21 December 2020

Macro Weekly

Week 52/2020

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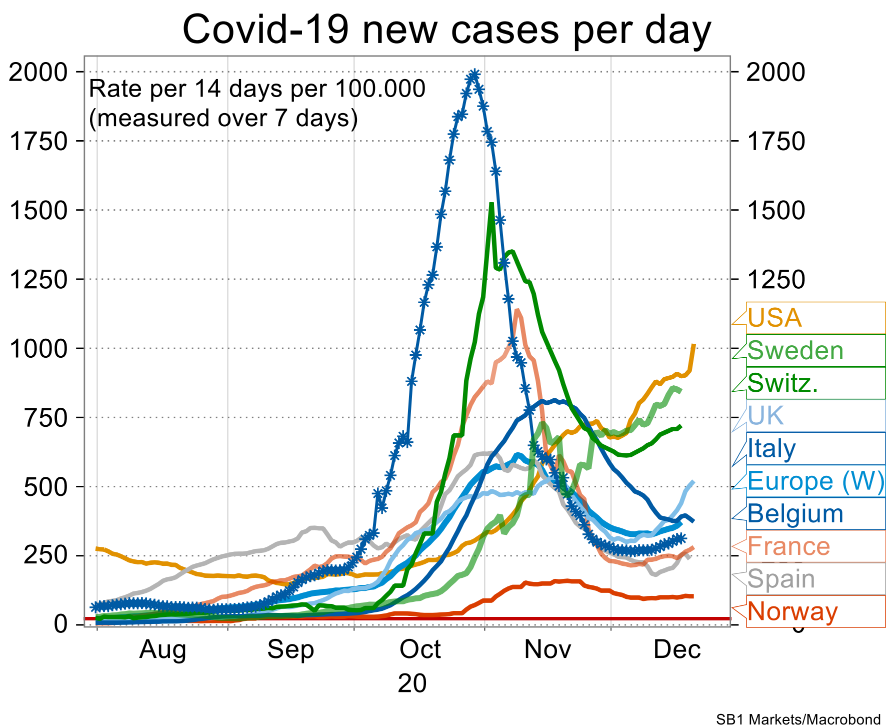
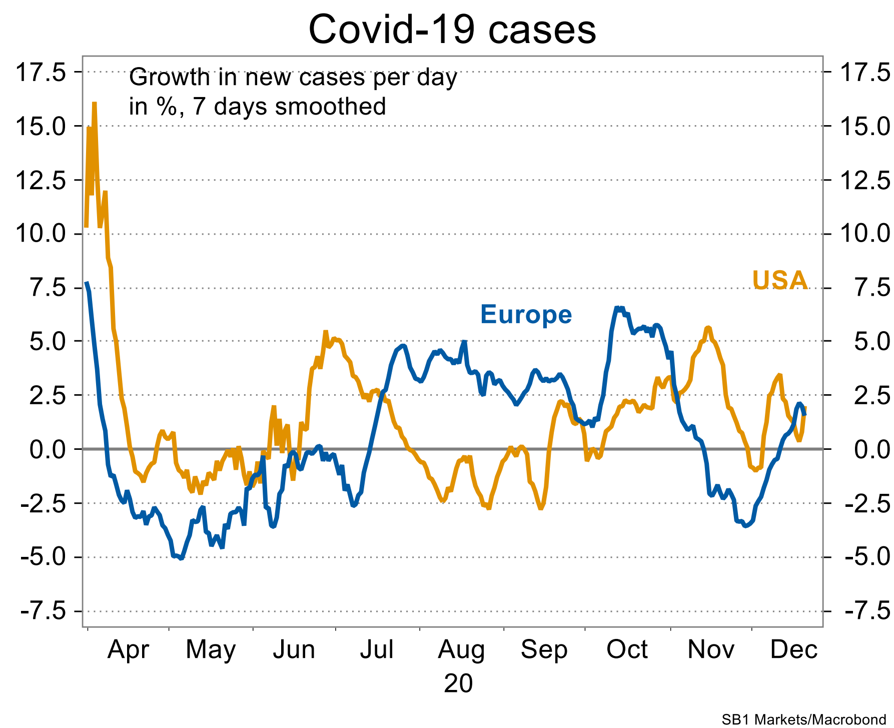
Last week:

- **The virus has mutated:** On Saturday, the UK reported that a mutated virus, that may be up to 70% more contagious (but not more dangerous for your health), has established itself as the main Covid-19 infection source in the UK. The government tightened restrictions further in South East. Several countries banned travel from UK yesterday. However, the mutated virus has already spread to other countries. If the UK scientists are correct, bad news of course, as much **more rigours social distancing may be required** to get the 'R' number down to 1 or below, hurting the economy harder. That will be necessary in order to prevent a health crisis in areas where hospital capacity is already under pressure (which is the case in some regions in several countries). The no of new cases continues upwards in several European – and in the US too (but the last data point is dubious), and it will take months before vaccination will have any significant impact on infections. The corona cycle is counted in weeks…
- The **vaccine news** are still mostly positive, and Moderna got the US acceptance for its vaccine at Friday. Pfizer will probably get its European licence today. However, Astra still has trial challenges. Even so, we expect mostly good news the coming weeks & months
- **Global PMI** was likely close to unch in Dec, at an average level, signalling growth at trend. The **European PMI** was much better than expected (the biggest estimate miss ever?) – as it climbed back up to 50, from 45 in Nov. Other Dec national surveys also recovered. EMU GDP probably fell in Q4 but the decline seems to be less harsh than many had expected. The **UK survey** recovered as well, but now the Brexit outcome and the mutated corona virus may create new challenges. The **US PMIs** were fell somewhat more than expected but is still reporting decent US growth in Q4. The same goes for US regional manufacturing surveys. No serious corona shock here
- **China** reported strong Nov data, confirming a continued recovery in Q4. The overall activity is back on the pre-corona growth path
- Late Sunday, the **US Congress agreed upon a second fiscal stimulus** package at USD 900 bn, equalling 4% of GDP – which face value seems to be more than what is really warranted. The Fed was allowed to continue its emergency lending programs. The **FOMC** revised its growth forecasts substantially upwards. Even so, the Bank decided to continue the USD 120 bn/m (equalling 6.5% of GDP) **QE program** until *maximum employment* (has been reached)*, and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time* (which is when the Bank also will start normalising the signal rate). **Retail sales** fell in Nov, and Oct was revised down, probably corona related. Still core goods sales are sky high! **Housing** remained strong in Nov. **Manufacturing production** rose further. The first Dec **regional manufacturing surveys** were on the weak side, still well above average, signalling growth above trend
- **UK/EU/Brexit: No (good) news**, of course. British **retail sales** fell sharply in Nov, but less than expected and will grow q/q if sales remain unch in Dec
- **Norges Bank** kept the signal rate unch at zero (which everybody expected) but lifted the interest rate path more than expected, by up to 36 bps, and moved the first rate hike forward by 6 months to Q1 (or Q3) 2022, from Q3 (or Q4) 2022. The bank revised its output gap upwards but forecast changes were not that large. However, higher growth, goods vaccine news, a higher oil price, upward investment forecasts, and the rapid rise in house prices inspired the bank to send a 'hawkish' signal. FRA-rates rose by up to 10 bps, and the NOK strengthened. **NAV unemployment** reversed almost half of the Nov increase in Dec. Unemployment was flat in transport/services but fell elsewhere, and in all regions barring Oslo (which has the highest unemployment rate, following the largest increase since pre corona). The homebuilders reported strong **new home sales** in Nov but starts were still slow

No more good Covid-19 news anymore? A UK mutation & lots of bad numbers

… and more lockdowns. The corona cycles are incredibly short just

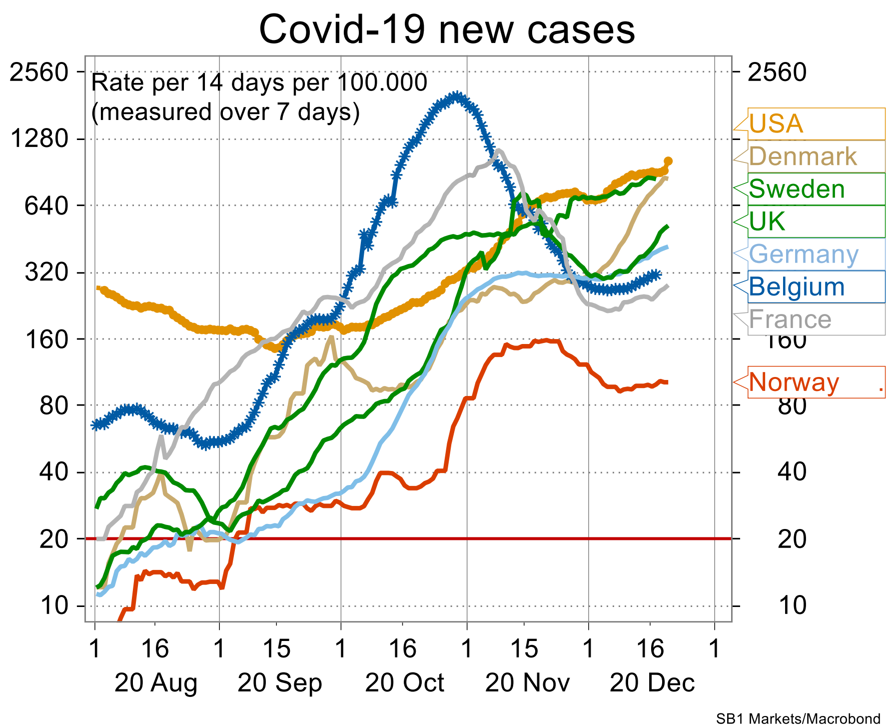


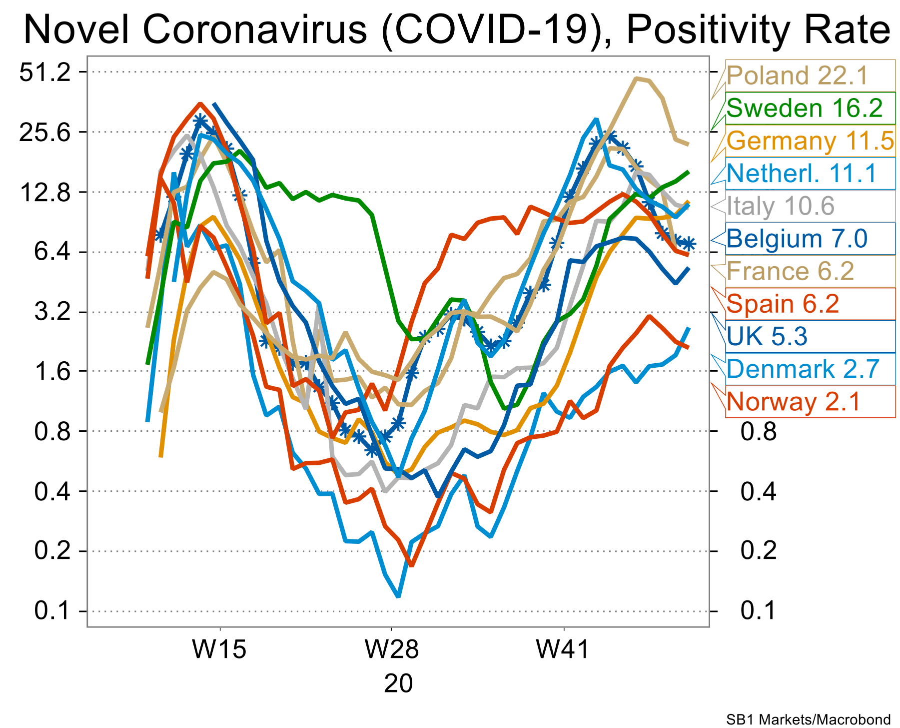


- The UK mutated virus is spreading to other countries – and it may be up to 70% more contagions than the 'standard' virus – and may explain the rapid increase in both UK and elsewhere. The mutated virus may require far more rigorous social distancing the coming months – until vaccines are sufficiently rolled out.
- In the US is the no of cases was high yesterday, taking the 7 d average up – but the hike may be an outlier
- Hospitals in some regions in several countries – including parts of the US - is struggling with handling Covid-19 patients
- The number of new cases in **Norway has turned marginally up, check next page. Here, there is no pressures at the health sector at all**

Denmark is reporting a steep increase in new cases, and higher positivity rate

Growth is accelerating in the UK, which introduced tight restrictions in the part of the country

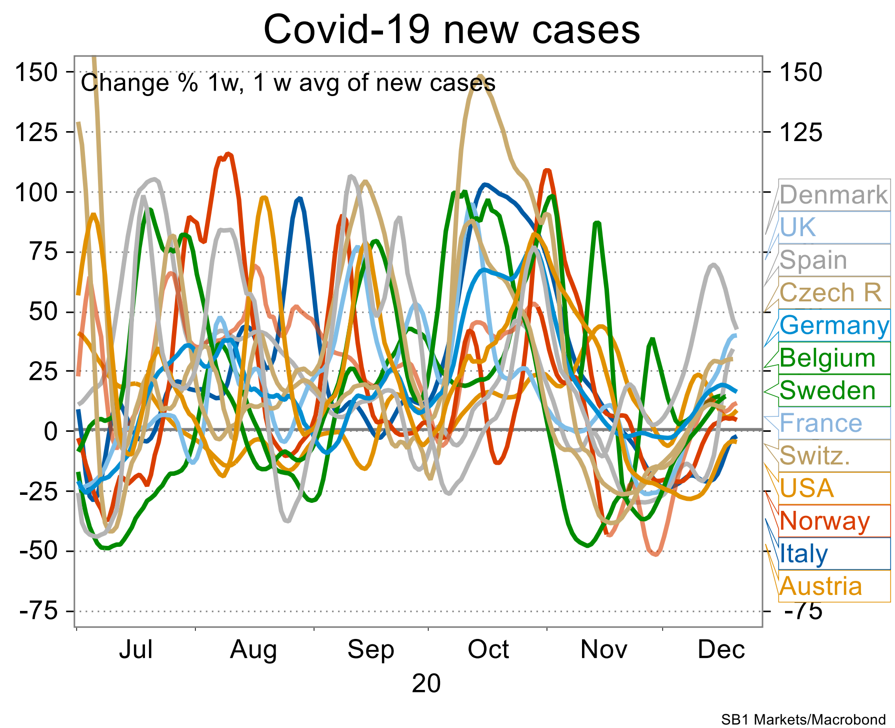




- Belgium is reporting more cases, but also a lower positivity rate
- The French positivity rate is declining too, and makes the increased no of new cases
- That's may be the case in Norway too (our positivity data are lagging by one week)

Another turn upwards?

Many countries are reporting more cases – partly due to more testing



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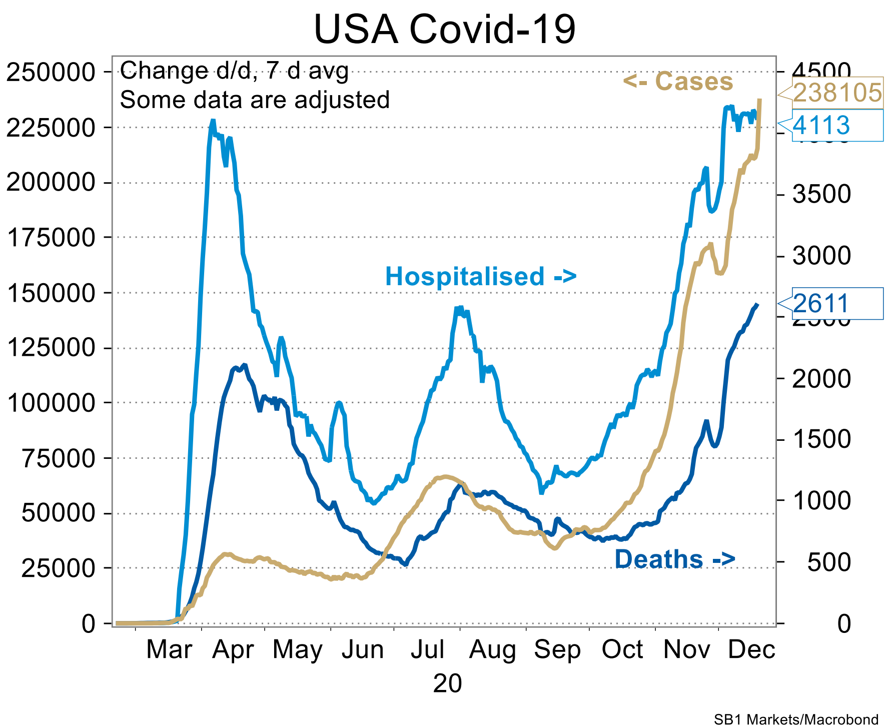
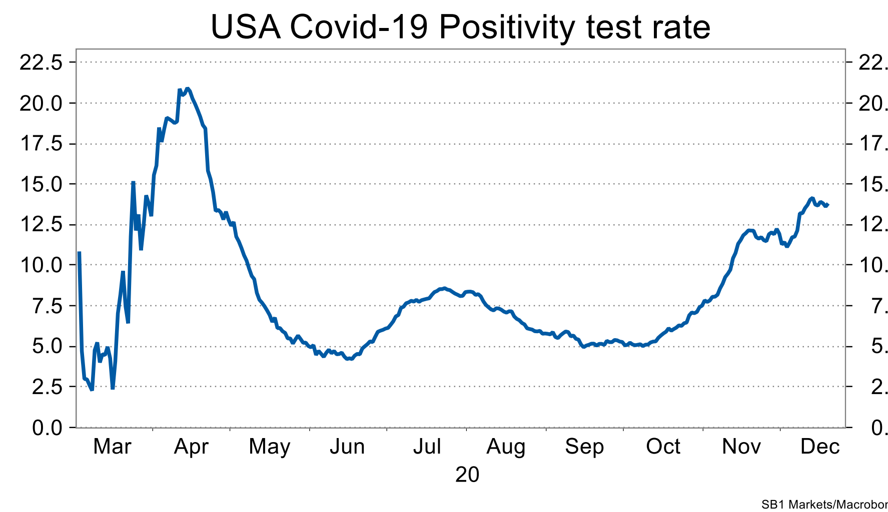
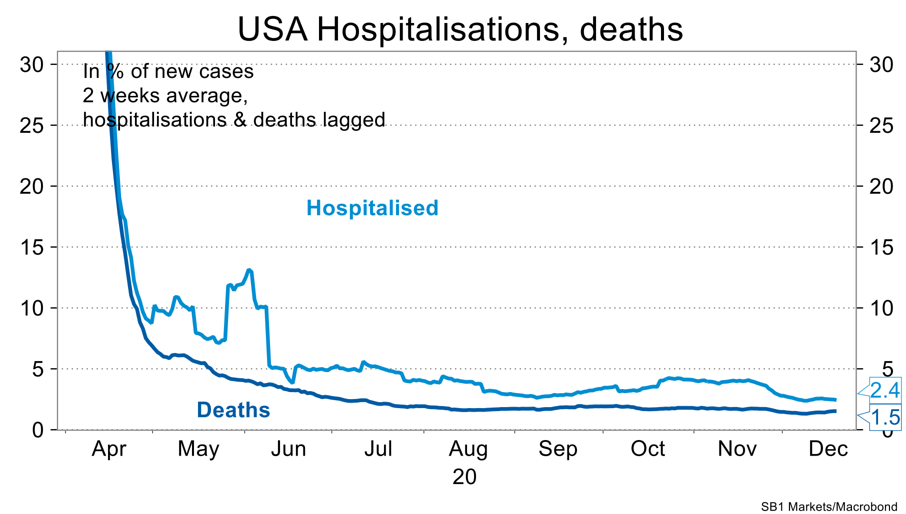
USA: Here we go again. Vaccines are badly needed. But it will take time…

More of everything last week – and this week the no. of deaths will rise to ATH too…



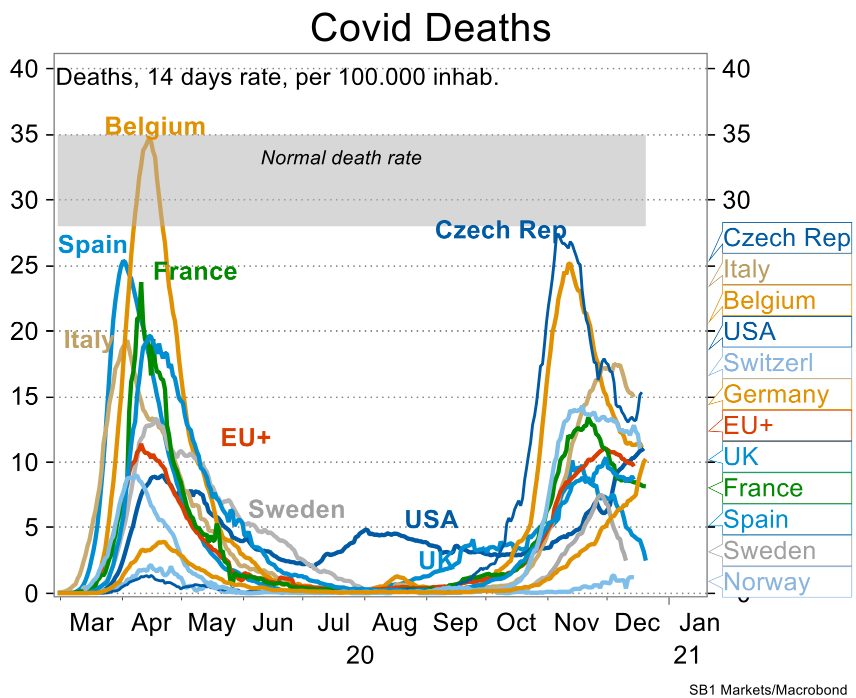


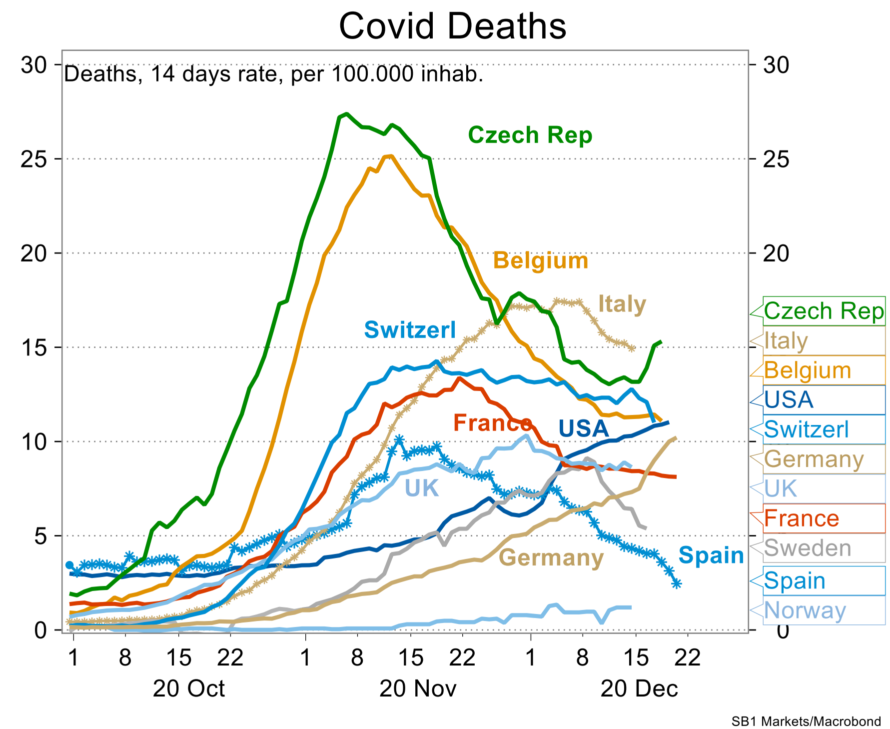


- The positivity test rate is not increasing anymore
- The hospitalisation rate has declined somewhat, while the death rate (CFR) is stabilised at 1.5%

The bottom line: The deaths

Germany, US on the way up. UK, France is flatting. Belgium, Spain, Sweden further on the way down





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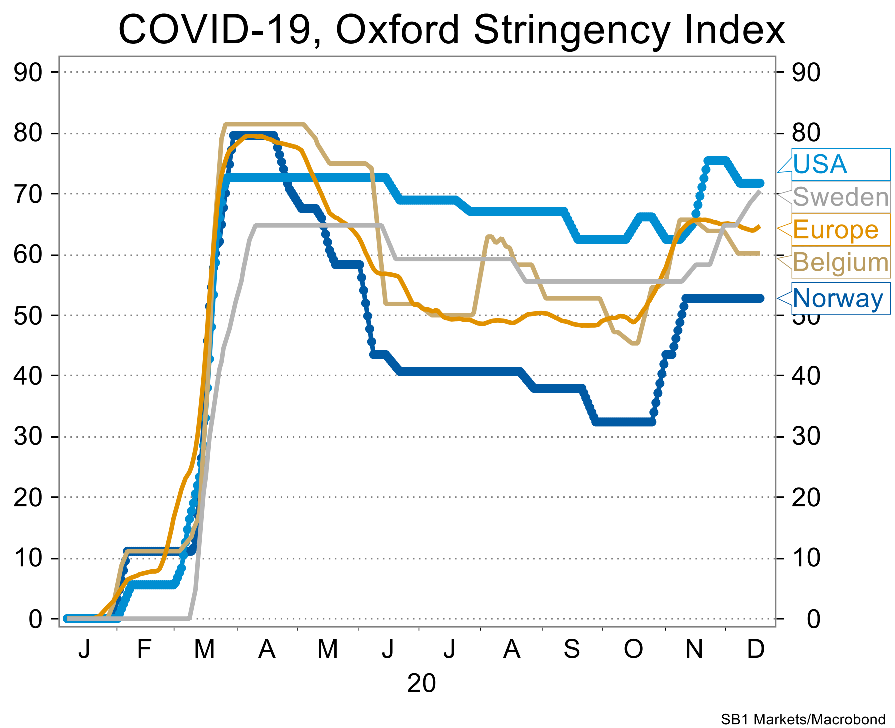
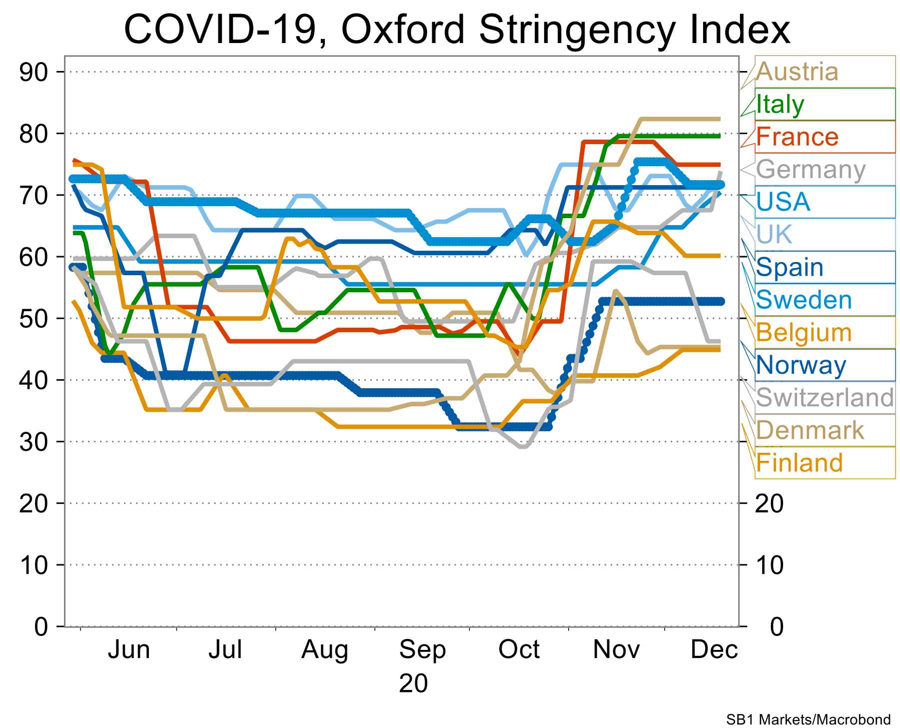
Sweden is pushing the brake pedal, as is Denmark (not yet registered by Oxford)

Germany has also imposed new restrictions to combat the spread of the virus

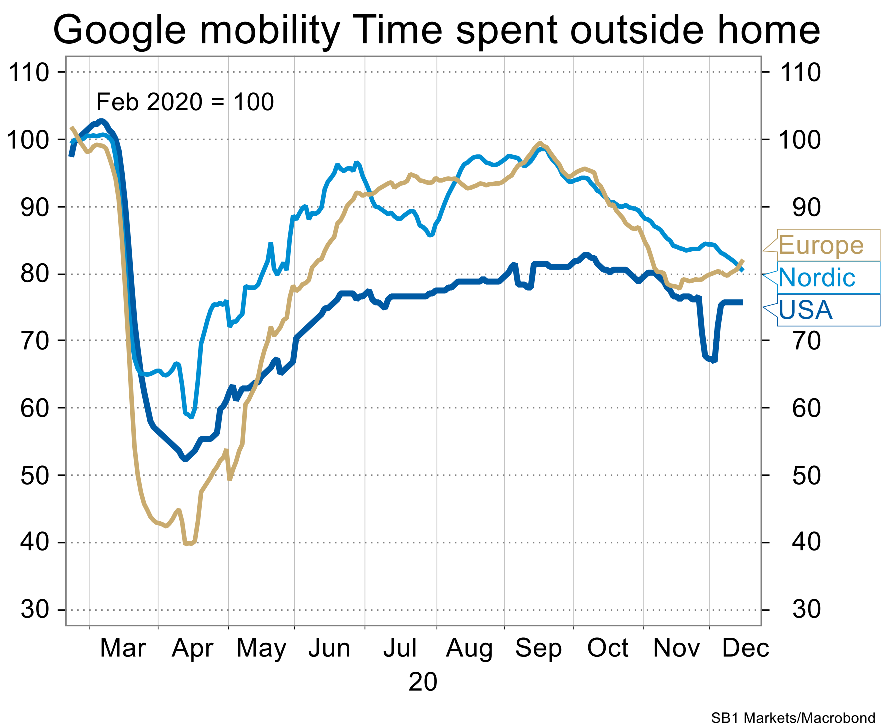


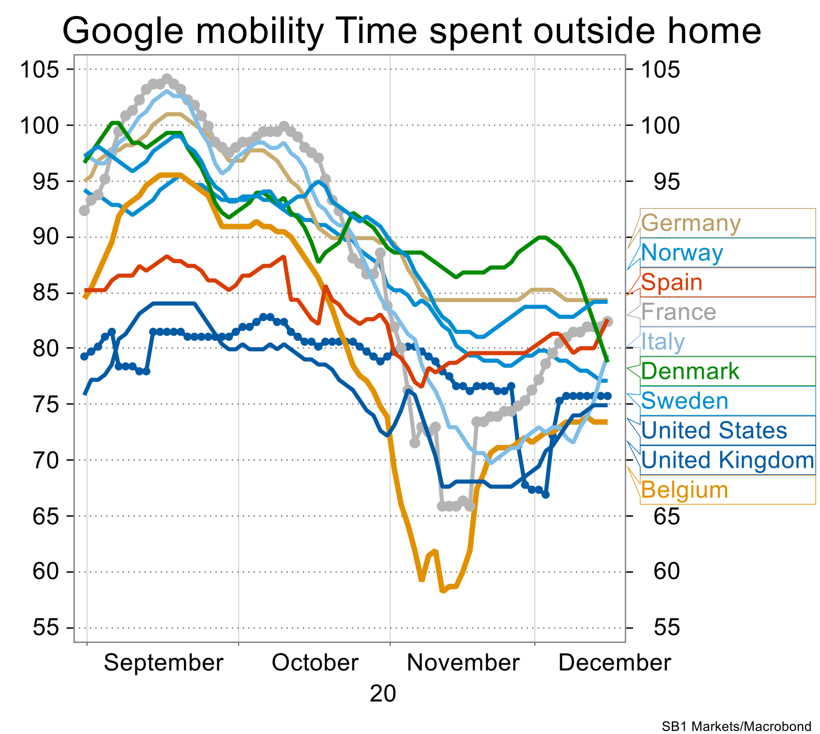


- Spain should soon ease restrictions, given the steep decline in cases & deaths
- We are not sure Oxford's stringency indices are correct all the time but the broad picture may still be relevant

Some still spend too much time outside home

However, where the virus is retreating, people walk out of their homes, like in France, Belgium & It.

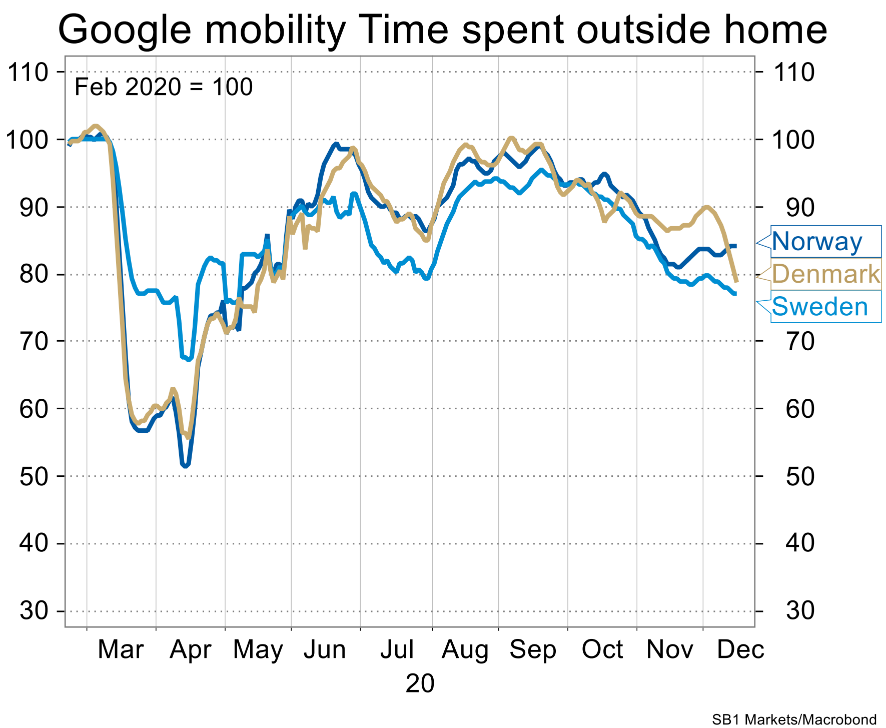


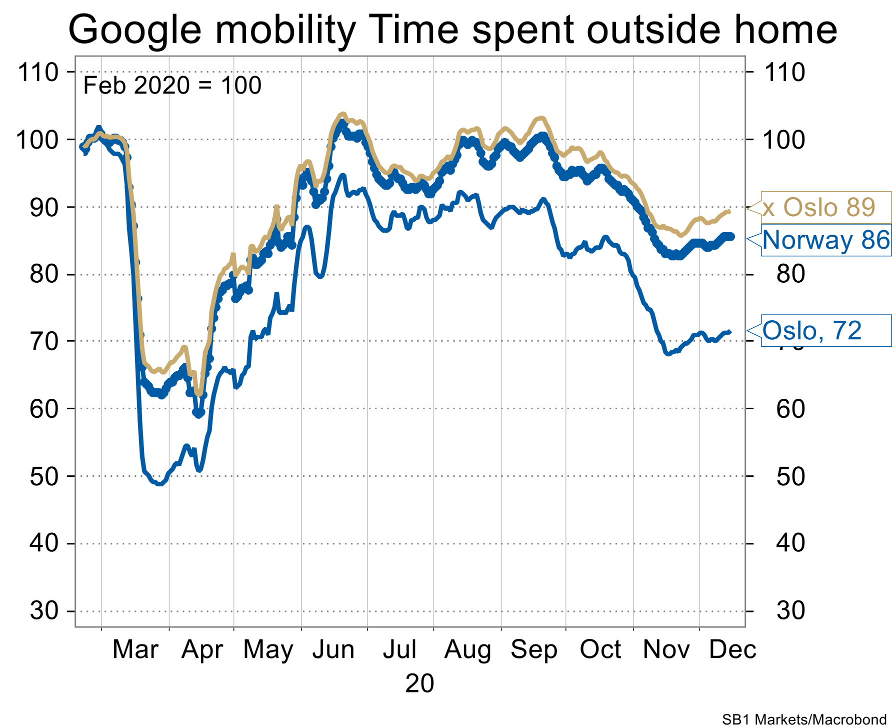


- Several countries have to increase social distancing in order to stabilise/bring down the no of infections – like Denmark, Germany & Sweden – and now UK, and most likely US – as the vaccine rollout will have no impact on the infection rate the coming weeks (and few months)
- There the 2nd wave is fought back, time spent outside the home has increased sharply. In some countries probably too much, at least in UK
- In the US, time spent outside home has flattened – at a level that likely is too high

The Danes are staying at home, increasingly so - as new cases are 'exploding'

… and new and tighter restrictions are imposed

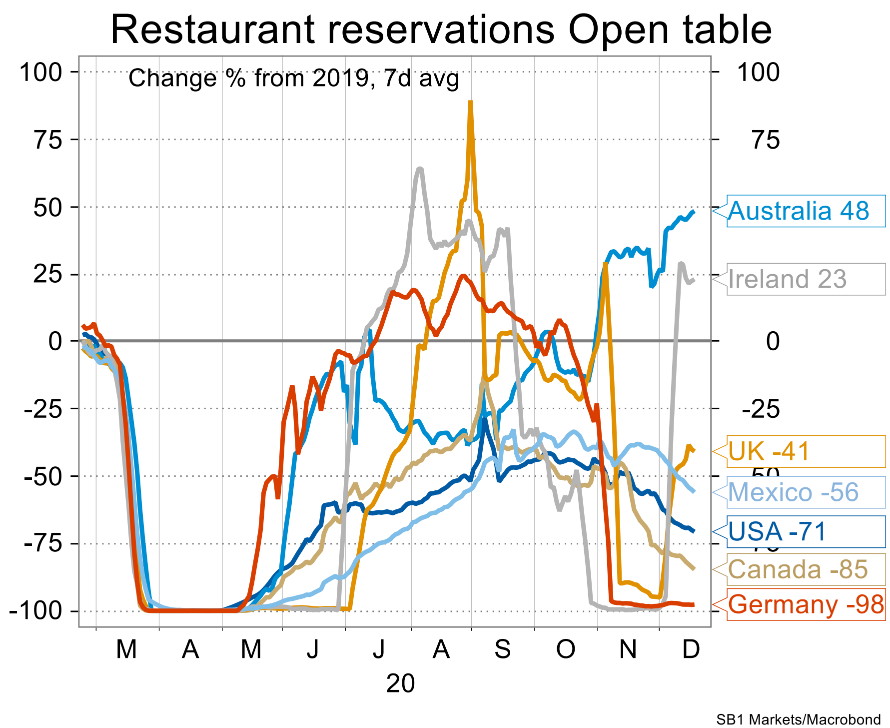


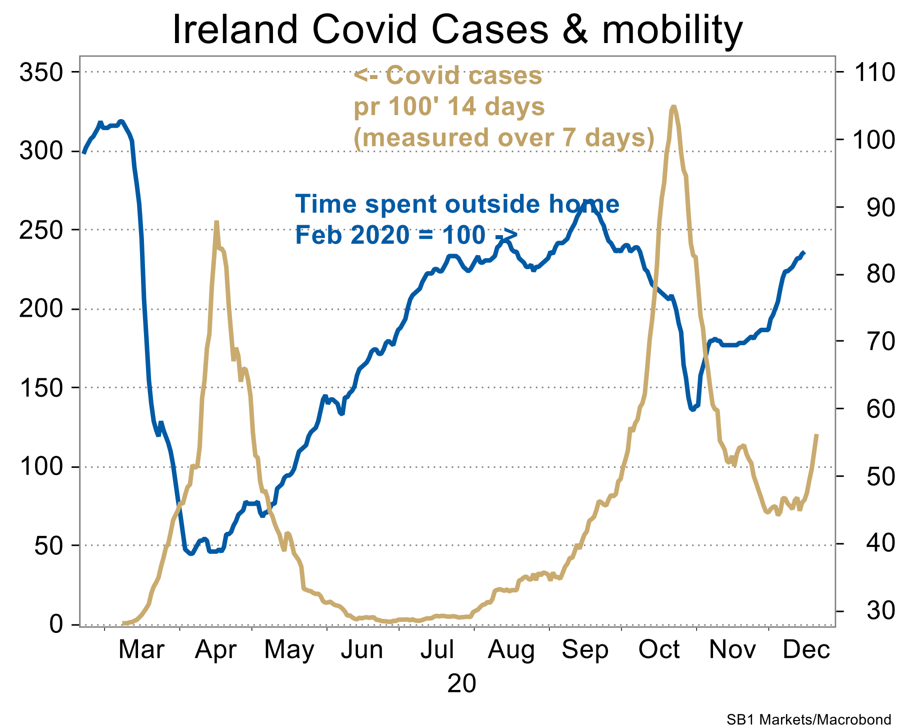


- In Norway, we are spending more time outside our homes again, at least before Christmas

Restaurants have opened up, some places – and guests turn up

We are not sure if we should trust Irish restaurant data but infections are (or were…) down



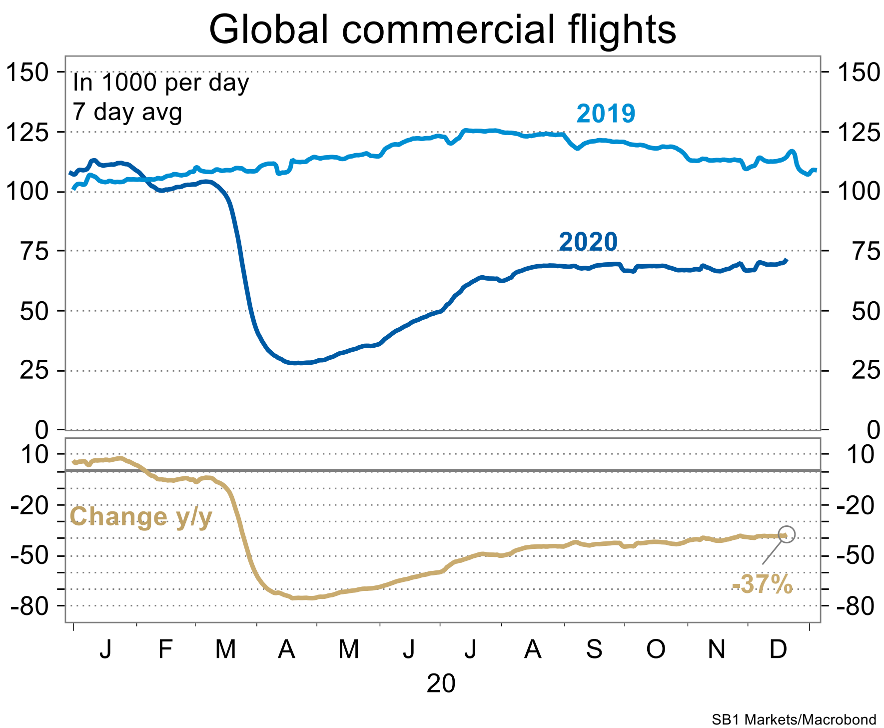


- … and more time is spent outside of home again – as has been the case in the UK, were restaurant go many clients back. Until now….

- We do not know the quality of the Open Table data – there may be changes in coverage, reporting issues etc. In most countries it still yields relevant information, we assume

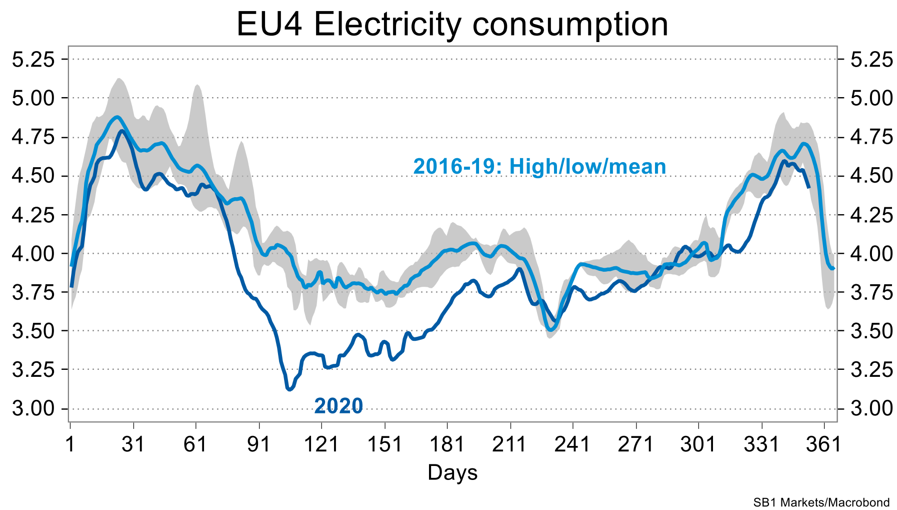
Global airline traffic: Slowly, slowly upwards – but still down 37% y/y

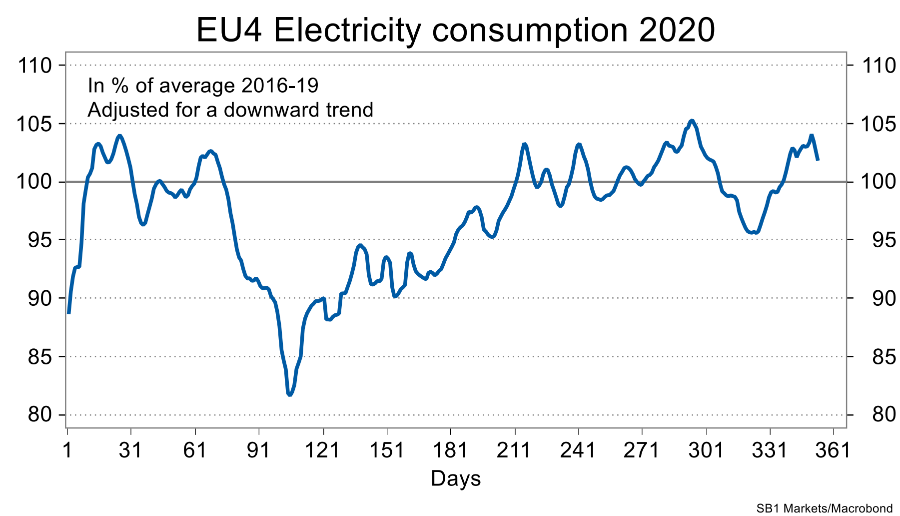
No normal seasonal decline, the gap is narrowing by some 2 pp per month

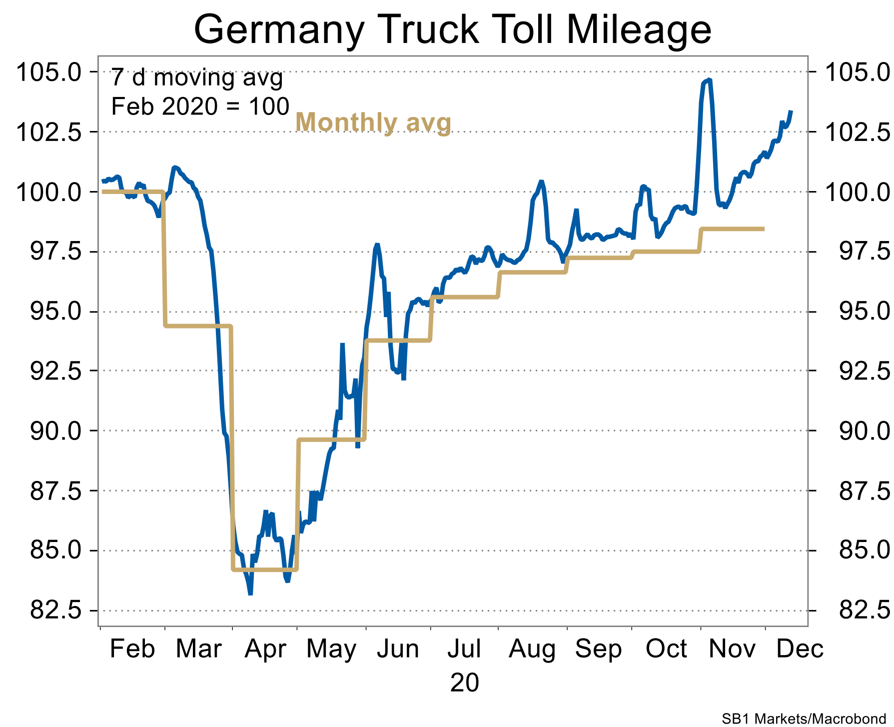


EMU: No signs of a slowdown in the 'goods' sectors

Truck traffic & electricity consumption shows no signs of weakness – rather the opposite







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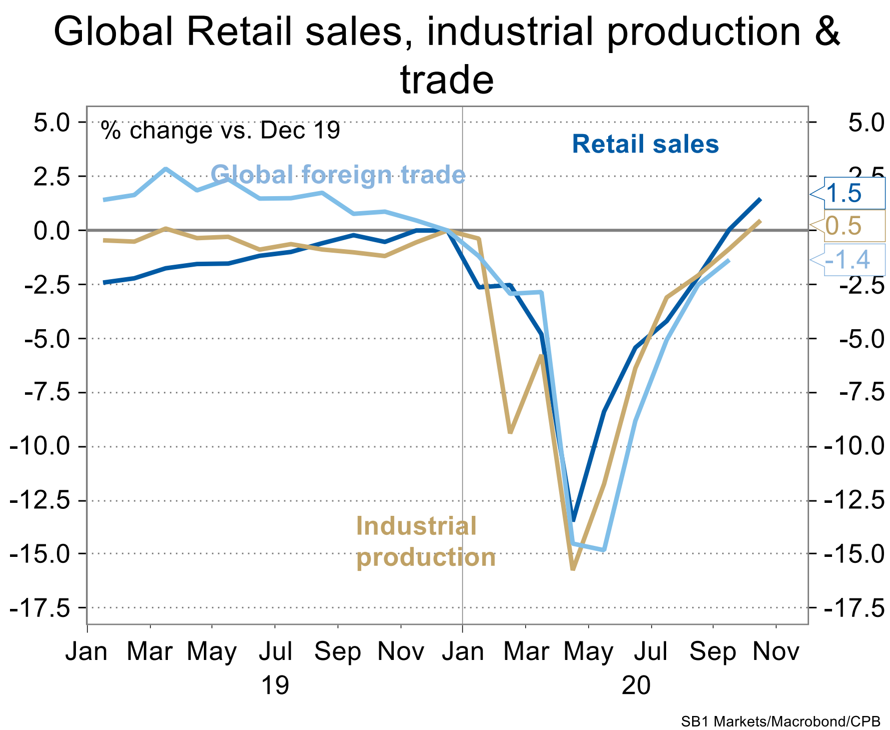
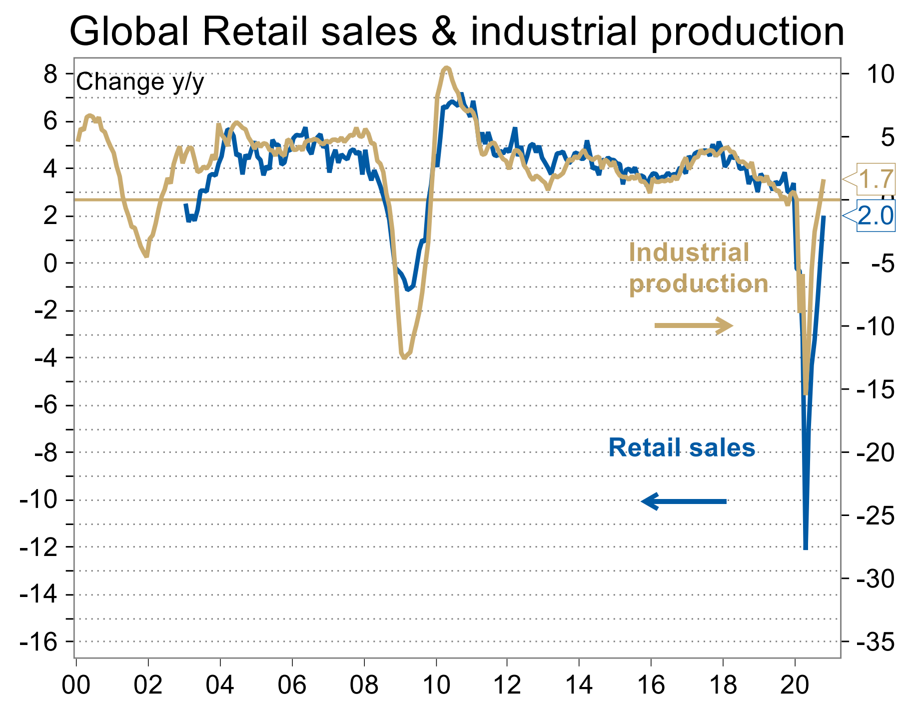
Industrial prod, retail sales up in October, gaps are closed!

Foreign trade rose in September – and very likely in October – and the trade gap is soon closed too





Memo: Keep in mind the different scales at the chart above

- Retail sales are 1.5% above the Dec-19 level, while manufacturing production is up 0.5, according to our Oct estimates – and even more up y/y
- Global foreign trade rose 1% in September, and the level is just 1.4% below Dec last year**.** The gap will be closed in October or November

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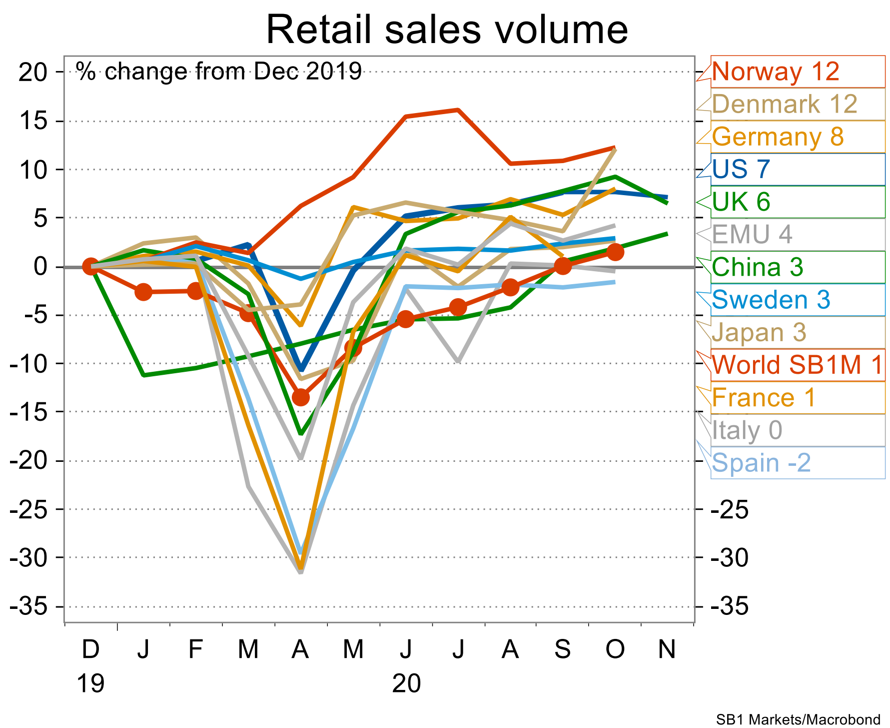
Global retail sales above the Dec-level in October in most rich countries

Even accumulated sales through the 'crisis' are above the 2019 level in many rich countries



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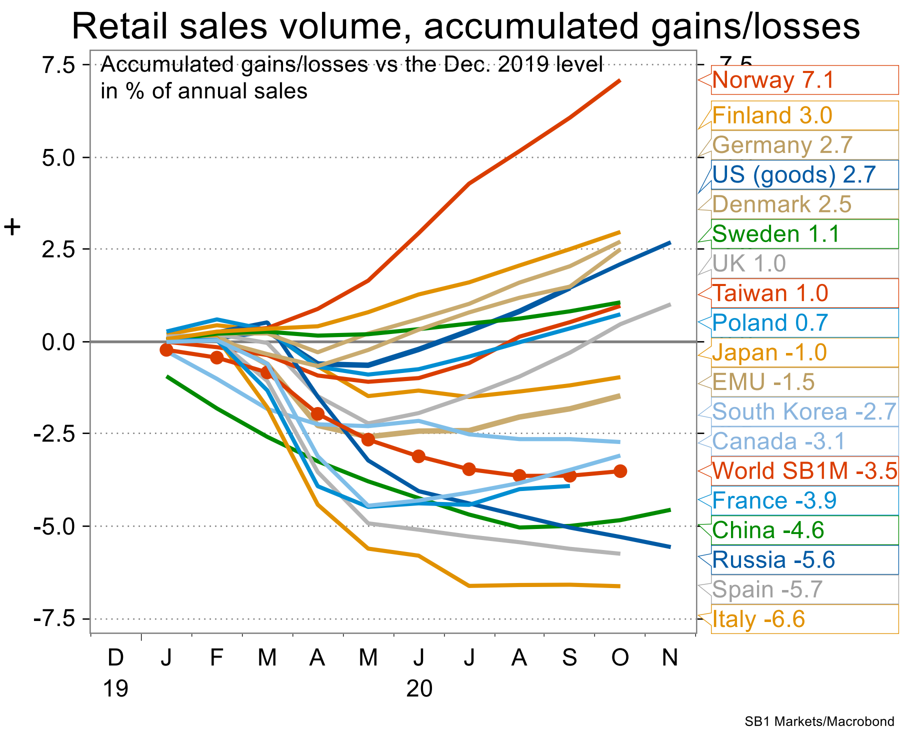
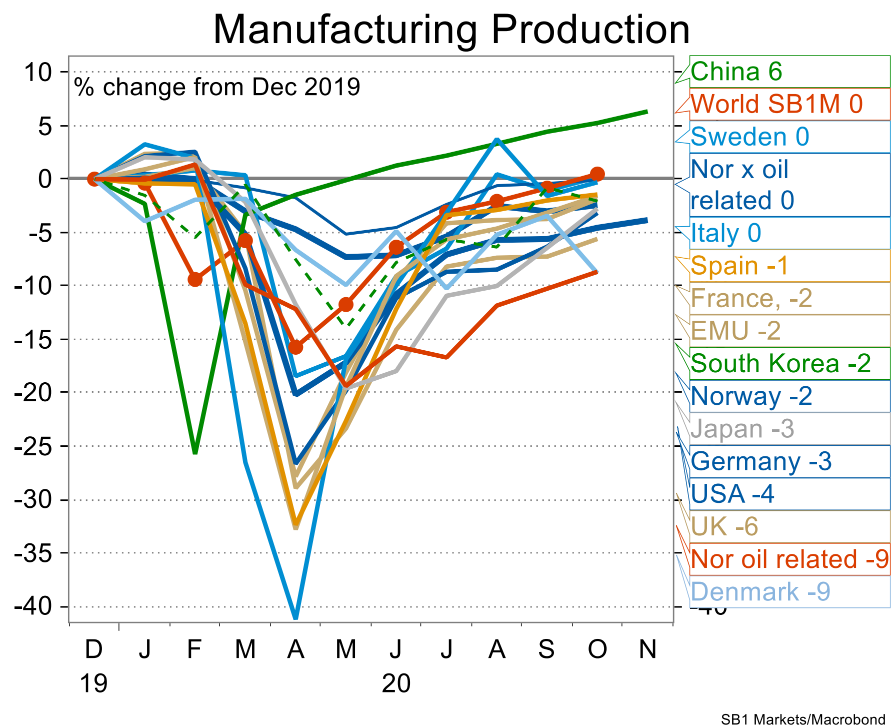
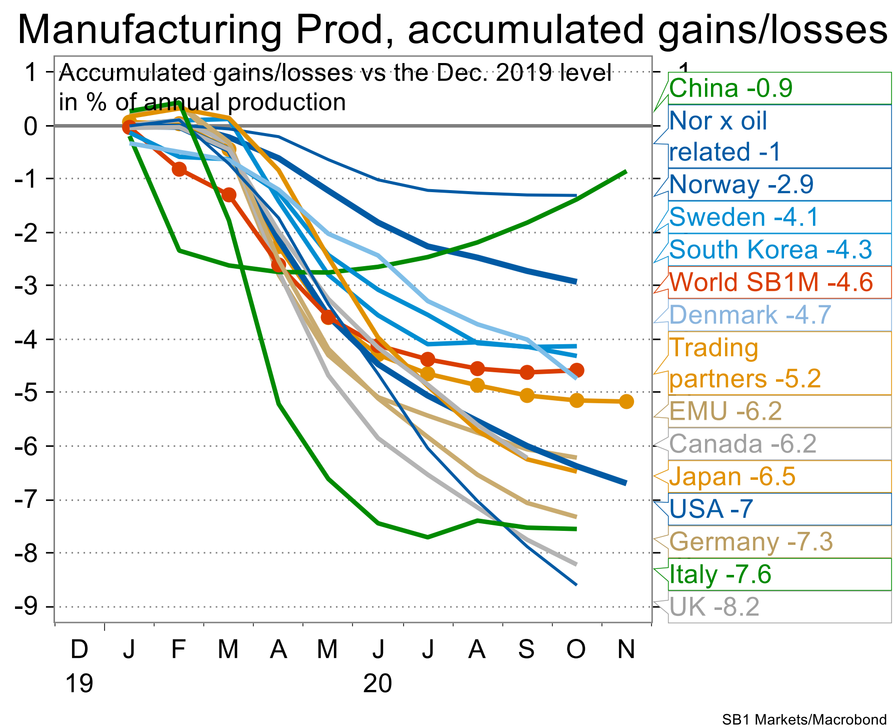


- In October, global retail sales were 1.5% above the Dec-19 level. Most rich countries are now reporting higher sales than before corona hit
  - » The chart to the right presents the accumulated gains/losses vs. the level in Dec 19, measured in percent of annual sales. Sales in the US were 7% above the pre-corona level in Oct (personal consumption goods ex auto, our Oct est), but total sales during the first 10 months of 2020 were still 'just' 2.7% above the pre corona level, measured in % of annual sales, due to the losses that occurred during the spring
- Consumption of services are not included in these retail sales data – and service consumption has fallen sharply, everywhere

Manufacturing production above the Dec-19 level in October too

Production rose at the same pace as during the previous two months – a brisk growth pace into Q4

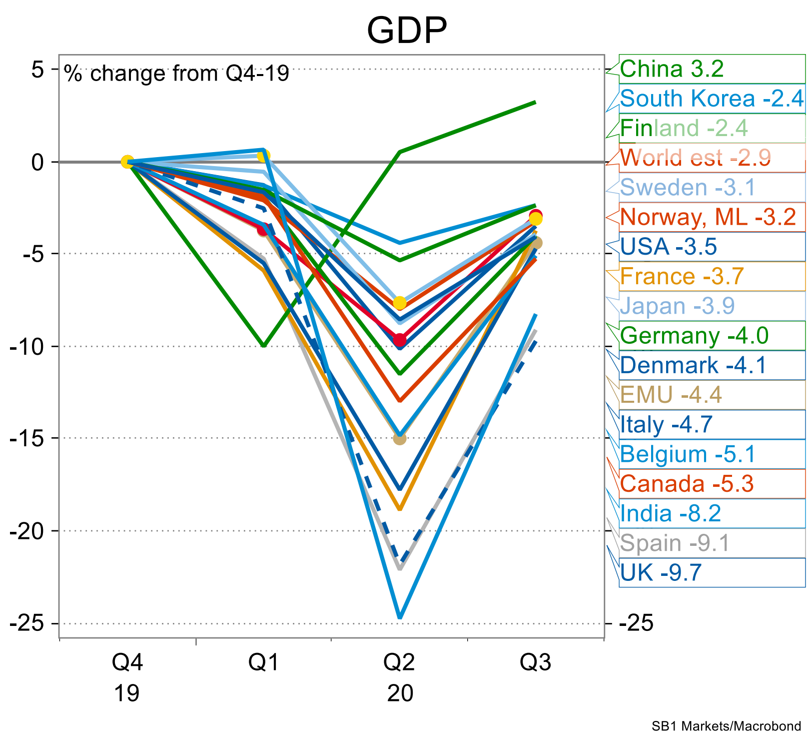




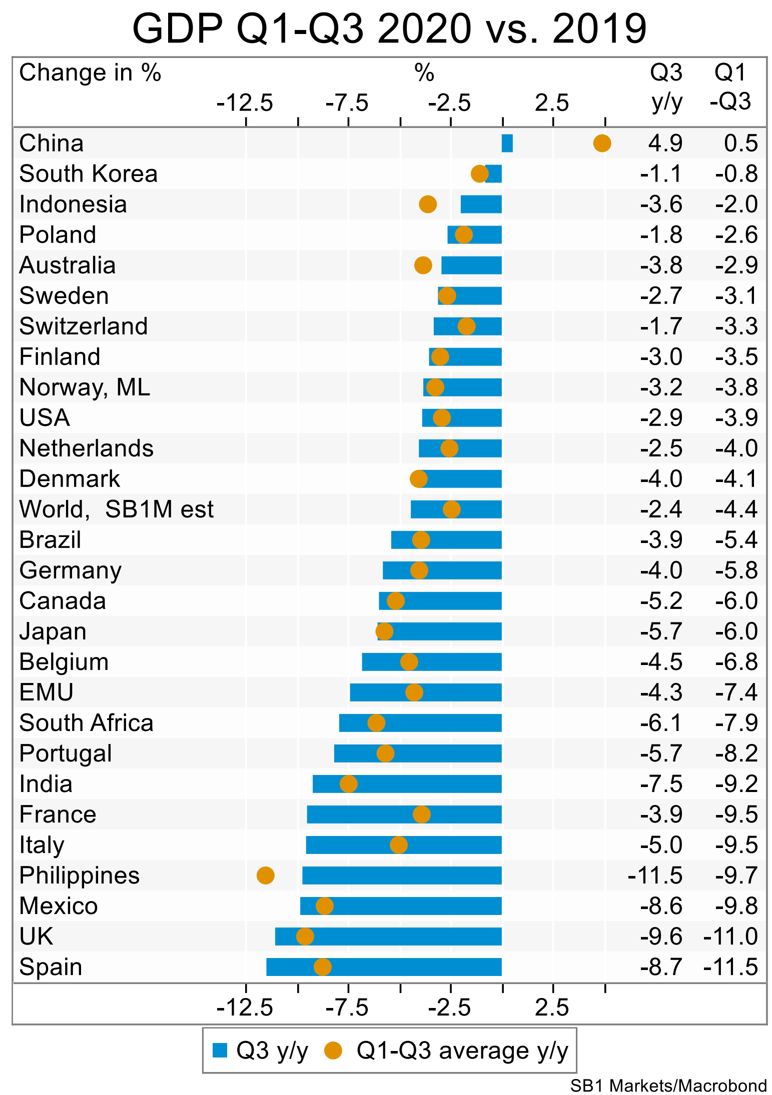
- Global manufacturing production was marginally above the Dec-19 level in October
  - » The chart to the right presents the accumulated gains/losses vs. the level in Dec 19, measured in percent of annual production. Production in US was 4 % below the pre-corona level in November. Total production during the first 11 months of 2020 was 7% below the pre-corona level, measured in % of annual production. *This illustrates the loss of production during the corona crisis*
- Service sector production is not included in these retail sales data – and service consumption(=production) is still way below a normal level

Global Q4 GDP ‘just’ 3% below Q4-19 level

The loss over the first 3 quarters equals 4.4% y/y

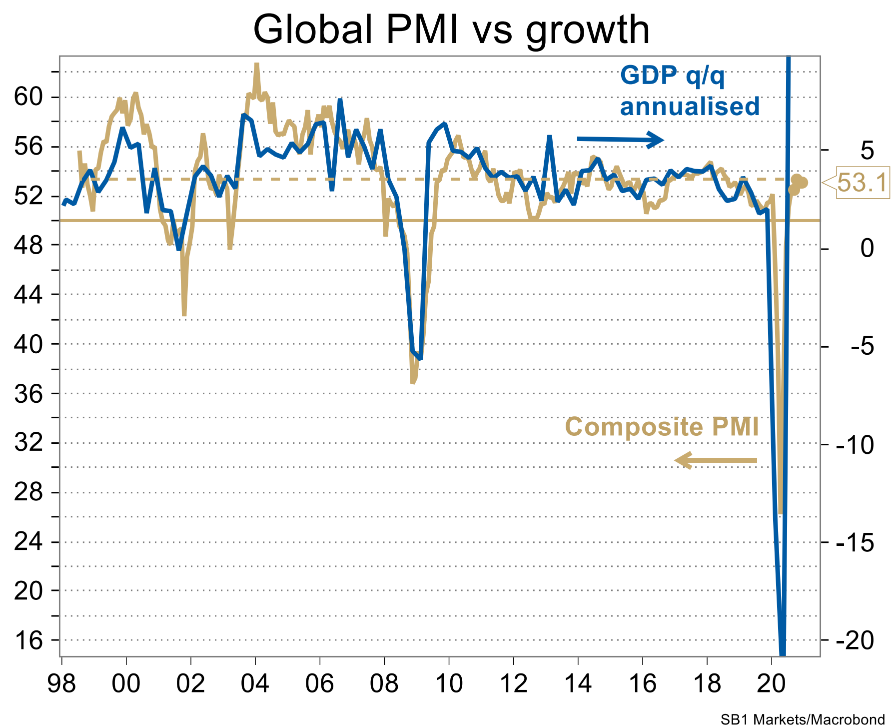


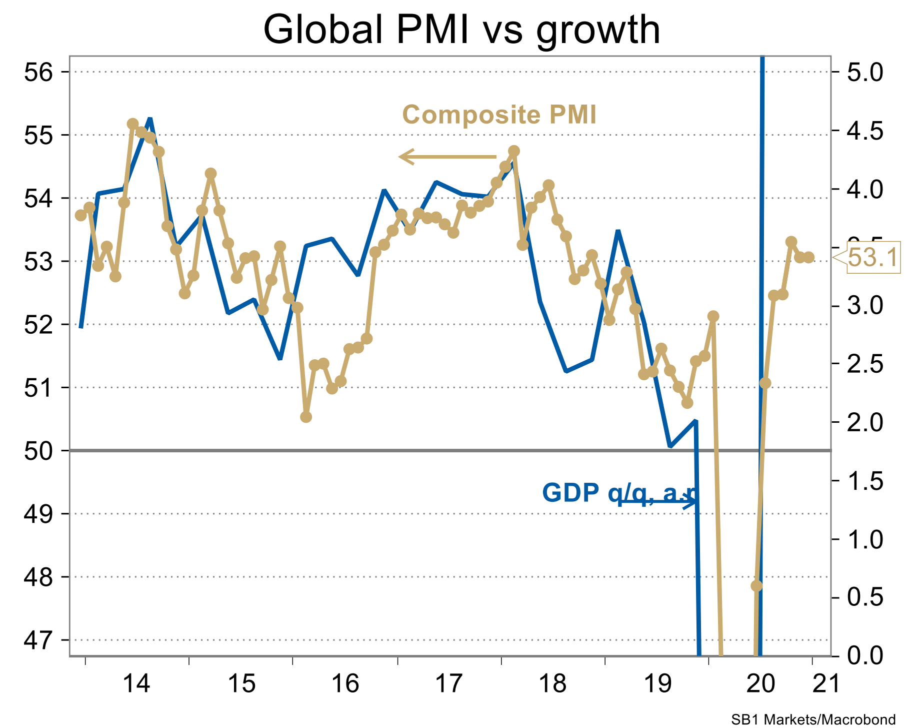
- Some observations – Q3 vs Q4-20:
  - » China 3.2% above Q4. Other are down:
  - » India still down 8.2%, even after a 22% recovery in Q3 (124% annualised ☺)
  - » Japan is down 3.9% (but 6% vs Q3 19, before the VAT hike tanked the economy in Q4)
  - » USA -3.5%
  - » EMU -4.4%, of which Spain -9.1%, France -4.1%
  - » UK down 9.7% (our forecast)
  - » Sweden -3.1% (and Finland just -2.2%, best in the rich mans’ class). Denmark -4.1%
  - » Norway (Mainland) -3.2%



The global composite PMI probably stable at OK level in Dec, EMU sharply up

We estimate a flat (-0.4 to 0.4) global PMI at 53.1 (centre est), signalling growth at 3%



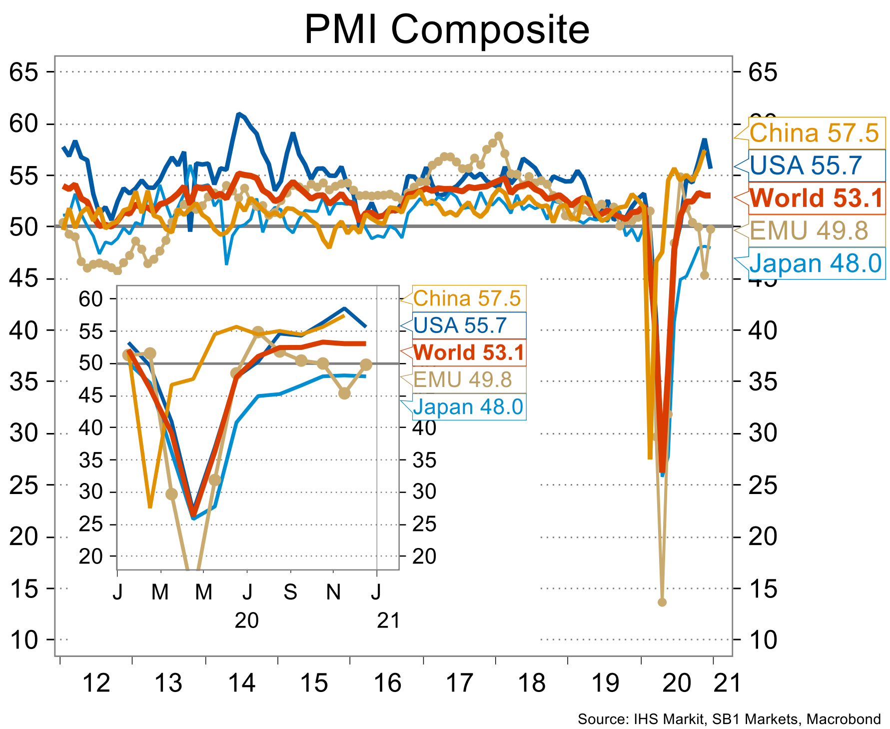


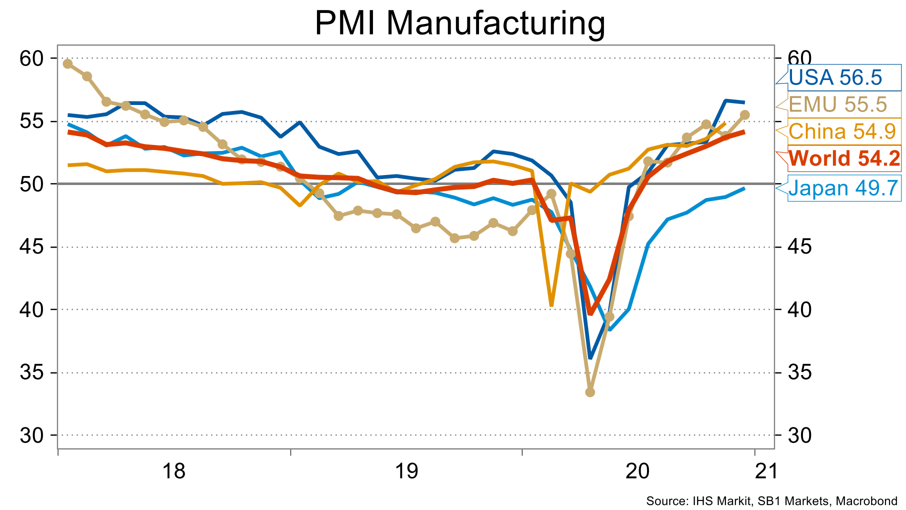
- The manufacturing PMI total index probably rose further (+0.5 p) in Dec even if both orders and output sub indices fell. (The output component is used when the composite PMI is calculated, not the headline total index)
- The global service sector PMI probably fell marginally, even if the EMU service PMI rose sharply following the decline in Nov. The US index headed down but remained at a high level
- Our Dec composite PMI estimate signal a continued recovery in the global economy in Q4 but probably not above trend growth due to a moderate downturn in Europe (even if the EMU index surprisingly rose sharply)

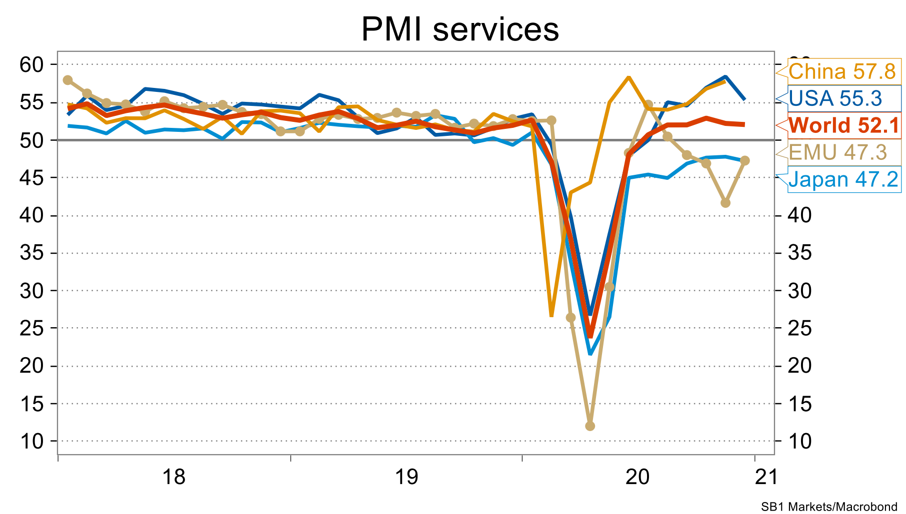
Our estimates are based on the preliminary PMIs from EMU, Japan UK, US. The estimates are uncertain, but usually by less than 0.5 p

A huge positive EMU surprise, US weaker than expected, still strong

The EMU PMI rose by 4.5 p to 49.8, exp. +0.4. Confirms just modest 2nd wave Q4 downturn



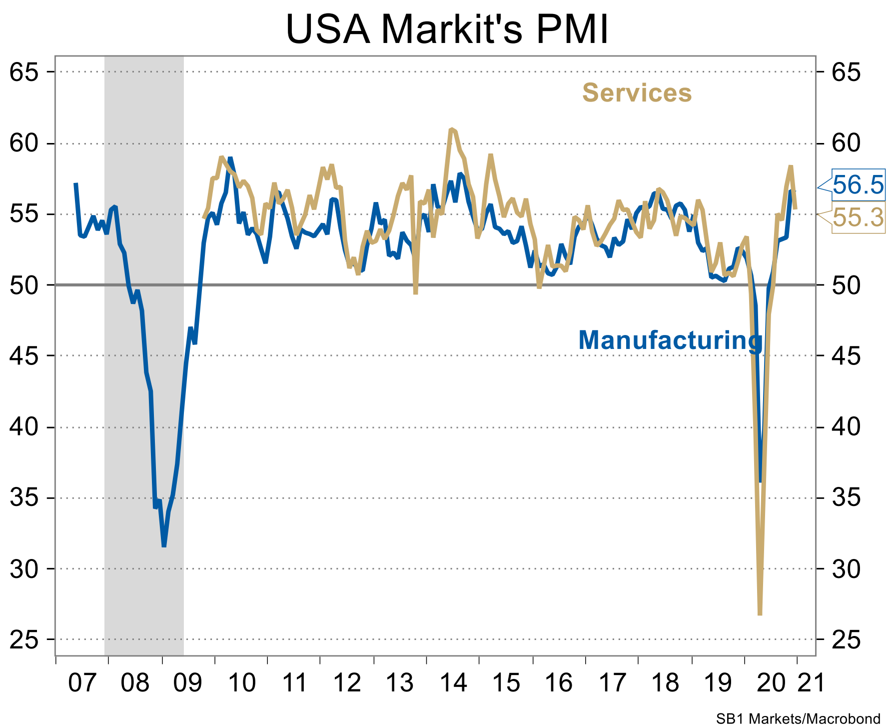


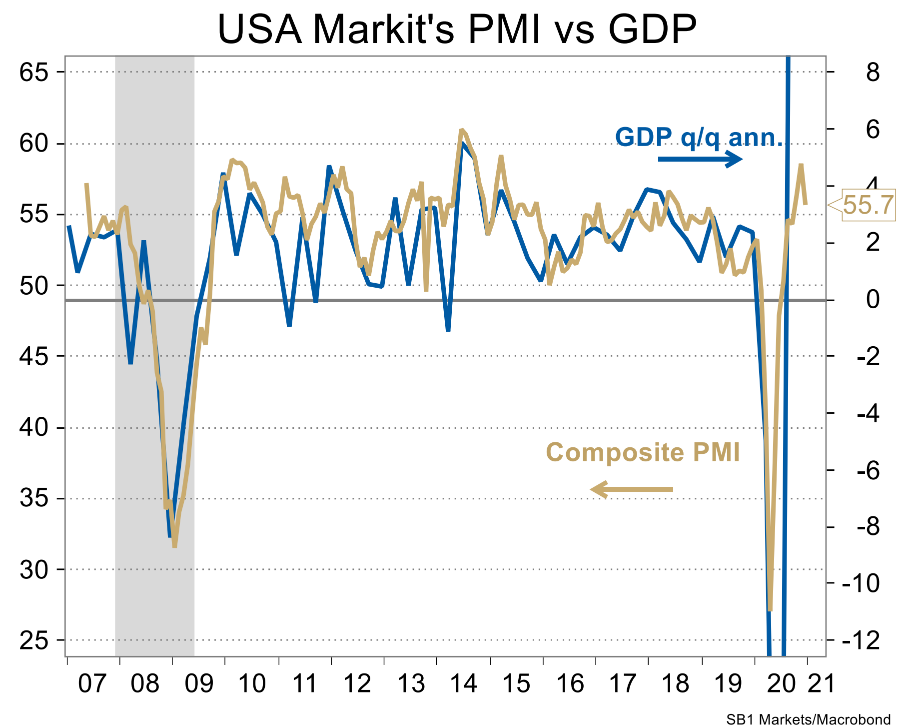


- In the EMU, service recovered sharply – but is still signalling a decline in activity. Manufacturing strengthened further, to 55.5. The composite at close to 50 does not signal any decline in GDP. Still a minor contraction is most likely?
- The US composite PMI fell by 2.9 p following strong months, and the level is still high, at 55.5. Not a serious 2nd wave setback!
- The UK surprised on the upside too. Japan still lags

The PMIs fell in Dec, still remains at strong level – signalling 3%+ growth in Q4

The comp. PMI -2.9 p to 55.7 – still far above average. The 2nd Covid wave doesn't bite (yet)

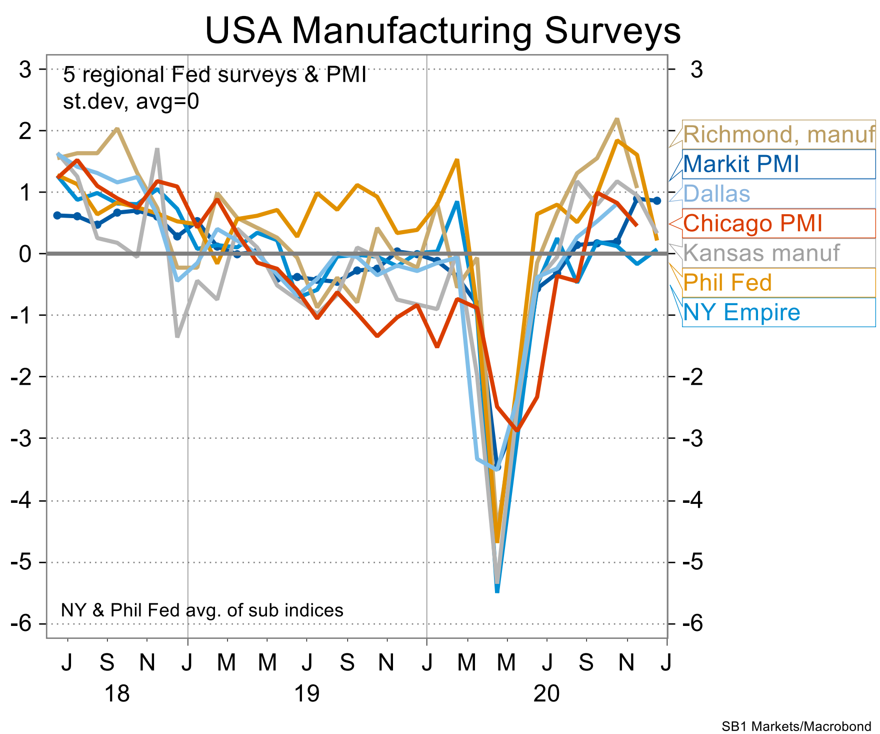


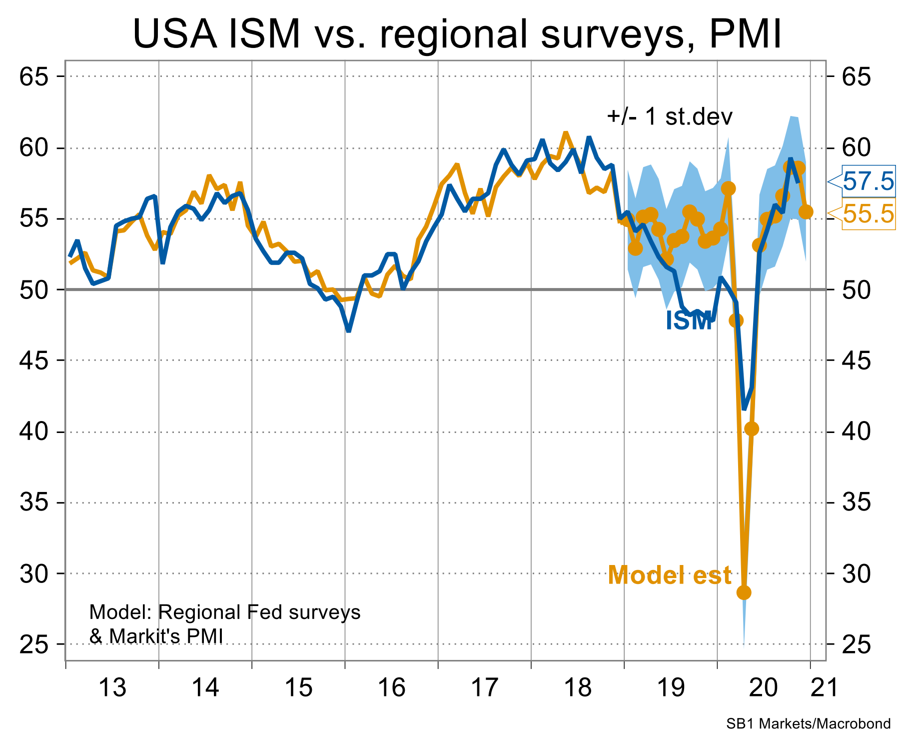


- The Nov print was the strongest since 2015 – and the Dec index is still at a high level
- Both services and manufacturing yielded, service the most – perhaps influenced by the 2nd Covid wave

Phil Fed sharply down, others better – but the models signals ISM down 2 p to 55

The Philadelphia Fed fell more than expected, Kansas down, the NY fed index up, PMI close to flat

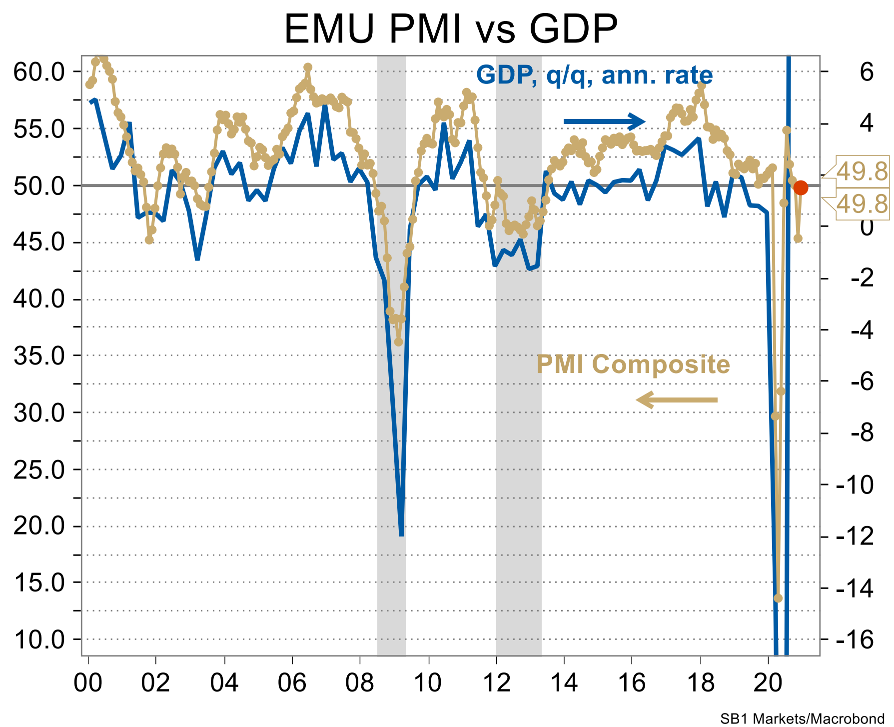


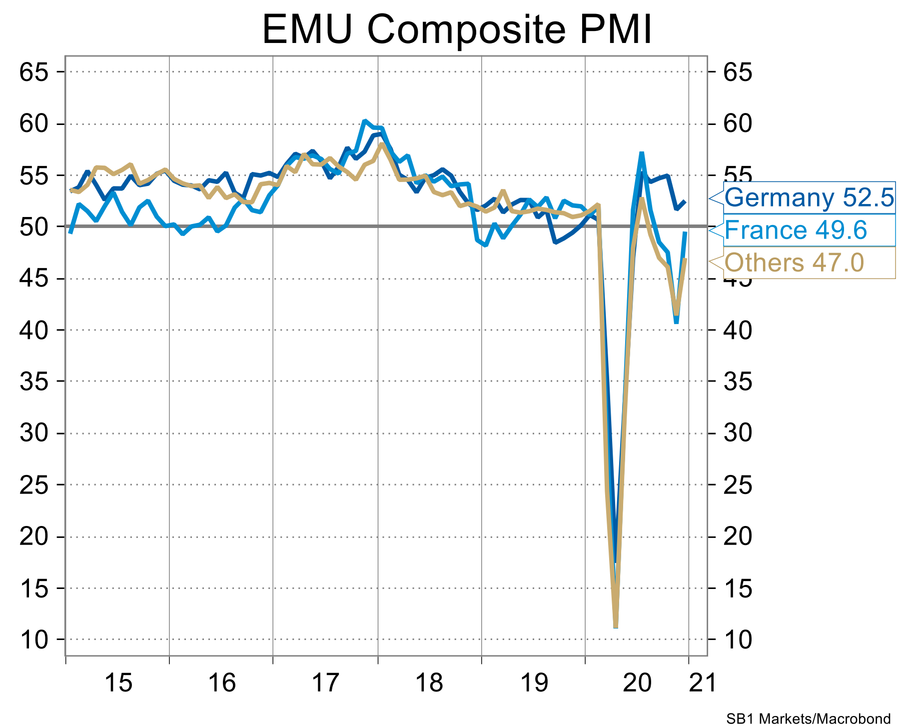


- The Phil Fed index fell to 11 from 26, expected 20. 11 is marginally above average – signalling growth above trend

The big Dec surprise: The PMI sharply up – almost back to 50! GDP has stabilised?

Both France and Italy/Spain turned around – still not signalling growth but not far from





- The preliminary **composite PMI** rose 4.5 p to 49.8 in December, 4.1 p above expectations. We cannot remember anything like this ever before in 'normal' times (PMIs were all over the place during the spring/early summer, for obvious reasons)
  - France rose by 9 p, 6.6 p more than expected.
  - Germany rose just marginally but was expected down.
  - The (implied, not published) average of Italy & Spain rose by 5 p, also miles ahead of expectations
- A PMI at 50 signals zero GDP growth. We still assume EMU GDP fell in Q4 but far less than many expected when the 2nd corona wave forced authorities to impose new restrictions in Oct and Nov.
  - It may be that a further tightening in some countries from mid Dec will hurt the economy more than the PMI respondents had experienced 1st half of Dec

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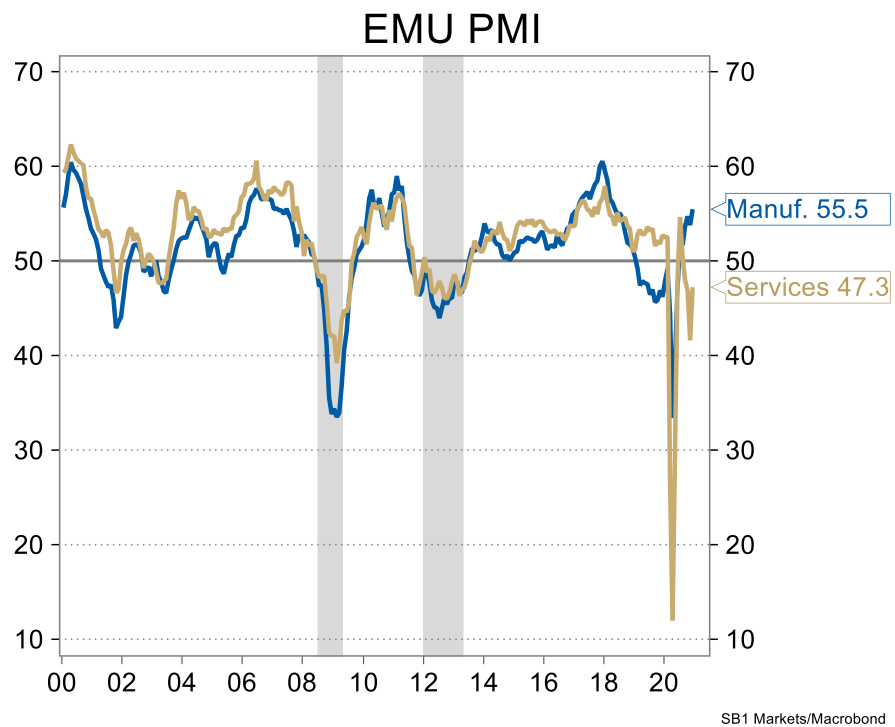
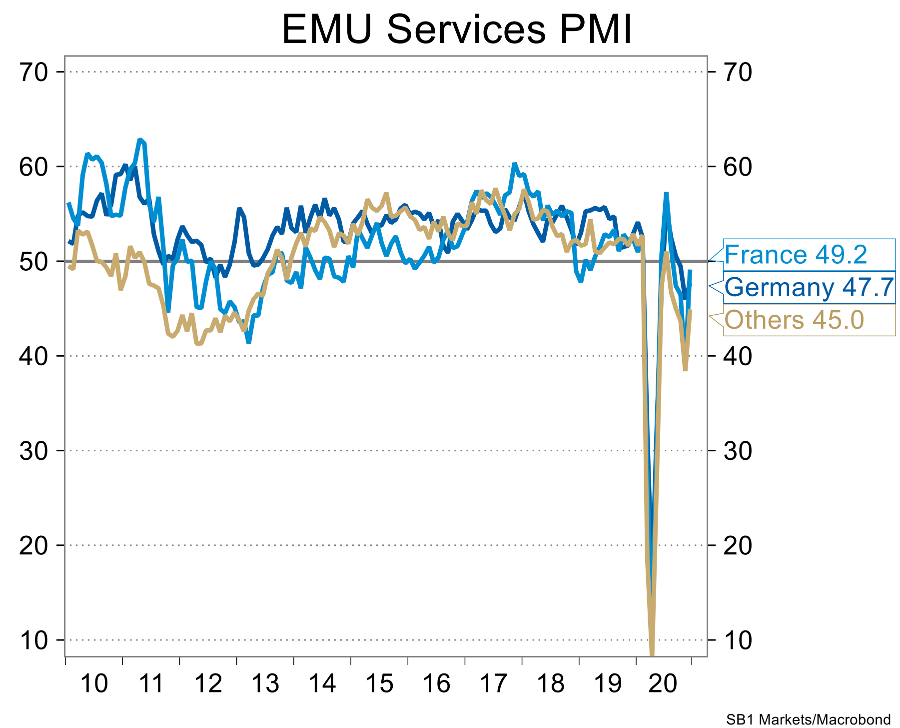
Services still in contraction mode, albeit far less than in Nov. Manuf. very strong!

The manufacturing PMI confirms that the downturn is nothing but corona trouble in some services



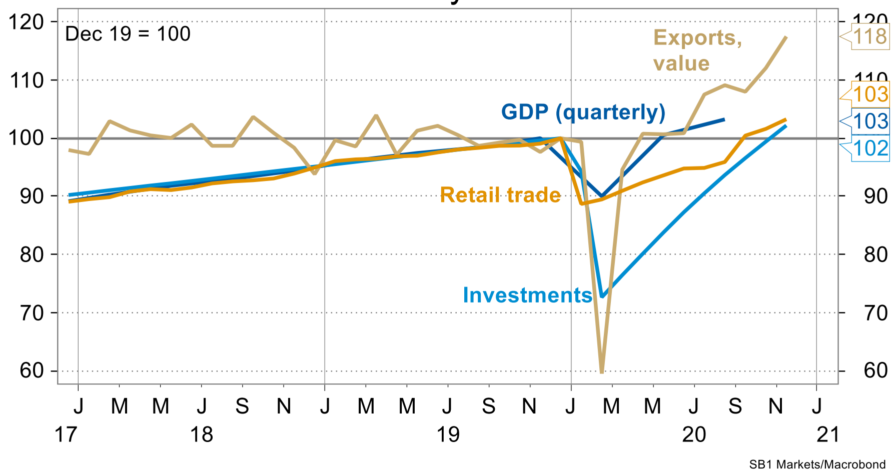


- The preliminary service sector PMI rose to 47.3 from 41.7 – signalling a further contraction but far less severe than in November, when the corona restrictions were introduced in several countries.
  - » The final German service sector index may be weaker, due to the partial lockdown implemented last week, and some services may struggle in January too
  - » However, as other countries have got some sort of control of the virus, the momentum may strengthen further here, and reopening growth in January is not unlikely. A permanent stable recovery is probably not possible before a substantial proportion of the population is vaccinated
- **Services** in France rose 10.4, and surprised by 9.2. Germany 3.5 above exp. The EMU total by 5.3 better than expected, still at 47.3
- Even the **manuf.** PMI surprised on the positive side by 2.5 p – and up to 55.5, driven by Germany and the (implied) Italian/Spanish avg

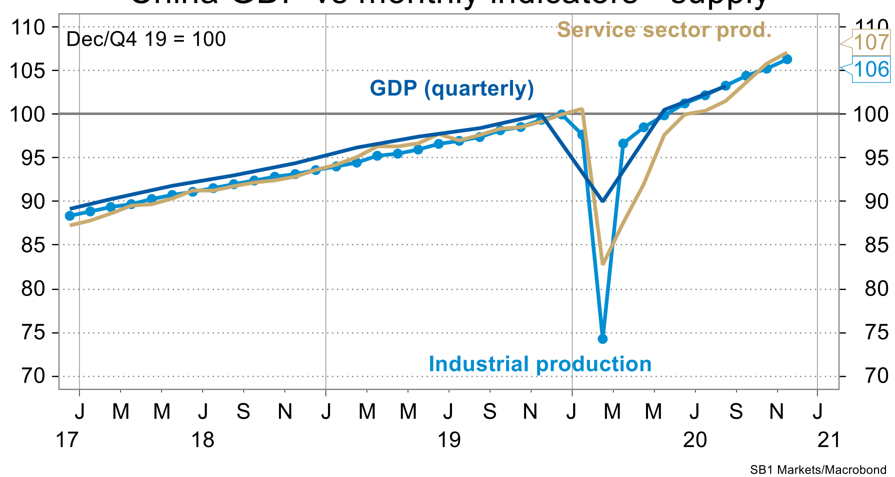
November data confirm the recovery – growth above trend, gaps are closed

Industrial & service sector production, exports above/at pre-corona trend; retail sales, investm. below

China GDP vs monthly indicators - demand



China GDP vs monthly indicators - supply

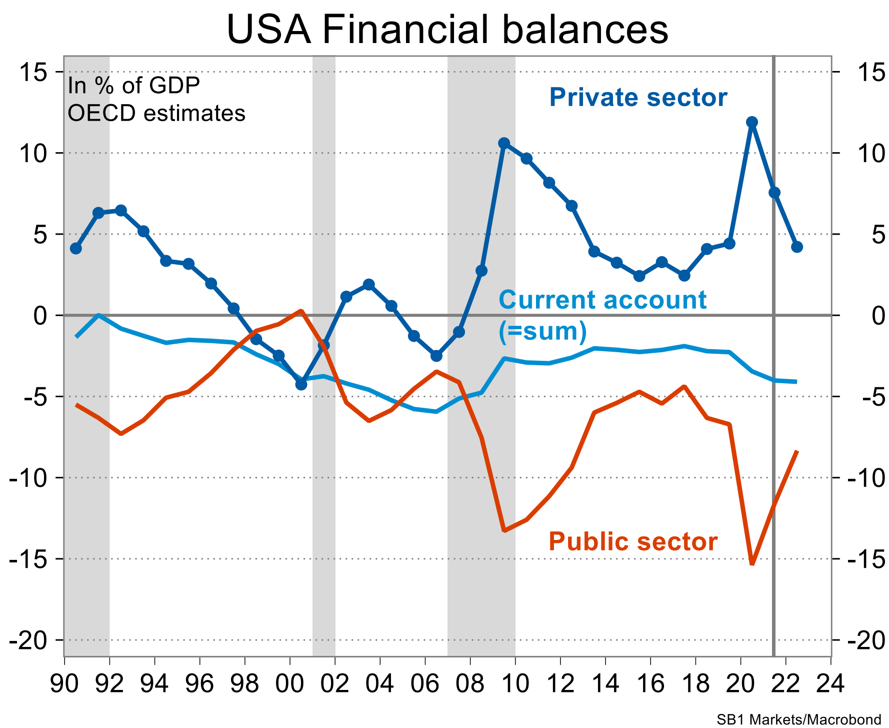


- **Industrial production** rose 1% m/m in Nov and 7.0% y/y, the latter as expected. Production is now 2% above the pre-corona trend path. Growth will now most likely slow
- **Service sector production** grew by 1.2% in Nov, slower than the prev. 2 months. Activity is 7% above the Dec 19 level – and 'finally' at the old trend path
- **Retail sales** rose 1.6% m/m in volume terms in Nov. Annual nominal growth rose by 0.7 pp to 5%, as expected. The gap to the pre-corona trend path is now just 1%! **CPI inflation** is falling sharply, and prices are down 0.5% y/y (from above +5% at the peak) as pork prices are heading down. Supportive for real household demand, of course
- **Investments** rose 2.9% m/m in Oct. Growth is slowing modestly, which is natural as the gap vs the pre corona trend is closing rapidly, now at 2% below. The gap will be closed in Dec/Jan
- **Credit growth** is slowing, and underlying growth has fallen to 9% (from 15) and it is now close no nominal GDP growth
- **Exports** were strong in Nov, signalling growth both abroad, and imports were far from weak – growth at home too. Other Asian exports are on the way up

In sum: Gaps are more or less closed. The economy has fully recovered from the corona downturn. So it is possible ☺

Another fiscal stimulus deal: USD 900 bn, 4% of GDP

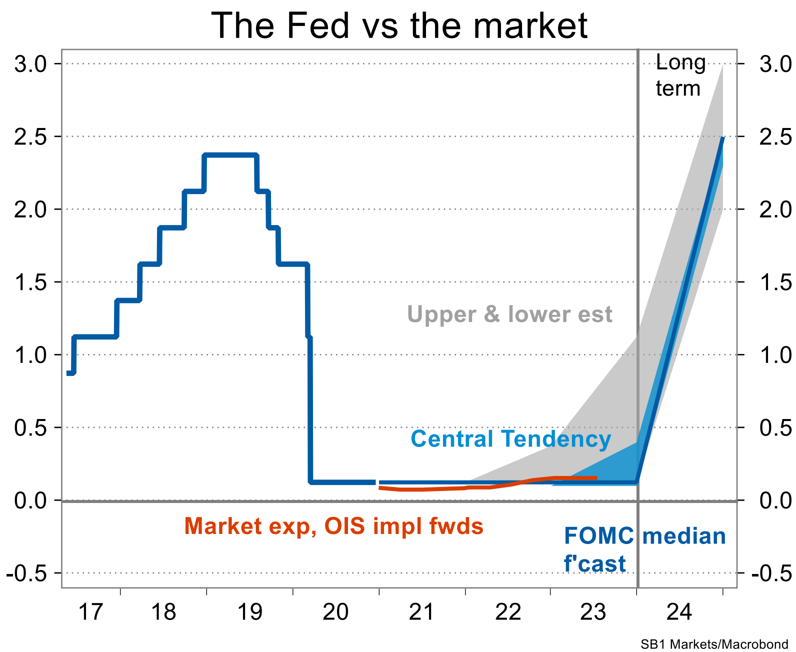
The Fed will be allowed to support the economy by emergency lending (in new programs)



- This is the **2nd emergency fiscal support package**. Yesterday' deal is the second largest in US history, only the April emergency deal at USD 1.800 bn, or 8% of GDP is larger
- **Cash support for households**: USD 600 to all adults earning less than USD 75'/year, and to their children – a not so targeted support. Household demand in general is not constrained by lack of income or low spending but rather by corona fears/public restrictions. Total household income is far above a normal level
- Prolonged temporary Federal **unemployment emergency support**, now at USD 300 per week per unemployed, for 10 more weeks – to perhaps as much as 12 mill. unemployed persons - a target measure
- A prolonged **Paycheck Protection Program** for small businesses (less than 500 employees) that can get loans, and write them down if they keep the employees on the payroll + support to airlines, some tax breaks, rental assistance, and the eviction moratorium is extended until Jan 31, education support (USD 82 bn!), nutrition assistance
- Funding for hospitals, covid-19 testing, **vaccine distribution** etc
- Even measures to counter **climate change** and to promote **clean energy** were included in the bipartisan bill, the first such legislation to pass Congress in nearly in a decade (according to NYT). Trump is loosing his grip?
- The Congress also prepared to fund the government next year to prevent another **shutdown** of the government activities
- How large will the **US budget deficit** be next year? Smaller than in 2020. But not small. The 4% of GDP deal in not included in OECD's estimates, at least not the whole package
- The **public sector deficit** will decrease when the private sector (households + businesses) reduces its savings – that were record high in 2020. That will happen as soon as households are allowed and able to spend money on services again. Sometime net year? Think so

Fed reassures market and reiterates need for fiscal stimulus

Economy suffering from pandemic, not highly accommodative financial conditions *Fed Chair Powell*



- Some investors had expected the Fed to increase the amount and/or lengthen the duration of its asset purchases. As a result of the lack of change in the pace of bond buying in the QE program, the longer end of the yield curve steepened after the statement was released. However, during the press conference Powell stressed the new timing guideline, and yields fell. At the end of the day, the 10y gov bond yield rose by 2 bps to 0.92%, driven by a 4 bps increase in inflation expectations, and 2 bps decline in the TIPS real rate

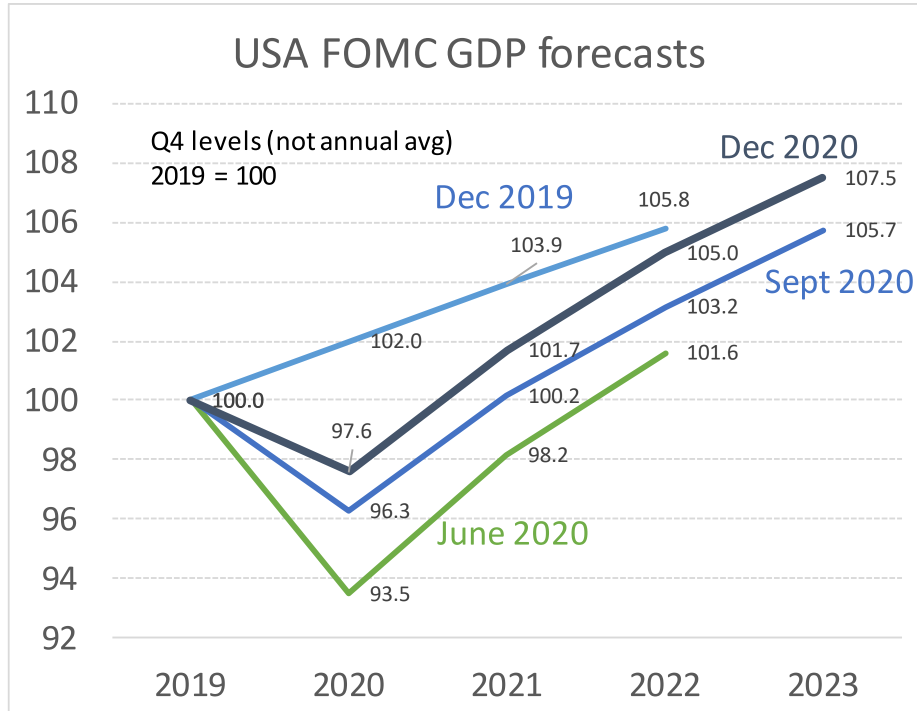
- The target rate was left unchanged at 0-0.25%, as expected, and the FOMC members expect an unchanged signal rate at least trough 2023
- QE until…
  - » *'The Federal Reserve will continue to increase its holdings of Treasury securities by at least \$80 billion per month and of agency mortgage-backed securities by at least \$40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals.*
- In the previous statements, the FOMC stated:
  - » *..over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities at least at the current pace*
  - » The two important changes:
    1) The QE program will not last just 'over coming months' but until employment and inflation has strengthened sufficiently. The same has already been the case for the signal rate, *the signal rate will not be lifted from zero until labour market conditions have reached levels consistent with the Committee's assessments of maximum employment, and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time.* So, QE will also continue until Fed has reached its mandated goals. When will that happen? In late 2023?? Check next page
    2) The FOMC will from now increase its bond holdings at least by USD 120 bn/m. So far, Fed's message was that QE would continue at least at the current pace – and the current case has been USD 80 bn/m. The new target quals 7% of GDP per year!
- Some focus on the limitations of monetary policy and a call for fiscal stimulus: 'The parts of the economy that are weak are the service sector businesses that involve close contact. Those are not being held back by financial conditions, but rather by the spread of the virus'
- **All in all: In line with expectations**

GDP, inflation once more revised upwards

Q4 2020 GDP up 1.3% and unempl. down 0.9 pp vs Sept. No changes to the Fed funds rate path

Percent

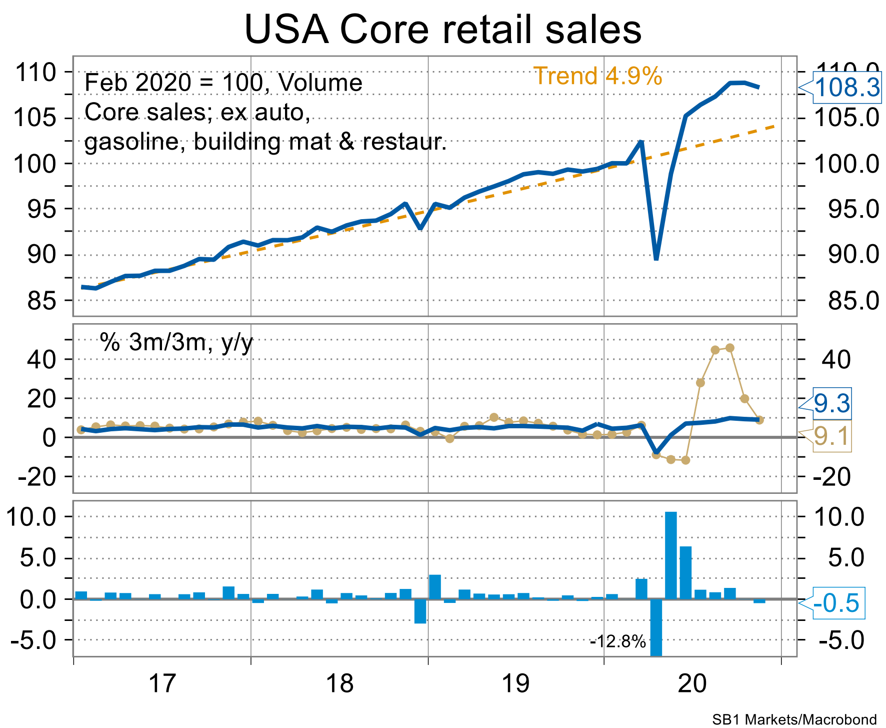
Variable	Median[1] 2020	2021	2022	2023	Longer run
Change in real GDP	-2.4	4.2	3.2	2.4	1.8
September projection	-3.7	4.0	3.0	2.5	1.9
Unemployment rate	6.7	5.0	4.2	3.7	4.1
September projection	7.6	5.5	4.6	4.0	4.1
PCE inflation	1.2	1.8	1.9	2.0	2.0
September projection	1.2	1.7	1.8	2.0	2.0
Core PCE inflation[4]	1.4	1.8	1.9	2.0	
September projection	1.5	1.7	1.8	2.0	
Memo: Projected appropriate policy path					
Federal funds rate	0.1	0.1	0.1	0.1	2.5
September projection	0.1	0.1	0.1	0.1	2.5

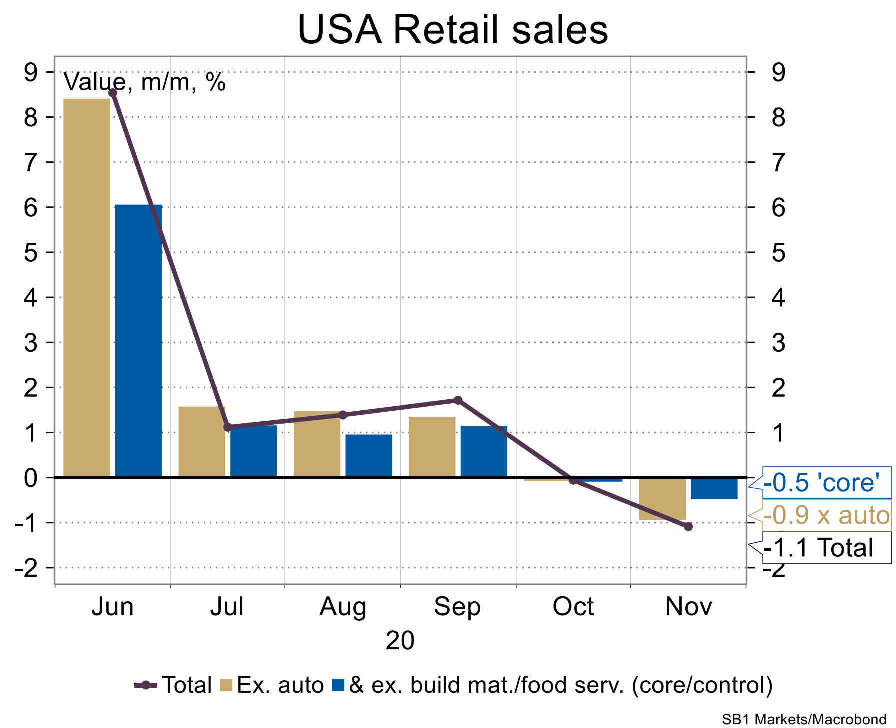


- The revisions in GDP and unemployment forecasts were smaller than those in September (which were the largest on record). The Q4 2019 GDP level is now supposed to be reached in mid 2021 vs the end of 2021 as f'casted in Sept (In June, the bank assumed that to happen in mid 2022). Most likely the Fed will – as all others – revise its forecast several times before Q4 2023. (In June, Q4 was expected down 6.5% vs. Q419. Now the est. is 2.4%)
- PCE inflation (Fed's preferred price measures, which is in average running some few tenths lower than the CPI inflation) is expected to reach 2.0% first by the end of 2023. Hence, the Fed will keep rates at zero for at least this long, and raise the Fed funds rate only when inflation is on track to exceed 2%. This is what the bank says now. Do not forget however, how much the Fed has revised its inflation forecasts along the way; check the next page
- **Given the substantial revision of GDP & inflation f'casts, the Fed could reach its 'trigger' targets much sooner than indicated at this point, perhaps even in 2021?**
- The bank did not change its forecast for the longer term neutral policy rate – now at 2.5% nominal and 0.5% in real terms

Retail sales fell further in Nov, as Oct data was revised down. Level still sky high

The 2nd/3rd corona wave, lack of jobless stimulus probably to blame. Core sales still up 8% vs Feb

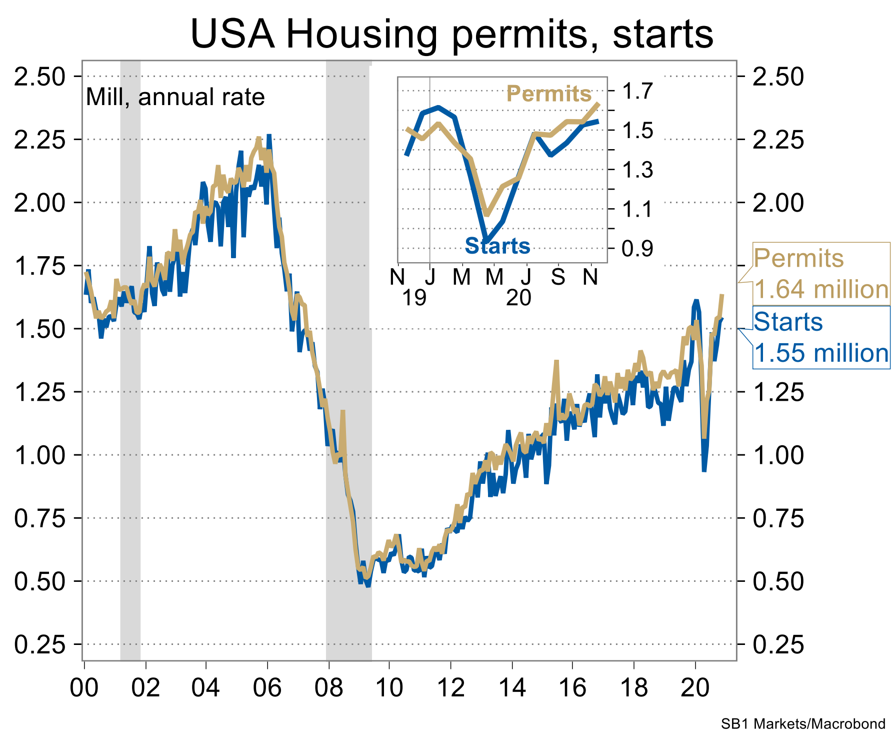


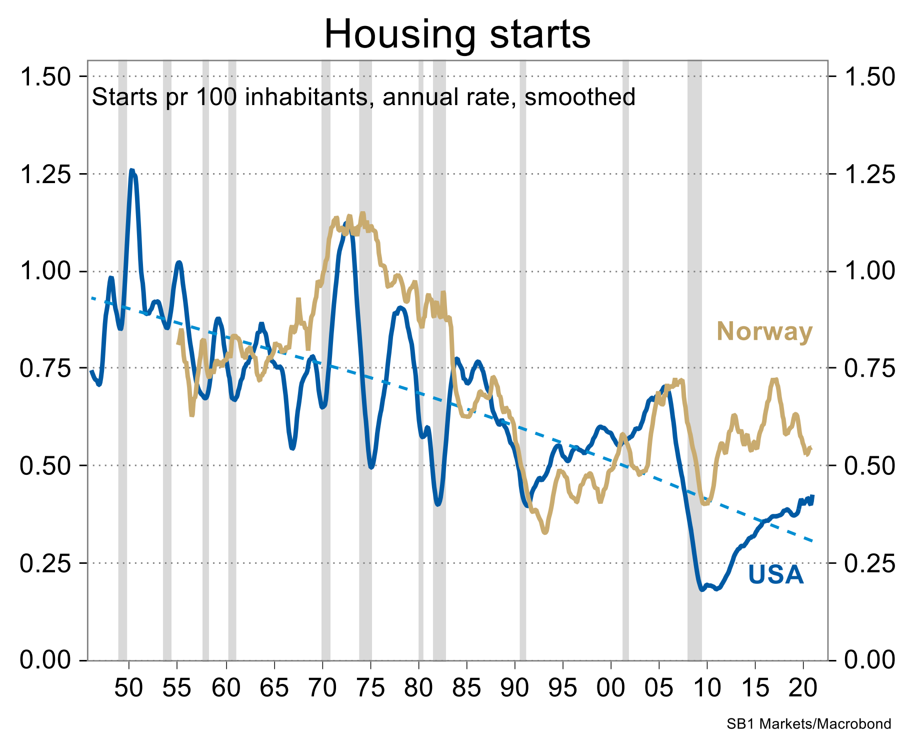


- Total nominal sales declined by 1.1%, expected down 0.2%, and Oct was revised down by 0.4 pp to -0.1%
- Core sales (=control group, excludes auto, gasoline, building materials & restaurants) fell by 0.5%. We assume the same amount in volume terms – following zero growth in October
- Core sales are still 8% above the Feb level – and up 9.3% y/y. At one stage, the level has to come down (like in most other rich countries)
- Check details next page, still huge discrepancies between sectors

Housing building permits the highest in 13 years in ~~October~~ November

Permits up 6% to 1.64 mill in Nov, the highest level since 2007. Starts up too, and the level is high

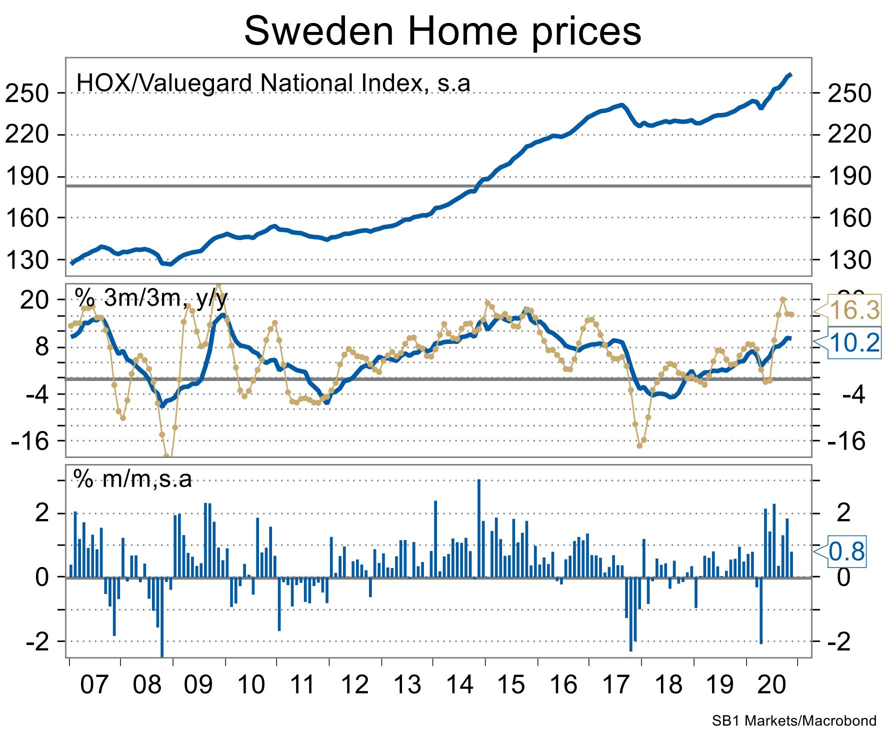




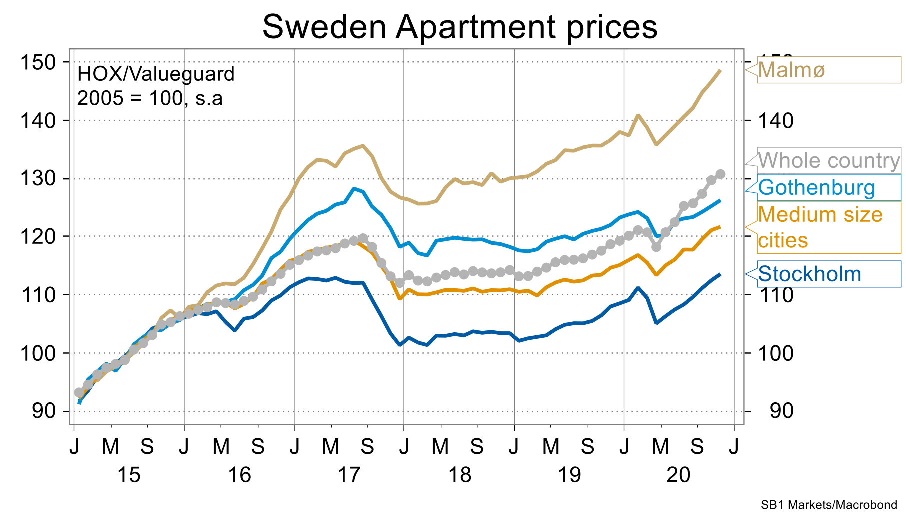
- Permits and starts are up 50 – 65% from the April trough – and are back to well above a 'normal' levels
  - » Starts are slightly below the local peak at the end of 2019 but far above the 2019 average – and barring the Dec 19 – Feb 20 local spike, the highest since 2007
  - » Permits were at the highest level since early 2007
- Housing starts are at a quite low level per capita vs. history, like in all other rich countries, as the 'country is built', at least in many cities – and starts have been trending downwards in most countries
  - » However, not in Norway the past 30 years

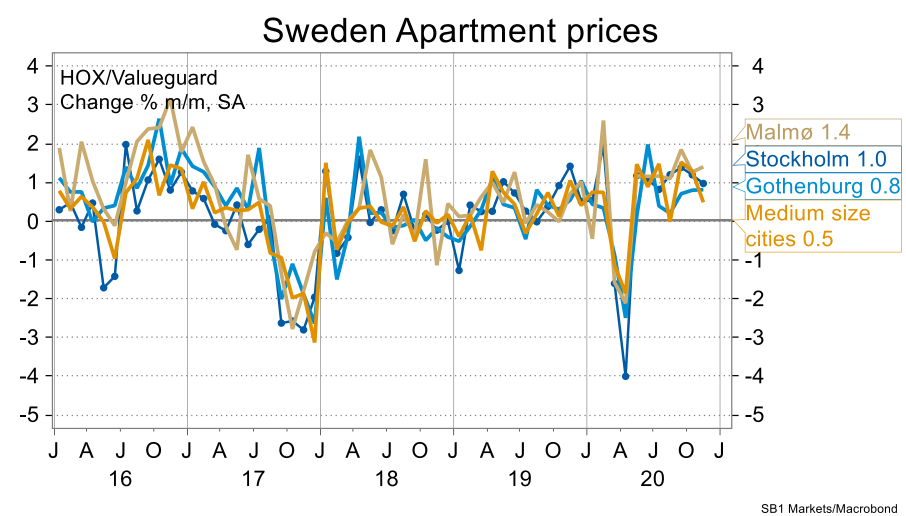
Swedish house prices up 0.8% in November, up 10% y/y

No corona crisis at the housing market



- Underlying price growth is now 15 – 20%, even higher than in Norway
- Prices are now increasing in all the major cities – and finally both Stockholm and Gothenburg prices are above the February level, after being lagging sharply recent months



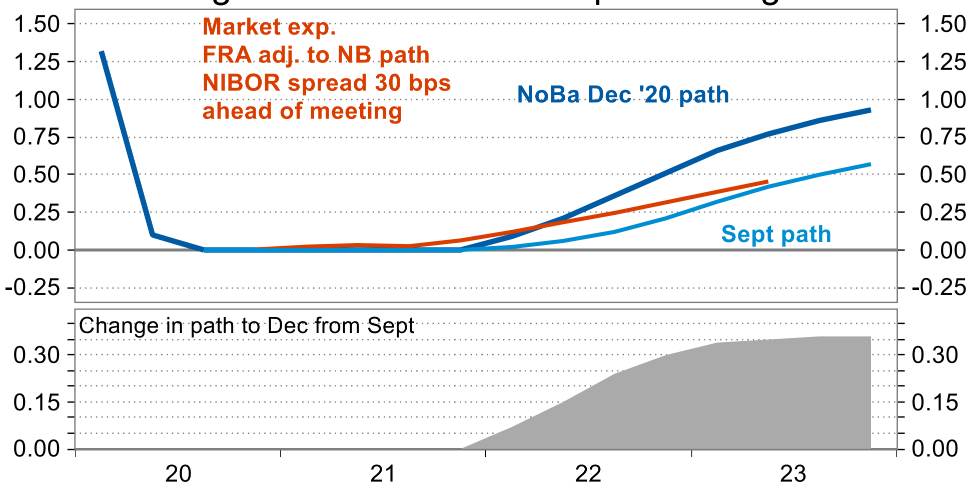


SpareBank 1 MARKETS

Norges Bank goes against the grain – lifts rate path by up to 36 bps!

First rate hike moved forward by two quarters to Q1 2022 – two hikes before the year end

Norges Bank Interest rate path changes



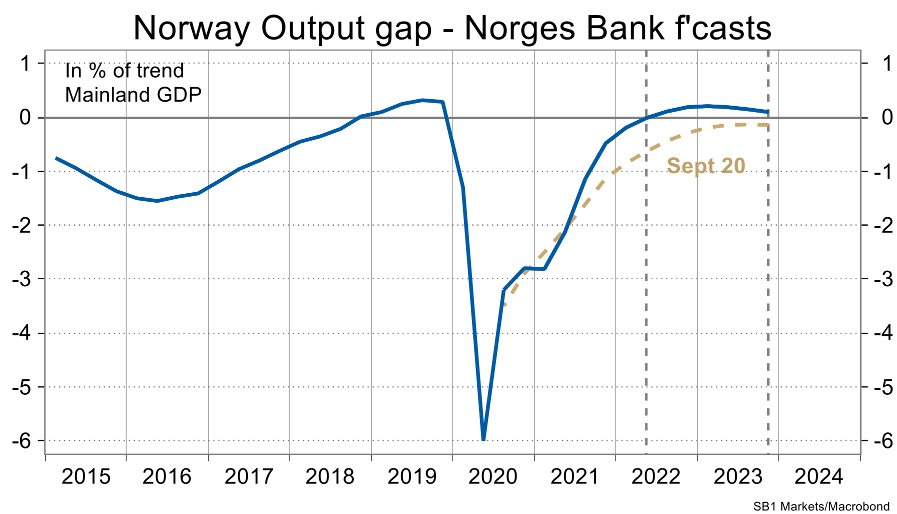
Norges Bank, SB1 Markets/Macrobond

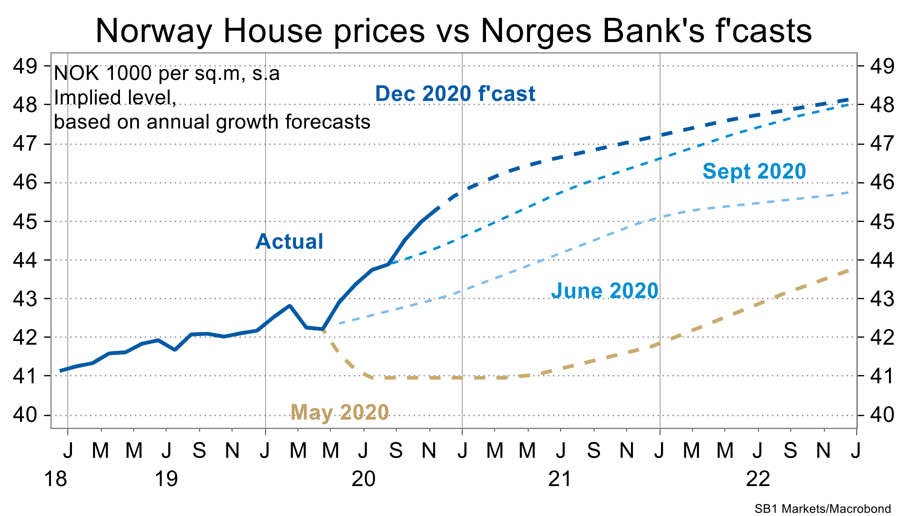
Interest rate paths	Path 3-20	Path 4-20	Change bps	SB1M est	Fair FRA *) @IMM, NoBa	FRA now	NoBa - FRA
Q2 20	**0.10**	**0.10**	**0**	**0.10**			
Q3 20	**0.00**	**0.00**	**0**	**0.00**			
Q4 20	**0.00**	**0.00**	**0**	**0.00**	0.30		0.30
Q1 21	**0.00**	**0.00**	**0**	**0.00**	0.30	**0.35**	-0.05
Q2 21	**0.00**	**0.00**	**0**	**0.00**	0.30	**0.34**	-0.04
Q3 21	**0.00**	**0.00**	**0**	**0.00**	0.30	**0.38**	-0.08
Q4 21	**0.00**	**0.00**	**0**	**0.02**	0.38	**0.45**	-0.07
Q1 22	**0.02**	**0.09**	**7**	**0.06**	0.49	**0.52**	-0.03
Q2 22	**0.06**	**0.21**	**15**	**0.12**	0.64	**0.60**	0.04
Q3 22	**0.12**	**0.36**	**24**	**0.21**	0.79	**0.68**	0.11
Q4 22	**0.21**	**0.51**	**30**	**0.32**	0.94	**0.77**	0.17
Q1 23	**0.32**	**0.66**	**34**	**0.44**	1.05	**0.84**	0.22
Q2 23	**0.42**	**0.77**	**35**	**0.55**	1.15	**0.91**	0.23
Q3 23	**0.50**	**0.86**	**36**	**0.64**	1.22	**0.98**	0.24
Q4 23	**0.57**	**0.93**	**36**	**0.72**	1.29	**1.08**	0.21

**) Assuming a 30 bps NIBOR spread*

- Norges Bank kept the **key policy rate** unchanged at 0%, as expected. However, **the rate path** was significantly lifted, and more than expected. While the Sept MPR indicated the first rate hike in Q3 2022, the Bank now signals **Q1 2022** and another hike by Q3-Q4, and up to 4 hikes by late 2023
- **Vaccine** news, softer fall in **investments**, a rise in **house prices**, and high savings rates (indicating future spending) contributed to the rate path adjustment. The output gap will be fully closed in Q2-22, and not (almost) in Q3-23, which also explain the change of timing of the first rate hike (more on the details next page)
  - » Norges Bank stresses the uncertainty regarding the vaccines and the impact on the economy. In an upside scenario, just few restrictions will be in place from Q2 and the output gap is closed in early 2022, the downside scenario implied a negative gap for years ahead, and restrictions not fully lifted before Q3 2022
- Norges Bank was **more hawkish than expected**, and the FRAs rose by up to 10 bps & the NOK immediately appreciated some 0.5%.
- We expect the first hike to be **brought further forward to H2 2021** if the vaccine rollout is successful – and if house price inflation doesn't slow down significantly through H1. We expect domestic demand for service to 'explode' as soon as the virus is brought under sufficient control and restrictions eased
- There is still an **upside risk in the short (and presumably) in long end of the curve**. A **further NOK appreciation** is also more likely than another weakening

Norges Bank: The future is (probably) somewhat brighter



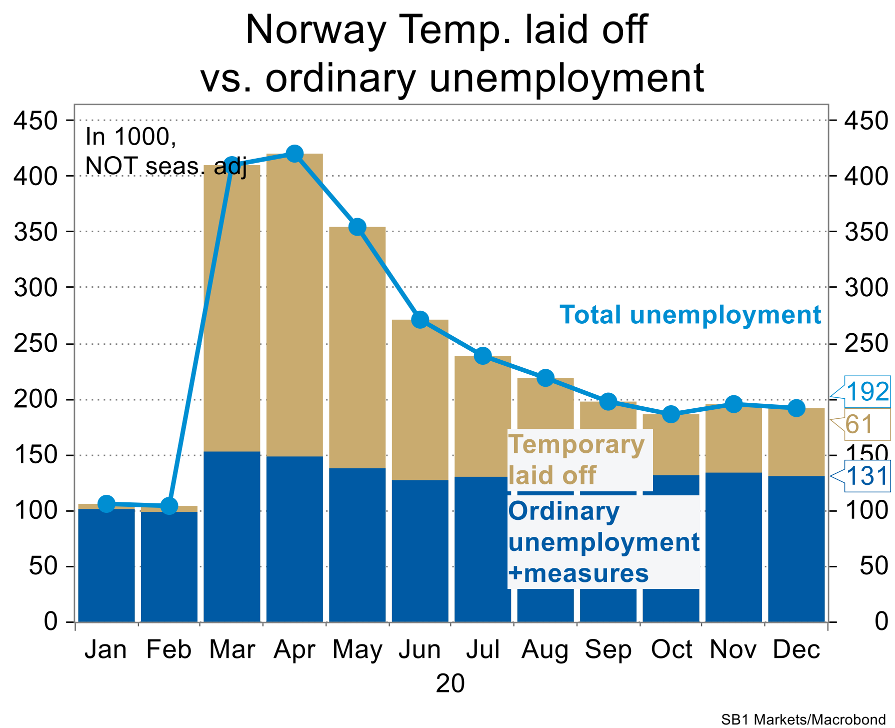


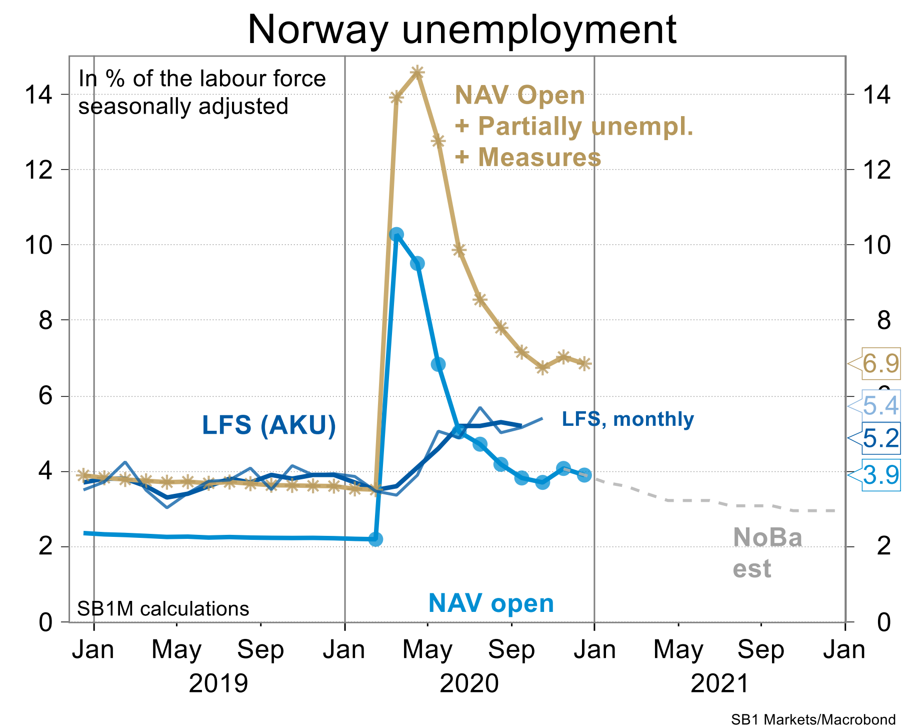
- **Mainland GDP** f'cast revised up 0.1% to -3.5% for 2020; f'cast for 2021 unch. at 3.7%; while the f'cast for 2022 is revised up to 3.1% from 2.7%
- Both **Mainland business investments and oil investments** are expected to decline less than indicated in the Sept. report.
- Fiscal policy is clearly tighter next year than in 2021, than assumed in Sept (before the Budget proposal was published)
- The **unemployment** rate f'casts for 2022/23 were revised marginally down. A gradual decline to a normal unempl. level is expected by 2022
- Even if the change in the growth forecasts were limited, their impact on the **output gap** was significant. The gap is now expected to be closed by **Q2-2022**. In the Sept MPR the gap 'never' closed, but is was approx at zero in **Q3-Q4 2023**
- **Core CPI inflation** is expected to slow faster the next years. Wage inflation at 2.2% in 2020 and 2.0% in 2021
- **House price inflation** is expected to slow substantially during next year, to 3% through 2021 from 8% through 2020.
  - » Media has reported that average annual growth rates will accelerate to 6.7% in 2021 from 4.4% in 2020, which is not the most relevant information, as most of the 2021 price inflation already has taken place in 2020
- The Bank expects **credit growth** to be somewhat higher than growth in disposable income. **Household savings** are expected down the coming years, supporting a strong recovery in private consumption (abroad, that is)

SpareBank 1 MARKETS

NAV unemployment down in in December, no serious 2nd wave trouble

As indicated by weekly data, unemployment fell by 5' (seas adj) in Dec, reversing half of the Nov hike





- **Open 'full time' unemployment** measured at NAV, which includes furloughed workers fell by 5' through Dec (we expected -3') to 110', 3.9% of the labour force, as Norges Bank (and we) assumed. The rate fell to 3.8% not seas adjusted, in line with consensus). Thus, half of the hike in Nov was reversed, without any formal 'corona restriction easings'.
  - **Including labour market measures**, unemployment fell by 3' to 124', as we assumed, equalling 4.4% of the labour force, down from 4.5%. In February, the rate was 2.6%. The decline open unemployment was in line with NoBa's f'cast
  - **Including part time unemployed**, the grand total declined by 7' to 192' or 6.9% (seas adj). Before corona: 3.5%
- The LFS (AKU) reported a decline to 5.2% in September (3 m avg). These data have been lagging NAV figures as furloughed workers have not been counted as unemployed before staying 3 months at the dole

The Christmas calendar

The last 2020 sweets: US orders, housing data, Chinese PMIs & Norwegian LFS unempl & retail sales

Time	Count.	Indicator	Period	Forecast	Prior
Monday Dec 21					
14:30	US	Chicago Fed Nat Activity Index	Nov		0.83
16:00	EC	Consumer Confidence	Dec A		-17.6
Tuesday Dec 22					
08:00	NO	Unemployment Rate AKU	Oct	5.2%	5.2%
08:00	NO	Housing starts	Nov		
09:00	SW	Economic Tendency Survey	Dec		97.5
09:00	SW	Consumer Confidence	Dec		88.3
09:00	SW	Manufacturing Confidence SA	Dec		110.6
09:30	SW	Retail Sales MoM	Nov	-0.4%	0.5%
16:00	US	Conf. Board Consumer Confidence	Dec	97	96.1
16:00	US	Existing Home Sales	Nov	6.70m	6.85m
Wednesday Dec 23					
14:30	US	Initial Jobless Claims	Dec-19	863k	885k
14:30	US	Durable Goods Orders	Nov P	0.6%	1.3%
14:30	US	Cap Goods Orders Nondef Ex Air	Nov P	0.5%	0.8%
14:30	US	Personal Income	Nov	-0.2%	-0.7%
14:30	US	Personal Spending	Nov	-0.2%	0.5%
14:30	US	PCE Core Deflator YoY	Nov	1.4%	1.4%
16:00	US	U. of Mich. Sentiment	Dec F	80.5	81.4
16:00	US	New Home Sales	Nov	990k	999k
Friday Dec 25					
00:50	JN	Retail Sales MoM	Nov	-0.8%	0.4%
Monday Dec 28					
	GE	Retail Sales MoM	Nov	-2.0%	2.6%
00:50	JN	Industrial Production MoM	Nov P		4.0%
08:00	NO	Retail Sales MoM	Nov	(-1%)	1.2%
Tuesday Dec 29					
15:00	US	S&P CoreLogic CS 20-City MoM SA	Oct	0.90%	1.27%
Wednesday Dec 30					
14:30	US	Advance Goods Trade Balance	Nov	-$81.5b	-$80.3b
16:00	US	Pending Home Sales MoM	Nov	-0.5%	-1.1%
Thursday Dec 31					
02:00	CH	PMI Manufacturing, NBS	Dec	51.9	52.1
02:00	CH	PMI Non-manufacturing	Dec	56.3	56.4
14:30	US	Initial Jobless Claims	Dec-26		
Monday Jan 4					
02:45	CH	PMI Manufacturing, Markit	Dec	55.2	54.9

- **PMIs**
  - » The **Chinese Dec PMIs** will be reported by the end of next week and Jan 4. So far, they have been signalling a continued recovery, well above a trend growth pace
- **USA**
  - » **Manufacturing durable orders** have been very strong during H2, especially investment orders – which are well above the pre corona level, signalling strong growth in business investments in Q4 too. **Housing data** has been strong as well, **existing home sales & prices indices** out this week. House prices have climbed much faster than expected previous months, according to the (less trustworthy) realtors they are up 15% from May (and y/y). Case/Shiller reports more modest price hikes, but still an unusual acceleration
- **EMU**
  - » **German retail** sales probably fell in November, even before the harsh restrictions were implemented in mid December
- **UK/EU/Brexit: Perhaps gods know but probably not**
  - » Guess they can continue until 11.59 PM Dec 31. And then agree upon to continue…
- **Norway**
  - » **Retail sales** probably fell in November, from a high level in October
  - » We expect a small uptick in the **LFS (AKU) unemployment rate** in October (avg Sept – Nov). The NAV unemployment rate rose 0.3 pp in November (but reversed half of the lift in December

Source: Bloomberg. SB1M est. in brackets. Key data points are highlighted, **the most important in bold**

Highlights

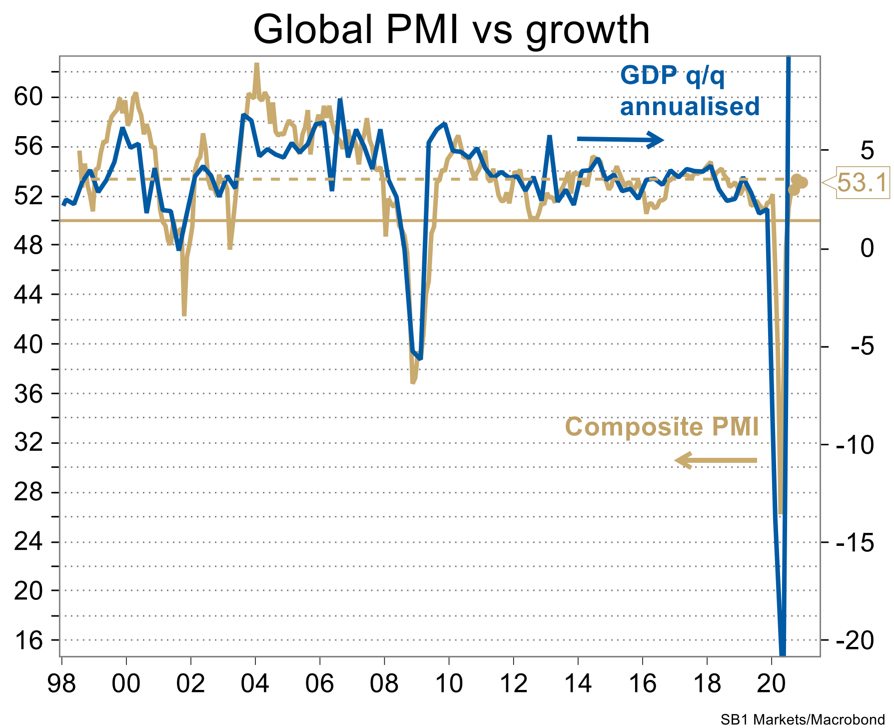
The world around us

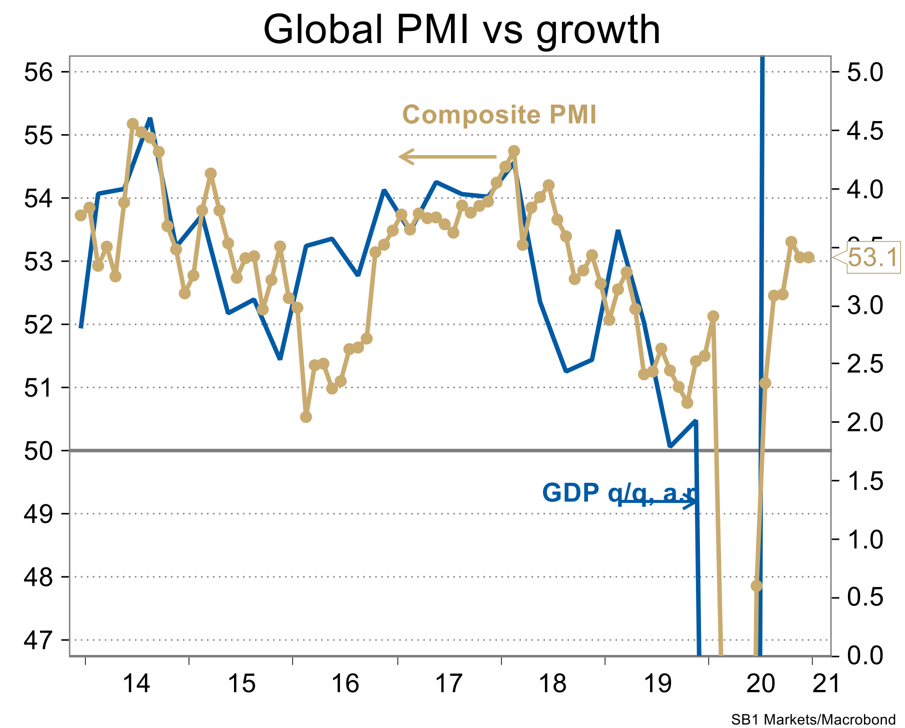
The Norwegian economy

Market charts & comments

The global composite PMI probably stable at OK level in Dec, EMU sharply up

We estimate a flat (-0.4 to 0.4) global PMI at 53.1 (centre est), signalling growth at 3%



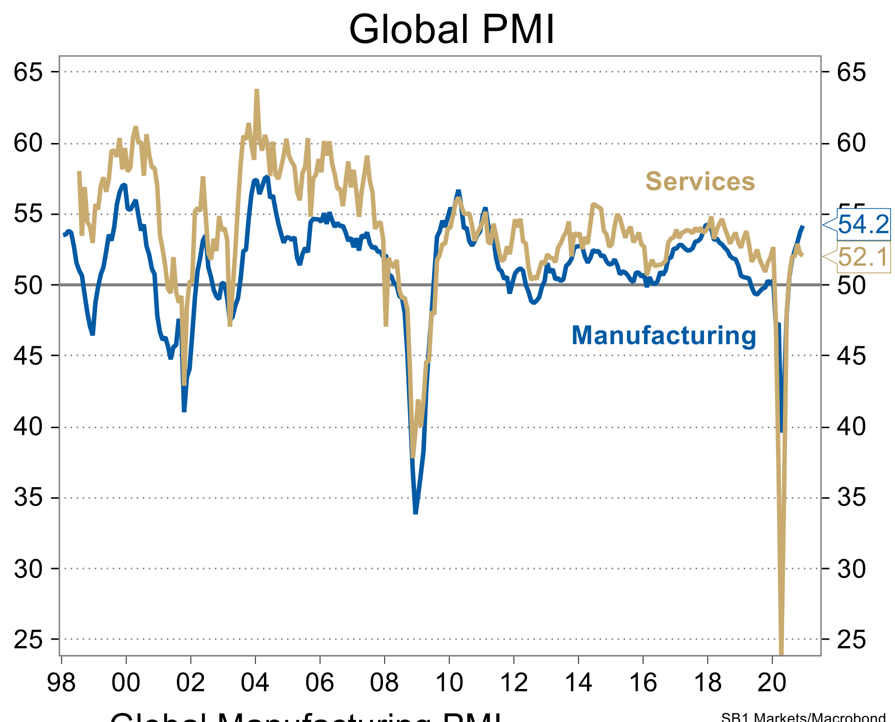


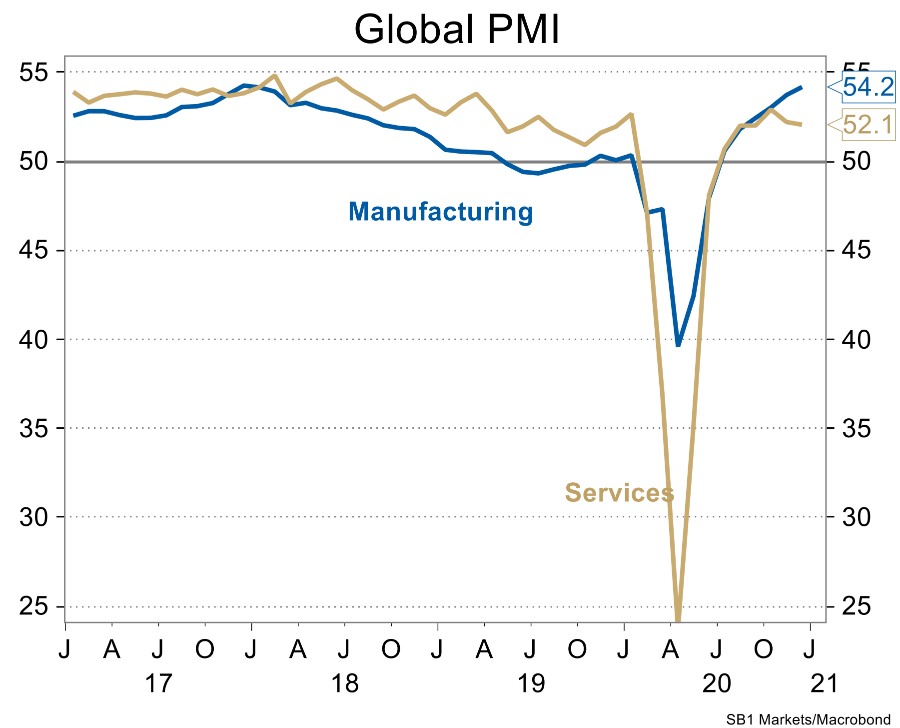
- The manufacturing PMI total index probably rose further (+0.5 p) in Dec even if both orders and output sub indices fell. (The output component is used when the composite PMI is calculated, not the headline total index)
- The global service sector PMI probably fell marginally, even if the EMU service PMI rose sharply following the decline in Nov. The US index headed down but remained at a high level
- Our Dec composite PMI estimate signal a continued recovery in the global economy in Q4 but probably not above trend growth due to a moderate downturn in Europe (even if the EMU index surprisingly rose sharply)

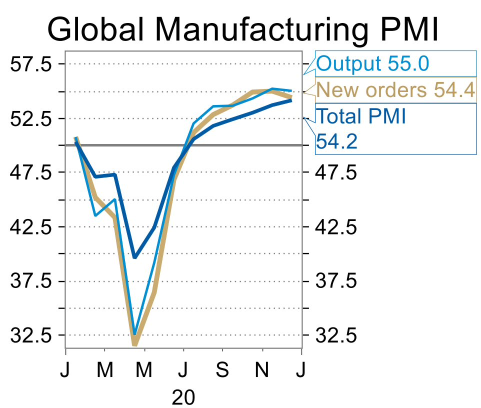
Our estimates are based on the preliminary PMIs from EMU, Japan UK, US. The estimates are uncertain, but usually by less than 0.5 p

Services marginally down, manufacturing (total index) further up in December

The most important components in the manufacturing PMI, orders & output, slightly down



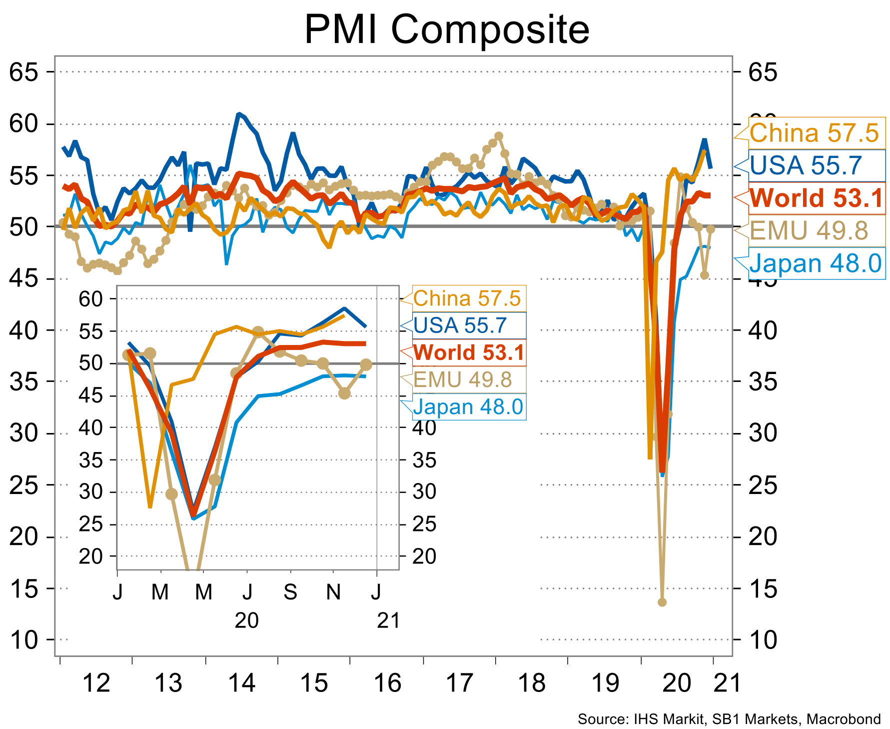


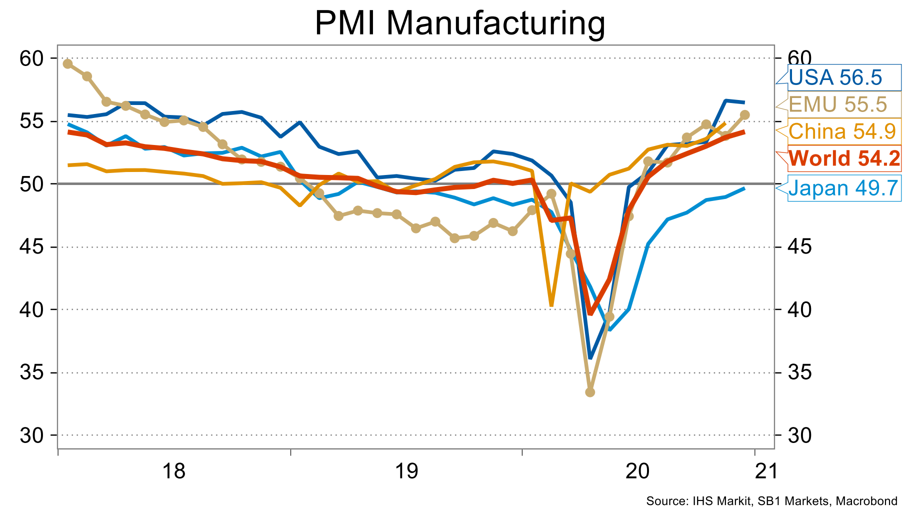


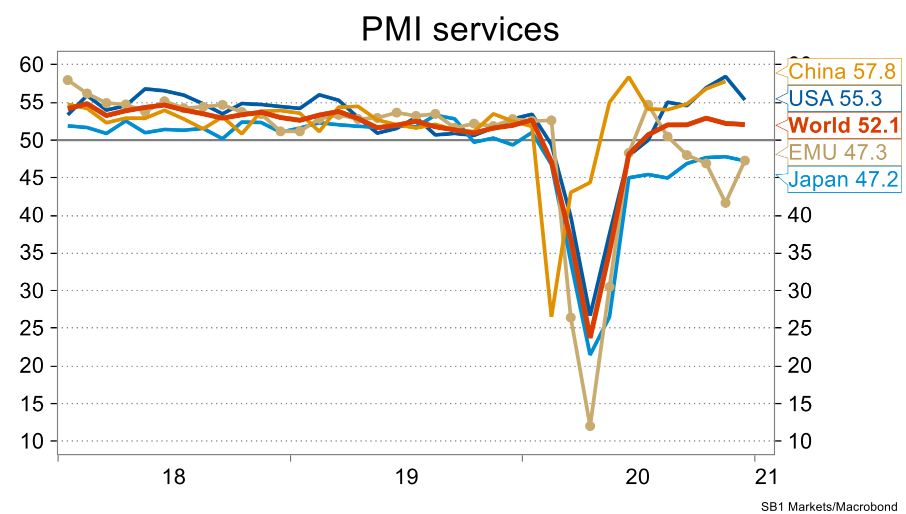
Our estimates are based on the preliminary PMIs from EMU, Japan UK, US. The estimates are uncertain, but usually by less than 0.5 p

A huge positive EMU surprise, US weaker than expected, still strong

The EMU PMI rose by 4.5 p to 49.8, exp. +0.4. Confirms just modest 2nd wave Q4 downturn



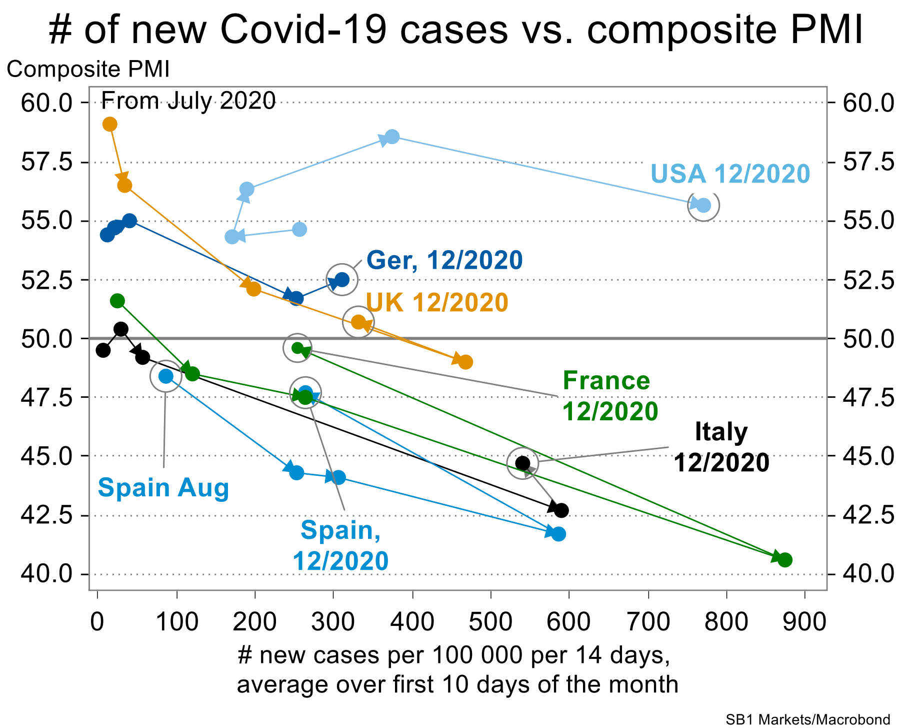




- In the EMU, service recovered sharply – but is still signalling a decline in activity. Manufacturing strengthened further, to 55.5. The composite at close to 50 does not signal any decline in GDP. Still a minor contraction is most likely?
- The US composite PMI fell by 2.9 p following strong months, and the level is still high, at 55.5. Not a serious 2nd wave setback!
- The UK surprised on the upside too. Japan still lags

The virus was beaten down in Nov, the EMU & UK PMIs rose in Dec!

The US PMI down, still not seriously hurt by the 2nd corona wave

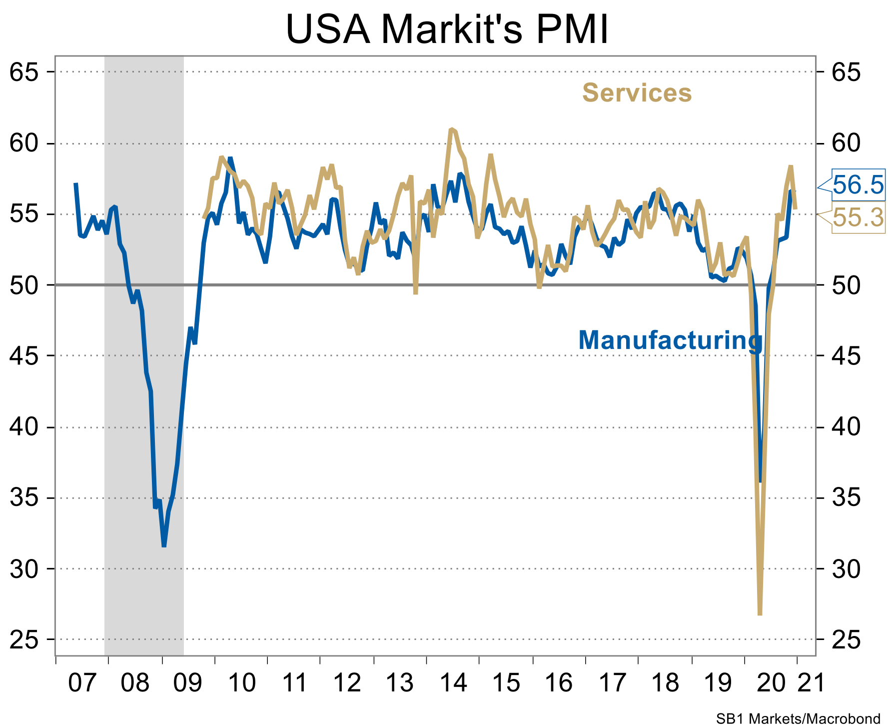


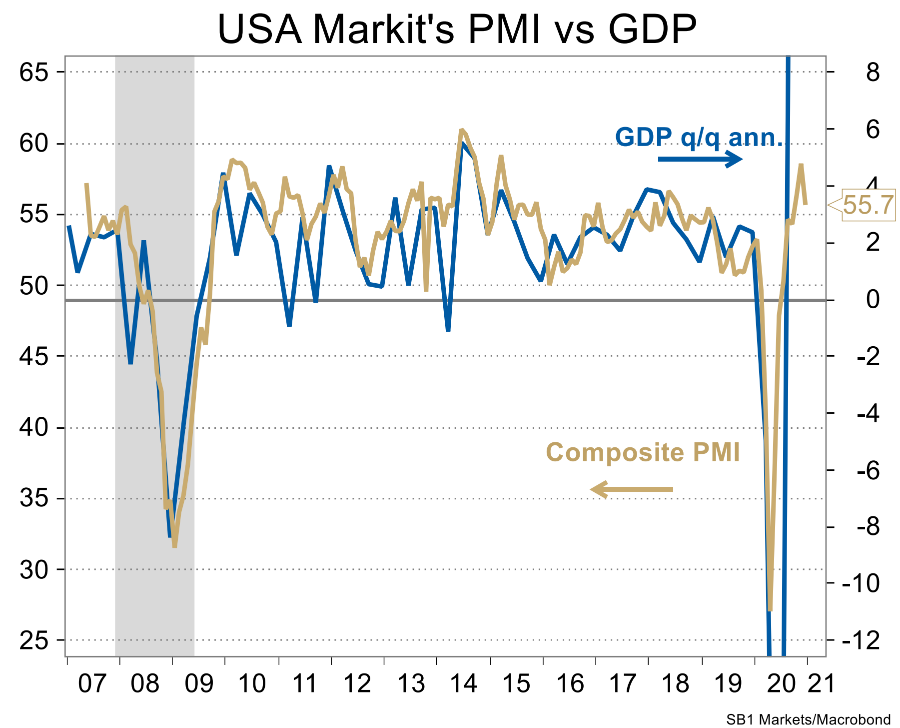
- In Dec, the US PMI fell at the same pace as the European PMIs fell earlier in the autumn – when the virus hit here (the lines are quite parallel)
- In Europe, the PMIs in France and UK recovered at the same pace as the PMIs fell when the virus spread faster to November from Aug/Sept. We assume the same was the case in Spain and Italy
- The German PMI rose, even in Services – in spite of a small increase in virus cases in December

- *The Spain and Italy December PMIs are our estimates, with downside risk for Spain, upside potential for Italy (we still just know the average for the two)*

The PMIs fell in Dec, still remains at strong level – signalling 3%+ growth in Q4

The comp. PMI -2.9 p to 55.7 – still far above average. The 2nd Covid wave doesn't bite (yet)

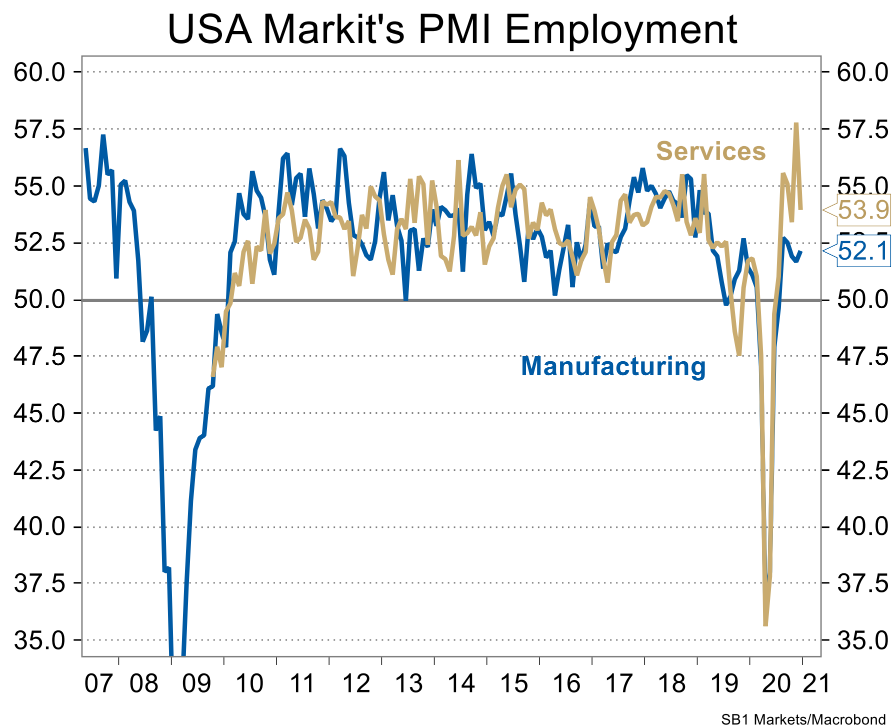


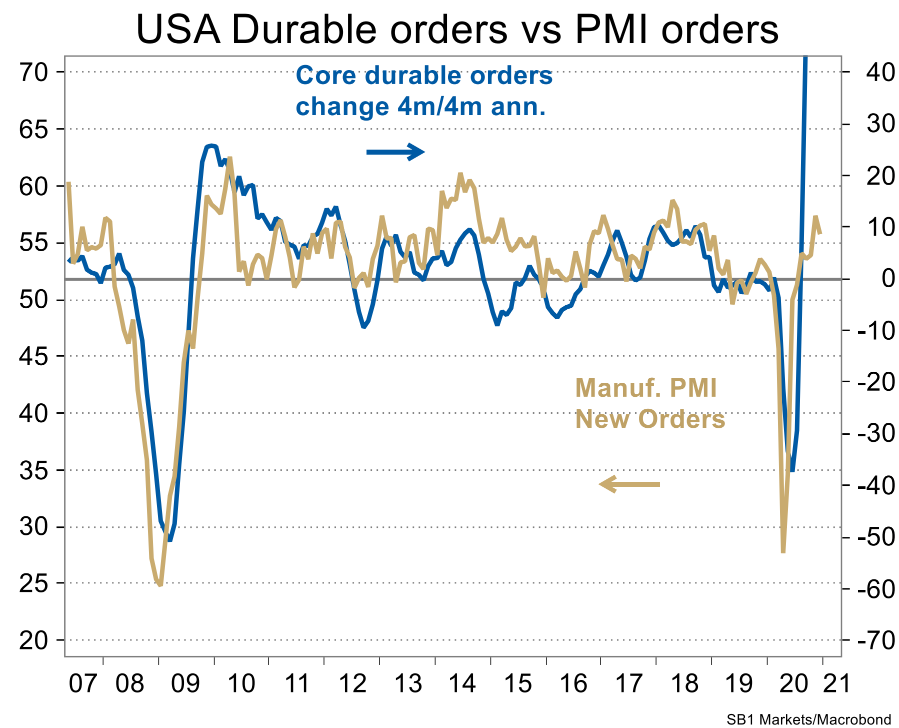


- The Nov print was the strongest since 2015 – and the Dec index is still at a high level
- Both services and manufacturing yielded, service the most – perhaps influenced by the 2nd Covid wave

Services are EMPLOYING again, they say – the empl. index down, still strong

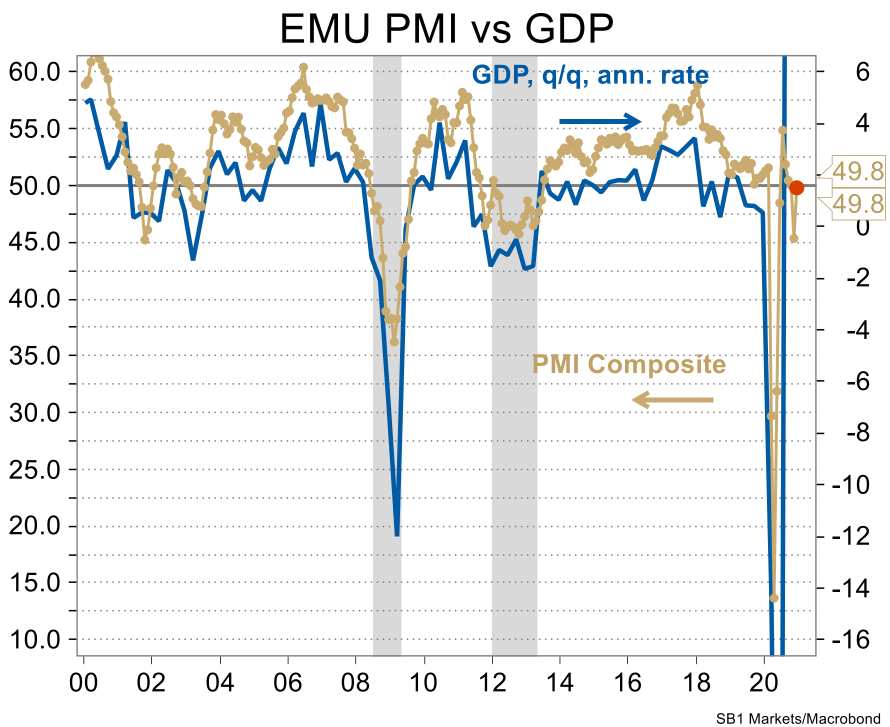
Order inflow to the manufacturing sector is strong too – far above a normal level

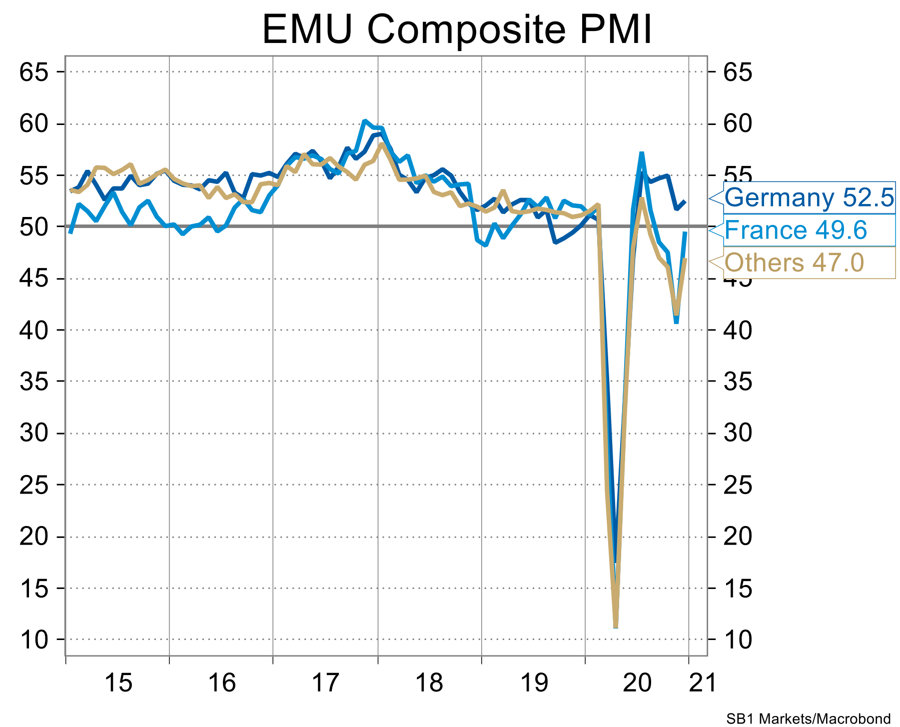




The big Dec surprise: The PMI sharply up – almost back to 50! GDP has stabilised?

Both France and Italy/Spain turned around – still not signalling growth but not far from

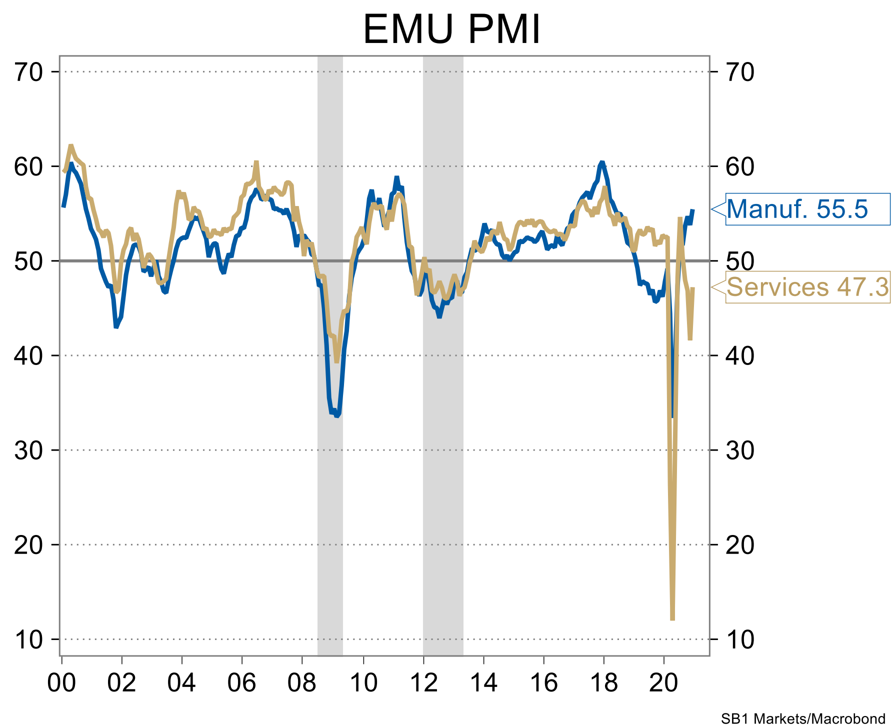


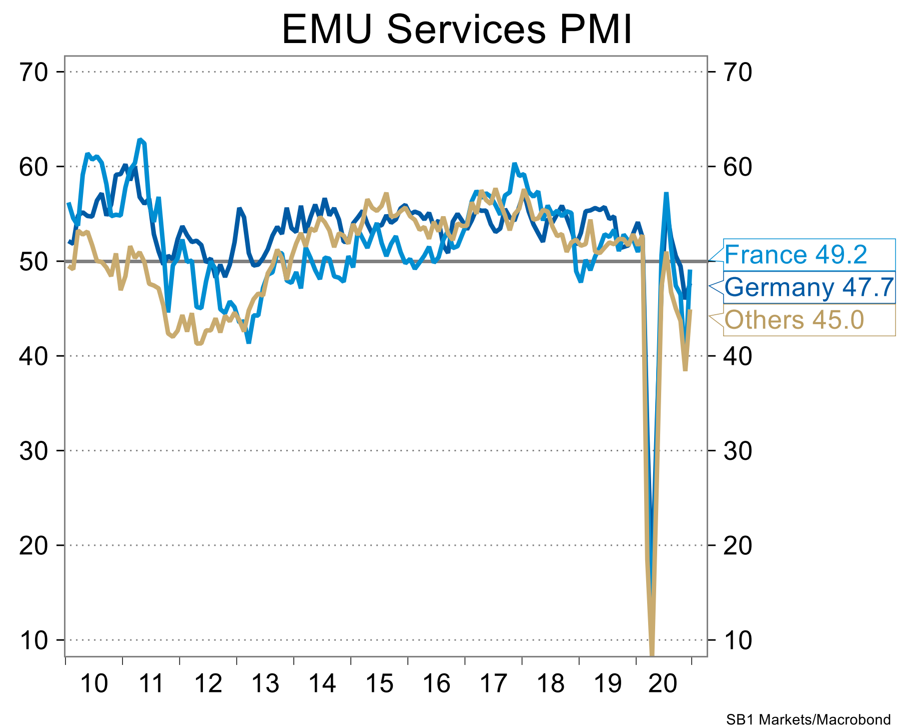


- The preliminary **composite PMI** rose 4.5 p to 49.8 in December, 4.1 p above expectations. We cannot remember anything like this ever before in 'normal' times (PMIs were all over the place during the spring/early summer, for obvious reasons)
  - » France rose by 9 p, 6.6 p more than expected.
  - » Germany rose just marginally but was expected down.
  - » The (implied, not published) average of Italy & Spain rose by 5 p, also miles ahead of expectations
- A PMI at 50 signals zero GDP growth. We still assume EMU GDP fell in Q4 but far less than many expected when the 2nd corona wave forced authorities to impose new restrictions in Oct and Nov.
  - » It may be that a further tightening in some countries from mid Dec will hurt the economy more than the PMI respondents had experienced 1st half of Dec

Services still in contraction mode, albeit far less than in Nov. Manuf. very strong!

The manufacturing PMI confirms that the downturn is nothing but corona trouble in some services

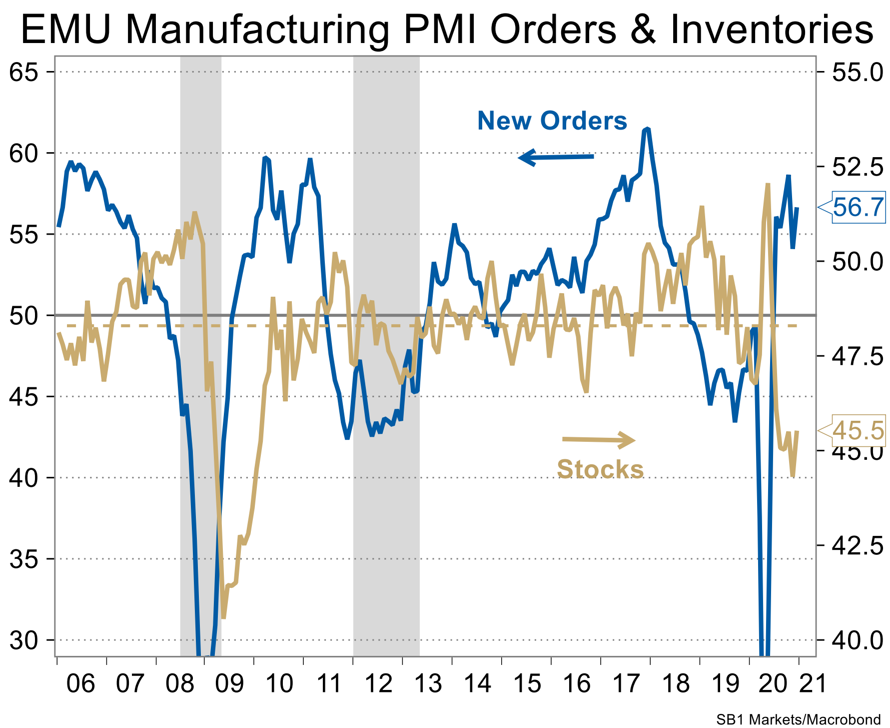


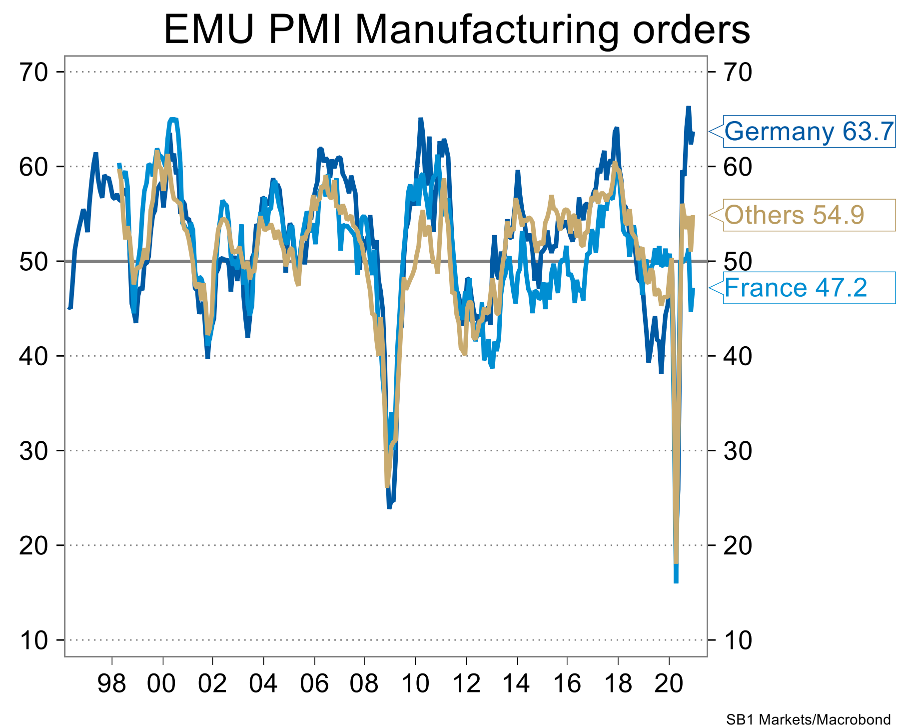


- The preliminary service sector PMI rose to 47.3 from 41.7 – signalling a further contraction but far less severe than in November, when the corona restrictions were introduced in several countries.
  - The final German service sector index may be weaker, due to the partial lockdown implemented last week, and some services may struggle in January too
  - However, as other countries have got some sort of control of the virus, the momentum may strengthen further here, and reopening growth in January is not unlikely. A permanent stable recovery is probably not possible before a substantial proportion of the population is vaccinated
- **Services** in France rose 10.4, and surprised by 9.2. Germany 3.5 above exp. The EMU total by 5.3 better than expected, still at 47.3
- Even the **manuf.** PMI surprised on the positive side by 2.5 p – and up to 55.5, driven by Germany and the (implied) Italian/Spanish avg

Upbeat manuf. orders across the region – German manuf. PMI at 63.7!

… the 4th consecutive month above 60. Confirms the rapid recovery in the manufacturing sector

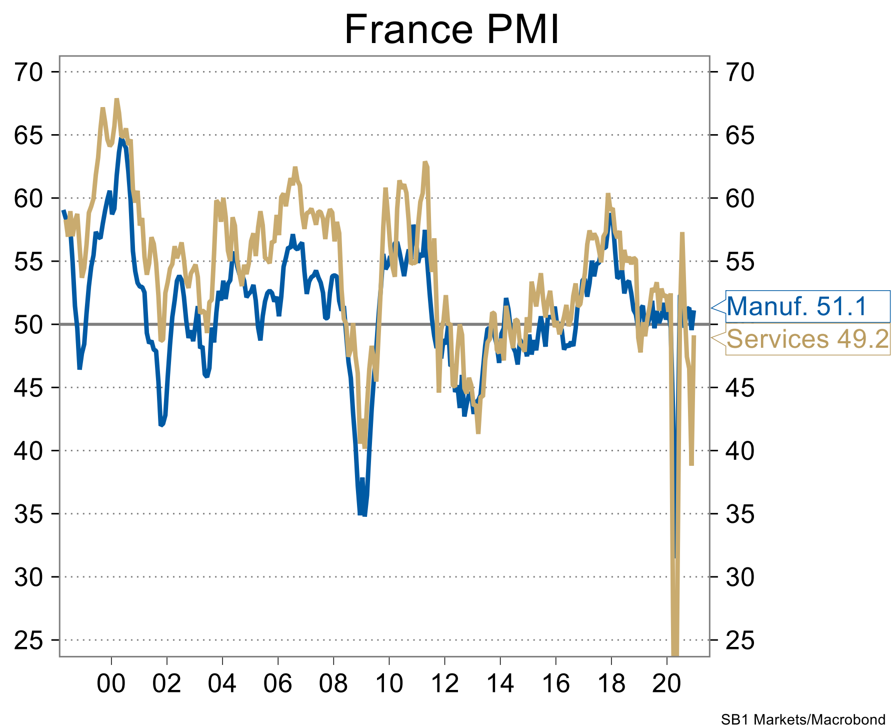


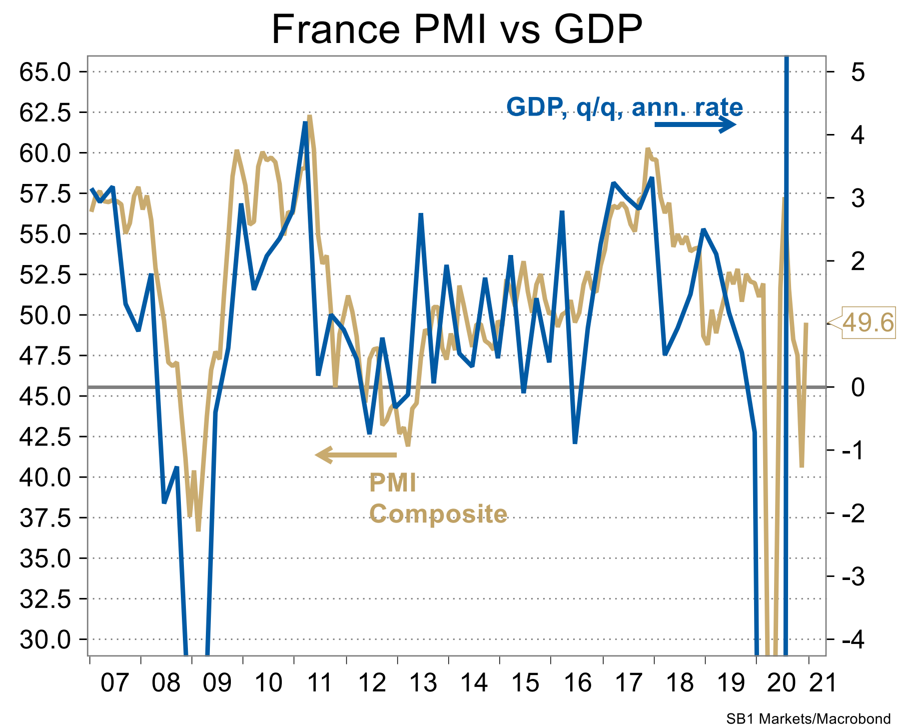


- New orders rose to 56.7 in December from 54.1
- German manufacturing orders rose 1.4 p to 63.7 in December
- Germany will be in a partial lockdown from last week until January 10th which may have an impact even on the manufacturing sector (but no signs of that so far)

France: Dec PMI far stronger than expected – still <50 but signals growth??

The service sector PMI rebounded to 49.2 from 38.8 the previous month – manuf. in expansion mode

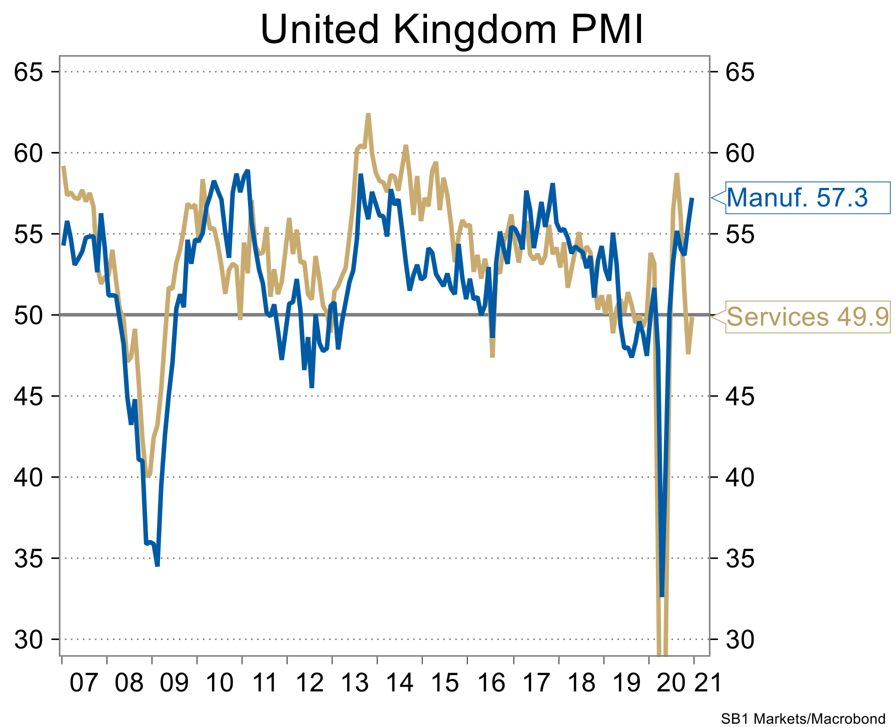


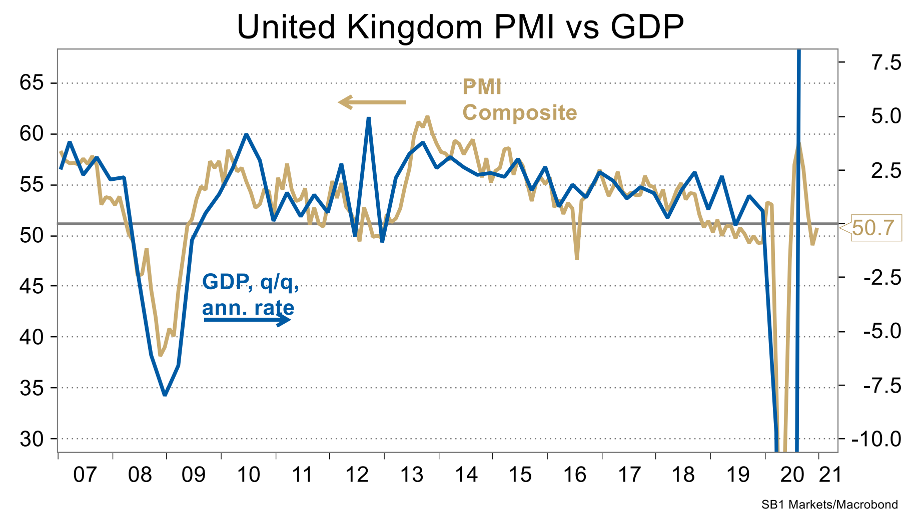


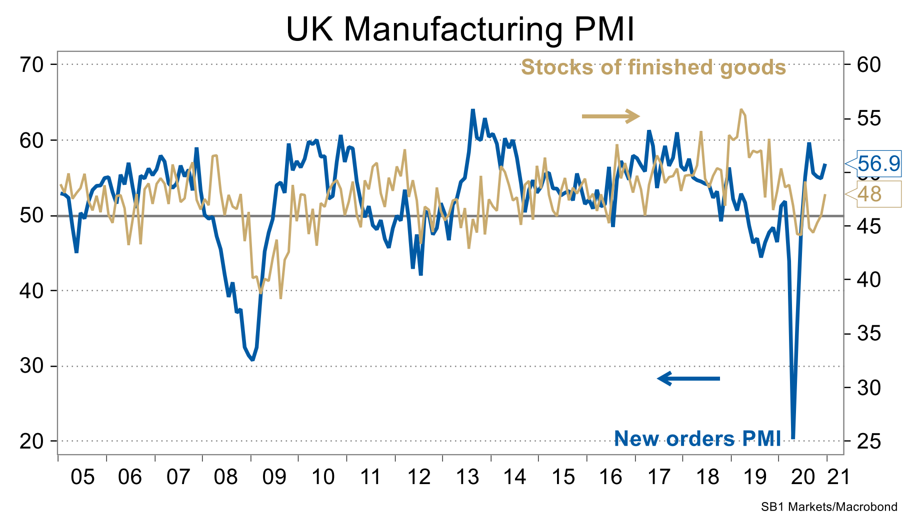
- **The composite** PMI rose 9 p in December, 6.6 p above consensus - probably driven by easing of restrictions and vaccine news. Composite PMI at 49.6 suggests a GDP growth around 1% (and not a minor decline, if we take the PMI print literally)
- The 10 p hike in the **service sector** index to 49.2 is the 3. strongest ever, just May & June were better. With a history back to 1998, the Dec lift was twice as large as any other month (barring the two earlier this year)!
- **Manufacturing PMI** climbed 1.5 p to above the 50-mark, at 51.1

The composite PMI back in positive territory at 50.7

Highest manufacturing PMI in 3 years, but composite clocked in below consensus





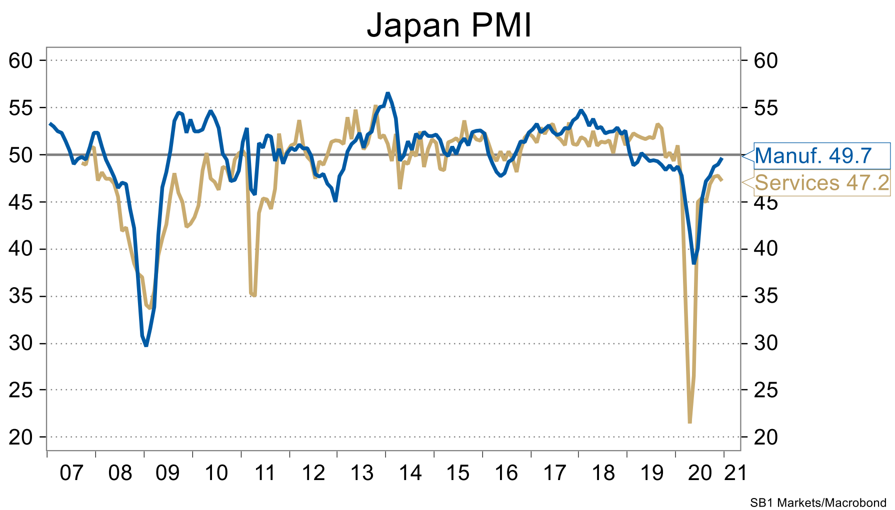


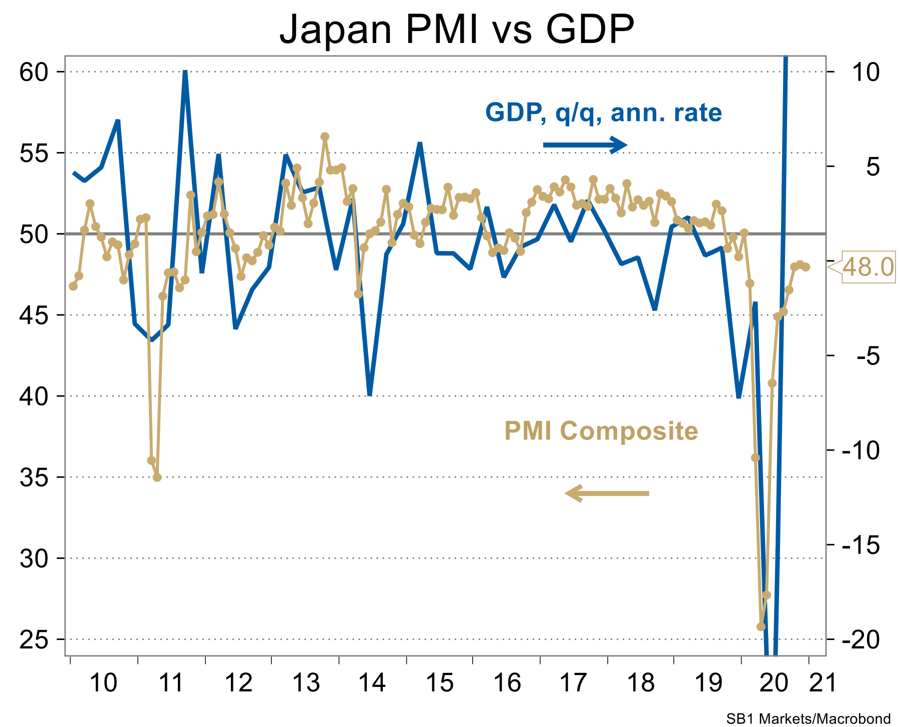
- Covid-19?
- Brexit??
- Don’t worry, be happy!

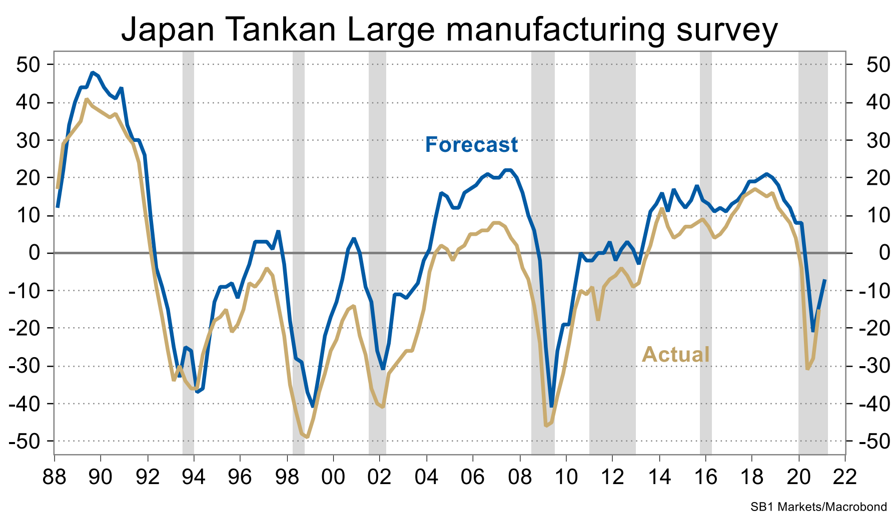
SpareBank 1 MARKETS

Japanese PMIs up in December but still below 50 – even if the economy grows

Manuf. PMI up to 49.7 from 48.3, services PMI up to 46.7 to 47.2



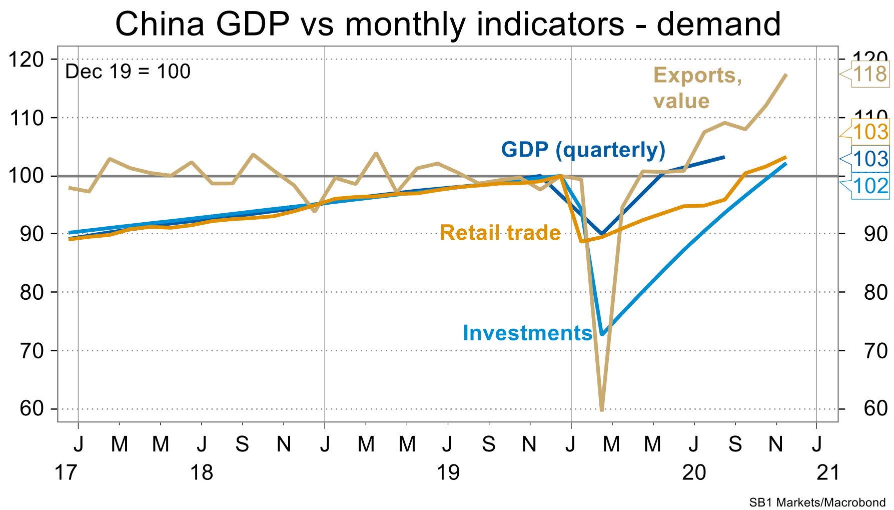


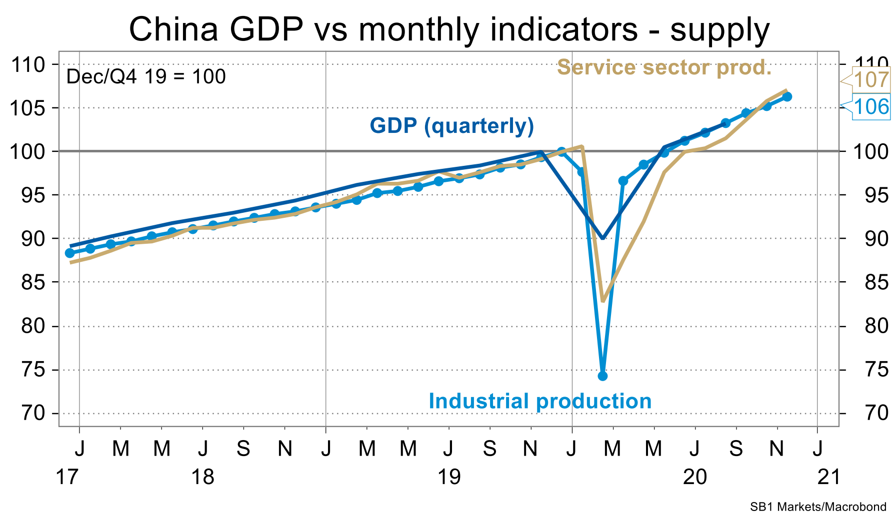


- The PMI – like other surveys – did not report the unprecedented Q3 GDP surge. We think the PMIs still underestimate growth, conf. the strong recover in Jap. Manufacturing.
- According to the BoJ Tankan business survey, most manufacturing firms are less pessimistic in Dec than in Sept. In fact it was the largest increase in the Tankan index since 2002, however, index is still in negative territory.

November data confirm the recovery – growth above trend, gaps are closed

Industrial & service sector production, exports above/at pre-corona trend; retail sales, investm. below



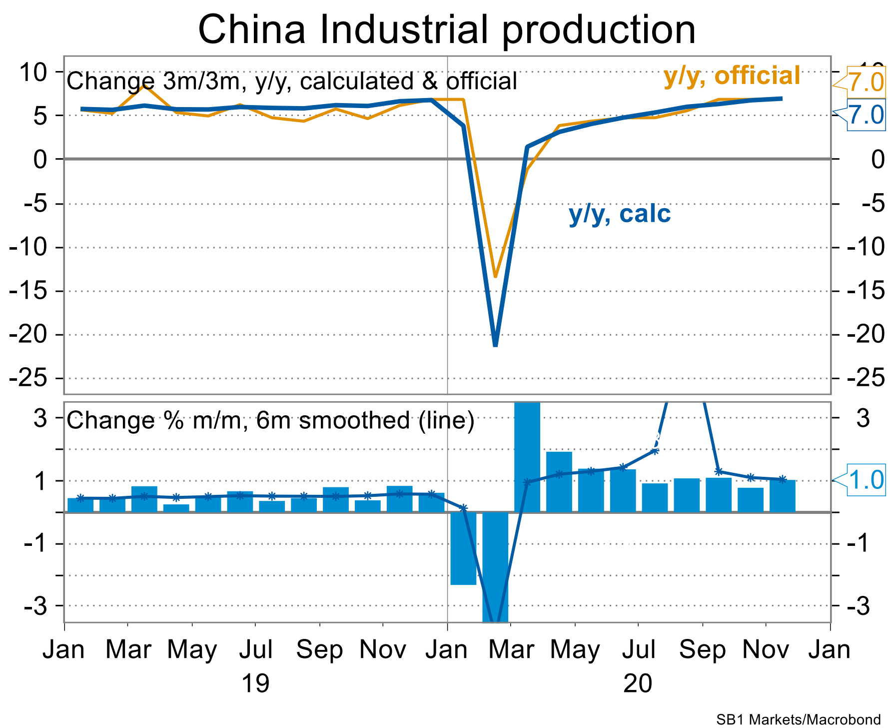


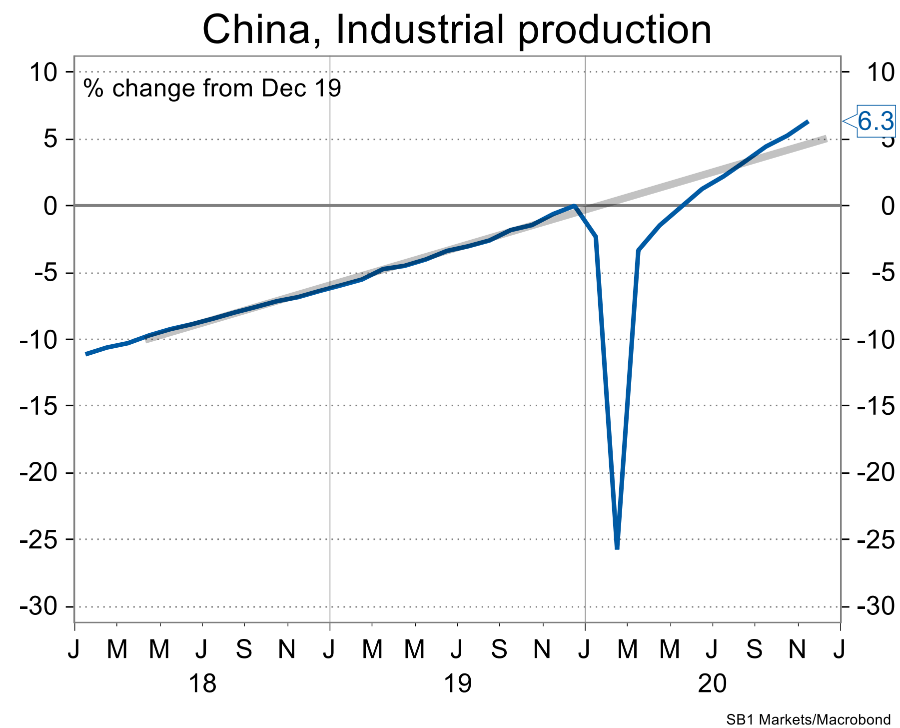
- **Industrial production** rose 1% m/m in Nov and 7.0% y/y, the latter as expected. Production is now 2% above the pre-corona trend path. Growth will now most likely slow
- **Service sector production** grew by 1.2% in Nov, slower than the prev. 2 months. Activity is 7% above the Dec 19 level – and 'finally' at the old trend path
- **Retail sales** rose 1.6% m/m in volume terms in Nov. Annual nominal growth rose by 0.7 pp to 5%, as expected. The gap to the pre-corona trend path is now just 1%! **CPI inflation** is falling sharply, and prices are down 0.5% y/y (from above +5% at the peak) as pork prices are heading down. Supportive for real household demand, of course
- **Investments** rose 2.9% m/m in Oct. Growth is slowing modestly, which is natural as the gap vs the pre corona trend is closing rapidly, now at 2% below. The gap will be closed in Dec/Jan
- **Credit growth** is slowing, and underlying growth has fallen to 9% (from 15) and it is now close no nominal GDP growth
- **Exports** were strong in Nov, signalling growth both abroad, and imports were far from weak – growth at home too. Other Asian exports are on the way up

In sum: Gaps are more or less closed. The economy has fully recovered from the corona downturn. So it is possible ☺

Industrial production up 1% in Nov , level 2% above the pre-corona trend

Annual growth at 7%, as expected

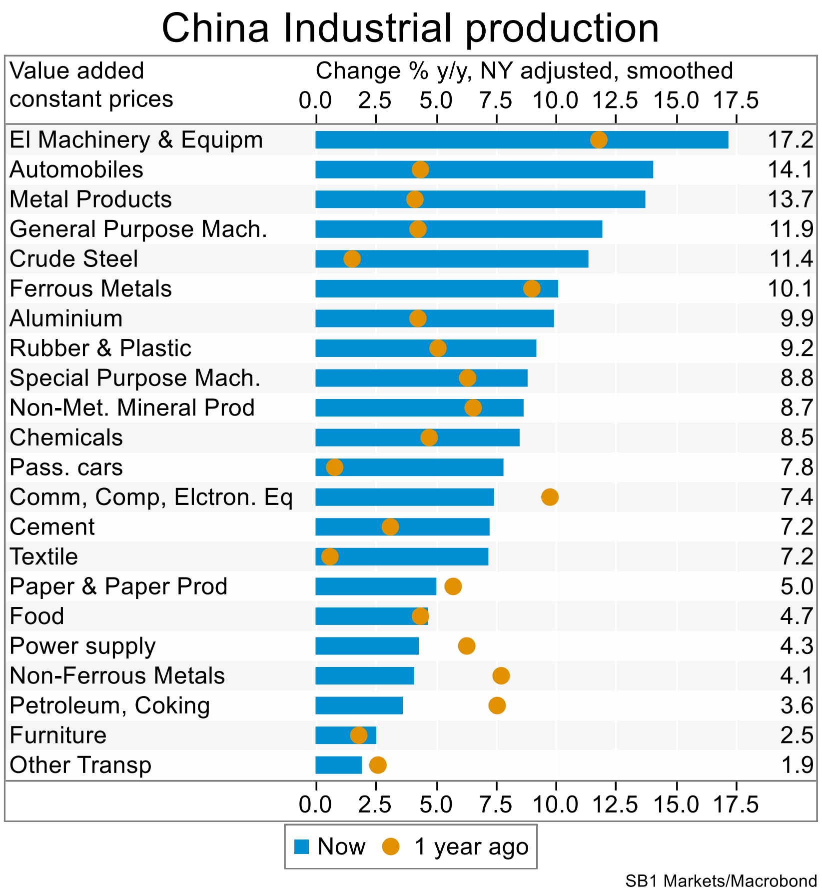




- Production is 6% above the Dec 19 level and some 2% above a reasonable pre-corona growth path
- The official y/y rate rose 0.1 pp to 7.0%, as expected
- As the production level is above the pre corona growth path we do not expect industrial production to keep growing faster than trend growth, at some 0.5% per month. Both supply and demand may be limiting factors

All sectors back in black!

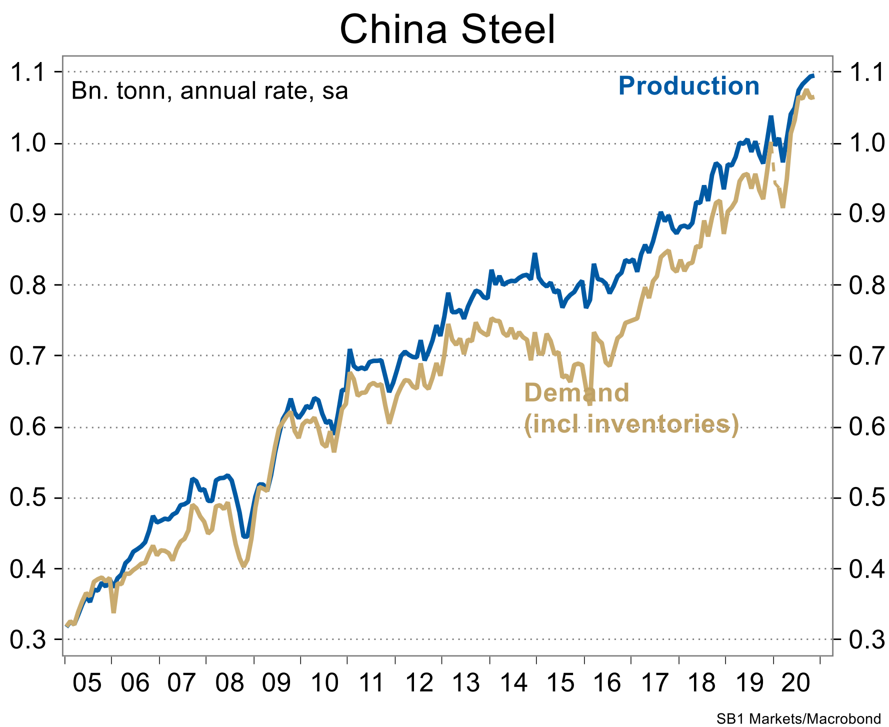
... at least measured y/y



- All construction inputs are back at brisk pre-corona **growth paths** (plate glass a tad below)

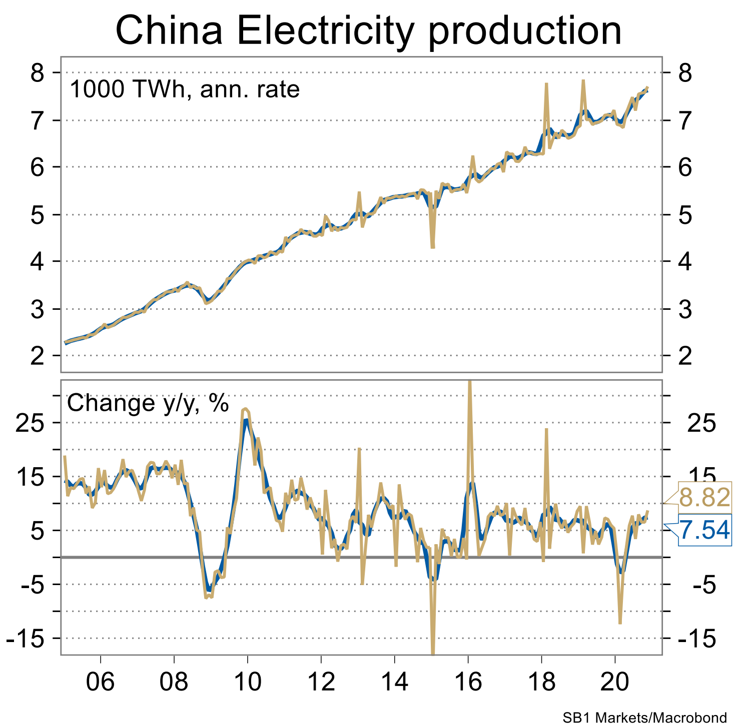
Construction record strong but is not expanding that fast anymore

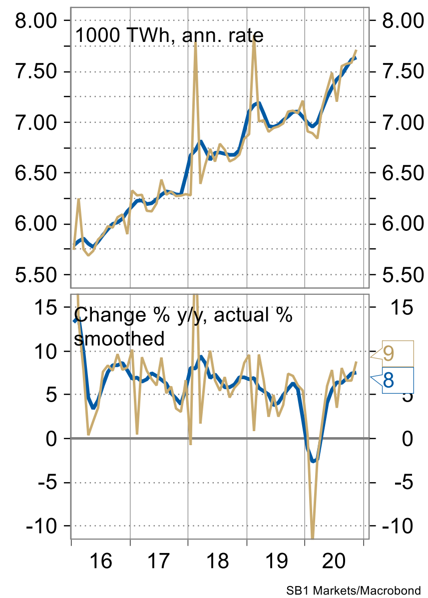
The current steel growth trajectory seems to be on the high side? Prod. growth slowed Sept-Nov

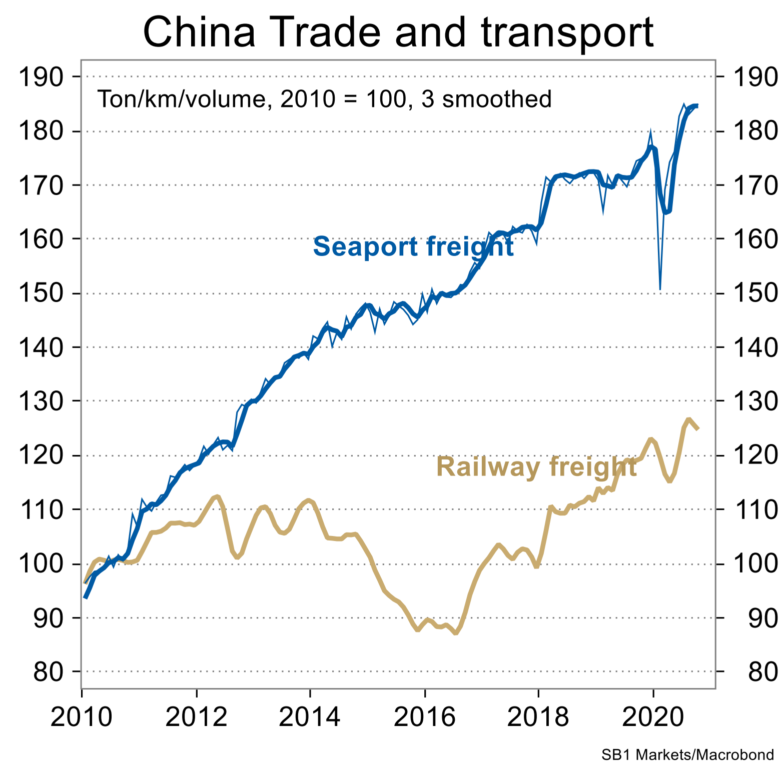


- Demand has increased sharply since the spring by 17% and is back on a strong growth trend since 2017
- Domestic demand includes changes in inventories

Electricity production more than back on track too, transport activities as well



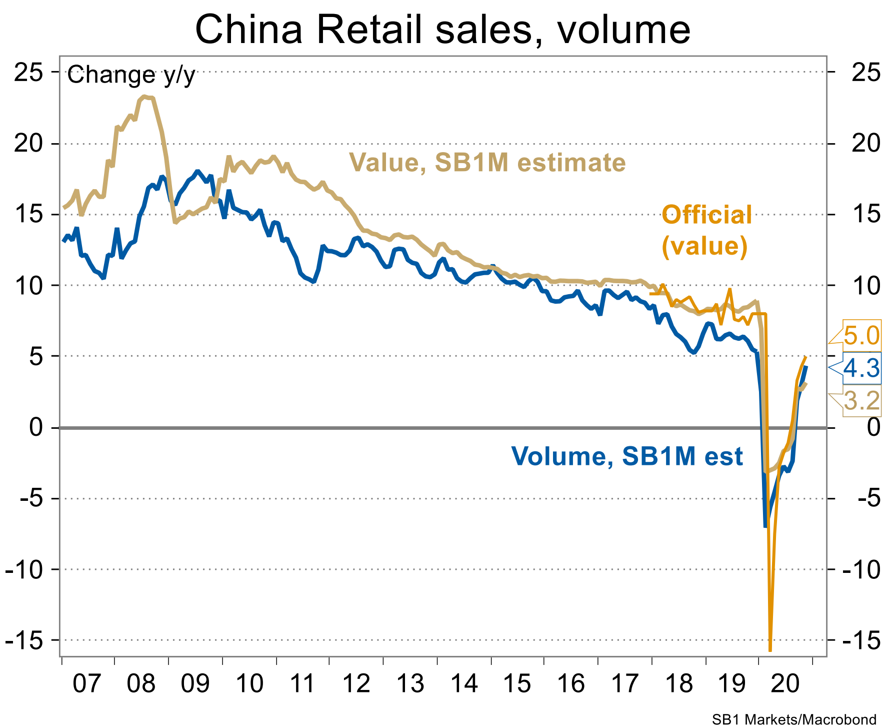


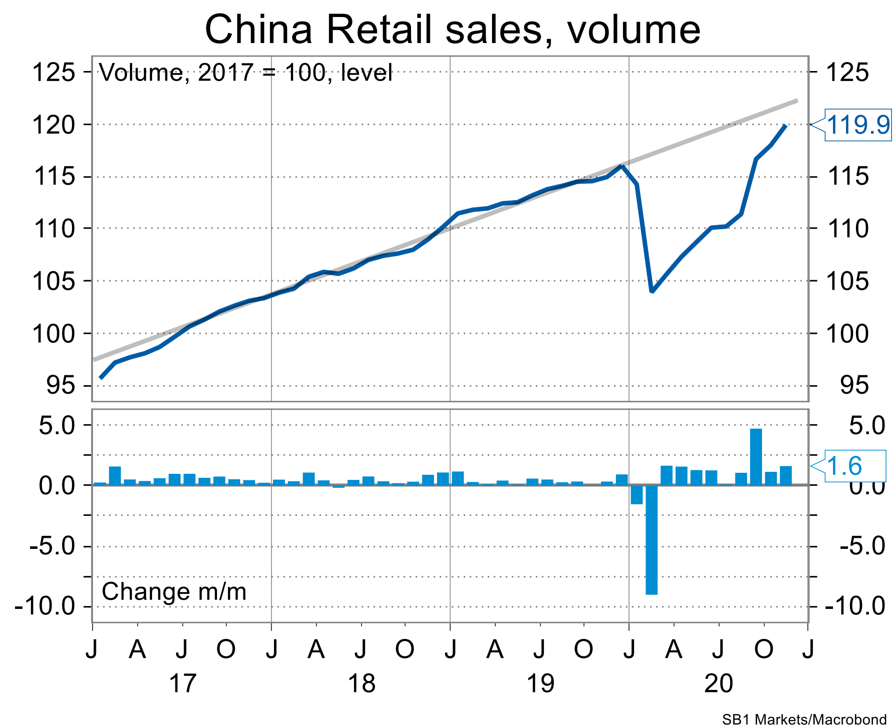


- Transport activity (goods - seaports & railway) has recovered sharply recent months, following a setback earlier in 2020

Retail sales volume up 1.6% m/m in Nov – almost back on trend!

Sales up as expected 5% nominal y/y

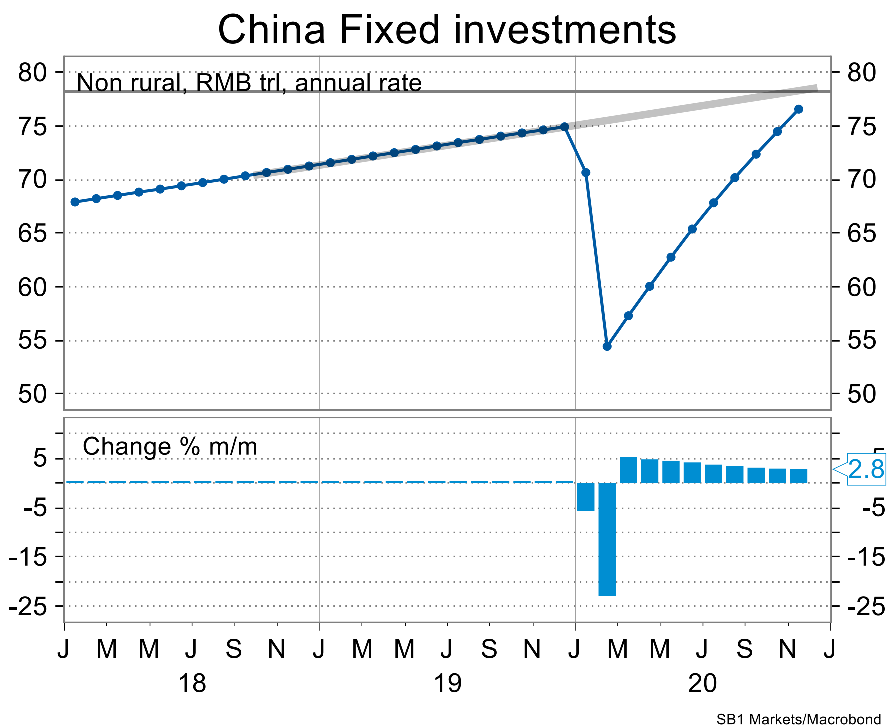




- Sale volumes grew for the 4th consecutive month; now just 1% below the pre-corona growth path. Back in Feb. sales were 11% below trend
- The official annual sales (value) rose 5% y/y, as expected. Our value growth estimate, based on published monthly seasonally adjusted growth rates is up 3.2% - and our volume estimate is up 4.3% y/y. The retail sales price index was down 1.1% due to the sharp decline in pork prices. This illustrates the positive impact of the decline the overall consumer price level in China, which is supporting volume growth in demand

Nominal investments up 2.8% m/m in Nov, just 2% below pre-corona trend

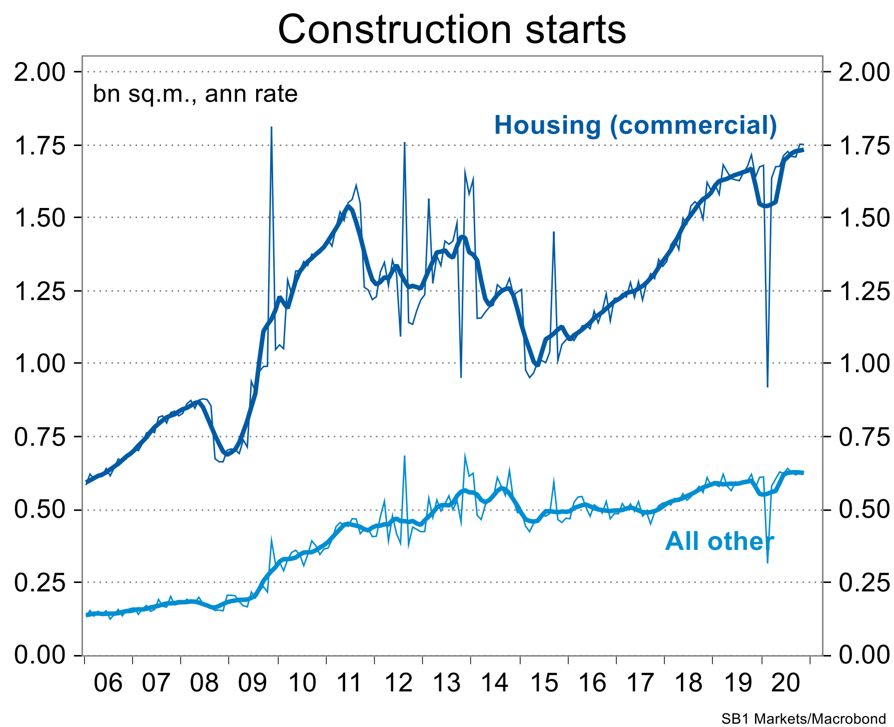
The gap will probably close in December, another sharp Chinese 'V'

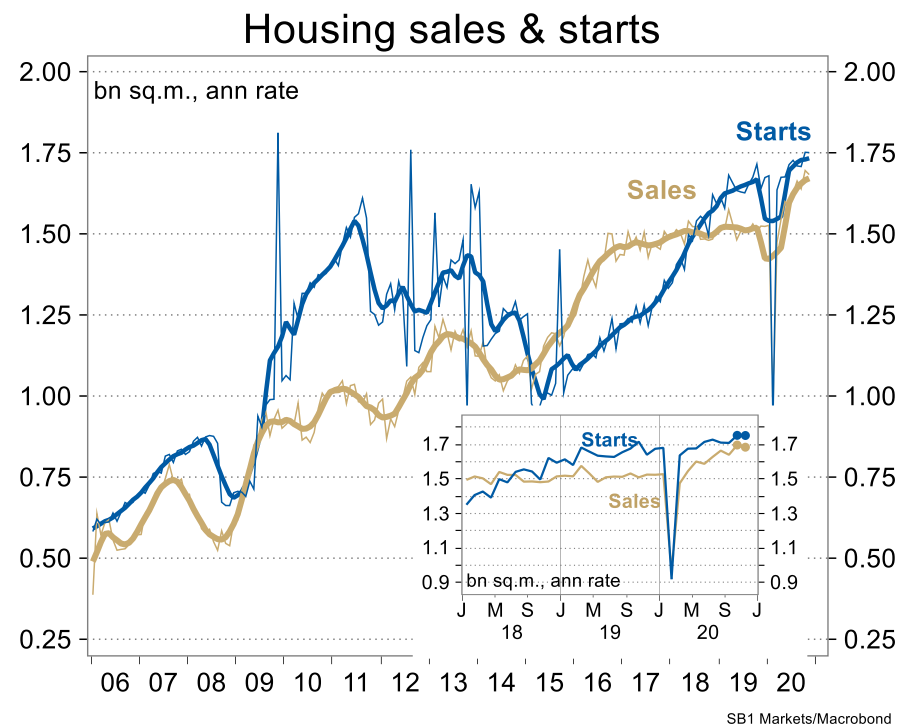


- Measured ytd, investments are up 2.6% in Nov, expected 2.5% - and up from 1.6% in Oct
- Investments rose by 2.8% m/m (nominal), down from 3.2% in Oct. Growth has been slowing since peak growth in March (following the 27% decline in Jan+Feb) but remains far above the normal growth rate, at 0.4 -0.5% per month. The level is now up 3% y/y, up 2% from the Dec 19 level and just 2% below the pre-corona trend. The gap will probably be closed in December/January
- In real terms, investments are up approx by the same amount as in nominal terms (due to lack of an updated investment price index, we utilise a mix of a producer price index, and a GDP deflator

Construction activity revised up to record-high level

Both home sales and starts flat m/m in November, but levels are record high

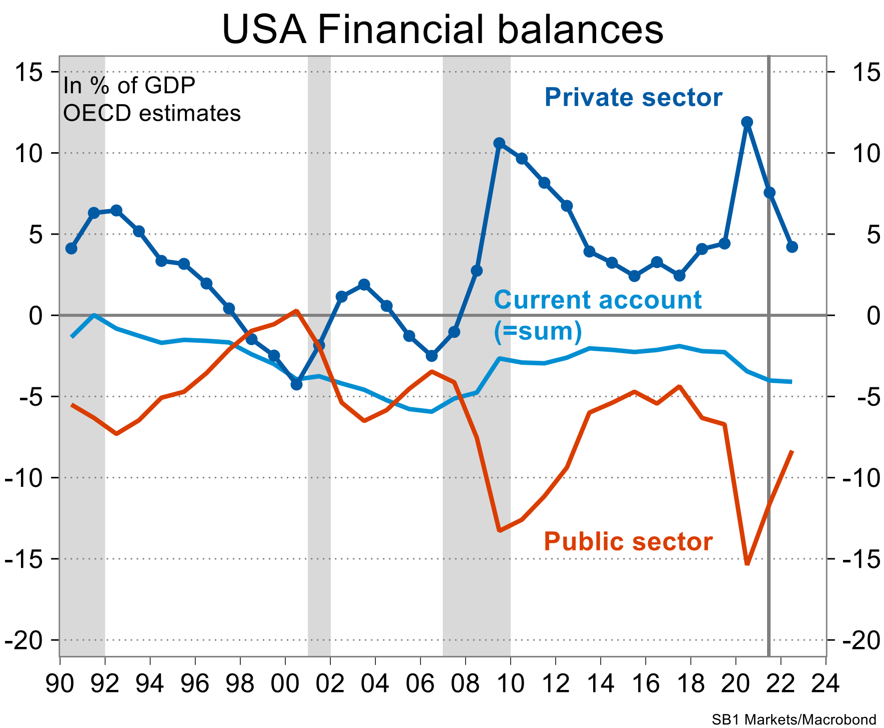




- In fact, just February was a disaster; sales and starts fully recovered in March, and housing activity has continued upwards until now. New home sales are up 12% vs the pre-corona 2019 level. Since late 2018 starts have been higher than sales and inventory of new unsold homes must have built up, following a huge rundown from 2015 through 2017
- Non-residential construction has flattened at a record-high level

Another fiscal stimulus deal: USD 900 bn, 4% of GDP

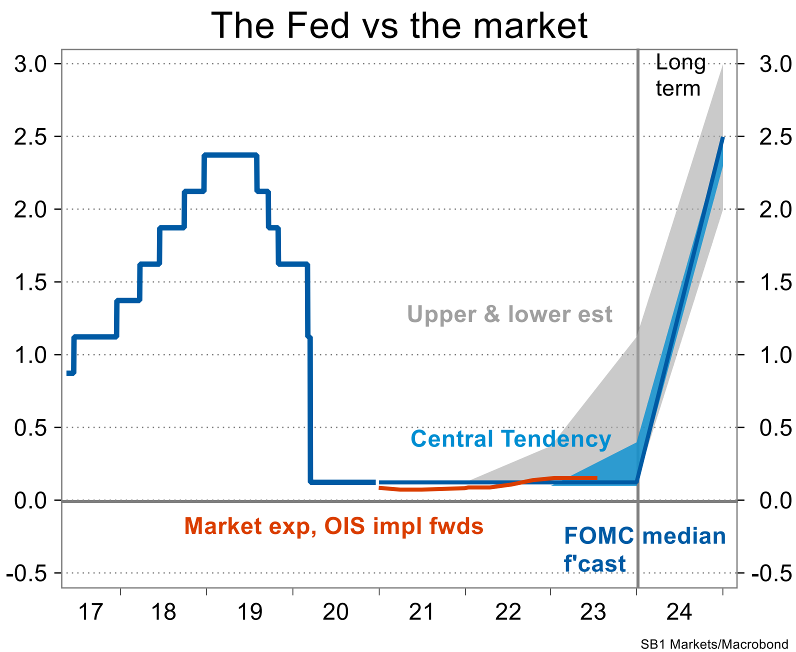
The Fed will be allowed to support the economy by emergency lending (in new programs)



- This is the 2nd **emergency fiscal support package**. Yesterday' deal is the second largest in US history, only the April emergency deal at USD 1.800 bn, or 8% of GDP is larger
- **Cash support for households**: USD 600 to all adults earning less than USD 75'/year, and to their children – a not so targeted support. Household demand in general is not constrained by lack of income or low spending but rather by corona fears/public restrictions. Total household income is far above a normal level
- Prolonged temporary Federal **unemployment emergency support**, now at USD 300 per week per unemployed, for 10 more weeks – to perhaps as much as 12 mill. unemployed persons - a target measure
- A prolonged **Paycheck Protection Program** for small businesses (less than 500 employees) that can get loans, and write them down if they keep the employees on the payroll + support to airlines, some tax breaks, rental assistance, and the eviction moratorium is extended until Jan 31, education support (USD 82 bn!), nutrition assistance
- Funding for hospitals, covid-19 testing, **vaccine distribution** etc
- Even measures to counter **climate change** and to promote **clean energy** were included in the bipartisan bill, <u>the first such legislation to pass Congress in nearly in a decade</u> (according to NYT). Trump is loosing his grip?
- The Congress also prepared to fund the government next year to prevent another **shutdown** of the government activities
- How large will the **US budget deficit** be next year? Smaller than in 2020. But not small. The 4% of GDP deal in not included in OECD's estimates, at least not the whole package
- The **public sector deficit** will decrease <u>when the private sector (households + businesses) reduces its savings</u> – that were record high in 2020. That will happen as soon as households are allowed and able to spend money on services again. Sometime net year? Think so

Fed reassures market and reiterates need for fiscal stimulus

Economy suffering from pandemic, not highly accommodative financial conditions *Fed Chair Powell*



- Some investors had expected the Fed to increase the amount and/or lengthen the duration of its asset purchases. As a result of the lack of change in the pace of bond buying in the QE program, the longer end of the yield curve steepened after the statement was released. However, during the press conference Powell stressed the new timing guideline, and yields fell. At the end of the day, the 10y gov bond yield rose by 2 bps to 0.92%, driven by a 4 bps increase in inflation expectations, and 2 bps decline in the TIPS real rate

- The target rate was left unchanged at 0-0.25%, as expected, and the FOMC members expect an unchanged signal rate at least trough 2023
- QE until…
  - » *'The Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals*.
- In the previous statements, the FOMC stated:
  - » *..over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities at least at the current pace*
  - » The two important changes:
    1) The QE program will not last just 'over coming months' but until employment and inflation has strengthened sufficiently. The same has already been the case for the signal rate, *the signal rate will not be lifted from zero until labour market conditions have reached levels consistent with the Committee's assessments of maximum employment, and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time.* So, QE will also continue until Fed has reached its mandated goals. When will that happen? In late 2023?? Check next page
    2) The FOMC will from now increase its bond holdings at least by USD 120 bn/m. So far, Fed's message was that QE would continue at least at the current pace – and the current case has been USD 80 bn/m. The new target quals 7% of GDP per year!
- Some focus on the limitations of monetary policy and a call for fiscal stimulus: 'The parts of the economy that are weak are the service sector businesses that involve close contact. Those are not being held back by financial conditions, but rather by the spread of the virus'
- **All in all: In line with expectations**

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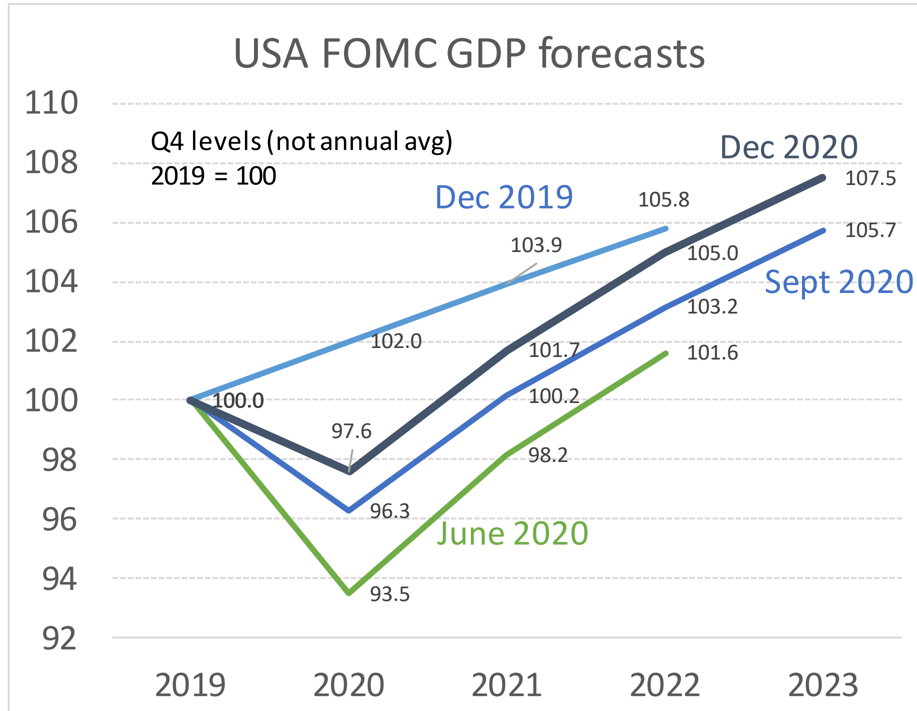
GDP, inflation once more revised upwards

Q4 2020 GDP up 1.3% and unempl. down 0.9 pp vs Sept. No changes to the Fed funds rate path

Percent

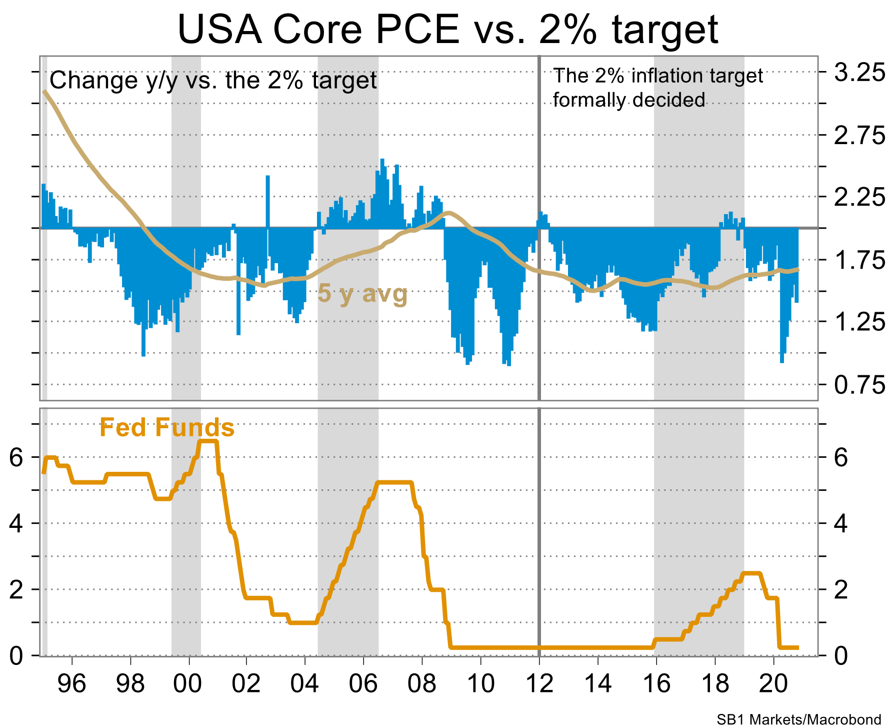
Variable	Median[1] 2020	2021	2022	2023	Longer run
Change in real GDP	-2.4	4.2	3.2	2.4	1.8
September projection	-3.7	4.0	3.0	2.5	1.9
Unemployment rate	6.7	5.0	4.2	3.7	4.1
September projection	7.6	5.5	4.6	4.0	4.1
PCE inflation	1.2	1.8	1.9	2.0	2.0
September projection	1.2	1.7	1.8	2.0	2.0
Core PCE inflation[4]	1.4	1.8	1.9	2.0	
September projection	1.5	1.7	1.8	2.0	
Memo: Projected appropriate policy path					
Federal funds rate	0.1	0.1	0.1	0.1	2.5
September projection	0.1	0.1	0.1	0.1	2.5

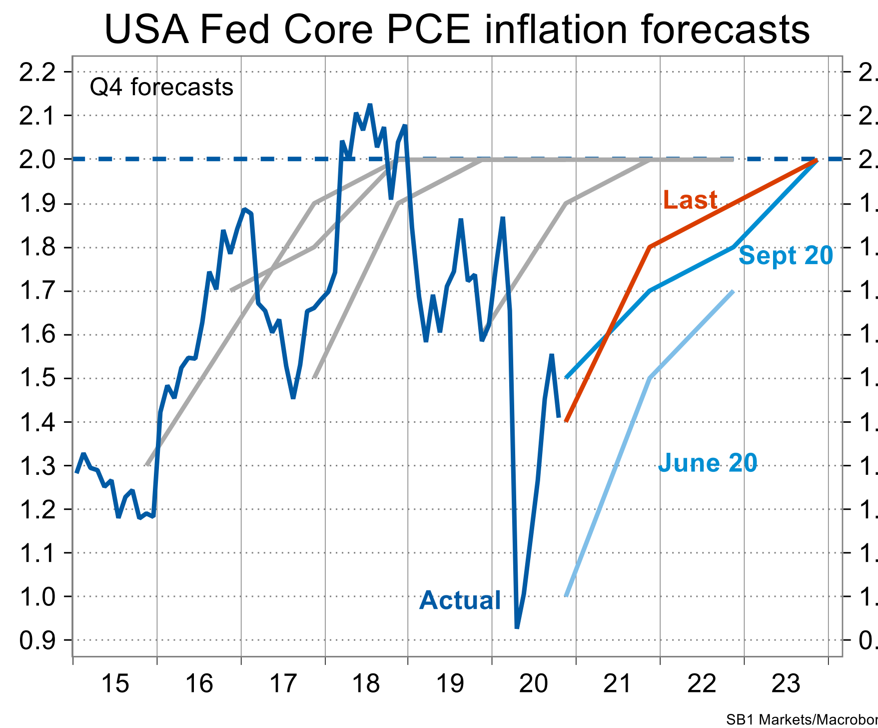


- The revisions in GDP and unemployment forecasts were smaller than those in September (which were the largest on record). The Q4 2019 GDP level is now supposed to be reached in mid 2021 vs the end of 2021 as f'casted in Sept (In June, the bank assumed that to happen in mid 2022). Most likely the Fed will – as all others – revise its forecast several times before Q4 2023. (In June, Q4 was expected down 6.5% vs. Q419. Now the est. is 2.4%)
- PCE inflation (Fed's preferred price measures, which is in average running some few tenths lower than the CPI inflation) is expected to reach 2.0% first by the end of 2023. Hence, the Fed will keep rates at zero for at least this long, and raise the Fed funds rate only when inflation is on track to exceed 2%. This is what the bank says now. Do not forget however, how much the Fed has revised its inflation forecasts along the way; check the next page
- **Given the substantial revision of GDP & inflation f'casts, the Fed could reach its 'trigger' targets much sooner than indicated at this point, perhaps even in 2021?**
- The bank did not change its forecast for the longer term neutral policy rate – now at 2.5% nominal and 0.5% in real terms

Fed lifted inflation forecasts but do not expect any overshoot the coming 3 yrs!

The Q4 est. was revised at tad down but ‘21 & ‘22 marginally up. 2% is reached in 2023

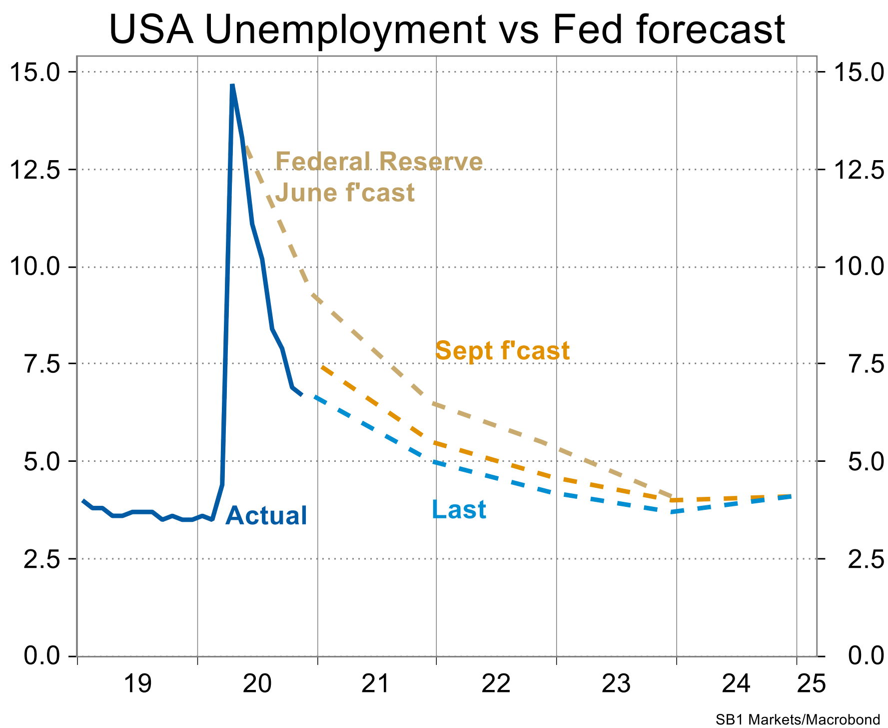




- The new ‘average inflation target’ strategy did not materialise in the FOMC inflation forecasts, as the committee do not expect to overshoot the inflation target, at least during the coming 3 years – even if inflation is, and has been running below 2 % almost all the time since the 2% target was formalised back in 2012
- At the same time, the FOMC pledges to keep the signal rate at zero until inflation has (moderately) overshot the target for a while – <u>and now in addition the bank ‘promised’ to continue QE at the present pace until the same milestone is reached. It may – or may not – happen before end of 2023. We think the risk is for an earlier timing</u>

Unemployment once more revised down

… but will still not reach the ‘natural rate’ before end of 2023



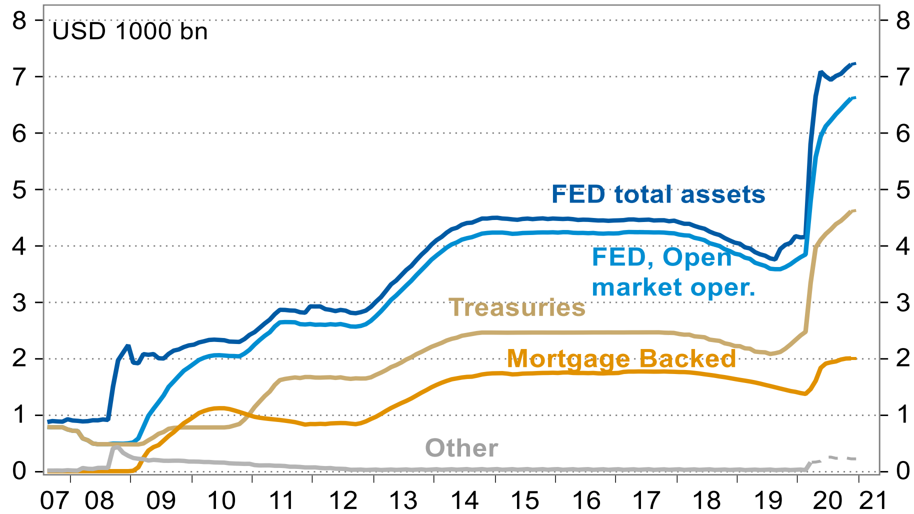
- No significant cut in the unemployment rate in the coming year, even if a reopening of at least parts of the labour intensive service sector seems reasonable

SpareBank 1 MARKETS

FOMC: QE ‘until substantial further progress is made’ towards target infl.

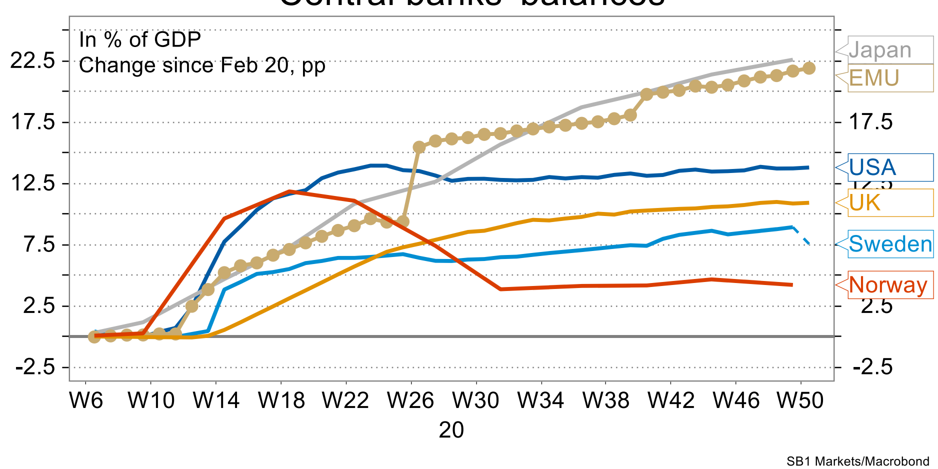
No formal yield curve control

USA Federal Reserve balance

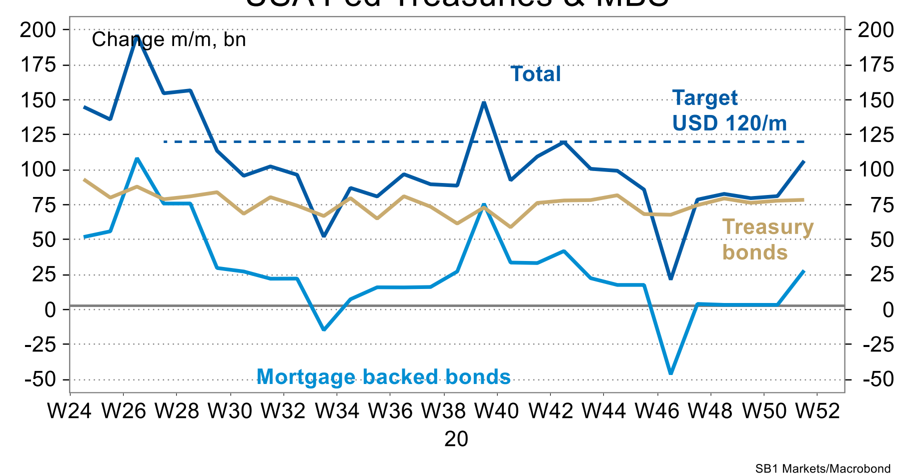


- Federal Reserve will increase its holdings of Treasury bonds and agency mortgage-backed bonds at least at the current pace - which has been announced to USD 120 bn/month (80 + 40)
  - » The actual current pace is lower, at USD 100/b, as the stock of mortgage bonds have not increased further
- USD 120 bn/month equals 7% of GDP per year, a substantial share of the net increase in government og mortgage-backed bonds. Since February, Fed’s balance sheet has increased by 14% of GDP (and it now equals an unprecedented 35% of GDP
- There were no signals of any formal yield curve control (YCC) in order to strengthen forward guidance. The average maturity of Fed’s bond holdings was not changed either

Central banks' balances

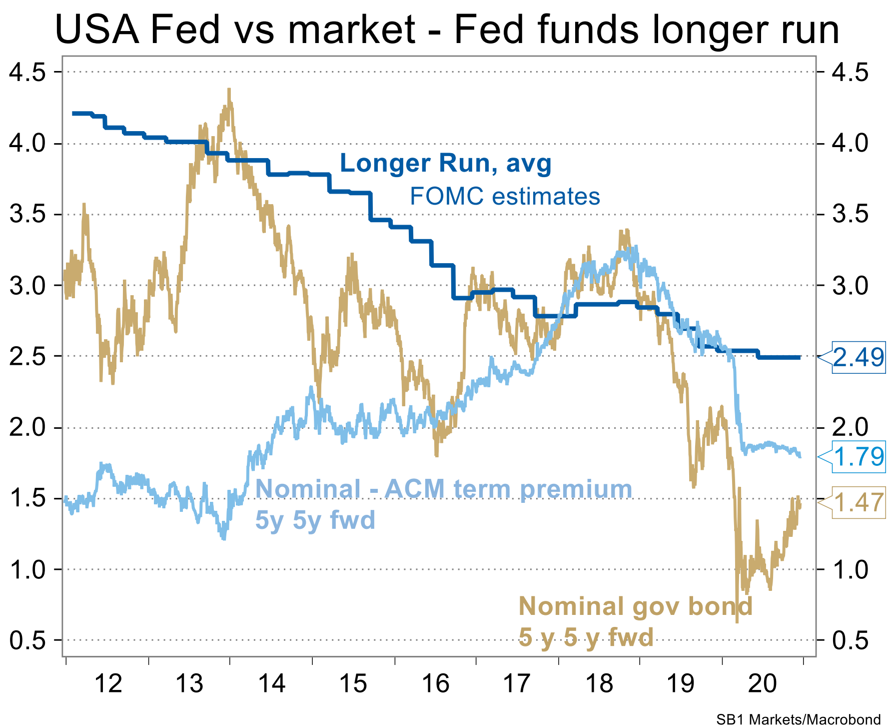


USA Fed Treasuries & MBS



Long term, a 2.5% neutral nominal rate. At 2% inflation, a 0.5% real r*

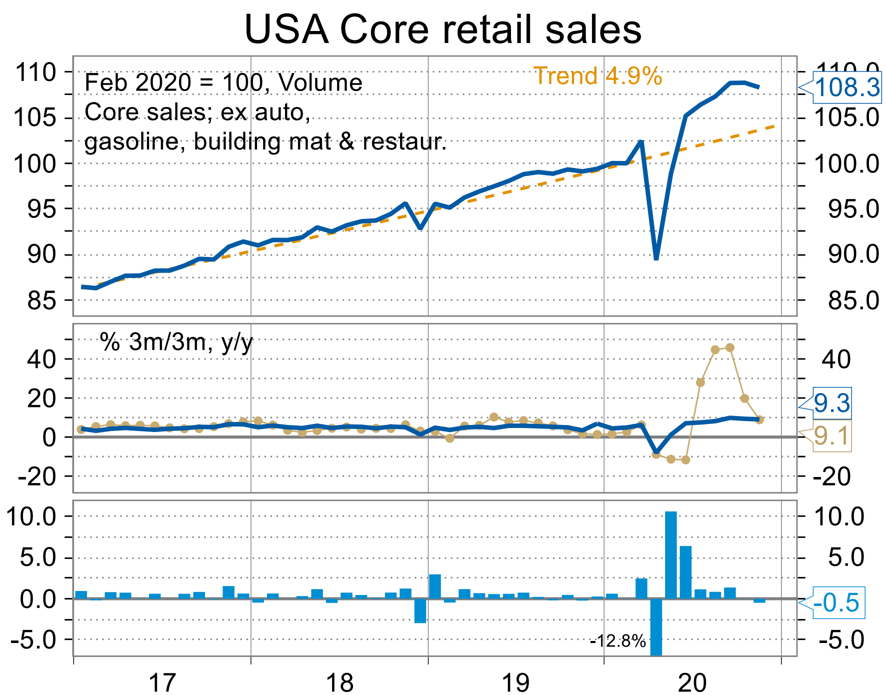
Market rates are well below, even after a term premium adjustment (here the ACM estimate)

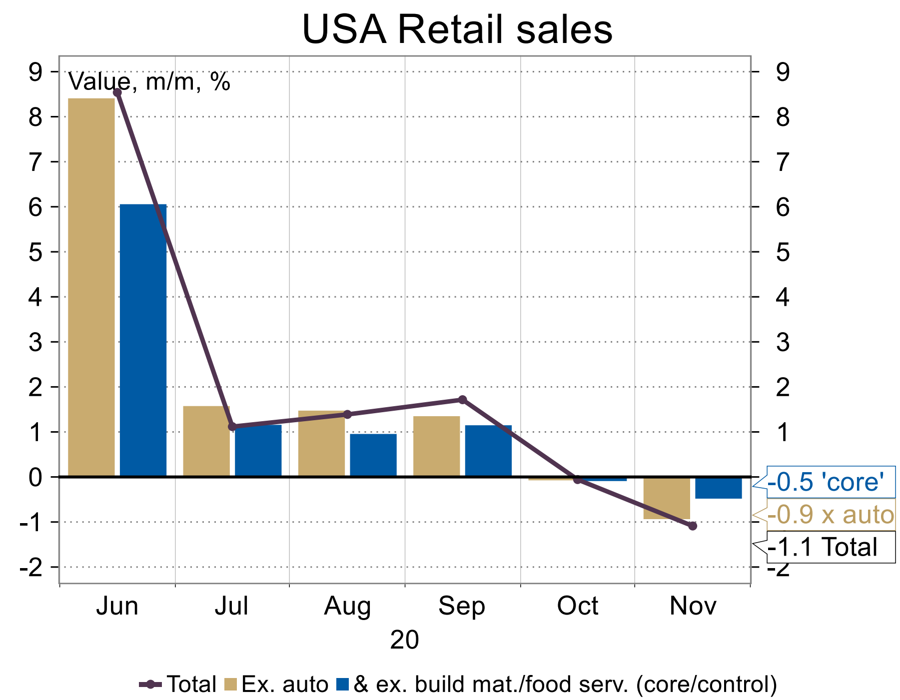


- The 5 y 5y fwd gov bond yield is at 1.5%, the real rate at -0.43%
- Adjusted for various estimates of the term premium, the component of long term bond yields that are not decided by expectations of future short term interest rates, market rates are below Fed's estimate of the natural rate (r*) (market – ACM term prem 1.8% vs. Fed at 2.5%)
  - » The unobservable term premium is calculated by decomposing the yield curve by different techniques
- The Fed is probably not that sure where the r* is these days (or over the recent years), the estimate has fallen by 1.7 pp over the past 8 years – and is now at 0.5%

Retail sales fell further in Nov, as Oct data was revised down. Level still sky high

The 2nd/3rd corona wave, lack of jobless stimulus probably to blame. Core sales still up 8% vs Feb

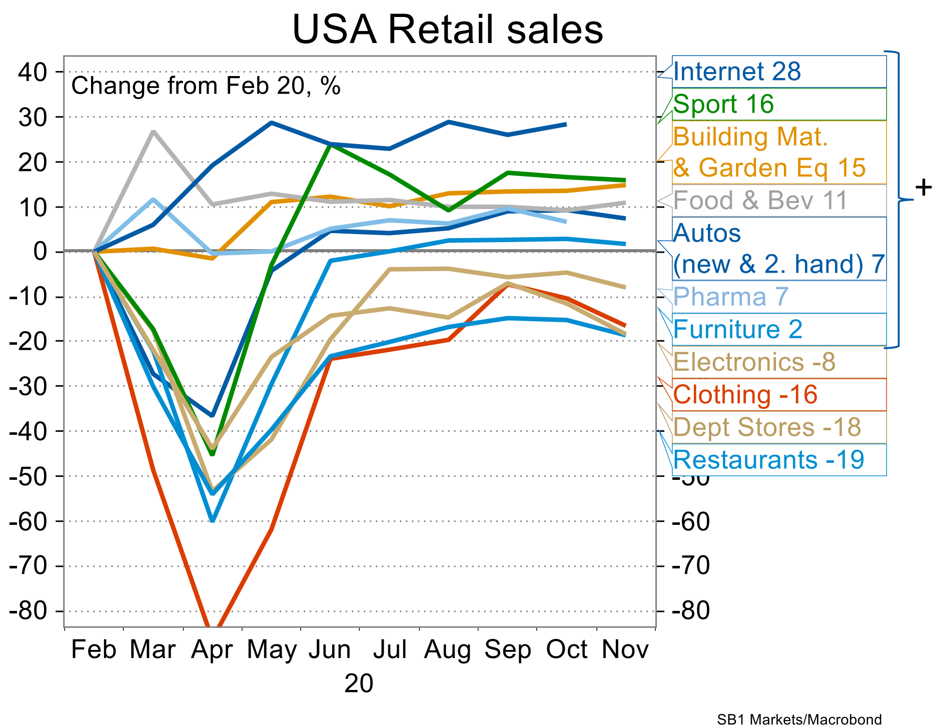




- Total nominal sales declined by 1.1%, expected down 0.2%, and Oct was revised down by 0.4 pp to -0.1%
- Core sales (=control group, excludes auto, gasoline, building materials & restaurants) fell by 0.5%. We assume the same amount in volume terms – following zero growth in October
- Core sales are still 8% above the Feb level – and up 9.3% y/y. At one stage, the level has to come down (like in most other rich countries)
- Check details next page, still huge discrepancies between sectors

Still huge differences between sectors: Restaurants -19%, Internet +28%

Food & beverages +11%! Sports +16% Clothing -16%. Our spending habits have changed (for a while)



November

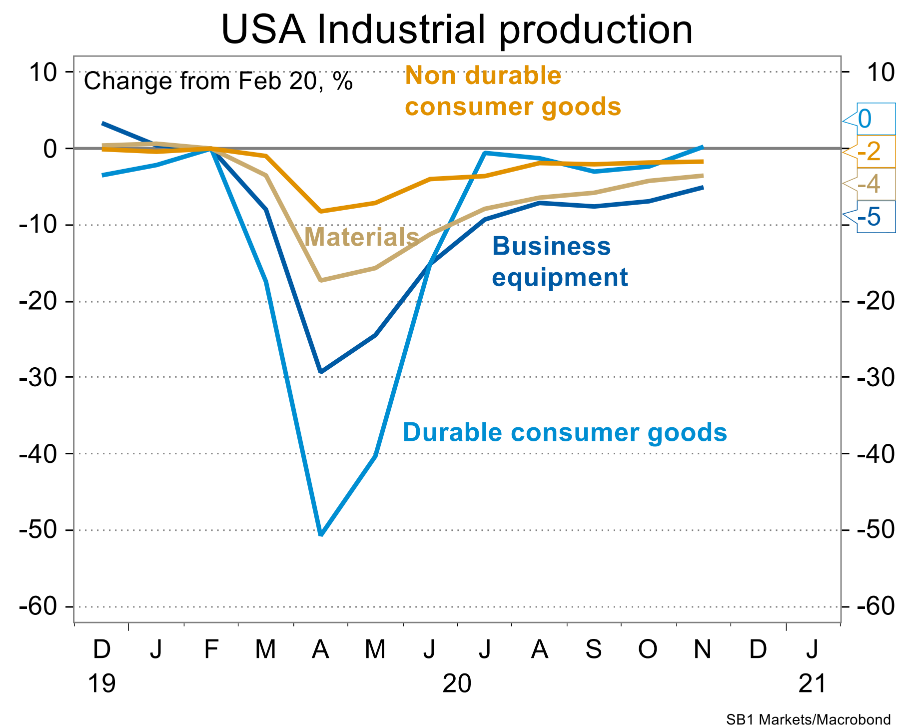
- The decline was rather broad, just food sales in shops rose as sales in restaurants fell

Since pre corona

- Americans – as all others – are buying more food in shops and less at restaurants
- Clothing is probably down due to more time spent at home, less outside
- Gyms are partly closed, more sport equipment is bought
- But why are electronics still so weak?

Manufacturing up 0.8% in Nov, exp. 0.4%. Remains 3.7% below pre corona level

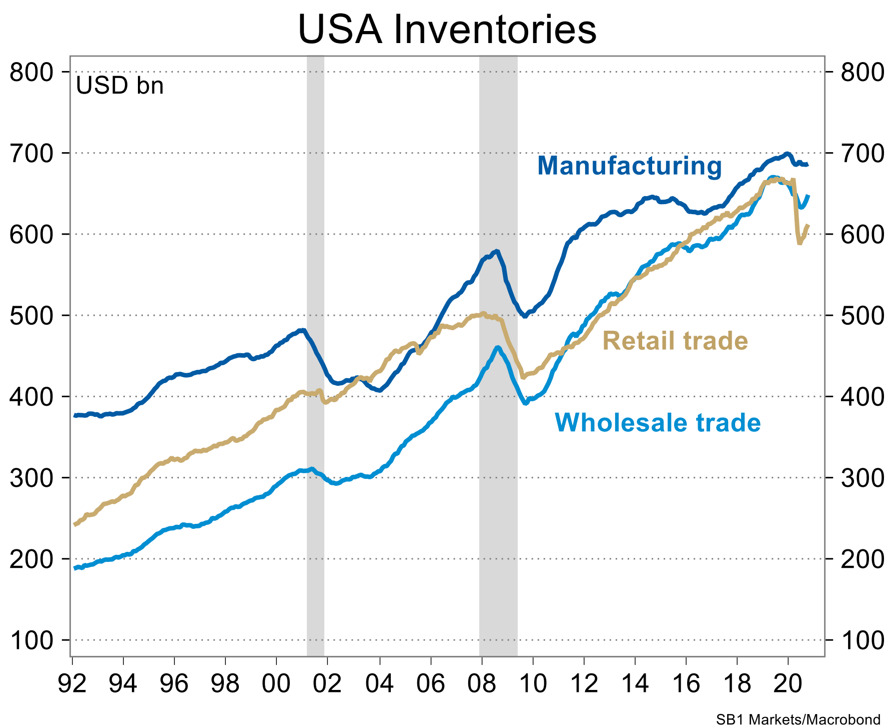
The trend is still upwards –and given retail sales, investment demand, inventories more gains to come

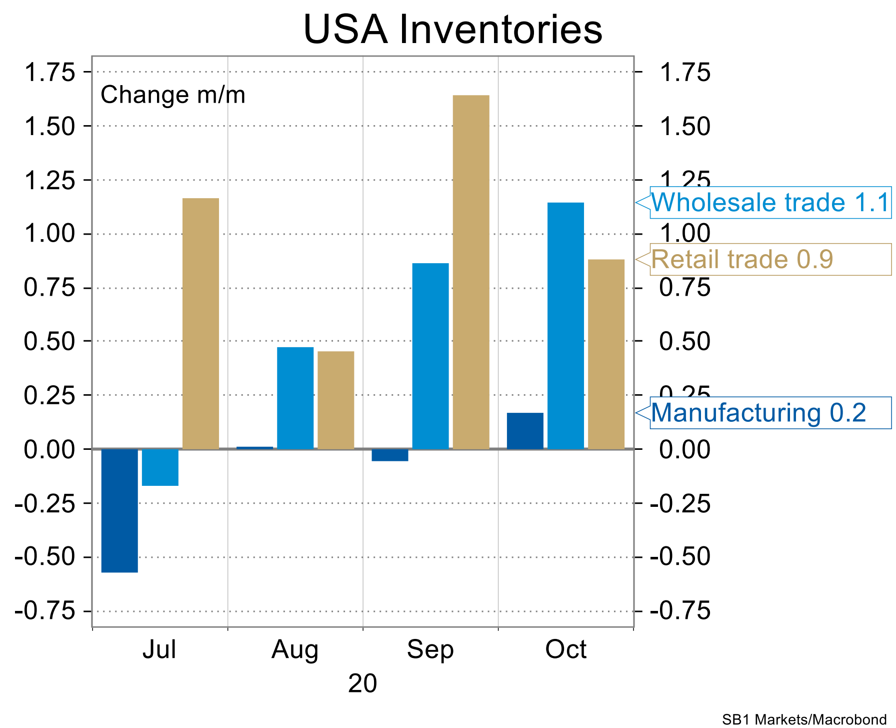


- Manufacturing production rose more than expected in November, and Oct was marginally revised up to +1.1%
- All main categories rose barring a stable production of non durable consumer goods
- Total industrial production, including utilities, mines/oil production, rose 0.3 % in September, expected up 0.4%
- PMI/ISM and other surveys signal a further recovery, but not at a incredible brisk pace, given the low production level

Inventories have been run down, production will have to be ramped further up

... if demand does not fall off the cliff, again

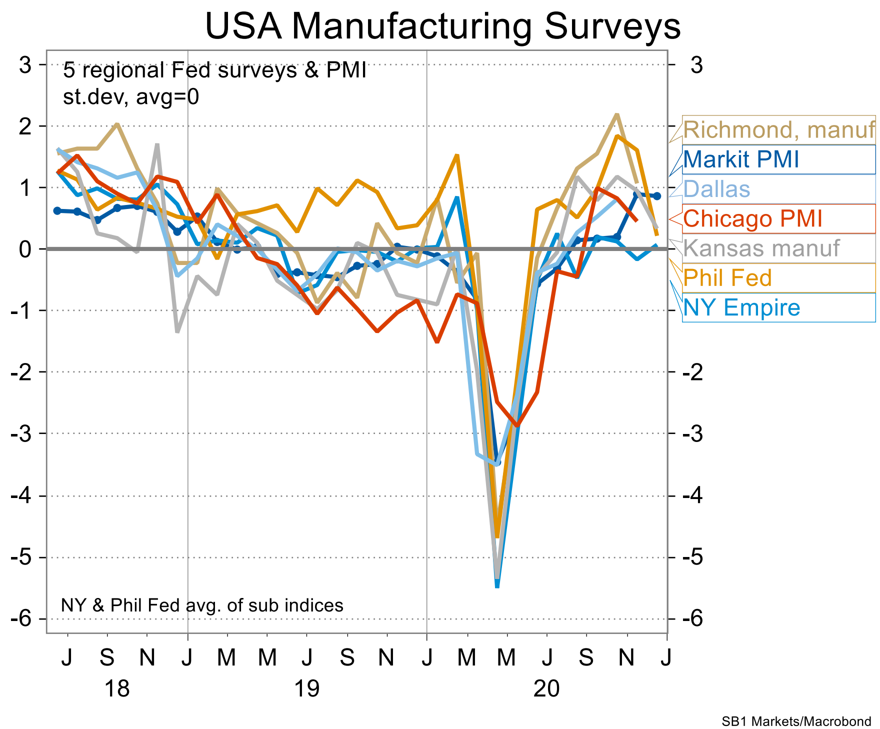


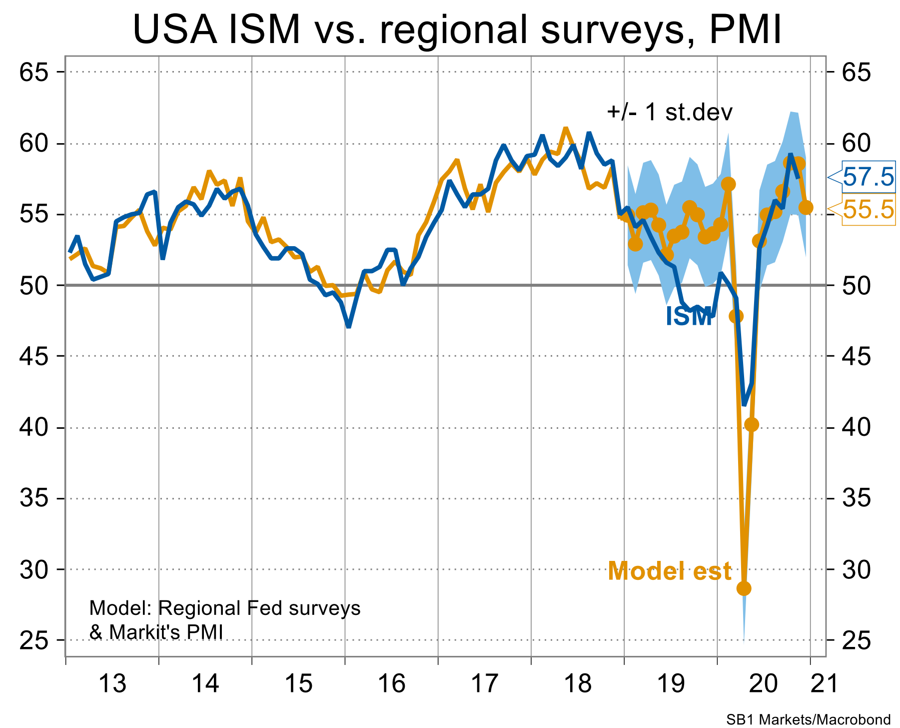


- Retail trade inventories fell sharply in April-June. Inventories are now in the way up, but levels are still low, especially in retail trade – where sales are far above normal levels

Phil Fed sharply down, others better – but the models signals ISM down 2 p to 55

The Philadelphia Fed fell more than expected, Kansas down, the NY fed index up, PMI close to flat

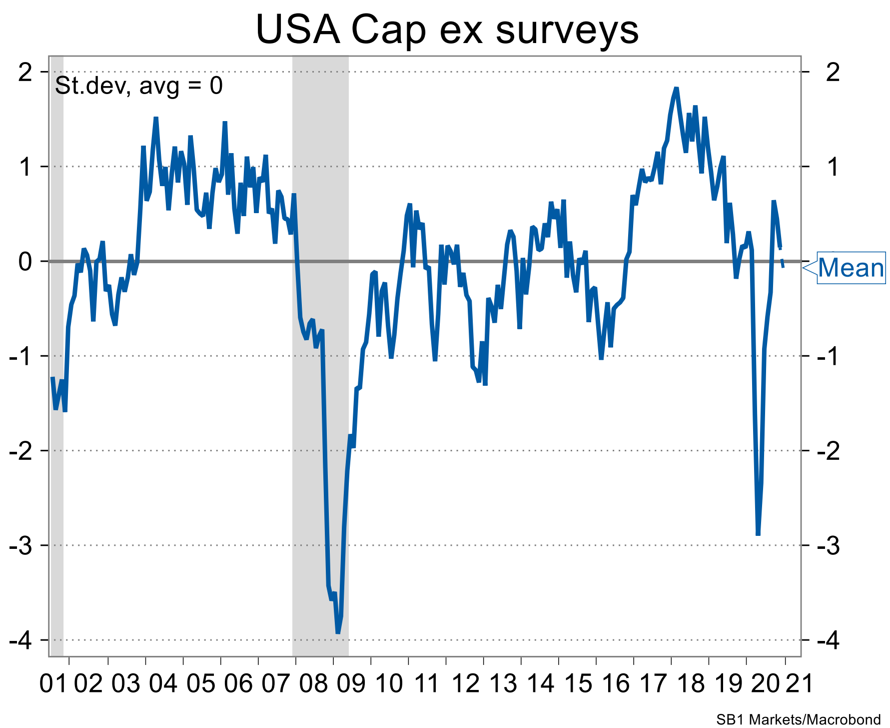


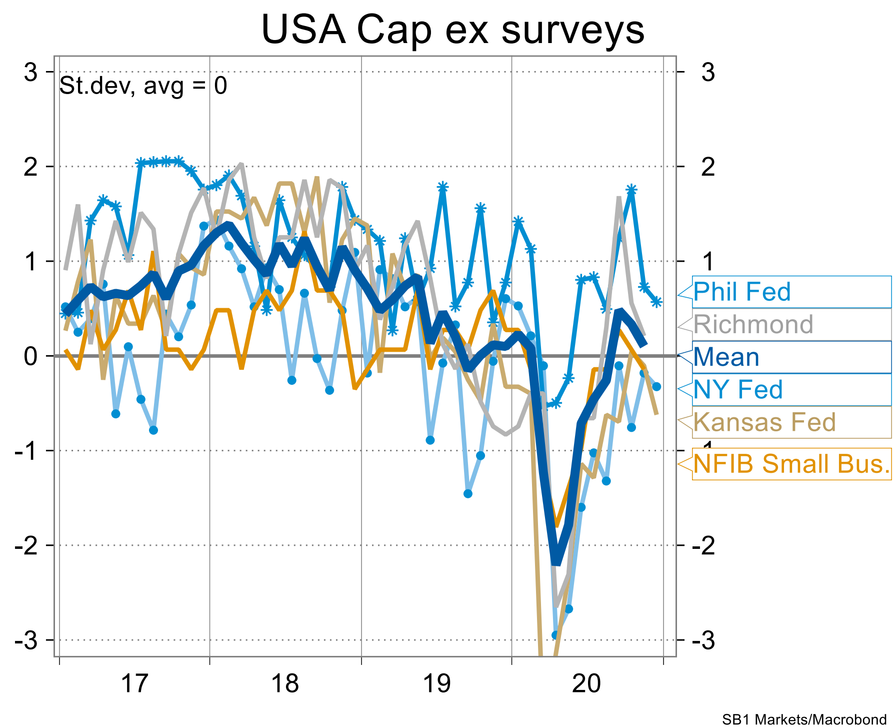


- The Phil Fed index fell to 11 from 26, expected 20. 11 is marginally above average – signalling growth above trend

Cap-ex plans a tad weaker everywhere – probably slightly below par in Dec

Manufacturers are not slashing their investment plans but signal growth below average

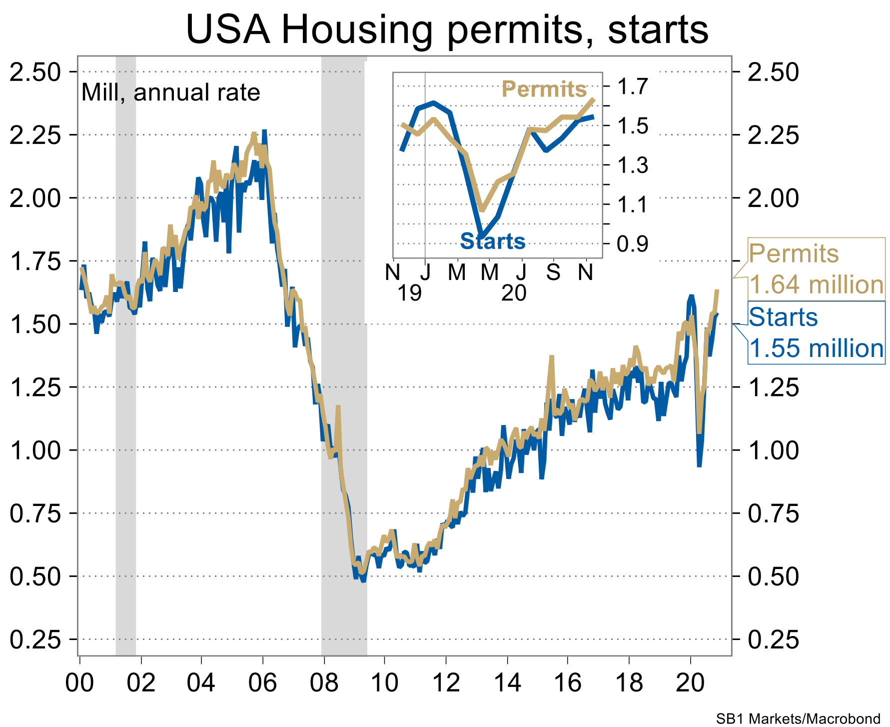


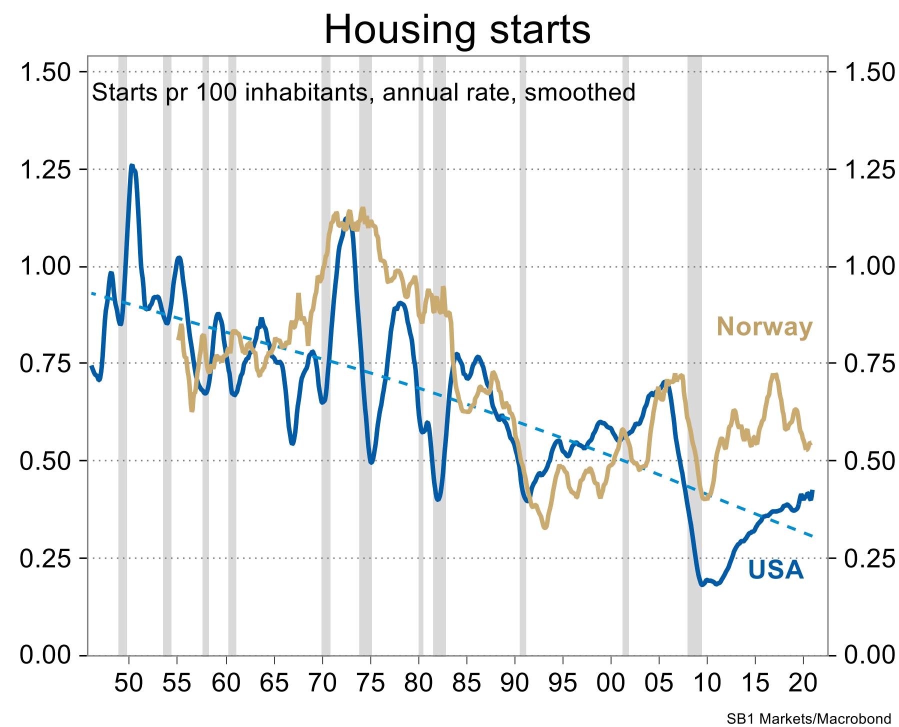


- Investment plans for manufacturers have been mixed recently – and seem to be so in Oct too

Housing building permits the highest in 13 years in ~~October~~ November

Permits up 6% to 1.64 mill in Nov, the highest level since 2007. Starts up too, and the level is high

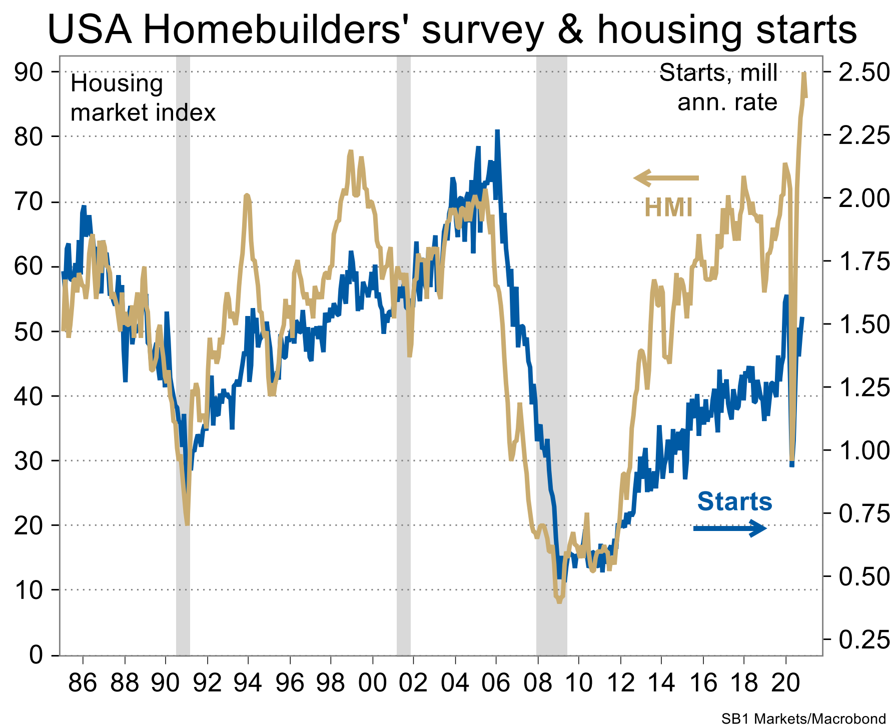


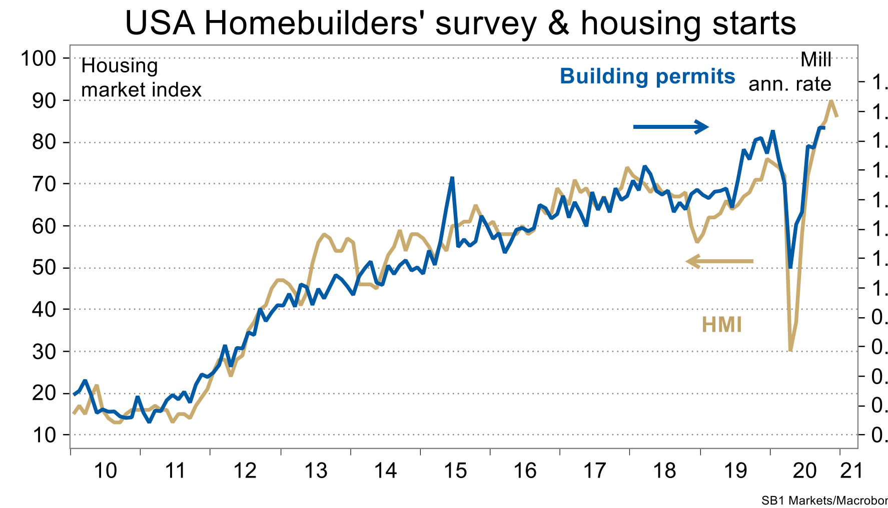


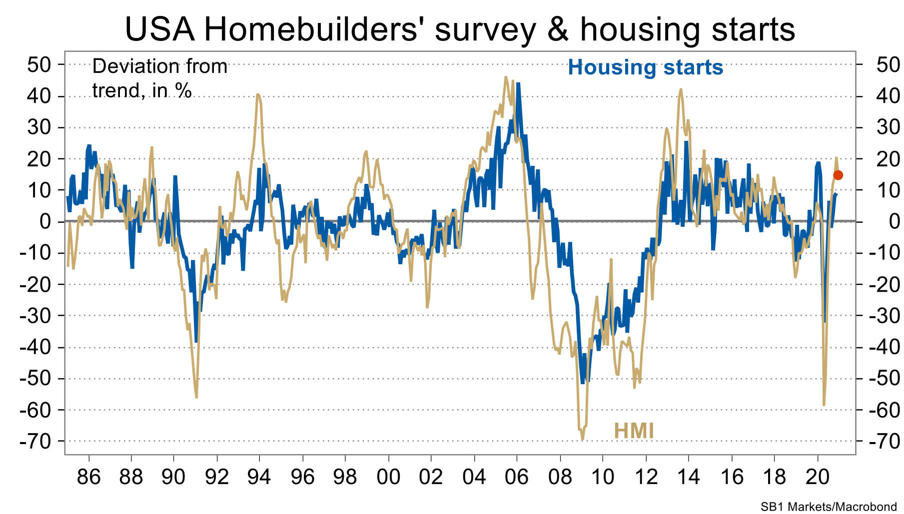
- Permits and starts are up 50 – 65% from the April trough – and are back to well above a ‘normal’ levels
  - » Starts are slightly below the local peak at the end of 2019 but far above the 2019 average – and barring the Dec 19 – Feb 20 local spike, the highest since 2007
  - » Permits were at the highest level since early 2007
- Housing starts are at a quite low level per capita vs. history, like in all other rich countries, as the ‘country is built’, at least in many cities – and starts have been trending downwards in most countries
  - » However, not in Norway the past 30 years

Homebuilders index marginally down in Dec, from the ATH level in Nov

A rapid growth in home building – from a rather high level – is still signalled



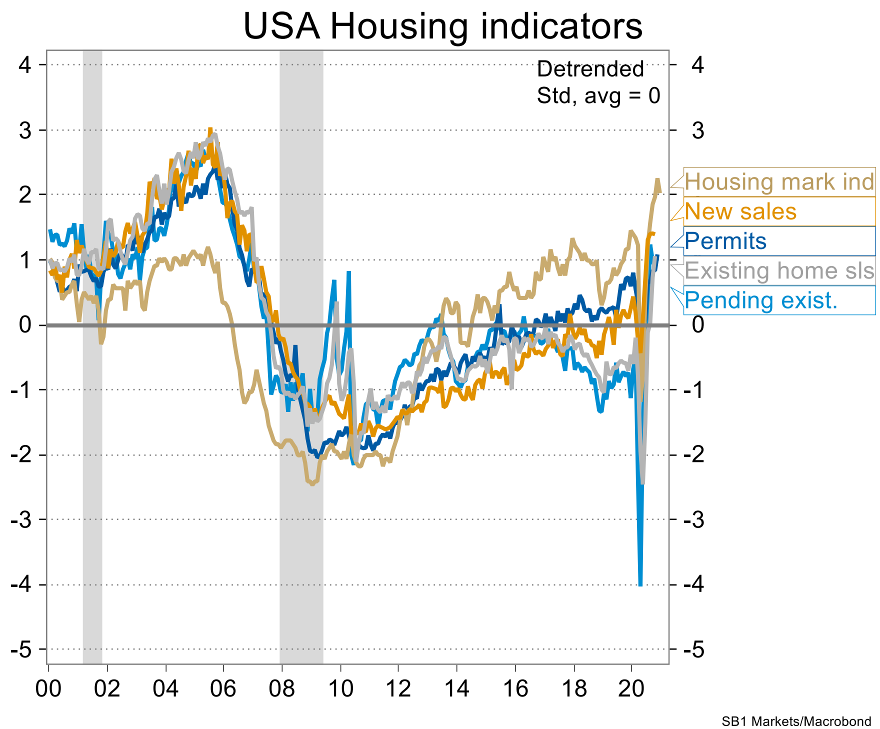


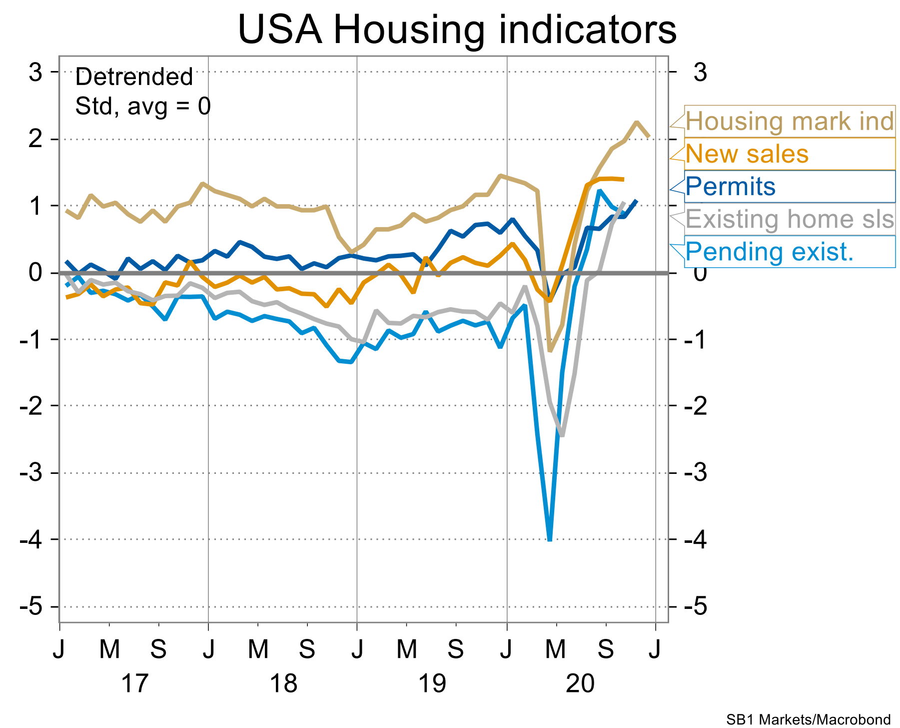


- Builders confidence came in at 86, 2 p below consensus, down from 90 in November. Present sales level, expectations for the next months, and buyer-traffic were all down
- The HMI is not an assessment of growth in housing stars nor the level of housing starts vs a long term average. The best fit is vs deviation of starts from a more flexible trend, check the difference between the chart above and the two to the right
- The current index signals another lift in housing starts vs the level in November, but not more than some 10%

Check the housing market 'V's. It just took 4 – 5 months. Last time: '*Never*'

Starts, home sales & the housing market index all sharply up, boosted by low interest rates

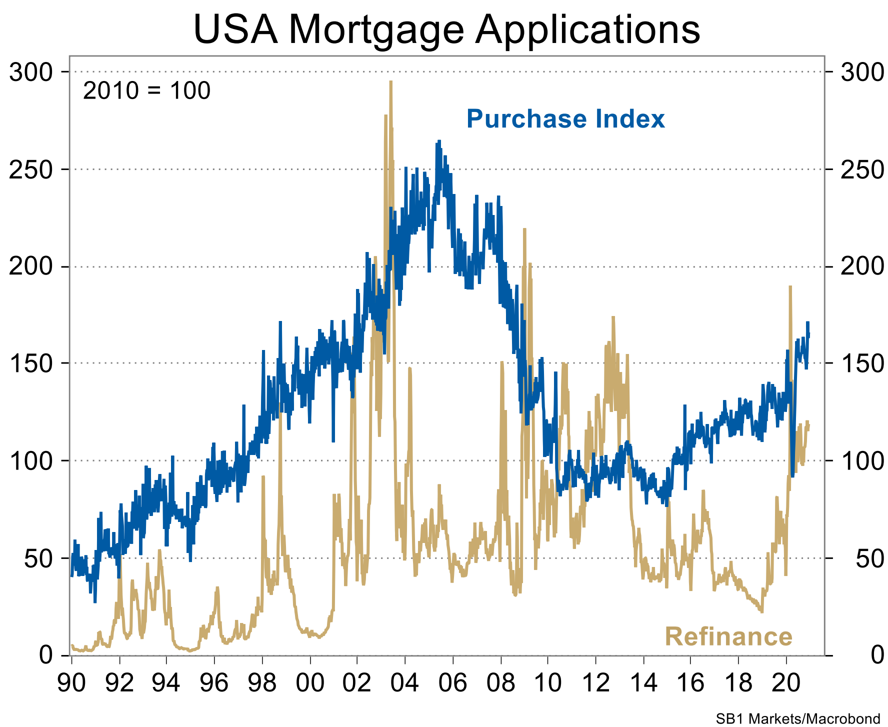


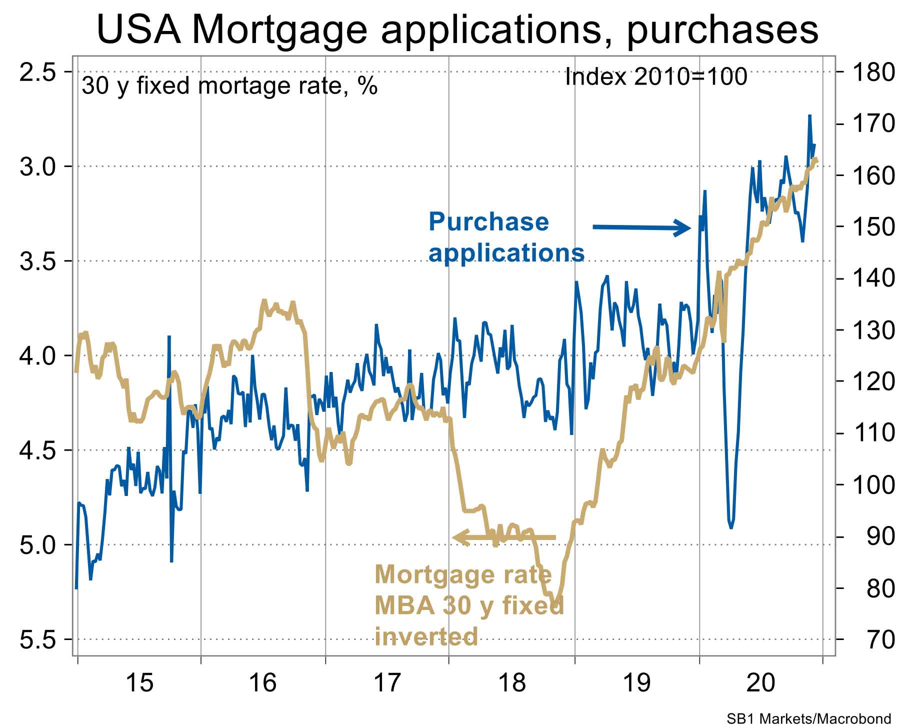


- Compare this 4 – 5 month downturn/recovery to what happened during/after the housing/financial crisis: Housing has not yet come back to the pre-corona peaks. It even took some 10 years to come back to an average housing market activity level (barring the Homebuilder's market index)!
  - » BTW: The peak in the housing market was in late 2005/early 2006, and most of the downturn was done when the 'financial crisis' hit 2 – 2 ½ years later

Mortgage applications the highest level since ‘08, mortgage rates the lowest ever

Applications fell sharply during the spring, then a sharp ‘V’ recovery, up to the best levels in 12 years

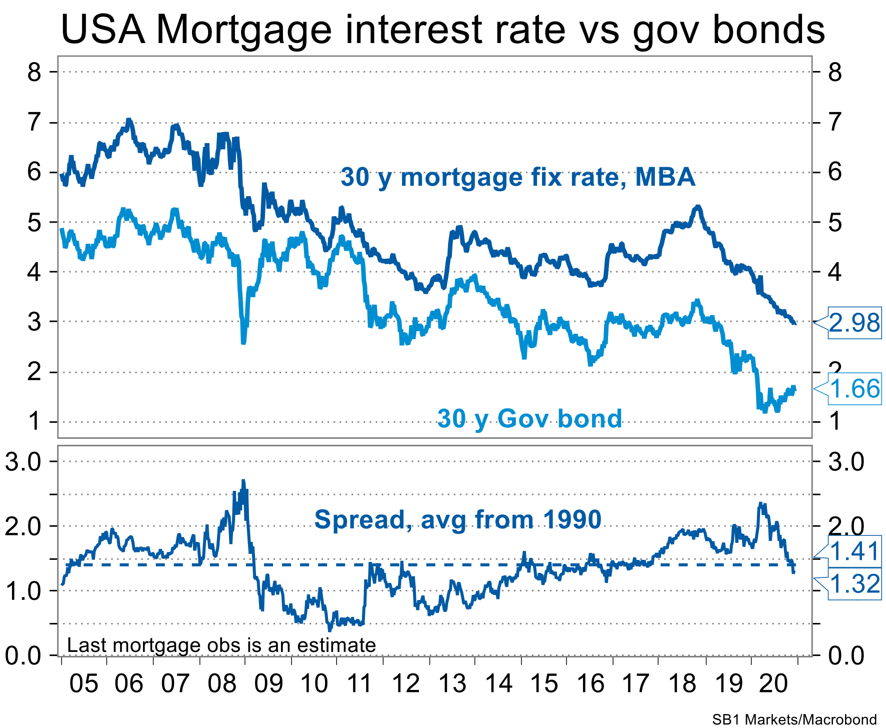




- No doubt, low mortgage rates have stimulated demand
- 30 y fixed mortgage rates have fallen to 3.0% from 5.25% late 2018 via almost 4% at the end of 2019 (details next page)
- Disclaimer: Demand for new mortgages has <u>not</u> been a reliable leading indicator for the housing market. Still, strong demand for new mortgages cannot be a sign of weakness

The 30 y gov bond rate up is <u>up</u> 50 bps, 30 y mortgage rate is <u>down</u> 50 bps

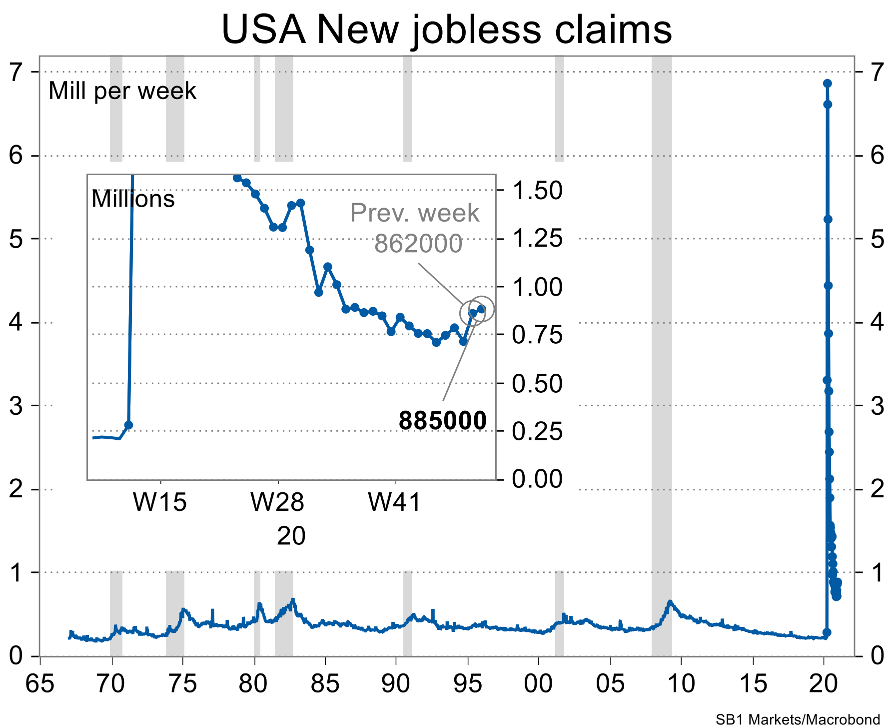
... as the spread is down 100 bps – and still just at an average level!

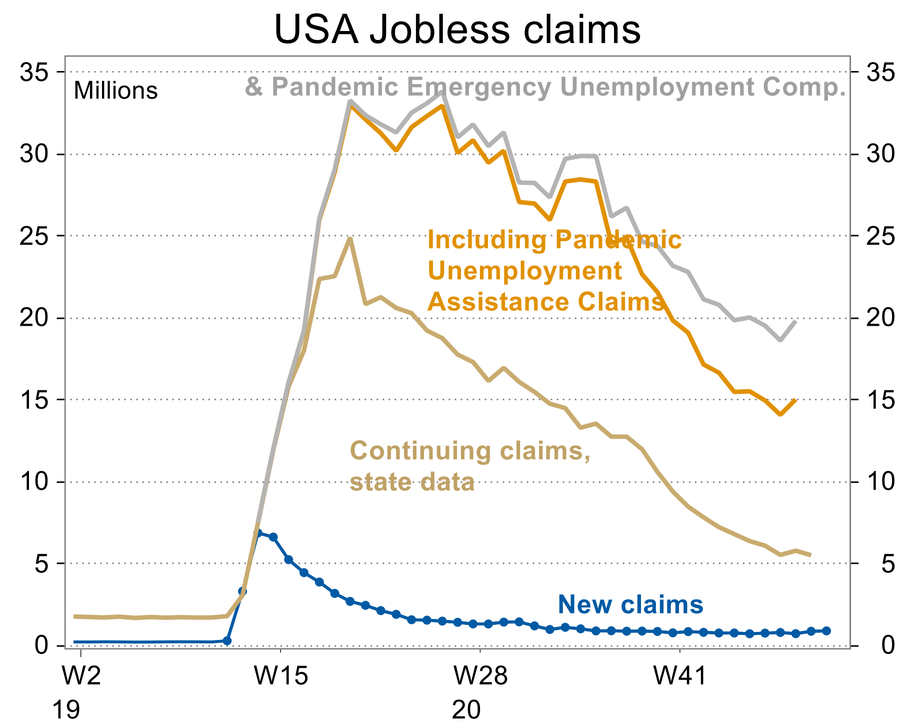


- This may be an QE impact, as the Fed has bee buying large quantities of mortgage backed bonds

Another unexp. hike in new jobless claims. Likely due to corona lockdowns

The trend has been down but the no of new claims have climbed over the past 5 weeks

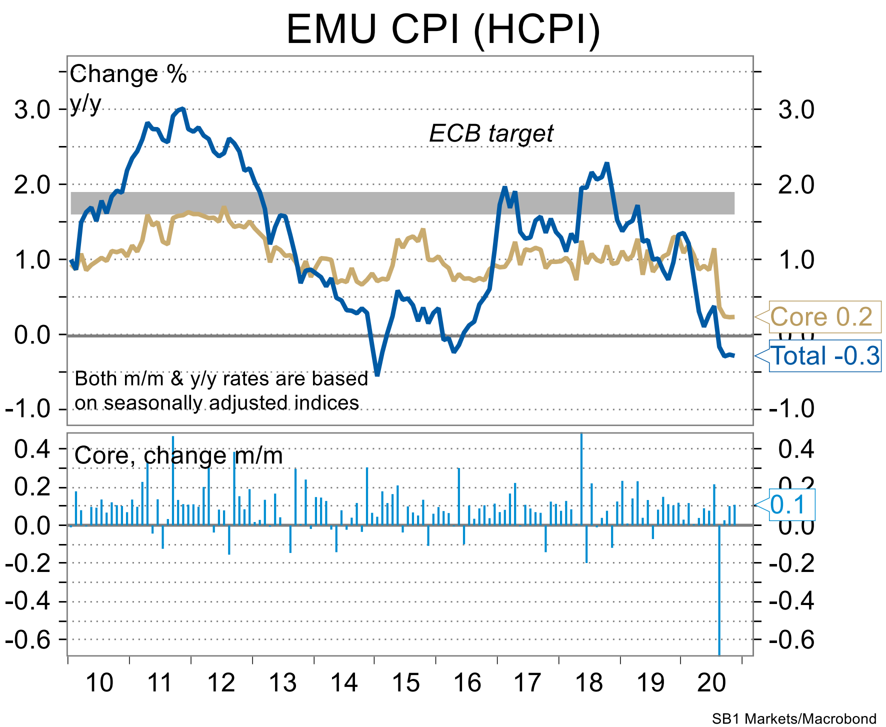


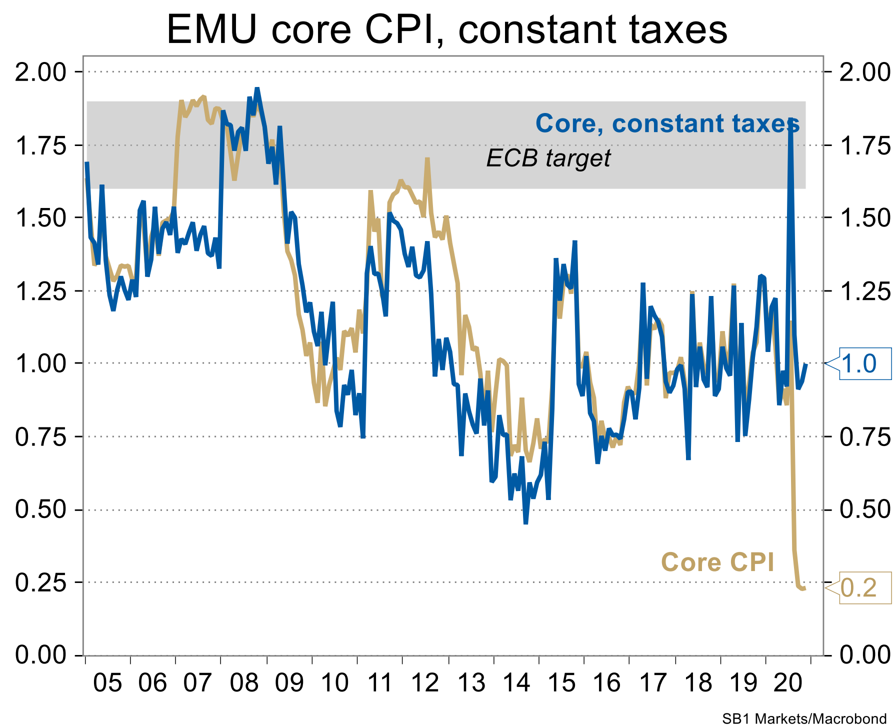


- The no. of new claims rose by 23’, to 885’ the highest level in more than 2 months – the inflow was expected down to close to 800’. Most likely, the economy is slowing somewhat, as tighter Covid-19 restrictions are imposed in several states
- Late Sunday, the Congress finally agreed upon a second fiscal stimulus bill, including a prolonged Federal unemployment support at USD 300/week

Core inflation stable at 0.2% (y/y…), total at -0.3%

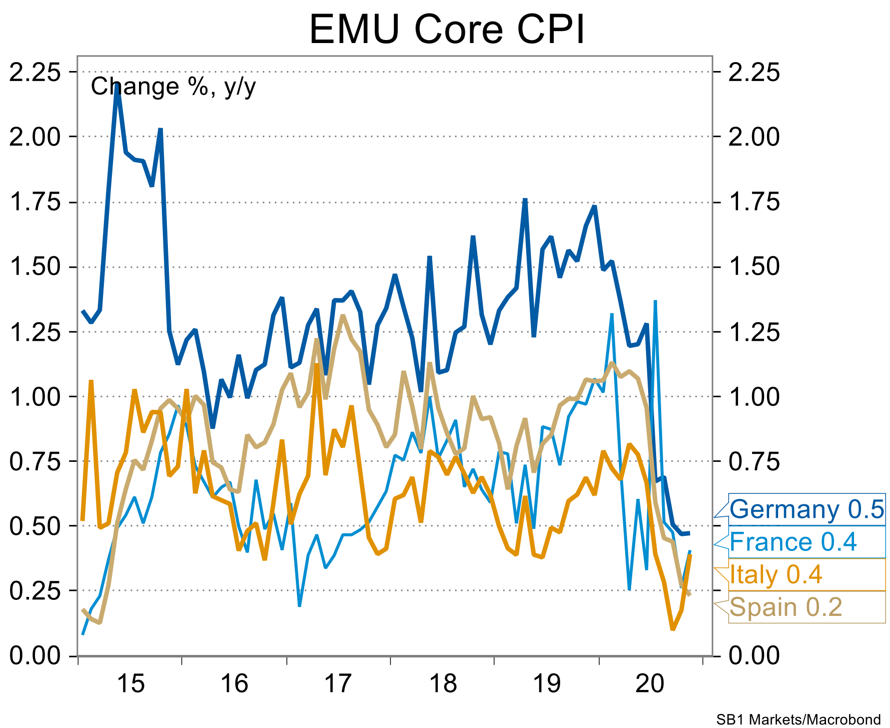
The German VAT cut (& other tax cuts) have lowered EMU infl. by some 0.8 pp. Still, 'real' infl. is low

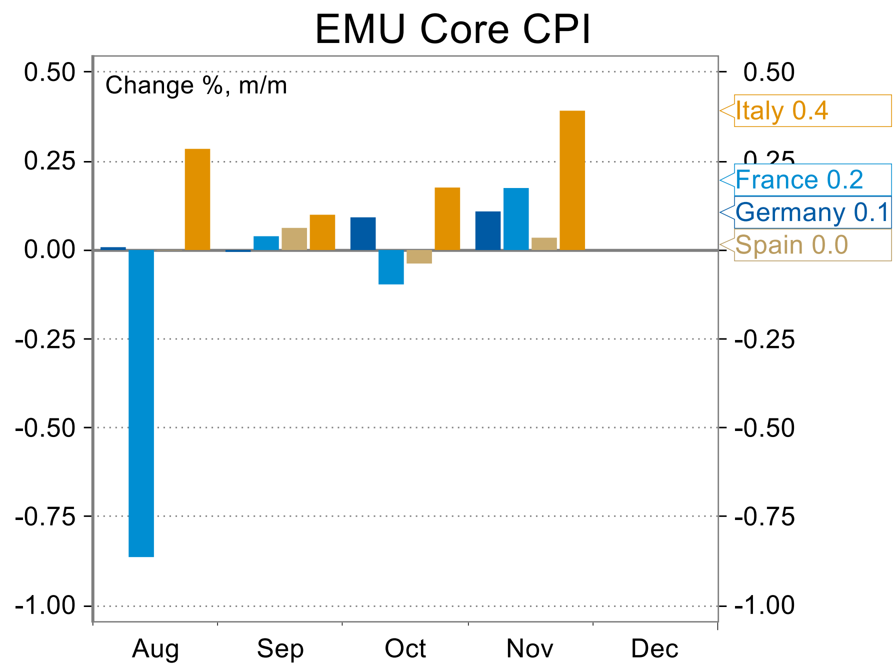


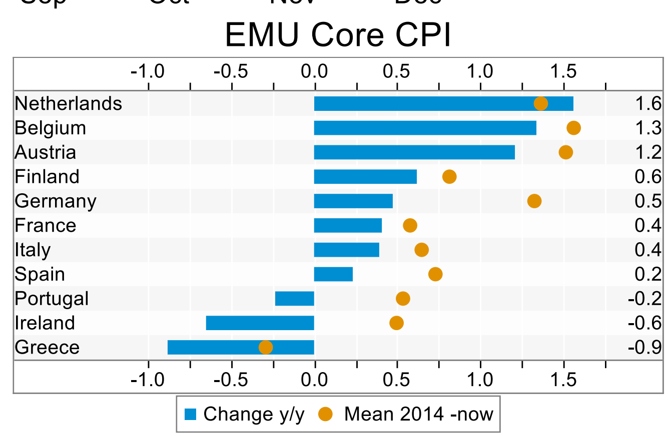


- In November, core prices grew 0.1% m/m and the annual rate was unch at just 0.2%. Core inflation has fallen in all the major countries. However, the German VAT cut partly explain the slowdown in EMU inflation. The core, constant taxes CPI was 1,0%. Thus, taxes are explaining 0.8 pp of the decline in core inflation, after taxes (like the Norwegian CPI-ATE, 'JAE')
- Energy prices have taken the total CPI down – and the headline HICP was down 0.3% y/y in Nov, like in the two previous months. *Good news for European households, and their purchasing power*

Core inflation is low everywhere, Germany and Italy have slowed the most



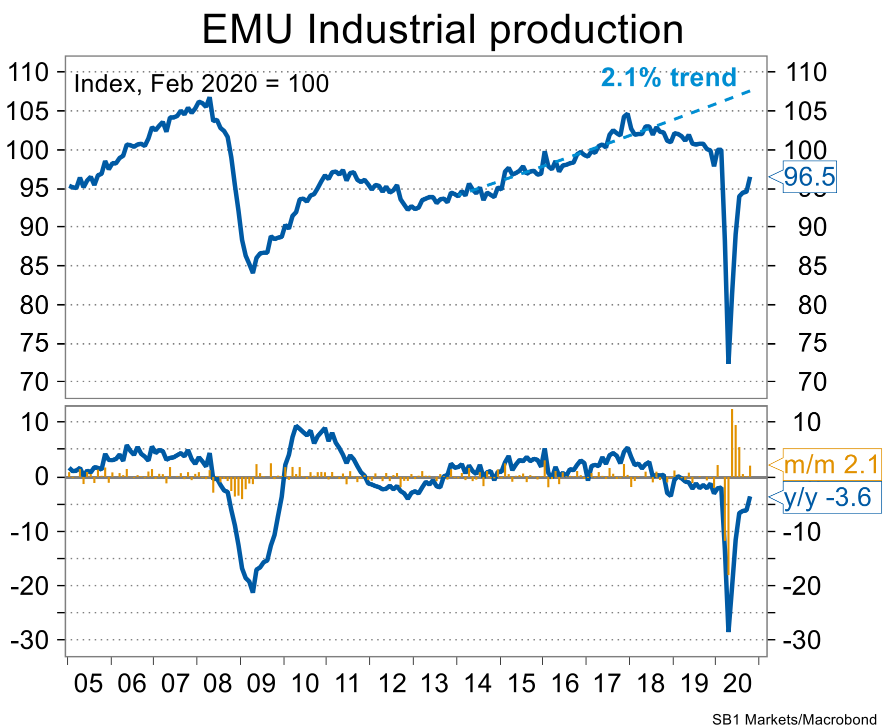


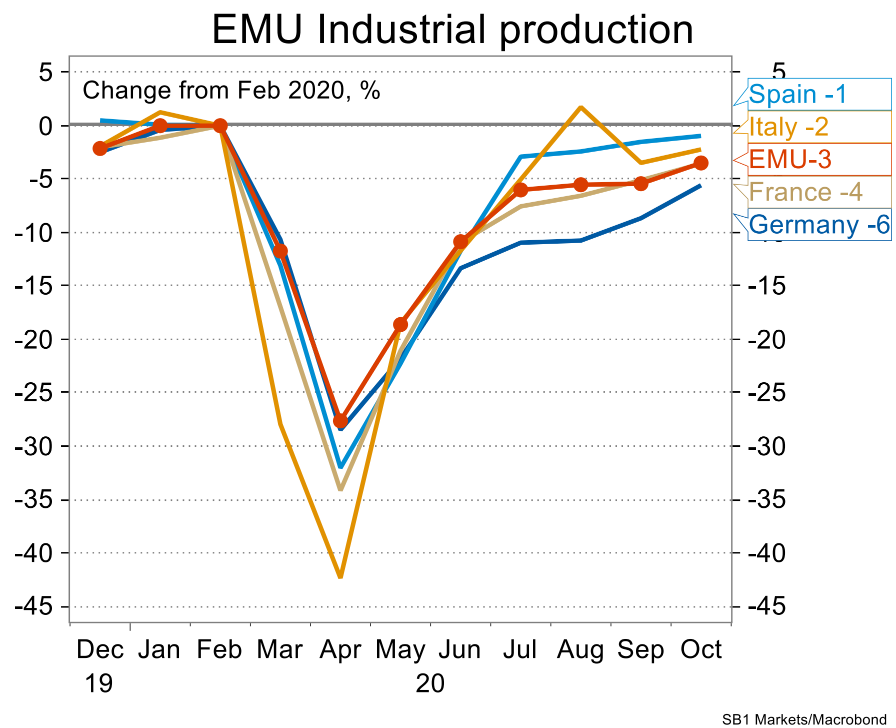


- Greece has fallen into deflation again – and prices are not higher than in 2010 (and core since '08). Core inflation below zero in Ireland and Portugal too

Manufacturing production up 2.1% m/m in Oct (exp. 2.0%), down 3.5% vs. Feb

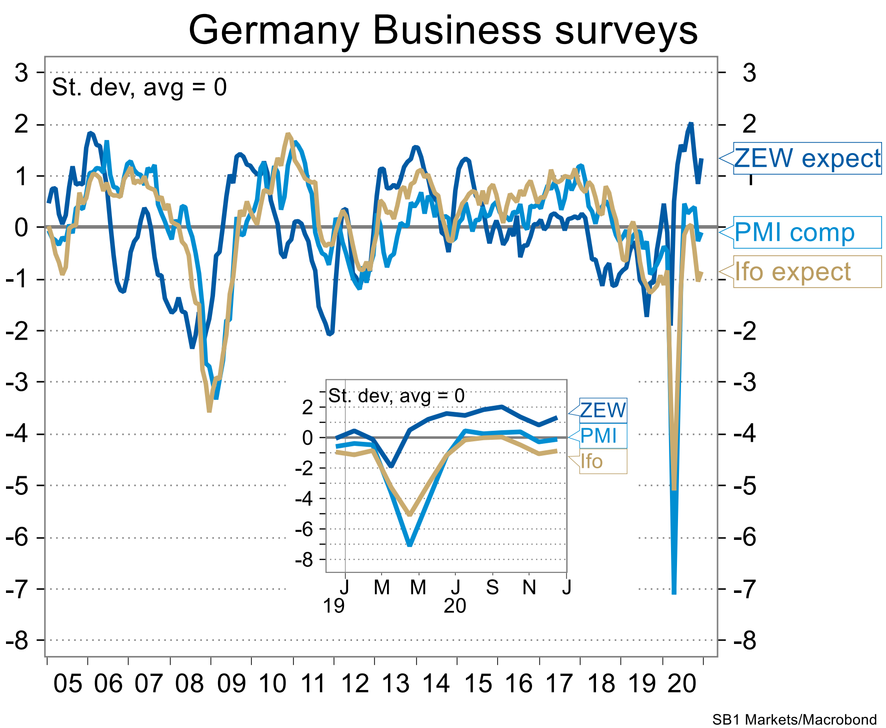
Production increased in all the big 4: Germany, France, Italy, and Spain

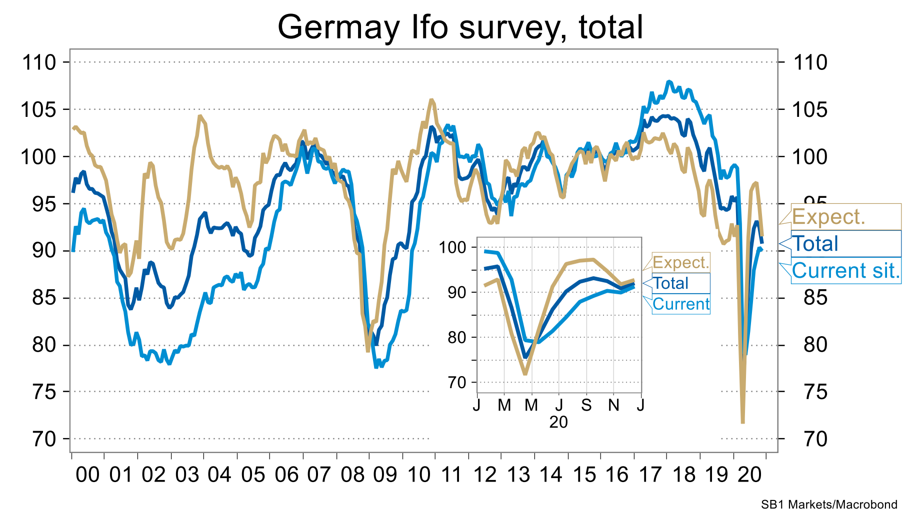


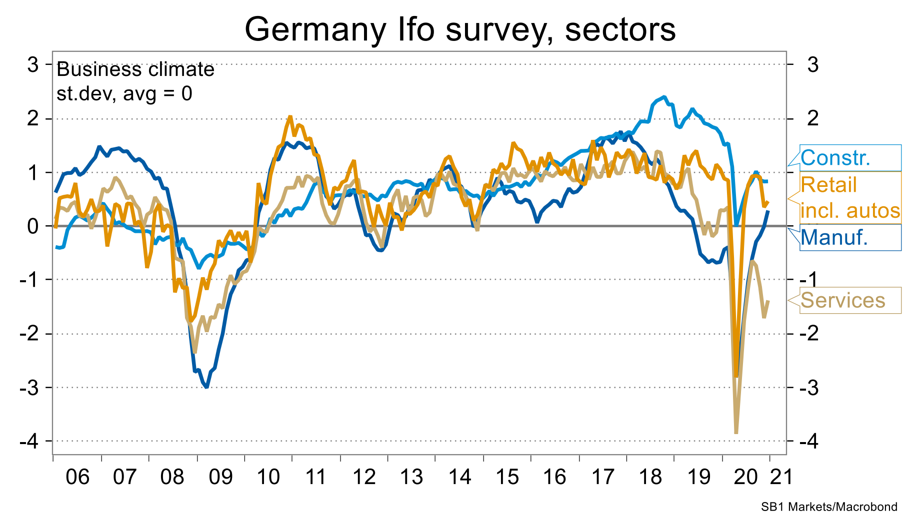


Dec Ifo better than expected but still signals a mild Q4 contraction

Retail trade, construction & now manufacturing are reporting growth above trend, services not



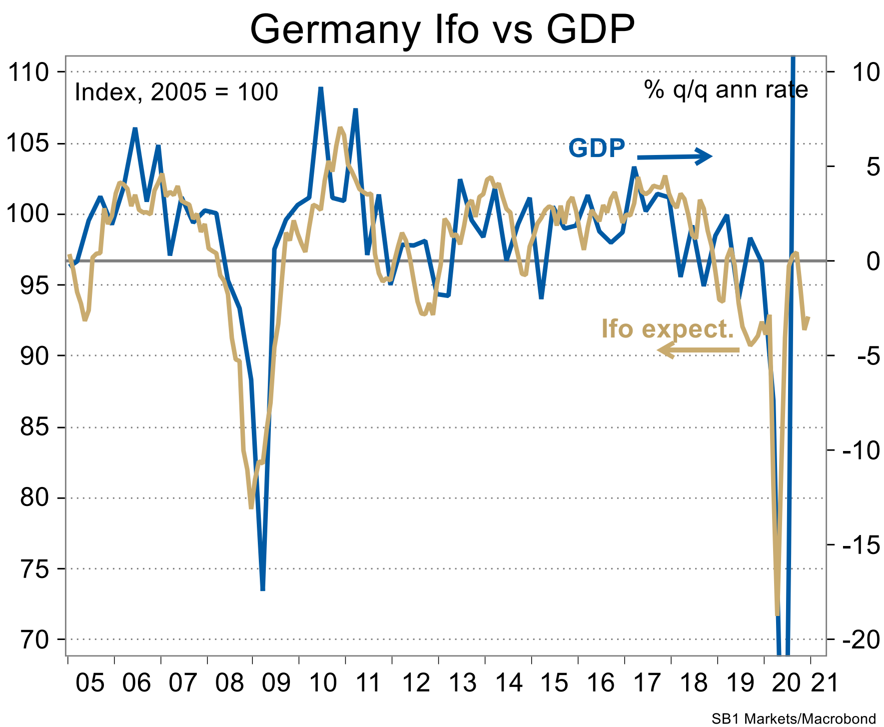




- Both the assessment of the current situation and expectations rose more than expected (the current situation was expected down)
- The ZEW expectation survey (which is a survey among economists and investors, not a business survey) rose in Dec, and is the most upbeat
- The PMI survey also climbed in Dec, and up to an average level (signals growth at trend)

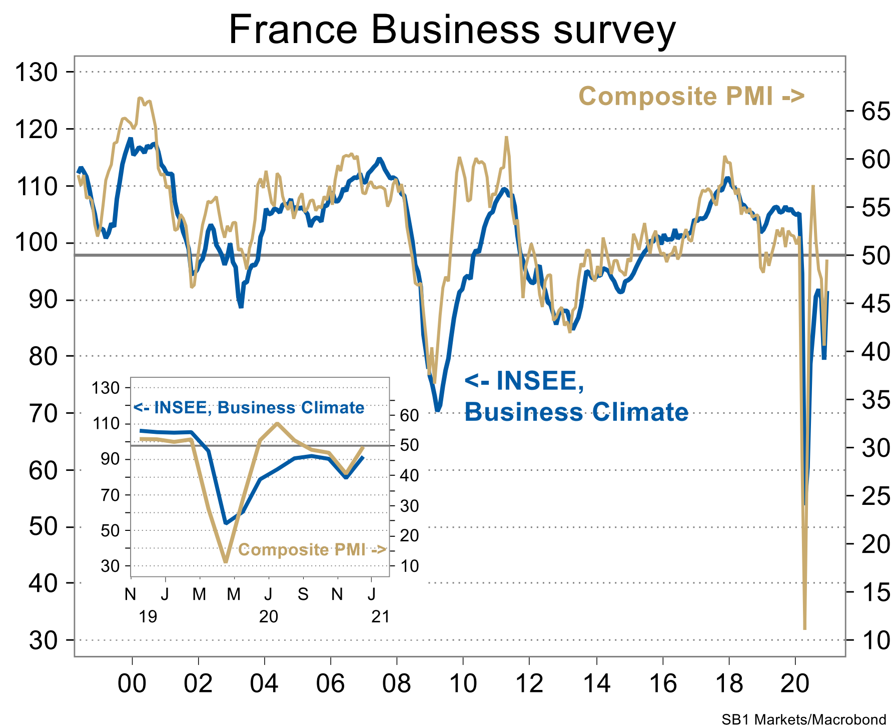
Ifo signals 1% GDP drop in Q4 (3% annualised), a tad weaker than the PMI

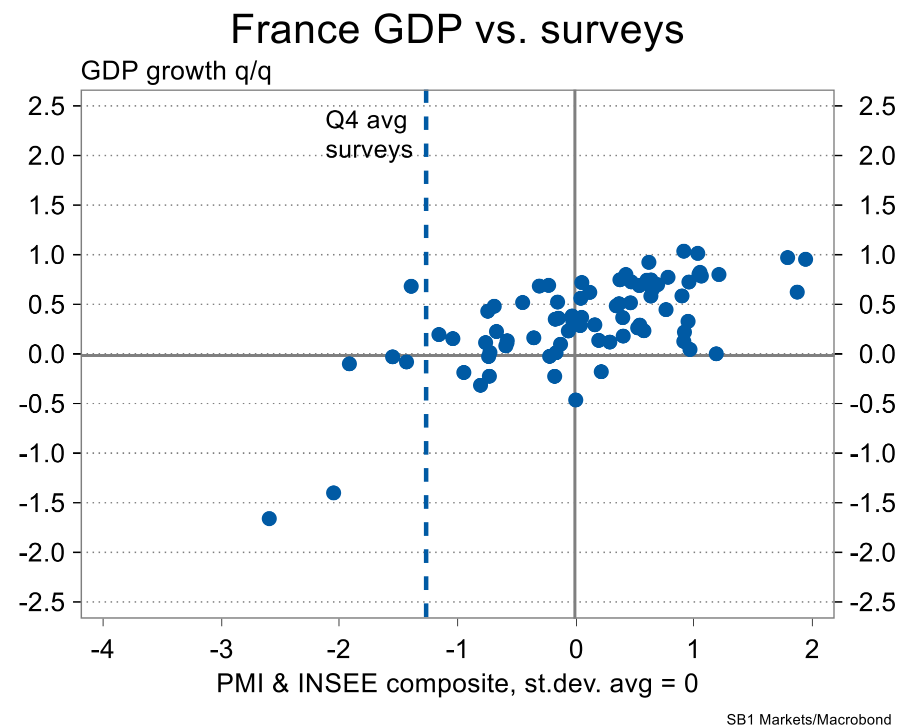
The Ifo index did not match the Q2 setback nor the Q3 recovery but should capture the Q4 drop?



France: The INSEE survey up much more than expected (like the PMI) in Dec

A flat Q4 GDP is signalled. Better than rather dramatic forecasts

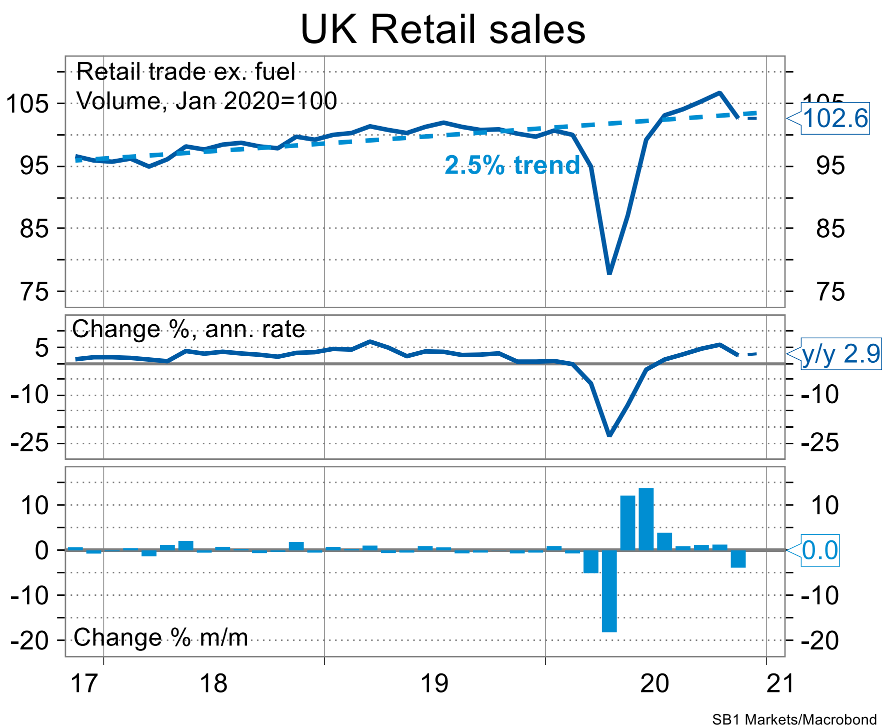


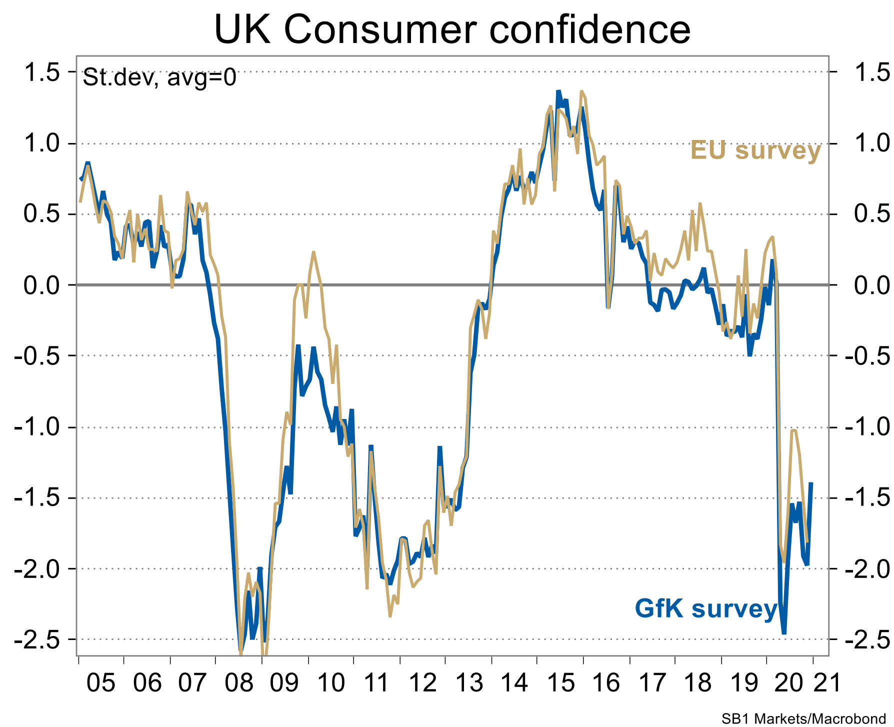


- The INSEE survey (business confidence) rose to 91.5 from 79.4 – expected up to 81. The level is back to the October print
- The INSEE survey & the PMI does not signal growth in Q4 but definitely not a dramatic downturn

Retail sales down 3.8% during the new lockdown month, was -18% in April

If sales are unchanged in Dec (better in 1st half, weaker 2nd half), Q4 will decline by 0.2% from Q3



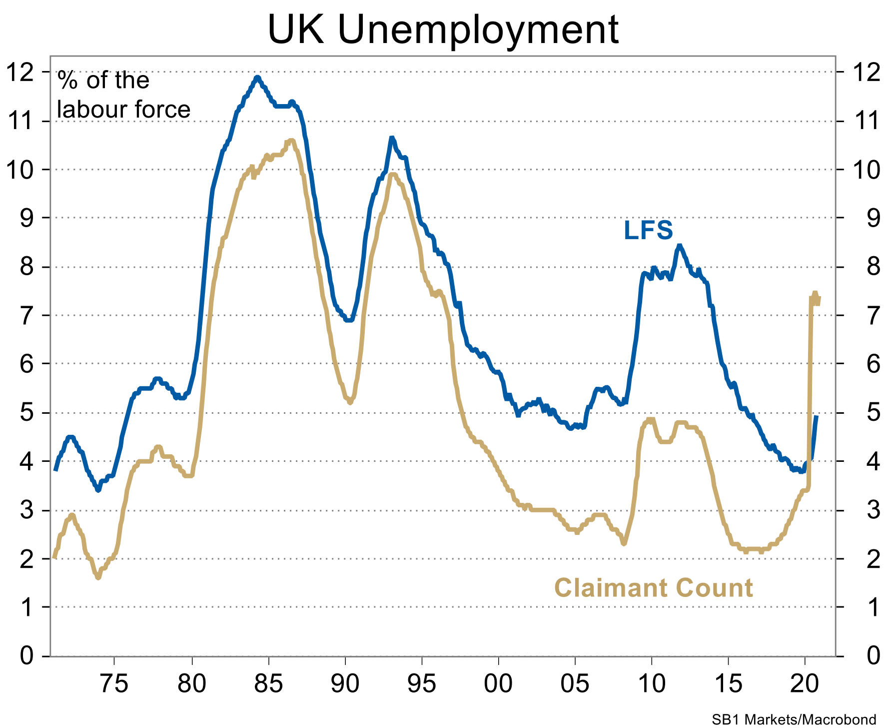


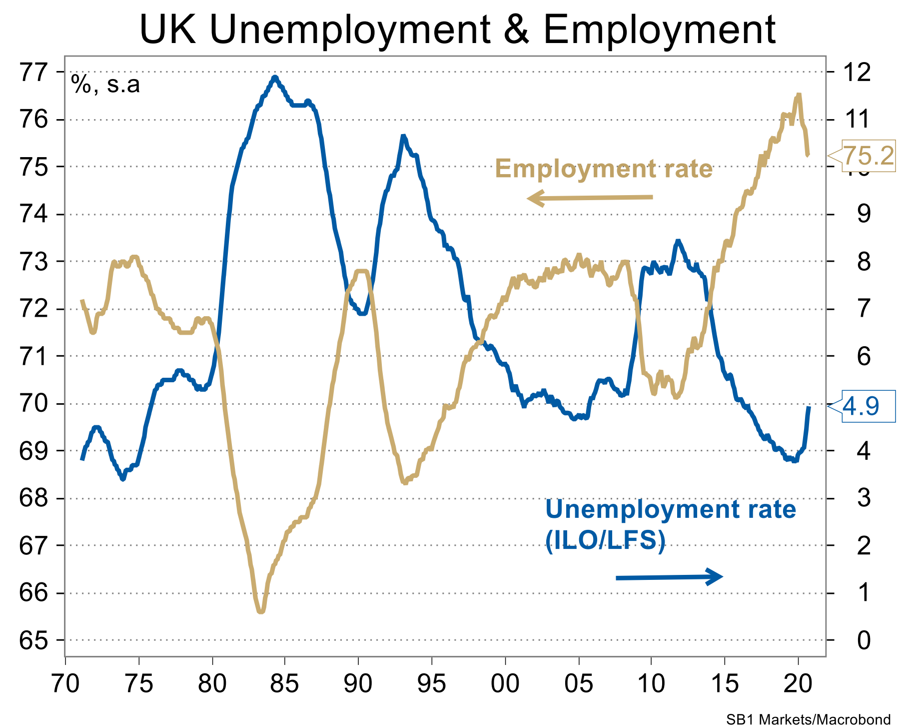
- Sales fell less than expected
- The new corona restrictions that are imposed will probably hurt some services harder than retail sales – and a 1% decline in GDP in Q4 is not that unlikely (BoE forecast)
- Consumer confidence has recovered in December, at least according to the GfK survey (which of course does not cover news on the mutated virus or new restrictions). The confidence level is still well below par

SpareBank 1 MARKETS

'Open' unemployment at 7.4% in Nov – has hoovered at these levels since Aug

The ILO unemployment data do not yet reflect the actual labour market conditions

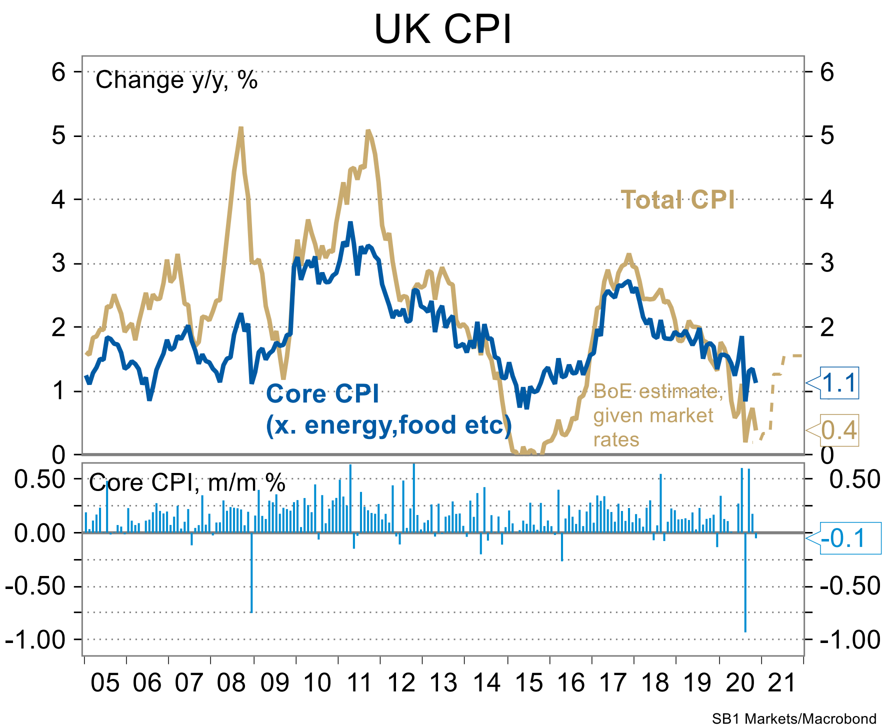


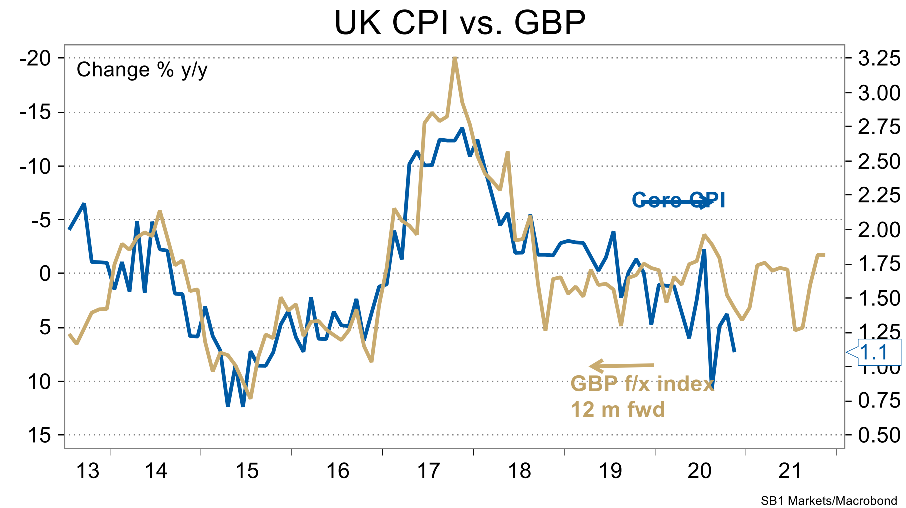


- The ILO/LFS unemployment rate has too much of a time lag to be relevant. Th data does not include furloughed/temporary laid off workers until after 3 months
- According to the claimant count data (registered unemployment), the unemployment rate is now running at 7.4%, up from 3.4% before corona. Still, compared to many other Western countries, the upturn has been limited. This is probably related to the generous rescue program for businesses, as the UK government has compensated businesses for a share of workers salaries

CPI inflation is still trending down, at 1.1% in Nov, well below the target

Core CPI down 0.1% pp m/m – and the cost pressures are measured

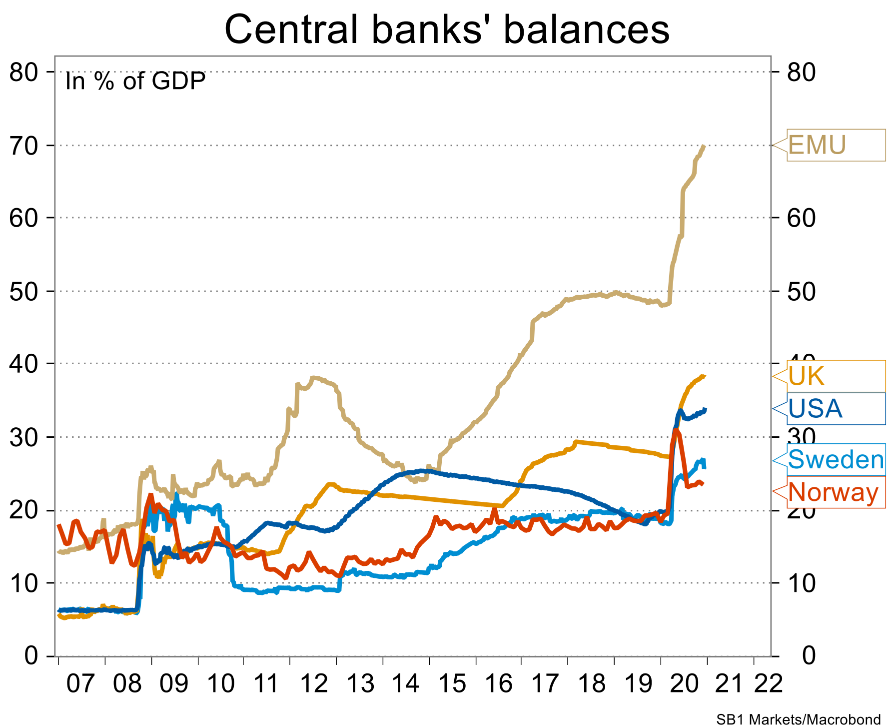




- Total inflation fell to 0.4% in November
- Our simple f/x based model indicates that the impact from the GBP depreciation in 2018 is fully recognised; the slowdown in the UK economy is more important now

BoE leaves interest rate and asset purchase programme unchanged

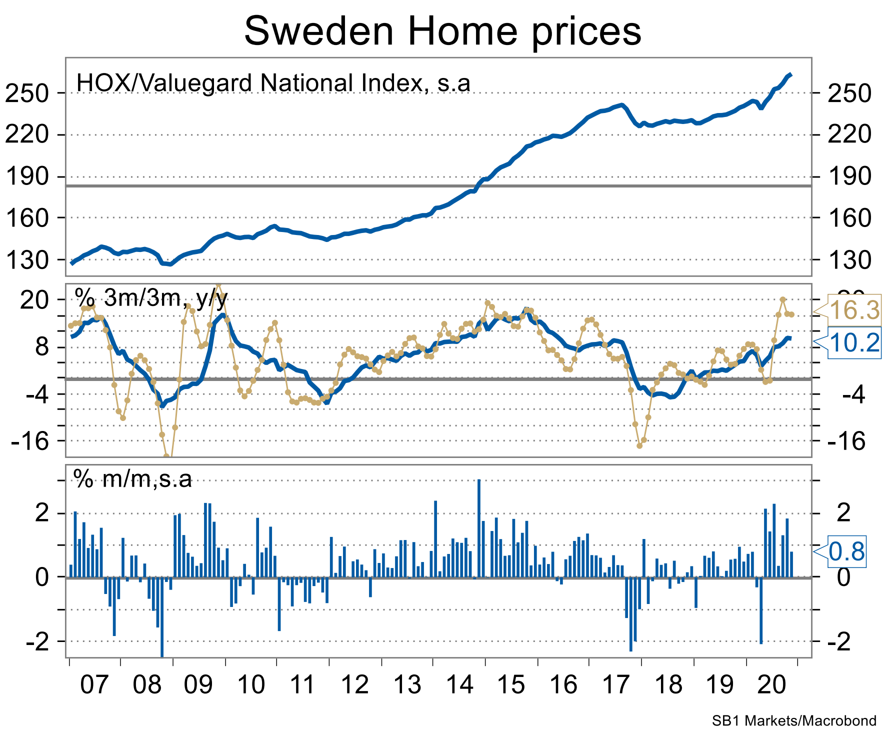
'The outlook on the economy remains unusually uncertain' *BoE Monetary Policy Summary*



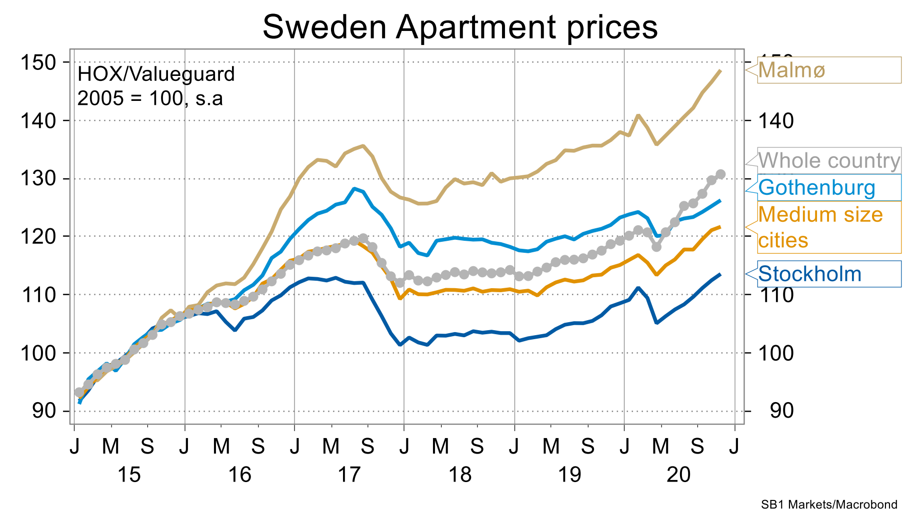
- The Bank left the **interest rate at 0.1%** and maintained the target for asset purchases at £895
- **Funding scheme** for small and medium-sized business was extended for 6 months until Oct. 2021
- **Outlook considered unchanged** – vaccine news considered most important update since Nov, however, the Bank stated that the outlook remains unusually uncertain.
- The Q4 y/y GDP forecast is unchanged at -11%, as the Bank expects a 1% decline in GDP in Q4 – Covid-related fiscal spending expected to boost GDP by 1% in 2021
  - » This decline is probably the largest in the rich part of the world – even larger than in Spain
- **Inflation** is expected to rise sharply towards target in the spring as a result of the cut in VAT coming to an end
- **GBP interest rates** rose sharply last week due to Brexit optimism
- However, **Saturday's news on the mutated virus** and new and **stricter lockdown** for more than ¼ of the population during Christmas and Sunday's comments from the EU trade commissioner on **lack of progress in the negotiations on a Brexit trade deal** may sour the mood in the markets this week. The GBP has depreciated somewhat

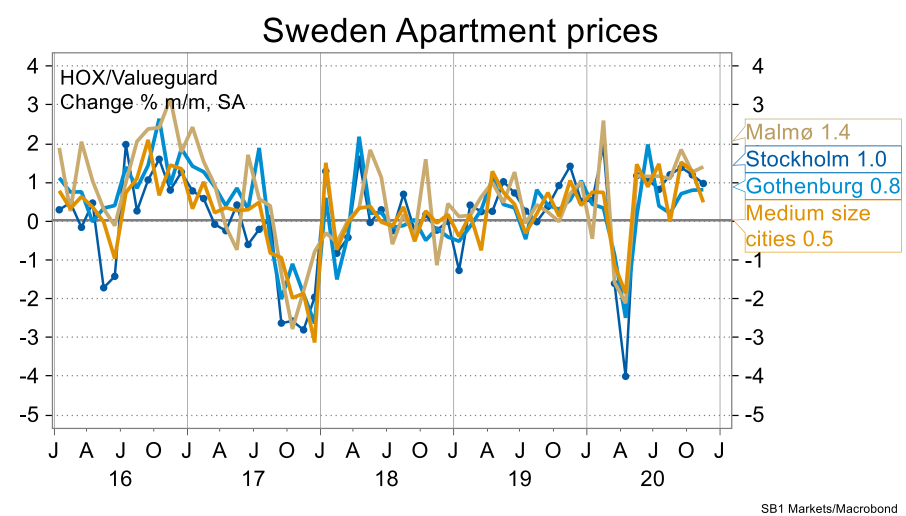
Swedish house prices up 0.8% in November, up 10% y/y

No corona crisis at the housing market



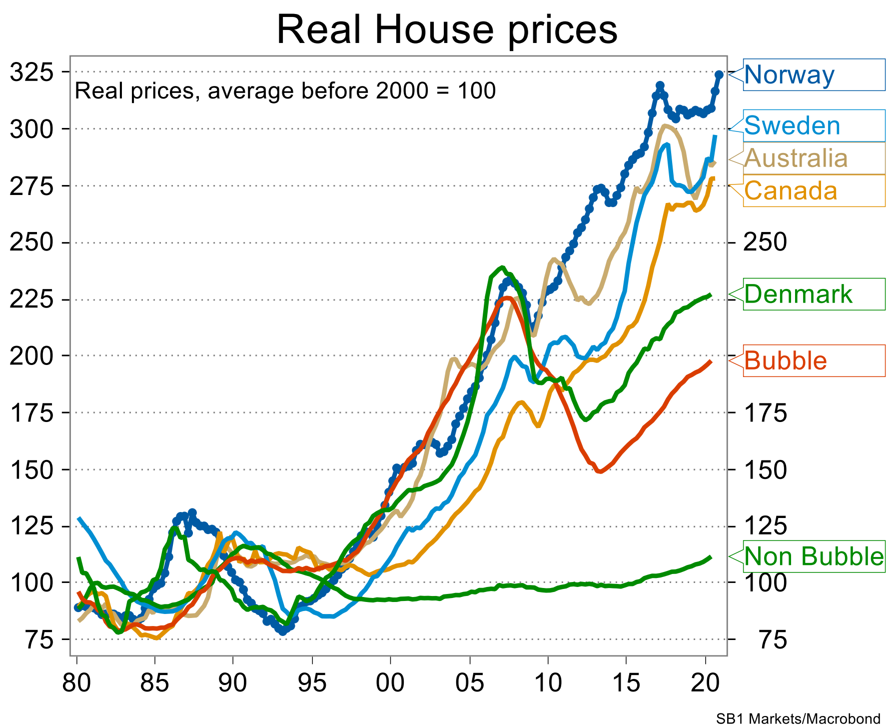
- Underlying price growth is now 15 – 20%, even higher than in Norway
- Prices are now increasing in all the major cities – and finally both Stockholm and Gothenburg prices are above the February level, after being lagging sharply recent months

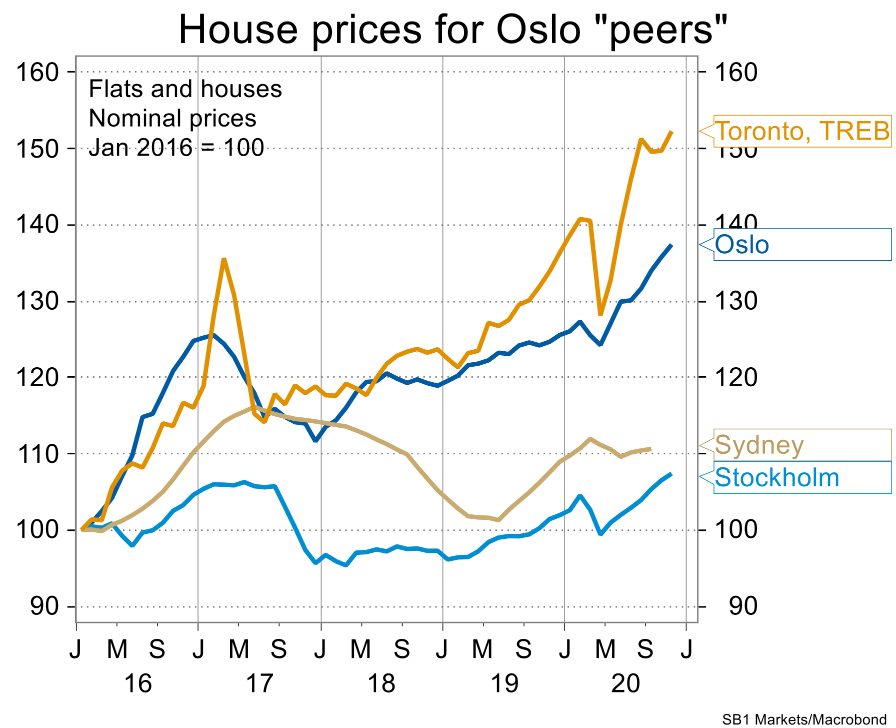




Here we go again…

Prices are soaring in many countries now – with the 'supercycle' countries in the lead

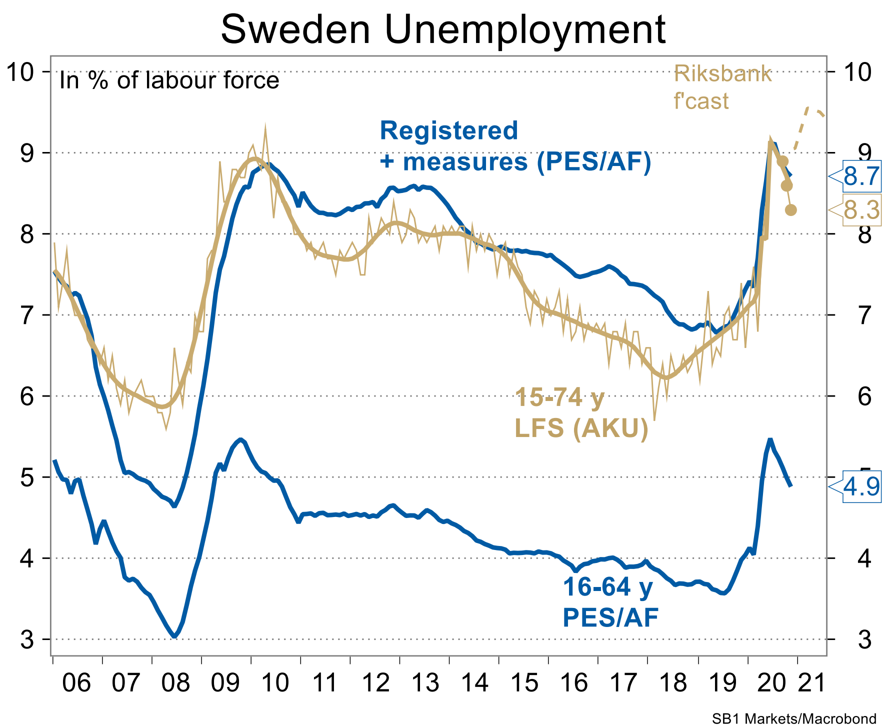


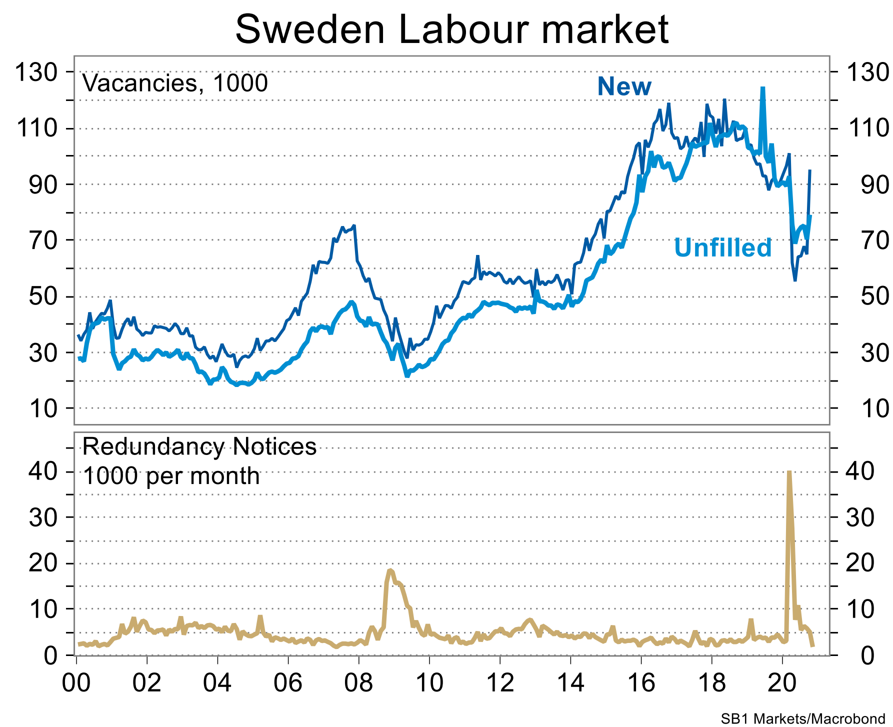


- Real house prices are at high levels in both Australia, Canada, Norway, and Sweden

LFS unemployment further down in November – to 8.3%, employment, hours up

More new vacancies also signals better labour market. Few announced layoffs too

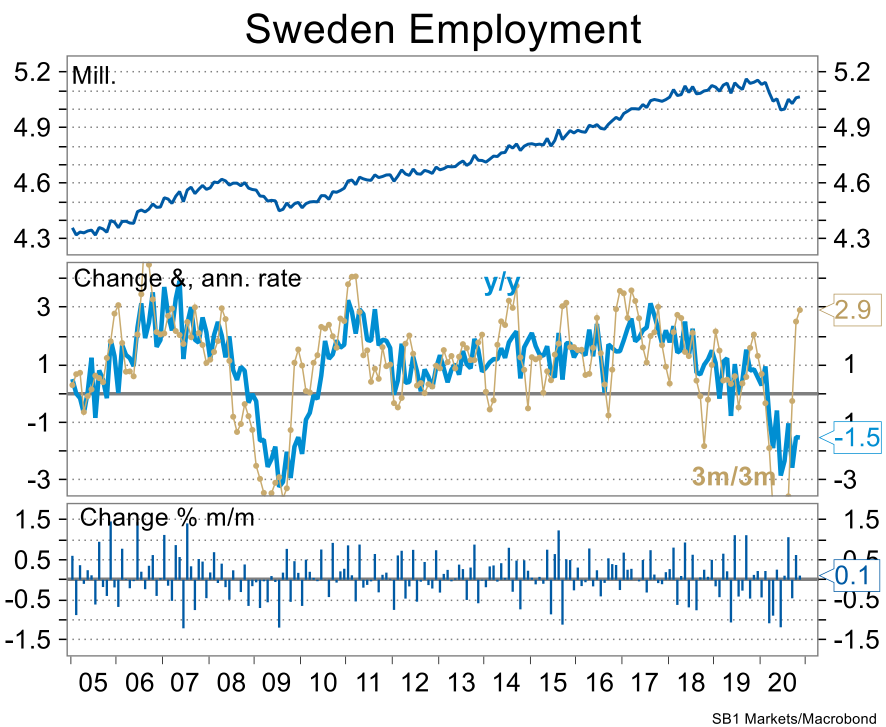


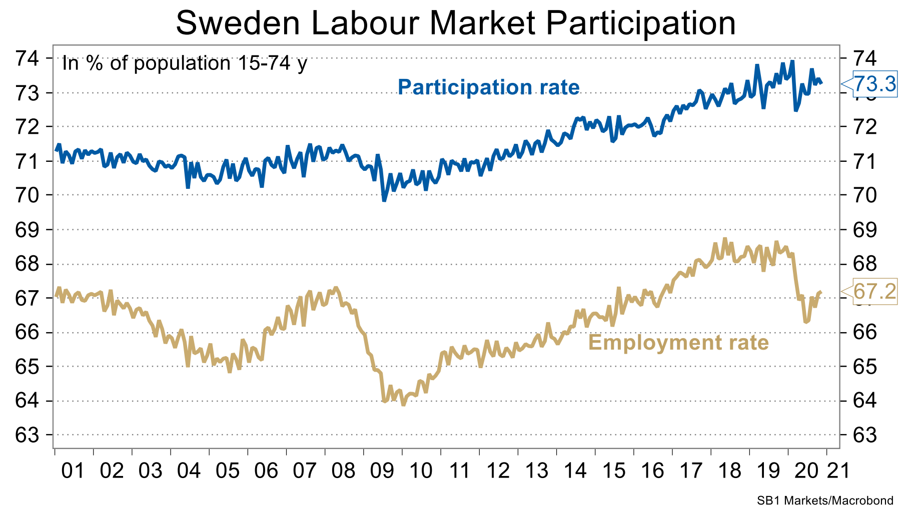


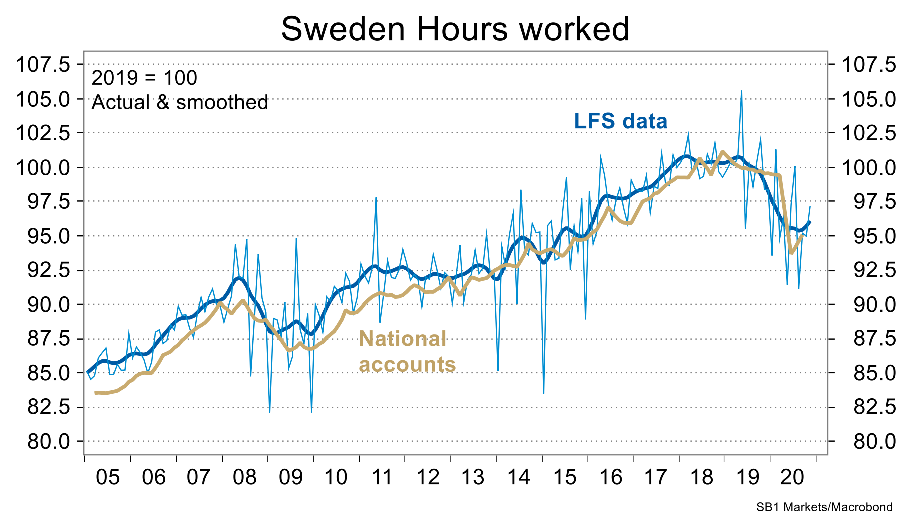
- Sweden has less furlough schemes, and less measures to subsidise employers to keep workers at job in some other countries. Still, employment & unemployment are heavily 'distorted' in Sweden too, and do not reflect the 'real' demand for labour
- LFS unemployment 0.3 pp to 8.3% in Oct – but is still up 1 pp from the pre-corona level
- Registered unemployment has inched down past 3 months, to 8.7% incl. labour market measures in Oct – still up from 7.3% in February
- The number of new and unfilled vacancies rose sharply in Oct, especially new vacancies – almost back up to the pre-corona level

Employment on the way up since the summer, hours worked have bottomed too

Employment is still down 1½% y/y, and hours worked 4%. However, the direction is upwards



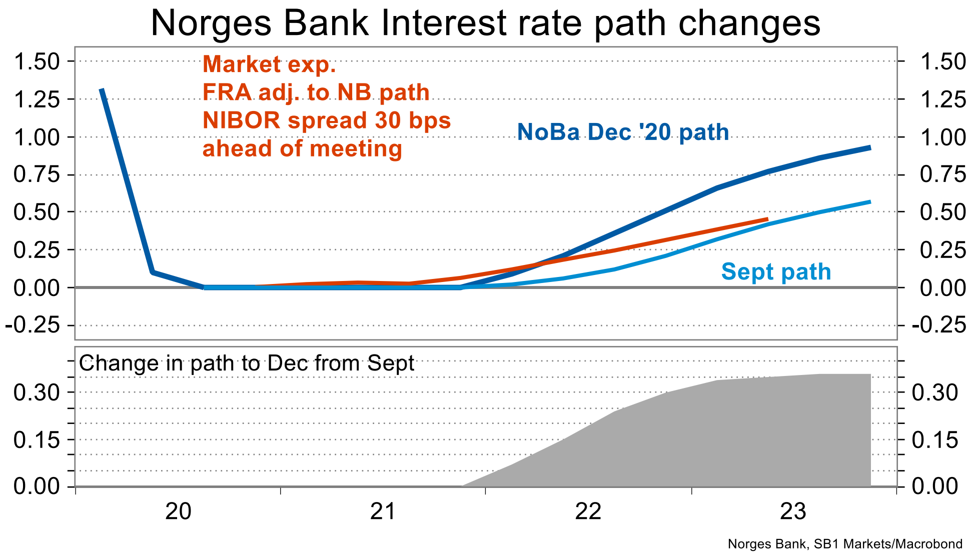




SpareBank 1 MARKETS

Norges Bank goes against the grain – lifts rate path by up to 36 bps!

First rate hike moved forward by two quarters to Q1 2022 – two hikes before the year end



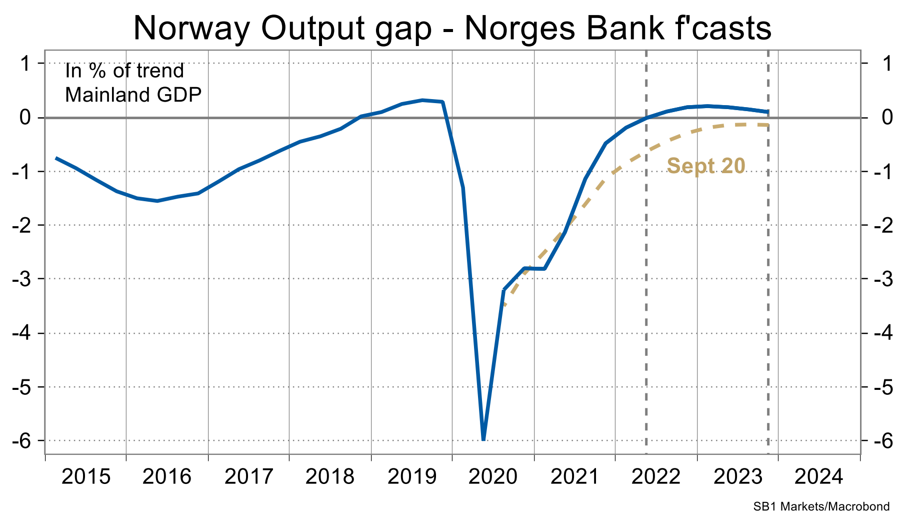
Interest rate paths			Change	SB1M	Fair FRA *)	FRA	NoBa -
	Path 3-20	Path 4-20	bps	est	@IMM, NoBa	now	FRA
Q2 20	0.10	0.10	0	0.10			
Q3 20	0.00	0.00	0	0.00			
Q4 20	0.00	0.00	0	0.00	0.30		0.30
Q1 21	0.00	0.00	0	0.00	0.30	0.35	-0.05
Q2 21	0.00	0.00	0	0.00	0.30	0.34	-0.04
Q3 21	0.00	0.00	0	0.00	0.30	0.38	-0.08
Q4 21	0.00	0.00	0	0.02	0.38	0.45	-0.07
Q1 22	0.02	0.09	7	0.06	0.49	0.52	-0.03
Q2 22	0.06	0.21	15	0.12	0.64	0.60	0.04
Q3 22	0.12	0.36	24	0.21	0.79	0.68	0.11
Q4 22	0.21	0.51	30	0.32	0.94	0.77	0.17
Q1 23	0.32	0.66	34	0.44	1.05	0.84	0.22
Q2 23	0.42	0.77	35	0.55	1.15	0.91	0.23
Q3 23	0.50	0.86	36	0.64	1.22	0.98	0.24
Q4 23	0.57	0.93	36	0.72	1.29	1.08	0.21

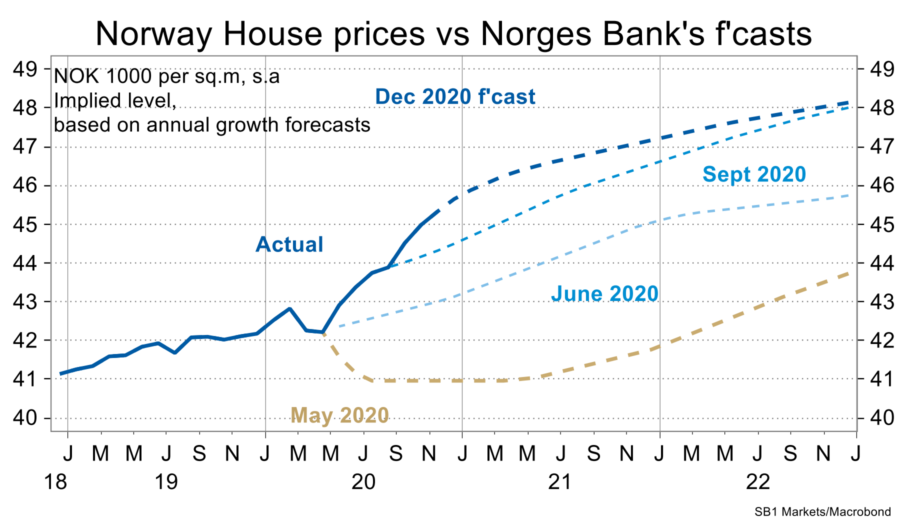
**) Assuming a 30 bps NIBOR spread*

- Norges Bank kept the **key policy rate** unchanged at 0%, as expected. However, **the rate path** was significantly lifted, and more than expected. While the Sept MPR indicated the first rate hike in Q3 2022, the Bank now signals **Q1 2022** and another hike by Q3-Q4, and up to 4 hikes by late 2023
- **Vaccine** news, softer fall in **investments**, a rise in **house prices**, and high savings rates (indicating future spending) contributed to the rate path adjustment. The output gap will be fully closed in Q2-22, and not (almost) in Q3-23, which also explain the change of timing of the first rate hike (more on the details next page)
  - » Norges Bank stresses the uncertainty regarding the vaccines and the impact on the economy. In an upside scenario, just few restrictions will be in place from Q2 and the output gap is closed in early 2022, the downside scenario implied a negative gap for years ahead, and restrictions not fully lifted before Q3 2022
- Norges Bank was **more hawkish than expected**, and the FRAs rose by up to 10 bps & the NOK immediately appreciated some 0.5%.
- We expect the first hike to be **brought further forward to H2 2021** if the vaccine rollout is successful – and if house price inflation doesn't slow down significantly through H1. We expect domestic demand for service to 'explode' as soon as the virus is brought under sufficient control and restrictions eased
- There is still an **upside risk in the short (and presumably) in long end of the curve**. A **further NOK appreciation** is also more likely than another weakening

SpareBank 1 MARKETS

Norges Bank: The future is (probably) somewhat brighter

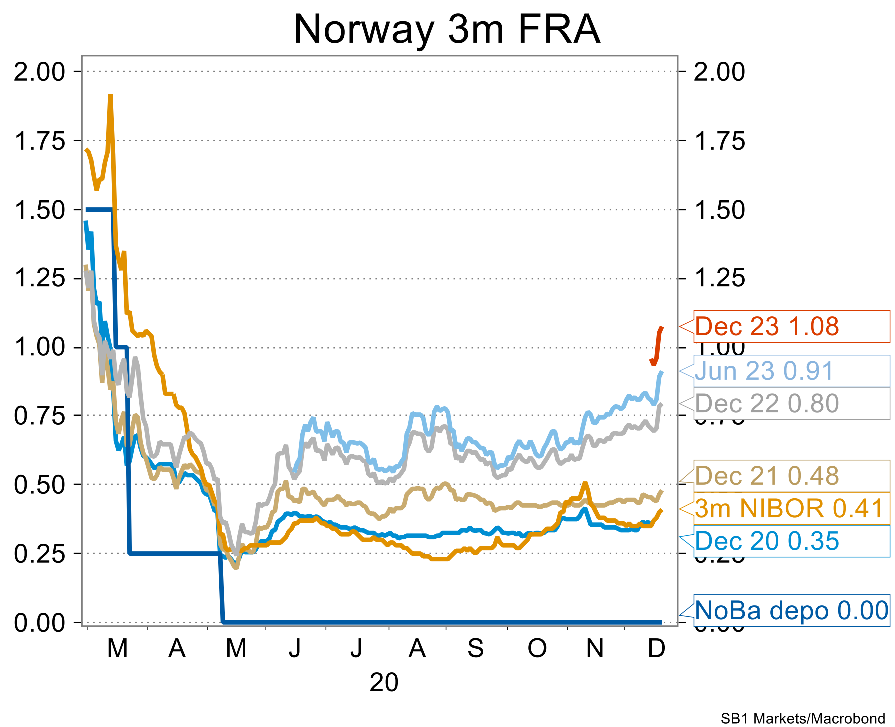


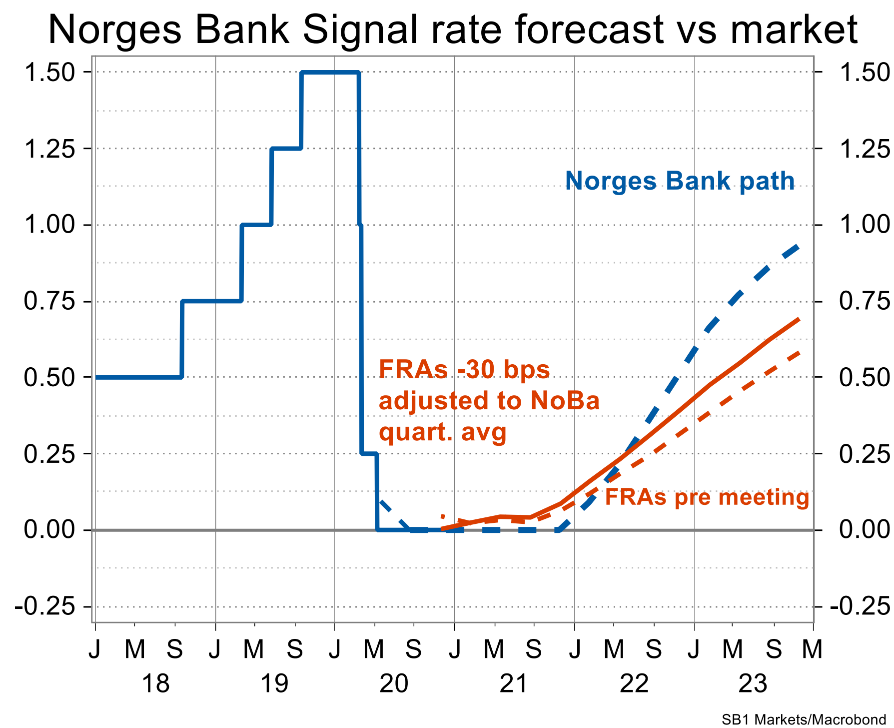


- **Mainland GDP** f'cast revised up 0.1% to -3.5% for 2020; f'cast for 2021 unch. at 3.7%; while the f'cast for 2022 is revised up to 3.1% from 2.7%
- Both **Mainland business investments and oil investments** are expected to decline less than indicated in the Sept. report.
- Fiscal policy is clearly tighter next year than in 2021, than assumed in Sept (before the Budget proposal was published)
- The **unemployment** rate f'casts for 2022/23 were revised marginally down. A gradual decline to a normal unempl. level is expected by 2022
- Even if the change in the growth forecasts were limited, their impact on the **output gap** was significant. The gap is now expected to be closed by **Q2-2022**. In the Sept MPR the gap 'never' closed, but is was approx at zero in **Q3-Q4 2023**
- **Core CPI inflation** is expected to slow faster the next years. Wage inflation at 2.2% in 2020 and 2.0% in 2021
- **House price inflation** is expected to slow substantially during next year, to 3% through 2021 from 8% through 2020.
  - » Media has reported that average annual growth rates will accelerate to 6.7% in 2021 from 4.4% in 2020, which is not the most relevant information, as most of the 2021 price inflation already has taken place in 2020
- The Bank expects **credit growth** to be somewhat higher than growth in disposable income. **Household savings** are expected down the coming years, supporting a strong recovery in private consumption (abroad, that is)

The FRA curve got a boost from Norges Bank, rates climbed by up to 10 bps

The market is – reasonably – sniffing at a Q4-21 rate hike possibility

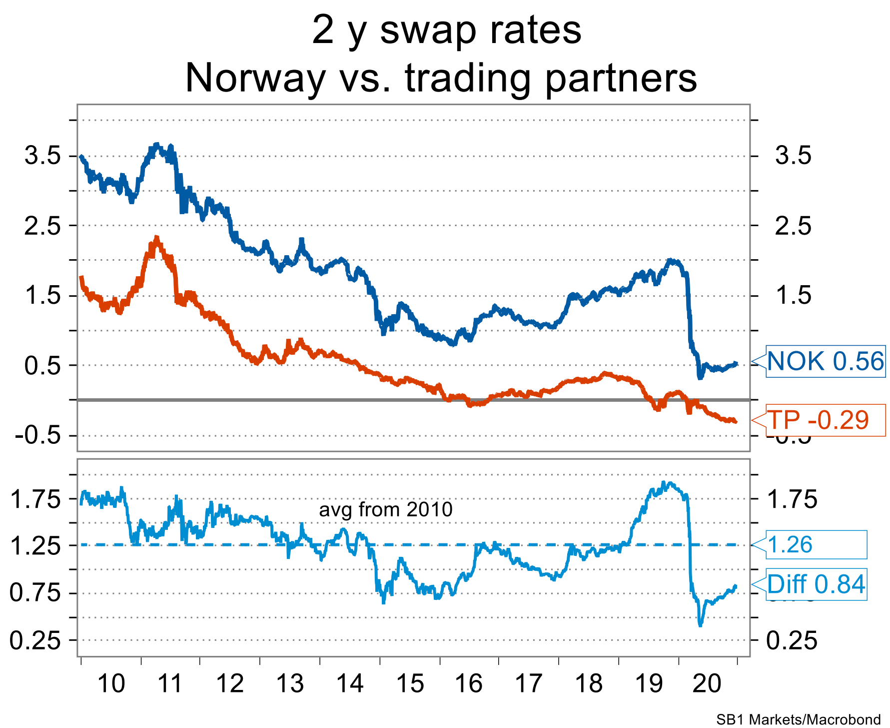


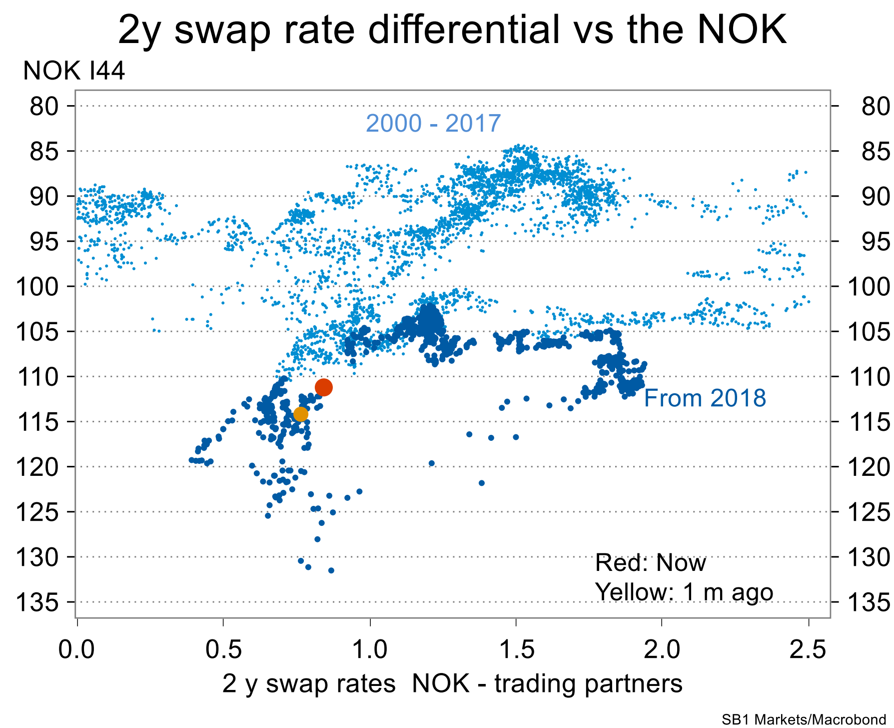


- The FRA curve steepened due the 'aggressive' rate message from NoBa. Of course, the Bank was not specifically 'hawkish' per se but no doubt signalled at steeper rate path than the market expected
  - » FRAs rose by up to 10 bps, the largest daily upward change in 2020
  - » The market changed its timing for 50% probability for a first hike forward by some 2 months to Dec 21/Jan 22
- We still expect Norges Bank to start hiking H2-21 based on 3 assumptions
  1) A successful rollout of vaccines that makes it possible to reopen most of the service sector as the no of hospitalisations and deaths is reduced during H1
  2) A rapid recovery in domestic demand for the re-opened services
  3) No meltdown abroad

Can Norges Bank walk the walk alone? Or will the NOK become too strong?

In our models, a 2 y swap 1 pp spread widening yields a 7% stronger NOK

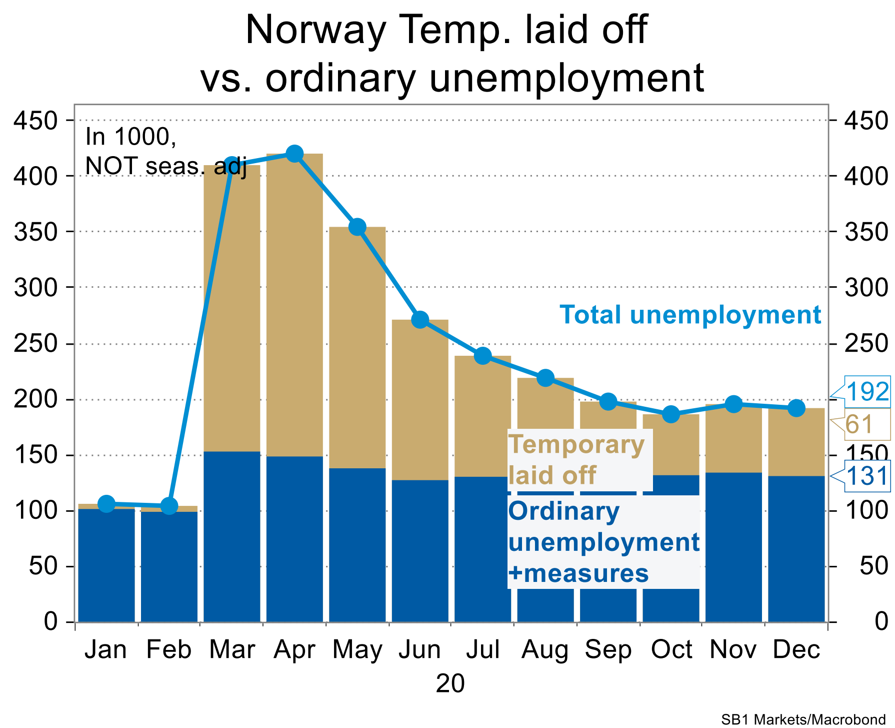


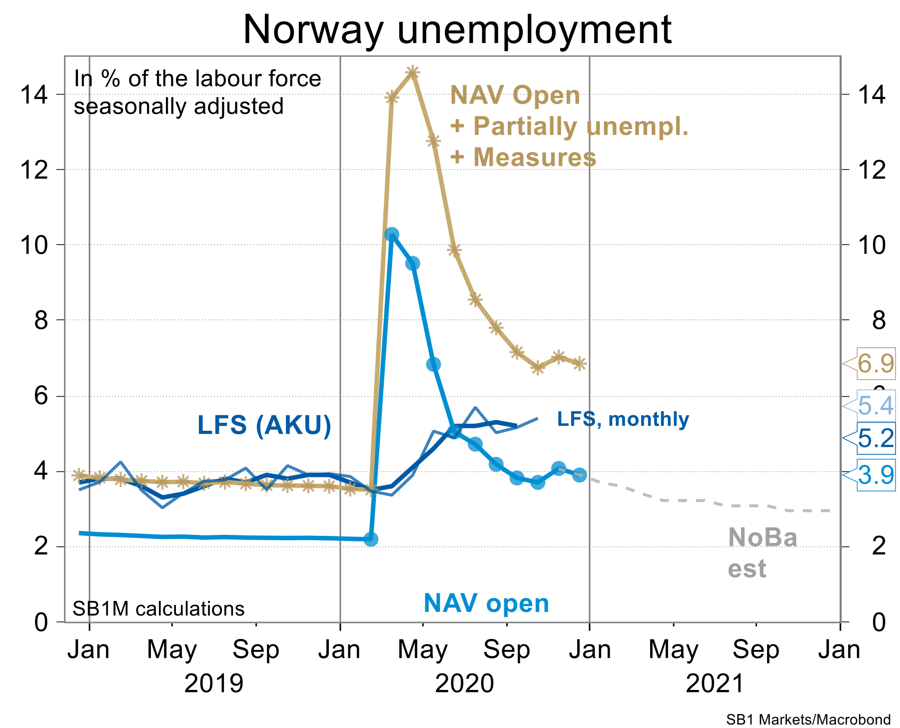


- The interest rate spread has been trending upwards since the May trough, in sum by some 50 bps. The NOK has appreciated 7%. At the same time, the oil price is up from USD 20/b, and stock markets are up 30%
- The relationship between the interest rate spread is far from stable – and other factors are more important, at least from time to time. So, there is not any straight line between the spread and the NOK, *check the chart to the left*

NAV unemployment down in in December, no serious 2nd wave trouble

As indicated by weekly data, unemployment fell by 5' (seas adj) in Dec, reversing half of the Nov hike

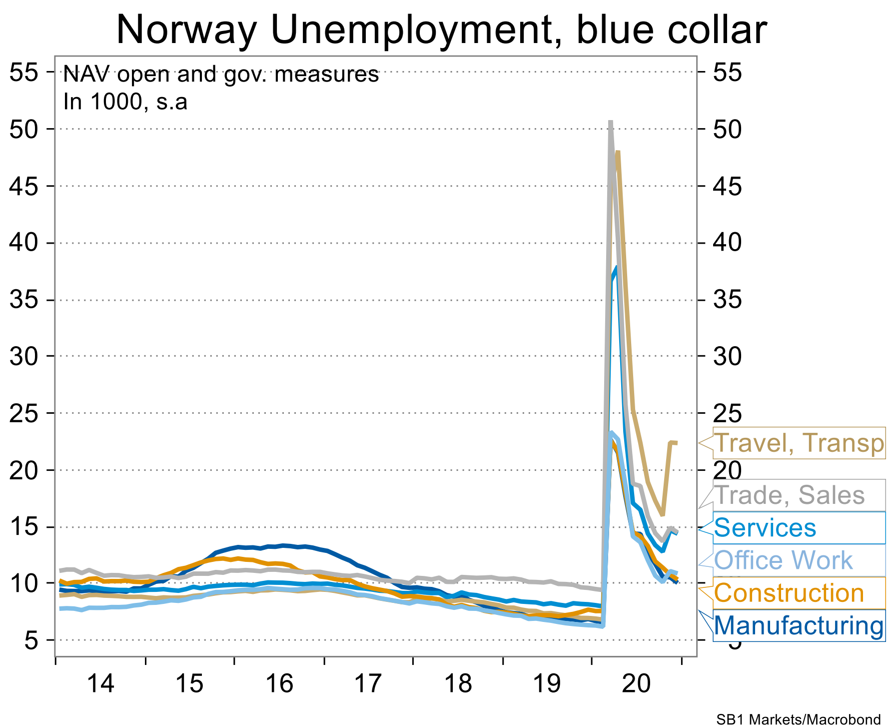


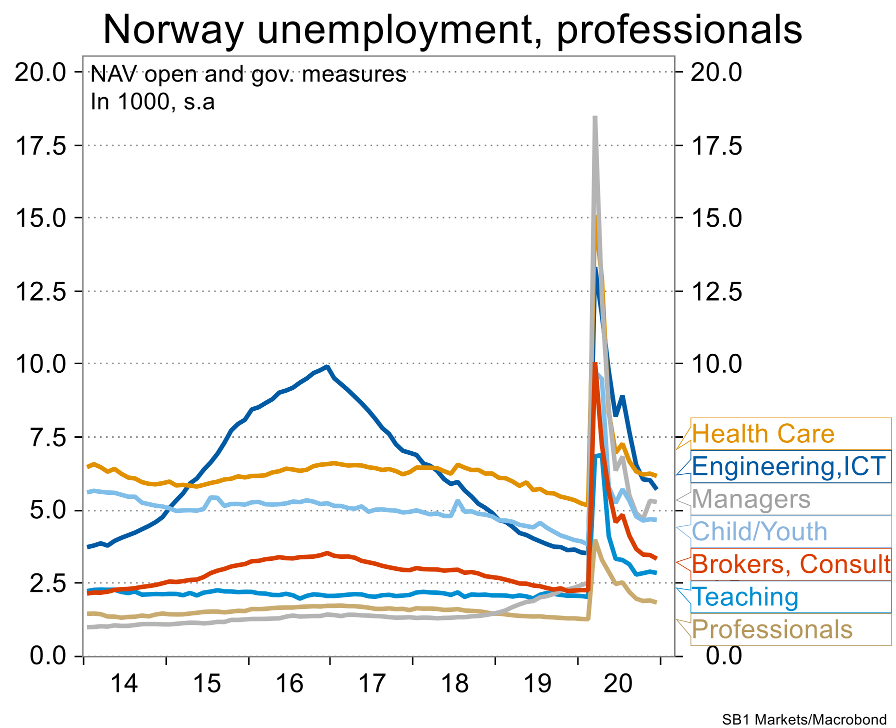


- **Open 'full time' unemployment** measured at NAV, which includes furloughed workers fell by 5' through Dec (we expected -3') to 110', 3.9% of the labour force, as Norges Bank (and we) assumed. The rate fell to 3.8% not seas adjusted, in line with consensus). Thus, half of the hike in Nov was reversed, without any formal 'corona restriction easings'.
  - **Including labour market measures**, unemployment fell by 3' to 124', as we assumed, equalling 4.4% of the labour force, down from 4.5%. In February, the rate was 2.6%. The decline open unemployment was in line with NoBa's f'cast
  - **Including part time unemployed**, the grand total declined by 7' to 192' or 6.9% (seas adj). Before corona: 3.5%
- The LFS (AKU) reported a decline to 5.2% in September (3 m avg). These data have been lagging NAV figures as furloughed workers have not been counted as unemployed before staying 3 months at the dole

No much decline in the ‘corona sectors’ but other down December

The impact of the 2nd ‘lockdown’ has been narrow – and limited

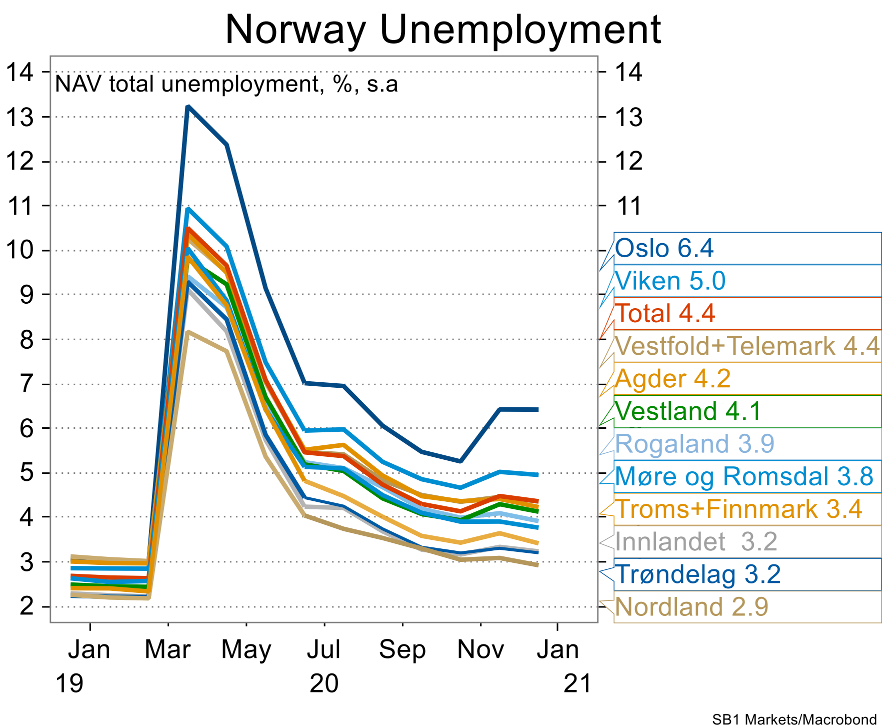


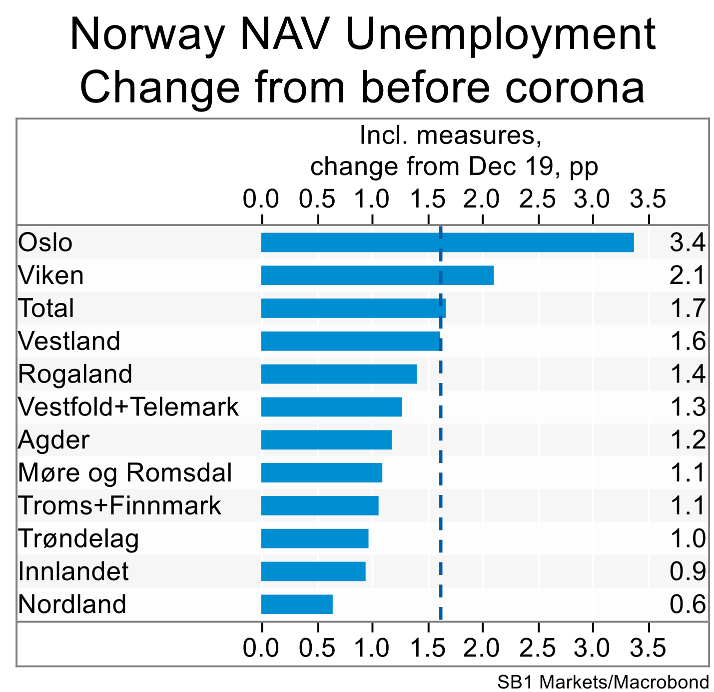


- We deem the risk for wide-spread increases in unemployment in other sectors due to the 2nd wave – like we saw during March & April ‘panic’ – to be non-existent (we said last month – and we have not changed our mind)

Oslo the outlier: No decline in unemployment in Dec, all others down!

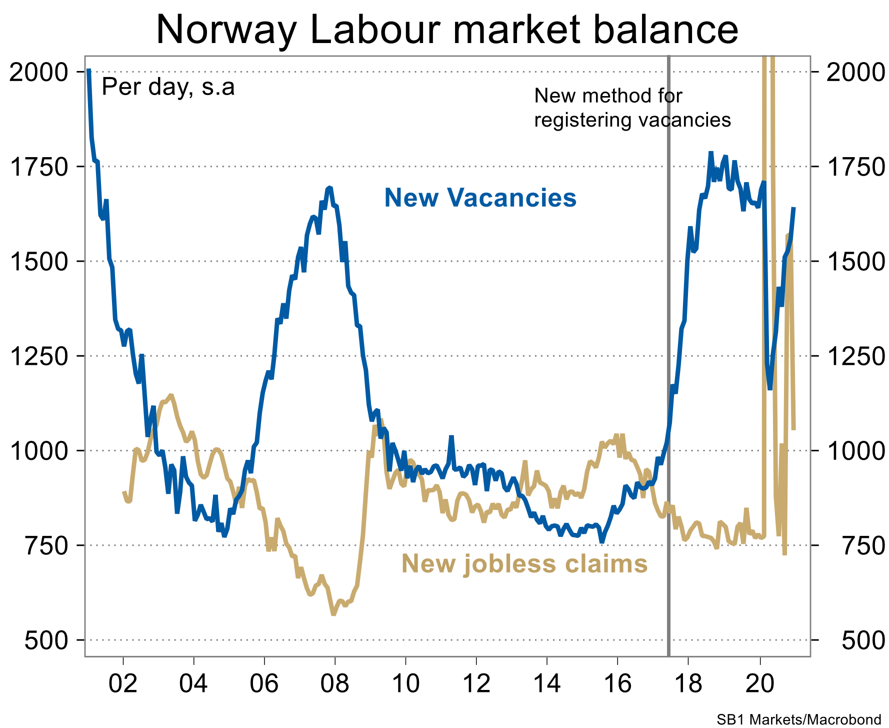
Oslo has the highest unemployment rate, following the steepest rise since before corona

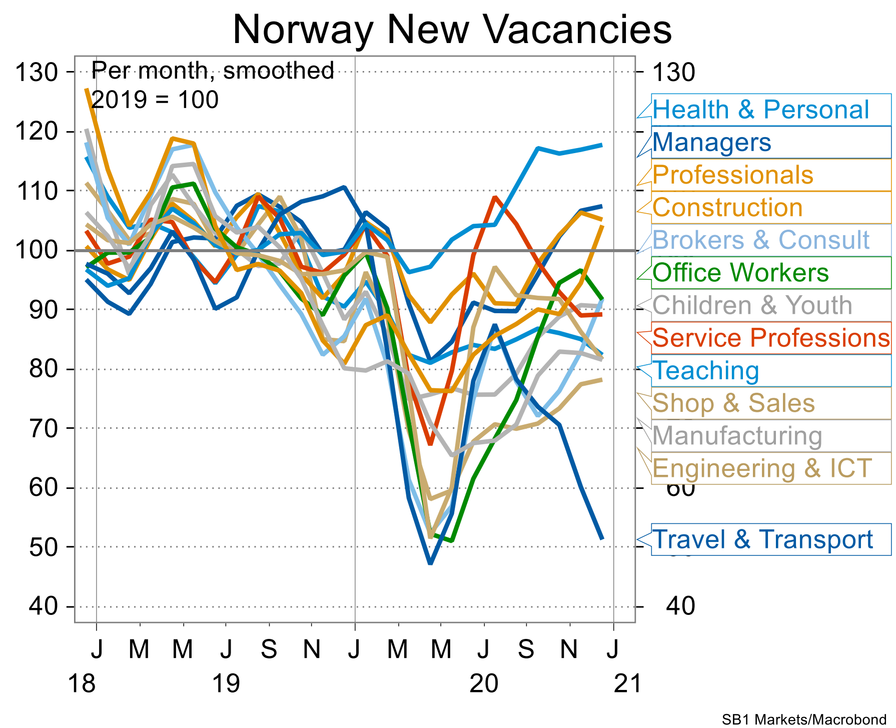




Fewer new jobless claims in December – and more vacancies

The '2nd wave' has not reduced demand for labour in other sectors than travel/transp & services

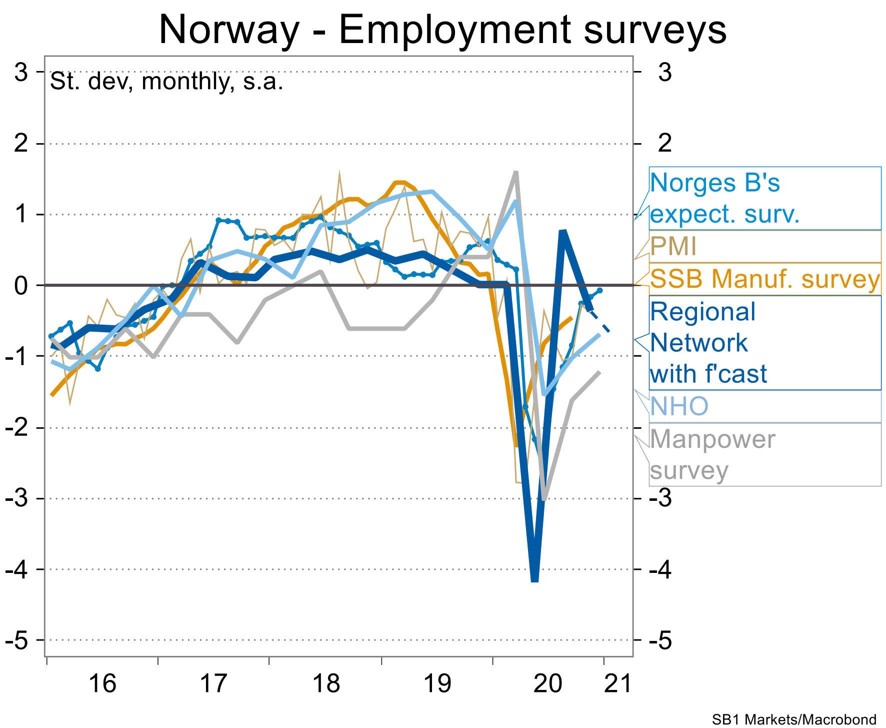


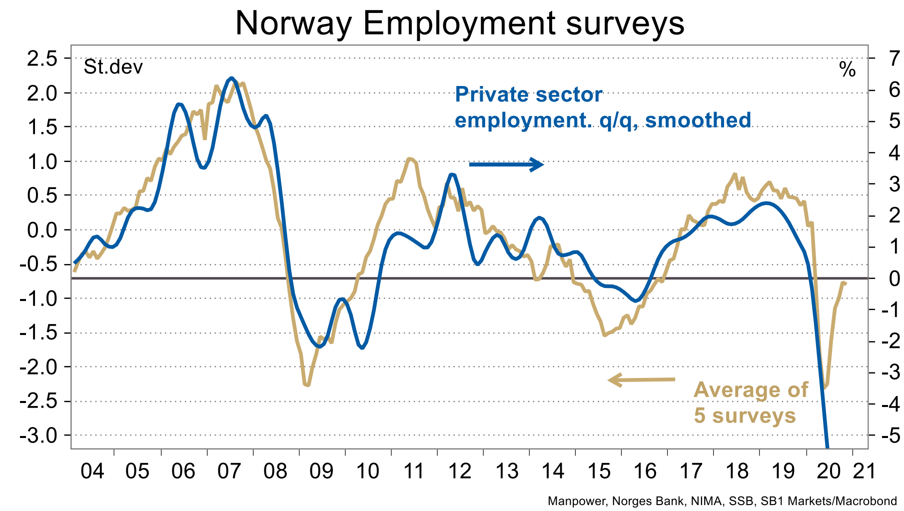


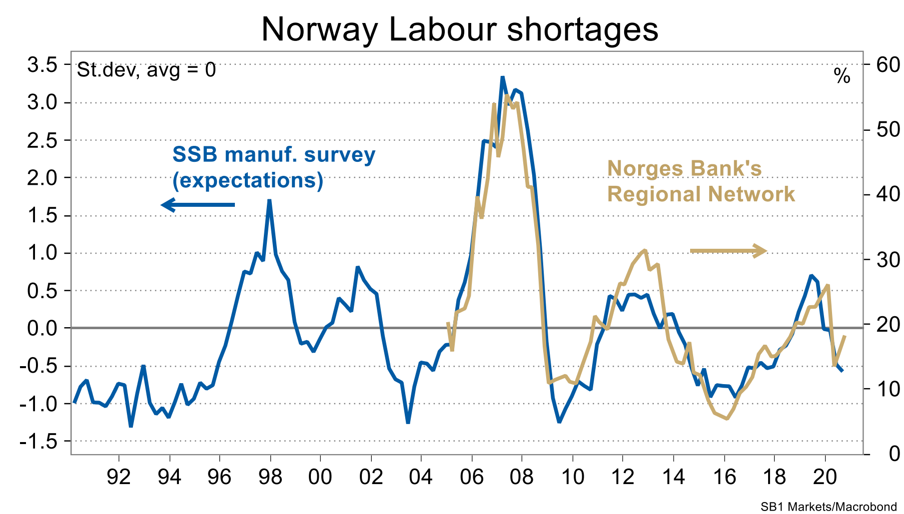
- New jobless claims are not seasonally adjusted through 2020 – and are very uncertain

Employment surveys are heading up, average

Employment surveys are softening but just the Regional Network is signalling a rapid slowdown



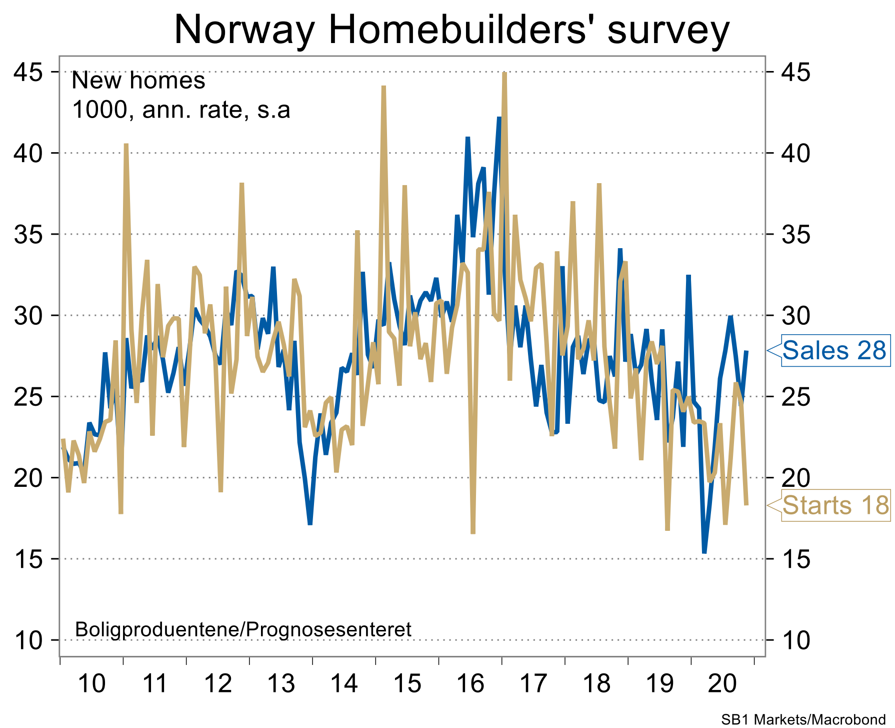


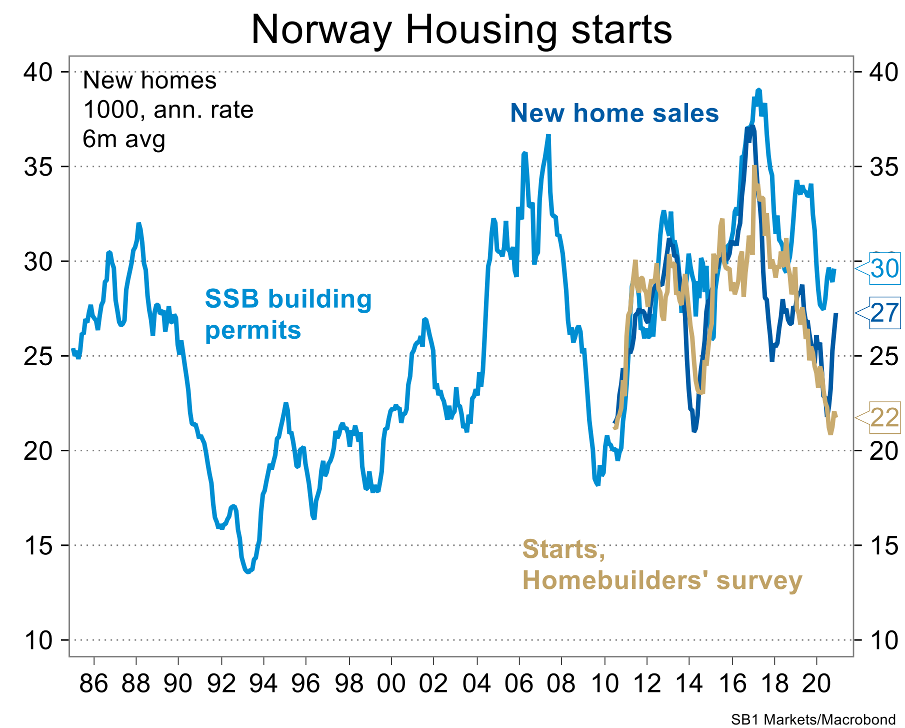


- Employment surveys are mixed, the avg of 6 surveys do not point to any slowdown. However, some of the most reliable of surveys, like NoBa's Reg. Network, points to substantially softer growth in employment
- The Regional Network reported higher labour shortages in Q4, however, the level is rather low, indicating that the labour market tightness is not very pronounced

New home sales up to above the pre-corona level, starts will follow suit

Sales rose to 28’ in November, starts fell to just 18’ but will very likely follow starts upwards

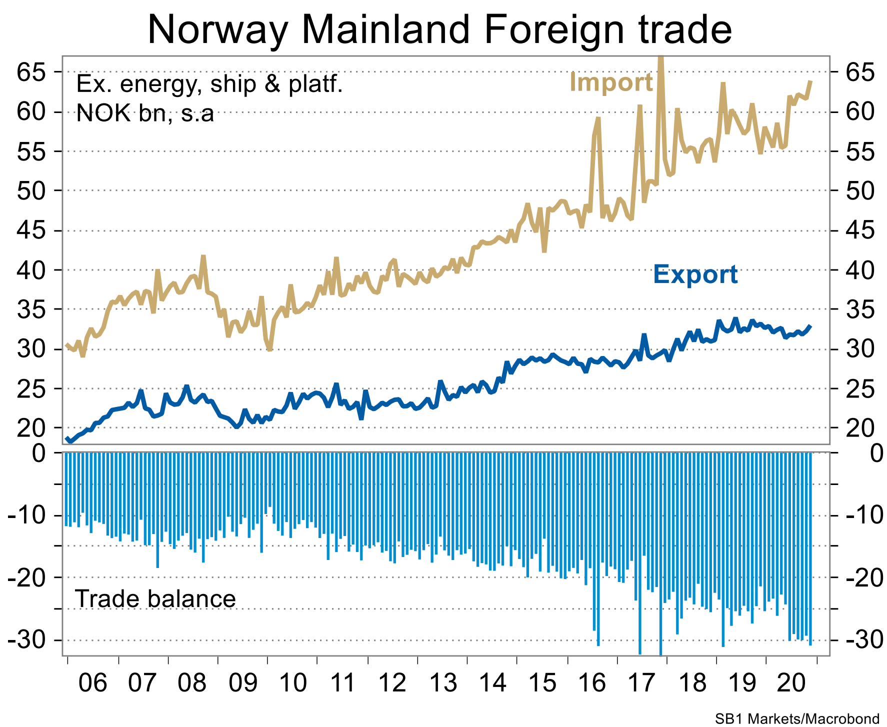


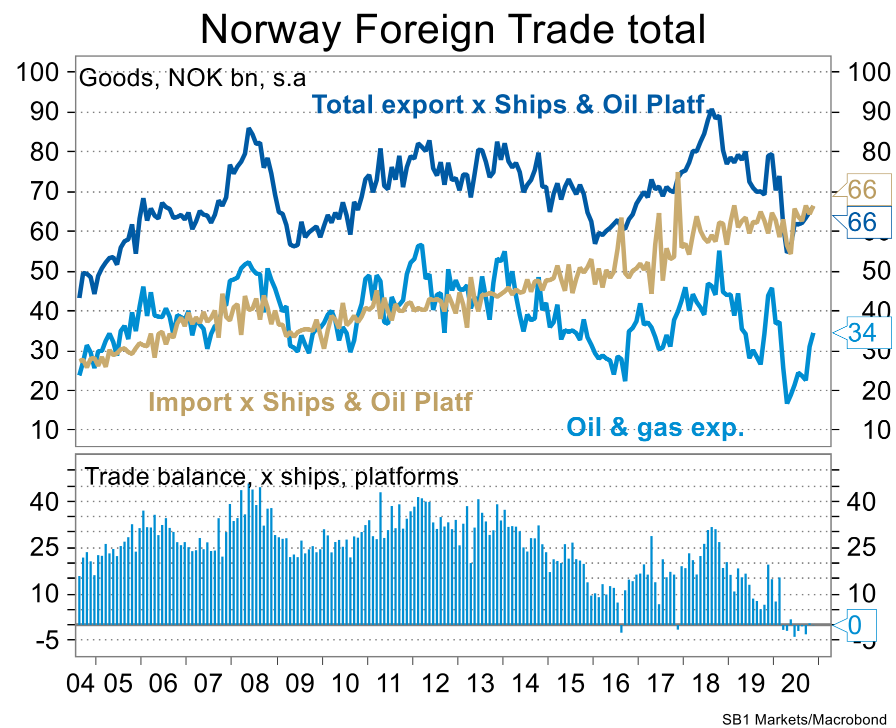


- New home sales up 4’ to 28’ in Nov but sales are well up from the 15’ trough in March. Starts down 7’ to 18’, an unusual low number
- New homes sales peaked at 35 – 40’ in 2016, and trended down to 25’ before the corona crisis. During the summer and into the autumn, sales have recovered to he pre crone level, alongside the strengthening of the existing home market since mid April
- We assume the strong existing home market will encourage new home sales & starts the coming months

The trade balance in balance

Imports are still rising sharply - fish and oil related manuf. products drags on exports





- The Mainland (non energy) trade deficit in goods was close to NOK 33 bn in Nov. Exports are still hurting from the corona crisis (down 2% vs early 2020, measured in f/x, down 12% y/y) while strong demand for goods have kept imports up (up 13% vs pre corona) – and the 'traditional goods' deficit has widened almost to NOK 31 bn from NOK 23 bn in early 2020 to, or by 2.6% of Mainland GDP
- The 13% y/y (1.3% m/m) increase in the value of imports was largely driven by the import of cars
- At the same time, exports of oil and gas have fallen to approx. NOK 34 bn from 40 bn – and the total trade balance is marginally in red (0.2 bn) over the past 5 months

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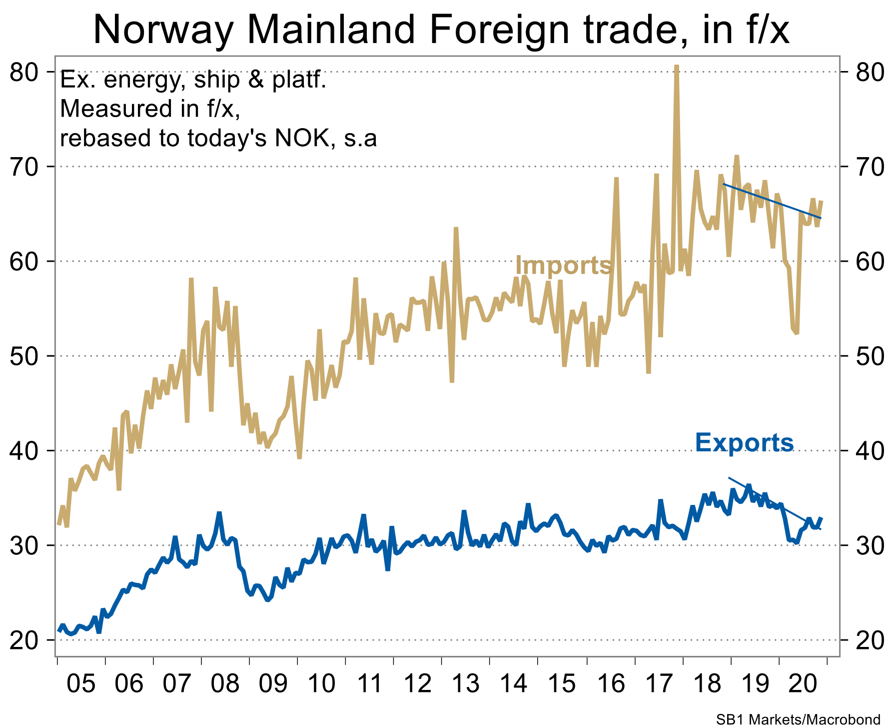
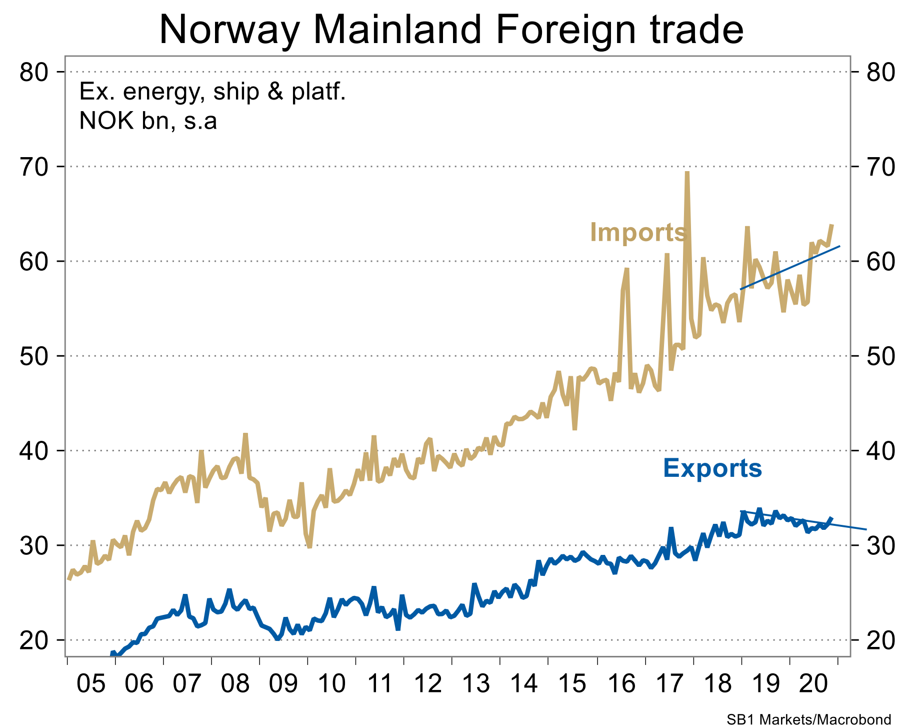
… in f/x, both exports and imports are heading down

The NOK depreciation has lifted import values in NOK. This impact will soon fade

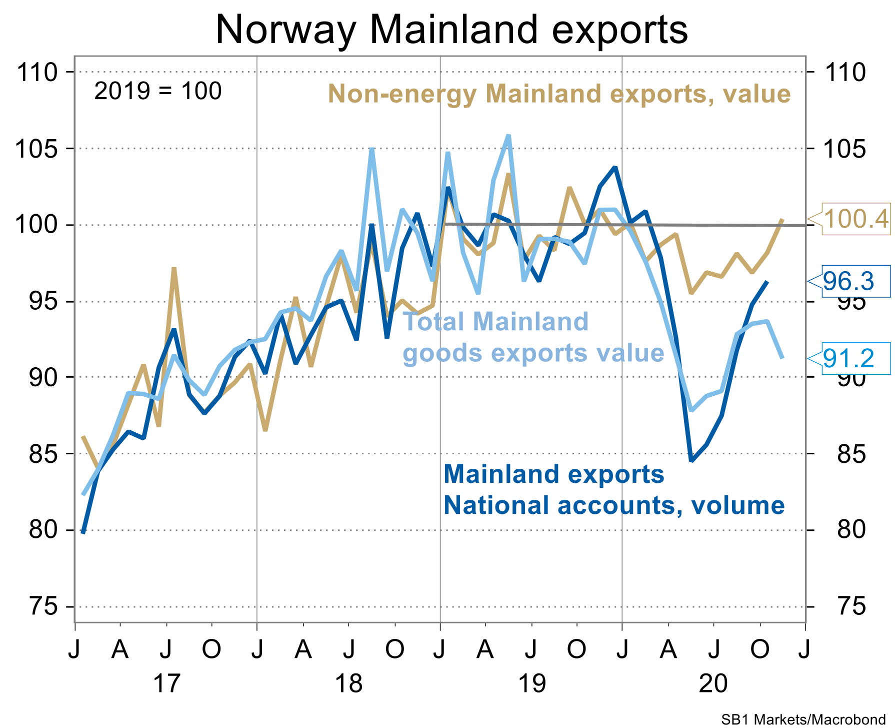




- At the chart to the left, trade values measured in f/x, adjusted by the NOK I-44 index, and rebased to today's NOK I-44 index

Mainland exports down on lower 're-export' of oil and gas

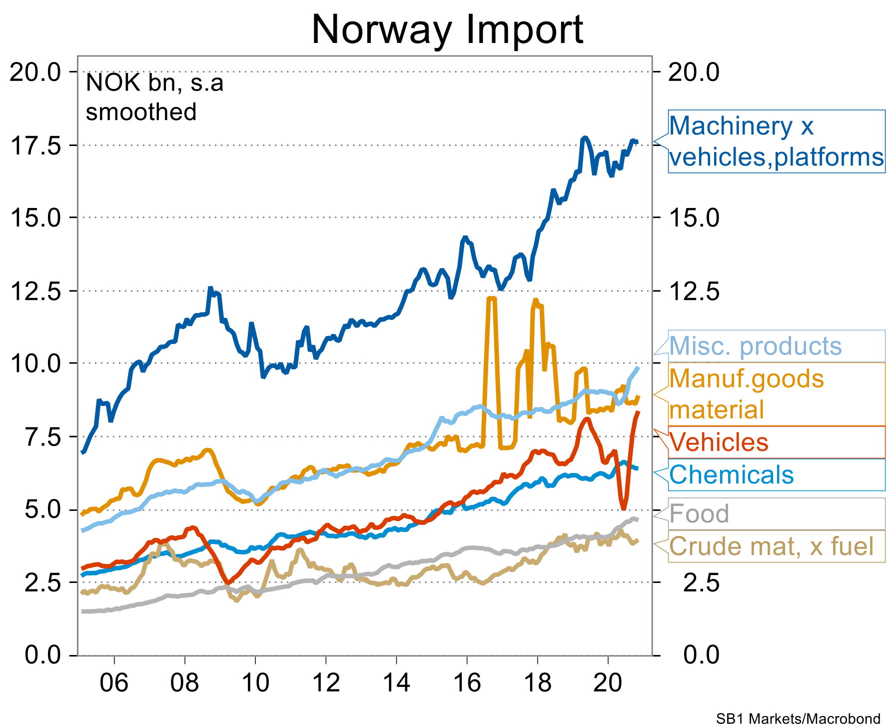
Real mainland exports has kept up better than what is often called 'Mainland export'

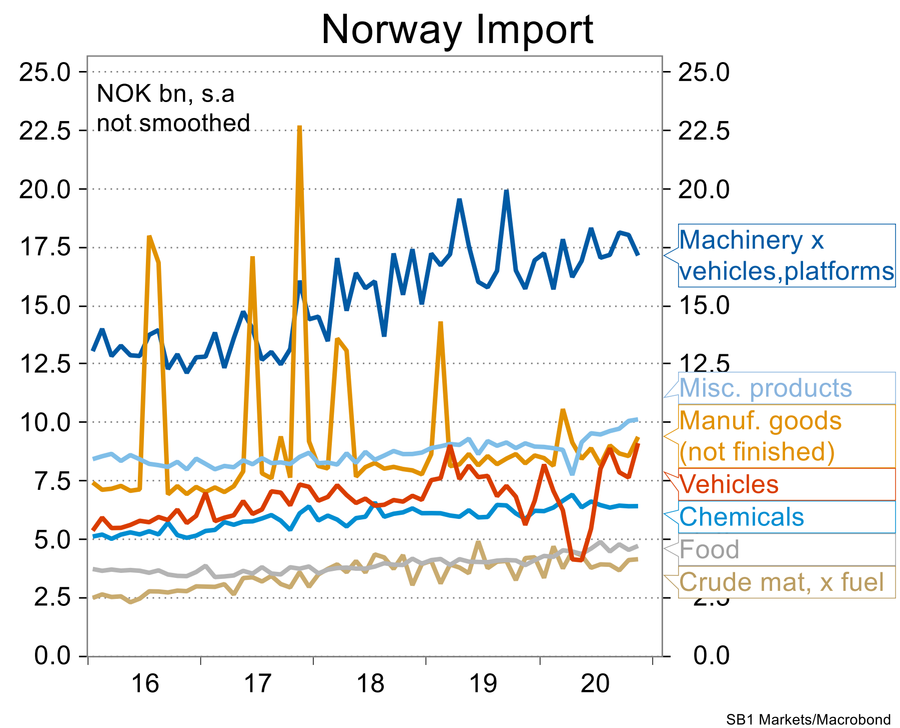


- We usually adjust Mainland export for re-exports of oil and gas that has just been lightly processed onshore before being exported abroad. In addition we take of electricity exports (and imports) as this trade does not tell any relevant on activity in 'ordinary' Mainland exporting businesses
- Now, the difference is substantial as both electricity exports and exports of processed petroleum products have fallen sharply – in nominal terms by 9% vs the 2019 average (0.4% vs. -8.8%)
- Monthly national accounts data report a 4% decline in Mainland exports vs the 2019 level, in volume terms

Imports of vehicles straight up, machinery heading slowly up

Auto imports fell rapidly in March/April but are now soaring. Most others slightly up

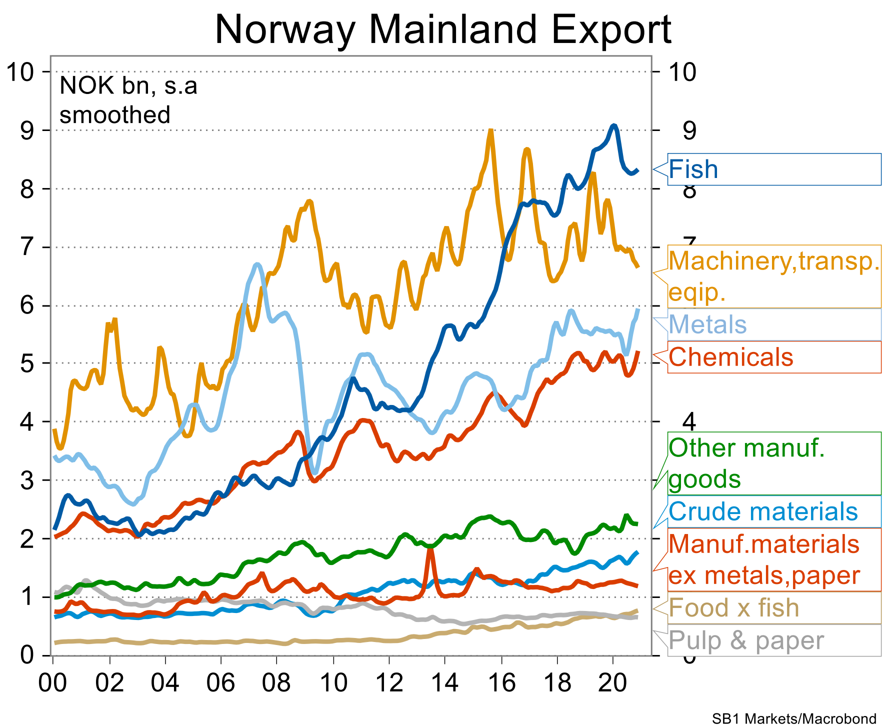


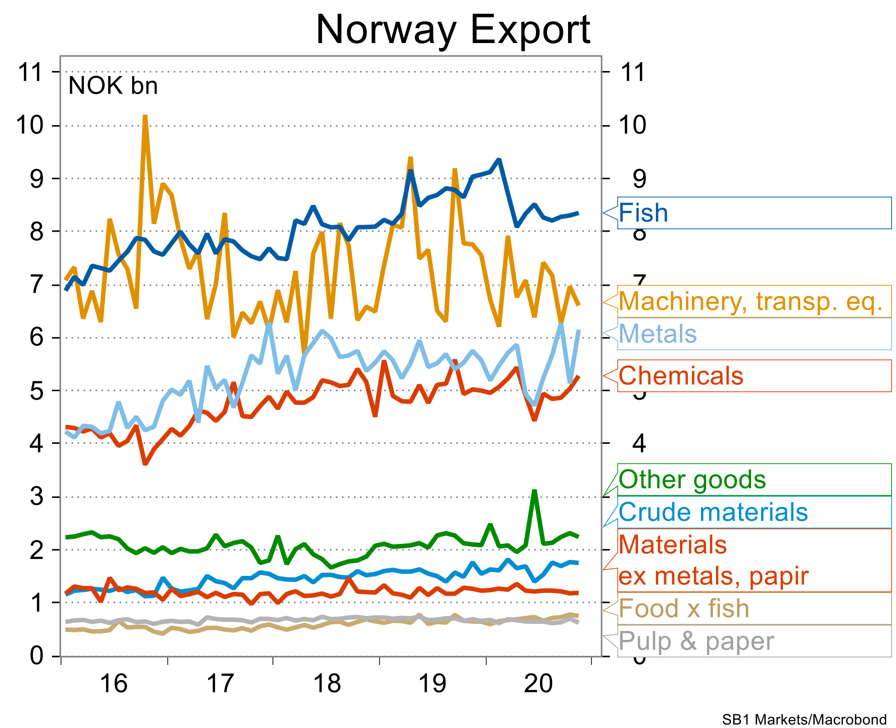


- Import values are somewhat higher than before corona hit in most sectors
- Imports of chemicals, food, and machinery have all increased this year. Machinery imports are recovering and is now at the 2019 level. Manufactured materials more or less flat recent years, with some ridiculous volatility, due to huge transactions of oil platforms, and wind mills
- Vehicle imports slowed rapidly in H2 2019 and early 2020, along with auto sales. Since April, imports have picked up, both in tons and in NOK (although the level is even higher, relatively, in value, due to the prior NOK depreciation). Auto sales have recovered and are far above the pre-corona level

Mixed exports – fish & machinery on the way down

Other sectors up, due to the strong recovery in industrial production abroad

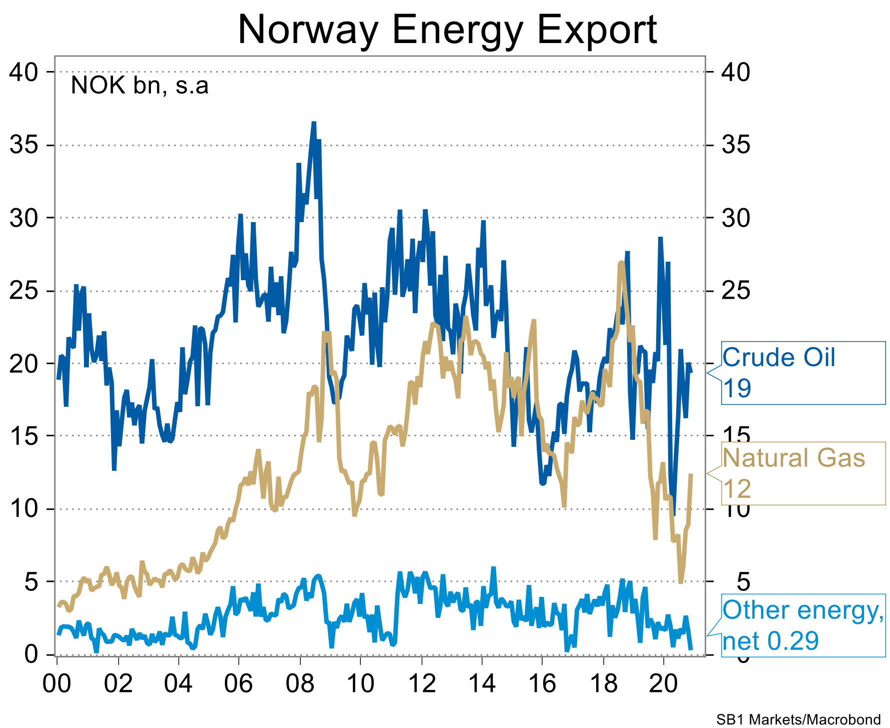


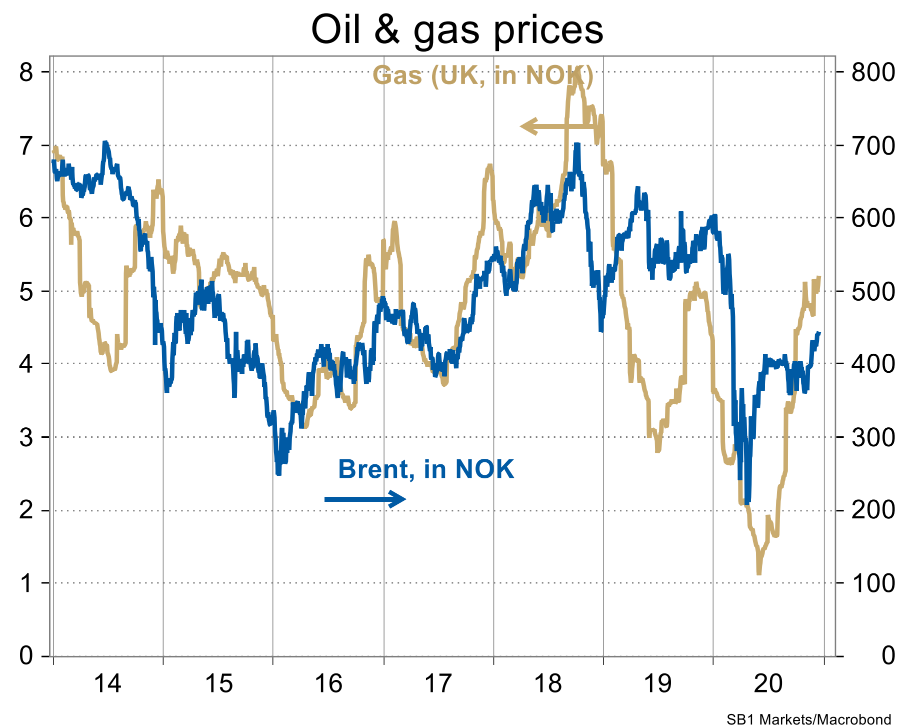


- Exports of machinery and transport equipment (of which much is related to oil activities abroad) is trending down, due to lower oil sector investments abroad

Oil & gas exports sharply up recent months

Oil exports have recovered almost half the March/April drop (in value terms)





- **Crude oil** exports (in NOK bn) fell rapidly in March and April as the oil price dropped and global demand subsided. Exports have turned up since then, with the oil price. Oil exports are still far lower than before corona, just below 50% of the decline is now reversed
- **Gas** export values fell sharply during H1 but has recovered to the (low) pre-corona level as gas prices have recovered substantially

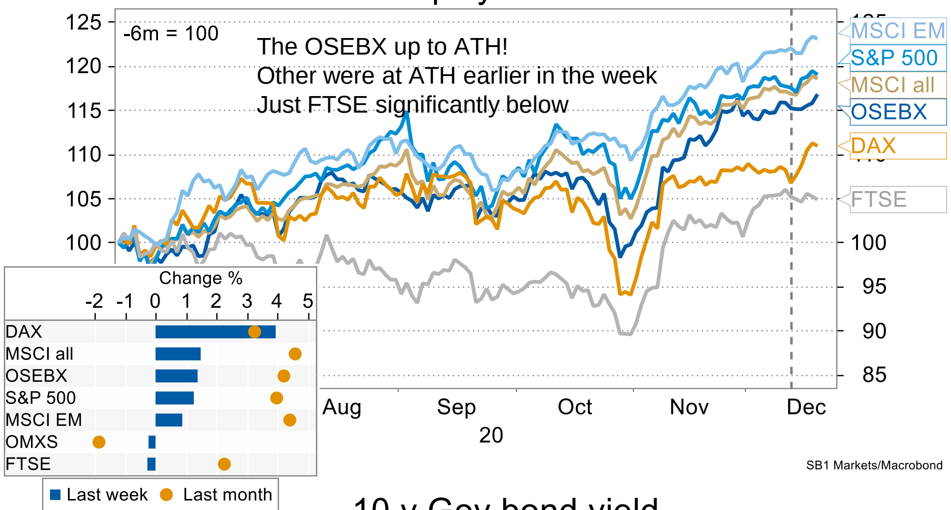
- Highlights
- The world around us
- The Norwegian economy
- Market charts & comments

SpareBank 1 MARKETS

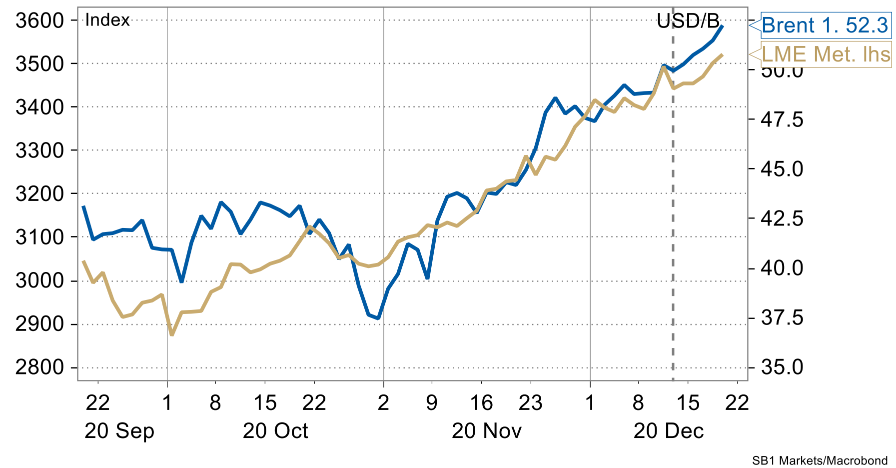
Equities, yields, oil/raw materials & NOKup. The USD fell further. Risk on

Optimism is spreading, even if corona & economic news are mixed. Hope for a Brexit deal, US stimulus

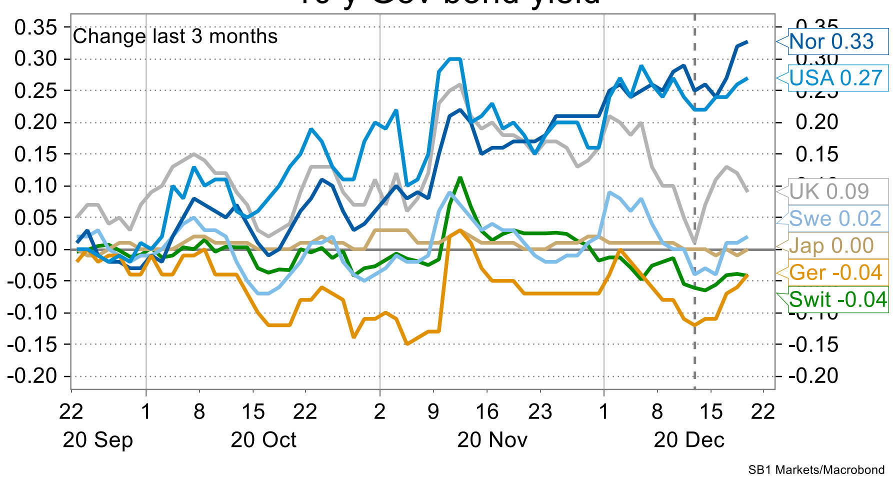
Equity Indices



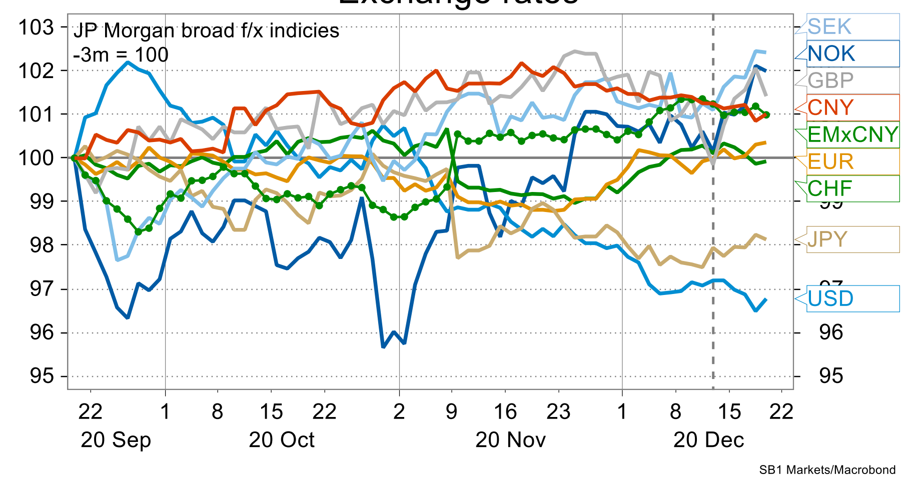
Oil vs. metals



10 y Gov bond yield



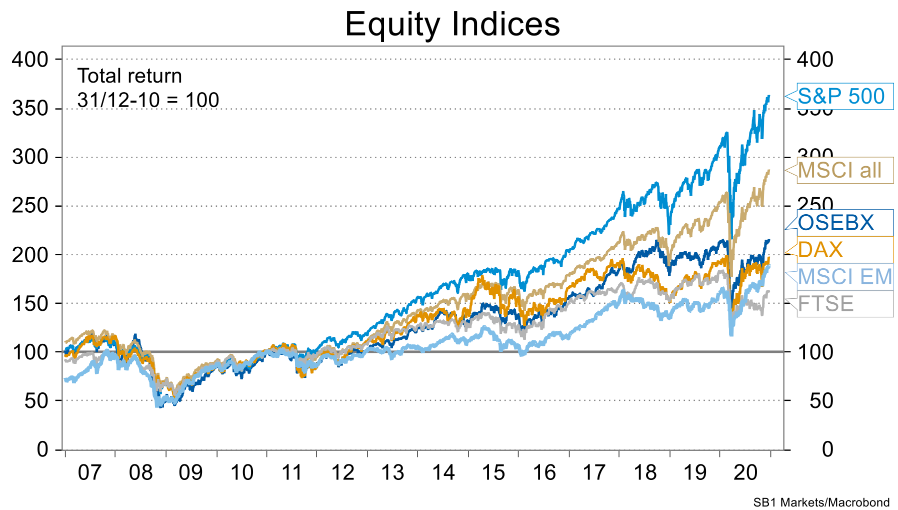
Exchange rates

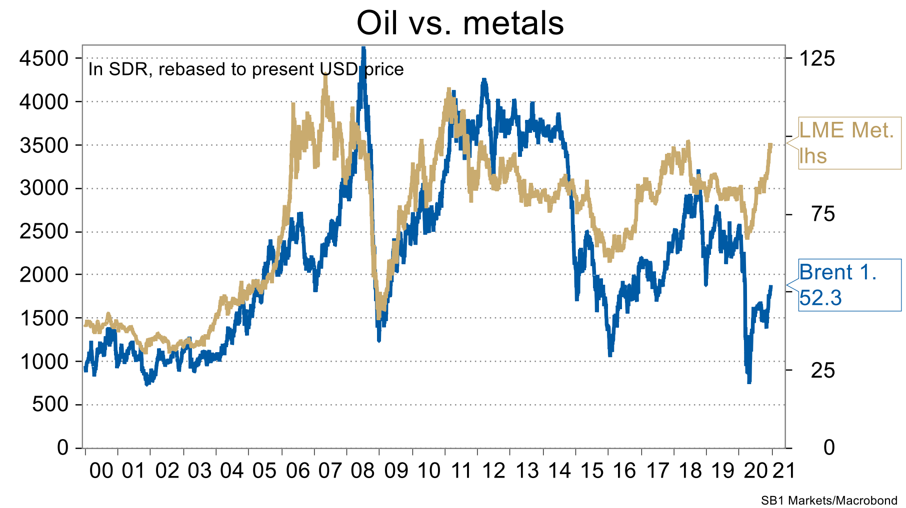


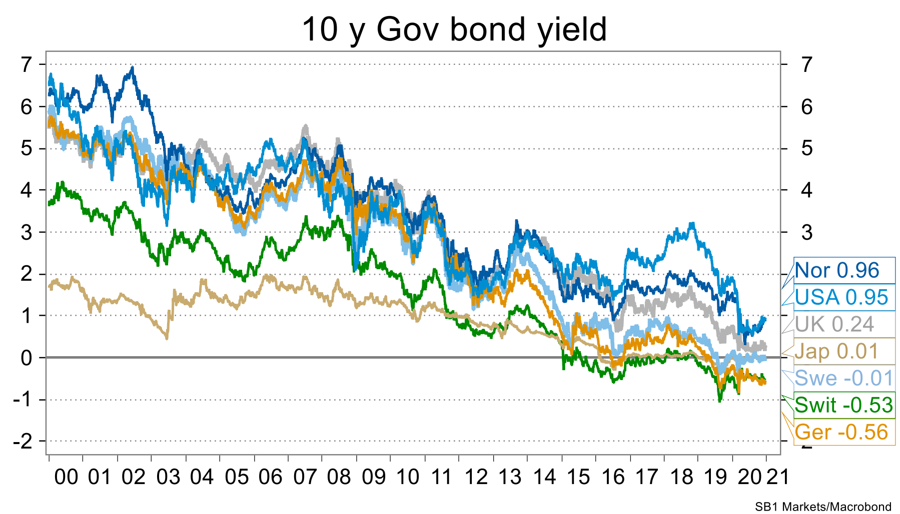
This week, the GBP may be exposed to bad corona news and lack of progress in the Brexit negot.?

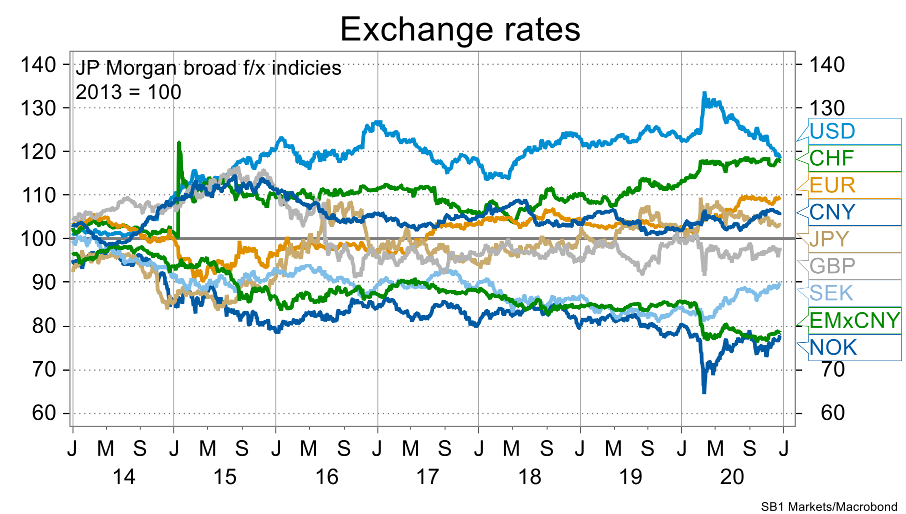
The big picture: Growth optimism everywhere. Even in some bond markets

USD is sliding down, less need for a 'safe' haven





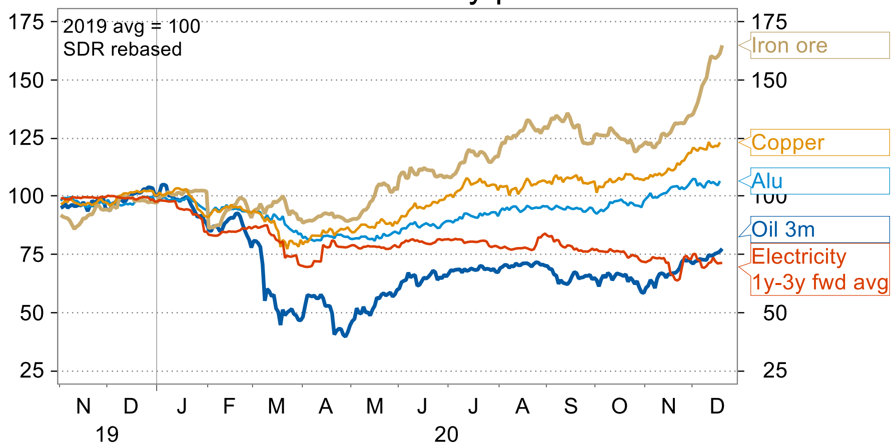




The USD is down but not dramatically – and it is still quite strong (though the weakest since mid 2018 (measured by broad f/x indices). NOK still a loser

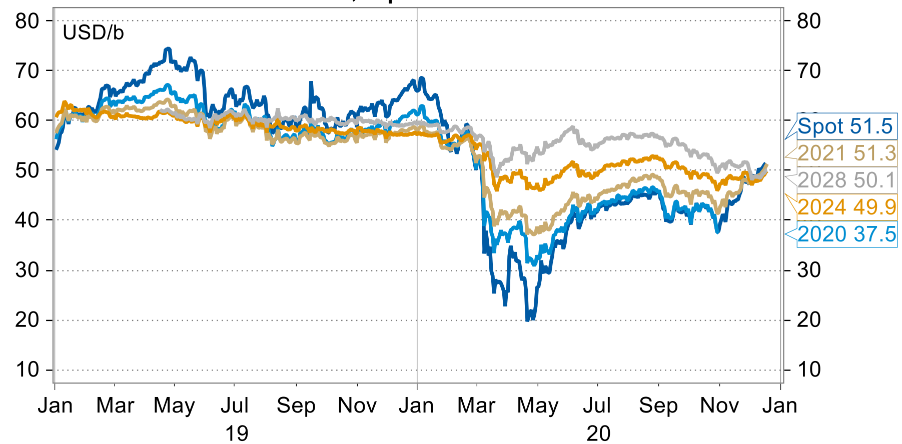
Oil curve in backwardation - while the recovery in raw materials continues

Commodity prices



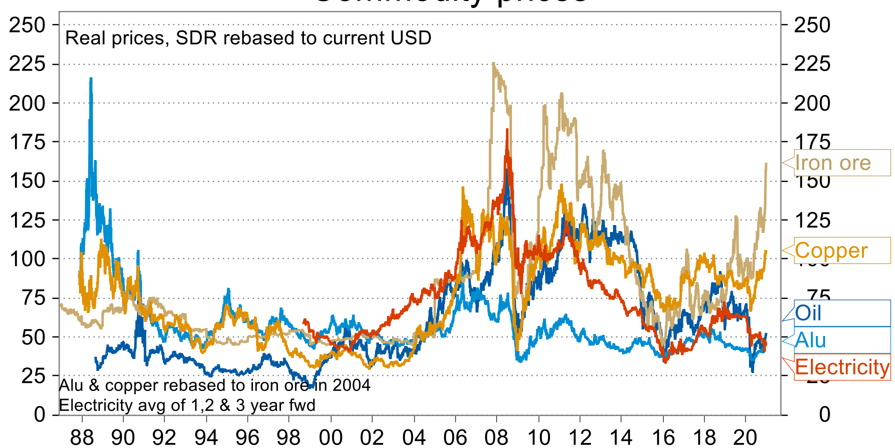
SB1 Markets/Macrobond

Brent oil, spot & Dec contracts



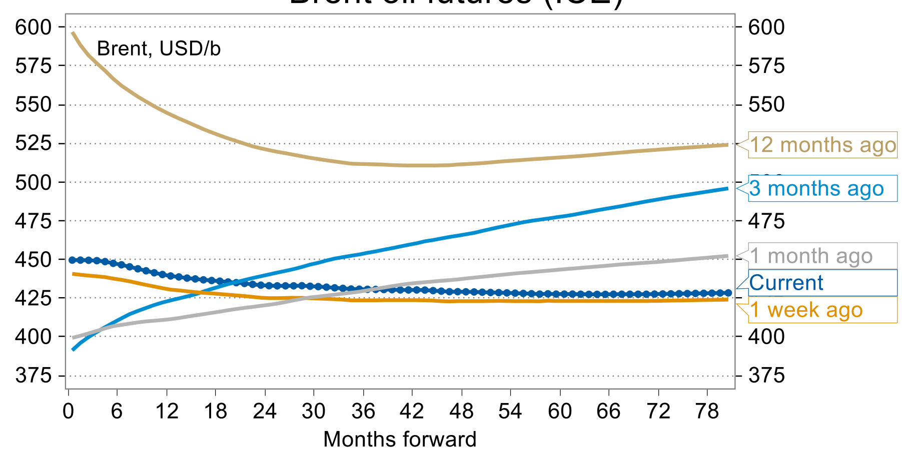
SB1 Markets/Macrobond

Commodity prices



SB1 Markets/Macrobond

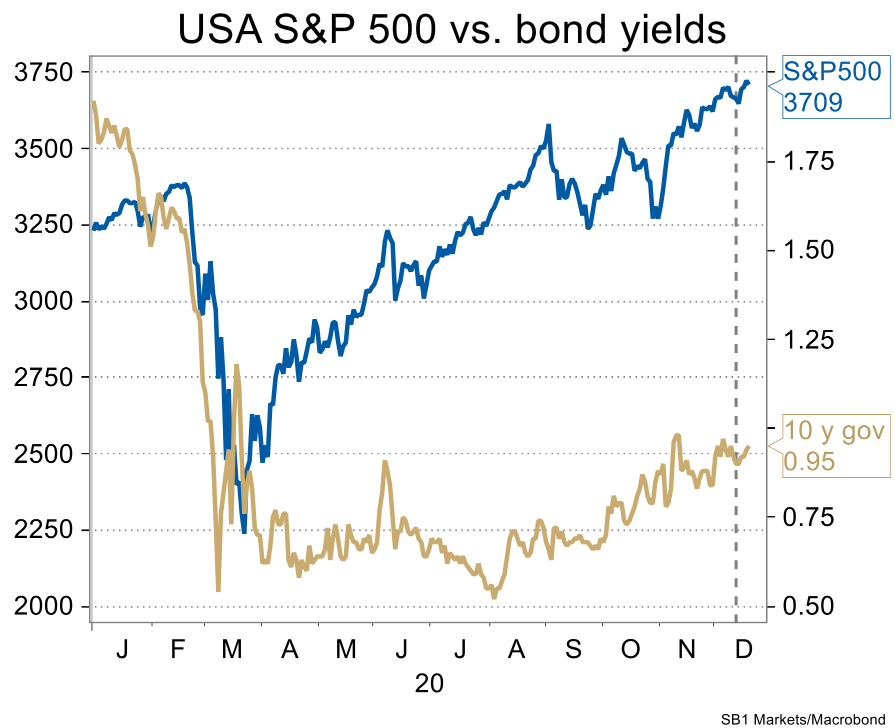
Brent oil futures (ICE)

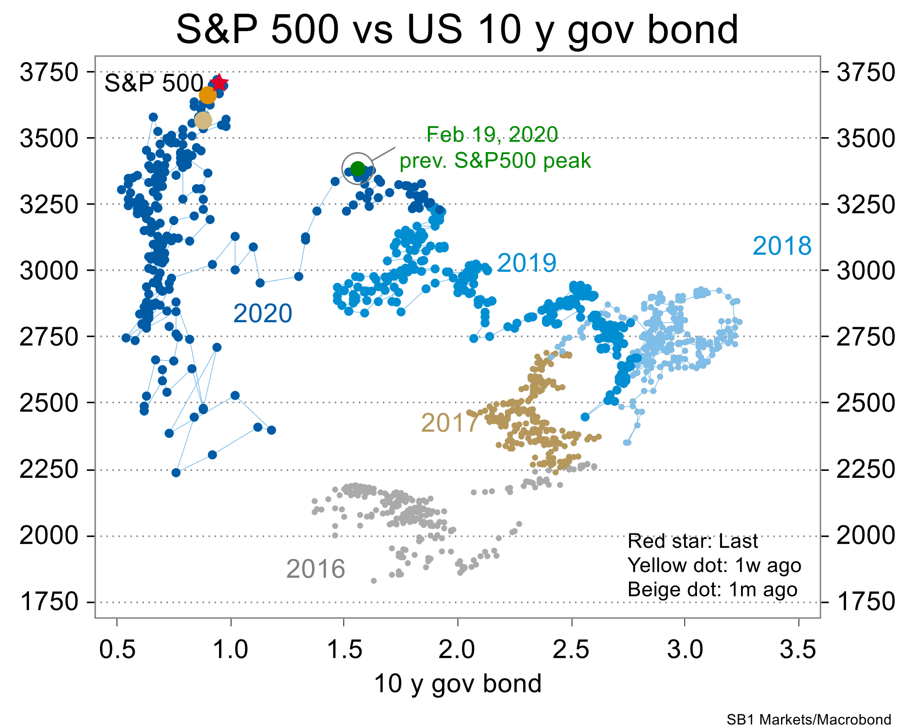


SB1 Markets/Macrobond

S&P 500 up 1.3%, 10 y bond yields up 5 bps

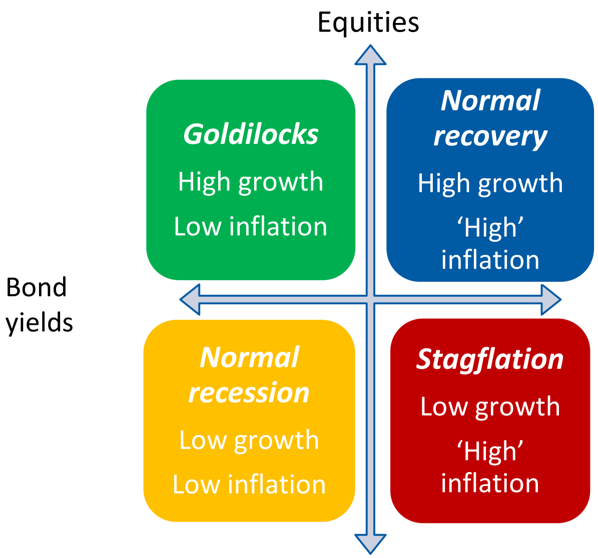
Still mixed corona news, and the economy may be slowing. But US fiscal stimulus package no 2 is here

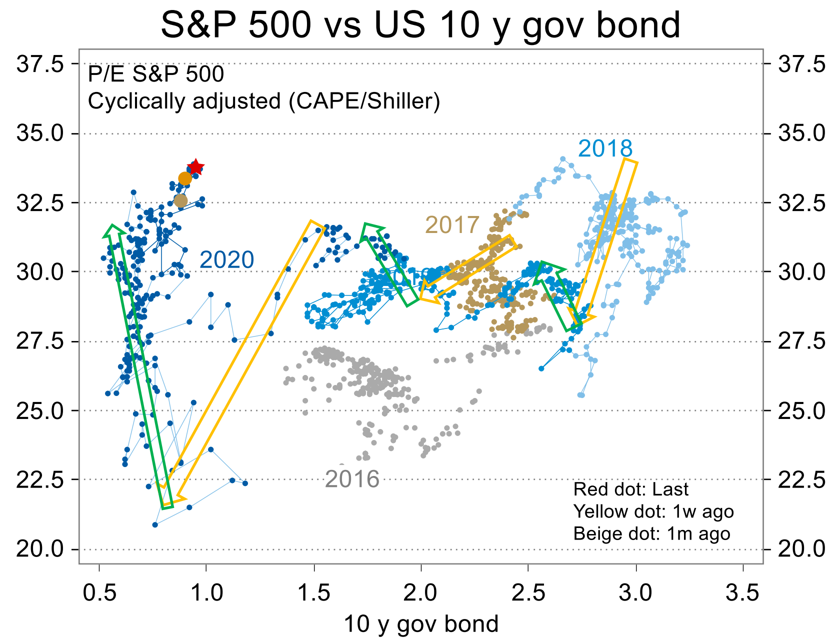




A long term view: From the 'Goldilocks corner', where to go?

Over the past month/week: Small changes – equites have been trending up, yields not



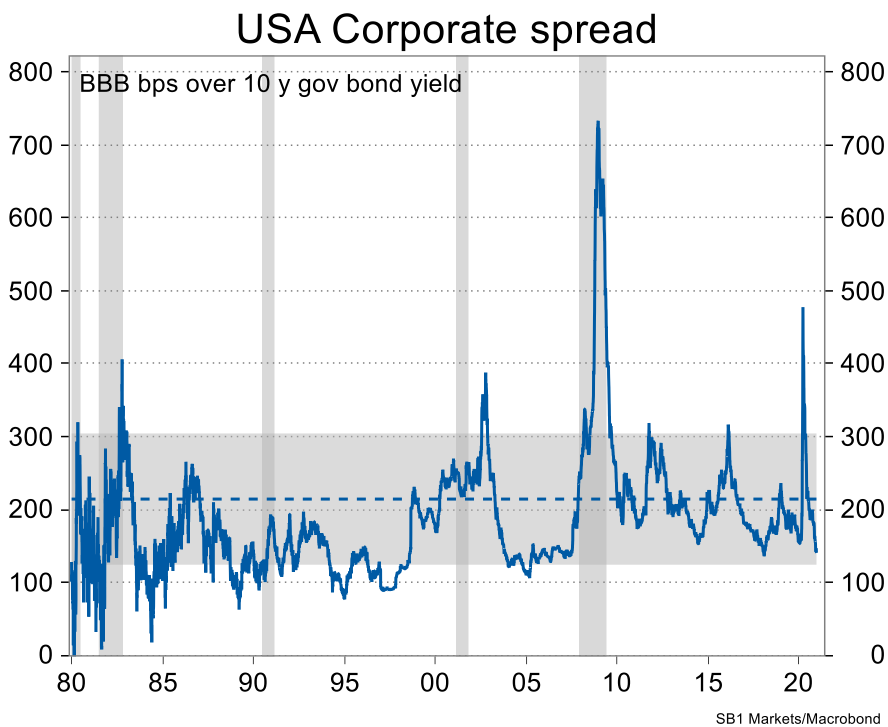


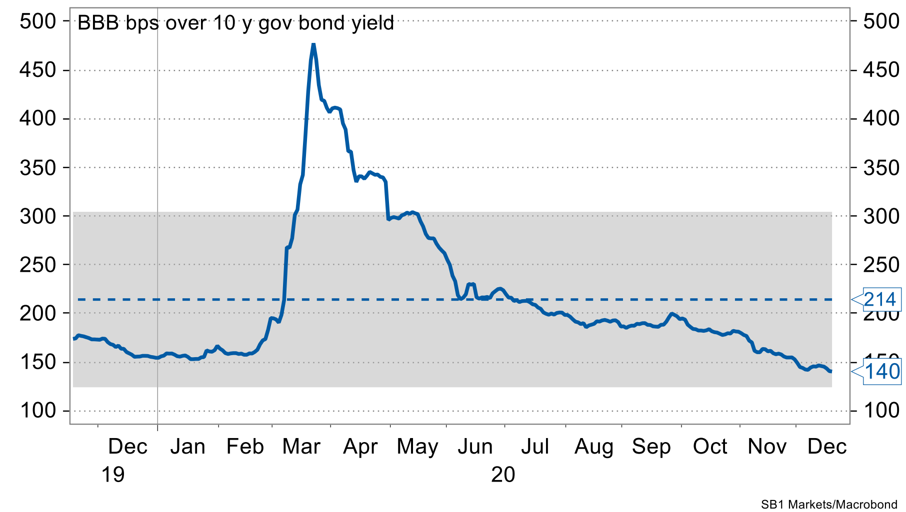
SB1 Markets/Macrobond

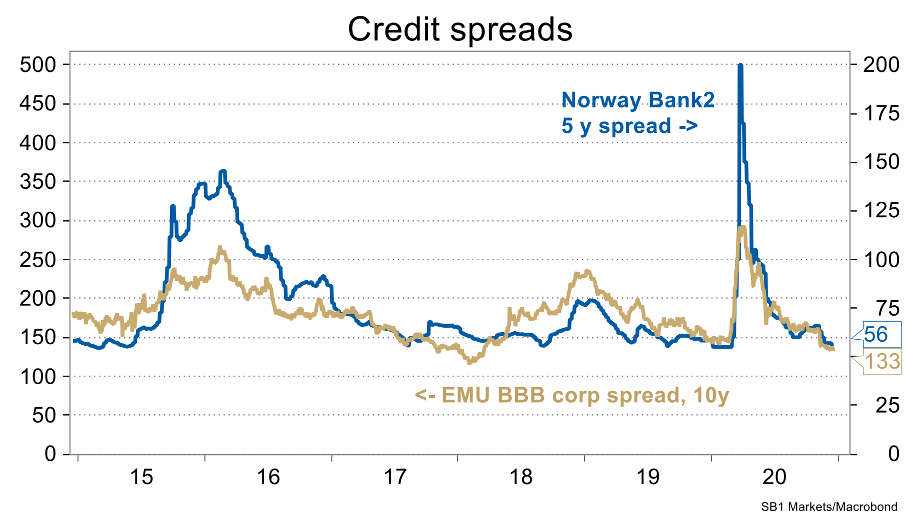
- Usually, we have associated drifts towards the 'green corner' - low inflation and solid growth at the same time - as a <u>temporary</u> sweet spot for markets
- The US Federal Reserve promises to keep monetary policy expansionary, until actual inflation reaches the 2% target and is expected to exceed 2% for some time. As a bonus (at a late stage of a cycle), that would also make it possible for the Fed to push employment higher and profits margins lower (which the market will not discount before it is too late?)
- Will we stay up here, in the green? <u>Perhaps, for while – but probably not, long term</u>
  - » The economy has rebounded rapidly from the corona trough. Any substantial disappointment on corona/vaccine or the growth cycle in general would be challenging for the equity market. Still, the corona hit is most likely behind us, and vaccines are soon here
  - » The Fed will not yield from its new strategy anytime soon. However, (higher than expected) actual wage or price inflation numbers or just a rapid decline in the unemployment rate may shake the market's confidence in the sustainability of Fed's strategy, pushing long term bond yields up. Again, the risk is not serious, short term
- Why are we sceptical vs. the long term outcome? Before corona, the employment rate was high in the core age group, businesses reported (and are now again reporting) unprecedented lack of labour, wage growth was not low vs. CPI inflation or productivity. Profits were under pressure, and investments on the way down. <u>Interest rates had not been too low, even if that is the popular view these days</u>

Credit spreads are down, down – to levels not seen before the financial crisis

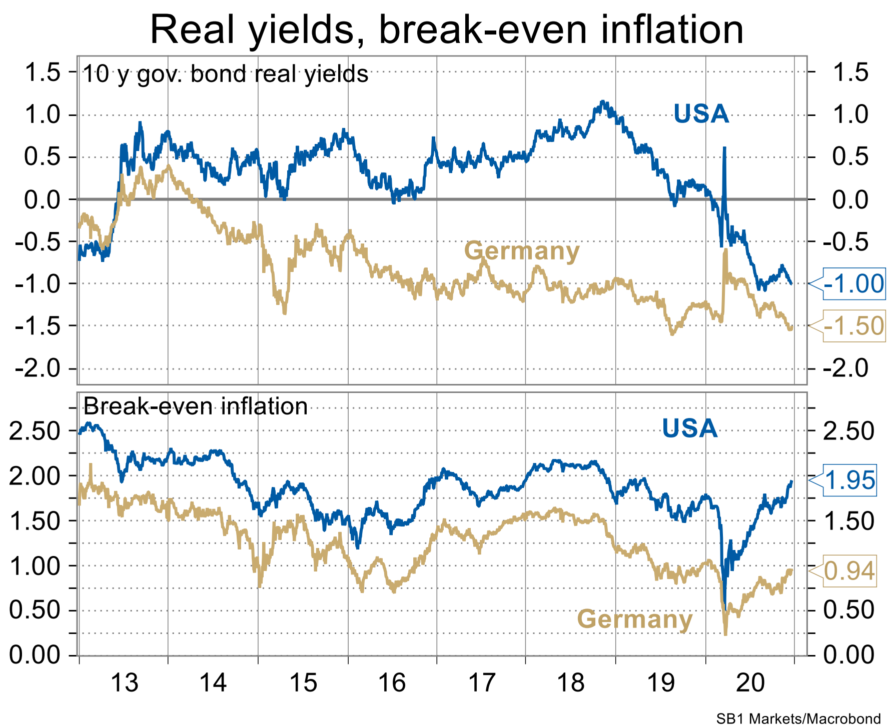
... or close to; In the US, in Europe – and in Norway. The risk sentiment is close to perfect

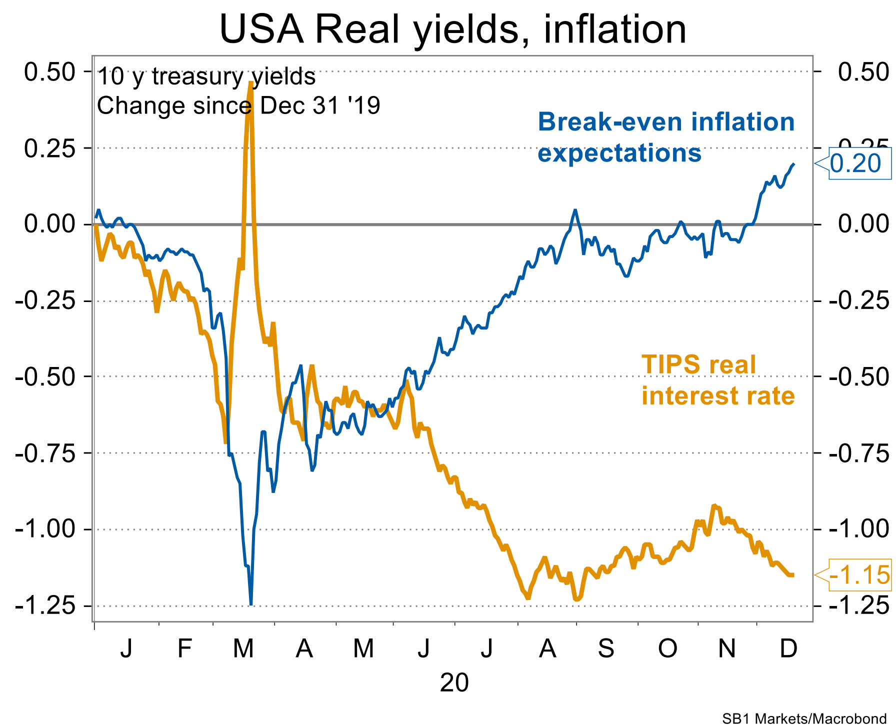






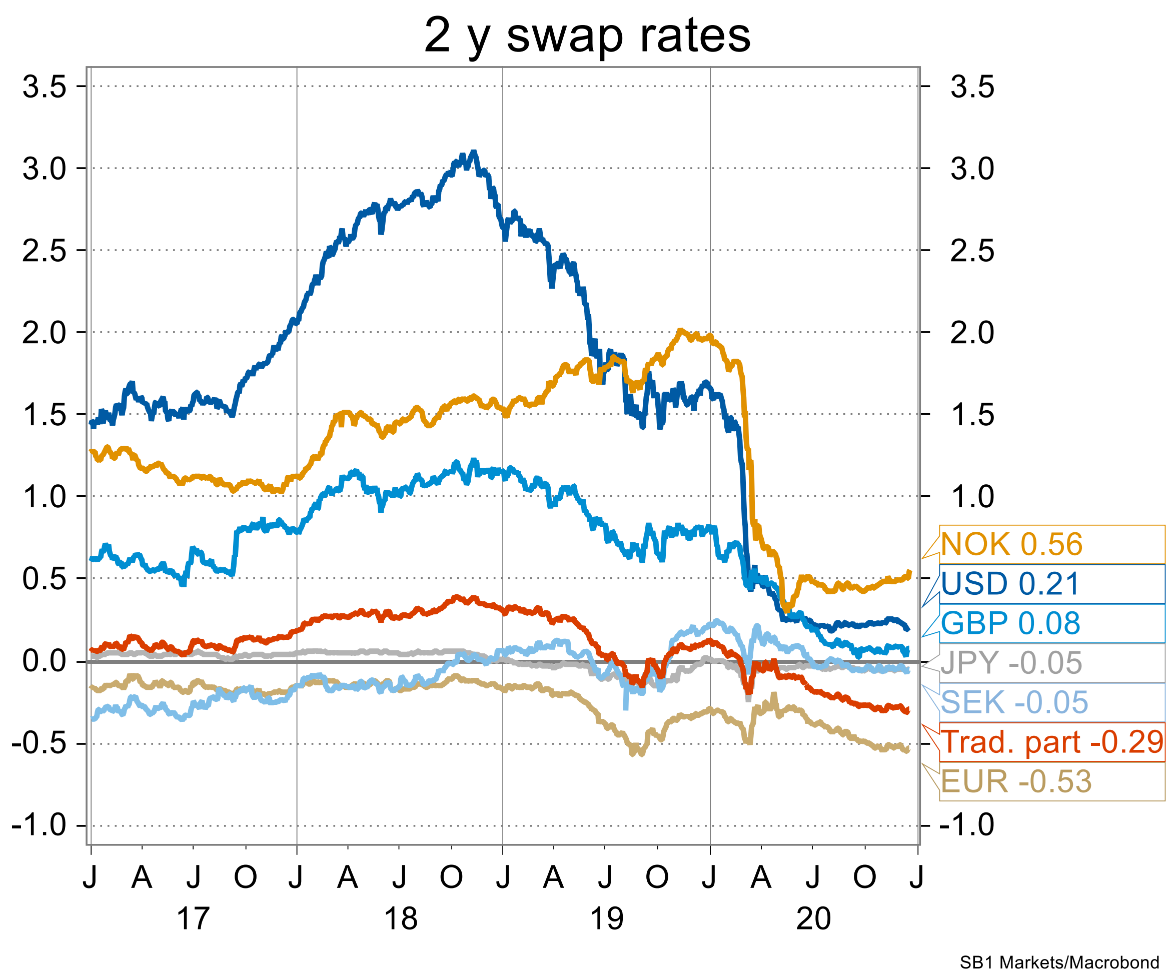
A pause last week – inflation expectations did not climb further

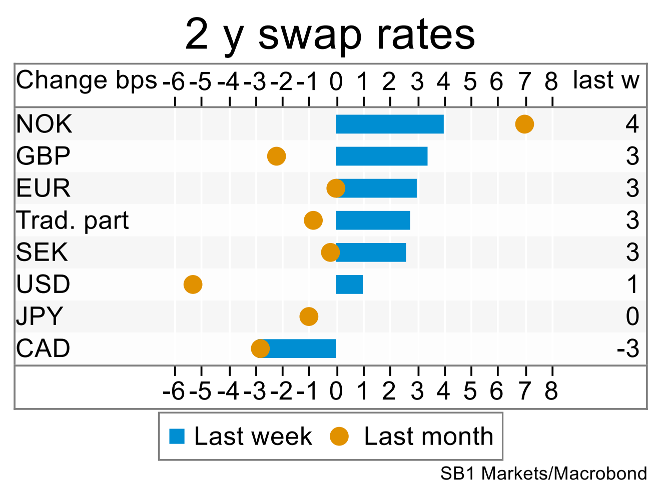




- US 10 y -7 bps (following +13 bps the previous week)
  - Inflation expectations down 2 bps 1.879%, higher than before corona
  - The TIPS real rate down 5 bps to -0.97% - and it is 70 bps below the (low) pre-corona level
- Germany 10y -8 bps (after +3 the previous week)
  - Inflation expectations down 6 bps to 0.90% last week
  - Real rate down 6 bps -1.54%, close to ATL

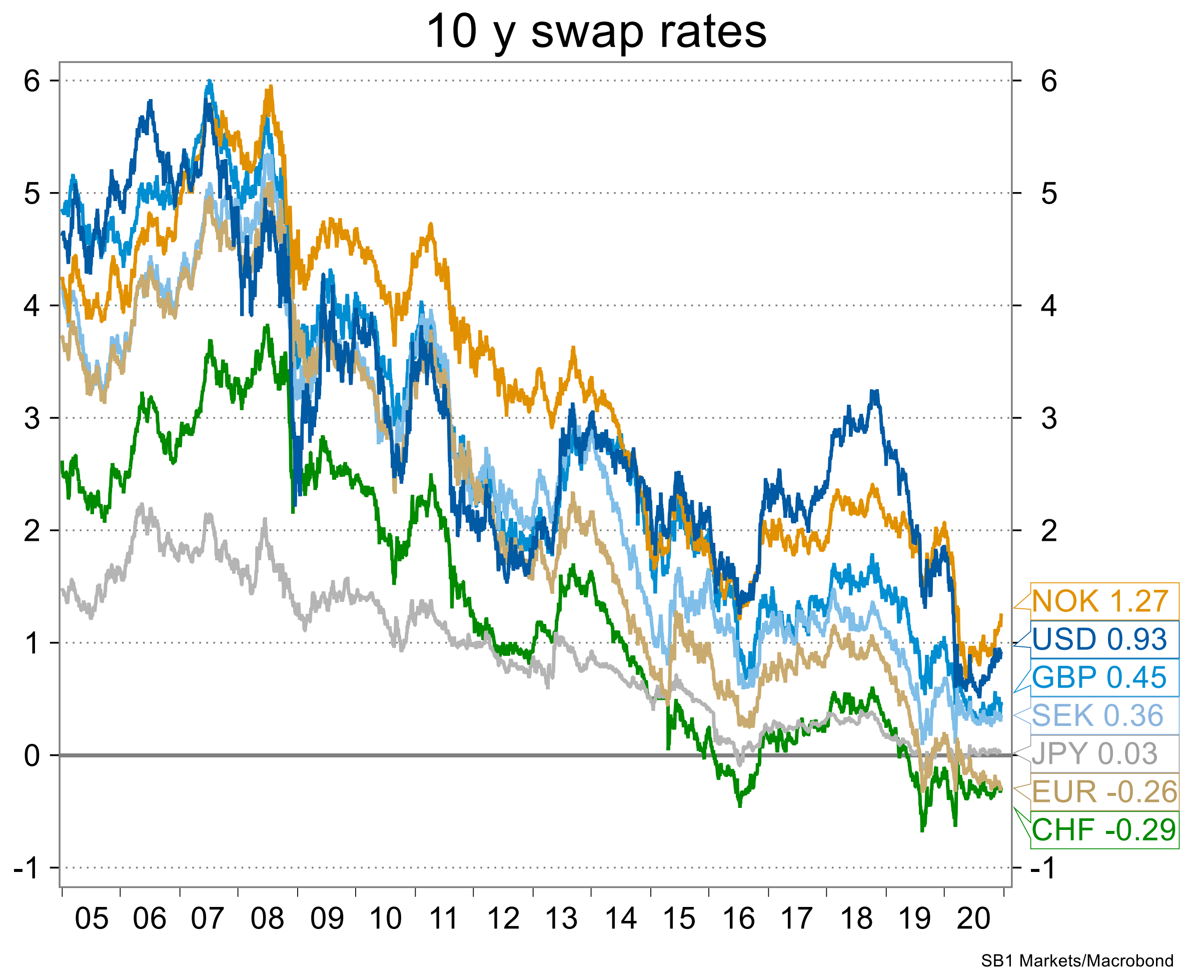
Short term swap rate up most places – and more in Norway than abroad

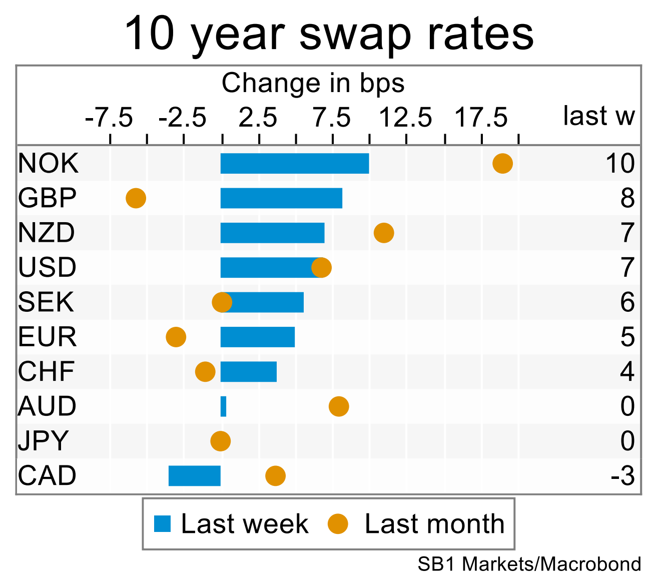




Long swap up almost everywhere last week – and over the previous month

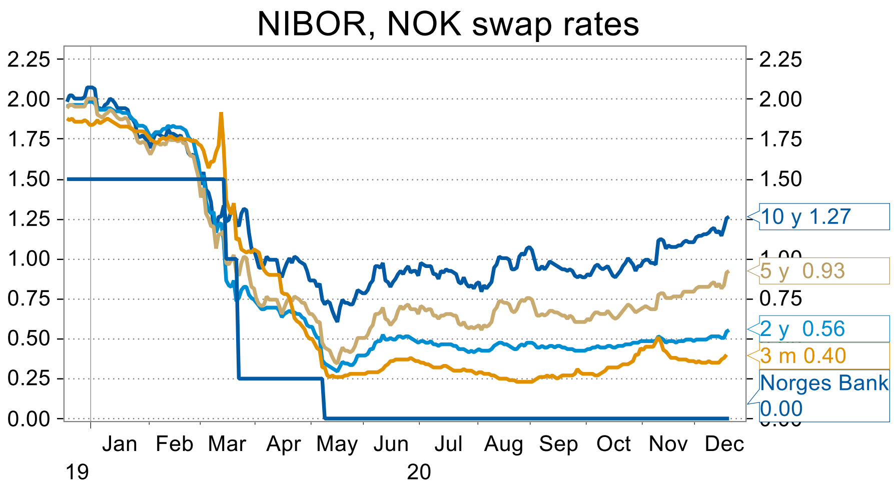
Norway reported the largest increase at 10 bps, but GBP rate rose sharply, due to Brexit deal hopes

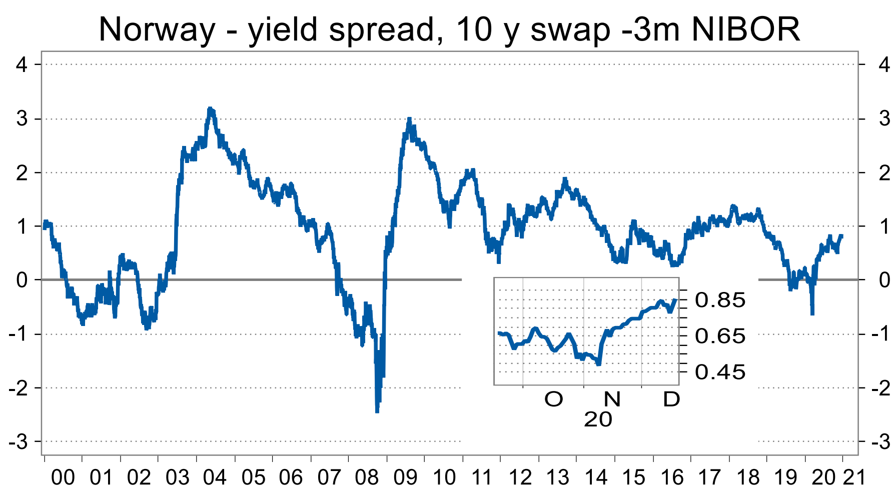


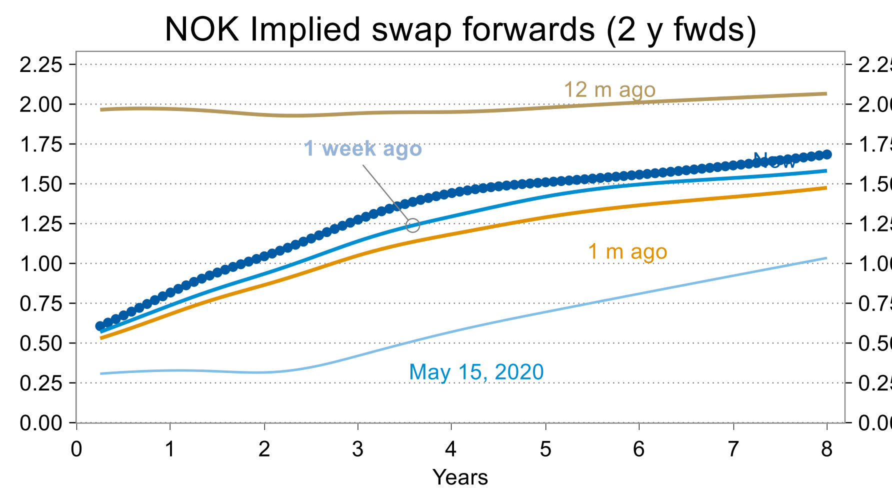


Another uptick last week, all over the curve, which is gradually steepening

The 10 y swap rate has more than doubled vs the May trough – still at low level

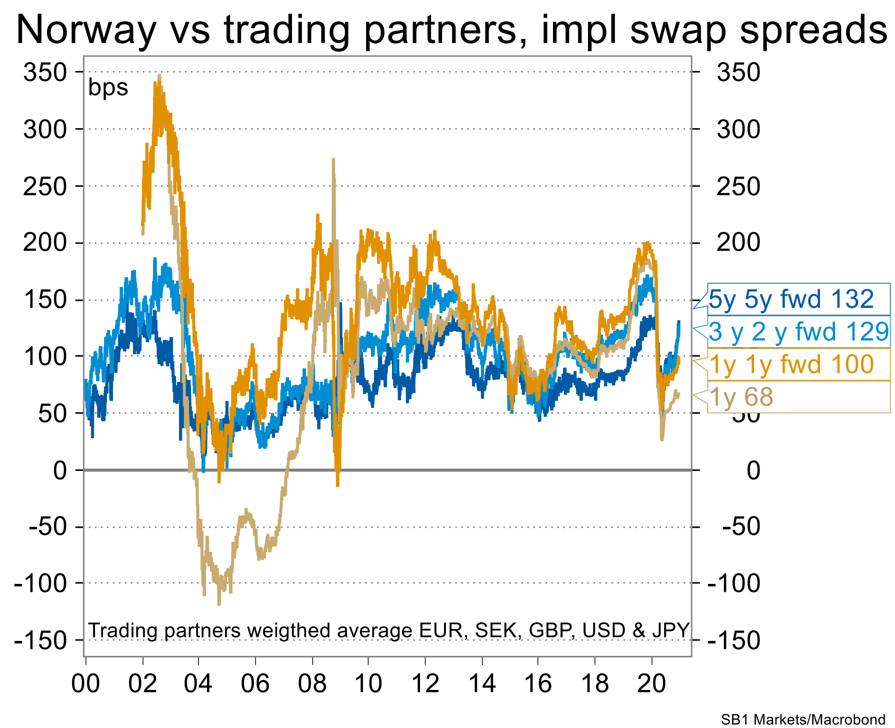


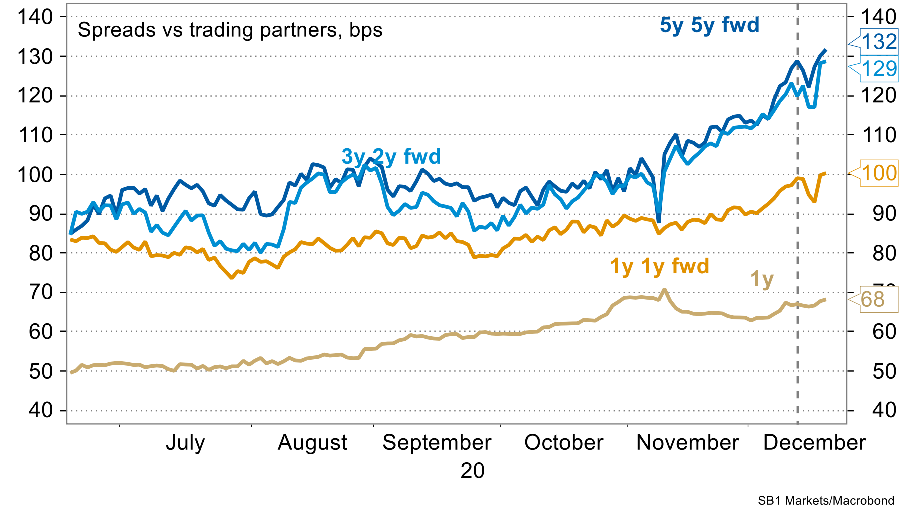


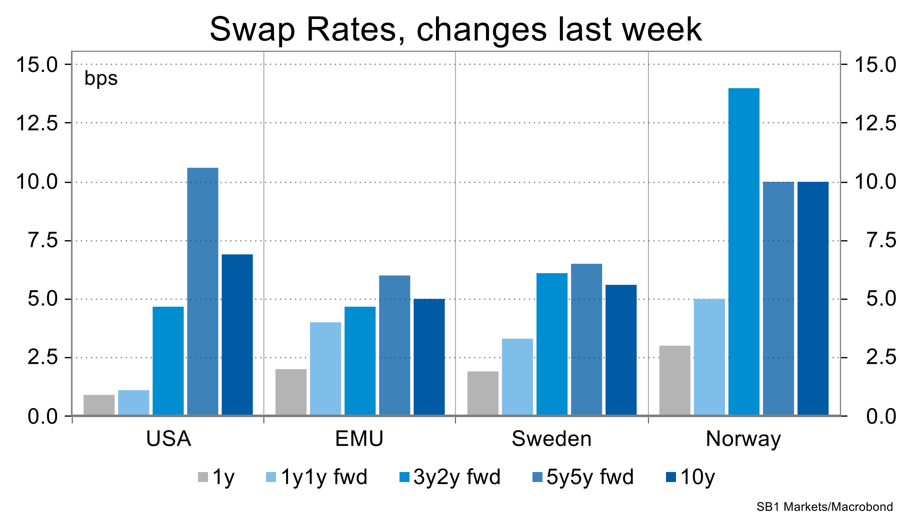


Spreads vs trading partners keep widening

NOK swap rates sharply up last week, and more than among our trading partners. NoBa to 'blame'?



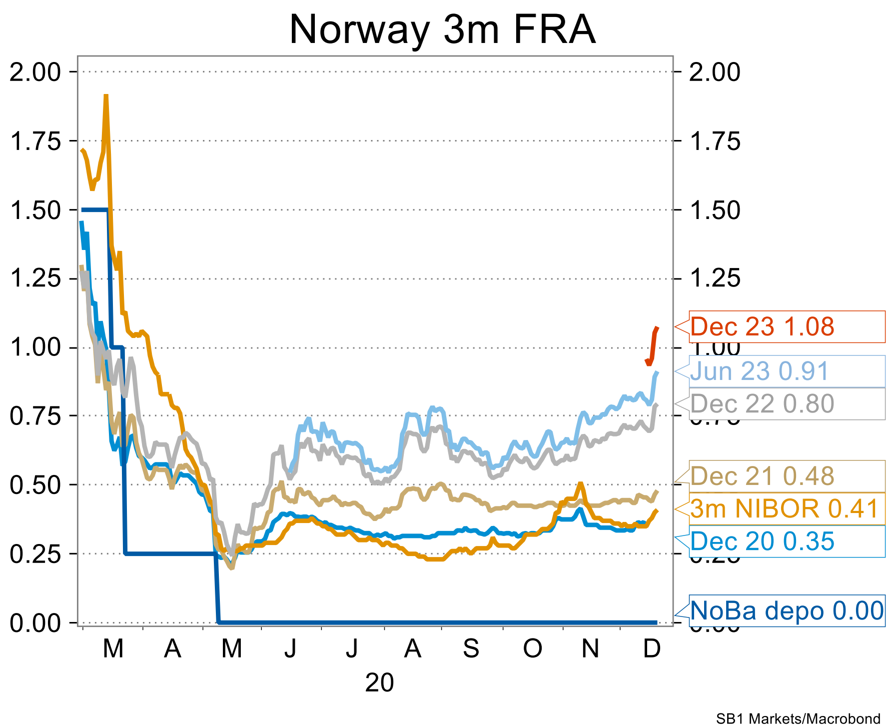


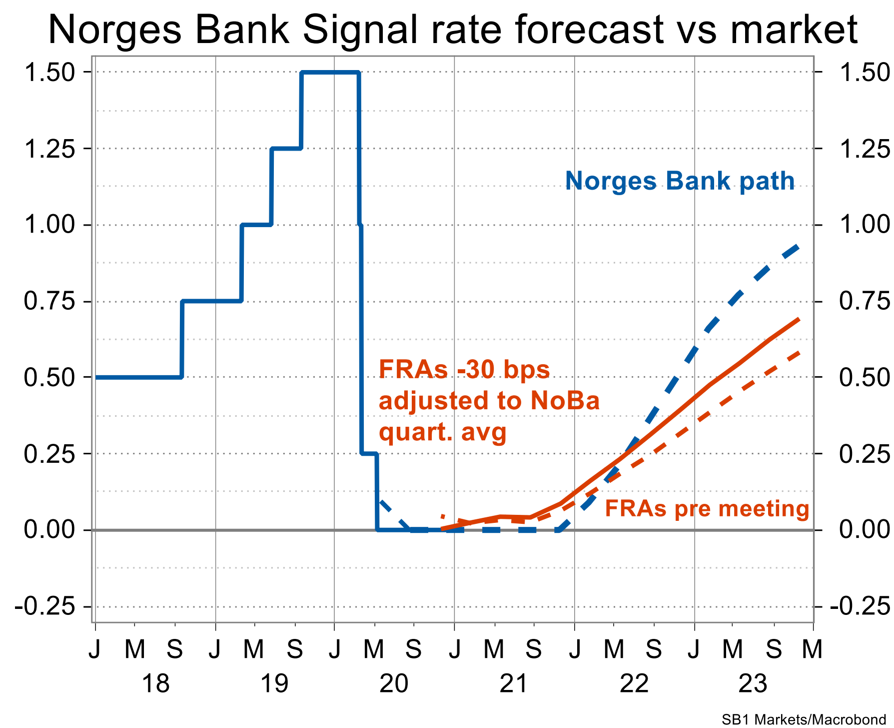


- The spread has widened substantially since the spring. We have been neutral to the spread. We expected rates to rise both abroad and in Norway. As we were uncertain on the investment outlook in Norway, we did not recommend betting on a more rapid steepening in Norway than abroad – even in the Norwegian housing market recovery from May could trigger at faster tightening in Norway. The spreads have to widen more before it's 'too much'

The FRA curve got a boost from Norges Bank, rates climbed by up to 10 bps

The market is – reasonably – sniffing at a Q4-21 rate hike possibility



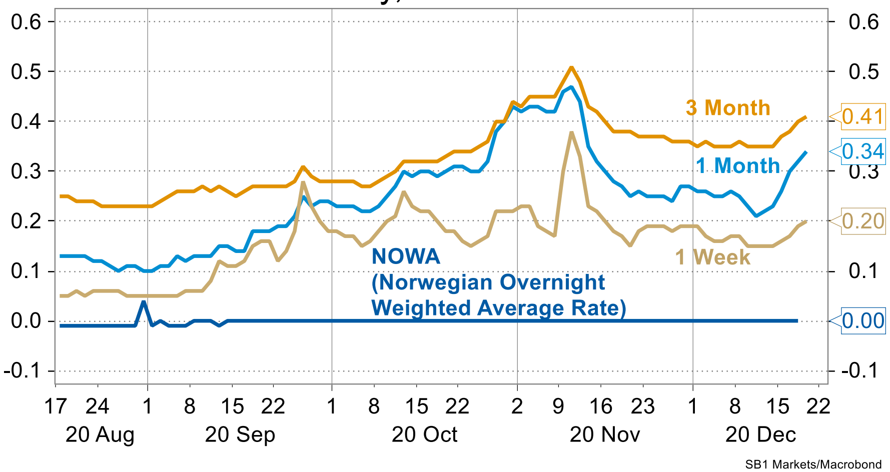


- The FRA curve steepened due the the 'aggressive' rate message from NoBa. Of course, the Bank was not specifically hawkish per se but no doubt more hawkish than the market expected on beforehand
  - » FRAs rose by up to 10 bps, the largest daily upward change in 2020
  - » The market changed its timing for 50% probability for a first hike forward by some 2 months to Dec 21/Jan 22. We have not

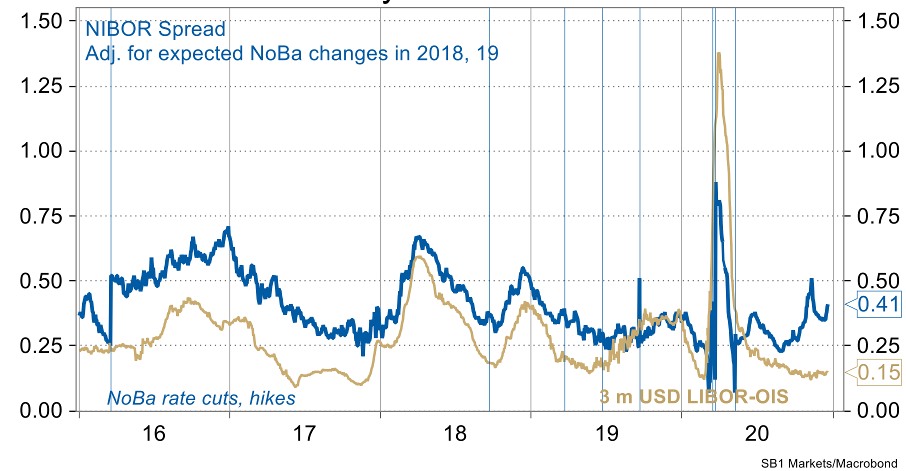
Trouble at the short end, again? 3 m NIBOR up 6 bps to 0.41%

… and impossibly not due to Norges Bank, we will not get a hike in Q1 2021!

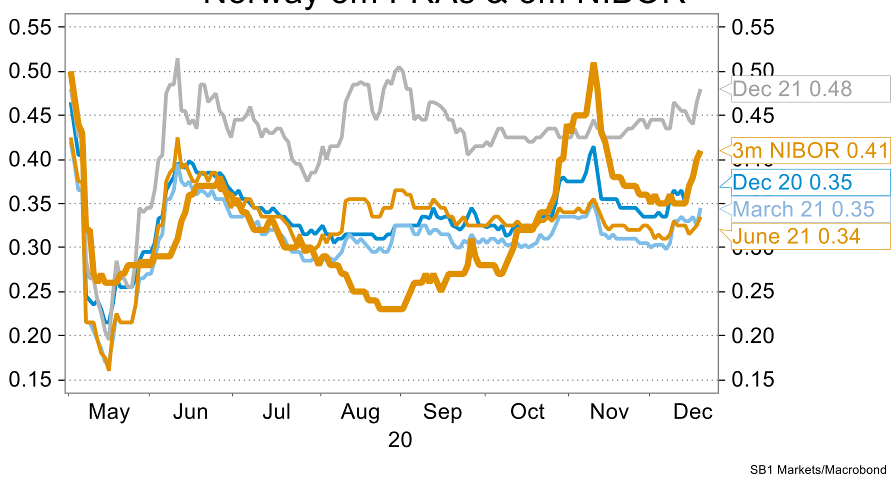
Norway, NIBOR rates



Money market friction



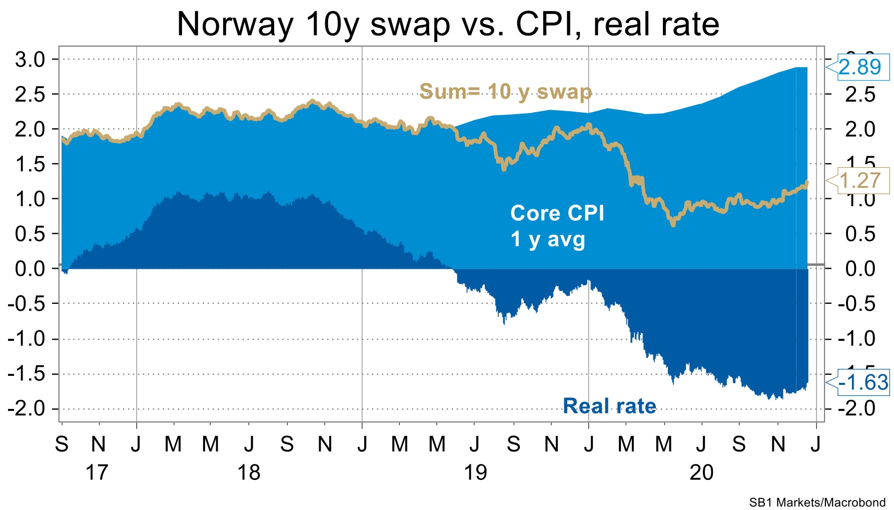
Norway 3m FRAs & 3m NIBOR



- Even shorter dated NIBOR rates rose last week – so it's 'just' liquidity, again
- Last week even March and June contracts added some bps to their (low) heights
- There is no stress in the US money market – or in other money markets
- We expect the money market to normalise in early 2021, if not by itself, by help of a supporting hand from our Central Bank
- (The rise in longer dated FRA contracts were not doubt due the 'hawkish' NoBa stance)

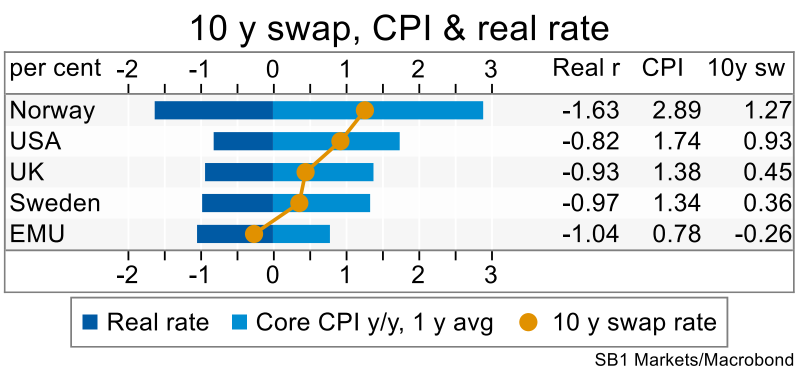
SpareBank 1 MARKETS

Negative (actual) real interest rates everywhere – NOK at the bottom



NOK 10 y swaps are drifting upwards

- The 10y NOK swap rate has climbed by almost 50 bps since the bottom in May, to 1.27%!
- The real rate, after deducting average inflation over the 2 past years equals -1.6%

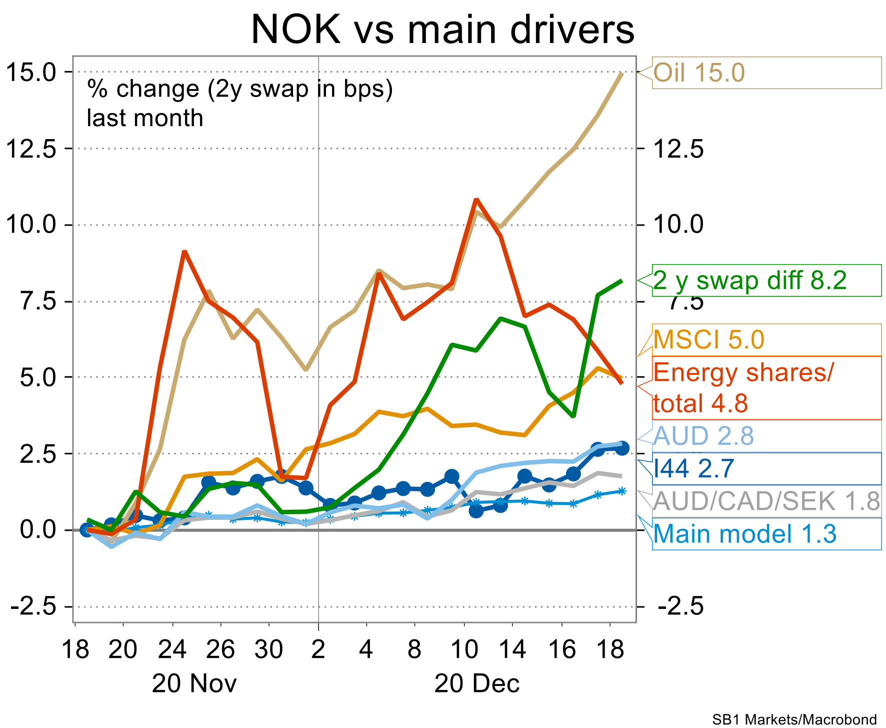


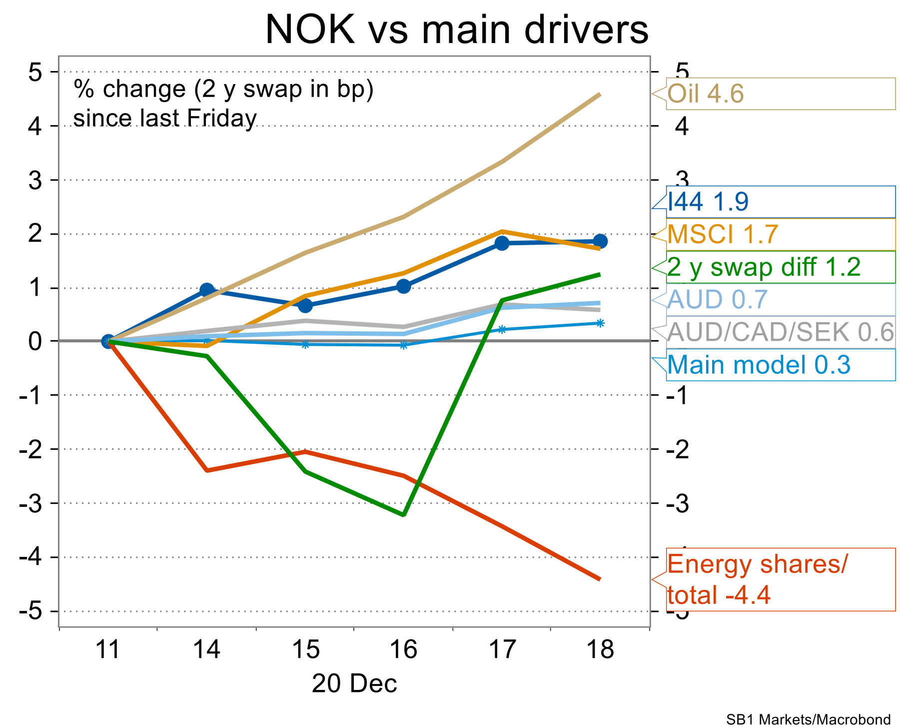
NOK real rates among the lowest, as inflation is at the top

- Inflation among Norway and our main trading partners varies between 0.8 pp to 2.9% (here measured by actual annual core inflation, smoothed over 12 months). EMU at the bottom, Norway at the top, by far
  - » Other measures of inflation trends, looking backward or including forward expectations yields the same ranking
- Real rates are quite similar among our trading partners, at -0.8% to -1.0% measured vs. the 10 y swap rate and core inflation over the past two years
- Thus, the Norwegian real rate at -1.6% is an outlier at the downside, even if the nominal rate is the highest

NOK up last week – supported by 'everything' included a 'hawkish' Norges Bank

The other usual suspects signalled a stronger NOK (except energy shares)

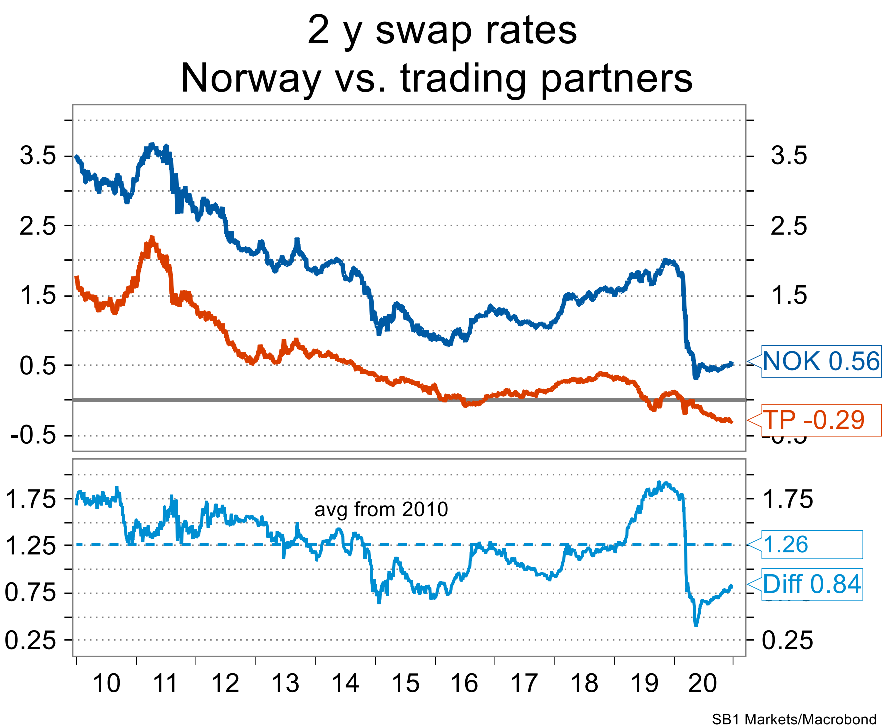


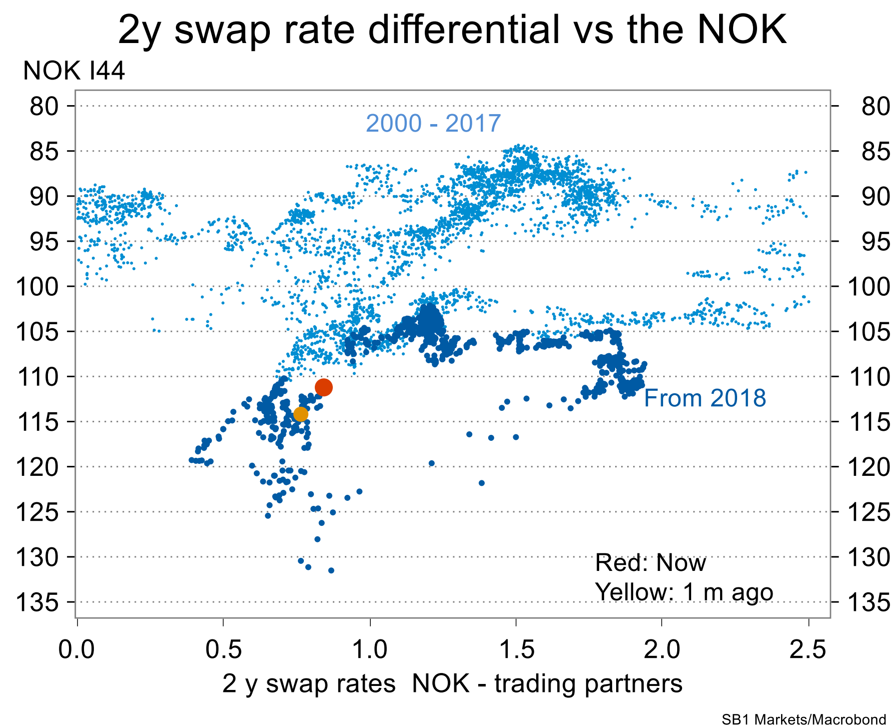


- The NOK is 2% <u>weaker</u> than suggested by our standard model
- The NOK is some 6% '<u>below</u>' the global stock market vs the correlation between the two in 2020
- The NOK is 8% <u>weaker</u> than an average of AUD/CAD/SEK, our 'supercycle peers'
- On the other hand, the NOK is far (12%) <u>stronger</u> than a model that included global energy companies share prices (vs the global stock market), even after the impressive energy sector recovery recent weeks (that took a break last week)

Can Norges Bank walk the walk alone? Will the NOK become too strong?

In our models, a 2 y swap 1 pp spread widening yields a 7% stronger NOK

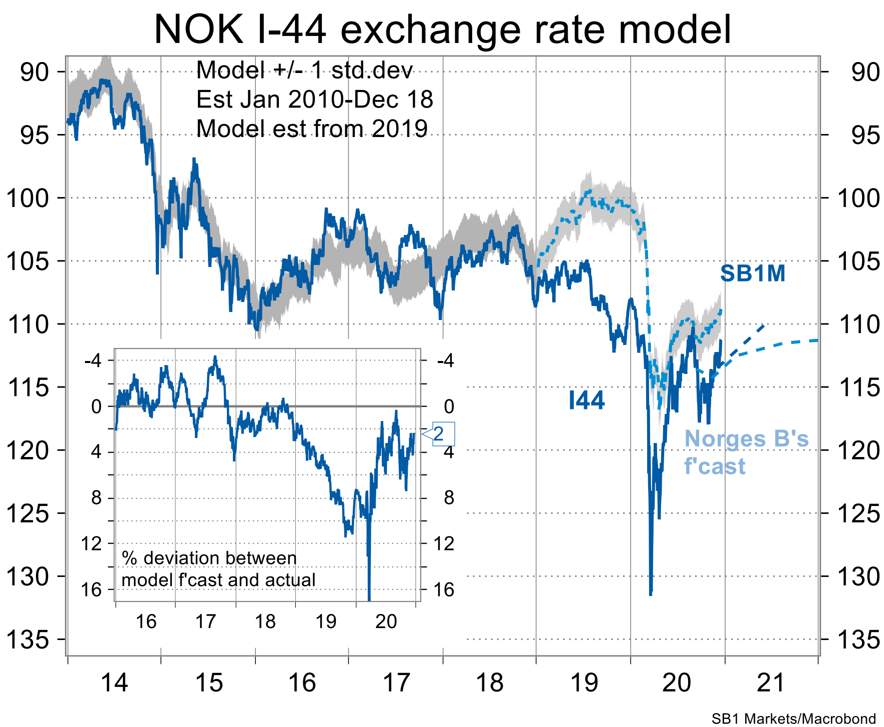


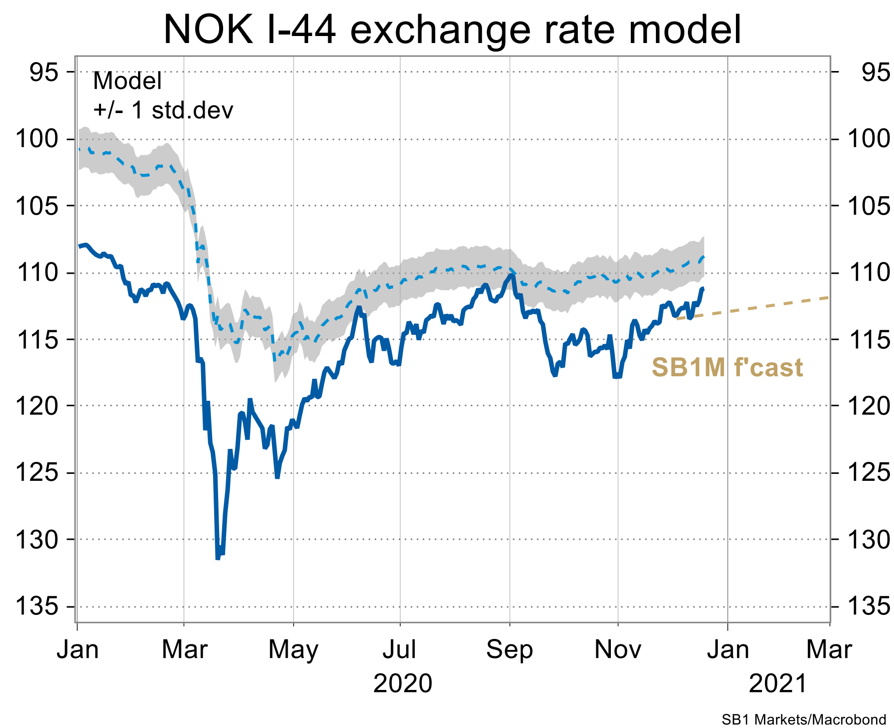


- However, the relationship is far from stable – and the oil price is usually much more important – and other factors are more important, at least from time to time

NOK I44 1.8% last week, our model said just 0.3%

The NOK is 5% below the model forecast

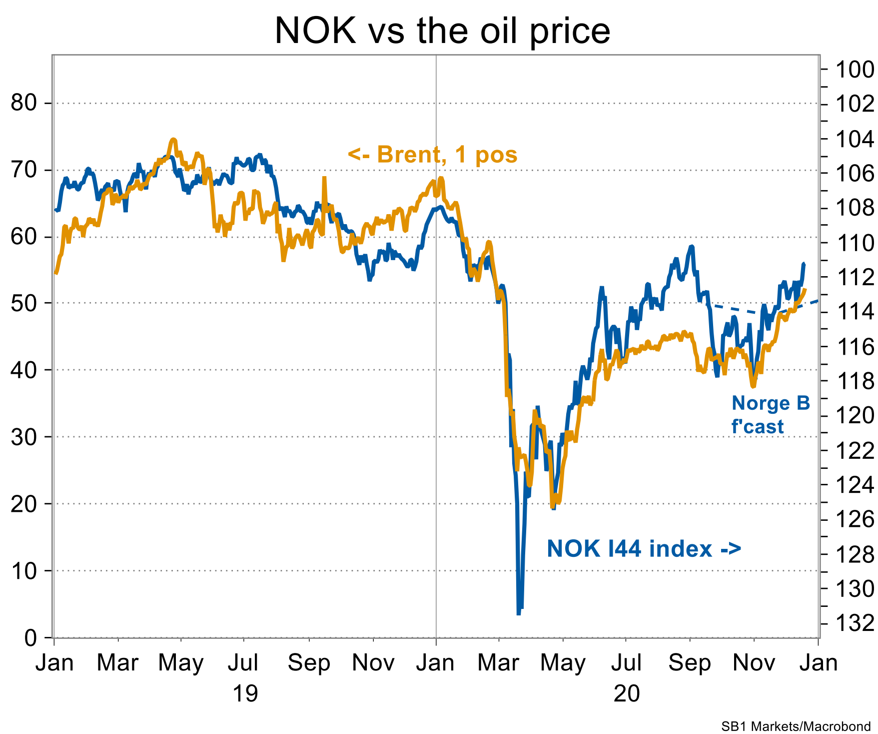


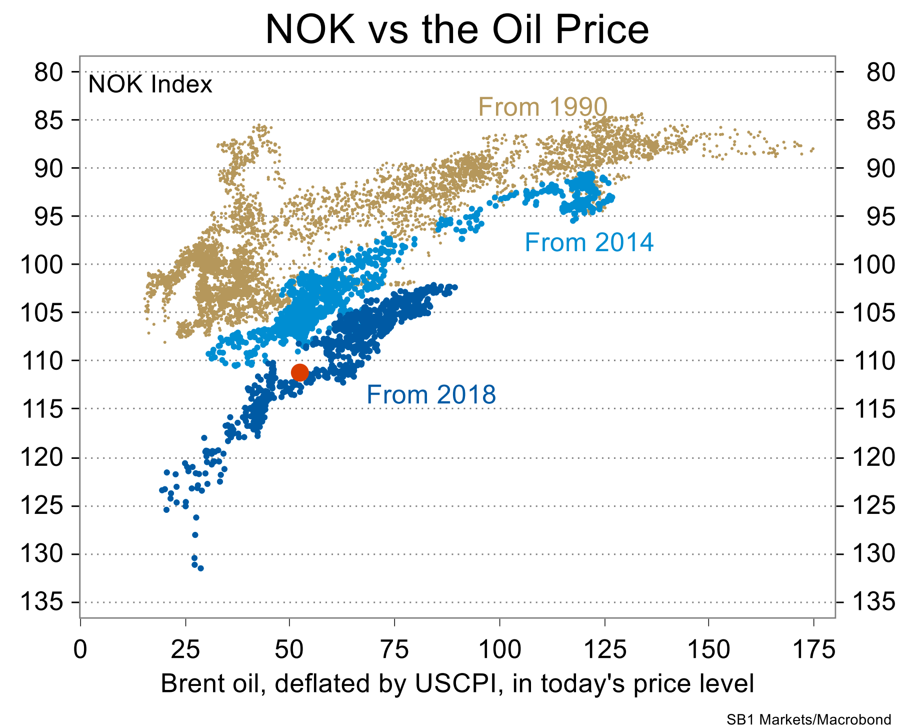


- The estimation period now includes 2018. The inclusion of the extra year did not change the model's forecasts significantly (well below 1%)

An oil price above 50 supported the NOK last week

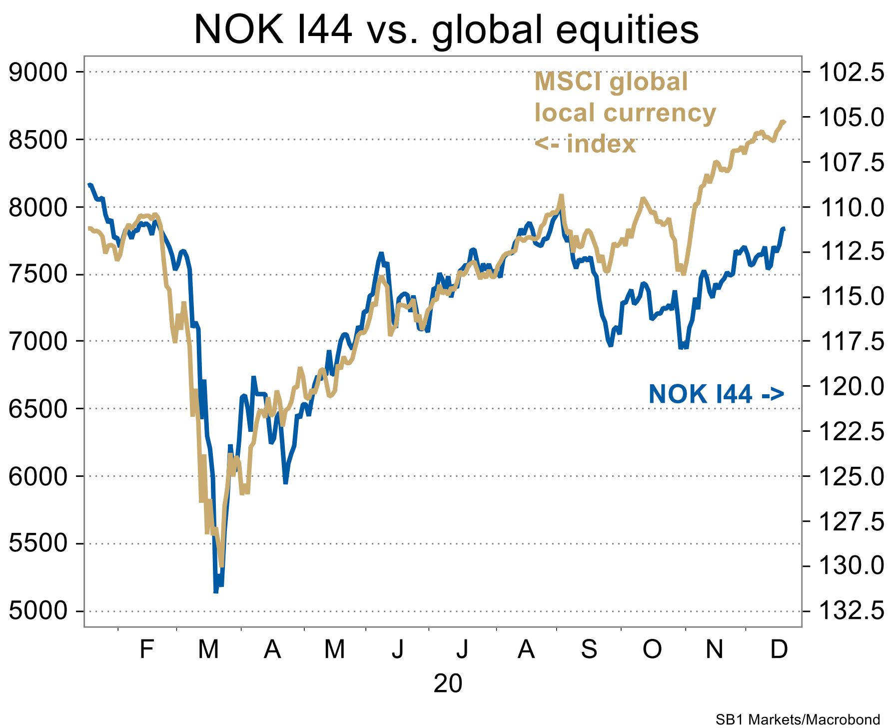
The oil price is still important for the NOK but the correlation has not been impressive since July

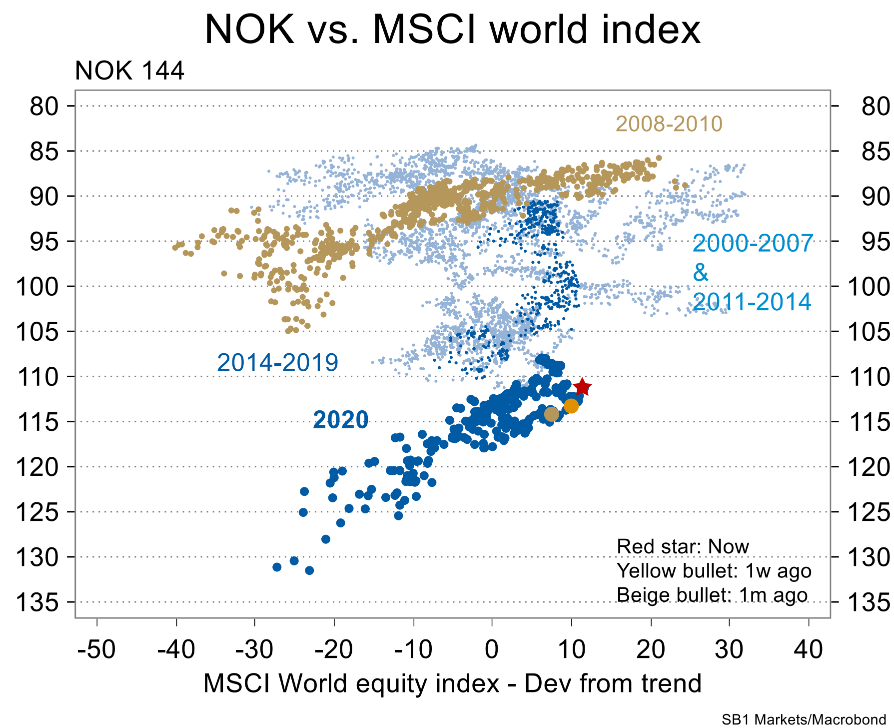




NOK & global equities down – and the NOK is 6% down vs the '2020 relationship'

The NOK has been closely correlated to the global stock market in 2020 but has lost ground since Sept



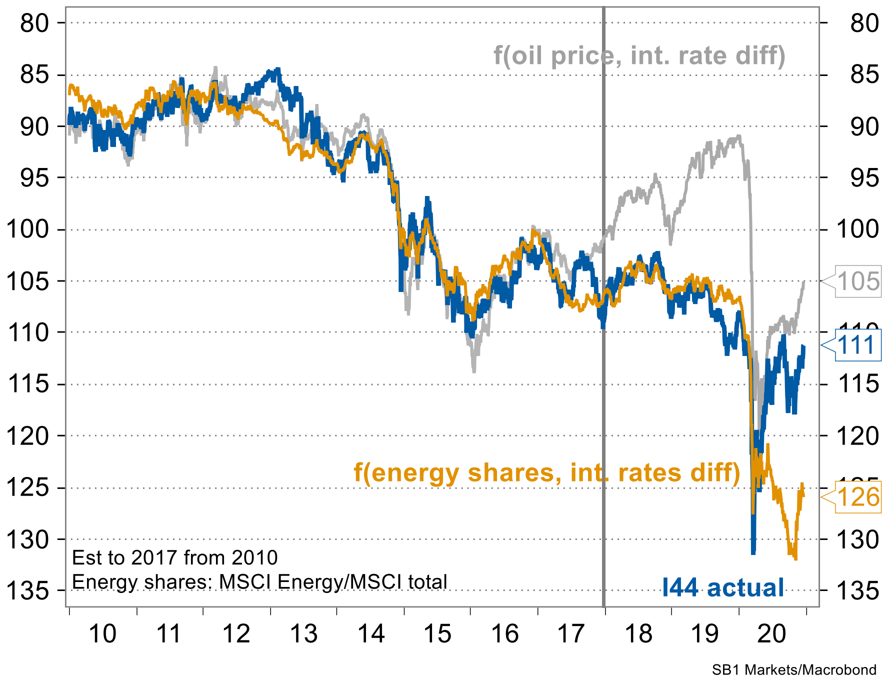


- Over time, there has not been a stable correlation between NOK and stock markets (the Oslo Stock Exchange, S&P 500 or the MSCI, the global equity index) – but there have been periods with pretty close correlation like we have seen since early 2020
  - » NOK has not been correlated to OSE/MSCI (which could be interpreted as specific Norwegian factor)
- We have long argued that global equity prices should be more important for the NOK than the oil price, as our global equity assets in the Oil fund are larger then the value of the remaining oil & gas reserves. Has the market 'finally' (and rather sudden) come to the same conclusion? Doubtful
- Now, the NOK is 6% weaker than 'normal' vs the stock market – (the gap that built up since early September, based on the link between the NOK and MSCI since Jan 2020)

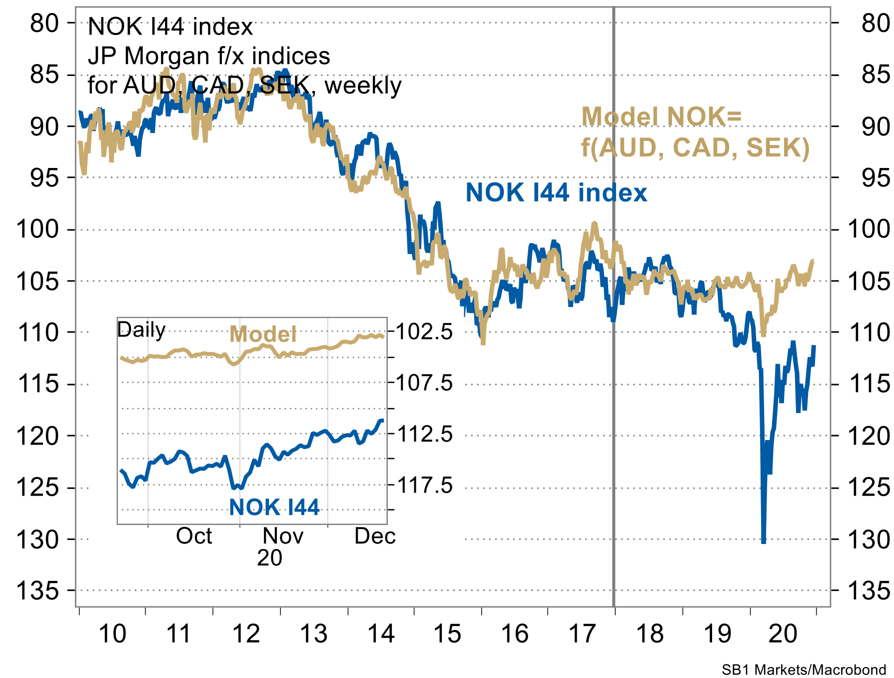
NOK up, oil companies down

Energy shares have recovered sharply, still ‘weak’ vs the NOK

NOK models



NOK vs AUD/CAD/SEK



- On the alternative NOK models
  - » Our NOK model based on pricing of oil companies (oil shares/total market) has ‘explained’ the NOK much better than our traditional model since 2017, as have our ‘super-cycle’ peers currency model [NOK=f(AUD, CAD, SEK), with just a marginal contribution from SEK]. The EM x CNY currency aggregate is also quite closely correlated to the NOK
  - » Energy shares have been sliding down since June but have turned up two past weeks. The NOK is still far stronger than the oil equity model estimate – and we recognise that the NOK has said goodbye to the still struggling oil companies
  - » The NOK has fallen more than our AUD/CAD/SEK model forecast the past month and last week, even as all are sensitive to market risk sentiment. The NOK is 10% below our model est. We think this model is more relevant than the oil stock price model

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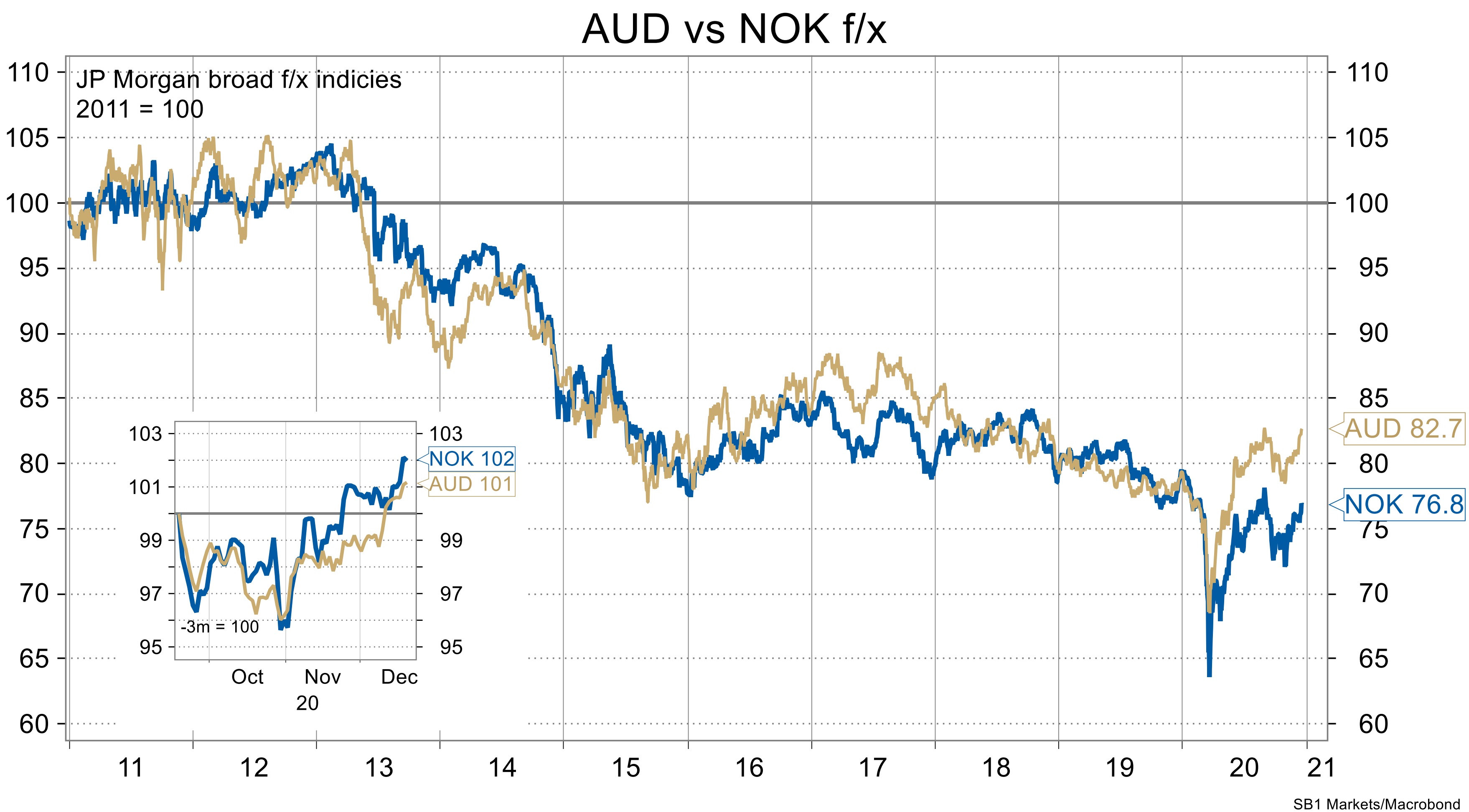
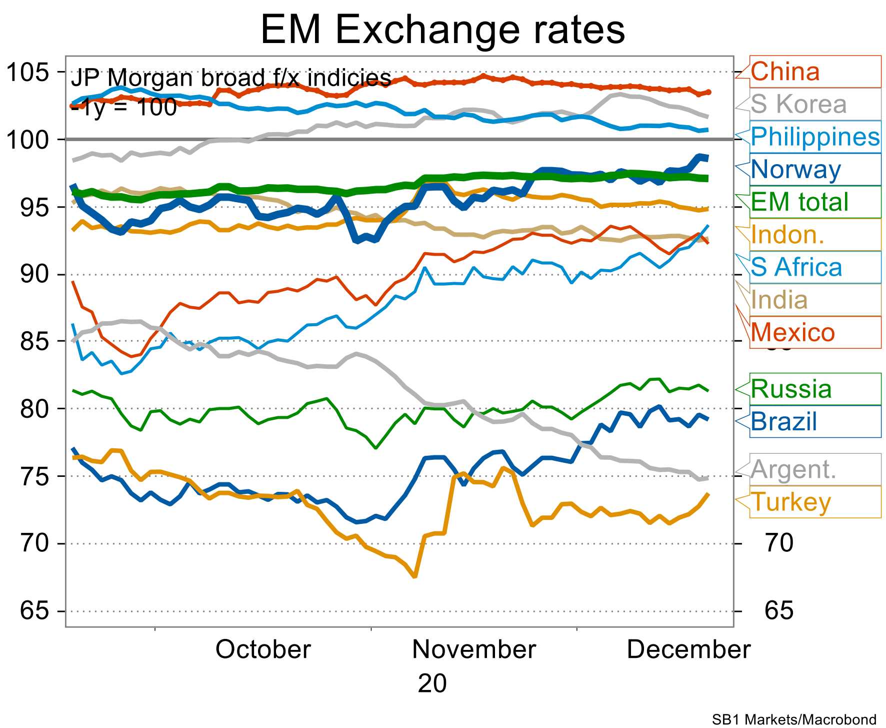
NOK recovered some of the loss vs the AUD last week, still 7% 'too weak'

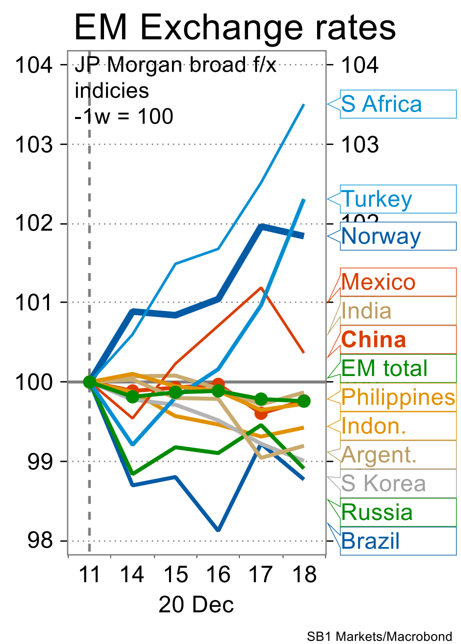
The NOK has lost 7% vs. the AUD since Feb

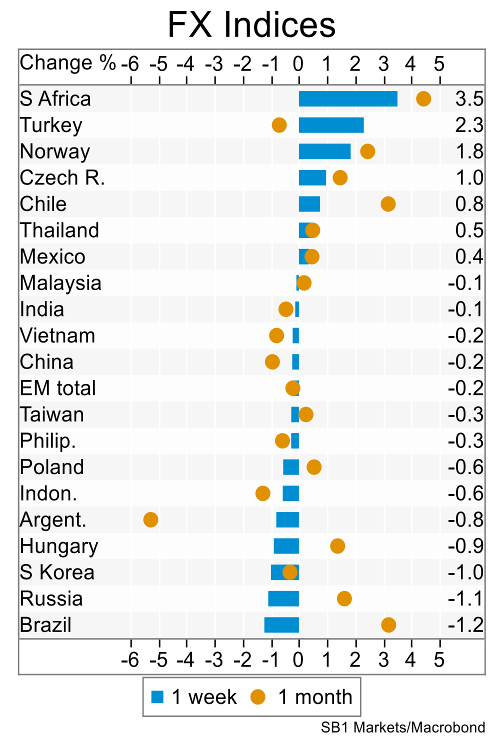


Mixed in the EM universe, in total down, even if raw materials are strong

China is still drifting, as is Argentina (on another scale)







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