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# Macro Research

## Weekly update 47/2019

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*The elements on the the page "In this report" are linked*
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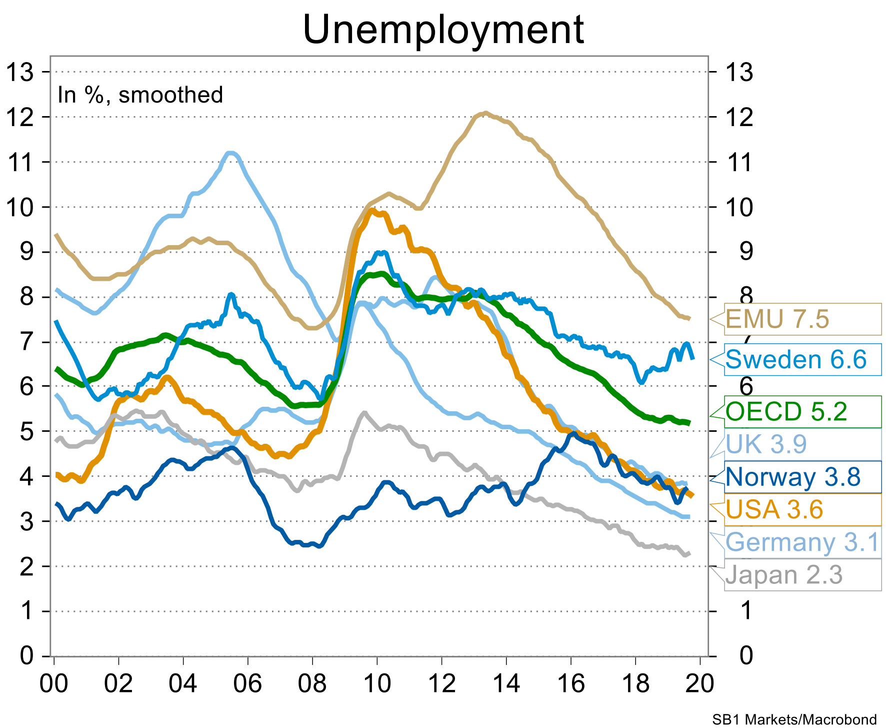
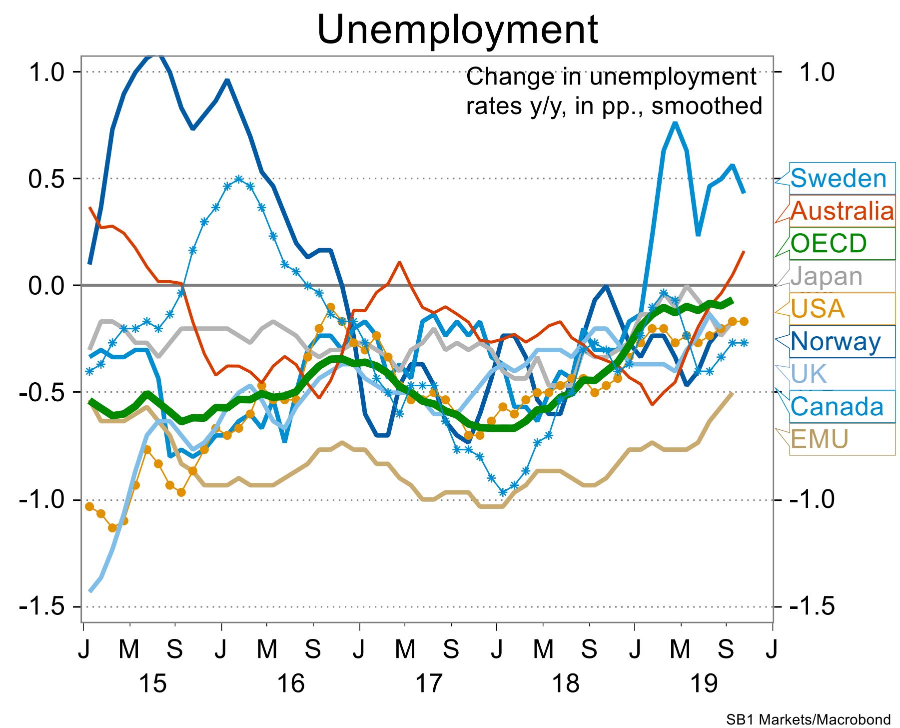
# Last week – the main takes

- Hopes of a **phase one US/China trade deal** were dashed on reports that the two parties are struggling to finalize a deal, and Trump warned of a possible tariff hike if a deal is not reached. Until Friday, when White House economic advisor Kudlow (once again…) signaled the parties now were close to a deal. (Trump may badly need a deal these days?)
- **October data from China** were below expectations. **Manufacturing production** slowed to 5.7% y/y (our calc), trending slowly down the past year. **Retail sales** are cooling at a somewhat faster rate, our volume estimate is 7.8% y/y, a 0.4 pp slowdown from Sept, as **CPI inflation** is soaring due to higher pork meat prices. **Investments** are growing steadily and slowing just marginally (nominally), but **housing starts** surprisingly soared in Oct, and have been accelerating the past 2 months, after an upward revision. **Credit growth** eased more than expected in October, trending slowly up
- **US core CPI inflation** inched down to 2.3% y/y, underlying growth is approaching 3%. Still, producer prices and inflation models do not suggest much higher inflation now. **Retail sales** rose modestly in Oct (core volume up 0.2%, our est.)**,** growth is slowly cooling. **Manufacturing production** fell again, surveys do not point to any recovery, but not an accelerating decline either. **Federal budget deficit** continues to widen, to 5.2% of GDP. **Jobless claims** increased last week, but the 8 w average is very low and do not signal any weakness at the labour market
- **Eurozone GDP Q3 growth** was revised up just marginally to a 0.9% annualised pace. **German GDP** avoided contraction in Q3, up 0.3% q/q annualised. **Eurozone employment** is slowing along with GDP growth, still up 0.7% in Q3. Expectations in the **German ZEW survey** recovered in Nov, more upbeat than other (and more reliable) German surveys
- Statistics Sweden released **revised labour market data** back to mid-2018 after substantial data flaws have been revealed. About half of the unemployment upturn is now removed, the unempl. rate is 6.8%, vs 7.3%, and the employment figures are much better than assumed. The new data reflect a slowly weakening labour market – but no abrupt setback
- **Norwegian Mainland GDP** rose by 0.7% q/q in Q3, a tad weaker than expected. Private consumption rose modestly, housing investments marginally up, Mainl. bus. investm. spiked (but probably peaking now), while oil investments rose less than expected. No significant market/NoBa implications. **Core CPI inflation** held steady at 2.2%, 0.1 pp below expectations. **The labour market vacancy rate** dropped 0.3 pp to 2.3% in Q3, adding to signs of a softening labour market. **The Ministry of Finance** decided to extend the **mortgage regulations,** and did not to implement the tightening proposed by the Financial Supervisory Authority

# Unemployment is low and still declining in most DM, but…

## The speed down is decelerating most places, probably an early sign of a turning cycle




- Labour markets have been softening in many DM recent months, and employment is increasing at a slower pace
  - » Unemployment is now rising in Sweden and Australia. Unemployment is still declining, but at a slower pace (the 2nd derivative is increasing) in the Eurozone, UK, Japan, Canada and Norway. Total OECD unemployment fell by just 0.07 pp in September compared to one year ago, and the pace down has slowed since early 2018
- Most likely, these early signs of labour market slowdowns are results of mature economic cycles in most DM, and not primarily due to a trade war led downturn, although these factors of course may have triggered a shift
  - » Unemployment is primarily a lagging indicator, not a leading one

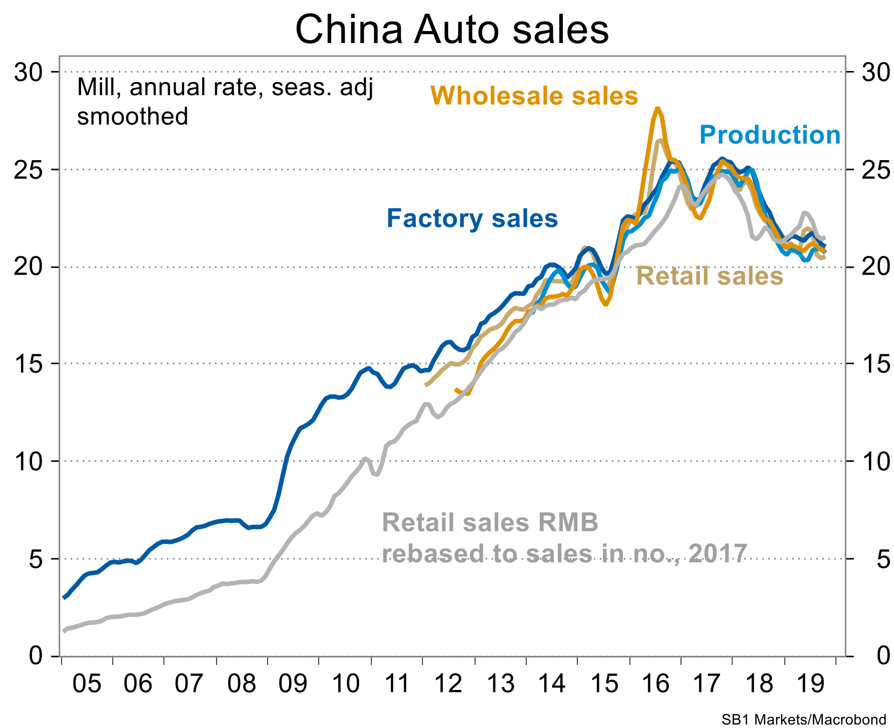
# October data on the soft side, growth is slowly cooling

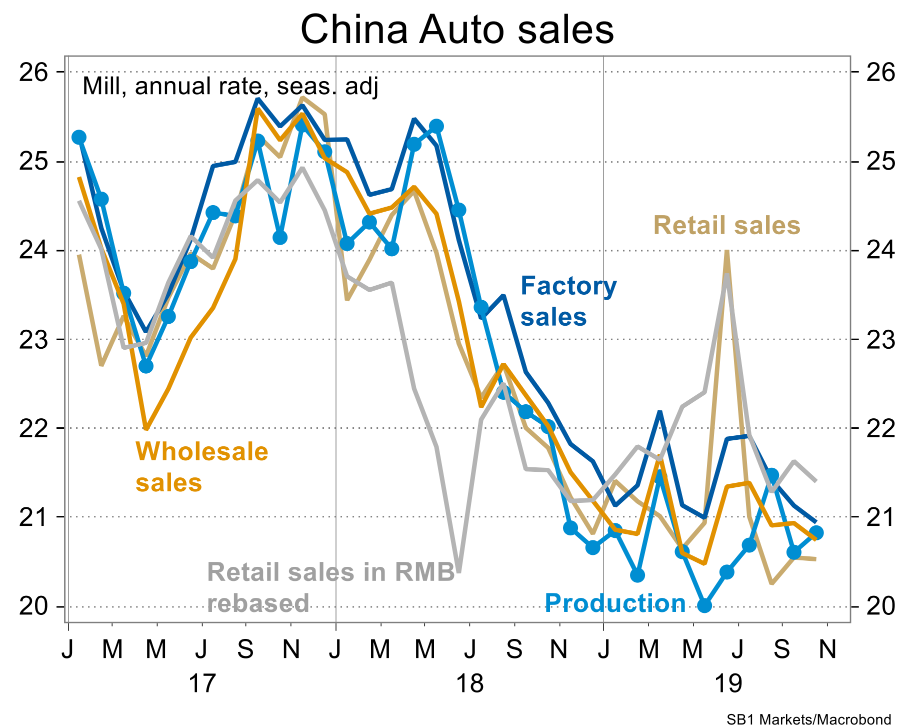
## Manufacturing, investments and retail all slowed more than expected in Oct


- **Growth is slowing amid slowing domestic demand and persistent trade war uncertainties – but data are not at all signalling any abrupt setback**
- **Industrial production** rose just 0.2% m/m but the 3m average speed is steady at 0.5%. The official y/y rate dropped sharply to 4.7%, while our less volatile calculation yields a 5.7% speed, down 0.3 pp from Sept. Growth is easing but slowly, and the PMIs are signalling lower growth
- **Retail sales** growth is easing at a faster pace, suggesting that the Chinese slowdown is not merely a result of the trade war but (primarily?) of softening domestic demand. The official y/y rate fell to 7.2%, from 7.8%, our volume estimate came down 0.4 pp to 5.3%. **CPI inflation** accelerated to almost 4%, due to higher food/pork meat prices
- **Investments** have been expanding steadily and growth is slowing just marginally over the past 2 years. The annual rate inched down to 5.1% (while the official YTD rate fell to 5.2%, down 0.2 pp). Nominal investments are still growing slower than GDP. Real growth is strengthened to some 3%
- **Credit growth** retreated in October, after a acceleration the prior months, helped by bank lending. The credit impulse is marginally positive, following the 2018 contraction

# Broad signs of stabilisation in the auto sector

## Sales/production is still down y/y but all measures have been 'stable' since late '18/early '19




- Production: Production in factories in China, in number of units
- Factory sales: Deliveries from factories in China or imported cars, in units. This is the most common used data series for Chinese auto sales
- Wholesale sales: Sales from wholesalers, in units
- Retail sales: Sales from retailers, in units. This measure is the closest to definitions of auto sales in other countries (sales from retailers in the US, first time registrations in most other countries)
- Retail sales RMB: Value of sales from retailers, in renminbi. Rebased to retail sales in units in 2017

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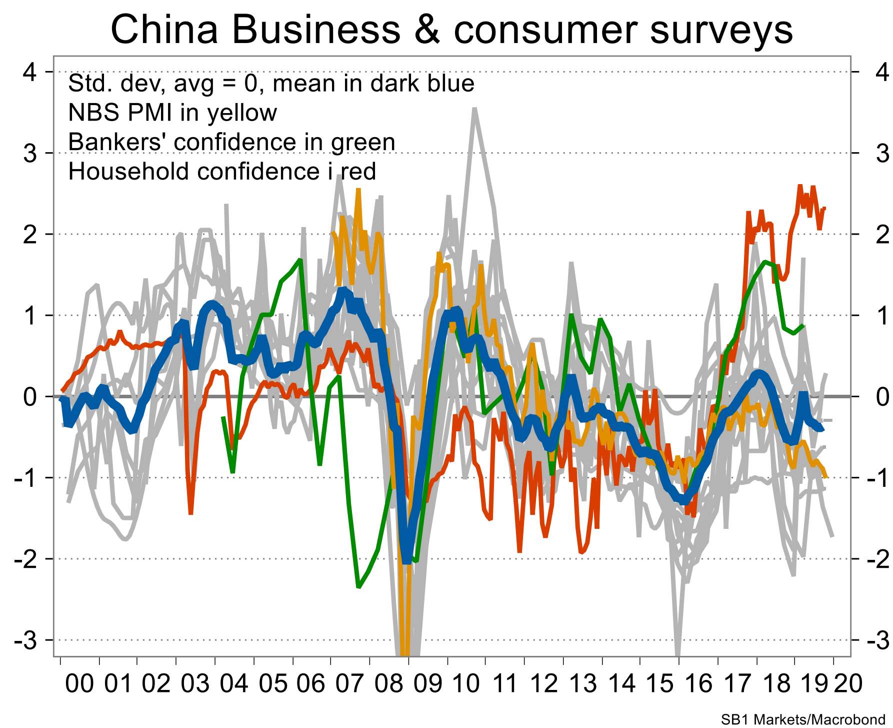
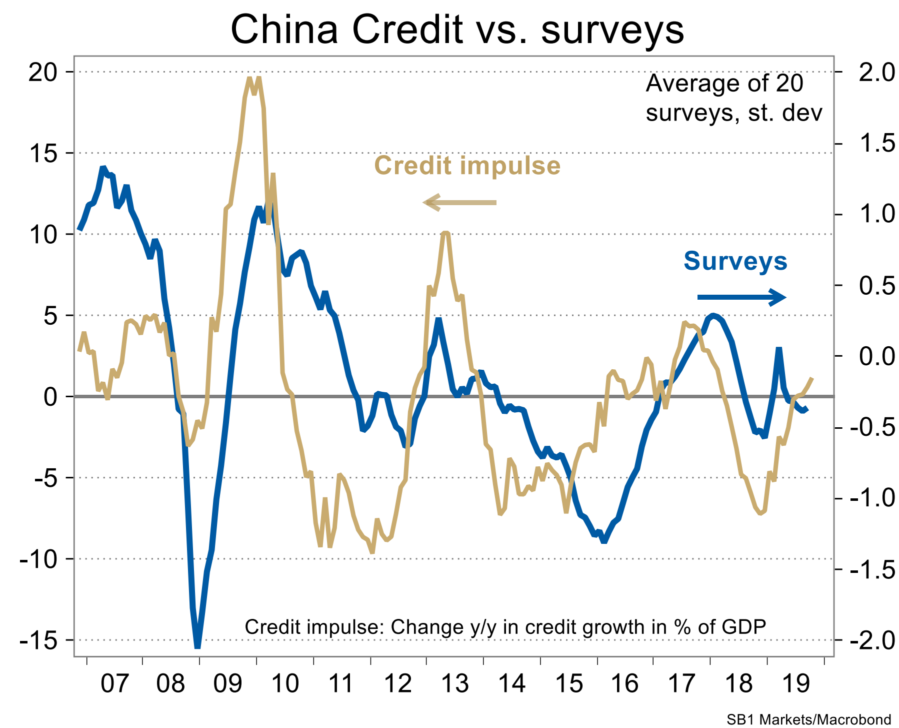
# Credit has been tightened, usually dampens growth

## Now, credit has turned marginally positive again 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)

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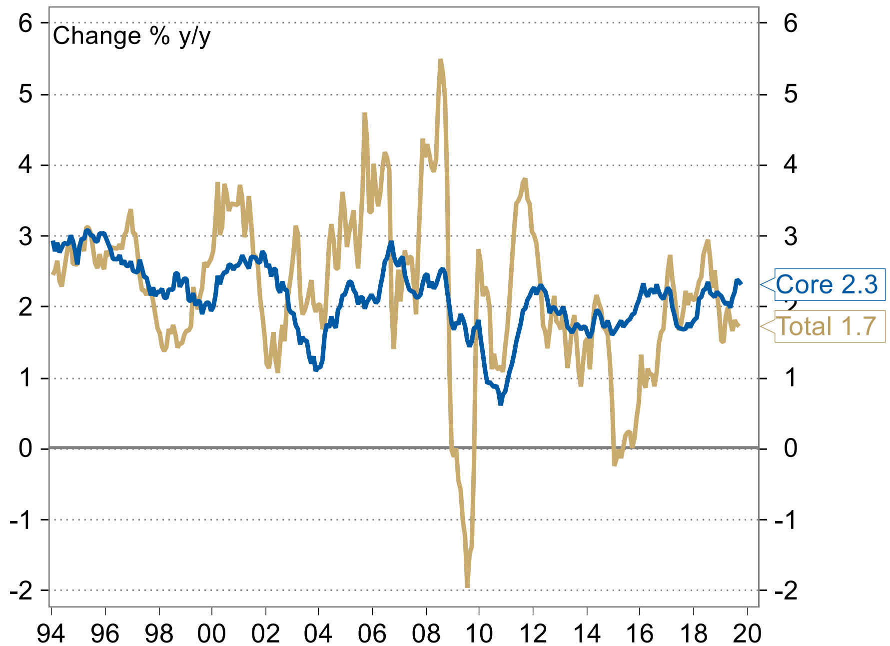
# Core inflation one inch down to 2.3%, underlying growth still close to 3%

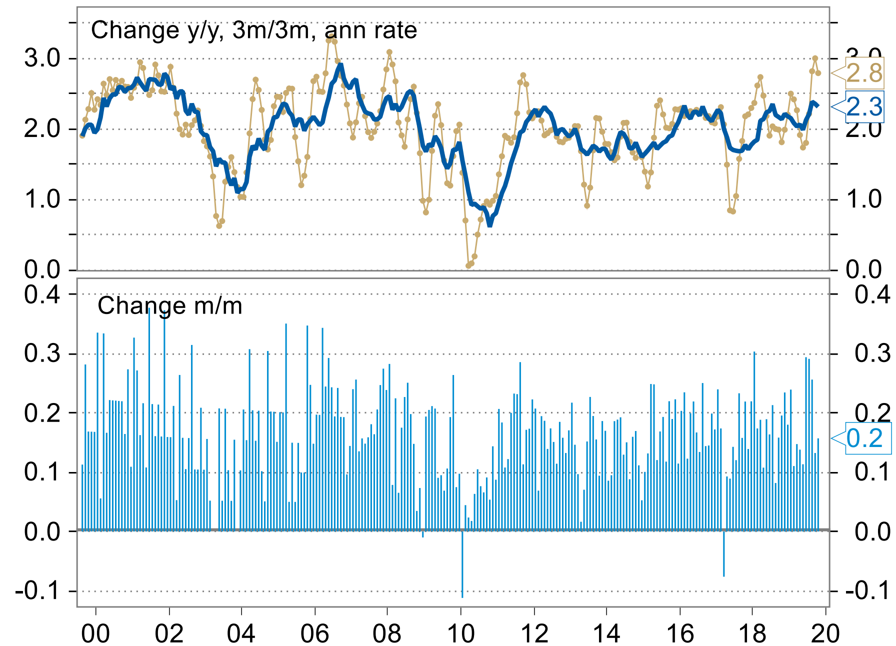
## Core CPI up 0.2% m/m, the annual rate inched down to 2.3%, expected unchanged

USA Consumer Price Index




SB1 Markets/Macrobond

USA Core CPI

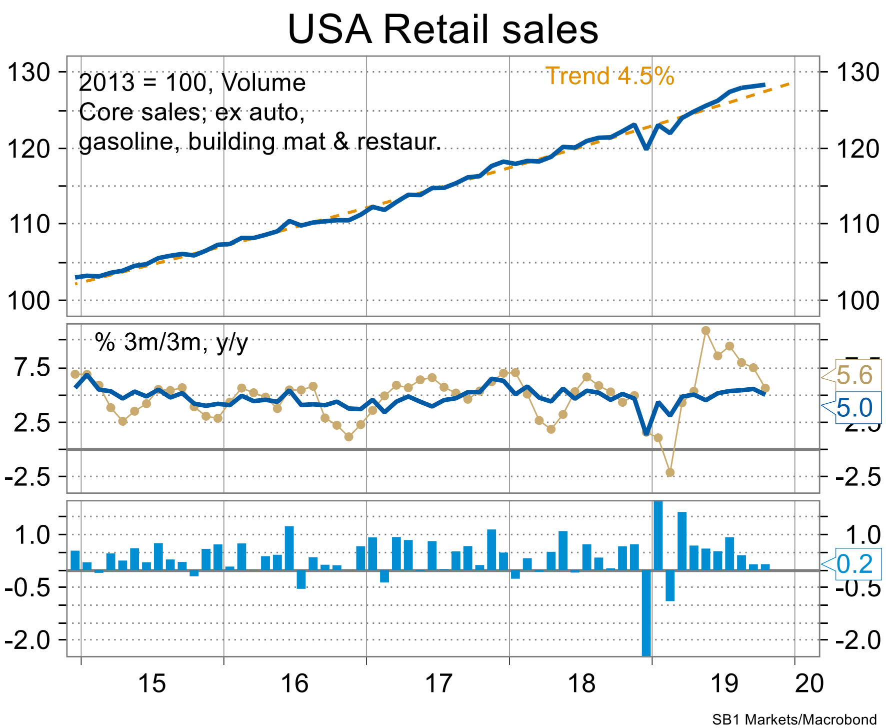


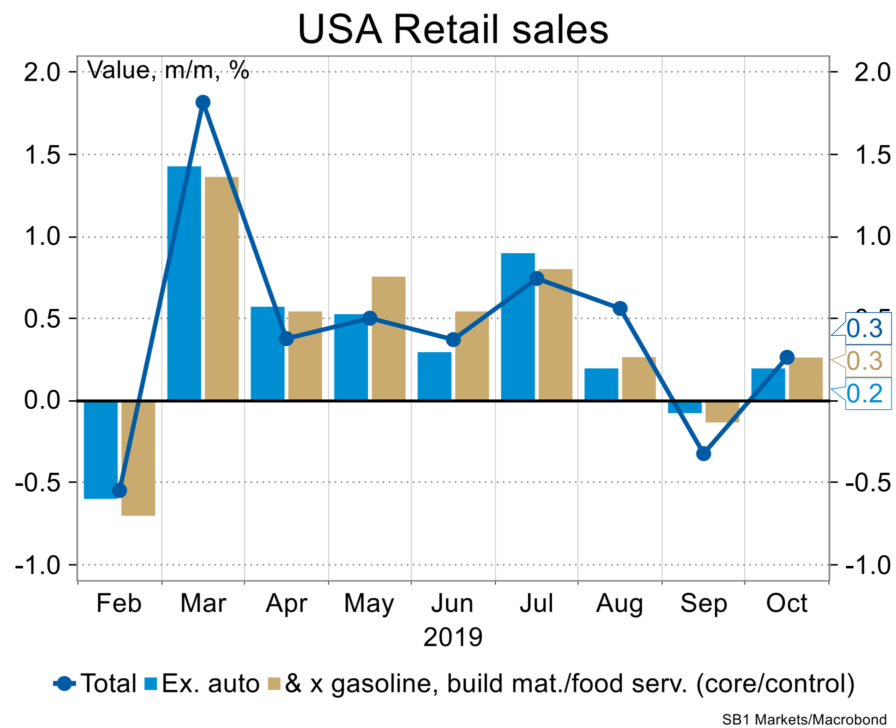

SB1 Markets/Macrobond

- Core CPI increased by 0.2% m/m in October (0.16, to be accurate), in line with expectations. The annual rate came down marginally to 2.3%, was expected flat at 2.4%. Still, core inflation is heading up and the underlying speed at 2.8% (!). However, we doubt that inflation will increase much from this pace, as producer prices and inflation models indicate that inflation may be peaking now. But it is not 'too' low, at least according to the CPI index
  - » Fed preferred price measure, the core PCE (the consumption deflator) is up 1.7%, slightly below Fed's 2% price target, but prices rose 2.2% q/q in Q3
- Headline inflation declined marginally to 1.7%. The total CPI inflation has stabilised recent months (no big energy impact)

# Retail sales are slowly losing steam

## Core sales rose 0.3% m/m and 0.2% in volume (our est), underlying growth slows, but still not low




- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by 0.3% m/m in nominal terms in October, in line with expectations. September was revised down marginally. Total retail sales rose 0.3%, auto sales declined
- We estimate a 0.2% m/m increase in core sales volume, an unchanged pace from the prior month. Growth has eased, after soaring in H1. The 3m/3m speed at still at an impressive 5.6%, and the annual rate is solid at 5.0% but growth the past 3 months has slowed to 3% (which is not that low, of course)
  - » The slowdown the two past months may be an early indication that the manufacturing led slowdown is now spreading to the consumer side
  - » Income growth has slowed somewhat but consumer confidence remains strong. Still, the risks are now skewed to the downside

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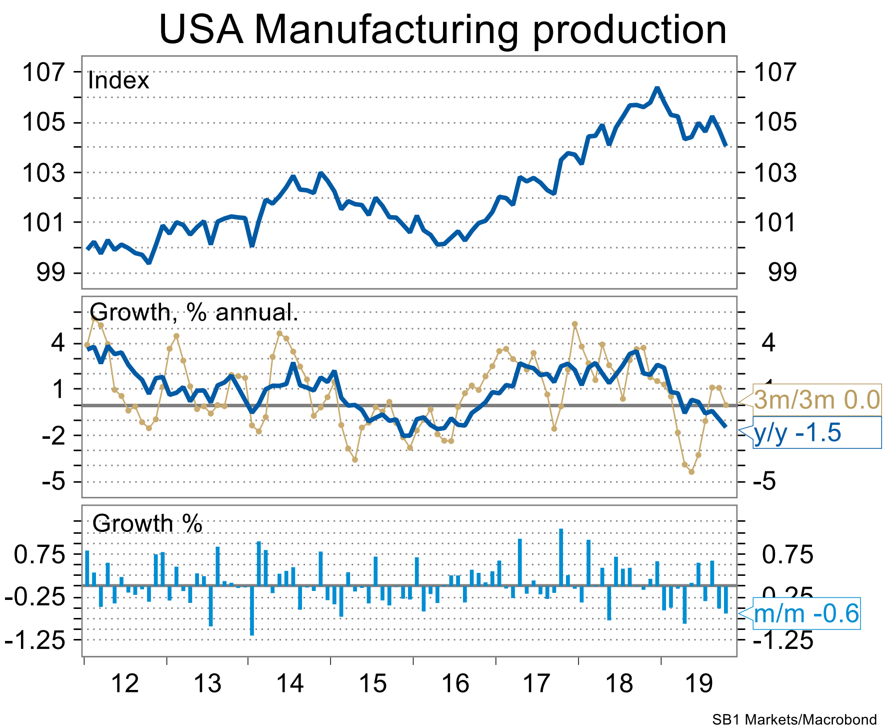
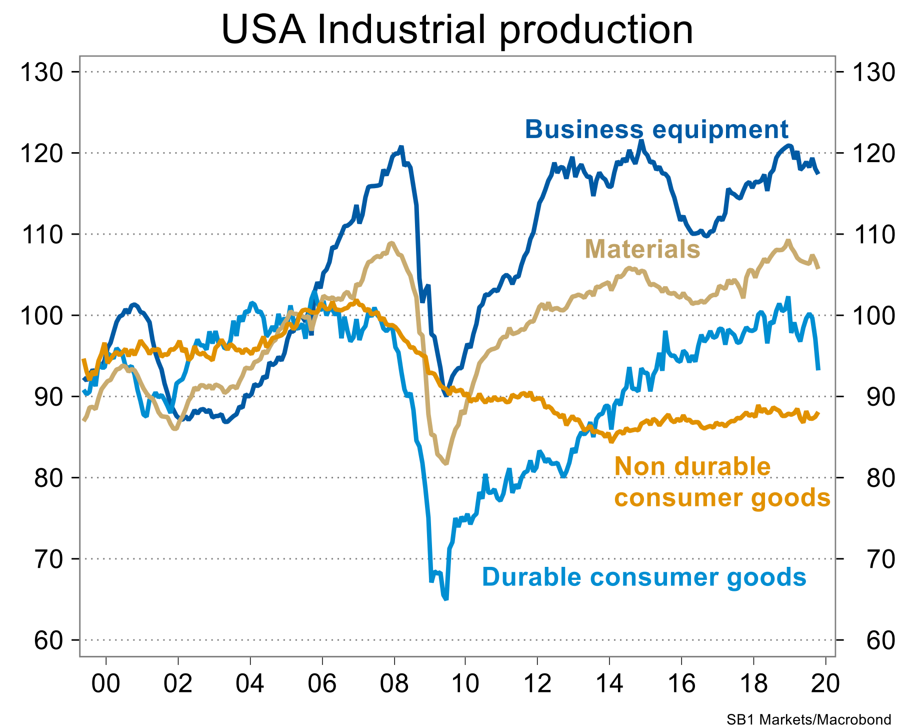
# Manufacturing production drops again, as expected

## Production fell by 0.6% m/m in Oct, Q4 is off to a weak start. Durable consumer goods are slipping

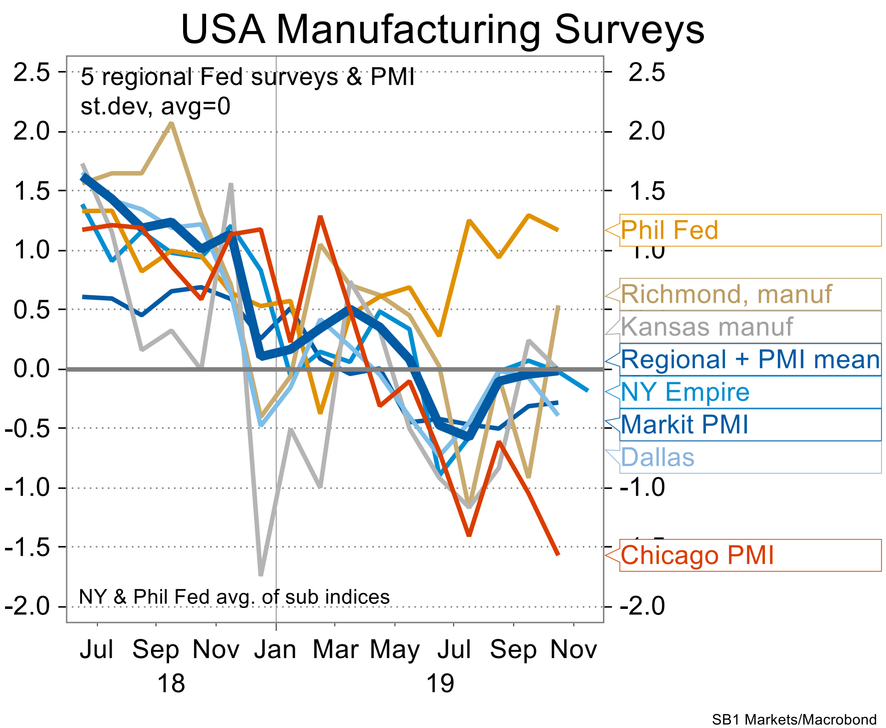


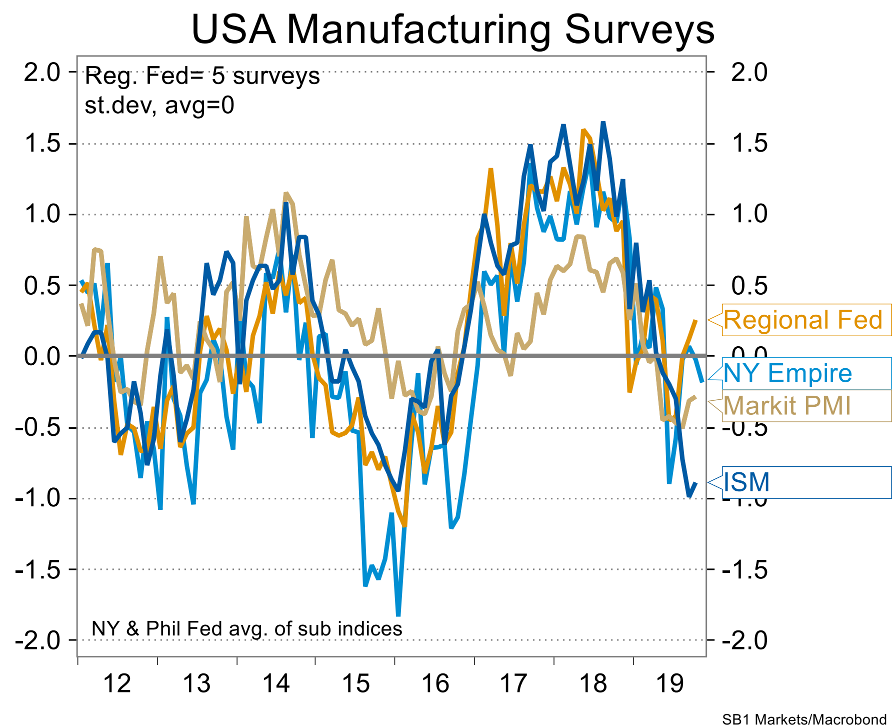




- Manufacturing production fell by 0.6% m/m in October, expected down 0.7%. The decline came after a similar decline in Sept, thus, the speed into Q4 is rather weak. The annual rate slipped to 1.5%
  - » Total industrial production including energy & mining dropped 0.9% m/m but underlying growth is marginally stronger than for manuf.
  - » Production has slowed in most sectors recently, and rapidly in durable consumer goods and visibly also in business equipment the past 2 months, in sum weaker than signalled by durable orders, which has just stalled. Anyway bad news, consumer durables are usually leading total manufacturing production by a few months
- Surveys signal a bleak outlook but no 'collapse'. The first Nov survey, from NY Fed, weakened just slightly

# NY Fed's manufacturing index inched down in Nov, marginally below avg

## The first Nov manufacturing survey came in below expectations but has stabilized recent months

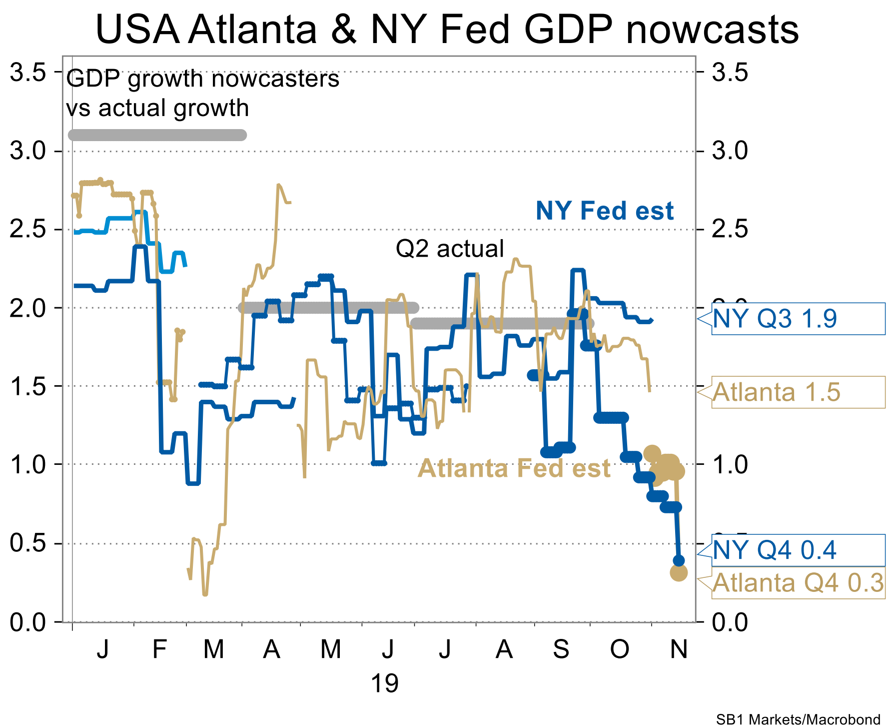


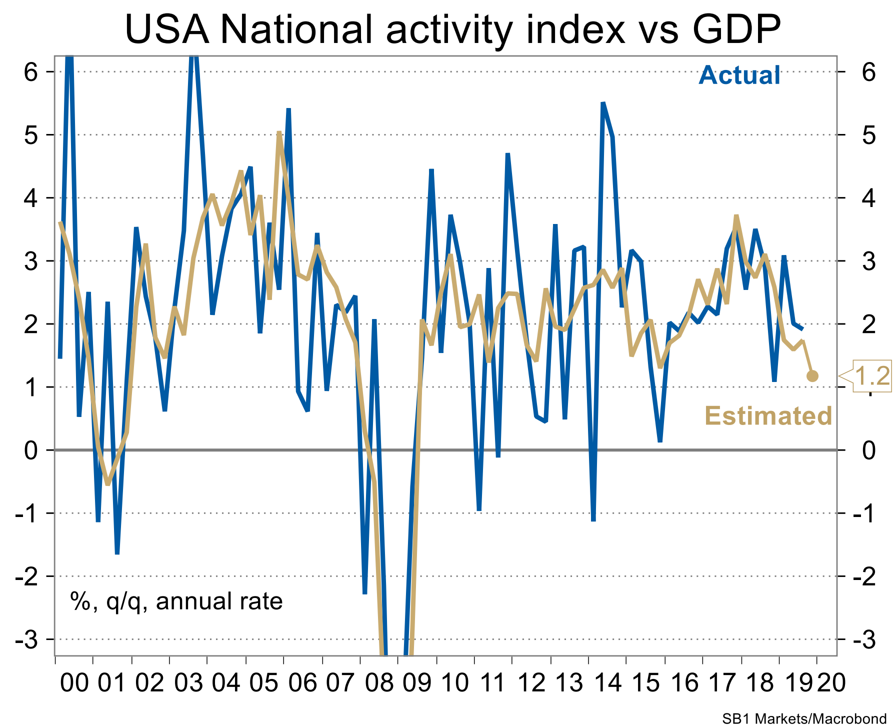




- The NY Fed's Empire manufacturing index fell to 2.7 in Nov, from 4.2 in Oct, a small improvement was expected. The index is just marginally below the avg level, stabilized the past 4-5 months. The NY Empire is in the mid-range of the regional surveys but better than both the PMI and the ISM
  - » We measure the NY Empire index by an average of 6 components within the 'current condition' index. The expectations index improved

# Oops… towards zero growth in Q4?? Manufacturing production a bad omen

Both NY & Atlanta Fed nowcasters fell of the cliff Friday, lowering the Q4 GDP sharply




- NY Fed's forecast fell to 0.4%, from 0.7%
- Atlanta Fed's forecast fell to 0.3%, from 0.9%
- The National Activity Index, which suggested 1.8% GDP growth in Q3 (0.1 pp below the actual number), now points to a slowdown to 1.2% into Q4 (Sept data)

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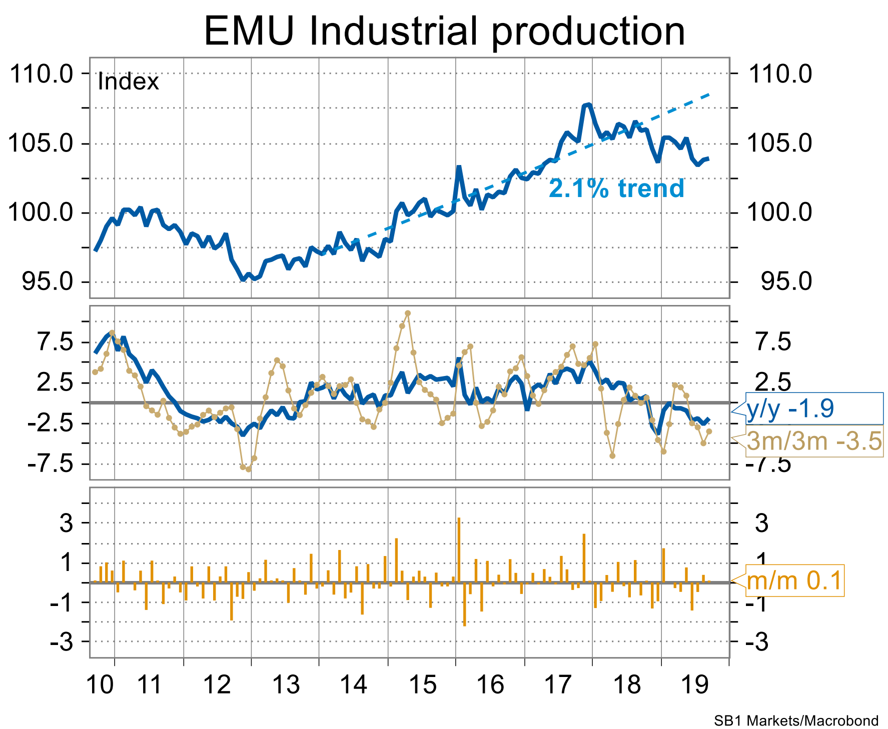
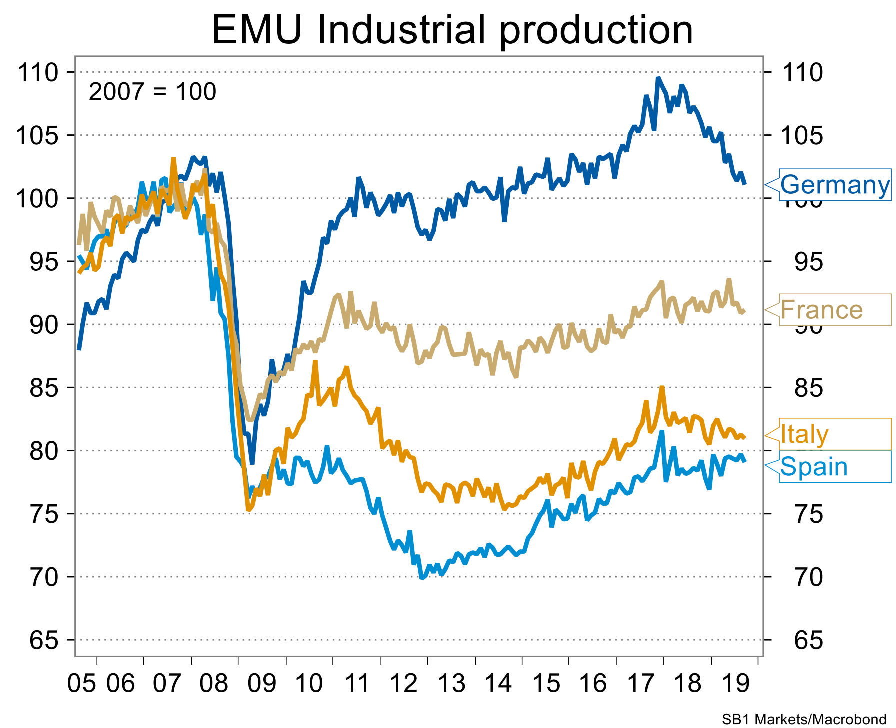
# Industrial production marginally up in Sept too but trend still down

Production rose 0.1% m/m but fell 3.5% in Q3. Germany, France, Italy down, Spain close to flat

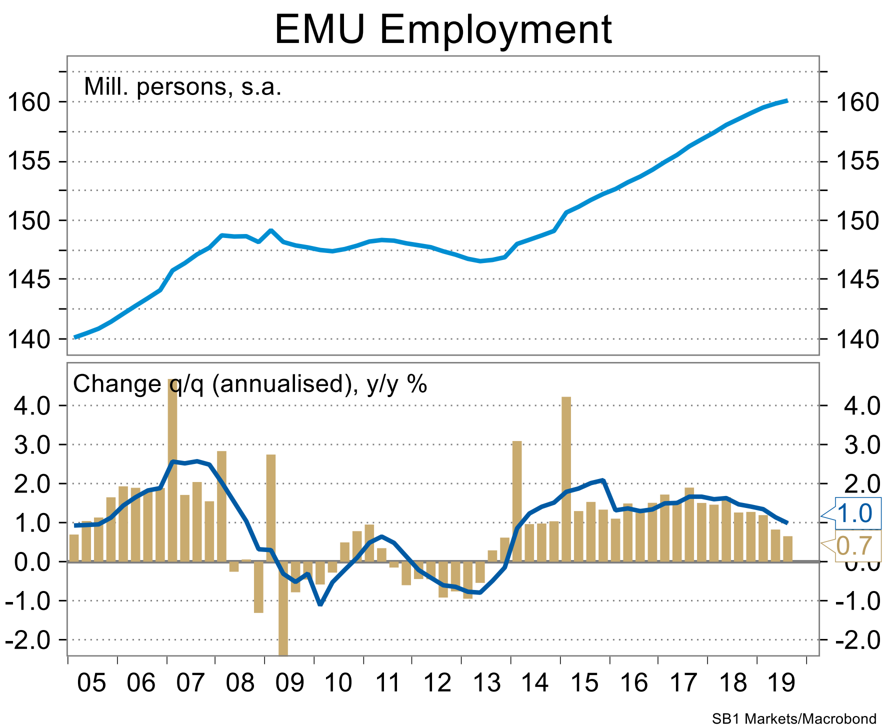


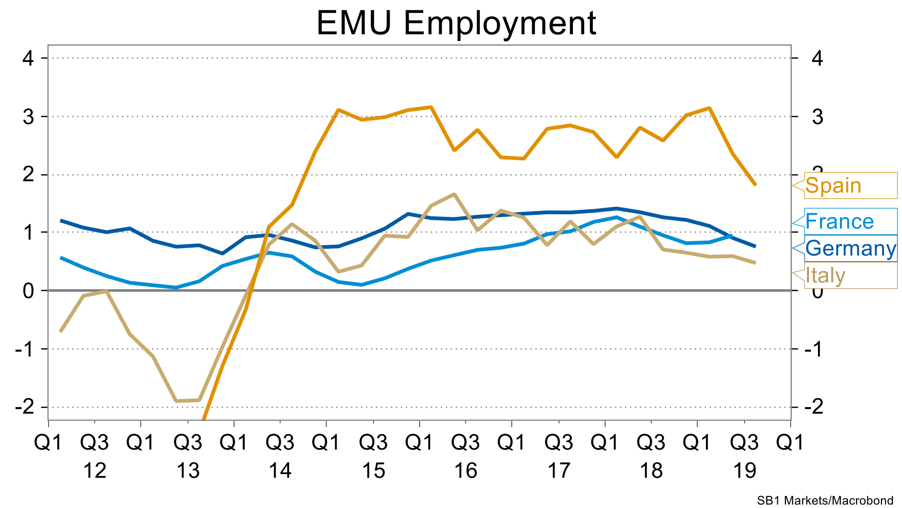



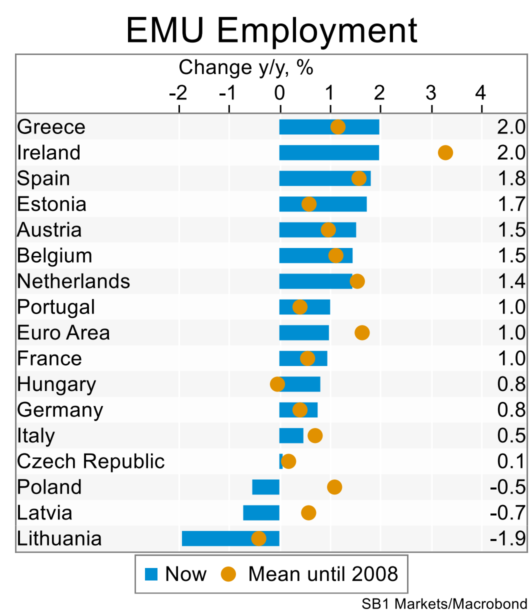

- EMU industrial production (ex construction) increased by 0.1% m/m in Sept, we f'casted zero growth, consensus -0.2%. Production inched up in Aug too, after the sharp July slip, and Q3 was weak, down 3.5%, from Q2. The downturn is led by Germany
  - » Production dropped in both Germany, Spain and Italy, France rose modestly in Oct. Netherlands and Ireland brought total EMU up
  - » Other major countries are so far holding up better than Germany but not are shining. Germany is down 8% from the 2018 peak. France has stagnated (and fallen the past months), Italy slides down slowly, while Spain is still heading modestly up
- Manufacturing PMI is plummeting, suggesting that the Eurozone manufacturing dip has not yet hit bottom

# Employment growth is slowing, productivity growth (probably) still very low

Employment rose 0.7% in Q3, down 0.1 pp from Q2 and the lowest since 2014.



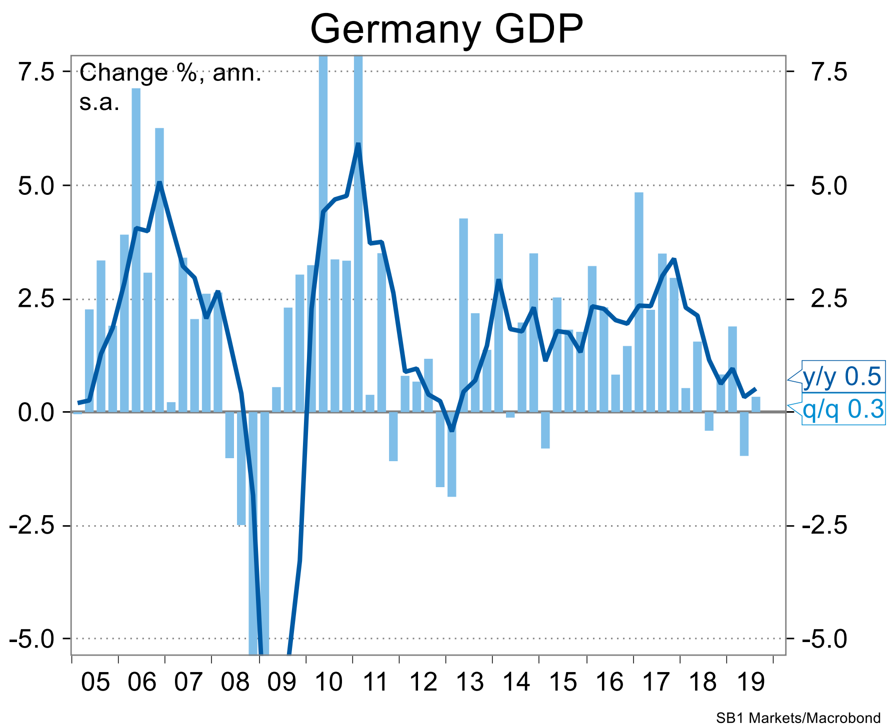



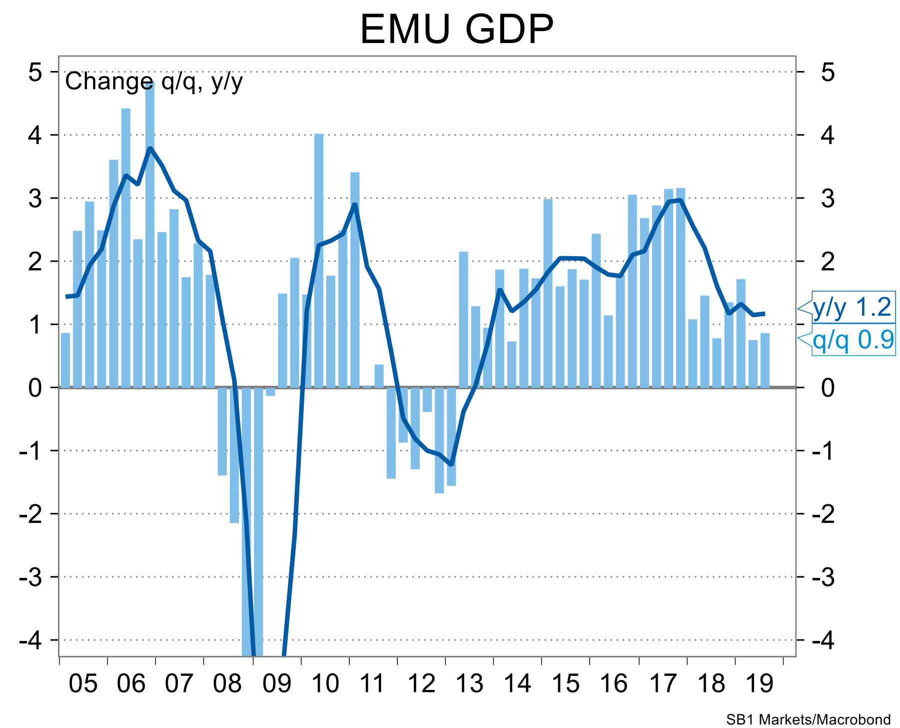




- Employment growth has been slowing along with GDP growth this since mid-2018. Employment rose 0.7% annualised in Q3 vs GDP at 0.9%, indicating positive but low growth in productivity (but hours worked not yet published)
- Employment is still growing in all but three countries, and faster than before '08 in most countries. Still, the slowdown recent quarters has been broad, all the 'main four' are sliding down
- Employment growth is still above population growth

# GDP rose marginally in Q3, supported by private consumption

GDP rose 0.1% (0.3% annualized), vs expectations at -0.1%. EMU GDP revised up, on the 2nd decimal

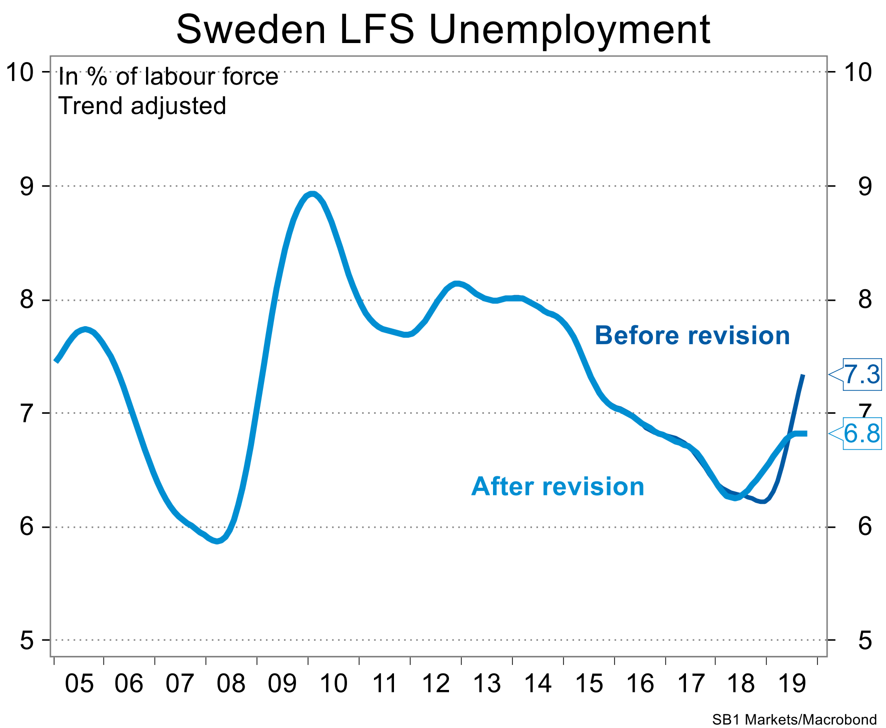


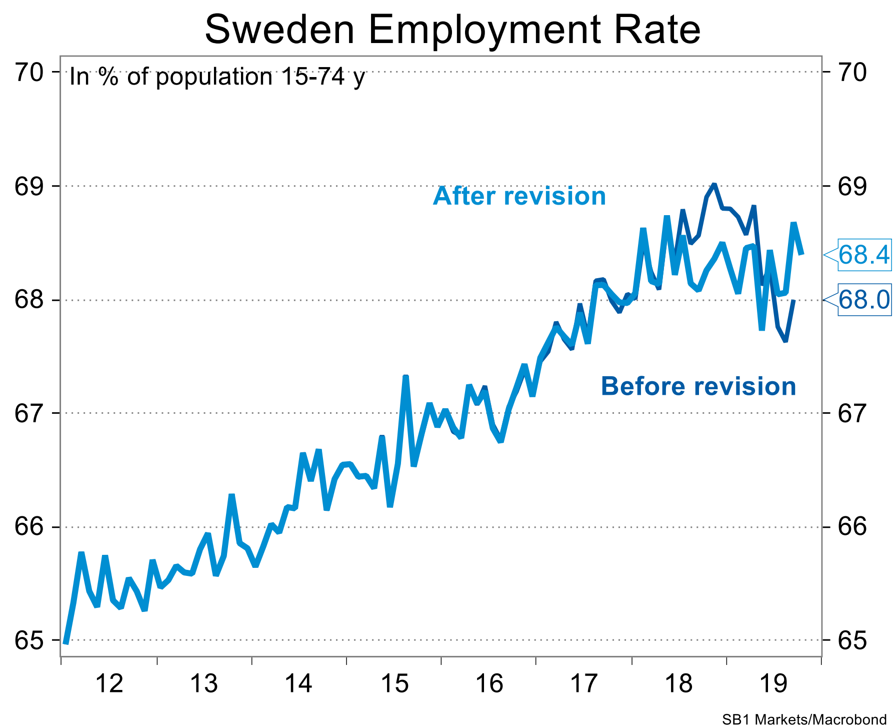




- German GDP expanded by 0.1% in Q3 (0.3% annualised, 0.2 pp better than expected, thus, avoiding a two successive quarters with negative growth - 'a technical recession'. (We do not reckon this technical assessment to be very useful). Growth y/y inched up to 0.5%. Q2 revised down by 0.1 pp
- No details have been released, however, the Statistic Bureau reports that private consumption was the main positive contribution, as retail sales data have been indicating – with a growth boost from higher net exports as well
  - » German surveys (like the PMI, Ifo, ZEW) are pointing to declining GDP, yet, these have overestimated the downturn in both Q2 and Q3
- Eurozone GDP was revised up just marginally, thus, the annualized q/q rate inched up 0.1 pp, to 0.9%

# After huge revisions; half of the recent unemployment upturn is removed

Unemployment has risen by 0.5 pp, vs 1.1 pp previously reported and employment has flattened out

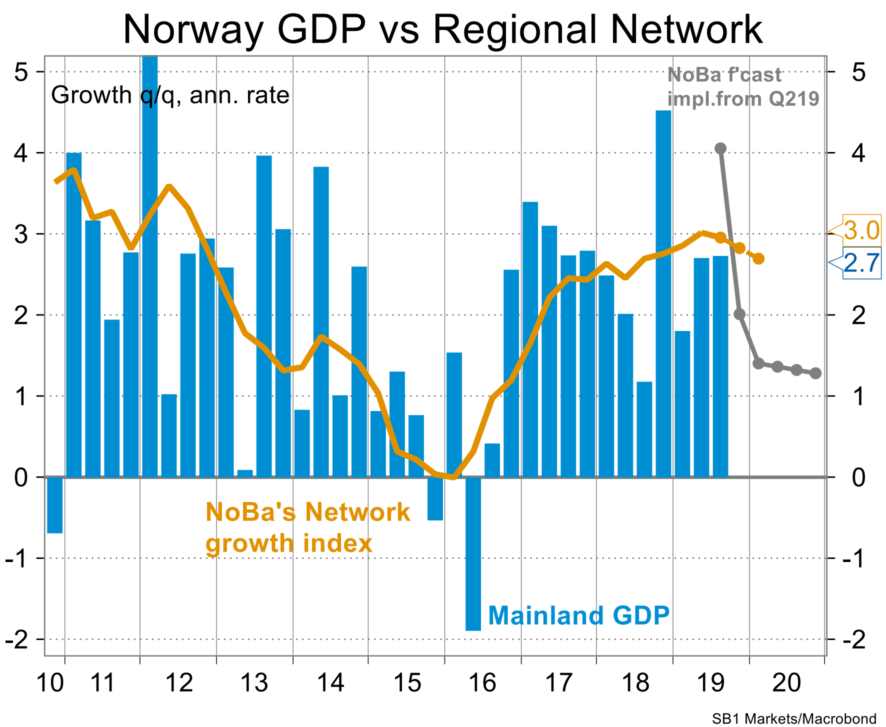


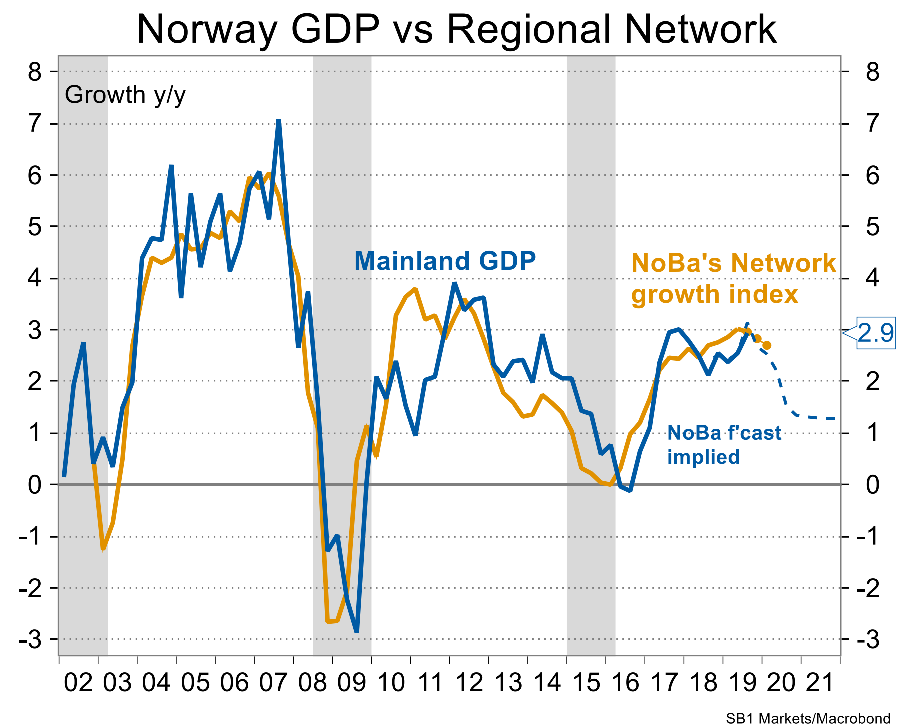




- Statistics Sweden are reporting revised force survey data back to mid-2018, as substantial quality flaws have been disclosed. Data from Evry, which has been conducting half of the surveys on behalf of Statistics Sweden, have had substantial quality flaws, and Aftonbladet reports that interviews have been falsified. These errors caused an underestimation of the number of unemployed in early 2018 and an substantial overestimation recent months. Data collected by Evry are removed from the new figures
- The new labour market data confirms that the labour market is softening, however, at a much slower pace than previously reported. 0.5 pp of the 1.1 p upturn in the trend adjusted unempl. rate has been removed. More on the next slide

# Mainland GDP is growing steadily – Q3 came in a tad below expectations

GDP rose 0.7% q/q (2.7% annualised) and 2.9% y/y, vs consensus at 0.8% and our f'cast at 0.9%

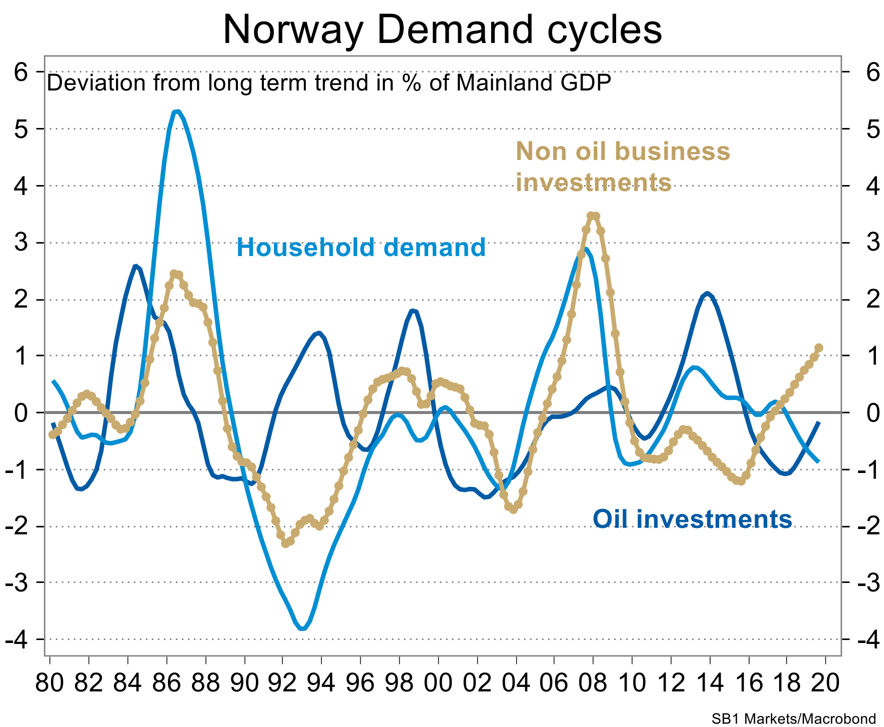


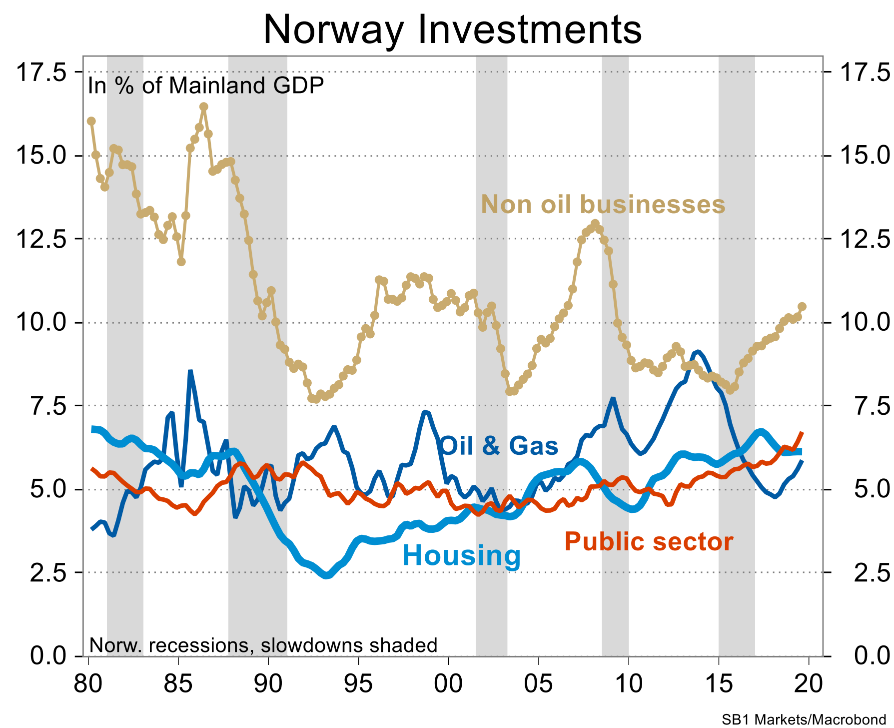




- Mainland GDP rose by 0.7% q/q (2.7% annualised) in Q3, an unchanged speed from Q2. We expected 0.9%, consensus 0.8% and NoBa 1%. The annual rate spiked to 2.9%, up 0.4 pp. The details were mostly in line with our expectations, barring oil investments
  - » Private consumption rose modestly as expected, Mainland business investments soared (we do not expect the upturn to last). Oil investments rose but less than we expected. Housing investments marginally up. Government demand was strong, as in Q2, and net exports fell
  - » Employment growth is softening yet still solid, up 0.3% q/q. Productivity growth is still slow, while wage compensation is increasing, reducing profit rates
- Growth is above trend and cost inflation is trending up. A slowdown is expected in Q4 and more swiftly through 2020, due to a muted contribution from oil investments and (probably) decreasing Mainland business investments. No substantial NoBa impact

# Household demand slows, mainland business and oil investments close to peak?

## Growth will most likely slow the coming quarters/years as the 'heavy lifters' will pull back

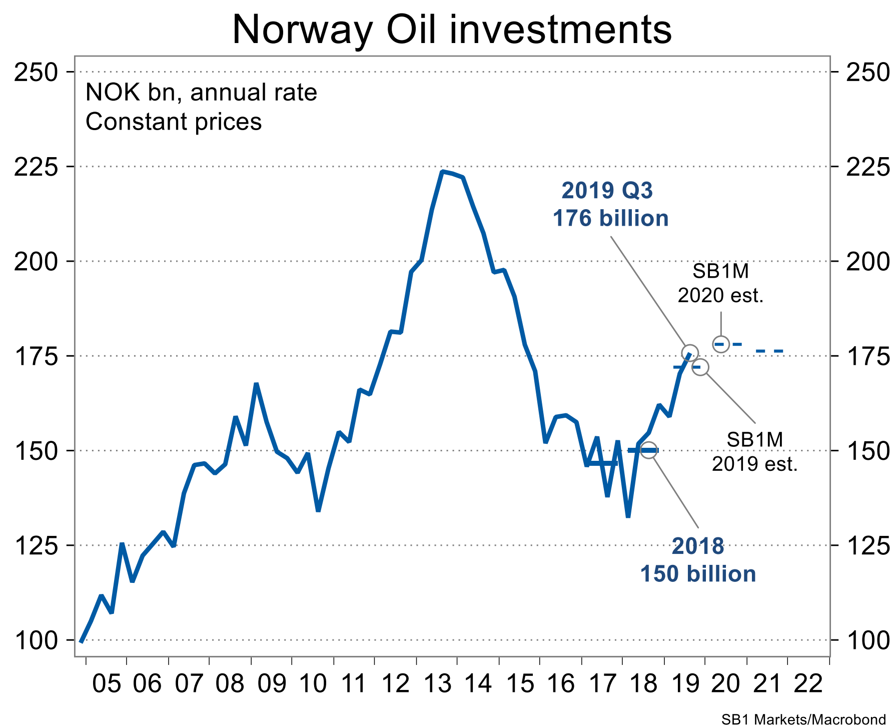


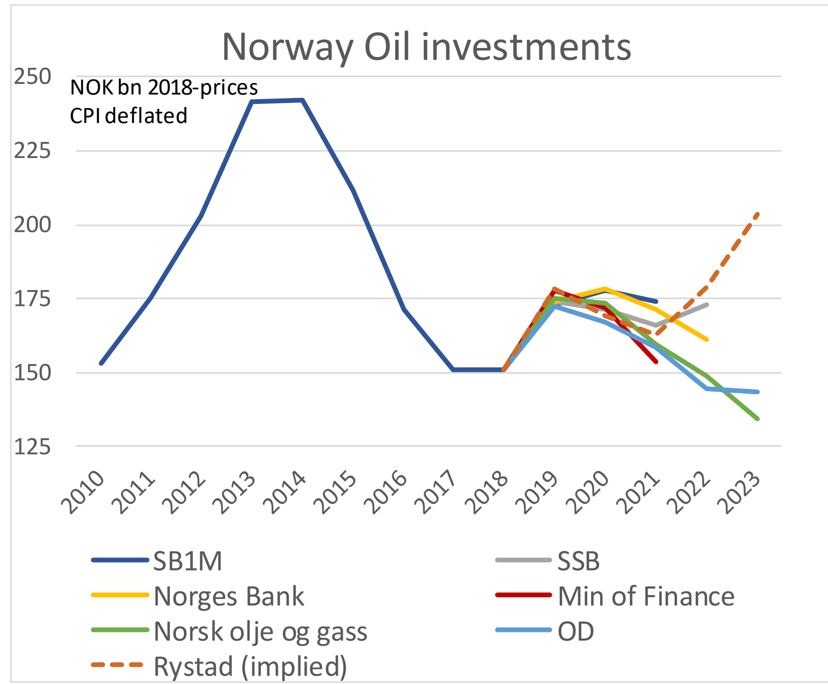




- Both manufacturing and power supply are reporting declining investments in 2020, according to SSB surveys
- Housing investments are at high level vs GDP but is not increasing anymore (flat, following the '17/18 mild setback)

# Oil investments: Somewhat more left for Q4 – but nothing thereafter?

Unless oil companies' 2020 f'casts are lifted considerably, investments will have to fall through 2020

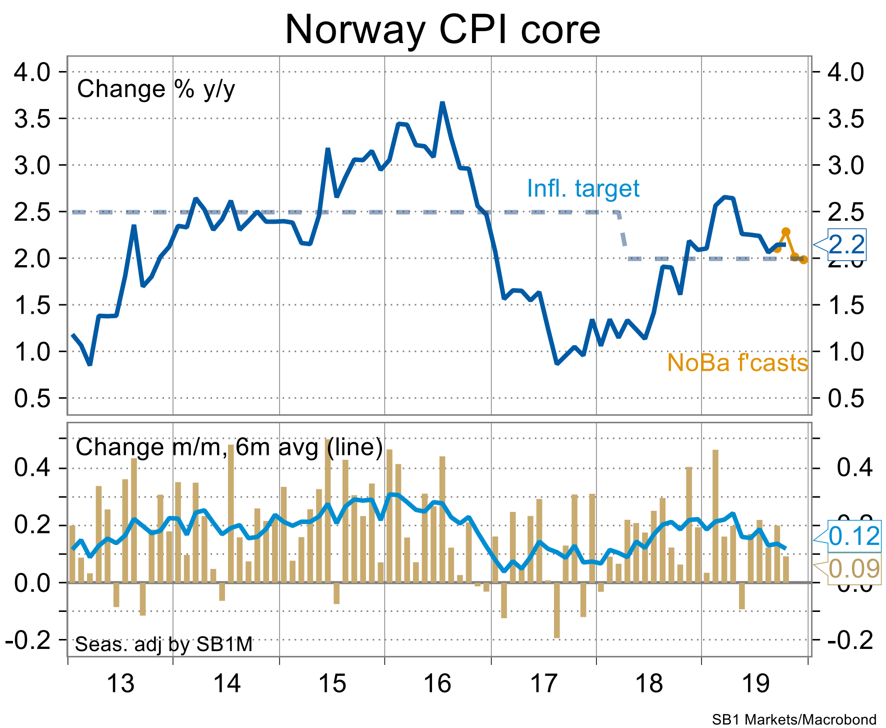



- Oil investments increased by 3.2% q/q in Q3, to NOK 176 bn (measured in constant prices). The investment level in Q3 is 2% above our 2019 f'cast, yet the level have to increase by some 4% in order to reach the annual forecast.
- In 2020, investments will most likely subside (unless the companies nudge up their 2020 f'cast substantially) **Hence, after 2019, the growth boost from oil investments will most likely subside**
  - » No doubt, the oil price will influence the investment level from 2021 onwards, as more projects may be added

# Core inflation flat at 2.2% in Oct, a tad weaker than expected

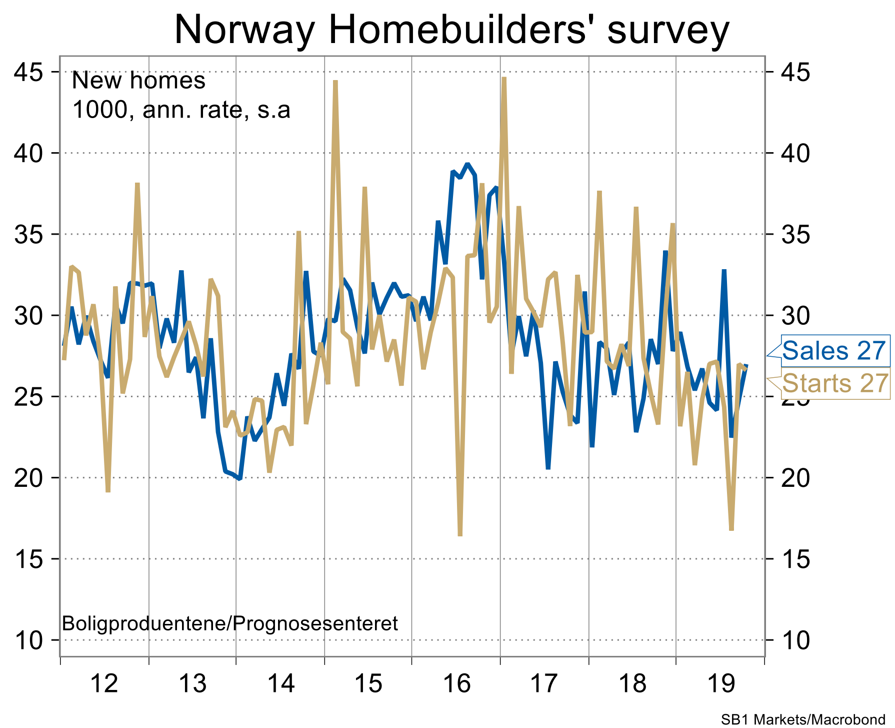
## Core CPI inflation has softened somewhat since the spring. Total inflation rose to 1.8%

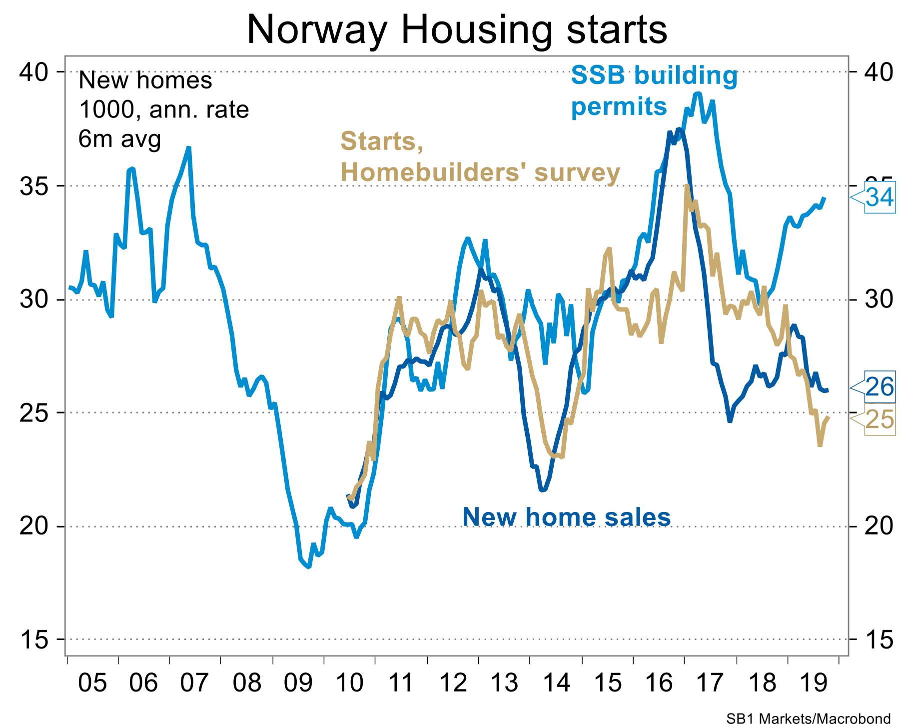



- CPI-ATE (ex. energy and taxes) was unchanged at 2.2% y/y in October, 0.1 pp below ours, consensus' and Norges Bank's f'cast
  - » CPI-ATE rose just 0.1% m/m (seas adj), just below the 6 m average
  - » Declining prices on food and airline tickets dampened inflation this month, while hotels&restaurant prices boosted inflation
  - » Imported goods are up just 1% y/y, the NOK depreciating points to somewhat higher imported inflation – but no take off. Domestic goods & serv. up 2.8%, due to wage inflation above 3%, slow productivity growth and capacity to increase prices are demand is not weak
- Total CPI growth ticked up to 1.8%, from 1.5%, close to expectations. Higher electricity prices brought total inflation up this month
- **Implications**
  - » Core inflation remains just above the price target and the small deviation from NoBa's projection this month will not be vital towards the December meeting
  - » No significant market reaction

# Homebuilders report stable starts, at a much lower level than SSB is reporting

## Starts were unchanged in October and sales rebounded. Still, both trending down




- The Homebuilders' housing starts were flat in October (s.a), after an upturn the prior month. Still, starts are trending steeply down – the gap to SSB's starts(permits) data is much wider than usual (34' vs. 25', 6m avg). Student homes, which is only included in the SSB figures, explains some of the deviance. Thus, our take is that ordinary housing starts may have turned down or are flat, at best
- New home sales recovered somewhat in Oct, however, sales are still sliding down (to 26' 6m avg) and do not signal higher starts
- Total housing starts (in sq.m) is close to flat, at a comfortable level, and indicate a muted growth in housing investments

# The Calendar

## In focus: The first Nov PMIs, US housing, Fed meeting minutes, Norwegian oil investment survey

| Time | Country | Indicator | Period | Forecast | Prior |
|---|---|---|---|---|---|
| **Monday Nov 18** | | | | | |
| 16:00 | US | NAHB Housing Market Index | Nov | 71 | 71 |
| **Tuesday Nov 19** | | | | | |
| 06:00 | SW | House Prices MoM, Valueguard | Oct | | 0.6% |
| 06:30 | NO | Consumer Confidence | 4Q | | 17.1 |
| 12:00 | UK | CBI Trends Total Orders | Nov | -30 | -37 |
| 14:30 | US | Building Permits | Oct | 1387k | 1387k |
| 14:30 | US | Housing Starts | Oct | 1320k | 1256k |
| **Wednesday Nov 20** | | | | | |
| 02:30 | CH | 1-Year Loan Prime Rate | Nov | 4.2% | 4.2% |
| 08:00 | NO | Population Growth | 3Q | | |
| 20:00 | US | FOMC Meeting Minutes | Oct-30 | | |
| **Thursday Nov 21** | | | | | |
| 05:30 | JN | All Industry Activity Index MoM | Sep | 1.5% | 0.0% |
| 08:00 | NO | Oil & Gas Investments, 2020 f'cast | 4Q | (184 bn) | 174.1 bn |
| 08:00 | NO | Manufacturing Investment, 2020 f'cast | 4Q | | 21.6 bn |
| 10:00 | NO | Norges Bank Expectations Survey | 4Q | | |
| 11:00 | WO | OECD Economic Outlook | | | |
| 14:30 | US | Philadelphia Fed Business Outlook | Nov | 7 | 5.6 |
| 14:30 | US | Initial Jobless Claims | Nov-16 | 215k | 225k |
| 16:00 | US | Leading Index | Oct | -0.1% | -0.1% |
| 16:00 | EC | Consumer Confidence | Nov A | -7.2 | -7.6 |
| 16:00 | US | Existing Home Sales | Oct | 5.49m | 5.38m |
| **Friday Nov 22** | | | | | |
| 00:30 | JN | CPI Ex Fresh Food, Energy YoY | Oct | 0.6% | 0.5% |
| 01:30 | JN | PMI Composite | Nov P | | 49.8 |
| 08:00 | NO | Housing Starts (Permits) | Oct | | 33' |
| 08:00 | GE | GDP QoQ, details | 3Q F | 0.1% | 0.1% |
| 10:00 | EC | Manufacturing PMI | Nov P | 46.4 | 45.9 |
| 10:00 | EC | Services PMI | Nov P | 52.4 | 52.2 |
| 10:00 | EC | Composite PMI | Nov P | 50.9 | 50.6 |
| 15:45 | US | Markit Services PMI | Nov P | | 50.6 |
| 15:45 | US | Markit Manufacturing PMI | Nov P | 51.2 | 51.3 |
| 15:45 | US | Markit Composite PMI | Nov P | 51.5 | 50.9 |
| 16:00 | US | U. of Mich. Sentiment | Nov F | 95.8 | 95.7 |

- **Preliminary November PMIs**
  - **US composite PMI** (Markit, not the ISM) has stabilized just above 50 the past 4-5 months. Both sectors are noting a slowdown. The first Nov manufacturing survey, from NY Fed, reported a modest downturn
  - **Eurozone** PMI ticked up in Oct after a steep drop the month before, the manufacturing PMI is far weaker than other DM countries/regions
  - **Japan PMI** plunged in Oct due to a VAT-increase, we expect a recovery the coming months. Manufacturing is anyway weak
- **US**
  - **Minutes from the Fed October meeting,** at which the interest rate was cut by 25 bps, will probably continue to highlight a split FOMC
  - **Both housing starts & building permits** are trending up. So is the **housing market index,** however, the index does not point to another lift in starts
  - **Existing home sales** are heading up too, boosted by low mortgage rates
- **Norway**
  - **We expect oil companies to nudge up their 2020 investment forecast** to NOK 184 bn, a 10 bn increase from the Q3 f'cast. Unless the 2020 est is raised substantially more (or the '19 f'cast lowered), oil investments may be peaking in Q4, and will most likely have to decline through 2020
  - **Manufacturing businesses** will probably still signal a substantial decline in **investments** in 2020, following the huge increase in 2019. **Power supply investments** are already falling, and companies will very likely indicate a further substantial decline in 2020
  - **Population growth** may have bottomed out, both western/labour immigration and other have turned marginally up, from a low level

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

# Our main views

| | Main scenario | Recent key data points |
|---|---|---|
| Global growth cycle | The cycle is maturing, in the real economy, markets, and the trade conflict is now doubt a factor behind the recent slowdown, especially in the manufacturing sector. Rich countries (DM) are slowing, more to go in most EM. Unemployment is low, wage inflation on the way up (but slowing some places), not low vs. productivity. Most 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. Investment rates are not far too high, few debt bubbles this time. **Still, growth has slowed to 3% from 4%, and we expect a further slowdown to 2.5% in 2020, even if trade conflicts are 'solved'. If ramped up, more downside risk** | Global composite PMI ticked down 0.3 p in October, slightly more than we f'casted. The level at 50.8 points to below 3% GDP growth, somewhat slower than Q3 (our est). Manufacturing stabilized, services slow |
| China | The governments' stimulus measures may have stabilised the economy, surveys and data do not point to a hard downturn, rather, a stabilization. The invest/GDP ratio is still sliding down. Debt growth has slowed, and will not accelerate much even if authorities are stimulating 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) 20% decline here is manageable. **A full scale trade and even more a tech war will of course hurt the economy. But a trade deal will not bring growth back up, as this is not the reason behind the Chinese slowdown** | Both manufacturing production and retail sales slowed in October, well below expectation. Investment growth slowed just marginally, monthly growth is steady. Inflation accelerates on swine flue |
| USA | Growth has slowed, from well above trend. The employment rate is still trending up, and unemployment down, but wage growth is not accelerating. Price 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 but may now be softening (and partly funded by lower, although still high savings). Housing mostly positive. Fiscal stimulus continues but not by much. The deficit is far, far too high, given the low unemployment rate. Recession risk is increasing, but still not overwhelming, short term. **Risks: Trump/trade/business investments** | Core CPI inflation eased marginally in Oct, underlying growth still close to 3%. The federal budget deficit continues to widen. Volume growth in retail sales is slowing, from a high speed. Manufacturing production slides down, down 0.6% in Oct |
| EMU | Growth has slowed and manufacturing data are worrying while the consumer sector remain resilient. The labour market is still tightening, but at a slower speed, 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 does not have that much ammunition left, barring a huge QE, and the ECB policy makers are split. Fiscal policy debate has turned. **Risks: Trade war (but less risk for a US/EU war after G7). Italy. Weak short term data signal a substantial further slowdown risk** | Eurozone GDP growth revised up marginally, to 0.9%. Employment rose 0.7%, lowest since the Euro crisis. German GDP up meagre 0.1% q/q, an equal contraction was expected. ZEW survey expectations recovered in Nov |
| Norway | Growth is still above trend but may soon be peaking. Unempl. is still declining, although at a slower pace. Wage inflation is accelerating. Oil investments are peaking now. Mainland business inv. not low anymore, will probably slow in '20. Mixed signals from the housing market, starts probably slowing, prices rising moderately. Electr. prices have taken the headline CPI down but core still slightly above target. Credit growth slowing (households) still above income growth, is spite of heavy regulations. **Risks: Debt, housing. A harsh global slowdown** | Mainland GDP rose 0.7% in Q3, slightly below f'casts. Lower growth in oil investments was the major outlier. Core CPI inflation flat at 2.2%. The vacancy rate turned steeply down in Q3 |

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

# In this report

**Global**

- Global macro data steady in negative territory, Eurozone less disappointing

**China**

- October data on the soft side, growth is slowly cooling
- Industrial production cooled in October, trend slowly down
- Retail sales volume growth slides down
- Nominal investments are slowing (but just marginally)
- Credit growth eased more than expected in October, after a slow acceleration
- Total inflation soared to 3.8% in Oct, core CPI eased to 1.6%

**USA**

- Core inflation one inch down to 2.3%, underlying growth still strong
- Retail sales are slowly losing steam, growth still above trend
- Manufacturing production drops again
- NY Fed's manufacturing index inched down in Nov, marginally below avg
- Small businesses' optimism steady in Oct, miles above PMI/ISM (activity)
- The federal budget deficit is widening further
- Jobless claims edged up last week, 8 w average still very low, at 216'
- Nowcasters sharply down, signalling below 0.5% GDP growth in Q4

**EMU**

- Industrial production marginally up in Sept too but trend still down
- Employment growth is slowing, productivity growth probably still low
- German GDP rose marginally in Q3
- ZEW survey expectations recovers, current situation remains lacklustre

**UK**

- GDP rose modestly in Q3 amid Brexit slowdown
- Manufacturing production is declining
- Core CPI inflation inched up to 1.8%, trend tilting downwards?
- Unemployment inched down and employment rose but some signs of weakness

**Sweden**

- After huge revisions; half of the recent unemployment upturn is removed
- Core inflation ticked up in Oct, the Riksbank f'casts an acceleration

**Japan**

- GDP stalled in Q3, far below expectations

**Norway**

- Mainland GDP is growing steadily – Q3 came in a tad below expectations
- Core inflation flat at 2.2% in Oct, a tad weaker than expected
- Unfilled vacancies dropped in Q3, adding to signs of a softer labour market?
- Homebuilders report a stabilisation in starts, at a much lower level than SSB

Highlights

The world around us

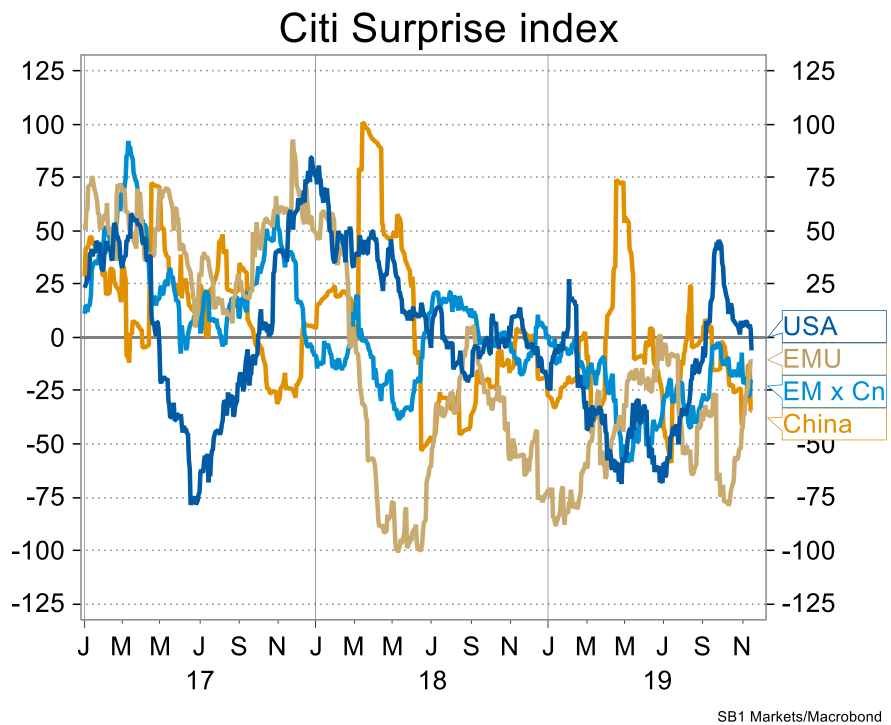
The Norwegian economy

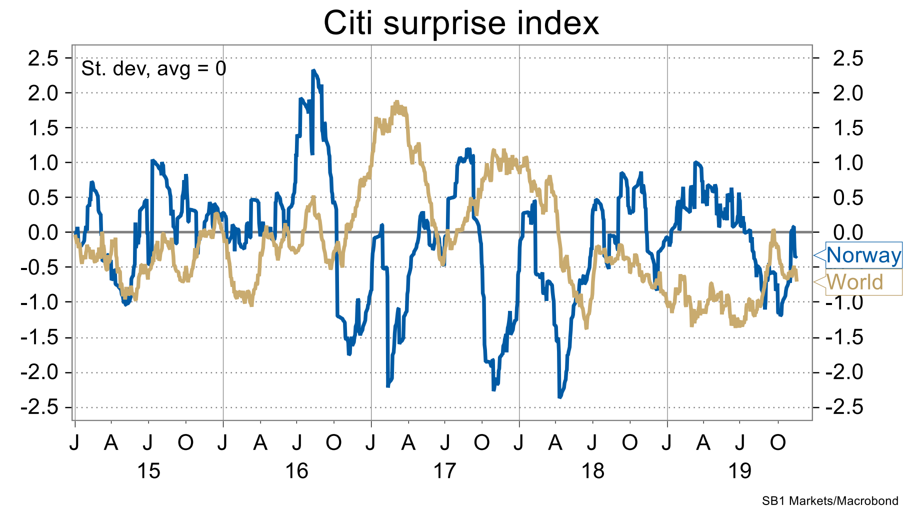
Market charts & comments

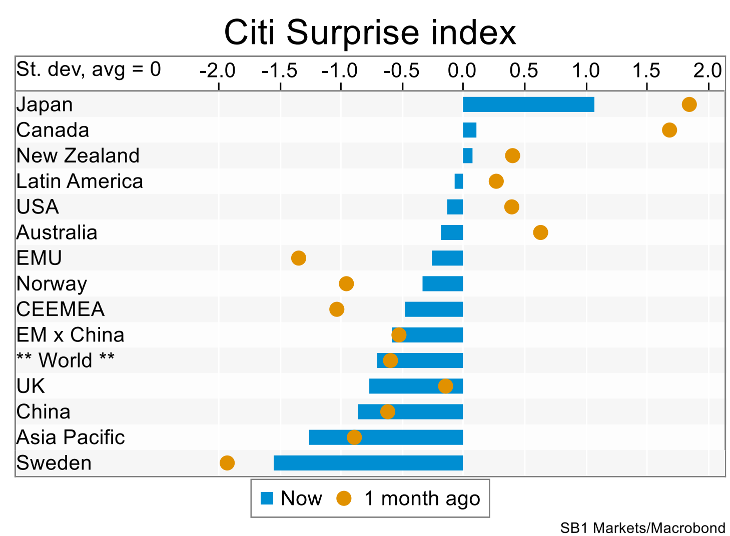
SpareBank 1 MARKETS

# Global macro data steady in negative territory; USA, China weaker last week

## Data from the US are neutral vs f'casts, China down on soft Oct figures, Eurozone less downbeat



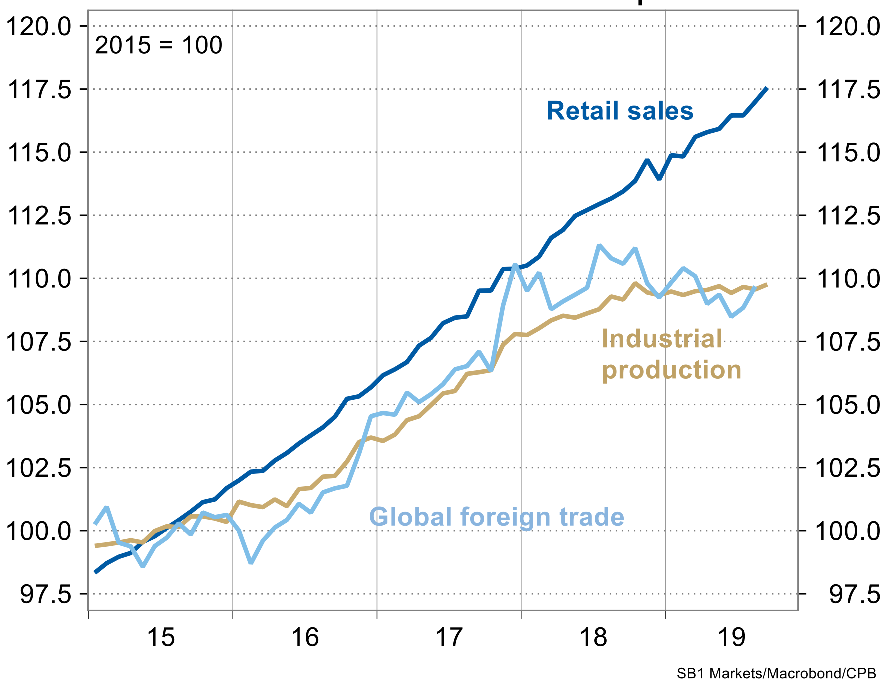



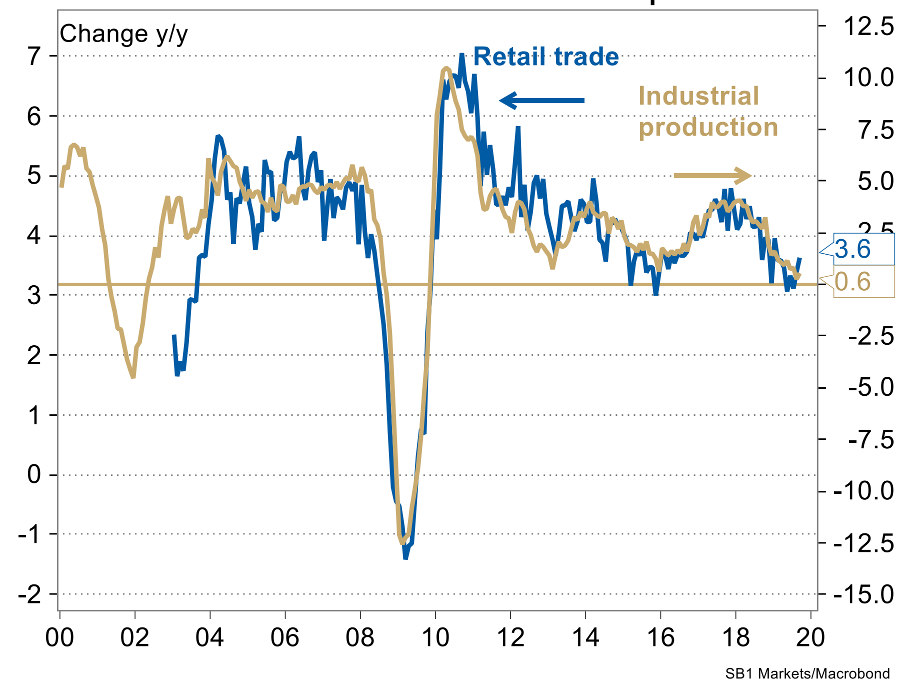

- The global surprise index climbed to a 'neutral' level for the first time this year in mid-Sept. Since then, data have been slightly more disappointing, in sum
- US data flows were beating expectations in Oct, but turned negative last week, partly due to weak manufacturing data
- EMU data have been less disappointing recently, not many data points have deteriorated
- China sliding down again, Oct data below f'casts. China is slightly weaker than other EM
- Norwegian data slightly negative again, and Sweden is far into negative, both reasonable

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

# Global retail sales boosted by Japanese VAT, manufact. heads slowly upwards

## Global foreign trade rose further in August, has stabilised?

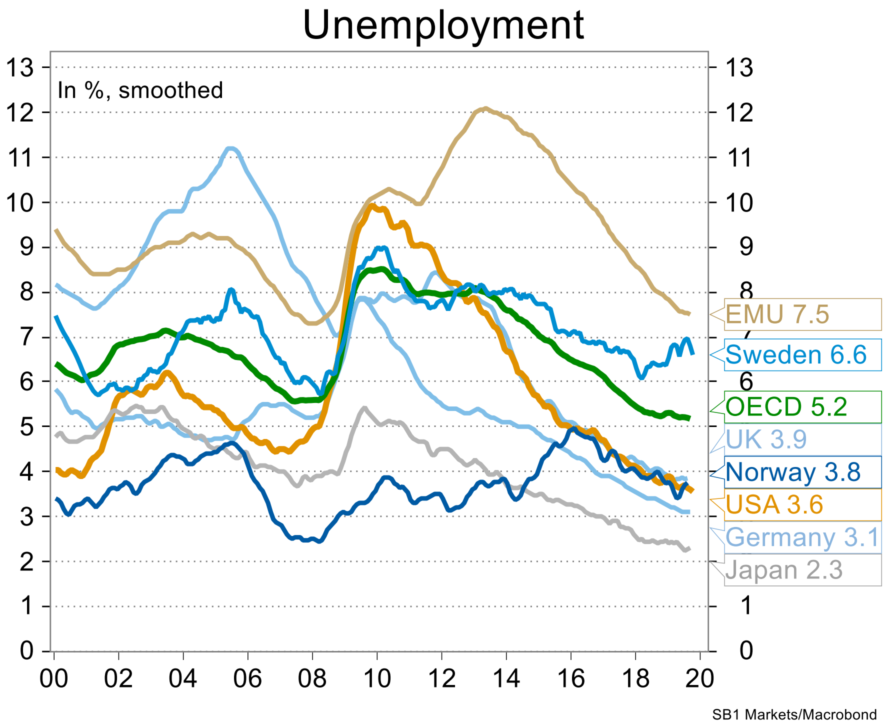


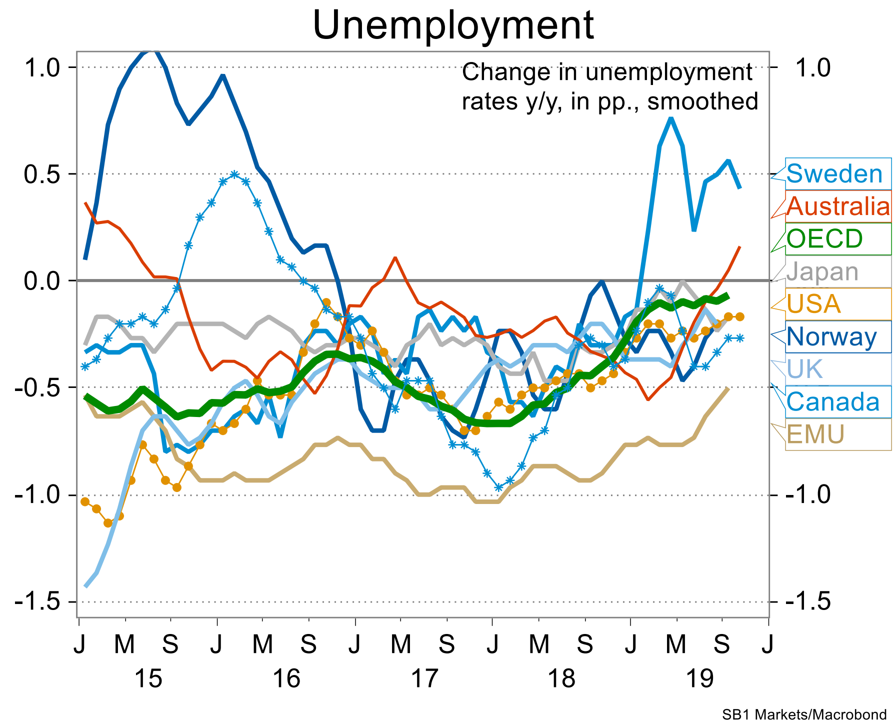




- **Retail sales** grew by 0.5% m/m in Sept (our prelim. est), as in Aug. Half of the 1% Aug/Sept lift is due to a 11% boost in retail sales in Japan ahead of the VAT hike in October – just like we have seen before earlier Japanese VAT hikes, and sales will 'collapse' in Oct. Without this surge, the growth in Aug/Sept is in line with previous months, at a 3% pace
- **Global industrial production** rose 0.2% in Sept (our prelim. est). Recent months production has climbed marginally. Global business surveys signal a modest decline
- **Global foreign trade** rose by 0.8% m/m in August (with our seas adj.) up from 0.3% in July (revised down from 0.7%). Trade flows have been trending down since last summer, at 2% pace but may now have stabilised; the August level is the best since March

# Unemployment is low and still declining in most DM, but…

## The speed down is decelerating most places, probably an early sign of a turning cycle




- Labour markets have been softening in many DM recent months, and employment is increasing at a slower pace
  - » Unemployment is now rising in Sweden and Australia. Unemployment is still declining, but at a slower pace (the 2nd derivative is increasing) in the Eurozone, UK, Japan, Canada and Norway. Total OECD unemployment fell by just 0.07 pp in September compared to one year ago, and the pace down has slowed since early 2018
- Most likely, these early signs of labour market slowdowns are results of mature economic cycles in most DM, and not primarily due to a trade war led downturn, although these factors of course may have triggered a shift
  - » Unemployment is primarily a lagging indicator, not a leading one

# October data on the soft side, growth is slowly cooling

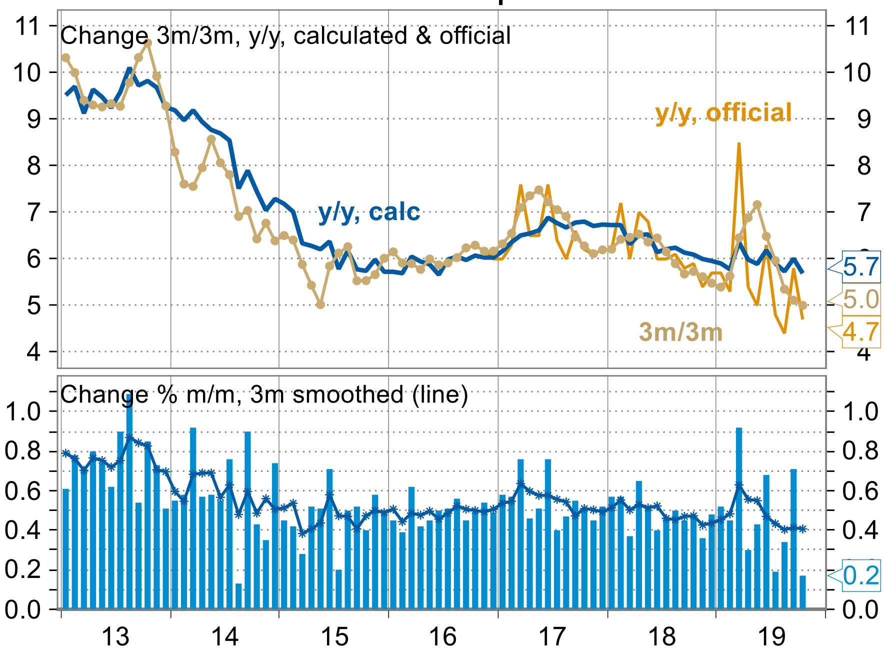
## Manufacturing, investments and retail all slowed more than expected in Oct


- **Growth is slowing amid slowing domestic demand and persistent trade war uncertainties – but data are not at all signalling any abrupt setback**
- **Industrial production** rose just 0.2% m/m but the 3m average speed is steady at 0.5%. The official y/y rate dropped sharply to 4.7%, while our less volatile calculation yields a 5.7% speed, down 0.3 pp from Sept. Growth is easing but slowly, and the PMIs are signalling lower growth
- **Retail sales** growth is easing at a faster pace, suggesting that the Chinese slowdown is not merely a result of the trade war but (primarily?) of softening domestic demand. The official y/y rate fell to 7.2%, from 7.8%, our volume estimate came down 0.4 pp to 5.3%. **CPI inflation** accelerated to almost 4%, due to higher food/pork meat prices
- **Investments** have been expanding steadily and growth is slowing just marginally over the past 2 years. The annual rate inched down to 5.1% (while the official YTD rate fell to 5.2%, down 0.2 pp). Nominal investments are still growing slower than GDP. Real growth is strengthened to some 3%
- **Credit growth** retreated in October, after a acceleration the prior months, helped by bank lending. The credit impulse is marginally positive, following the 2018 contraction

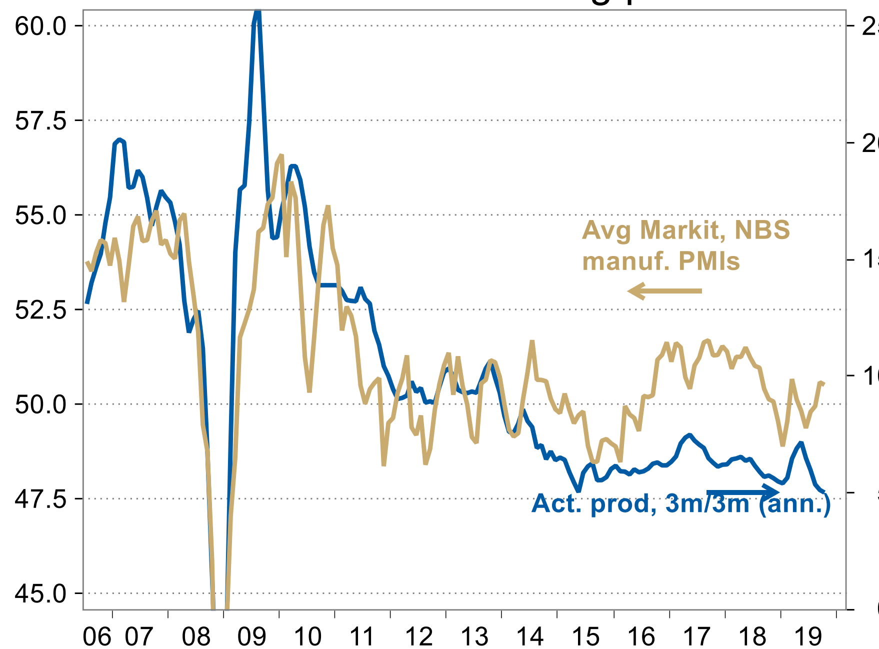
# Industrial production cooled in October, trend slowly down

## Production rose just 0.2% m/m after the Sept 0.7% spike. Our y/y calculation slowed to 5.7%

China Industrial production



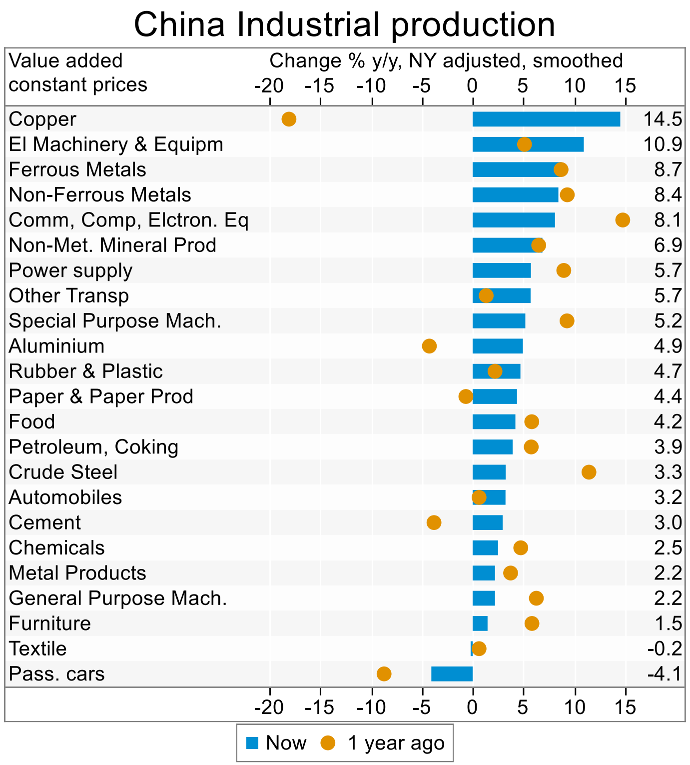

China PMI vs manufacturing production



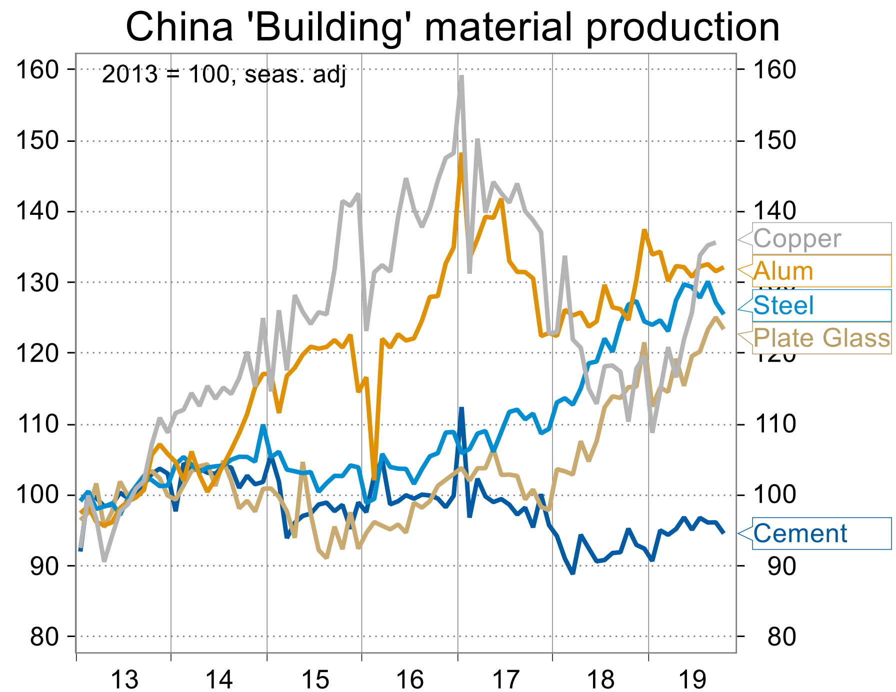

- Production rose just 0.2% m/m in October, following a 0.7% spike in Sept. These monthly data are volatile, the 3m average rate held steady at 0.4%, for the 3rd straight month, sliding slowly down this year, now equalling a 5% annualised growth pace. Our y/y rate edged down 0.3 pp to 5.7%, trending slowly down the past year, but the downturn has not accelerated recent months, as some are reporting!
  - » The official y/y growth rate is 'useless', far too volatile as it is not adjusted for holidays or working days. In October, growth fell 0.5 pp to 4.7%, after a 1.4 pp increase the previous month. The official rate came in far below expectations in Oct
- The two PMIs have (in average) improved and are not signalling any further slowdown. Export volumes are trending up and are close a peak levels. China has most likely not been brought to a halt, in fact, the slowdown was more dramatic in 2018 than it has been so far in 2019

# Production slows in most sectors but just autos are down y/y

## Compared to one year ago, 12 sectors are slowing, 8 sectors are accelerating, not a horrible mix




SB1 Markets/Macrobond

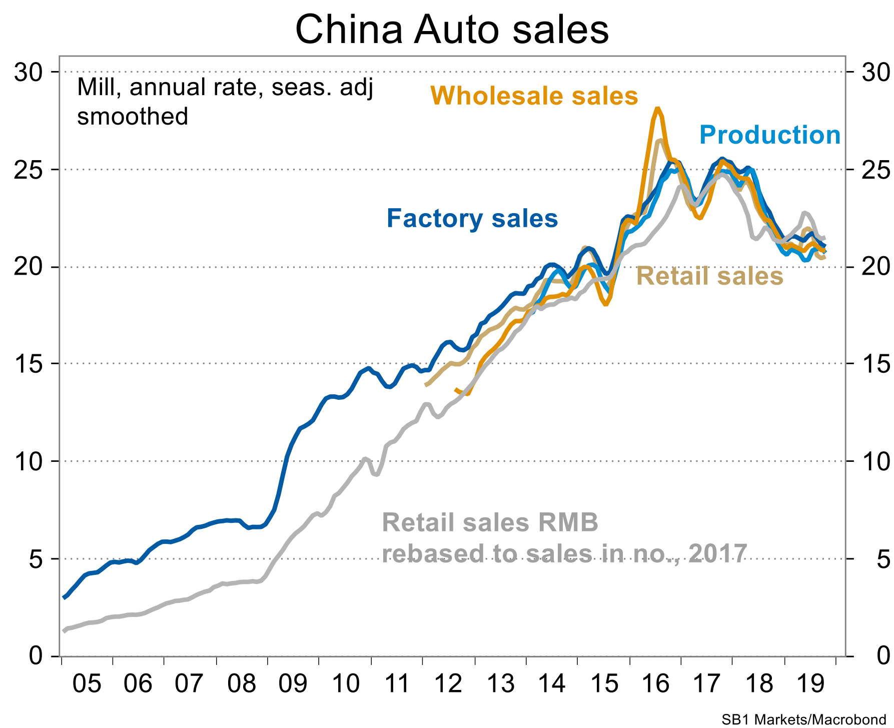


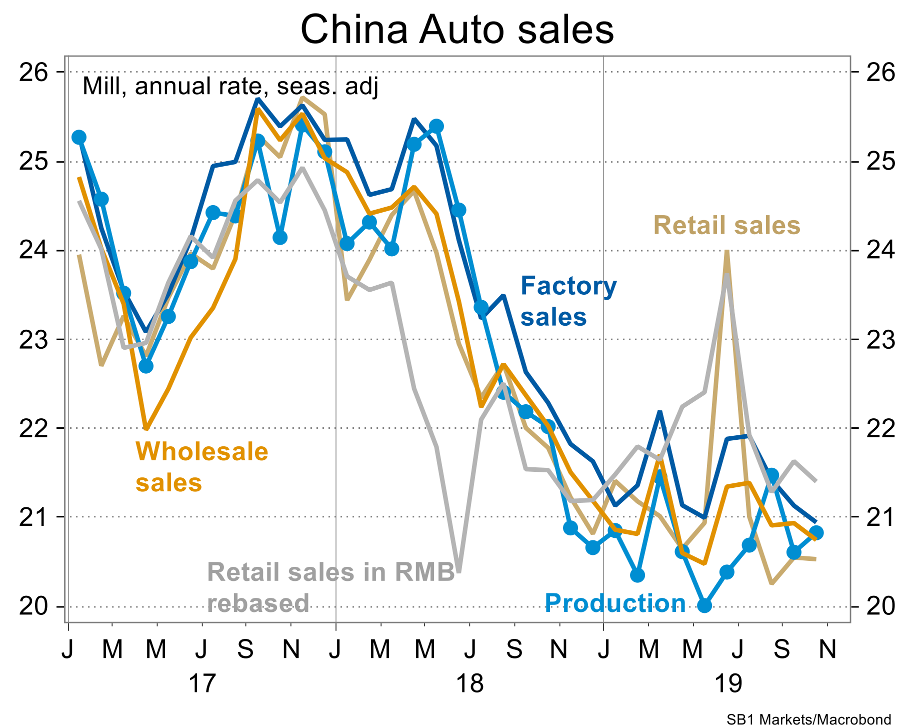

SB1 Markets/Macrobond

- Crude steel production fell for the second month in a row, trending flat? Annual growth +3.2% (3 m smoothed)
- Aluminium production is recovering swiftly from the downturn in 2017 and is increasing by 5% y/y
- Cement production slowed this month and is trending just marginally upwards, +2.9% y/y
- Copper production has recovered sharply in 2019, and is up 14.4% y/y (Sept data)
- Auto production (valued added) has been hurt by weaker sales, however, production has stabilised recent months, together with sales. The annual rate is down 4.1%, from -23% in the spring. Auto sales are down 20% from the peak

# Broad signs of stabilisation in the auto sector

Sales/production is still down y/y but all measures have been ‘stable’ since late ‘18/early ‘19

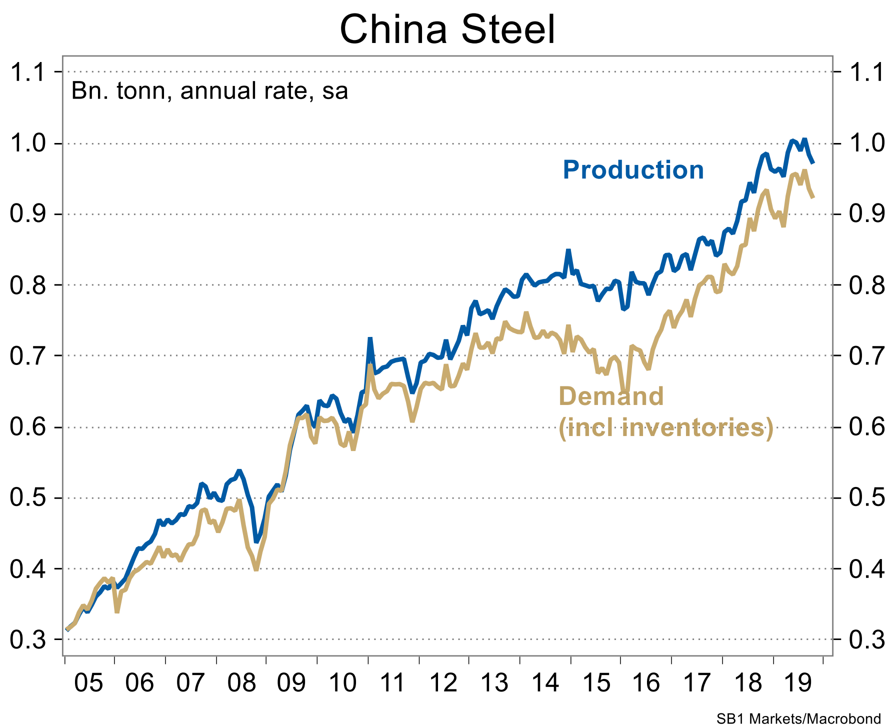



- Production: Production in factories in China, in number of units
- Factory sales: Deliveries from factories in China or imported cars, in units. This is the most common used data series for Chinese auto sales
- Wholesale sales: Sales from wholesalers, in units
- Retail sales: Sales from retailers, in units. This measure is the closest to definitions of auto sales in other countries (sales from retailers in the US, first time registrations in most other countries)
- Retail sales RMB: Value of sales from retailers, in renminbi. Rebased to retail sales in units in 2017

# Steel production (and demand) down in Sept/Oct. Too early to call a slowdown

## Both demand and production have slowed somewhat. Overcapacity (=net exports) is reduced

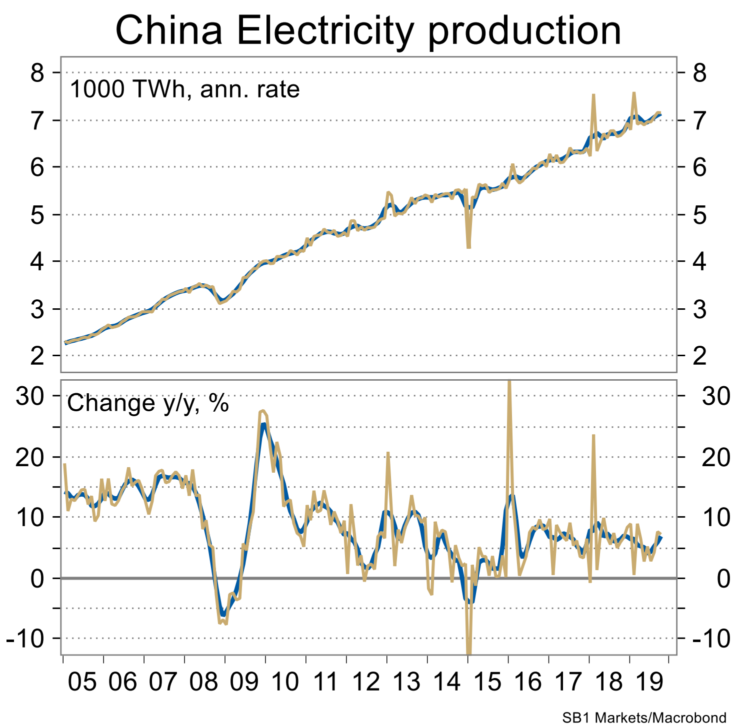


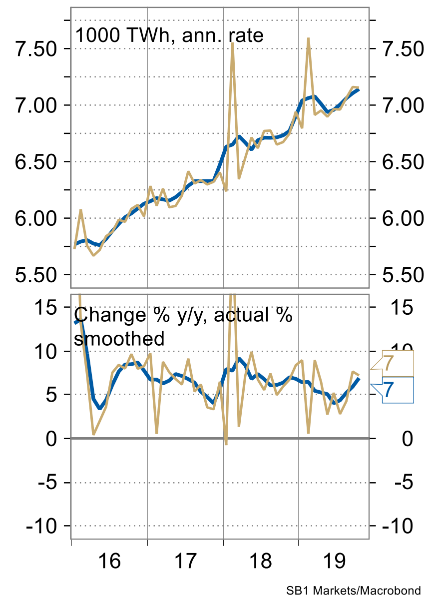


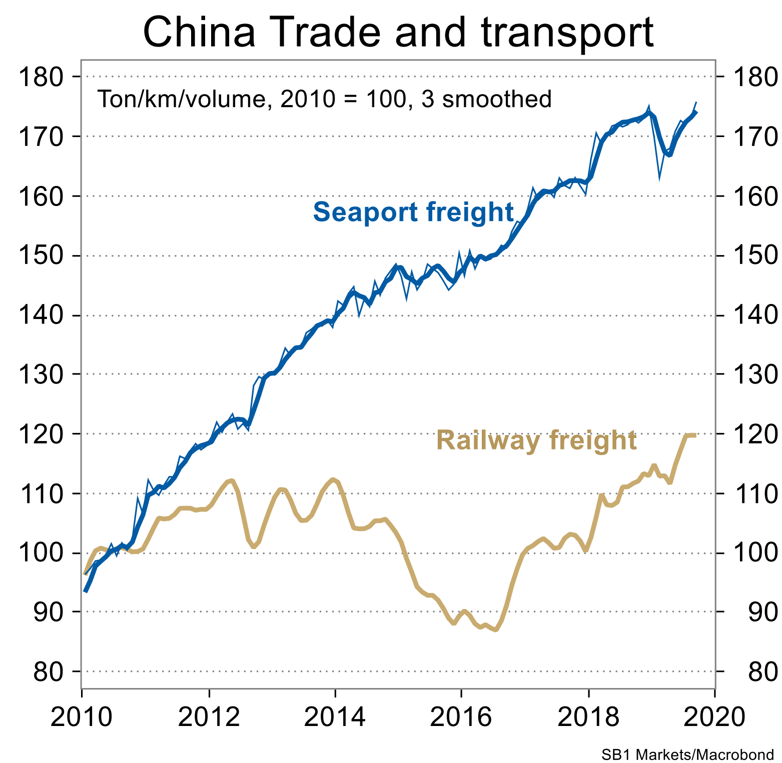
- Production is up some 3.2% y/y (smoothed) and demand is expanding a tad faster, 4.2%, well explained by the strong growth in construction starts. On the other hand, weak auto production signals softening steel demand
- China is still a net steel exporter, but far less than during the 2015-16 setback 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, transport activity still on the way up

Electricity prod. has turned up after a slowdown in H1, trend up, at a 7% y/y pace



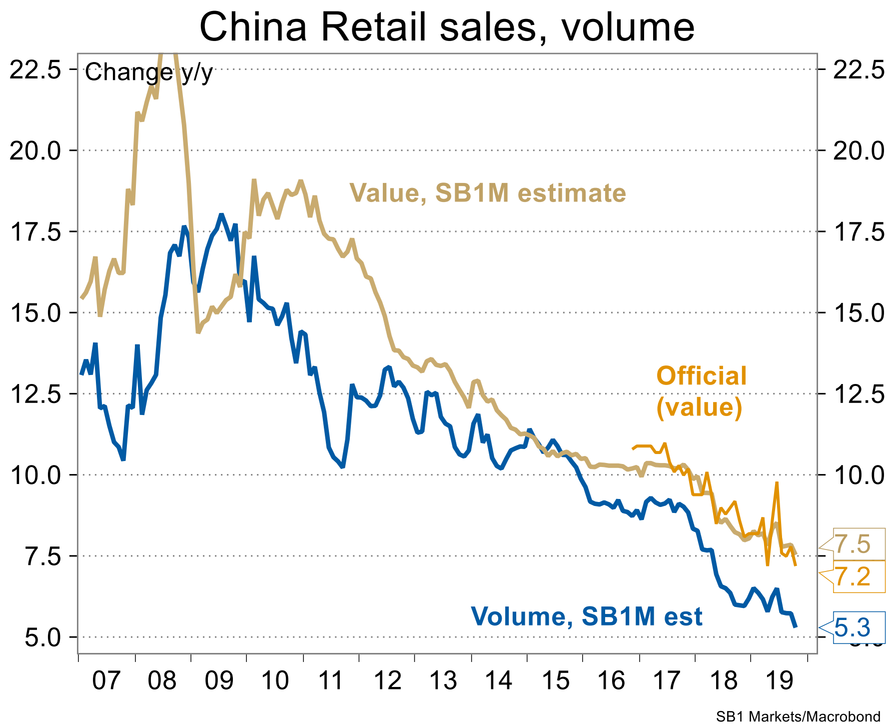




- Transport activity (seaports & railway) has recovered recent months, following a setback earlier in 2019

# Retail sales volume growth slides down

## Sales rose just marginally m/m in Oct, according to our volume estimate. Annual rate down to 5.3%

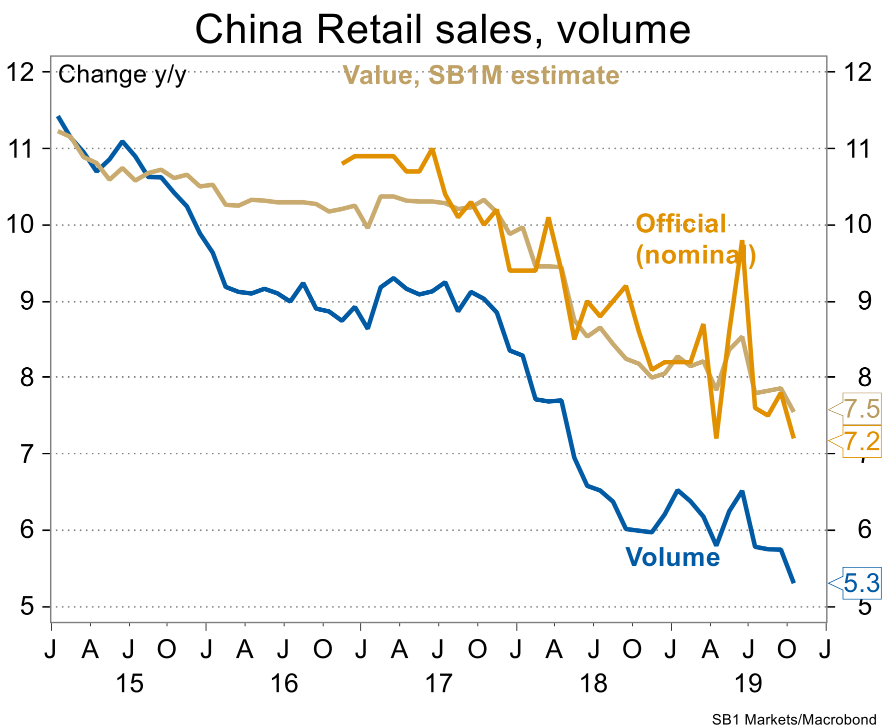


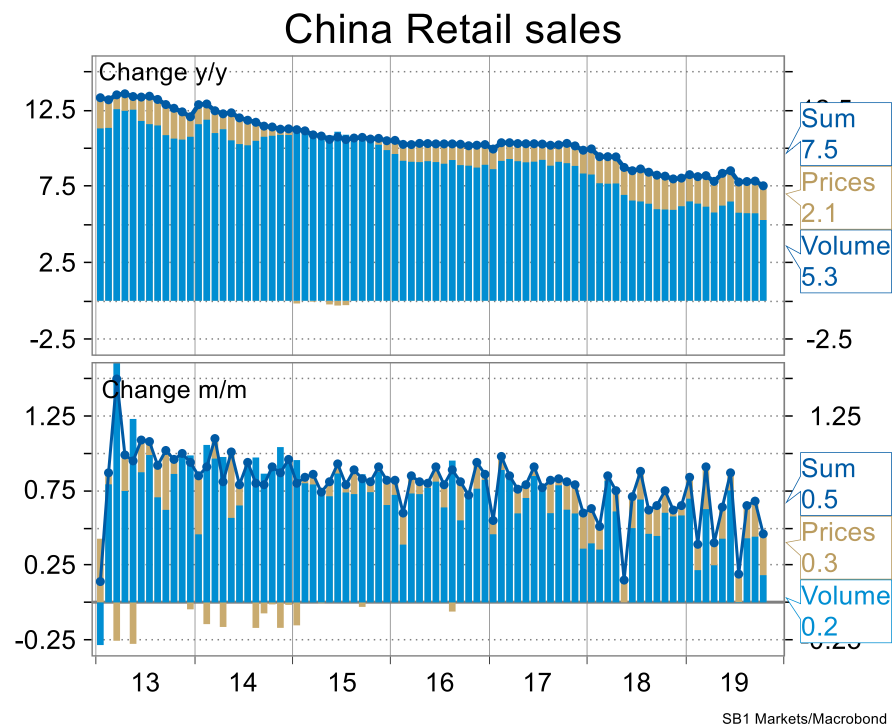


- The official value growth rate came down to 7.2%, down 0.6 pp from Sept, expected unchanged. Our less volatile value growth estimate (based on monthly seas adj. data) yields a 7.5% speed, a 0.4 pp slowdown (and recent months revised down slightly). Value growth is no doubt cooling, however, the speed down is slower than it was in 2018
- We assume a 0.2% m/m volume growth, weaker than 'normal'. The annual rate fell to 5.3%, a 0.4 pp drop from the month before. Inflation has accelerated due to the high pork meat prices, taking its toll on spending. (on retail prices vs. total CPI, check next page)
- Growth in consumption is slowing, even larger tax cuts may be needed to bring consumption growth up. On the other hand , consumer confidence is very high and does indicate any demand weakness

# Retail sales: A closer look

## Price inflation has gradually taken a larger proportion of the slowing nominal growth

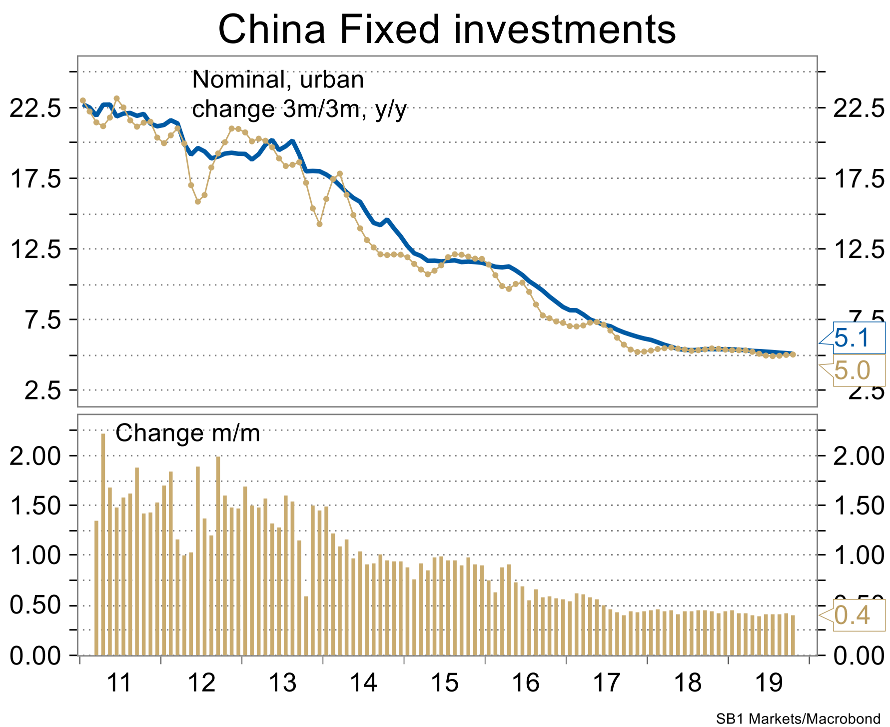



- According to the NBS, retail price inflation has been accelerating the past 3 months, to 2.1% y/y, while the total CPI is up 3.8% y/y. The reported retail price inflation is low, given the 15% lift in food prices (and the overall CPI inflation). The main differences between the two indices is that clothing has a much larger weight in the RPI than in the CPI (and housing and services are included in the CPI). Still, we caution that retail sales volume growth is slower than we assume, because the 'real' inflation is higher than 2.1%

# Nominal investments are slowing (but just marginally)

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

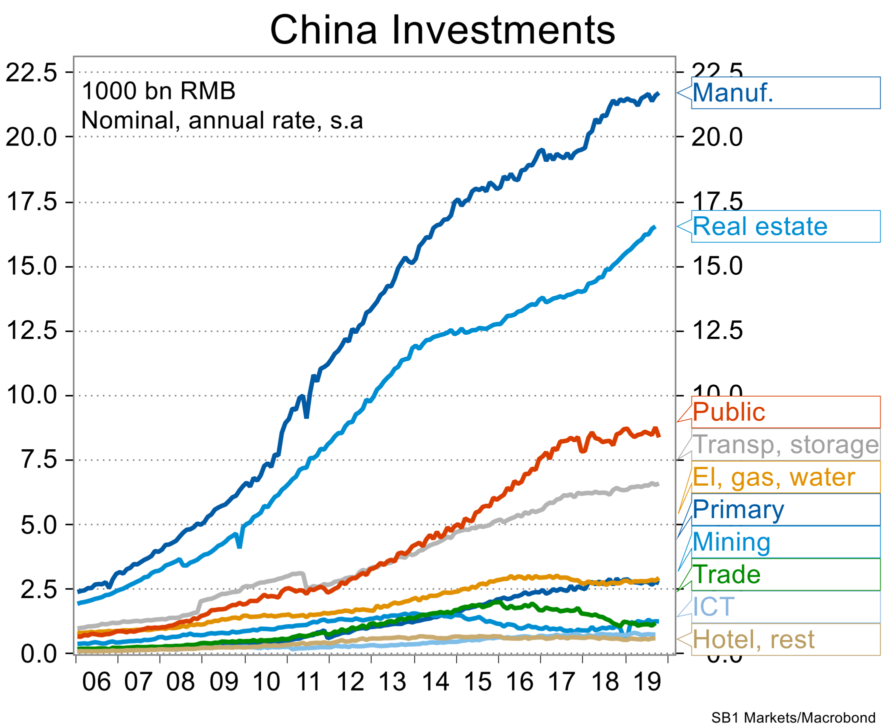


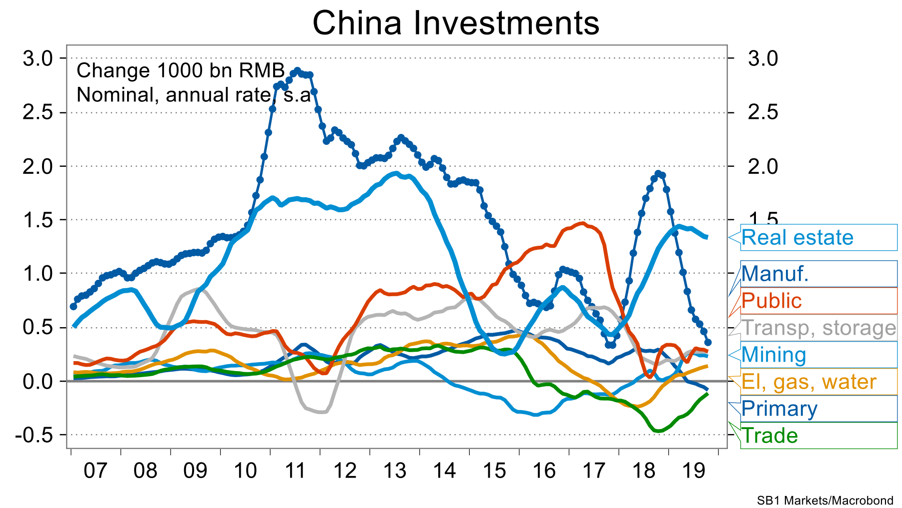


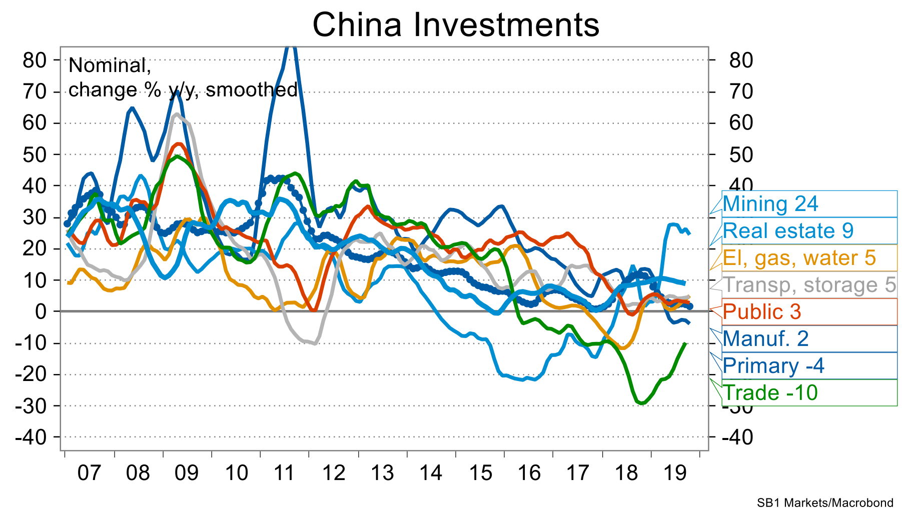
- Urban investments increased by 5.2% y/y ytd in October, according to the official data, down from a 5.4% speed in Sept, weaker than expected
- Our less volatile calculation yields a 5.1% y/y growth, trending just marginally down the past year. The m/m rate was steady at 0.4%, the same pace as recent months and a slight slowdown from last year. In real terms, we assume an acceleration to 3%, from close to zero last year
- Manufacturing investments are still increasing, at a much slower pace. Retail trade investments are still falling, while real estate is 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. The investment ratio is continuing down

# Manufacturing investments are slowing, real estate is booming

## Public sector investments have stalled, no signs of any fiscal stimulus



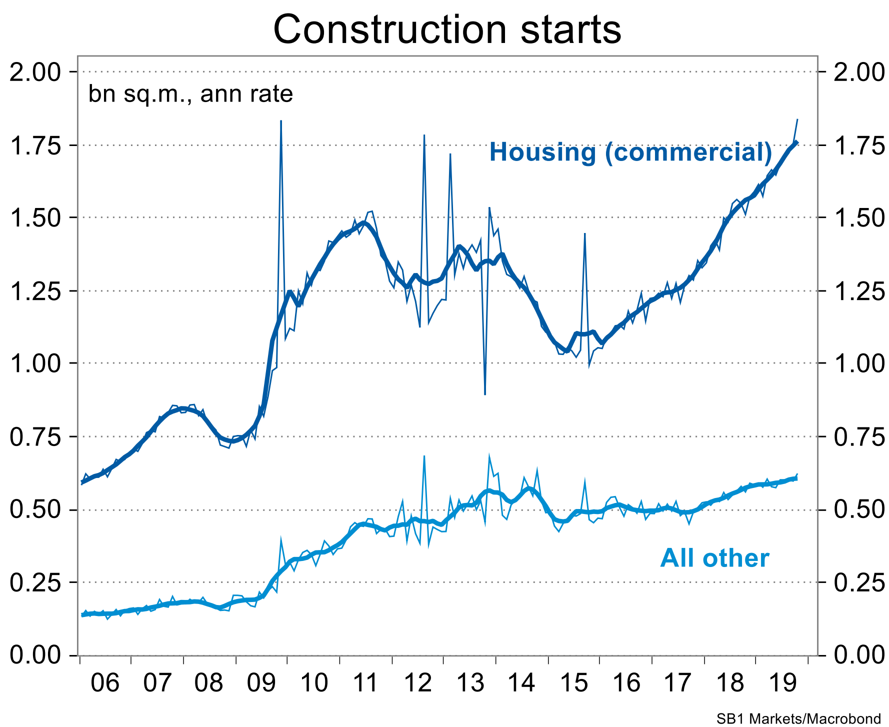



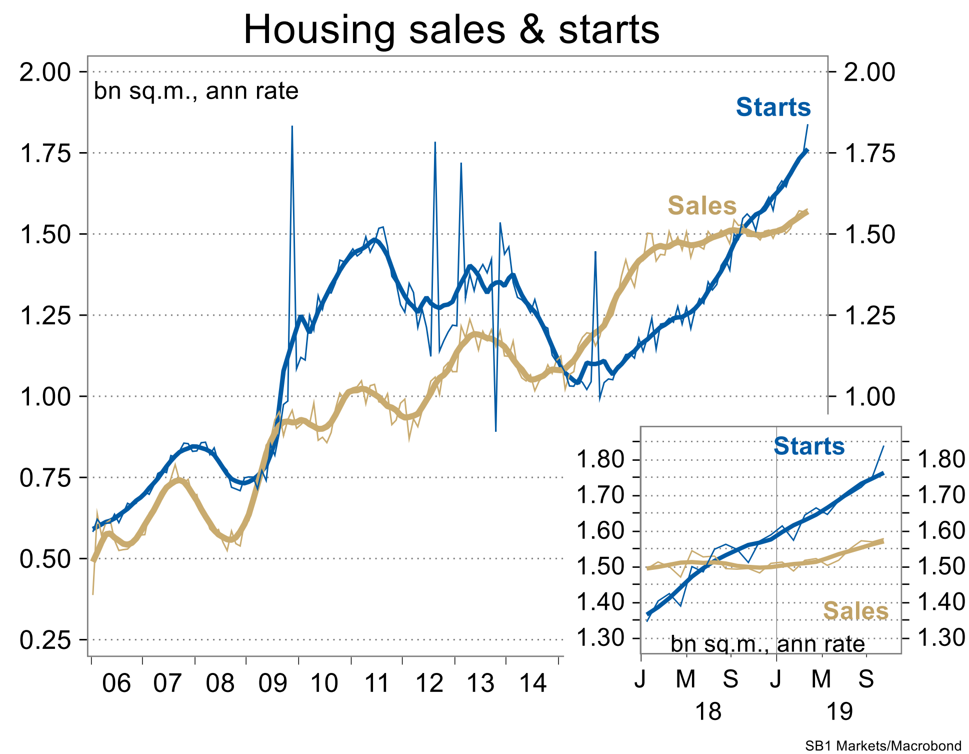

*Not all sectors have reported data for the last month*

- Manufacturing investments are still slowly on the way up but just by 2% y/y, down from 12% y/y one year ago! Most likely due to the escalating trade war
- Weak retail sales through 2018 brought investments in trade sharply down; -10% y/y – but the level is stabilising now
- Real estate investments are now the only growth engine. Not sure that's what the authorities have aimed for…
- Public sector investments slowed in 2017 and most of 2018, have picked up just marginally now. **No signs of any substantial fiscal stimulus**

# New home starts are gaining speed (after revisions), sales are accelerating softly

## Starts jumped in Oct and prior months revised up substantially, to new record (too??) high levels

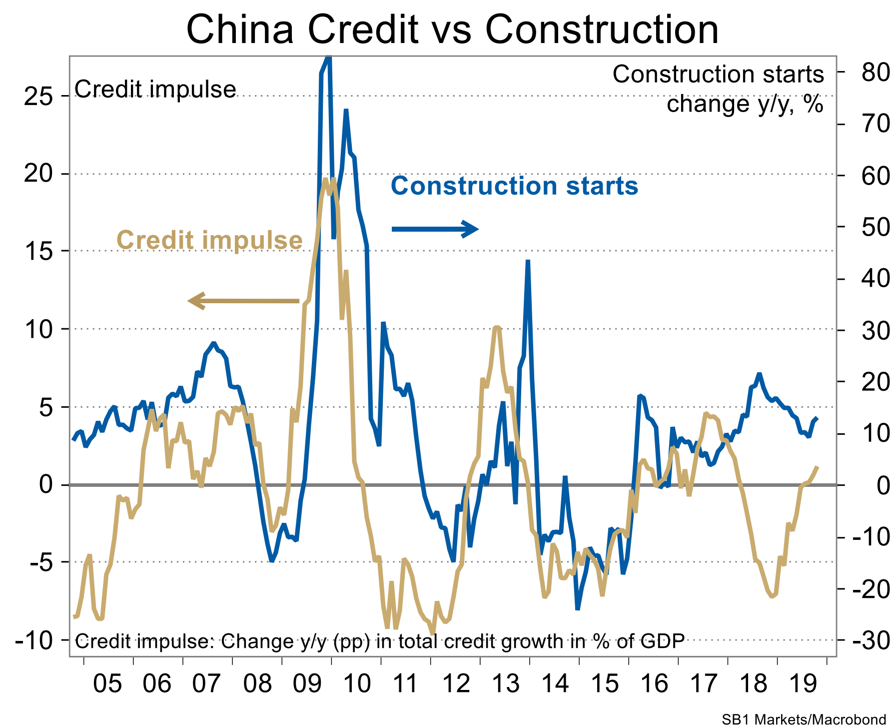



- Starts increased rapidly in October and recent months were higher than previously reported. According to these revised data, starts have accelerated the past two months, after a slowdown in H1 2019, to a 17% y/y speed (smoothed). Starts are up almost 70% from the 2015 trough, by far a record high level. Close to peak? Well, the level is high (in sq.m. growth per person), and there are plenty of reports on unsold homes. However, sales are still strong (and have accelerated recently). In addition, we are not that worried that sales are below sales (implying an increasing inventory) as the inventory drawdown from 2014 – 2018 was substantial
- Other construction starts are up 7% y/y (still 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 have moved in opposite directions recently

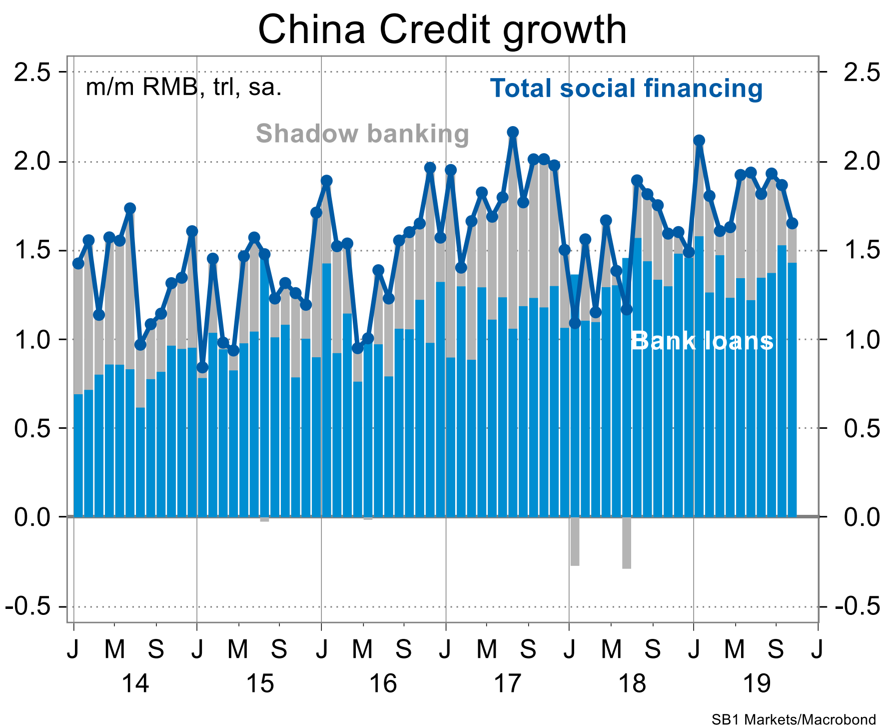
## Usually, credit growth and construction starts are correlated

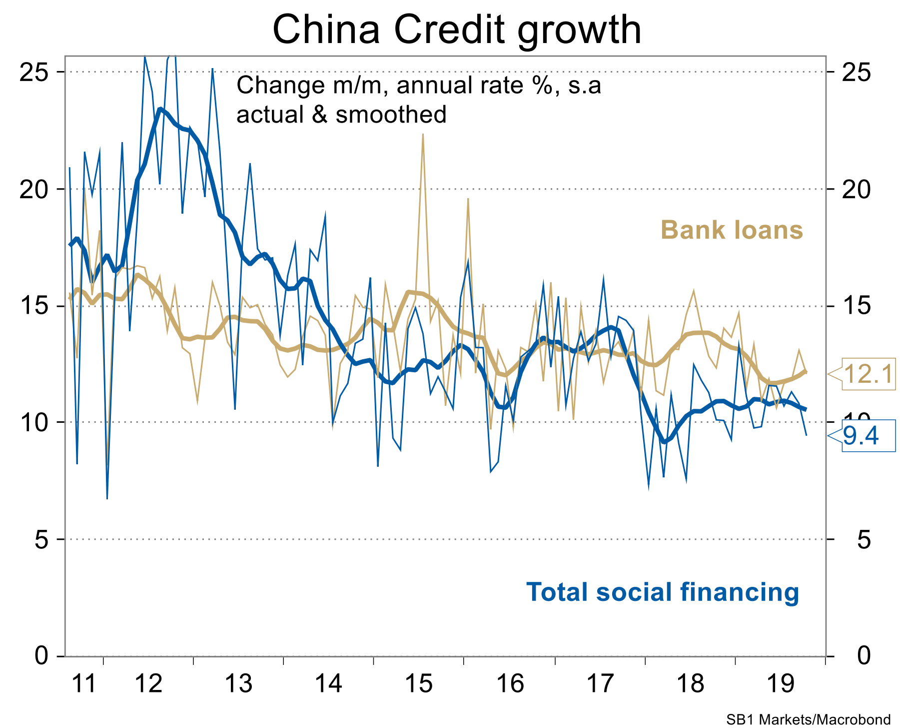




- During 2017/18 credit was tightened but construction activity accelerated. This year, credit has been increasing and is no longer contracting while growth in construction is slowing

# Credit growth eased more than expected in October, after a slow acceleration

## Both bank lending and shadow banking activity slowed month, bank lending still trending slowly up

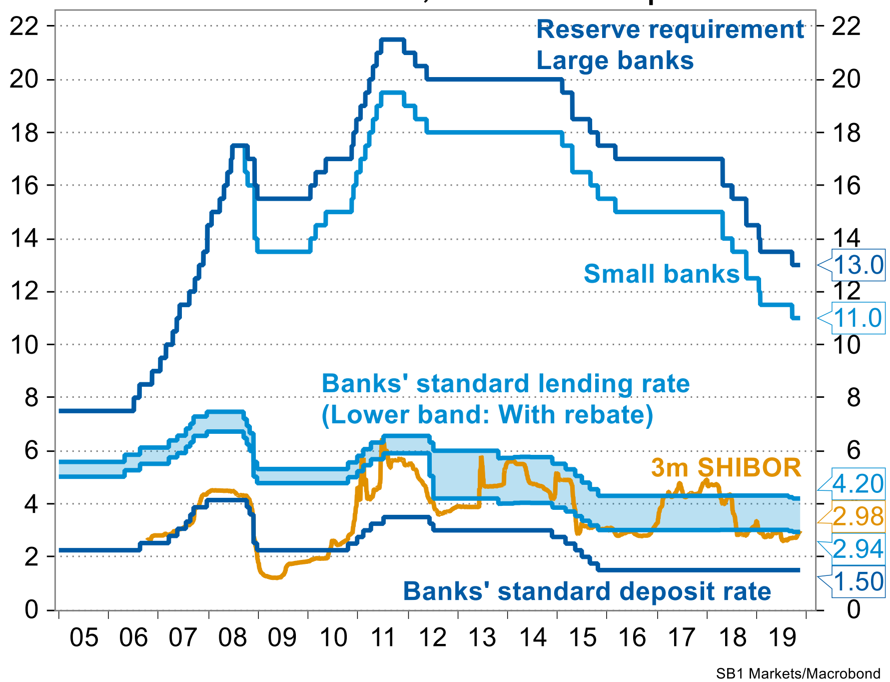


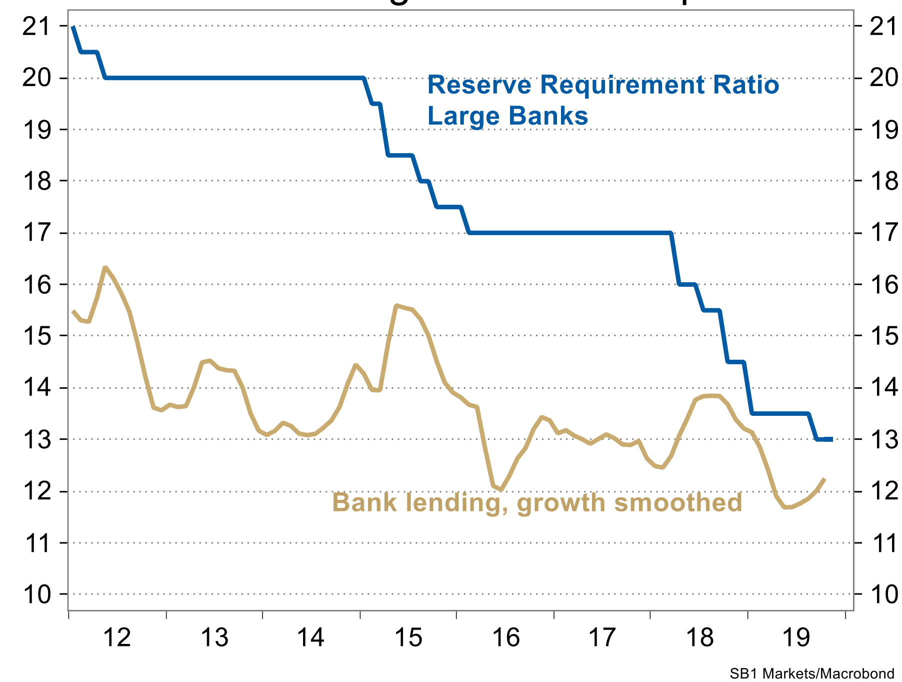

- Total credit rose by 9.4% m/m annualised in Oct, from a 10.8% pace in Sept. In RMB, total credit rose by 'just' 619 bn, from 2.27 trl, expected at 950 bn (not seasonally adjusted). The underlying trend is slowly up since early '18, the credit impulse is marginally positive
  - » Growth in bank lending slowed marginally after a 3 months acceleration. Easing monetary policy is probably boosting lending, but there is so far no take off. Banks' reserve requirement have been cut 6 times, releasing close to 5% increase in lending capacity. Credit supply through the non bank ('shadow') credit market, has slowed the past months. Shadow banking now accounts for some 20% of total credit supply
- What's next? Many expect the PBoC to turn more expansionary, interest rates have so far been cut just marginally. However, there are good arguments against pushing the credit accelerator even harder. Credit growth is well above growth in nominal GDP, and high debt ratios are climbing – and construction activity remains very strong

# Rates just marginally cut so far but reserve requirements are slashed

China Interest rates, reserve requirements



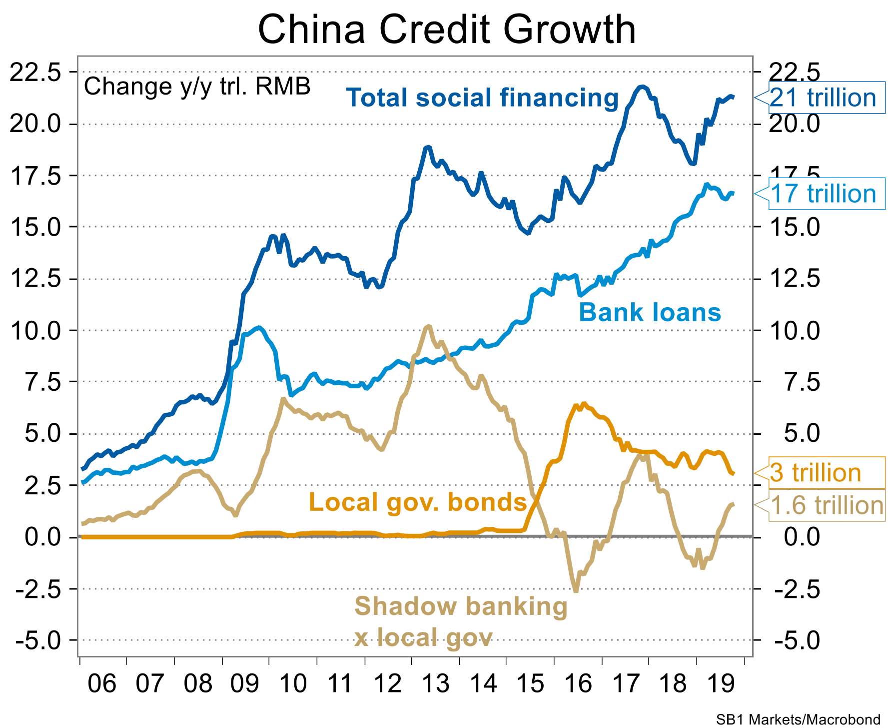

China Bank lending vs reserve requirements

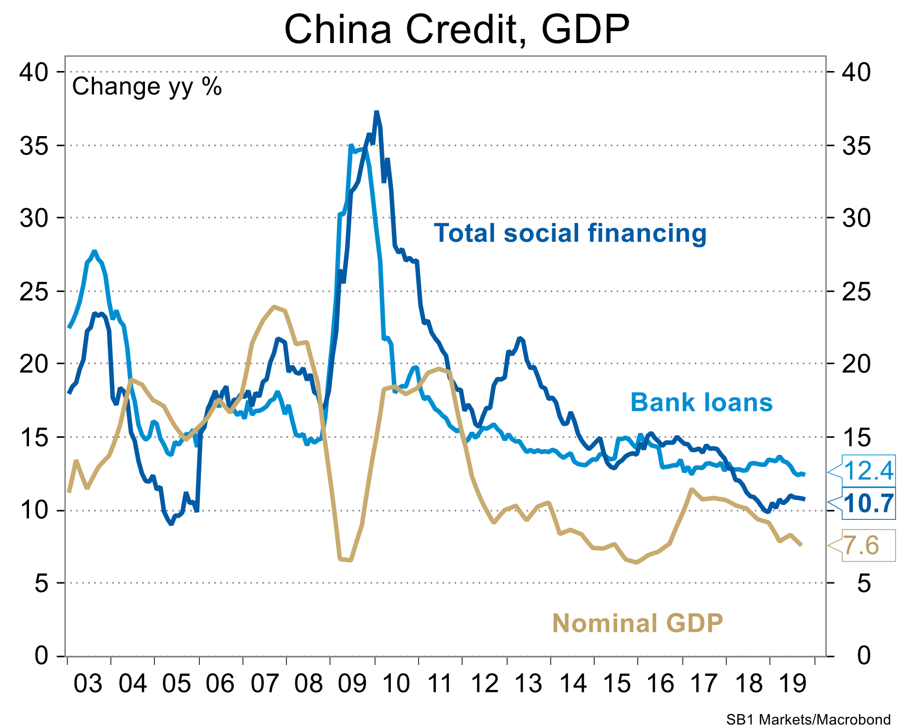



- In October, the PBoC announced a CNY 200 bn cash injection into the banking system to ease lending conditions. This amount equals just 1/10th of one month's increase in bank lending, and cannot have any significant impact on credit condition
- The one year loan prime rate has been kept unchanged at 4.2%, after a 5 bps cut in September. In November, the PBOC cut the one year medium term facility rate (MLF) by 5 bps. Is president Xi a weak guy??

# Credit growth has accelerated slowly over the past year

Bank lending has slower somewhat y/y, the shadow banking market (ex local gov) filled the void

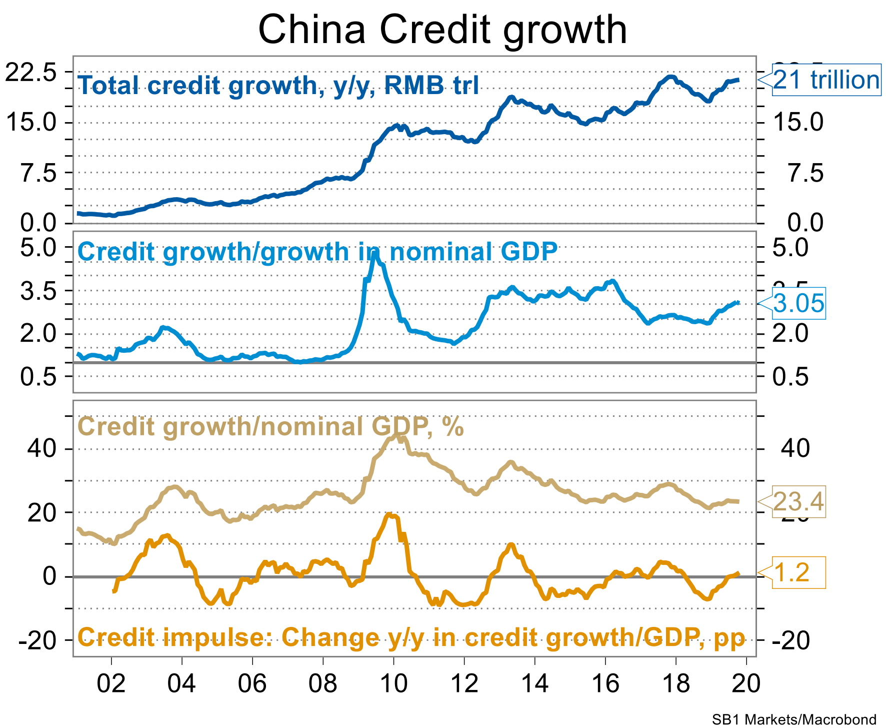


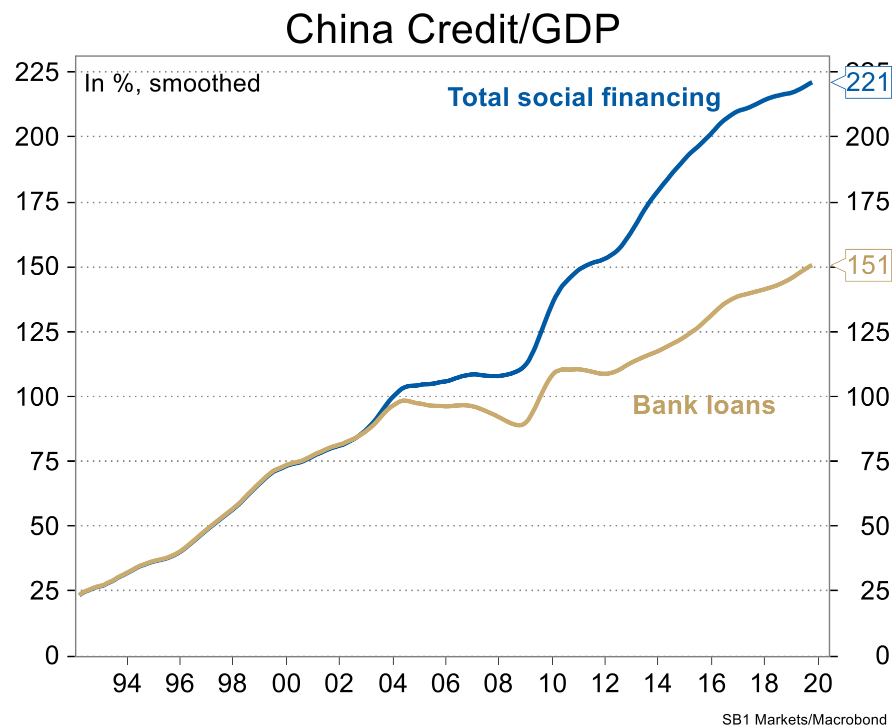




- Over the past 12 months, total credit has grown by CNY 21 trl, equalling 23% of GDP. The annual rate bottomed out in Dec
- Banks supplied CNY 17 trl of the y/y increase in Sept, equalling 80% of the total rise in credit volume
- Local governments borrowed CNY 3 trl in the bond market, slowing recent months
- Other credit – via the shadow credit market x gov bonds – is up 1.6 trl, from a negative drag short time ago
- Total credit growth at 10.7% is well above growth in nominal GDP (7.6% in Q3), and debt/income is still on the way up

# Credit impulse has turned marginally positive, from negative

## Credit growth is now slowly increasing vs GDP

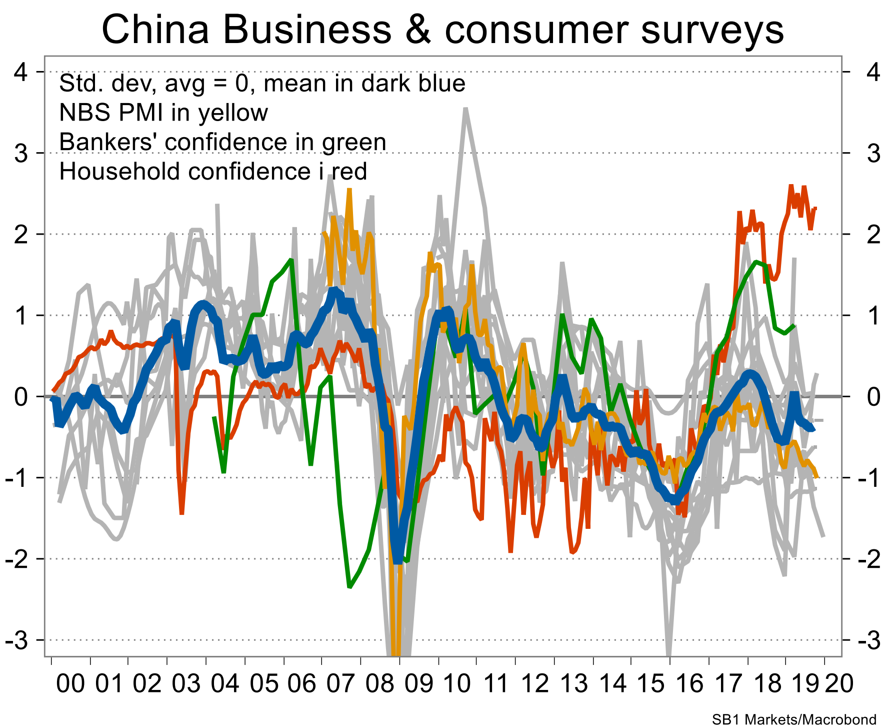


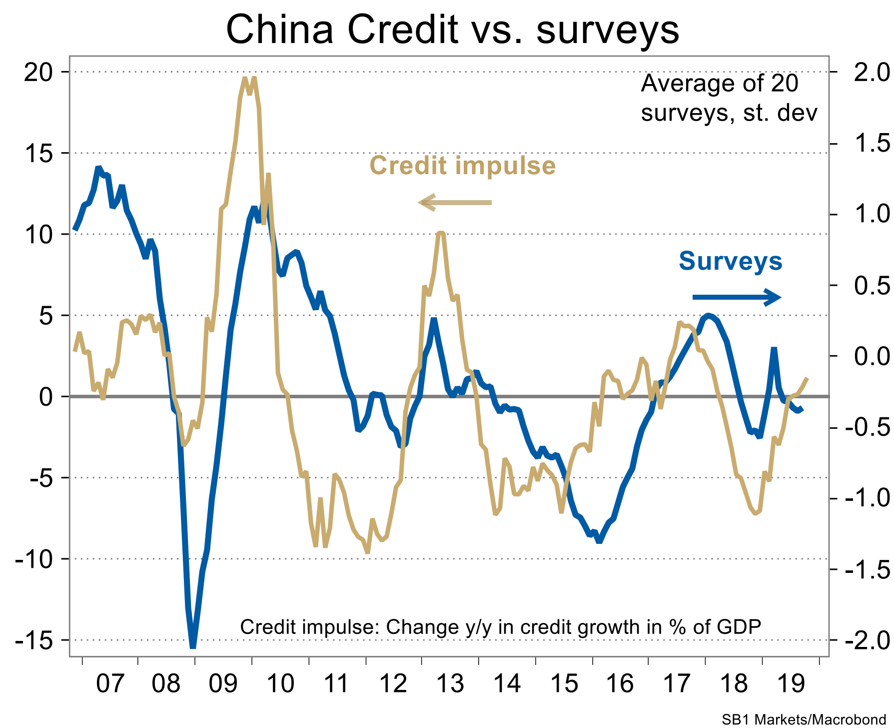




- A positive credit impulse implies that the credit growth/GDP ratio is increasing (the 2nd derivative of credit vs the GDP level)
  - » A negative credit impulse indicates credit tightening (or weaker demand) and has been associated with slowdowns in the Chinese economy
  - » Now, the credit impulse has risen to marginal positive
- We are uncertain how far the authorities are willing or able to bring credit growth back up. The credit/income level is high – and it is still increasing. For every RMB GDP grows, credit increases 3 by RMBs, and each year growth in credit equals more than 20% of GDP. That's not sustainable, neither for lenders nor borrowers in the long run, if nominal GDP growth is less than 10%. The Government may succeed in increasing credit supply short (if they dare to, vs long term risks) but the problem may turn out to be demand for credit

# Credit has been tightened, usually dampens growth

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

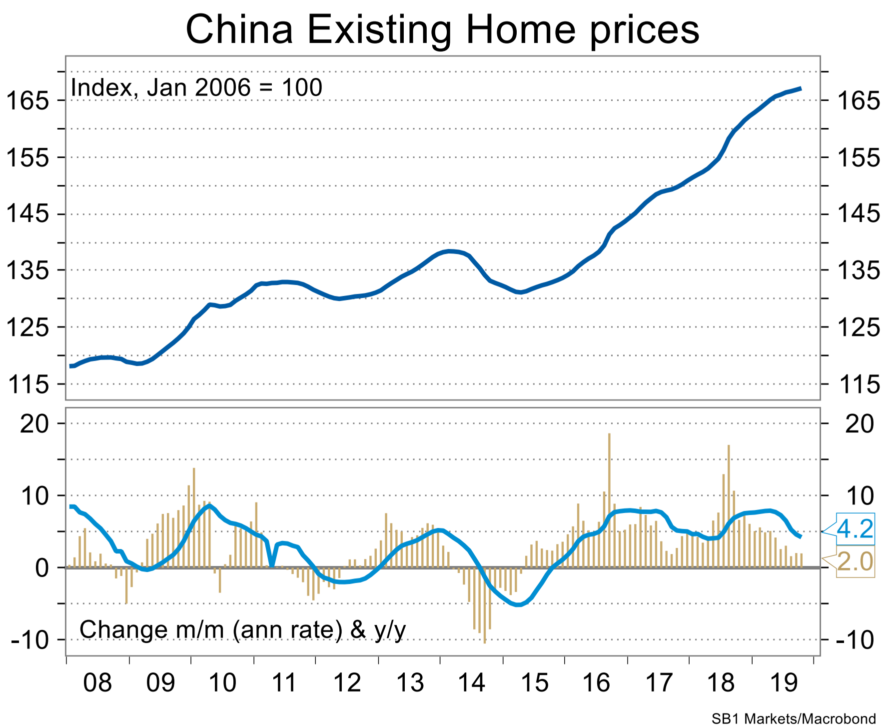


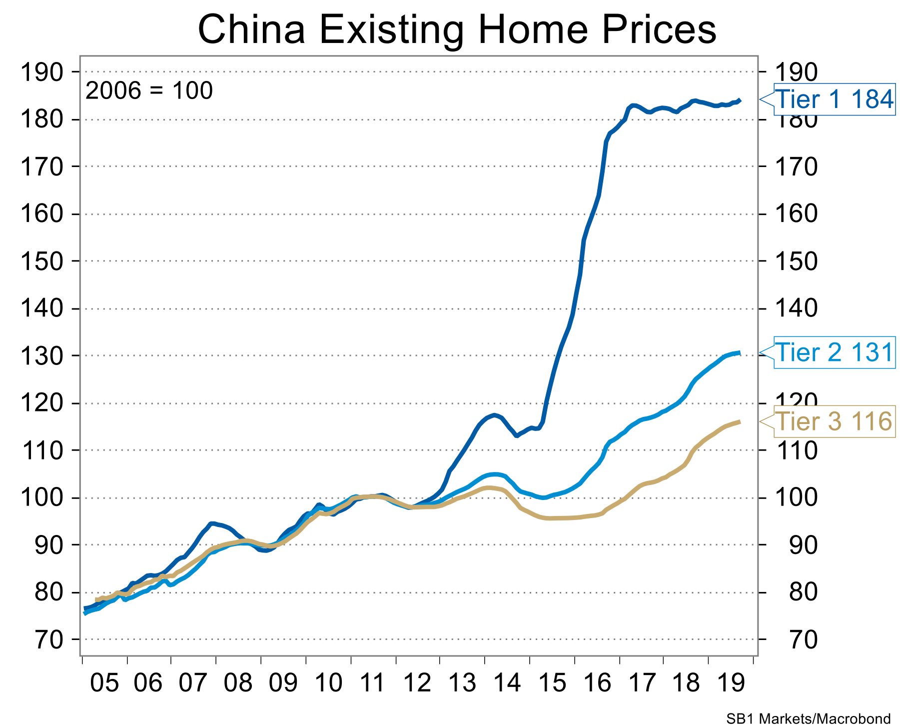




- An avg of Chinese business & consumer surveys indicates that growth has slowed, however, the level is still at an historical average and above the 2018 level (and it was weaker in 2014-2016 and 2012)

# House price inflation is slowing – and credit probably not to blame

## Price growth ticked up to 2.0% annualised in Oct, still slow vs above 10% one year ago

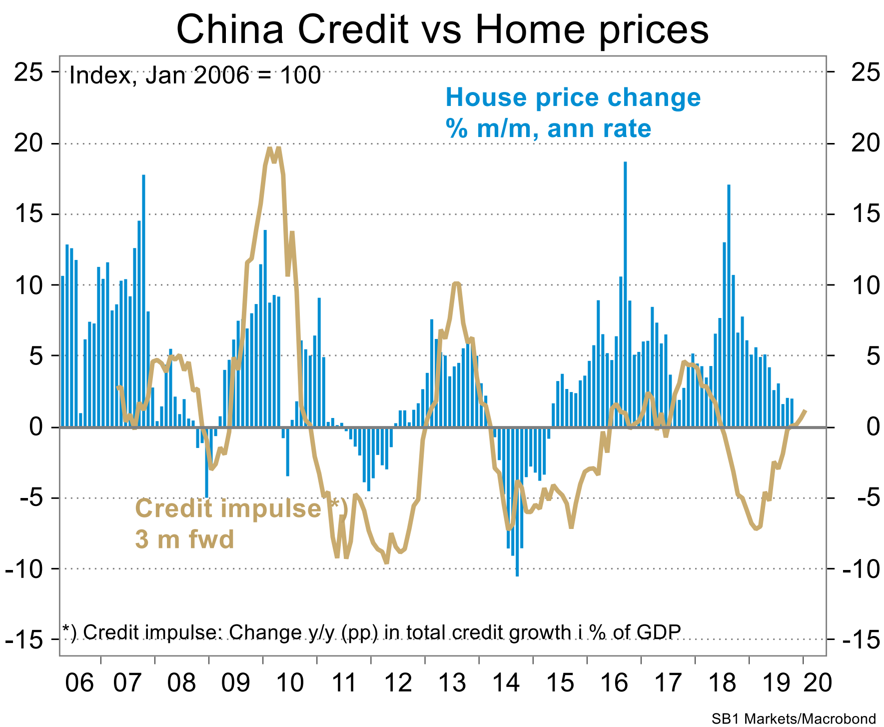


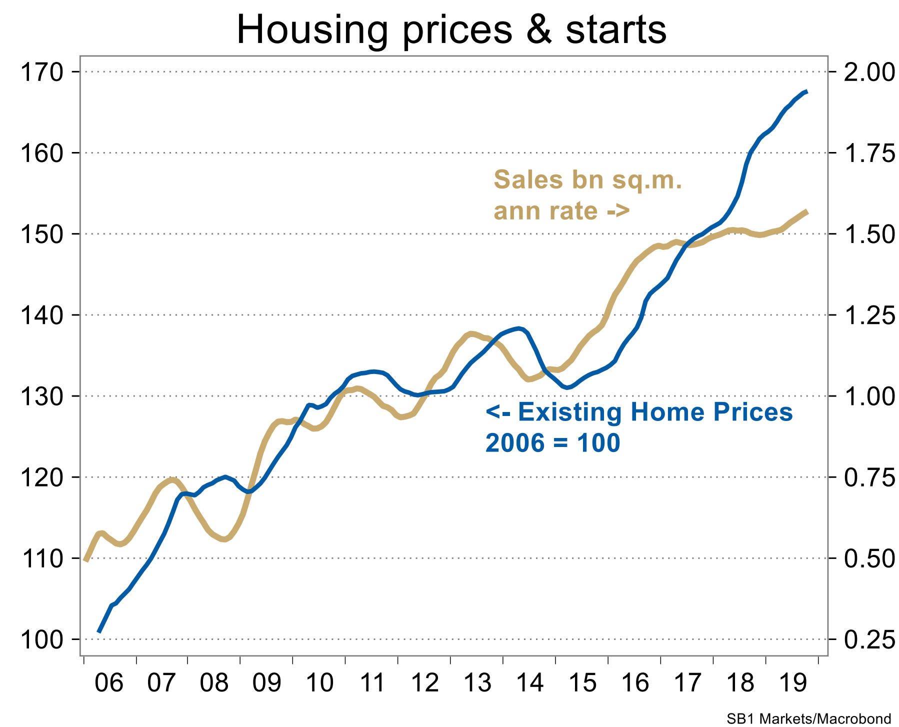




- The annual growth rate came down to 4.2% in October, down 0.4 pp from the prior month. Monthly price inflation was up 0.2% (2.1% annualised), the same pace as in Sept. Growth has been slowing gradually since last summer, which was partly 'announced' a long time ago due to high monthly growth rates last year. The annual growth rate will decline further coming months
  - » Prices in the four tier 1 cites have remained more or less flat since early 2017 (following a 60% lift past 2 years), prices in the 'smaller' cities are still on the way up, but at a slower pace than in early 2019
  - » SouFun reported a slowdown in the m/m rate to 1.8% in October, the second month of downturn
- The credit (impulse) contraction in 2017 and into 2018 was most likely the main reason for the mild downshift in late 2018. Now, credit cannot be attributed, as the authorities are stimulating lending – and the credit impulse is turned marginally positive

# Credit impulse slightly positive, should not be a drag on house prices

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

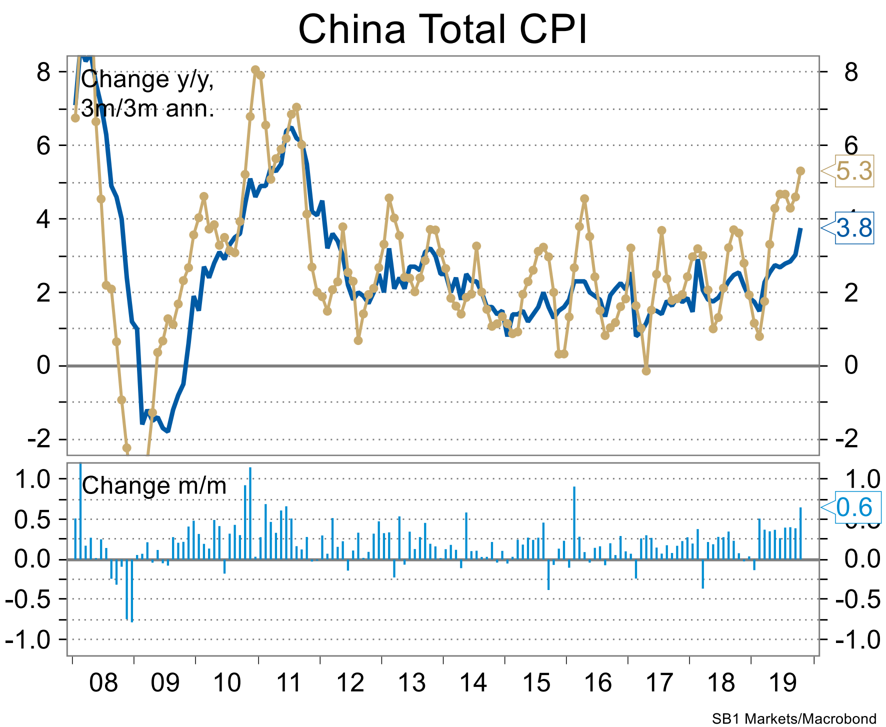


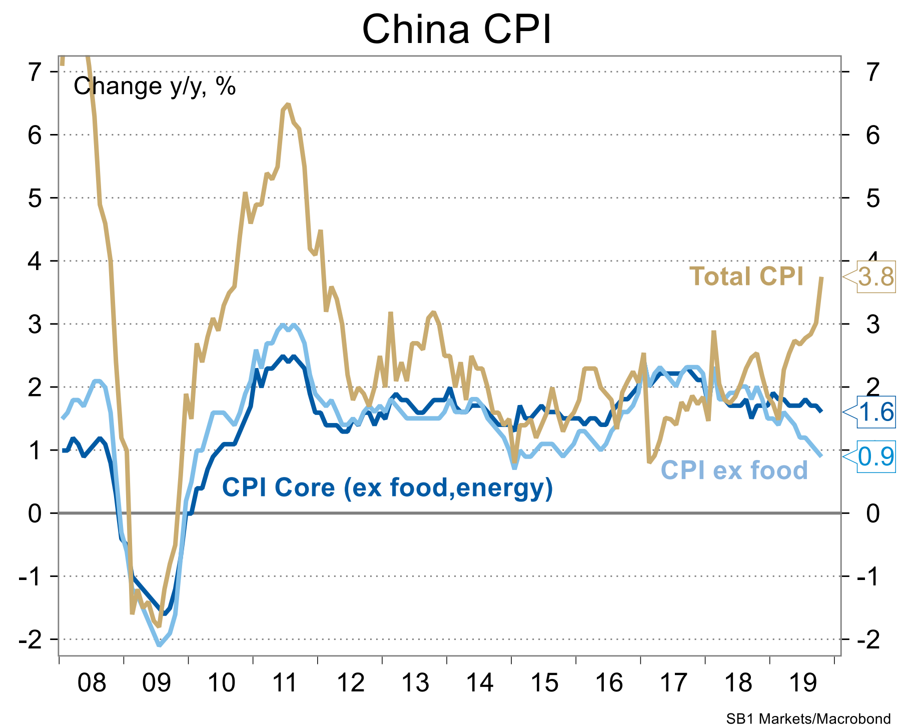




- Through 2018, house prices kept up surprisingly well, given the negative credit impulse
  - » That has been the case with new homes sales too – and sales are still trending slowly up
- Now, the authorities are pushing the credit accelerator – and they may succeed, as many times before, at least the credit impulse have turned marginally positive
- New home sales are still moving upwards, normally a sign of higher existing house prices

# Total inflation soared to 3.8% in Oct, core CPI eased to 1.6%

## Total inflation climbs on a rapid increase in pork prices, core inflation holds steady

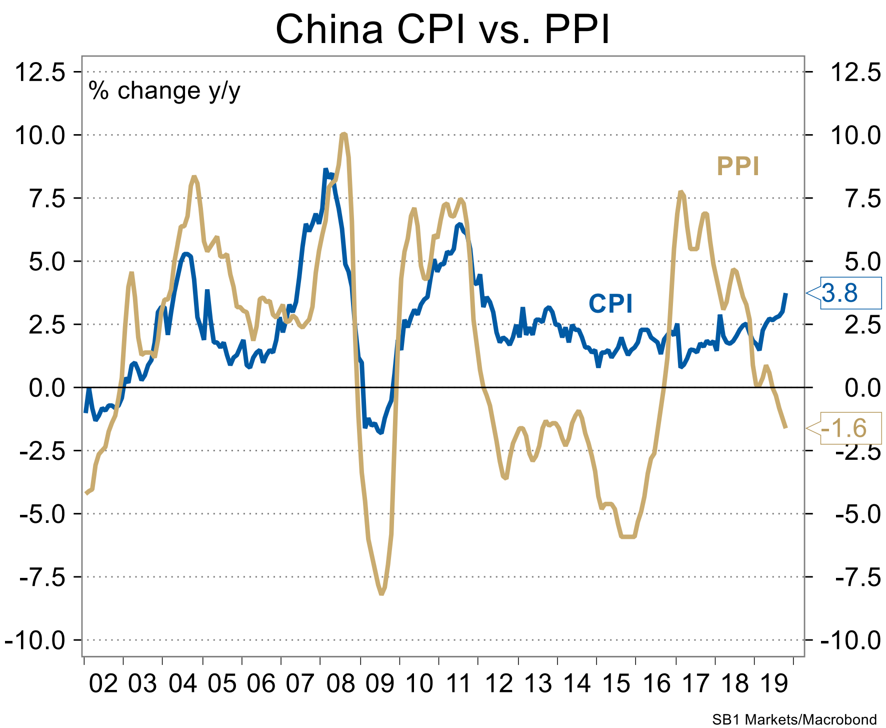


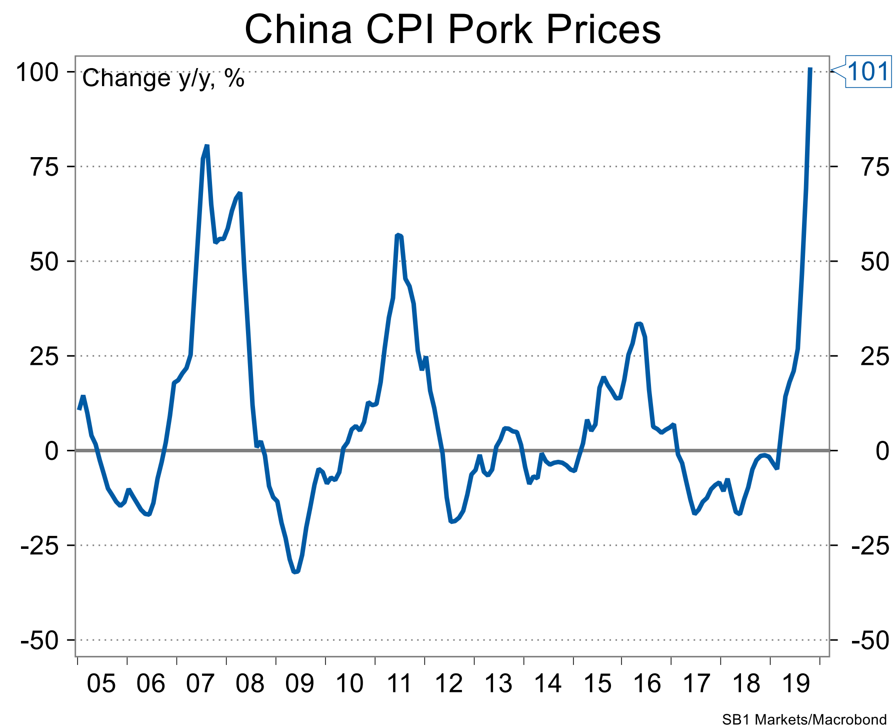




- Headline inflation climbed to 3.8% in Oct, a 0.8 pp jump! Total inflation is fuelled by accelerating food prices
  - » Food prices jumped 3.2% m/m and the annual rate rose to 15.5%, the highest since 2008. Pork meat prices are up 101% y/y!!
- Core inflation (x food & energy) slowed marginally to 1.6%, trending more or less flat. CPI ex food fell to 0.9% in Sept, sliding down, due to lower energy prices
- Higher total inflation is dampening real consumption growth. Moreover, the decline in the PPI may signal a slowdown in the Chinese economy, check next page

# China producer prices are falling, not a signal of strength

PPI down 1.6% y/y in Oct, dragged down by oil, raw materials. Food prices are soaring

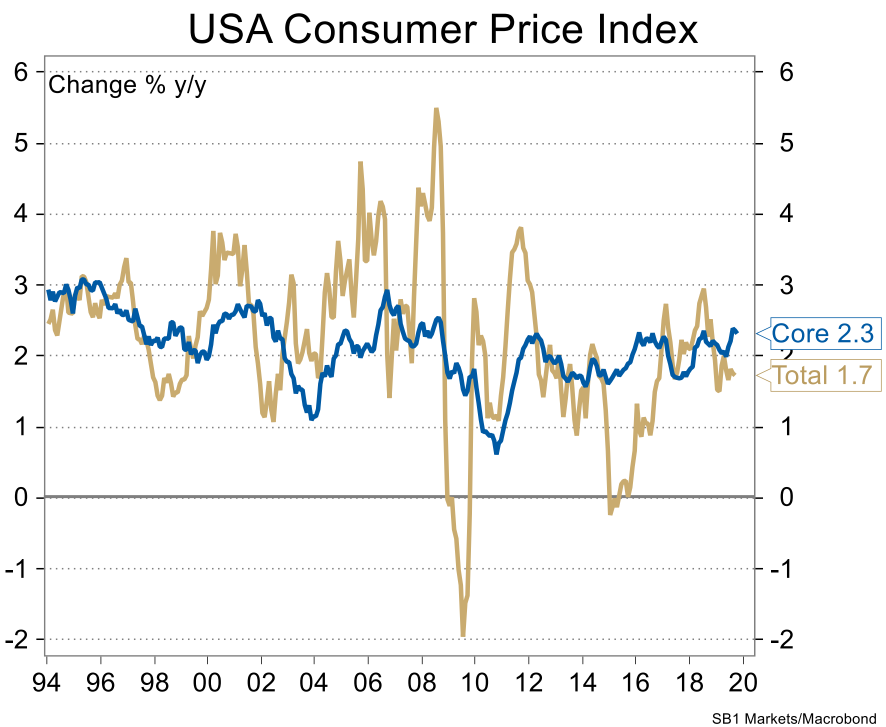


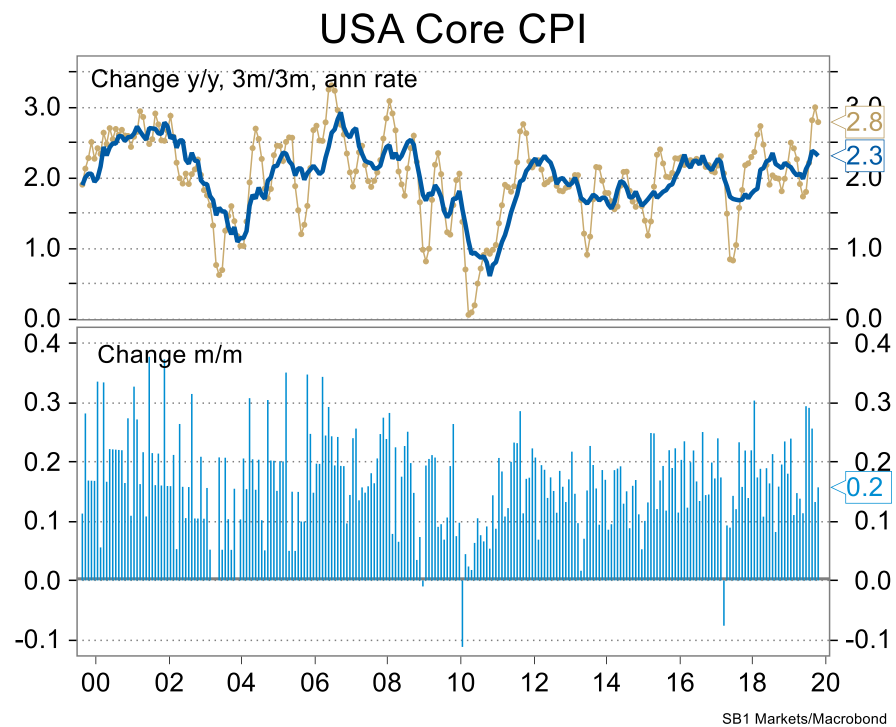




- The decline in PPI is so far not serious compared to previous periods with falling produced prices. From 2012 to 2016 prices fell by 3% per year in average, lowering the price level by more than 13%. Even that did not kill the Chinese economy
- Pork meat prices have soared by 101% due to the swine flue, driving total consumer price inflation up (but meat constitute a very minor part of the PPI and does not influence PPI by much

# Core inflation one inch down to 2.3%, underlying growth still close to 3%

## Core CPI up 0.2% m/m, the annual rate inched down to 2.3%, expected unchanged




- Core CPI increased by 0.2% m/m in October (0.16, to be accurate), in line with expectations. The annual rate came down marginally to 2.3%, was expected flat at 2.4%. Still, core inflation is heading up and the underlying speed at 2.8% (!). However, we doubt that inflation will increase much from this pace, as producer prices and inflation models indicate that inflation may be peaking now. But it is not 'too' low, at least according to the CPI index
  - » Fed preferred price measure, the core PCE (the consumption deflator) is up 1.7%, slightly below Fed's 2% price target, but prices rose 2.2% q/q in Q3
- Headline inflation declined marginally to 1.7%. The total CPI inflation has stabilised recent months (no big energy impact)

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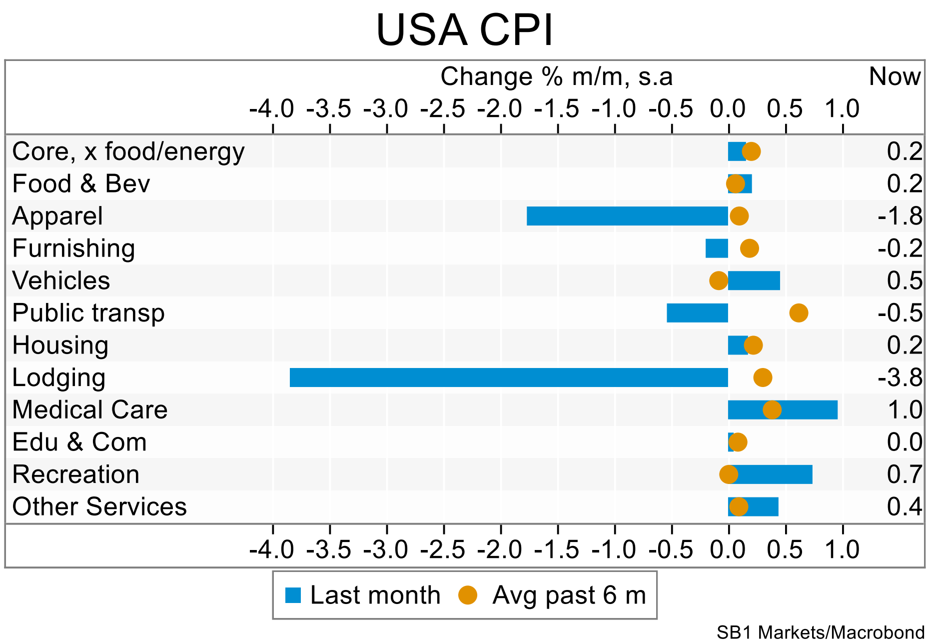
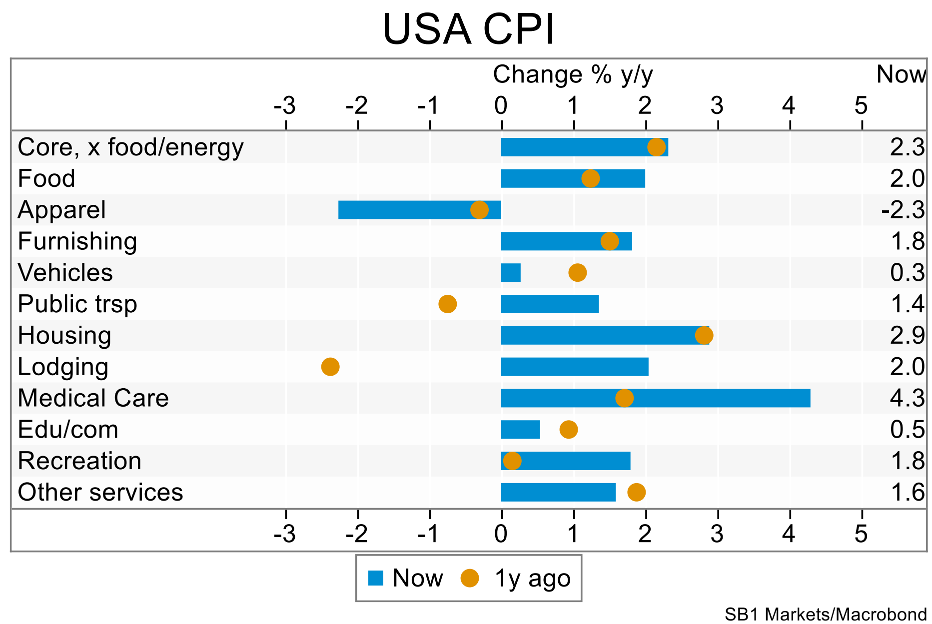
# Prices are increasing in all sectors y/y, except clothing

In October, a steep drop in lodging prices after a spike the prior month drove m/m growth down

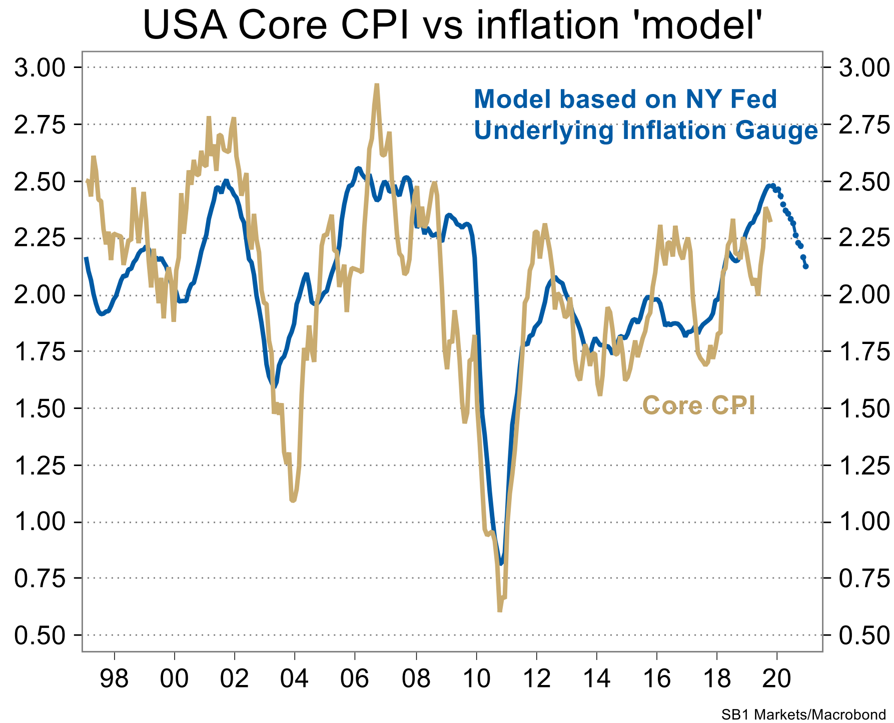


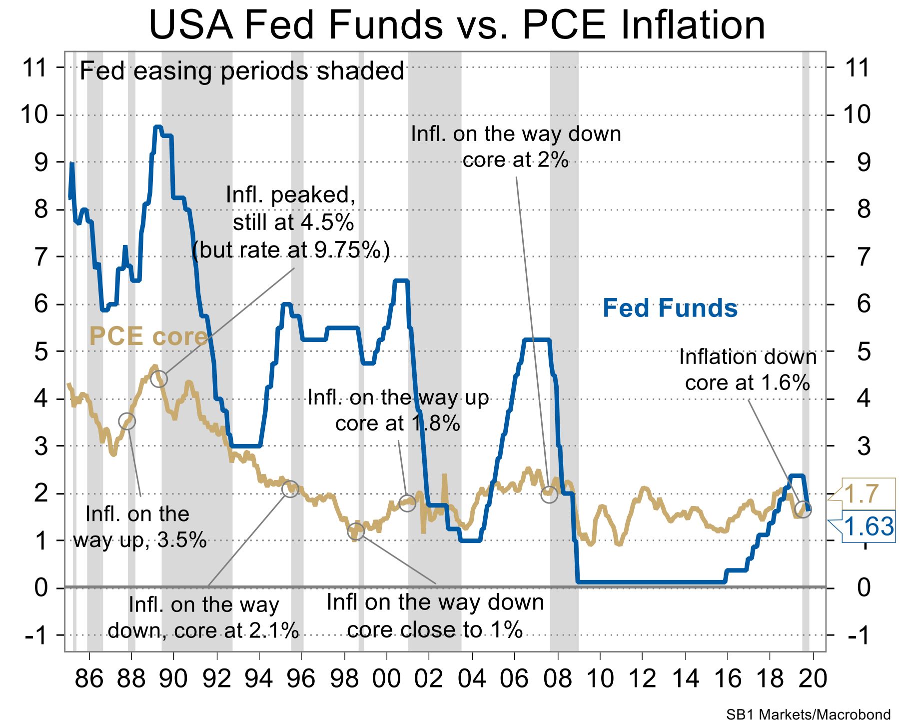




- Prices are increasing faster than 1 year ago in 6 of 11 sectors, slowing or declining in 3 sectors
- Higher prices on lodging, medical care and housing (rents & services) and food are boosting annual inflation
- In October, lodging price dropped, after a steep rise the prior months. Clothing and public transport prices dragged m/m inflation down too

# NY Fed’s inflation model suggests that inflation is close to peak

## The model signals 2.5% inflation this autumn, and a slowdown thereafter




- 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 1.7% y/y in Sept, below Feds inflation target at 2% - but it rose by 2.2% in Q3 (from Q2, annualised)
- Fed’s actual rate setting has not been well explained by actual inflation during the past two decades. (Wage inflation is a far better indicator). PCE inflation below target has been one of the arguments used in favour of the interest rate cuts this autumn. The economy – taking care of the ‘dual mandate’, full employment – will anyway decide Feds action from, more than inflation (as almost always, BTW)

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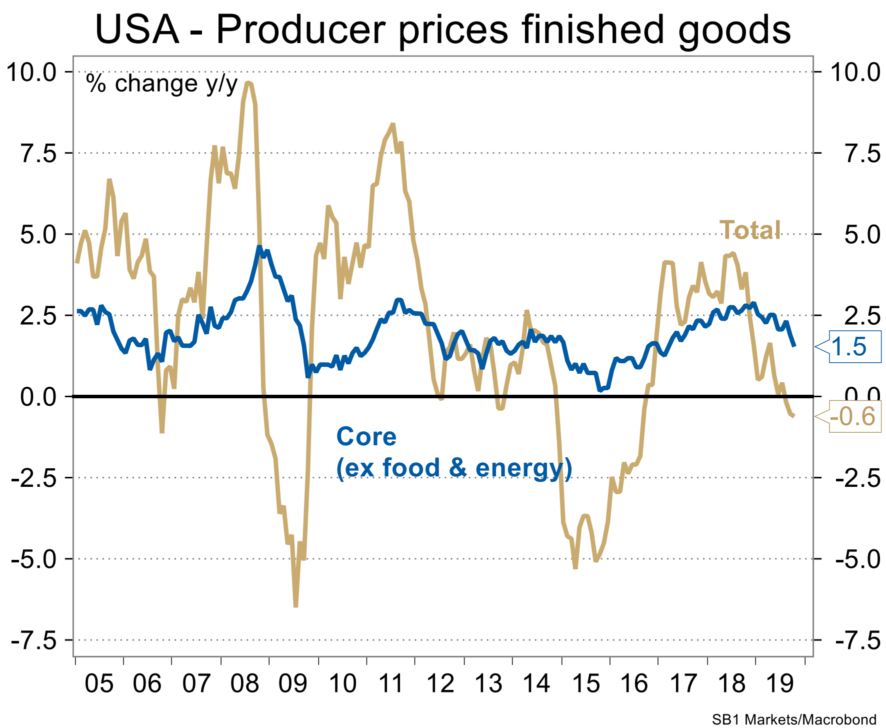
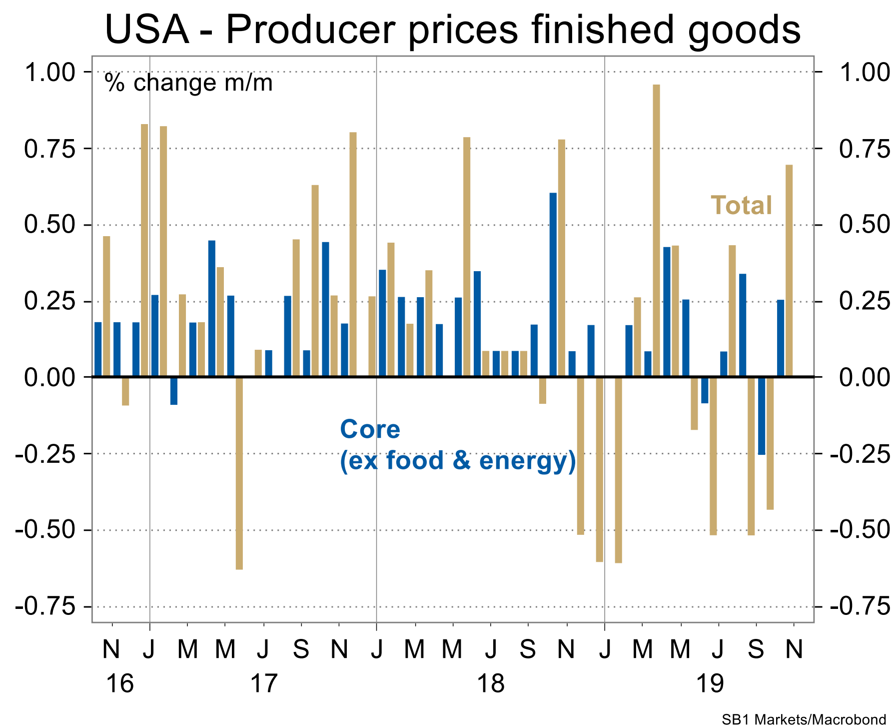
# Producer price inflation is heading down

However, in October, core finished goods prices rose a solid 0.3% m/m and total PPI soared 0.7%

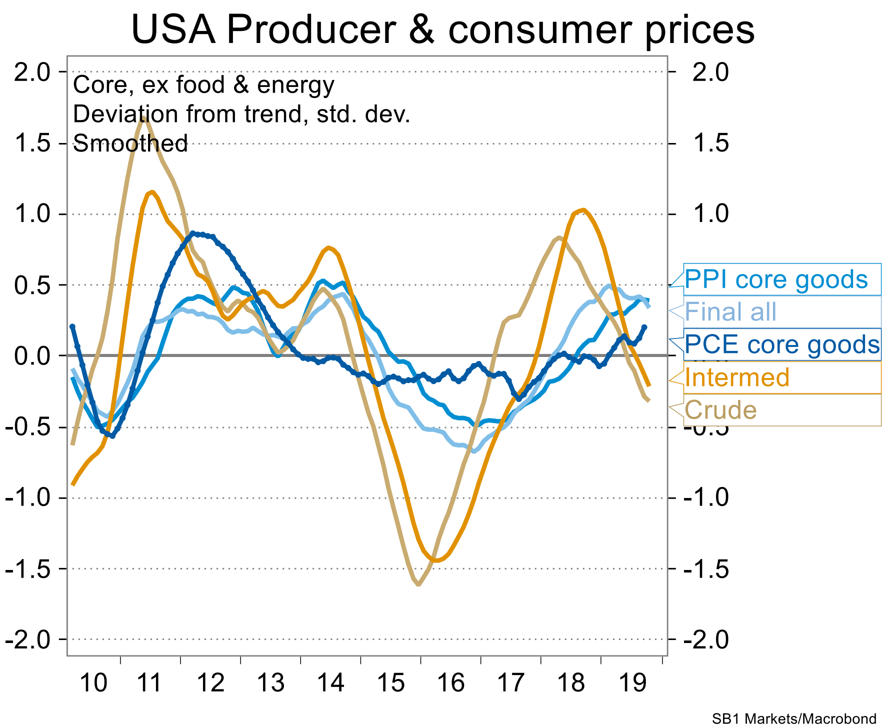


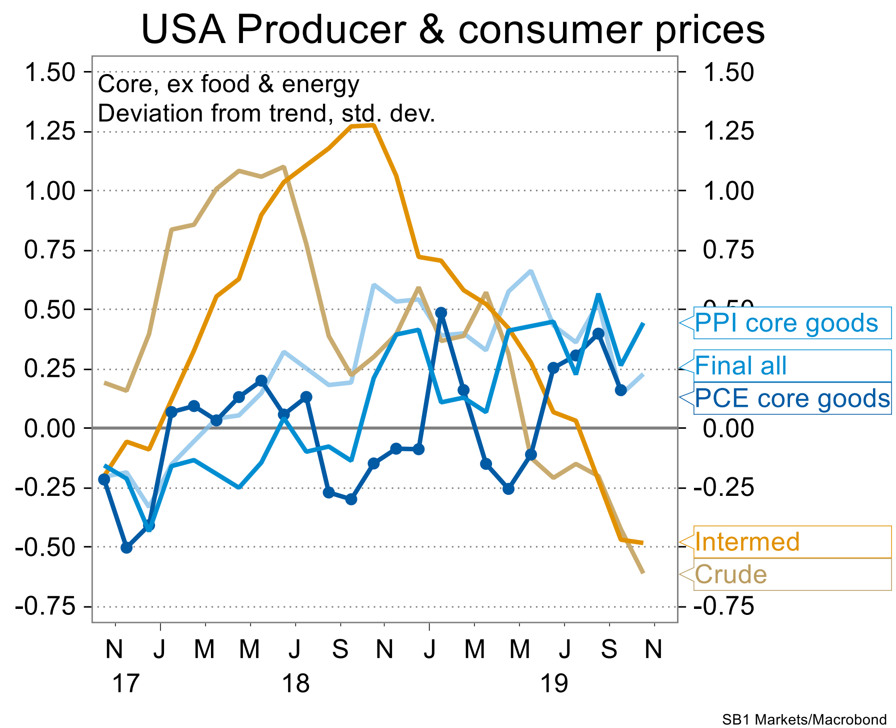




- Core finished goods x food & energy PPI increased by 0.3% m/m in October, 0.1 pp higher than expected, after an equal decline the prior month. The annual rate slipped to 1.5%, just a base effect. Regardless, inflation is slowly sliding down – and underlying growth (measured 3m/3m) has fallen to 1%
- Headline PPI soared 0.7% m/m in Oct, these monthly data are volatile. The annual rate fell to -0.6%, 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 follow

## And then consumer prices – core producer prices do no longer signal much higher PCE inflation

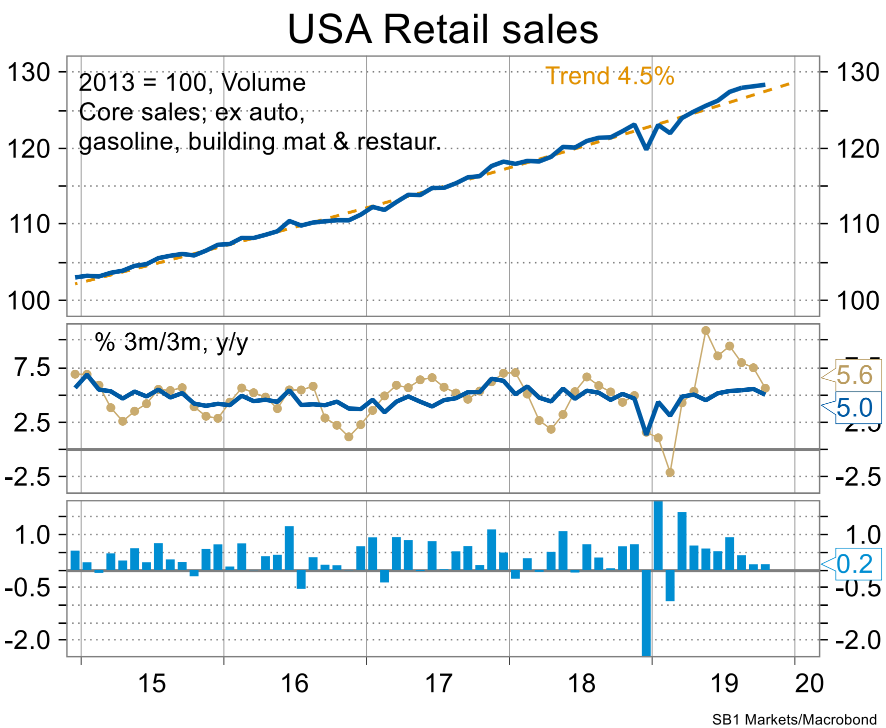


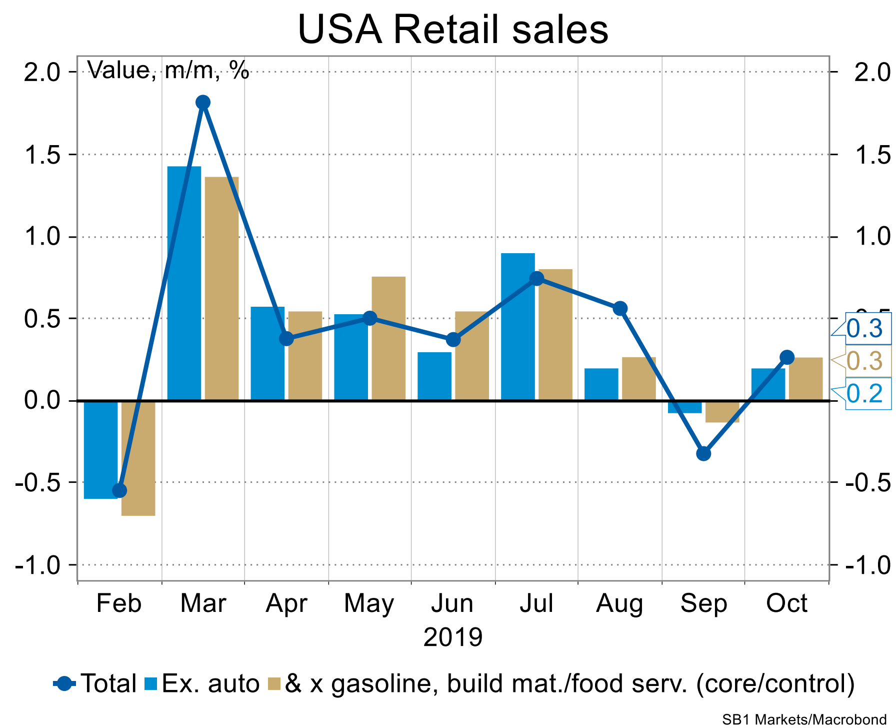




- Crude PPI prices (ex food & energy) are heading steeply down, as are intermediate goods prices. Core consumer goods prices (at the producer level) increased in Oct but will over time turn south if prices at earlier stages do not recover
  - » Short term, there might be some upside risks vs. goods prices at the consumer level but not much

# Retail sales are slowly losing steam

## Core sales rose 0.3% m/m and 0.2% in volume (our est), underlying growth slows, but still not low

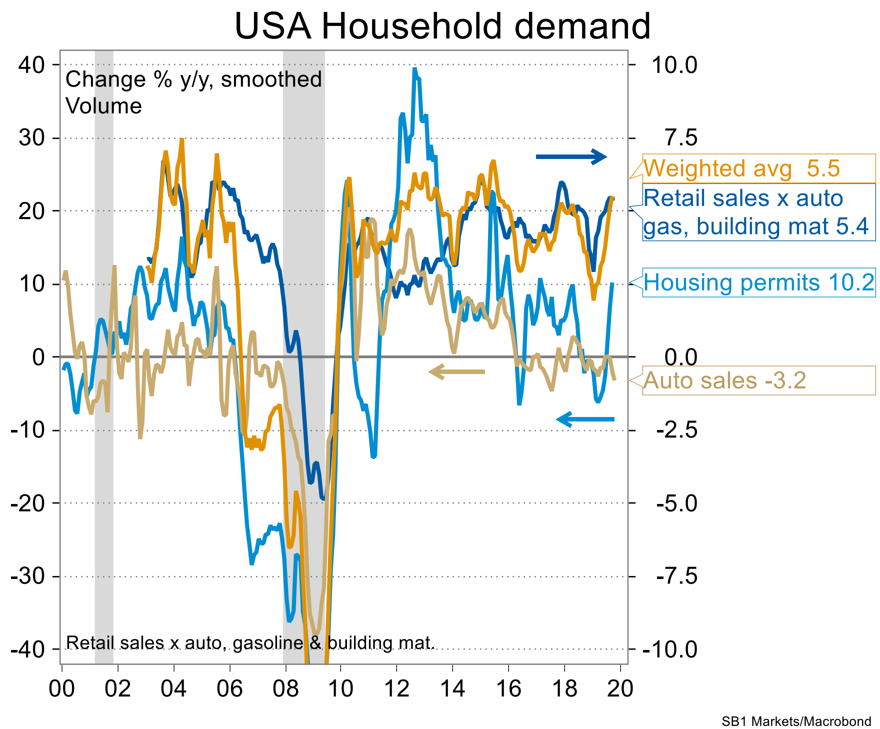


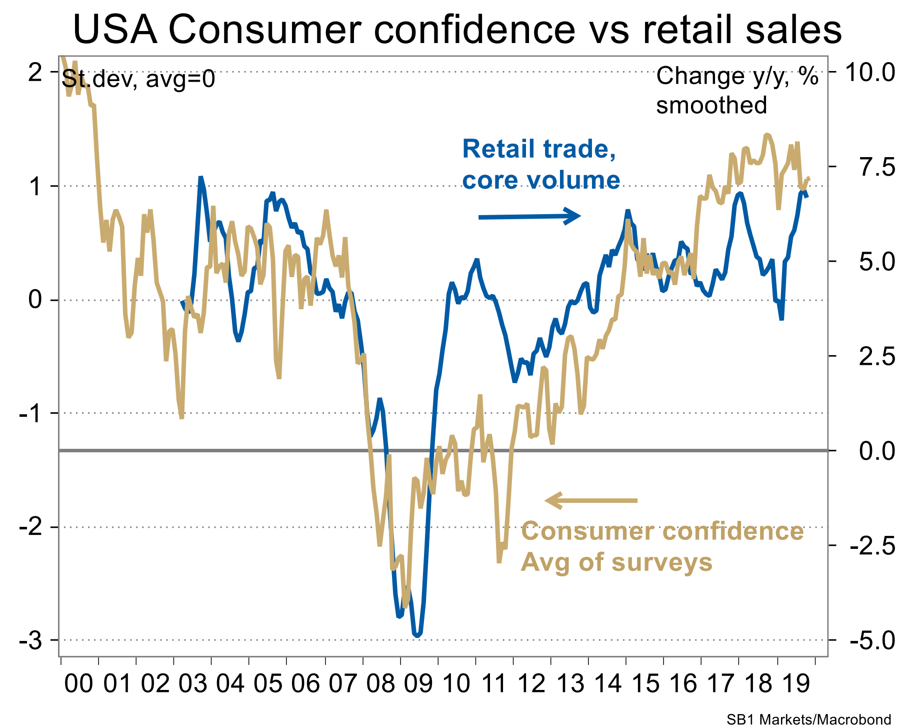




- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by 0.3% m/m in nominal terms in October, in line with expectations. September was revised down marginally. Total retail sales rose 0.3%, auto sales declined
- We estimate a 0.2% m/m increase in core sales volume, an unchanged pace from the prior month. Growth has eased, after soaring in H1. The 3m/3m speed at still at an impressive 5.6%, and the annual rate is solid at 5.0% but growth the past 3 months has slowed to 3% (which is not that low, of course)
  - » The slowdown the two past months may be an early indication that the manufacturing led slowdown is now spreading to the consumer side
  - » Income growth has slowed somewhat but consumer confidence remains strong. Still, the risks are now skewed to the downside

# Household demand is still strong, at least y/y (and barring auto sales)

Retail sales are still up 5% y/y, housing has turned up, while auto sales are trending slowly down

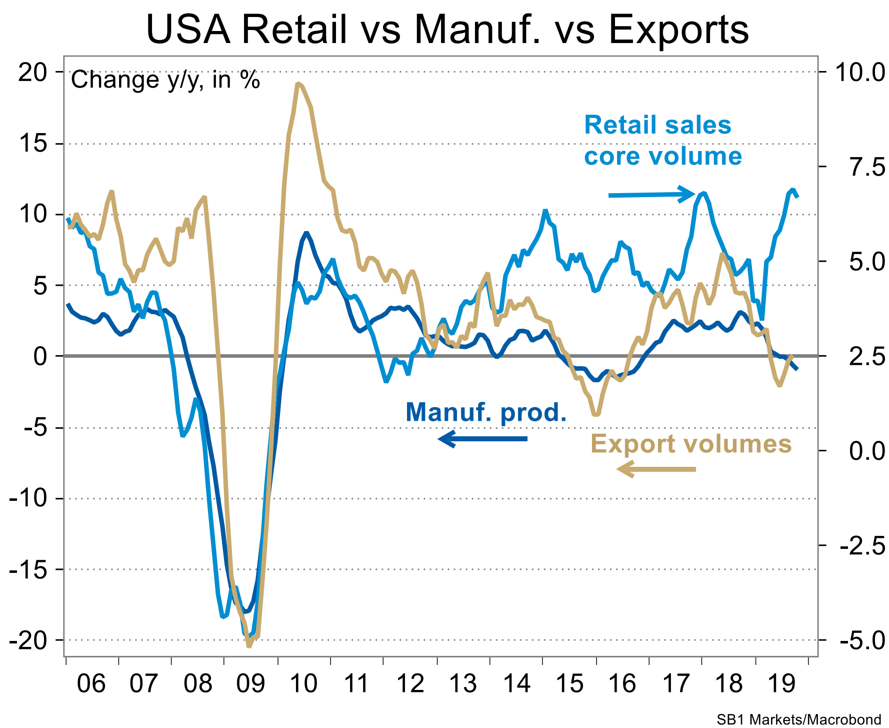


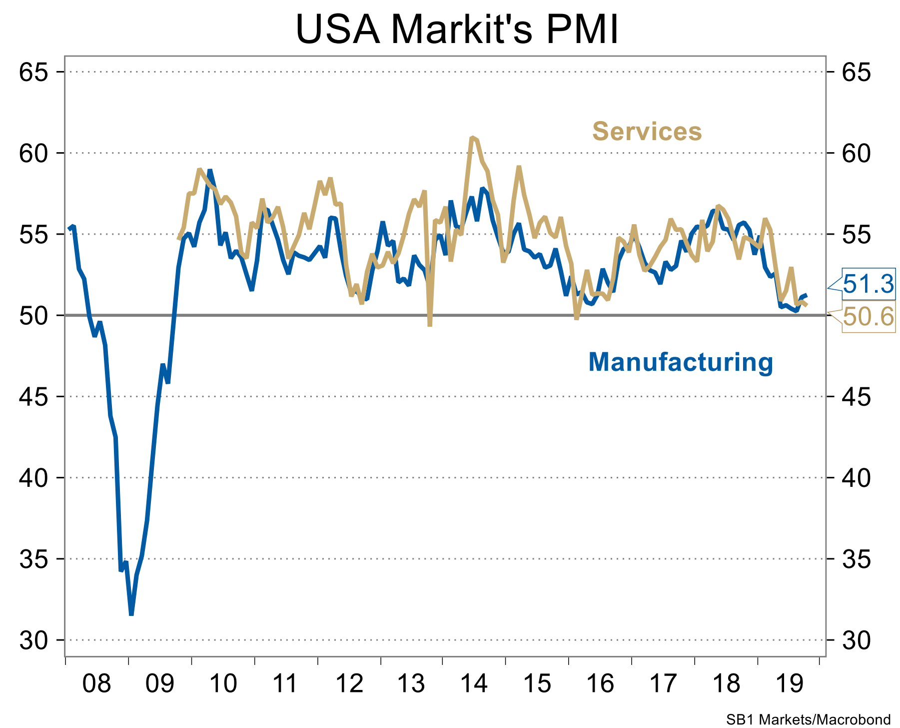




- Total household demand is not on the brink of sending the US into recession. The weakness in the US economy is stemming from businesses and global demand, not US consumers
- Consumer confidence (measured by the avg of University of Michigan's and Conference Board's indices) has moderated somewhat this autumn but remains at an elevated level

# Consumer spending has been the pillar of economic growth this year

Consumer demand has been resilient to the manufacturing and slump and the global slowdown

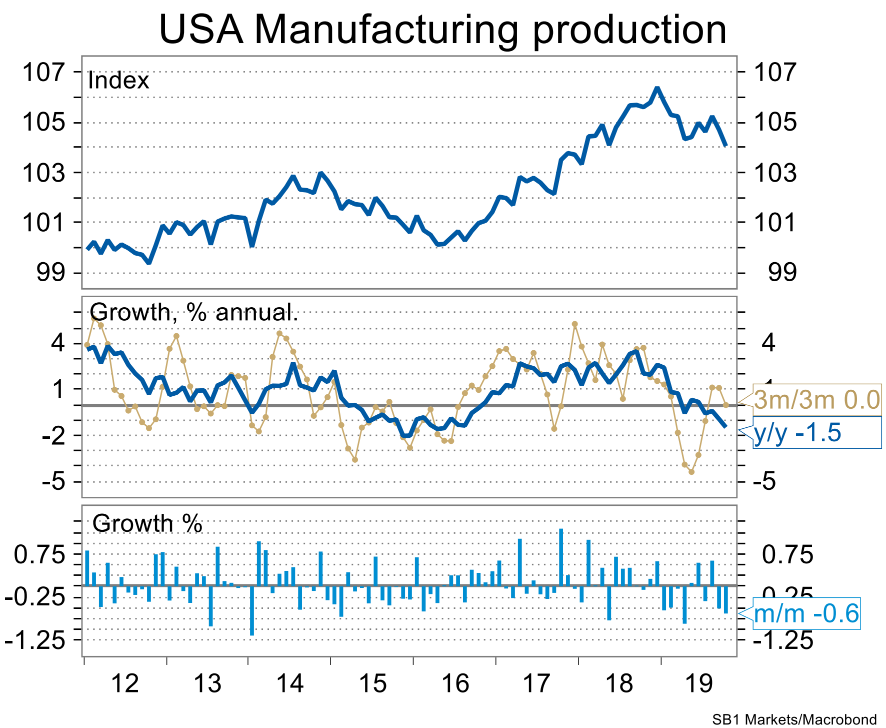


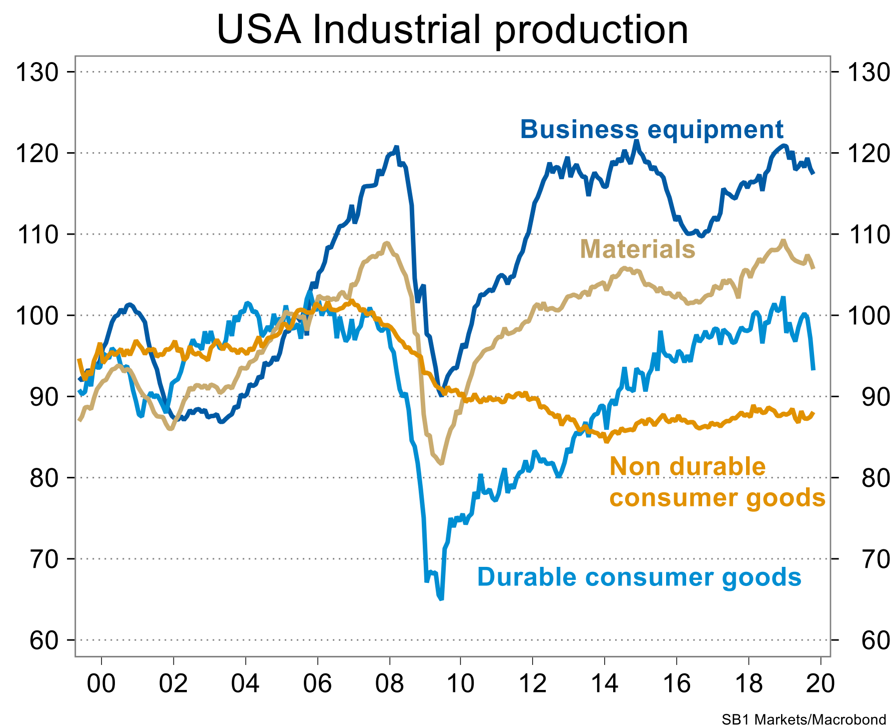




- The services PMI covers much more than retail (such as hotels, banks, education, health, professional services, real estate etc), however, the downturn in the PMI recent months <u>may be</u> a sign of weakness on the consumer side

# Manufacturing production drops again, as expected

Production fell by 0.6% m/m in Oct, Q4 is off to a weak start. Durable consumer goods are slipping

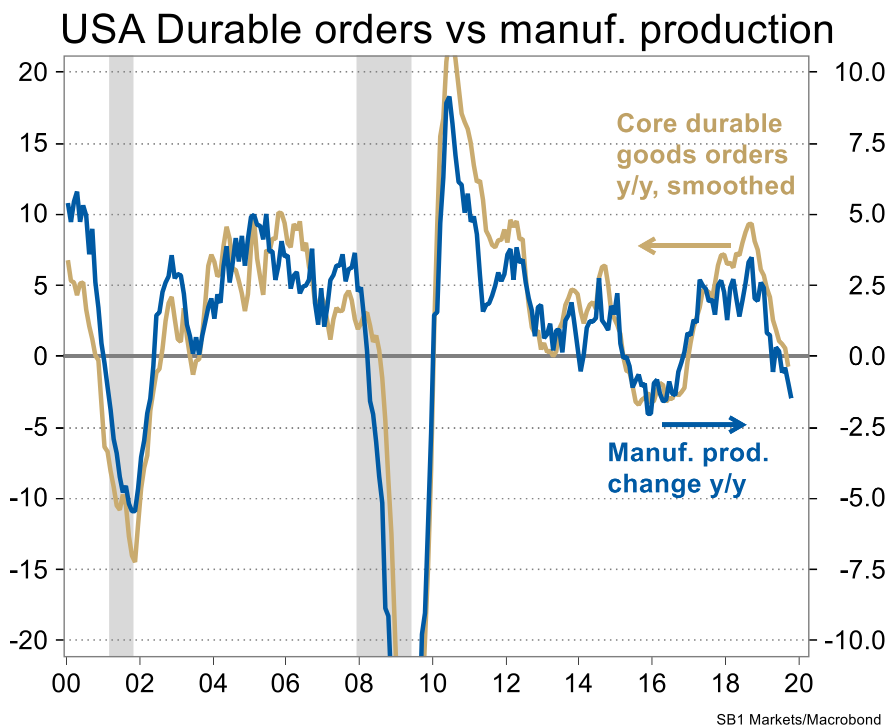


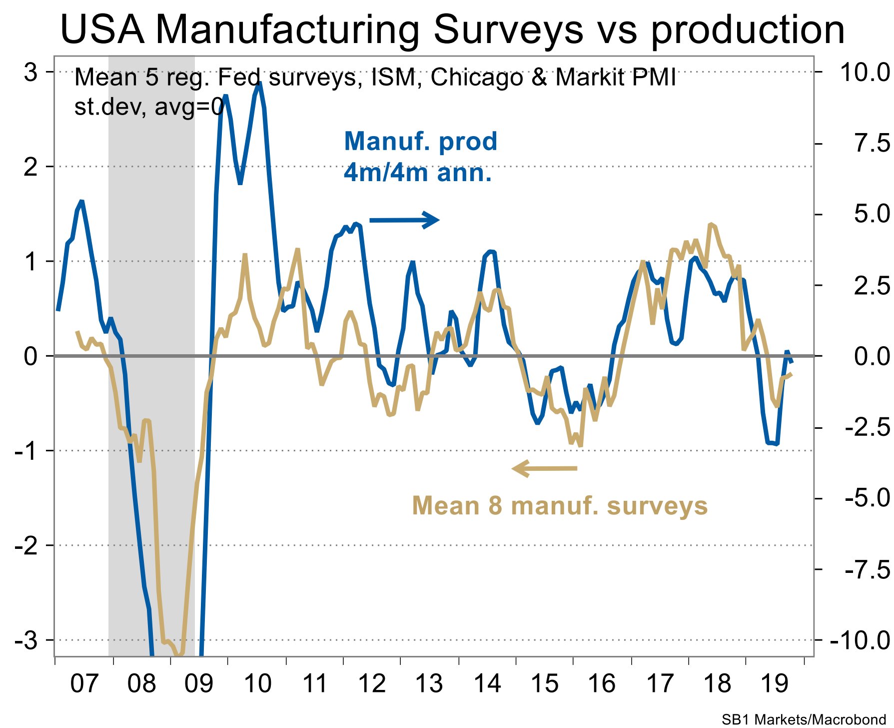




- Manufacturing production fell by 0.6% m/m in October, expected down 0.7%. The decline came after a similar decline in Sept, thus, the speed into Q4 is rather weak. The annual rate slipped to 1.5%
  - » Total industrial production including energy & mining dropped 0.9% m/m but underlying growth is marginally stronger than for manuf.
  - » Production has slowed in most sectors recently, and rapidly in durable consumer goods and visibly also in business equipment the past 2 months, in sum weaker than signalled by durable orders, which has just stalled. Anyway bad news, consumer durables are usually leading total manufacturing production by a few months
- Surveys signal a bleak outlook but no ‘collapse’. The first Nov survey, from NY Fed, weakened just slightly

# Orders & surveys do not signal any rapid downturn

An average of surveys signals a modest decline in production and orders point to just a stagnation

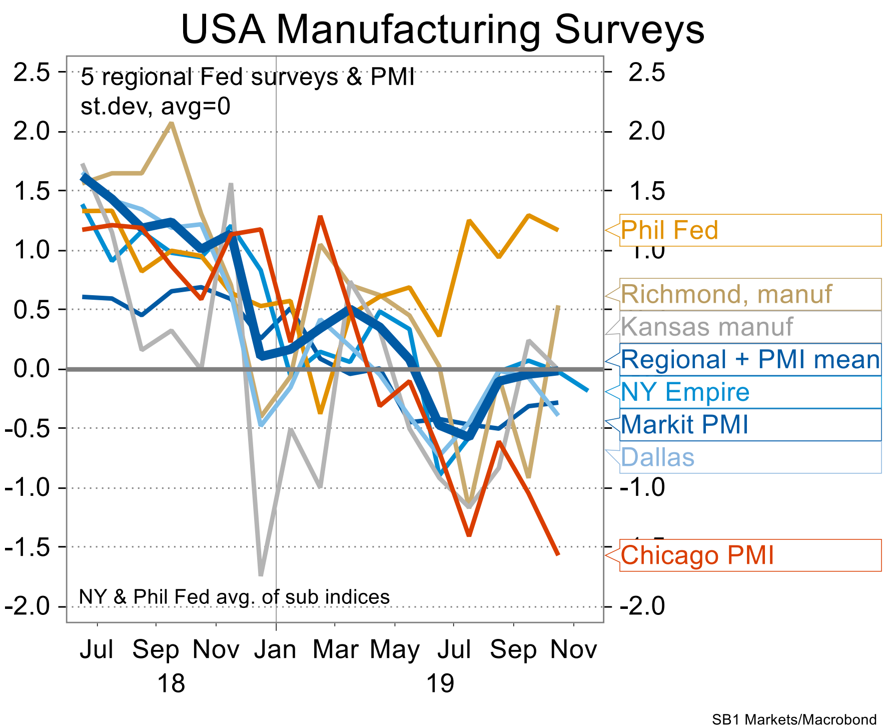


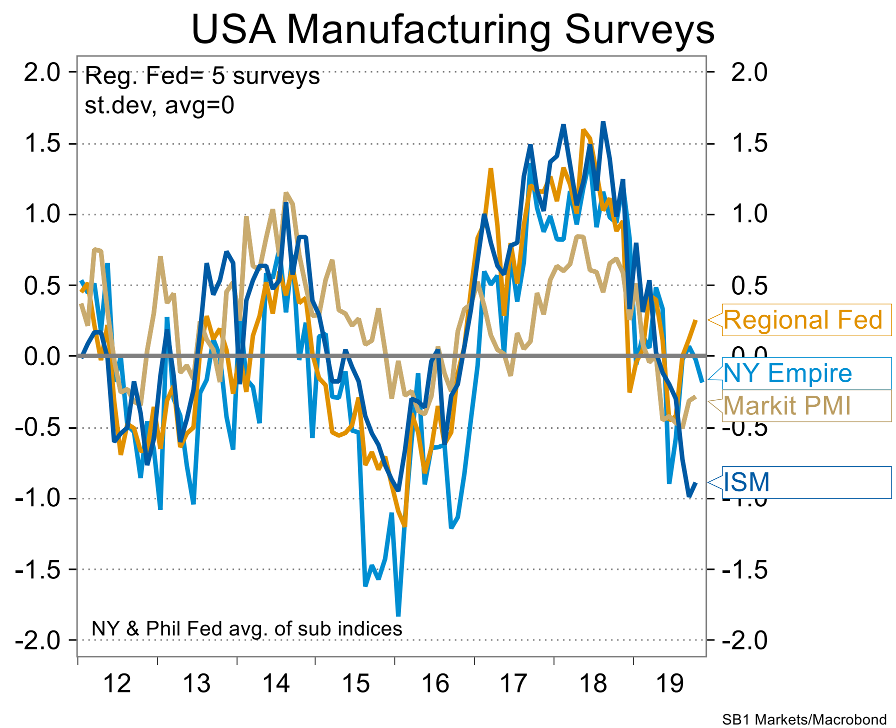




- Flip to the next slide for the first November survey

# NY Fed's manufacturing index inched down in Nov, marginally below avg

The first Nov manufacturing survey came in below expectations but has stabilized recent months




- The NY Fed's Empire manufacturing index fell to 2.7 in Nov, from 4.2 in Oct, a small improvement was expected. The index is just marginally below the avg level, stabilized the past 4-5 months. The NY Empire is in the mid-range of the regional surveys but better than both the PMI and the ISM
  - » We measure the NY Empire index by an average of 6 components within the 'current condition' index. The expectations index improved

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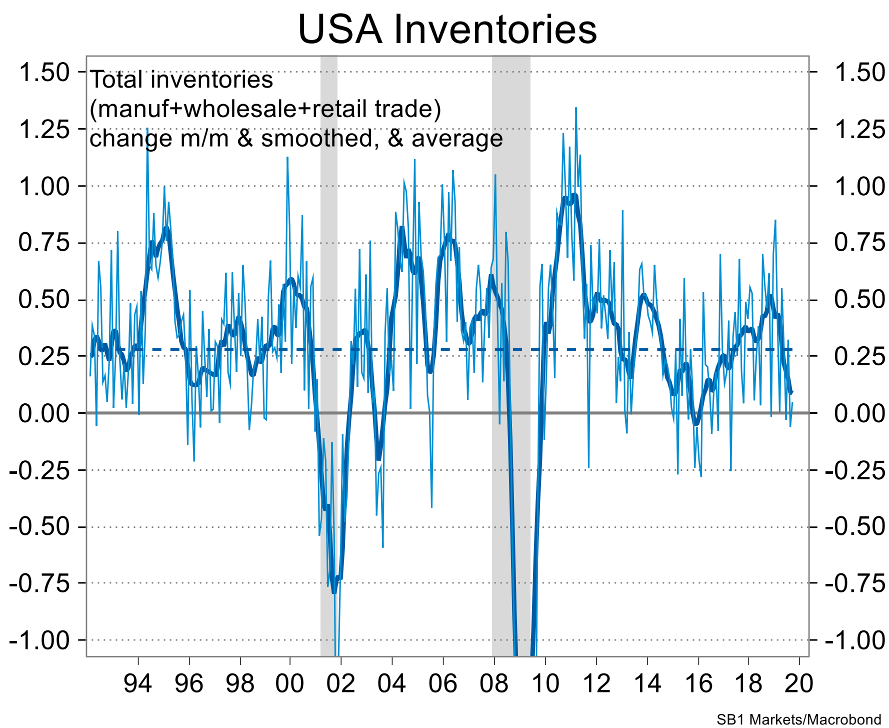
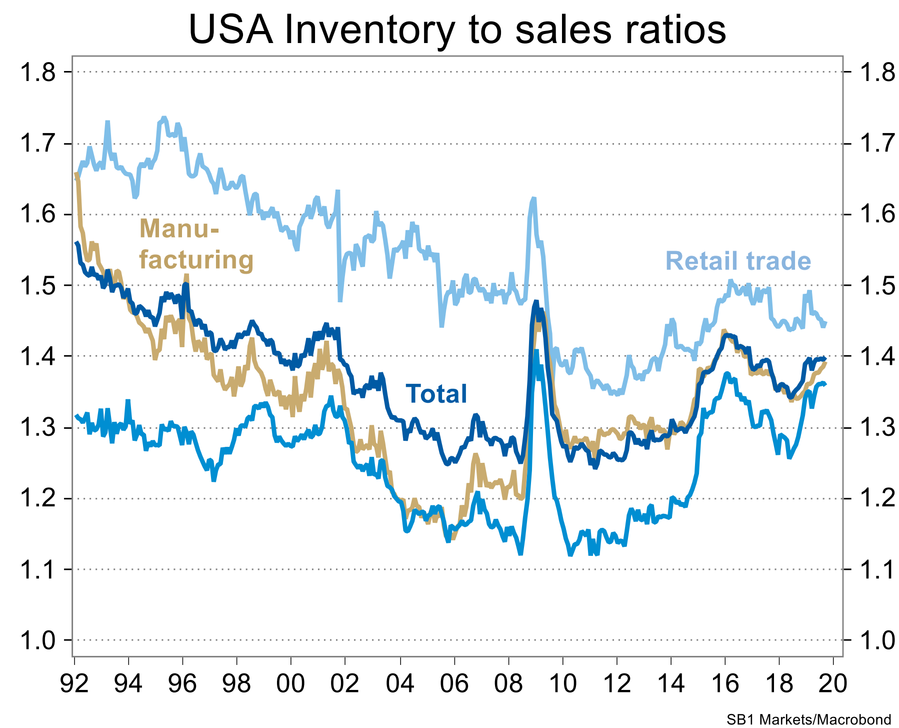
# Growth in inventories has slowed, now below par

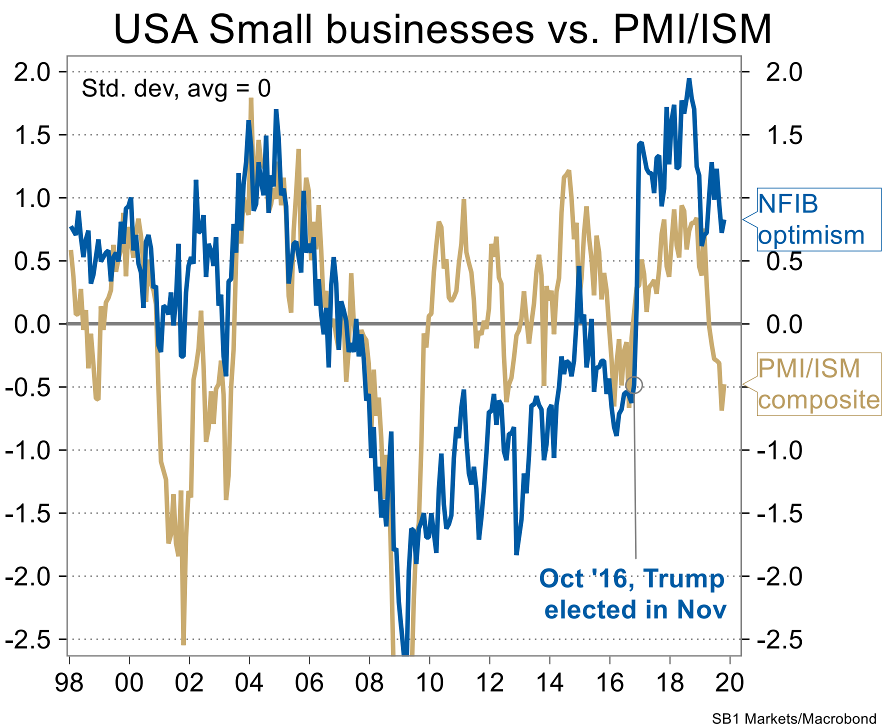
Still, inventories are higher than normal vs. sales – a further inventory correction most likely

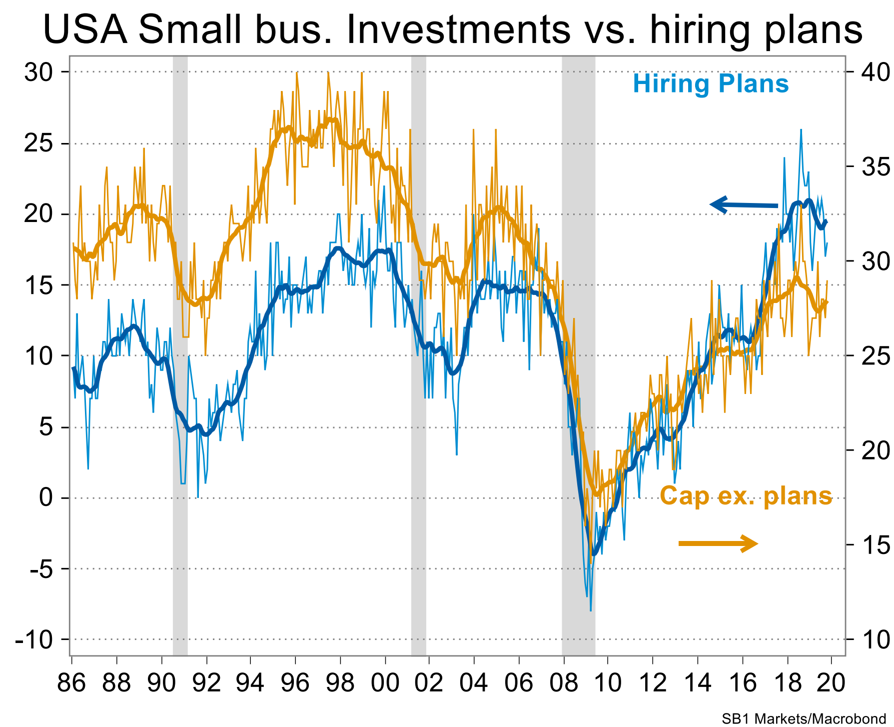


# Small businesses' optimism steady in Oct, miles above PMI/ISM (activity)

## NFIB optimism index has stabilized since early 2019, details slightly more upbeat this month

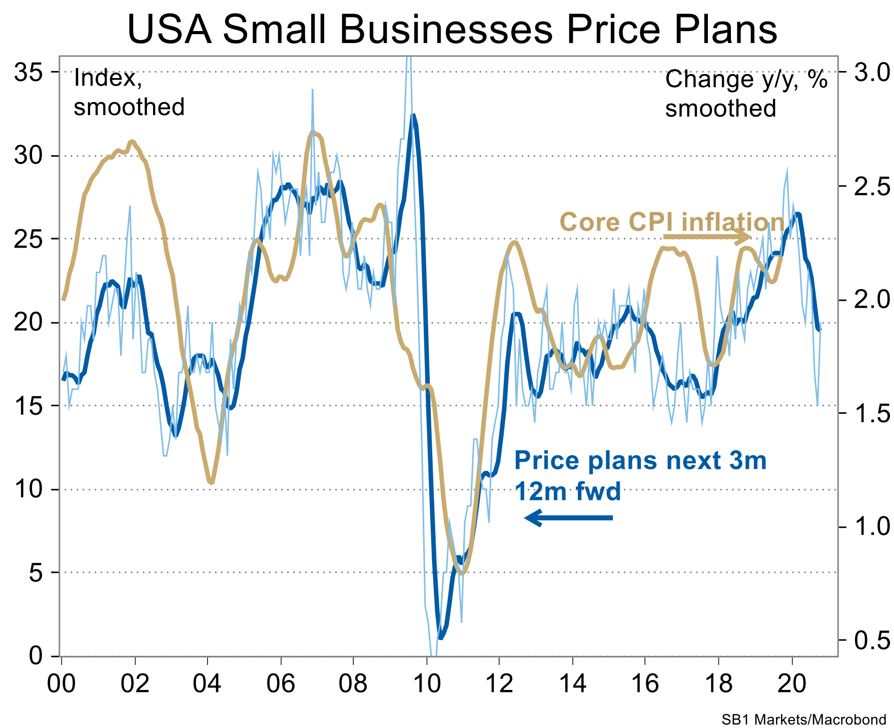


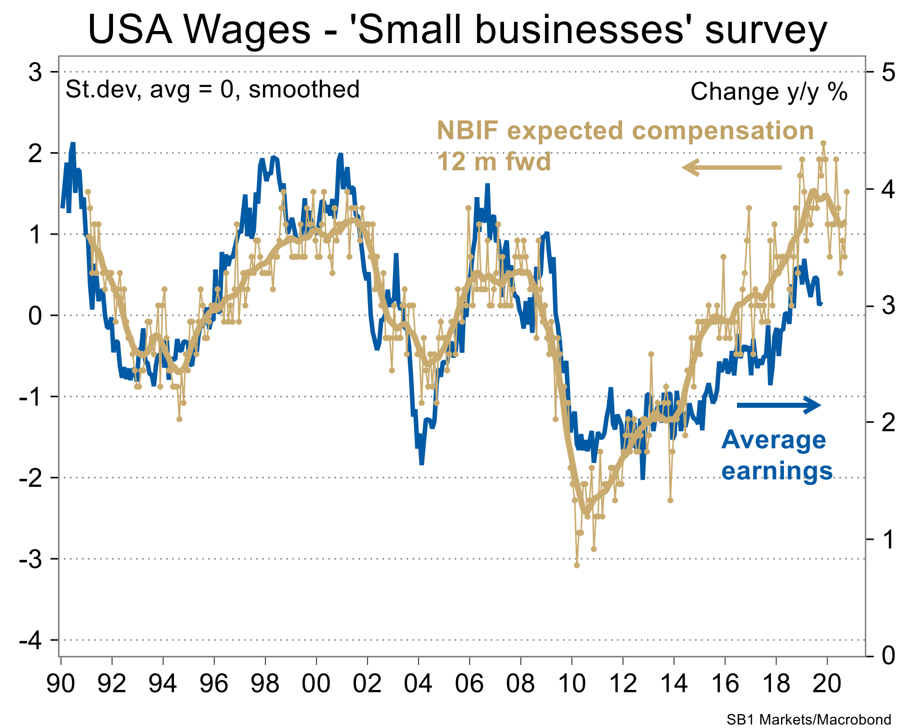




- The NFIB optimism index, measuring small businesses' expectations on business conditions, rose marginally to 102.4 in October, close to expectations. Yet, the index has stabilised this year, still at a rather high level, after dropping in late 2018
  - » The NFIB optimism index is 0.8 st.dev above average. The surveys from ISM/Markit PMI (and most others) reports are well below average, indicating declining production. 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 in the ISM/PMI are more influence by trade war uncertainties
- Investment plans are slowly heading south but spiked in Oct. The level is a rather low level, compared to previous highs
- Hiring plans har probably peaked but they are still aggressive. Companies are still not able to fill vacant positions

# SMEs price plans have been nudged down substantially

## The index suggests lower consumer inflation in spite a Oct rebound. And not higher wage inflation?

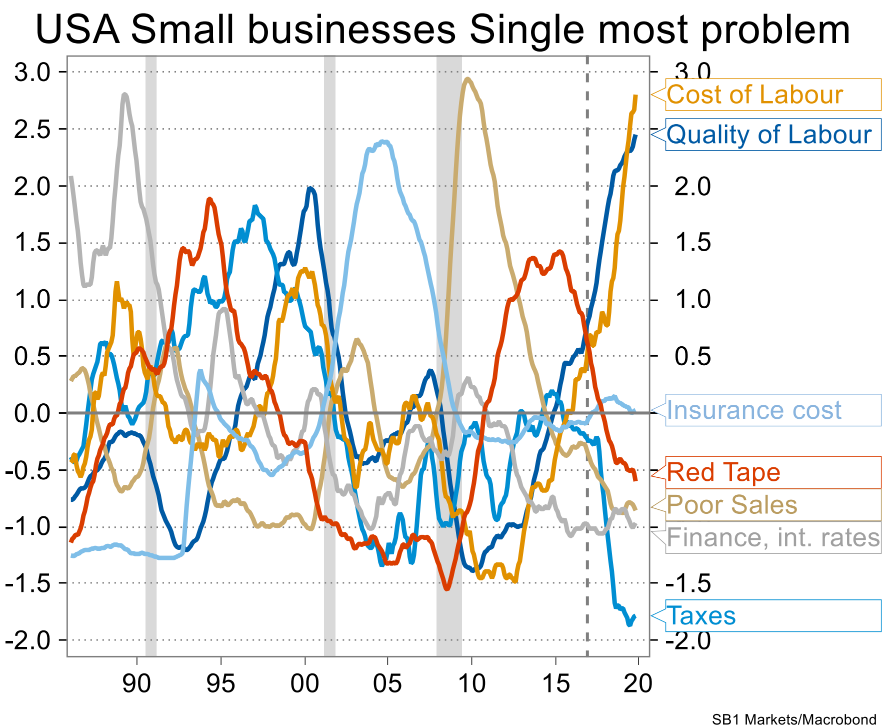


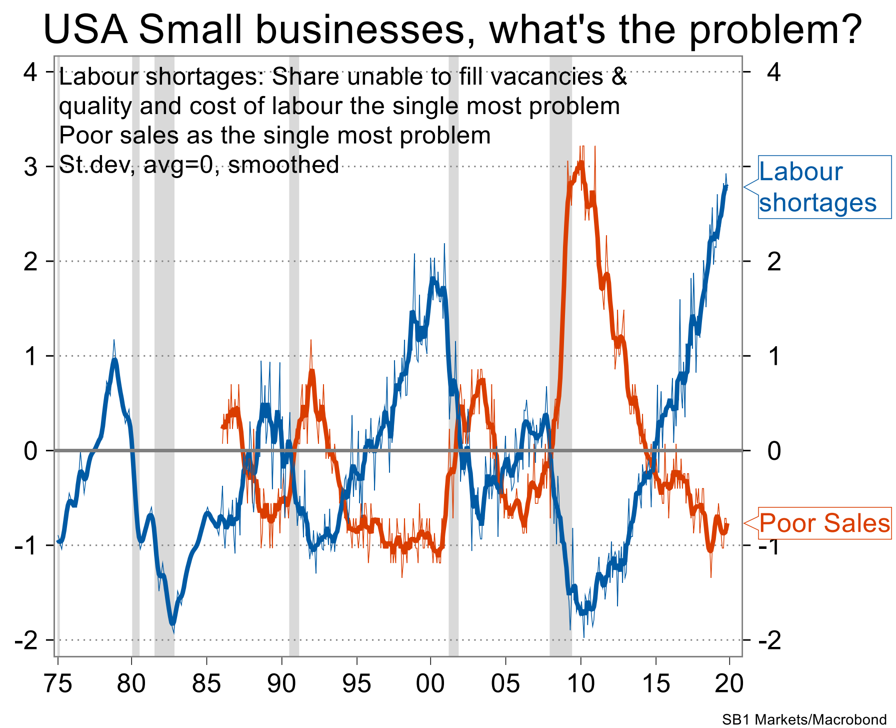




- 20% of small businesses are planning to hike prices, higher than in Sept but down from a peak at 29% one year ago. The smoothed share has fallen to 20% too, heading straight now. Are companies suffering from waning demand growth? But they are still optimistic, and are still hiring (almost like never before?)
- Businesses are still reporting quite aggressive plans to raise compensation – and the index spiked in Oct. Actual wage growth has cooled somewhat, the survey has fallen from the peak, and is probably not signaling an acceleration in wage inflation, even as the labour market is very tight (but wage inflation is not low vs CPI or productivity)

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

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

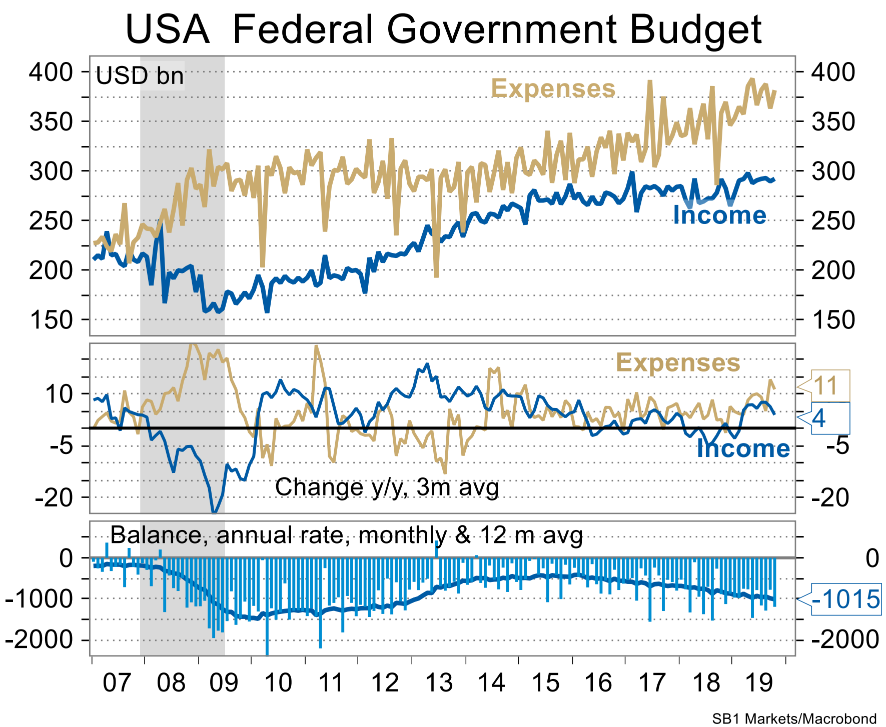


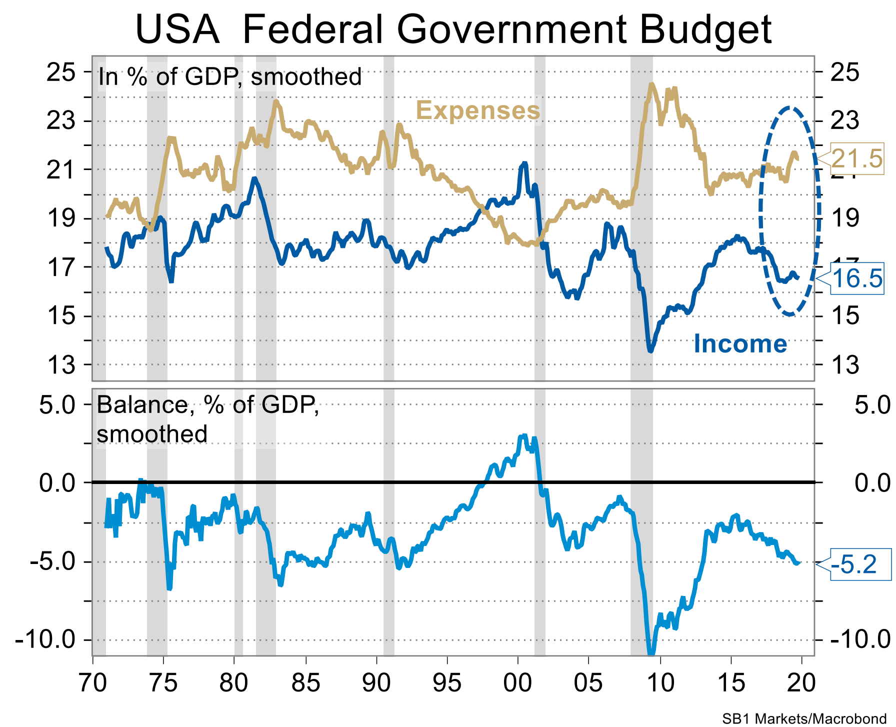




- And fewer than ever are complaining about finance/interest rates and about taxes, following last year's tax cuts
- Sales are not the problem either, almost 20 year since so few stated sales as the most important problem
- So the answer is obvious: The Fed must cut the fed fund to zero, or below, the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

# The federal budget deficit is widening

The federal deficit widened to 5.2% of GDP, and the total public sector deficit at 7.1% of GDP (in Q2)

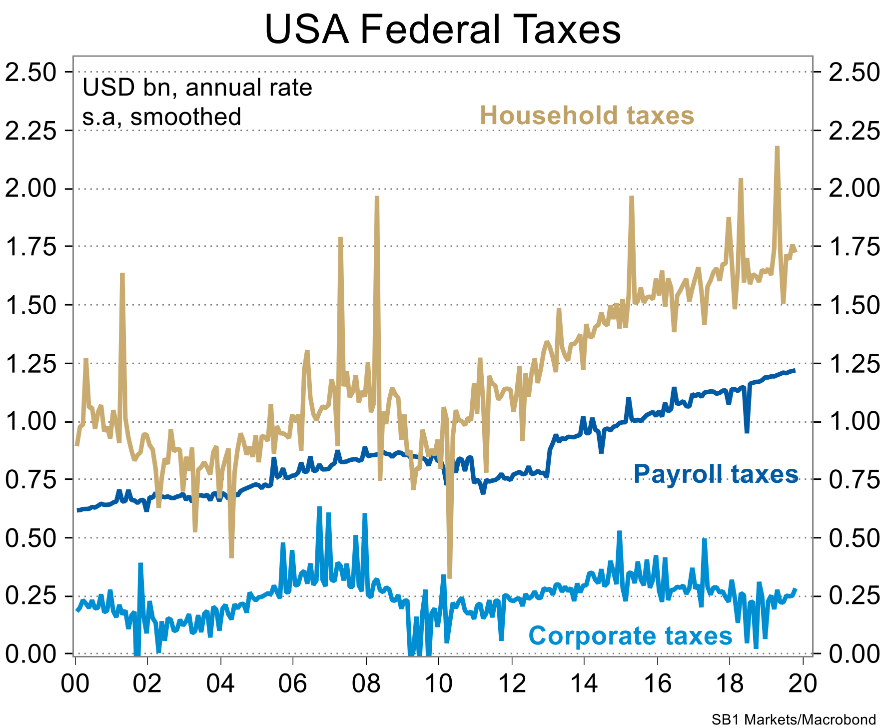


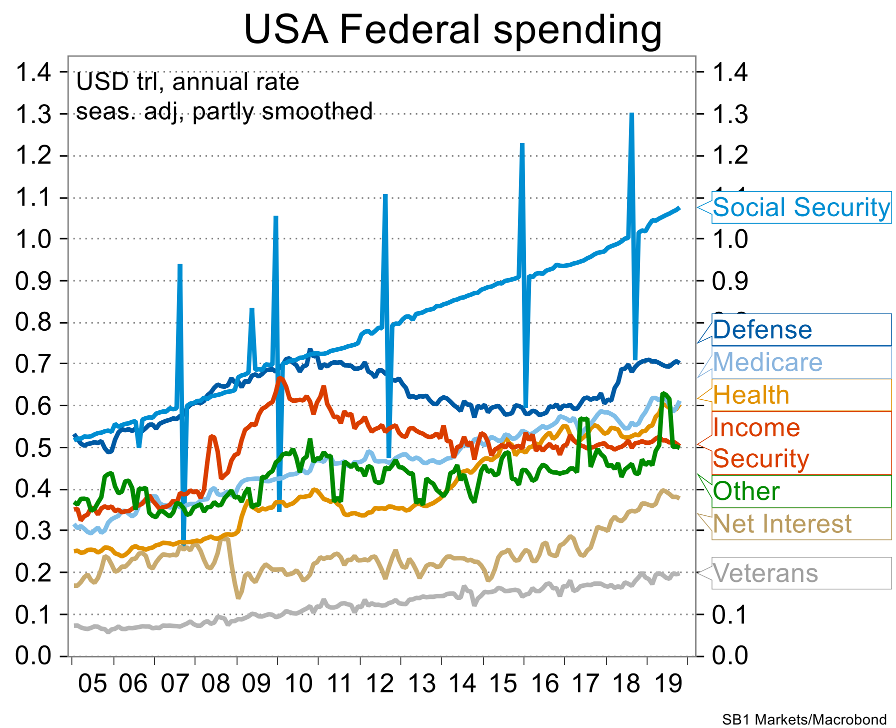




- The budget deficit expanded to USD 1.200 bn in annual rate in October (seas. adj), and the 12 m (=fiscal year) increased to 1.015 bn, steadily widening. The deficit equals 5.2% of GDP. Incl. local government etc, the US was running full employment, peacetime deficit at 7.1% in Q2 (from 6.9% in Q1); totally unprecedented!
- Federal spending is up 11% y/y 3m smoothed, well above growth in nominal GDP. Income is up just 4% y/y (3 m smoothed). The underlying growth in expenditures is lower, in revenues higher – but still the gap between the two is widening
- In % of GDP, federal spending equals 21.5%, way above a normal level (except for during recessions). Regrettably, federal income equals just less than 16.5% of GDP, 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 '19 and '20 deficit, but no more than some 0.2 pp of GDP

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

More money spent on… everything?

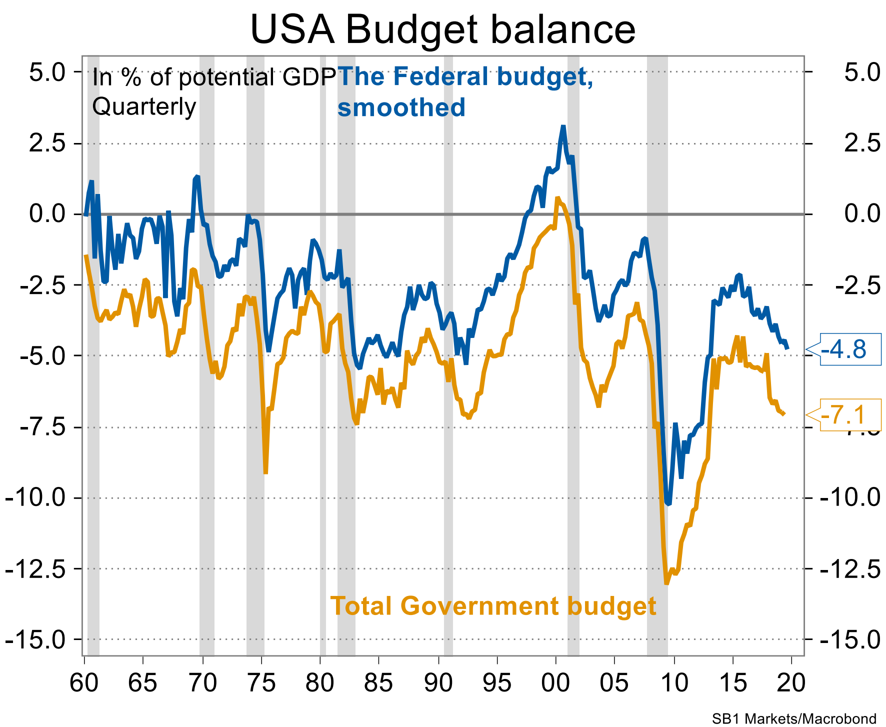


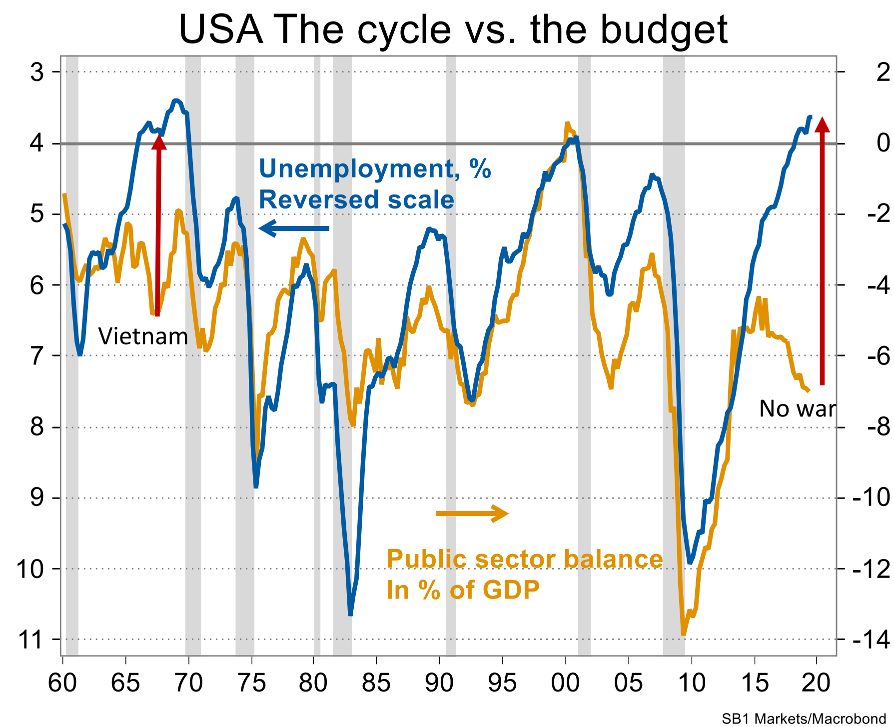




- The biggest spending changes the past year: Health, medicare and net interest payments (highest ever, even if interest rates are rather low…

# The public sector deficit up to 7.1% of GDP in Q2

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

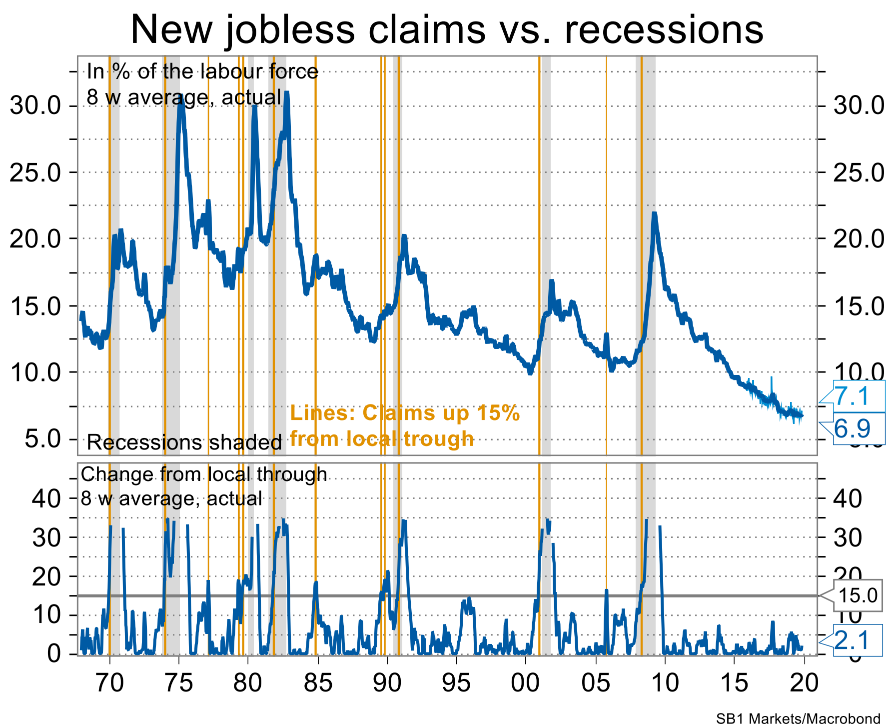


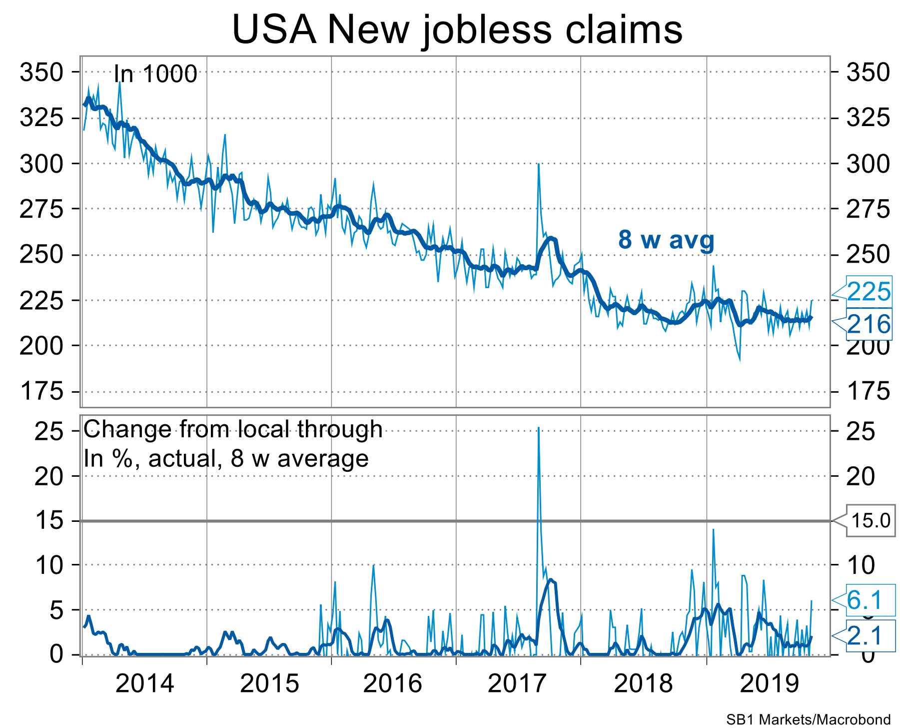




- The deficit has never been anywhere close to the present level in peace time when unemployment is as low as now
  - » We have not seen anything like this in other countries either (except Greece in 2007, partly Japan)
  - » The deficit at 5% was large vs the unemployment rate in 1967 too, when the Vietnam war was fought. BTW, afterwards, inflation and a lot of other problems turned up
- *The total public sector deficit is larger than the Federal Government's, as local gov. & social security are included*

# Jobless claims edged up last week, 8 w average still very low, at 216'

Jobless claims remain at a very low level, no signs of weakness

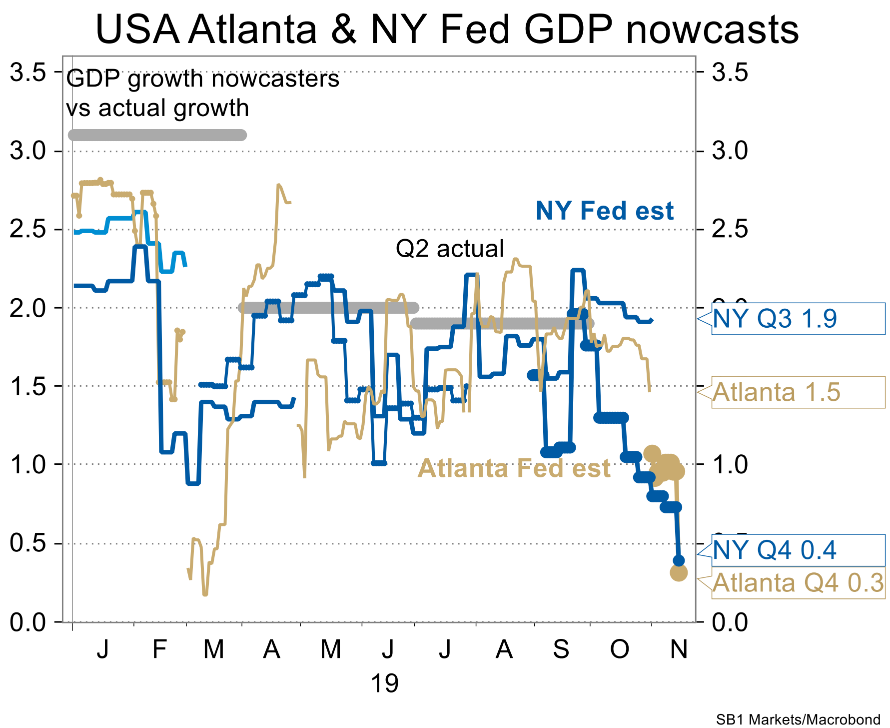


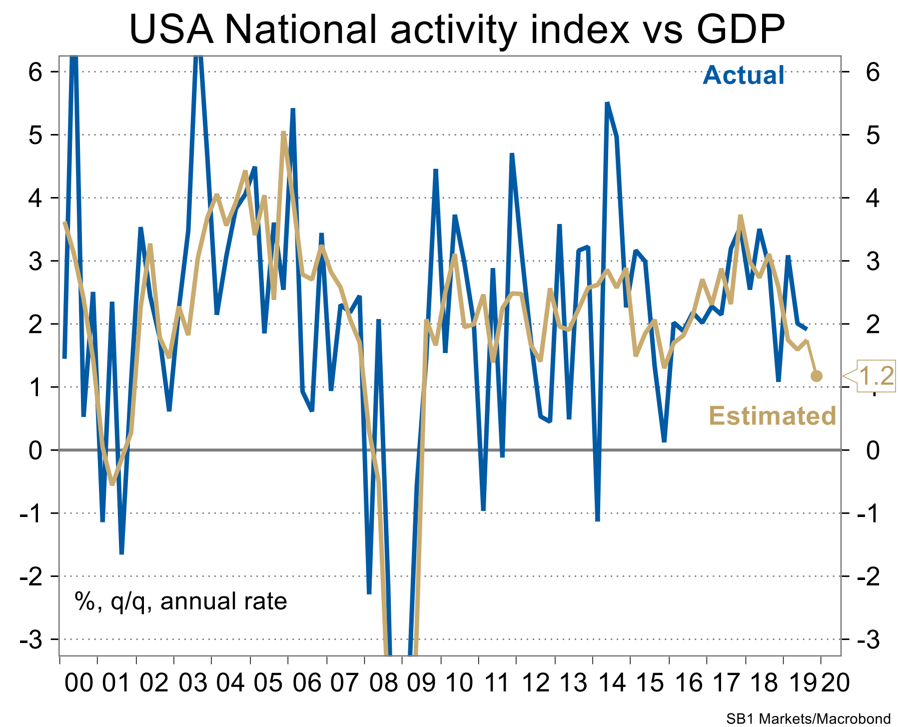




- A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow 'recession' warning line is to be drawn, check the chart to the left. So, no reason to worry now?

# Oops… towards zero growth in Q4?? Manufacturing production a bad omen

Both NY & Atlanta Fed nowcasters fell of the cliff Friday, lowering the Q4 GDP sharply




- NY Fed's forecast fell to 0.4%, from 0.7%
- Atlanta Fed's forecast fell to 0.3%, from 0.9%
- The National Activity Index, which suggested 1.8% GDP growth in Q3 (0.1 pp below the actual number), now points to a slowdown to 1.2% into Q4 (Sept data)

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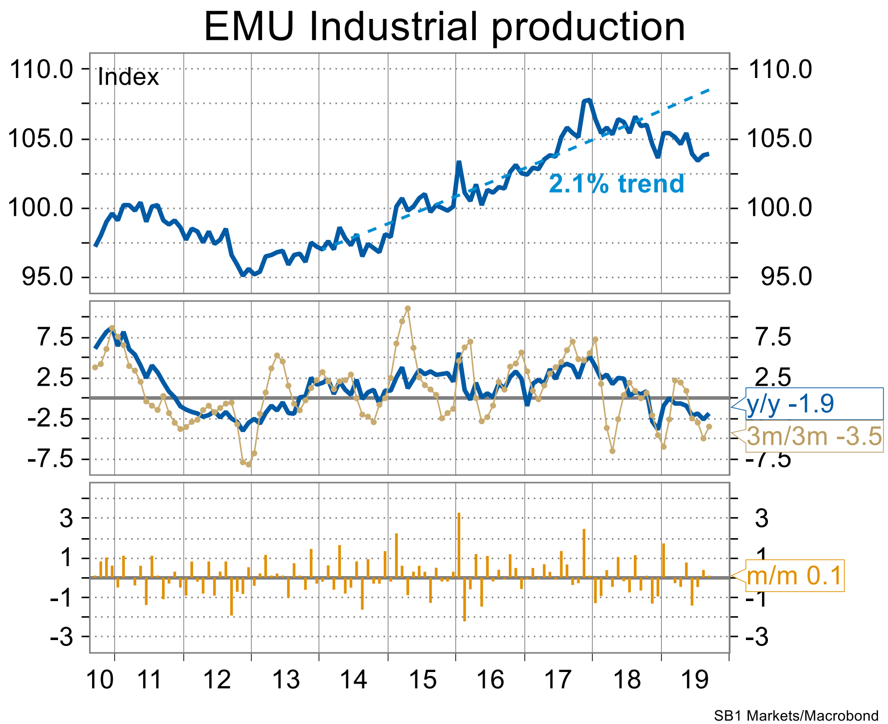
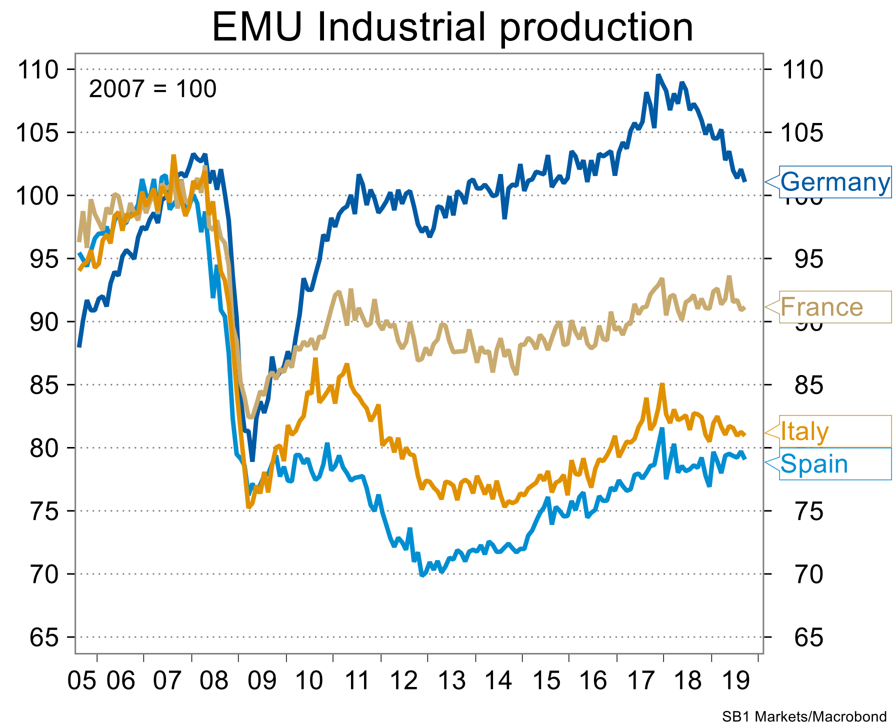
# Industrial production marginally up in Sept too but trend still down

Production rose 0.1% m/m but fell 3.5% in Q3. Germany, France, Italy down, Spain close to flat




- EMU industrial production (ex construction) increased by 0.1% m/m in Sept, we f'casted zero growth, consensus -0.2%. Production inched up in Aug too, after the sharp July slip, and Q3 was weak, down 3.5%, from Q2. The downturn is led by Germany
  - » Production dropped in both Germany, Spain and Italy, France rose modestly in Oct. Netherlands and Ireland brought total EMU up
  - » Other major countries are so far holding up better than Germany but not are shining. Germany is down 8% from the 2018 peak. France has stagnated (and fallen the past months), Italy slides down slowly, while Spain is still heading modestly up
- Manufacturing PMI is plummeting, suggesting that the Eurozone manufacturing dip has not yet hit bottom

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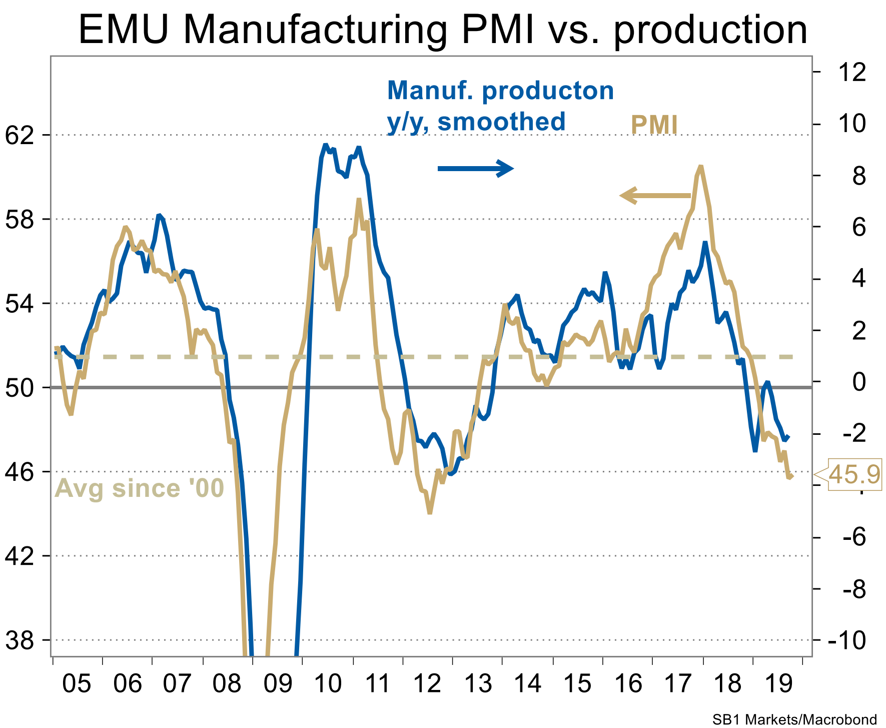
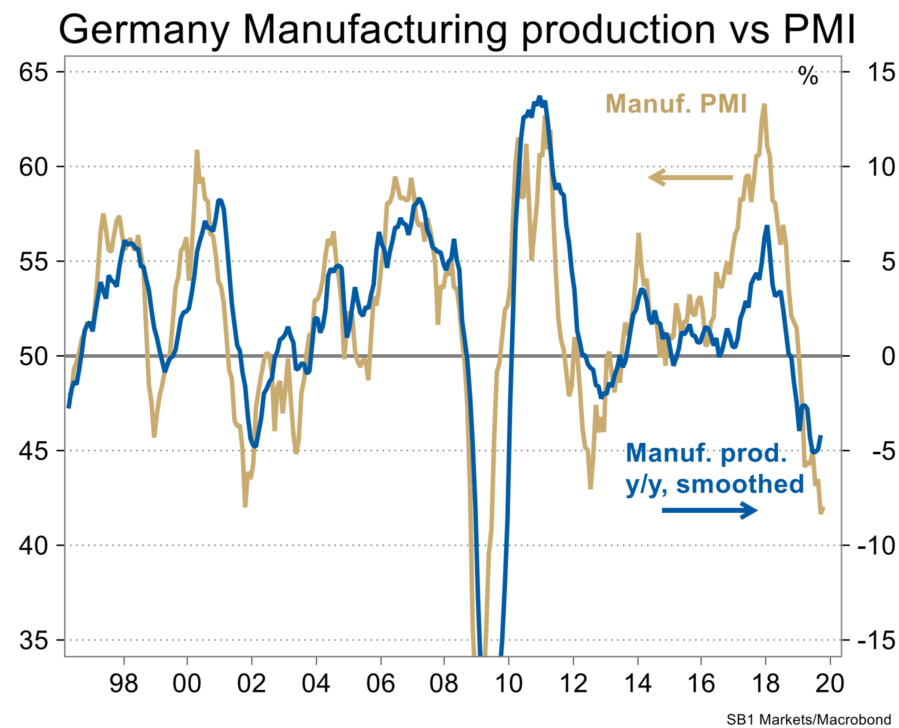
# The PMI point to a further contraction, led by Germany

The outlook is not bright, according to manufacturers. PMI suggests a 3% decline in production




- The German manufacturing PMI signals the sharpest downturn since the financial crisis

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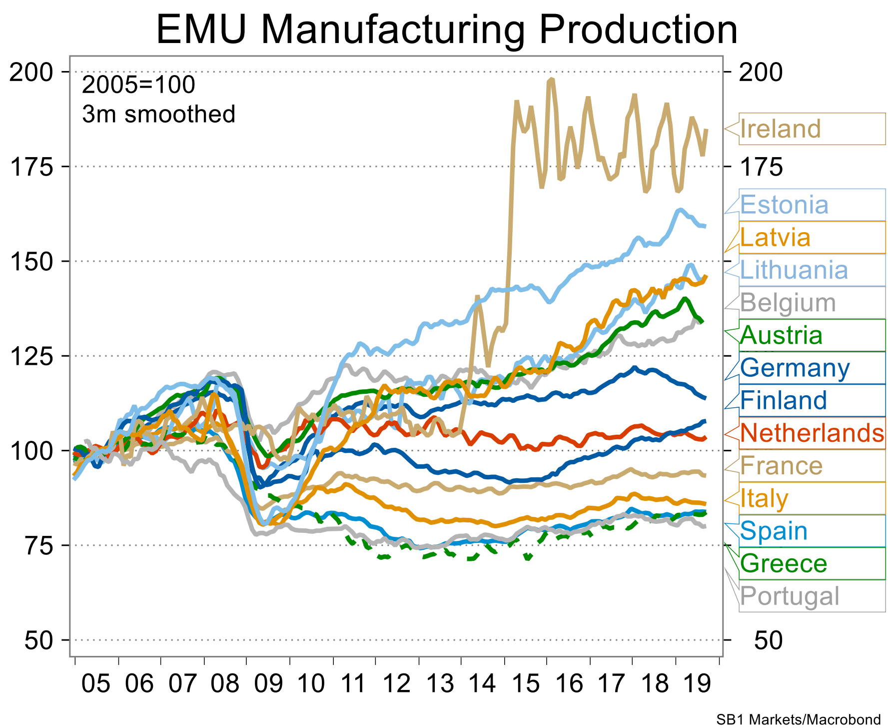
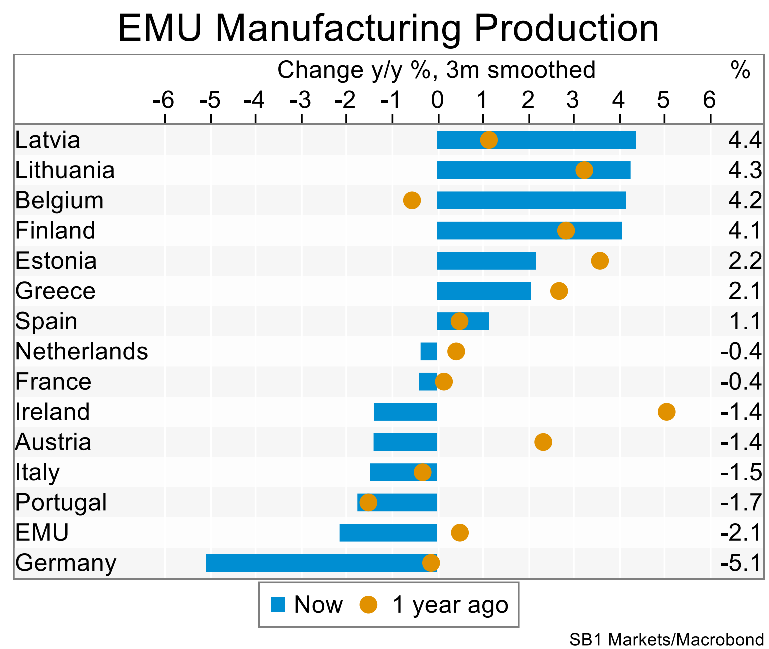
# Just Eastern Europe is thriving

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

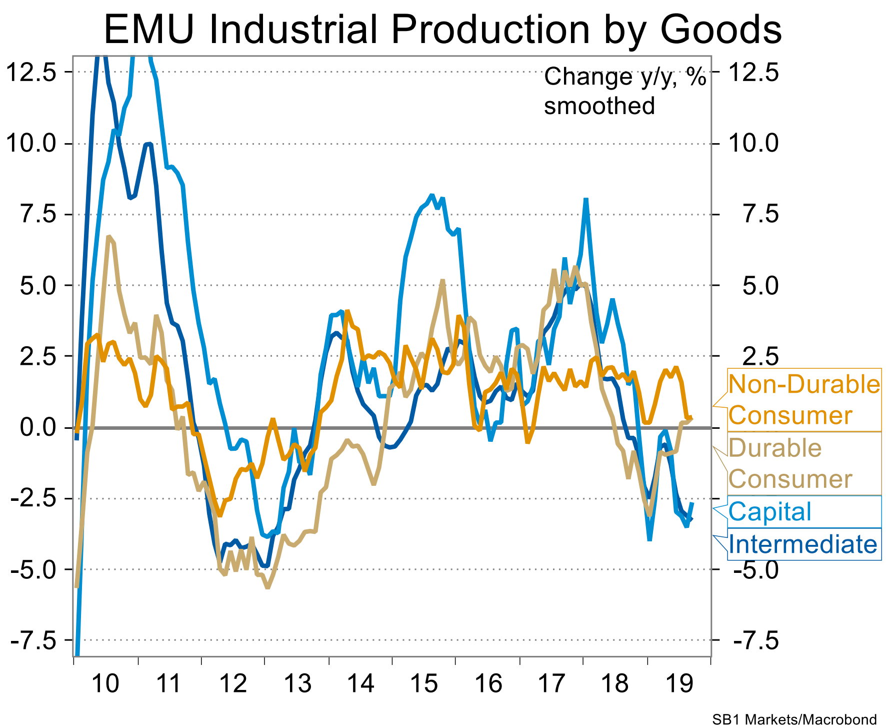


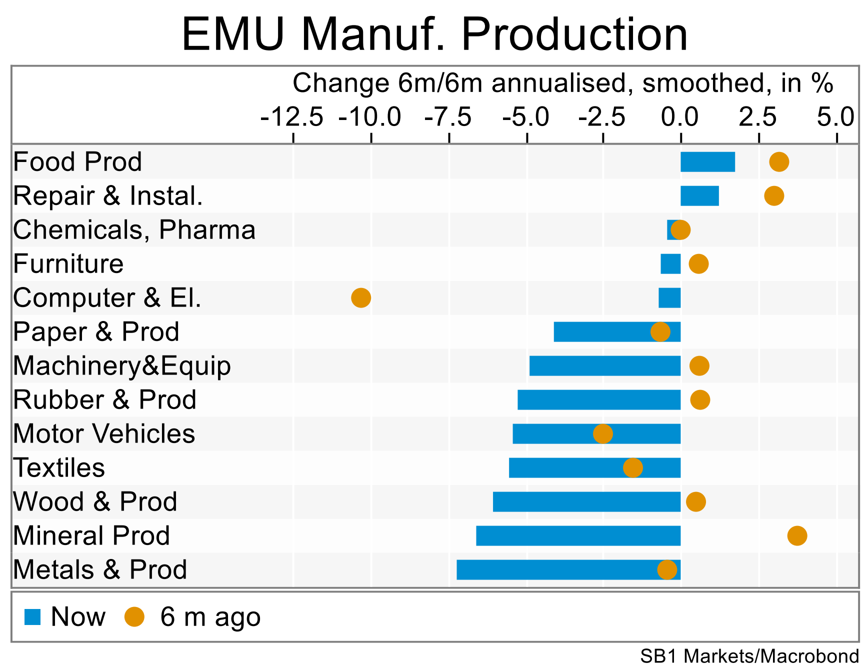




- Production is still up y/y in 7 of 14 countries. Latvia and Lithuania the top, both are accelerating, along with most other Eastern European countries. Barring these countries, just Finland and Spain have been gaining speed recent months. 10 countries are slowing or declining, Germany by far steeper than the others
- The slowdown has been broad sector wise, *check next page*

# A broad downturn sector wise, just 2 of 13 are still growing

## Capital and intermediate goods are weakest but consumer sectors are not thriving either

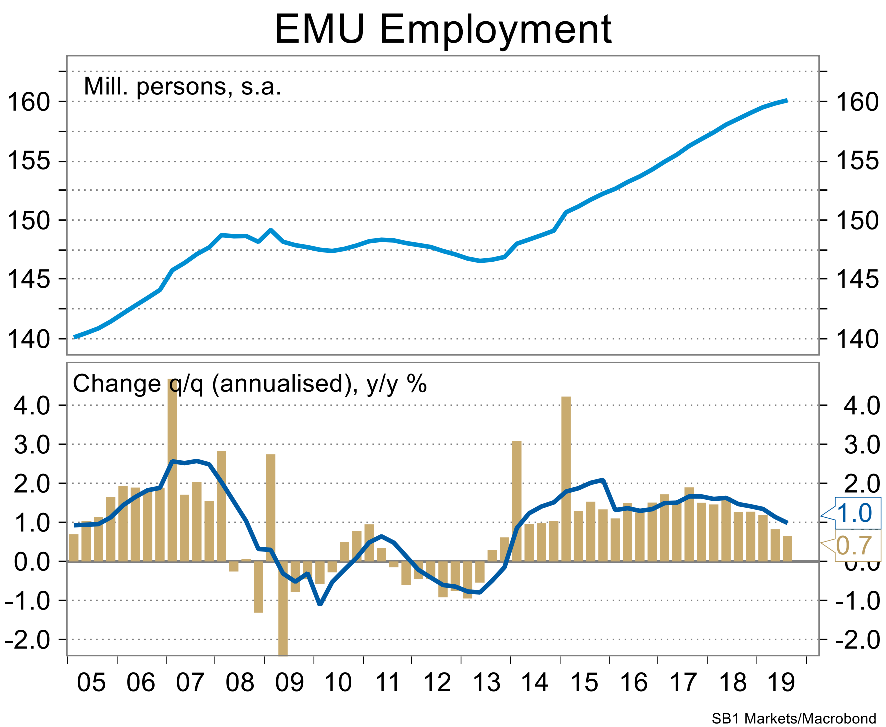


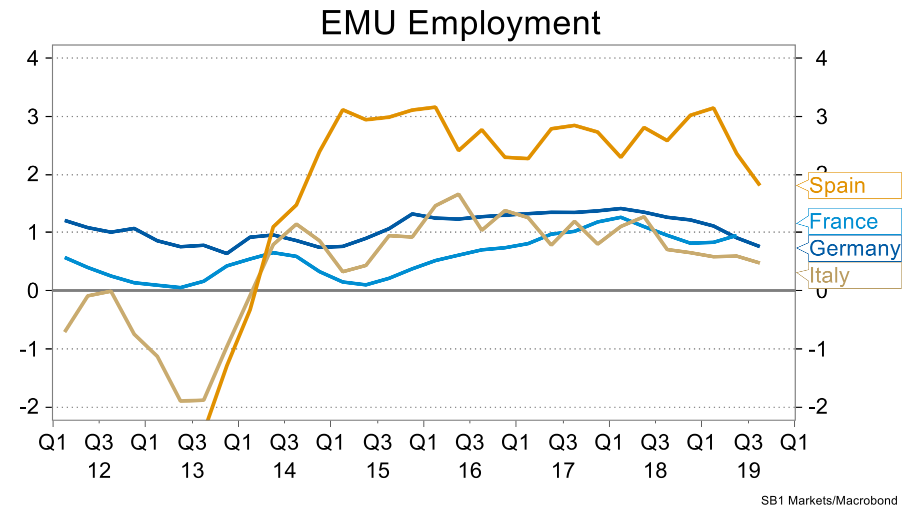



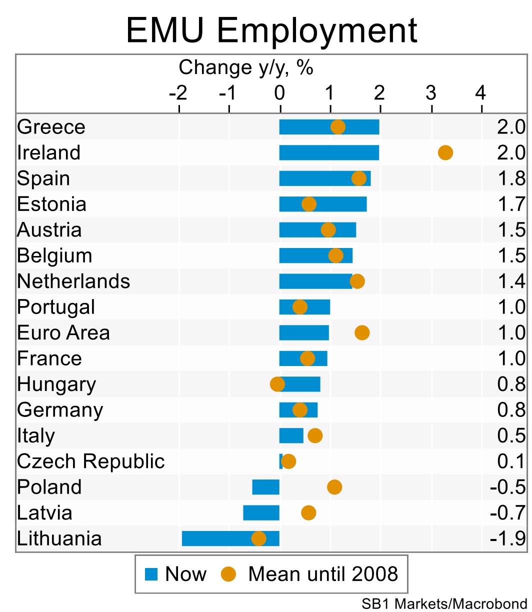

- In September, just 2 of 13 manufacturing sectors were expanding (measured 6m/6m), the other 10 declining. Moreover, 12 sectors have slowed compared to 6 months ago, just computer & electronics are declining slower
  - » 9 of 13 manufacturing sectors were declining y/y (3m smoothed) and just 3 growing, a substantial deterioration from one year ago. Auto production is falling steeply but the downturn is no doubt broad

# Employment growth is slowing, productivity growth (probably) still very low

Employment rose 0.7% in Q3, down 0.1 pp from Q2 and the lowest since 2014.



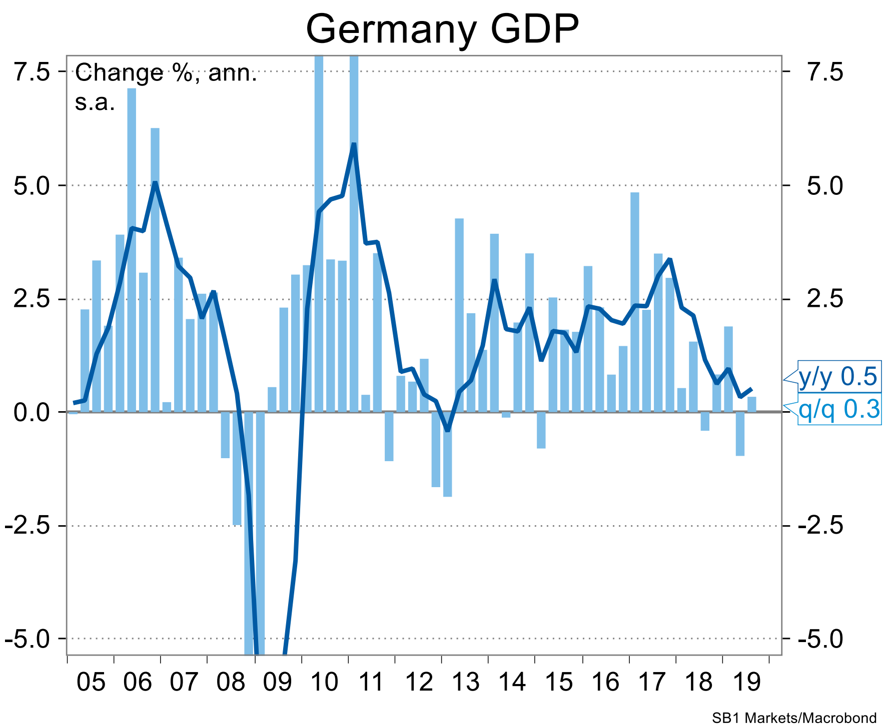



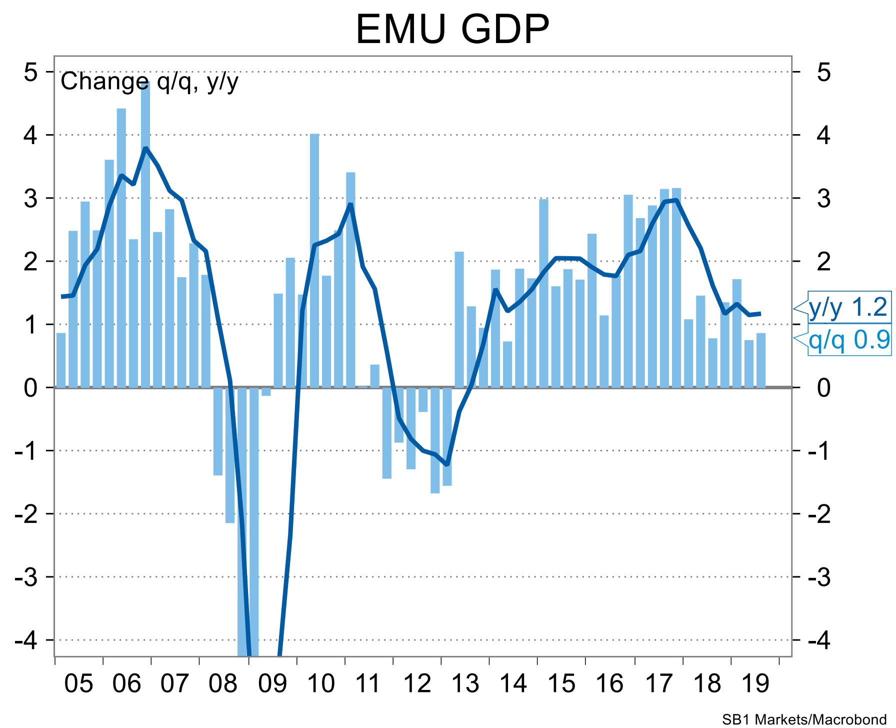




- Employment growth has been slowing along with GDP growth this since mid-2018. Employment rose 0.7% annualised in Q3 vs GDP at 0.9%, indicating positive but low growth in productivity (but hours worked not yet published)
- Employment is still growing in all but three countries, and faster than before '08 in most countries. Still, the slowdown recent quarters has been broad, all the 'main four' are sliding down
- Employment growth is still above population growth

# GDP rose marginally in Q3, supported by private consumption

GDP rose 0.1% (0.3% annualized), vs expectations at -0.1%. EMU GDP revised up, on the 2nd decimal

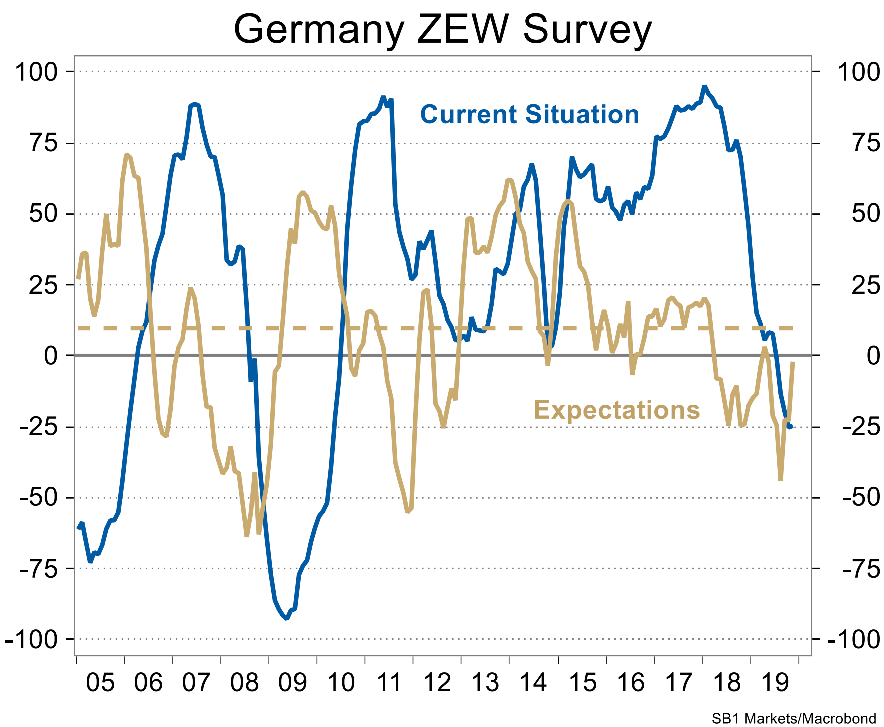


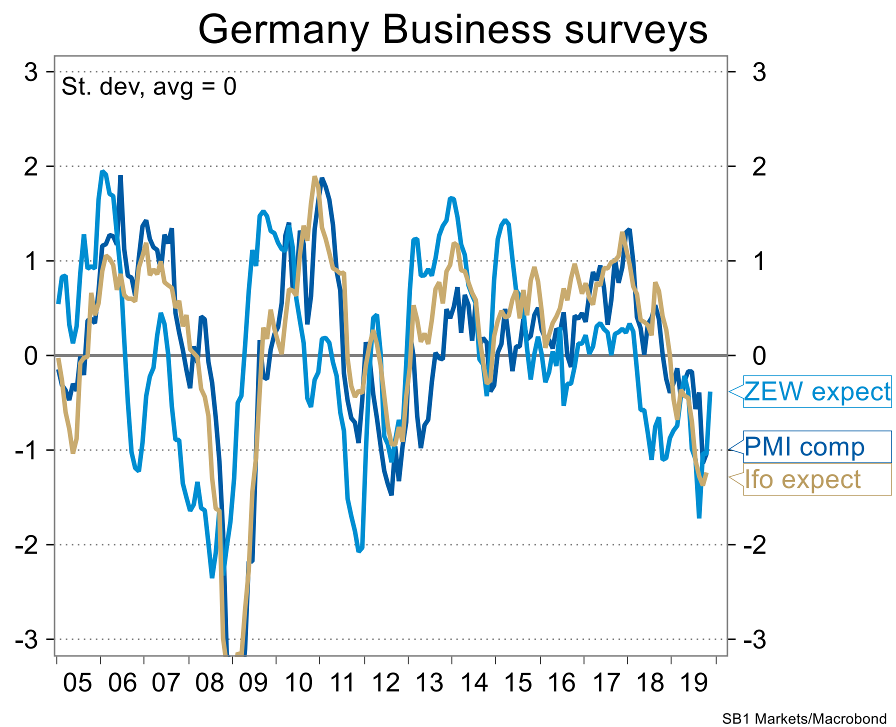




- German GDP expanded by 0.1% in Q3 (0.3% annualised, 0.2 pp better than expected, thus, avoiding a two successive quarters with negative growth - 'a technical recession'. (We do not reckon this technical assessment to be very useful). Growth y/y inched up to 0.5%. Q2 revised down by 0.1 pp
- No details have been released, however, the Statistic Bureau reports that private consumption was the main positive contribution, as retail sales data have been indicating – with a growth boost from higher net exports as well
  - » German surveys (like the PMI, Ifo, ZEW) are pointing to declining GDP, yet, these have overestimated the downturn in both Q2 and Q3
- Eurozone GDP was revised up just marginally, thus, the annualized q/q rate inched up 0.1 pp, to 0.9%

# ZEW survey expectations recovers, current situation remains lacklustre

Investors & economists expectations have improved the past 3 months, more upbeat than PMI & Ifo

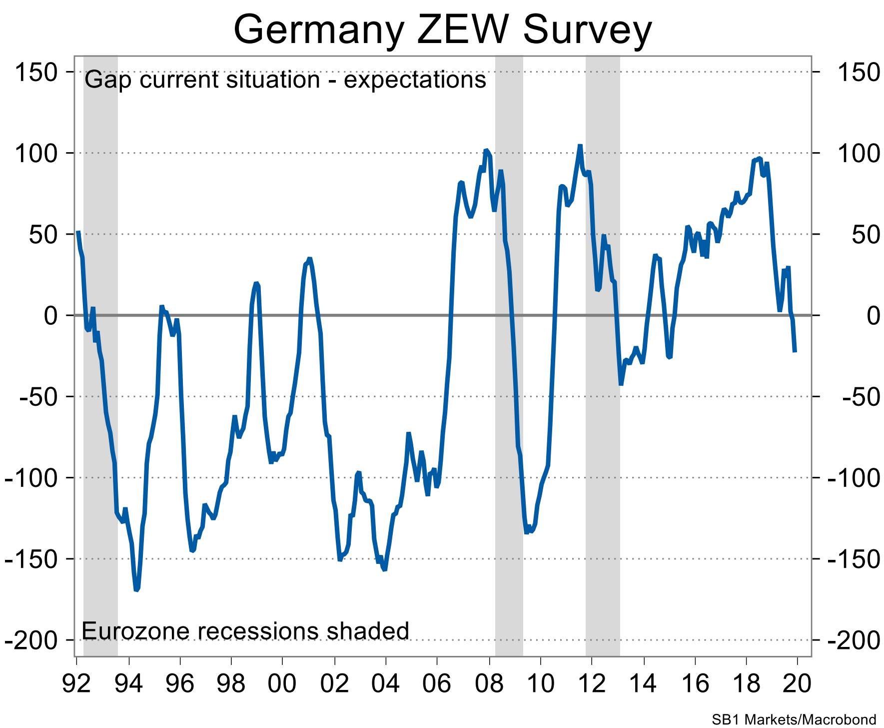


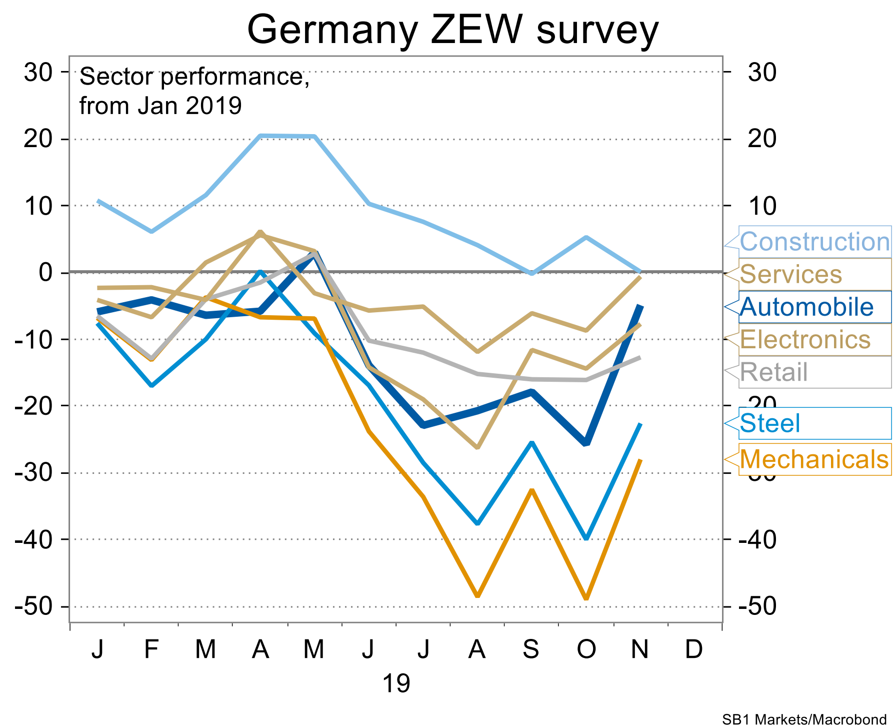




- The ZEW survey noted a stronger rebound of economic expectations than expected in November. Still, the level remains soft, below the avg since 2005. The assessment of the current situation was unchanged at a 9 ½ year low
  - » Signs of a partial US/China trade deal, less probability of a hard Brexit have probably offered some comfort, German macro data have not improved, in sum (although there are some signs of a soft recovery, like manufacturing orders and auto sales)
  - » The ZEW survey is more upbeat than the PMI and Ifo surveys (which have not reported any November data). The ZEW is a sentiment survey and not a business survey, as the PMI and Ifo. ZEW is usually leading the Ifo and PMI – however with a rather weak correlation. We prefer the business surveys
- All German surveys are pointing to a bleak outlook; the PMI (composite), the avg of surveys point to a steep contraction

# The gap between the ZEW current situation and expectations is not promising

## On the other hand, most sectors are now improving and the auto industry recovered swiftly in Oct

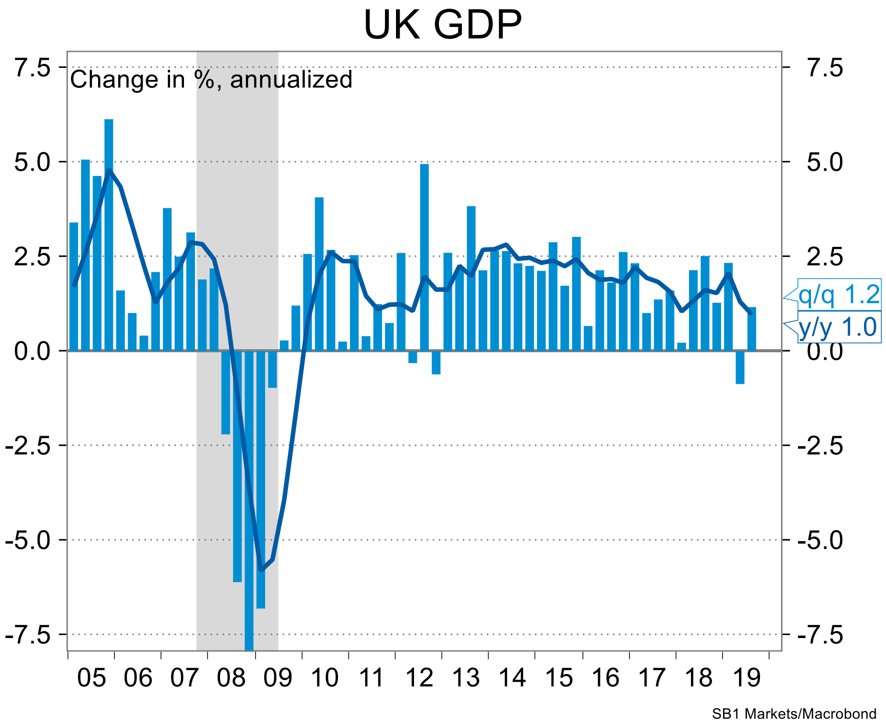


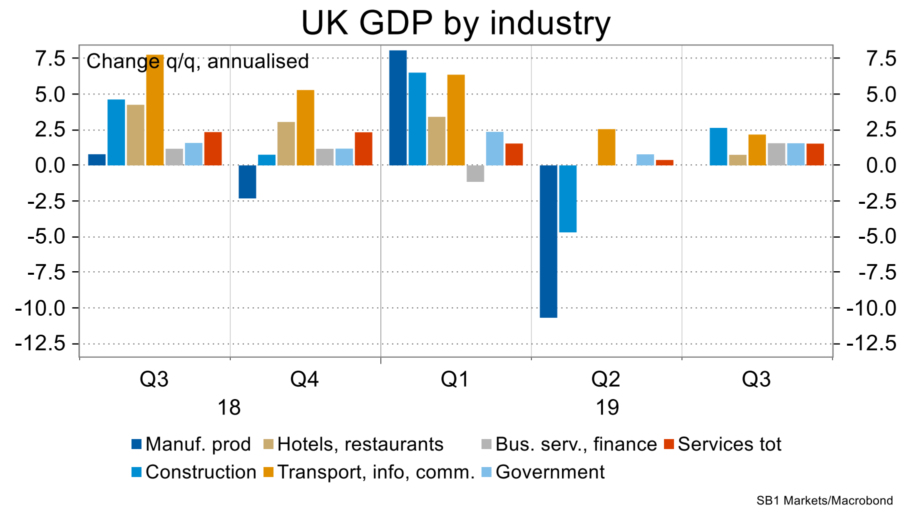



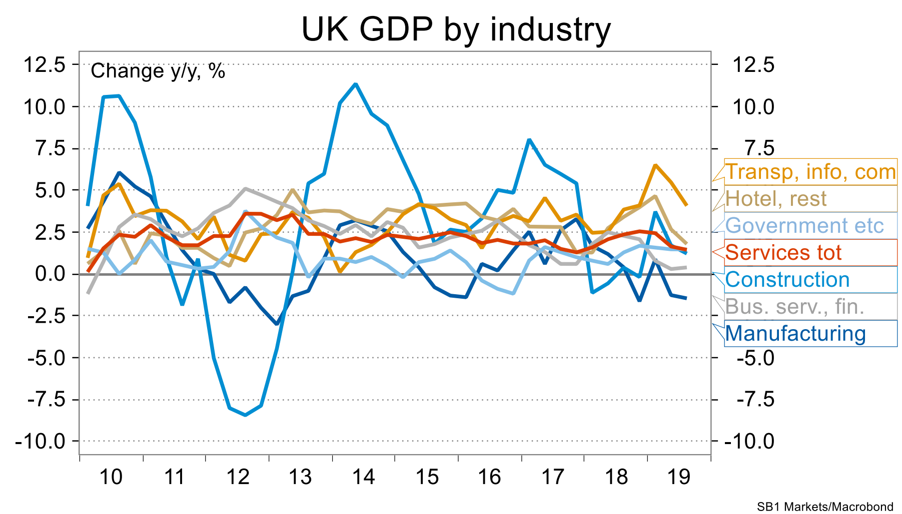

- Just before recessions hit (the 3 recessions since 1990 at least), the expectations component of the ZEW survey has fallen steeply, while the view of the current situations remains elevated. During the recession, the current situation assessment follows expectations down. Hence, based on data before/during the past 3 recessions, we should already be in a recession now. Surely, 3 observations are not sufficient, but still..
- We doubt the EMU is in a technical recession now, as parts of the economy are holding up well in spite the manufacturing dip; the consumer sector is still growing moderately, credit is increasing and overall unemployment is still declining

# GDP rose modestly in Q3 amid Brexit slowdown

## GDP rose 0.3% (1.2% annualised), marginally weaker than expected. Details are not bright




- GDP increased by 0.3% q/q (1.2% annualised), vs expectations at 0.4%. The annual rate fell to 1.0%, the weakest print since 2009
- From the production side; Activity was muted in manufacturing and leisure in Q3, modest growth elsewhere, but the pace of increase has been slowing in all sectors. Manufacturing is falling y/y

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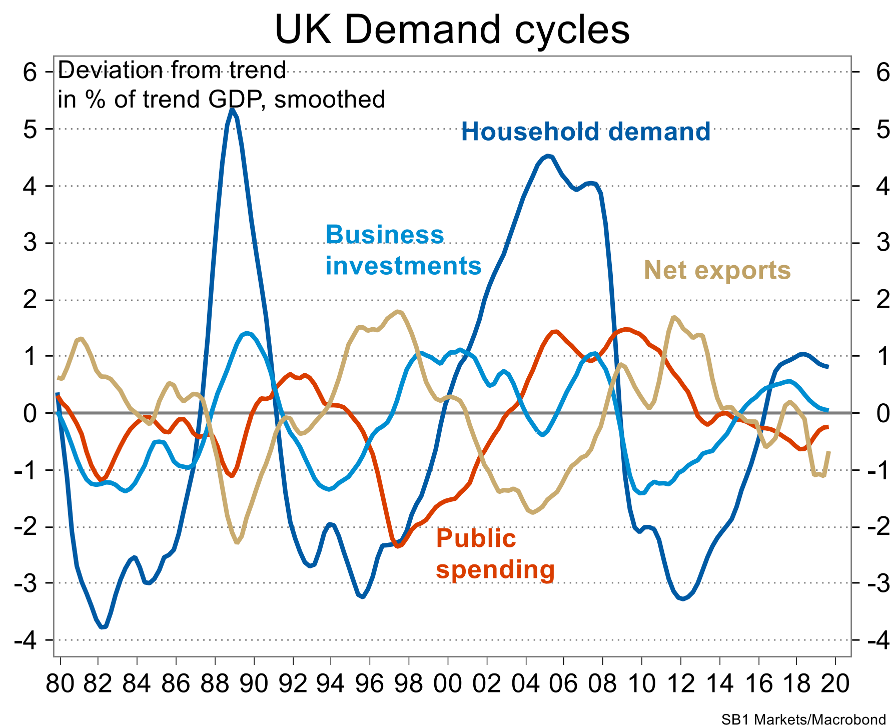
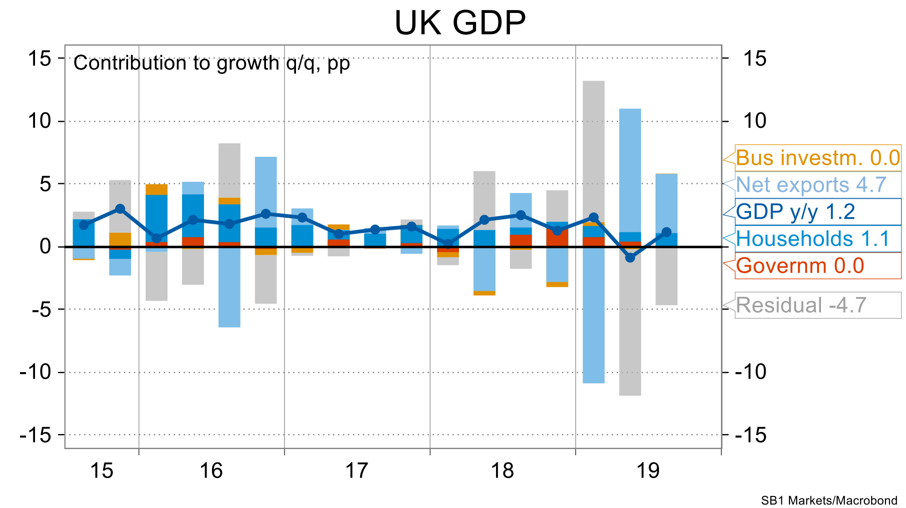
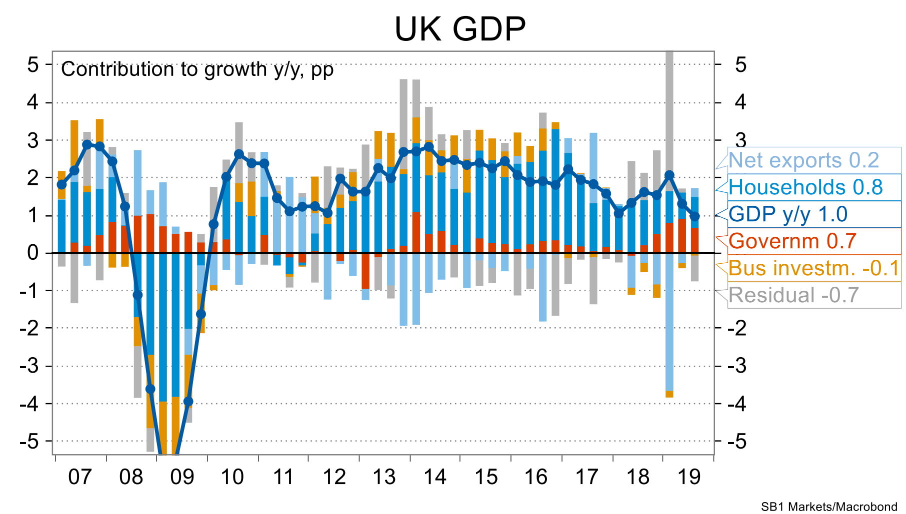
# Households are slowing, business investm. flat - but public demand saves the day

Businesses have been struggling inventory build up, which is now reduced as net exports soar



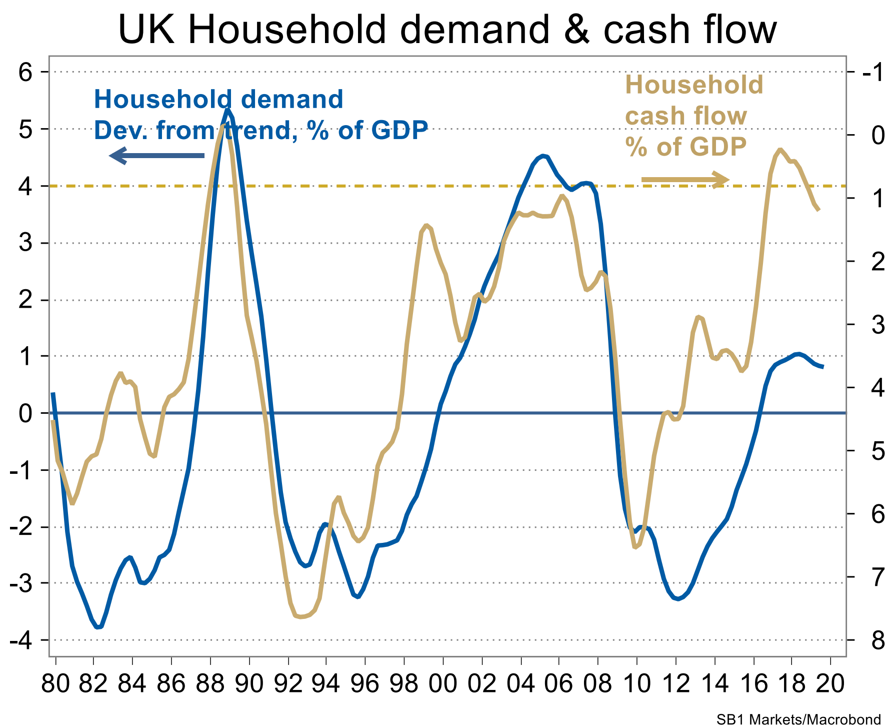



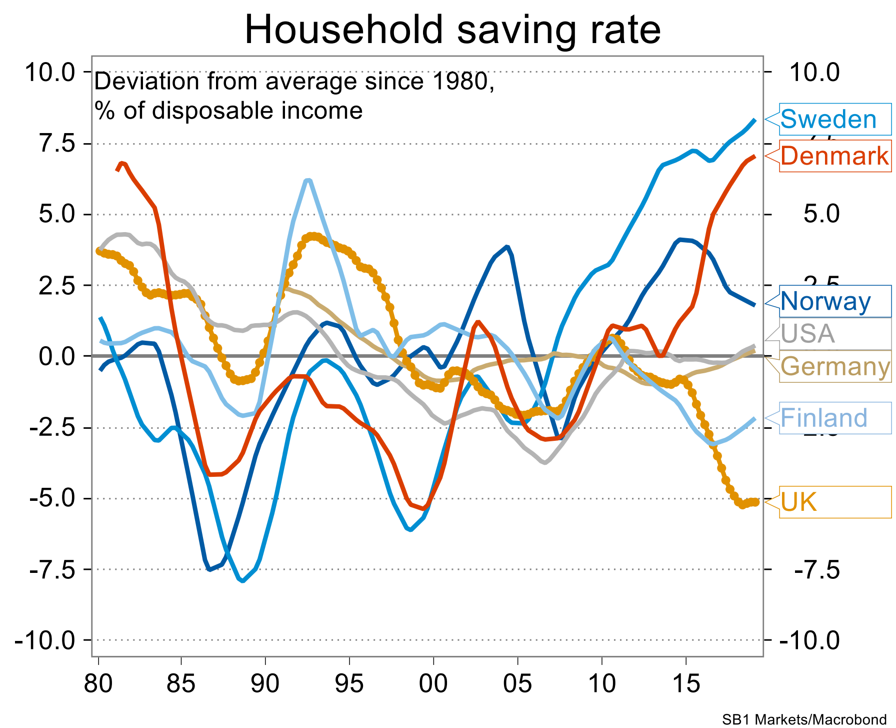




- The decline in the 'residual' indicates that stockpiling was being reduced further in Q3 (the 2nd derivative of the inventory), after a lift in Q1, as businesses built up stocks ahead of the original Brexit deadline. A new inventory build up may occur in Q4?
- Household demand contributed moderately to GDP growth. Households have increased spending faster than normal but it does not look like a wild boom, from the spending side. ***However, check the savings rate, next slide***
- Businesses investments were muted in Q3. Exports soared while imports rose marginally. And the big thing: Public demand is soaring, pushing up GDP growth 0.7 pp out the 1% GDP grew y/y

# Households are not saving anymore, without any huge demand boom…

The UK saving trend is bad, savings have fallen sharply recent years, and the cash flow is negative




**A rather scary picture, both short and long term. Short term: A substantial risk for a savings shock, sending the UK into recession**

- The savings rate has fallen 4 pp since late 2015. The brits have compensated slow income growth by cutting savings in order to keep consumption up – which have 'saved' the British economy, demand wise, recent years
- The household sector's cash flow has fallen into negative territory, for the first time since 1988, this time without any huge spending boom, just a small one. This illustrates the much slower income generation capacity in the UK economy, due to very low productivity growth. Employment growth has been decent, and the employment ratio is record high but that has still not been enough to fund spending

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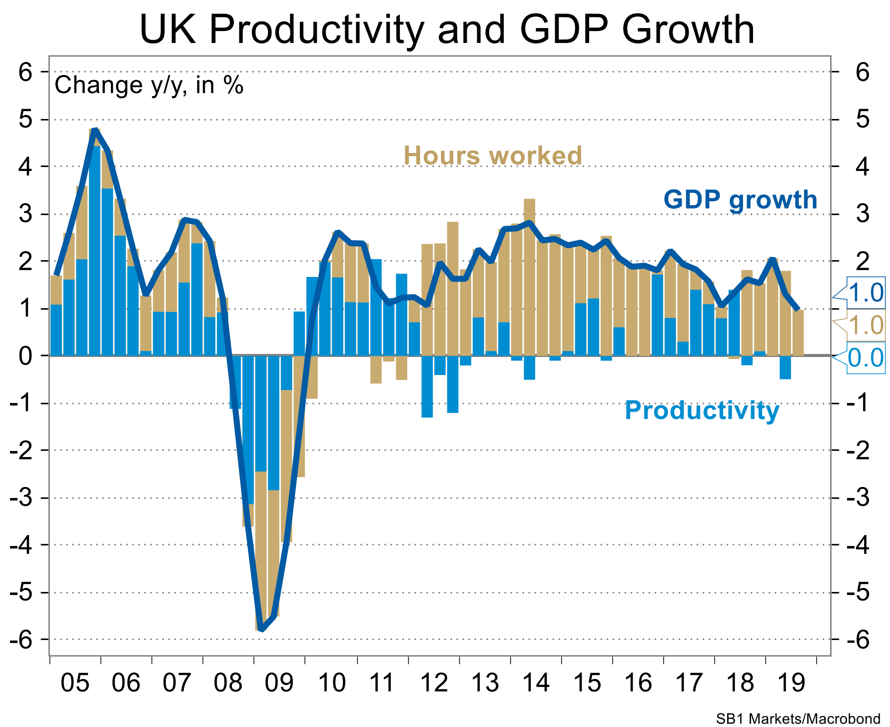
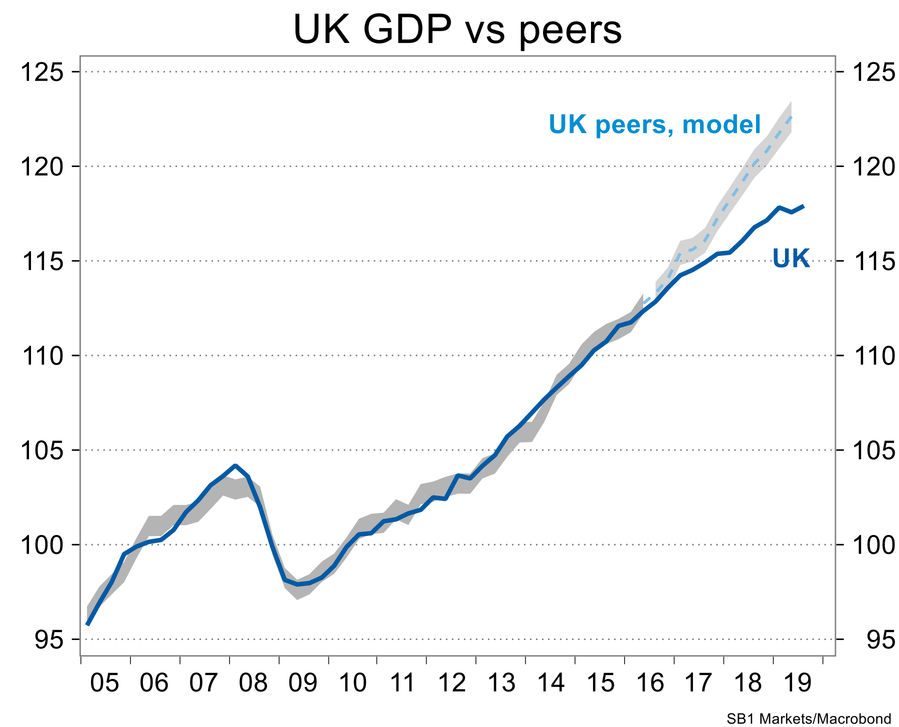
# No growth in productivity since mid-2018

## Productivity growth has vanished – and hours worked slowed to 1% in Q3



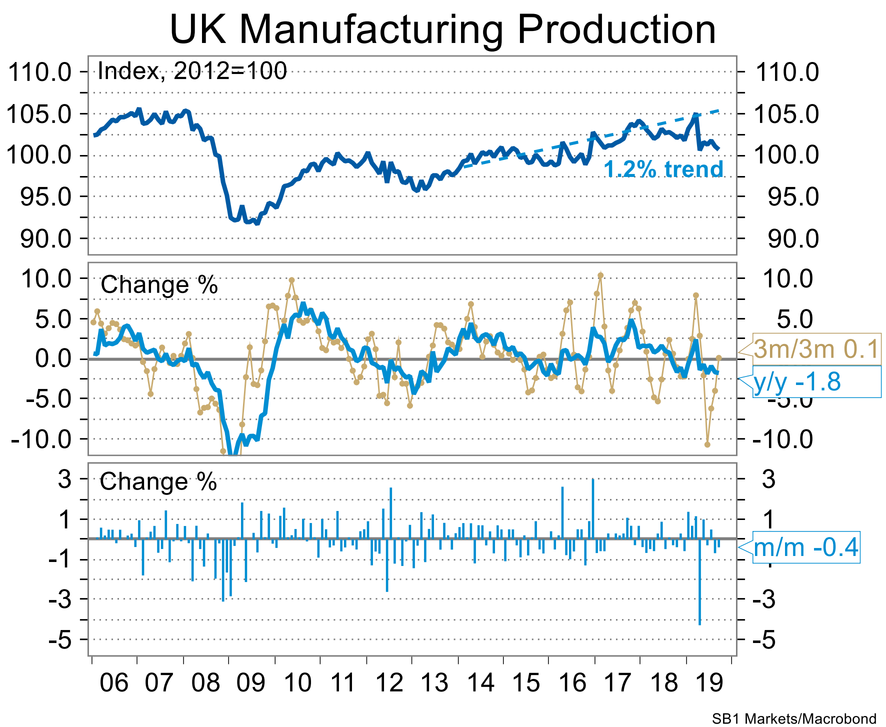



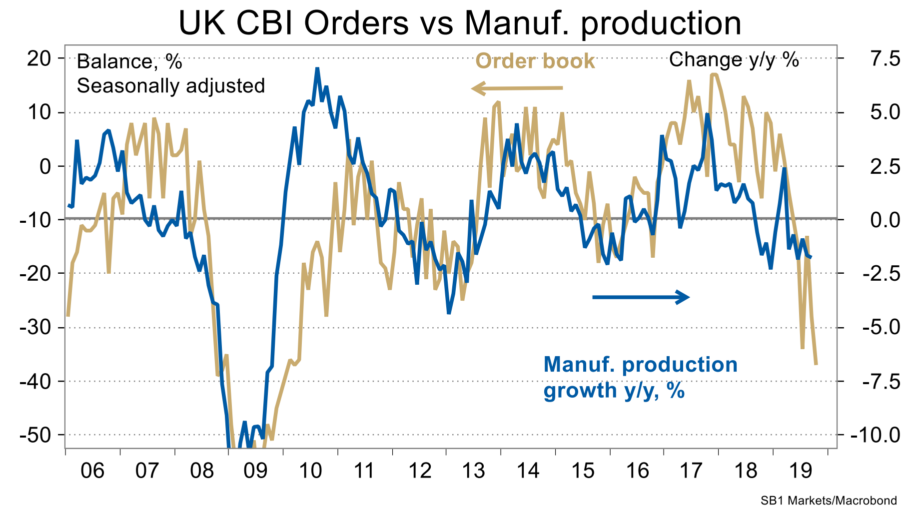

- Since the 2016 Brexit referendum: UK is sagging, GDP some 4% weaker vs UK peers. It may be a coincidence, it may not
  - » The regression model is based on GDP growth in the US, Spain, Hungary and Denmark, which used to be closely correlated to UK growth. Might be a spurious correlation but growth has been slower since 2016, compared to other countries as well

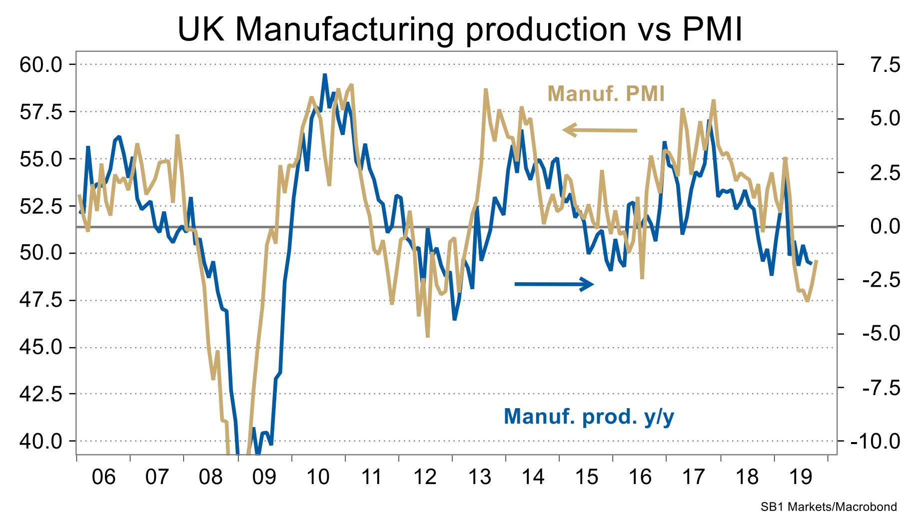
SpareBank 1 MARKETS

# Manufacturing production is declining, more downside risk

## Production fell 0.4% m/m in Sept, stabilised recent months. PMI, order book signal a larger decline



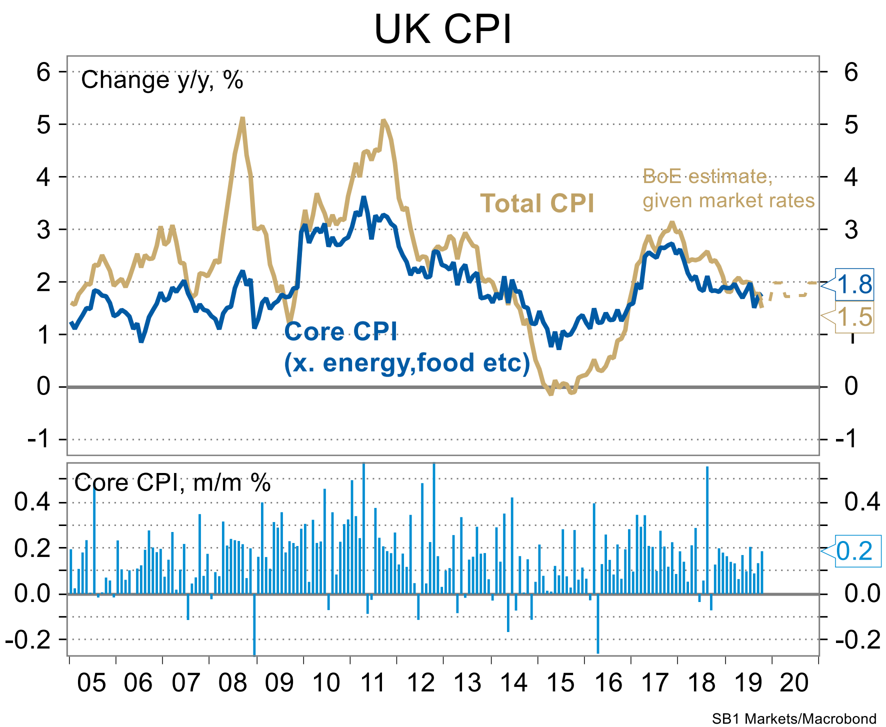



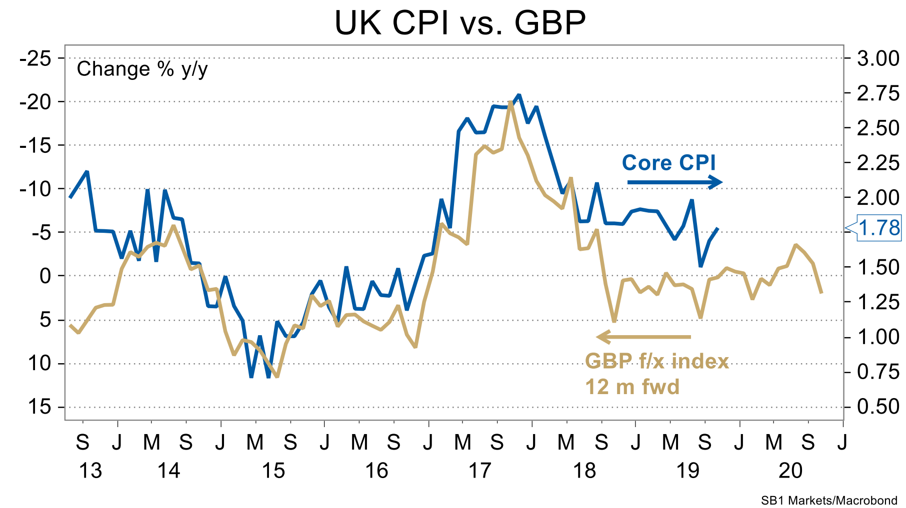



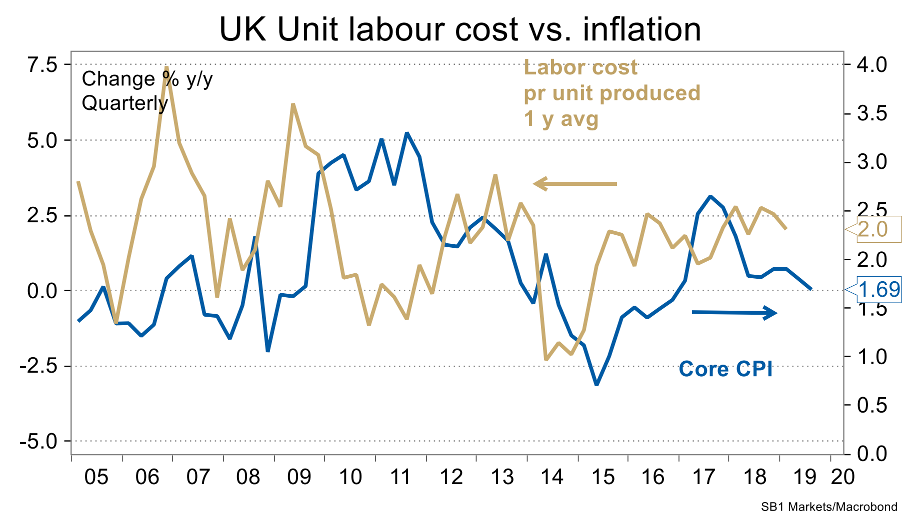

- Production was ‘artificially’ high in March, before the previously assumed Brexit date, March 30, and fell rapidly after. Inventories were build sharply up before the deadline, and this effect has later been set in reverse
- All activity surveys have turned south recently, the production outlook is rather bleak. In October, the manuf. PMI was boosted by a new inventory build up ahead of the Oct Brexit deadline, will most likely drop in November

# Core CPI inflation inched up to 1.8%, trend tilting downwards?

## The (2016) GBP impact is probably taken out. Core inflation just below target, total down to 1.5%



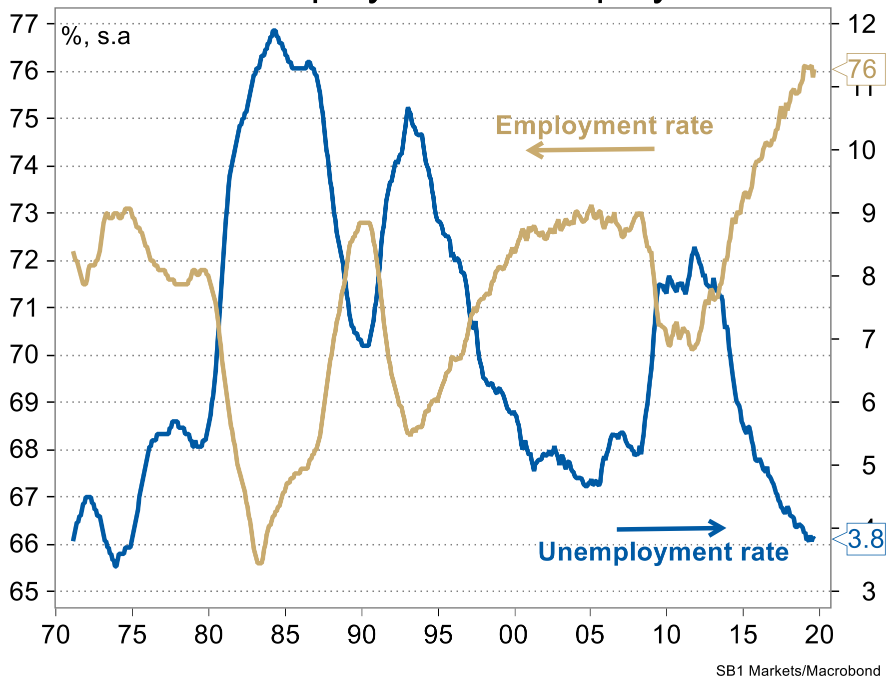

- Core CPI rose 0.2% m/m in Oct and the annual rate rose marginally to 1.8%. Core inflation is heading very slowly down, just below the BoE's price target. Total inflation fell to 1.5%
- Inflation came down through 2018, as the upward pressure from the GBP depreciation in 2016 changed sign. Our simple f/x based model does not indicate much lower inflation. Moreover, domestic cost inflation is not low, and wage inflation is above 3%

SpareBank 1 MARKETS

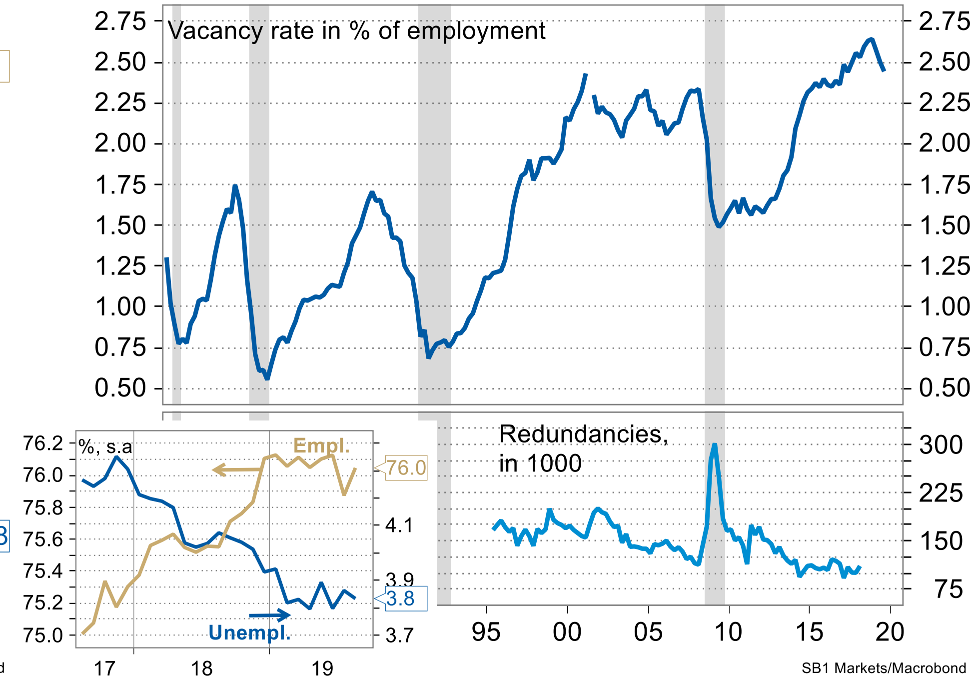
# Unemployment inched down and employment rose but some signs of weakness

## Unemployment has flattened, employment softens, job vacancies down. And wage growth cools?

### UK Unemployment & Employment




### UK Job Vacancies




- Unemployment (LFS/ILO) inched down to 3.8% in Aug (avg July-Sept), expected unchanged at 3.9%, after an uptick the prior month. Unemployment has flattened out since early 2019, at the lowest level since 1974
- The employment rate rose to 76.0%, a 0.1 p uptick. However, employment have stalled this year and may be trending slowly down. Due to supply constraints or lack of demand?
- The vacancy ratio has fallen to 2.2%, down from 2.6% in late 2018. And wage inflation has eased recent months
- In sum: these data signal that the tight labour market is slowly softening, the Brexit slowdown may be hitting the labour market

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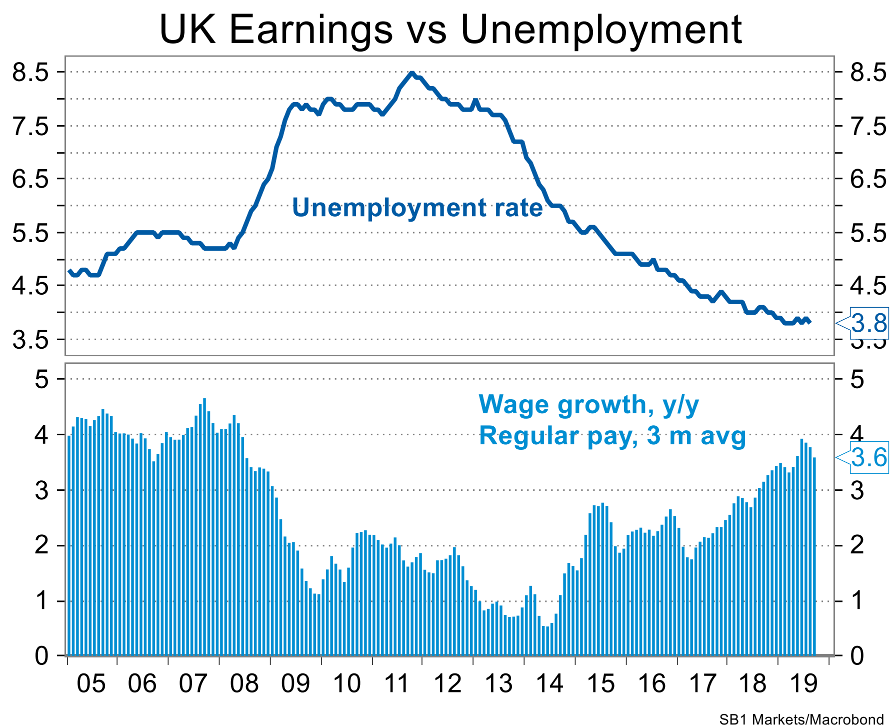
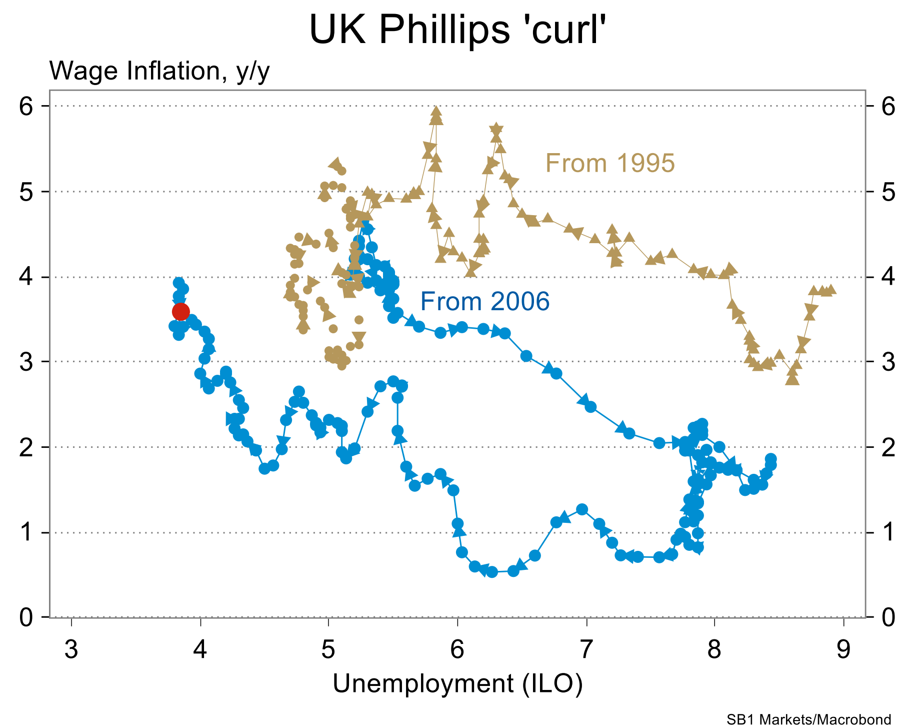
# Wage inflation has slowed somewhat, still at 3.5%, a rather high level…

.. without productivity growth. A tight labour market has been boosting wage inflation, peaking now?



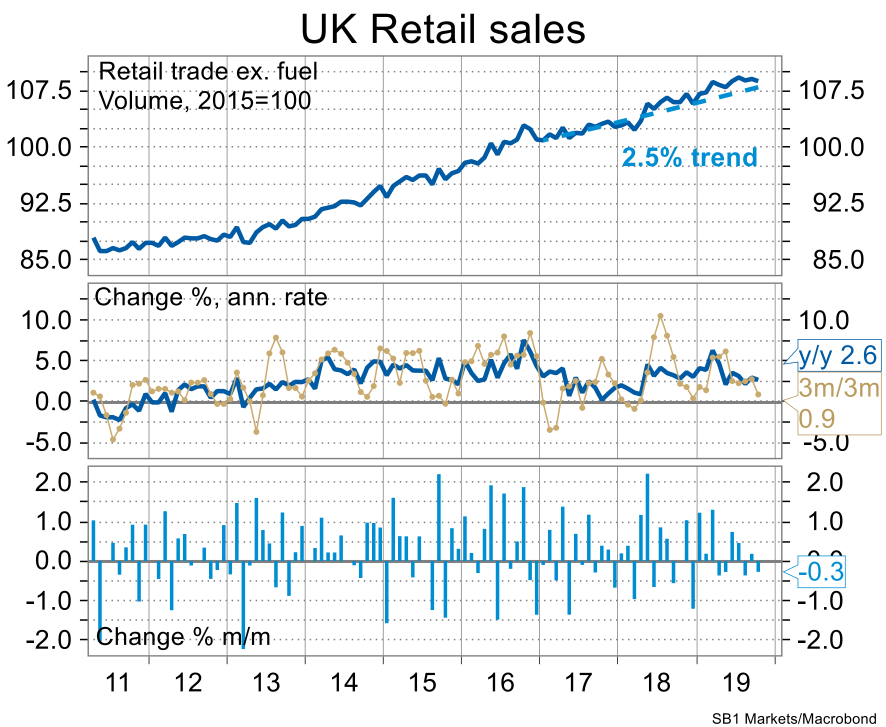



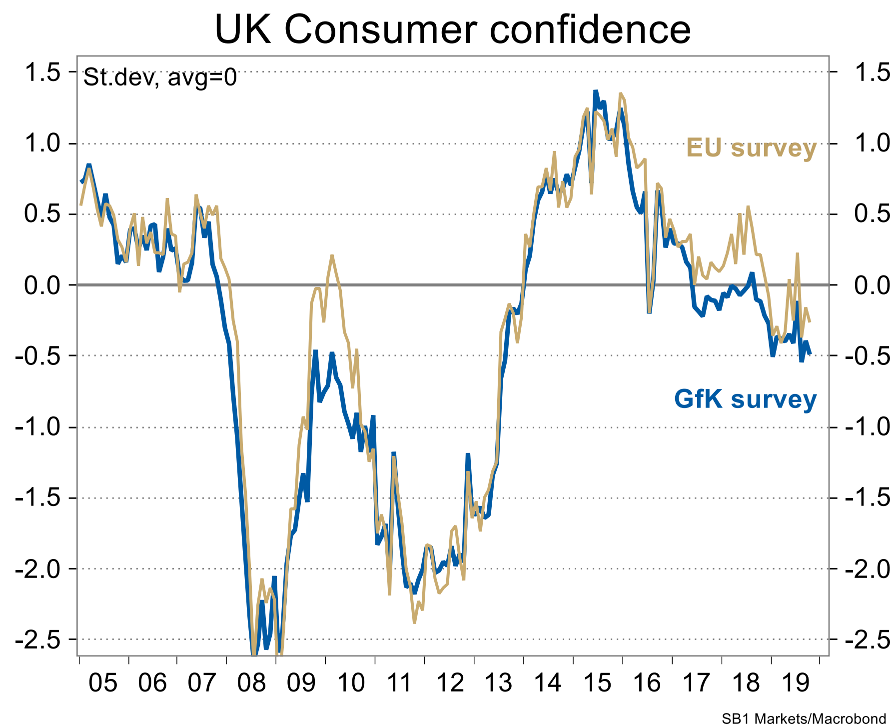

- Wage growth (regular pay) edged down to 3.5% y/y, a 0.1 pp decline, lower than expected. The smoothed rate (which we apply at the chart above) inched down to 2.6%, the 3rd month of deceleration, after a steep upturn the prior months
- UK productivity growth is muted, and unit labour cost inflation was running at 2% in Q1 (no data have been published since then, strange) but is higher in Q3 (at least for the total economy).
  <u>Cost pressure are building up, profits are under pressure</u>

SpareBank 1 MARKETS

# Retail sales still on the way up but slowing

## Sales fell 0.3% m/m in Oct, and underlying growth is slowing.  Confidence still below par

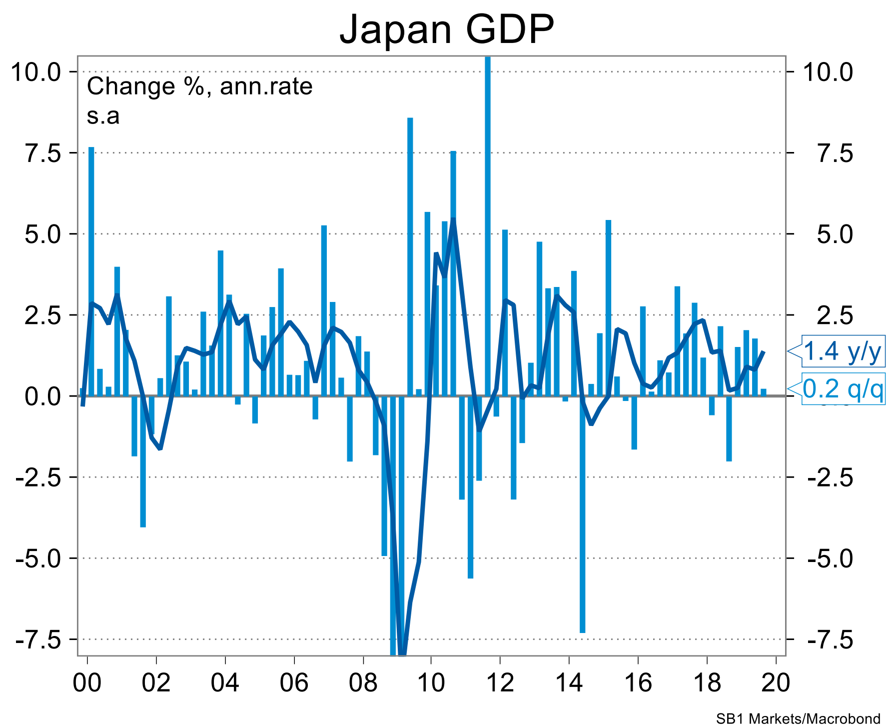


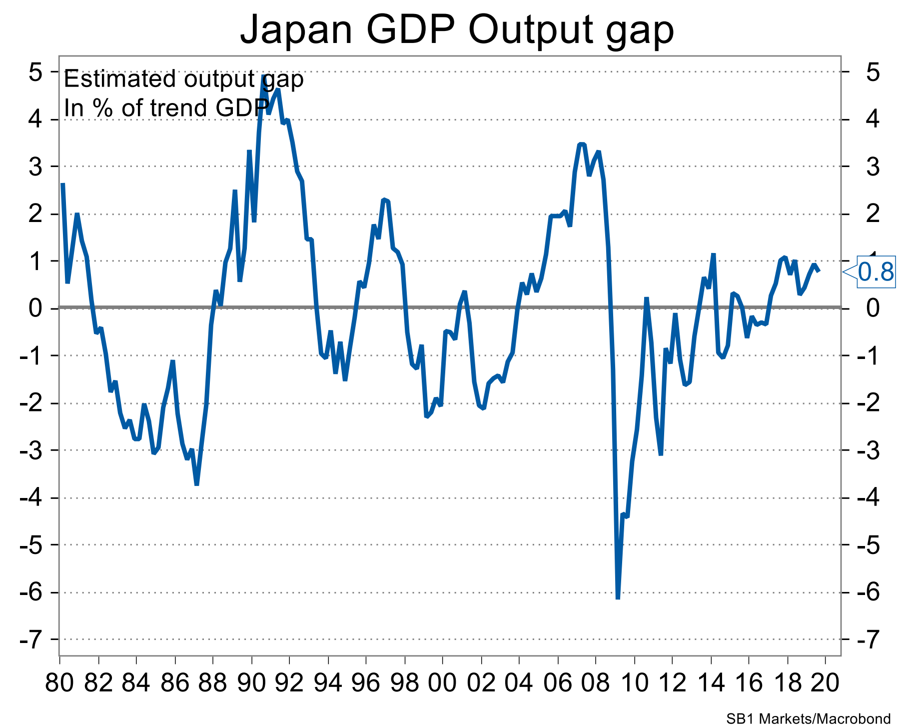




- Sales were weaker than expected and the history revised marginally down.  Sales is running above the 2.5% trend path from 2017 but growth is demand may now be slowing
  - » A steep decline in the savings rate has funded much of the increase in consumption – but the savings rate has stabilised as growth in consumption is slowing
- Consumer confidence has trended down since 2016, even if the labour market has been strong. Confidence improved slightly in September, probably helped by hope of a Brexit deal. The level is not far below average

# GDP stalled in Q3, far below expectations

GDP rose just 0.2% annualised, the weakest in a year and short of expectations at 0.9%

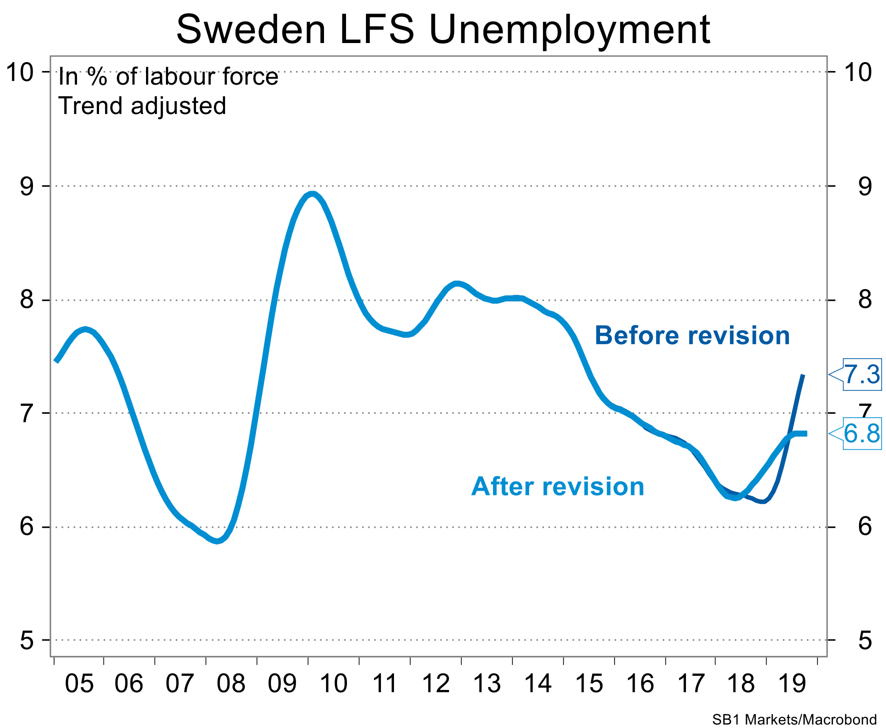


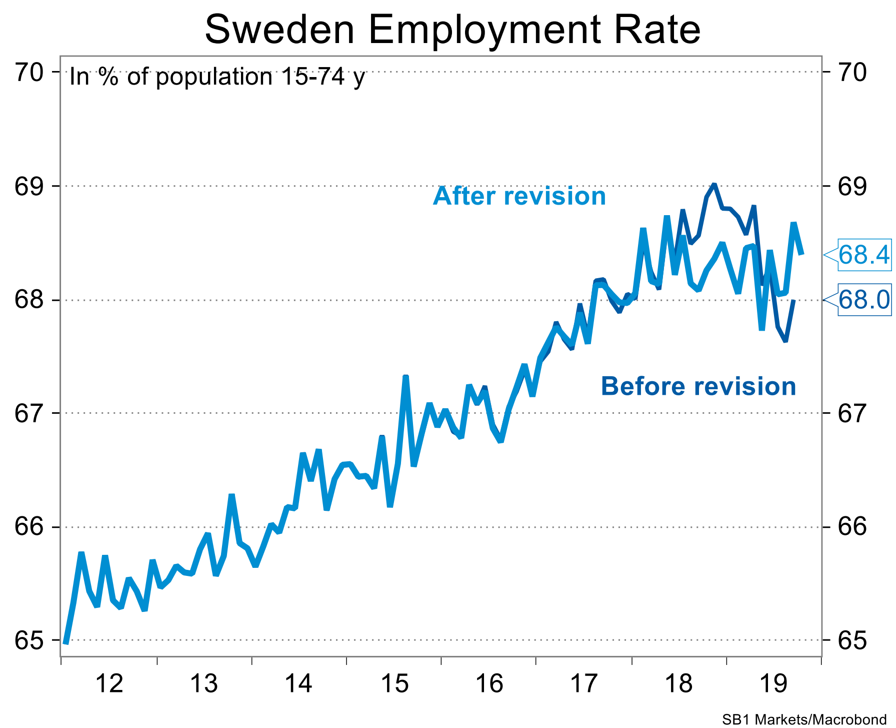




- GDP rose just 0.06% q/q, 0.2% annualized, 0.7 pp below expectations. Growth y/y rose to 1.4%, due to a slip in Q3 2018
  - » Business investments rose at a brisk pace, so did public demand, and household demand (ahead of the VAT hike), while net exports and inventories contributed sharply on the downside in Q3 ('the shops' shelves were emptied').
  - » Over the past year, STRONG growth in domestic demand, but net trade down – and inventories
- Japanese GDP data are volatile and often substantially revised. Q2 rate was revised up to a 1.8% pace, from 1.3%
  - » The output gap has been steady at just below 1% the past year since late 2017, the 2nd highest level since 2008
- The mute GDP growth is weaker than both the PMI (before the Oct drop, that it, and it was caused by a VAT hike) and the Nation Activity index have been suggesting. Still, most Japanese business surveys have weakened

# After huge revisions; half of the recent unemployment upturn is removed

## Unemployment has risen by 0.5 pp, vs 1.1 pp previously reported and employment has flattened out



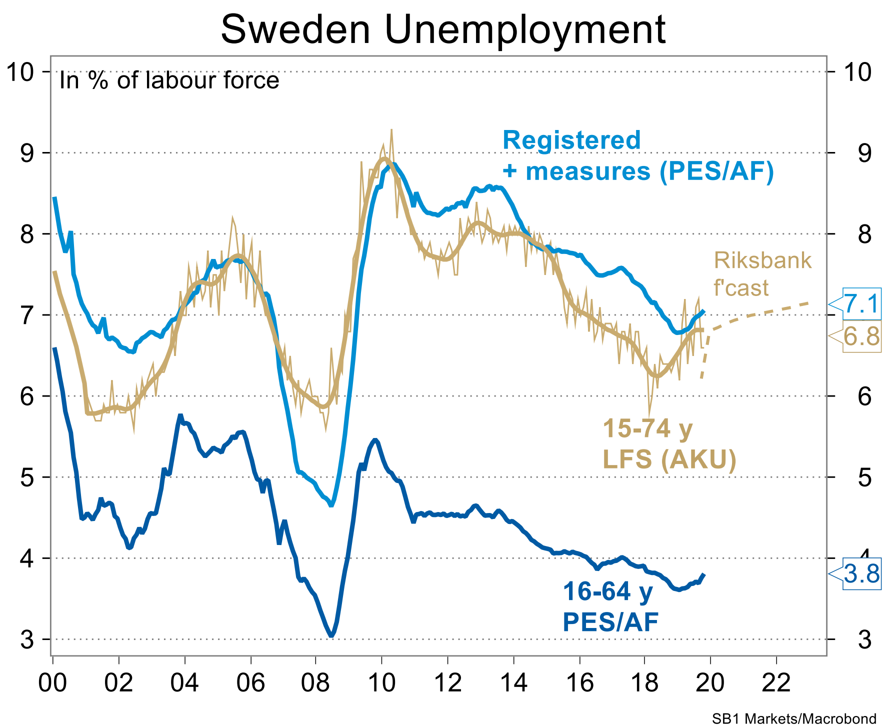

- Statistics Sweden are reporting revised force survey data back to mid-2018, as substantial quality flaws have been disclosed. Data from Evry, which has been conducting half of the surveys on behalf of Statistics Sweden, have had substantial quality flaws, and Aftonbladet reports that interviews have been falsified. These errors caused an underestimation of the number of unemployed in early 2018 and an substantial overestimation recent months. Data collected by Evry are removed from the new figures

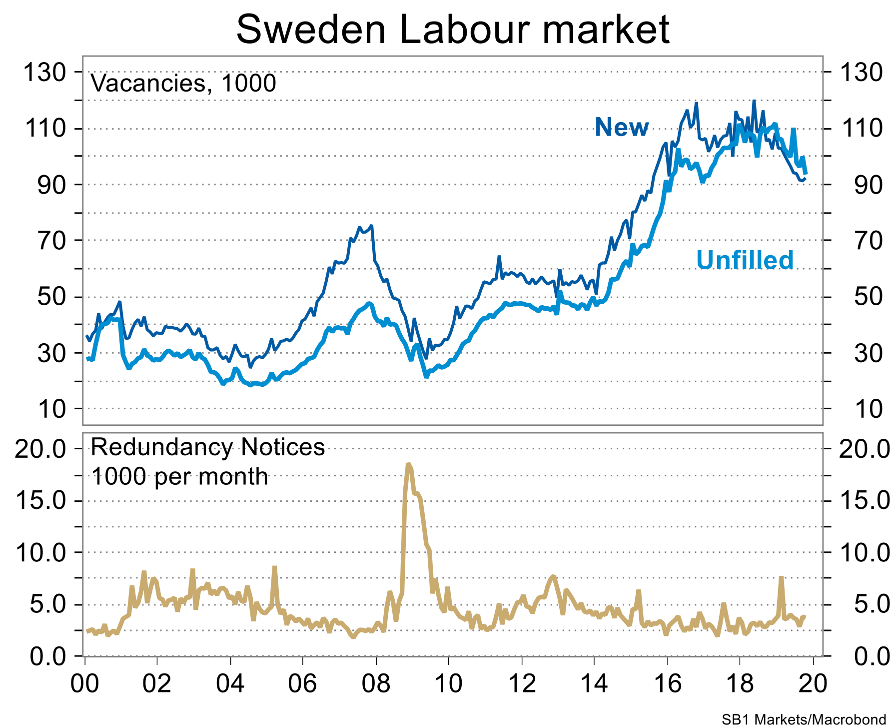
- The new labour market data confirms that the labour market is softening, however, at a much slower pace than previously reported. 0.5 pp of the 1.1 p upturn in the trend adjusted unempl. rate has been removed. More on the next slide

Sweden

# Both LFS and registered unemployment are edging up and new vacancies falling

## Registered unemployment is slowly tilting upwards, confirming a slowly softening labour market

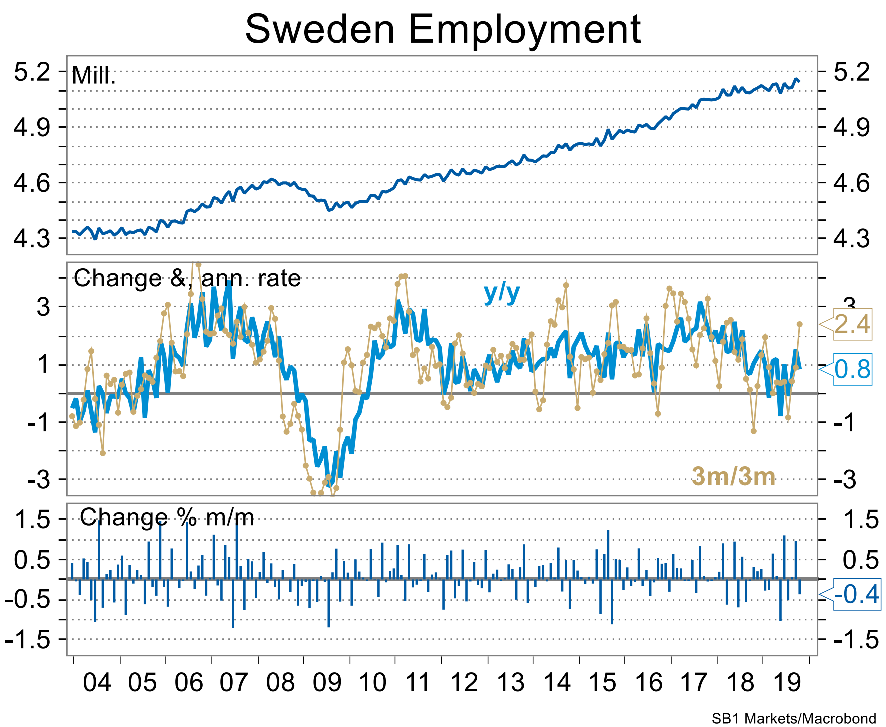


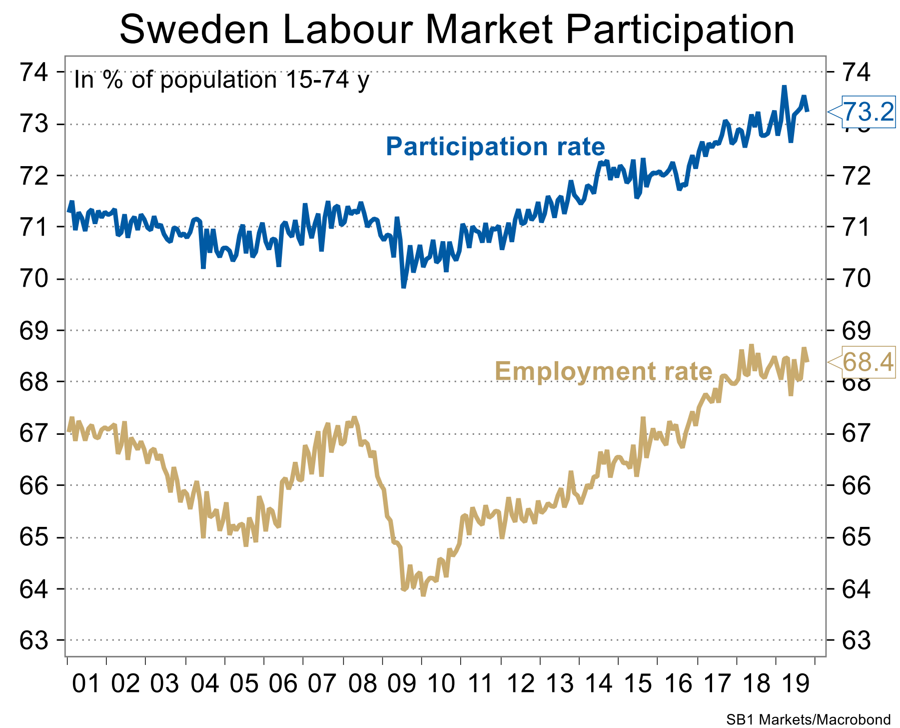




- Following revisions of the LFS data, unemployment has increased by 0.5 pp since the spring, measured by the smoothed rate (vs 1.1 pp as previously reported). In October (avg Sept-Nov), unemployment held steady at 6.8%
- Employment data have been revised up substantially, the new figures show that employment is still increasing, although at a slightly softer pace the past year. We are much less concerned of a rapid labour market downturn which would bring the Swedish economy to its knees after these adjustments
- The PES/AF registered unemployment rate, which is more reliable than the LFS, is slowly turning up. In October, the 'open' unemployment rate held steady at 3.8% (it rose on the 2nd decimal), up 0.2 pp from early 2019. Moreover, both new and unfilled vacancies have turned down from the peak, confirming a cooling labour market

# Employment is slowing, far less than reported

The employment rate has flattened out, while participations keeps climbing, bringing unempl. up

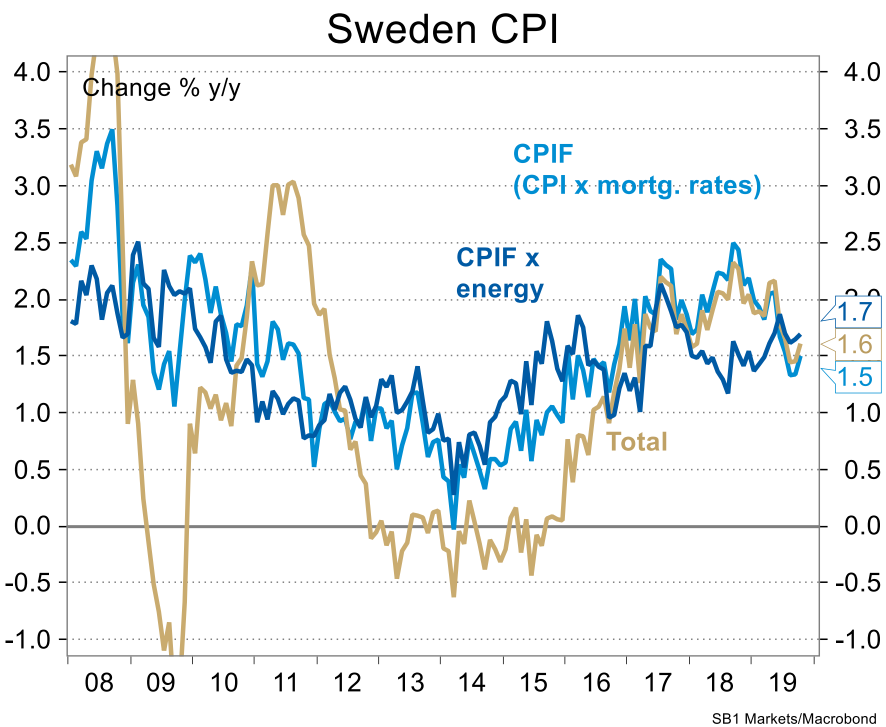


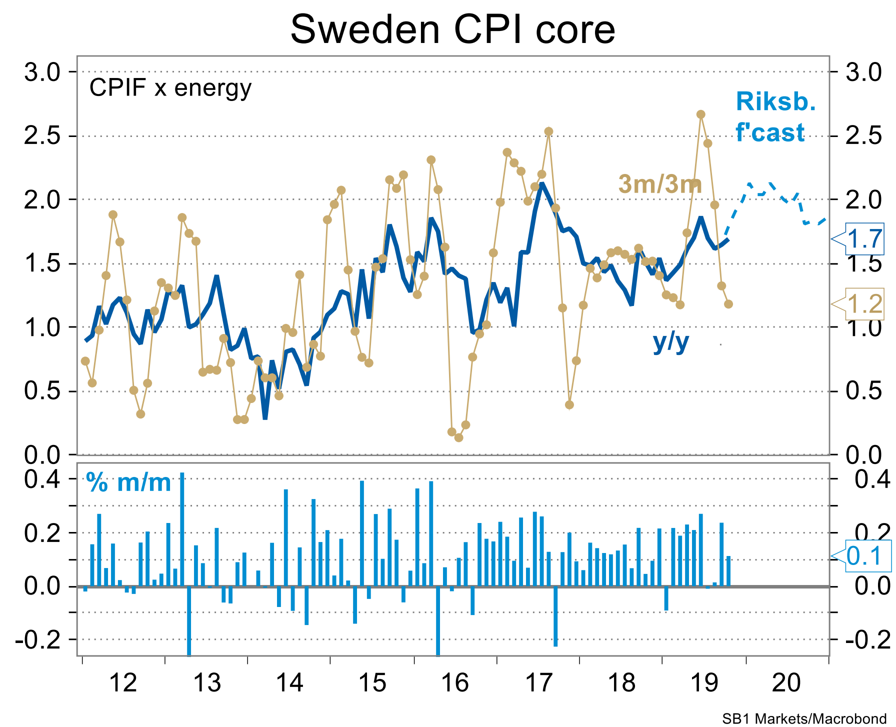




- Employment fell by 0.4% m/m October, the underlying growth rate is solid at 2.4%, due to a strong Sept, vs the 3% decline which was previously reported. Annual rate up modestly 0.8%. The employment rate inched down to 68.4, flattening out since early 2018 (but slightly up recent months)
- Labour market participation came down to 73.2% in Oct, still trending slowly up
- Thus, the revised figures point to a substantially better labour market than previously anticipated, with unemployment rising as a consequence of rising participation, not due to a rapid decline in employment!

# Core inflation ticked up in Oct, the Riksbank f'casts a further acceleration

Core CPIF rose to 1.7%, a 0.1 pp uptick, as expected. Inflation is not far below the Riksbank's target




- The 'real' core (CPIF ex energy) increased by 0.1% m/m in October. The annual rate ticked rose to 1.7%, from 1.6%, in line with consensus and 0.1 pp below the Riksbank's projection. Core inflation has slowed somewhat this autumn, and underlying growth is lower than the annual rate. Still, the Riksbank expects an acceleration to 2.1% in 3 months time
  - » CPIF (ex mortgage rates) edged up to 1.5% y/y – a 0.2 pp increase. CPIF is running lower than core CPIF, due to lower energy prices
  - » Our simple inflation model signals above 2% core inflation but a slowdown going forward
- The Riksbank surprised markets by announcing a planned December hike at the October meeting. Core inflation is closing in on the price target, thus, no argument for the Riksbank to abandon its hiking plans

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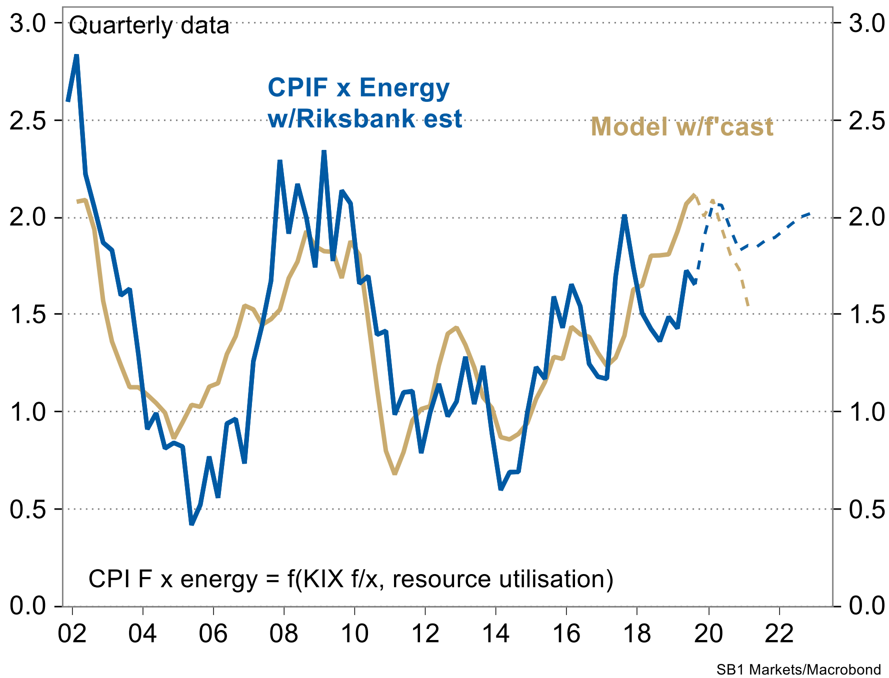
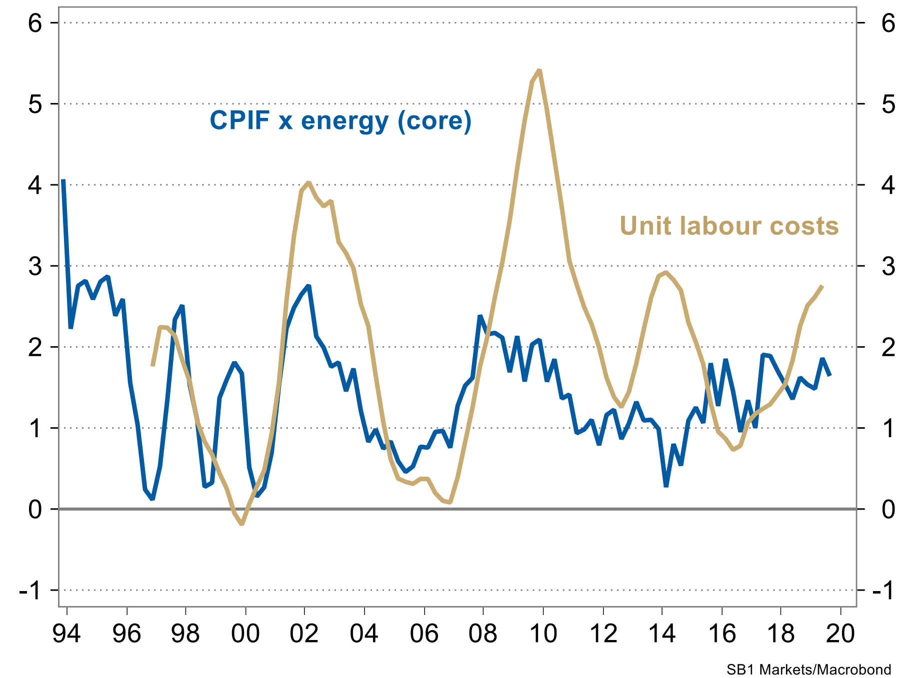
# Our model says inflation is peaking now (at a much higher level)

## Softening capacity utilisation does not indicate higher inflation but the SEK and unit labour costs do

### Sweden Core CPI model




### Sweden Unit labour cost, inflation




- Our model includes SEK and the Riksbank's Resource Utilisation indicator, measuring deviation from potential GDP growth. The RU indictor has weakened this year, although capacity utilisation is still higher than normal. The inflation model points higher inflation now, at 2.1%, vs Q3 growth at 1.7%, before easing next year
- On the other hand, productivity has disappeared, it fell 0.1% y/y in Q2 and unit labour costs were up 2.8% y/y. Hence, the cost pressure is not low at all!
- In contradiction to our model f'cast, the Riksbank expects inflation to accelerate the coming months and peak at 2.1% in early 2020

Highlights

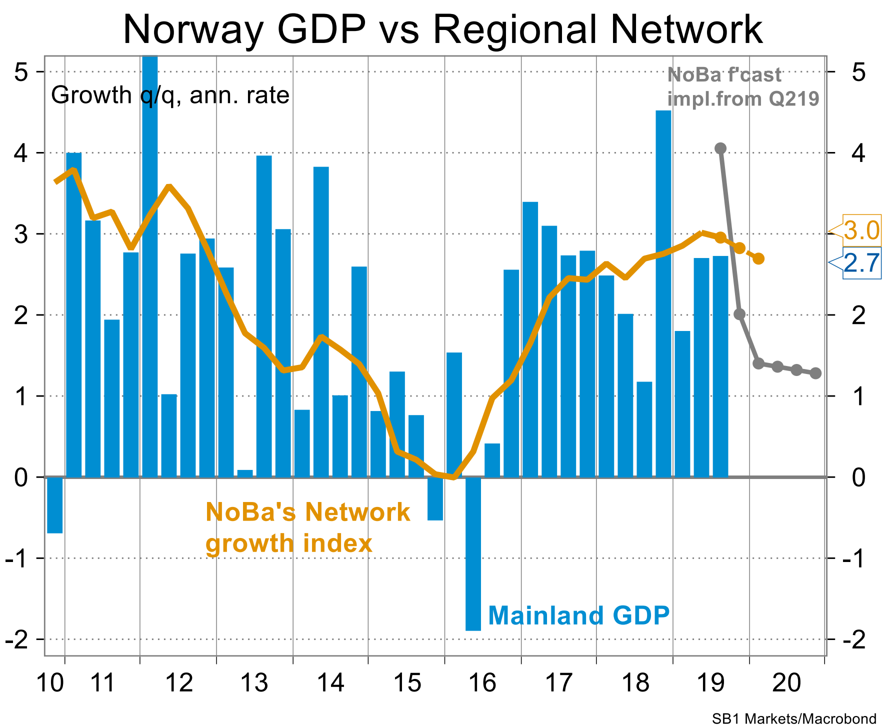
The world around us

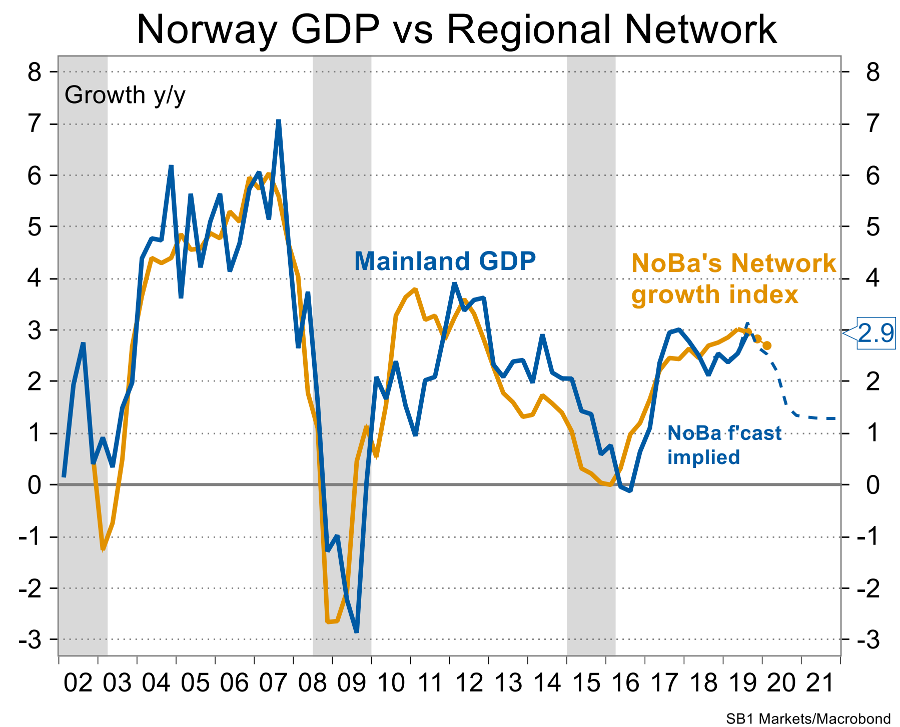
The Norwegian economy

Market charts & comments

# Mainland GDP is growing steadily – Q3 came in a tad below expectations

GDP rose 0.7% q/q (2.7% annualised) and 2.9% y/y, vs consensus at 0.8% and our f'cast at 0.9%

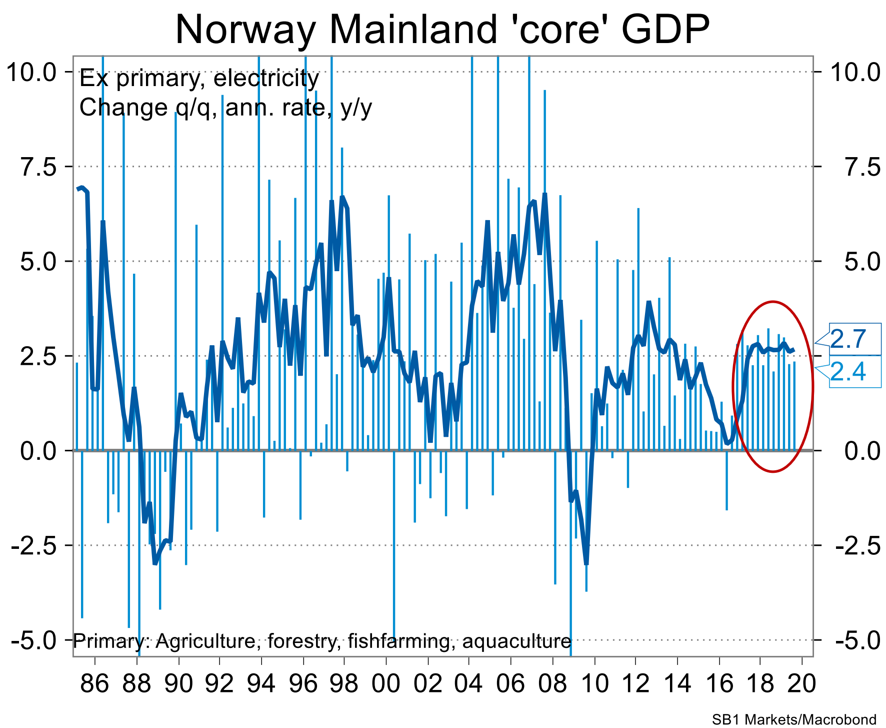


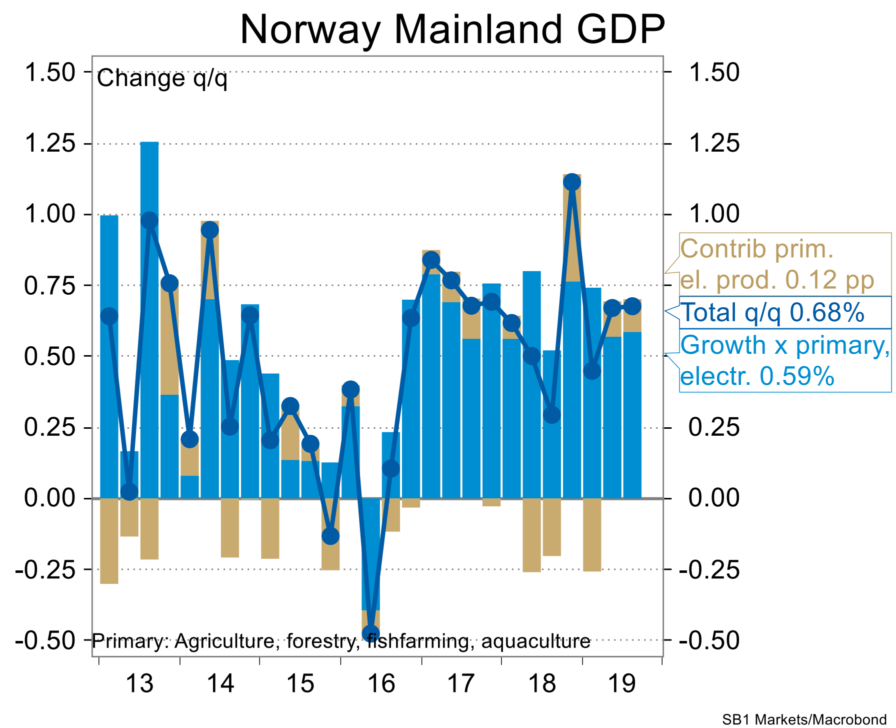




- Mainland GDP rose by 0.7% q/q (2.7% annualised) in Q3, an unchanged speed from Q2. We expected 0.9%, consensus 0.8% and NoBa 1%. The annual rate spiked to 2.9%, up 0.4 pp. The details were mostly in line with our expectations, barring oil investments
  - » Private consumption rose modestly as expected, Mainland business investments soared (we do not expect the upturn to last). Oil investments rose but less than we expected. Housing investments marginally up. Government demand was strong, as in Q2, and net exports fell
  - » Employment growth is softening yet still solid, up 0.3% q/q. Productivity growth is still slow, while wage compensation is increasing, reducing profit rates
- Growth is above trend and cost inflation is trending up. A slowdown is expected in Q4 and more swiftly through 2020, due to a muted contribution from oil investments and (probably) decreasing Mainland business investments. No substantial NoBa impact

# Growth ex. electricity production & primary sectors at 0.6% in Q3

'Core' GDP growth has been unusually stable since end of 2016, at 0.5-0.8%




- Weather conditions affect the Norwegian economy in many ways, primary & electricity production are particularly exposed
- Increased production of electricity, agriculture and fishing boosted growth by 0.1 pp, barring these sectors; Mainland GDP ex these sectors rose 0.6% q/q, as in Q2
  - » Electricity production rose 4.6 q/q, aquaculture & fishing up 2.4%, while agriculture & forestry fell 2.1% q/q
- Since end of 2016, when the Norwegian economy entered the post oil downturn recovery, the 'core' quarterly growth rates have been among the more stable we have ever seen. The coming quarters, we expect a slowdown

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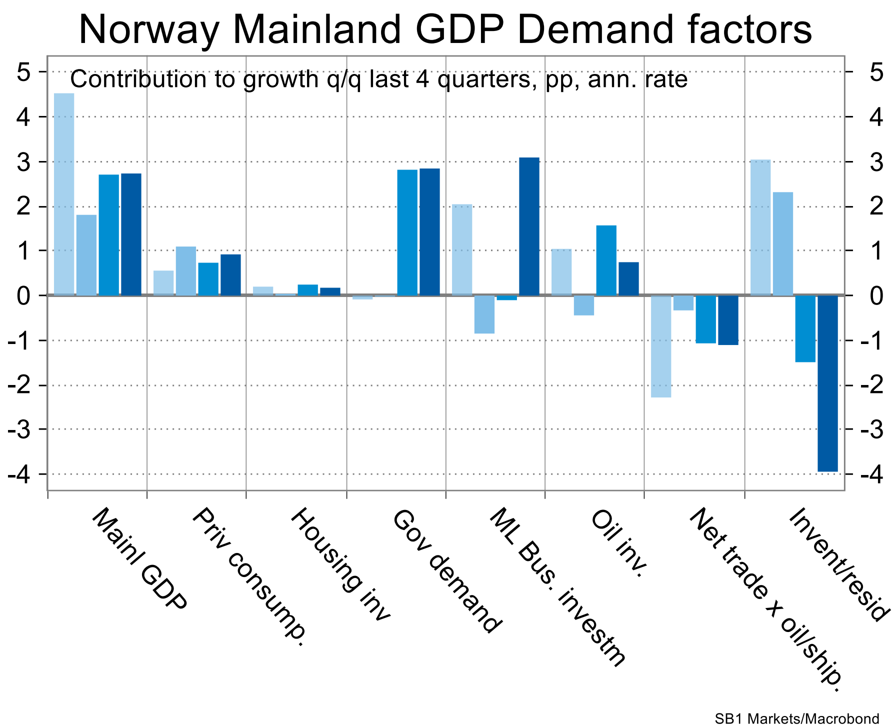
# GDP expenditure components solid in Q3 – but point to softer outlook

Mainland business investments were the major growth engine, oil investments rose less than exp.




- **Private consumption** rose modestly in Q3, up 0.4% q/q, slightly weaker than we expected. The growth contribution has been rather steady recent quarters. No reason to expect any acceleration
- **Housing investments** increased softly in Q3, up 0.7%, as investments have turned slowly up from the 2018 trough. However, our take is that the upside is limited
- **Mainland business investments** soared 7.2%, close to our estimate. Still, we expect a rapid setback the coming quarters – as manufacturing and electricity investments most likely will subside
- **Oil investments** increased by 3.2%, a more restrained contribution than expected. If the oil companies' 2019 investment f'cast is accurate, an uptick in Q4 is likely. In 2020, we expect investments to ease. A crucial growth engine will most likely subside the coming year
- **Government demand** spiked 6.8%, much more than expected, partly due to purchases of military aircrafts (which is offset by higher imports)
- **Net exports** declined, as total imports rose while exports fell. Measured in 'traditional' goods, x oil, ships etc, both imports and exports fell (imports the most)
- **Inventories** fell sharply, probably mostly due to the lift in Mainland business investments, possibly also due the high public investments

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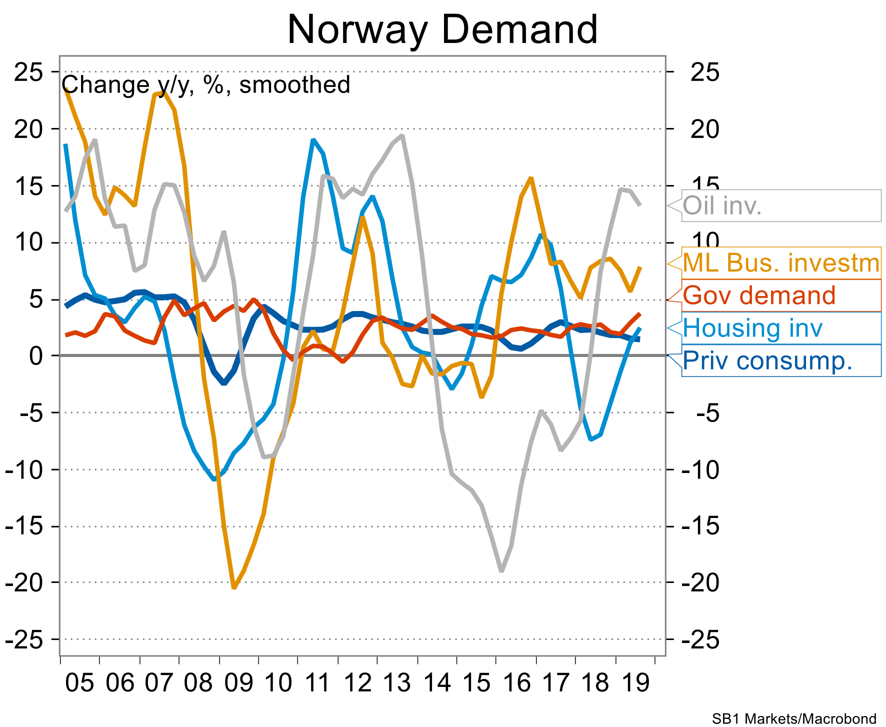
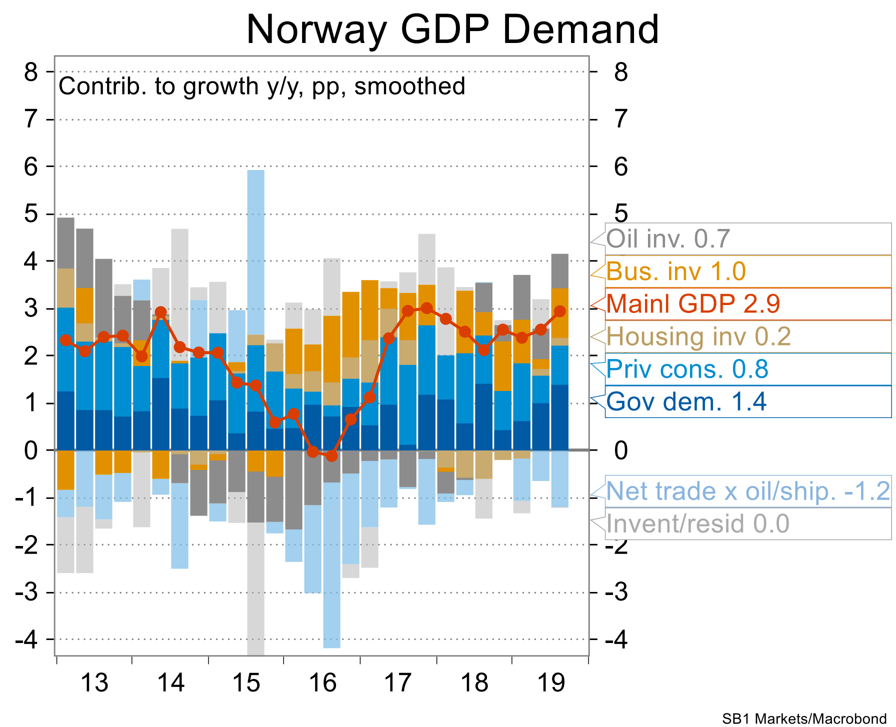
# The big picture: Oil investment are peaking, this time not offset by housing?

## Consumption is slowly softening, housing has turned up, and government demand. Limited upside

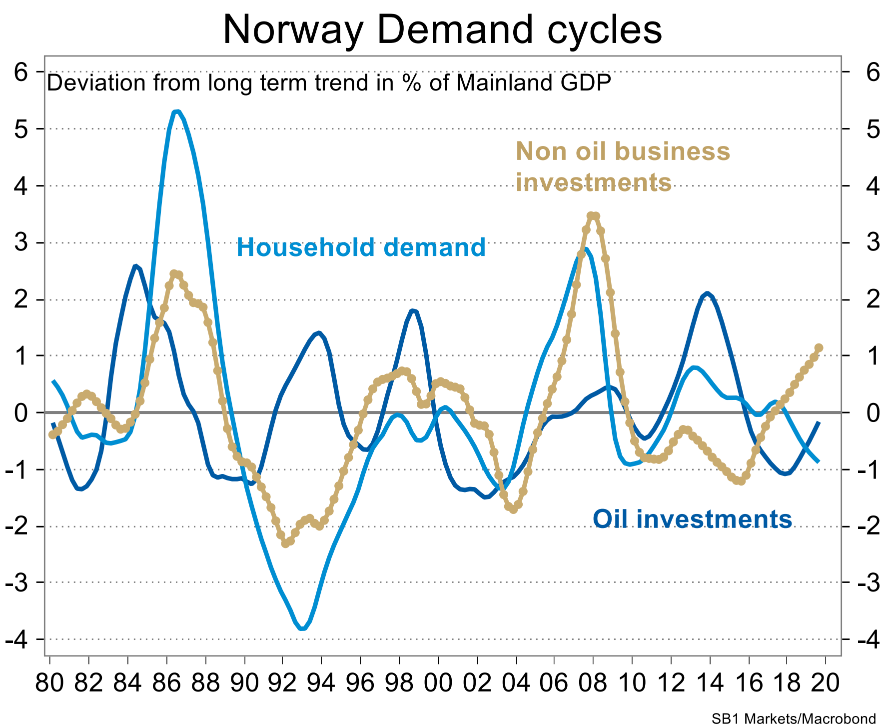


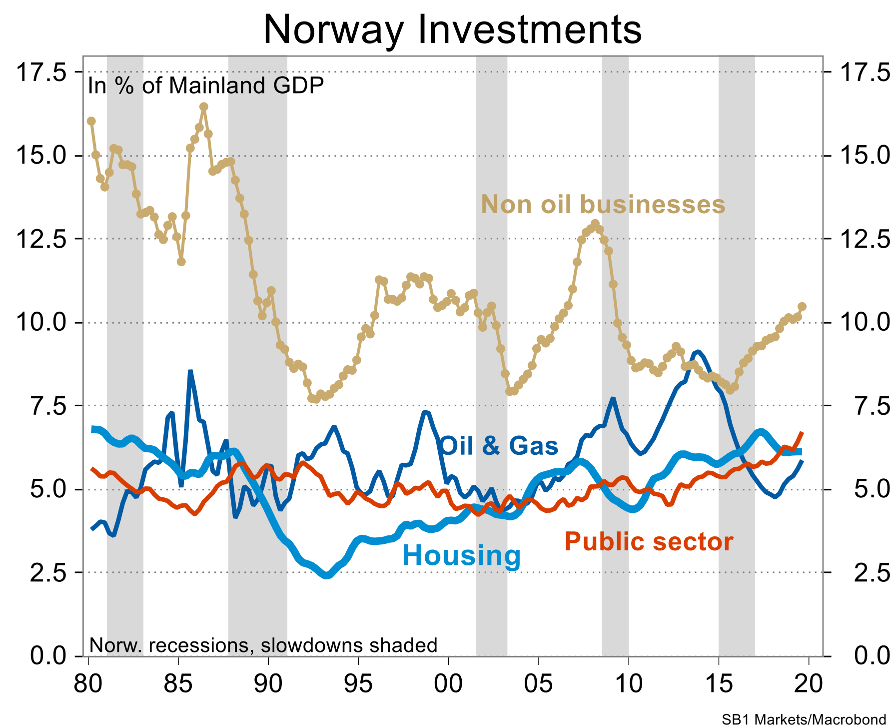




- Mainland business investments accelerated in Q3, up 7.9% y/y (smoothed). However, the trend is not much more than flat since 2017 and we expect a slowdown the coming quarters
- Oil investments have been soaring but are probably peaking now. Annual growth eased to 13% y/y. More on the outlook here
- Housing investments are back to a decent pace, after the 2017/2018 setback. Limited upside, housing starts are slowing

# Household demand slows, mainland business and oil investments close to peak?

Growth will most likely slow the coming quarters/years as the 'heavy lifters' will pull back

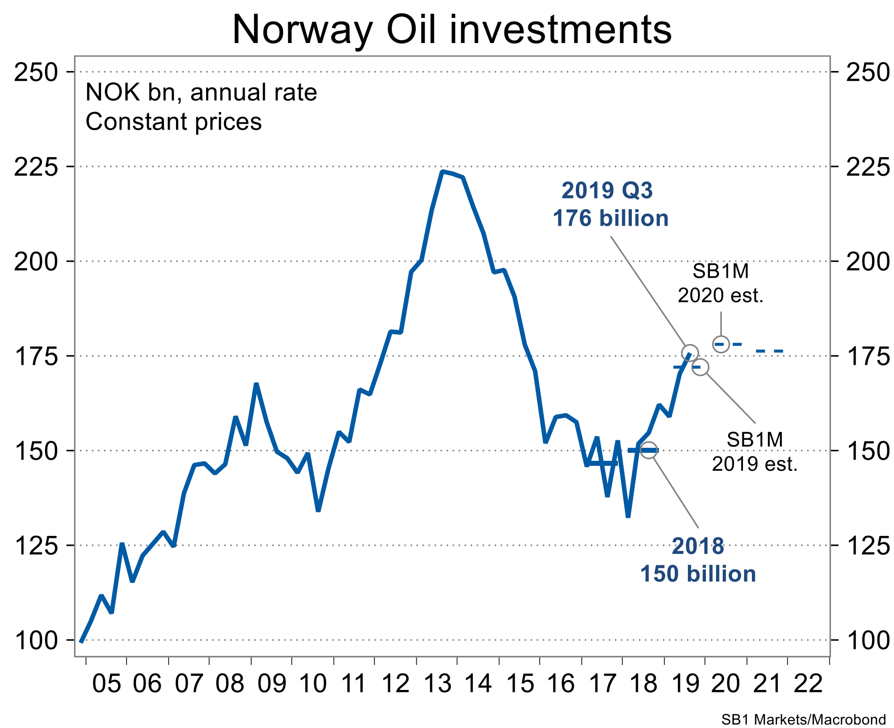


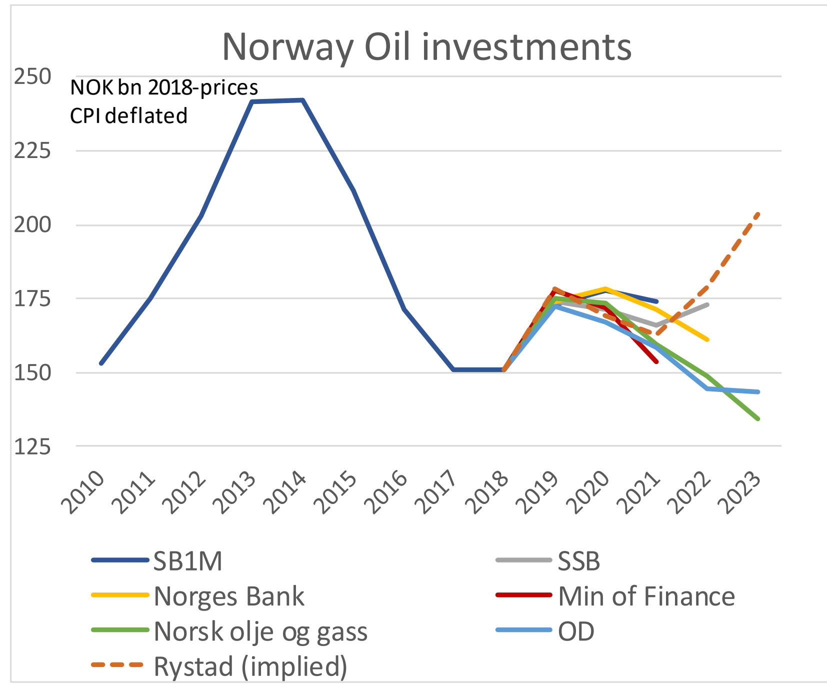




- Both manufacturing and power supply are reporting declining investments in 2020, according to SSB surveys
- Housing investments are at high level vs GDP but is not increasing anymore (flat, following the '17/18 mild setback)

# Oil investments: Somewhat more left for Q4 – but nothing thereafter?

Unless oil companies' 2020 f'casts are lifted considerably, investments will have to fall through 2020

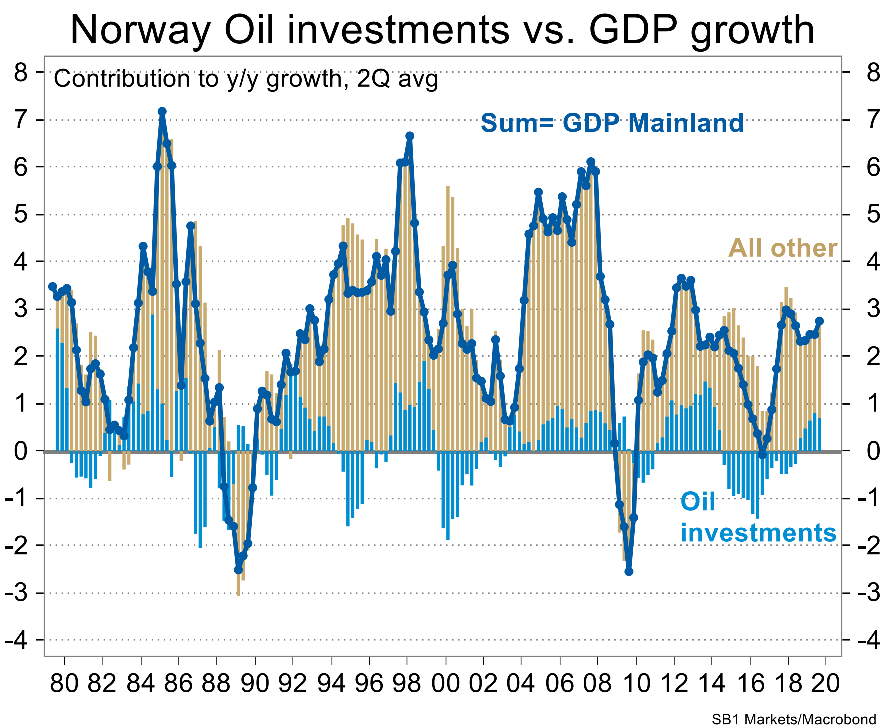



- Oil investments increased by 3.2% q/q in Q3, to NOK 176 bn (measured in constant prices). The investment level in Q3 is 2% above our 2019 f'cast, yet the level have to increase by some 4% in order to reach the annual forecast.
- In 2020, investments will most likely subside (unless the companies nudge up their 2020 f'cast substantially) **Hence, after 2019, the growth boost from oil investments will most likely subside**
  - » No doubt, the oil price will influence the investment level from 2021 onwards, as more projects may be added

# The 'oil boom' was not that large – but has given a decent GDP support

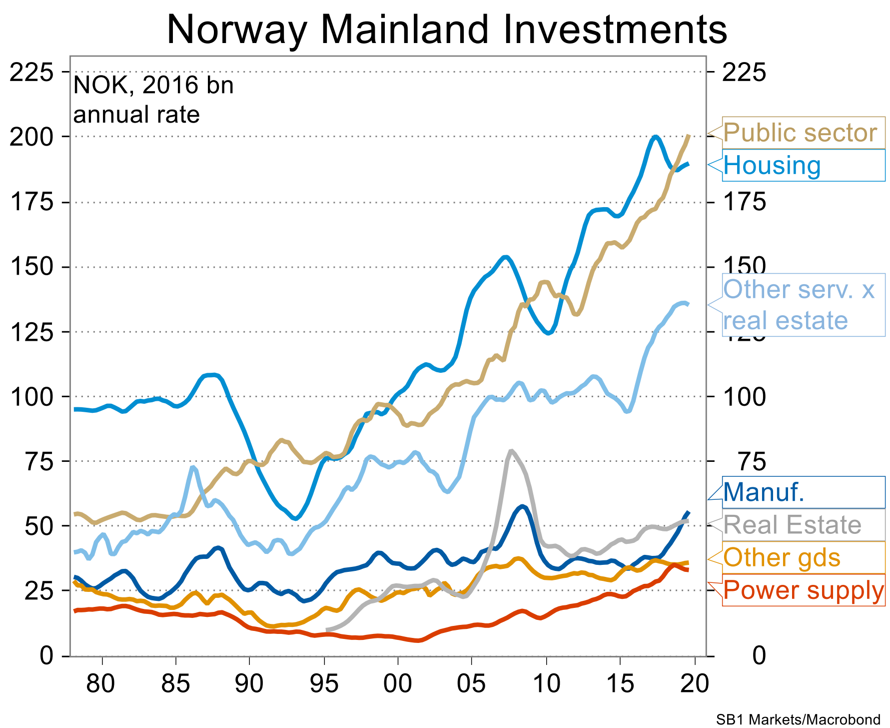
The contribution will rapidly decline towards zero the coming quarters, from some 0.7 pp now




- The contribution on the chart is not adjusted for direct and indirect import to oil sector investments – the net impact is less than the gross contribution

# Public investments straight up, private services have been soaring

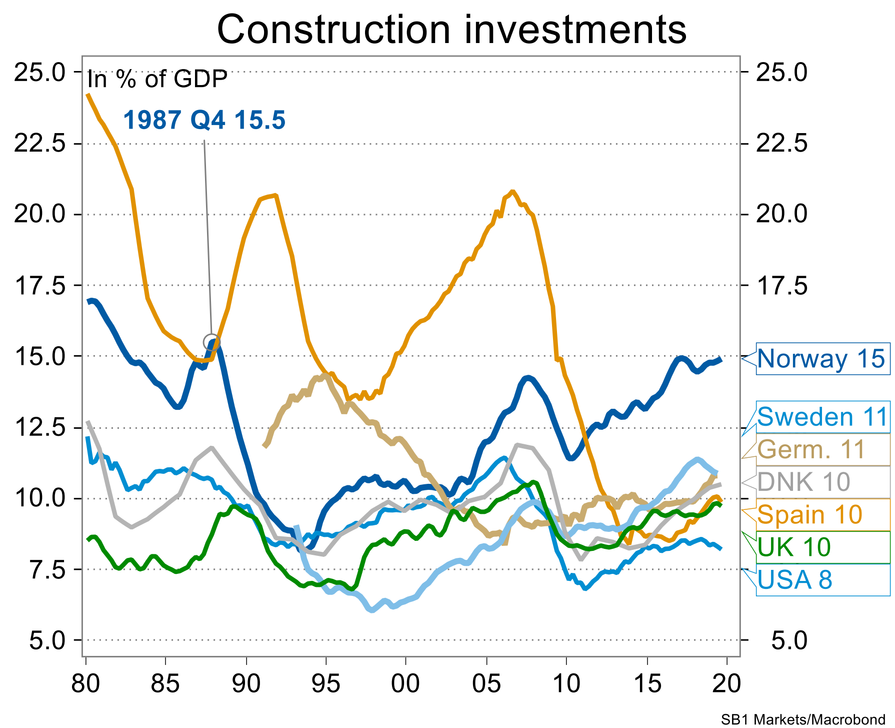
## Housing investments have stabilised after the downturn. Manufacturing soon peaking

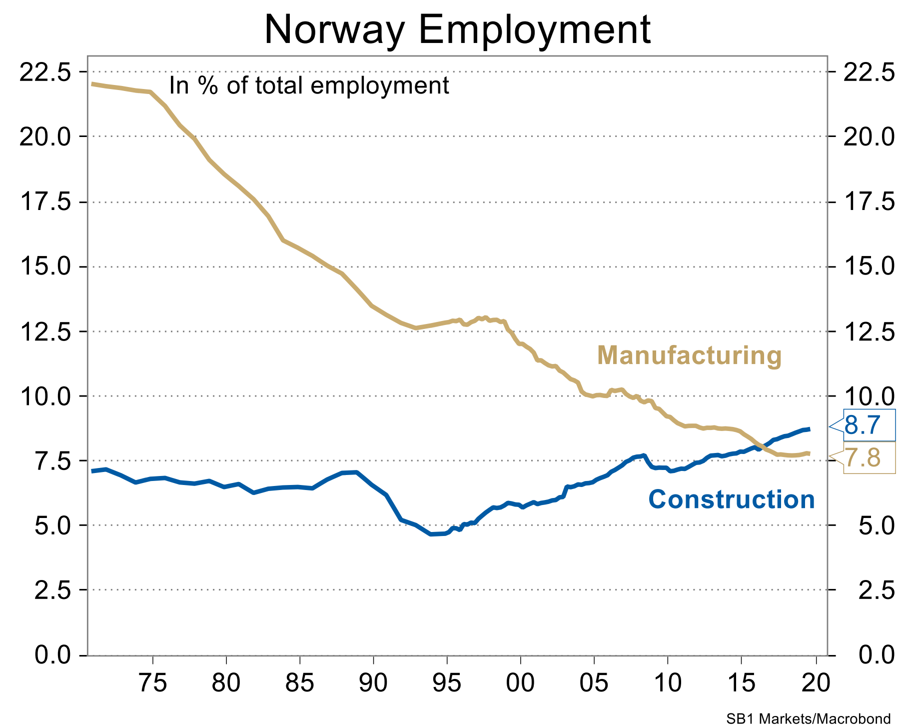



- Private services investments soared in 2016-2017, flattening out recent quarters – and is probably well above a reasonable long term level
- Manufacturing investments are still on the way up, but SSBs investment survey indicates a steep decline the next  year
- Investments in power supply peaked in early 2019, and is now heading down – and will continue down next year, according to the investment survey for this sector
- Real estate is slowly increasing (at a slower pace)
- Public sector investments are soaring, and not only due to new fighters to Air Force

# Construction investments on the way up, the level is very high

## We are quite confident: Construction activity is higher than needed, long term

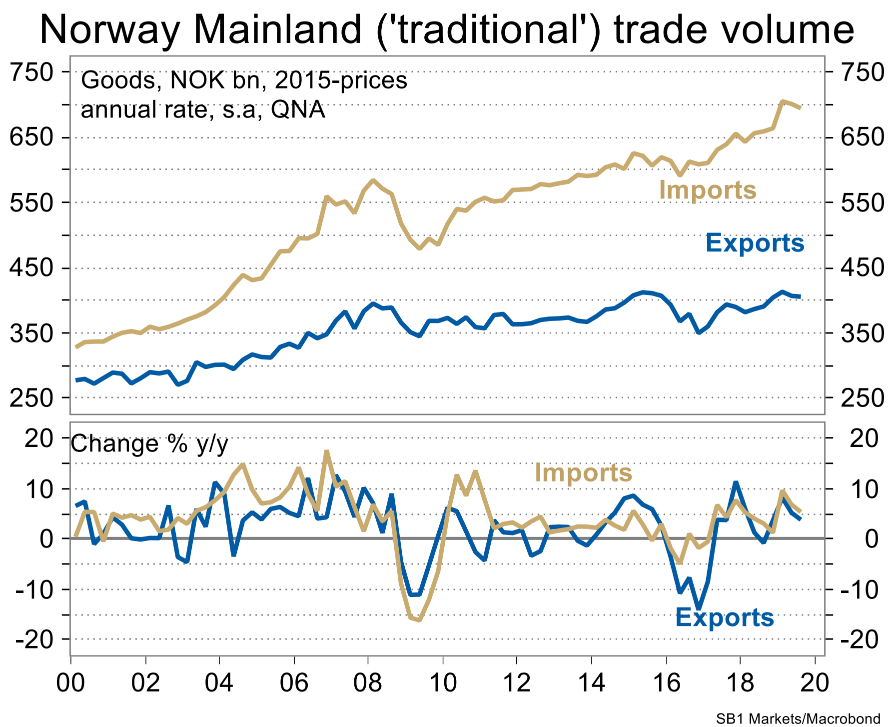


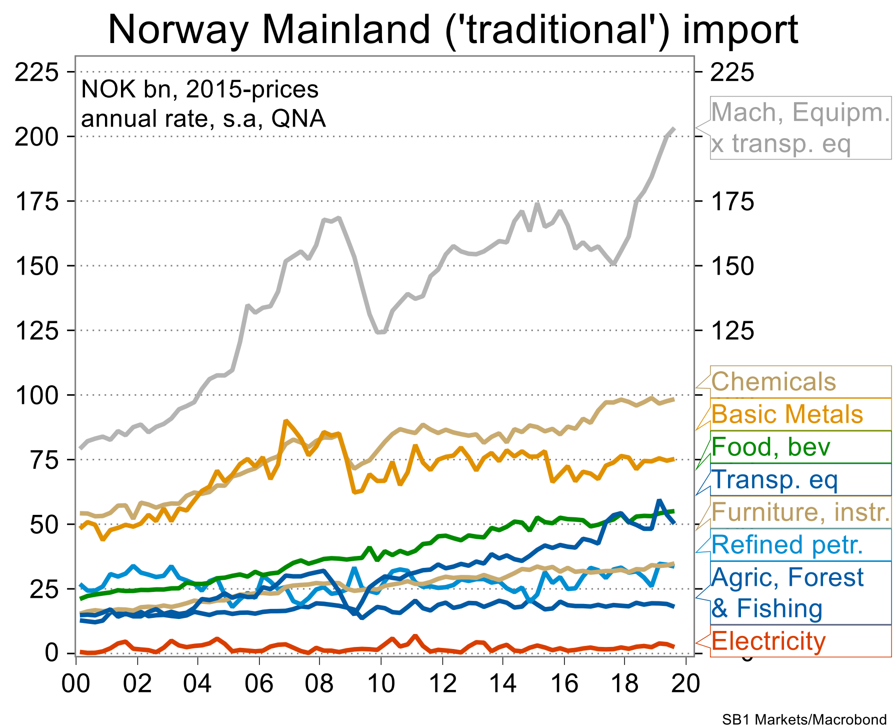




- Construction investments/GDP is climbing, and is back at the same level as in 2017
  - » We could have added the long term (assumed permanent) income from the Petroleum fund to GDP (in order to measure construction demand vs income), but the ratio would still have been very high, and much higher than in other countries
- Construction employment now equals 8.7% of total employment, much higher than anytime before
  - » Construction is larger than manufacturing industries, employment wise, probably for the first time in a civilised country (except Spain and Ireland)

# Goods imports (and exports) edged down in Q3, after a steep rise

Imports of machinery/equipment are surging, most other sectors are slowly increasing

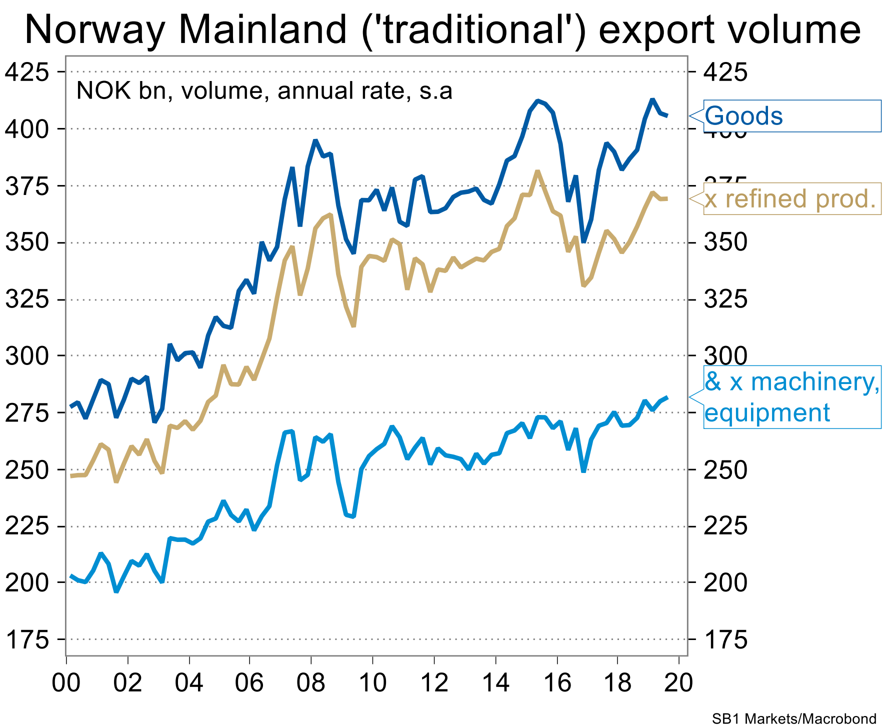


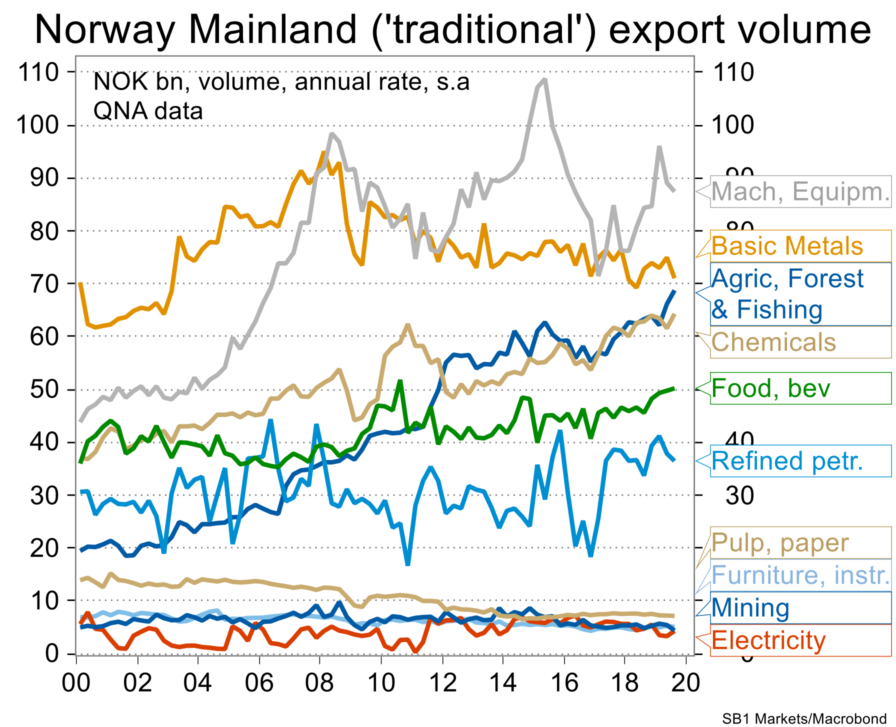




- Higher imports of machinery reflect higher oil investment demand, but also high investments in the manufacturing sector. Still, the level is rather high…

# Mainland good exports turn down, due to oil related goods

## Goods x oil related are still trending up, lifted by fish exports, food and chemicals

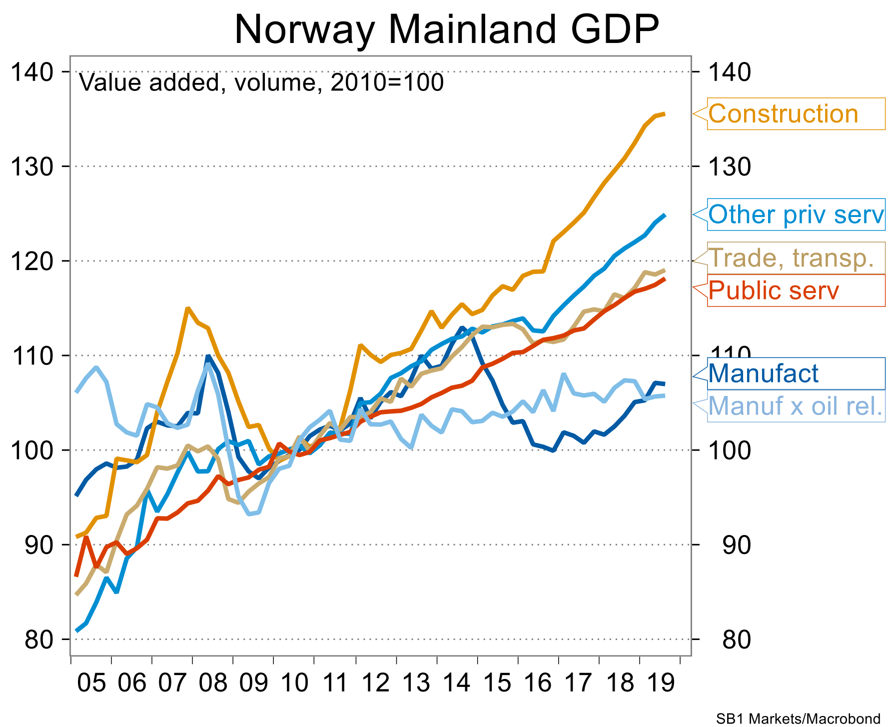


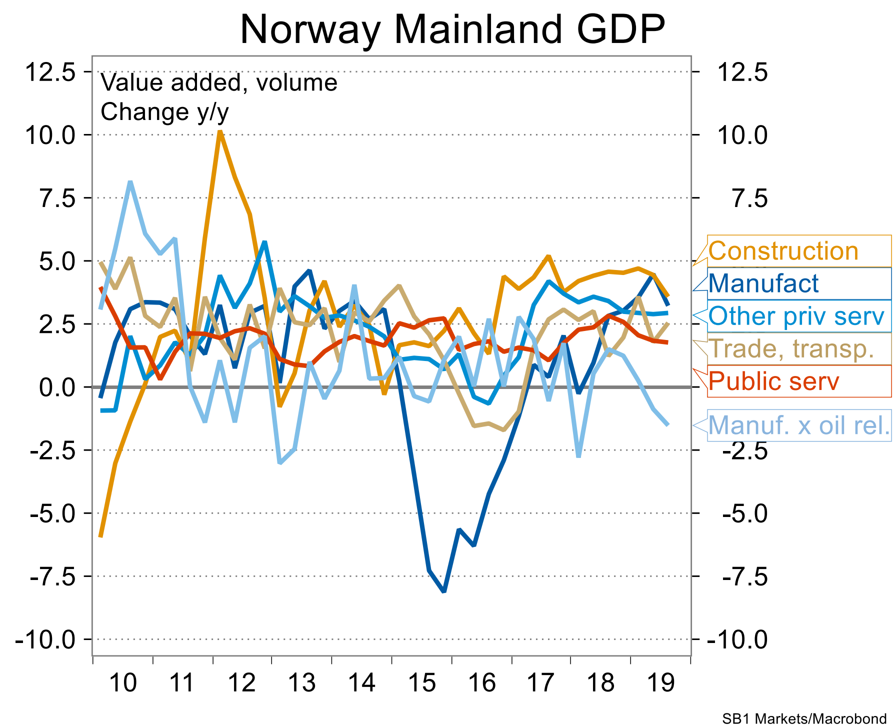




- Total goods exports inched down in Q3, while exports x refined petro. and machinery equipment increased. Exports of both machinery & equipment and refined petroleum are slowing
- Chemicals are steadily trending up, fish exports have been soaring recent quarters (here, in volume terms, not in nominal!). Food exports gaining pace, other sectors not that impressive

# Production: Growth in construction & manuf. may have peaked, services steady

Manufacturing production x oil related is declining. Retail trade, private services grow moderately




- Growth in private services has been hoovering around 3% recent quarters
- Construction production cooled to a 3.6% speed y/y, a deceleration from 4.7% in Q1
- Manufacturing softened in Q3, to 3.2% y/y, after accelerating through 2018 and early 2019, thanks to oil related sectors. Manufacturing x oil related is declining by 1.5%
- Production in retail trade and transport ticked up to a moderate 2.6% speed. Trend marginally down the past 2 years

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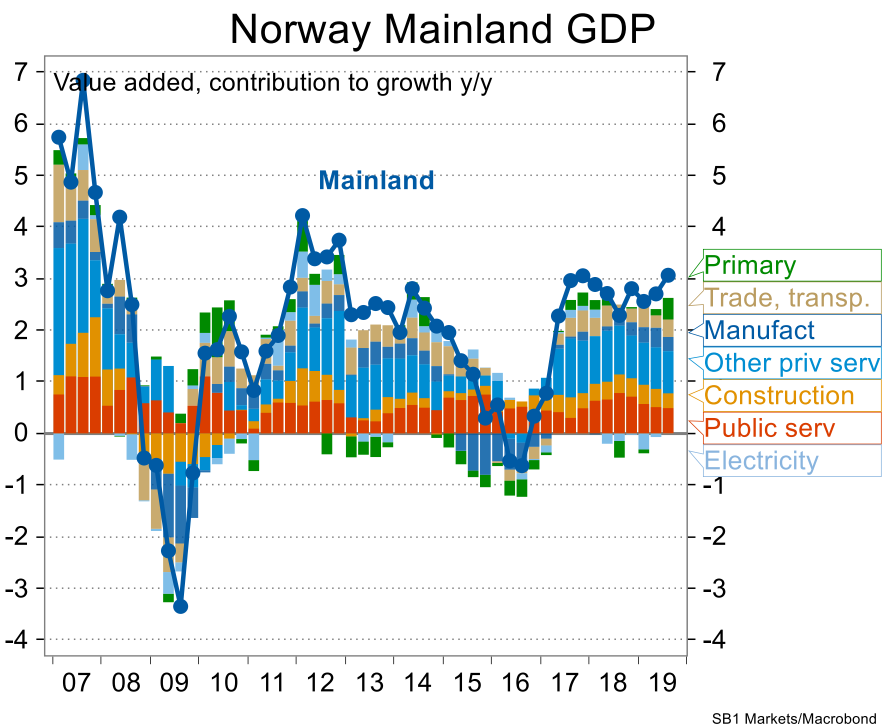
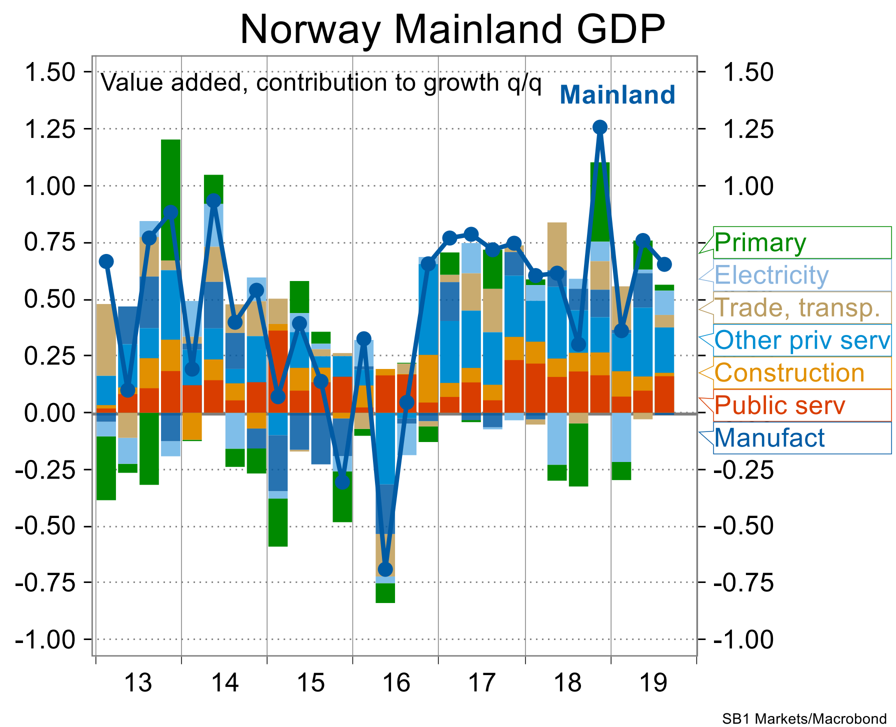
# Production: A broad upswing in Q3, boosted by private & public services

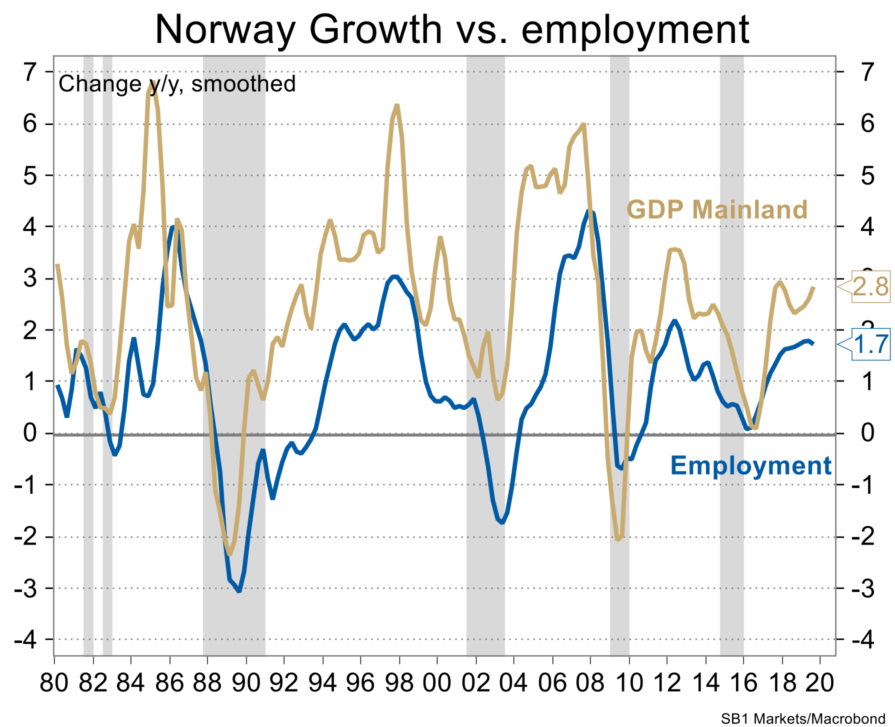
Production expanded in all sectors ex muted manufacturing (and a marginal lift in construction)

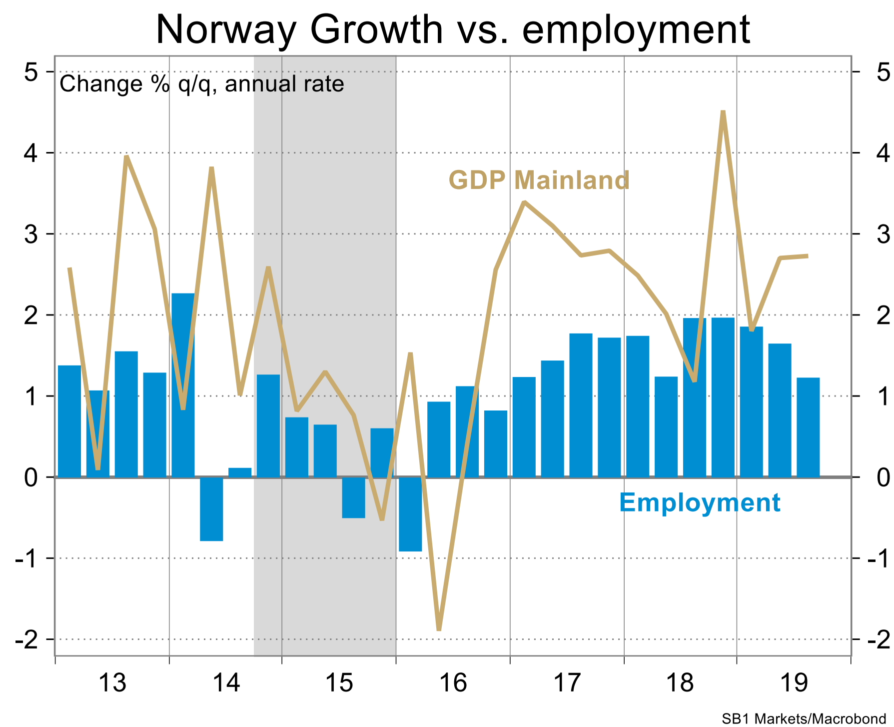


# Employment growth is slowly softening but still solid

## Employment rose 1.2% q/q annualised, the annual rate inched down to 1.7%

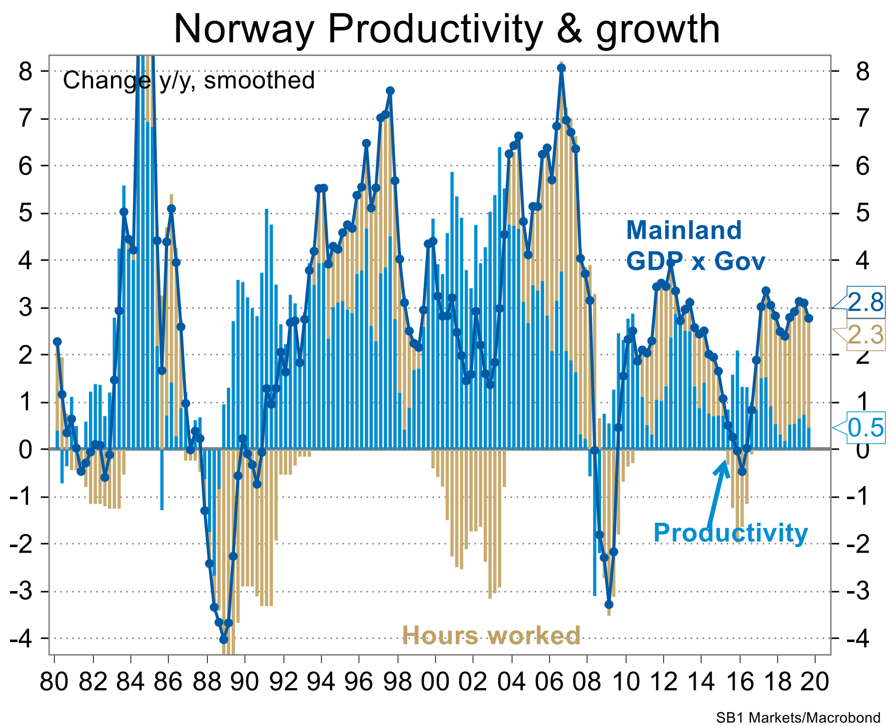


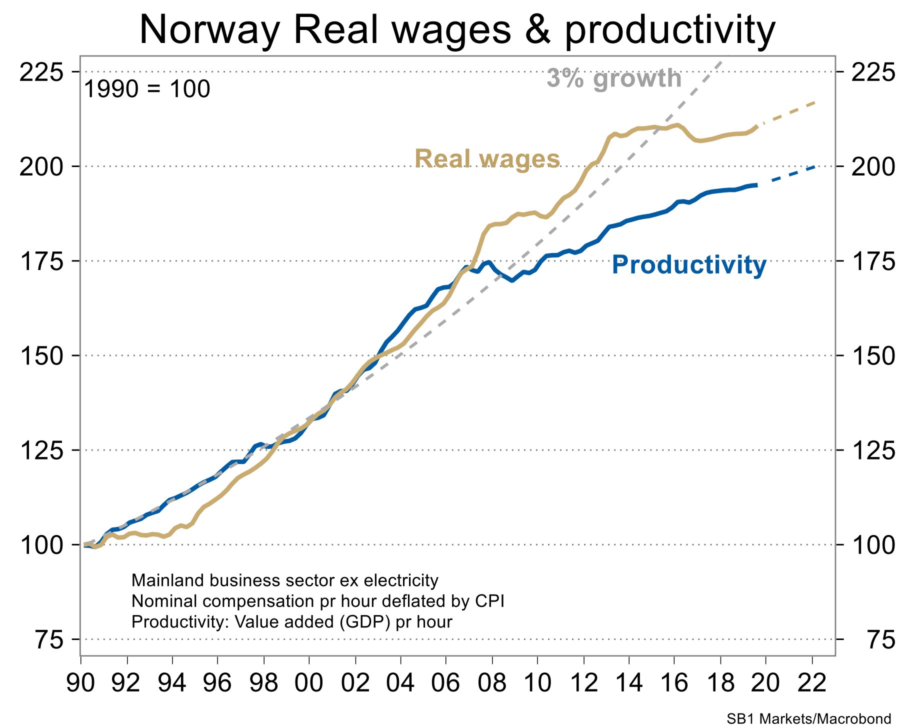




- Employment growth has slowed the past 3 quarters. Still, employment is rising faster than the working age population

# Productivity growth remain lacklustre

Mainland productivity rose 0.9 y/y in Q3, the smoothed rate fell to 0.5%. Real wages up 1.2%

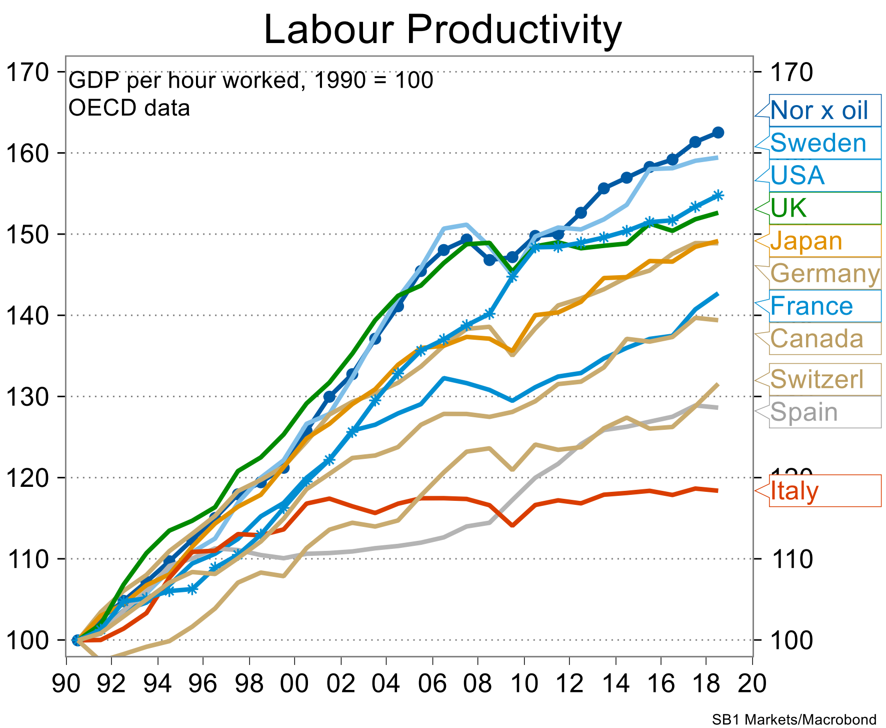


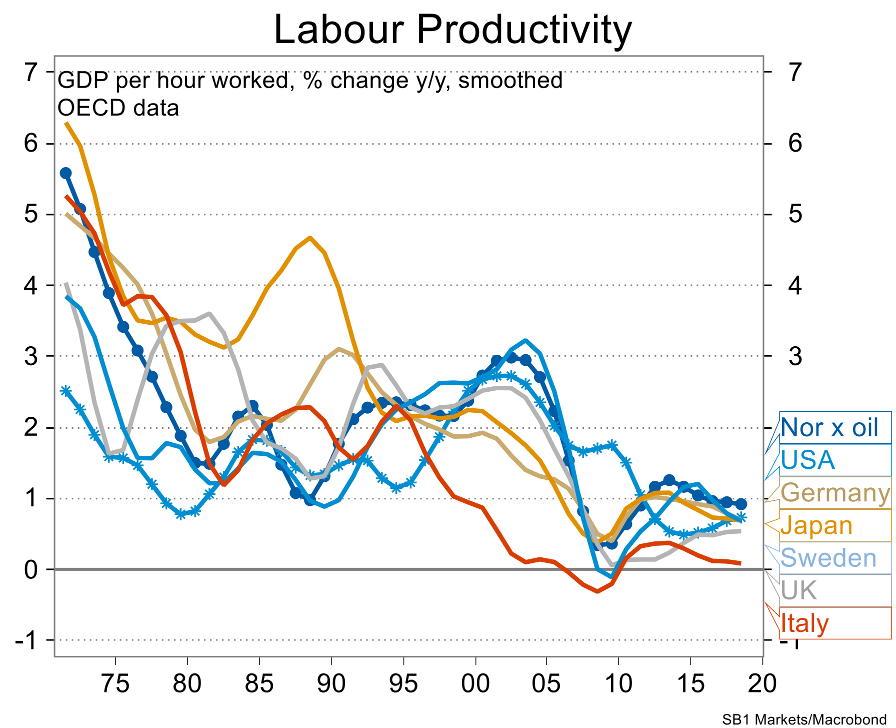




- Underlying productivity growth remains low, at below 1%, and the smoothed rate ticked down in Q3, to 0.5%
- Hours worked explains 2.3 pp of the 2.8% growth in Mainland x government GDP (1 y smoothed)
- Real wages are slowly increasing, following the decline in 2016 but are not higher than 5 years ago
- We expect just modest growth in real wages – as long as the underlying productivity growth is this slow

# No specific Norwegian productivity slowdown

If anything, the opposite

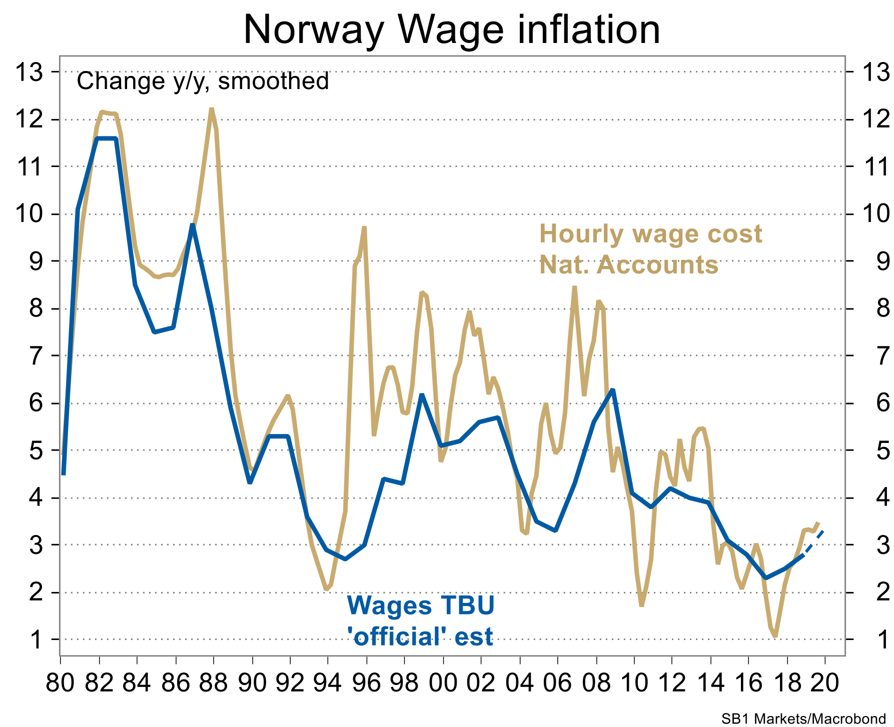


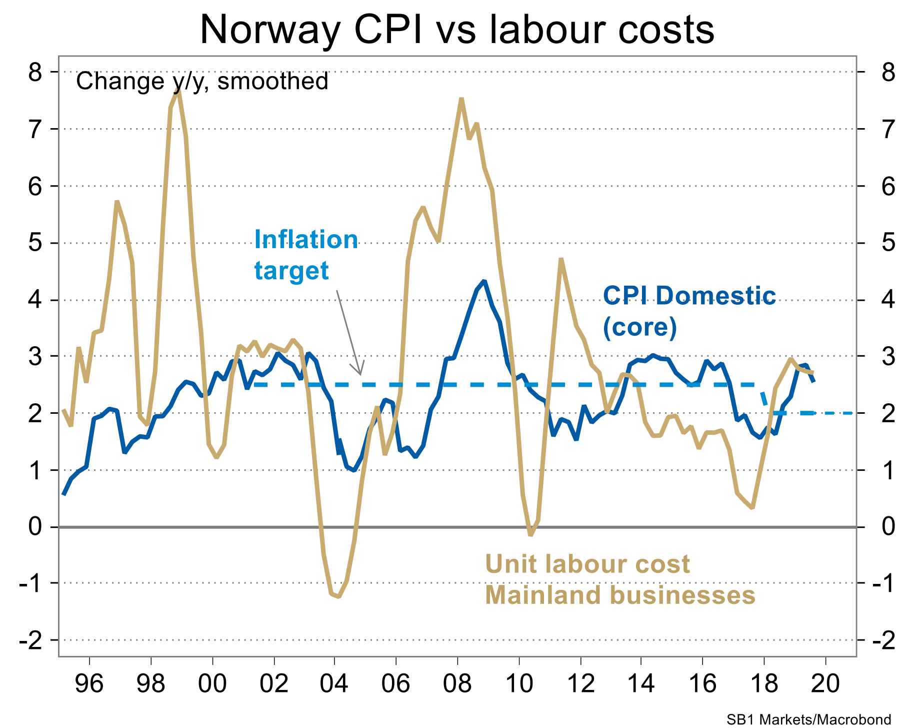




- Annual data compiled by OECD, last year is 2018

# Labour cost inflation on the way up

(Volatile) hourly wage cost rose to 3.5%, up 0.2 pp, unit labour cost inflation at 2.7%+ (smoothed)

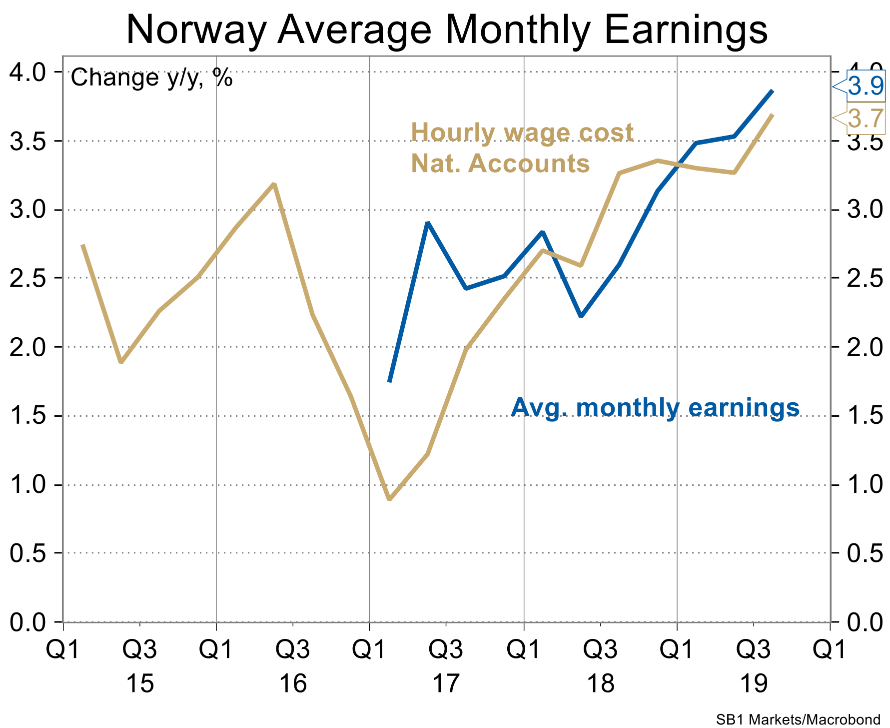


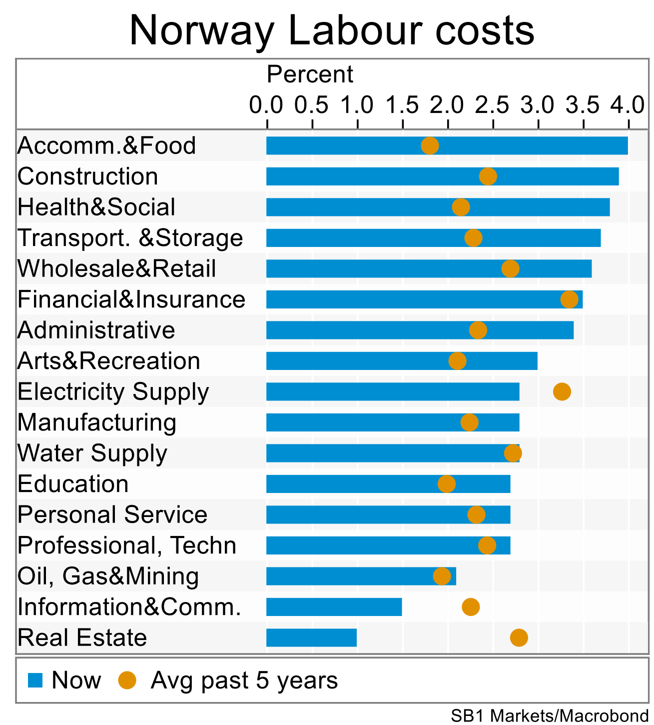




- Hourly wage costs bottomed out in Q2 2017 and are back at the 2014 level, still below ‘normal’ Norwegian wage inflation

# Wage inflation approaching 4%?

SSB reported average wage earnings at 3.9% in Q3, from 3.5% in Q2, just above Nat. Acc.

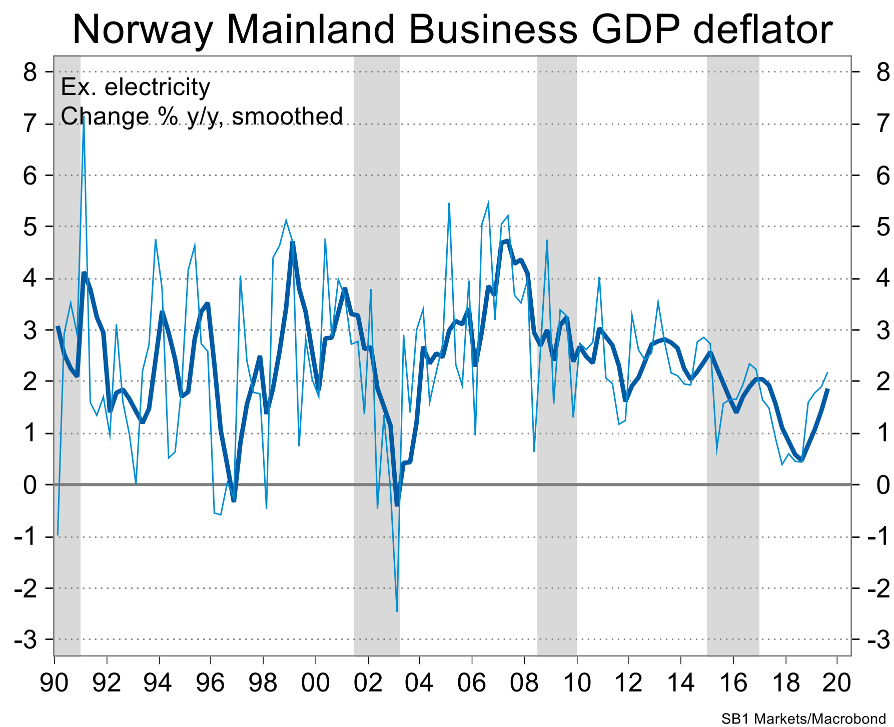


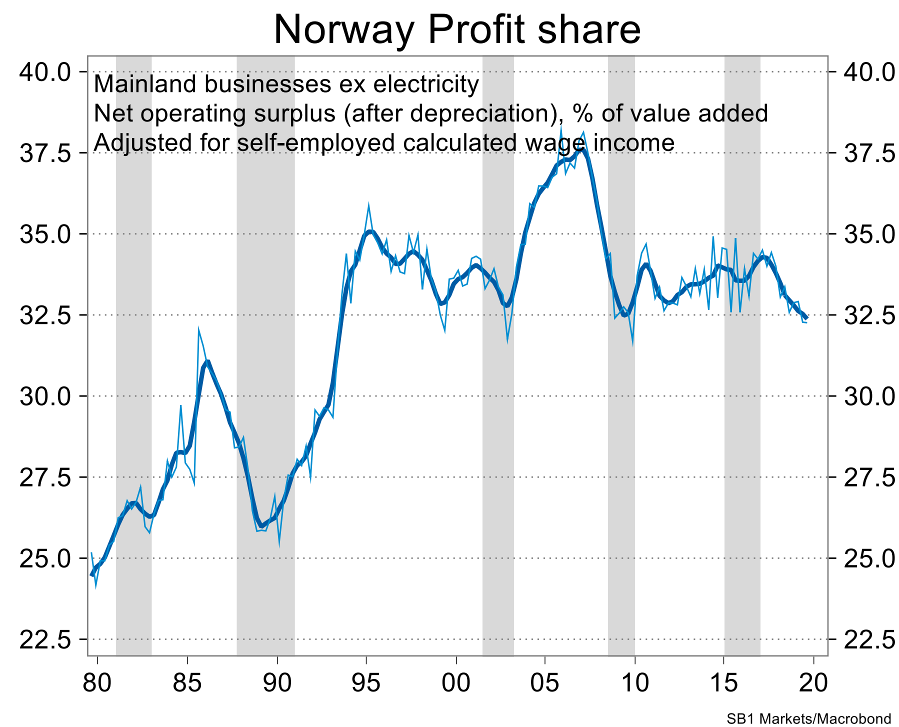




- Monthly earning have accelerated from a 2.6% speed one year ago
  - At the chart above, we have not smoothed the Nat.Acc. Hourly wage cost, as on the previous slide (yielding a 3.5% rate)
- Labour costs are accelerating in most sectors, with accommodation & food in the lead. The data above are from Q2

# The profit share is under pressure, profit rate at 10 y low

## GDP price deflator is growing, although still well below unit labour cost growth

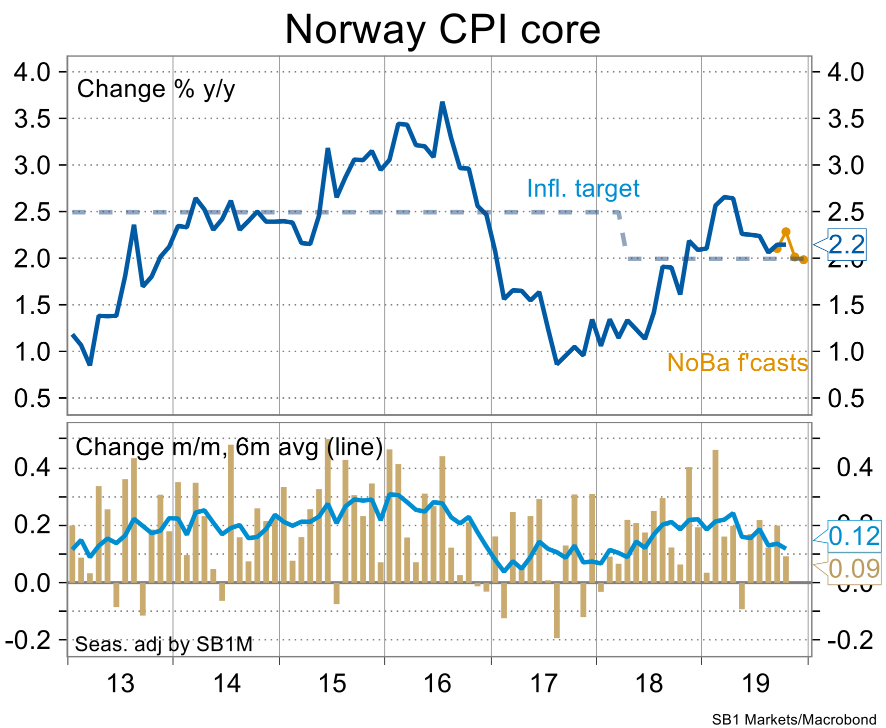



- The Mainland business GDP price deflator (ex the volatile electricity sector) ticked up to 2.2% in Q3. The price deflator is growing modestly compared to the history, but up from 0.5% one year ago
- As prices are rising slower than production costs (unit labour cost), the profit share in Mainland businesses is declining – as has been the case since 2017– and the profit share is probably too low

# Core inflation flat at 2.2% in Oct, a tad weaker than expected

## Core CPI inflation has softened somewhat since the spring. Total inflation rose to 1.8%




- CPI-ATE (ex. energy and taxes) was unchanged at 2.2% y/y in October, 0.1 pp below ours, consensus' and Norges Bank's f'cast
  - CPI-ATE rose just 0.1% m/m (seas adj), just below the 6 m average
  - Declining prices on food and airline tickets dampened inflation this month, while hotels&restaurant prices boosted inflation
  - Imported goods are up just 1% y/y, the NOK depreciating points to somewhat higher imported inflation – but no take off. Domestic goods & serv. up 2.8%, due to wage inflation above 3%, slow productivity growth and capacity to increase prices are demand is not weak
- Total CPI growth ticked up to 1.8%, from 1.5%, close to expectations. Higher electricity prices brought total inflation up this month
- **Implications**
  - Core inflation remains just above the price target and the small deviation from NoBa's projection this month will not be vital towards the December meeting
  - No significant market reaction

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# Airline tickets and food prices were the major drags in October

## Core CPI prices rose just 0.1% m/m, 0.1 pp below our f'cast

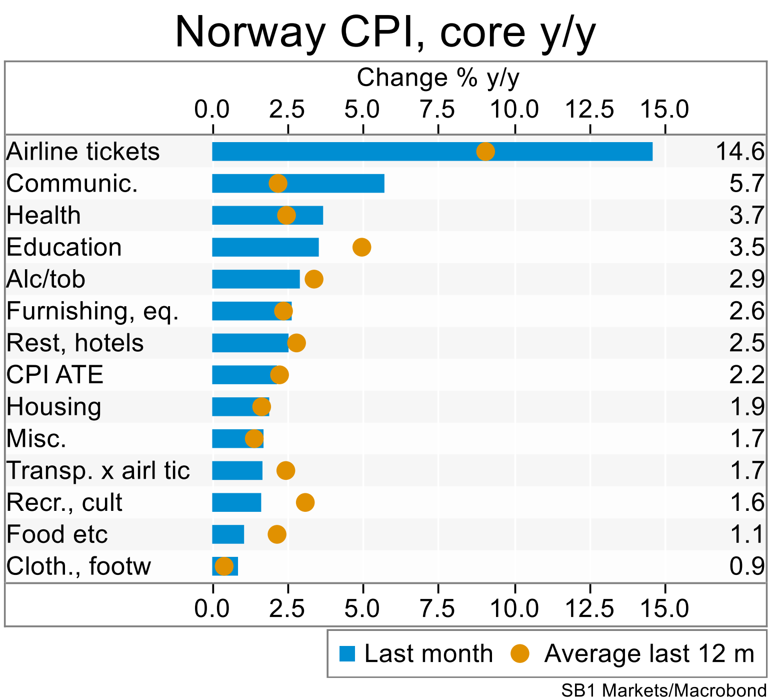
| | | Change m/m, seas. adj | | | Change y/y | | | Contribution, pp | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *Oct-19* | Weight | Out- | SB1M | Dev. | Last | Out- | SB1M | | | Dev. vs |
| CPI ATE | % | come | f'cast | pp | month | come | f'cast | m/m | y/y | f'cast |
| Food, non alc bev | 12.5 | -0.4 | 0.2 | -0.6 | 1.5 | 1.1 | 2.0 | -0.04 | 0.13 | -0.07 |
| Alcohol, tobacco | 3.9 | 0.3 | 0.2 | 0.1 | 2.7 | 2.9 | 2.8 | 0.01 | 0.11 | 0.00 |
| Clothing, footwear | 4.9 | -0.2 | 0.0 | -0.2 | 1.2 | 0.9 | 1.0 | -0.01 | 0.04 | -0.01 |
| Housing x. energy | 20.1 | 0.2 | 0.2 | 0.0 | 1.8 | 1.9 | 1.8 | 0.04 | 0.38 | 0.01 |
| Furnishing | 6.6 | -0.2 | 0.0 | -0.2 | 2.6 | 2.6 | 2.8 | -0.01 | 0.17 | -0.01 |
| Health | 3.2 | 0.1 | 0.2 | -0.1 | 3.8 | 3.7 | 3.8 | 0.00 | 0.12 | -0.00 |
| Transp. ex. gas, airl. tick | 12.0 | 0.1 | 0.2 | -0.1 | 2.0 | 1.8 | 1.9 | 0.01 | 0.21 | -0.01 |
| Airline tickets | 1.2 | -7.3 | 0.2 | -7.5 | 25.5 | 14.6 | 27.0 | -0.08 | 0.17 | -0.09 |
| Communication | 2.2 | 2.6 | 0.3 | 2.3 | 3.1 | 5.7 | 3.3 | 0.06 | 0.13 | 0.05 |
| Recreation, culture | 11.9 | -0.1 | 0.2 | -0.3 | 1.8 | 1.6 | 2.0 | -0.01 | 0.19 | -0.03 |
| Education | 0.5 | - | - | - | 3.5 | 3.5 | 3.5 | | 0.02 | 0.00 |
| Restaurants, hotels | 6.2 | 1.2 | 0.2 | 1.0 | 1.4 | 2.5 | 1.6 | 0.07 | 0.16 | 0.06 |
| Other | 8.8 | 0.4 | 0.1 | 0.3 | 1.3 | 1.7 | 1.4 | 0.03 | 0.15 | 0.02 |
| **CPI-ATE** | 94 | **0.1** | **0.2** | -0.1 | **2.2** | **2.2** | **2.3** | | | |
| *Norges Bank est.* | | | *0.2* | | *2.1* | | *2.3* | | | |
| Imported | 33 | -0.1 | 0.1 | -0.2 | 1.2 | 1.0 | 1.2 | -0.04 | 0.31 | -0.06 |
| Domestic | 61 | 0.2 | 0.2 | 0.0 | 2.7 | 2.8 | 2.3 | 0.13 | 1.71 | 0.01 |
| Energy, housing | 4 | 4.7 | 5.0 | -0.3 | -12.0 | -3.6 | -1.8 | 0.18 | -0.14 | -0.01 |
| Energy, transport | 4 | -0.4 | 0.0 | -0.4 | -2.1 | -2.9 | -2.6 | -0.01 | -0.10 | -0.01 |
| **CPI Total** | 101 | **0.2** | **0.3** | -0.2 | **1.5** | **1.8** | **1.9** | 0.18 | 1.85 | -0.16 |

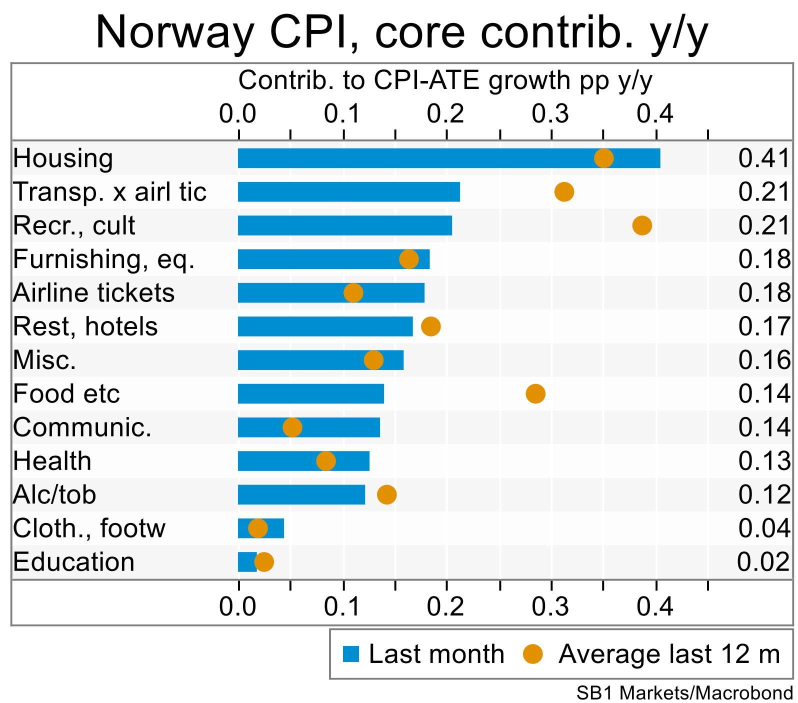
- Food prices fell 0.4% m/m, we expected a small uptick
- Airline ticket prices are ridicolously volatile. This time prices slipped 7.3%, deducting 8 bps on the monthly rate
- **CPI-ATE up 0.1% m/m and 2.2% y/y, 0.1 pp below ours and consensus' forecasts**
- Imported prices are increasing much less than domestic, up just 1% y/y vs domestic at 2.8%
- Electricity prices rose 4.7% m/m (we expected 5%) but still falling 3.6% y/y
- Headline inflation rose to 1.8%, we assumed 1.9% (consensus 1.8%)

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

# Housing and transport are boosting core annual inflation

Prices are increasing in all sectors; housing, transport and recreation the major contributions

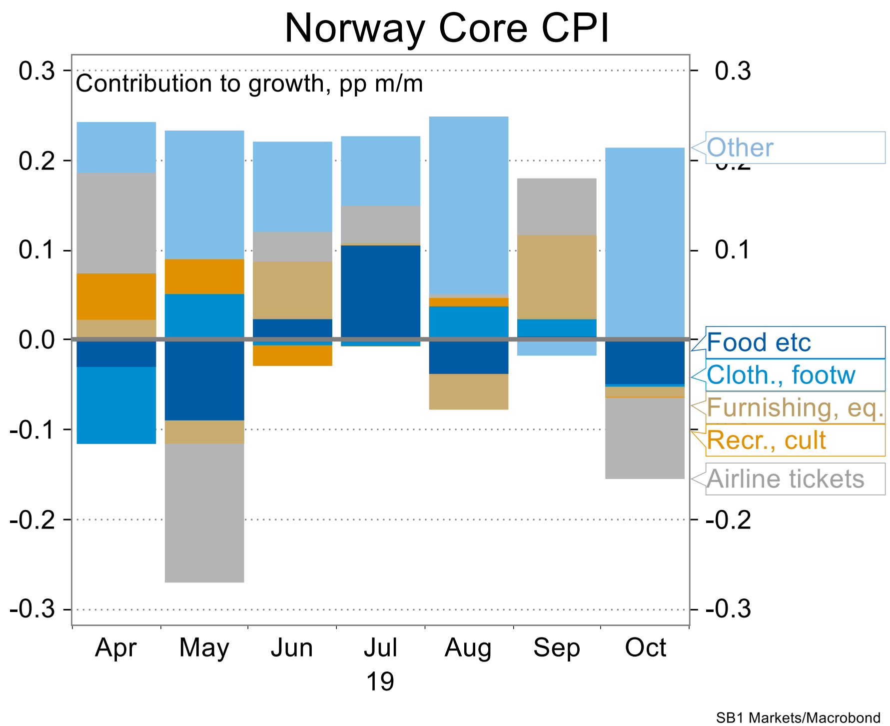


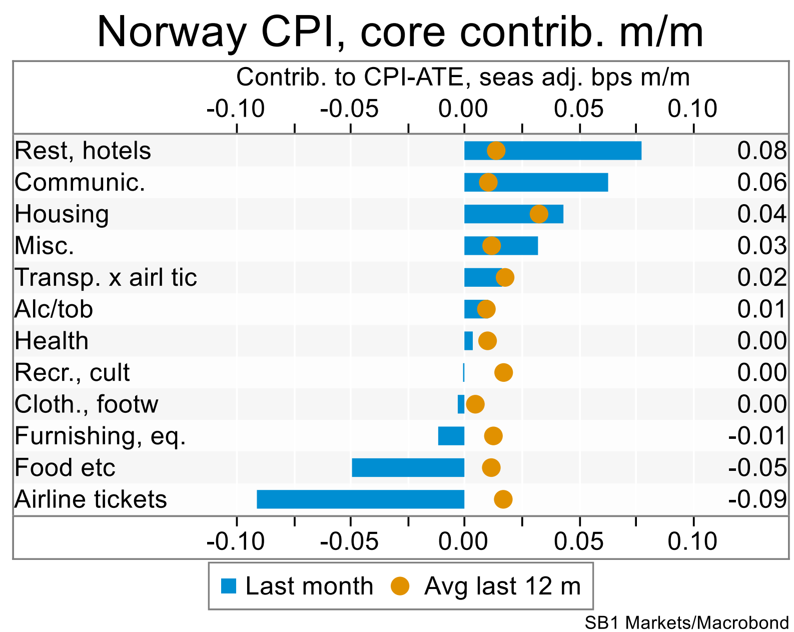




- Airline tickets are up 14.6% y/y, which gives a 0.2 pp contribution on the annual rate. Housing (rent etc) contributes the most, by 0.4 pp

# Food and airline tickets surprised on the downside

Higher prices on hotels & restaurants and telecomm. lifted monthly inflation

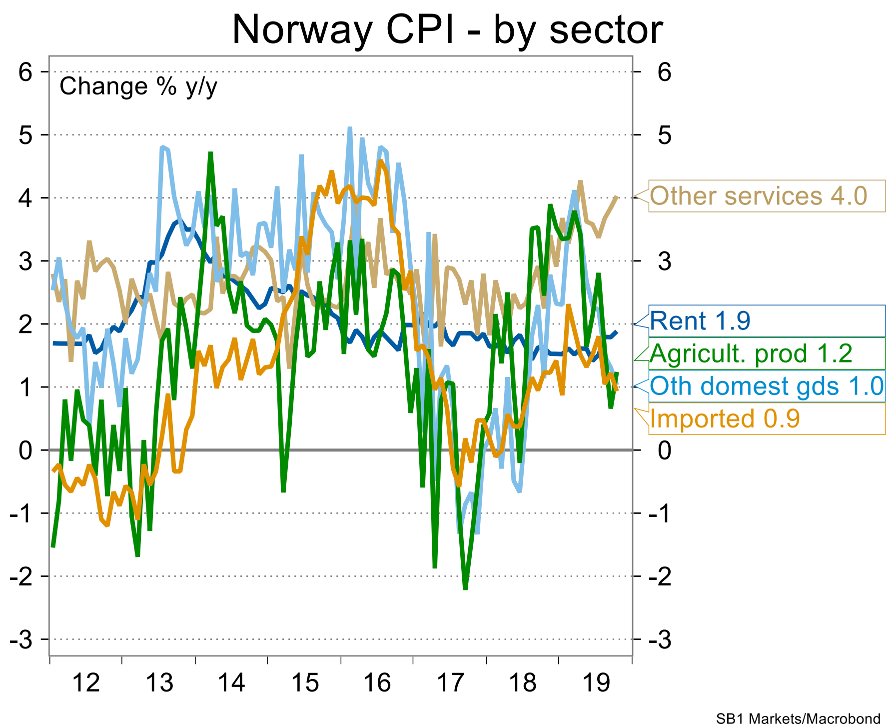


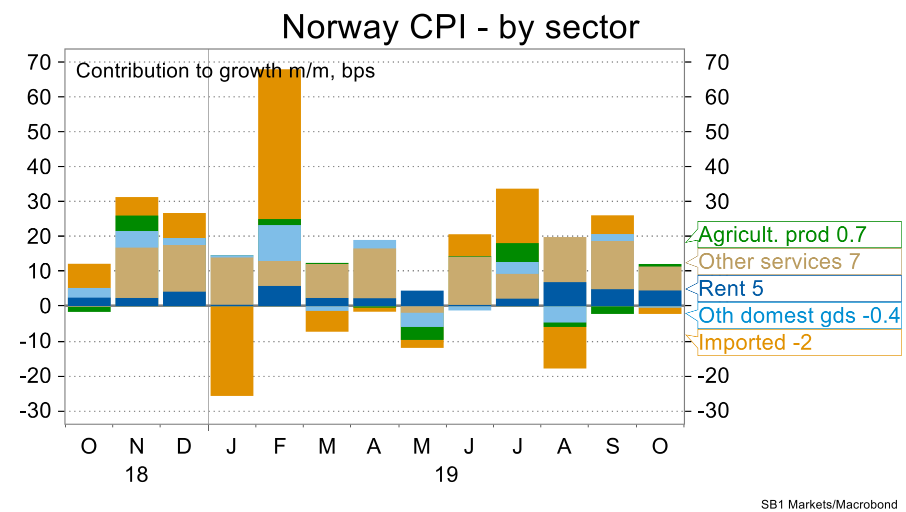



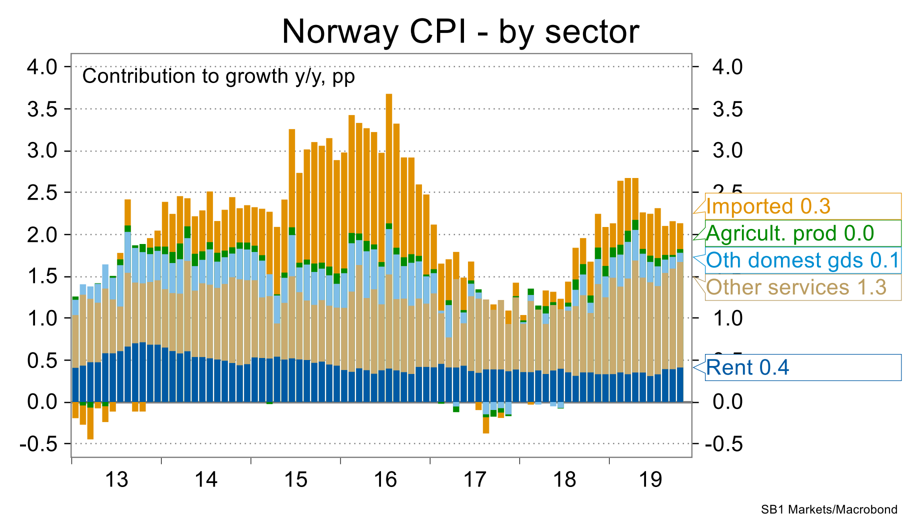

- Prices rose in 7 sectors in October, declined in 4

# Modest price growth on imported goods, domestic services are soaring at 4%

Domestic services (culture, travelling etc) are boosting core inflation, domestic goods are slowing



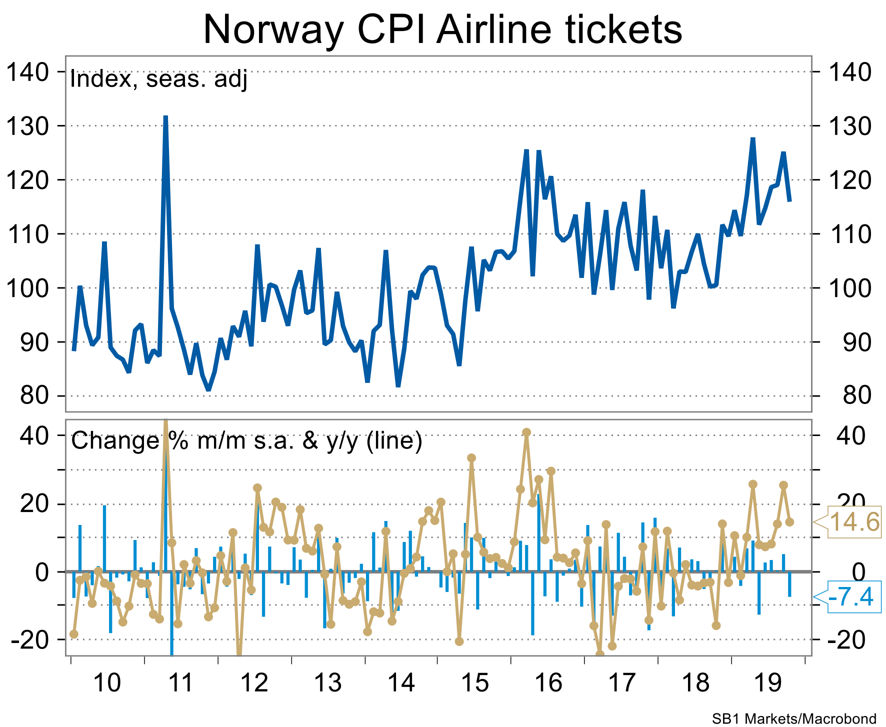



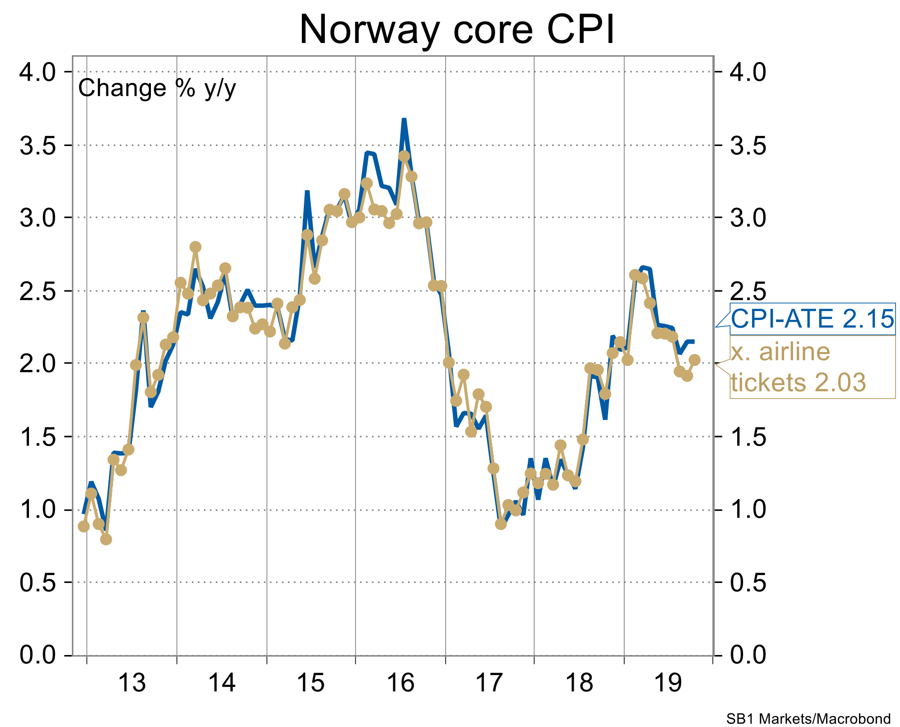




- Price growth in services are up 4% y/y. Other domestic goods and imported goods have slowed, after accelerating the past year. Rent inflation has picked up the past months, to 1.9% y/y
- The NOK depreciation has lifted import prices but the impact has been modest, we expect somewhat more

# Volatile airline tickets prices down in Oct, still up close to 15% y/y

## Airline ticket prices fell 7.4% m/m in Oct – still lifting core annual inflation by 0.12 pp



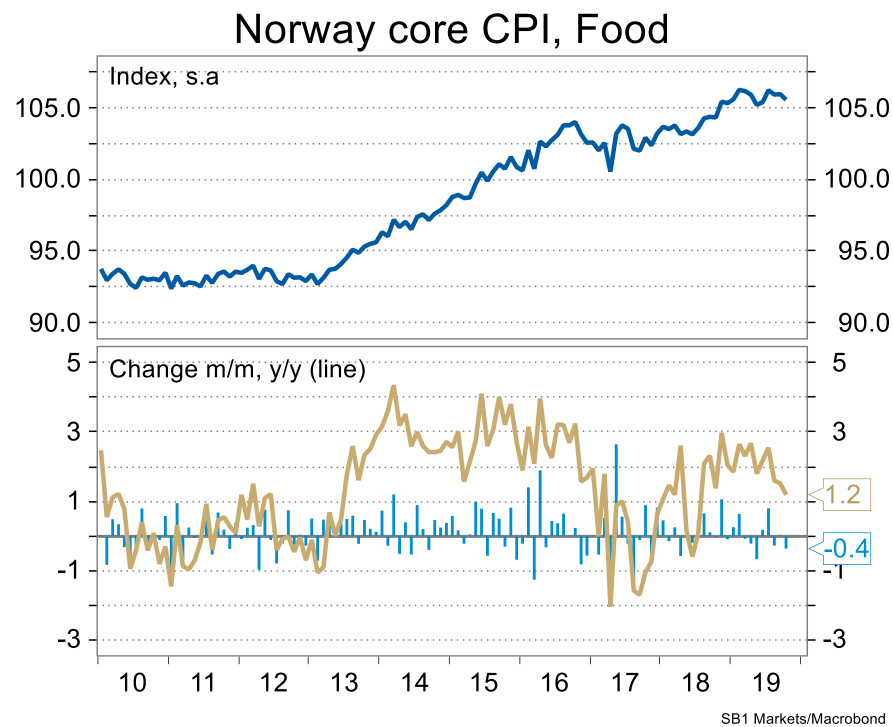



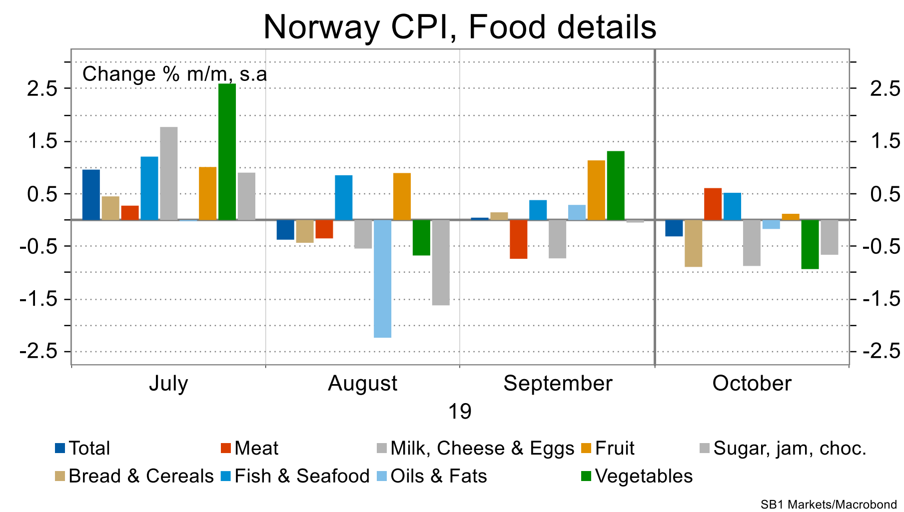

- Airline ticket prices fell 7.4% m/m (seasonally adjusted), up 14.6% y/y
  - » These data are very volatile

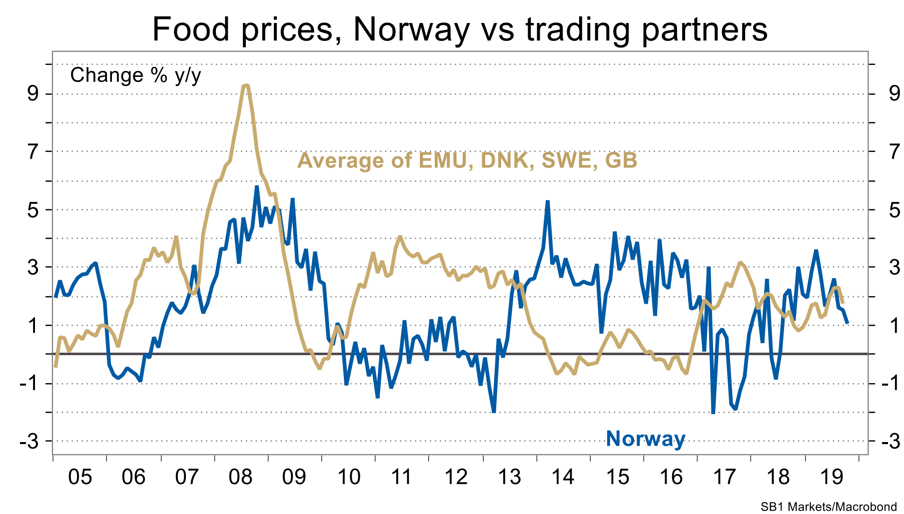
SSB is using a sophisticated net search model to calculate average prices in the relevant week. We assume that the real volatility in average monthly air ticket prices are lower than calculated

# Food prices have slowed recent months, trending flat the past year

## Discounts on chocolate and sugar have been larger than usual this autumn



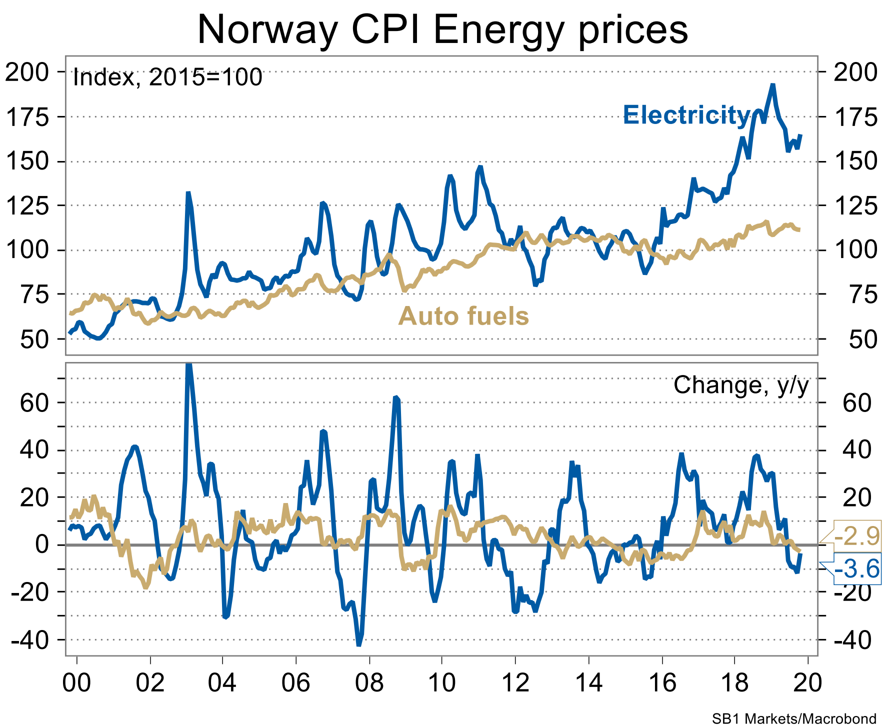



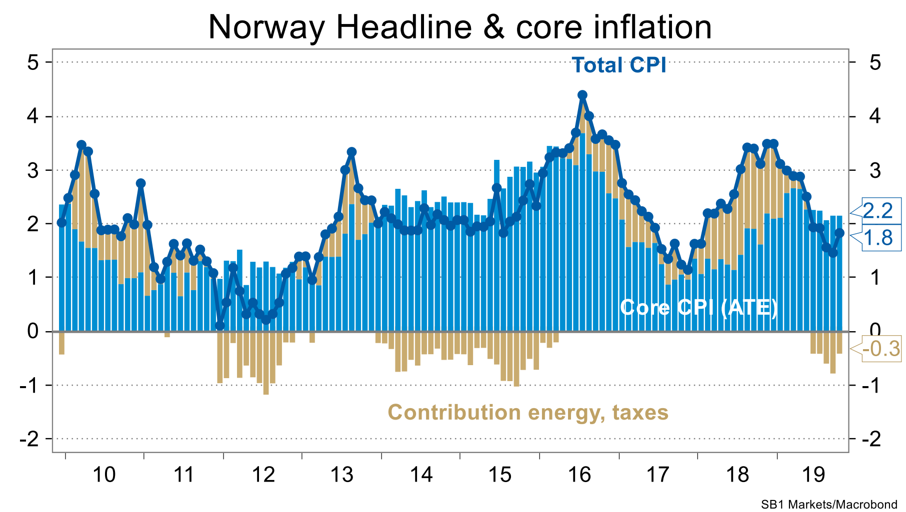



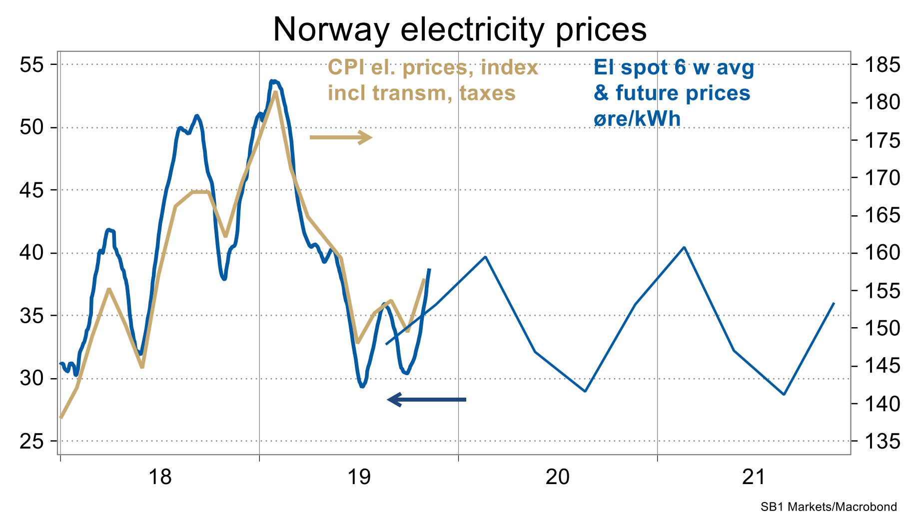

- Prices fell 0.4% m/m in August, we expected +0.2%
  - » Prices fell among most food sectors
- Food prices are now increasing at a slightly lower pace than in our neighbouring countries

# The negative electricity impact on inflation has probably bottomed out

## Electricity prices rose in Oct, the contribution on total CPI shrank to -0.3%, from -0.7% in Sept



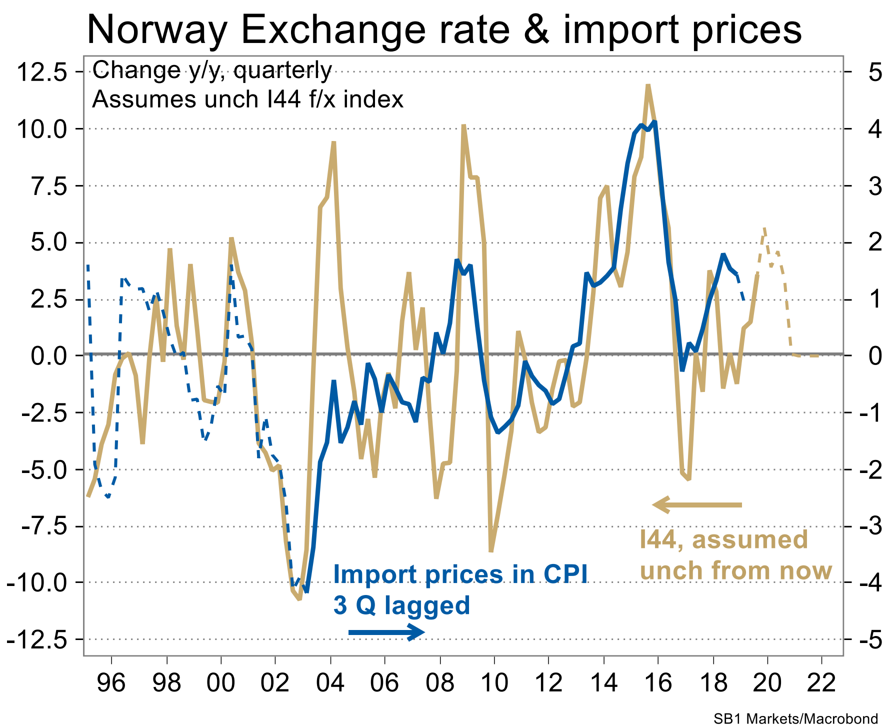



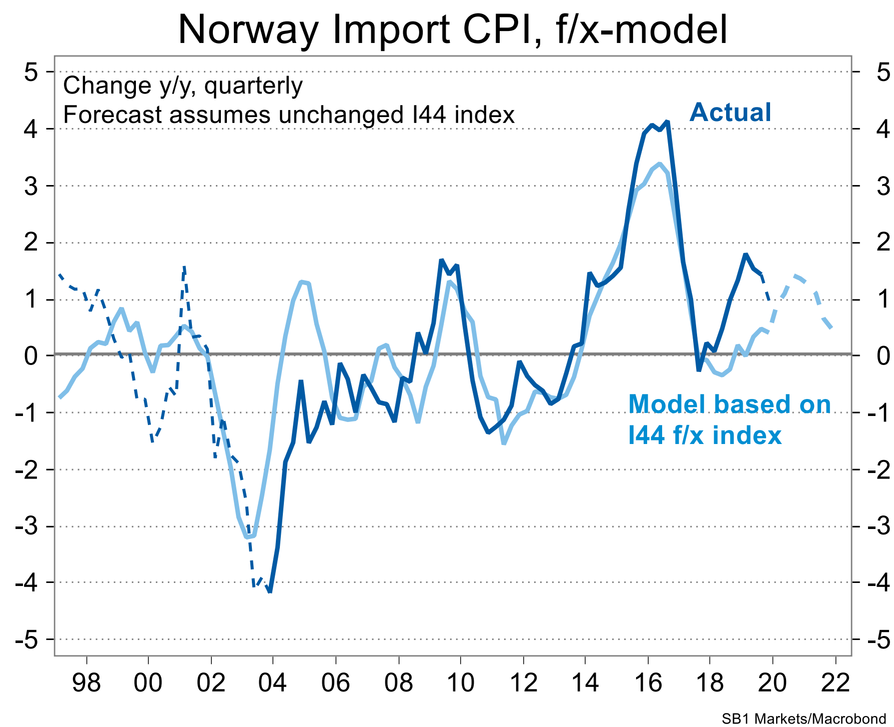




- In 2017/18 the surge in electricity prices lifted the headline CPI, reducing real disposable income significantly. This effect was put in reverse this year, electricity prices have been falling sharply. In Oct, prices jumped some 5% m/m
  - » Spot & near term future prices have stabilized recent months. The forward prices are indicating somewhat higher prices in Q4, the normal seasonal change. If correct, negative the contribution from lower el. prices will subside the coming months
- Auto fuel prices are close to neutral vs. headline CPI

# A somewhat higher but still moderate impact from the weak NOK?

## The model indicates imported inflation up to 2% the coming months/quarters

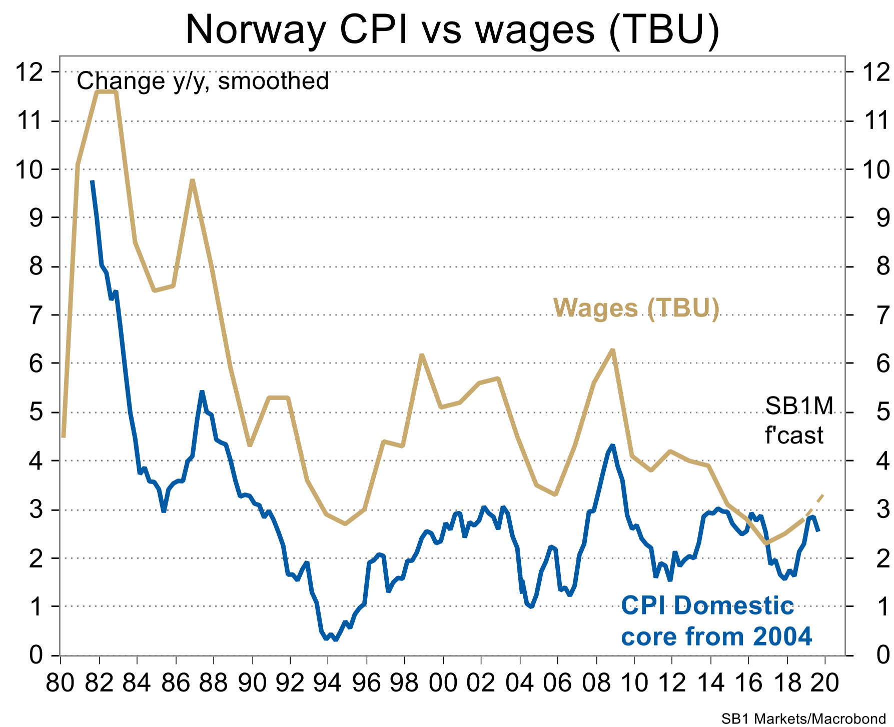


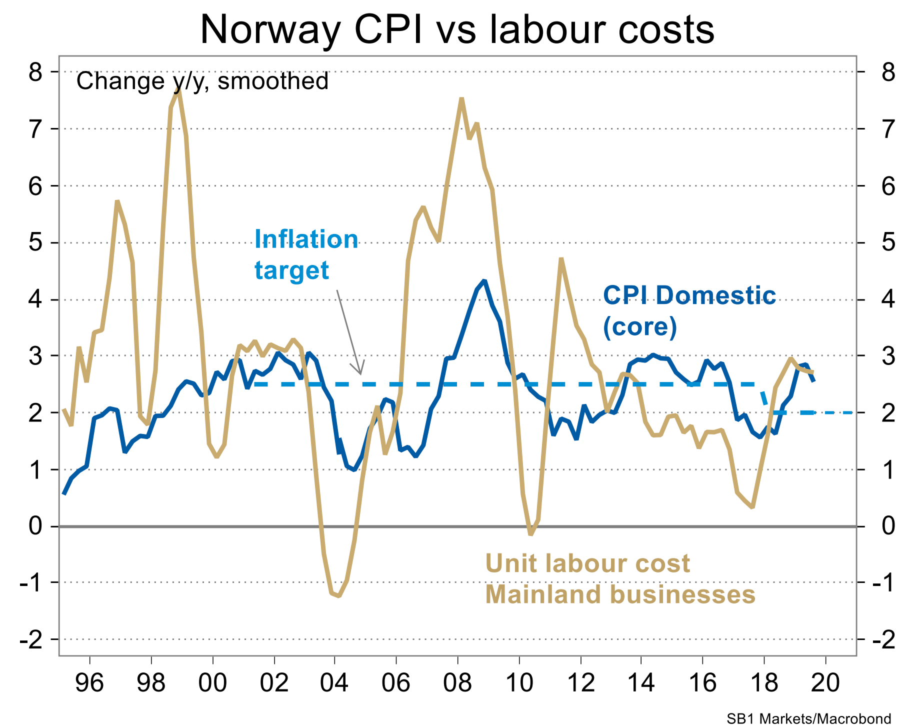




- In general, retail demand is so weak that it does not seem likely that the retailers are able to push up their margins like they have before. It does not seem likely that prices are accelerating abroad

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

Wage inflation is on the way up. Unit labour cost up some 2.8% y/y in Q2

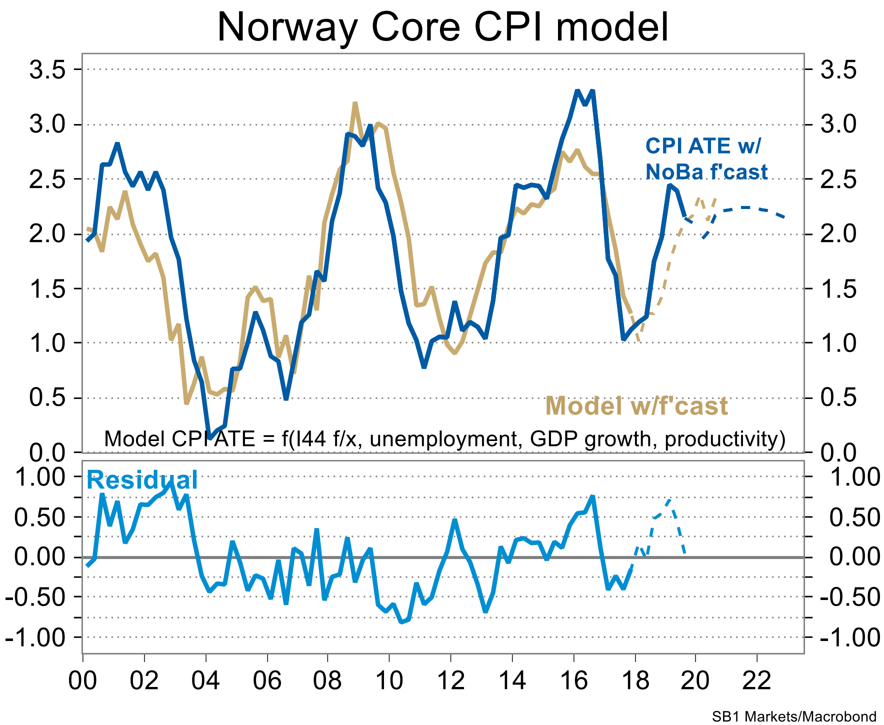



- Wage inflation is increasing and is now approaching 3%, will probably edge up to 3.2% in 2019
- Productivity growth remains meagre
- (Underlying) Unit labour costs inflation up to 2.7% y/y in Q3 (smoothed), a marginal slowdown from Q2 and unchanged from one year ago – and from below 1% in 2017

# The outlook: Not much upside left, core CPI inflation has peaked?

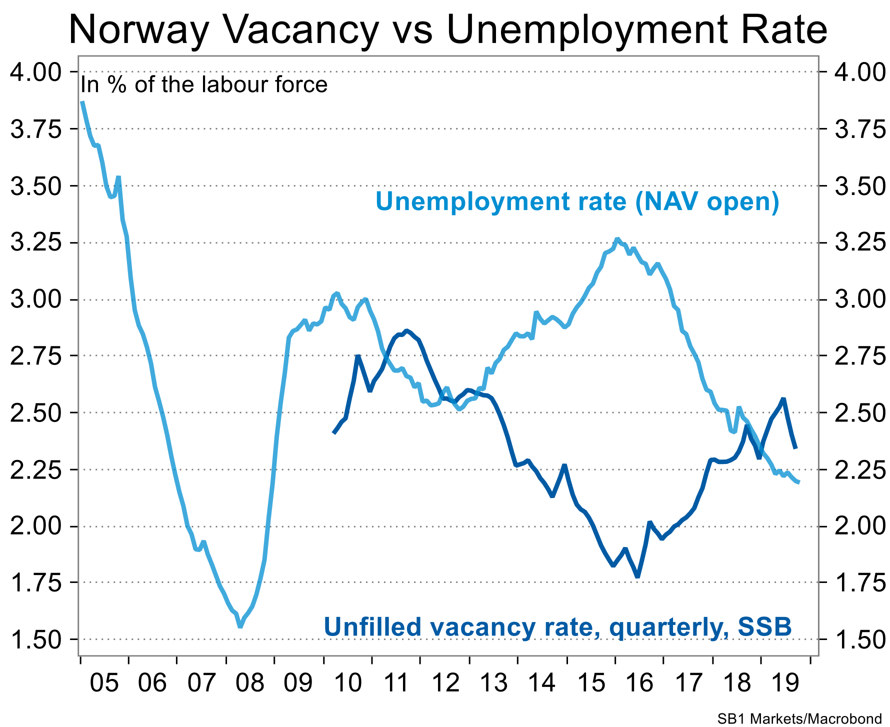
Actual inflation close to the model forecast now – it suggest a peak at 2.4% in early 2020

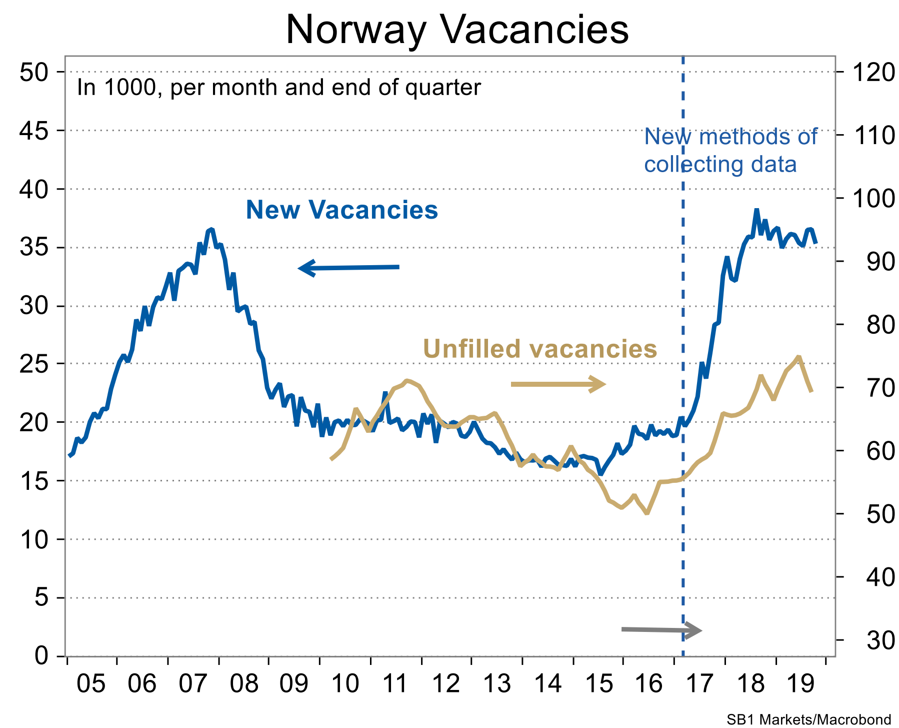



- Core CPI growth was running well above the model f'cast in Q1 and Q2. In Q3, inflation slowed to 2.2%, just marginally below the Q3 model f'cast
- The model, which includes unemployment, GDP and the NOK, signal steady inflation the coming year, up to 2.4% in Q1 2020
- Norges Bank expects core CPI at 2.3% in 2019, and down to 2.1% in 2020 (Sept Monetary Policy report). Probably fair estimates.

# Unfilled vacancies dropped in Q3, adding to signs of a softer labour market?

## Vacancy rate slipped to 2.3%, from 2.6%. Still more vacancies than unempl. (in % of labour force)




- The vacancy rate dropped to 2.3% of the labour force in Q3, from a 6 year high at 2.6% in Q2. The vacancy rate is still 0.15 pp above the share of unemployed, thus, the labour market is tight. The number of unfilled vacancies (at the end of quarter) fell by 6' from Q2, some 40% higher than at a the 2016 through. However, the steep decline in Q3 adds to signs of a somewhat weaker labour market:
  » Registered unemployment is still declining – but at a noticeably lower pace recent months. LFS unemployment has ticked up and the participation rate is climbing
- The number of new vacancies, reported by NAV, is not increasing anymore. NAV reported a much sharper rise in <u>new</u> vacancies in 2017-2018, partly due to a new method of collection, thus, the numbers from early 2017 an onwards are not comparable with previous figures, due to a new method of collecting vacancy data. We trust the SSB figures to be more accurate

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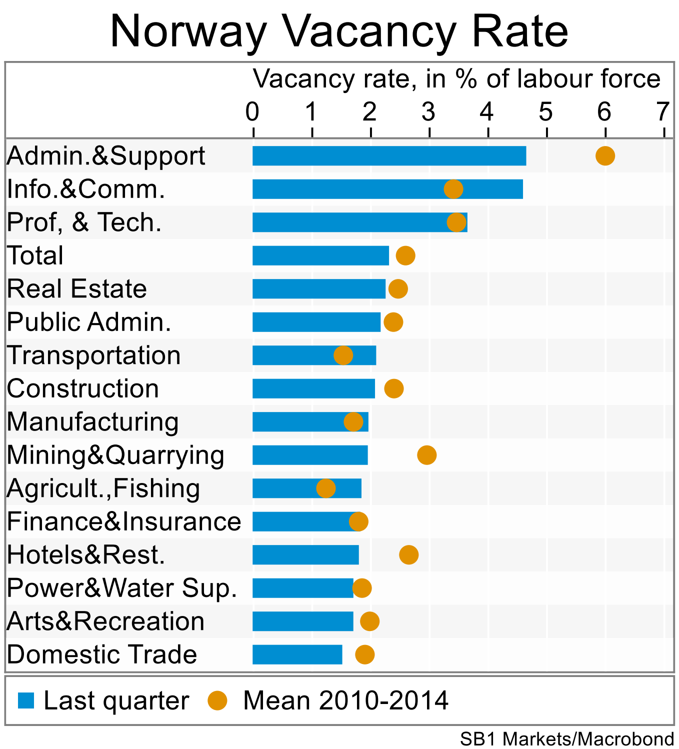
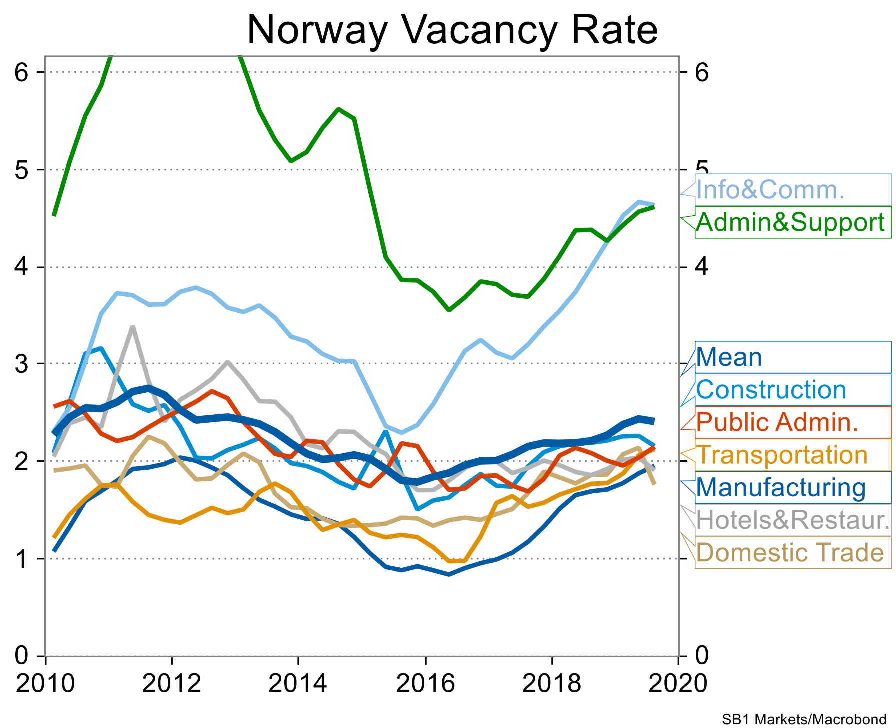
# Highest vacancy rate among office work, info&comm, lowest in retail trade

Unfilled vacancies trending up in most sectors, modest level in most blue collar occupancies



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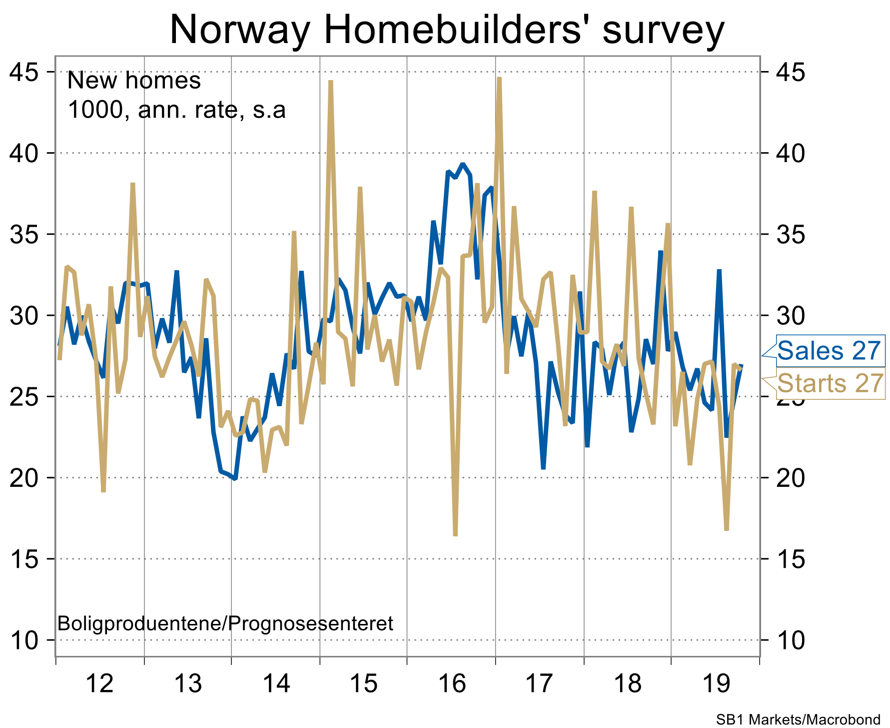
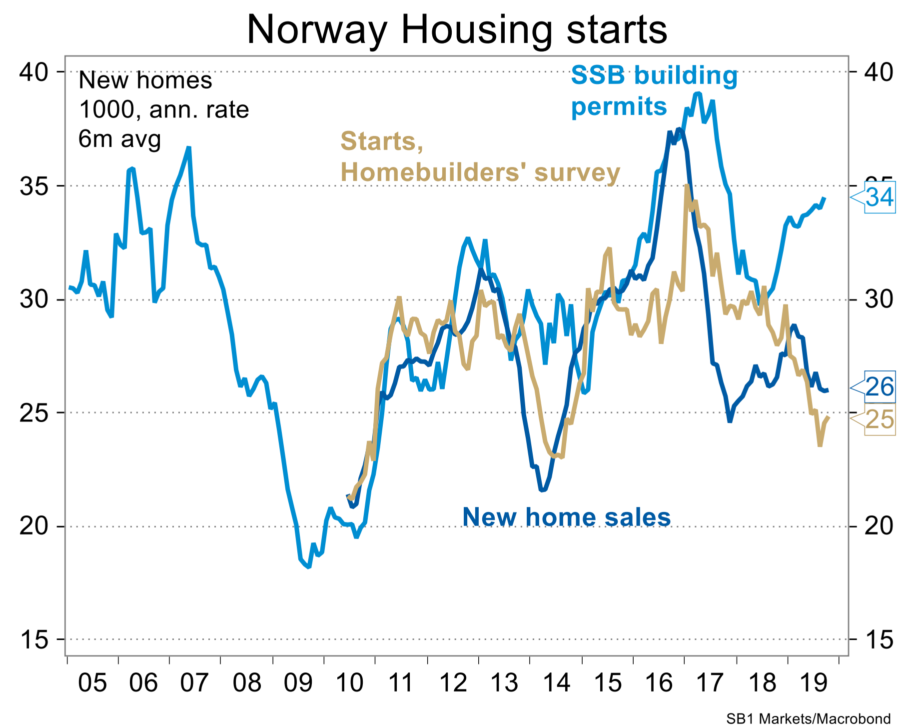
# Homebuilders report stable starts, at a much lower level than SSB is reporting

Starts were unchanged in October and sales rebounded. Still, both trending down




- The Homebuilders' housing starts were flat in October (s.a), after an upturn the prior month. Still, starts are trending steeply down – the gap to SSB's starts(permits) data is much wider than usual (34' vs. 25', 6m avg). Student homes, which is only included in the SSB figures, explains some of the deviance. Thus, our take is that ordinary housing starts may have turned down or are flat, at best
- New home sales recovered somewhat in Oct, however, sales are still sliding down (to 26' 6m avg) and do not signal higher starts
- Total housing starts (in sq.m) is close to flat, at a comfortable level, and indicate a muted growth in housing investments

Highlights

The world around us

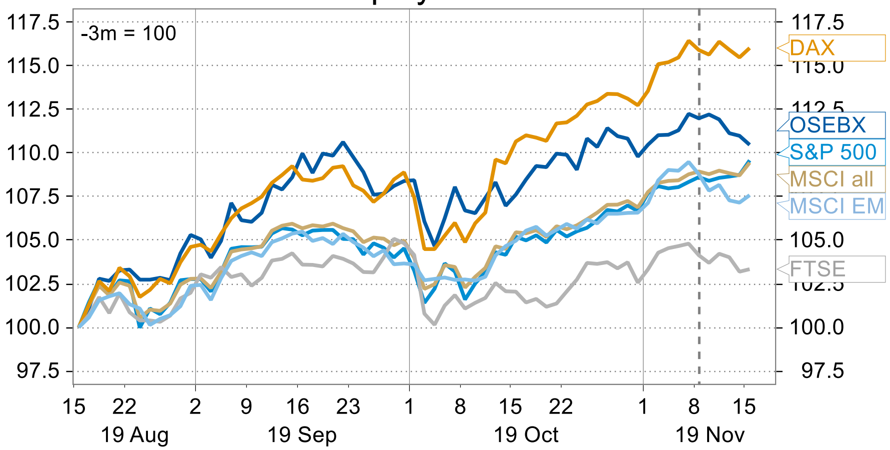
The Norwegian economy

Market charts & comments

# Stocks, bond yields cooled amid US/China trade deal uncertainties, still ATH in US

New trade truce hopes lifted US equities Friday. The NOK up for the 2nd week in row!

## Equity Indices




Stock markets climbed through October and early November, most markets edged down last week. However, S&P up to ATH!

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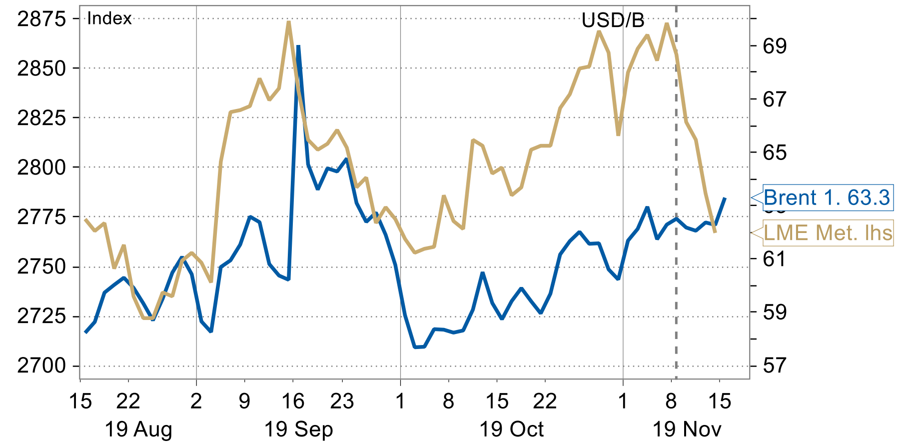
## Oil vs. metals




Brent oil price further up, to USD 63.3 last week, metal prices slipped but not by much, check next page

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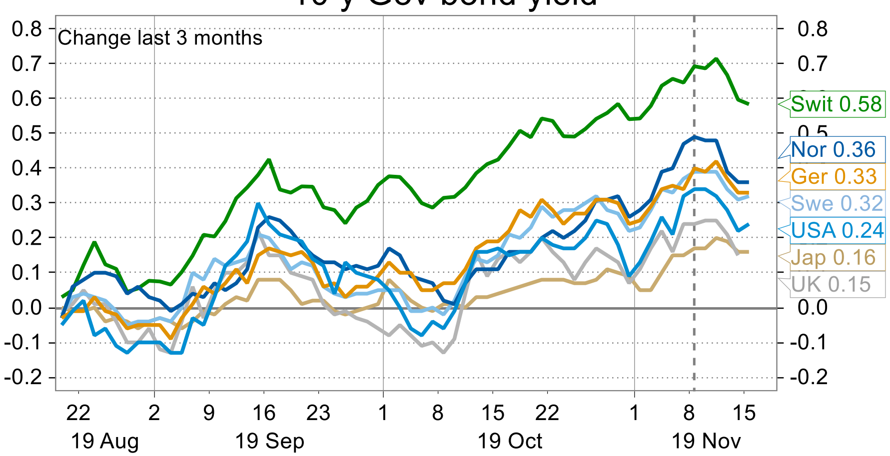
## 10 y Gov bond yield




Bond yields fell everywhere last week, as uncertainties on the US/China partial trade deal and weak China data weigh on investors' risk appetite

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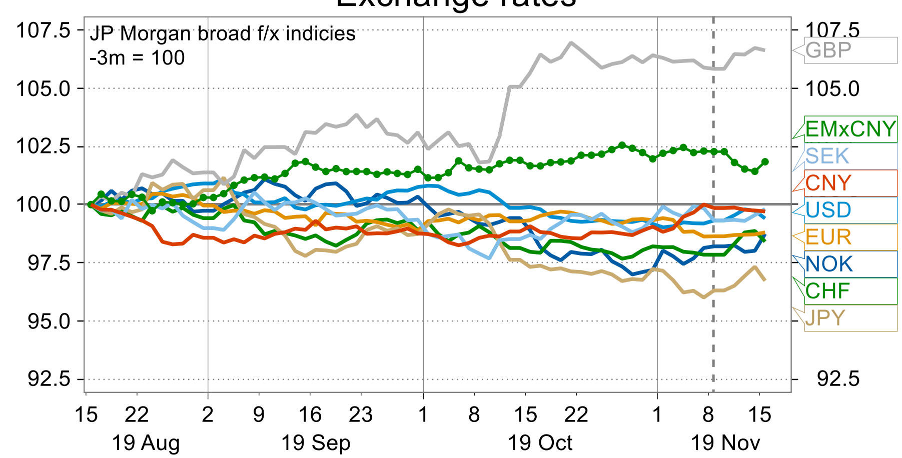
## Exchange rates




EM fx/CNY weakened last week. USD and JPY strengthen after a depreciation the past weeks

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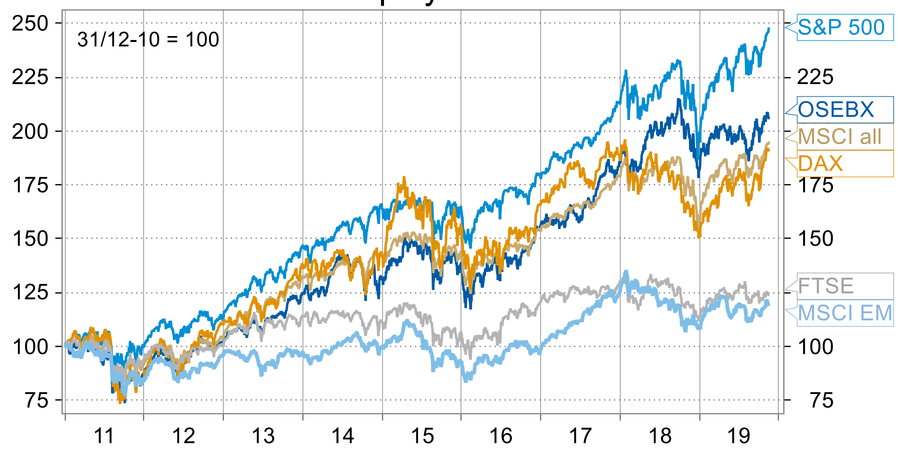
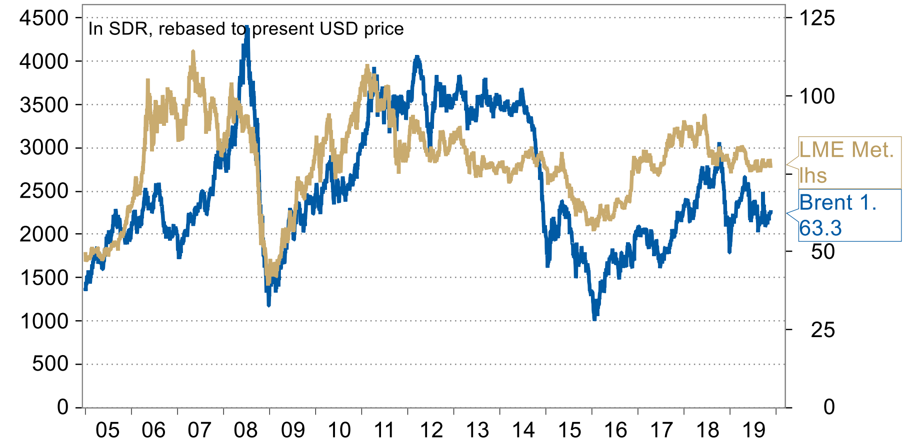
# In the long run: US stocks at/close to ATH, bond yields not that far above ATL

Oil, metals are trending slowly down. The trade war rules. And then some economic data

## Equity Indices

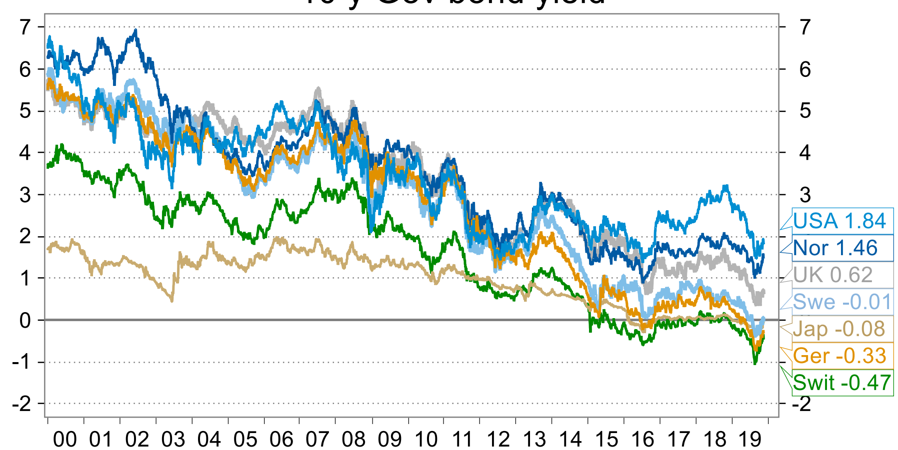



## Oil vs. metals

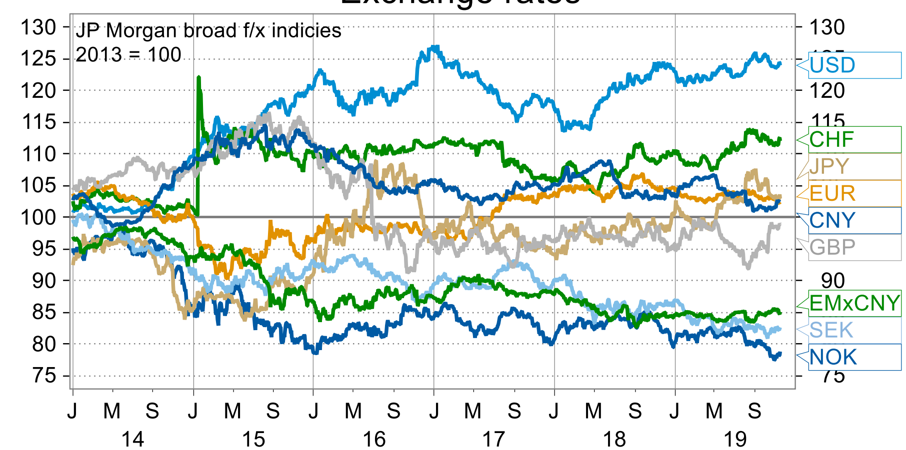



Metal prices may be trending down but slowly and the decline from the local peak is not large

## 10 y Gov bond yield

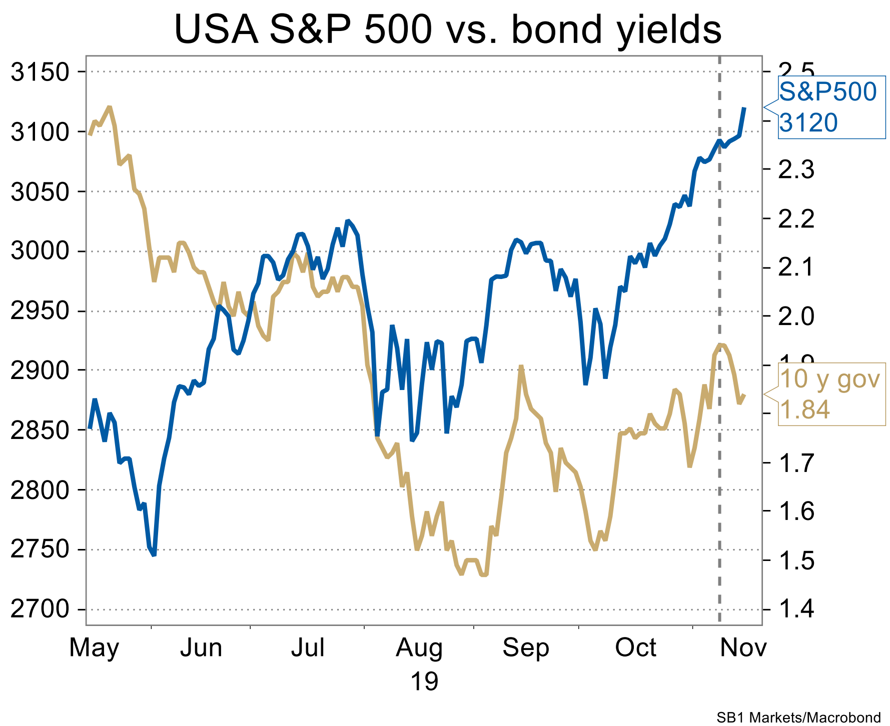


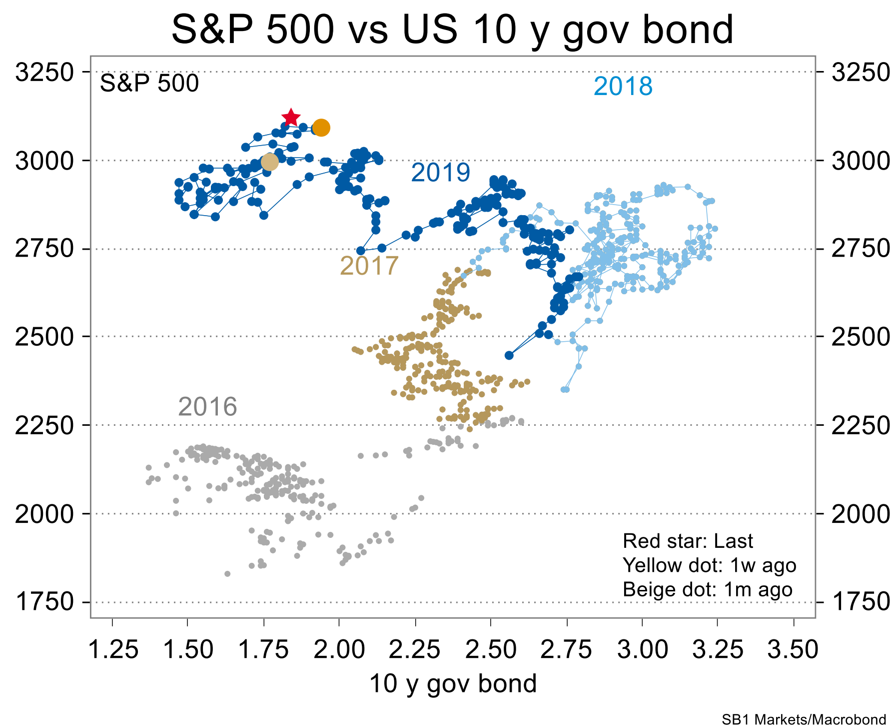

## Exchange rates



# US: All 3 main indices up to ATH, a lift Friday on US/China trade truce hopes

Still, the 10y bond yields fell 10 bps, following the rise last weeks

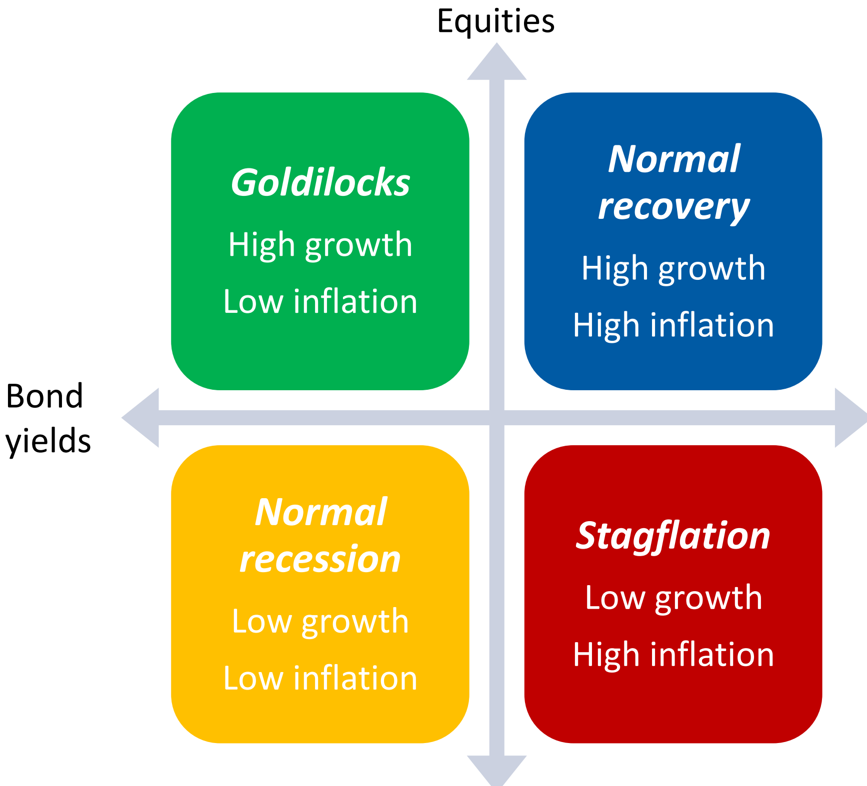


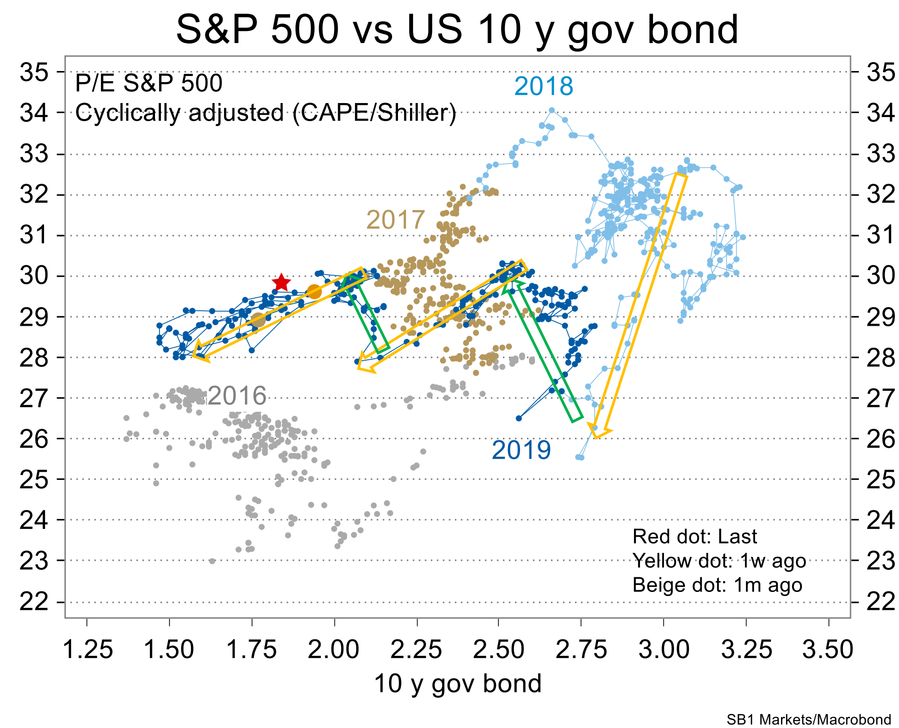




- Stock markets have been soaring since early October, to more than 3% above the July peak (S&P500), if which 0.9% last week, most of it on Friday
- Bond yields slipped late last week, after optimism on the US/China partial deal sent yields steeply up the week before. The 10 y gov yields finally fell 10 bps, both real rates and inflation expectations edged down

# US markets are moving towards the normal recovery corner

## Well, at least until last week, when markets took a small step towards the goldilocks’

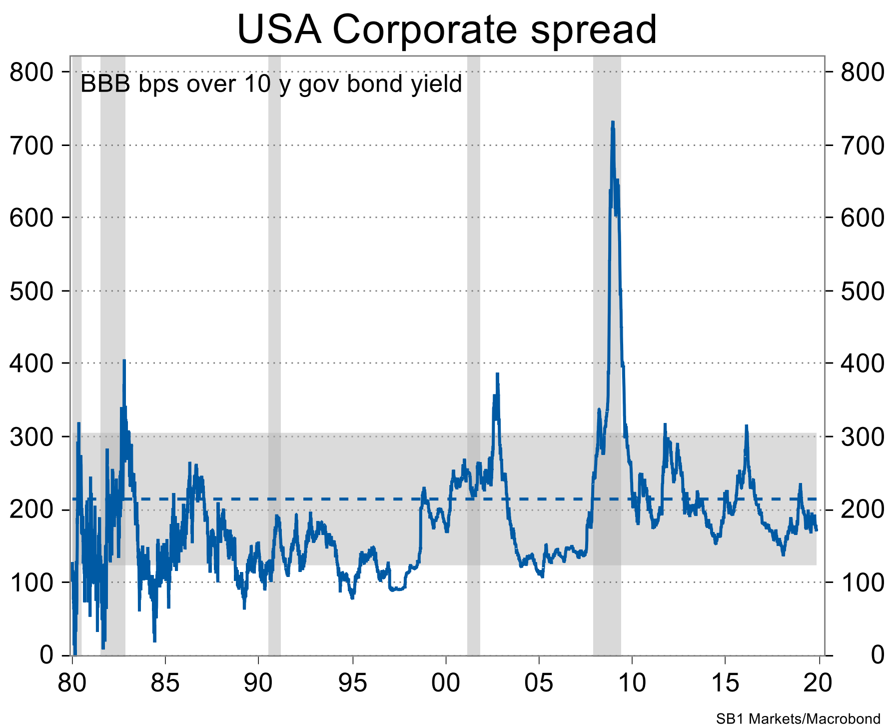


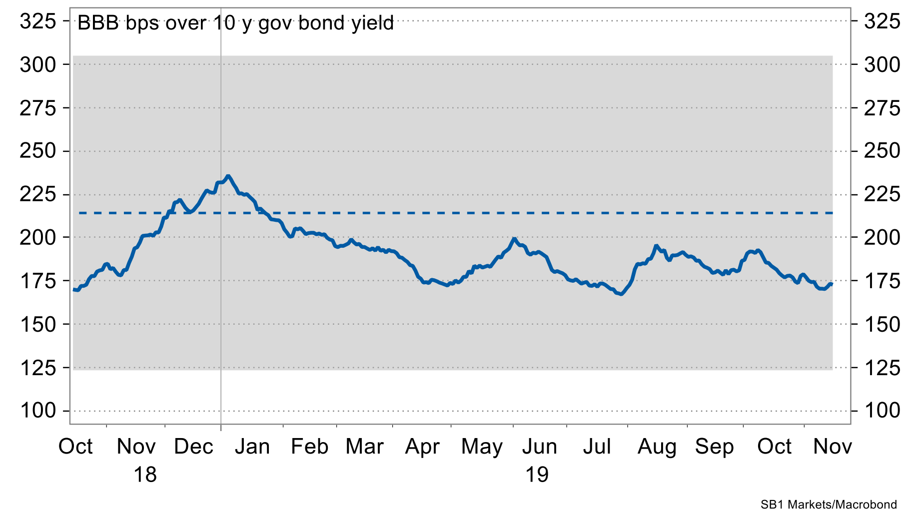



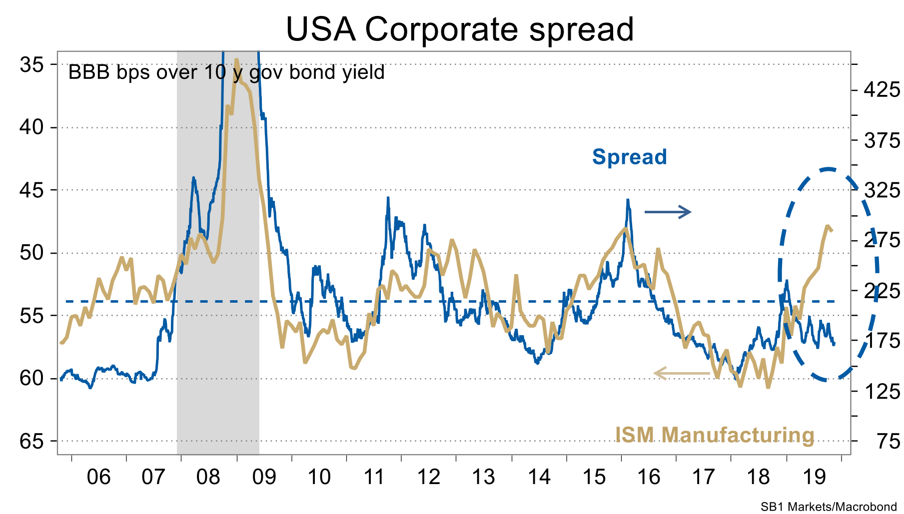

- Recent months, markets have been zig-zagging along with developments/news on the trade war. In October and early November, trade news have been positive and markets have moved towards the ‘normal recovery’ corner. Last week, doubts on the trade deal sent bond yields down, while stocks rose slightly
- We do not think a long term Goldilocks scenario is likely. Should yield decline substantially, 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. So, the normal recession/recovery axis is the most likely

# Credit spreads are below an average level, far too low?

Spreads are <u>far too low</u> if the ISM is correct; that is, <u>*if growth is slowing*</u>

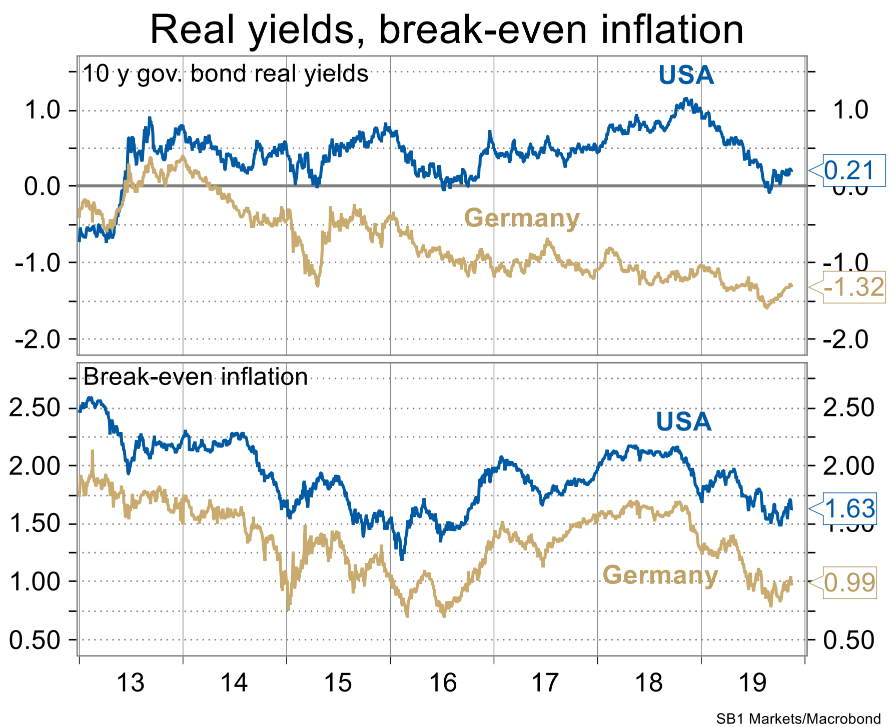


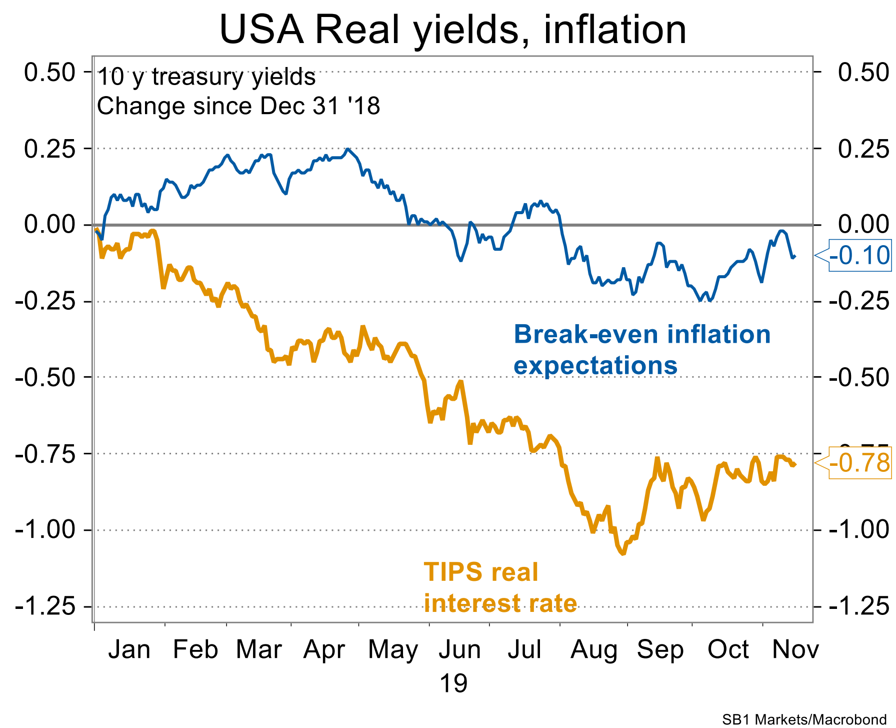



# Both US real rates, inflation expectations down last week

## While equity markets climbed to new ATHs

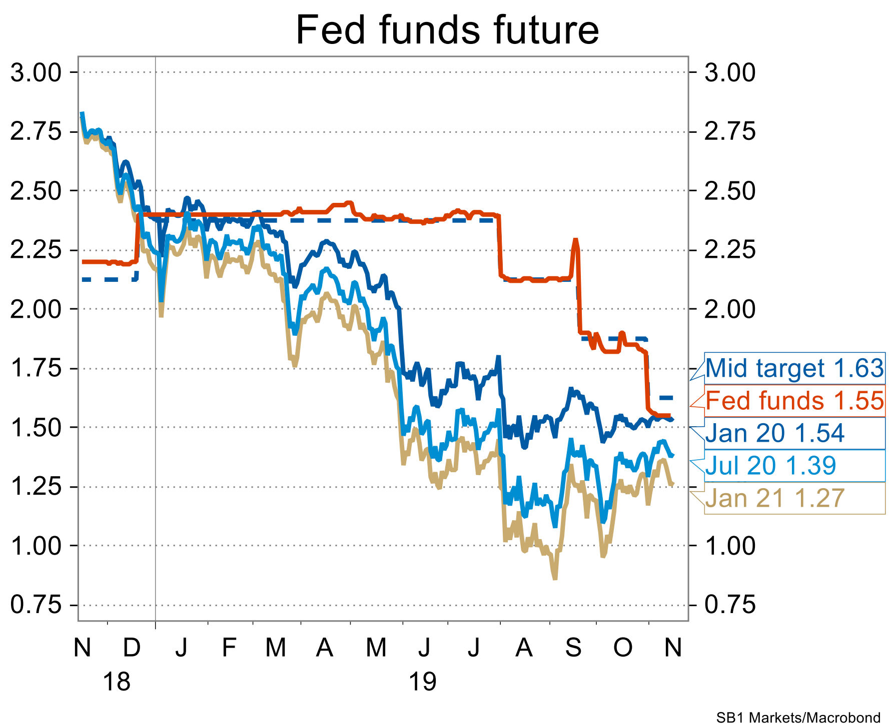


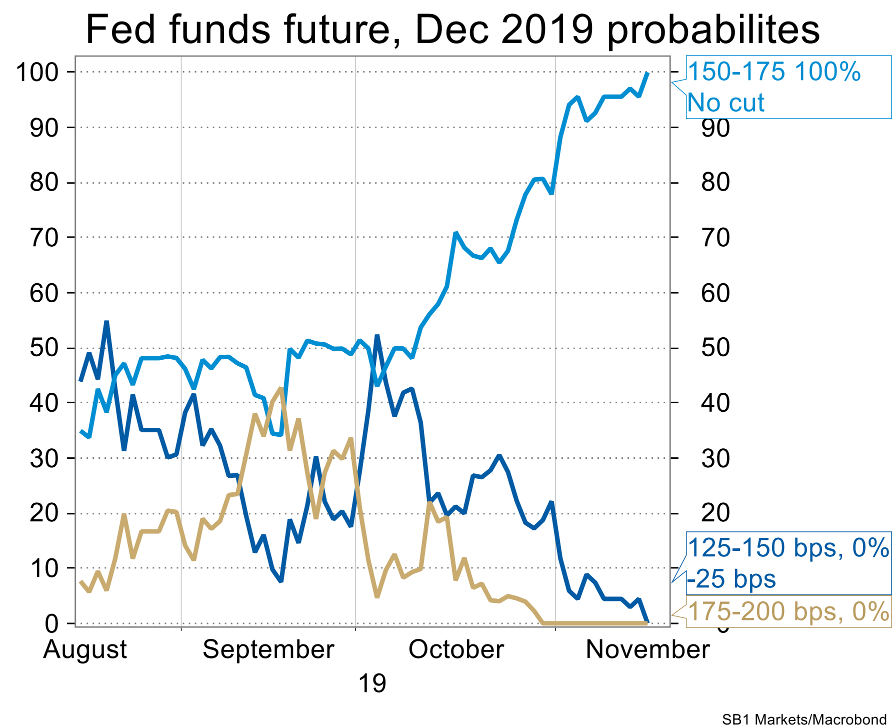




- Both real rates and break even inflation have been heading steeply down this year, in US and Germany. Since early Sept, real rates have recovered somewhat more than inflation expectations, probably primarily due to hopes of a trade war solution
  - » Last week, inflation expectations in the US fell more than real rates. German inflation expectations inched down too, real rates marginally up
- German real rates bottomed have increased to -1.32%, still very low. Inflation expectations at 0.99% does not seem that far off, although well below the ECB's price target at close to 2%
- US 10y inflation expectations at 1.63% seems more reasonable, real rate still low, at 0.21%

# No expectations of a Dec Fed cut, for good reasons

## Further out on the curve, Fed funds future rates fell somewhat, and 1½ cuts are expected in 2020

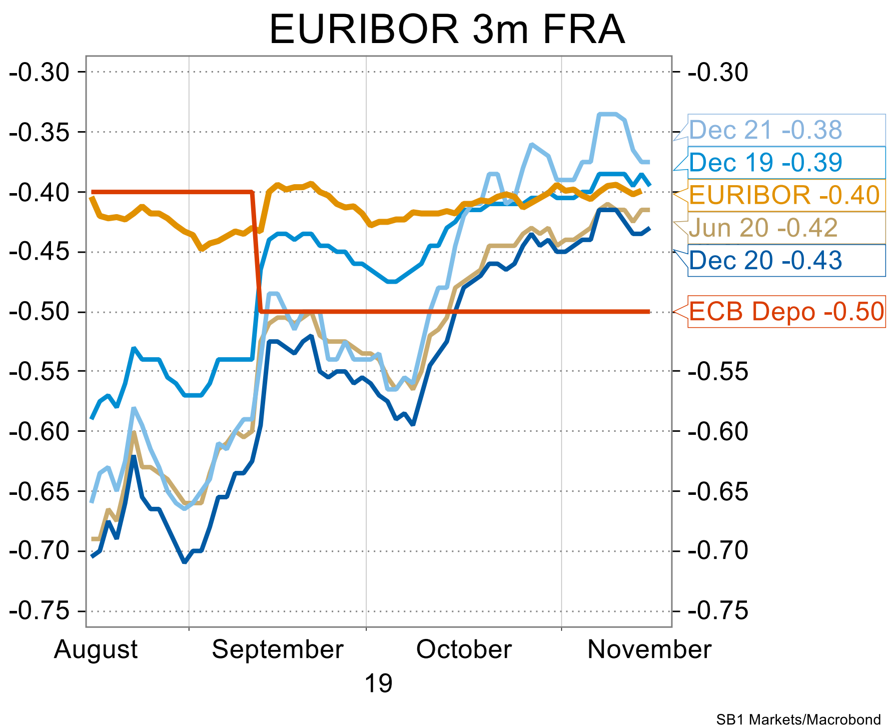


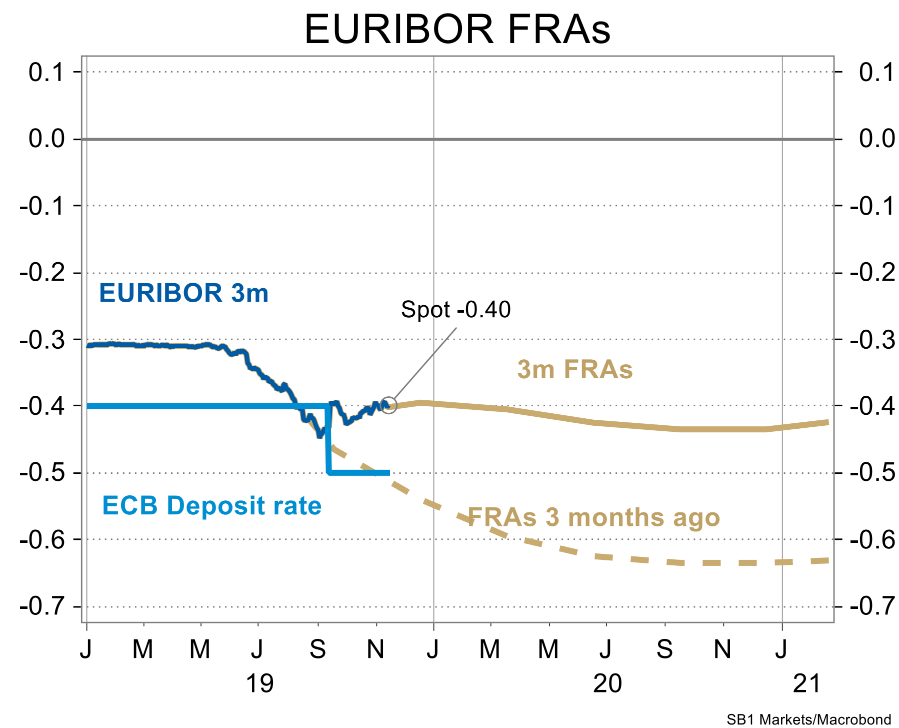




- At the October meeting, the Fed cut the interest rate to 1.5-1.75% but signaled no additional cuts the coming year. For the first time since the trade war escalation, markets now have (more) faith in Fed's plans, probabilities for another 2019 cut have been reduced to just above zero
- The Jan' 21 FRA fell 9 bps last week, to 1.27%, indicates that markets are pricing 1½ interest rate cuts (of 25 bps) in 2020. One cut is expected in H1
- The actual Fed Funds rate remains well below the target rate, which is not usual. Liquidity in the money market must be rich

# EUR FRAs marginally down, interest rate cut expectations have almost vanished

Markets expect an unchanged interest rate the coming year (with some 40% prob. of a '20 cut)

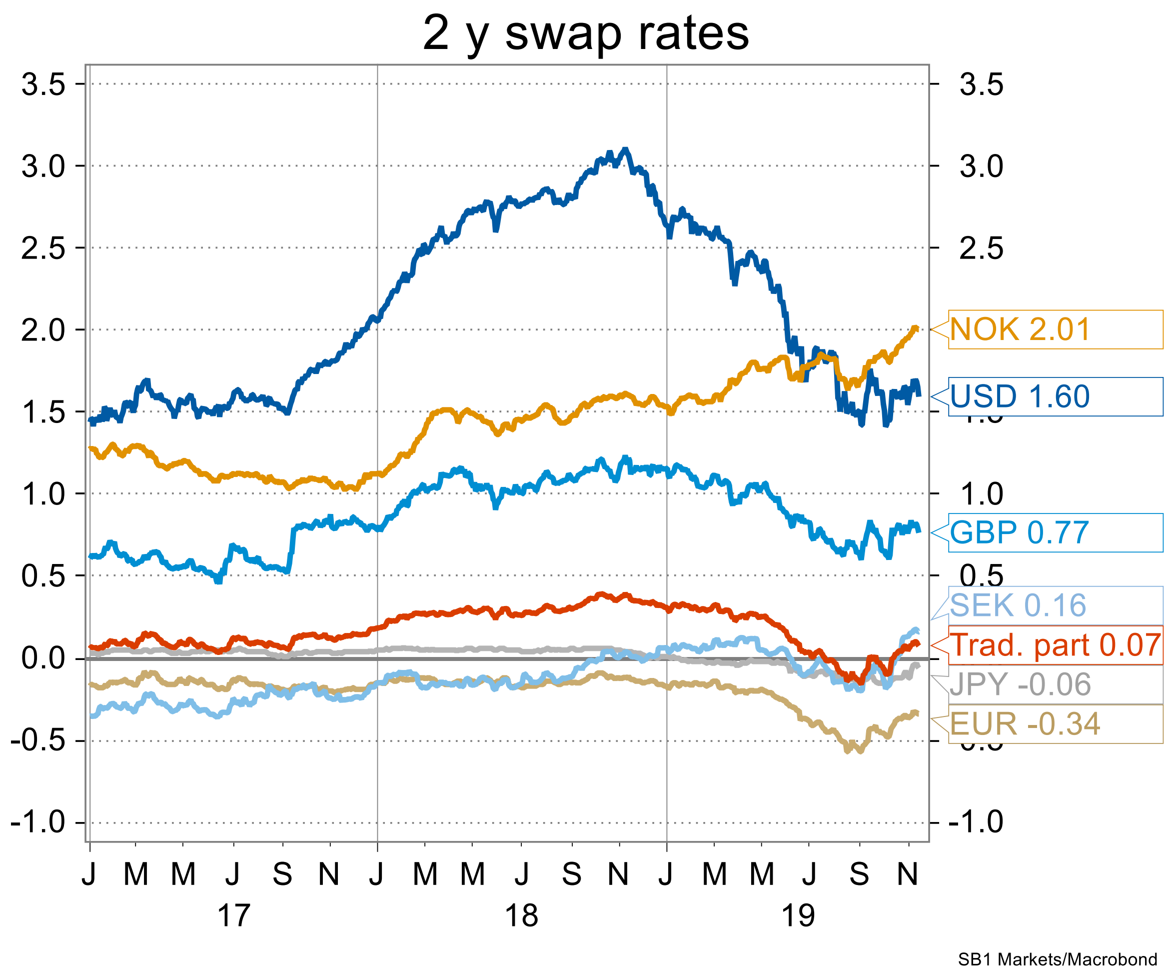


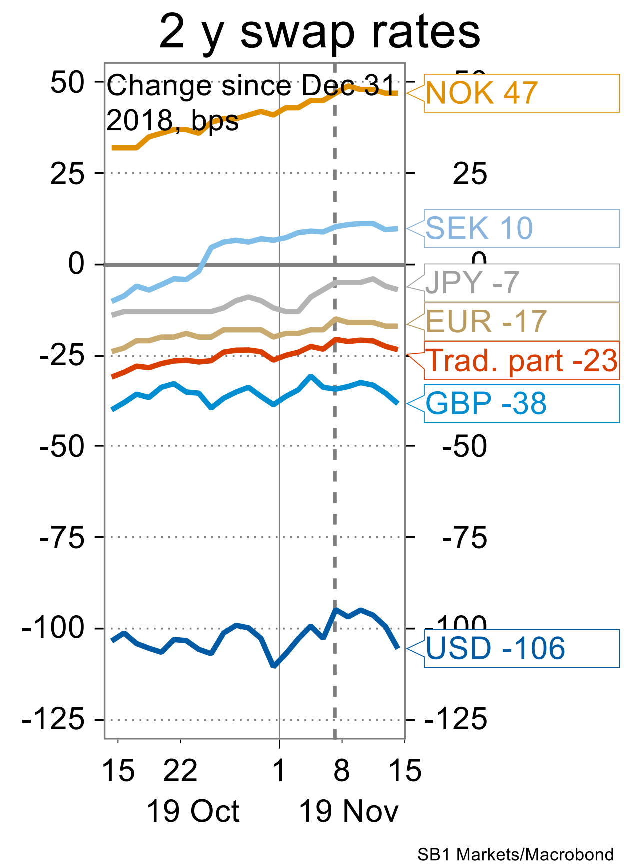




- Since early October, the FRA rates have turned steeply up all over the curve. Several rounds of positive news from the US/China trade talks have helped turned the mood. Hopes of a soft Brexit has contributed as well – and a divided ECB, which are split on the appropriate level of monetary easing
- Last week, the FRAs came down in the long end, steady in the short end. Markets are pricing an unchanged interest rate this year and some 40% probability of a cut in 2020

# Short term rates up have been slowly edging up recent weeks

Last week, short term rates were flat/down, US/UK rates fell more than others



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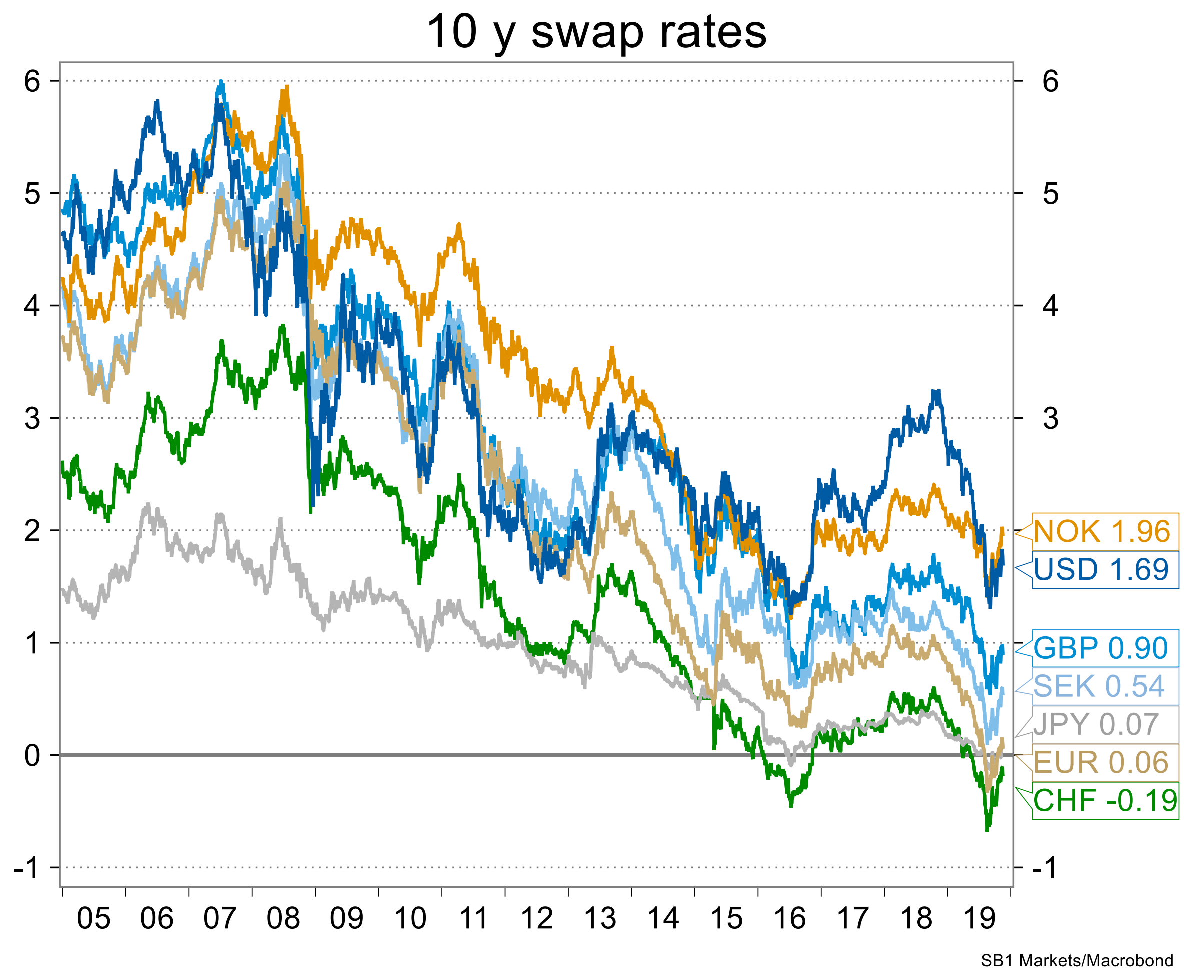
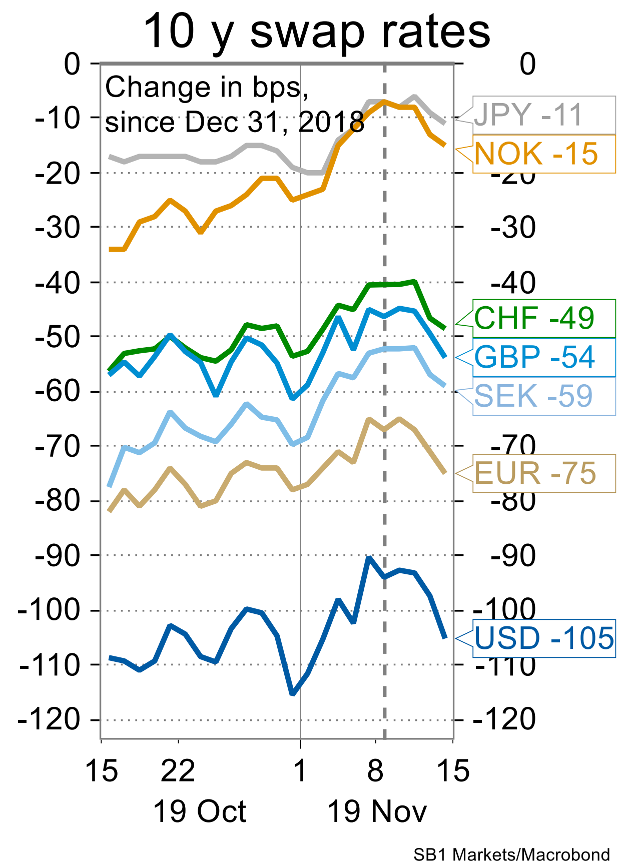
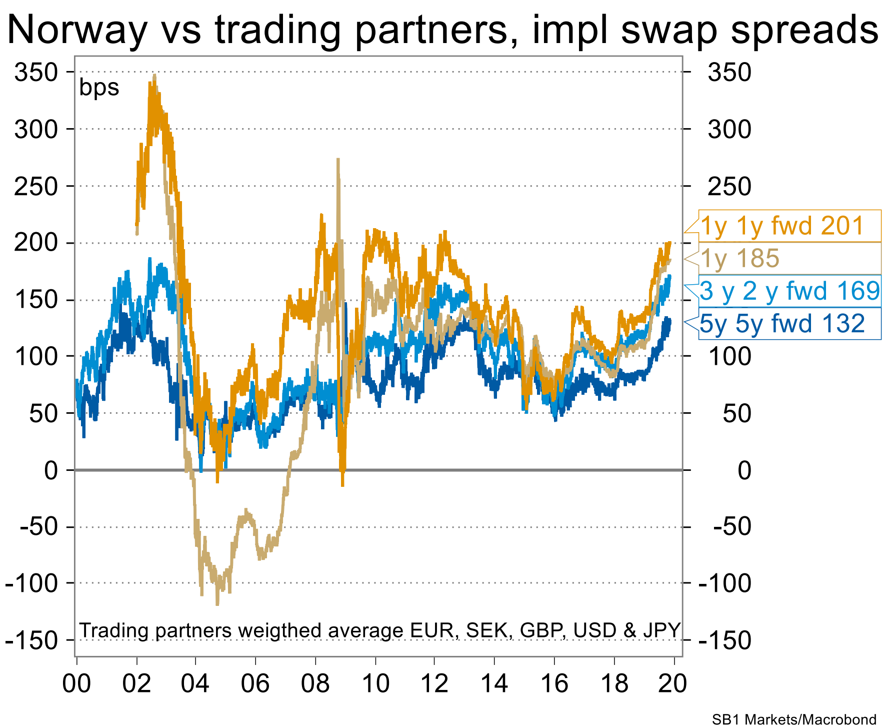
# Long term swap rates have recovered all over – and fell last week

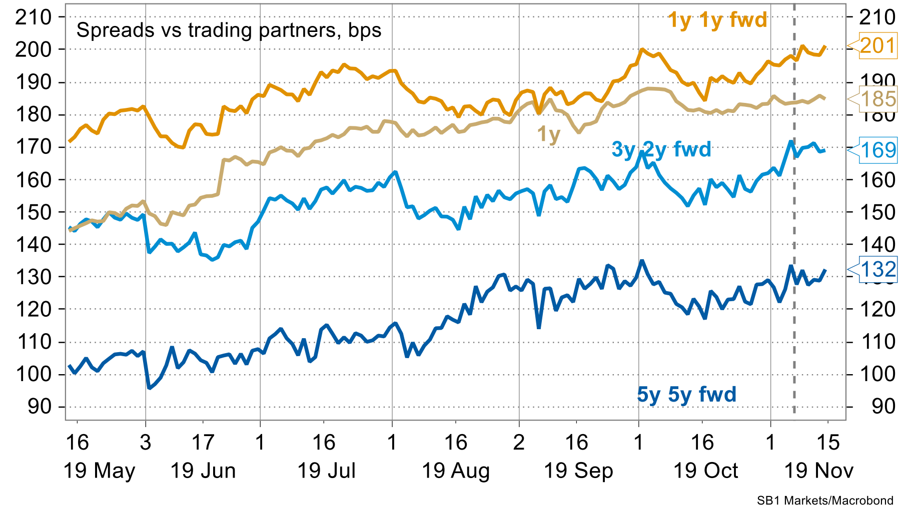


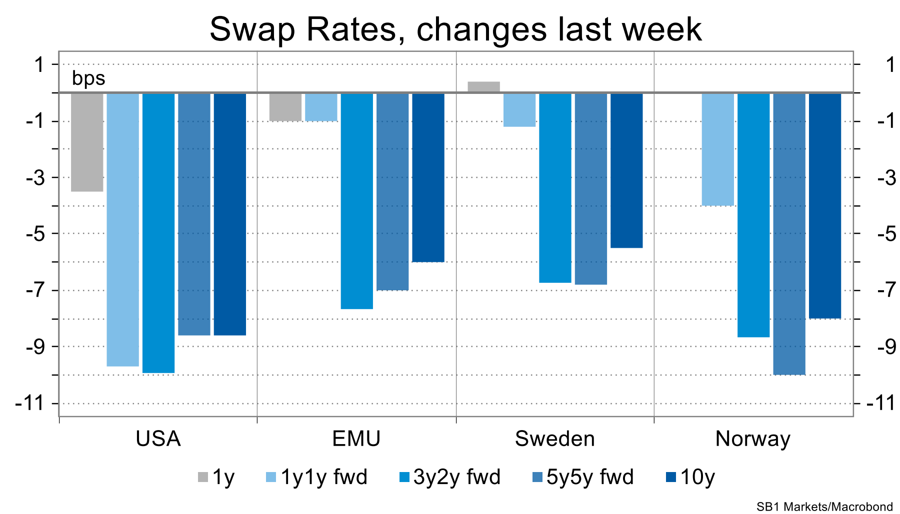



# Swap spreads vs trading partners are widening again

## Last week, swap rates fell everywhere, NOK less than EUR and USD rates




- Swap spreads between NOK rates and our trading partners have been widening rapidly this year, all over the curve. Spreads were narrowed in early Oct, widening again the past month
- 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. 130 bps is too much, long term

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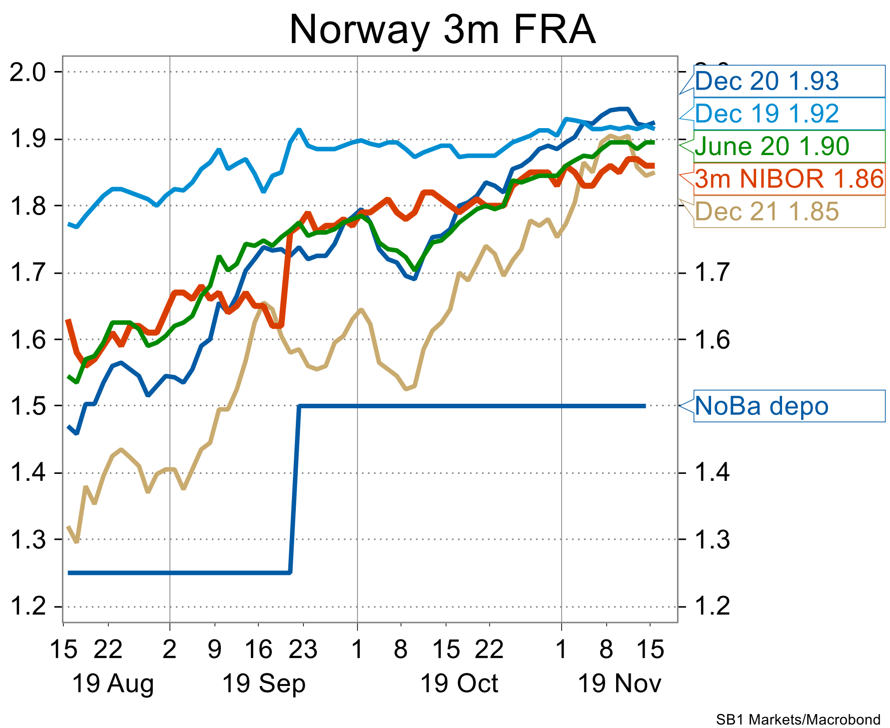
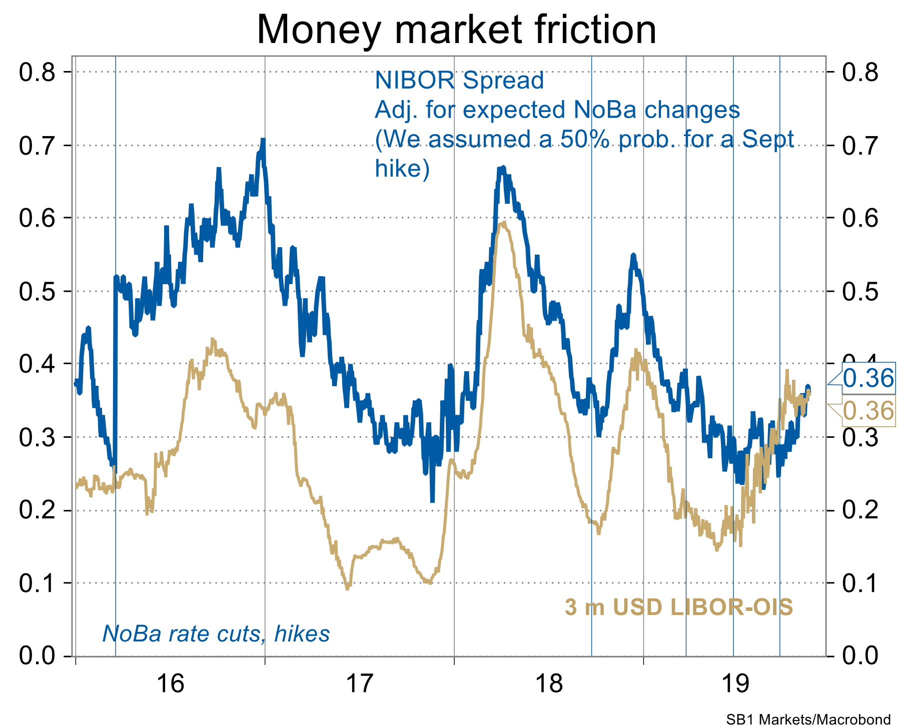
# 3m NIBOR is slowly rising, and somewhat more to come?

Dec 20 3m FRA at 1.92% signals a higher NIBOR the coming weeks. A 2020 cut no longer expected

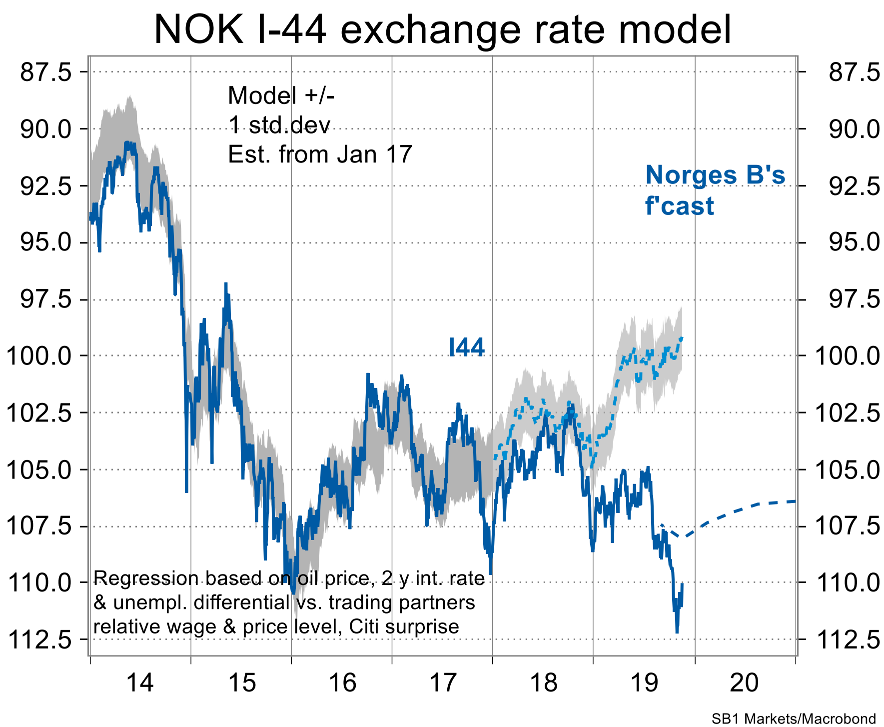


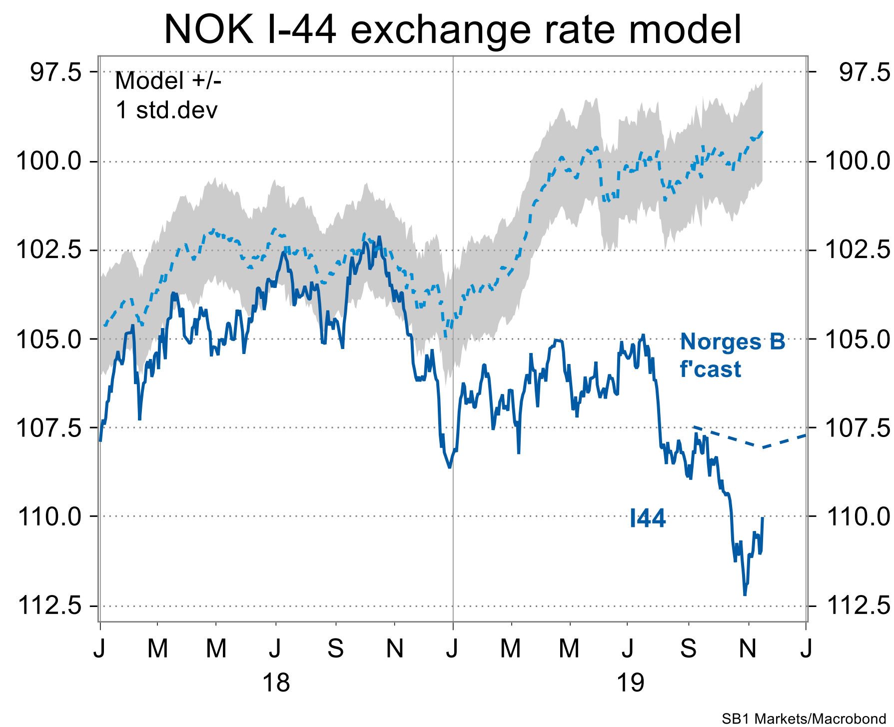




- The 3m NIBOR was flat at 1.86% last week, after climbing the prior weeks. The Dec ‘19 FRA was steady at 1.92%, implying a 42 bps NIBOR – NoBa deposit spread. The US the LIBOR-OIS spread is 36 bps, like the actual NIBOR spread (assuming no expectations of any NoBa change the next 3 months). Historically, the NIBOR spread has been significantly wider than the LIBOR-OIS spread. We expect the 3m NIBOR to drift up the coming weeks
  - » The Dec spread may be influenced by expectations of a year end liquidity squeeze – which has happened before
- Longer dated FRAs fell last week. Still, the Dec 21 3m FRA fell by 5 bps to 1.85%, still reflecting expectations of an unchanged interest rate the next two years, with a small probability of a 2021 cut, probably some 25%. The FRA curve is no longer inverted after Dec ’19 (but it is after Dec ’20)

# Finally, a small NOK appreciation

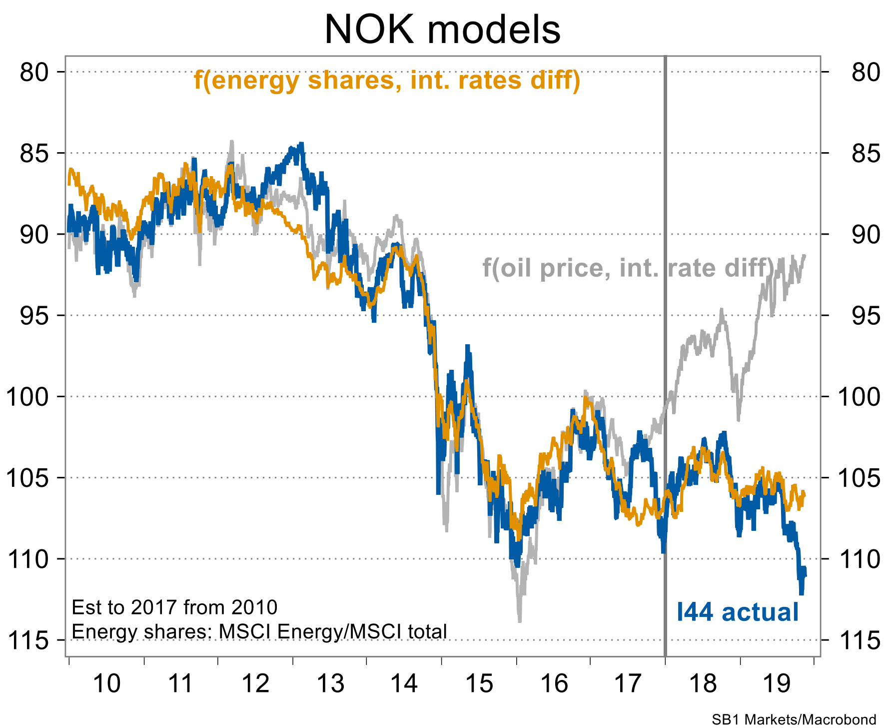
NOK is 8.8% below the standard model and even 4% below other supercycles

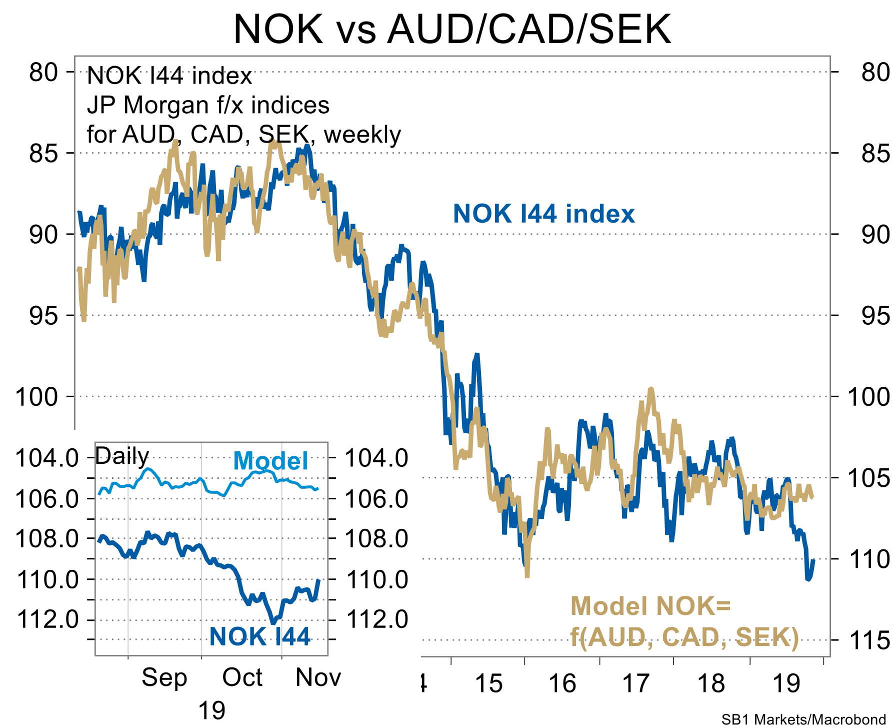



- NOK depreciated 0.5% last week (like the previous week), and is up 2% from the record low bottom late October. Our old work horse f/x model explains less than the half of the appreciation. The gap between the model estimate and the actual I44 index is more than 10%, still extremely high
- Our 'new' models, based on the other super cyclical currencies or energy (oil) equities are far closet to the ball (check next page), but still the NOK is 'too' weak
- We stick to our **buy NOK** recommendation

# NOK has recovered somewhat but remains weak vs our 'alternative' models too

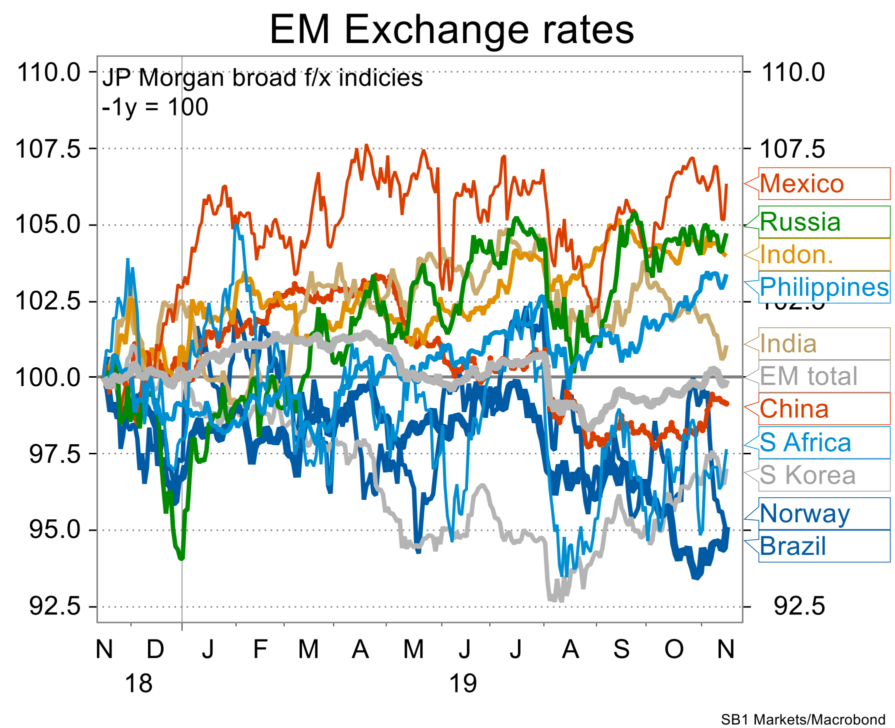


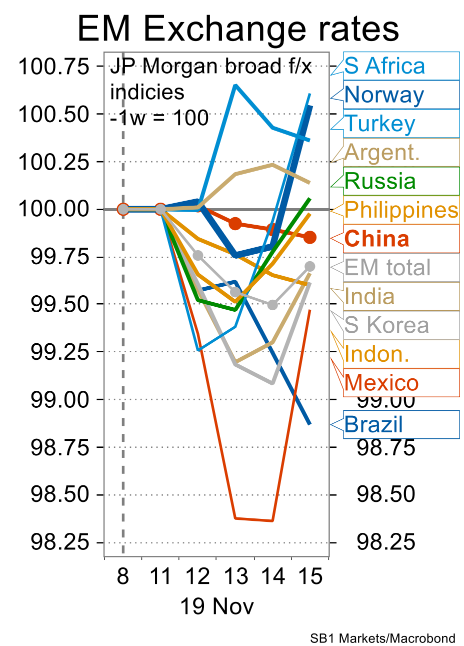



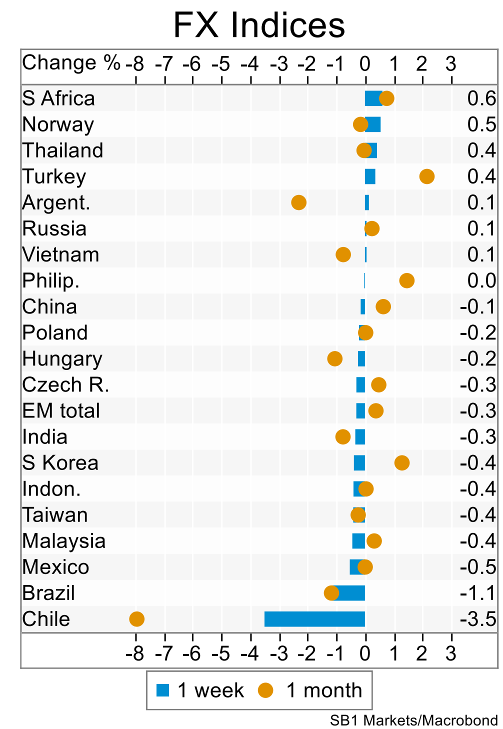

- Our NOK model based on pricing of oil companies has 'explained' the weak NOK much better than our traditional model since 2017, as have our 'supercycle currency model (NOK=f(AUD, CAD, SEK)
- Both AUD and CAD are sensitive to oil/energy prices and – together with the SEK – global growth outlook
  - » In October, both CAD, AUD and SEK recovered, probably fueled by hopes of Brexit solution, and a (slight) de-escalation of the US/China trade war. Unlike our peers, the NOK tumbled. The past 2 weeks, NOK has recovered some 2% from the bottom, without help from our friends but with some help from firmer energy stocks (vs. the total market)

# EM f/x weakened last week, we assume on trade deal concerns

## EM currencies have strengthened this autumn, supported by less risk off sentiment




- Most EM currencies have stabilized/recovered in Sept&Oct, trade war de-escalation probably the best explanation. Last week, Mexican, South Korean and Indian currencies all fell steeply, we assume triggered by Trump's negative comments on a possible tariff hike if a phase one deal is not reached – but the peso and won strengthened Friday
- BTW, if we take out the Argentinian peso, the NOK has fallen substantially more than most of the main EM currencies the past year!! Even after at NOK 'recovery' the two past week

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