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Macro Research

Weekly update 51/2019

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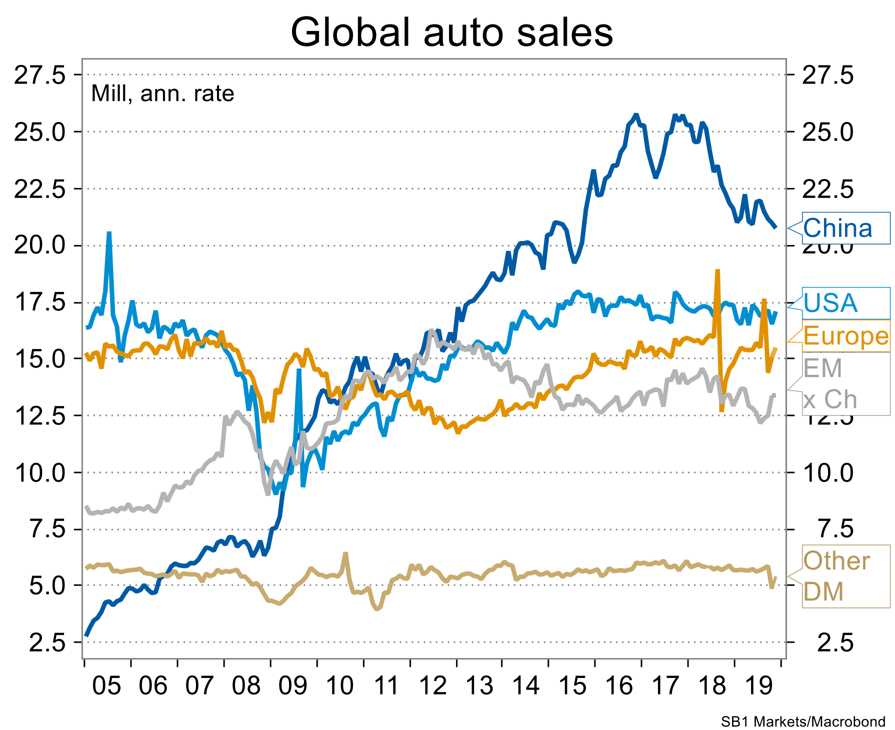
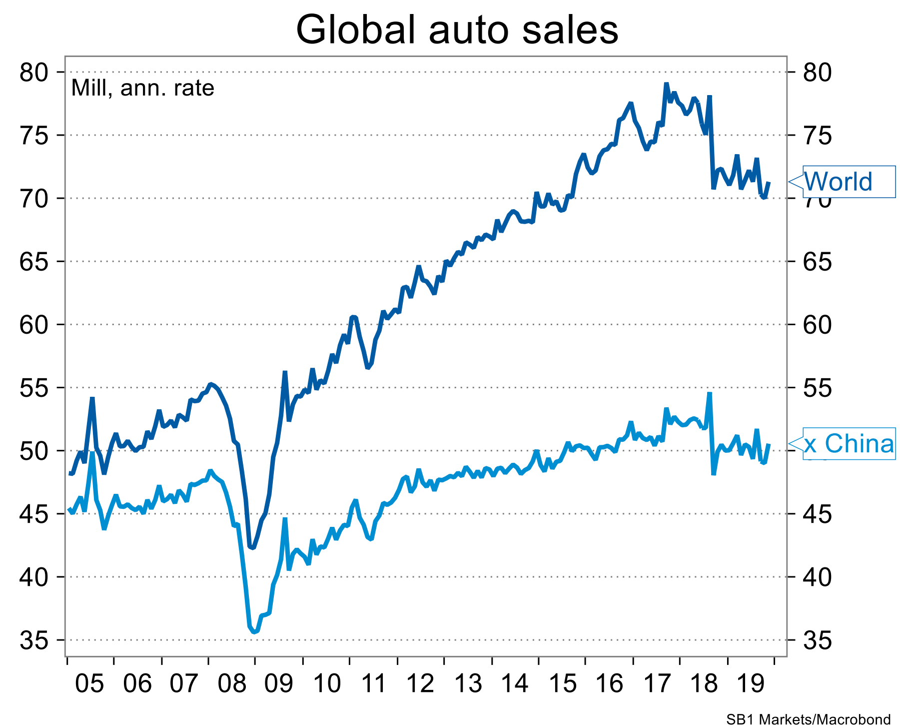
Last week – the main takes

- **US & China** reached a phase 1 trade deal, as widely expected (just technical details/translations to be sorted out before signing in January). China has promised to buy more (to USD 40 bn, up from 24 bn) quality US agricultural stuff that are competitive in the market. China has made other (probably just as vague) pledges too, on IP, opening up of Chinese markets, and on currency manipulation – and it will cut some tariffs. In exchange, US will not implement the announced Dec 15 tariffs, and will cut half the 15% tariffs implemented in Sept on a 1/4th of US imports from China (USD 156). The 25% tariff on 50% (USD 250 BN) of US imports from China, introduced before Sept, remains intact. China 'hawks' in the US were not satisfied – and the really difficult questions like technology, China's economic model etc are postponed to the next round of trade talks, and the 'future organisation' of the world economy remains uncertain. Markets were 'underwhelmed' by the deal, even if the risk for a further escalation of the trade war was removed
- The US Congress accepted the **USMCA** (US/MEX/CAN) trade deal, with minor changes; the NAFTA is basically intact, fine. **In the UK,** Johnson broke the Brexit deadlock as the Conservatives secured a huge majority in the Parliament, paving the way for the UK to have an orderly (soft) departure from the EU by January 31. The pound and financial markets cheered the news, as uncertainties are reduced
- **Global auto sales** rose in Nov, due to higher sales in the US and Europe, and a modest recovery in Japan. Chines sales have not yet fully stabilised. Global sales are still down 8% from the 2018 peak
- China November data were is sum much better than expected, as both industrial production, retail sales and credit growth surprised on the upside. **Industrial production** accelerated sharply, both m/m and y/y, and even the high meat prices have not killed **retail sale** volumes. **Investment** growth was stable, at a comfortable, low level. **Credit growth** has picked up speed since the summer, and the credit impulse is marginally positive. Total **CPI inflation** soared to 4.5% due to pork prices, core inflation eased to 1.5%
- **The US Fed** held the interest rate unchanged, as everyone expected, an continued to signal an unchanged rate through 2020, followed by a hike in 2021. **Core CPI inflation** was unchanged at 2.3% in Nov. **Producer price inflation** is abating, signalling that consumer inflation may be peaking now. **Retail sales growth** is slowly losing steam, core sales up just 0.1% m/m in Oct. **Households' credit growth** eased marginally to 3% y/y in Q3, well below income growth. **Corporate credit** up 5.3%, still above corporate GDP growth, hence, the debt ratio keeps climbing. **Initial jobless claims** soared last week but just due to a later than usual Thanksgiving holiday
- **The ECB** signalled no changes to its monetary policy stance in Lagarde's debut. In the statement, she focused on the planned strategic review. **Eurozone industrial production** dropped 0.5% m/m in Nov, the contraction is persisting. Some positive data points from Germany; **ZEW survey** recovered swiftly in Dec – and **German exports** are increasing
- New data from the **Swedish labour market** confirms a labour market weakening. The upturn in unemployment is due to rising participation and not a declining employment rate (although it has flattened), a more promising scenario than a few months ago
- **Norges Bank's Q4 Regional Network reports** a marked slowdown the coming 2 quarters, to a 1.9% growth rate. The Network was weaker than expected but it does not suggest that growth will abate faster than Norges Bank f'casted in Sept. Growth is subsiding rapidly in oil related sectors and construction. The **Mainland GDP** slowed to an underlying speed of 1.4% in Nov, Q4 is off to a modest start. **Homebuilders** reports another decline in new home sales and starts. **Core CPI inflation** edged down to 2.0%, primarily due to base effects. Our inflation model suggests that inflation is at/close to peak.

Auto sales probably edged up in Nov, from a low level

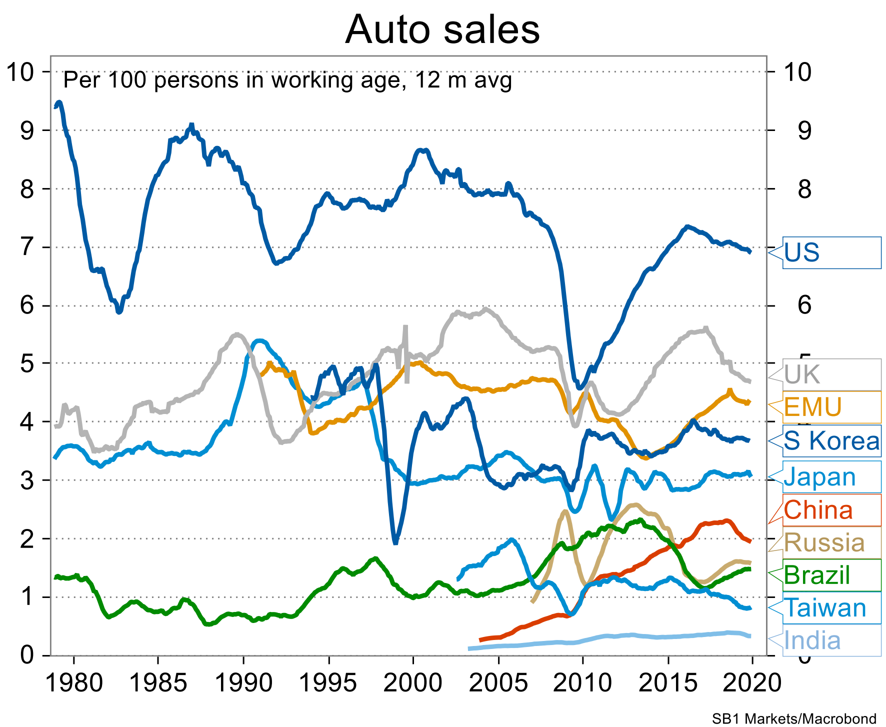
Global sales saved by US, Europe, and a slight recovery in Japan. China not fully stabilise, rest EM up

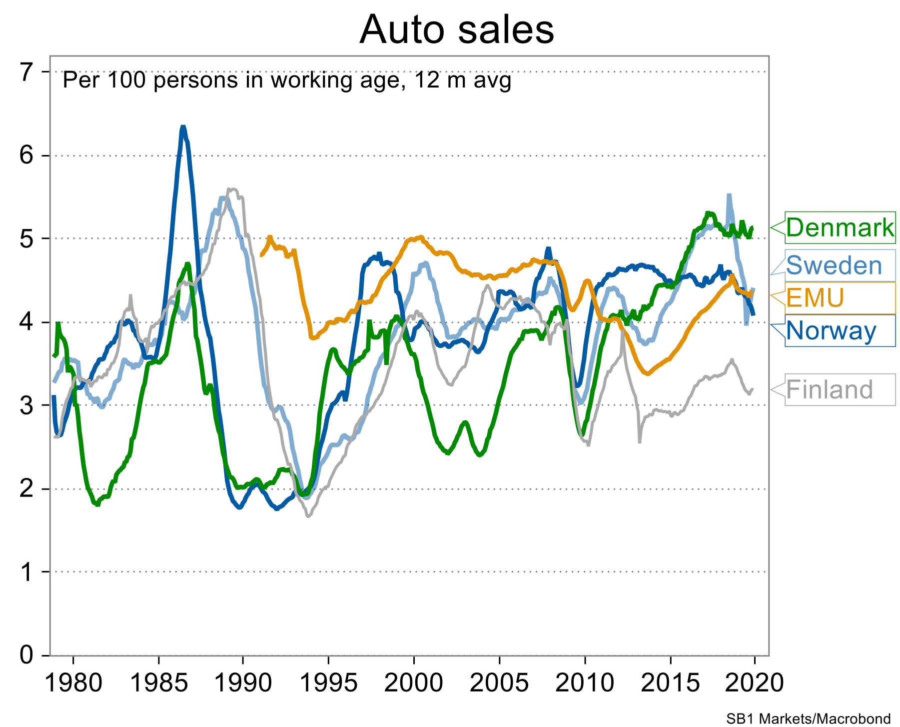




- Global sales increased by 1.9% m/m, and are down 1.4% y/y but some 8% from the level last summer
- Sales in Europe have been zig-zagging du to emission regulation this autumn too, and may now also be influenced by another tightening from January. Anyway sales were somewhat a 'normal' level in Nov. US sales rebounded but is trending down . Sales in Japan recovered just partly in Nov, after plunging in October, due to the hike in the VAT rate (included in other DM at the chart to the left above)
- Chinese sales fell further in Nov, by 1.1%. Sales have not yet fully stabilised, and are down by 5.1% y/y – and -20% from the peak last year
- Auto sales in EM ex. China probably increased just marginally in Nov, after a steep rise in Oct, due to a surprising 32% hike in sales in India. EM x China sales have been weak the prior months, mostly due to low sales in India

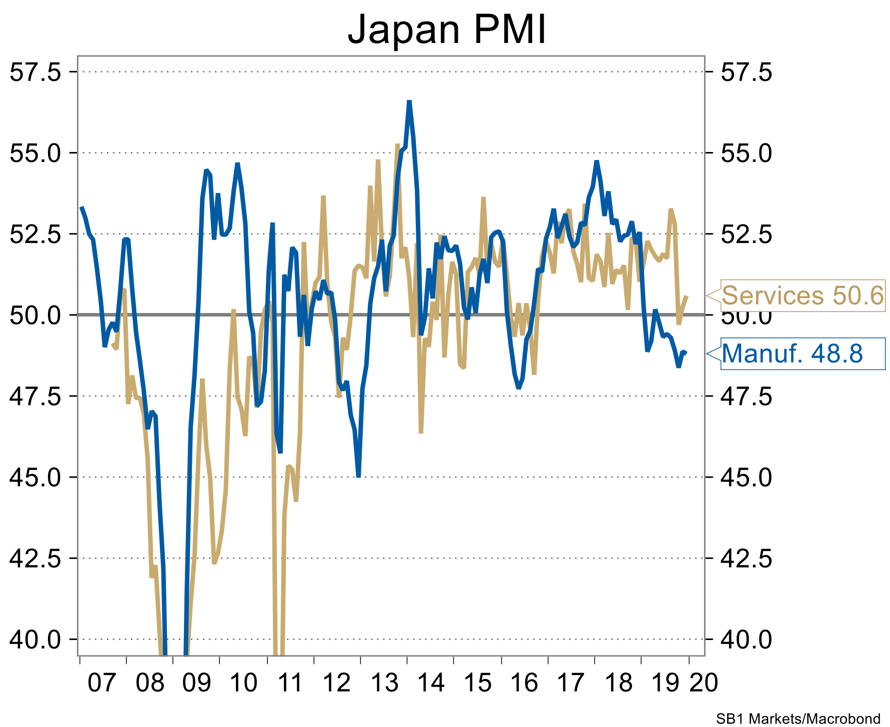
Sales are sagging almost everywhere – in the Nordics too

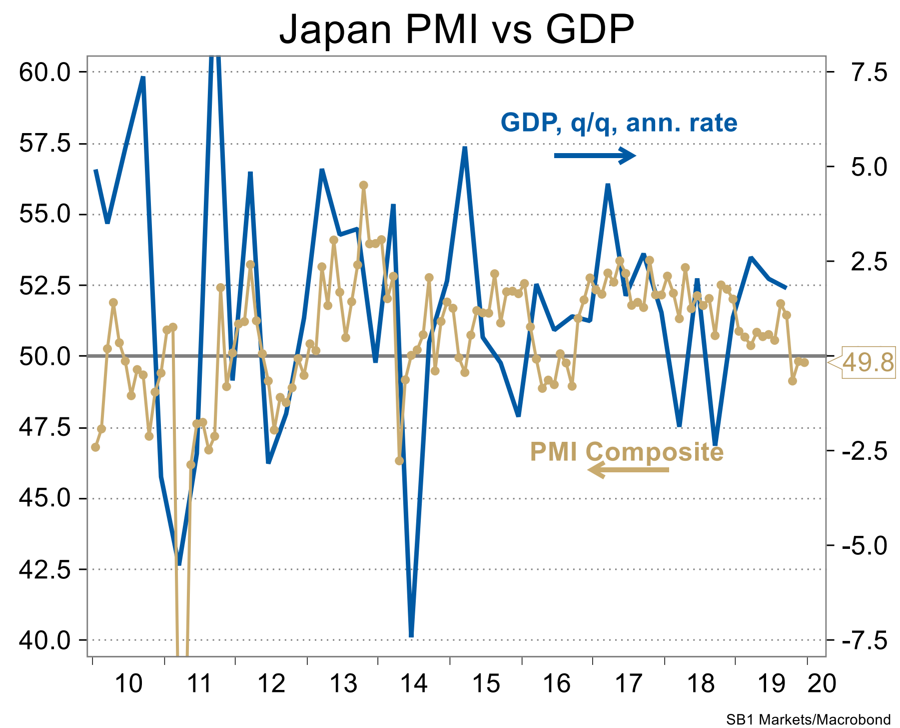




Both PMIs weak in December too

Businesses are still struggling in the aftermath of the October VAT hike, a gradual rebound is likely





- Composite PMI was unchanged at 49.8 in Dec, following the 0.8 p lift in Nov. Thus, the index remains close to the lowest level in 3 years as it signals close to zero GDP growth
  - » The services PMI continued slowly upwards in Dec, while the manufacturing index fell marginally. We expect a recovery the coming months, but it may take some time. In 2014, the last time consumer tax was raised, the services PMI was back at the pre-hike level after 3-4 months. Thus, during these months, we cannot tell whether or not the weak prints reflect a 'fundamental' slowdown
  - » Manufacturing PMI inched down to 48.8, still reflecting declining activity. Japanese manufacturing is slowing along with global demand
- Other Japanese surveys confirms a slowdown – but not more than in '16, 13' or 11'

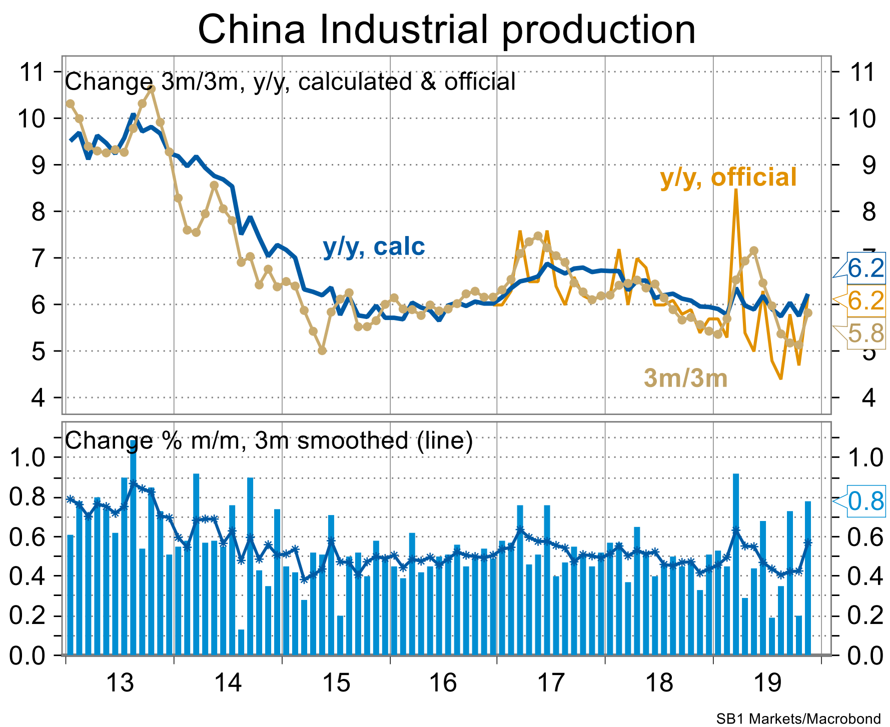
November data on the strong side

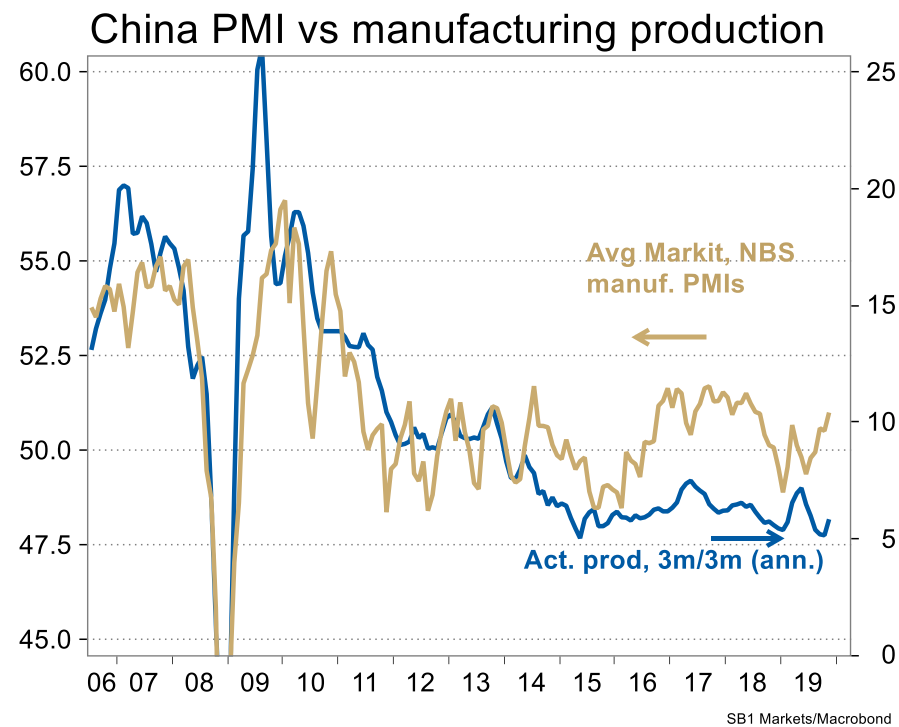
Industrial production, retail and credit growth better than expected

- **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 0.8% m/m and the 3 m average speed rose 0.2 pp to 0.6%, a 7% pace. The (useless!) official y/y rate shot up to 6.2% from 4.7%, expected at 5.0%. The PMIs have recovered from H1 and is now signalling higher growth
- **Retail sales** recovered in November (& monthly data were revised up), and the annual growth rate was much better than expected . Volume growth is still slowing, as high meat prices takes its toll on disposable income. **CPI inflation** accelerated to almost 4%, due to higher food/pork meat prices
- **Investments** have been expanding steadily, at a comfortable low rate, 5% y/y nominally, well below growth in nominal GDP. The official YTD y/y rate was flat at 5.2% in Nov, as expected Real growth has accelerated to 3% through 2019, from zero. Still, building starts fell m/m in Nov, and was flat y/y
- **Credit growth** accelerated in November, due to a more rapid growth in bank loans. The credit impulse is now clearly positive again, following the 2018 contraction

Industrial production recovered sharply in Nov (not only in useless official data)

Production rose 0.8% m/m, up from 0.2% in Oct. Our y/y calculation up 0.4 pp to 6.2%





- Production rose 0.8% m/m in Nov, following a weak 0.2% growth in Oct (but 0.7% in Sept). These monthly data are volatile, but even the 3m average accelerated to 0.6% from 0.4%, equalling a 7% annualised growth pace. Our y/y rate edged up 0.4 pp to 6.2% - and it has been trending flat since spring 2018
  - » The official y/y growth rate is 'useless', far too volatile as it is not adjusted for holidays or working days. In Nov, growth accelerated by 1.5 pp to 6.2% %, after a 0.5 pp drop the previous month. The official rate was expected up to 5.0%!
- The two PMIs have (in average) improved substantially from the Jan & June 2019 local troughs, and are now signalling higher growth. Export volumes are trending up and are close a peak levels. China has most likely not been brought to a halt

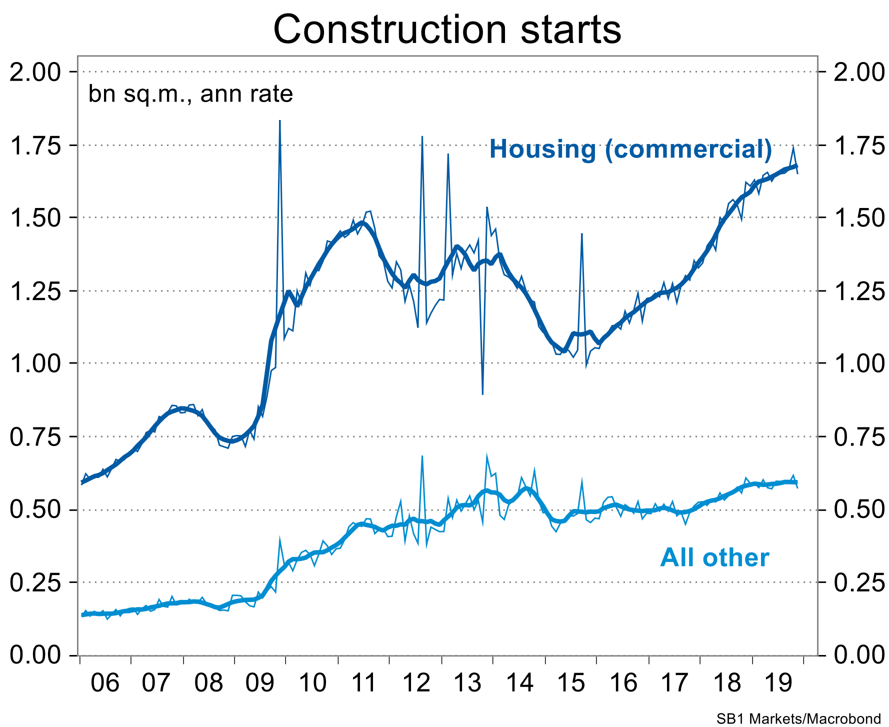
Retail sales volume growth slides down, influenced by the swine flu

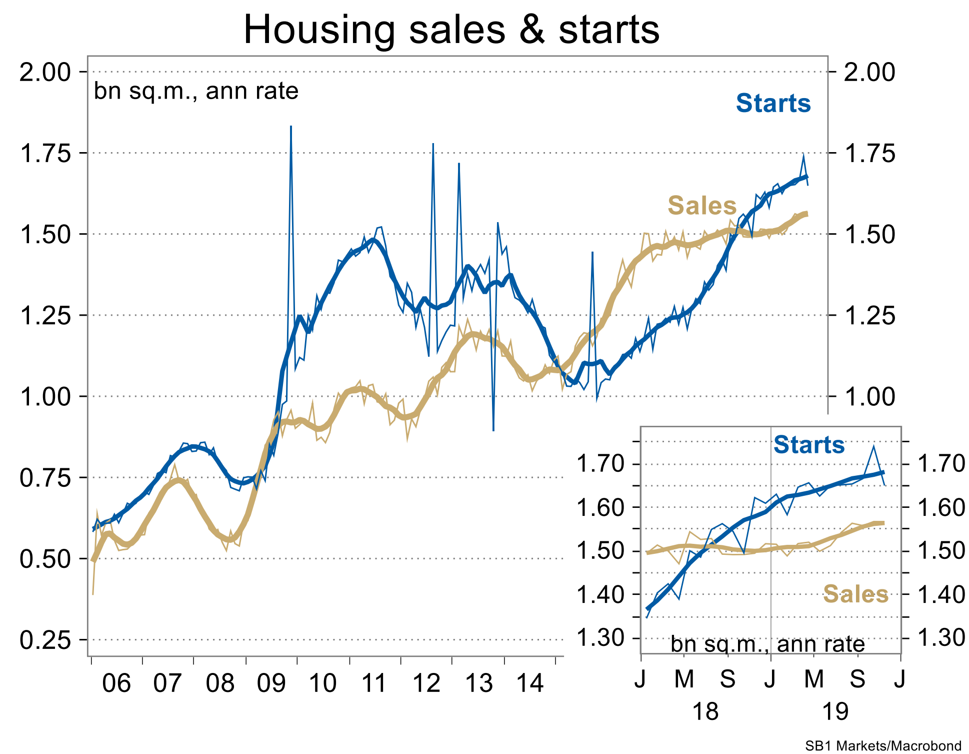
Sales rose 0.4% in Nov, according to our volume estimate. Annual rate down to 5.1%

- The official value growth rate rose to 8%, from 7.2% in Oct, expected at 7.2%. Our far less volatile value growth estimate (based on monthly seas adj. data) yields a 8.1% speed, up 0.3 pp. Value growth is no doubt cooling, however, the speed down is slower than it was in 2018
- We assume a 0.4% m/m volume growth. The annual rate fell to 5.1%, a 0.2 pp drop from Oct. Inflation has accelerated due to the high pork meat prices (inflation up to above 4%, curbing real income growth sharply
- 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 – and at some stage pork meat prices will decline (perhaps some more American pork meat now??), boosting overall buying sharply

New home starts down in Nov, and Oct was not that impressive

New home sales are still trending up

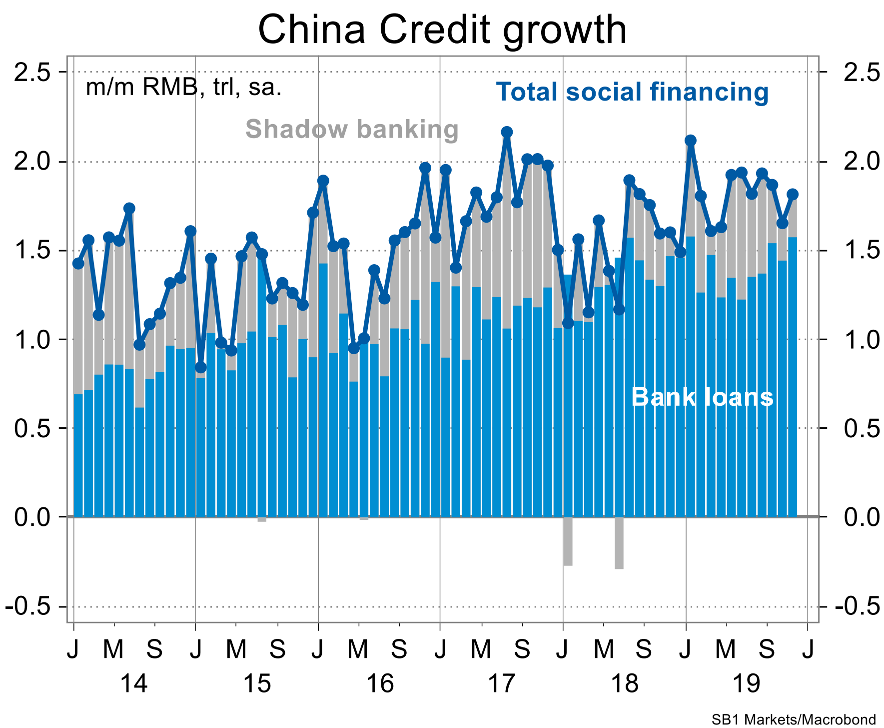


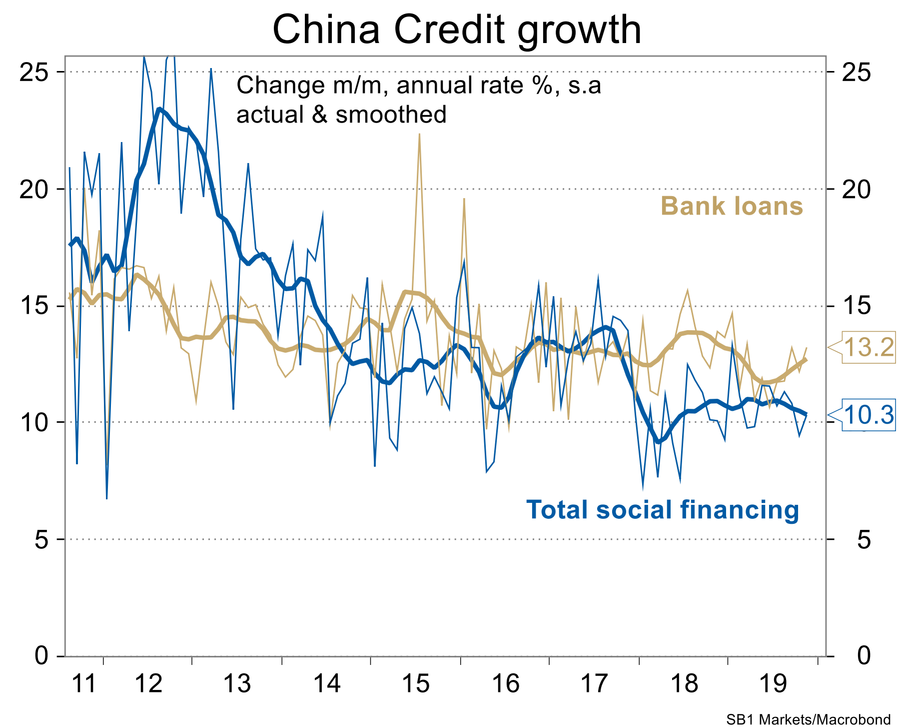


- Housing starts fell m/m in Nov and was flat y/y. Still the trend is up, even if starts in Oct was revised 5% down. Starts are up almost 70% from the 2015 trough, to a high level. Close to peak? Well, the level is high (in sq.m. growth per person), and there are plenty of reports on unsold homes. However, 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 also fell in Nov, and they are marginally down y/y. Recent months (smoothed) 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 growth accelerated in November, due to more bank lending

Bank lending trending up recent months, shadow banking activity cooling

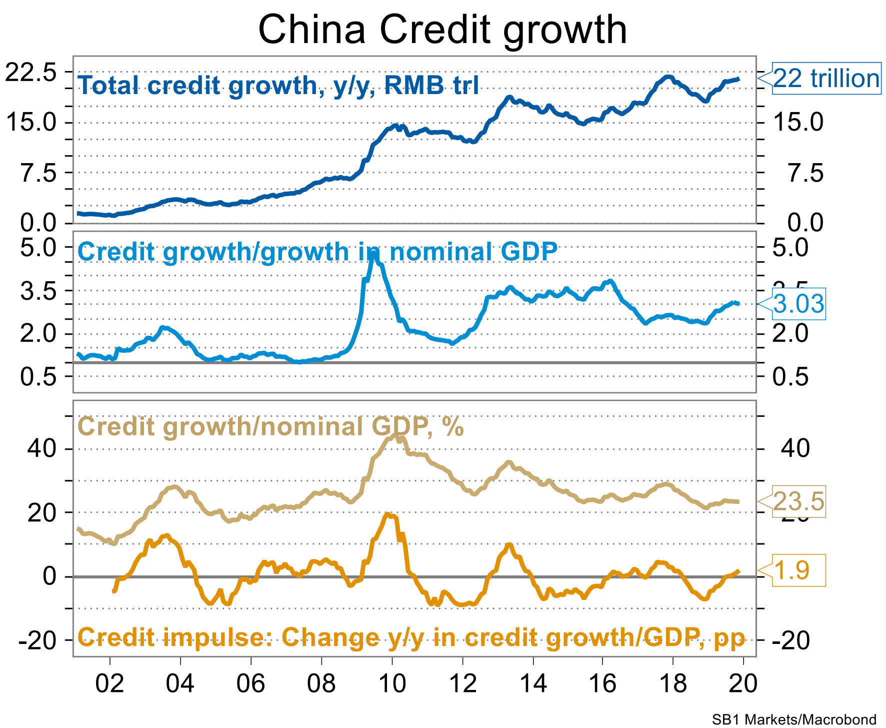


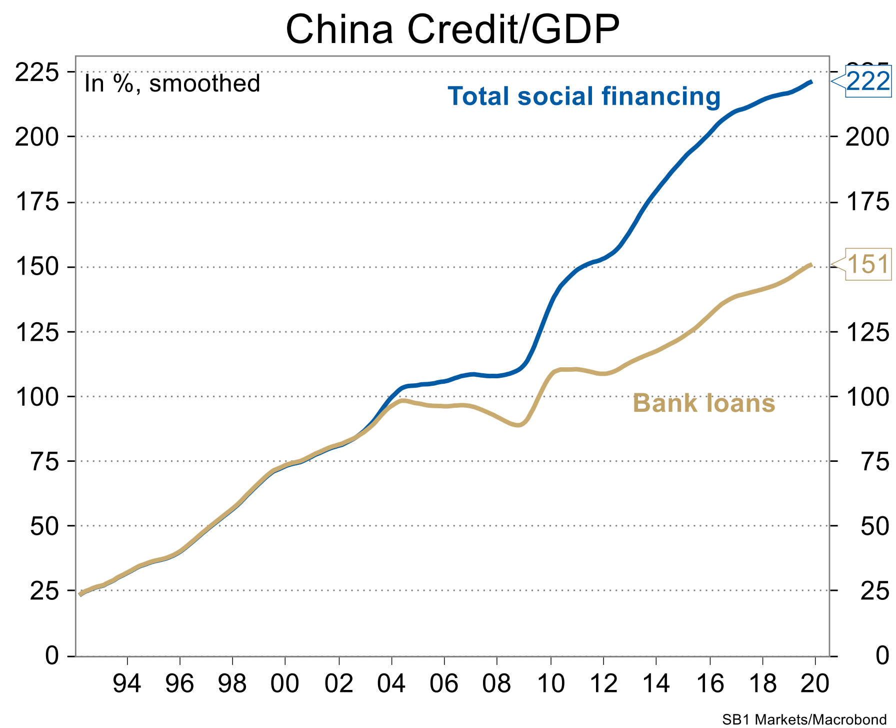


- Total credit rose by 10.3% m/m annualised in Nov, from a 9.8% pace in Oct. In RMB, total credit rose by 1.7 trl, from 0.6 trl, expected at 1.5 trl (not seas. adj). The underlying trend is slowly up since early '18, the credit impulse (y/y) is marginally positive
  - Growth in bank lending har accelerated since the summer, perhaps due to the cut in reserve requirements. They 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 accounts for some 20% of total credit supply (but less the recent months)
- 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. Overall growth has not slowed that much either

Credit impulse has turned marginally positive, from negative

Credit growth is now slowly increasing vs GDP

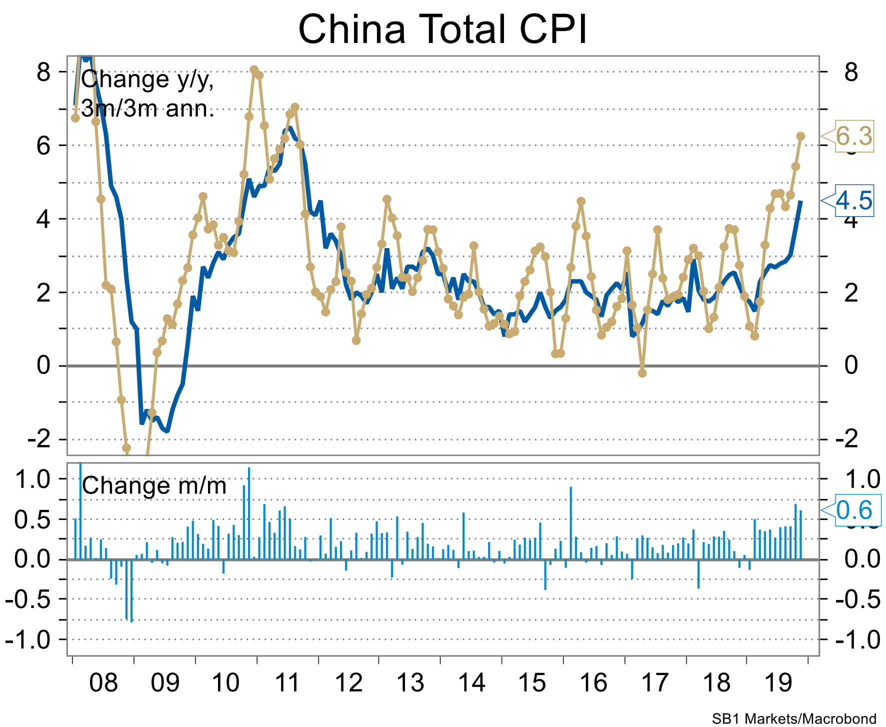


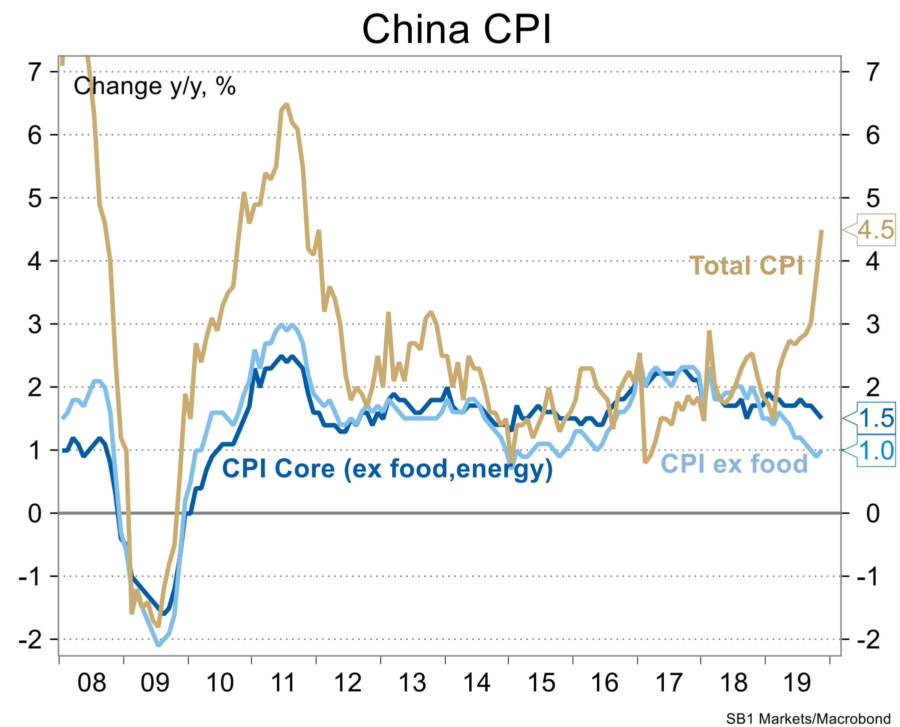


- A positive credit impulse implies that the credit growth/GDP ratio is increasing (the 2nd derivative of credit vs the GDP level)
  - » A negative credit impulse indicates credit tightening (or weaker demand) and has been associated with slowdowns in the Chinese economy
  - » Now, the credit impulse 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 23% of GDP. <u>That's not sustainable, neither for lenders nor borrowers in the long run, as nominal GDP growth is less than 10%</u>. The Government may succeed in increasing credit supply short term (if they dare to, vs long term risks) but the problem may turn out to be demand for credit

Total inflation soared to 4.5% in Nov, core CPI eased to 1.5

Total inflation climbs on a rapid increase in pork prices, core inflation is trending down

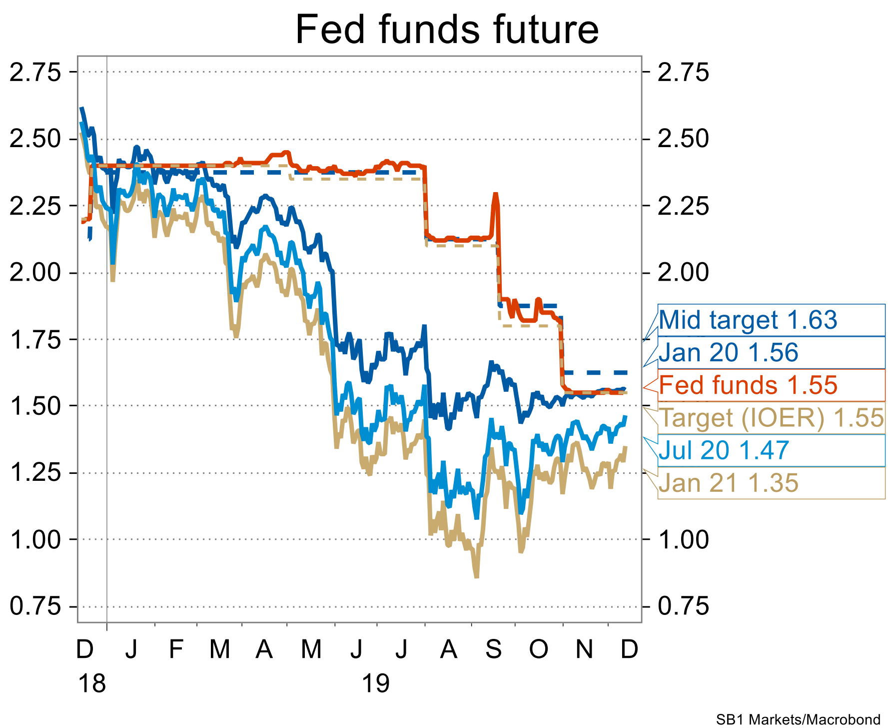


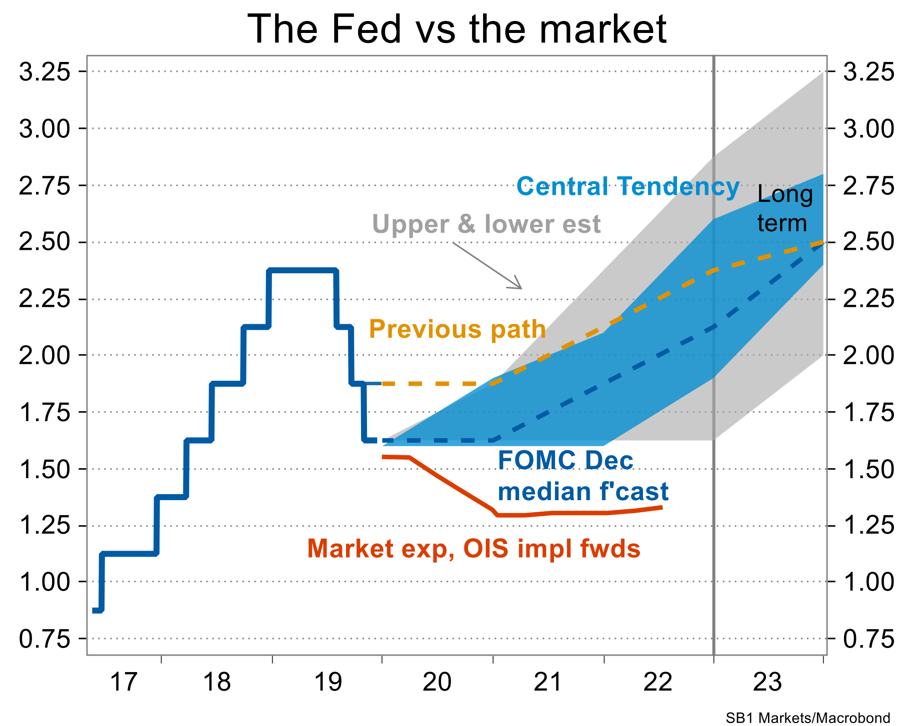


- Headline inflation climbed to 4.5% in Nov, a 0.7 pp jump! Total inflation is fuelled by accelerating food prices
  - » Food prices jumped 2.1% m/m and the annual rate rose to 19%, the highest since 2008. Pork meat prices are up 110% y/y!!
- Core inflation (x food & energy) slowed further to 1.5%, trending more or less flat. CPI ex food fell to 0.9% in Sept, sliding down, due to lower energy prices
- High CPI growth due to this supply shock is not any argument for a tighter monetary policy, rather the opposite. Higher total inflation is dampening real consumption growth. Moreover, the decline in the PPI <u>may</u> signal a slowdown in the Chinese economy, check next page.

The Fed is on hold; signals an unchanged interest rate through 2020

FOMC held the Fed Funds rate unchanged, of course, and does not plan any hike before 2021

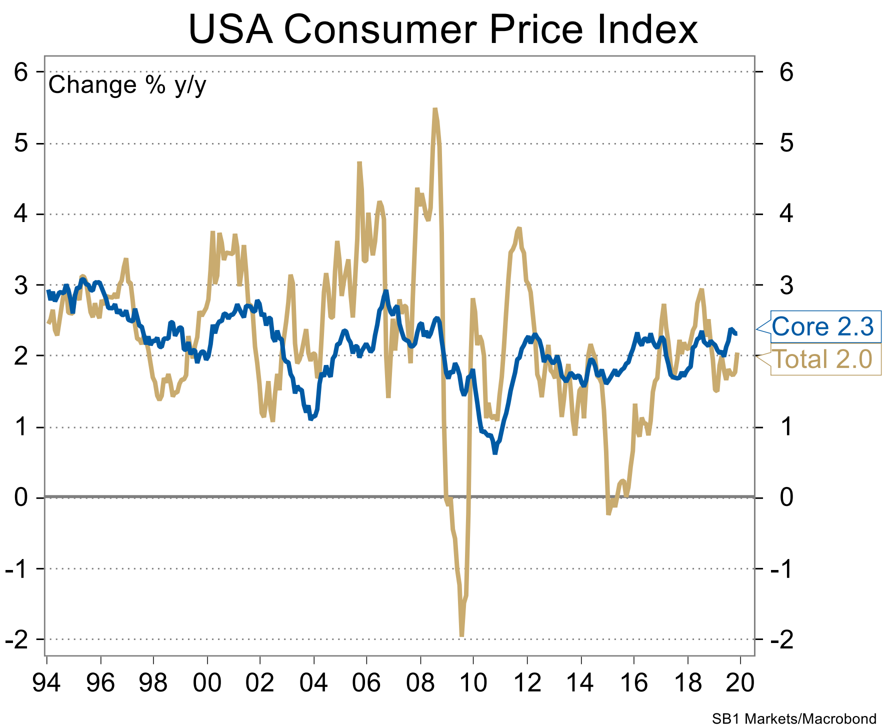


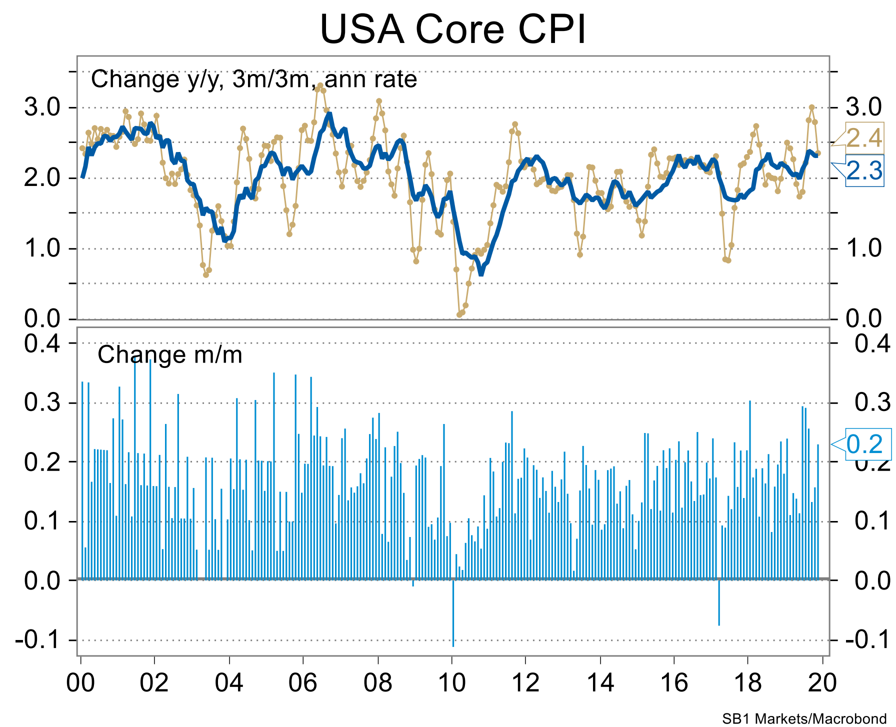


- The FOMC kept the Fed funds rate unchanged at 1.5-1.75%, as everyone anticipated. The decision was unanimous, for the first time since May
- The dot plot signals an unchanged interest rate through 2020 and one hike in 2021 and one in 2022, with the longer run rate unchanged at 2.5%
  - » At the news conf., Chairman Powell signaled that the interest rate would remain at the current level unless incoming economic data deteriorates materially. An appropriate assessment, in our view, as consumer spending remains strong, labour markets are tight and overall growth is not weak
- Market reactions: Stock markets cheered the decision to keep interest rates on hold through 2020, as some worried about a signalled hike (although markets are pricing a cut). Bond yields fell, the 10 y gov down by 3 bps (and by 6 bps during the day). Fed Funds futures inched down, the Jan' 21 contract by 3 bps. The market still prices a cut in 2020, but less than a 40% prob. of a cut in H1 (after promising trade deal reports)

Core inflation steady at 2.3%, peaking now?

Core CPI up 0.2% m/m, as expected, and the annual rate was unchanged at 2.3%

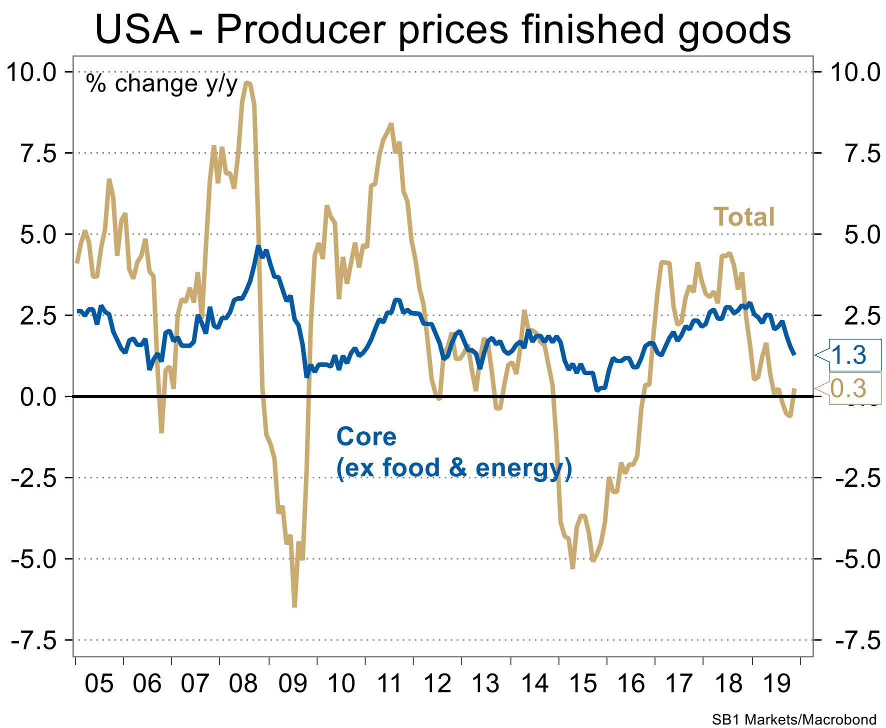


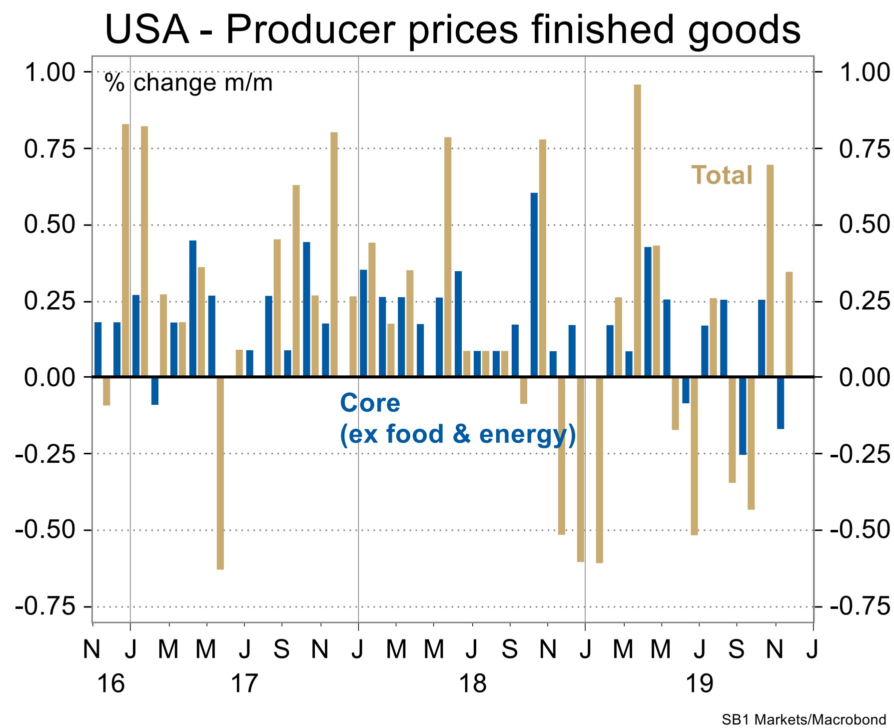


- Core CPI increased by 0.2% m/m in Nov, in line with expectations. The annual rate held steady at 2.3%. The underlying speed has slowed to 2.4% and does not suggest much higher annual rates. Moreover, producer prices and inflation models indicate that inflation may be peaking now. But it is not ‘too’ low, at least according to the CPI index
  - » Fed preferred price measure, the core PCE (the consumption deflator) is up ‘just’ 1.6%, below Fed’s 2% price target
- Headline inflation edged up to 2.0%, a 0.2 pp increase. Total CPI inflation was pulled down by lower energy prices in late 2018/early 2019, this impact is now turning as energy prices are slowly climbing

Producer price growth heading down, does not signal higher consumer inflation

Core finished goods prices dropped 0.2% m/m in Nov, vs the 0.2% expected increase

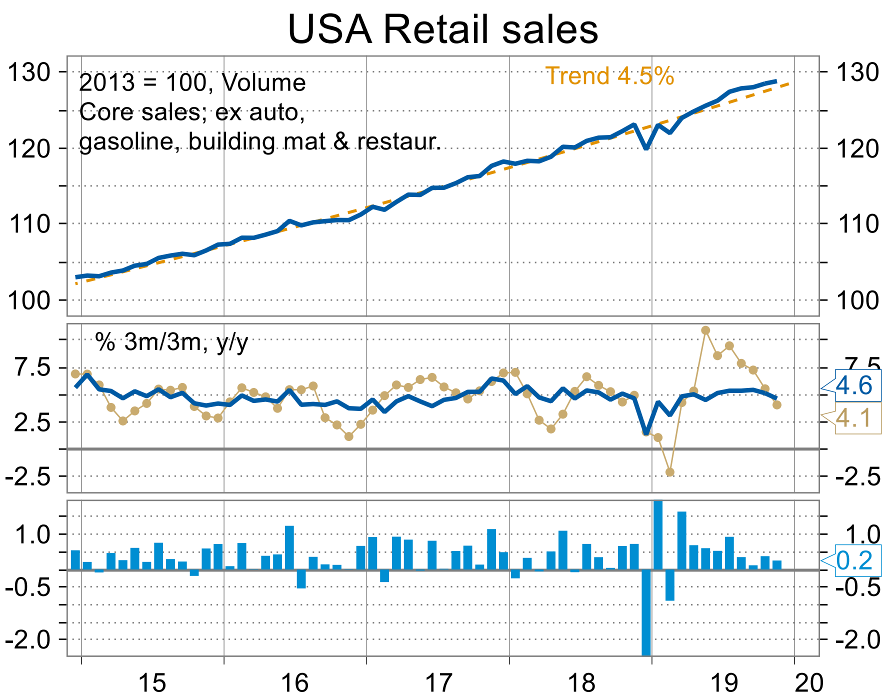




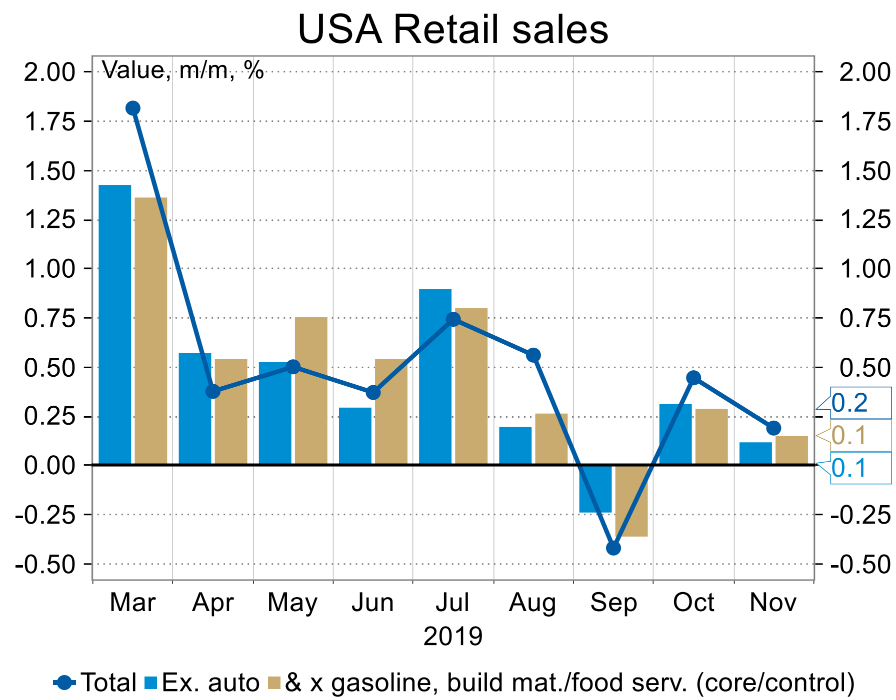
- Core finished goods x food & energy PPI fell by 0.2% m/m in November, 0.4 pp weaker than expected. The annual rate slipped to 1.3%, an uptick to 1.7% was expected. Producer inflation is slowing rapidly, and underlying growth (measured 3m/3m) has fallen to 0.3%, does not signal any recovery in the annual inflation rate
- Headline PPI increased by 0.3% m/m, 0.1 pp higher than expected after a spike last month. The annual rate has turned up to 0.3%, as the impact from lower energy prices the past year is subsiding
- Easing core producer price inflation does not point to any uptick in core consumer inflation

Retail sales growth is slowly cooling

Core sales rose 0.1% m/m, underlying growth slows but still not low



SB1 Markets/Macrobond

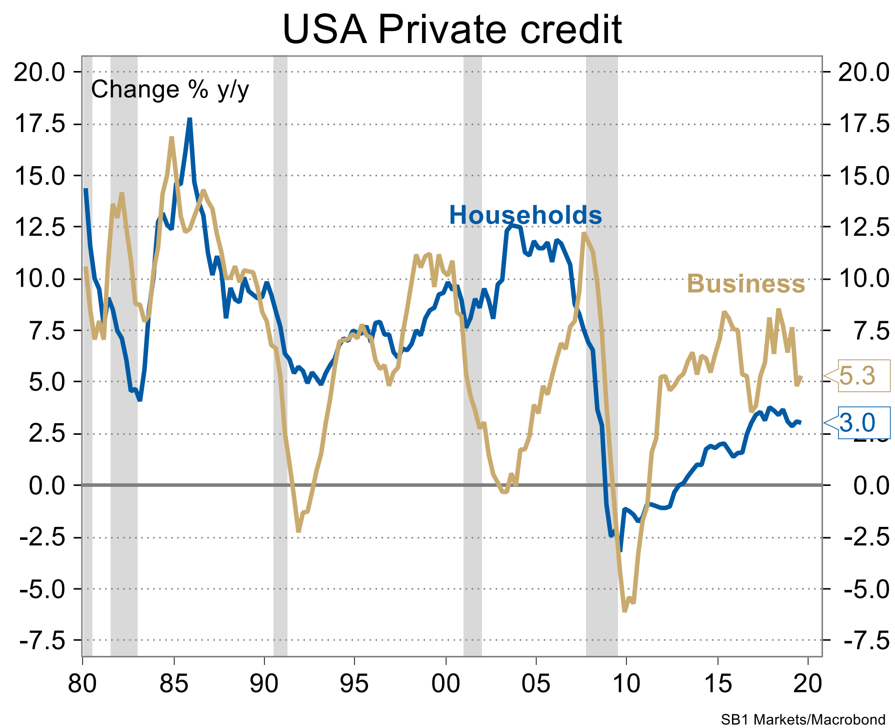


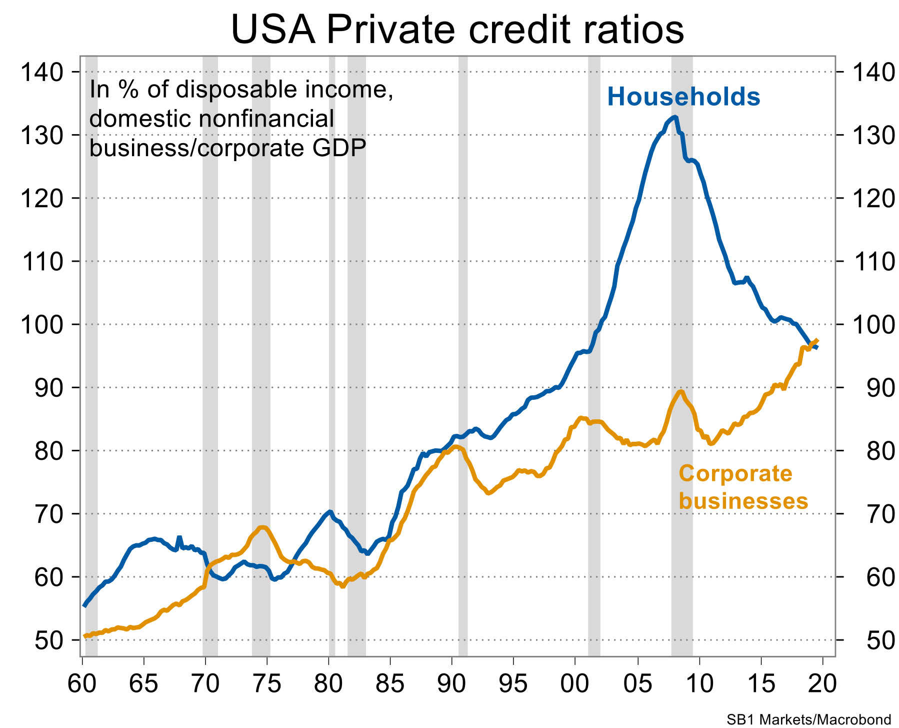
SB1 Markets/Macrobond

- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by just 0.1% m/m in nominal terms in November, 0.3 pp weaker than expected
  - » Total retail sales rose 0.2%, (Oct revised up 0.1pp to 0.4, but Sept revised down by the same amount) – and the avg nominal growth past 3 months is just 0.1% per month
- <u>We estimate 0.2% growth m/m in core sales volume</u>. October sales volume came in 0.2 pp higher than we expected, at 0.4%, as prices fell. Regardless, growth has eased the past months, the 3m/3m speed down to 4.1%, from hovering above the double pace during the summer! Contribution to growth from total private consumption will most likely slow in Q4 vs Q2 & Q1
  - » Income growth has slowed somewhat the past year but consumer confidence remains strong, we do not expect any hard downturn now

Household credit growth still muted, corporate debt growth has slowed

Household debt up 3% y/y, well below income growth. Corp debt has slowed to 5%, still above GDP

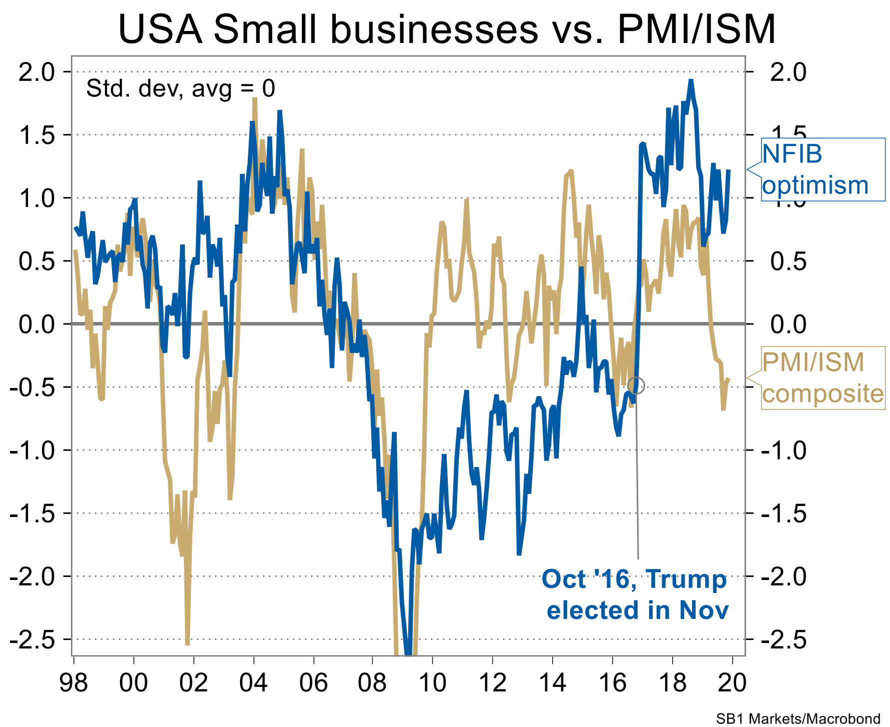


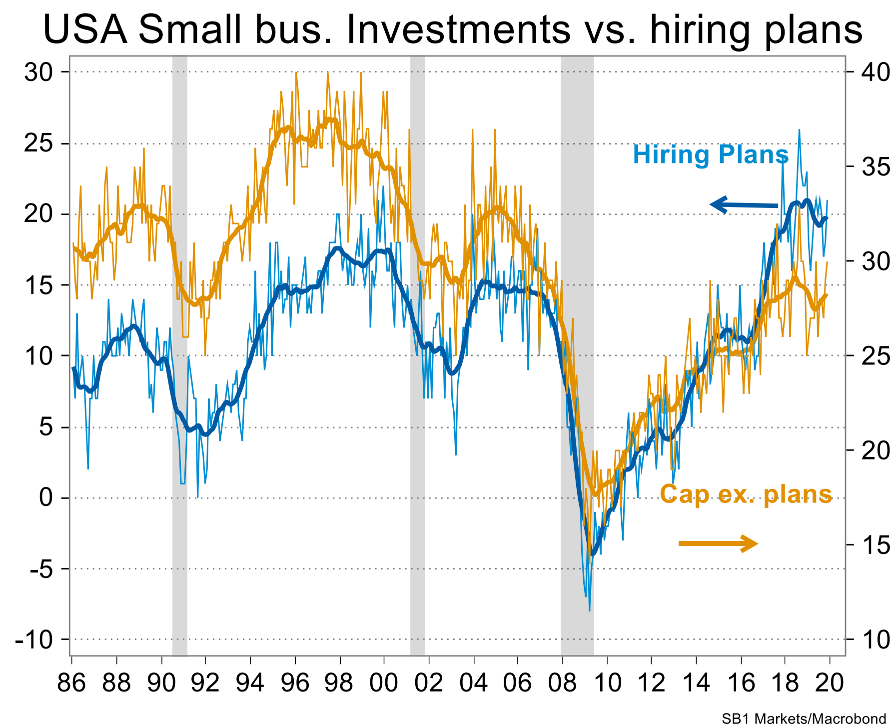


- Household debt growth slowed slightly q/q in Q3 and is increasing slower than household income. The debt/income ratio has fallen to well below 100%, down from 133% in 2007! The largest deleveraging ever in the US. Even so, unemployment has fallen most of the time!
- Corporate credit growth is more volatile but growth has slowed somewhat, the past quarters to approx 5%, still faster than growth in corporate (or total) GDP. The debt/GDP ratio has increased sharply since the financial crisis, and it was record high in Q3. If not for equity buybacks the past 10 years the debt ratio would not have been 98% (vs corp GDP) but in the 50'ies, lowest since the 1950'ies, from 90% at local peak during the financial crisis (and it fell to close to 80% after the crisis)

Small businesses' optimism bounced back in Nov, miles above PMI/ISM

NFIB optimism index has stabilized since early 2019 and the details were upbeat this month

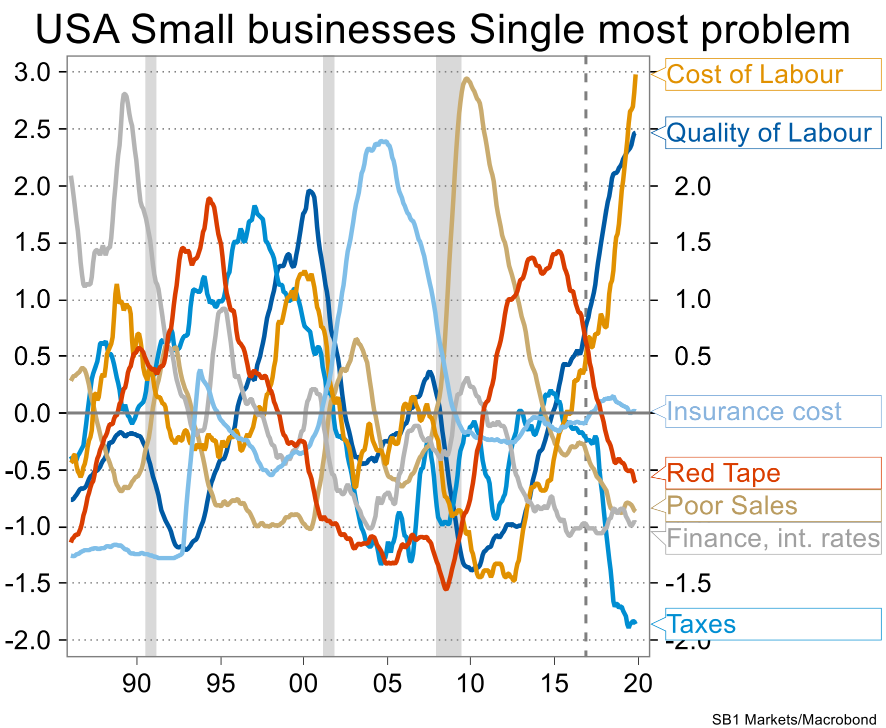


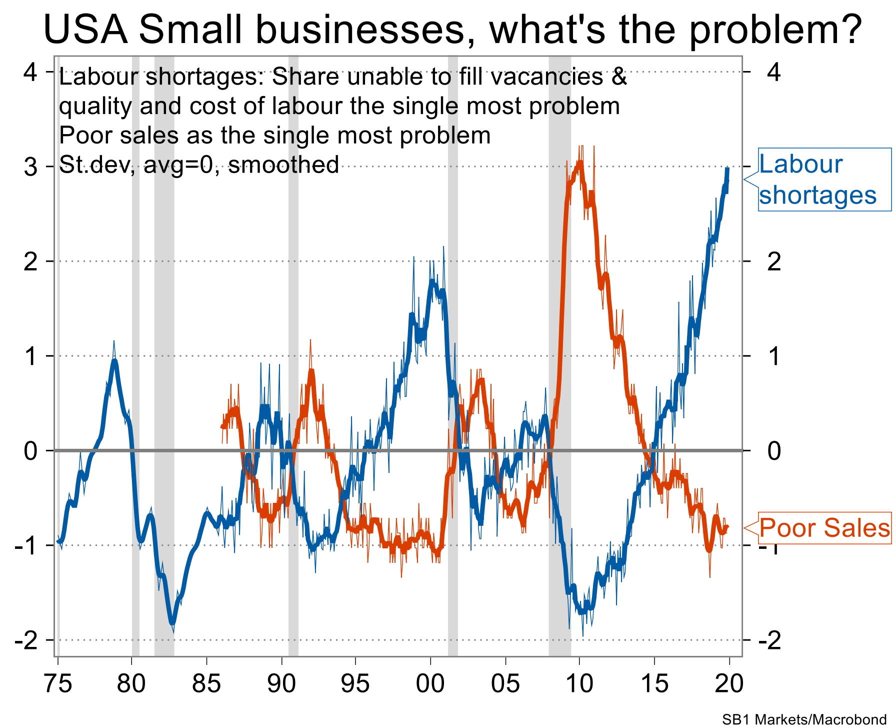


- The NFIB optimism index, measuring small businesses' expectations on business conditions, rose to 103.7 in November, better than expected. The index has stabilised this year, at a rather high level, after dropping in late 2018
  - » The NFIB optimism index is 1.3 st.dev above average (since 1998). The avg of the surveys from the ISM/Markit PMI is well below average. 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 PMI/ISM (particularly the latter) are more influence by trade war uncertainties
- Investment plans have been soaring in Oct/Nov, although trending down from the mid-2018 peak. The level is not high
- Hiring plans have probably peaked but they are still aggressive – and were lifted in Nov. Companies are still not able to fill vacant positions – and they plan record high wage compensation!

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!



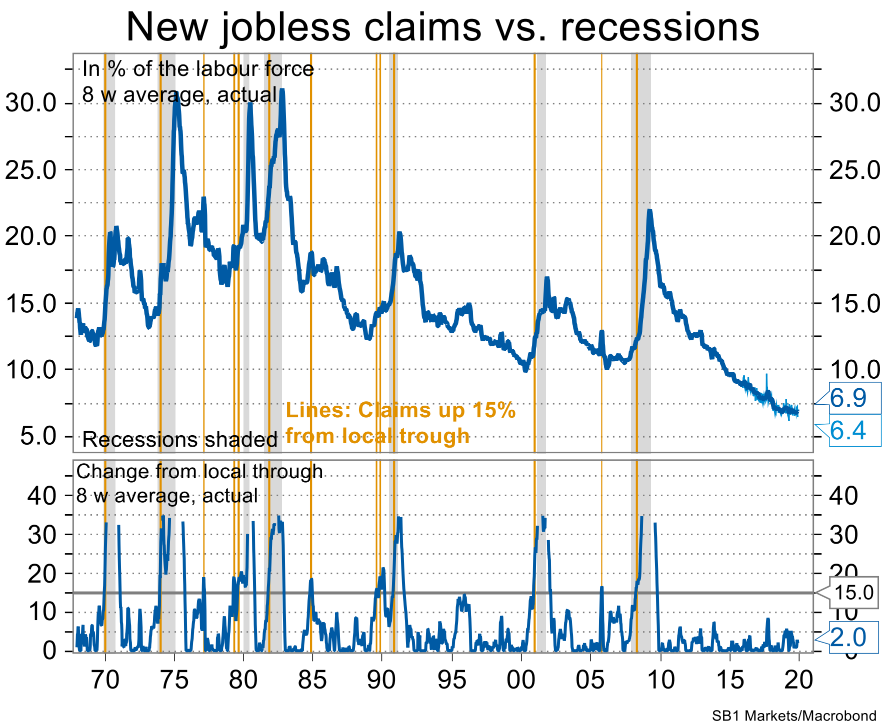


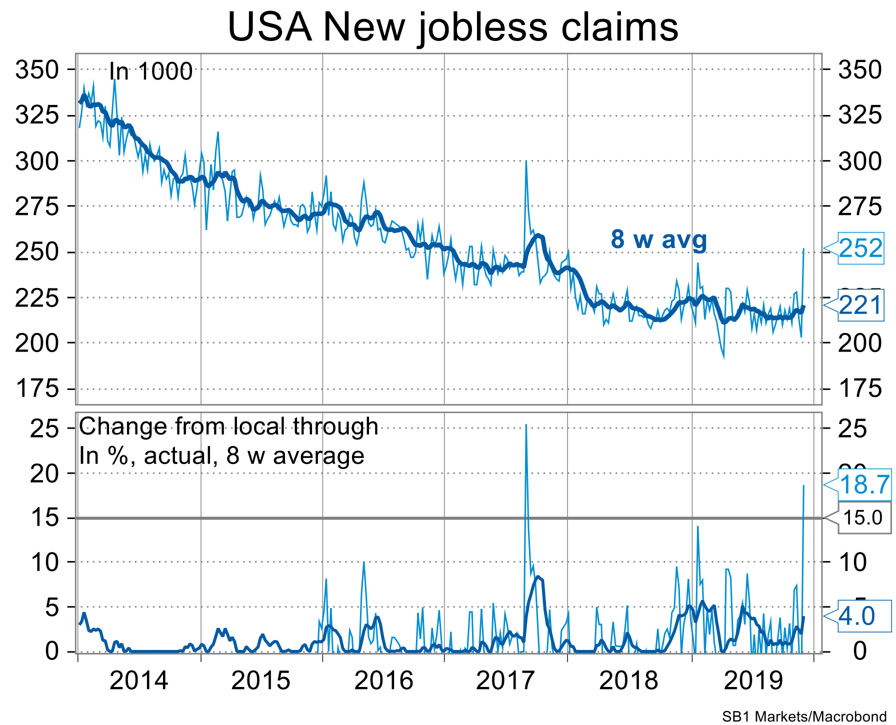
- Unusually few are complaining about finance/interest rates and about taxes, following last year's tax cuts
- Sales are not the problem either, almost 20 year since so few stated sales as the most important problem
- So the answer is obvious: The Fed must cut the fed fund to zero, or below, the USD must be taken down, as must taxes!

SpareBank 1 MARKETS

Jobless claims spiked to 252', very likely due to Thanksgiving distortions

The pickup reflects a later than usual holiday, not any underlying labour market weakness

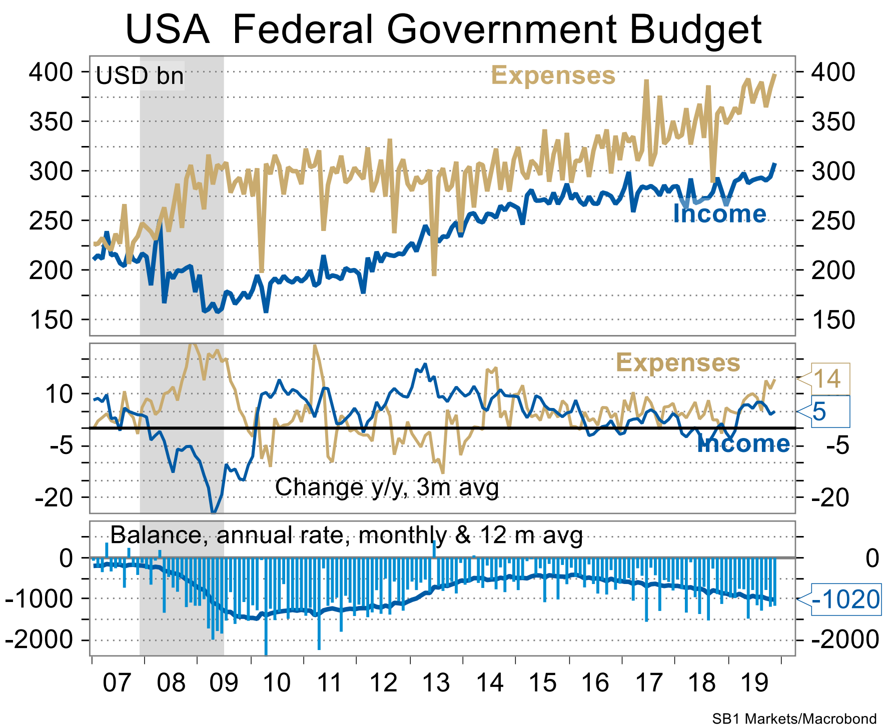


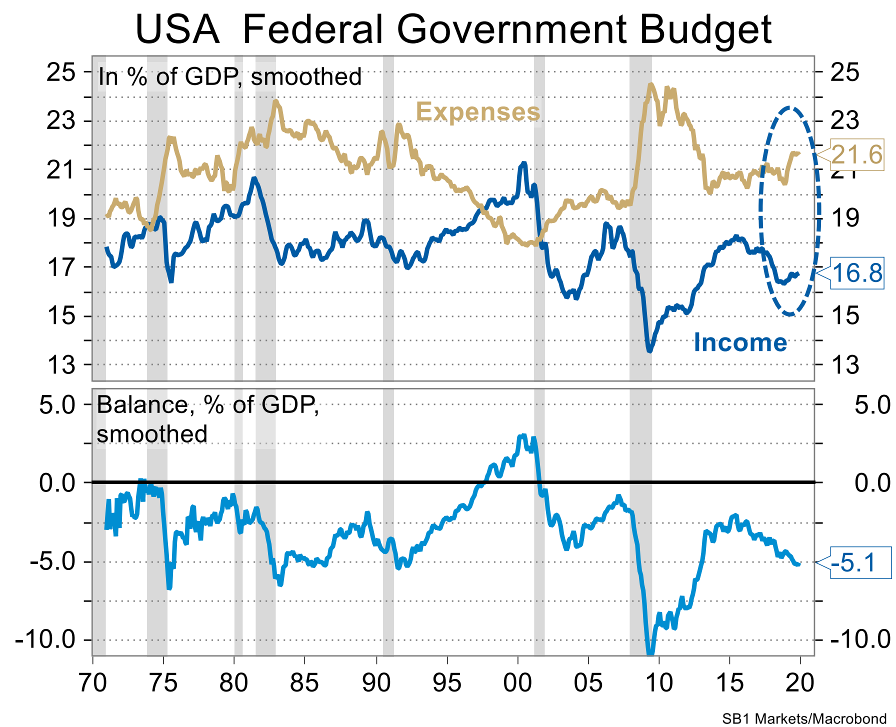


- During the Thanksgiving holiday, fewer than usual are filing their jobless claims, and the next week, claims tend to soar. As Thanksgiving can fall on different weeks, the seasonal adjustments are troublesome. This year, Thanksgiving was one week later than 'usual'. Looking at the unadjusted data, the spike last week was equal to that of the previous years. Thus, the uptick does not reflect any underlying increase in unemployment – and we expect a retreat the coming week
- The 8 week average inched up to 221', still a very low level and just a marginal increase
  - » A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow 'recession' warning line is to be drawn, check the chart to the left. So, no reason to worry now?

The federal budget deficit is widening

The federal deficit has widened to 5.1% of GDP, and the total public sector deficit at 7.4% of GDP!





- The budget deficit came in marginally to USD 1.170 bn in annual rate in November (seas. adj), and the 12 m avg increased to 1.020 bn, rising steadily since 2016. The deficit equals 5.1% of GDP. Incl. local government etc, the US ran a full employment, peacetime deficit at 7.4% in Q3 (from 6.9% in Q1); totally unprecedented!
- Federal spending is up 14% y/y 3m smoothed, well above growth in nominal GDP. Income is up just 5% 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 21.6%, way above a normal level (except for during recessions). Regrettably, federal income equals just less than 16.8% 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 '20 deficit, but no more than some 0.2 pp of GDP

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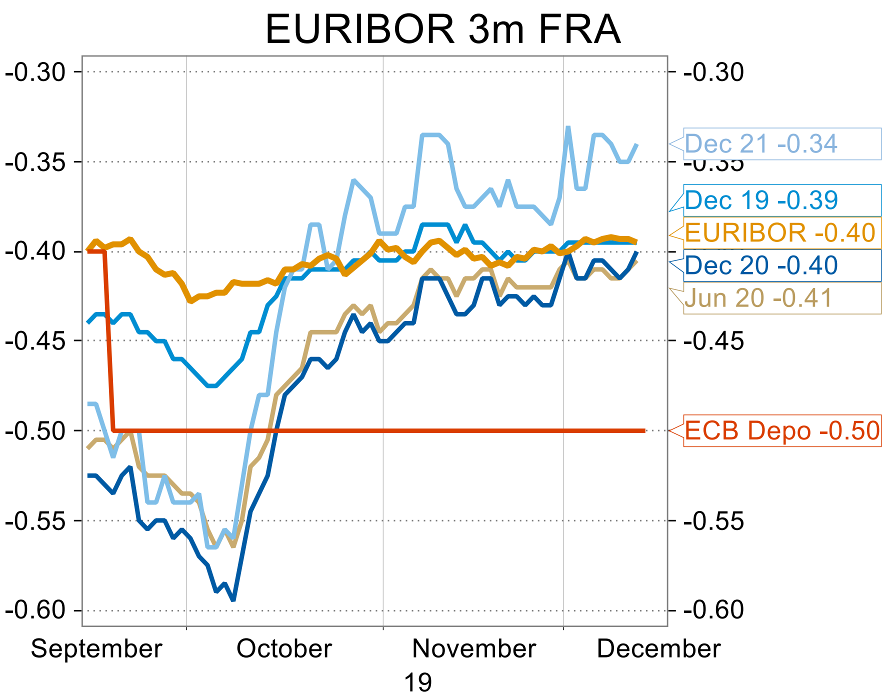
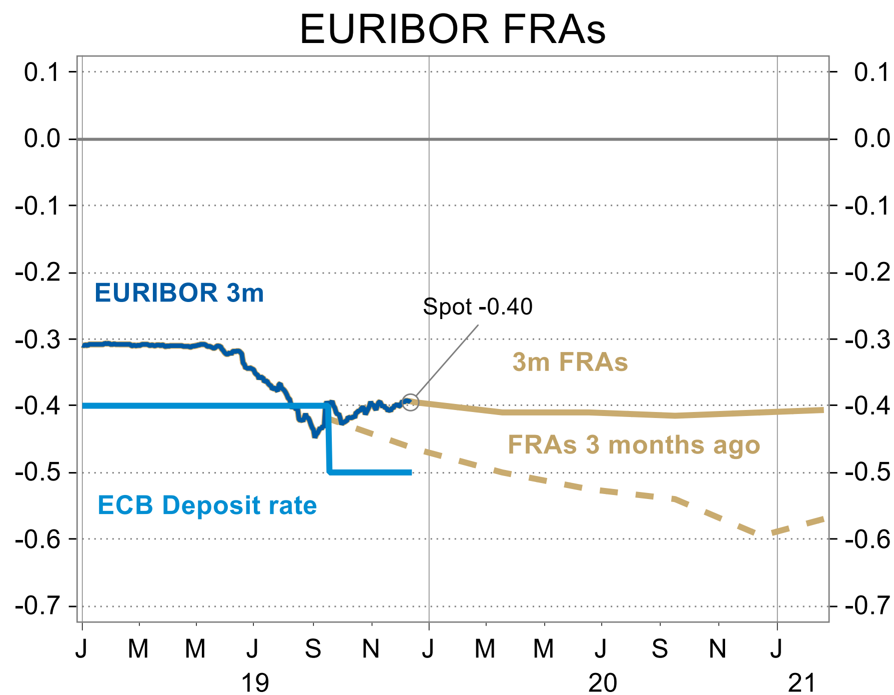
The ECB signalled no monetary policy changes at Lagarde's ECB debut

Christine Lagarde focused on the planned strategic review of ECB's objectives in her first statement

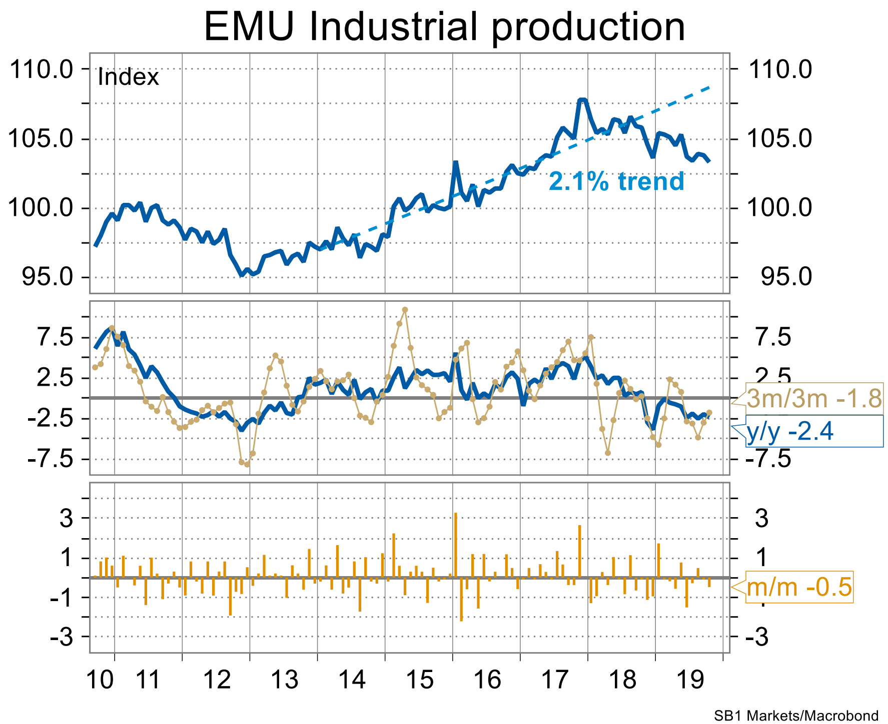


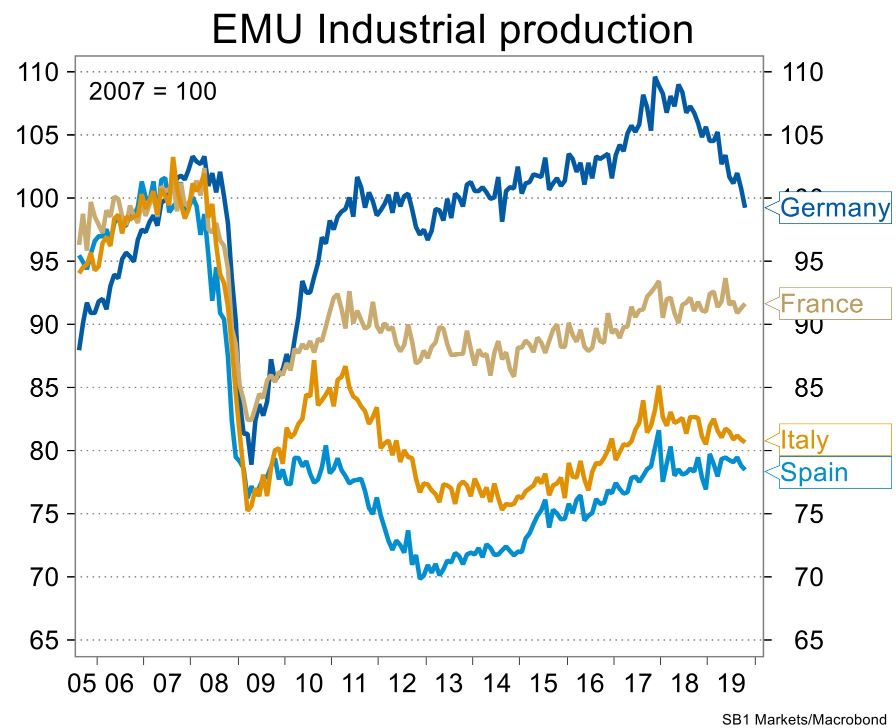


- The ECB held the deposit rate unchanged at 0.5% and asset purchases will continue at EUR 20 bn per month. Markets expected no changes in the monetary policy meeting, all eyes were on Christine Lagarde's debut
  - » The main messages from the last meeting were broadly repeated, although downside risks were cited as somewhat less pronounced. Lagarde did not reveal much of her monetary approach, other than that she will aim to be a 'wise owl' and not a hawk or dove. She set out the plans for the ECB strategic review, which will be exercised for the first time in 16 years. It will address ECB's objective and examine the effectiveness of the policy tools
- The 2019 GDP f'cast was nudged up to 1.2%, from 1.1% and the 2020 f'cast was lowered 0.1 pp to 1.1%, and 2021 unchanged at 1.4%. The 2019 inflation outlook was held unchanged at 1.2%, 2020 nudged up to 1.1%, from 1.0%, 2021 f'cast was reduced to 1.4%, from 1.5%.
- No large market reactions, FRAs inched up 1 bps, 10 y swap rate up 4 bps. Markets are pricing a flat rate in 2020 – and a hike in 2021

The downturn persists; industrial production dropped again in Oct

Production fell by 0.5% in Oct. Germany nosedives, France & Spain have flattened, Italy slides down

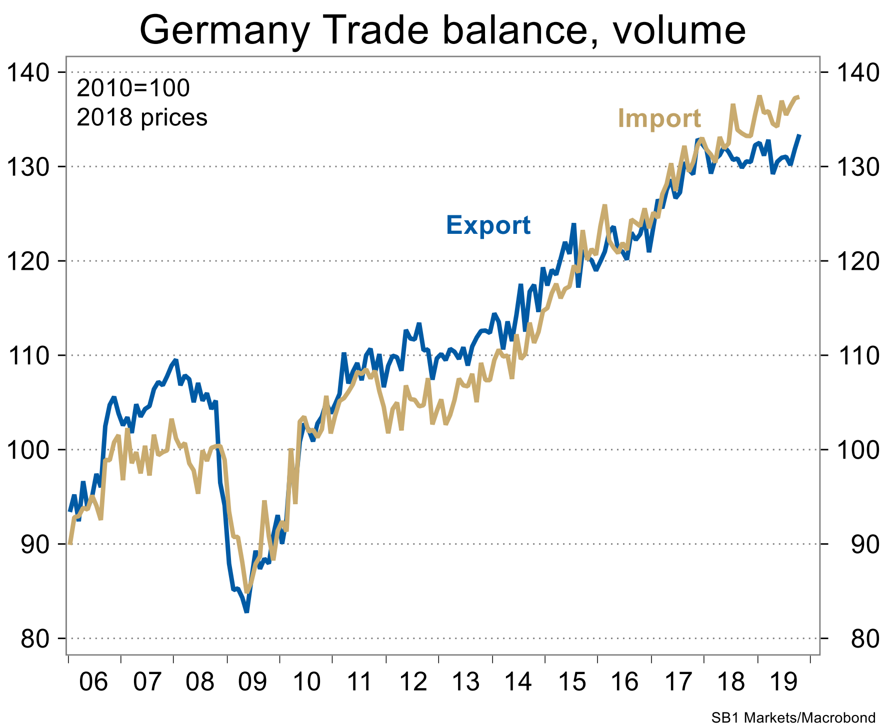


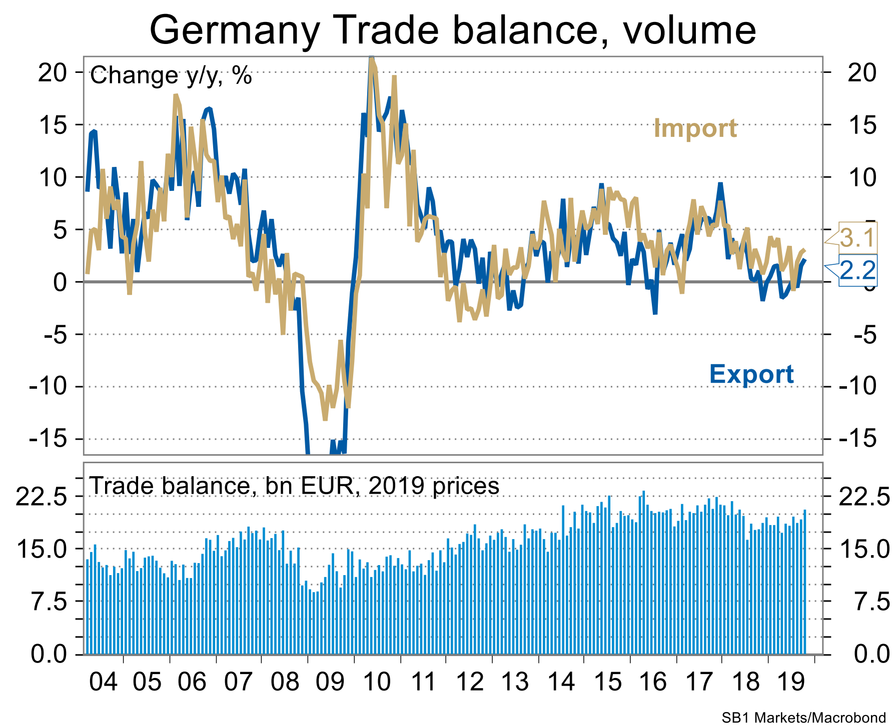


- EMU industrial production (ex construction) decreased by 0.5% m/m in Oct, as expected. Underlying growth is - 1.8%, the downturn has eased just marginally recent months. The annual rate is -2.4%
  - » Production plunged 1.5% in Germany, and Spain, Italy and Ireland reported moderate declines. Production rose 0.4% in France
  - » The other large countries are so far holding up better than Germany but none are shining. In Germany, production has dropped 9% from the 2018 peak. France and Spain have stagnated (and weakened the most recent months), Italy slides steadily down
- Manufacturing PMI is very weak but may signal that the manufacturing dip is bottoming now, check the next slide

Exports have been soaring the past 2 months, imports on the rise too

Where is the German 'collapse'? Exports gained pace in Sept/Oct, trend flat. Imports heading up

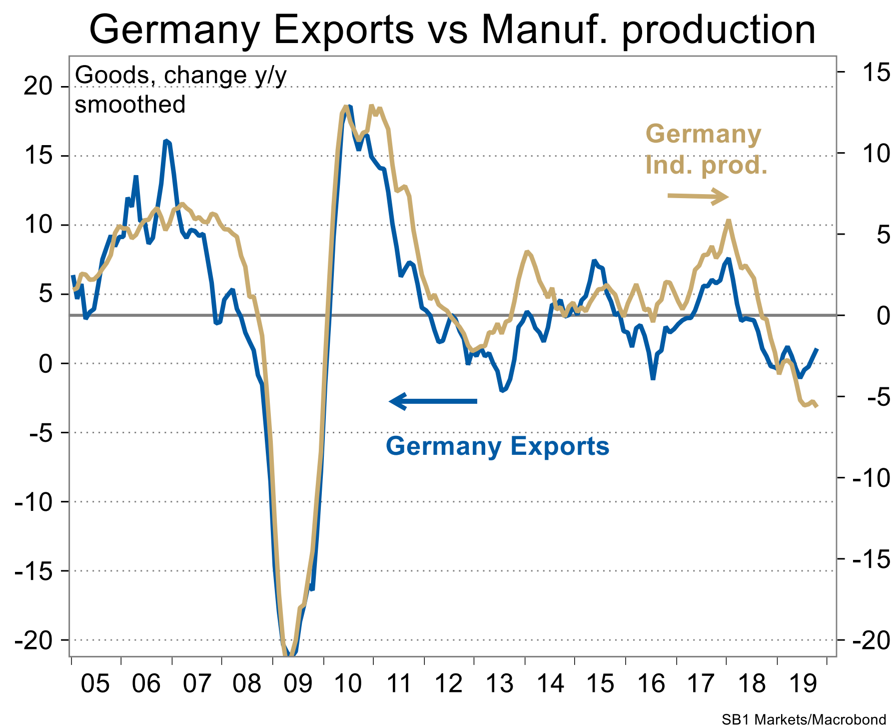




- Export volumes increased by 1.2% m/m in October, after a 1.3% rise the prior month. Exports are trending more or less flat since early 2018, and the annual rate edged up to 2.2% in October
  - » Manufacturing production is much 'weaker' than exports, down 6% y/y . However, that's not much more than usual, manufacturing production is usually expanding a tad slower than exports. Now, the decline in manuf. production is slightly larger than 'usual' vs exports
- Import volumes rose marginally, up 0.1% m/m, the third month of growth. Imports are up 3.1% y/y 0.6%
- The German trade surplus is slowly shrinking, equalling approx. 6% of GDP, from 8% in 2016

Guess what, German foreign trade is very closely correlated to…

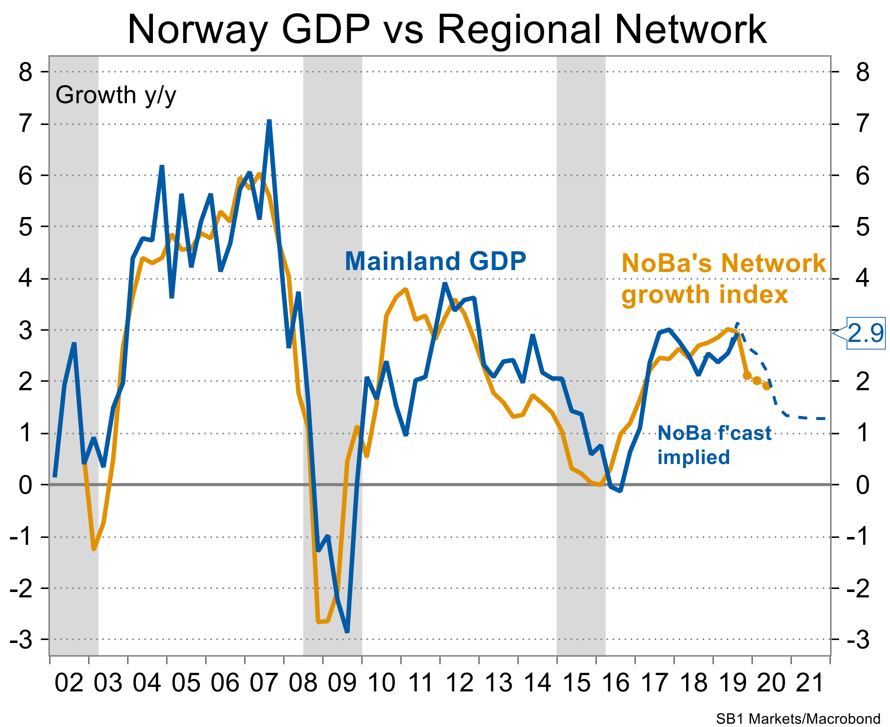
.. global trade. Now, both have been struggling amid trade uncertainties and a mature cycle



- Both German foreign trade (and thus global trade) is highly correlated to German industrial production, though with production growing at a slower pace. In addition, production is a tad more volatile than exports
  - » In sum, the current decline in production is slightly harsher than 'normal' vs exports, as exports have increased the past months, whereas manufacturing production has kept declining. However, the gap is not much larger than we have seen several times before
- The reason is that domestic demand weakens in line with global demand (or some inventories are emptied or imports have taken a larger market share). Given the upturn in exports and some signs of an easing manufacturing downturn from PMIs/other surveys, some hope??

Norges Bank's Q4 Network shows the economy shifts into lower gear

Businesses report 2.1% the past months and expect 1.9% the next 6 months, well below expectations



The Network's expected growth pace the coming 6 months is lower than NoBa's y/y f'casts – but above the q/q f'casts, which we prefer, check the next slide

Summary of the Q4 Regional Network report

- **Growth**
  - » Norges Bank's Regional Network reports 2.1% growth the past 3 months, 0.6 pp weaker than respondets expected in the Q3 survey but 0.1 pp above NoBa's Q4 GDP f'cast (from Sept)
  - » Businesses expect a slowdown to a 1.9% growth pace the coming 6 months. We expected 2.3% growth, consensus 2.5%. The network mirrors a substantial downshift, from 2.7% expected growth just 3 m ago (and 3.1% 6 m ago)
  - » However, the slowdown is not any more abrupt than what Norges Bank projected in Sept; the Bank expected a drop to 1.4% q/q annualized rates in Q1/Q2 2020 (see graph next page)
- **Capacity utilisation/investments**
  - » The Network reports unchanged capacity constraints. Capacity utilisation is well above average and marginally higher than at the 2012 peak. The share of businesses reporting labour shortages increased but remains unusually low vs the unemployment rate
  - » Businesses expect softer employment growth, down to just 1%, vs 1.7% in Q3 (still far above population growth, though)
  - » 2020 wage expectations at 3.2%, up from 3.1% in '19
- **Implications**
  - » The Network suddenly became among the weakest of Norwegian business surveys. Still, the pace of decline is not any more abrupt than Norges Bank assumed in Sept, thus, we do the bank to change its view on the outlook based on the Network. We anyway expect the Bank to signal an unchanged interest rate

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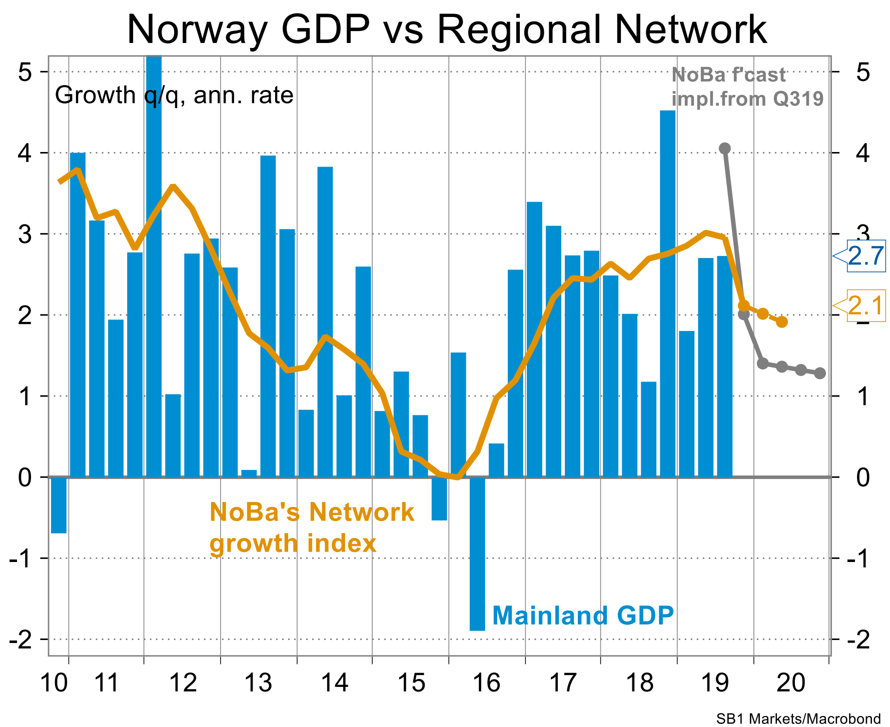
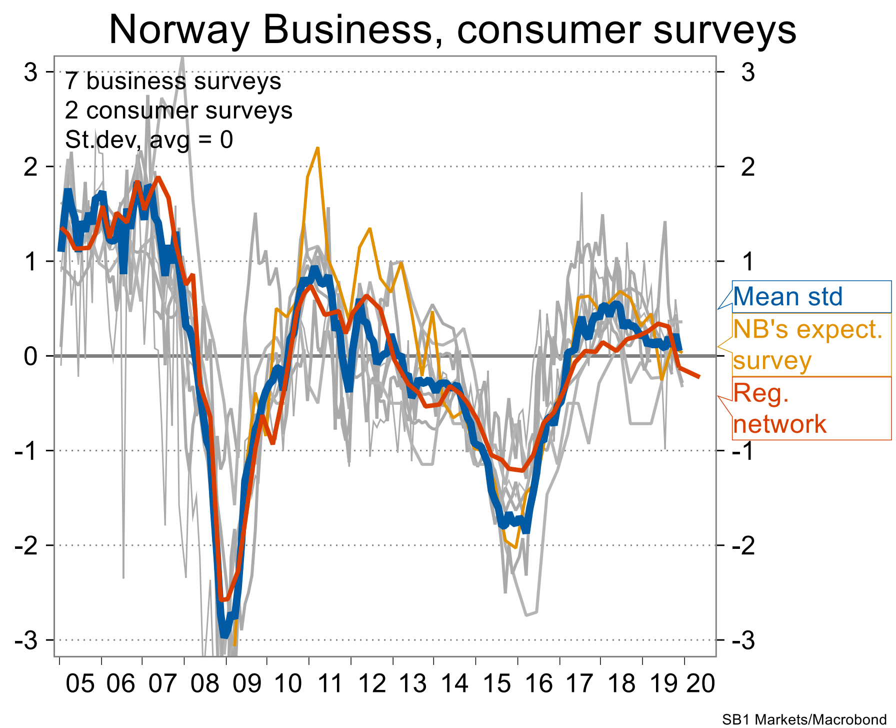
Growth peaked in Q2/Q3, according to the Network

The Network signals 1.9% GDP growth in Q1/Q2, still above NoBa's quarterly f'cast at 1.4%

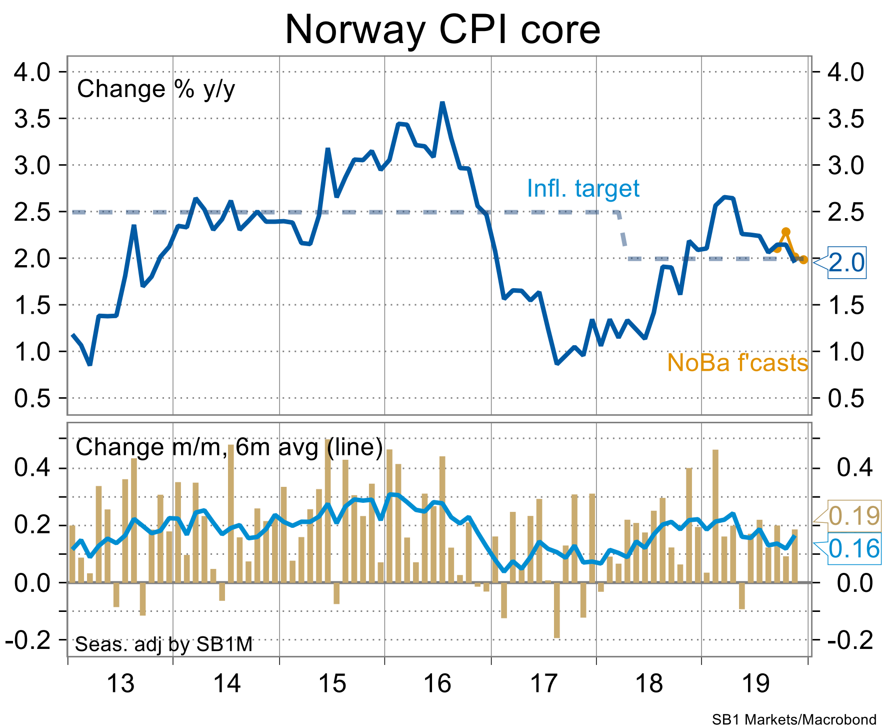




- Norges Bank's Network estimates economic activity to expand by a 1.9% speed the coming 6 months, which is still above Norges Bank's q/q f'cast (implicitly, our f'cast). The bank expects 1.4% growth in Q1 and Q2
- The Network is among the weakest of Norwegian surveys, although all have softened, confirming that the growth peak is now behind us. Consumer confidence surveys are weaker than their respective averages, as well as the NHO Q4 economic outlook survey. SSB's manufacturing survey is marginally more upbeat than the Network, still signaling zero growth in the manufacturing sectpr

Core inflation ticked down to 2.0% in Nov, close to expectations

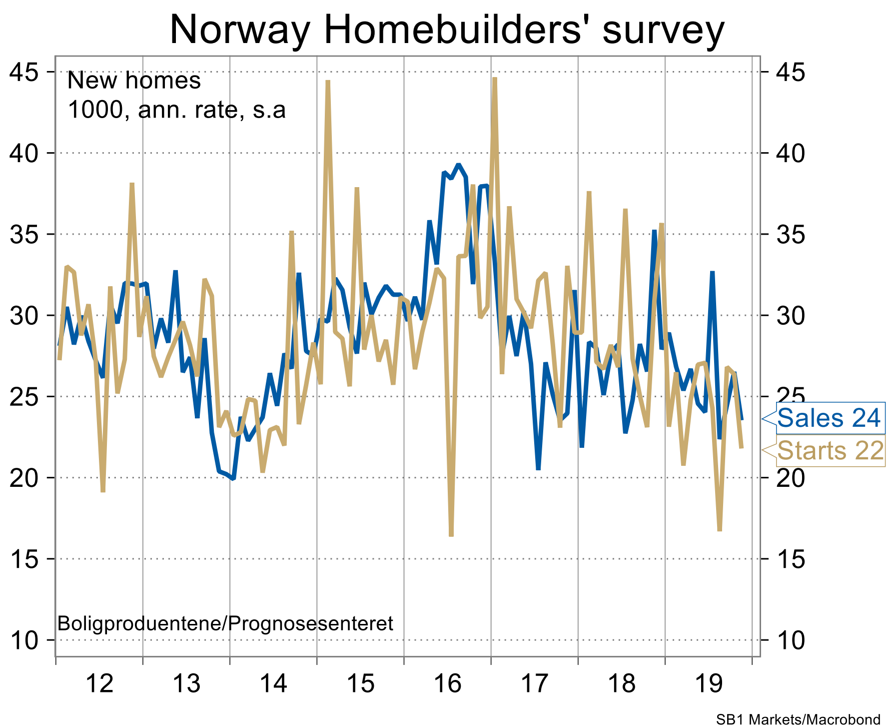
Core CPI inflation has softened somewhat the past 6 months. Total inflation slowed to 1.6%

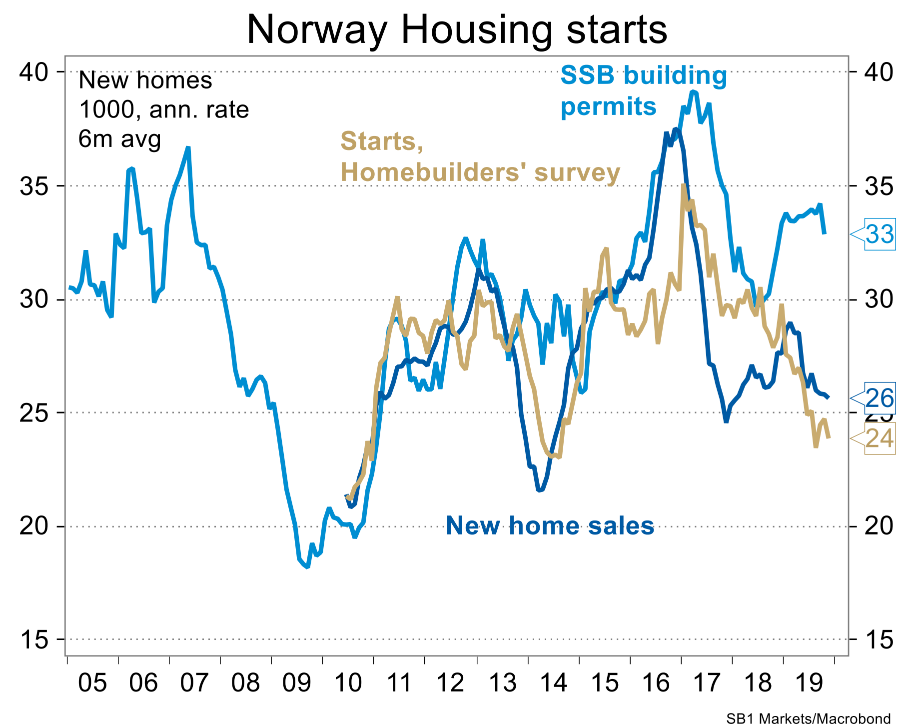


- CPI-ATE (ex. energy and taxes) rose 2.0% y/y in November, from 2.2%, 0.1 pp above our f'cast and in line with consensus and Norges Bank's estimate from the Sept MPR
  - » CPI-ATE rose 0.2% m/m (seas adj), marginally above the 6 m avg. The annual rate was brought down by a steep rise in Nov last year
  - » Recreation & culture, furnishing and housing boosted inflation this month. Lower prices on clothing and footwear (Black Friday?) dampened price growth
  - » Imported goods are up just 0.9% y/y, the NOK depreciating points to somewhat higher imported inflation, but no take off. Domestic goods & serv. up 2.6%, due to wage inflation above 3%, slow productivity growth and capacity to increase prices, as demand is not weak
- Total CPI growth slowed to 1.6%, from 1.8%, close to expectations. Annual inflation is dragged down by electricity prices, which are declining y/y (but rose m/m in Nov, lifting monthly inflation)
- **Implications**
  - » Core inflation is at the price target and close to Norges Bank's f'cast from September. Thus, inflation will probably not contribute to any substantial changes in the bank's new interest rate path on Dec 19.
  - » No significant market reaction, NOK strengthened marginally following the release

Homebuilders report declining new home sales and starts

Both starts and sales fell in Nov, starts may have stabilized, at a far lower level than SSB reports





- The Homebuilders' housing starts (seasonally adjusted) fell to an annual rate of 22' in Nov, down from 26' the prior month. Starts have fallen steeply since early 2017, according to the Homebuilders, stabilized the past 3 months. The gap to SSB's starts(permits) data is much wider than usual (33' vs. 24', 6m avg), although the SSB reported a drop in October. Student homes, which are only included in the SSB figures, explains some. Thus, our take is that ordinary housing starts are turning slowly down
- New home sales ticked down to 24' in Nov. The 6m average has fallen since early 2019 and does 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

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The Calendar

In focus: Prelim. December PMIs, Norges Bank & Riksbank meetings, US manufacturing, consumption

Time	Country	Indicator	Period	Forecast	Prior
Monday Dec 16					
08:00	NO	Trade Balance	Nov	--	5.9b
10:00	EC	Eurozone Composite PMI	Dec P	50.7	50.6
10:30	UK	UK Composite PMI	Dec P	49.5	49.3
11:00	EC	Labour Costs YoY	3Q	--	2.7%
14:30	US	NY Empire Manufacturing Index	Dec	5	2.9
15:45	US	Markit Composite PMI	Dec P	52.1	52
16:00	US	NAHB Housing Market Index	Dec	71	70
Tuesday Dec 17					
10:30	UK	Average Weekly Earnings YoY	Oct	3.4%	3.6%
10:30	UK	ILO Unemployment Rate	Oct	3.9%	3.8%
12:00	UK	CBI Trends Total Orders	Dec	-25	-26
14:30	US	Housing Starts	Nov	1340k	1314k
14:30	US	Building Permits	Nov	1405k	1461k
15:15	US	Manufacturing Production	Nov	0.7%	-0.6%
16:00	US	JOLTS Job Openings	Oct	7000	7024
Wednesday Dec 18					
09:00	SW	Economic Tendency Survey	Dec	--	94.7
09:00	SW	Consumer Confidence	Dec	--	91.9
10:00	GE	IFO Expectations	Dec	92.9	92.1
10:30	UK	CPI Core YoY	Nov	1.7%	1.7%
Thursday Dec 19					
	JN	Bank of Japan Policy Rate	Dec-19	--	-0.10%
06:00	SW	House Prices MoM, Valuegard	Dec		0.9%
09:30	SW	Riksbank Interest Rate	Dec-19	0.0%	-0.25%
10:00	NO	Norges Bank Deposit Rate + MPR	Dec-19	(1.5%)1.5%	1.50%
10:30	UK	Retail Sales Core MoM	Nov	0.4%	-0.30%
13:00	UK	Bank of England Deposit Rate	Dec-19	0.75%	0.75%
14:30	US	Current Account Balance	3Q	-$121.0b	-$128.2b
14:30	US	Philadelphia Fed Business Outlook	Dec	9	10.4
14:30	US	Initial Jobless Claims	Dec-14	--	252k
16:00	US	Leading Index	Nov	0.1%	-0.1%
16:00	US	Existing Home Sales	Nov	5.45m	5.46m
Friday Dec 20					
00:30	JN	CPI Core YoY	Nov	0.7%	0.7%
02:30	CH	1-Year Loan Prime Rate	Dec	4.10%	4.15%
08:00	NO	Housing Starts	Nov		29'
09:30	SW	Retail Sales MoM	Nov	0.3%	0.2%
10:00	NO	Unemployment Rate, Registered	Dec	2.2%	2.1%
16:00	EC	Consumer Confidence	Dec A	-7.2	-7.2
16:00	US	Personal Income	Nov	0.3%	0.0%
16:00	US	Personal Spending	Nov	0.4%	0.3%
16:00	US	PCE Core Deflator YoY	Nov	1.5%	1.6%

- **Preliminary December PMIs**
  - Will the first **December PMIs** continue to point to a modest uptick in global GDP growth, or at least in manufacturing? We will particularly search for signs of recovery in the Eurozone. The Japanese PMI was unchanged and still weak
- **US**
  - **Manufacturing production** is sliding down, by 1.5% y/y. Durable orders signal a stabilization, so does the PMI (Markit), ISM points to a continued decline
  - **Private consumption** is slowly losing steam. Total retail sales rose modestly in Nov, consumption estimate too upbeat?
  - **Core PCE inflation** is running 0.4 pp below the 2% price target, producer prices or inflation models do not signal any upturn
  - **Housing starts/building permits** are rebounding strongly, as low mortgage rates and solid employment have been propping up the market
- **Eurozone**
  - **Labour cost inflation** has stagnated since mid-2018, at a moderate 2.4% pace. Given sluggish growth and flattening unempl., any lasting uptick is unlikely. As the productivity growth is sluggish, cost inflation is not low
  - The **German** business surveys have edged up this autumn, will the **Ifo December survey** confirm a moderating downturn?
- **Sweden**
  - We expect the **Riksbank** to deliver the 25 bps hike to 0%, as signalled in October. The market is putting some 70% probability of a hike
- **Norway**
  - **Norges Bank** will no doubt keep the interest rate unchanged at 1.5%. We expect the bank to signal an unchanged interest rate in 2020 (as the market is already pricing) but to lift the interest rate path marginally further out
  - **Registered unemployment** has flattened out the past months and other data suggest a softening labour market. Still, a hard downturn is unlikely

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

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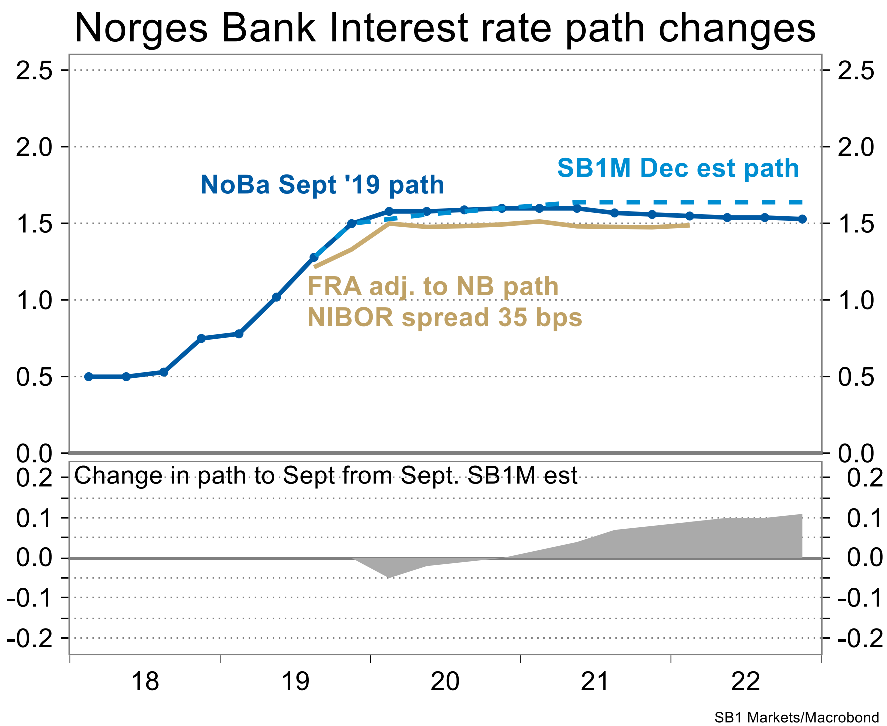
Ahead of Norges Bank: Interest rate unch and a small lift in the path, in 2021?

Norway is slowing but surveys still signals higher growth than NoBa's f'cast. NOK very weak



Changes in the interest rate path from the September NoBa meeting	Impact bps
Domestic demand (incl oil price), capacity util.	-12
Money Market (money market, lending spreads)	8
Prices, wages	-5
Foreign factors	4
NOK	15
Judgement (surveys, fin. stab, global risk etc)	0
Sum	**9**
Check details next page	

Source: Norges Bank MPR 3/19, SB1 estimates

- Norges Bank will no doubt hold rates unchanged at this week's meeting, 'no one' expect otherwise. We expect the Bank to lift the interest rate path marginally in the 'long' end and lifting the probability of a hike in 2021 but at the same time judge the probability for an early 2020 hike down from 40%.
- Our examination of the factors affecting the path yields a 5-10 bps lift, mostly due to a weaker NOK and foreign factors (rates up, trade tensions, hard Brexit risk reduced), as well as lower NIBOR margins. Domestic demand is somewhat weaker than expected but in total, growth is not slowing faster than NoBa expected in Sept, as illustrated by the Q4 Network survey. Still, as the impact of the previous 4 hikes probably is not consumed, and credit growth is slowing, the Bank can afford to call off a March hike
- A minor upside risk for NOK FRAs and for the (still weak) NOK?

NOK and foreign factors will lift the path, domestic economy the drag

Our assessment of the factors behind the interest rate path yields a marginal (9 bps) lift

Factor	Norges Banks' scenario	What's new since Sept?	Impact	Impact	Next?
Foreign factors			Up	4	
	Growth: Slightly more upbeat	Global PMI improved, Q3 GDP steady from Q2. OECD nudged down global growth f'casts (0.4 in 2020). In sum neutral	Neutral	0	Neutr
	Short term rates: Recovering	Trading part. 1y swap +7 bps, 1y1y fwd +13, 3y2y fwd +21	Up	4	
Oil price	NoBa f'cast 60 in Nov, 59 in Dec	Spot at 64 (avg in Dec 63), longer contracts marginally up	Up	3	Down
Domestic demand			Down	-10	Down
	Consump. 1.8% in '19, 2.3 '20	Consumption fell in Q3, '19 f'cast prob. too high	Down	-4	Neutr
	Investments				
	.. Housing: 0.9% in '19, 0.6% in '20	Homebuilders' starts softening, SSB starts have turned down	Down	-2	Down
	.. Mainl bus. 3.8% in '19, 2.6% in '20	Spiked in Q3, '19 f'cast well within reach, '20 revised down?	Neutral	0	Down
	.. Oil 14.5% in '19, 2.5% in '20	2020 may be revised up (we have), but not by much	Up	2	Down
	Public demand 1.9 in '19, 1.2% in '20	Stronger growth than expected so far this year	Up	2	Down
	Fiscal policy indic.: +0.1% per year	2020 budget more contractionary than expected	Down	-8	Neutr
Money market, lending spreads			Up	8	
	MM: 40 bps from Oct '19	Money marked: 3m FRA close to f'cast, implies 35 bps spread	Up	5	Neutr
	Mortgage rates: +17 bps in Q3, +21 Q4	Mortg. rates up as expected in Q4, probably far less so in Q4	Up	3	Neutr
NOK	Index 107.1 in Q3, 106.1 in Q4	NOK 3 % below expected path	Up	15	Down
Prices, wages			Down	-5	
	CPI-ATE 2.1% Sept, 2.3% Oct, 2% Nov	CPI ATE in sum close to expectations in Sept-Nov	Neutral	0	Neutr
	Wages 3.3% in '19	Hourly wage costs 3.5% in Q3, ULC 2.7%. Netw. Slightly lower	Down	-5	Neutr
Capacity			Down	-5	
	NAV unempl 2.2%, LFS 3.4%	NAV marginally below f'cast, LFS 0.5 pp above	Down	-5	Down
	Outp. gap slowly closing	Reg. Network reports unch capacity utilisation but higher labour shortages. Labour force turns up	Neutral	0	Neutr
Judgement/ corrections			Neutral	0	Neutr
	Surveys, growth signal vs. NB path	Most down, Reg. Net and SSB's manuf. signal slowdown	Neutral	0	
	Financial imbalances, credit	Household credit growth on the way down	Down	-8	
	Housing prices	Prices are rising moderately, close to f'casts	Neutral	0	
	Consumer confidence	Finance Norway weaker in Q4, Opinion slowly down	Down	-2	
	Financial conditions	Finacial markets up since Sept	Up	5	
	Caution (uncertainties, risk)	Trade war calms down, hard Brexit less likely	Up	5	
Sum changes	Growth above trend, CPI above target	Global outlook in sum unch, uncertainties/trade war calmed. Norwegian slows but not fasther than exp., the NOK weaker	Up	9	Down
Memo: Market	Changes in NOK int. rate expect, from after the last MPR	3m FRA Dec 19 -5 bps, Dec 20 +14 bps, Dec 21 +24 bps, avg 11	Up	16	
		1 y swap 1 y fwd	Up	22	

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

- Factors which indicate a steeper path:
  - » The NOK, which once again has missed the bank's (and everyone else's) f'cast
  - » Higher interest rates among trading partners and strong financial markets
  - » De-escalation of the US/China trade war and much less probability of a hard Brexit
  - » A marginally higher oil price than projected
- On the downside:
  - » Domestic data are mirroring a slowdown. Consumption and housing investment f'cast will probably be nudged down, oil investments perhaps a tad up
    - ▪ The Network and other surveys confirm a weaker growth momentum (but not weaker than the bank already expects).
  - » Several signs of a softer labour market, unemployment is flattening out and participation is rising
  - » Household credit growth is easing

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 slowdown, especially in the manufacturing sector. Rich countries (DM) in the lead, more to go in most EM. Unemployment is low, wage inflation on the way up, not low vs. productivity. Most emerging countries (EM) x China are in recovery mode. Some hotspots EMs will get burned, as usual – but there are fewer EM imbalances than normal. The global PMI is still trending down but improved broadly in November. Barring policy mistakes, the global economy is not rigged for a *hard* downturn. Investment rates are not far too high, few debt bubbles this time. **Growth has slowed to 3% from 4%, but has stabilized since Q4 2018. We expect a modest slowdown to 2.7% in 2020, even if trade conflicts are 'solved', if ramped up, more downside risk**	Global composite PMI rose 0.7 p in Nov, better than expected. The PMI points to above 3% growth, an upturn from the past 4 quarters. Manufacturing is in recovery mode, boosted by China and the US. EMU still weak but the pace down may now be slowing
China	The governments' stimulus measures may have boosted the economy, and data do not point to a hard downturn. Rather, the PMIs suggest an upturn recent months. The invest/GDP ratio is still sliding down. Debt growth has slowed, and will not accelerate much even if authorities are trying to stimulate credit in order to compensate for the negative impacts from the trade war/previous tightening. Fiscal policy is also activated. Exports to US approx 2% of GDP, and a (so far) 10 % decline here is manageable. **However, a full scale trade and even more a tech/world hegemony war will hurt the Chinese economy**	Nov data better than expected. Industrial production rose sharply and retail sale volumes are not killed by high CPI inflation (pork prices). Investment growth is stable. Credit growth is slowly accelerating, this time from bank lending.
USA	Growth has slowed, from well above trend. The employment rate is still trending up (steeply recent months), and unemployment down, but wage growth is not accelerating. Price inflation is close to target. No serious overinvestments but most sectors at/above trend and corporate debt is high. Business investments have softened amid weaker growth in profits and trade war uncertainty. Recent consumption data are solid but slowing now (and partly funded by lower, although still high savings). Housing positive. Fiscal stimulus continues but not by much. The deficit is far, far too high, given the low unemployment rate. Recession risk is not overwhelming, short term, and further rate cuts are unlikely, barring a much weaker economy. **Risks: Trump/trade/business invest.**	The Fed is on hold, will keep interest rates unchanged unless the economy weakens rapidly. Core CPI inflation at 2.3%, may be at/close to peak, PPI growth is slowing. The Federal budget is widening. Retail sales growth is slowing, the contribution to GDP growth will be more modest in Q4 than in Q3/Q2
EMU	Growth has slowed and manufacturing is contraction, while services remain rather resilient. The manufacturing downturn may now be easing, at least that is what the PMIs/other surveys are indicating. The labour market is tight, and labour cost infl. is back to a normal level. Investment ratios are above trend. Credit growth is increasing, but still muted. Household savings are high, still consumption has kept up well. Policy: ECB does not have that much ammunition left, barring a huge QE, and the ECB policy makers are split. Fiscal policy debate has turned, some stimulus possible. **Risks: Trade war (but less risk for a US/EU war after G7). Italy. Weak short term data signals a substantial further slowdown risk**	ECB did not signal any changes, Lagarde focused on the strategic review. Industrial production keeps declining, down 0.5% in Oct. Some positive data from Germany; exports have accelerated the past 2 months and imports are rising too. The ZEW survey rebounded strongly
Norway	Growth is still above trend but is peaking now. Unempl. is declining at a much slower pace, probably flattening out now. Wage inflation is accelerating. Oil investments are peaking in H2 2019. Mainland business inv. are not low anymore, will probably slow in '20. Mixed signals from the housing market, starts probably slowing. Electr. prices have taken the headline CPI down but core still slightly above target. Credit growth slowing (households) and underlying growth is now finally lower than income growth. **Risks: Debt, housing. A harsh global slowdown**	NoBa's Q4 Reg. Network reports a marked slowdown the coming quarters, to a 1.9% speed. Construction and oil related will not boost growth anymore. Core inflation fell to 2%, not much upside? Housing starts are trending down

In this report

Global, Auto sales

- Global macro data slightly more negative vs expectations so far in Q4
- Global retail sales hit by the Japanese VAT hike, Oct level probably too low
- Auto sales probably edged up in Nov, low level

China

- XXX October data on the soft side
- Industrial production recovered sharply in Nov (not only in useless official data)
- Retail sales volume growth slides down, influenced by the swine flu
- Growth in nominal investments marginally up in November
- Credit growth accelerated in November, due to more bank lending
- Total inflation soared to 4.5%, core eased to 1.5

US

- The Fed is on hold; signals an unchanged interest rate through 2020
- Core inflation steady at 2.3%, peaking now?
- Producer price growth is heading down
- Retail sales growth is slowly cooling
- Household credit growth still muted, corporate debt growth has slowed
- No productivity growth in Q3, cost inflation rises (but less than first reported)
- Small businesses' optimism bounced back in Nov, far above PMI/ISM, serious labour short.
- Jobless claims spiked amid Thanksg. distortions
- The federal budget deficit is widening
- One nowcaster signals 2.0% Q4 GDP growth, the other 0.8%

EMU

- The ECB made no changes to its monetary policy at Lagarde's ECB debut
- The downturn persists; industrial production dropped again in Oct
- German Exports have been soaring the past 2 months, imports on the rise too
- German ZEW survey notes a strong rebound in expectations, current sit. still weak

UK

- Manufacturing production is sliding down and the short term outlook is bleak

Japan

- Q3 GDP growth revised up to 1.8%, from 0.2%!

Sweden

- Both LFS and registered unemployment confirm a souring labour market
- Core inflation ticked up to 1.8% in Nov, the Riksbank is set for a Dec hike

Norway

- Norges Bank's Q4 Network shows the economy shifts into lower gear
- NHO business survey confirms the slowdown
- Core inflation ticked down to 2.0% in Nov, close to expectations
- GDP growth up 1.4% 3m/3m annualized, Q4 is off to a soft start
- Homebuilders report declining new home sales and starts

Highlights

The world around us

The Norwegian economy

Market charts & comments

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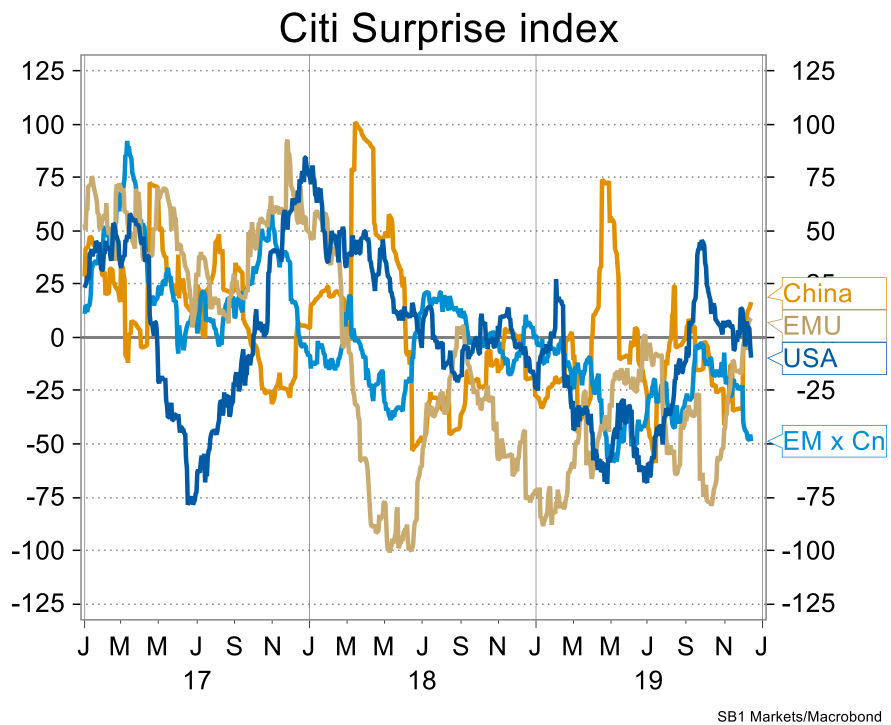
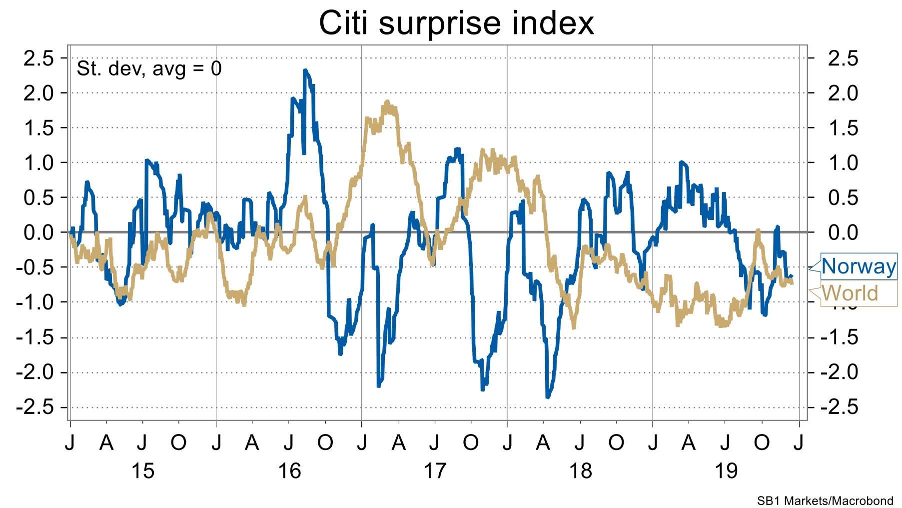
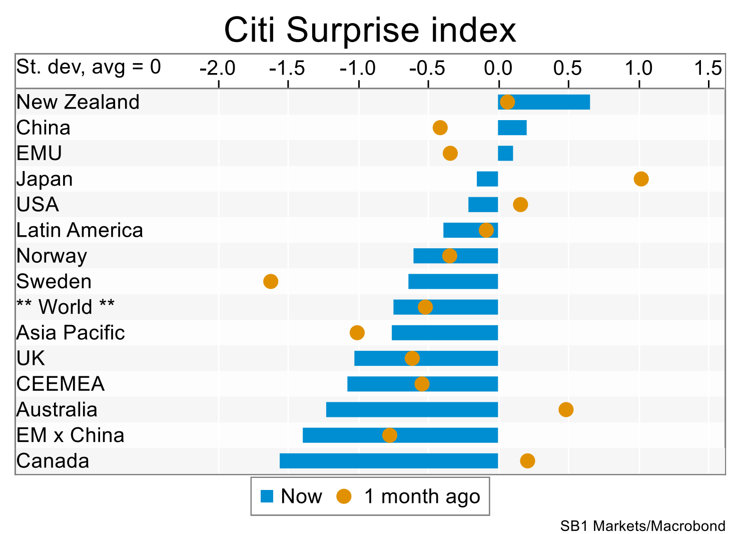
Global macro data slightly more negative vs expectations so far in Q4

US data flows back to neutral, China above expectations, EMU at 1 ½ y high. Just EM x China down





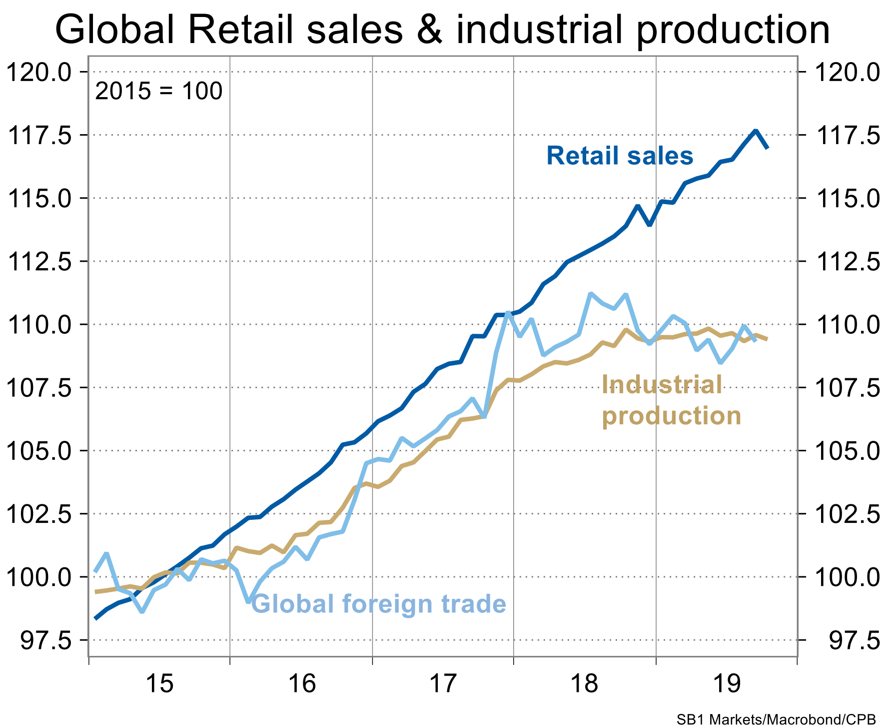


- The global surprise index climbed to a 'neutral' level for the first time this year in mid-Sept. Since then, data have been more disappointing, in sum, and steady recent weeks
- US data flows were upbeat in Sept-Nov. Since late Nov, the surprise index has turned back to 'neutral', due to a weak ISM, slightly softer consumption, manufacturing
- EMU data are beating expectations by the most since early 2018. Due to somewhat better data – and adjusted expectations?
- China spiked on strong PMIs, back in positive territory. Other EM much weaker
- Norwegian data are negative again, and Sweden too, both reasonable

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

Global retail sales hit by the Japanese VAT hike, Oct level probably too low

Global foreign trade fell in September, and manufacturing production probably fell in Oct



- **Retail sales** fell by 0.6% m/m in Oct (our prelim. est) reversing half of the 1% Aug/Sept lift. The volatility is due to the hike in VAT in Japan, that pushed sales forward to Aug/Sept and they collapsed by 14% in October, like 'normal' following Japanese VAT hikes (check for more here). The underlying growth in global retail sales recent months seems to be approx 3%, and quite stable
- **Global industrial production** probably fell marginally in Oct, our estimate yields a 0.2% m/m decline. Production is still heading slowly down, and the annual rate is -0.4%. The global manufacturing PMI now suggests modest growth in production
- **Global foreign trade** dropped by 0.6% m/m in Sept (with our seasonal adjustment), reversing most of the 0.8% upturn the prior month. Trade flows have been trending down since last summer and the annual rate is down 1.2%, however, the uptick in July and August may reflect a stabilization – the level is not lower than in Q4 2018!

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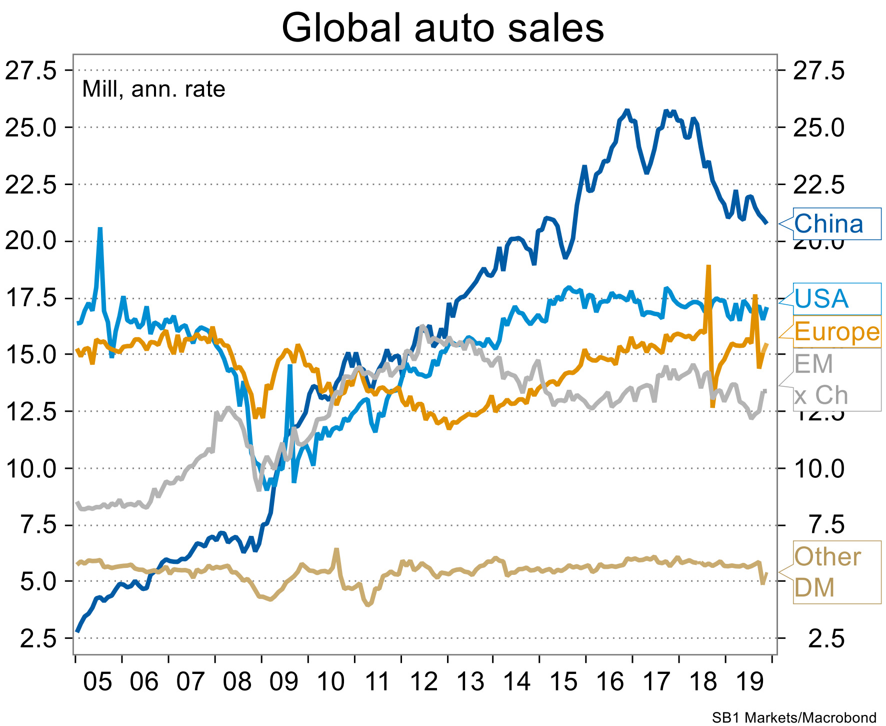
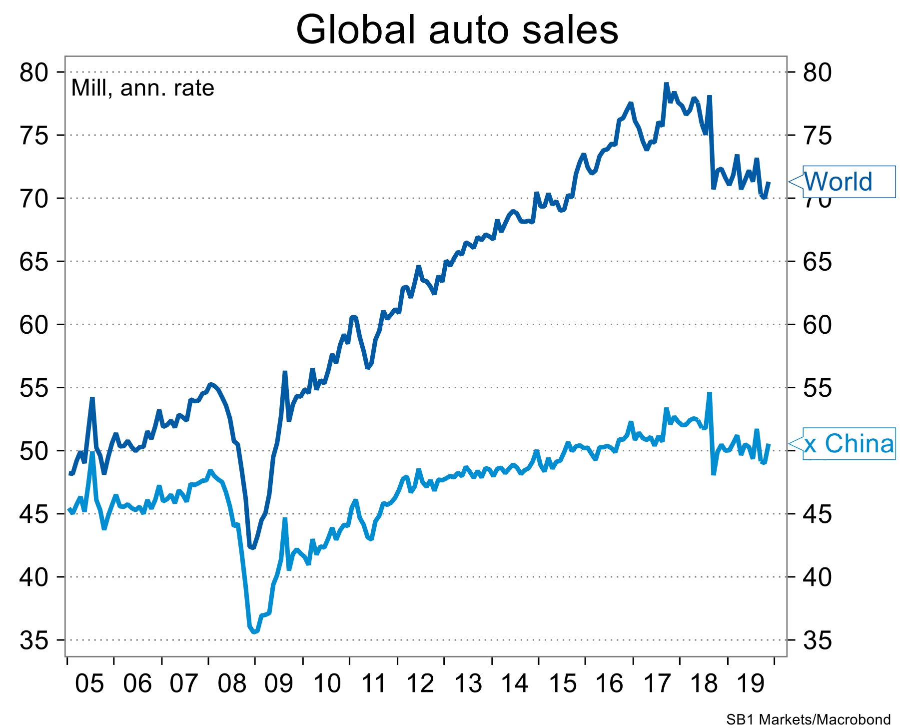
Auto sales probably edged up in Nov, from a low level

Global sales saved by US, Europe, and a slight recovery in Japan. China not fully stabilise, rest EM up

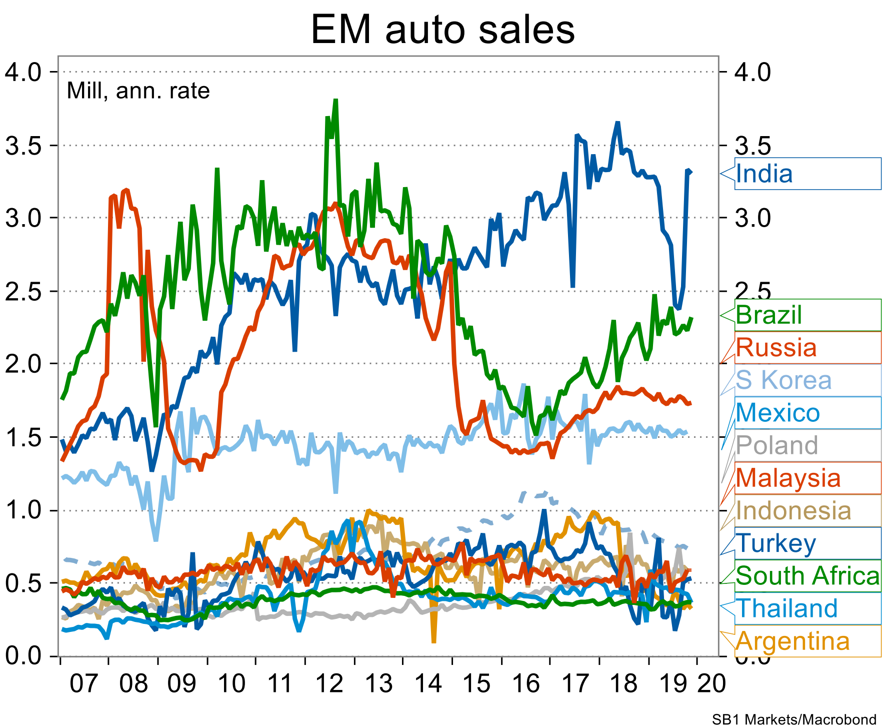


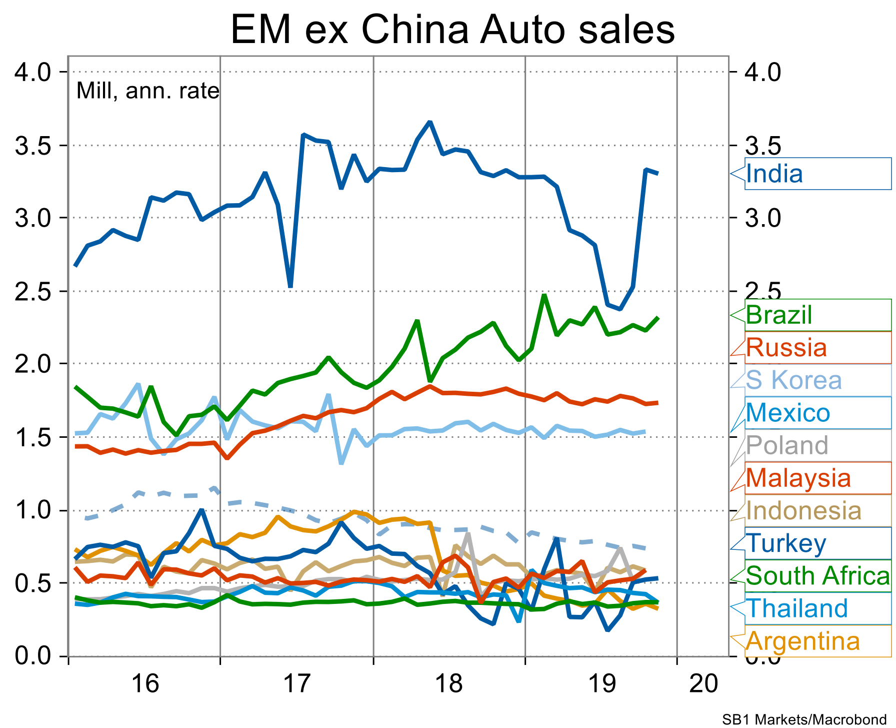


- Global sales increased by 1.9% m/m, and are down 1.4% y/y but some 8% from the level last summer
- Sales in Europe have been zig-zagging du to emission regulation this autumn too, and may now also be influenced by another tightening from January. Anyway sales were somewhat a 'normal' level in Nov. US sales rebounded but is trending down . Sales in Japan recovered just partly in Nov, after plunging in October, due to the hike in the VAT rate (included in other DM at the chart to the left above)
- Chinese sales fell further in Nov, by 1.1%. Sales have not yet fully stabilised, and are down by 5.1% y/y – and -20% from the peak last year
- Auto sales in EM ex. China probably increased just marginally in Nov, after a steep rise in Oct, due to a surprising 32% hike in sales in India. EM x China sales have been weak the prior months, mostly due to low sales in India

Indian auto sales steady in Nov after soaring in October, H1 downturn reversed

EM x China sales probably rose marginally in Nov, following Oct spike





- Indian sales rose 32% m/m in Nov, fully recovering from the 5 months downturn in the spring/summer, in one month! The level remained at 3.2 mill (annual rate) in Nov, close to the record high level in early 2018
- Brazilian sales increased in Nov but may have flattened. Russia is still trending slowly down. Sales are sluggish in South Korea & even more in Mexico. Sales in Turkey are up the recent months

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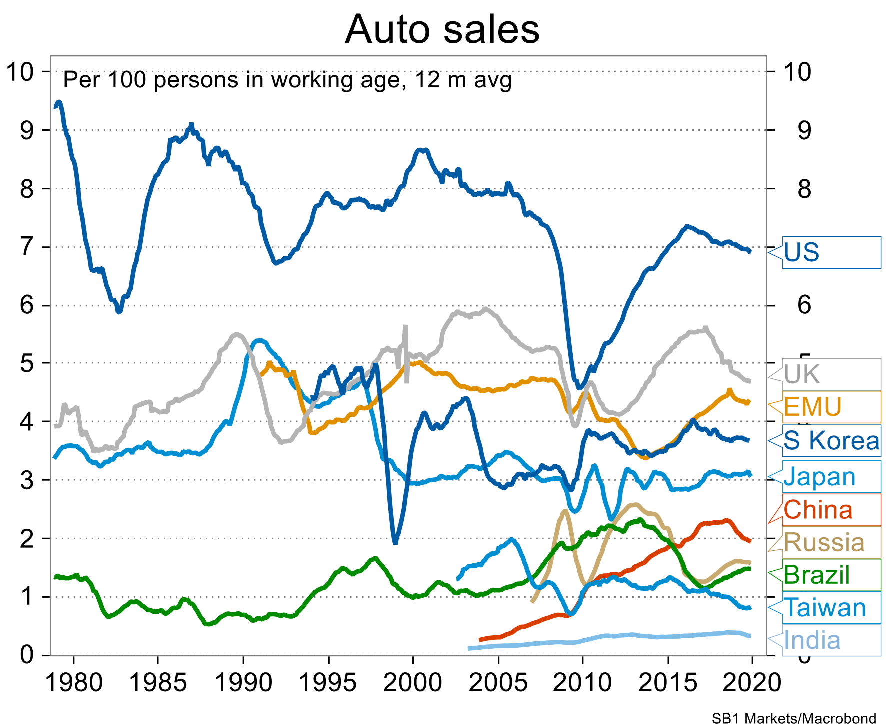
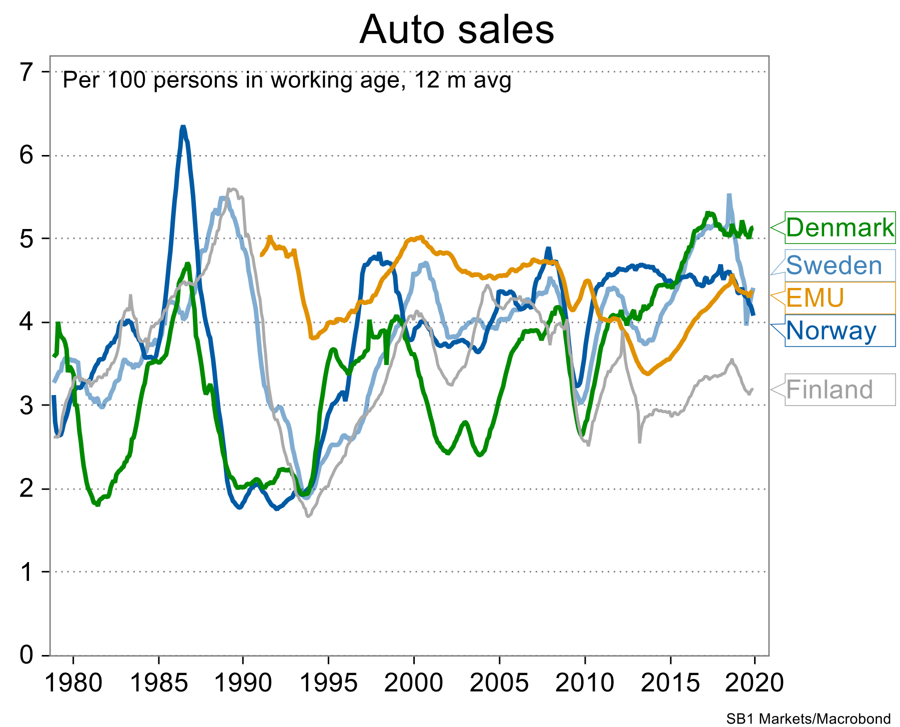
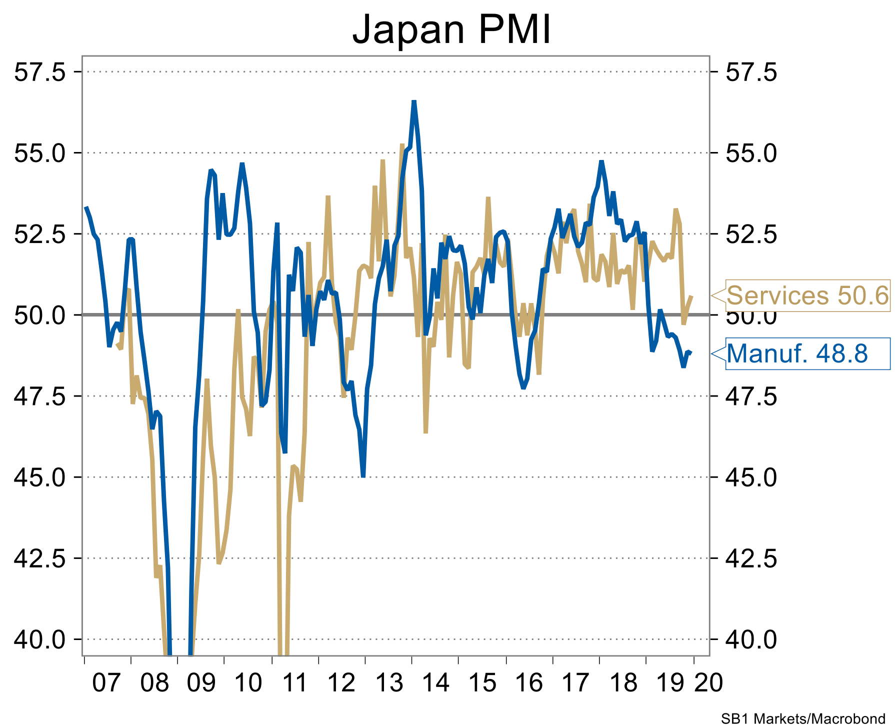
Sales are sagging almost everywhere – in the Nordics too

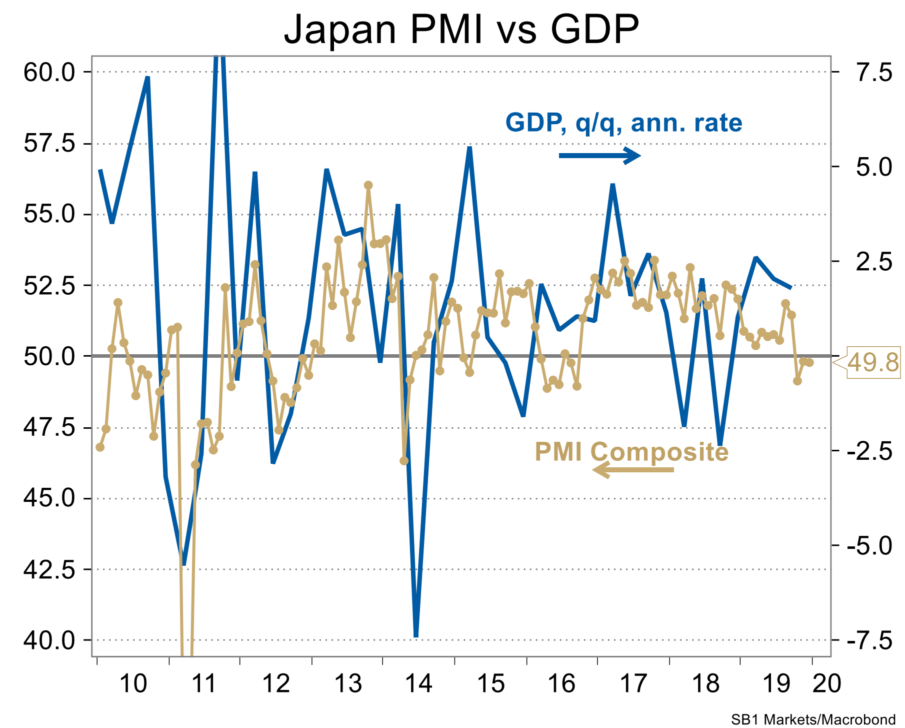




Both PMIs weak in December too

Businesses are still struggling in the aftermath of the October VAT hike, a gradual rebound is likely





- Composite PMI was unchanged at 49.8 in Dec, following the 0.8 p lift in Nov. Thus, the index remains close to the lowest level in 3 years as it signals close to zero GDP growth
  - » The services PMI continued slowly upwards in Dec, while the manufacturing index fell marginally. We expect a recovery the coming months, but it may take some time. In 2014, the last time consumer tax was raised, the services PMI was back at the pre-hike level after 3-4 months. Thus, during these months, we cannot tell whether or not the weak prints reflect a 'fundamental' slowdown
  - » Manufacturing PMI inched down to 48.8, still reflecting declining activity. Japanese manufacturing is slowing along with global demand
- Other Japanese surveys confirms a slowdown – but not more than in '16, 13' or 11'

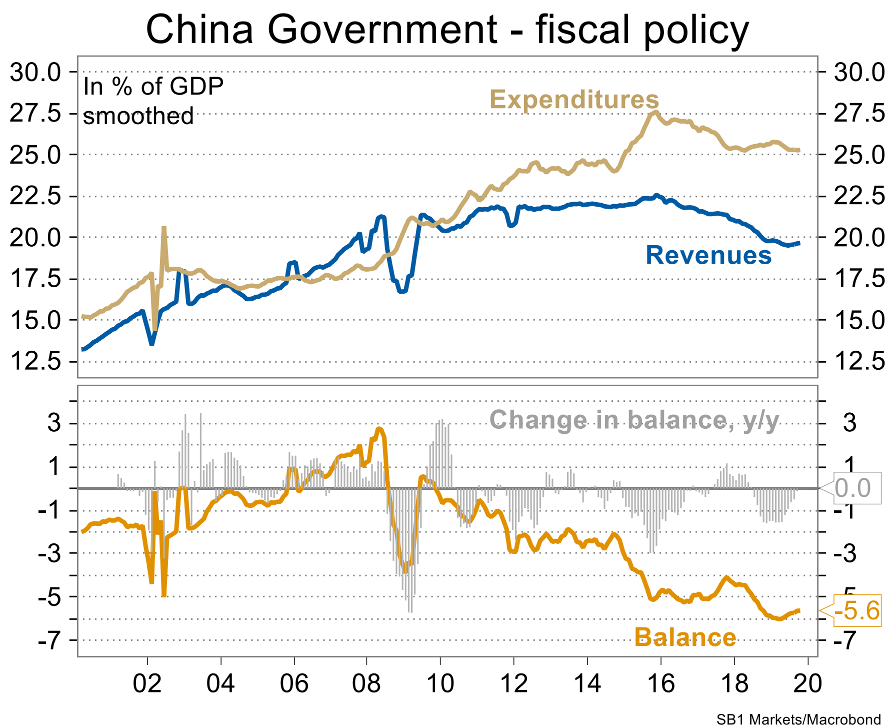
November data on the strong side

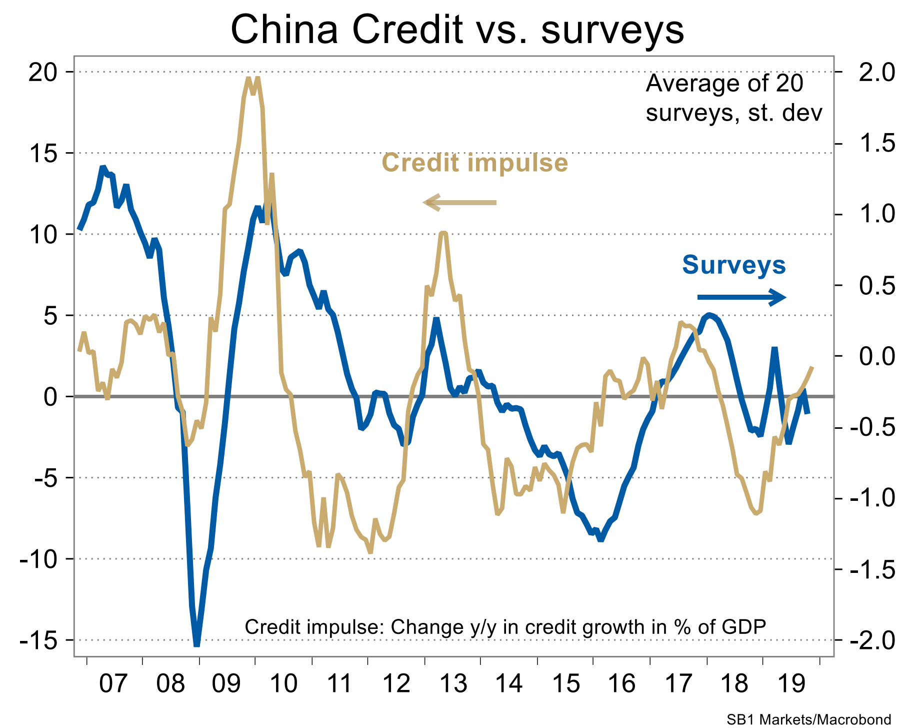
Industrial production, retail and credit growth better than expected

- **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 0.8% m/m and the 3 m average speed rose 0.2 pp to 0.6%, a 7% pace. The (useless!) official y/y rate shot up to 6.2% from 4.7%, expected at 5.0%. The PMIs have recovered from H1 and is now signalling higher growth
- **Retail sales** recovered in November (& monthly data were revised up), and the annual growth rate was much better than expected . Volume growth is still slowing, as high meat prices takes its toll on disposable income. **CPI inflation** accelerated to almost 4%, due to higher food/pork meat prices
- **Investments** have been expanding steadily, at a comfortable low rate, 5% y/y nominally, well below growth in nominal GDP. The official YTD y/y rate was flat at 5.2% in Nov, as expected Real growth has accelerated to 3% through 2019, from zero. Still, building starts fell m/m in Nov, and was flat y/y
- **Credit growth** accelerated in November, due to a more rapid growth in bank loans. The credit impulse is now clearly positive again, following the 2018 contraction

No more fiscal stimulus (and nothing happened on the expenditure side)

Still, the budget deficit is large, at 5.6%. Credit growth has marginally accelerated over the past year

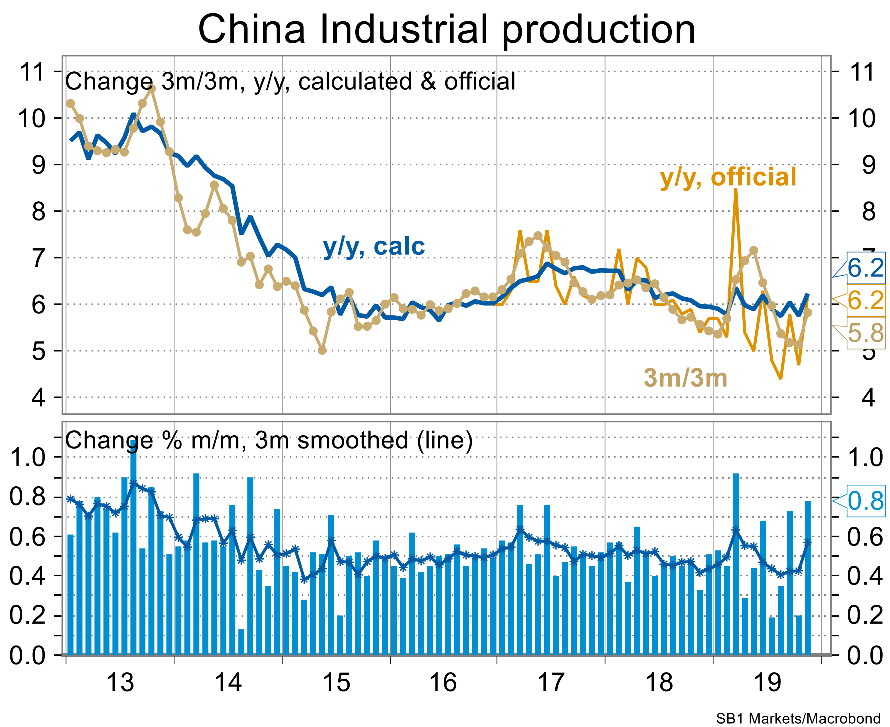


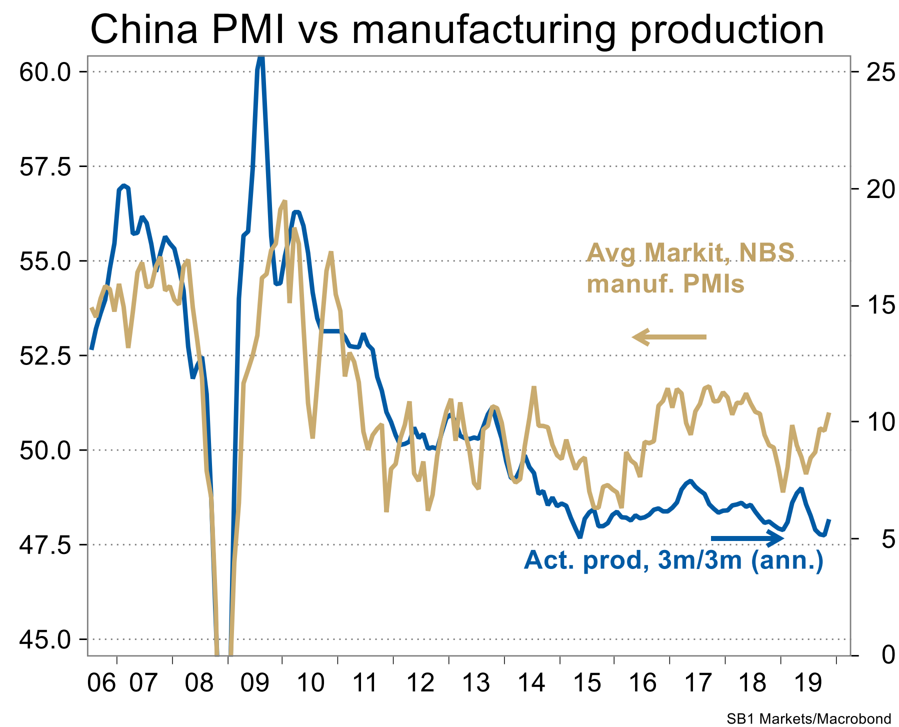


- Fiscal policy: Taxes are cut, spending programs decided – but the latter are not easy to reveal in aggregated spending number. Revenues have been declining vs. nominal GDP
- Credit growth is slowly accelerating, and the credit impulse has turned marginally positive (measured y/y, positive ‘now’), from sharply negative

Industrial production recovered sharply in Nov (not only in useless official data)

Production rose 0.8% m/m, up from 0.2% in Oct. Our y/y calculation up 0.4 pp to 6.2%

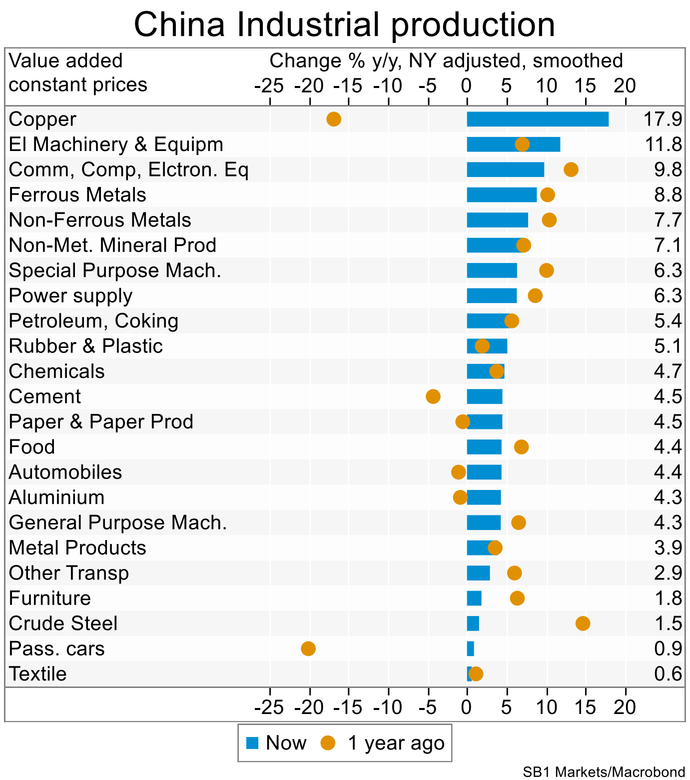




- Production rose 0.8% m/m in Nov, following a weak 0.2% growth in Oct (but 0.7% in Sept). These monthly data are volatile, but even the 3m average accelerated to 0.6% from 0.4%, equalling a 7% annualised growth pace. Our y/y rate edged up 0.4 pp to 6.2% - and it has been trending flat since spring 2018
  - » The official y/y growth rate is 'useless', far too volatile as it is not adjusted for holidays or working days. In Nov, growth accelerated by 1.5 pp to 6.2% %, after a 0.5 pp drop the previous month. The official rate was expected up to 5.0%!
- The two PMIs have (in average) improved substantially from the Jan & June 2019 local troughs, and are now signalling higher growth. Export volumes are trending up and are close a peak levels. China has most likely not been brought to a halt

Growth y/y in all production sectors, even cars

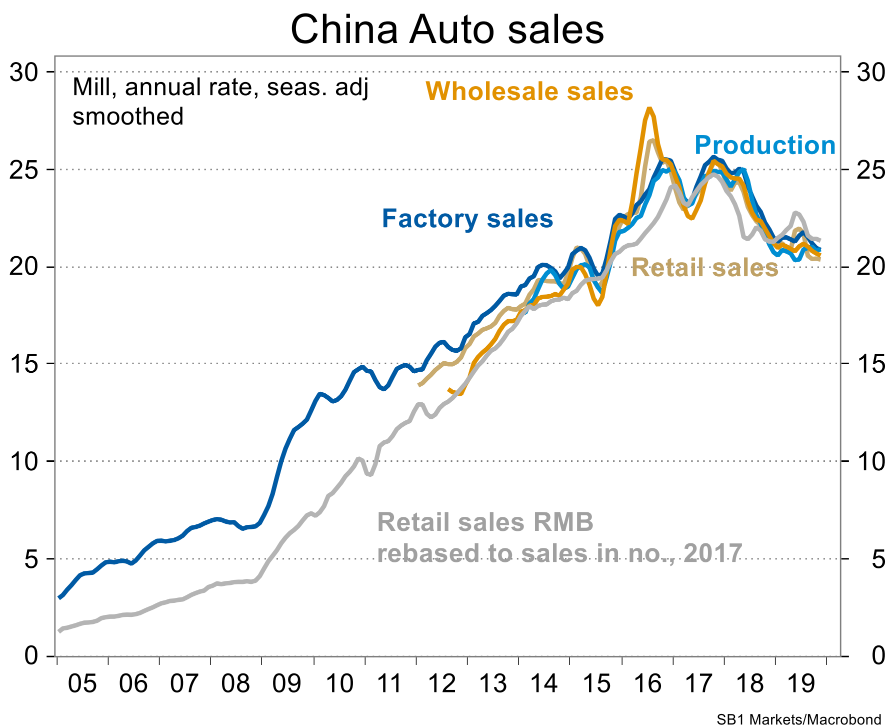
Compared to one year ago, 10 sectors are slowing, 4 sectors are accelerating

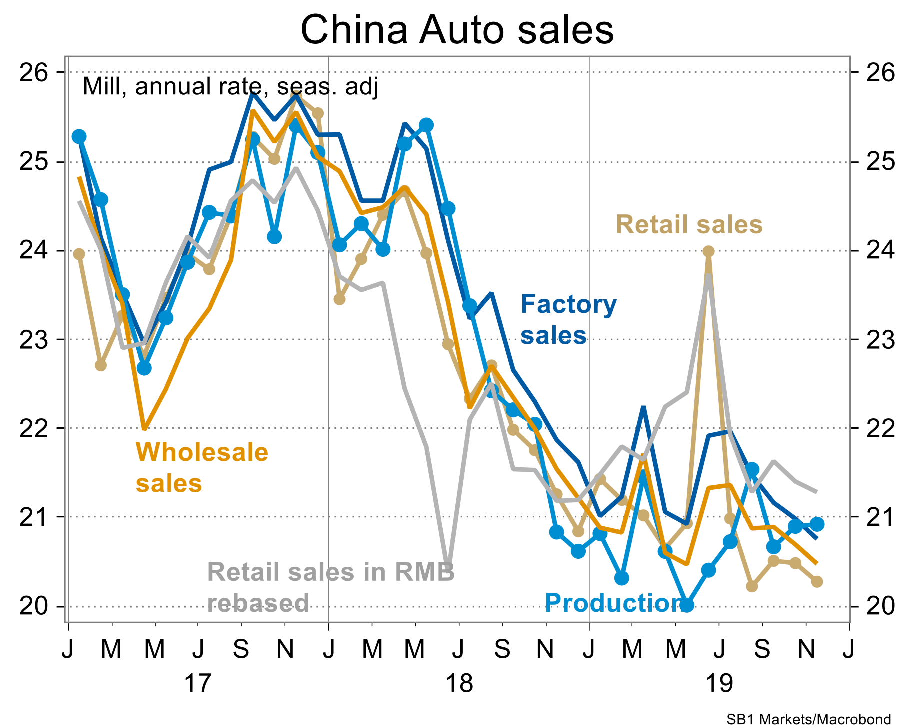


- Crude steel recovered from the Sept/Oct decline. Annual growth +2.5% (3 m smoothed)
- Aluminium production is recovering swiftly from the downturn in 2017 and is increasing by 4% y/y
- Cement production increased this month and is trending just marginally upwards, +4% y/y
- Copper production has recovered sharply in 2019, and is up 18% y/y (Sept data)
- Auto production (valued added) has been hurt by weaker sales, however, production bottomed in May and is now slowly growing, even if most sales indicators are still weak (next page). Production is flat y/y (smoothed) from -23% in the spring. Auto sales are down 20% from the peak

Broad signs of stabilisation in the auto sector (but no recovery)

Most indicators down y/y but all measures have been ‘stable’ since late ‘18/early ‘19

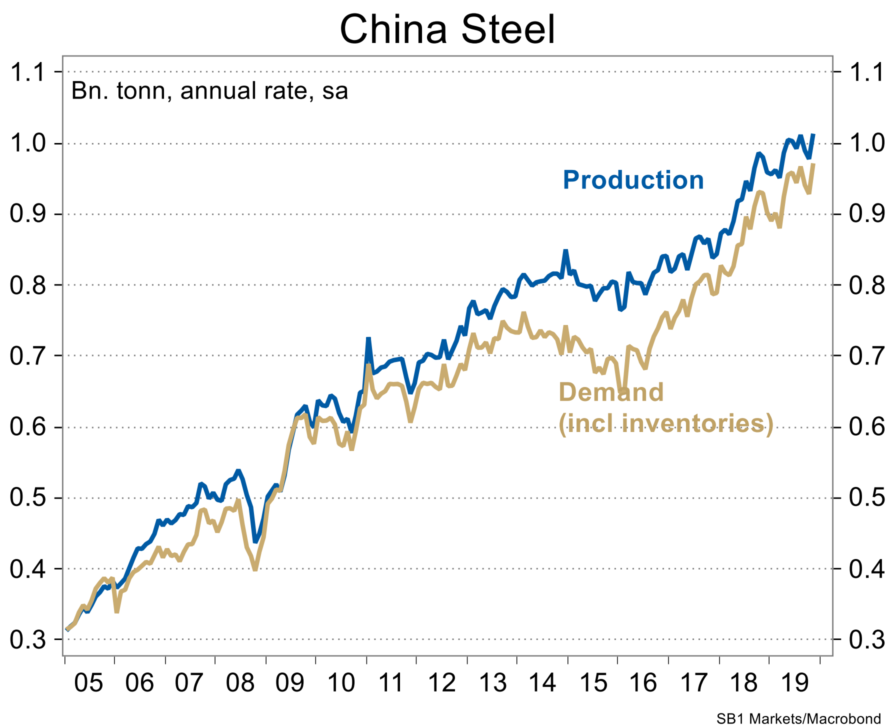




- Production: Production in factories in China, in number of units (now up y/y)
- Factory sales: Deliveries from factories in China or imported cars, in units. This is the most common used data series for Chinese auto sales
- Wholesale sales: Sales from wholesalers, in units
- Retail sales: Sales from 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) (now up y/y)
- Retail sales RMB: Value of sales from retailers, in renminbi. Rebased to retail sales in units in 2017

Steel production (and demand) up in Nov

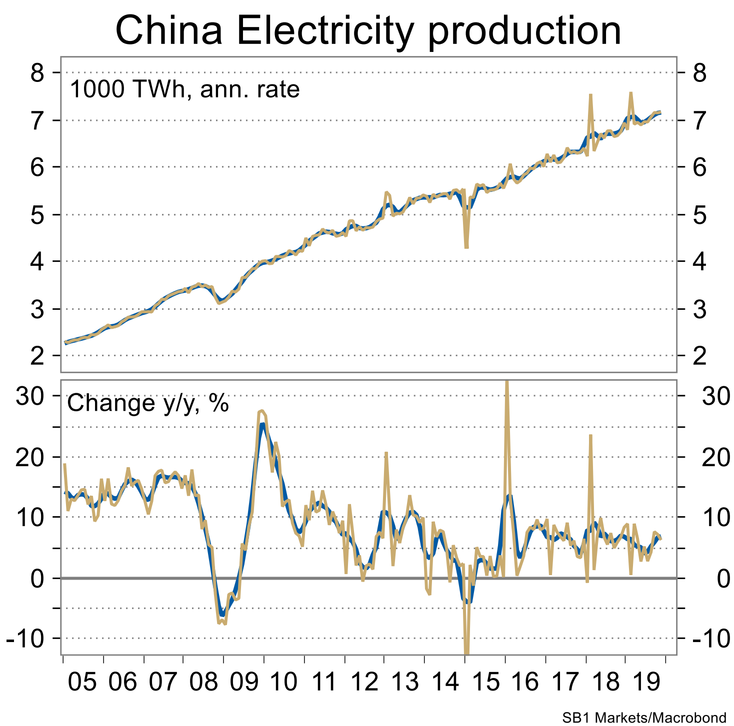
Both demand and production had slowed somewhat recent months but recovered in Nov, to ATH

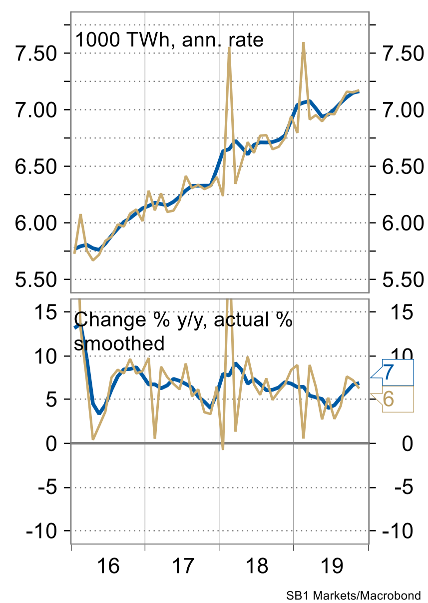


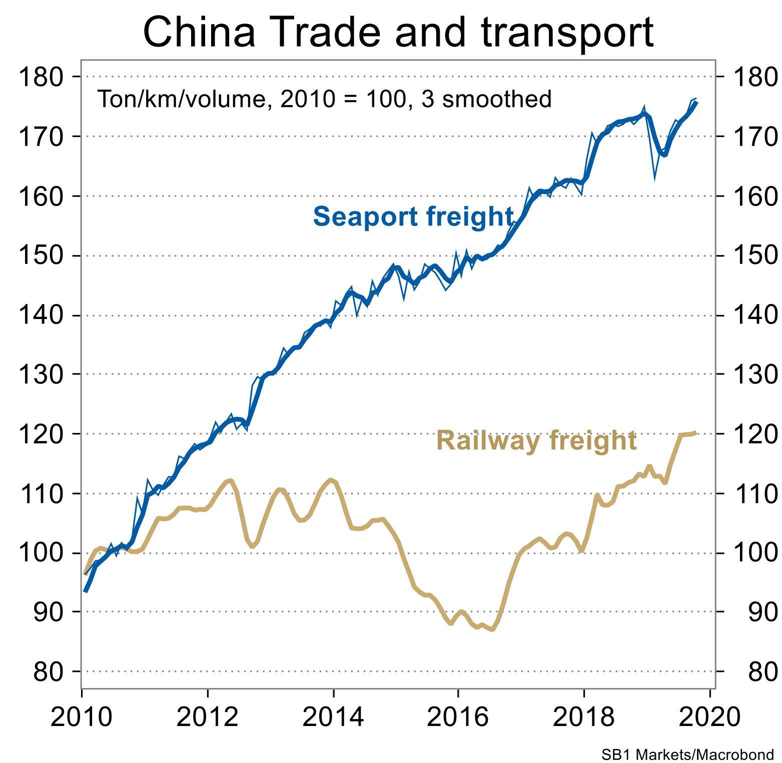
- Production & demand is up some 2.5% y/y (smoothed), well below the level in 2018 into 2019 (above 10%). Growth in constructions starts has slowed too. Auto production has fallen in 2019
- China is still a net steel exporter, but far less than during the 2015-16 setback in domestic demand. Back then, 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

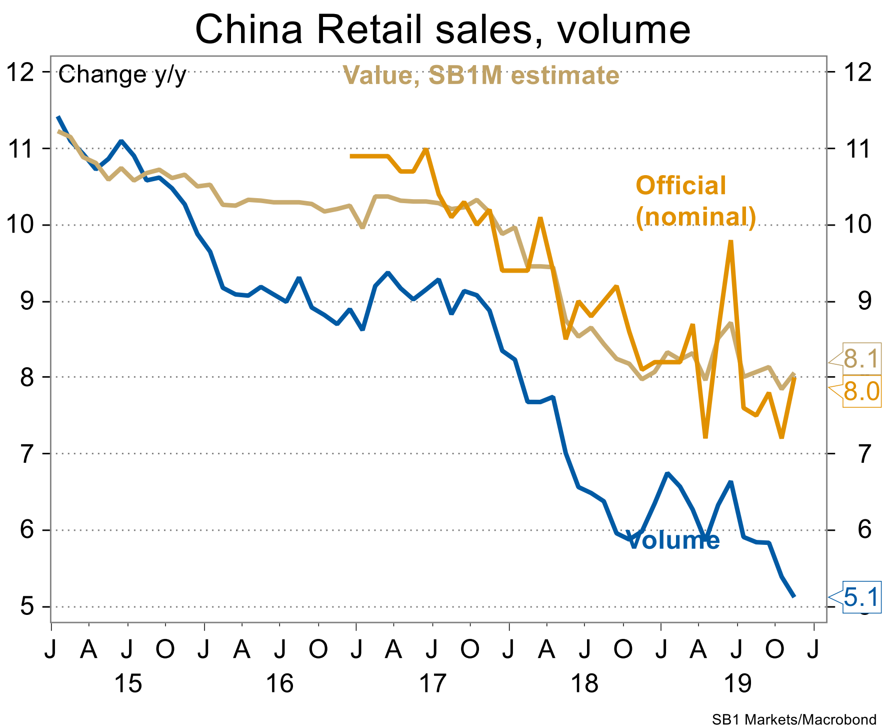
Retail sales volume growth slides down, influenced by the swine flu

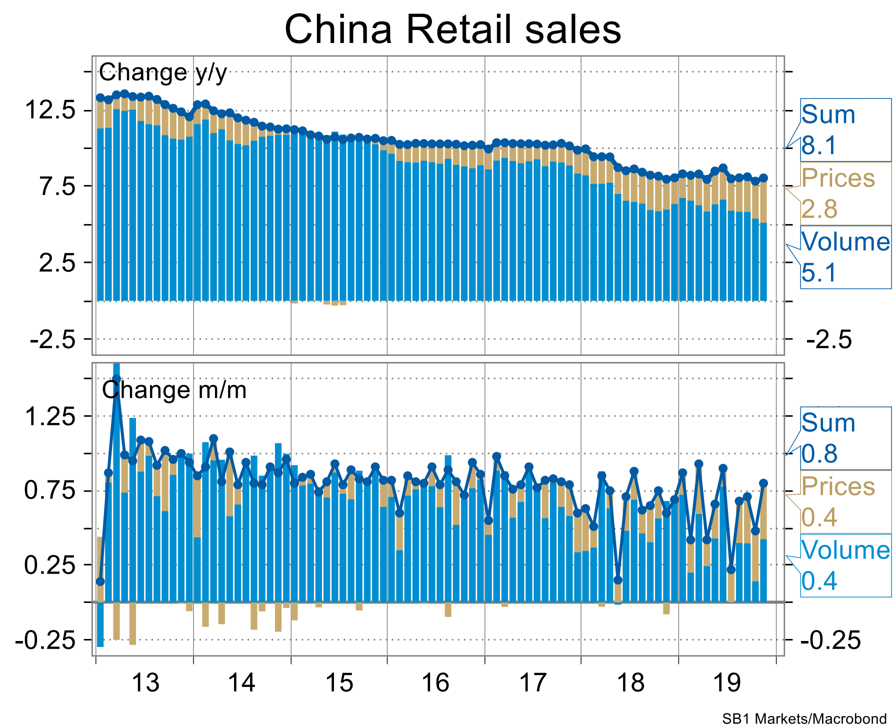
Sales rose 0.4% in Nov, according to our volume estimate. Annual rate down to 5.1%

- The official value growth rate rose to 8%, from 7.2% in Oct, expected at 7.2%. Our far less volatile value growth estimate (based on monthly seas adj. data) yields a 8.1% speed, up 0.3 pp. Value growth is no doubt cooling, however, the speed down is slower than it was in 2018
- We assume a 0.4% m/m volume growth. The annual rate fell to 5.1%, a 0.2 pp drop from Oct. Inflation has accelerated due to the high pork meat prices (inflation up to above 4%, curbing real income growth sharply
- 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 – and at some stage pork meat prices will decline (perhaps some more American pork meat now??), boosting overall buying sharply

Retail sales: A closer look

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

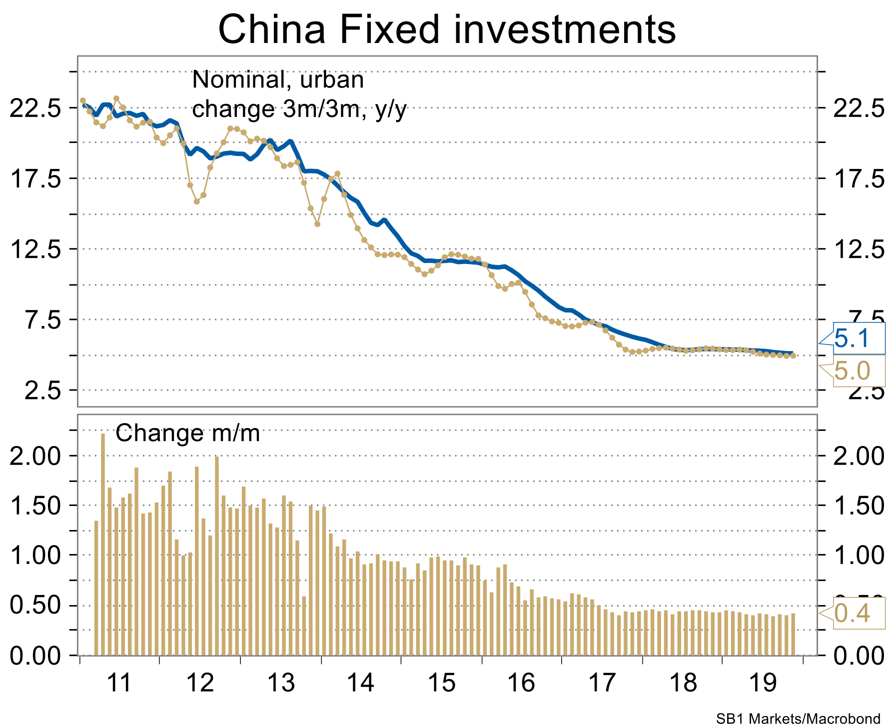




- Nominal m/m sales growth the previous months were revised somewhat up
- According to the NBS, retail price inflation has been accelerating the past 3 months, to 2.8% y/y, while the total CPI is up 4.1% y/y. The reported retail price inflation is low, given the 15% lift in food prices (and the overall 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%

Growth in nominal investments marginally up in November

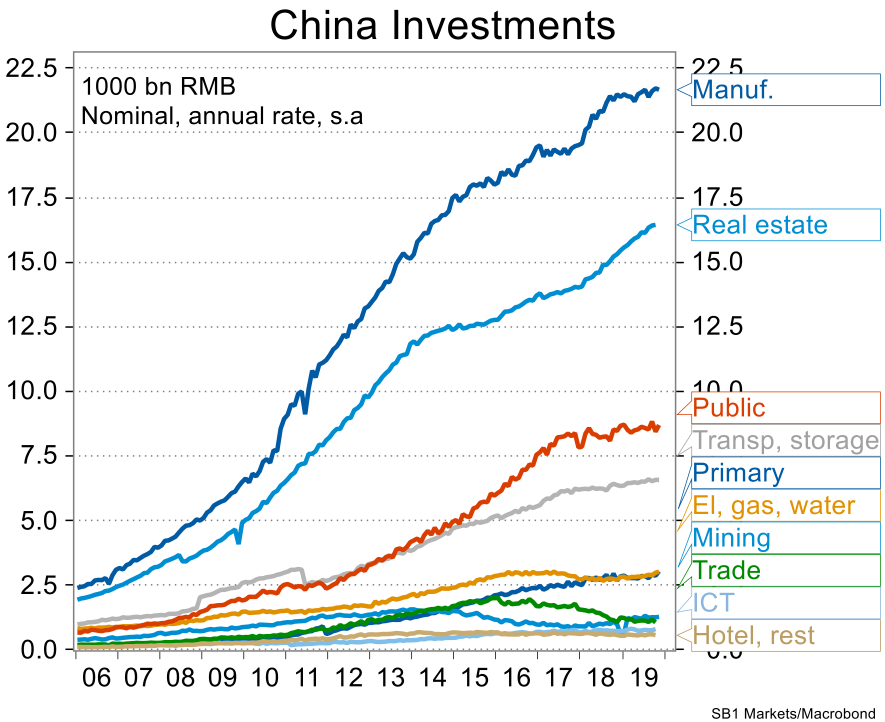
The long term decline in investment growth has halted, at a comfortable, low level

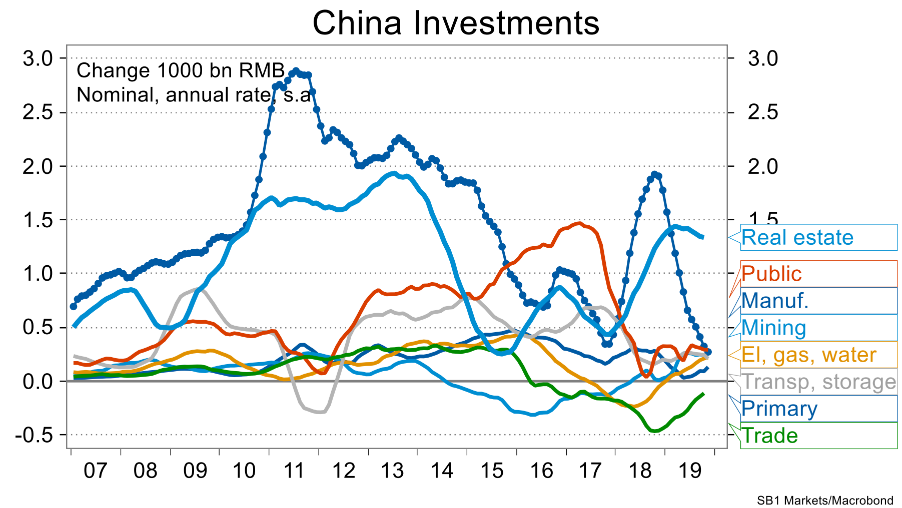


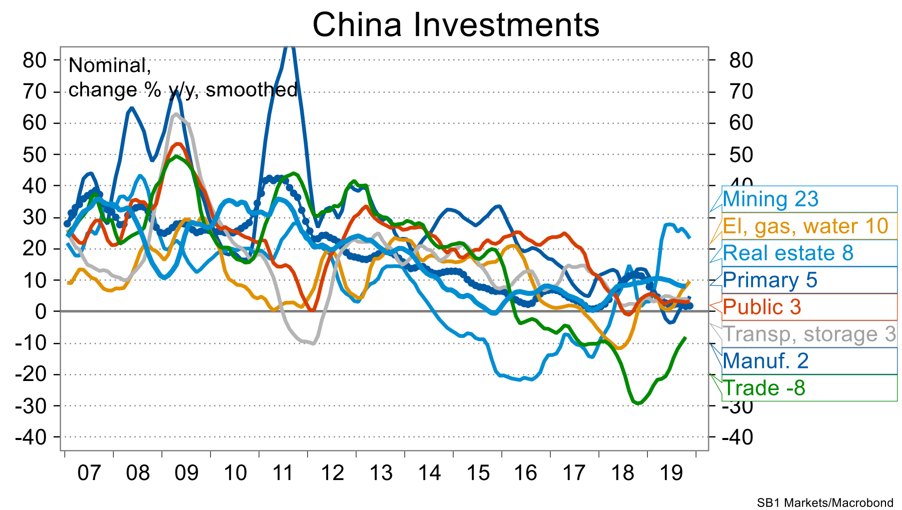
- Urban investments increased by 5.2% y/y ytd in Nov, according to the official data, unch from Oct, and as expected
- Our less volatile calculation yields a 5.1% y/y growth, trending just marginally down the past year. The m/m rate was steady at 0.4% (but marginally up with 2 decimals), the same pace as recent months and a slight slowdown from last year. In real terms, we assume an acceleration to 3% through, up 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 peaking?

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





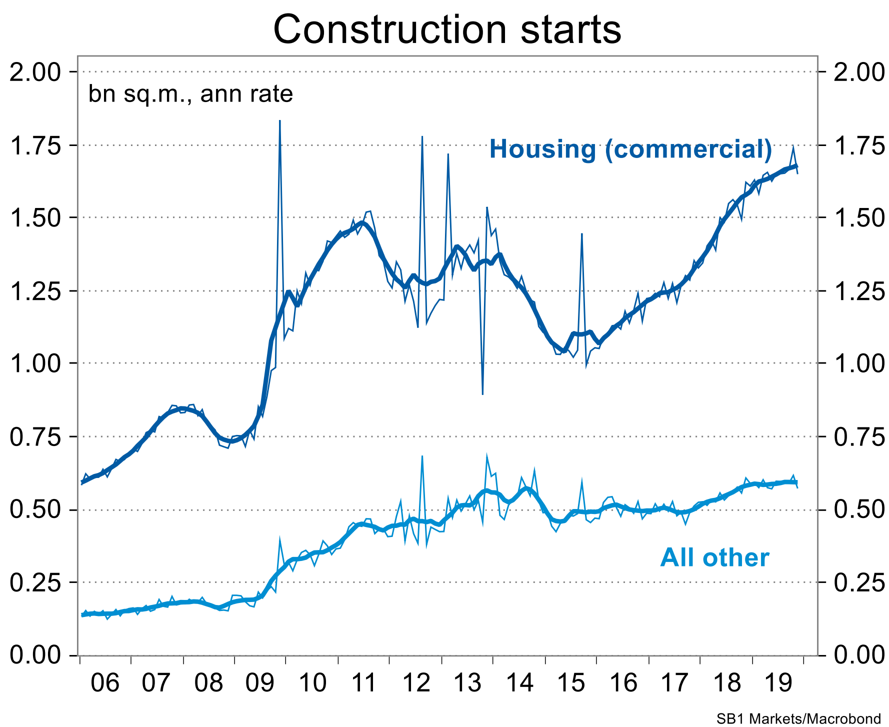


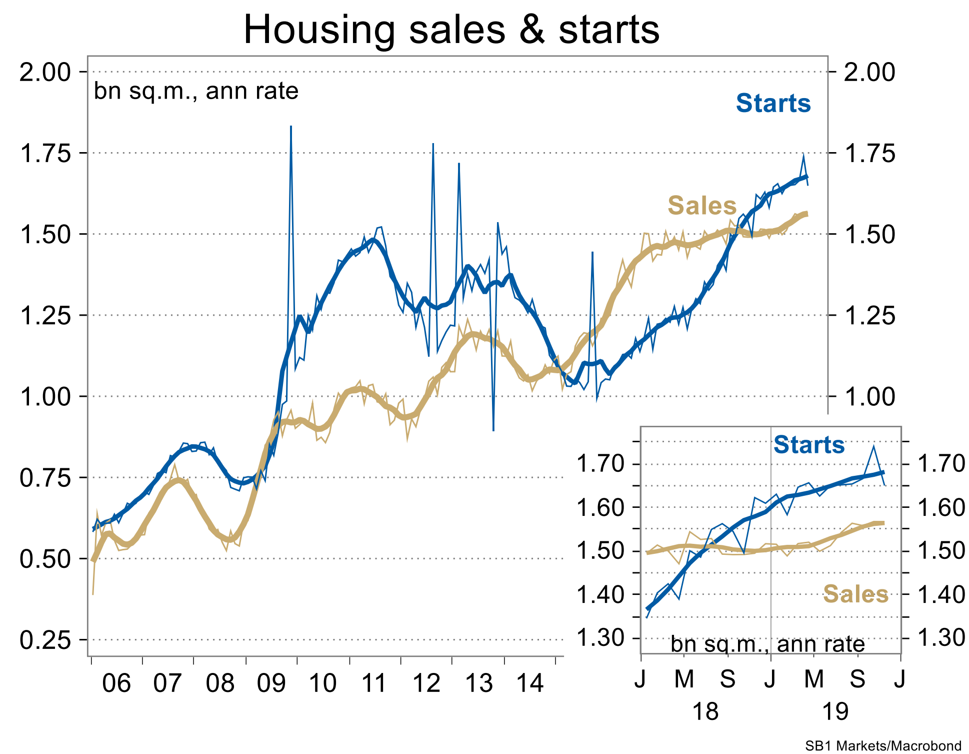
Not all sectors have reported data for the last month

- 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; -8% 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… But growth may have peaked
- 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 down in Nov, and Oct was not that impressive

New home sales are still trending up

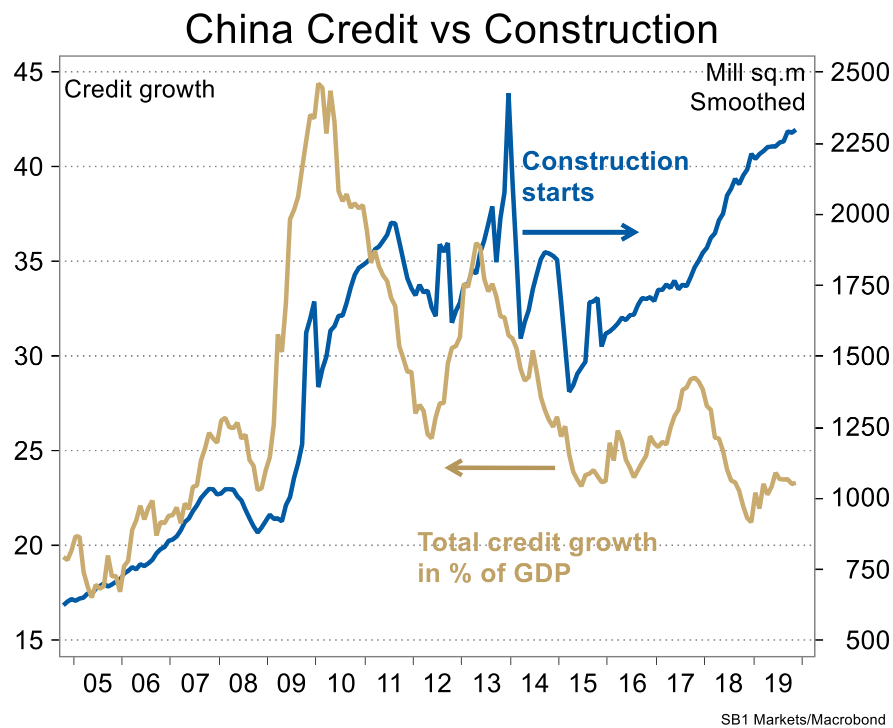


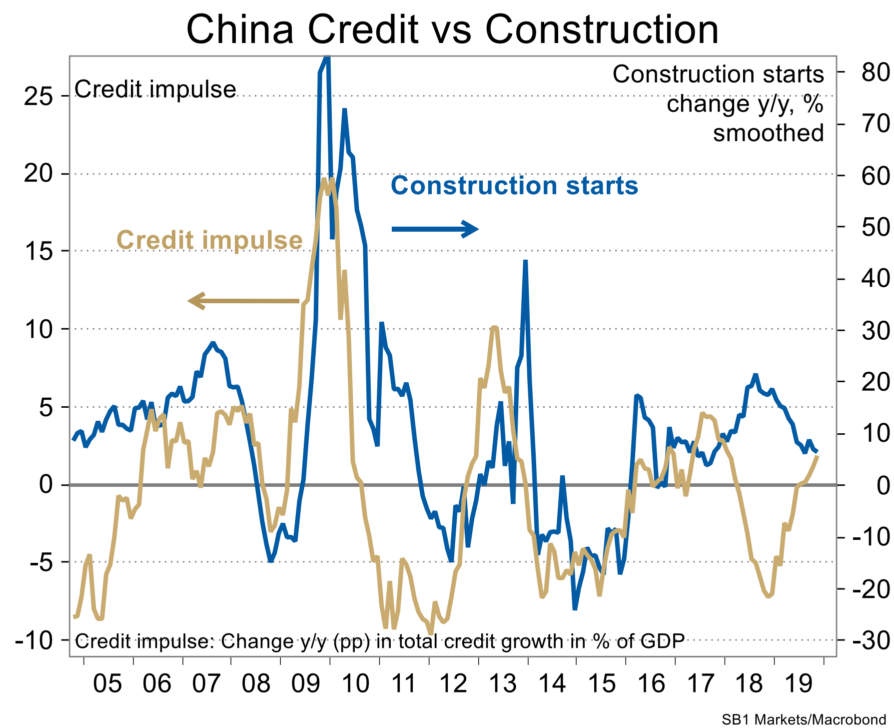


- Housing starts fell m/m in Nov and was flat y/y. Still the trend is up, even if starts in Oct was revised 5% down. Starts are up almost 70% from the 2015 trough, to a high level. Close to peak? Well, the level is high (in sq.m. growth per person), and there are plenty of reports on unsold homes. However, 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 also fell in Nov, and they are marginally down y/y. Recent months (smoothed) 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

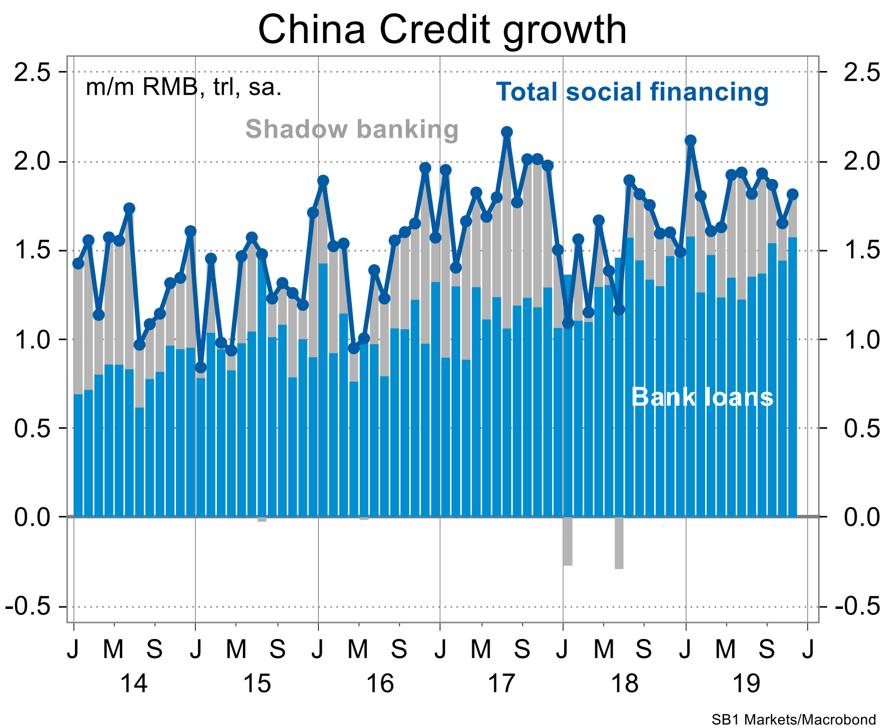


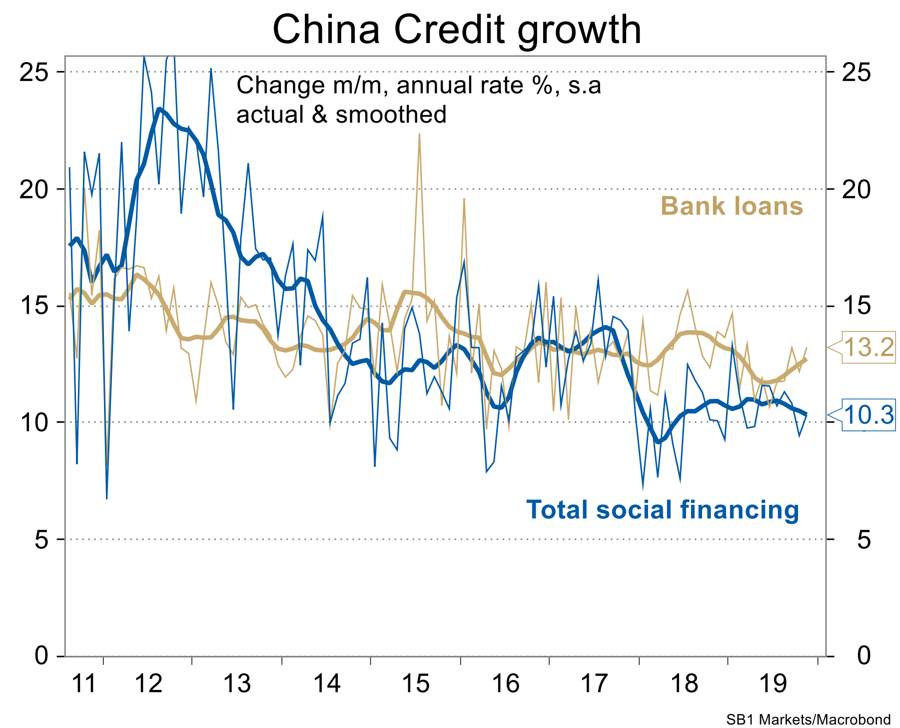


- During 2017/18 credit was tightened but construction activity accelerated. This year, credit has been increasing and is no longer contracting while growth in construction is slowing

Credit growth accelerated in November, due to more bank lending

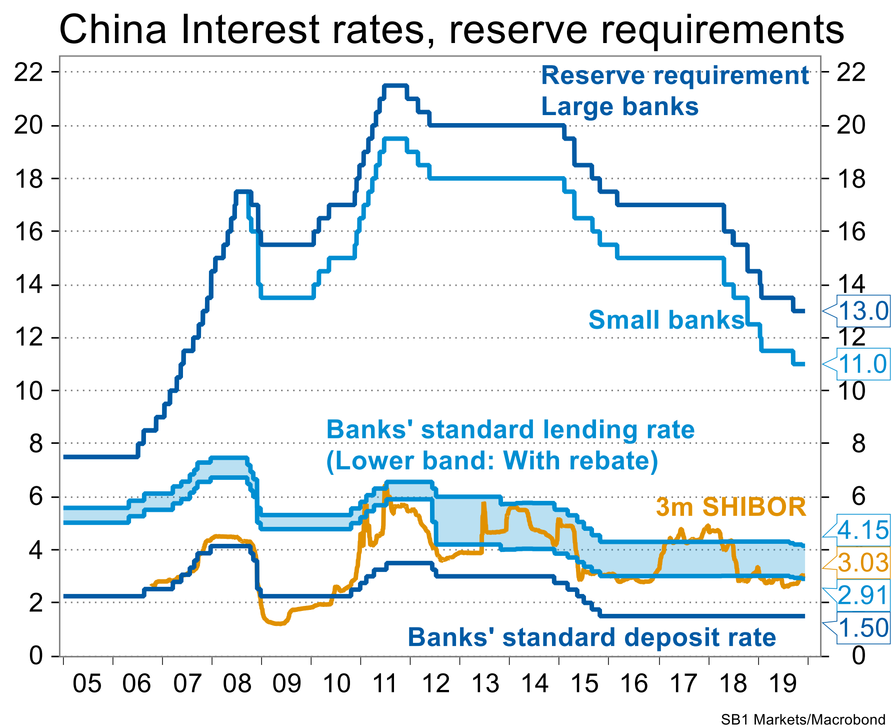
Bank lending trending up recent months, shadow banking activity cooling

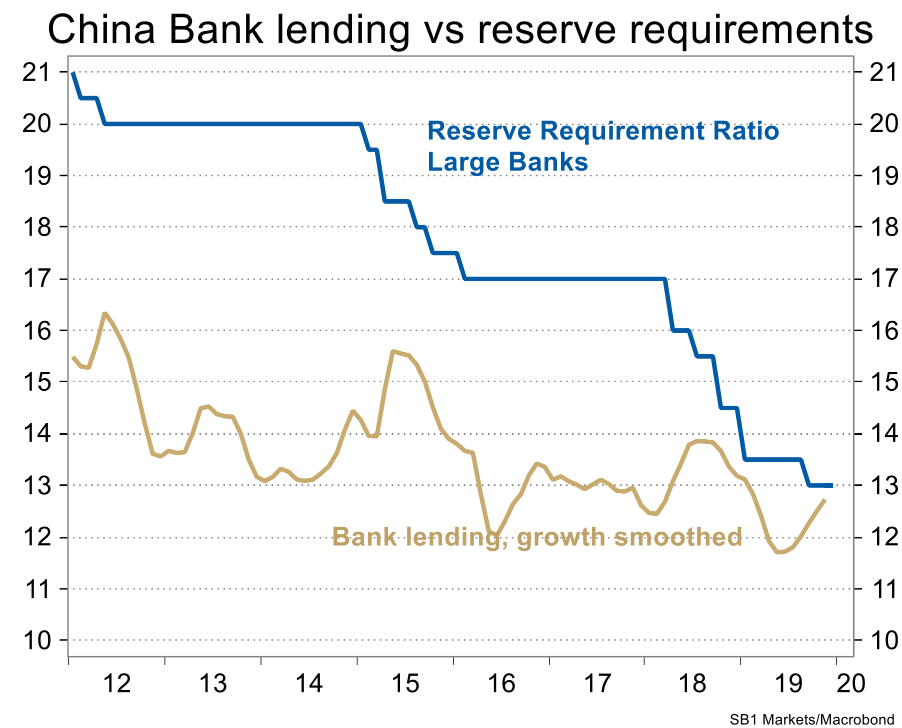




- Total credit rose by 10.3% m/m annualised in Nov, from a 9.8% pace in Oct. In RMB, total credit rose by 1.7 trl, from 0.6 trl, expected at 1.5 trl (not seas. adj). The underlying trend is slowly up since early '18, the credit impulse (y/y) is marginally positive
  - » Growth in bank lending har accelerated since the summer, perhaps due to the cut in reserve requirements. They 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 accounts for some 20% of total credit supply (but less the recent months)
- 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. Overall growth has not slowed that much either

Rates just marginally cut so far but reserve requirements are slashed

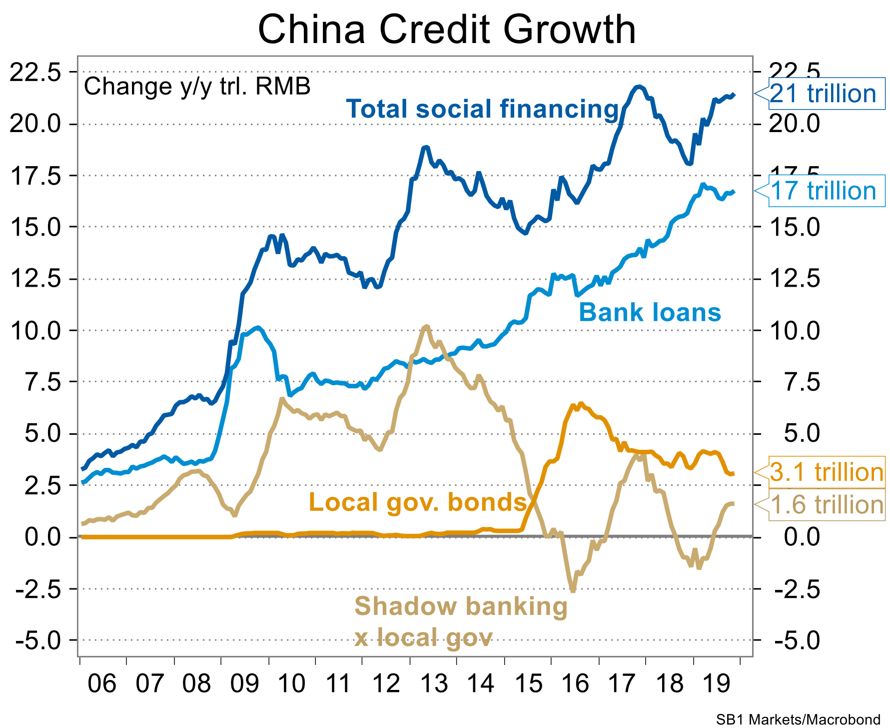


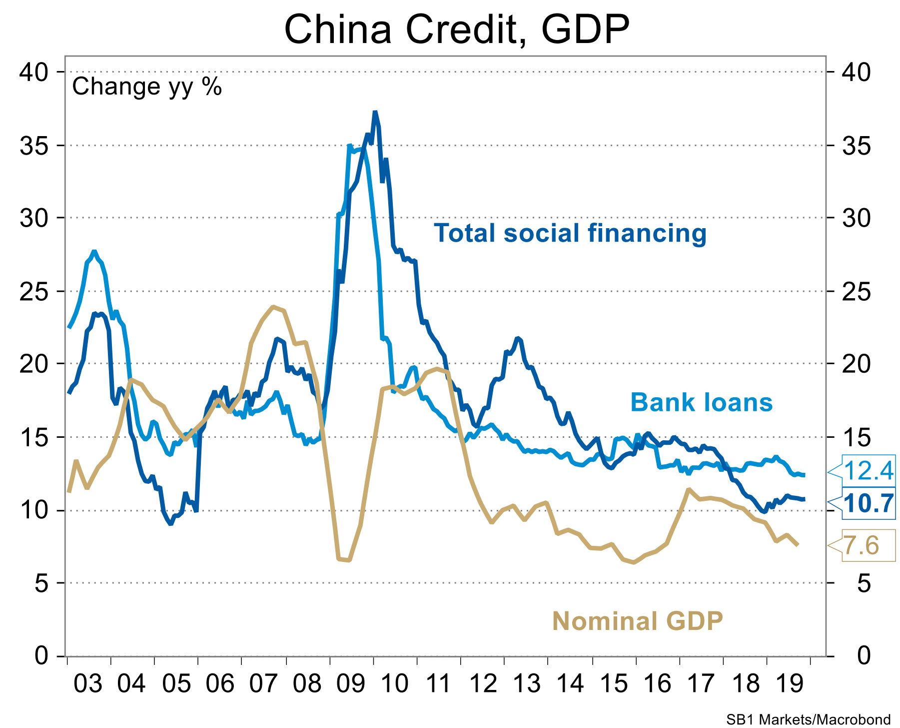


- In October, the PBoC announced a CNY 200 bn cash injection into the banking system to ease lending conditions. This amount equals just 1/10th of one month's increase in bank lending, and cannot have any significant impact on credit condition
- The PoBC's signal rates have been cut 3 times since Sept, but no more than some 5 bps each times

Credit growth has accelerated slowly over the past year

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



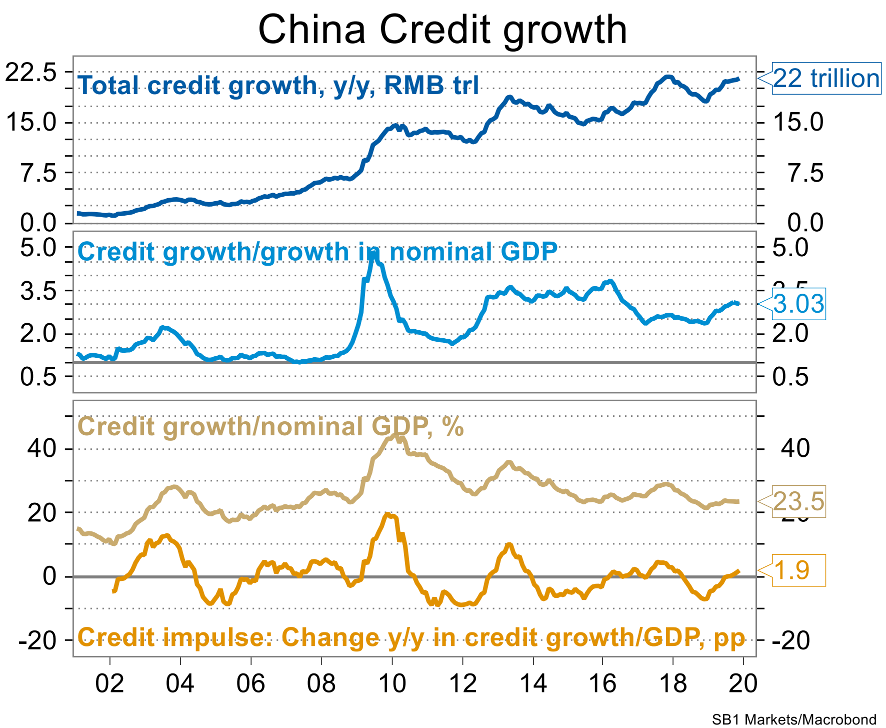


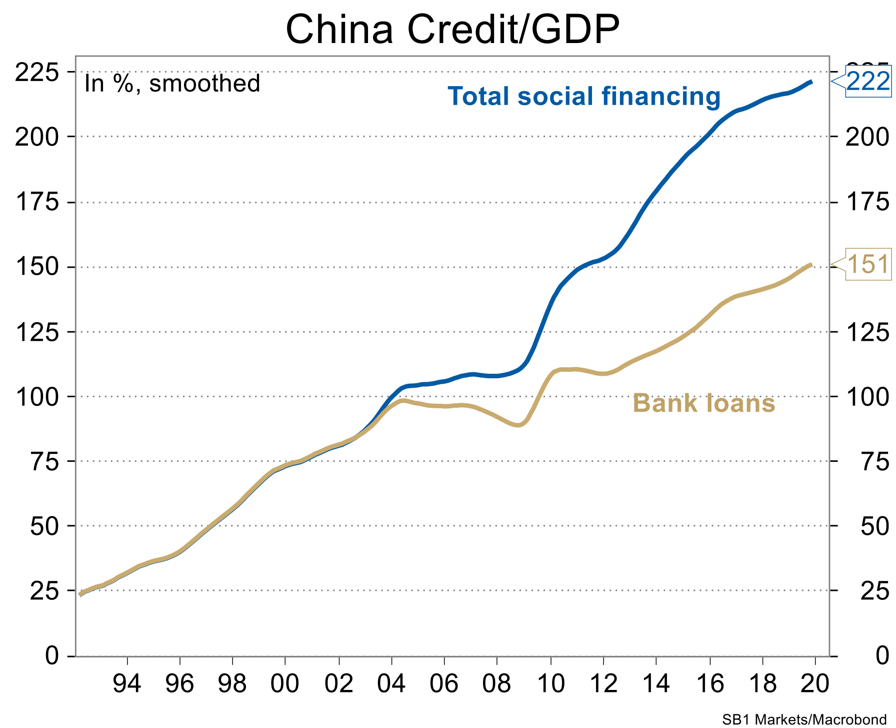
- Over the past 12 months, total credit has grown by CNY 21 trl, equalling 23% of GDP. The annual rate bottomed out last Dec
- Banks supplied CNY 17 trl of the y/y increase in Sept, equalling 80% of the total rise in credit volume
- Local governments borrowed CNY 3 trl in the bond market, slowing recent 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

SpareBank 1 MARKETS

Credit impulse has turned marginally positive, from negative

Credit growth is now slowly increasing vs GDP

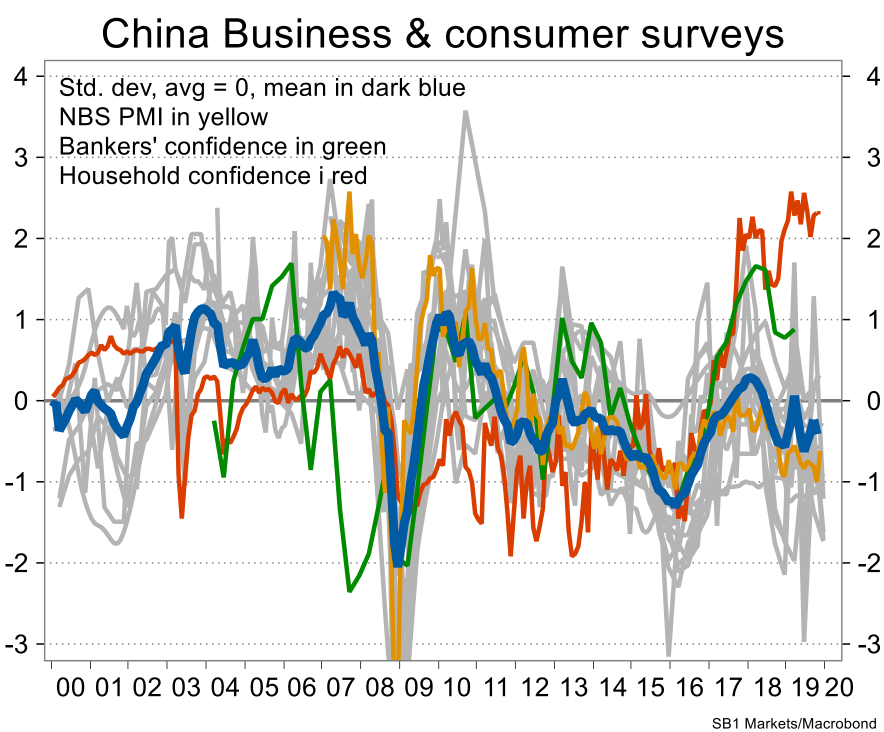


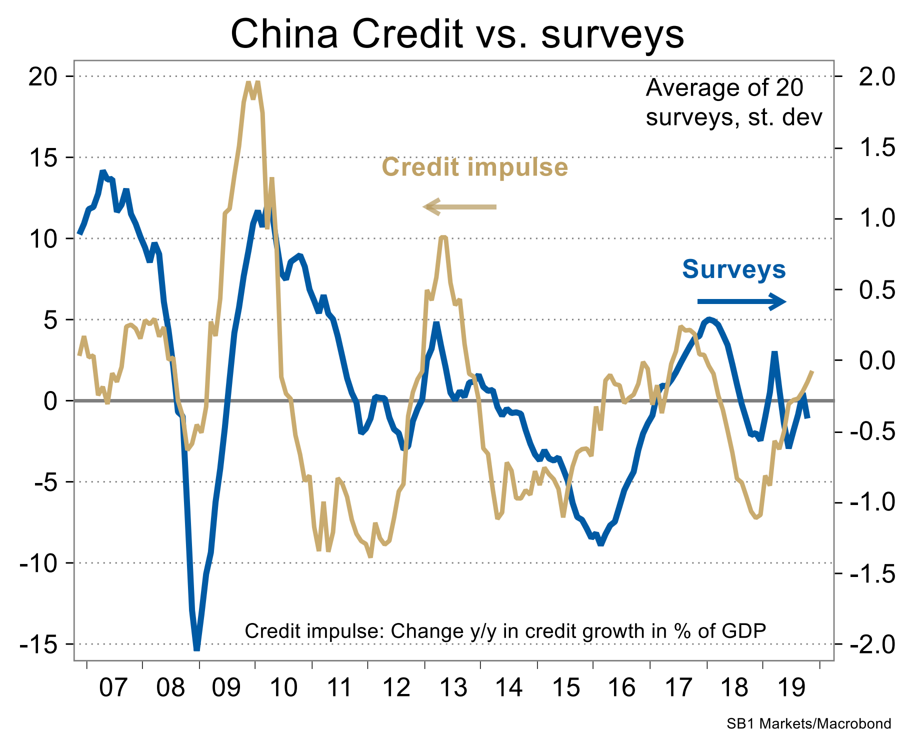


- A positive credit impulse implies that the credit growth/GDP ratio is increasing (the 2nd derivative of credit vs the GDP level)
  - » A negative credit impulse indicates credit tightening (or weaker demand) and has been associated with slowdowns in the Chinese economy
  - » Now, the credit impulse 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 23% of GDP. That's not sustainable, neither for lenders nor borrowers in the long run, as nominal GDP growth is less than 10%. The Government may succeed in increasing credit supply short term (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

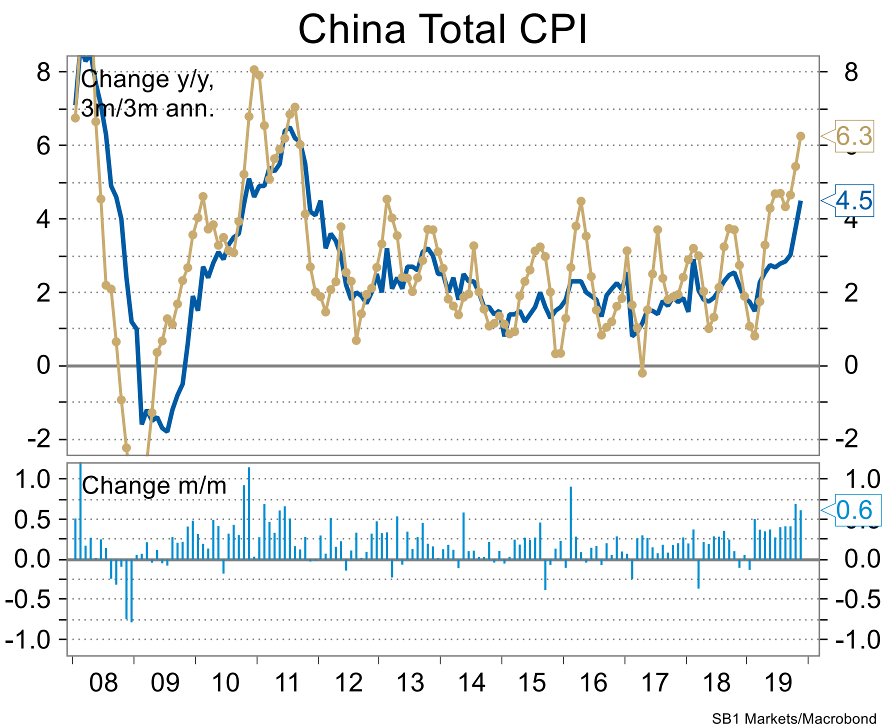


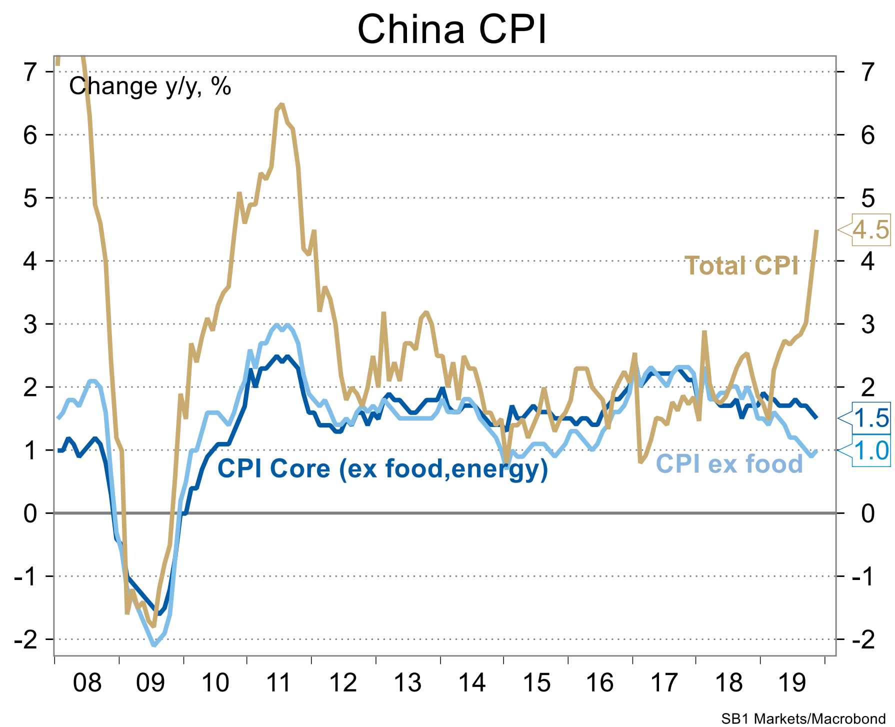


- An avg of Chinese business & consumer surveys indicates that growth has slowed, however, the level is still at an historical average and above the 2018 level (and it was weaker in 2014-2016 and 2012)

Total inflation soared to 4.5% in Nov, core CPI eased to 1.5

Total inflation climbs on a rapid increase in pork prices, core inflation is trending down

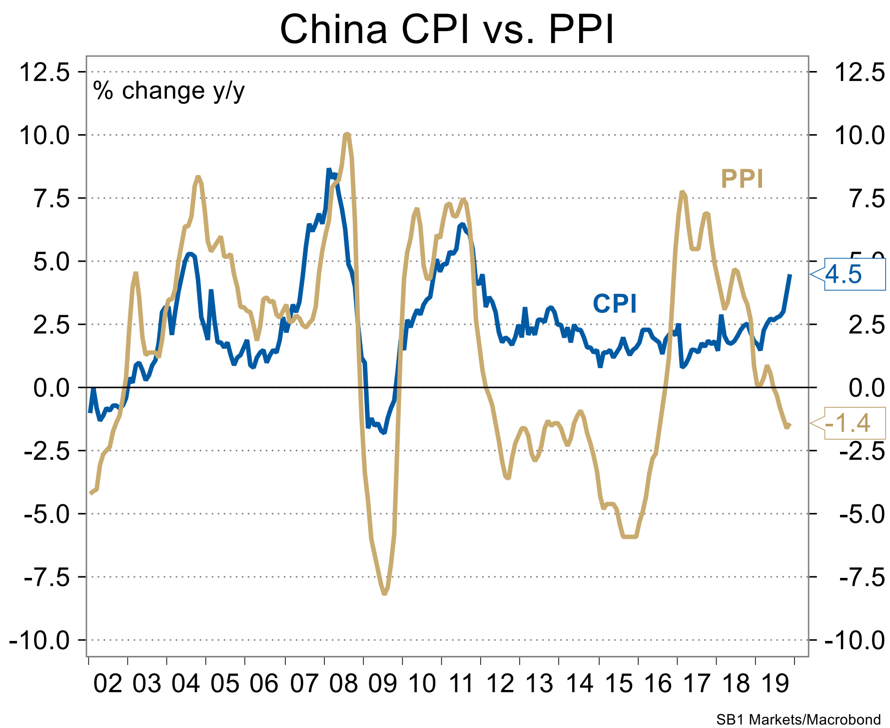


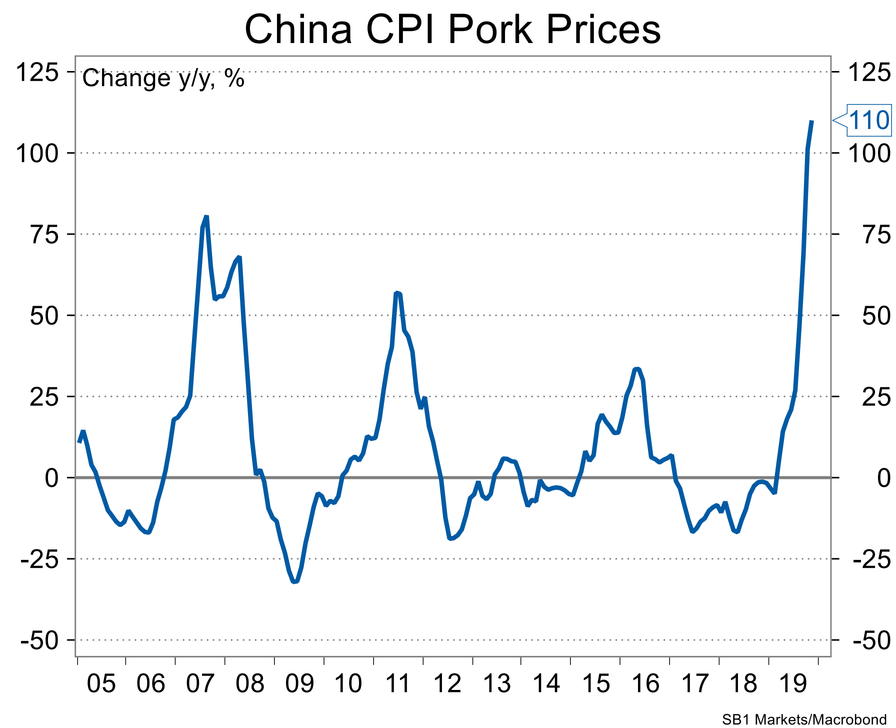


- Headline inflation climbed to 4.5% in Nov, a 0.7 pp jump! Total inflation is fuelled by accelerating food prices
  - » Food prices jumped 2.1% m/m and the annual rate rose to 19%, the highest since 2008. Pork meat prices are up 110% y/y!!
- Core inflation (x food & energy) slowed further to 1.5%, trending more or less flat. CPI ex food fell to 0.9% in Sept, sliding down, due to lower energy prices
- High CPI growth due to this supply shock is not any argument for a tighter monetary policy, rather the opposite. 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 1.4% y/y in Nov, dragged down by oil, raw materials. Food prices are soaring

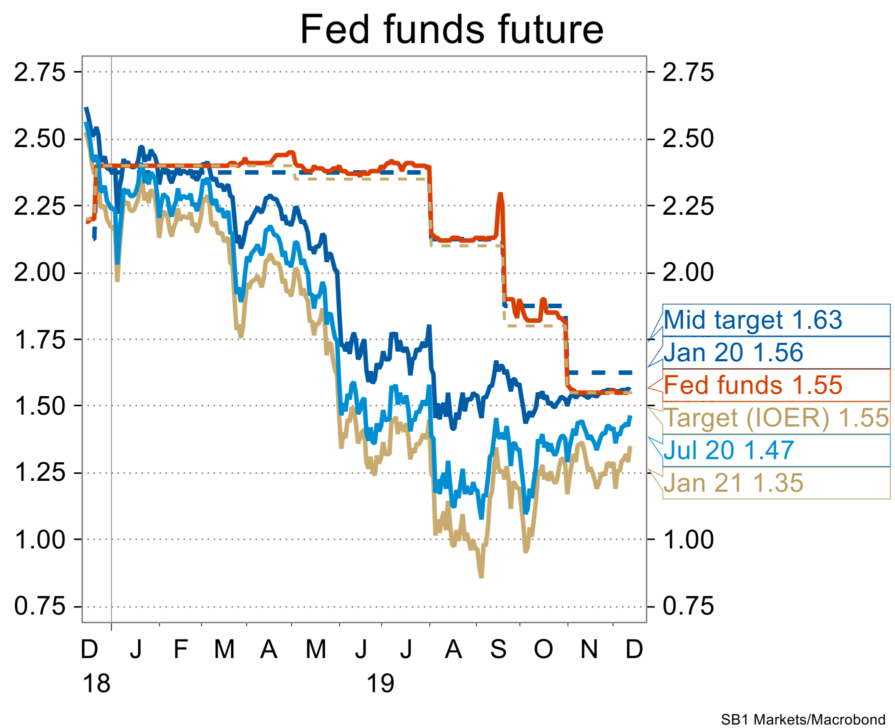


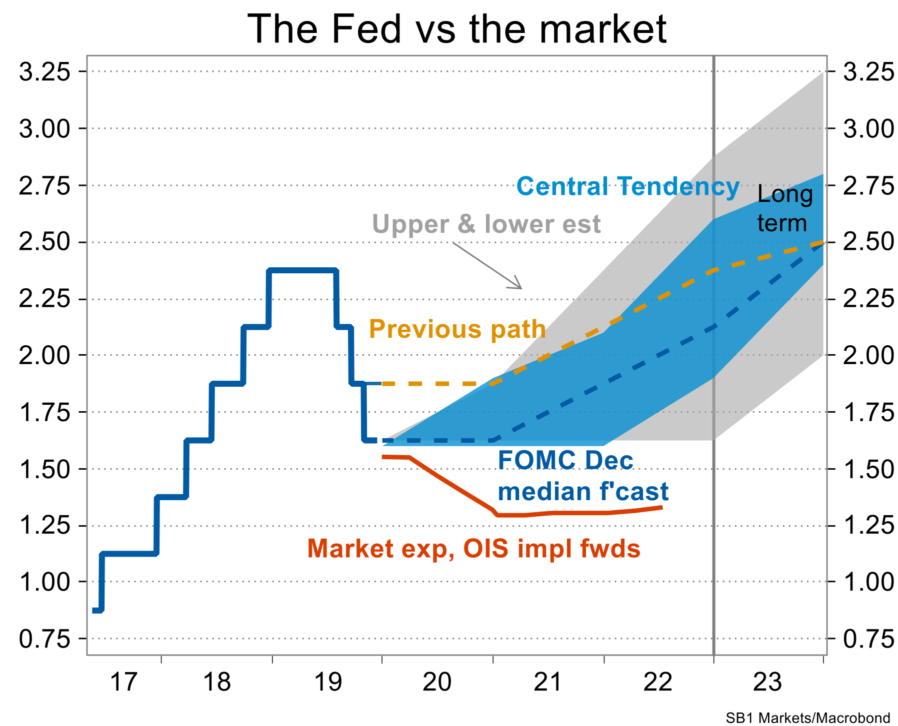


- The decline in PPI is so far not serious compared to previous periods with falling produced prices. From 2012 to 2016 prices fell by 3% per year in average, lowering the price level by more than 13%. Even that did not kill the Chinese economy
- Pork meat prices have soared by 110% due to the swine flue, driving total consumer price inflation up (but meat constitute a very minor part of the PPI and does not influence PPI by much

The Fed is on hold; signals an unchanged interest rate through 2020

FOMC held the Fed Funds rate unchanged, of course, and does not plan any hike before 2021





- The FOMC kept the Fed funds rate unchanged at 1.5-1.75%, as everyone anticipated. The decision was unanimous, for the first time since May
- The dot plot signals an unchanged interest rate through 2020 and one hike in 2021 and one in 2022, with the longer run rate unchanged at 2.5%
  - » At the news conf., Chairman Powell signaled that the interest rate would remain at the current level unless incoming economic data deteriorates materially. An appropriate assessment, in our view, as consumer spending remains strong, labour markets are tight and overall growth is not weak
- Market reactions: Stock markets cheered the decision to keep interest rates on hold through 2020, as some worried about a signalled hike (although markets are pricing a cut). Bond yields fell, the 10 y gov down by 3 bps (and by 6 bps during the day). Fed Funds futures inched down, the Jan' 21 contract by 3 bps. The market still prices a cut in 2020, but less than a 40% prob. of a cut in H1 (after promising trade deal reports)

No major changes to the projections on the economic outlook

Growth and inflation f'casts were held unchanged, unemployment f'casts were nudged down

Percent

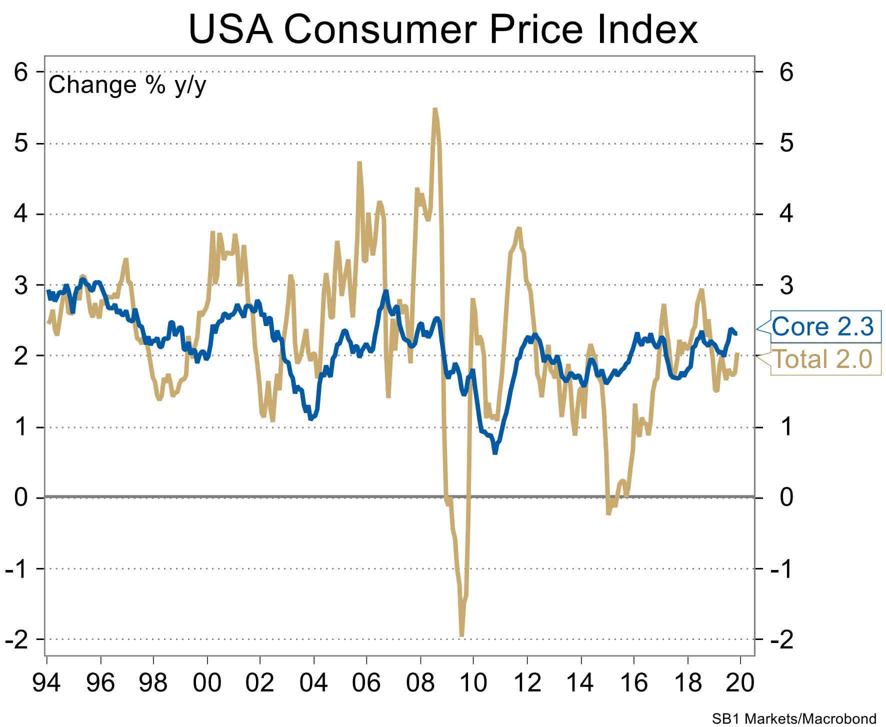
Variable	Median[1] 2019	2020	2021	2022	Longer run
Change in real GDP	2.2	2.0	1.9	1.8	1.9
September projection	2.2	2.0	1.9	1.8	1.9
Unemployment rate	3.6	3.5	3.6	3.7	4.1
September projection	3.7	3.7	3.8	3.9	4.2
PCE inflation	1.5	1.9	2.0	2.0	2.0
September projection	1.5	1.9	2.0	2.0	2.0
Core PCE inflation[4]	1.6	1.9	2.0	2.0	
September projection	1.8	1.9	2.0	2.0	
Memo: Projected appropriate policy path					
Federal funds rate	1.6	1.6	1.9	2.1	2.5
September projection	1.9	1.9	2.1	2.4	2.5

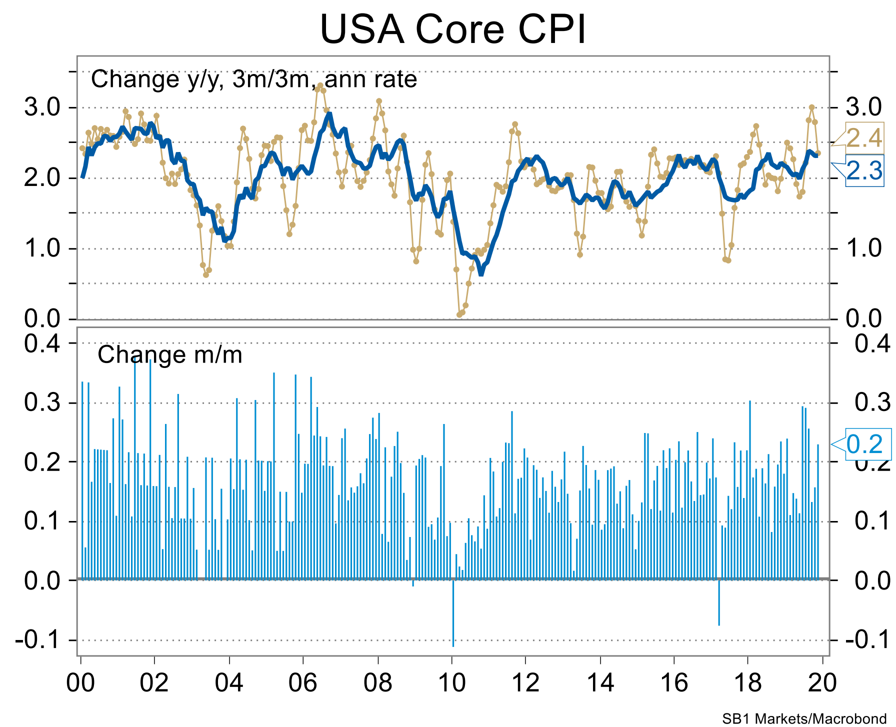
Source: Federal Reserve

- Fed emphasized that the outlook remains favourable, with solid labour markets and strong household spending
- The weak spots are sluggish business investments and exports
- The Fed expressed concerns of the consequences of inflation running below the 2% target for a long time. Core PCE inflation is expected to gradually pick up, to 2% by 2021 (unchanged from the Sept report)
- GDP growth f'casts were held unchanged, growth is expected too slowly ease, to 2% in '20 and 1.9% in '21
- Unemployment projections were nudged down by 0.2 pp in 2020-2022. Fed expects unemployment to bottom out at 3.5% in 2020 and gradually turn up thereafter
- Our take is that the risks are tilted to the downside vs the Fed's projections. However, the Fed has more ammunition left and will not hesitate do lower rates should the outlook deteriorate substantially

Core inflation steady at 2.3%, peaking now?

Core CPI up 0.2% m/m, as expected, and the annual rate was unchanged at 2.3%

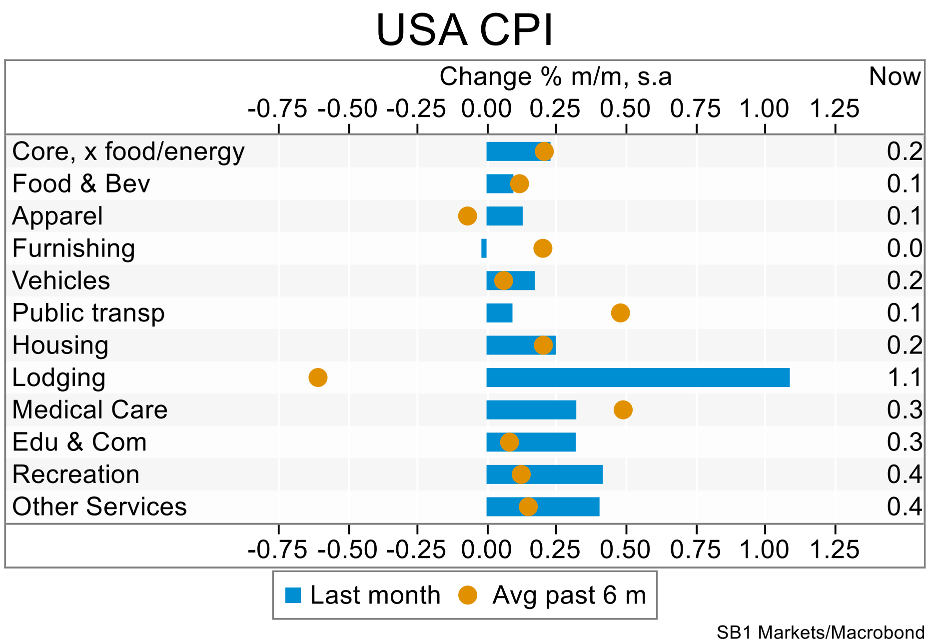


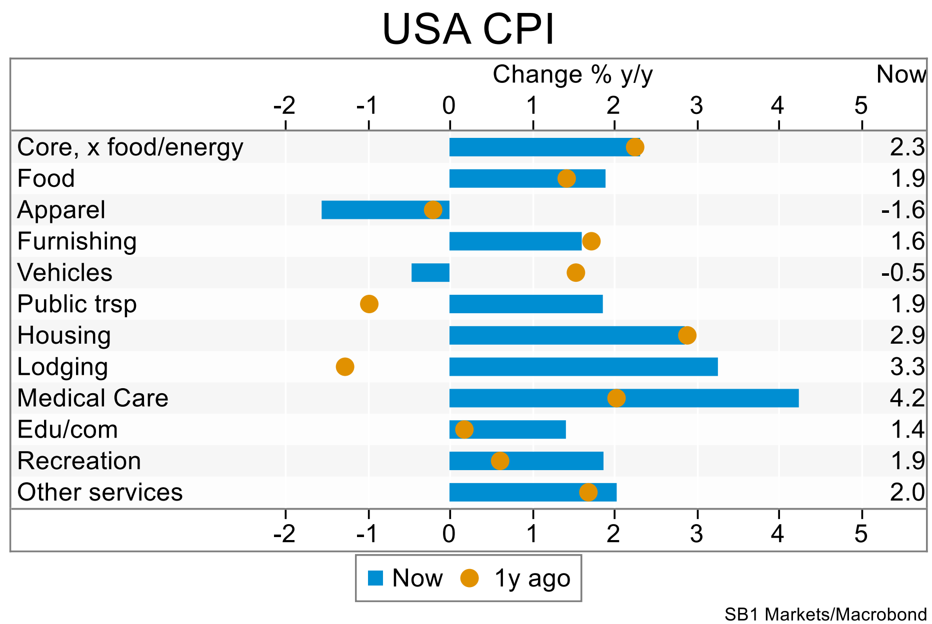


- Core CPI increased by 0.2% m/m in Nov, in line with expectations. The annual rate held steady at 2.3%. The underlying speed has slowed to 2.4% and does not suggest much higher annual rates. Moreover, producer prices and inflation models indicate that inflation may be peaking now. But it is not ‘too’ low, at least according to the CPI index
  - » Fed preferred price measure, the core PCE (the consumption deflator) is up ‘just’ 1.6%, below Fed’s 2% price target
- Headline inflation edged up to 2.0%, a 0.2 pp increase. Total CPI inflation was pulled down by lower energy prices in late 2018/early 2019, this impact is now turning as energy prices are slowly climbing

Prices increased in almost all sectors in Nov, and most are up y/y

Just prices on apparel and vehicles (sales are softening) are declining y/y

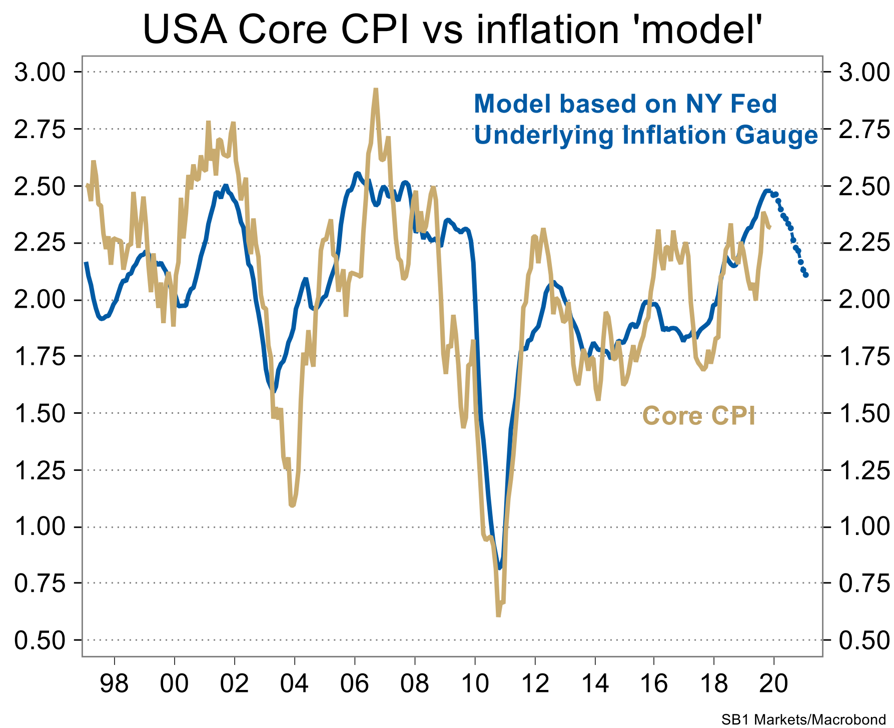


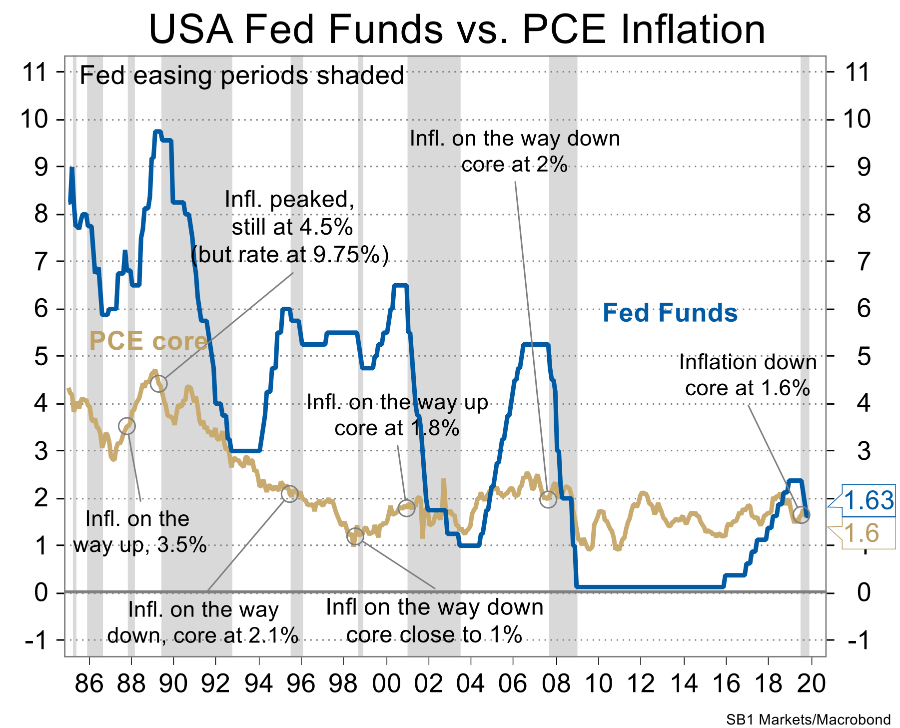


- Prices are increasing faster than 1 year ago in 7 of 11 sectors, unchanged in 2 and declining in 2 sectors
- Higher prices on lodging, medical care and housing (rents & services) are boosting annual inflation
- In October, prices rose m/m in all sectors x furnishing, and lodging prices increased the most

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

The model signals 2.5% inflation now – and a slowdown the next year

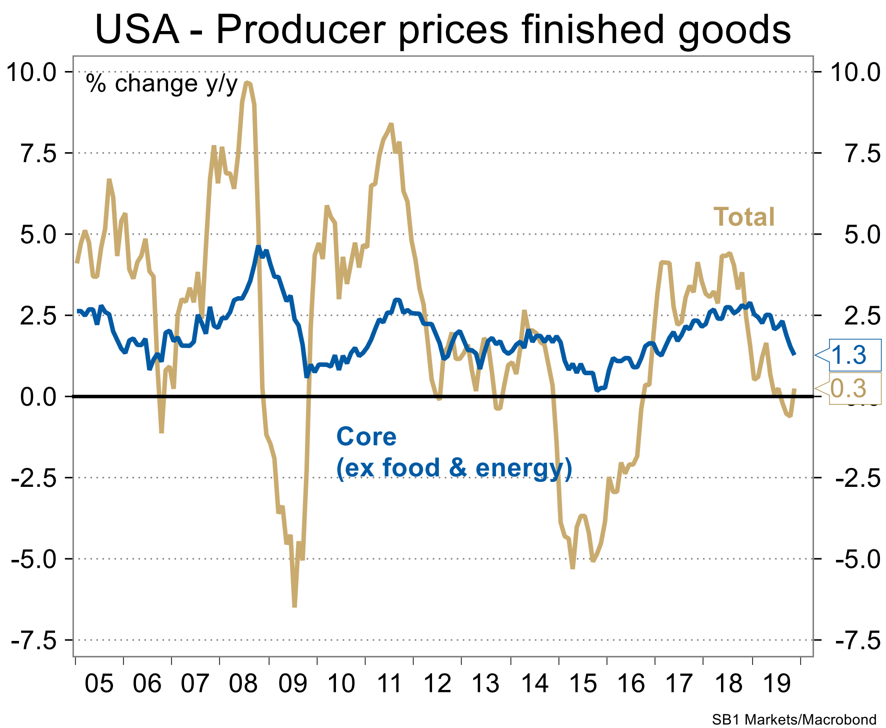


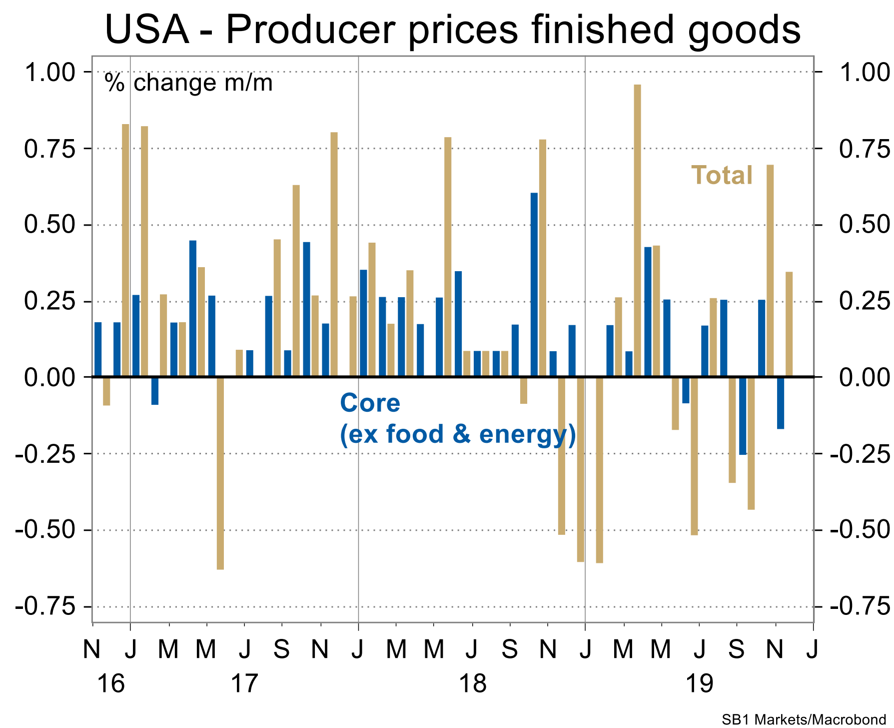


- The NY Fed's Underlying Inflation Gauge model includes a wide range of macroeconomic and financial components in addition to some CPI components. The UIG model leads the actual inflation rate by some 15 – 20 months. The model now signals somewhat lower inflation than it did some months ago, and does no indicate much higher inflation than today
- The personal consumption expenditure price deflator (PCE deflator) is the Fed's preferred inflation measure, not the CPI. The core PCE (ex food, energy) was up 1.6% y/y in Oct, 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 here, more than inflation (as almost always, BTW)

Producer price growth heading down, does not signal higher consumer inflation

Core finished goods prices dropped 0.2% m/m in Nov, vs the 0.2% expected increase

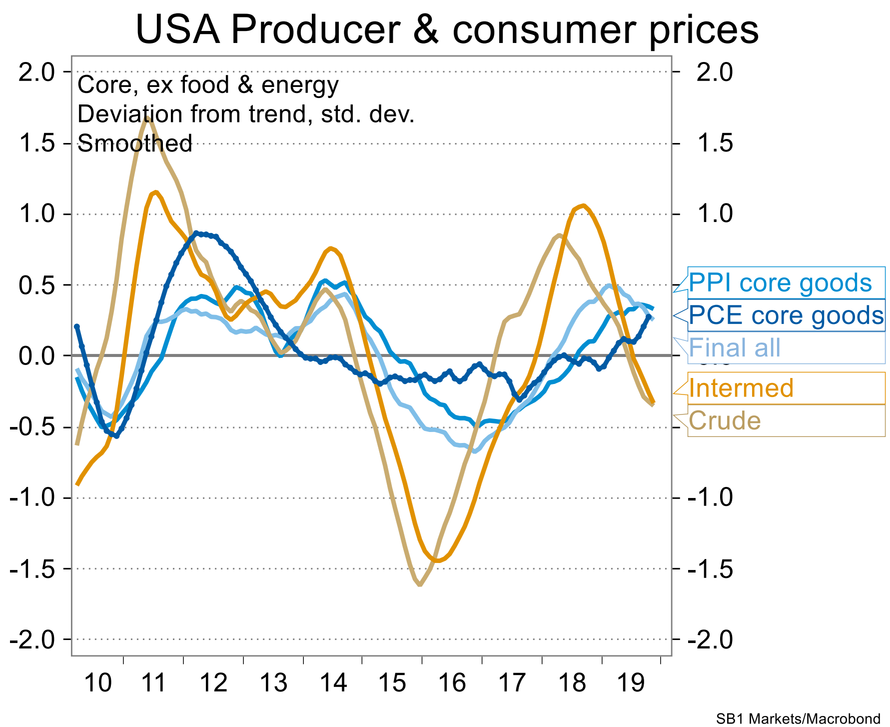


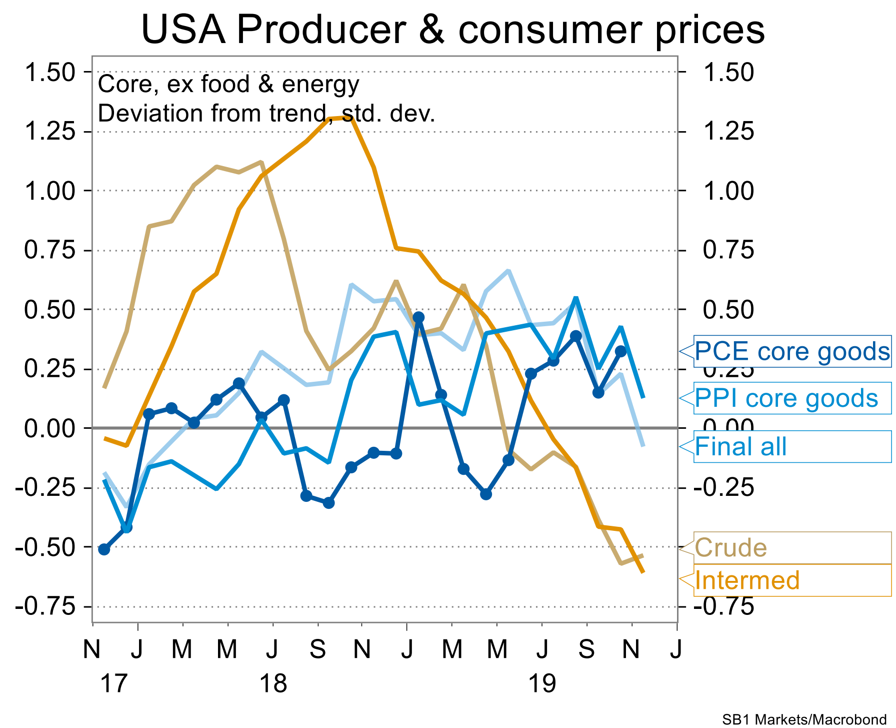


- Core finished goods x food & energy PPI fell by 0.2% m/m in November, 0.4 pp weaker than expected. The annual rate slipped to 1.3%, an uptick to 1.7% was expected. Producer inflation is slowing rapidly, and underlying growth (measured 3m/3m) has fallen to 0.3%, does not signal any recovery in the annual inflation rate
- Headline PPI increased by 0.3% m/m, 0.1 pp higher than expected after a spike last month. The annual rate has turned up to 0.3%, as the impact from lower energy prices the past year is subsiding
- Easing core producer price inflation does not point to any uptick in core consumer inflation

Crude, intermediate good prices (PPI) down, final goods are following

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

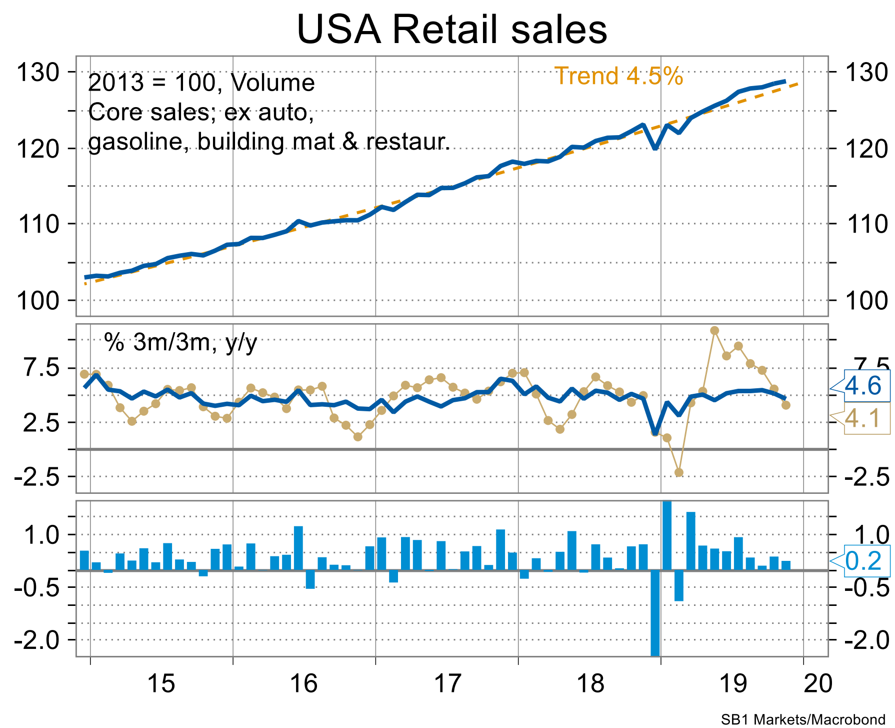


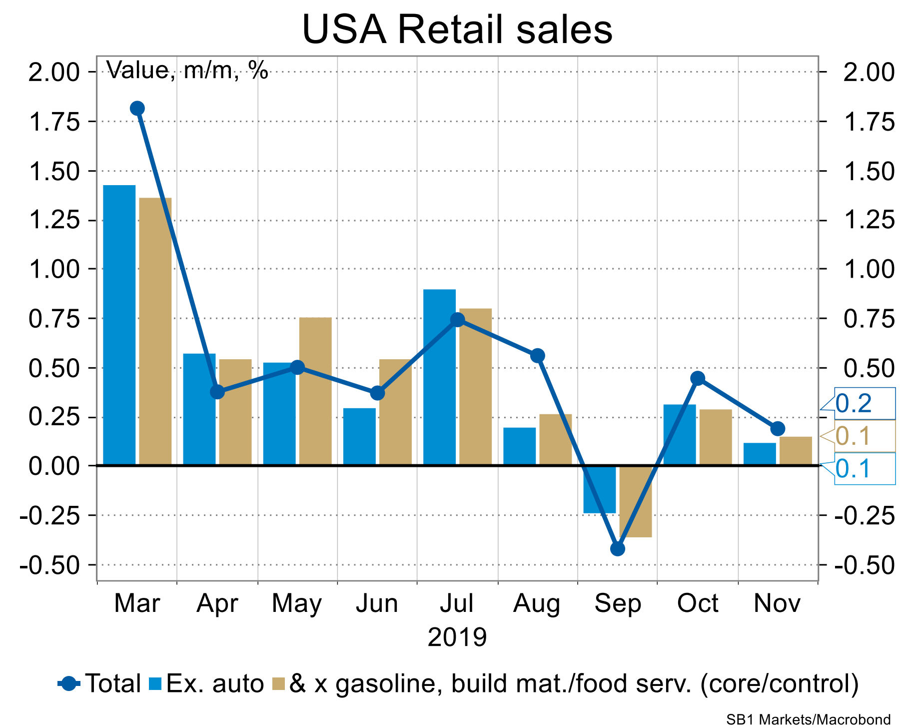


- Crude PPI prices (ex food & energy) are heading steeply down, as are intermediate goods prices. Core consumer goods prices (at the producer level) fell in Nov and will over time head down if prices at earlier stages do not recover

Retail sales growth is slowly cooling

Core sales rose 0.1% m/m, underlying growth slows but still not low

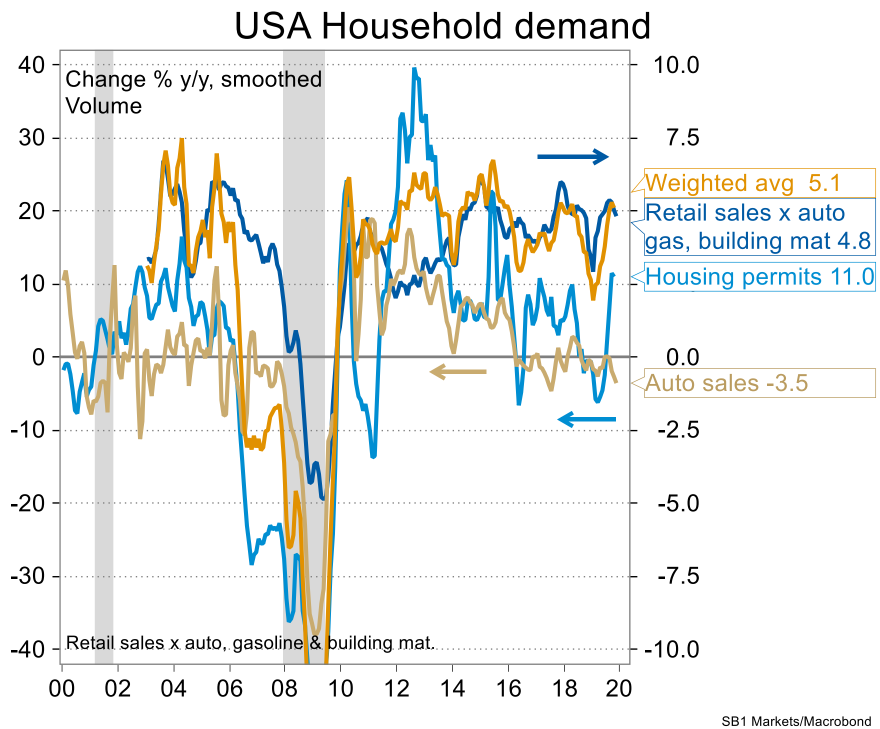


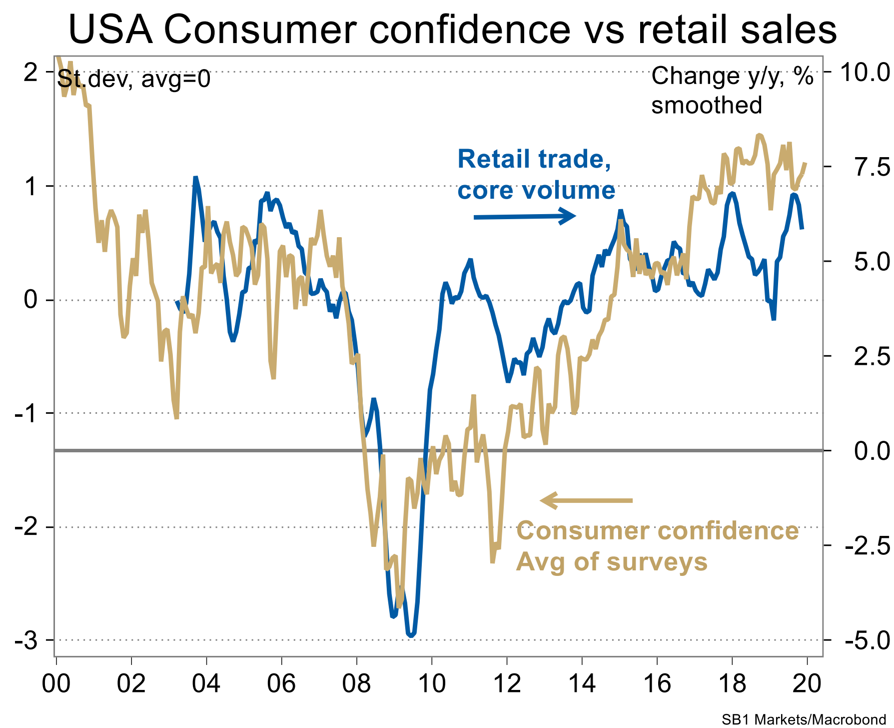


- Core retail sales (ex. auto, gas, building materials & restaurants; control group) increased by just 0.1% m/m in nominal terms in November, 0.3 pp weaker than expected
  - » Total retail sales rose 0.2%, (Oct revised up 0.1pp to 0.4, but Sept revised down by the same amount) – and the avg nominal growth past 3 months is just 0.1% per month
- We estimate 0.2% growth m/m in core sales volume. October sales volume came in 0.2 pp higher than we expected, at 0.4%, as prices fell. Regardless, growth has eased the past months, the 3m/3m speed down to 4.1%, from hovering above the double pace during the summer! Contribution to growth from total private consumption will most likely slow in Q4 vs Q2 & Q1
  - » Income growth has slowed somewhat the past year but consumer confidence remains strong, we do not expect any hard downturn now

Household demand is still strong, in sum, close to peak?

Retail sales up 4.8% y/y, housing has accelerated, while auto sales are trending slowly down

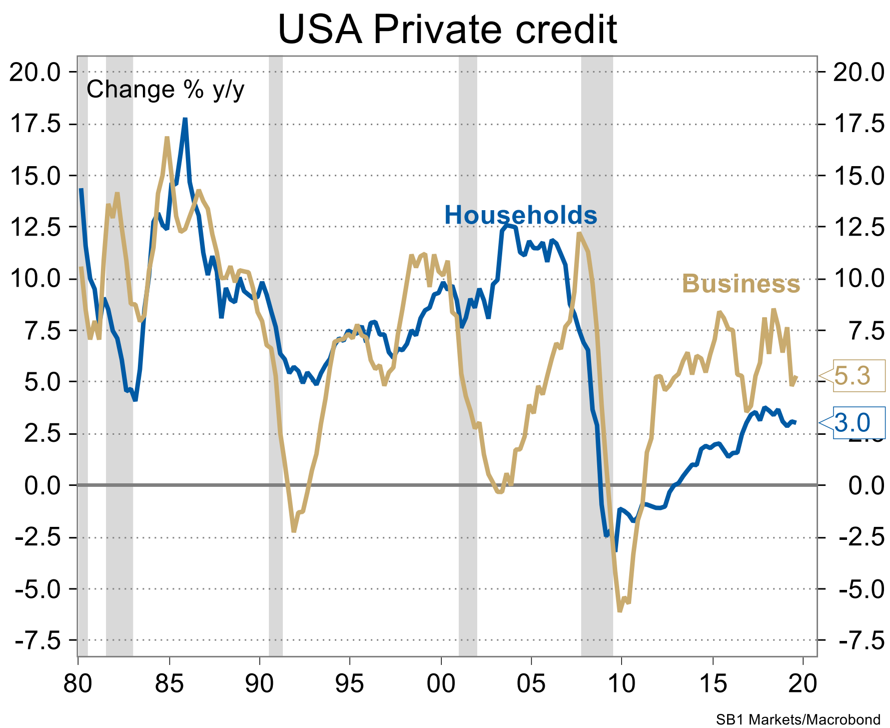


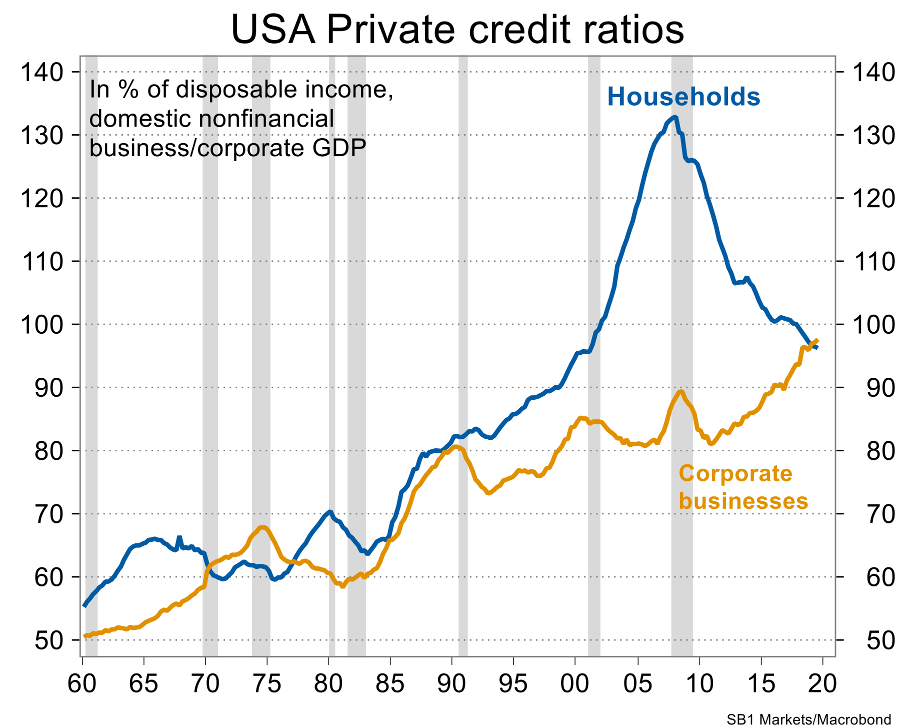


- Total household demand is not on the brink of sending the US into recession. The weakness in the US economy is stemming from businesses demand, not the consumers (and not from net foreign trade either)
- Consumer confidence (measured by the avg of University of Michigan's and Conference Board's indices) remains at an elevated level. Jobs are extremely easy to get and unemployment is at a 50 y low
- Still, given that retail sales growth has been slowing somewhat recent months, and auto sales are heading slowly down, household demand may be close to/at peak now? The housing market upside is probably not that large anymore, either

Household credit growth still muted, corporate debt growth has slowed

Household debt up 3% y/y, well below income growth. Corp debt has slowed to 5%, still above GDP

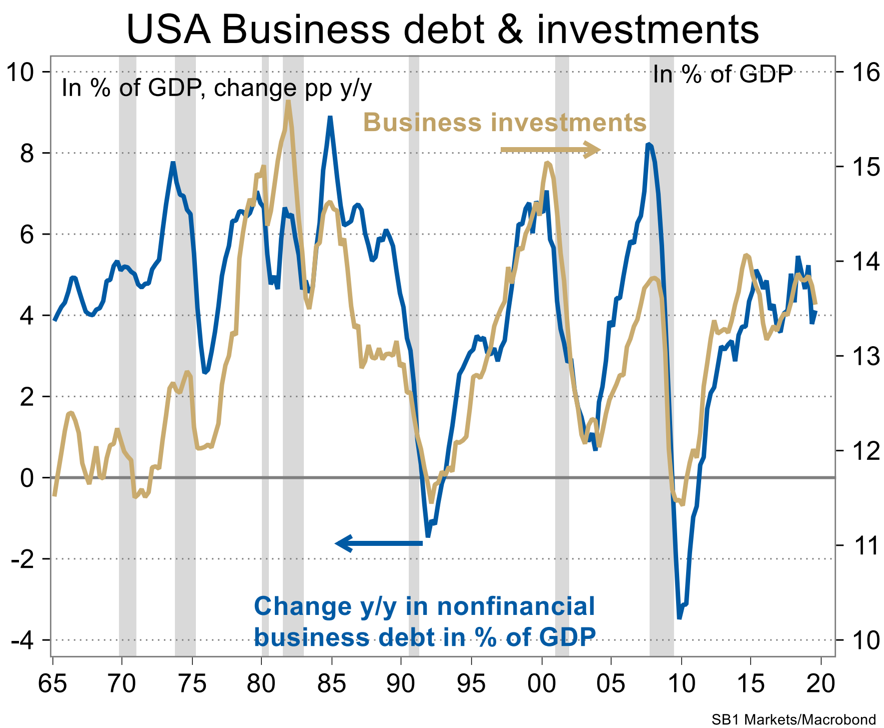




- Household debt growth slowed slightly q/q in Q3 and is increasing slower than household income. The debt/income ratio has fallen to well below 100%, down from 133% in 2007! The largest deleveraging ever in the US. Even so, unemployment has fallen most of the time!
- Corporate credit growth is more volatile but growth has slowed somewhat, the past quarters to approx 5%, still faster than growth in corporate (or total) GDP. The debt/GDP ratio has increased sharply since the financial crisis, and it was record high in Q3. If not for equity buybacks the past 10 years the debt ratio would not have been 98% (vs corp GDP) but in the 50'ies, lowest since the 1950'ies, from 90% at local peak during the financial crisis (and it fell to close to 80% after the crisis)

Corporate credit and investments, usually hand in hand

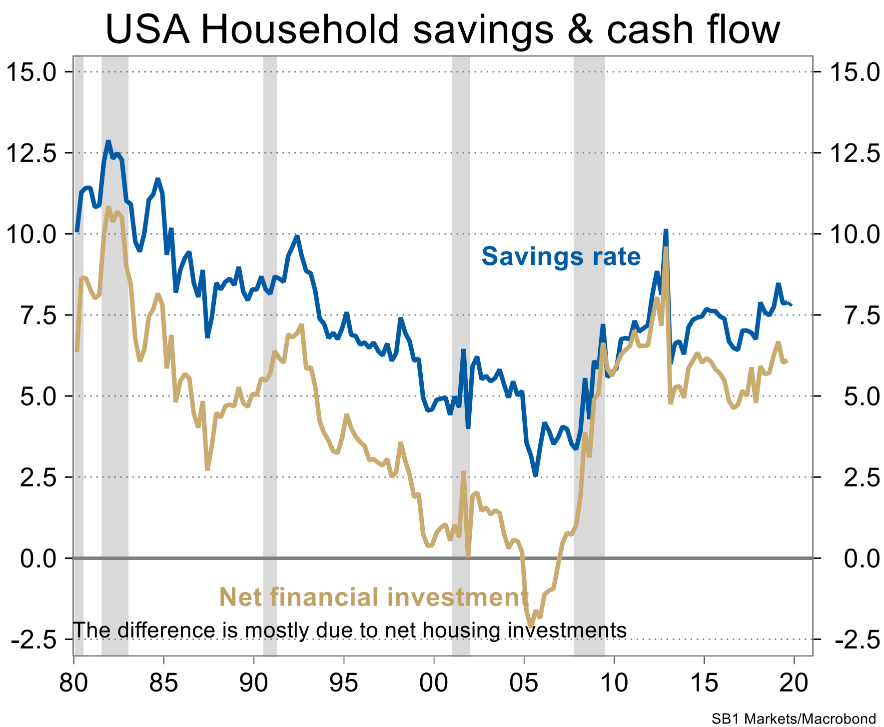
Now, corporate credit confirms a business investment slowdown but not an abrupt one

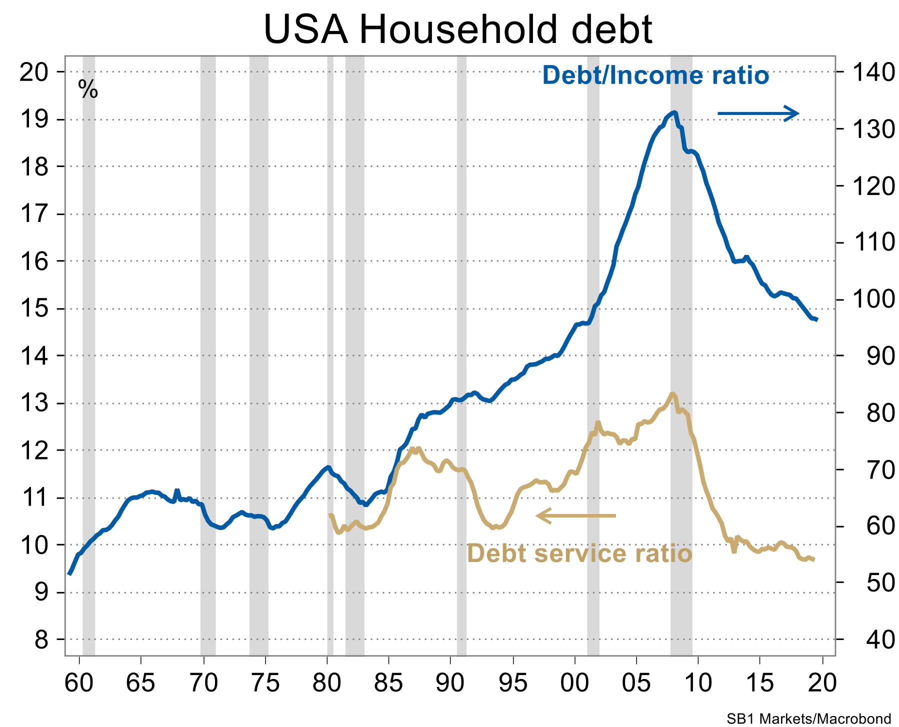


- Cash flow in the business sector is better than usually before recessions. Tax cuts have contributed

Households' savings down but still high. Strong cash flow, debt ratio still falling

Households are saving – and paying down debt (relative to income), debt service cost record low

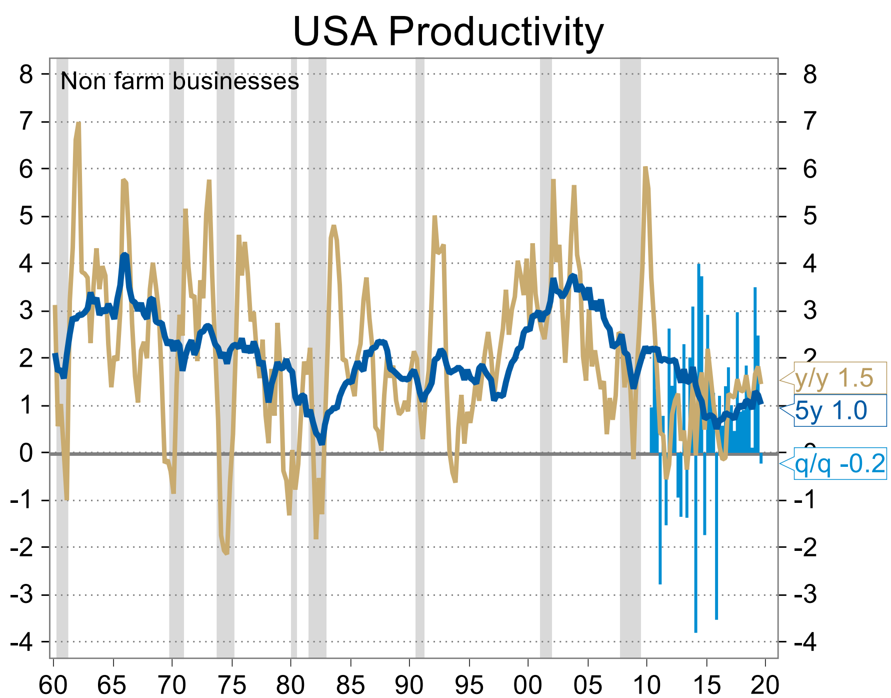




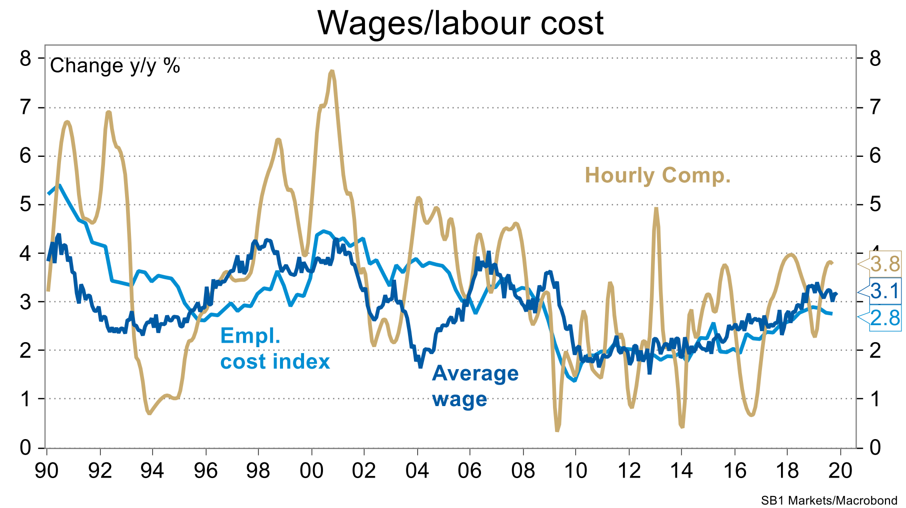
- The savings rate may have fallen marginally in 2019 but it has been rather stable the past years. The level is quite high (at least after a higher tax dodging estimate was added…) The cash surplus is at approx 5% and stable too, not a household drive recession signal
- Households were running a cash surplus at 6.1% in Q3, marginally lower than in Q1/Q2. The level is quite high
  - » Cash balance (net financial investments) = Savings – net (of depreciation) investments in fixed real capital (mostly housing)
  - » The savings was 8% of disp. income in Q3
- Households' debt ratio is much lower than 10 years ago and is still sliding down, almost back to the level in y 2000. <u>Households have never before (data from 1980) spent less of their income serving debt!</u>
  - » There are few signs of financial stress, at least barring student loans

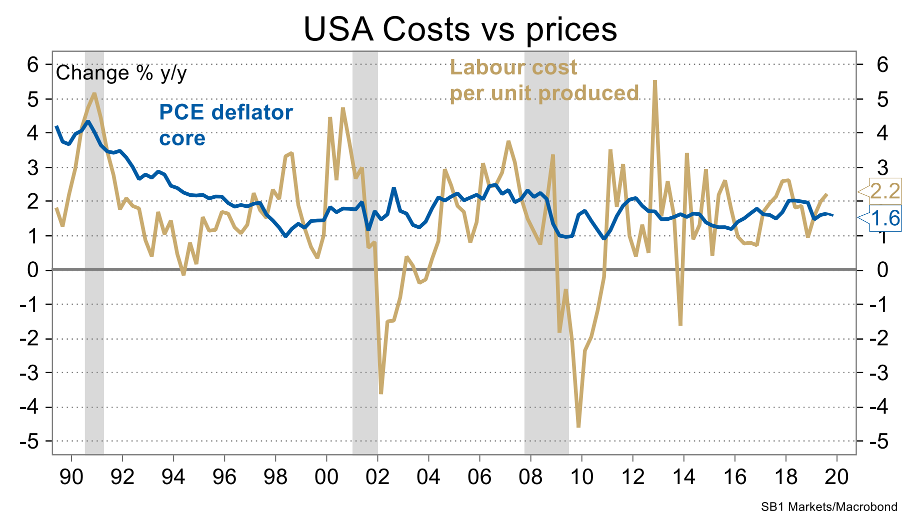
No productivity growth in Q3, cost inflation rises (but less than first reported)

Productivity fell 0.1 pp less than first reported, annual growth 1.5%; cost pressure is slowly building



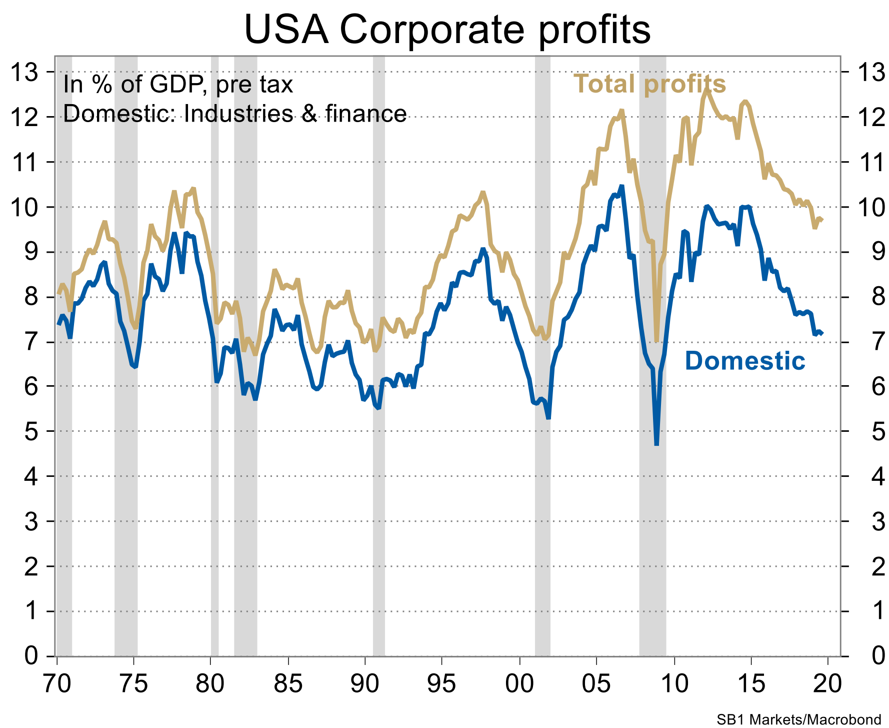
- Productivity fell by 0.2% q/q annualised in Q3, 0.1 pp better than first reported. The annual rate slowed to 1.5% (first report at 1.4%), still trending up. The 5 y average is inching up too, to 1%. **Still a very low growth rate but it is at least heading up**
- On the other hand: **Labour cost inflation is increasing**, unit labour costs rose 2.5% q/q annualized, revised down by 1.1 pp. Annual growth at 2.2%, vs first reported 3.1%. Cost pressure is anyway building up, taking its toll on corporate profits. The profit rate is declining sharply
- **Underlying wage inflation is approx. 3%, and underlying productivity growth at just above 1%. <u>Underlying ULC inflation is probably approx 2%, like we have assumed for a while</u>**

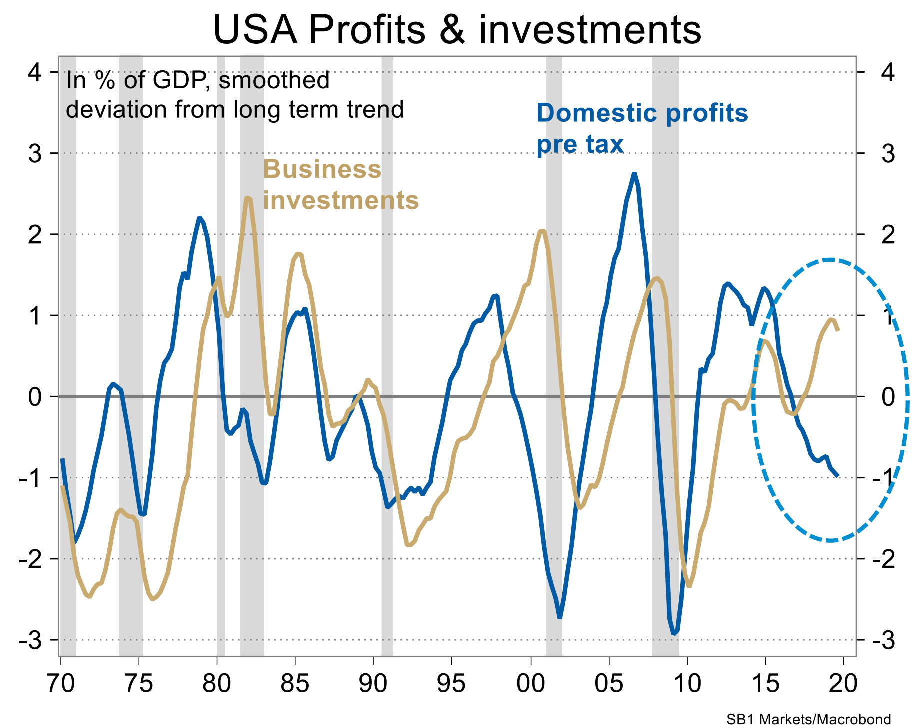




Cost inflation higher than price inflation – and profits are under pressure

The profit cycle turned in 2015, and pre tax profits are not high anymore. Investments exposed?

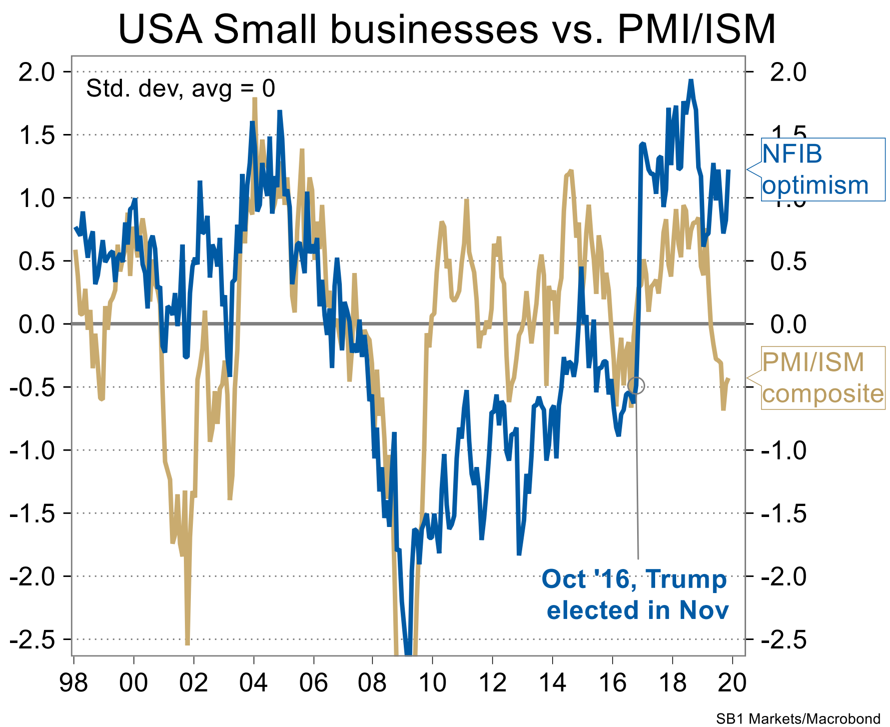


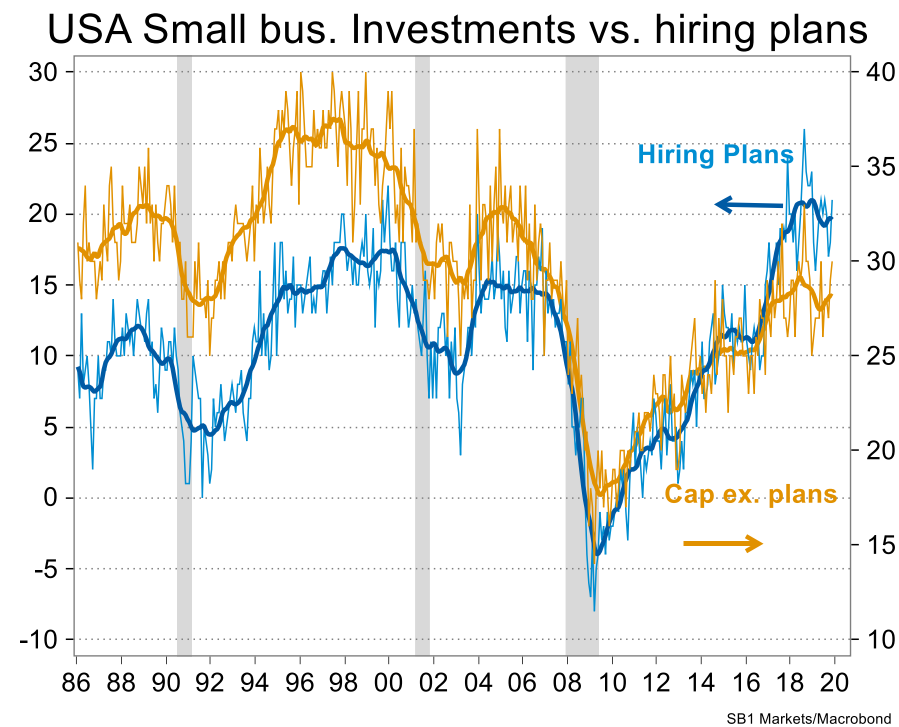


(Q3 domestic profits/GDP ratio our estimate)

Small businesses' optimism bounced back in Nov, miles above PMI/ISM

NFIB optimism index has stabilized since early 2019 and the details were upbeat this month

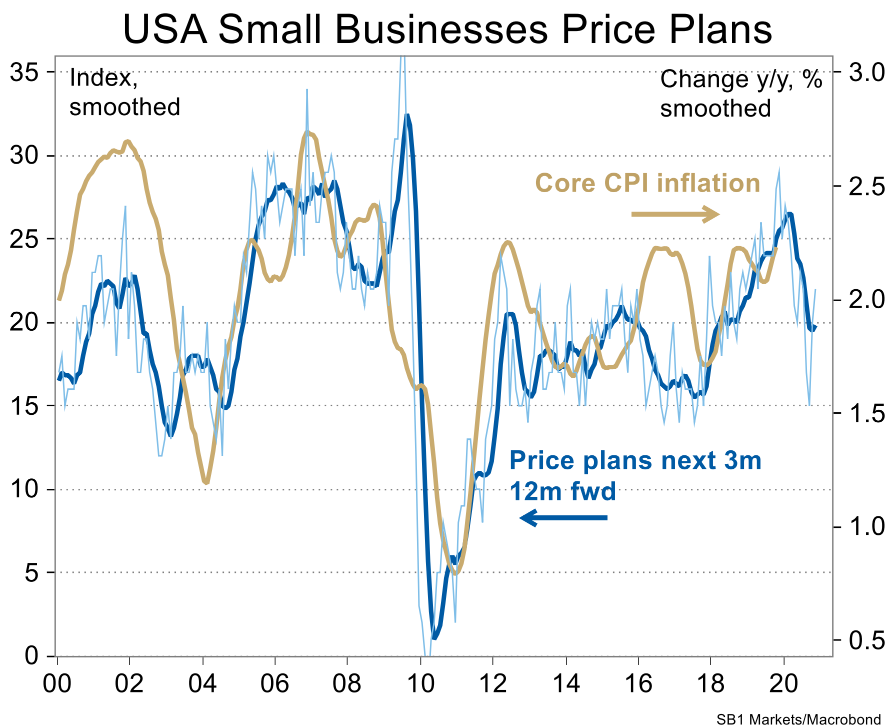


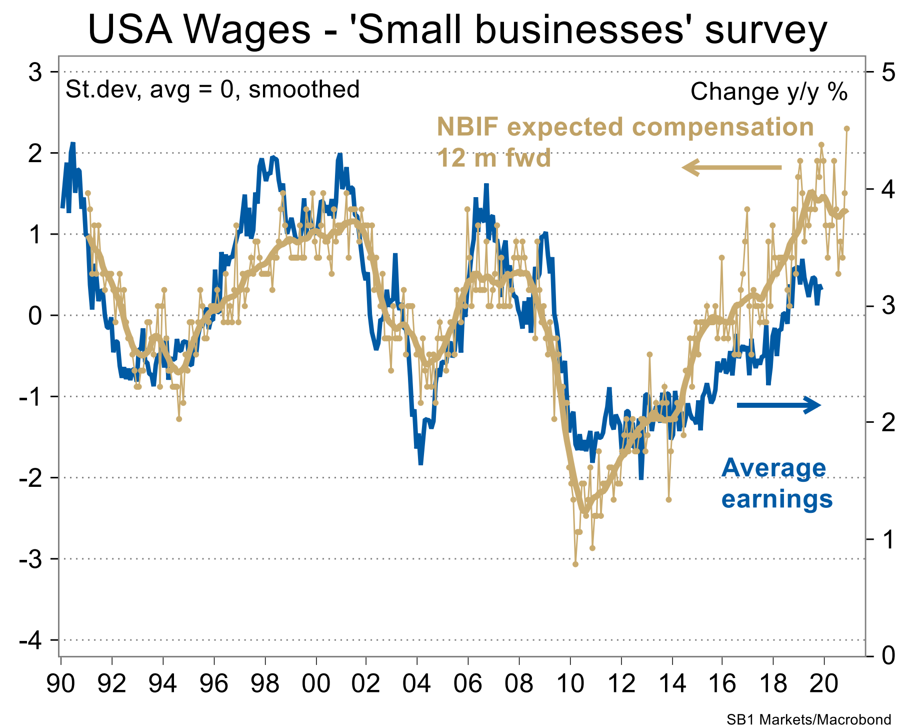


- The NFIB optimism index, measuring small businesses' expectations on business conditions, rose to 103.7 in November, better than expected. The index has stabilised this year, at a rather high level, after dropping in late 2018
  - The NFIB optimism index is 1.3 st.dev above average (since 1998). The avg of the surveys from the ISM/Markit PMI is well below average. 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 PMI/ISM (particularly the latter) are more influence by trade war uncertainties
- Investment plans have been soaring in Oct/Nov, although trending down from the mid-2018 peak. The level is not high
- Hiring plans have probably peaked but they are still aggressive – and were lifted in Nov. Companies are still not able to fill vacant positions – and they plan record high wage compensation!

SMEs price plans on the way up again, and compensation plans are soaring

Price plans still signal lower consumer inflation but less so in Oct/Nov. And higher wage inflation!

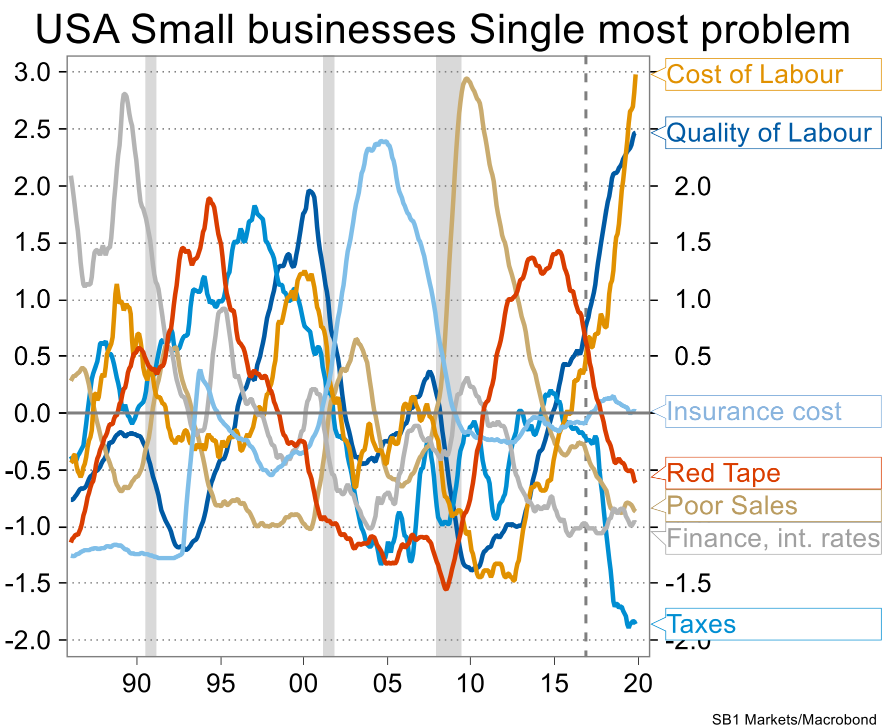


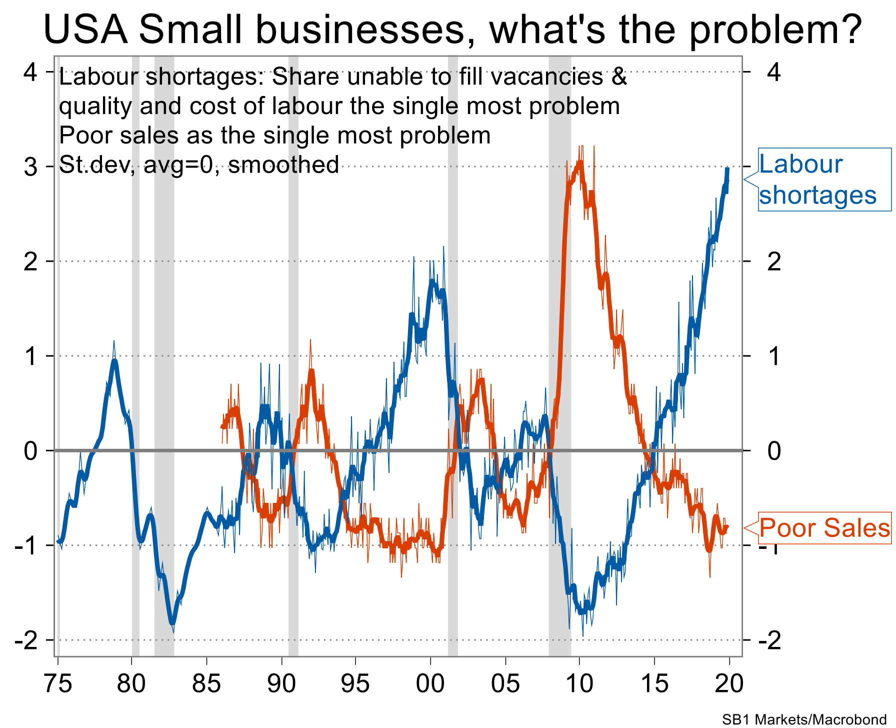


- 22% of small businesses are planning to hike prices, up from 16% in September – but down from 29% one year ago. We do not put much weight on these monthly data, the smoothed share has fallen steeply, as price plans were nudged down rapidly in the spring and summer. Demand must have slowed, even as optimism has stabilized
- Businesses are still reporting record aggressive plans to raise compensation. Actual wage growth has cooled, the survey is probably not signaling any steep acceleration in wage inflation, at least not if we apply the smoothed rate

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!

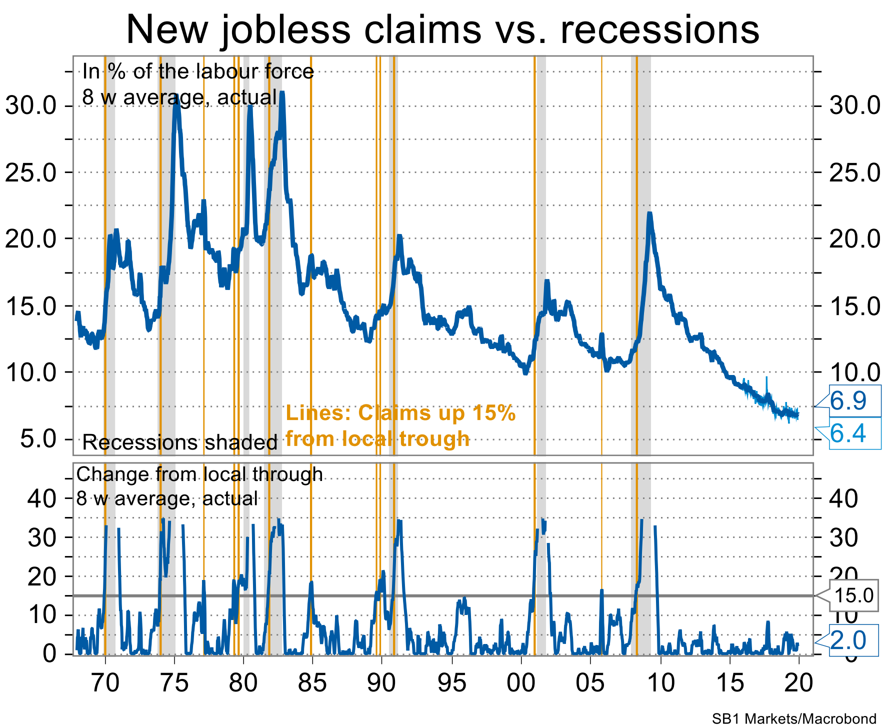


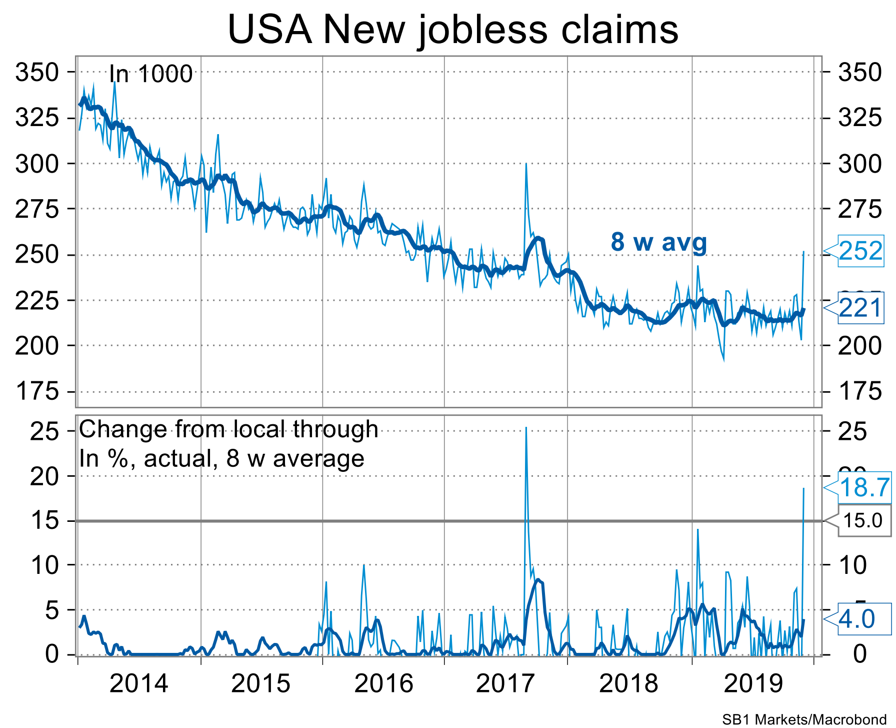


- Unusually few are complaining about finance/interest rates and about taxes, following last year's tax cuts
- Sales are not the problem either, almost 20 year since so few stated sales as the most important problem
- So the answer is obvious: The Fed must cut the fed fund to zero, or below, the USD must be taken down, as must taxes!

Jobless claims spiked to 252’, very likely due to Thanksgiving distortions

The pickup reflects a later than usual holiday, not any underlying labour market weakness

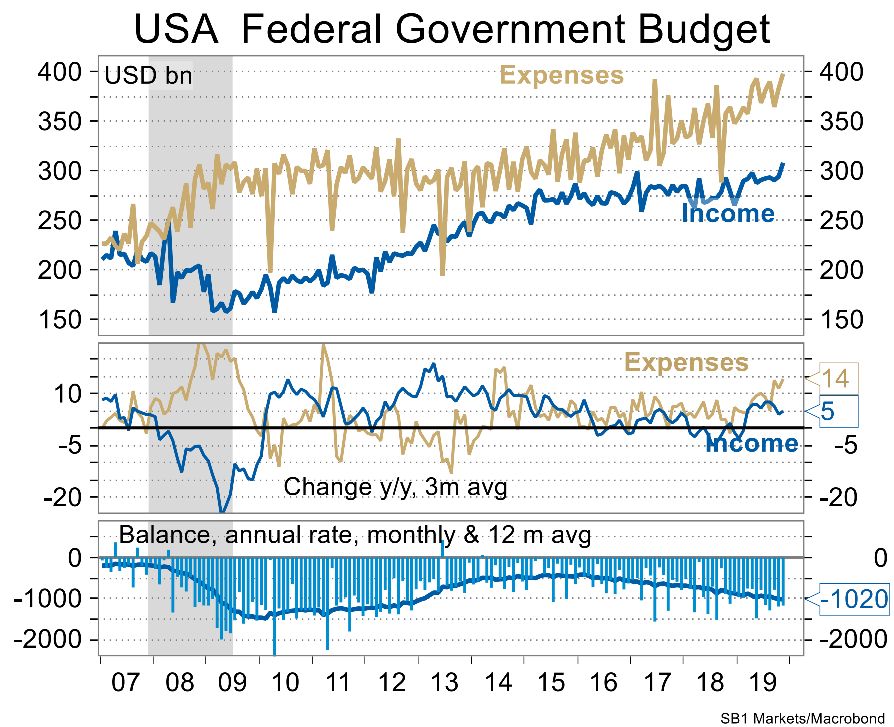


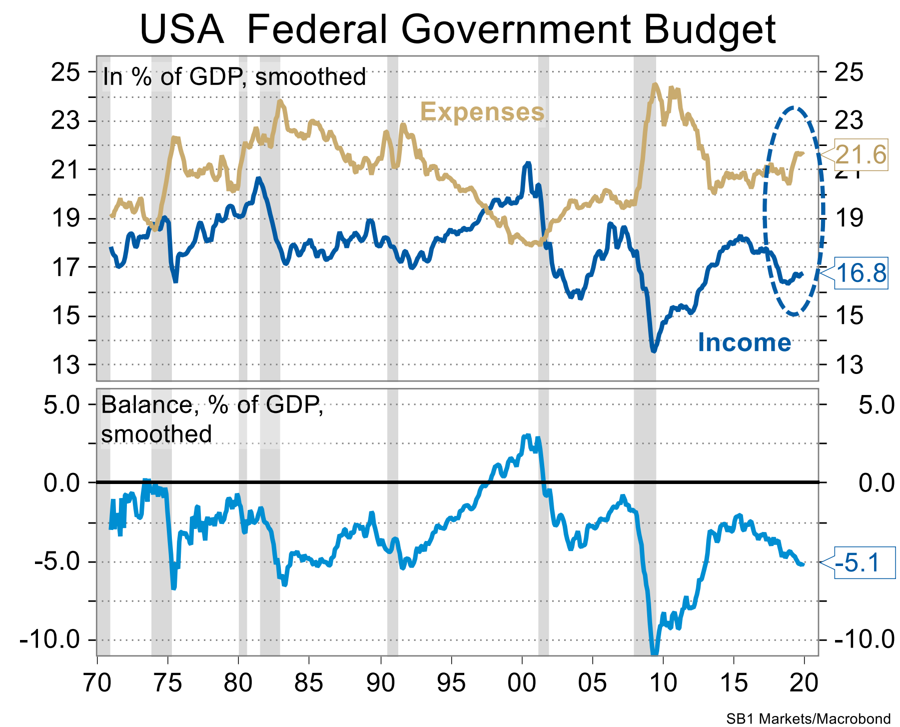


- During the Thanksgiving holiday, fewer than usual are filing their jobless claims, and the next week, claims tend to soar. As Thanksgiving can fall on different weeks, the seasonal adjustments are troublesome. This year, Thanksgiving was one week later than ‘usual’. Looking at the unadjusted data, the spike last week was equal to that of the previous years. Thus, the uptick does not reflect any underlying increase in unemployment – and we expect a retreat the coming week
- The 8 week average inched up to 221’, still a very low level and just a marginal increase
  - » A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow ‘recession’ warning line is to be drawn, check the chart to the left. So, no reason to worry now?

The federal budget deficit is widening

The federal deficit has widened to 5.1% of GDP, and the total public sector deficit at 7.4% of GDP!

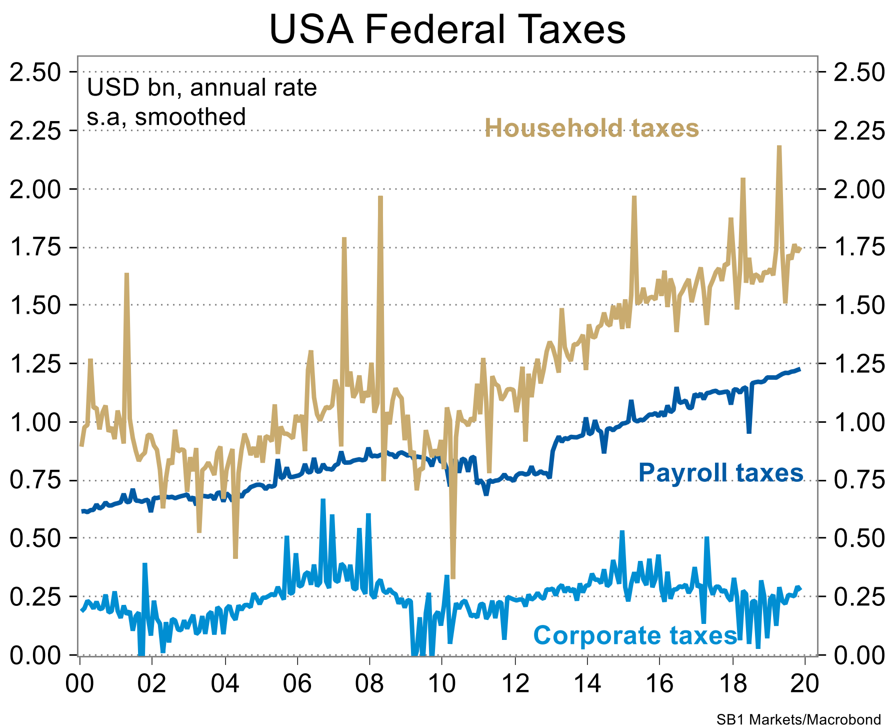


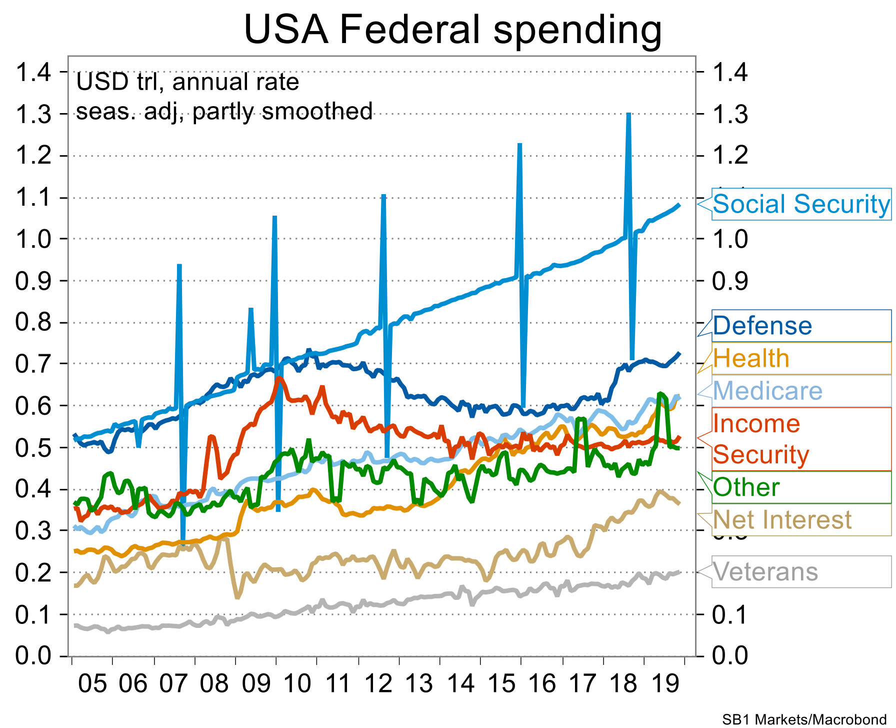


- The budget deficit came in marginally to USD 1.170 bn in annual rate in November (seas. adj), and the 12 m avg increased to 1.020 bn, rising steadily since 2016. The deficit equals 5.1% of GDP. Incl. local government etc, the US ran a full employment, peacetime deficit at 7.4% in Q3 (from 6.9% in Q1); totally unprecedented!
- Federal spending is up 14% y/y 3m smoothed, well above growth in nominal GDP. Income is up just 5% 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 21.6%, way above a normal level (except for during recessions). Regrettably, federal income equals just less than 16.8% 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 ’20 deficit, but no more than some 0.2 pp of GDP

Corporate taxes zigzag upwards but remain low

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…)

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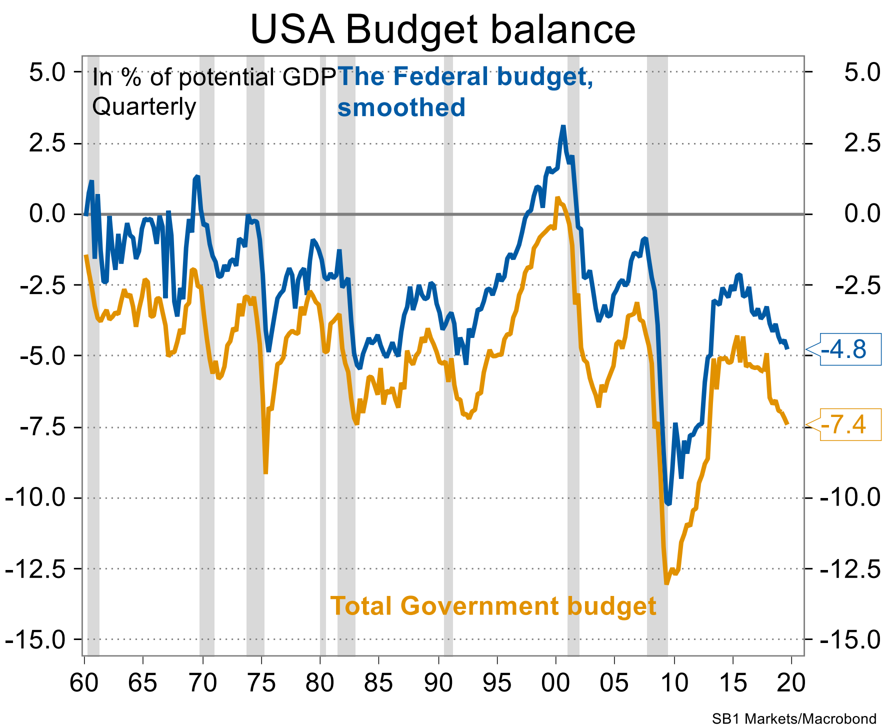
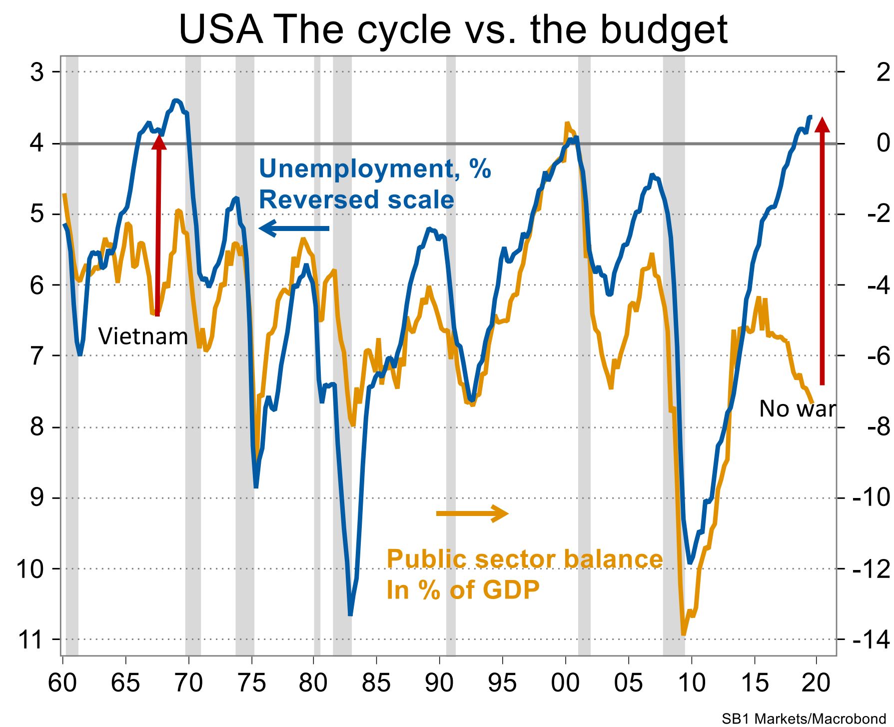
The public sector deficit widened to 7.4% of GDP in Q3

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

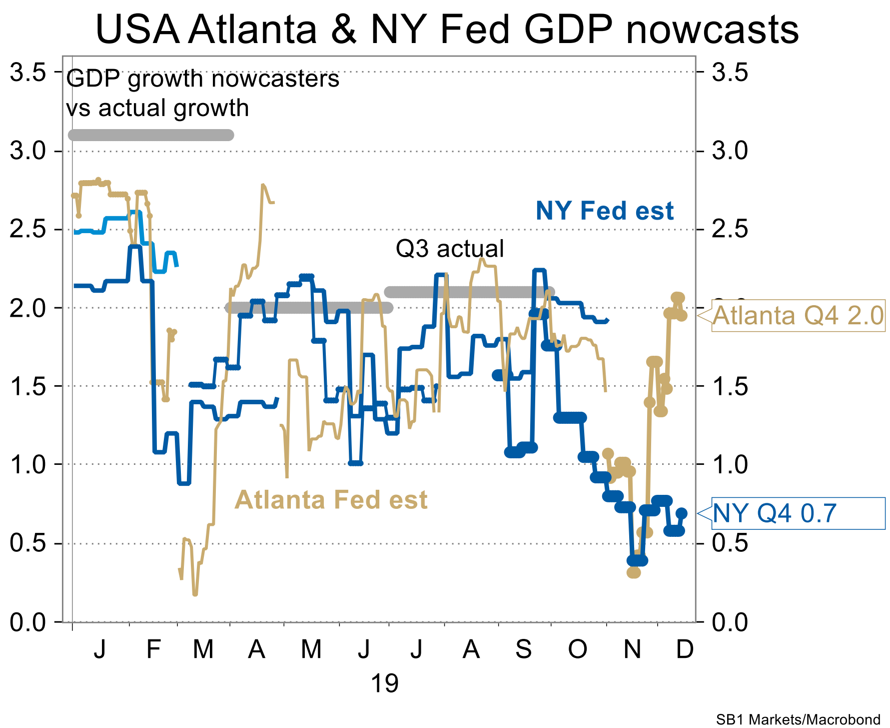


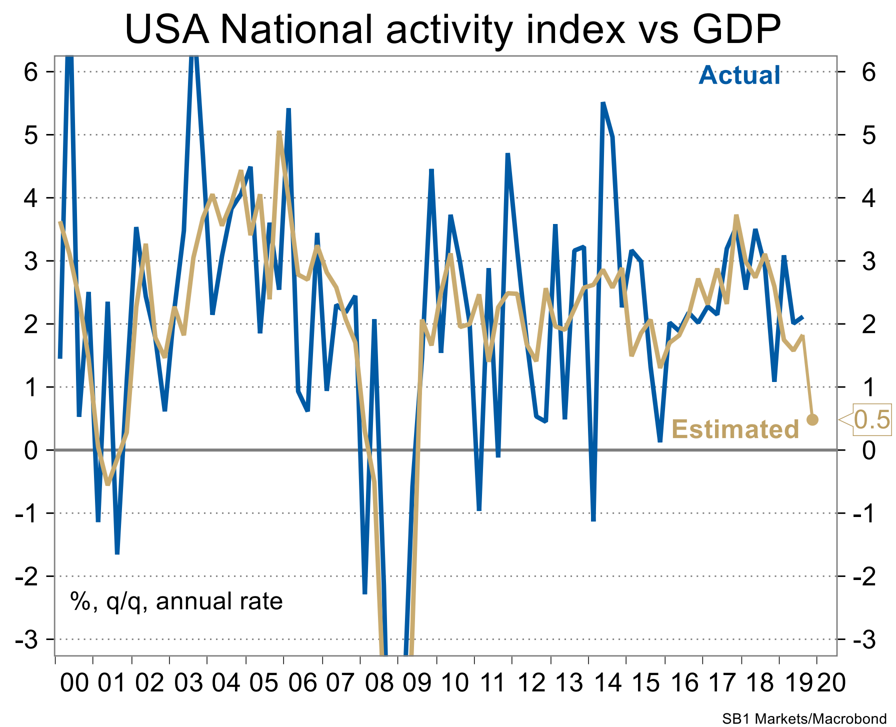


- The deficit has never been anywhere close to the present level in peace time when unemployment is as low as now
  - » We have not seen anything like this in other countries either (except Greece in 2007, partly Japan)
  - » The deficit at 5% was large vs the unemployment rate in 1967 too, when the 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*

One nowcaster signals 2.0% Q4 GDP growth, the other 0.7%

Atlanta Fed's Q4 estimate stable last week, at 2%. NY Fed does not agree, the est +0.1 pp to 0.7%





- Atlanta Fed's forecast shot up to three weeks ago, supported by strong net trade and housing data. The employment report lifted the forecast further two weeks ago, to 2% Q4 growth – and was unch last week
- However, NY Fed's nowcaster estimates just a 0.7% growth rate, up from 0.6% last week. The truth may be something in between?
- The National Activity Index, which suggested 1.8% GDP growth in Q3 (0.3 pp below the actual number), now points to a slowdown to 0.5% into Q4 (Oct data)

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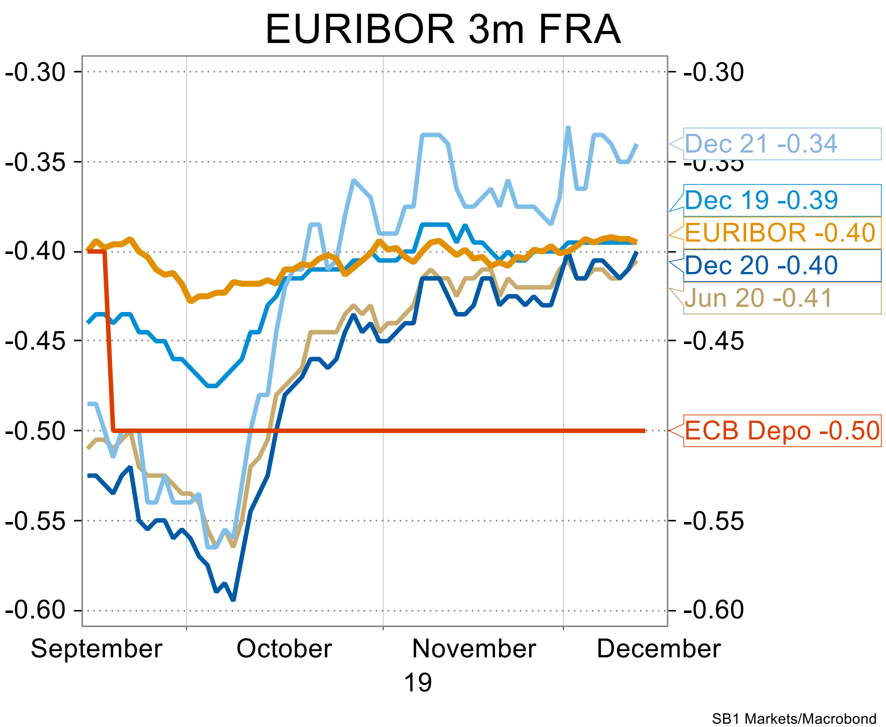
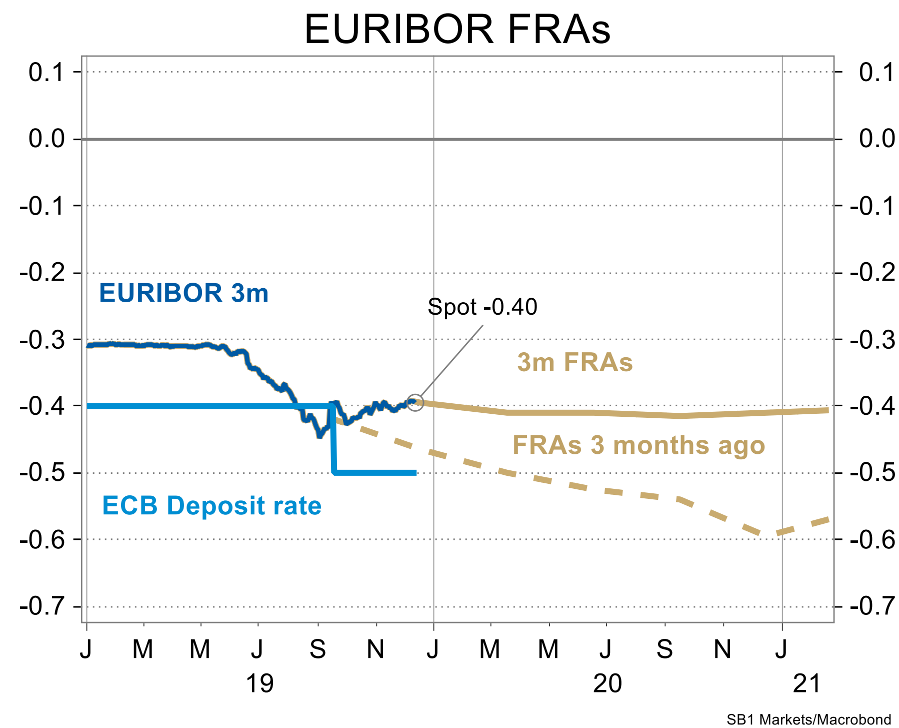
The ECB signalled no monetary policy changes at Lagarde's ECB debut

Christine Lagarde focused on the planned strategic review of ECB's objectives in her first statement

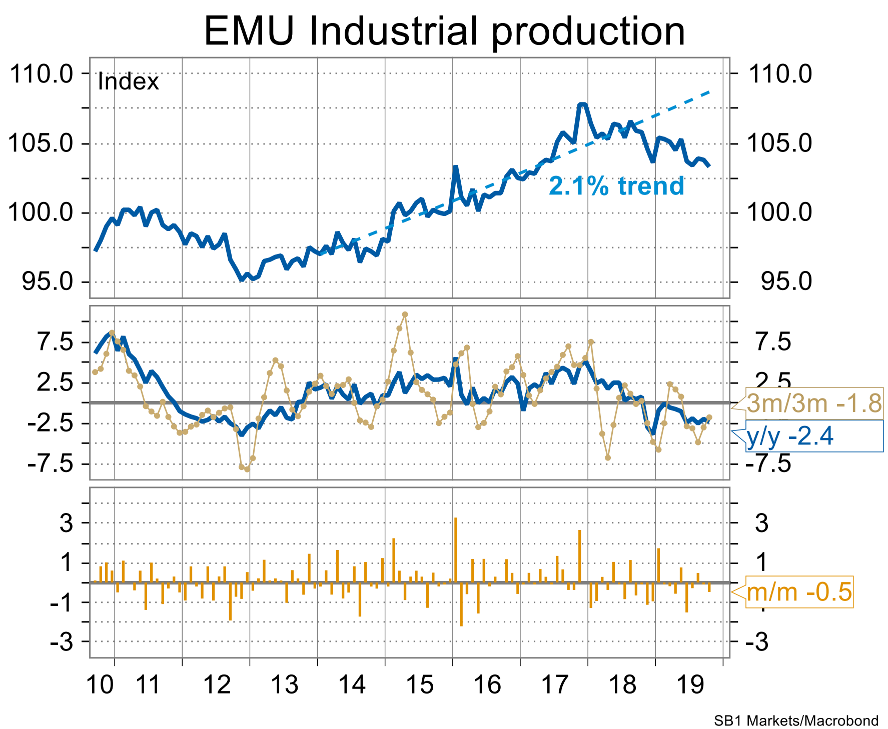


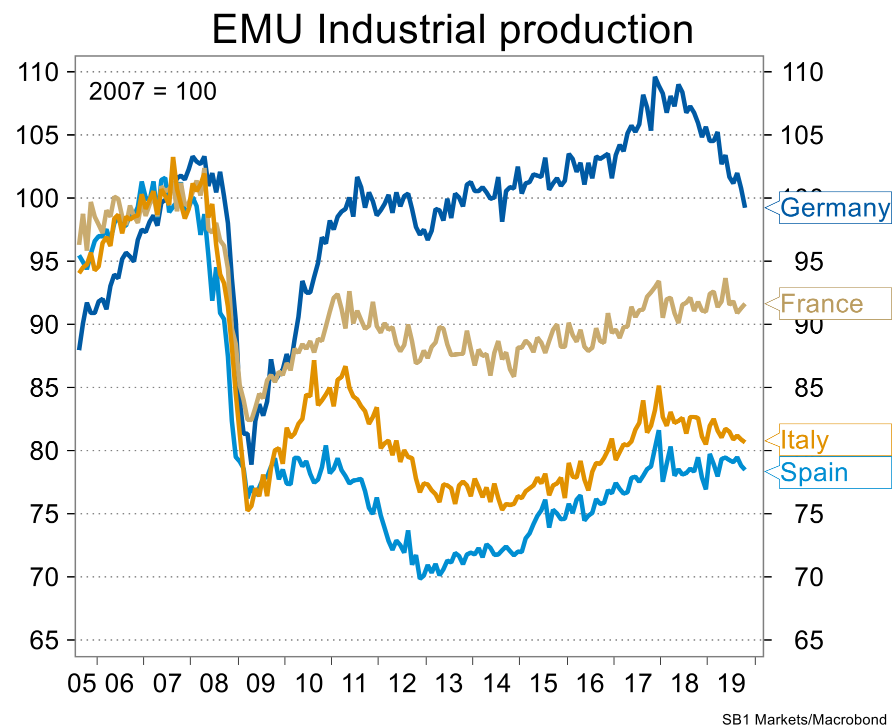


- The ECB held the deposit rate unchanged at 0.5% and asset purchases will continue at EUR 20 bn per month. Markets expected no changes in the monetary policy meeting, all eyes were on Christine Lagarde's debut
  - » The main messages from the last meeting were broadly repeated, although downside risks were cited as somewhat less pronounced. Lagarde did not reveal much of her monetary approach, other than that she will aim to be a 'wise owl' and not a hawk or dove. She set out the plans for the ECB strategic review, which will be exercised for the first time in 16 years. It will address ECB's objective and examine the effectiveness of the policy tools
- The 2019 GDP f'cast was nudged up to 1.2%, from 1.1% and the 2020 f'cast was lowered 0.1 pp to 1.1%, and 2021 unchanged at 1.4%. The 2019 inflation outlook was held unchanged at 1.2%, 2020 nudged up to 1.1%, from 1.0%, 2021 f'cast was reduced to 1.4%, from 1.5%.
- No large market reactions, FRAs inched up 1 bps, 10 y swap rate up 4 bps. Markets are pricing a flat rate in 2020 – and a hike in 2021

The downturn persists; industrial production dropped again in Oct

Production fell by 0.5% in Oct. Germany nosedives, France & Spain have flattened, Italy slides down





- EMU industrial production (ex construction) decreased by 0.5% m/m in Oct, as expected. Underlying growth is - 1.8%, the downturn has eased just marginally recent months. The annual rate is -2.4%
  - » Production plunged 1.5% in Germany, and Spain, Italy and Ireland reported moderate declines. Production rose 0.4% in France
  - » The other large countries are so far holding up better than Germany but none are shining. In Germany, production has dropped 9% from the 2018 peak. France and Spain have stagnated (and weakened the most recent months), Italy slides steadily down
- Manufacturing PMI is very weak but may signal that the manufacturing dip is bottoming now, check the next slide

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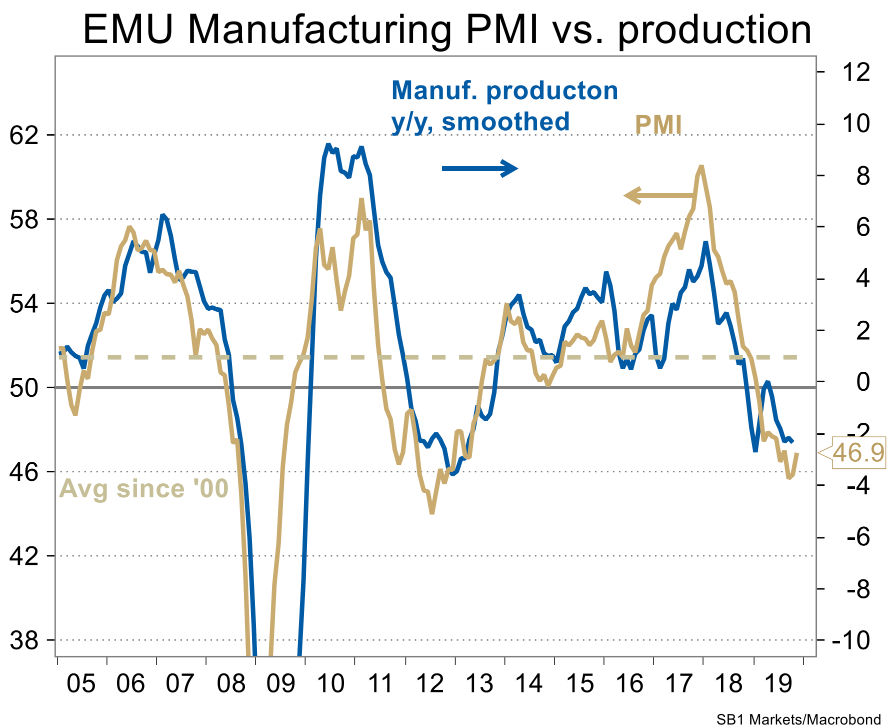
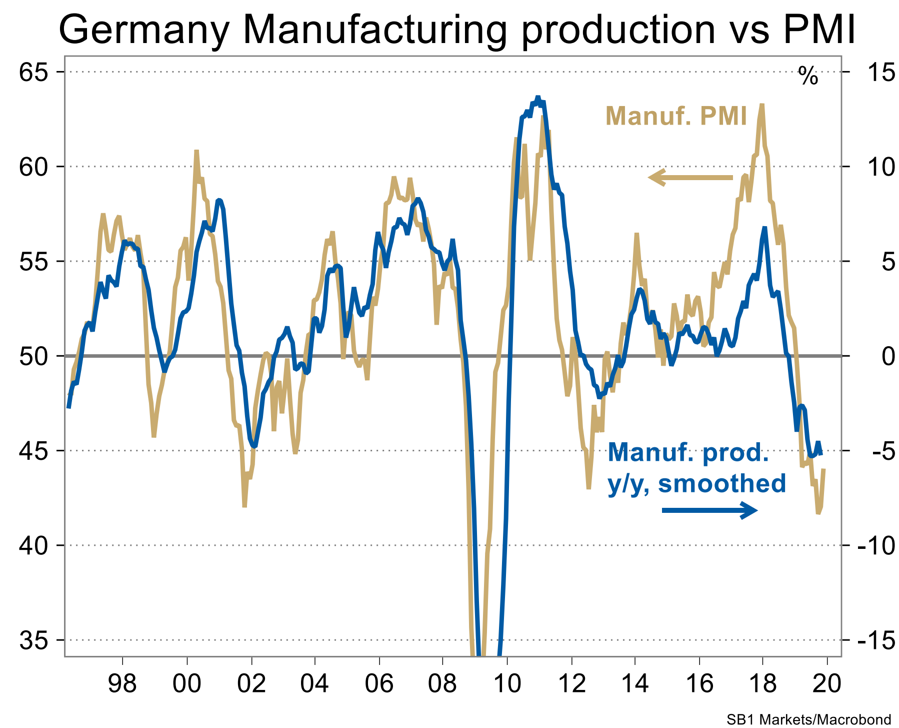
The manuf. PMIs have inched up, may signal a moderating downturn

Yet, the outlook is anyway not bright, according to manufacturers, PMI still signals a steep decline





- The German manufacturing PMI edged up to 44.1 in November, still a very low level. However, the upturn suggests that the decline in production may ease somewhat (the EMU manuf. PMI rose to 46.9)

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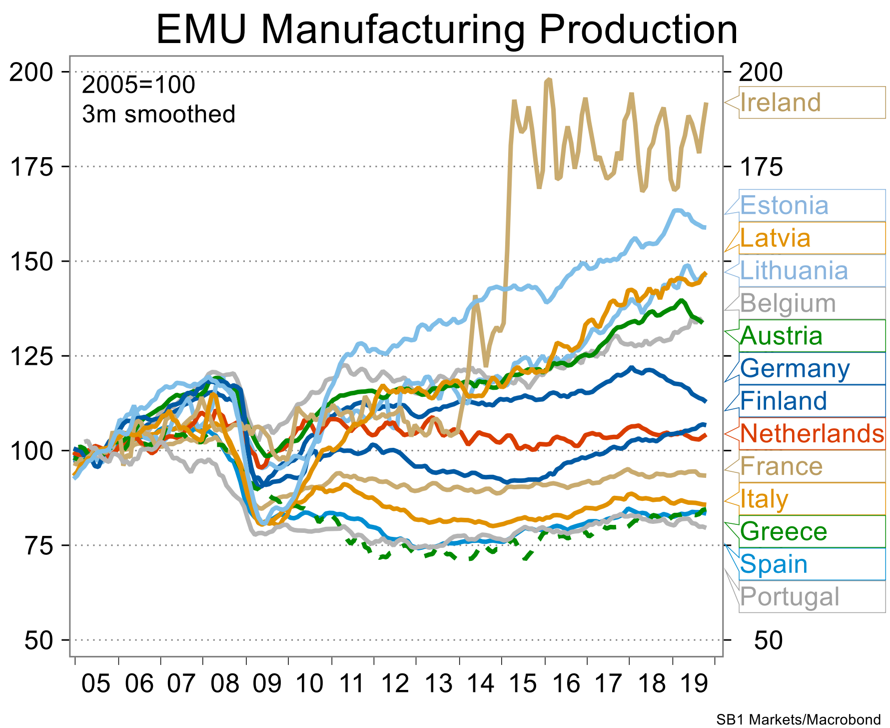
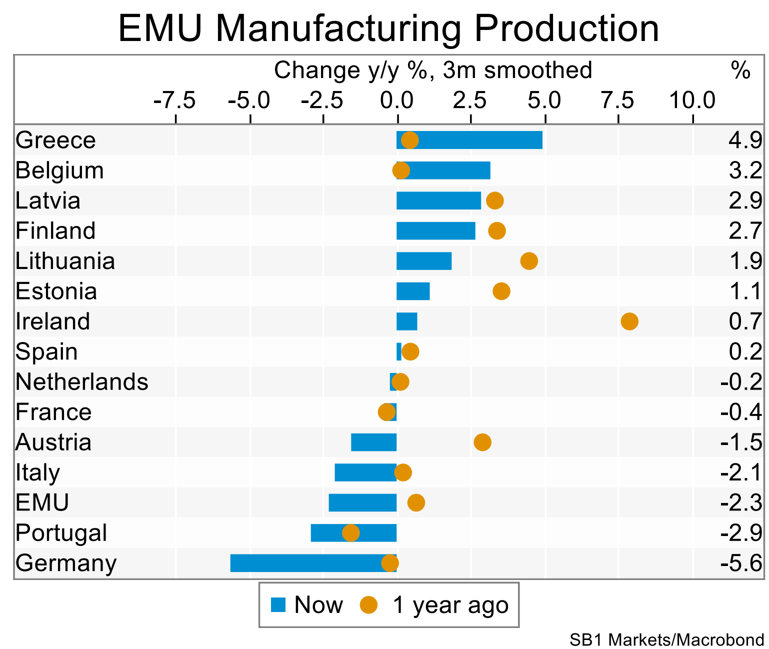
Production is declining half of the 'main' EMU countries

Production is increasing in Finland, Belgium, Greece (from a low level) and Eastern Europe

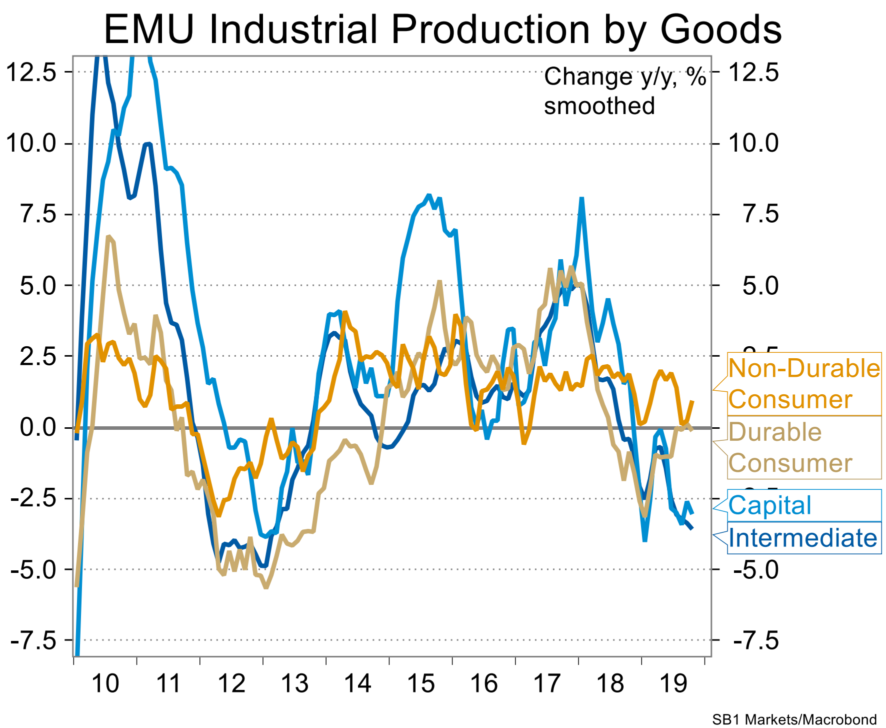


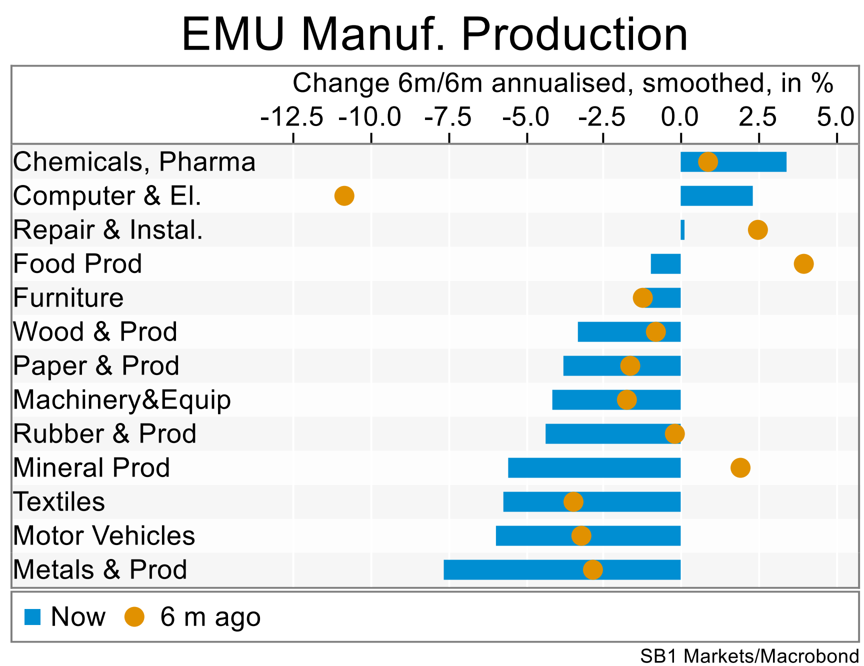


- Production is still up y/y in 7 of 14 countries. Greece and Belgium are now at the top, followed by Eastern Europe and Finland. The upward speed is slowing in 5 of the 7 countries
- 6 countries are reporting a decline, Germany by far steeper than the others. Portugal, Italy and Austria are all struggling too
- 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

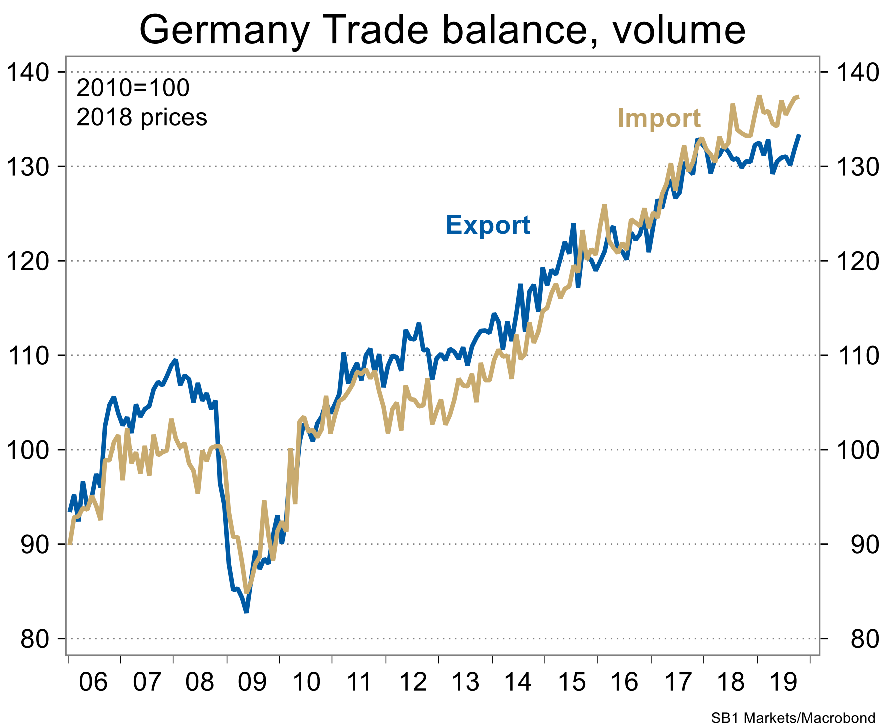


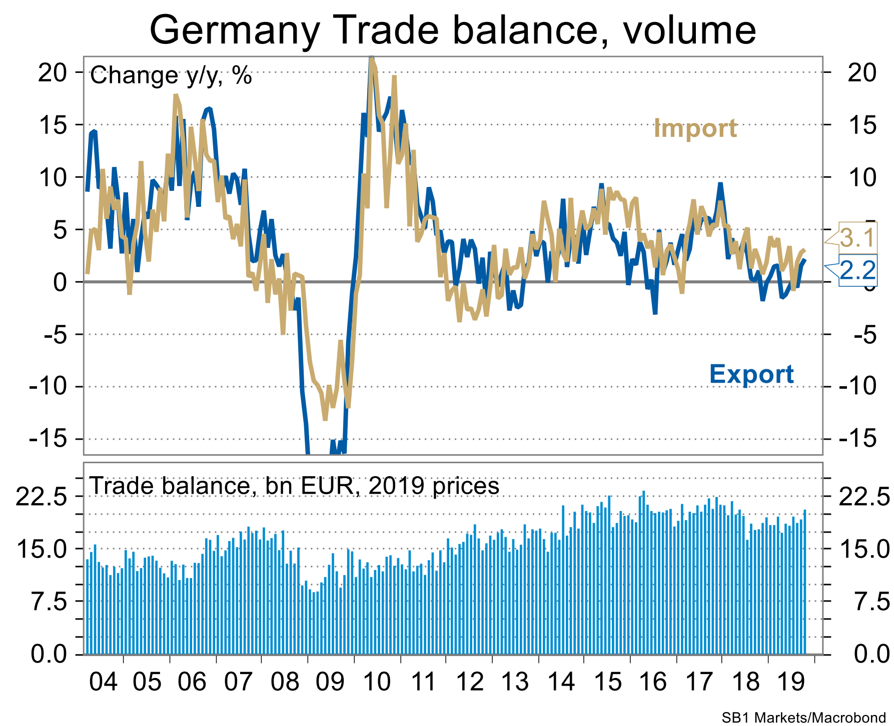


- In October, just 2 of 13 manufacturing sectors were expanding (measured 6m/6m), 1 flat and the other 10 declining
- Of the 10 sectors which are reporting decreasing production, the downturn is accelerating in 9 sectors!
- All the typical 'cyclical' manufacturing sectors are declining, led by autos and metals

Exports have been soaring the past 2 months, imports on the rise too

Where is the German 'collapse'? Exports gained pace in Sept/Oct, trend flat. Imports heading up

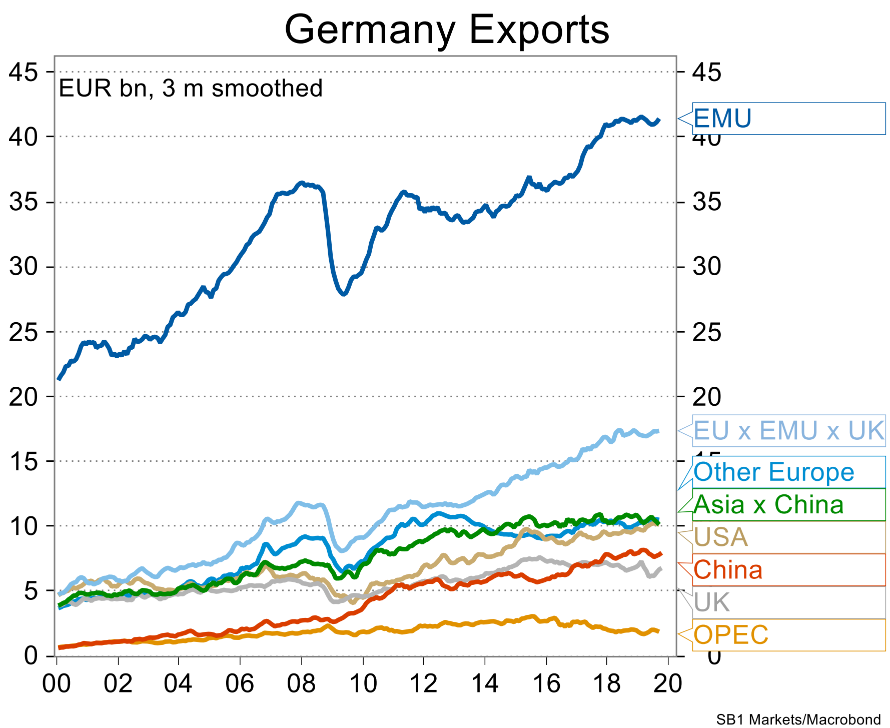


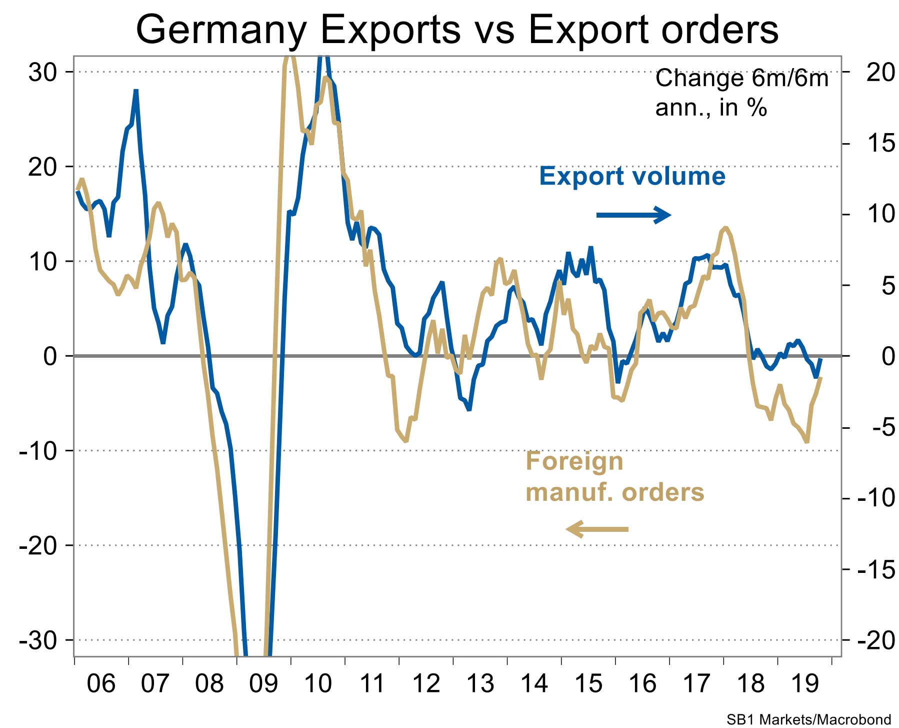


- Export volumes increased by 1.2% m/m in October, after a 1.3% rise the prior month. Exports are trending more or less flat since early 2018, and the annual rate edged up to 2.2% in October
  - » Manufacturing production is much 'weaker' than exports, down 6% y/y . However, that's not much more than usual, manufacturing production is usually expanding a tad slower than exports. Now, the decline in manuf. production is slightly larger than 'usual' vs exports
- Import volumes rose marginally, up 0.1% m/m, the third month of growth. Imports are up 3.1% y/y 0.6%
- The German trade surplus is slowly shrinking, equalling approx. 6% of GDP, from 8% in 2016

Exports have flattened out in several directions, US still heading up

Foreign orders may have bottomed out, do not signal much weaker exports

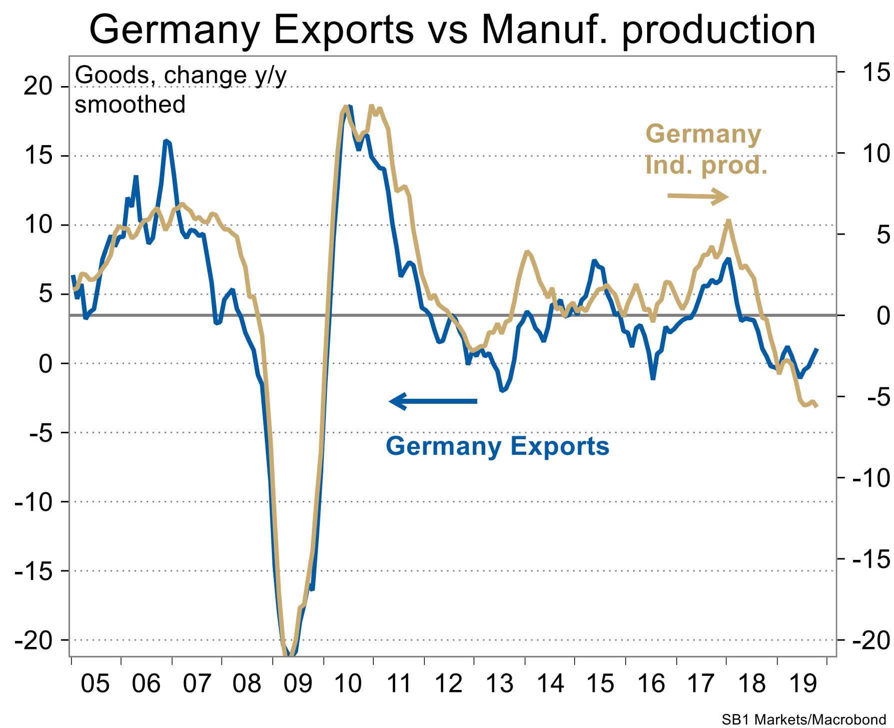




- Most likely, exports have been softening over the past year due to a global retreat in business investments, triggered by trade war/Brexit uncertainties and probably also a 'normal' mature cycle, in Germany and elsewhere
  - » Exports to China have slowed somewhat and are down 1.6% y/y, vs above +8% growth in the spring. However, the impact on total exports is limited as exports to China constitutes just 7% of overall German export
  - » Exports to UK are recovering after a steep decline in the spring, Brexit 'preparations'. Exports to the US is still trending up and are growing by some 6% y/y. Exports to other EMU partners have slowed, but gained pace in Aug/Sept. Exports to Europe x EU are up 6% y/y
  - » Germany's main export markets: The other EMU countries (37%), other EU countries x UK (15%), Asia x China (9%), Europe x EU (10%), USA (9%), China (7%), UK (6%)

Guess what, German foreign trade is very closely correlated to…

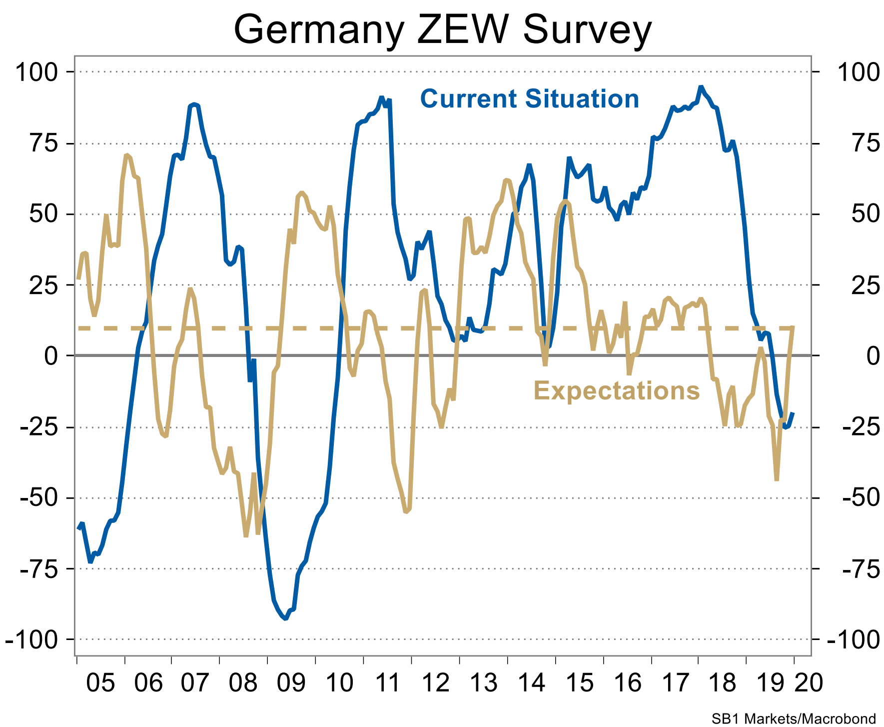
.. global trade. Now, both have been struggling amid trade uncertainties and a mature cycle

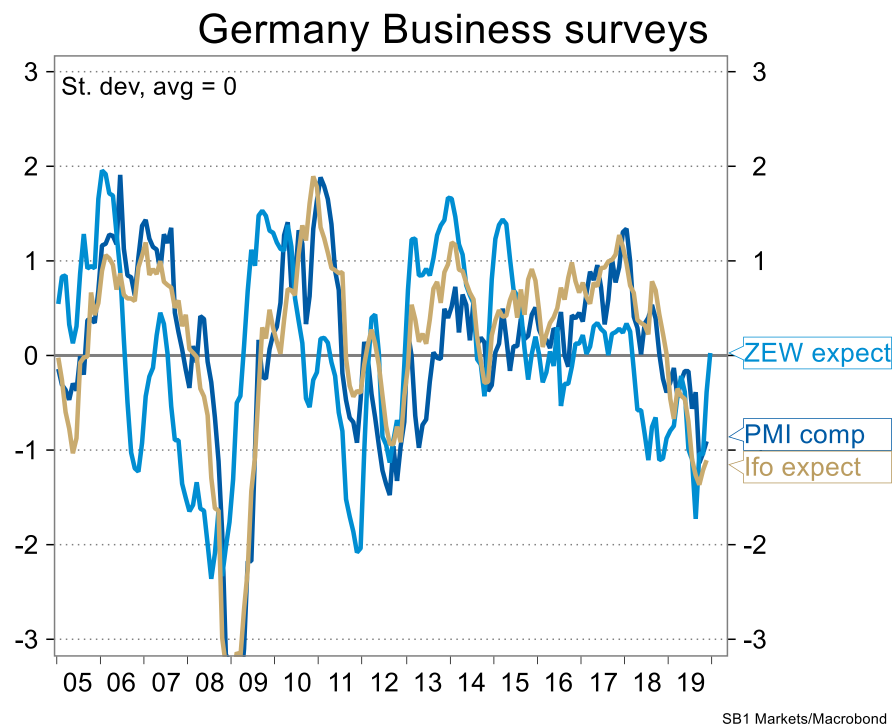


- Both German foreign trade (and thus global trade) is highly correlated to German industrial production, though with production growing at a slower pace. In addition, production is a tad more volatile than exports
  - » In sum, the current decline in production is slightly harsher than 'normal' vs exports, as exports have increased the past months, whereas manufacturing production has kept declining. However, the gap is not much larger than we have seen several times before
- The reason is that domestic demand weakens in line with global demand (or some inventories are emptied or imports have taken a larger market share). Given the upturn in exports and some signs of an easing manufacturing downturn from PMIs/other surveys, some hope??

ZEW survey notes a strong rebound in expectations, current sit. still weak

Expectations have improved the past two months, along with other (more modest) surveys

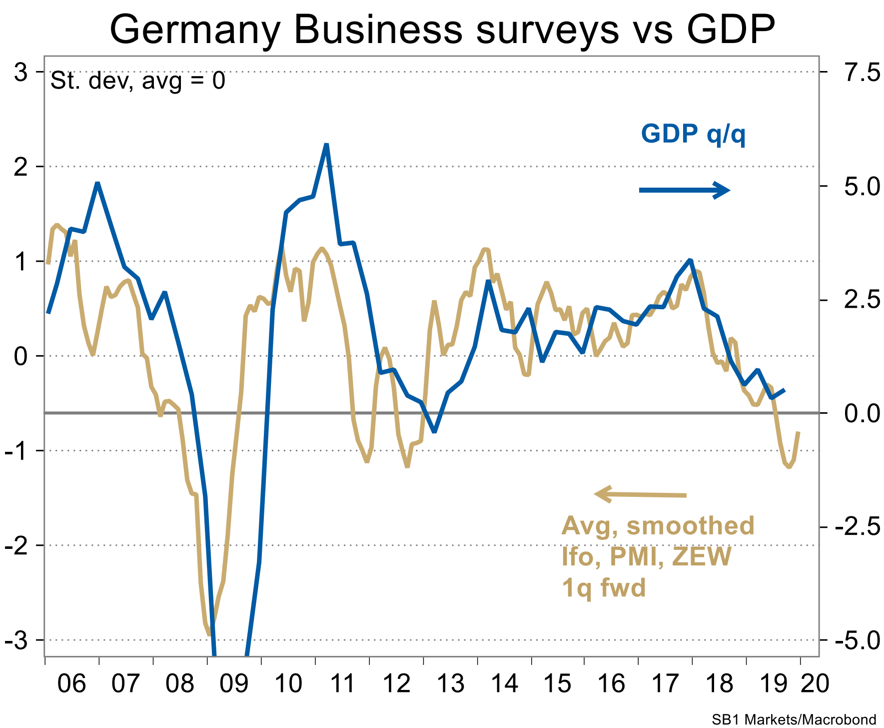


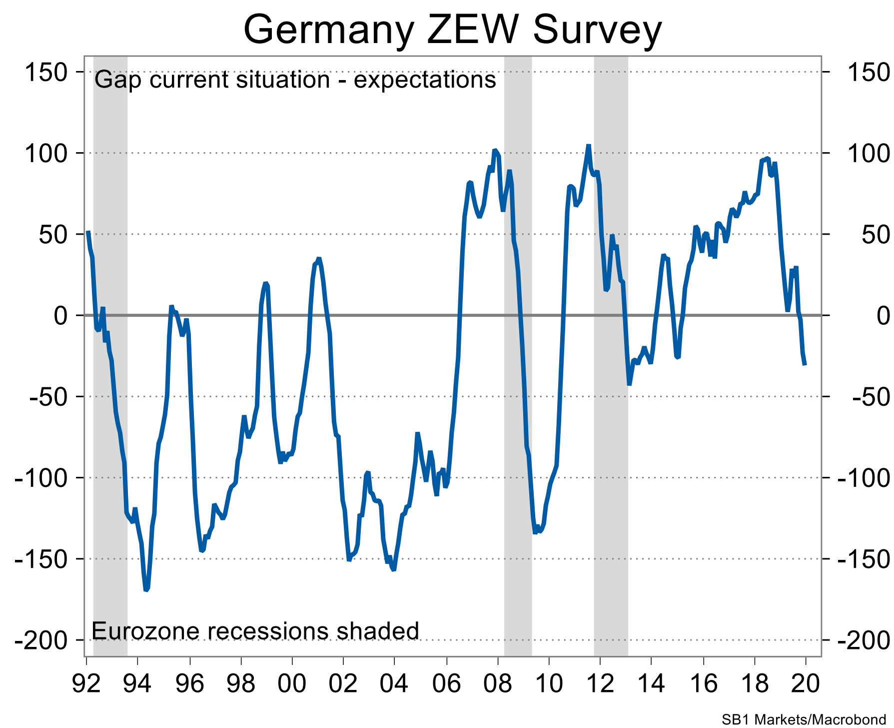


- An intensified trade dispute, Brexit turmoil and subpar domestic data flows, darkened the economic outlook through 2018 and most of 2019. In October and November, the ZEW survey has reported improved expectations. In Nov, expectations came back to the average level, the best since Feb 2018
  - Steady global GDP growth, hopes of US/China trade deal, less probability of hard Brexit and signs of recovery in the global auto sector are supportive?
- The assessment of the current situation edged up modestly, the level is still at the lowest in 9 ½ years
  - The ZEW is a sentiment survey among economists and investors, and not a business survey, as the PMI and Ifo. ZEW is usually leading the Ifo and PMI – however with a rather weak correlation, and the correlation to actual economic growth is weaker than the two other surveys. We prefer the business surveys
- <u>The ZEW survey confirms what other German surveys have been suggesting; that the downturn may now have bottomed out</u>

Some hope? Well, surveys still point to a contraction but less so the past 2 m

The avg of PMI, Ifo and ZEW suggests that the speed down may now be easing

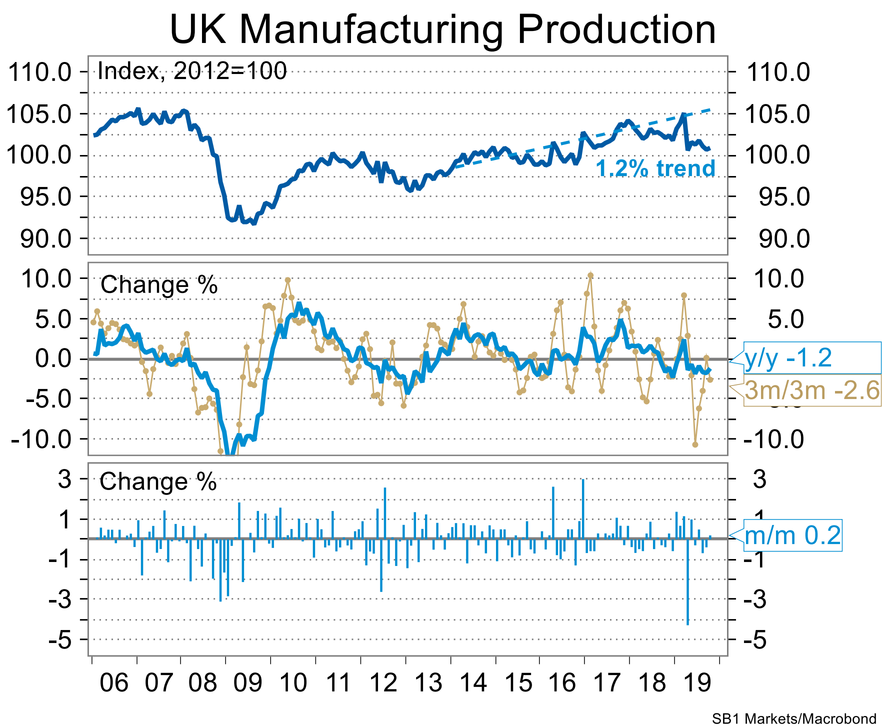


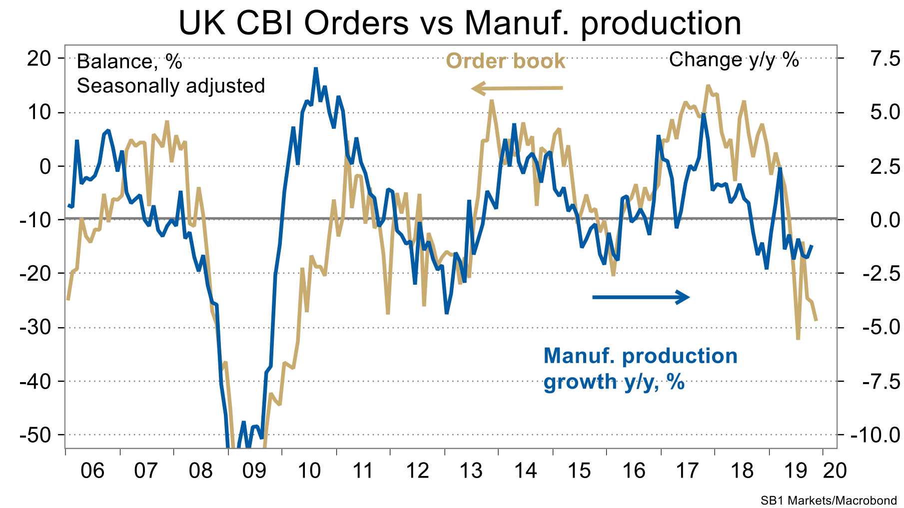


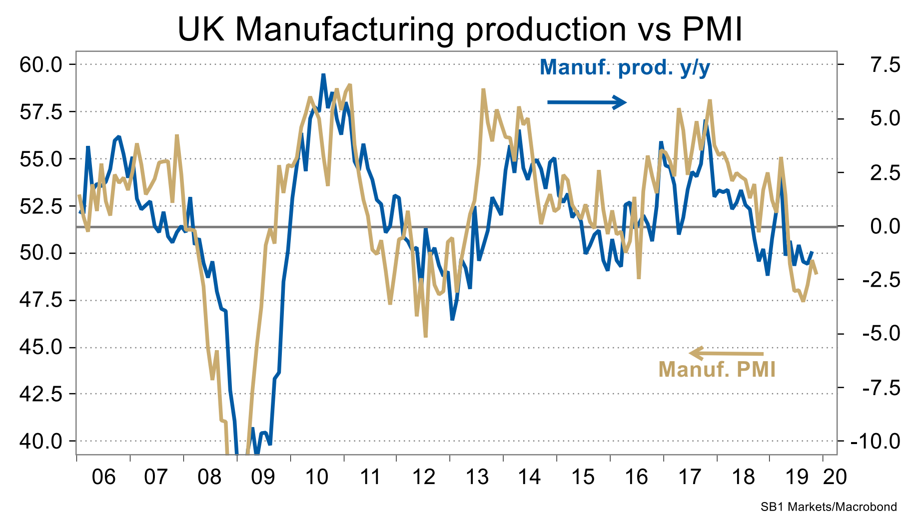
- The gap between the ZEW current situation and expectations is not promising: Just before recessions hit (the 3 recessions since 1990 at least), the expectations component of the ZEW survey has fallen steeply, while the view of the current situations remains elevated. During the recession, the current situation assessment follows expectations down. Hence, based on data before/during the past 3 recessions, we should already be in a recession now
  - » We highly doubt the EMU (or Germany) is in a 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

Manufacturing production is sliding down, and the short term outlook is bleak

Production rose by 0.2% in Oct, helped by inventory build-up? Order book signals a larger decline



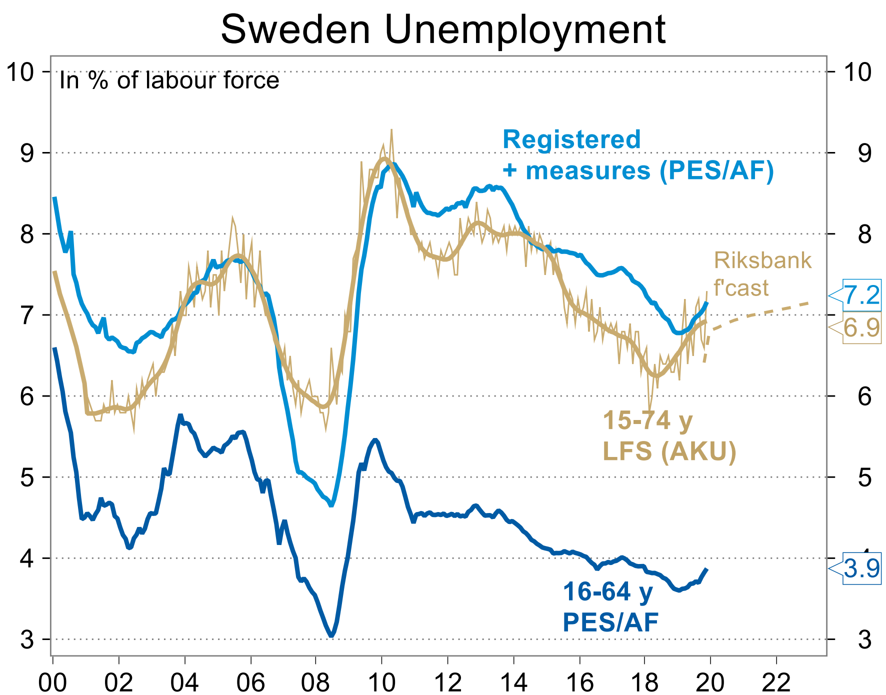


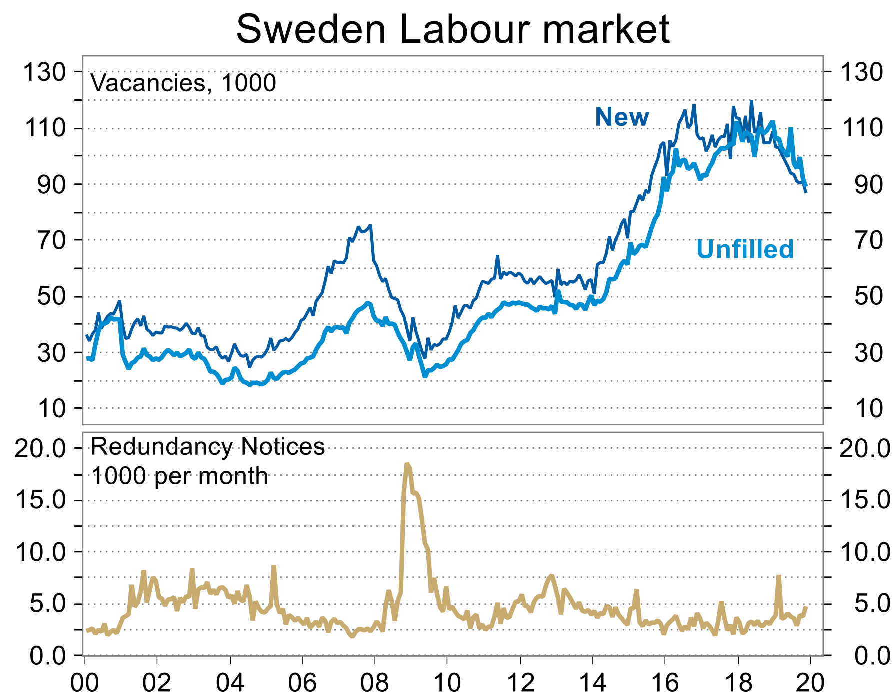


- Production was ‘artificially’ high in March, before the previously assumed Brexit deadline, and fell rapidly after. Inventories were build sharply up before the assumed Brexit, and this effect was later set in reverse
- All activity surveys have turned south recently, the production outlook is rather bleak. In October, the manuf. PMI was boosted by a new inventory build up ahead of the Oct Brexit deadline, and it fell modestly in Nov, a further decline is likely the coming months?

Both LFS and registered unemployment confirm a souring labour market

Registered unemployment edged up 0.1 pp to 3.9% in Nov and LFS unempl. rose marginally

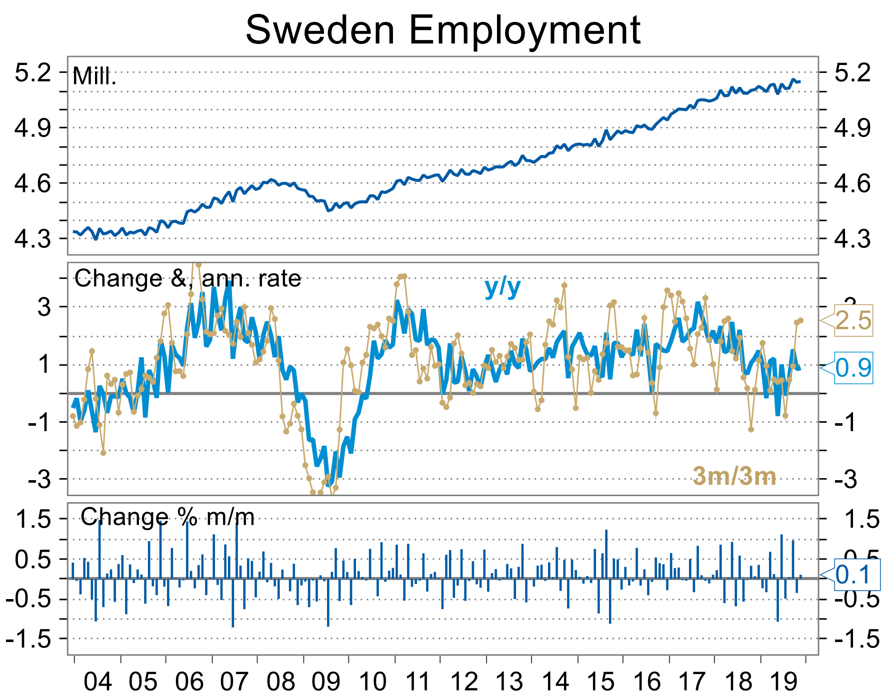




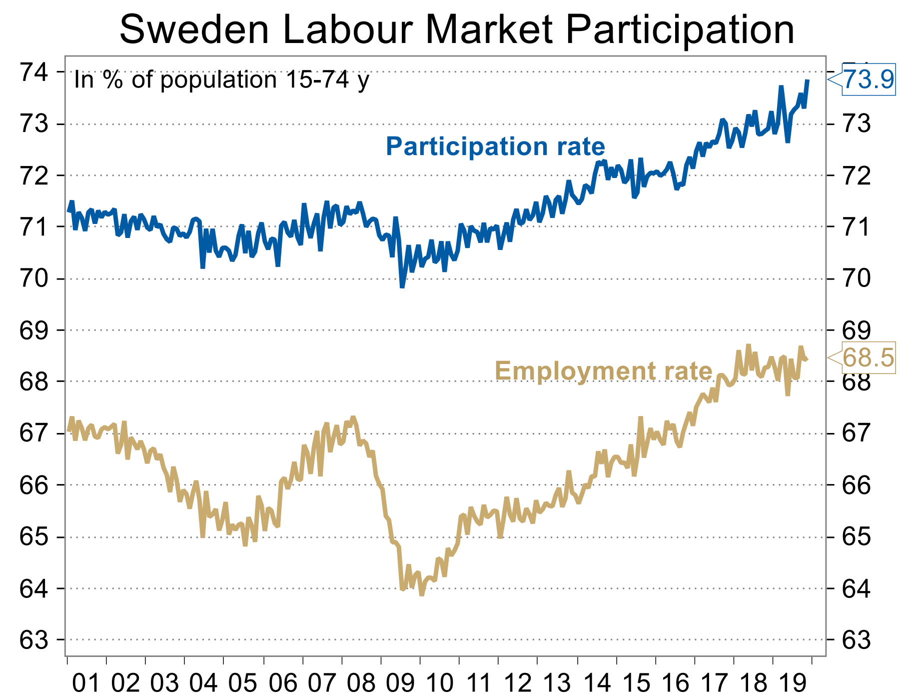
- The PES/AF registered unemployment rate (far less volatile than LFS data) ticked up to 3.9% (7.2% incl. measures) in Nov. Unemployment is slowly climbing, up 0.3 pp since early 2019. Both new and unfilled vacancies have turned steeply down from the peak, confirming a cooling labour market
- LFS unemployment held steady at 6.9% measured by the smoothed rate, up 6.3% in the spring. The unadjusted, volatile rate spiked to 7.3%, the highest in 3 ½ years. Last month, Statistics Sweden revised the LFS data substantially, after serious data flaws were revealed. About half of the unemployment upturn was removed. Nonetheless, the labour market is no doubt weakening and unemployment is increasing, though not as abruptly as previously reported
- The good news: Employment is still inching up, although the upward speed has slowed substantially the past year. Labour market participation is increasing at a faster pace, thus, bringing unemployment up. We would be much more concerned of a rapid downturn in the Swedish economy if the unemployment uptick was due to lower employment!

Employment is slowing but not declining – and participation picks up

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



SB1 Markets/Macrobond

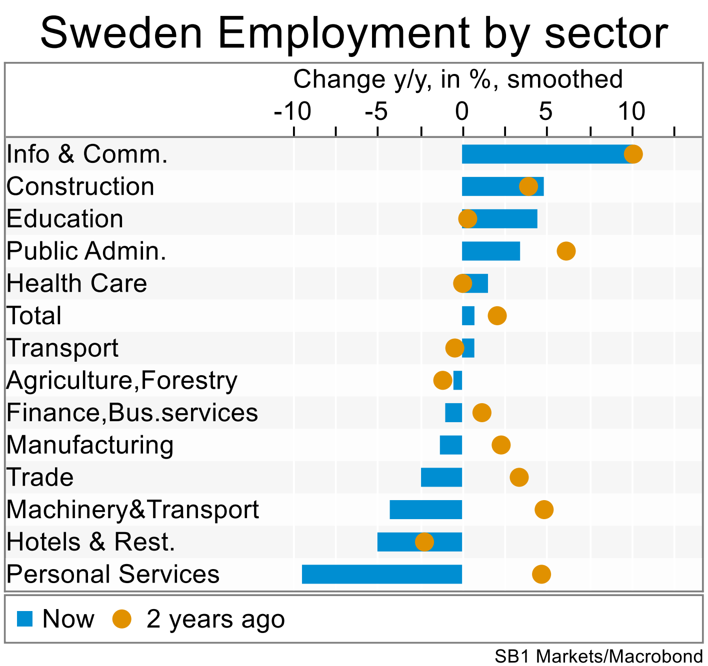


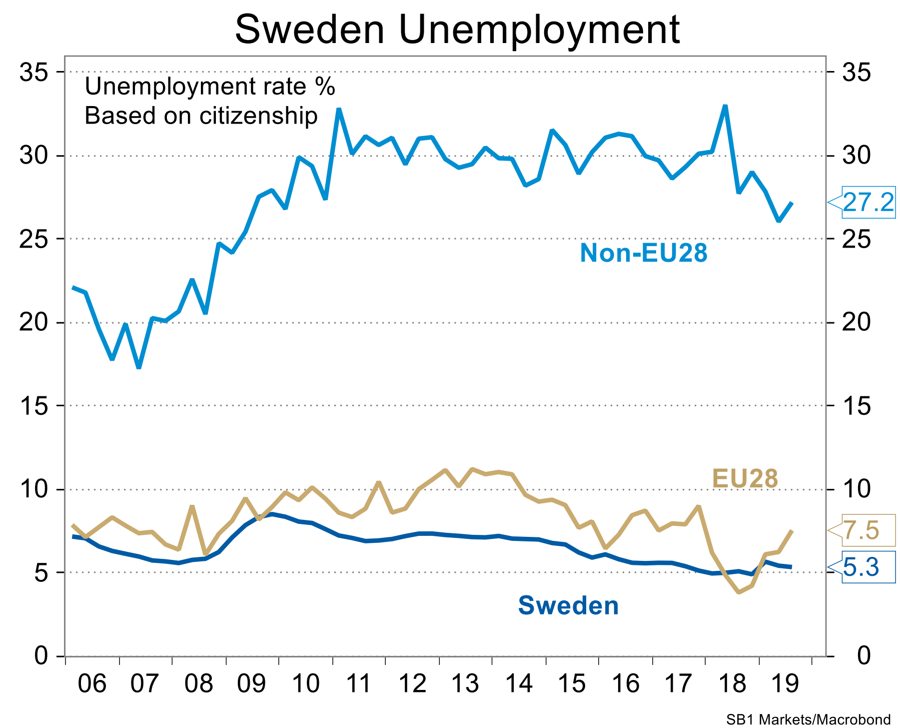
SB1 Markets/Macrobond

- Employment increased by 0.1% m/m November, the underlying growth rate is solid at 2.4%, lifted by a strong Sept. The annual rate up modestly 0.9%. The employment rate inched up to 68.5, flattening out since early 2018 (but slightly up recent months)
- Labour market participation soared 0.6 pp to 73.9% in Nov, still trending up. Participation has increased by 1.1 pp this year, employment is up just 0.2 pp
  - » 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

Employment is decreasing in half the sectors, accelerating in just 3

Unemployment is increasing among Swedes and EU citizens, other citizenships are still declining

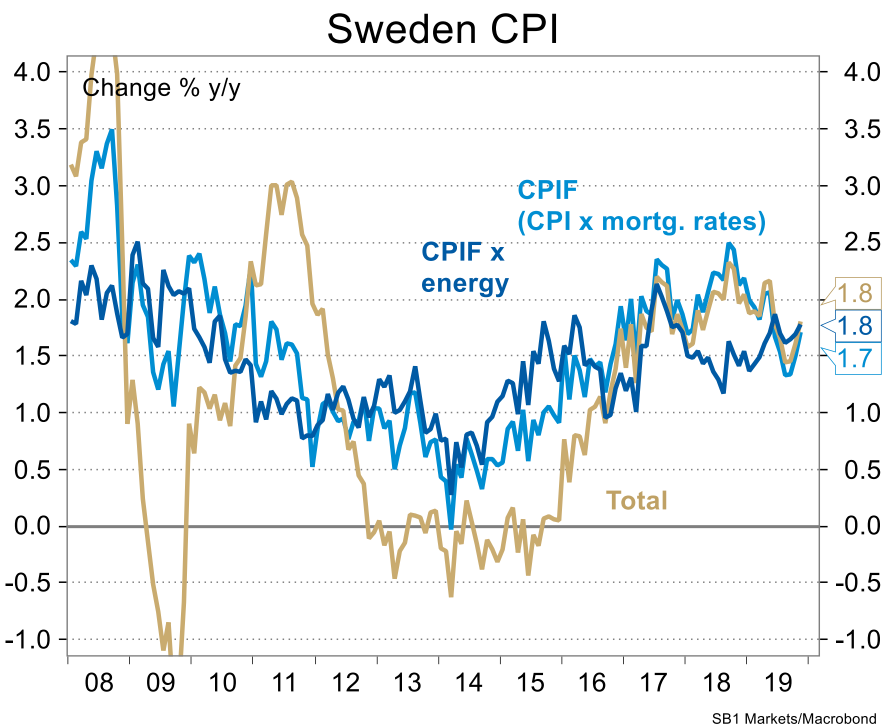


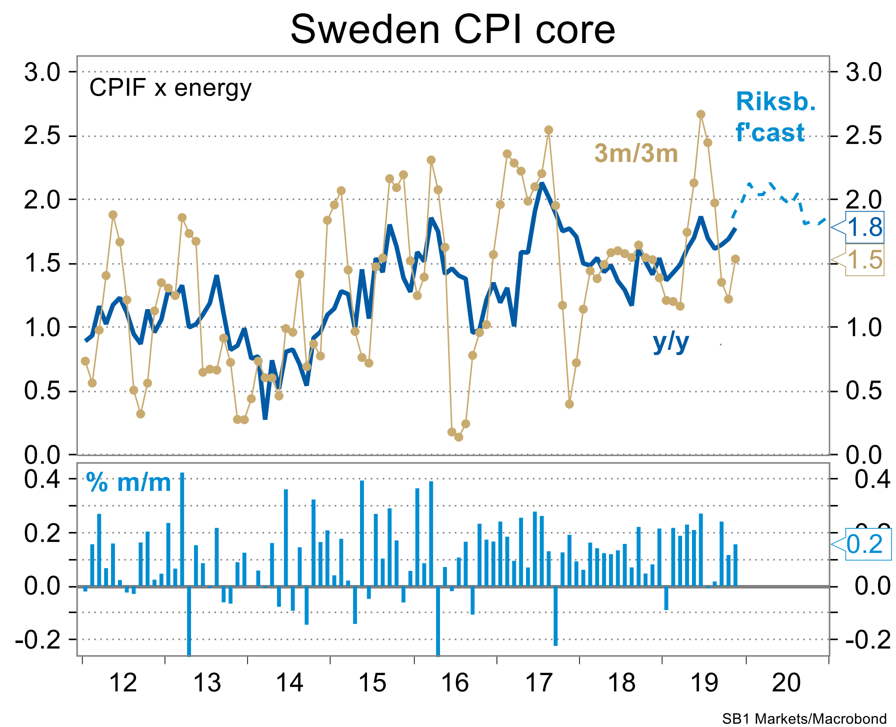


- A broad labour market slowdown; employment is declining or slowing in 8 of 13 sectors. Personal service sectors, hotels & restaurants, machinery and manufacturing and retail trade are all struggling. Employment in information & communication sectors, construction and education are still rising strongly
- Unemployment among EU citizens is increasing rapidly, and it has edged up by some 0.4 pp from the 2018 bottom among Swedish citizens too (usually less volatile than unempl. among foreigners). Among non-EU citizens, unemployment is still declining

Core inflation ticked up to 1.8% in Nov, the Riksbank is set for a Dec hike

Core CPIF rose to 1.8%, a 0.1 pp uptick, expected unch. Inflation just 0.2 pp below Riksbank's target

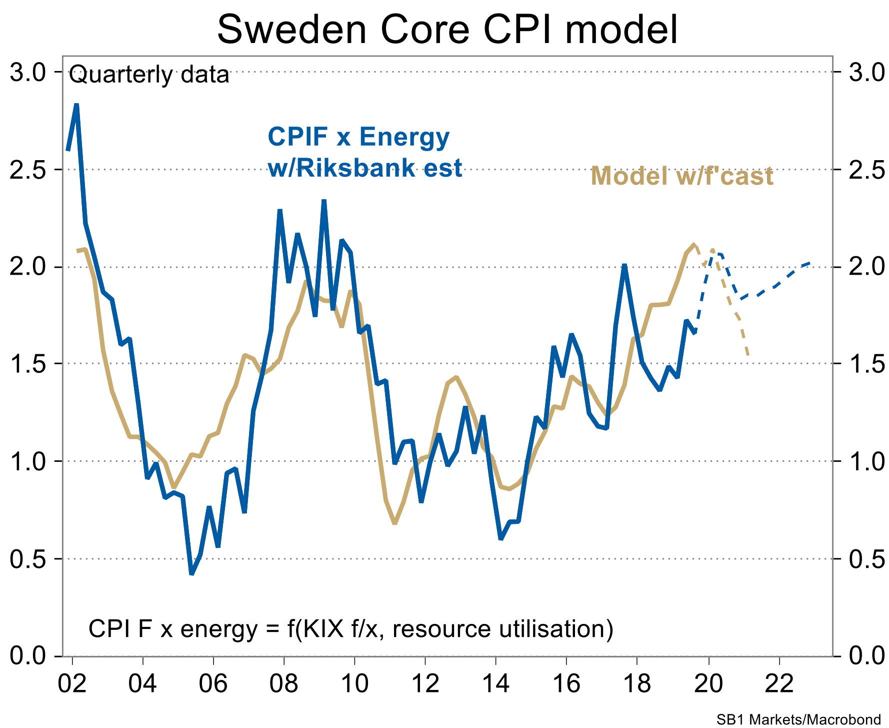


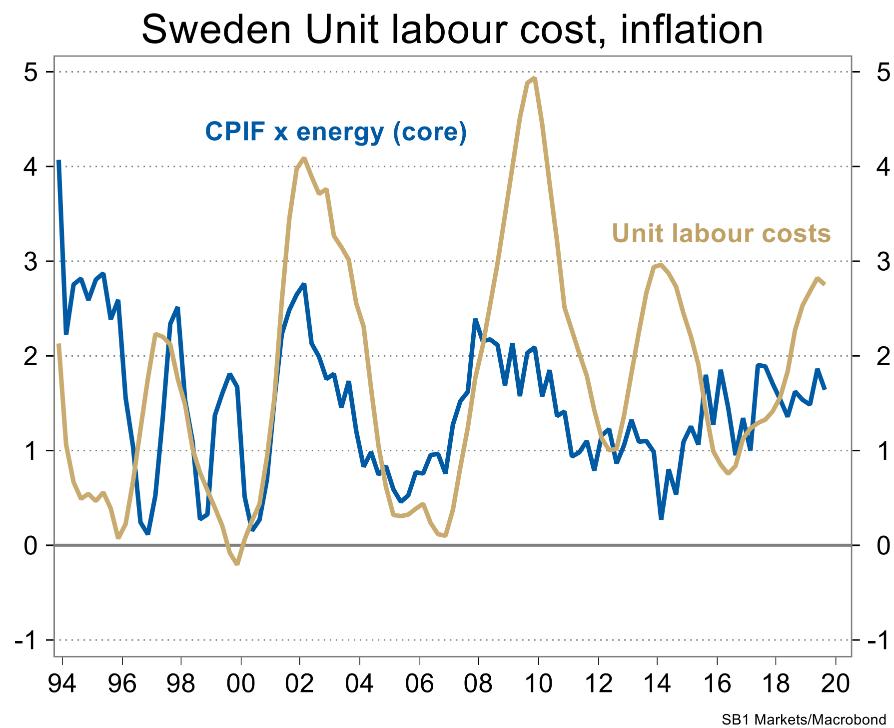


- The 'real' core (CPIF ex energy) increased by 0.2% m/m in November. The annual rate ticked up to 1.8%, from 1.7%. Core inflation has gained some pace recent months, after slowing in the summer. Underlying growth is still somewhat lower than the annual rate. Annual core inflation is 0.1 pp below the Riksbank's f'cast from October
  - » CPIF (ex mortgage rates) edged up to 1.7% y/y, a 0.2 pp increase. CPIF is running lower than core CPIF, due to lower energy prices
  - » The Riksbank expects an acceleration to 2.1% in January, probably too optimistic. Our simple model suggests that inflation is peaking now
- The Riksbank will nudge up the interest rate to 0% on Dec 19, at least that's what the bank signalled in October. Core inflation is closing in on the price target, thus, no argument for the Riksbank to abandon its hiking plans. (But PMIs and labour market data may be…)

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

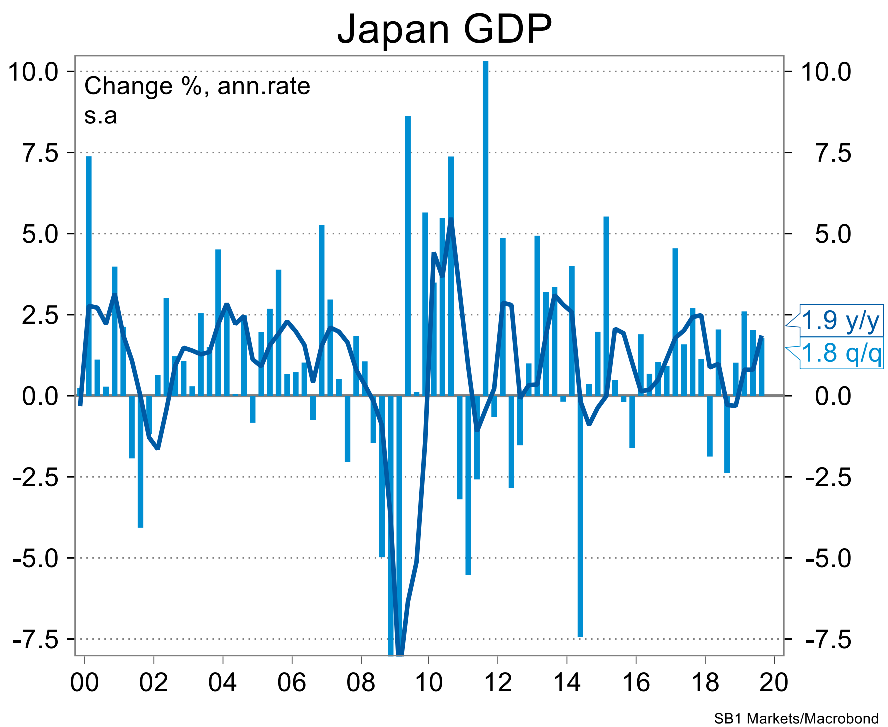


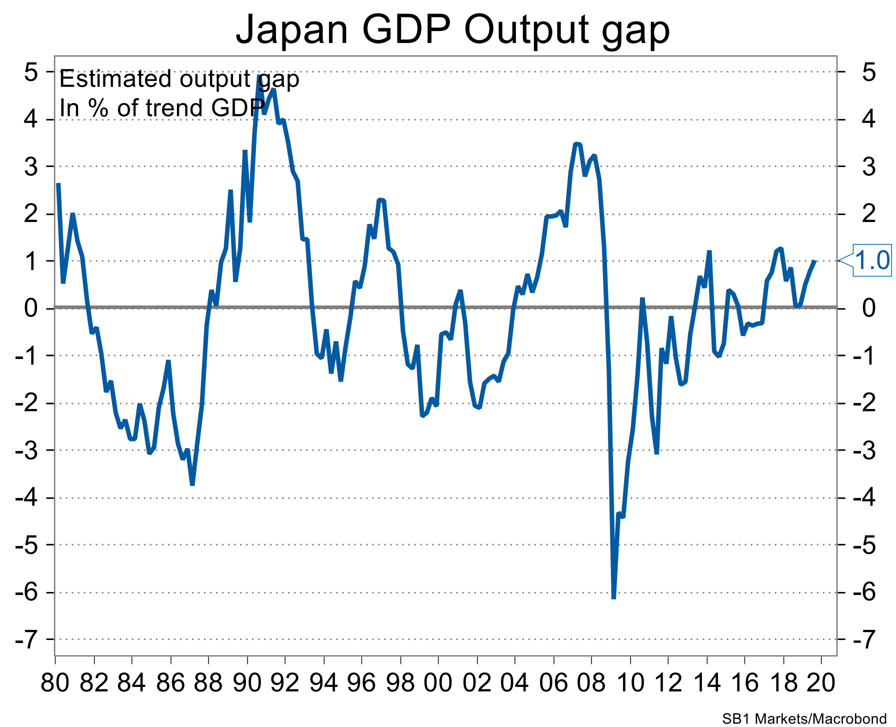


- Our model includes SEK and the Riksbank's Resource Utilisation indicator, measuring deviation from potential GDP growth. Capacity utilisation has weakened rapidly this year, according to this index, it fell to just 0.2% in Q3, thus, still marginally higher than normal. The inflation model points to higher inflation now, at 2.0%, vs Q3 growth at 1.7%, before easing next year
  - » A weakening labour market and a softer Economic Tendency survey have pulled the RU indicator steeply down
- On the other hand, productivity has almost disappeared, up just 0.7% y/y and unit labour costs are up 2.8% y/y (slowing the past quarters, we apply a heavy smoothing at the chart above, these data are volatile). 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

Q3 GDP growth revised up to 1.8%, from 0.2%!

An even larger revision than normal



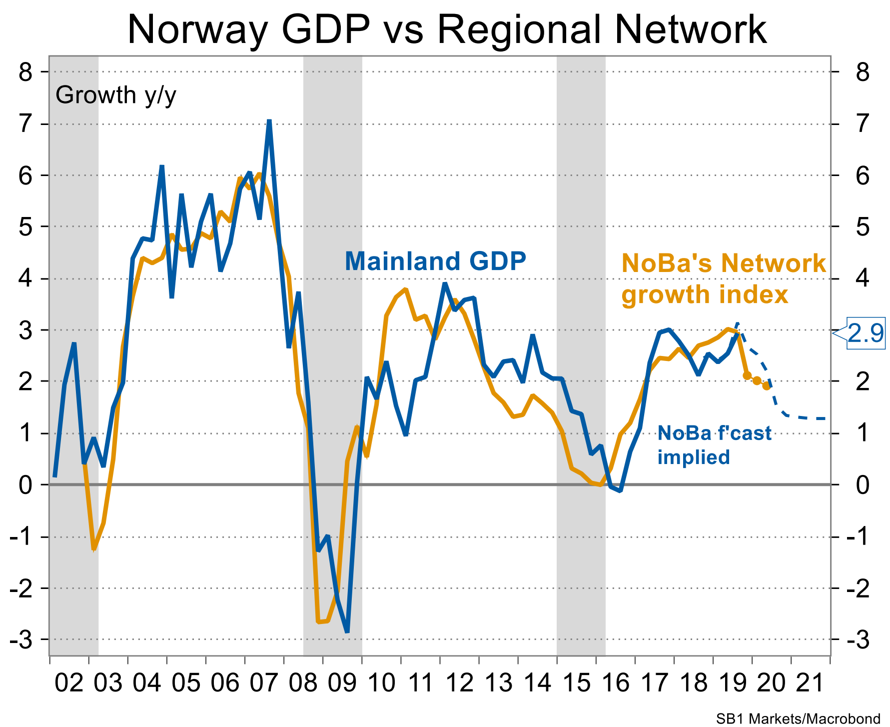


- Japanese GDP data are notoriously volatile and often substantially revised. This time, the Q3 GDP growth rate was revised up by 1.6 pp (q/q annualized rate). Thus, growth slowed just marginally from Q2. Growth y/y at 1.9%, from 1.4% in the first report
  - » Strong domestic demand lifted growth, while net exports contributed sharply on the downside
  - » The output gap has been steady at just below 1% since late 2017, the 2nd highest level since 2008
- The October VAT hike will no doubt take its toll on Q4 growth, and may have boosted activity in Q3. PMI suggest zero growth

SpareBank 1 MARKETS

Norges Bank's Q4 Network shows the economy shifts into lower gear

Businesses report 2.1% the past months and expect 1.9% the next 6 months, well below expectations



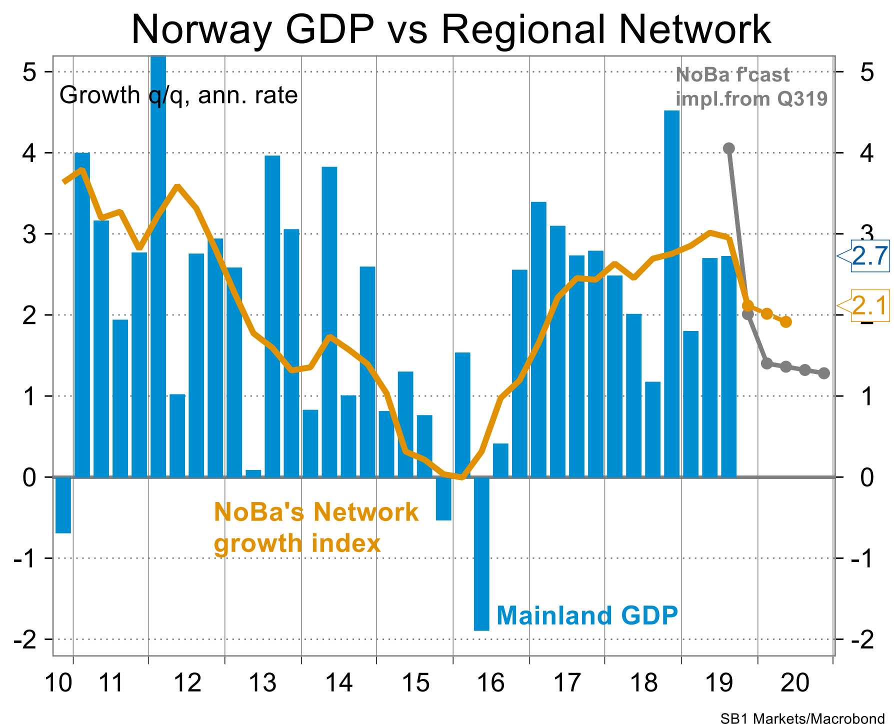
The Network's expected growth pace the coming 6 months is lower than NoBa's y/y f'casts – but above the q/q f'casts, which we prefer, check the next slide

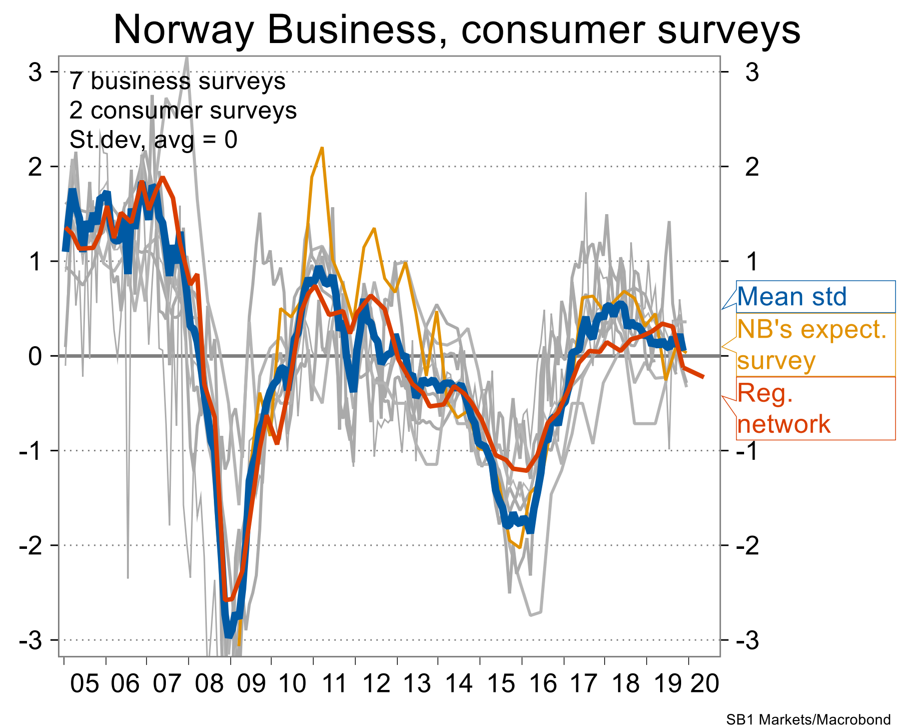
Summary of the Q4 Regional Network report

- **Growth**
  - » Norges Bank's Regional Network reports 2.1% growth the past 3 months, 0.6 pp weaker than respondets expected in the Q3 survey but 0.1 pp above NoBa's Q4 GDP f'cast (from Sept)
  - » Businesses expect a slowdown to a 1.9% growth pace the coming 6 months. We expected 2.3% growth, consensus 2.5%. The network mirrors a substantial downshift, from 2.7% expected growth just 3 m ago (and 3.1% 6 m ago)
  - » However, the slowdown is not any more abrupt than what Norges Bank projected in Sept; the Bank expected a drop to 1.4% q/q annualized rates in Q1/Q2 2020 (see graph next page)
- **Capacity utilisation/investments**
  - » The Network reports unchanged capacity constraints. Capacity utilisation is well above average and marginally higher than at the 2012 peak. The share of businesses reporting labour shortages increased but remains unusually low vs the unemployment rate
  - » Businesses expect softer employment growth, down to just 1%, vs 1.7% in Q3 (still far above population growth, though)
  - » 2020 wage expectations at 3.2%, up from 3.1% in '19
- **Implications**
  - » The Network suddenly became among the weakest of Norwegian business surveys. Still, the pace of decline is not any more abrupt than Norges Bank assumed in Sept, thus, we do the bank to change its view on the outlook based on the Network. We anyway expect the Bank to signal an unchanged interest rate

Growth peaked in Q2/Q3, according to the Network

The Network signals 1.9% GDP growth in Q1/Q2, still above NoBa's quarterly f'cast at 1.4%

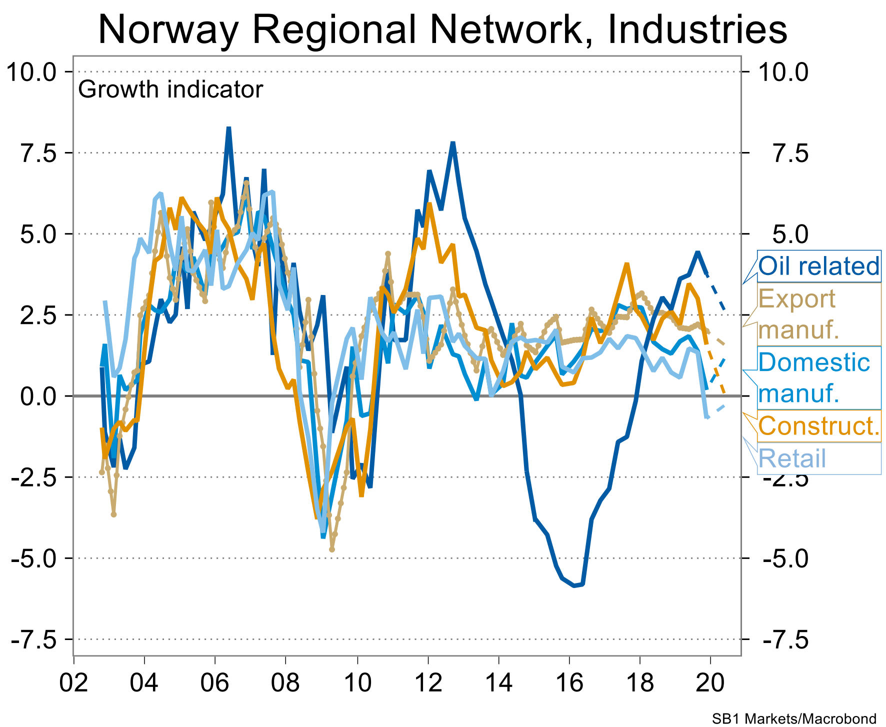


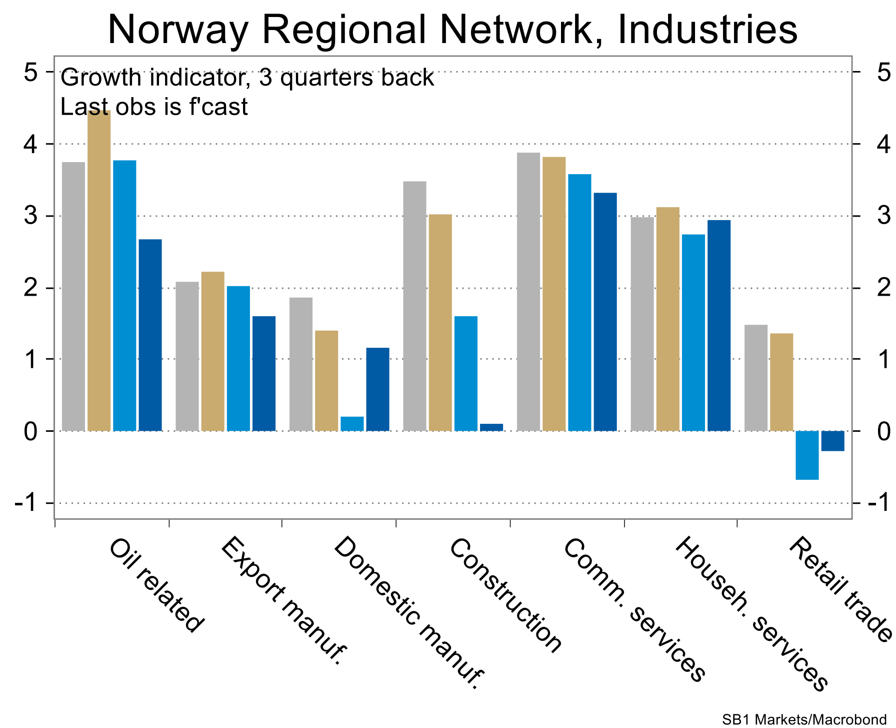


- Norges Bank's Network estimates economic activity to expand by a 1.9% speed the coming 6 months, which is still above Norges Bank's q/q f'cast (implicitly, our f'cast). The bank expects 1.4% growth in Q1 and Q2
- The Network is among the weakest of Norwegian surveys, although all have softened, confirming that the growth peak is now behind us. Consumer confidence surveys are weaker than their respective averages, as well as the NHO Q4 economic outlook survey. SSB's manufacturing survey is marginally more upbeat than the Network, still signaling zero growth in the manufacturing sectpr

A pronounced slowdown in construction, and in oil related industries

Construction reports no growth, oil related a further slowdown. Other manuf. mixed. Retail down!

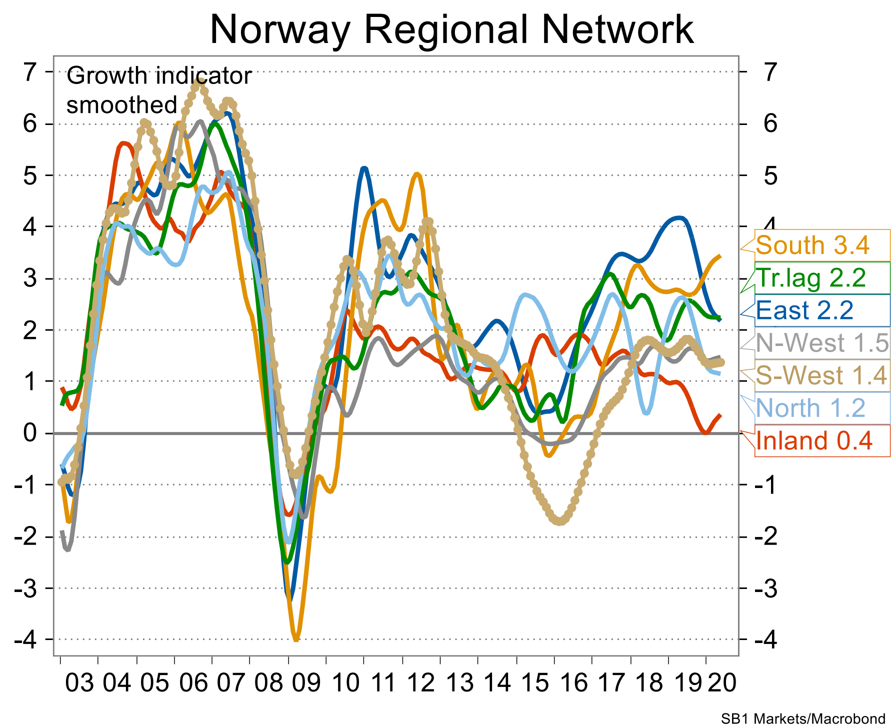


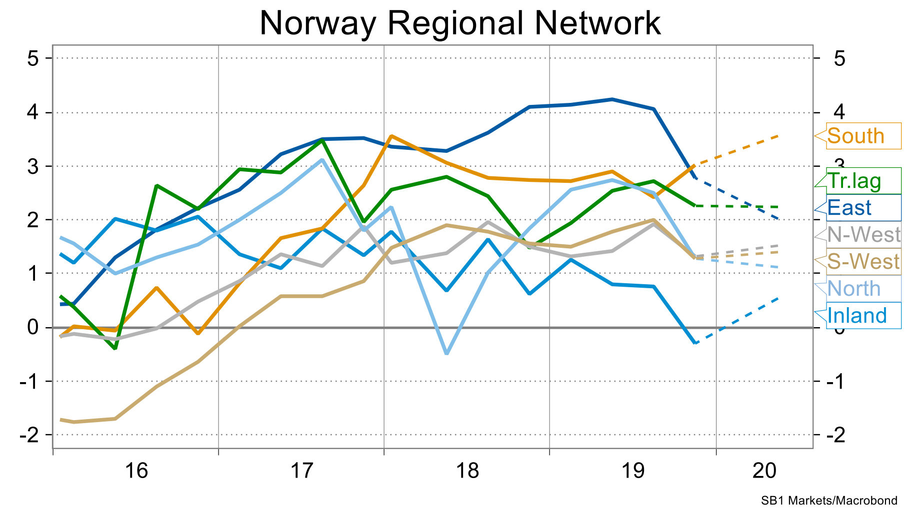


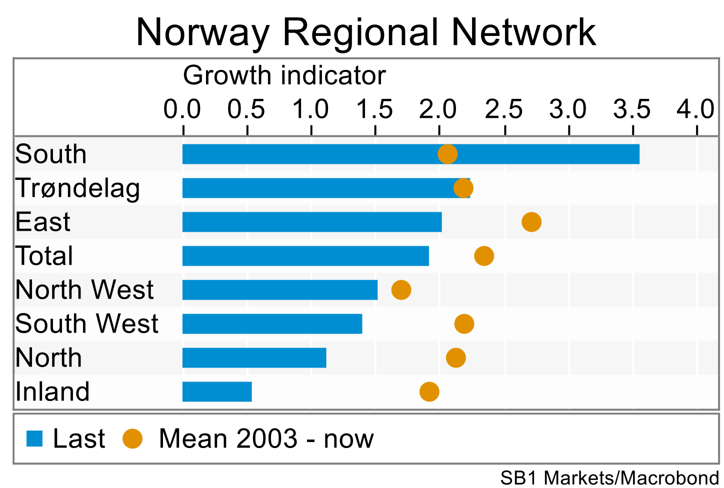
- Oil related companies (manufacturers & service providers) confirms that growth in oil related industries have peaked. Output growth has fallen the past 3 months and are expected to slow further the coming 6 months, down to some 2.5% growth. We think there is more downside risk
- Construction reports a slowdown in Q4 and expects growth to wane the coming months. Weaker housing sales are a drag, and fewer infrastructure development projects
- Export oriented manuf. sectors experience just a tad softer demand, in spite global uncertainties. The weak NOK has offset some of the effects from global trade turbulence. Domestic manuf. slowed in Q4 but a slight upswing is expected
- Retail is the only sector which reported zero actual growth in Q4, and no rebound is in sight. Online competition, recycling trend are troublesome, and new auto regulations creates problems for auto dealers

Growth sharply down in the East, North. South the big winner. West flattish, 1.5%

Higher growth expected just in the South and Inland, East down to a 4 y low, construction to blame?



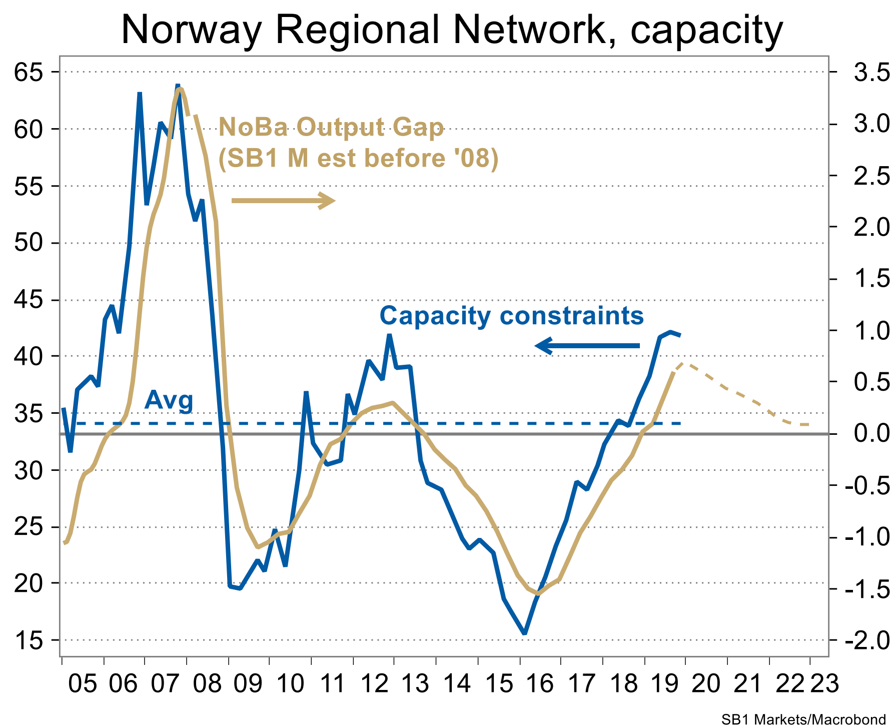


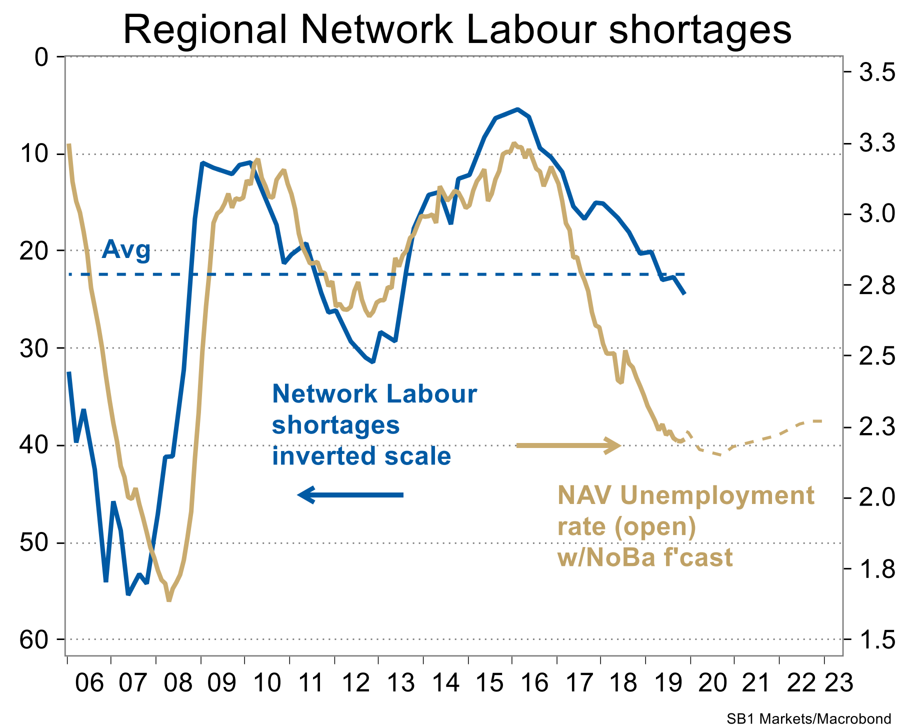


- Activity increased in most regions through 2017, 2018 and until mid-2019. In the East, growth slowed rapidly in Q4 and another downtick is expected the coming months. Trøndelag steady at 2%+, North has slowed substantially. Inland failed to expand in Q4, and just a modest uptick is excepted. The south is accelerating, to some 3.5% growth??
- The two western 'oil' regions are reporting lower growth but no additional slowdown into 2020 (speed 1.5%), less than the slowdown in oil related industries

Capacity utilisation at local peak, labour shortages are slowly increasing

Capacity utilisation is far above the avg since '05 and marginally above the 2012 peak

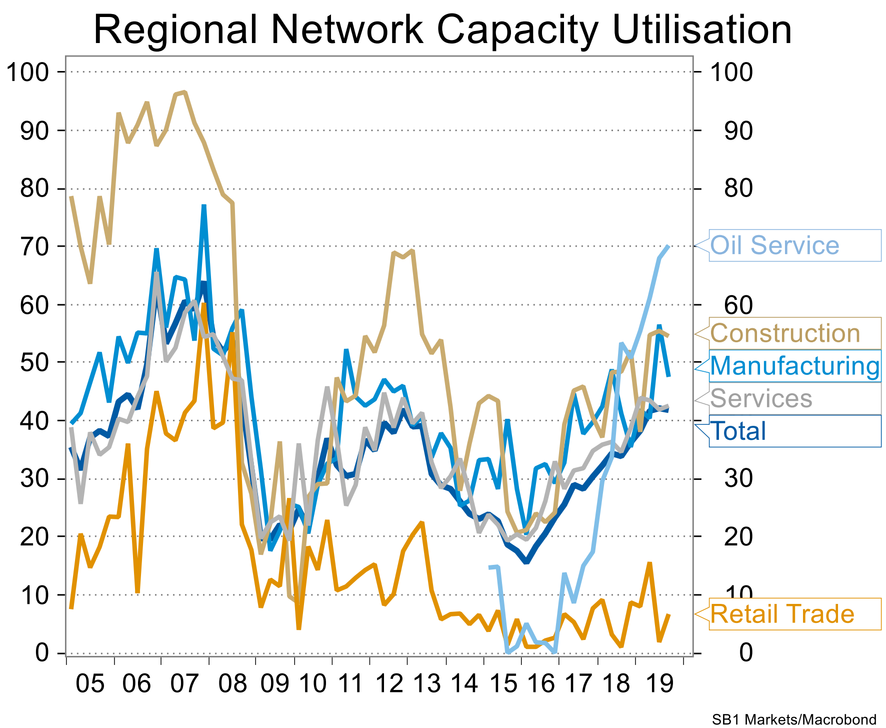


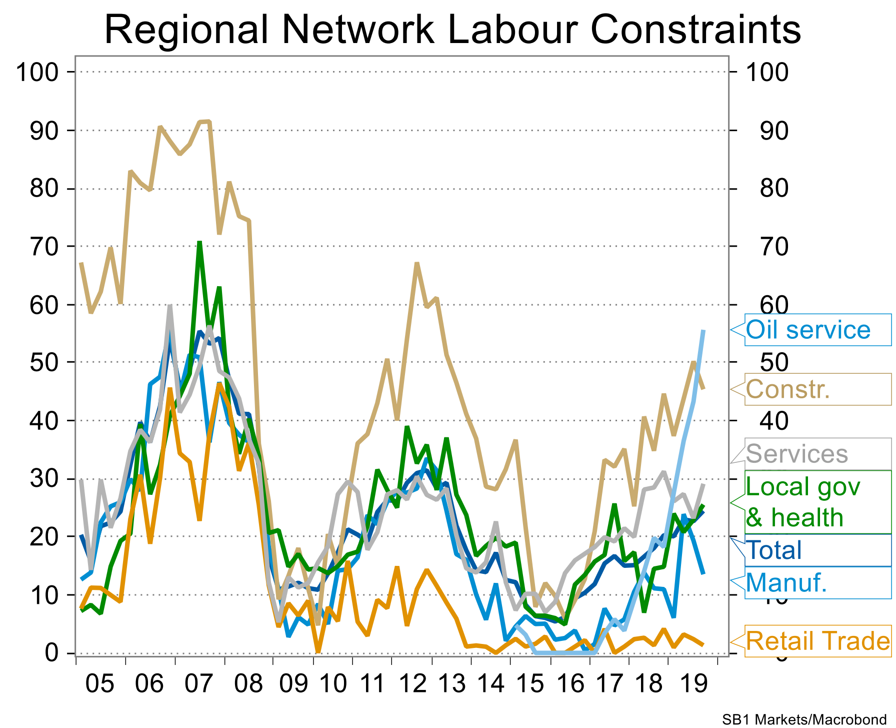


- Capacity utilisation has been improving rapidly since 2016. The past 2 quarters, capacity constraints have flattened out, at a level marginally higher than in 2012 – but still well below the 2007 peak!
- In spite rising capacity utilisation and low unemployment, businesses have not been reporting any substantial labour supply constraints. The share of businesses noting difficulties recruiting labour increased in Q4, but remains far lower than 'usual', given the unemployment rate at 2.2%! An indication that labour is still available
  - » Given that unemployment may be flattening out and the number of unfilled vacancies is edging down, labour shortages are not likely to increase much, from here, even as the level is lower than 'usual' vs unemployment

Capacity utilisation is soaring in oil service industries, construction, services

70% of oil related businesses are reporting full capacity utilisation – and just 7% in retail sectors!

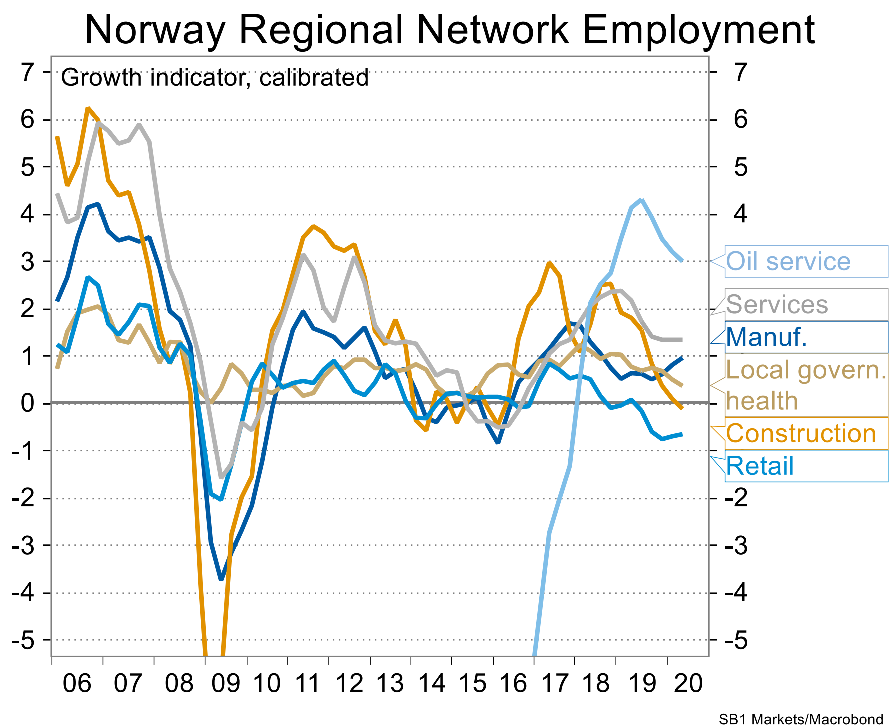


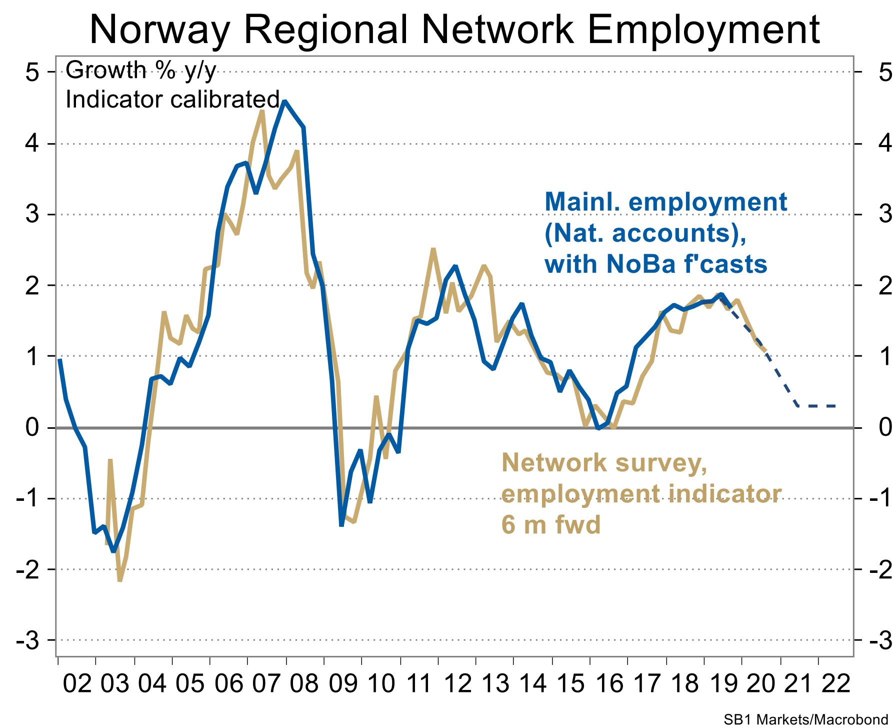


- The share of oil-related businesses (not oil companies) reporting problems accommodating rising demand is soaring, to 70% in Q4! Labour constraints are increasing rapidly too, 56% of businesses are being constrained by shortage of qualified labour. The labour market in oil related sectors must be very tight!
- In construction, capacity utilisation and labour shortages shrank marginally after increasing rapidly through 2017 and 2018
- Retail trade is reporting very low capacity utilisation and does not have any problems attracting labour
- 48% of manufacturers are reporting full capacity utilisation, a smaller share than in Q3. Yet, the share of businesses that are reporting problems attracting labour is 14% (from 24% in Q3)

The Network notes slower employment growth, down to 1% from close to 2

Employment growth slows in oil services, construction cuts, and just manufacturing is gaining pace



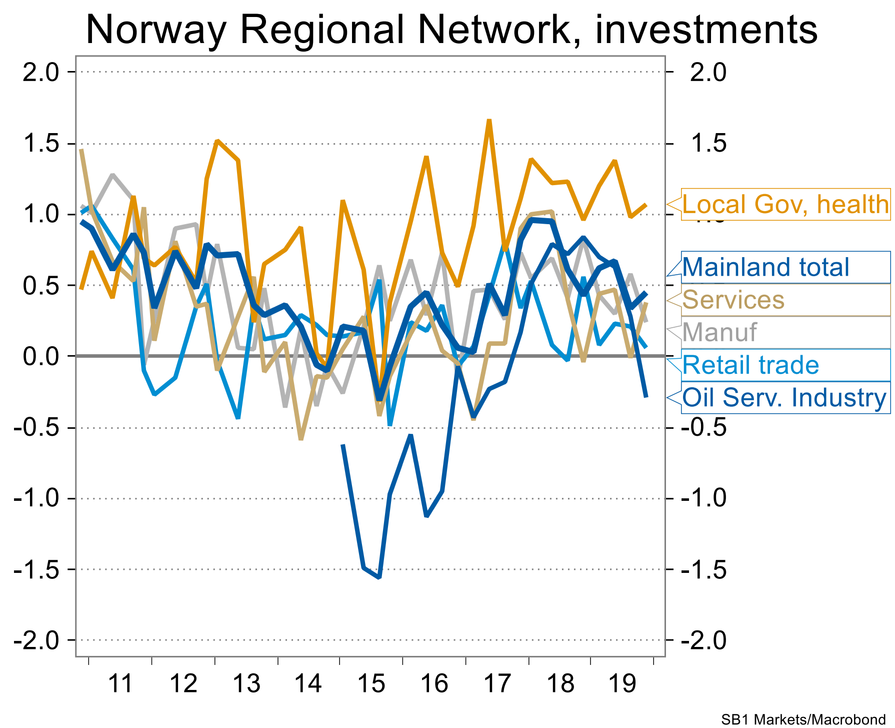


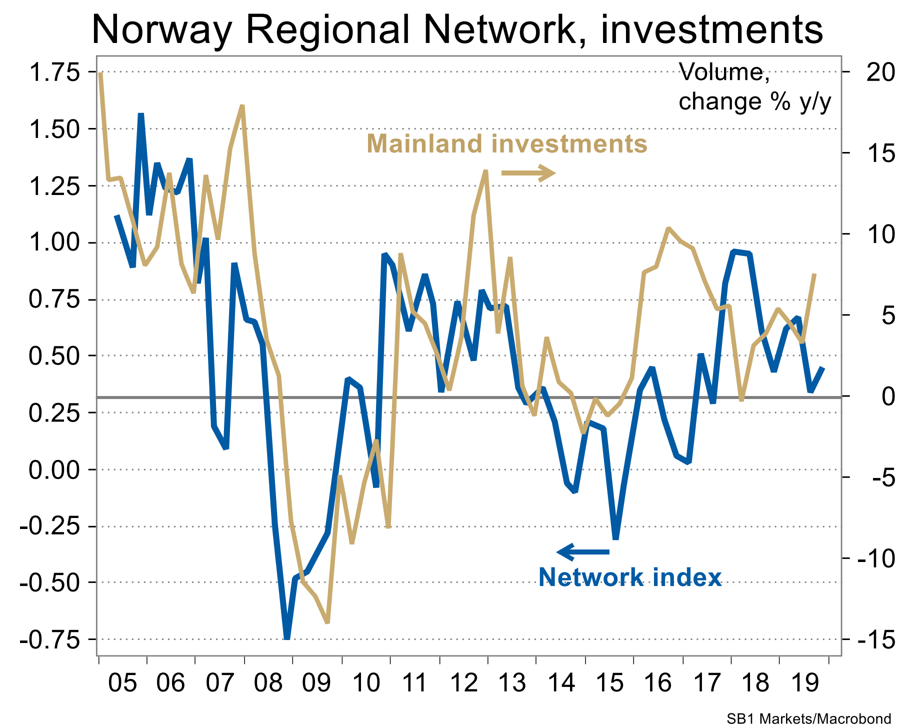
- In total, the Network employment indicator points to a slowdown to 1% growth, from 1.7% in Q3 (according to National Accounts)
- The downturn is in line with Norges Bank's employment f'cast but more pronounced than other surveys. An avg of 6 business surveys still point to above 2% growth! The Regional Network is now the most updated and is anyway more accurate. The correlation to actual employment growth is rather strong. Growth in working age population is below 0.5% and the participation rate will have to increase substantially to prevent unemployment to decline further, if employment should increase 1%
  - » In oil related services, employment growth has eased the past 2 quarters, along with decelerating activity. Construction employment growth has turned steeply down, to zero growth. Manufacturing is gaining some pace but the upside is probably rather limited. Employment in the service sector is easing too

SpareBank 1 MARKETS

The Network signals subdued business investments but no decline

Investment plans surprisingly edged up in Q4, however, still pointing to a substantial slowdown

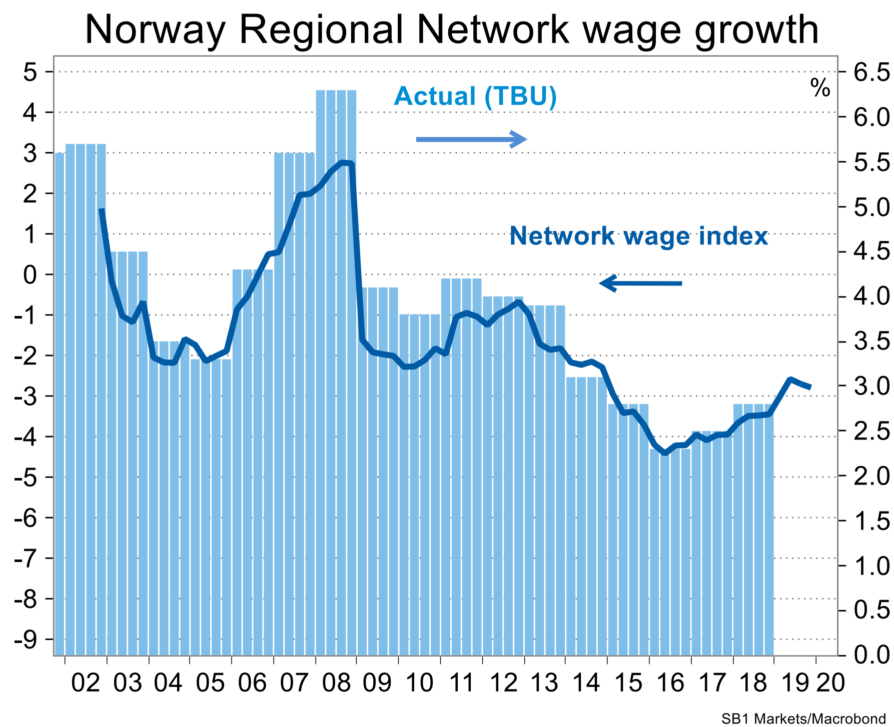


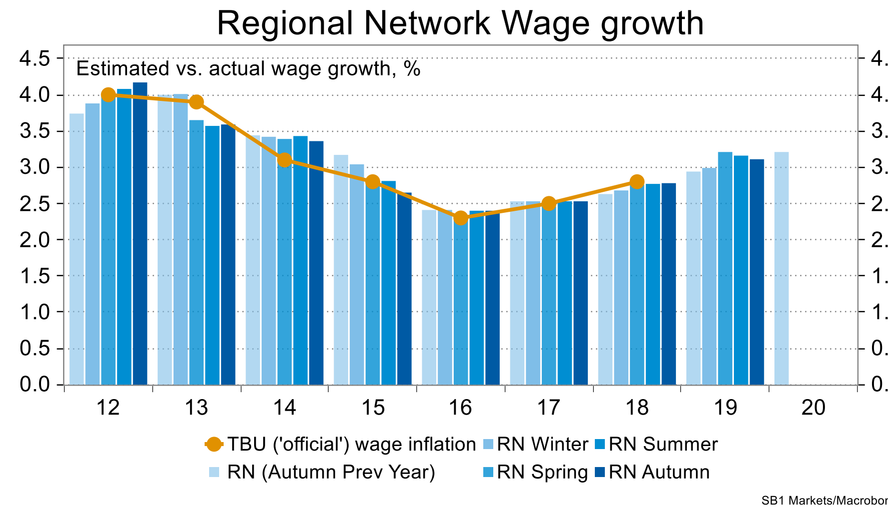


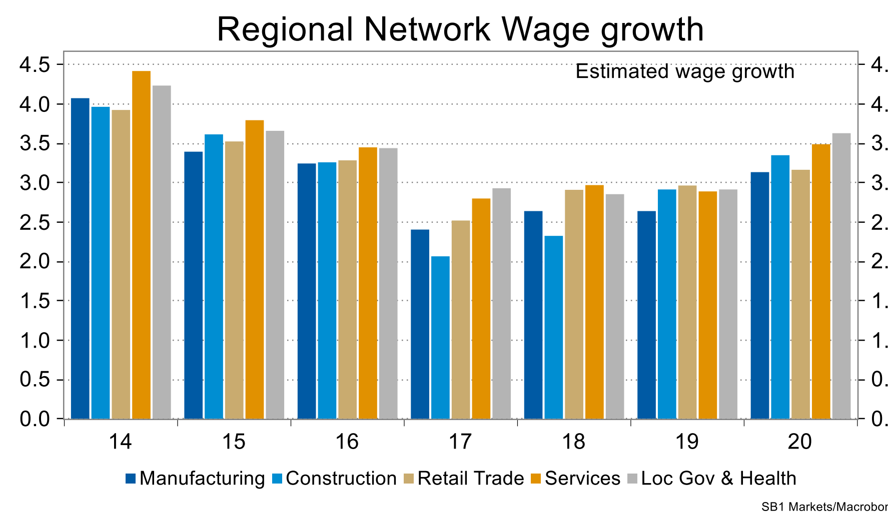
- Oil service/oil related manufacturing industries have been reducing their investment plans. Investments from the oil companies are probably peaking in Q4 and will no doubt be a drag on activity in oil services
- Non-oil related manufacturing have gradually lowered their investment plans the past year. SSBs investment survey reported a sharp decline in investments in 2020
- Investments in retail trade remains soft, services picked up somewhat in Q4. Local govt/health remains on the top
- Actual Mainland business investments rose 5% q/q in Q3 (and was up 7.6% y/y) – we expect a substantial slowdown next year

The Network lowers 2019 wage growth to 3.1%, expects 3.2% in 2020

Are wage growth expectations peaking now?



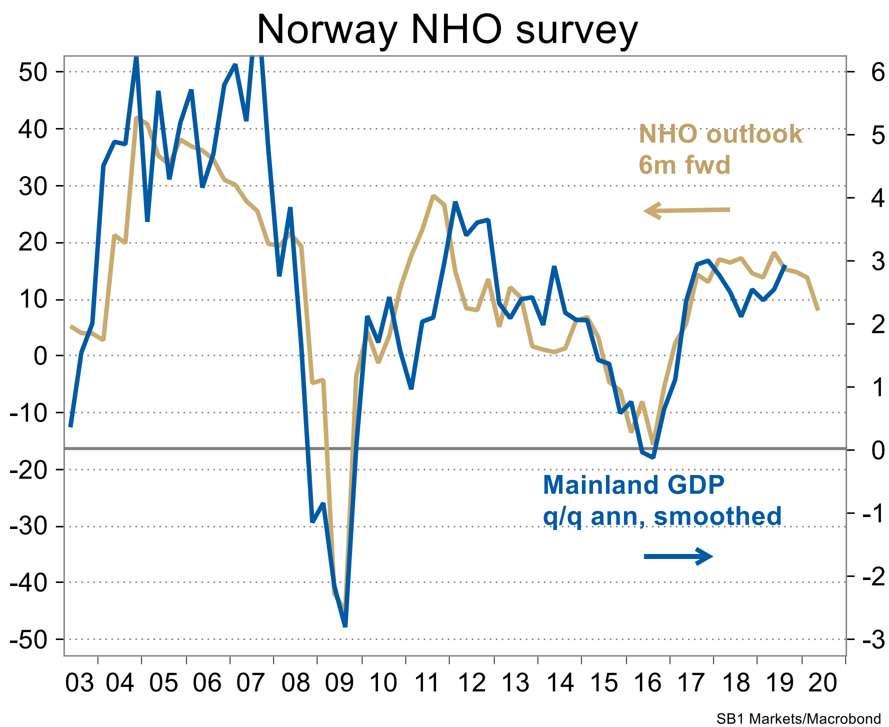


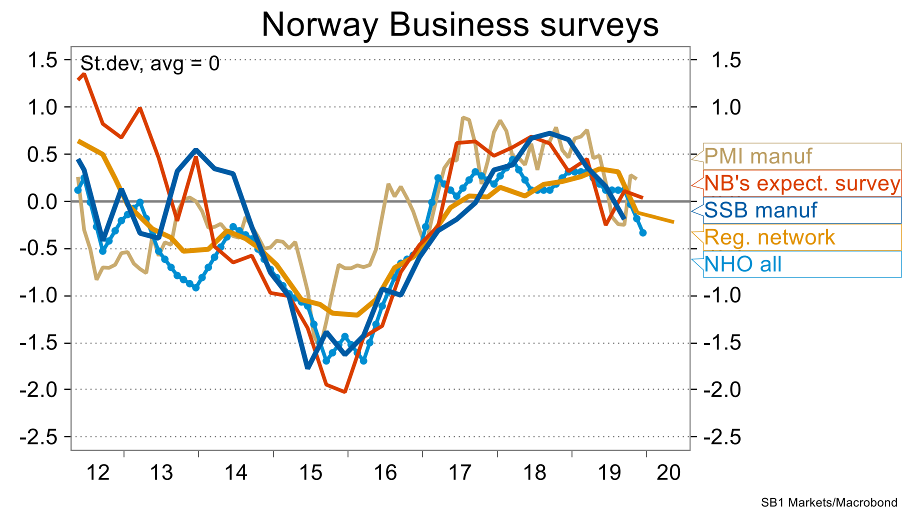


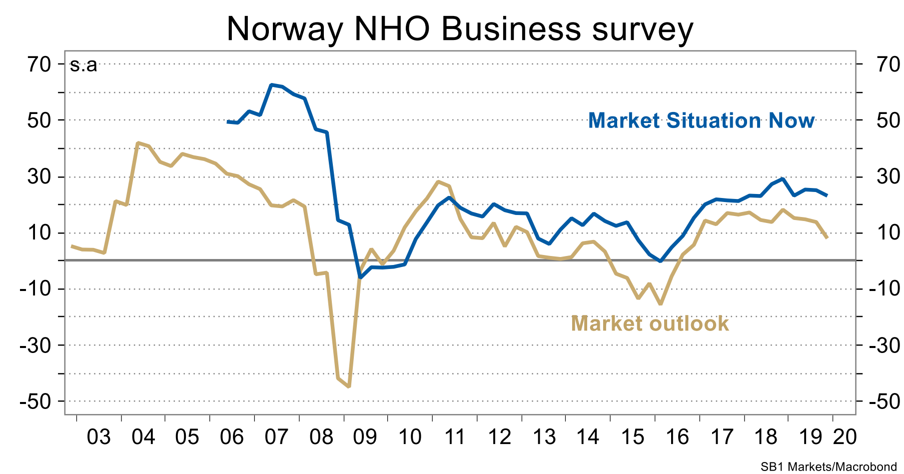
- The Network expects higher wage inflation in many sectors in 2019 vs 2018. Steepest in construction sectors, which is also reporting higher capacity constraints
- NoBa assumed wage growth at 3.3% in the Sept MPR, somewhat too optimistic?

NHO business survey confirms the slowdown, too

NHO economic outlook indicator edged down in Q4, a tad weaker (vs avg) than the Reg. Network





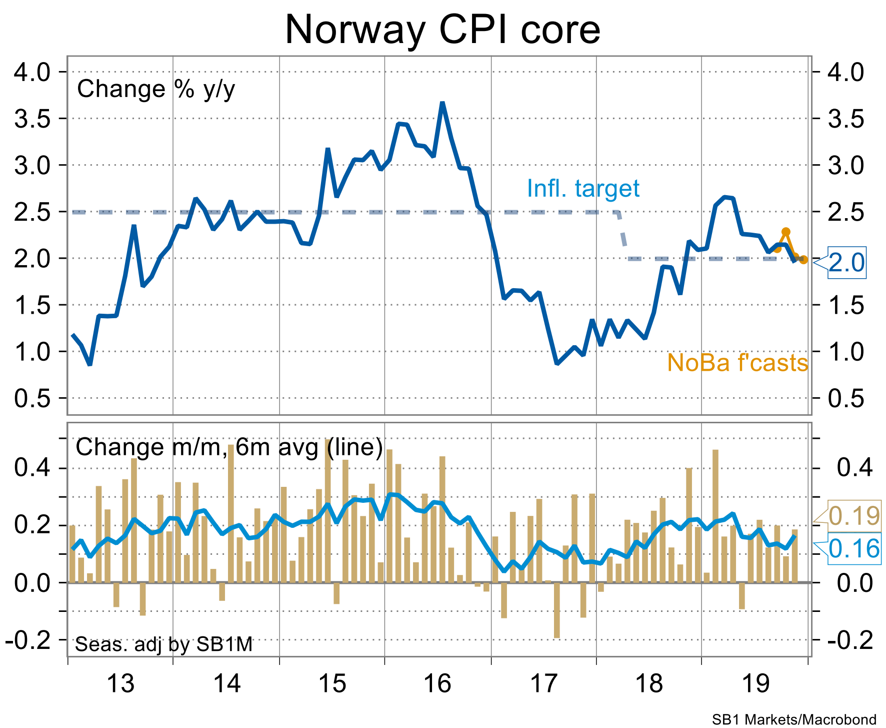


- The NHO (Confederation of Norwegian Enterprise) Q2 survey points to a slowdown to just above 2% GDP growth, down from the 2.9% speed in Q3
- NHO is the softest of Norwegian business surveys (not all have released Q4 figures), marginally weaker than Norges Bank's Q4 Regional Network

SpareBank 1 MARKETS

Core inflation ticked down to 2.0% in Nov, close to expectations

Core CPI inflation has softened somewhat the past 6 months. Total inflation slowed to 1.6%



- CPI-ATE (ex. energy and taxes) rose 2.0% y/y in November, from 2.2%, 0.1 pp above our f'cast and in line with consensus and Norges Bank's estimate from the Sept MPR
  - » CPI-ATE rose 0.2% m/m (seas adj), marginally above the 6 m avg. The annual rate was brought down by a steep rise in Nov last year
  - » Recreation & culture, furnishing and housing boosted inflation this month. Lower prices on clothing and footwear (Black Friday?) dampened price growth
  - » Imported goods are up just 0.9% y/y, the NOK depreciating points to somewhat higher imported inflation, but no take off. Domestic goods & serv. up 2.6%, due to wage inflation above 3%, slow productivity growth and capacity to increase prices, as demand is not weak
- Total CPI growth slowed to 1.6%, from 1.8%, close to expectations. Annual inflation is dragged down by electricity prices, which are declining y/y (but rose m/m in Nov, lifting monthly inflation)
- **Implications**
  - » Core inflation is at the price target and close to Norges Bank's f'cast from September. Thus, inflation will probably not contribute to any substantial changes in the bank's new interest rate path on Dec 19.
  - » No significant market reaction, NOK strengthened marginally following the release

SpareBank 1 MARKETS

No substantial outliers in Nov, recreation & culture rose more than expected

Core CPI prices increased by 0.2% m/m, in line with our f'cast

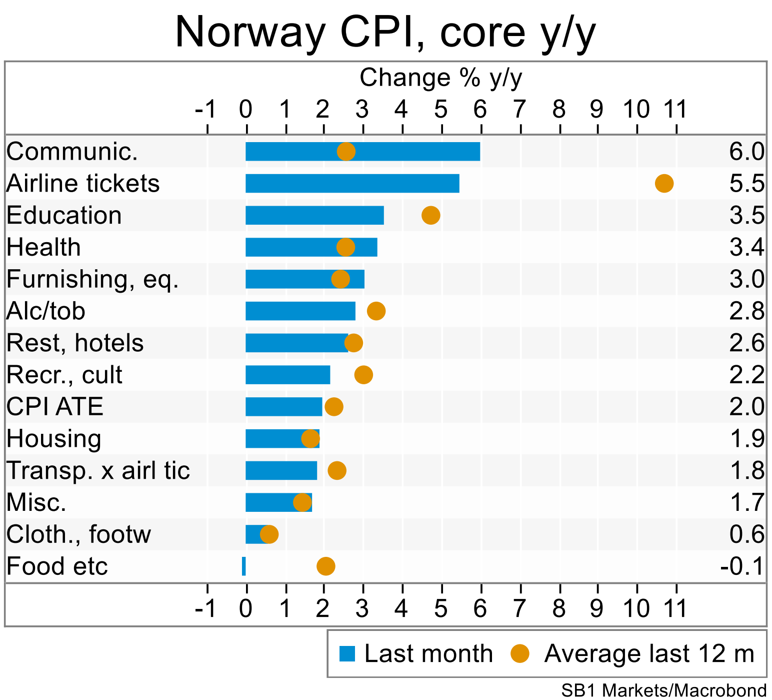
		Change m/m, seas. adj			Change y/y			Contribution, pp		
Nov-19	Weight	Out-	SB1M	Dev.	Last	Out-	SB1M			Dev. vs
CPI ATE	%	come	f'cast	pp	month	come	f'cast	m/m	y/y	f'cast
Food, non alc bev	12.5	-0.0	0.3	-0.3	1.1	-0.1	0.3	-0.01	-0.01	-0.04
Alcohol, tobacco	3.9	0.3	0.2	0.1	2.9	2.8	2.7	0.01	0.11	0.00
Clothing, footwear	4.9	-0.4	0.1	-0.5	0.9	0.6	1.1	-0.02	0.03	-0.02
Housing x. energy	20.1	0.1	0.2	-0.1	1.9	1.9	2.0	0.03	0.38	-0.01
Furnishing	6.6	0.5	0.2	0.3	2.6	3.0	2.5	0.03	0.20	0.02
Health	3.2	0.1	0.2	-0.1	3.7	3.4	3.4	0.00	0.11	-0.00
Transp. ex. gas, airl. tick	12.0	0.1	0.2	-0.0	1.8	1.9	1.9	0.01	0.22	-0.01
Airline tickets	1.2	2.0	2.0	0.0	14.6	5.5	5.3	0.02	0.06	0.00
Communication	2.2	0.2	0.0	0.2	5.7	6.0	5.8	0.00	0.13	0.00
Recreation, culture	11.9	0.5	0.2	0.4	1.6	2.2	1.8	0.06	0.26	0.05
Education	0.5	-	-	-	3.5	3.5	3.5		0.02	0.00
Restaurants, hotels	6.2	0.1	0.3	-0.1	2.5	2.6	2.8	0.01	0.16	-0.01
Other	8.8	0.2	0.0	0.2	1.7	1.7	1.4	0.02	0.15	0.02
CPI-ATE	94	**0.2**	**0.2**	-0.0	**2.2**	**2.0**	**1.9**			
Norges Bank est.			*0.1*		*2.3*		*2.0*			
Imported	33	0.1	0.1	-0.0	1.0	0.9	0.9	0.04	0.28	-0.00
Domestic	61	0.2	0.2	-0.0	2.8	2.6	2.4	0.14	1.56	-0.01
Energy, housing	4	1.8	5.0	-3.2	-3.5	-4.1	0.5	0.07	-0.16	-0.13
Energy, transport	4	2.7	-1.0	3.7	-2.9	-1.7	-5.2	0.10	-0.06	0.13
CPI Total	101	**0.3**	**0.4**	-0.1	**1.8**	**1.6**	**1.7**	0.27	1.66	-0.08

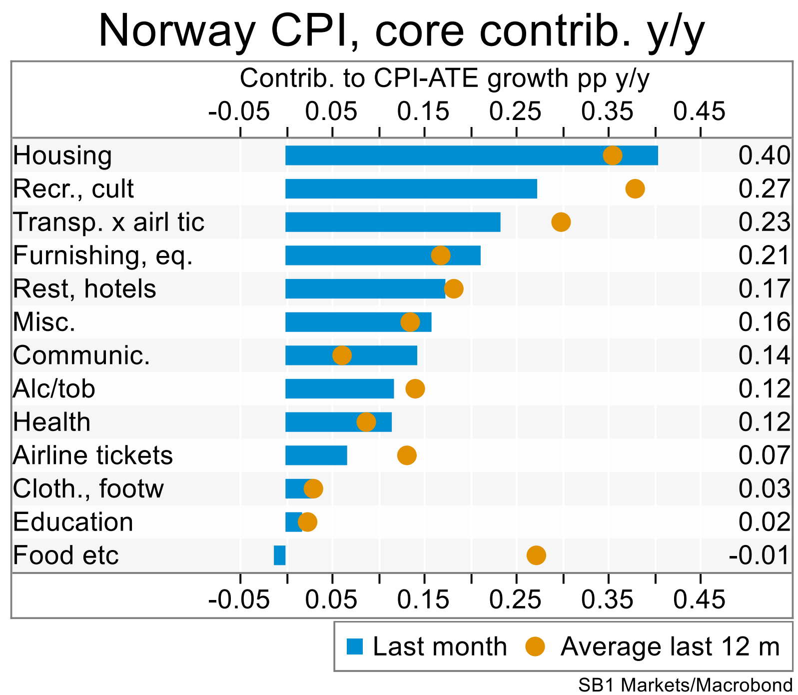
- Food prices were unchanged m/m and fell 0.1% y/y, 0.04 pp weaker than we expected
- Airline ticket prices are ridicolously volatile. This time prices rose by 2% m/m, as we f'casted!
- Prices on recreation and culture increased more than we expected, lifting y/y inflation by 0.3%
- **CPI-ATE increased by 0.2% m/m and 2.0% y/y, marginally higher than we expected**
- Imported prices are increasing much less than domestic, up just 0.9% y/y vs domestic at 2.6%
- Electricity prices rose 1.8% m/m (we expected 5%) but are still falling 4.1% y/y, a 0.16 pp drag on total inflation
- Headline inflation slowed to 1.6%, from 1.8%m we expected 1.7%

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 recreation/culture prices are boosting core annual inflation

Prices are increasing in all sectors x food, which have slowed substantially the past months

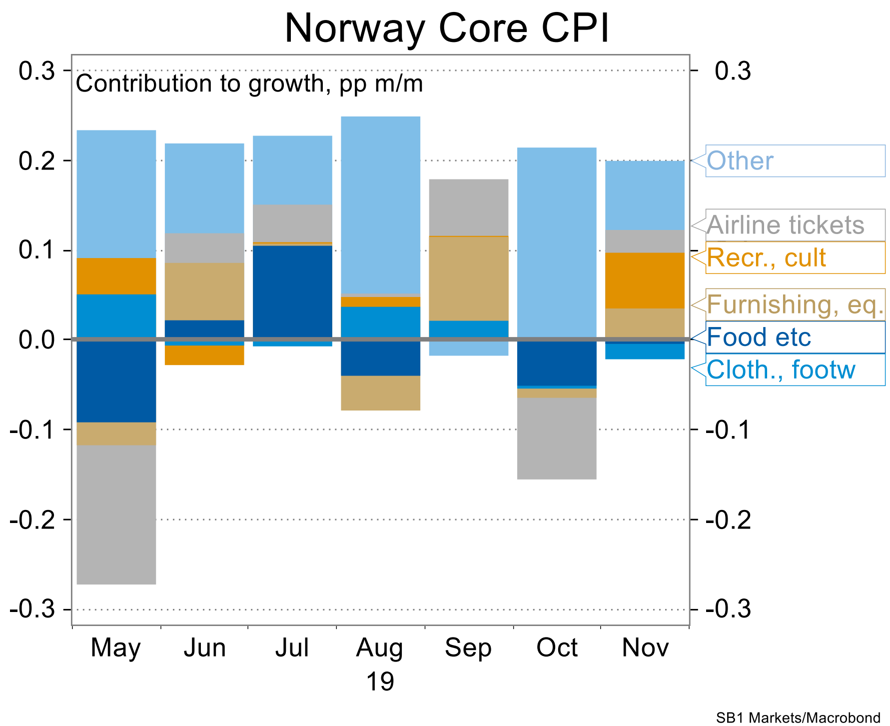


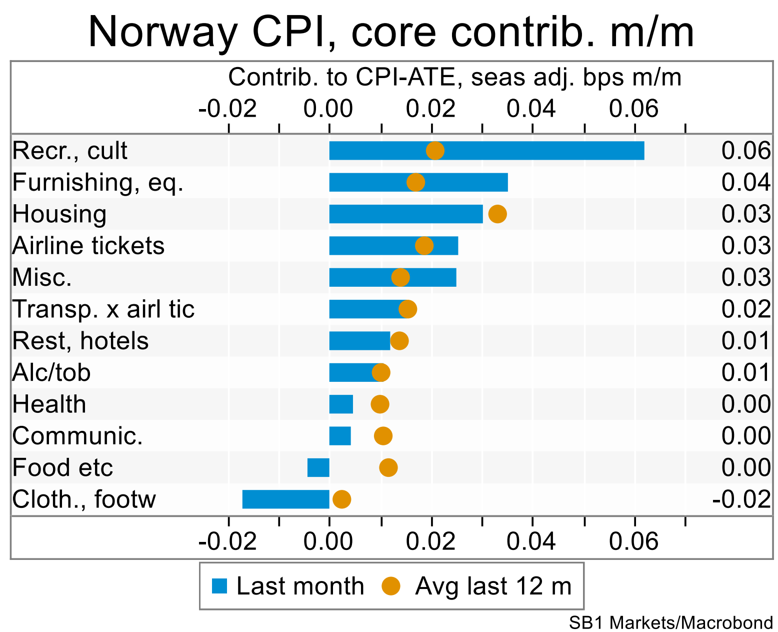


- Airline tickets are up 5.5% y/y, which gives a 0.1 pp contribution on the annual rate. Housing (rent etc) contributes the most, by 0.4 pp, followed by recreation and culture with a 0.3 pp boost

Recreation, housing, furnishing lifted monthly inflation

Lower prices on clothing & footwear and food sent inflation down, surprisingly

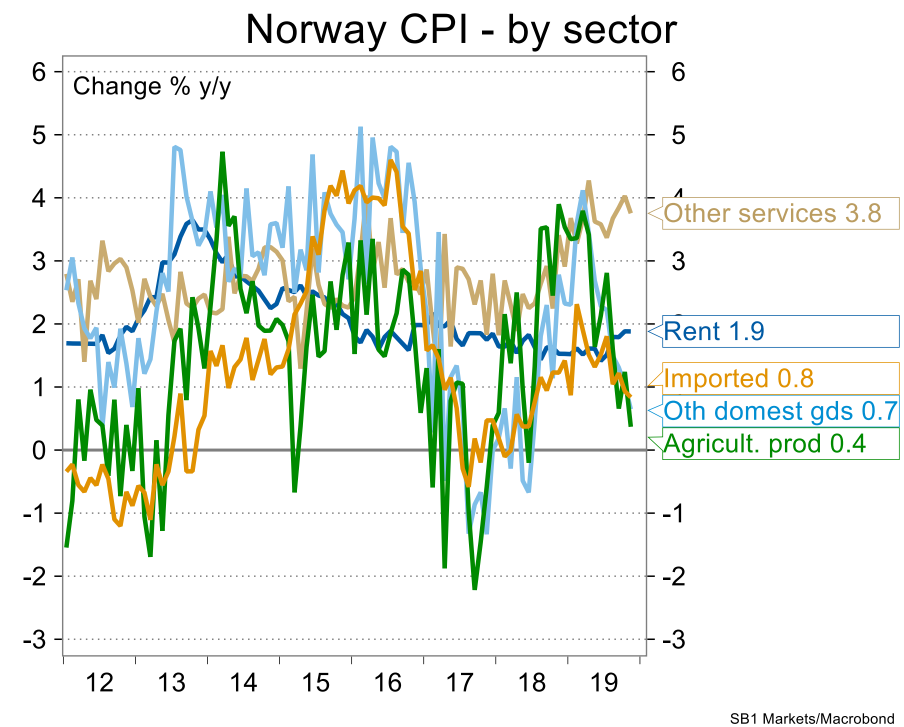


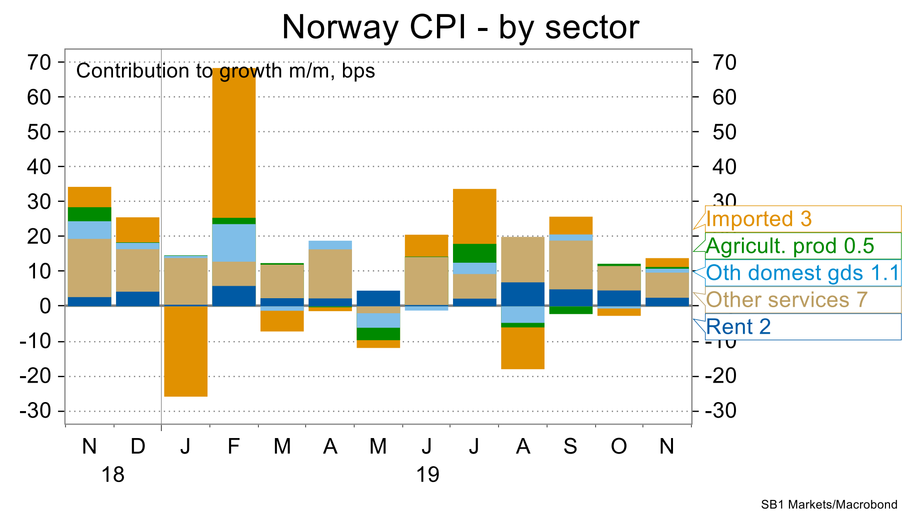


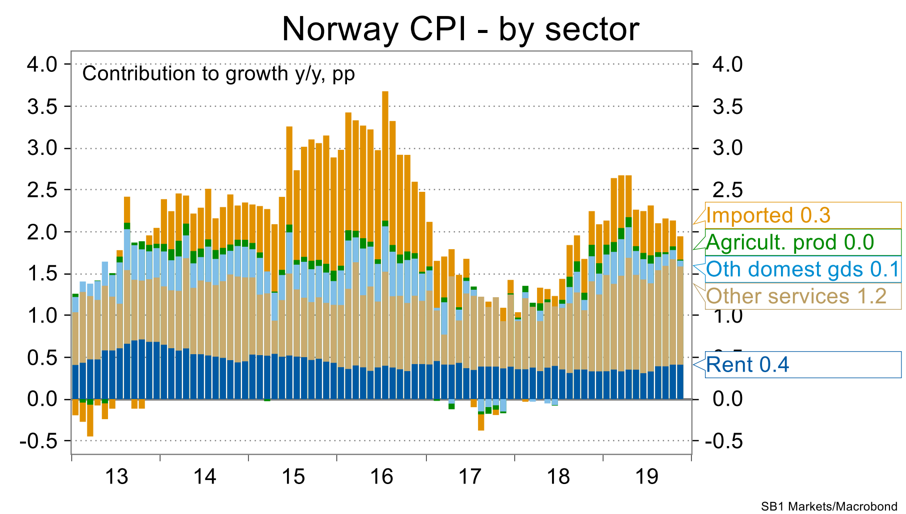
- Prices rose m/m in 10 sectors in Nov, declined in just 2
- Black Friday clothing sales may have pulled prices down? These effects may not be fully incorporated into the seasonal adjustments yet

No acceleration in imported inflation, domestic services are soaring at 3.8%

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



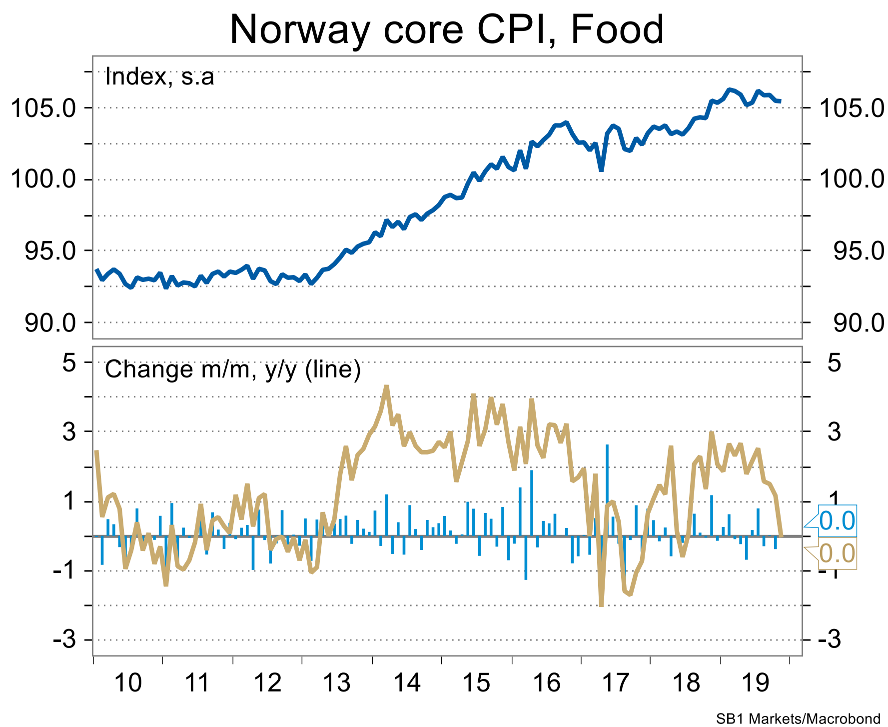


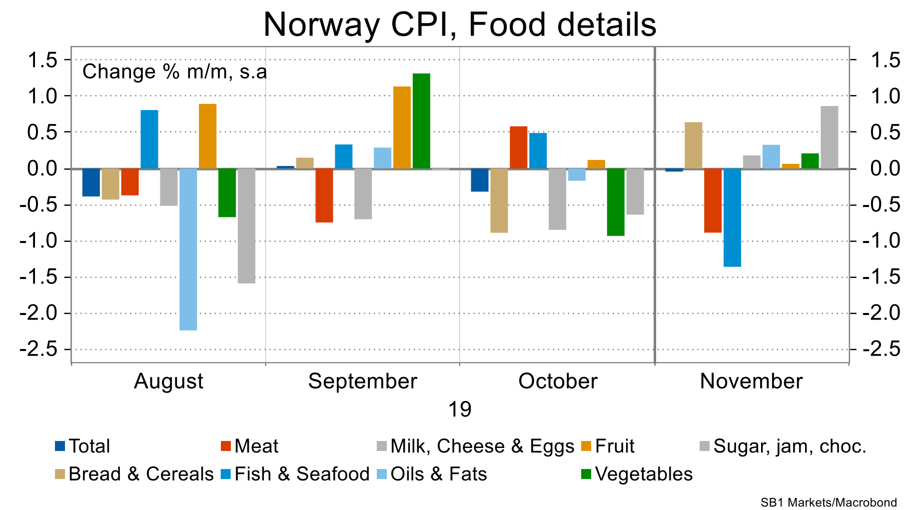


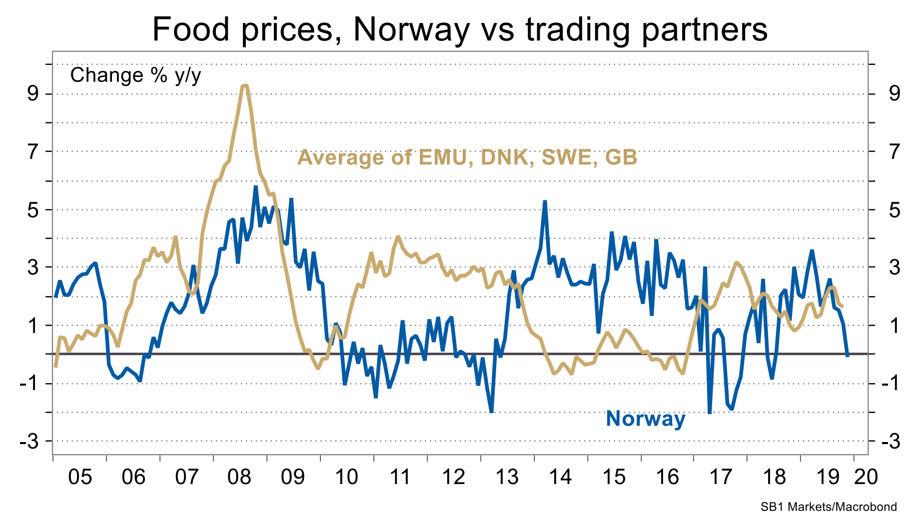
- Price growth in services is up 3.8% y/y. Other domestic goods and imported goods have slowed, after accelerating in 2018. Rent inflation has picked up the past months, to 1.9% y/y
- The NOK depreciation has lifted import prices but the impact has been rather modest, we expect somewhat more

Food prices have slowed, trending flat the past year

Discounts on chocolate and sugar have been larger than usual this autumn (not in Nov)



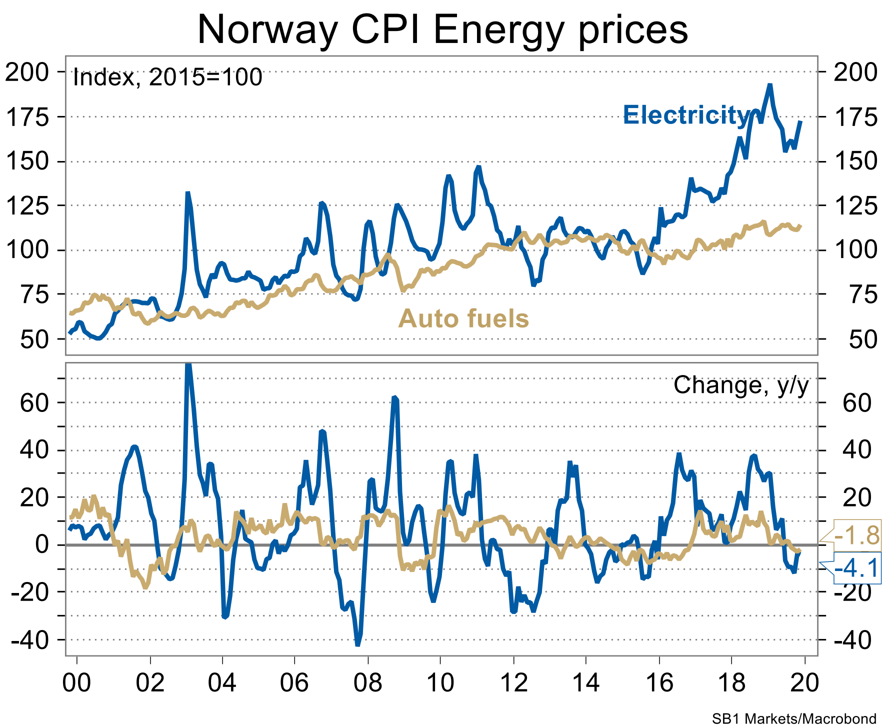


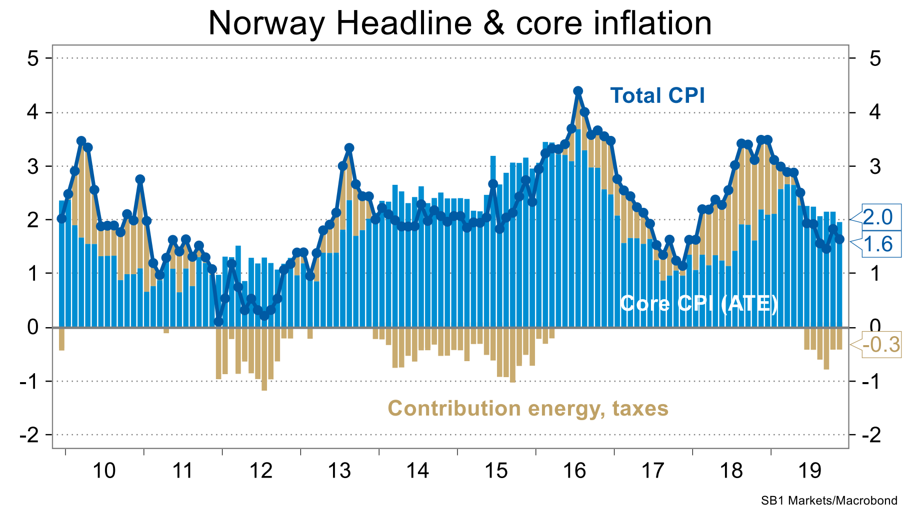


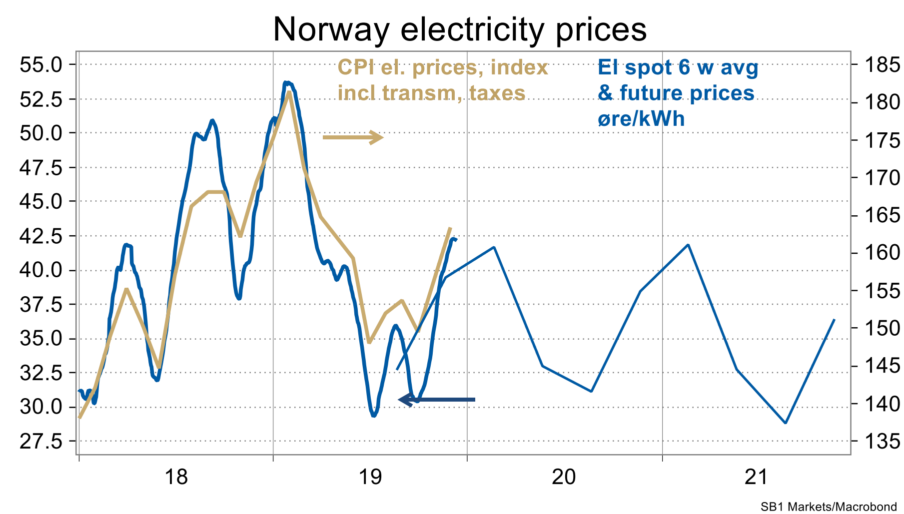
- Prices were flat m/m in Nov, we expected a 0.3% uptick, after a slowdown the prior months. Prices have stalled the past year
- This months, prices on sugar bounced back up, after large discounts in Oct/Sept/Aug. Fish&seafood prices dropped, as did meat
- Food prices are now increasing at a slower pace than in our neighbouring countries

The negative electricity impact on inflation has bottomed out

Electricity prices rose in Oct & Nov, contribution on total CPI still at -0.3% y/y (was 7% in Sept)





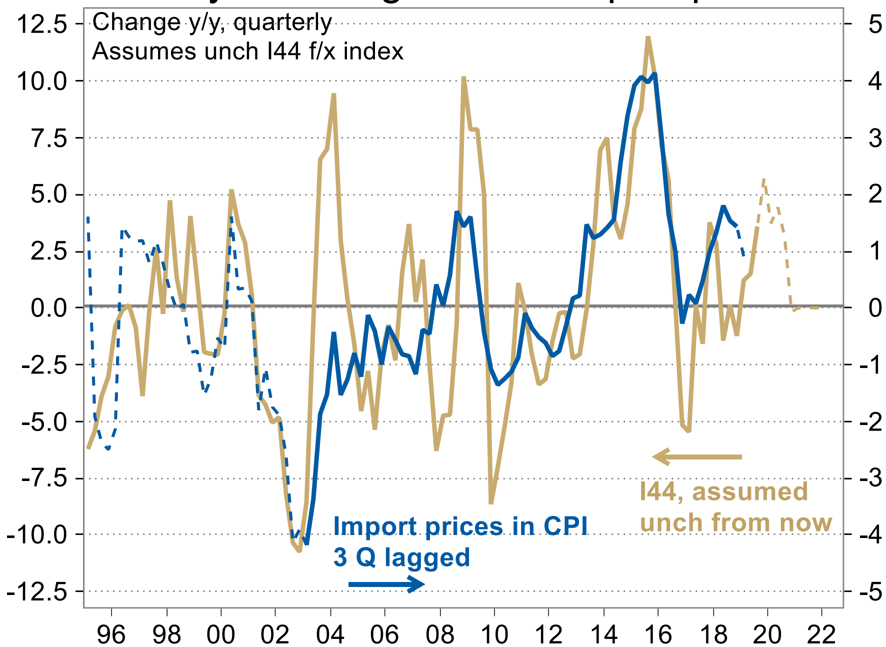


- In 2017/18 the surge in electricity prices lifted the headline CPI, reducing real disposable income significantly. This effect has been put in reverse in 2019, as electricity prices have fallen sharply. The past 2 months, prices have turned up
  - » Spot & near term future prices have stabilized. The forward prices are indicating steady prices the next few months. Thus, the negative contribution from lower el. prices will probably subside
- Auto fuel prices are close to neutral vs. headline CPI

A slightly higher but still modest impact from the weak NOK?

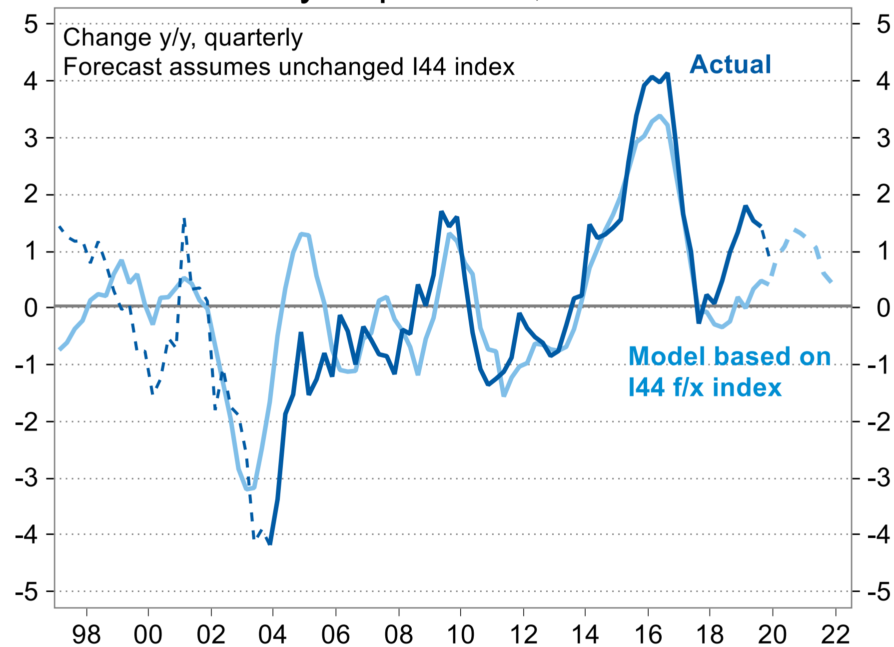
The model indicates imported inflation up to 2% the coming months/quarters

Norway Exchange rate & import prices



SB1 Markets/Macrobond

Norway Import CPI, f/x-model



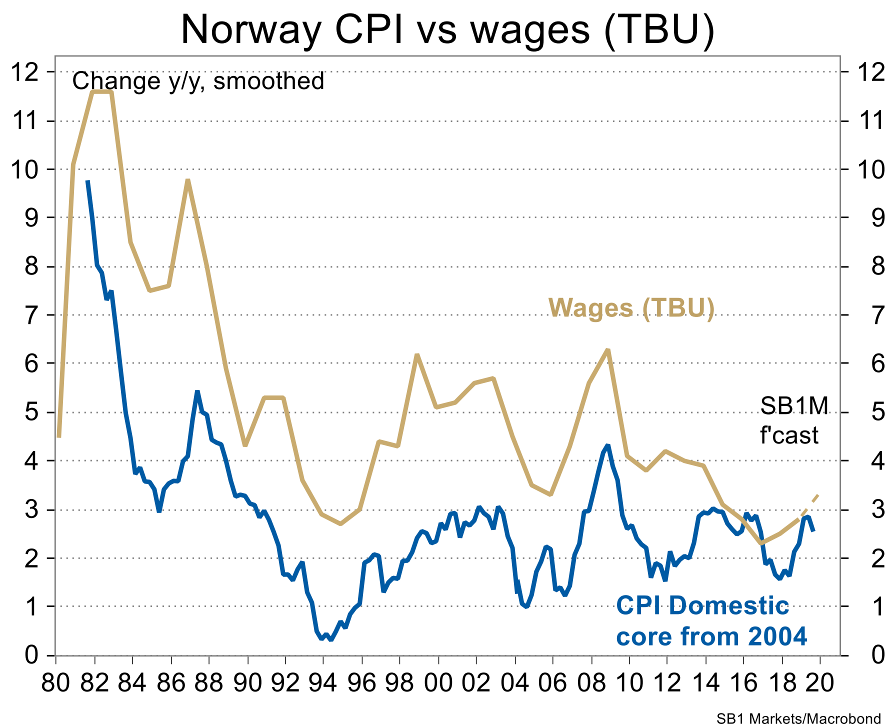
SB1 Markets/Macrobond

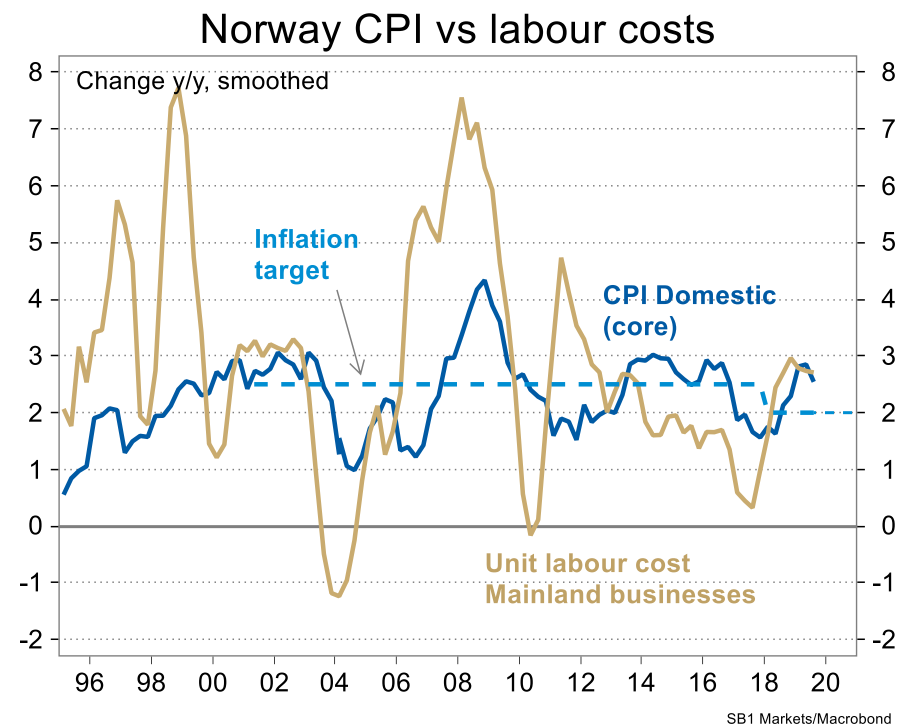
- In general, retail demand is so weak that it does not seem likely that the retailers are able to push up their margins like they have before. It does not seem likely that prices are accelerating abroad

SpareBank 1 MARKETS

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

Wage inflation is on the way up. Unit labour cost up some 2.7% y/y in Q3

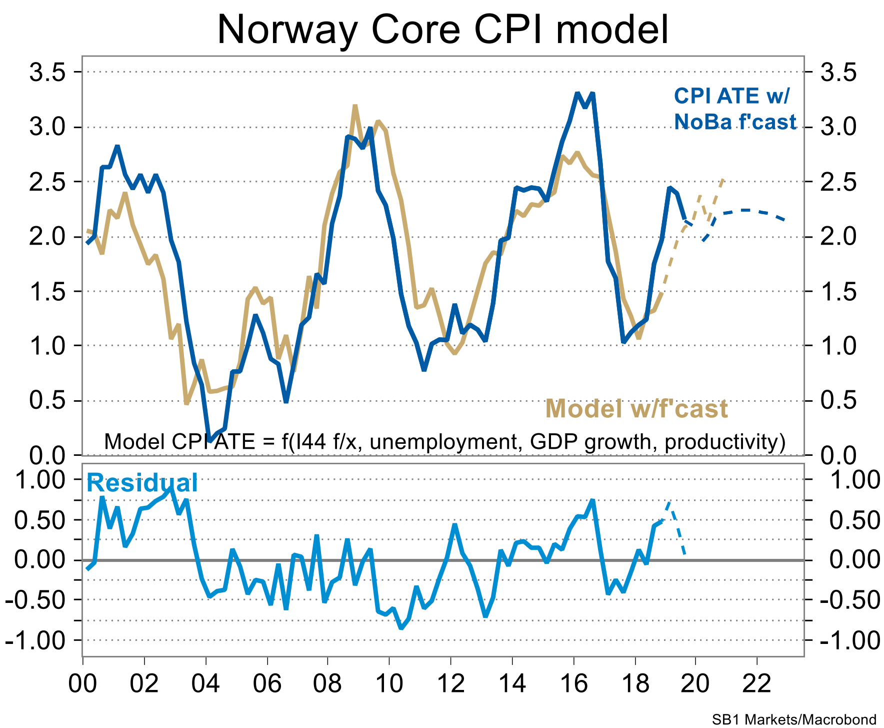




- Wage inflation is increasing and is now approaching 3%, will probably edge up to 3.2% in 2019
- Productivity growth remains meagre
- (Underlying) Unit labour costs inflation up to 2.7% y/y in Q3 (smoothed), a marginal slowdown from Q2 and unchanged from one year ago – and from below 1% in 2017

The outlook: Core CPI inflation at/close to peak now?

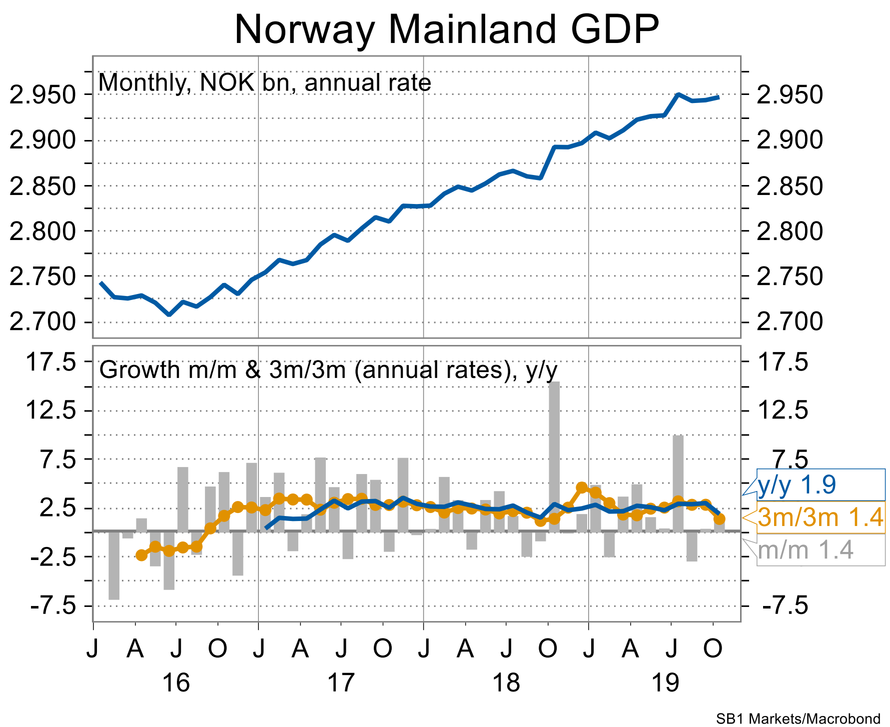
Actual inflation close to the model forecast now – it suggest a peak at 2.5% in late 2020

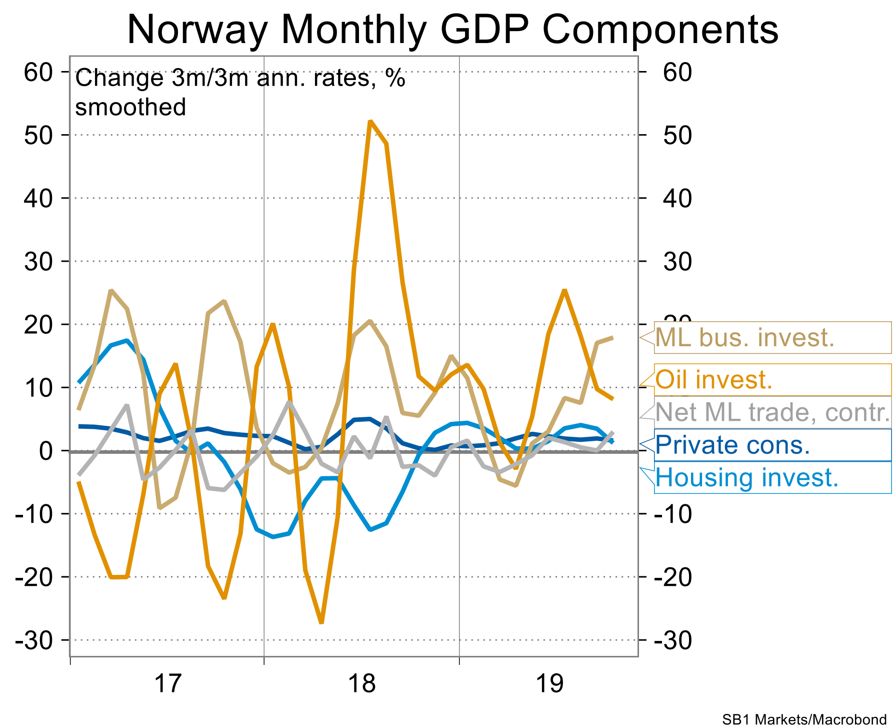


- Core CPI growth was running well above the model f'cast in Q1 and Q2. In Q3, inflation and so far in Q4, inflation has slowed, to 2.1% now, just in line with the model Q4 f'cast
- The model, which includes unemployment, GDP and the NOK, signal a modest uptick in inflation the coming year, up to 2.4% in Q1 2020 and to 2.5% in Q4 2020
- Norges Bank expects core CPI to be running at 2.3% in 2019 and slow down to 2.1% in 2020 (Sept Monetary Policy report). Probably fair estimates

GDP growth up 1.4% 3m/3m annualized, Q4 is off to a soft start

Mainland GDP rose by 0.1% m/m in Oct, a tad weaker than expected

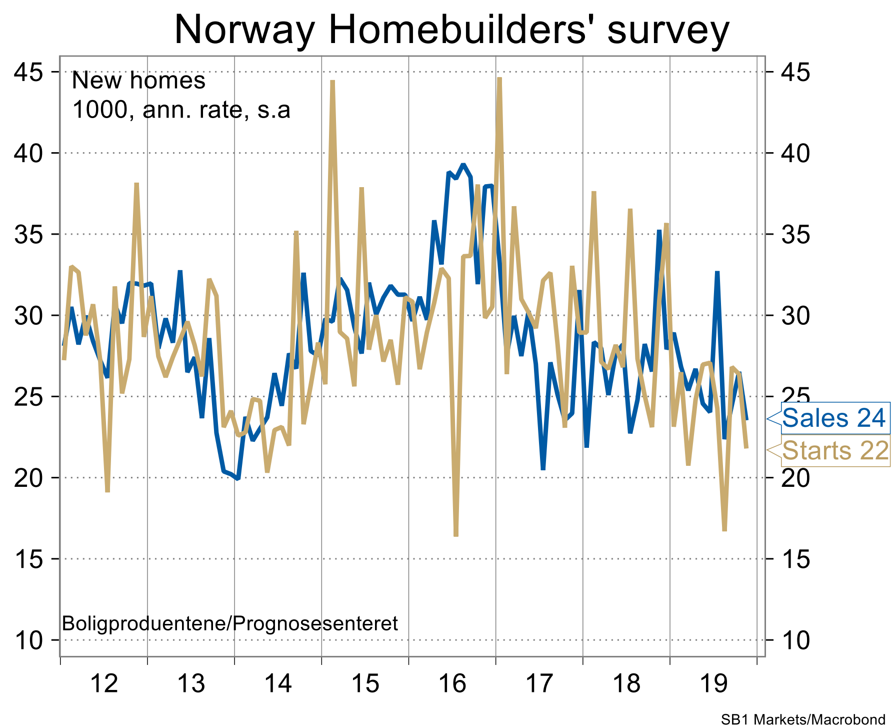


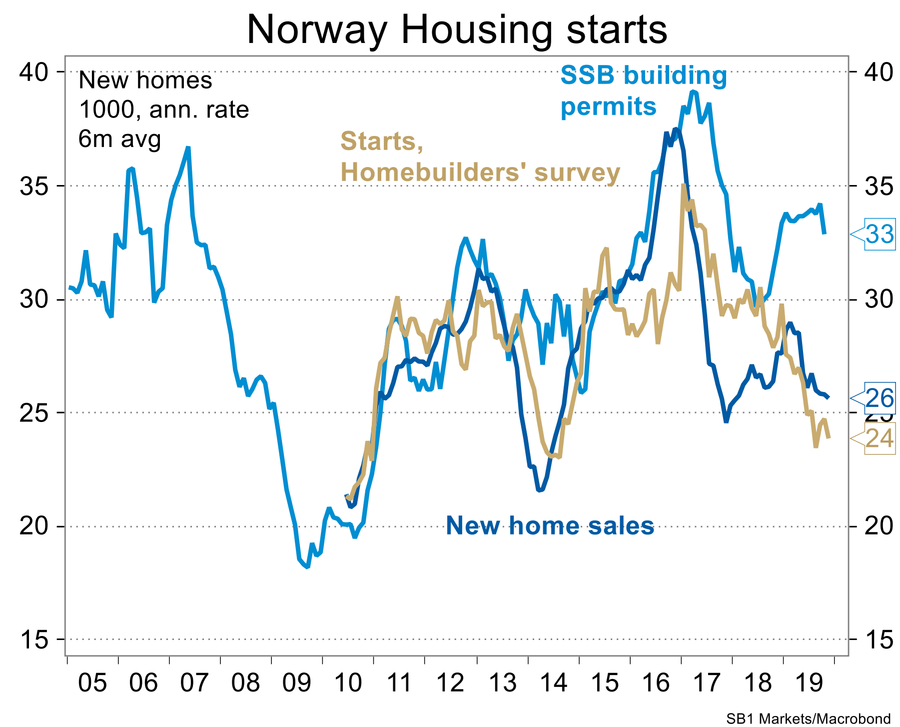


- Mainland GDP increased by 0.1% m/m in Oct (equalling a 1.4% annualized rate), we and consensus expected 0.2%. The monthly data are too volatile to give us any useful signals. Underlying growth slowed to 1.4%, measured 3m/3m, and the speed going into Q4 is just 0.2%
  - Norges Bank's implicit Q4 f'cast (from the Sept MPR) is 2.0% q/q annualized, growth will have to spike in Nov/Dec in order for this 'fcast to be reached
- On the demand side: Private consumption is growing modestly, at a steady pace. Mainl. business investments have been increasing strongly, peaking now? Oil investments slowed in Q3 but soared in Oct – and we expect strong growth in Q4 (and a sharp slowdown thereafter). Housing investments are growing modestly and are most likely cooling now. Mainland net trade is just marginally positive

Homebuilders report declining new home sales and starts

Both starts and sales fell in Nov, starts may have stabilized, at a far lower level than SSB reports





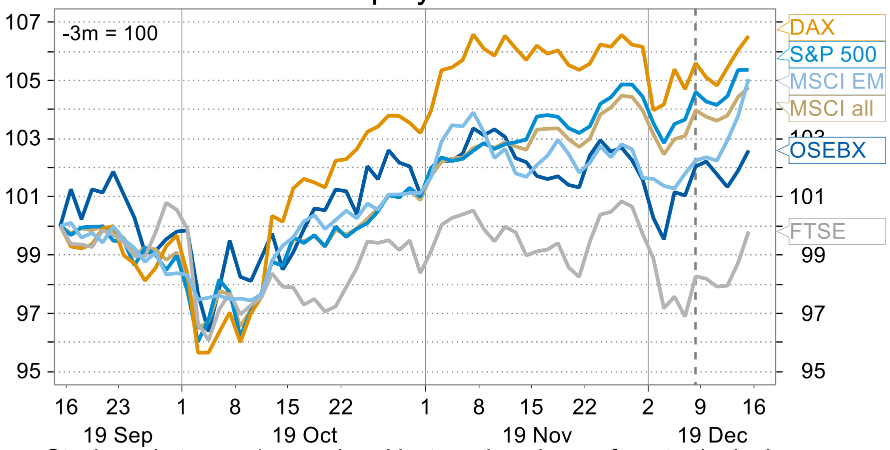
- The Homebuilders’ housing starts (seasonally adjusted) fell to an annual rate of 22’ in Nov, down from 26’ the prior month. Starts have fallen steeply since early 2017, according to the Homebuilders, stabilized the past 3 months. The gap to SSB’s starts(permits) data is much wider than usual (33’ vs. 24’, 6m avg), although the SSB reported a drop in October. Student homes, which are only included in the SSB figures, explains some. Thus, our take is that ordinary housing starts are turning slowly down
- New home sales ticked down to 24’ in Nov. The 6m average has fallen since early 2019 and does 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

SpareBank 1 MARKETS

Stock markets climbed on the rumour, flattened on the fact

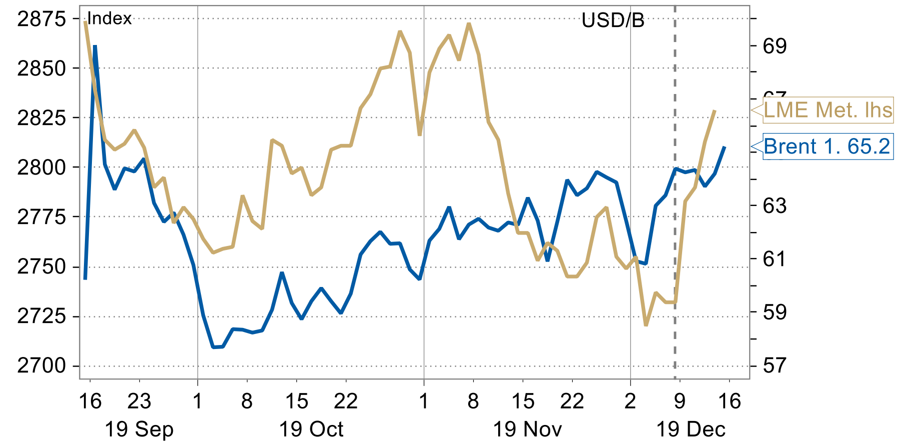
The US/China deal underwhelmed markets Friday. However, Boris J’s landslide victory pleased markets

Equity Indices



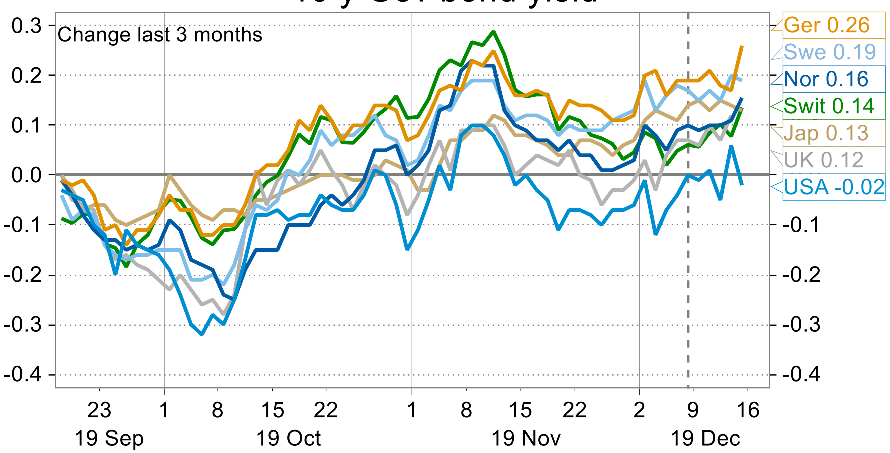
Stock markets rose ‘everywhere’ last week on hopes for a trade deal (which did not impress) and UK Tory win. Fed, ECB on hold helped too

Oil vs. metals



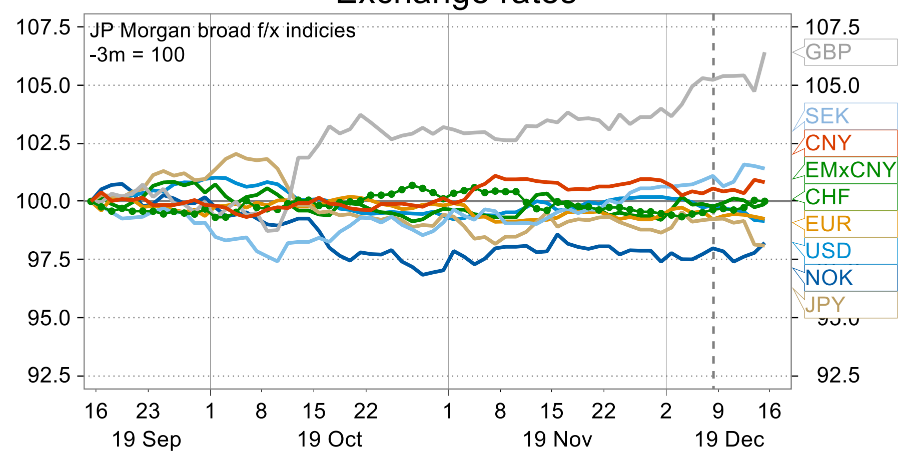
Oil price up on Opec/Saudi cut, then growth expectations. Metal prices have recovered most of the November decline

10 y Gov bond yield



Bond yields soared in UK & Europe as the risk for a do deal Brexit (now) was eliminated by the Tory landslide win. However, US yields fell Friday, markets were not impressed by the trade deal (or retail sales)

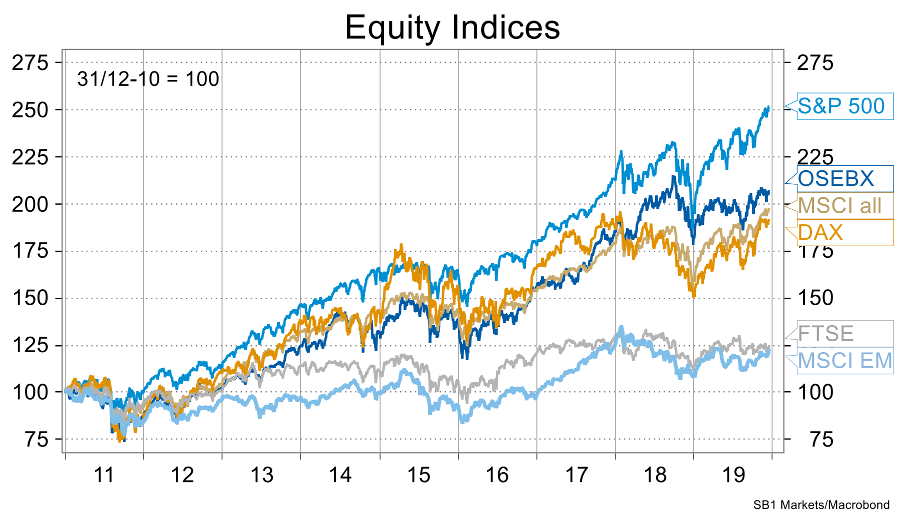
Exchange rates

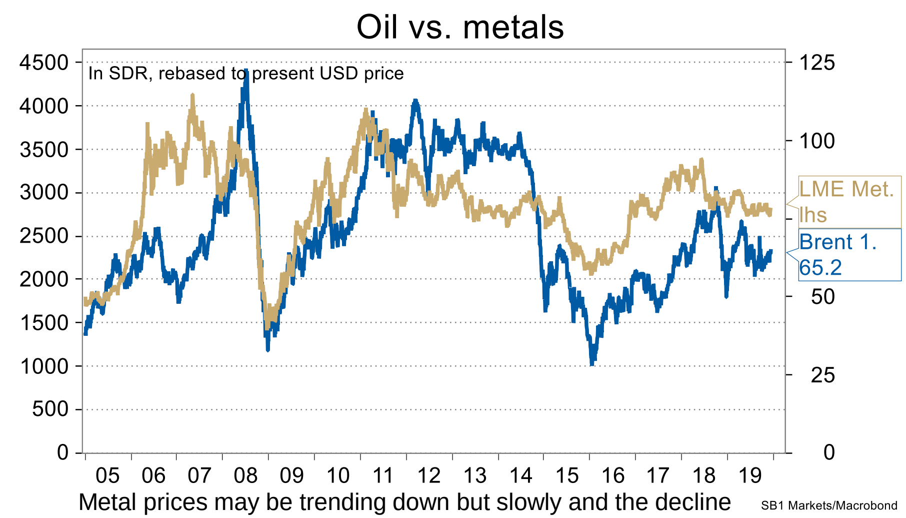


GBP climbed 1.5% on the Tory victory. CNY strengthened on trade deal hopes (but not on the ‘fact’), USD and JPY down

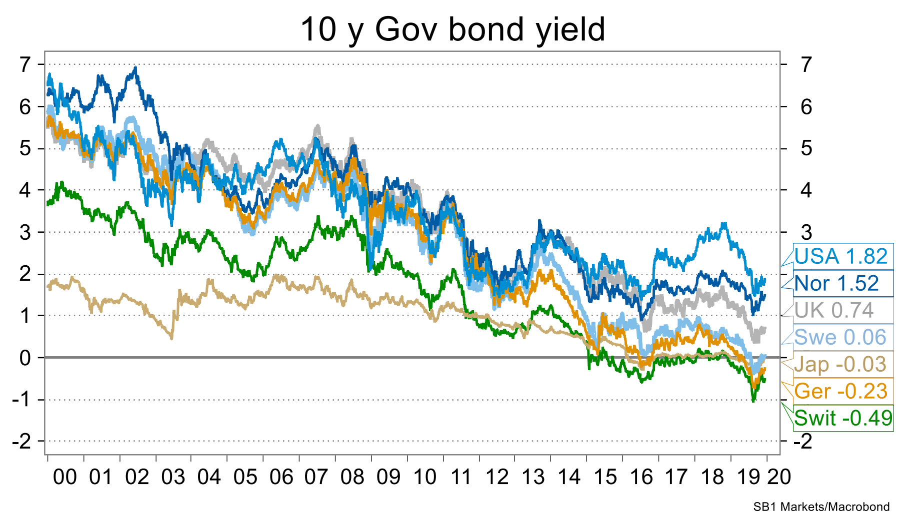
In the long run: US stocks at ATH, bond yields not that far above ATL

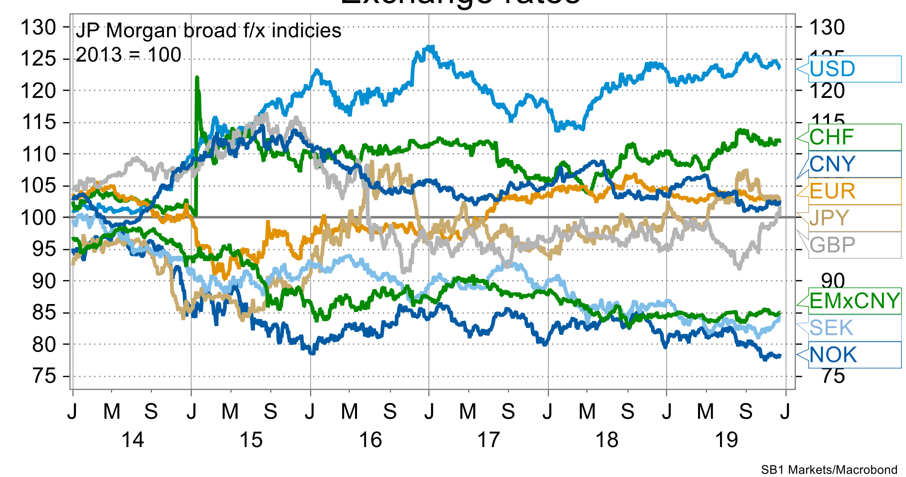
Raw materials have not followed equities up, neither have bond yields





Metal prices may be trending down but slowly and the decline from the local June 2018 peak is not large. Oil prices quite stable too

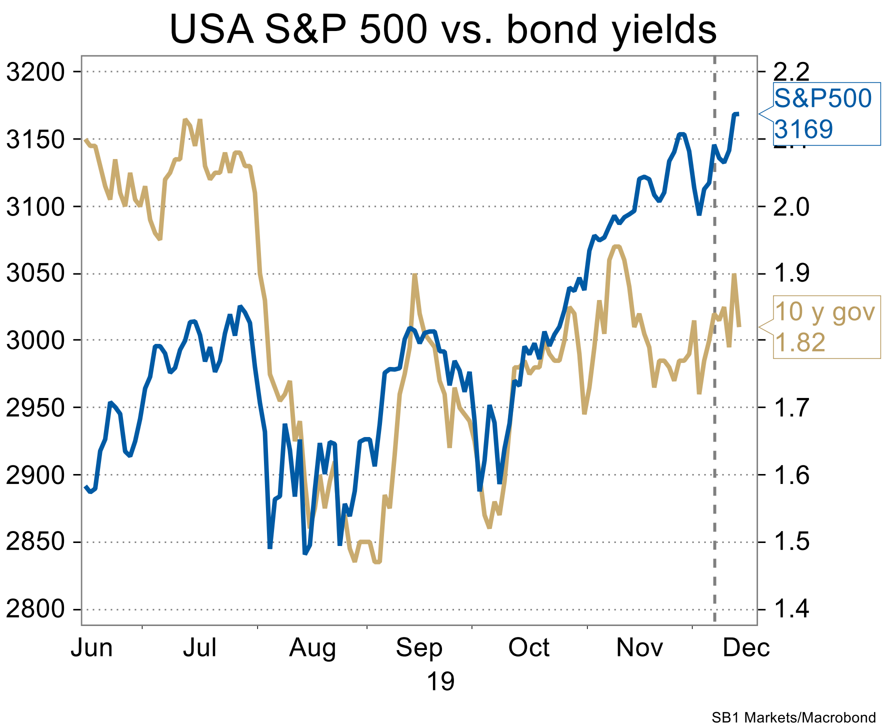


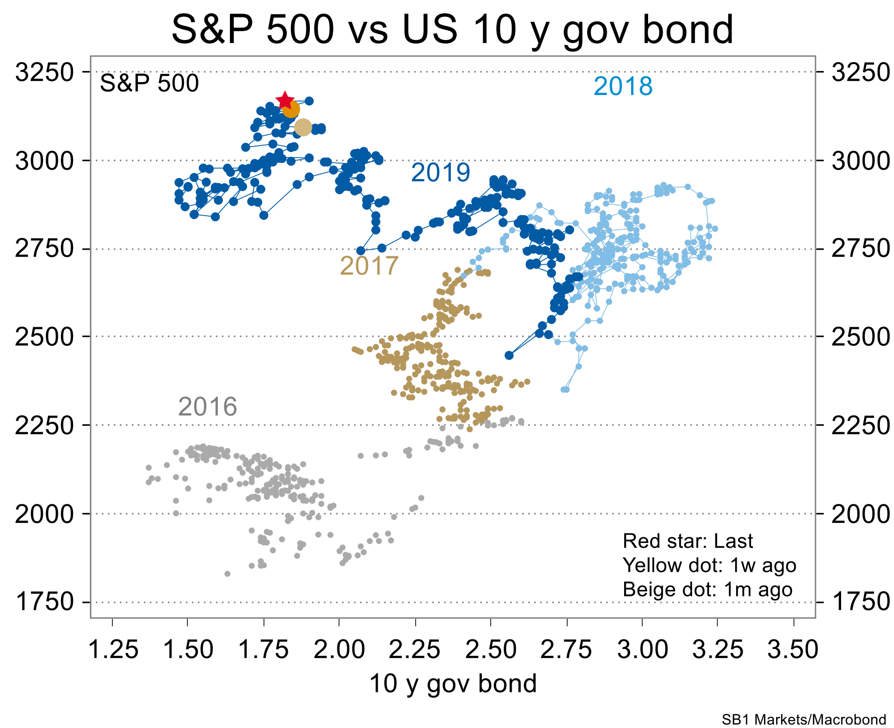


SpareBank 1 MARKETS

US: Stock markets are thriving, bond yields recovered too – until Friday

The US 10 y gov up 11 bps on trade deal hopes Thursday, then fell 8 bps on the 'fact' Friday

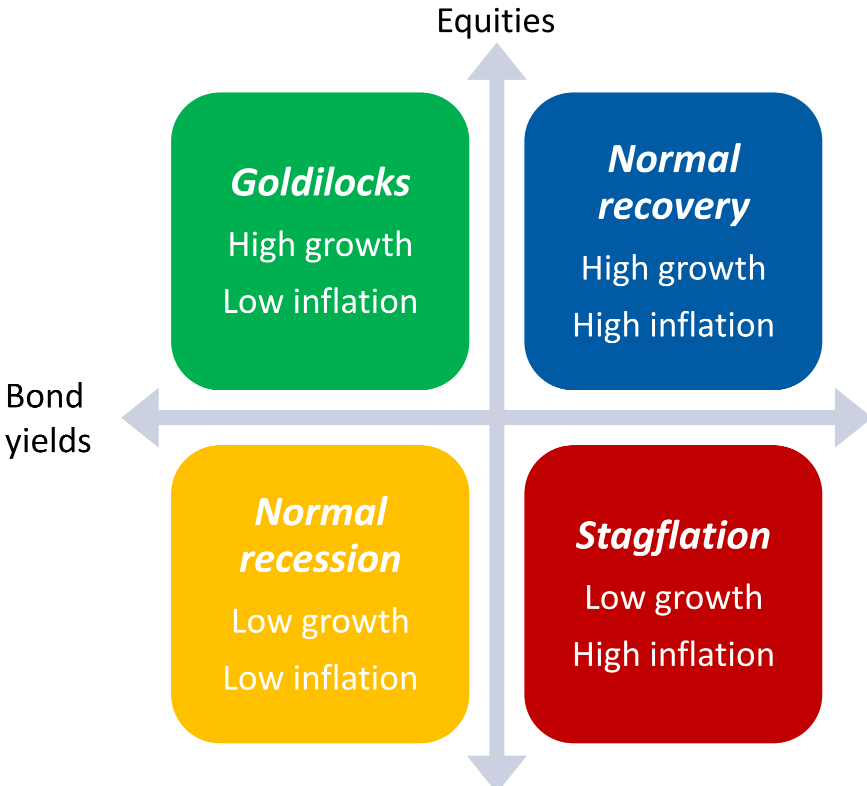


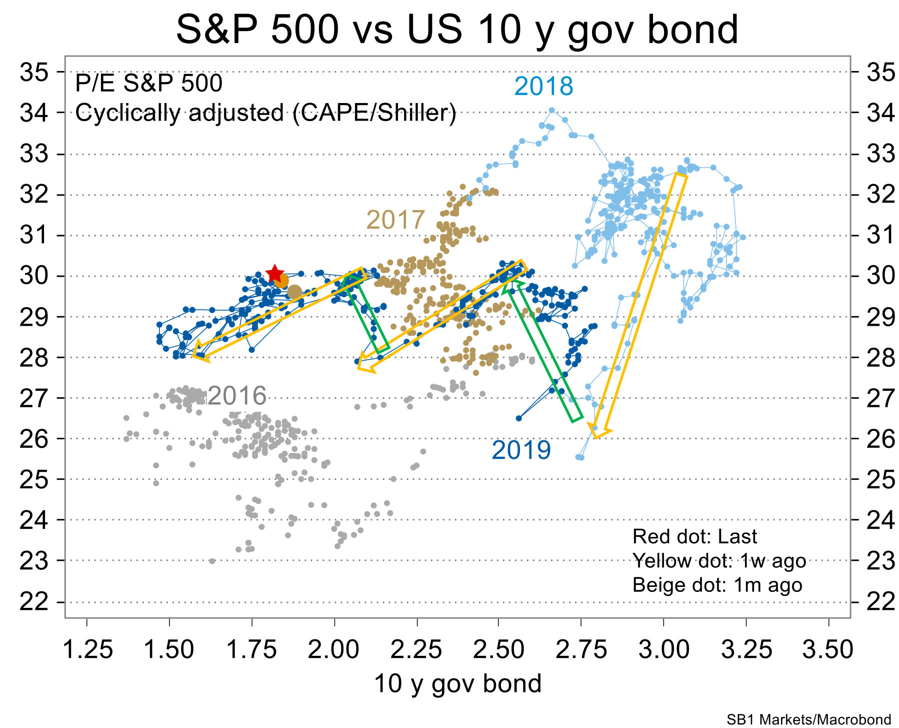


- Stock markets soared Thursday and Friday morning after Trump tweeted that the trade deal with China (the VERY BIG deal) was close to finalised but soured Friday afternoon as the details on the phase 1 deal (or perhaps lack thereof) did not impress markets. (Or just because a deal was fully discounted). The USMCA (aka NAFTA…) deal was accepted by Congress too. S&P was up 0.7% on the week
  - » Anyway, the US stock market is up 11.6% from the mid August trough, both due to somewhat better economic data globally and the de-escalation of the trade war
- Bond yields are up 35 bps from the late summer trough but fell 2 bps last week, following the 8 bps drop Friday afternoon, after the trade deal was announced

US markets mostly moving towards in the normal recovery direction since Aug

No significant changes last week – or last month. And 2019 was a 'Goldilocks', due to the Fed?



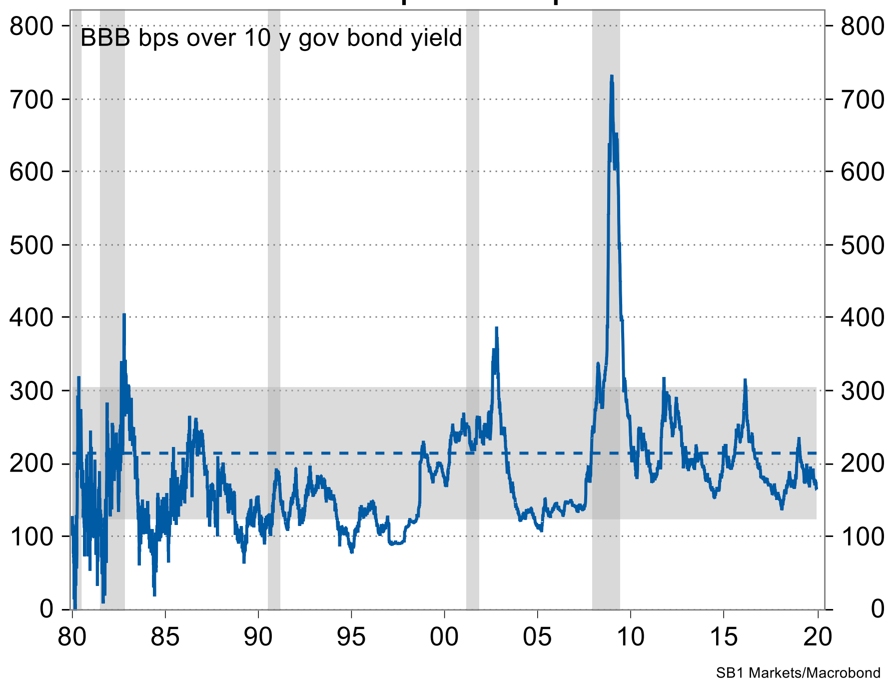


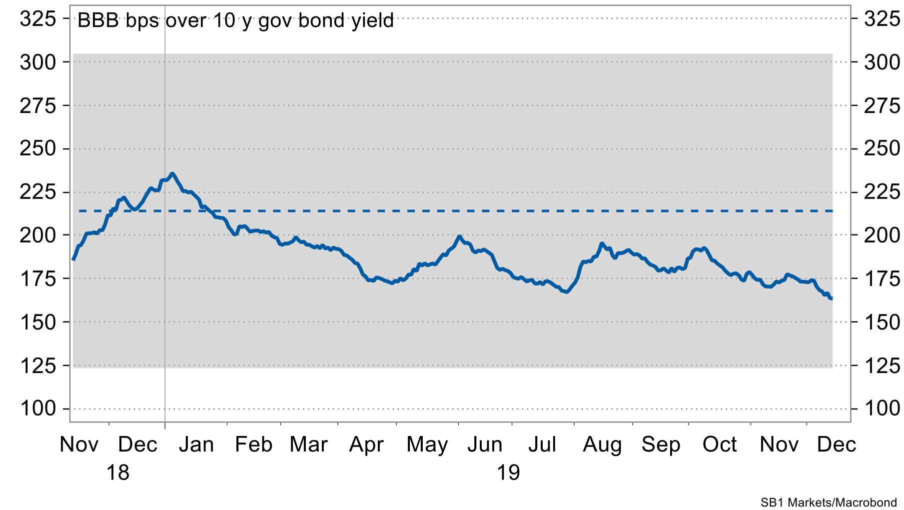
- Recent months, markets have been zig-zagging along with news on the trade war, most of the time along the 'normal recession/recovery' axis.
- We do not think a long term Goldilocks scenario is likely. Should yields decline substantially, it will be due to really weak economic news, which will not be good news for the equity markets. We are not that worried for the 'Stagflation' corner either; a take off in inflation without strong growth seems unlikely. Thus, the normal recession/recovery axis is the most likely – growth will be the main driver for both markets, not inflation.

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

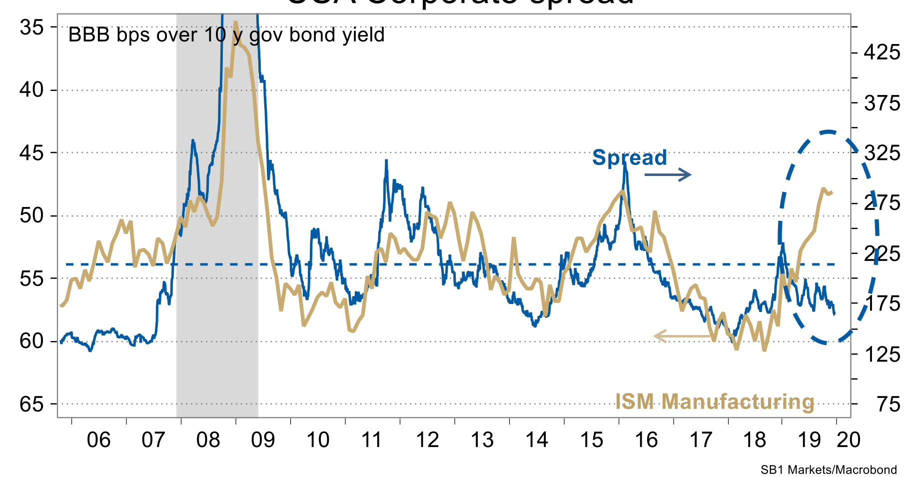
Spreads are <u>far too low</u> if the ISM or other surveys are correct; that is, *<u>if growth is slowing</u>*

USA Corporate spread



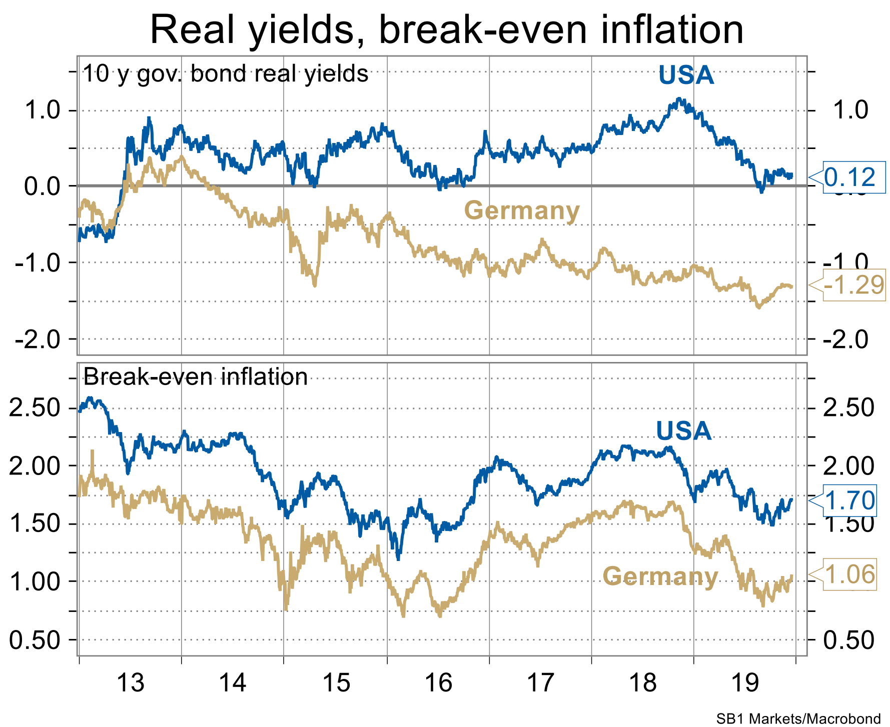


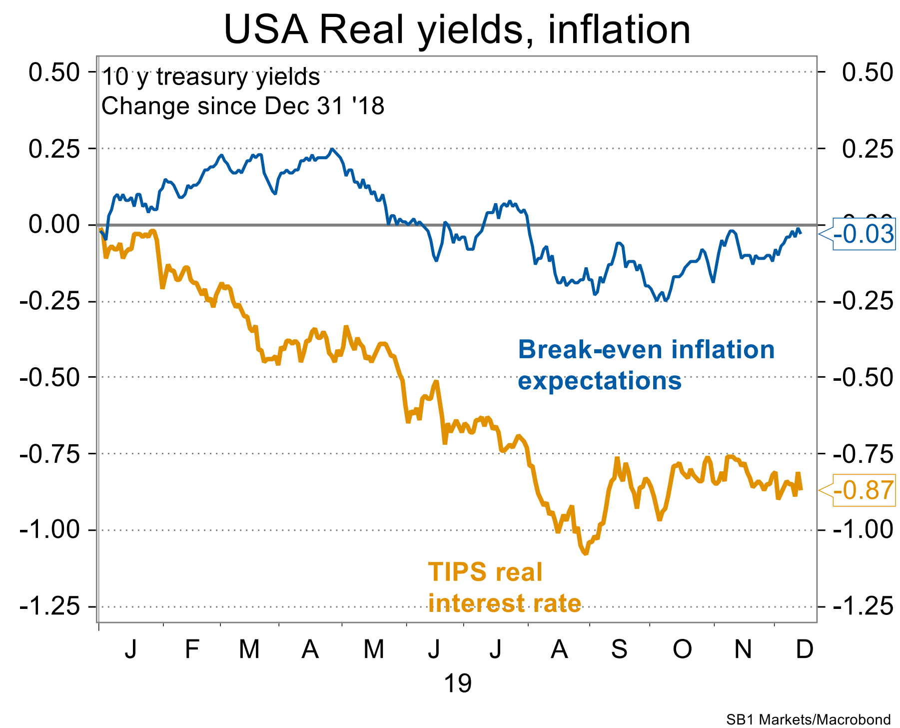
USA Corporate spread



US real rates and inflation expectations up last week, German real rate down

Still, over the past months, both US and German real rates and infl. expectations are trending up



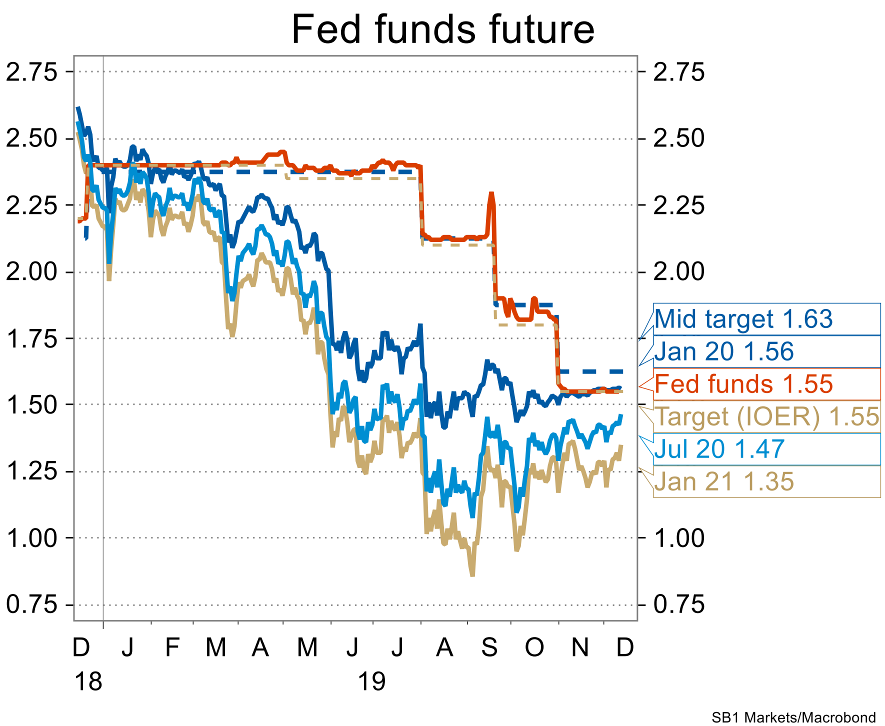


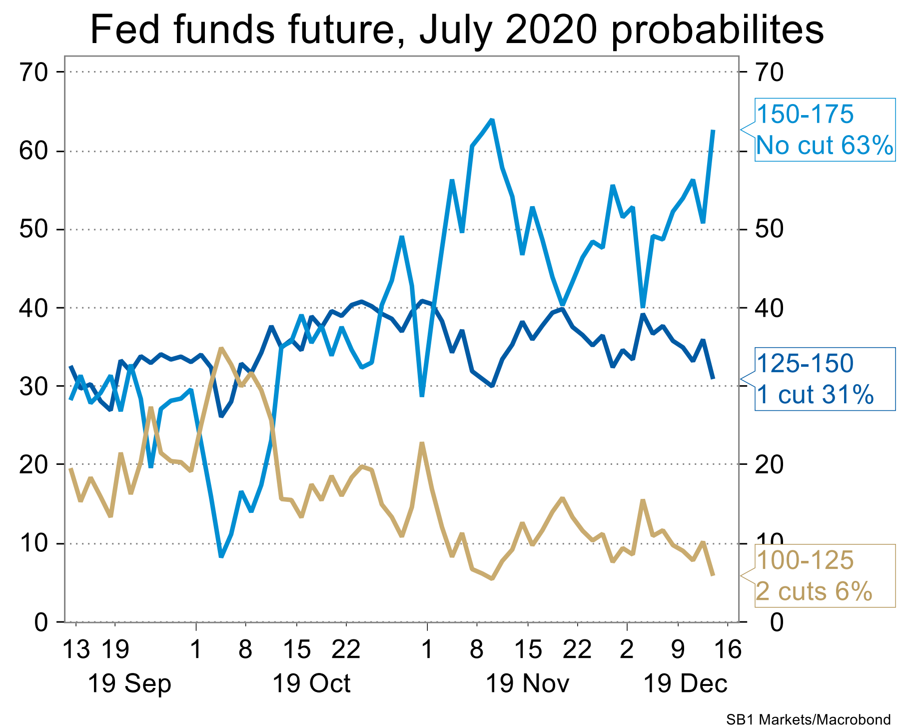
- Both real rates and break even inflation have been heading steeply down this year, in US and Germany. This autumn, both real rates and inflation expectations turned up, primarily due to hopes of a trade war solution and somewhat better economic data. The past weeks, inflation expectations have increased, while real rates have remained flat
- Last week, both US 10y inflation expectations and real rates were close to unch, first up, than down. Inflation expectations at 1.70% seems reasonable. The real rate remains very low, at 0.12%
- German inflation expectations continued upwards last week too (but no Lagarde shock), while real rates was unch. Both have probably bottomed out. However, the real rate at -1.29% is still too low, in the longer term. Inflation expectations at 1.06% is not that far off, although below the ECB's price target at close to 2% - and is exposed to changes in both monetary and fiscal policy

SpareBank 1 MARKETS

Expectations of a July 2020 cut reduced to below 40%, 80% by the end of '20

Fed funds futures climbed last week, supported by the trade deal and a Fed on hold



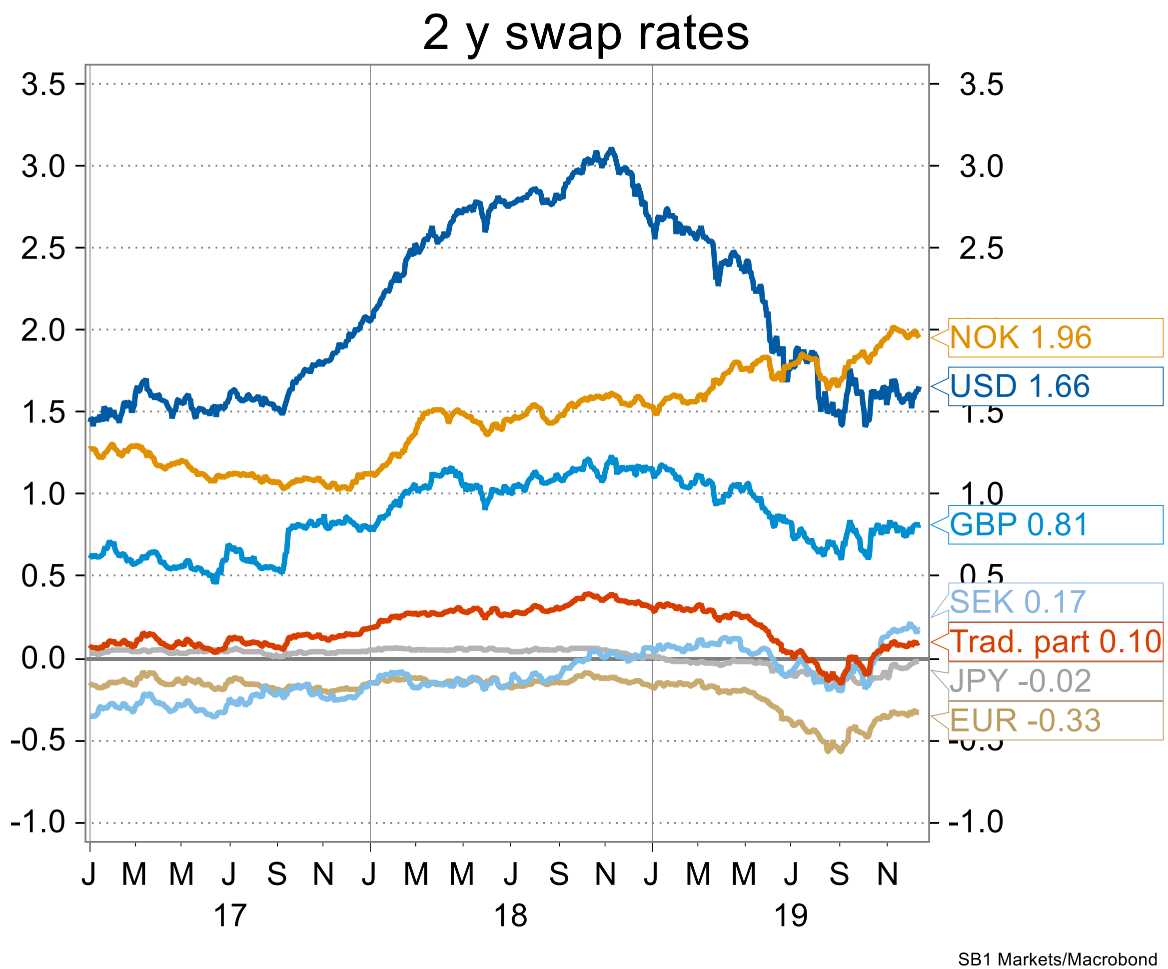


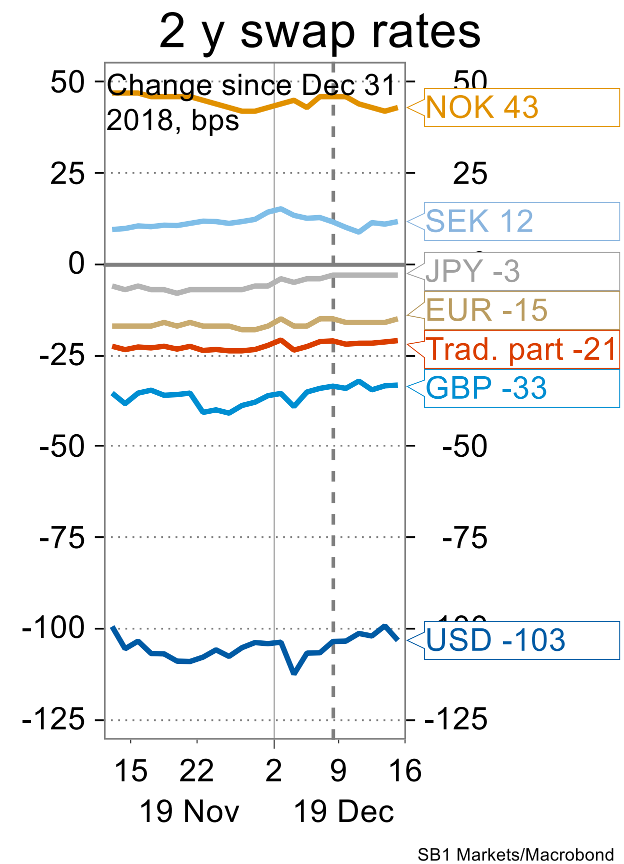
- More on the Fed's December meeting at this slide
- The actual Fed funds (daily clearing) rate remains close to the IOER (rate on bank's excess reserves at the Fed) at 1.55%, as the Fed has gained control on the short end of the curve by the measures taken late October
- Markets are more in line with the Fed's plans than in a long time. Markets are still expecting a cut by the end of 2020 (with some 80% probability). Probabilities of a cut in H1 have been reduced to below 40%

SpareBank 1 MARKETS

Short term rates have flattened/turned down the past month

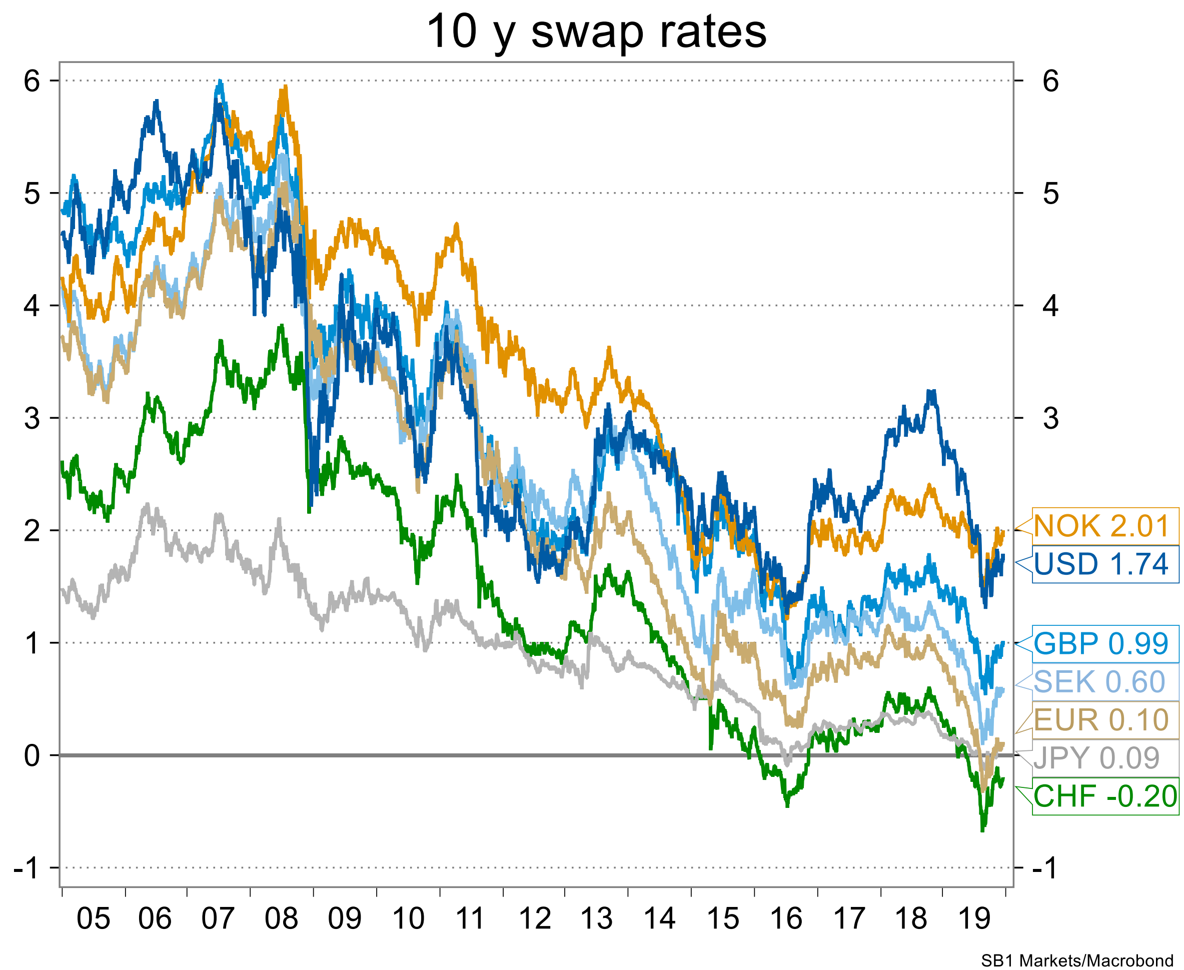
Small changes last week

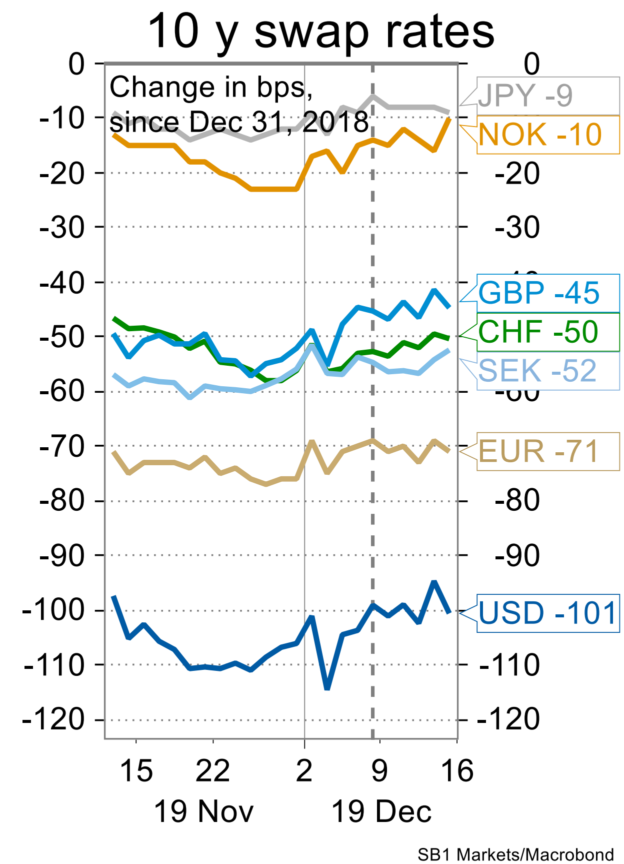




Long term swap rates marginally up everywhere in December

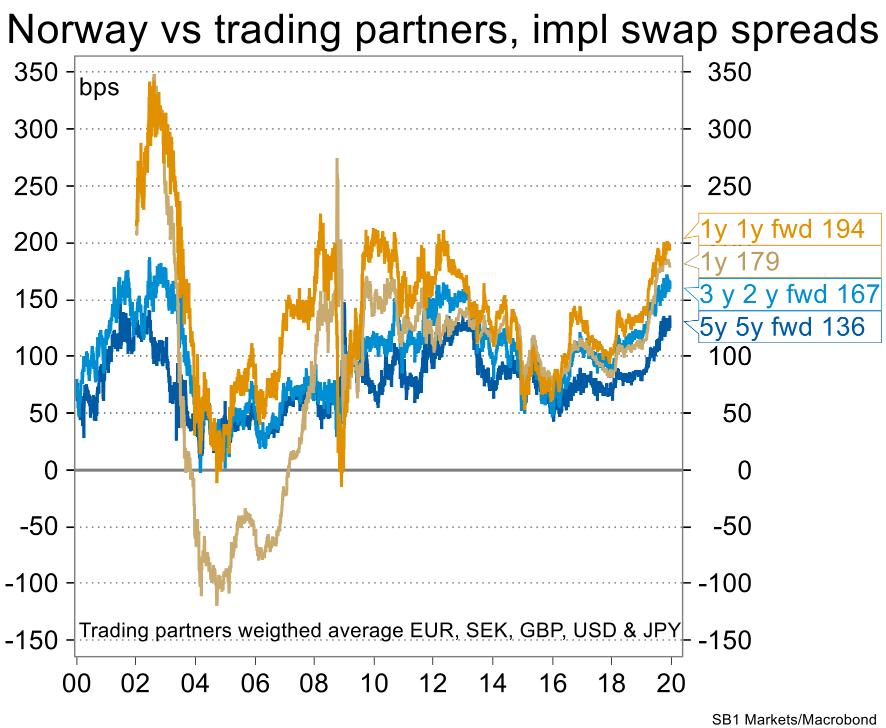
But in average, not further last week

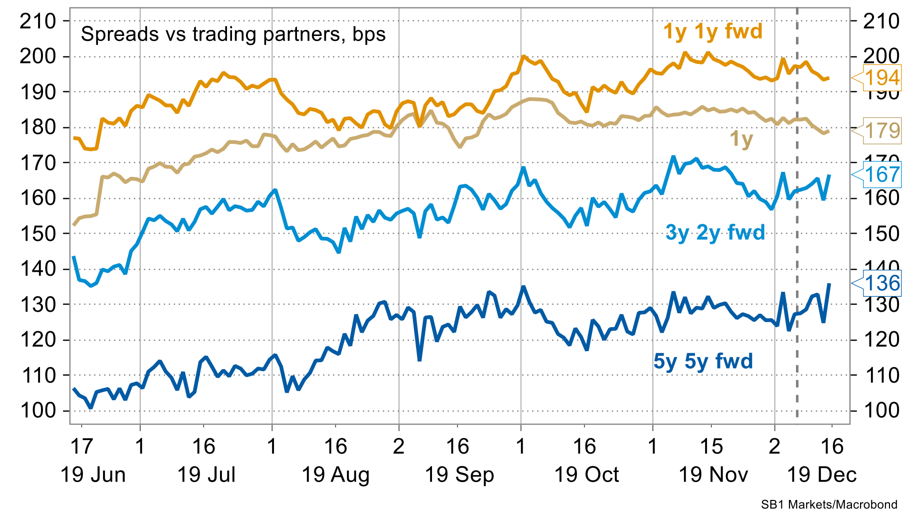


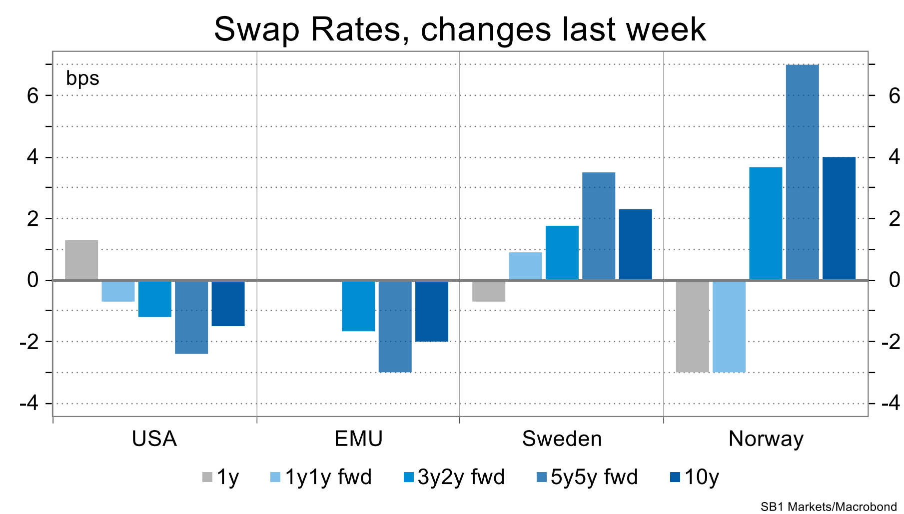


Swap spreads vs trading partners are shrinking, at least in the short end

Last week, spreads narrowed at the short end of the curve but widened from 2y -10 y



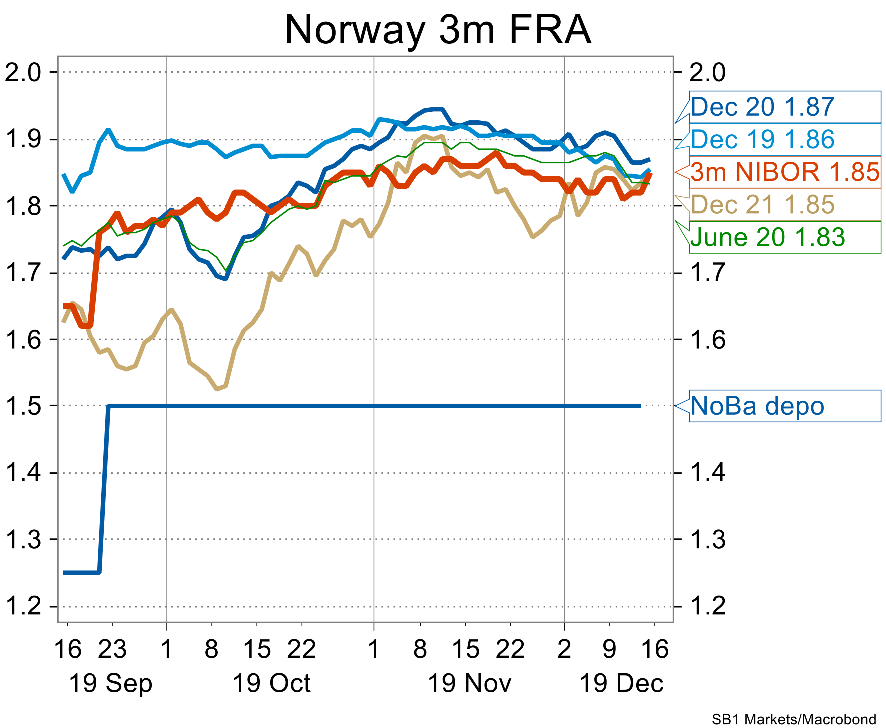


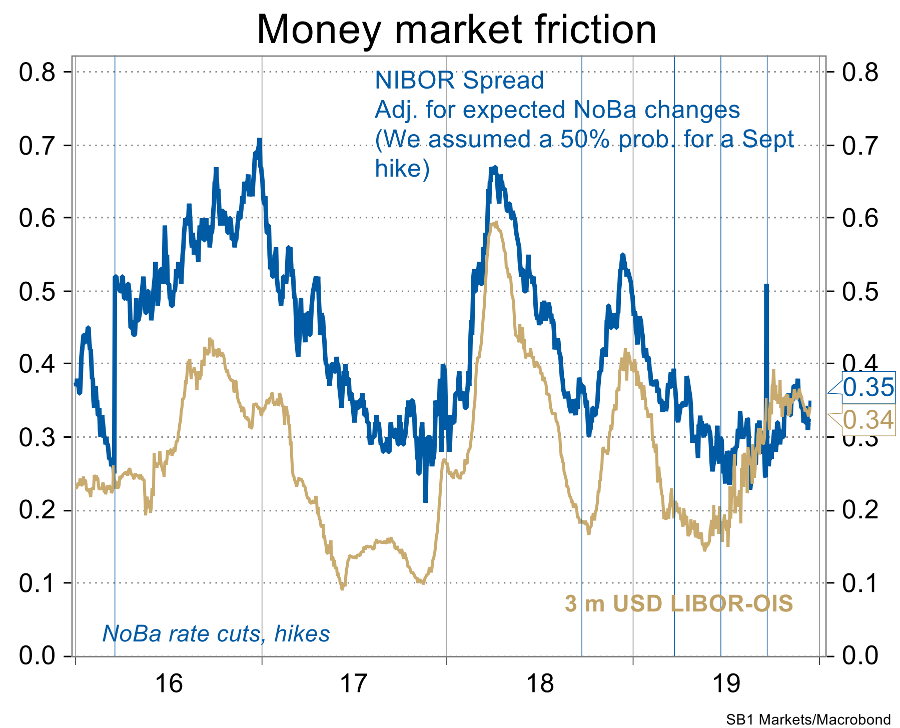


- Swap spreads between NOK rates and our trading partners have been widening rapidly in 2019, all over the curve
- While the short term spread is well explained, we have been surprised by the wide spread in the long end of the curve of the since March. A 5y 5y fwd spread at 136 bps is still far too wide, long term

NIBOR/FRAs have slowly drifted down – the curve is flat

Interest rate expectations are still muted but no cut is expected in 2020 or 2021

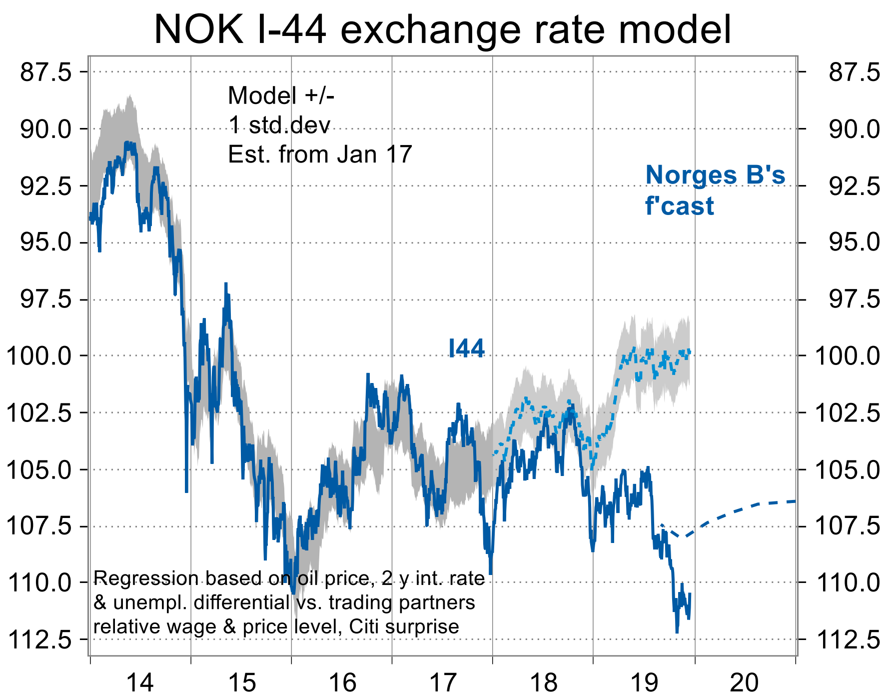


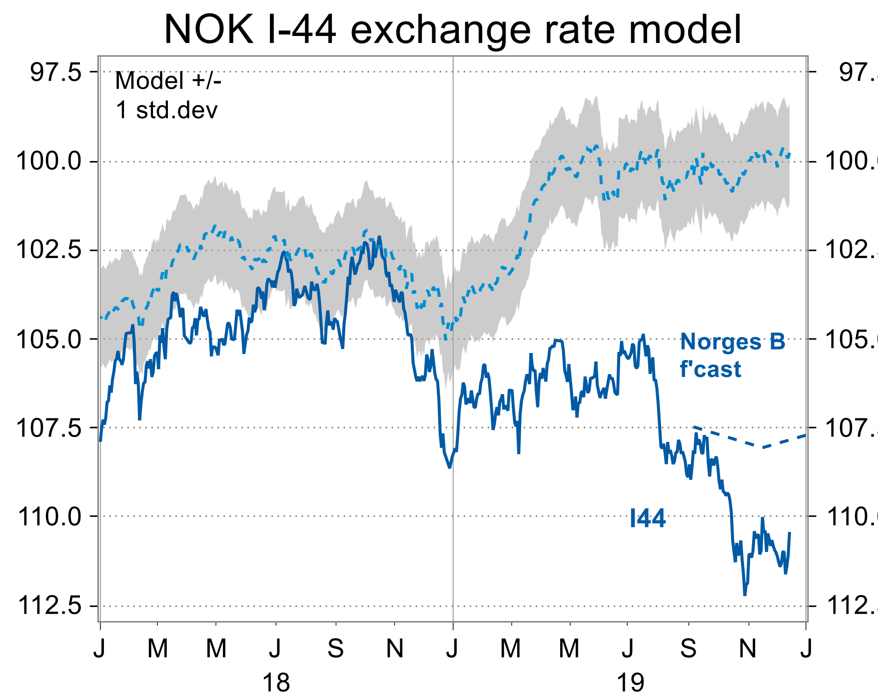


- The 3m NIBOR rose 1 bps to 1.85% last week. The Dec '19 3 m FRA fell 2 bps to 1.86% (implying a 36 bps NIBOR vs NoBa spread), as the two will 'merge' today. We assume this small downshift in the Dec FRA is due to a marginally lower NIBOR spread, not interest rate cut expectations the coming 3 months
- The US the LIBOR-OIS spread is 34 bps, close to the NIBOR spread (assuming still no expectations of any NoBa change the next 3 months). Historically, the NIBOR spread has been significantly wider than the LIBOR-OIS spread
- Longer dated FRAs rate have been sliding down the past month, after climbing through October and early November. An as good as flat FRA curve reflects expectations of an unchanged NoBa signal rate through '20 and '21 (Dec '20 and '21 3m FRAs are at 1.87, 1.83 resp., vs a 1.85% NIBOR now)

NOK lifted by less hard Brexit risk – up 0.5% last week without any 'model help'

NOK is 11% below the standard model and 4-6% below the oil stocks & the supercycle models





- NOK rose 0.6% at Friday, no doubt due to Boris Johnson's landslide victory in the UK election – which completely reduced the risk for a hard Brexit, without any separation agreement
- The NOK I44 index appreciated 0.5% last week, and is up almost 2% from the ATL late October. The gap between the our 'old', standard model estimate and the actual I44 index narrowed 10.6%, still extremely high
- Our 'new' models, based on the other super cyclical currencies or energy (oil) equities are far closer to the ball (check next page), but still the NOK is 'too' weak
- We stick to our **buy NOK** recommendation (and even stronger as soon as the year end is behind us…)

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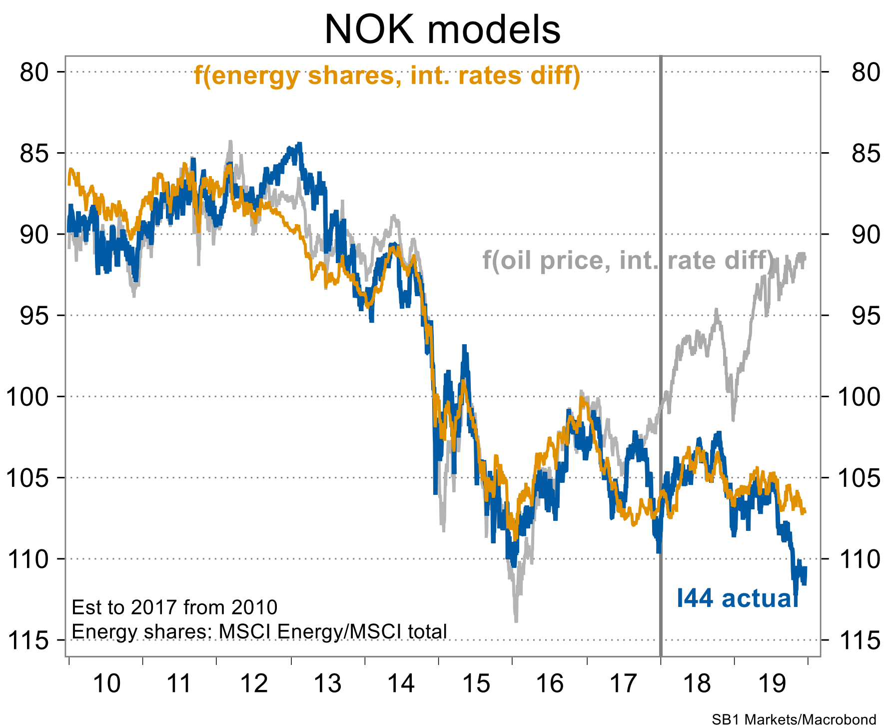
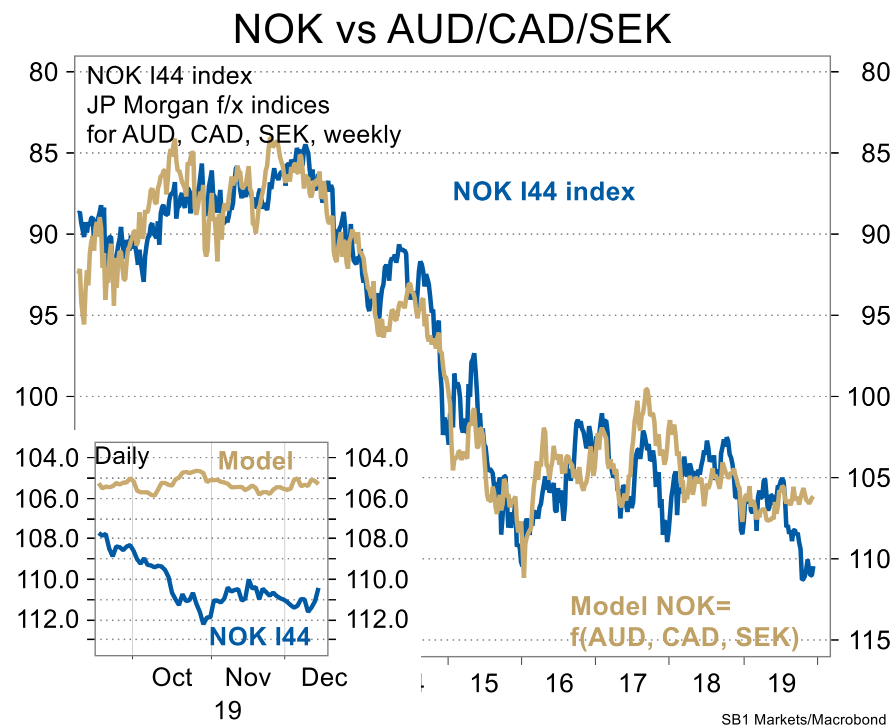
NOK remains weak vs our 'alternative' models too

NOK is 5% too weak vs the other 'supercycle' currencies and 4% below the oil stock price model

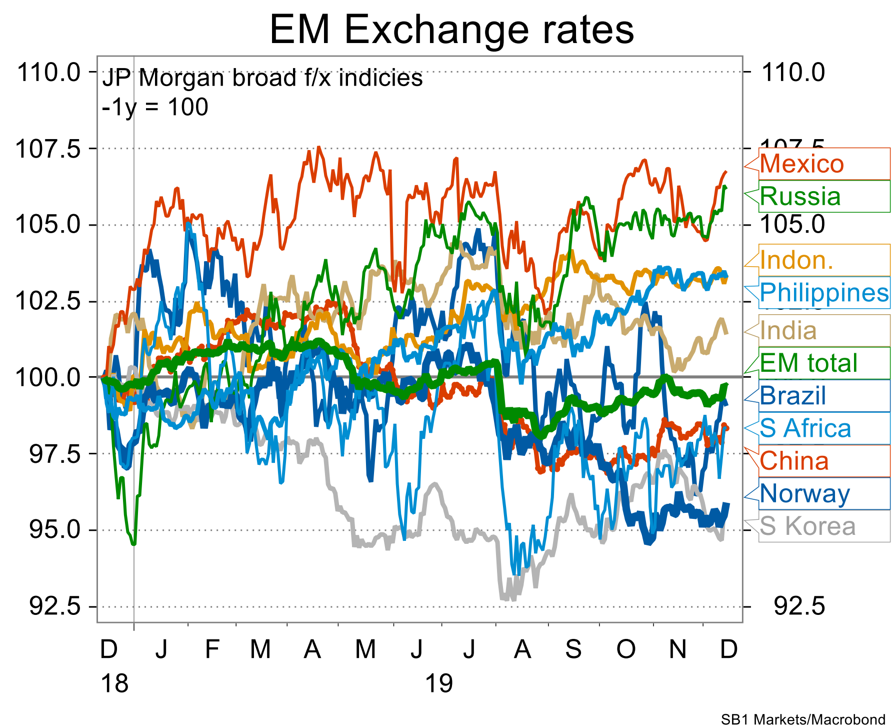


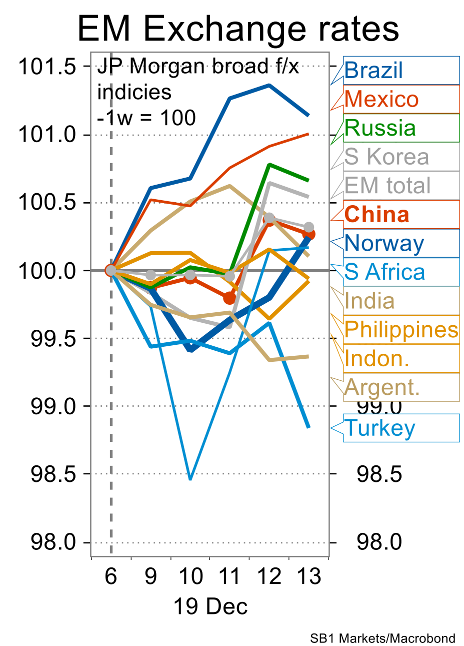


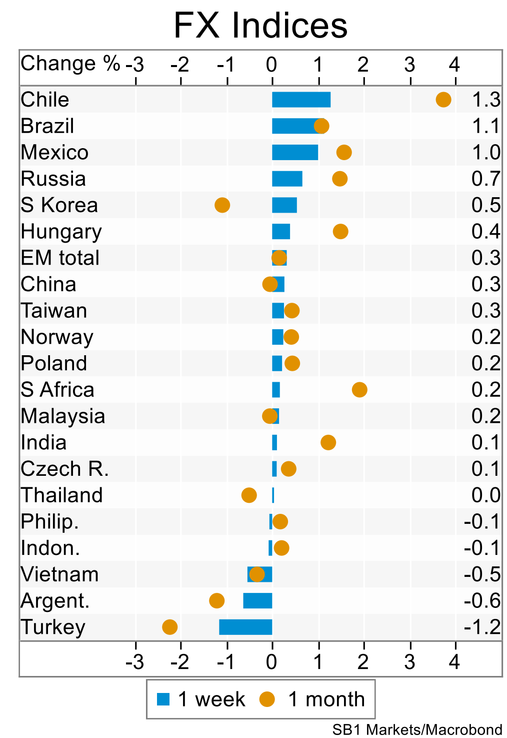
- Our NOK model based on pricing of oil companies has 'explained' the weak NOK much better than our traditional model since 2017, as have our 'supercycle' currency model (NOK=f(AUD, CAD, SEK)
- Both AUD and CAD are sensitive to oil/energy prices and – together with the SEK – global growth outlook
  - » CAD, AUD and SEK have been much stronger than the NOK since September, and SEK has been recovering swiftly (without any obvious macro explanation). In December, both AUD and CAD have appreciated somewhat, and SEK much more, while the NOK holds steady

EM f/x up on US/China trade deal

CNY (phase 1 deal), Mexico (new NAFTA), Brazil and Russia (oil) all appreciated strongly last week







- Most EM currencies have stabilized/recovered this autumn, trade war de-escalation and signs of a slight recovery in the global manufacturing sector probably the best explanations. Last week, CNY appreciated, after reports that a trade deal is being finalized – and Mexican peso got support from the compromise on USMCA (aka NAFTA) in the US political system

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