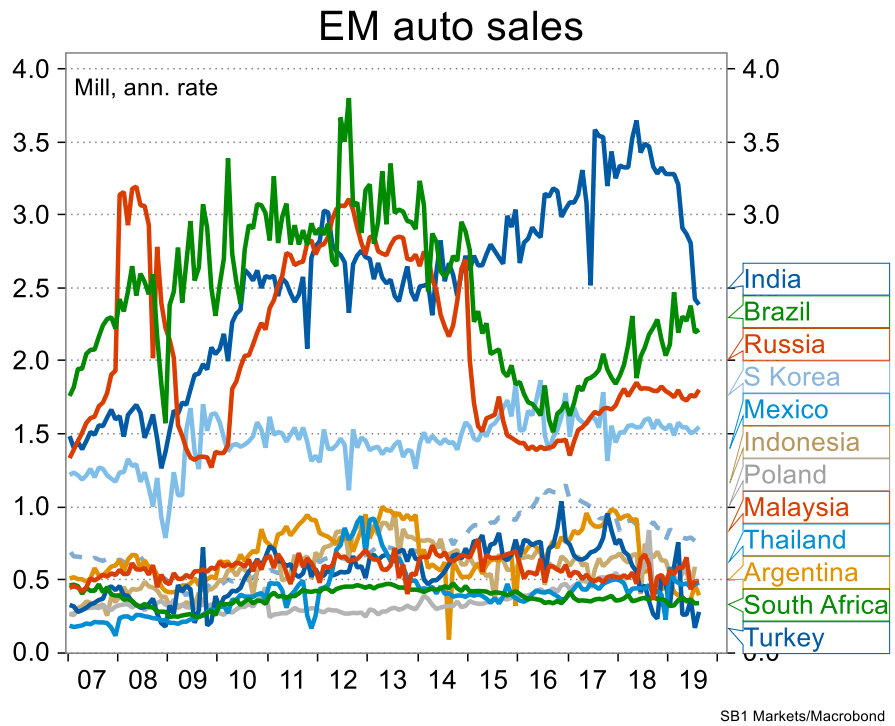


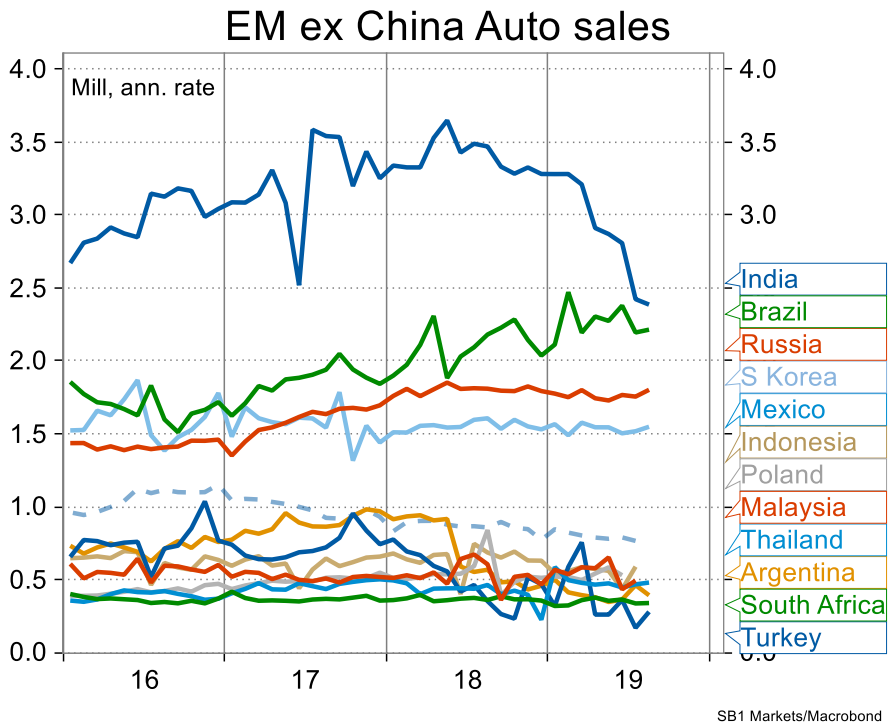


- Global auto sales rose 2% m/m in August, following a 0.9% decline in July, and they are down 8% y/y (preliminary data)
- Chinese sales fell 2.1% m/m in August. Sales have stabilised since Q4 last year but are still down some 16% from the peak
- Sales in EMU spiked in August (no official total data yet), as sales rose steeply in all four main countries. We wonder who have produced these cars, as production has dropped sharply in the EMU. US sales increased marginally in August but may be trending slowly down
- Auto sales in EM ex. China is heading down again (steady in August); mostly due to lower sales in India, Russia, Argentina and Turkey – and Indonesia and Mexico. Sales are down 15% from the local peak early 2018. Even worse, sales are down almost 25% (!!) from the 2012 ATH – equalling a close to 5% drag on global sales in the period (!!)

EM x China up is trending down, weakness most places

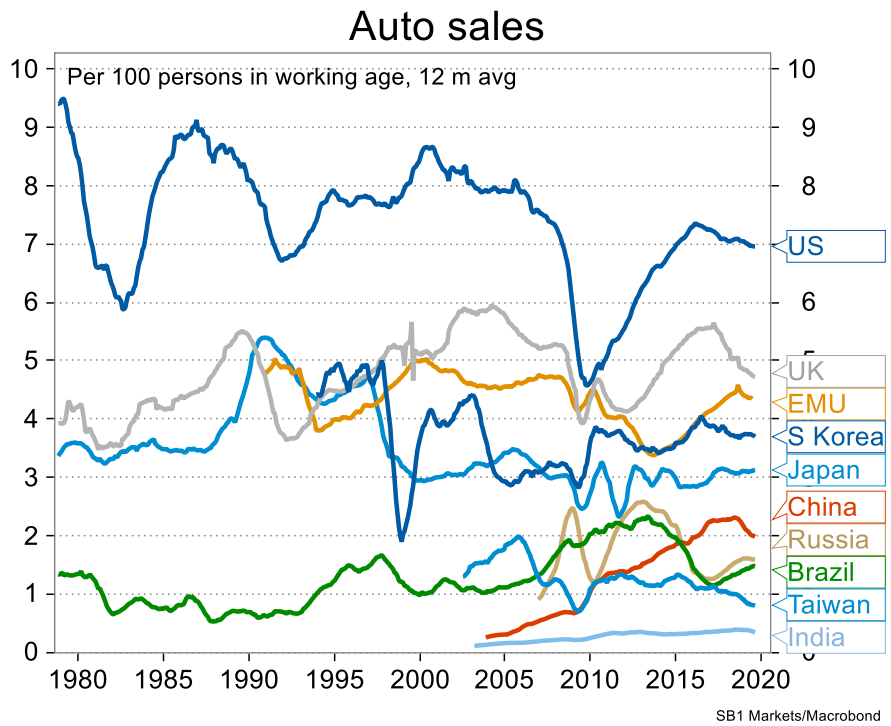
Indian sales have fallen more than 10% past 4 months, more than 20% from last year's peak

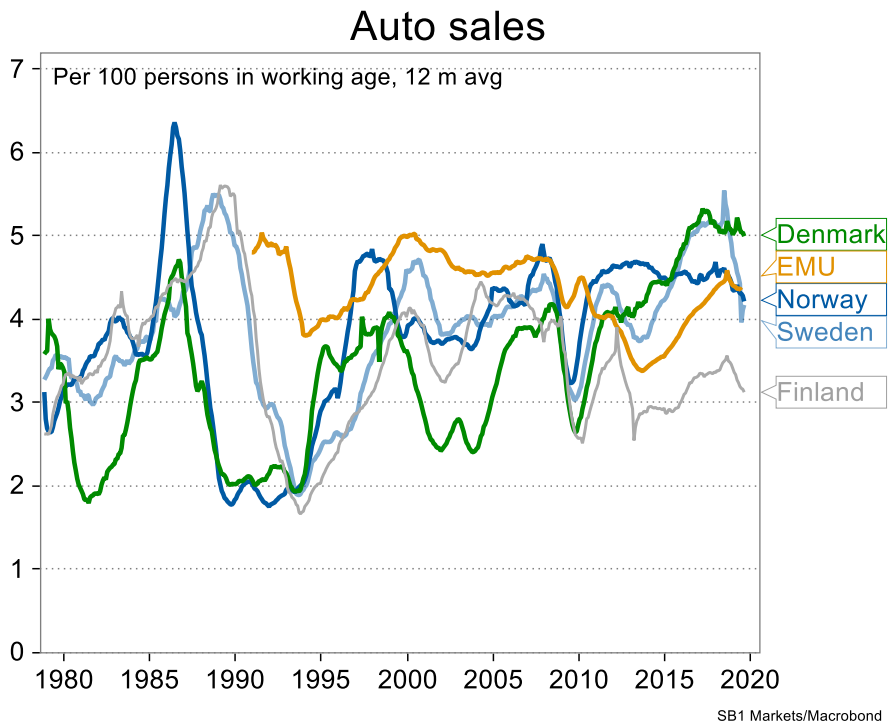




- Sales in Russia are heading slowly down too, as in South Korea & in Mexico (no August data). Thus, sales in 4 out of the 5 largest EM X China are now slowing
- Sales in Brazil have flattened recent months
- Turkish sales have been extra volatile recently and were 'record' low in July, Argentina has grounded too – and others are weak
- In case you did not read the last lines on the previous page… Sales are down 15% from the local peak early 2018. Even worse, sales are down almost 25% (!!) from the 2012 ATH – <u>equalling a close to 5% drag on global sales in the period (!!)</u>

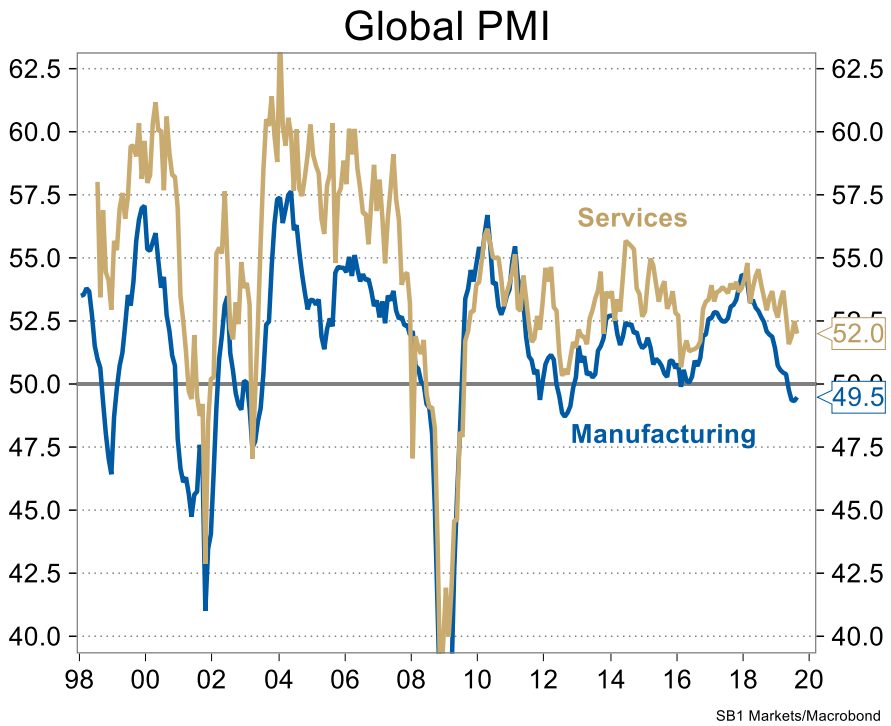
Sales are sagging almost everywhere – in the Nordics too

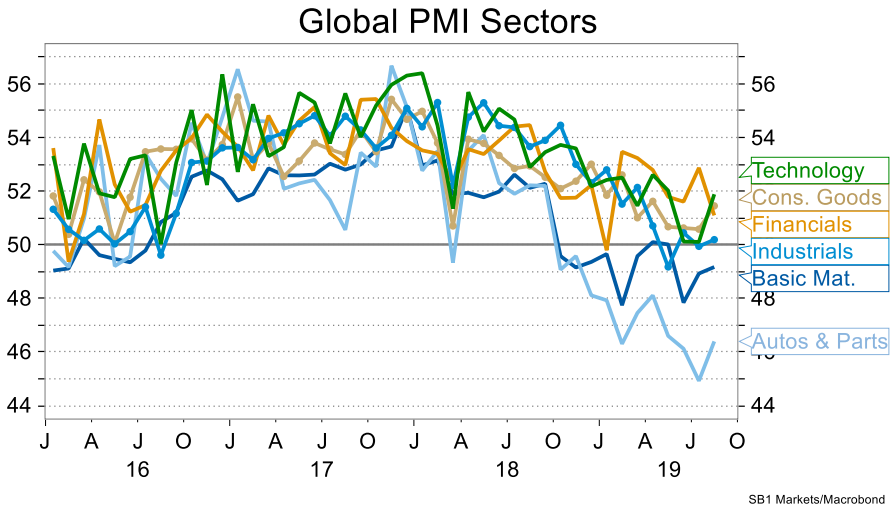


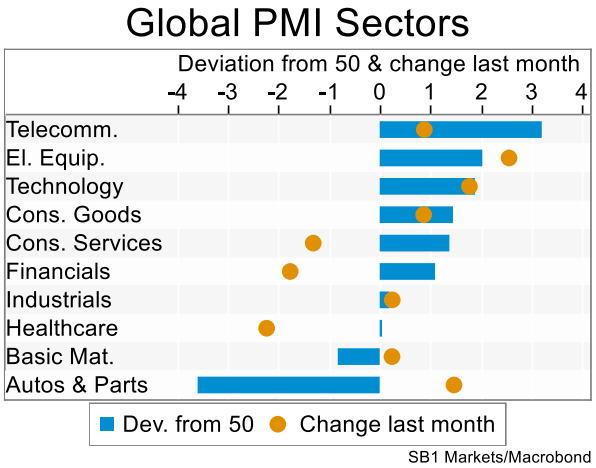


Most main sector PMIs up in August, and most are growing

Telecom, technology and el. equipment, consumer goods recovered in August. Autos up but still low



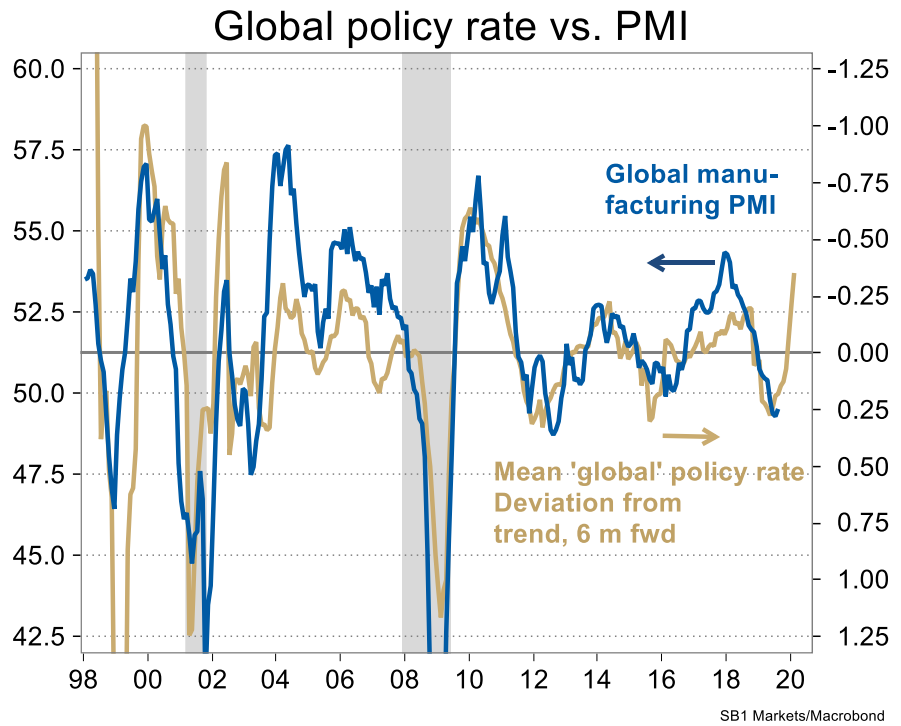


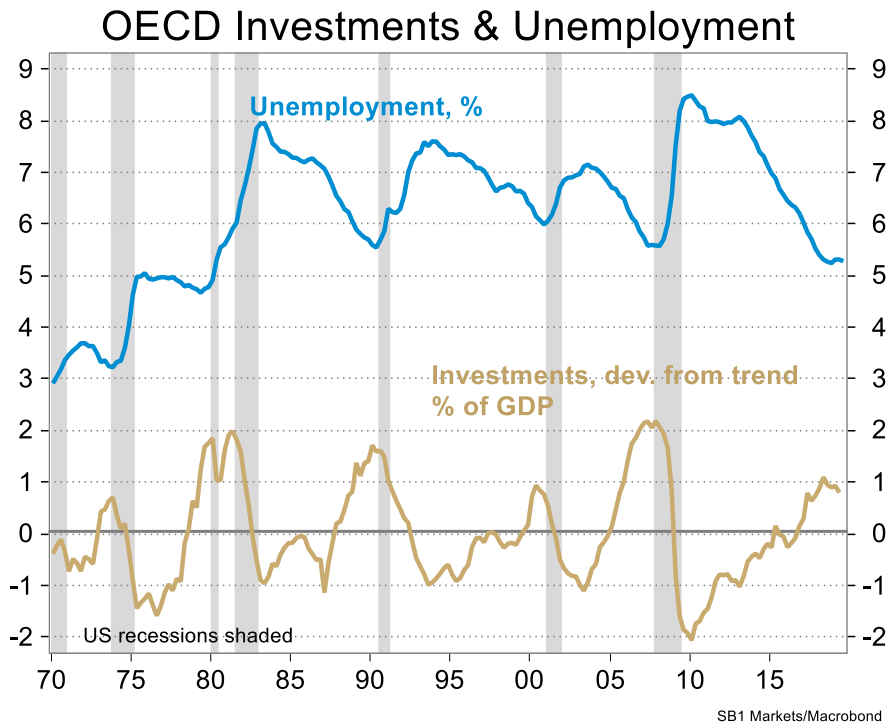


- Manufacturing has no doubt been hurt by uncertainties caused by the trade war, as business investments, and trade have suffered. The index rose marginally in August due to a lift in the output index. Orders declined faster
- Services have slowed too, but much less than manufacturing, at businesses reported decent growth in Aug, even if the index fell
- August sector data: The auto industry is still the weakest link in the chain but most other sectors rose to above the 50-line. Good news!!

Central bank's are coming to the rescue. Will they succeed? In the end, yes

Often, lower interest rates quickly stimulate the economy – but capacity is now constrained





- If so, the PMIs are close to the bottom now, after a close to 50 bps cut in an unweighted global policy rate proxy (far less in DM of course, but these rates have been less volatile than EM rates recent decades)
  - » Downturns do not last forever, and monetary & fiscal policy are normally important 'helpers'. So, the sky is clear?
- Well, we do not have any guarantee that a monetary boost will save the world from a further slowdown.
  - » Unemployment is low (less capacity for growth)
  - » Investment demand is very likely above trend – and is exposed anyway

SpareBank 1 MARKETS

Growth is slowing but just slowly

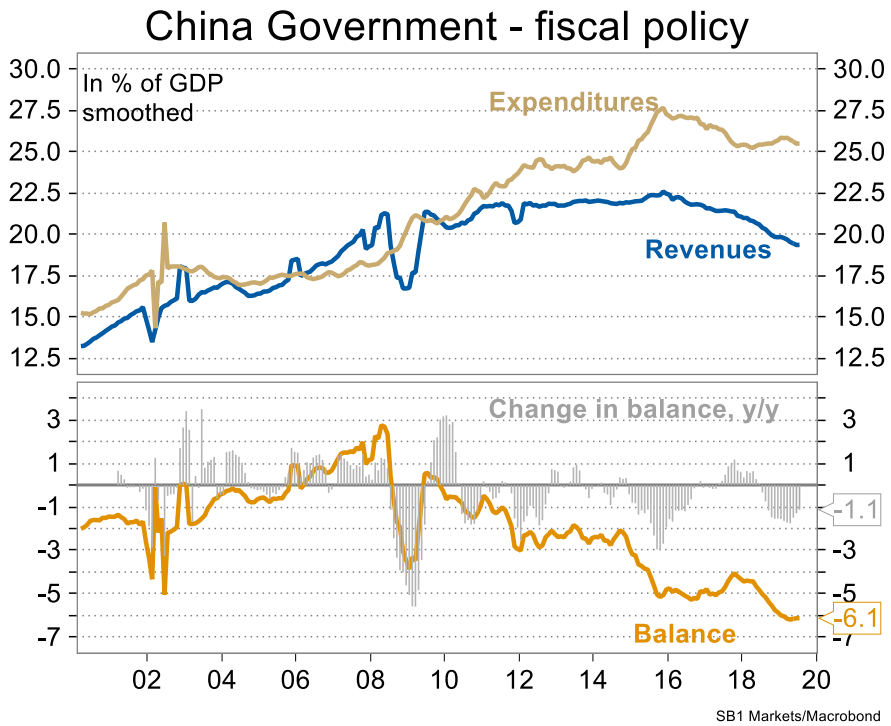
August data broadly weaker than expected but still no signs of a sharp slowdown

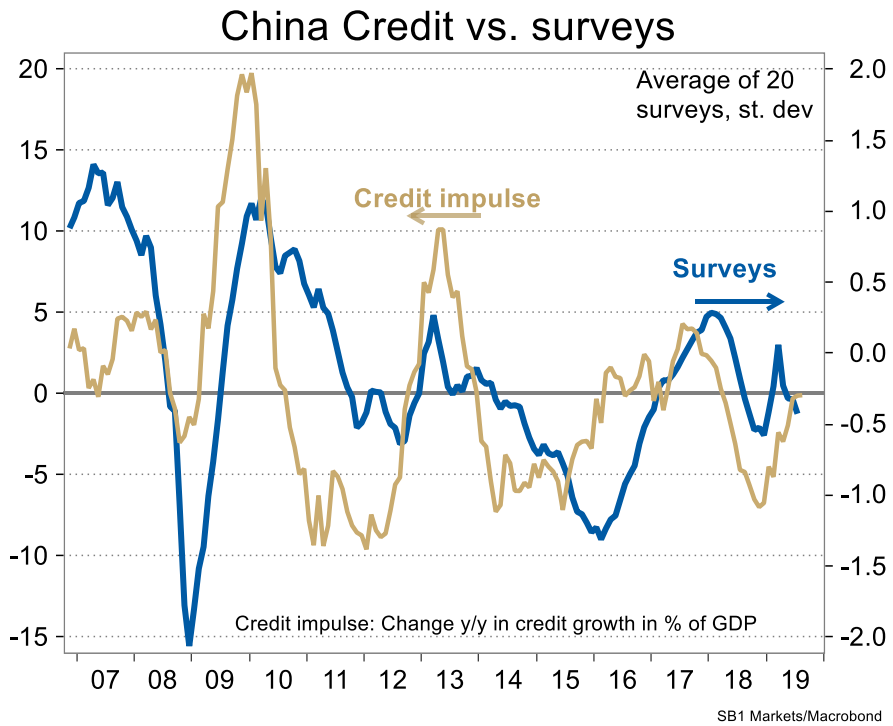
Growth is most likely slowing amid the escalating trade war, but data are not signalling an abrupt setback

- **Industrial production** slowed to 4.4% from 4.8% in June, to the lowest level since 1990 (according to the 'useless' official annual growth rate). While production rose just 0.3% m/m (following the 0.2% July growth in July), the underlying growth pace past months is still at above 5%. Surveys do not signal any slowdown from this level
- **Retail sales** growth slowed to 7.5% y/y from 7.6% in July, expected 7.9%. Sales rose 0.7%, following the 0.2% hike in June. Underlying volume growth has fallen below 6% but has not slowed further recent months
- **Investment** growth softened 0.2 pp to 5.5% y/y in July (official YTD rate), weaker than exp. Our calc yields a stable 5.2% growth pace. Real growth at some 2%. Construction starts are still trending up, but slower
- **Credit growth** was higher than expected in August, and the credit impulse is now back to neutral (measured y/y). Bank credit is slowing even if reserve requirements are cut 6 times (the last one a week ago), while 'shadow' banking credit is accelerating. Total credit growth is still well above income (GDP) growth, and the debt/income level is increasing, from an unusual high level

Growth is gradually slowing even if policies try to stimulate

Budget deficit at 6.1% of GDP, +1.1 pp last year. In addition: A modest credit turnaround





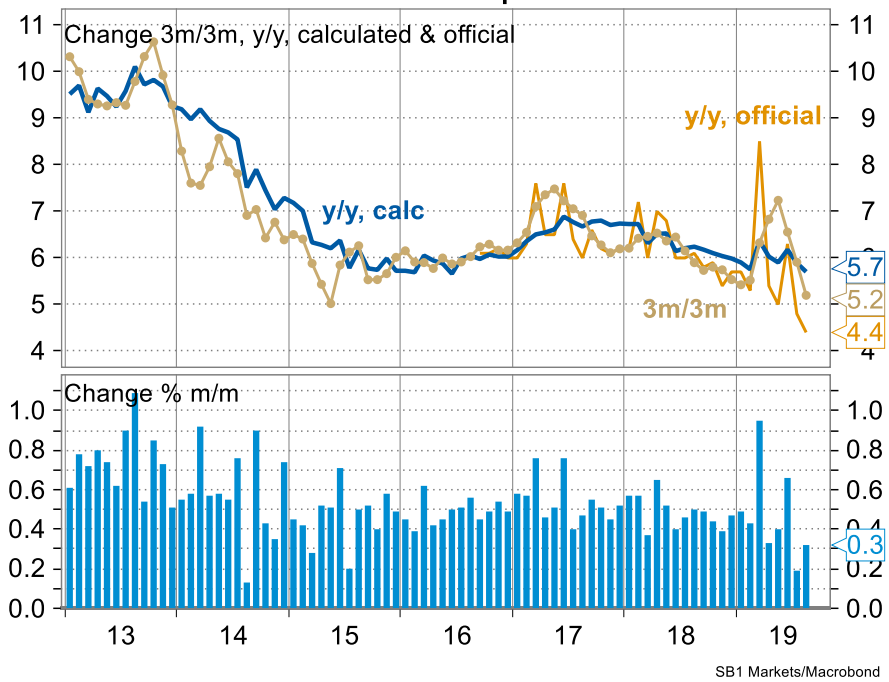
- Fiscal policy: Taxes are cut, spending programs decided. Over the past year, the deficit has increased by 1.1% of GDP, a substantial fiscal expansion – but it is slowly petering out, as spending declining marginally (in % of GDP). The deficit has increased to 6.1% of GDP, according to our calculations
- Credit growth is slowly accelerating (more here), and the credit impulse has turned neutral (measured y/y, positive 'now'), from sharply negative
- CNY has depreciated 10% since 2015, of which 5% since May (and 2 % since early August)

SpareBank 1 MARKETS

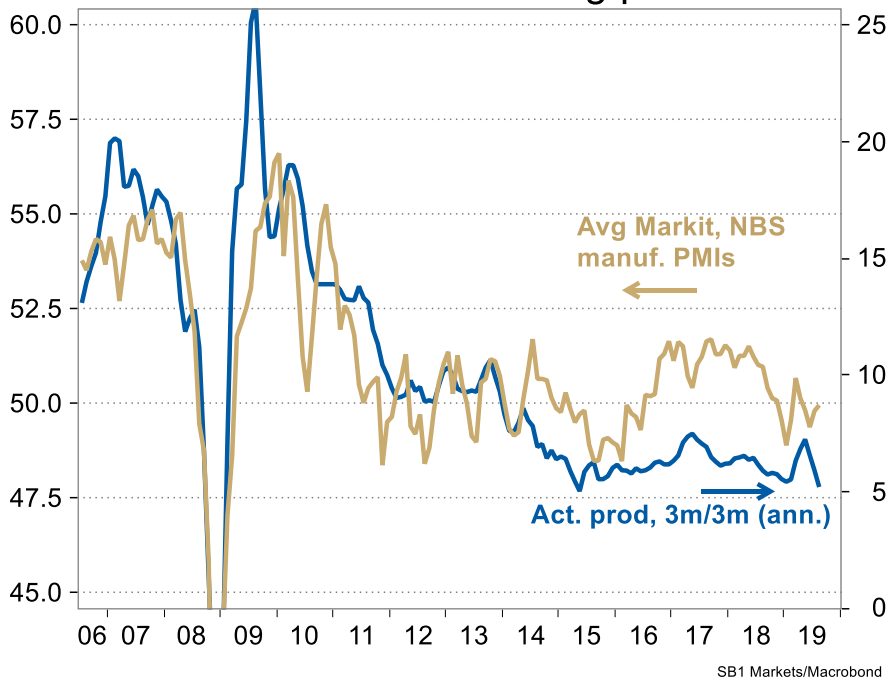
Industrial production is slowing (but not as sharply as the official y/y rate signals)

The official y/y down 0.4 pp to 4.4%, lowest since 1990. Our calculation yields 5.7%, down from 5.9%

China Industrial production



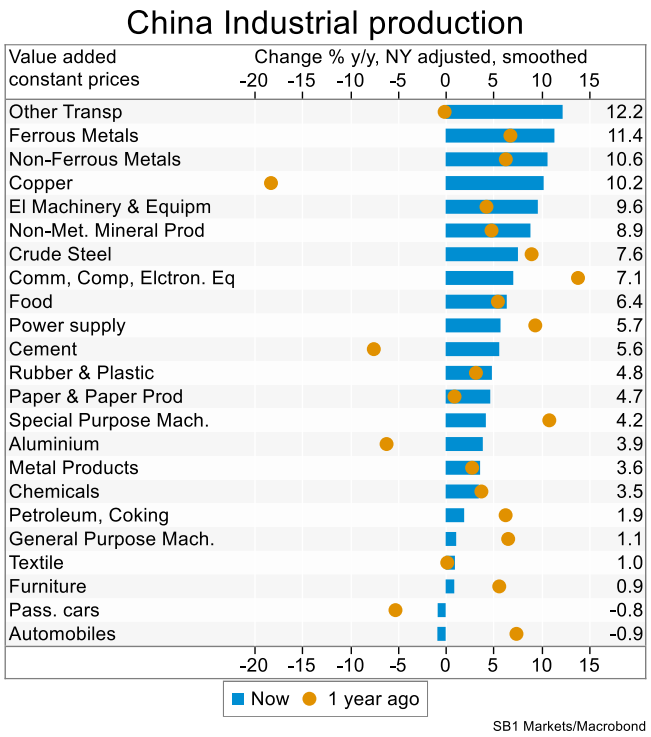
China PMI vs manufacturing production



- Production rose just 0.3% m/m in August, up from the 0.2% print in July. The two past months (3% annualised growth pace) are the weakest since the setback in Oct/Nov 2008. Measured 3m/3m the decline is less dramatic; growth has just slowed to 5.2%, a tad weaker than in January
  - » The official y/y growth rate is 'useless', far too volatile as it is not adjusted for holidays or working days. Even so, the 4.4% growth rate was the lowest since 2002, but that was a one month exception, like 4 times in the years before that. A 'real' 4.4% growth (officially measured) has not been seen since 1990.
- Still, PMIs or other surveys are not signalling an abrupt halt in manufacturing. Export volumes close to peak levels. China has most likely not been brought to a halt – but **the two past months send strong warning, something may take place now**

Broad based slowdown but just autos (+furniture) are down y/y

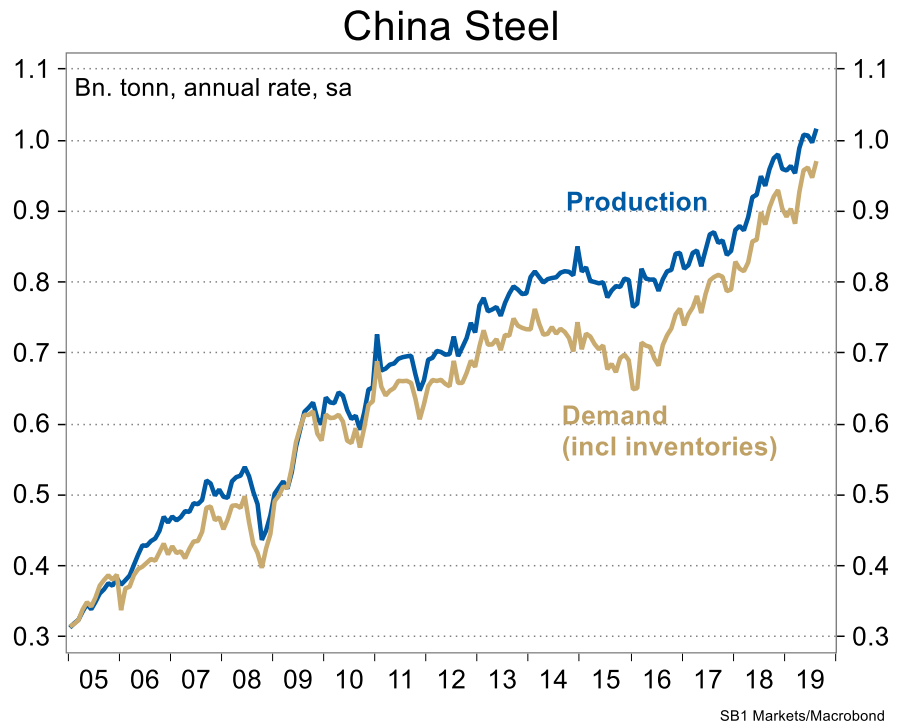
7 sectors are accelerating (vs. 1 y ago), 16 are slowing. Auto production falling

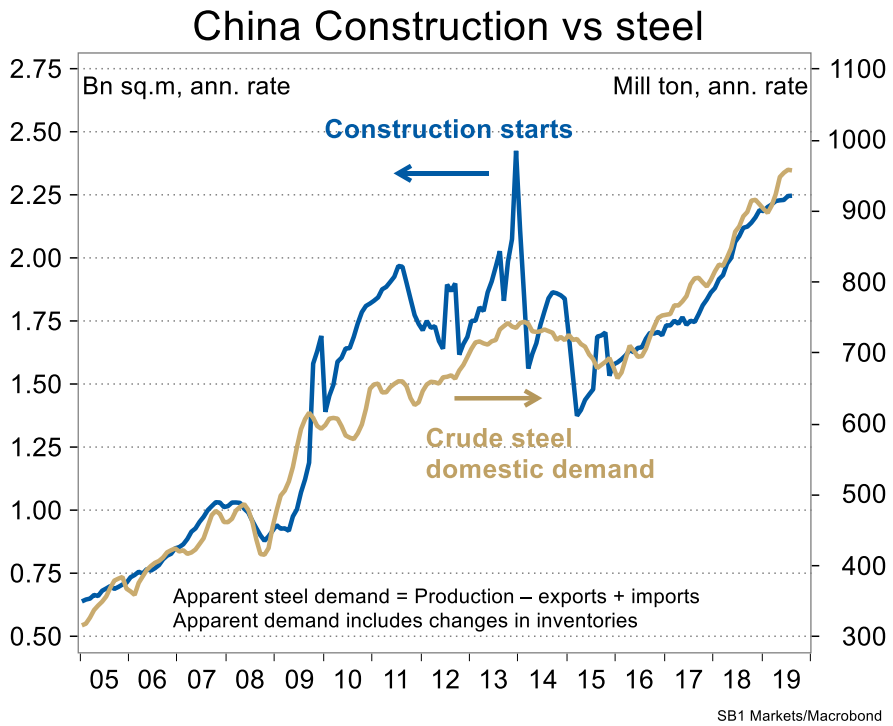


- Crude steel production rose in August, is still trending up, up 8% y/y (3 m smoothed)
- Aluminium production is recovering from the downturn in 2017 and is increasing by 4% y/y
- Cement production is slowly climbing, up just 5% y/y
- Copper production has recovered sharply in 2019 , and is up 10% y/y (in July, no Aug data yet)
- Auto production (valued added) has been hurt by weaker sales but has kept (unbelievable?) stable, down just 1% y/y, while sales are sharply down (even as they have flattened recently)

Steel production (and demand) still on the way up

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

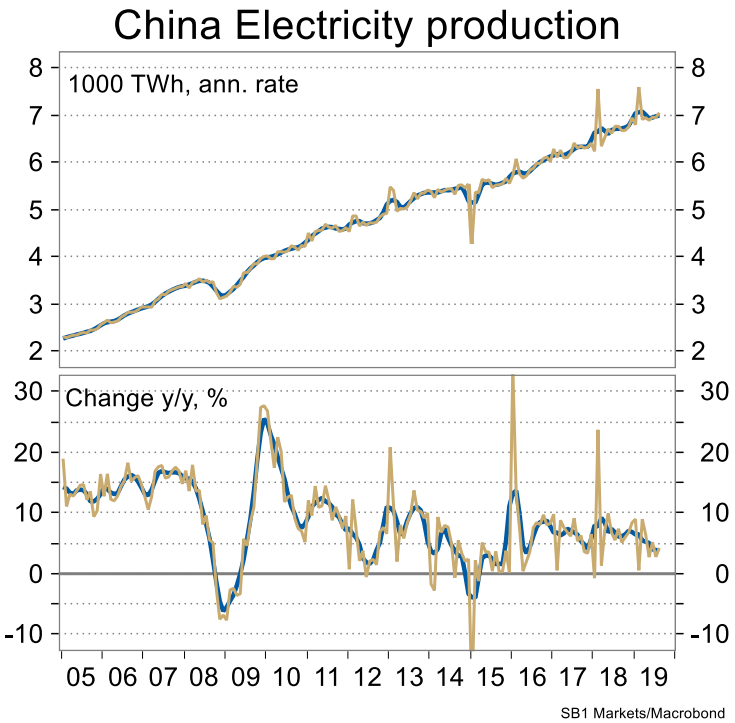


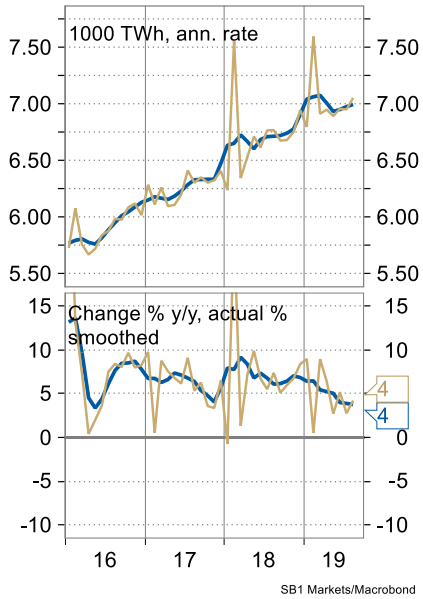


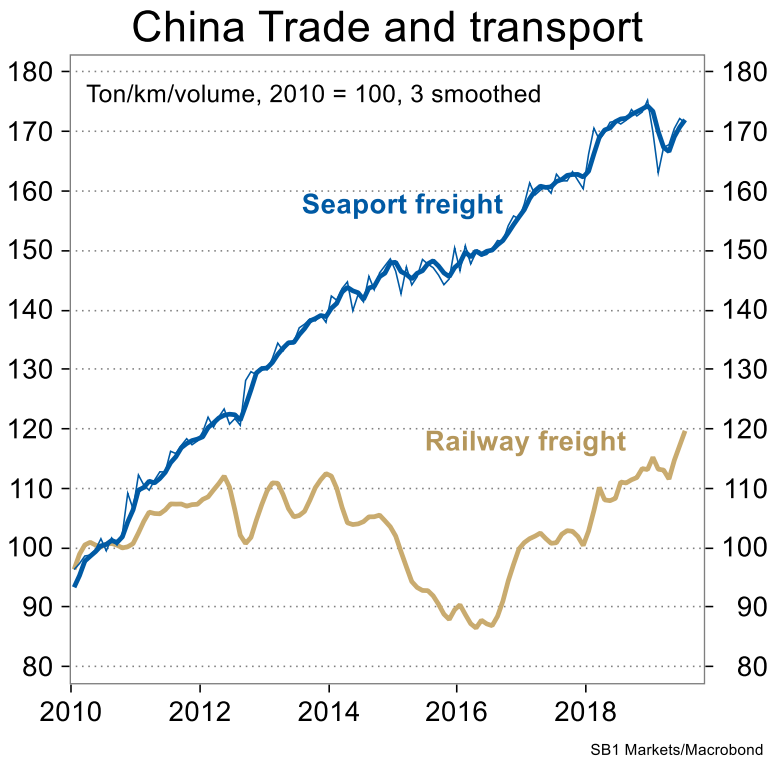
- Production is up some 8% y/y (smoothed) and demand is expanding a tad faster, (almost) well explained by the strong growth in construction starts. On the other hand, slowing auto production signals softening steel demand from that sector
- China is still a net steel exporter, but far less than during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

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



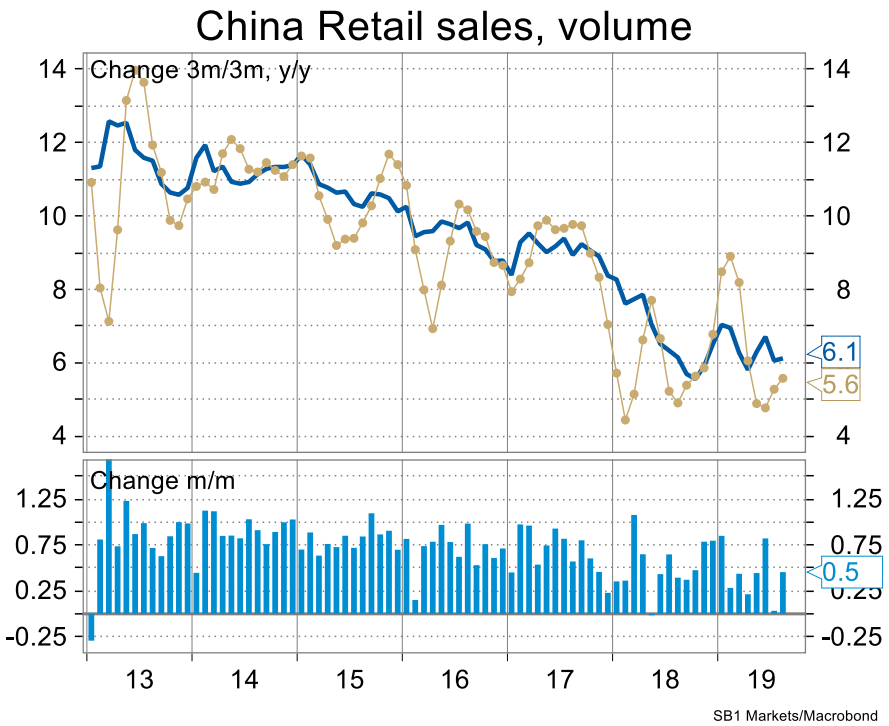




- Transport activity (seaports & railway) has recovered past two months, following a setback earlier in 2019

Retail sales volume up in August

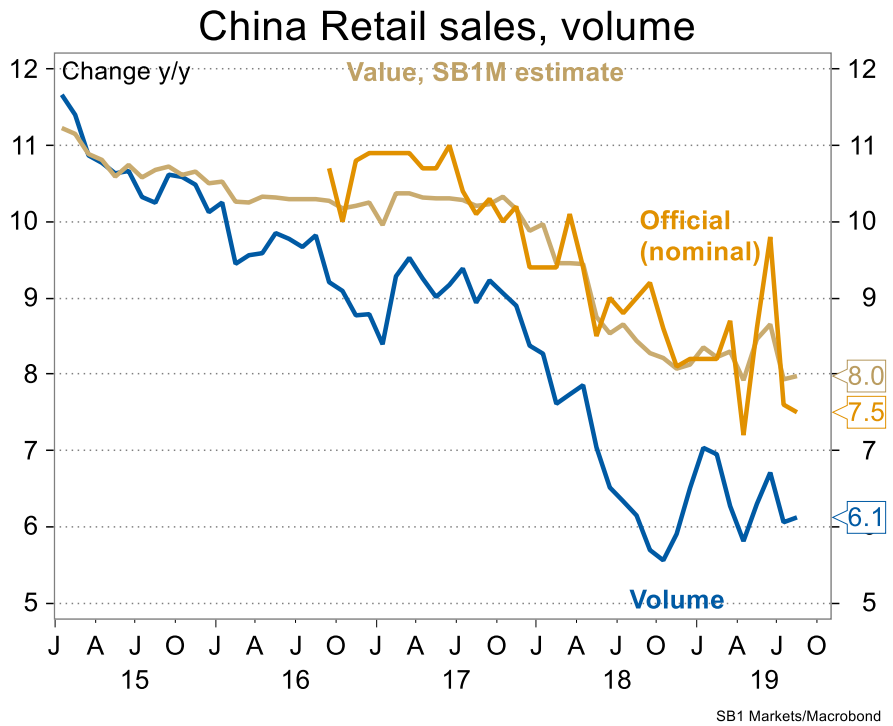
Growth has slowed the past two years but has not collapsed

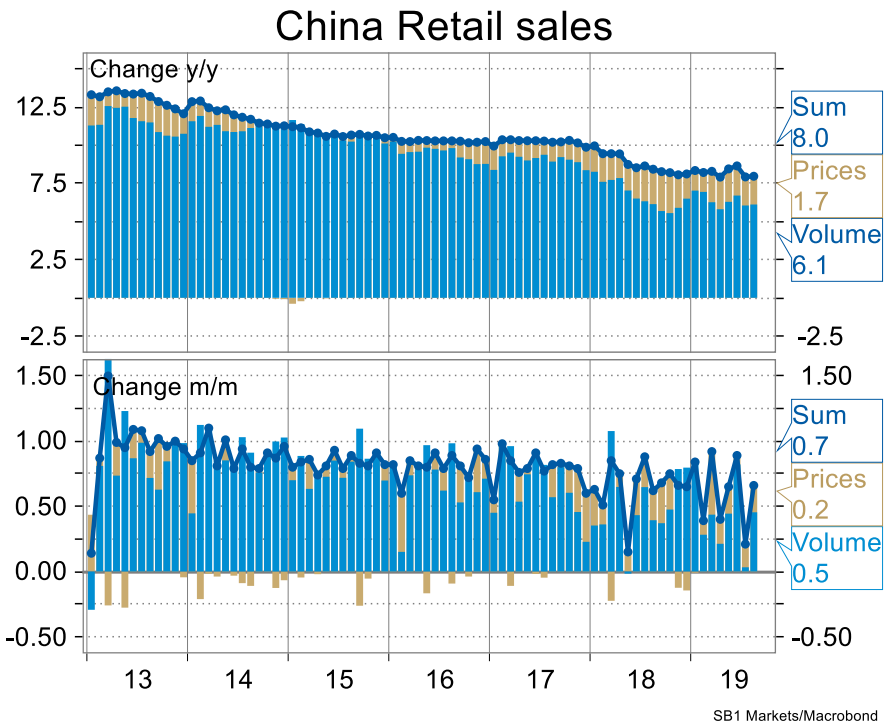


- The <u>official value</u> growth rate fell to 7.5% from 7.6% in July, and well below expectations at 7.9%. <u>Our (normally) less volatile value growth estimate</u> (based on monthly seas adj. data) yields 8.0%, up from 7.9%
- Sales rose 0.7% m/m in Aug (NBS estimate), and we assume 0.5% volume growth, up from the unusual zero print in July (0.2% in nominal terms)
  - » The annual <u>volume</u> rate accelerated 0.1% pp to 6.1%. The 3m/3m growth rate has stayed below 6% the past 4 months, but is not slowing further – and it is not much below the average since early 2018
- <u>Consumer confidence</u> is very high and does 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

Price inflation has gradually taken a larger proportion of the (moderately) slowing nominal growth

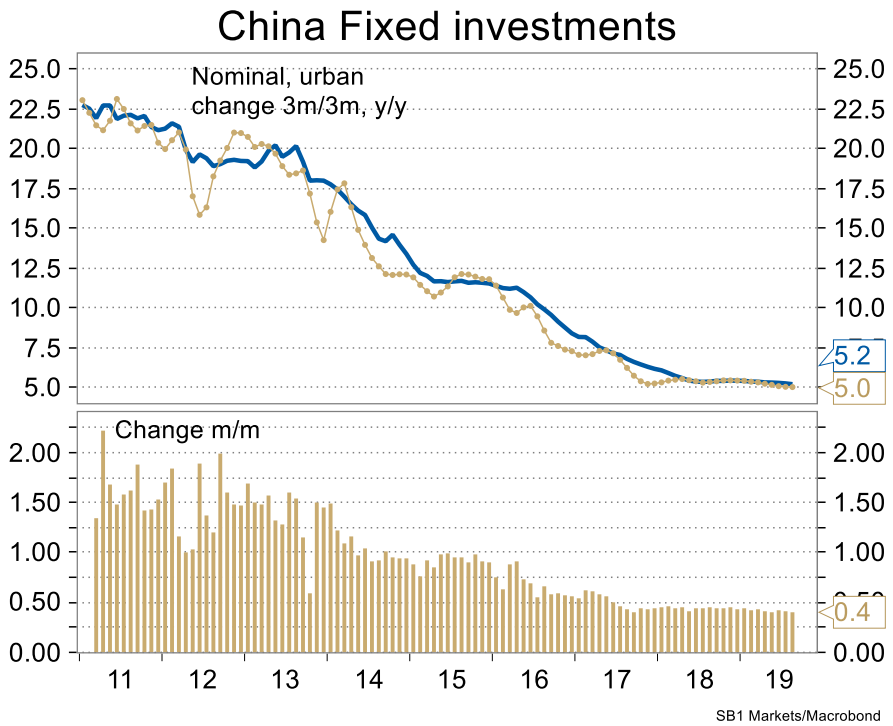




- Retail prices are up just 1.7% y/y, while the total CPI is up 2.8%. The discrepancy is not due to services, and the low retail price inflation <u>does not seem that reasonable as food prices are soaring. Thus, the 'real' real growth may be lower than our estimate</u>

Nominal investments are growing steadily, according to monthly stats

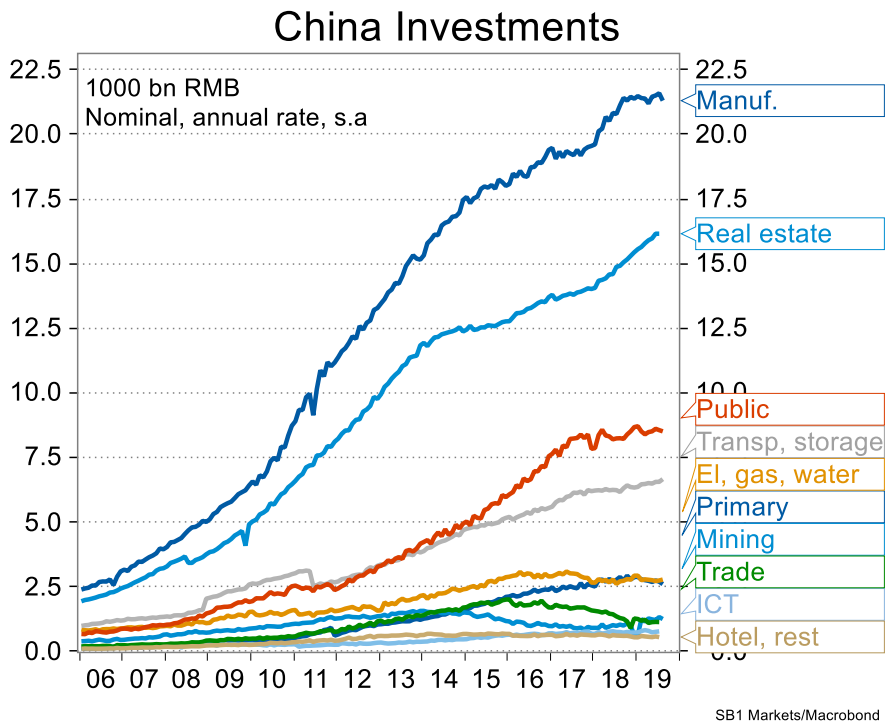
The long term decline in investment growth has halted, at a comfortable, low level

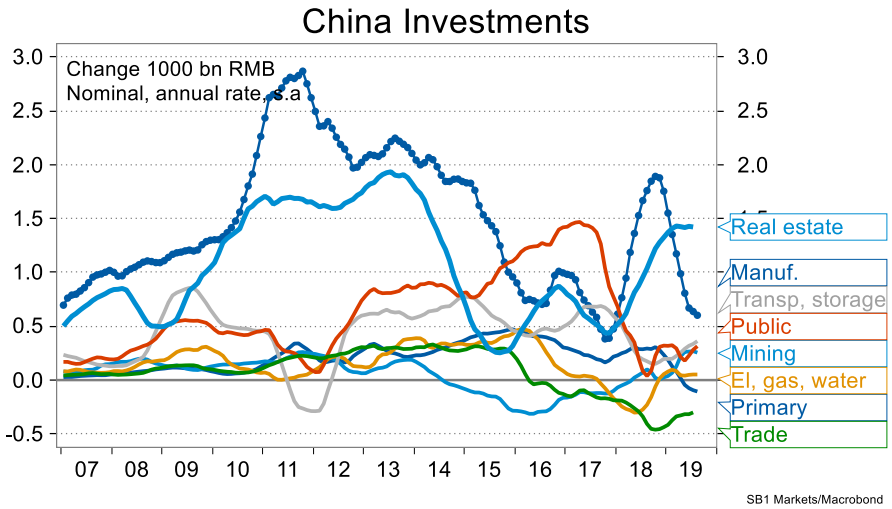


- Urban investments rose 5.5% y/y ytd in August, according to the official data, down from 5.7% in July, expected unch. Our calculation yields a 5.2% y/y growth, slooooowly trending down. The m/m rate was stable at 0.4%. Growth has been stable since late 2017. In real terms, we assume growth has accelerated to some 2%, from close to zero through last year
- Manufacturing investments are still increasing but just marginally. Retail trade investments are sharply down, while real estate is still booming
- Long term, nominal investment growth (measured this way) has been on a downward path, from 25-30% before 2009 – but it has now stabilised, well below nominal GDP or income growth

Manufacturing investments are slowing, still trending up

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



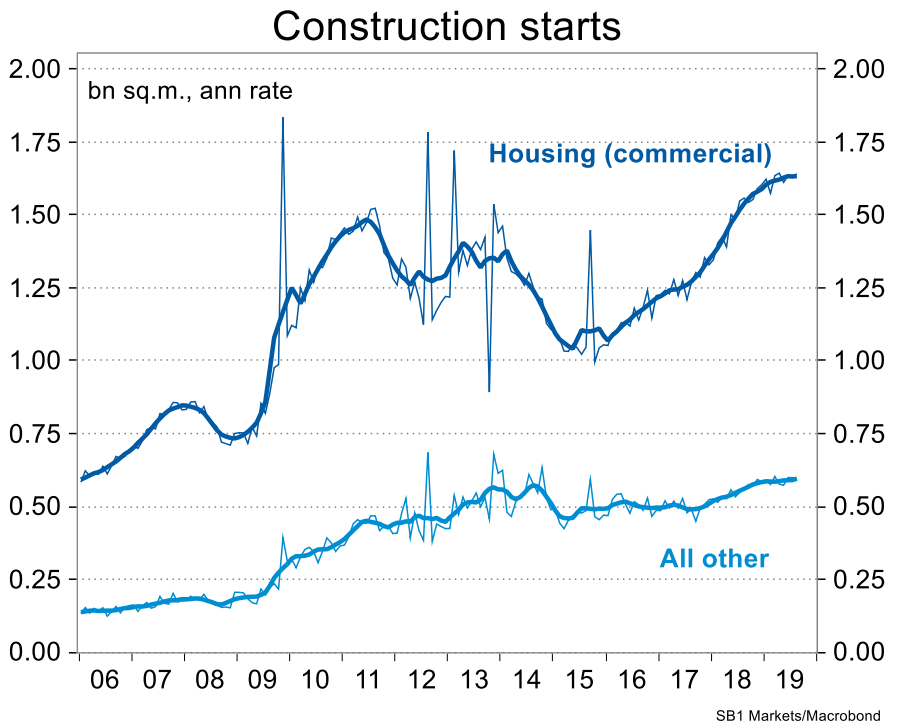


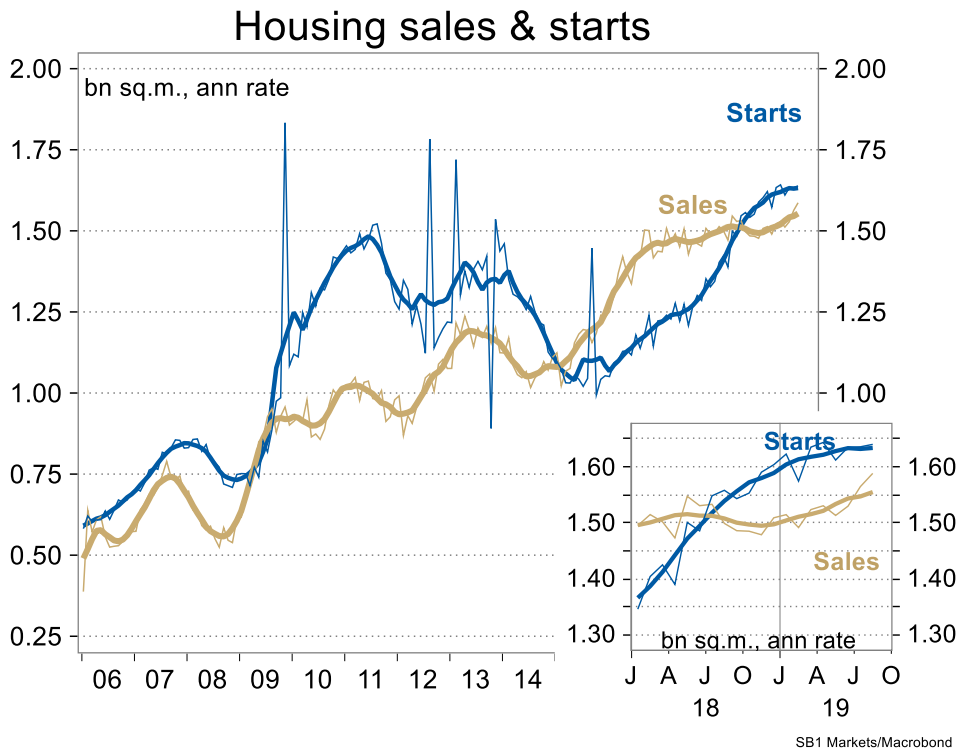
Not all sectors have reported data for the last month

- Manufacturing investments are still on the way up but just 2% y/y, 10 pp down over the past year! <u>Most likely due to the escalating trade/tech war</u>
- Weak retail sales through 2018 probably brought investments in trade sharply down; -20% y/y/ - while the level is stabilising now
- Real estate investments are now the main growth engine, up 9% y/y
- Public sector investments have slowed past 2 years (3% now), as have investments in transport (6%). **<u>No signs of any fiscal stimulus</u>**

New home sales up in August; starts have almost flattened

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

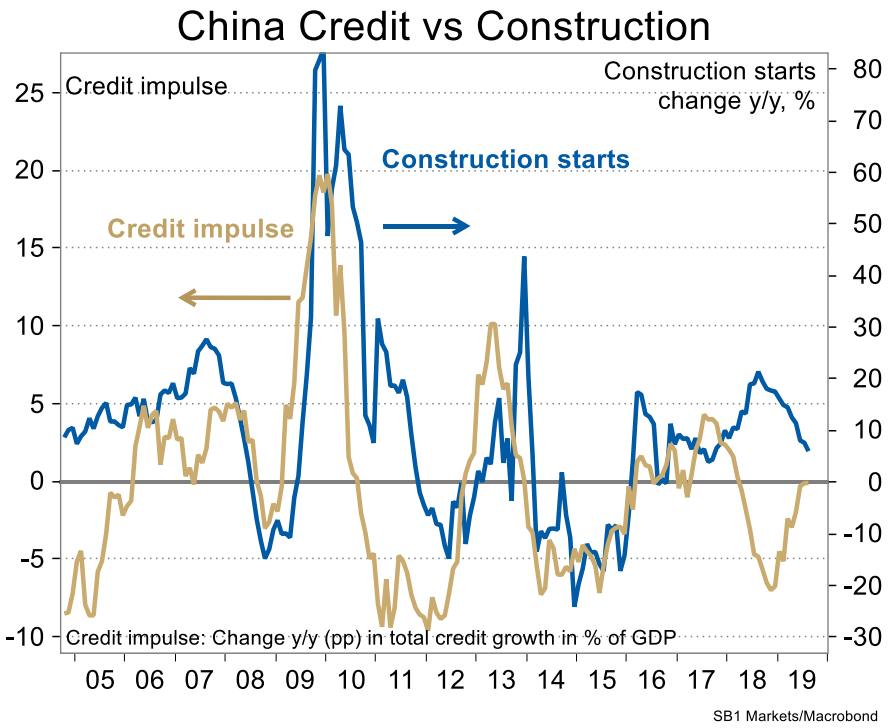




- Sales of new homes have accelerated through the summer, and is not far below housing starts
- Housings starts are running higher than sales, still trending up but slower and rose just marginally in Aug. Even if sales are below starts – implying an increasing inventory – we are not that worried, given the large inventory drawdown from 2014 – 2018. Still starts are record high, are up more than 50% from the 2015 trough, and are up 5% y/y (smoothed) – and are now slowing. The downside risk is still there
- Other construction starts have been flattening since late 2018 but are still up 8% 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 residential construction

Credit and construction usually correlated but not recently

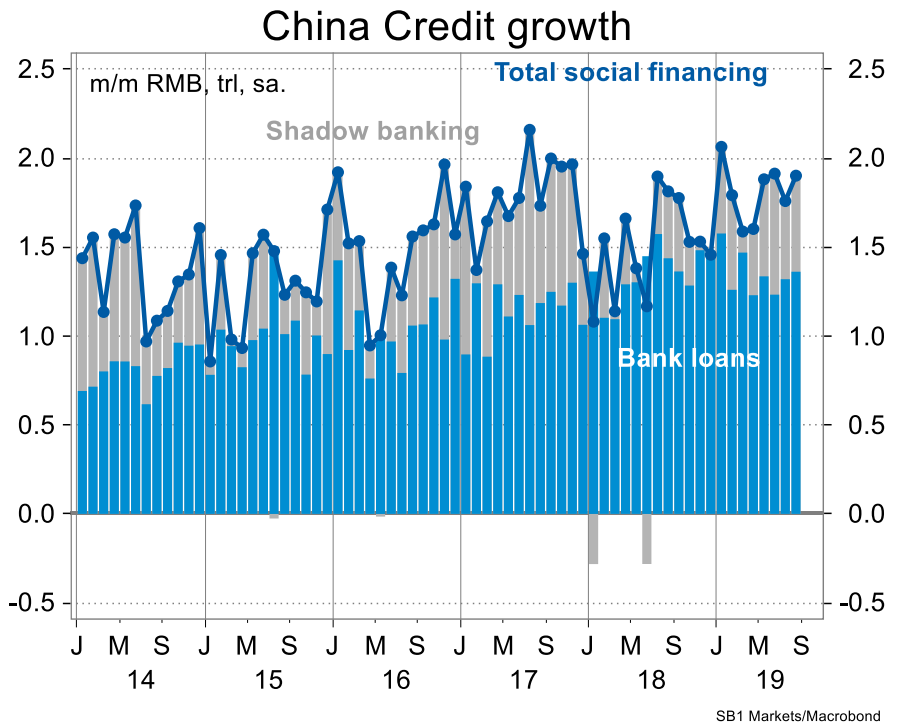
Credit is not contracting anymore but growth in construction is slowing

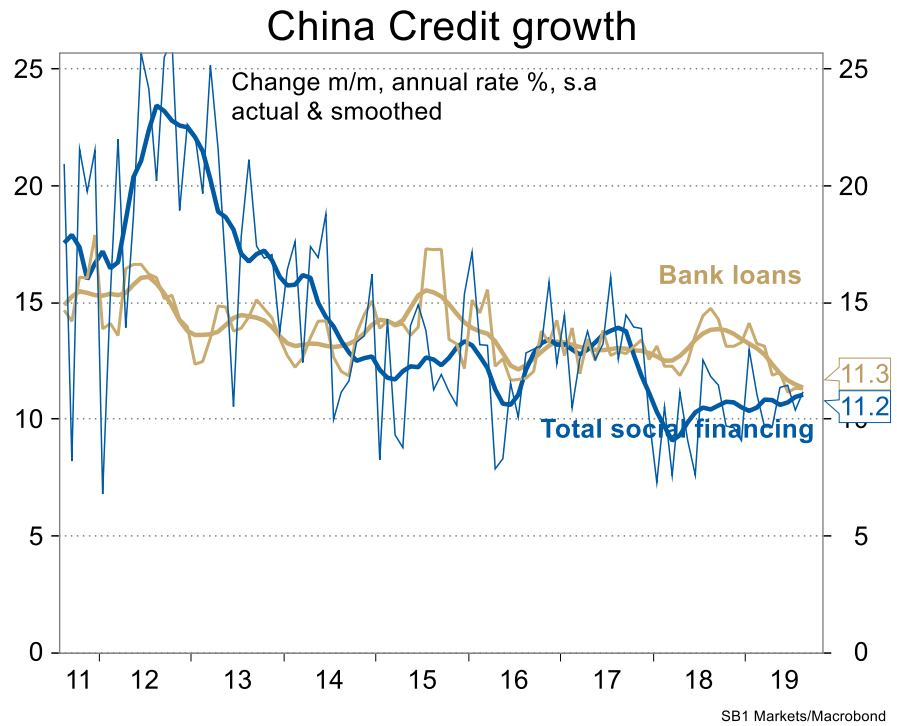


- During 2017/18 credit was tightened but construction activity accelerated – not the usual response

Bank lending is slowing but the void is filled in the shadows, total is accelerating

Credit growth higher than expected in August





- Total credit rose by 11.2% m/m annualised in Aug, down from 10.4% in July. In RMB, total credit rose by 1.9 trl, expected 1.6 trl. The underlying trend is slowly up, since the trough in early 2018. The credit impulse (measured over 12 months) is close to neutral
  - » However, the mix has been somewhat surprising. Growth in bank loans is slowing in spite of 5 (and now 6) cuts in the reserve requirement that has released a 4% increase in lending capacity (close to 5% now). The authorities successfully clamped down on credit supply through the non bank ('shadow') credit market early 2018, but since then growth has picked up again, and now accounts for 1/3rd of total credit supply again
- What's next? Many expect the PBoC to turn more expansionary, and cuts in interest rates are quite likely. 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

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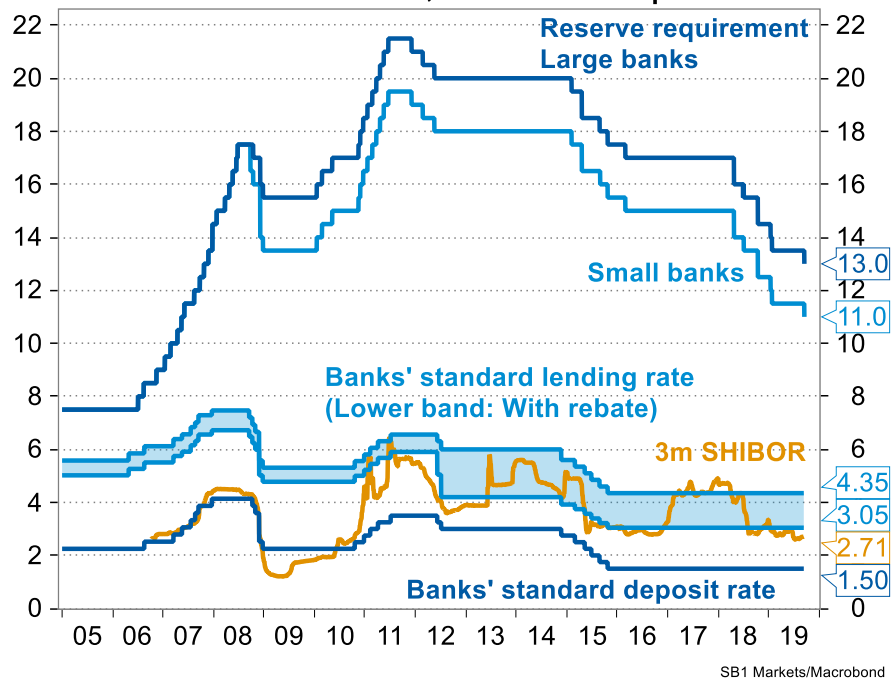
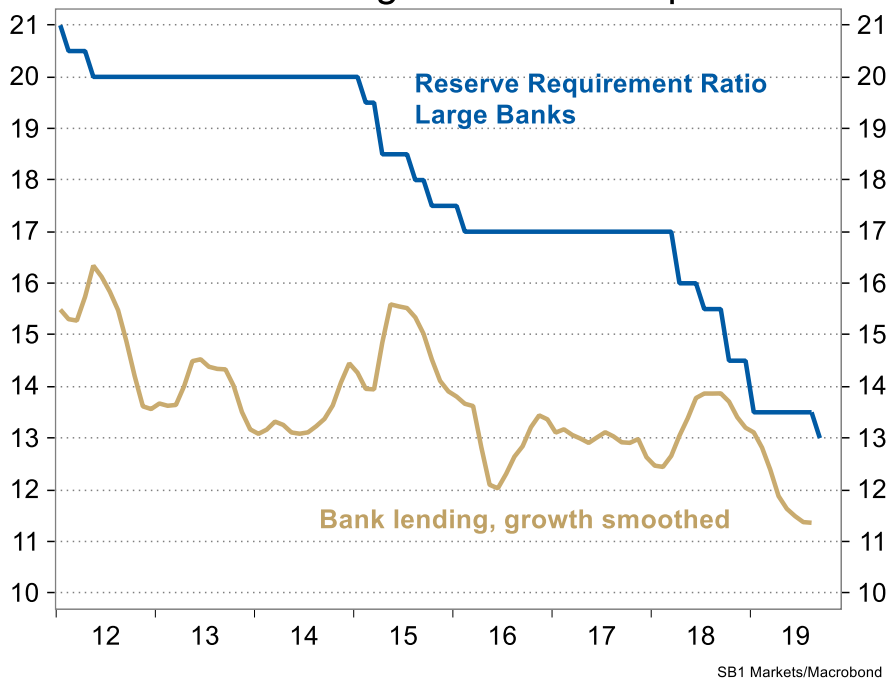
Another cut in banks' reserve requirements, will it make wonders? Probably not

Requirements cut 0.5 pp to 11/13%, were 15/17% when this easing cycle started. But lending slows

China Interest rates, reserve requirements



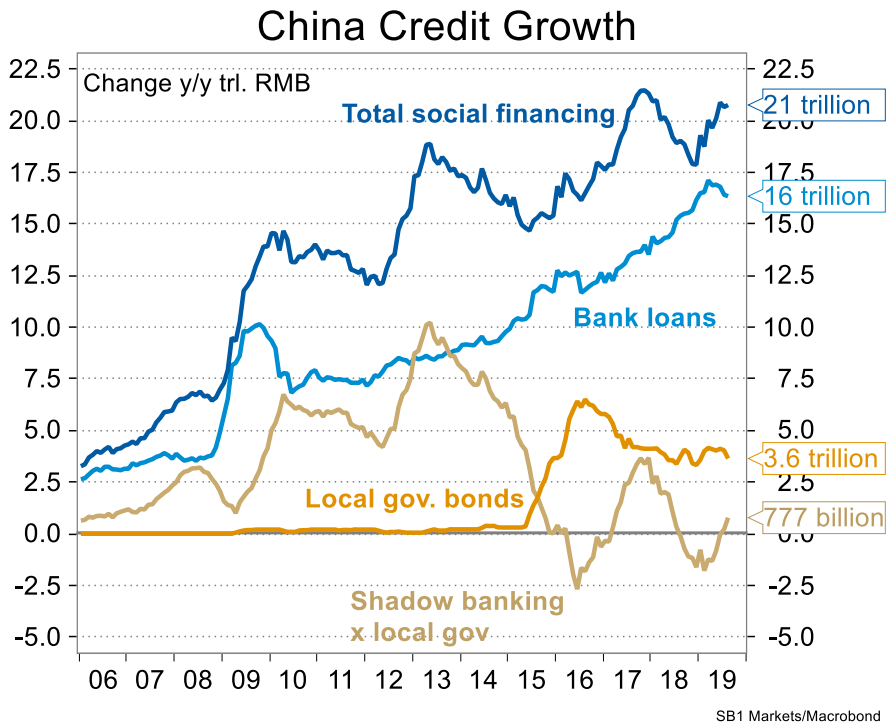
China Bank lending vs reserve requirements

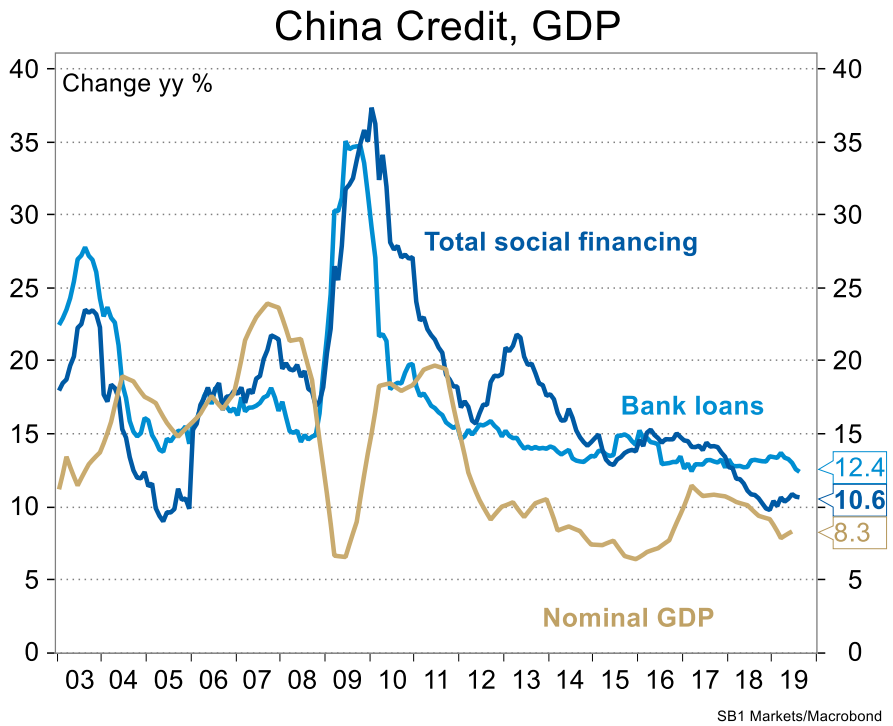


- Last weekend, the PBoC cut in the reserve requirement for the 6th time since April last year, in total 4 pp, to 11 for small banks and 13 for large banks. The ratio is down 8.5 p from the peak in 2011. The requirement ratio has been reduced by 3.5 pp last year (until Fridays cut), freeing up bank lending equalling above 4% of outstanding loans. Still, actual bank lending has slowed somewhat of course not because the requirements ratio is cut but because other factors have been stronger, on the downside. We do not expect the last cut to have a huge impact on bank lending either
- The 3 m SHIBOR at 2.71% has been trending marginally down. There are wide spread expectations of interest rate cuts. In addition, the CNY exchange rate is down from the peak, stimulating the (foreign) exposed sector in China
- The PBoC recently introduced a new model for setting interest rates a prime lending rate has been cut by 0.1 pp below the banks' standard lending rate

Credit growth has accelerated slowly over the past year

Banks are slowing somewhat, while the shadow banking market (ex local gov) fills the void

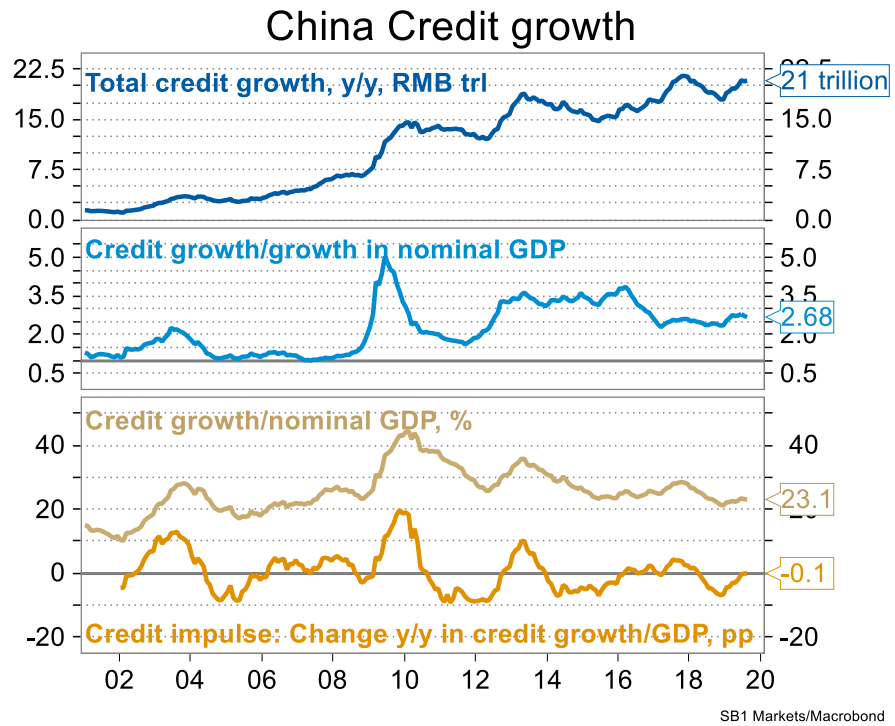


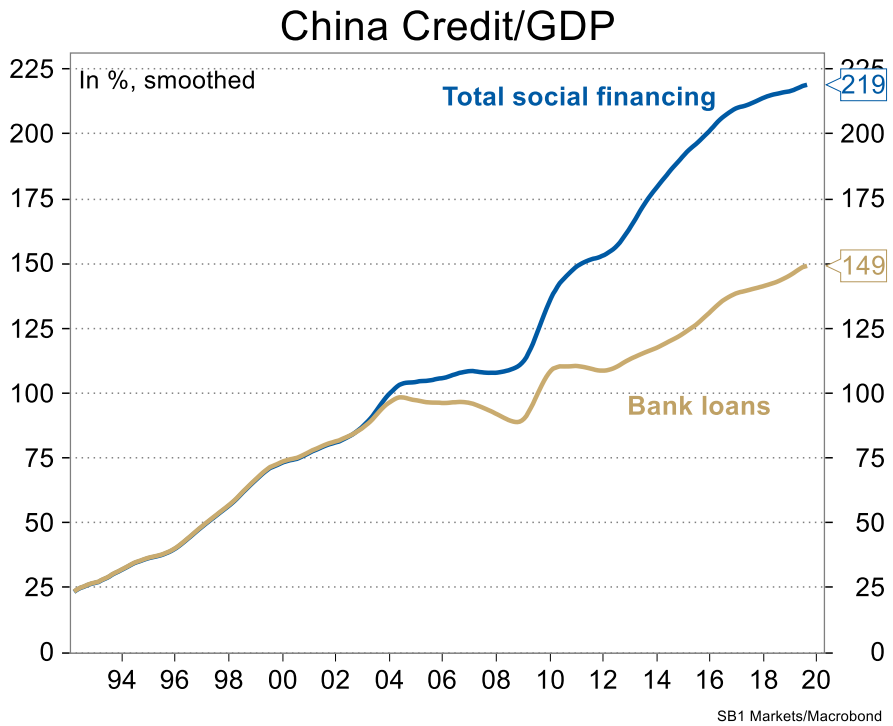


- Over the past 12 months, total credit has grown by CNY 21 trl, equalling 23% of GDP. The annual rate bottomed out in Dec
- Banks supplied CNY 16 trl, 80% of the increased credit volume
- Local governments borrowed CNY 4 trl in the bond market
- Other credit – via the shadow credit market x gov bonds – are up 1 trl, from a negative drag over the previous year
- Total credit growth at 10.6% is well 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)

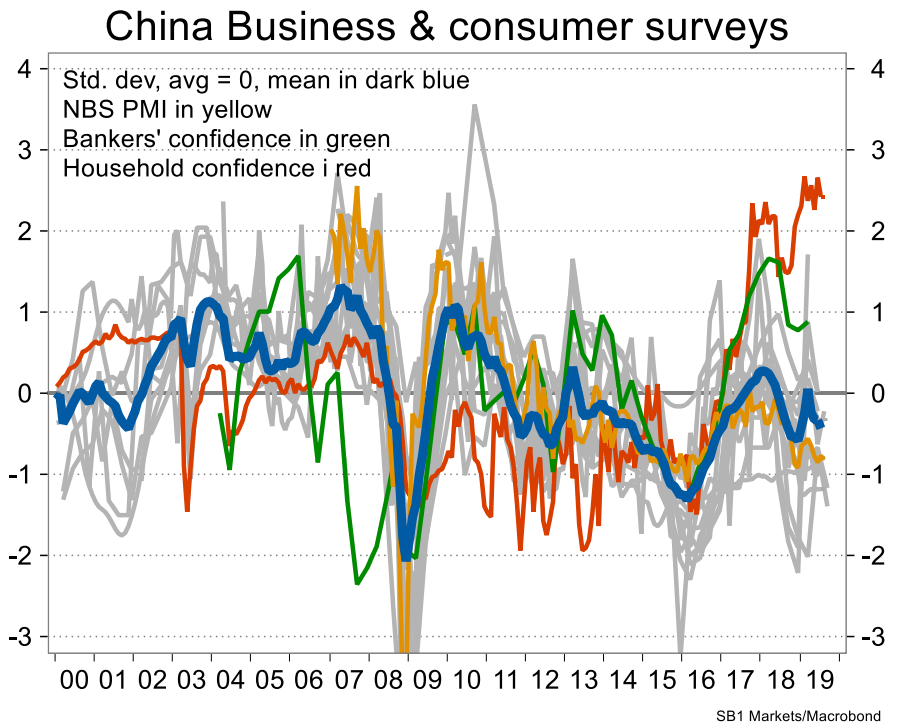


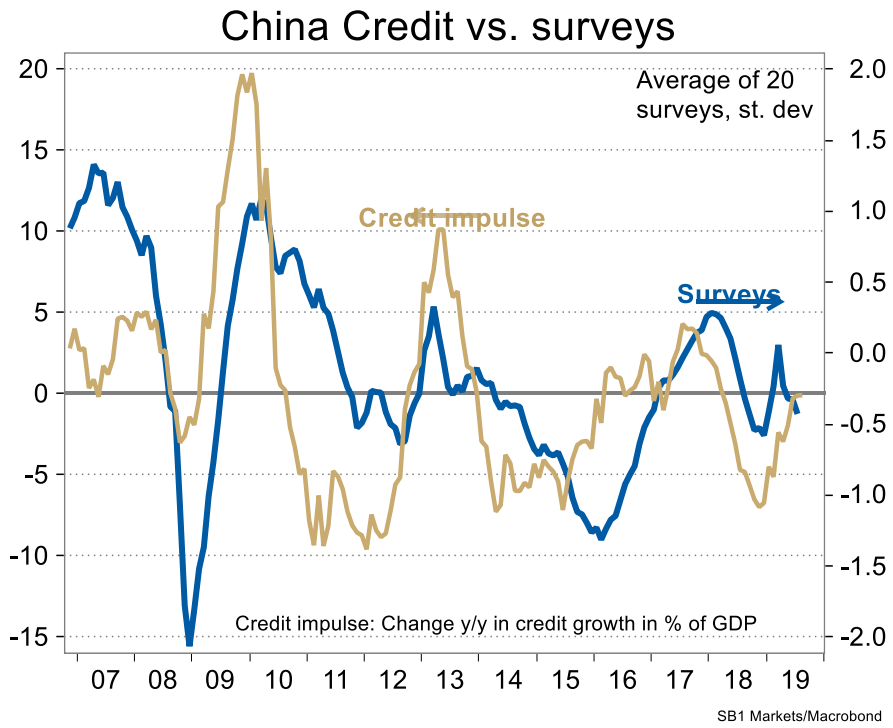


- A negative credit impulse implies that the credit growth/GDP ratio is declining (the 2nd derivative)
  - » Indicates credit tightening (or weaker demand)
  - » Has been associated with slowdowns in the Chinese economy
  - » Now, the credit impulse is has risen to neutral measured y/y (the 3rd derivative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

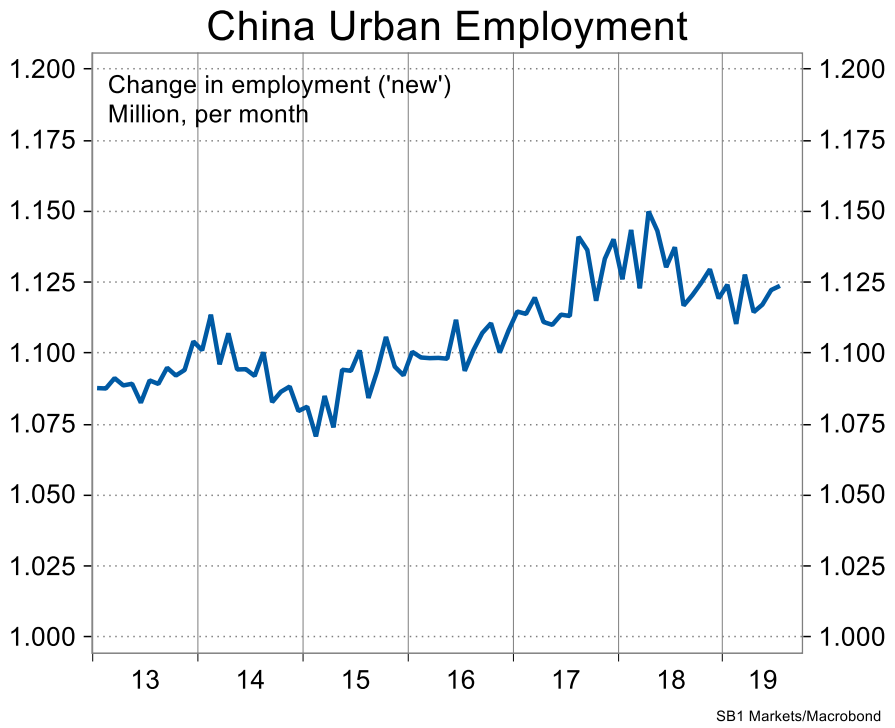


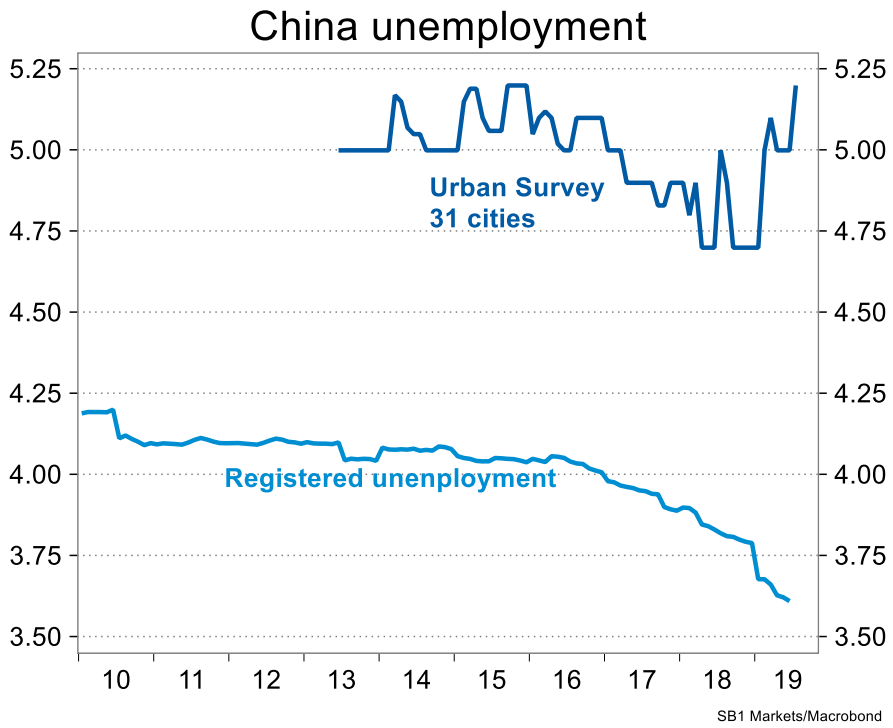


- An avg of Chinese business & consumer surveys indicates that growth has slowed, however, the level is still at an historical average and above the 2018 level (and it was weaker in 2014-2016 and 2012)

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

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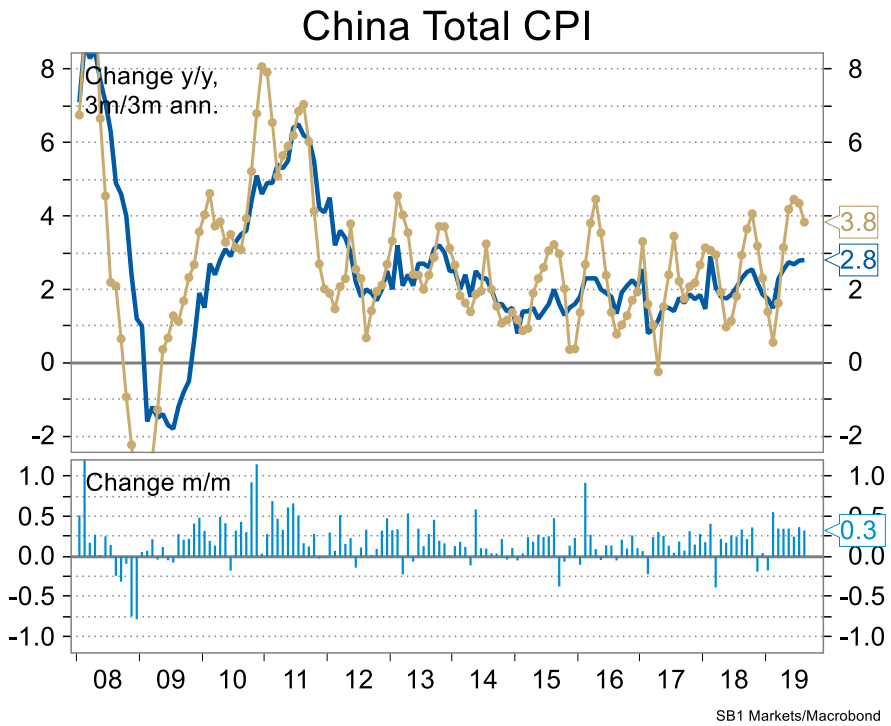
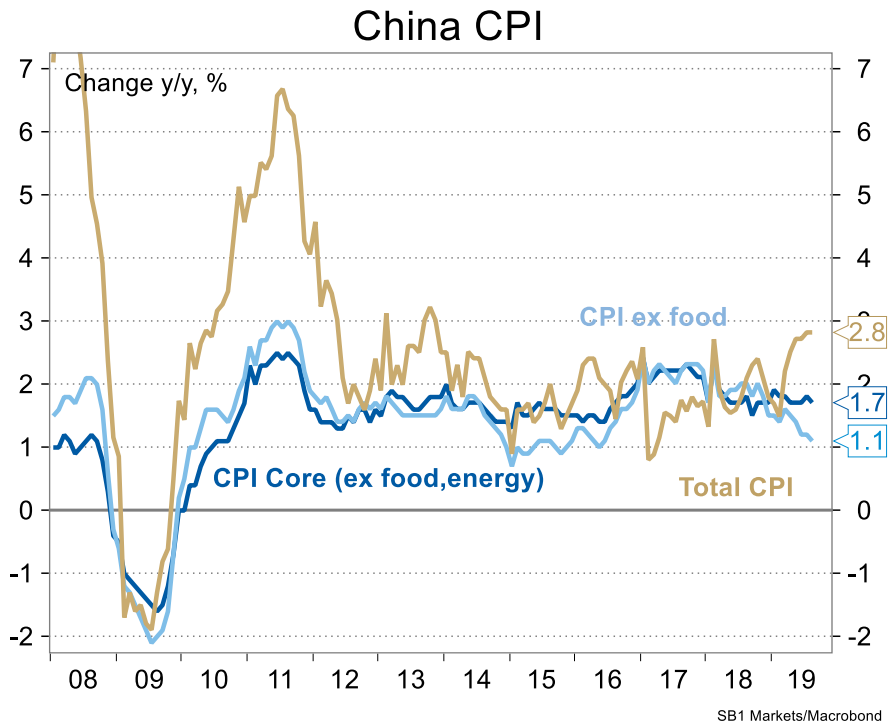
Core CPI ticked down to 1.7%, trending flat, total inflation soared to 2.8%

Total inflation is climbing on a rapid increase in food (pork) prices, core inflation holds steady

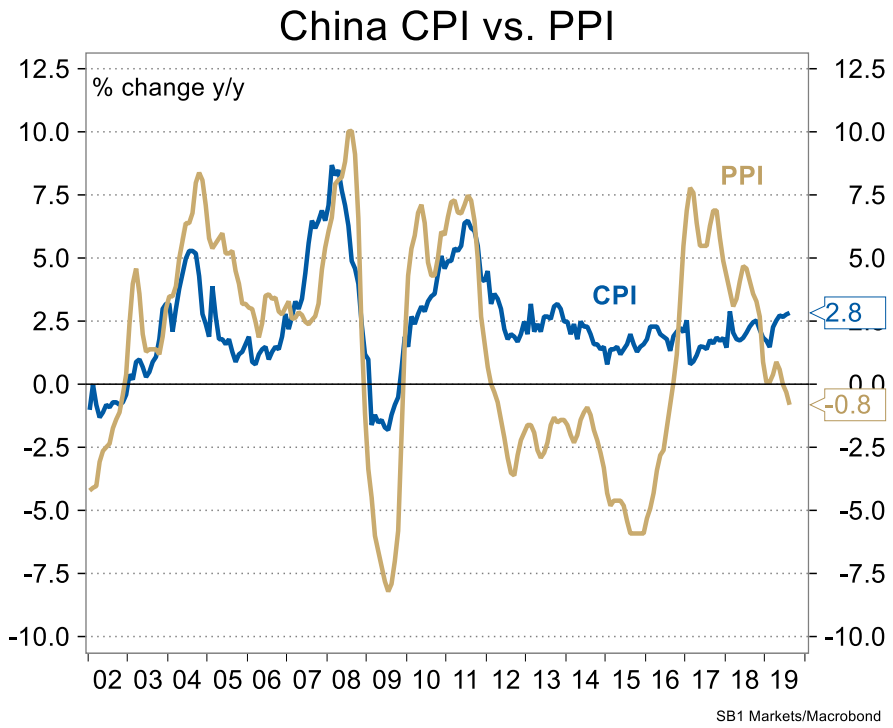




- Headline inflation was flat at 2.8% in August and prices fell 0.1% m/m. Recent months, total inflation has been brought up by accelerating food prices
  - » Food prices rose 0.6% m/m in Aug and the annual rate accelerated to 10%. Pork prices are still rising due to the swine flu, up almost 50% y/y!
- CPI ex food inched down to 1.1%. The decline recent months is just due to lower energy prices, the core – CPI ex food and energy – is up 1.7% y/y, and the trend is flat. <u>The CPI does not send a 'China slowing' signal, while the PPI may</u>, check next page

China producer prices are falling y/y, usually not a sign of strength

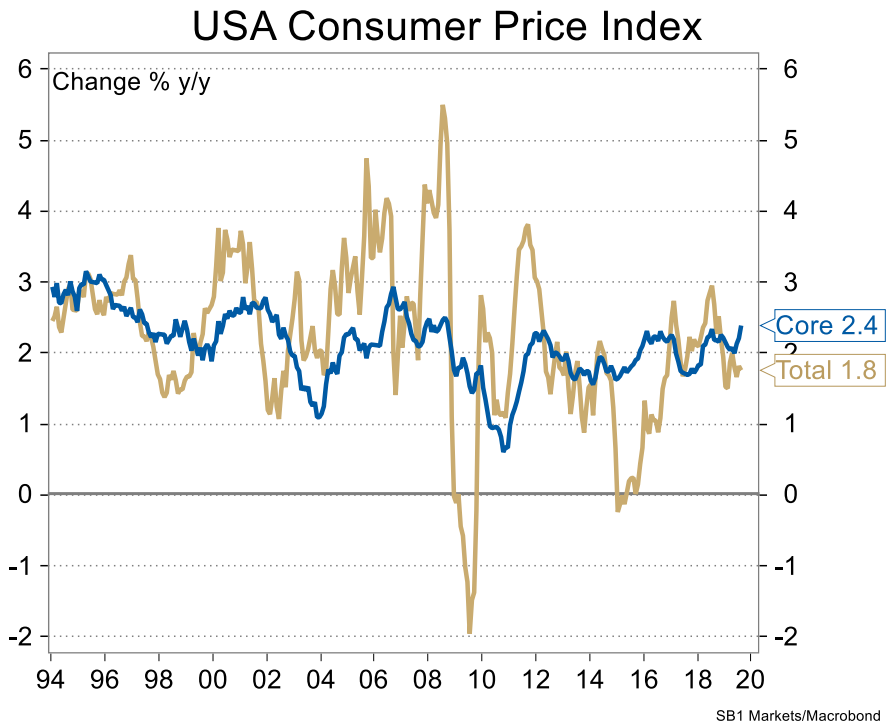
PPI down 0.8% y/y in August, even as meat prices are soaring

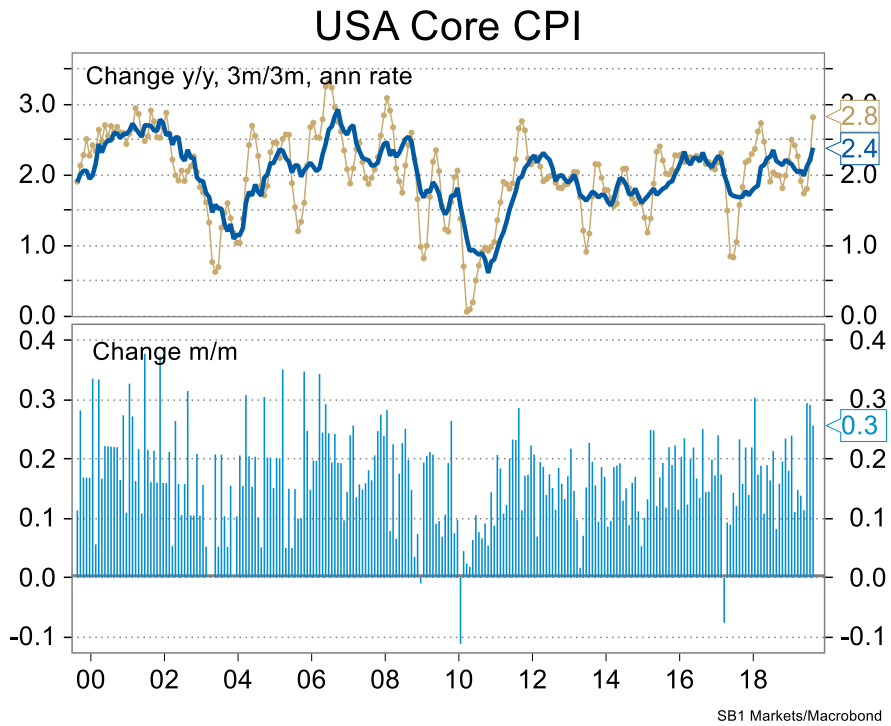


(Trump's words, not ours☺)

Core inflation at 2.4% = time for the Fed 'boneheads' to slash interest rates!!

No 'no inflation', sir; Core CPI up 0.3% m/m in August, underlying growth at 2.8%

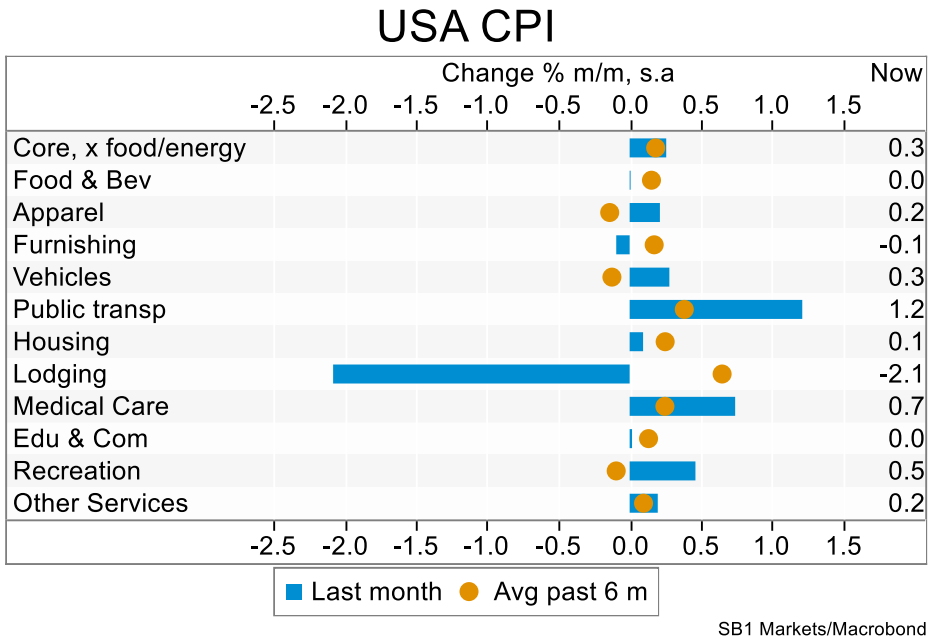


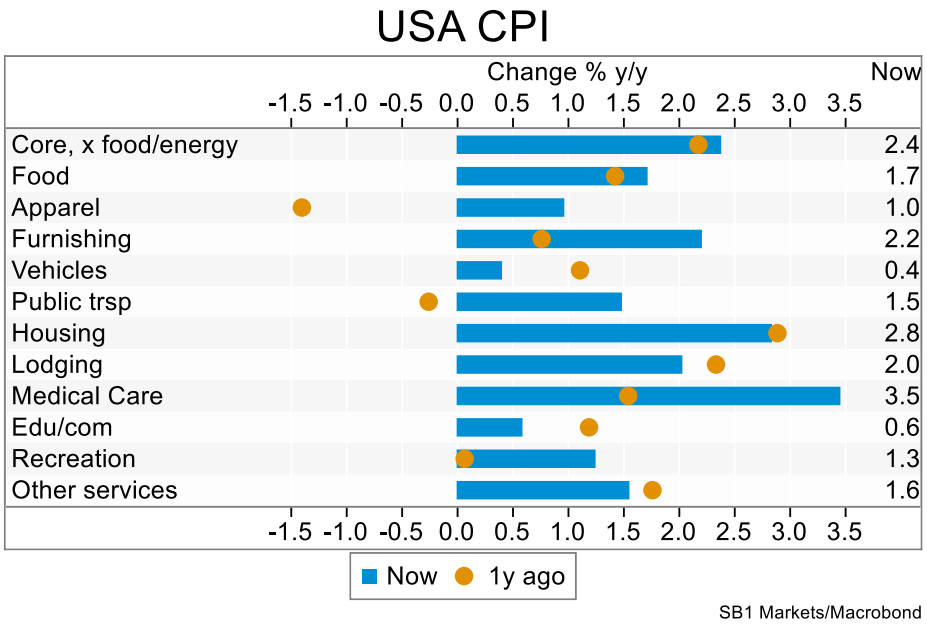


- Core CPI increased by 0.3% m/m in August, for the 3rd month in row, 0.1 pp above f'casts. The annual rate ticked up to 2.4%, from 2,2%, the highest since 2008 (partly lifted by muted m/m growth in Aug last year). Underlying growth, measured 3m/3m, soared to 2.8% (highest since 2008 too). High inflation underway? We doubt so, looking at producer prices or inflation models. Still, inflation has not disappeared!
  - » Fed preferred price measure, the core PCE (the consumption deflator) was up just 1.6% y/y in July, below Fed's 2% price target, will most likely accelerate in August
- Headline inflation was flat at 1.8%. Inflation has stabilised after being pulled down by declining energy prices in the spring

Lodging priced dropped in Aug, public transport and medical boosted growth

Prices are increasing in all sectors y/y – and accelerating in 6 of 11





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

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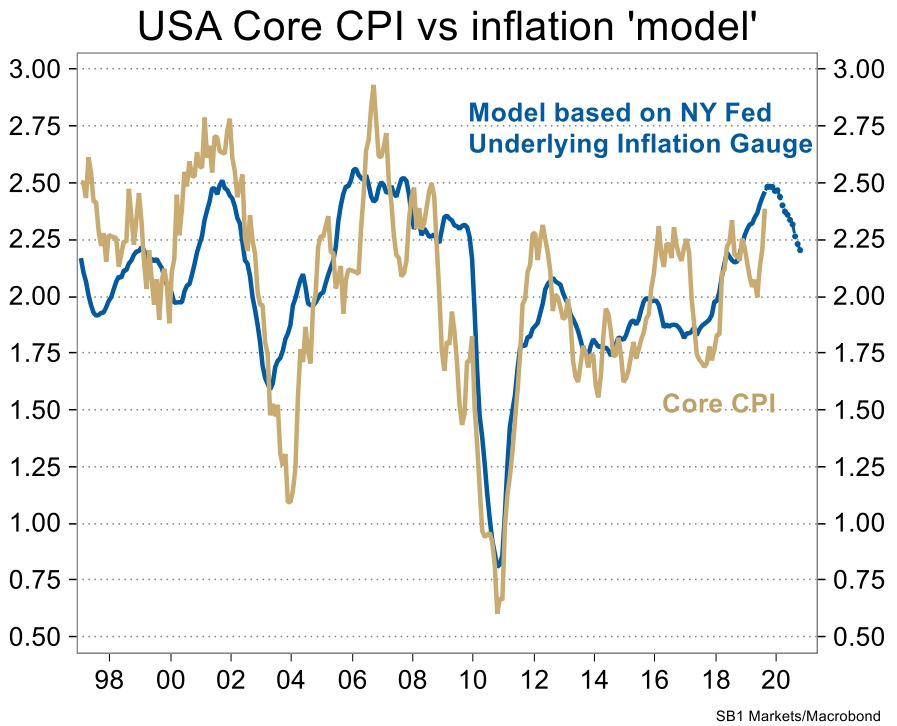
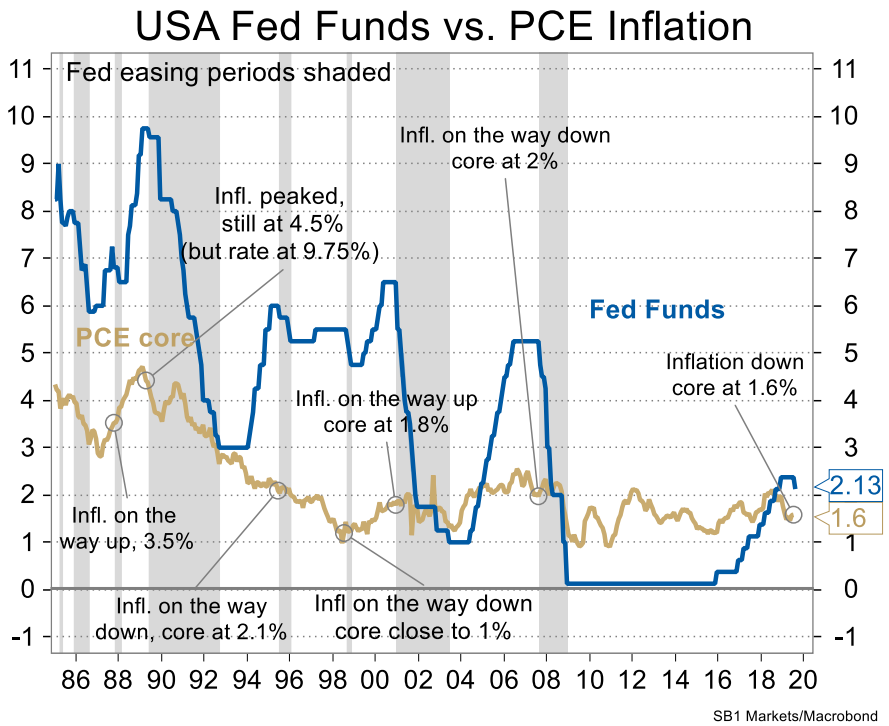
NY Fed's inflation model suggests that inflation is close to peak





- 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) and does no indicate much 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 July, below Feds inflation target at 2% - but underlying growth is up 2%
- Fed's actual rate setting has <u>not</u> been well explained by actual inflation during the past <u>two decades</u>. The present PCE inflation rate is low enough to 'justify' Fed's interest rate cuts (but not the CPI!) The economy – taking care of the 'dual mandate', full employment - will anyway decide Feds action from here – and the trade war of course.

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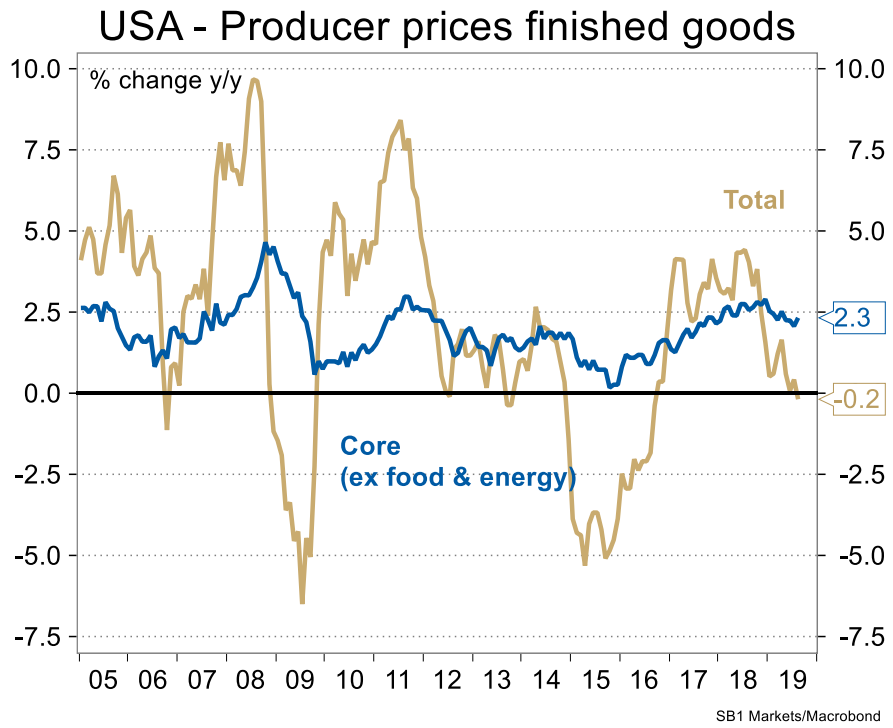
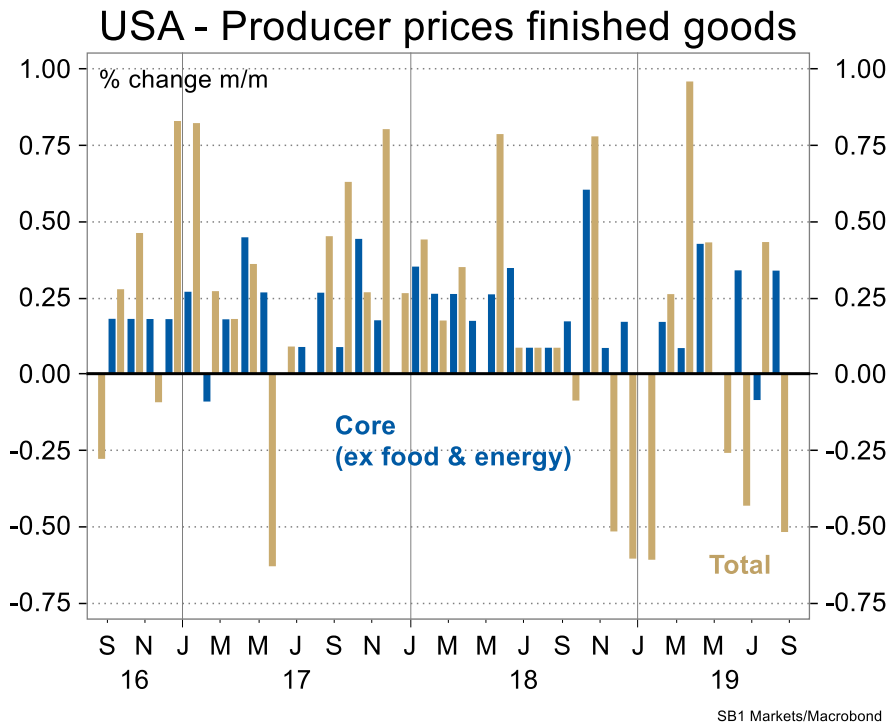
Producer prices are moderating, although August came in above expectations

Core finished goods inflation climbed to 2.3% y/y in Aug, total PPI inched down 0.2% y/y

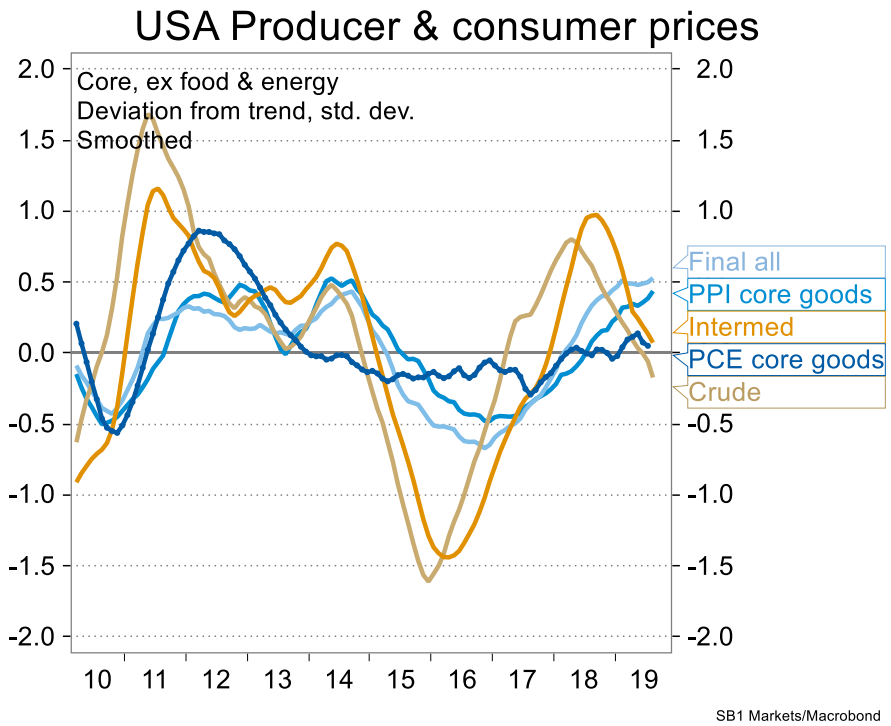


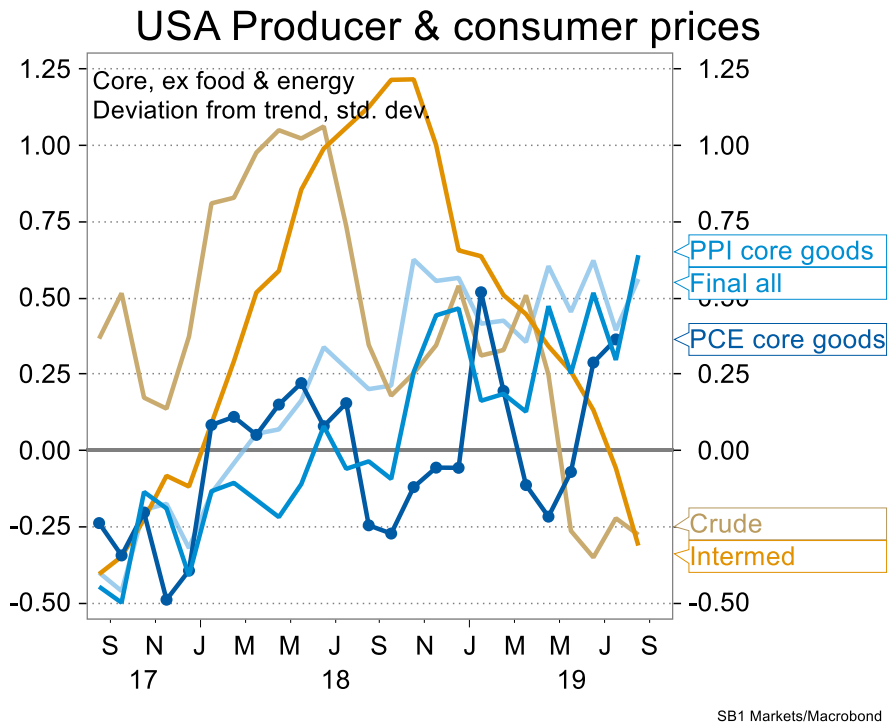


- Core finished goods x food & energy PPI rose 0.3% m/m in August, 0.1 pp above expectations. Monthly growth has been meagre recent and the annual rate is sliding down (barring the uptick to 2.3% in Aug)
- Headline PPI dropped 0.5% m/m. The annual rate fell to -0.2%, it has been brought sharply down by lower energy prices the past year
- BTW, when the Fed started hiking the Fed funds rate, core PPI was 0.3%, and total PPI was down 4.5% y/y

Crude, intermediate good prices (PPI) down, final goods will follow

And then consumer prices – but the first leg for consumer goods prices may still be up

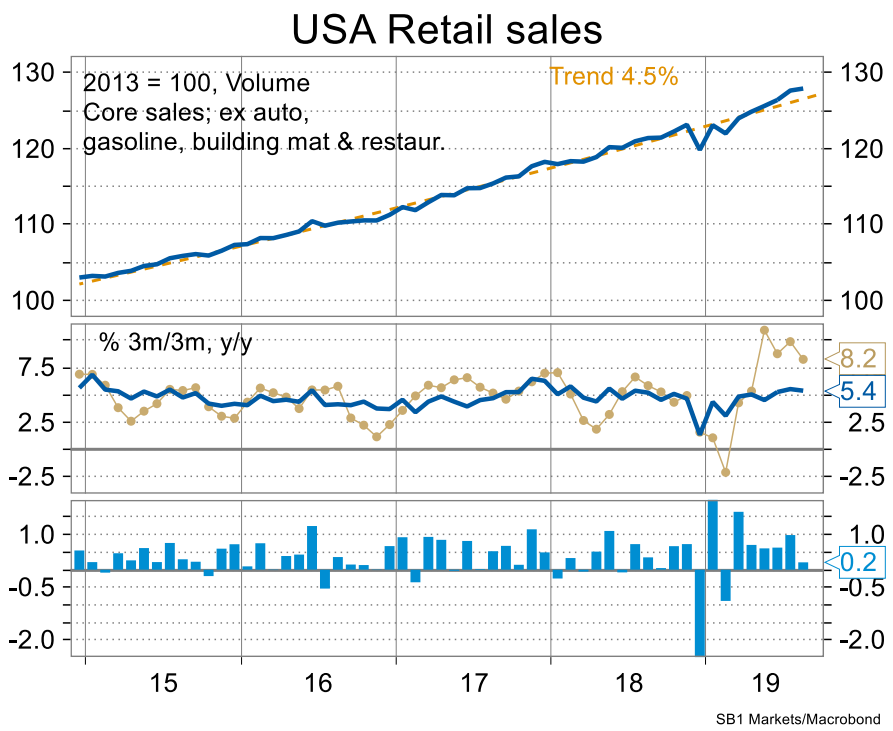


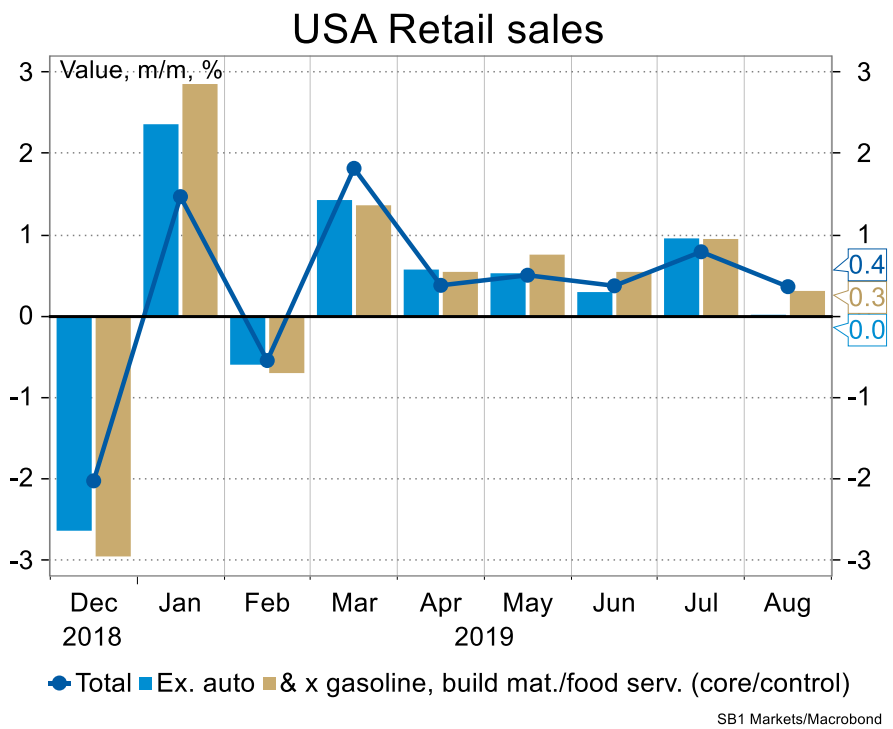


- Crude (core) PPI prices fell in August and are trending steeply down, as are intermediate goods prices. Core consumer goods prices (at the producer level) bounced up in August, will over time turn south if prices at earlier stages do not recover
  - » Short term, there might be some upside risks vs. goods prices at the consumer level as these prices have been rather muted recently

Retail sales slowed in August, the speed is still impressive

Core sales volume rose 0.2% in Aug (our est) and are up 8.2% 3m/3m





- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by 0.3% m/m in nominal terms in Aug, just in line with expectations, following a strong July (just marginally revised down). Total retail sales rose 0.4%, auto sales increased marginally
- We estimate a 0.2% m/m volume growth in core sales, after a 1.0% lift in July. Growth recent months has been very strong, up 8.3% measured 3m/3m annualized and the annual rate is 5.4%!
  - » Income growth has slowed somewhat and consumer confidence is mixed – but neither signal an abrupt slowdown in household demand (even if declining savings have been funding half of the growth in consumption so far in 2019…)

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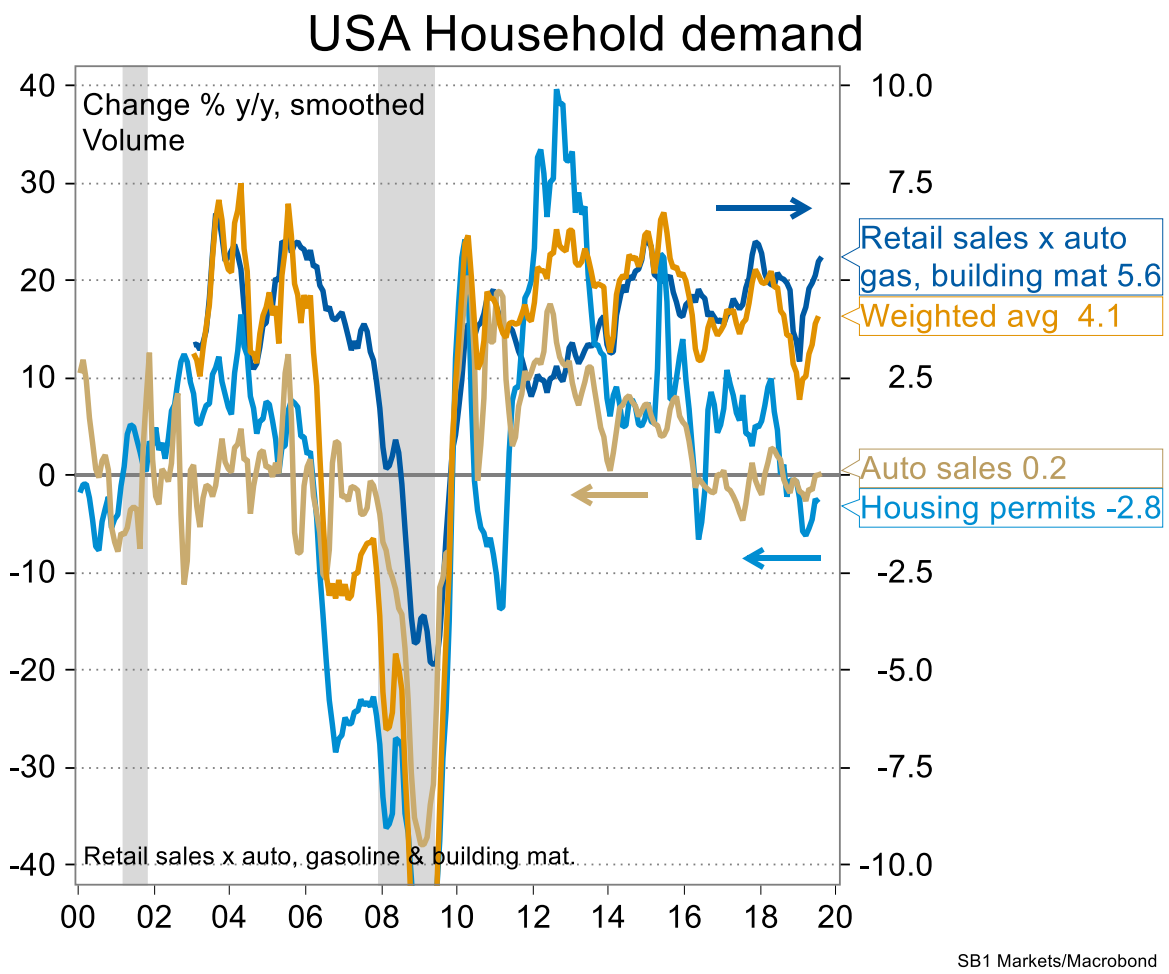
Household demand is rising, at least retail sales (ex autos)

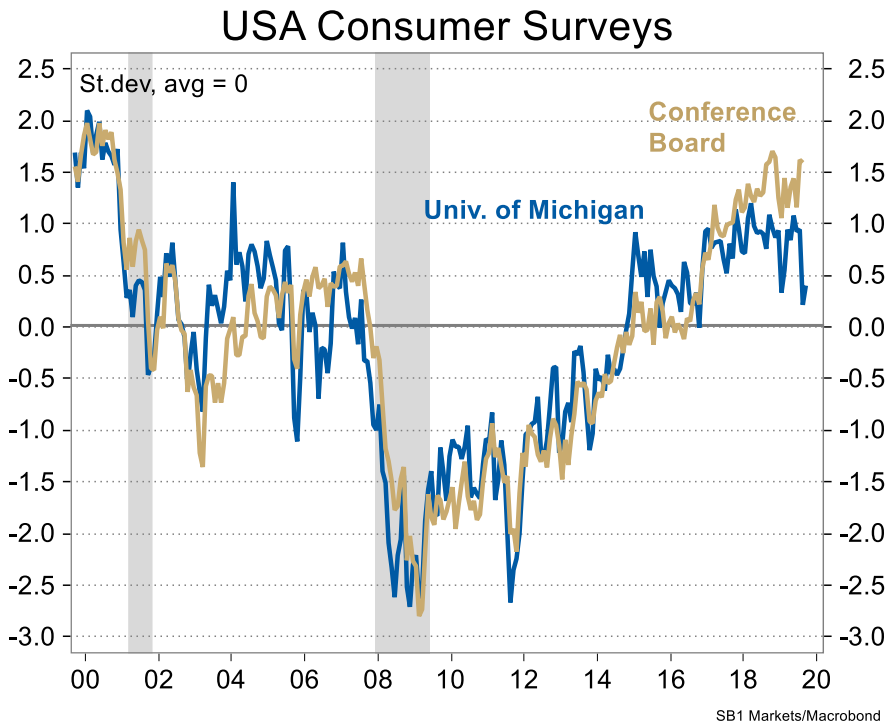
Auto sales have stagnated, housing is flattish – but retail sales are soaring – and saves the day?

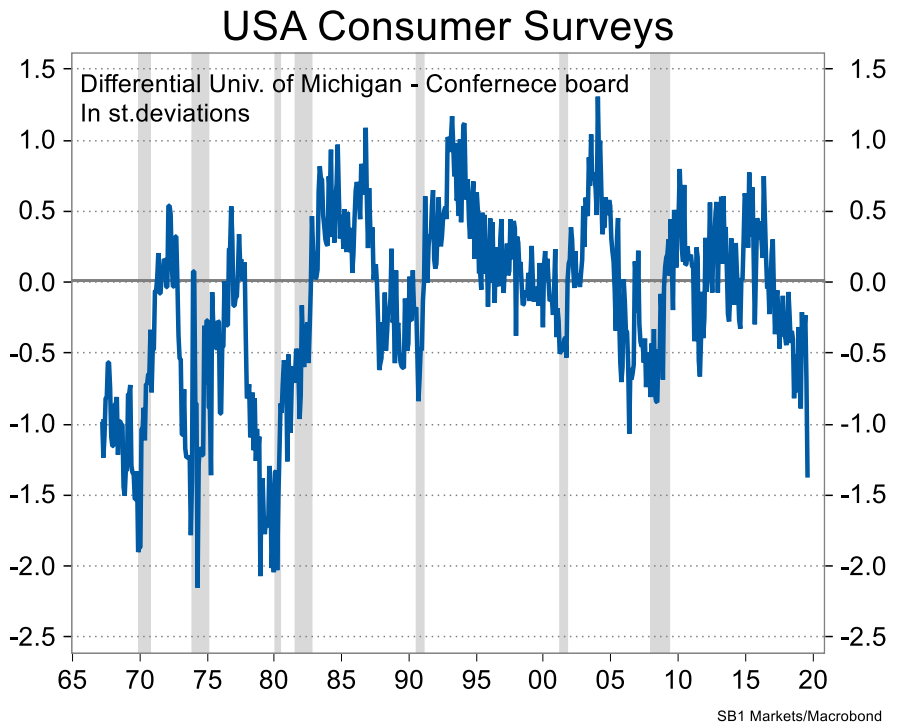


- Total household demand is not on the brink of sending the US into recession! The weakness in the US economy is stemming from businesses and global demand, not US consumers

Michigan consumer sentiment a tad up in Sept, still at a 'low' level

Sentiment rose more than expected, but just a small part of the Aug decline was reversed





- University of Michigan's sentiment survey climbed to 92 in Sept from 90 – but remains well below the July level at 98. The August setback was unusual. The level is still above average for the total index (current situation well above, expectations at average).
- Conference Board's consumer confidence survey did not report any setback in August, and the difference between the two surveys suddenly became unusually large. Ahead of economic downturns, this usually happens
- Still, both surveys are above their long term averages and they do not signal a sudden halt in consumption. But…

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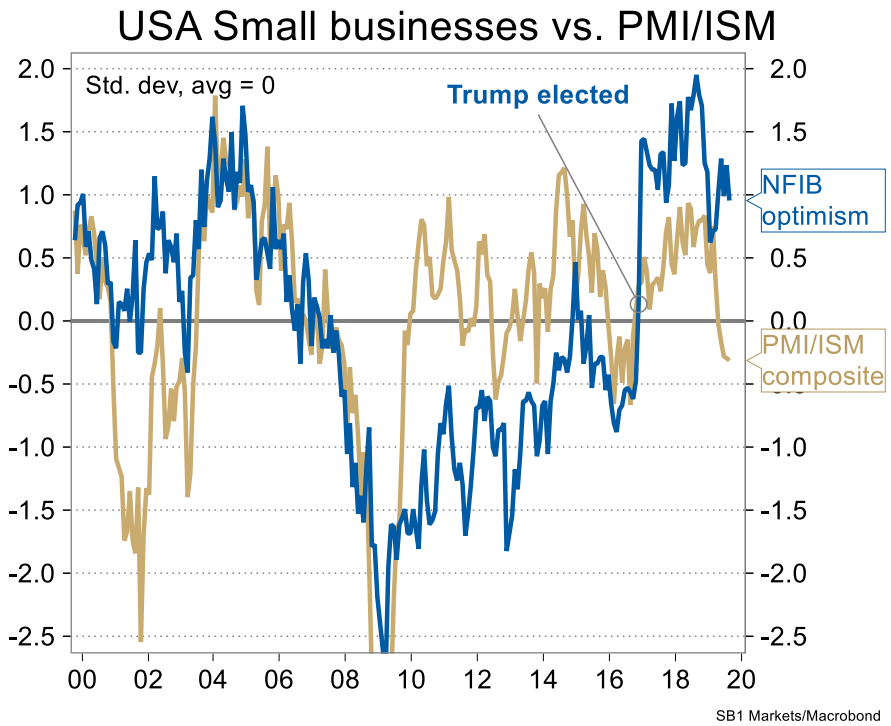
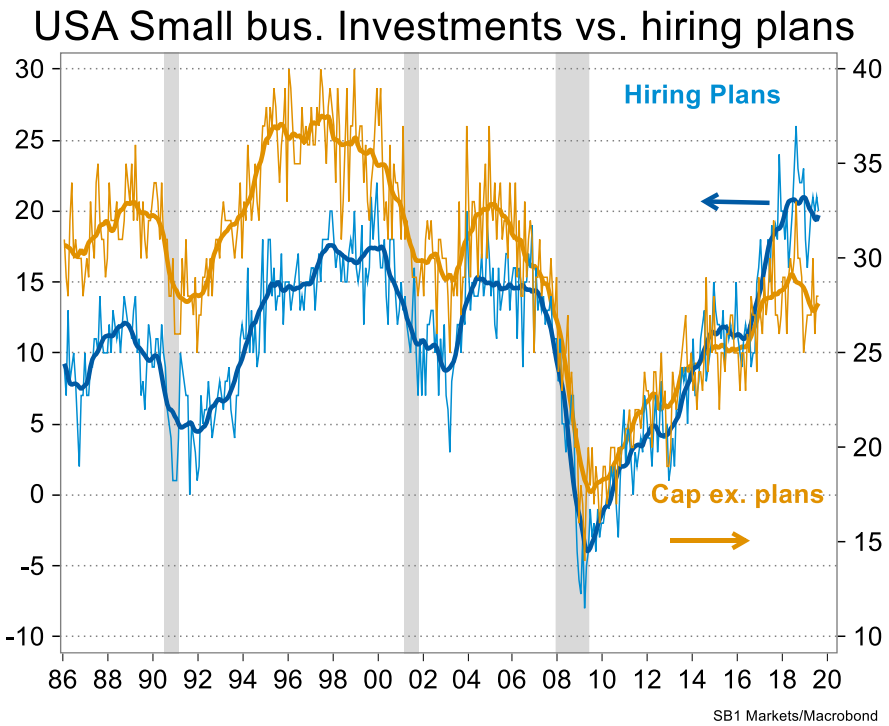
Small businesses' optimism down in Aug, still miles above PMI/ISM (activity)

NFIB optimism index is still upbeat – but cap ex plans, wage and price plans are edging down

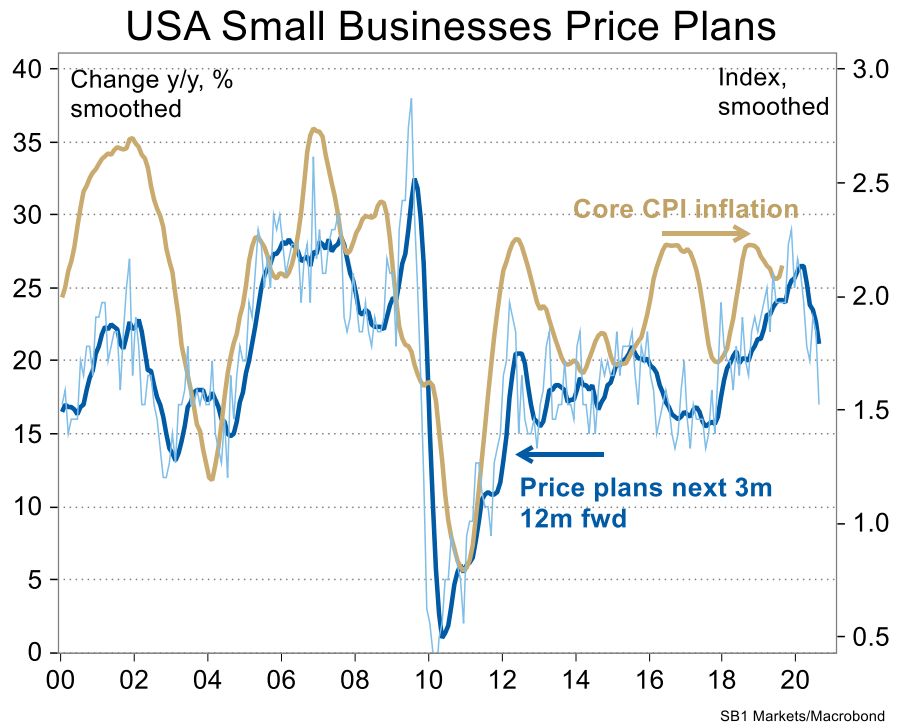


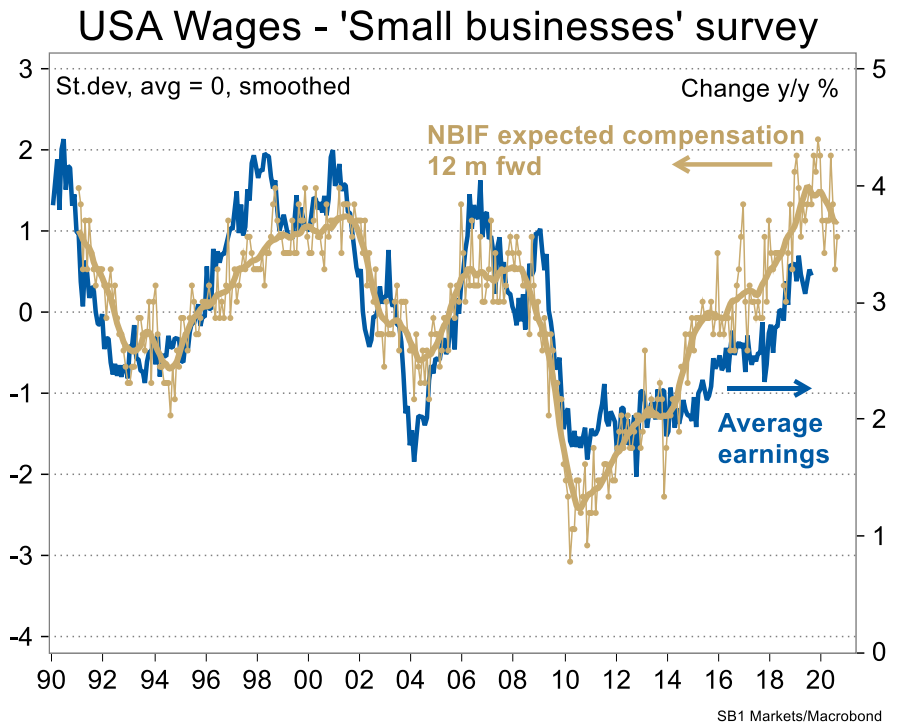


- The NFIB optimism index, measuring small businesses' expectations on business conditions, ticked down in August, as expected. The index slipped in late 2018 and has stabilised this year, still at a high level
  - » The NFIB optimism index is 1 st.dev above average. The surveys from ISM/Markit PMI (and most others) reports are below average, and signals falling production below average levels. These different measures are not very closely correlated. 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, from a rather low level, compared to previous peaks
- Hiring plans har probably peaked but they are still extremely aggressive. Companies are still not able to fill vacant positions

SMEs price plans have been nudged down substantially, demand is slowing?

… Yet, the index does not signal much lower price inflation – and still higher wage inflation





- Just 17% of small businesses are planning to hike prices in August, down from a peak at 29% in November last year (21% reasonably smoothed). The smoothed share is still just above the average share since 2000 (but the actual Aug figure is well below). 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 slowdown - but probably not an acceleration either

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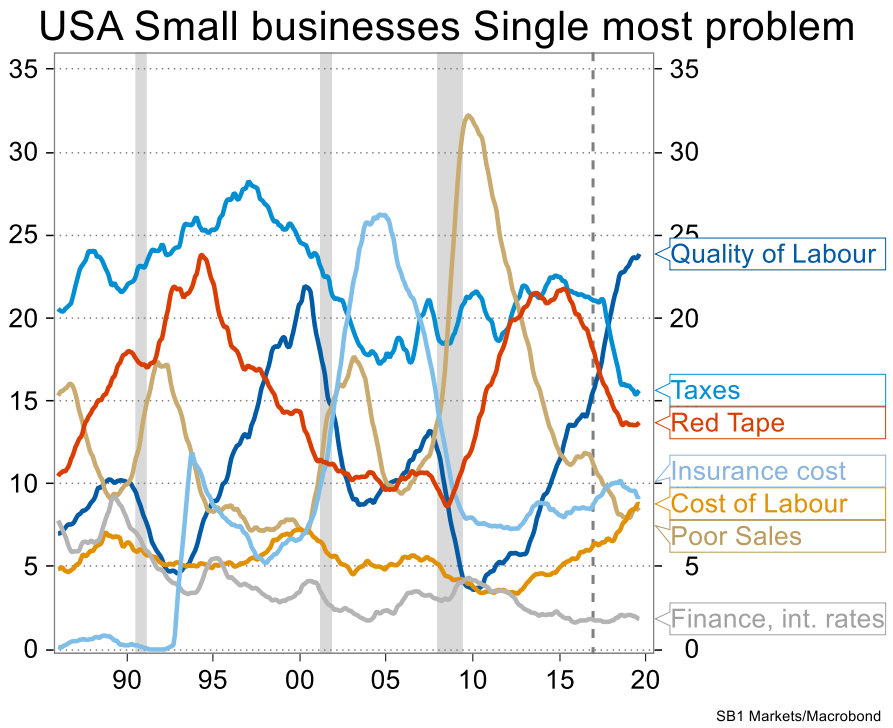
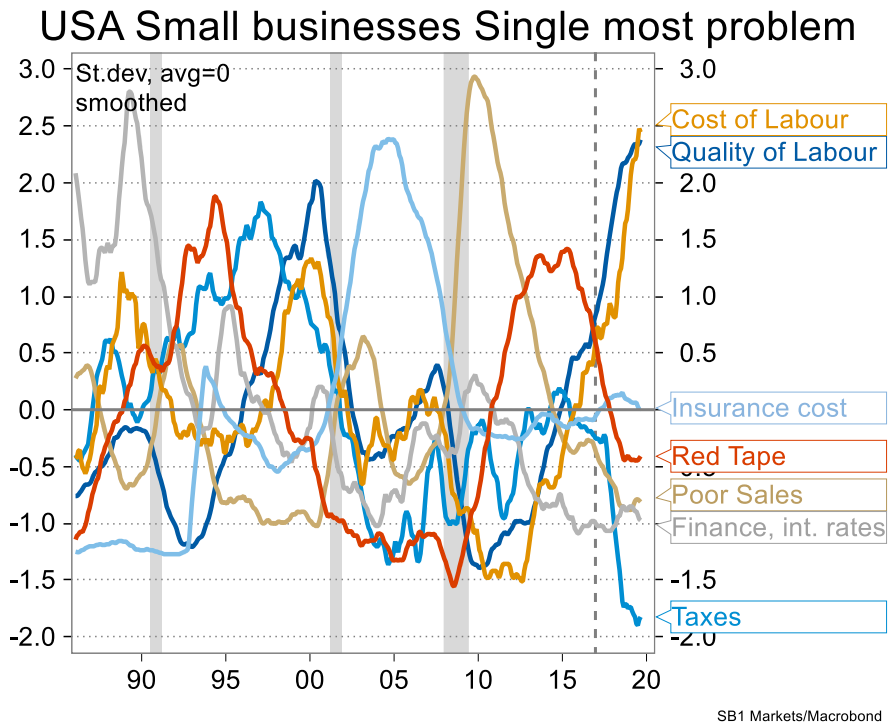
What's the problem? Cost & quality of labour, not sales, interest rates or taxes

US SMEs have never before reported more problems due to cost and quality of labour!

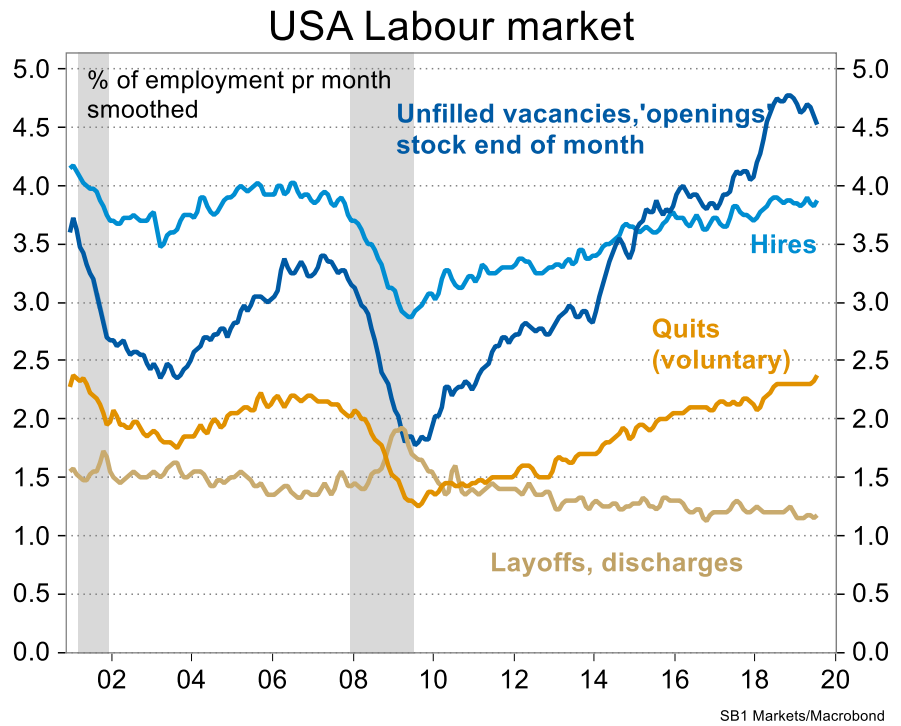


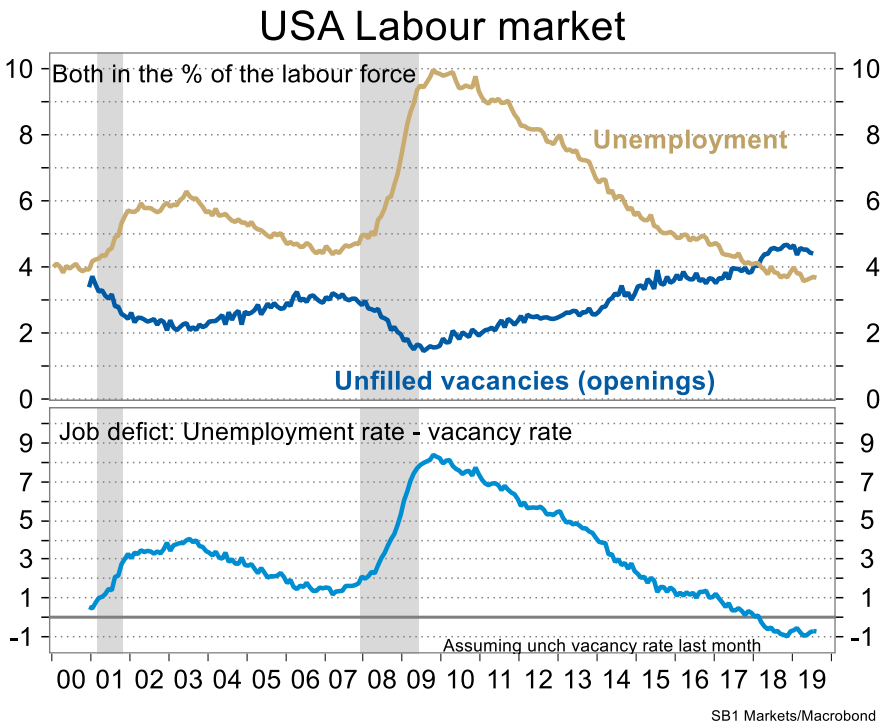


- And fewer than ever are complaining about finance/interest rates and about taxes, following last year's tax cuts
- Sales are not the problem either, almost 20 year since so few stated sales as the most important problem, constraining production.
- So the answer is obvious: The Fed must cut the fed fund to zero, or below, the USD must be taken down, as must taxes!
  - » Sure, at one stage in the economic cycle interest rate cuts will be appropriate. It's just not now!

Unfilled vacancies have probably peaked, at a very high level. Still few layoffs

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

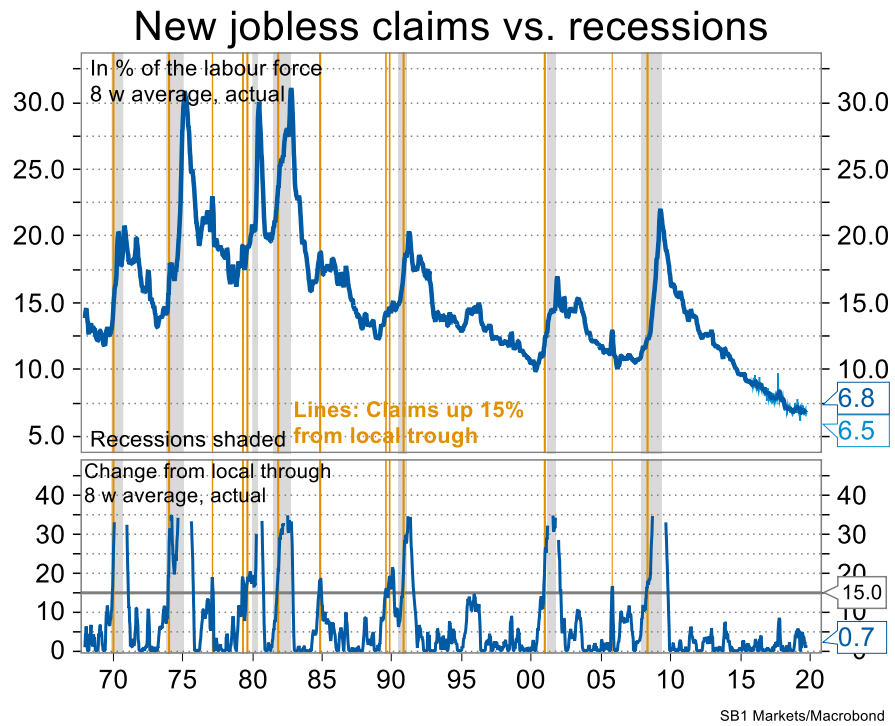


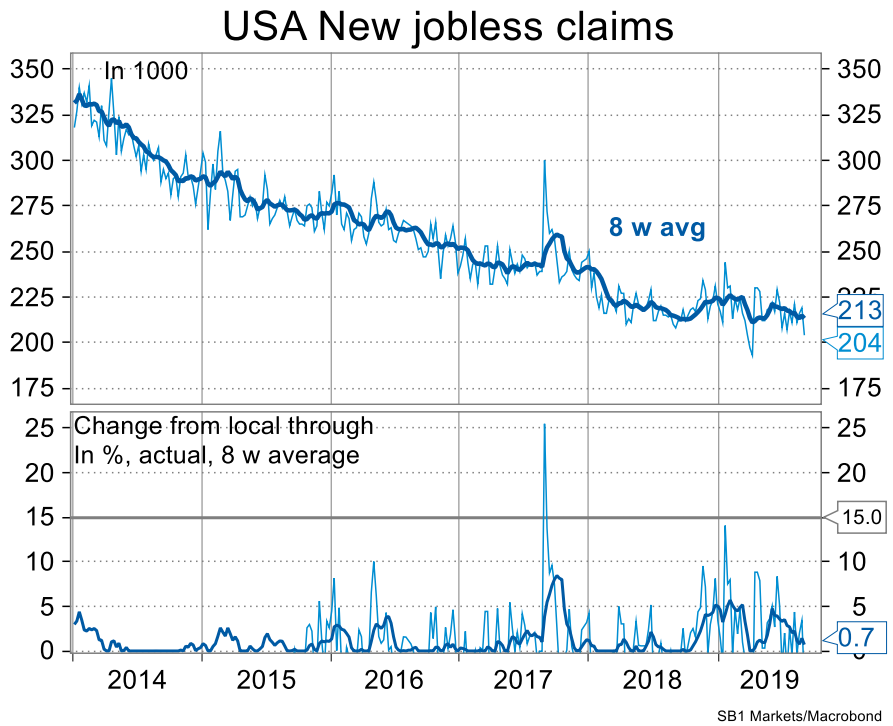


- The July JOLTS report does not signal a further tightening labour market, as 'job openings' are ticking down from the top. A turning point? Perhaps, but the labour market is no doubt tight; there are still more unfilled jobs (4.4%) than unemployed people (3.7%). Monthly (gross) hiring equals 3.9% (of total employment) and is not increasing anymore, as businesses struggle to attract labour
- The number of voluntary quits ticked up in July and is at a very high level – as many employees leave for better (paid) jobs. Not a sign of a weakening labour market! Layoffs are trending down and is at very low level

Jobless claims another tick down last week, no signs of weakness

Jobless claims fell to 204' last week, the 4th lowest in 50 years, and the 8 w avg is very low, at 213'

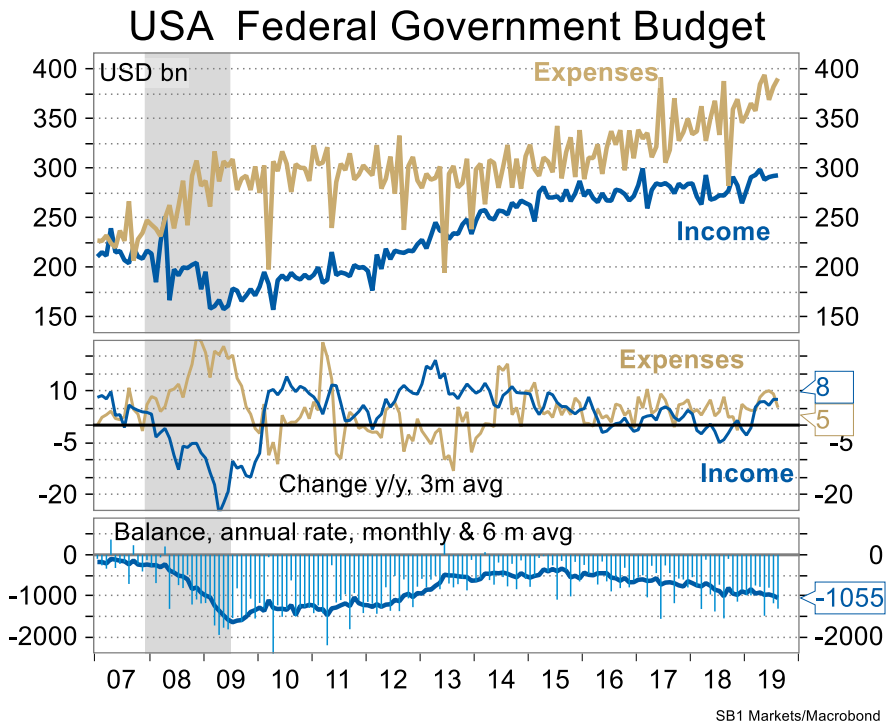


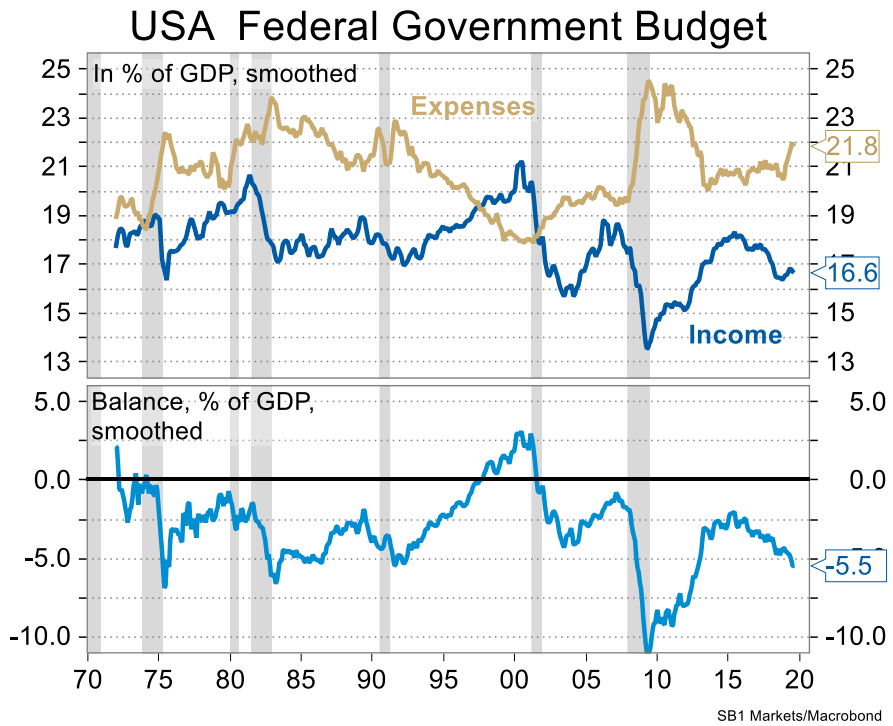


- A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow 'recession' warning line is to be drawn, check the chart to the left. So, no reason to worry now?

The federal budget deficit is widening amid soaring spending

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

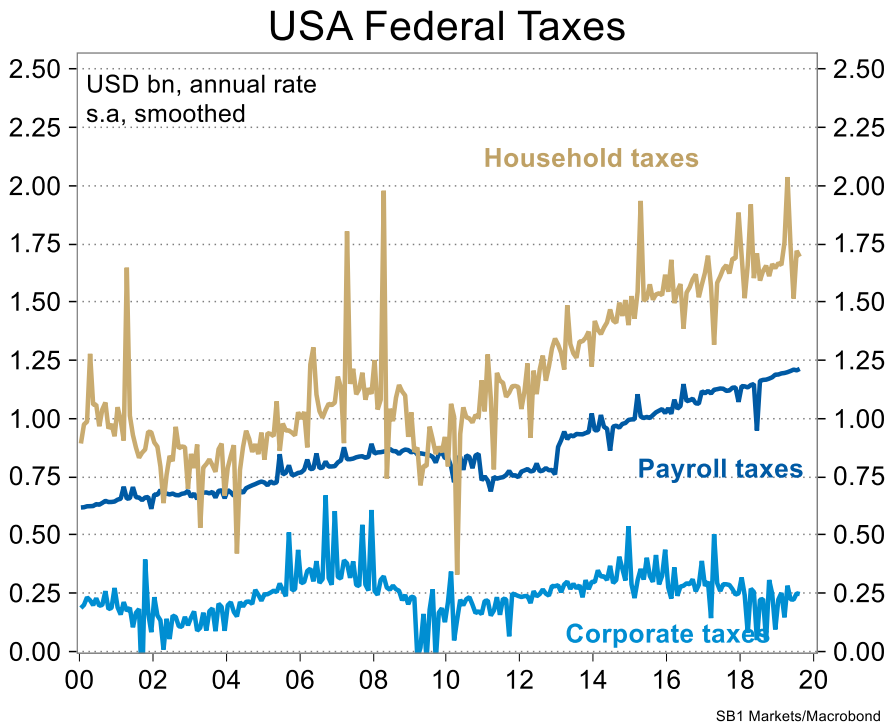


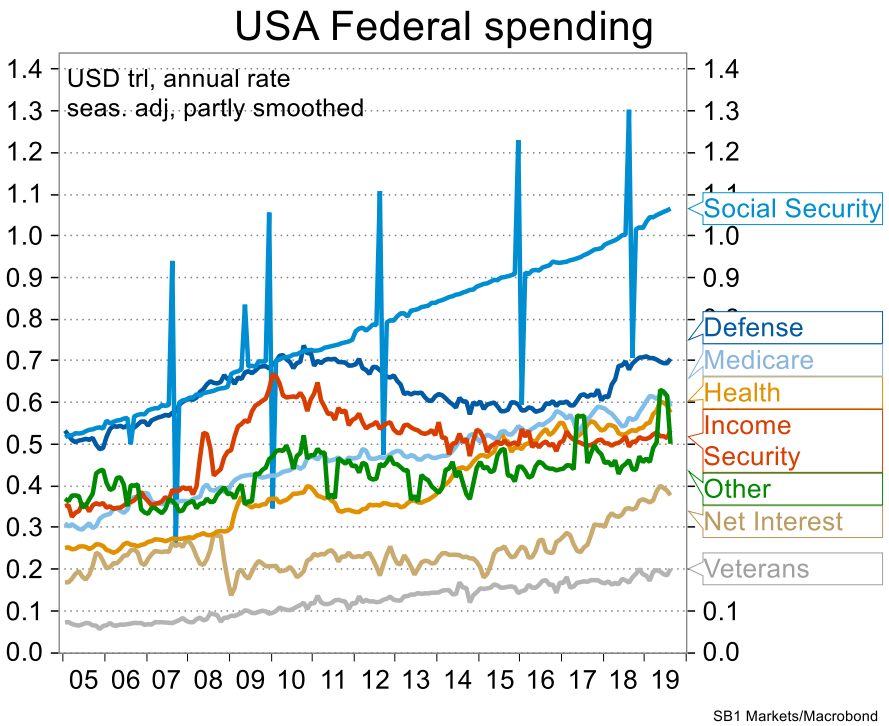


- The budget deficit fell to USD 1360 bn in annual rate in August (seas. adj), and the 6 m avg is at USD 1.050 bn. Including local government etc, the US was running full employment, peacetime deficit at 6.9% in Q1 (from 6.7% in Q4); totally unprecedented!
- Federal spending inched is up 5% y/y (smoothed), way 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 less than 17% of GPD, much lower than normal in a blooming economy – of course because taxes have been cut
- A divided Congress has agreed upon a modest further increase for the deficit in 2019 and 2020, but no more than some 0.2 pp of GDP (extra)

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

More money spent on… everything?



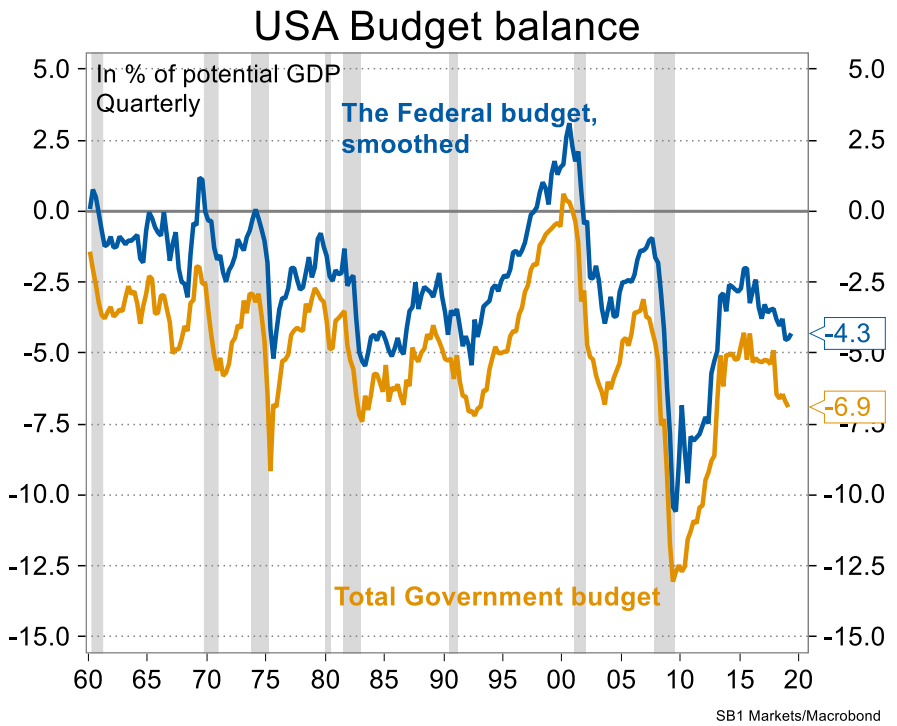


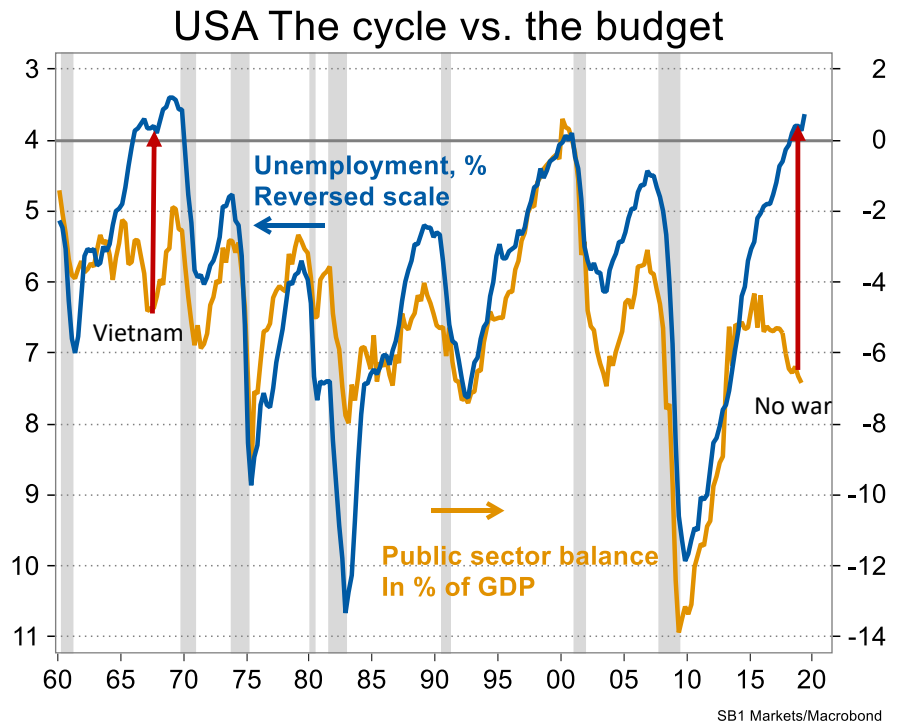
- The biggest spending changes the past year: medicare, health, net interest payments (highest ever, even if interest rates are rather low… but doesn't somebody propose to refinance the public debt, after Fed has brought (all?) interest rates down

SpareBank 1 MARKETS

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

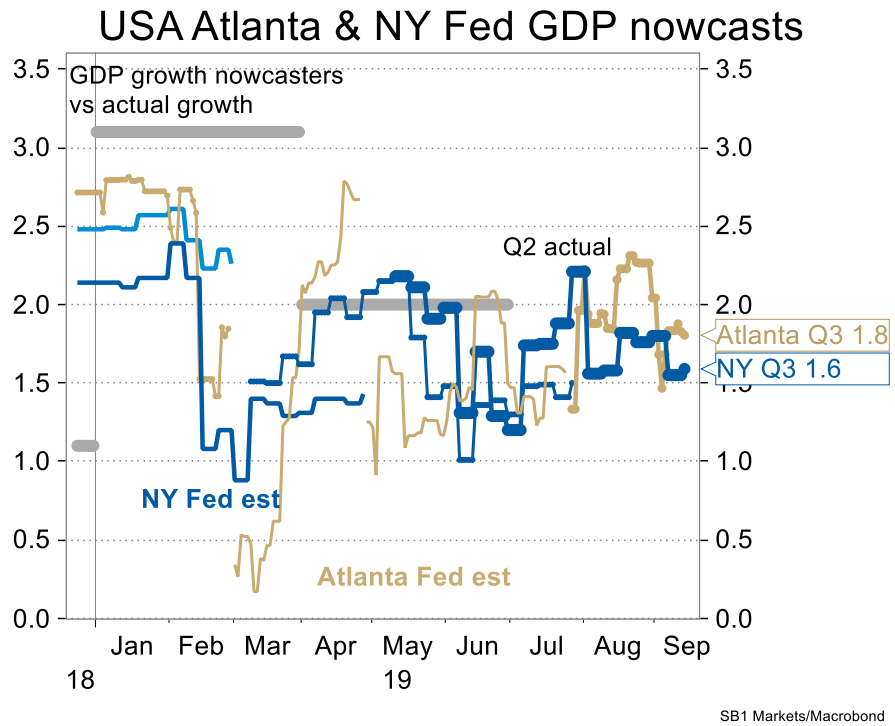


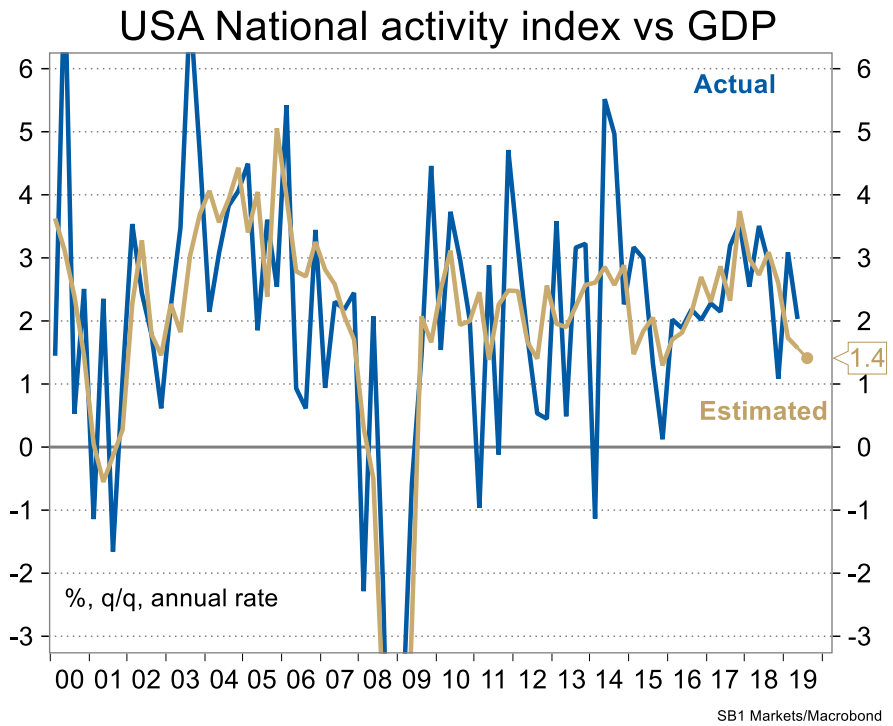


- The deficit has never been anywhere close to the present level in peace time when unemployment is as low as now – and it will most likely become even worse as all of the tax cuts and increased expenditures kick in
  - » We have not seen anything like this in the US or elsewhere before (except Greece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

Q3 GDP growth below 2%?

The nowcasters are noting 1.6-1.8% GDP growth in Q3, the National Activity index at 1.4%





- The decline in Atlanta Fed' GDP now Q3 growth forecast to 1.5% from 2.3% is mainly du to lower business investments but also weaker private consumption
- The National activity reports 1.4% GDP growth in Q3 vs the 2.1% in Q2 (However, the index was too downbeat, at 1.7%)

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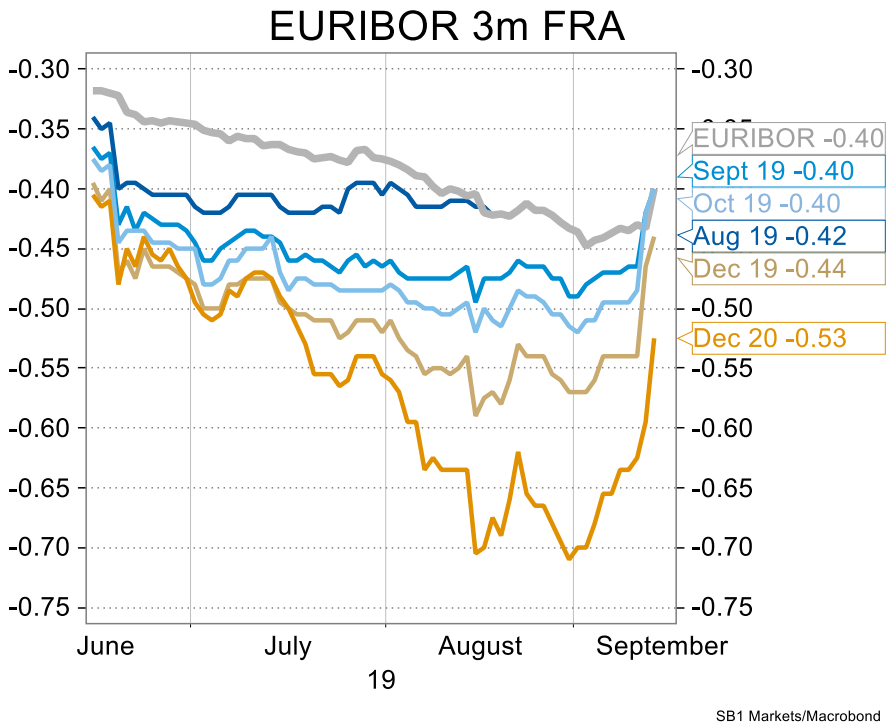
The ECB goes all in; 10 bps cut, introduces 'eternal QE', more bank support

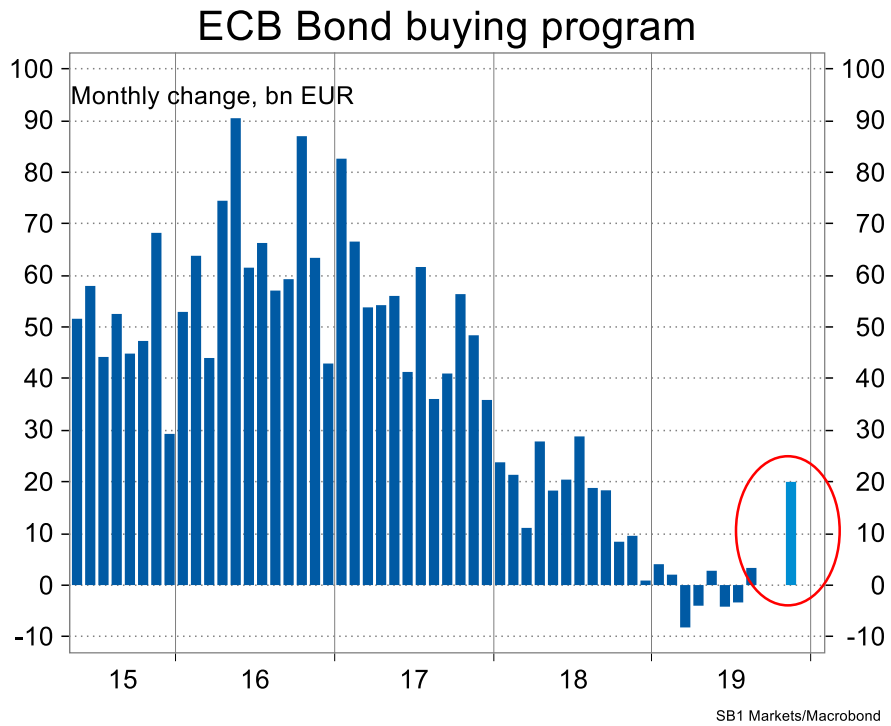
ECB delivered an extensive stimulus package, less QE than expected but no time limit

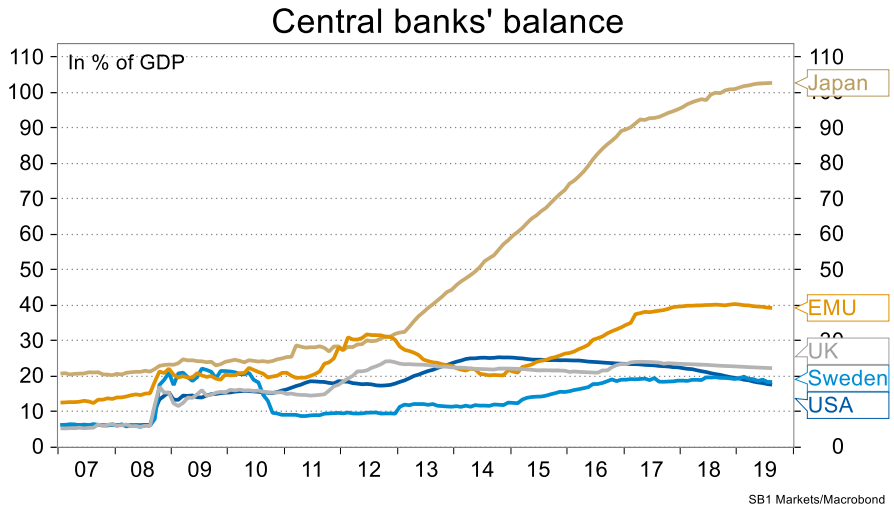


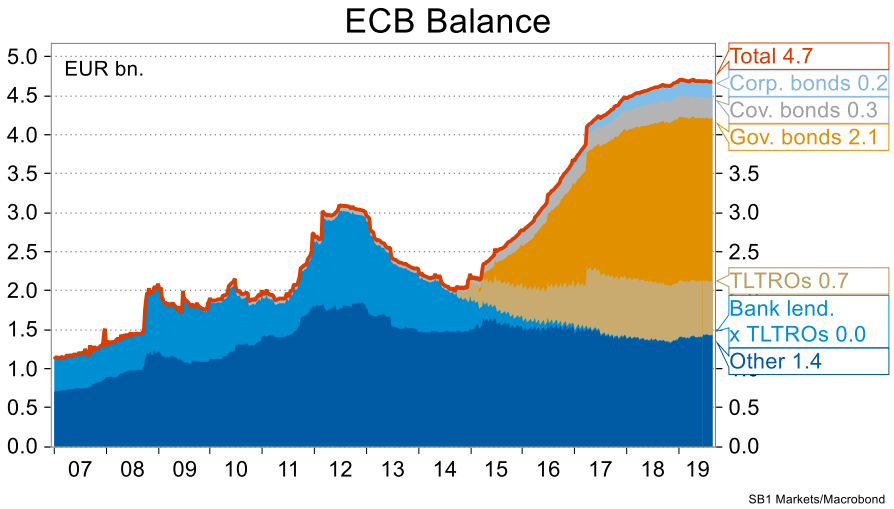
- The ECB's delivered a sweeping stimulus package but saves <u>some</u> ammunition (rightfully)
  - » The deposit rate cut by 10 bps to -0.5%, the market was even split between 10 or 20 bps. Moreover, the bank opened up for further rate cuts if the inflation outlook does not improve substantially. <u>The bank pledgedit will not hike before ECB's inflation f'cast approaches the below but close to 2% target</u>
  - » Asset purchases are reintroduced, at a monthly pace of EUR 20 bn (from Nov 1.). Less than expected (Bloomberg consensus 45 bn) but with <u>no fixed end date,</u> which was more aggressive than anticipated. <u>QE will continue until just before the first rate hike</u>
  - » In order to lessen the negative earnings impact for banks from the negative ECB deposit rate, parts of their holdings of excess liquidity will be sheltered from the negative rate (though with limited impact.) Moreover, changes were made to the TLTRO refinancing operation so that banks with loans exceeding a certain benchmark will be given an interest rate as low as the deposit rate, from +10 bps
  - » Several times during the press conference, Draghi urged for more expansionary fiscal policy measures (guess from which country!)
- The 2019 GDP f'cast was nudged down to 1.1%, from 1.2% in June, and the 2020 f'cast was lowered by 0.2 pp to 1.2%. The inflation outlook was held unchanged in 2019, 2020 revised down by 0.2 pp to 1.3%
- Volatile markets as the ECB package was digested; initially, EUR and interest rates slipped. The following hours, the mood changed and interest rates closed far above the pre-ECB levels, EUR 2 y swap up 7 bps. Because markets became concerned as to whether the ECB will add more stimulus? Positive trade war developments probably helped too, interest rates spiked all over

ECB reintroduces QE for as 'long as necessary', until ECB's infl. f'cast reach target

The EUR 20 bn per month was somewhat below expectations, however, the ECB sets no time limit



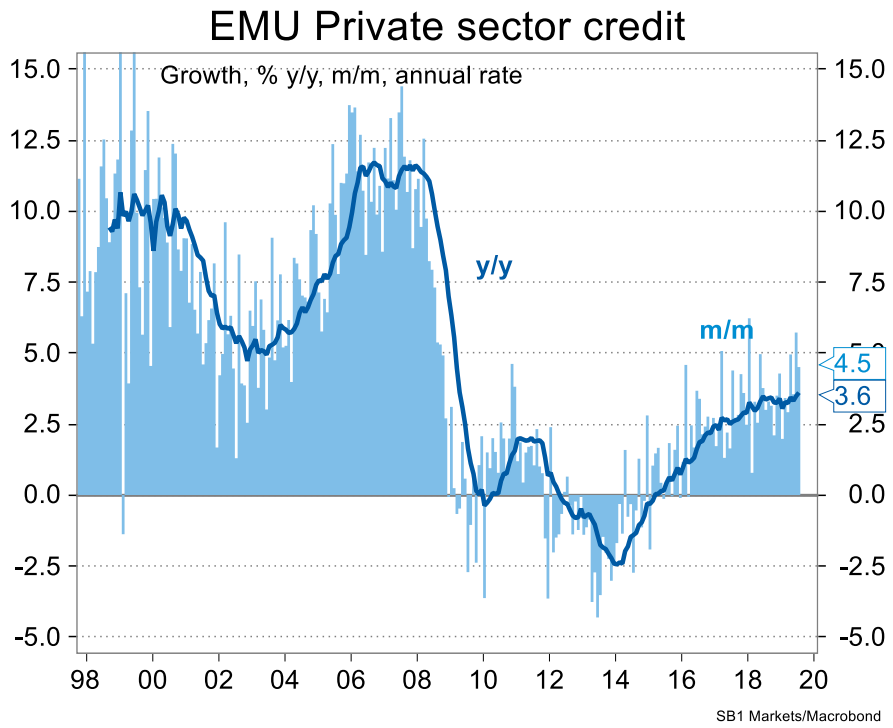


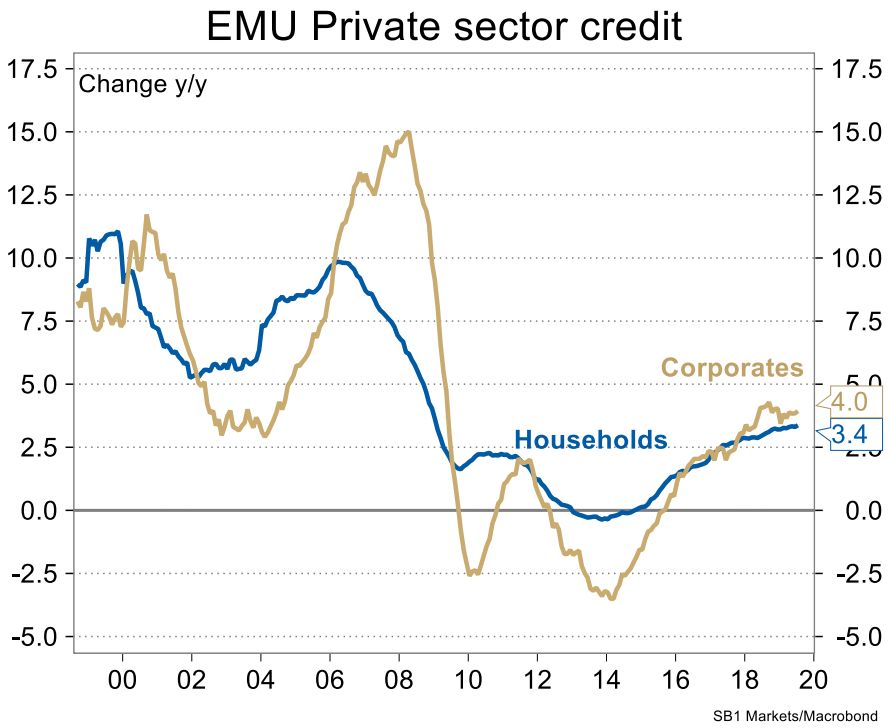


- An EUR 20 bn QE equals just 2% of GDP, and if nominal GDP increases 2% per year, ECB's QE holdings will be flat vs. GDP. A modest QE, compared to the 3 times larger buying program in 2016. A compromise??
- At the press conference, Draghi noted that the ECB has the headroom to prolong the asset purchases for 'quite a long time' without approaching the limits of holdings av government bonds (1/3 of total). However, this limit is self imposed, and may be lifted

What's the (credit) problem?

Credit is flowing just the way it should, it seems like – and definitely no signs of contraction

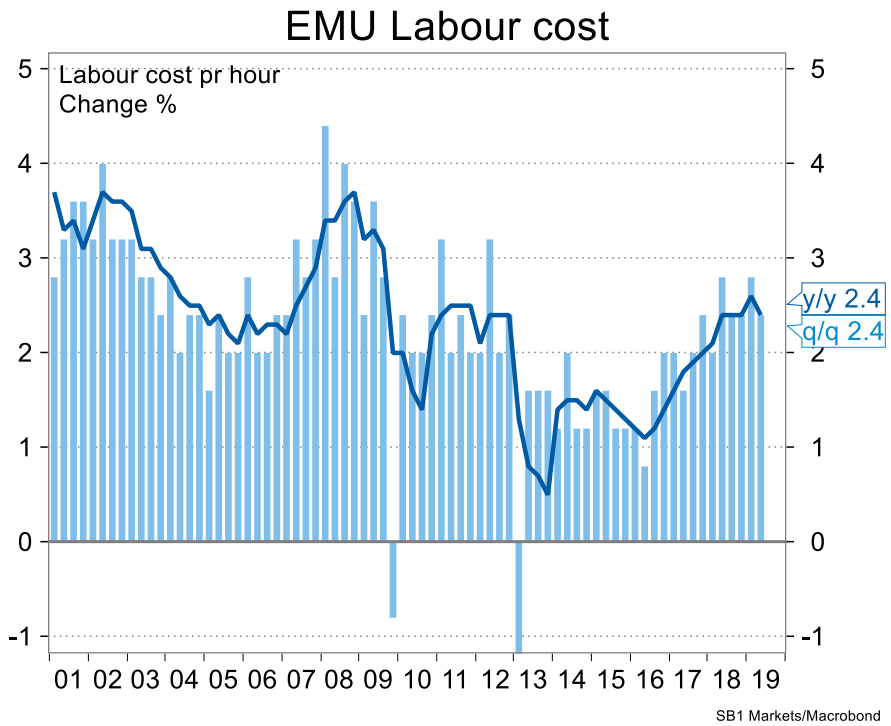


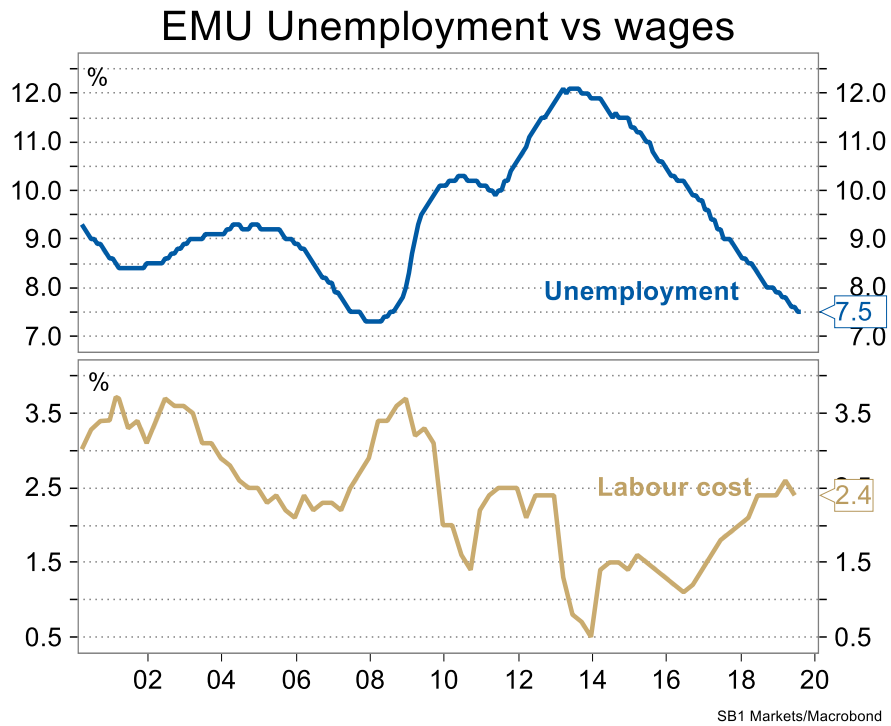


- No doubt, growth has slowed in the Euro area but is the economy in really bad shape?

Wage inflation cooled in Q2, trending up

Labour cost eased to 2.4% y/y in Q2, from 2.6% in Q1, even as unemployment is declining

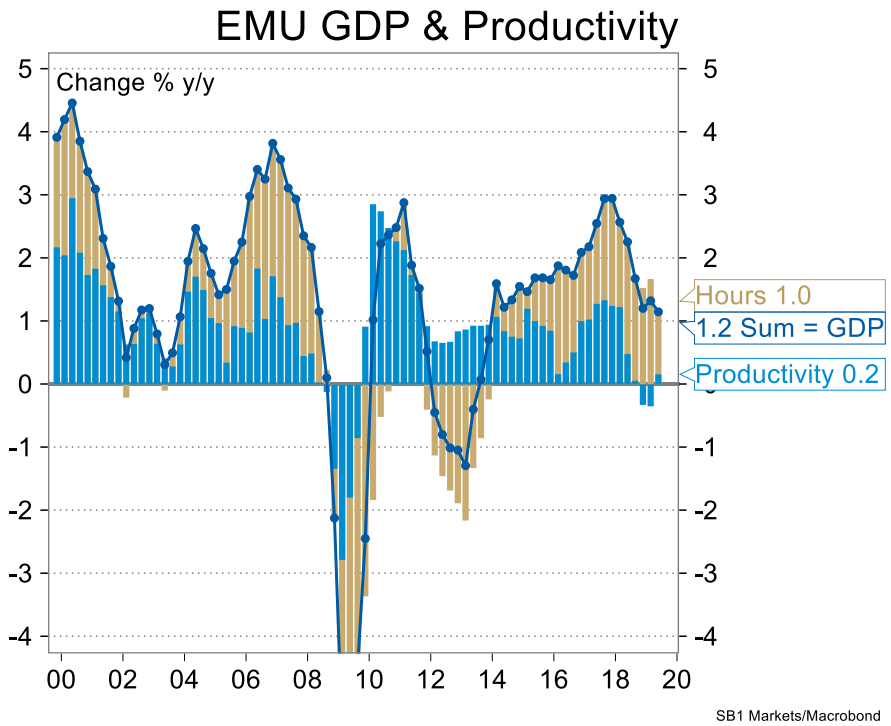


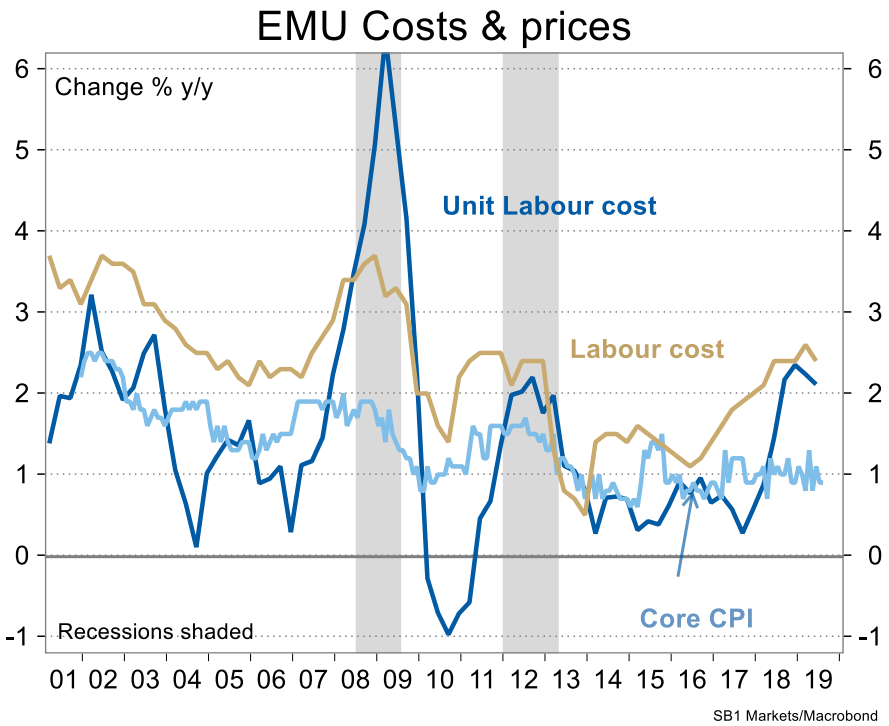


- Wage inflation slowed to 2.4% y/y in Q2, thus, flattening out the past year, after a steady upturn. Growth q/q annualised fell to 2.4% as well, from 2.8% in Q1
  - » Unemployment is still sliding steadily down and the level is not high anymore. The strengthening labour market stands in contradiction to the loss of momentum in the EMU economy, particularly within manufacturing, however, it is probably a lagging indicator
  - » In spite the Q2 slowdown, wage inflation is trending up and will have to to translate into higher CPI inflation at one point?
  - » No Q2 country details are published yet

Unit labour cost inflation above 2%, productivity stalls

ULC at 2.1% and muted productivity growth, not great arguments for expansionary monetary policy





- Total economy productivity rose 0.2% y/y in Q2 and the 1 year average is below zero! Hours worked up 1.0% - and GDP 1.2%
- Unit labour costs (wage costs per unit) are on the way up, as labour costs rise and productivity is slowing. In the total economy, Unit Labour Cost rose 2.1%, much higher than over the previous 4 years (the 2.4 hourly labour cost inflation refers to the business sector, not the total economy)
- Unit labour cost inflation is above ECB's CPI inflation target at close to but below 2%. However, the ECB will not raise interest rates or end the newly announced QE as long as core CPI inflation remains subdued (it is now running at 1%)

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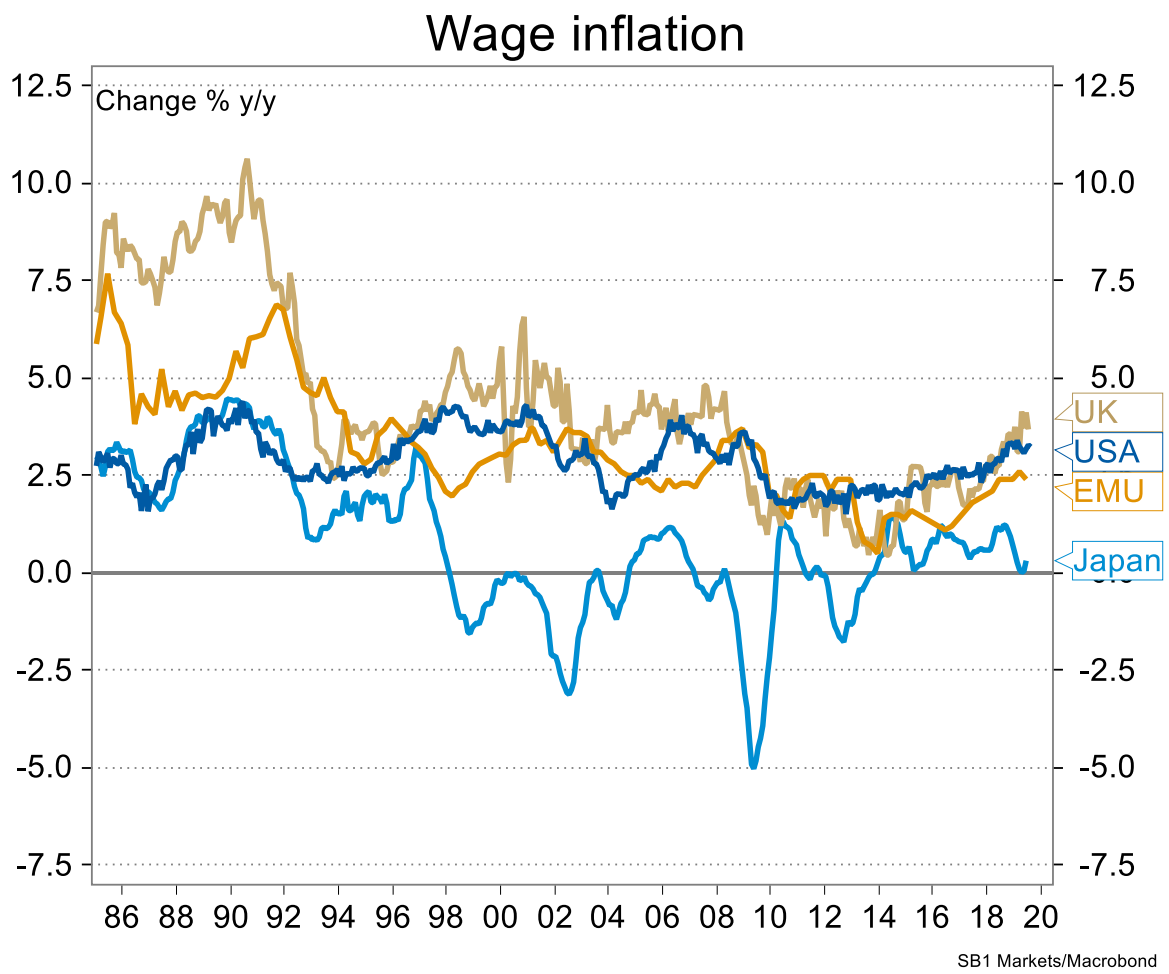
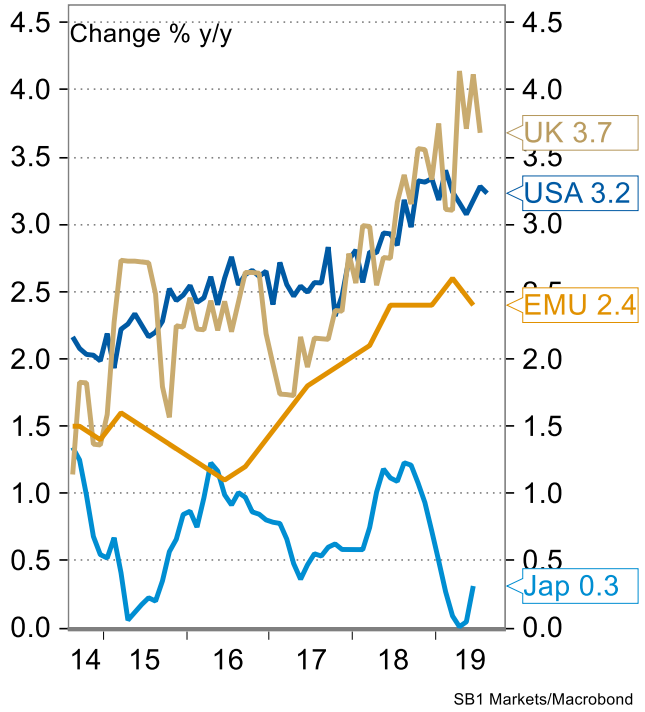
Wage inflation is heading slowly up most places, ex Japan

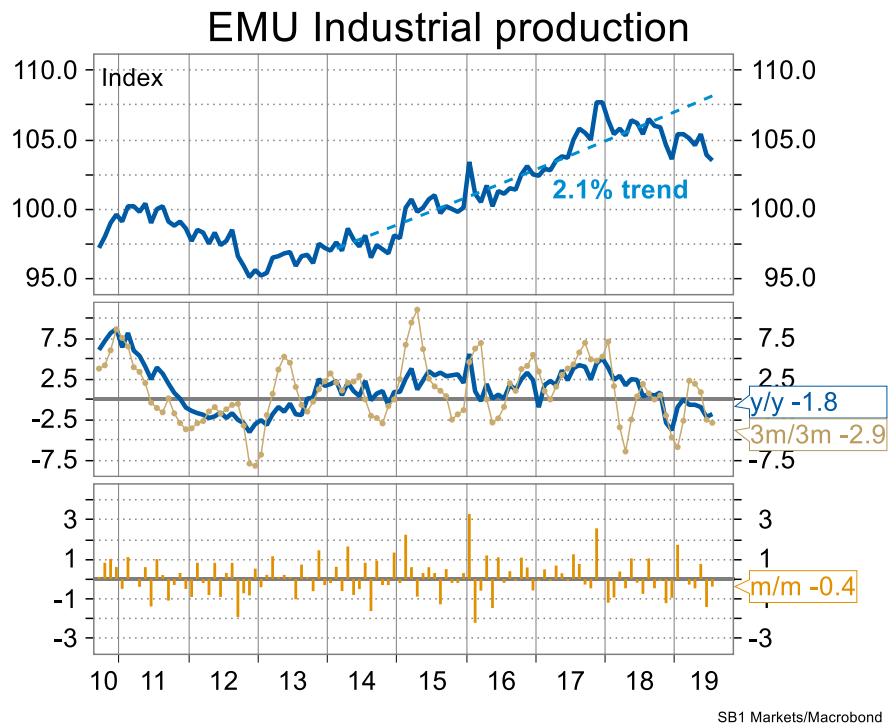
Productivity growth is slow everywhere and cost inflation is rising

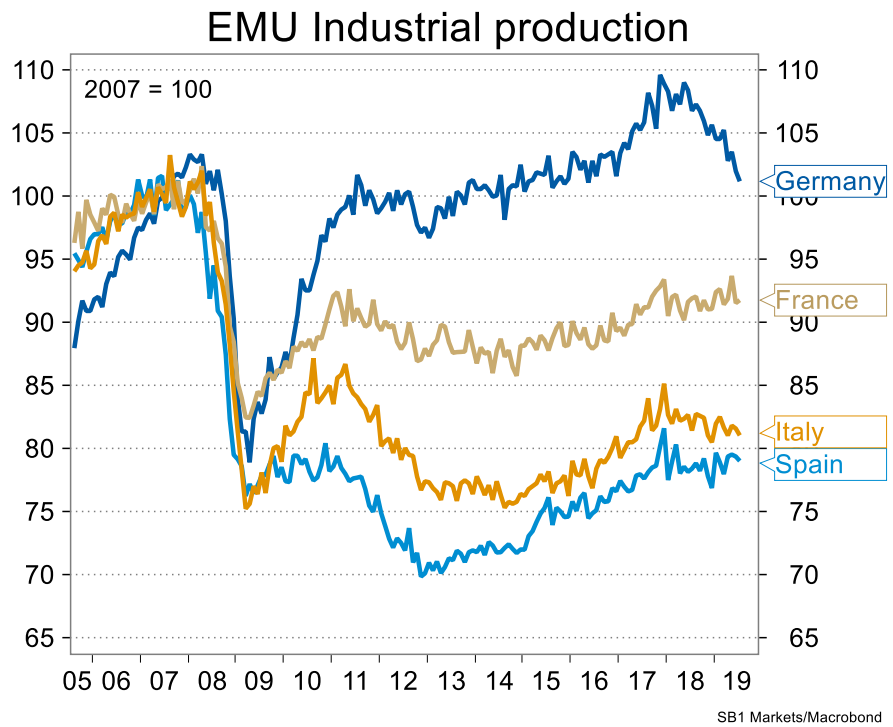




Industrial production slides down, led by Germany

Production fell 0.4% m/m in July, Germany down 5.6% y/y, France flat, Spain still heading slowly up

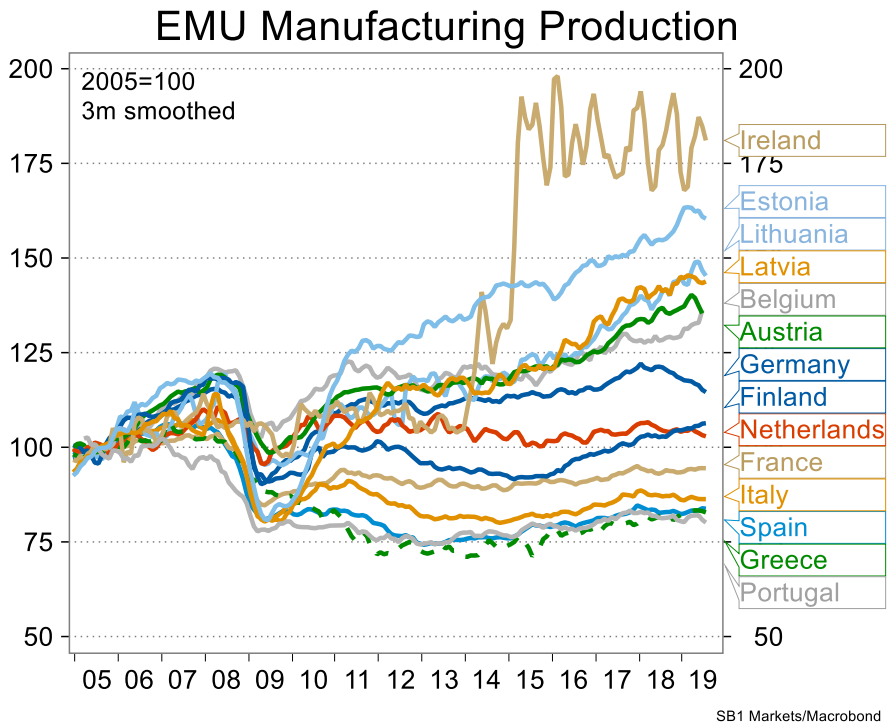


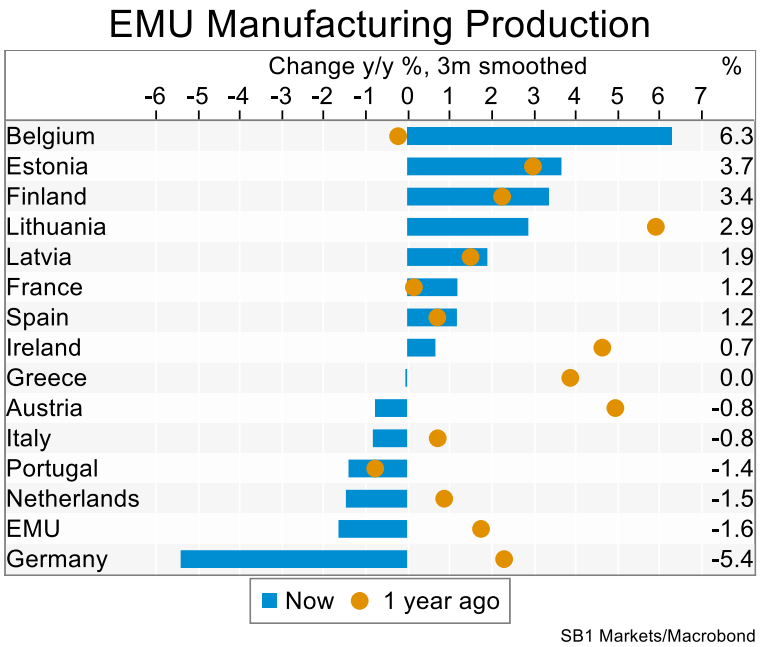


- Industrial production in the Eurozone declined by 0.4% in July, a tad more than expected, following a steep drop in June. Over the last year production has fallen 1.8% and is down 3.9% from the late 2017 peak
  - » Germany is plummeting; down 5.6% y/y (smoothed), and by 7.7% from the peak
  - » France has stagnated but is not declining, and Spain is still heading slowly up. Italy trending down, at a softer pace than Germany
- <u>The manufacturing PMI and orders remain in the doldrums, no signs of recovery</u>

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

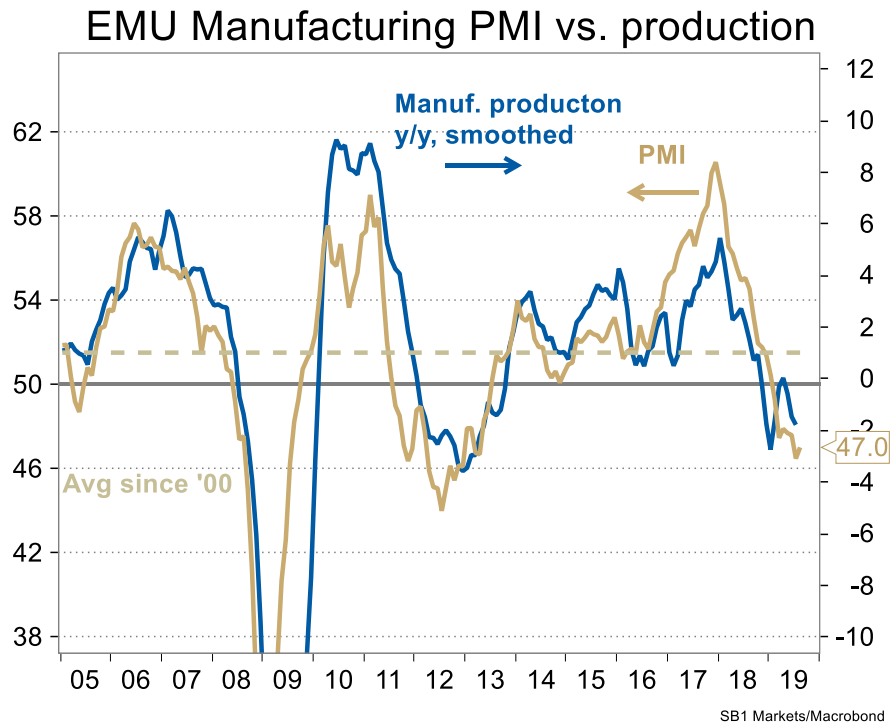
Production is falling in Germany, Netherlands, Portugal, Italy and Austria

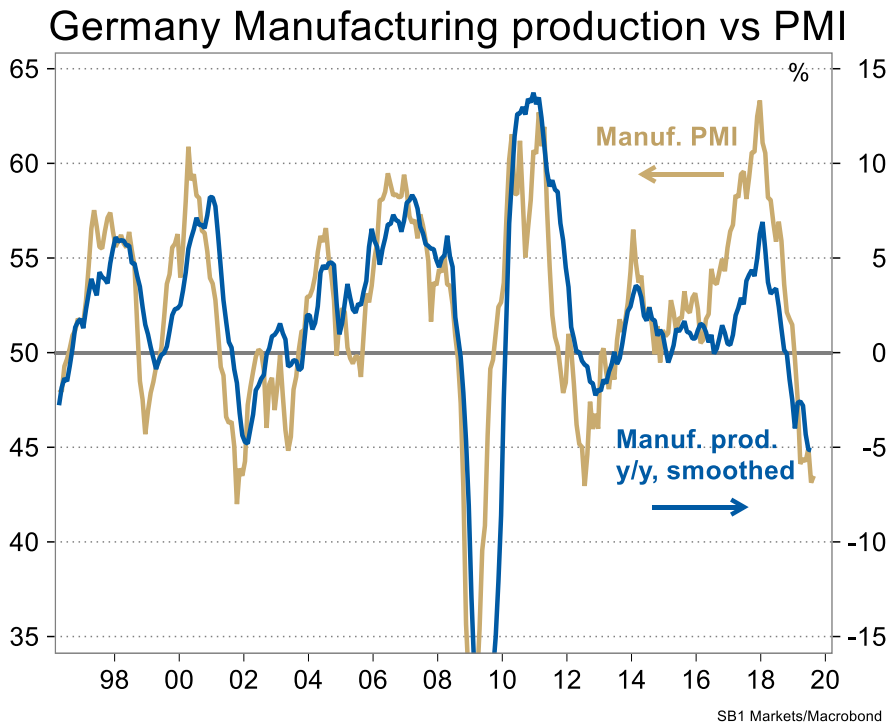




The PMIs told you so…

.. and the outlook is not bright, the PMIs are reporting a deterioration, at least in Germany

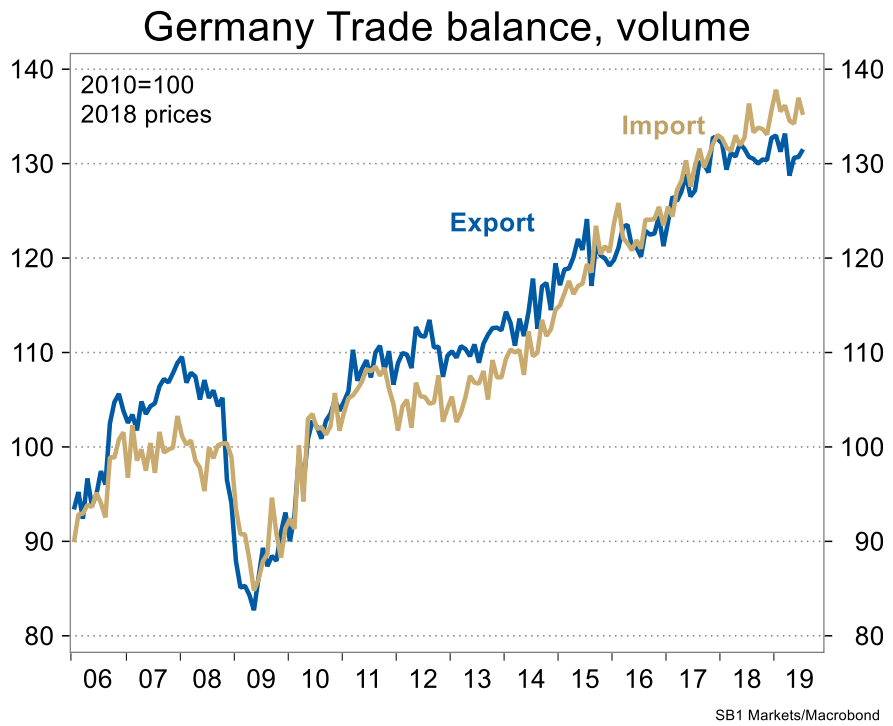


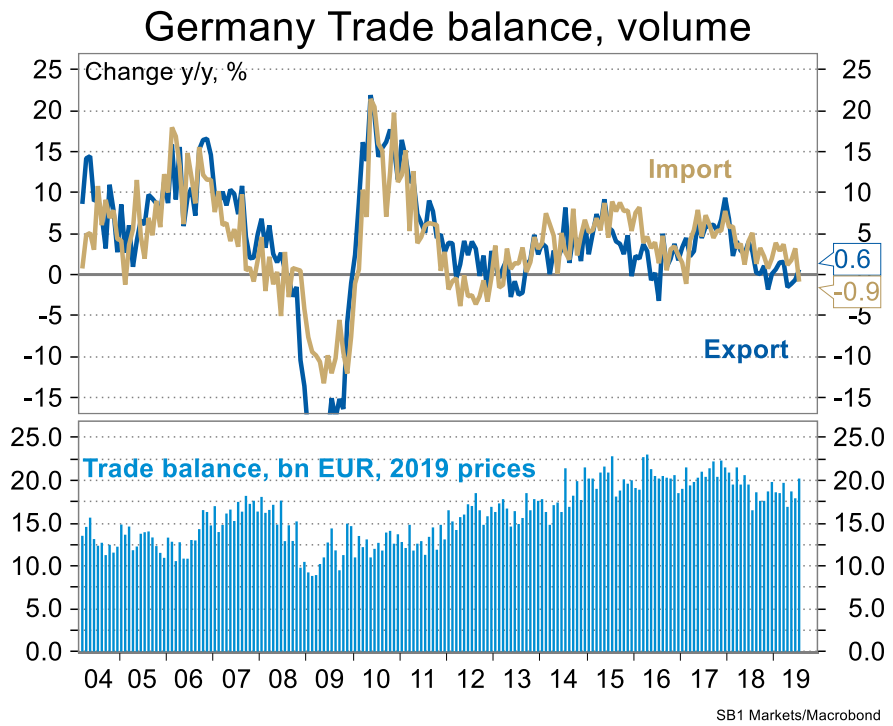


SpareBank 1 MARKETS

Both exports and imports have stalled but no disaster

Exports explain some of the weakness in German manufacturing, not all. Imports are not that weak

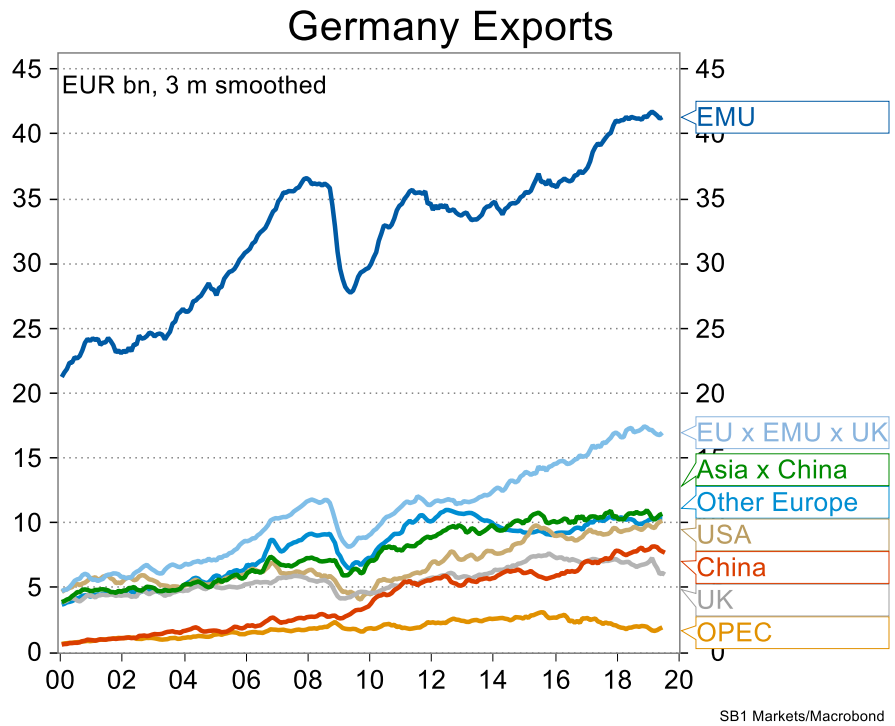


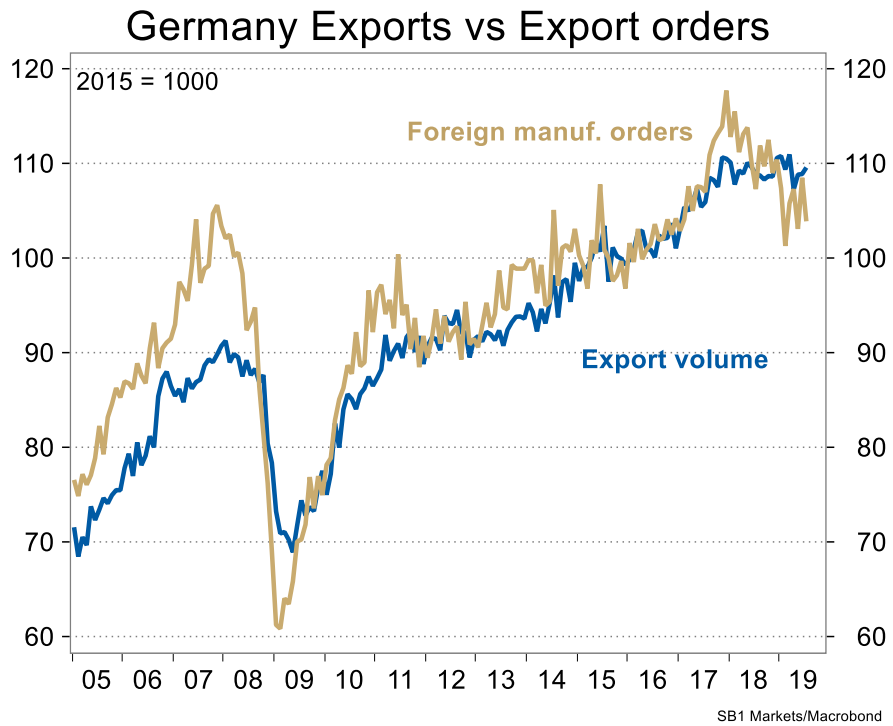


- Export volumes increased in July and are marginally up y/y, up 0.6%. Exports have stagnated, however, holding up much better than manufacturing production and the PMIs have been indicating (flip to this slide for more)
  - » Exports to China have flattened out. Exports to the UK are falling sharply, Brexit to blame. Some weakness in exports to other EU countries, US still on the way up
  - » Export orders may have stabilised following a substantial downturn but are probably signalling weaker exports
- Import volumes slipped in July and are down 0.9% y/y. Still, imports are not far below a medium term trend
- The German trade surplus widened in July but is slowly shrinking, and now equals approx 6% of GDP, from 8% in 2016

Exports have slowed in most directions, US still heading up

It cannot be just exports that have halted the German manufacturing sector





- Most likely, exports are weakening due to a global retreat in business investments, triggered by trade war/Brexit uncertainties and probably also a 'normal' mature cycle
  - » Exports to China have slowed the past 3 months and are down 1.2% y/y, vs above 8% growth in April
  - » Exports to UK have fallen rapidly since the spring, as businesses there are cutting back purchases after a huge stockpiling ahead of the prior Brexit deadline. Exports to the US is still trending up. Exports to other EMU partners have slowed, as have exports to other EU countries
  - » Germany's main export markets: The other EMU countries (37%), other EU countries x UK (15%), Asia x China (10%), Europe x EU (10%), USA (9%), China (7%), UK (6%)

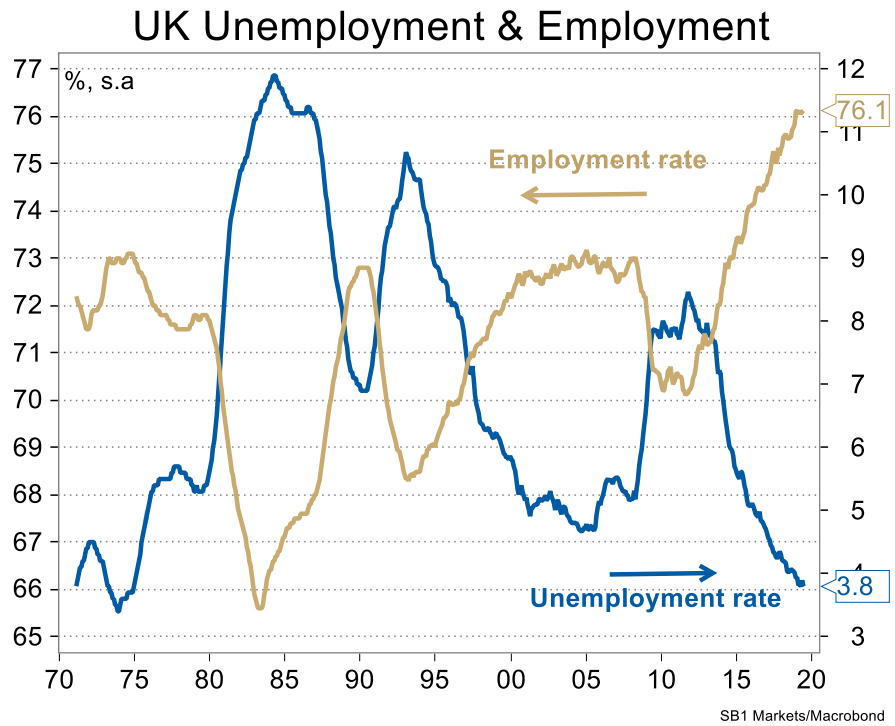
Guess what, German trade is closely correlated to…

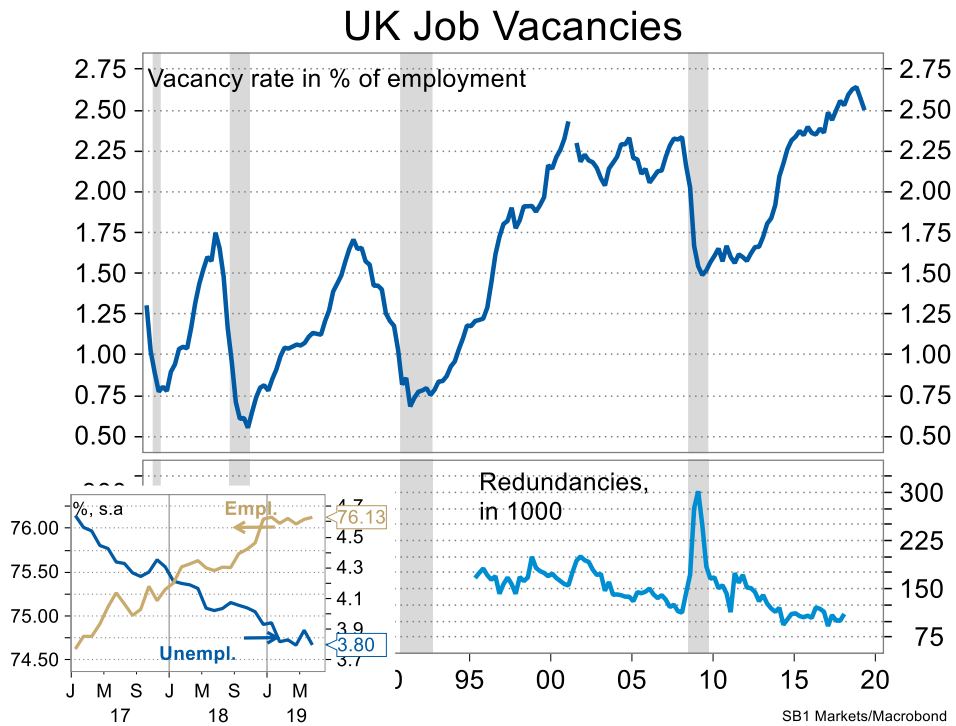
.. global trade. Now, both have stagnated due to trade war/Brexit uncertainties and a mature cycle

- Both German and global trade are highly correlated to German industrial production. It cannot be just exports that have halted the German manufacturing sector, as manufacturing production has fallen much more than trade (which is not that unusual). This implies that domestic demand must have fallen more than foreign (or some inventories are emptied or imports have taken a larger market share). Given signals from PMIs/other surveys, a near term production recovery is not likely

Unemployment still heading down, employment flattening out. 3.8% wage infl.

Employment growth has slowed to below population growth, fewer vacancies (but still many)

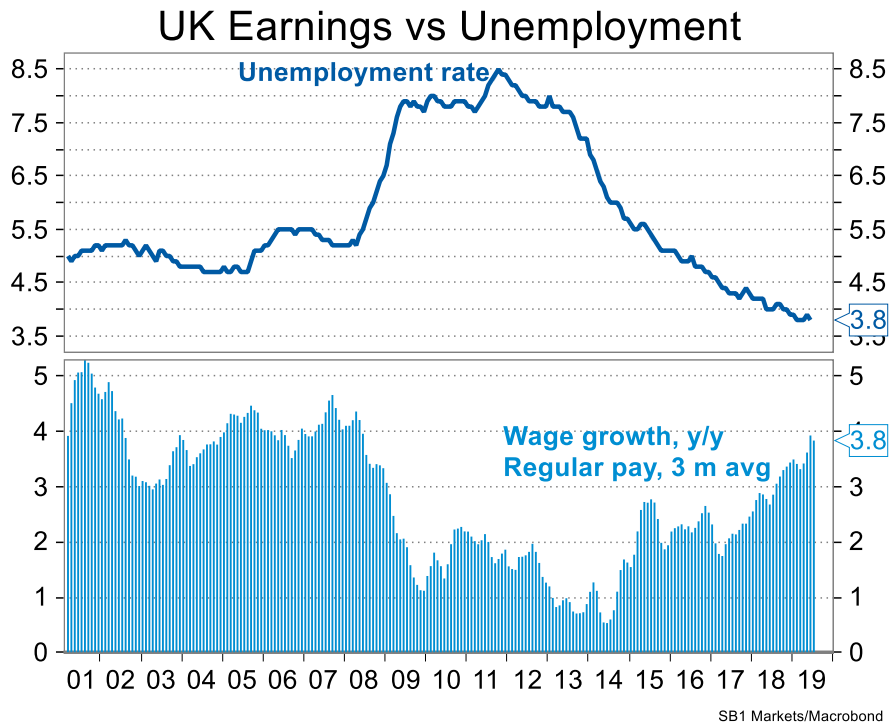


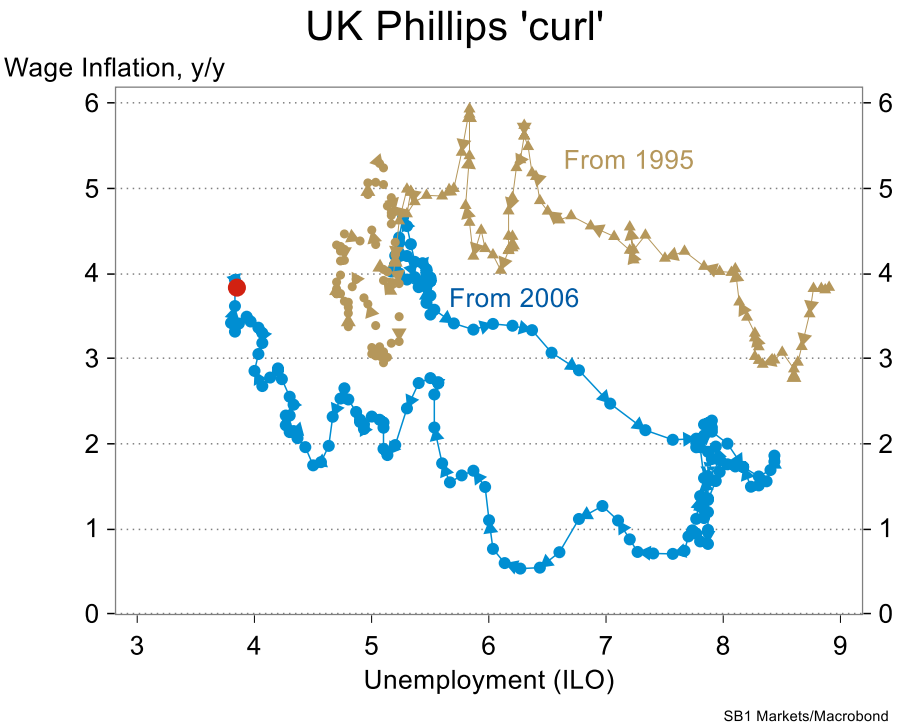


- Unemployment (LFS/ILO) fell to 3.8% in June (avg May-July), to the April level – both the lowest since 1974!
- The employment rate was unchanged at 76.1%. The rate has flattened out since January, due to supply constraints or lack of demand? The vacancy ratio is just marginally down from a record high level. Wage inflation is approaching 4% (check next page). In sum: The employment rate flattening out due to supply constraints?

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

The Phillips curve is not dead, it has just moved somewhat to the left? Rapid wage acceleration now



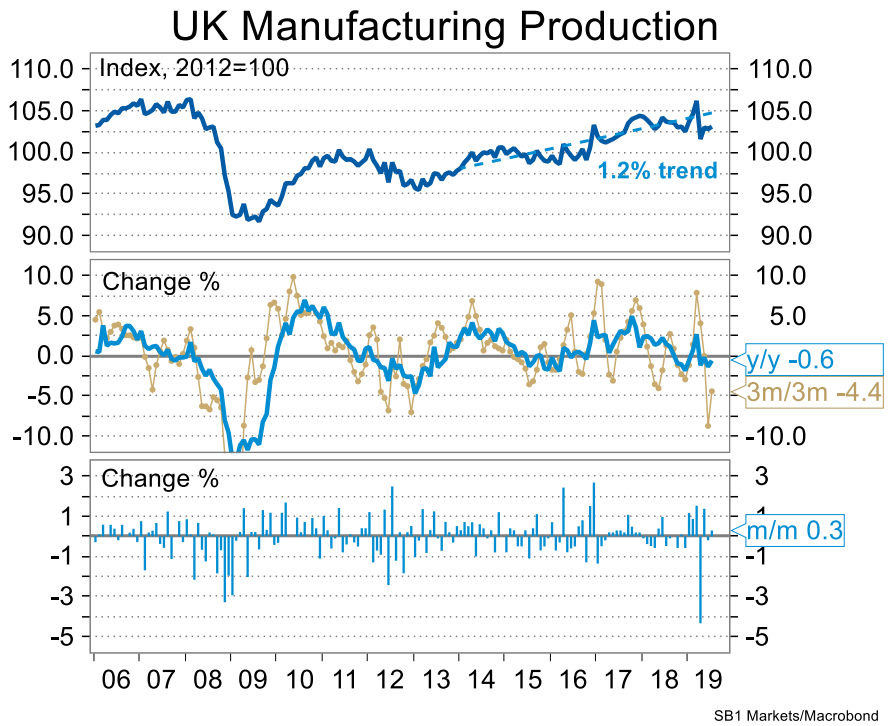


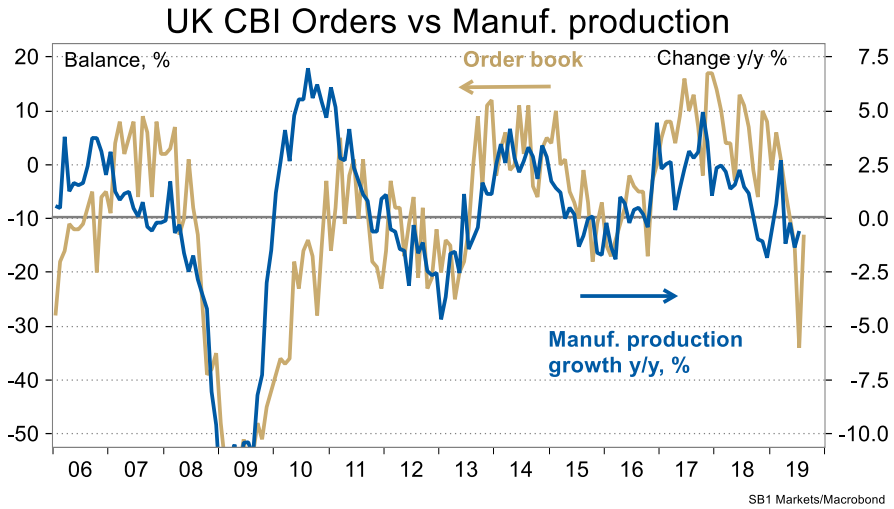
- Wage growth (regular pay) eased marginally to 3.8% y/y in July (regular pay), measured by the 3 m average. Wage inflation is heading straight up, to an 11 year high in June
- UK productivity growth is still well below 1%, and unit labour cost inflation is running far above the inflation target. Either will inflation become too high or corporate profits will take a hit

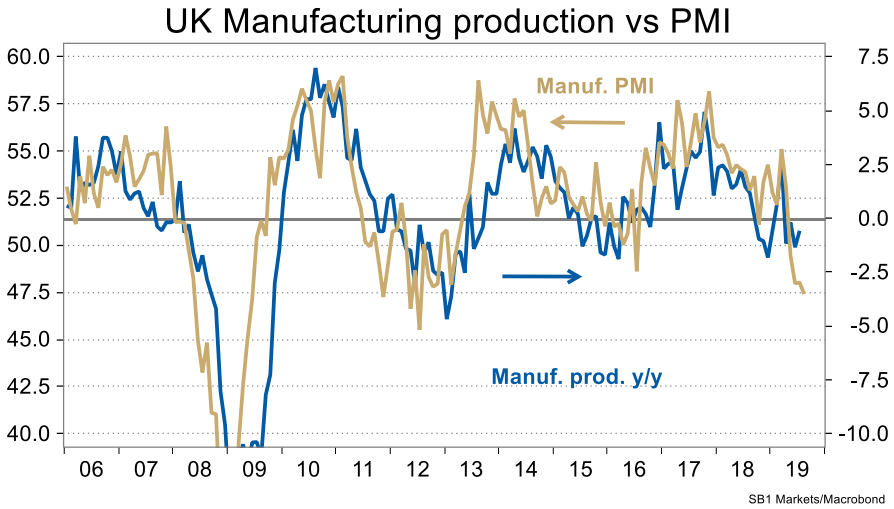
SpareBank 1 MARKETS

Manufacturing production has cooled, more downside risk?

Production rose 0.3% in July, heading slowly downwards. PMI, order book signal a larger decline



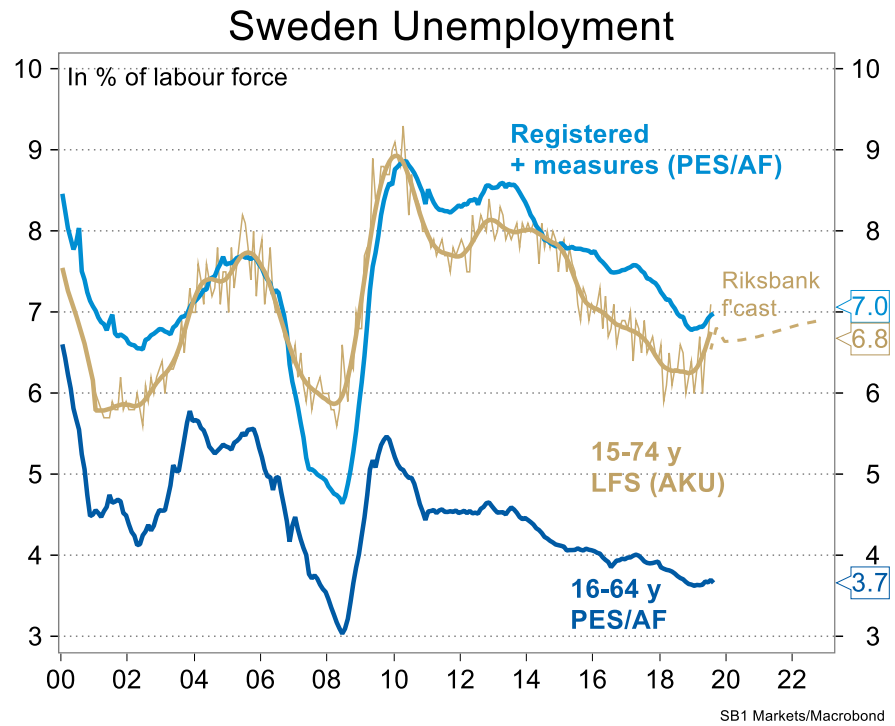


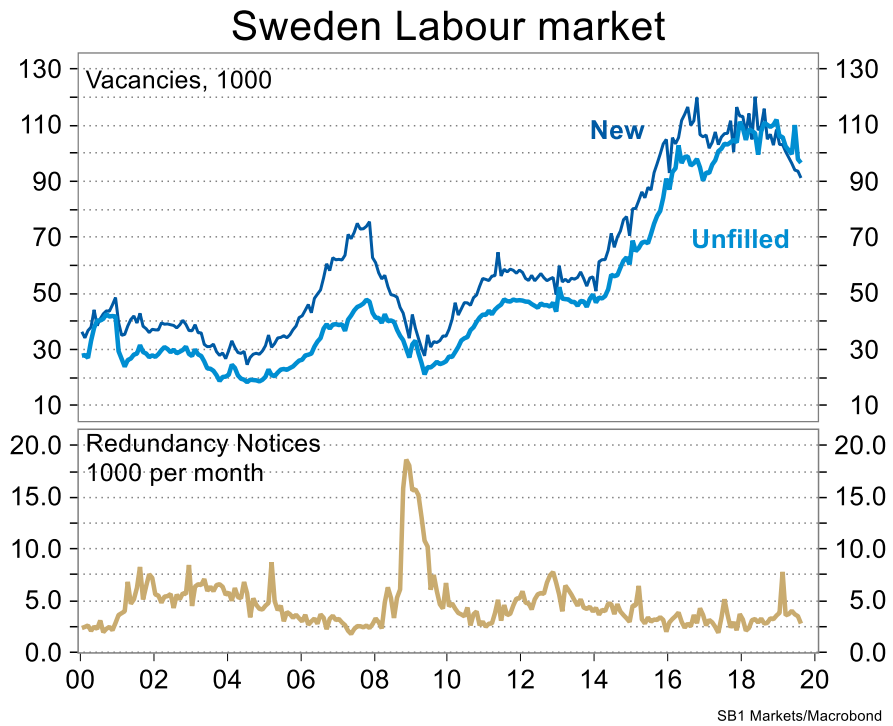


- Production was 'artificially' high in March, before the previously assumed Brexit date, March 30. Inventories were build sharply up before the deadline, and this effect has later been set in reverse. Inventories are being trimmed and orders are cut
- All activity surveys have turned south recently, the production outlook is bleak

Is the labour market souring? Probably.

Total AF unemployment unch at 7% in Aug, up 0.2 pp from the bottom – and LFS is up 0.5 pp



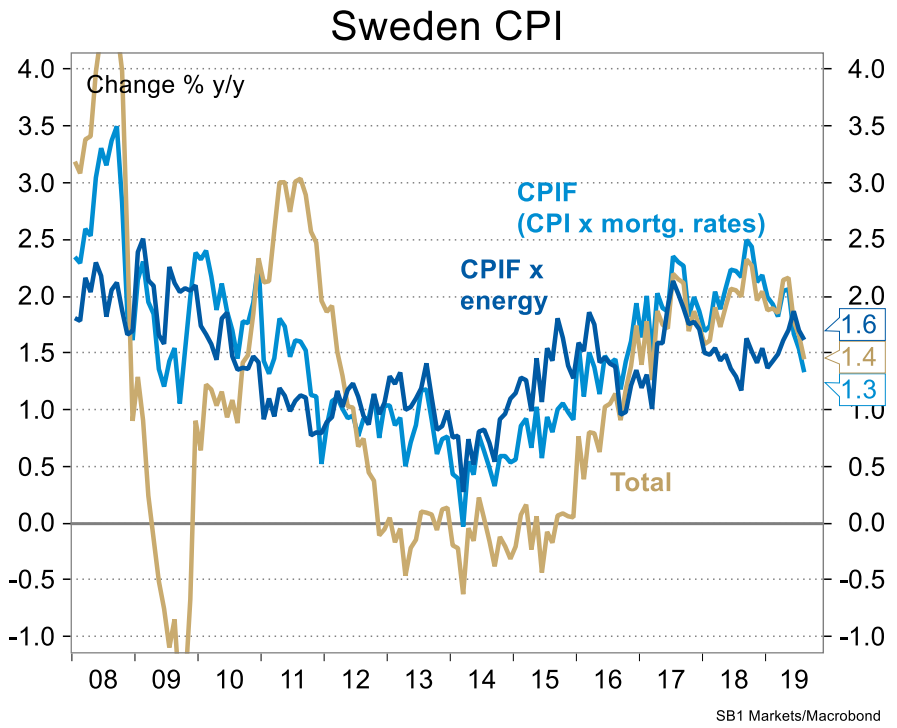


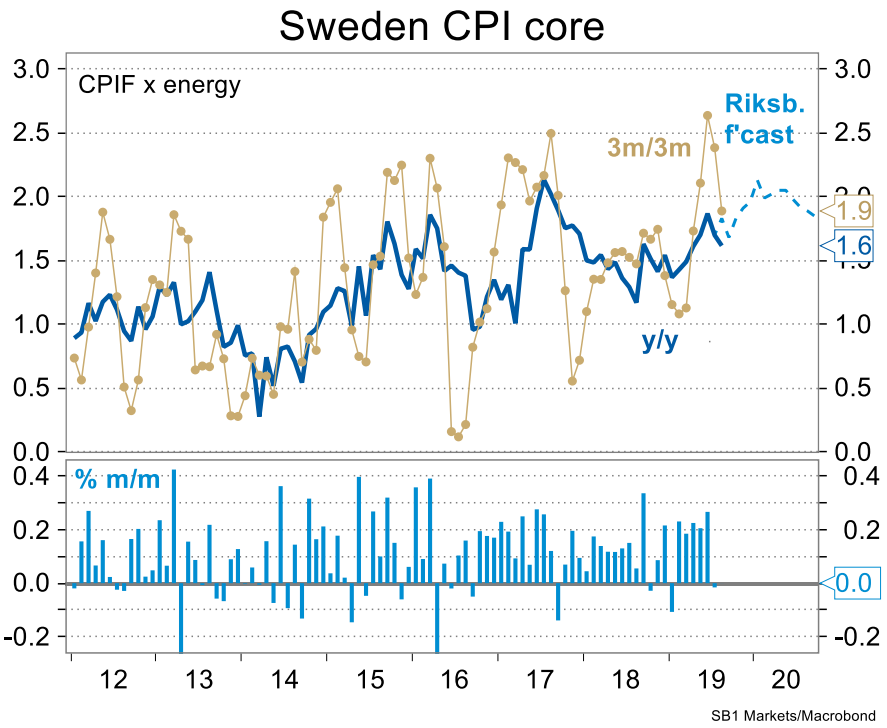
- PES/AF (registered open + labour market measures) unemployment rate held steady at 7.0% in Aug (3.7% x measures). The PES rate has turned marginally up recent months data, signalling a less tight labour market
- The LFS unempl. rate has increased for 3 straight month (1.1 pp, smoothed to 6.8% in July, from 6.3% early 2019). Employment is softening rapidly, the annual rate has turned negative (-0.8%), something must be brewing
- The number of unfilled vacancies inched down in Aug, as did new vacancies continued downwards. We assume the trend is down for both, but levels are still very high. On the other hand, the number of redundancies fell in Aug and is trending flat

SpareBank 1 MARKETS

Core inflation missed expectations once again in August

Core CPIF fell 0.1 pp to 1.6%, expected up 0.1 pp. pp to 1.8%. Total CPIF inflation down to 1.3%



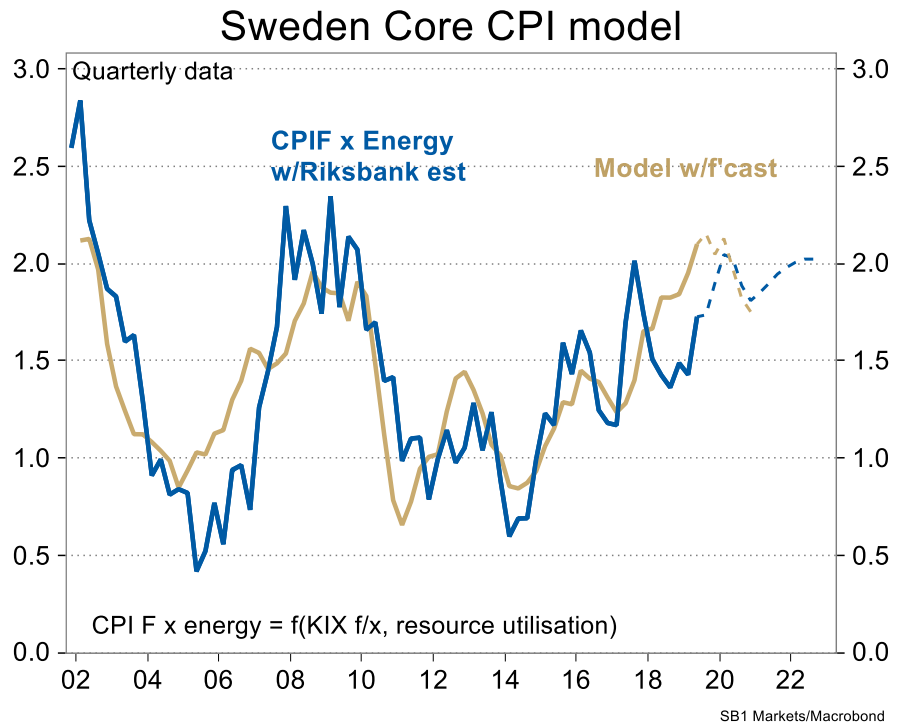


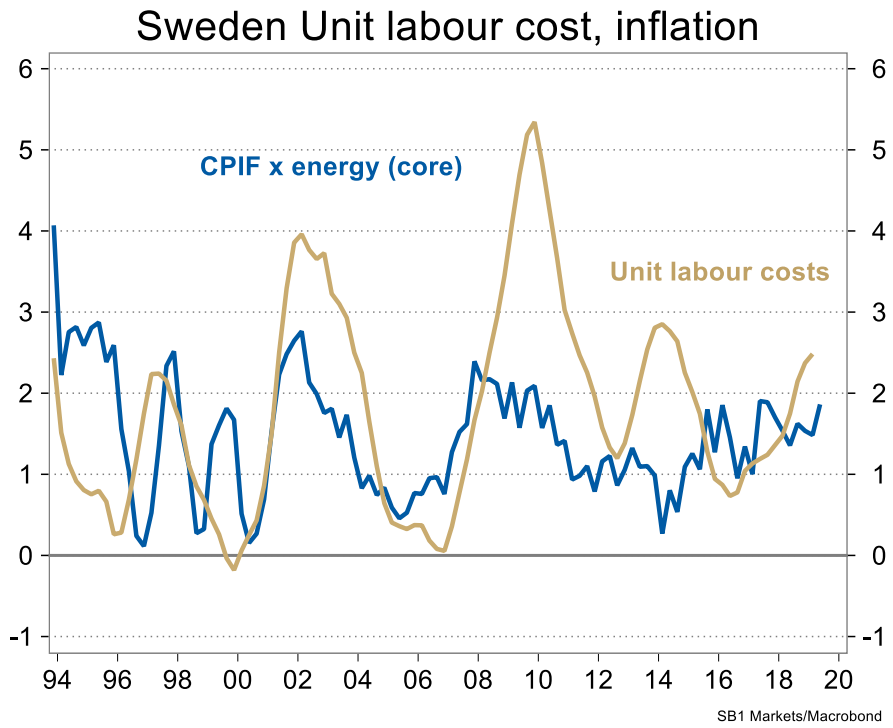
- The 'real' core (CPIF ex energy) was unch m/m for the second month in a row. The annual rate inched down to 1.6%, 0.2 pp above consensus f'casts and the Riksbank's estimate. Core inflation has moved upwards over the past year and measured 3m/3m, the rate is higher, at 1.9%
  - » CPIF (ex mortgage rates) fell 0.2 pp to 1.3% y/y - due to lower energy prices
  - » Our simple inflation model signals above 2% core inflation. Domestic cost inflation is accelerating due to falling productivity
- At the September meeting, the Riksbank surprised markets by sticking to its plans to hike interest rates in Q4 '19 or Q2 '20 (which the market does not believe at all). The SEK depreciated some 0.3% after the soft inflation report

SpareBank 1 MARKETS

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, up just 0.1 y/y in Q2 and unit labour costs were up 2.5% y/y (volatile data). The cost pressure is not low at all!
- The Riksbank expects inflation to accelerate this winter/spring and peak at approx. 2% early 2020

Highlights

The world around us

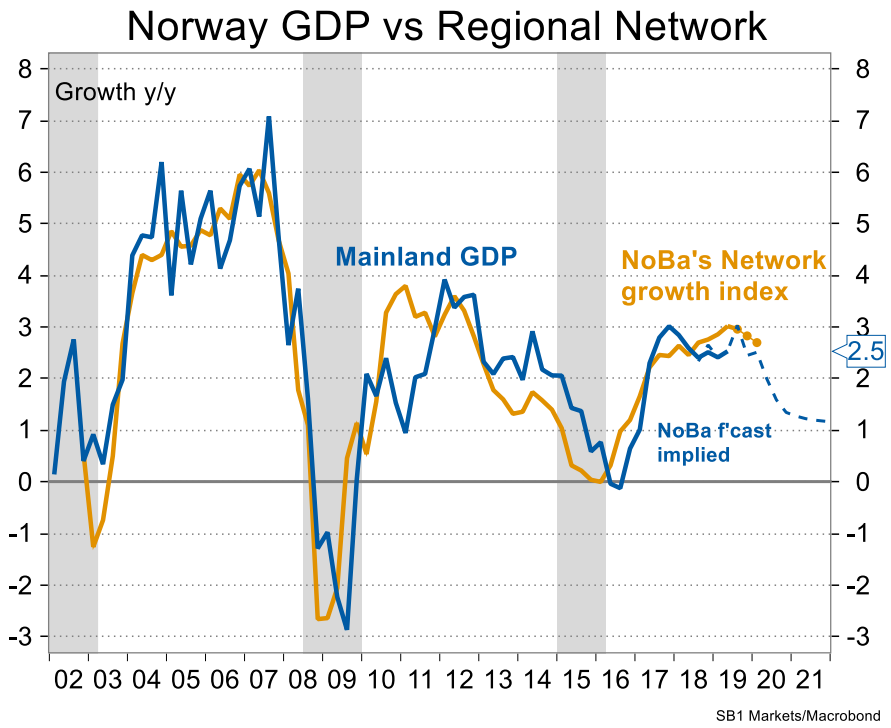
The Norwegian economy

Market charts & comments

SpareBank 1 MARKETS

Norges Bank's Network confirms strong growth, NoBa have to revise its f'cast up?

Reported growth stable at 3%, expected growth down to 2.7% from 3.1% - but that's not slow!

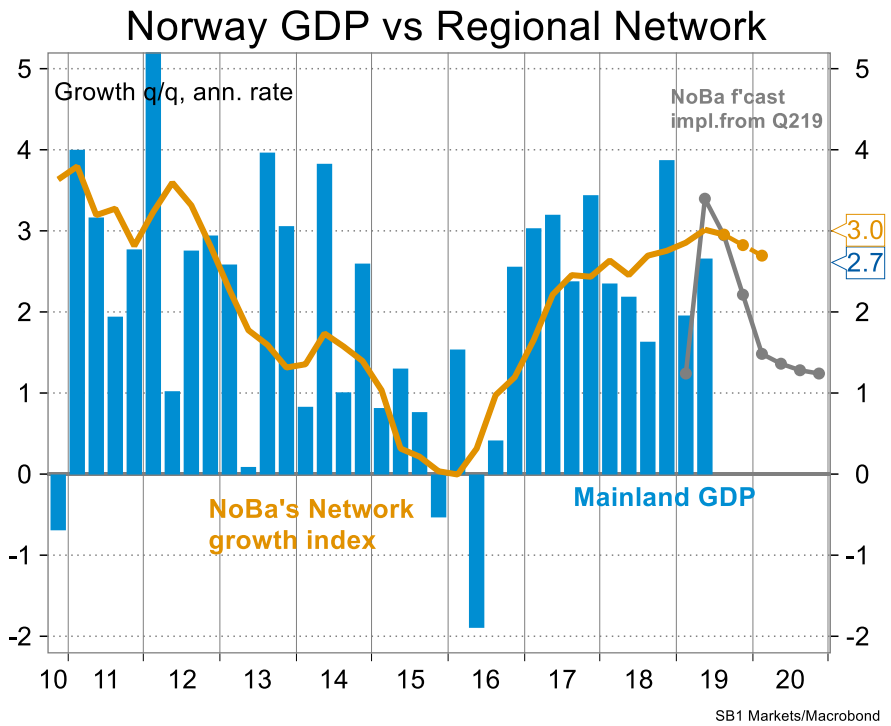


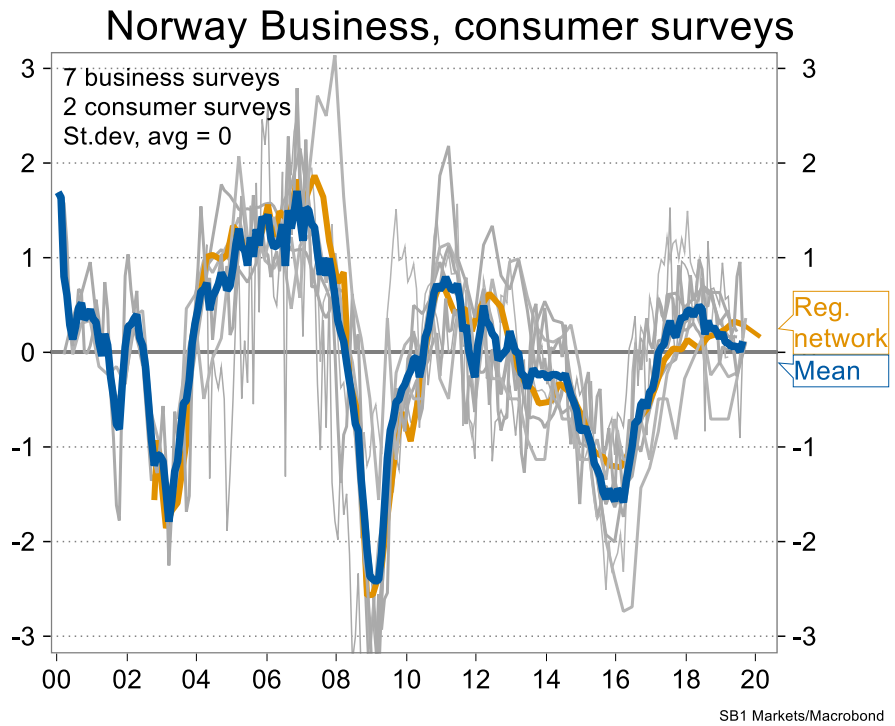
Summary of the Q3 report

- **Growth**
  - » Norges Bank's Regional Network reports 3.0% growth the past 3 months, the same pace as in the Q2 survey and in line with Norges Bank's Q3 forecast
  - » Businesses expect 2.7% growth the coming 6 months, spot on our f'cast. This is 0.4 pp softer than in the Q2 survey but far above Norges Bank's Q4 2.2% and Q1 1.5% estimates (our calc, and further down through '20). Most likely, the Bank will have to nudge up its 2020 growth f'cast (which also is below SSB's and consensus)
- **Capacity utilisation/investments**
  - » The Network reports marginally higher capacity constraints, above Norges Bank's f'cast. Capacity utilisation is slightly higher than at the 2012 peak. Still, the share of businesses reporting labour shortages did not increase and remains low vs the unemployment rate
  - » Businesses expect slower employment growth, still above 1% (and faster than working age popul. Growth
  - » 2019 wage exp. were nudged down marginally to 3.2%
- **Sectors**
  - » Mixed outlook; Oil services are peaking, will slow the coming quarters. Manufacturing stable but global uncertainties are expected to act as a drag on export oriented sectors. Retail is struggling
- **Implications**
  - » The Network confirms that growth is now peaking and will decline, however, at a slower pace than Norges Bank assumes. Thus, the Network supports our view that Norges Bank will hike on Thursday

The Network points to slower growth but not as steep as NoBa expects

The Network expects 2.7% GDP growth in Q4/Q1, NoBa a rapid slowdown to 1.5% by Q1



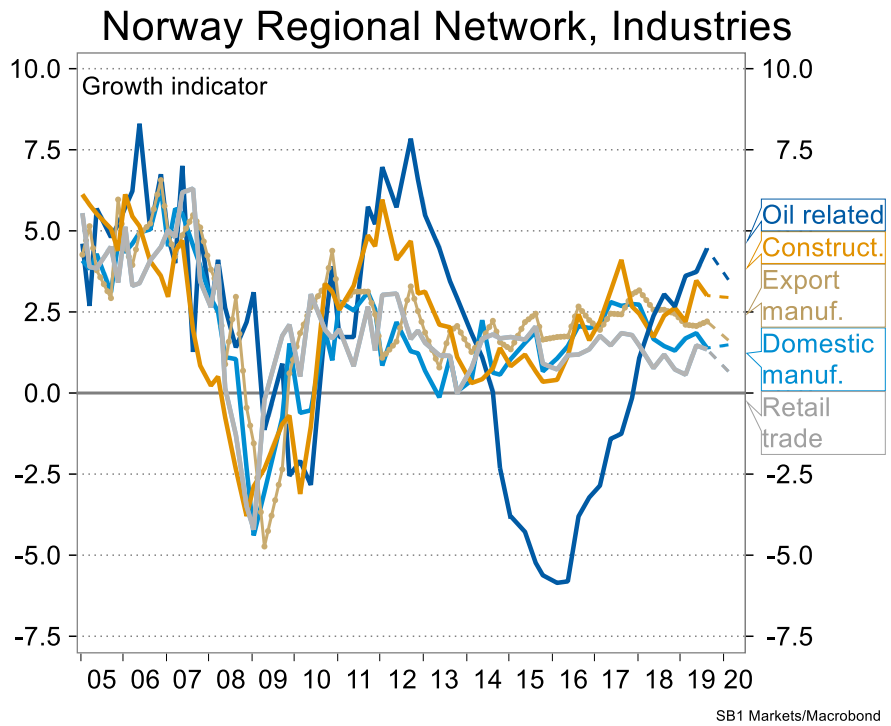


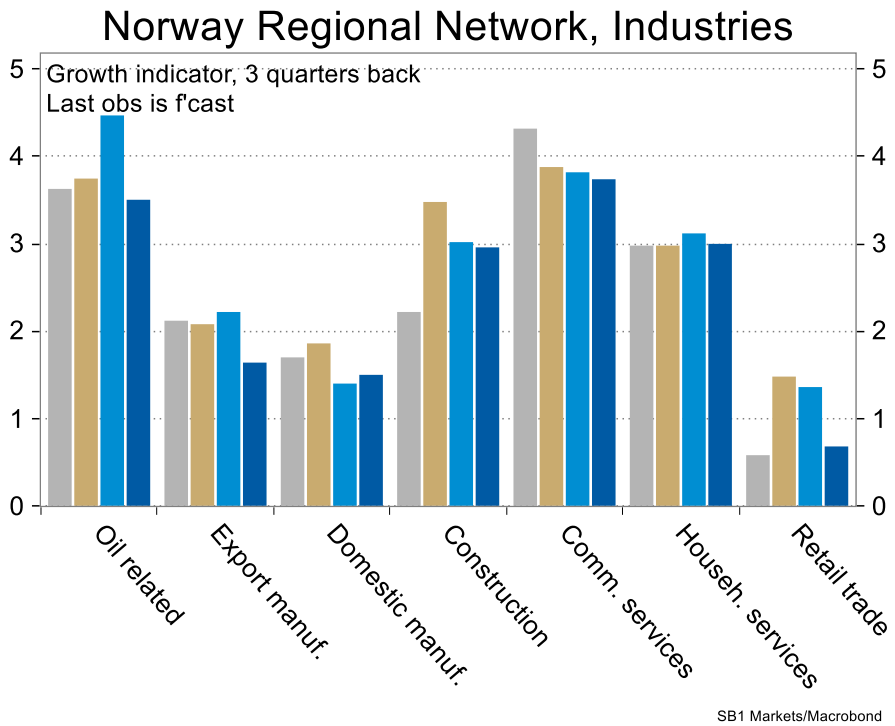
- Norges Bank's Network estimates economic activity to expand by a 2.7% speed the coming 6 months, which is well above Norges Bank's f'cast. The bank expects 2.2% in Q4 and 1.5% in Q1 (implicitly, our calc), in average 1.9%
- Most other business surveys have softened and are in average somewhat weaker than the Network. SSB's manufacturing survey and Manpower's empl. survey are more optimistic and 3 surveys are weaker than the Network

SpareBank 1 MARKETS

Growth is peaking in oil related, construction and manufacturing

Businesses expect a slower expansion in oil related sector, export manufacturing and retail trade

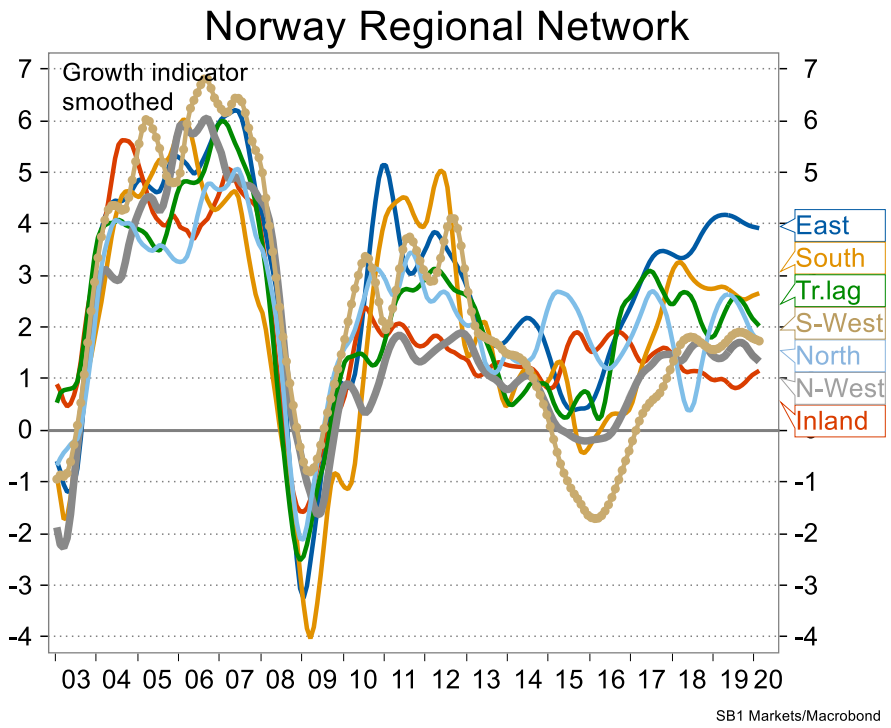


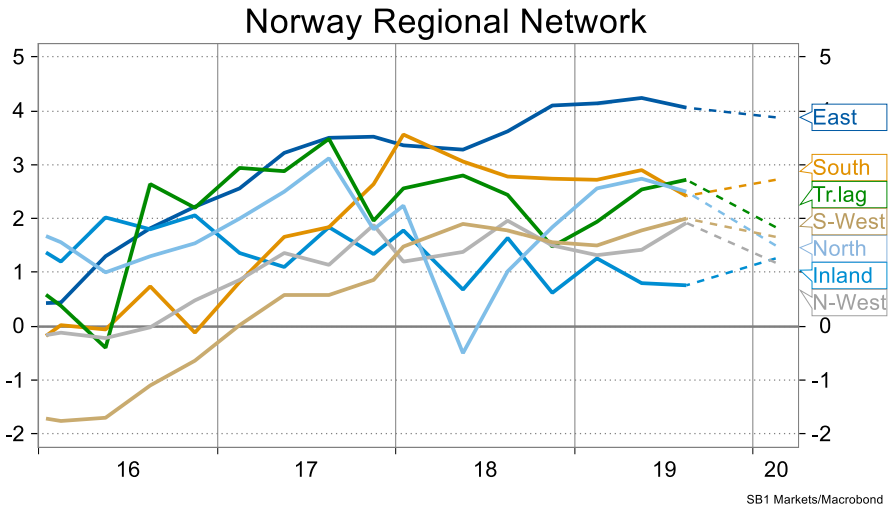


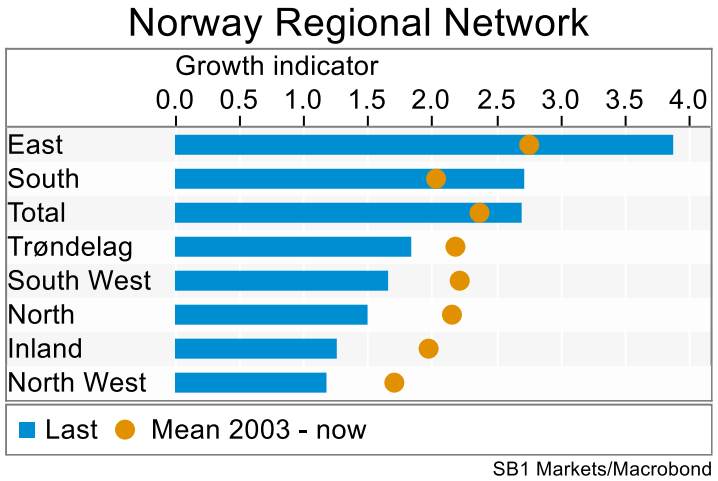
- Oil related companies (manufacturers & service providers) are reporting higher output growth the past 3 months but expect a slowdown the next 2 quarters. Hence, the Network confirms what oil companies reported in the investment survey; growth in oil related sectors will soon turn south
- Export oriented manuf. sectors experience steady demand in spite global uncertainties. Some cite that impacts from the weak NOK have offset the slowdown in global demand. However, they expect growth to moderate the coming months. Domestic manuf. slowed in Q3 and is expected steady
- Construction slowed in Q3 and activity is expected to increase at a steady pace the coming 6 months. Businesses note somewhat softer housing sales
- Growth in commercial services has slowed but is still expanding quite rapidly, household services stable at a somewhat slower pace
- The retail sector is struggling, growth slowed marginally in Q3 and the outlook is not bright, according to these businesses. Competition from online shopping and new market trends such as sustainability and recycling are cited as challenging for the sector

Still high growth in East, slower in Trøndelag and the West

West, Trøndelag and North are expecting a slowdown, South and Inland are to accelerate





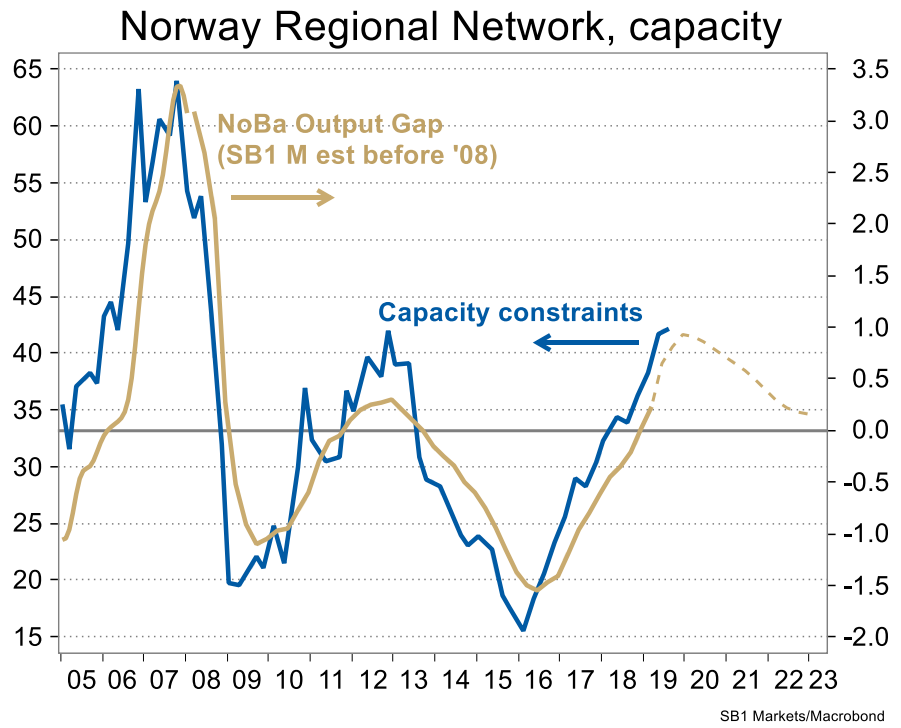


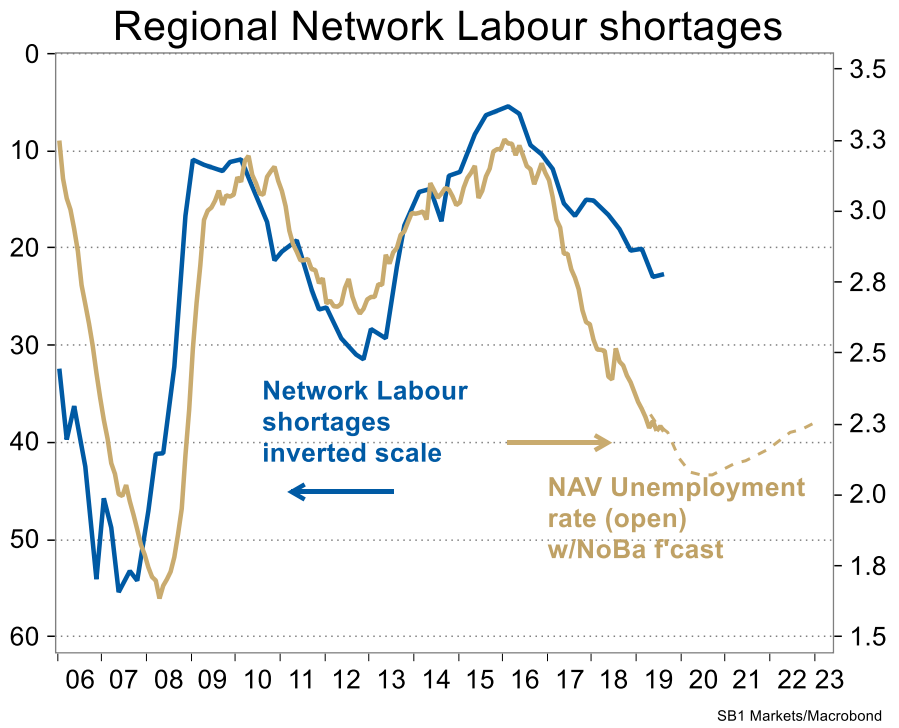
- Growth have strengthened in most regions over the past couple of years. The Network now expects steady growth in the East (at a high 4% level) and stronger growth in the South (2.8%) and Inland (but just to above 1%)
- The two western regions are projecting lower growth, after accelerating to 2% in Q3

SpareBank 1 MARKETS

Capacity utilisation is increasing, yet labour shortages remain modest

Capacity utilisation is slightly higher than the 2012 peak and ahead of Norges Bank's f'cast

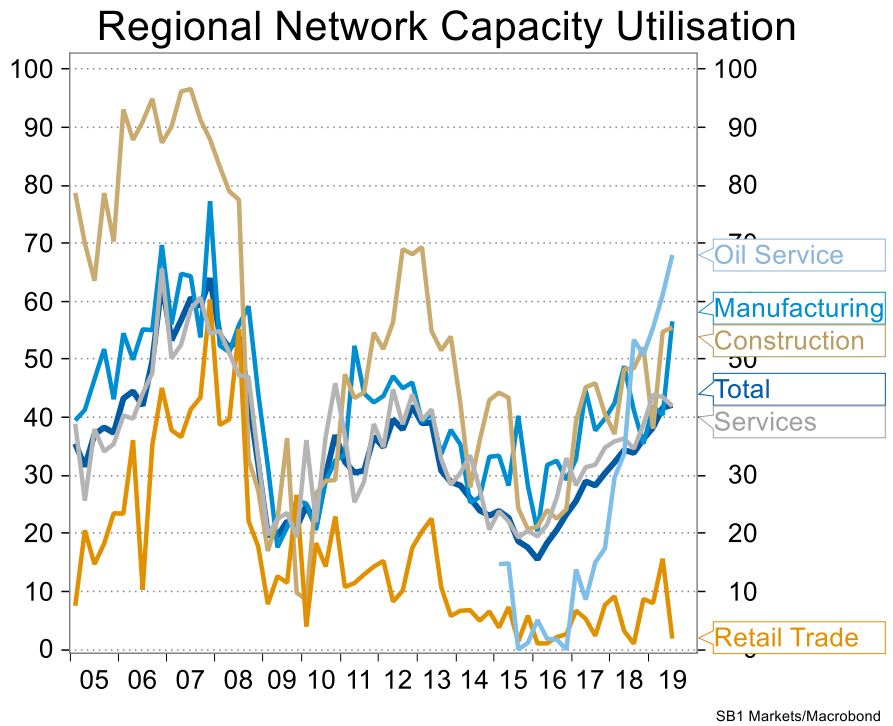


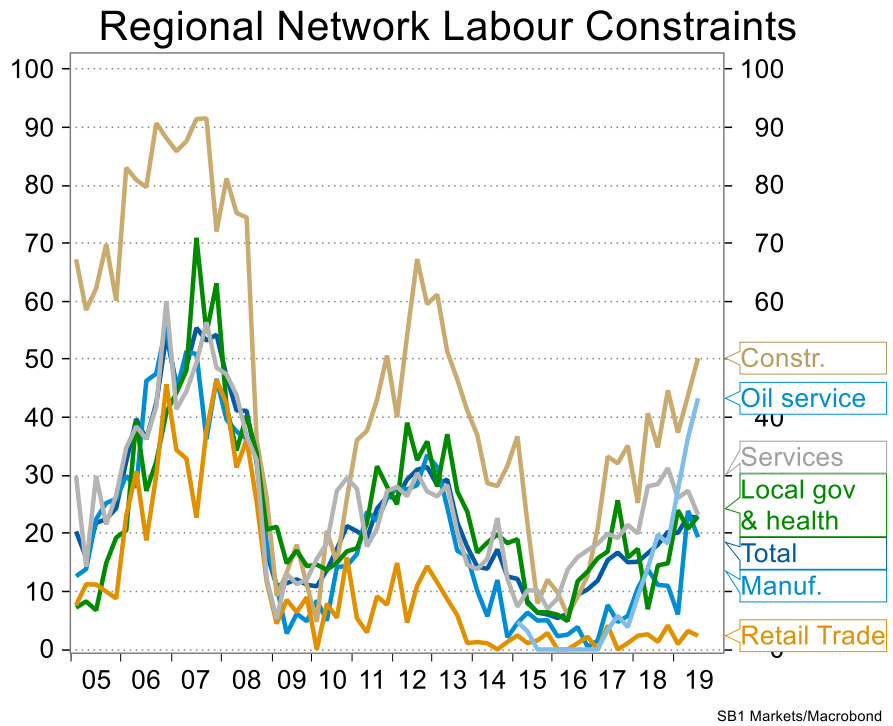


- Capacity utilisation is improving and increased to marginally above the 2012 level in Q3 (but still well below 2007!)
- In spite rising capacity utilisation and low unemployment, businesses are not reporting any substantial labour supply constraints. The share of businesses noting difficulties recruiting labour actually declined marginally in Q3 and is very low given the unemployment rate at 2.2%! Indicating that <u>labour is still available</u>. Probably the softest labour market indicator at hand today, and <u>not</u> an unimportant one
  - » Many businesses are recruiting labour from abroad and/or bringing in expertise from foreign units of the company. Thus, labour shortages may not be a constrain to activity, even as demand is increasing. Still, this must have been the case in 2012-2013 too?

Capacity utilisation is increasing in all sectors except retail trade

68% of oil related businesses report full capacity utilisation, and almost 60% in manuf. +construction



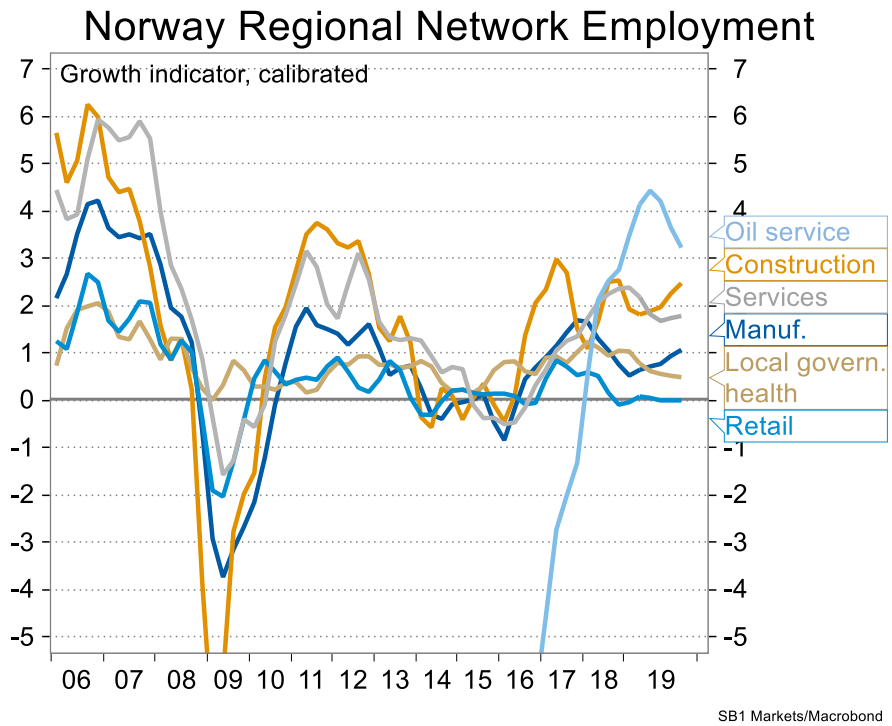


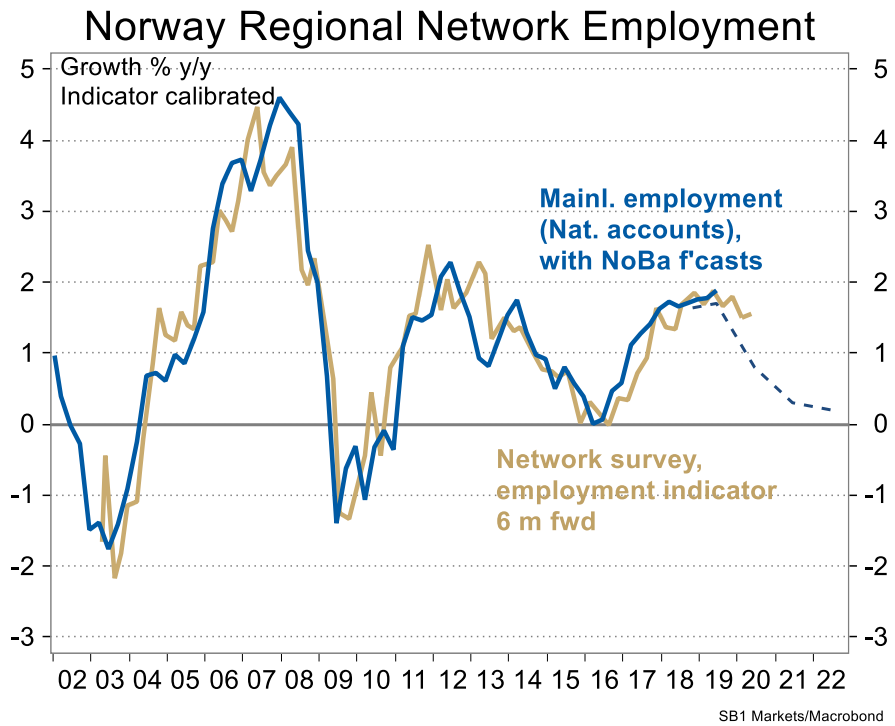
- The share of oil-related businesses (not oil companies) reporting problems accommodating rising demand is soaring, to 68%! Still, just 40% are experiencing labour supply constraints
- In construction, capacity utilisation has increased rapidly to the highest level since 2013. Rising housing starts (for now) and muted labour immigration are putting pressure on the sector and is approaching a capacity limit, according to the Network
- Retail trade is reporting a drop in capacity utilisation and does not have problems attracting labour. The sector is no doubt under pressure
- 57% of manufacturers are reporting full capacity utilisation, a steep increase from Q2 and the highest since 2008! Regardless, these sectors are not reporting any substantial problems attracting labour. Anyway, limited upside in this sector!

SpareBank 1 MARKETS

The Network signals somewhat slower employment growth but not low

Employment is slowing in oil services, will accelerate in manufacturing and construction? Strange



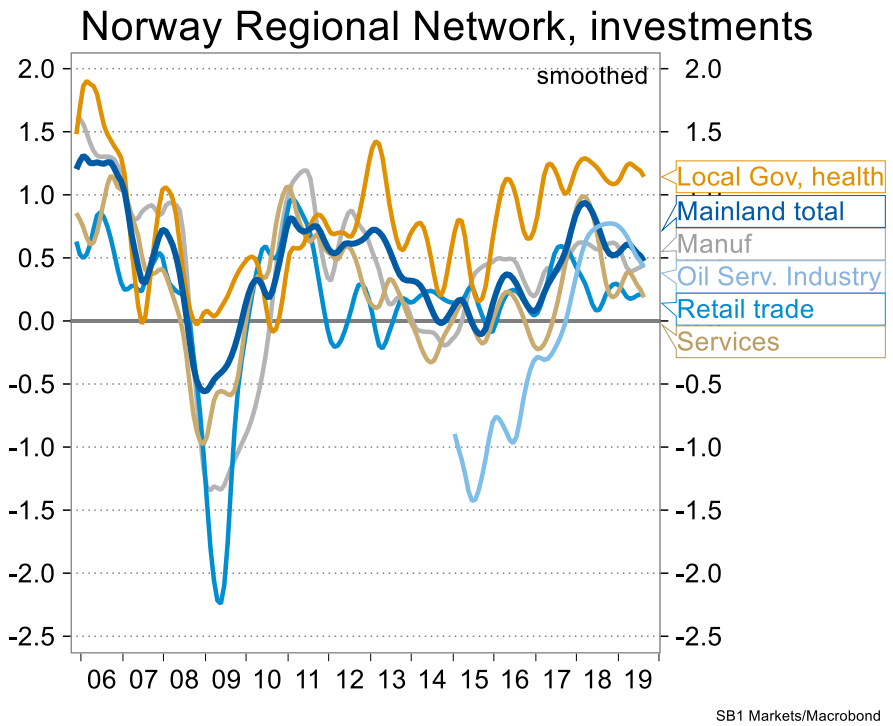


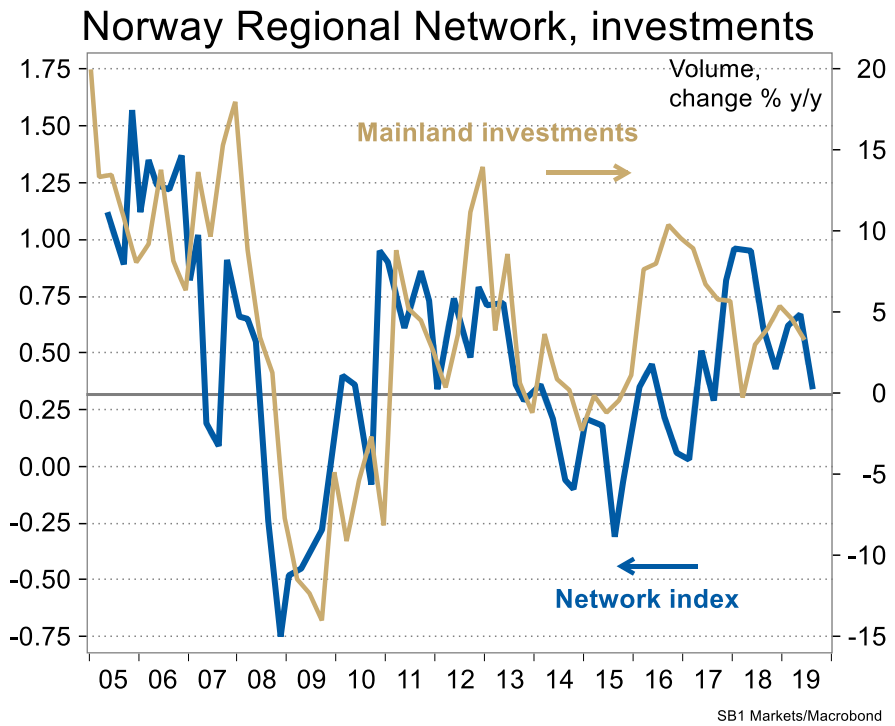
- In total, the Network employment indicator points to a slowdown to 1.5% growth, similar to other surveys. Growth in working age population is well below 1% and the participation rate will have to increase substantially to prevent unemployment to decline further
- In oil related services, employment growth is expected to ease somewhat the coming months
- Construction employment has been slowing but will accelerate, according to the Network. Our take is that the upside is limited. The same goes for manufacturing, which is also expecting a slight upswing the next 6 months
- Other sectors are expecting a somewhat lower pace of increase than over the past year

SpareBank 1 MARKETS

The Network signals muted business investments

Investment plans are moderated in several sectors, most apparent in oil related sectors

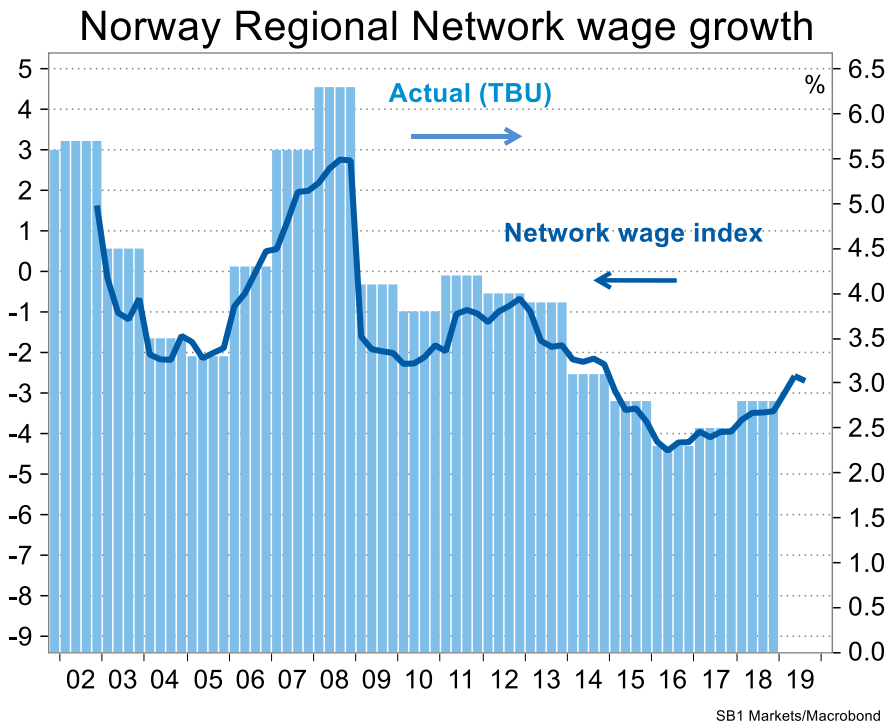


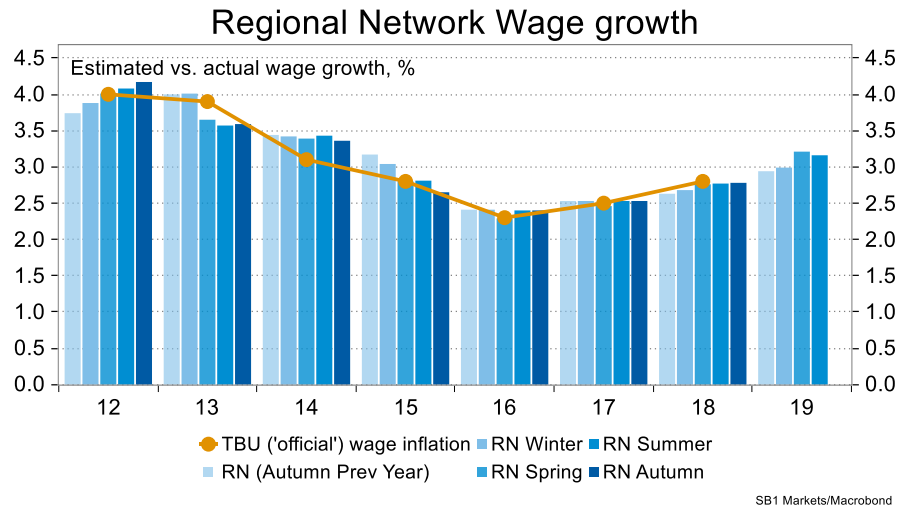


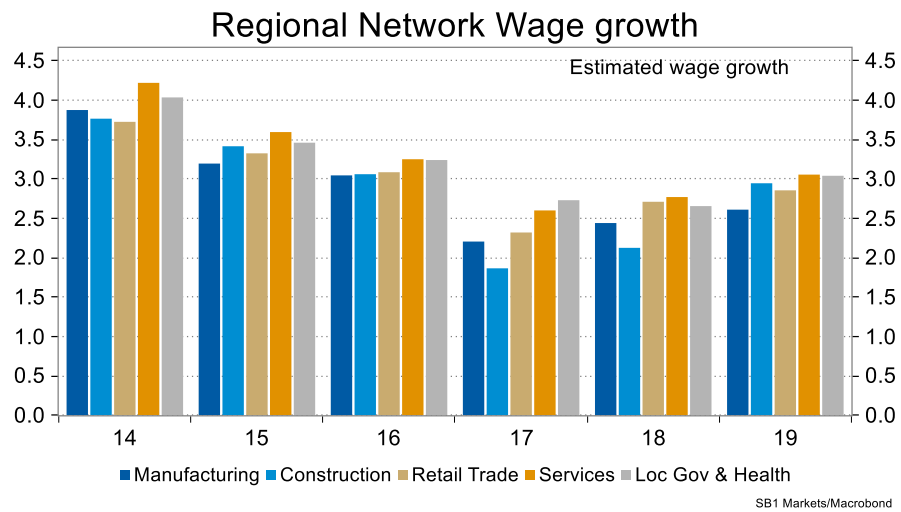
- Oil service/oil related manufacturing industries have reduced their investment plans through 2019. Investments from the oil companies are probably at/close to peak and will no doubt be a drag on growth in oil services
- Non-oil related manufacturing is reporting lower growth but they expect a slight rebound. We doubt so
- Investments in retail trade remains soft, services are not thriving either. Local govt/health remains on the top
- Actual Mainland business investments rose 3.3% y/y in Q2 (but fell slightly q/q), the Network do not signal an upturn. Norges Bank expects 3.5% growth in 2020, may be too optimistic

Network reports steady wage growth in 2019, at 3.2%

Businesses estimate 3.2% wage growth in 2019, just a marginal decline from the previous report



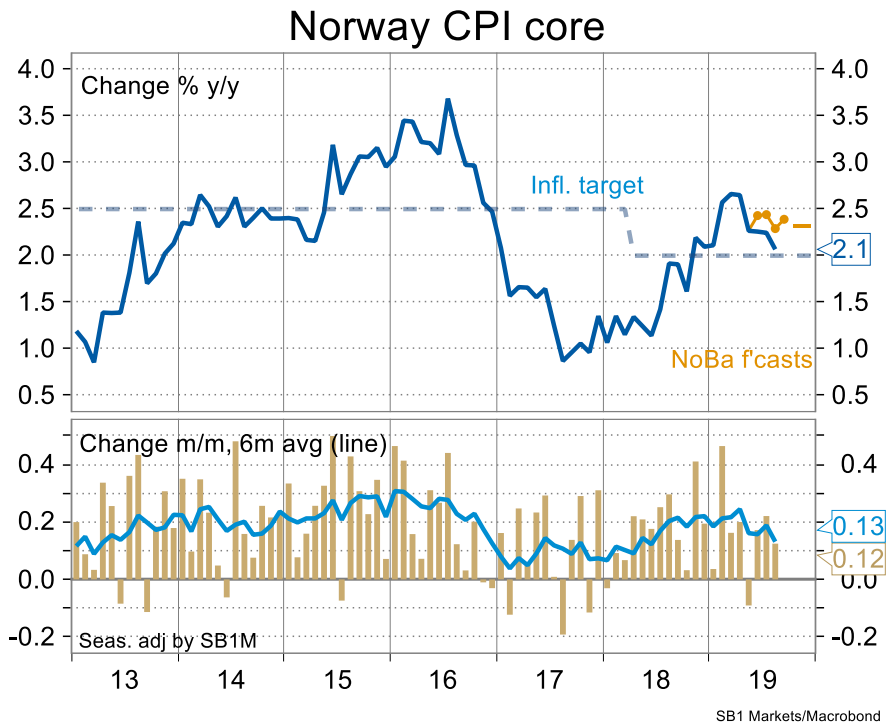




- The Network expects higher wage inflation in all sectors in 2019 vs 2018. Steepest in construction sectors, which is also reporting higher capacity constraints
- NoBa assumed wage growth at 3.3% in the June MPR, somewhat too optimistic?

Core inflation inched down to 2.1%, total inflation fell to 1.6%

Core CPI inflation ticked down 0.1 pp in August, the 3rd month just below Norges Bank's f'cast



- CPI-ATE (ex. energy and taxes) slowed 0.1 pp to 2.1% y/y in August. Consensus was for an unchanged pace of inflation (like our f'cast). Core inflation has been running below Norges Bank's f'cast (from June) for 3 months now, the Bank expected a 2.3% speed in August
  - » CPI-ATE rose 0.1% m/m (seas adj), down from 0.2% in July
  - » Higher food and clothing discounts sent inflation down, while prices on health services and housing (rent) boosted price growth
  - » Imported goods are up just 1.1% y/y and we do not expect much more, even as the NOK is weak. Domestic goods & services are up 2.8%!
- Total CPI growth came in at 1.6%, a 0.3 pp decrease from July. Total inflation has been pushed down by a steep decline in electricity prices. Good for real income growth, thus, consumption!
- **Implications**
  - » Core inflation remains just above the price target, we do not expect Norges Bank to put much emphasis on a slight deviation from its forecast the past 3 months. Nonetheless, the bank will probably nudge down the inflation f'cast, contributing to a lower interest rate path
  - » No substantial market reaction, NOK depreciated marginally following the report

SpareBank 1 MARKETS

Food prices and furnishing came in below f'casts, health service prices spiked

Core CPI prices up 0.1% m/m, missing our f'cast by 0.1 pp

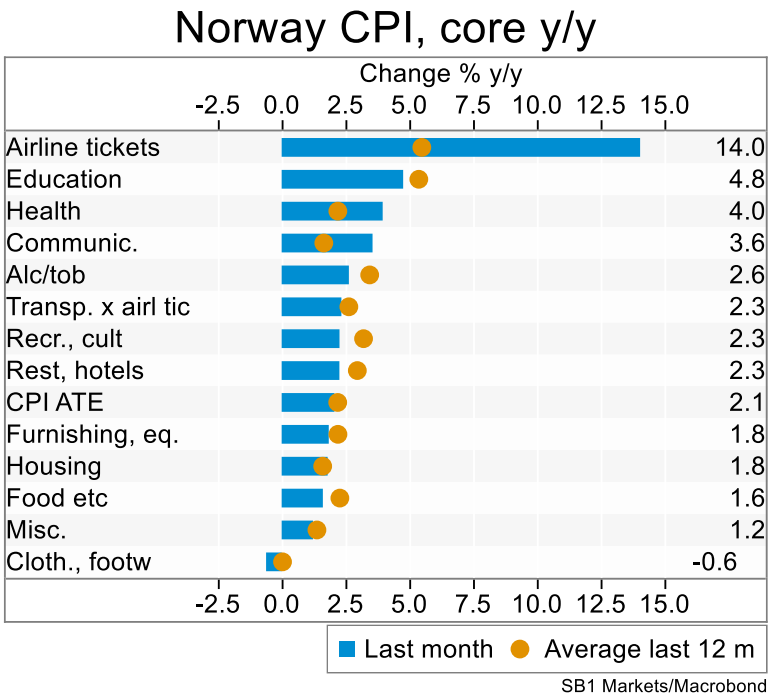
		Change m/m, seas. adj			Change y/y			Contribution, pp		
Aug-19	Weight	Out-	SB1M	Dev.	Last	Out-	SB1M			Dev. vs
CPI ATE	%	come	f'cast	pp	month	come	f'cast	m/m	y/y	f'cast
Food, non alc bev	12.5	-0.2	0.2	-0.4	2.6	1.6	2.1	-0.03	0.20	-0.05
Alcohol, tobacco	3.9	0.1	0.2	-0.1	2.8	2.6	2.8	0.01	0.10	-0.00
Clothing, footwear	4.9	0.7	0.2	0.5	2.0	-0.6	-1.4	0.03	-0.03	0.03
Housing x. energy	20.1	0.3	0.2	0.2	1.5	1.8	1.6	0.07	0.36	0.04
Furnishing	6.6	-0.5	0.2	-0.6	2.1	1.8	3.0	-0.03	0.12	-0.04
Health	3.2	2.3	0.2	2.1	1.6	4.0	1.8	0.07	0.13	0.07
Transp. ex. gas, airl. tick	12.0	0.0	0.3	-0.2	2.7	2.4	2.7	0.00	0.29	-0.03
Airline tickets	1.2	0.7	1.0	-0.3	8.2	14.0	13.9	0.01	0.16	-0.00
Communication	2.2	0.8	0.1	0.7	2.4	3.6	2.6	0.02	0.08	0.02
Recreation, culture	11.9	0.2	0.3	-0.1	2.9	2.3	2.6	0.02	0.27	-0.02
Education	0.5	-	-	-	4.8	4.8	4.8		0.02	0.00
Restaurants, hotels	6.2	0.2	0.2	-0.0	2.6	2.3	2.3	0.01	0.14	-0.00
Other	8.8	0.1	0.2	-0.1	1.4	1.2	1.3	0.01	0.11	-0.01
CPI-ATE	94	**0.1**	**0.2**	-0.1	**2.2**	**2.1**	**2.2**			
Norges Bank est.			***0.1***		***2.4***		***2.3***			
Imported	33	-0.3	0.2	-0.5	1.8	1.1	1.7	-0.11	0.35	-0.16
Domestic	61	0.4	0.2	0.2	2.5	2.6	2.4	0.23	1.59	0.09
Energy, housing	4	0.6	2.0	-1.4	-9.3	-9.3	-7.4	0.02	-0.36	-0.06
Energy, transport	4	-2.1	0.0	-2.1	1.5	-1.0	1.1	-0.07	-0.03	-0.07
CPI Total	101	**0.0**	**0.3**	-0.3	**1.9**	**1.6**	**1.9**	0.00	1.58	-0.27

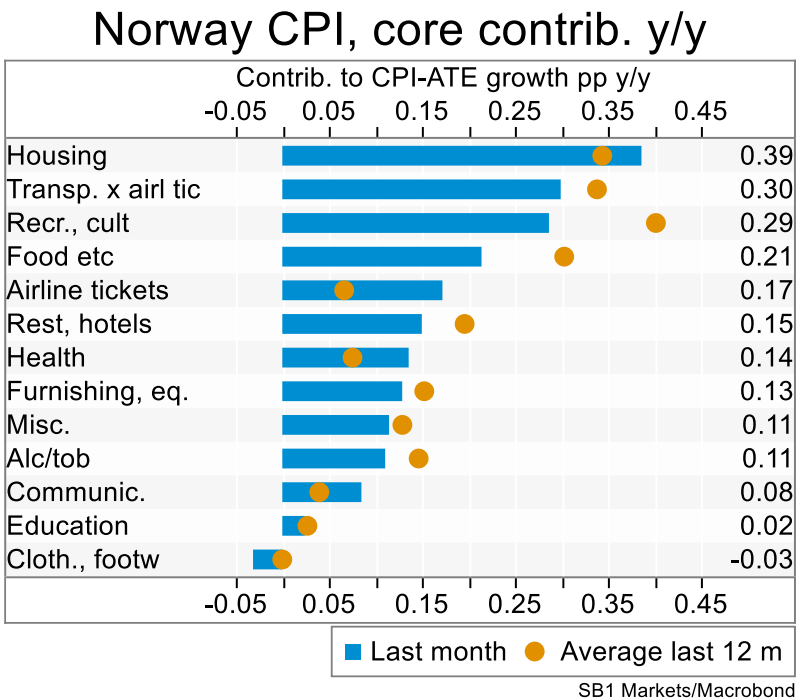
- Food prices fell 0.2% m/m, we expected +0.2%. Food deducted 0.03 pp of the monthly rate
- Housing (rent etc) lifted monthly inflation by 0.07 pp, more than we f'casted
- Prices on furnishing fell
- Health service prices surprisingly jumped 2.3% m/m, SSB reports higher priced on dentists
- **CPI-ATE up 0.1% m/m and 2.1% y/y, 0.1 pp below our forecast (and consensus)**
- Imported prices are increasing much less than domestic, up just 1.1% y/y vs domestic at 2.6%
- Electricity prices rose 0.6% m/m and are down 9.3% y/y, more than we expected. Prices will probably continue down for a while
- Headline inflation eased to 16%, we assumed unchanged at 1.9%

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

Domestic services are the big contributors to core inflation

Housing, transport, recreation & culture and food are lifting the annual rate, just clothing is falling

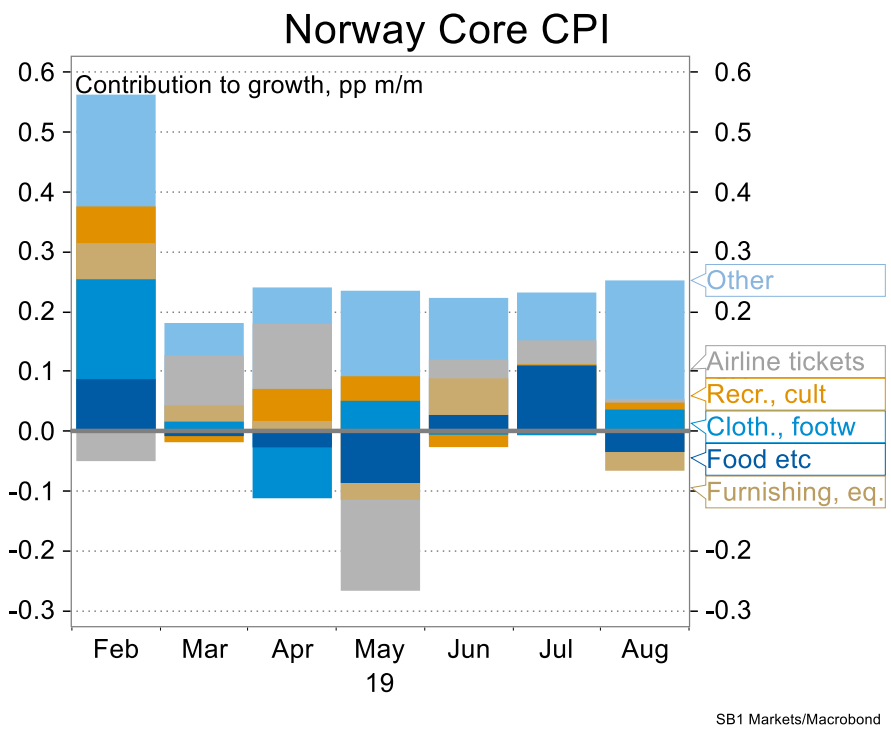


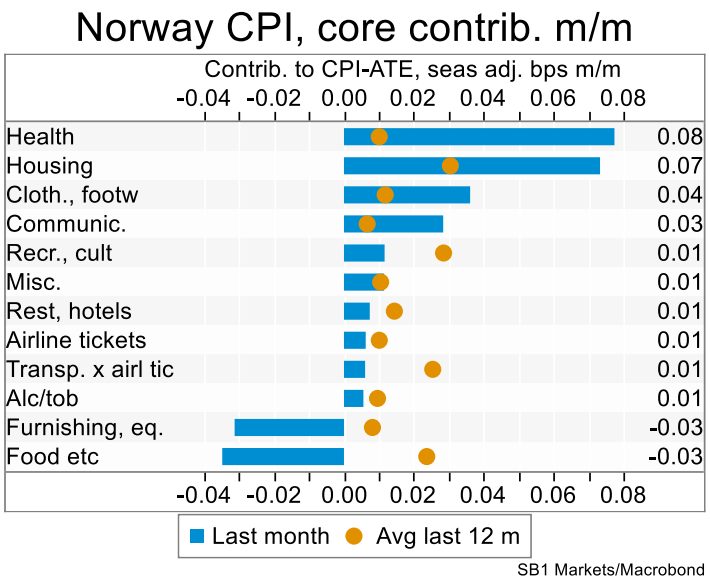


- Prices are increasing y/y in all main sectors except from clothing & footwear, which are down 0.6%

Health services, housing and clothing drove monthly inflation up in August

Food & beverages discounts were higher than usual, furnishing & household equip. prices fell



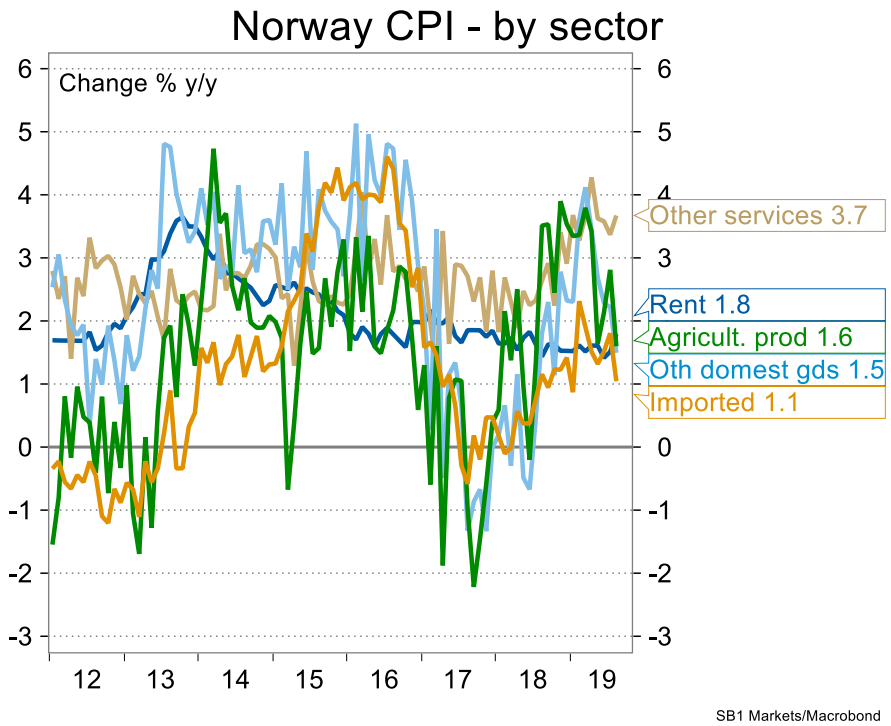


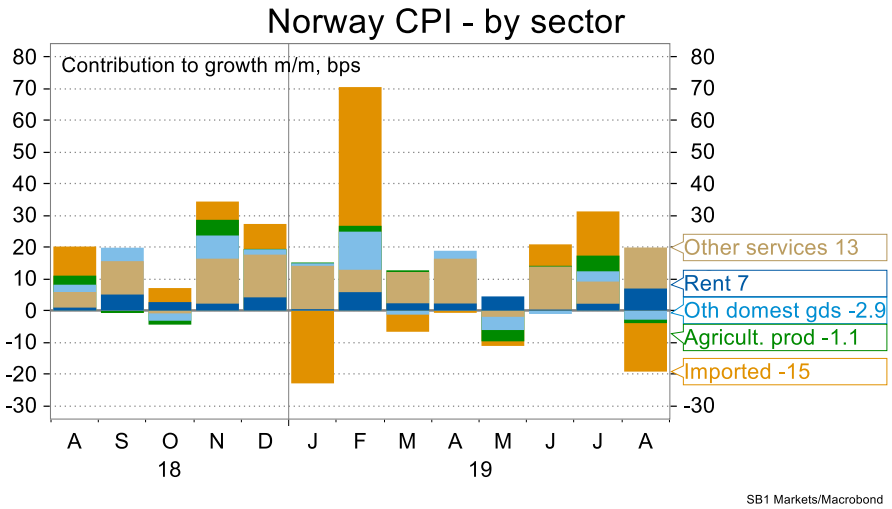
- Prices in health services spiked in August, SSB reports a lift in prices on dental treatments. Housing (mostly rent) and clothing & footwear prices boosted core inflation too

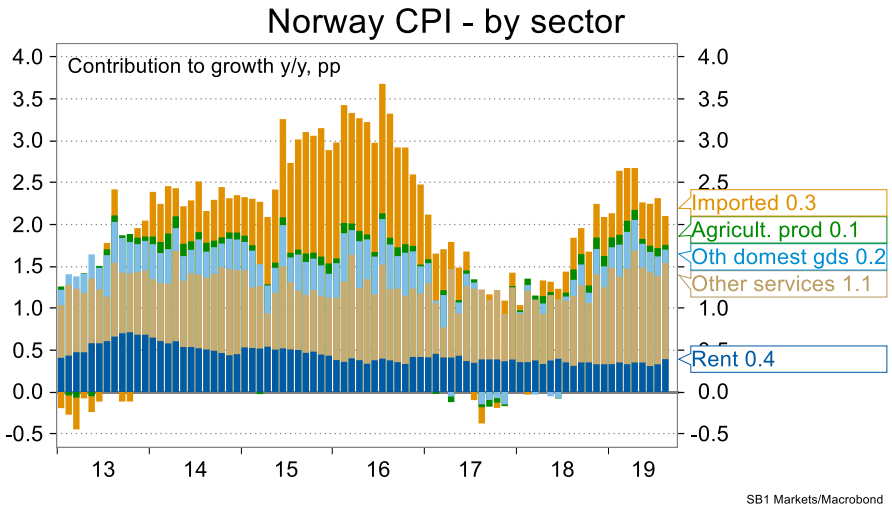
SpareBank 1 MARKETS

Imported inflation retreating, domestic goods&services lifts inflation

Modest price growth on imported goods, domestic services are soaring



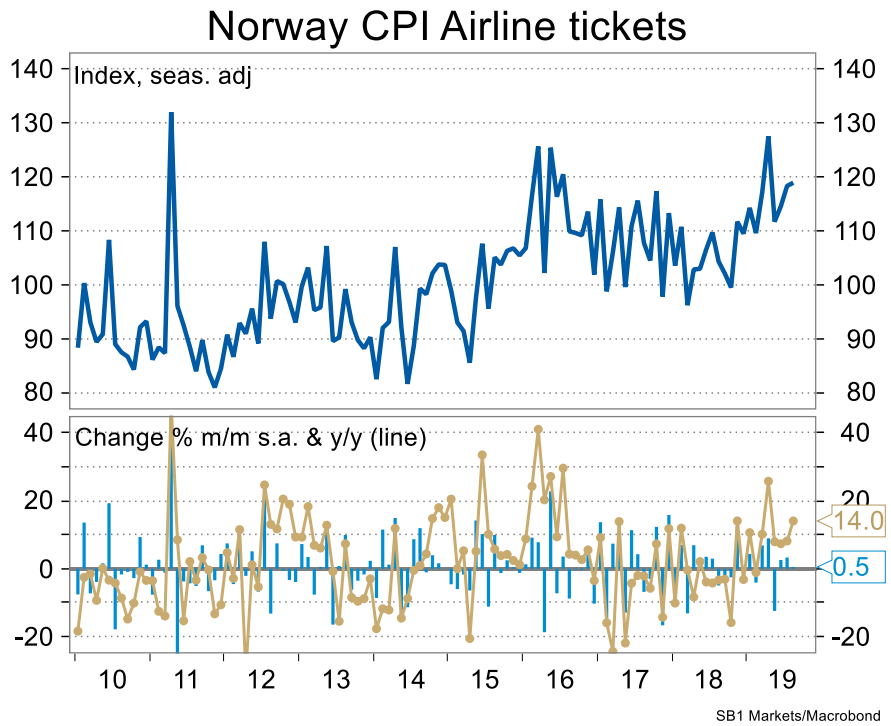


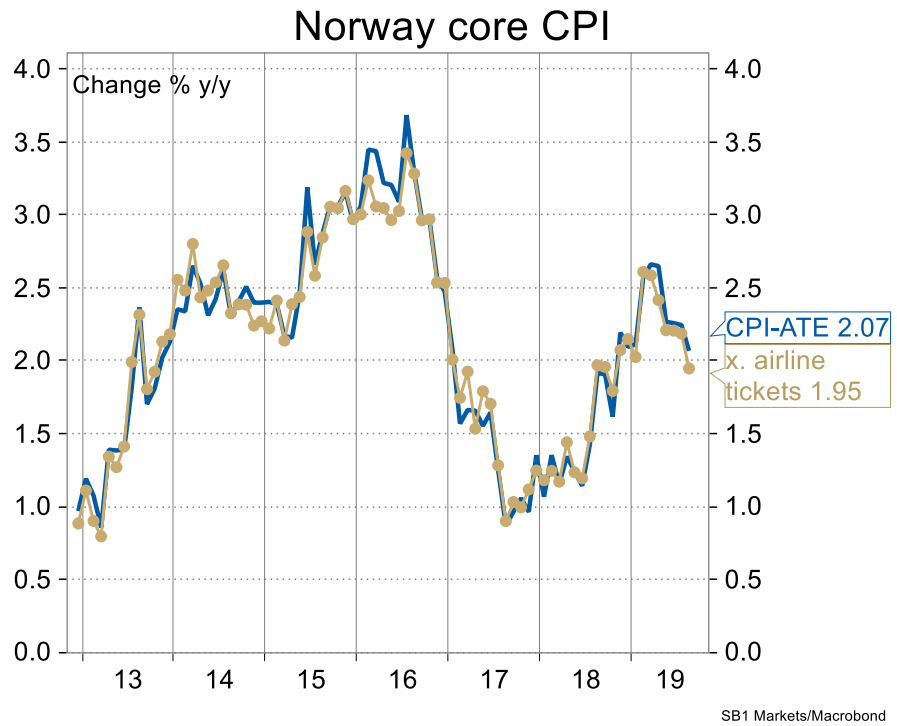


- Price growth in services (such as culture, travelling etc) has been soaring, they are up 3.7% y/y. Other domestic goods and imported goods have slowed, after accelerating the past year. Rent inflation has been slowing but spiked in August, up 1.8% y/y
- The NOK depreciation has lifted import prices but the impact will probably remain modest (check here)

Airline tickets prices just marginally up in August

Airline ticket prices are still boosting inflation, by some 0.12 pp



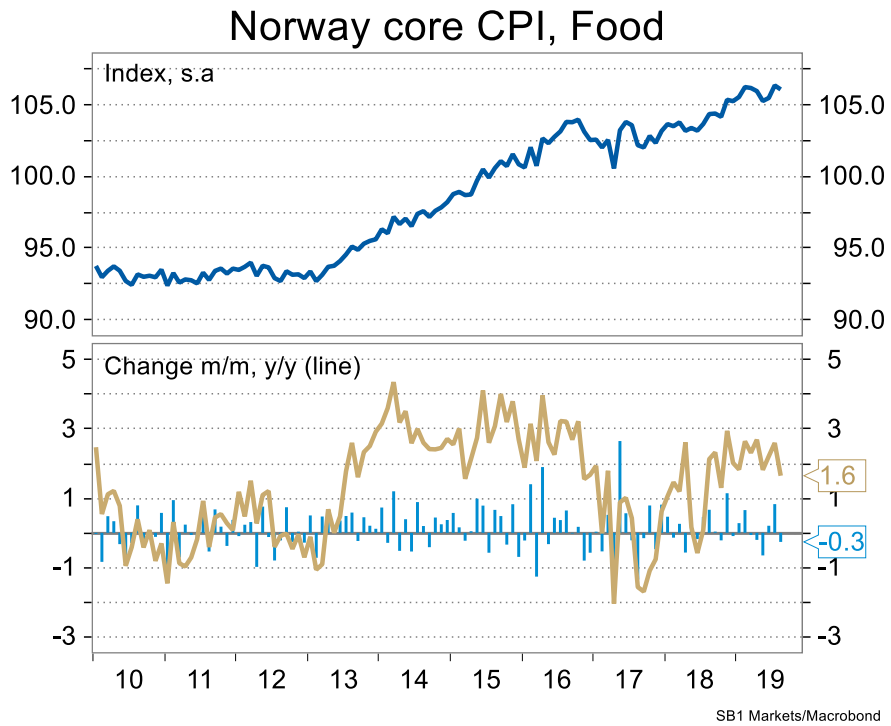


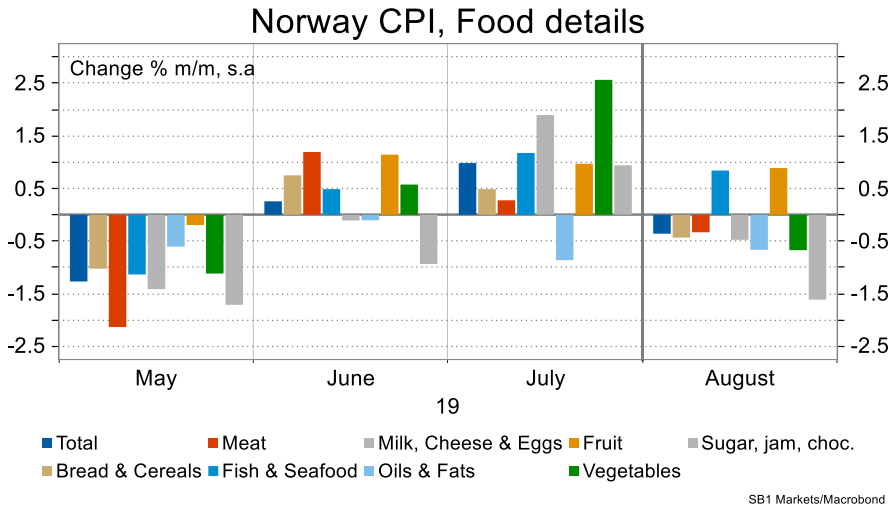
- Prices rose 0.5% m/m(seasonally adjusted) and are up 14% y/y
  - » These data are very volatile

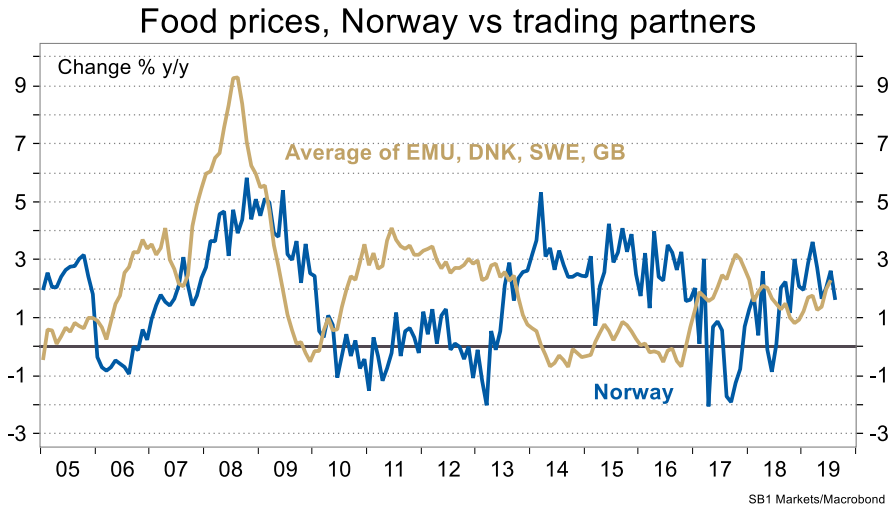
SSB is using a sophisticated net search model to calculate average prices in the relevant week. We assume that the real volatility in average monthly air ticket prices are lower than calculated

Food prices edged down in August, up 1.6% y/y

Discounts on chocolate and sugar were larger than usual in August



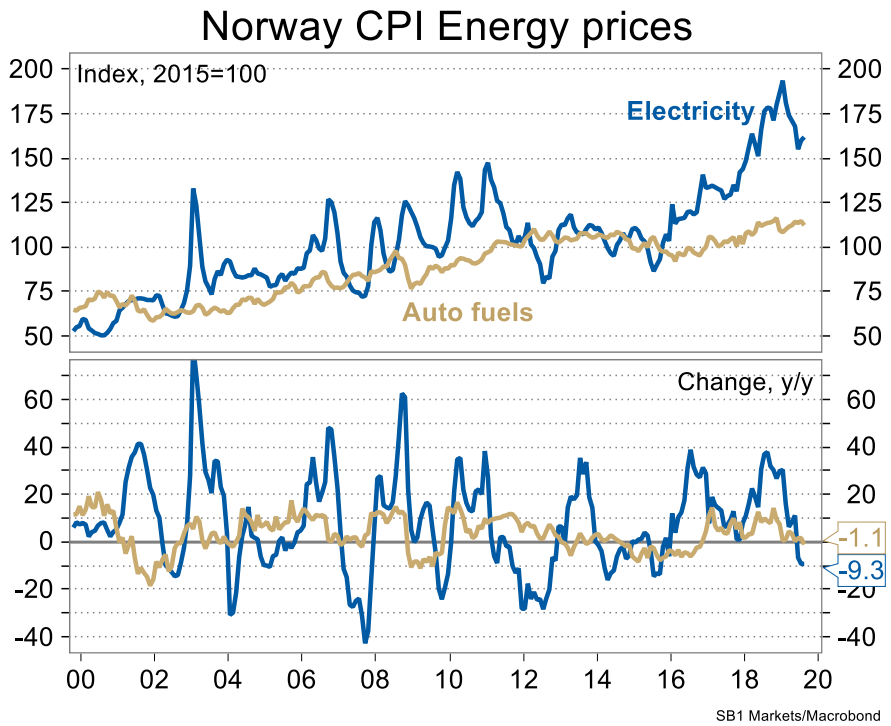


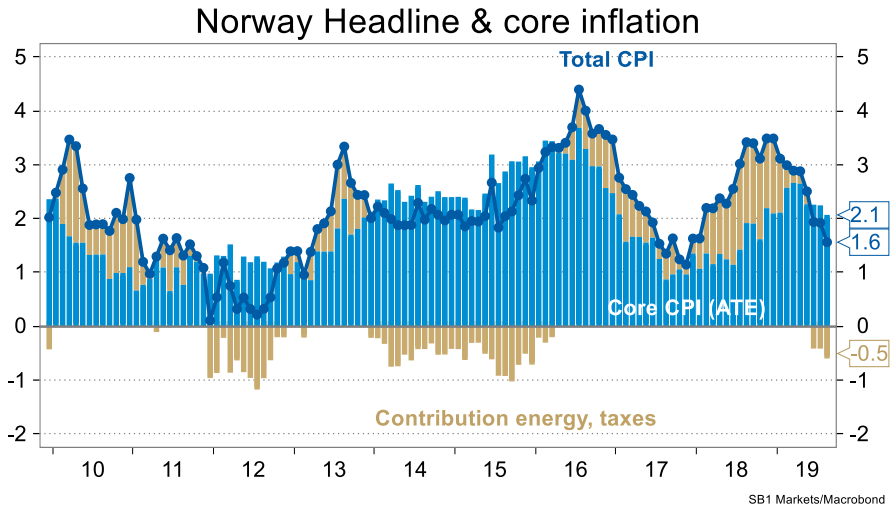


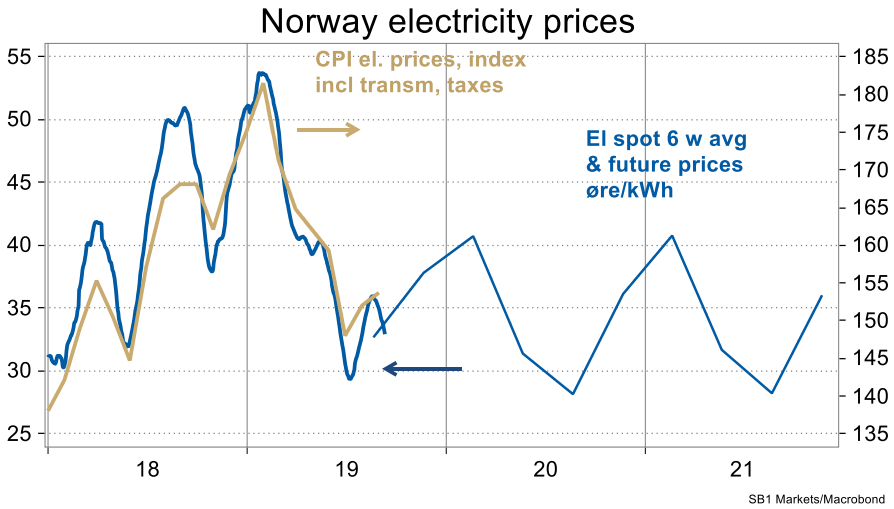
- Prices fell 0.3% m/m in August, we expected +0.2%
  - » Prices fell among most food sectors
- Food prices are now increasing at the same speed as in our neighbouring countries

Electricity prices a 0.5 pp drag on headline CPI, not that much more left?

Electricity prices are down 9.3% y/y, from almost +40% y/y in August last year!



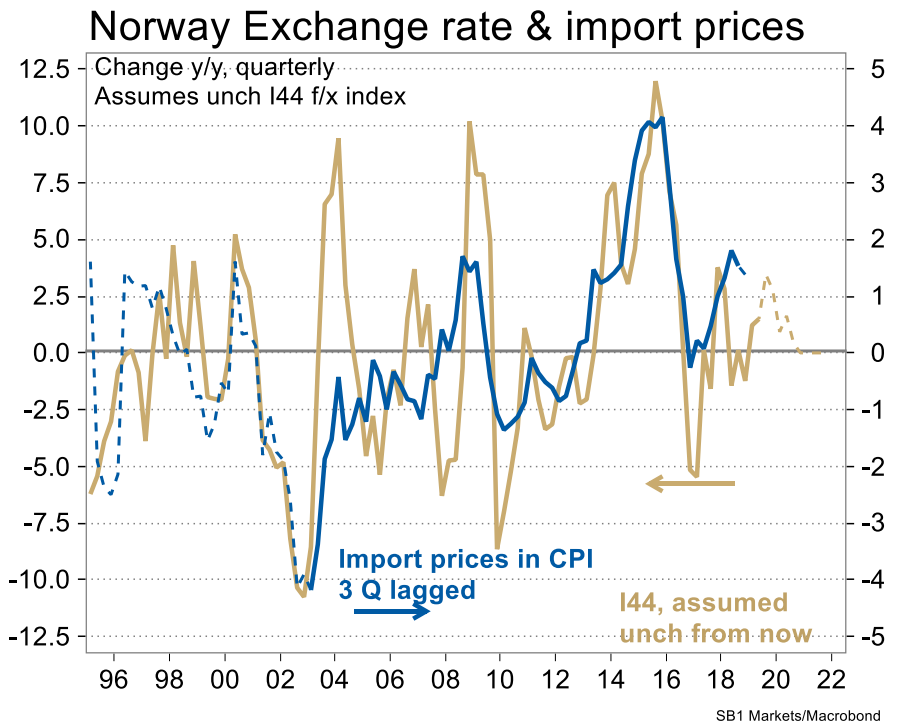


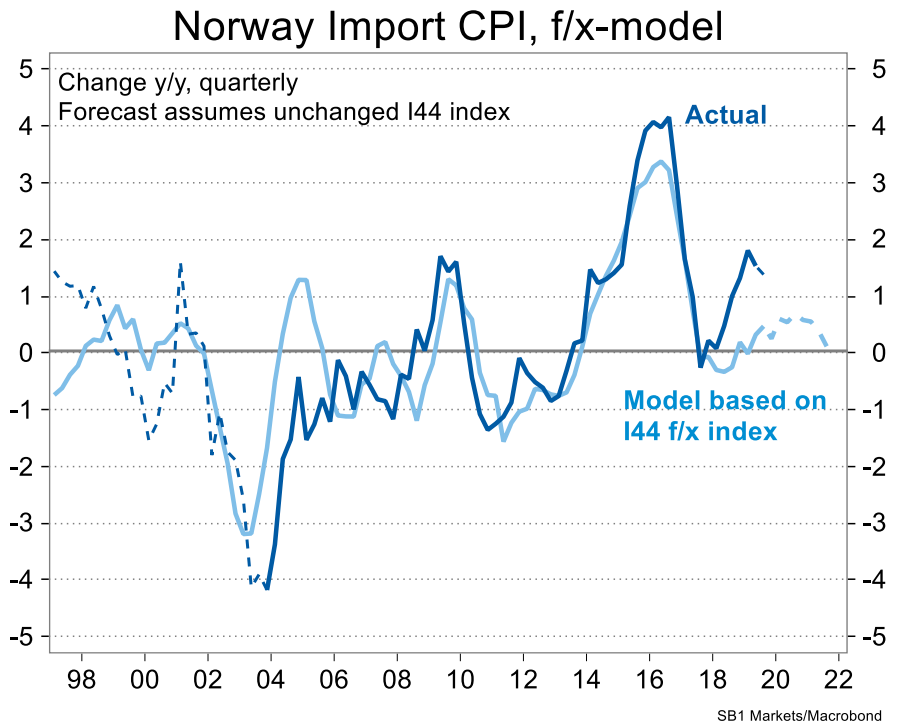


- In 2017/18 the surge in electricity prices lifted the headline CPI, reducing real disposable income significantly. Now, this effect has gone into reverse, as electricity prices are falling sharply. The y/y contribution was -0.5 pp in July, vs +1.5 pp 6-7 months ago!!
  - » Spot & near term future prices have collapsed since mid May. Prices turned up in July, stabilised in August. The forward prices are indicating higher prices in Q3 and Q3, the normal seasonal change. If correct, negative the contribution from lower el. prices will subside rapidly the coming months
- Auto fuel prices are close to neutral vs. headline CPI

Most likely, the impact from the weak NOK will remain modest

Imported inflation is somewhat higher than the modest contribution which the NOK implies



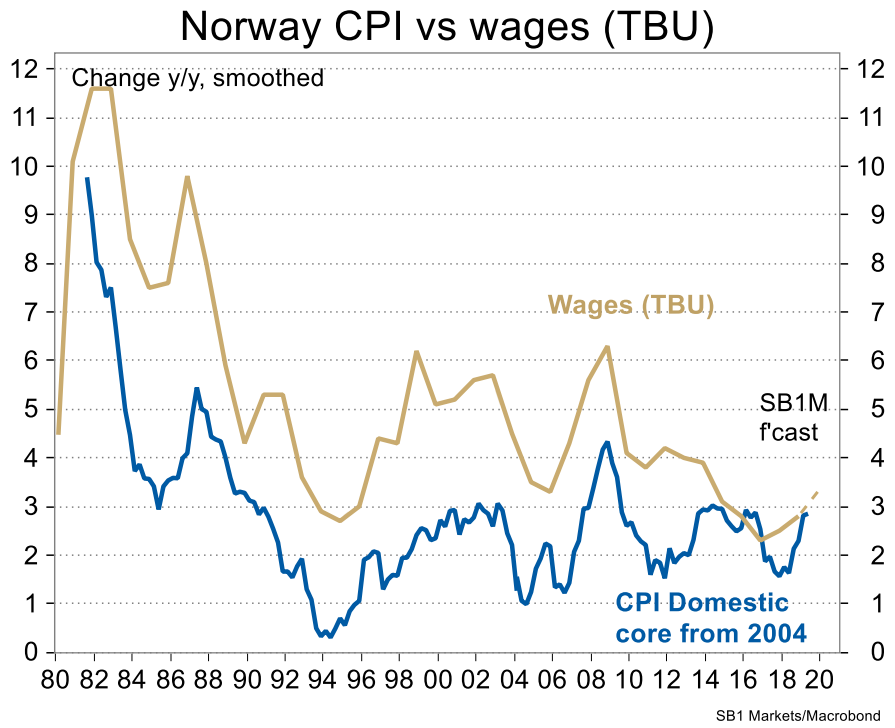


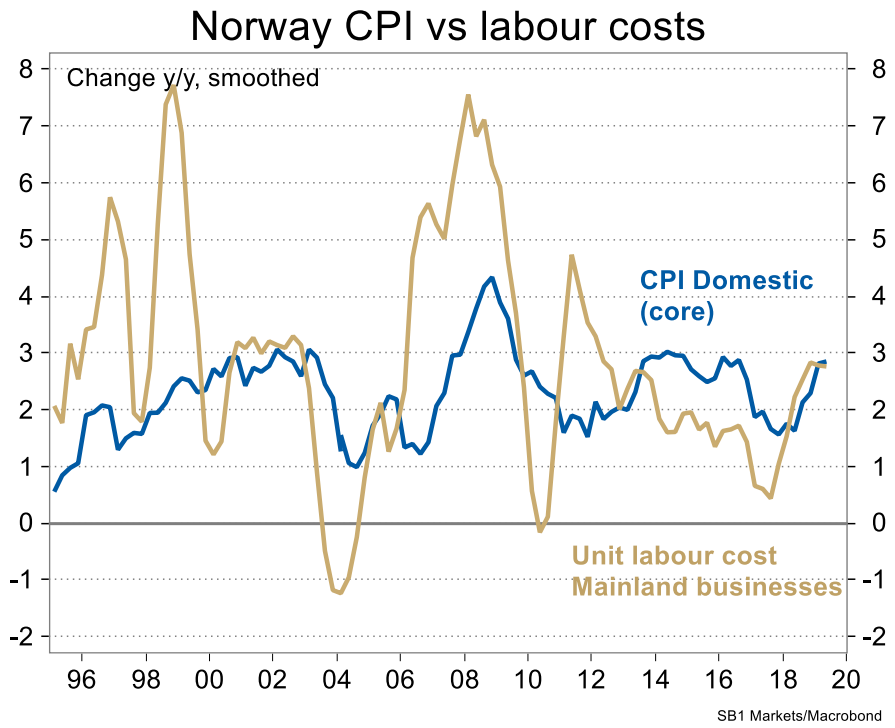
- In general, retail demand is so weak that it does not seem likely that the retailers are able to push up their margins. It does not seem likely that prices are accelerating abroad

SpareBank 1 MARKETS

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

Wage inflation is on the way up. Unit labour cost up some 3.3% in Q2

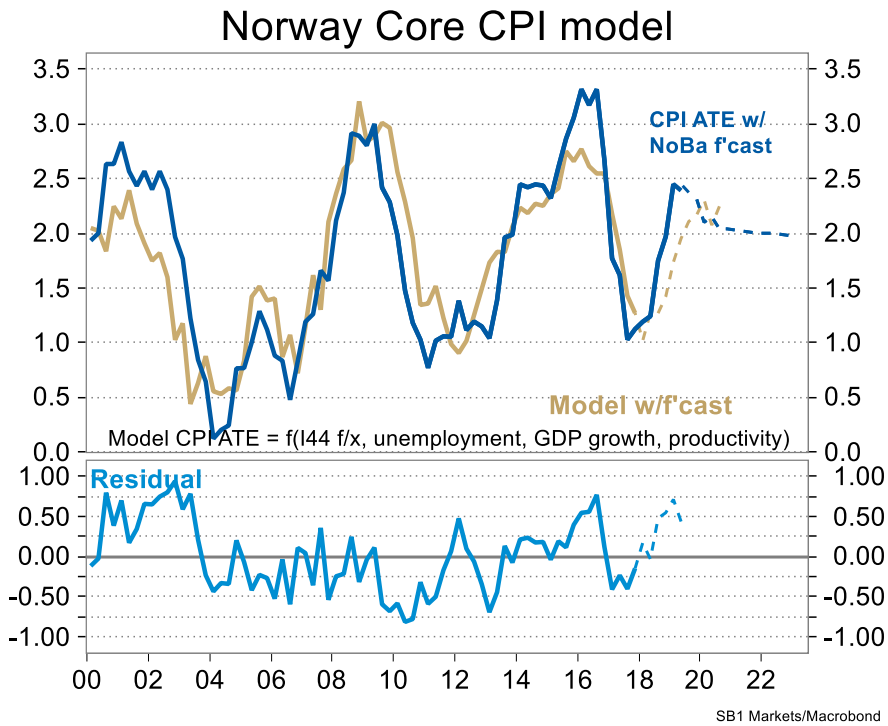




- Wage inflation is increasing and is now approaching 3%, will probably edge up to 3.2% in 2019
- Productivity growth remains meagre
- (Underlying) Unit labour costs inflation up to 3.3% y/y in Q2 (smoothed), unchanged from Q1 and up from 2.6% one year ago – and from below 1% in 2017

The outlook: Core CPI inflation has peaked?

Actual inflation higher than our model forecast now – and it suggest 2.2% in a year's time

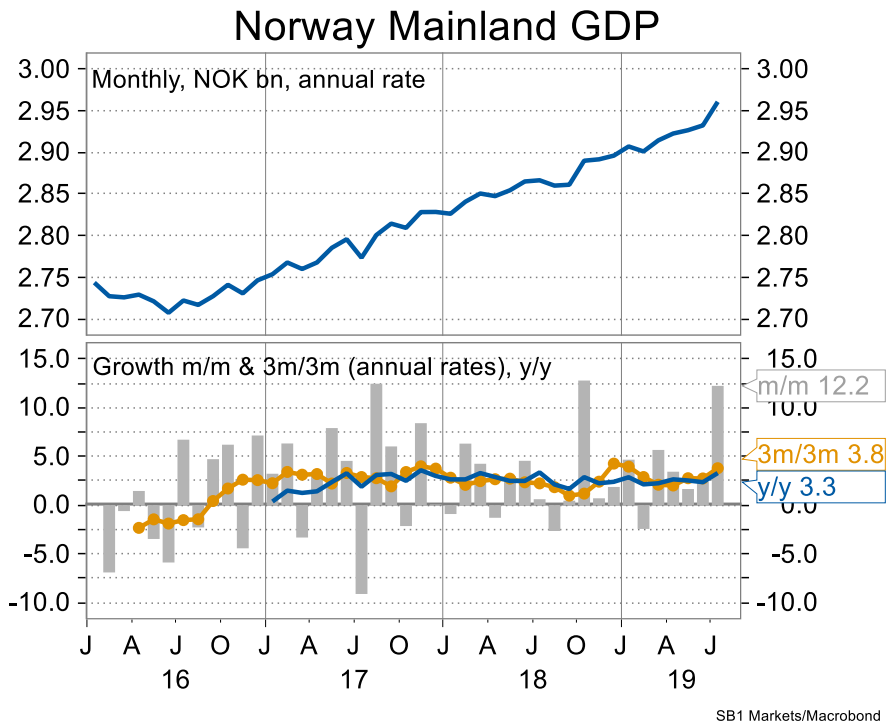


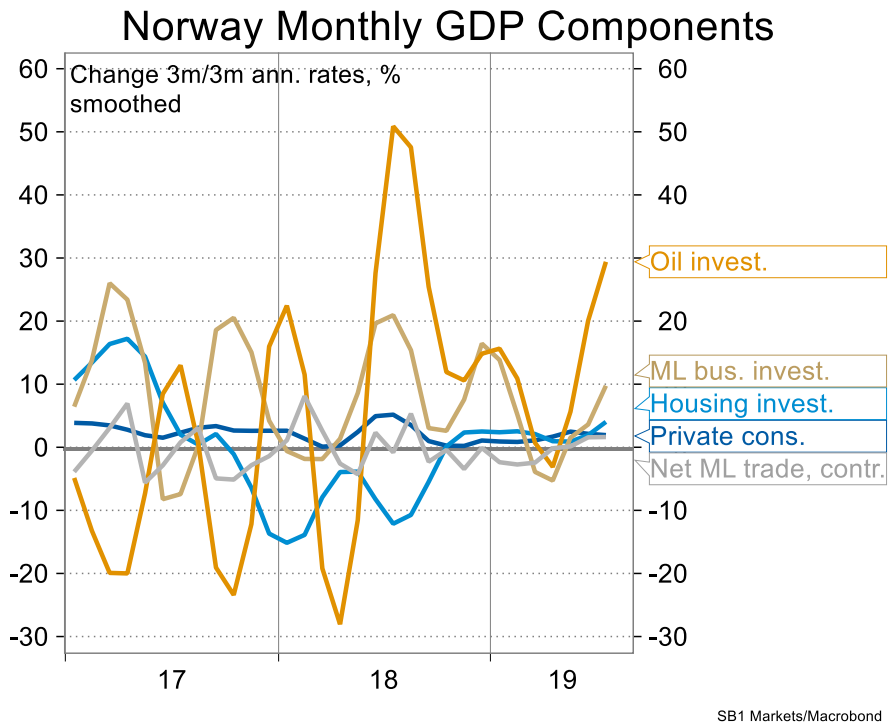
- Core CPI growth has been well above the model f'cast recent months. The deviation is not that large anymore, the 2.1% speed in August is in line with the Q3 model f'cast
- Declining unemployment and solid GDP growth signal modest inflation the coming year, up to 2.3% in Q1 2020
- Norges Bank expects core CPI at 2.4% in 2019, and down to 2.1% in 2020 (June Monetary Policy report). Fair estimates

SpareBank 1 MARKETS

GDP growth spiked July, Q3 is off to a solid start

GDP soared 12% m/m annualized in July, surely just a one off but the speed into Q3 is anyway strong

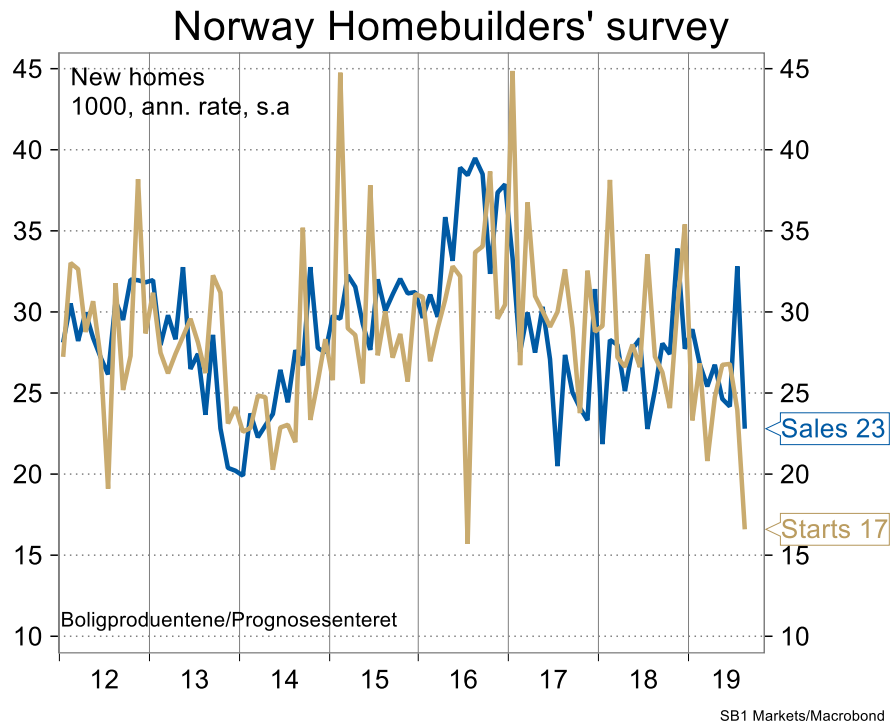


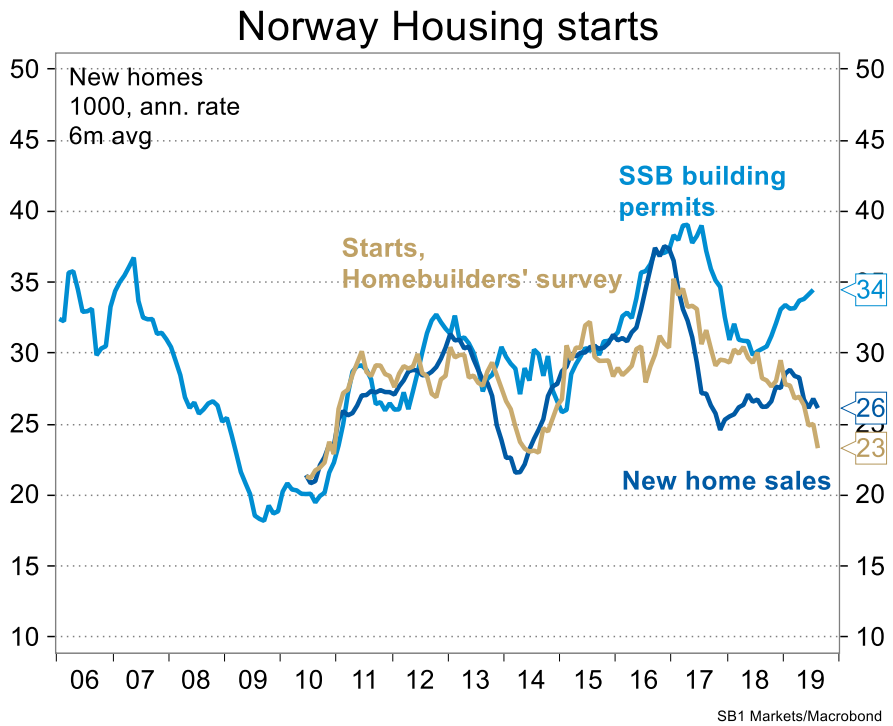


- Mainland GDP rose 1% m/m in July, equalling an annual rate of 12.2%. The monthly data are too volatile to give us any useful signals, but still confirms that growth is still above trend. GDP grew 2.7% in Q3, and the 3m/3m growth rate accelerated to 3.3% in July
  - » Norges Bank's implicit Q3 f'cast (from the June MPR) is 3.0% q/q annualized. The f'cast is within reach
  - » GDP is up 3.3% from July last year, of course 'artificially' boosted by the 1% m/m in July this year
- <u>On the demand side:</u> Private consumption is growing moderately. Mainl. business investments rose sharply in July but will probably slow in Aug/Sept. Oil investments rose in July (oil companies' est) and the trend recent months is strong – while we still think we are now close to th local peak. Housing invest. growing modestly. Mainland net trade has turned marginally positive
- <u>Monthly GDP data are useless but growth is above trend, supporting our view that Norges Bank will nudge up the interest rate later this week</u>

Homebuilders report softer sales – and a steeper decline in starts

SSB housing permits kept much better up due to a (temporary) hike in student homes starts



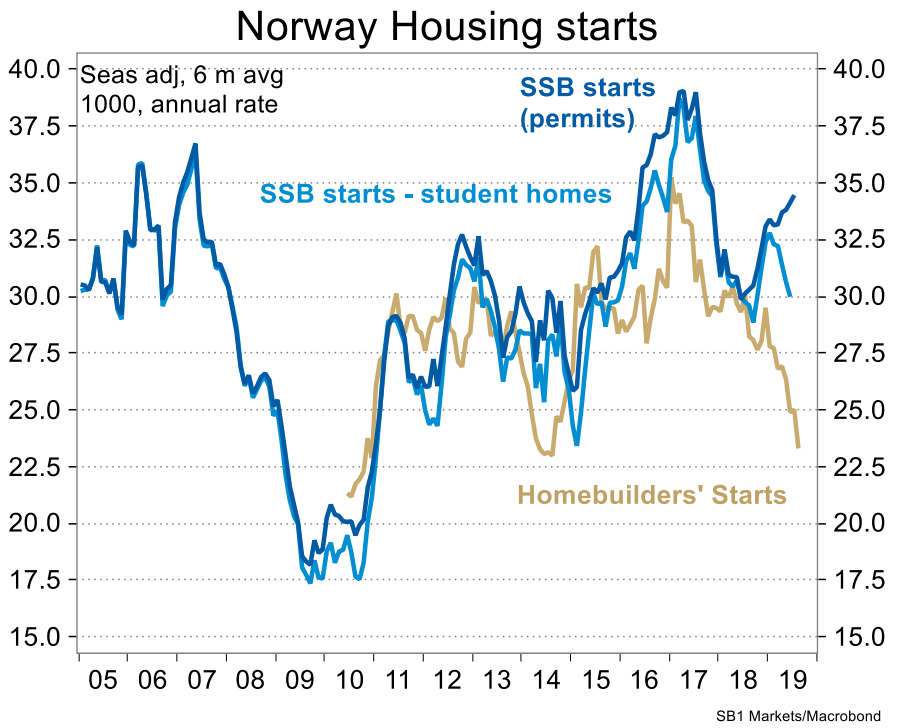


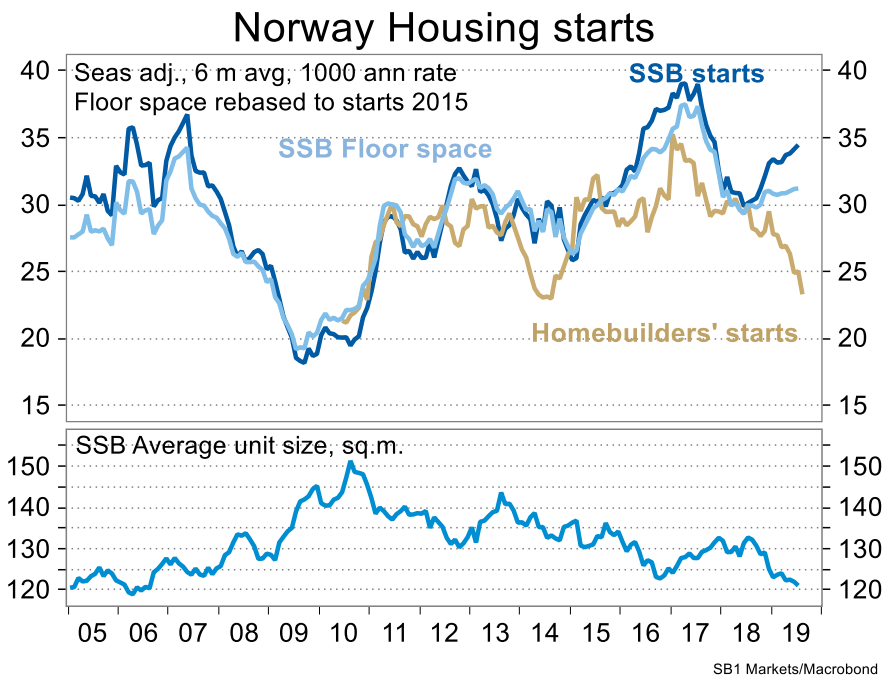
- The Homebuilders reported **new home sales** at an annual rate of 23' in August (seas. adj.), after soaring to 33' in July. Sales have been sliding down since early 2019 but is still slightly up from the late 2017 trough. The 6m average has fallen to 26'
- Homebuilders' **housing starts** dropped to an annual rate of 17' in August (seas. adj.), down 7' from July and the weakest month since 2016. The 6m average has fallen to 23', <u>heading steeply down the past 6-7 months</u>
  - » SSB reports building permits at 34' (6 m avg), trending up, the gap to the Homebuilders at 23' is unprecedented. We can explain part of it by a boom in student homes, check the next slide

SpareBank 1 MARKETS

Barring student housing, housing starts have most likely peaked

… Although the downturn is much steeper according to the Homebuilders





- In Q2, student housing, which is only included in SSB's statistics, explained more than half the gap. Student home construction equalled 4' in annual rate in H1, no doubt a temporary hike. In addition, student homes are smaller than other homes, and the contribution to construction activity and to housing supply is less than for other housing (some 1/3rd per unit we guess)
  - » Measured by total sq.m., starts have not increase by much recent quarters according to SSB – <u>but it has not fallen either</u>!
- If Homebuilders' data were representative, it would have substantial impact on the assessment of the Norwegian economy. Norges Bank's regional network did not report any broad weakening in the construction sector where supply constraints were more important than demand challenges
- Still, we cannot completely disregard data from the homebuilders either, and they are supported by other reports of slower new home sales. (BTW, there are also far larger volumes of existing homes for sale in most places outside Oslo, so far without depressing existing home prices)

Highlights

The world around us

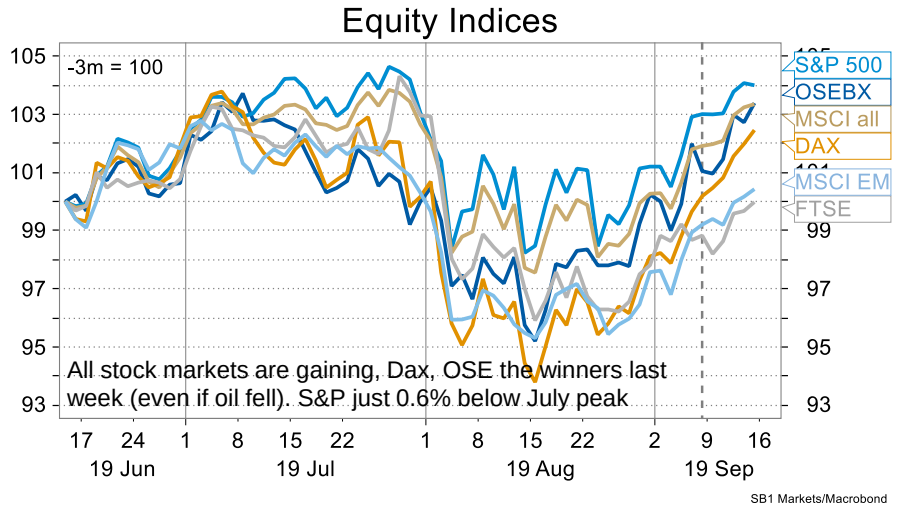
The Norwegian economy

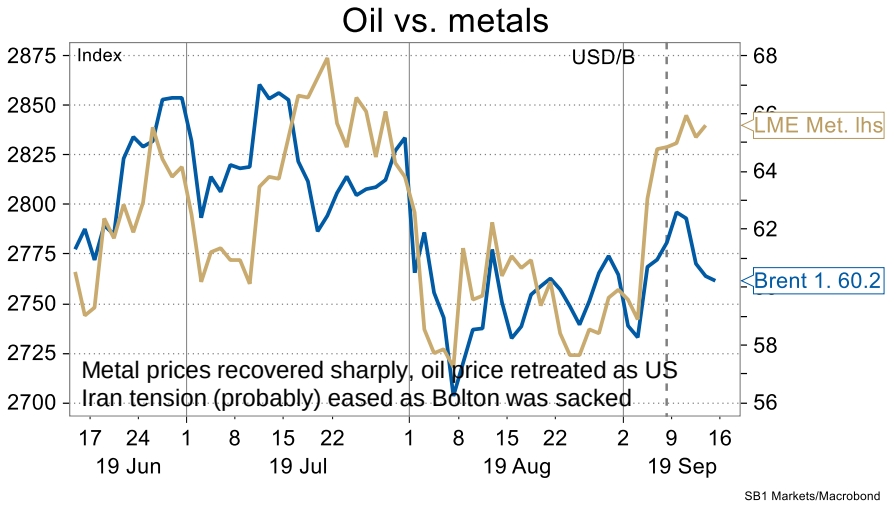
Market charts & comments

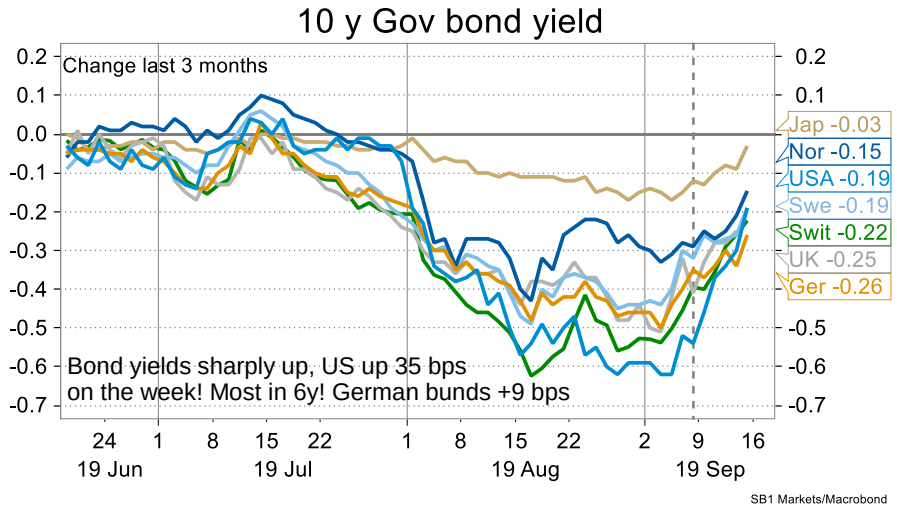
SpareBank 1 MARKETS

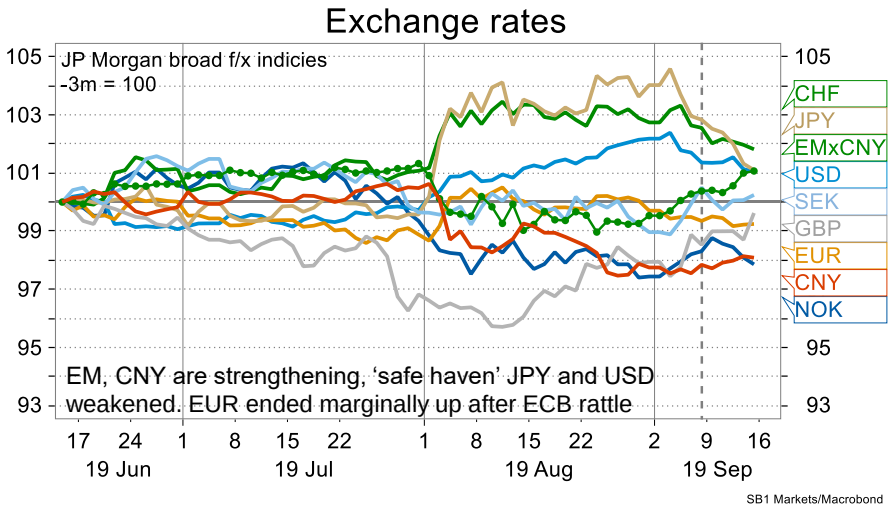
Risk markets climb on trade war optimism – and enough ECB stimulus for now?

A broad stock market upswing and bond yields recovered. Metal prices soaring, oil down with Bolton (!)





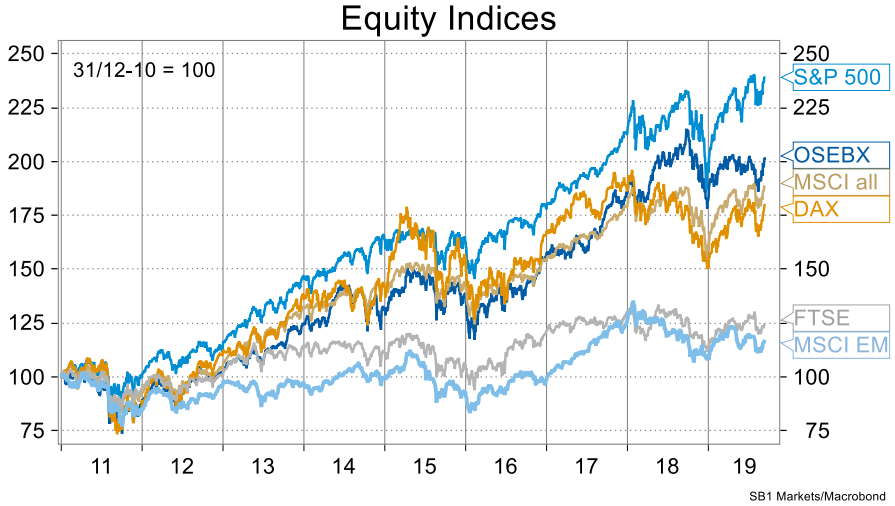


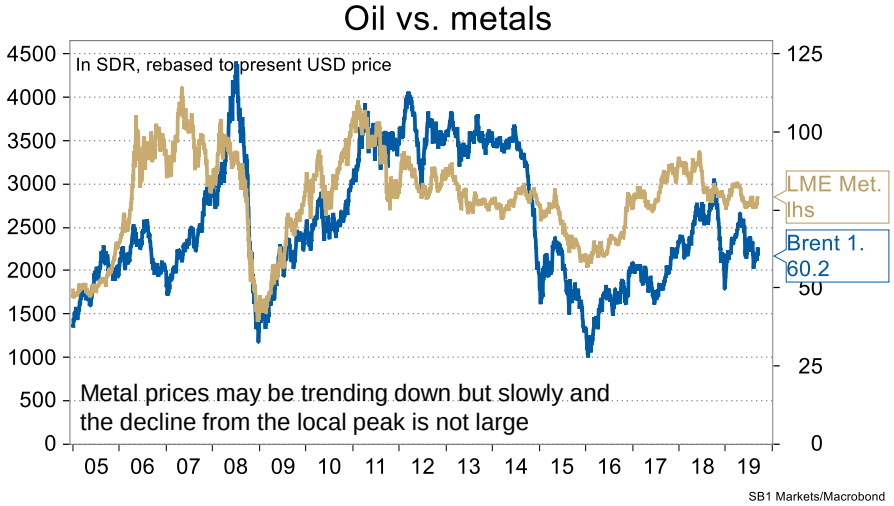


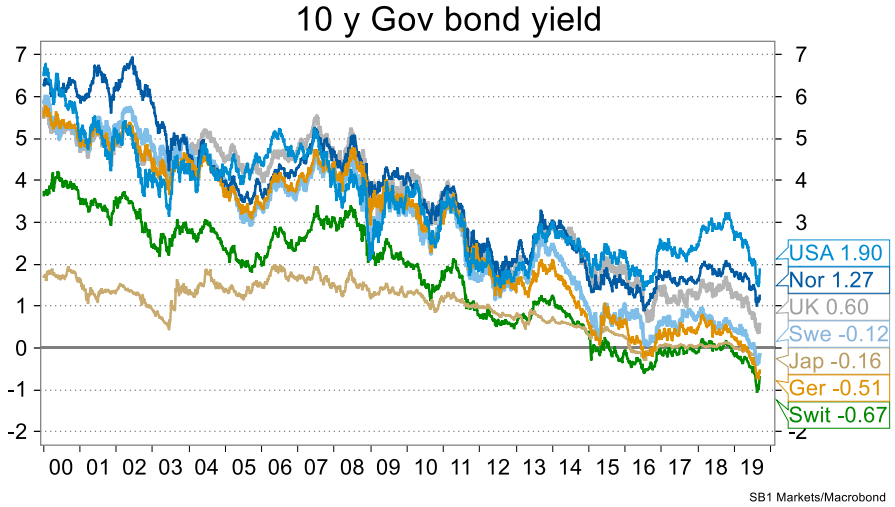
SpareBank 1 MARKETS

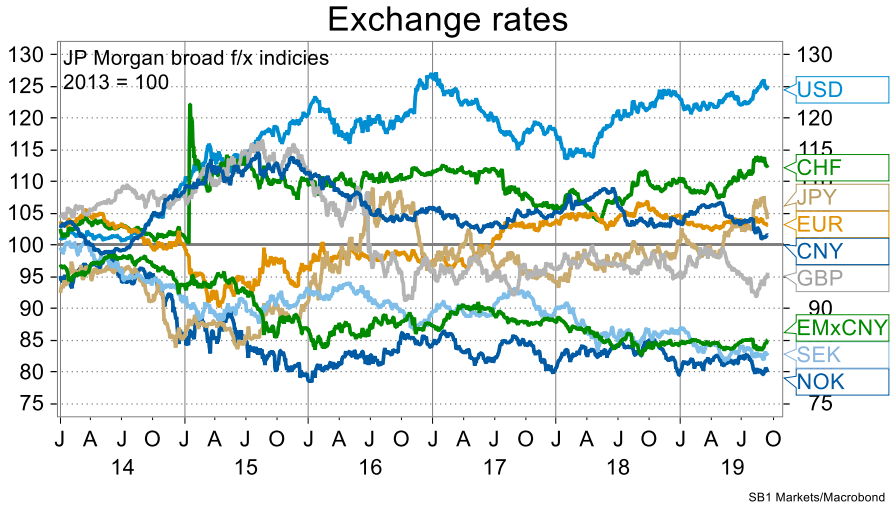
In the long run: Bond yields at/close to ATLs, US stock markets close to ATH

The trade war rules. And then some economic data. Volatility is probably here to stay





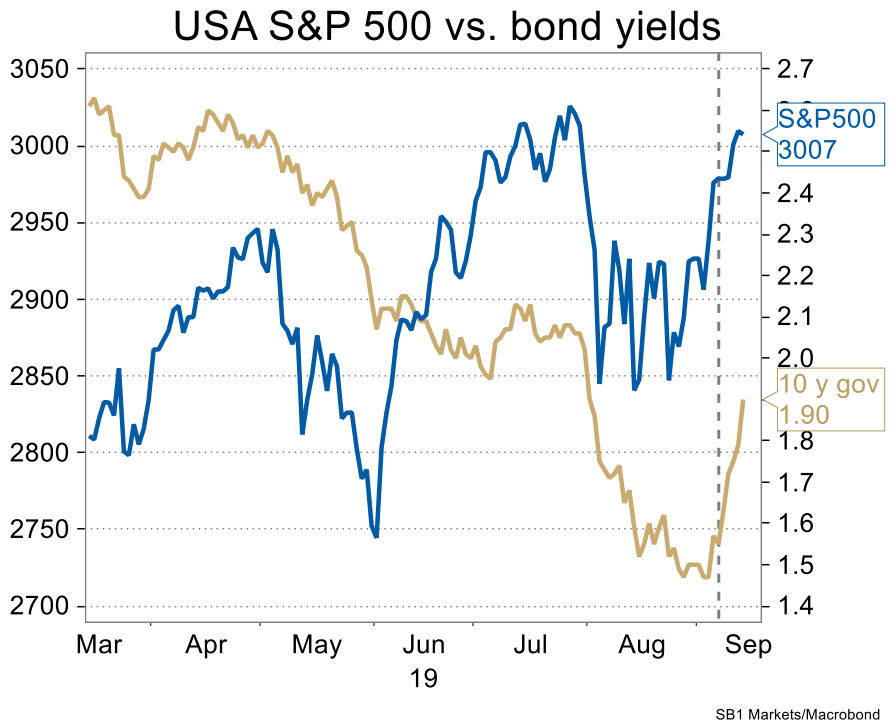


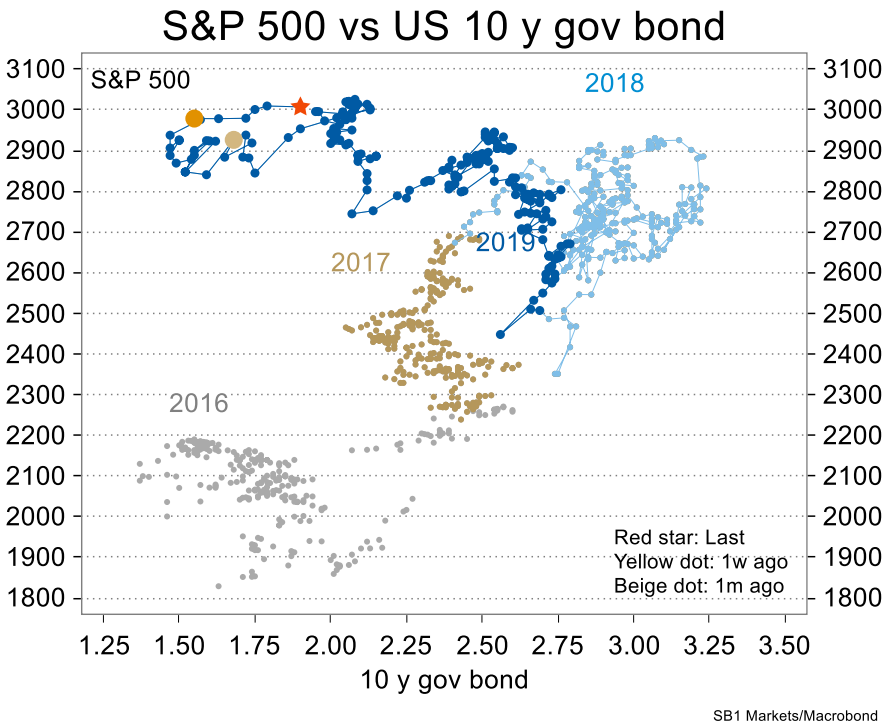


SpareBank 1 MARKETS

US: Renewed hope of a trade war de-escalation adds to the rebound

10 y gov up 35 bps to 1.90%, S&P closing in on July peak. The trade war cycle continues…



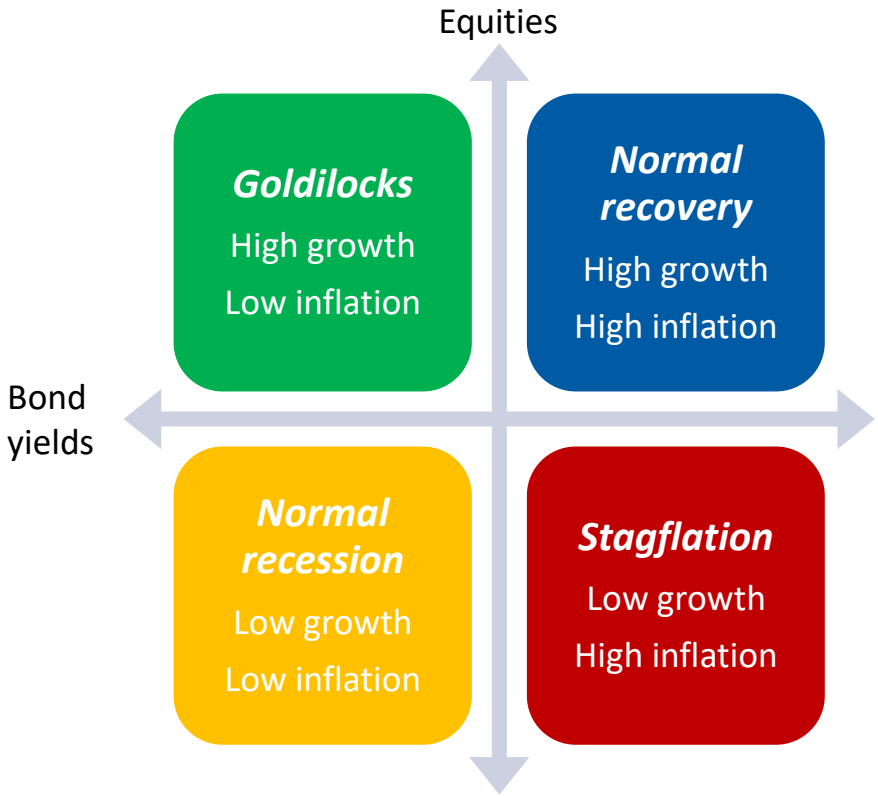


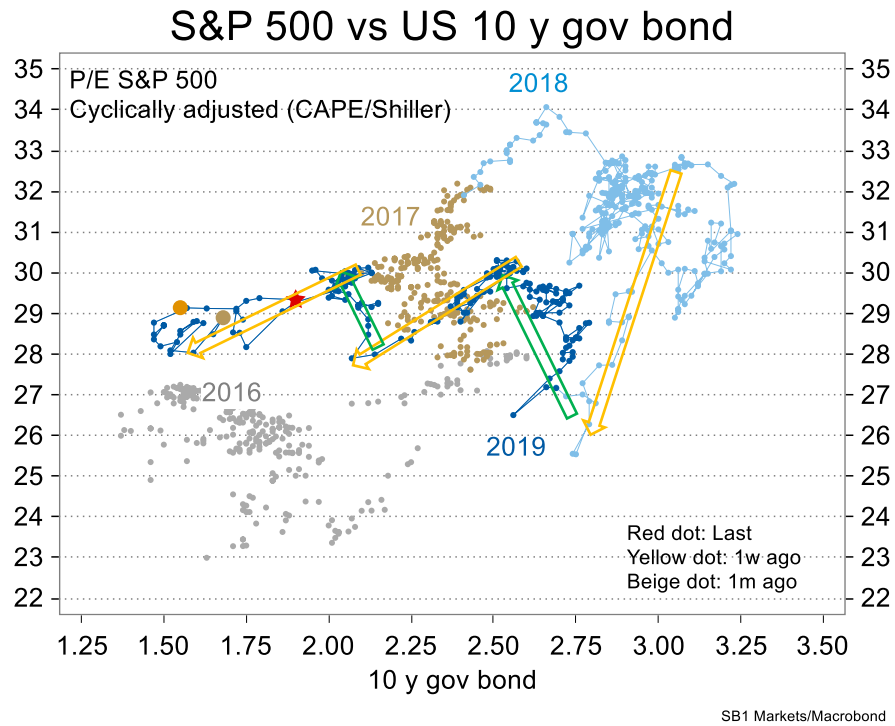
- Stock markets climbed last week amid optimism ahead of the US China trade talks. China announced a 'goodwill' gesture and Trump answered by postponing the planned tariff hike from Oct 1 to Oct 15, and saying he would consider an interim deal with China
- Bond yields soared 35 bps on the week, a quite unusual lift (most since 2013), to the highest level since early August. Strong macro data probably helped too; CPI inflation came in above expectations and the number of new jobless claims fell close to a 50 y low. But no doubt, the Fed have to cut the interest rate! What a world…
- For more on the relation between stocks and bonds, check next page

SpareBank 1 MARKETS

US markets are moving towards the 'normal recovery' corner

The mood has changed the past couple of weeks; both stocks and bond yields are gaining



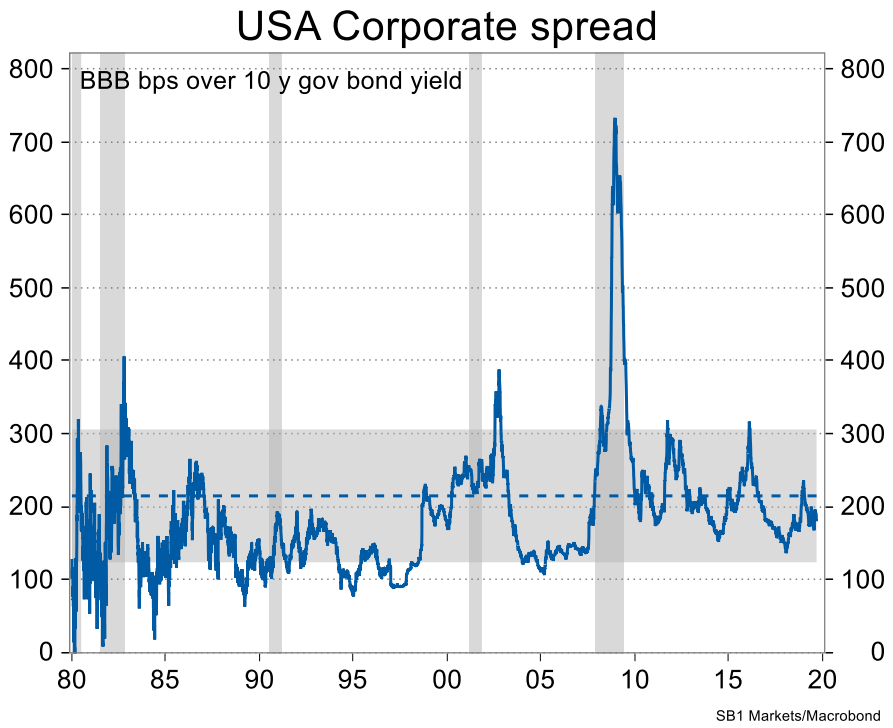


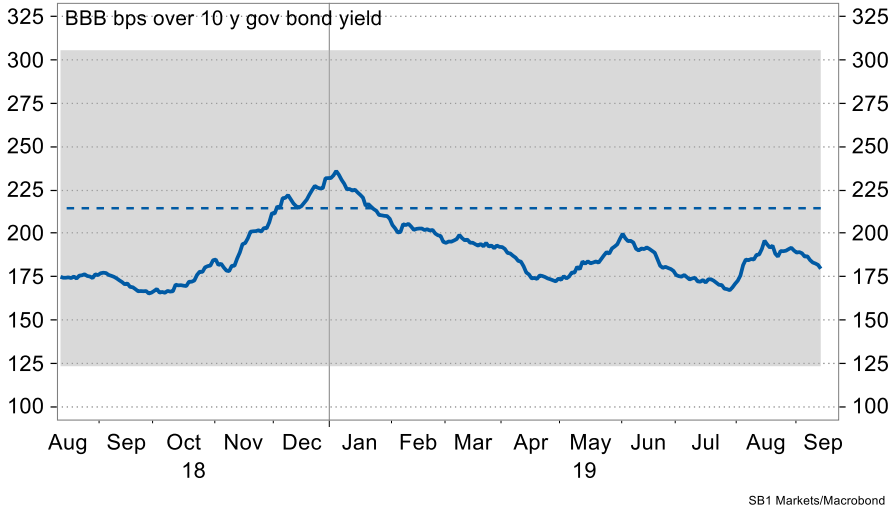
- In July, the market fluctuated mostly along the normal recession/normal recovery axis
- In August, markets moved towards the recession corner following the bad trade policy news. So far in September, both markets are recovering, on renewed hopes of a trade war de-escalation and some upbeat US macro data
- We do not think a long term 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

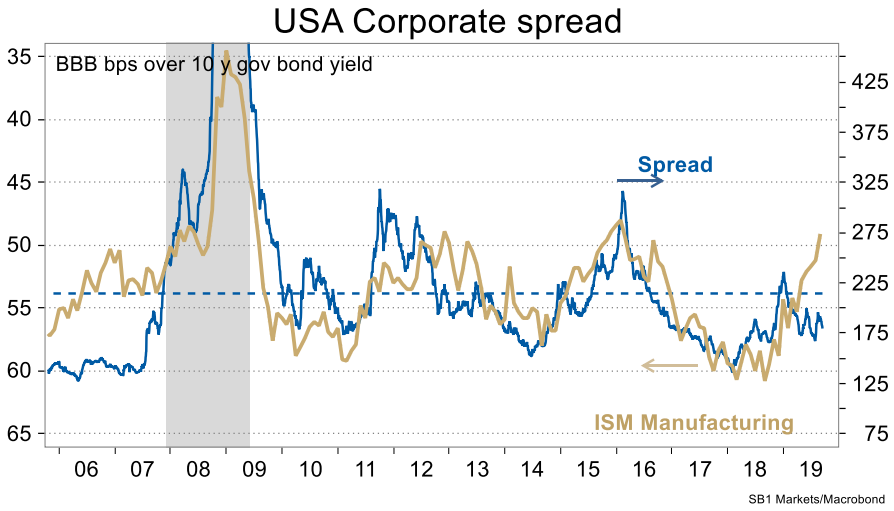
SpareBank 1 MARKETS

Credit spreads are far 'too' low – if the ISM is anywhere close to the ball

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



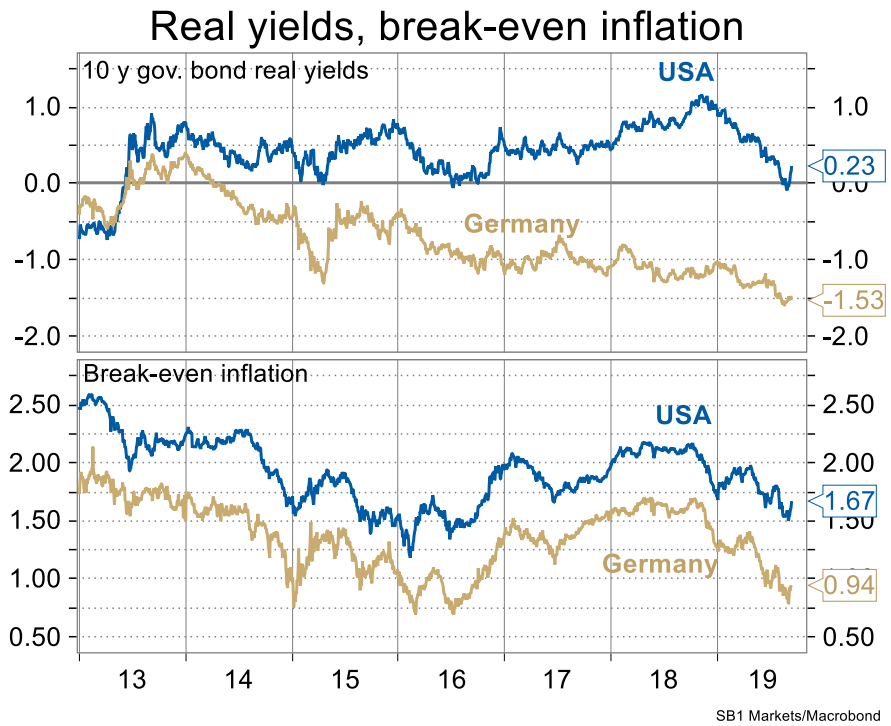


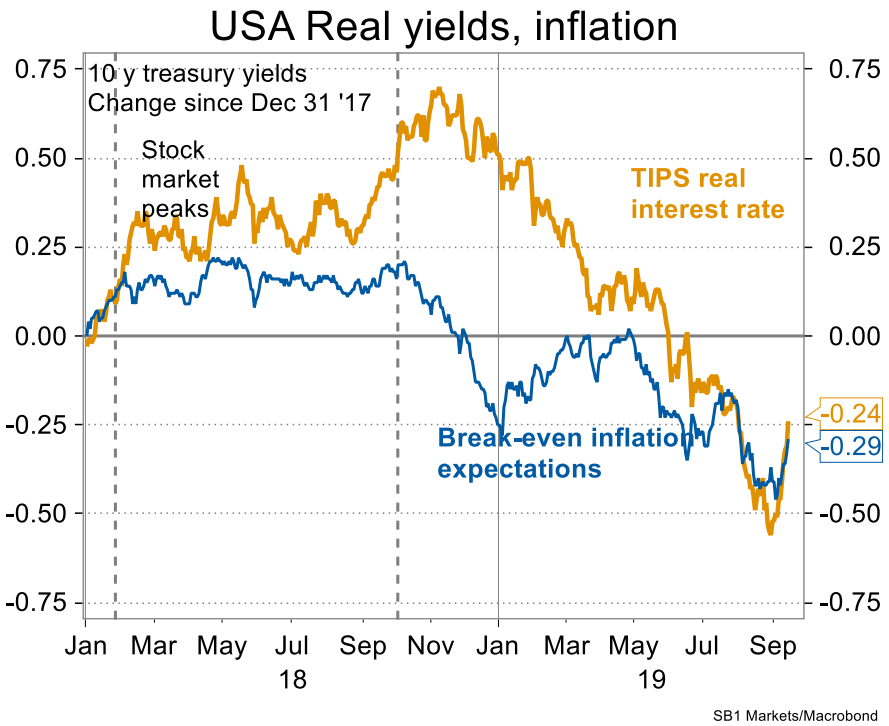


SpareBank 1 MARKETS

US real rates and inflation exp. picking up, Germany inflation a tad up too

US real rates up 32 bps from trough (Germany 16 bps) – and infl.exp. up 17 bps (still far below target)





- Both real rates and break even inflation have been heading steeply down this year, in both US and Germany
- German real rates are recovered modestly, up to -1.53% (flat last week) while inflation expectations have recovered somewhat more, up 16 bps since the bottom at Sept 4 (just marginally up last week). Inflation expectations at 0.94% does not seem <u>that</u> far off, although far below the ECB's price target at close to 2%. Real rates, on the other hand..
- Inflation expectations rose to 1.67% in the US, up 13 bps on the weak. Real rates are recovering more swiftly, to 0.23%

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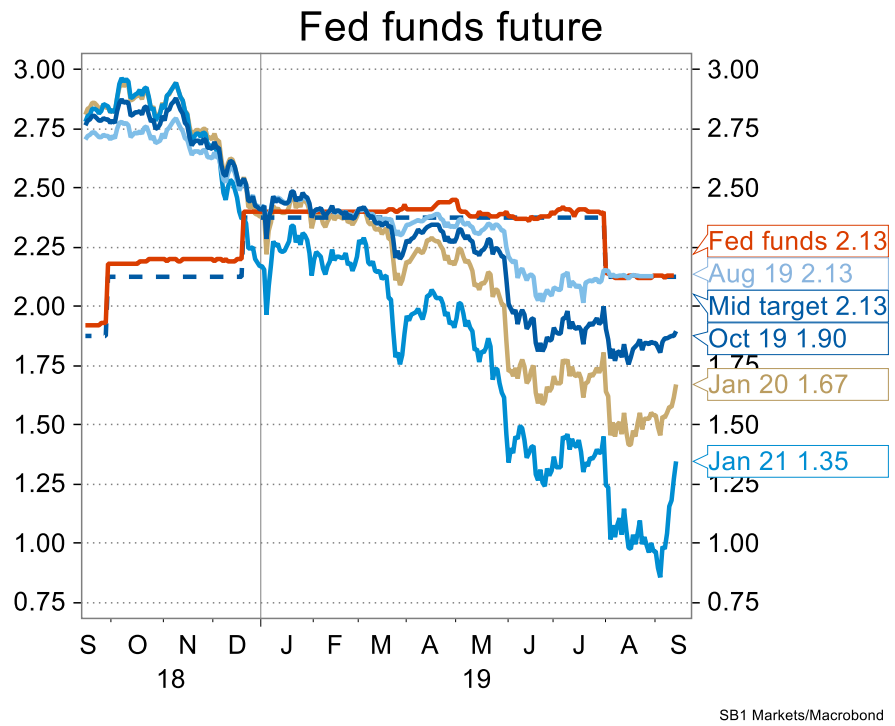
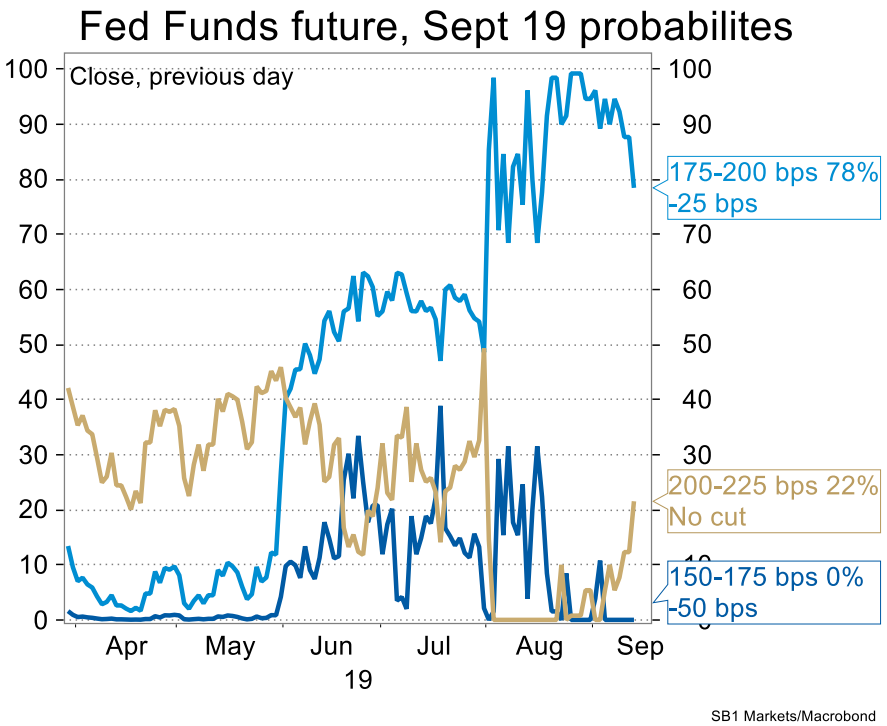
Fed fund futures steeply up in the long end, and some doubt even on 25 bps now

A cut now is still expected but the prob. of no cut up to 22%! (No good reason to cut, of course)

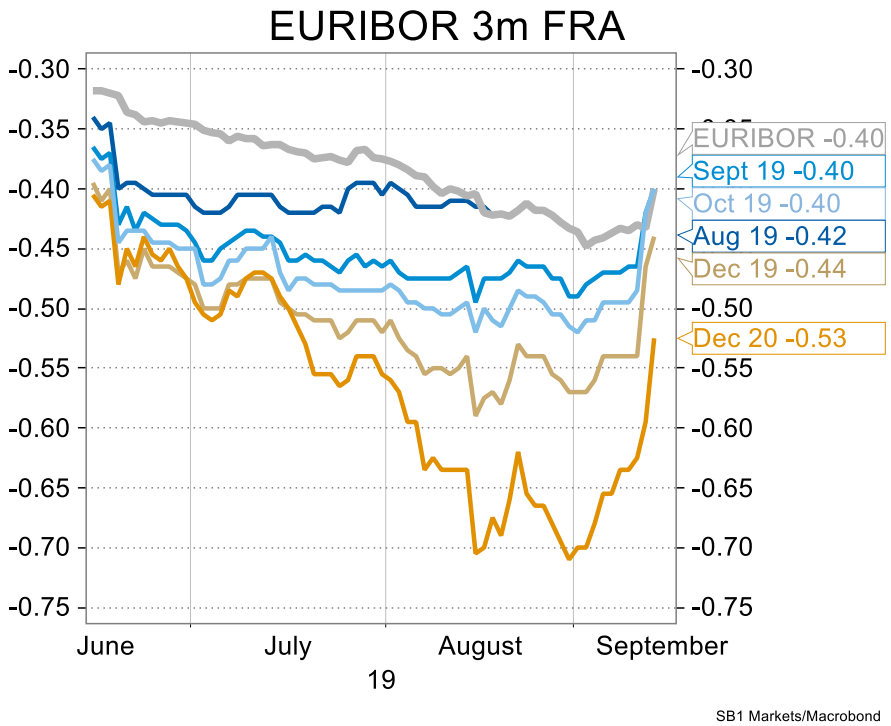


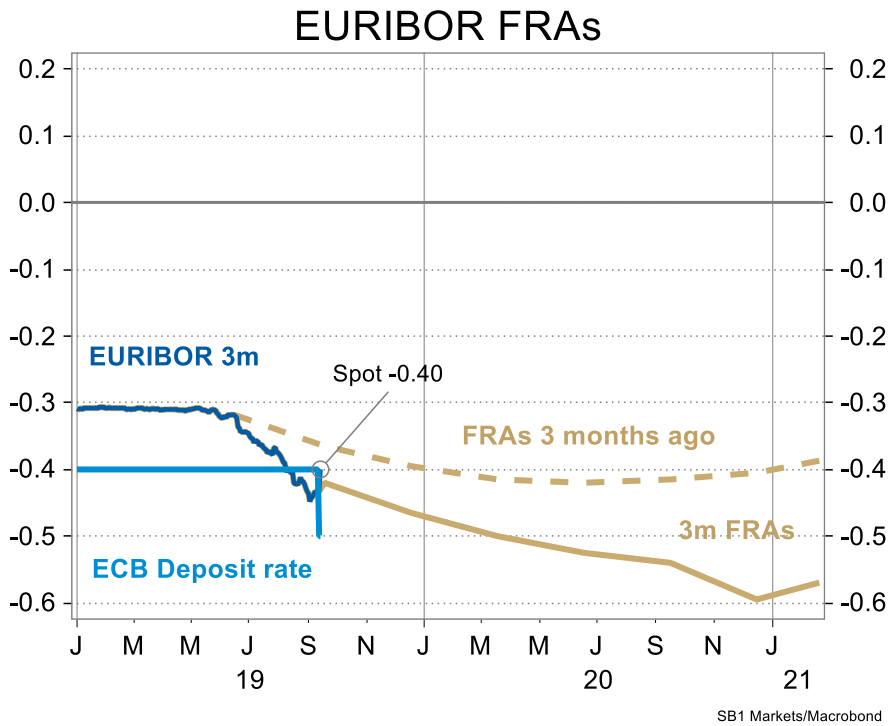


- The trade war escalation and growth concerns took the Fed fund futures steeply down until early Sept. Then the mood changed, bringing the FRAs sharply up. The Oct '19 contract is up 15 bps from the bottom on Aug 15 and the Jan '21 contract has increased by 50 bps since Sept 4, two hikes where wiped away. Which is fully understandable, at least given the far tool low starting point
- The probability of a 50 bps cut this week is reduced to zero, and 22% for no cut, form zero some few days ago. Market is pricing in less than 2 cuts before Jan (a 3rd cut has been removed during the past 2 weeks) and 3 cuts by the end of 2020 (was 5 at the bottom)
- US growth is slowing but it is still above or at trend. PCE inflation is not far below the target. Yes, there are clouds at the horizon but it is still not raining. The USD is stronger than normal but not by that much. The economy does not AT ALL justify another interest rate cut now, but another 'precautionary' 25 bps cut is the most likely outcome. However, the opposition within the FOMC must be 'exploding', given recent data, trade talk and market developments and we would not be that surprised if the rate was kept unchanged. Markets would…

The EUR curve steeply up after ECB announcement, slashing cut expectations

ECB cut by 10 bps (20 bps prices in by some 50%) and announced less aggressive QE than expected





- <u>More on the ECB on this slide</u>

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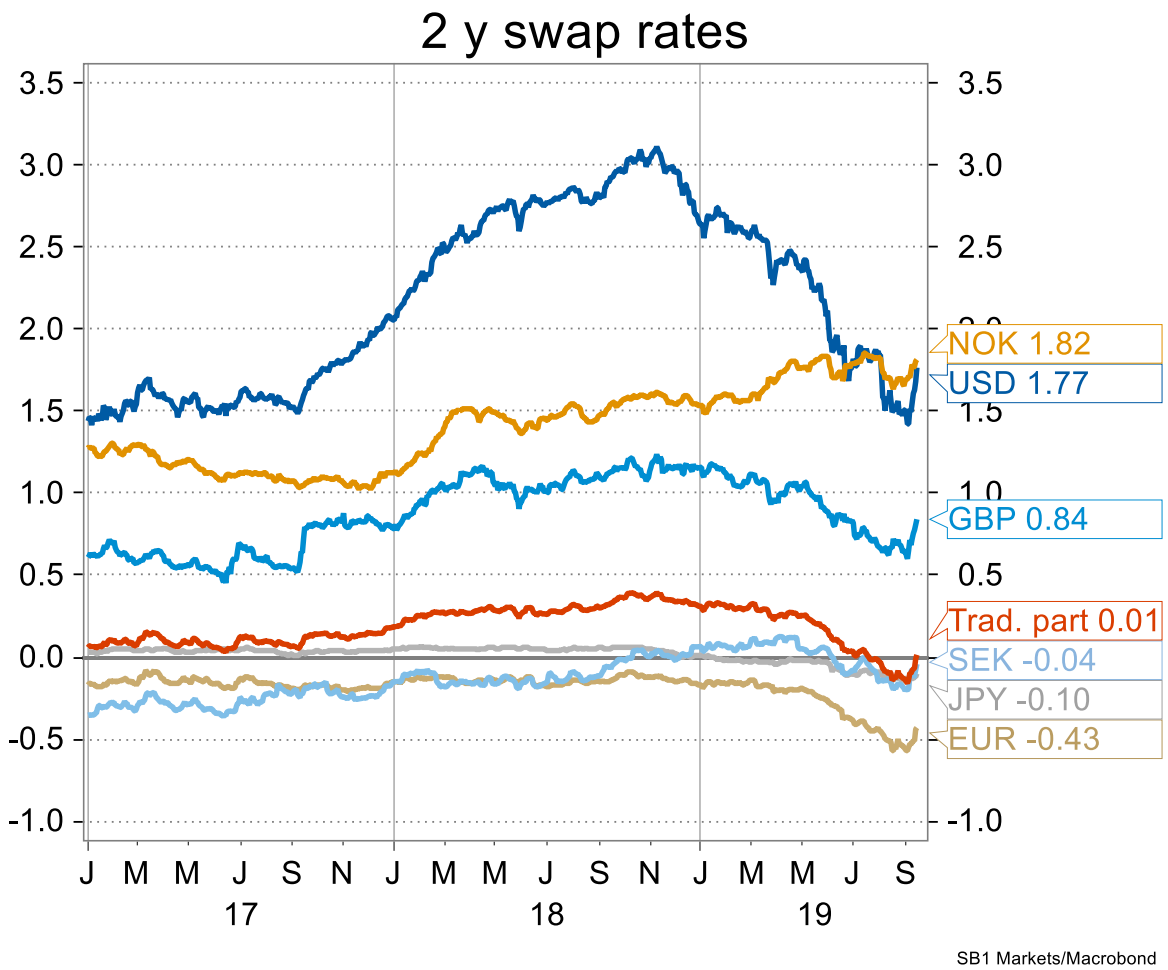
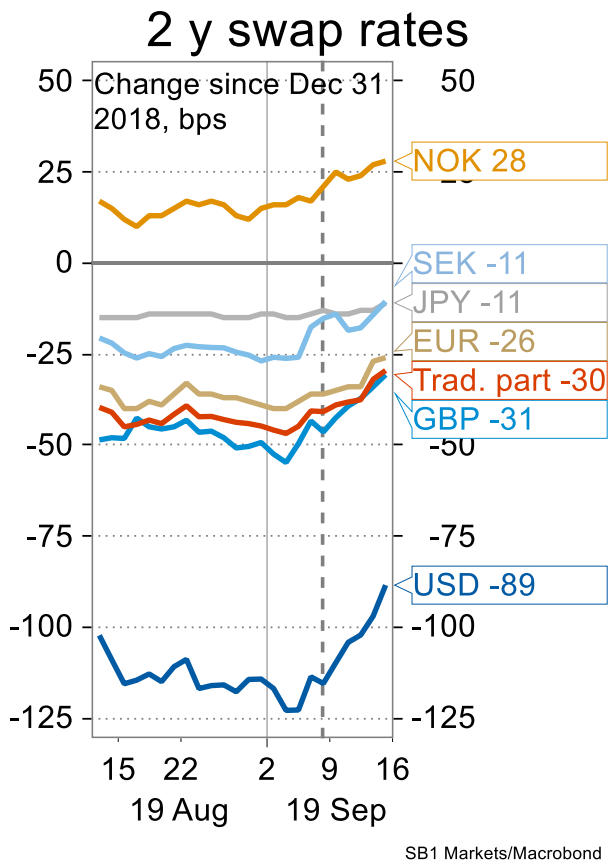
Short term rates are climbing all over, USD and EUR steeply up last week

Trade war easing and the ECB sent EUR 2 y rates up 7 bps and USD by 5 bps on Thursday





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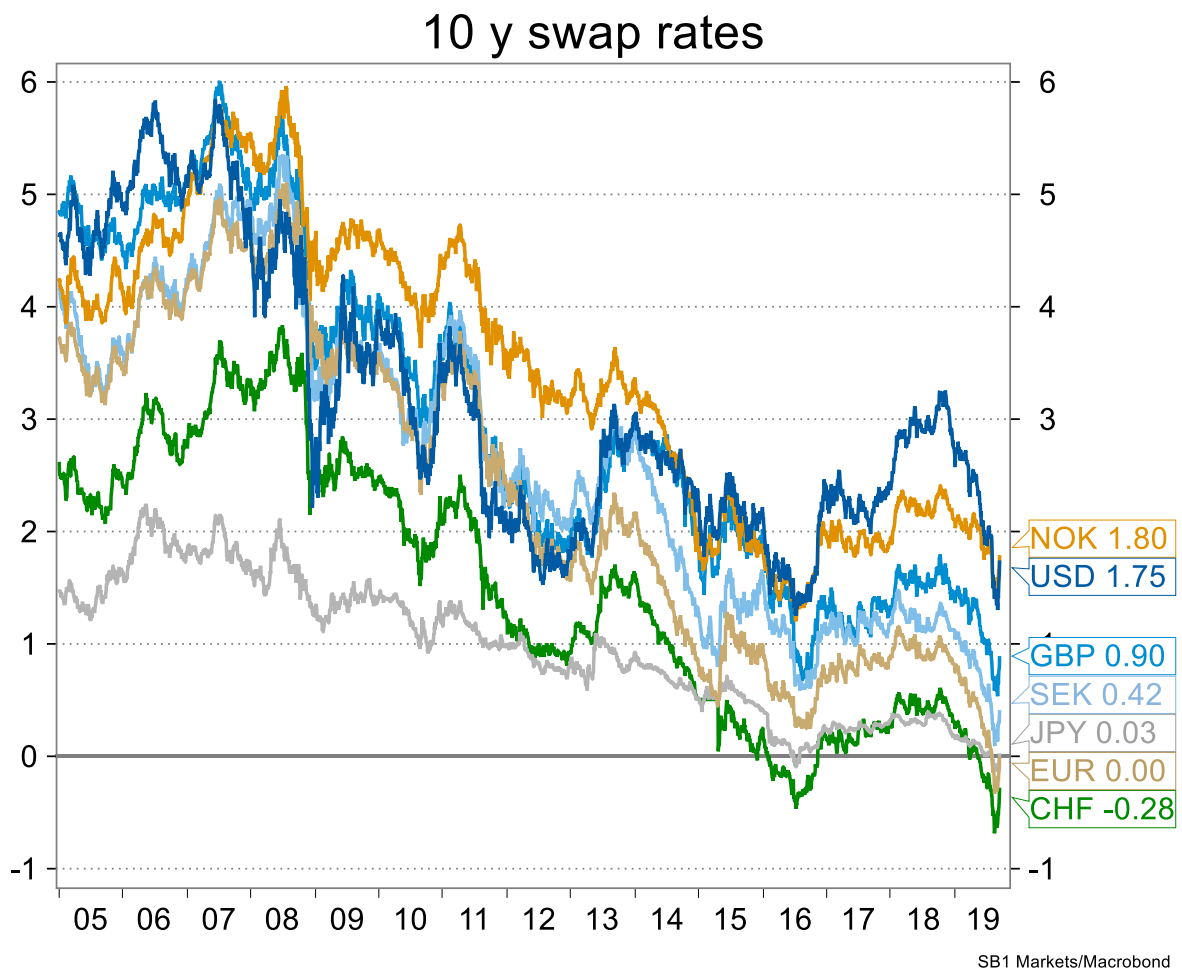
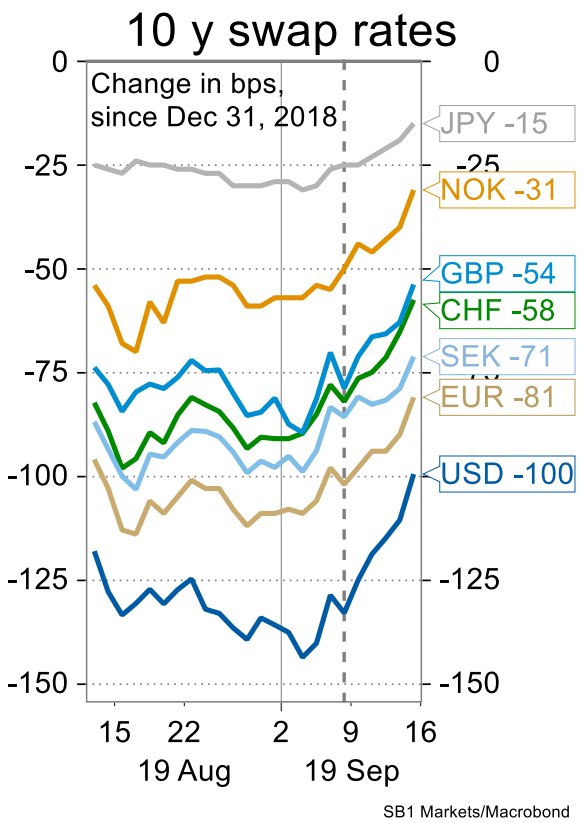
Long term swap rates recovered 'everywhere' – less in Norway

10y USD swap up 34 bps last week, EUR 21 bps, GBP 25, and NOK 19 bps





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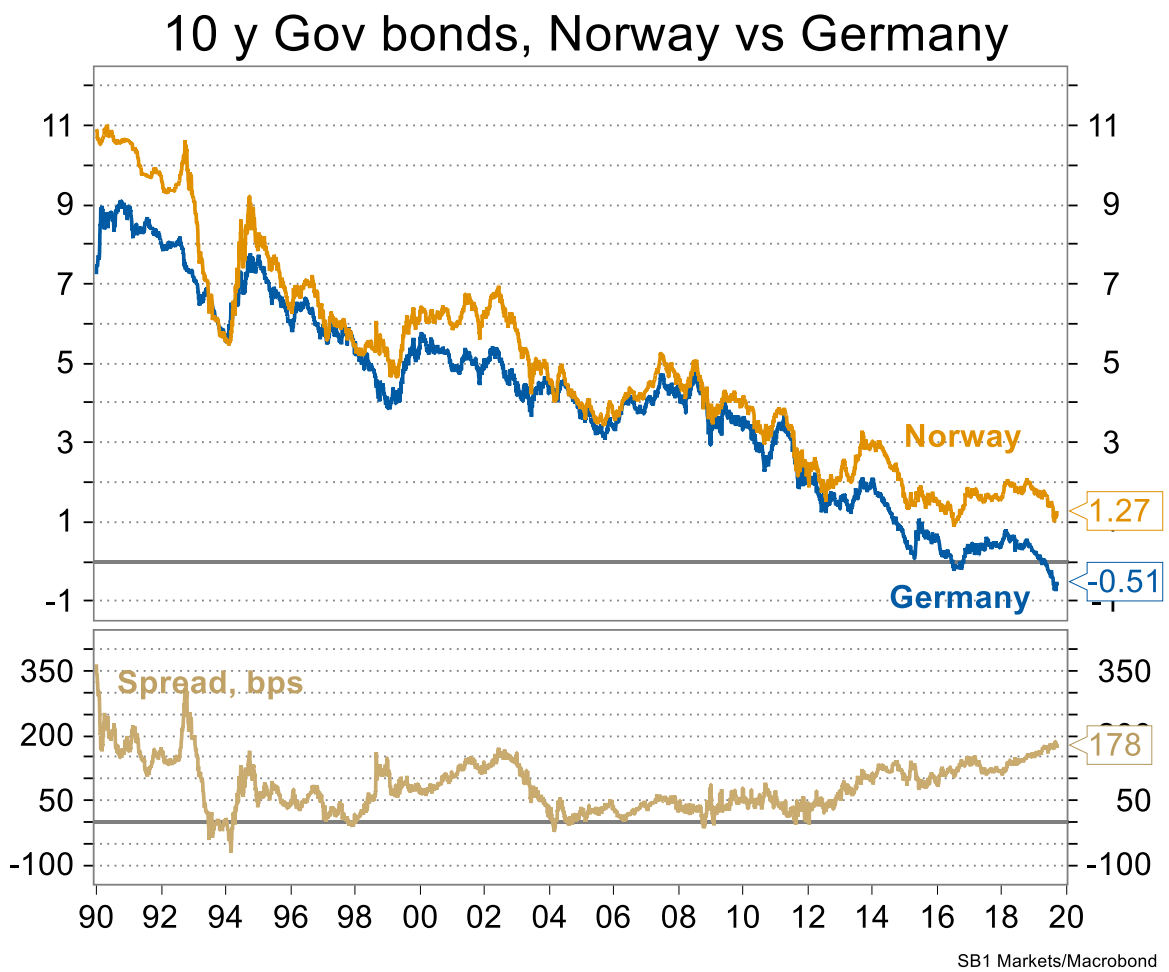
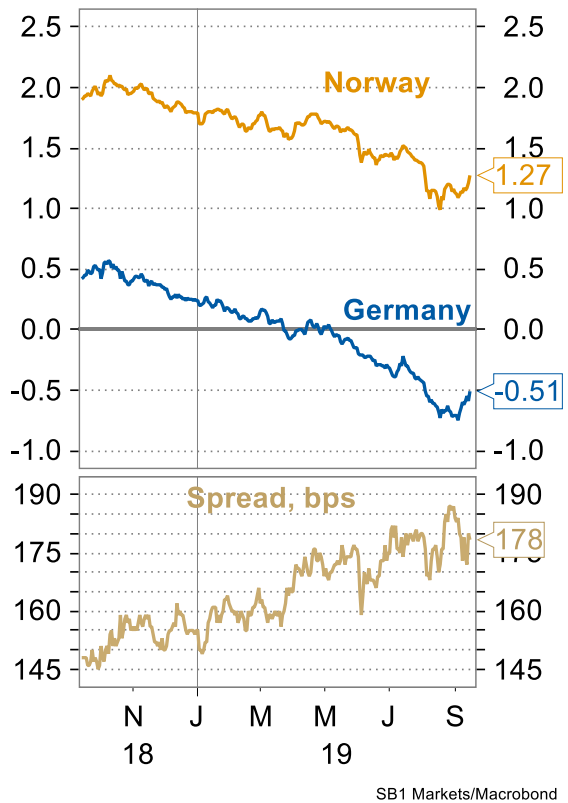
The Norway/German 10 y gov spread down from the peak, but not more last w.

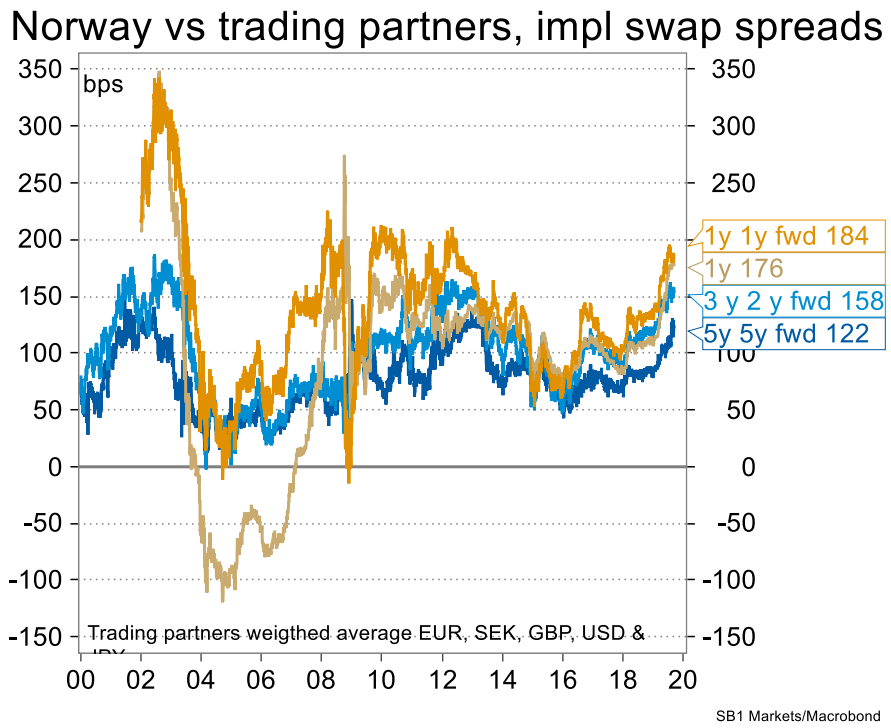
The spread has stabilized past 2 weeks, still unusually elevated

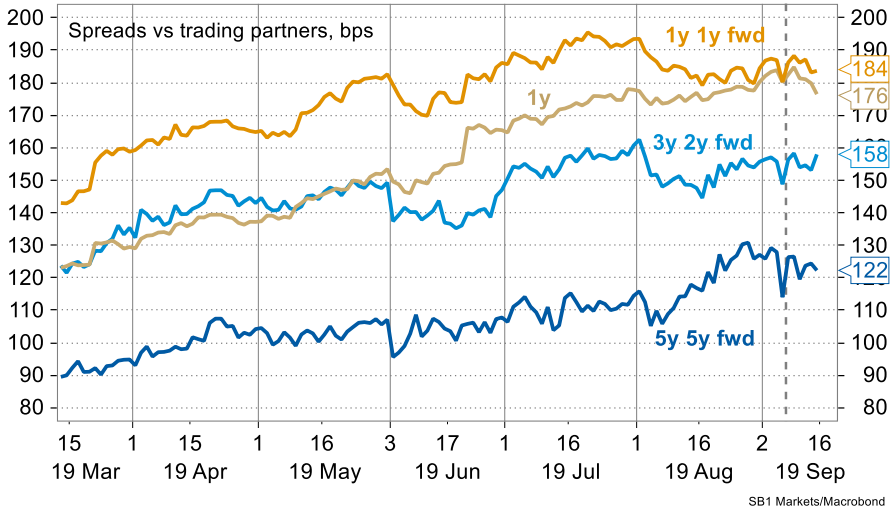


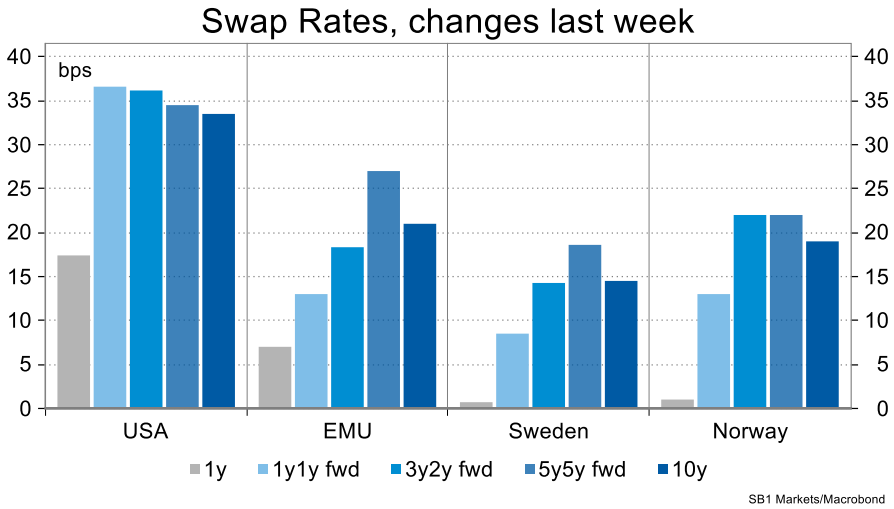


Spreads vs trading partners have finally peaked?

Spreads have been too high, particularly in the long end







- Swap spreads between NOK rates and our trading partners have been widening rapidly this year. The past weeks, the spreads have flattened out (mixed last week)
- While 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. Last week, long term yields recovered more in Norway than trading partners (x the US) and the spread came out. <u>It must be 'too' high?</u>

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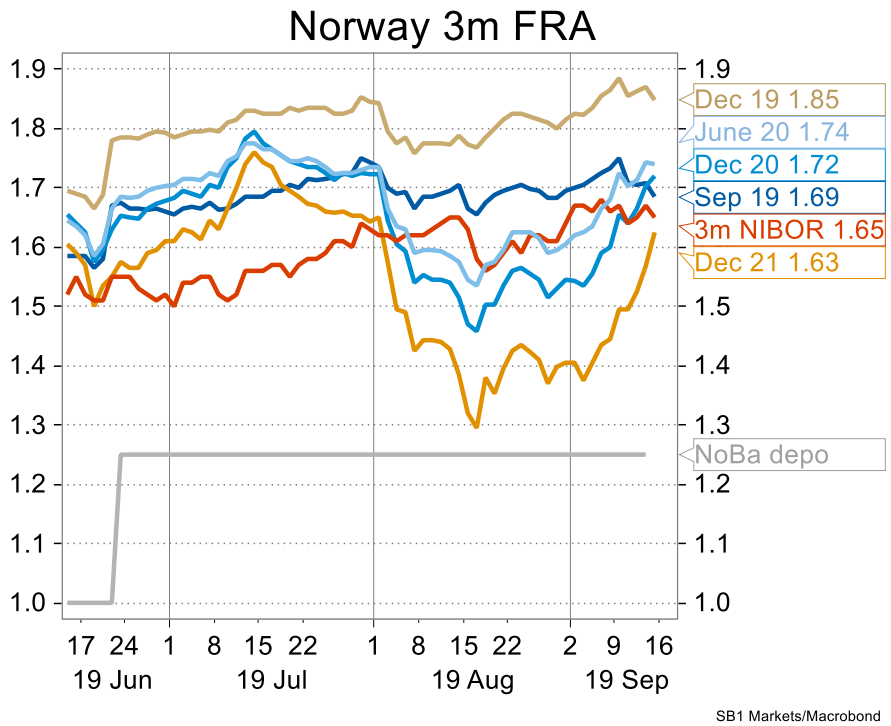
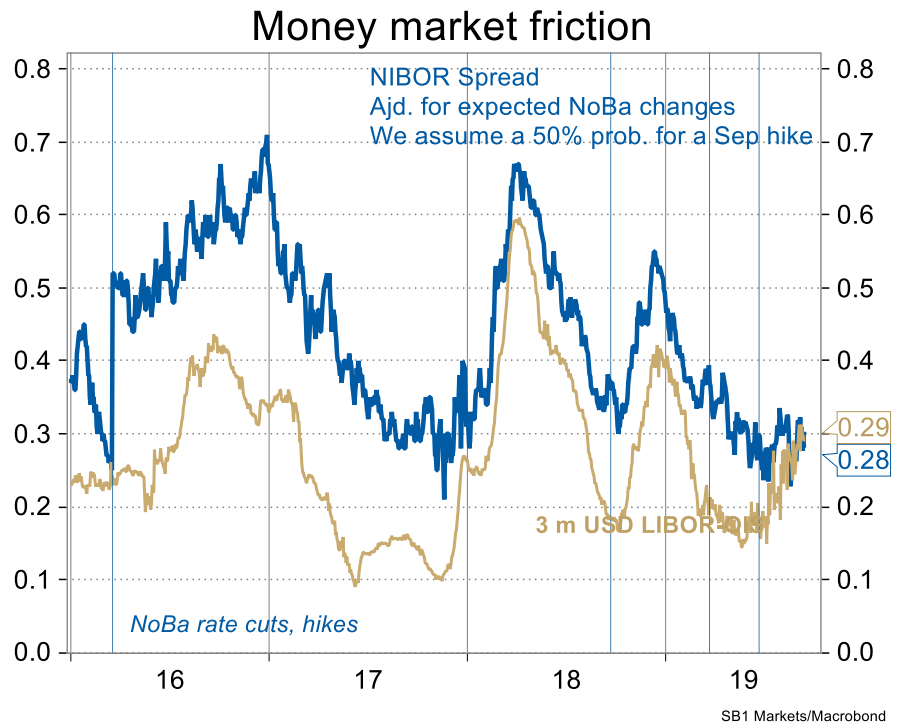
FRAs came down last week, discounts a 1/3rd probability for a hike?

Most likely, the NIBOR spread has widened. NIBOR 4 bps below Sept FRA, will converge on Wedn.!





- We have been waiting for the difference between the 3m NIBOR, and the SEP 3m FRA contract to narrow as the differential has been far too high for three weeks. The gap came in last week, but the remaining 4 bps will disappear at the 18th
- The Sept 3 m FRA fell 5 bps last week to 1.69, still implying a 1/3rd probability of a NoBa hike in September if we assume a 35 bps NIBOR spread (from 30 in mid June). However, the US LIBOR - OIS spread has widened, and the NIBOR spread may now be higher
  - » On the chart to the right we calculate the spread by using the 3 m NIBOR, which is probably 4 bps too low now, signalling a too low 'real' NIBOR spread
- The DEC 3 m FRA at 1.85% indicate a substantially higher spread too, the market can't possibly not take it for granted that NoBa will hike before Christmas (implying a 35 bps spread), even if this is our main scenario. A 75% probability for a 25 bps hike yields a 40 bps NIBOR spread, a 50% probability a 48 bps spread. The longer dated FRA rates have soared past two weeks, like abroad

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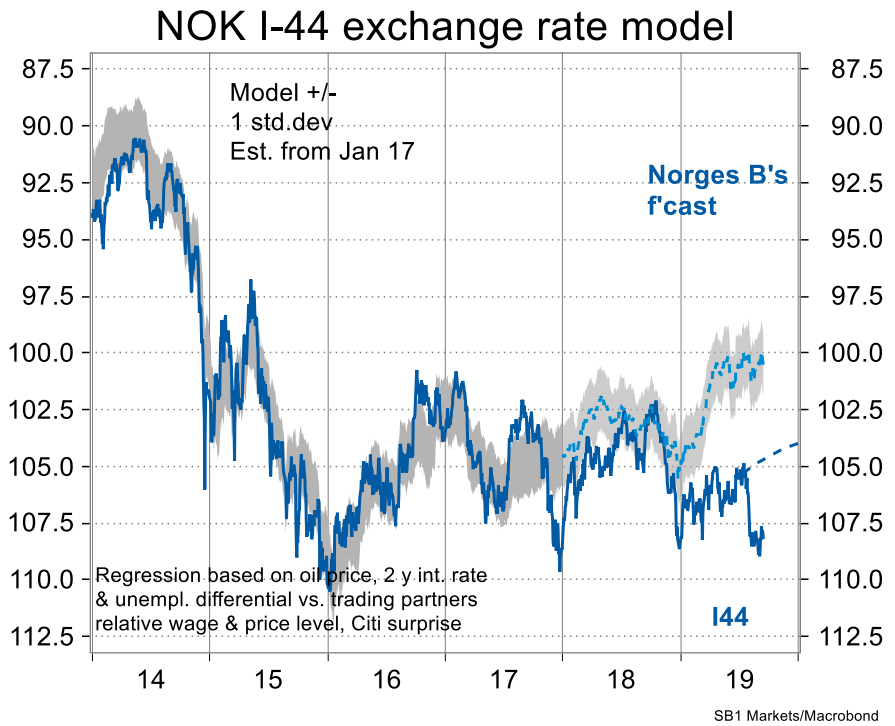
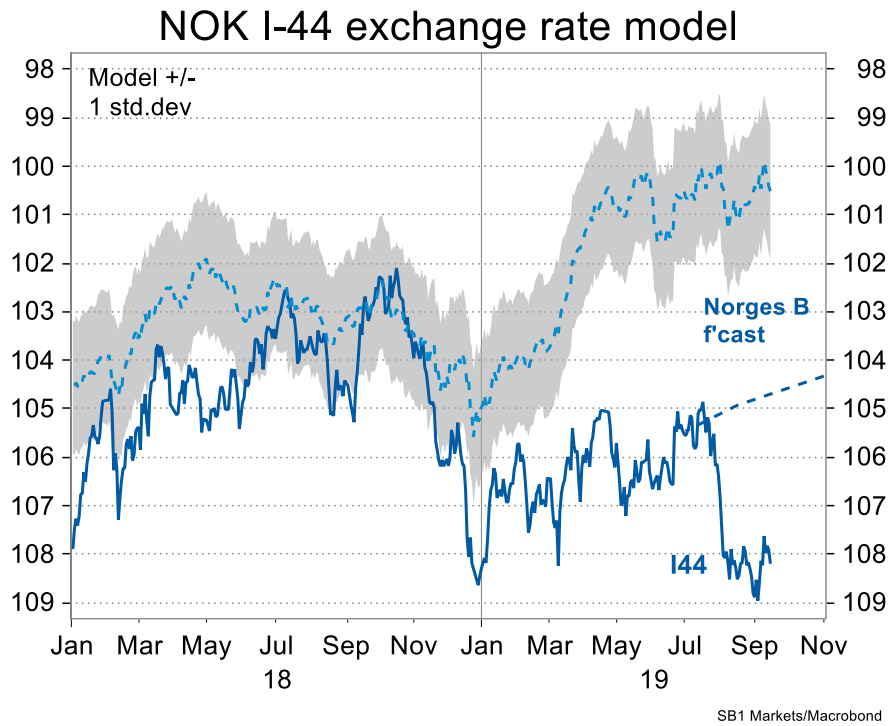
NOK flat w/w, better than the model estimate

NOK is still unusually weak vs the model as vs 'supercycles' currencies too





- NOK appreciated more than the oil price and interest rate spreads suggested last week, up 0.2% on the week. The gap to the model is still wide, at 7.5% (from record high 8.5% two weeks ago)
- Even our super-cycle f/x model does not fully explained the NOK weakness since mid July. Last week, all supercycles appreciated, as trade tensions eased
  - » We have tested our models with global risk etc., without success
- Long term, we stick to our long term **buy NOK** recommendation

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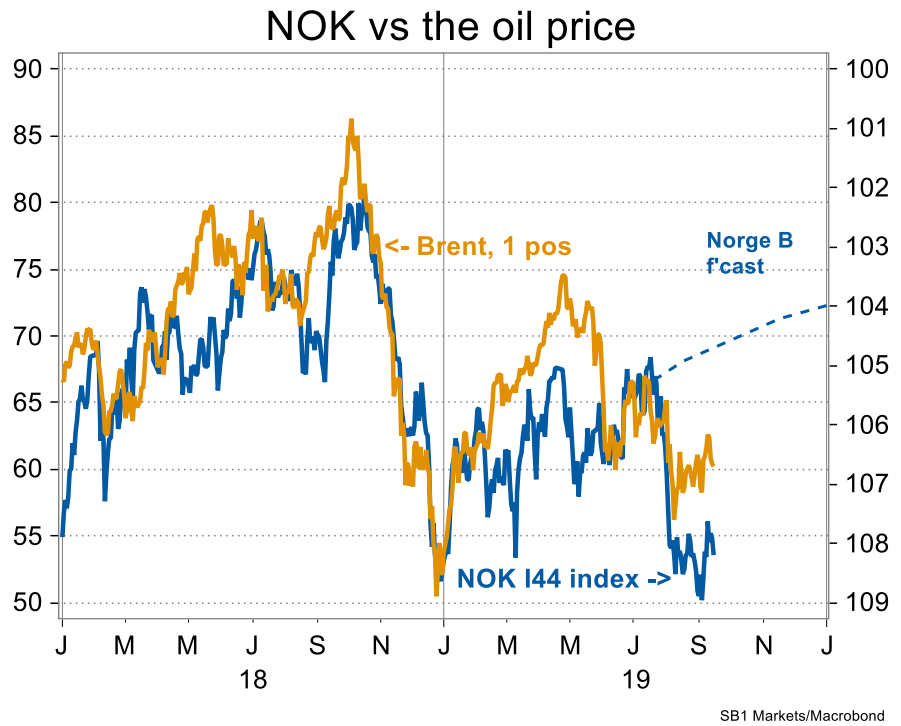
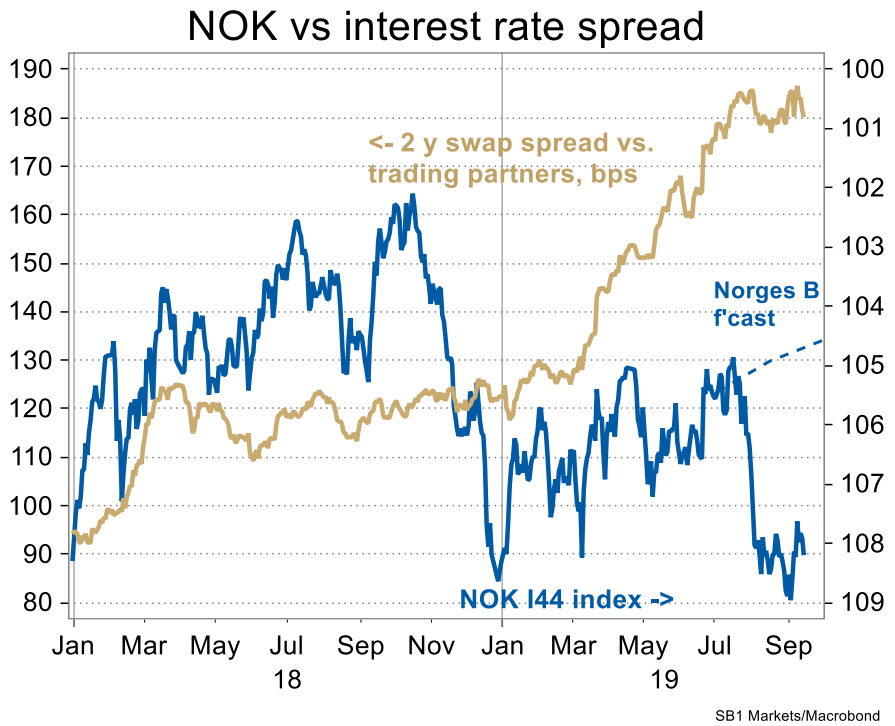
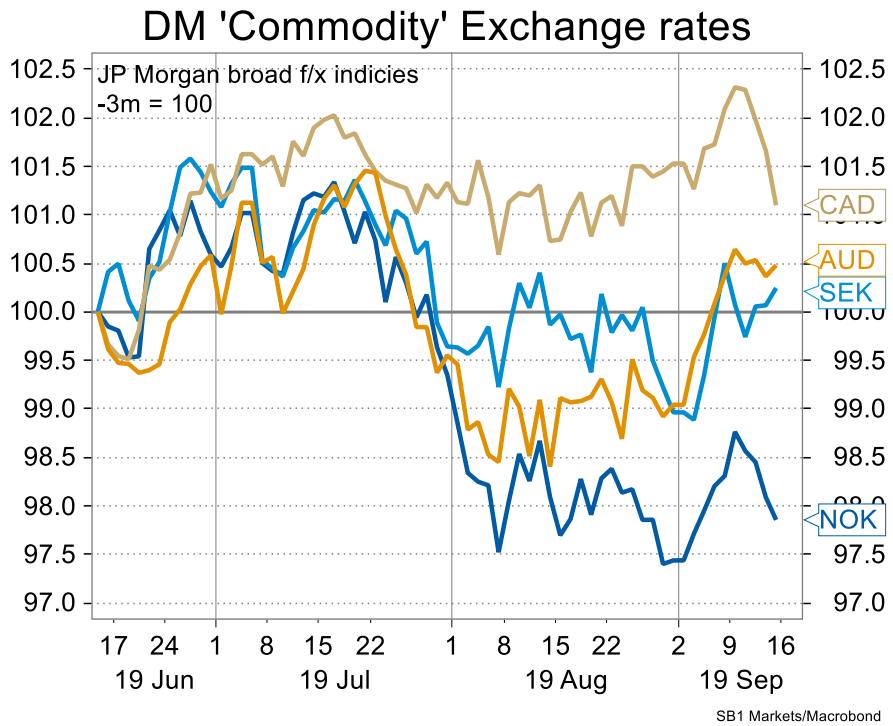
The NOK is weak vs. oil & the interest rate spread

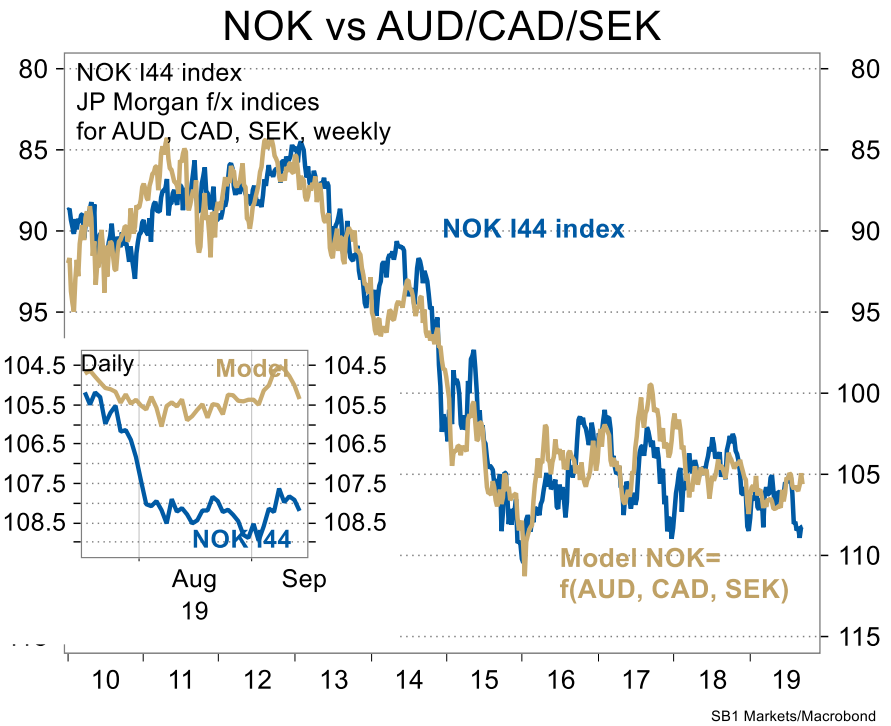




All 'supercyclicals' down last week, 'gap' still 3%

The CAD depreciated last week, some say on households' debt risk

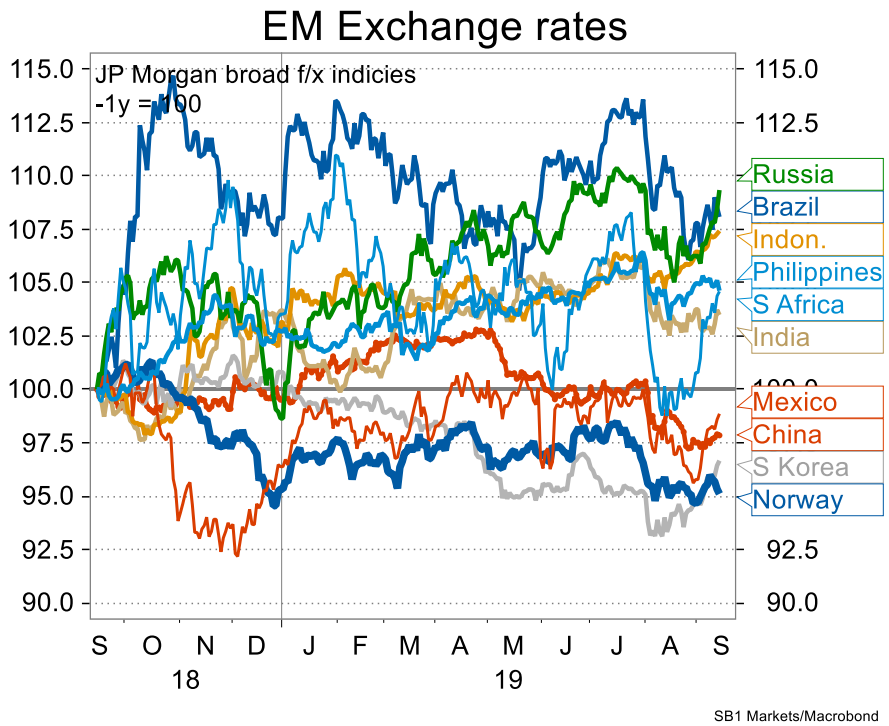


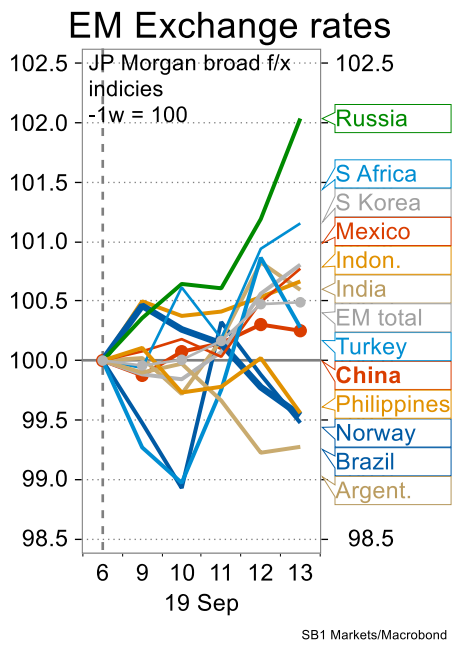


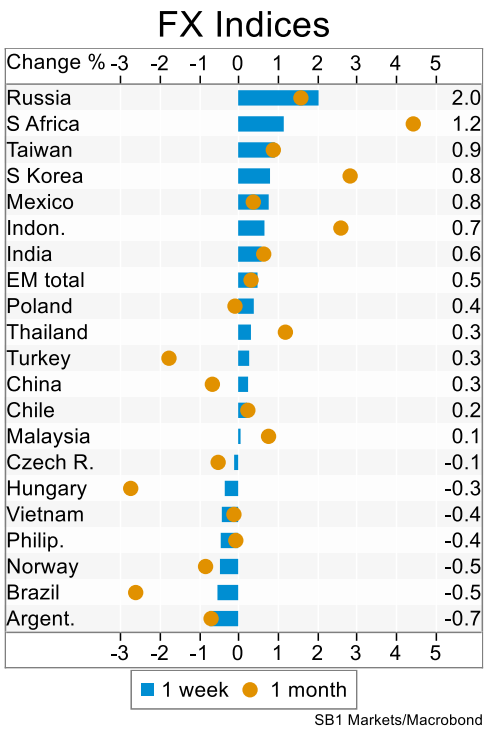
- Together, the other supercyclicals cannot 'explain' the recent NOK setback. The NOK has lost 3% vs. the supercycle f/x model estimate since mid July (when the NOK was at a fair value vs. our model). The discrepancy is not unusual but not something that happens that often either
  - » Our model is tilted towards the link between NOK and CAD, more than towards AUD or SEK (even if AUD works pretty good). Since July, the CAD has appreciated (even accounting for the decline last week), while AUD & SEK has depreciated but less than the NOK
  - » SEK appreciated two weeks ago, after the Riksbank maintained its plans to hike the repo rate in Q4/Q1

EM f/x: Emerging markets strengthen, boosted by trade deal hopes

A broad upswing the past 2 weeks, just Argentina depreciated



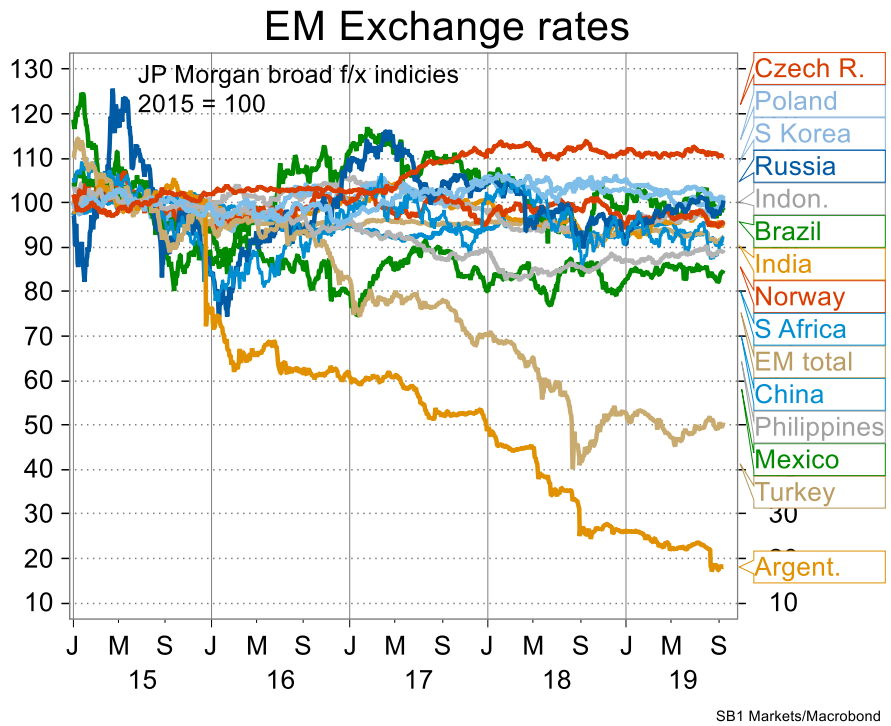


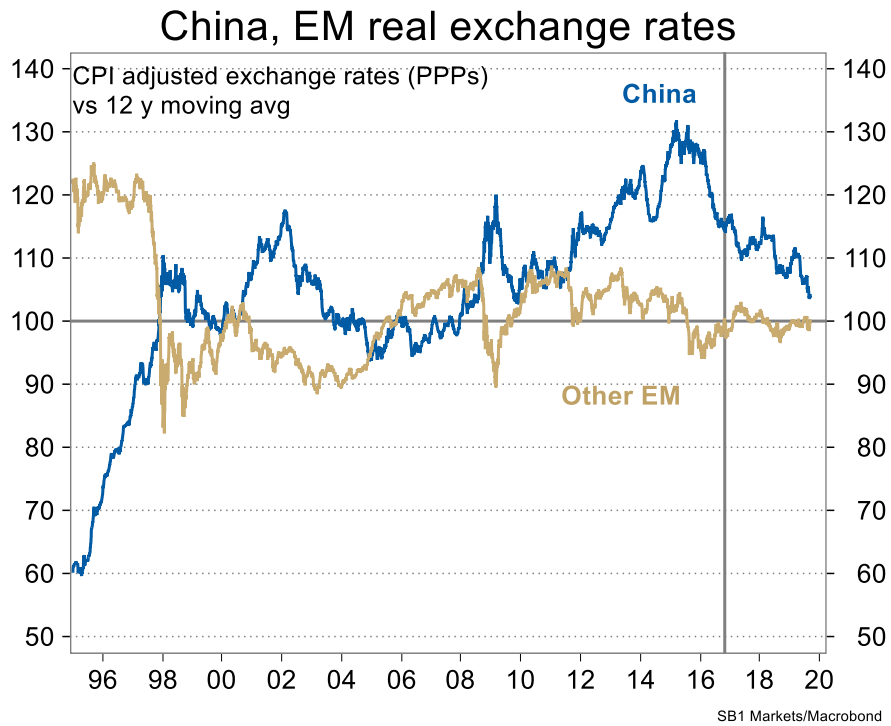


- Most EM currencies have recovered after falling in early August. Because trade war and growth anxiety have been easing, of course
- Argentina struggles, but the peso has stabilised as the government imposed capital controls and proposed (another) debt re-scheduling plan

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 82% (from 2015)

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