18 May 2021

Macro Weekly

Week 20/2021

Harald Magnus Andreassen
Phone : (+47) 24 13 36 21
Mobile : (+47) 91 14 88 31
E-mail : hma@sb1markets.no

Tina Norden
Phone : (+47) 24 13 37 48
Mobile : (+47) 93 22 62 24
E-mail : tina.norden@sb1markets.no

SpareBank 1 Markets
Phone : (+47) 24 14 74 00
Visit address : Olav Vs gate 5, 0161 Oslo
Post address : PO Box 1398 Vika, 0114 Oslo

Highlights, corona update

The world around us

The Norwegian economy

Market charts & comments

Last week: Our pandemic section is getting shorter ☺

The virus

- **Good news on new cases, vaccination & the impact of vaccines** in the rich part of the world. Just a really bad mutation will prevent a rapid normalisation of activity the coming weeks/few months
- **Mobility** is rising almost everywhere in DM as the negative drag from corona restrictions/cautious behaviour are easing
- **US** lifted its mask recommendation for those who are vaccinated. **UK** lifted a large bulk of the remaining corona restrictions as new infections remain low
- **In India**, the no. of cases fell last week, if official data is to be trusted. Mobility is still on the way down, and at a low level

The Economy, part I - US

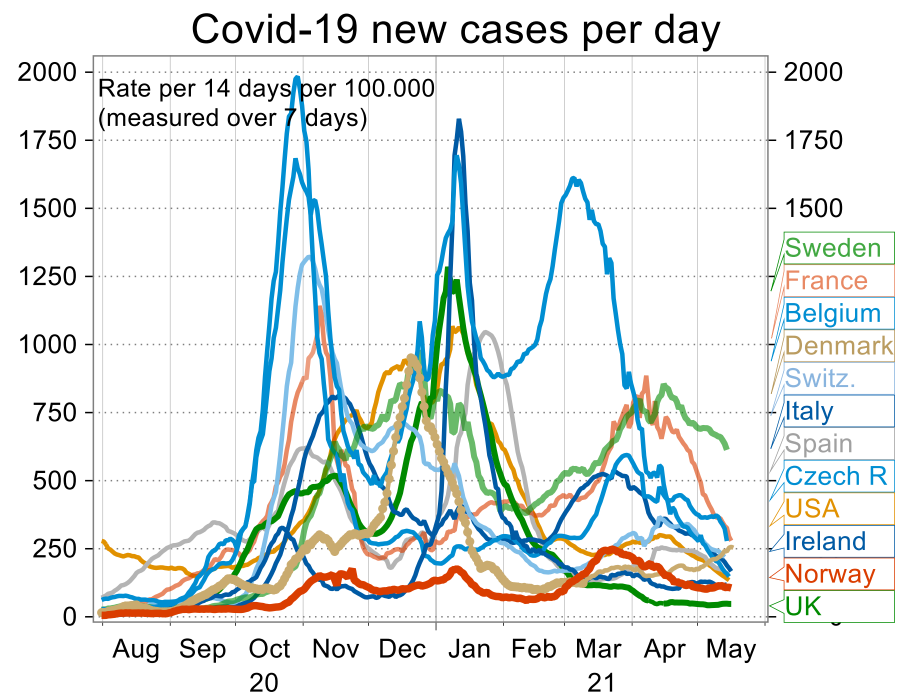
- For months, a substantial hike in **US consumer prices have been better announced than anytime in modern history**, both due the base effect of the decline in prices m/m last spring, and due to expected faster m/m prices lifts this spring, as signalled by a barrage of surveys and surging raw material and producer prices. Still, the April CPI surprised on the upside, headline shot up by 1.6 pp to 4.2%, the core by 1.4 pp to 3.0%, the highest in 13 & 25 years resp. Average CPI inflation over 3, 5 or 10 years is now at or above 2%. The Fed still insists the price hikes are transitory, and the market by and large buys its story. Given the rather narrow m/m increases in April, in used auto prices, lodging, and airline tickets, it is not that unlikely. Over the past year, energy prices have contributed by 1.5 pp. Looking forward, the pressure from higher input prices will not abate immediately. In May last year, prices fell and the annual rate may climb further. However, in both June & July last year, prices rose sharply m/m, and the pressure on the headline index should ease, if not prices 'explode' from here. It could happen, but over the coming quarters raw material/intermediate prices will probably calm down, as consumers, at least in the rich part of the world will reallocate spending back to services from goods, where spending is well above likely long term trends, and supply chain bottlenecks are sorted out, as usual. Anyway, it is unlikely that raw material prices will continue upwards at the same pace as over the past year. Higher margins alone is anyway unlikely to push inflation sharply up, over time.
- **The real inflation risk is accelerating wage inflation, as always**. We have so far not seen definitive signs of a broad based take off in wages, even if anecdotes are plentiful (Amazon & McDonalds last week), and data suggest the risk is on the upside. The no. of **unfilled vacancies** soared in March, to the highest level ever, and small companies report that they are not able to fill them, like never before. They anyway plan to **hike their selling prices** more than in decades. The make or break for the length of the recovery & bond yields: Will the end of the pandemic and the extraordinary federal pandemic unemployment programs release a badly needed flood wave of workers? If not, wage inflation will likely accelerate – and higher costs will easily push prices up as demand is strong but still hurting corporate earnings. This is the main risk for bond and risk markets – a whiff of a stagflation scenario. 18 states have decided/are discussing to opt out of the federal unemployment emergency support programs 3 – 4 months ahead of schedule, to make in more profitable to work. For the nerds, 28 pages on US inflation, wages etc in this report ☺
- Other US news last week: **Retail sales** (core goods) fell slightly in in April but March was revised up, and the level is anyway extremely high. Even so, just a small fraction of the stimulus cheques are so far spent. **Restaurant sales** rose further in April and are just 2% below Feb-20, in nominal terms. **Manufacturing production** rose just slightly in April, partly due to supply problems. Auto production fell 4%, even if sales are the best several years. Production is 2% below the pre-pandemic level. **Homebuilders** are still upbeat, as are **NY Manufacturers**. **Nowcasters** are signalling 5% – 11% Q2 GDP growth (and to achieve that, more workers are needed)

Last week: The economy, part II

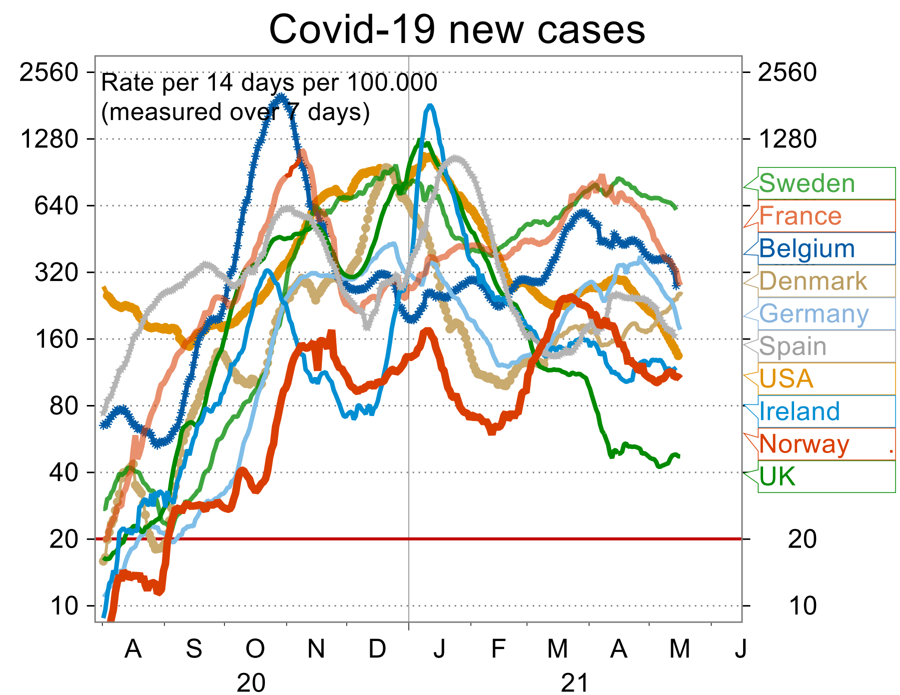
- **China**
  - » Mixed April data**: Industrial production** and **investments rose**, while **retail sales** volumes barely rose and **service sector production** surprisingly fell, all measured m/m (forget 'silly' annual growth rates for some more months). Growth in industrial production is slowing down to the pre-pandemic growth speed, while the level is 3% above the pre-pandemic trend! Investments closed the gap to the pre-Covid trend in April, while retail sales are still below. **Housing starts** have at least flattened, and fell in April, as have **other construction**, while **steel production** still is heading rapidly upwards. **Credit growth** slowed further in April, due to a flattening of credit created outside banks, very likely induced by the authorities measures. **CPI inflation** remains low even if **producer prices** are soaring
- **Japan**
  - » **GDP** fell by 1.3% in Q1, as expected – and GDP is down 2.7% below the Q4-19 level
- **UK**
  - » **GDP** grew faster than expected in March too, by 2.1%. Even so, GDP fell 1.5% in Q1, a tad less than expected – and the level was down 8.7% vs Q4-19. We hope for something much better in Q2 & Q3
- **Norway**
  - » **The Revised 2021 budget** was more expansionary than some expected but the NOK 90 bn (close to 3% of Mainland GDP) increase in the pre-oil structural deficit vs the Oct-20 original budget proposal should not come as a surprise given the huge extra bills that already have been voted on in the Parliament and several leakages of new measures announced before the budget was published last Tuesday. The pre-oil deficit is above the long term spending rule guideline, which it should in bad times. (It has been well below on average the past 10 years). The real test will come later: Will the stated NOK 95 bn 2021 corona-related extra spending disappear? If so, the 2022 budget will be well within the budget rule. If not…
  - » **Mainland GDP** fell by 0.5% in March, as expected or a tad more. In Q1, GDP fell by 1.0%, 0.3 weaker than expected. However, that's history now
  - » **The core CPI-JAE** fell more than expected, to 2.0% in April from 2.7% in April. Food, clothing & airline ticket surprised us at the downside. A stronger NOK, and modest domestic cost inflation do not signal a 'Norwegian" high inflation story. **Construction costs** are soaring due to higher timber & steel prices
  - » **The no. of new vacancies** rose further in Q1, to the 2nd highest level since 2011. All sectors contributed. **New jobless, and continuing claims** are heading down so far in May

Almost all rich countries are on the way down

Denmark against the flow, Norway has flattened, so has UK, at a very low level. All others down



SB1 Markets/Macrobond



SB1 Markets/Macrobond

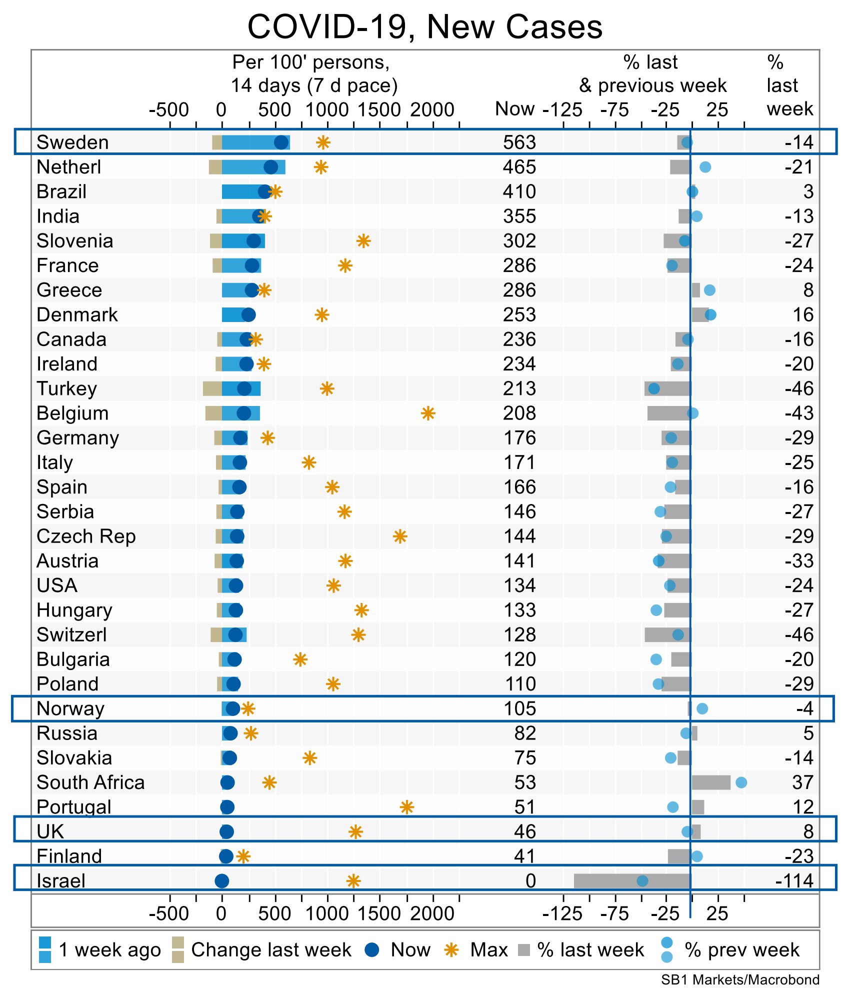
- Vaccines work very well: The no. of new infections, hospitalised, and even more deaths have fallen everywhere in rich countries
- Most rich countries are likely to be able to return to 'a normal life' during the summer, at the latest in August
- The situation in Emerging Markets is mixed, and India is still struggling with it's 2nd wave – with limited access to vaccines & hospital capacity, but at least growth in new cases is now pointing down (as has happened everywhere when mobility collapses during serious outbreaks)

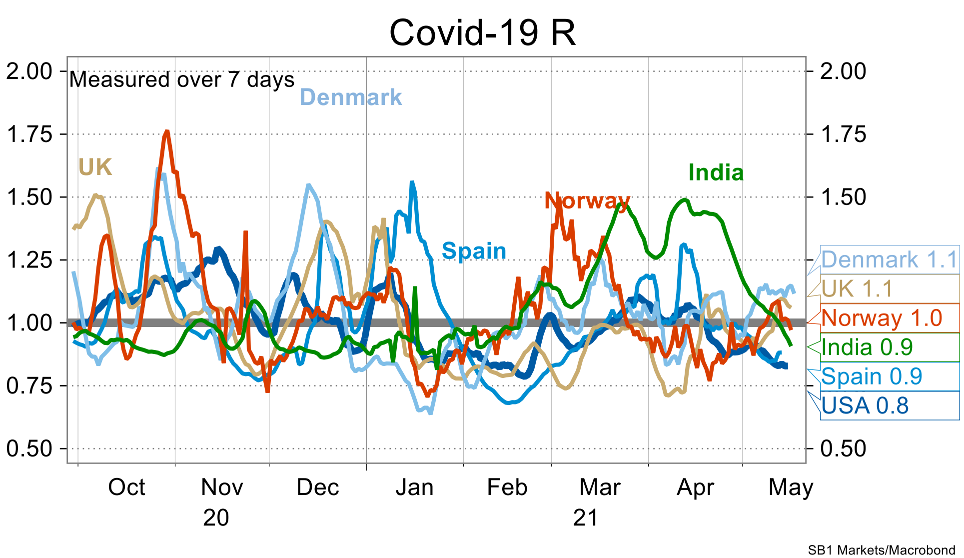
SpareBank 1 MARKETS

Just some very few countries are reporting more cases. India has stabilised

(but we have not analysed Indian testing policy/capacity)

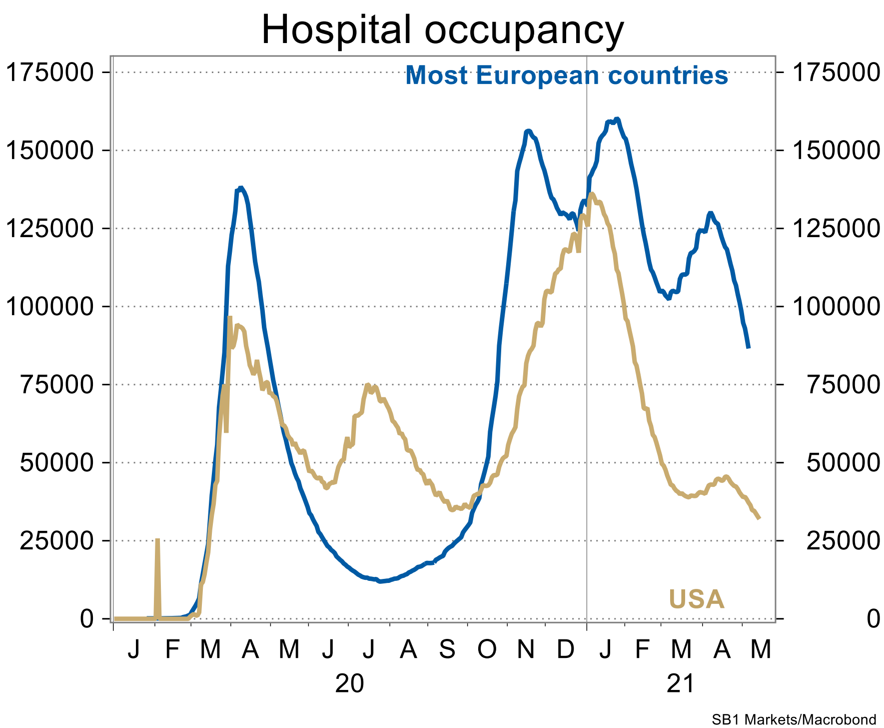
- **The broad decline in new cases continues, and almost all rich countries are reporting fewer cases.**
- **Denmark** is almost the only exception but the level is low – and UK, from a very low level
- **Sweden** is still at the top among rich countries on our list but the no. new cases is finally declining
- In **Norway** the no. of cases has flattened, following a substantial decline (and a slight increase 2 weeks ago)
- In **Israel**, the virus has <u>disappeared. Or they are just preoccupied counting other causalities these days?</u>
- **In India**, the no. of new cases peaked more than one weak ago, if official reporting is to be believed. Mobility has nosedived over the past month

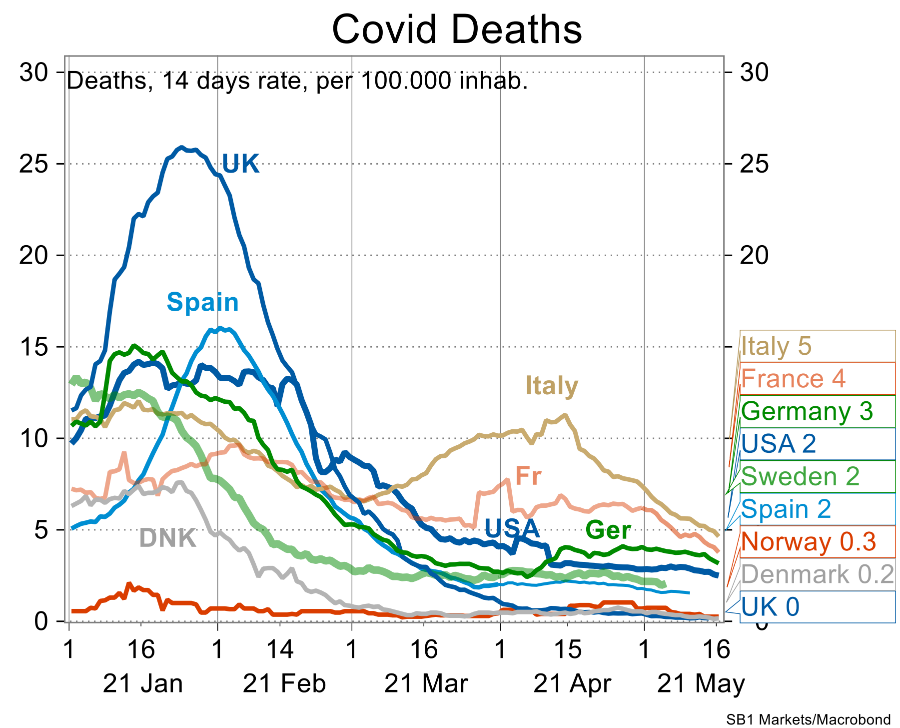




The vaccines are working very well: Hospitalisations & deaths sharply down

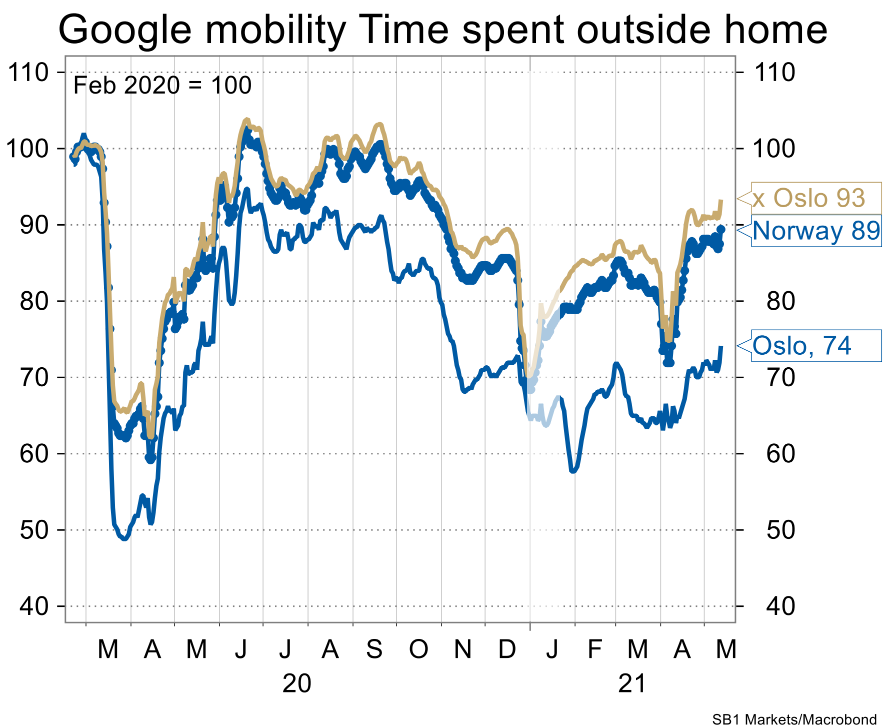
…Even where the no. of new infections remains ‘high’





Mobility sharply on the way up, so far without more cases. Can it last?

More restrictions were eased last week

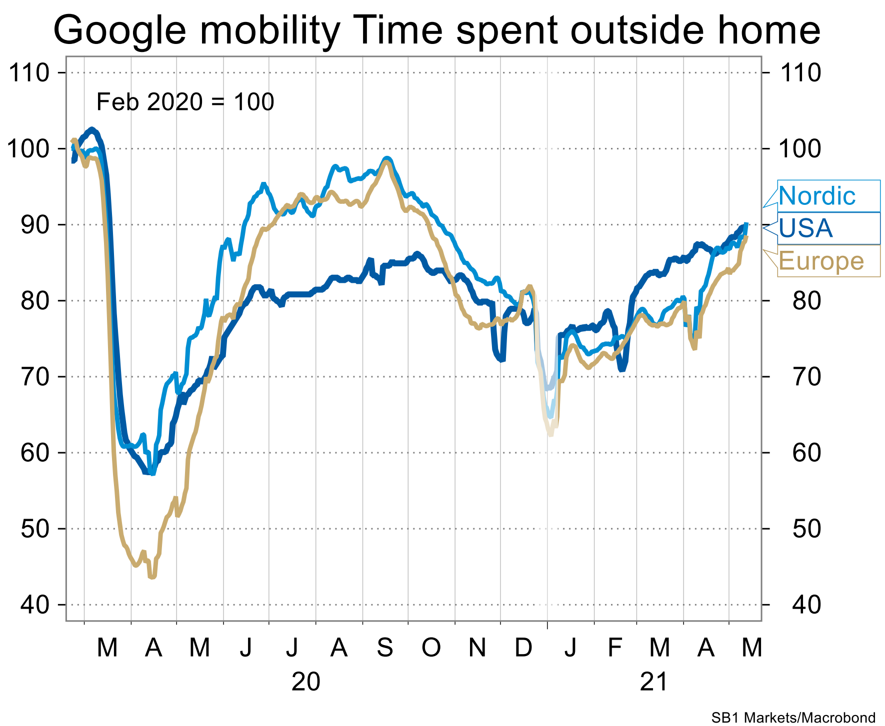


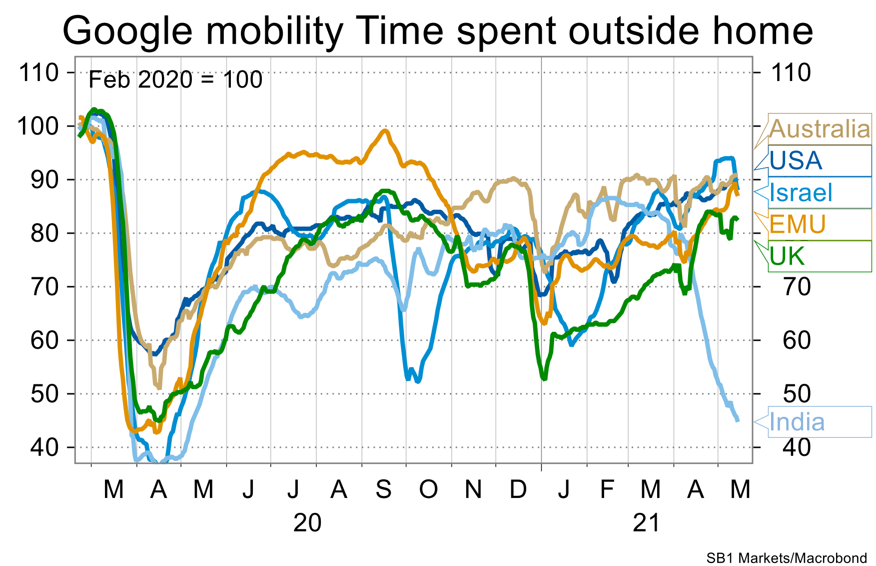
- Some 3% of the population is vaccinated per week, leaves room for more mobility without lifting the R

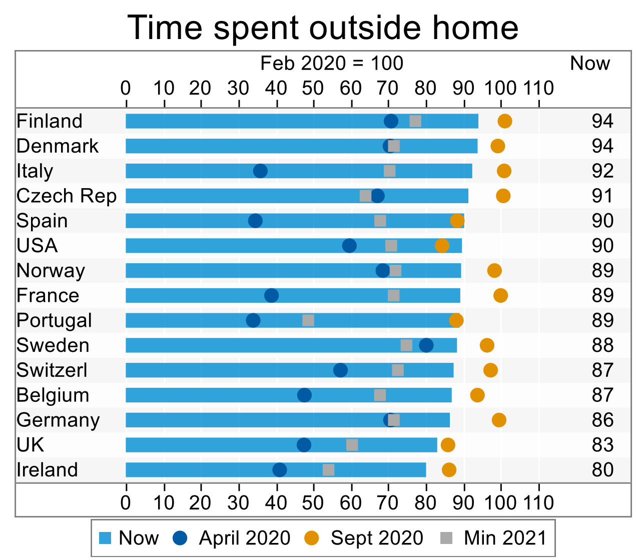
SpareBank 1 MARKETS

Mobility is trending rapidly upwards everywhere

Time spent outside home is on the way up in all rich countries – even in France, from a low level





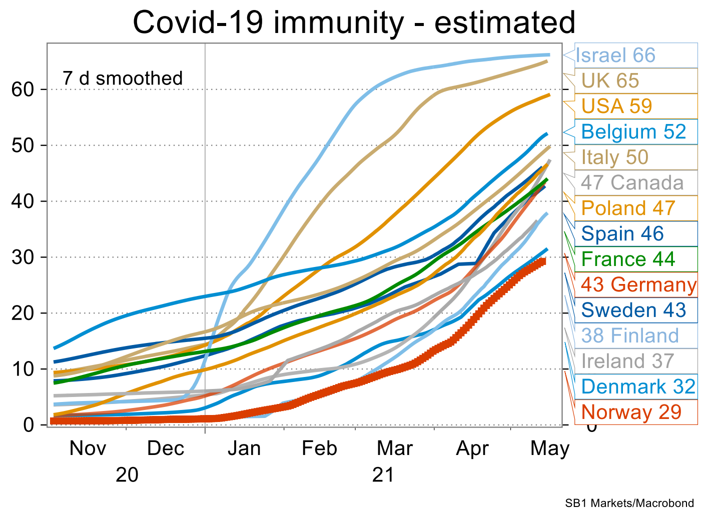


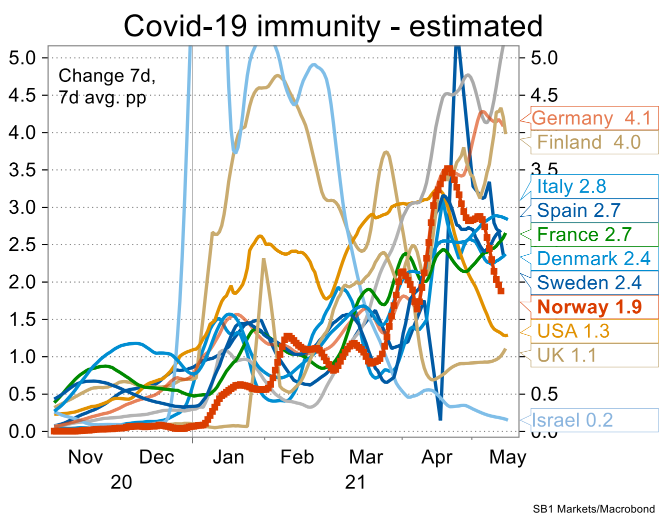
- Mobility still some 10% – 15% below par – which illustrates the substantial social & economic upside potential in the coming months
  - » In Q1, mobility was 25% below a normal level
- Some noice in the data around May 1st and bank holidays (like in the UK & Ireland)

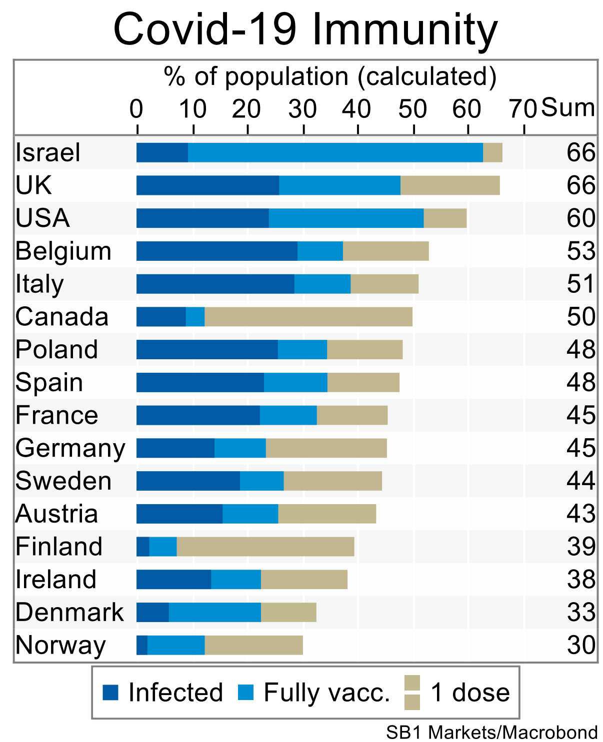
SpareBank 1 MARKETS

Vaccinations: EU/Norway are gaining more speed, 3% are inoculated per week

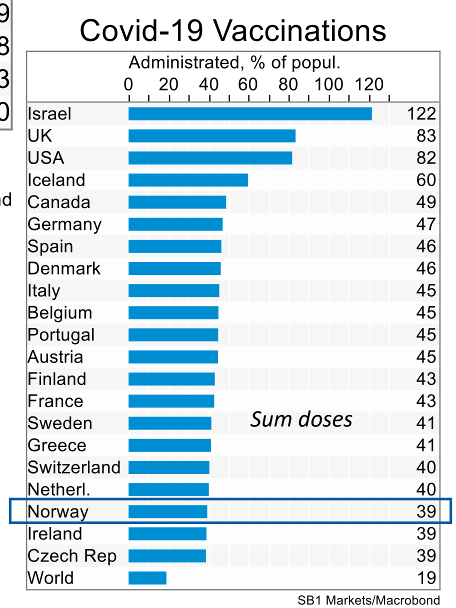
The US is slowing to 1.5%, UK remains below 1% - from high levels







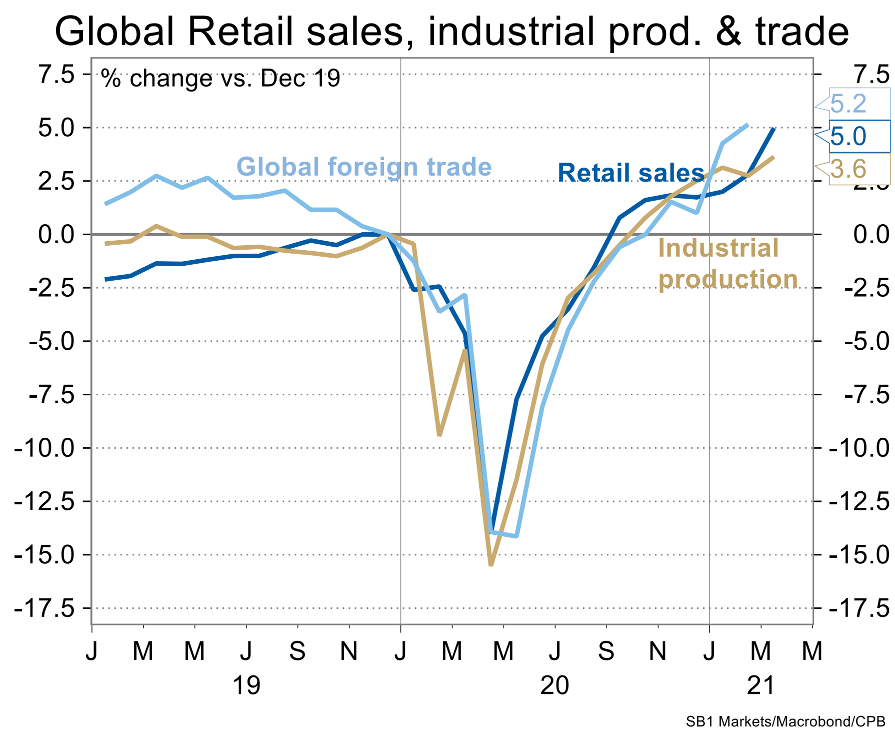
- Norway and Denmark have decided not to use the AstraZenica nor the Johnson & Johnson vaccines, and will lose some momentum vs. other European countries the coming weeks/months
- However, the supply of BioNTech/Pfizer will accelerate sharply from next week

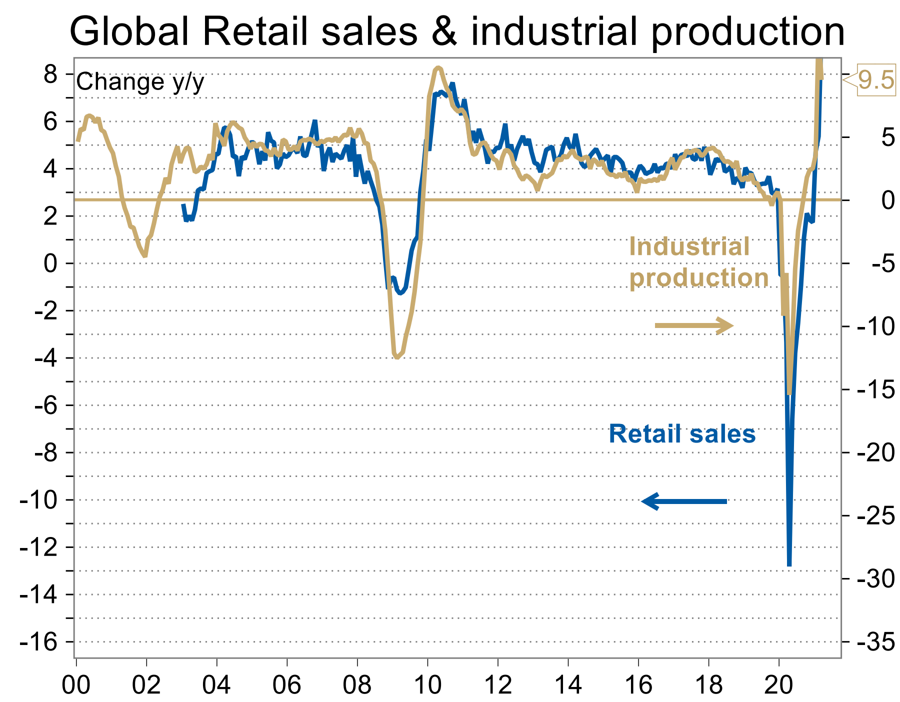


We calculate the infected rate by assuming a 0.66% infection fatality rate, and a 90% immunity from infection.
We assume those who have been infected are vaccinated in line with others

The recovery in the goods sector continues – level up 4% – 5% vs pre Covid

Both retail sales & industrial production sharply up in March. Global trade was strong in February



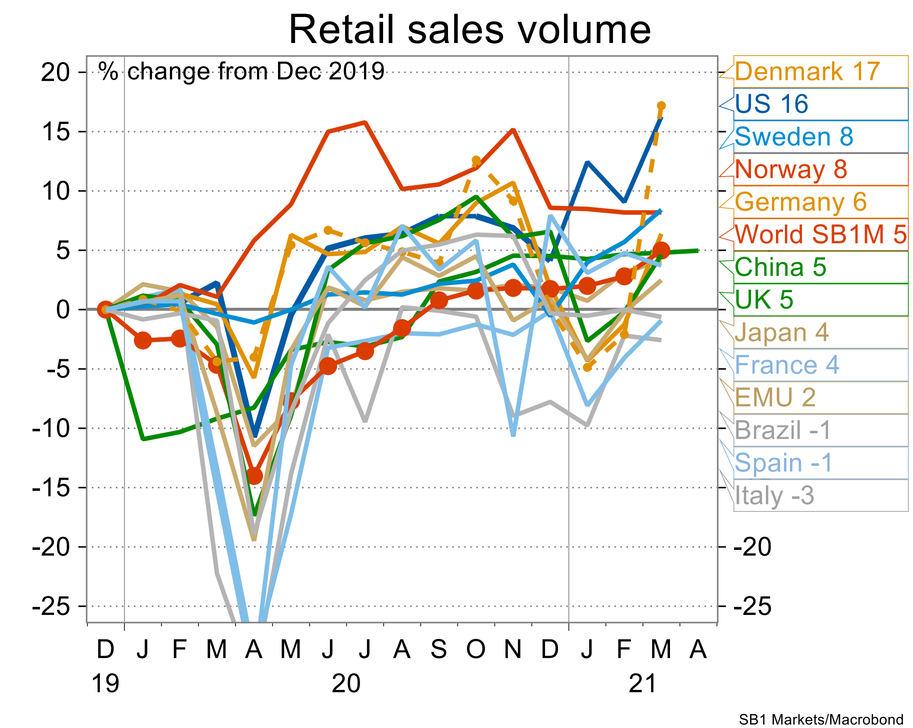


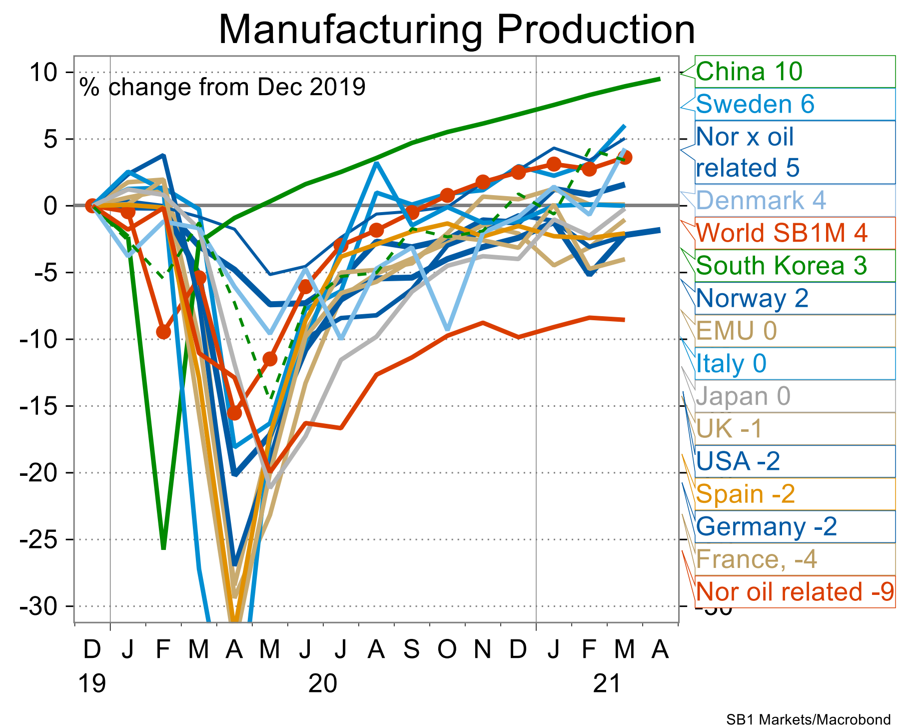
Memo: Keep in mind the different scales at the chart above

- **Retail sales** rose sharply in <u>March</u>, mostly due to the lift in US retail sales (ex. autos!). Global sales are 4.5% above the pre-pandemic level
- **Manufacturing production** rose more than 1% in March (prelim. estimate), and is up 4% vs. Dec-19
- **Global foreign trade** rose further in February, to 5% above pre Covid, according to CBP in Netherlands

Volatile retail trade data, but the trend is still up

Manufacturing production flattened in Feb due to the decline in EMU & the US, up again in March

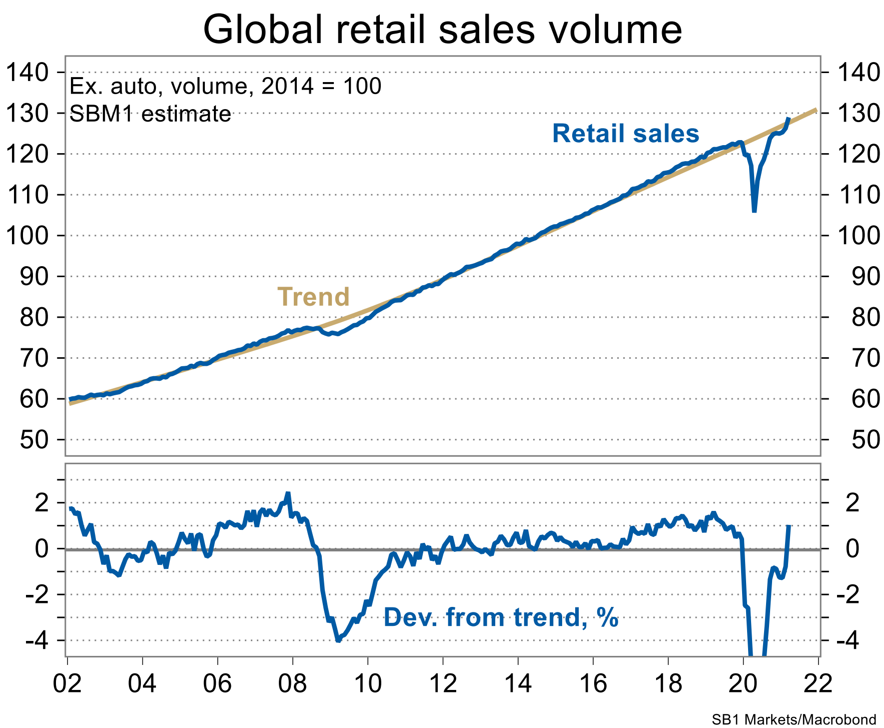


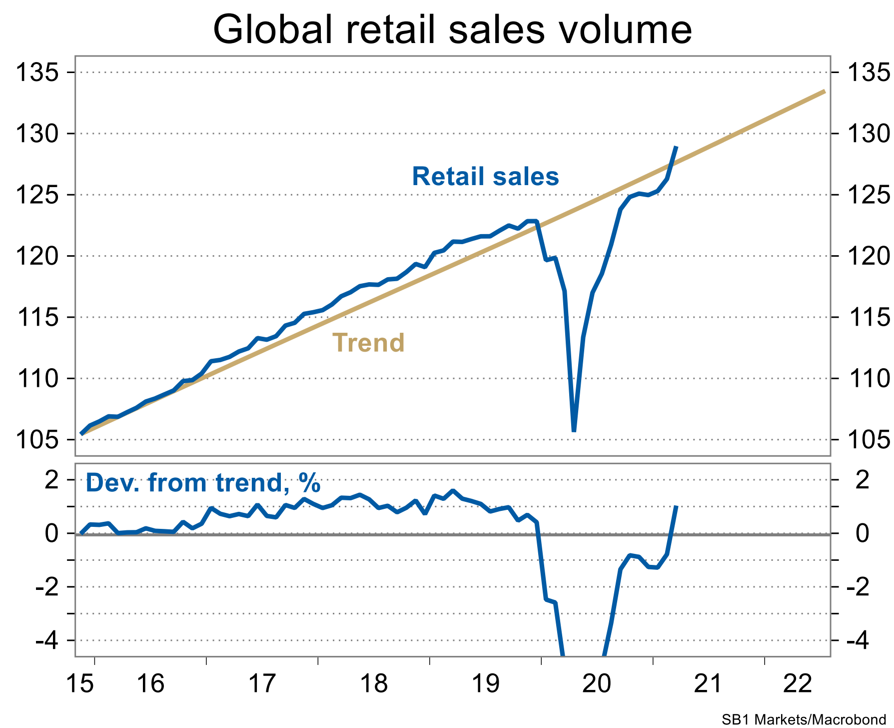


- Global manufacturing production grew some 1% in March
- Retail sale rose much more, following some weaker months where sales in several European countries fell during the 3rd wave

Global retail sales probably at or above long-term trend – but likely not far above

Thus, no reason to expect a sharp post-pandemic setback, globally

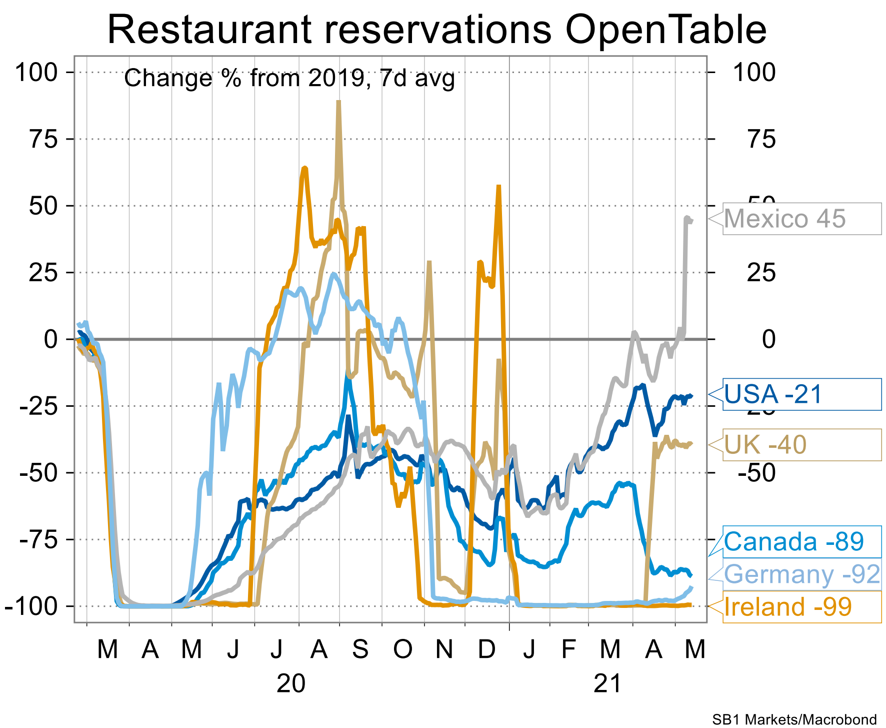


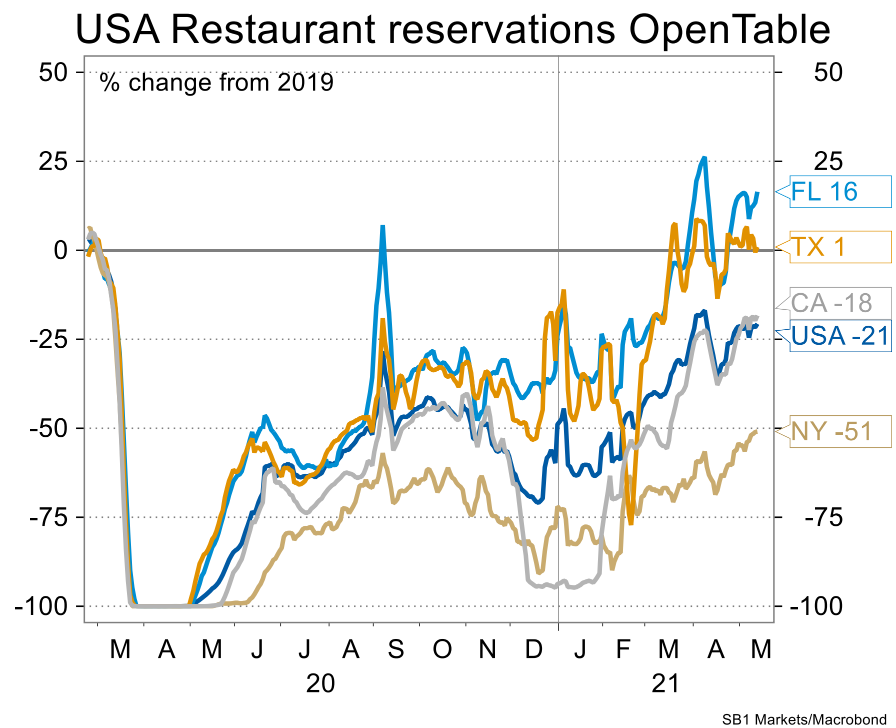


- In several rich countries sales will have to normalise, though (and as Europe now reopens retail sales earlier than most services, that would go for most rich countries, barring Japan)

Some restaurants are still closed, more are opening up

In March, total restaurant sales (including canteens, Mc D, take-away etc) were down 5% vs. Feb-20

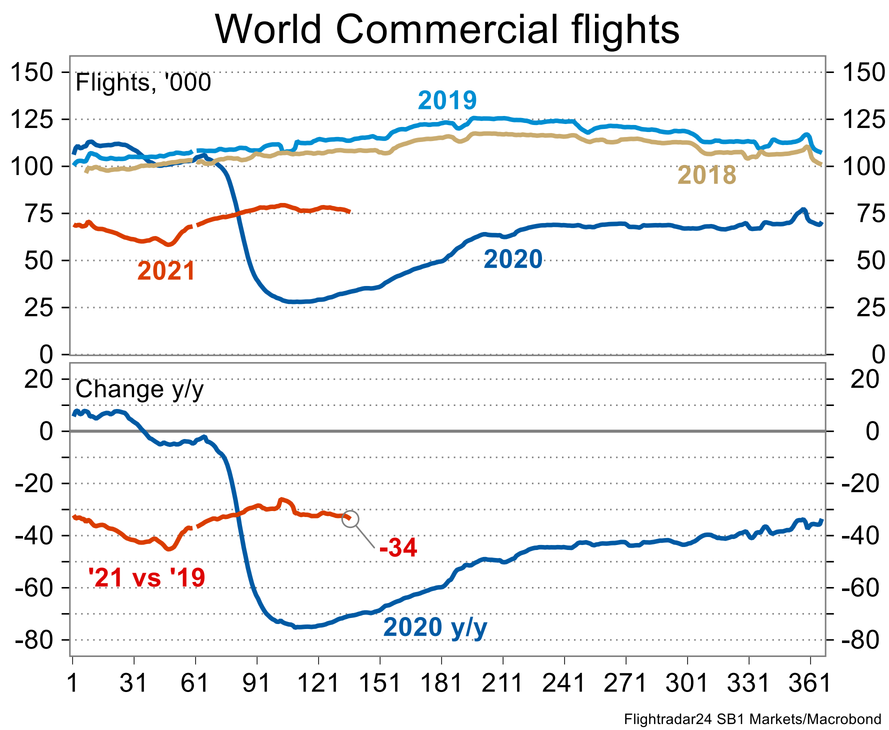


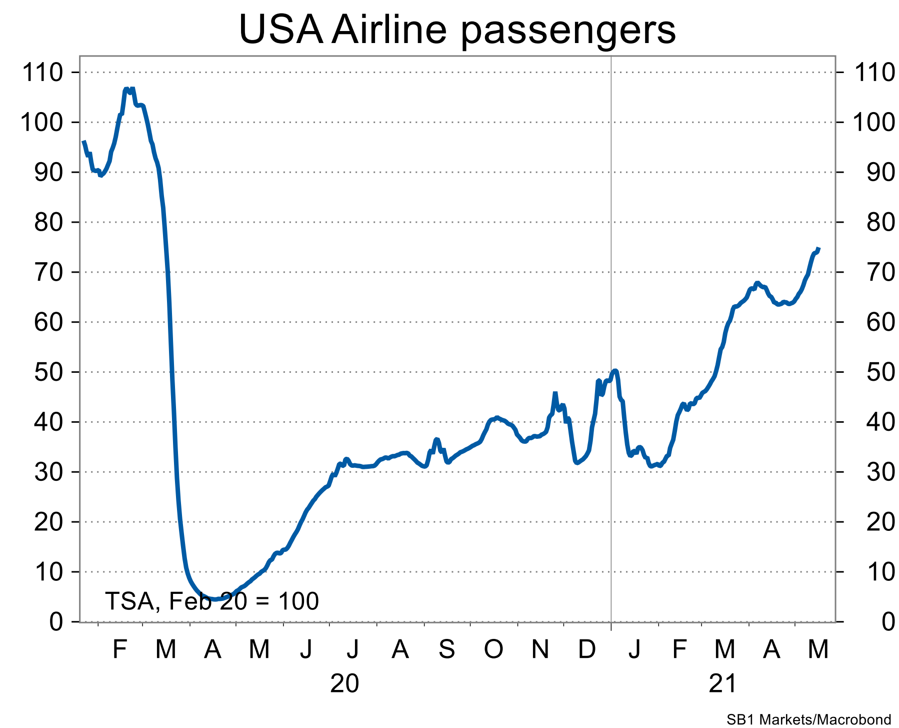


- Restaurants still mostly closed in Germany and fully closed in Ireland, at least those who are tracked by OpenTable
- Sales in restaurants in the US were down 2% in April vs. the Feb-20 level, far better than indicated by OpenTable data

Global airline traffic is... stalling?? No further lift past 5 weeks

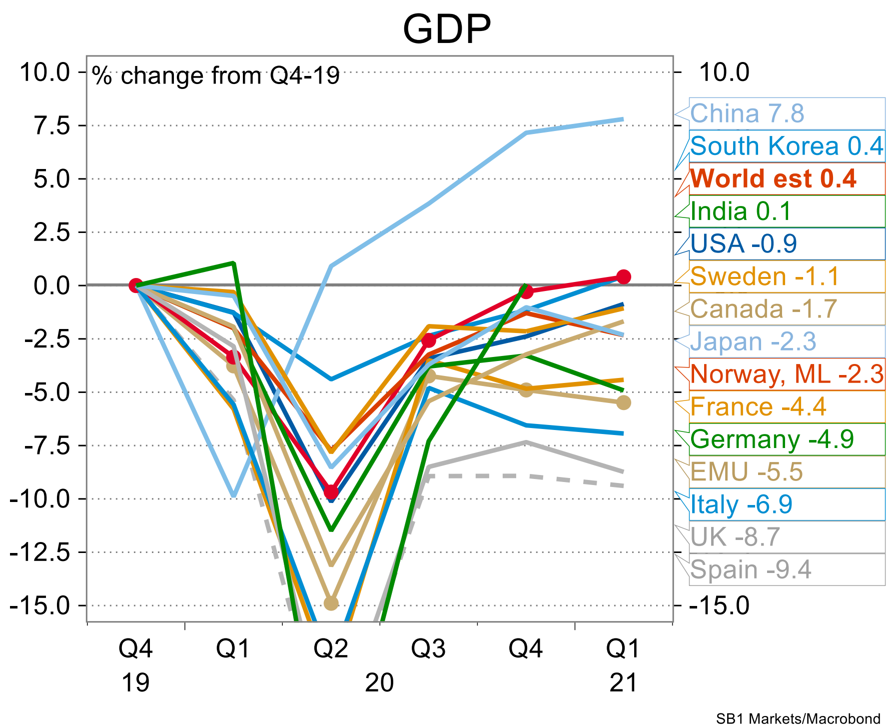
The Indian/Asian Covid wave at least partly to blame? Many more US airline passengers

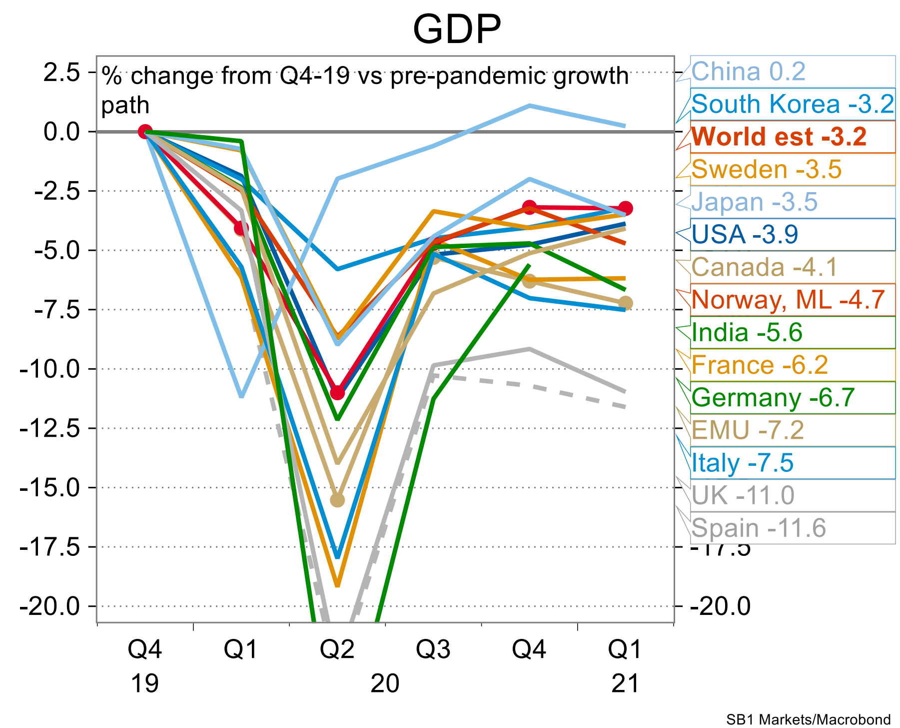




A 3% global GDP growth pace in Q1, level 0.4% above Q4-19

China in the lead, US only down 0.9% vs Q4-19. EMU down 5.5%, UK 8.7%



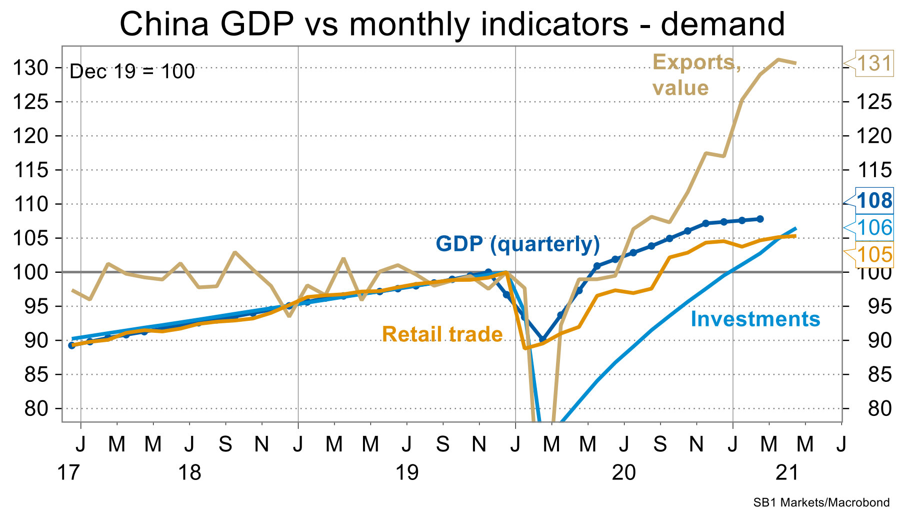


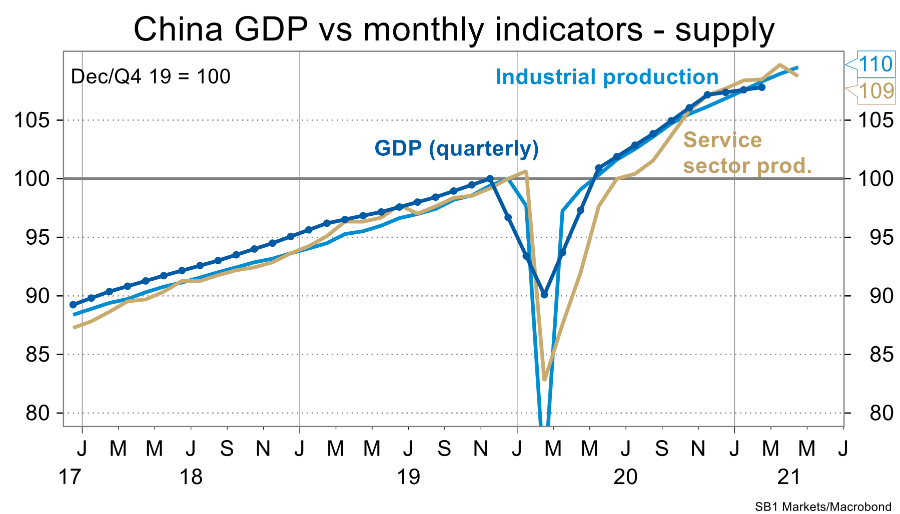
- Following an 8% growth pace in Q4, we estimate 4% growth through Q1 (1% not annualised)
  - GDP growth in **China** slowed to a 'trickle' (a 2.4% pace…), and GDP in the **EMU** contracted further
  - In the **US**, GDP grew at a 6.4% pace, up from 4.3% in Q4 – and the level is just 0.9% below GDP in Q4-19
  - **Sweden** surprised on the upside in Q1, and is just 1.1% below the Q4-19 level
- We expect a far higher growth rate in Q2, as China returns to a more 'normal' growth rate, and Europe (at least) partially reopens

- Accumulated losses in activity vs. the pre-pandemic trend growth (the accumulated pandemic output gap) is substantial everywhere except for China – which has closed the gap
- The global loss is 3.2%, US 3.9%, and EMU is down 7.2%
- Norway is down 4.7% vs. 3.5% for Sweden, due to the different response to the 2nd wave (by Q4, he positions were the opposite)

Mixed April data, retail sales, services at the weak side

Industrial production & investments on the strong tide. Credit growth is slowing rapidly



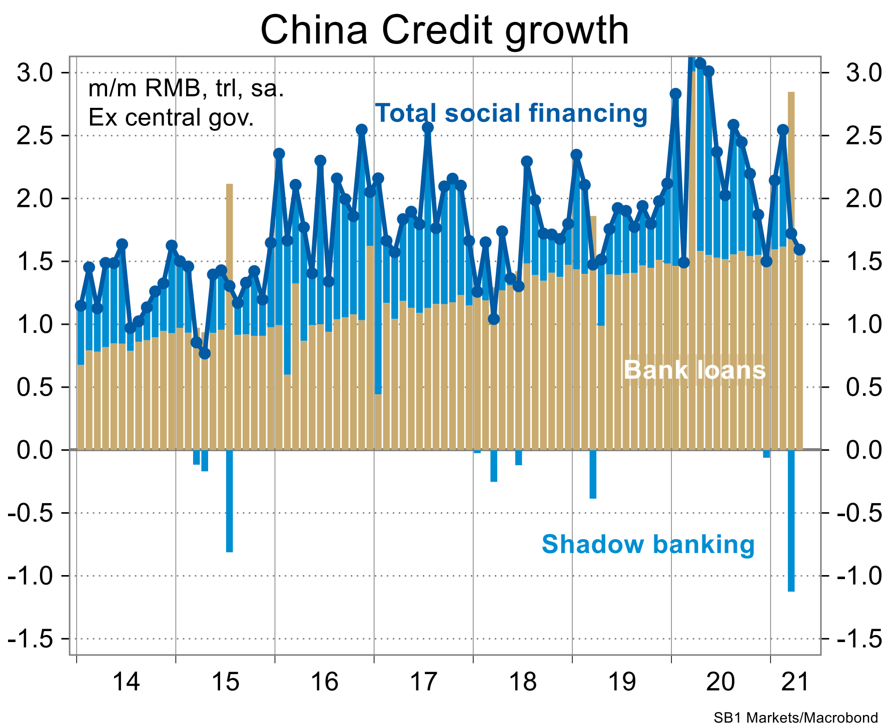


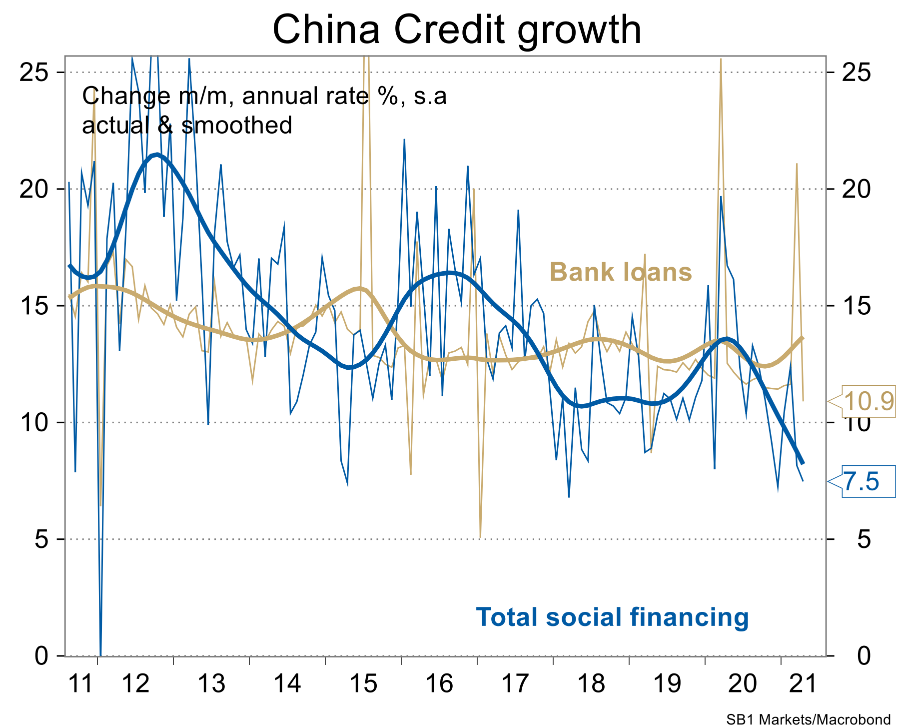
- **Industrial production** rose 0.5% in April, down 0.1 pp vs. March. Measured y/y, production is up 9.8%, somewhat more than expected. Production is 3% above the pre-corona trend path but growth has finally slowed to the pre-pandemic level, as we expected
- **Service sector production** surprised us sharply on the downside in April (-0.9%). Activity is still not weak, following the 1.2% lift in March – and small monthly volatility has not been that uncommon
- **Retail sales volumes** were revised down this month (the opposite in March) and sales barely rose m/m in April. Expectations were far too high, and the 7 pp y/y miss is irrelevant
- **Investments** finally came back to the pre-pandemic growth path in April, and growth m/m has slowed but remains far above the 2019 level. **New home sales** fell in April but remain strong. However, **housing starts** are sagging, and so are **non-residential construction** starts. **Steel production** is still expanding, and so are net steel exports
- **Credit growth** slowed in March and further in April, as credit outside banks are curbed, very likely by purpose
- **CPI inflation** remained low in April but producer prices are soaring (which is felt more outside China than inside)
- **Last week: Exports** & **imports** remained very strong in April

In sum: Covid measures held parts of the back economy somewhat during the festive season but March data signals full speed ahead

Credit growth is slowing sharply – impacts will be felt in many corners

A slowdown in the shadows, bank lending is keeping up

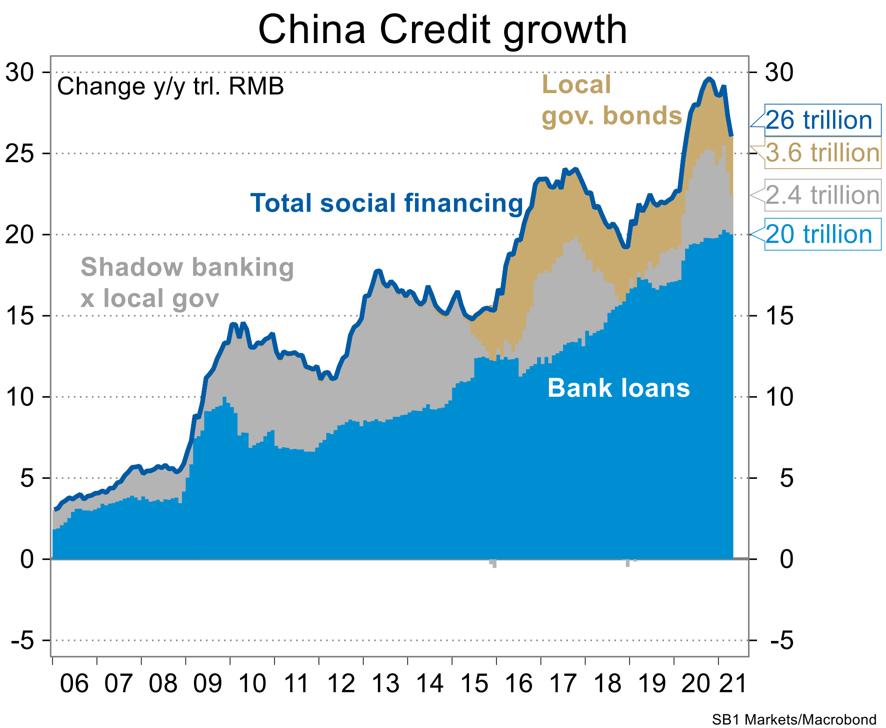


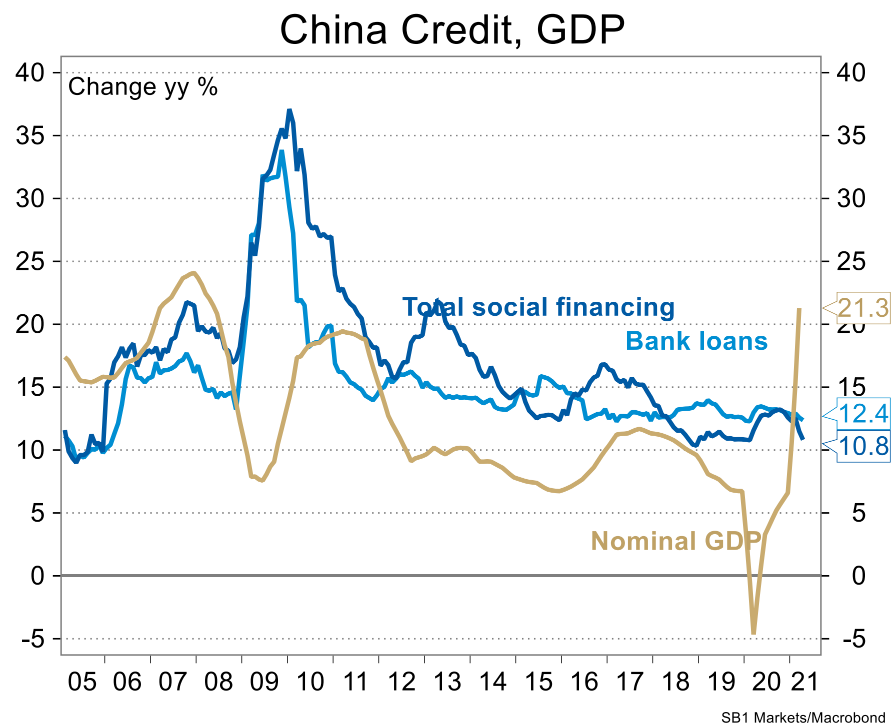


- In April **total credit** grew at just a 7.5% rate (m/m, annualised), down from 8.5% in March. Smoothed, the underlying rate may be some 9% - 10%, down from 13% during last spring (and >15% during some months). A 9%-10 % growth rate is still somewhat above trend growth in nominal GDP
  - » **Total credit** rose by RMB 1.9 trl, expected 2.3 trl (not seasonally adjusted, total social financing, including central & local government bond, and corporate equities). Seasonally adjusted the core total social credit (total ex central gov bonds & corporate equites) grew by 1.6 bn, down from 1.7 bn in Feb. The annual rate fell to 10.8%, down from 11.5%
  - » **Bank loans** rose by RMB 1.6 trl, both actual & seas adjusted. Bank loans are up 13% y/y
  - » **Shadow banking credit** was unch in April, following the unprecedented RMB 1.1 trl decline in March (equalling 1.4% of all outstanding credit outside banks!)
- **The Chinese authorities** have signalled that credit growth outside banks should slow, and it has been growing slower than bank credit since early 2018, barring an uptick during the pandemic last spring (when all stimulus was needed). The contraction in shadow banking credit over the past year equals 5% of total cred

Credit growth curve has turned south

As it usually does, every 3rd - 4th year. The turnaround now is not faster than before (in percent. p.)

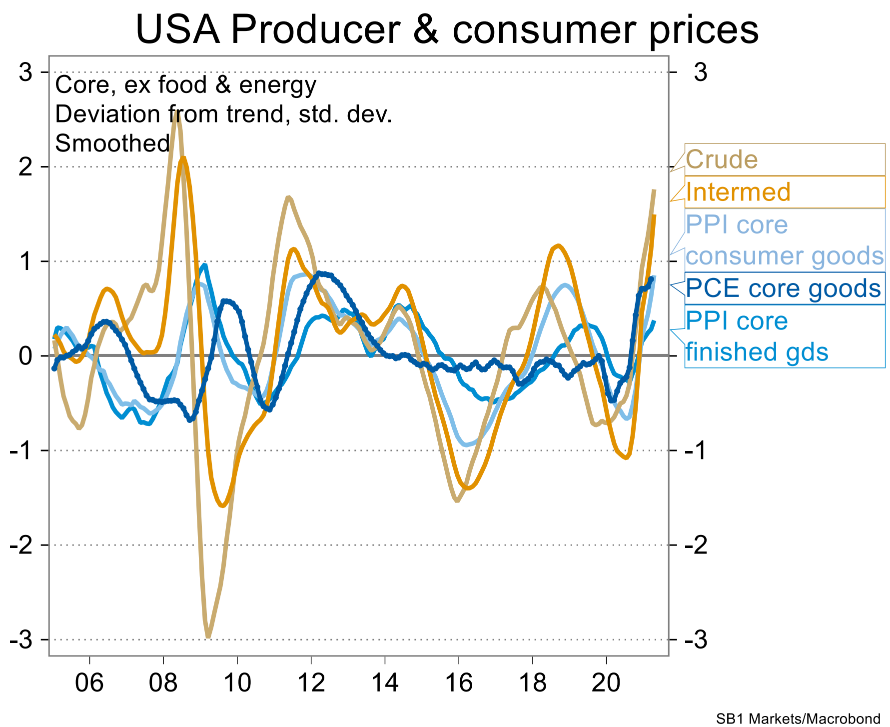


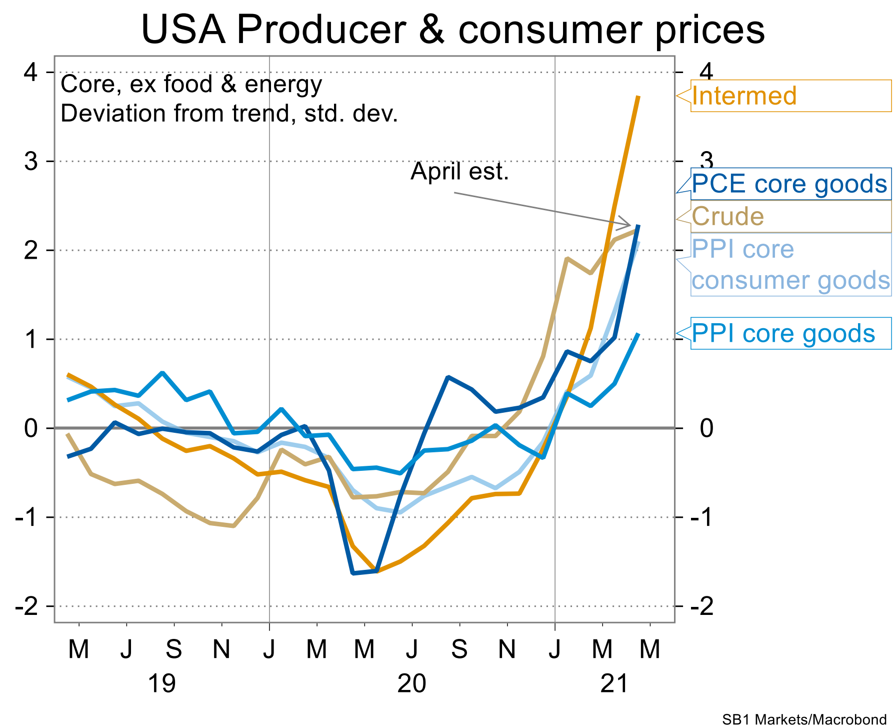


- Over the past year, **total credit** has expanded by CNY 26 trl, equalling >25% of annual GDP, down from CNY 30 trl at the peak
- Banks supplied CNY 20 trl of the y/y increase
- **Local governments** have not yet accelerated their borrowing by much, at least not in the bond market, still up 3.6 bn y/y
- Other credit – via the **shadow credit market** x local gov bonds gained speed last spring but has slowed substantially in recent months just up 2.4 trl (from +5 trl!)
- **Total credit** growth at 10.8% is well above nominal GDP trend growth (but below the y/y high growth rate in Q1)

It's not brewing, it's boiling: And it is still getting hotter

Crude & intermed. goods prices are still on the way up, expect more pressure on finished goods

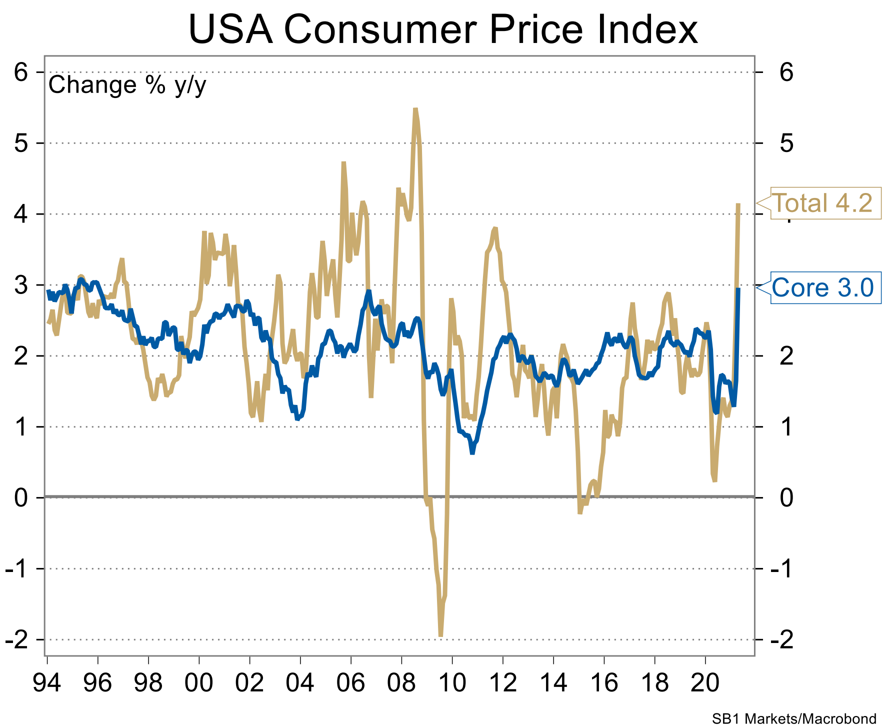


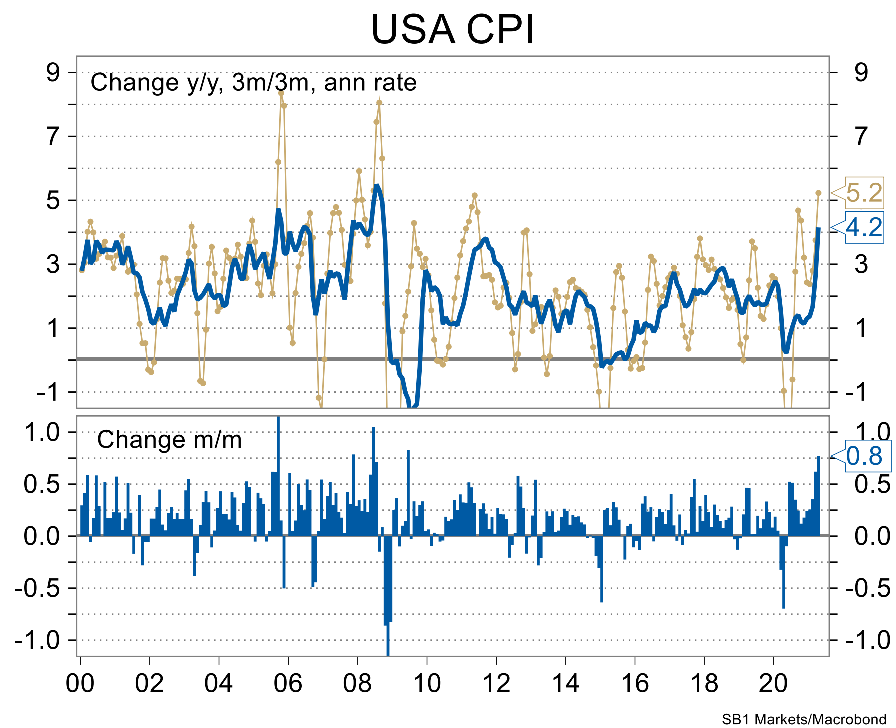


- Delivery times & prices are on the way up – and production is increasing rapidly. Hmm…
- It seems likely that finished goods PPI will climb further, given the continued increases in crude & intermediate goods
- Crude goods prices are leading intermediate goods by 4 months, and consumer prices by 12 months – and crude prices have not yet peaked
- Some comfort: Prices at the consumer level have already responded to the hike in producer prices, and the upside risk for the PCE from here may not be that large (we have added a 1% m/m forecast for the core goods PCE in the chart above)

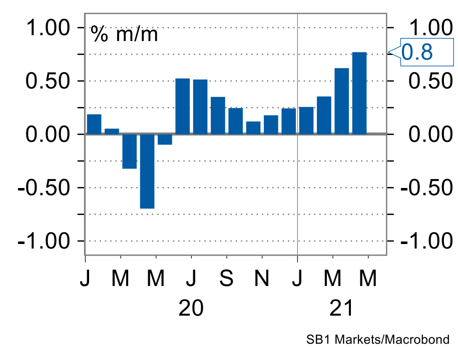
3% – 4% inflation, well above expect., and the base effect is not the only to blame

Highest monthly & annual increases in 12 to 40 years. Fed's patients may well be seriously tested



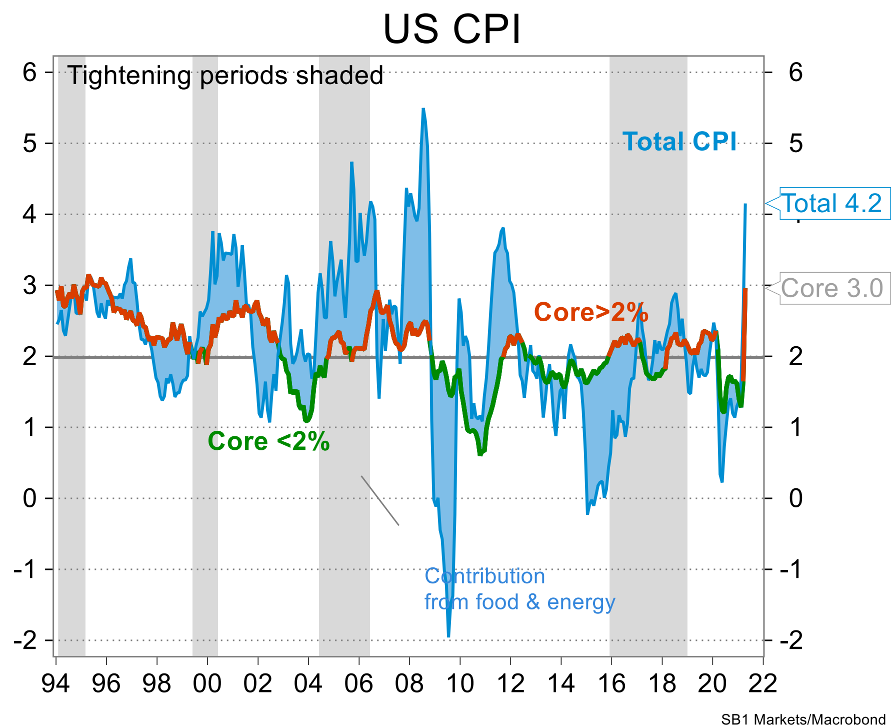


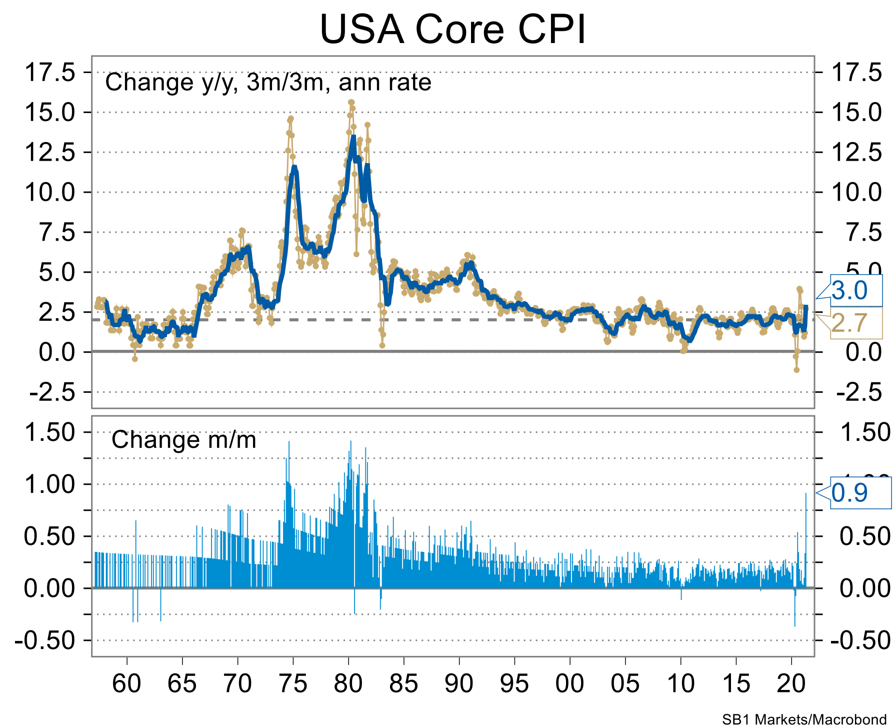
- **Headline CPI** rose 0.8% m/m in March, expected 0.2%. The annual rate rose by 1.4 pp to 4.0%, as prices fell 0.7% last April. This is the highest CPI print both m/m & y/y since 2009
- Prices have been accelerating m/m since last October, and the 3m/3m rate is now up to 5.2%, highest since 2009
- In April surveys, companies reported that they expect to lift prices sharply. We doubt all planned price hikes were competed by mid April…
- The annual rate may increase further in May, but in both June & July last year prices rose sharply m/m
- The Federal Reserve can still afford to wait and see, but the 2% average inflation 'over time' is already reached and communication will have to become more nuanced, with more assessment of the upside risks on inflation than until now. The Times They May Be A'Changin', Jerome
- Many more details on prices & wages at the following 26 pages ☺ (if you include the previous 3 pages that is)



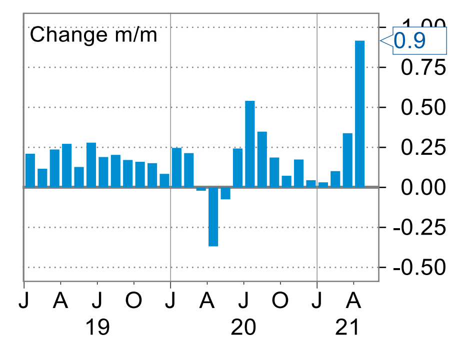
Core inflation sharply up too, auto prices mostly to blame

Prices +0.9% m/m in April, expected 0.3%, the y/y rate jumped 1.4 pp to 3.0%, highest since '96



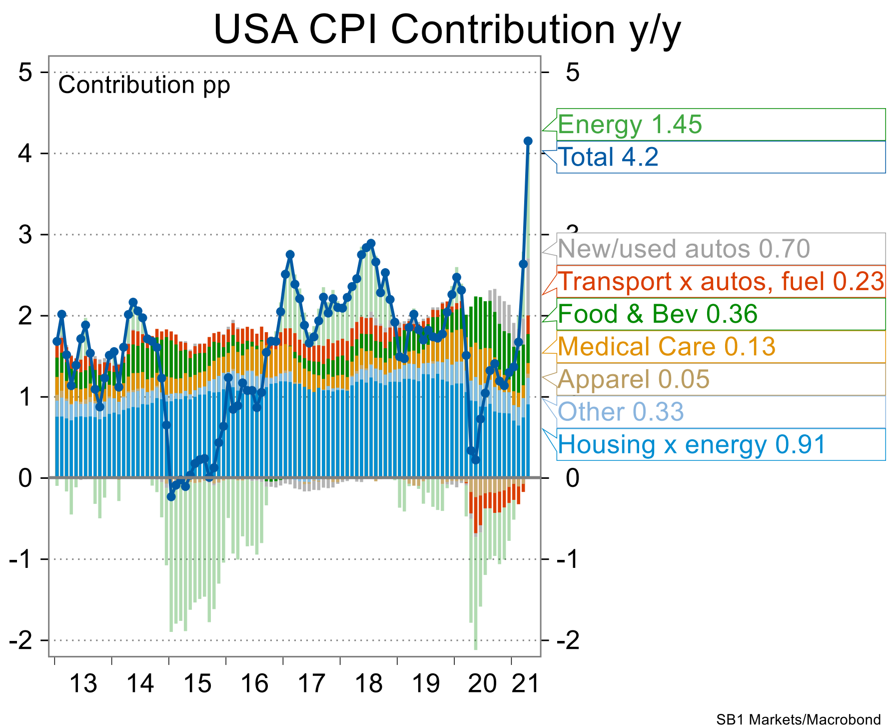


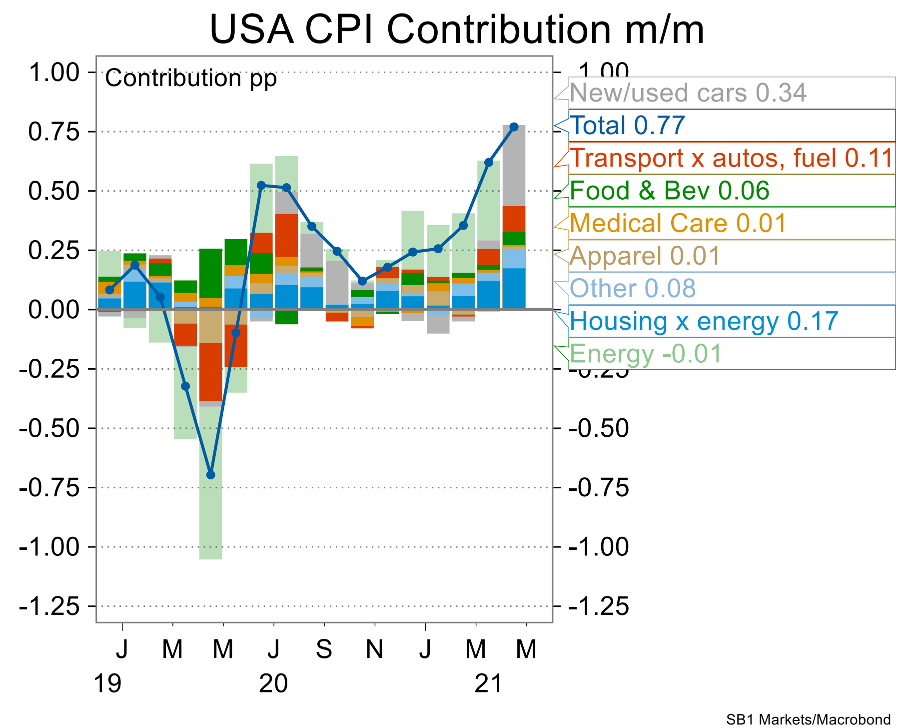
- The 0.9% m/m hike in the **core CPI** was the highest since 1981
  - » Until the April 'shock' the 3m/3m underlying price growth at 1.2% did not signal any serious pressures
- The price hike in April was at least partly due to one-offs which will not be repeated, or will be reversed
  - » Auto prices seem to be a candidate on the downside
  - » However, some prices are still too low, like lodging, transport & recreation – sectors that should be able to lift prices during the reopening process
- Prices fell 0.1% m/m in May last year. Don't bet that trick will be repeated this year…



Transport contributed by 2.2 pp of the 4% annual headline CPI y/y growth

... Of which half from auto fuel, but new/used vehicles are sharply up too



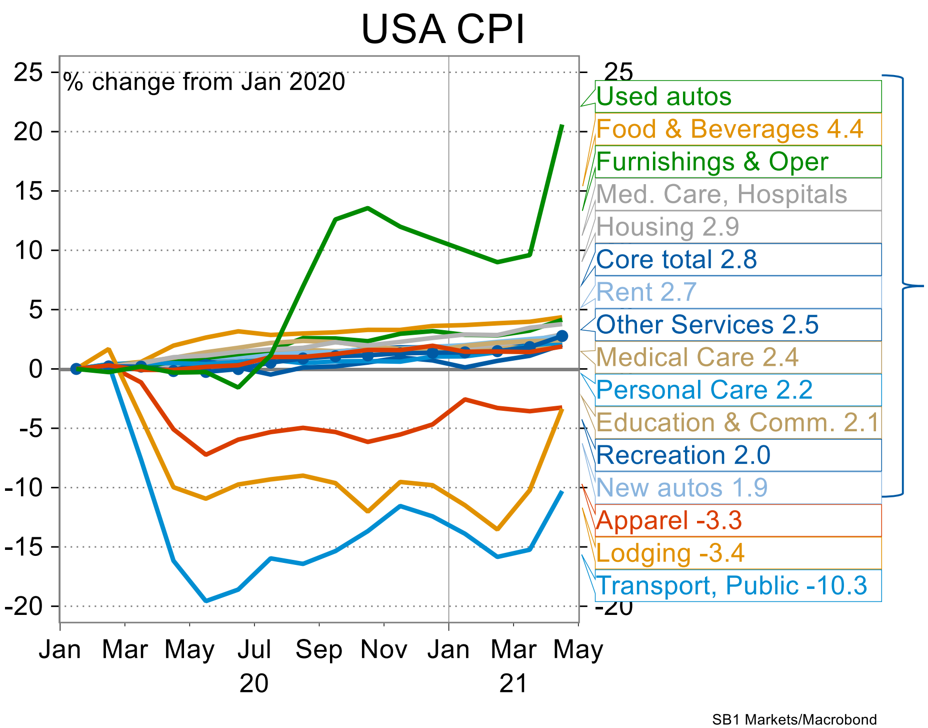


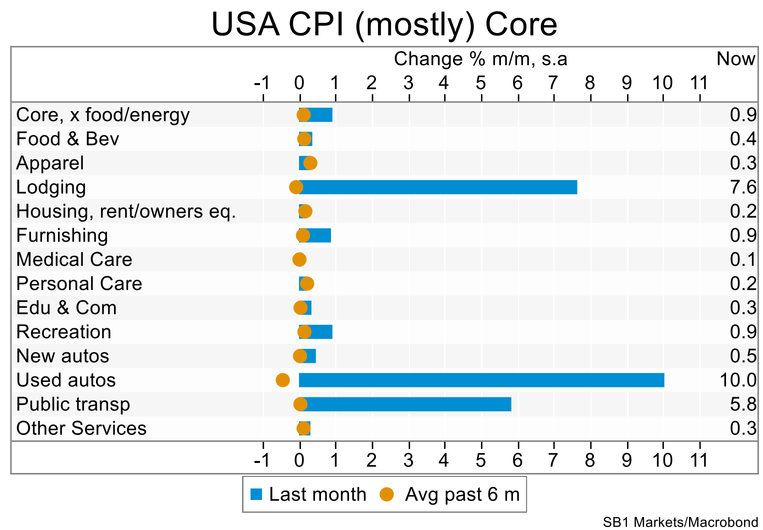
- In April, **new & used cars** explained almost half of the m/m lift in total CPI, and 0.7 pp of the 4.2% growth in headline CPI
  - » Used car prices rose 10% in April, and are up 20% y/y. They are probably to expensive now, but not necessarily that much. The upside must be limited, though
- **Energy** has lifted the headline CPI by 1.5% last year (but was not to blame for anything in April, as oil prices have flattened. If the oil price does not skyrocket from here, the contribution to the annual growth rate from energy will quickly fade
- Excluding the 2.2 pp **contribution the headline CPI from energy & cars**, "remaining" inflation is still at 2%, and quite stable. Thus, the sharp acceleration in headline & core CPI is not that broad

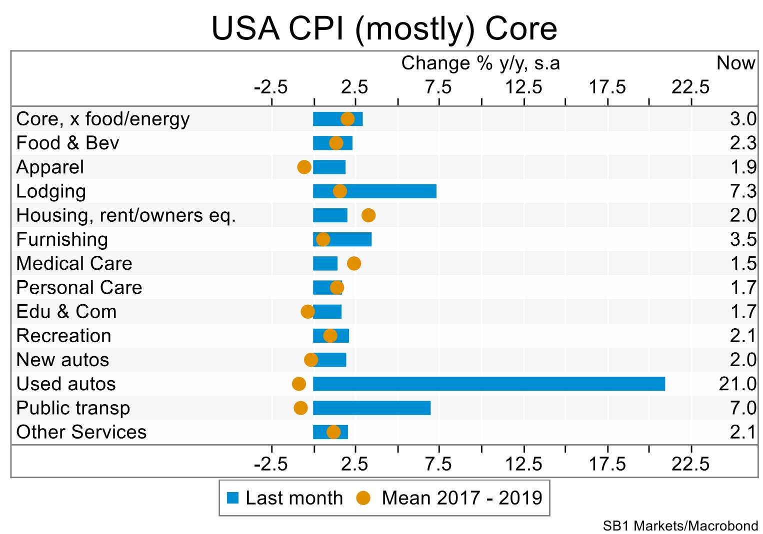
Lodging away from home is a part og housing at the charts above

Lodging up 8% m/m - still some more to go. Public (air) trasp. +6%, still too cheap

Used auto prices up 10%, +20% vs pre-pandemic! Too high? Somewhat, check next page



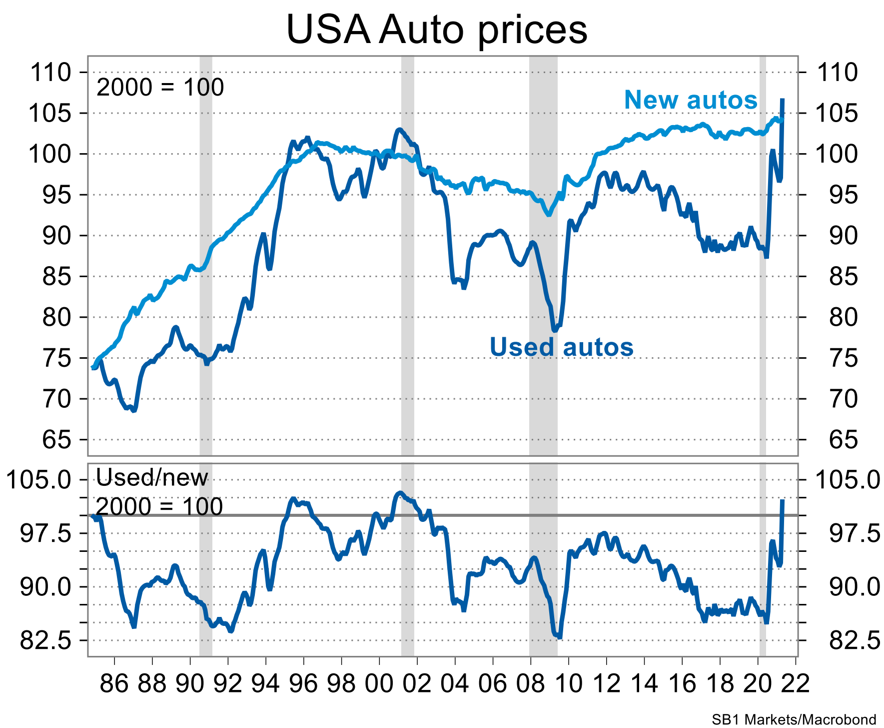




- Just some few components of the CPI contributed to the 'corona' setback: **Public transport** (airline tickets) **lodging** away from home (hotels ect), and apparel. Other components of the CPI have not slowed
- Now these sectors are hitting back, bringing their prices up to more normal levels again
- **Used auto prices** have been on the way up since last summer – and shot up in April

Are 2nd hand cars too expensive following the 20% lift?

Very likely. But they were too cheap before the pandemic too?

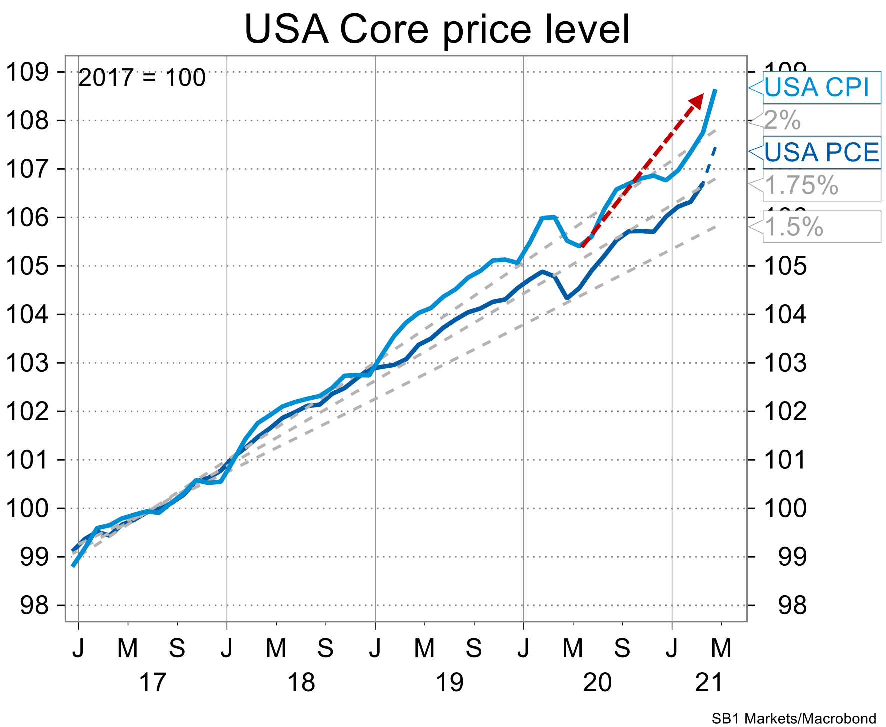


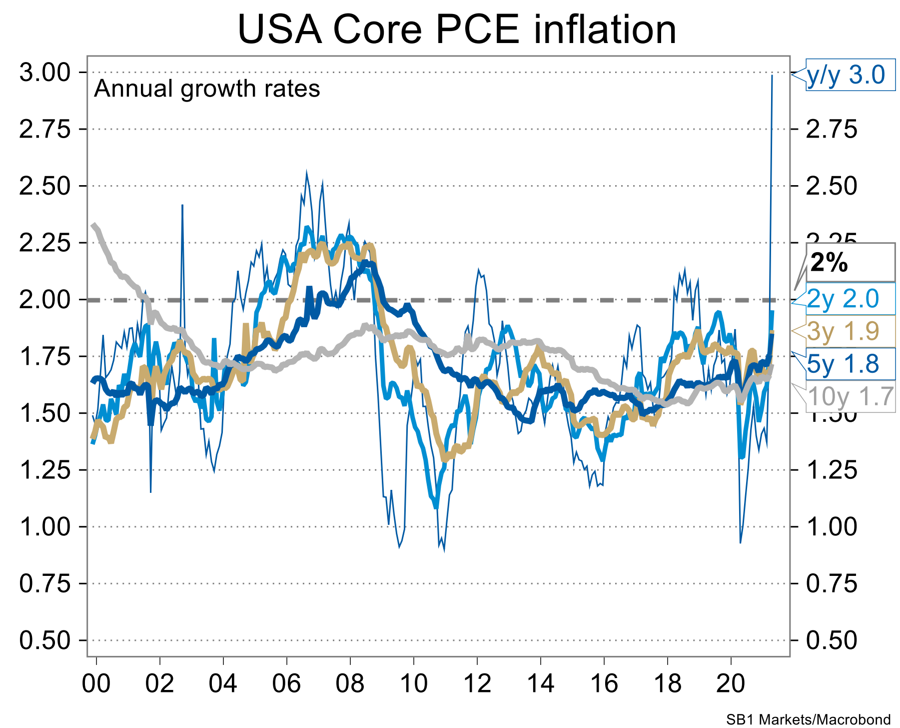
- By the way, prices for **new autos** are up 3% since 1996, quality adjusted, that is. And until the recent price hikes in a very tight US auto market, 2nd hand prices were down 10% the past 25 years (quality adjusted)
- It is impossible from these data to be sure if there is an equilibrium between new and used cars – and even less what it might be. Still, the current used auto prices seems to be stretched vs new autos

What if average PCE inflation is 2%? Well, it is – or at least not far below

Federal Reserve has rephrased its inflation target: Will aim for 2% inflation over time

At the charts below: We assume an 0.7% increase in the core PCE in April

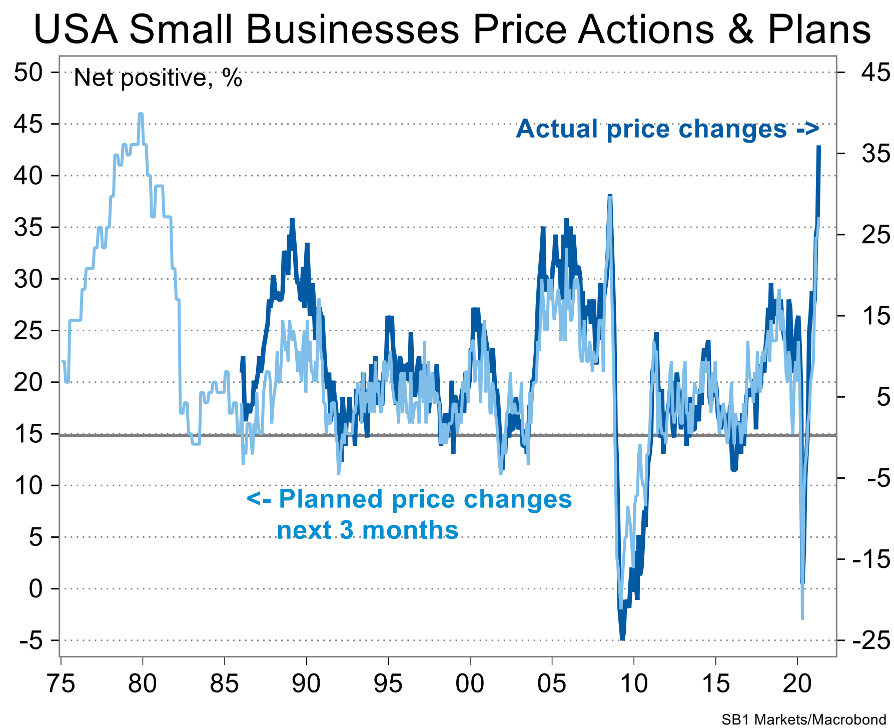


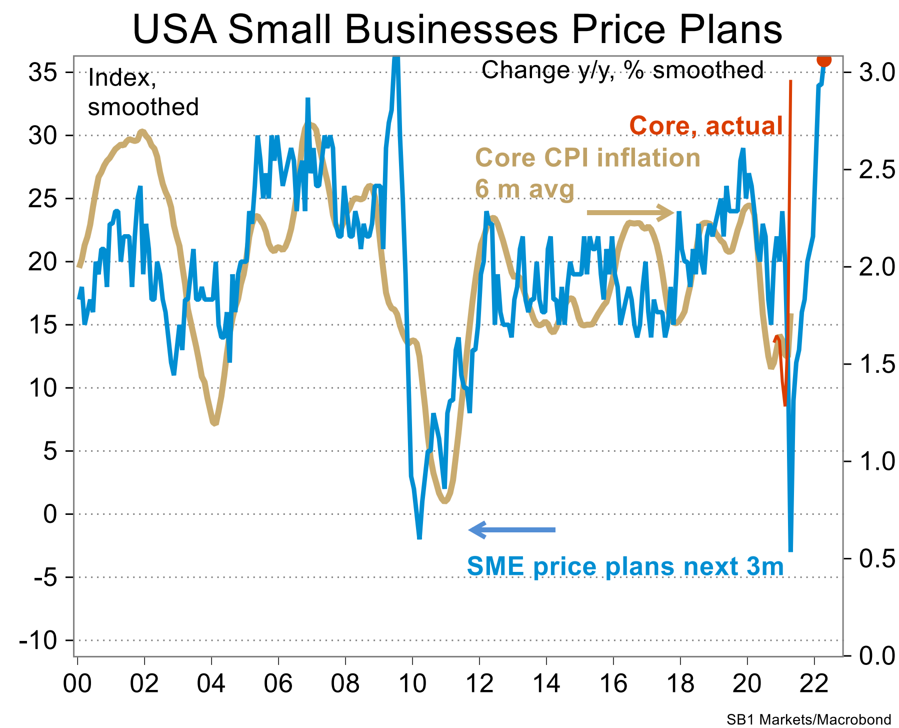


- … and not for each and every year. So, if inflation has been too low, like until now, the Fed will aim for pushing inflation to above 2% for a while, to reach 2%, over time
- The Fed has not defined its **time horizon**, should the average 2% inflation target be reached over 2, 3, 5 or 10 years? We guess 2 years is too short, and 10 years is a too long period. So something around 3 – 5 years?
- If so, given a fair estimate for the core PCE (the deflator for personal consumption, Fed's preferred price measure) in April, the 3 y rate is now 1.9%, and the 5 y rate 1.8% - thus not much below 2%. At the chart to the left, the core PCE price level now is not far below the 2% line, starting at the average price level in 2017 (4 years ago)
- **Measured vs. the CPI**, the average core inflation is at or above 2%, whatever period we check, see next page
- The 3% y/y lift in prices in April is of course both due to the price cuts last April – but even more due the brisk increase in prices past (check the red arrow)
- **Inflation expectations** are way above 2% in markets & among households and very likely among companies as well

SMEs' selling price expectations confirmed at the highest level in 12 years

And more companies than ever before say they have already increased their prices

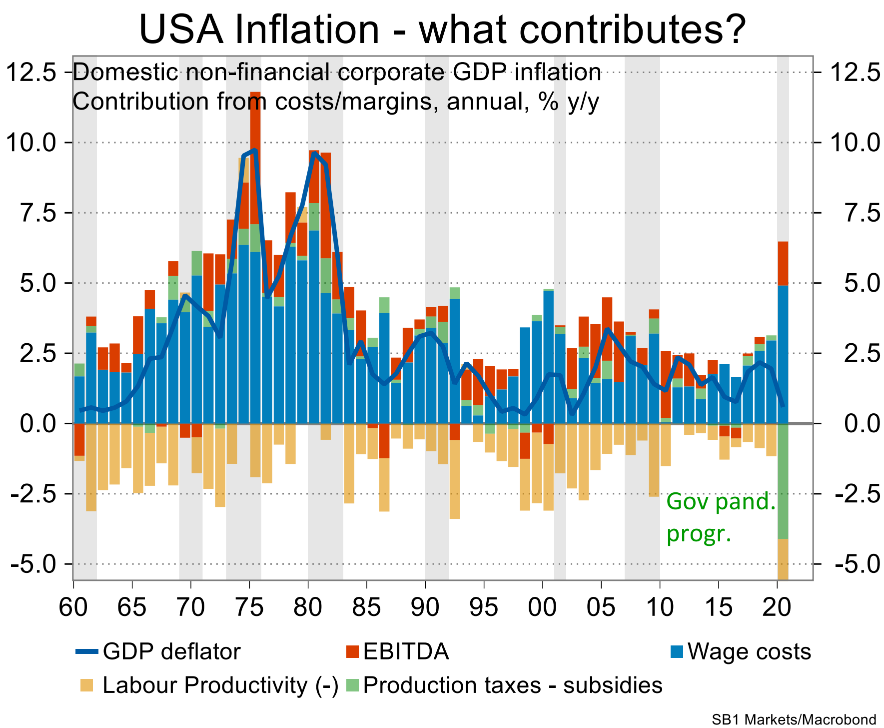




- Early last week we wrote:
  - » *Seems like we may have to change the scales on two axes on the chart to the right, we wrote early last week.*
  - » *At least on the left hand side of the chart, as the red dot climbed to 35 (per cent of companies that planned to hike prices, net). However, that does not have any direct consequences, of course*
    But what if we then have to change the scale on the right hand side axis too? Would that be a bigger problem, Jerome??
- At Wednesday we almost had to adjust the right hand side axis! The core inflation rate shot up to 3.0%, just what the SME's had signalled (if not measured by our 6 m smoothed average)

Higher inflation, how worried should we be?

Raw materials, higher margins are not the main challenge. Wages may become so

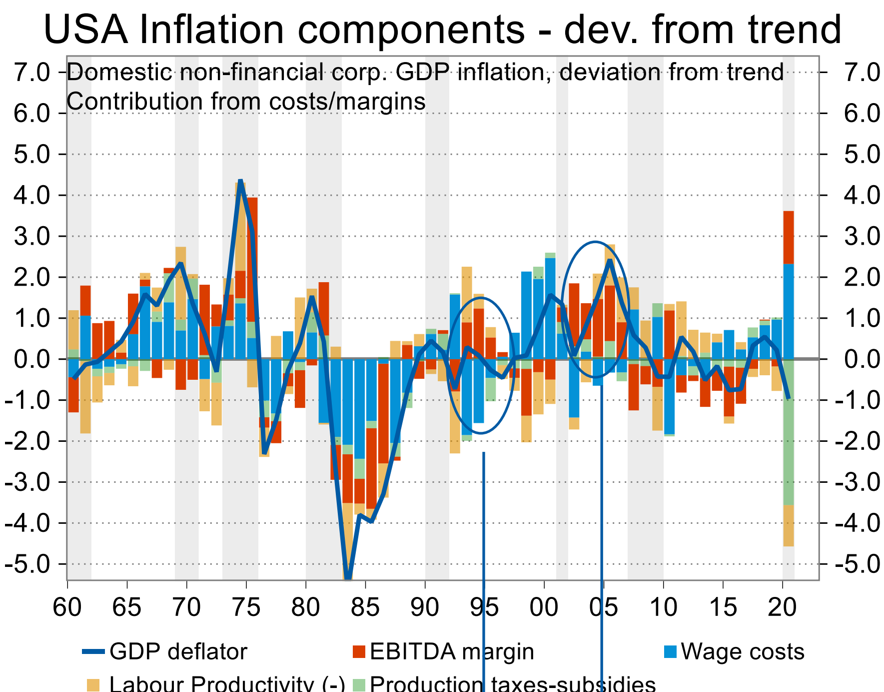


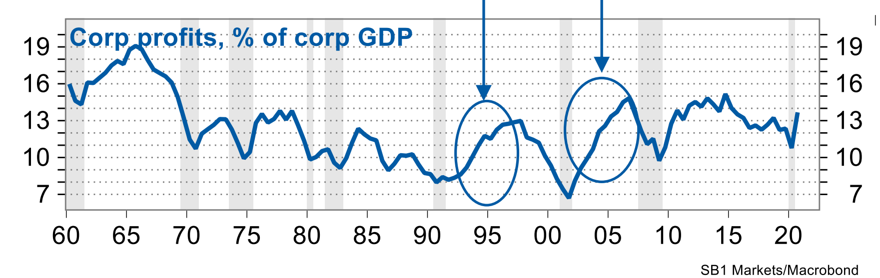
- **Higher EBITDA or profit margins**, due to higher selling prices to end users (consumption, investments), without any increase in wage costs – have normally not been important for explaining substantial and sustained lifts in inflation
  - » The reason is simply that historical or any likely variation in the EBITDA margin or in the profit rate normally have been too small to explain substantial and sustained changes in the inflation rate.
  - » If inflation should accelerate by 2 pp and stay there for 2 years, just due to a lift corporate sector margins, they would have to increase by almost 4pp. From a normal profit level, like today, that's close to 'impossible', in macro
  - » If anything – and over time – corporate margins are negatively correlated with inflation
- **Sort term,** changes in corporate margins may explain changes in inflation without changes in other costs, normally when raw material prices increase rapidly – like what we observe now
- **Faster growth in unit labour costs** (wage growth – productivity growth), has normally been the main driver for substantial and sustained increases in inflation
- **Wage inflation** is so far kept reasonable in check in the US, but signals from the labour market are unanimous, the labour market has become extremely tight over the past few months
  - » **Demand for labour** is very strong, as witnessed by all surveys, official vacancy data and endless anecdotes
  - » **Supply of labour** is still lacklustre – and far below the pre-pandemic level. Most likely, supply will strengthen substantially the coming months as
    1) The virus is brought fully under control, and there will be no reason for workers not apply for work (2.7 million (1.8% of the labour force stayed outside due covid in April)
    2) The federal pandemic schemes for extra support to the unemployed runs through Sept (some 16 states has decided/are discussing to close theses programs immediately). Lower benefits will probably increase supply of workers
  - » However, even **before the pandemic**, the labour market was tight, wage costs were increasing and profit margins were under pressure
  - » Reports on **wage increases** are common too, both in surveys and from individual sectors & companies – as from Amazon, and McDonalds last week

More charts & comments on the following pages

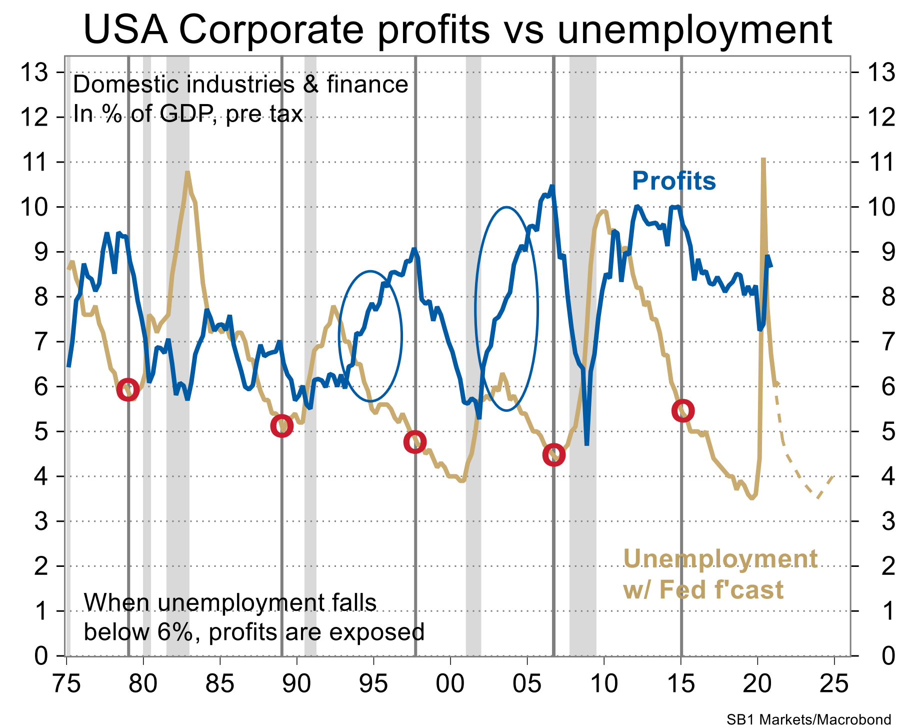
1993-'96, 2002-'06 da capo? Probably not, check the current margin (& unempl)!

Higher corporate margins contributed to higher inflation in 1993 – '96 & 2002 – '05





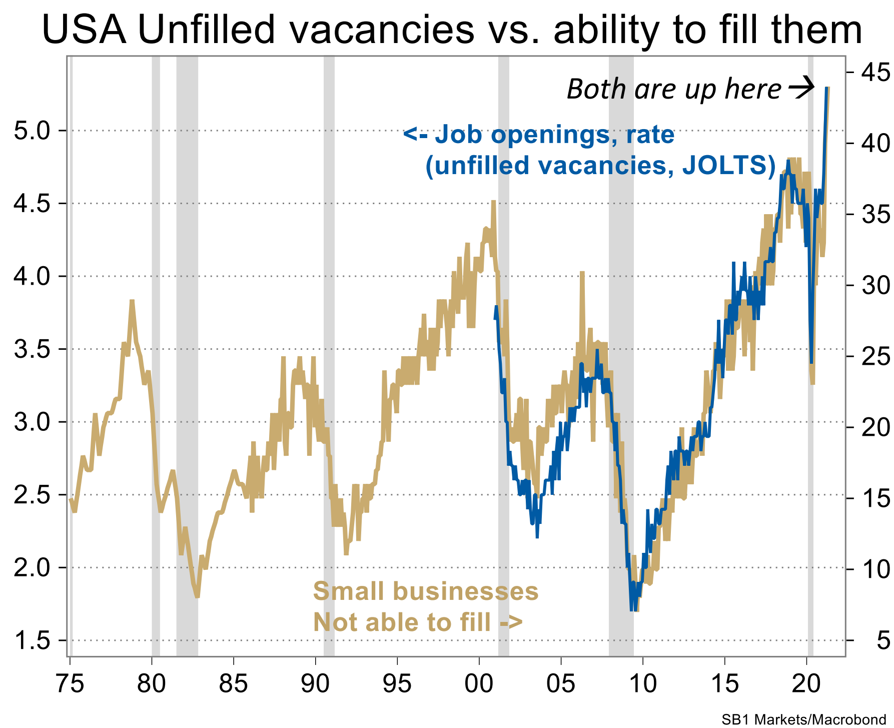
On the upper left chart, contributions to deviation from trend inflation is calculated

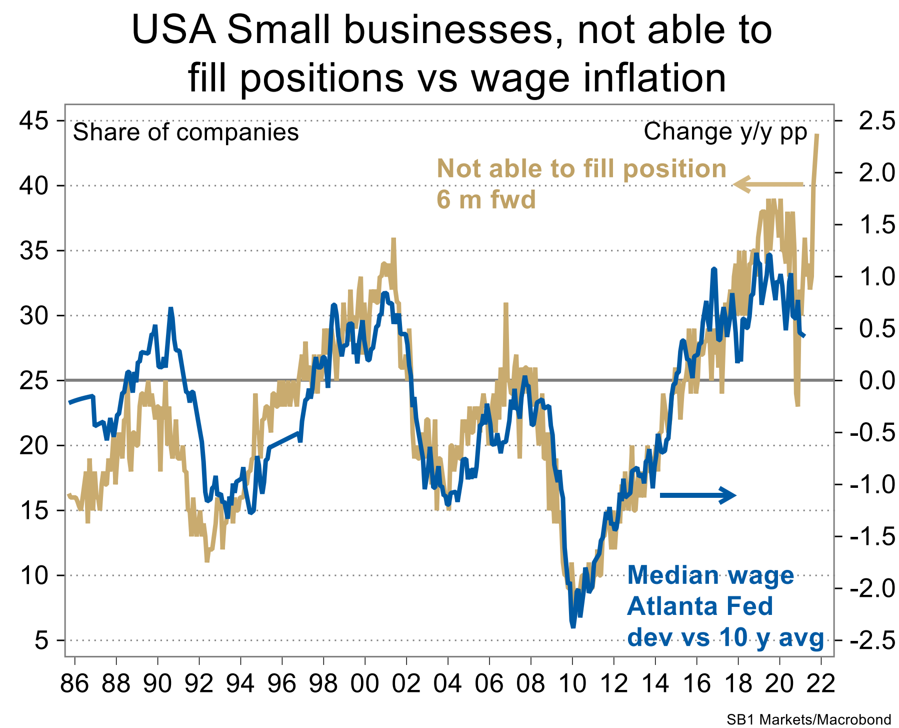


- **The main difference is obvious – where are we in the cycle?**
  - » The **profit rate** was low following 'normal' recessions, and the **unemployment rate** was still not low
  - » Now, the profit rate <u>is not low</u>. Unemployment will very likely <u>fall sharply</u> the coming quarters, which <u>normally makes it 'impossible' for businesses to keep the profit rate up</u>
  - » **Pressures in commodity markets** will probably dampen as at demand for goods from consumers in the rich part of the world will slow, as demand for services will recover the coming months

Vacancies are record high, and businesses are not able to fill positions

Many have already increased wages. Are unemployment benefits really holding workers back?



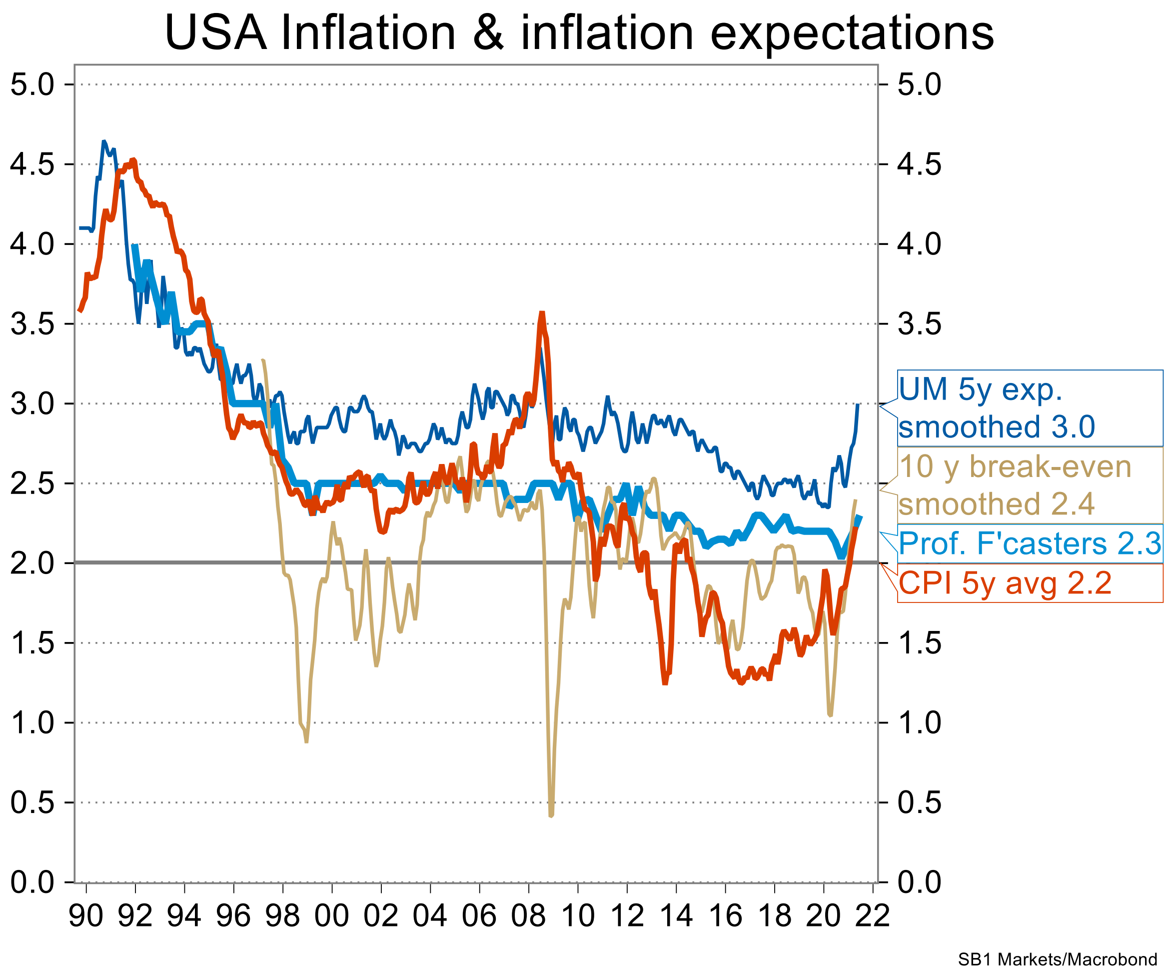


- The fraction of businesses saying that they **actually raised compensation** is at the highest level since before corona
- The **expected increases in compensation the next 3 months** is also sharply up from March, and businesses say that <u>costs are being passed on to customers in the form of higher prices!</u>
- However, so far **actual wage increases**, when adjusted for changes in the mix of labour during the pandemic have not gained speed (the Employment Cost Index rose more than expected in Q1 but just to a large wage lift in the financial sector (2020 bonuses), while other sectors reported normal wage gains. The median wage may have flattened, but is not yet reported up. <u>We expect that to happen the coming months</u>

SpareBank 1 MARKETS

Inflation expectations are drifting up but are not yet worryingly high

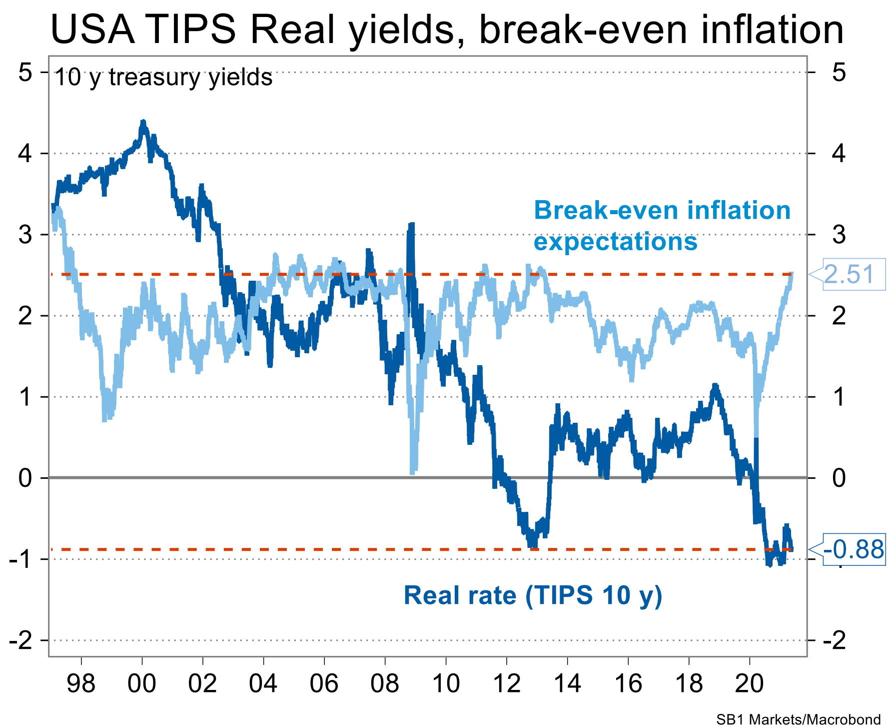
Univ. of Mich survey 5 y inflation expectations have climbed to 3.1% from 2.4%

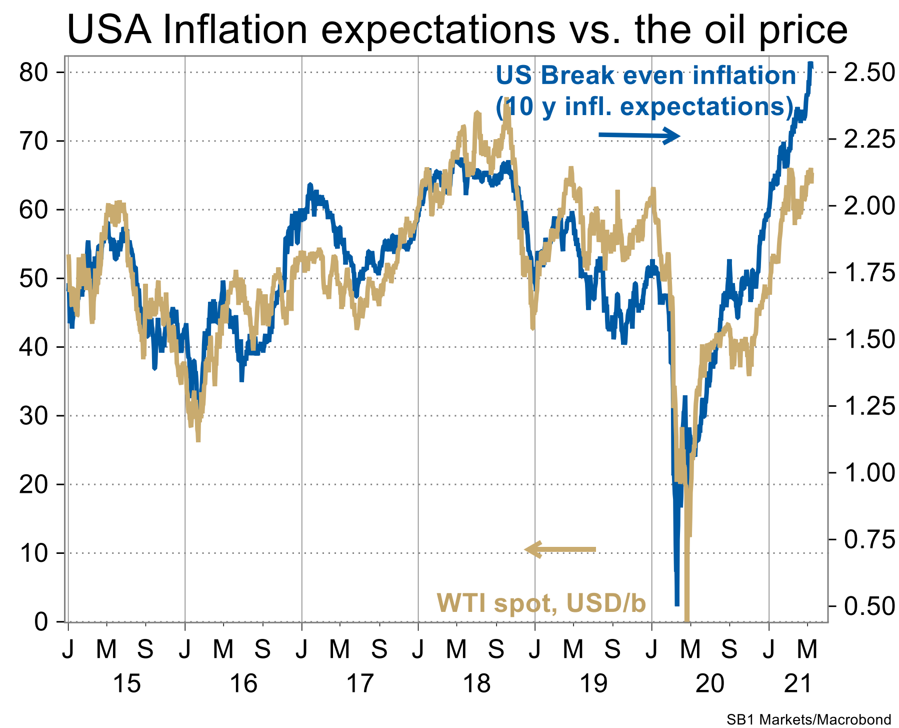


- **The UM's survey's** 3.1% rate is the highest in 10 years (3% smoothed at the chart to the left), and it is 0.8 pp higher than before the pandemic (2.5%)
  - » Still the level is not far above the past 10-year average – but it is a sign for the Fed, of course
  - » The UM short term inflation expectation at 4.6% is the highest since 2011, up 0.9% from March (and he survey was conducted ahead of the CPI surprise last week). These expectations usually correlated to recent changes in energy prices – like now
- **Professional Forecasters** expect a 2.3% 10 y rate of inflation in Q2, according to Philadelphia Fed, up from 2.0% in Q4. The Q4 level was the lowest ever, and 2.3% is just marginally above the past 7 years average, and it refers to CPI, which over time grows 0.3 pp faster than Fed's referred inflation measure, the PCE
- The 10 y **break-even inflation expectation** is at 2.5% (not smoothed) among the highest prints since 1998. Still not far too high for Federal Reserve
  - » However the direction is not that comforting?

Break-even inflation is even running ahead of its ol' pal, the oil price

Much could be said about the correlation between the <u>present</u> oil price & <u>10 y</u> inflation expectations



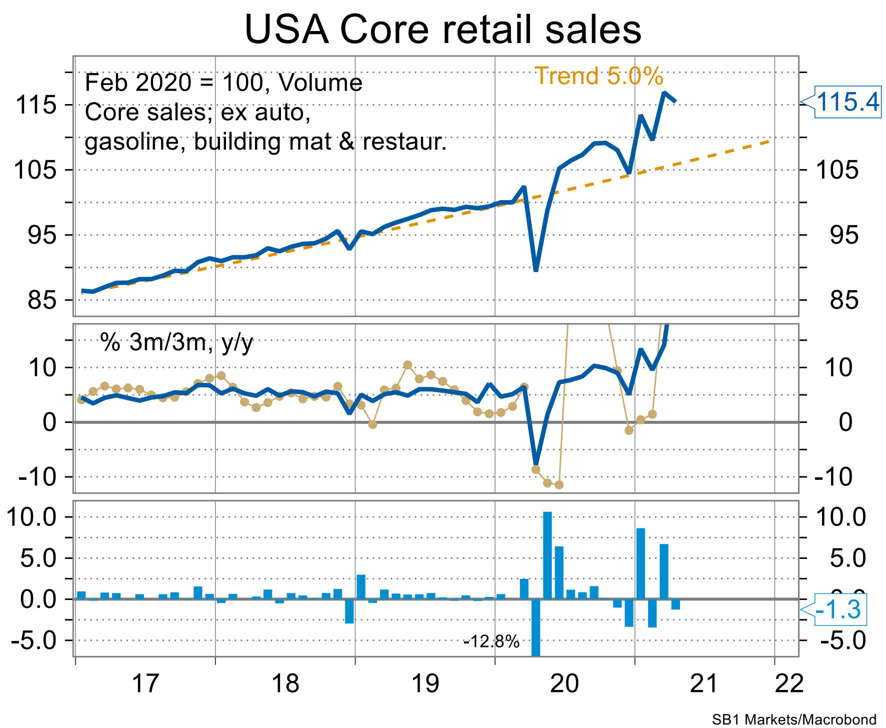


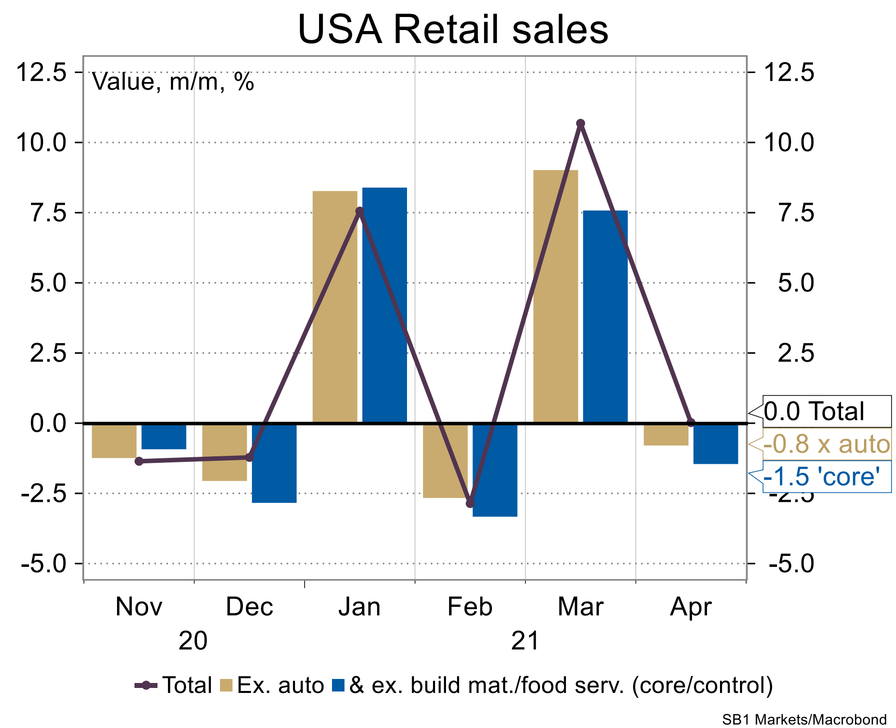
- But there are some possible links, of course (which still do not explain this close link)
- However, we have even more problems with the other part of the bond yield, the real rate. What is the best explanation for this yield, barring Fed's actions?

SpareBank 1 MARKETS

The 2nd best retail sales, ever! Core volume up 16% from Feb-20!! And from here?

No doubt, the direction is down, even if not much of the stimulus checks are spent, on aggregate





- **Total nominal sales** was unch. in April, expected up 1%. March was revised up by 1 pp to 10.8% - and the level in April was as expected
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) fell 1.5%, following the 0.6 pp upward revised 7.5% hike in March. We assume a 1.8% volume decline in April (autos are not included). Core sales are up 15.9% vs. the pre-pandemic level. The downside is substantial the coming months/quarters
- Mixed among sectors, more than half down, but none by much. **Auto** and **restaurant** sales rose 3% (none included in 'core goods'). Restaurant sales are just 2% below the pre-pandemic level (but employment is far more below, strange)
- Retail sales – and other consumption – have received a real boost from the **two rounds of stimulus cheques**, the first distributed in January and the second in March and April. Just a fraction of the received amounts have so far been spent – and savings have increased substantially

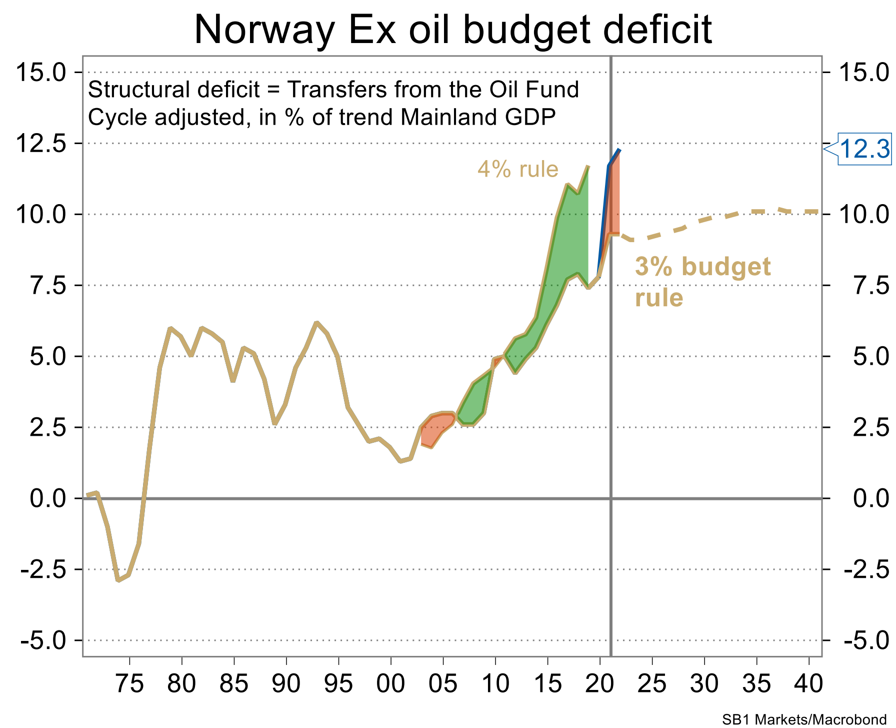
A ton of spending. At least as long as the pandemic lasts

The question is, how much afterwards?

Structural non-oil balance

NOK bn	Actual 2019	Actual 2020	Rev bud 2021	*SB1 Markets est 2022*	*SB1 Markets est 2023*
Pre pandemeic outlook	239	240	251	*262*	*274*
Now	**239**	**370**	**403**	***325***	***325***
Corona measures		135	94	*10*	*0*
Other measures (residual)		-5	58	*53*	*51*
Balance, % of trend ML GDP	**7.8**	**11.7**	**12.3**	***9.5***	***9.2***
... fiscal stance, change in bal.		3.9	0.6	*-2.8*	*-0.4*
Balance, % of Oil fund		**3.7**	**3.7**	***2.9***	***2.8***
Spending rule, 3% of Oil fund		303	327	*338*	*352*
Deviation		67	76	*-13*	*-27*

Sources: Min. of Finance, SB1 Markets

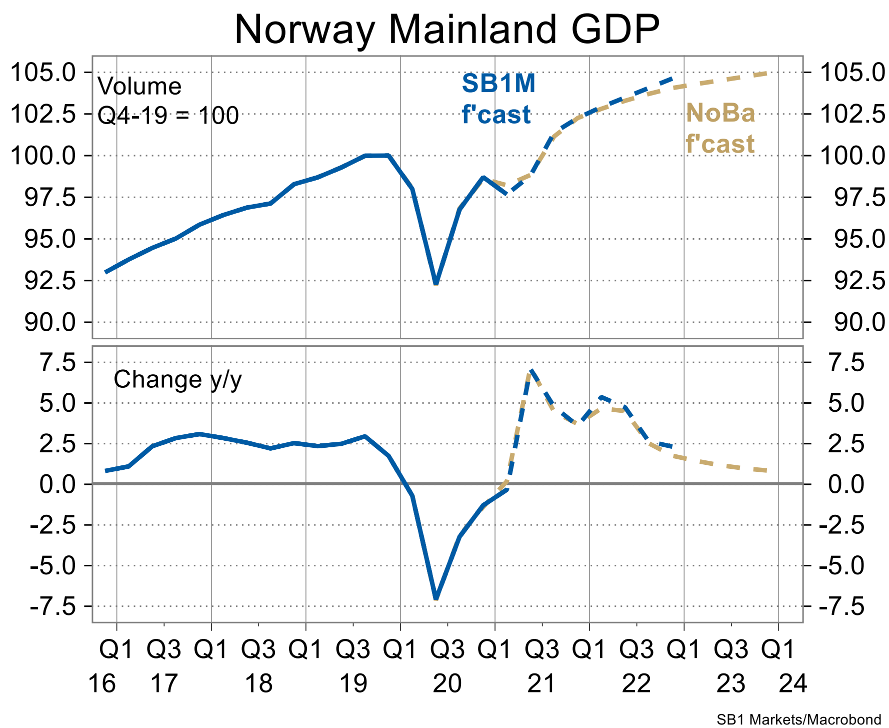


- The **2021 non-oil structural deficit** was NOK 90 bn larger than in the original 2021 budget (Oct-20) but a big extra support was decided in February, and some extra 'minor' expenditures were added now – so the proposal was close to our estimate. The structural deficit is larger than last year in % of trend GDP, and thus it is expansionary, even in the economy recovers (if all the money is spent)
- The **2020 budget deficit** was far smaller than assumed last autumn
- The **non-oil structural deficit**, funded by a transfer from the oil fund is well above the long term budget rule (3% of the funds value) in 2020/21 but the extra spending now (in red at the chart to the right) is far smaller than the accumulated 'under-spending vs. budget rule over the previous years (in green).
- The 2021 deficit is 2.5%-of-GDP higher than the long term budget rule advices. No other country is closer to their long term target these days?
- **The risks:** Spending remains too high, after the pandemic. A substantial decline in the value of the Oil Fund

SpareBank 1 MARKETS

GDP down 1% in Q1, but the (near term) future is so bright…

Corona measures were not for free but no dramatic downturn in Q1

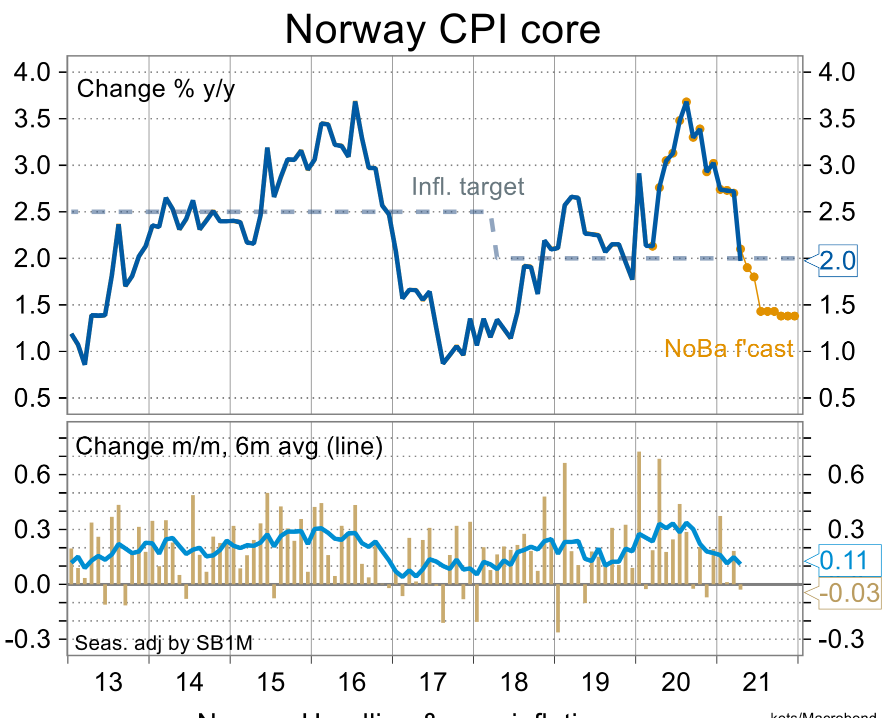


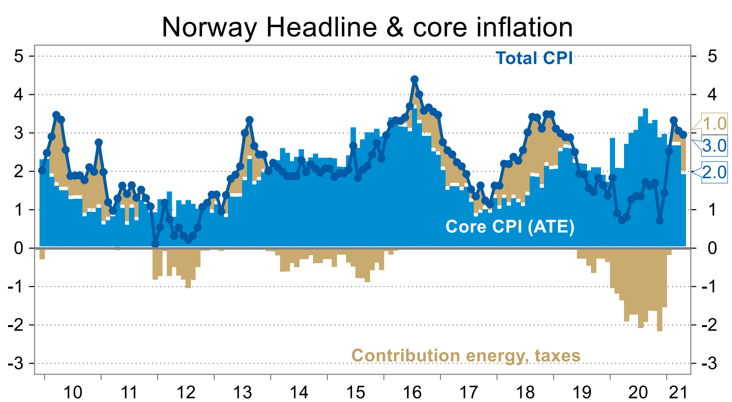
No kidding, our forecast was not produced to replicate NoBa's forecast. It was NoBa that revised its forecast up to ours ☺

- **GDP** fell by 0.5% in March and 1% in Q1, in sum a tad weaker than expected
- However, what happened during the 'closedown' months until April will very likely not have any impact on activity in Q3 or in Q4
- The **remaining restrictions** will very likely be gradually lifted the coming weeks, and we are confident activity will rapidly pick up in the down beaten services sectors
- **Business air travel/hotel usage**, foreigners spending will not recover to a normal level anytime soon, but these activities are not a big part of the Norwegian economy
- On the other hand, **Norwegians** will very likely not travel abroad as normal this summer – and they have no choice but to spend their holiday budget in Norway, as last year.
  - » After the summer, more of business air travel/foreigners tourist traffic will support activity
- **Consumption of goods** will very likely approach a long term trend growth path over the coming 2 – 3 quarters implying a slight decline for the present level
- **Business investments** in both on and off-shore have stabilised and housing investments are on the way up
- **Exports** has recovered, and the outlook is not that bad

Core inflation down 0.7 pp to 2.0% y/y in April, below expectations

NoBa expects a further decline the coming months. Not unlikely

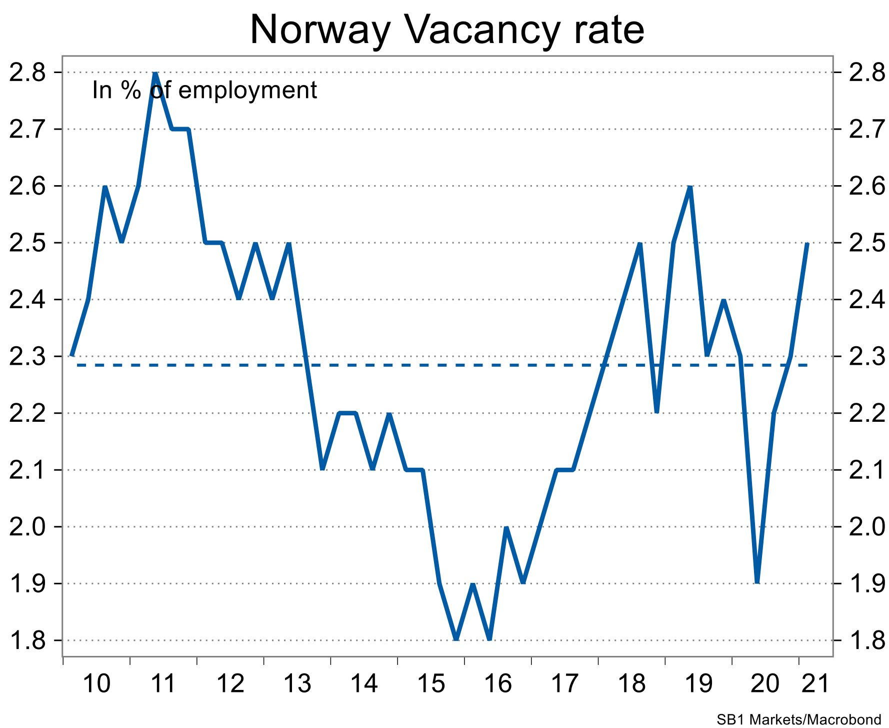


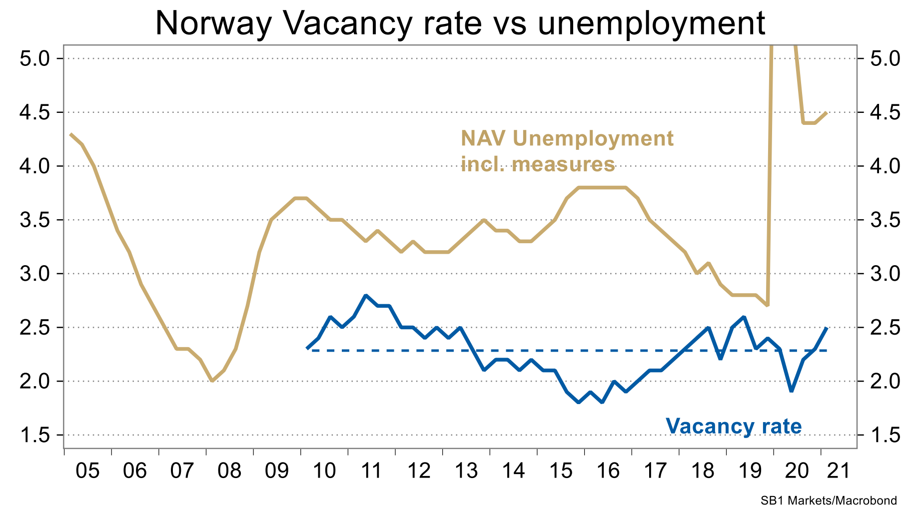


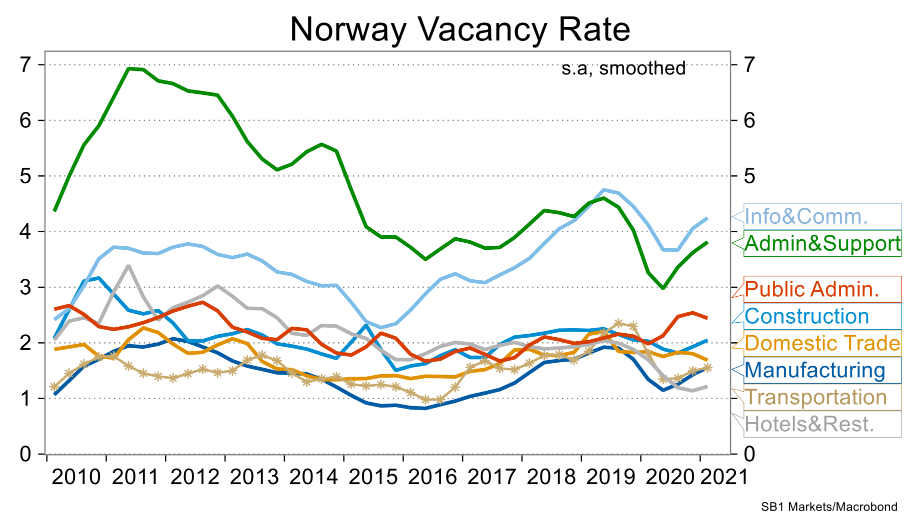
- **CPI-ATE** (ex. energy and taxes) inflation is down 0.7 pp to 2.0% in April; 0.1 pp below consensus & Norges Bank's f'cast, and 0.3 pp below our estimate
  - » Prices rose were flat m/m (seas adj), down from 0.2% in March
  - » Inflation is below 2% for housing, clothing, food, alcohol, communication and airline tickets – others are still above
  - » As we predicted, imported goods price inflation is now receding, due to NOK effect
  - » Domestic inflation has slowed substantially but remains at 2%
- **Total inflation** slowed 0.1 pp to 3.0%
- **The price outlook**
  - » **We expect inflation to slow** the coming quarters as the NOK effect fades and wage inflation remains moderate (if not low). Demand for goods will have to decline from a very high level. Upside risk: Higher raw material prices/global price pressures
  - » Anyway, CPI inflation will not have any material impact on Norges Bank's monetary policy the coming months. It's all about the Covid-19 impact on the real economy, and the outlook for the recovery - and the housing market

More unfilled vacancies in Q1 – the 2. highest since 2011

And that's before the unusual hike in new vacancies in April



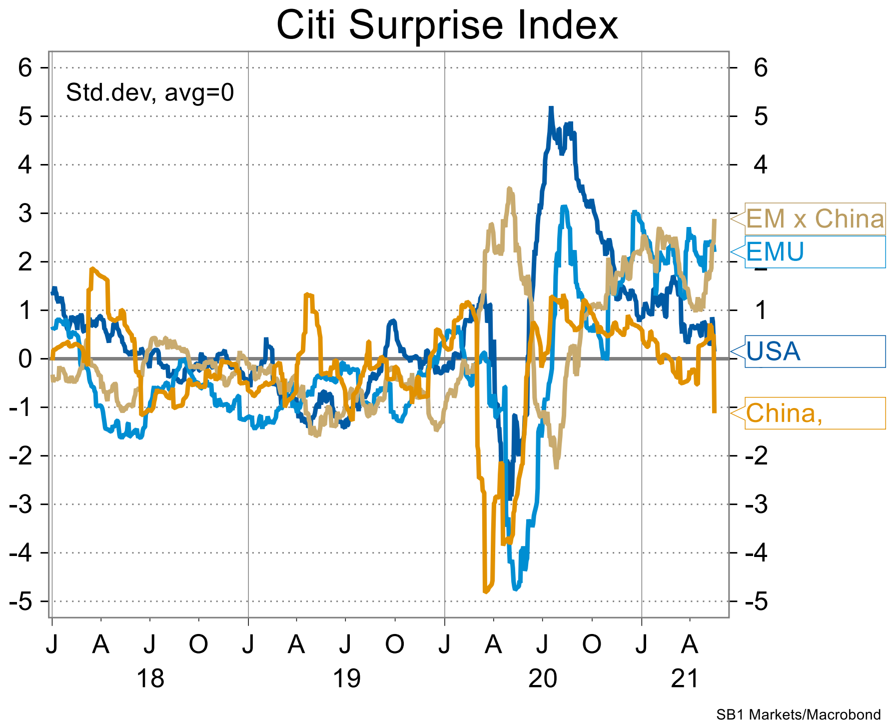


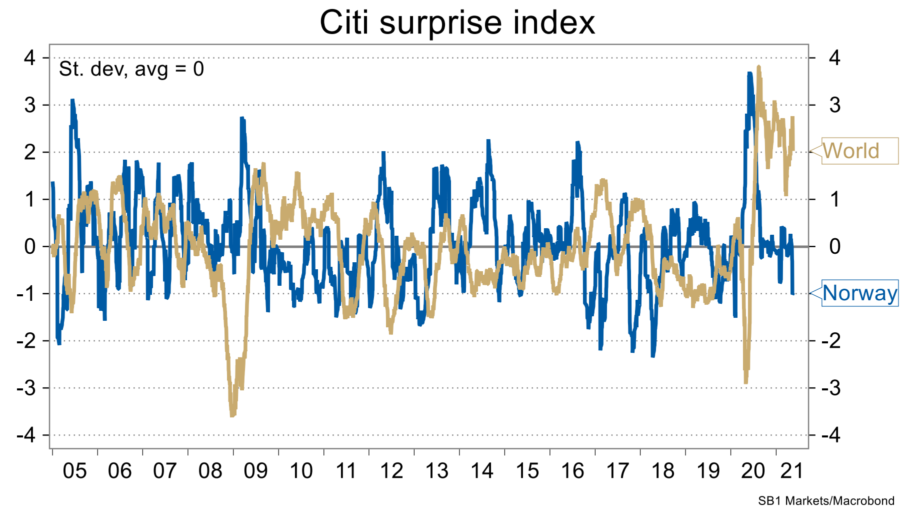


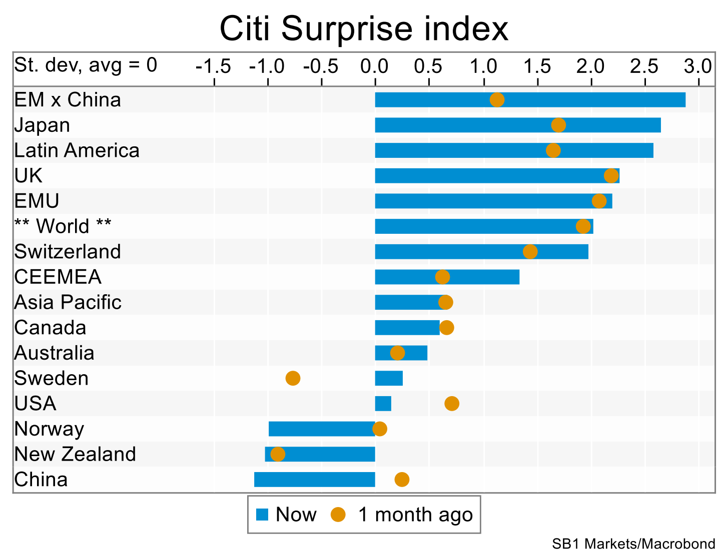
- The vacancy rate has been higher just once since 2011, which is strange give the still rather high unemployment rate
- Almost all sectors have reported more unfilled vacancies the past 3 quarters, since the shock in Q2 last year

Economic data are still surprising at the upside (but not China & Norway)

… according to Citi's surprise index. EM x China, Japan at the top, with Japan, EMU







- **Japan, UK & EMU** at the top of the list, followed by Lat-Am
- The **US** surprise index rose last week
- **China** surprised on the downside with its mixed April data, according to Citi
- **Emerging Markets x China** are reporting much better data than expected
- **Norway** fell sharply last week, due to GDP & CPI data

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

The Calendar: May PMIs, US & NOR housing starts

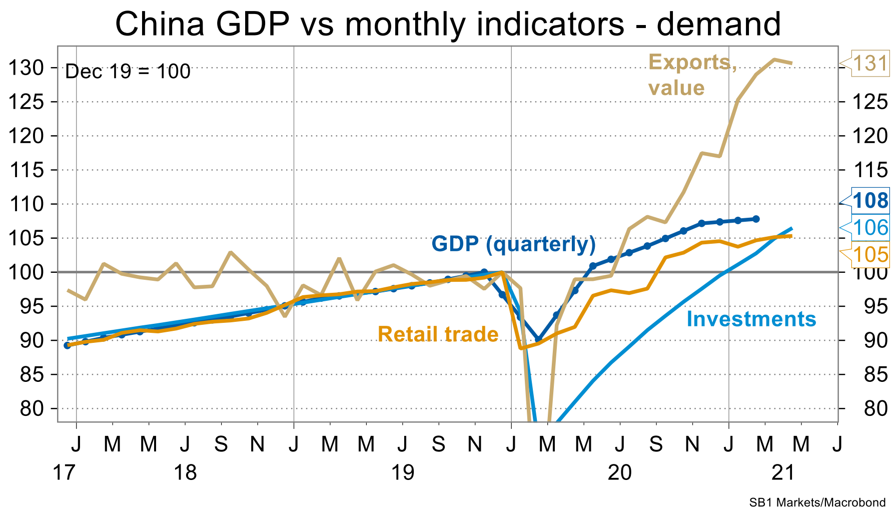
Time	Count.	Indicator	Period	Forecast	Prior
Tuesday May 18					
08:00	UK	ILO Unemployment Rate	Mar		4.9%
08:00	NO	Trade Balance	Apr		25.4b
10:00	NO	NAV weekly unemployment			3.6%
11:00	EC	Employment QoQ	1Q		0.3%
11:00	EC	GDP SA QoQ, revised	1Q	-0.6%	-0.6%
14:30	**US**	**Building Permits**	**Apr**	**1770k**	**1766k**
14:30	US	Housing Starts	Apr	1710k	1739k
Wednesday May 19					
08:00	UK	CPI Core YoY	Apr		1.10%
08:00	NO	Building Permits	Apr		2 565
08:00	NO	Population growth	Q1		
11:00	EC	CPI Core YoY	Apr F	0.8%	0.8%
20:00	US	FOMC Meeting Minutes	Apr-28		
Thursday May 20					
06:00	SW	Home-Price Index			
10:00	EC	ECB Current Account SA	Mar		25.9b
14:30	US	Philadelphia Fed Bus. Outlook	May	41.9	50.2
14:30	US	Initial Jobless Claims	May-15		
16:00	US	Leading Index	Apr	1.30%	1.30%
Friday May 21					
01:30	JN	CPI Ex Fresh Food, Energy YoY	Apr	0.00%	0.30%
02:30	JN	PMI Manufacturing	May P		53.6
02:30	JN	PMI Services	May P		49.5
08:00	UK	Retail Sales Ex Auto Fuel MoM	Apr		4.90%
09:15	FR	PMI Manufacturing	May P	58.0	58.9
09:15	FR	PMI Services	May P	51.5	50.3
09:30	GE	PMI Manufacturing	May P	66.0	66.2
09:30	GE	PMI Services	May P	52.0	49.9
10:00	NO	Norges Bank Expectation Surv.	Q2		
10:00	**EC**	**PMI Manufacturing**	**May P**	**62.5**	**62.9**
10:00	**EC**	**PMI Services**	**May P**	**51.8**	**50.5**
10:00	**EC**	**PMI Composite**	**May P**		**53.8**
10:30	UK	PMI Manufacturing	May P		60.9
10:30	UK	PMI Services	May P		61
15:45	**US**	**PMI Manufacturing**	**May P**	**61.3**	**60.5**
15:45	**US**	**PMI Services**	**May P**	**64.9**	**64.7**
15:45	US	PMI Composite	May P		63.5
16:00	EC	Consumer Confidence	May A	-7.5	-8.1
16:00	US	Existing Home Sales, Prices	Apr	6.05m	6.01m

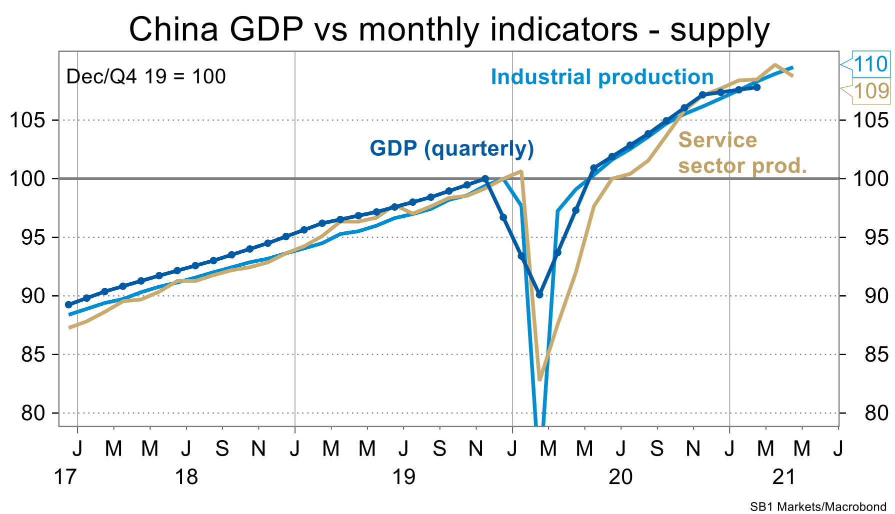
- **May PMIs**
  - » The **composite PMIs** have been strong across almost all countries, and the global composite ticked in at 56.3 in April best since 2010, signalling growth far above trend! **Manufacturing PMIs** have been record strong in many countries, with Sweden in the lead, followed by EMU and US. In the **service sector**, EMU is the laggard, but still just above the 50 line in April – and we expect more to come in May, and if not now, then in May. We do not expect any signs of slowdown in the US
- **USA**
  - » **Home sales** have been exceptionally strong lately and we expect the trend continues and that the number will come out strong – it is of course somewhat limited by the historically low inventories. Both **building permits** and **housing starts** were rose in March, and have not been higher since 2006
  - » **FOMC meeting minutes** should be a non-event, reiterating the Fed's policy and stronger economic outlook. The June meeting will be the real deal
  - » **Jobless claims** have fallen in the past four weeks but the level is still high. A further decline is likely demand for labour is strong, and lay-offs are at a record low level
- **EMU**
  - » Preliminary data showed that **GDP** for the Euro area was down 0.6% in Q1. Tuesday's number is just a preliminary update
  - » The preliminary data showed that **inflation** rose to 1.6% in the Eurozone in April, with the core at just 0.8% - somewhat below 3% at the other side of the pond
- **Norway**
  - » **Norges Bank's expectation survey** will confirm that the inflation target is anchored just among some economists but not at all among households or business leaders
  - » **Weekly unemployment** figures are out on Tuesday. New jobless claims have fallen sharply since early April, and unemployment is heading down

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

Mixed April data, retail sales, services at the weak side

Industrial production & investments on the strong tide. Credit growth is slowing rapidly



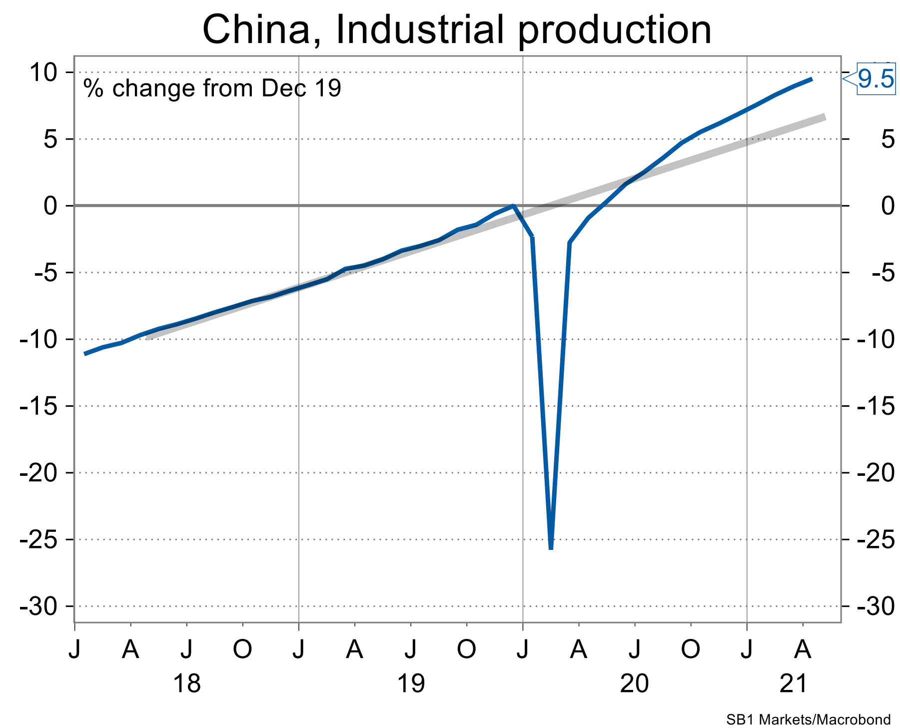


- **Industrial production** rose 0.5% in April, down 0.1 pp vs. March. Measured y/y, production is up 9.8%, somewhat more than expected. Production is 3% <u>above the pre-corona trend path but growth has finally slowed to the pre-pandemic level</u>, as we expected
- **Service sector production** surprised us sharply on the downside in April (-0.9%). Activity is still not weak, following the 1.2% lift in March – and small monthly volatility has not been that uncommon
- **Retail sales volumes** were revised down this month (the opposite in March) and sales barely rose m/m in April. Expectations were far too high, and the 7 pp y/y miss is irrelevant
- **Investments** finally came back to the pre-pandemic growth path in April, and growth m/m has slowed but remains far above the 2019 level. **New home sales** fell in April but remain strong. However, **housing starts** are sagging, and so are **non-residential construction** starts. **Steel production** is still expanding, and so are net steel exports
- **Credit growth** slowed in March and further in April, as credit outside banks are curbed, very likely by purpose
- **CPI inflation** remained low in April but producer prices are soaring (which is felt more outside China than inside)
- **Last week: Exports** & **imports** remained very strong in April

In sum: Covid measures held parts of the back economy somewhat during the festive season but March data signals full speed ahead

Industrial production up 0.5% in March, level 3% above the pre-corona trend

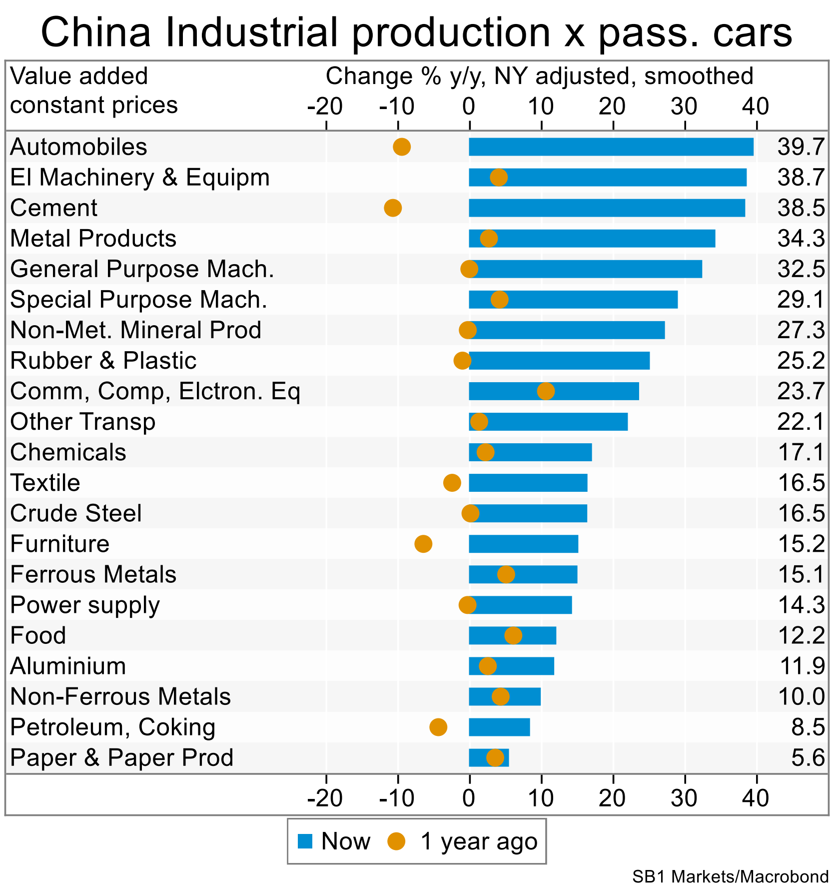
Annual growth rates are still useless – but production is up 9.8% y/y, 0.7 pp above expectations

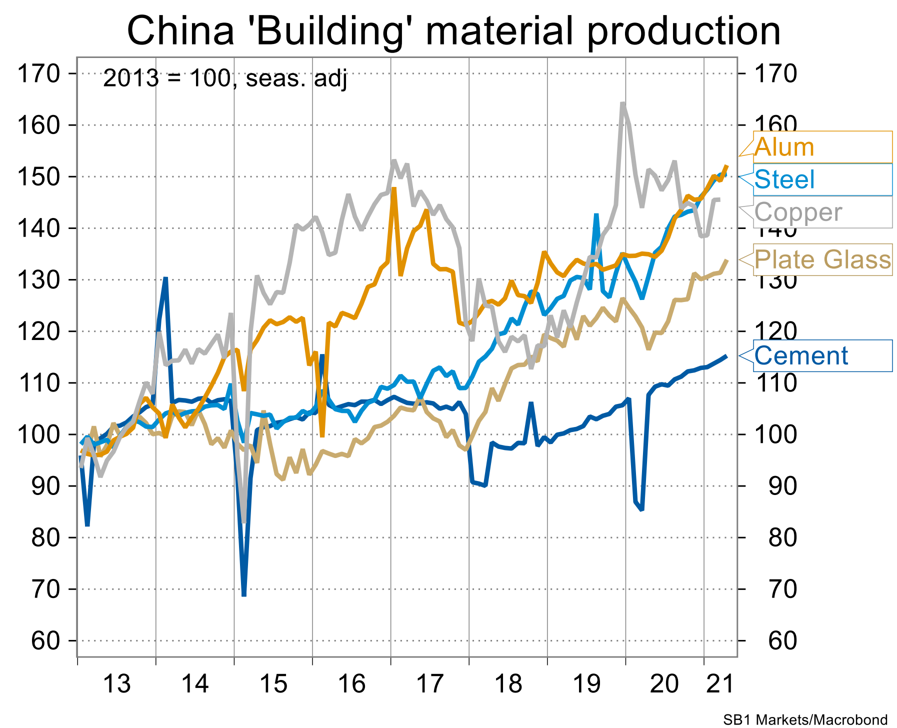


- Growth in production has finally come down the pre-pandemic level, some 0.5%+ pr month
- Production is 9.5% above the Dec '19 level and some 3% above a reasonable pre-corona growth path. Impressive!
  - » *As the production level is above the pre-corona growth path we do not expect industrial production to keep growing faster than trend growth, at some 0.5% per month, we said last month.* Both supply and demand factors may be limiting factors the coming months – supply side probably most important short term

Annual growth rates: A good picture of the effects of last year's lockdown

... but nothing more. Still, strong underlying growth in many sectors



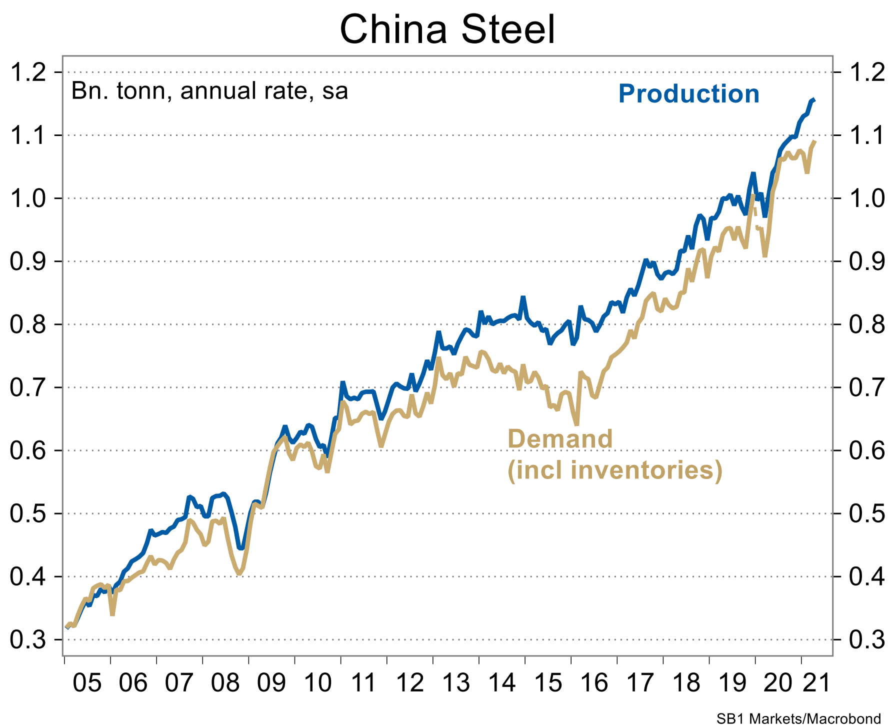


- **All construction inputs** are back on brisk pre-corona <u>growth paths</u>, except copper production

SpareBank 1 MARKETS

Construction starts revised down – and April was weak

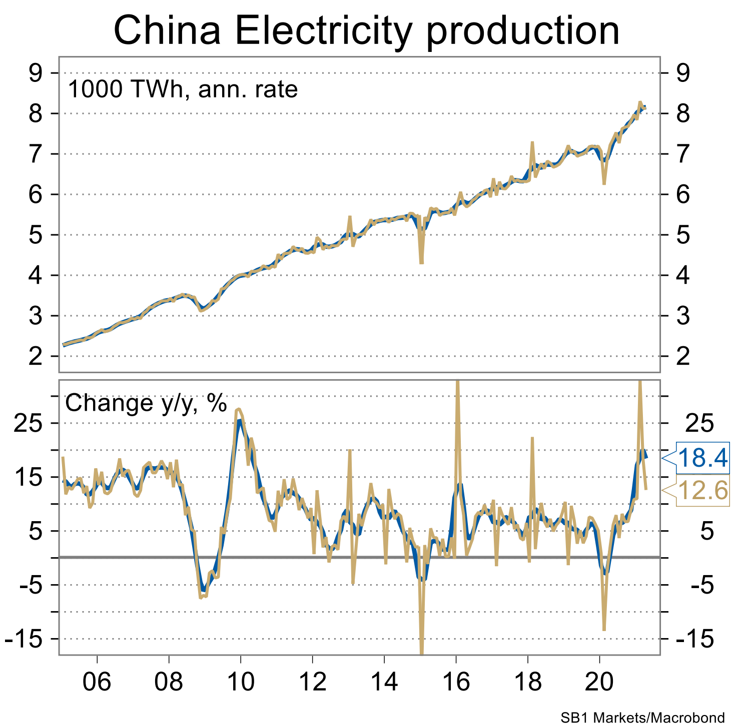
Some risk vs. domestic steel demand? And production is even higher, net exports are increasing

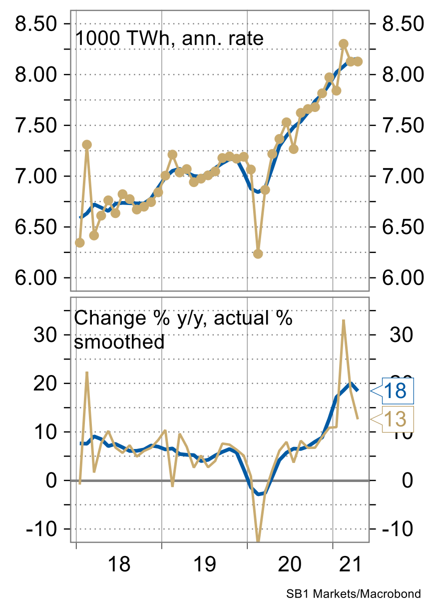


SpareBank 1 MARKETS

Very strong electricity production data, up 13% vs. the pre-pandemic level

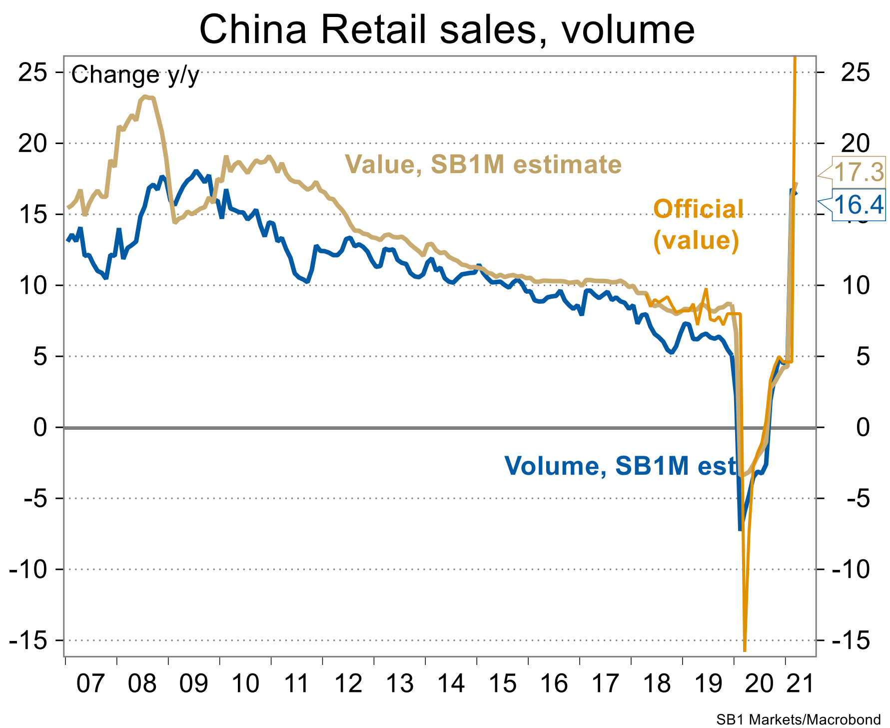
Transport activity robust too

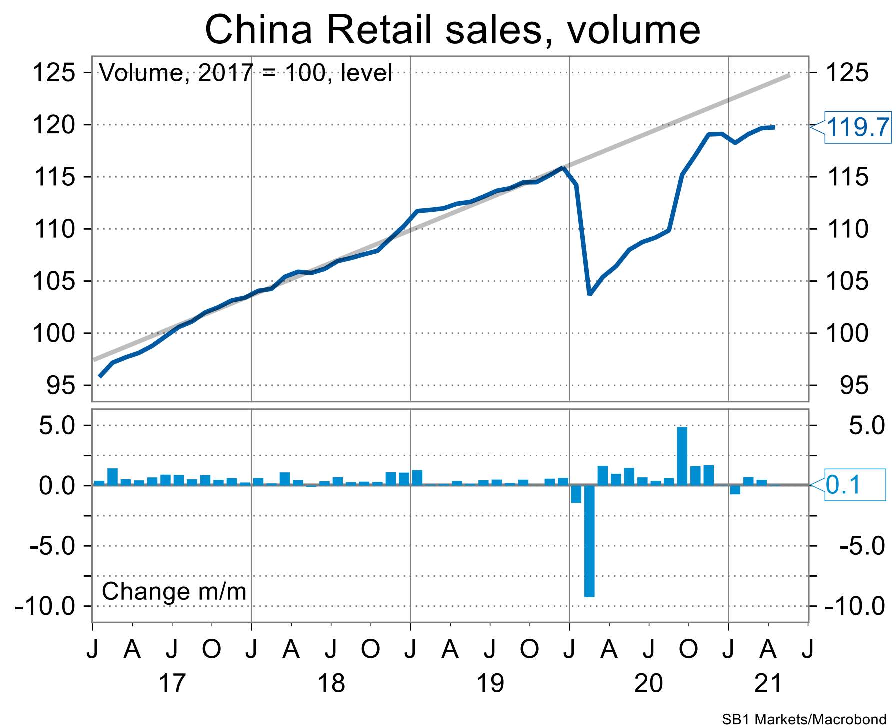




Retail sales are sagging? Monthly data received down, suggest a flattish April

Substantial data revisions once more, now downward – and almost no growth in April

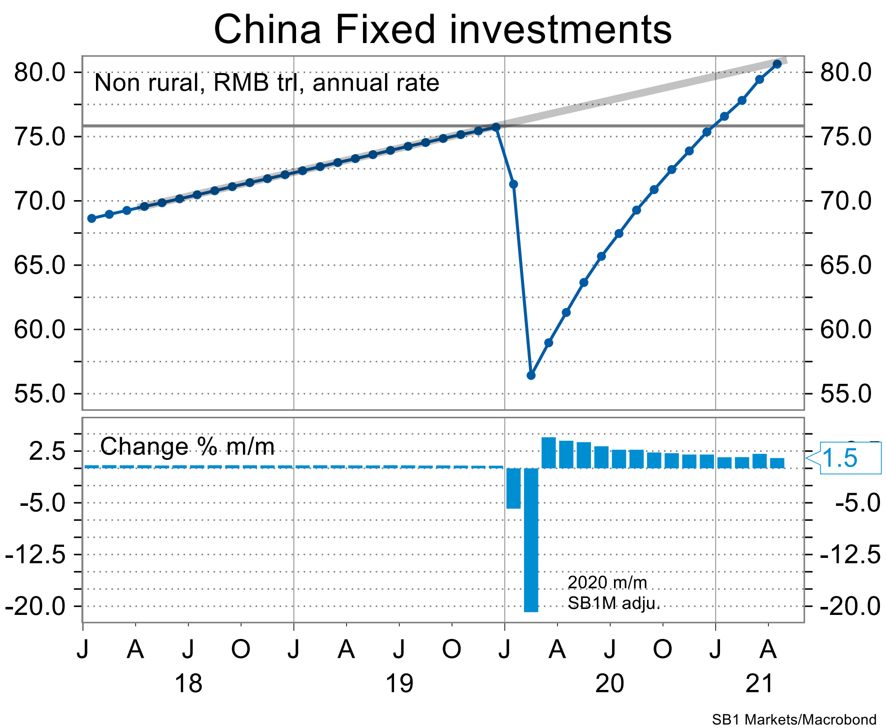




- Adjusted for inflation, sales rose just 0.1% in April, and March was revised down by 0.6 pp to 0.7% growth. The recovery has more or less stalled since November – it these data are to be trusted (and we are far from sure we can, following 2 – 3 revisions and some obvious 'impossible' data, which we have adjusted for). According to our calculation, sale volumes are 4% below the pre-pandemic trend path – and some 10% up vs. April 2019
  - » The official yearly changes are extreme, of course. March is up 17.7% in value terms, expected 24.9%. Expectations were strangely high, as it would have implied a 16% growth from April-19, a large change from the March rate at 13%

Investments are finally back on the pandemic growth track!

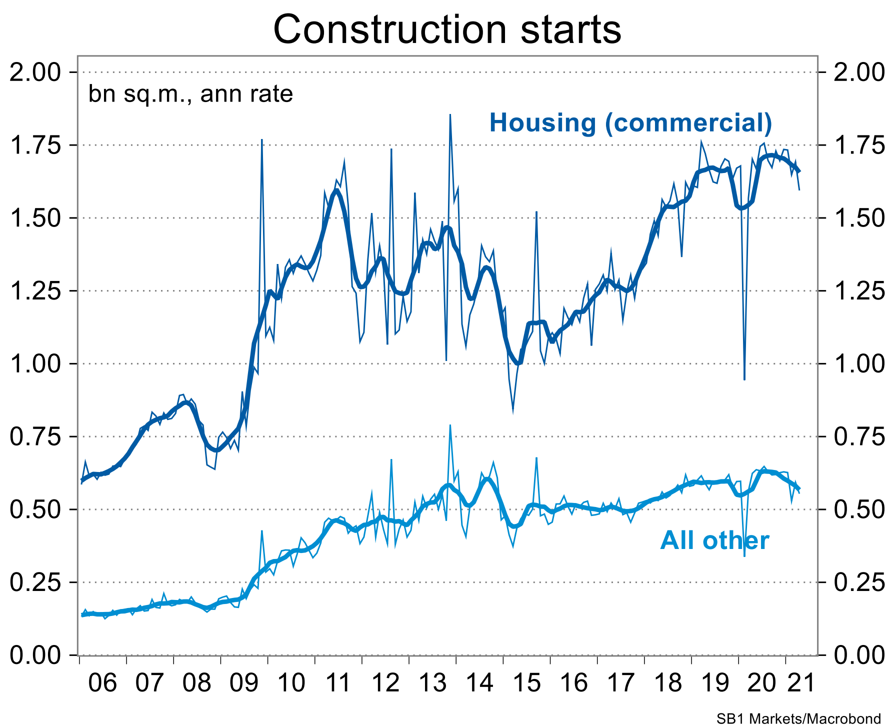
Investments rose by 1.5% in April, as in March (before March was revised up to +2.1%)

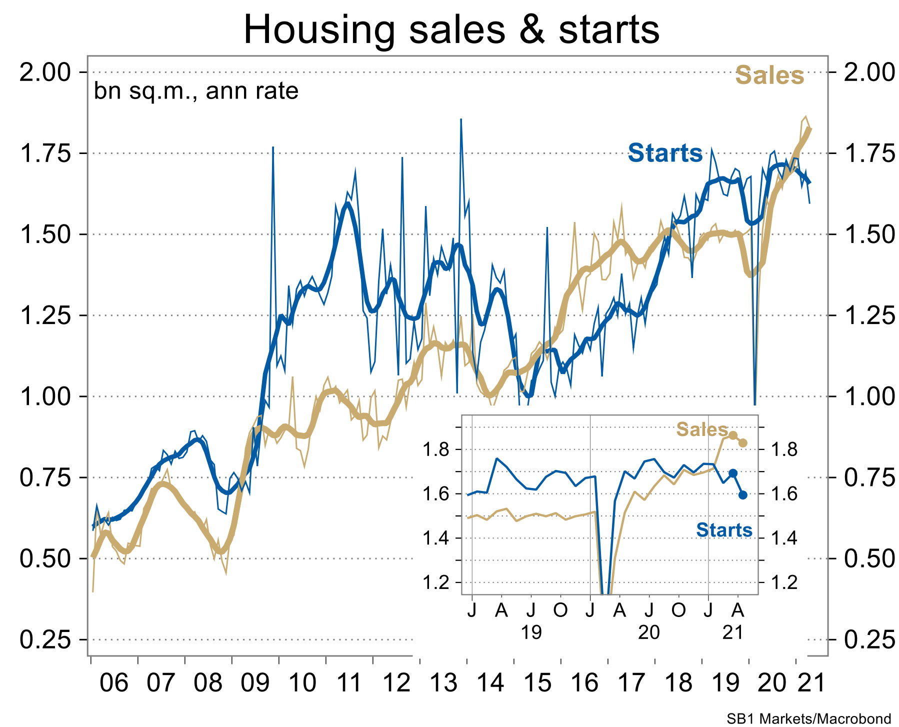


- Measured ytd, investments are up by silly digits y/y – which are not useful for analysis
  - » The figures: YTD + 19.9%, expected 19.2% down from 25.6% in March
- Growth m/m has gradually slowed the past months but remains well above the pre-pandemic growth pace, which was at 0.4% per month, 5% per year, in nominal terms
- Annual real growth rates are just as meaningless as the nominal growth rates

New home sales down from a high level – housing starts rev. down &down in Apr.

Sales have been very strong since last spring. Level +20% vs pre-Covid

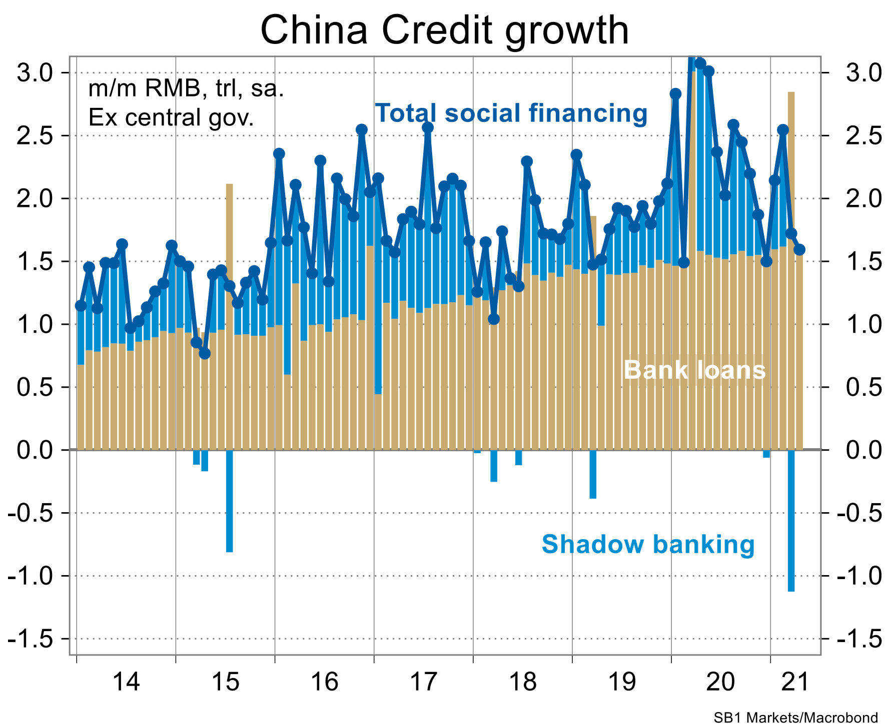


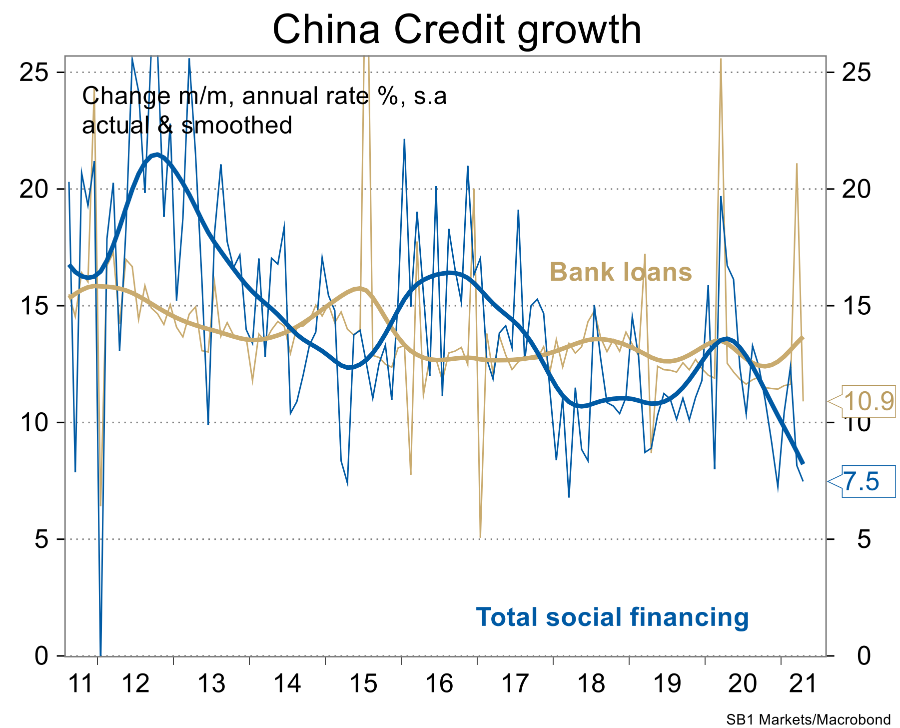


- The rise in new home sales has been spectacular, and not driven by strong growth in new home prices
- Housing starts data were revised down from an upward trend to a flattish, at best – and starts fell sharply in April. The inventory of unsold new homes is now shrinking rapidly
- Non-residential construction was revised down to – and start are heading down
- In sum, construction starts are slowing. Look up for demand for steel - if this version of Chinse construction data are the correct ones

Credit growth is slowing sharply – impacts will be felt in many corners

A slowdown in the shadows, bank lending is keeping up

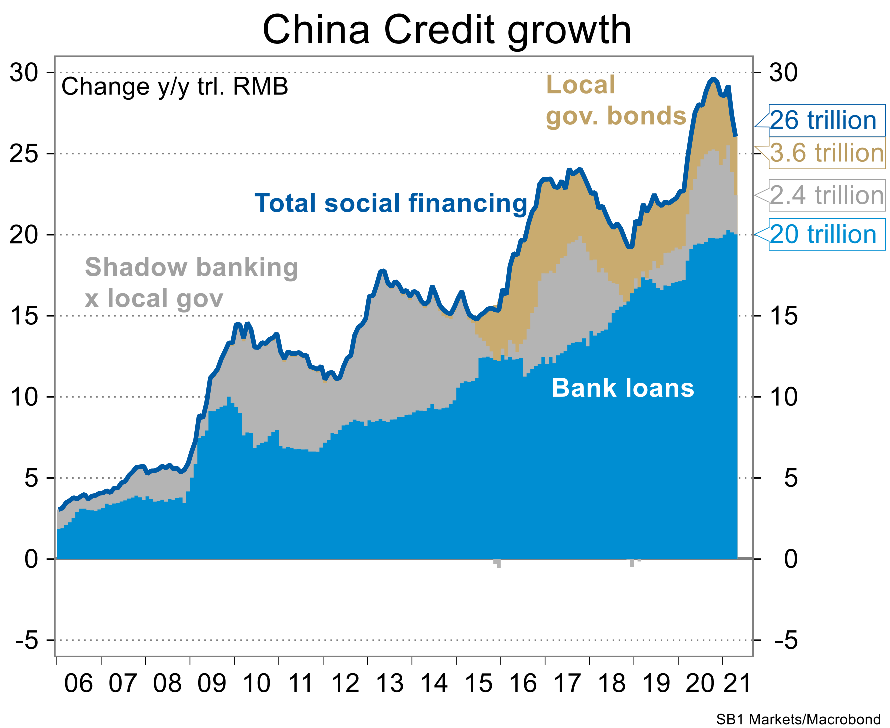


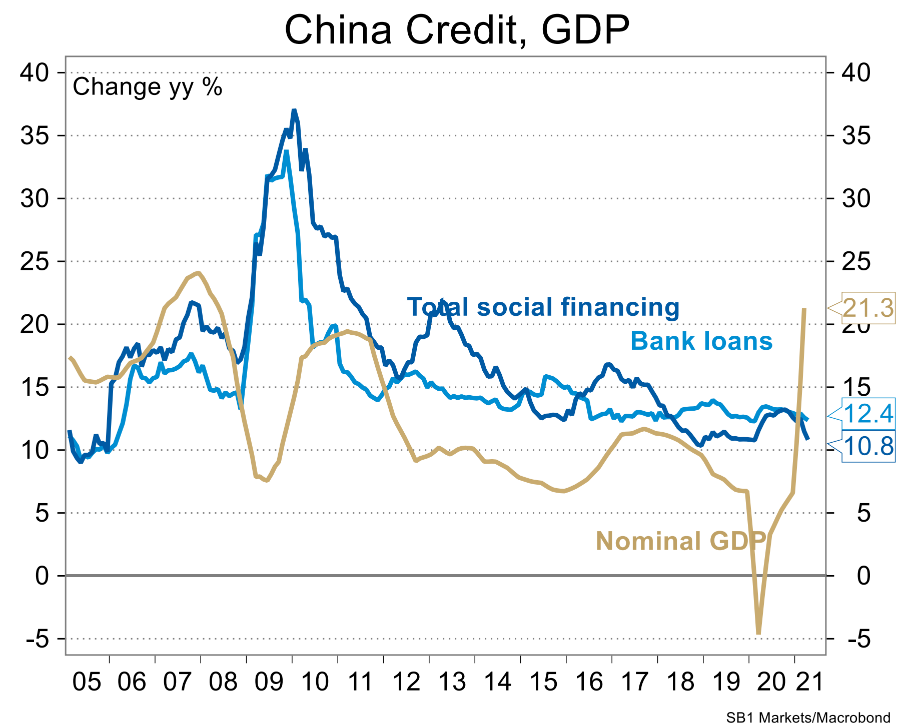


- In April **total credit** grew at just a 7.5% rate (m/m, annualised), down from 8.5% in March. Smoothed, the underlying rate may be some 9% - 10%, down from 13% during last spring (and >15% during some months). A 9%-10 % growth rate is still somewhat above trend growth in nominal GDP
  - » **Total credit** rose by RMB 1.9 trl, expected 2.3 trl (not seasonally adjusted, total social financing, including central & local government bond, and corporate equities). Seasonally adjusted the core total social credit (total ex central gov bonds & corporate equites) grew by 1.6 bn, down from 1.7 bn in Feb. The annual rate fell to 10.8%, down from 11.5%
  - » **Bank loans** rose by RMB 1.6 trl, both actual & seas adjusted. Bank loans are up 13% y/y
  - » **Shadow banking credit** was unch in April, following the unprecedented RMB 1.1 trl decline in March (equalling 1.4% of all outstanding credit outside banks!)
- **The Chinese authorities** have signalled that credit growth outside banks should slow, and it has been growing slower than bank credit since early 2018, barring an uptick during the pandemic last spring (when all stimulus was needed). The contraction in shadow banking credit over the past year equals 5% of total cred

Credit growth curve has turned south

As it usually does, every 3rd - 4th year. The turnaround now is not faster than before (in percent. p.)

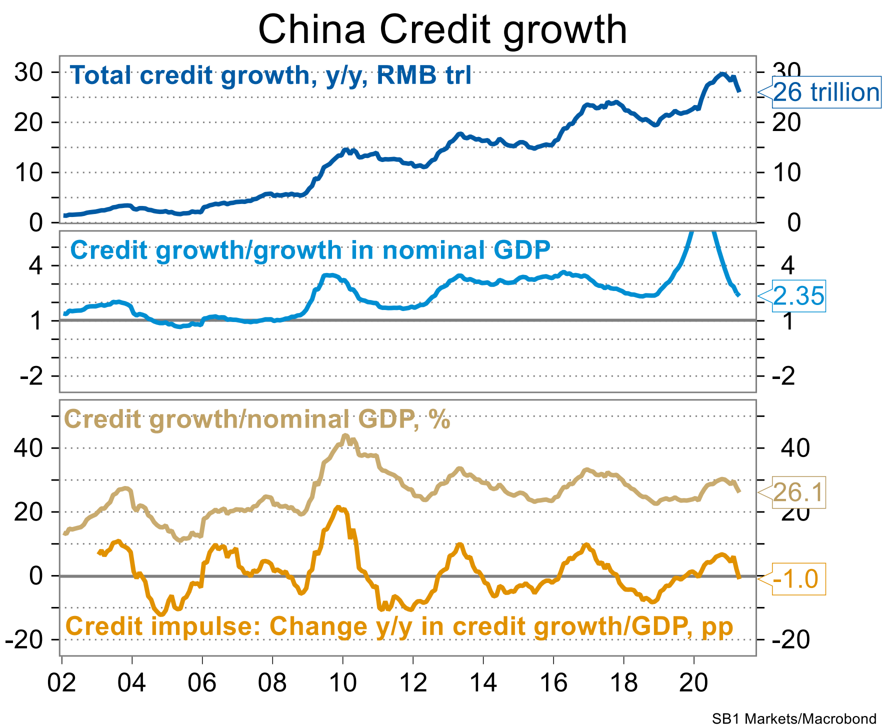


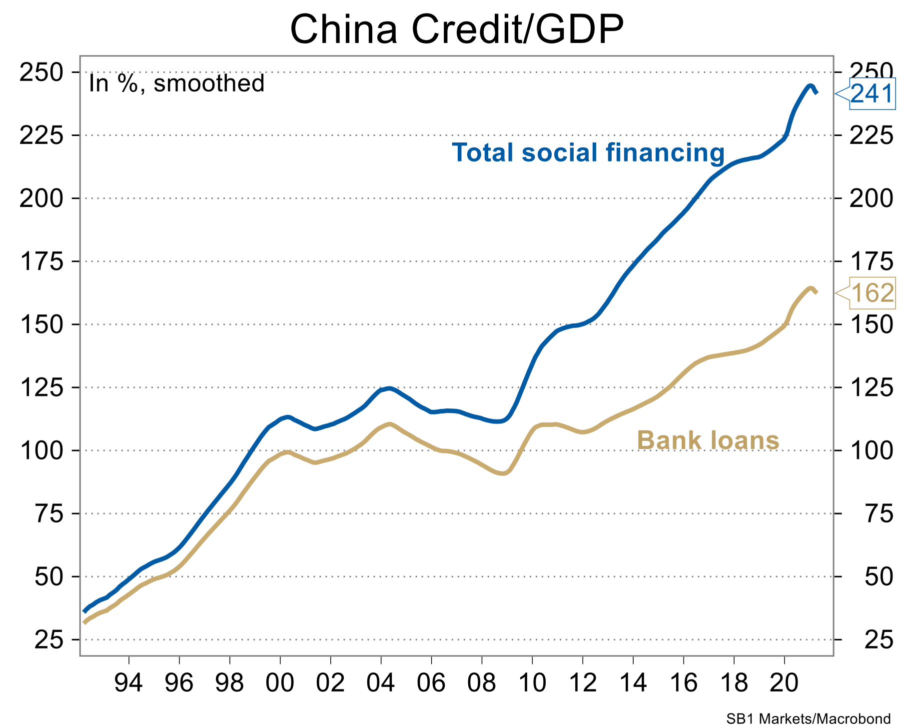


- Over the past year, **total credit** has expanded by CNY 26 trl, equalling >25% of annual GDP, down from CNY 30 trl at the peak
- Banks supplied CNY 20 trl of the y/y increase
- **Local governments** have not yet accelerated their borrowing by much, at least not in the bond market, still up 3.6 bn y/y
- Other credit – via the **shadow credit market** x local gov bonds gained speed last spring but has slowed substantially in recent months just up 2.4 trl (from +5 trl!)
- **Total credit** growth at 10.8% is well above nominal GDP trend growth (but below the y/y high growth rate in Q1)

The credit impulse has slowed markedly

A moderate pressure at the brake pedal is reasonable, given strong growth and a high debt/GDP ratio



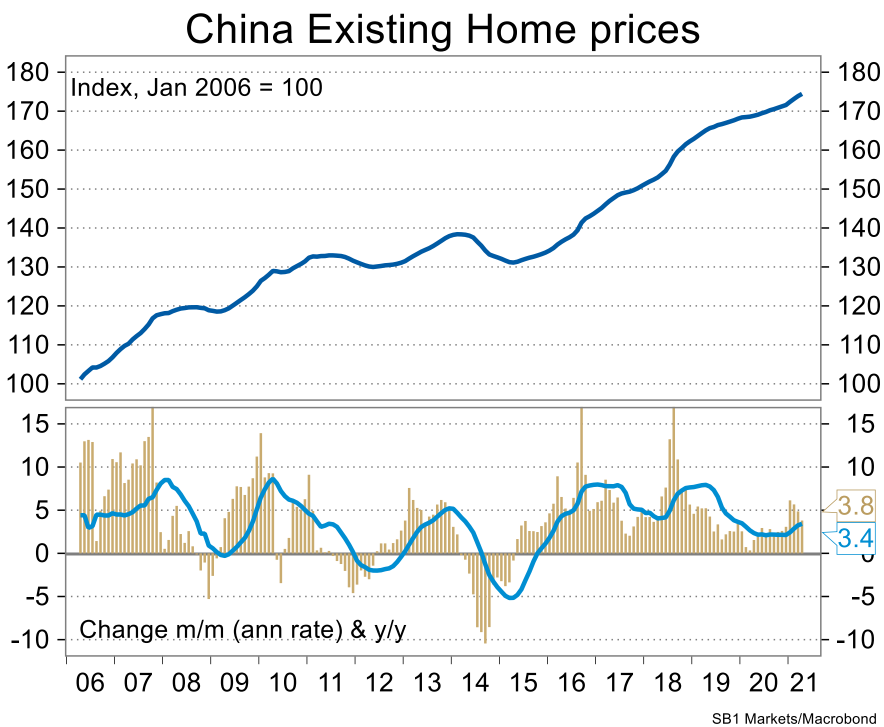


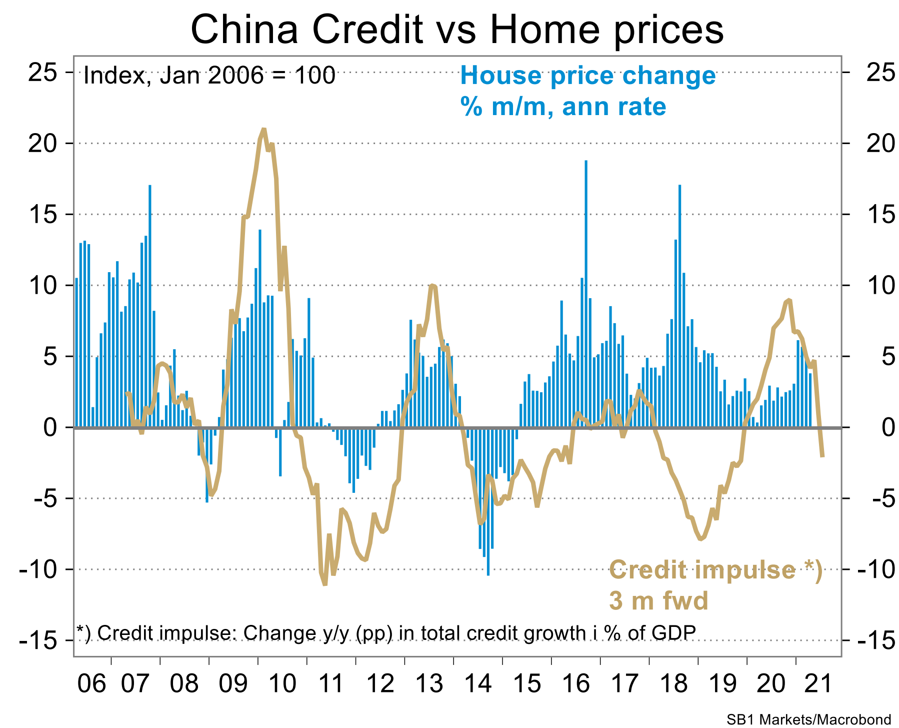
- A positive **credit impulse** implies that the credit growth/GDP ratio is increasing (the 2nd derivative of credit vs the GDP level)
  - » A negative credit impulse indicates credit tightening (or weaker demand) and has been associated with slowdowns in the Chinese economy
- The credit impulse has been in the positive territory since late 2019, but have peaked – and it is now approaching a neutral territory, measured y/y (while it already negative measured over a shorter time span, but the short term volatility is large)

GDP is smoothed at the calculations at the charts above

House price inflation is slowing – amid the credit tightening?

Prices up 'just' 3.8% % m/m in April (annualised), slightly down vs the previous months

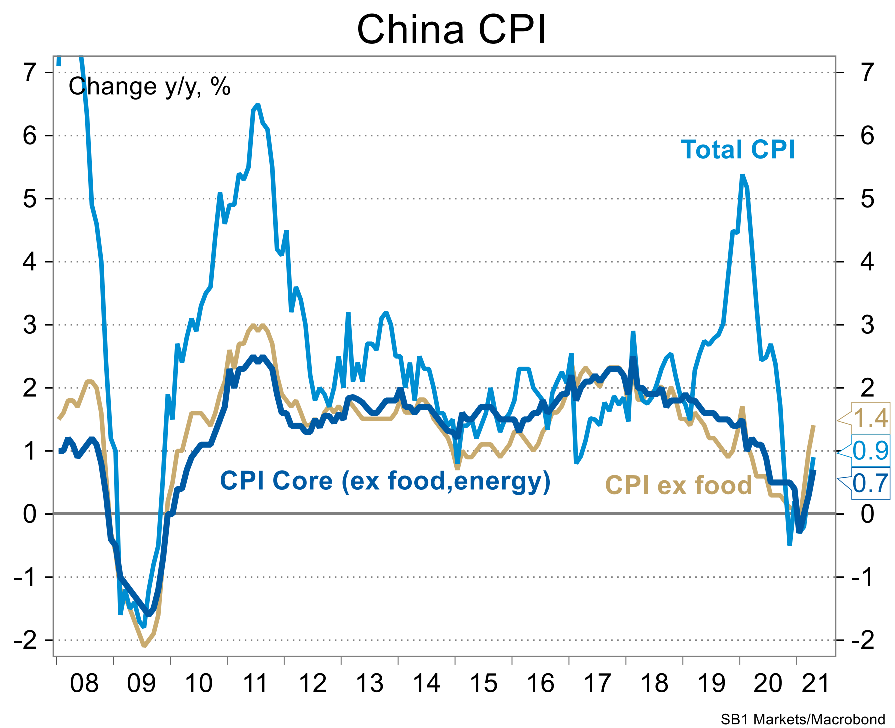


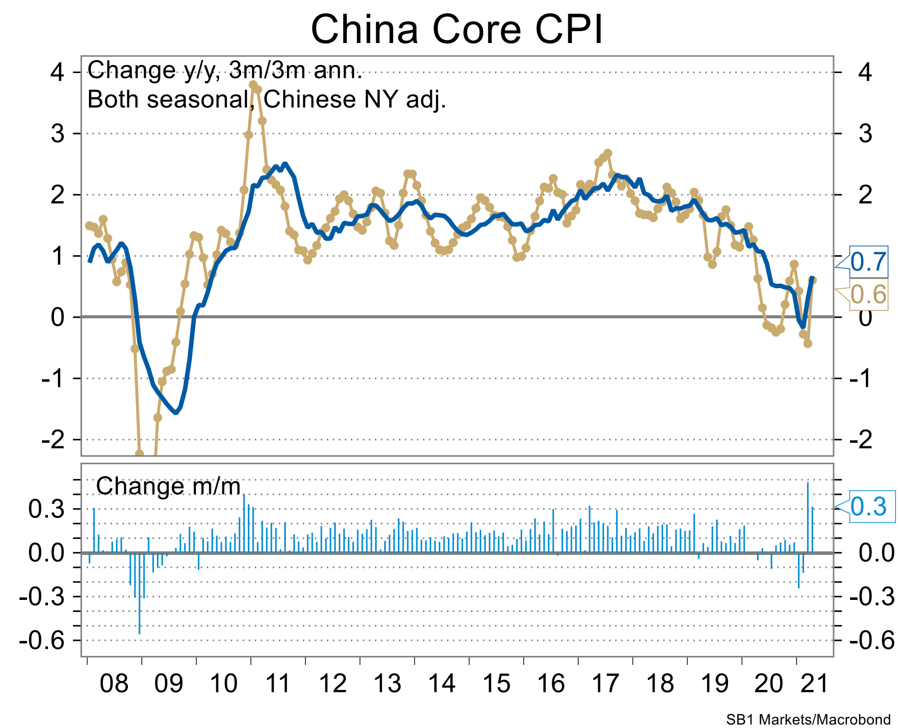


- Credit policy has been supportive, until now, but recent months the tide has turned
- The correlation to house prices is far from tight

Chinese inflation slightly below consensus, up 0.9% y/y

Core CPI up 0.3% m/m, and up to 0.7% y/y

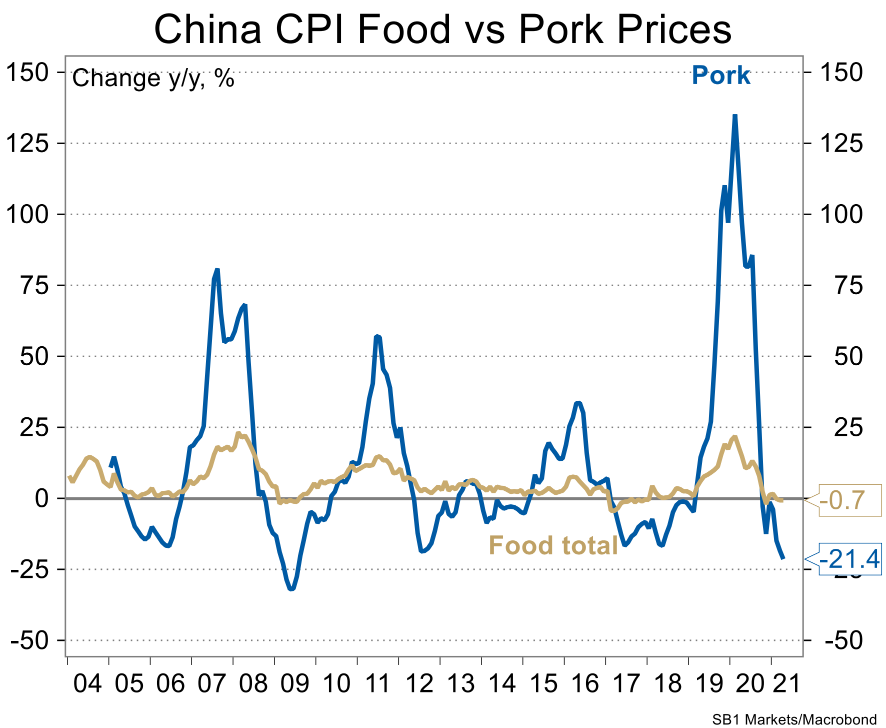


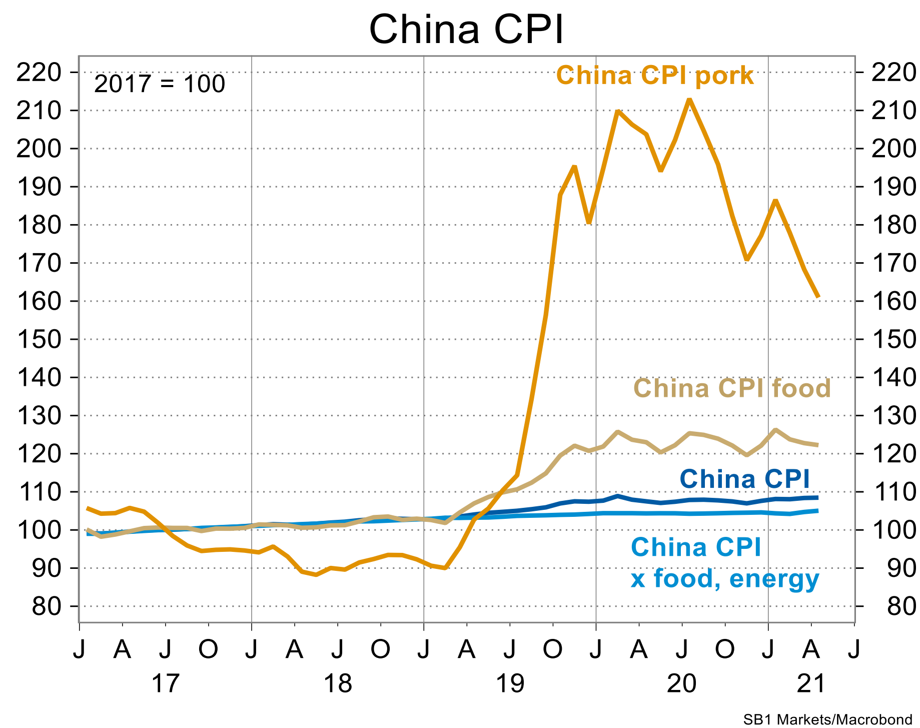


- **Total annual CPI** growth fell from above 5% in early 2020 to -0.2% in Feb. In April, CPI was at 0.7% y/y, up 0.3 pp from the previous month. The steep decline in headline CPI is mostly due to a partial reversal of the ultra high pork prices last year, and pork prices are likely to keep falling as the level is still elevated
- **Food prices** fell by 0.6% m/m as pork prices fell 4.4%. Food prices are down 0.7% y/y (unchanged from March). However, the latter is trending down following the 130% price increase due to the 'pig massacre' (swine flu), and prices are still up 60% - 70% vs. the level before the flu, and will probably continue to decline substantially over time
- **The core, ex food & energy price index** rose by 0.3% m/m, and is up 0.7% y/y, from 0.3% in March
- **Low inflation** support real income growth. **Monetary policy** will not respond at low inflation per se, the real economy is more important

Pork prices down 4% (s.a) in April, pulling down food price inflation

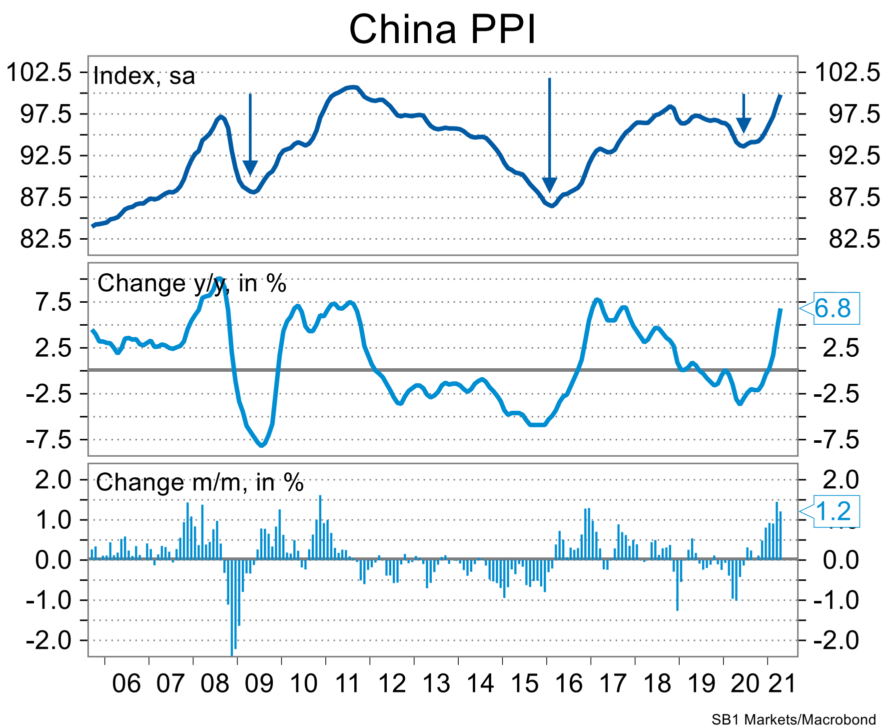
Pork prices are down almost 25%, will most like decline further, bringing total CPI down

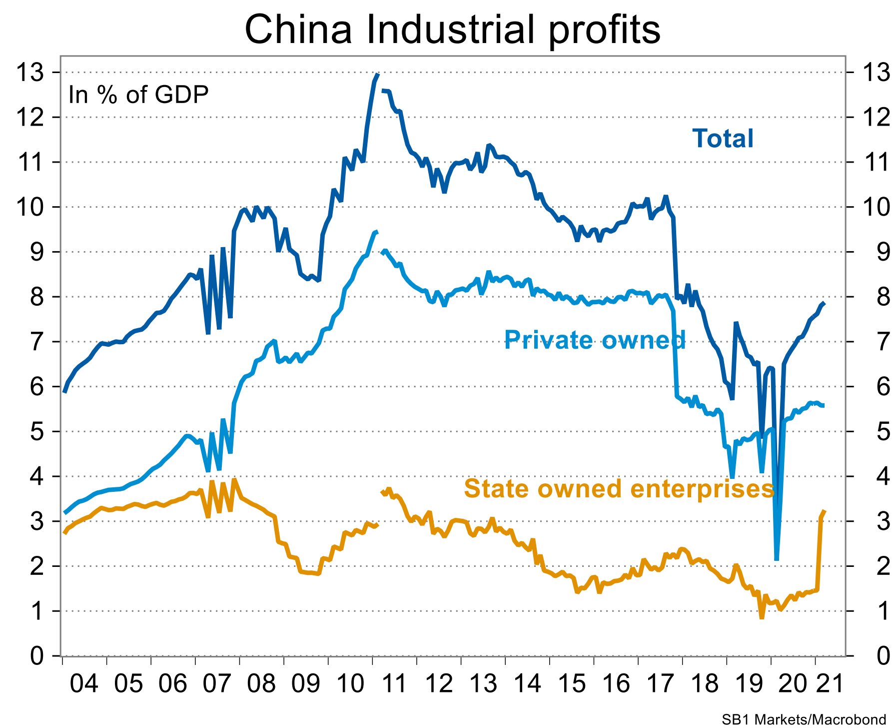




Factory gate prices are still surging

PPI up 1.2% m/m in April, up 6.8% y/y, expected 6.5%. And the impact is felt around the world?

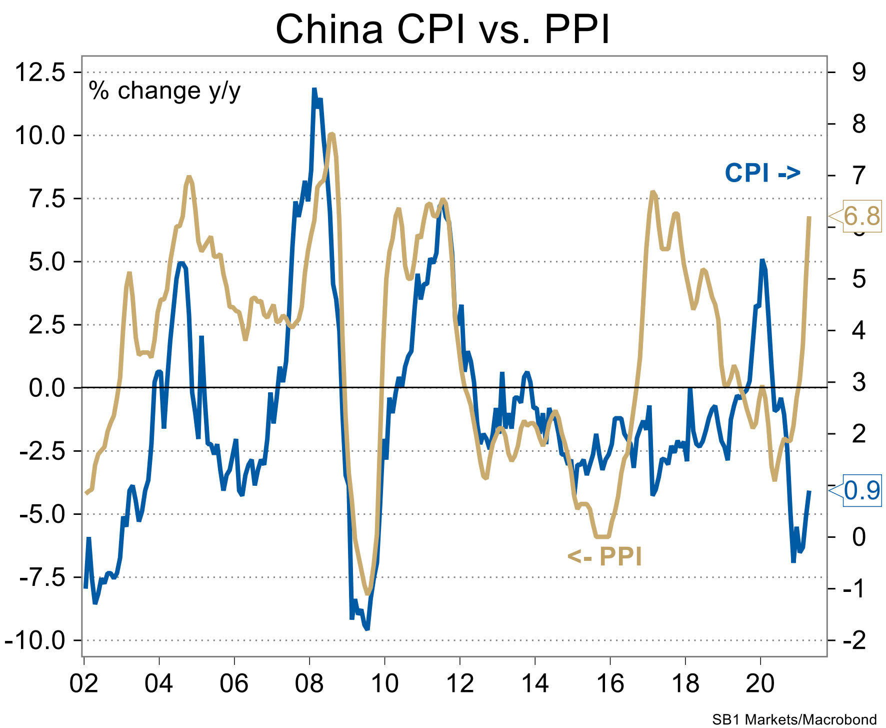


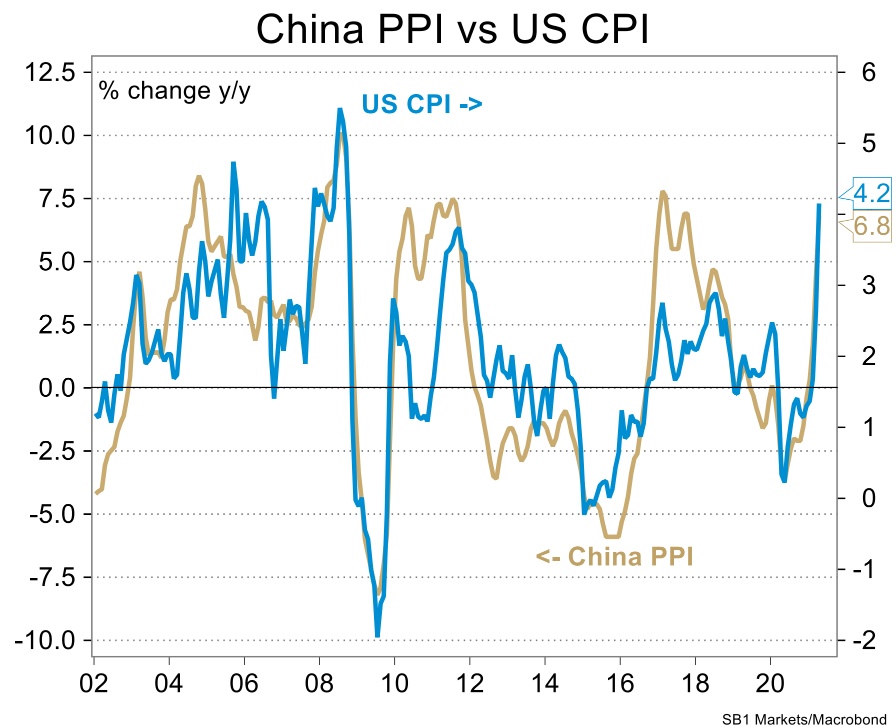


- The **PPI** peaked in late 2018 but prices just fell some 4%, some of it during the spring. During previous setbacks, PPI has fallen up to 13% (and never less than 8%). The rise in PPI in the last couple of months can largely be contributed to an increase in the price of commodities
  - » The correlation to Chinese CPI is not that strong. It is more important for other countries, check next page
- **Profits in privately owned industrial enterprises** fell by 50% in February '20. Profits rose to a normal level in April/May '20 – if we label the profit level in 2019 and early 2020 as normal – at 5% of GDP – and now it has climbed to 5.5%
- **Profits in state owned enterprises profits** have now come back above 3% - a level not seen since 2013

The Chinese PPI is even more important for the US CPI than for the Chinese CPI

... as food prices are important in the Chinese CPI but not in the Chinese PPI (nor in the US CPI)

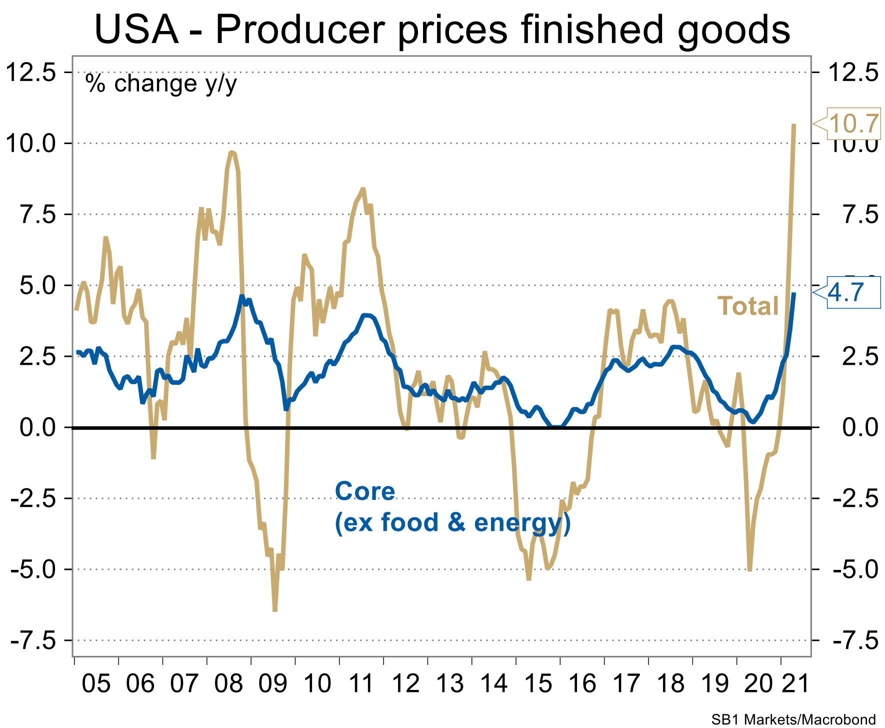


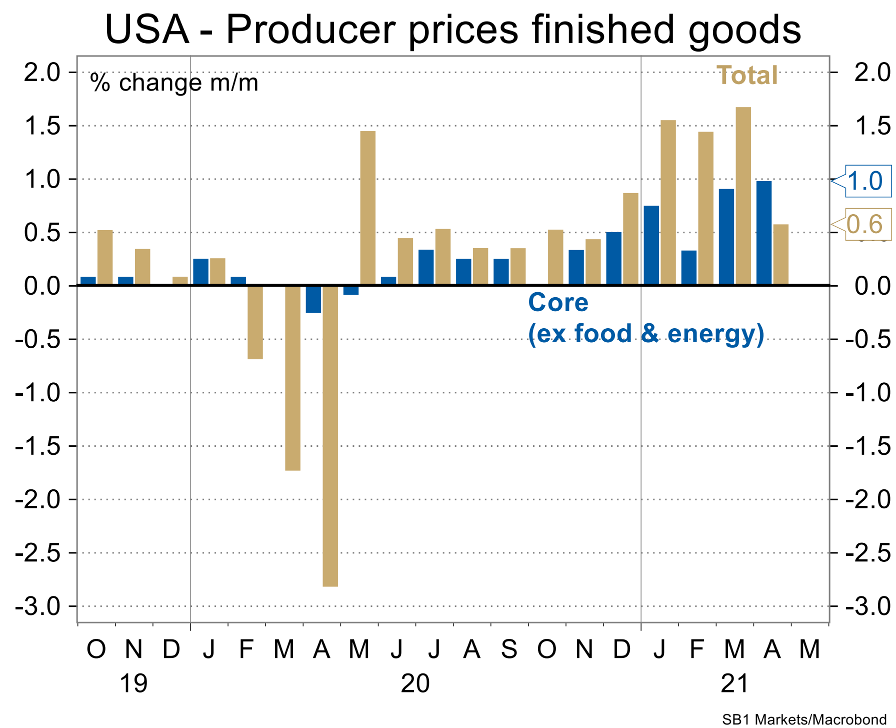


- ... And the 'model' worked perfectly in April, check chart to the right ☺

Producer prices further up of course, and more than expected

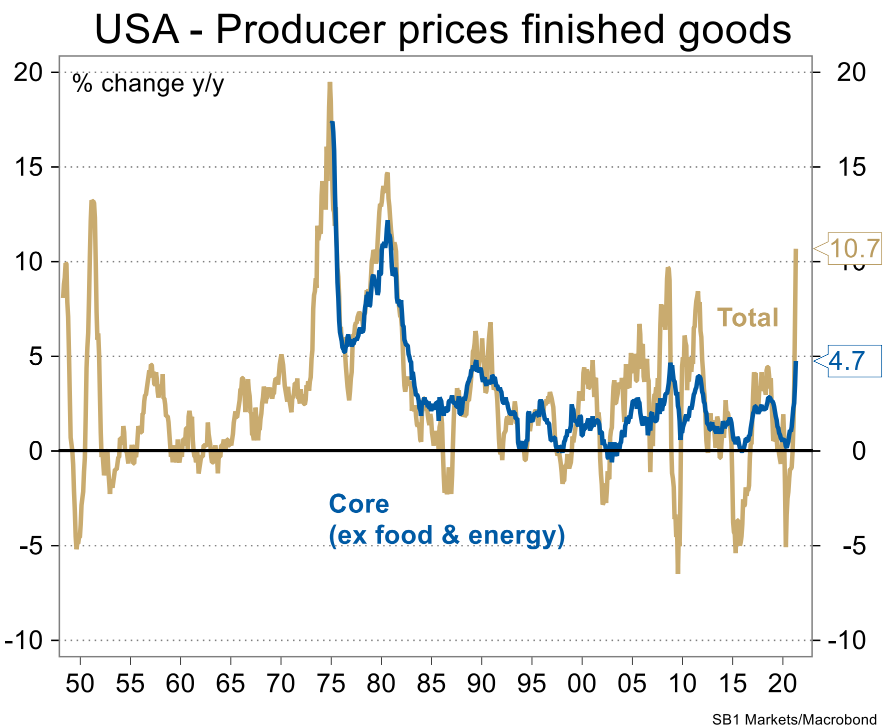
The highest price increases in 4 – 5 decades have been reported the last 3 – 4 months

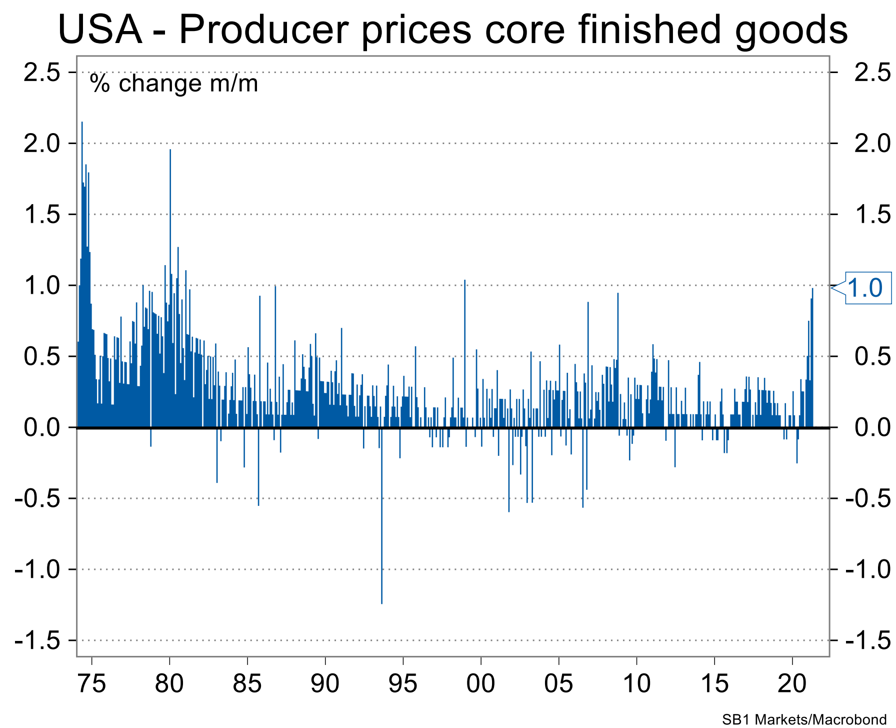




- **Core finished goods x food & energy** PPI rose 1.0% in April, up from 0.9% in March. The annual growth rate accelerated 1.2 pp to 4.7%, the highest level in 22 years
- **Headline finished goods PPI** rose 0.6% m/m (expected 0.3%), as energy prices contributed on the downside, following the 1.5 – 1.7% price hikes the previous months. The annual rate climbed 3.7 pp to 10.7%
- **The 'official' total final demand PPI**, including services, rose by 0.6% (6.2% y/y), 0.3 pp more than expected. Even services are up 4.0% y/y
- The PPI confirm what business surveys have told us, no more, no less

A historical perspective: Monthly & annual rates the highest in 22 to 40 years

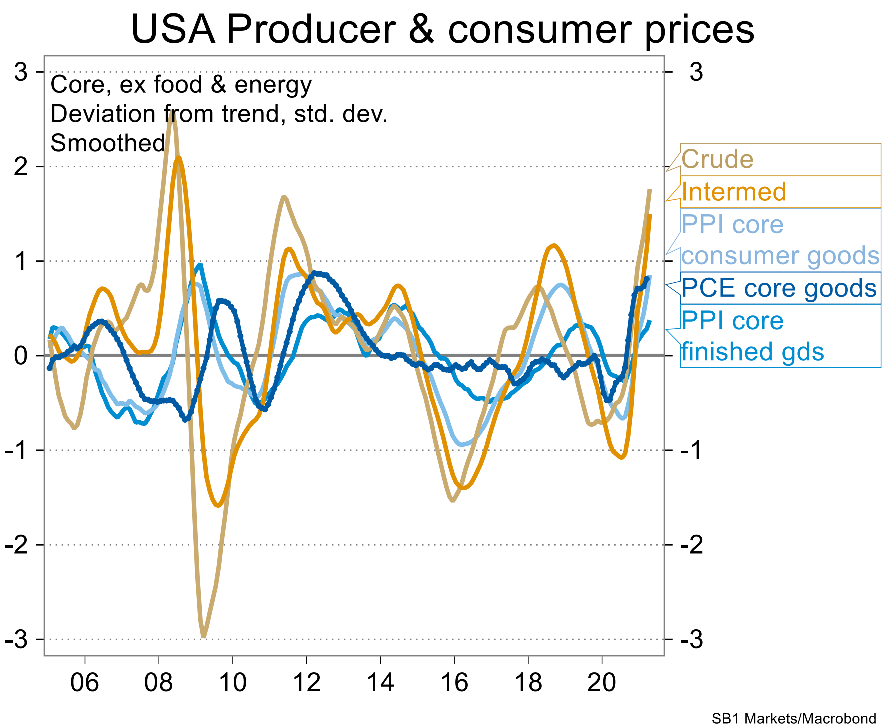


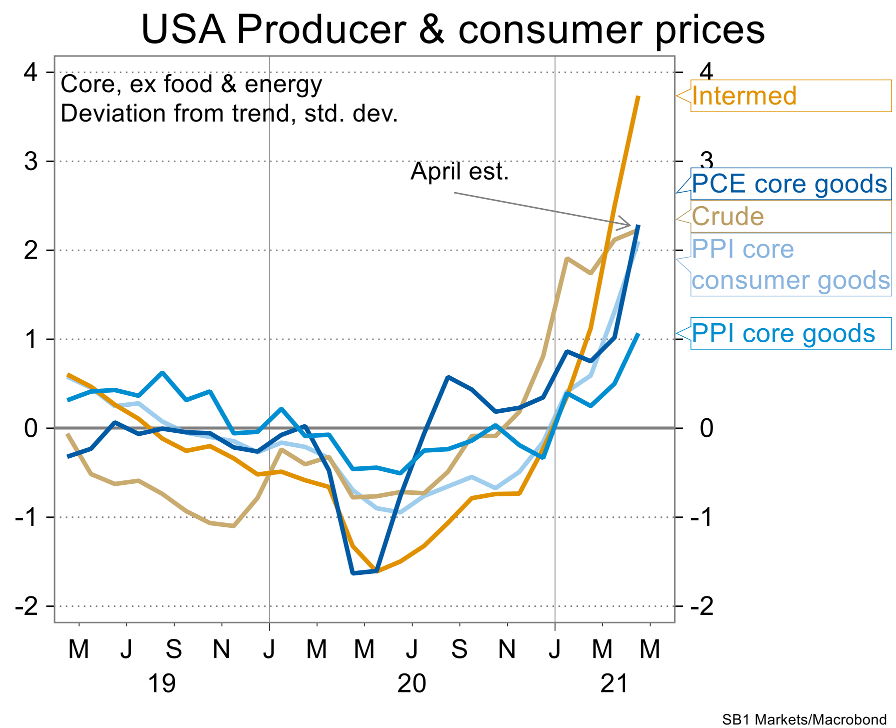


- Core PPI prices rose more last month than since 1999. The past 3 to 4 months, the most since 1980
- Total finished goods PPI has not climbed faster the past 4 months than since 1975
- This is all in line with reports from surveys and companies

It's not brewing, it's boiling: And it is still getting hotter

Crude & intermed. goods prices are still on the way up, expect more pressure on finished goods

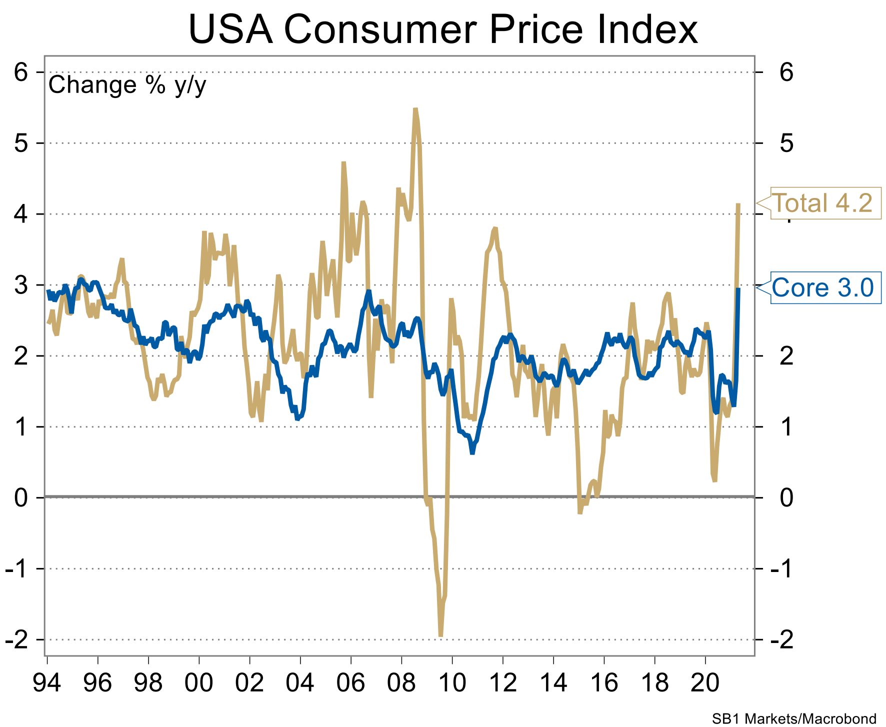


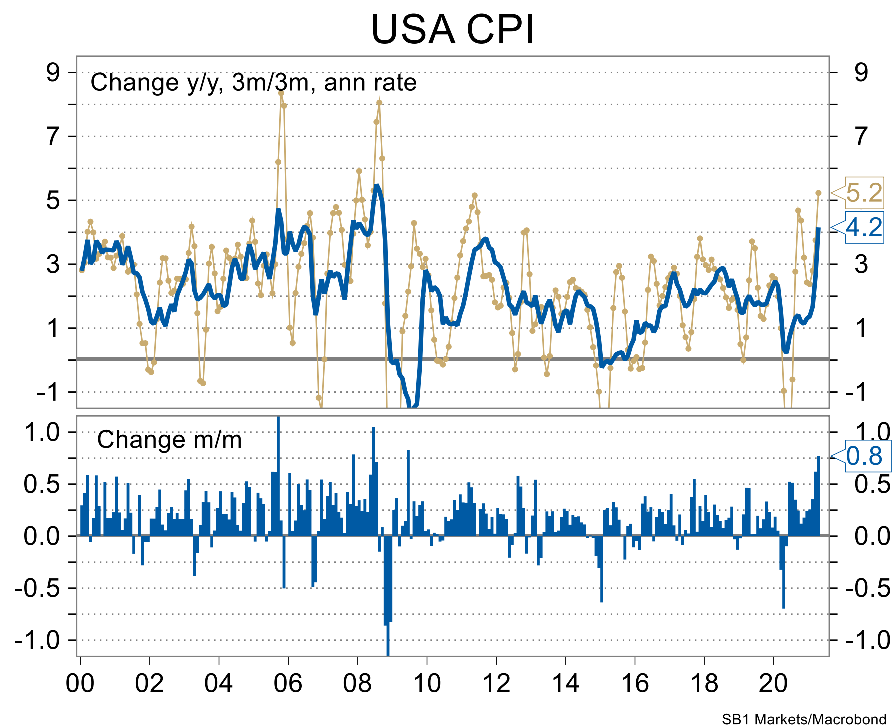


- Delivery times & prices are on the way up – and production is increasing rapidly. Hmm…
- It seems likely that finished goods PPI will climb further, given the continued increases in crude & intermediate goods
- Crude goods prices are leading intermediate goods by 4 months, and consumer prices by 12 months – and crude prices have not yet peaked
- Some comfort: Prices at the consumer level have already responded to the hike in producer prices, and the upside risk for the PCE from here may not be that large (<u>we have added a 1% m/m forecast for the core goods PCE in the chart above</u>)

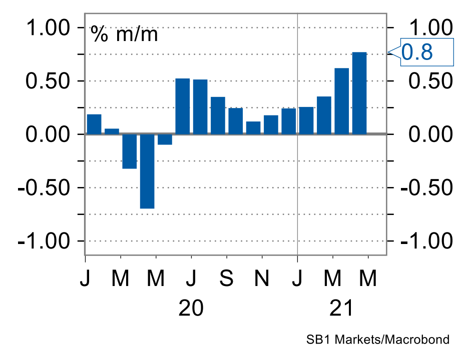
3% – 4% inflation, well above expect., and the base effect is not the only to blame

Highest monthly & annual increases in 12 to 40 years. Fed's patients may well be seriously tested



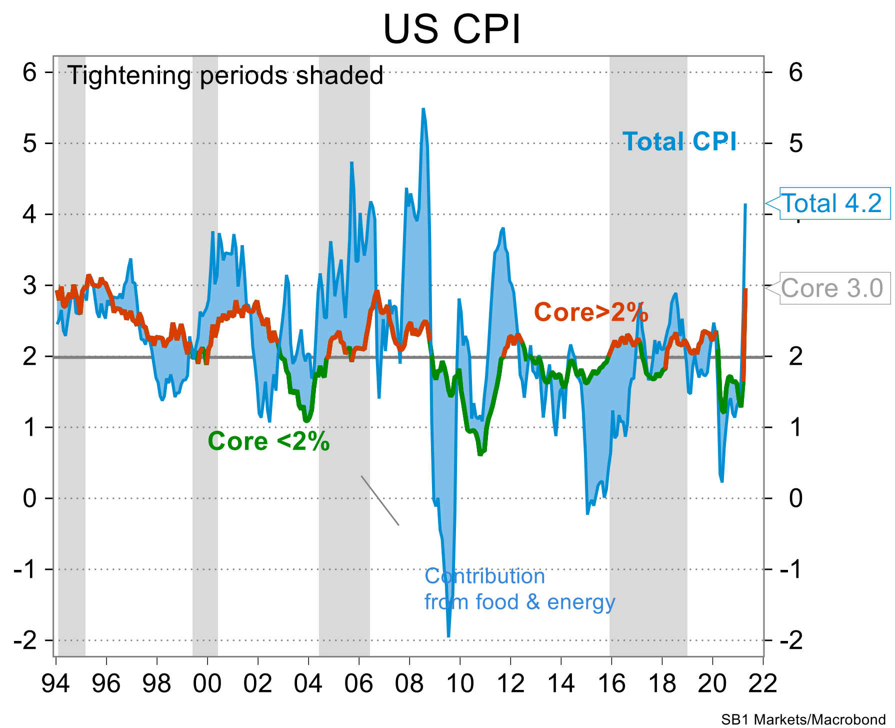


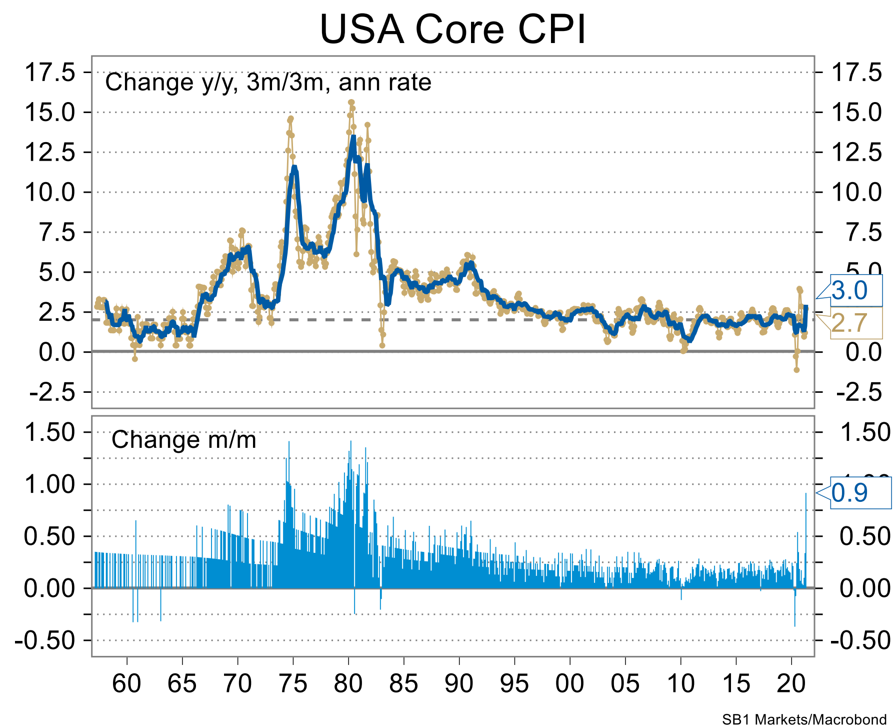
- **Headline CPI** rose 0.8% m/m in March, expected 0.2%. The annual rate rose by 1.4 pp to 4.0%, as prices fell 0.7% last April. This is the highest CPI print both m/m & y/y since 2009
- Prices have been accelerating m/m since last October, and the 3m/3m rate is now up to 5.2%, highest since 2009
- In April surveys, companies reported that they expect to lift prices sharply. We doubt all planned price hikes were competed by mid April…
- The annual rate may increase further in May, but in both June & July last year prices rose sharply m/m
- The Federal Reserve can still afford to wait and see, but the 2% average inflation 'over time' is already reached and communication will have to become more nuanced, with more assessment of the upside risks on inflation than until now. The Times They May Be A'Changin', Jerome
- Many more details on prices & wages at the following 26 pages ☺ (if you include the previous 3 pages that is)



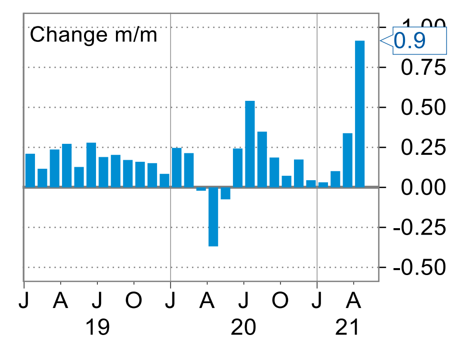
Core inflation sharply up too, auto prices mostly to blame

Prices +0.9% m/m in April, expected 0.3%, the y/y rate jumped 1.4 pp to 3.0%, highest since '96



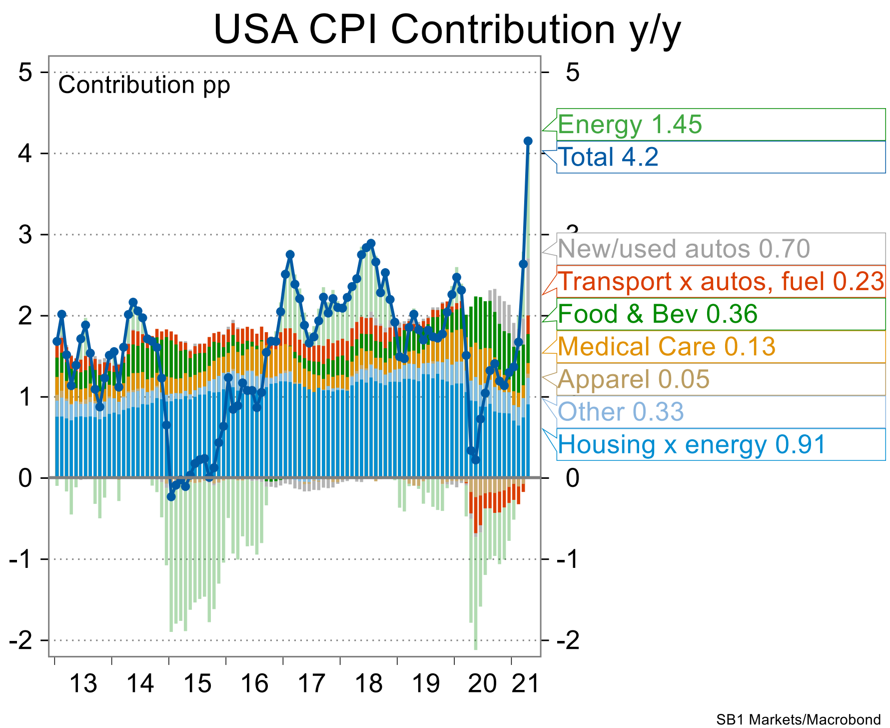


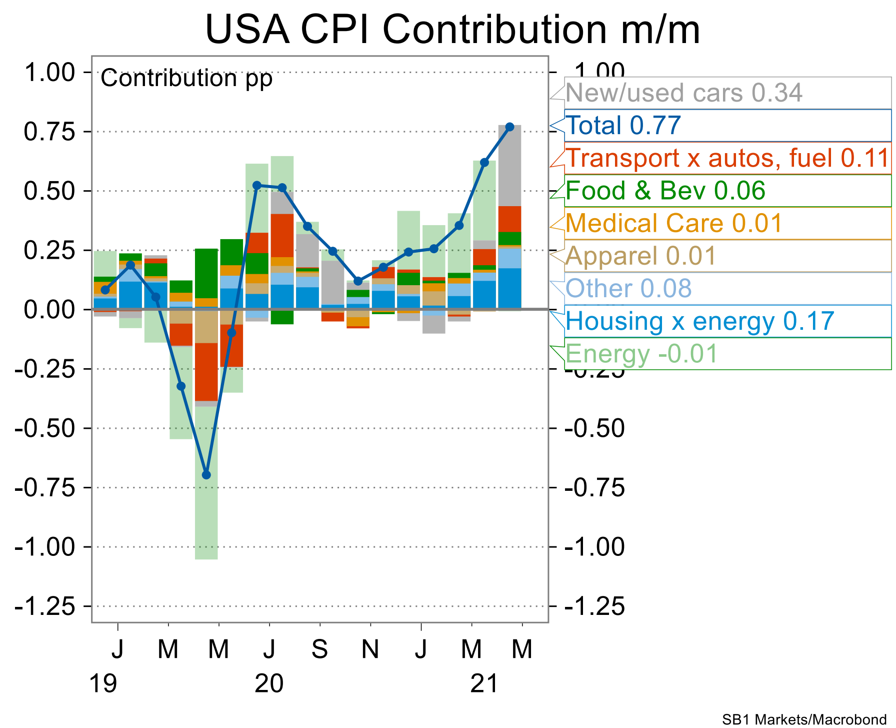
- The 0.9% m/m hike in the **core CPI** was the highest since 1981
  - » Until the April 'shock' the 3m/3m underlying price growth at 1.2% did not signal any serious pressures
- The price hike in April was at least partly due to one-offs which will not be repeated, or will be reversed
  - » Auto prices seem to be a candidate on the downside
  - » However, some prices are still too low, like lodging, transport & recreation – sectors that should be able to lift prices during the reopening process
- Prices fell 0.1% m/m in May last year. Don't bet that trick will be repeated this year…



Transport contributed by 2.2 pp of the 4% annual headline CPI y/y growth

... Of which half from auto fuel, but new/used vehicles are sharply up too



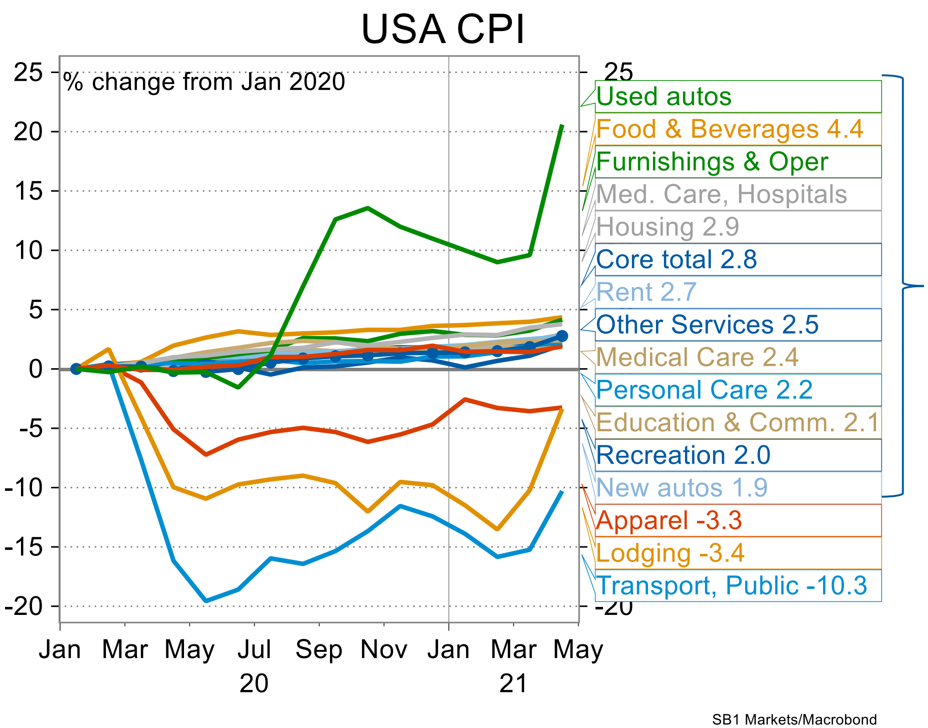


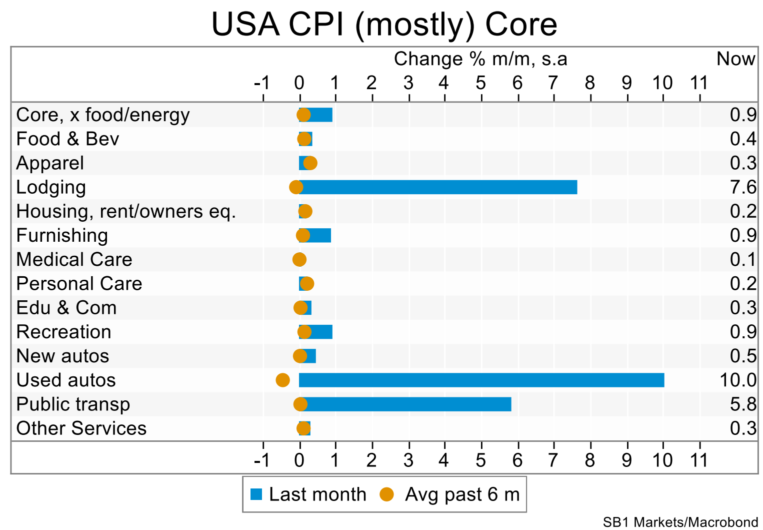
- In April, **new & used cars** explained almost half of the m/m lift in total CPI, and 0.7 pp of the 4.2% growth in headline CPI
  - » Used car prices rose 10% in April, and are up 20% y/y. They are probably to expensive now, but not necessarily that much. The upside must be limited, though
- **Energy** has lifted the headline CPI by 1.5% last year (but was not to blame for anything in April, as oil prices have flattened. If the oil price does not skyrocket from here, the contribution to the annual growth rate from energy will quickly fade
- Excluding the 2.2 pp **contribution the headline CPI from energy & cars**, "remaining" inflation is still at 2%, and quite stable. Thus, the sharp acceleration in headline & core CPI is not that broad

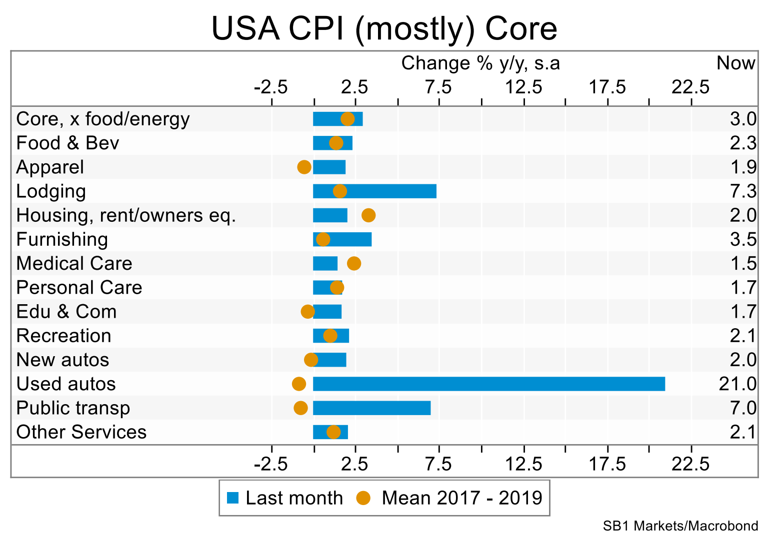
Lodging away from home is a part og housing at the charts above

Lodging up 8% m/m - still some more to go. Public (air) trasp. +6%, still too cheap

Used auto prices up 10%, +20% vs pre-pandemic! Too high? Somewhat, check next page



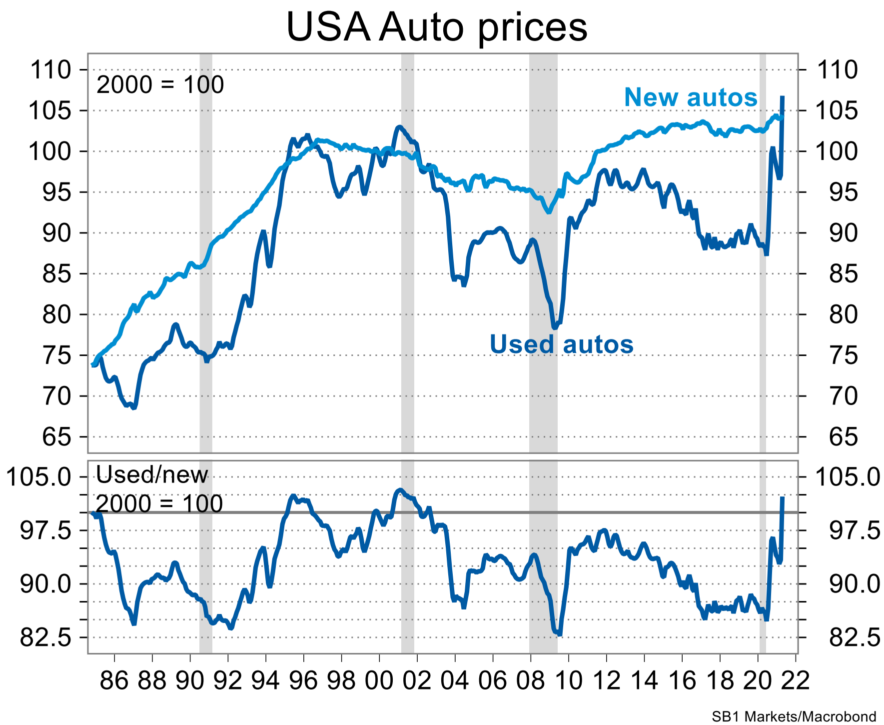




- Just some few components of the CPI contributed to the 'corona' setback: **Public transport** (airline tickets) **lodging** away from home (hotels ect), and apparel. Other components of the CPI have not slowed
- Now these sectors are hitting back, bringing their prices up to more normal levels again
- **Used auto prices** have been on the way up since last summer – and shot up in April

Are 2nd hand cars too expensive following the 20% lift?

Very likely. But they were too cheap before the pandemic too?



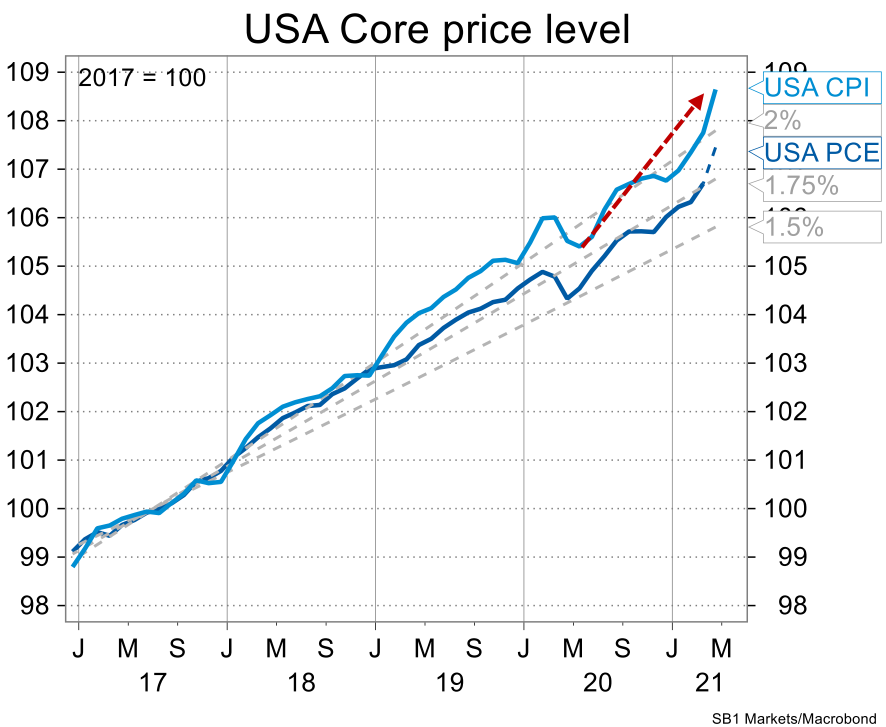
- By the way, prices for **new autos** are up 3% since 1996, quality adjusted, that is. And until the recent price hikes in a very tight US auto market, 2nd hand prices were down 10% the past 25 years (quality adjusted)
- It is impossible from these data to be sure if there is an equilibrium between new and used cars – and even less what it might be. Still, the current used auto prices seems to be stretched vs new autos

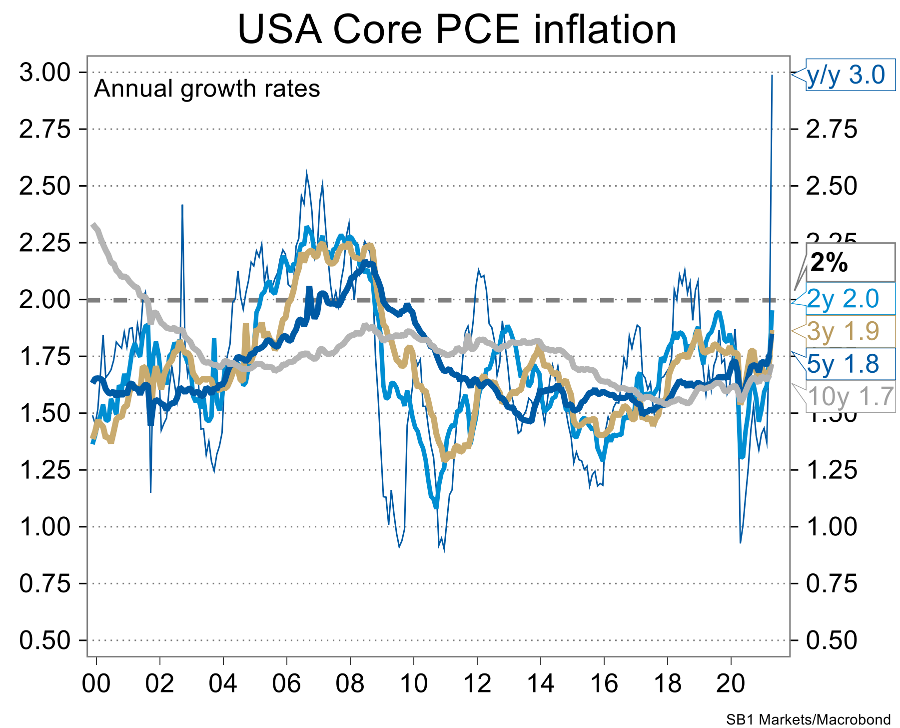
SpareBank 1 MARKETS

What if average PCE inflation is 2%? Well, it is – or at least not far below

Federal Reserve has rephrased its inflation target: Will aim for 2% inflation over time

At the charts below: We assume an 0.7% increase in the core PCE in April

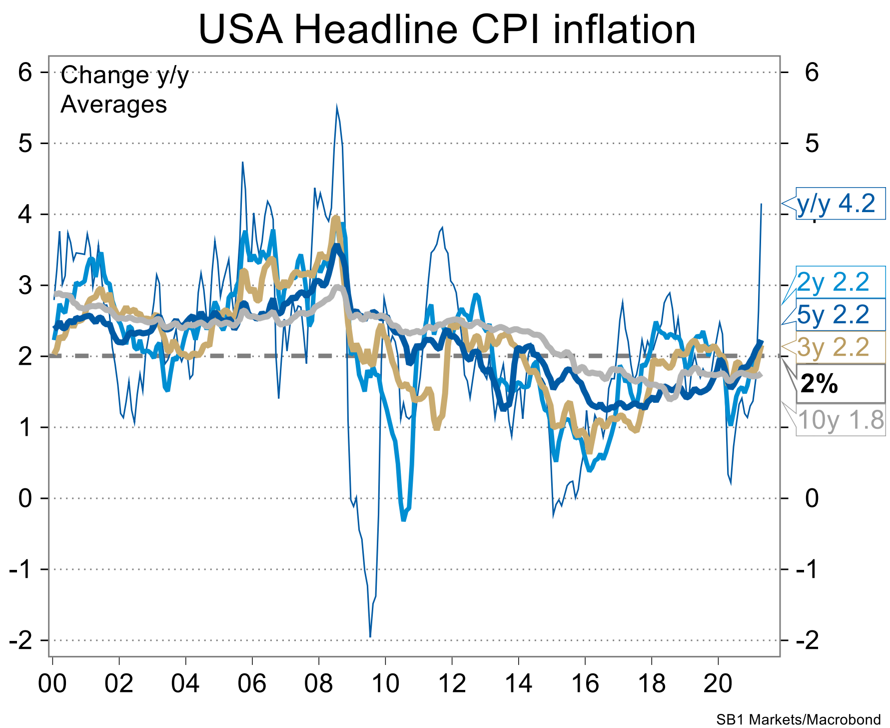


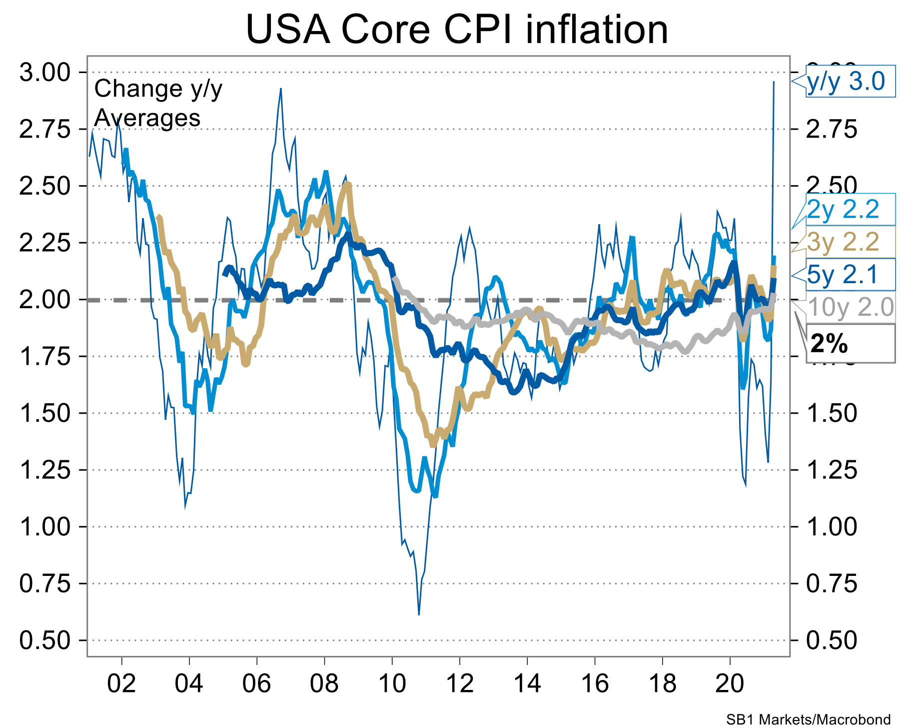


- … and not for each and every year. So, if inflation has been too low, like until now, the Fed will aim for pushing inflation to above 2% for a while, to reach 2%, over time
- The Fed has not defined its **time horizon**, should the average 2% inflation target be reached over 2, 3, 5 or 10 years? We guess 2 years is too short, and 10 years is a too long period. So something around 3 – 5 years?
- If so, given a fair estimate for the core PCE (the deflator for personal consumption, Fed's preferred price measure) in April, the 3 y rate is now 1.9%, and the 5 y rate 1.8% - thus not much below 2%. At the chart to the left, the core PCE price level now is not far below the 2% line, starting at the average price level in 2017 (4 years ago)
- **Measured vs. the CPI**, the average core inflation is at or above 2%, whatever period we check, see next page
- The 3% y/y lift in prices in April is of course both due to the price cuts last April – but even more due the brisk increase in prices past (check the red arrow)
- **Inflation expectations** are way above 2% in markets & among households and very likely among companies as well

‘Average’ CPI inflation is already above 2%, both the core & the total

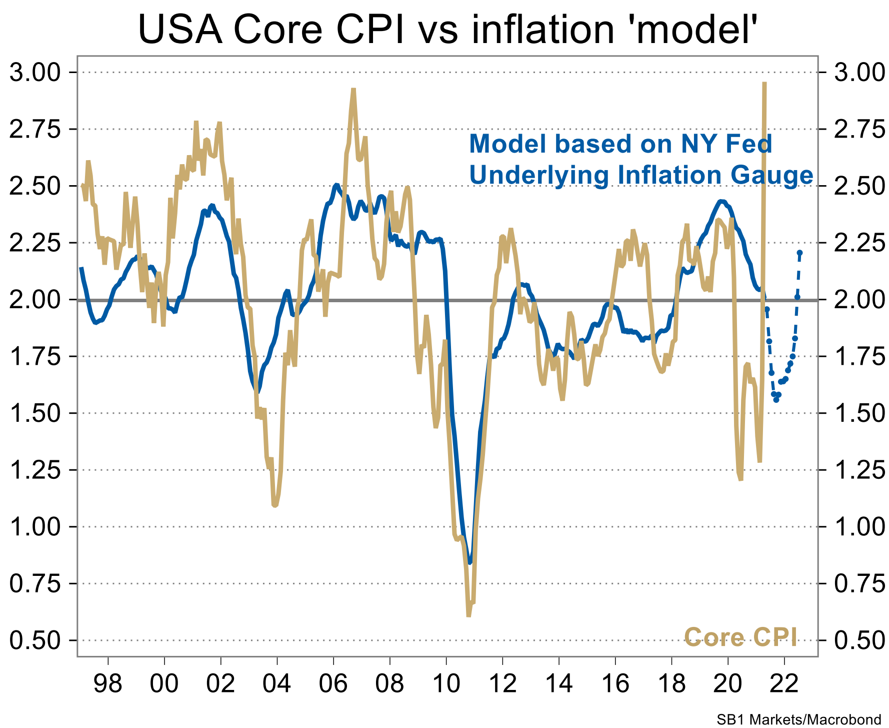
The consumption deflator PCE inflation (Fed’s preferred price index) is 0.3 pp below the CPI on avg.





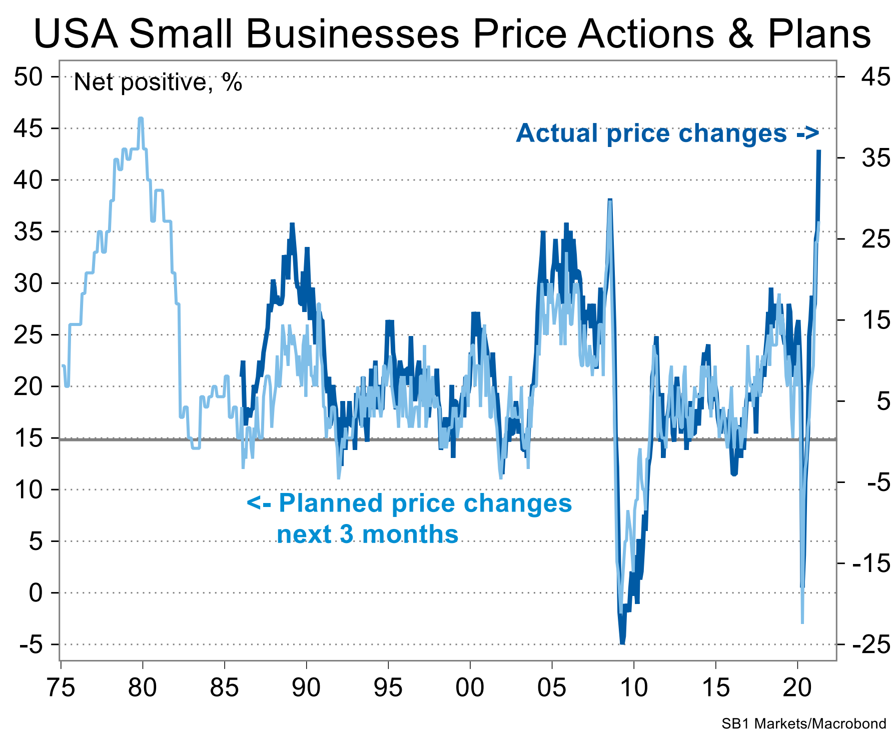
Fed's price model: A warning sign is sent but just a minor one

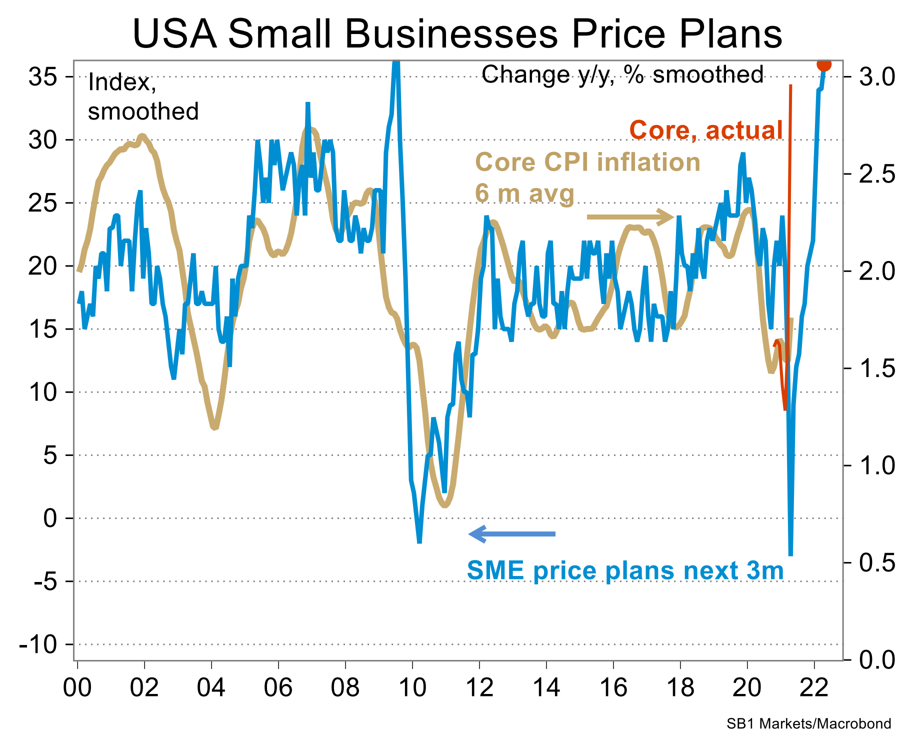
Fed's Underlying Inflation Gauge (UIG) signals core CPI inflation at 2.2%, yields >2.0% for the PCE



SMEs' selling price expectations confirmed at the highest level in 12 years

And more companies than ever before say they have already increased their prices

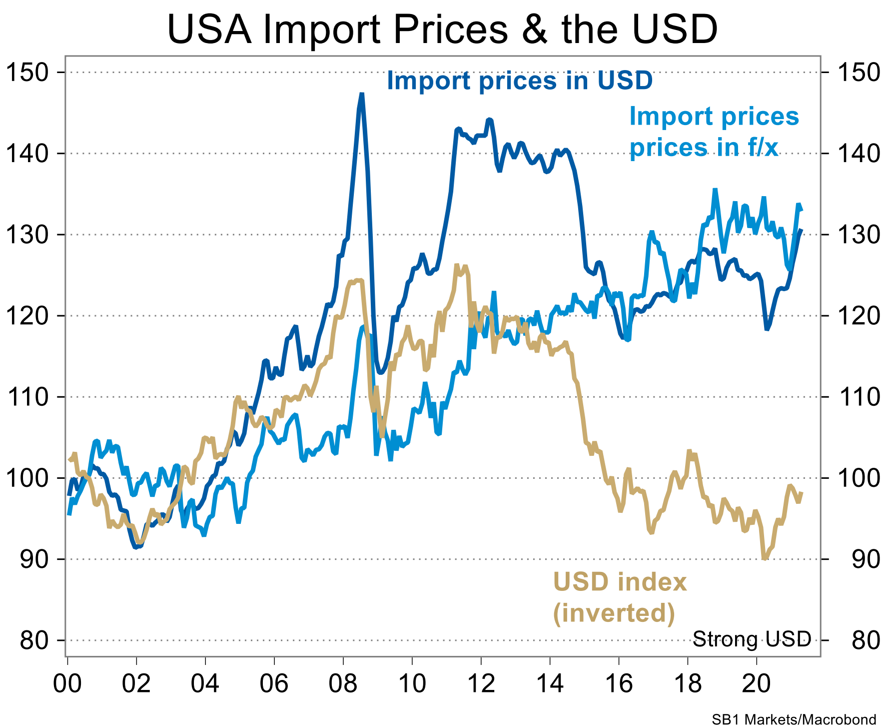


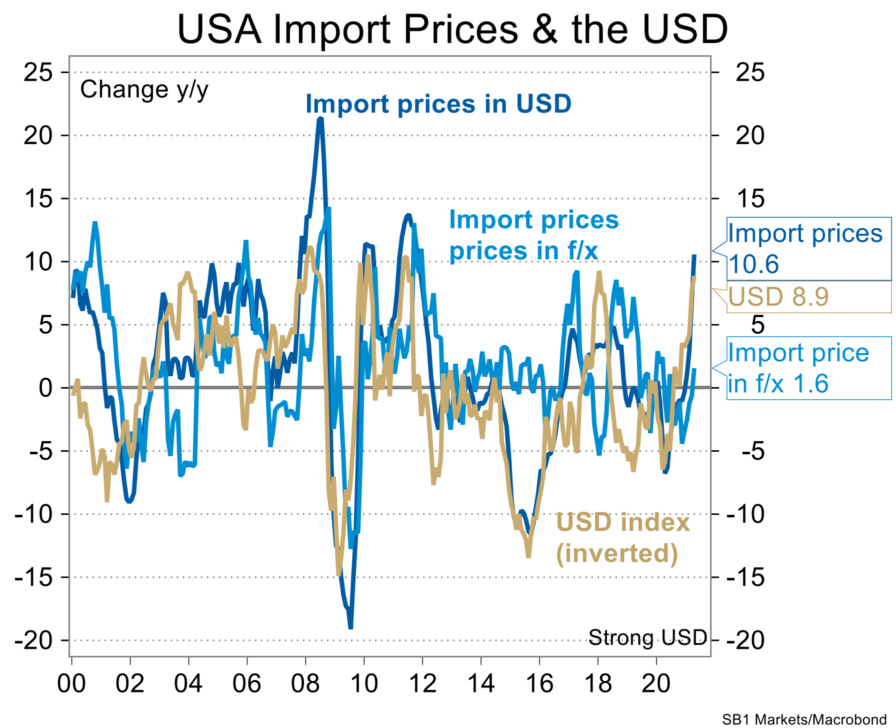


- Early last week we wrote:
  - » *Seems like we may have to change the scales on two axes on the chart to the right, we wrote early last week.*
  - » *At least on the left hand side of the chart, as the red dot climbed to 35 (per cent of companies that planned to hike prices, net). However, that does not have any direct consequences, of course*
    But what if we then have to change the scale on the right hand side axis too? Would that be a bigger problem, Jerome??
- At Wednesday we almost had to adjust the right hand side axis! The core inflation rate shot up to 3.0%, just what the SME's had signalled (if not measured by our 6 m smoothed average)

No import price drama: Total import prices are up 11% - 'due to' a 9% USD decline

Measured in exporters' currencies, prices are just marginally up y/y but is up m/m recent months



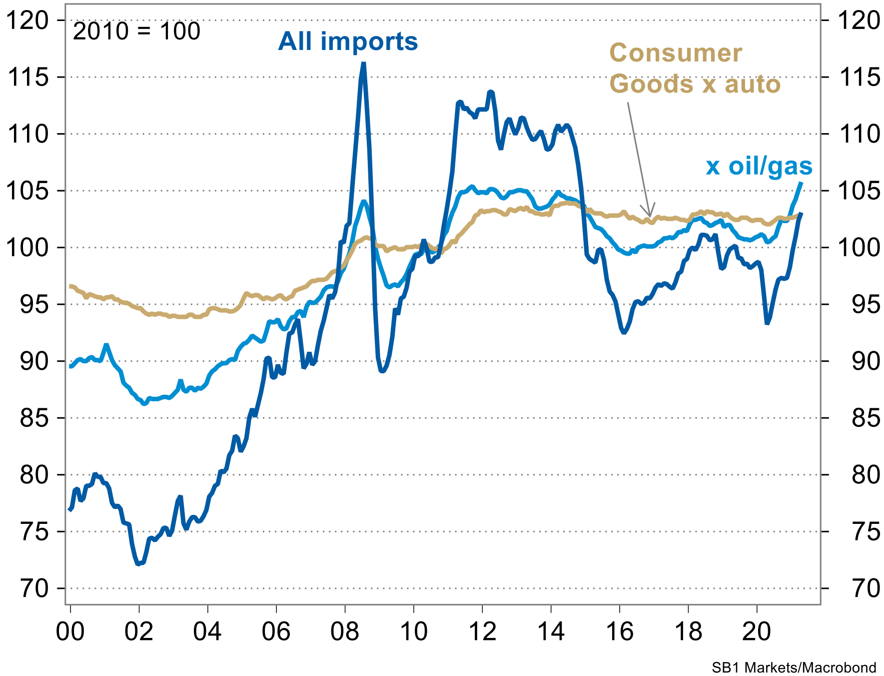


- Import prices, measured in sellers' currencies are at the same level as 3 years ago
- However, a mild deflationary pressure in the US, the USD appreciation (in average) in the 2012 – 2020 period has come to an end. The impact on domestic CPI is though limitied

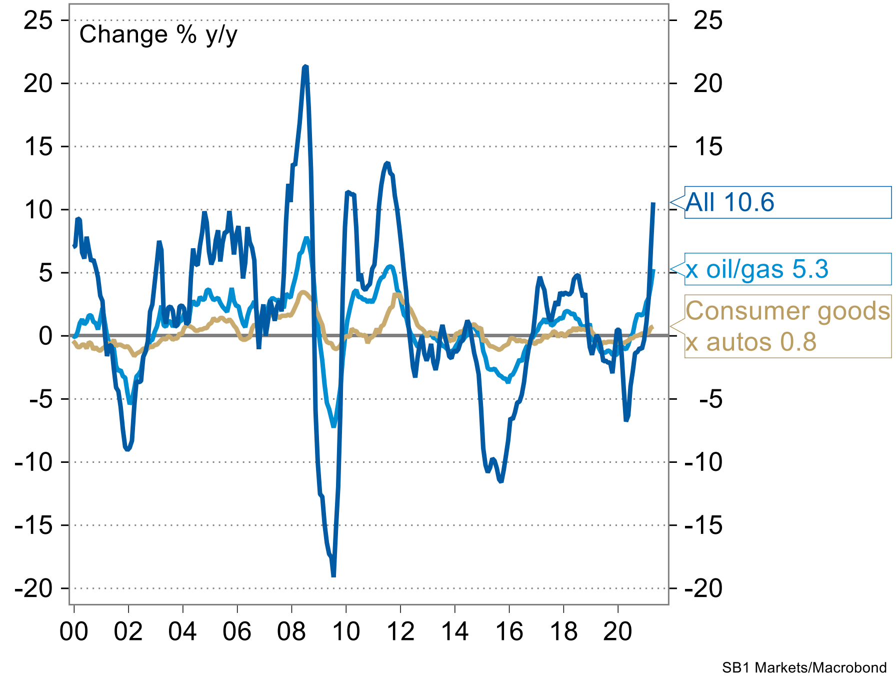
Still no growth in imported consumer goods, even measured in a 9% weaker USD

Total import prices up, also ex petroleum – <u>but consumer goods prices are just marginally up</u>

USA Import prices



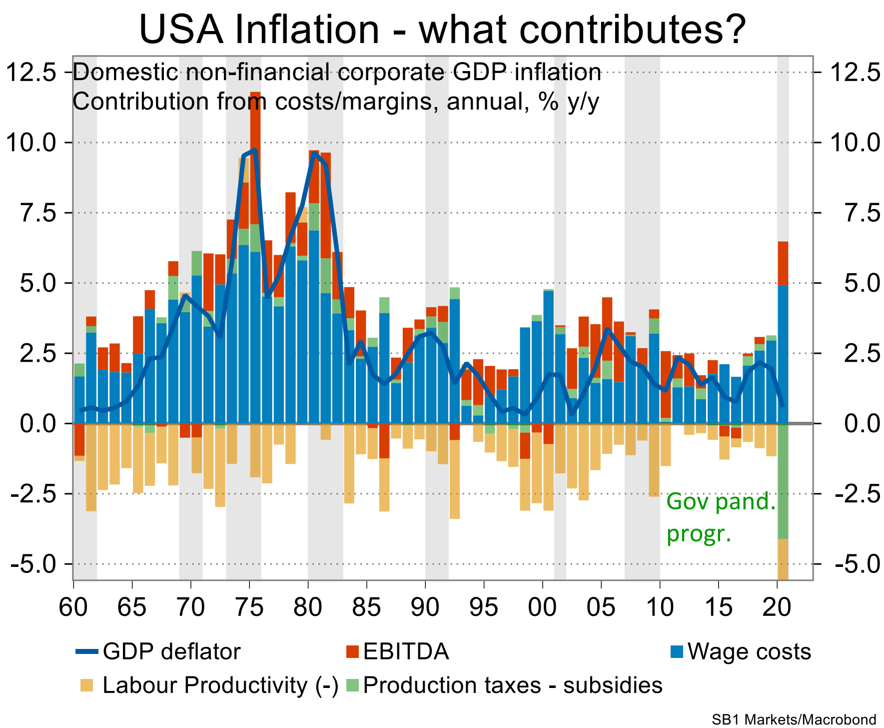
USA Import prices



- Exporters in other countries have so far not been able to lift their prices when selling to the US

Higher inflation, how worried should we be?

Raw materials, higher margins are not the main challenge. Wages may become so

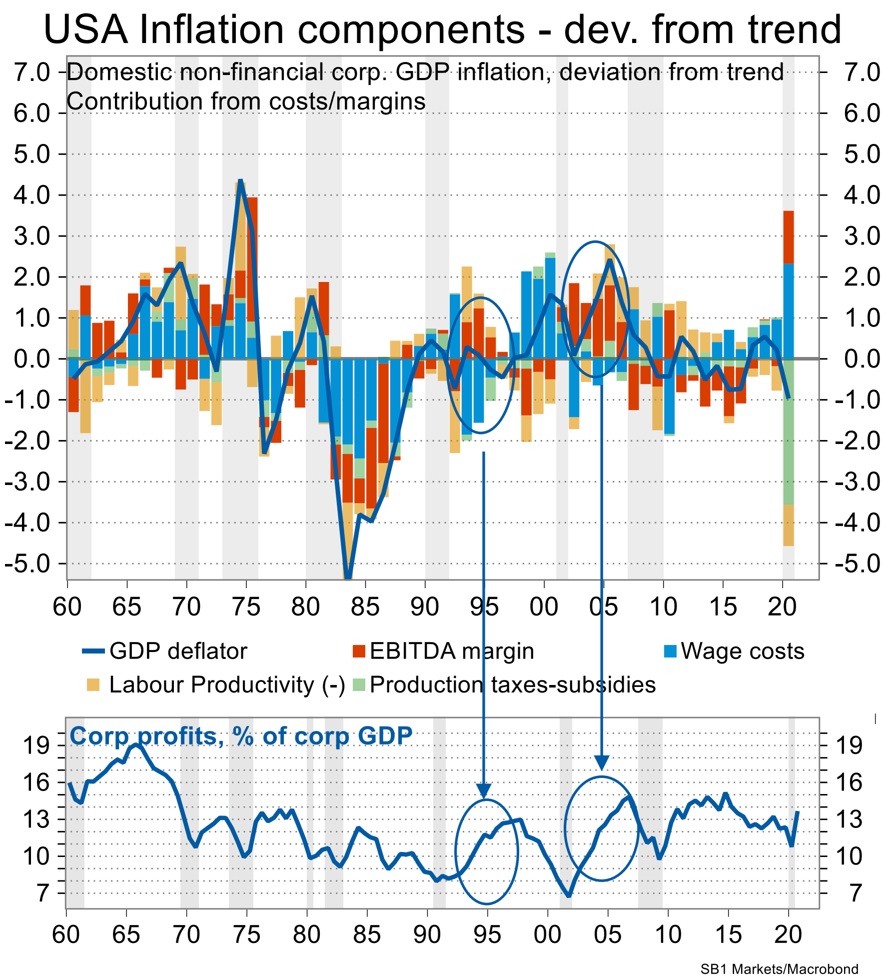


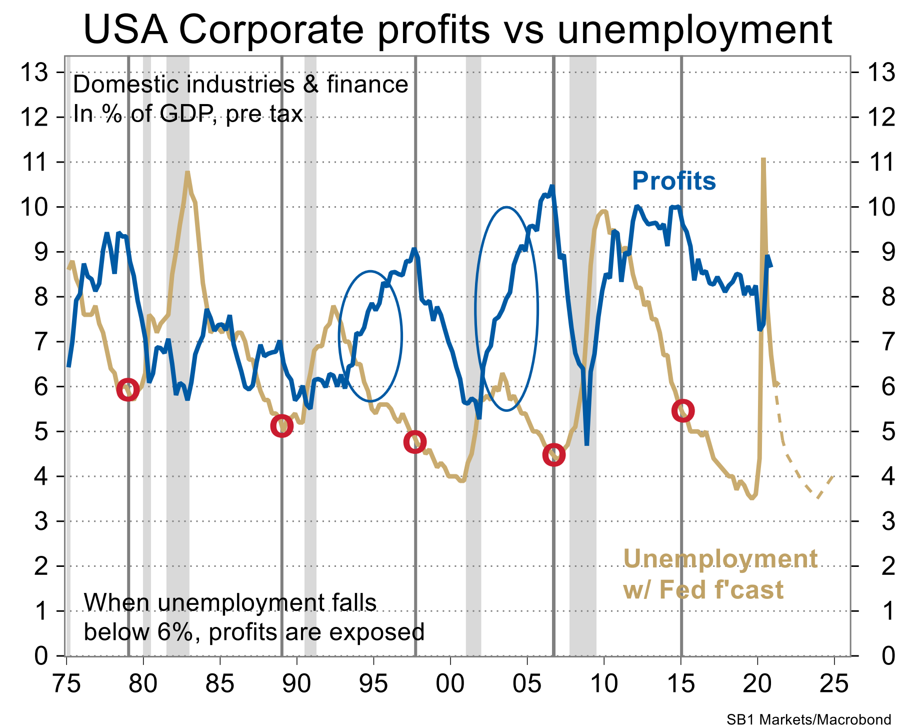
- **Higher EBITDA or profit margins**, due to higher selling prices to end users (consumption, investments), without any increase in wage costs – have normally not been important for explaining substantial and sustained lifts in inflation
  - » The reason is simply that historical or any likely variation in the EBITDA margin or in the profit rate normally have been too small to explain substantial and sustained changes in the inflation rate.
  - » If inflation should accelerate by 2 pp and stay there for 2 years, just due to a lift corporate sector margins, they would have to increase by almost 4pp. From a normal profit level, like today, that's close to 'impossible', in macro
  - » If anything – and over time – corporate margins are negatively correlated with inflation
- **Sort term,** changes in corporate margins may explain changes in inflation without changes in other costs, normally when raw material prices increase rapidly – like what we observe now
- **Faster growth in unit labour costs** (wage growth – productivity growth), has normally been the main driver for substantial and sustained increases in inflation
- **Wage inflation** is so far kept reasonable in check in the US, but signals from the labour market are unanimous, the labour market has become extremely tight over the past few months
  - » **Demand for labour** is very strong, as witnessed by all surveys, official vacancy data and endless anecdotes
  - » **Supply of labour** is still lacklustre – and far below the pre-pandemic level. Most likely, supply will strengthen substantially the coming months as
    1) The virus is brought fully under control, and there will be no reason for workers not apply for work (2.7 million (1.8% of the labour force stayed outside due covid in April)
    2) The federal pandemic schemes for extra support to the unemployed runs through Sept (some 16 states has decided/are discussing to close theses programs immediately). Lower benefits will probably increase supply of workers
  - » However, even **before the pandemic**, the labour market was tight, wage costs were increasing and profit margins were under pressure
  - » Reports on **wage increases** are common too, both in surveys and from individual sectors & companies – as from Amazon, and McDonalds last week

More charts & comments on the following pages

1993-'96, 2002-'06 da capo? Probably not, check the current margin (& unempl)!

Higher corporate margins contributed to higher inflation in 1993 – '96 & 2002 – '05



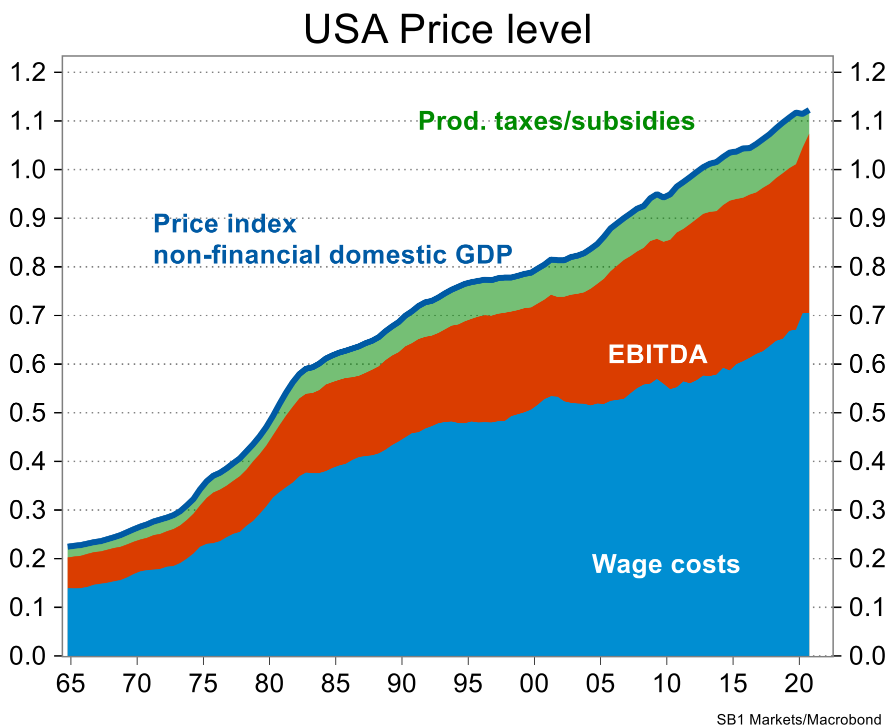


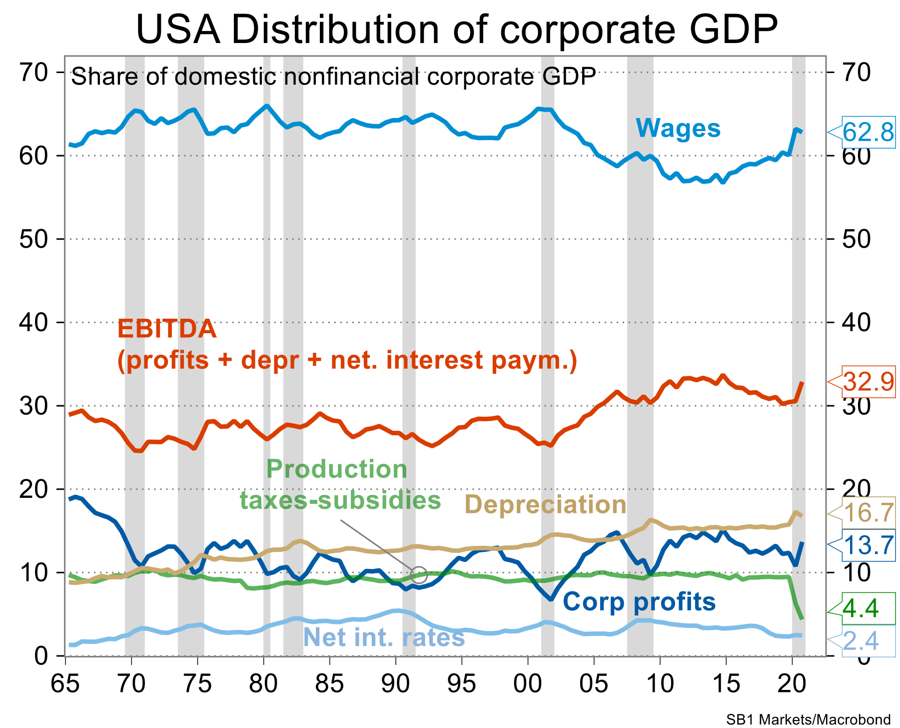
On the upper left chart, contributions to deviation from trend inflation is calculated

- **The main difference is obvious – where are we in the cycle?**
  - » The **profit rate** was low following 'normal' recessions, and the **unemployment rate** was still not low
  - » Now, the profit rate is not low. Unemployment will very likely fall sharply the coming quarters, which normally makes it 'impossible' for businesses to keep the profit rate up
  - » **Pressures in commodity markets** will probably dampen as at demand for goods from consumers in the rich part of the world will slow, as demand for services will recover the coming months

SpareBank 1 MARKETS

For the record: The distribution of corporate income (& the cost/margin factors)

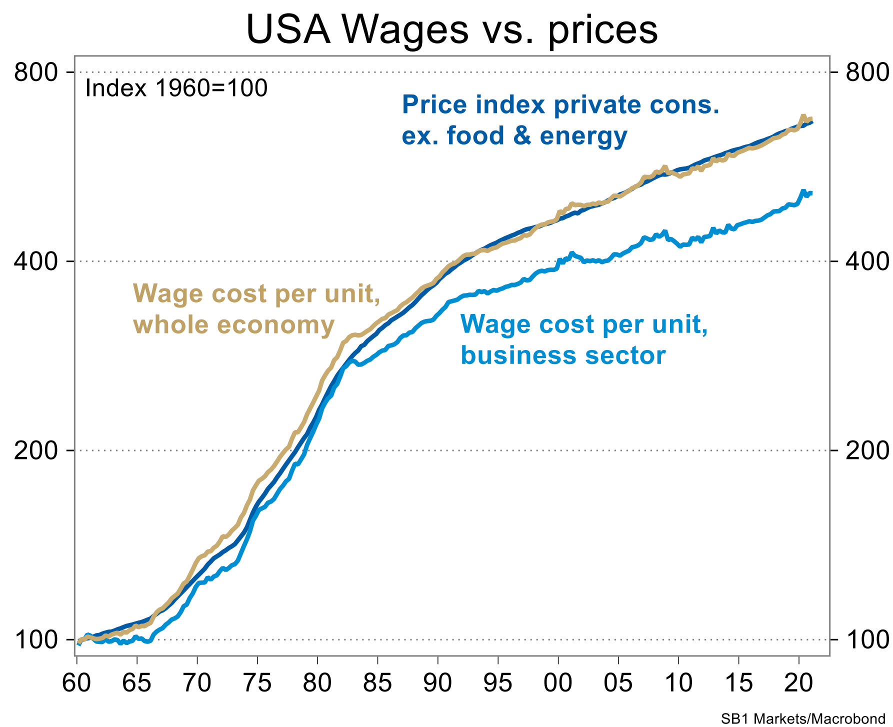


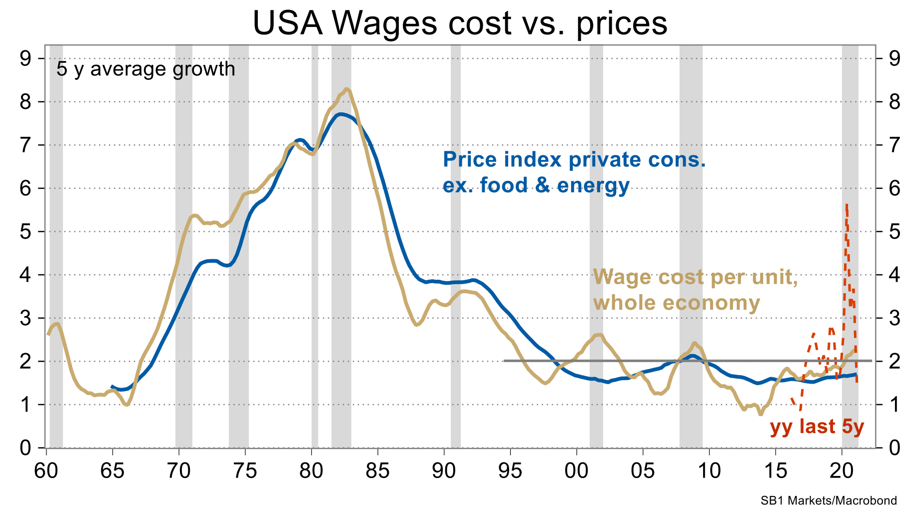


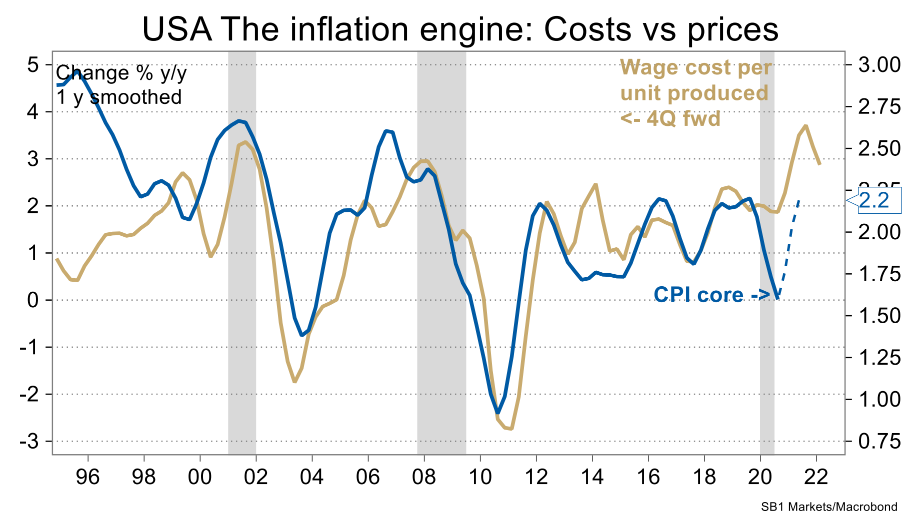
- Over time, a substantial part of the EBITDA margin is wage cost related too, as 50% this margin is depreciation of capital – and the lion's share of the cost of this capital is over time related to wage costs for producing this capital

In the long run: Wage costs are driving the price level & inflation cycles

Before corona: Unit wage costs were drifting upwards to above 2%





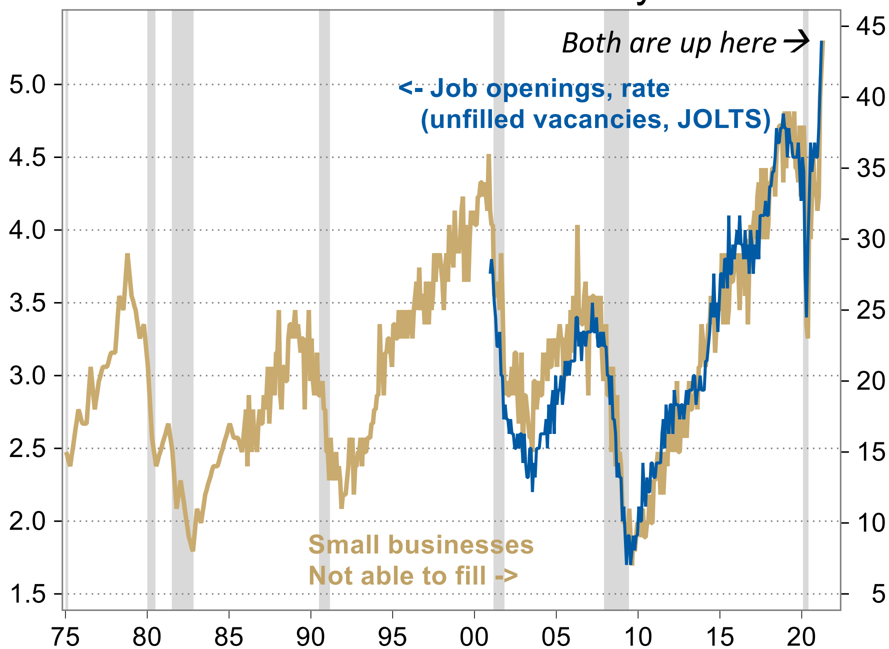


- Wage costs are clearly leading inflation cycles – and over time, wage cost level equals the price level
- The rapid increase in ULC through last year was very likely not ‘for real’, check next page

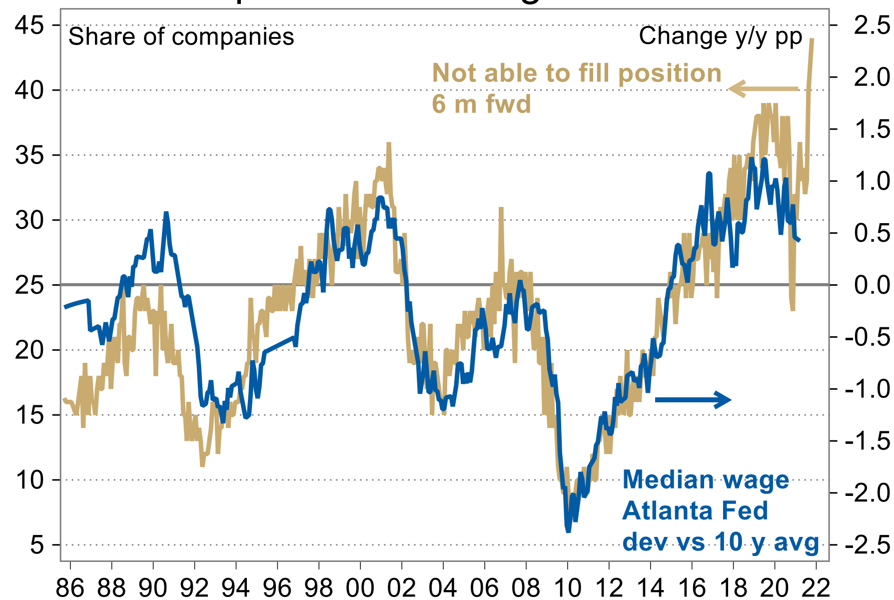
Vacancies are record high, and businesses are not able to fill positions

Many have already increased wages. Are unemployment benefits really holding workers back?

USA Unfilled vacancies vs. ability to fill them



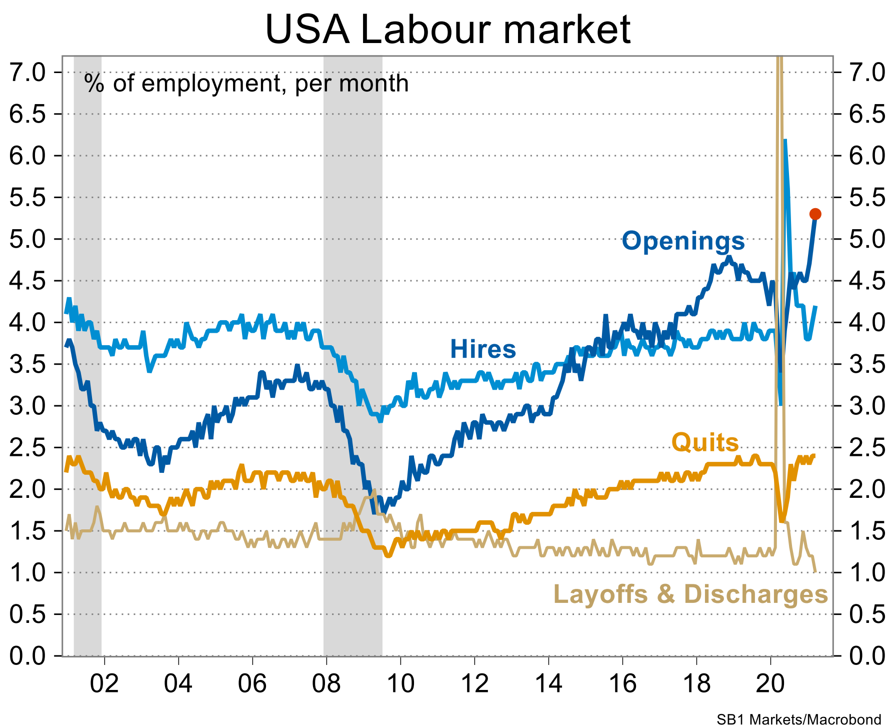
USA Small businesses, not able to fill positions vs wage inflation



- The fraction of businesses saying that they **actually raised compensation** is at the highest level since before corona
- The **expected increases in compensation the next 3 months** is also sharply up from March, and businesses say that costs are being passed on to customers in the form of higher prices!
- However, so far **actual wage increases**, when adjusted for changes in the mix of labour during the pandemic have not gained speed (the Employment Cost Index rose more than expected in Q1 but just to a large wage lift in the financial sector (2020 bonuses), while other sectors reported normal wage gains. The median wage may have flattened, but is not yet reported up. We expect that to happen the coming months

The vacancy rates the highest ever, by far. Quits rate at ATH too. And 'no' layoffs!

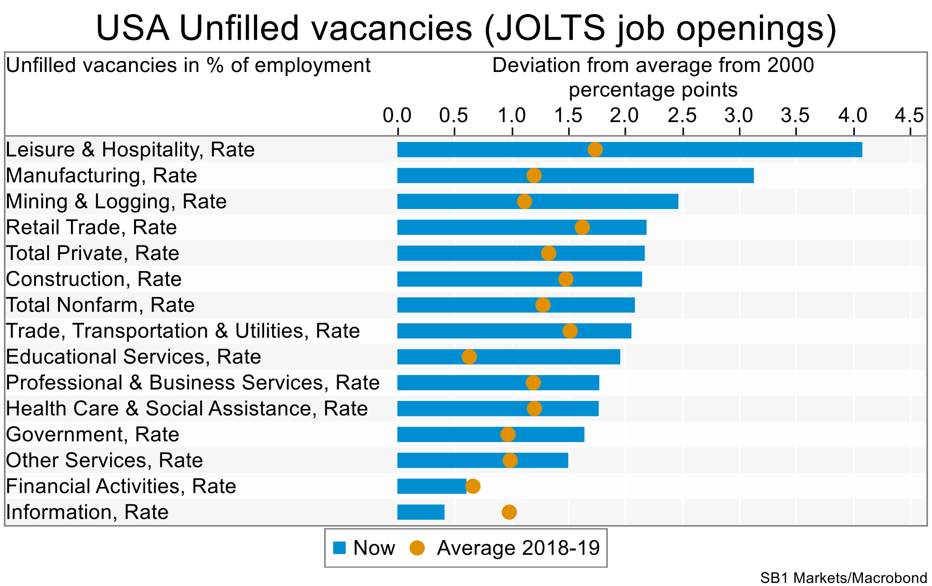
The vacancy rate up to 5.3%, 8.1 mill vacant positions, up from 7.6 mill in February



- The no. of **unfilled vacancies** rose more than expected in March, and is at record high, both in the actual number (8.1 mill) and in % of employment (5.3%). The highest rate before corona was 4.8%, in 2018. Given the still high 6.1% unemployment rate, the record high vacancy rate is warning signs
  - » It may be that many of those unemployed do not try for real to get these available jobs due to the higher than normal level of unemployment benefits. If so, they will soon turn up at the labour market
  - » Alternatively, the vacant positions are not suitable for those unemployed, due to qualifications, geography or what ever – that is a much higher mis-match than before. Is so, a 'disaster'
- **Businesses are hiring** at a very rapid pace, at more than 4% per month, only beaten by the first part of the recovery last year (March data, net growth in employment in April was slow)
- The rate of voluntary **quits** rose to 2.4% in March, and it has never been higher. That's a sign of a tight labour market as workers are leaving their jobs voluntarily to get at better job, which is harder in bad times
- **Layoffs** fell to the lowest level every in March. Thus, it is strange that the inflow of new jobless claims remain far above normal levels, check 2 pages forward
- **In sum:** At least the report signals an extreme tight labour market, now – and may explain slow growth in actual employment

Almost all sectors are reporting more vacancies than before the pandemic

The problem is largest in sectors that have been closed down, in leisure & hospitality

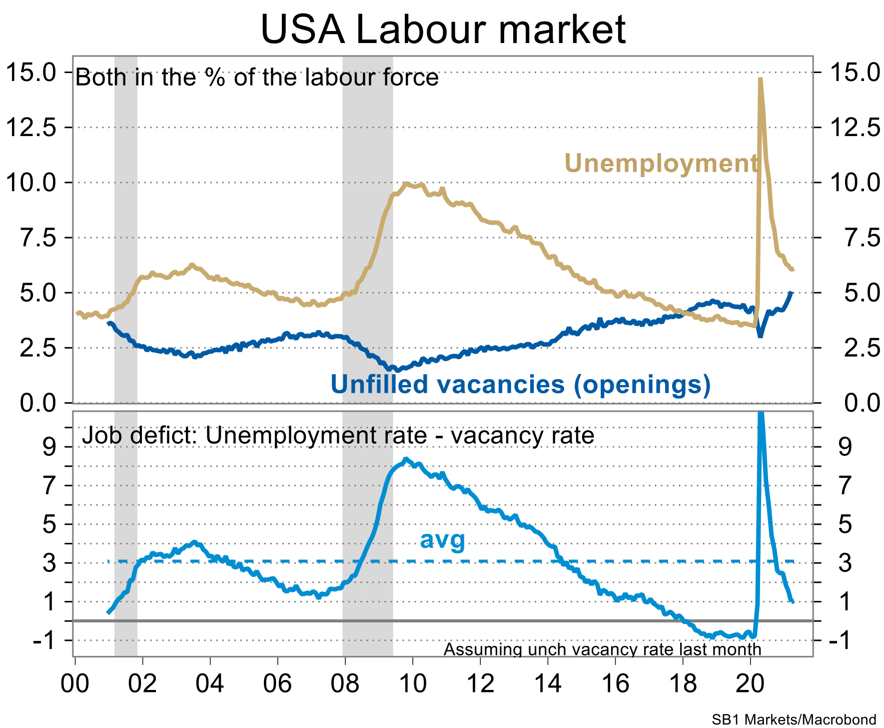


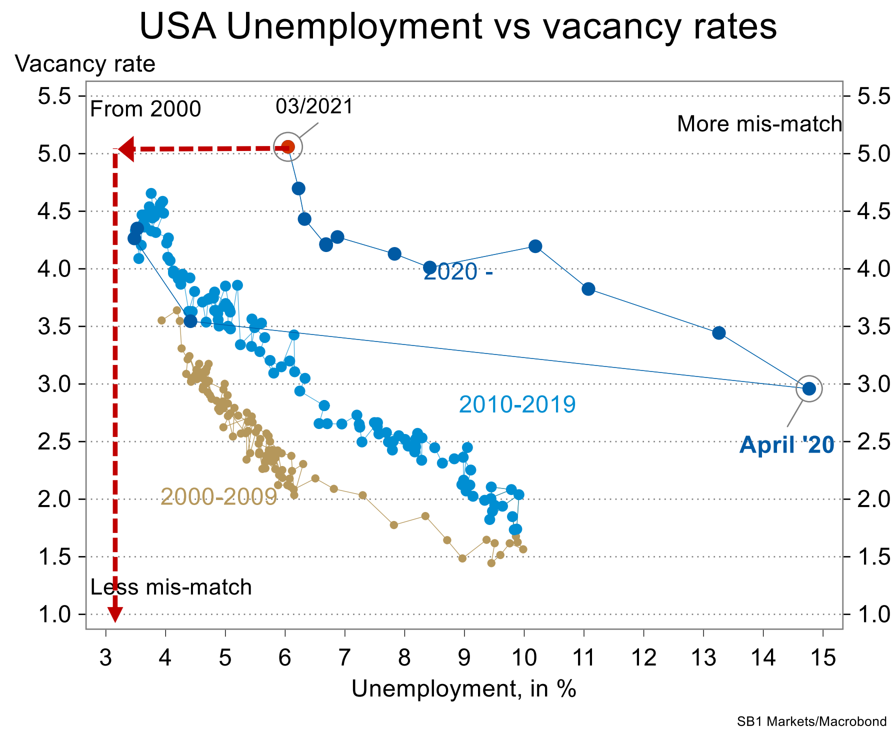
- … but also in manufacturing and retail trade
  - » Just the financial sector and information are reporting fewer vacancies than before the pandemic

- Have previous active workers
  - » Left the labour market temporary, due to corona?
  - » Left these low paid sectors for better jobs elsewhere?
  - » Or are they staying outside the labour market because unemployment benefits are too generous due to the temporary USD 300/week extra federal support?

Such a high level of vacancies would normally signal a record low unempl. rate

… as if the unemployment were 3% in March, and not 6%

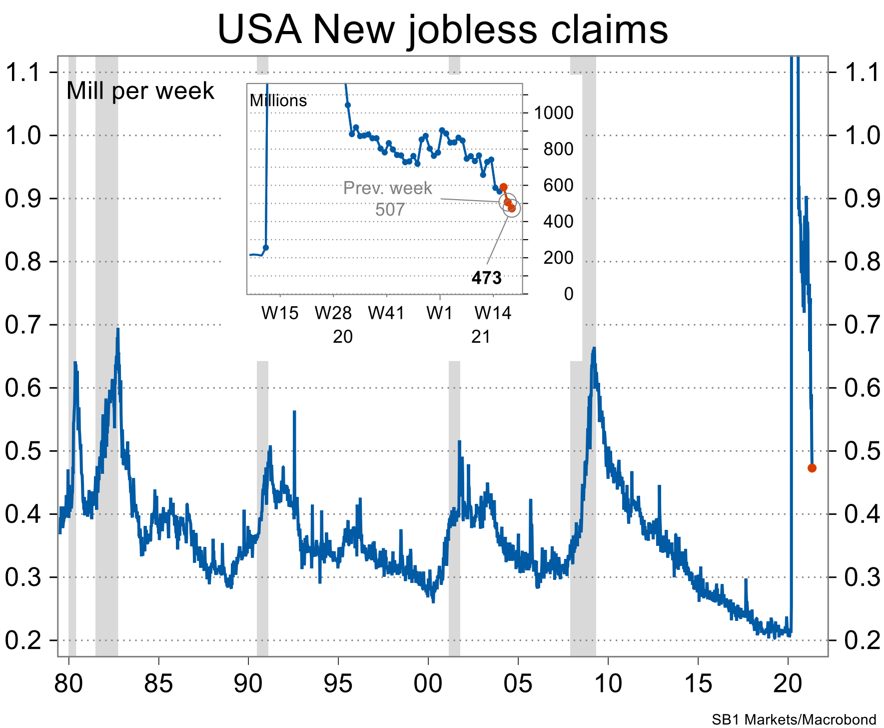


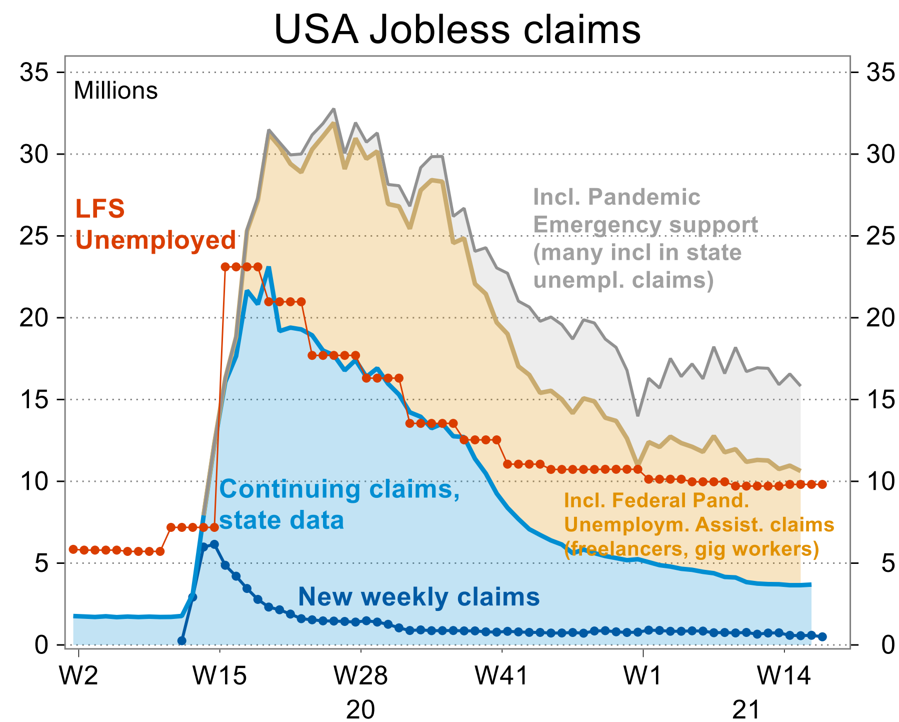


- Has the **UV "Beveridge" curve** moved outwards, once more, signalling a tight labour market, even if the unemployment rate is far above normal low levels – that is: The labour market is tight 'for real' now?
- Or is the labour market in a **temporary 'sour spot'**, as a many have withdrawn from the labour marked due to corona or due to generous unemployment benefits? The next few months will tell us a lot!

Jobless claims continue down as economy opens up, still at a high level

…and continuing claims are trending down too but remain suspiciously high, given demand for labour

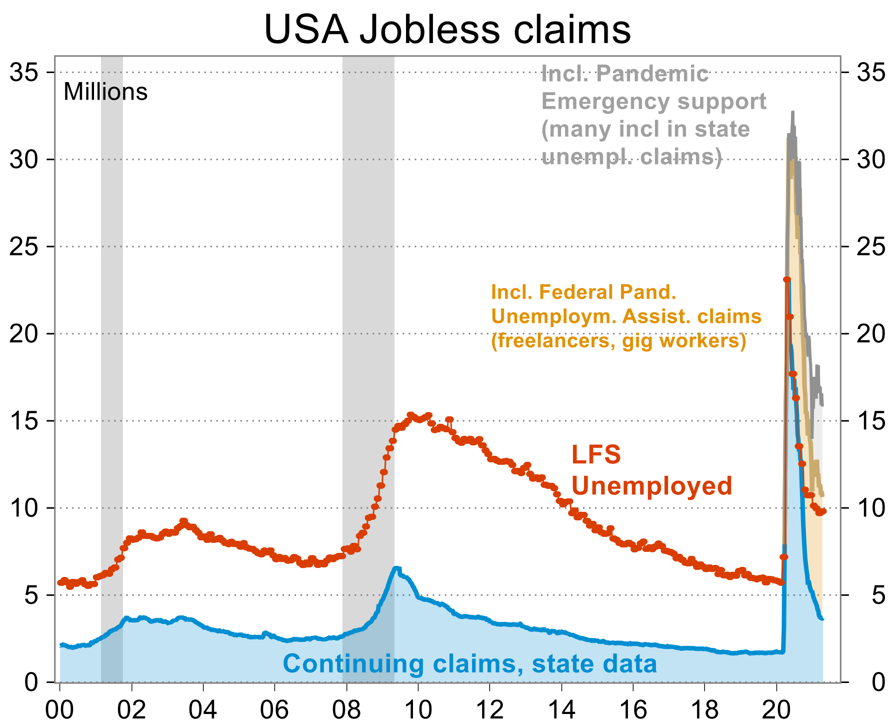




- **New claims** at 473'down from 507' the previous week, expected 500'
- **Continuing claims** was up by 35' from prev. week, while the applic. for the two pandemic support programs fell somewhat more (2 weeks ago)
  - » The **Pandemic Unemployment Assistance** extends federal support to freelancers & gig workers who are not covered by state unemployment schemes. The federal **Pandemic Emergency Unemployment Compensation** adds USD 300/week to state programs, which on average pays somewhat above USD 300/week, and can be paid for a longer period (so these claims are partly included in number of the ordinary state benefit receivers, so there is some double counting in the grey area at the chart to the right). Both programs run until September
  - » Those who receive both ordinary state and emergency program support, receives north of USD 600/week, equalling some USD 15/hour for a full time job, way above the 7/h minimum wage
  - » The no. of receivers of unemployment benefits is far higher than normal vs. the number of unemployed persons (measured by the LFS, check the chart next page)

Why are so many on the dole?

... vs. the number of regularly unemployed (in the Labour Force Survey?)

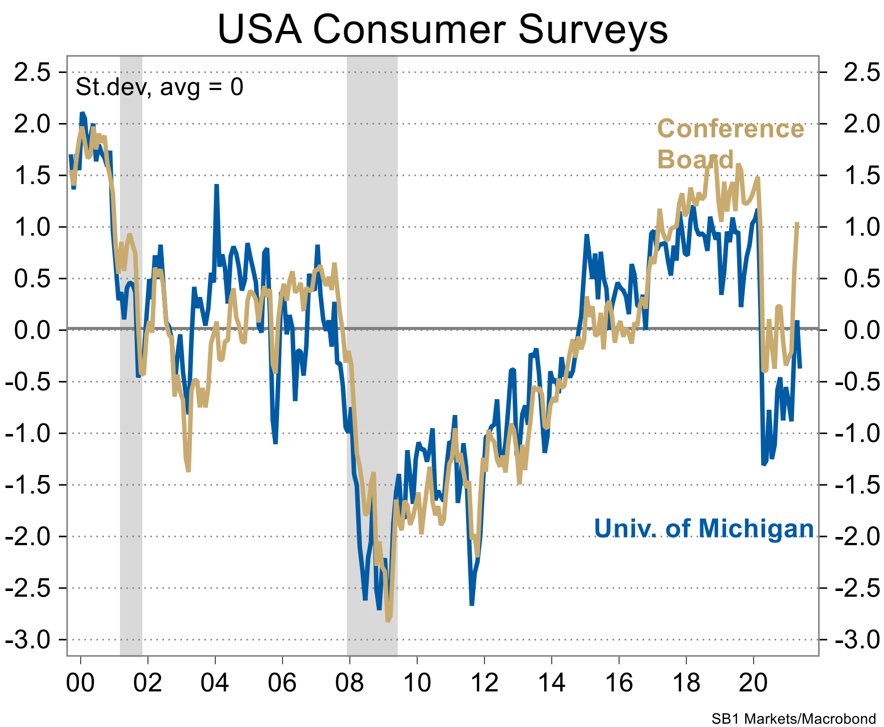


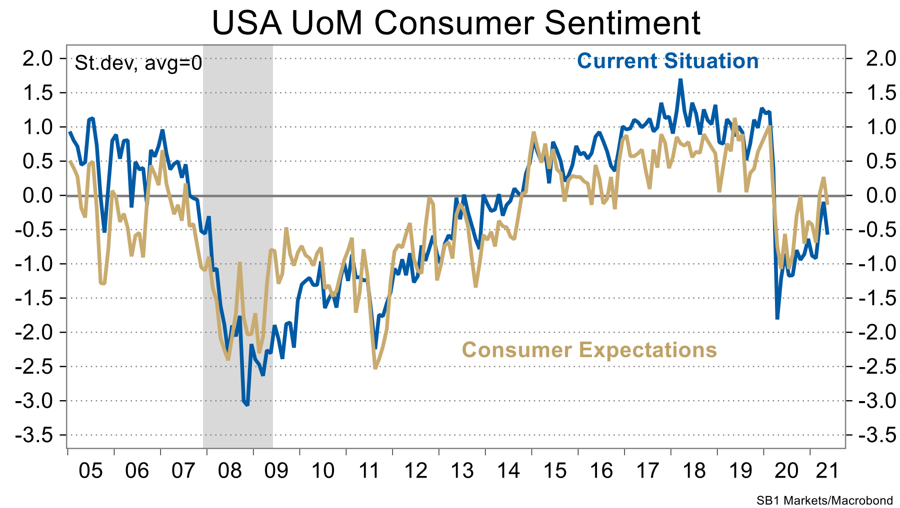
- Normally, the number of unemployed in the LFS is some 2 – 3x higher than number of receivers of unemployment benefits ('continuing claims') from the states
  - » State unemployment insurance schemes normally just covers the first 26 weeks of unemployment
  - » There are restrictions who can get these benefits – and they are low, just above USD 300/week in average
- Last year the federal government introduced extraordinary unemployment support schemes, extending the coverage 52 week, and later to 18 months, and a brand new gig workers' unemployment program was implemented
- Now, there are more receivers of unemployment benefits than the no. of people that report that they are actively seeking for work (and thus counted as unemployed in the LFS). (Parts of the 'grey' area, the emergency support program, is double counting vs. the 'blue' area, but even if assuming that all receivers of these emergency benefits also receive state support, the conclusion holds
- Most likely, there are many receivers of unemployment benefits that rather want to stay on the dole, than take a low or for many, a lower paid job

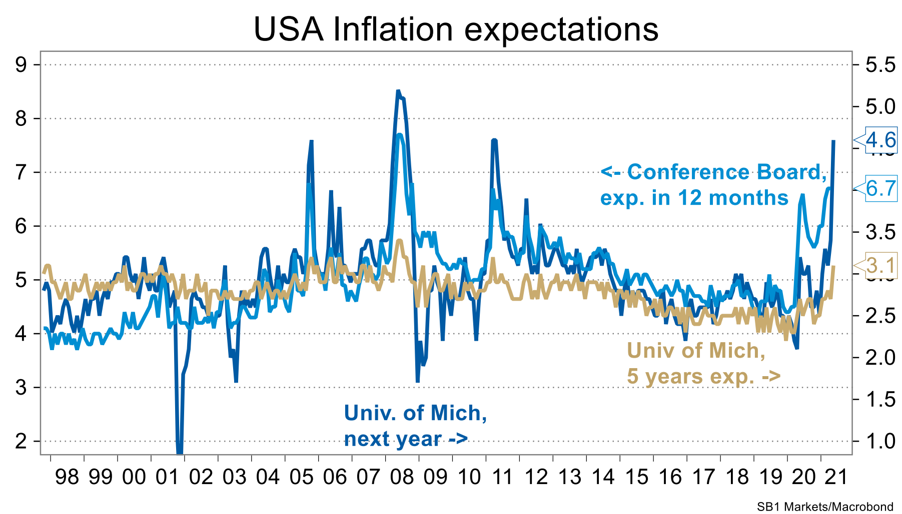
- **The debate is of course heating up**: Do the 'generous' unemployment programs make it too attractive to stay on the dole, instead of trying to find a job? The record high no. of unfilled vacancies & the record high share of companies reporting that that are not able to fill vacancies, very likely signal that something is 'wrong'
- **16 (GOP governed) states** (up from 7 two weeks ago) have decided or is contemplating to say 'no, thank you' to the federal support programs immediately in order to 'push' more unemployed workers back to the labour market now, and not in September. It is disputed whether states in fact can opt out of these federal programs of behalf of their citizens

Univ. of MI: A market sentiment setback in May! Why worry now? Inflation??

Inflation expectations shot up in April, to the highest level in a decade



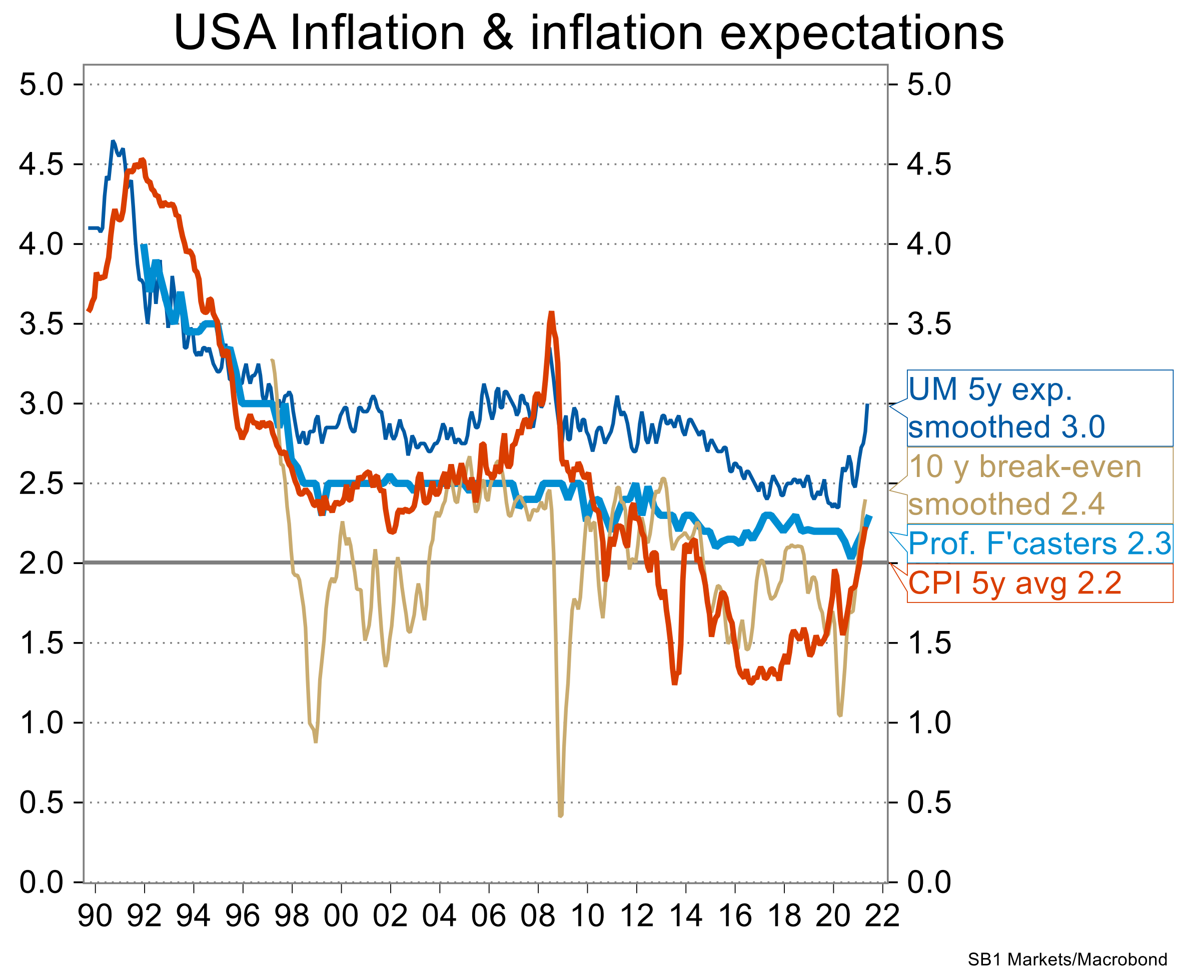




- **The UM sentiment index,** totally out of the blue, fell to 82.8 in May from 86.5, expected up to 90.8. The index level is 0.3 st.dev below average, down from +0.1 in April
  - » Both the assessment of the current situation and expectations fell sharply
- **What happened?** The researchers refer to much higher inflation expectations – which both for the coming year and the next 5 years shot up to the highest level in 10 years

Inflation expectations are drifting up but are not yet worryingly high

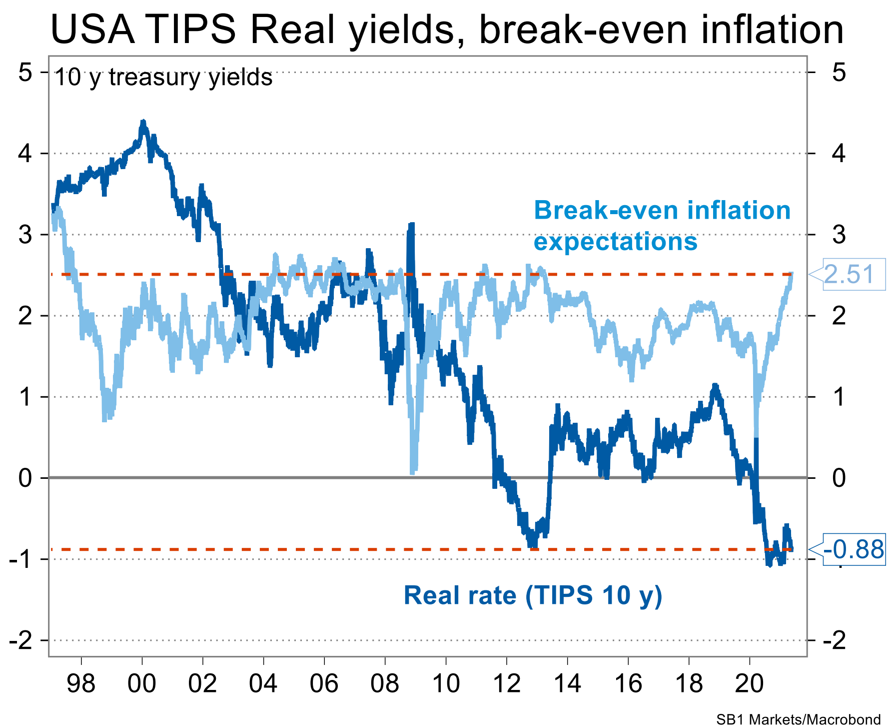
Univ. of Mich survey 5 y inflation expectations have climbed to 3.1% from 2.4%

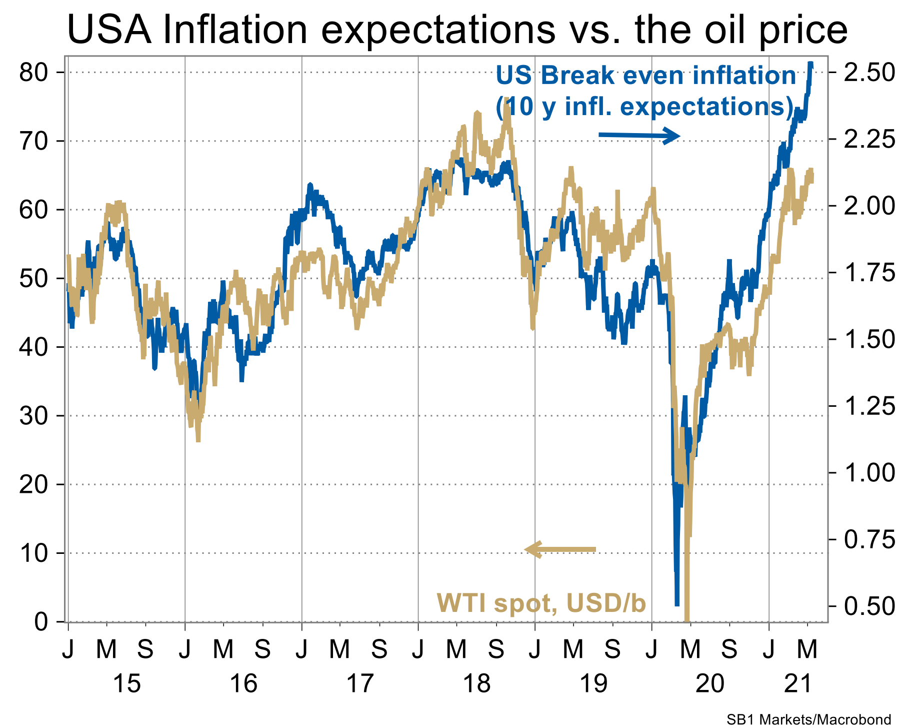


- **The UM's survey's** 3.1% rate is the highest in 10 years (3% smoothed at the chart to the left), and it is 0.8 pp higher than before the pandemic (2.5%)
  - » Still the level is not far above the past 10-year average – but it is a sign for the Fed, of course
  - » The UM short term inflation expectation at 4.6% is the highest since 2011, up 0.9% from March (and he survey was conducted ahead of the CPI surprise last week). These expectations usually correlated to recent changes in energy prices – like now
- **Professional Forecasters** expect a 2.3% 10 y rate of inflation in Q2, according to Philadelphia Fed, up from 2.0% in Q4. The Q4 level was the lowest ever, and 2.3% is just marginally above the past 7 years average, and it refers to CPI, which over time grows 0.3 pp faster than Fed's referred inflation measure, the PCE
- The 10 y **break-even inflation expectation** is at 2.5% (not smoothed) among the highest prints since 1998. Still not far too high for Federal Reserve
  - » However the direction is not that comforting?

Break-even inflation is even running ahead of its ol' pal, the oil price

Much could be said about the correlation between the present oil price & 10 y inflation expectations

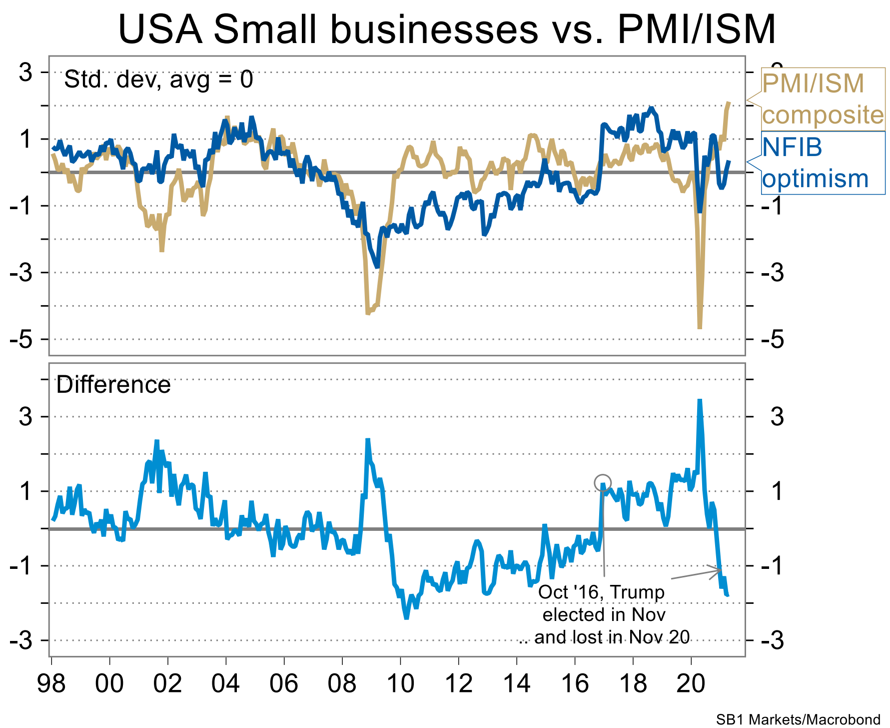


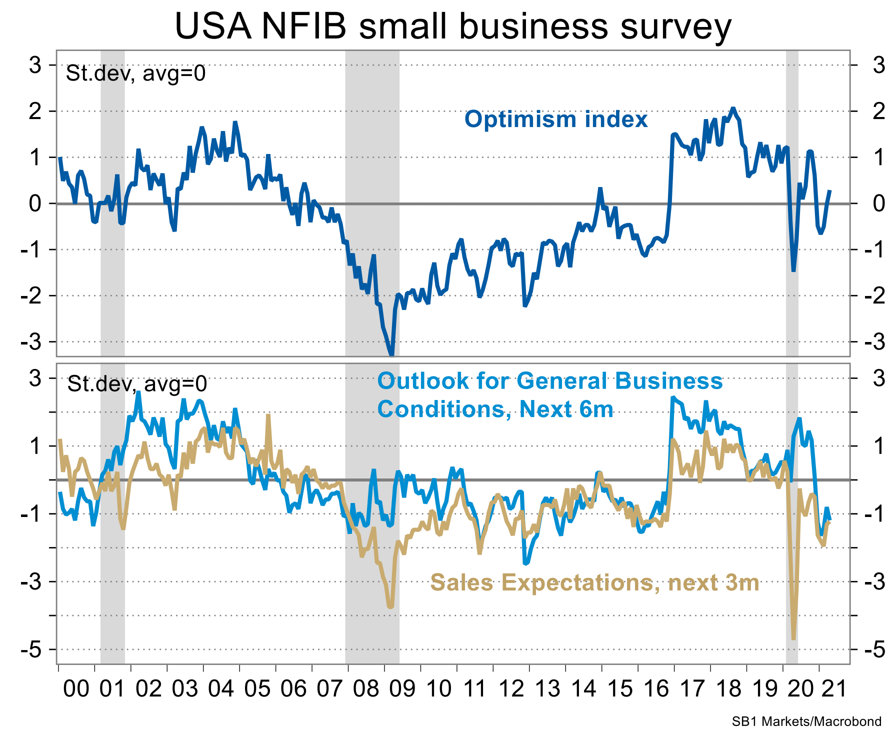


- But there are some possible links, of course (which still do not explain this close link)
- However, we have even more problems with the other part of the bond yield, the real rate. What is the best explanation for this yield, barring Fed's actions?

Small businesses optimism back above average in April

In spite of positive vaccine news, assessment of the outlook, but investment plans up to par!

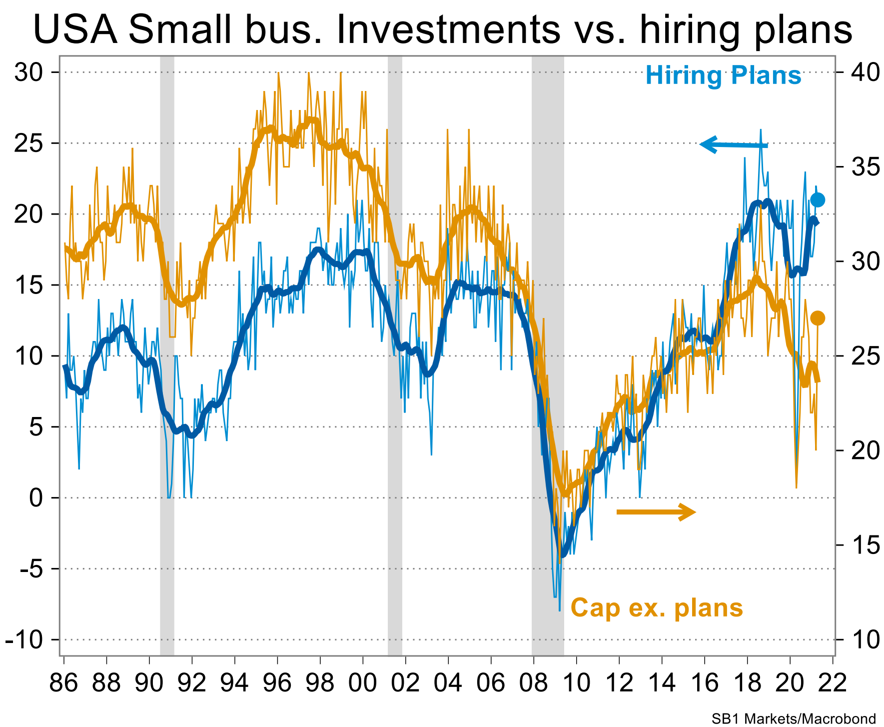


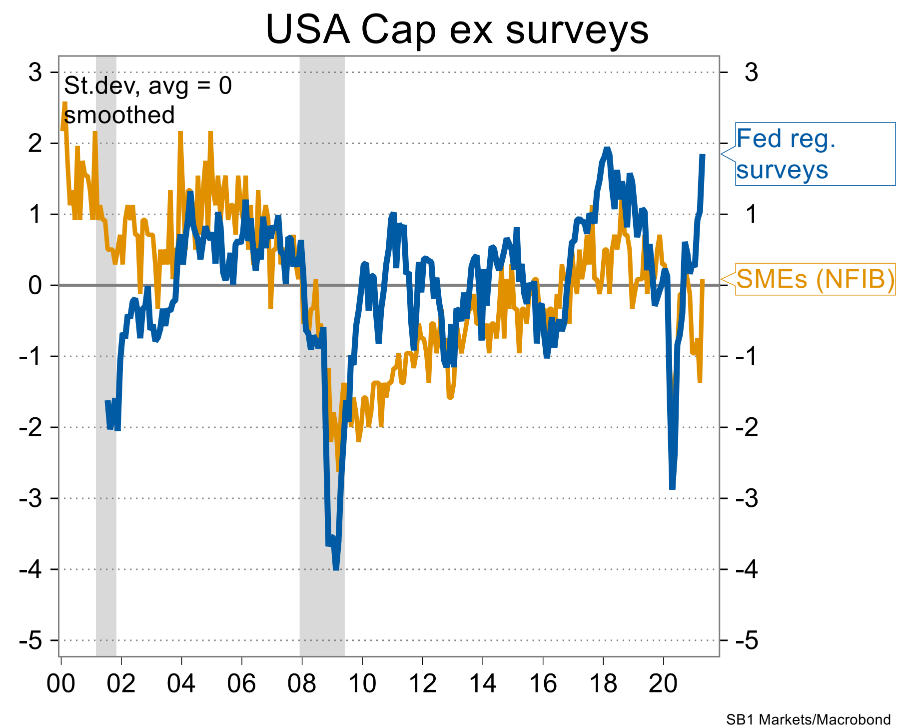


- The **NFIB optimism index** increased to 99.8 in April from 98.2 (expected up to 100.8). 8/10 components improved, while 2/10 fell. The index is above an average level but far behind the PMI/ISMs, and almost all other surveys
- **The sales expectation index**, the outlook for the next 6 months, declined in April and is 1.2 st.dev below par, which des not seem reasonable, amid the reopening of the US economy
  - » Sectors: Finance and construction are the most downbeat, while manufacturing and wholesale in the lead
- **Investment plans** index increased 7p in April, and is now finally at an average level
- **Hiring plans** were flat but at a very high level. However, the SMEs are not able to **fill their record high level of vacancies**

Hiring plans very high, investment plans are on the way up too

… and back up to a normal level among the SMEs

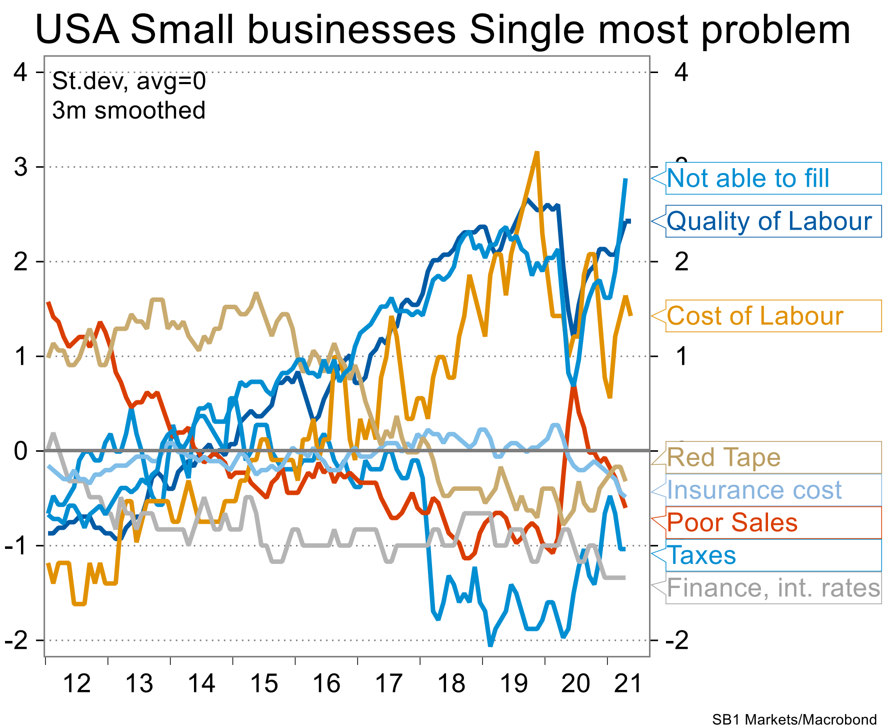


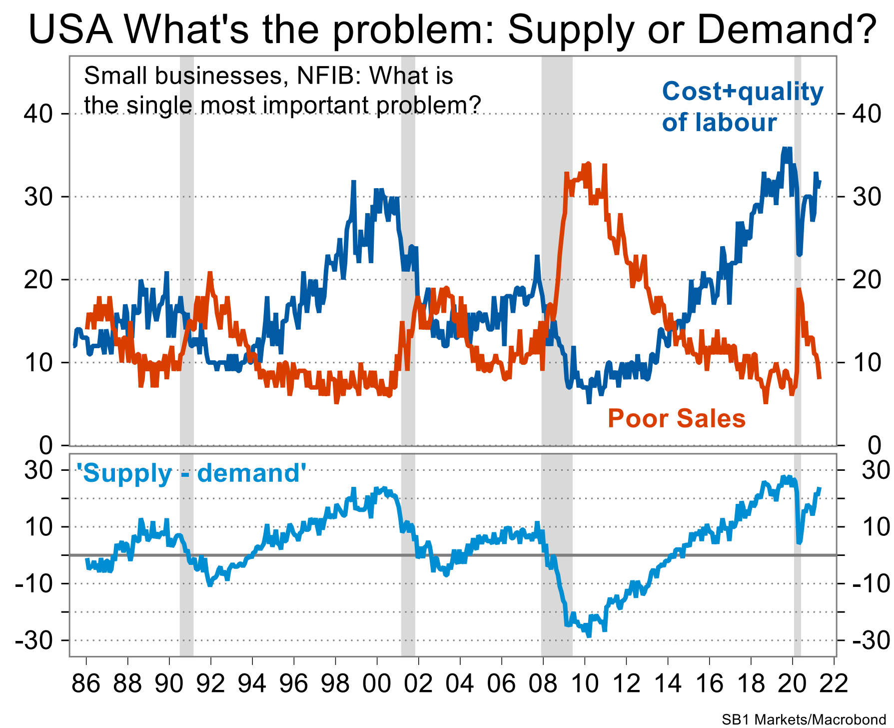


SpareBank 1 MARKETS

Supply, quality & cost of labour yet again reported as the major problems!

Sales are not. It's really looking like we are at the end of a cycle, not a beginning…

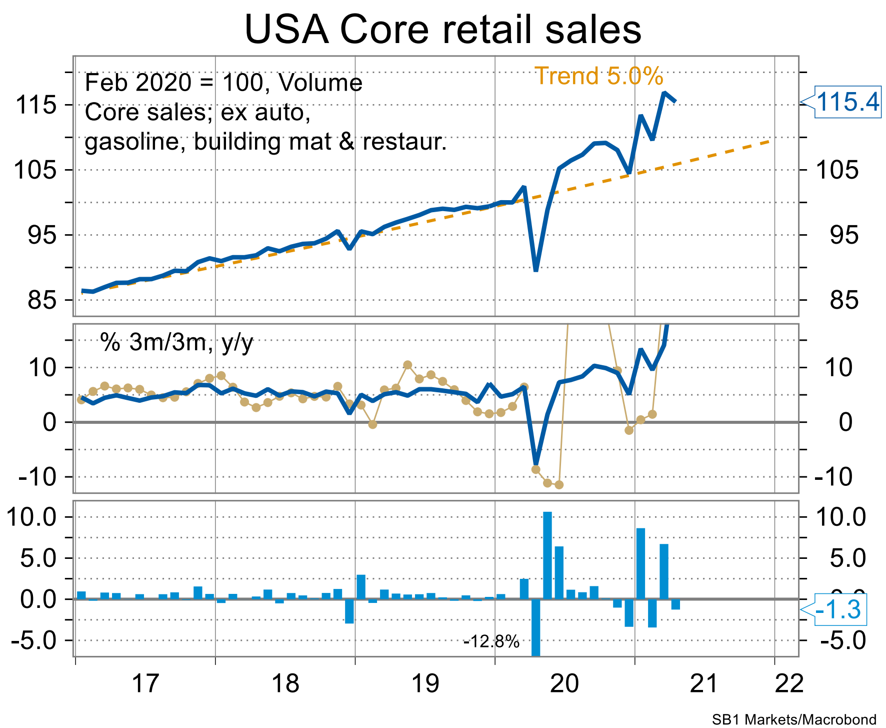


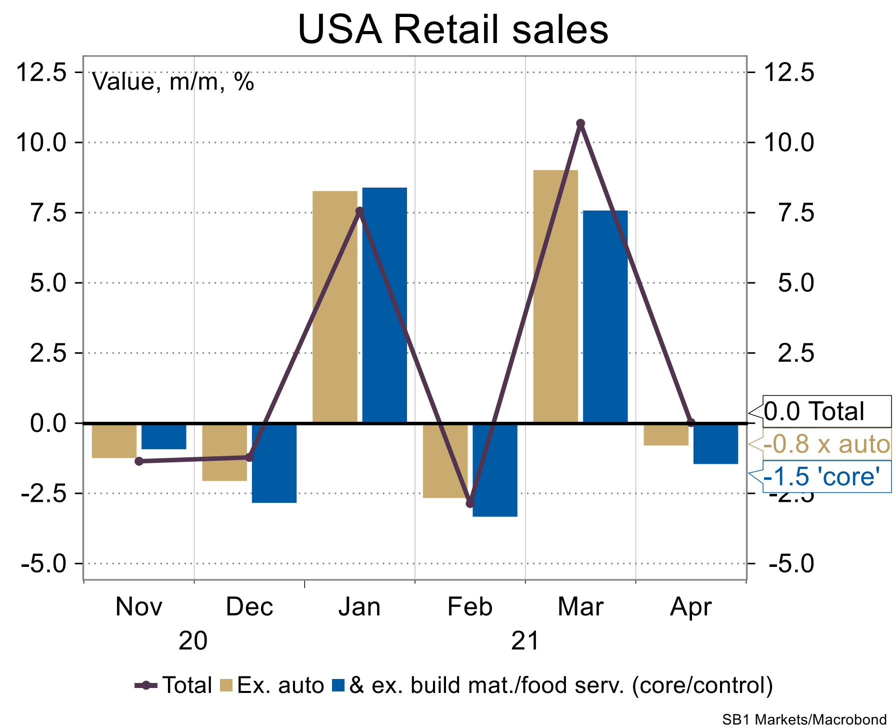


- While more businesses than normal stated **weak sales** as the major problem during the pandemic, there were never that many, and <u>now fewer than the average share of companies say than poor sales is the problem</u>
- **Availability, quality, and cost of labour** is a much more serious problem than normal, the share is now almost back up to the same level as before the pandemic, after subsiding somewhat
- <u>Thus, companies are constrained from the supply side, not from the demand side, they say</u>
- Unusually few companies are complaining about **finance/interest rates** and about **taxes** (and tax concerns have receded in the past couple of months despite messages of increased taxes)

The 2nd best retail sales, ever! Core volume up 16% from Feb-20!! And from here?

No doubt, the direction is down, even if not much of the stimulus checks are spent, on aggregate

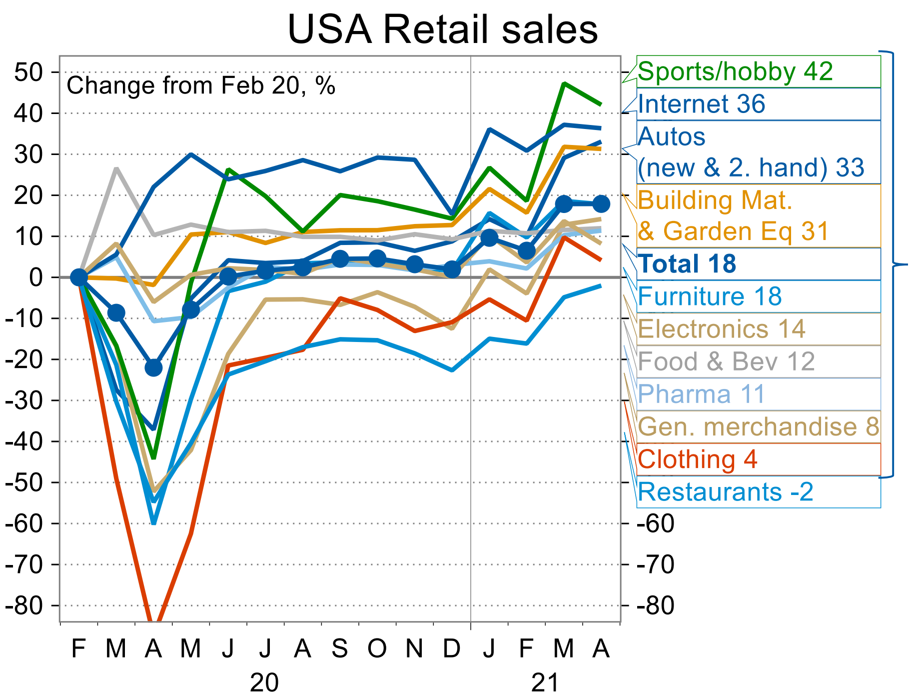




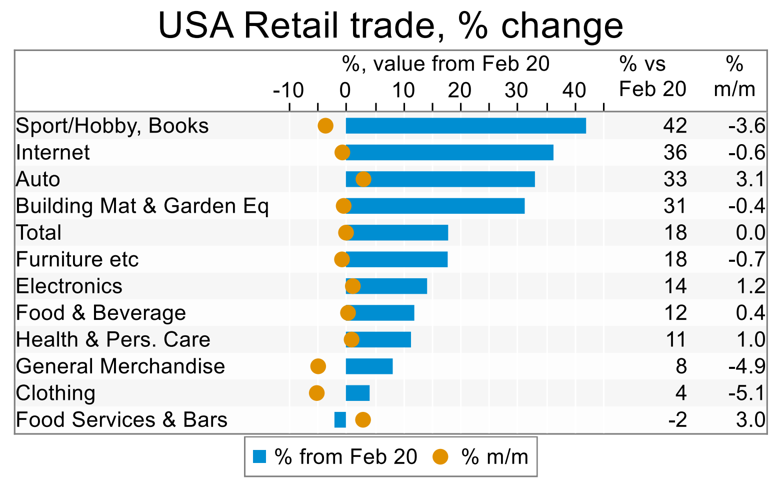
- **Total nominal sales** was unch. in April, expected up 1%. March was revised up by 1 pp to 10.8% - and the level in April was as expected
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) fell 1.5%, following the 0.6 pp upward revised 7.5% hike in March. We assume a 1.8% volume decline in April (autos are not included). Core sales are up 15.9% vs. the pre-pandemic level. The downside is substantial the coming months/quarters
- Mixed among sectors, more than half down, but none by much. **Auto** and **restaurant** sales rose 3% (none included in 'core goods'). Restaurant sales are just 2% below the pre-pandemic level (but employment is far more below, strange)
- Retail sales – and other consumption – have received a real boost from the **two rounds of stimulus cheques**, the first distributed in January and the second in March and April. Just a fraction of the received amounts have so far been spent – and savings have increased substantially

Several sectors down in April but restaurants further up, just 2% below Feb-20

… which is a bit strange, given the still huge employment gap vs. pre-pandemic level

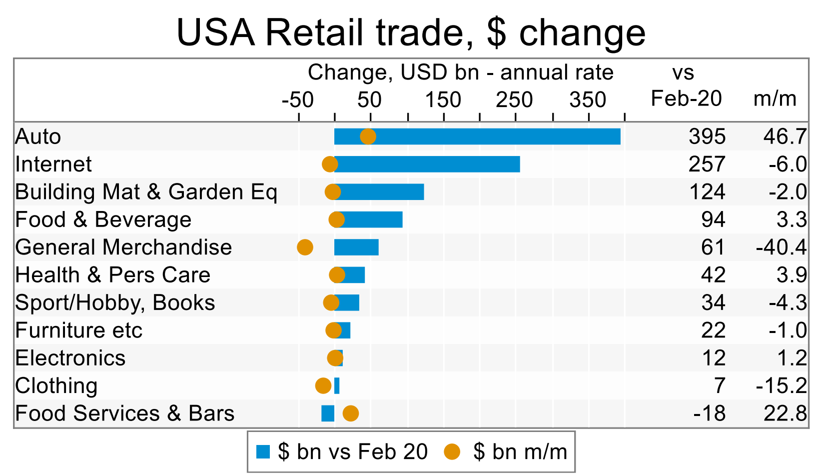


SB1 Markets/Macrobond



	% vs Feb 20	% m/m
Sport/Hobby, Books	42	-3.6
Internet	36	-0.6
Auto	33	3.1
Building Mat & Garden Eq	31	-0.4
Total	18	0.0
Furniture etc	18	-0.7
Electronics	14	1.2
Food & Beverage	12	0.4
Health & Pers. Care	11	1.0
General Merchandise	8	-4.9
Clothing	4	-5.1
Food Services & Bars	-2	3.0

SB1 Markets/Macrobond



	vs Feb-20	m/m
Auto	395	46.7
Internet	257	-6.0
Building Mat & Garden Eq	124	-2.0
Food & Beverage	94	3.3
General Merchandise	61	-40.4
Health & Pers Care	42	3.9
Sport/Hobby, Books	34	-4.3
Furniture etc	22	-1.0
Electronics	12	1.2
Clothing	7	-15.2
Food Services & Bars	-18	22.8

SB1 Markets/Macrobond

February

- 6 out of 11 main sectors reported a decline in sales in April. **Auto sales** rose 3% (incl 2nd hand cars, where prices are soaring), **restaurants** up 3% too

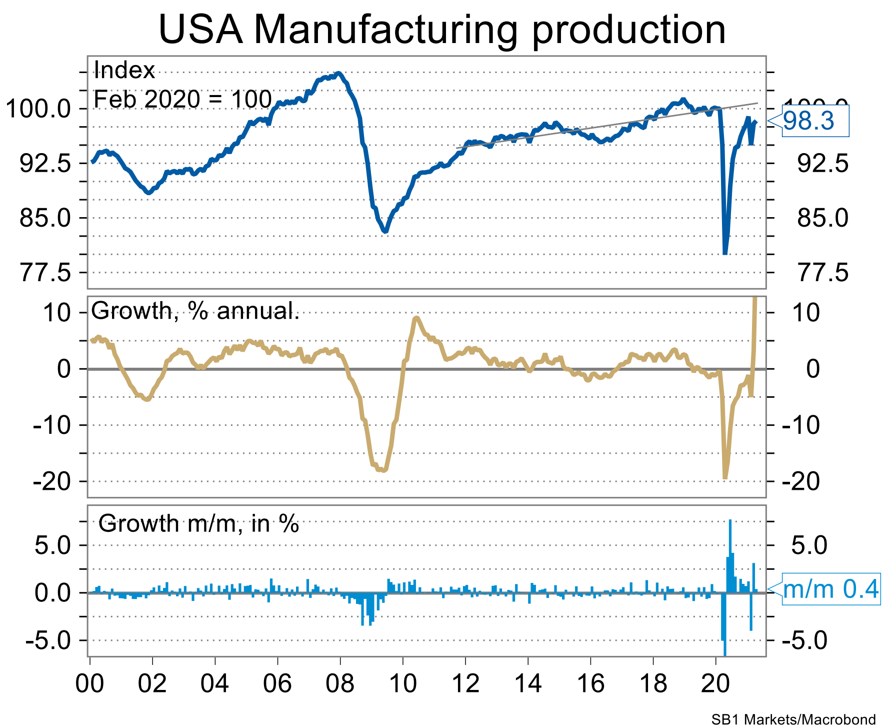
Since pre corona

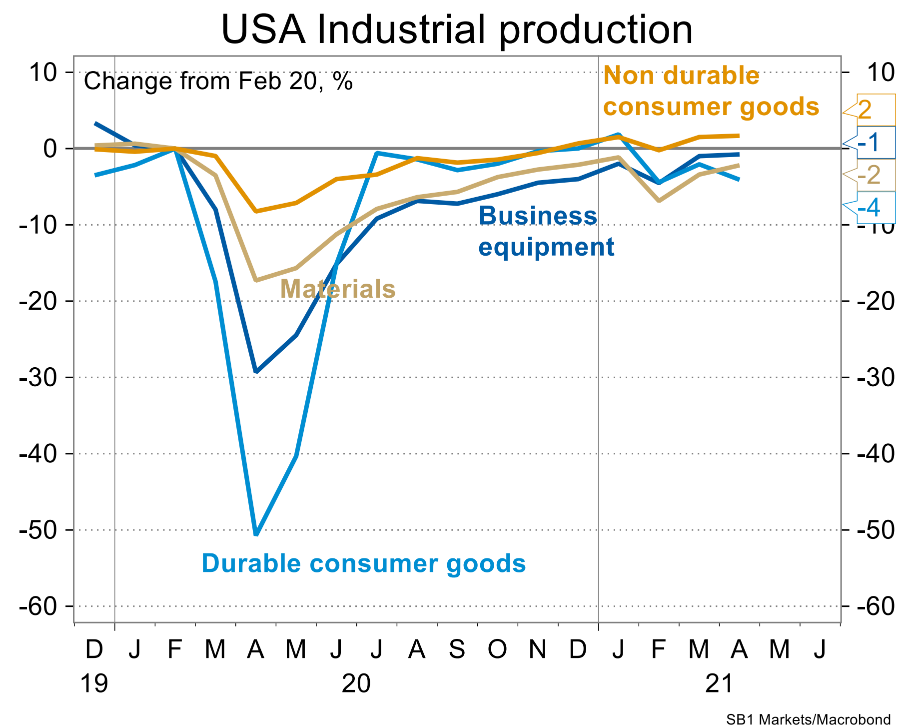
- **Internet** has taken a substantial market share, to well above 10%
- **Restaurants** are almost back to start, finally. Employment in restaurants is still down far more than sales. Guess more jobs will be added the coming months, even if more sales than before the pandemic will be delivered (or picked-up)
- **Clothing** is finally in plus vs Feb-20, it is time to dress up again?

SpareBank 1 MARKETS

Manufacturing up 0.4% in April, still down 1.7% vs. Feb-20

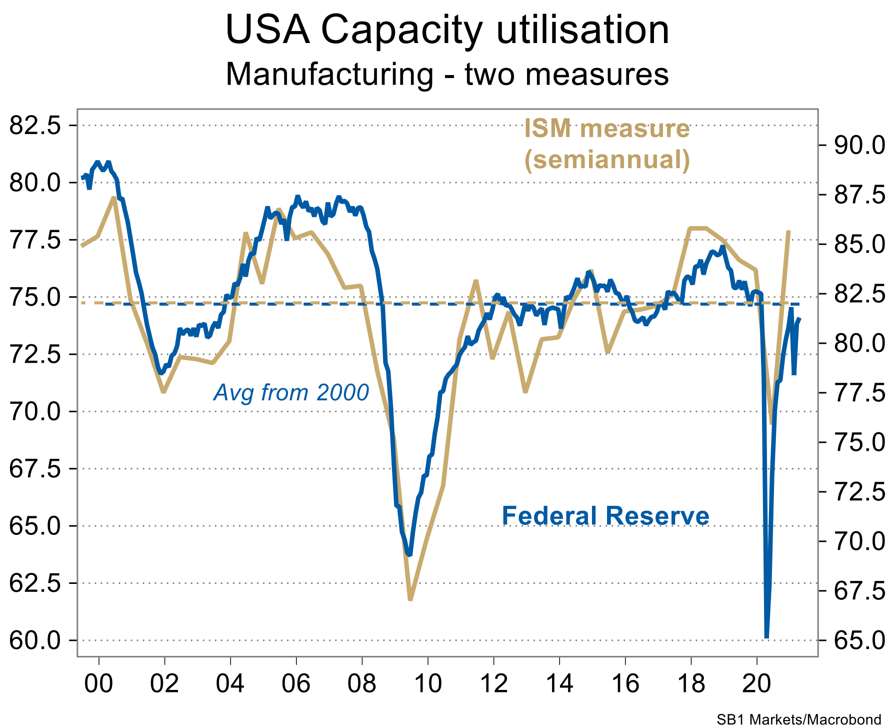
Auto production fell by 4.3%, a 0.3% drag on total production – and not due to lack of demand…





- **Manufacturing production** rose 0.2 pp more than expected – as some weakness in auto production probably was factored in. Production is still almost 2% below the pre-pandemic level, even if retail sales volumes are up 16%, and investments are up. Importers have had a strong year
  - » Materials production rose further in April others stalled, and durable consumer goods declined (due to autos)
- **Total industrial production**, including utilities, mines/oil production rose by 0.7%, expected 1%
- **PMI/ISM and all other surveys** signal a continued, exceptional strong recovery – way above the current growth rates

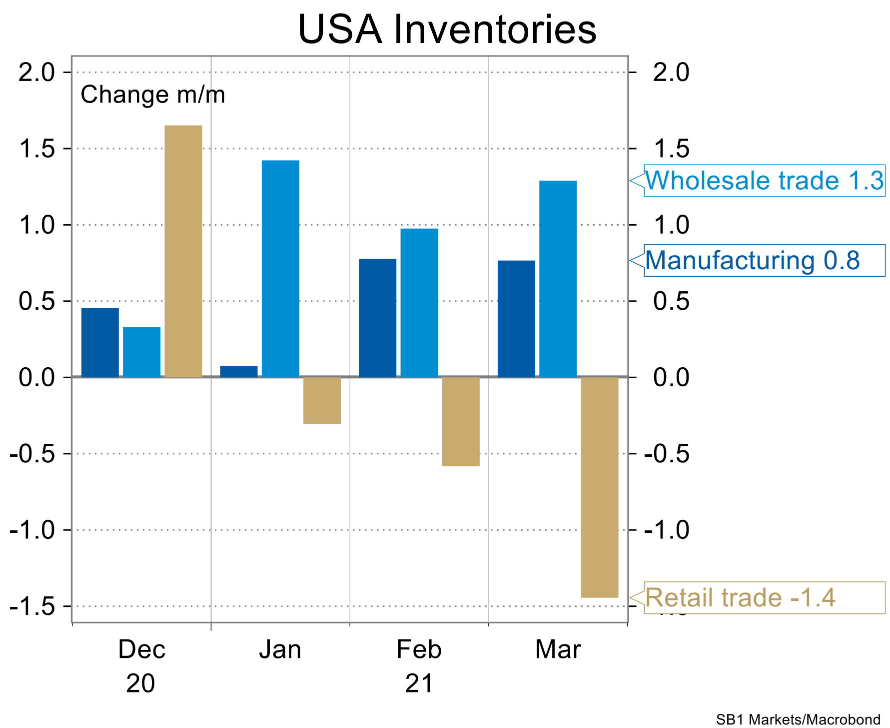
Is capacity utilisation at or above normal?



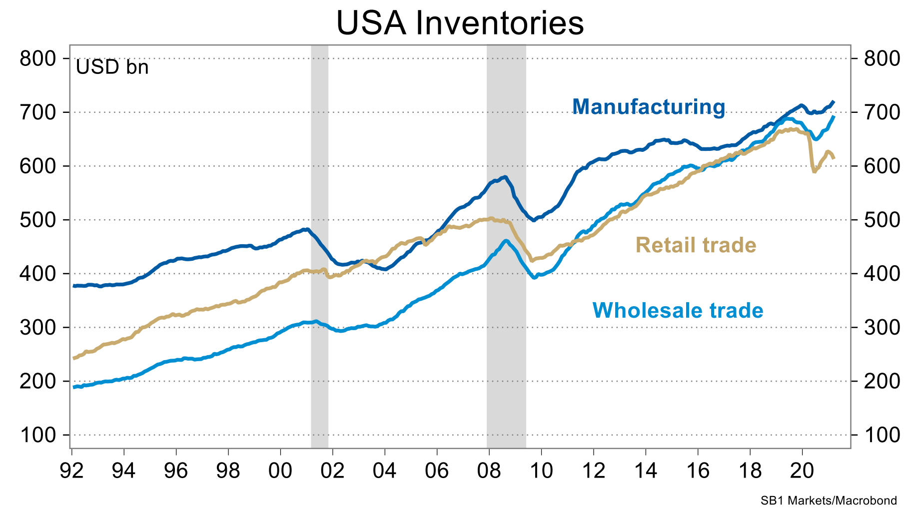
- **The Federal Reserve's** measure yields slightly below normal capacity utilisation rate, and below the pre-pandemic level
- **ISM's semi-annual** survey reported a close to record high utilisation rate, the last survey from Dec last year
  - » The ISM will publish its semi-annual H1 report this week

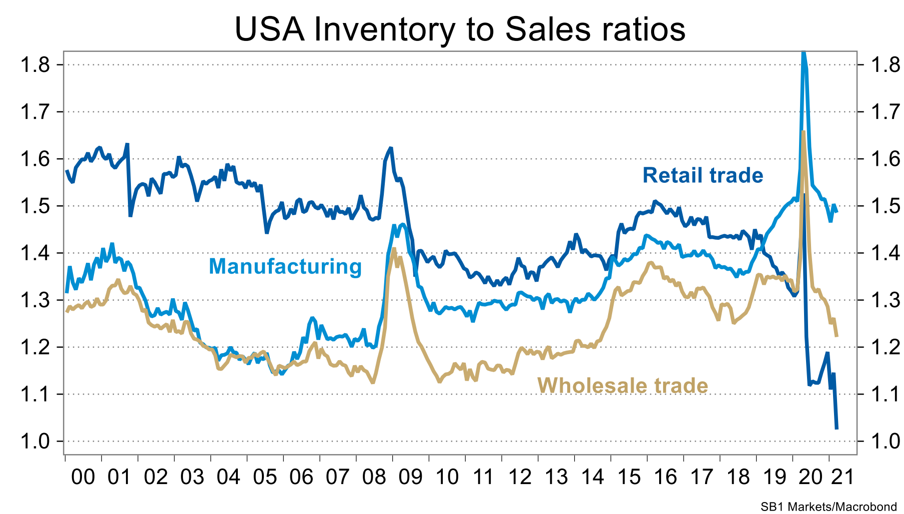
Retail shelves were 'emptied' in March, at least inventories fell sharply

We doubt they were filled up in April – and we think some restocking is needed



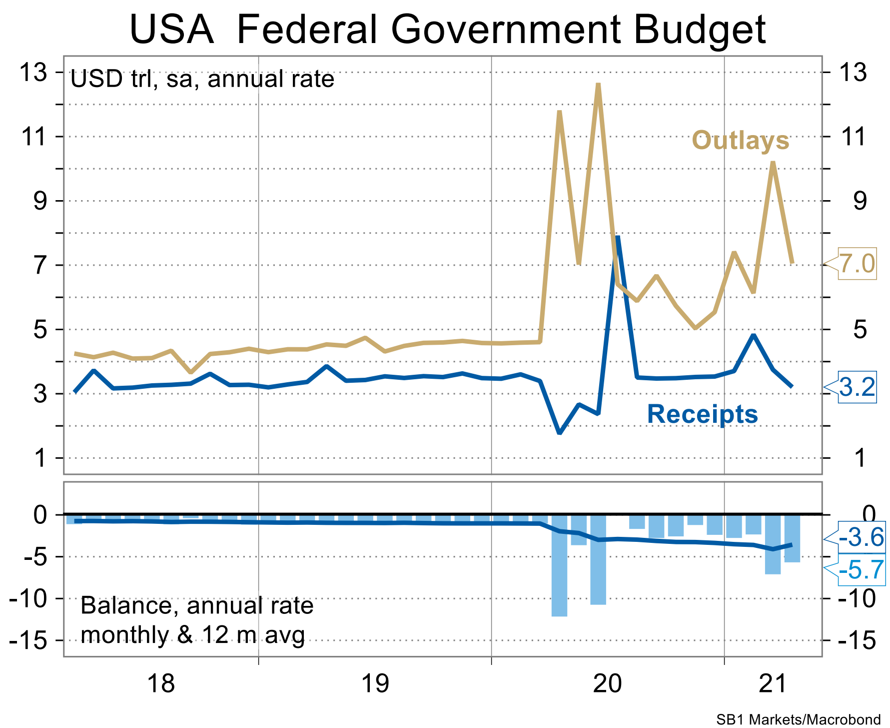
- Retail trade inventories are record low vs. record high sales but they are low in value terms as well
- Inventories are probably too low in wholesale trade as well
- A bit surprising, manufacturing inventories are on the way up – and they are not specifically low
- <u>In sum, we assume inventories are at too low levels now</u>

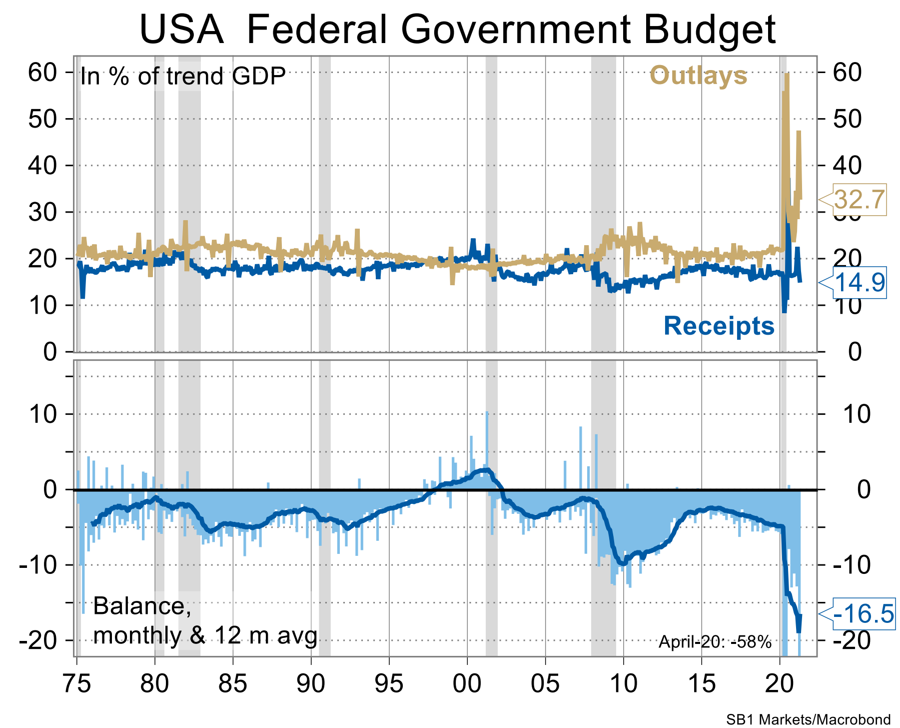




Far fewer stimulus checks in April, but Biden & Co are not done spending

Deficit will increase, and the debt ceiling will once more be on the table

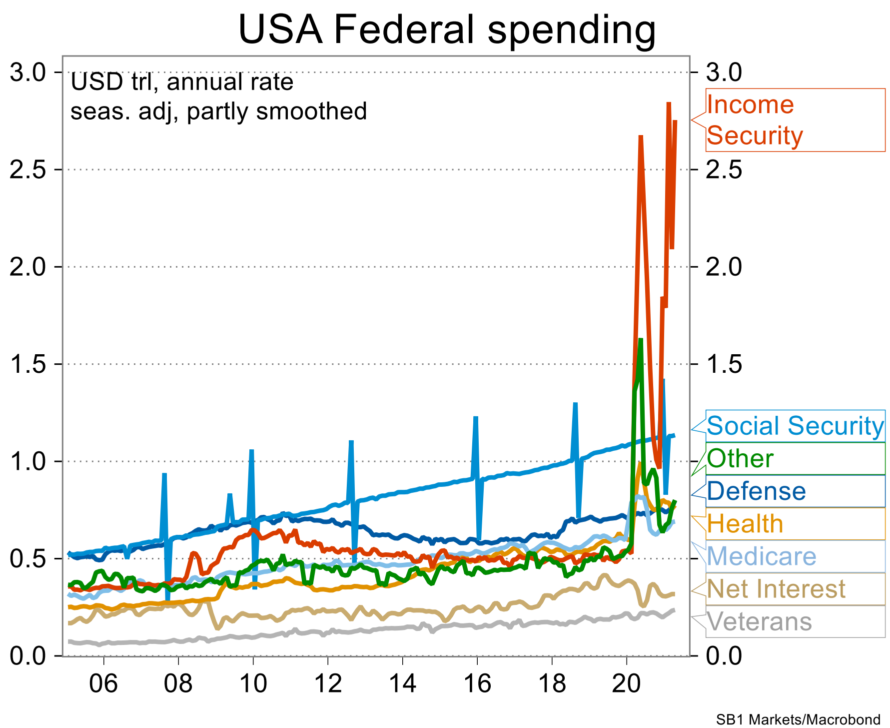


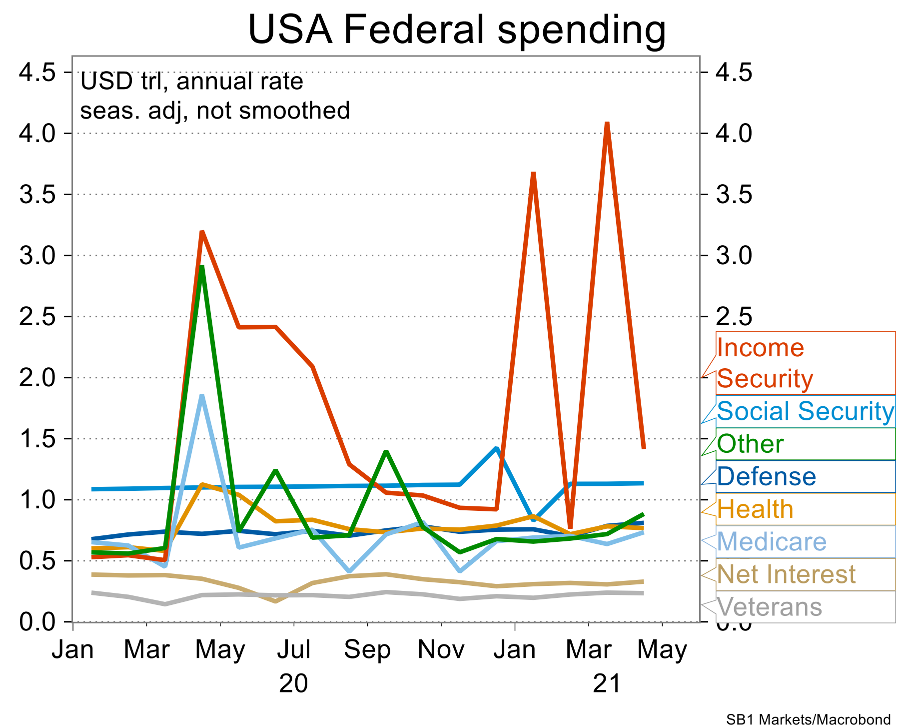


- **Federal expenses fell** to USD 665 bn in April from USD 860 bn. **Federal income** was 439 bn, or 66% of the expenses. The personal USD 1.400 cheques explained almost all of the monthly decrease in spending, 340 bn were distributed in March, while 'just' 58 bn were distributed in April – and there is not much more to wait for
  - » In annual seas. adjusted rate, spending fell to USD 7.0 trl in April from 10.1 trl, while revenues fell to 3.2 trl, from 3.8 trl in March
- The April **deficit** was at USD 226 bn (as expected), but almost USD 500 bn seas adjusted or more than 2% of annual GDP, and 26% of the monthly GDP. Over the previous 12 months, the deficit equalled 16.5% of GDP
- The **Federal Reserve** is buying gov bonds, but 'just' at a rate equalling 4.5% of GDP. So no lack of paper for the rest of us

Spending lower as only 17% as many checks were sent out compared to March

Considering all the other parts of Biden's packages, overall spending and the deficit will remain high



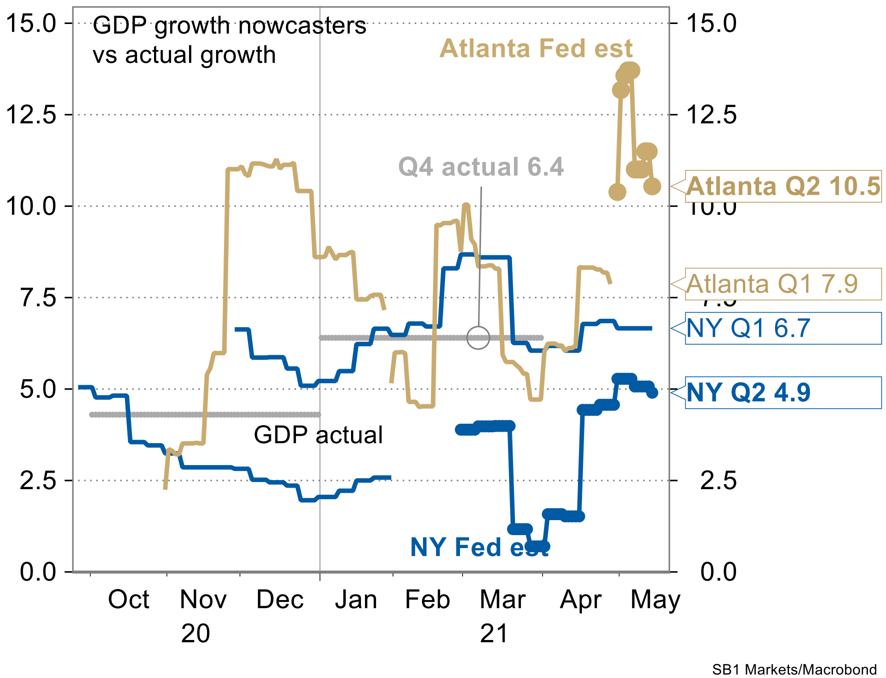


- There will still be federal spending on increased unemployment benefits, larger child tax credit, vaccine distribution, health care, food assistance programs, support for businesses, aid to local governments. These payments will take place of the next several months.
  - Of the total **USD 900 (Trump) + 1.900 bn (Biden)** stimulus package decided, 40% is distributed (our approx estimate). So expenses will stay high over the next 6 – 9 months ☺, by some USD 200 bn per month – or 10% of GDP – above 'normal' spending (which in turn was 5% higher than revenues in % of GDP)
- In addition, the Biden administration has proposed two long term programs, the **infrastructure (jobs) plan**, and a **family support program** (welfare initiatives), each at some USD 2.000 bn, though distributed over the next 10 years, and funded by higher corporate taxes and more taxes on 'the rich'. The Congress is now debating these proposals, which very likely will be scaled down but will still be substantial – and far from fully funded?

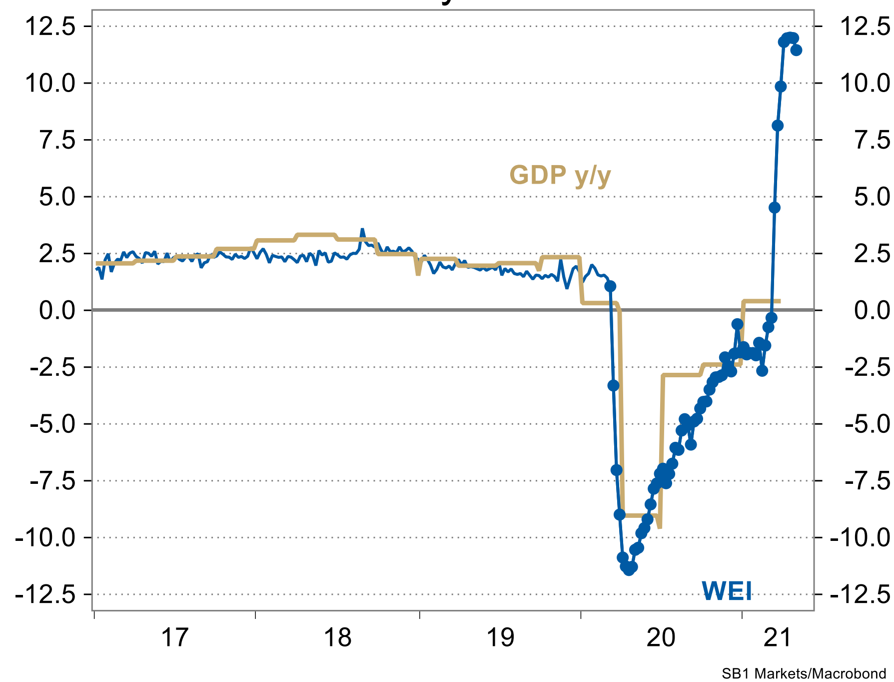
The nowcasters signal 5% to … 11% GDP growth in Q2

Friday's job report shaved 2.5% from Atlanta Fed's Q2 GDP growth estimate, still at 11%

USA Atlanta & NY Fed GDP nowcasts



USA NY Fed weekly economic indicator

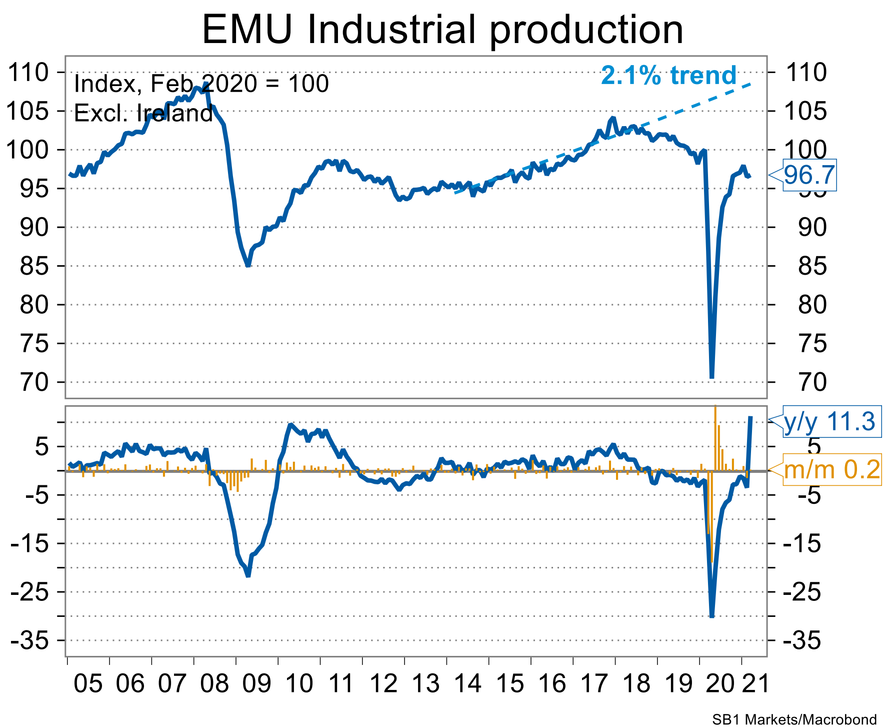


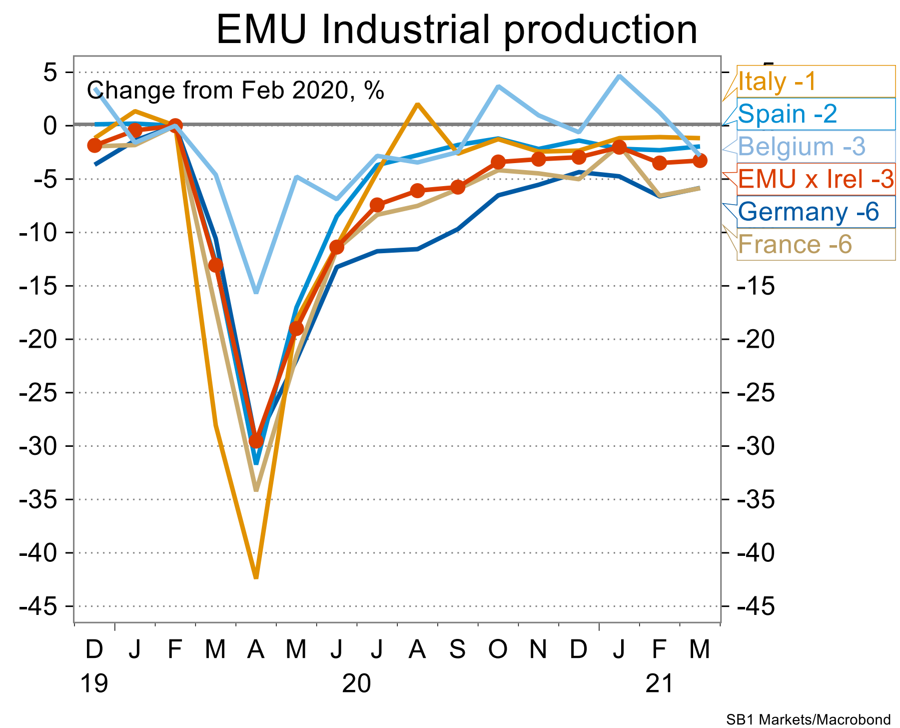
- NY Fed hints close to 7%
- NY Fed's weekly y/y economic indicator up in the sky (vs. last year 10%+ nosedive), implying a 8% growth pace in Q2
- The PMI/ISM signal a 8% growth pace

SpareBank 1 MARKETS

Industrial production up just 0.2% in March, well below expectations

Production is still 3.3% below the pre-pandemic level

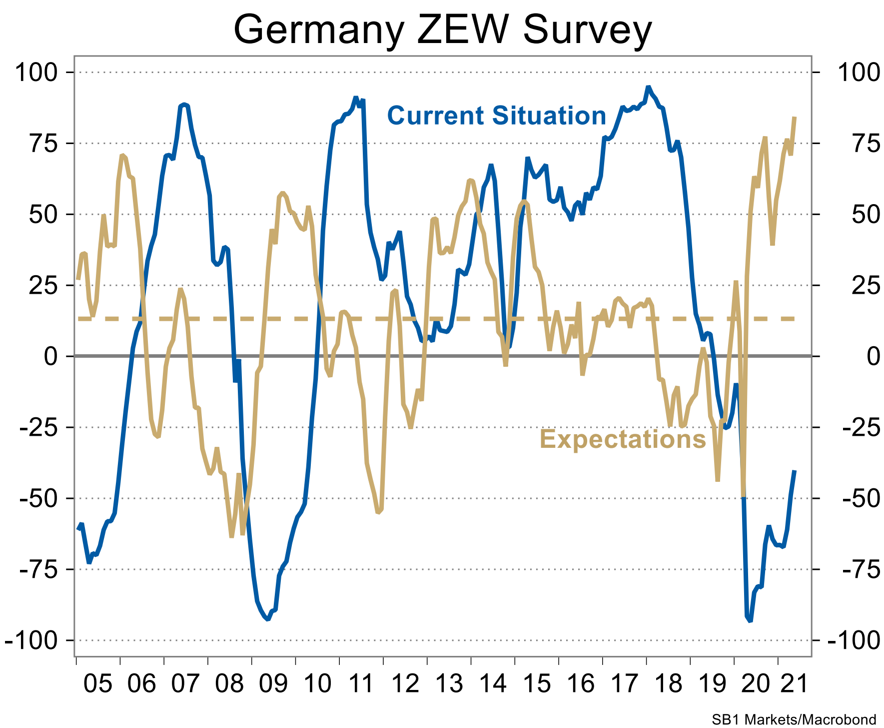


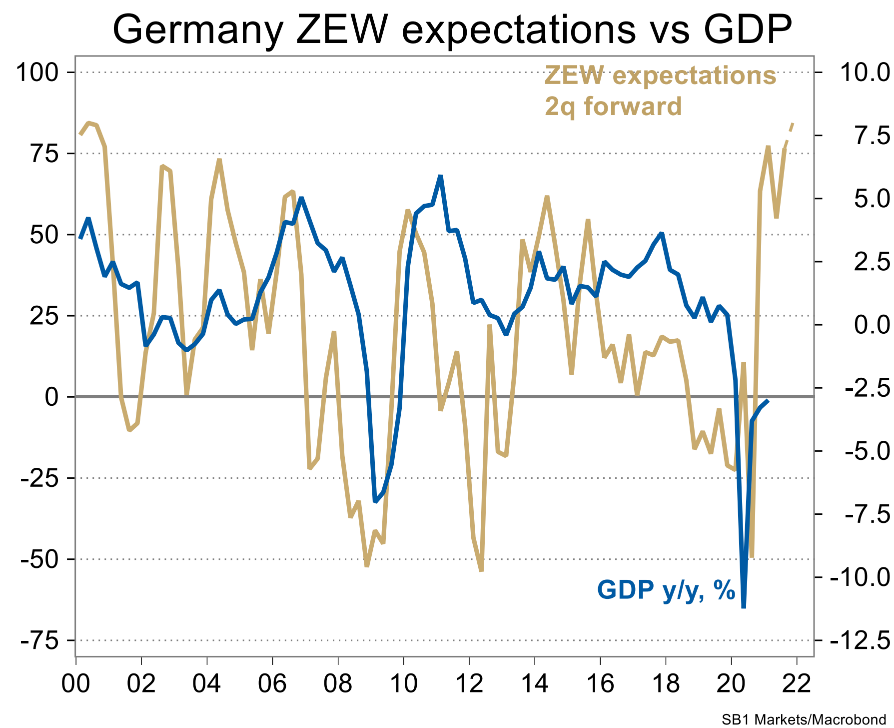


- Industrial production rose by 0.1% m/m in March. (Our figure refer to EMU x Ireland, due to extreme changes here from time to time. No drama in Ireland in March)
- Of the four major countries, only Italy reported a (small) decline in production
  - » However, production in Belgium fell sharply, which explained the modest growth in EMU production (we expected 0.5%, consensus was at 0.8%). Most likely, the volatile Belgium industrial sector will turn up in April
- Manufacturing production was flat m/m but it is down ‘just’ 1.5% vs February last year
- Despite weak actual production data (or due the them?), manufacturers in Europe are reporting unprecedented growth in activity. The coming months will be exiting!

ZEW analyst/investor sentiment sharply up in Apr, to levels not seen since Jan-00

Fears of tighter restrictions are grippling investors amid 3rd Covid wave

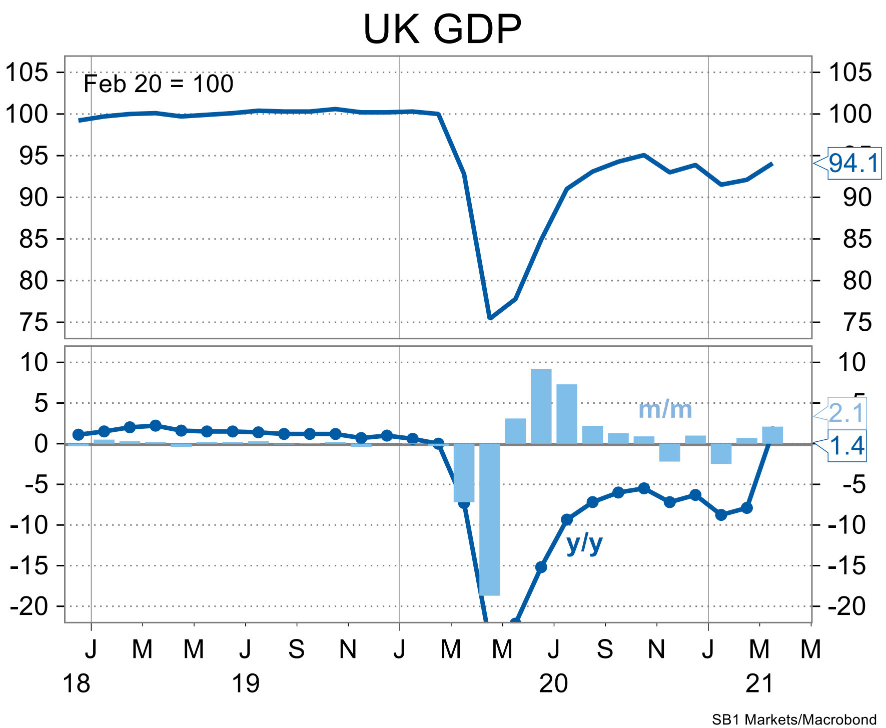


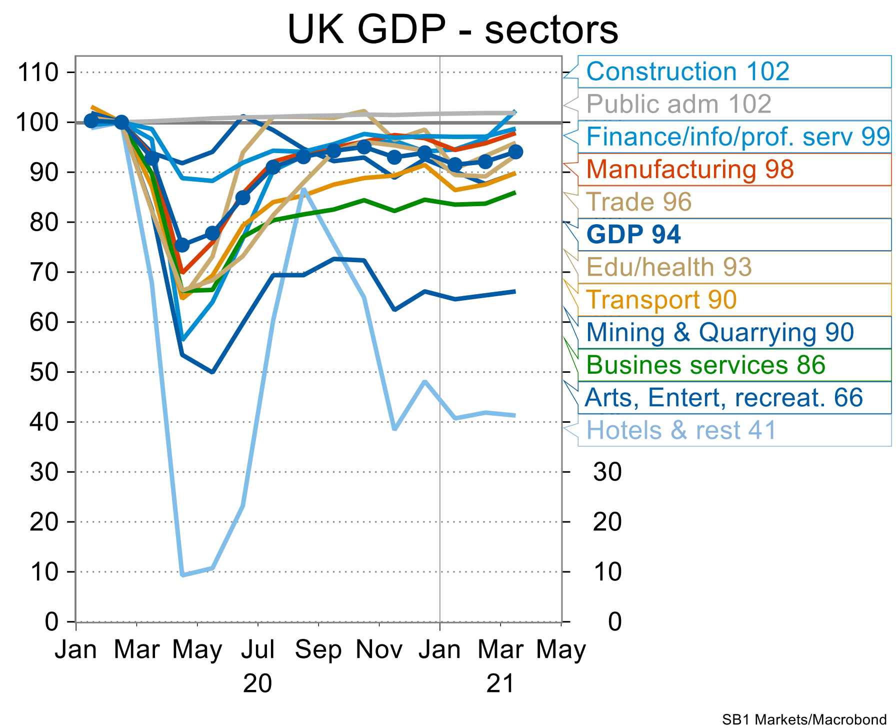


- The ZEW expectation index jumped 13.7 p to 84.4 in May, expected up to 72. The index is 1.7 st.dev above average, and just marginally below the best prints the past 20 years
  - Thus, investors and analysts are just pretty sure that the economy will not remain in the basement forever, and a strong recovery is expected. Which is reasonable
- Assessment of current situation improved in May, as some restrictions have been lifted and vaccinations are under way. During the next months the gap between the two components should narrowed substantially, mostly from the downside

UK GDP grew by 2.1% m/m in March, exceeding expect. Still down 1.5% in Q1

March GDP is 5.9% down vs. the pre-pandemic level, but the tide has definitiely turned

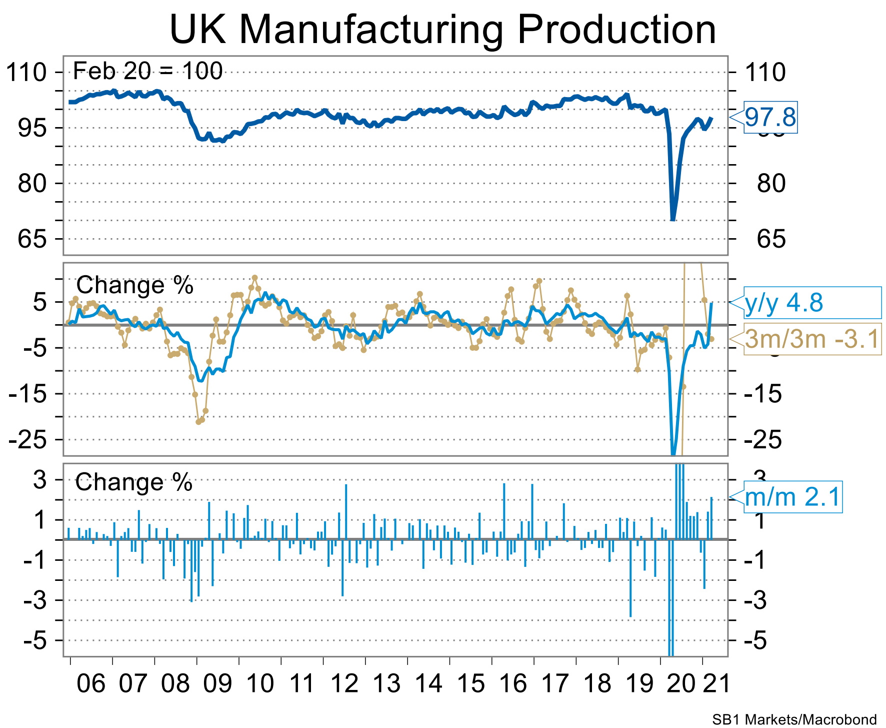


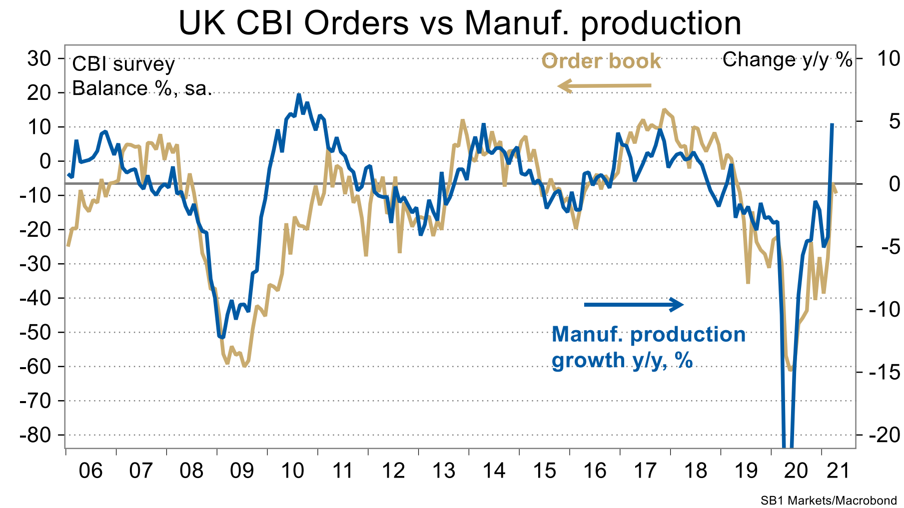


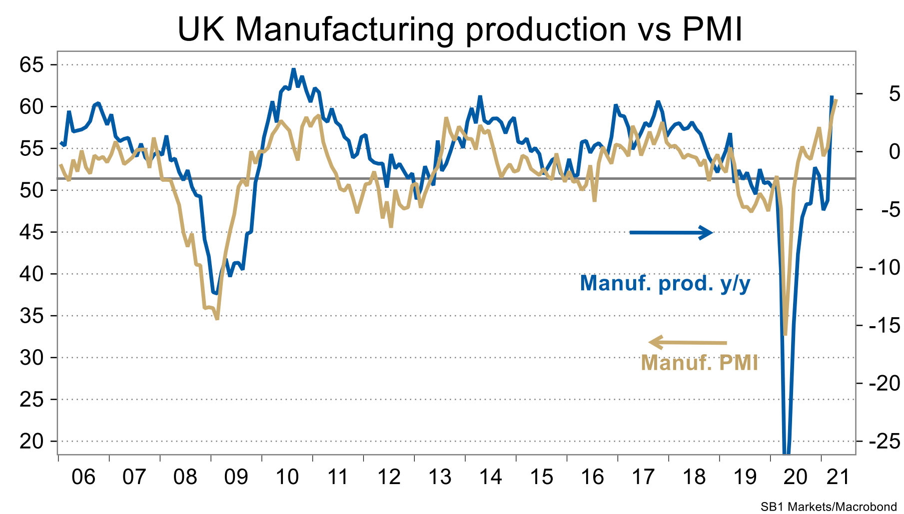
- GDP grew 2.1%, as the UK partially reopened after the initial successful vaccination rollout, was expected up by 1.5%
- In Q1, GDP fell by 1.5% (5.9% annualised), expected down 1.6%. Q1 GDP is down 8.7% vs Q4-20 (the monthly & quarterly data are not yet consolidated)
- Hotels & restaurants was the only main sector with a decline in activity in March
- The coming months will no doubt be far better for the service sector as UK is now opening rapidly up

Manufacturing indicators further up in March & the PMI still strong

Manufacturing production up 2.1% in March – beating expectations by 1.1 pp



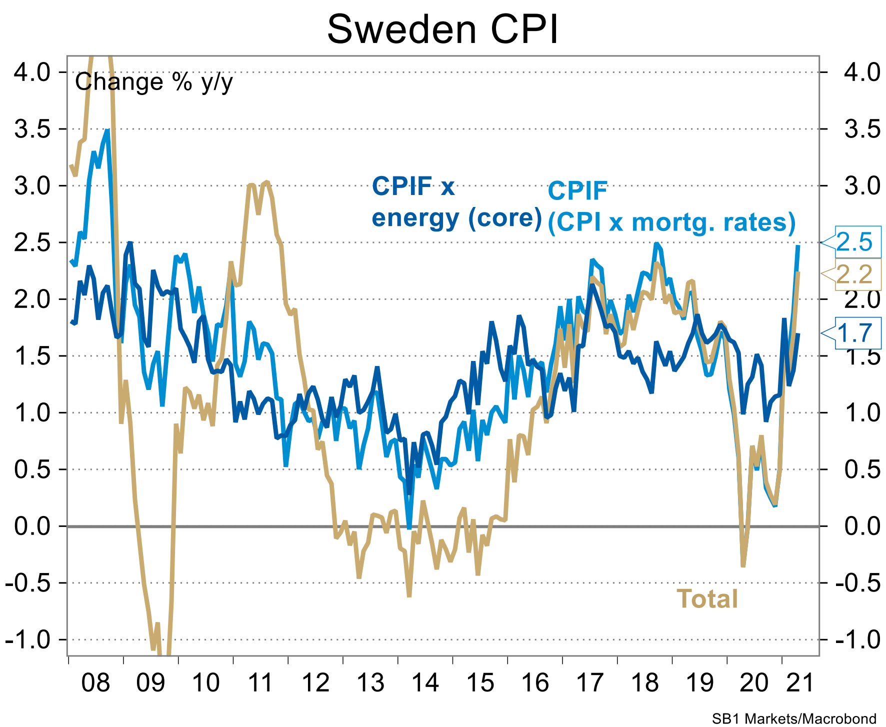


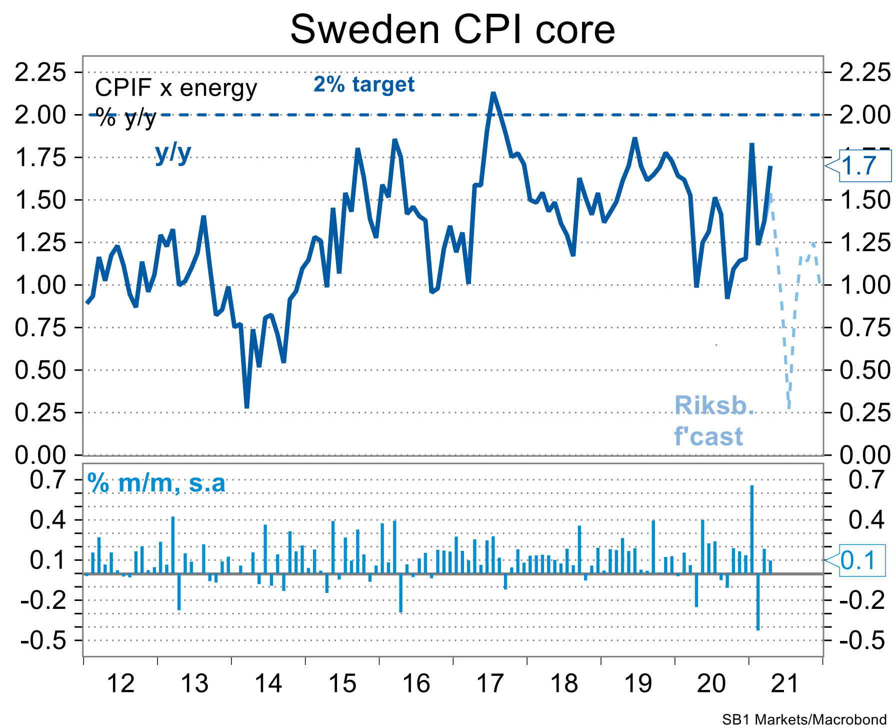


- 10/13 manuf. subsectors saw an increase in March
- Industrial production was up 1.8% m/m (expected 1.0%)
- Manufacturing production is still 2.2% below the pre-pandemic level

Core inflation up 0.3 pp to 1.7% in April; above consensus & Riksbank f'cast

Riksbank expects core to remain low for long, and expects core CPI to dip from here until summer

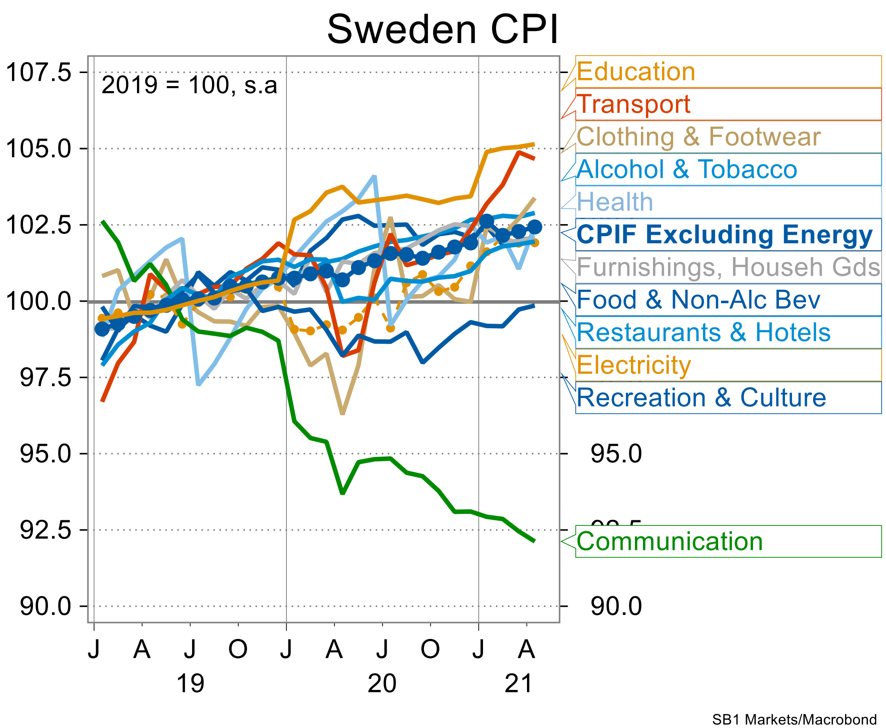


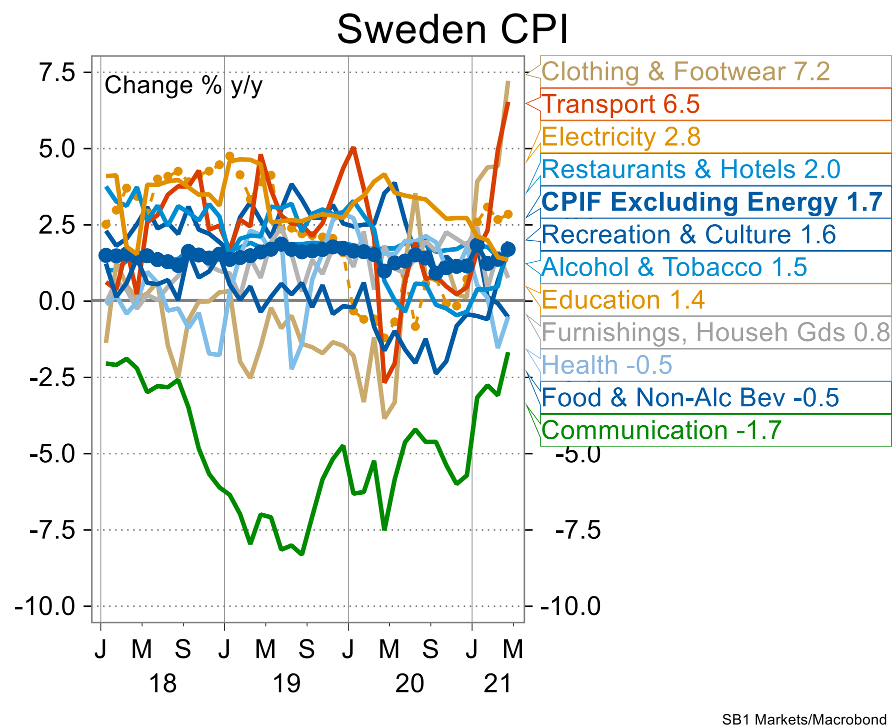


- **Headline inflation** increased to 2.2% y/y from 1.7% - largely due to base effects
- **The CPI-F**, the constant interest rate inflation (CPI x mortgage rates) was up 0.6 pp to 2.5% y/y in April, 0.1 pp above expectations
- CPI-F x energy, the 'real core' was up 0.1% m/m – and by 1.7% y/y
- The increase in inflation was largely driven by increase in food, clothing & footwear prices, whereas electricity was the largest contributor on the downside

Food, healthcare, recreation & culture, clothing & footwear biggest contributors

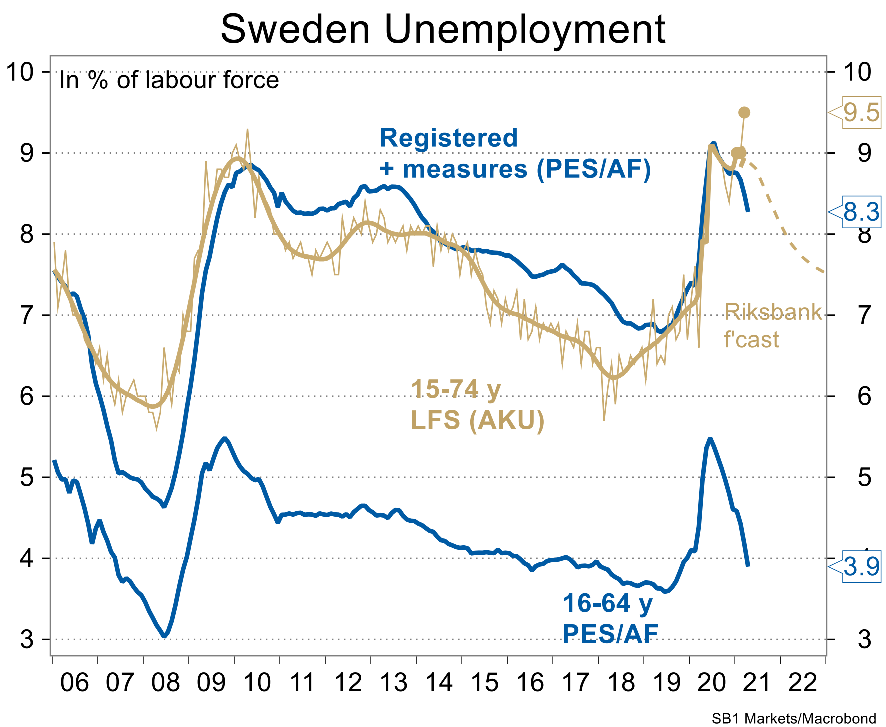
…and the majority of sectors are still reporting inflation below 2%

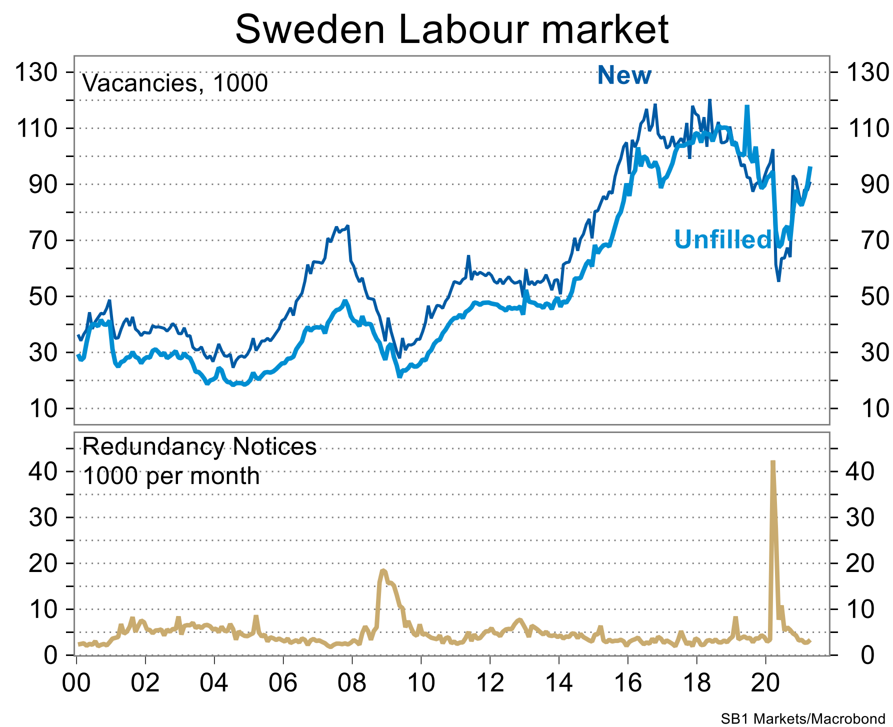




LFS unemployment up in April. Perhaps. However, vacancies are on the way up

New survey method, definitions & calculations makes especially employment data 'useless'

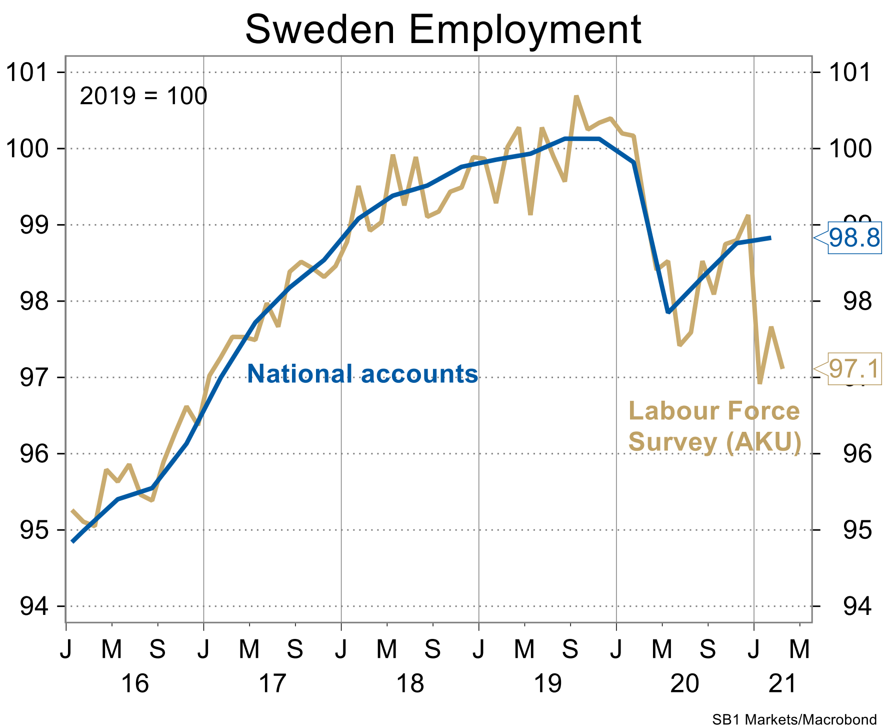


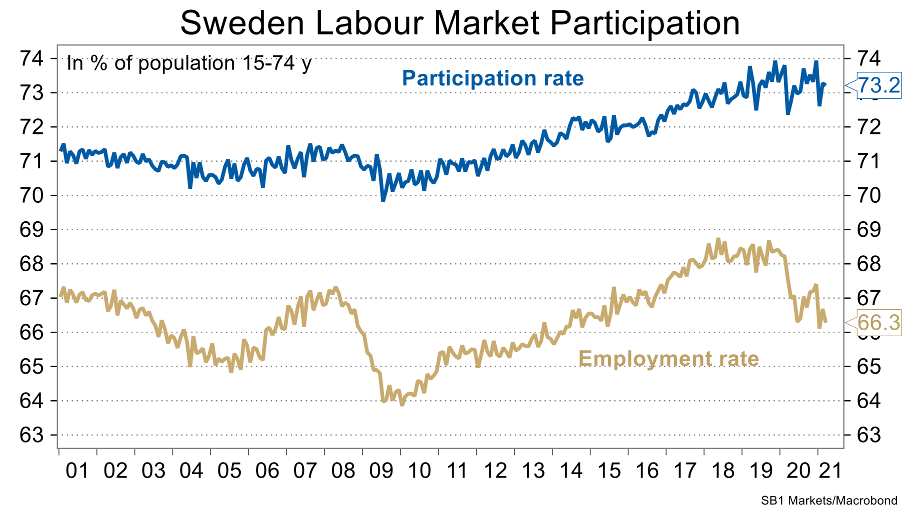


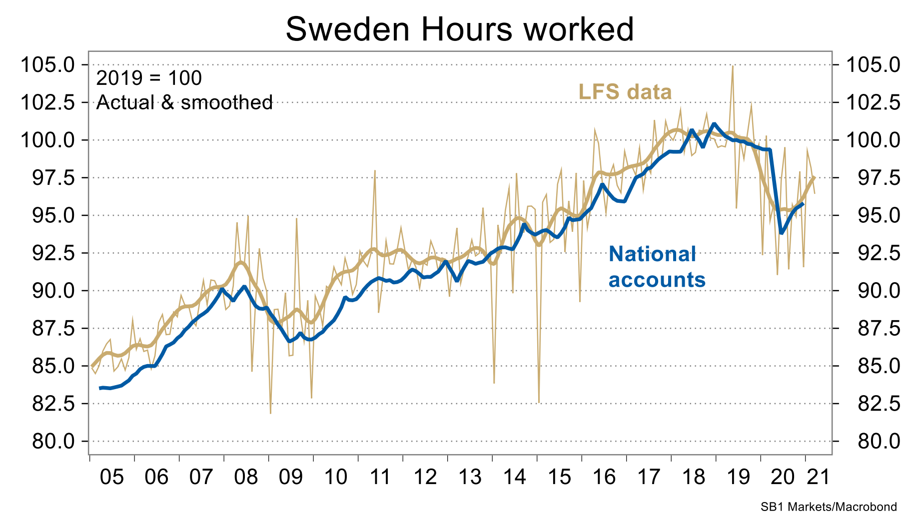
- The seasonally adjusted **LFS unemployment rate** rose 0.5 p to 9.0% - probably. The whole LFS apparatus is revised (EU standards) and the old and new method is not yet directly comparable in Sweden. SSB in Norway seems to have done a better job making now and old data comparable
- **Registered unemployment** has inched down and currently stands at 3.9%. Incl. labour market measures, unemployment has fallen somewhat less, and is at 8.3%, 0.1 pp higher than a year ago
- The number of **new and unfilled vacancies** increased, and **layoffs** were up in April

The LFS report a sharp decline in employment. National accounts don't

The National accounts are no doubt the best data source, based on much more input than the LFS



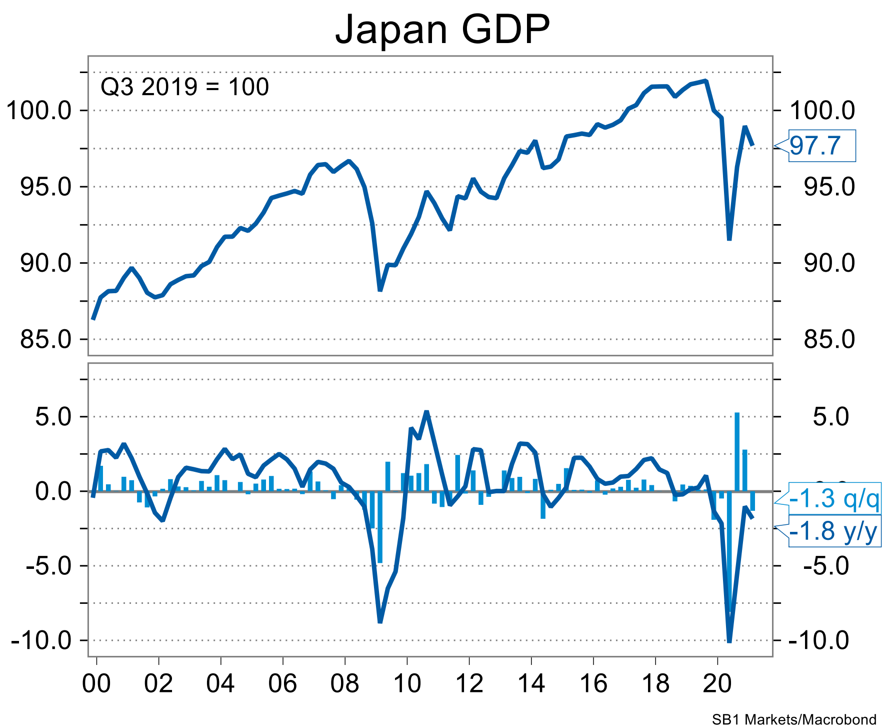


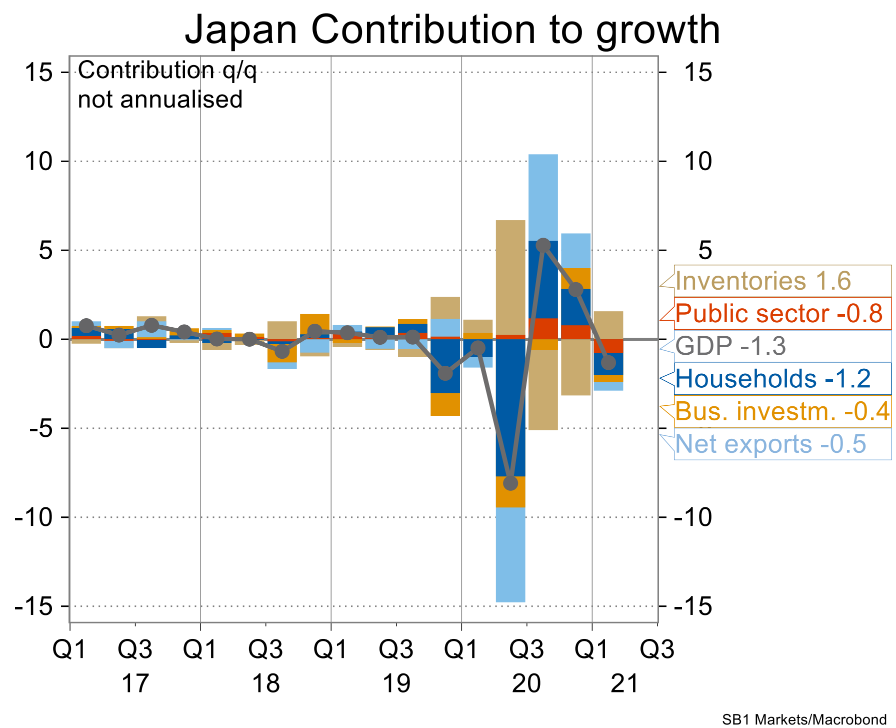


- Employment is most likely down some 1.5% from before the pandemic
- Hours worked has recovered substantially vs last spring, and are still on the way up - but remain 3% – 4% below the Q4-19 level (but Nat. account has not yet reported Q1 hours worked)

GDP -1.3 in Q1 (-5.1% annualised), down 2.3% vs Q4 19 (a very easy comparison)

The decline was expected

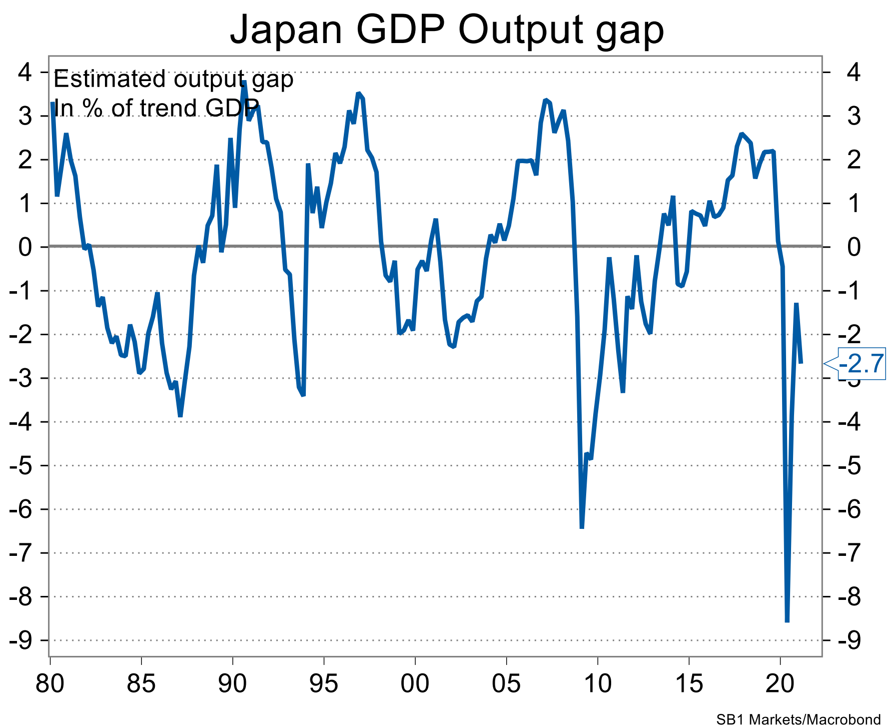


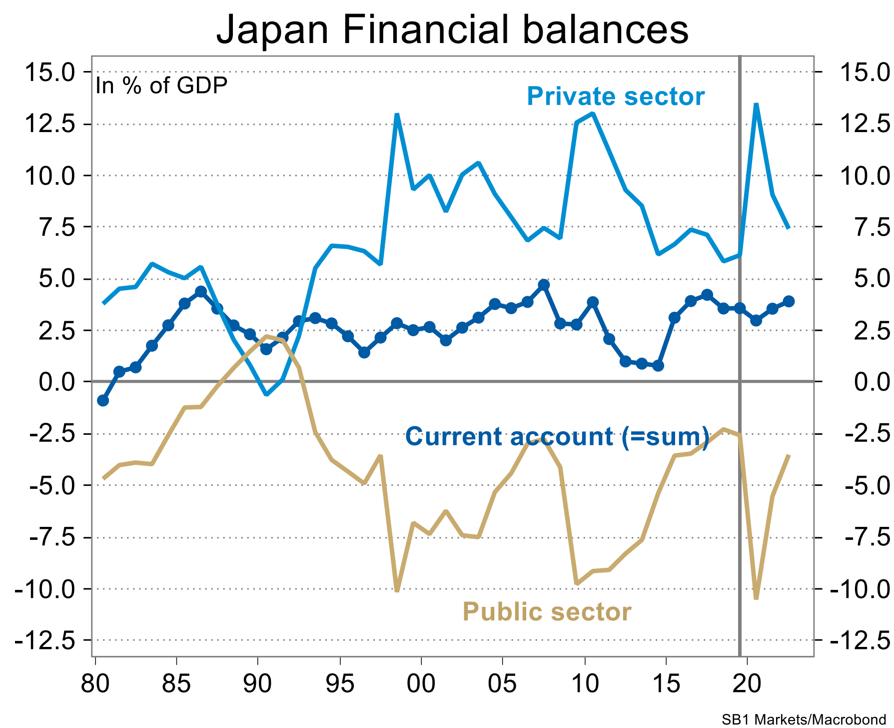


- Final demand fell even more than GDP as inventories rose faster than in Q4, contribution to a 1.6 pp lift in GDP
- Household contributed most on the downside but also public demand, business investments & net exports fell
- GDP is down more than 2% vs Q4-19 but as GDP fell sharply in that quarter due to a hike in the VAT, GDP is down almost 5% vs. Q3-19 – and the output gap is no doubt substantial
- Short term indicators do not so far signal any brisk recover

A deep downturn – but not that far up to the pre corona level

However, its more than a 2 pp longer way up the the pre VAT hike level





Highlights

The world around us

The Norwegian economy

Market charts & comments

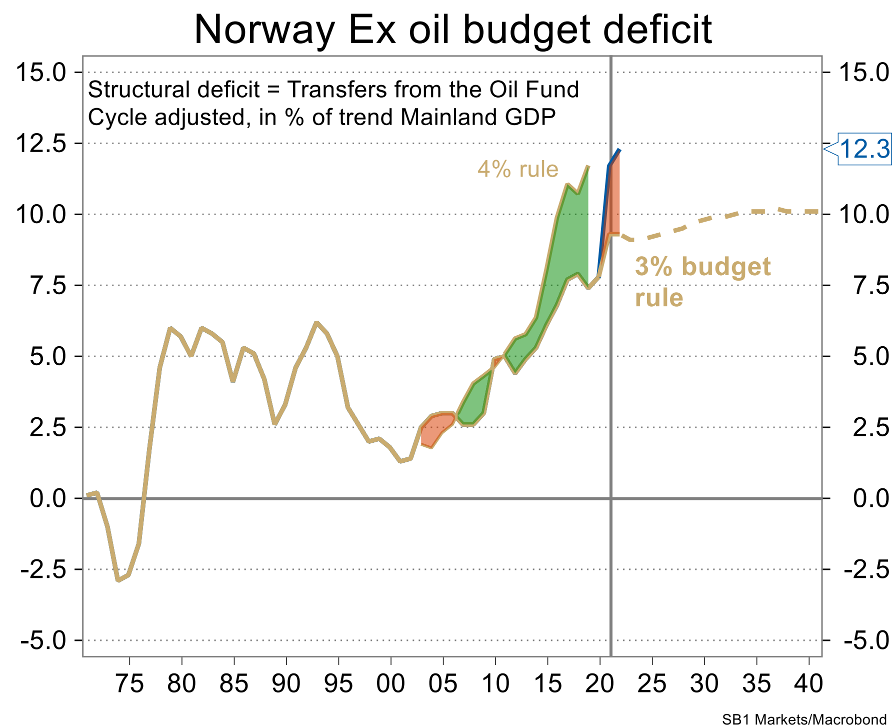
A ton of spending. At least as long as the pandemic lasts

The question is, how much afterwards?

Structural non-oil balance

NOK bn	Actual 2019	Actual 2020	Rev bud 2021	*SB1 Markets est 2022*	*2023*
Pre pandemeic outlook	239	240	251	*262*	*274*
Now	**239**	**370**	**403**	***325***	***325***
Corona measures		135	94	*10*	*0*
Other measures (residual)		-5	58	*53*	*51*
Balance, % of trend ML GDP	**7.8**	**11.7**	**12.3**	***9.5***	***9.2***
... fiscal stance, change in bal.		3.9	0.6	*-2.8*	*-0.4*
Balance, % of Oil fund		**3.7**	**3.7**	***2.9***	***2.8***
Spending rule, 3% of Oil fund		303	327	*338*	*352*
Deviation		67	76	*-13*	*-27*

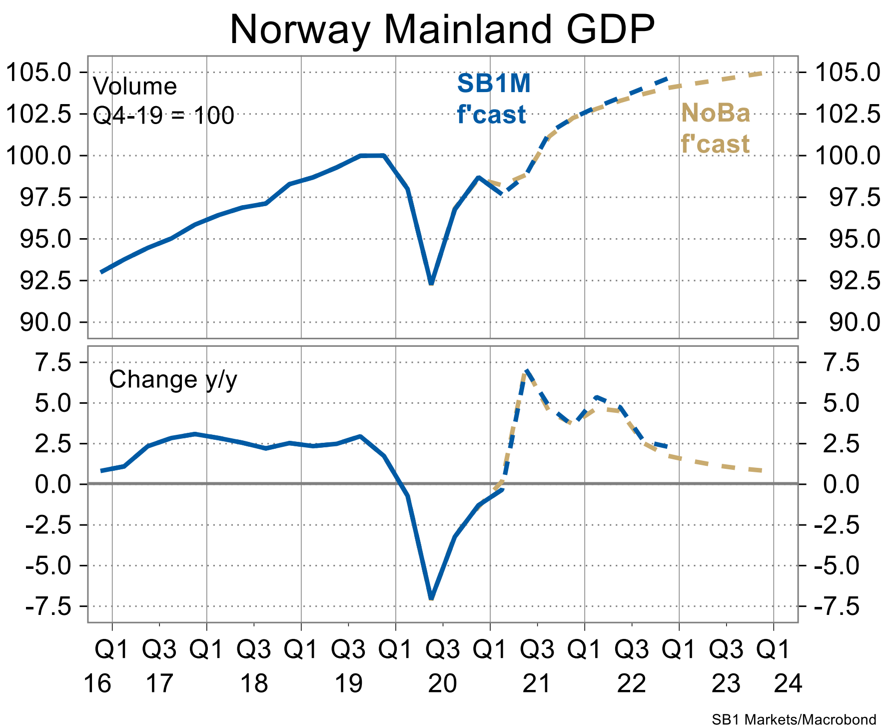
Sources: Min. of Finance, SB1 Markets



- The **2021 non-oil structural deficit** was NOK 90 bn larger than in the original 2021 budget (Oct-20) but a big extra support was decided in February, and some extra 'minor' expenditures were added now – so the proposal was close to our estimate. The structural deficit is larger than last year in % of trend GDP, and thus it is expansionary, even in the economy recovers (if all the money is spent)
- The **2020 budget deficit** was far smaller than assumed last autumn
- The **non-oil structural deficit**, funded by a transfer from the oil fund is well above the long term budget rule (3% of the funds value) in 2020/21 but the extra spending now (in red at the chart to the right) is far smaller than the accumulated 'under-spending vs. budget rule over the previous years (in green).
- The 2021 deficit is 2.5%-of-GDP higher than the long term budget rule advices. No other country is closer to their long term target these days?
- **The risks:** Spending remains too high, after the pandemic. A substantial decline in the value of the Oil Fund

GDP down 1% in Q1, but the (near term) future is so bright…

Corona measures were not for free but no dramatic downturn in Q1

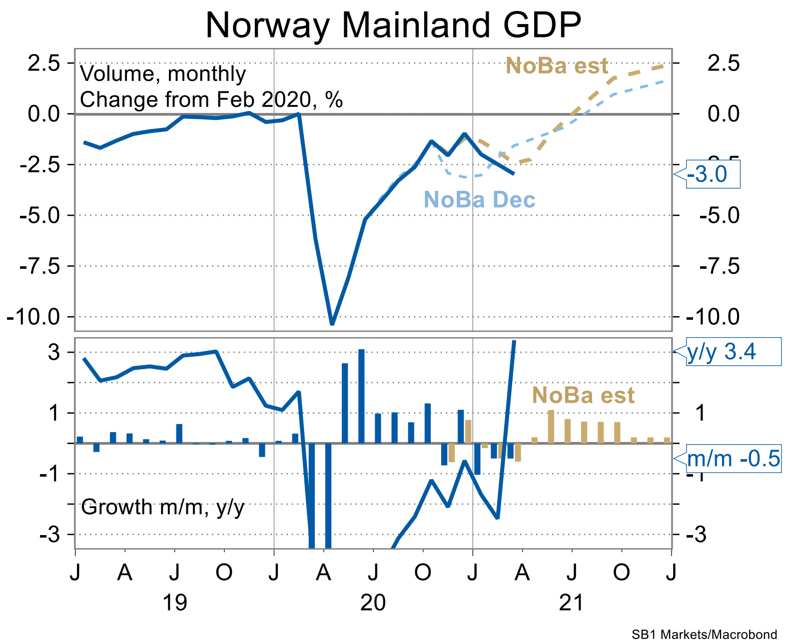


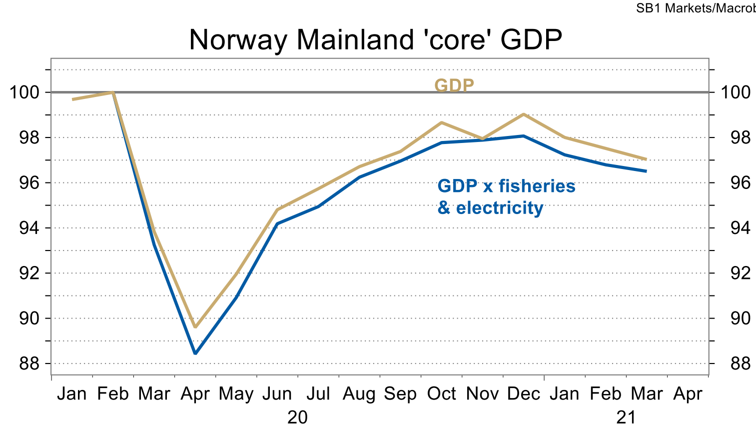
No kidding, our forecast was not produced to replicate NoBa's forecast. It was NoBa that revised its forecast up to ours ☺

- **GDP** fell by 0.5% in March and 1% in Q1, in sum a tad weaker than expected
- However, what happened during the 'closedown' months until April will very likely not have any impact on activity in Q3 or in Q4
- The **remaining restrictions** will very likely be gradually lifted the coming weeks, and we are confident activity will rapidly pick up in the down beaten services sectors
- **Business air travel/hotel usage**, foreigners spending will not recover to a normal level anytime soon, but these activities are not a big part of the Norwegian economy
- On the other hand, **Norwegians** will very likely not travel abroad as normal this summer – and they have no choice but to spend their holiday budget in Norway, as last year.
  - » After the summer, more of business air travel/foreigners tourist traffic will support activity
- **Consumption of goods** will very likely approach a long term trend growth path over the coming 2 – 3 quarters implying a slight decline for the present level
- **Business investments** in both on and off-shore have stabilised and housing investments are on the way up
- **Exports** has recovered, and the outlook is not that bad

Mainland GDP down 0.5% in March, Q1 down 1%

The decline in March was in line with consensus but less than NoBa expected. Q1 down 1%

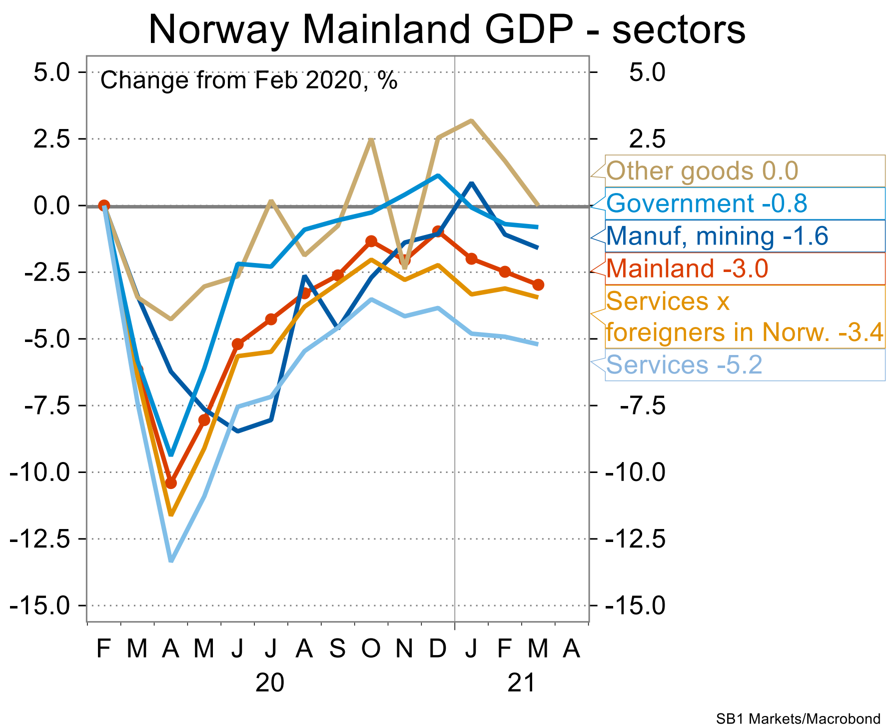


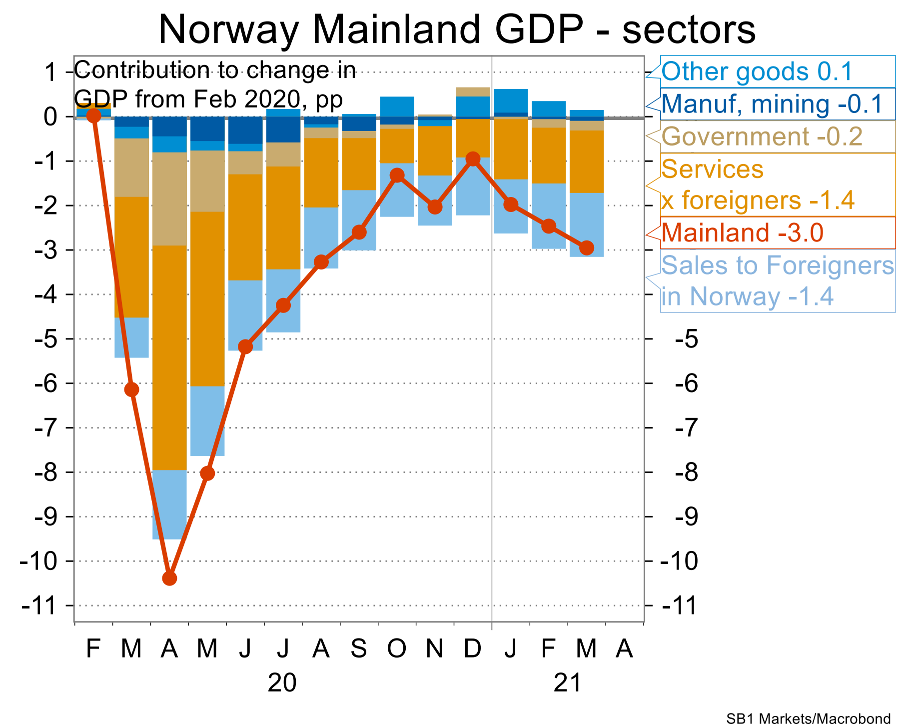


- **Mainland GDP fell by 0.5% m/m in March**, in line with consensus, we exp. -0.4%. Norges Bank assumed -0.6%. The decline in January was once more revised up, from initially -0.2%, via -0.8% to -1.0% now. GDP is down 2.7% from October last year
- Q1 GDP fell 1% from Q4, expected -0.7%. Thus, in sum, marginally weaker than expected.
  - » **Production:** Private services are of course hampered by restrictions, and activity fell by 0.3% in March – and by 1.2% in Q1. Still hotels/restaurants, culture entert. stabilised in March. Manufacturing was down 1% in March, but was up 1.1% in Q1
    - **Fisheries and electricity** slightly down in March, 'core ML GDP' down 0.3%
  - » **Demand:** Norwegians' spending at home fell 1% in March, goods down 2%, services flat. Both investments oil, Mainland businesses and housing investments rose in March, while all fell in Q1. Exports x travel +4% in March
- **Mainland GDP is down 3% vs the Feb-20 level**
  - » **The GDP level** is marginally below Norges Bank's estimate in the March MPR. Ex fisheries & electricity, GDP is down 3.5%
  - » **Production:** The 4 hard hit services are down 21% (business services) to 46% (hotels & restaurants). The total negative drag equals 3% of Mainland GDP. Other sectors are up is sum flat, with trade, manufacturing & education in the lead. Construction is down 5%, even if housing investments are up
  - » **Demand:** Norwegians are spending 2% less in Norway than in Feb-19, services down 12%, goods up 9%. Spending abroad has fallen by 97% (equalling 9% of disp. income), and the money is saved. Housing investments are up. Mainland business investments have fallen by 6%, while oil investments are down 8%. Exports ex petroleum (and tourism) are back to the Feb-20 level. Foreigners are not spending anything in Norway, a cut equalling 1.5% of Mainland GDP

Production: A broad decline recent months, services not more than others

The 2nd /3rd wave was felt, production down in all main sectors

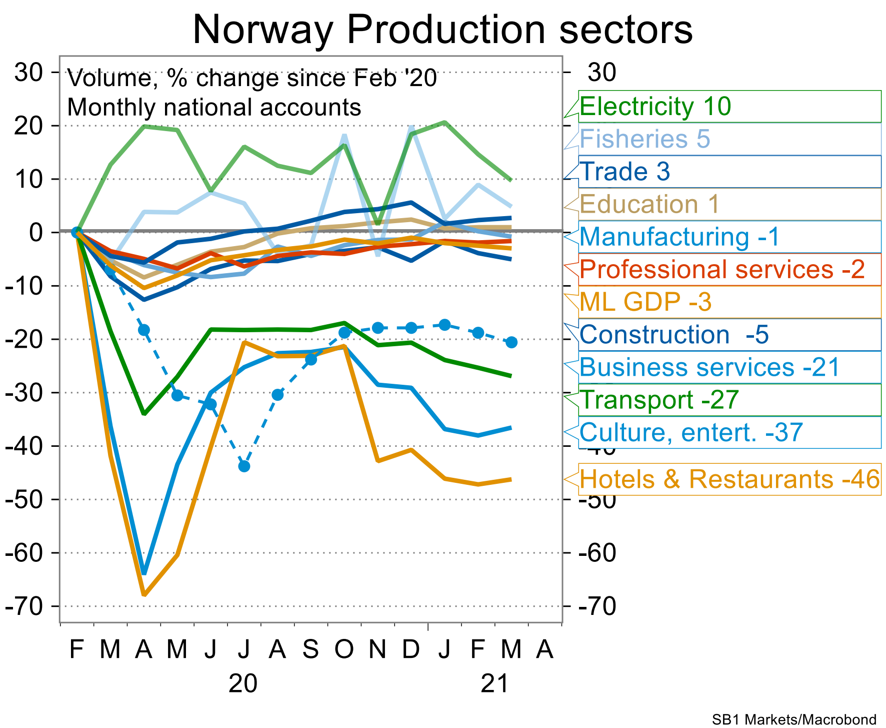


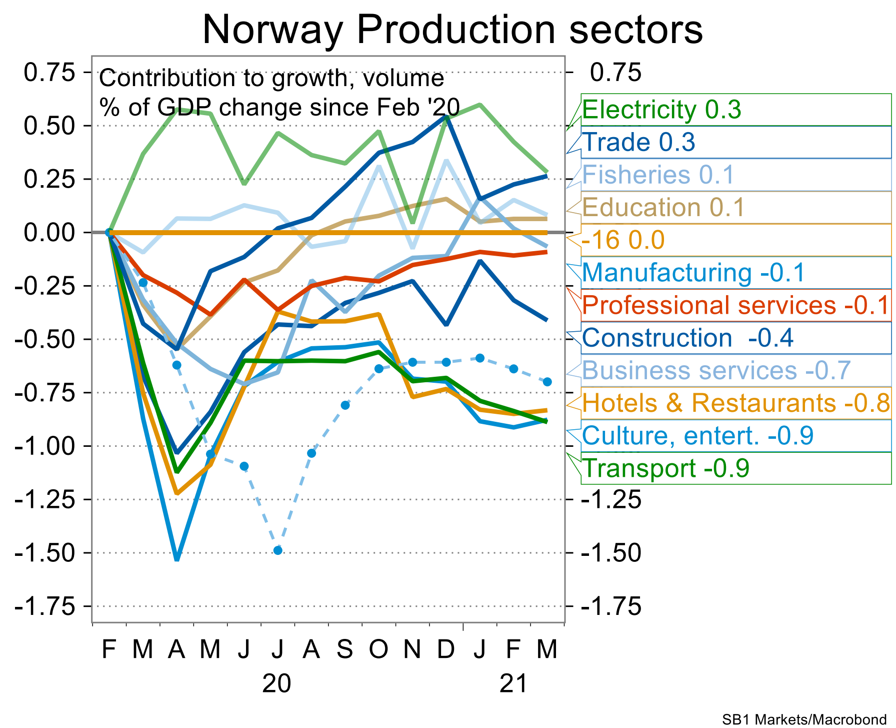


- **Service sector production was down 0.3%** in March, amid tighter corona restrictions – but this is nothing compared to the 13% drop last March/April. Most likely, March was the bottom (or April)
- **Manufacturing production (incl mining)** also hit a rough patch in Feb and was down 0.6% m/m, and it is 1.6% below the Feb-20 level (weaker than in monthly production stats have signalled)
- **Other goods production** is volatile mostly due to (ocean) **fisheries and electricity production** but the negative impact from these sectors in March was not that large. Construction activity fell too

Production details: More sectors down than up in March

Peoples' businesses (restaurants etc) down 21% - 36% vs Feb-20, in sum a 3.3% neg. drag on GDP



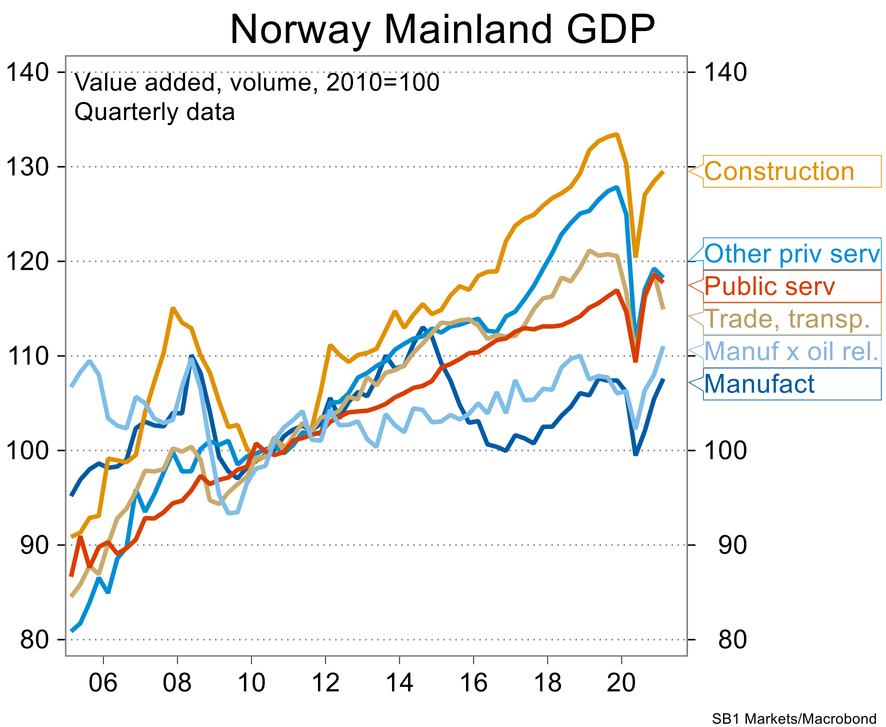


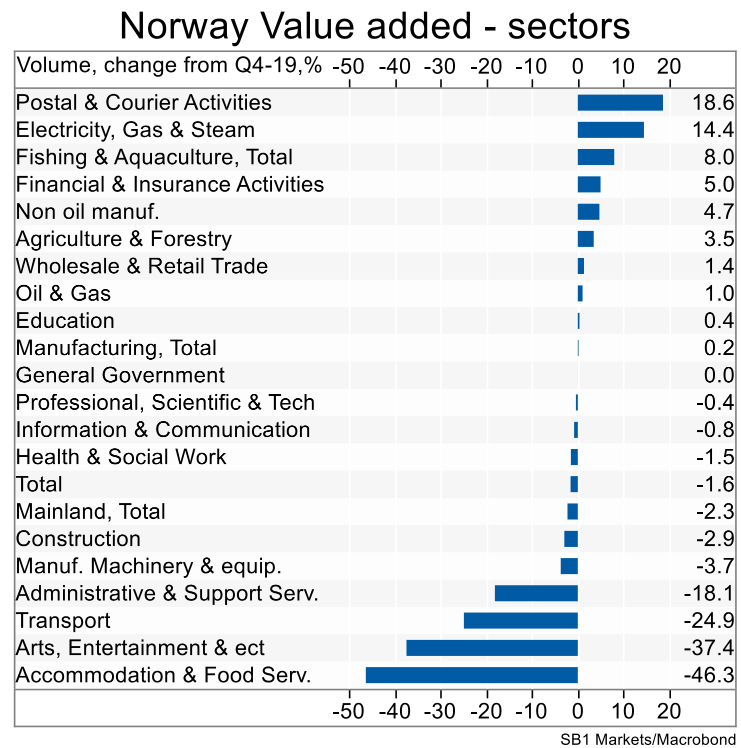
- **Hotels & restaurants and culture** stabilised in March, while **transport and business services** contracted further
- **Fisheries & aquaculture, trade,** and **construction** reported a decline too - the latter two probably due to corona restrictions

Business services: Temp services, travel agencies, call centres, congresses, cleaning, canteens, property services, leasing

Production: A longer view… On the way back to normality

Transport, arts, entertainment, hotels & restaurants at the bottom – down 25% – 46% vs. Q4-19



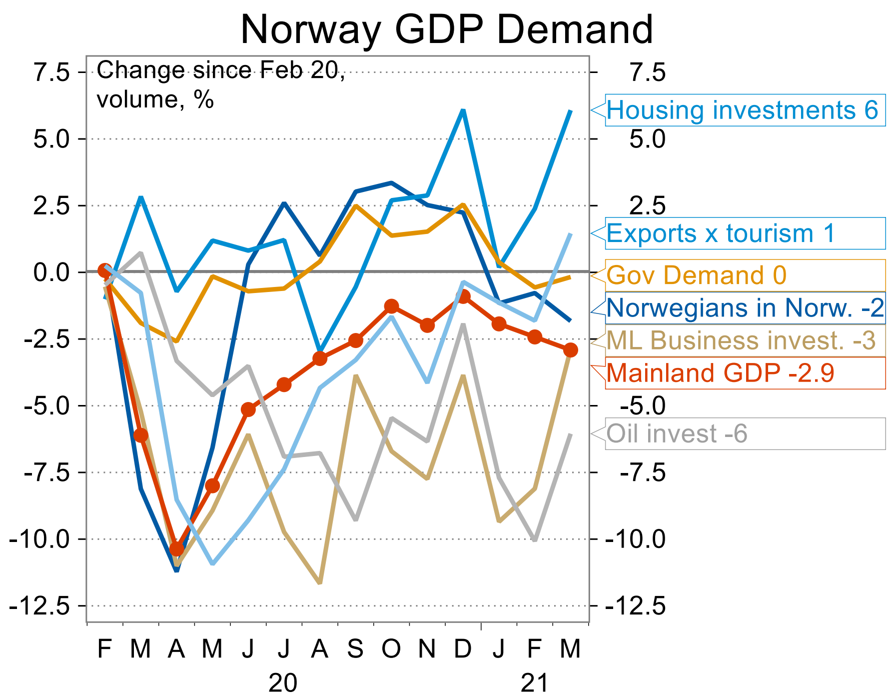


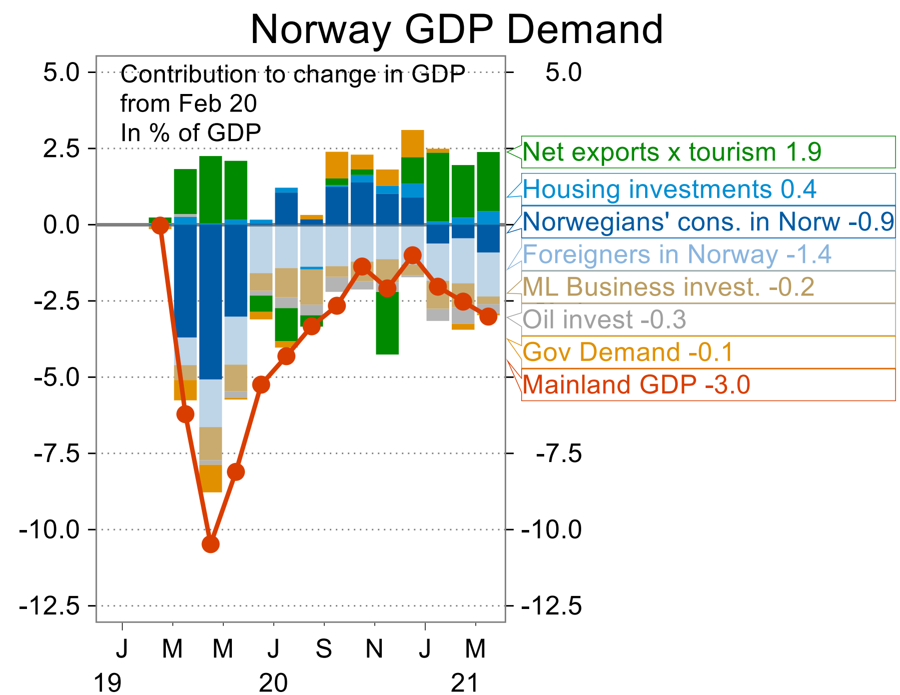
The Q1 data vs Q4-19(vs. the monthly data at the previous pages)

- Hotels & restaurants are down 46% vs Q4-19. Culture & Entertainment -37%
- Administrative & support services (like staffing & travel agencies, cleaning, canteens, leasing etc) are down 18%
- Transport -25%, both due to a steep decline in personal transport (airlines, train etc)
- Construction is weaker than we have assumed, 3% down vs. Q4-19 – but activity is now on the way up
- Manufacturing flat, due to the decline in production in oil related industries, others are up 5% vs Q4 19
- Non-oil manufacturing & finance are close to the top of the list
- And the winner is: Postal & courier Activities, +19%. We have all seen them around

Demand: Consumption down, all other demand up in March

Norwegians' consumption fell 1%. Investments sharply in March but down in Q1

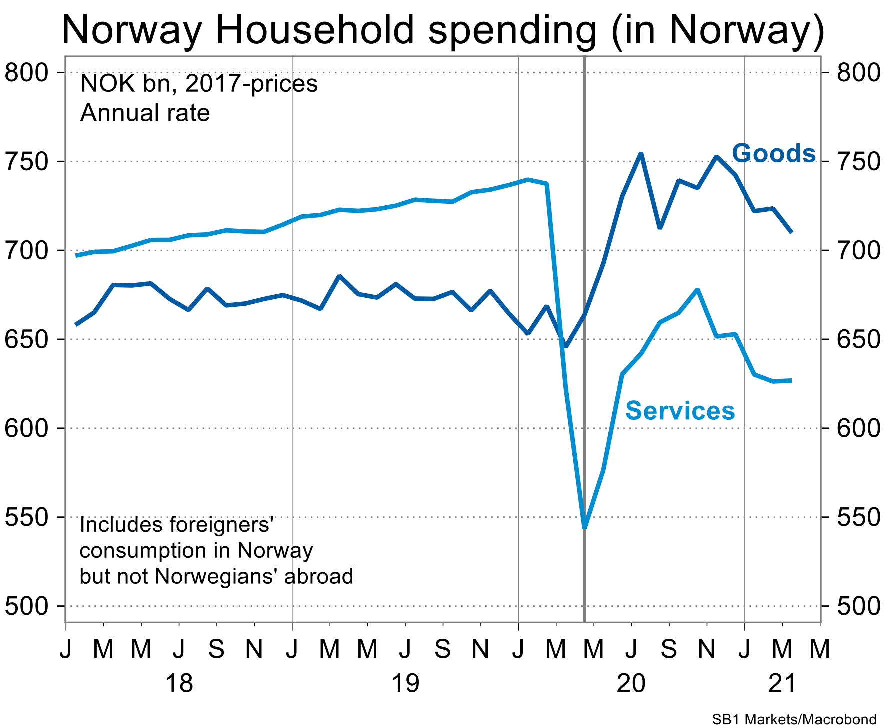


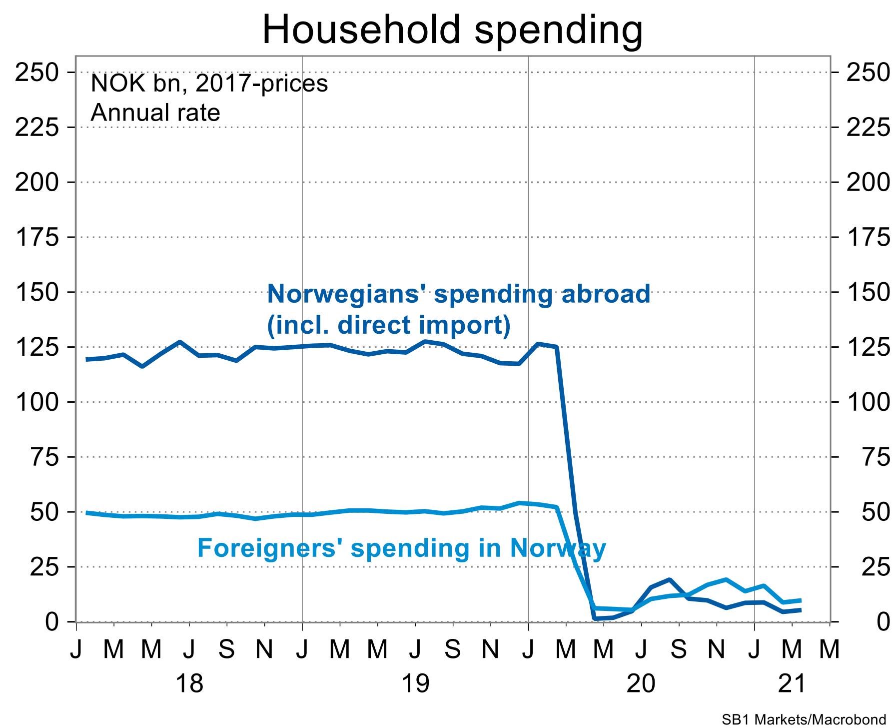


- **Norwegians' consumption in Norway fell by** 1% due to a 2% decline in consumption of goods. **Foreigners spent** are still not spending anything, and deducts 1.4% from GDP (not adjusted for import content of goods they (used to) buy here)
- **Mainland business** investments rose 5% in March but are still 3% down vs. Feb-20
- **Oil investments** gained 5% in March, and are now just down 6% since Feb-20, deducting 0.3% from GDP
- **Government demand** rose marginally in March, is flat vs. Feb-20
- **Domestic demand** fell by 0.2% m/m. Mainland final demand rose by 0.5%, due to higher investment demand
- **Mainland exports** (x tourism) rose by 3% in March, and are 1% above the **Feb-20 level**. Net exports are higher than in Feb last year, as **imports** are below the Feb-20 level (in volume terms)
- **The trends:** Norwegians' spending in Norway has weakened by 4% since Oct, government demand by 2%, while investments a d net trade is up

In March, services consumption flat, just goods down (and not due to retail sales)

Is consumption of goods already on the way back to a more normal level? A huge upside for services!





SpareBank 1 MARKETS

Norwegians are consuming almost like normal – in total – in Norway

Goods consumption fell in March, services not! And no foreigners are spending money here!

Norway Consumption spending

Sales of consumer goods/ services & consumption	Change from Feb 20, NOK bn, annual rate, const. bn	% Change %
Sales in Norway	-70	-4.9
Goods	41	6.1
Services	-111	-15.0
Norwegians in Norway	-27	-2.0
Goods	58	8.9
Services	-85	-12.1
Foreigners in Norw.	-42	-81.3
Norwegians' consumption	-147	-9.9
In Norway	-27	-2.0
Abroad	-120	-95.7

SB1 Markets/Macrobond

Norway Consumption spending

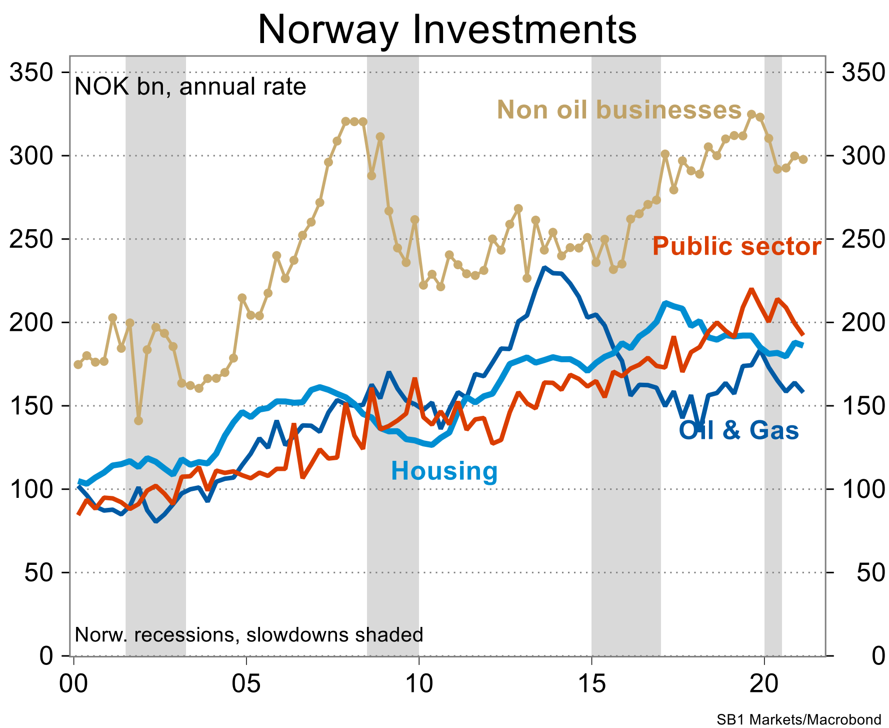
Sales of consumer goods/ services & consumption	Change m/m NOK bn, annual rate, const. bn	% Change m/m %
Sales in Norway	-13	-1.0
Goods	-14	-1.9
Services	1	0.1
Norwegians in Norway	-14	-1.0
Goods	-14	-2.0
Services	0	0.0
Foreigners in Norw.	1	10.8
Norwegians' consumption	-13	-1.0
In Norway	-14	-1.0
Abroad	1	18.9

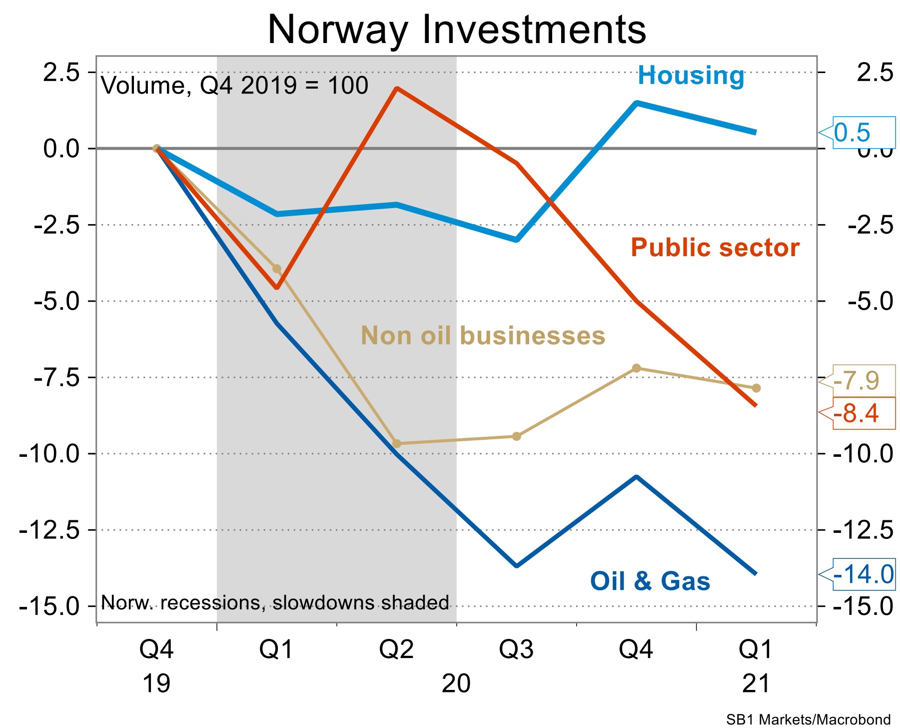
SB1 Markets/Macrobond

- **Sales of consumer goods** in Norway are up 6% vs. Feb-20, while services are down 15%, the sum is down 5%
  - » 3.4 pp is due to lack of foreigners' demand in Norway – which has fallen by 81%
- **Norwegian households** have increased their consumption of goods in Norway by 9% but reduced consumption on services by 12% in sum 2.0% down. In March just consumption of goods fell, by 2%
- **Total (Norwegian) household consumption** has fallen by 10% vs. Feb-20. Of this is almost 8 pp due to the 96% (!) decline in Norwegians' spending abroad
- **We expect consumption to normalise** the coming quarters. Demand for goods is still too high and will decrease when spending on services pick up, and when we can start spending abroad again, probably starting in late Q2 or in Q3. We expect the savings rate to decline substantially – but in Q1 the savings rate very likely rose sharply as labour income rose – and spending decline

Investments: A broad setback in Q1, probably not the new trend

Housing investments above the pre-pandemic level, other are still below

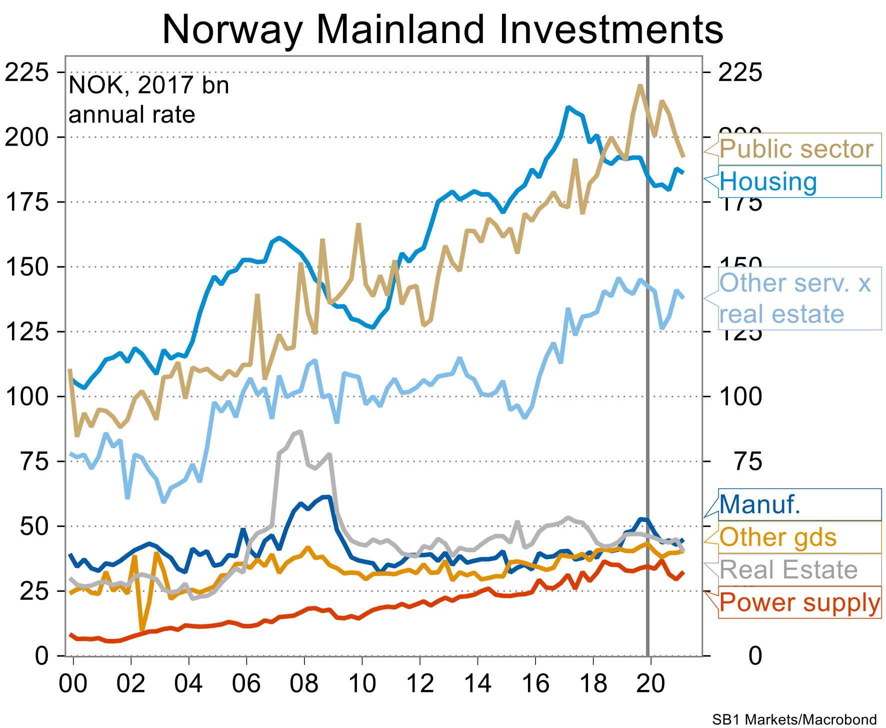


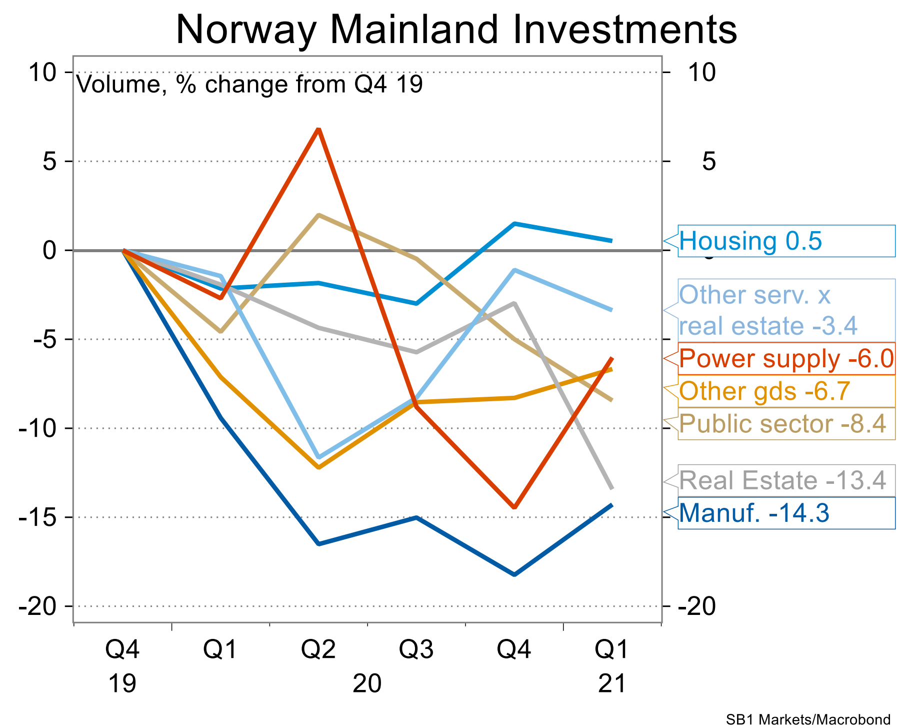


- Both Mainland business, housing, and oil sector investments were headed down, before the corona virus hit, either measured by actual investments (Mainland businesses, housing) and as signaled by investment plans/surveys (oil)
- Oil investments is down 14% vs Q4-19, Mainland businesses by 8% - while housing investments is up 0.5%
- Public investments have fallen 8% (some fewer F-35 fighters?)

Mainland business investments down but mixed sector wise

Some activities may have been dampened due to corona restrictions, like lack for foreign labour

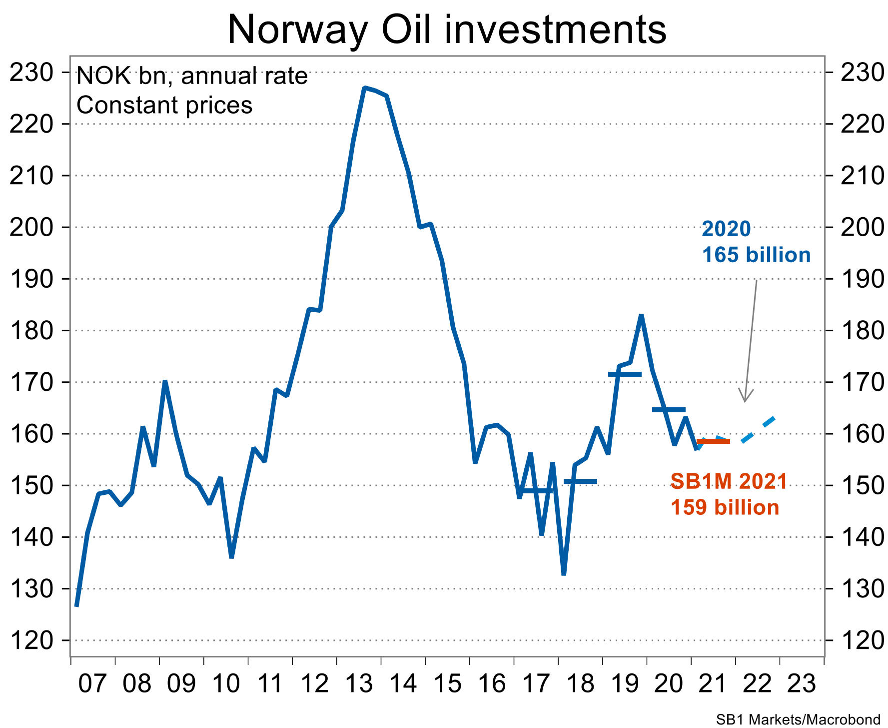


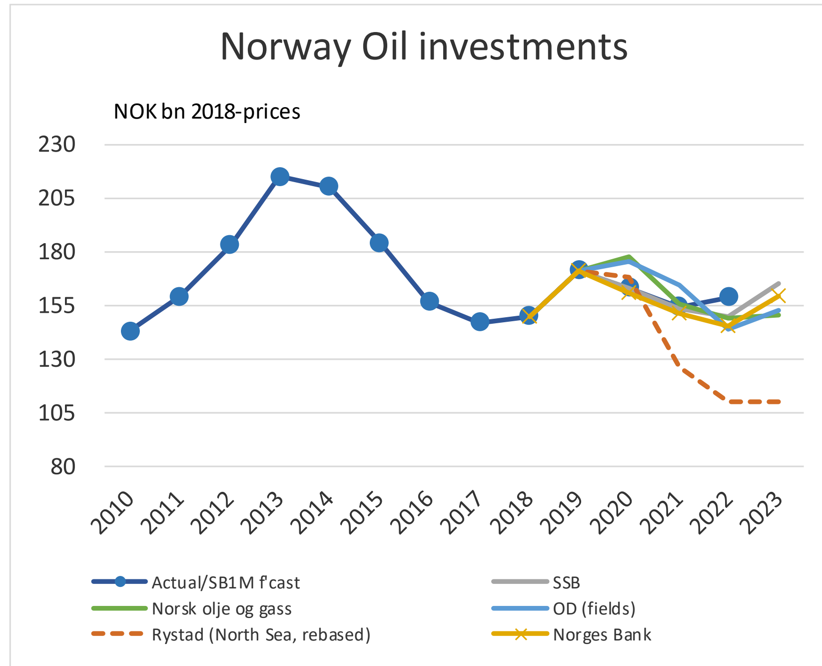


- **Public sector** investments are volatile (F35 fighter jets imported) but the underlying trend still upwards
- **Housing** investments have been falling since 2017, but recovered sharply in Q4, now up y/y
- Investments in **private services** soared in 2016-2017, then flattened and fell sharply in H1 last year. Almost all of the corona setback was reversed in H2
- **Manufacturing** has flattened, following a 15% decline H1-20 as signalled by investment surveys before the pandemic. Surveys have now recovered
- **Real estate** investments are declining, and fell sharply in Q1. The level is not that high, and the downside is probably not that large
- **Power supply** investments fell last year – as signalled by SSB's investment survey – but gained speed in Q1. Probably not any growth in 2021

Oil investments: Down in Q1, but now close to a local bottom?

Taxes are cut, oil price close to USD 70/b

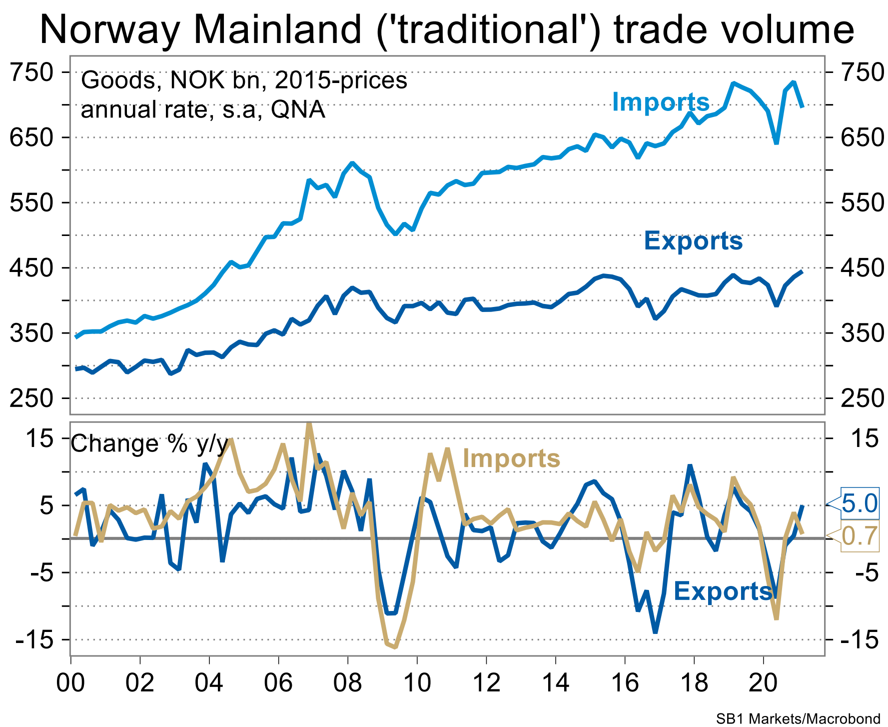


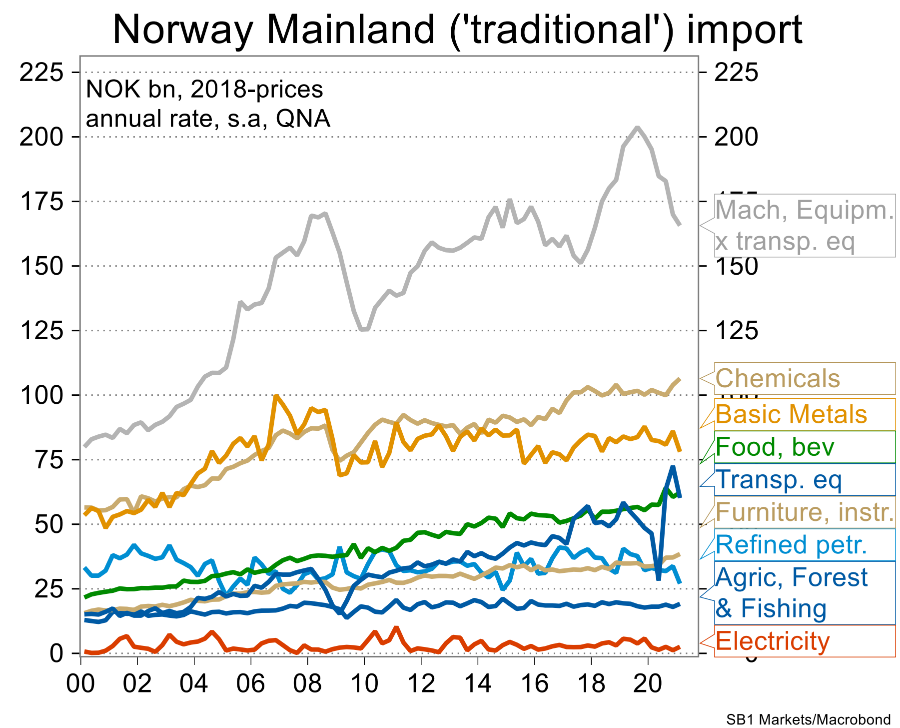


- The downturn in oil investment in this cycle has been very limited vs the 2013 – 2017 setback – but still substantial
- Investments are down 14.4% vs. the local peak in Q4-19

Imports have slowed, exports on the way up

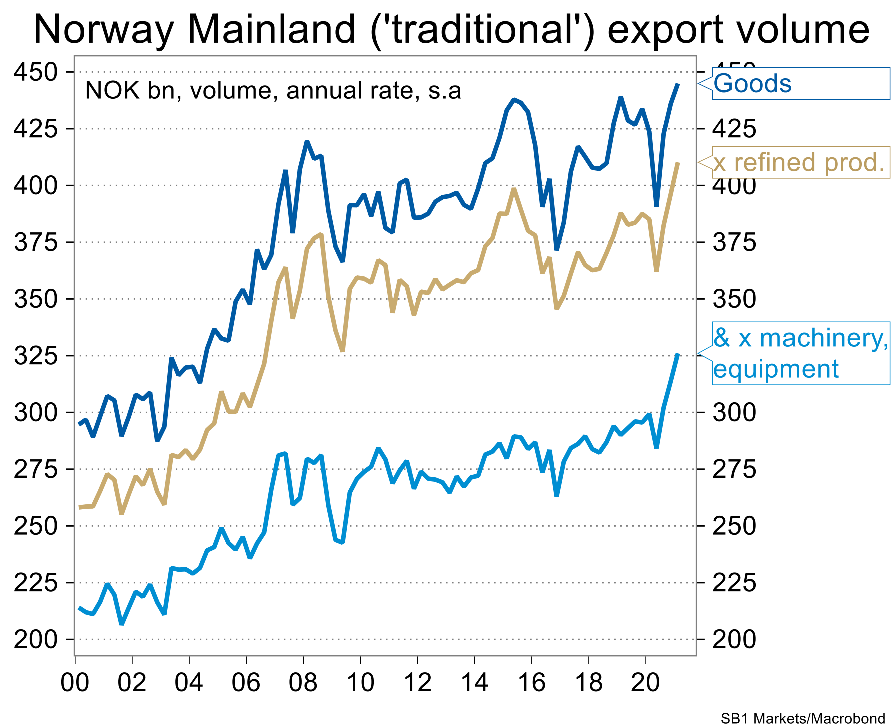
Machinery imports, we assume mostly to the oil sector, are sharply down

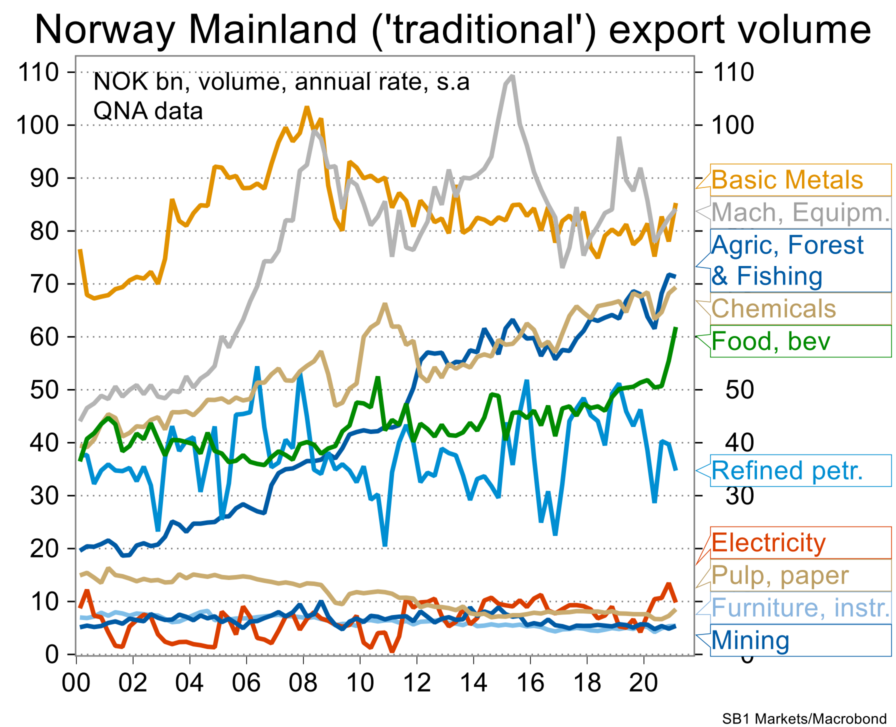




Mainland goods exports ex (oil related) machinery quite impressive

Machinery is still far below previous peaks, many others are on the strong side

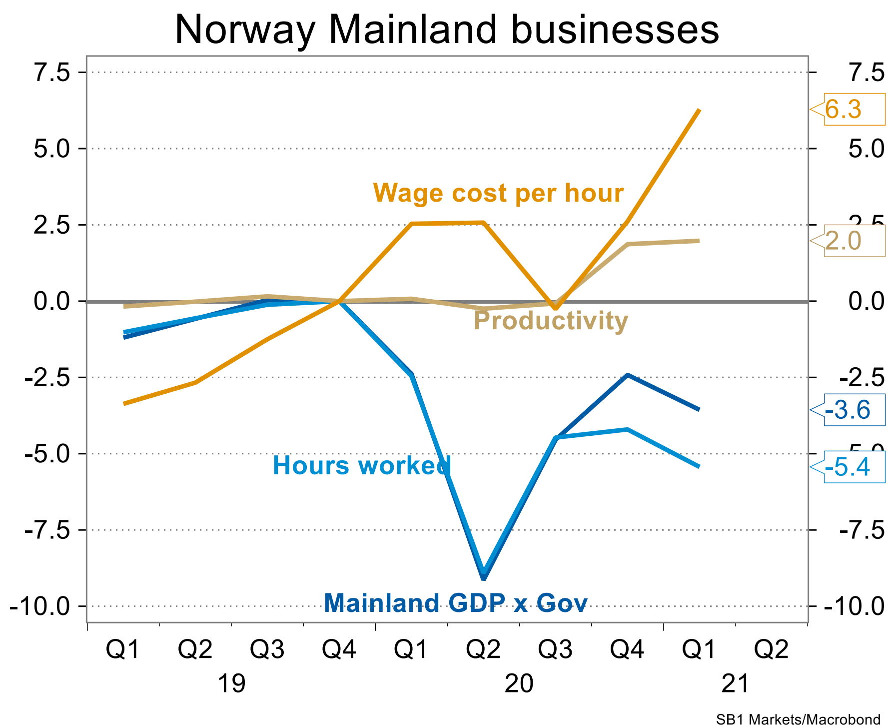


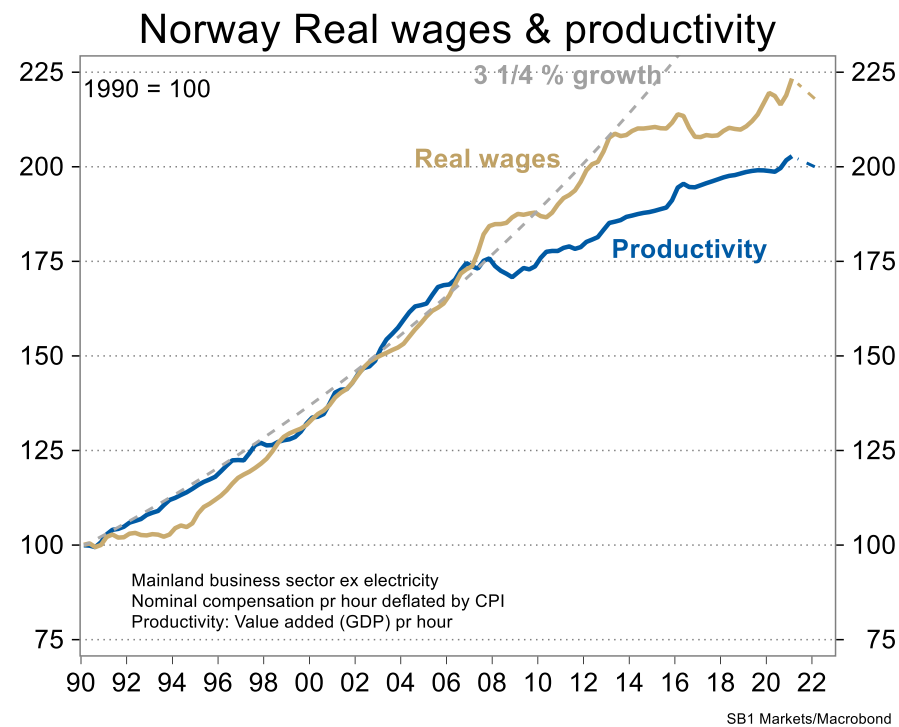


- Much of exports of machinery is oil related - and these markets have not yet recovered

Hours worked revised down – and productivity up – still not impressive

We take these data with a grain of salt – both production, hours worked and average wages

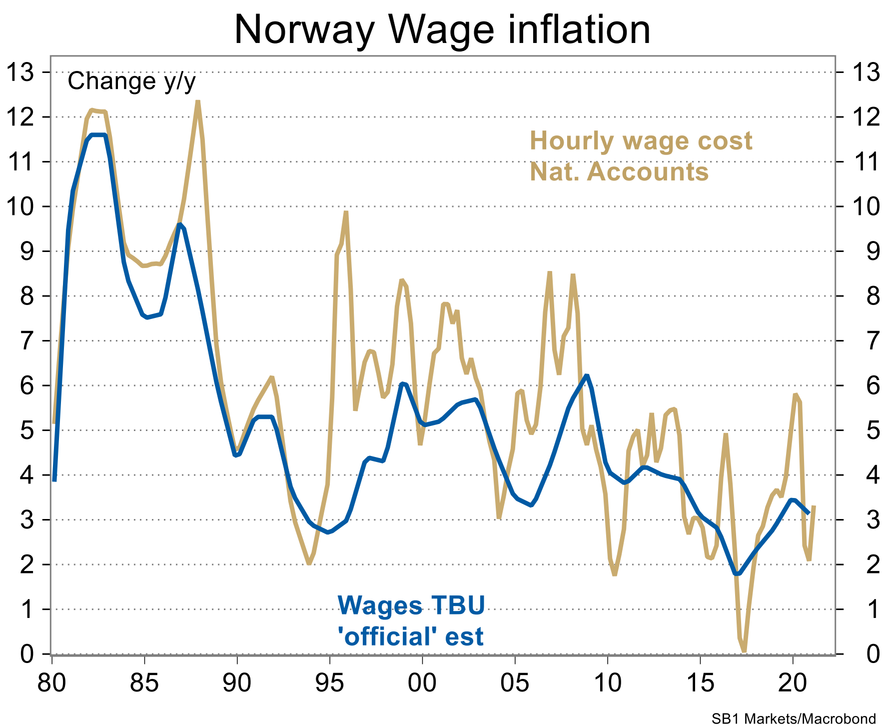


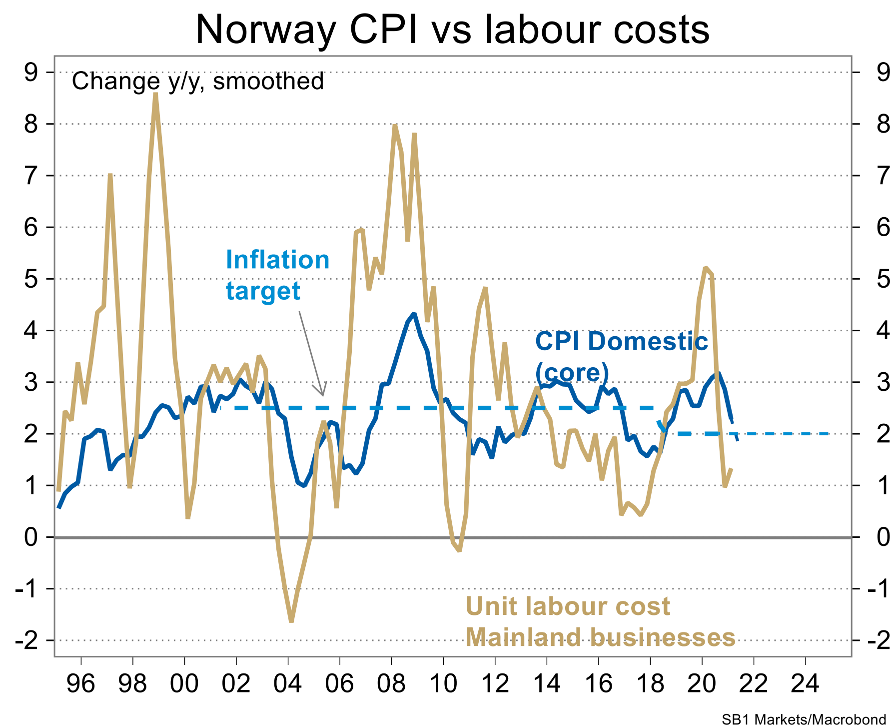


- Changes in **hours worked** in the private sector were equal to change in GDP until Q3-20, and have been somewhat weaker since, as productivity has increased somewhat
- The **average hourly wage has climbed sharply since Q4-19.** These data are influenced by government measures, like how the furlough program is booked, and by the change in the employment mix. Lower paid service jobs are lost.
- We do not expect **real wages** to show strength the coming quarters. Wage inflation has slowed, and will probably not pick up sharply this year. Headline inflation will – at least for a while – get a boost from electricity prices – and those prices will most likely not turn negative y/y and core inflation will not collapse. The underlying weakening of corporate profitability may also contribute to keep inflation up – as may the post-corona recovery in domestic demand

Labour cost at some 3%, and at least not slowing but no cost problem vs CPI

Unit labour costs are probably increasing by more than 2%

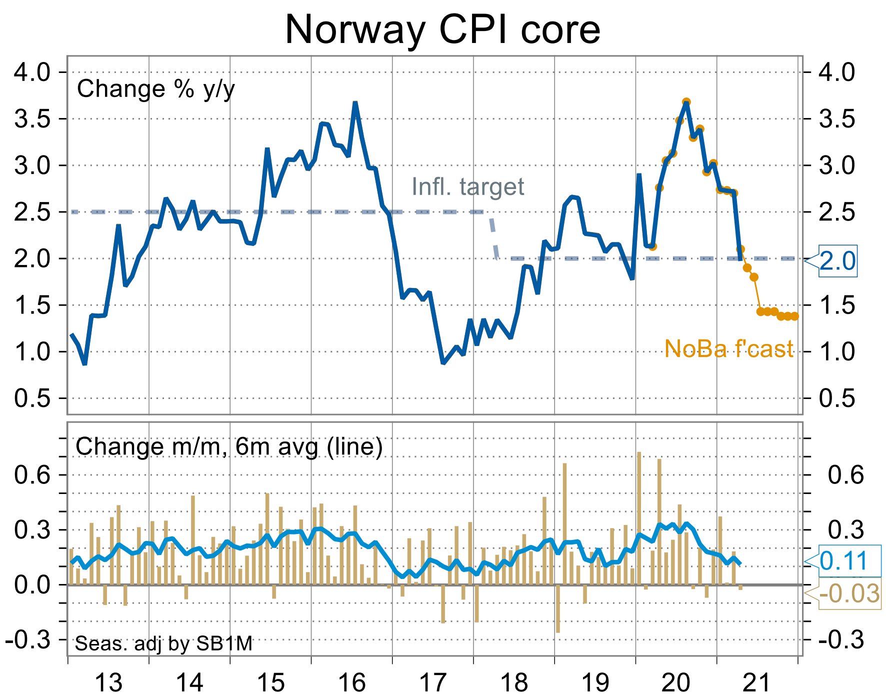




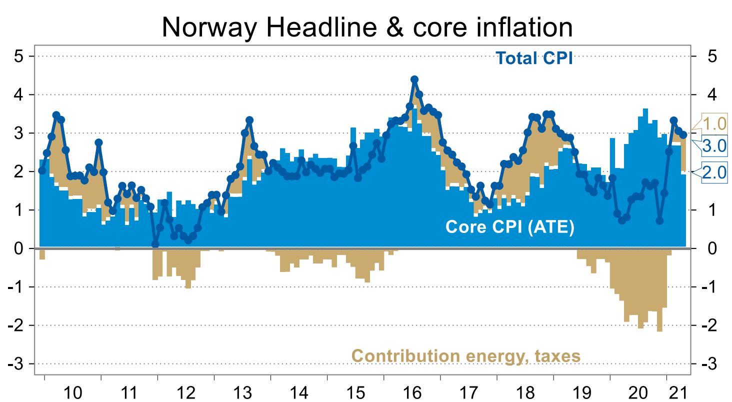
- The corona downturn makes most data uncertain, including these wage & ULC data

Core inflation down 0.7 pp to 2.0% y/y in April, below expectations

NoBa expects a further decline the coming months. Not unlikely



kets/Macrobond



- **CPI-ATE** (ex. energy and taxes) inflation is down 0.7 pp to 2.0% in April; 0.1 pp below consensus & Norges Bank's f'cast, and 0.3 pp below our estimate
  - » Prices rose were flat m/m (seas adj), down from 0.2% in March
  - » Inflation is below 2% for housing, clothing, food, alcohol, communication and airline tickets – others are still above
  - » As we predicted, imported goods price inflation is now receding, due to NOK effect
  - » Domestic inflation has slowed substantially but remains at 2%
- **Total inflation** slowed 0.1 pp to 3.0%
- **The price outlook**
  - » **We expect inflation to slow** the coming quarters as the NOK effect fades and wage inflation remains moderate (if not low). Demand for goods will have to decline from a very high level. Upside risk: Higher raw material prices/global price pressures
  - » Anyway, CPI inflation will not have any material impact on Norges Bank's monetary policy the coming months. It's all about the Covid-19 impact on the real economy, and the outlook for the recovery - and the housing market

Lower food, clothing, and auto prices than expected

		Change m/m, seas. adj			Change y/y			Contribution, pp		
Apr-21	Weight	Out-	SB1M	Dev.	Last	Out-	SB1M			Dev. vs
CPI ATE	%	come	f'cast	pp	month	come	f'cast	m/m	y/y	f'cast
Food, non alc bev	13.0	-0.5	0.3	-0.8	1.6	-0.2	0.3	-0.07	-0.02	-0.10
Alcohol, tobacco	4.3	0.1	0.2	-0.0	1.4	1.4	1.5	0.00	0.06	-0.00
Clothing, footwear	4.9	-0.9	0.2	-1.1	-2.0	-2.5	-1.1	-0.05	-0.12	-0.06
Housing x. energy	20.5	0.1	0.1	-0.0	0.9	0.8	1.0	0.01	0.17	-0.01
Furnishing	6.8	0.1	0.3	-0.2	7.6	5.6	5.9	0.00	0.38	-0.01
Health	3.2	0.2	0.2	-0.0	3.3	3.3	3.3	0.01	0.11	-0.00
Transp. ex. gas, airl. tick	12.0	-0.3	0.3	-0.6	5.0	3.3	4.2	-0.04	0.40	-0.07
Airline tickets	1.0	1.7	2.0	-0.3	-16.9	-18.0	-11.9	0.02	-0.18	-0.00
Communication	2.5	0.1	0.2	-0.1	2.2	1.7	1.6	0.00	0.04	-0.00
Recreation, culture	11.2	0.3	0.3	0.0	5.3	4.8	4.7	0.04	0.53	0.00
Education	0.5	-	-	-	2.1	2.1	2.1		0.01	0.00
Restaurants, hotels	5.9	0.4	0.3	0.1	3.0	3.7	3.4	0.02	0.22	0.01
Other	8.7	0.3	0.2	0.1	3.1	3.1	2.9	0.03	0.27	0.01
CPI-ATE	94	**-0.0**	**0.2**	-0.24	**2.7**	**2.0**	**2.3**			-0.23
Norges Bank est.			**0.0**		**2.7**		***2.1***			
Imported	34	-0.1	0.2	-0.3	3.8	2.2	2.7	-0.04	0.75	-0.10
Domestic	60	0.1	0.3	-0.2	2.1	2.0	2.3	0.03	1.19	-0.12
Energy, housing	4	2.9	1.0	1.9	37.8	52.1	45.4	0.11	1.87	0.07
Energy, transport	2	1.5	0.0	1.5	2.1	11.2	7.2	0.03	0.23	0.03
CPI Total	100	**0.1**	**0.2**	-0.2	**3.1**	**3.0**	**2.9**	0.09	2.95	-0.16
Change m/m based on seasonally adjusted data (calc by SB1M)										
Sum of parts does not necessarily add up to totals										
Norges Bank m/m s.a. estimate is implied, calc by SB1M										

- Food prices fell by 0.5%, and far below our f'cast
- Clothing prices fell for the 2nd month, by 0.9% m/m, and are down 2.5% y/y
- Furniture/hardware/equipm. prices are up 5.6% y/y
- Transport ex. gas/airline – mostly cars – fell 0.3%, we expected 0.3%
- Airline ticket prices were up 1.7% m/m. Still down 18% y/y, to the extent they are measurable.
- Prices of books rose 16.4% m/m; recreation in sum up 4.8% y/y
- Restaurant/hotel prices are up 3.7 y/y%

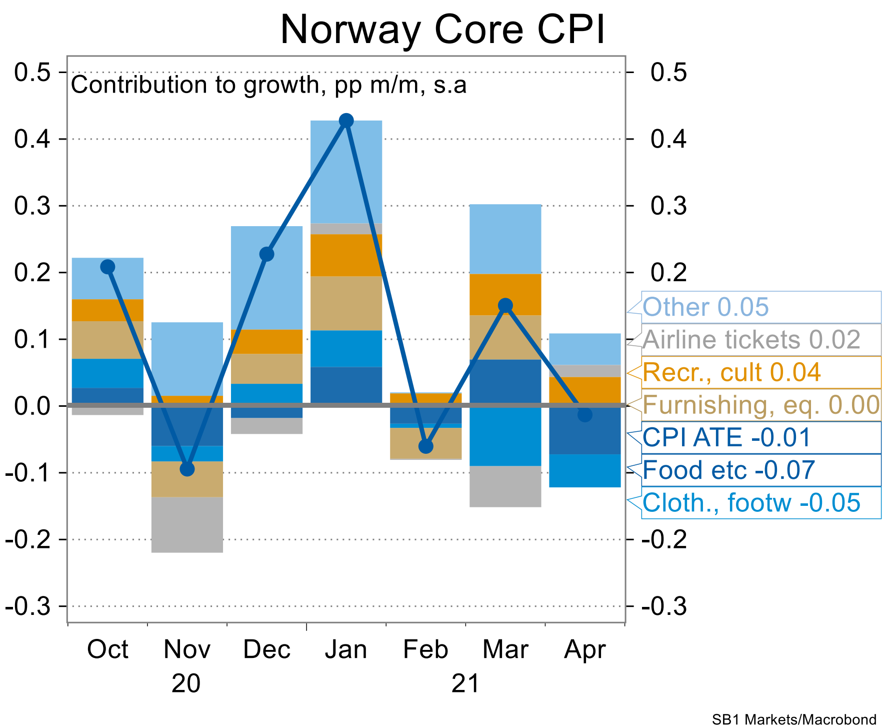
- **CPI-ATE up 2.0% y/y, 0.3 pp below our expectations, NoBa f'casted 2.1%**

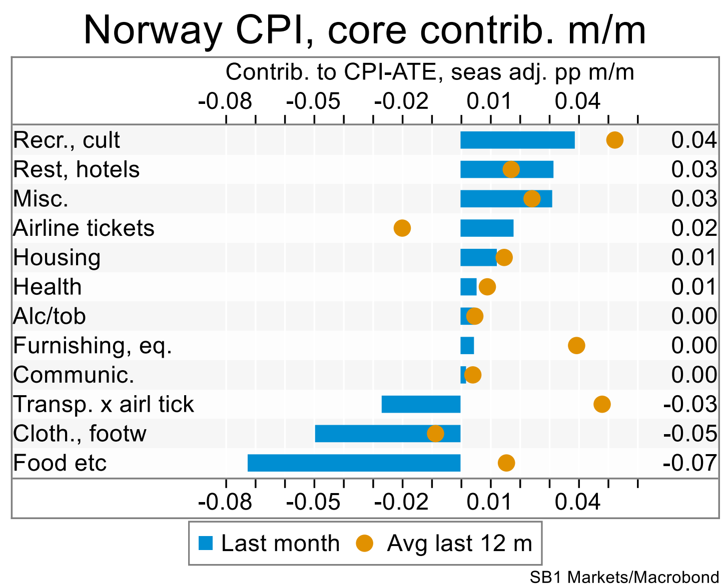
- Prices on imported goods fell by 0.1%, mostly due to lower clothing prices
- Prices on domestically produced goods & services rose by 0.1% m/m. The annual rate at 2.0% is low, according to Norwegian standards
- Electricity and gasoline prices rose more than expected. Electricity is up 52% y/y
- **… and the headline inflation came in at 3.0%, 0.1 pp above our estimate**

Monthly changes are seasonally adjusted by SB1 Markets. The weighted sum of the components does not necessarily sum exactly up to the total, and deviations m/m and y/y do not necessarily add up. Norges Bank m/m s.a. estimate is implied, calculated by us. Sources: SSB, Norges Bank, SB1 Markets calculations

Food prices the main drag in April, but clothing & transp. x airlines down too

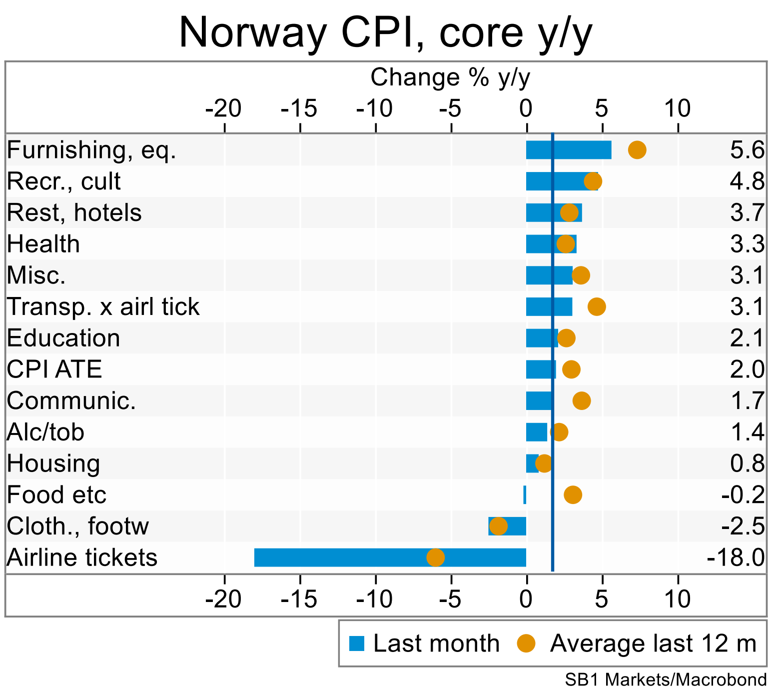
Other goods & services up in April – but none by much

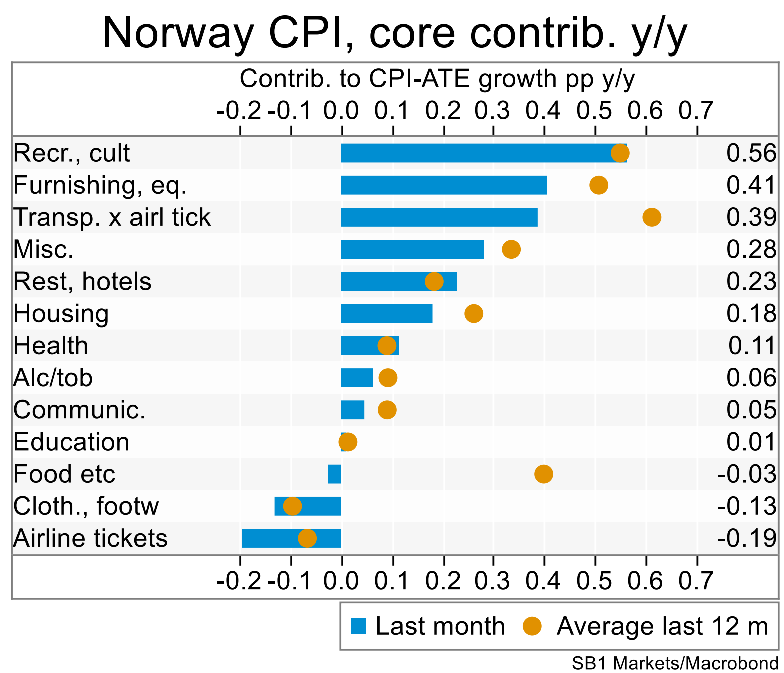




6 sectors report inflation above 2%, 1 is close to 2%, 5 clearly below

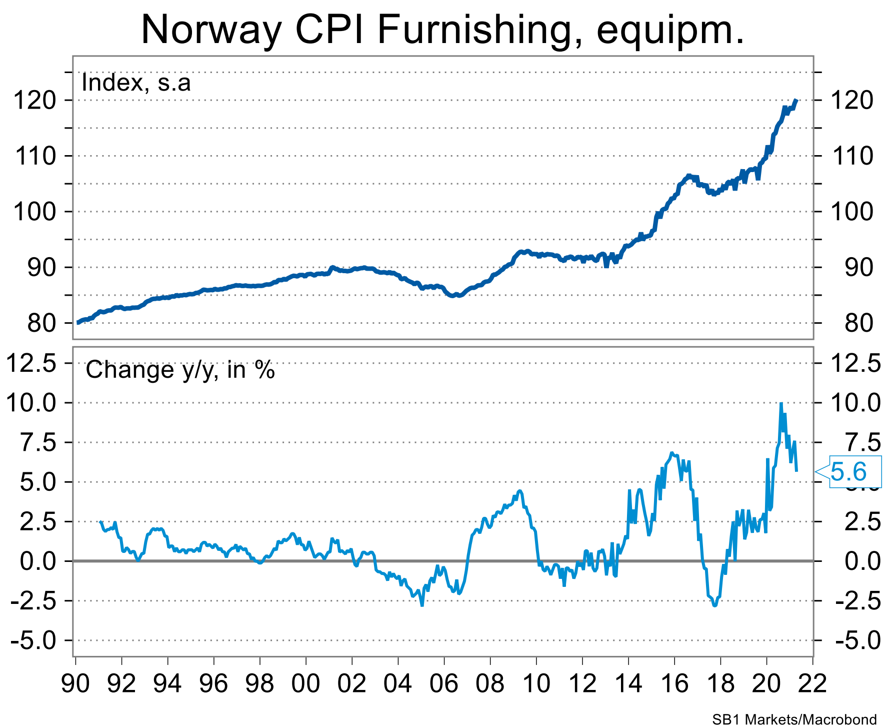
Food inflation down to 0; Clothing, rents, alcohol, communication & airfares << the 2% infl. target

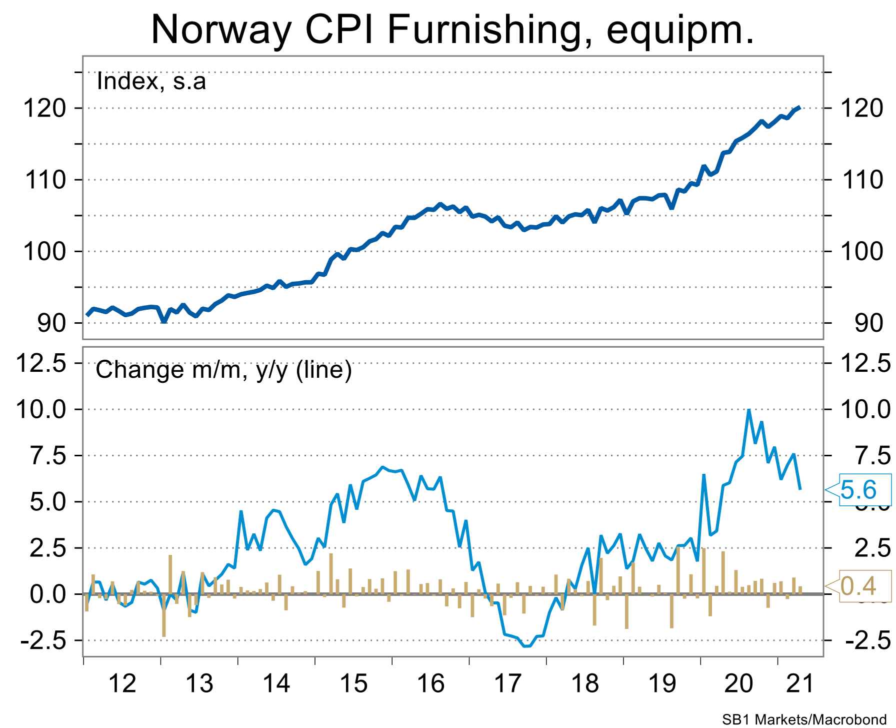




Furnishing prices up 0.4% m/m, 5.6% y/y – on the way down

We expect furnishing price inflation to taper further off, even if demand is strong

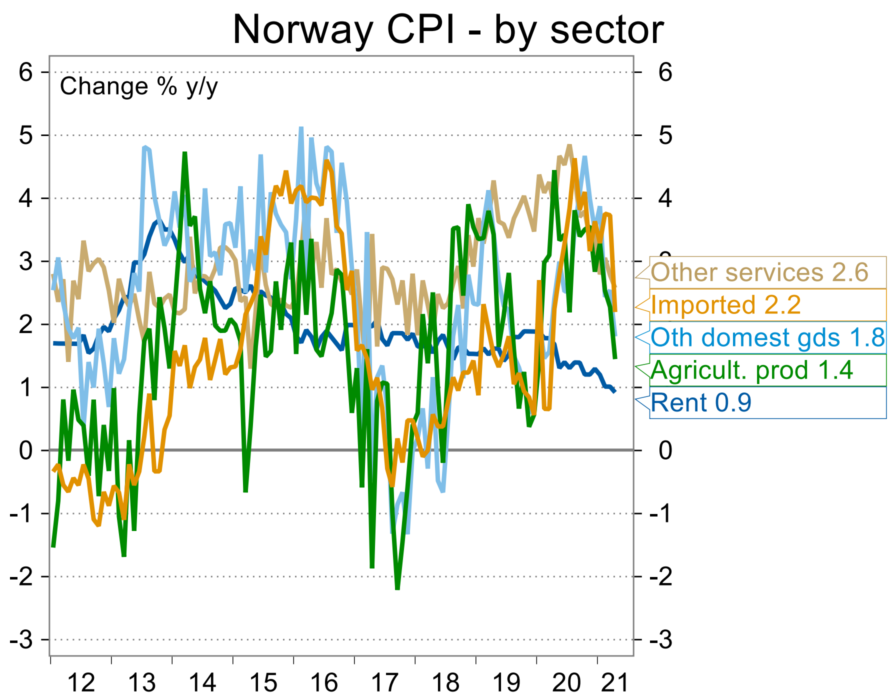




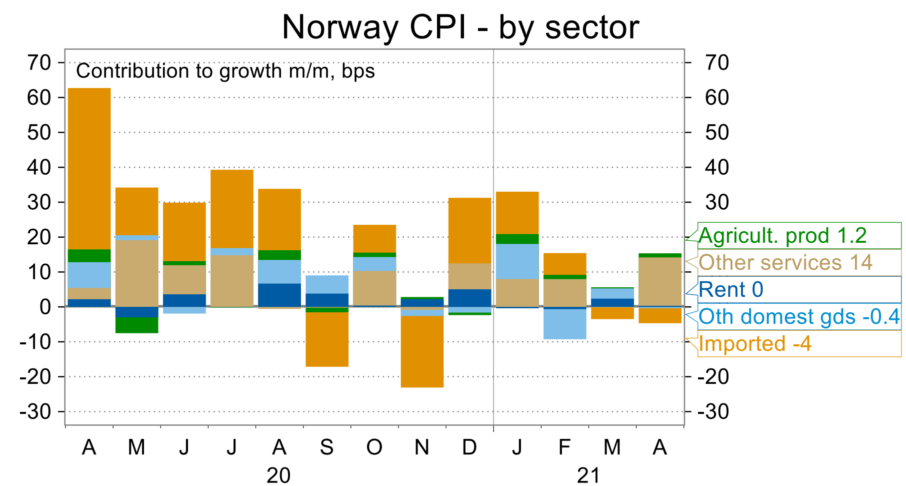
SpareBank 1 MARKETS

Imported goods prices down 0.1% m/m – and are up ‘just’ 2.2% y/y

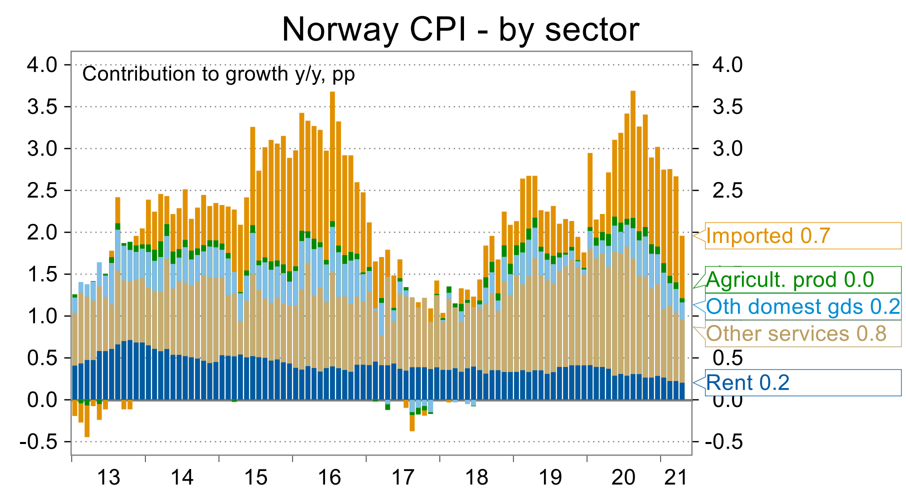
Slowing as a result stabilisation/strengthening of NOK



SB1 Markets/Macrobond



SB1 Markets/Macrobond

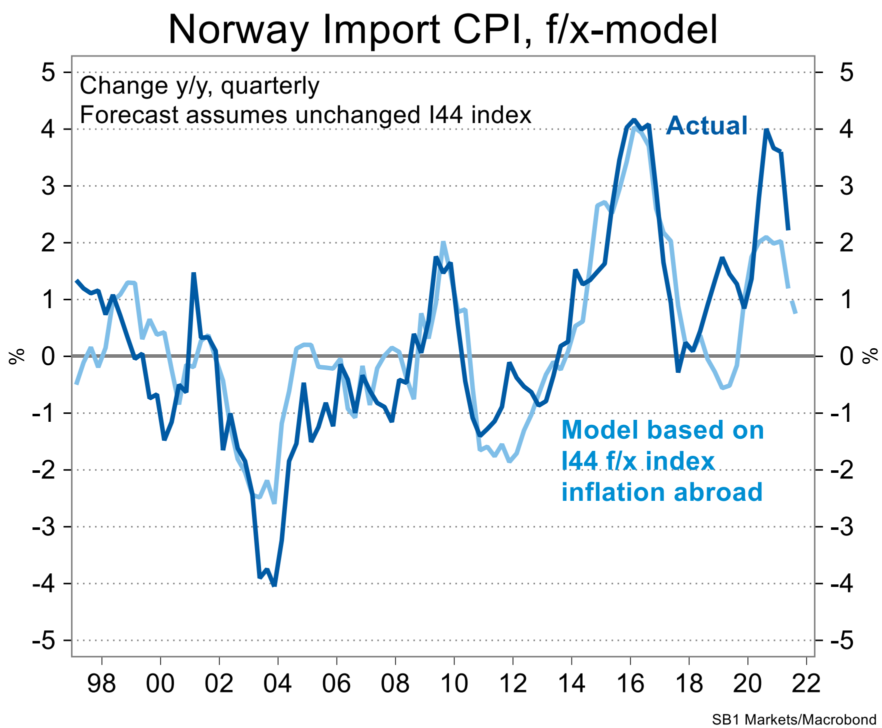


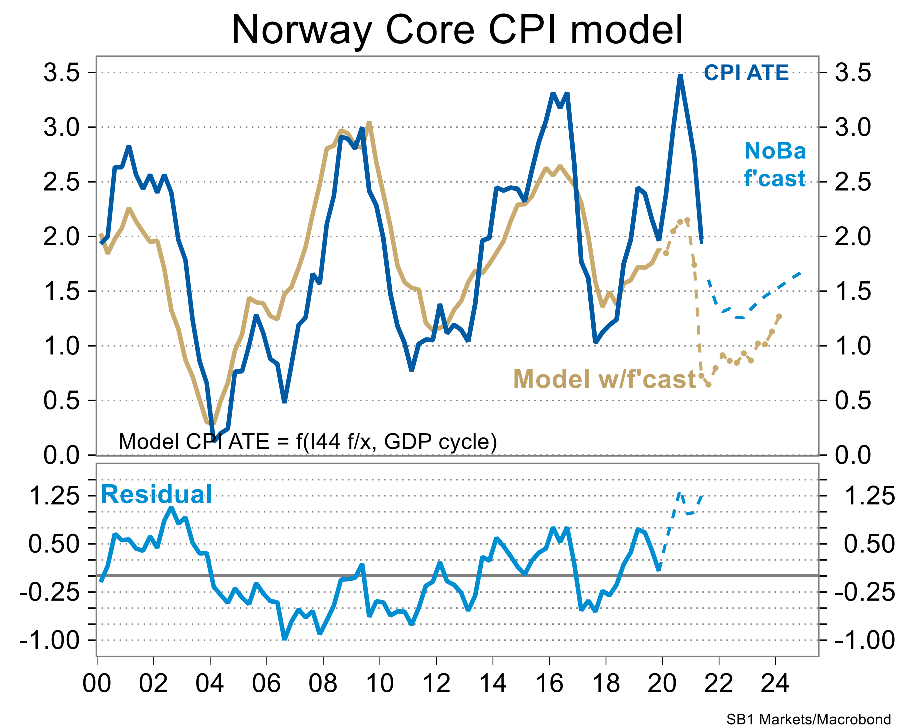
SB1 Markets/Macrobond

- **Domestic services inflation** has slowed during the corona crisis
- **Rent inflation** is steadily slowing, from 2% to 1%, partly due to lower mortgage rates but also probably due to a less tight renting market (rents are both calculated and observed)

Imported goods prices: Finally on the way down

Our total core CPI model is not calibrated for a huge decline in GDP, but the sign is probably correct

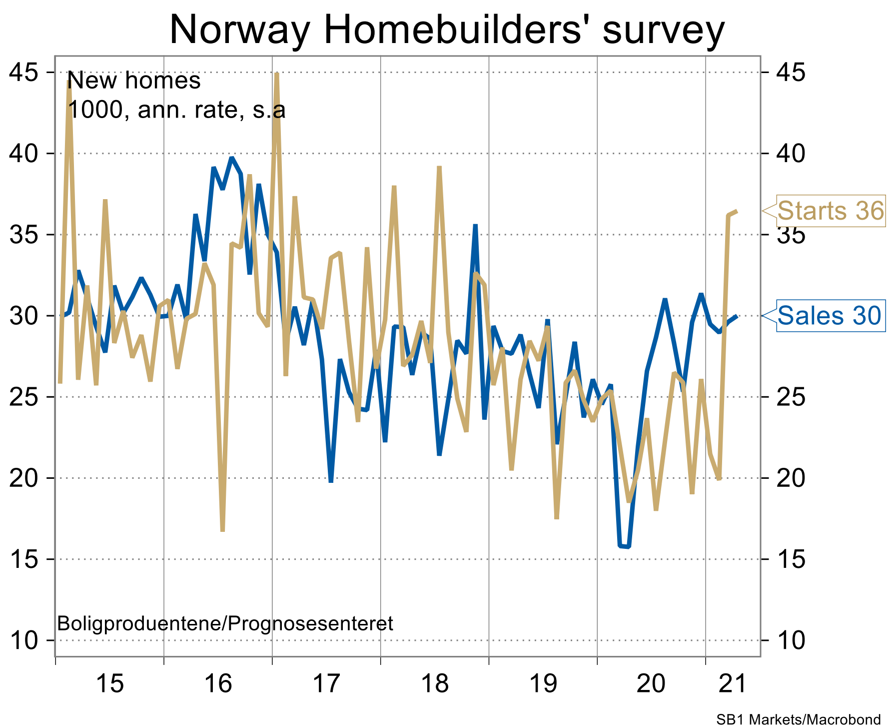


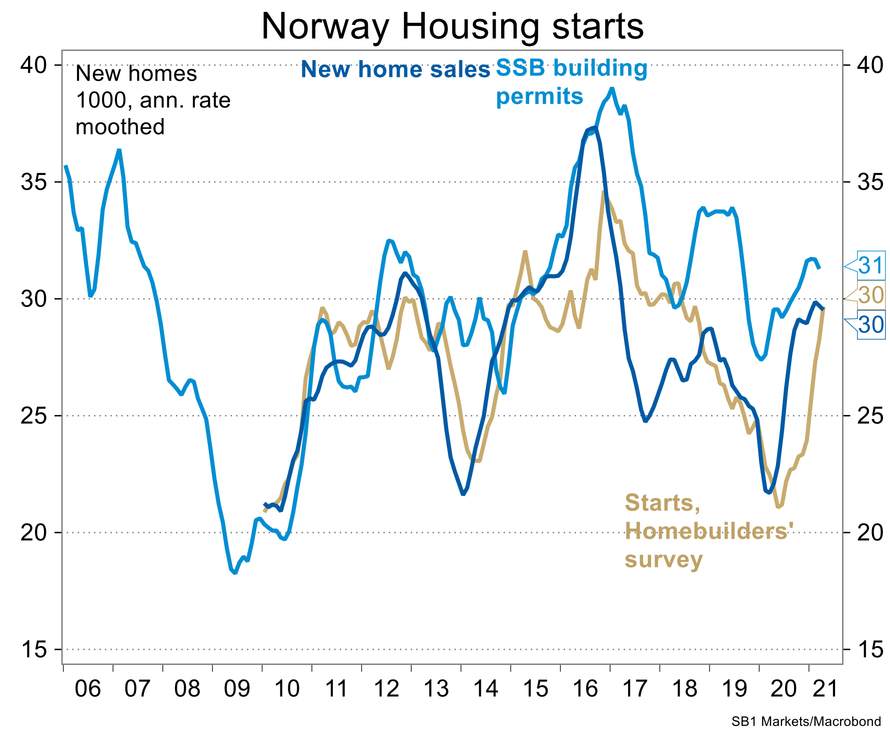


- The NOK steep depreciation in early 2020 no doubt drove **imported inflation** up last year. Closed borders/supply chain challenges due to Covid-19 may have contributed to the lift in import prices too, and more importantly: the strong growth in demand for some goods (like sport equipment/furniture) made it possible to increase prices
  - » Even if goods price inflation is on the way up, we assume imported inflation to slow further due to the stabilisation of the NOK
- Domestic inflation will be kept in check due to moderate wage inflation – and overall core inflation will come down, as signalled by our **total core CPI** model (to the right)

Housing starts finally underway, sales still OK, according to Homebuilders

Start at 36’ (annual rate) in April, like in March, the two best months in 4 years. Sales stable at 30’

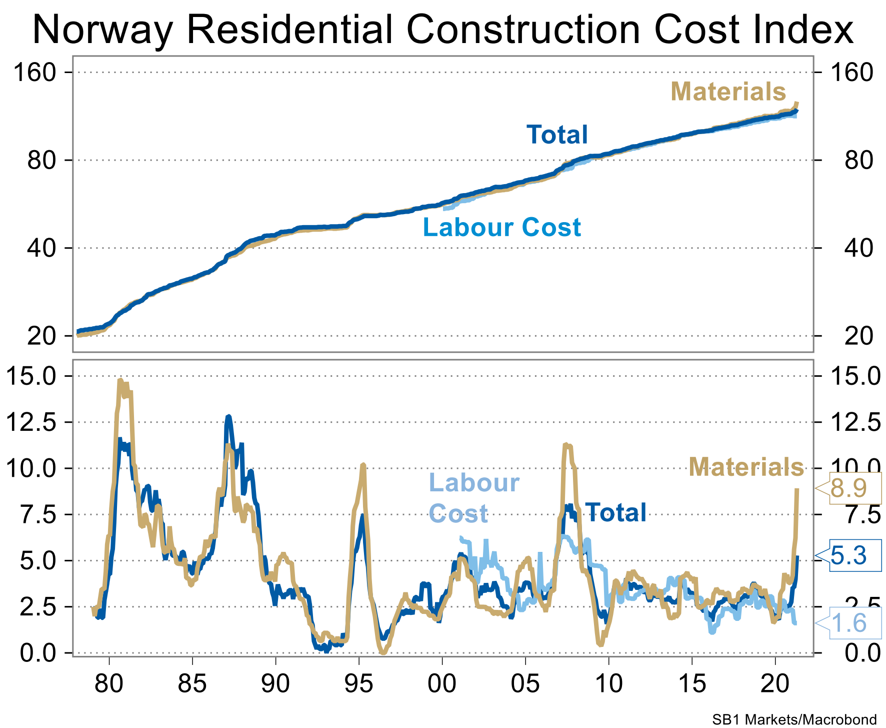


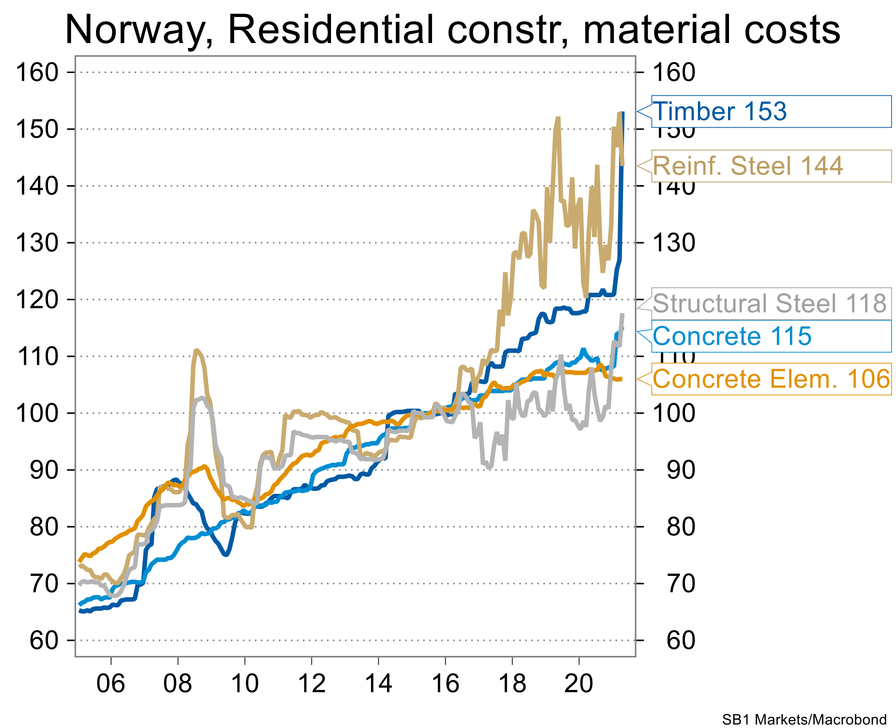


- Both sales and starts have now recovered from the sharp downturn in March/April last year, which ended the gradual decline since 2017
- Homebuilders report of some delays in projects due to travel restrictions for foreign workers and thereby lack of trained personnel
- In addition, increasing lumber prices is also a concern, at least for detached & semidetached houses
- SSB reports April construction data next week

Some cost pressure in the Norwegian construction sector too

But just from some materials; lumber & steel. The sum is still up 5.3%, highest in 13 years

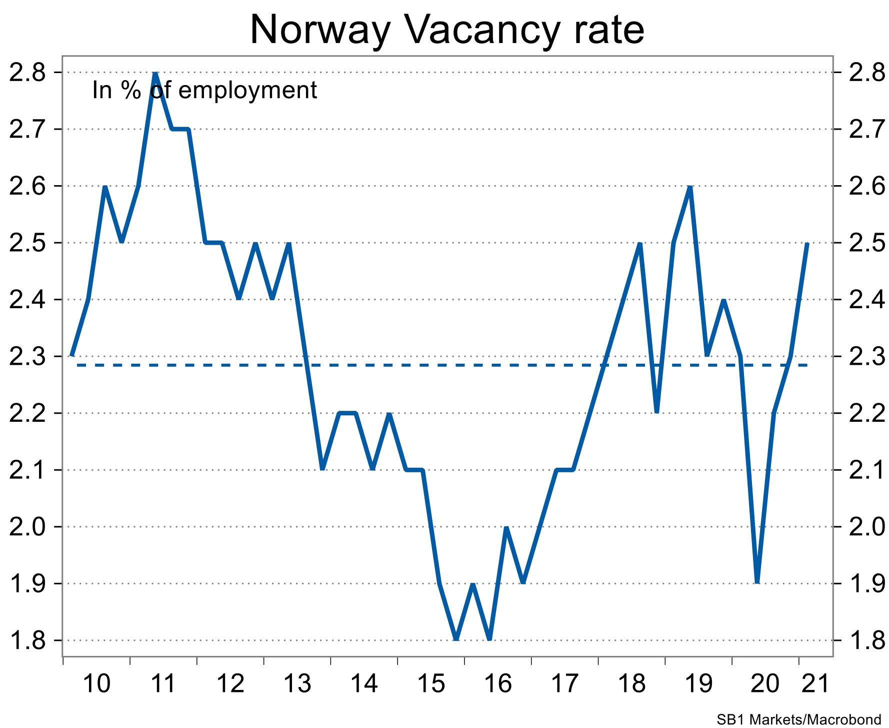


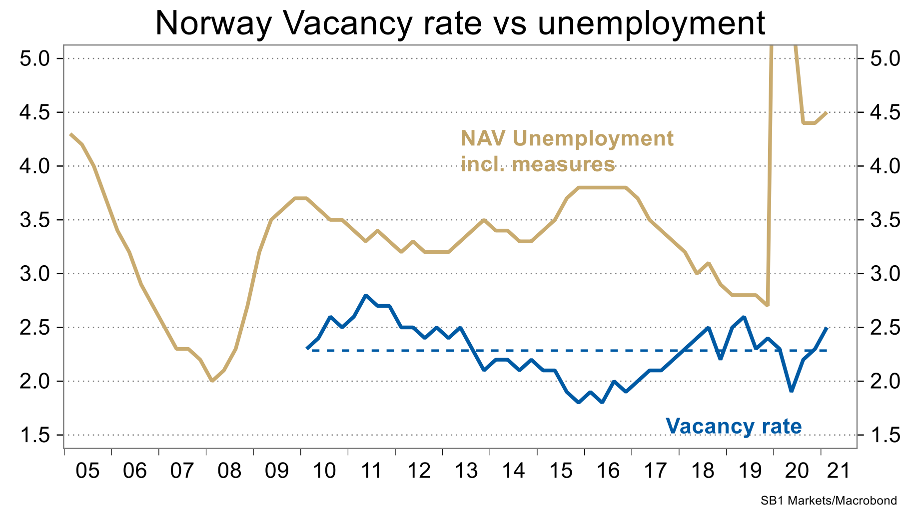


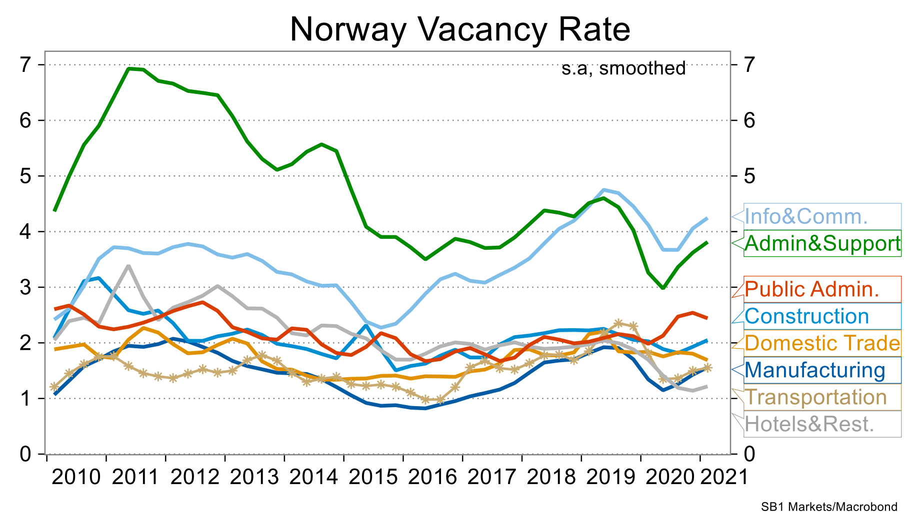
- The 25%+ lift in lumber/timber prices over the past months is unprecedented

More unfilled vacancies in Q1 – the 2. highest since 2011

And that's before the unusual hike in new vacancies in April



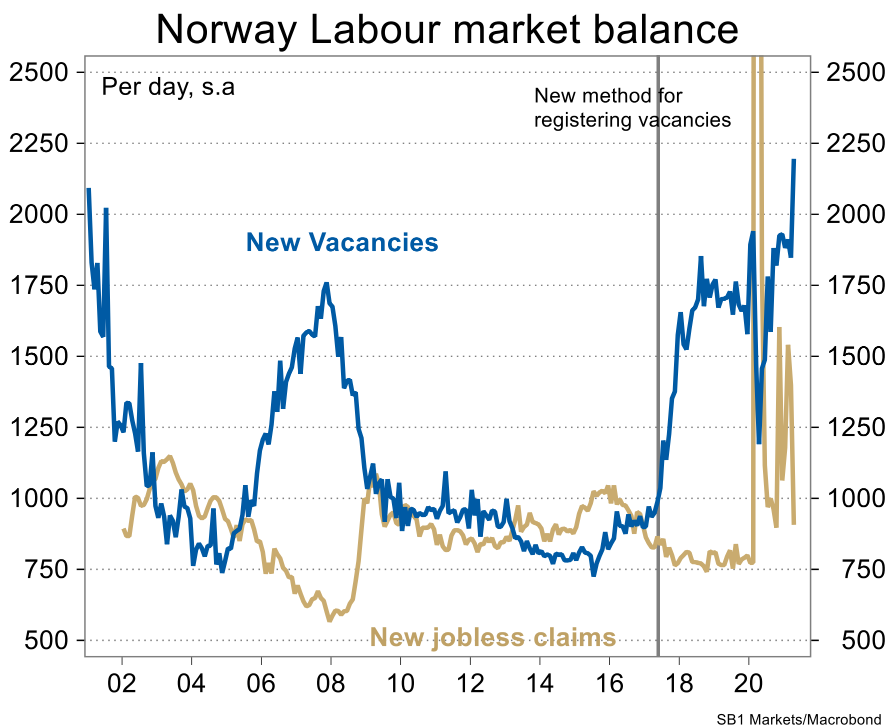


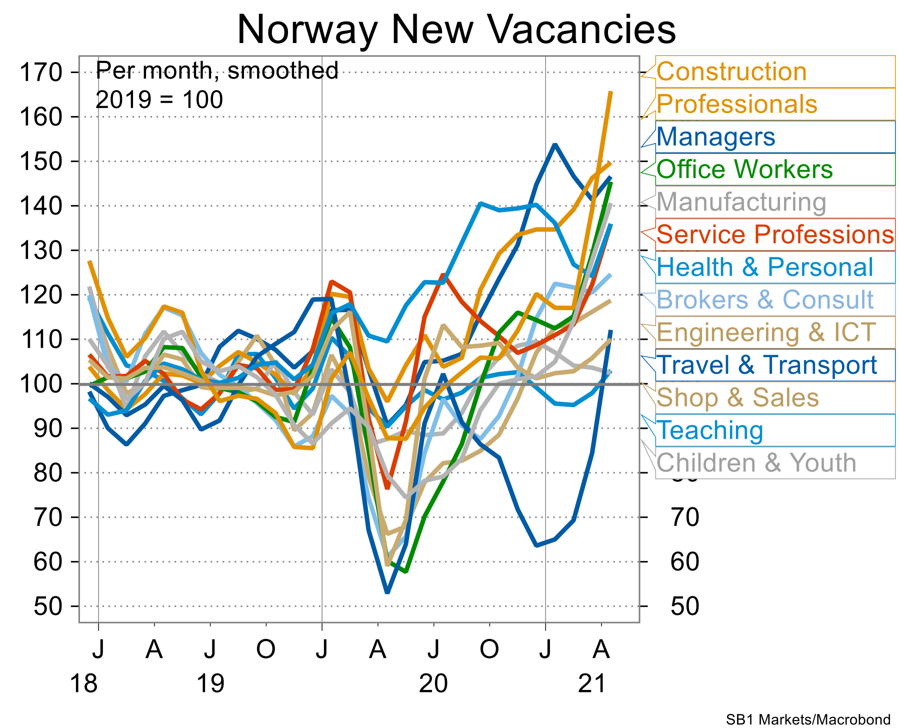


- The vacancy rate has been higher just once since 2011, which is strange give the still rather high unemployment rate
- Almost all sectors have reported more unfilled vacancies the past 3 quarters, since the shock in Q2 last year

Vacancies have increased sharply during the spring

…and that was before restrictions were eased



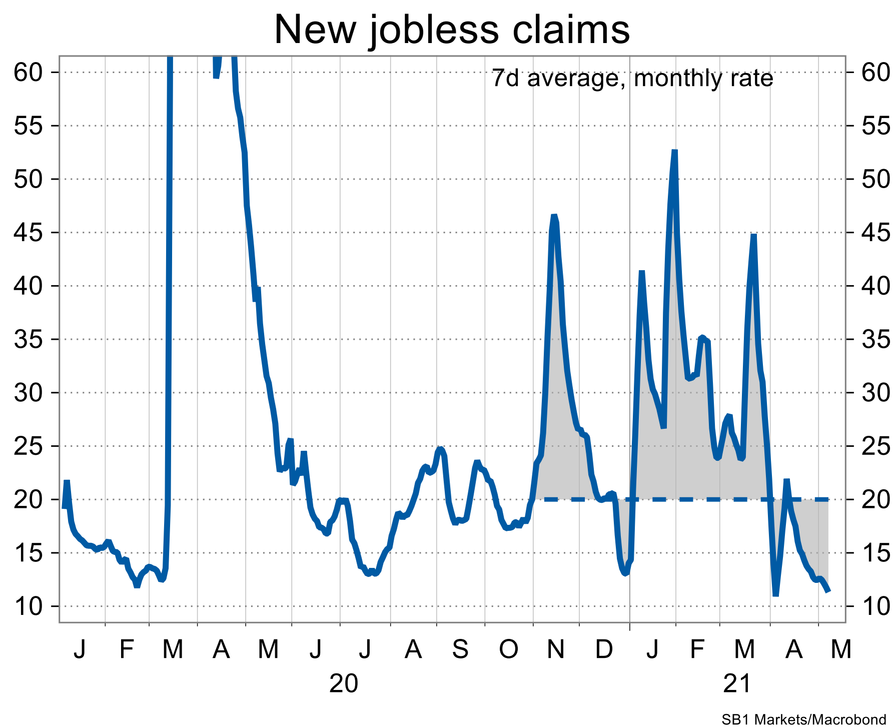


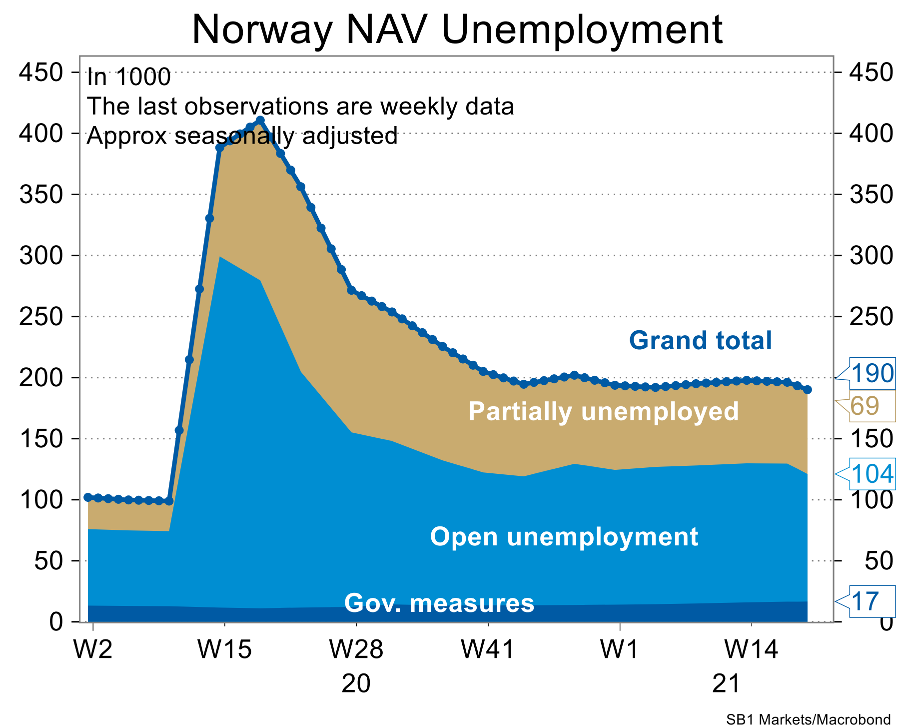
We have made a preliminary adjustment of the 2020 vacancy data due to a NAV reporting error which have led to under reporting of new positions through the year. NAV reports that the no. of new vacancies is at the same level in January 2021 as one year ago

SpareBank 1 MARKETS

New jobless claims fall sharply, and NAV unemploym. probably down in May

The increased inflow of new jobless claims from last October to March did not lift unemployment





Highlights

The world around us

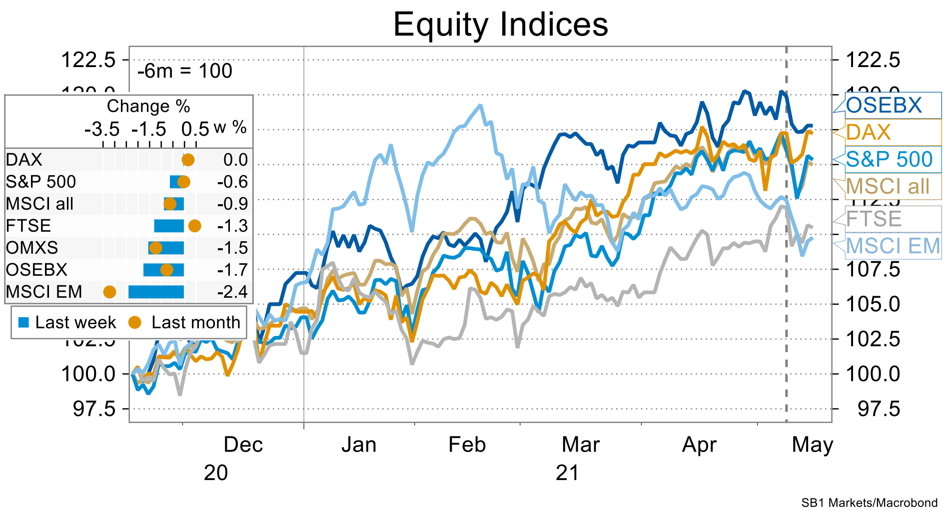
The Norwegian economy

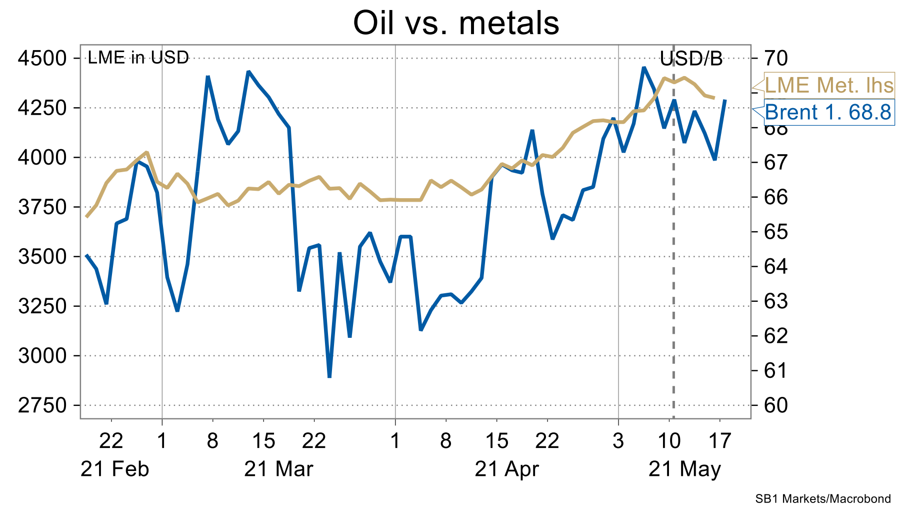
Market charts & comments

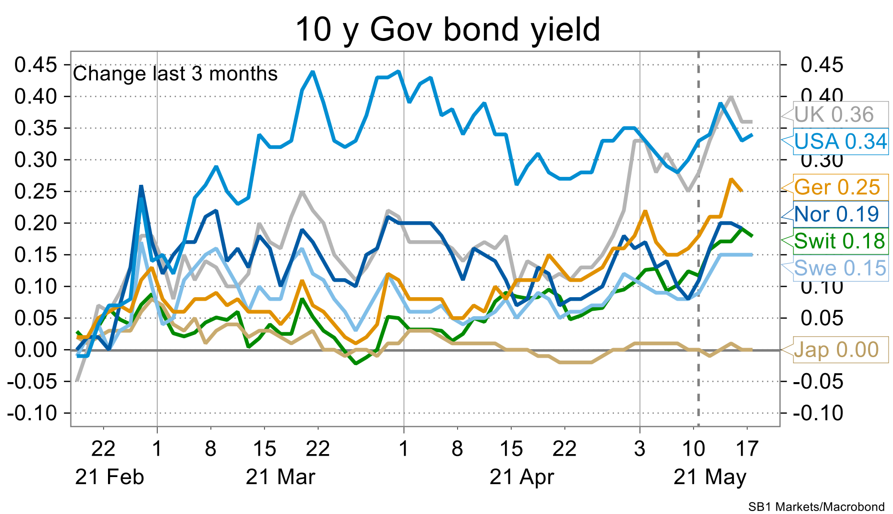
SpareBank 1 MARKETS

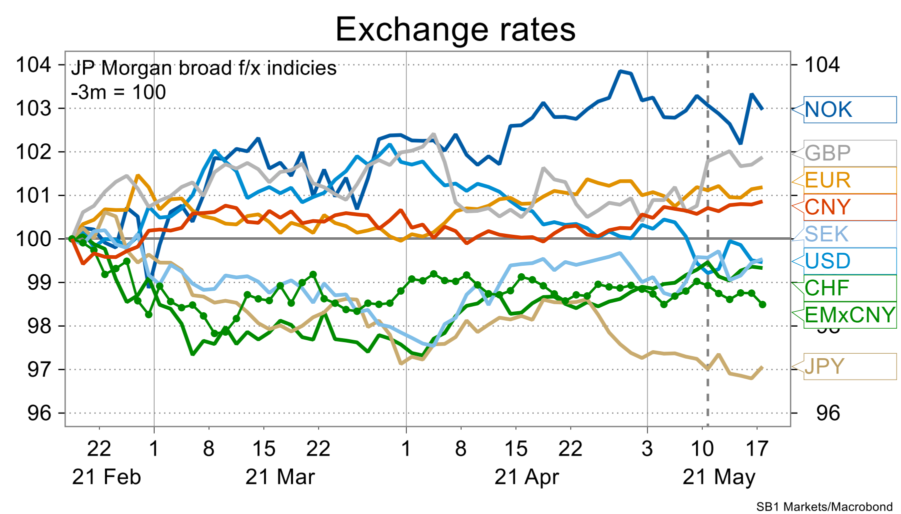
A volatile inflation week at the markets – stocks down, bond yields up

Metal prices fell slightly, the oil price recovered Monday. The USD is still trending down



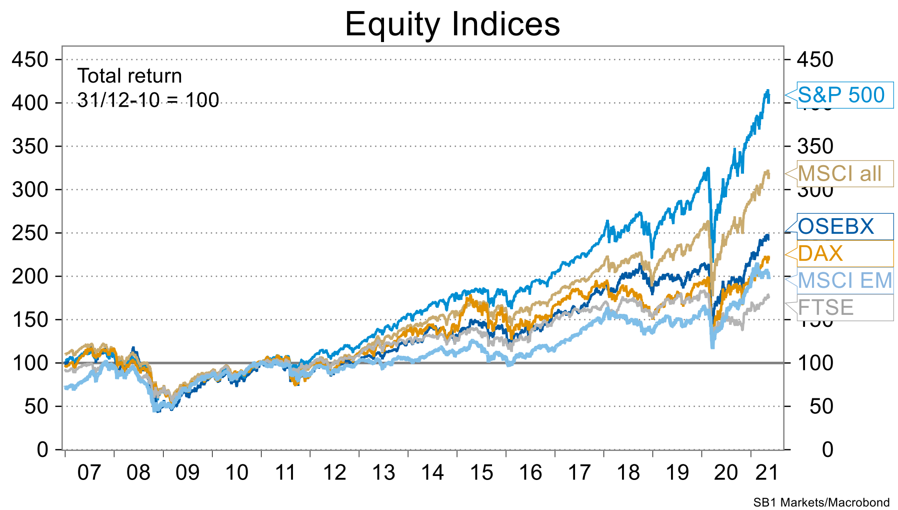


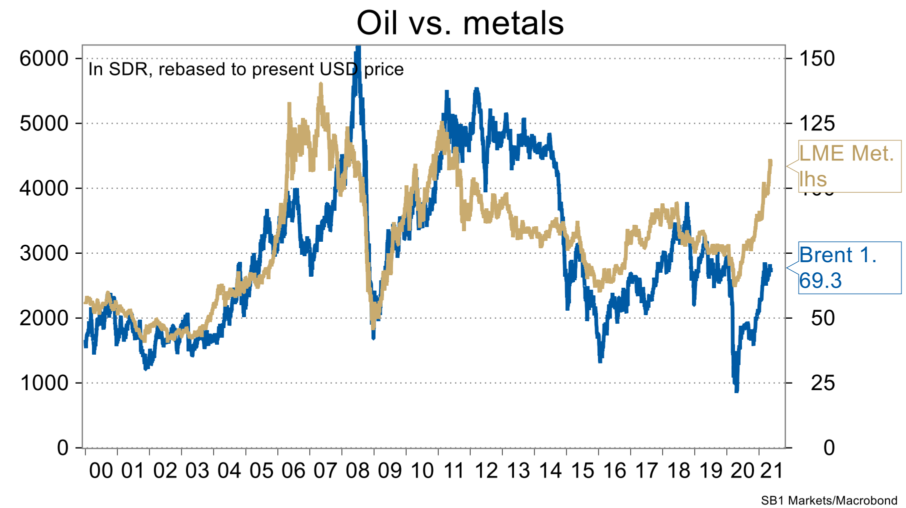


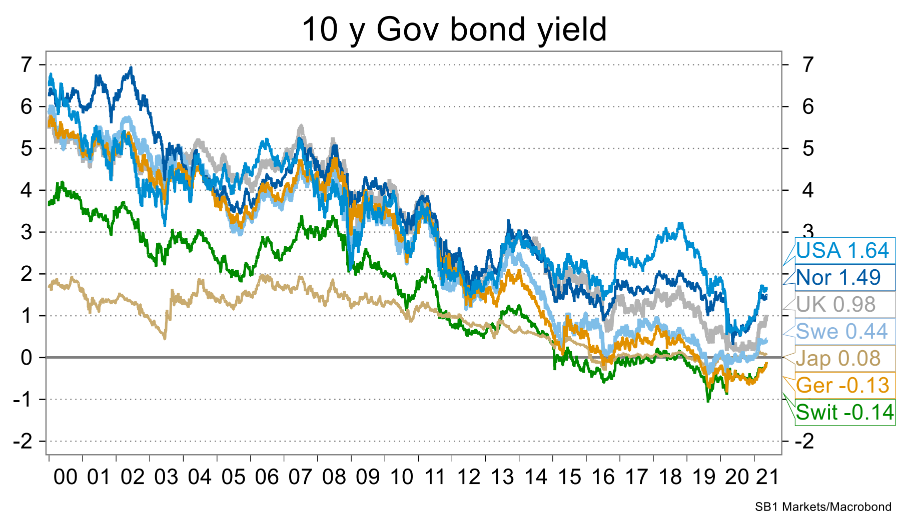


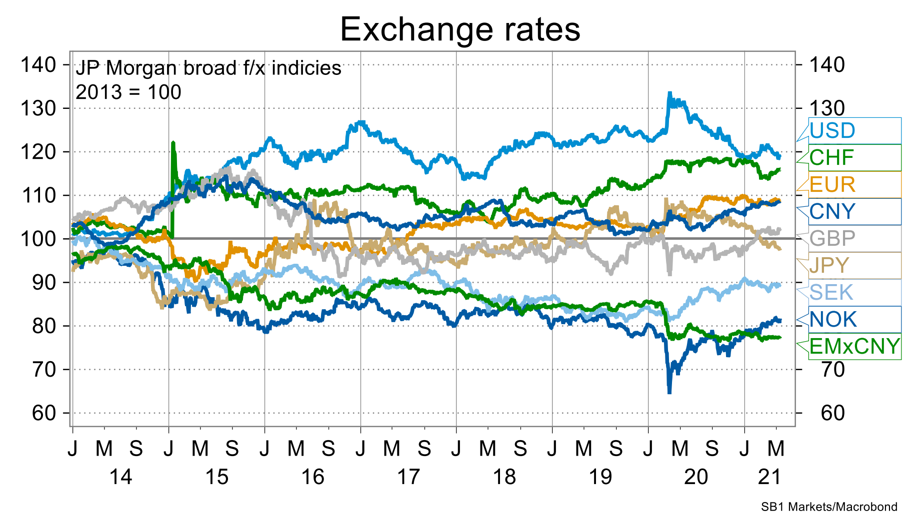
The big picture: Strong stock markets, commodity prices record high

... The latter in nominal USD, at least. The real price, in SDRs is still below the 2007 peak





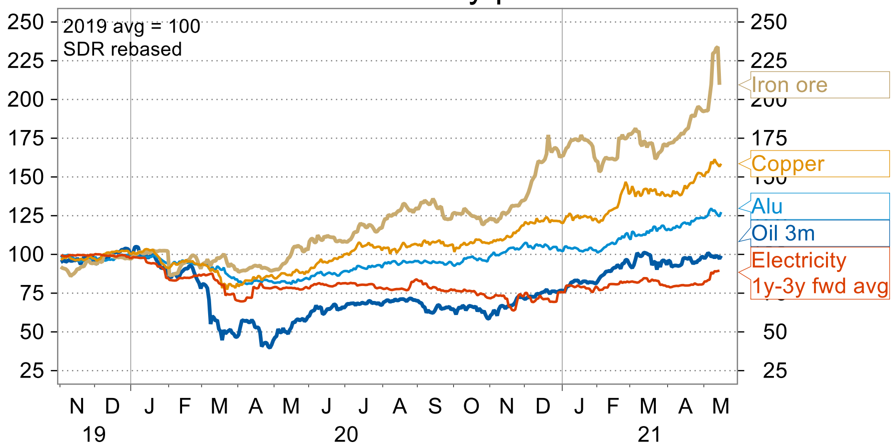




SpareBank 1 MARKETS

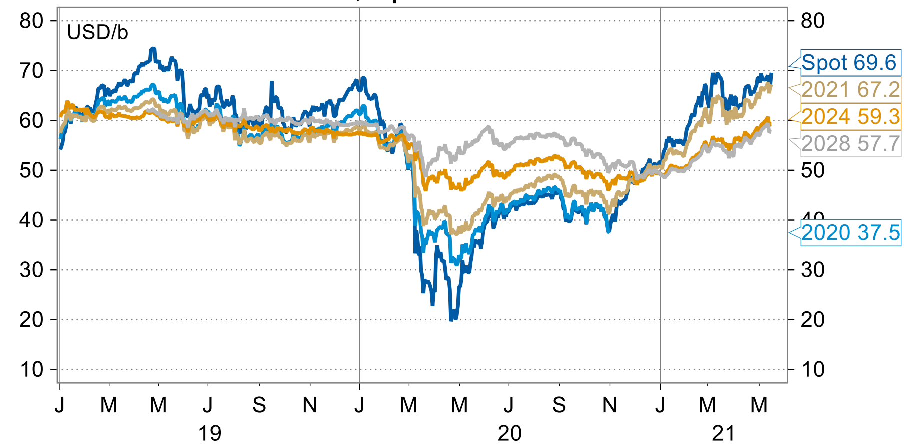
Iron ore, copper took a breather last week but the level is still sky high

Commodity prices



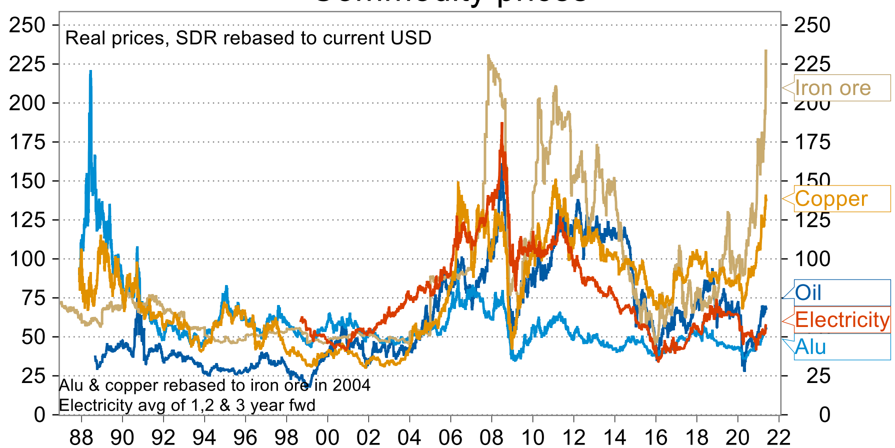
SB1 Markets/Macrobond

Brent oil, spot & Dec contracts



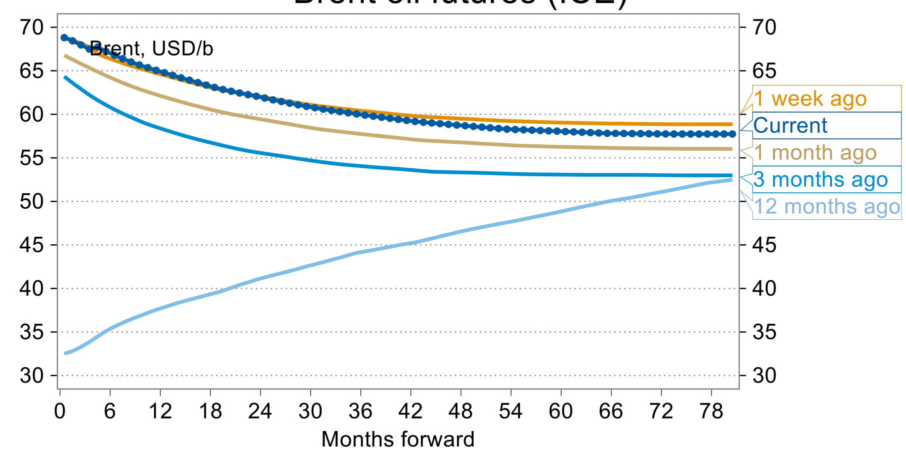
SB1 Markets/Macrobond

Commodity prices



SB1 Markets/Macrobond

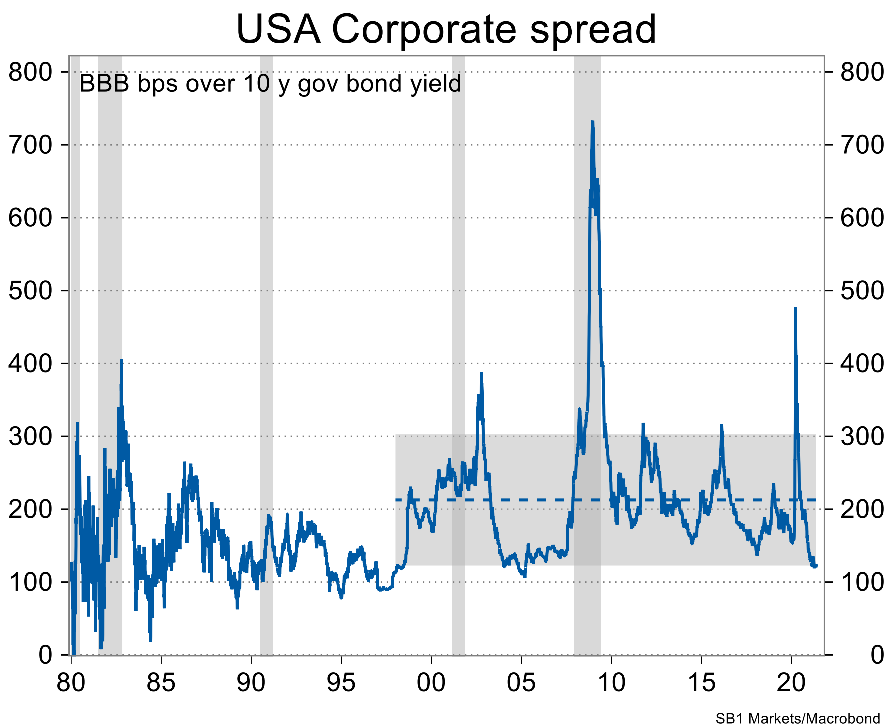
Brent oil futures (ICE)

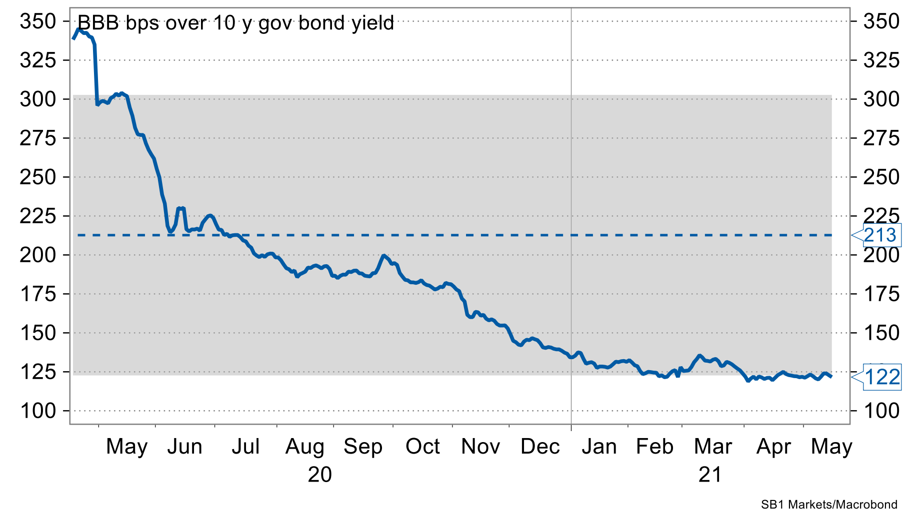


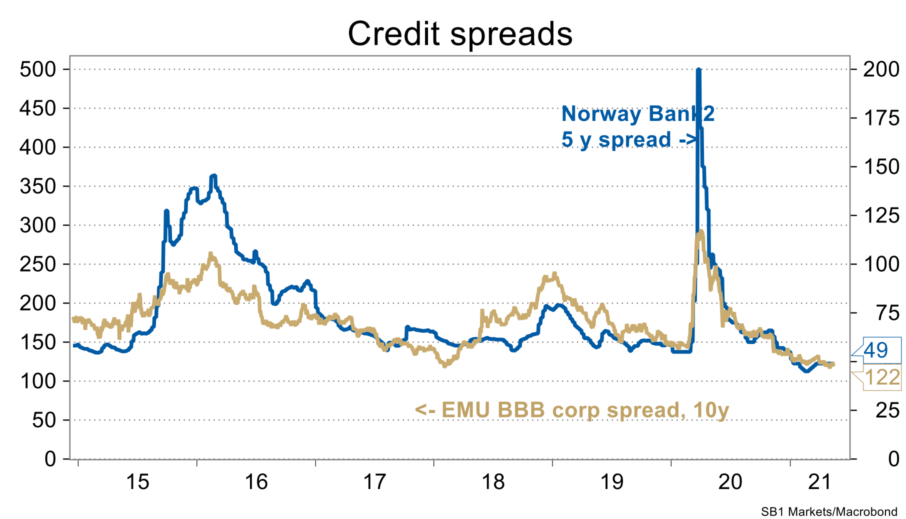
SB1 Markets/Macrobond

Credit spreads have flattened, at low levels

The US corp. BBB spread marginally up

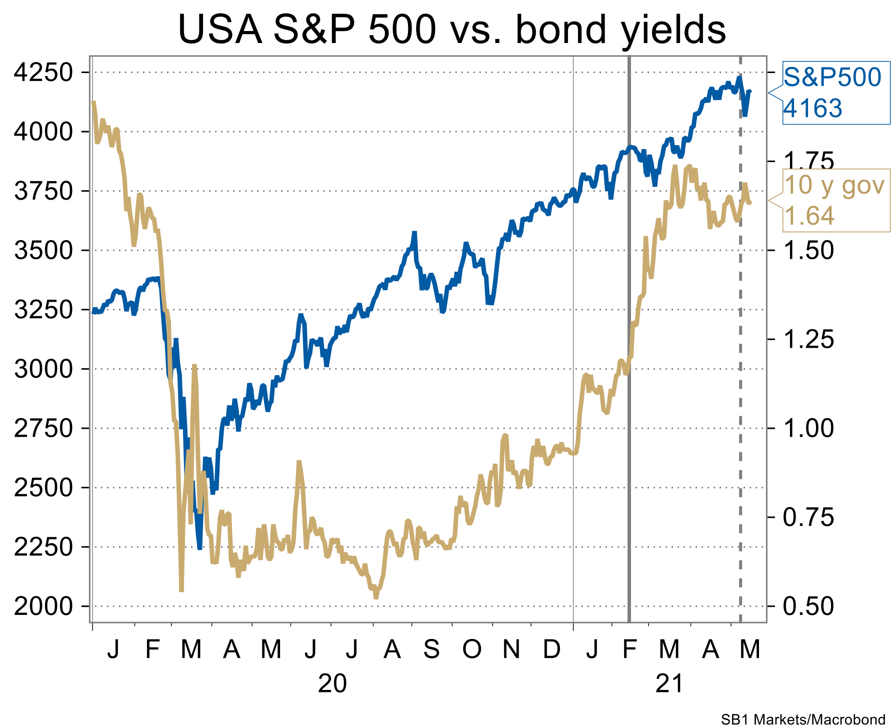


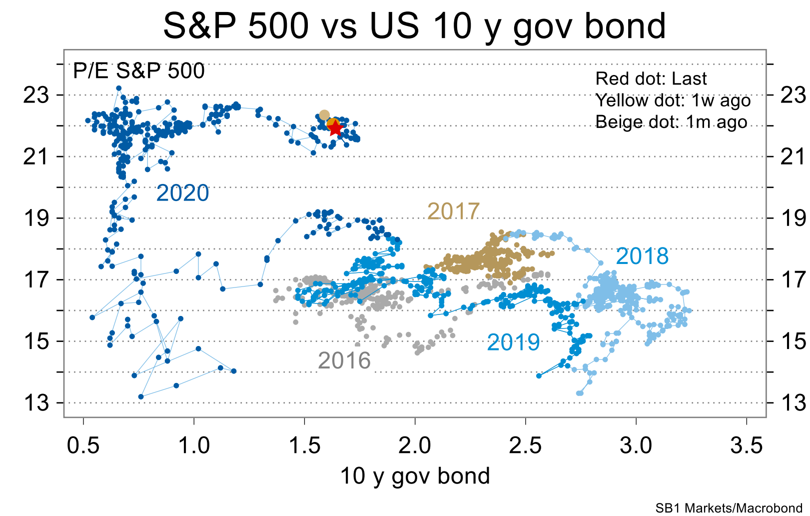


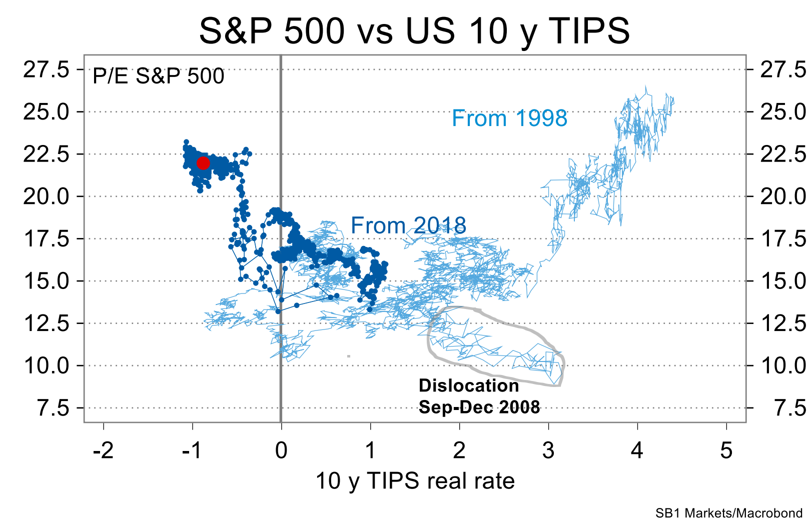


S&P 500 in the end down just 1.4%, the 10 y bond yield up 4 bps

(but was up more just after the inflation 'shock' at Thursday)



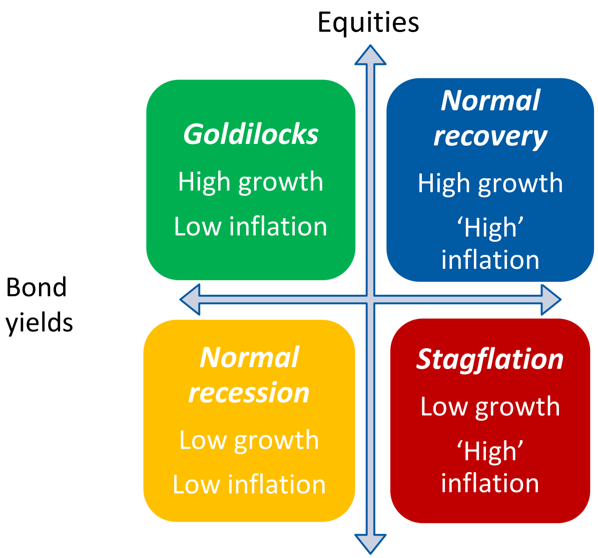


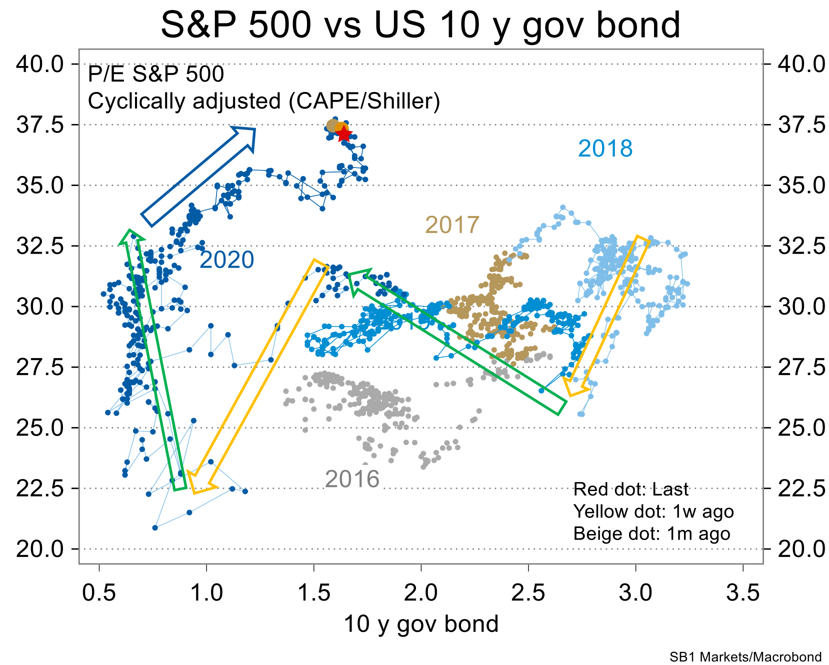


- The market was moving back into the 'Goldilocks' corner, with lower yields & higher equity valuations – until inflation become uncomfortable

A long term view: Still in the 'Goldilocks corner'

But will markets remain there? Actual wage/price inflation dynamics will in the end decide. And not the Fed…





- 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

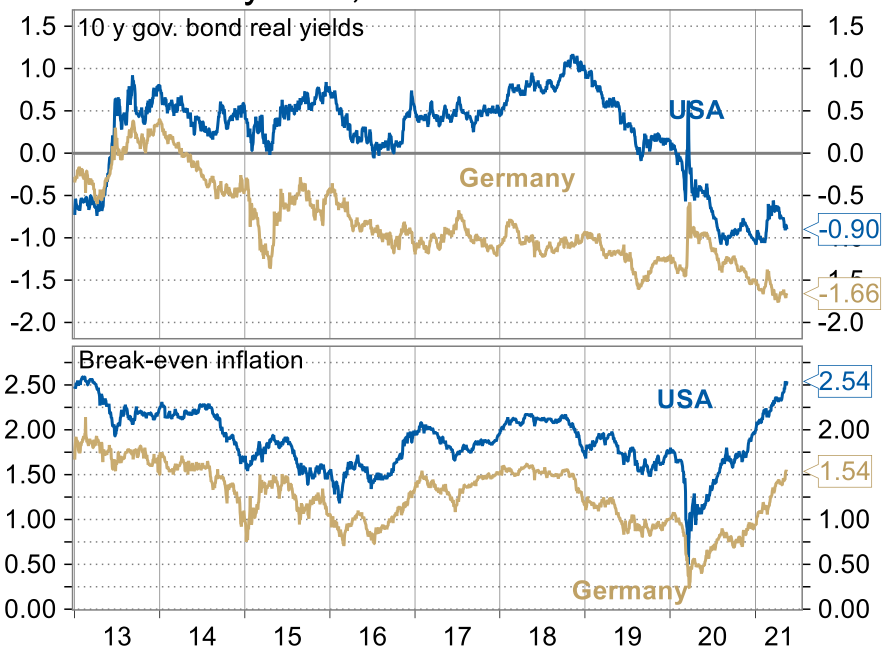
- **The FOMC/Powell** has reiterated that the bank will not hike its signal rate before the economy has recovered, unemployment is brought down, and inflation has increased to above 2% and is expected to remain above 2% for a while – and that the bank plans to keep the Fed funds rate at zero at least until 2024. A modest increase in bond yields in a such positive growth environment without the Fed hiking could be associated with a move towards the recovery corner, which is positive for stock markets too… if the starting point were in the normal recession (yellow) corned, low yields & cheap equities
- However, since H2 2018 bond yields have fallen, and the equity market has climbed – and markets moved well into the 'green corner', as growth expectations have not fallen together with lower yields, as has been the norm, at least since 1998 (in the US), at least partly due to aggressive central bank actions
- Now, vaccines are underway, and fiscal policy is 'running crazy' (4%+9% of GDP in budget stimulus). The Fed had to revise its growth forecast sharply. The equity market has for a long time discounted a rapid recovery – without having to take into account the normalisation of bond yields<u>, which is now taking place</u>
- Suddenly, there are alternatives (sorry, TINA) for investors, even if yields still are way below reasonable growth expectations. <u>Probably the best to hope for</u>, is unchanged equity market pricing (P/E-wise) but growing earnings will yield moderate returns even as yields increase. <u>The 2nd best alternative is 'normal multiples' and 'normal' rates.</u> Which is not a 23x 12m fwd P/E, or a 37x Shiller P/E – and not a 10 y bond rate at 1.5 – 1.7% - or even less a -0.77% 10 real TIPS bond yield
- <u>The 3rd alternative, which is not good at all: The stagflation scenario, the red corner.</u> At the least, the probability has increased recent months. And the Fed did not calm these fears last week, by giving some nods to the market. Thus, markets may start to fear central banks are running crazy too. It has happened befo

SpareBank 1 MARKETS

Inflation expectations are trending up, real rates down

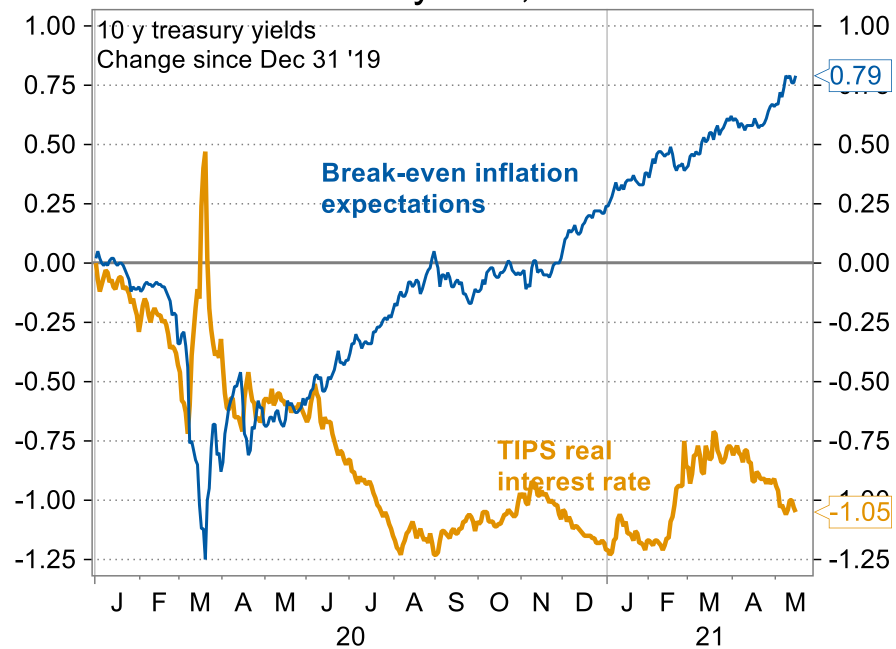
A break-even inflation expectation at 2.54% is no crisis for the Fed, but if this trends continues…

Real yields, break-even inflation



SB1 Markets/Macrobond

USA Real yields, inflation



SB1 Markets/Macrobond

US & Germany 10 y Gov bond yield

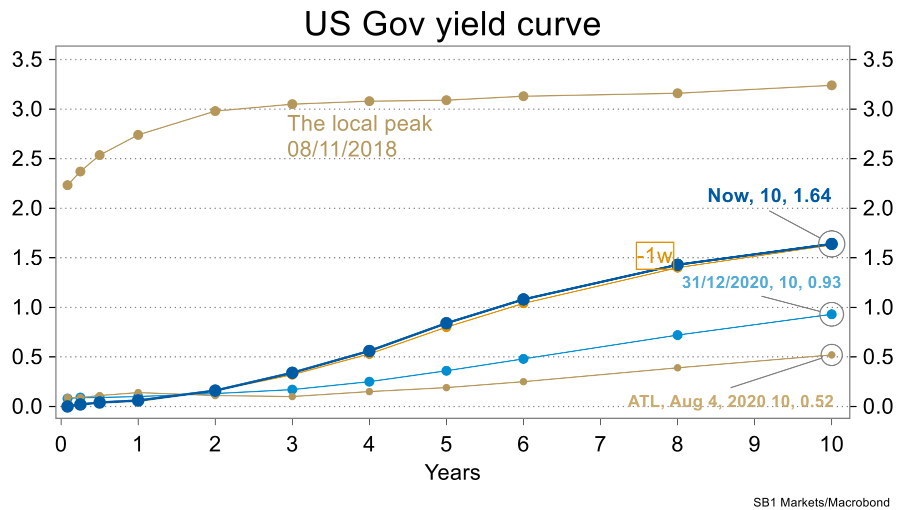
	Yield	Change 1w	Change 1m	Min since April-20
USA nominal treasury	1.64	0.01	0.05	0.52
.. break-even inflation	2.54	0.00	0.18	1.06
.. TIPS real rate	-0.90	0.01	-0.13	-1.08
Germany nominal bund	-0.13	0.09	0.17	-0.65
.. break-even inflation	1.54	0.10	0.12	0.40
.. real rate	-1.66	0.04	0.00	-1.76

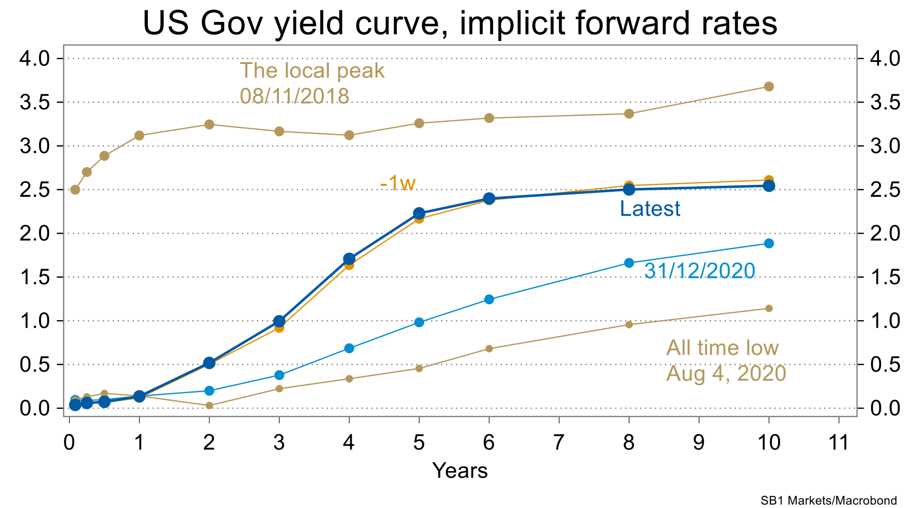
SB1 Markets/Macrobond

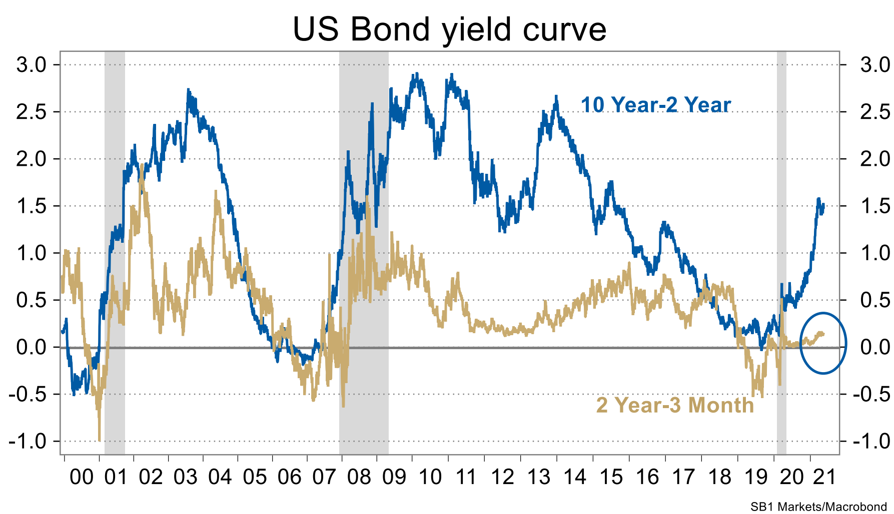
- The 10y break even expected CPI inflation is now at 2.54%, which signal an expected PCE inflation rate clearly above 2.0% the coming 10 years in average
- Inflation expectations in Germany are heading upwards too, and is approaching the highest level since 2014
- German real rates are still trending upwards, from a very low level

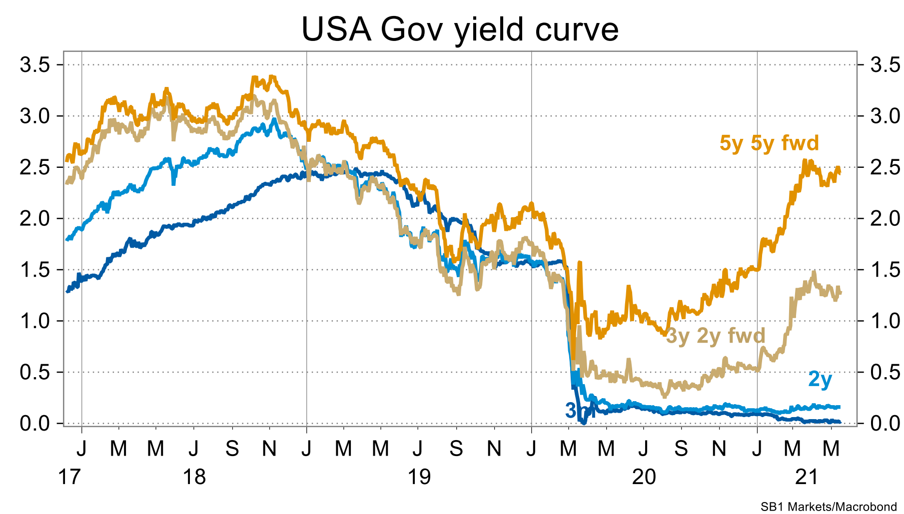
The inflation 'shock' did not impress markets much

However, a minor lift at the short end of the US gov bond yield curve





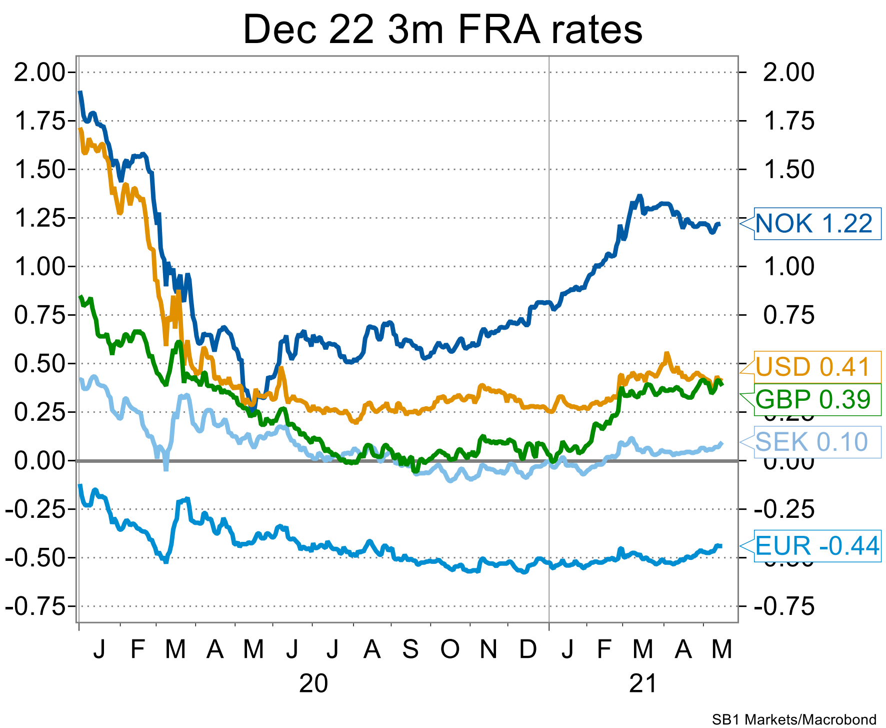


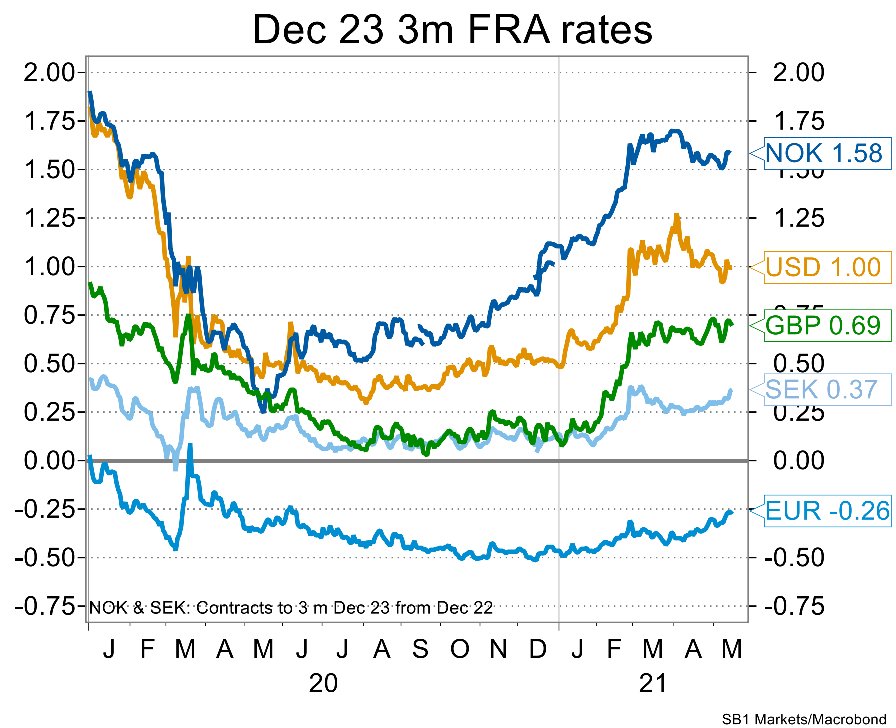


SpareBank 1 MARKETS

Interest rate expectations: Up last week. And by the most in EUR & SEK!

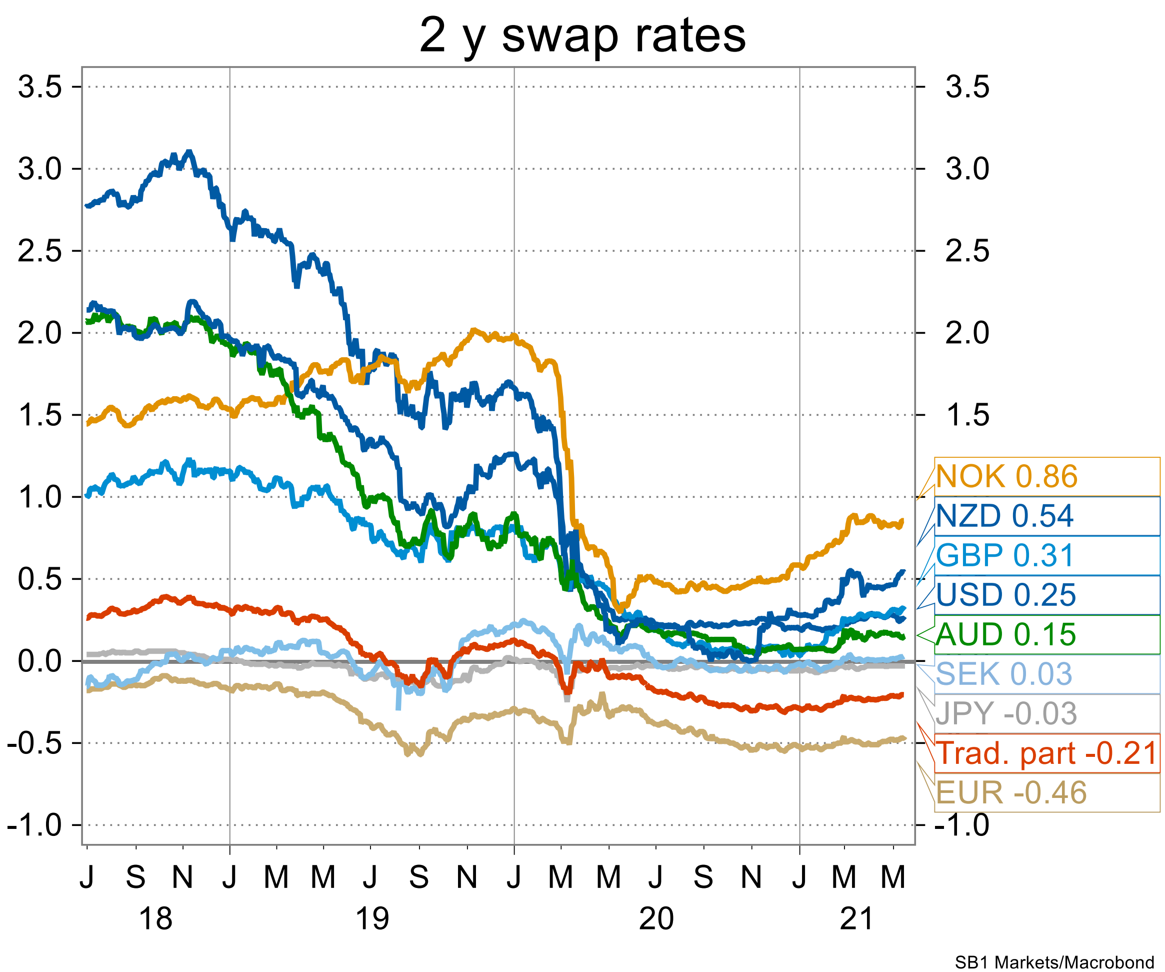
A Fed hike is priced into the curve by Q4-22. EUR rates are now trending upwards again

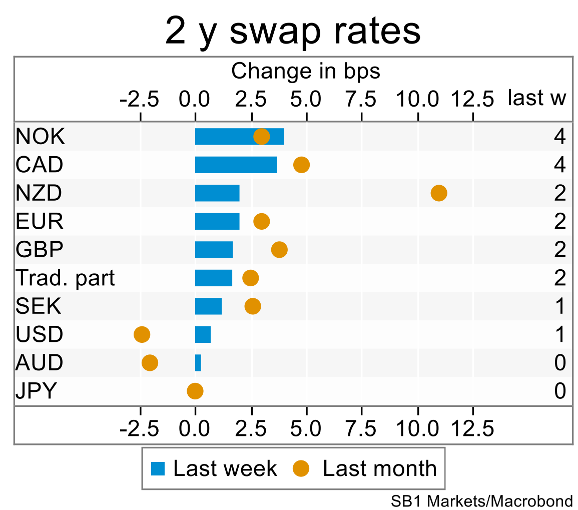




Short term swap rates up everywhere last week

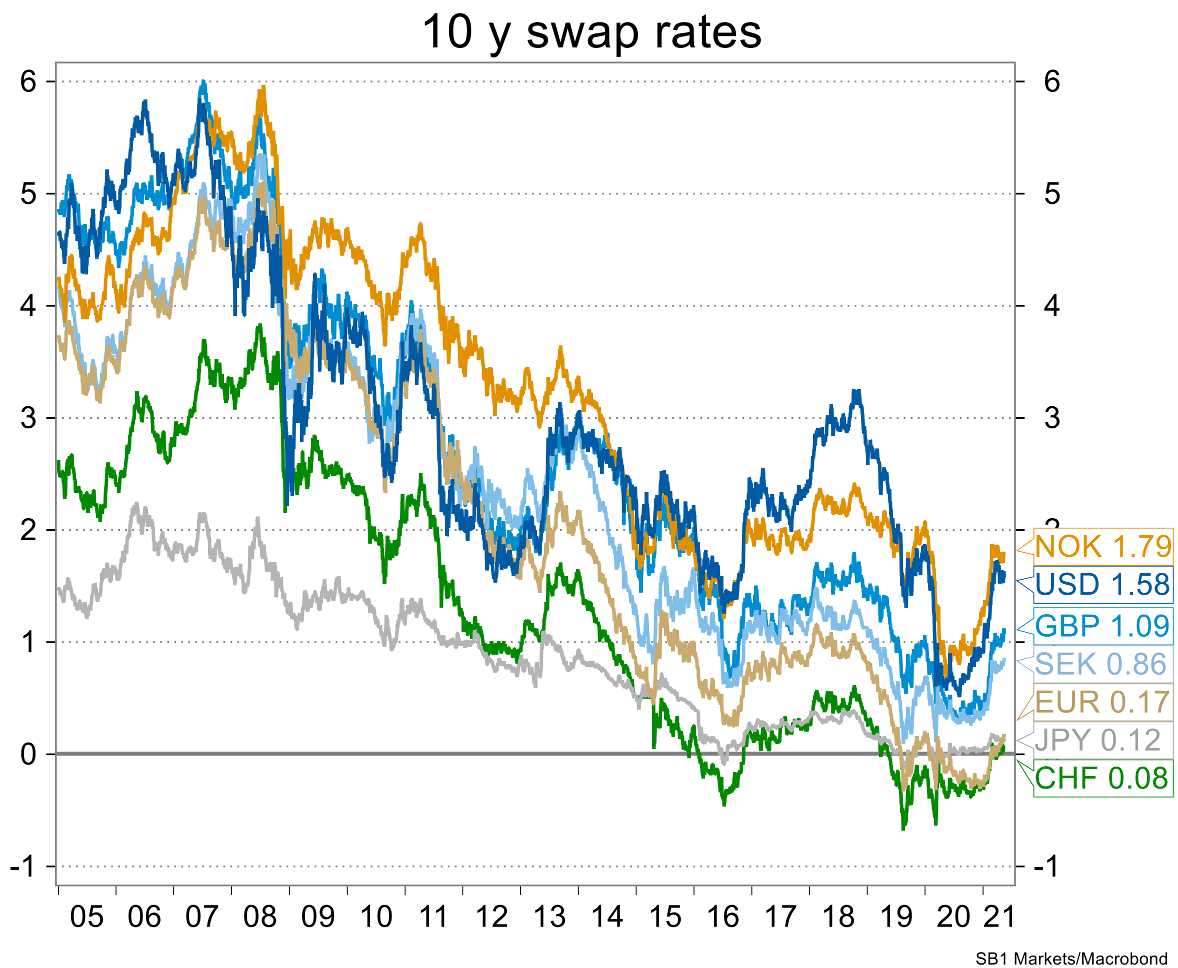
… but not much in the US following the inflation 'shock'

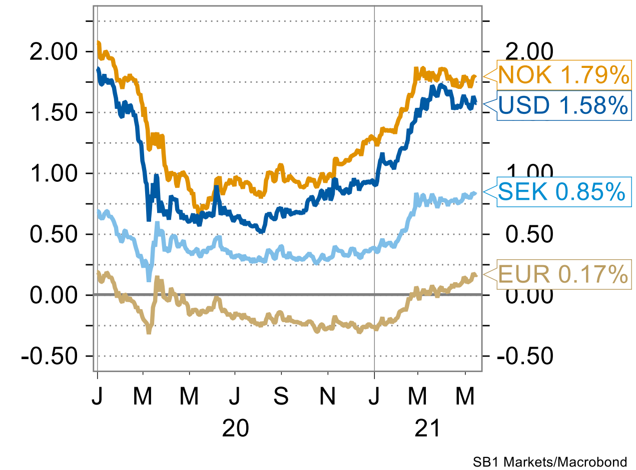


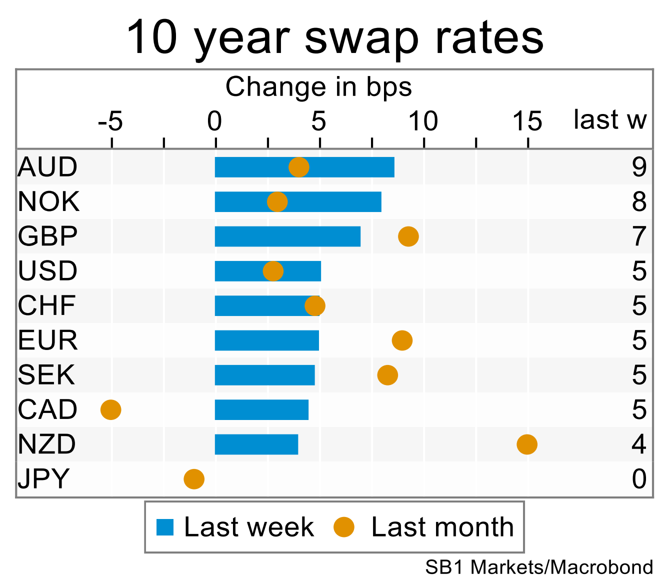


SpareBank 1 MARKETS

10y swap rates up: All up last week – and not by the most in the US

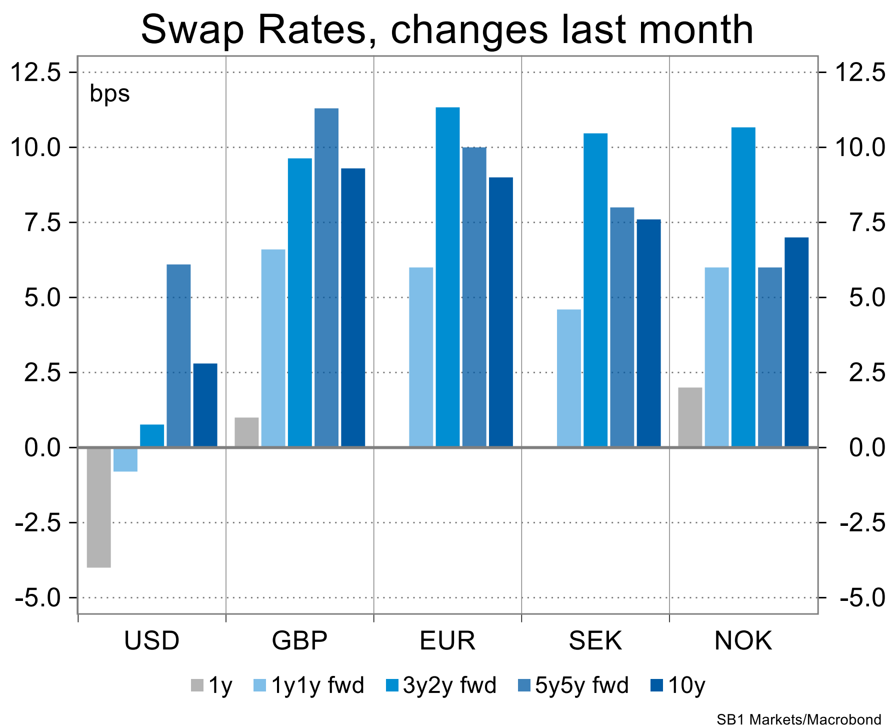


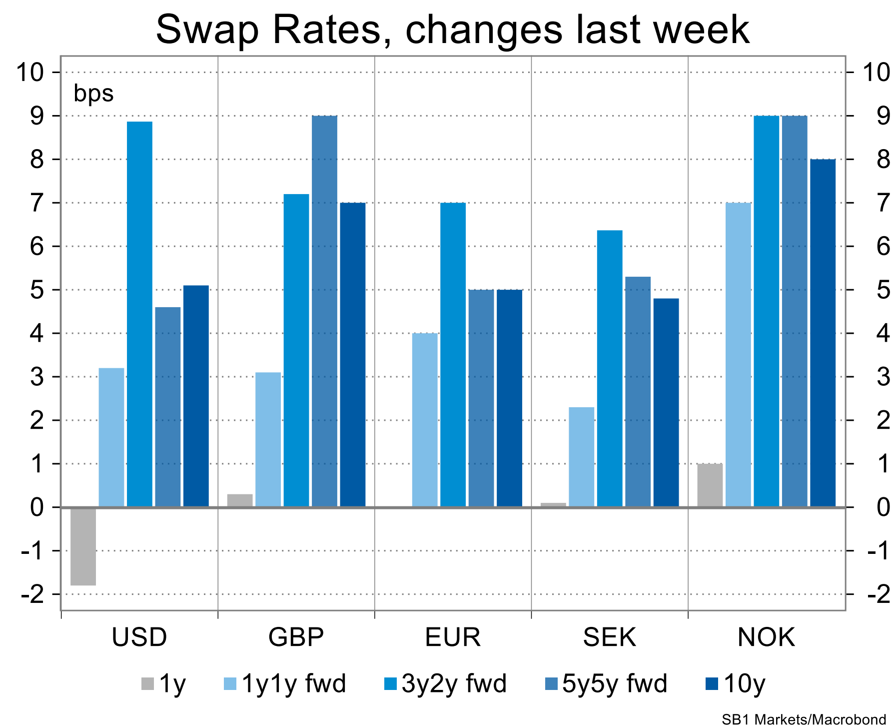




Down the previous week, up last week but not specifically much in the US

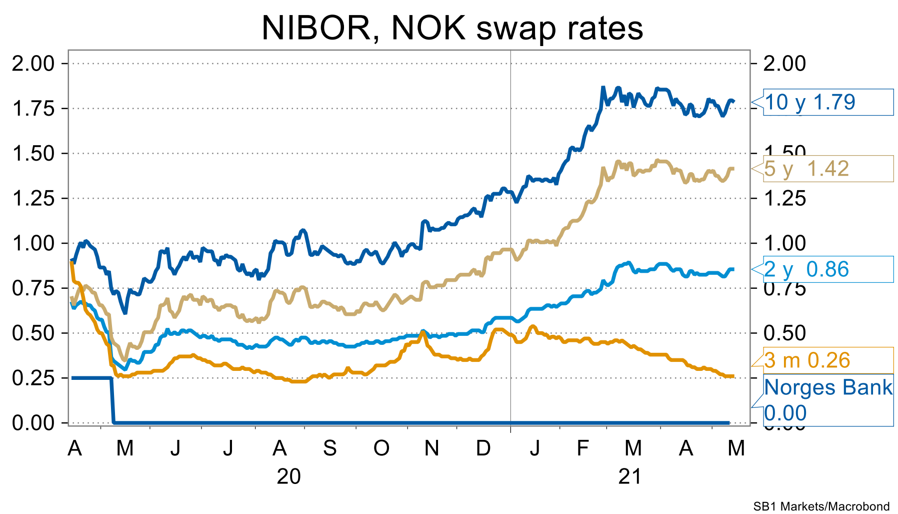
… even if inflation accelerated sharply in US. And more in Norway than abroad

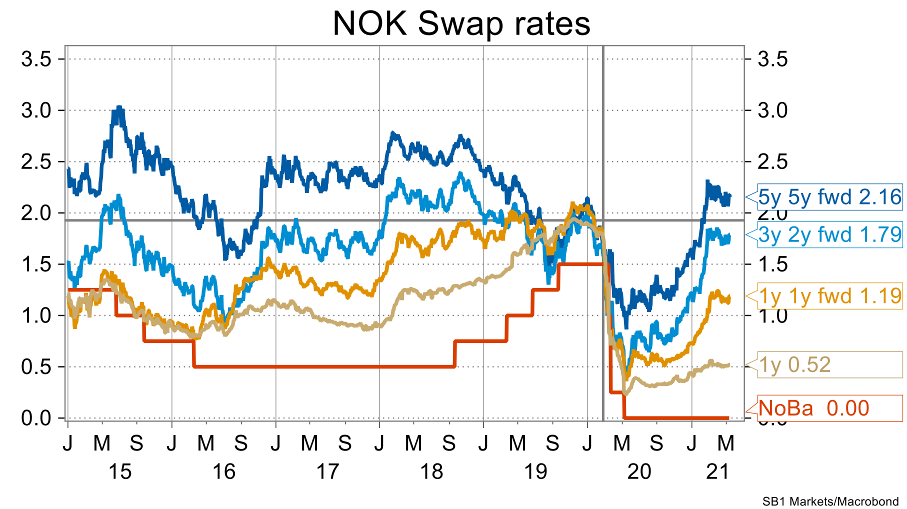


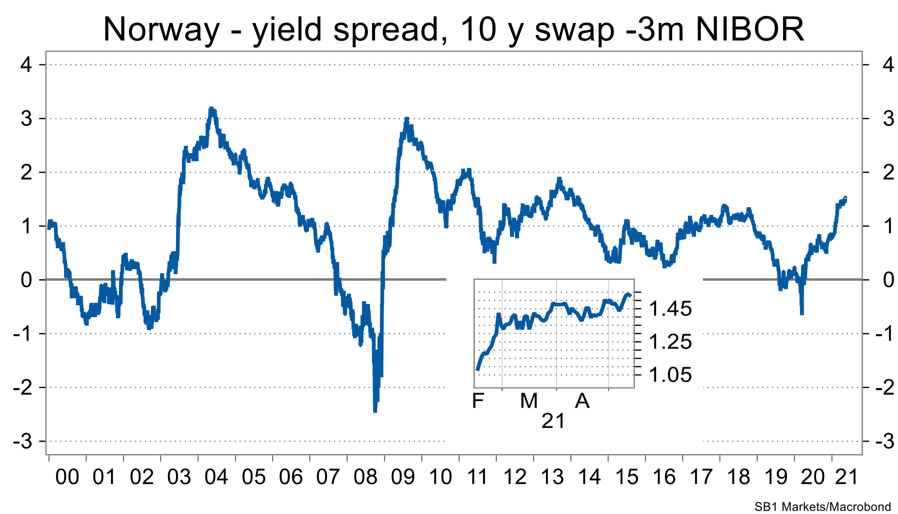


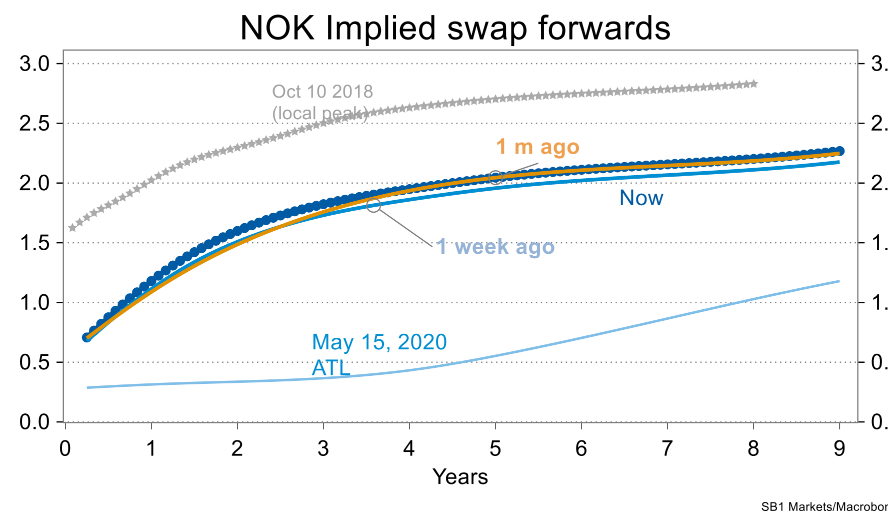
NOK rates has flattened (and rose marginally last week)

NOK 10 y at 1.79%, reversing the previous week decline



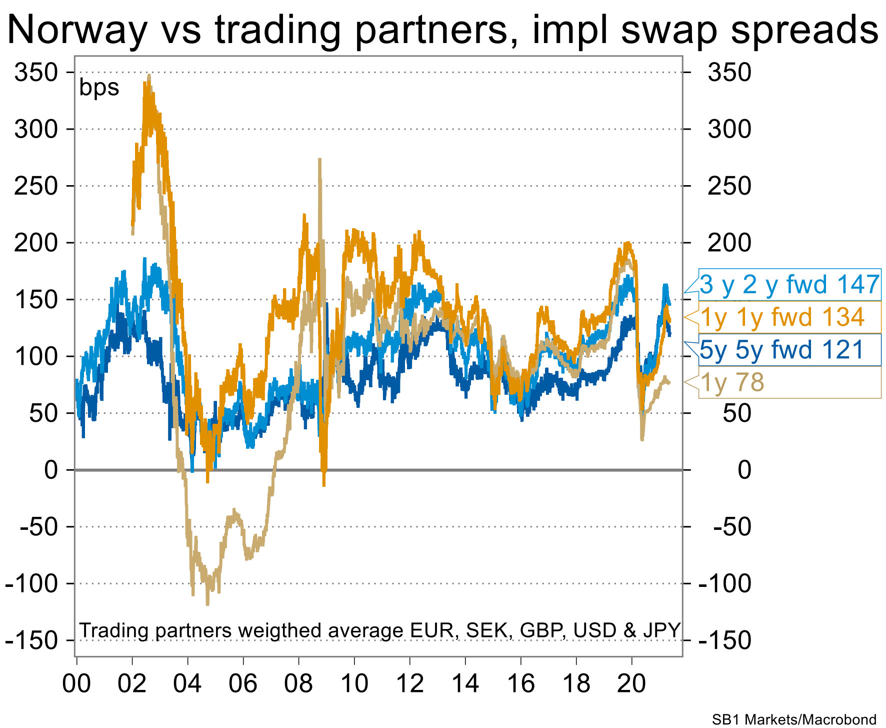


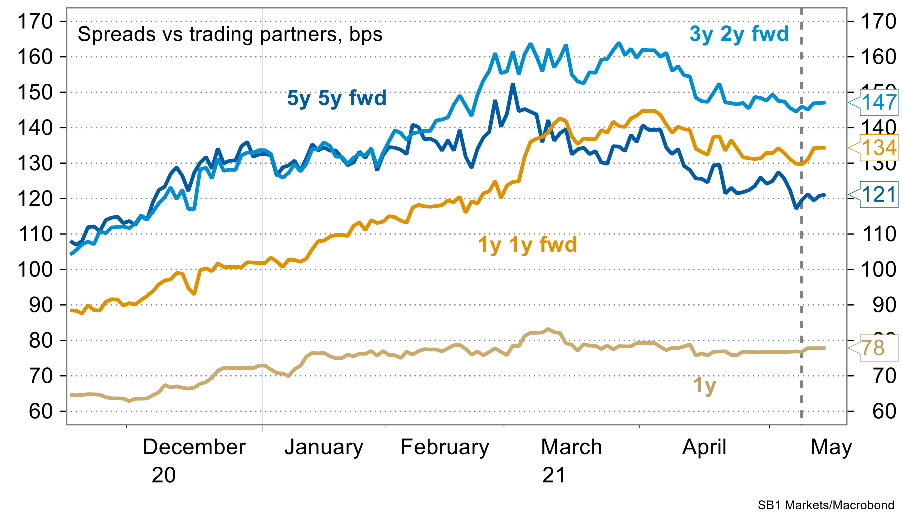


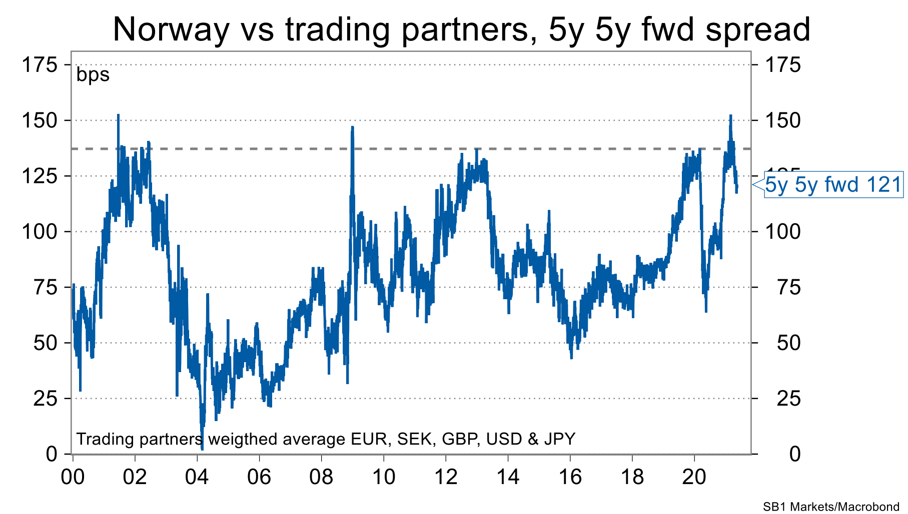


Forward spreads vs trading partners slightly up last week, without strong data

However, the revised budget was more expansionary than some had expected

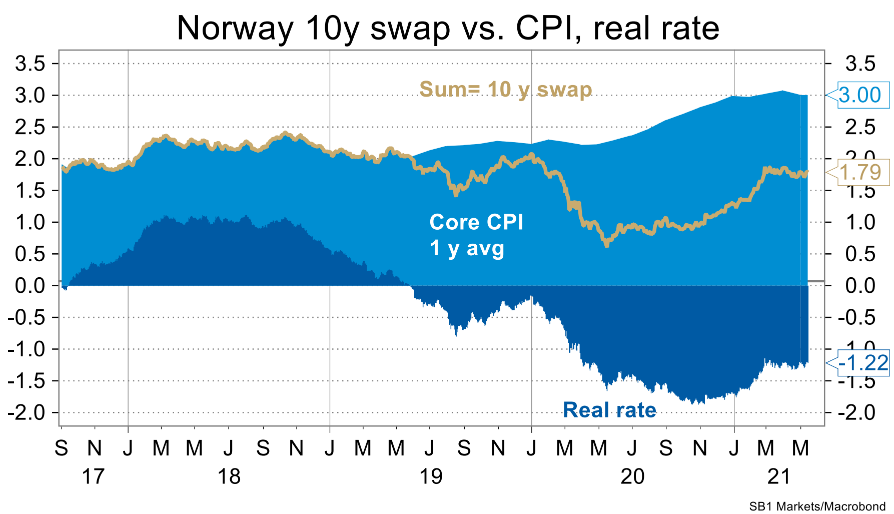






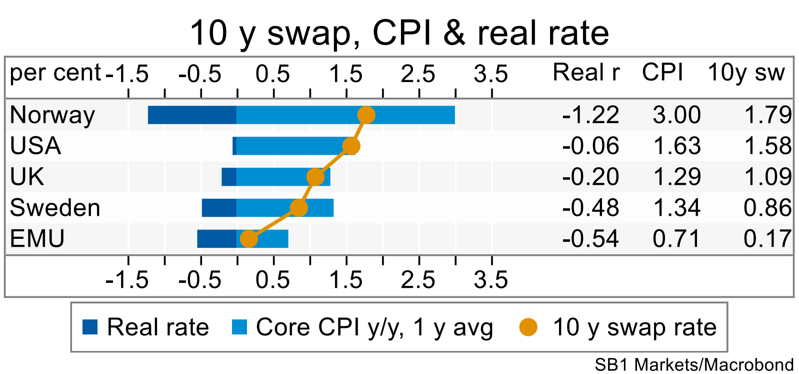
SpareBank 1 MARKETS

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



NOK 10 y swaps are drifting upwards

- The **10y NOK swap rate** up **9** bps to 1.79%
- **The real rate**, after deducting 3.0% average core CPI inflation over the 2 past years equals -1.2%
  - » However, if we use a longer CPI inflation average, the real rate is higher, as the average rate of inflation has been lower than the current 3.1%
  - » On the other hand, barring economists' in academia & finance, nobody else believe in the 2% inflation target. Other economists say 2.5%, business leaders 3.5% and households 3.8% (in 2 to 3 years' time)
  - » In seems unreasonable to assume an expected inflation below 2.5% - and in may in fact be that it is even higher than 3% among decision makers in the private sector



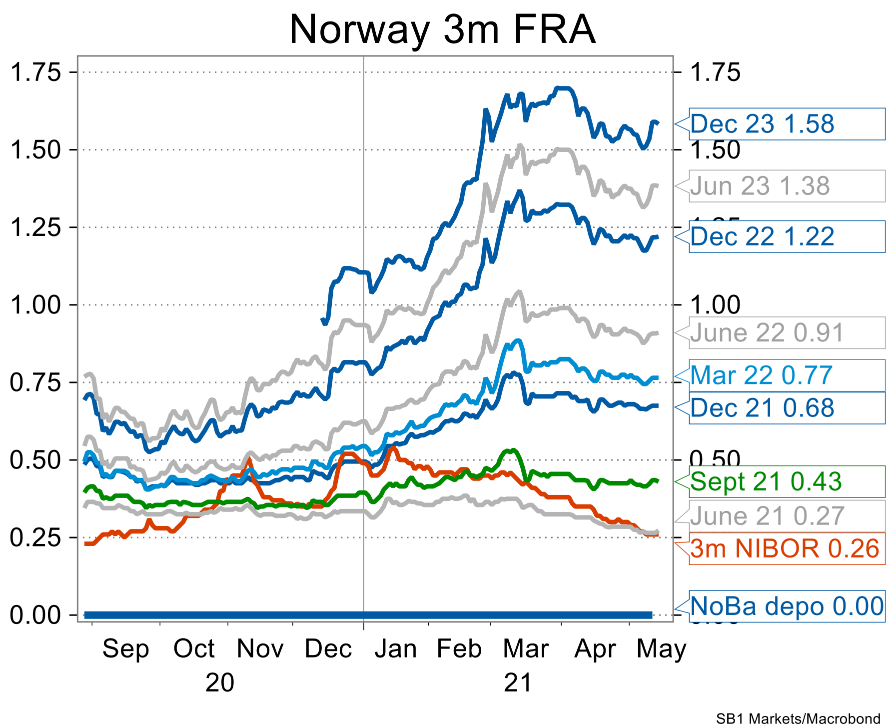
per cent	Real r	CPI	10y sw
Norway	-1.22	3.00	1.79
USA	-0.06	1.63	1.58
UK	-0.20	1.29	1.09
Sweden	-0.48	1.34	0.86
EMU	-0.54	0.71	0.17

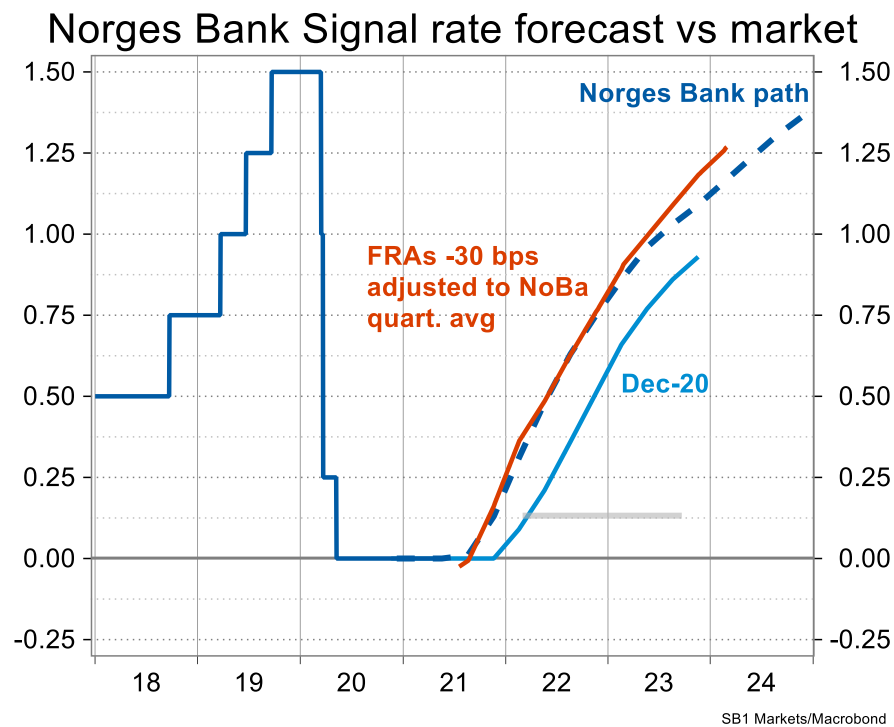
NOK real rates among the lowest, as inflation is at the top

- **Inflation** among Norway and our main trading partners varies between 0.7% to 3.1% (here again 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** among our trading partners, and ranging between -0.1% and -0.6% measured vs. the 10 y swap rate and core inflation over the past two years
- **Thus, the Norwegian real rate at -1.2% is an outlier at the downside, even if the nominal rate is the highest**

Longer dated FRAs visibly up, not due to NOK inflation data but rather USD data…

Longer dated FRA are down more than 20 bps since late March. Without much weak Norw. data

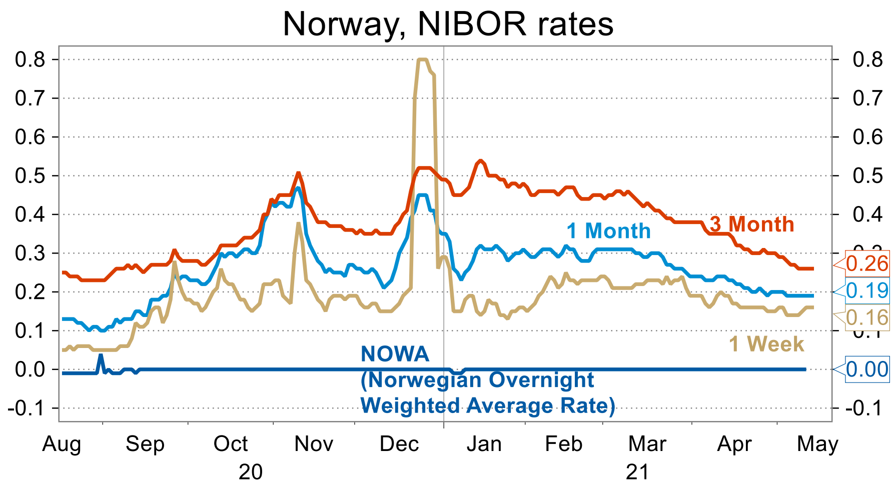


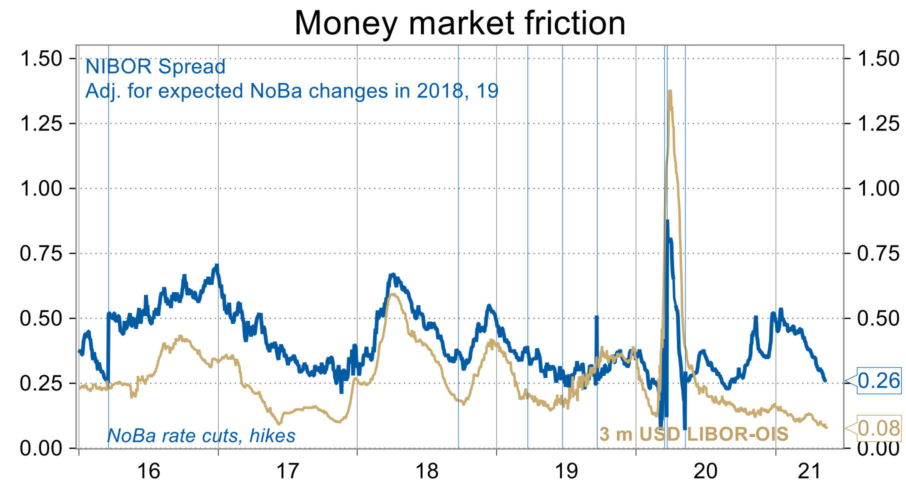


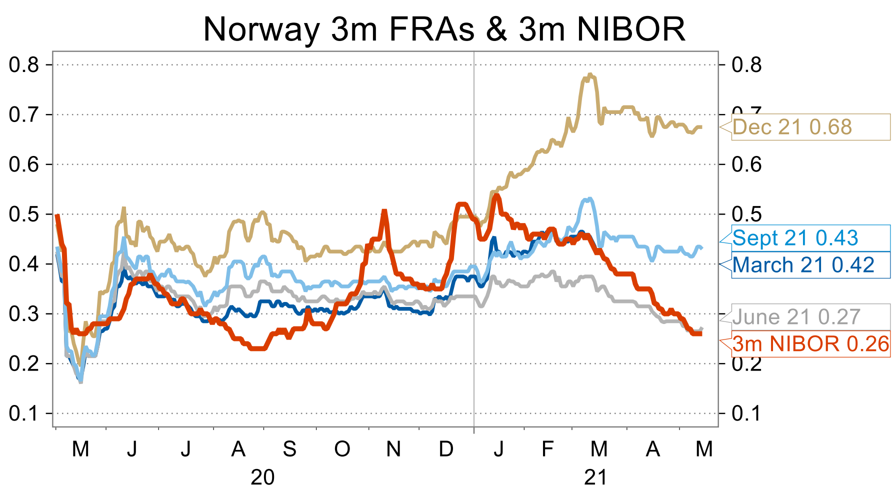
- The NoBa 23 Sept meeting is one weak after the Sept 3 m FRA IMM fixing date. If NoBa hikes to 0.25% on Sept 23, the average NoBa rate during the Sept-21 FRA contract period will be 0.23%. Assuming a 30 bps NIBOR spread the actual 0.43% Sep FRA-rate equals a 0.13% NoBa deposit rate. If so, a somewhat above 50% probability for a Sept hike is discounted, marginally above what NoBa signalled in its March MPR (50%)
- The Dec-21 FRA at 0.68%, and a 30 bps NIBOR spread, yields a 0.38% NoBa rate. However, the Dec FRA is normally some 5 – 8 bps 'too high' due to year liquidity adjustments at banks. We deduct this extra liquidity premium, and assumes market's 'real' NoBa expectation at approx. 0.31%. That implies a 20%+ probability for a 2nd hike in H2, again close to NoBa's path. A second hike in March-22 (if not in Dec) is almost fully discounted

The NIBOR spread is falling sharply: 3m NIBOR -1 bps to 0.26%

The June contract unch. at 0.27%. The NIBOR spread has not often been lower

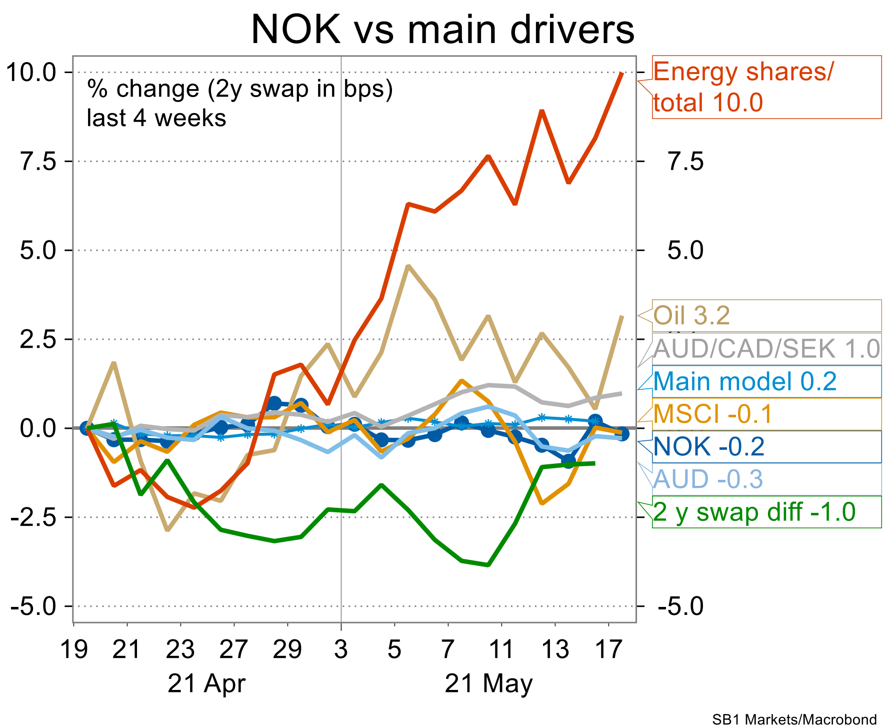


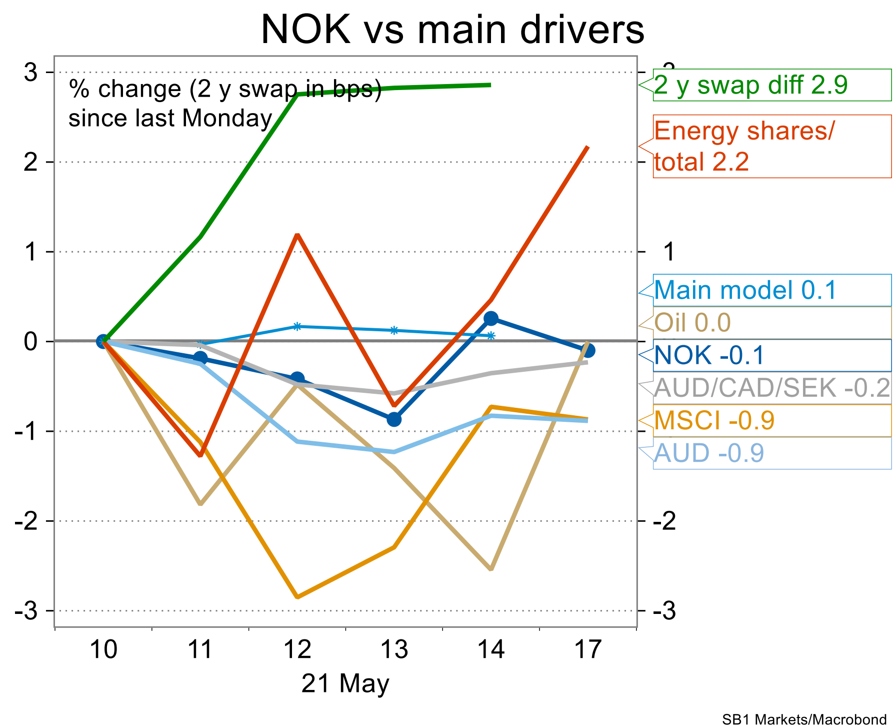




The NOK flat last week – and we expect it to remain so (at least, we do not have a case)

There may still be some upside, but risk markets are not cheap, and the oil price will not climb forever





Last week: NOK down 0.1%, our model signalled +0.1%. Both oil prices, global equities, and our f/x peers pointed down last week.

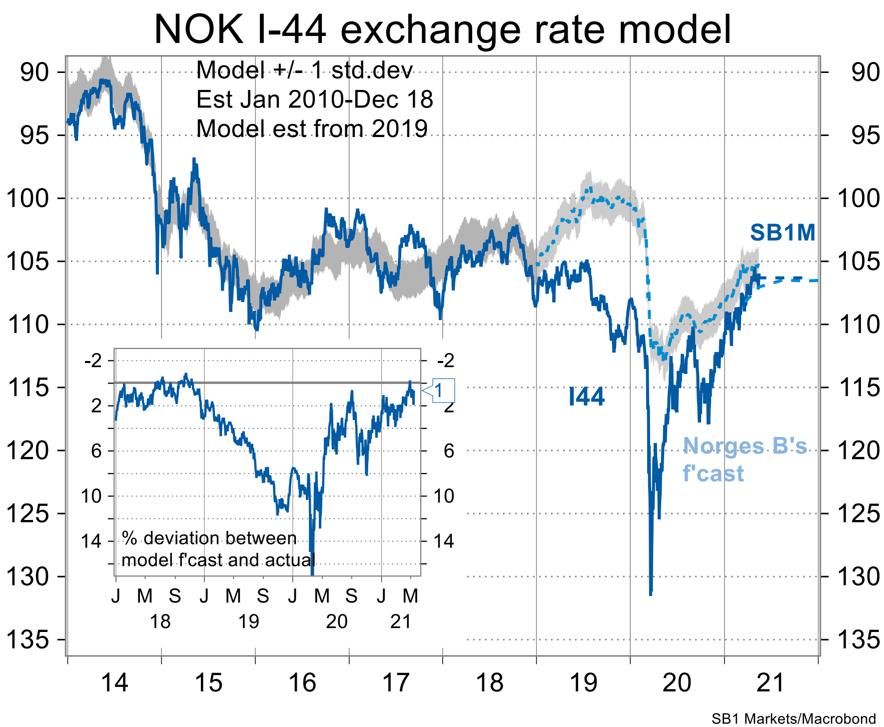
The status vs. the normal drivers:

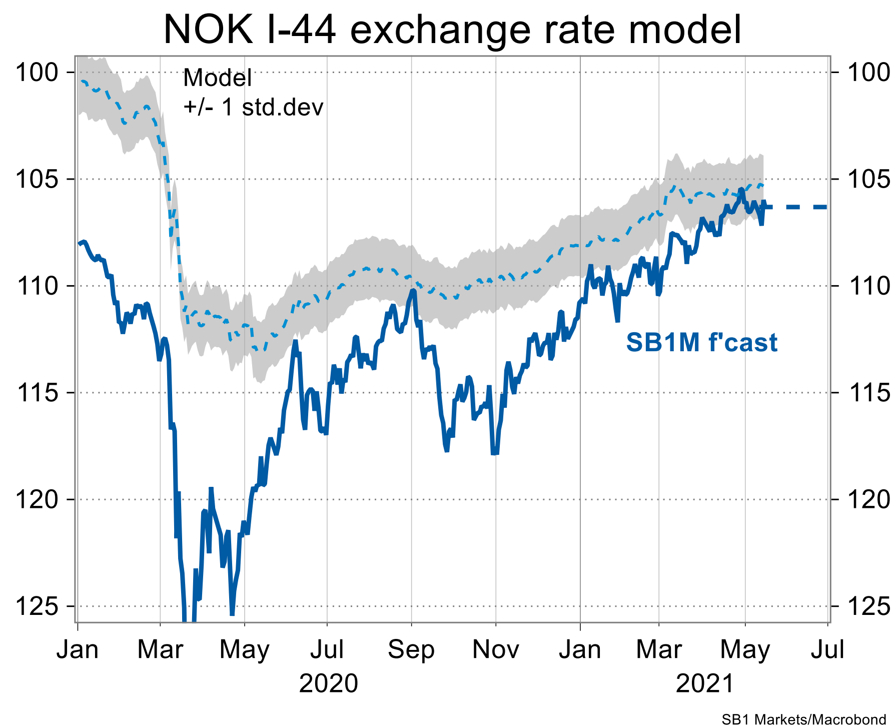
- The NOK is 1% weaker than suggested by our standard model
- The NOK is 2% 'weaker' than the global stock market vs the correlation between the two since beg. of 2020
- The NOK is 8% weaker than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts
- On the other hand, the NOK is far (12%) stronger than a model which includes global energy companies equity prices (vs the global stock market)

At this and the following pages we have swapped Norges Bank's I44 index for JP Morgan's broad NOK index for the last 25 observations. The I44 has an earlier closing time than the 'official' closing time for fx crosses, which is the same as for JP Morgan's indices. Thus, JP Morgan's index correlates closer to the 'official' main NOK fx crosses. There are no substantial difference between these two indices over time. JPM ind. is used for other f/x too

NOK less than 1% below our main model estimate

The gap has closed. NOK needs more support from here. Will it get it? Not so sure…

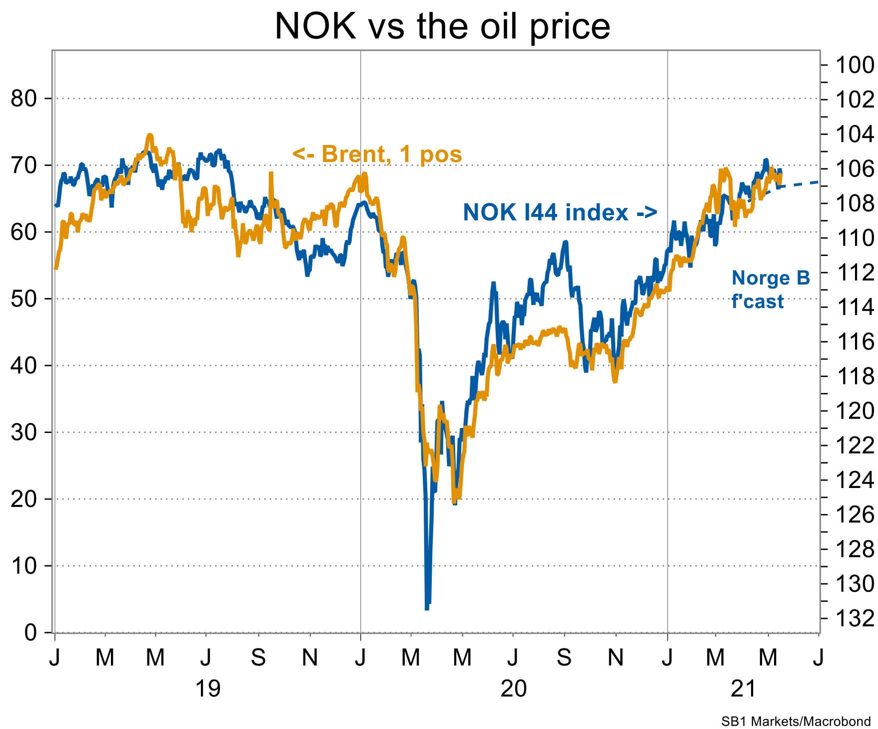


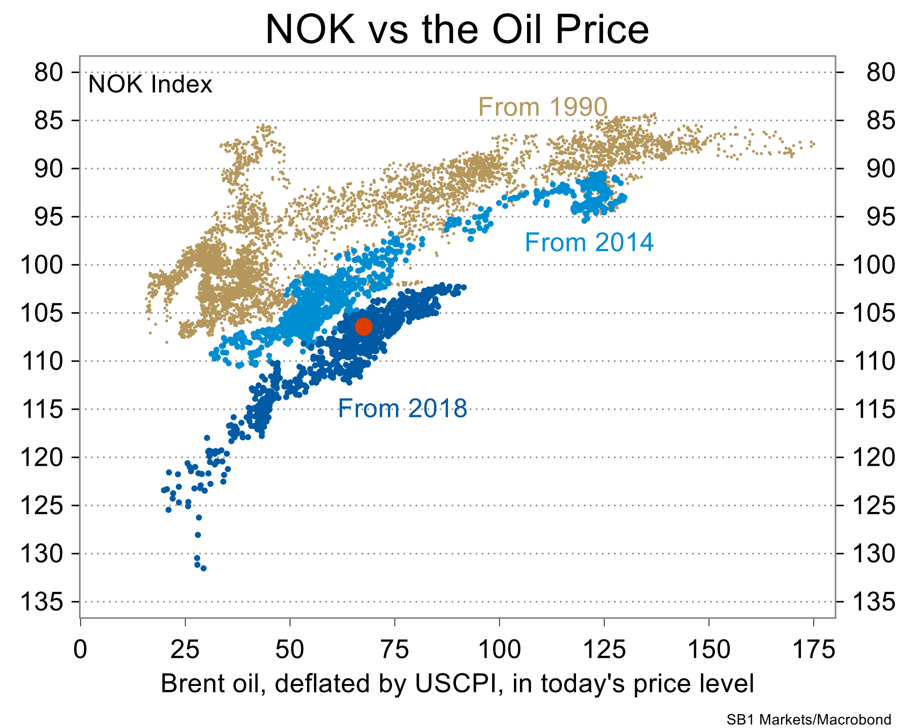


- The NOK is above the pre-pandemic level and in line with our workhorse model

NOK flat, oil marginally down

NOK is still correlating quite closely to the oil price but at a lower level than before 2018

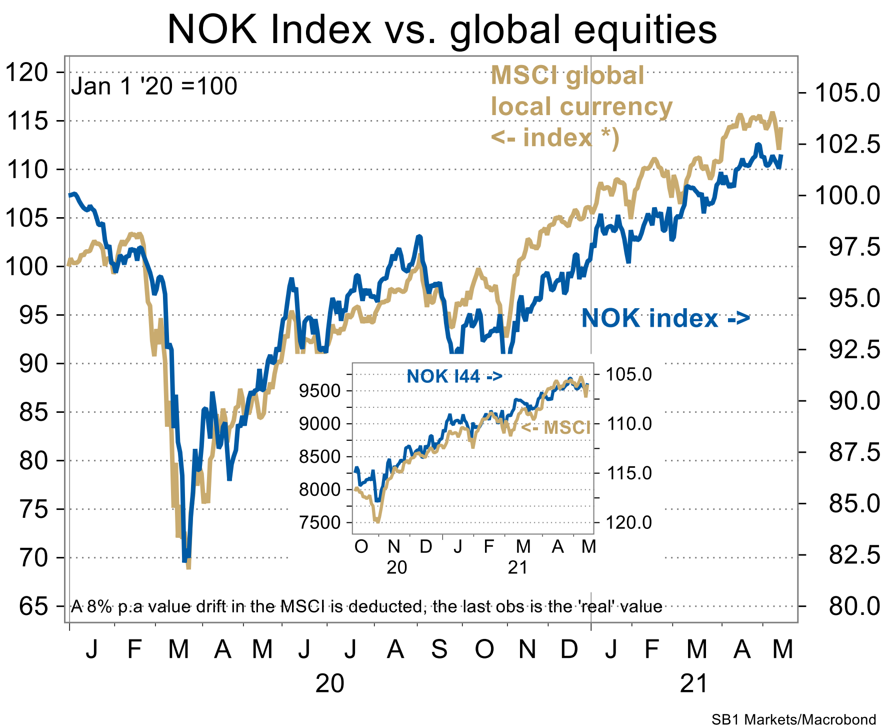


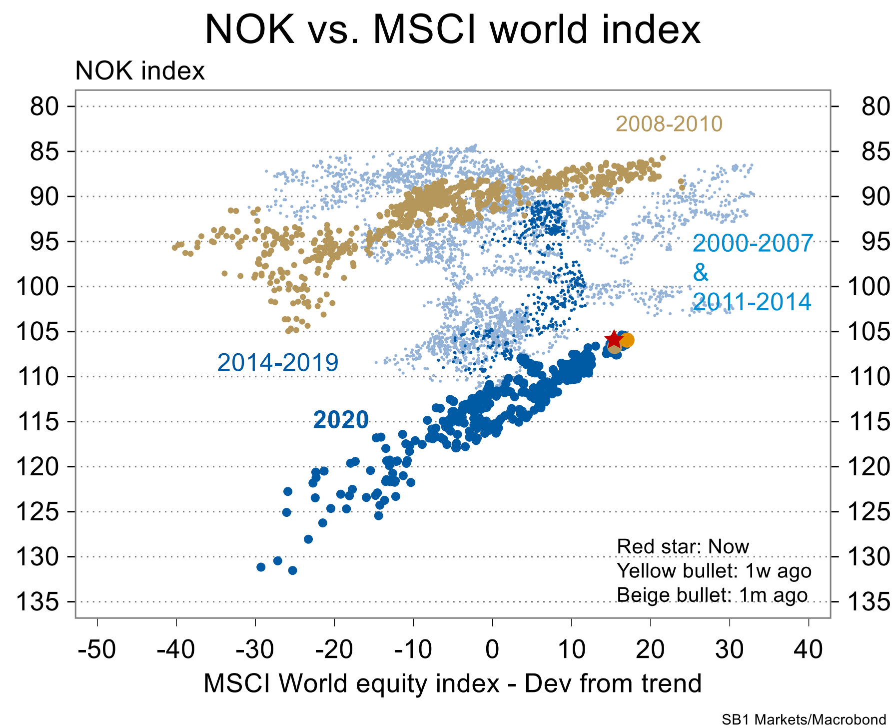


- A USD 10 drop in the oil price weakens the NOK by some 2.5%, as a partial effect. Within a broader model, the impact is somewhat smaller

Global stock markets lost some height last week, the NOK not

Except for Sept., NOK and global equities since early last year. The gap is at some 2%



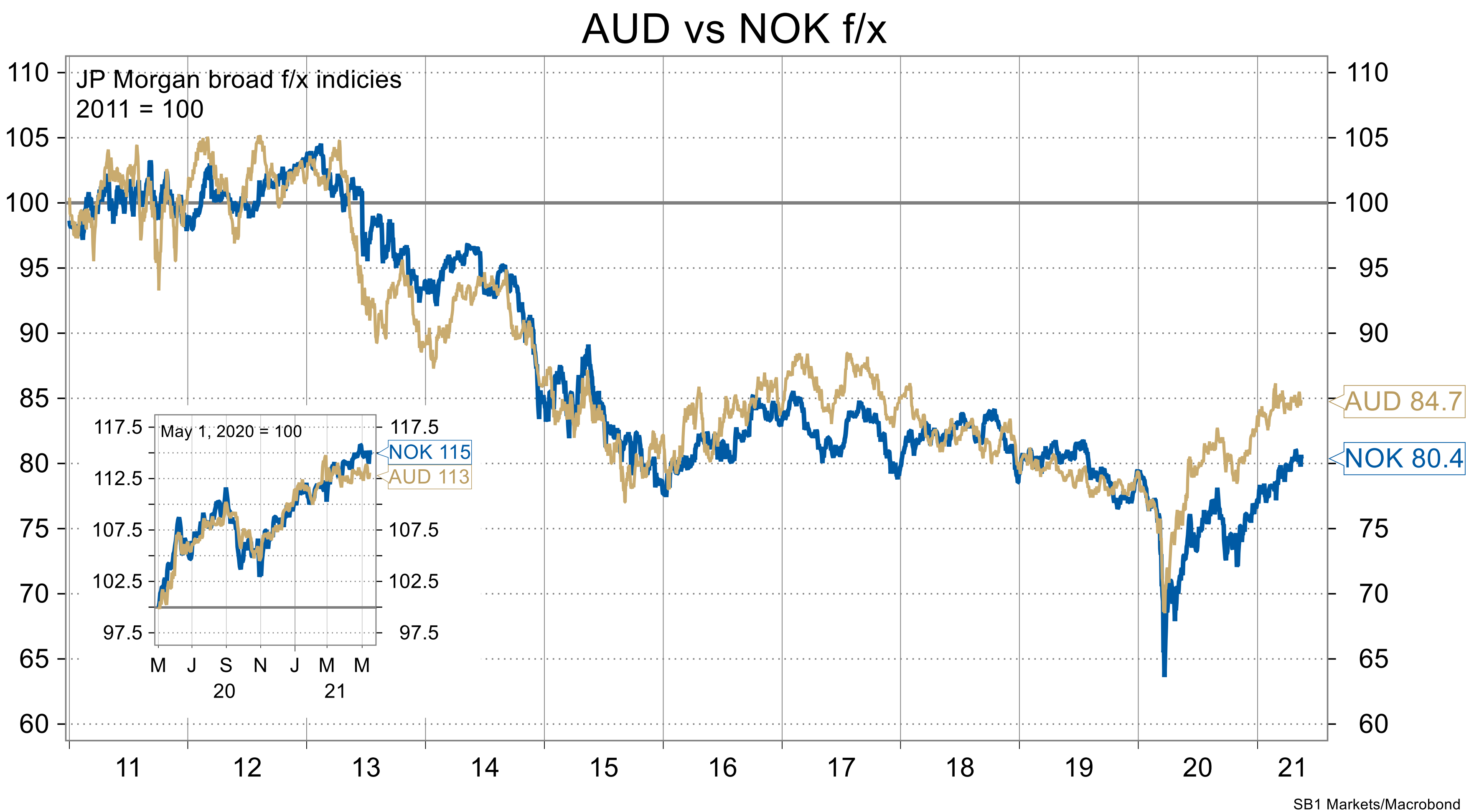


- Over time, there has not been a stable correlation between NOK and stock markets (the Oslo Stock Exchange, S&P 500 or the MSCI, the global equity index. (At the chart to the right, we have detrended the stock market as equities are drifting upwards, while NOK (hopefully) is stationary. However, the two has been pretty closely correlated from time to time
  - Now, the NOK is somewhat weaker than 'normal' vs the stock market as the NOK lost ground in mid Sept, based on the link between the NOK and MSCI since Jan 2020).
- 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 than the value of the remaining oil & gas reserves. Has the market 'finally' (and rather sudden) come to the same conclusion? We doubt. It's probably a "risk on, risk off" world, where many risky asses move in tandem, more than usually

SpareBank 1 MARKETS

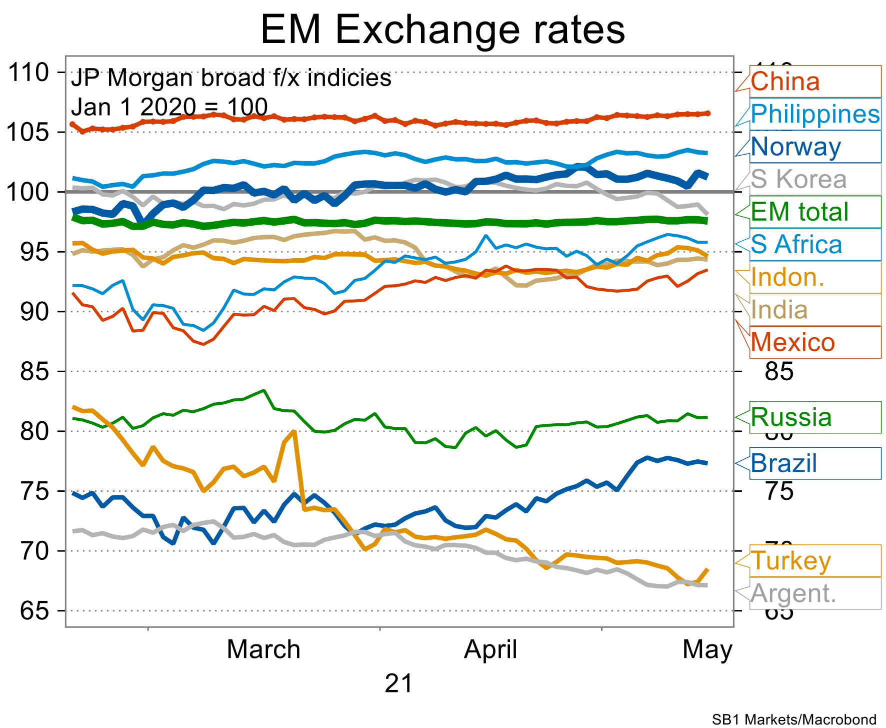
NOK still in tandem with the AUD – the AUD a tad stronger last week

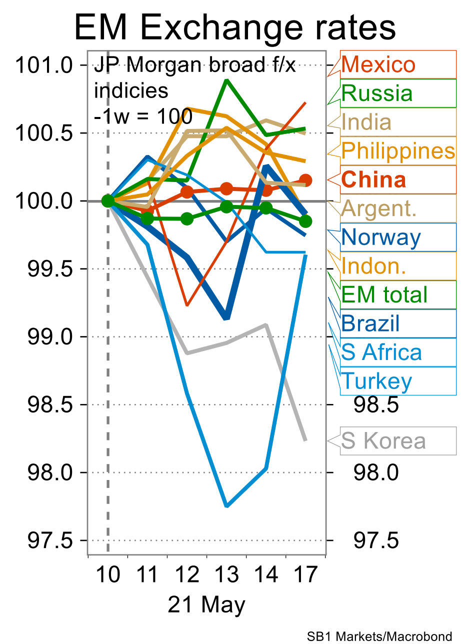
Both are up 13-15% since May 1 – but the NOK still 5% weaker than AUD since last spring

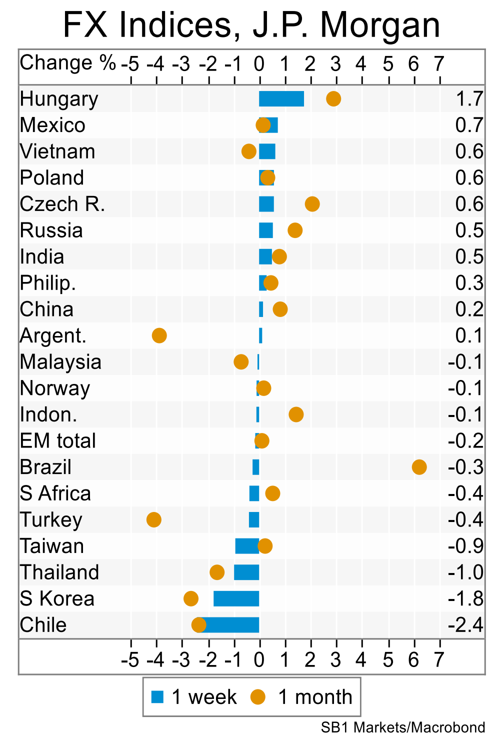


Quite stabile EM f/x markets last week

Turkey and Argentina are still the laggards







DISCLAIMER

SpareBank 1 Markets AS ("SB1 Markets")
This report originates from SB1 Markets' research department. SB1 Markets is a limited liability company subject to the supervision of The Financial Supervisory Authority of Norway (Finanstilsynet). SB1 Markets complies with the standards issued by the Norwegian Securities Dealers Association (VPFF) and the Norwegian Society of Financial Analysts. This message, and any attachment, contains confidential information and is intended only for the use of the individual it is addressed to, and not for publication or redistribution.

No investment recommendation
Any views and opinions relating to securities mentioned in this report should be interpreted as general market commentary, and not as investment recommendations within the meaning of Regulation (EU) No 596/2014 on market abuse (market abuse regulation**)** and associated rules, as implemented in the relevant jurisdictions.

No personal recommendation
The information contained in this publication is general and should not be construed as a personal recommendation within the meaning of the Norwegian Securities Trading Act, section 2-3 (4). It does not provide individually tailored investment advice regarding a particular financial situation, investment experience, risk profile or preferences of the persons who may receive this report. For tailored investment advice regarding stocks mentioned in this publication, please consult our brokerage desk or your individual investment advisor.

Research for the purposes of unbundling
This report is deemed to constitute a minor non-monetary benefit for the purposes of the inducement rules under MiFID II. The report is publicly available on our website (no log-in required).

Conflicts of interest
The authors of this report do not (alone or jointly with related persons) own securities issued by the companies mentioned in this report. SB1 Markets, affiliates and staff may perform services for, solicit business from, hold long or short positions in, or otherwise be interested in the investments (including derivatives) in any stock mentioned in this publication. To mitigate possible conflicts of interest and counter the abuse of confidential information and insider knowledge, SB1 Markets has set up effective information barriers between divisions in possession of material, non-public information and other divisions of the firm. Our research team is well versed in the handling of confidential information and unpublished research material, contact with other divisions, and restrictions on personal account dealing. The views expressed in this report accurately reflect the analyst's personal views about the companies and the securities that are subject of the report, and no part of the research analyst's compensation is related to the specific recommendations or views expressed in this report. Please refer to our webpage for an overview of all investment banking assignments carried out in the last 12 months: www.sb1markets.no. Note that assignments subject to confidentiality are excluded

Accuracy of sources
All opinions and statements in this publication are, regardless of source, given in good faith, and may only be valid as of the stated date of this publication and may be subject to change without notice. SB1 Markets has taken all reasonable steps to ensure that the information contained in this report is true and not misleading. Notwithstanding such efforts, we make no guarantee as to its accuracy or completeness.

Risk information
Return on investments is inherently exposed to risks. The value of an investment position may both rise and fall during the investment period. If the return on investments is positive at one time, there is no guarantee that it will remain such in future. In certain cases, losses may exceed the sum of the original investment.

Limitation of liability
Any use of information contained in this report is at your own individual risk. SB1 Markets assumes no liability for any losses caused by relaying on the information contained in this report, including investment decision taken on the basis of this report.

Limitation on distribution
This publication is not intended for, and must not be distributed to, individuals or entities in jurisdictions where such distribution is unlawful.