14 June 2021

Macro Weekly

Week 24/2021

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

Last week

The virus

- **Good news** from most corners of the world. However, the **UK reported a further steep rise** in new infections last week (R=1.4), and that the Indian (delta) variant has gained a large market share (90%). However hospitalisations are just slightly up, and even the delta variant may be manageable – in a country with the highest immunity rate, at some 70%. Further easing may be postponed
- **Mobility** is rising everywhere in DM as the negative drag from corona restrictions/cautious behaviour is easing

The economy, part I

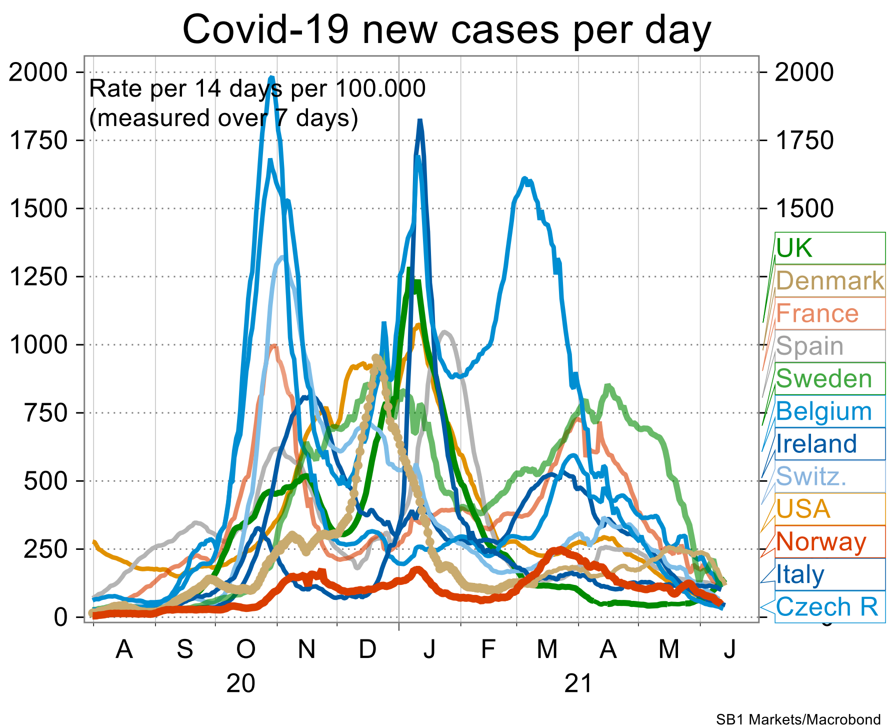
- **China**
  - **Credit growth** has slowed substantially recent months and the credit impulse has fallen well into negative territory, even if the m/m growth rose marginally in May. The authorities have deliberately tightened credit policy and growth in credit outside banks has slowed to a trickle. After a while, the impact is usually felt, both in the real economy and in raw material markets
- **US**
  - **Inflation** once more accelerated more than expected, to 5% for the headline CPI and 3.8% for the core index, the highest in 12 and 29 years respectively. Prices rose a tad slower m/m than in April but still far faster than normal. There are some 'excuses' as energy and transport (incl. used autos) contributed by 3.1 pp of the 5% headline print. However, price increases are broadening somewhat and demand may be strong the coming months and SMBs reported sky high price plans in their May survey. Anyway, Fed has reached its price level target (or 2% price growth over time) – but will not acknowledge that the employment target is met
  - … even if the number of **vacant jobs** soared further to a record high level in April amid still very low employment rates and a higher unemployment rate than during booming times. During the next weeks and few months we should get an answer to this incredible important conundrum. How many million workers that are not employed today are able or willing to fill the vacant jobs when the corona virus retreats further, and extraordinary unemployment benefits are abolished? The extra benefits run until September, but 25 states have decided or will likely decide to opt out before that. The first 4 ended these benefits on Saturday. ***The outcome will reveal the growth potential in the US economy, decide Fed's policy, yields & equity markets more any other 'single' factor we have seen over the past decades!***
  - **Markets greeted** the larger than expected jump in inflation and in unfilled vacancies by sending bond yields sharply down, and equities up to all time high!
  - **The trade deficit** fell in April, due to a decline in imports – following a much larger increase in March. At one stage (and quite soon we think), demand for goods in the US will slow, and imports will follow suit - but it has not happened yet. Exports recovered in April but remains below par
  - The **budget deficit** fell in May due to some technicalities and the underlying deficit remains large. However, it has most likely peaked, even if downscaled but not properly funded (it seems like) infrastructure & family programs should be decided

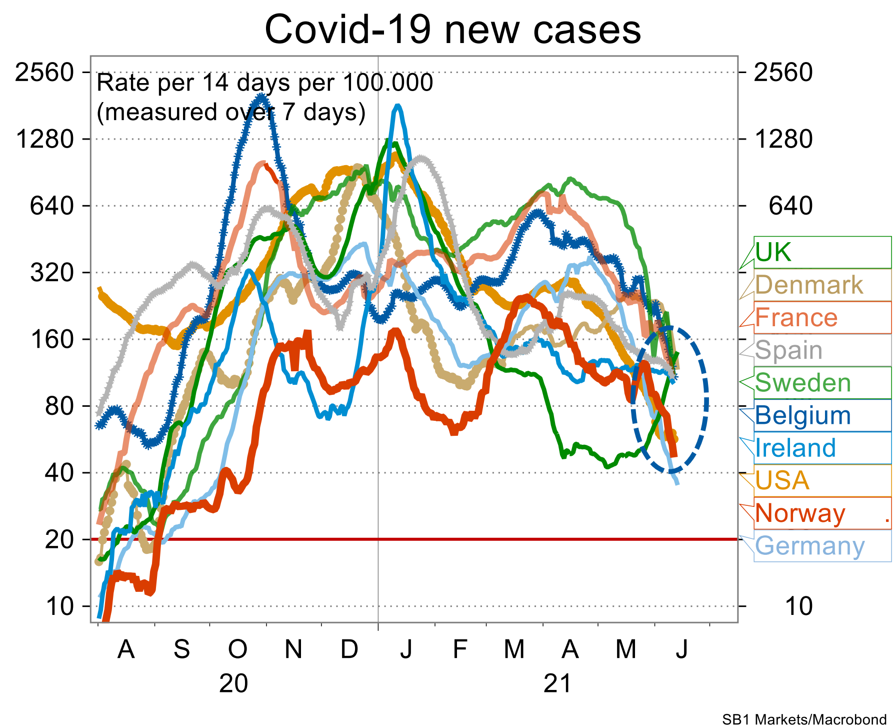
Last week: The economy, part II

- **EMU**
  - » **ECB** revised its March GDP growth forecast substantially upwards but kept policy unchanged – and did not signal that a change of tack is imminent
  - » **GDP** fell 'just' 0.3% in Q1, and not 0.6% due to a decline in private consumption. Business investments rose and is almost back to a pre-pandemic level. Net exports rose in Q1 but is still down vs Q4-19. GDP is 5.1% below the Q4-19 level
  - » **Industrial production** rose sharply in Italy and Spain, and production in the Euro Area probably rose in April even if Germany and France both surprised on the downside. All surveys are signalling strong growth - and orders are surging. Lack of components, and weak consumption of goods in the first tertial in Europe probably explain the discrepancy
- **UK**
  - » **GDP** grew 2.3% m/min April, as services came (partly) back to life. GDP is now 'just' 3.8% below the pre-pandemic level. In Q1, GDP was 8.8% below!
- **Norway**
  - » **Norges Bank's Regional Network** signals strong growth ahead but (at least) formally the Network signal a slower recovery than Norges Bank (and we) expect. All sectors and regions expect higher growth the coming months. Households services in the lead, for good reasons. Capacity utilisation & reported labour shortages are at average levels, even if all other measures of the output gap is well below zero. Expected wage inflation revised sharply up, by 0.4 pp to 2.7%. Businesses report higher prices for sales to other businesses but not to households
  - » **Mainland GDP** rose by 0.3% in April, as we expected (consensus 0.2%). GDP is still a tad weaker than NoBa assumed in June. Excluding electricity production, GDP was probably close to flat. May and even more June will be much better!
  - » **Inflation** is not on the way up everywhere, the **CPI-ATE core** index fell by 0.5 pp y/y, to 1.5%, expected unch. or 0.1 pp down. Furniture prices fell sharply, food prices were lower than we expected too – and they are flat y/y – and recreation was om the downside too. None surprised much on the upside. A stronger NOK has put a lid on import prices, and global raw material prices are not yet 'visible' in the Norwegian CPI
  - » **Unemployment** fell further last week

UK from the bottom of the rich man's league to the top, in 3 weeks

The level is still low as new cases in all others have fallen sharply. And no hospital problem either

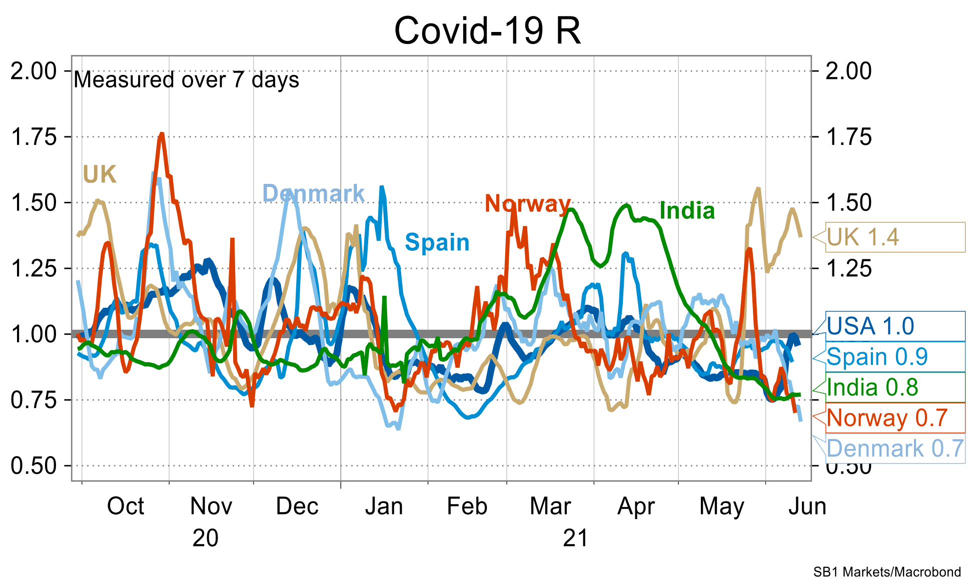


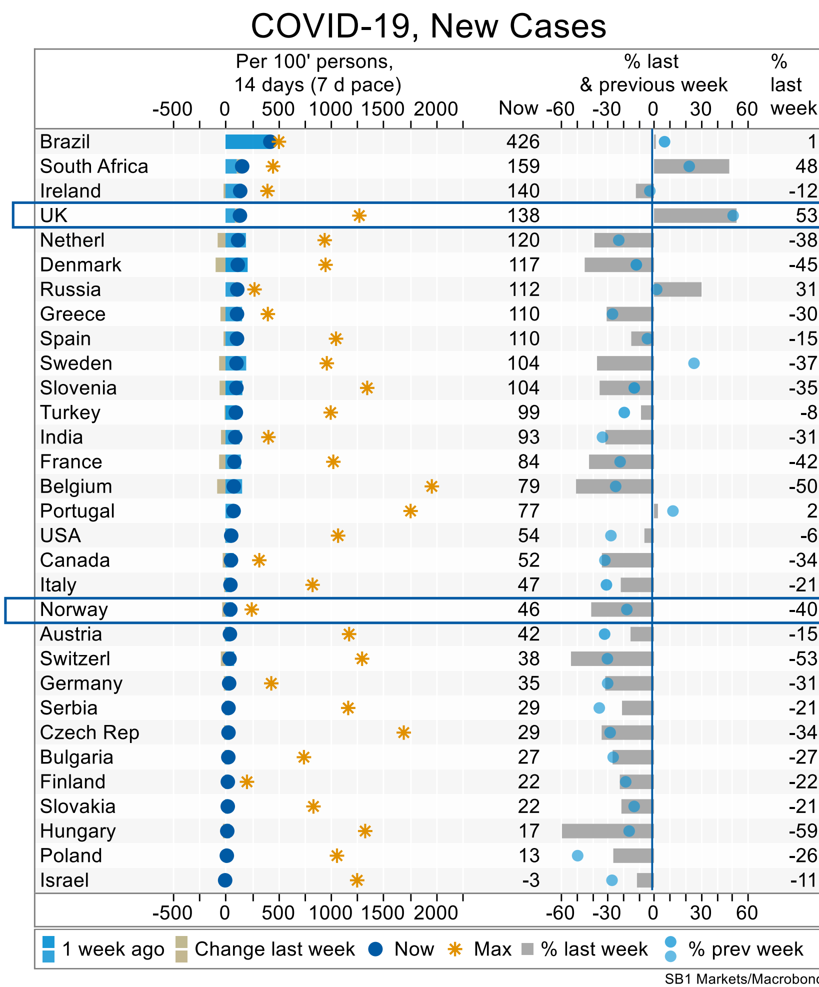


- **The UK** has reported a sharp increase in new infections, at least partly due to the new Indian mutant, which in some few weeks has gained a 90% 'market share'. The new variant is far more contagious (some now say 60%) than the British variant (which was substantially more contagious than the original corona virus). We estimate that almost 70% of the total British population is vaccinated or have been infected (the highest level in a major country) – but the virus is still able to spread at R=1.4 pace.
  - » Still, the UK infection level is still low, just 12% of the January peak, and hospital occupancy is at 2% of the peak level (and is rising just very slowly)
- **The US & Germany** are reporting very few new cases
- The no. of new cases in **Norway** is heading very rapidly down again
- The **hospital occupancy** has fallen even more than cases everywhere, while **deaths** have fallen even more than hospitalisations

UK has moved rapidly towards the top of the list

South Africa, Brazil at the top of the list. India is falling rapidly, cases down some 75% from the peak





Country	Now	% last week
Brazil	426	1
South Africa	159	48
Ireland	140	-12
UK	138	53
Netherl	120	-38
Denmark	117	-45
Russia	112	31
Greece	110	-30
Spain	110	-15
Sweden	104	-37
Slovenia	104	-35
Turkey	99	-8
India	93	-31
France	84	-42
Belgium	79	-50
Portugal	77	2
USA	54	-6
Canada	52	-34
Italy	47	-21
Norway	46	-40
Austria	42	-15
Switzerl	38	-53
Germany	35	-31
Serbia	29	-21
Czech Rep	29	-34
Bulgaria	27	-27
Finland	22	-22
Slovakia	22	-21
Hungary	17	-59
Poland	13	-26
Israel	-3	-11

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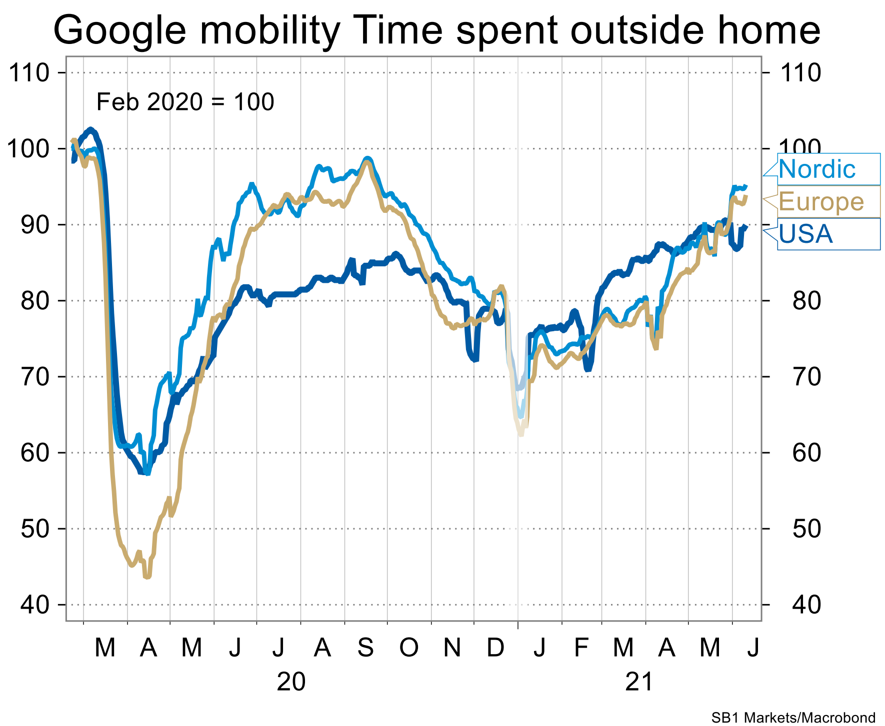
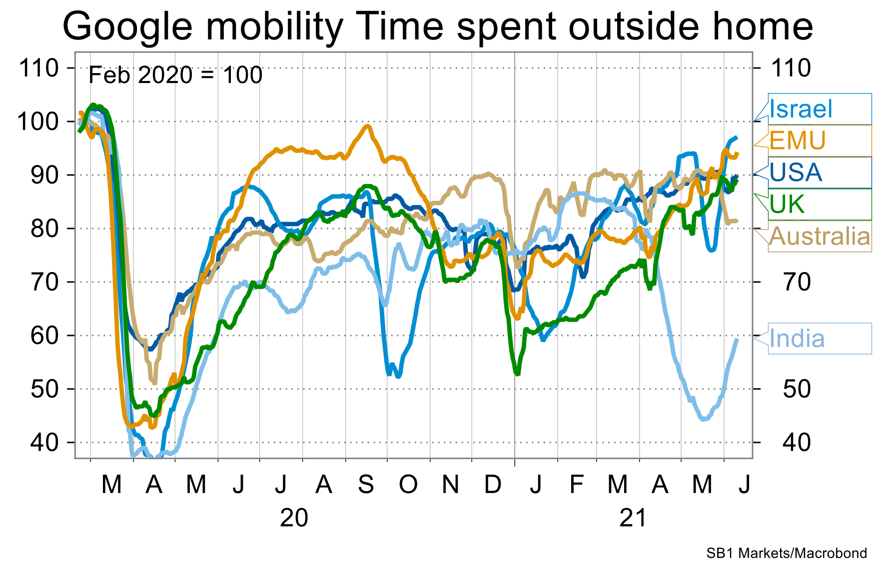
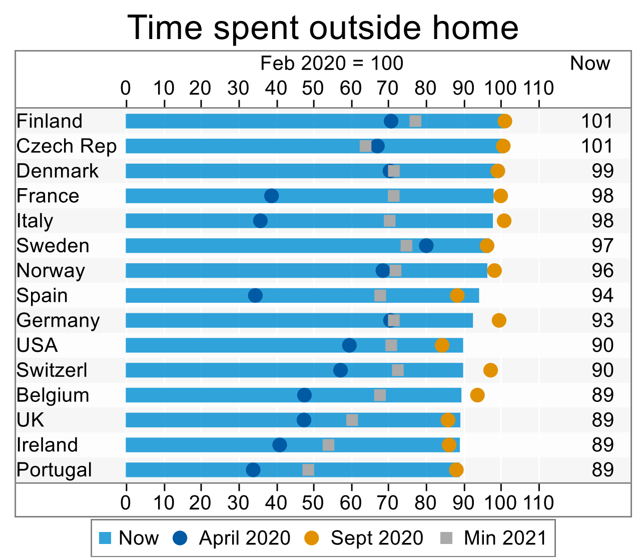
Mobility on the way back to a normal level – sharply up in Europe (Nordics incl.)

Even India turned up in the past two weeks



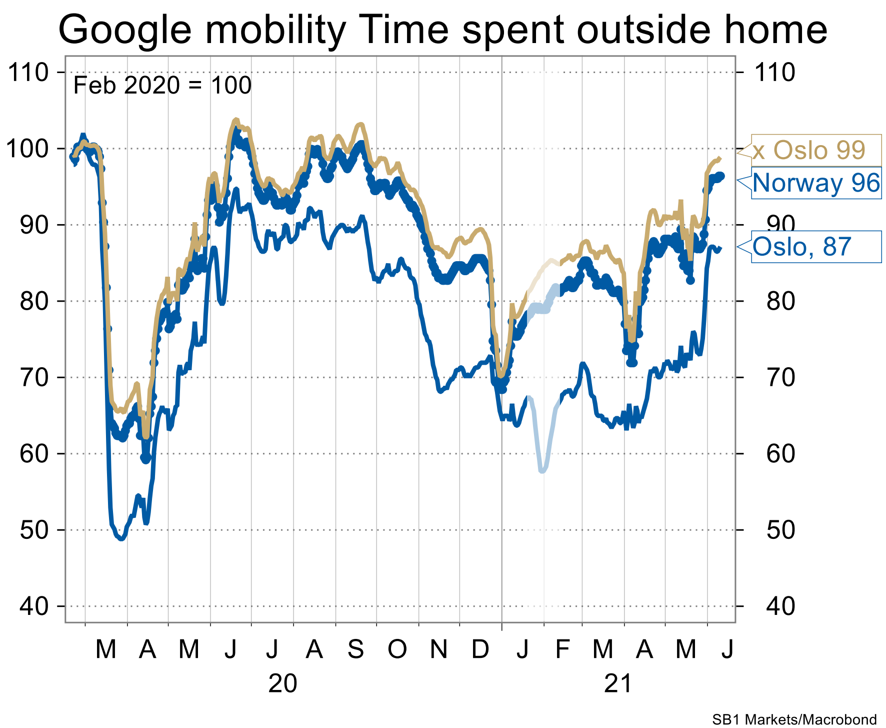


- Mobility still some 5% - 10% below par – still more some upside left



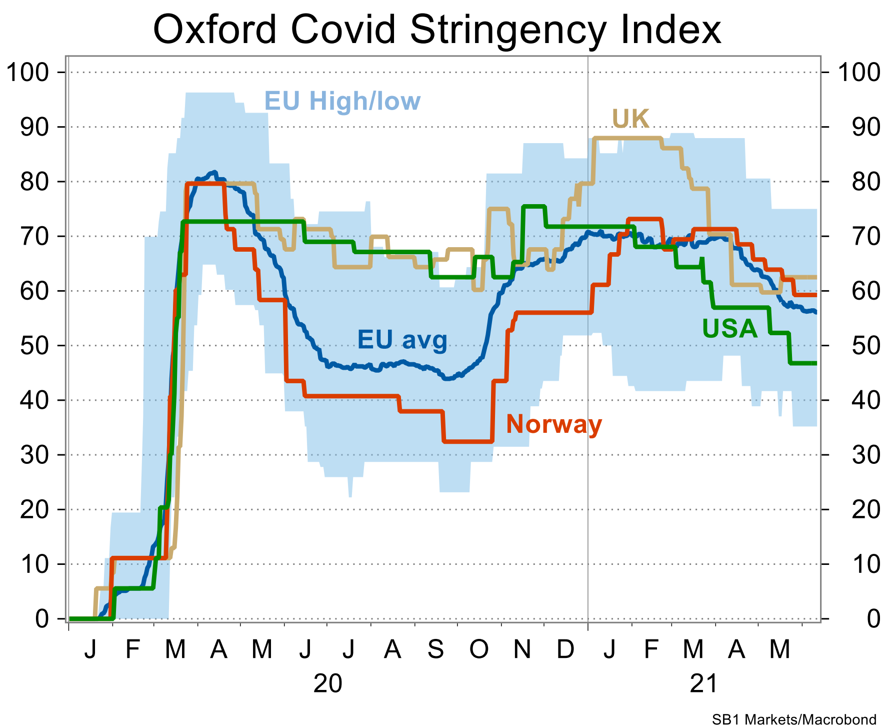
The weather, eased restrictions, or lack of fear for the virus?

Norwegian mobility sharply up



Restrictions are eased but most are still in place

Some may have small economic costs, others may be more expensive



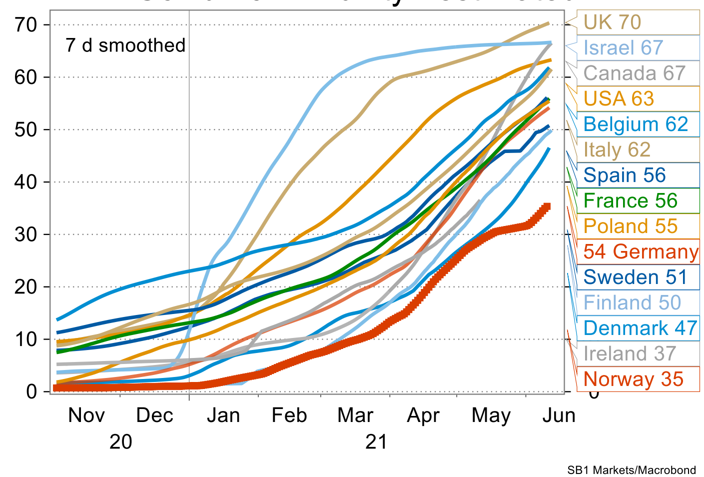
- The removal of restrictions are quite parallel among rich countries – but the UK has tightened marginally amid the 'delta' attack
- The remaining measures will be eased when the immunity rate is sufficiently lifted to keep even mutated viruses at bay

- Data are from the Oxford Covid stringency project, that at least are the best at hand

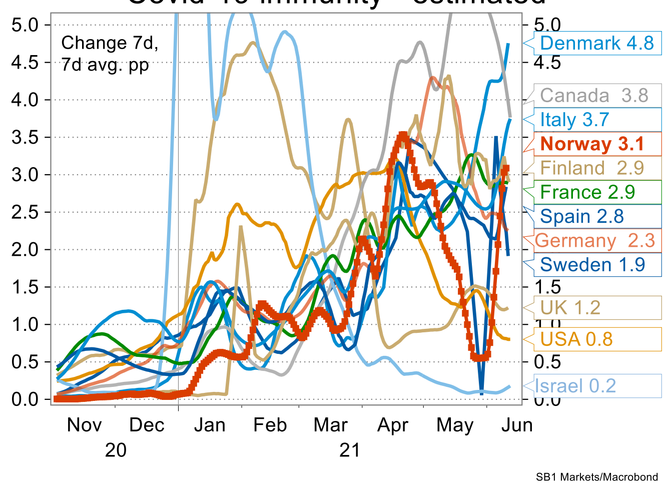
Vaccinations: Ups & downs, but the direction in EU/Norway is up

Few 1st dose vaccinations in Norway due to public holidays and more 2nd doses. Will soon change

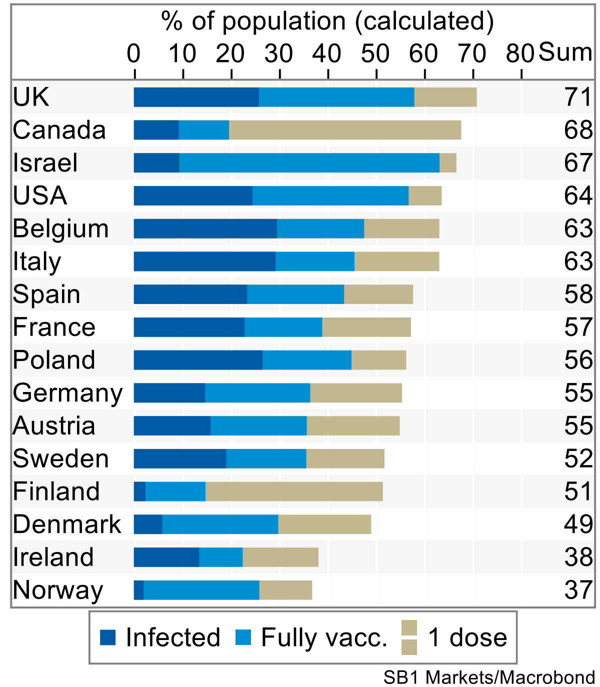
Covid-19 immunity - estimated



Covid-19 immunity - estimated

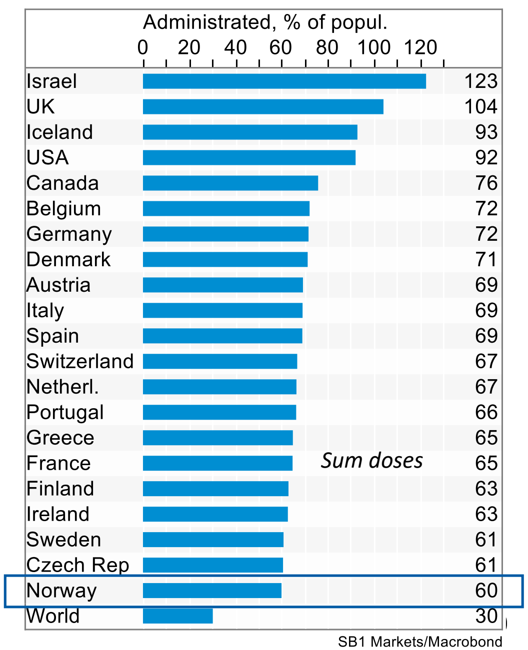


Covid-19 Immunity



- Norway is not using AstraZeneca nor Johnson & Johnson vaccines and is now a laggard in Europe vs. total no. of doses – and the gap will widen

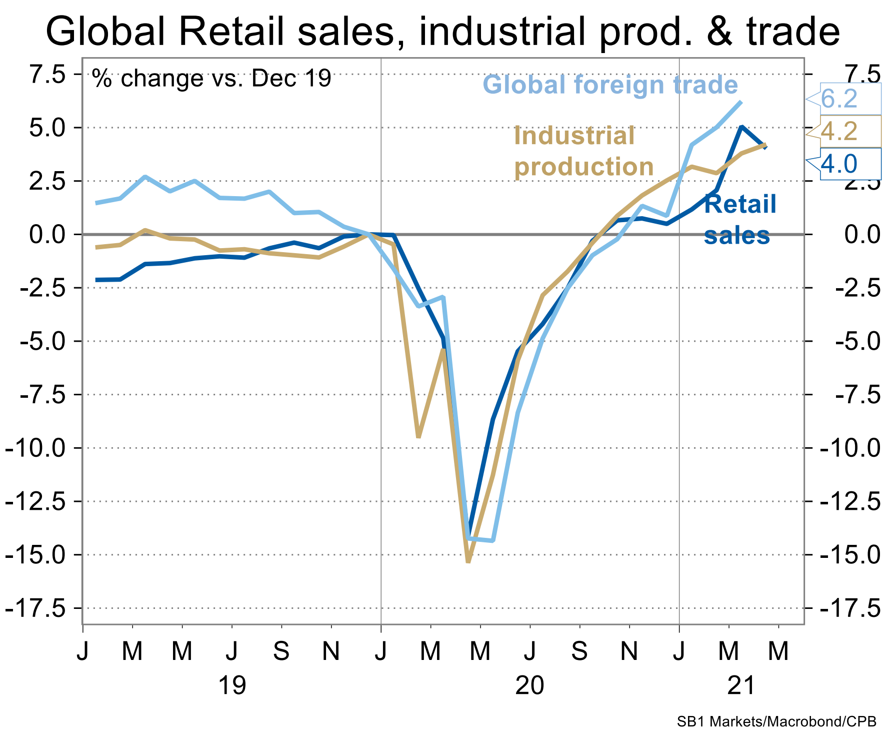
Covid-19 Vaccinations

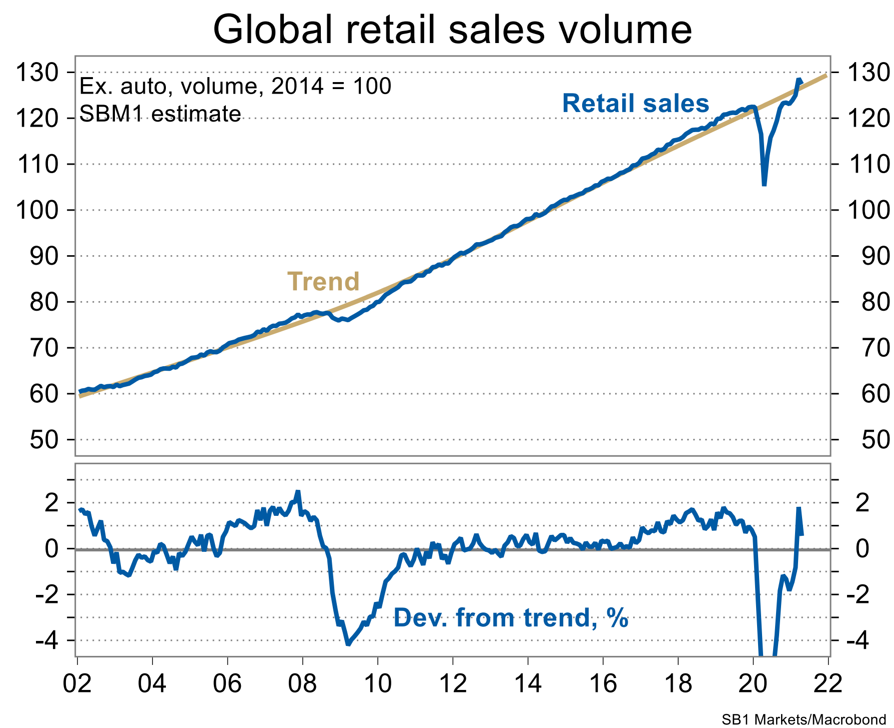


We calculate the infected rate by assuming a 0.66% infection fatality rate, and a 90% immunity from infection.
We assume those who have been infected are vaccinated in line with others

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

Retail sales may have fallen in April, due to EMU & India. Still the trend is up

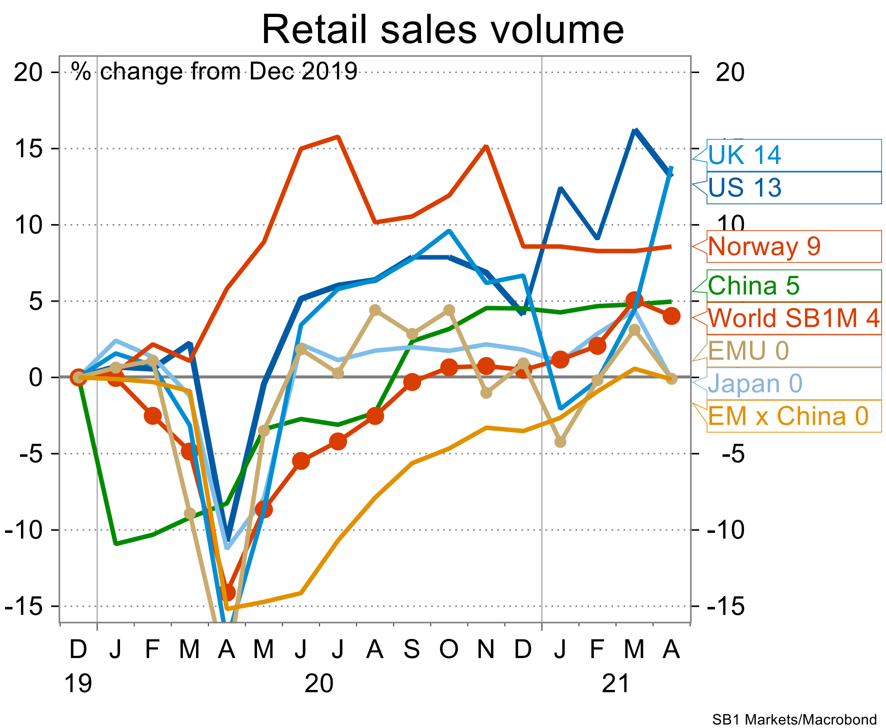


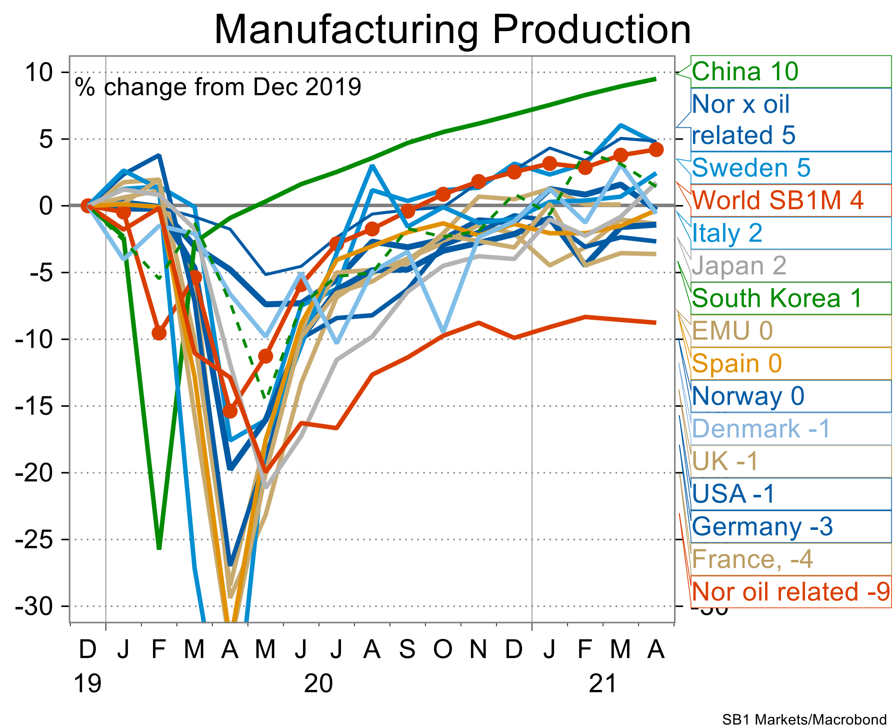


- **Retail sales** rose almost 3% in March, mostly due to the lift in US and partly also EMU retail sales. Our April estimate implies a 1%+ decline, due to lower sales in the US and (more than we assumed) in EMU, and very likely in India. Global sales are almost 4% above the pre-pandemic level
- **Manufacturing production** rose more than 1% in March, and another 0.4% in April – and is +4.1% vs Dec-19
- **Global foreign trade** rose further in March, to 6% above pre Covid, according to CBP in Netherlands – and the trend is straight upwards

Volatile retail trade data, but the trend is up

Sales down in US & EMU in April, in the US from a high level. Manufacturing steadily on the way up

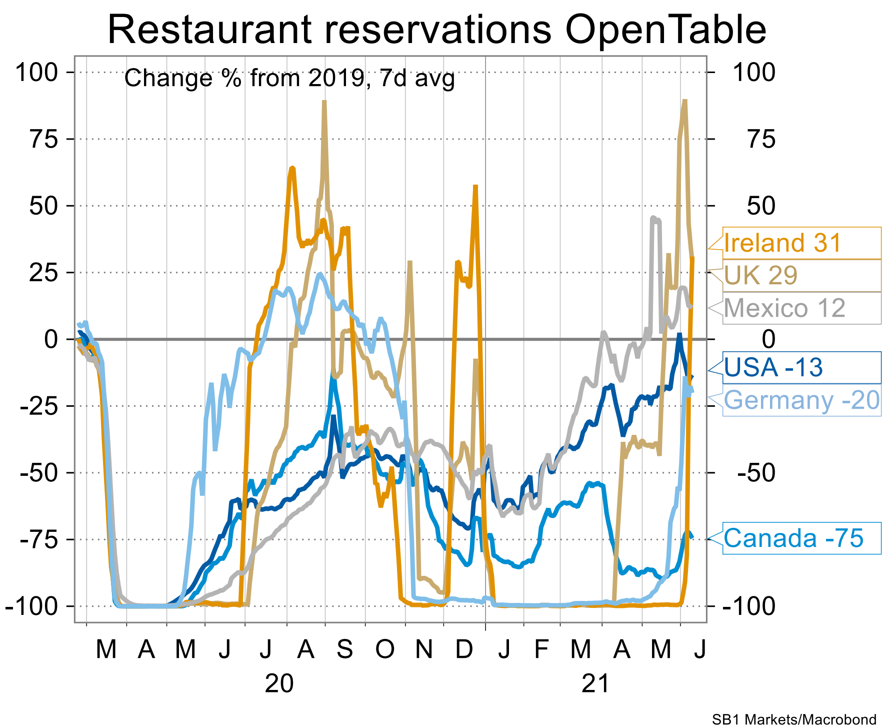


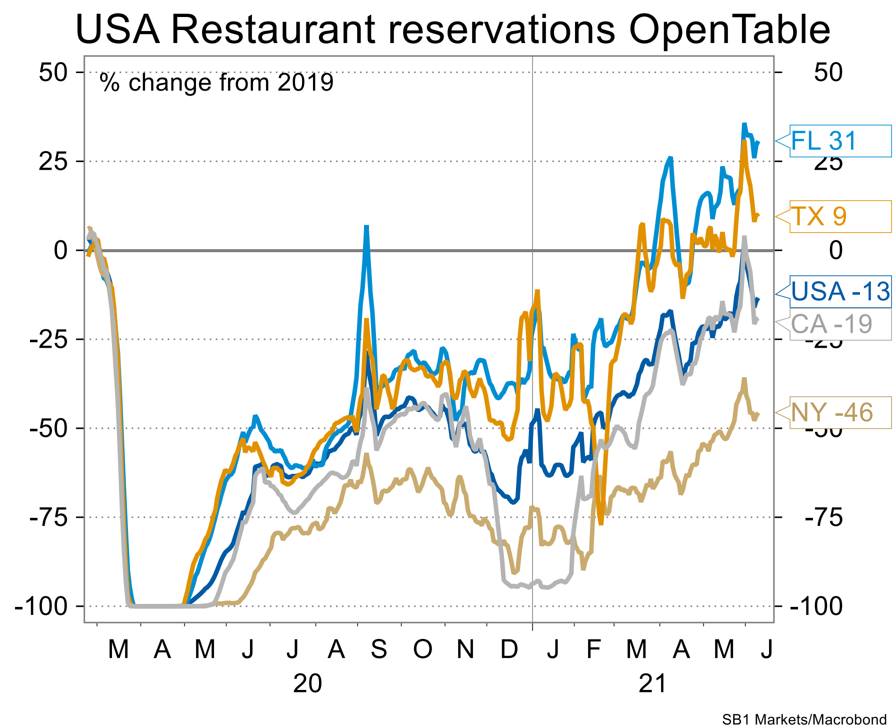


- Global manufacturing production grew some 1% in March, and probably slightly less in April
- Retail sales rose much more in March (2.6%, due to large gains in the US, EMU) but may likely have fallen in April, due to (expected) declines in EMU and India – and an actual decline in US

Here we go, German restaurants opened up too! And the Irish

The Brits seem to have become rather outgoing. The US not far below normal





- Sales in restaurants in the US were down 2% in April vs. the Feb-20 level, far better than indicated by OpenTable data

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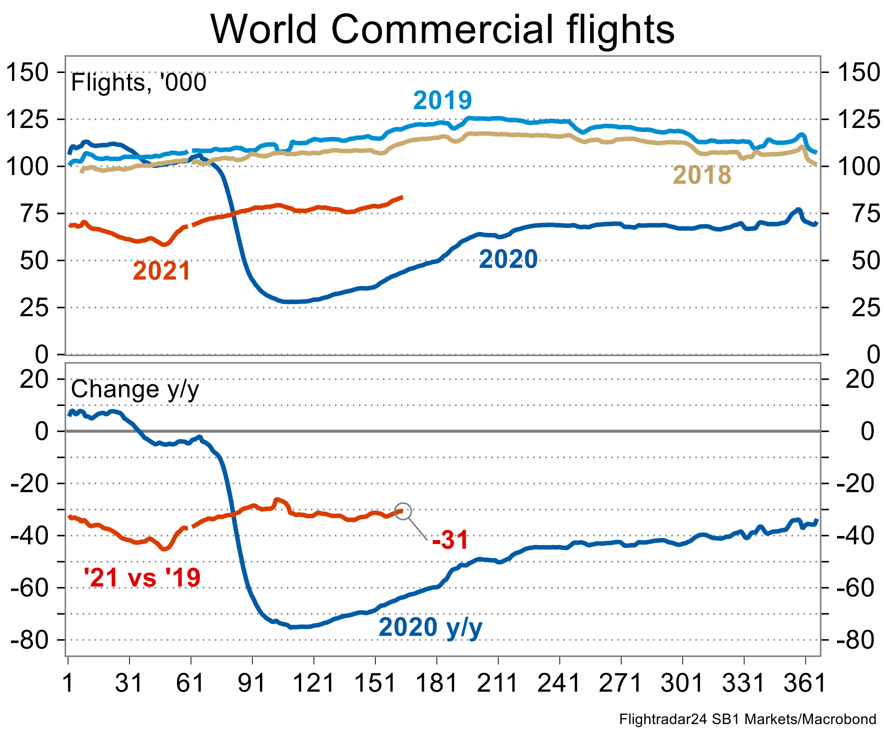
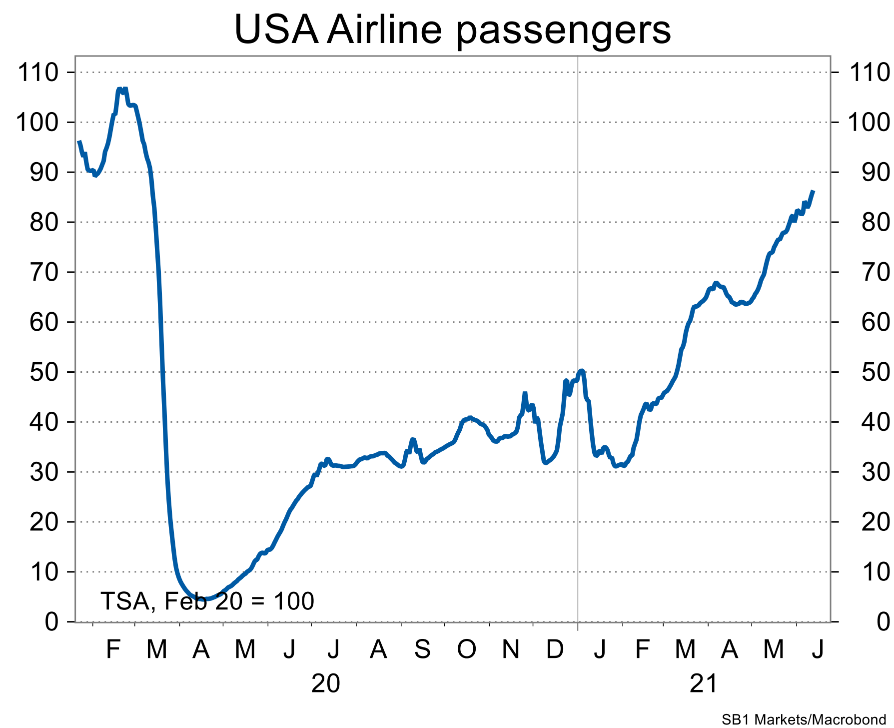
Global airline traffic on the way up again? US straight up

... and just 13% below par, even if international traffic is still in the doldrums





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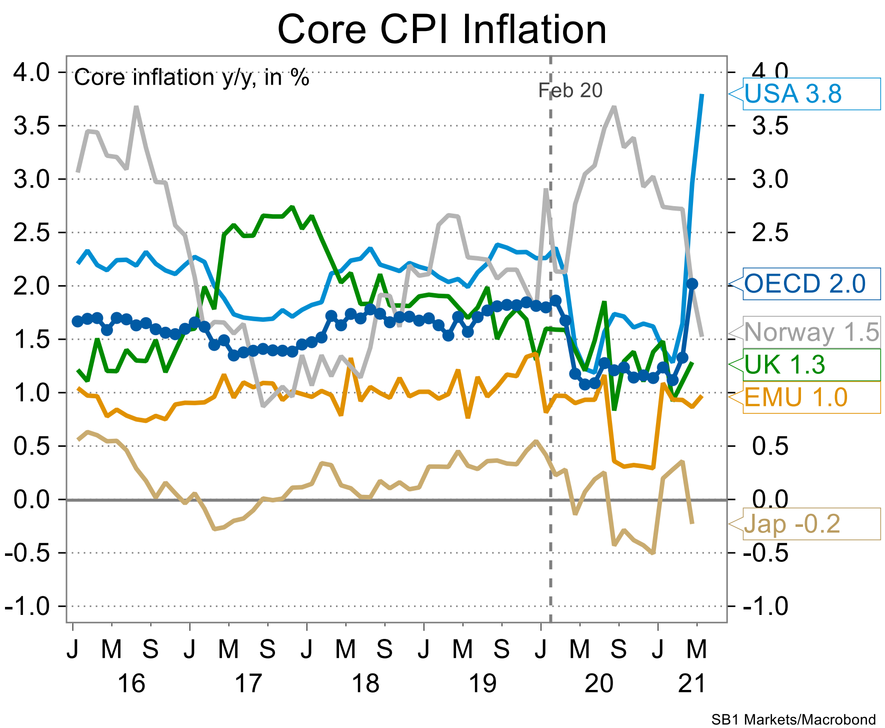
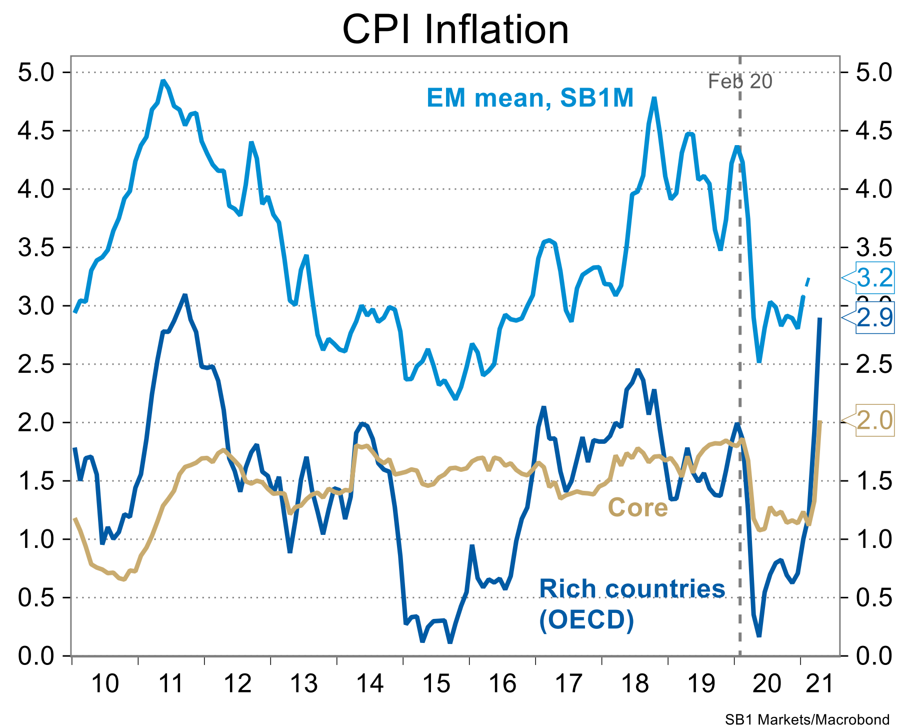
Inflation is on the way up, some places – and on average

Energy prices the main culprit, core inflation not much up outside the US (so far)

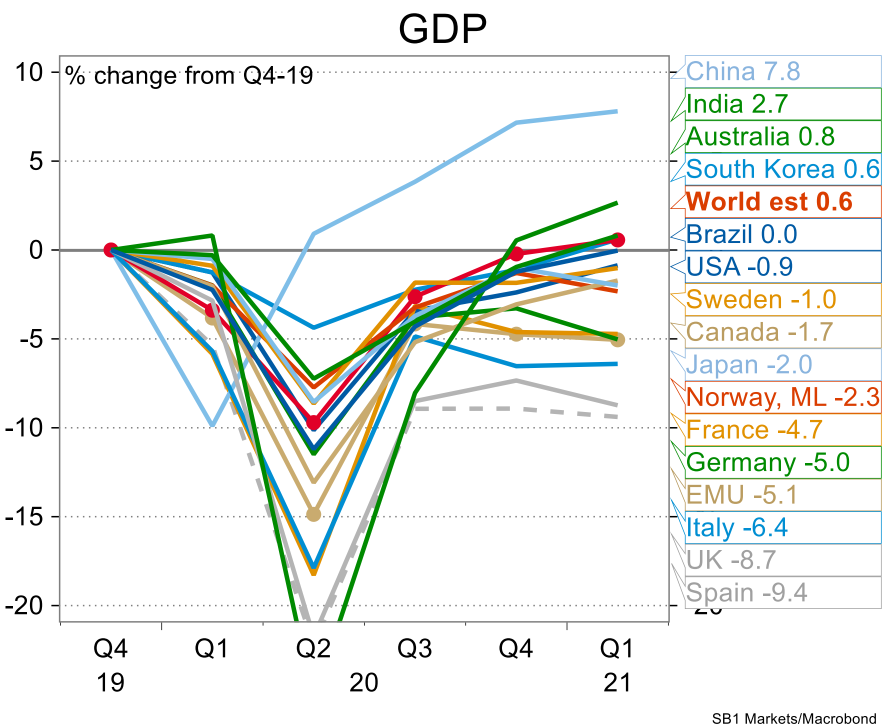


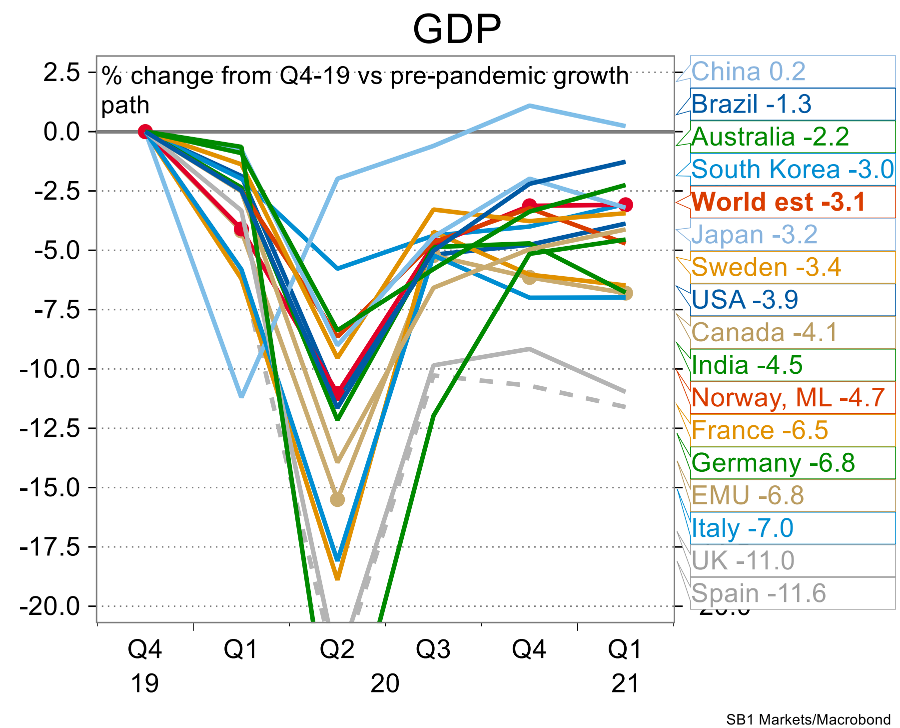


- The OECD data is updated through April. A further substantial lift in May, due to the acceleration in US inflation

A 3%+ global GDP growth pace in Q1, level 0.6% above Q4-19

China in the lead, India follows, at least in Q1, and measured absolutely





- Following an 8% growth pace in Q4, we estimate 3.2% growth through Q1 (0.8% 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
  - UK was 8.7% below in Q4-19 in Q1, but just 3.8% below in April!
  - **India, Brazil & Russia** all grew more than expected in Q1
  - **Sweden** was just 1% below the Q4-19 level, Norway was 2.3% below, in Q1
- When measured vs. the pre-pandemic trend growth path, China is the only country above – all others are below
  - **The global economy** is 3.1% below the pre-pandemic growth path – and the negative output gap is substantial
  - **The US** is 3.9% below, **EMU** 6.8%, and **UK** 11%
  - **India** is 4.5% below
  - **Sweden** is down 3.4%, **Norway** is down 4.7%, due to the different response to the 2nd wave (by Q4, the positions were the opposite)

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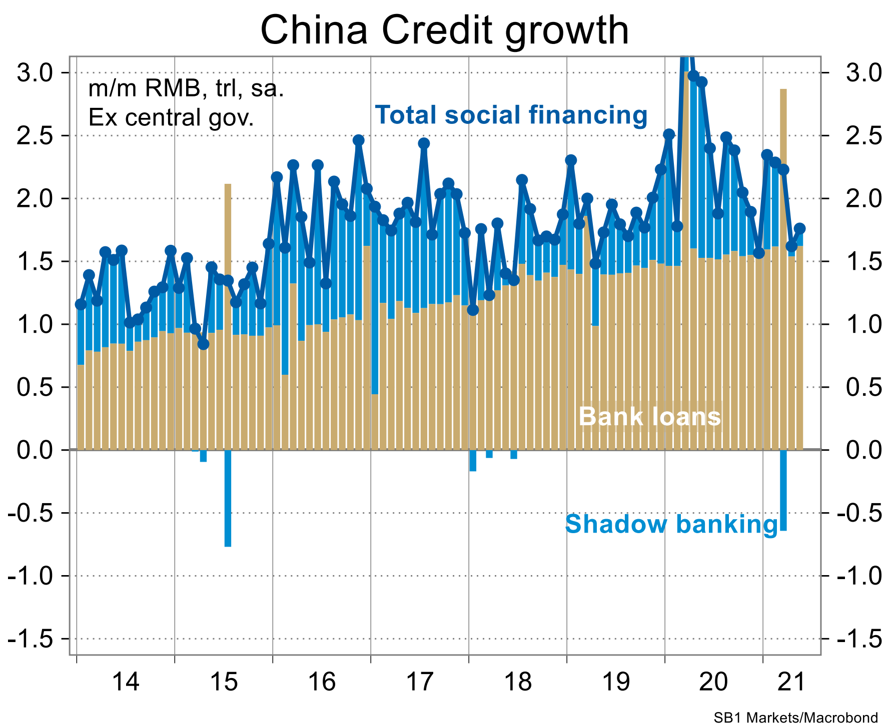
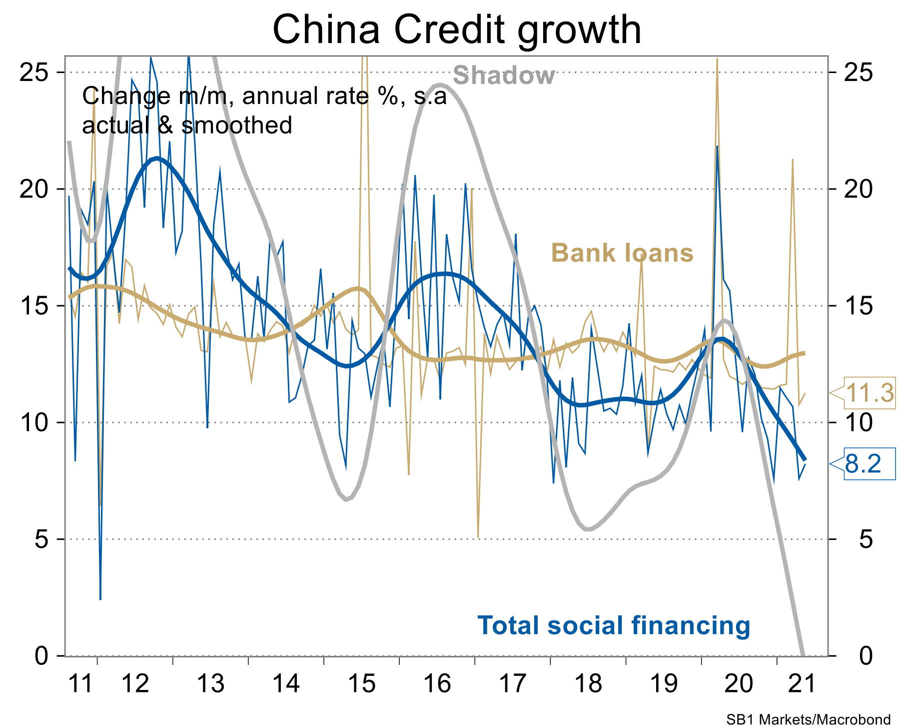
Credit growth slightly up in May but the credit cycle is tightening

Bank lending is keeping up but other credit channels are drying up, by purpose

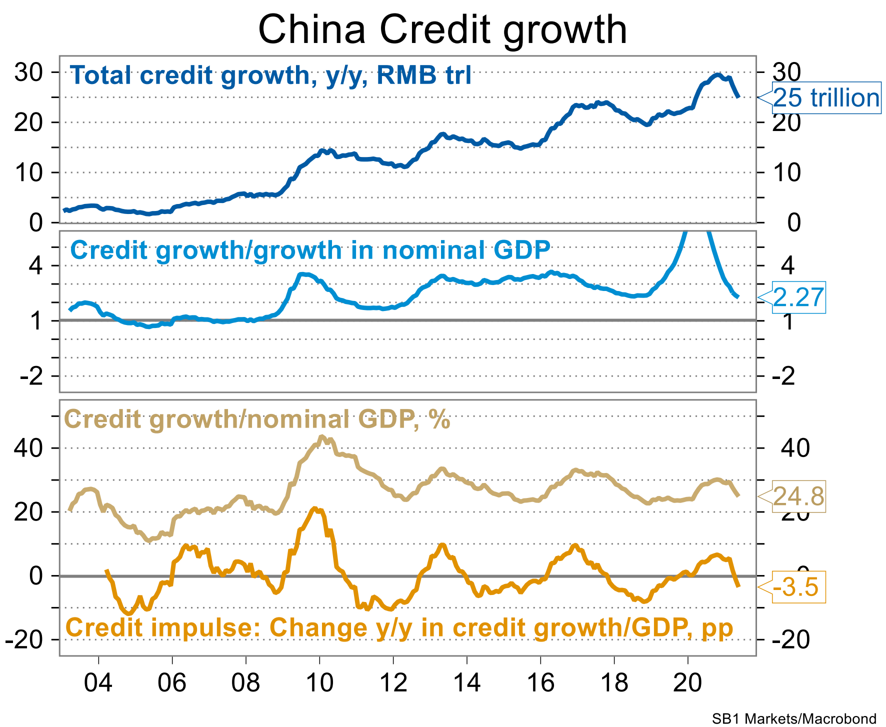


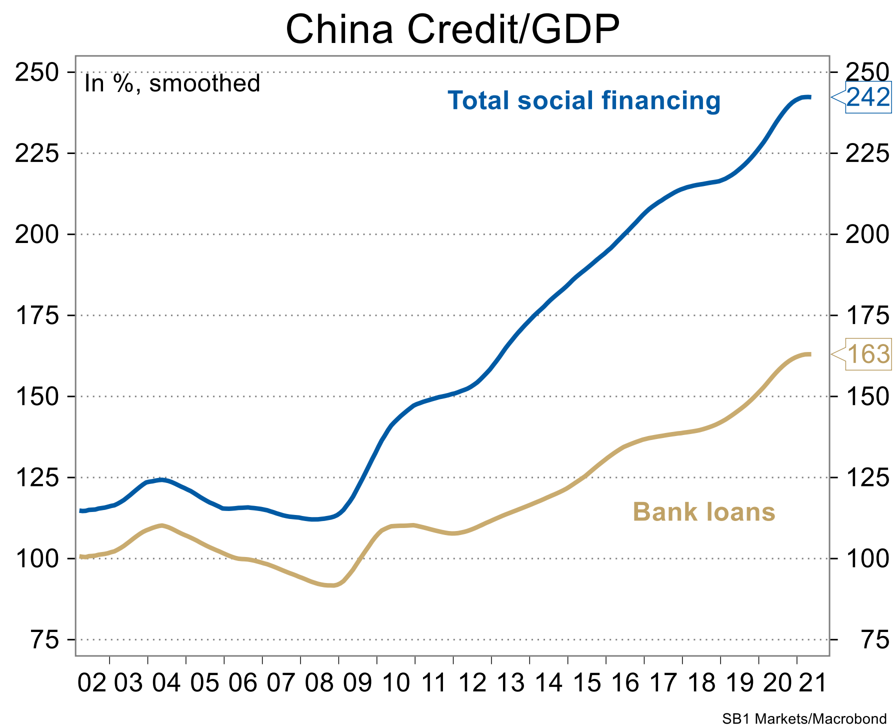


- **Total credit** grew at an 8.2% rate in May (m/m, annualised), up from 7.5% in April. Smoothed, the underlying rate may be 8%-9%, down from 13% during last spring (and >15% during some months). An 8% - 9% growth rate is close to the trend growth in nominal GDP
  - **Total credit** rose by RMB 1.9 trl, expected 2 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 1.76 trl, up from 1.62 trl in April
  - **Bank loans** rose by RMB 1.62 trl, both actual & seas adjusted. Bank loans are up 11% y/y
  - **Shadow banking credit** was marginally up (0.14 trl) in May, following no growth in April, and a decline in March. Underlying growth has fallen sharply
- **The Chinese authorities** have signalled that credit growth outside banks should slow, and it has been growing slower than bank credit since early 2018. The contraction in shadow banking credit over the past year equals 5% of total credit
- **The credit impulse has turned negative**, like it usually do every 4th year or so. The ramification may be felt in many markets

The credit impulse has turned negative

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



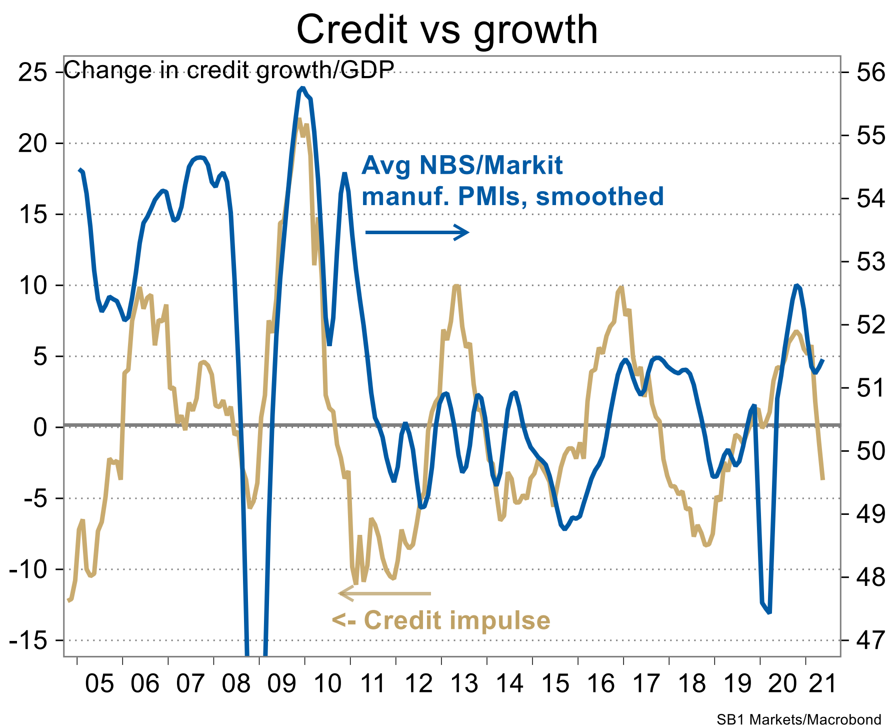


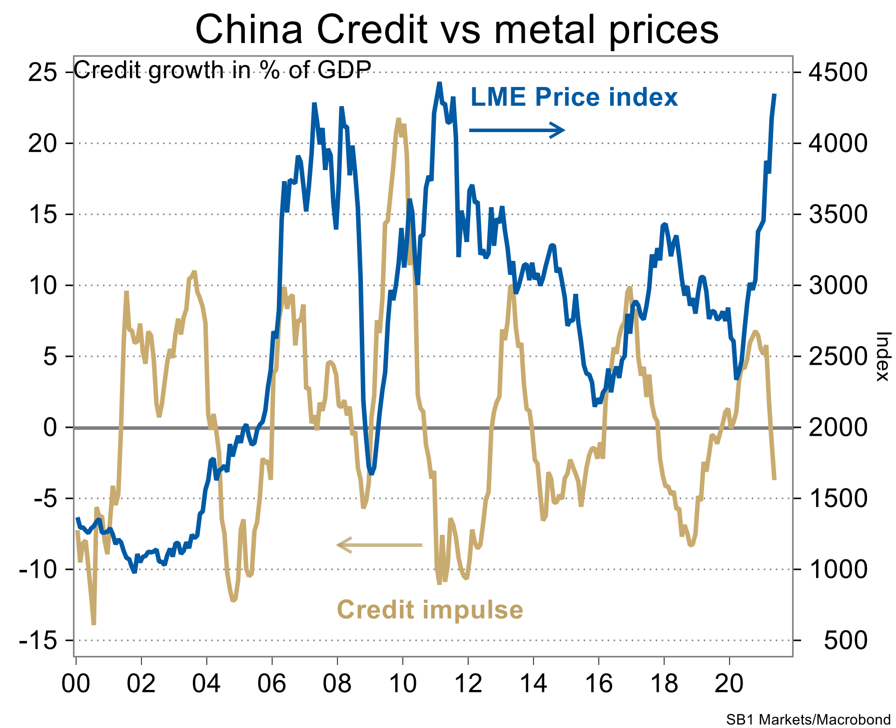
- A positive **credit impulse** implies that the credit growth/GDP ratio is increasing (the 2nd derivative of credit vs the GDP level)
  - » A negative credit impulse indicates credit tightening (or weaker demand) and has been associated with slowdowns in the Chinese economy, which have had impacts at other markets
- The credit impulse bottomed in late 2018, turned positive one year later, peaked last autumn and has now – and has now fallen into negative territory – growth in credit is slowing

GDP is smoothed at the calculations on the charts above

Credit impulse vs. PMI, metals prices

Correlations are not tight but a tighter Chinese credit market tends to lead Chinese PMIs…

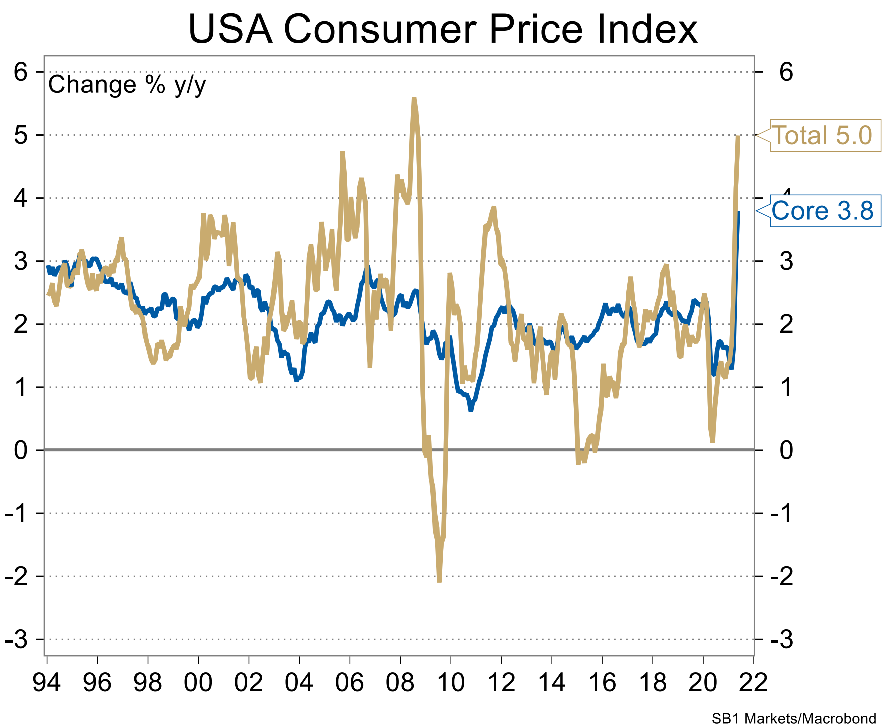


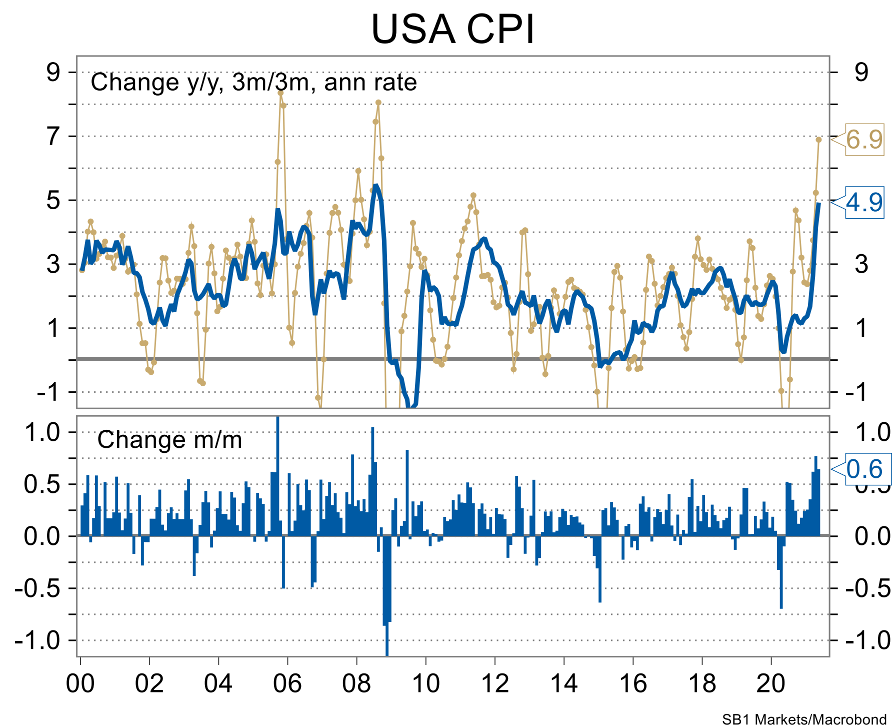


- ... by some few months
- And global metal prices (here the LME metal index) by several months, on average

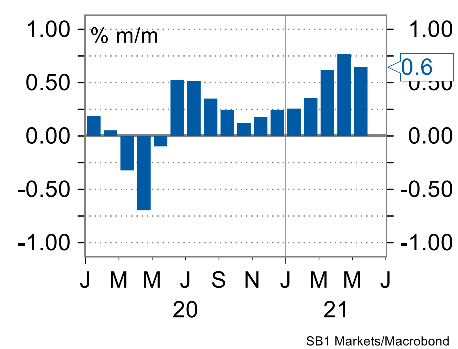
Dear Fed, we need to talk – or rather <u>you</u> need have the talk…

Of course, it could be transitory…





- **Headline CPI** rose 0.6% m/m in May, expected 0.4%. The annual rate climbed by 0.8 pp to 5.0%. So, it's not all base effects, as prices fell by 'only' 0.1% last May. <u>This is the highest headline CPI print y/y since 2009</u>
- **Prices have been accelerating** m/m since last October, and the 3m/3m rate is now up to 6.9%, highest since 2009
- In May surveys, companies reported that they expect to lift prices sharply. We doubt all these planned price hikes are competed
- **The annual rate** may come down over the summer as prices rose sharply m/m (0.5 pp) in both June & July <u>last year</u>
- **The Federal Reserve** can still afford to wait and see, but the 2% average inflation 'over time' (or the price level target) 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 <u>May Be</u> A'Changin', Jerome



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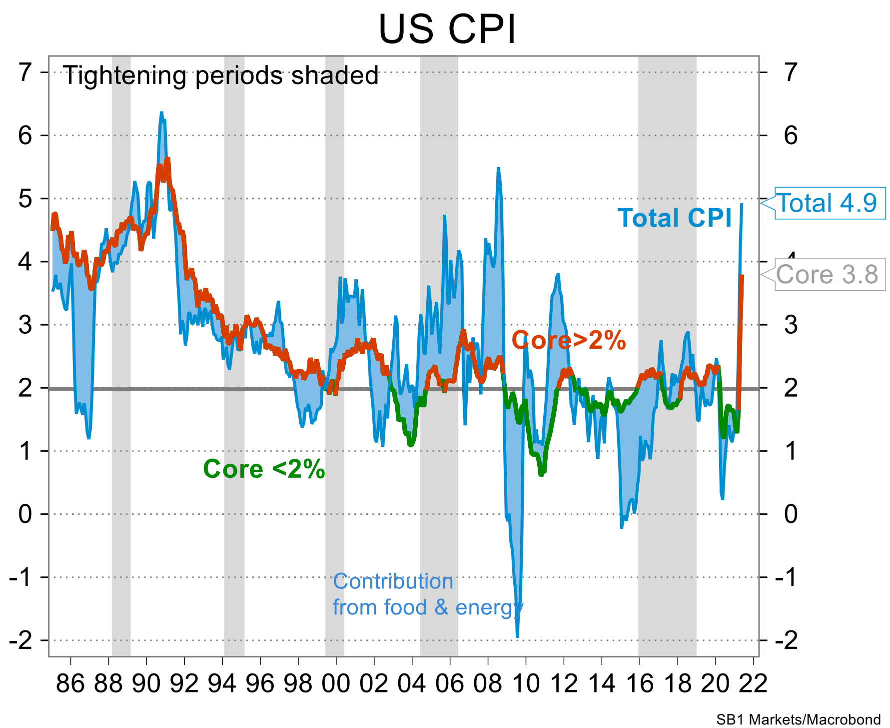
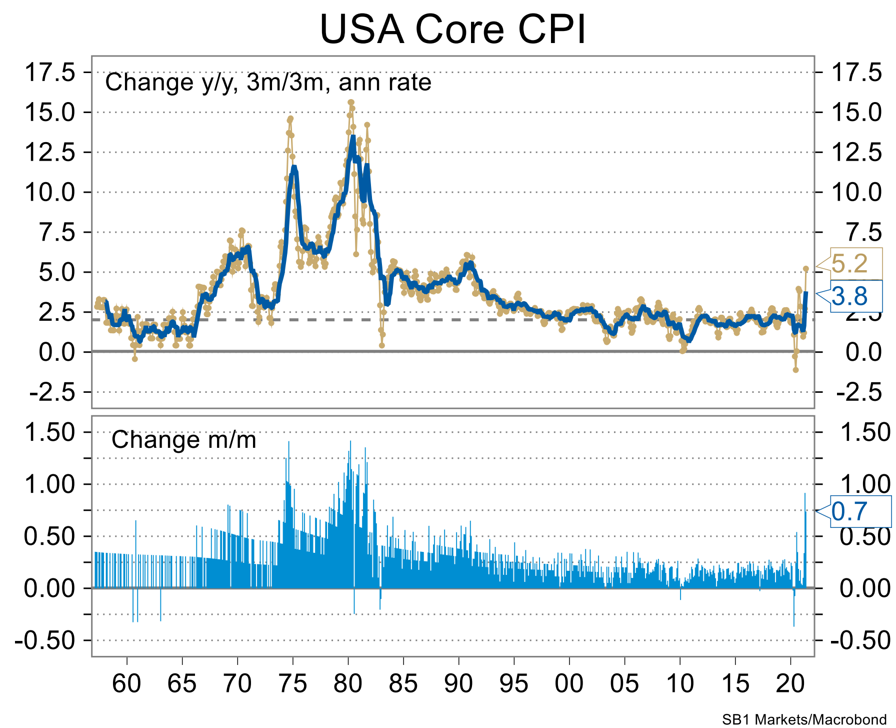
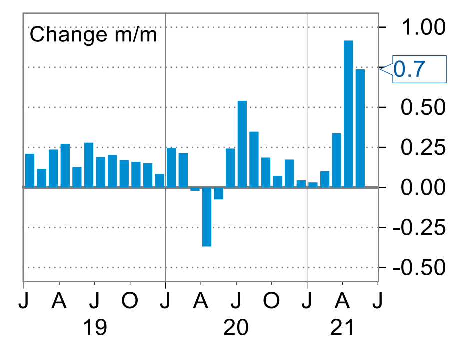
Core inflation sharply up too, the annual rate the highest in almost 30 years

Prices +0.7% m/m in May, expected 0.4%, the y/y rate jumped 0.8 pp to 3.8%. The 2 y avg at 2.5%



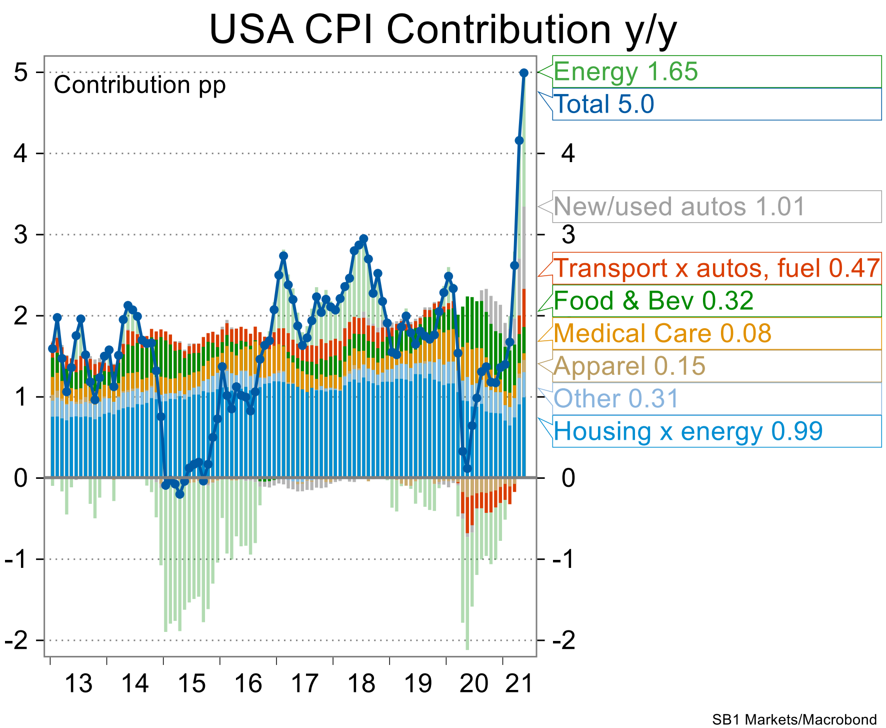


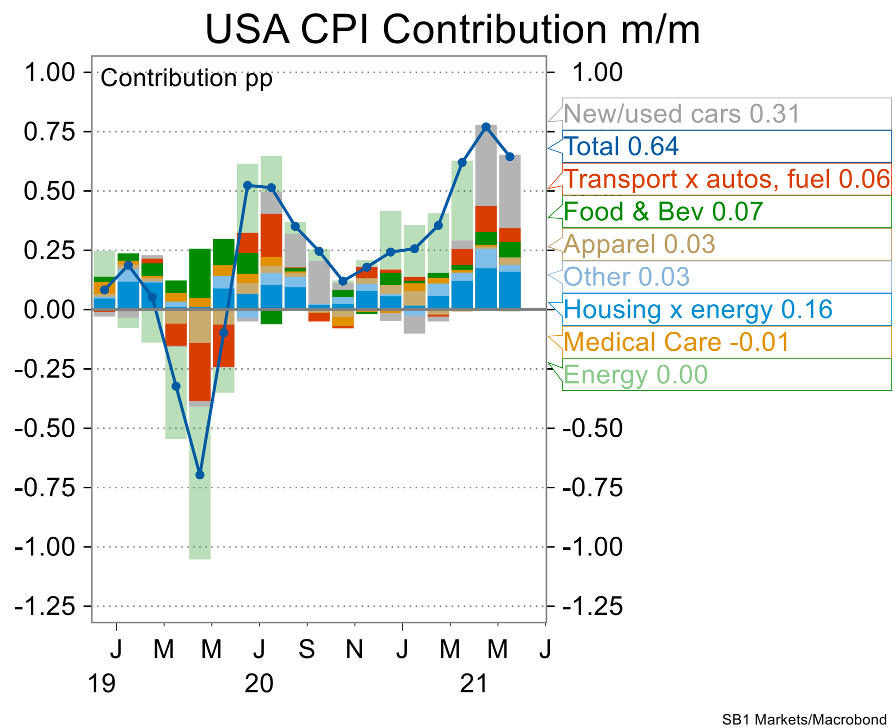
- **Core prices** rose 0.2 pp less than in April – which yielded the highest monthly increase since 1982
  - » Until the April 'shock' the 3m/3m price growth at 1.2% did not signal any serious pressures, now it is at 5.2%
- The price hikes in both April and May were at least partly due to one-offs which will not be repeated, or will be reversed
  - » Used auto prices (and auto rental 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. And there is some broadening of inflation
- Parts of the hike the annual rate is due to the falling prices last spring. However, the average inflation since April 2019 is 2.5% - and inflation has been above 2% whatever relevant starting point



Transport & energy explain 3.1 pp of the 5.0% lift in total CPI

... Of which half from energy, but new/used vehicles & airline tickets are sharply up too



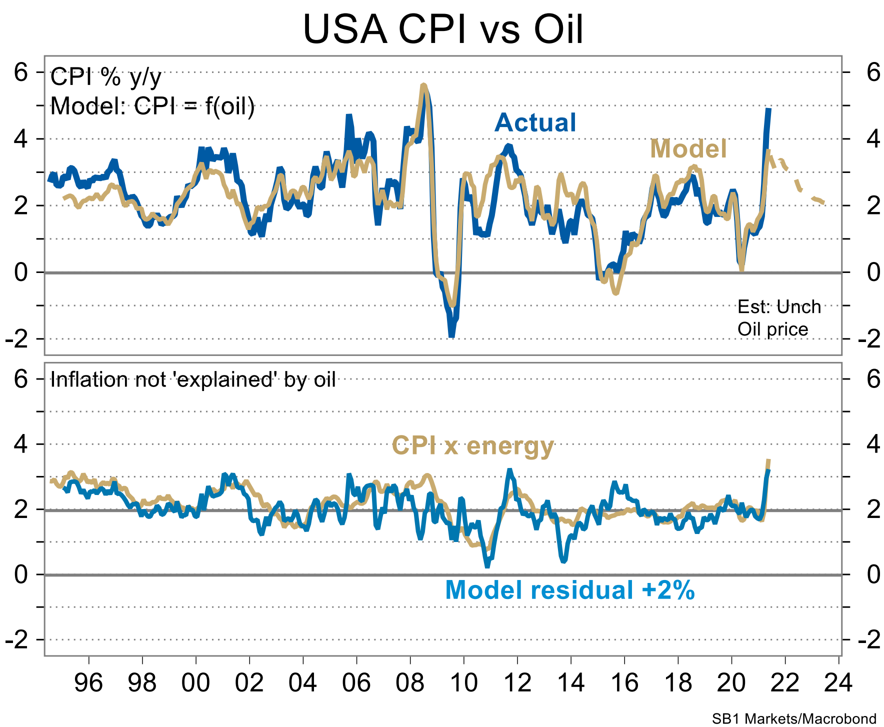


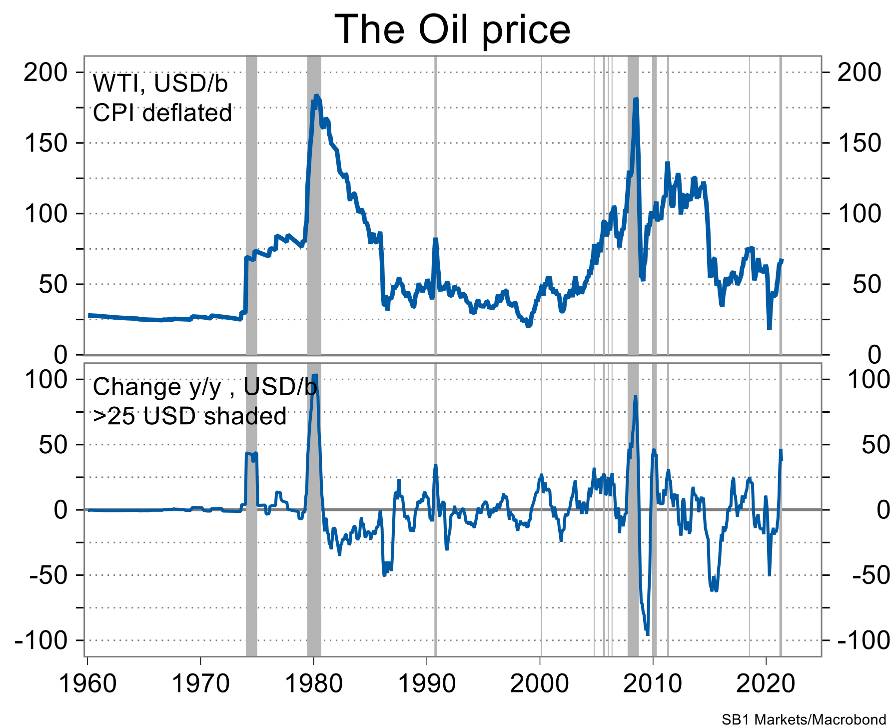
- In May (and almost in April), **new & used cars** explained half of the m/m lift in total CPI, and 1 pp of the 5% y/y growth in headline CPI
  - » Used car prices rose 7% in May, and are up 30% y/y. They are probably too expensive now, but not necessarily by 30%. The upside must be limited, though (as we said one month ago..)
- **Energy** has lifted the headline CPI by 1.65 pp in the past year (but was not to blame for any of the m/m lifts in April or in May, 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 (see more here)
- Excluding the 3.1 pp **contribution the headline CPI from energy & transport**, "remaining" inflation is well above 2% (weight adjusted) - however the highest level in several years. In addition, a far higher parts of the CPI is now reporting growth above 2% (even measured as an average over 2 years, in order to adjust for the impact of price cuts last spring)

Lodging away from home (incl hotels) is a part of housing at the charts above

The oil price moves the headline CPI – in both directions

The oil price has already increased a lot. More to go? Not a whole lot, in our opinion

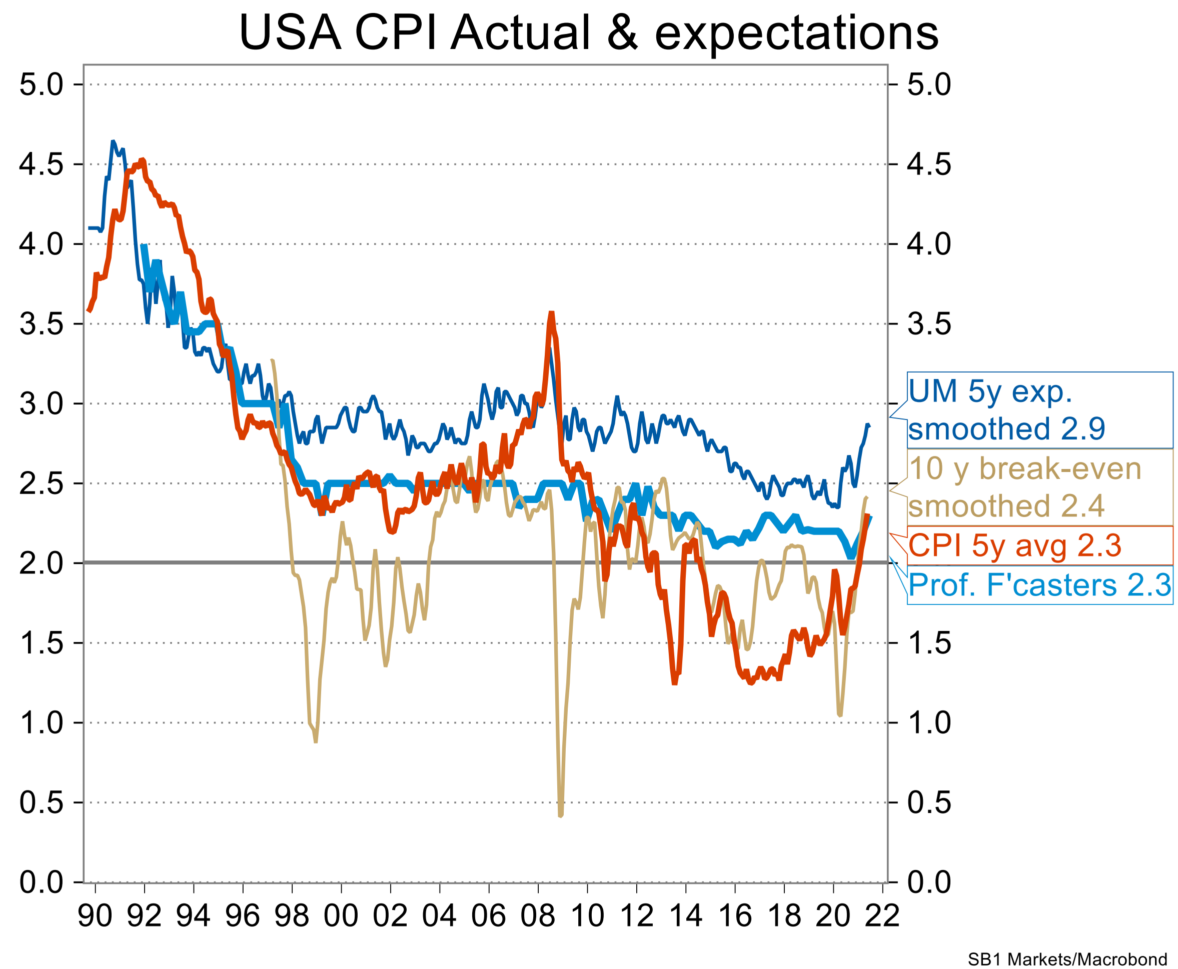




- **Oil price cycles** have explained some 80% of the changes in CPI growth the past 30 years
  - » In our model we incorporate all indirect impacts from changes in the oil prices – as well as the impact from other factors that influenced inflation which correlates to the oil price.
- From time to time, there are substantial residuals, like now: Headline inflation is more than 1 % above the model forecast, as is the CPI x energy index (which is close to the core CPI). Why?
  - » Other factors are pushing inflation up, which are not correlated to the oil price. Excess demand, higher wages or something else? We have to refine our model…

Inflation expectations are drifting up but are not yet worryingly

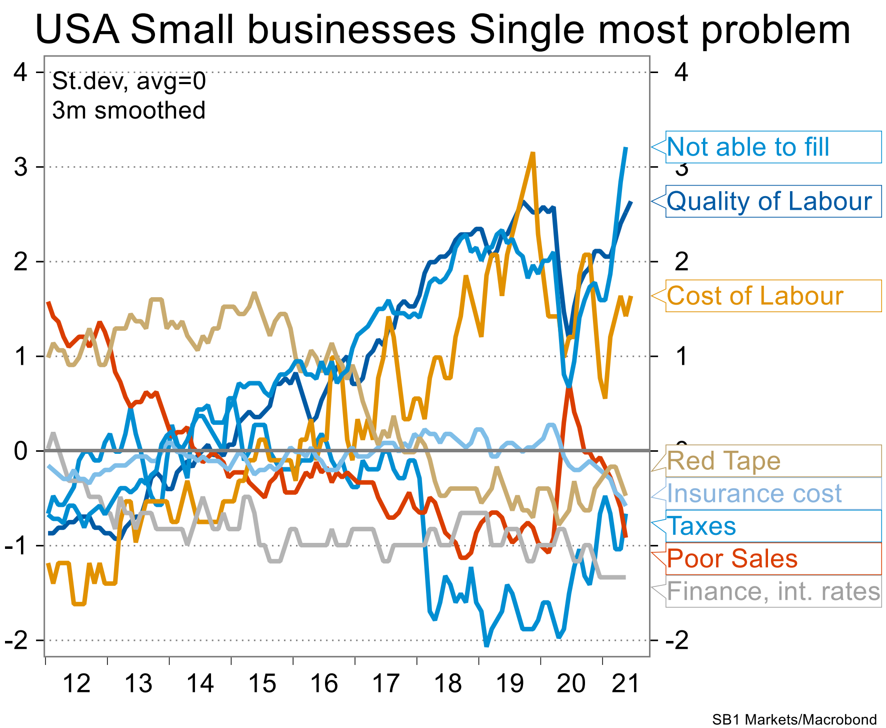
Univ. of Mich survey 5 y inflation expectations have climbed to 2.9% from 2.4%

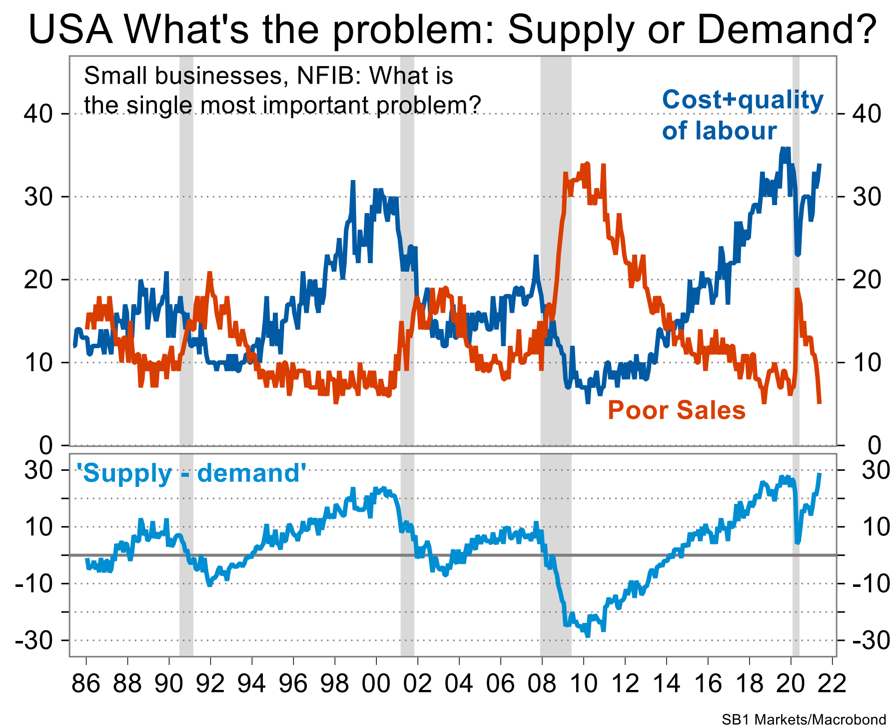


- **The UM's survey's** 2.% rate is close to the highest in 10 years (2.9% smoothed at the chart to the left), and it is 0.4 pp higher than before the pandemic (2.5%)
  - » Still the level is not far above the past 10-year average – but it is a sign for the Fed, of course
  - » The UM short term inflation expectation at 4.6% is the highest since 2011, up 0.9% from March (<u>and he survey was conducted ahead of the CPI surprise last week</u>). 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 (CPI) inflation expectation** has fallen to 2.32% (not smoothed) from above 2.5%. Not too high for Federal Reserve

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 at a beginning…

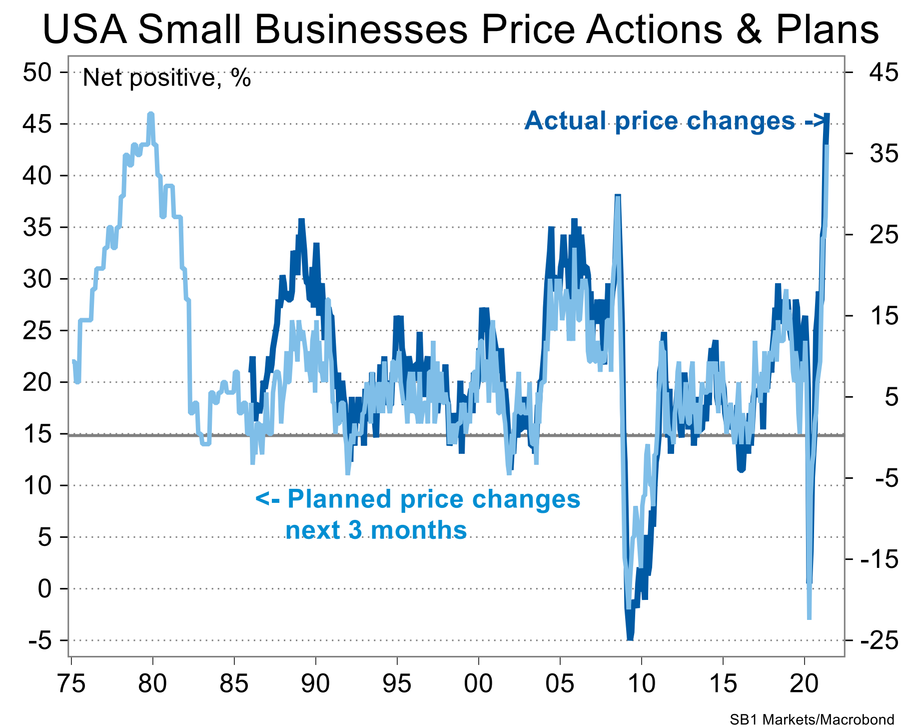


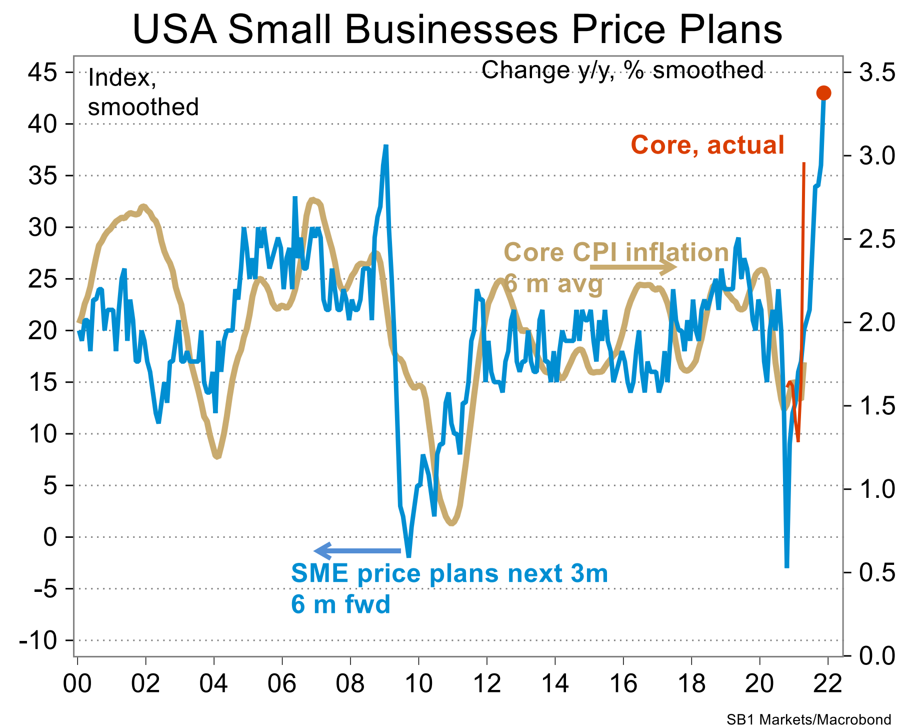


- While more businesses than normal stated **weak sales** as the major problem during the pandemic, there were never that many, and now fewer than the average share of companies say than poor sales is the problem
- **Availability, quality, and cost of labour** is a much more serious problem than normal, the share is now almost back up to the same level as before the pandemic, after subsiding somewhat
- Thus, companies report they are constrained from the supply side, not from the demand side
- Unusually few companies are complaining about **finance/interest rates** and about **taxes**

Check these price messages from the small businesses

We hope you will never see anything like this again

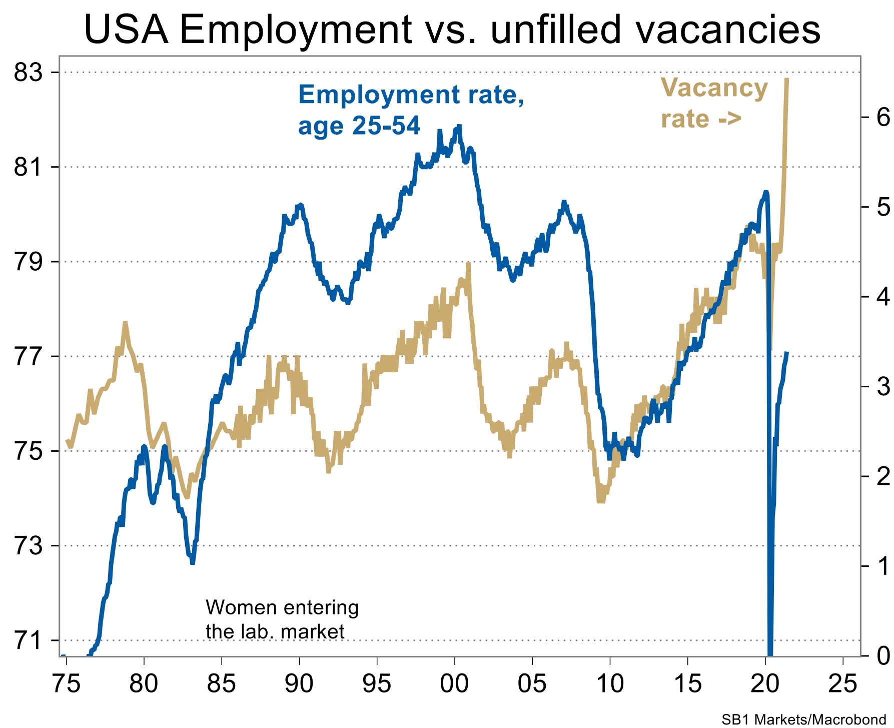


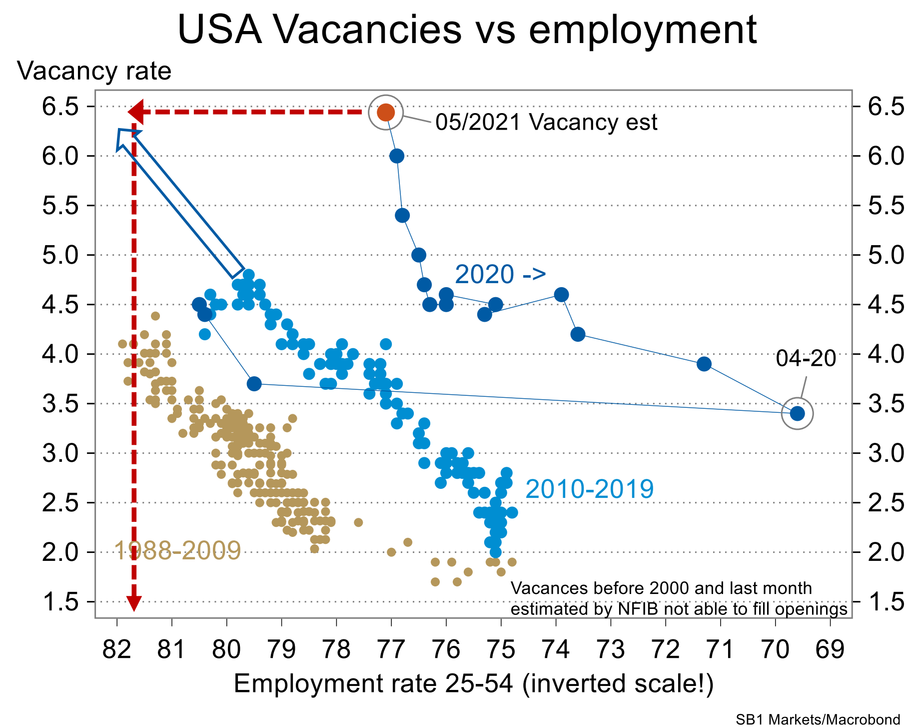


- It is long time since last time anyway, in December 1979, when price plans were as aggressive as today

An even more dramatic x-check: The employment rate is extremely low

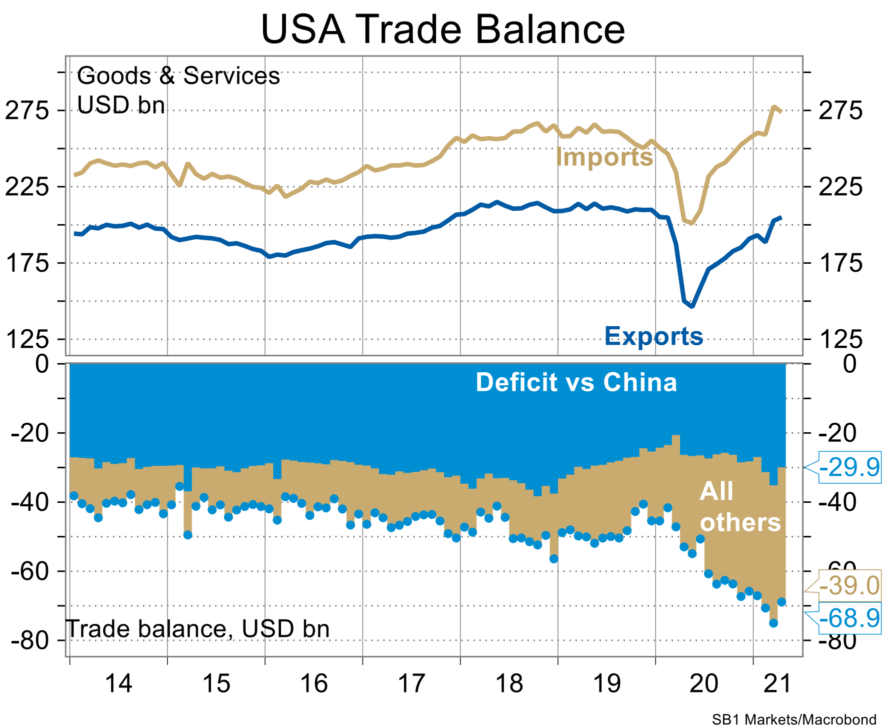
... given the high number of vacancies

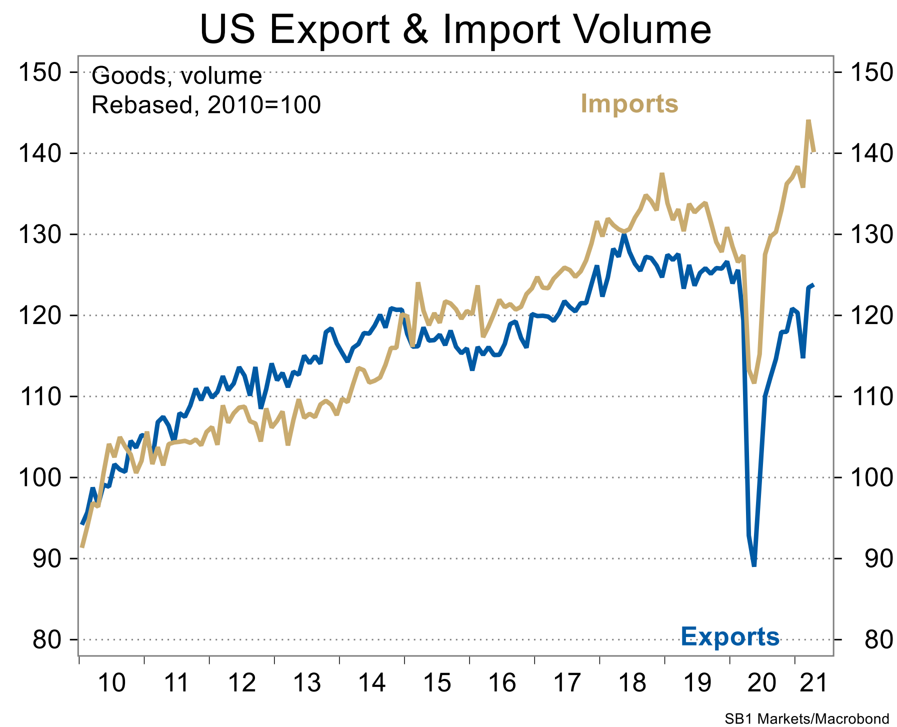




Deficit narrows as exports increased and imports fell – from a high level

Trade deficit down to USD 69 billion in April, from 75 billion in March

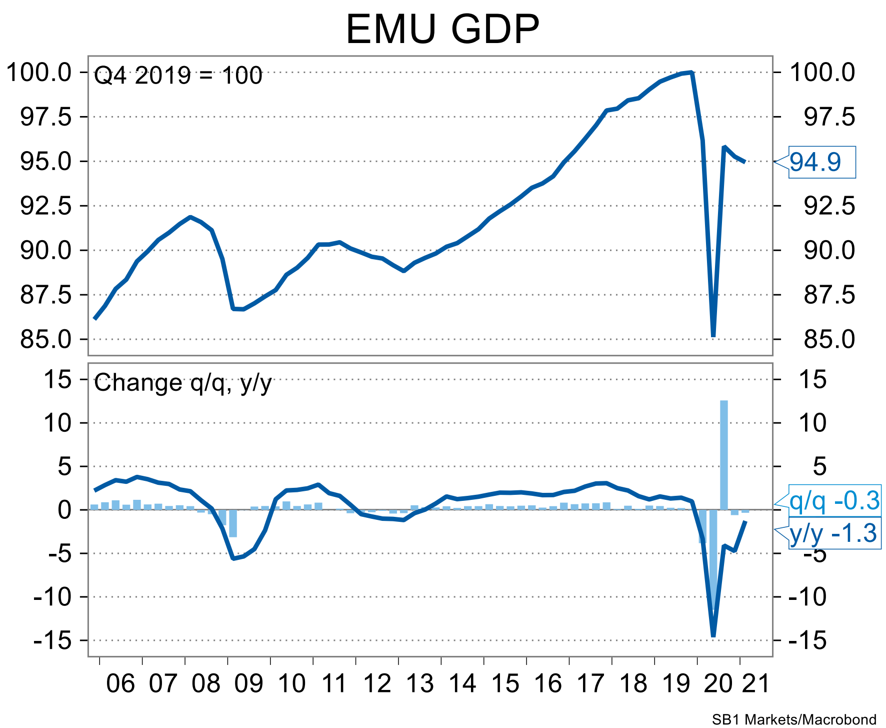


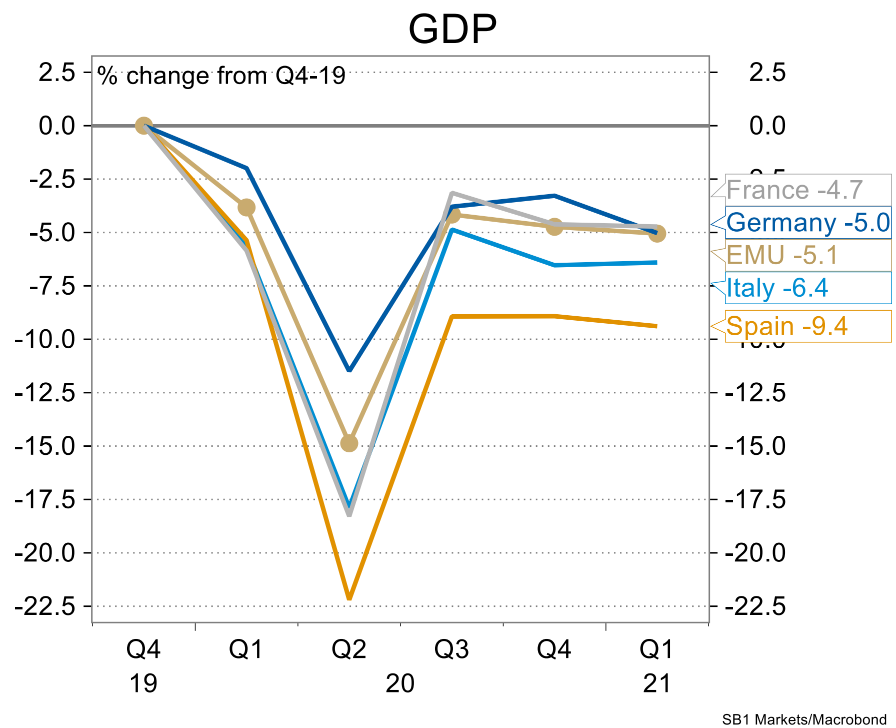


- **Exports** rose by 1.1% m/m, and are now on par with the pre-pandemic level (in value terms). In volume terms, exports of goods are down 1.4%
- **Imports** decreased by 1.4% in April, following the 7% jump in March, and remains almost 10% above the early 2020 level. In volume terms, the **imports of goods** are 11% above! The reason is no doubt strong demand for goods in the U.S. The decline in April is not an obvious sign of weakness. However, the ISM import index has fallen somewhat recently. We expect household demand for goods to slow in H2, from the present very high level
- **The deficit vs China** is almost at the same level as when Trump became president. However, the total deficit vs. other countries has exploded, has have the total deficit

GDP fell less than first reported in Q1: -0.3% vs. -0.6%

GDP is down 5.1% vs the Q4-19 level

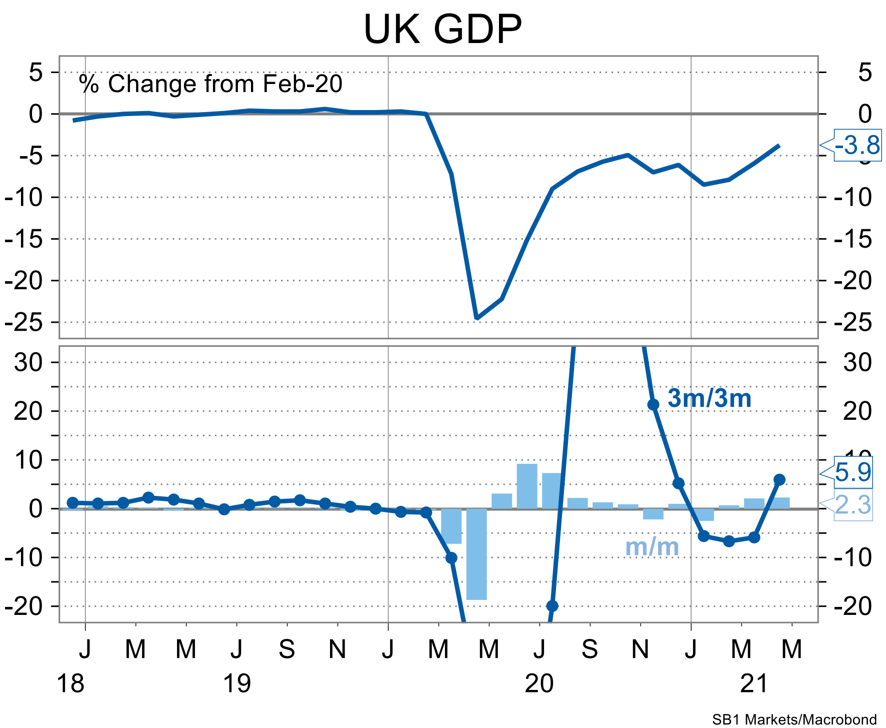


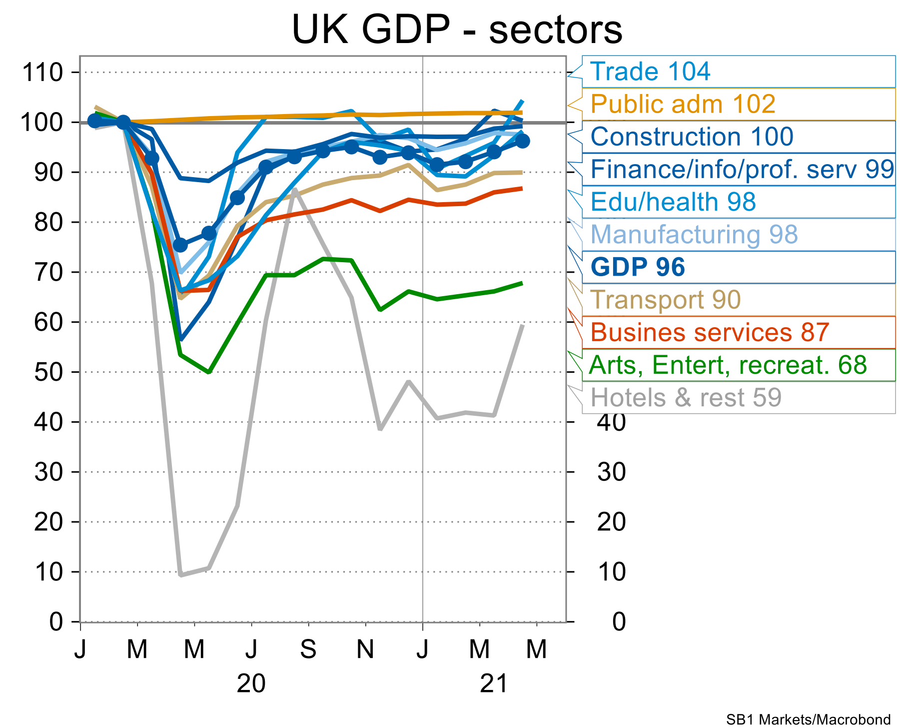


- Euro Area GDP fell by 6.7% in 2020 and GDP is still 5.1 % below the pre-corona level (revised up from -5.5%)
- GDP grew by 0.4% q/q in France (expected +0.1%), +0.1 in Italy (expected -0.4), while GDP decreased by 1.8% q/q in Germany (exp -1.7%), and -0.5% in Spain
- France, Germany are down 5% vs. the pre-pandemic level, Italy -6% and Spain -9%, as foreign tourism has collapsed

UK GDP grew by 2.3% m/m in April, boosted by the services, much more to go

GDP will probably return to (above) the pre-pandemic level in June as service activity will climb furth.

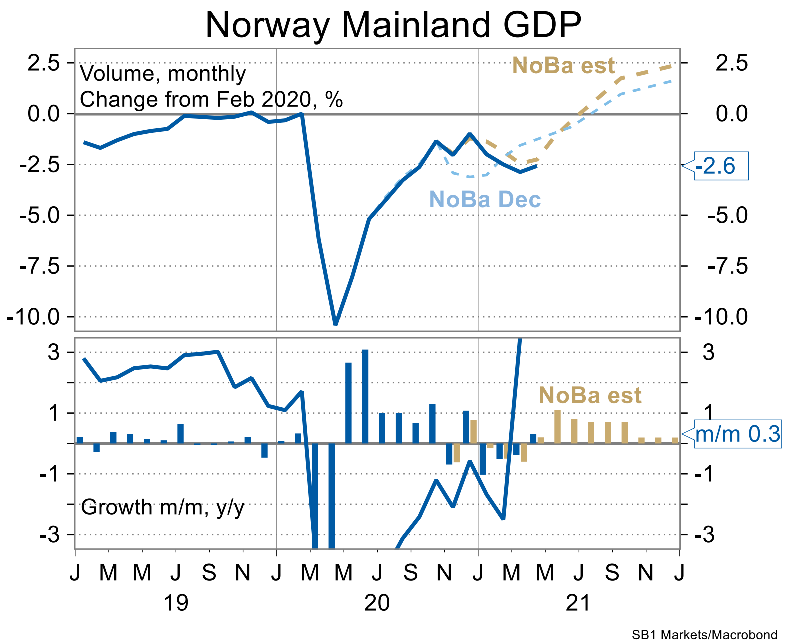


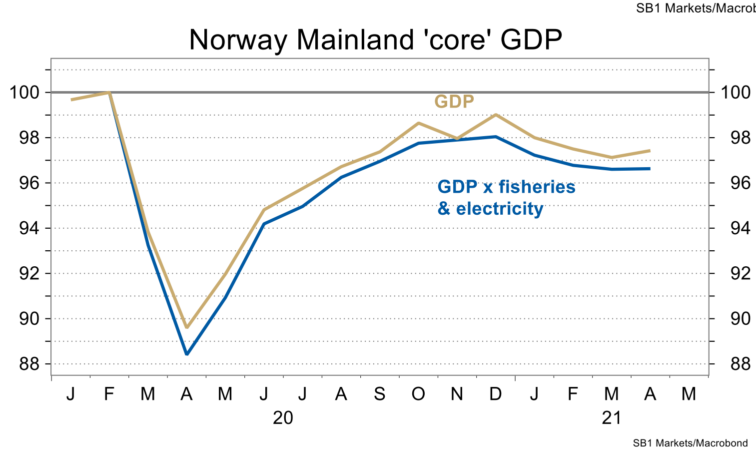


- **GDP** grew 2.3%, as more restrictions were eased, expected up by 2.4%, following the 2.1% m/m growth in March. GDP is still 3.8% below the Feb-20 level.
  - » January was the local trough (down 8.5% vs Feb-20), and GDP has been growing at 22% pace the past 3 months!
- **Services** were up 3.4% in March, supported by hotels & restaurant, up 44% (but they were still 40% below the pre-pandemic level – just wait for the May & June data!). Trade was up 8%, as more shops reopened
- Manufacturing, construction, and professional services were the only other sectors that were down – but all are trending up

Mainland GDP up 0.3% in April – 0.1 pp above expectations

The increase was above NoBa's expectation

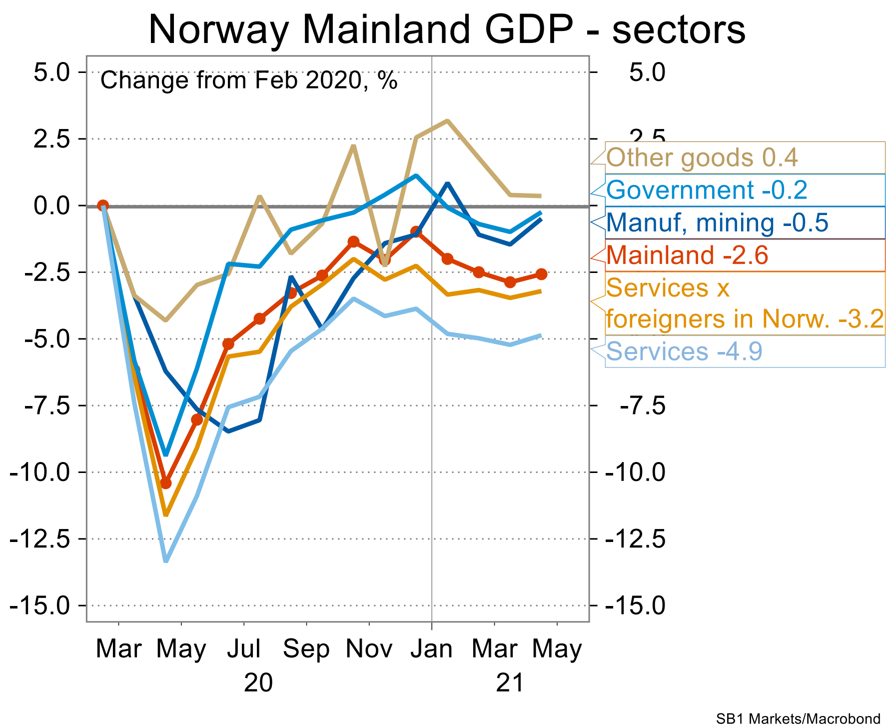


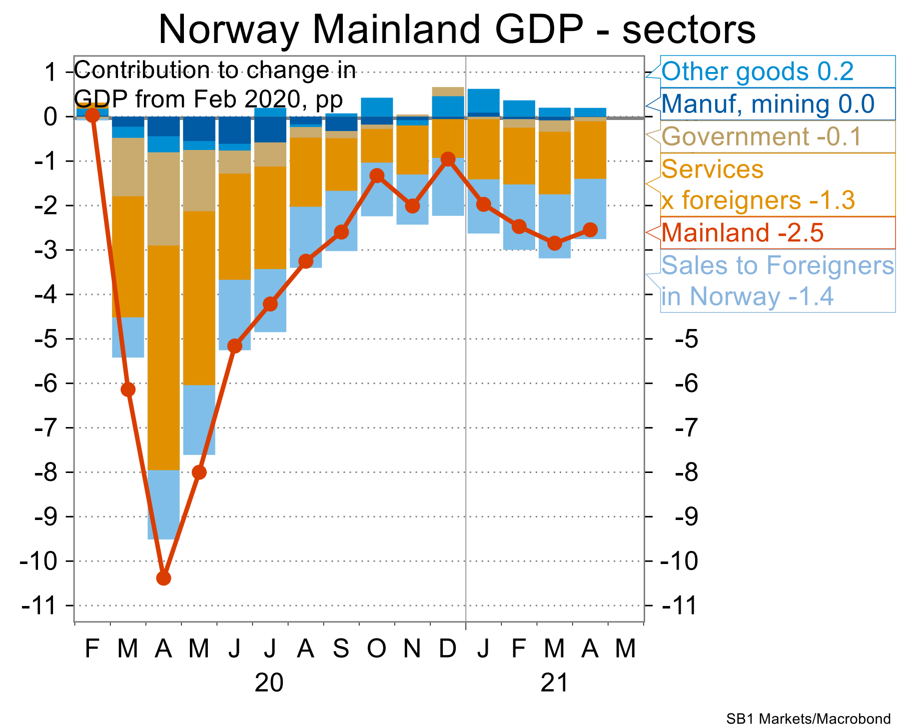


- **Mainland GDP grew by 0.3% m/m in April**, above consensus and NoBa expectations, but as we expected. The decline in March was a tad smaller than initially -0.4% vs. -0.5%. GDP is down 1.6% from the local peak last Dec
  - » **Production:** Private services were up by 0.4% in April even if hotels & restaurants were down 8.6%. Manufacturing was up 1.3% m/m, while construction was up 0.3%
    - **Fisheries** slightly down April, **and electricity** up 9%, 'core ML GDP' was flat
  - » **Demand:** Norwegians' spending at home fell 0.4% in April, goods up 0.8%, services down 1.6%. Both investments in oil, Mainland businesses and housing rose in April, while all fell in Q1. Exports x travel fell -4.4%
- **Mainland GDP is down 2.6% 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 3.4%
  - » **Production:** The 4 hard hit services are down 20% (business services) to 51% (hotels & restaurants). The total negative drag equals 3.4% 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 17%, goods up 8%. Spending abroad has fallen by 96% (equalling 9% of disp. income), and the money is saved. Housing investments are up. Mainland business investments have fallen by 3%, while oil investments are up 2%!! Exports ex petroleum (and tourism) are 3% below the Feb-20 level. Foreigners are not spending anything in Norway, a cut equalling 1.4% of Mainland GDP

Production: An improvement in all main sectors in April

The 2nd /3rd wave hit all sectors too, from late last year

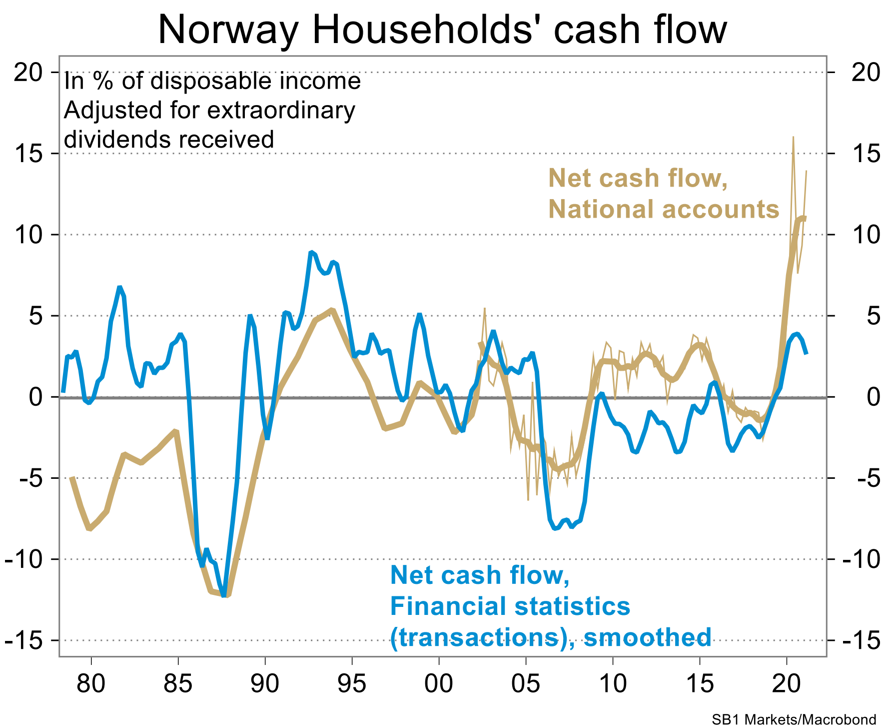


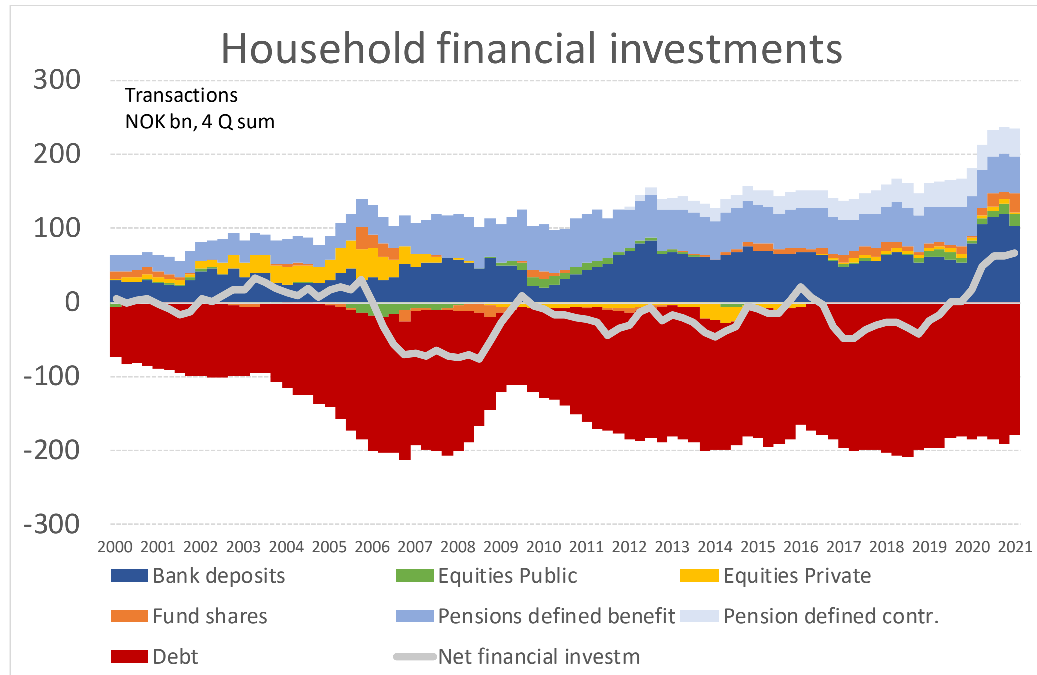


- **Service sector production was up 0.4%** in April, as corona restrictions were eased – Very likely, March was the bottom **Manufacturing production (incl mining)** also rose in April, up 1.3% m/m, while construction was up 0.3%
- **Other goods production** is volatile mostly due to (ocean) **fisheries and electricity production.** Production was flat in April, supported by a 9.1% increase in electricity production

Some savings lost in transactions

The national accounts report 11% net household 'cash' savings, financial accounts find just 4%

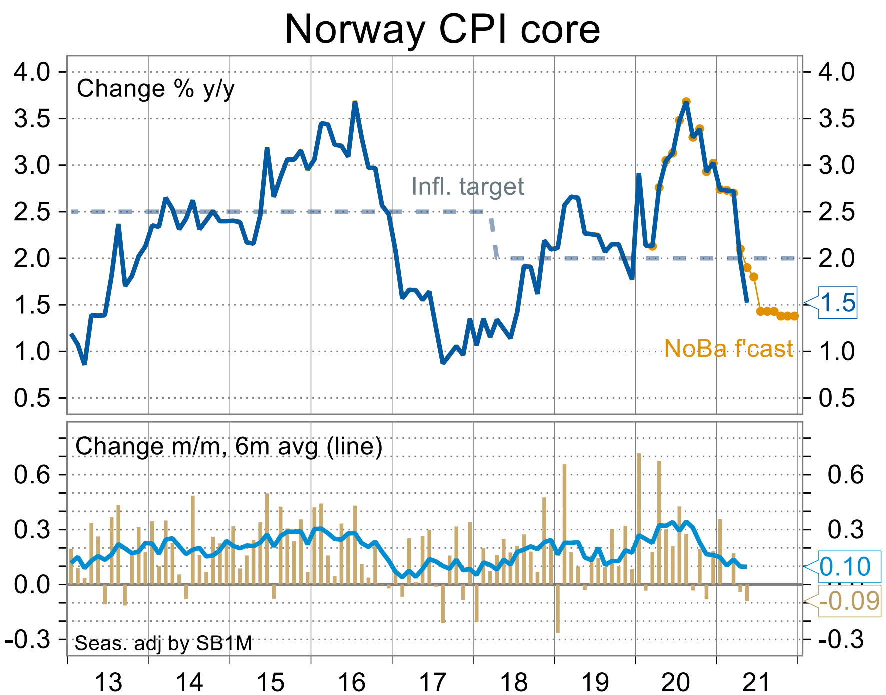


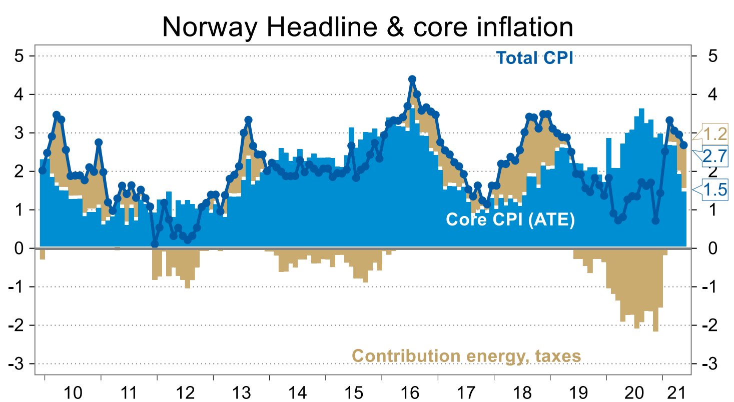


- The two stats are not always in line but the discrepancy is larger than normal
  - » The net financial investment calculated from the National income, consumption and housing investment data should equal household transactions in financial instruments – where the net cash is invested
- Financial accounts show that the extra net saving is invested in bank deposits, which are up NOK 100 bn, 50 bn more than 'normal'. Pensions is the other main savings vehicle, without any acceleration through the pandemic (sum 50 bn)
- Investments in fund shares have increased recent quarters, as have investments in public equities, by NOK 25 bn and 16 bn respecitvely
- Debt is increasing steadily, by almost NOK 200 bn per year

Inflation is not on the way up everywhere: CPI-ATE down 0.5 pp to 1.5% y/y!

Imported goods prices fell sharply, helped by a stronger NOK. Domestic inflation modest too

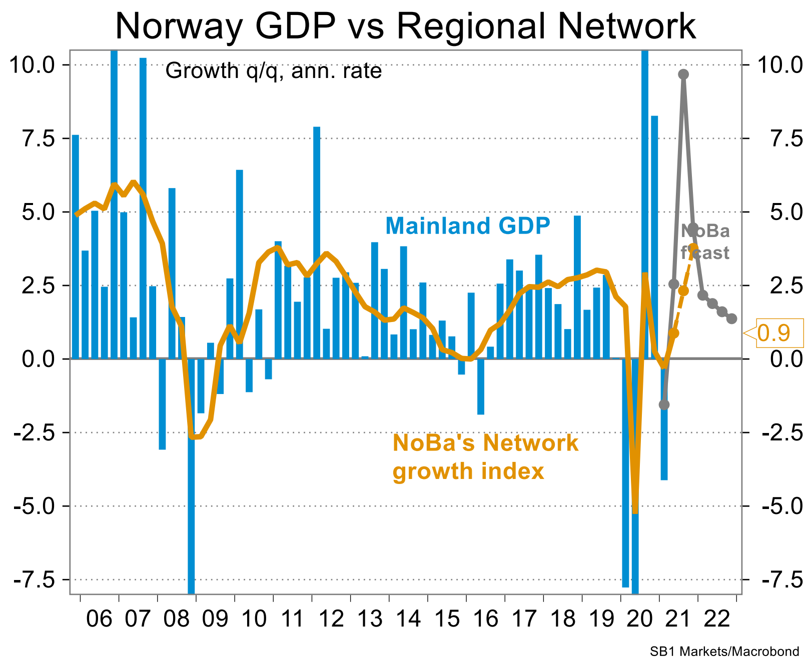




- **CPI-ATE** (ex. energy and taxes) inflation is down 0.5 pp to 1.5% in May; 0.4 pp below Norges Bank's f'cast, 0.5 pp below consensus estimate and our forecast
  - » Prices were down 0.1% m/m (seas adj), down from 0.04% in April
  - » Inflation is below 2% for housing, clothing, food, alcohol, communication, transportation, and airline tickets – others are still above
  - » The main miss (vs our f'cast) was a 2.5% drop in furnishing prices
  - » As we have expected, imported goods price inflation is now receding, due to NOK effect (and more than we assumed in May)
  - » Domestic inflation has slowed substantially to 1.5%
- **Total inflation** slowed 0.3 pp to 2.7%
- **The outlook**
  - » **Inflation may slow** somewhat more the coming quarters. 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 but the spillover to the Norwegian CPI is not that significant
  - » Anyway, CPI inflation will not have any material impact on Norges Bank's monetary policy the coming months. It's all about the post Covid-19 recover – and the housing market

Norges Bank's Network expects a brisk recovery but less than we expected

... And weaker than Norges Bank's growth forecasts (at least formally) imply

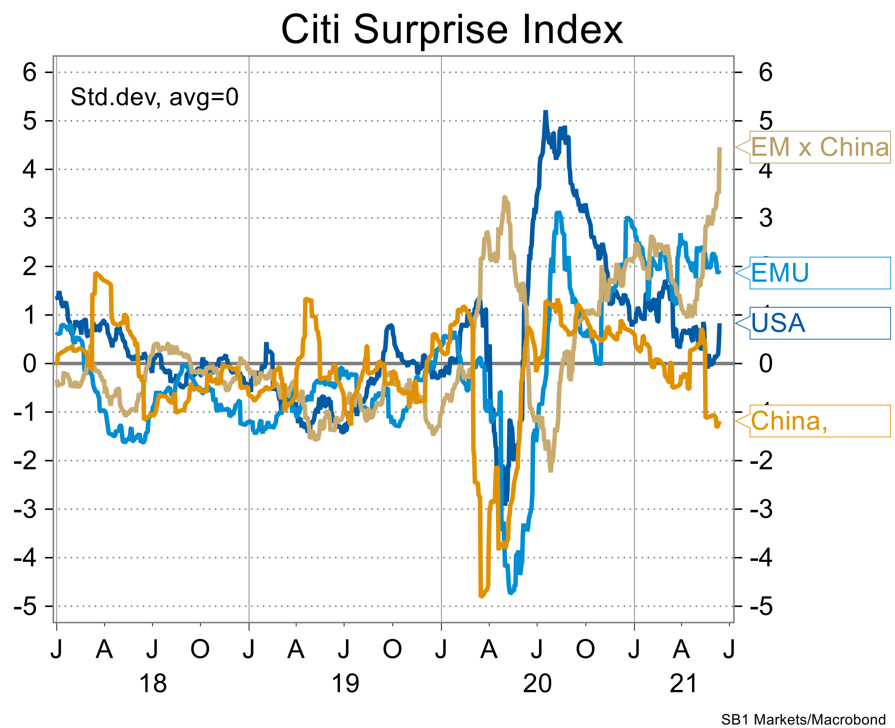


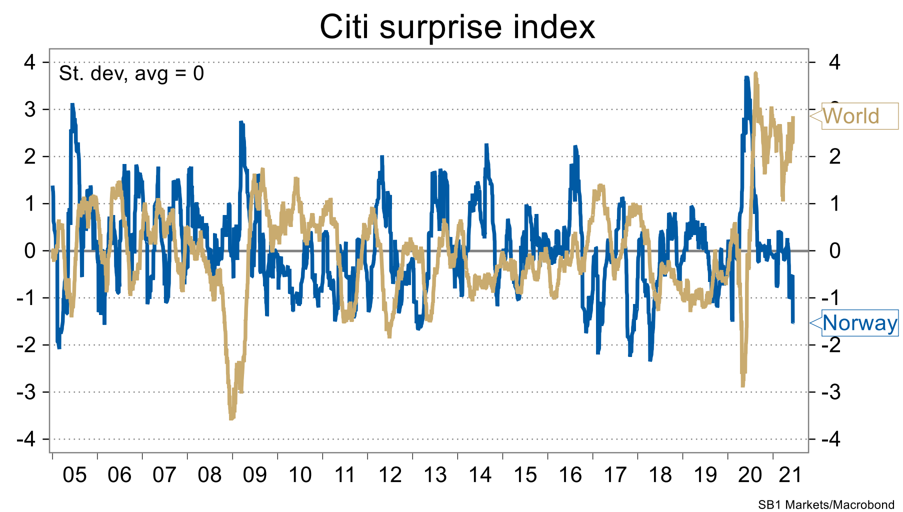
- **Implications**
  - » The Regional Network' growth outlook did not give Norges Bank an argument for lifting the interest rate path
  - » Still, we expect the bank to lift the interest rate outlook somewhat later this week, due to higher oil prices, higher wage inflation, a weaker NOK and a reduced NIBOR spread (though counterweighted by lower CPI inflation)

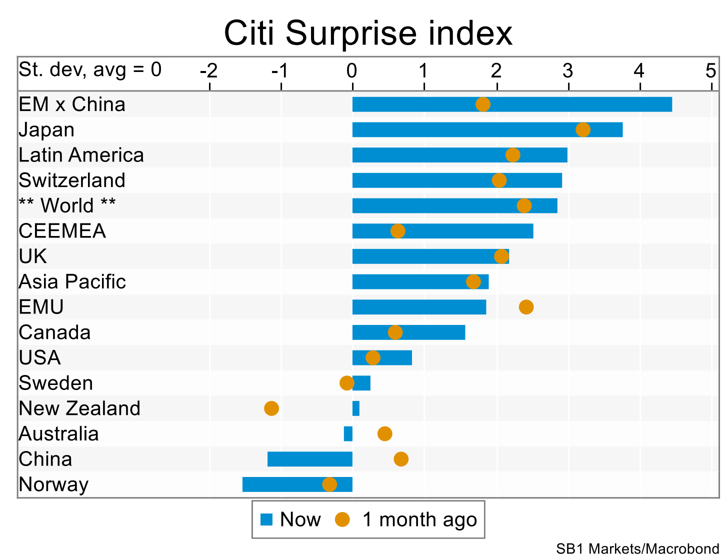
- **Activity the past 3 months**
  - » The Network reports a 0.9 growth pace (annualised, 0.2% not annualised) to Feb-April from Nov-Jan. In February, the network expected a 1.8% growth pace the next 6 months. Obviously the first 3 months have been weaker expected, and Mainland GDP was much weaker than the Network reports, as it fell at a 4% pace! Capacity utilisation & labour shortages are at average levels
- **Expectations for the coming months**
  - » The Network expect at 3.8% growth pace the next 6 months, best since 2010. We expected a 6% signal. In March, Norges Bank expected a 6% growth pace in Q2 and Q3 on average
    - All sectors are expecting higher growth
    - Household services are the most optimistic, for good reasons. Commercial services are no. 2 at the list
    - Construction expects growth, following a setback the previous the 3 quarters. Manufacturers are expecting brisk growth
    - Oil related sectors are the least optimistic
    - Retailers expect a 3% growth pace – we think they are too optimistic
  - » **Investment** plans are revised further up
  - » **Wage inflation** is revised up 0.4 p to 2.7%, the 2nd largest quarterly revision ever
  - » Companies expect to **lift prices** vs other businesses sharply but not (yet) vs. households

Economic data are still surprising on the upside (but not Chinese & Norw. data)

… according to Citi's surprise index. EM x China at the top, followed by Japan, UK & EMU







- **Emerging Markets x China** are reporting much better data than expected, it's rather extreme (>4 st.dev above avg)
- The **EMU** is still surprising on the upside
- The **US** surprise index shot up on the CPI, and we guess the vacancies report
- **China** slides down, to well below neutral, alongside a credit tightening
- **Norway** has surprised on the downside, last week on weaker CPI data

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

The Calendar: FOMC. FOMC. FOMC. And US retail sales, Chinese May data. NoBa

Time	Count.	Indicator	Period	Forecast	Prior
Monday June 14					
11:00	EC	Industrial Production SA MoM	Apr	0.4%	0.1%
Tuesday June 15					
06:00	SW	PES Unemployment Rate	May		3.7%
08:00	NO	Trade Balance	May		17.0b
08:00	UK	ILO Unemployment Rate 3Mths	Apr	4.7%	4.8%
14:30	**US**	**Retail Sales Advance MoM**	**May**	**-0.6%**	**0.0%**
14:30	US	Retail Sales Control Group	May	-0.4%	-1.5%
14:30	US	Empire Manufacturing	Jun	22	24.3
14:30	**US**	**PPI Ex Food, Energy, Trade MoM**	**May**	**0.5%**	**0.7%**
15:15	**US**	**Manufacturing Production**	**May**	**0.7%**	**0.4%**
16:00	US	Business Inventories	Apr	-0.1%	0.3%
16:00	US	NAHB Housing Market Index	Jun	83	83
Wednesday June 16					
08:00	NO	New Home prices	Q1		
08:00	UK	CPI YoY	May	1.8%	1.5%
08:00	UK	CPI Core YoY	May	1.5%	1.3%
09:00	**CH**	**Retail Sales YoY**	**May**	**13.8%**	**17.7%**
09:00	**CH**	**Industrial Production YoY**	**May**	**9.2%**	**9.8%**
09:00	CH	Fixed Assets Ex Rural YTD YoY	May	17.0%	19.9%
11:00	EC	Labour Costs YoY	1Q		3.0%
14:30	US	Building Permits	May	1730k	1760k
14:30	**US**	**Housing Starts**	**May**	**1640k**	**1569k**
20:00	**US**	**FOMC Rate Decision**	**Jun-16**	**0.00%**	**0.00%**
Thursday June 17					
03:30	CH	New Home Prices MoM	May		0.48%
10:00	**NO**	**Deposit Rates**	**Jun-17**	**0.00%**	**0.00%**
10:00	**NO**	**.. Change in interest rate path**		**+0.15%**	**+0.27%**
11:00	EC	CPI Core YoY	May F	0.9%	0.9%
14:30	US	Philadelphia Fed Business	Jun	31.0	31.5
14:30	US	Initial Jobless Claims	Jun-12	360k	376k
16:00	US	Leading Index	May	1.3%	1.6%
Friday June 18					
01:30	JN	Natl CPI Ex Fresh Food, Energy	May	-0.3%	-0.2%
06:00	SW	HOX Home-Price Index, YoY			18.9%
08:00	UK	Retail Sales Ex Auto Fuel MoM	May	1.4%	9.0%

- **China**
  - **Retail sales** were on the weak side in April, as was **service sector** production. **Industrial production** was OK, as were **investment**s. We expect May data to confirm that GDP growth will accelerate from the low print in Q1, but we expect growth to slow in H2. The activity level is high, and credit is tightened
- **USA**
  - **What will the Fed say they talked about?** Most likely, they will start discussing the timing of a tapering, for reducing the bond buying program. No precise message will be given. The bank will take credit for bringing inflation up (just transitory, of course) while noting that the economy is recovering but that the employment level is still too low. We expect the 'dot plot' to be lifted, as more members will find it appropriate to start hiking the signal rate in 2022 (4 of 18 in March) or in 2023 (3 more, in total 7 before end of '23 in March), as the markets is already discounting. We expect the bank to announce measures to dry up liquidity in the money market
  - **Retail sales** must be miles above normal level, following the distribution of the stimulus cheques and until now far less possibilities for spending on services. On the other hand, the savings rate is still high, and the accumulated increase in banks savings is impressive. Just a small decline in sales is expected in May
- **Norway**
  - **Norges** Bank will leave the signal rate unchanged at zero but we expect the bank to nudge the interest path up, but less than 3 months ago. The Bank will signal that the probability for a September hike has increased (vs. the 50% implied probability signalled in March). The market is well prepared. Se more at the next page

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

September is coming, and the rest of the interest rate path will be lifted too

Changes in the interest rate path from the March NoBa meeting	Impact bps
Domestic demand (incl oil price), capacity util.	3
Money Market (money market, lending spreads)	2
Prices, wages	10
Foreign factors	1
NOK	10
Judgement (surveys, fin. stab, global risk etc)	-12
Sum	**14**
Changes in NOK Dec-22 FRA since mid March	-9
Change in the interest path 1 1/2 - 2 years from now	

Interest rate paths

	Path 1-21	SB1M fcast	Change bps	Fair FRA *) @IMM, SB1M	FRA now	SB1M vs FRA
Q2 21	**0.00**	**0.00**	**0.00**	0.22	**0.21**	0.01
Q3 21	**0.01**	**0.01**	**0.00**	0.46	**0.46**	0.01
Q4 21	**0.13**	**0.19**	**0.06**	0.66	**0.65**	0.01
Q1 22	**0.31**	**0.39**	**0.08**	0.85	**0.82**	0.04
Q2 22	**0.48**	**0.58**	**0.10**	1.02	**0.97**	0.06
Q3 22	**0.63**	**0.75**	**0.12**	1.17	**1.10**	0.07
Q4 22	**0.75**	**0.89**	**0.14**	1.28	**1.20**	0.09
Q1 23	**0.86**	**1.00**	**0.14**	1.38	**1.31**	0.08
Q2 23	**0.96**	**1.10**	**0.14**	1.46	**1.40**	0.06
Q3 23	**1.03**	**1.17**	**0.14**	1.52	**1.47**	0.05
Q4 23	**1.09**	**1.23**	**0.14**	1.59	**1.53**	0.06
Q1 24	**1.16**	**1.30**	**0.14**	1.66	**1.59**	0.07
Q2 24	**1.23**	**1.37**	**0.14**	1.73		
Q3 24	**1.30**	**1.44**	**0.14**	1.79		
Q4 24	**1.36**	**1.50**	**0.14**	0.53		

**) Assuming a 30 bps NIBOR spread from Q3-21*

Q4 FRAs adjusted for liquidity prem

- Norges Bank will signal that a September hike now seems most likely – but not a done deal, and will not rule out a 2. hike in December. The average Q4 rate forecast will be revised to 19 bps, from 13 bps
- We expect just a small upward revision of the interest rate path thereafter, and less than the March lift

What has changed since NoBa's March MPR?

- **On the upside vs. the interest rate path**
  - » **Global growth** estimates have been revised marginally up
  - » **Interest rates** among our trading partners are unchanged
  - » **The oil price** (curve) is USD 4 -5/b higher
  - » **NOK** is 2% stronger than assumed
  - » **Wage inflation** will be revised up by approx. 0.4 pp
  - » The **NIBOR-NoBa deposit spread** will be revised down by at least 5 bps (to 30)
- **Neutral**
  - » **Domestic demand** mixed, consumption weaker than expected through April but 2021 Mainland business investments will be revised up, as may 2022 oil investments
  - » **Vaccination** process in line with NoBa f'cast
  - » **Fiscal policy**, even if extra measures are decided, will not lift domestic demand more than NoBa expected in March
- **On the downside**
  - » **CPI inflation** slightly down in the near end
  - » **The mortgage spread** has widened marginally
  - » **Judgement/grand picture**: The housing marked may be slowing somewhat down, household credit growth has been weaker (but corp. credit growth higher) than expected, no take-off in consumer confidence. The Network OK but did not signal faster growth than NoBa expected

Highlights

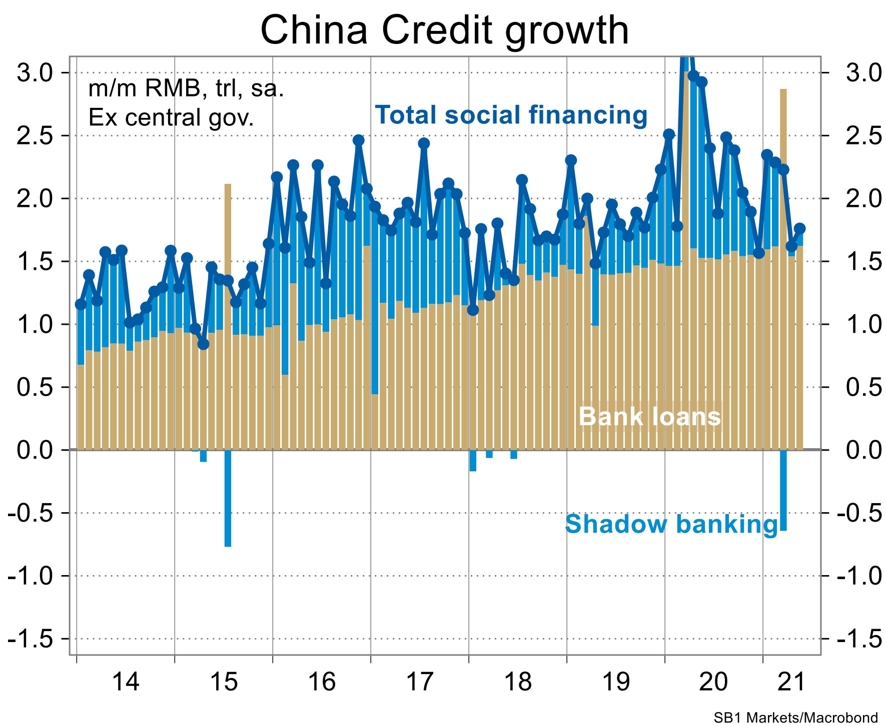
The world around us

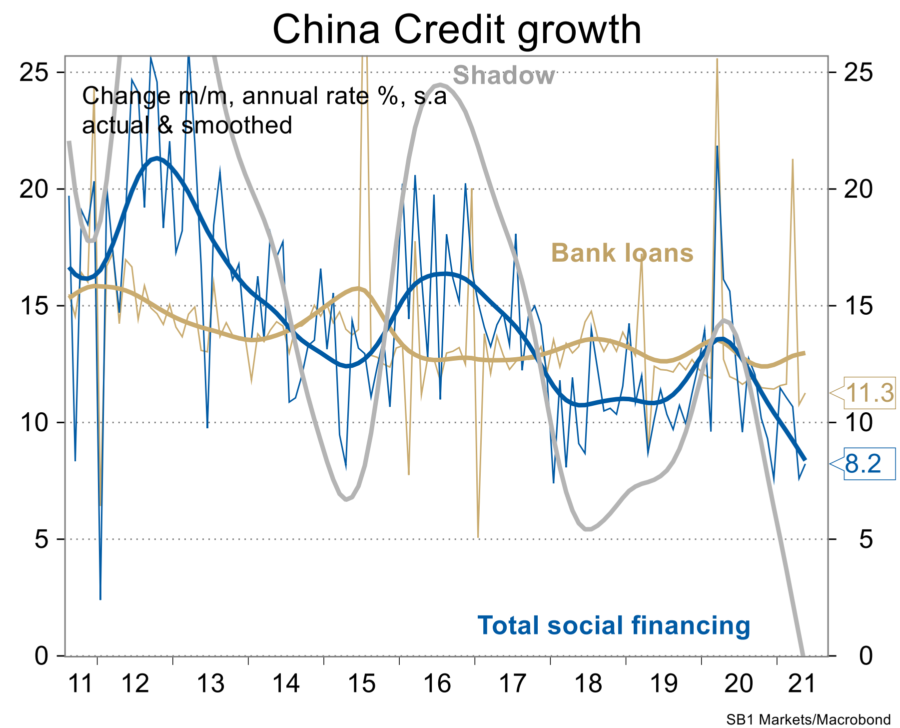
The Norwegian economy

Market charts & comments

Credit growth slightly up in May but the credit cycle is tightening

Bank lending is keeping up but other credit channels are drying up, by purpose

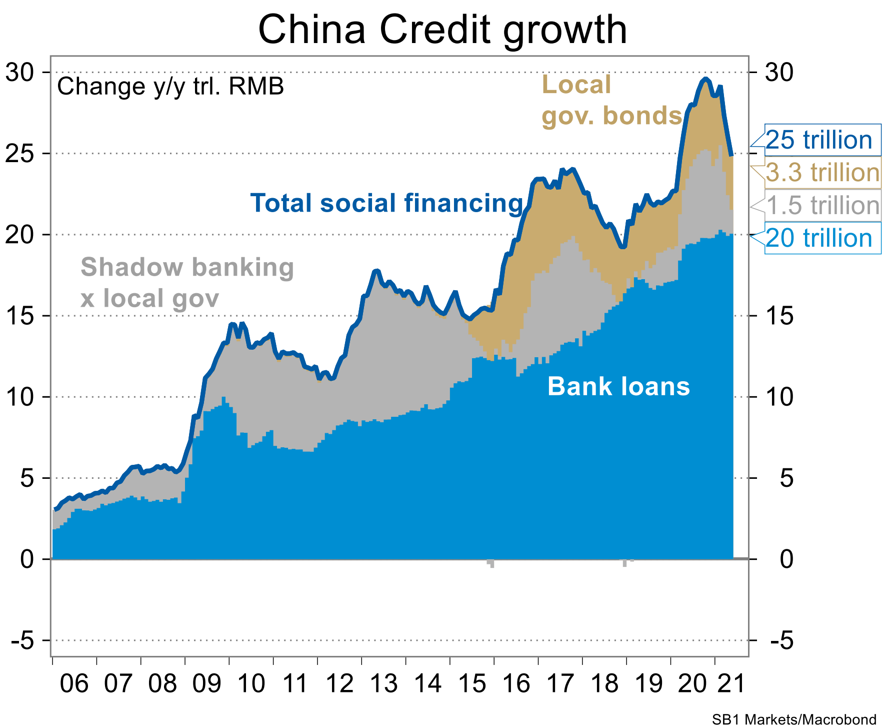


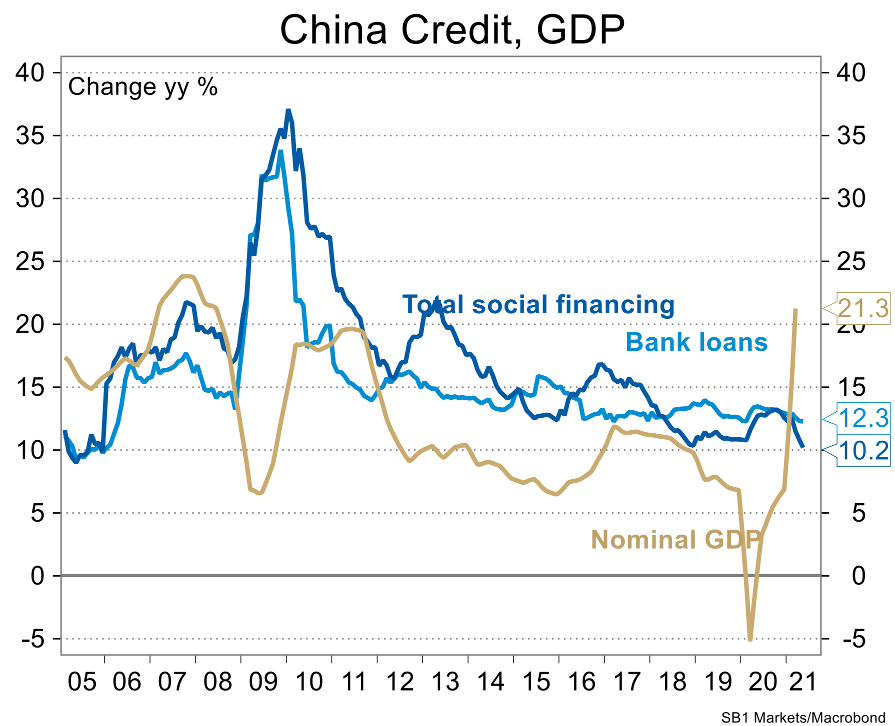


- **Total credit** grew at an 8.2% rate in May (m/m, annualised), up from 7.5% in April. Smoothed, the underlying rate may be 8%-9%, down from 13% during last spring (and >15% during some months). An 8% - 9% growth rate is close to the trend growth in nominal GDP
  - » **Total credit** rose by RMB 1.9 trl, expected 2 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 1.76 trl, up from 1.62 trl in April
  - » **Bank loans** rose by RMB 1.62 trl, both actual & seas adjusted. Bank loans are up 11% y/y
  - » **Shadow banking credit** was marginally up (0.14 trl) in May, following no growth in April, and a decline in March. Underlying growth has fallen sharply
- **The Chinese authorities** have signalled that credit growth outside banks should slow, and it has been growing slower than bank credit since early 2018. The contraction in shadow banking credit over the past year equals 5% of total credit
- **The credit impulse has turned negative**, like it usually do every 4th year or so. The ramification may be felt in many markets

Credit growth has turned south (as expected post gov't wish to curb growth)

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

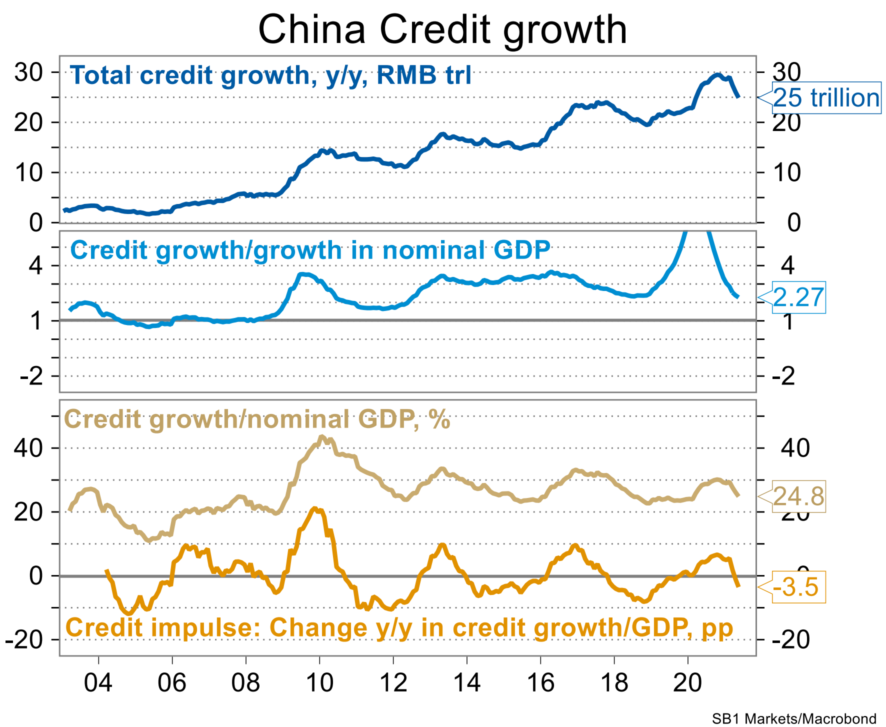


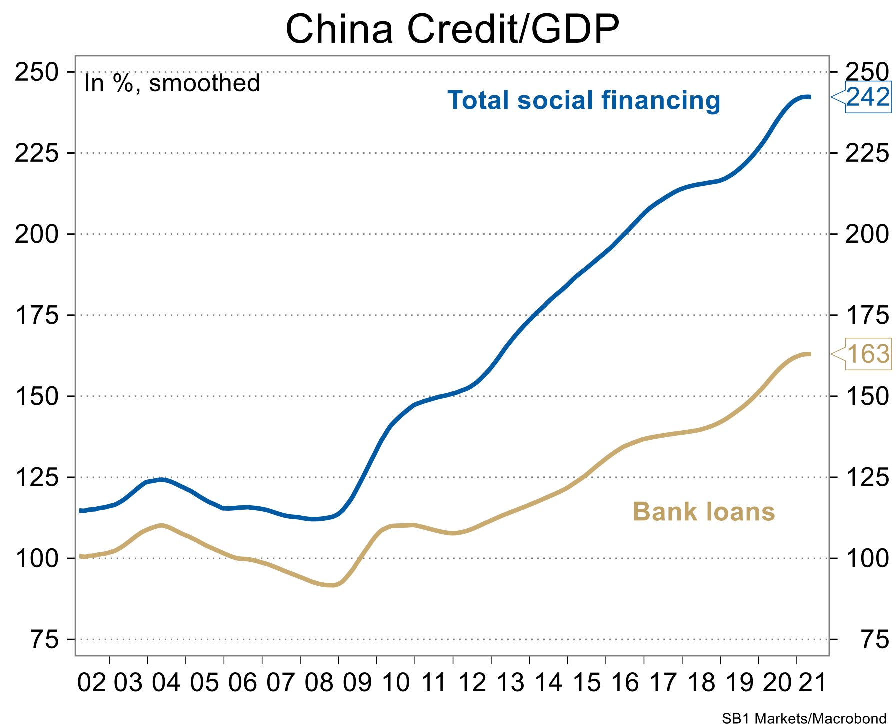


- Over the past year, **total credit** has expanded by CNY 25 trl, equalling >25% of annual GDP, down from CNY 30 trl at the peak
- **Banks** supplied CNY 20 trl of the y/y increase
- **Local governments** have not yet accelerated their borrowing by much, at least not in the bond market, still up 3.3 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 1.5 trl (from +5 trl!)
- **Total credit** growth at 10.2% y/y, the lowest since 2005, but still well above nominal GDP trend growth before the pandemic. (Underlying growth is even lower)

The credit impulse has turned negative

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



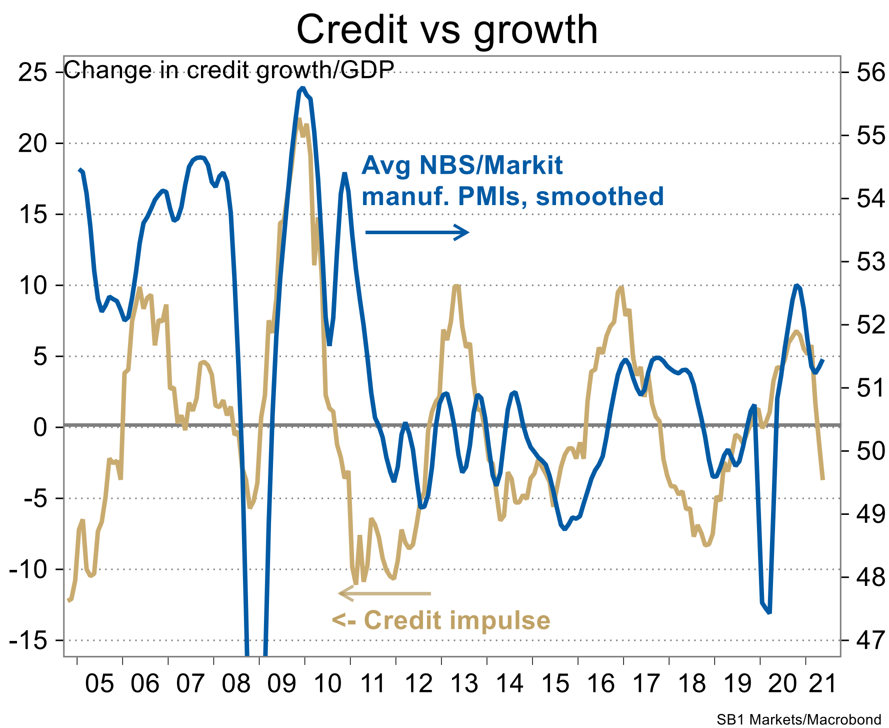


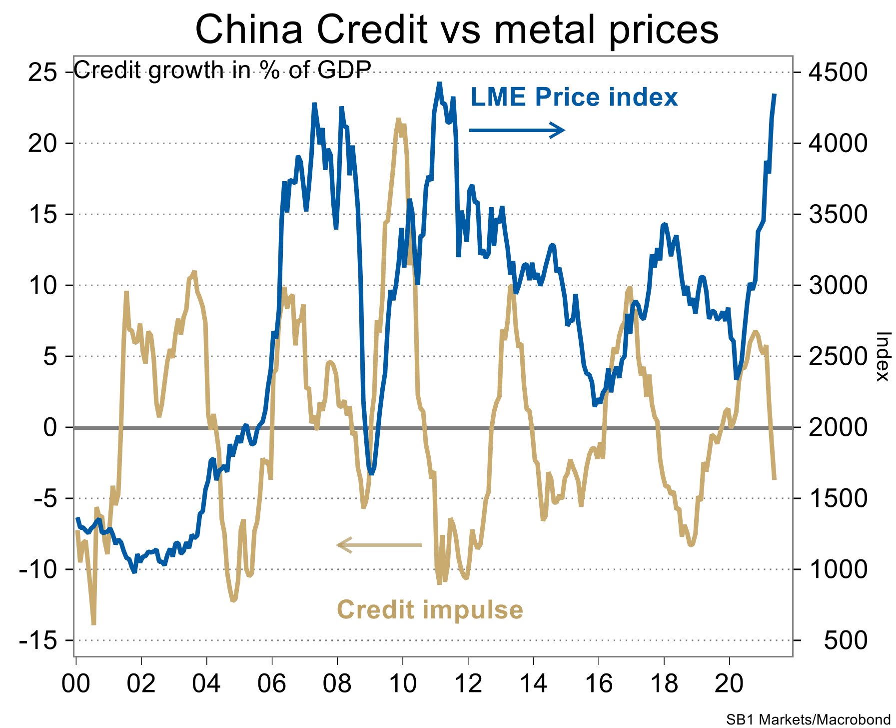
- A positive **credit impulse** implies that the credit growth/GDP ratio is increasing (the 2nd derivative of credit vs the GDP level)
  - » A negative credit impulse indicates credit tightening (or weaker demand) and has been associated with slowdowns in the Chinese economy, which have had impacts at other markets
- The credit impulse bottomed in late 2018, turned positive one year later, peaked last autumn and has now – and has now fallen into negative territory – growth in credit is slowing

GDP is smoothed at the calculations on the charts above

Credit impulse vs. PMI, metals prices

Correlations are not tight but a tighter Chinese credit market tends to lead Chinese PMIs…

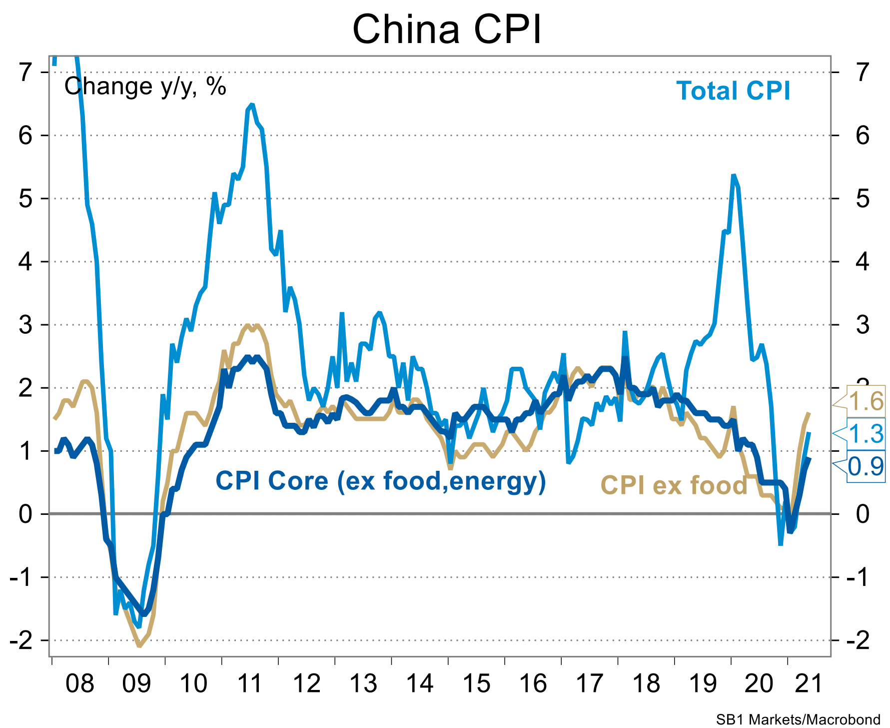


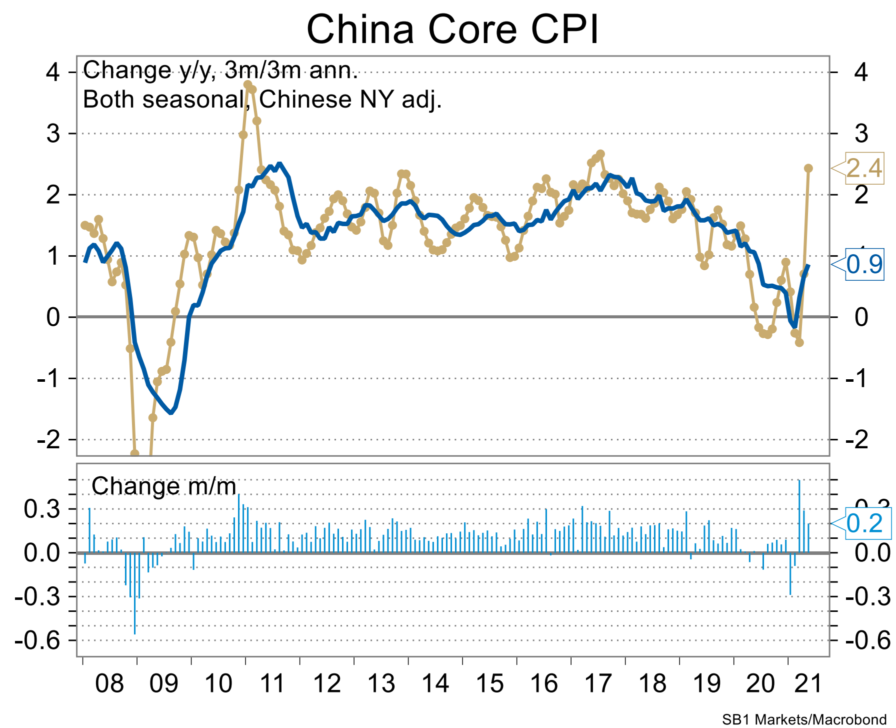


- ... by some few months
- And global metal prices (here the LME metal index) by several months, on average

Chinese inflation slightly below consensus, up 1.3% y/y – and has turned up

Core CPI up 0.2% m/m, and up to 0.9% y/y – but more rapid price increase the recent months

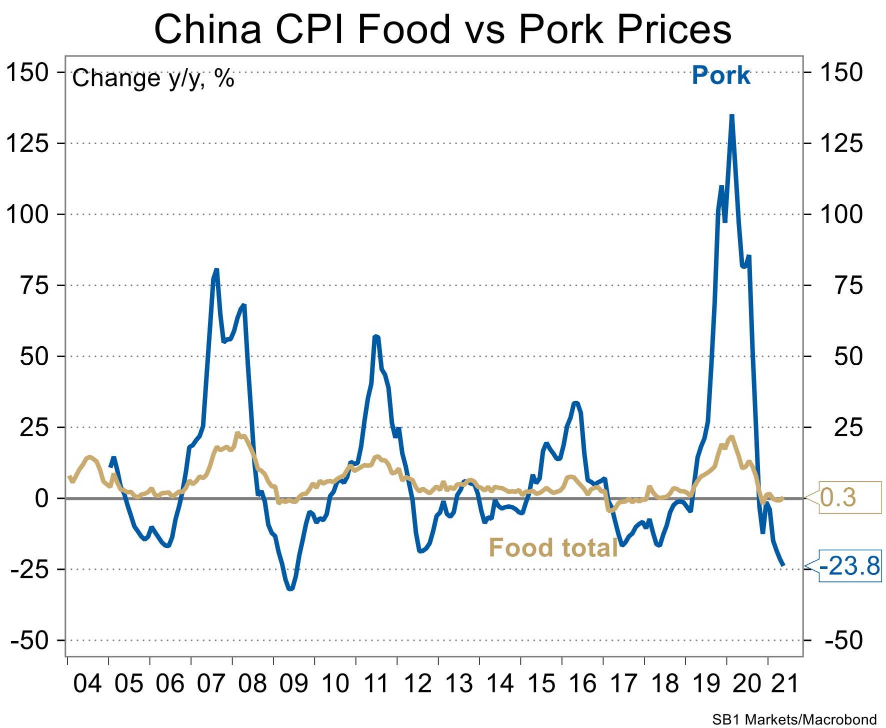


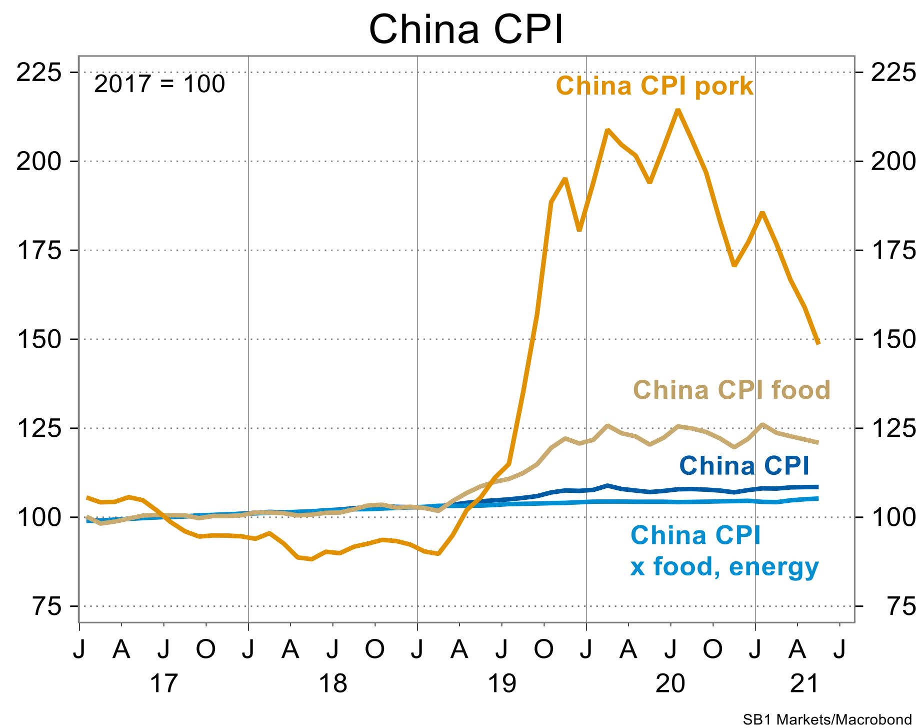


- **Total annual CPI** growth fell from above 5% in early 2020 to -0.2% in Feb. In May, CPI was at 1.3% y/y, up 0.4 pp from the previous month
- **Food prices** fell by 0.8% m/m as pork prices fell 6.6%. Food prices are up 0.3% y/y (down from 0.7% in April). However, the latter is trending down following the 130% price increase due to the 'pig massacre' (swine flu), and prices are still up 50% vs. the level before the flu, and will probably continue to decline substantially over time
- **The core, ex food & energy price index** rose by 0.2% m/m, and is up 0.9% y/y, from 0.7% in April. The monthly price increases were high in both March & April – and the 3m/3m rate has surged
- **Inflation is up but is still low** and supports real income growth. **Monetary policy** will not respond at low inflation per se, the real economy is more important – and it is more than strong enough to rely less on credit fuelled growth – check the previous pages

Pork prices down 7% m/m in May, pulling down food price inflation

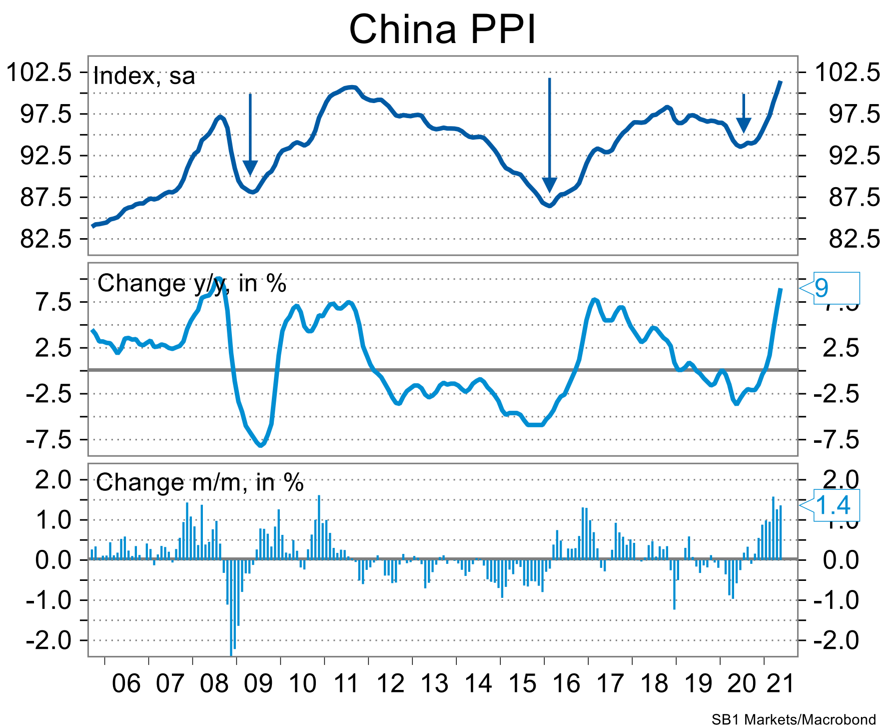
Pork prices are down 30%, but are still 50% higher than before the swine flu – probably more to go

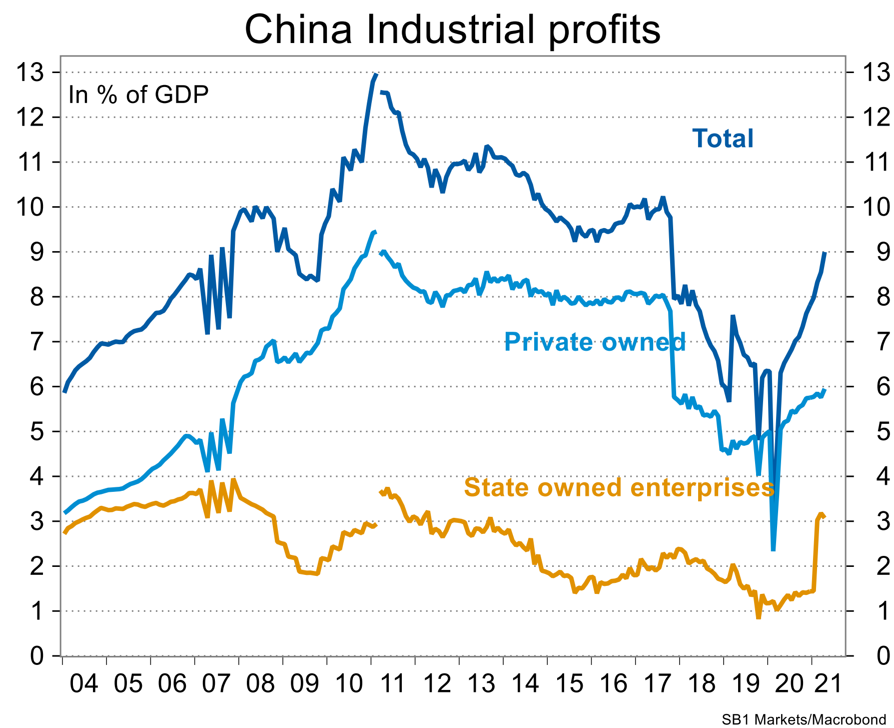




Factory gate prices are still surging thanks to commodity prices – profits are back

PPI up 1.4% m/m in May, up 9% y/y, expected 8.5%. And the impact is felt around the world?

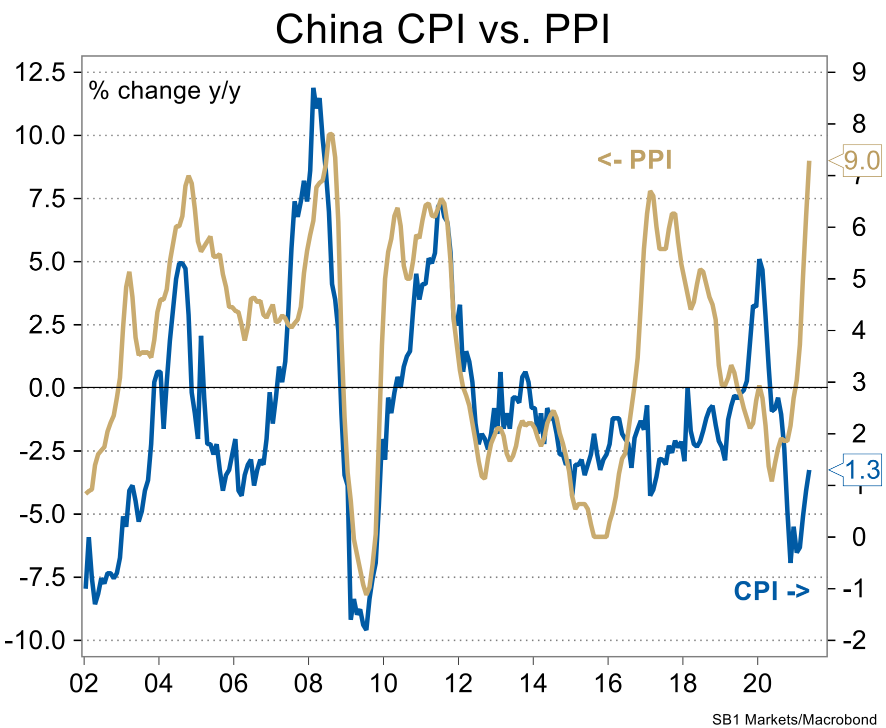


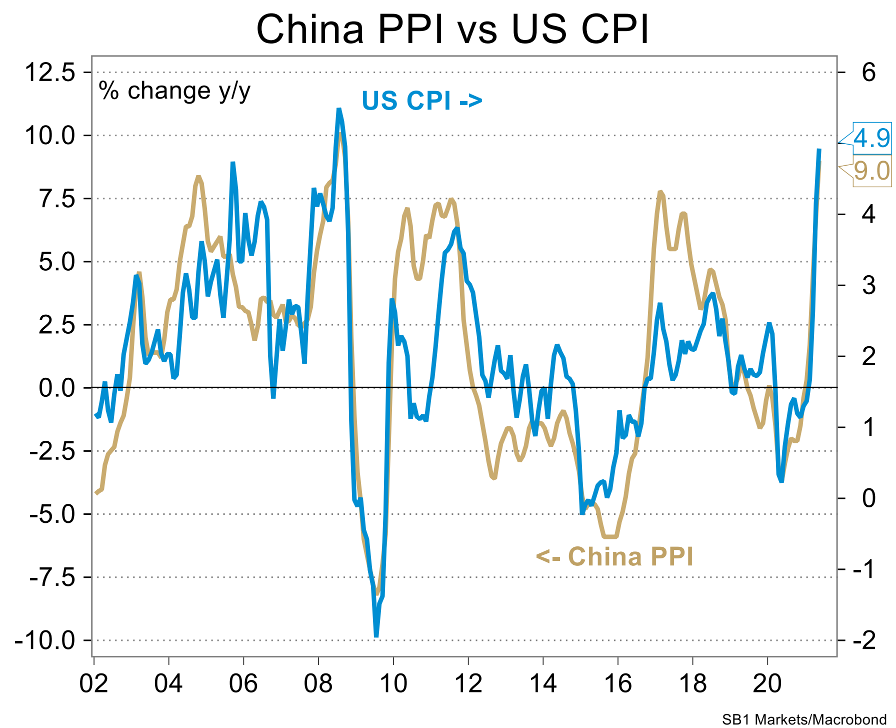


- The **PPI** peaked in late 2018 but prices just fell some 4%, some of it during the spring. During previous setbacks, PPI has fallen up to 13% (and never less than 8%). The rise in PPI in the last few months can largely be contributed to an increase in the price of commodities
  - » The correlation 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 6%
- **Profits in state owned enterprises profits** have now come back above 3% - a level not seen since 2013 (there is something strange in these data…)

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)

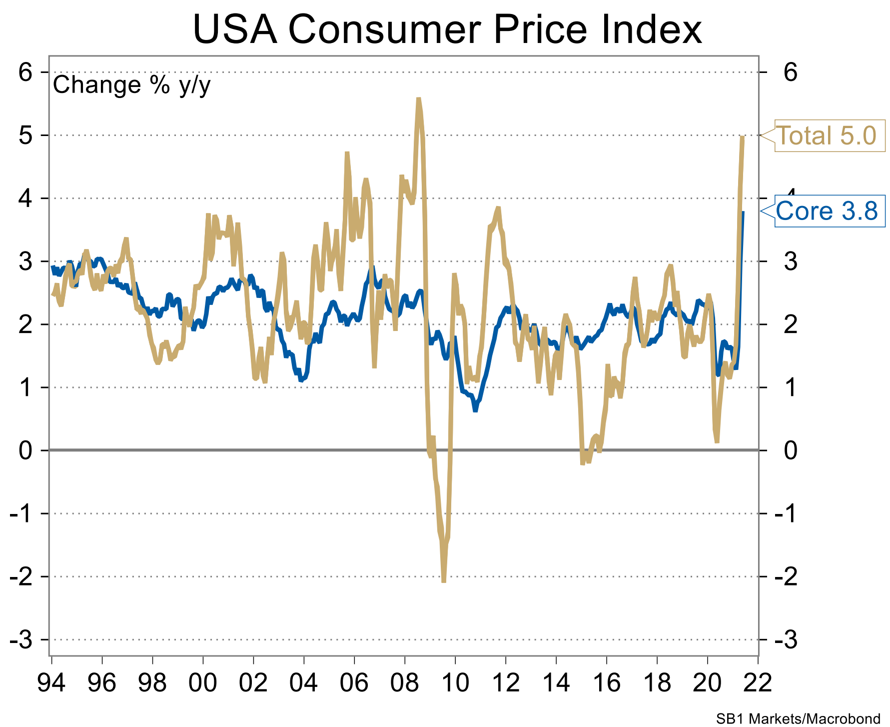


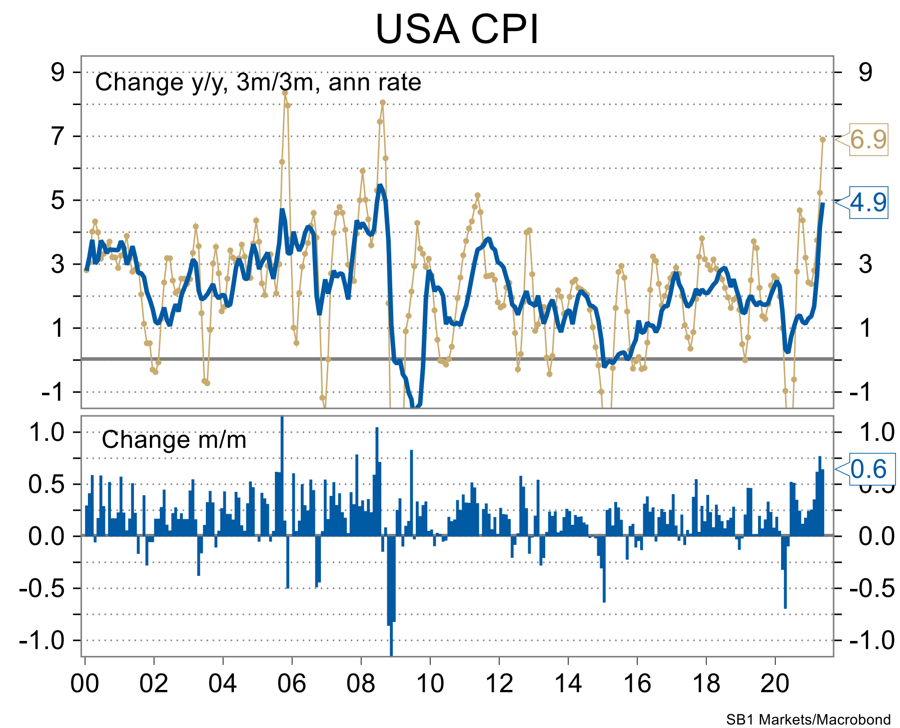


- … And the 'model' worked perfectly in May, check chart to the right ☺

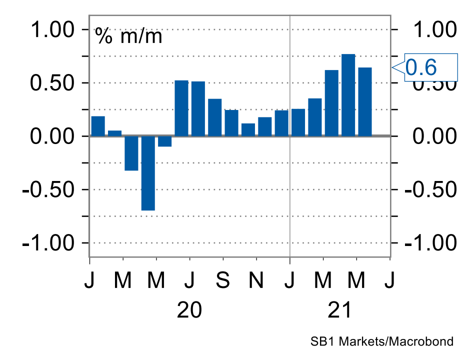
Dear Fed, we need to talk – or rather you need have the talk…

Of course, it could be transitory…



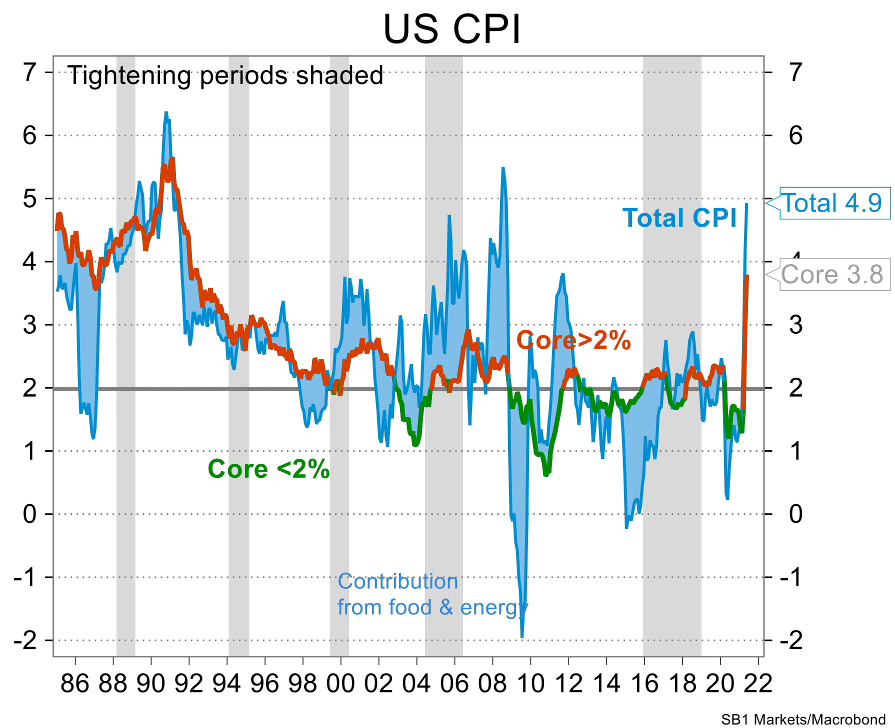


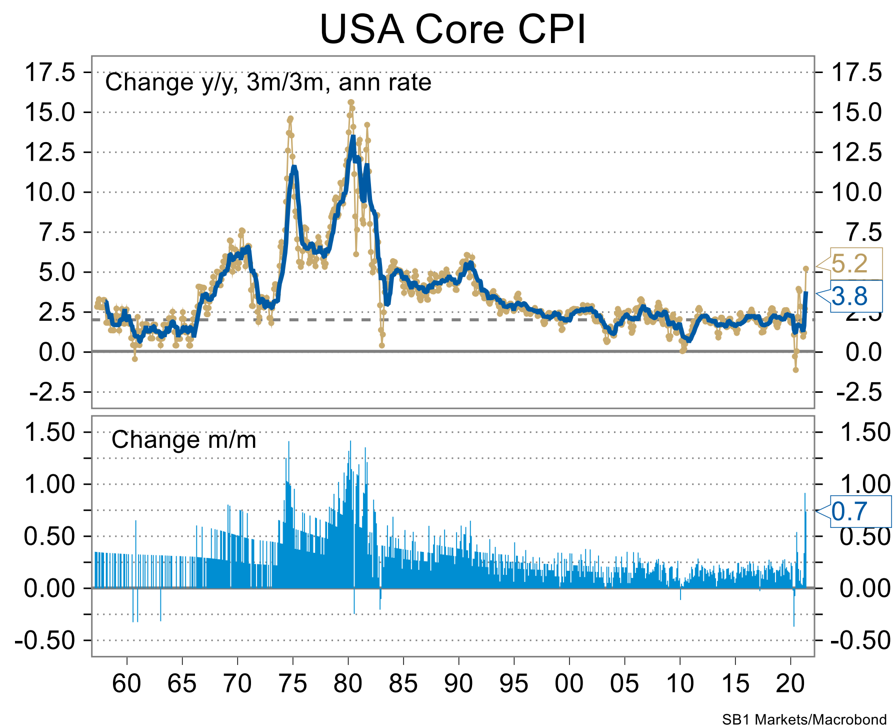
- **Headline CPI** rose 0.6% m/m in May, expected 0.4%. The annual rate climbed by 0.8 pp to 5.0%. So, it's not all base effects, as prices fell by 'only' 0.1% last May. This is the highest headline CPI print y/y since 2009
- **Prices have been accelerating** m/m since last October, and the 3m/3m rate is now up to 6.9%, highest since 2009
- In May surveys, companies reported that they expect to lift prices sharply. We doubt all these planned price hikes are competed
- **The annual rate** may come down over the summer as prices rose sharply m/m (0.5 pp) in both June & July last year
- **The Federal Reserve** can still afford to wait and see, but the 2% average inflation 'over time' (or the price level target) 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



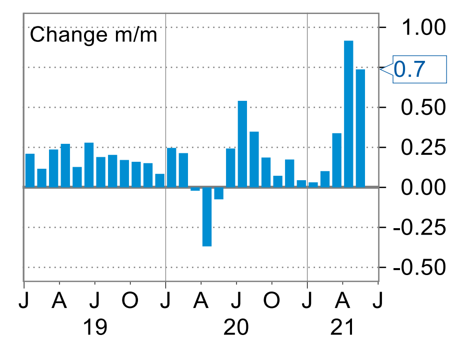
Core inflation sharply up too, the annual rate the highest in almost 30 years

Prices +0.7% m/m in May, expected 0.4%, the y/y rate jumped 0.8 pp to 3.8%. The 2 y avg at 2.5%



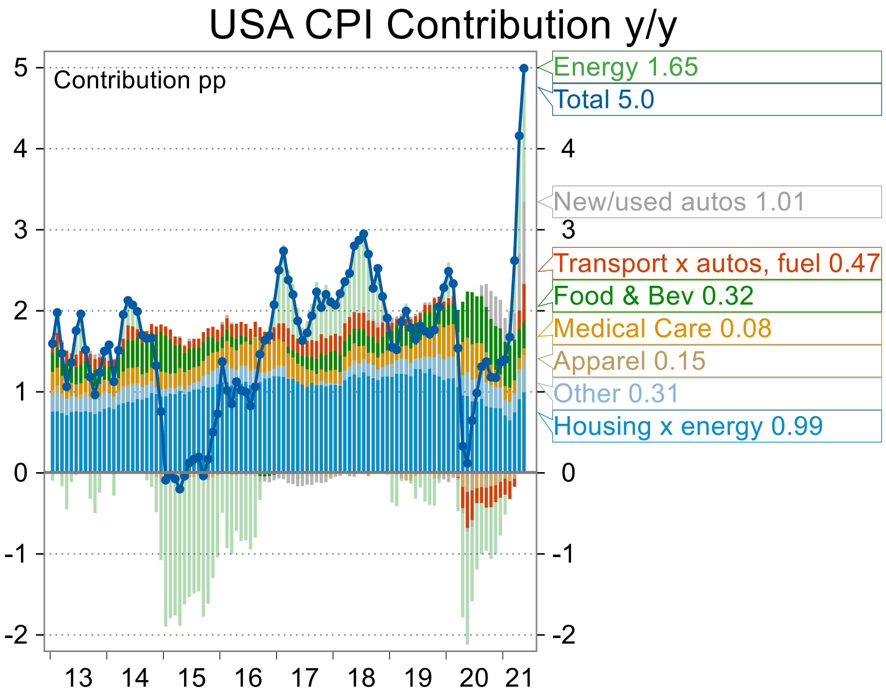


- **Core prices** rose 0.2 pp less than in April – which yielded the highest monthly increase since 1982
  - » Until the April 'shock' the 3m/3m price growth at 1.2% did not signal any serious pressures, now it is at 5.2%
- The price hikes in both April and May were at <u>least partly due to one-offs</u> which will not be repeated, or will be reversed
  - » Used auto prices (and auto rental 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. <u>And there is some broadening of inflation</u>
- Parts of the hike the annual rate is due to the falling prices last spring. However, <u>the average inflation since April 2019 is 2.5% - and inflation has been above 2% whatever relevant starting point</u>

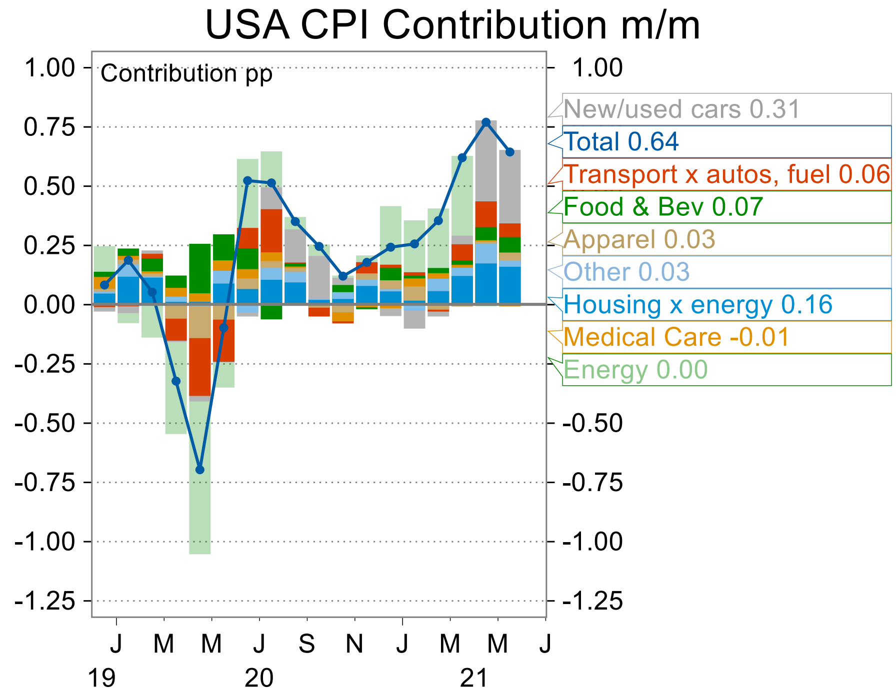


Transport & energy explain 3.1 pp of the 5.0% lift in total CPI

... Of which half from energy, but new/used vehicles & airline tickets are sharply up too



SB1 Markets/Macrobond



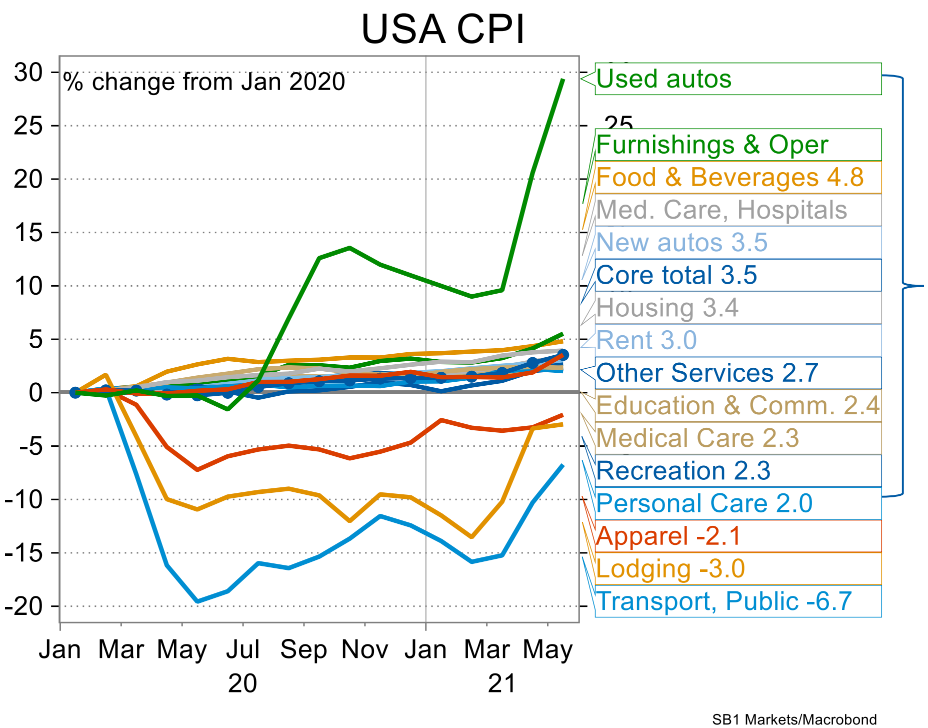
SB1 Markets/Macrobond

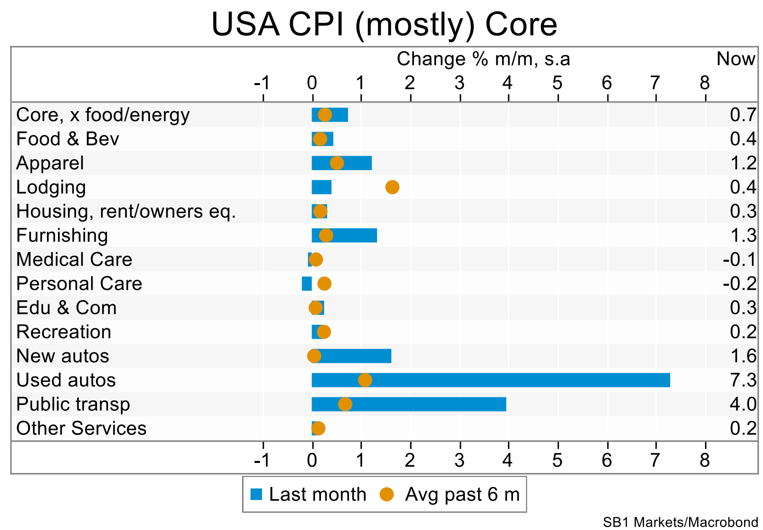
- In May (and almost in April), **new & used cars** explained half of the m/m lift in total CPI, and 1 pp of the 5% y/y growth in headline CPI
  - » Used car prices rose 7% in May, and are up 30% y/y. They are probably too expensive now, but not necessarily by 30%. The upside must be limited, though (as we said one month ago..)
- **Energy** has lifted the headline CPI by 1.65 pp in the past year (but was not to blame for any of the m/m lifts in April or in May, 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 (see more here)
- Excluding the 3.1 pp **contribution the headline CPI from energy & transport**, "remaining" inflation is well above 2% (weight adjusted) - however the highest level in several years. In addition, a far higher parts of the CPI is now reporting growth above 2% (even measured as an average over 2 years, in order to adjust for the impact of price cuts last spring)

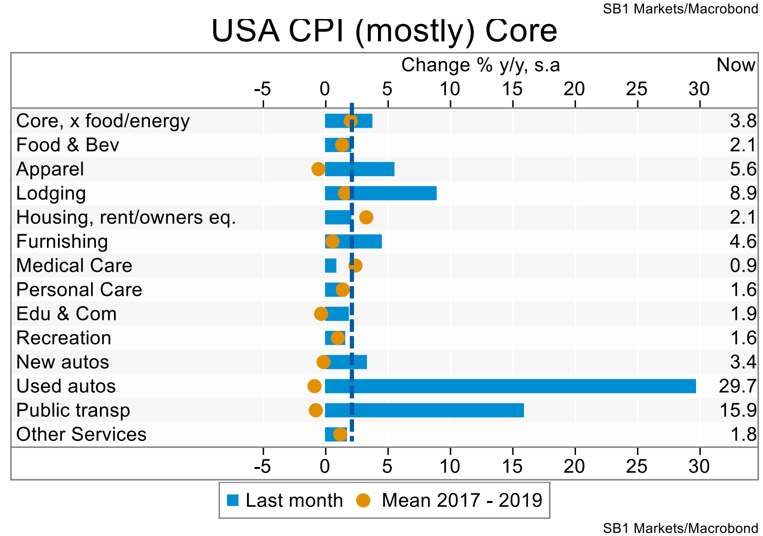
Lodging away from home (incl hotels) is a part of housing at the charts above

Used auto prices straight up in June, +7%, 30% y/y.

9 main sectors up >2% y/y, 5 are below







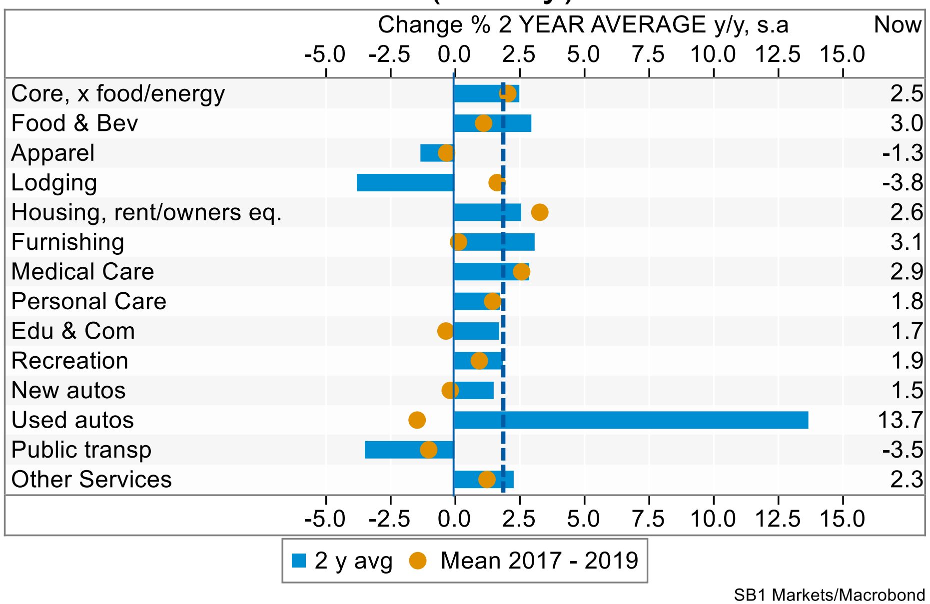
- Just some few components of the CPI contributed to the 'corona' setback last spring: **Public transport** (airline tickets) **lodging** away from home (hotels ect), and **apparel**. Other components of the CPI did not slow significantly
  - » Now these sectors are hitting back, bringing their prices up to more normal levels again – but they all remain well below par – more upside the coming months
- **Used auto prices** have been on the way up since last summer – and shot up almost 20% over the past couple of months, and by 30% y/y – and deliveries of new autos is hampered by lack of components. These pries are very likely above a normal level, if not by 30%

SpareBank 1 MARKETS

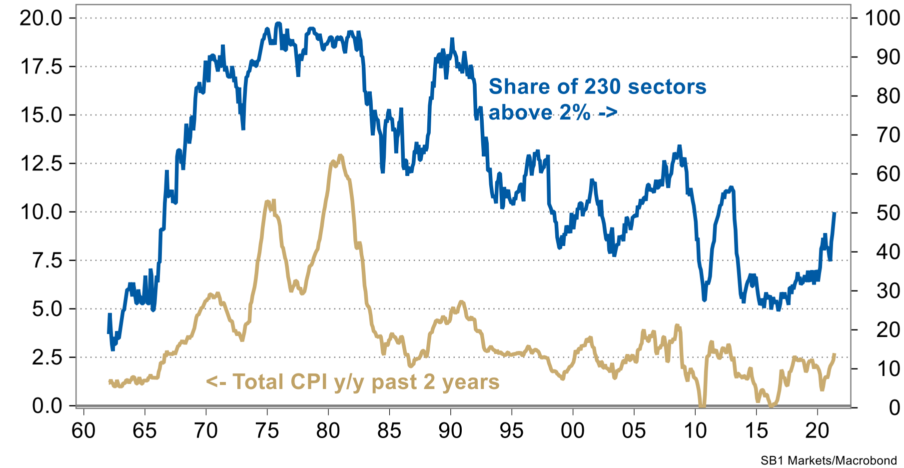
Inflation over the past 2 years: Some acceleration

Core inflation is up 2.5%, up from 2.1% average in 2017 – 2019 – and some broadening

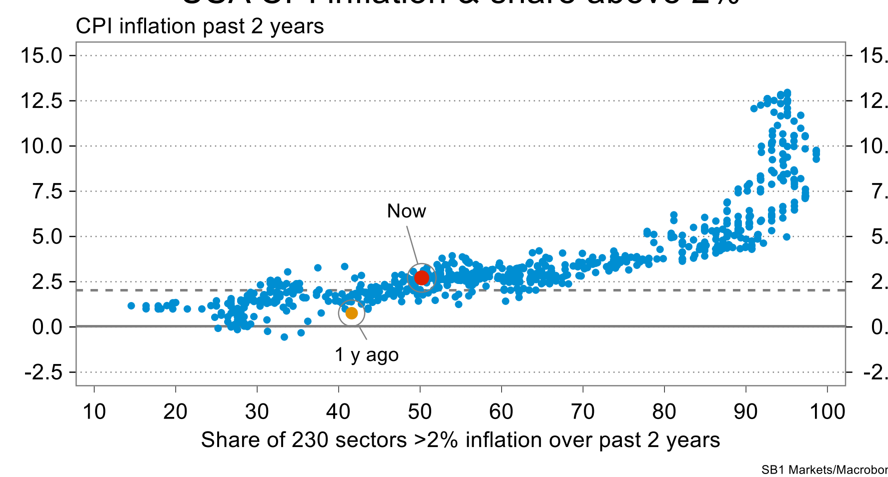
USA CPI (mostly) Core



USA CPI inflation & share above 2%



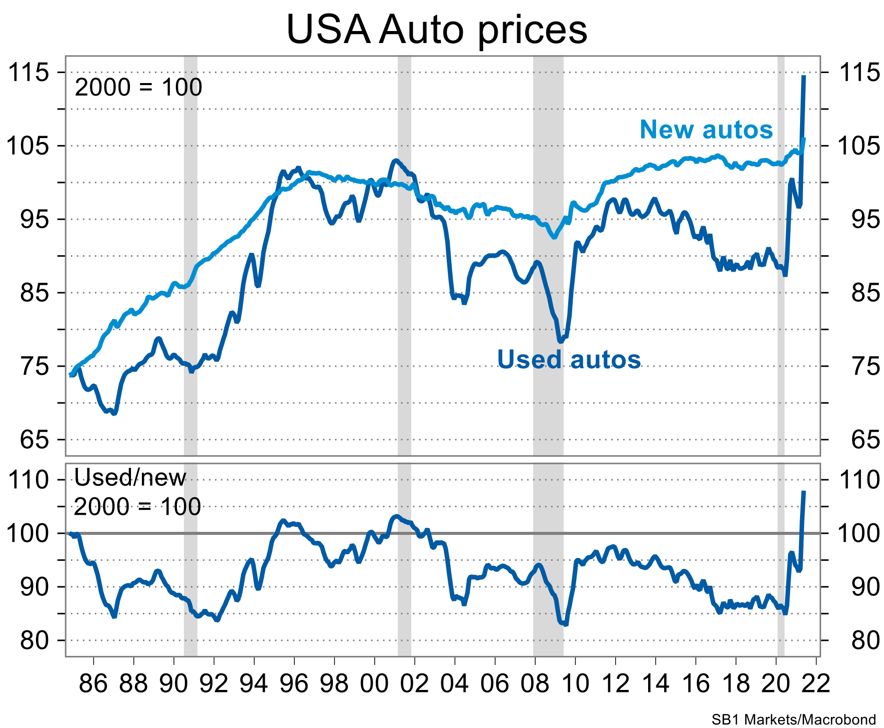
USA CPI inflation & share above 2%



- Of the 13 main sectors, 6 are up more than 2% per year since May 2019, and 7 are below the 2% line
- Over the past 2 years vs the 2017-19 average, inflation has accelerated in 9 sectors, and slowed in 4 sectors
- Of 230 sectors, 50% is up more than 2% over the 2 past years, 50 are stil below

Are 2nd hand cars too expensive following the 30% lift?

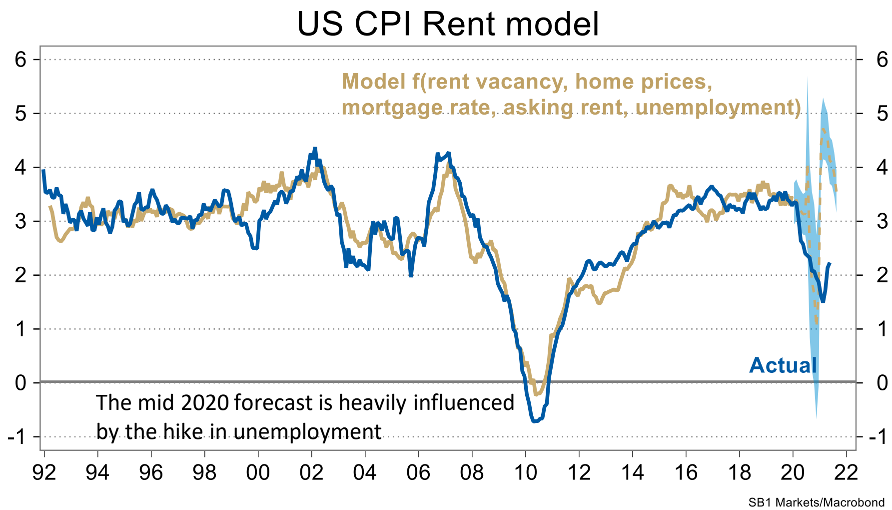
Very likely. But they were too cheap before the pandemic too?



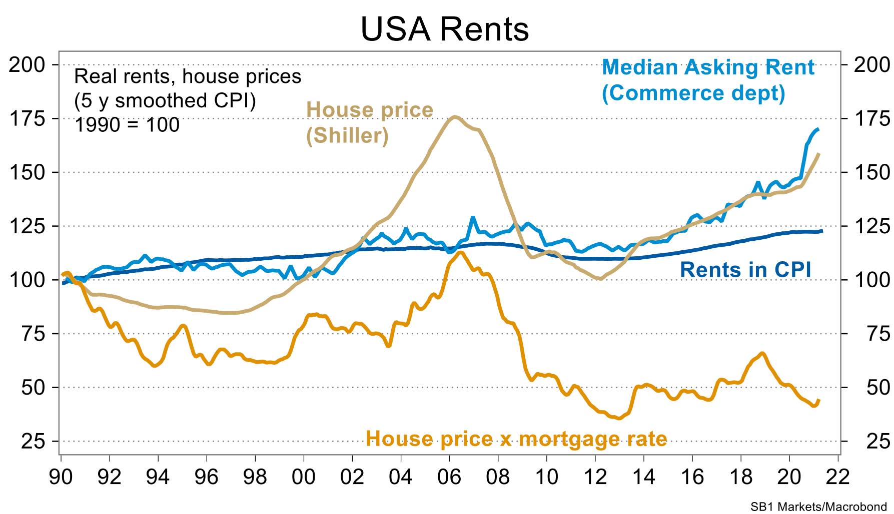
- By the way, prices for **new autos** are up 3% since 1996, quality adjusted, that is. And until the recent price hikes in a very tight US auto market, 2nd hand prices were down 10% the past 25 years (quality adjusted)
- It is impossible from these data to be sure if there is an equilibrium between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

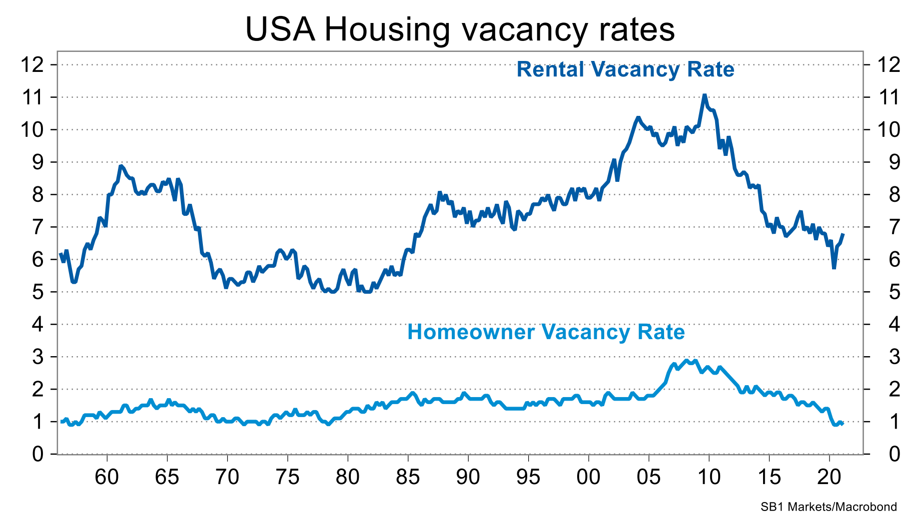
A tight rental market – a possible threat – even if mortgage rates are low

A low vacancy rate, rental asking prices are up (according to some measures), house prices are up



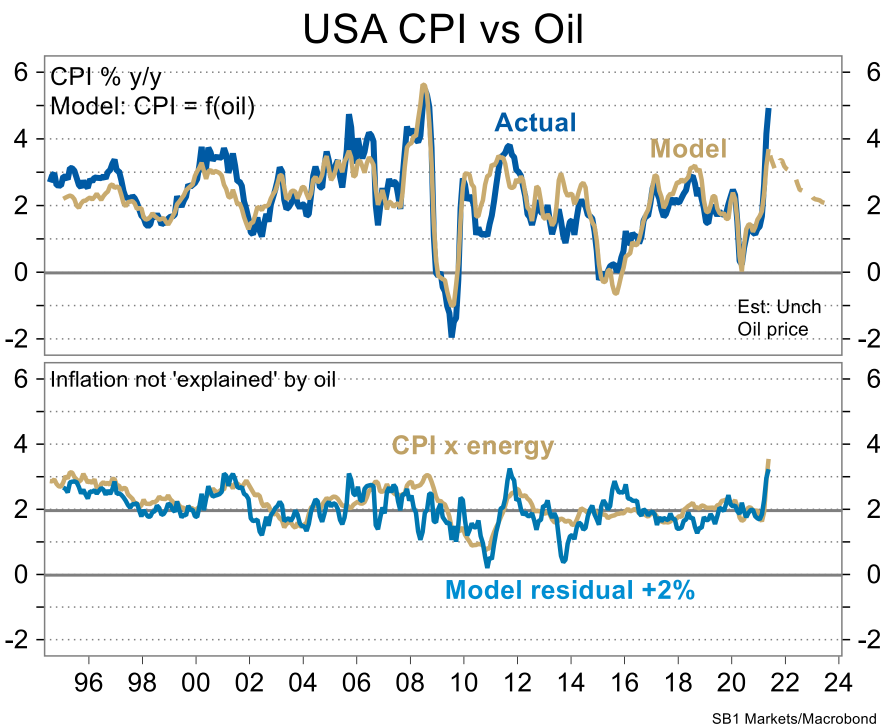
- **Vacancy rates** may have bottomed (more investors are entering the housing market) but are still low. Few owned homes are vacant too
- **Rent inflation** has been far lower than traditional models explain during the pandemic
  - » However, the pandemic was a special happening, at the rental market too – but the pandemic is now receding
- The official (Commerce dept) rental asking price index reports an 18% increase y/y. However, other rental surveys yield far lower increases in rents, as rents in several metropolitan areas have fallen sharply, and report an average growth between zero and 5%
- **Our model:** A significant increase in rental inflation is not unlikely at all, say by 1 – 1½ pp, which will just lift rent inflation up to a 'normal' level at 3 – 3½%. The impact on headline CPI would be substantial, 0.3 – 0.5 pp

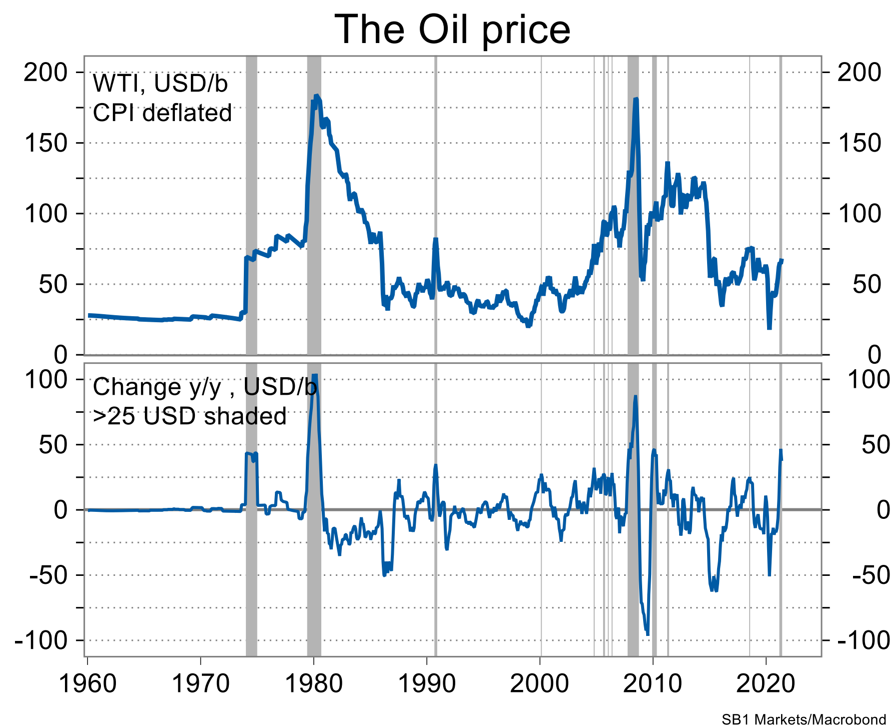




The oil price moves the headline CPI – in both directions

The oil price has already increased a lot. More to go? Not a whole lot, in our opinion





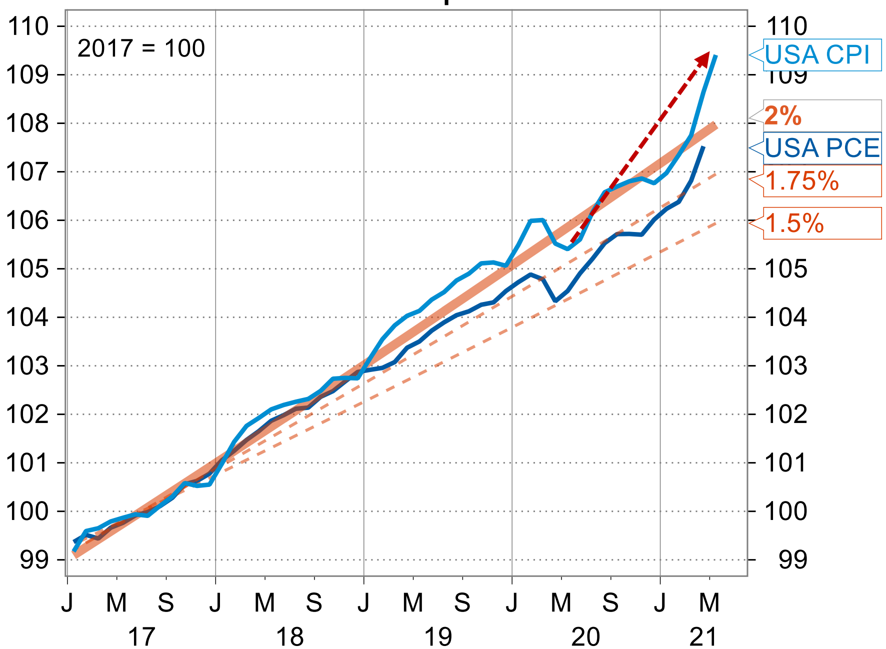
- **Oil price cycles** have explained some 80% of the changes in CPI growth the past 30 years
  - » In our model we incorporate all indirect impacts from changes in the oil prices – as well as the impact from other factors that influenced inflation which correlates to the oil price.
- From time to time, there are substantial residuals, like now: Headline inflation is more than 1 % above the model forecast, as is the CPI x energy index (which is close to the core CPI). Why?
  - » Other factors are pushing inflation up, which are not correlated to the oil price. Excess demand, higher wages or something else? We have to refine our model…

SpareBank 1 MARKETS

The price level target is met. The Fed will start talking about tapering this week

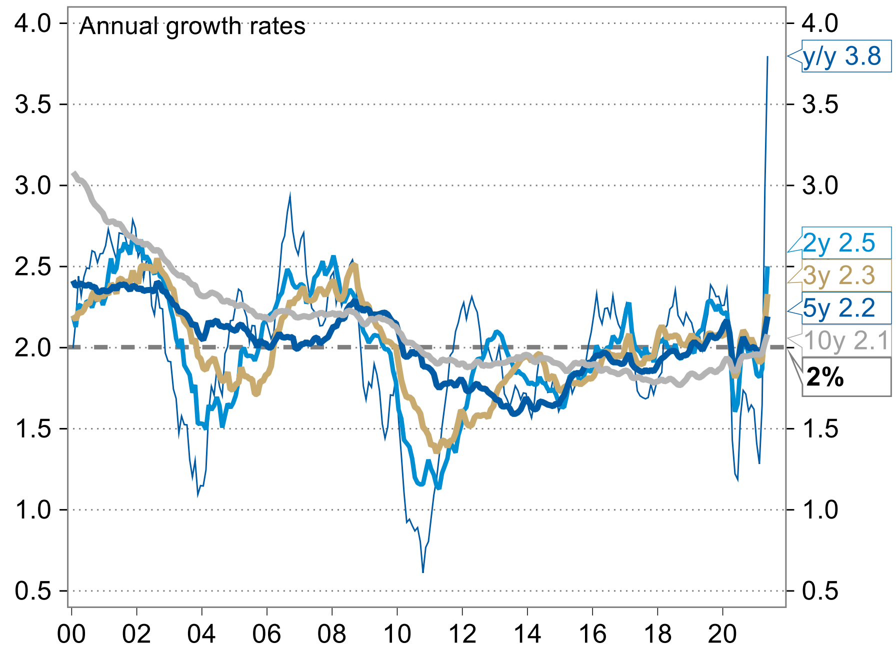
The maximum employment target is not met, and Fed do not have to change tack now

USA Core price level



SB1 Markets/Macrobond

USA Core CPI inflation



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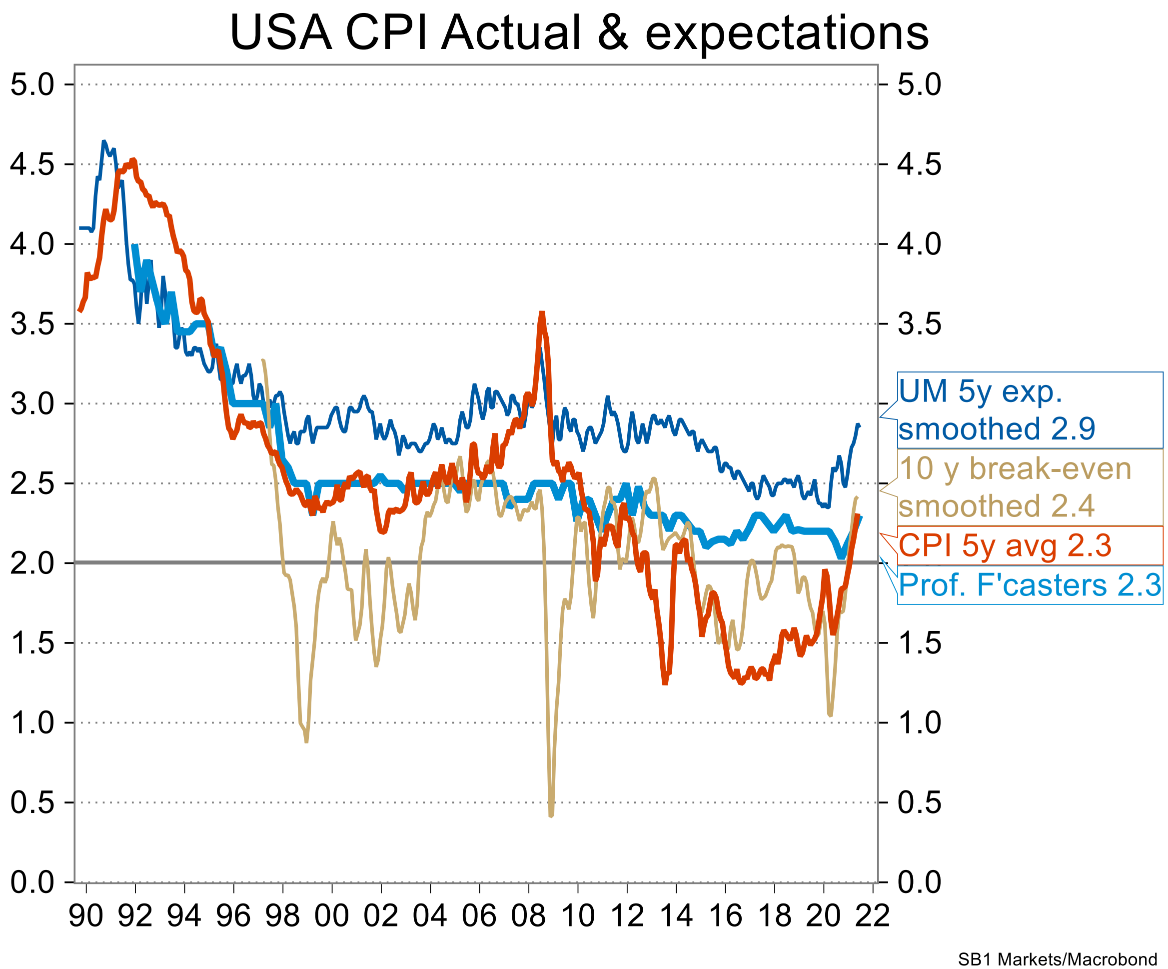
- The Fed has not defined its time horizon but the price level target is more or less met, whatever time horizon the Fed chooses
  - » **Measured vs. the CPI**, the average core inflation is at or well above 2%, whatever period we check. The core PCE deflator is close to 2%, whatever horizon
- **Inflation expectations** are above 2% in markets & among households and very likely among companies as well
- **The labour market is still 'impossible' to evaluate**. Will the millions that remain outside the labour market return as the corona virus retreats and extra unemployment benefits will be abolished, from now in some states, by Sept. everywhere

Inflation expectations are drifting up but are not yet worryingly

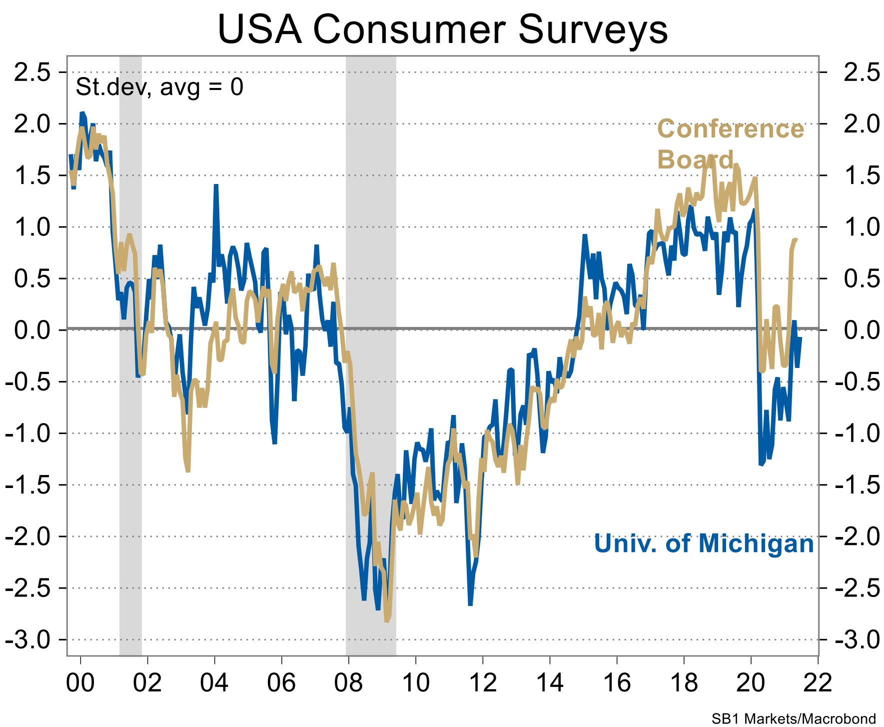
Univ. of Mich survey 5 y inflation expectations have climbed to 2.9% from 2.4%

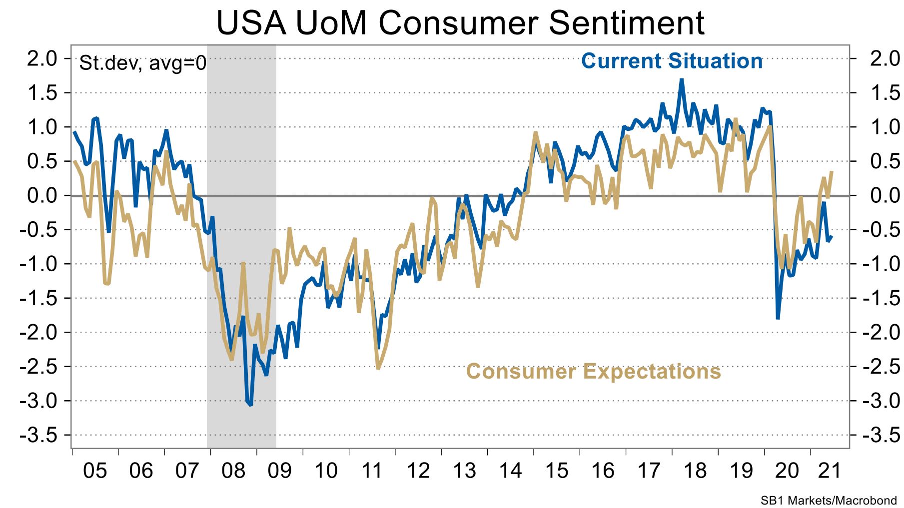


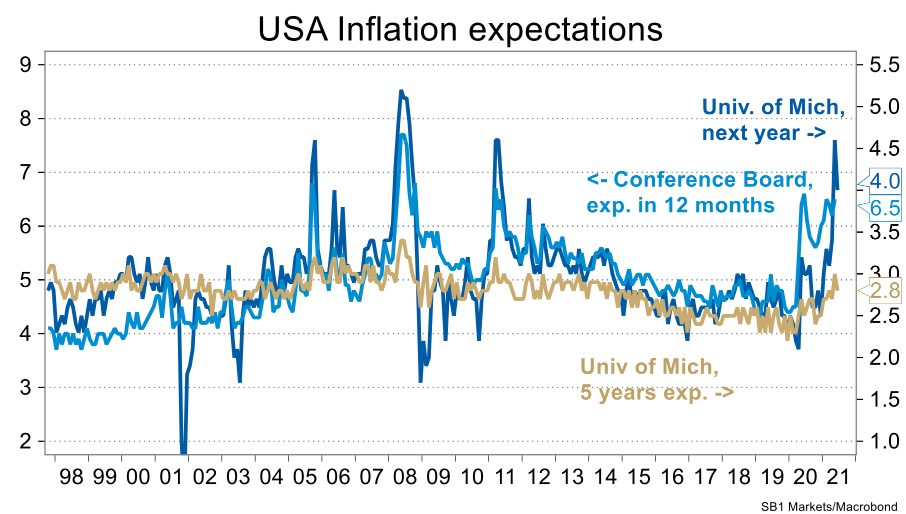
- **The UM's survey's** 2.% rate is close to the highest in 10 years (2.9% smoothed at the chart to the left), and it is 0.4 pp higher than before the pandemic (2.5%)
  - » Still the level is not far above the past 10-year average – but it is a sign for the Fed, of course
  - » The UM short term inflation 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 (CPI) inflation expectation** has fallen to 2.32% (not smoothed) from above 2.5%. Not too high for Federal Reserve

Univ. of MI: The May setback mostly reversed in June, level still below par

Expectations best since before corona, inflation expectations a tad down, in spite of higher act. infl.





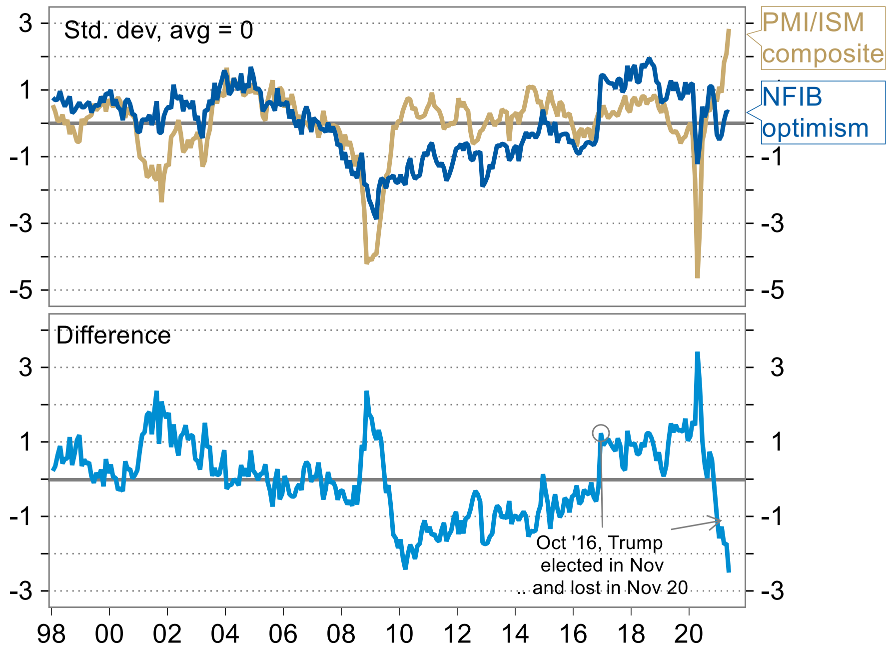


- **The UM sentiment index** rose to 86.4 in June from 82.8 in May, 2 p better than expected. The level is marginally below the historical average
  - » Expectations rose more than the current situation
- **Inflation expectations** have climbed substantially recent months, but fell slightly in May – even in actual inflation rose sharply in April published in May

Small businesses optimism marginally lower in May, and the outlook is... bad!

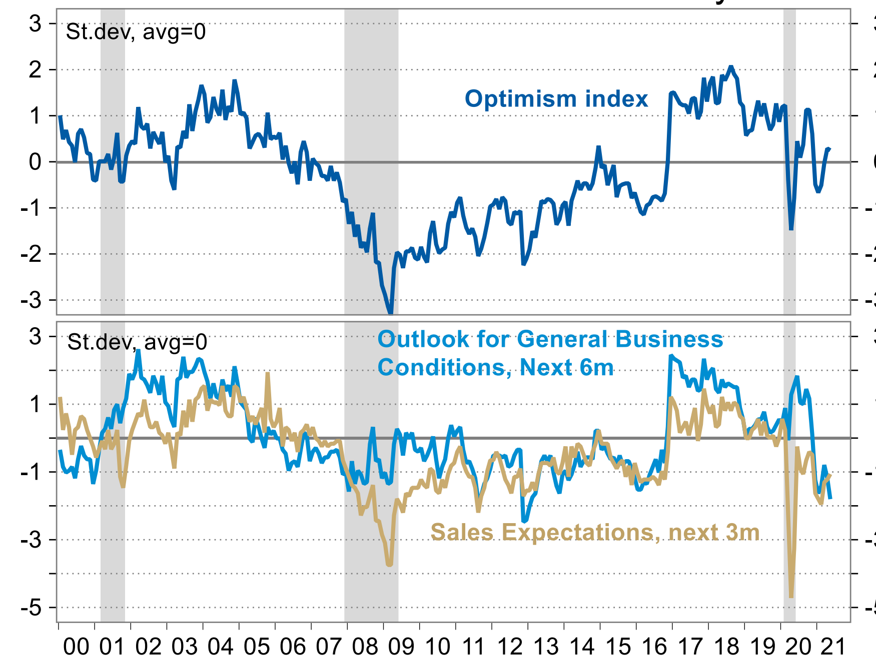
Small businesses cannot find workers, still plan to hire – and nobody complains about today's sale

USA NFIB Small businesses vs. PMI/ISM



SB1 Markets/Macrobond

USA NFIB small business survey



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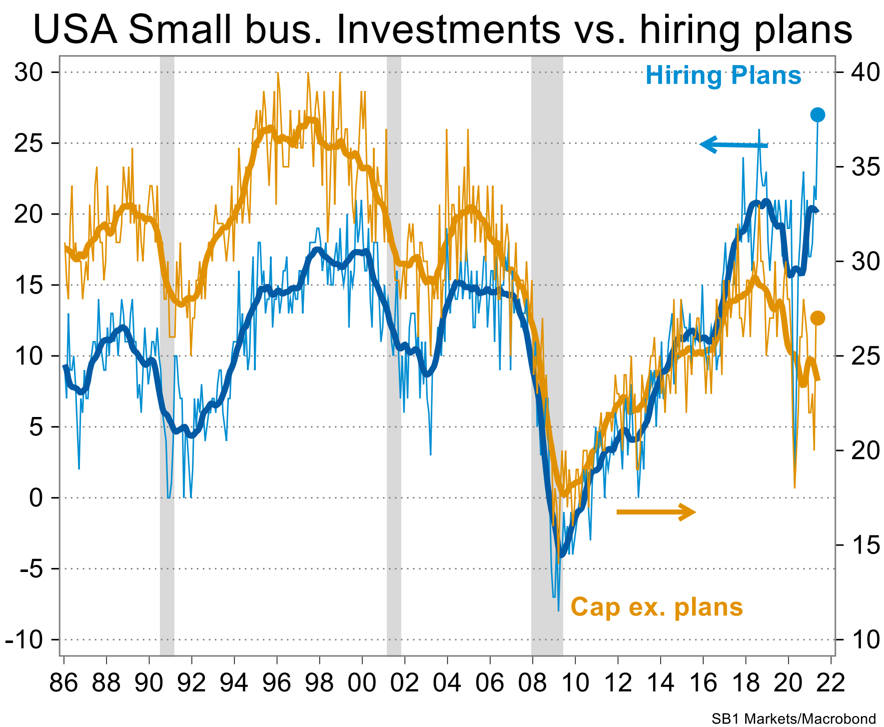
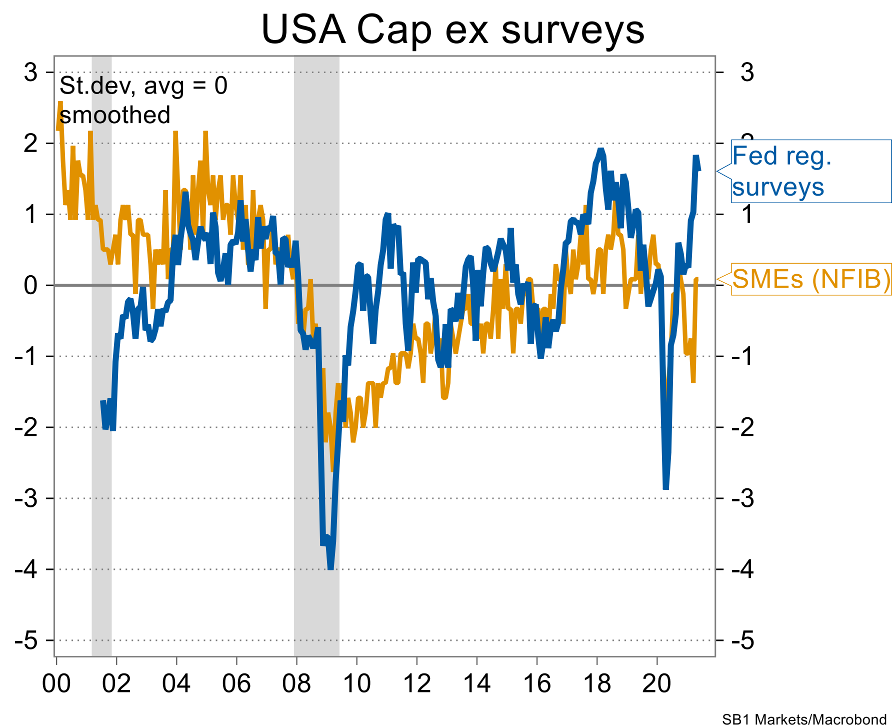
- The **NFIB optimism index** decreased to 99.6 in May from 99.8 (expected up to 101). 5/10 components improved, while 3/10 fell. The index is above an average level but far behind the PMI/ISMs, and all other surveys
- **The outlook for the next 6 months** declined in May and is 1.8 st.dev below par, which does not seem reasonable at all, amid the reopening of the US economy, but lack of qualified labour and inflation worries rattle small businesses
- **Investment plans** was unchanged at a marginally above average level
- **Hiring plans** increased 6 p in May and are at a sky high level. However, the SMEs are not able to **fill their vacancies**
- **Actual & planned price increases** are soaring – like we have never seen before (barring 1 month in 1979…)

Hiring plans through the roof, investment plans are up to an average level

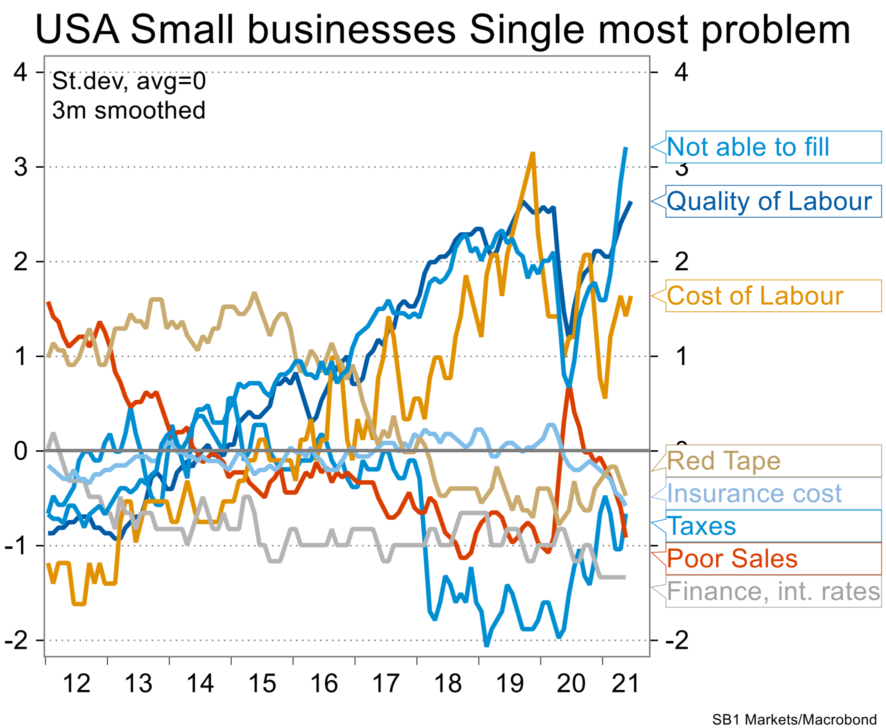


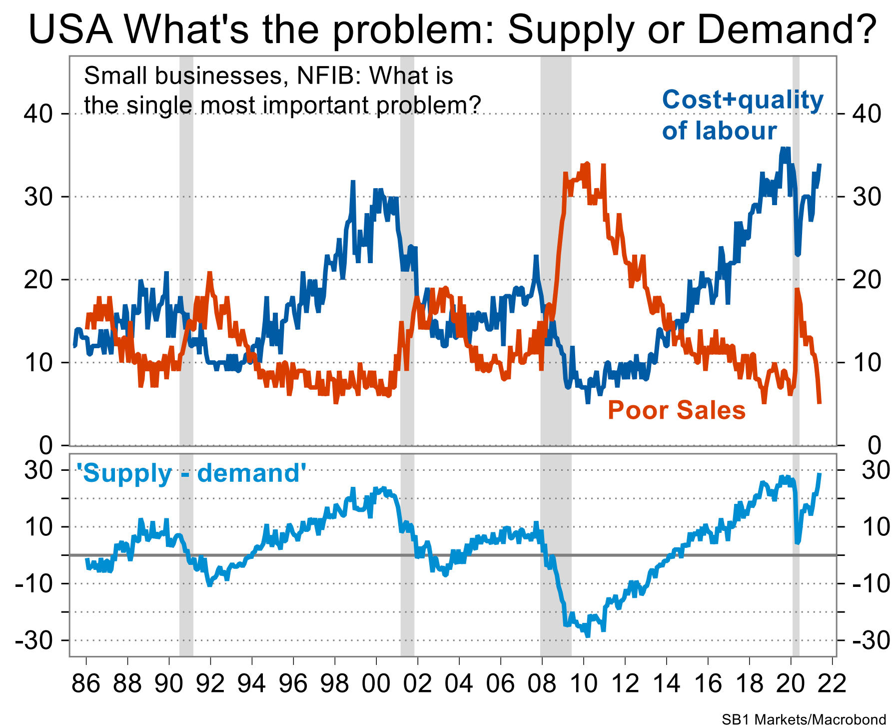


- Other investment surveys are more upbeat than the small business survey

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 at a beginning…

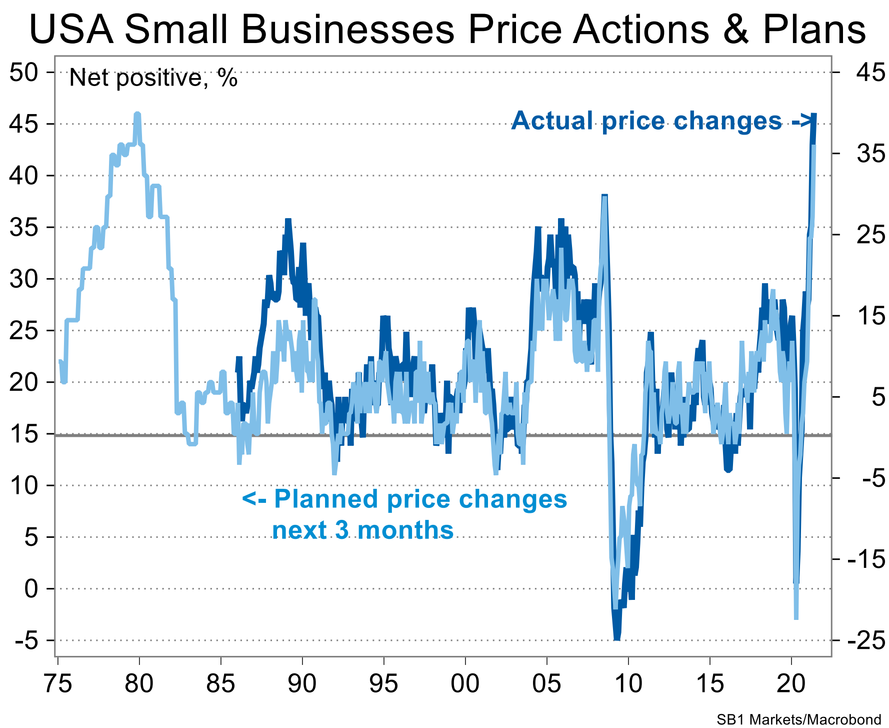


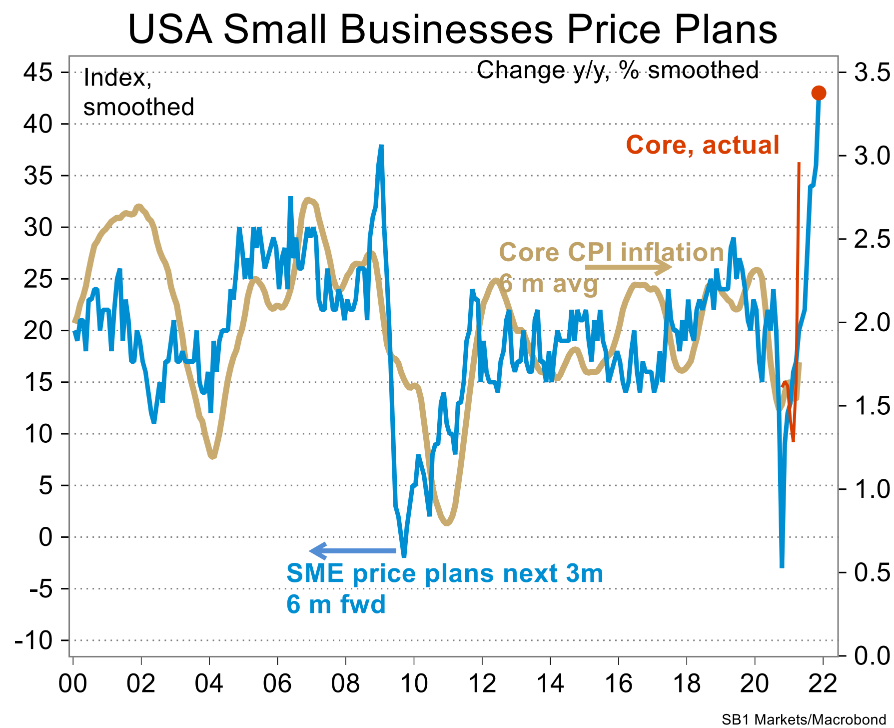


- While more businesses than normal stated **weak sales** as the major problem during the pandemic, there were never that many, and <u>now fewer than the average share of companies say than poor sales is the problem</u>
- **Availability, quality, and cost of labour** is a much more serious problem than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

Check these price messages from the small businesses

We hope you will never see anything like this again

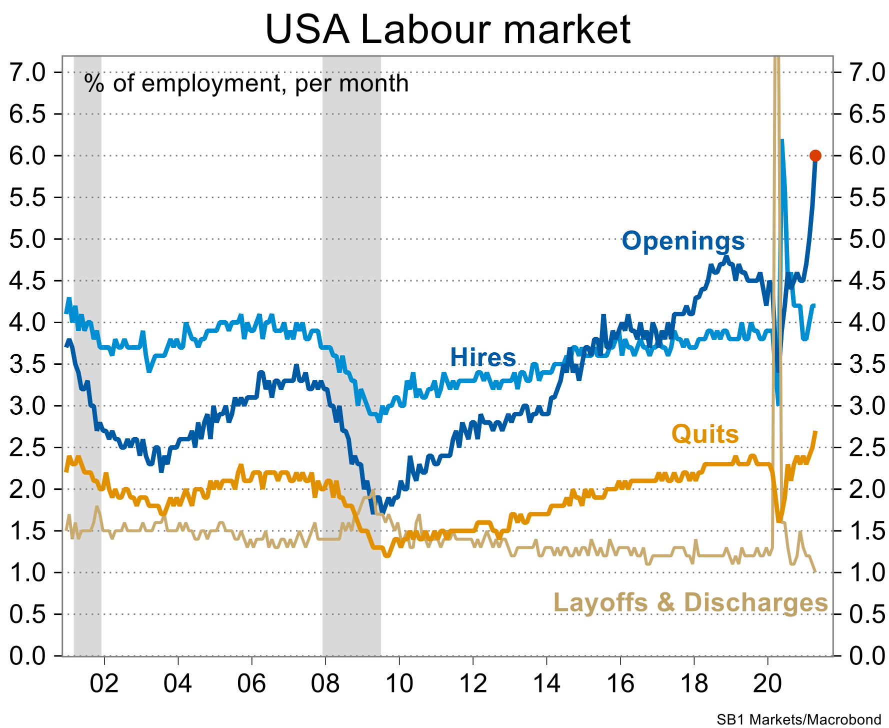




- It is long time since last time anyway, in December 1979, when price plans were as aggressive as today

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

The vacancy rate up to 6.0%, 9.3 mill vacant positions, up from 8.3 mill in March

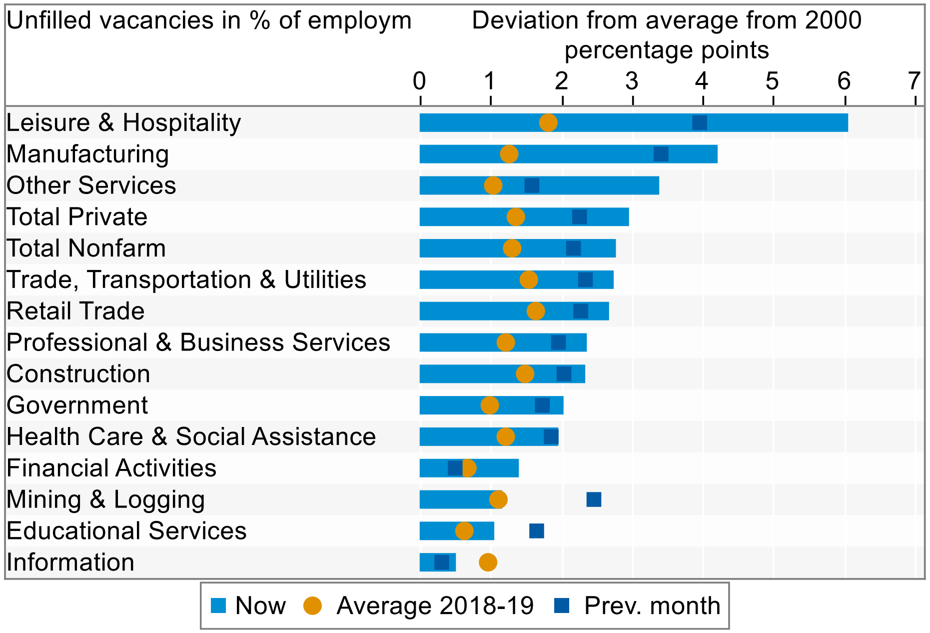


- The no. of **unfilled vacancies** rose more than expected in April, and is at record high, both in the actual number (9.3 mill) and in % of employment (6.0%). The highest rate before corona was 4.8%, in 2018 (and 3.5% before the financial crisis)
- **Businesses are hiring** at a very rapid pace, at more than 4% per month, only beaten by the first part of the recovery last year
- The rate of **voluntary quits** rose to 2.7% in April, 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. As with unfilled vacancies, quits are closely correlated to wage inflation – for obvious reasons
- **Layoffs** fell to the lowest level ever in April. Thus, it is strange that the inflow of new jobless claims remain above normal levels, check 6 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

USA Unfilled vacancies (JOLTS job openings)



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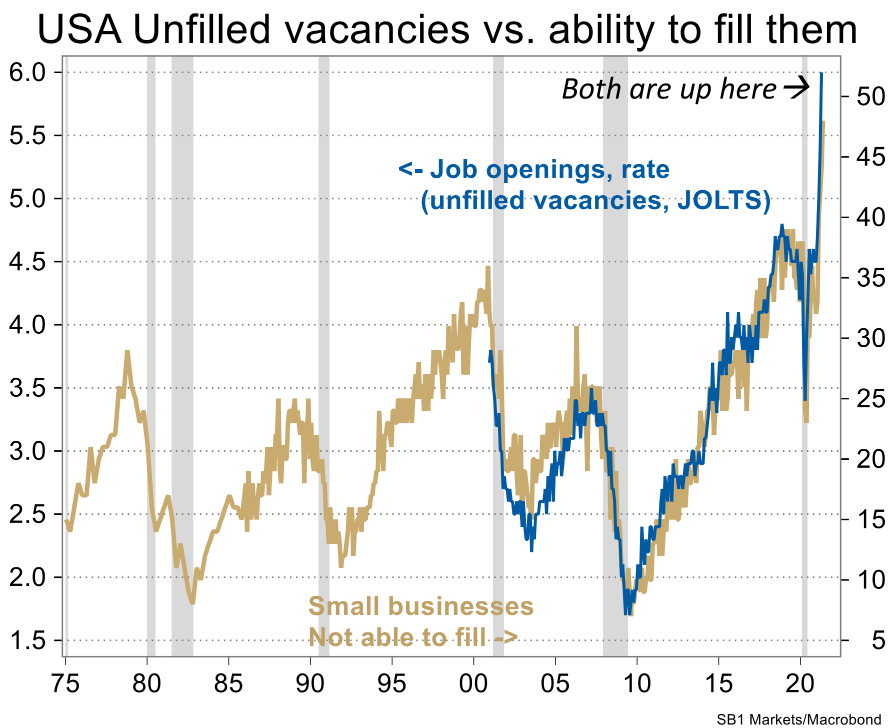
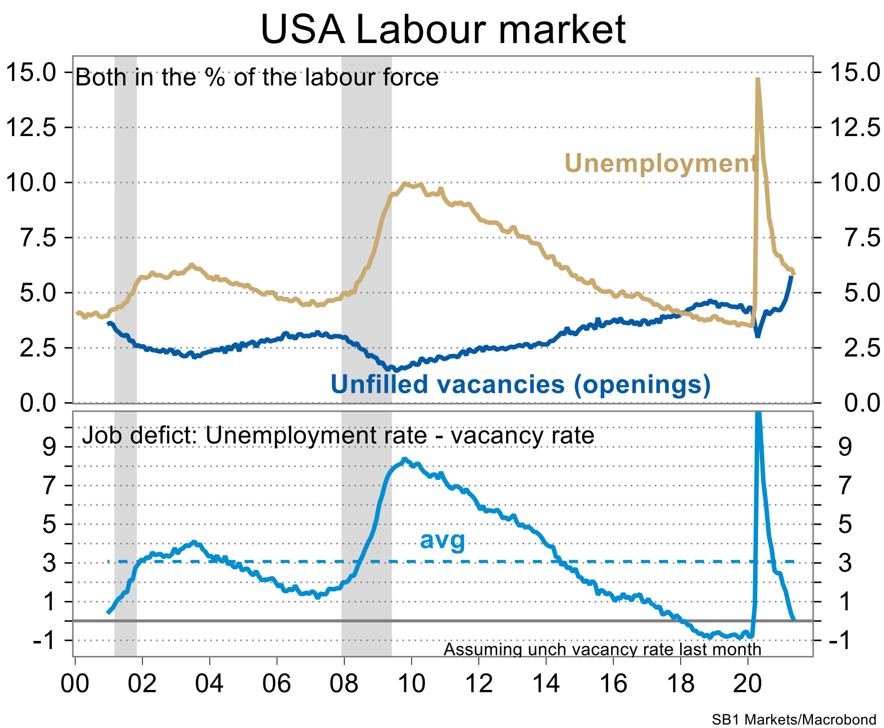
- … but also in manufacturing and retail trade
  - » Just the information sector is reporting fewer vacancies than before the pandemic
- Have previous active workers
  - » Left the labour market temporary, due to corona?
  - » Left these low paid sectors for better jobs elsewhere?
  - » Or are they staying outside the labour market because unemployment benefits are too generous due to the temporary USD 300/week extra federal support?

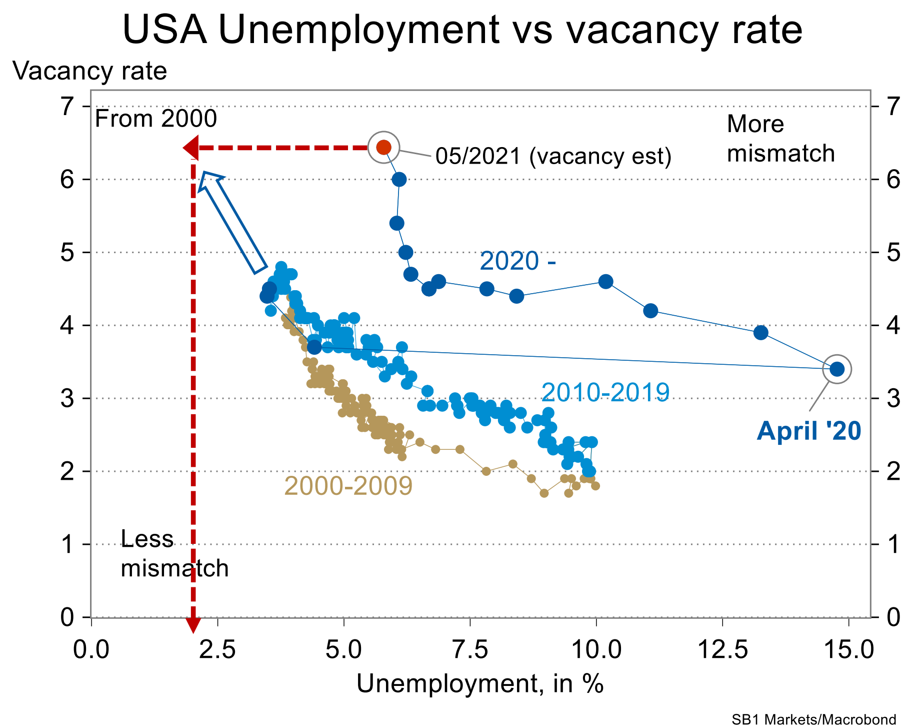
Official vacancy data confirm NFIB survey data (almost perfectly)



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

... as if the unemployment were below 3%, and not 5.8%

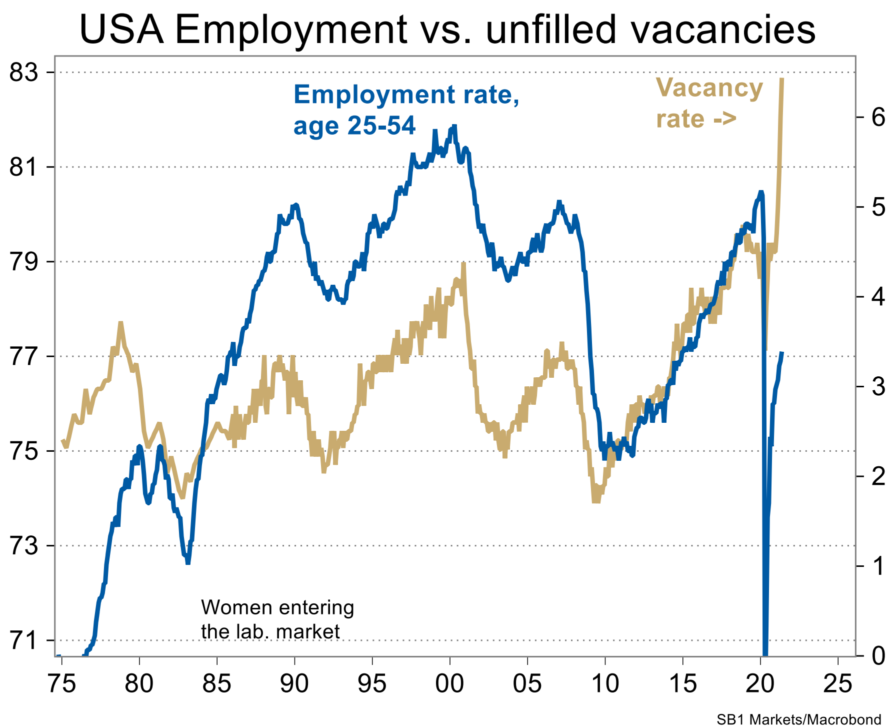


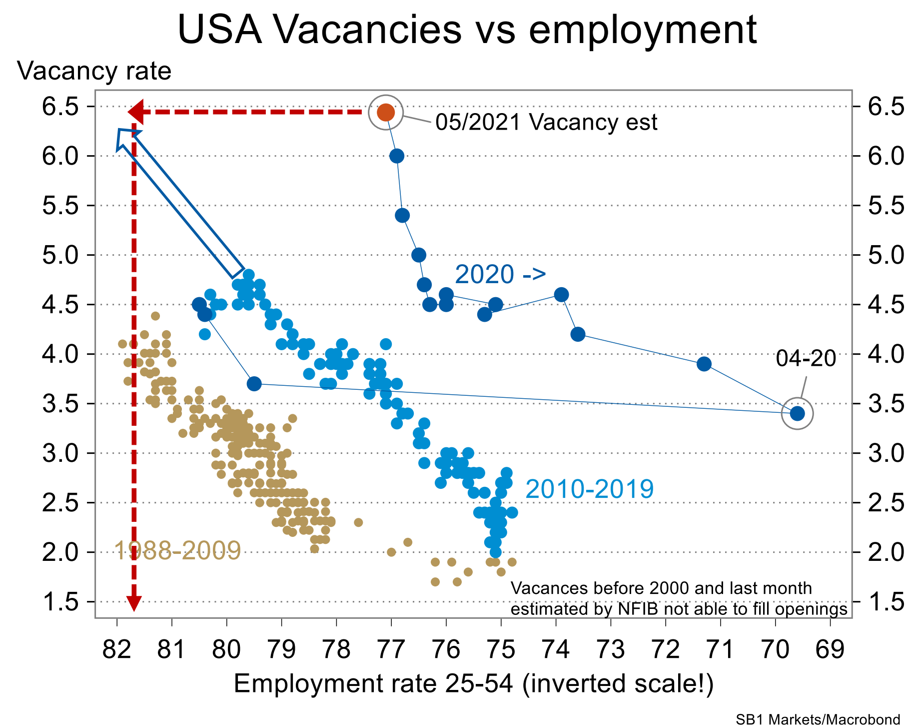


- **It is a permanent downward shift in labour supply** – a huge increase in mismatch in the labour market or that many workers now prefer to stay outside the labour market. If so, a 'disaster' – wage growth will accelerate sharply, inflation will be more than transitory & the Fed will have to respond. If the Fed does not respond, another disaster in the waiting, and a more abrupt and dramatic shift in policy will be needed
- **Or it just at temporary sweet/sour spot:** 1% of the working age population can not work due to Covid-10 (school children, own health etc, they say) and another 3% – 4% are receiving extraordinary unemployment benefits, more than those that would normally have received such benefits. At least he latter group will have no income if they do not turn up at the labour market during the coming months, as these support programs will end now (in some states) or in September (everywhere)

An even more dramatic x-check: The employment rate is extremely low

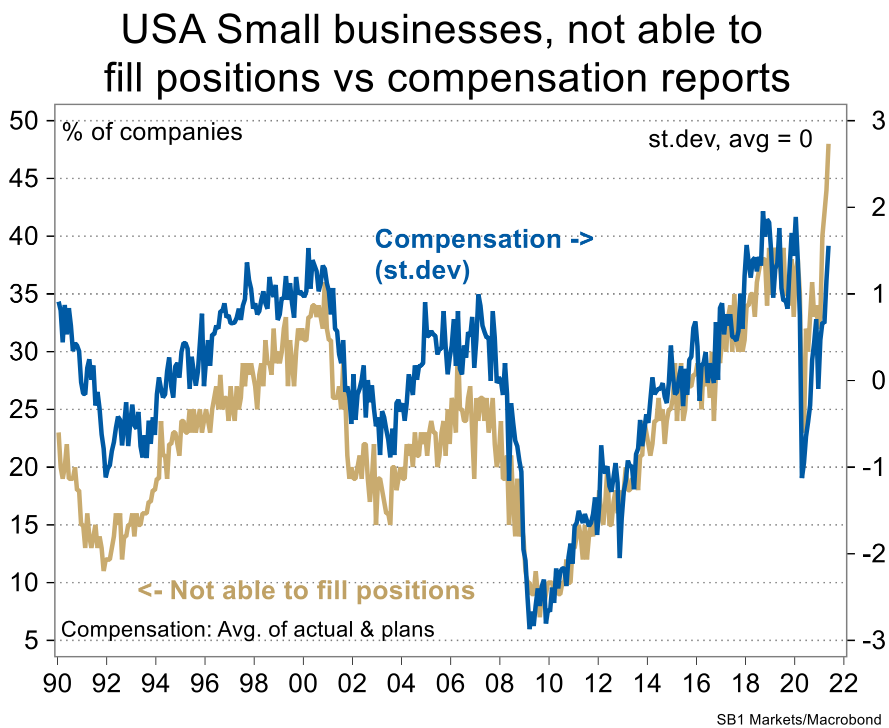
... given the high number of vacancies

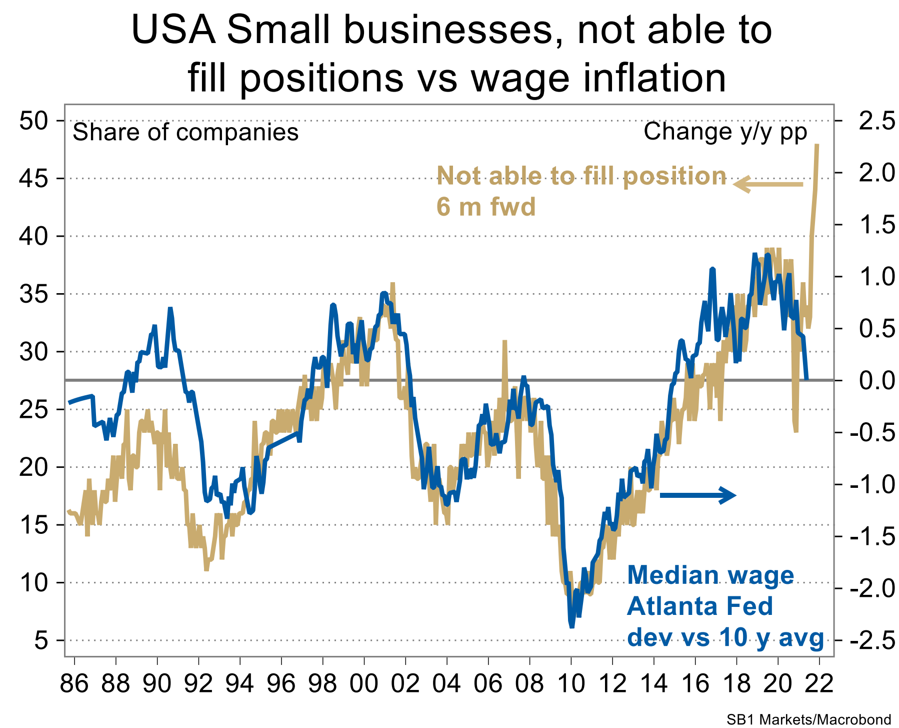




SMBs say they have increased compensation, and plan to do more

However, the 'best' wage indices have not yet reported higher wage inflation

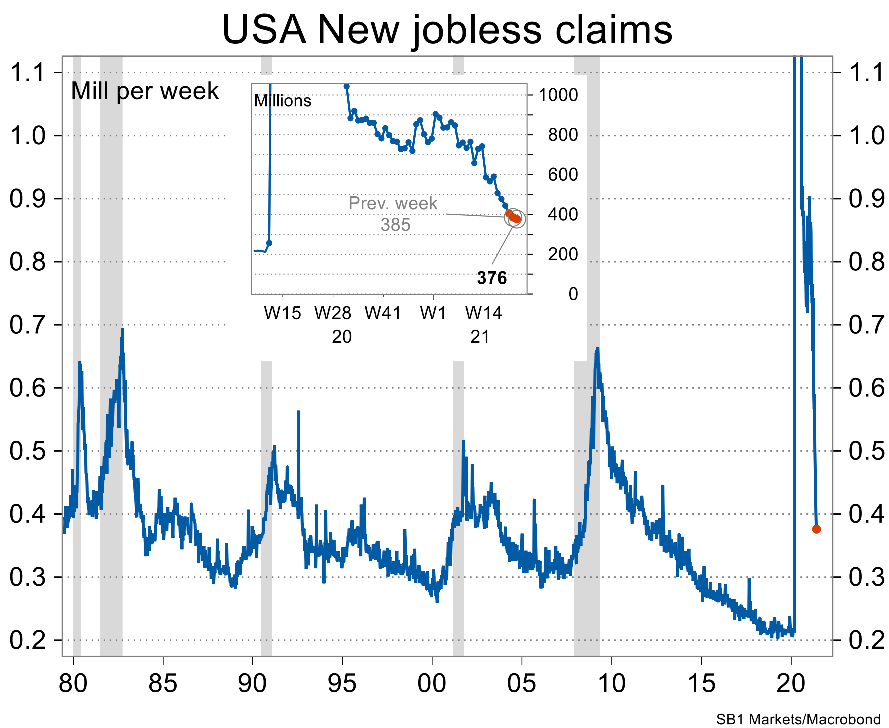


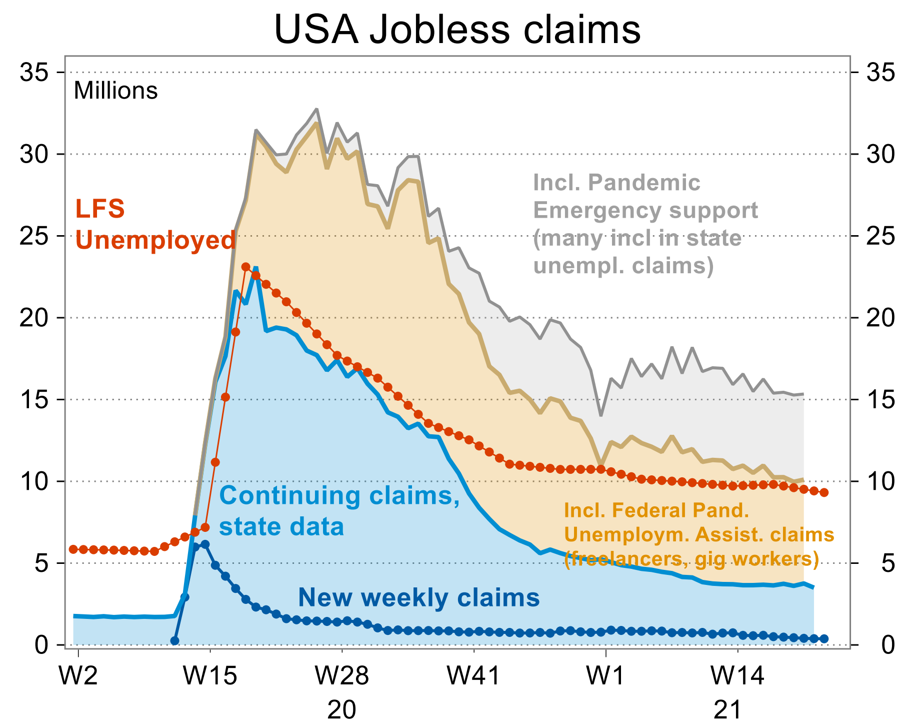


- The fraction of businesses saying that they **actually raised compensation** rose sharply in May, to above the average 2019 level. The **expected increases in compensation the next 3 months** also rose sharply, up the average 2019 level as businesses say that <u>costs are being passed on to customers 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 – like in the Median Wage survey (Atlanta Fed, based on individual wage earners) or in the quarterly Employment Cost Index (in Q1). In May the Median wage growth inflation slowed further, as it did in April (which surprised us!)
- <u>Still: The risk is very likely at the upside the coming months, given reports from the business sector, but in surveys and more anecdotical information from individual companies</u>

Jobless claims keep falling, albeit at a slower pace

Total continued claims are slowly on the way down – but are still higher than average

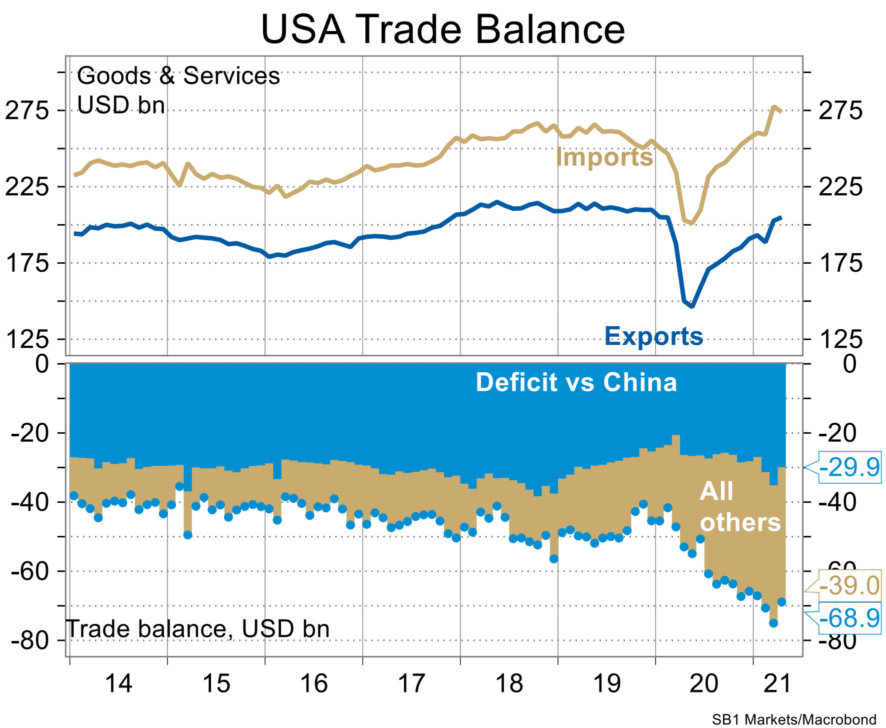


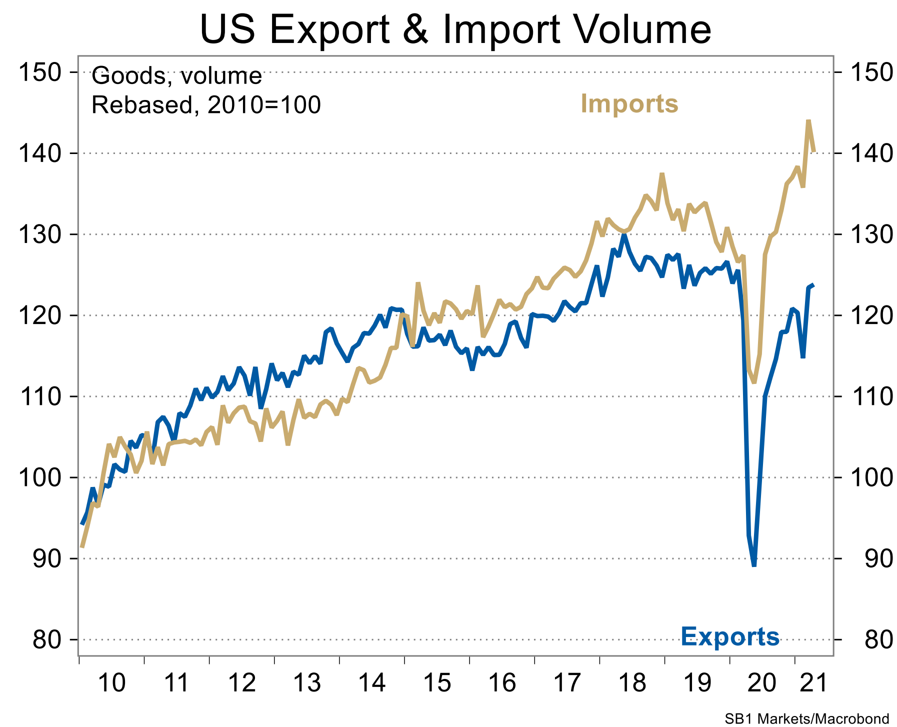


- **New claims** at fell to 376' from 405' (revised up from 385') the previous week, expected 370'. At the current speed (past 11 weeks), a very low level of new weekly claims (200') will be reached in just 5 - 6 weeks time
- **Ordinary continuing claims** fell by 258', and the no. of receivers of the Pandemic Emergency Support Program (52 weeks instead of 26, and USD 300 extra/week) and the no. of receivers of the Pandemic Assistance Program (gig & freelancers) also declined, but the level is still high, at 6.4 mill and 5.3 mill, resp. In sum more than 11 mill receives but some are also receiving ordinary benefits from the states. The net 'extra' receivers may be some 8 – 10 million. These temporary programs runs until September
  - » However, 25 GOP led states have decided to, or are considering, abolishing these programs immediately. The 4 first states stopped the programs last Saturday. A natural experiment with epic consequences ahead of us: Will cuts in benefits increase labour supply – which is badly needed?
  - » BTW, some securities companies argue that a huge part of these extra benefit payments have gone to criminals, in US and abroad. We have not seen others verify this info

Deficit narrows as exports increased and imports fell – from a high level

Trade deficit down to USD 69 billion in April, from 75 billion in March

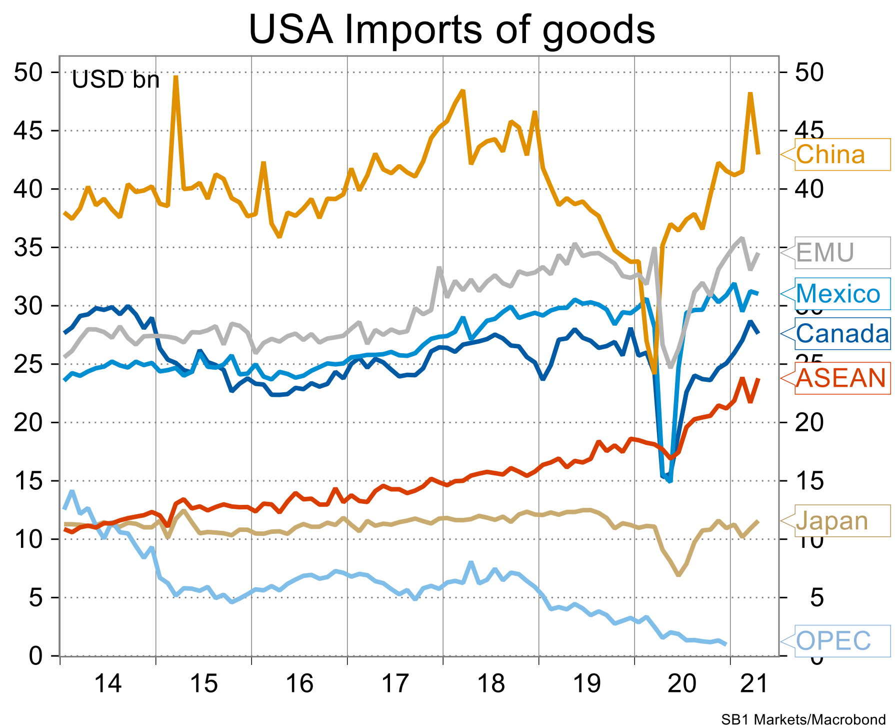


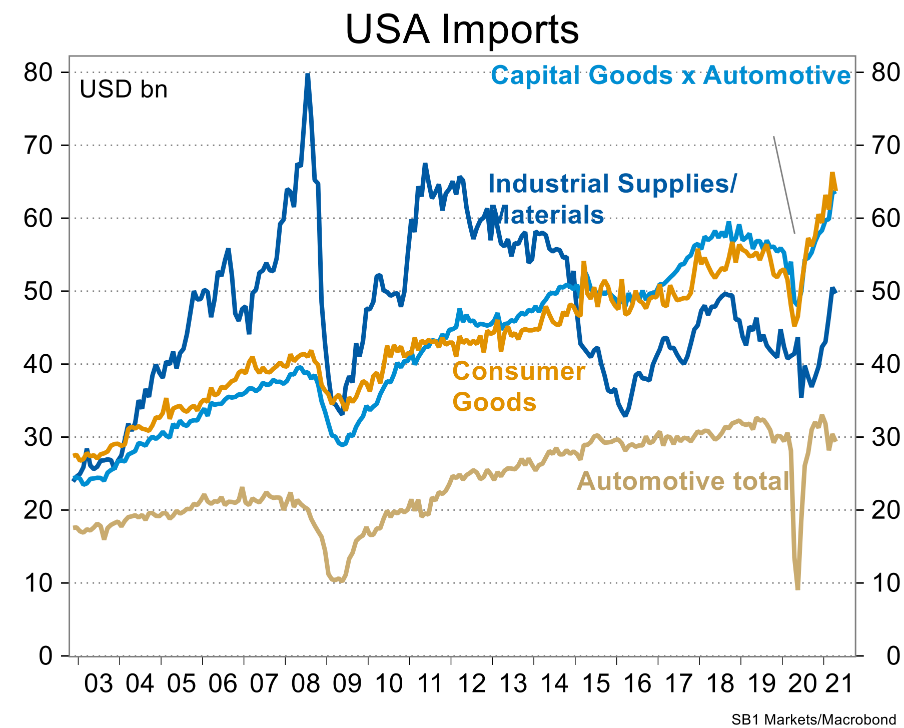


- **Exports** rose by 1.1% m/m, and are now on par with the pre-pandemic level (in value terms). In volume terms, exports of goods are down 1.4%
- **Imports** decreased by 1.4% in April, following the 7% jump in March, and remains almost 10% above the early 2020 level. In volume terms, the **imports of goods** are 11% above! The reason is no doubt strong demand for goods in the U.S. The decline in April is not an obvious sign of weakness. However, the ISM import index has fallen somewhat recently. We expect household demand for goods to slow in H2, from the present very high level
- **The deficit vs China** is almost at the same level as when Trump became president. However, the total deficit vs. other countries has exploded, has have the total deficit

Capital goods imports up in April, all others down but none are week (x auto)

Imports from China sharply down m/m – from a high level

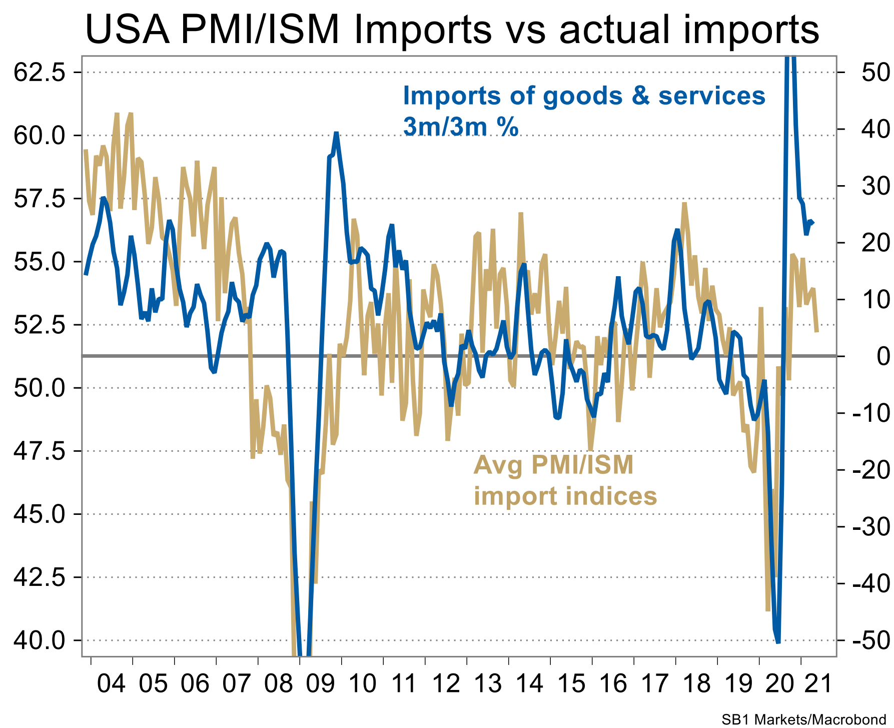




- **Imports from regions:**
  - » Imports from China are still back at 2019-levels
  - » Export from ASEAN (the minor Asians) are very strong too
  - » Exports to US from EMU are also back to a pre-corona level, and so are Canadian exports
- **Imports by type of goods:**
  - » Auto imports are low, very likely due to production problems abroad due to lack of semiconductors
  - » Consumer goods import a tad down in April, but the level still high – and higher than in February

PMI/ISM signal slower growth in imports

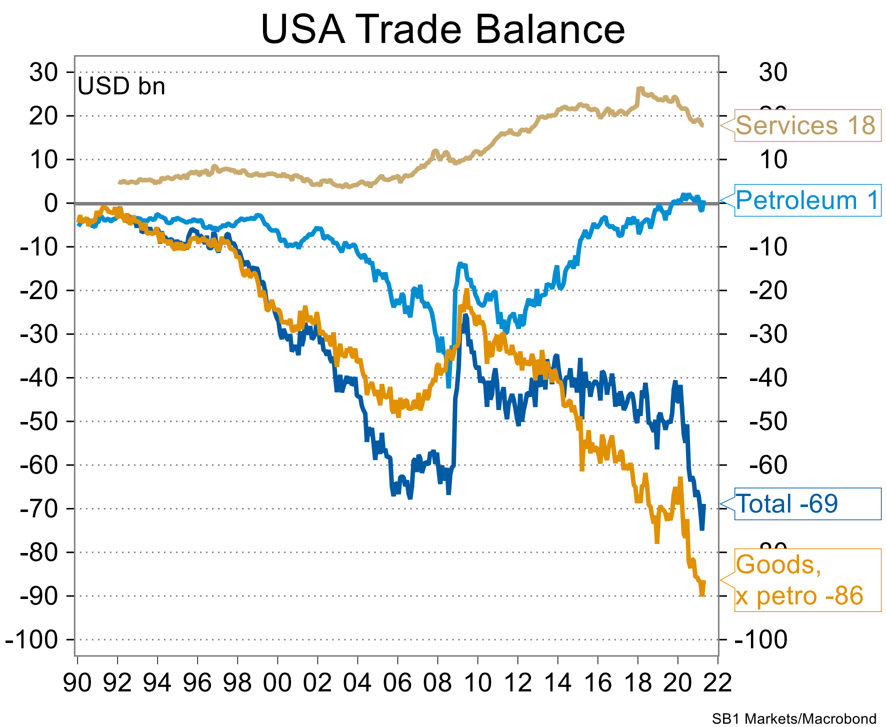
… following the surge. Consumption of goods will have to slow – taking some import down

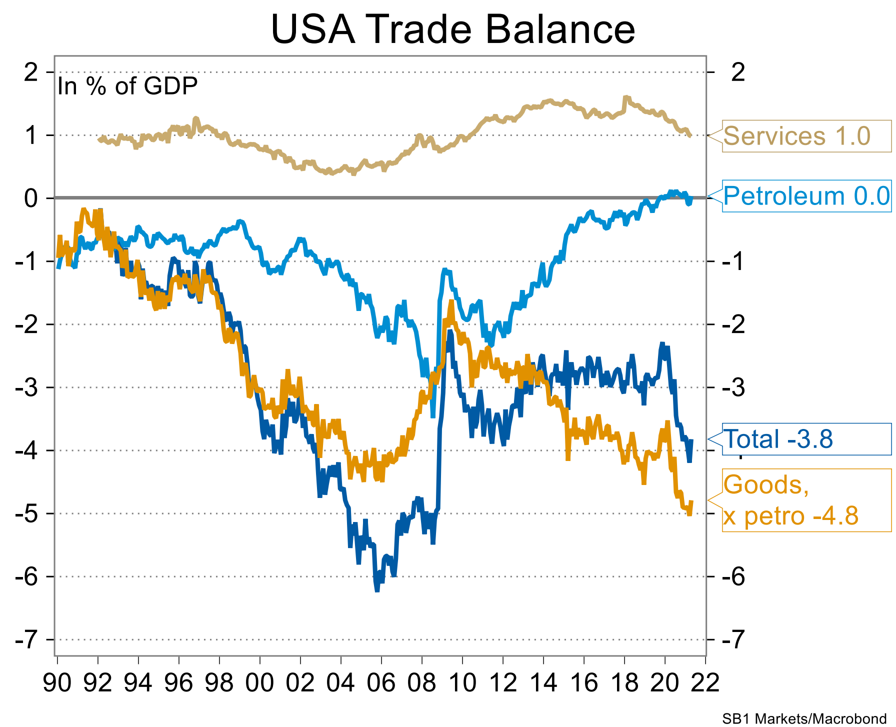


- However, the actual April import numbers are not weak at all

Goods deficit very high, even in % of GDP

Surplus in services keeps narrowing

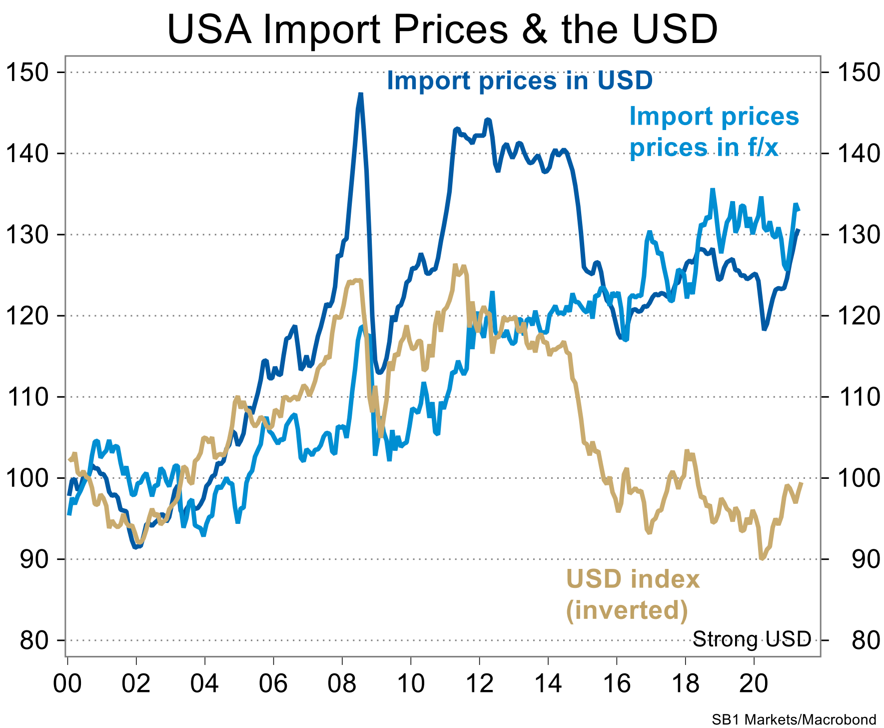


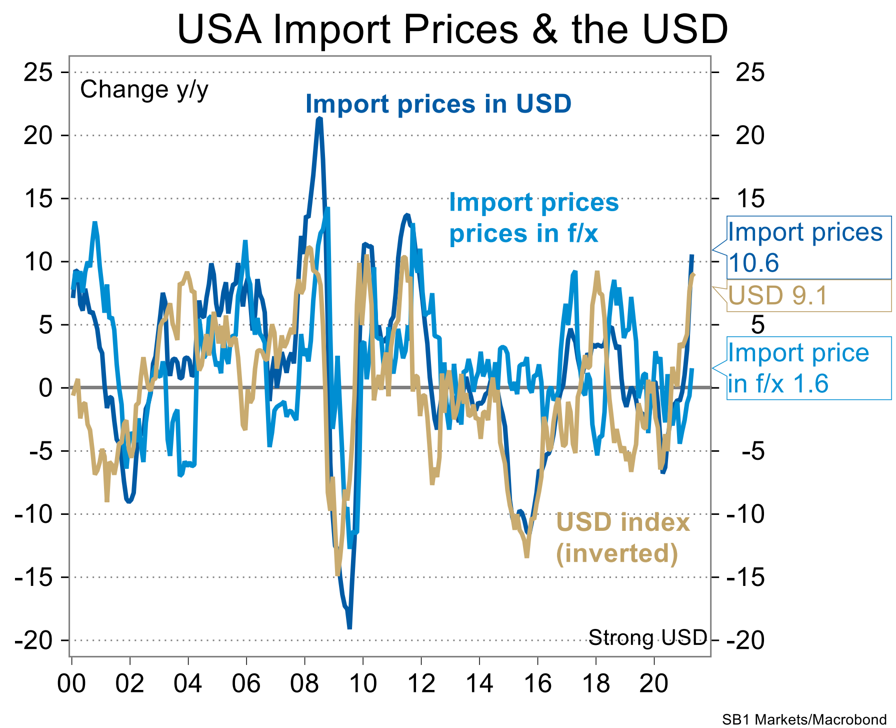


- **The goods x petro products** deficit was at USD -86bn in April, up from USD -89 bn in March (ATH). Deficit equal to 4.8% of GDP
- Before the corona virus hit, the trade deficit in goods was narrowing, as growth in the US slowed (and imports fell, which is normal)
  - » The petroleum trade deficit has become at surplus of +1 bn, from -30 bn/m in 2012!
- **The US runs a surplus in services** at USD 18 bn, equalling 1% of GDP but is trending sharply down (and the downturn started well before corona)
- The total trade deficit equals 3.8% of GDP, well below the record at 6.2% in late 2005, thanks to the shale oil revolution. The deficit has widened from 2.5 in early 2020 – as domestic demand has been stronger in the US than abroad

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

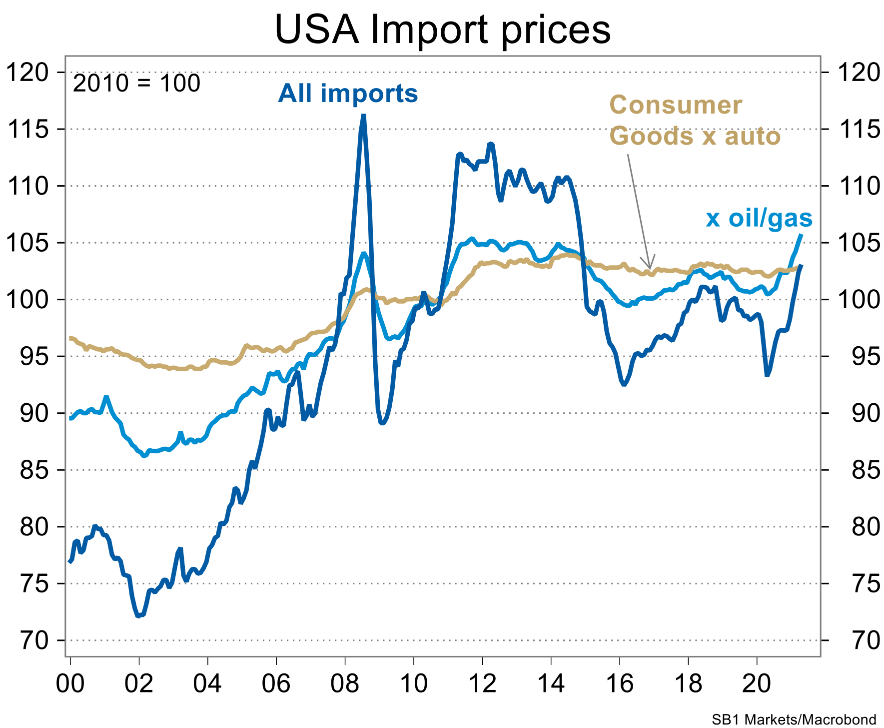
Measured in exporters’ currencies, prices are just marginally up y/y

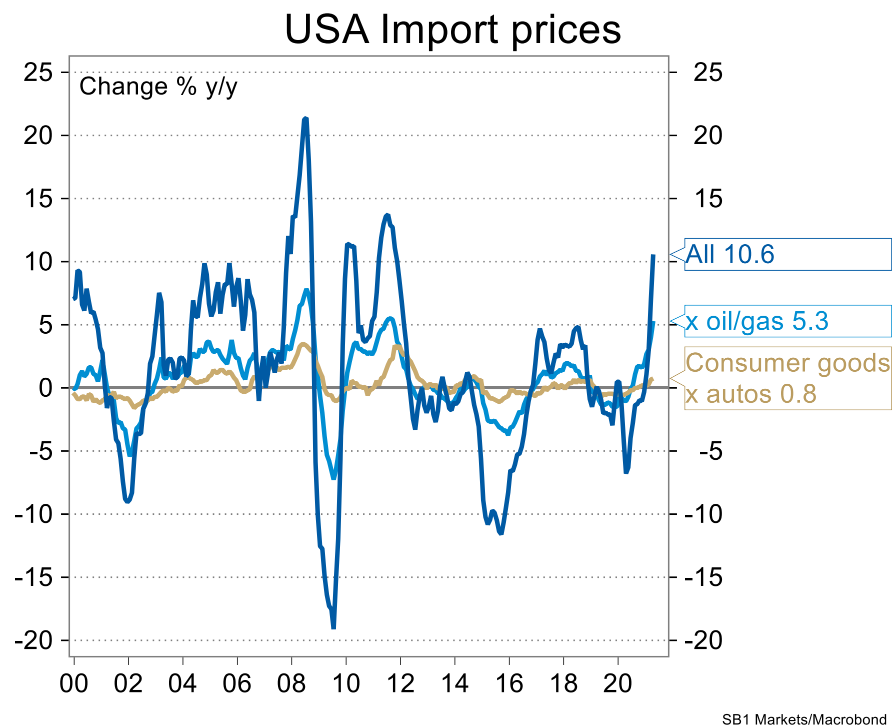




Still no growth in imported consumer goods, even measured in a 9% weaker USD

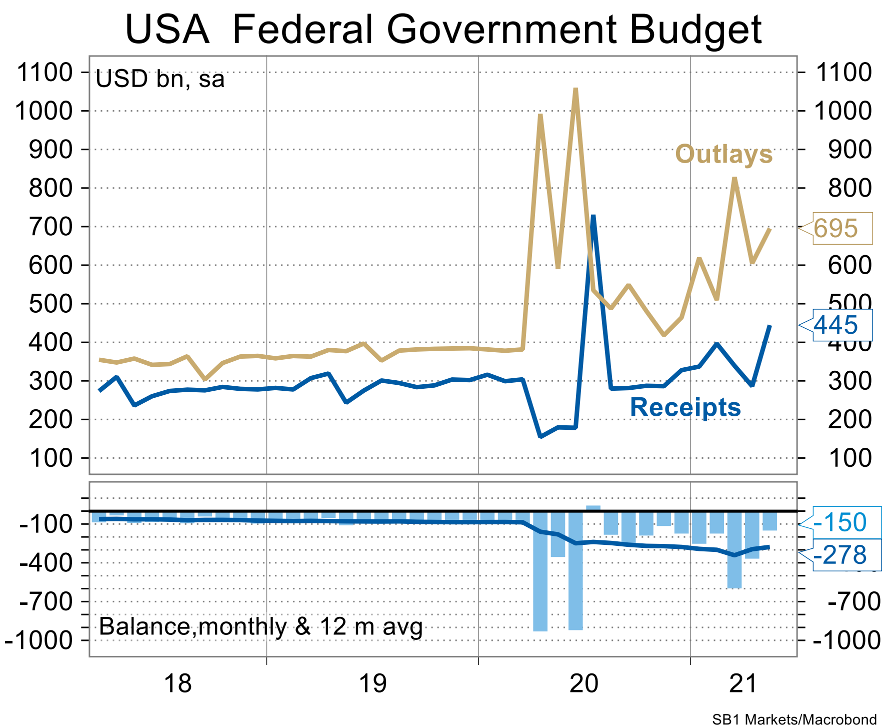
Total import prices up, also ex petroleum – but consumer goods prices are still not up

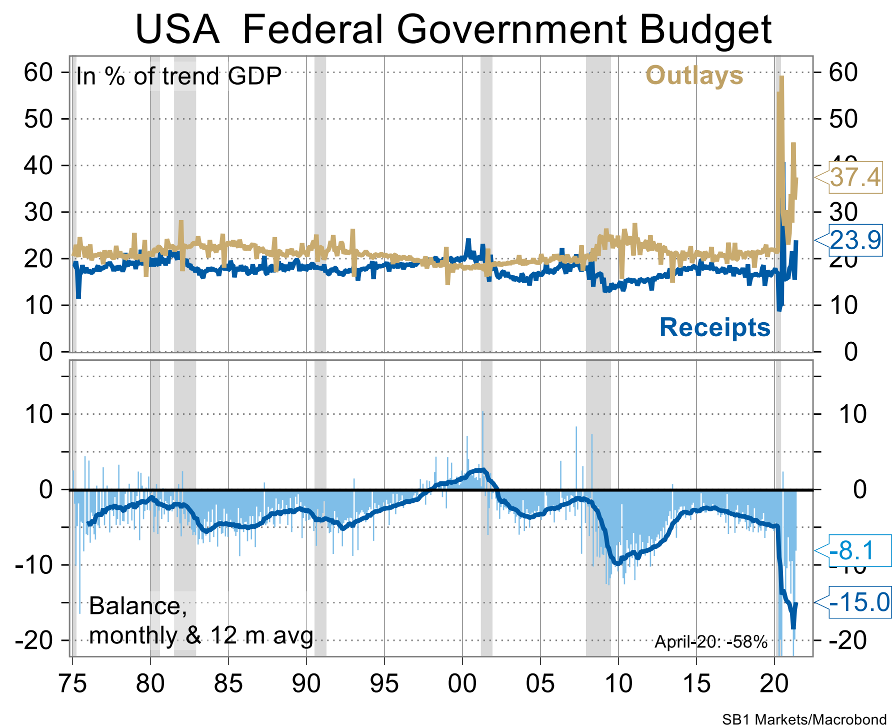




A 'small' May budget deficit – revenues were more boosted even more than spending

The deficit was smaller than expected, 'just' 8% of GDP, as household taxes soared (temporary)

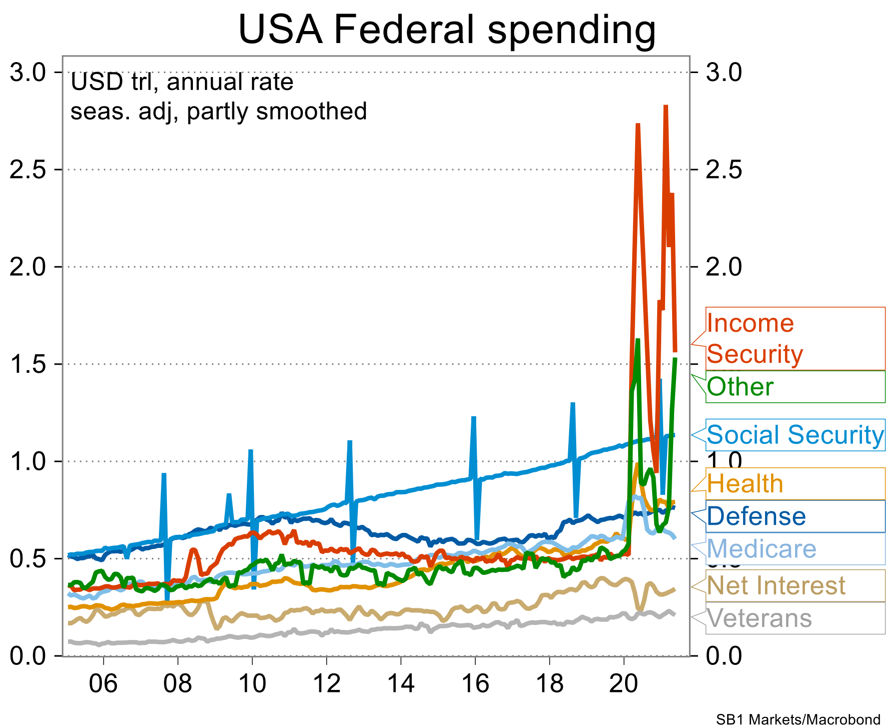


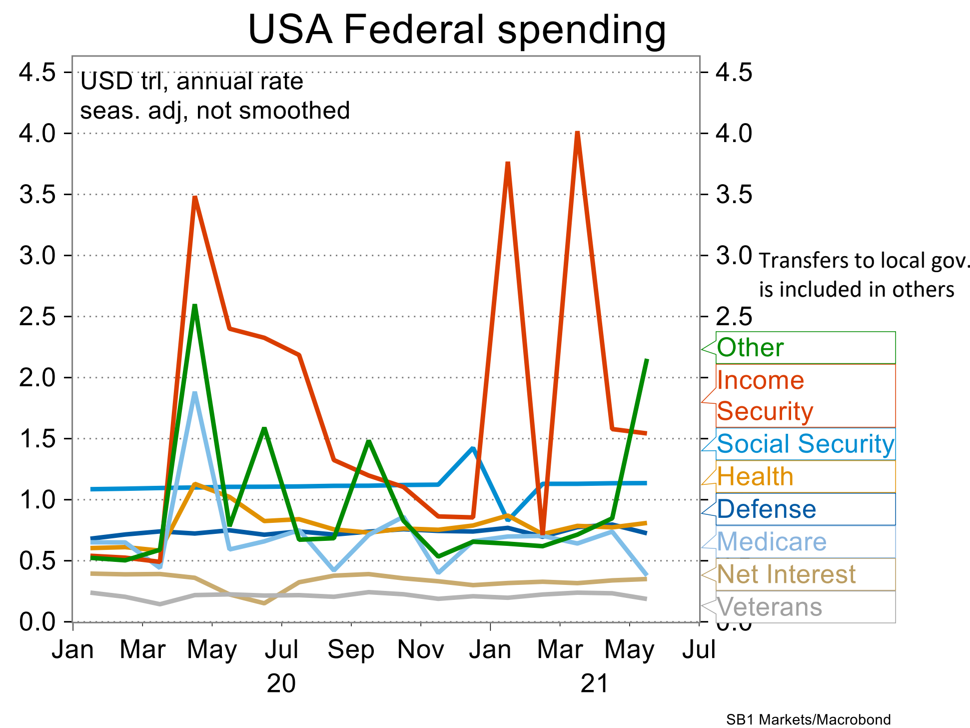


- **Federal expenses** rose again in May, almost by USD 100 bn to 695 bn (seasonally adjusted), equalling 37% of (monthly) GDP
  - The hike in spending in May was solely due to a one off USD 130 bn transfer to states, as part of the 2nd USD 1.900 bn stimulus package, and spending will decline in June. Stimulus check payments fell by USD 50 bn to almost zero. However, the underlying spending level is now – and will probably remain for the coming months – at some 50% above the pre-pandemic level
- **Federal income** rose almost USD 150 bn 445 bn, 24% of GDP – and covering 57% of the expenses, as household tax payment shot up again (but just for one month). The underlying revenues are up vs the pre pandemic level mostly due to the sharp increase in household income (and taxes)
- The May actual **deficit** was at USD 132 bn, expected USD 250 bn, the discrepancy very likely due to the hike in household taxes. The seas. adj deficit equalled USD 150 bn or 8% of GDP. Over the past 12 months the Federal deficit has equalled 15% 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

A one-off (we think) transfer to states lifted overall spending sharply

Income security payments were unch. from April, even if few stimulus cheques were distributed

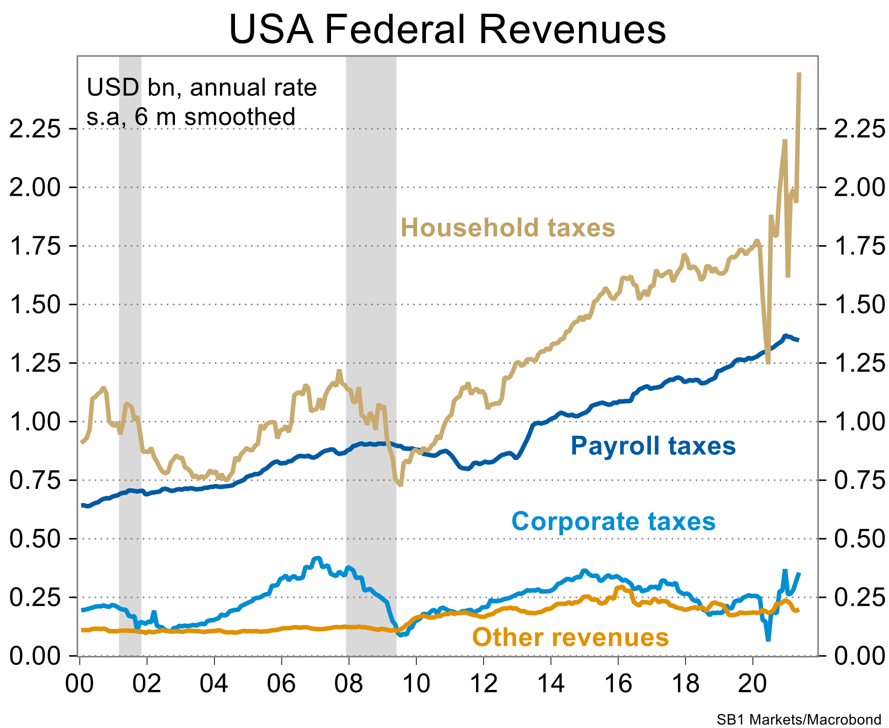


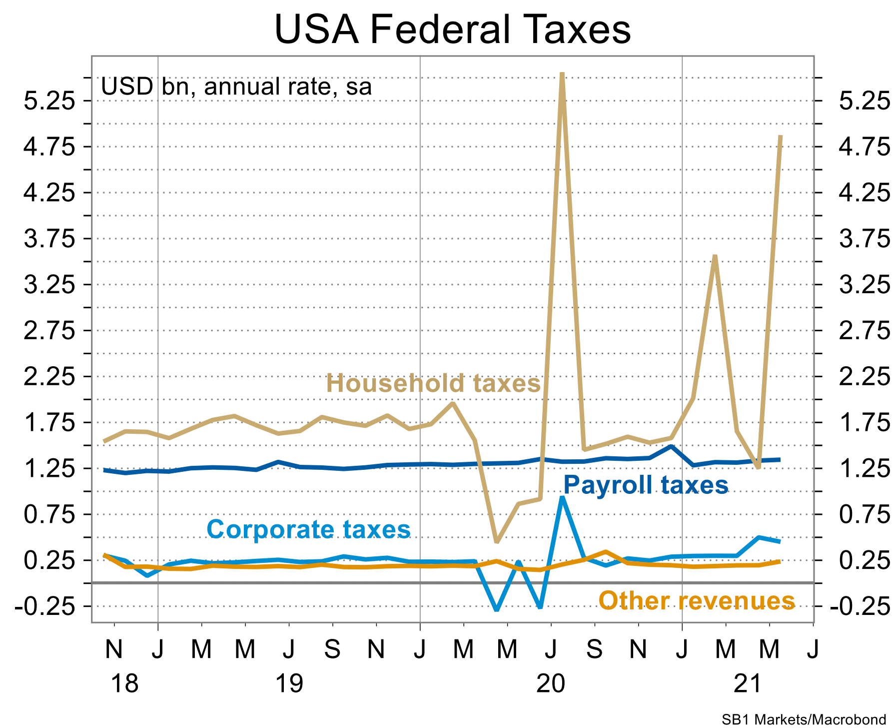


- However, there will still be federal spending on increased unemployment benefits, larger child tax credit, vaccine distribution, health care, food assistance programs, support for businesses, aid to local governments over next several months
  - Of the total **USD 900 (Trump) + 1.900 bn (Biden)** stimulus package decided, some 50% 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 (intentionally 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?

Household taxes sharply up in May (and will return to a normal level in June)

Monthly tax payments have become extremely volatile during the pandemic

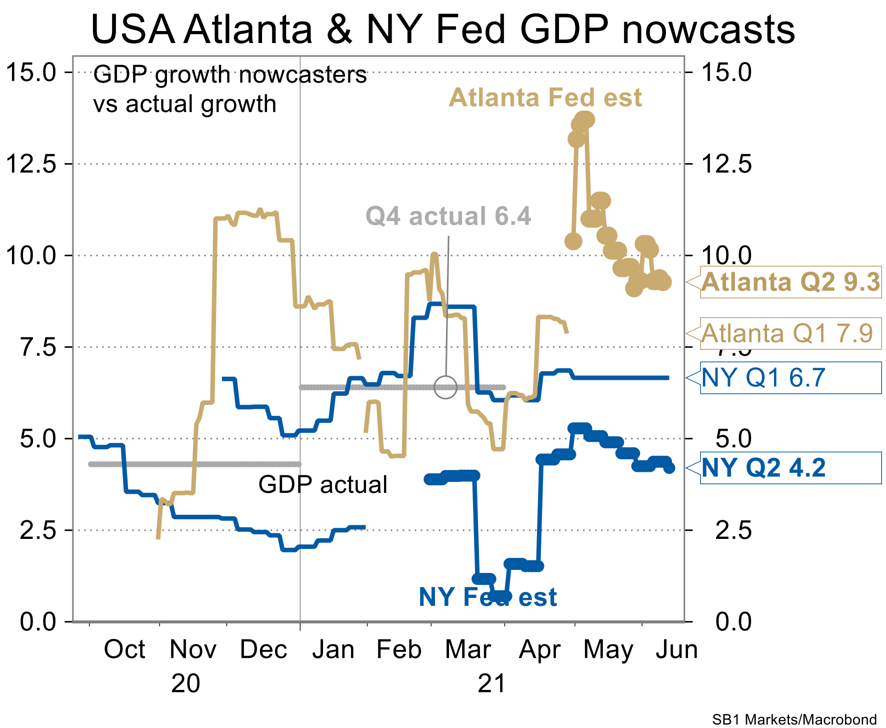


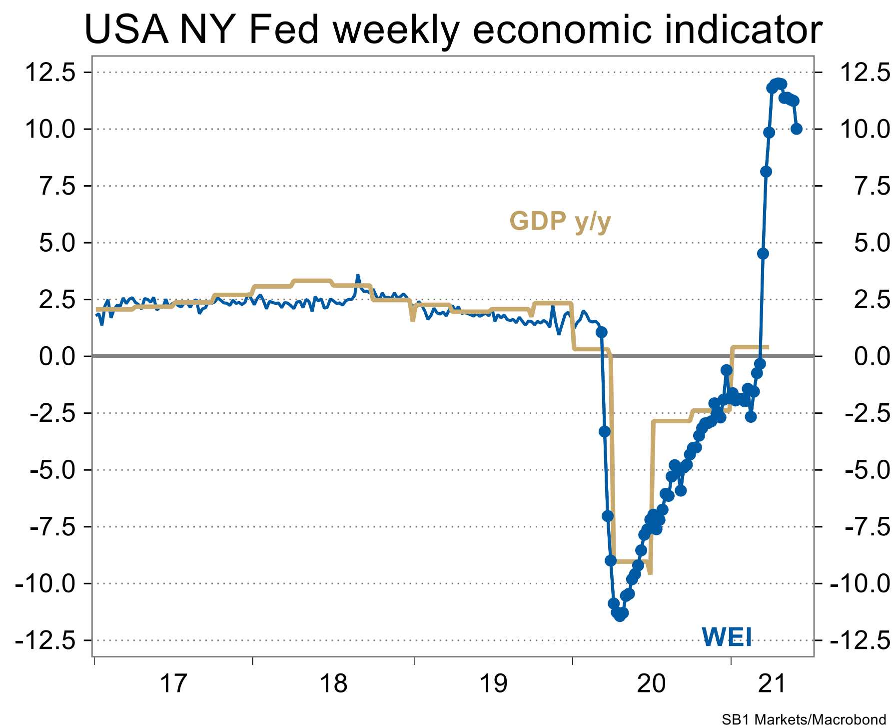


- **Household taxes** rose USD 110 (but more than USD 3 trl annualised & seas adj, but these adjustments are tricky with such larges outliers)

The nowcasters signal 4% to ... 9% GDP growth in Q2

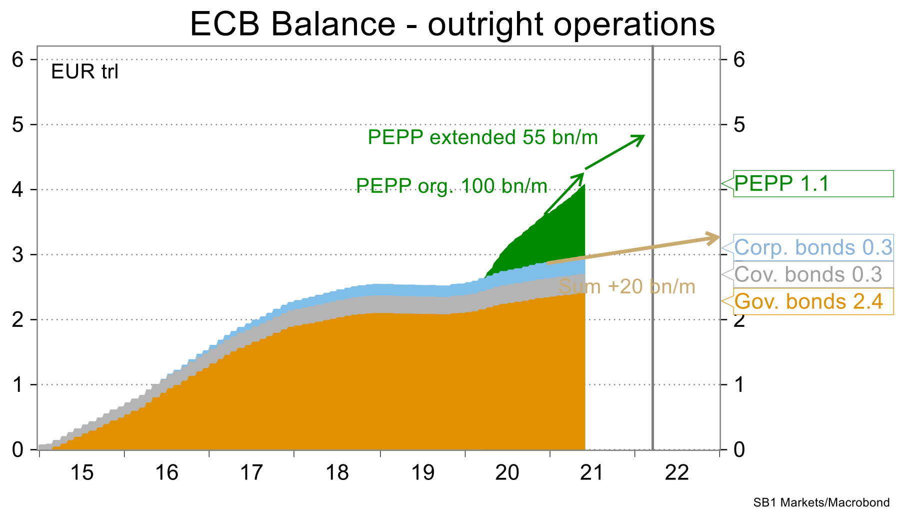
We think Atlanta Fed (9%) is closer to the ball than NY Fed (4%)

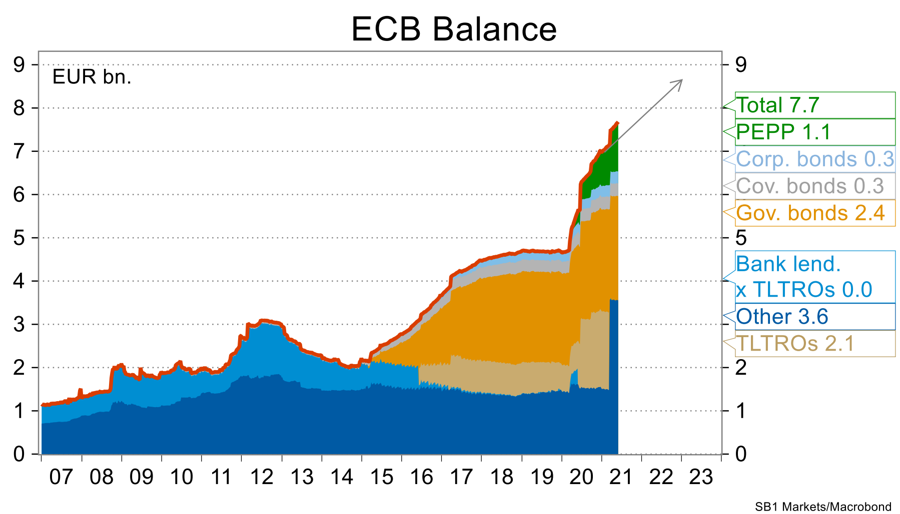




ECB sees rosier risk picture, but will yet again accelerate the bond buying program

Outlook improved and risks seen as 'broadly balanced'

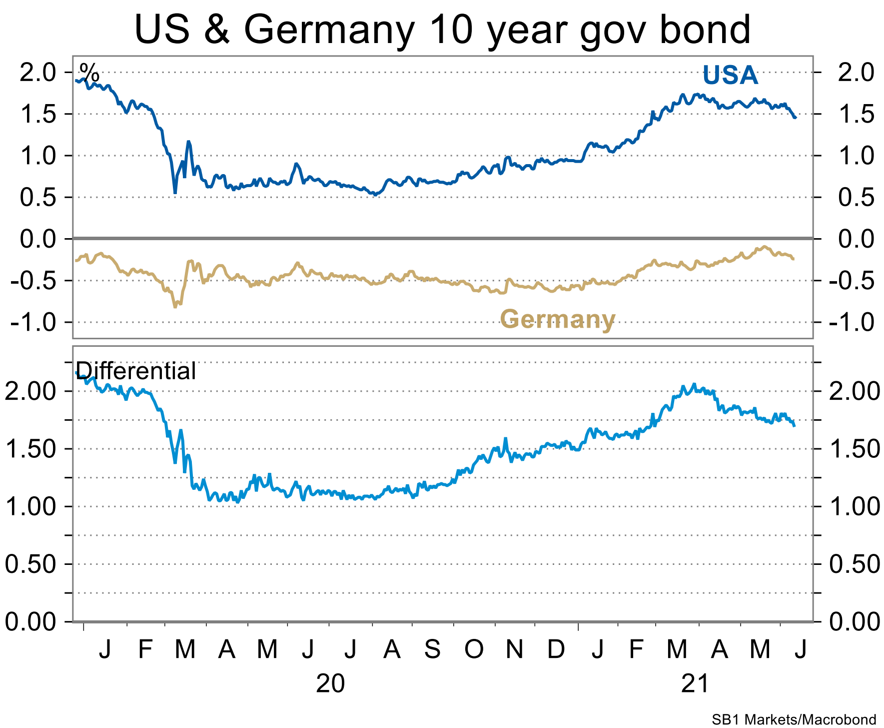


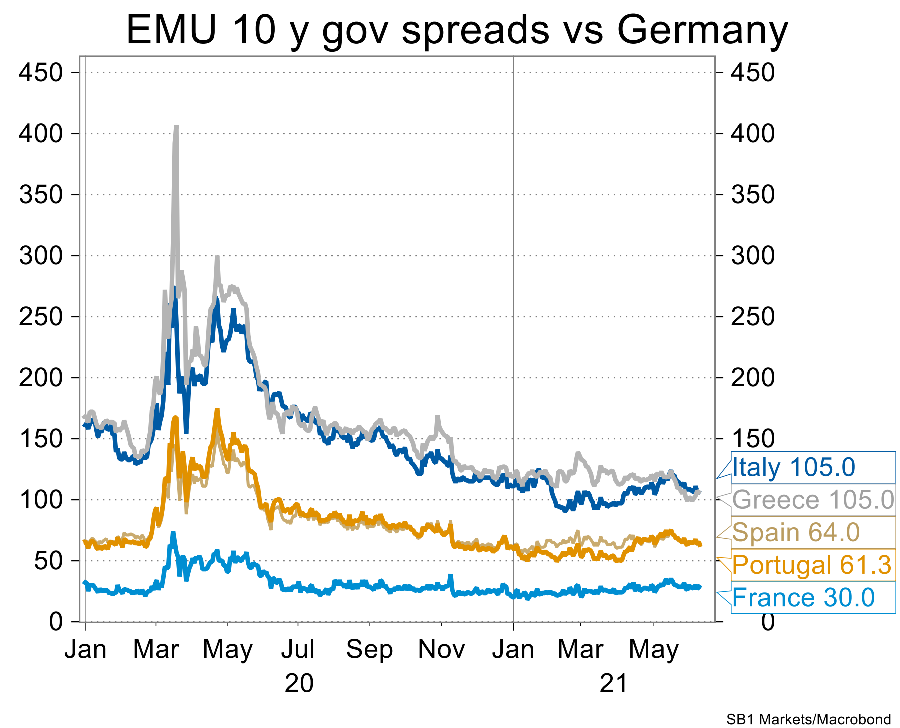


- **Programs not expanded, but more QE, now**
  - » Interest rate was, as expected, left unchanged
  - » The ECB increased its growth outlook by 0.6 pp for both 2021 and 2022 to 4.6% and 4.7% respectively, and is now characterizing risks as 'broadly balanced'
  - » The bank did not introduce any formal Yield Curve Control, but Lagarde & co pledged to prevent a premature tightening of financial conditions
  - » PEPP (Pandemic Emergency Purchase Program) was initiated at EUR 1.35 trillion, but was extended in Dec, to 1.85 trl, and the bank should buy government bonds equalling 100 bn/month. The bank has still EUR 0.9 trl left to buy. The bank increased its pace of bond purchases at the last meeting, and said that they will increase the pace further
- Bond yields fell across the member countries

Yields lower

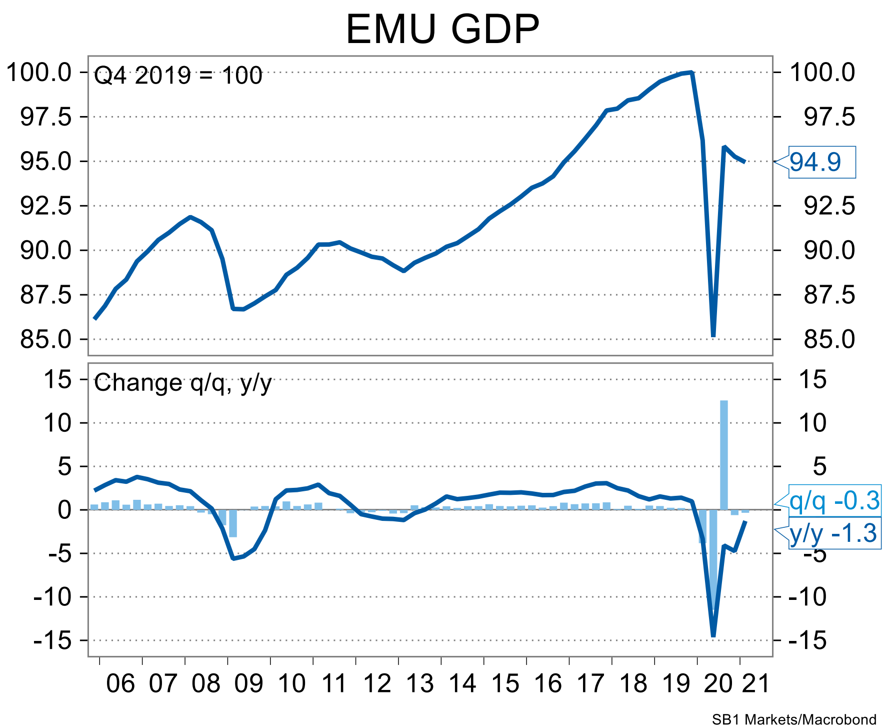
Alas, the ECB probably feels it succeeded

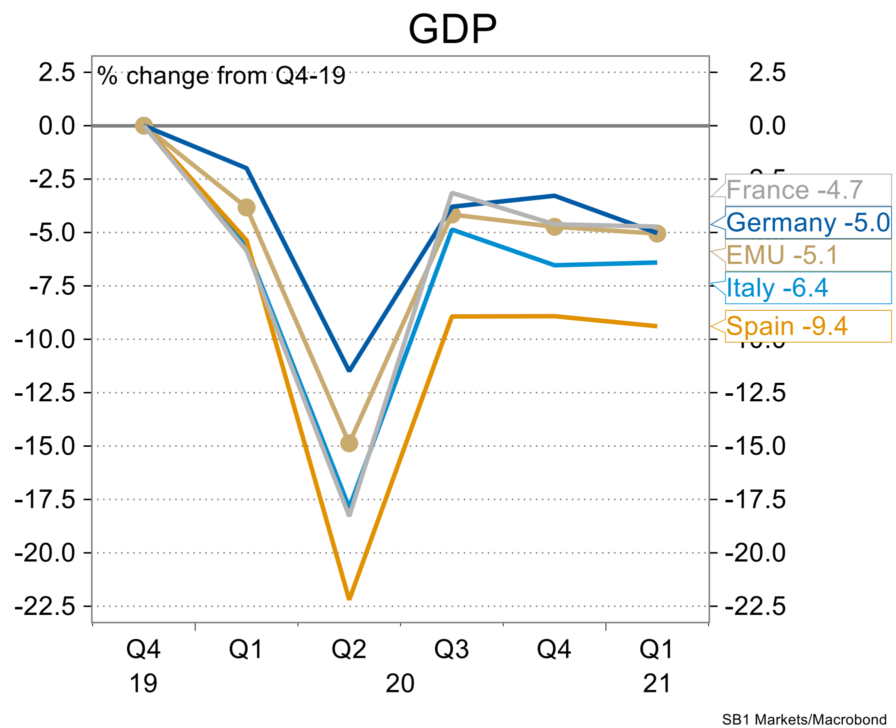




GDP fell less than first reported in Q1: -0.3% vs. -0.6%

GDP is down 5.1% vs the Q4-19 level

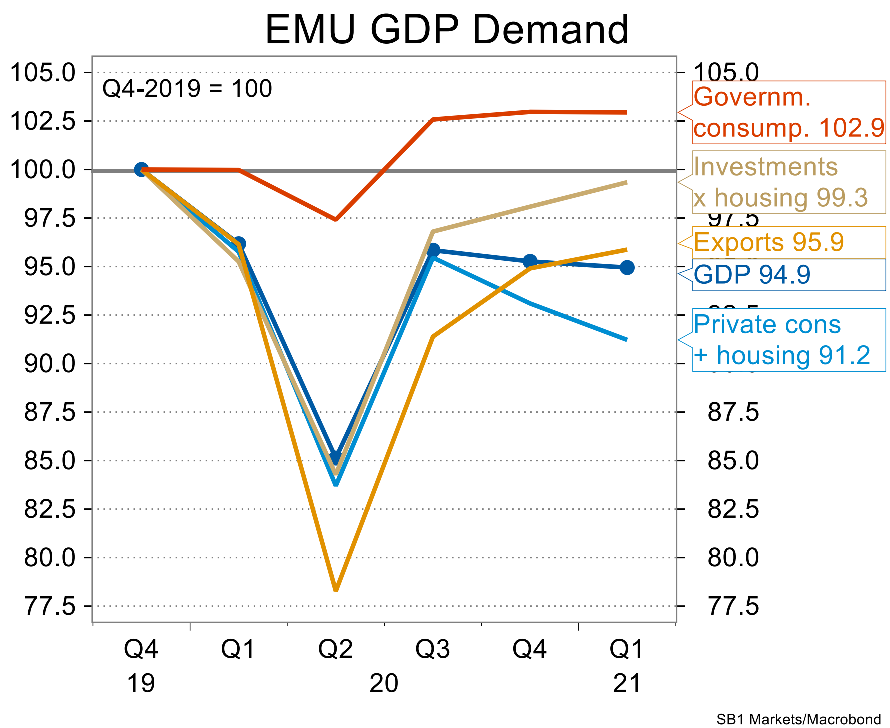


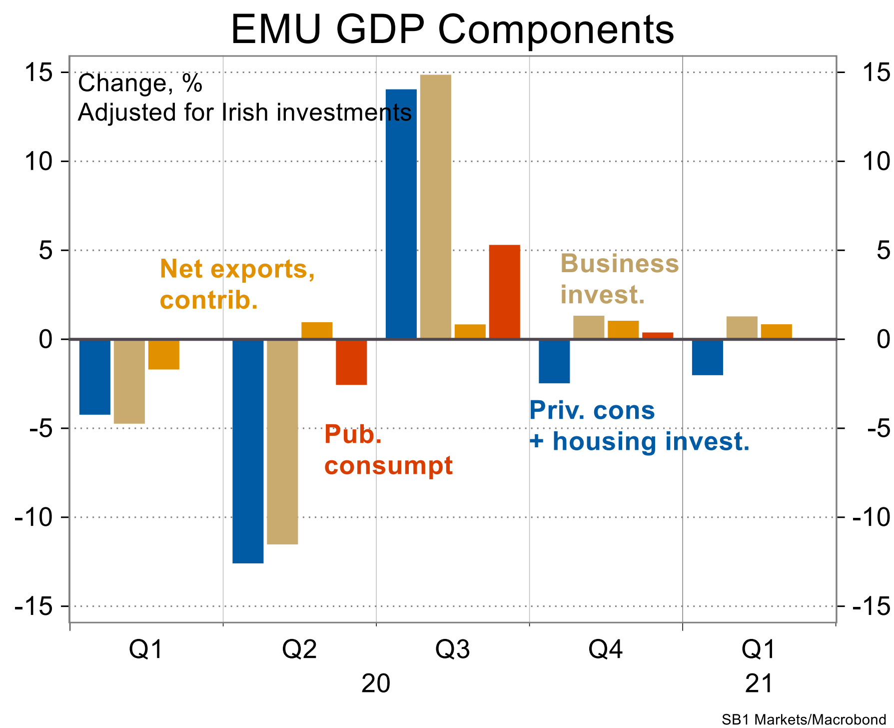


- Euro Area GDP fell by 6.7% in 2020 and GDP is still 5.1 % below the pre-corona level (revised up from -5.5%)
- GDP grew by 0.4% q/q in France (expected +0.1%), +0.1 in Italy (expected -0.4), while GDP decreased by 1.8% q/q in Germany (exp -1.7%), and -0.5% in Spain
- France, Germany are down 5% vs. the pre-pandemic level, Italy -6% and Spain -9%, as foreign tourism has collapsed

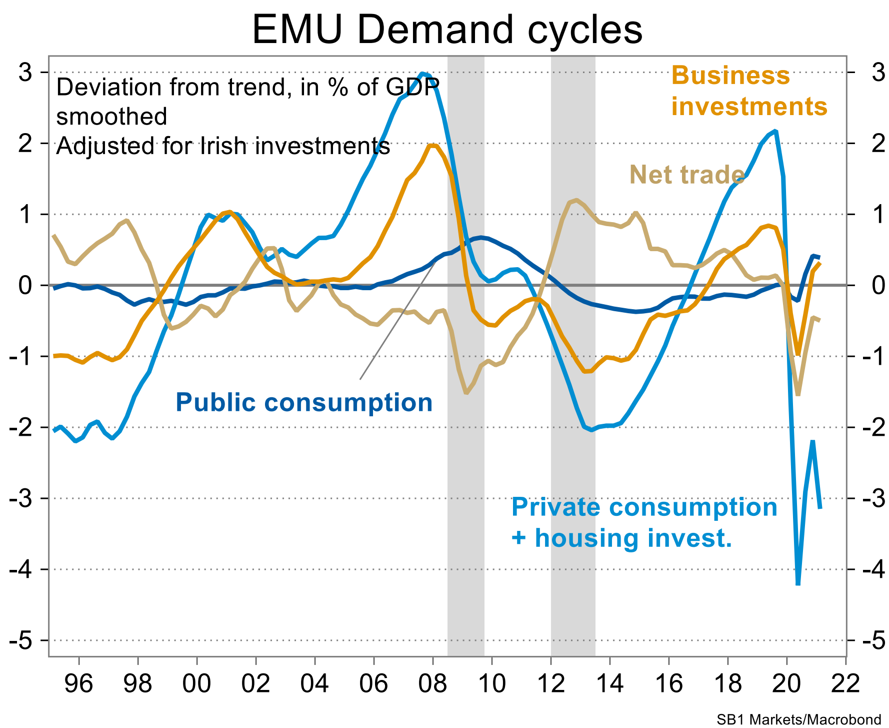
Household demand still weak – business investments almost back

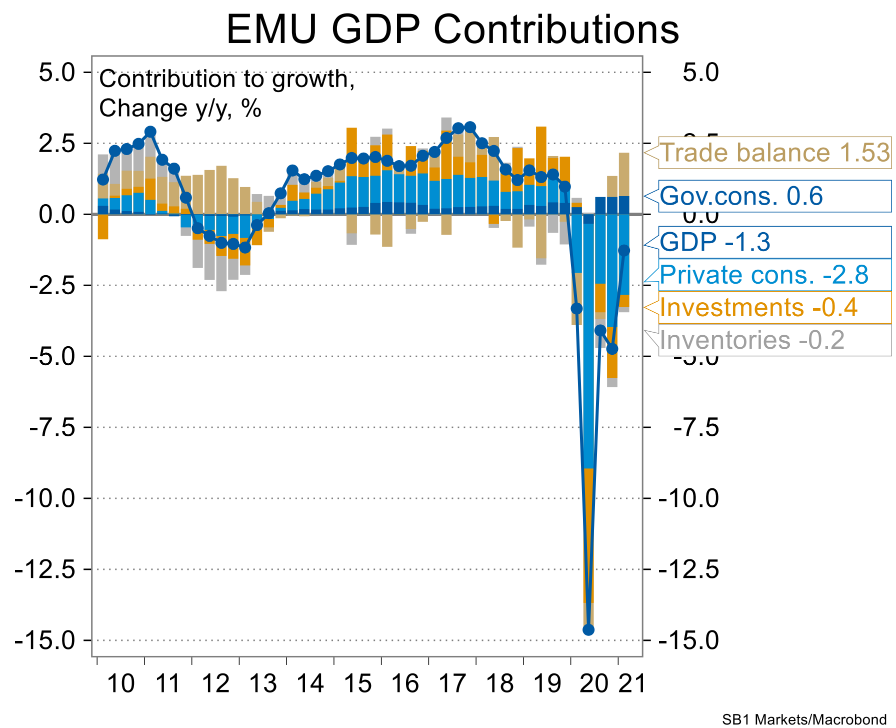
.. And exports are recovering





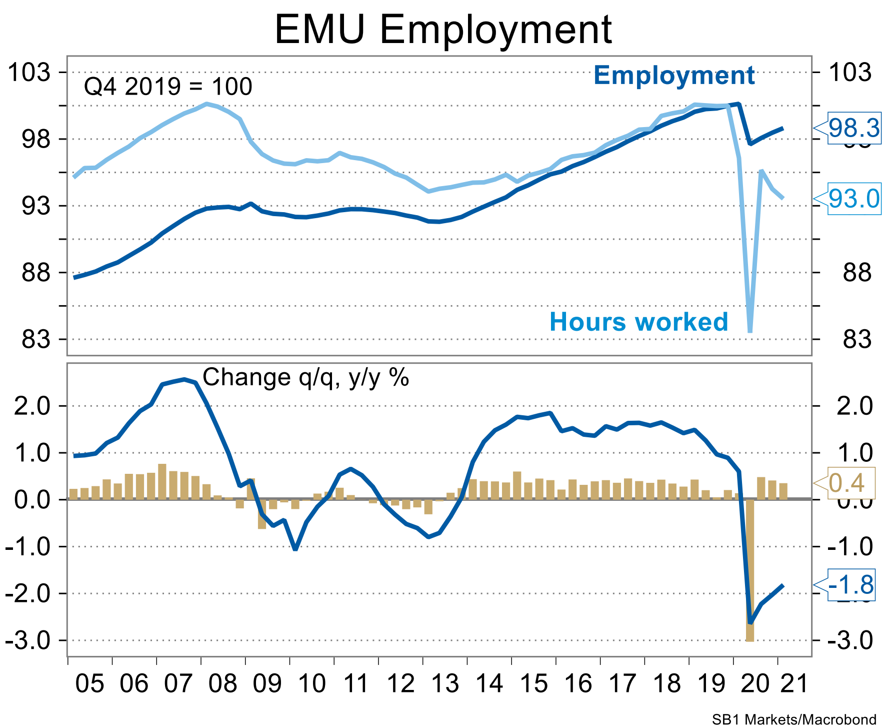
The next leg: Households start spending on services again

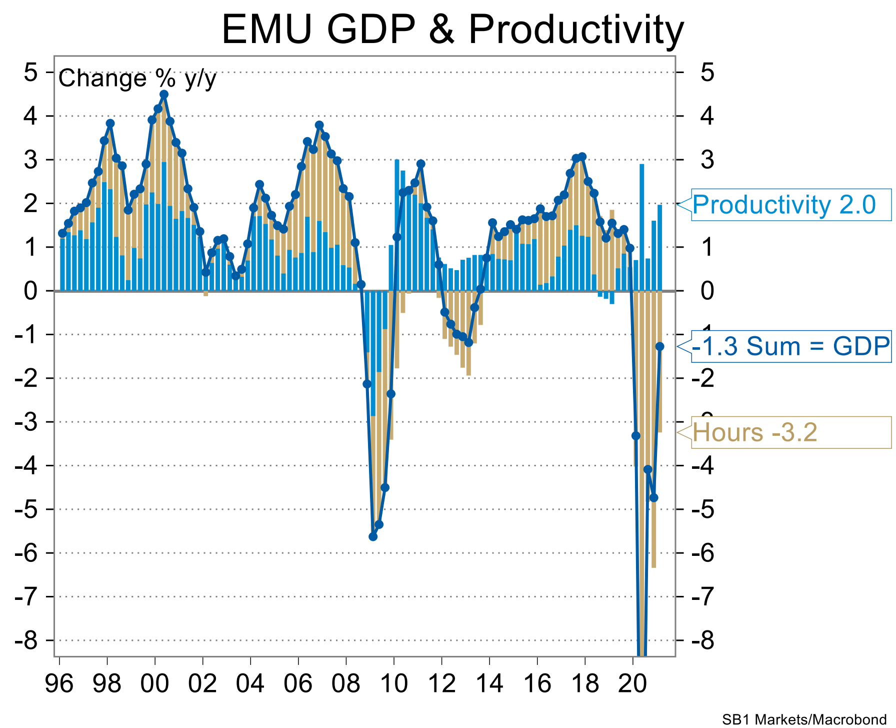




Employment down 1.7% from Q4-19 but hours worked are down 7%

.. And GDP is down 5.1% - a decent productivity growth (as low productive jobs were closed down…)



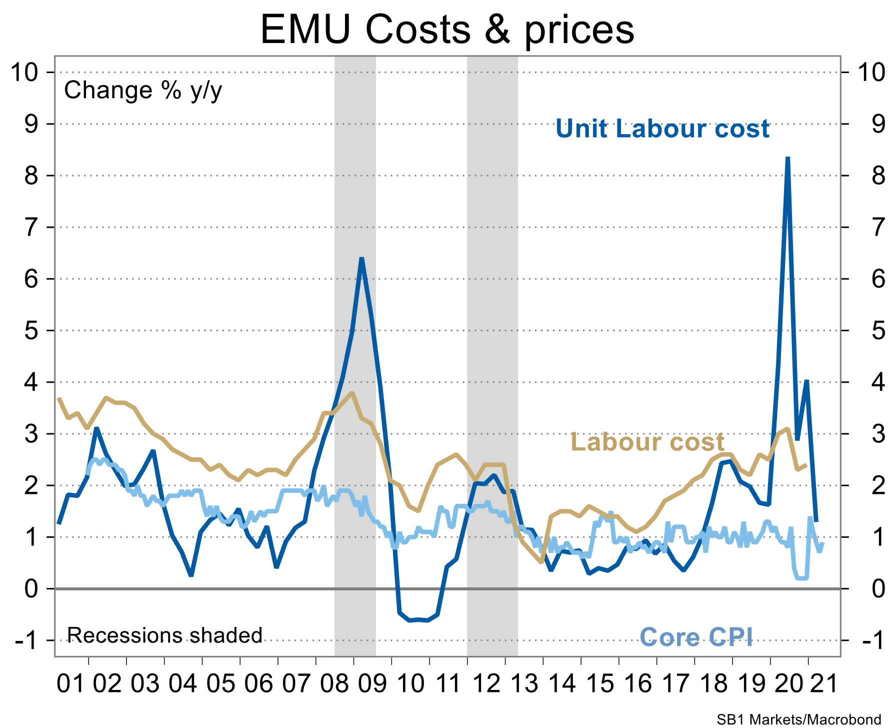


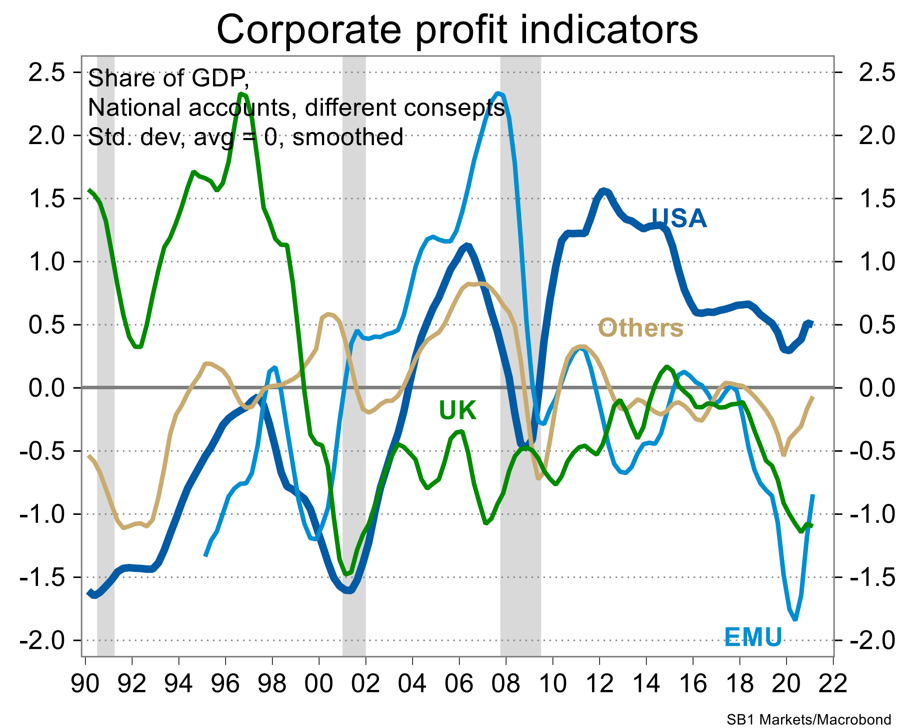
- Employment was up 0.4% q/q in Q1, while hours worked were down by 0.8%
- The -7% hours worked data point is the best to assess the downturn at the labour market

SpareBank 1 MARKETS

We do not yet have labour cost data – but unit labour cost is up just 1.3% y/y

National accounts data report higher profits – from a deep corona slump

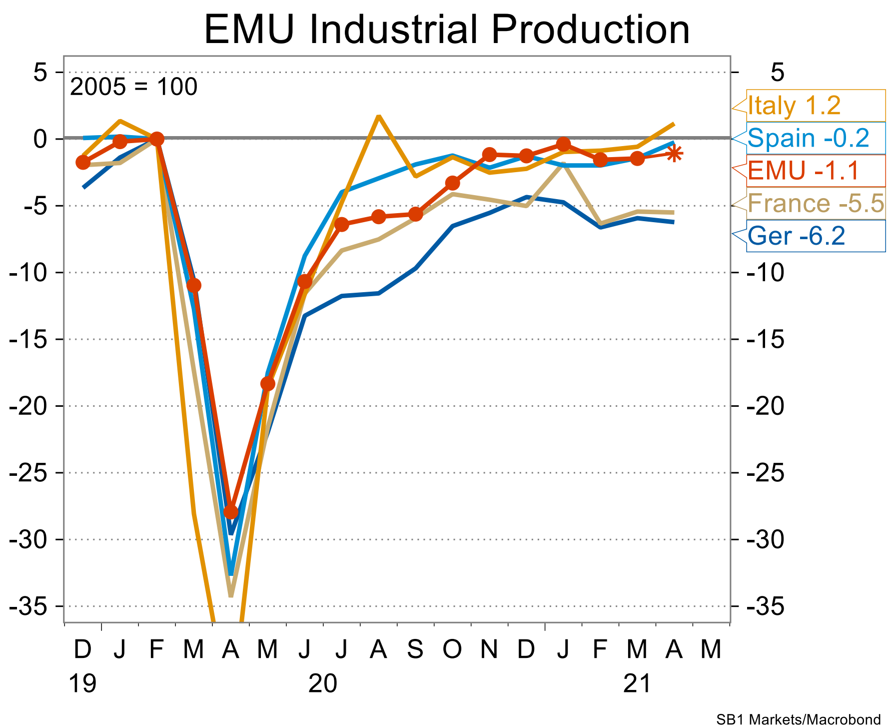


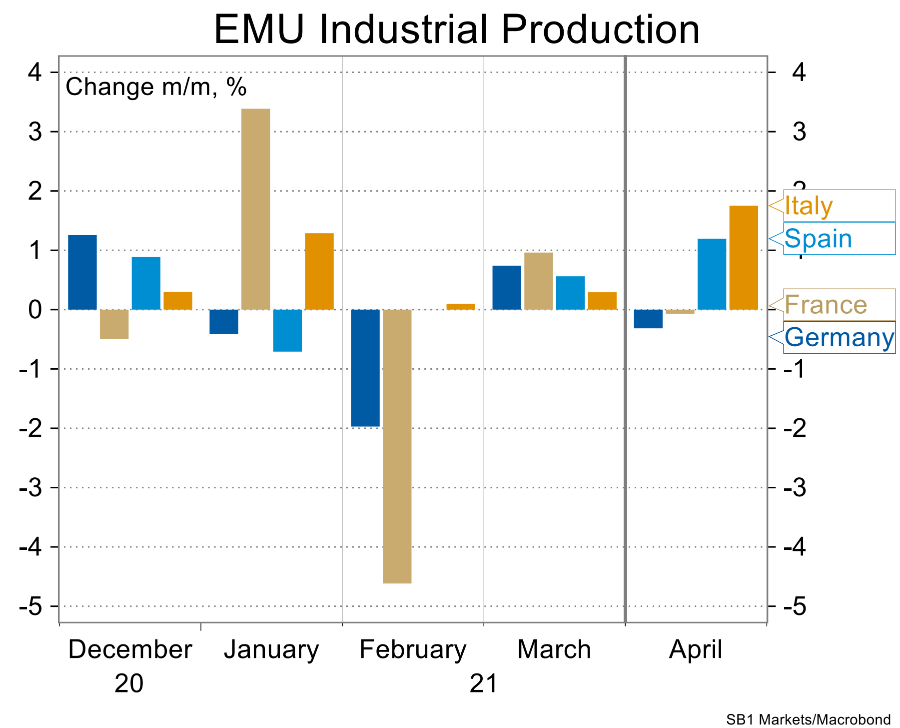


- Our EMU profit indicator (EBITDA margin), signals a deep decline in profits last spring but a recovery recent quarters

Italy & Spain came to the rescue, EMU production probably up in April

Gains at 1% - 2% down south compensates for smaller declines in Germany & France

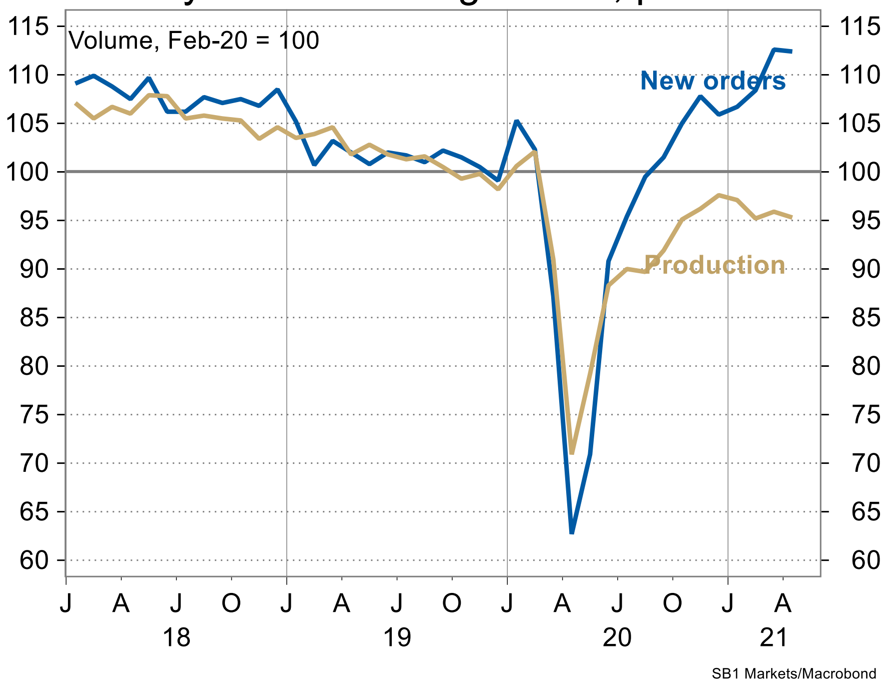




German production to turn up soon?

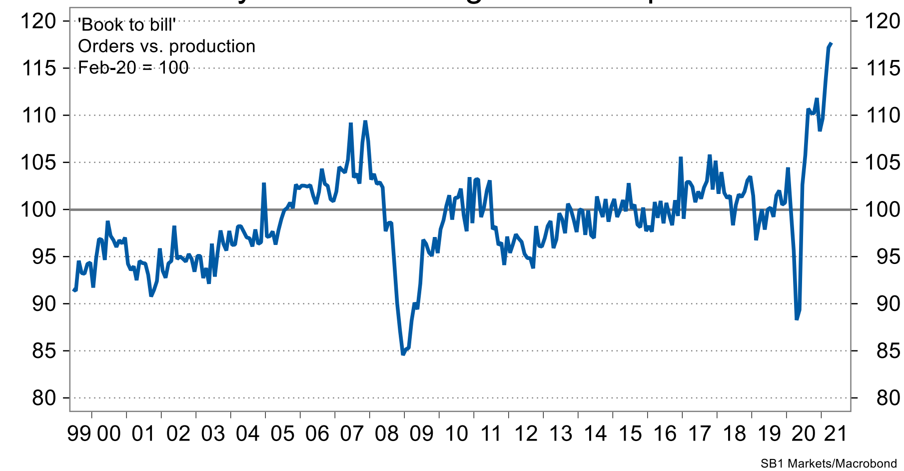
Moderate March growth in France and Germany (0.7%), less in Spain (0.3%)

Germany Manufacturing orders, productionn

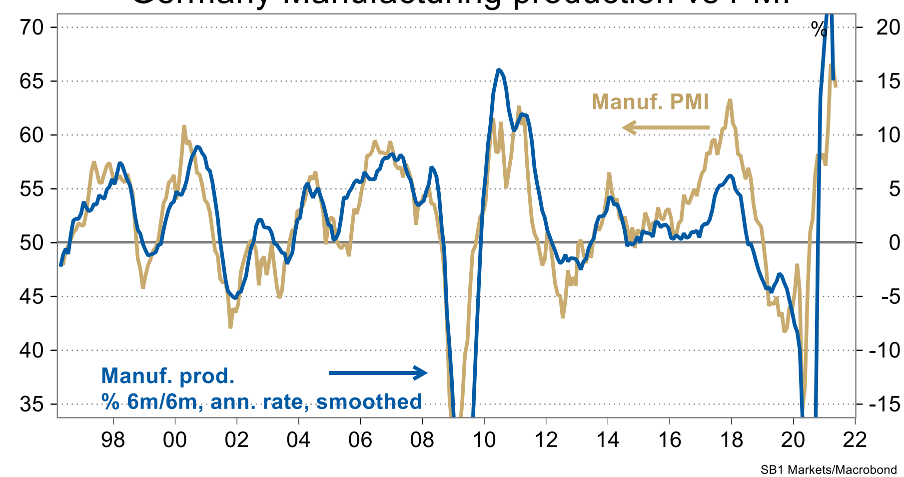


- **German manufacturing orders** fell 0.2% in April, expected up 1.0% - and are now almost over 12% above the pre-pandemic level.
- **German manufacturing production decreased** by 0.7% and is still 5% below (both are measured in constant prices)
  - » This discrepancy is unusual, to put it mildly
  - » Surveys confirm strong growth in order inflow – and hopefully in activity (even in longer delivery times are a major challenge, here too)

Germany Manufacturing orders vs production



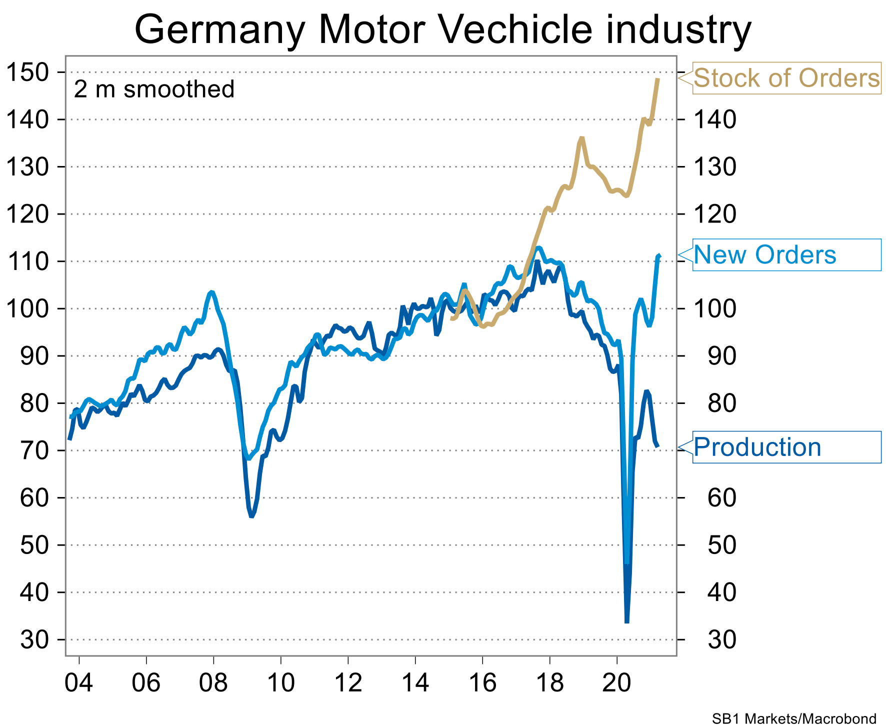
Germany Manufacturing production vs PMI

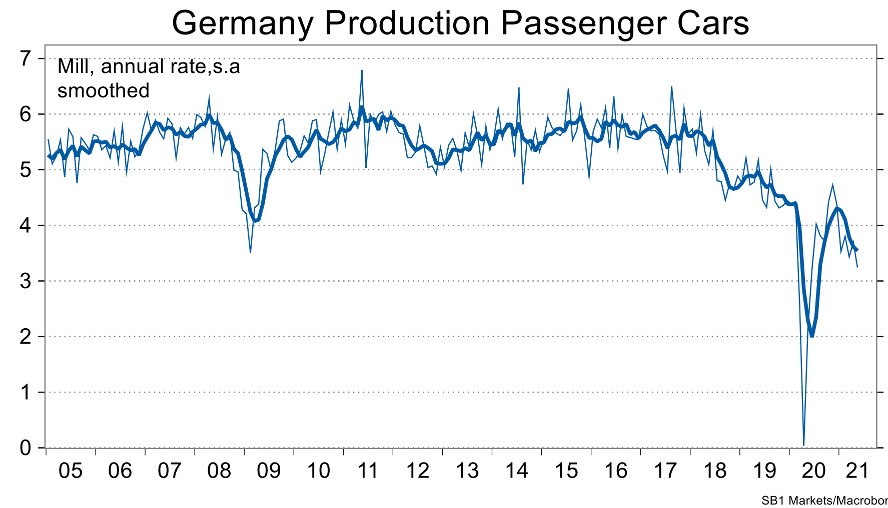


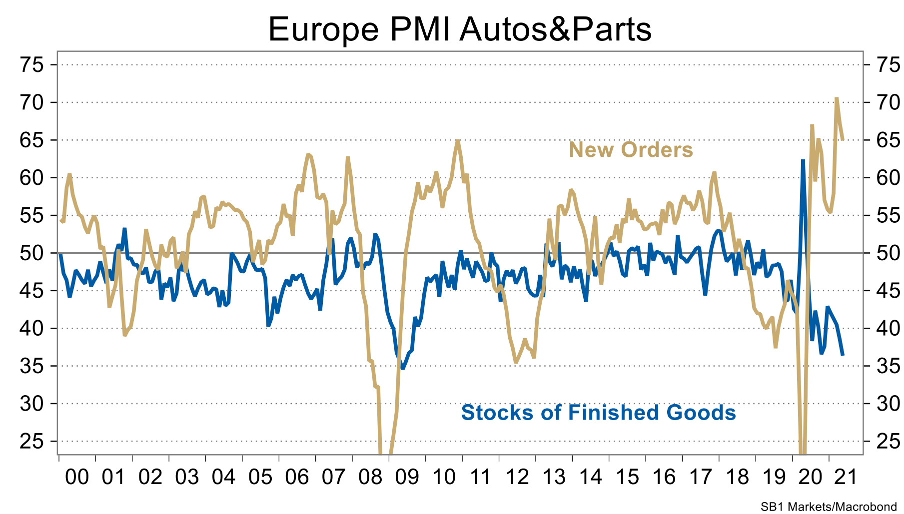
German total industrial production, including energy production and construction was down 1.0% m/m, expected +0.5%. Construction was down 4.3% in April

German auto production: orders are sky high

…but production is falling rapidly, very likely at least partly due to lack of semiconductors





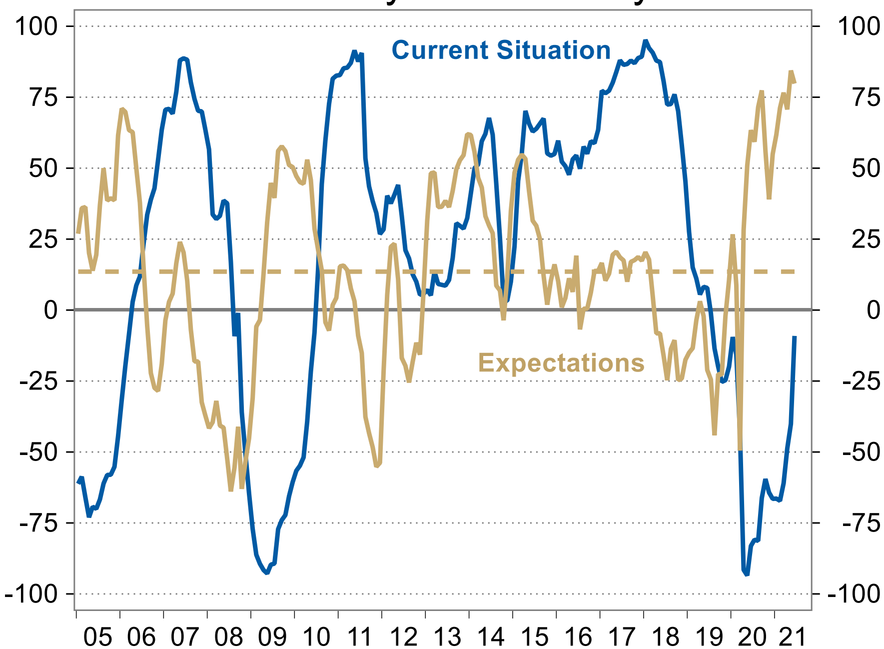


- The lockdown related 25% decline in auto sales in Europe the last months have not made a dent in orders or the order backlog, rather remarkable (both according to actual order data, and the European Auto PMI
- Production of cars in May was down 30% from last November. The latter part of the decline in production is very likely due to lack of components, especially semiconductors

ZEW analyst/investor sentiment down in June, still extremely high

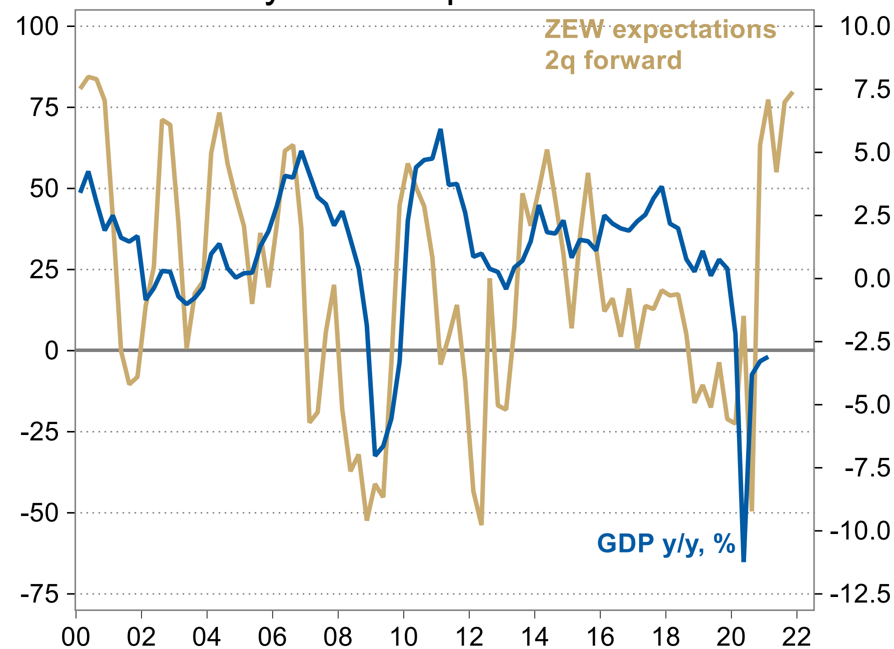
– signals very high growth

Germany ZEW Survey



SB1 Markets/Macrobond

Germany ZEW expectations vs GDP

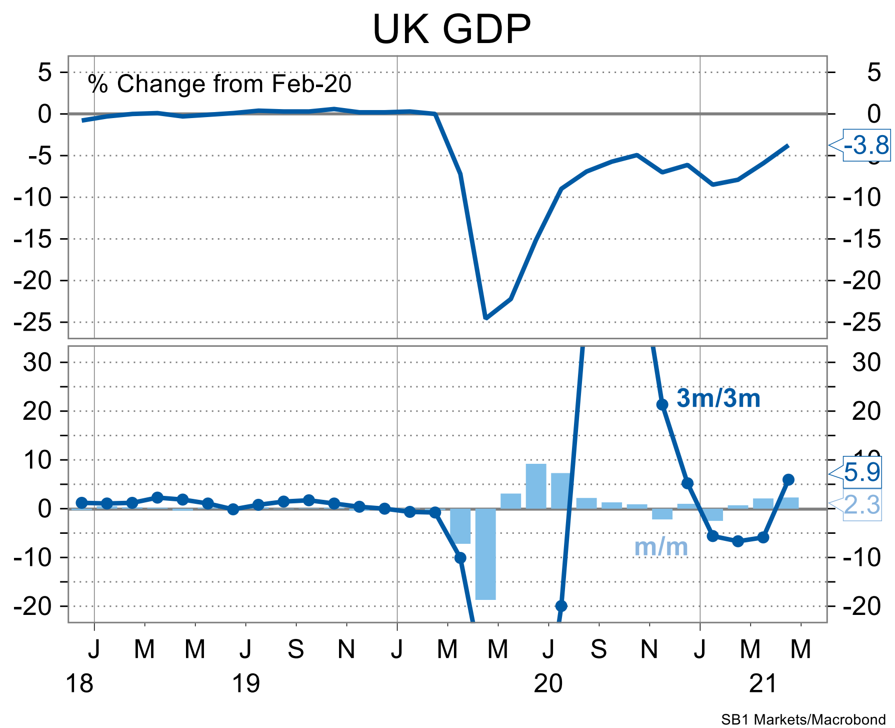


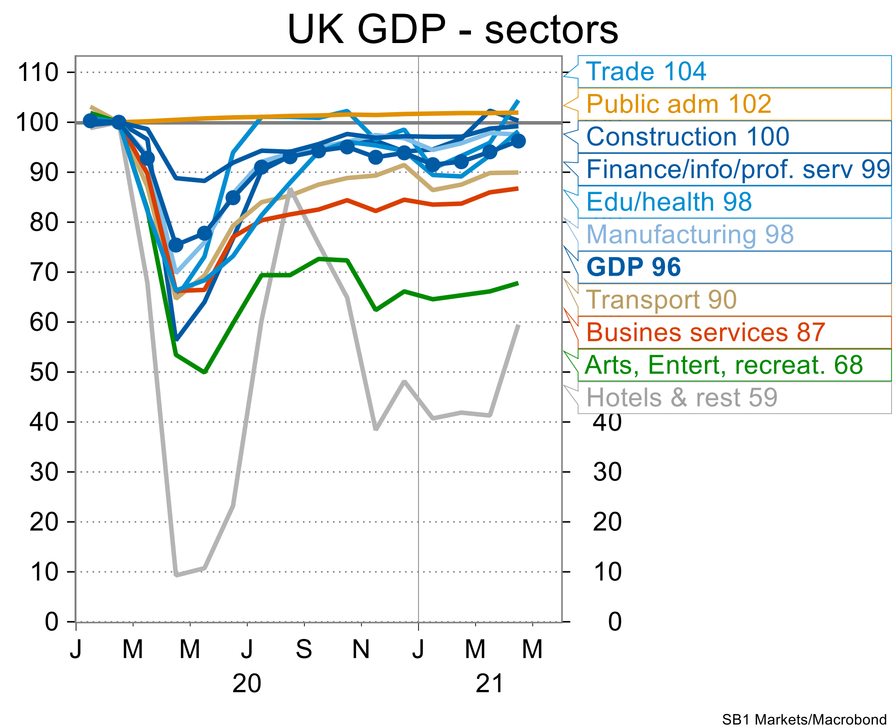
SB1 Markets/Macrobond

- The ZEW expectation index fell 4.6 p to 79.8 in June, expected up to 86. The index is 1.6 st.dev above average, and just marginally below the best prints the past 20 years – check the chart above!
  - » Thus, investors and analysts are just pretty sure that the economy recover sharply the coming months. Which is reasonable
- Assessment of current situation sharply improved in June, as some restrictions have been lifted and vaccinations are under way. The level is still below average – which also is reasonable. During the next months the gap between the two components should narrowed substantially, mostly from the downside

UK GDP grew by 2.3% m/m in April, boosted by the services, much more to go

GDP will probably return to (above) the pre-pandemic level in June as service activity will climb furth.

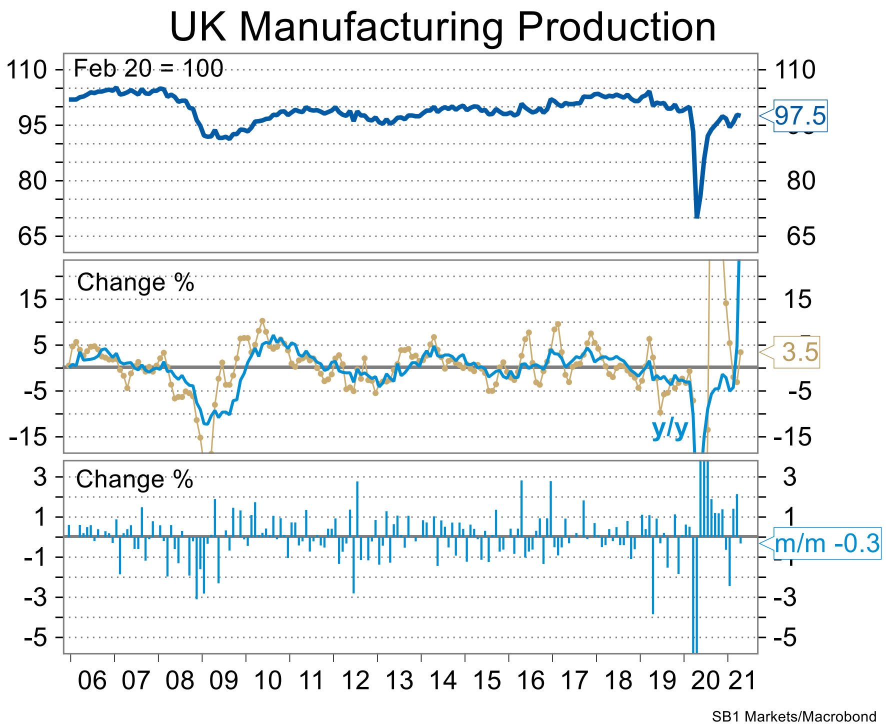


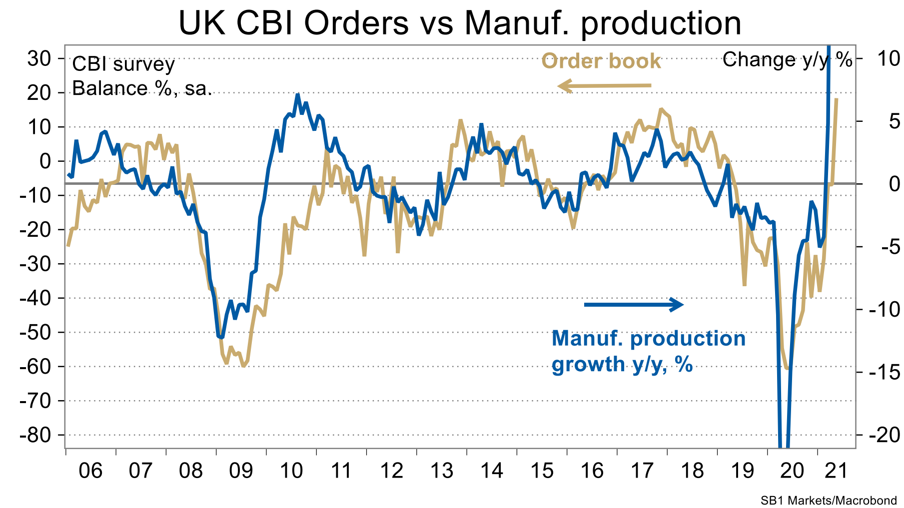


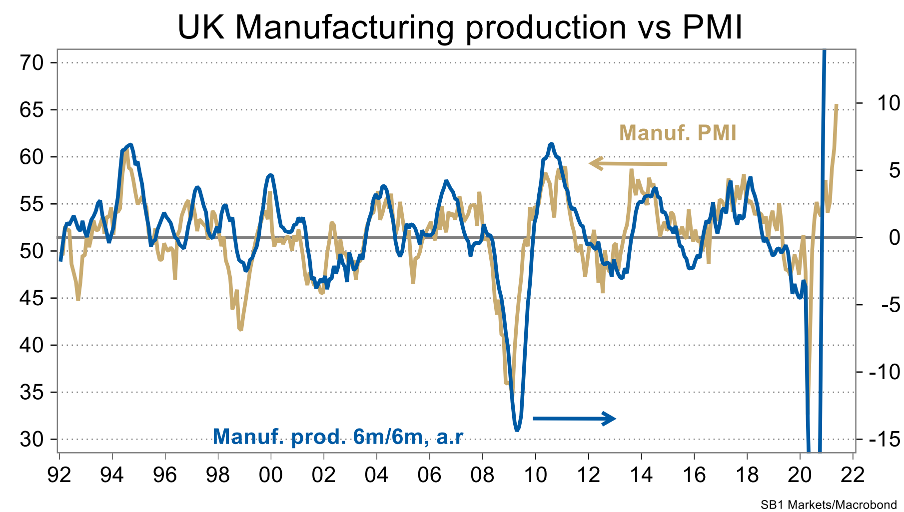
- **GDP** grew 2.3%, as more restrictions were eased, expected up by 2.4%, following the 2.1% m/m growth in March. GDP is still 3.8% below the Feb-20 level.
  - » January was the local trough (down 8.5% vs Feb-20), and GDP has been growing at 22% pace the past 3 months!
- **Services** were up 3.4% in March, supported by hotels & restaurant, up 44% (but they were still 40% below the pre-pandemic level – just wait for the May & June data!). Trade was up 8%, as more shops reopened
- Manufacturing, construction, and professional services were the only other sectors that were down – but all are trending up

A pause in the manufacturing sector, trend still up. Level 2.5% below pre Covid

Manufacturing production <u>down</u> 0.3% in April – expected <u>up</u> 1.5%. Orders, surveys the best ever



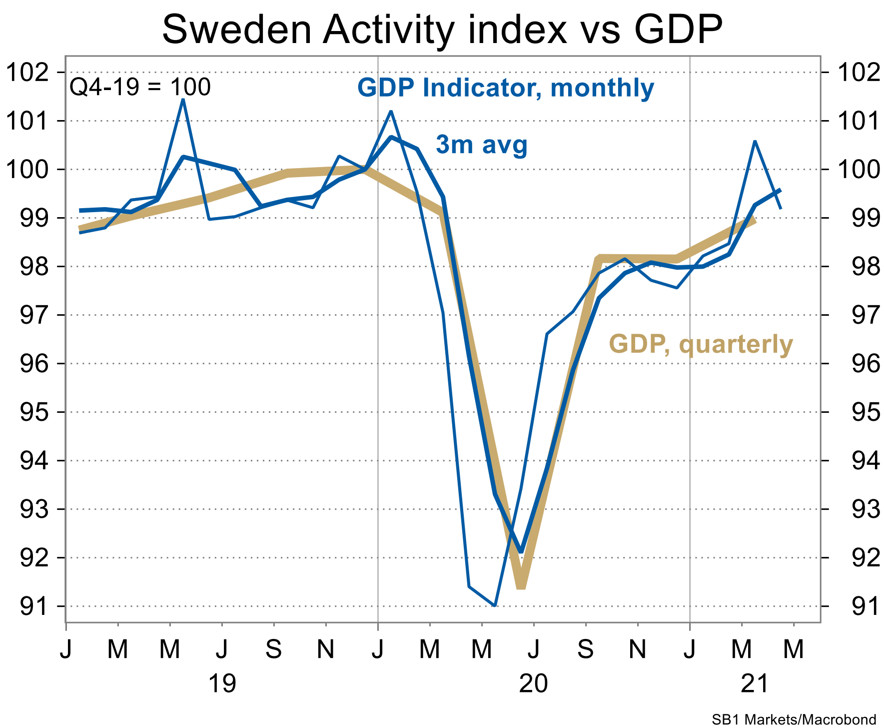


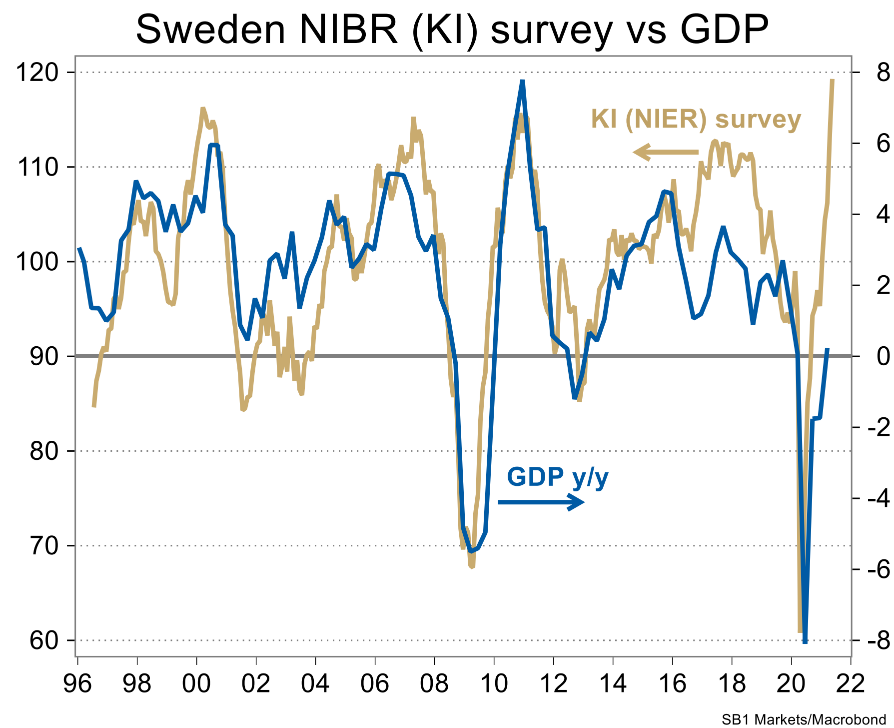


- 5/13 manuf. subsectors saw a decline inn production
- Industrial production (including oil, gas, electricity) was down 1.3% m/m (expected +1.5%)
- Manufacturing production is still 2.5% below the pre-pandemic level
- On a the bright side: PMIs and other surveys are at the best levels ever – and signalling terrific growth the coming months. If businesses have enough materials, labour of course…

GDP down 1.4% in April, still just 0.8% vs. the pre-pandemic Q4-19 level

GDP was expected up 0.3% but given the 2.2% lift in March that was very optimistic

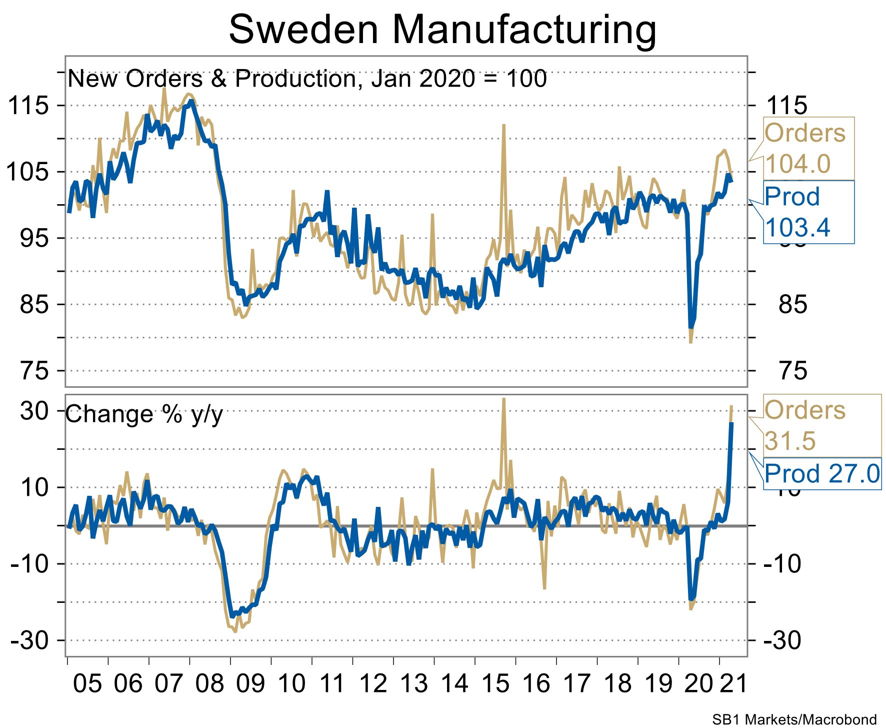


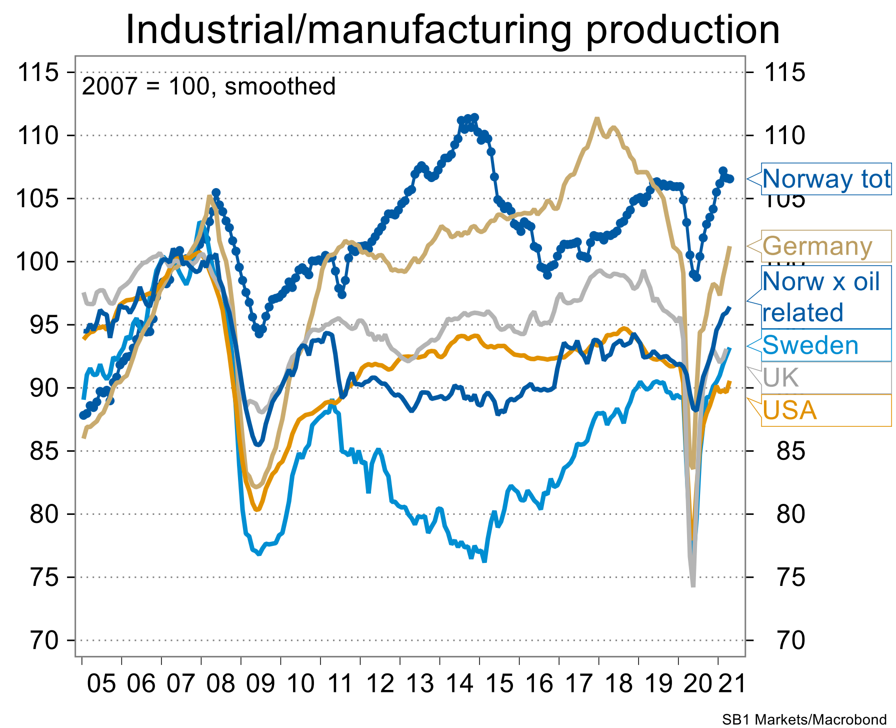


- **Q1 GDP** grew by 0.8%, below the initially estimated 1.1%. Still, the current data signals upside risk to the Riksbank's upward revised 2021 growth forecast
- **The outlook** for the coming months is extremely good, if we should believe the reports from the business sector, measured by KI or the PMI

Industrial production down 1.3%, orders down 2.7% in April

Production is still 3.4% above the pre-corona level, orders 4%

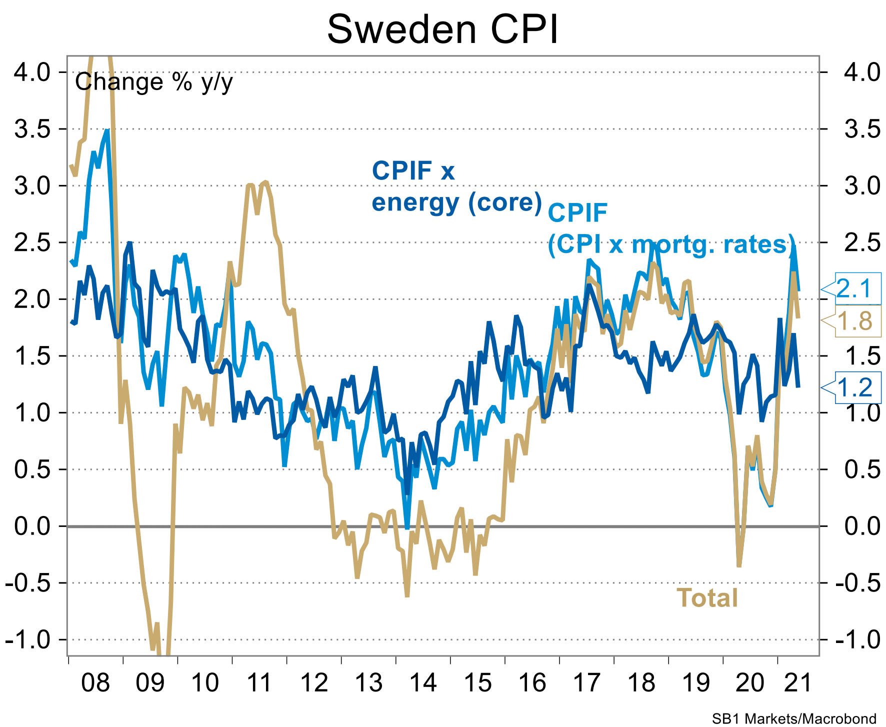


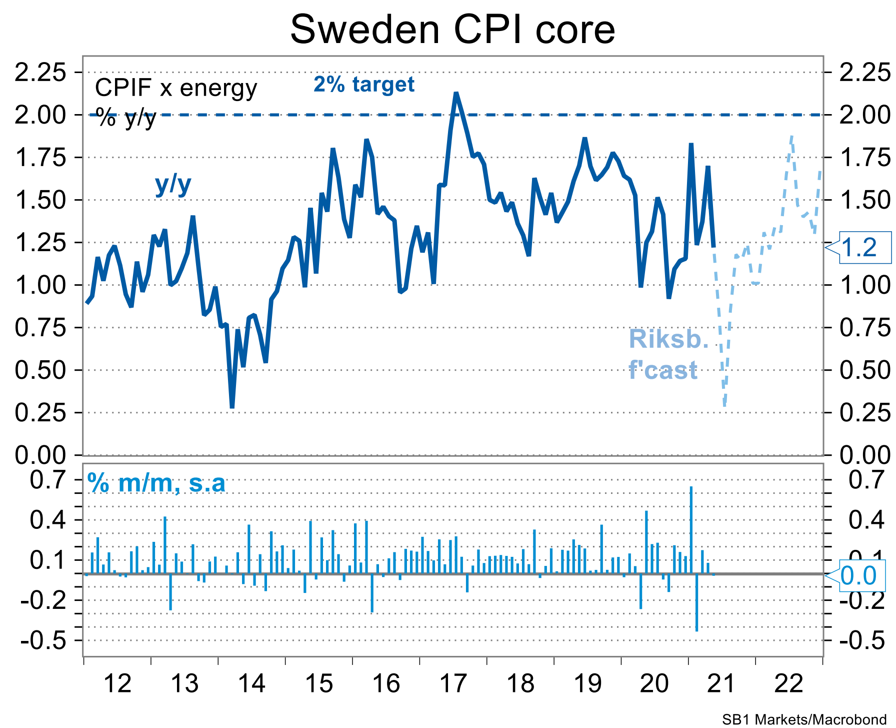


- Production will very likely continue on the upward trend the coming months
- Long term, manufacturing production in Sweden has not been that impressive

Core inflation down 0.5 pp to 1.2% in May

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

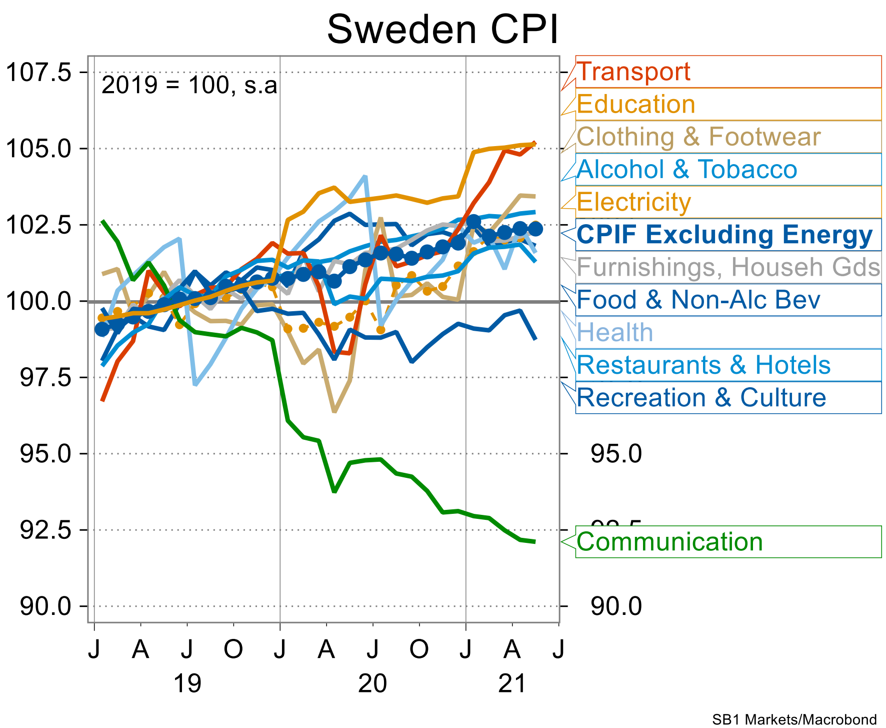


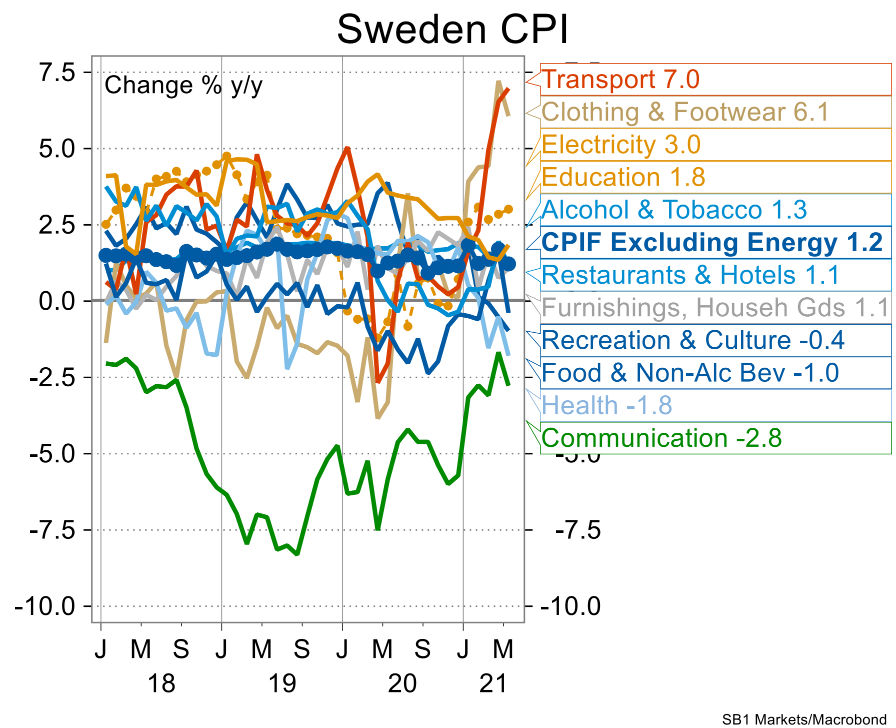


- **Headline inflation** fell to 1.8% y/y from 2.2% - expected at 2.0%
- **The CPI-F**, the constant interest rate inflation (CPI x mortgage rates) was down 0.4 pp to 2.1% y/y in May, 0.1 pp below expectations.
- **CPI-F x energy, the 'real core'** was flat m/m – and 1.2% y/y
  - The Riksbank expect a steep decrease in the core y/y rate in July, without any special base year impact
- The decrease in inflation was largely driven by decrease in food, recreation and communication, whereas electricity, vehicles and clothing were the largest contributors on the upside

Communication, healthcare, recreation & culture prices fell in May

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





Highlights

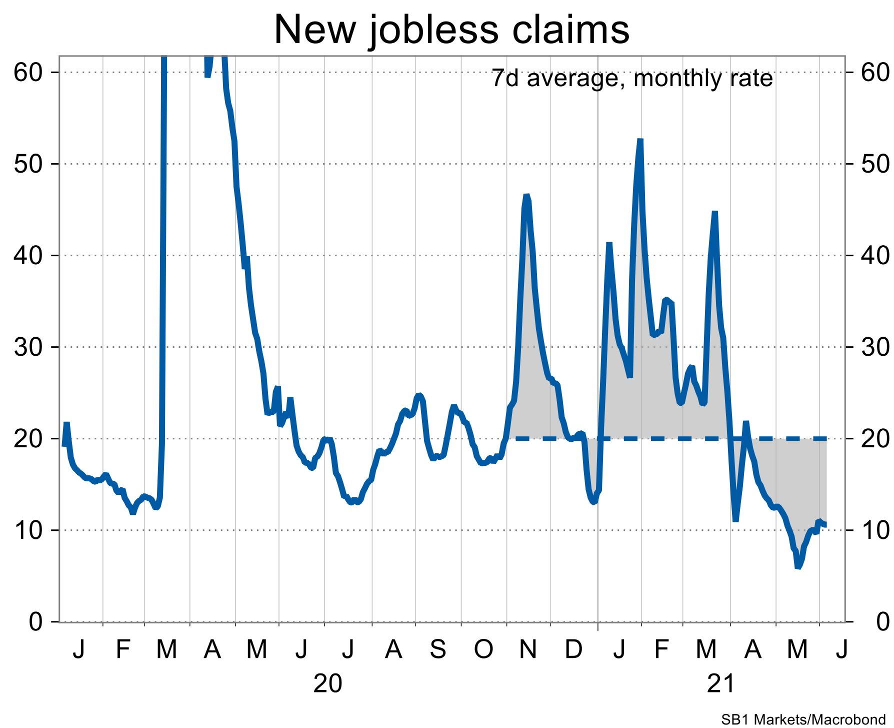
The world around us

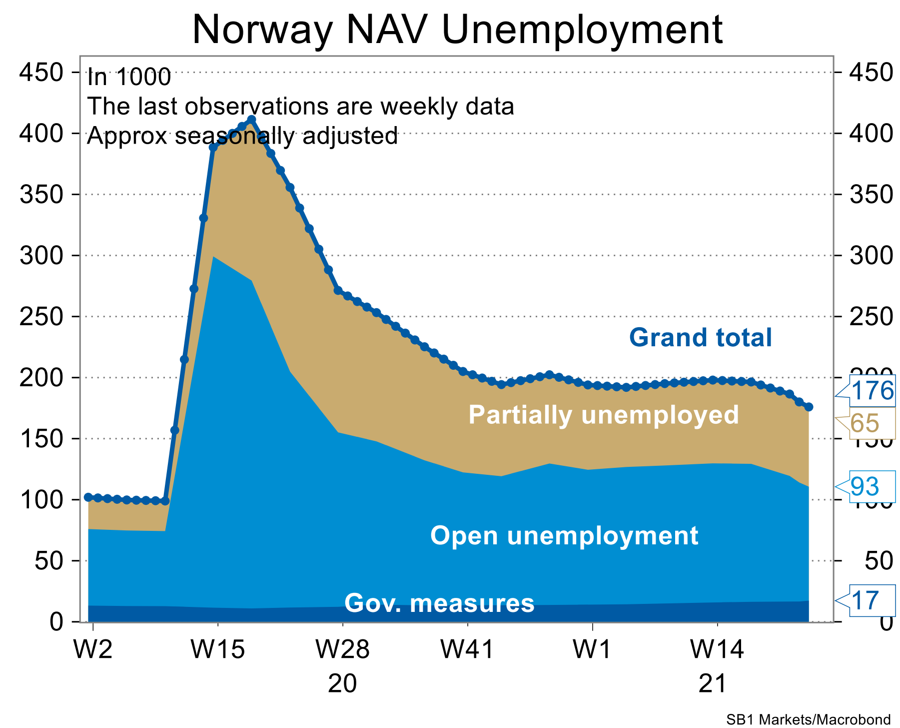
The Norwegian economy

Market charts & comments

‘No’ new jobless claims, unemployment is falling by 3’– 4’ per week

Total unemployment fell by 12’ (seas. adj) in May, and the pace is not slowing - some -4’ last week

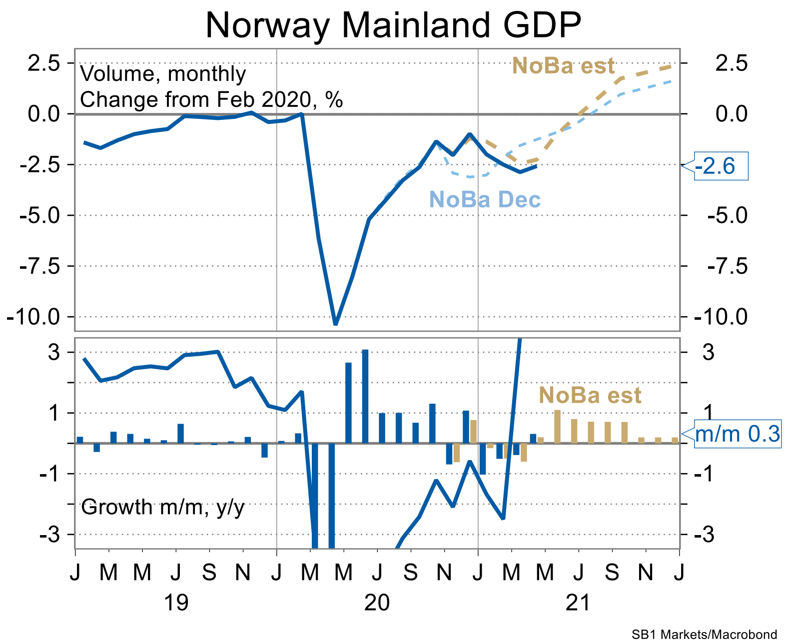


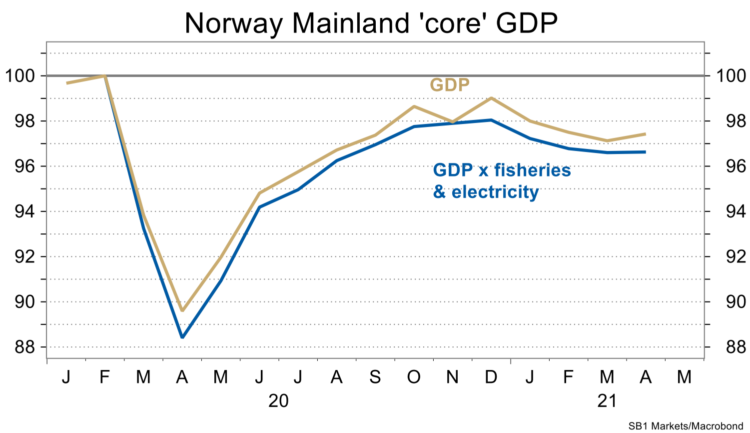


- We expect a rapid decline in unemployment the coming weeks/months as well

Mainland GDP up 0.3% in April – 0.1 pp above expectations

The increase was above NoBa's expectation

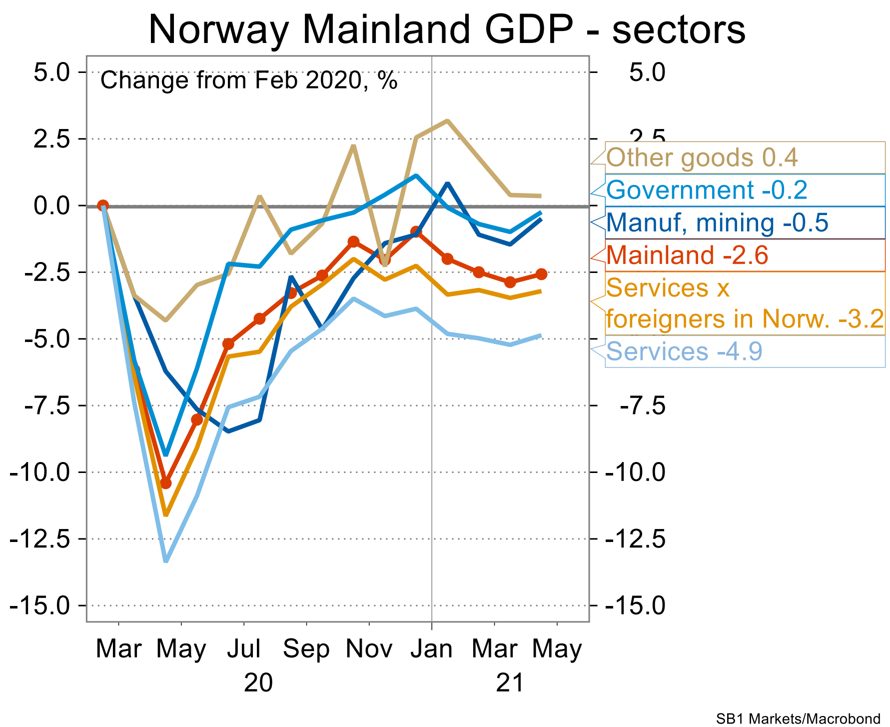


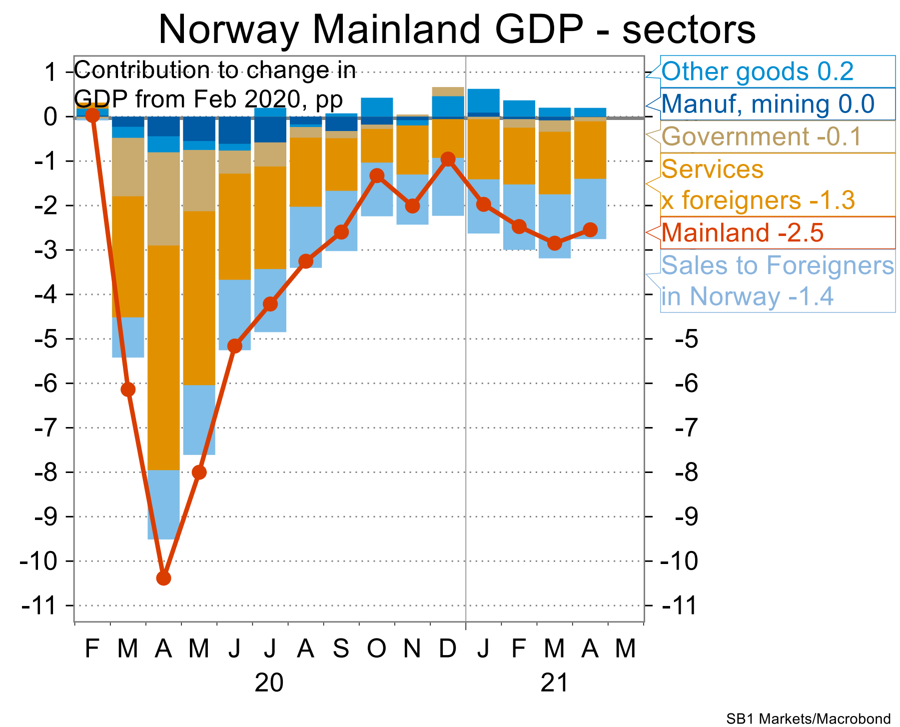


- **Mainland GDP grew by 0.3% m/m in April**, above consensus and NoBa expectations, but as we expected. The decline in March was a tad smaller than initially -0.4% vs. -0.5%. GDP is down 1.6% from the local peak last Dec
  - » **Production:** Private services were up by 0.4% in April even if hotels & restaurants were down 8.6%. Manufacturing was up 1.3% m/m, while construction was up 0.3%
    - **Fisheries** slightly down April, **and electricity** up 9%, 'core ML GDP' was flat
  - » **Demand:** Norwegians' spending at home fell 0.4% in April, goods up 0.8%, services down 1.6%. Both investments in oil, Mainland businesses and housing rose in April, while all fell in Q1. Exports x travel fell -4.4%
- **Mainland GDP is down 2.6% 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 3.4%
  - » **Production:** The 4 hard hit services are down 20% (business services) to 51% (hotels & restaurants). The total negative drag equals 3.4% 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 17%, goods up 8%. Spending abroad has fallen by 96% (equalling 9% of disp. income), and the money is saved. Housing investments are up. Mainland business investments have fallen by 3%, while oil investments are up 2%!! Exports ex petroleum (and tourism) are 3% below the Feb-20 level. Foreigners are not spending anything in Norway, a cut equalling 1.4% of Mainland GDP

Production: An improvement in all main sectors in April

The 2nd /3rd wave hit all sectors too, from late last year

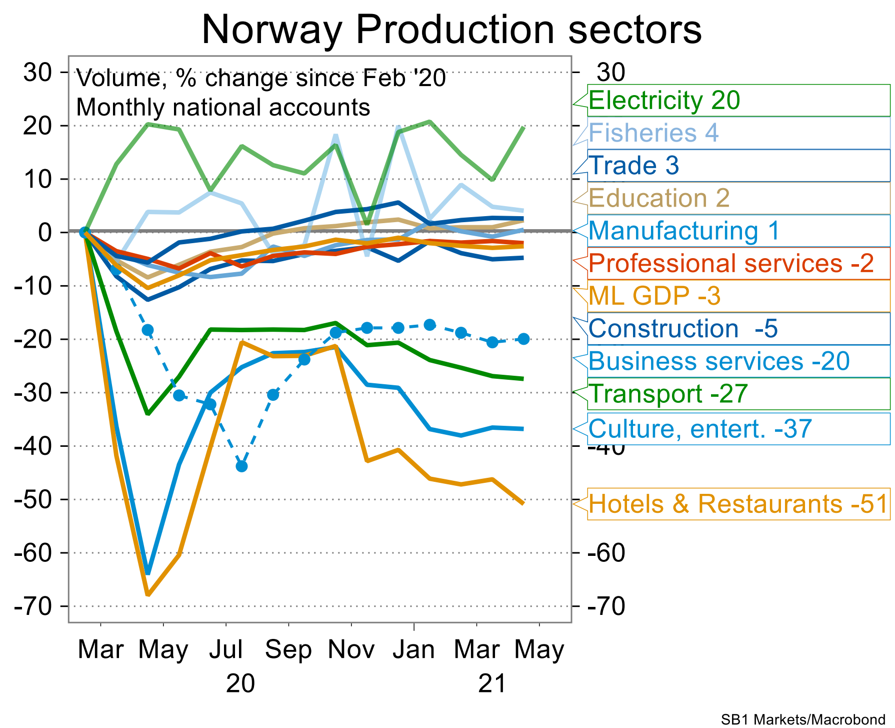


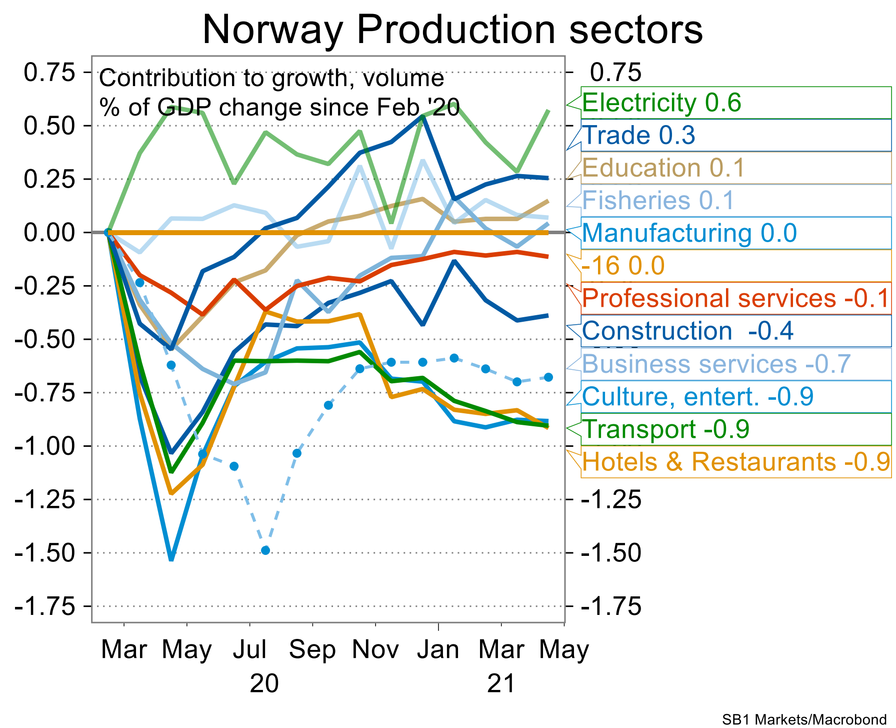


- **Service sector production was up 0.4%** in April, as corona restrictions were eased – Very likely, March was the bottom **Manufacturing production (incl mining)** also rose in April, up 1.3% m/m, while construction was up 0.3%
- **Other goods production** is volatile mostly due to (ocean) **fisheries and electricity production.** Production was flat in April, supported by a 9.1% increase in electricity production

Production details: More sectors down than up in April

Peoples' businesses (restaurants etc) down 20% - 51% vs Feb-20, in sum a 3.4% neg. drag on GDP



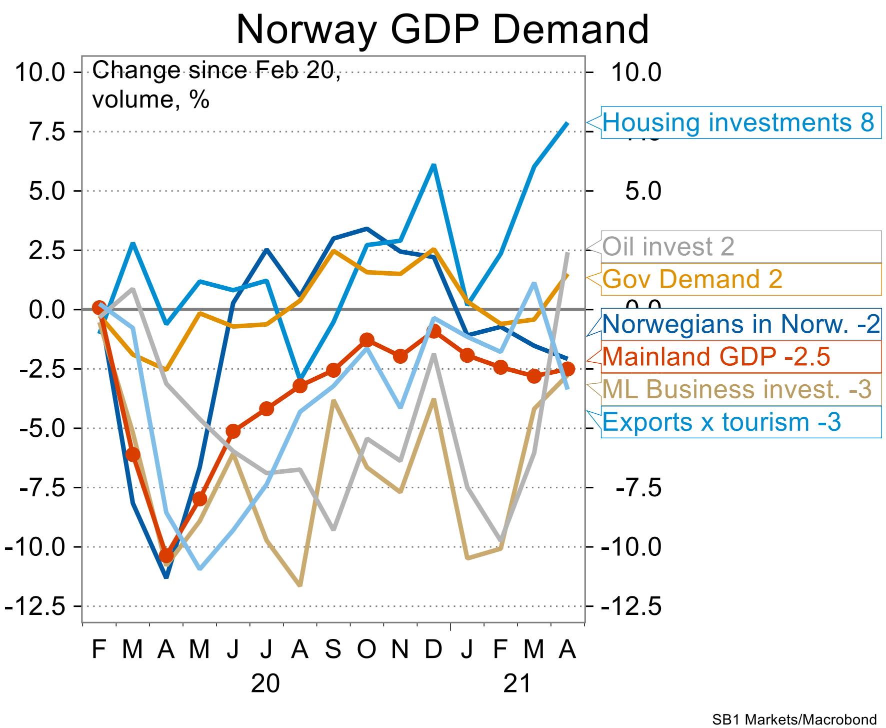


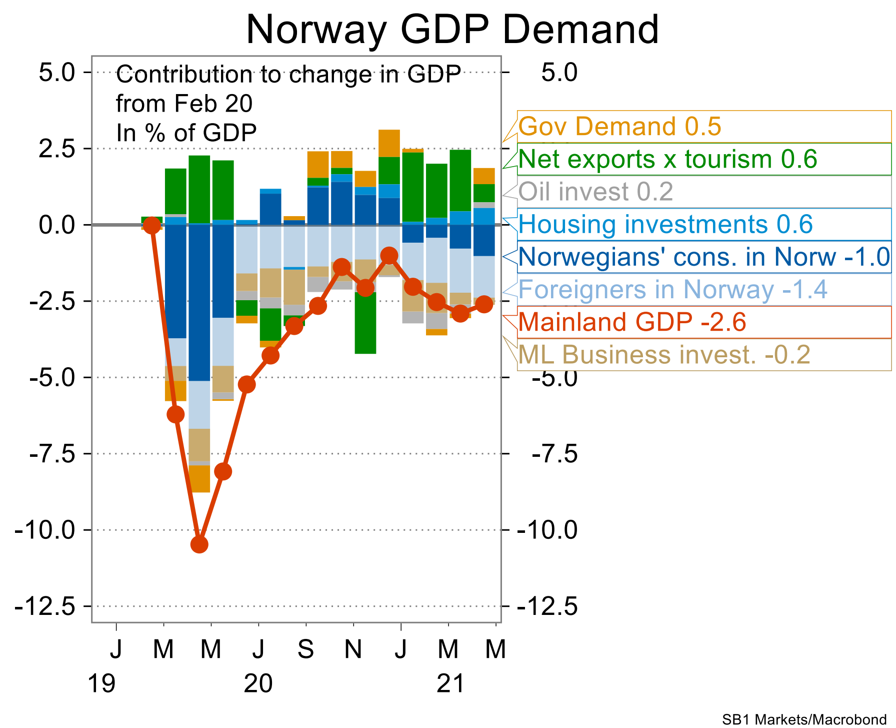
- **Hotels & restaurants, culture,** and **transport** contracted further in April
- **Fisheries & aquaculture, trade,** and **professional services** reported a decline too

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

Demand: Consumption and exports down, other demand up in April

Norwegians’ consumption fell 0.4%. Investments sharply up in April (were down in Q1)

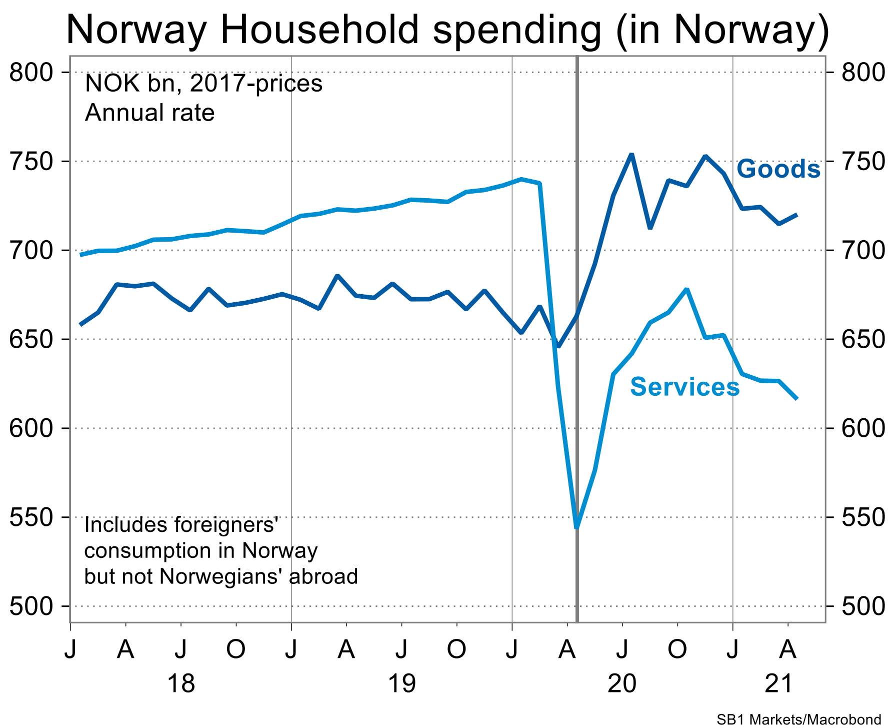


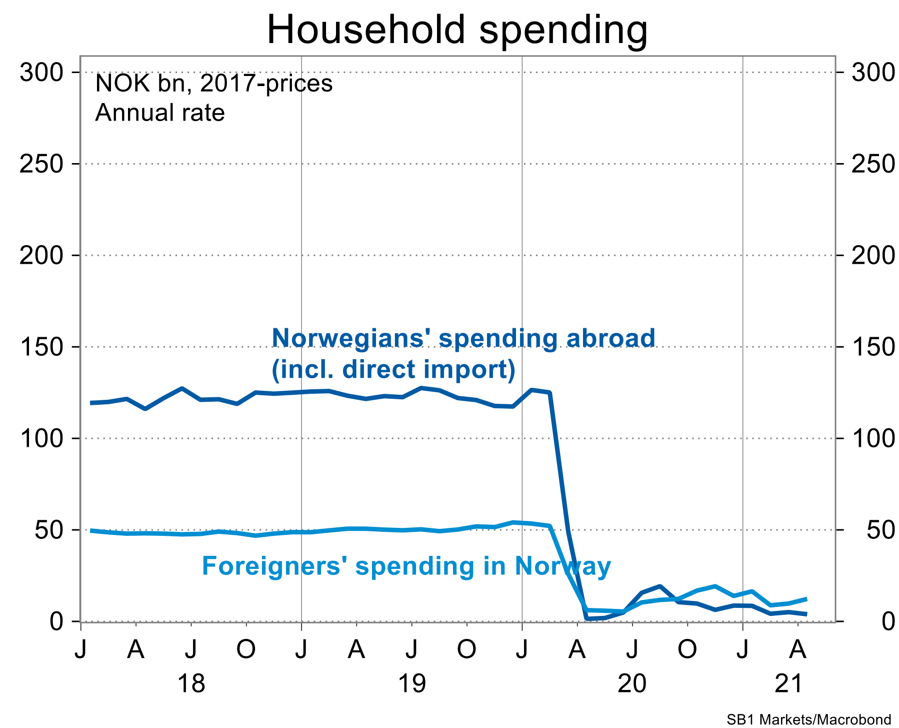


- **Norwegians’ consumption in Norway fell by** 0.4% due to a 1.6% decline in consumption of hotel and restaurant services. Food consumption was also down. F**oreigners** are still not spending anything, and deducts 1.4% from GDP (not adjusted for import content of goods they (used to) buy here)
- **Mainland business** investments rose 1.4% in April, but are still 3% down vs. Feb-20
- **Oil investments** increased 9.2% in April, and are now up 2% since Feb-20, adding 0.2% to GDP
- **Government demand** rose 1.9% in April, up 2% vs. Feb-20
- **Domestic demand x inventories** rose by 2.2%, due to higher investments
- **Mainland exports** (x tourism) fell by 4.4% in April, and are 3% below the **Feb-20 level.** Net exports are higher than in Feb last year, as **imports** are below the Feb-20 level (in volume terms)

Services consumption down, goods up in April

Huge upside for services as the economy opens up

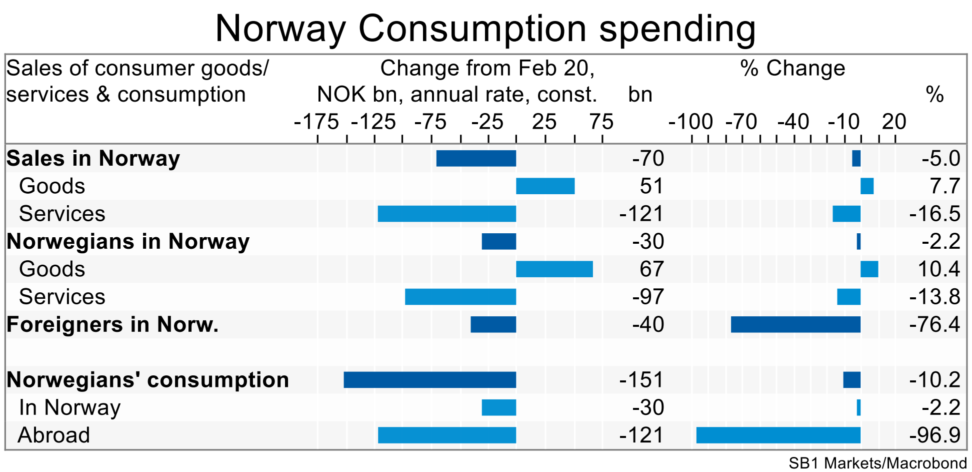


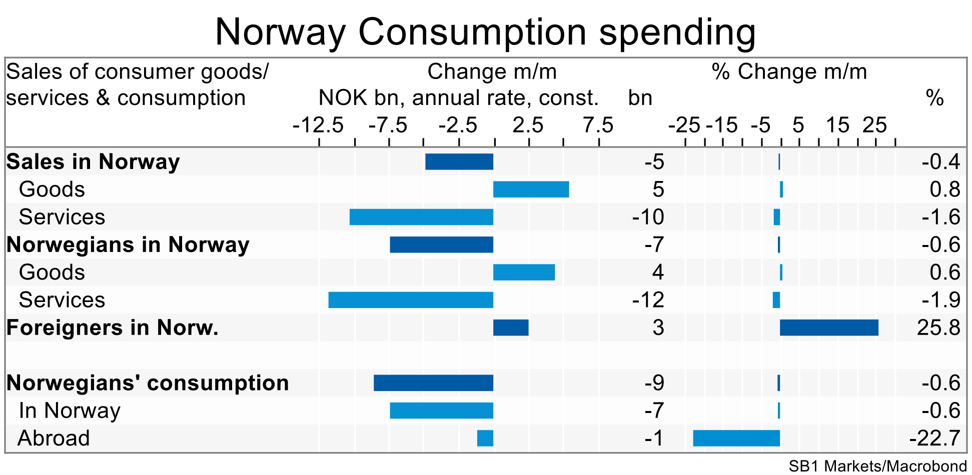


SpareBank 1 MARKETS

Norwegians are consuming almost like normal – in total – in Norway. Not abroad

Goods consumption rose in April, services not! And no foreigners are spending money here!



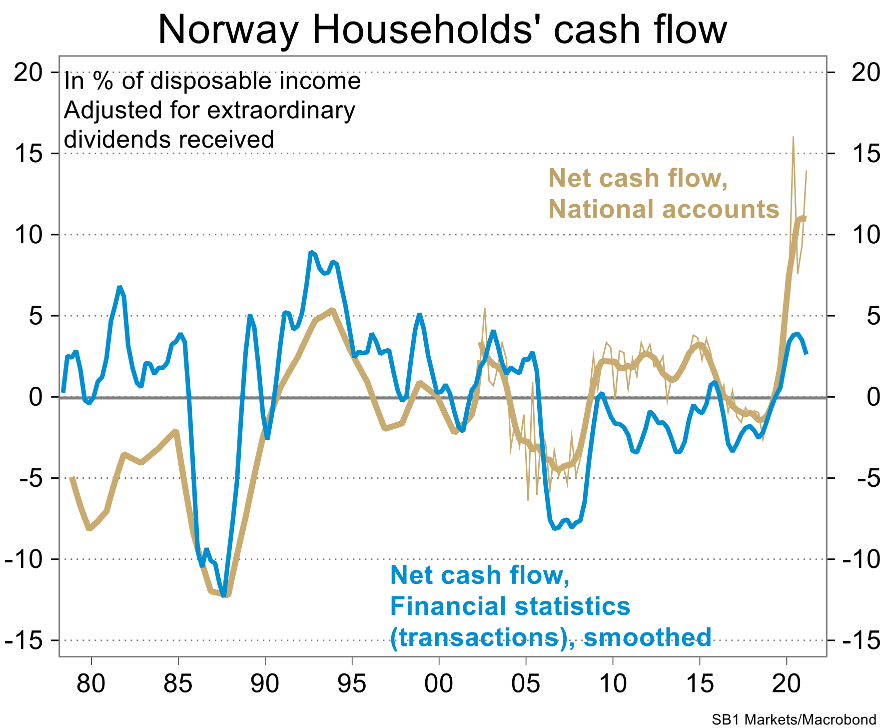


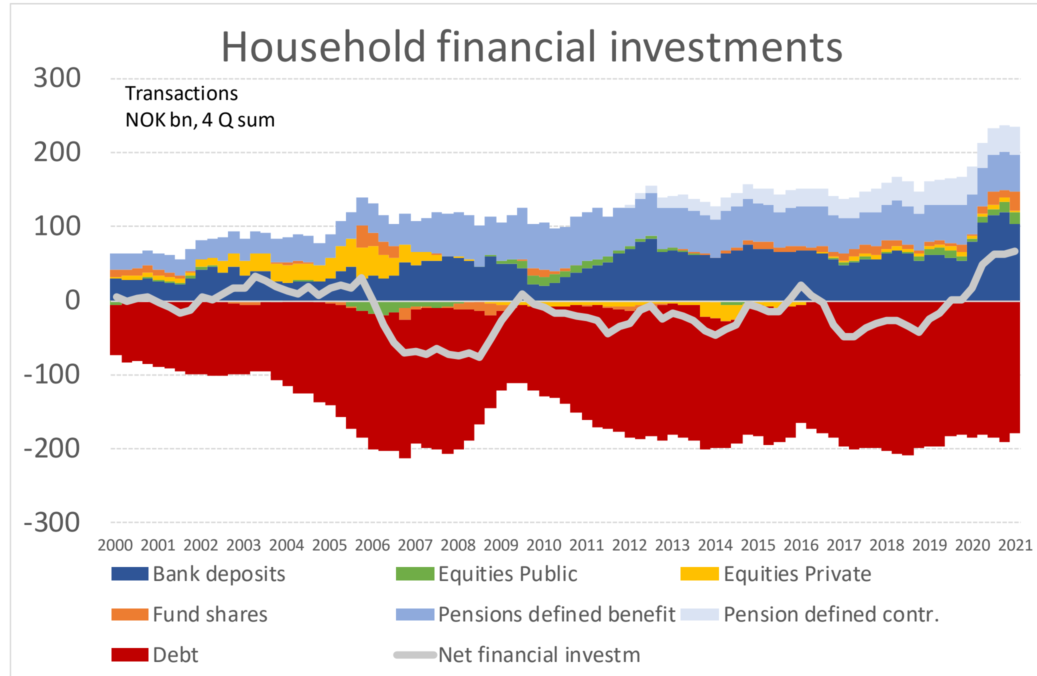
- **Sales of consumer goods** in Norway are up 7.7% vs. Feb-20, while services are down 16.5%, the sum is down 5%
  - » 2.8 pp of the setback is due to lack of foreigners' demand in Norway – which has fallen by 76%
- **Norwegian households** have increased their consumption of goods in Norway by 10% but reduced consumption on services by 14% in sum 2.0% down. In April just consumption of services fell, by 1.6%
- **Total (Norwegian) household consumption** has fallen by 10% vs. Feb-20. Of this is 8 pp due to the 96% (!) decline in Norwegians' spending abroad

- **We expect consumption to normalise** rapidly the coming quarters. Demand for goods is very likely above long term trend and will slow when spending on services picks up, and when we can start spending abroad again, probably in full scale during Q3. We expect the savings rate to decline substantially

Some savings lost in transactions

The national accounts report 11% net household 'cash' savings, financial accounts find just 4%

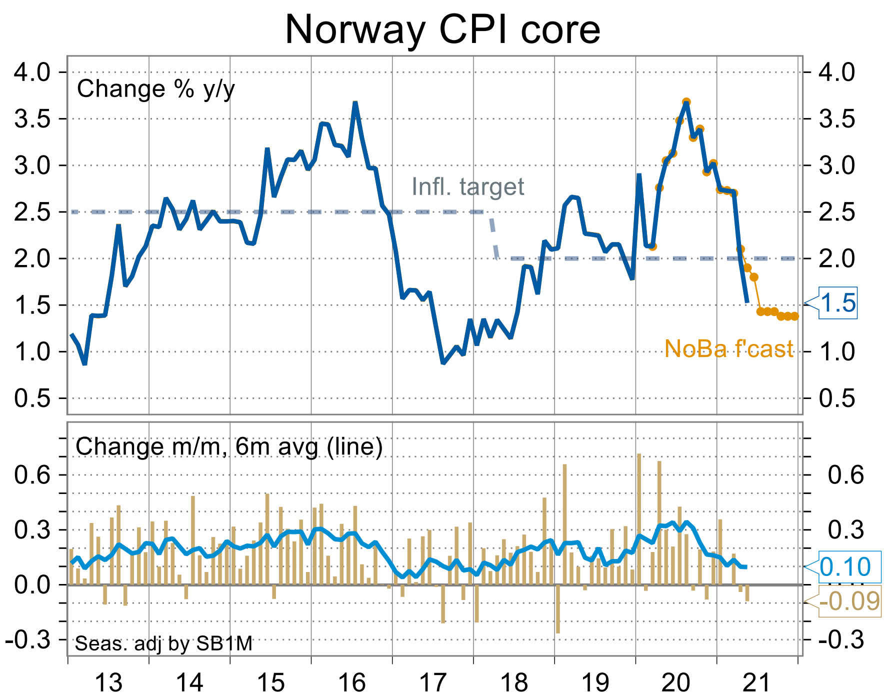


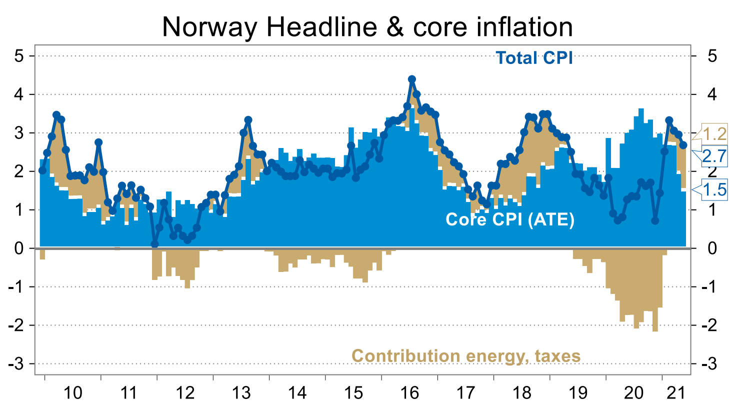


- The two stats are not always in line but the discrepancy is larger than normal
  - » The net financial investment calculated from the National income, consumption and housing investment data should equal household transactions in financial instruments – where the net cash is invested
- Financial accounts show that the extra net saving is invested in bank deposits, which are up NOK 100 bn, 50 bn more than 'normal'. Pensions is the other main savings vehicle, without any acceleration through the pandemic (sum 50 bn)
- Investments in fund shares have increased recent quarters, as have investments in public equities, by NOK 25 bn and 16 bn respecitvely
- Debt is increasing steadily, by almost NOK 200 bn per year

Inflation is not on the way up everywhere: CPI-ATE down 0.5 pp to 1.5% y/y!

Imported goods prices fell sharply, helped by a stronger NOK. Domestic inflation modest too





- **CPI-ATE** (ex. energy and taxes) inflation is down 0.5 pp to 1.5% in May; 0.4 pp below Norges Bank's f'cast, 0.5 pp below consensus estimate and our forecast
  - » Prices were down 0.1% m/m (seas adj), down from 0.04% in April
  - » Inflation is below 2% for housing, clothing, food, alcohol, communication, transportation, and airline tickets – <u>others are still above</u>
  - » The main miss (vs our f'cast) was a 2.5% drop in furnishing prices
  - » As we have expected, imported goods price inflation is now receding, due to NOK effect (and more than we assumed in May)
  - » Domestic inflation has slowed substantially to 1.5%
- **Total inflation** slowed 0.3 pp to 2.7%
- **The outlook**
  - » **Inflation may slow** somewhat more the coming quarters. the NOK effect fades and wage inflation remains moderate (if not low). Demand for goods will have to decline from a very high level. <u>Upside risk: Higher raw material prices/global price pressures but the spillover to the Norwegian CPI is not that significant</u>
  - » <u>Anyway, CPI inflation will not have any material impact on Norges Bank's monetary policy</u> the coming months. It's all about the post Covid-19 recover – and the housing market

SpareBank 1 MARKETS

Lower food, furnishing, recreation and transportation prices than expected

		Change m/m, seas. adj			Change y/y			Contribution, pp		
May-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	-0.2	0.2	-0.4	-0.2	0.0	0.7	-0.03	0.00	-0.05
Alcohol, tobacco	4.3	0.0	0.2	-0.1	1.4	0.6	0.9	0.00	0.03	-0.01
Clothing, footwear	4.9	0.2	0.1	0.1	-2.5	-1.7	-1.8	0.01	-0.08	0.00
Housing x. energy	20.5	0.2	0.1	0.1	0.8	1.3	1.1	0.04	0.27	0.02
Furnishing	6.8	-2.5	0.3	-2.8	5.6	2.8	5.7	-0.17	0.19	-0.19
Health	3.2	0.3	0.3	0.0	3.3	3.7	3.6	0.01	0.12	0.00
Transp. ex. gas, airl. tick	12.0	-0.1	0.4	-0.4	3.3	1.8	2.6	-0.01	0.22	-0.05
Airline tickets	1.0	0.6	1.0	-0.4	-18.0	-16.3	-15.7	0.01	-0.17	-0.00
Communication	2.5	-0.1	0.2	-0.3	1.7	1.6	1.9	-0.00	0.04	-0.01
Recreation, culture	11.2	-0.4	0.4	-0.8	4.8	3.4	4.3	-0.04	0.37	-0.09
Education	0.5	-	-	-	2.1	2.1	2.1		0.01	0.00
Restaurants, hotels	5.9	0.1	0.3	-0.2	3.7	3.0	3.2	0.01	0.18	-0.01
Other	8.7	-0.0	0.3	-0.3	3.1	2.5	2.8	-0.00	0.22	-0.02
CPI-ATE	94	**-0.1**	**0.2**	-0.31	**2.0**	**1.5**	**2.0**			-0.29
Norges Bank est.			**-0.0**		**2.1**		***1.9***			
Imported	34	-0.8	0.2	-1.0	2.2	0.8	2.0	-0.28	0.26	-0.33
Domestic	60	0.3	0.3	0.1	2.0	1.5	2.0	0.21	0.92	0.04
Energy, housing	4	2.8	1.0	1.8	52.2	55.2	51.6	0.10	1.98	0.07
Energy, transport	2	1.0	1.0	-0.0	11.2	12.0	11.1	0.02	0.25	-0.00
CPI Total	100	**0.1**	**0.3**	-0.2	**3.0**	**2.7**	**3.0**	0.09	2.68	-0.19

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 0.2%, and well below our f'cast, And flat y/y
- **Clothing** prices were up after falling for the past two months, by 0.2% m/m, but are down 1.7% y/y
- **Furniture/hardware/equipm.** surprised sharply at the downside, down 2.5% m/m!
- **Transport ex. gas/airline** – fell 0.1%, we exp +0.4%. Autos up just 1.1% y/y, was 5.3% in March
- **Airline ticket** prices were up 0.6% m/m. Still down 16% y/y, to the extent they are measurable
- **Recreation** was down 0.4% m/m, we expected +0.4%!
- **Restaurant/hotel** prices are up 3.0 y/y%

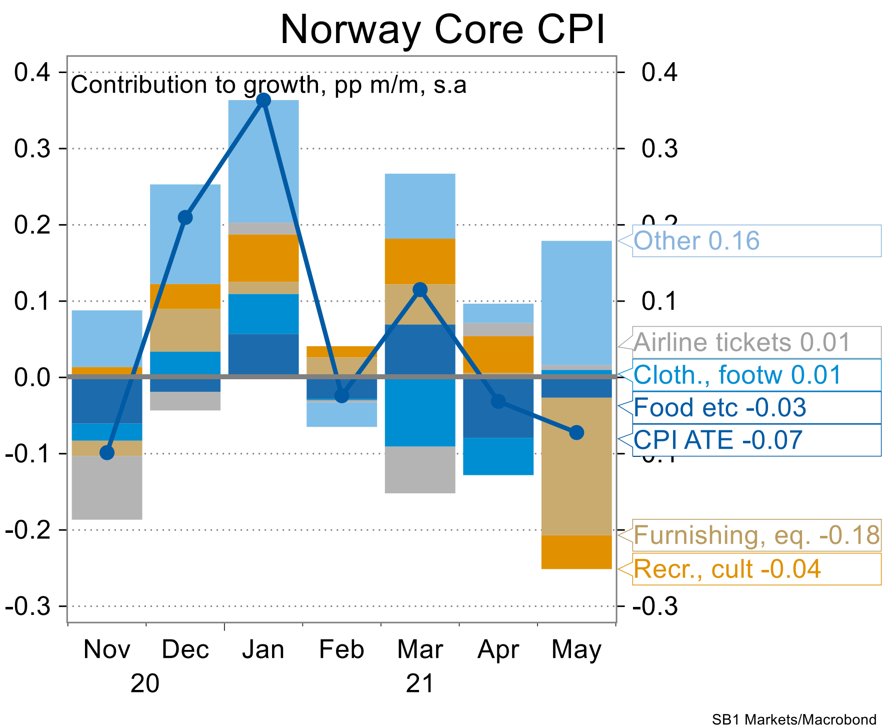
- **CPI-ATE up 1.5% y/y, 0.5 pp below our expectations, consensus & NoBa f'casted 1.9%**

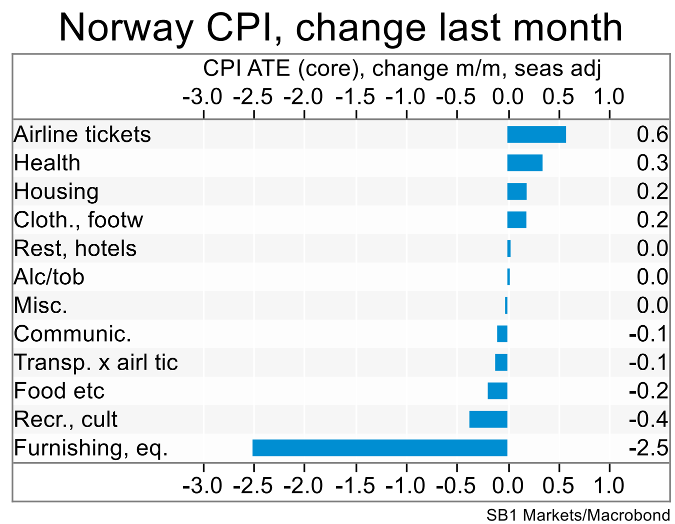
- Prices on **imported goods** fell by 0.8% due to the steep decline in furnishing prices
- Prices on **domestically produced** goods & services rose by 0.3% m/m. The annual rate at 1.5% is low, according to Norwegian standards
- **Electricity** prices rose more than expected and is up 55% y/y
- **… and the headline inflation came in at 2.7%, 0.3 pp below our estimate**

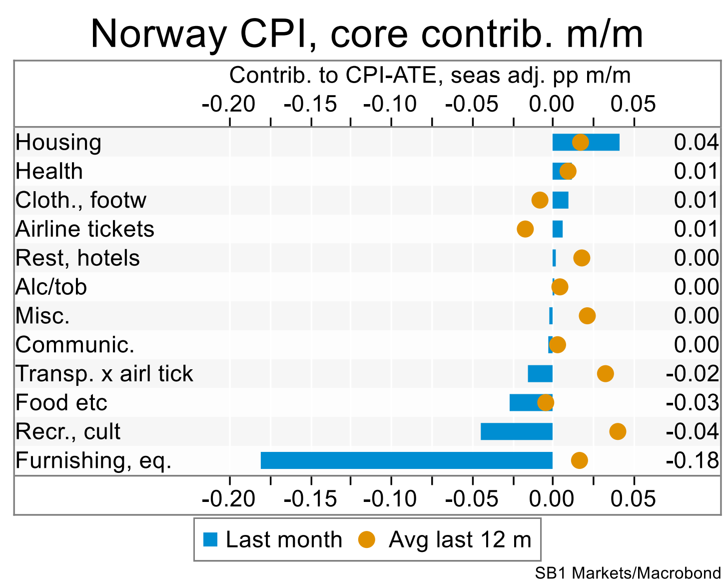
Monthly changes are seasonally adjusted by SB1 Markets. The weighted sum of the components does not necessarily sum exactly up to the total, and deviations m/m and y/y do not necessarily add up. Norges Bank m/m s.a. estimate is implied, calculated by us. Sources: SSB, Norges Bank, SB1 Markets calculations

Furnishing and food prices biggest downside contributors in May

Other goods & services up in May

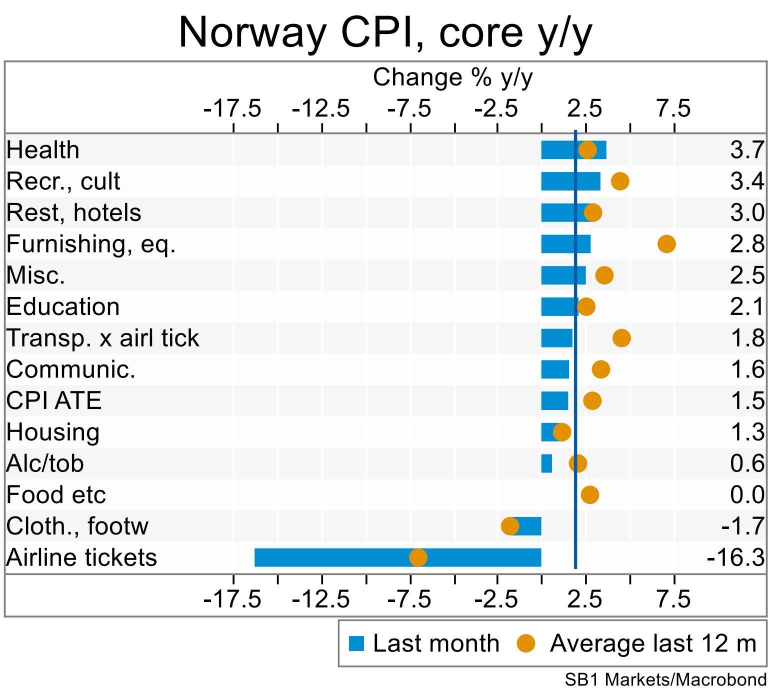


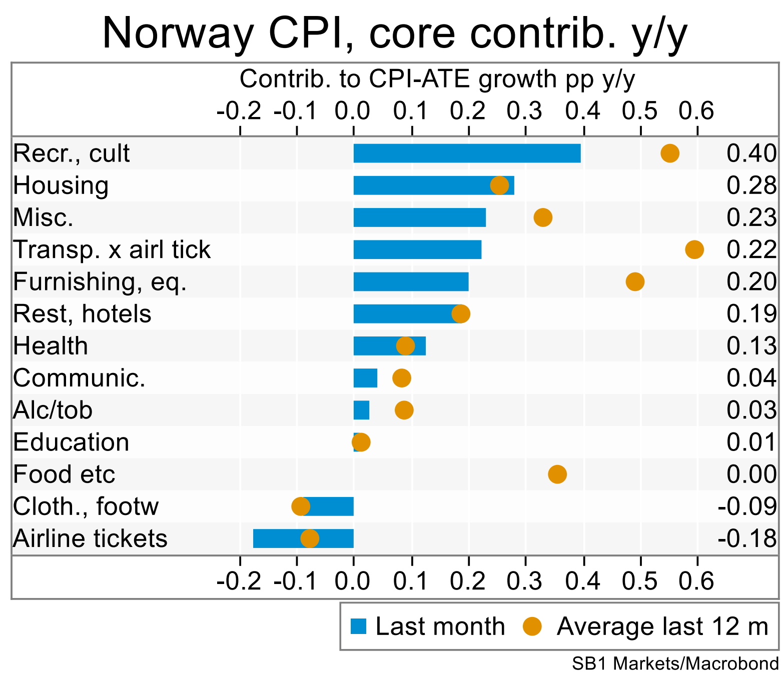




6 sectors report inflation above 2%, 1 is close to 2%, 6 clearly below

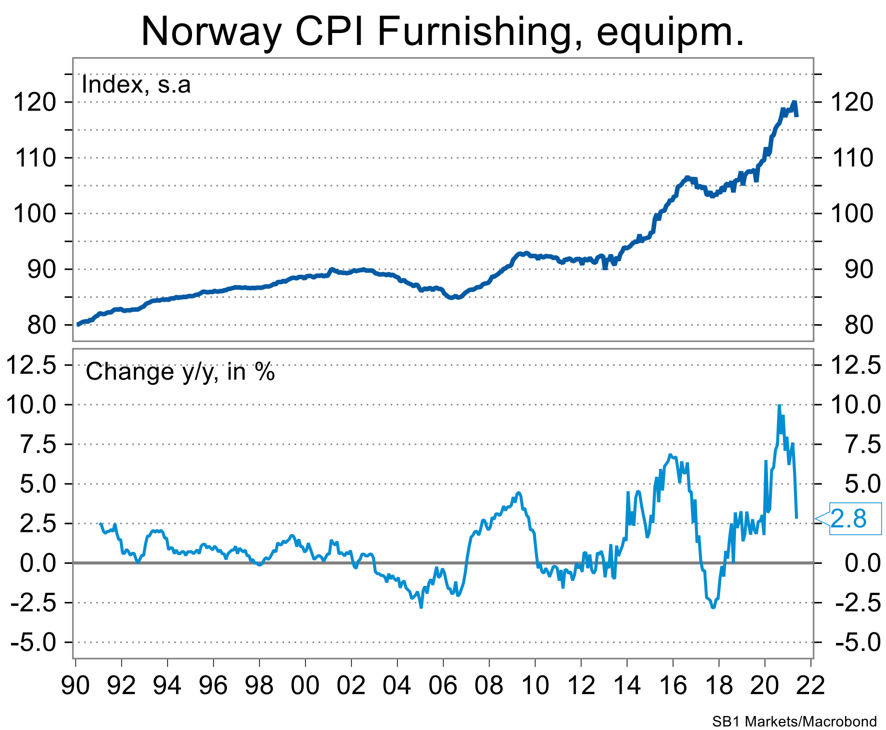
Food inflation down to 0; Clothing, rents, alcohol, communication & airfares << the 2% infl. target

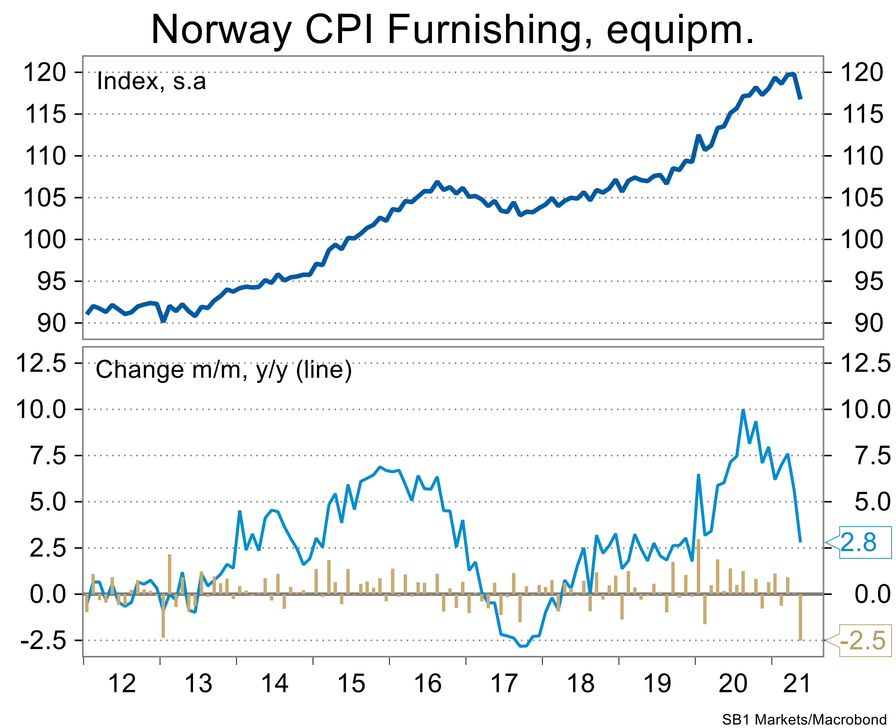




Furnishing prices are coming back down, -2.5% m/m in May, +2.8% y/y

At the peak, 10% y/y. Furnishing price inflation should taper further off, even if demand is strong

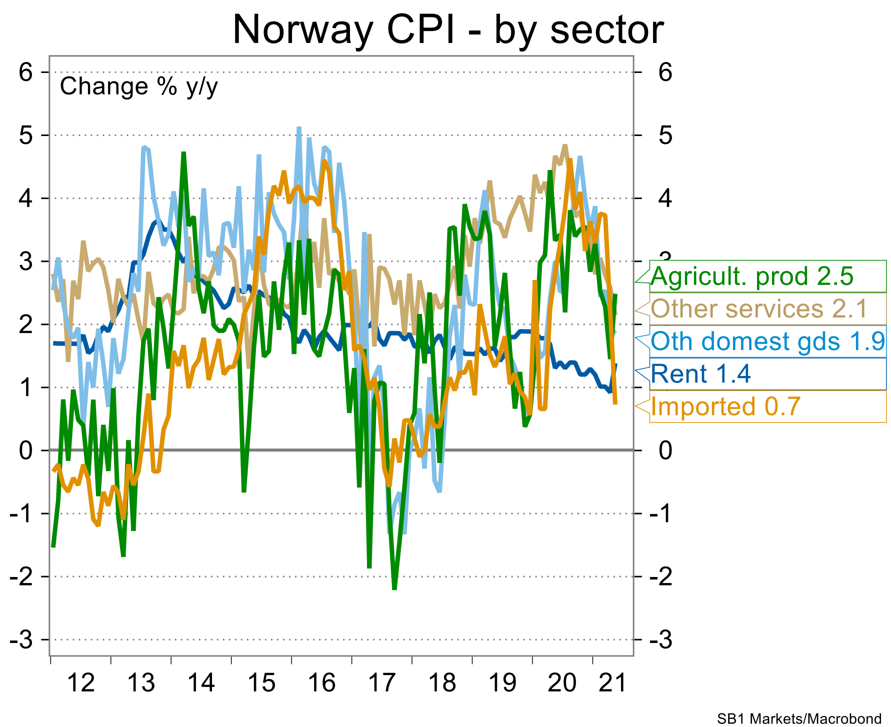


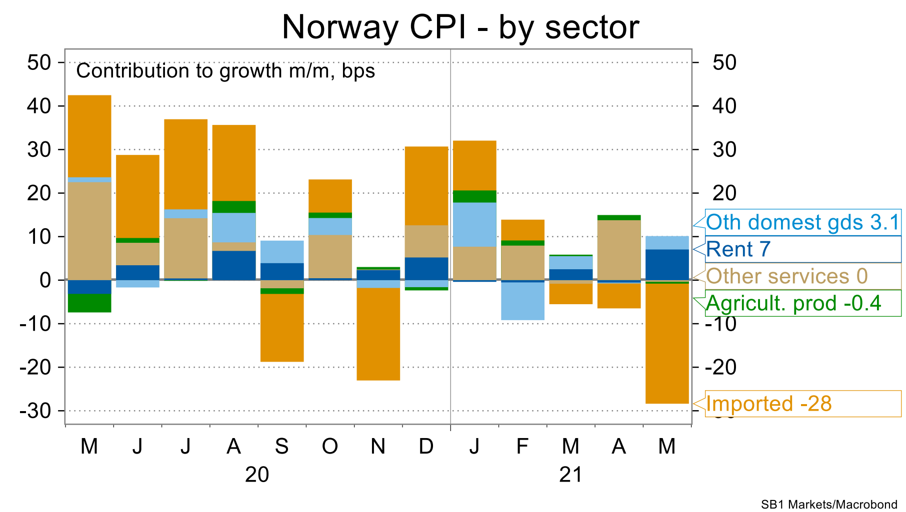


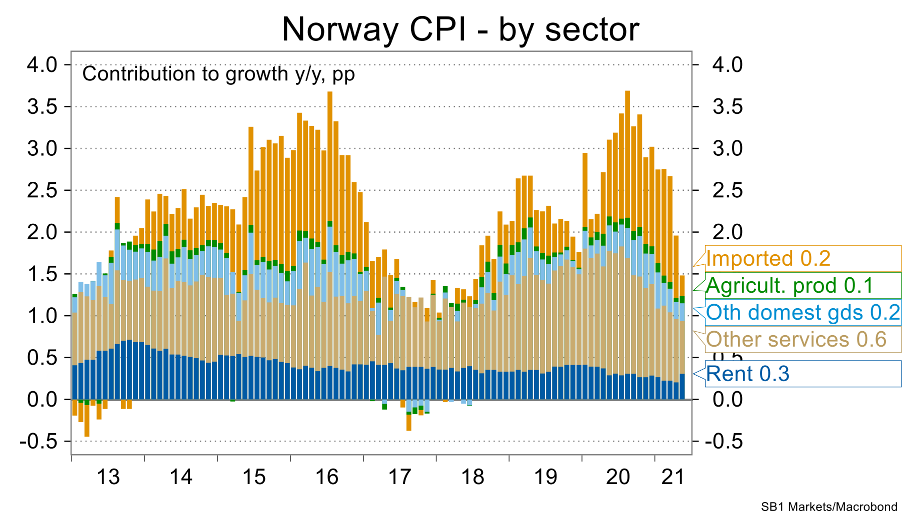
SpareBank 1 MARKETS

Imported goods prices down 0.8% m/m – and are up 'just' 0.7% y/y

Slowing as a result stabilisation/strengthening of NOK





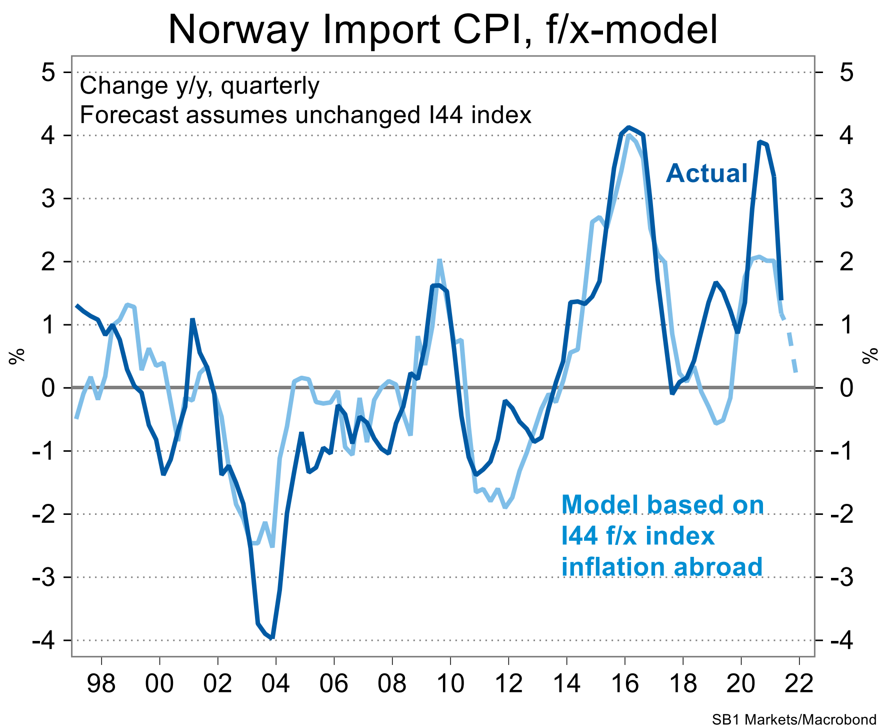


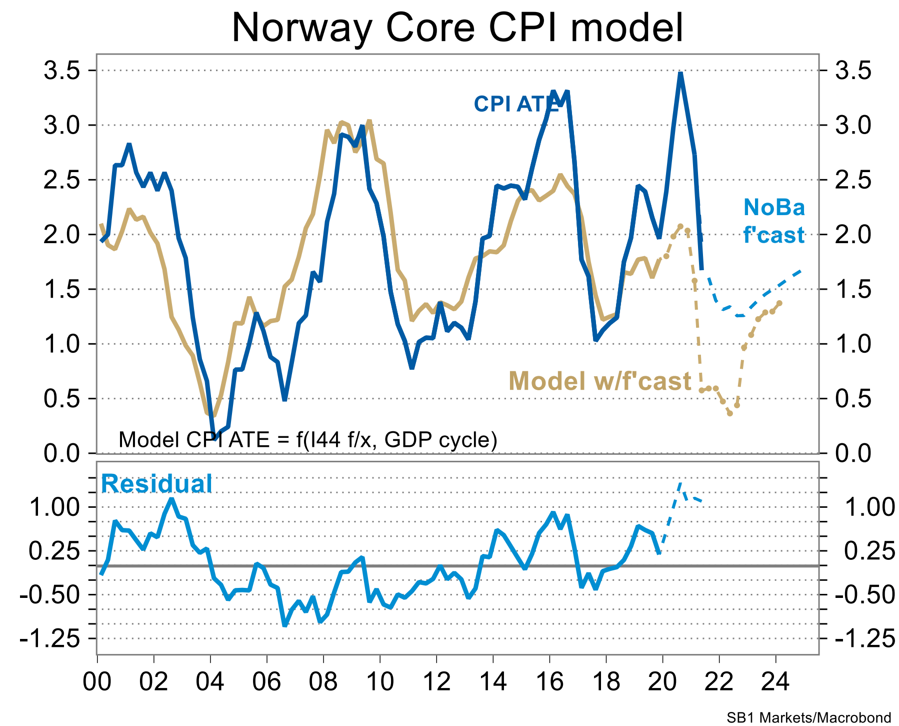
- **Domestic services inflation** has slowed during the corona crisis
- **Rent inflation** is steadily slowing, from 2% to 1%, partly due to lower mortgage rates but also probably due to a less tight renting market (rents are both calculated and observed)

SpareBank 1 MARKETS

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

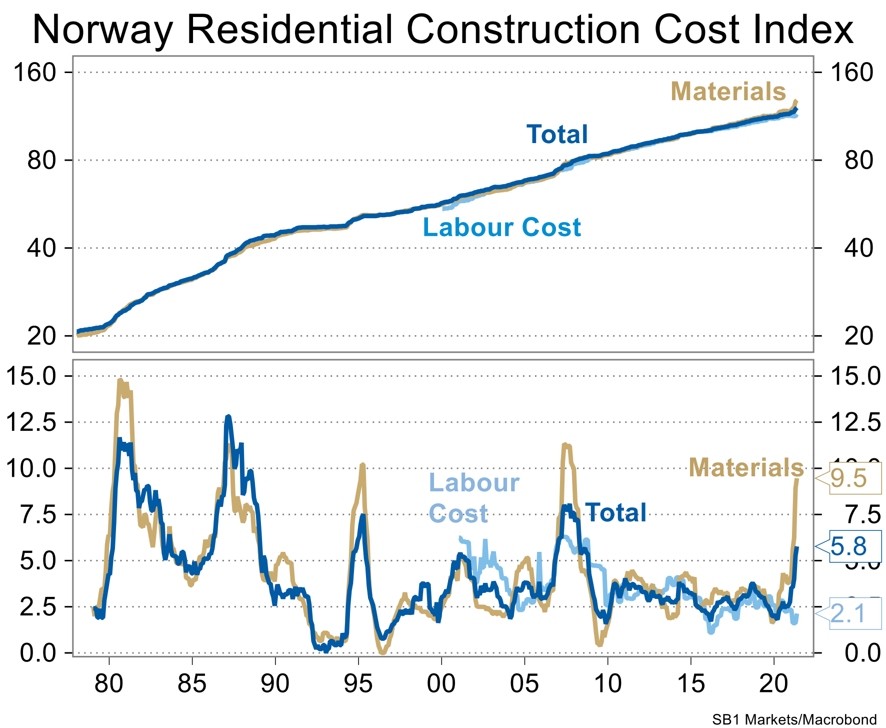


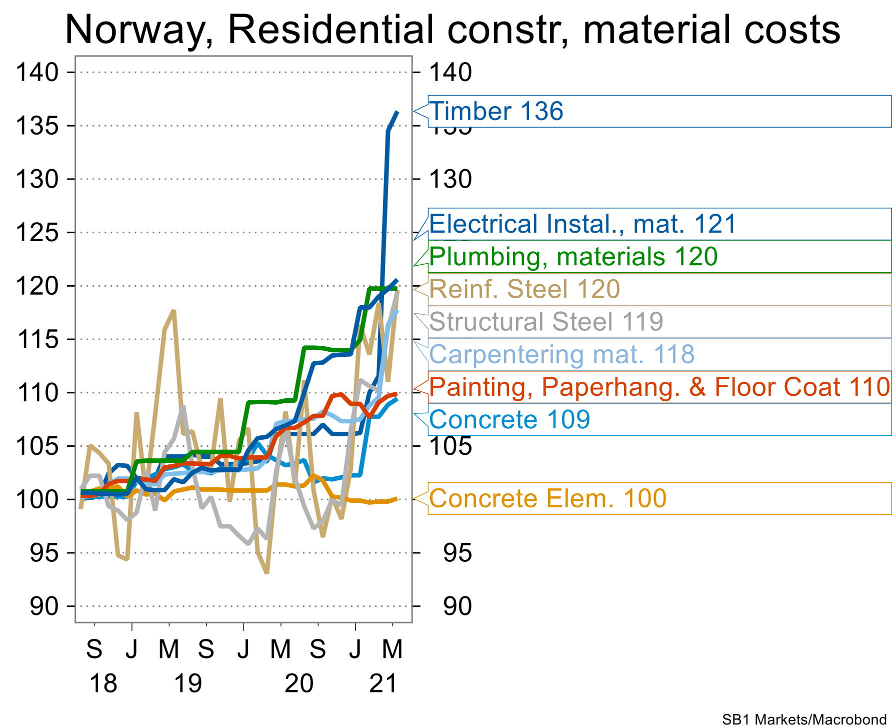


- **The NOK steep depreciation** in early 2020 no doubt drove **imported inflation** up last year. Closed borders/supply chain challenges due to Covid-19 may have contributed to the lift in import prices too, and more importantly: the strong growth in demand for some goods (like sport equipment/furniture) made it possible to increase prices. Now the NOK has recovered, and import price inflation is falling sharply
  - » Even if goods price inflation abroad 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)

‘Some’ cost pressure in the Norwegian construction sector too

But ‘just’ from some materials; lumber & steel, plumbing & electrical materials

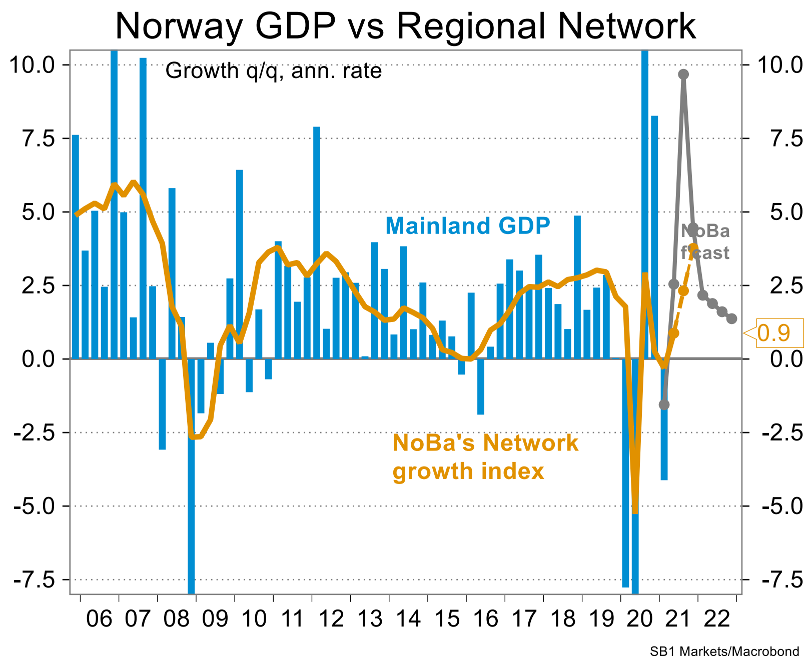




- Material prices are up 9.5%
  - » The 25%+ lift in lumber/timber prices over the past months is unprecedented
- Including labour costs, the total building cost index is up by 5.8%, the highest in 15 years

Norges Bank's Network expects a brisk recovery but less than we expected

... And weaker than Norges Bank's growth forecasts (at least formally) imply

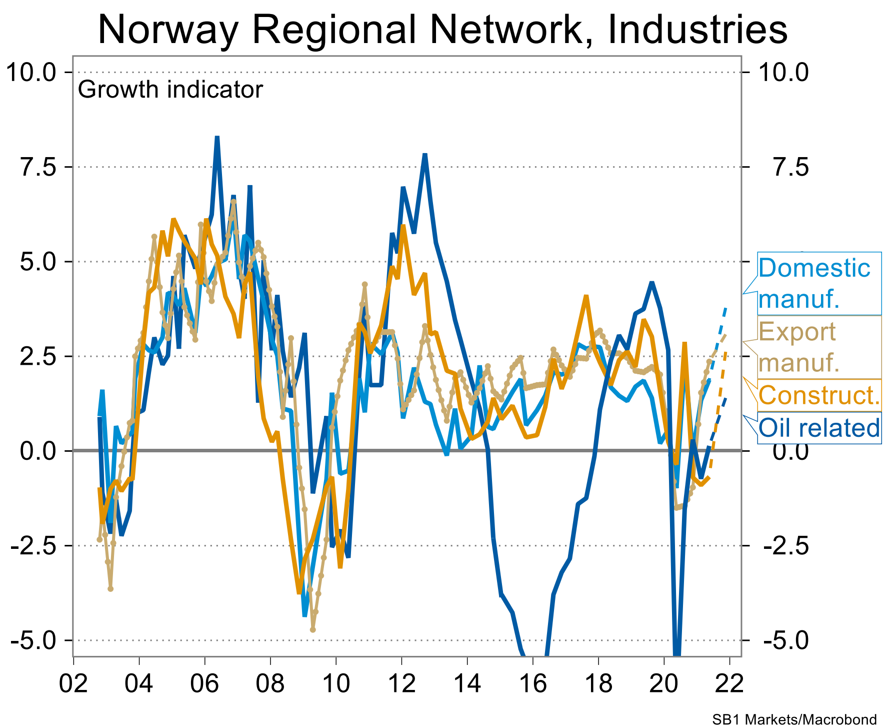


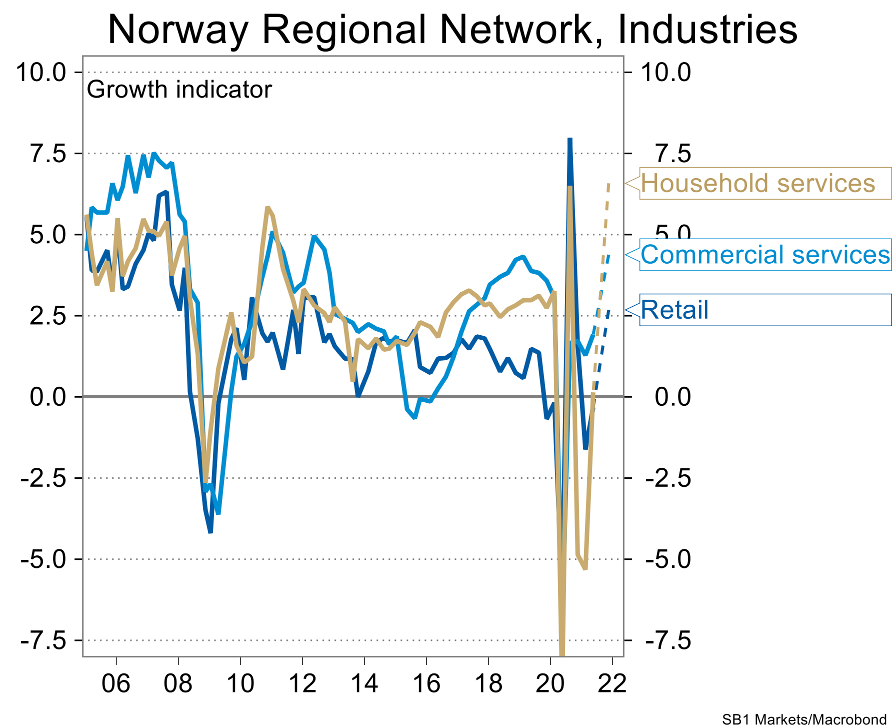
- **Implications**
  - » The Regional Network' growth outlook did not give Norges Bank an argument for lifting the interest rate path
  - » Still, we expect the bank to lift the interest rate outlook somewhat later this week, due to higher oil prices, higher wage inflation, a weaker NOK and a reduced NIBOR spread (though counterweighted by lower CPI inflation)

- **Activity the past 3 months**
  - » The Network reports a 0.9 growth pace (annualised, 0.2% not annualised) to Feb-April from Nov-Jan. In February, the network expected a 1.8% growth pace the next 6 months. Obviously the first 3 months have been weaker expected, and Mainland GDP was much weaker than the Network reports, as it fell at a 4% pace! Capacity utilisation & labour shortages are at average levels
- **Expectations for the coming months**
  - » The Network expect at 3.8% growth pace the next 6 months, best since 2010. We expected a 6% signal. In March, Norges Bank expected a 6% growth pace in Q2 and Q3 on average
    - ▪ All sectors are expecting higher growth
    - ▪ Household services are the most optimistic, for good reasons. Commercial services are no. 2 at the list
    - ▪ Construction expects growth, following a setback the previous the 3 quarters. Manufacturers are expecting brisk growth
    - ▪ Oil related sectors are the least optimistic
    - ▪ Retailers expect a 3% growth pace – we think they are too optimistic
  - » **Investment** plans are revised further up
  - » **Wage inflation** is revised up 0.4 p to 2.7%, the 2nd largest quarterly revision ever
  - » Companies expect to **lift prices** vs other businesses sharply but not (yet) vs. households

Household services (like hotels, restaurants) expect strong growth, of course

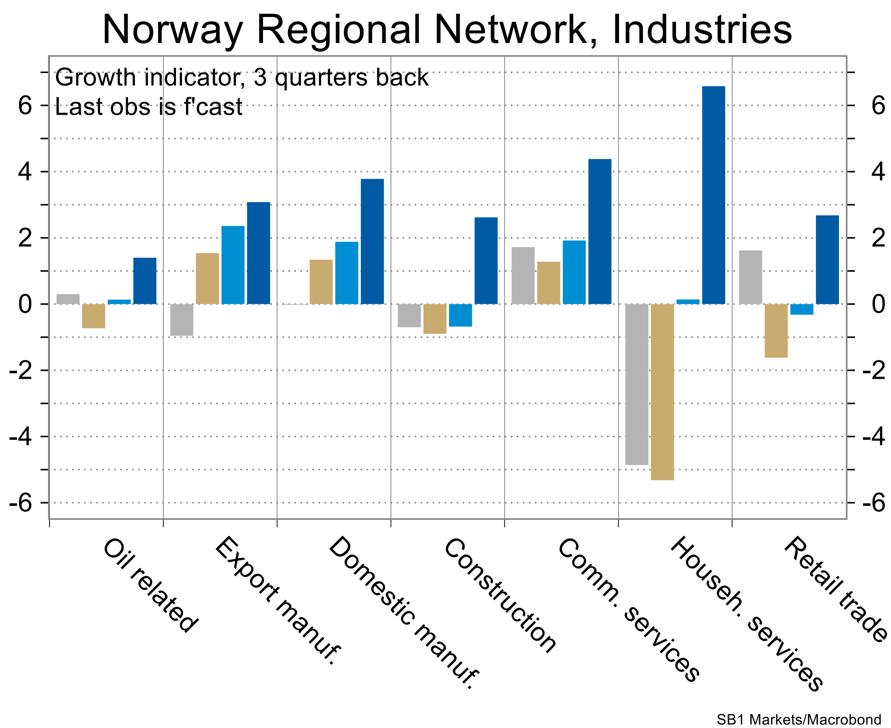
The manufacturing sector upbeat (both export & domestic), oil related expects slow growth





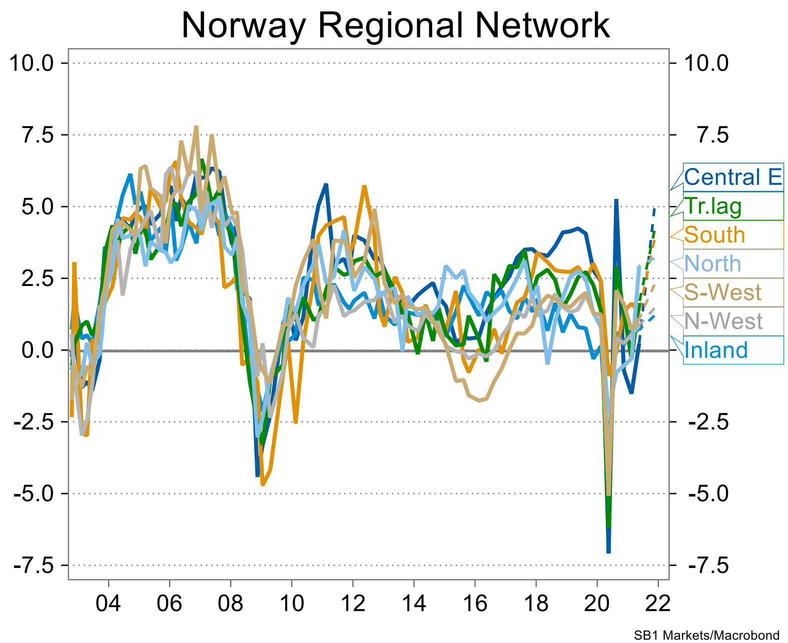
Finally, after some though quarters, services will turn up

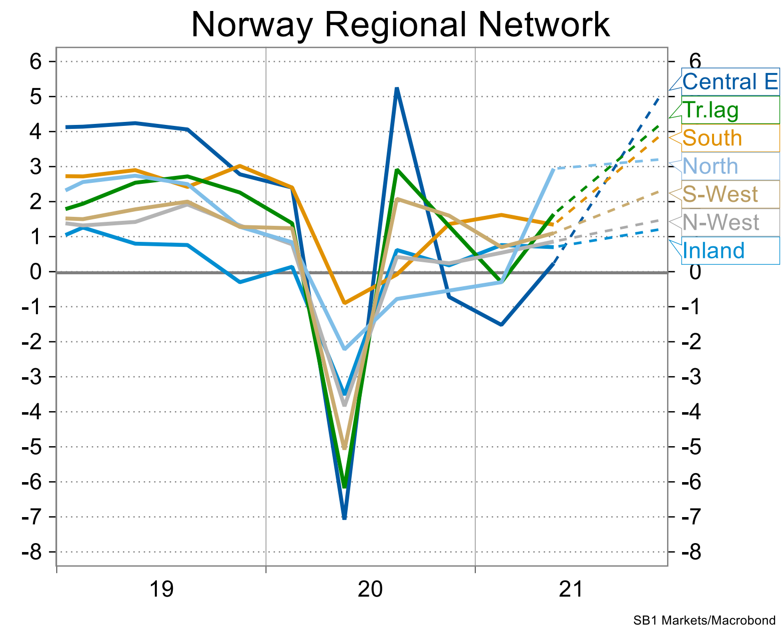
We think household services will grow faster than 6.5% annualised (=0.5% per month) the next 6 m

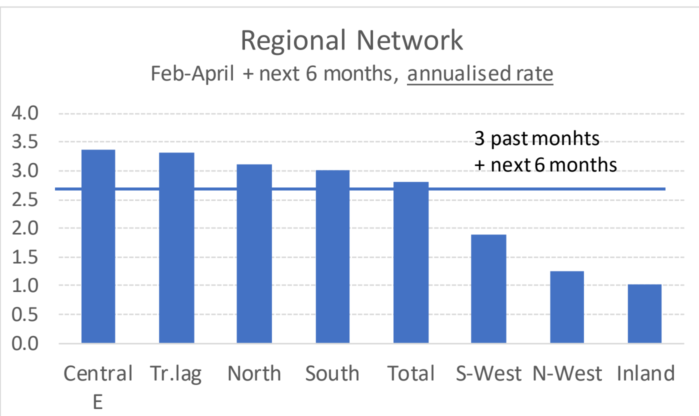


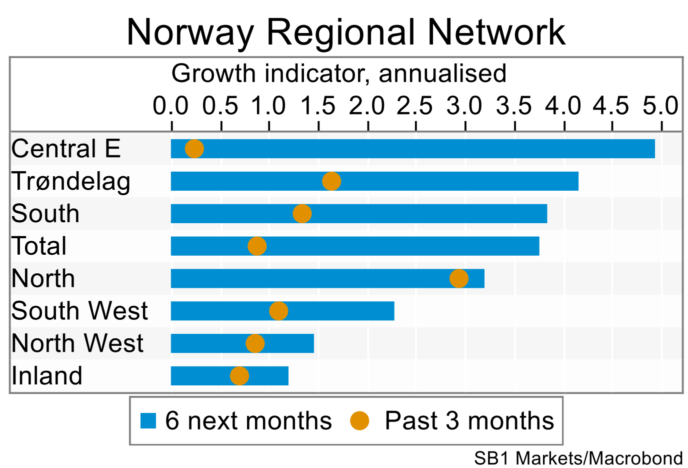
Regions: East in the lead, after having suffered the most

Trøndelag on the road again too! North West/Inland the laggards



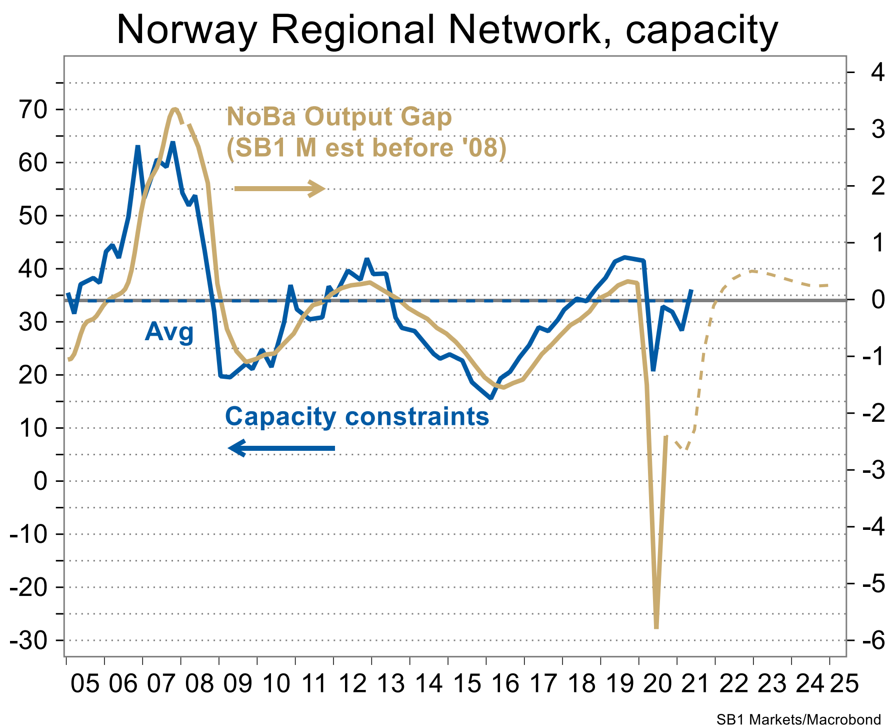


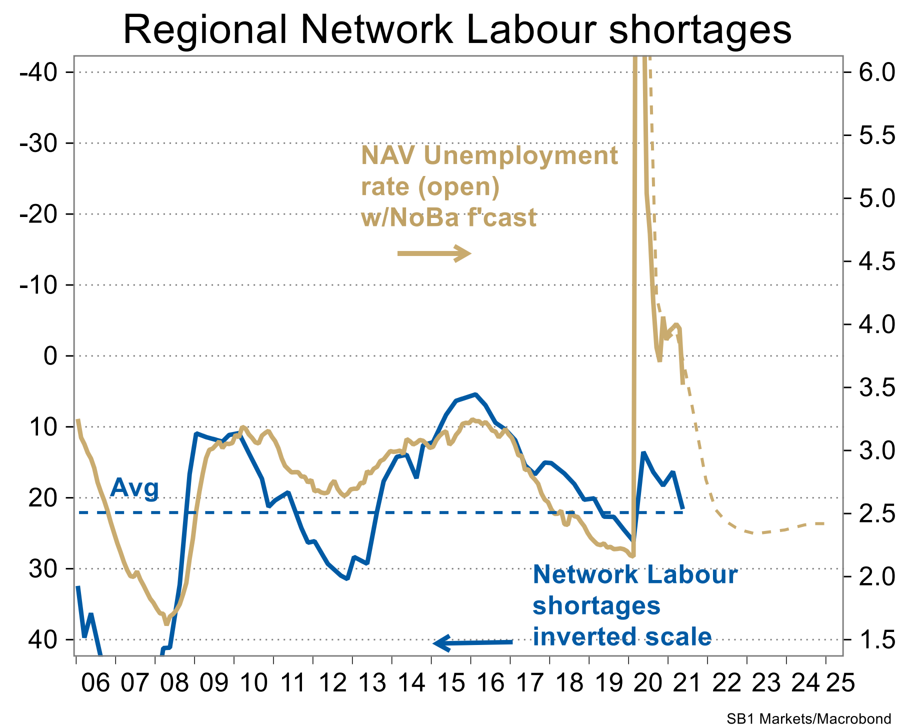




Capacity utilisation up past 3 months, up to an average level

All other economic indicators suggest a substantial negative output gap. Labour shortages up to avg.



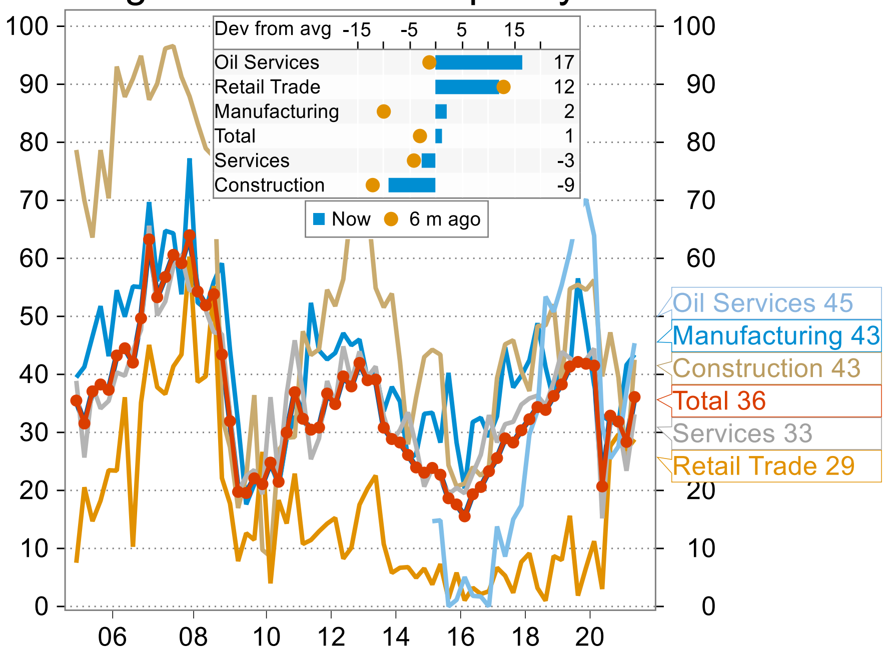


- We think a broad range of economic statistics and Norges Bank's output gap estimate is a better gauge of activity level in the Norwegian economy than the network report's capacity constraints indicator
- Labour supply shortages eased sharply last spring but have increase somewhat since before corona, and rose to an average level in May (the scale is reversed at the left axis at chart to the right). We expect more to come

Capacity utilisation high in oil services & retail trade, low in services & const.

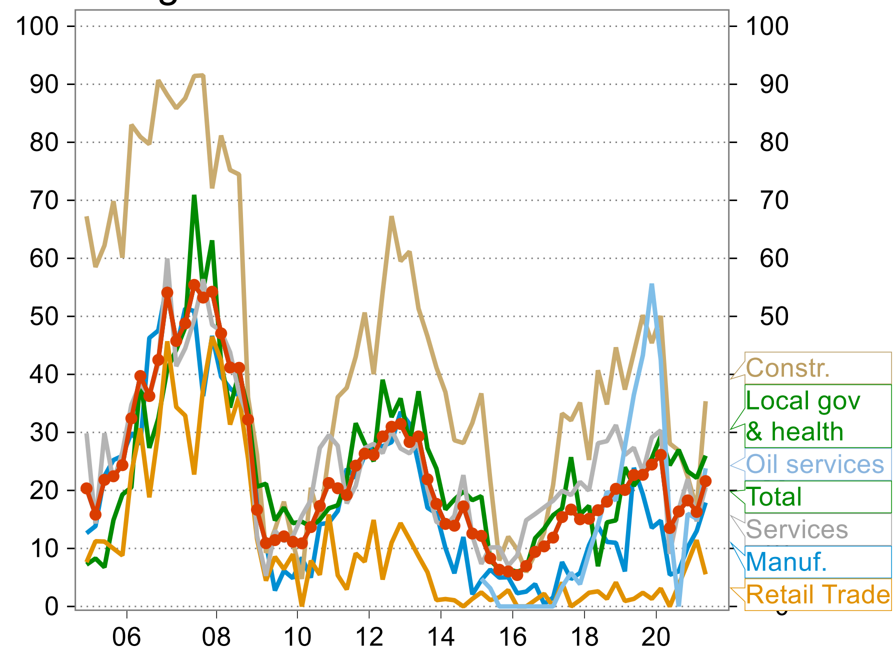
However, construction reports labour shortages, probably lack of foreign workers

Regional Network Capacity Contstraints



SB1 Markets/Macrobond

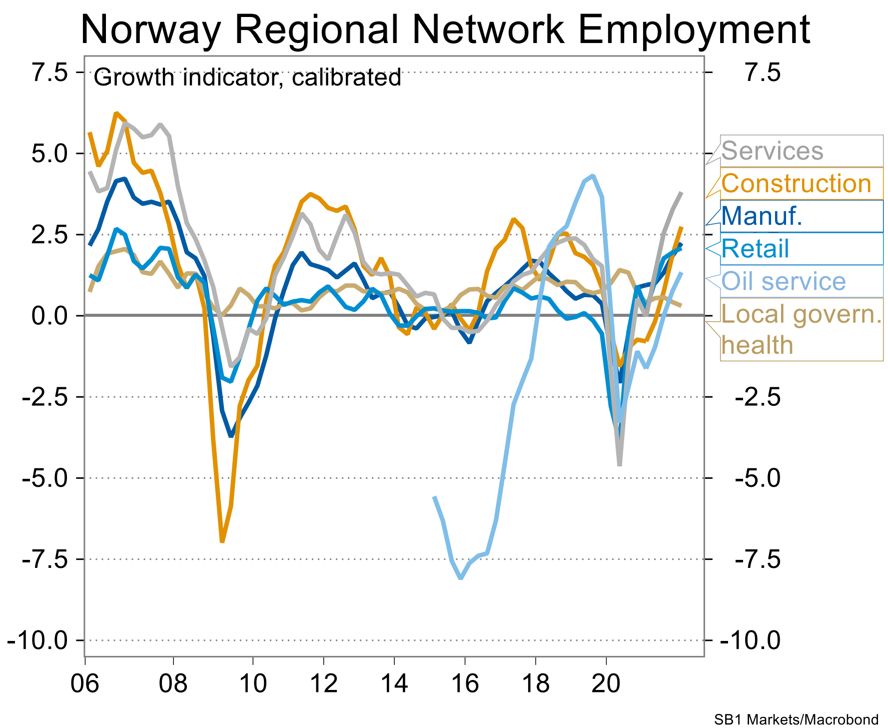
Regional Network Labour Constraints

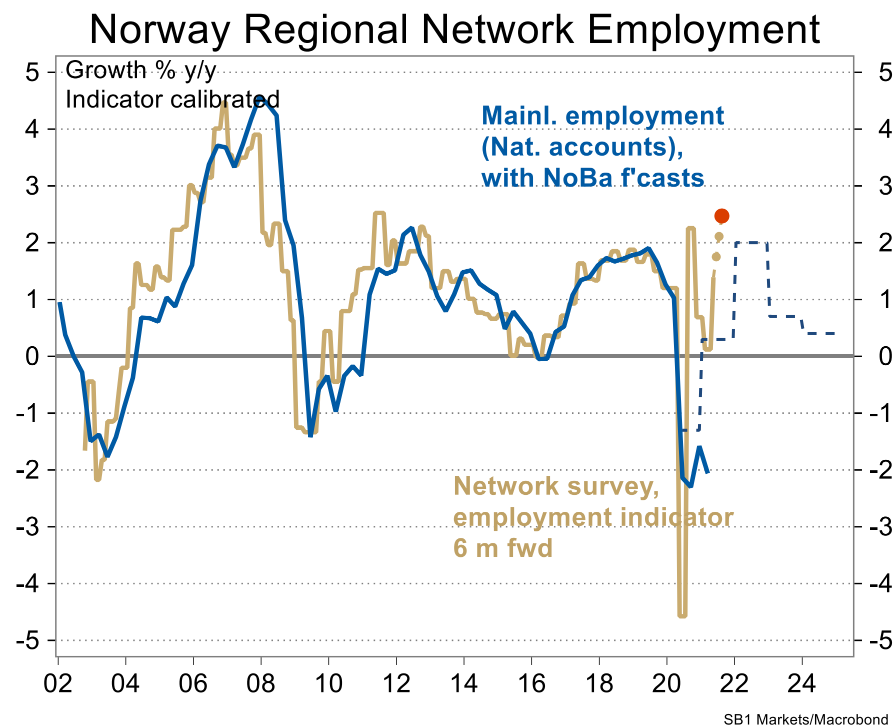


SB1 Markets/Macrobond

- Activity in construction has not been that high recent quarters – and besides lack of (foreign) labour, no capacity constraints (we expected some, like ‘raw’ materials)

The network expects report strong employment growth

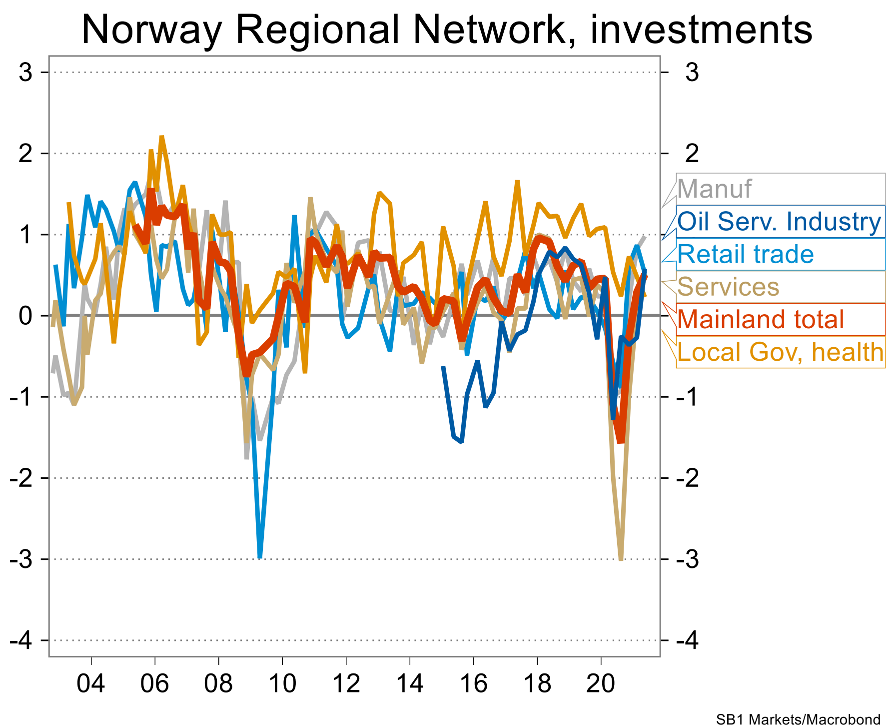


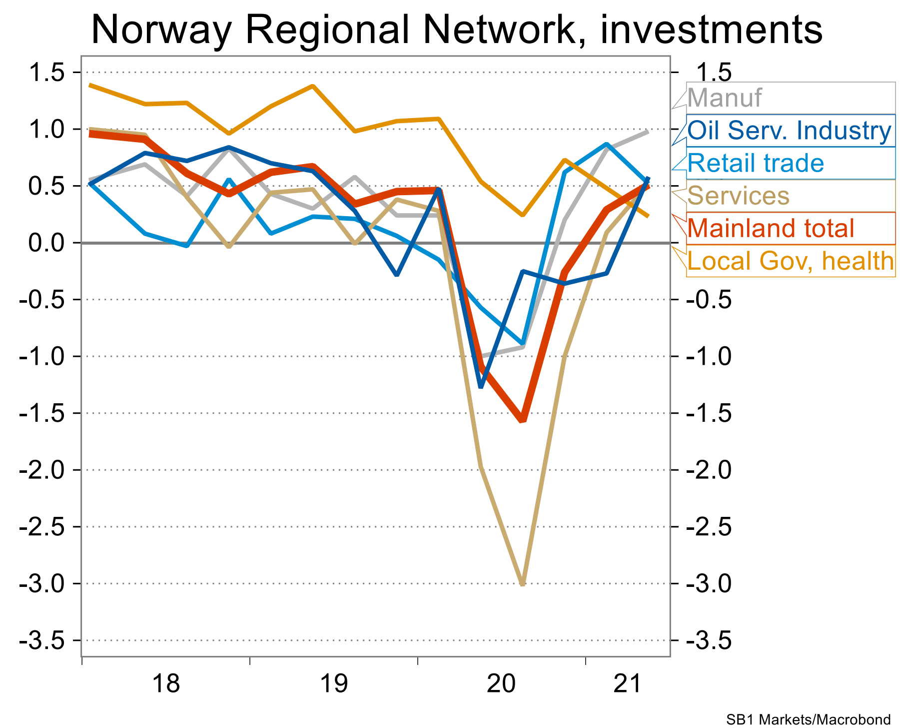


- Both services & constriction in the lead, we assume both are Covid related
- The NoBa forecast on the chart to the right represents the bank's annual averages

The Network signals solid growth in Mainland investments!

Businesses revised their investment plans by 0.5% over the next 12 months

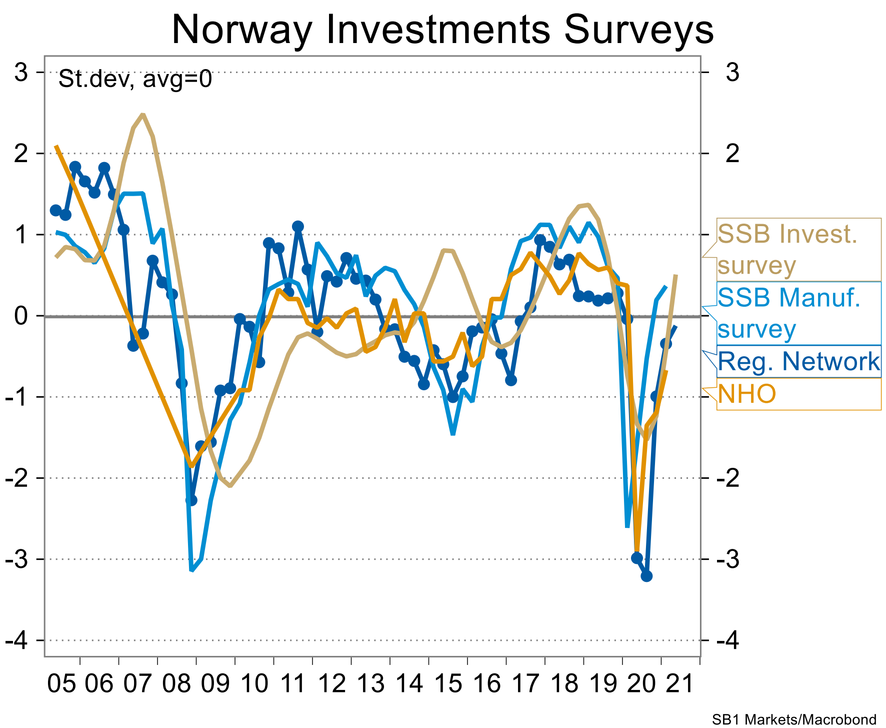


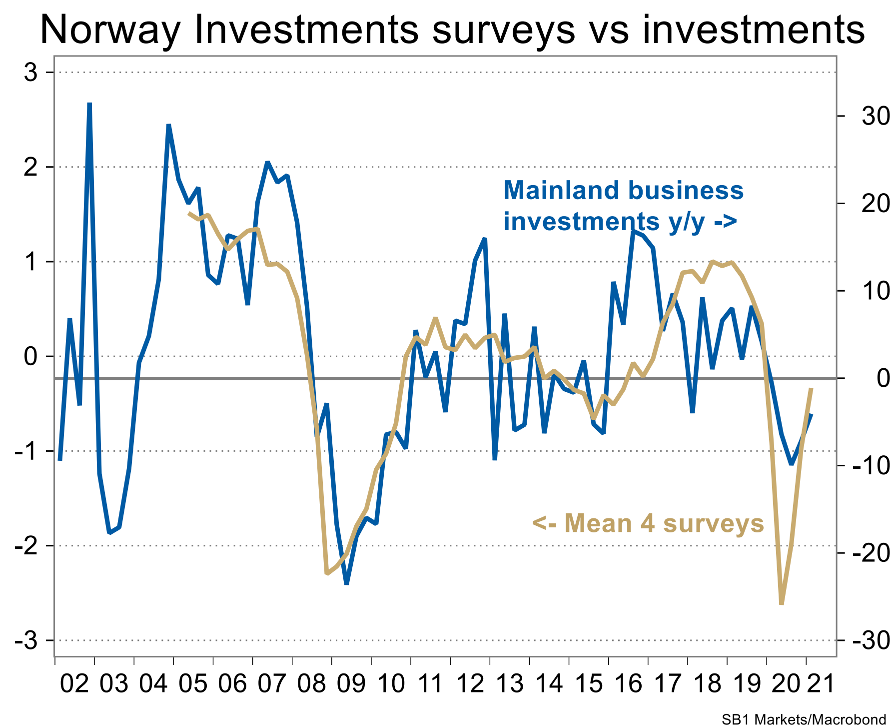


- Services, which represents almost 50% of Mainland non-residential investments, were signalling unprecedented, dramatic cuts six months ago. Still, following a modest decline in Q2, actual investments rose in through H2
- Oil services companies (not oil companies!) (9% of total) plan to increase their investments over the coming year
- Local governments (22%) and retail trade (7%) have revised their investments plans downwards, while the manufacturing sector revised its plans further upwards and is signalling strong growth
- **<u>The total Mainland investments index climbed further since Q1– signalling growth</u>**

Other investm. surveys tell the same story: Surveys better but not yet strong

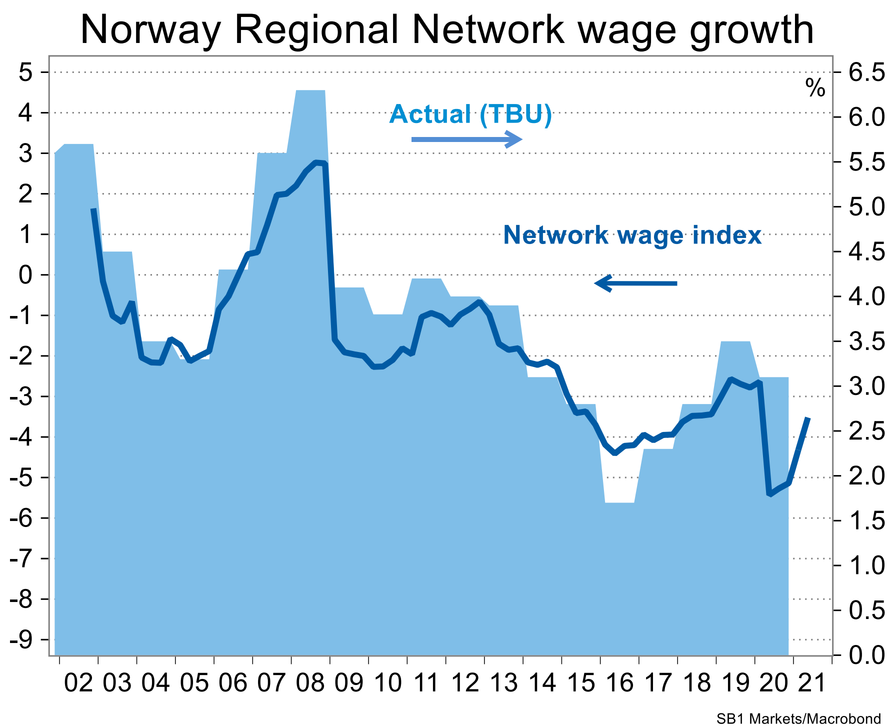
Surveys are mixed and are still signalling cuts in investments but not by much



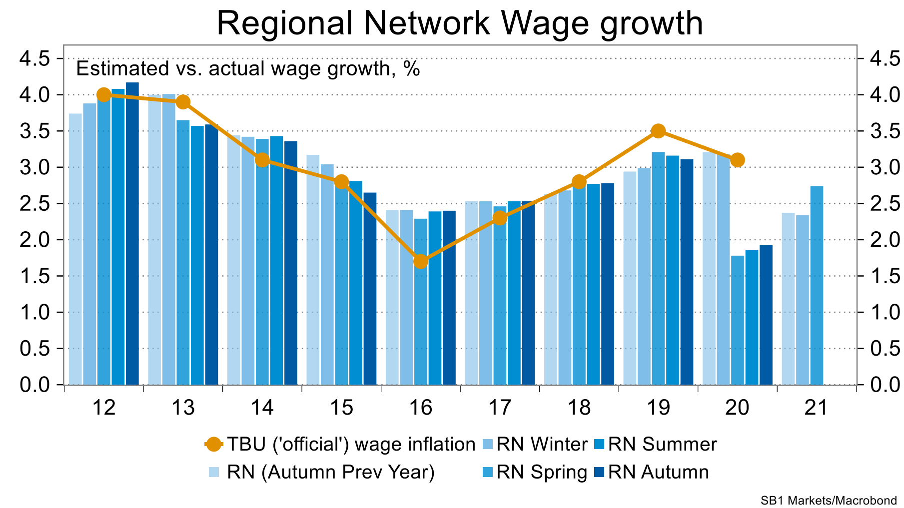


The Network revised its wage growth expectations for 2021 to 2.7% - sensible

The upward revision from the 2.3% February forecast was the 2. largest ever. NoBa to follow suit



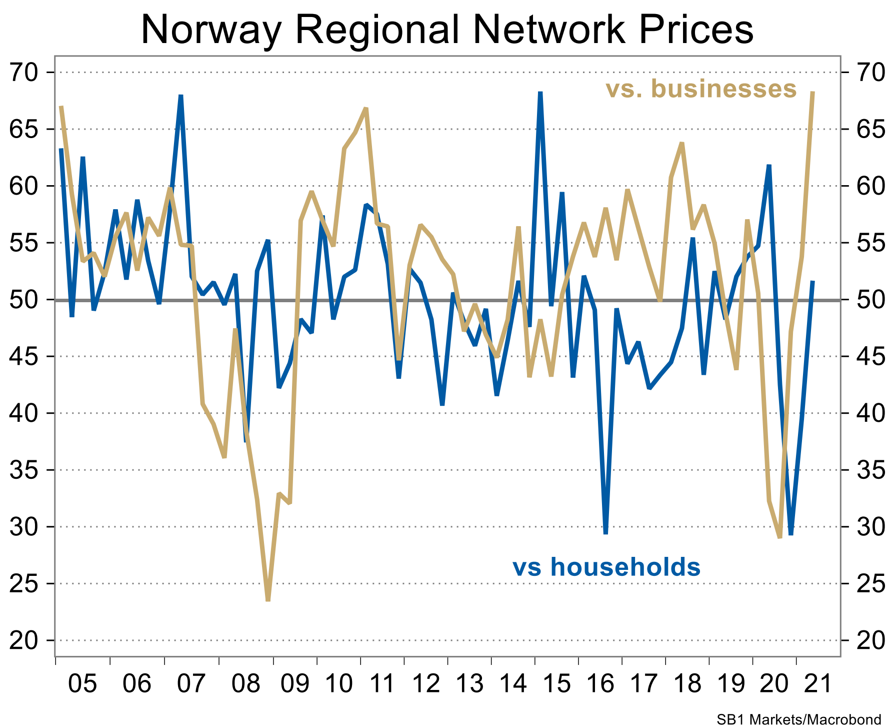
- Just once, in 2011, the Network has revised up its wage expectations more in one go than between Feb and May



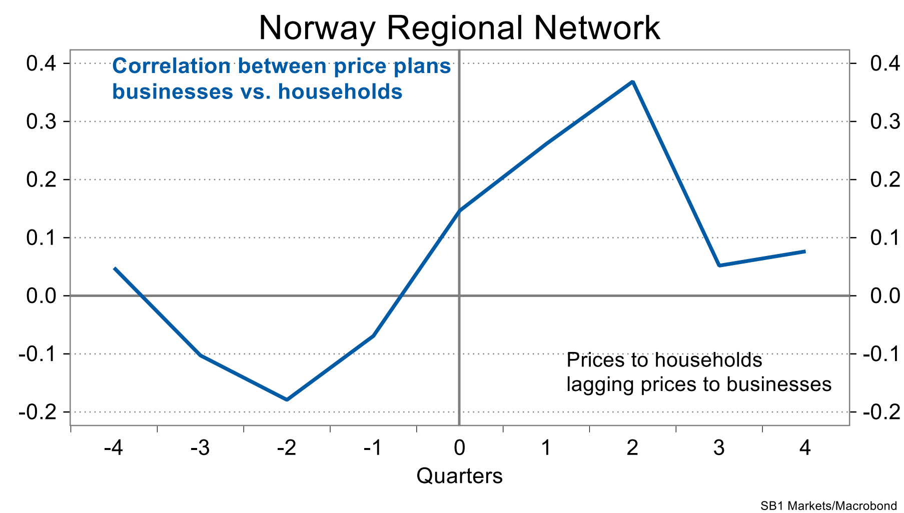
- **The negotiations between LO and NHO** yielded a 2.7% wage lift in 2021 vs 2020 in average (based assumptions on local wage drift). This guideline has been accepted by other parties in the private sector
  - » There are some minor conflicts in the public sector, and some have been rewarded 0.1 – 0.4 pp extra, but that's all
- **In Norges Bank expectation survey**, economists in trade unions & employers associations forecasted a 2.9% wage growth, and 3% in 2022
- **Norges Bank** assumed a 2.4% wage growth in 2021 and 2.6% in 2022 in its March MPR
  - » We expect Norges Bank to revise its wage inflation forecasts up in the upcoming MPR, by 0.4 pp both years

The network signals (much) higher prices vs. businesses. And thereafter?

More companies are reporting plans to hike prices vs. businesses than ever before (data from 2005)



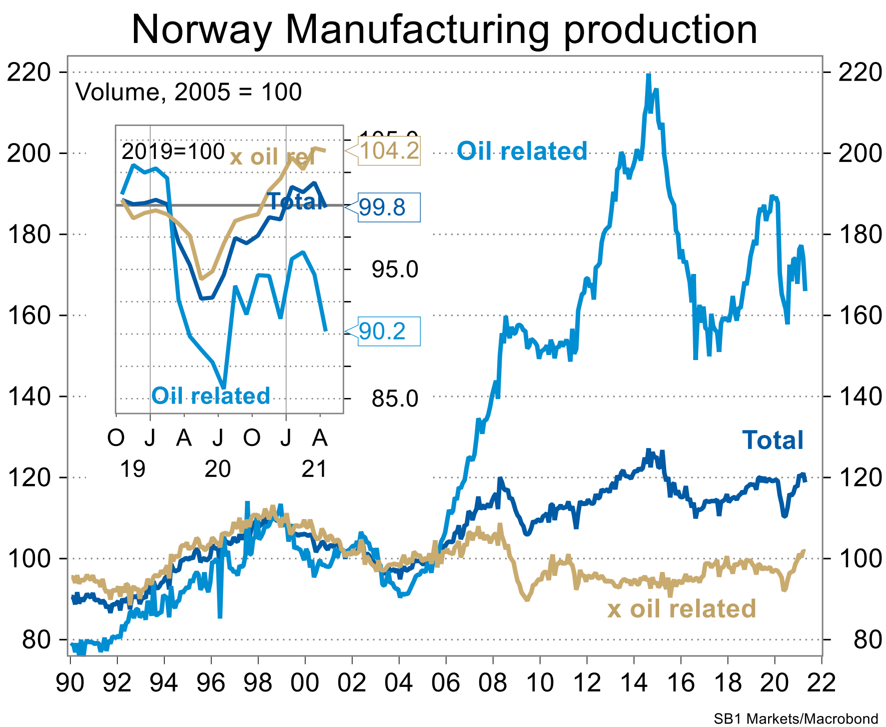
- However, the price plans are much more muted vs. households, just marginally above the neutral line
- On the other hand, business price plans are leading plans vs hiking prices for household goods & services

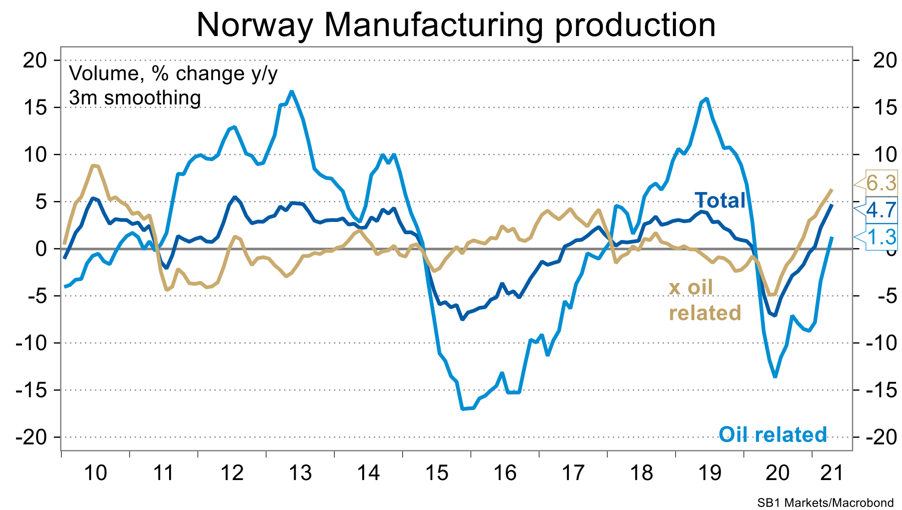


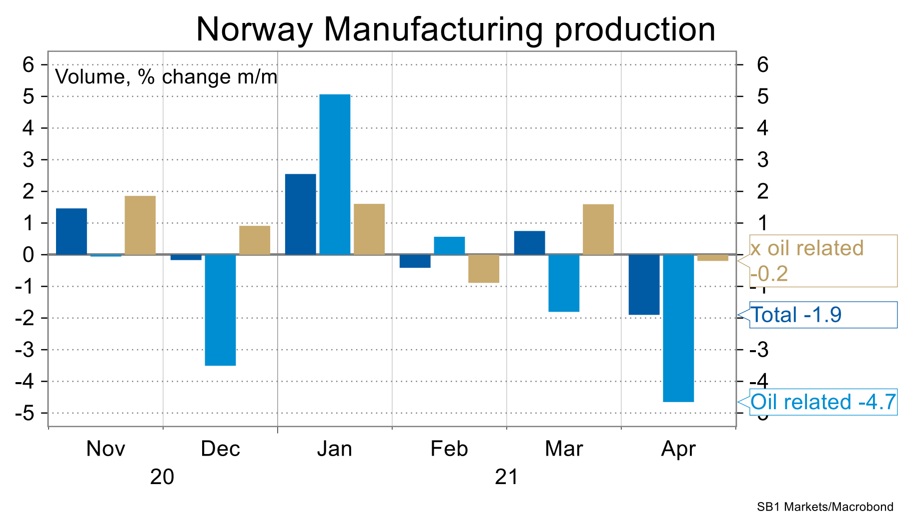
SpareBank 1 MARKETS

Manufacturing production down 1.9% in April – oil-related -4.7%

Production up 6% since June '20; down 0.2 % vs. pre covid; non-oil production the highest in 10 years



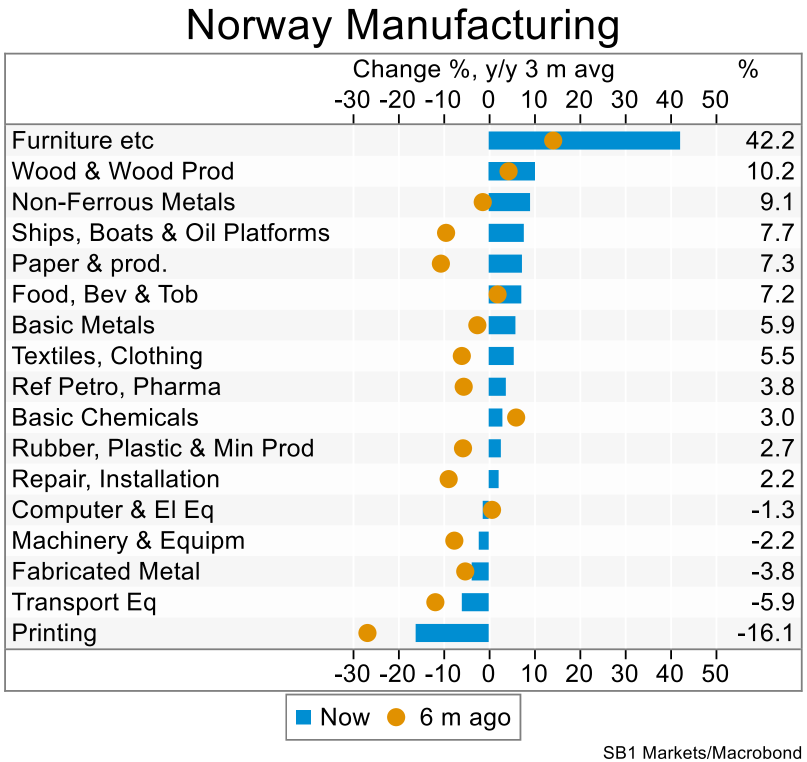


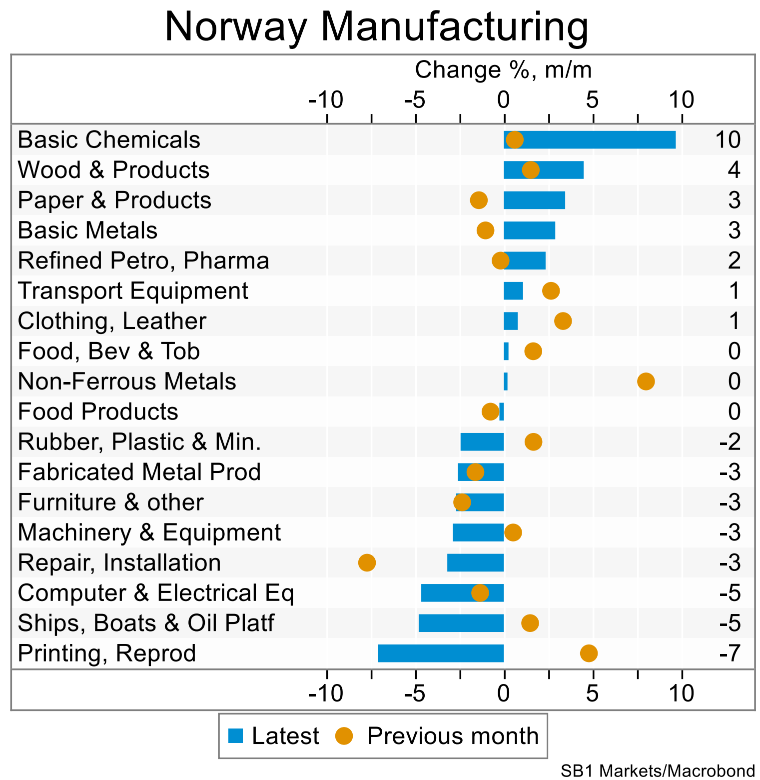


- Production has been at a steep upward trend since June, up over 6%. The decrease was mostly driven by refined petro, chemicals & pharma
- Total production decreased by 1.9% m/m, we expected 0.5% following the 0.7% increase in March. Production is down 0.2% vs. pre Covid
- Oil related production fell by 4.7% m/m, and is down 10% vs. pre Covid while non-oil related production fell by 0.2 % m/m, and is up 4% vs. the pre-pandemic level
- Surveys are signalling a further recovery, the PMI is just below 60

Mixed between sectors m/m, and now 70% are up y/y (from a low level last spring)

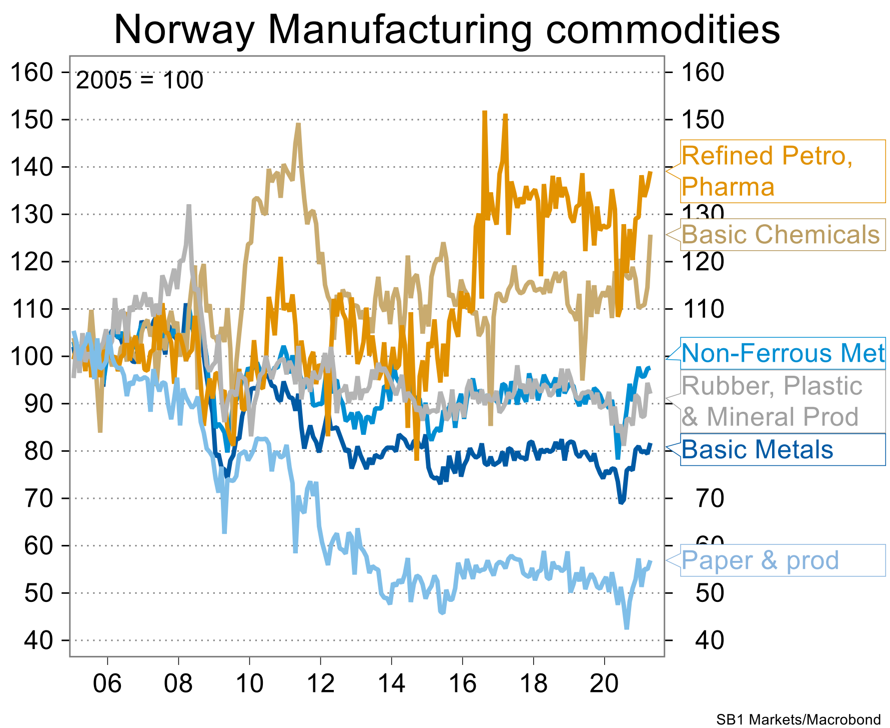
50% of the sectors are up m/m

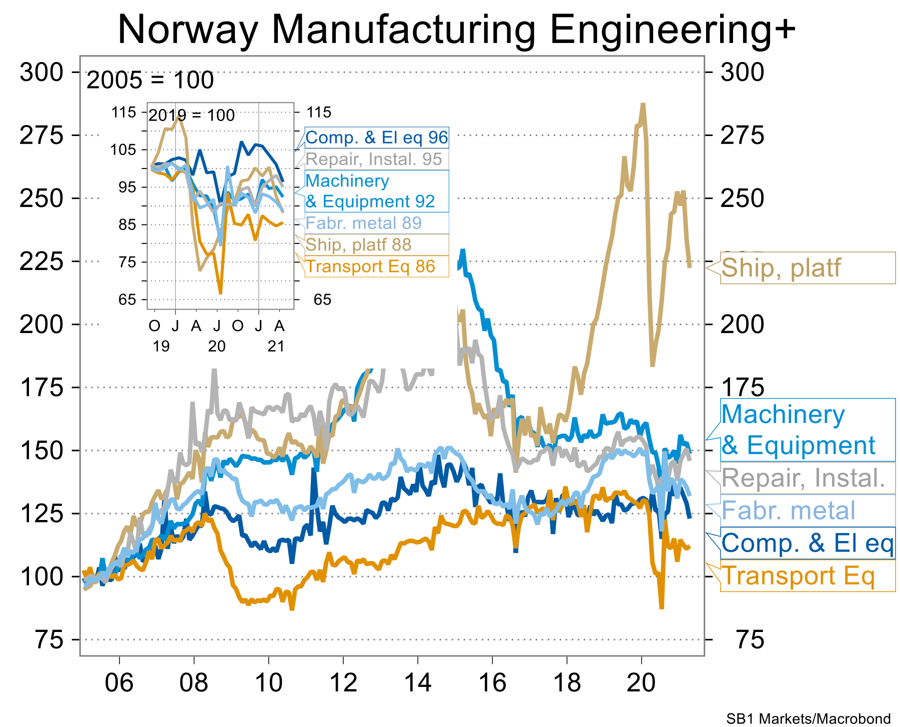




Commodities stronger in April

Engineering (and oil related) industries weaker

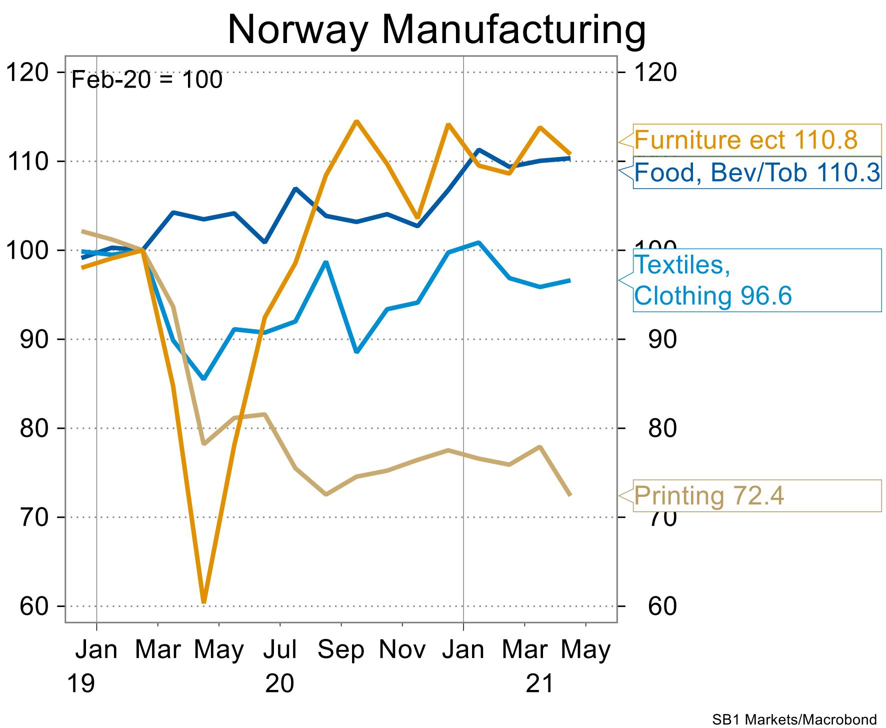




- **Production of ships & platforms** was incredibly strong in 2018/19, then fell 30% in H1 last year but has now recovered sharply since last e summer. The industry was down 4.7% in April, after falling 7.7% in March. **Transport equipment** production increased by 1.1% m/m. The rest were down
  - » Corona measures (lack of foreign labor, contacts with foreign vendors/customers), supply chain challenges probably explained parts of the drop during the spring
- **Commodities** have all recovered from the spring through, and after a sideways development for a couple of months, March and April have been strong months. Chemicals production was up 9.7% m/m, while rubber, plastic & mineral prod. was the only commodities group that was down in April (-2.4%)

Food and beverage production up in April and still very strong

… and will remain high until borders are opened



- The food and beverage industry was up 0.3% in April, and by almost 10% from Feb-20. Clothing was up 0.8% in April, down 3.4% vs. Feb-20
- Furniture was down 2.7%, but up 11% from before the pandemic
- Printing is weak, down by 7.1% in April, almost 30% from before Feb-20

Highlights

The world around us

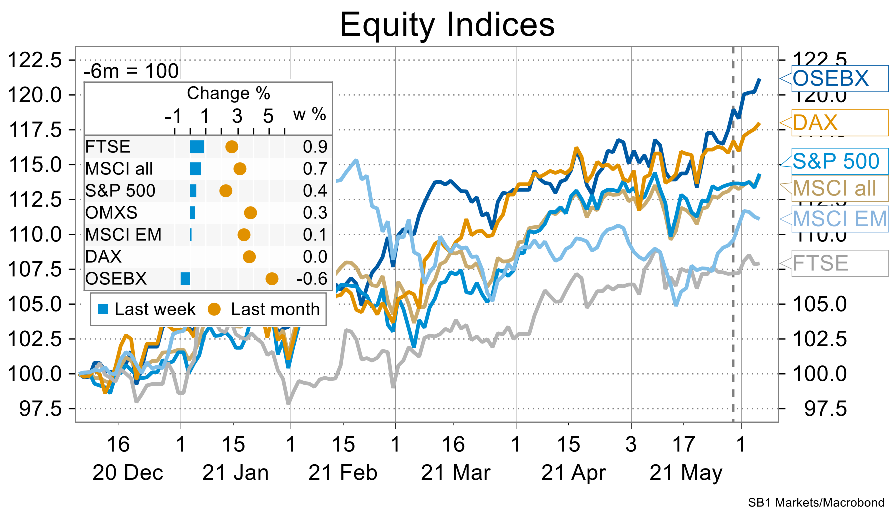
The Norwegian economy

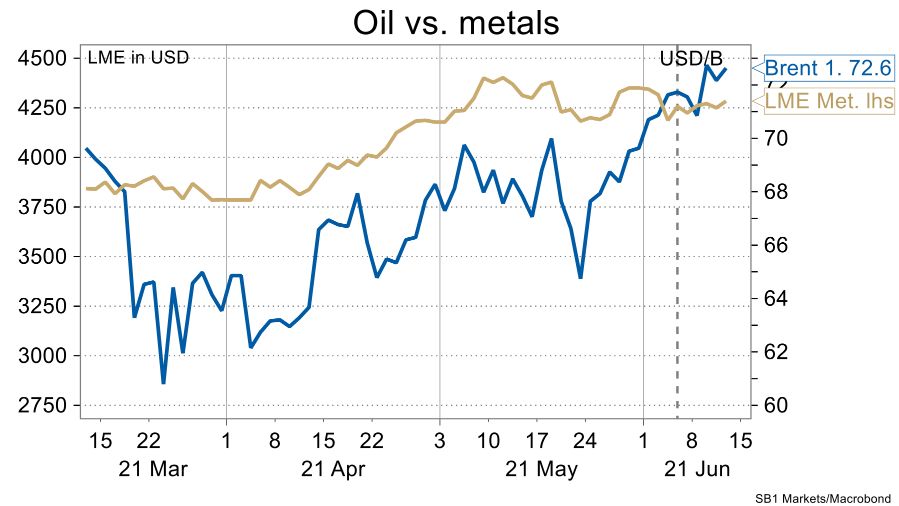
Market charts & comments

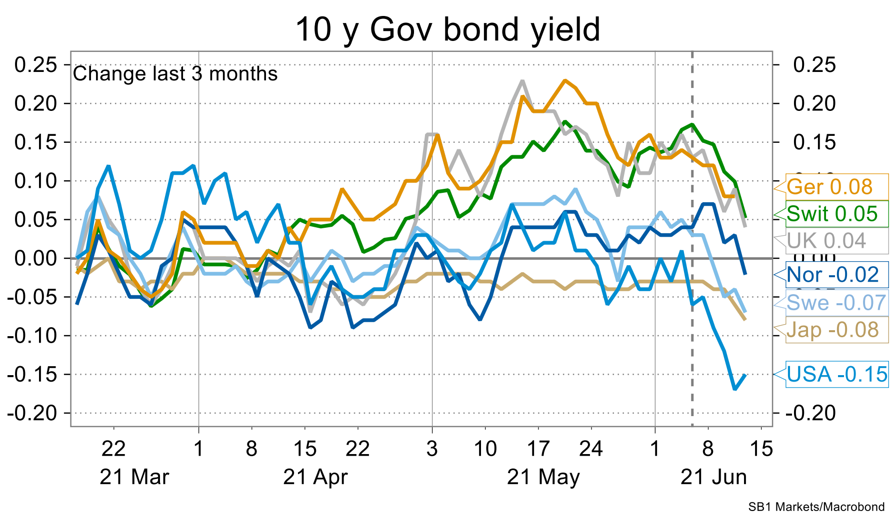
SpareBank 1 MARKETS

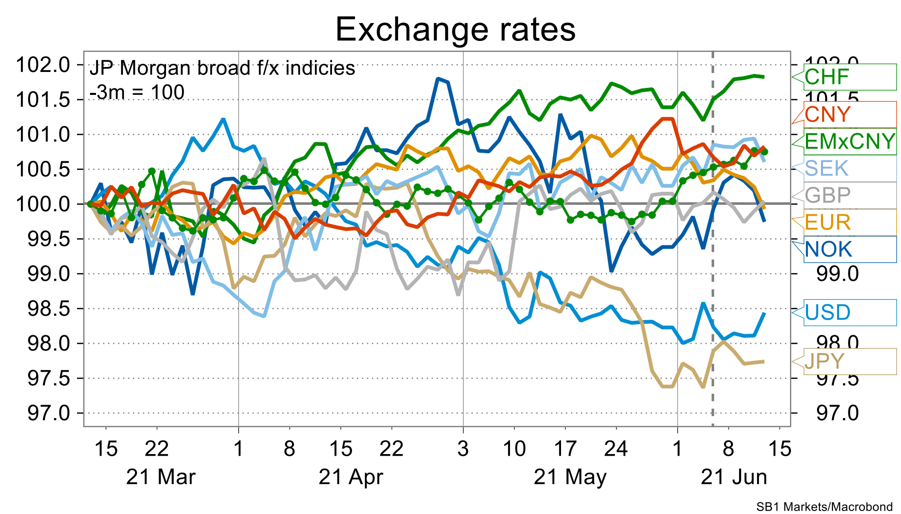
Equities (x OSE), oil up. Bond yields still sharply down.

However, metal prices have flattened. NOK & EUR down, USD marginally up





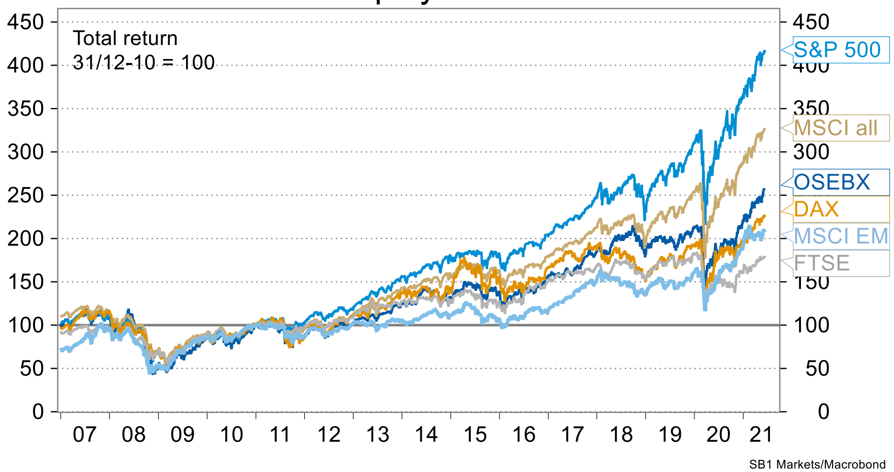




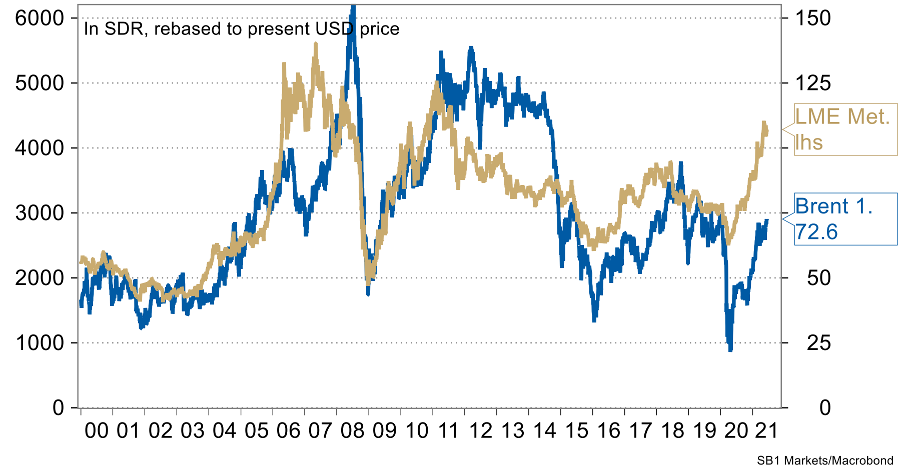
The big picture: Strong stock & commodity markets. USD trend is still down

The MSCI World at ATH on Friday, as were several local markets as well. And bond yields trend down

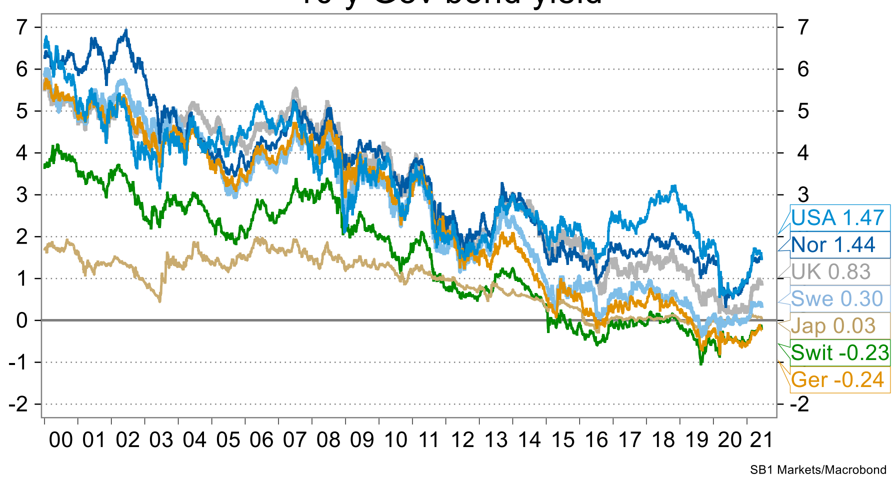
Equity Indices



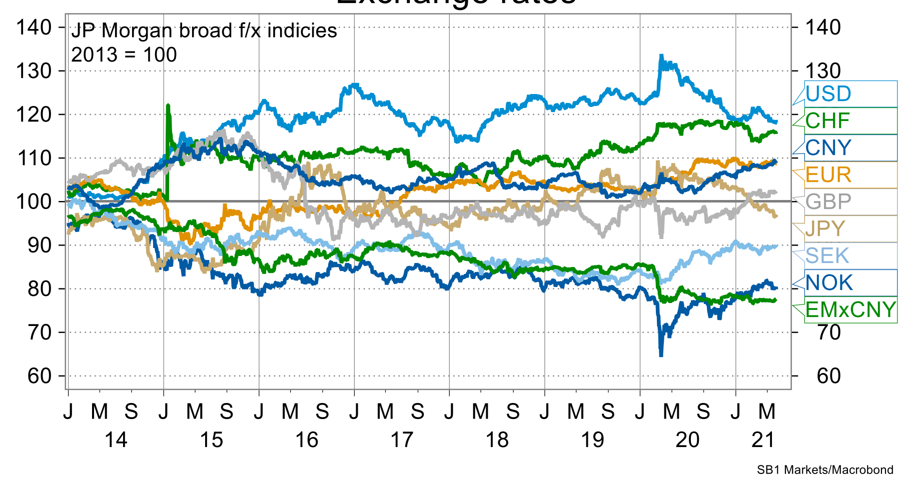
Oil vs. metals



10 y Gov bond yield

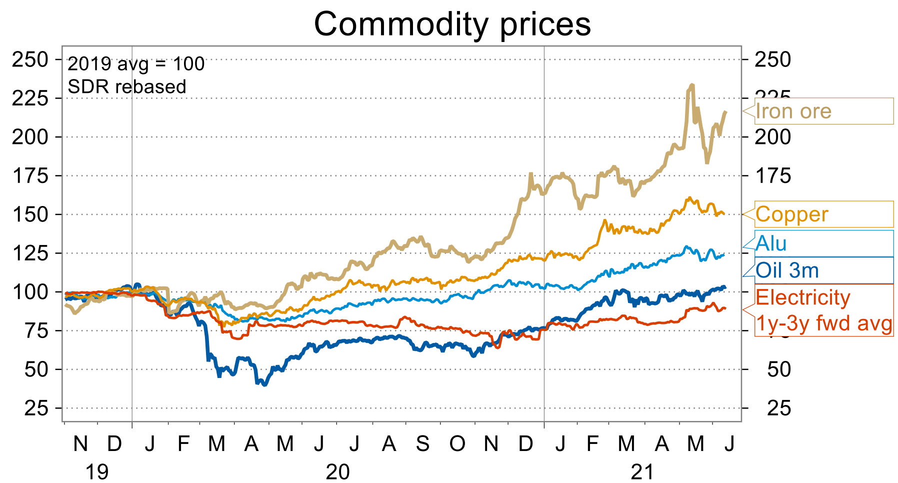


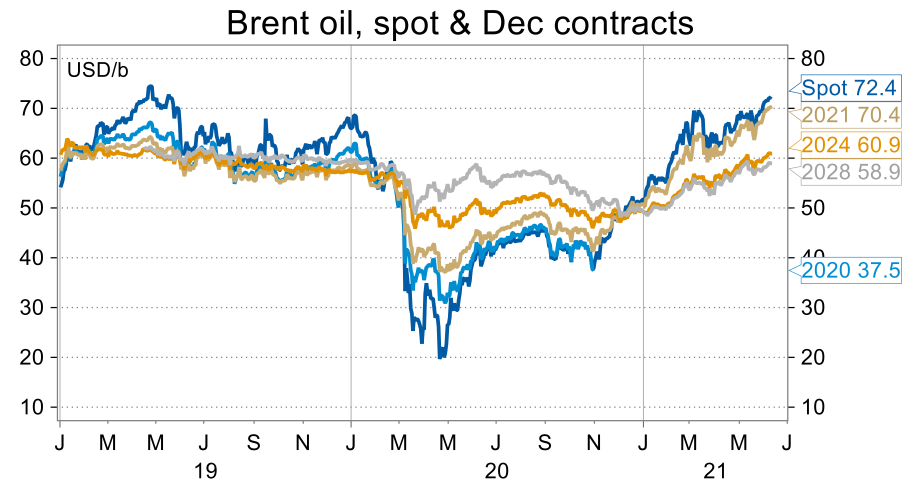
Exchange rates

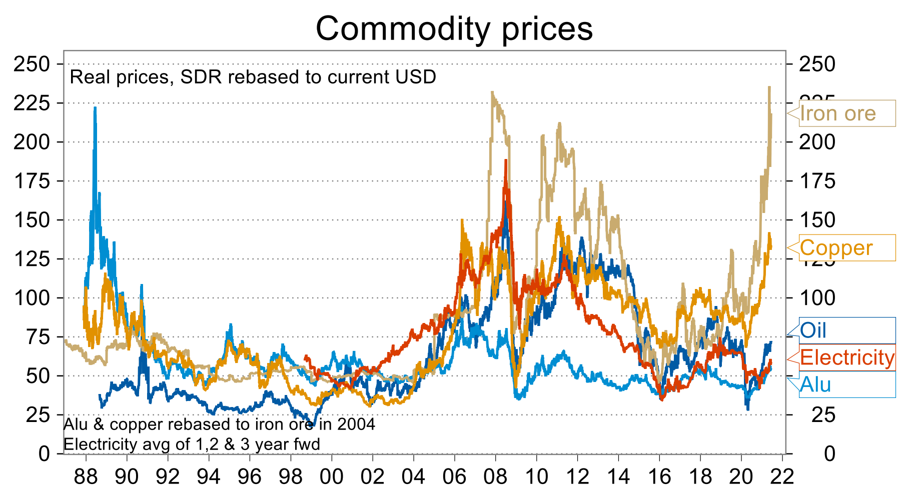


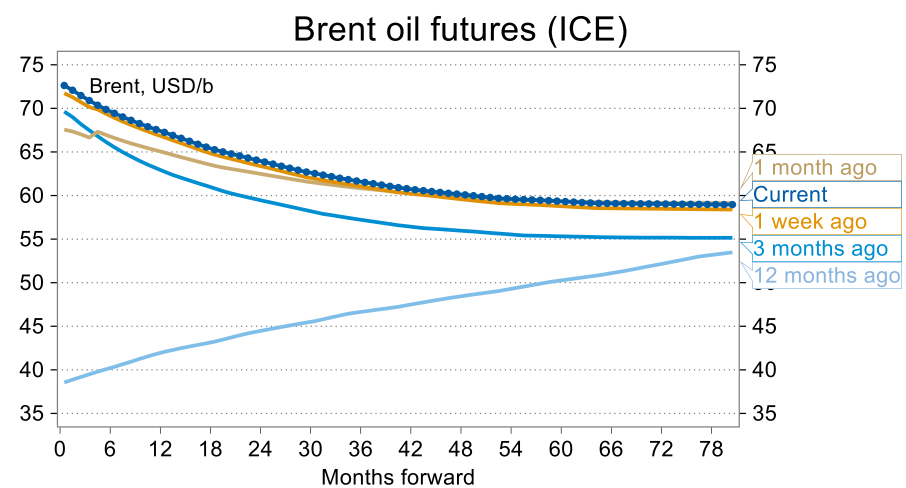
Iron ore has recovered 2/3 of May losses, oil trends up from USD 70/b

However, metals mixed last week – and they have more or less flattened recent weeks



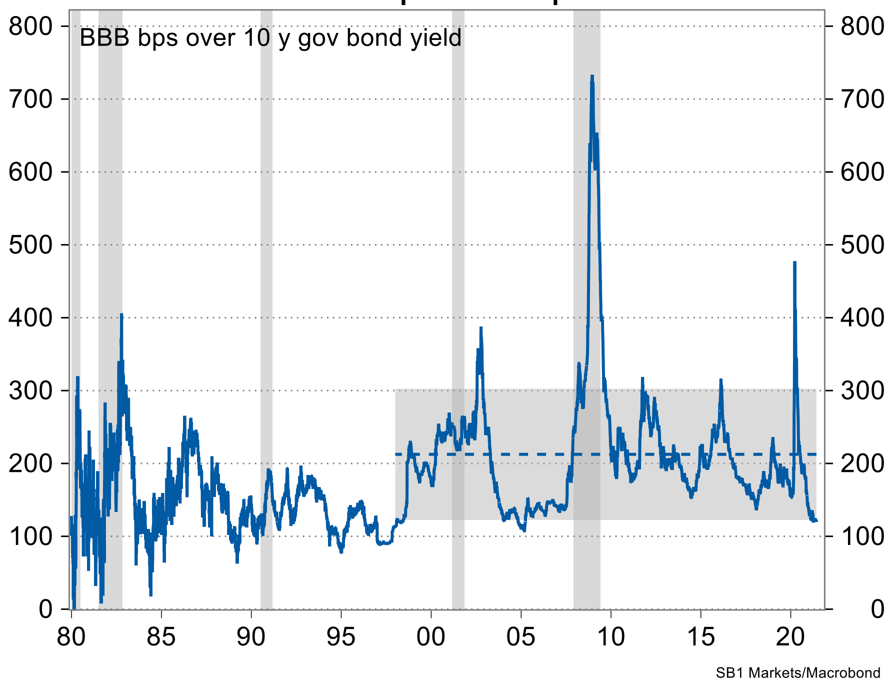


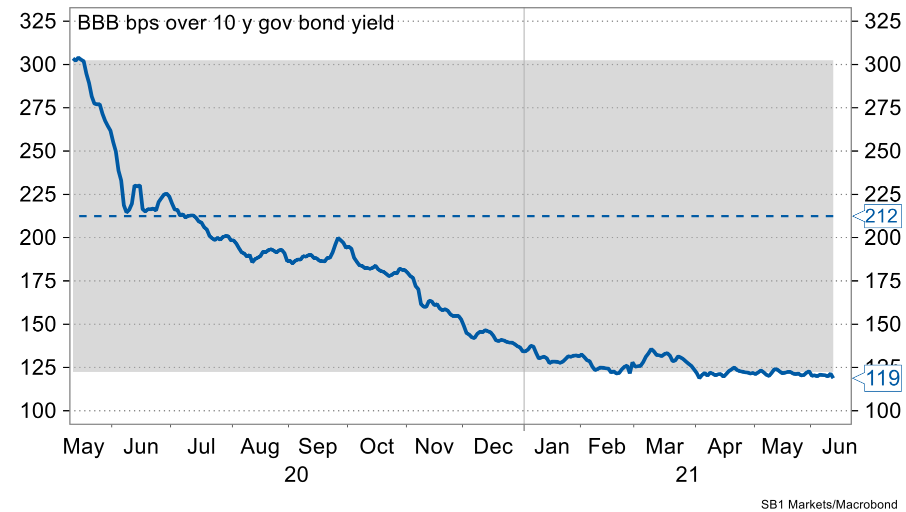




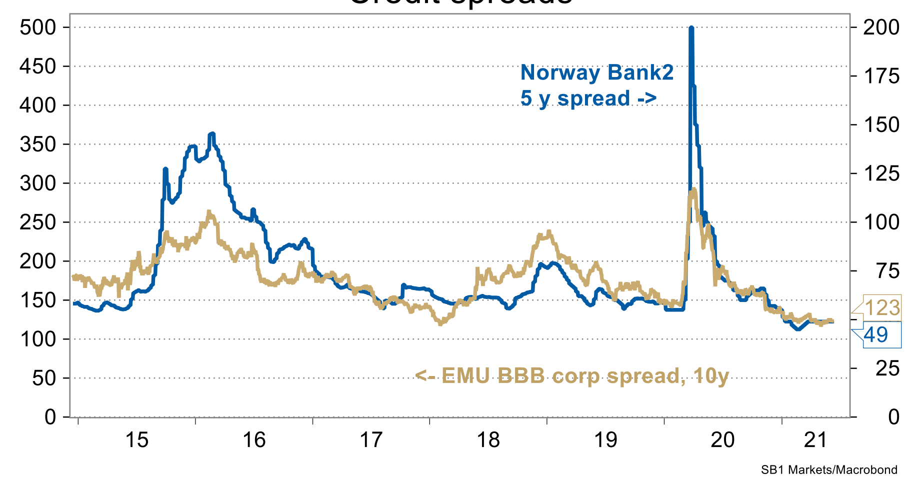
No worry at all, not anywhere – credit spreads remains very low

USA Corporate spread



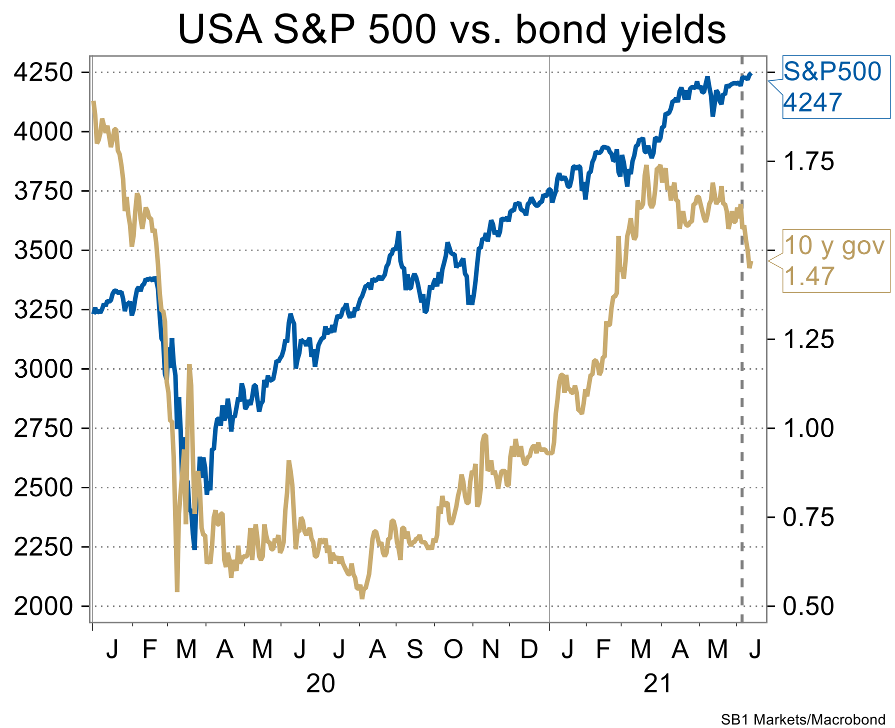


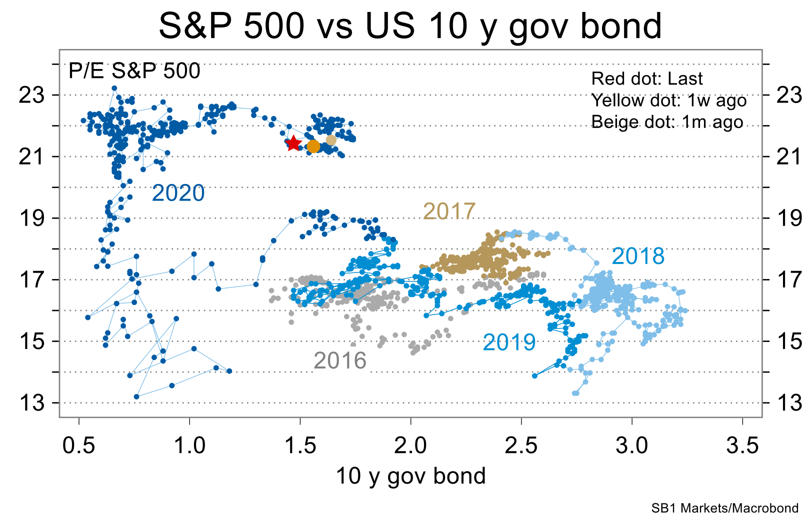
Credit spreads

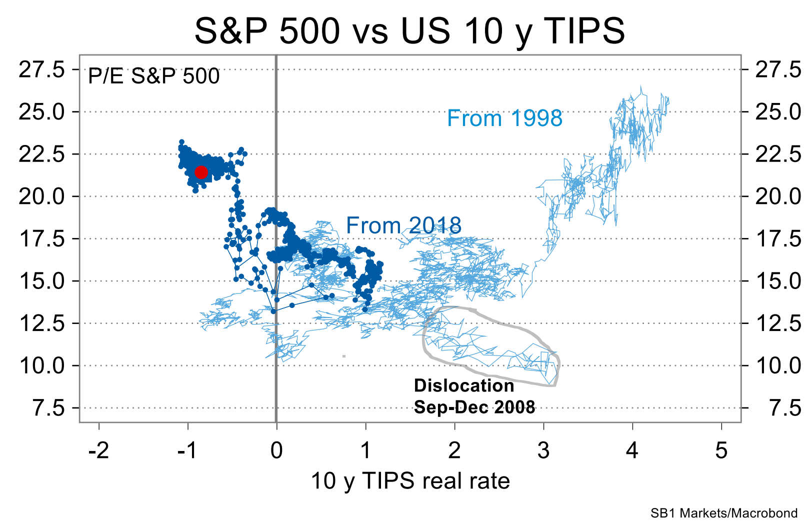


S&P 500 up 0.4%, and new ATH, the 10 y bond yield down 9 bps, to 1.47%

... at the same time as actual inflation surged to the highest levels in 12 – 30 years!





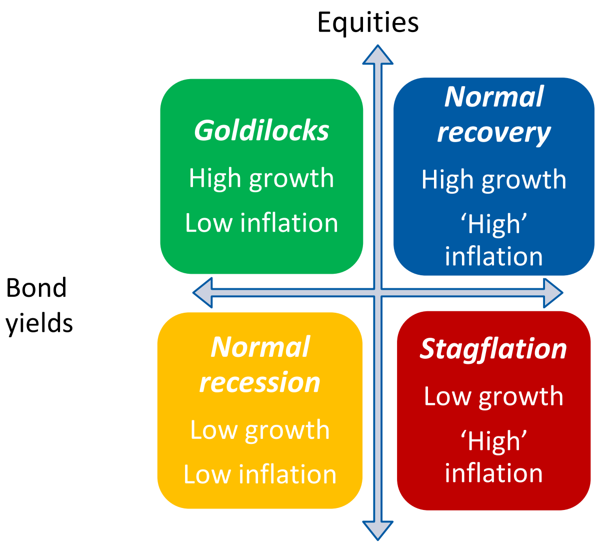


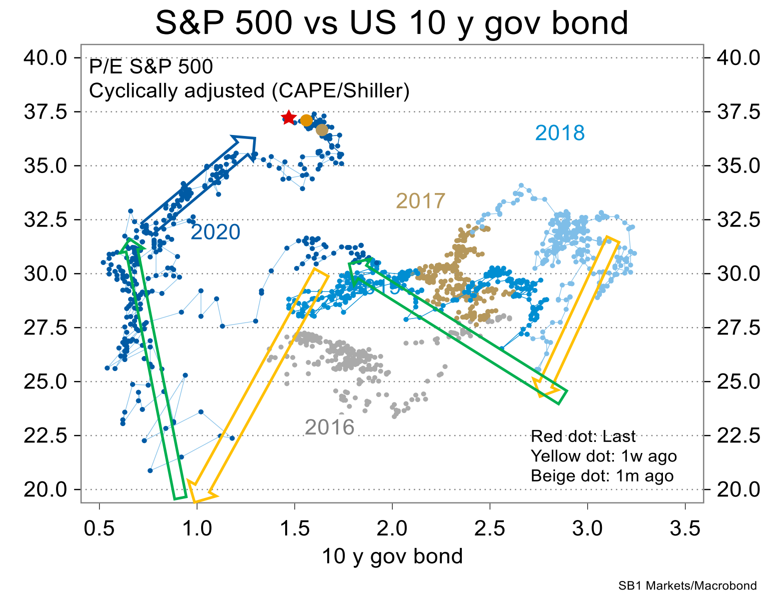
- Well, even if inflation was a tad higher than expected, the outcome was not a shock, just like one month ago – markets have braced themselves for some harsh numbers
- On the other hand: *Were there any news last week news that should have reduced inflation expectations??*

SpareBank 1 MARKETS

Further into the 'Goldilocks corner'

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

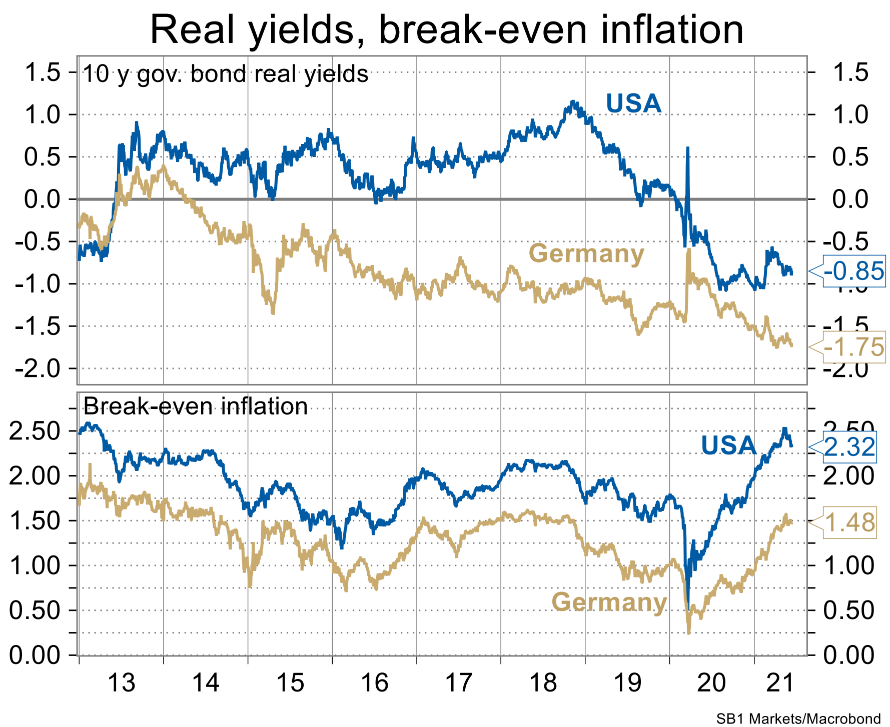


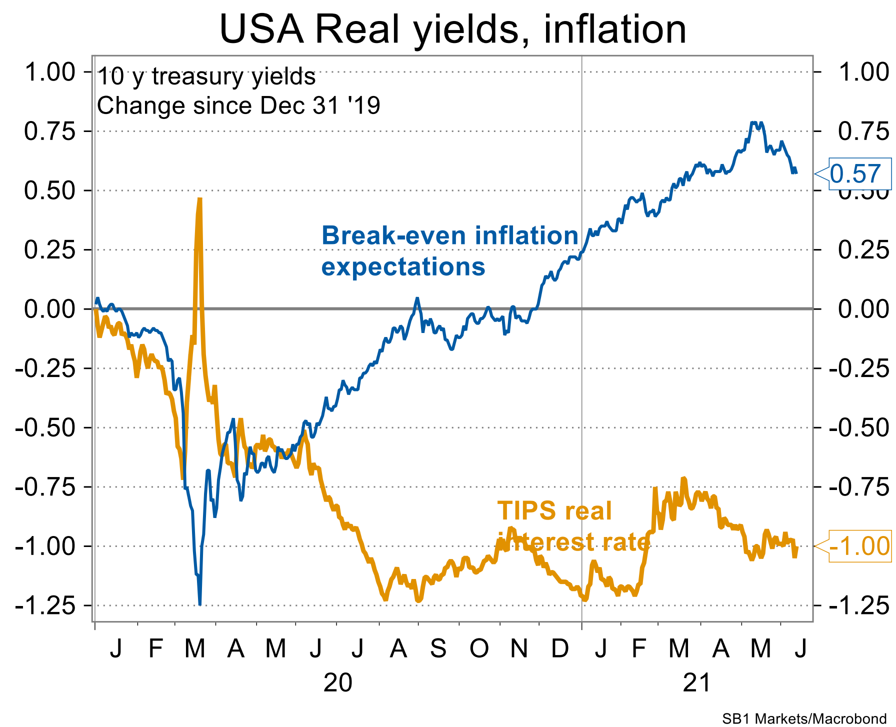


- Usually, we have associated drifts towards the 'green corner' - low inflation and solid growth at the same time - as a temporary sweet spot for markets
  - » Interest rates have climbed 100 bp+, and stock valuations have kept up or climbed (like the Shiller PE). Still, we deem the current yield level to qualify for the "Goldilocks" corner (especially the real bond yield, check the chart on the previous page). Where to go from here?
- The inflation/growth mix will decide:
  - » If 'nothing' happens, we can stay in this Green quadrant. Raw material prices normalises, wage inflation is kept in check because the US labour supply finally returns to normal. Inflation turned out to be transitory, profits are OK, yields remain low
  - » If the labour supply in the US does not yield, wage inflation will very likely accelerate
    - If companies are able to increase their selling prices, profits will be kept up, but higher inflation well very likely push the Fed to tighten monetary policy, which is challenging for high multiples. Move to the blue quadrant. However, after a while profits will anyway come under pressure. The stock market will be rewarded with lower profits & lower multiples (it will resemble the Red corner, before moving to the Yellow
    - If companies are not able to increase their selling prices, inflation will be kept in check but profits will decline rapidly. A 2% lift in wages, cuts profits by well above 10%. That's the Yellow corner

So here's the rule: When inflation surges, expect lower inflation ahead

That is not as strange as you may think – the future upside must be limited, the hike is just transitory





US & Germany 10 y Gov bond yield

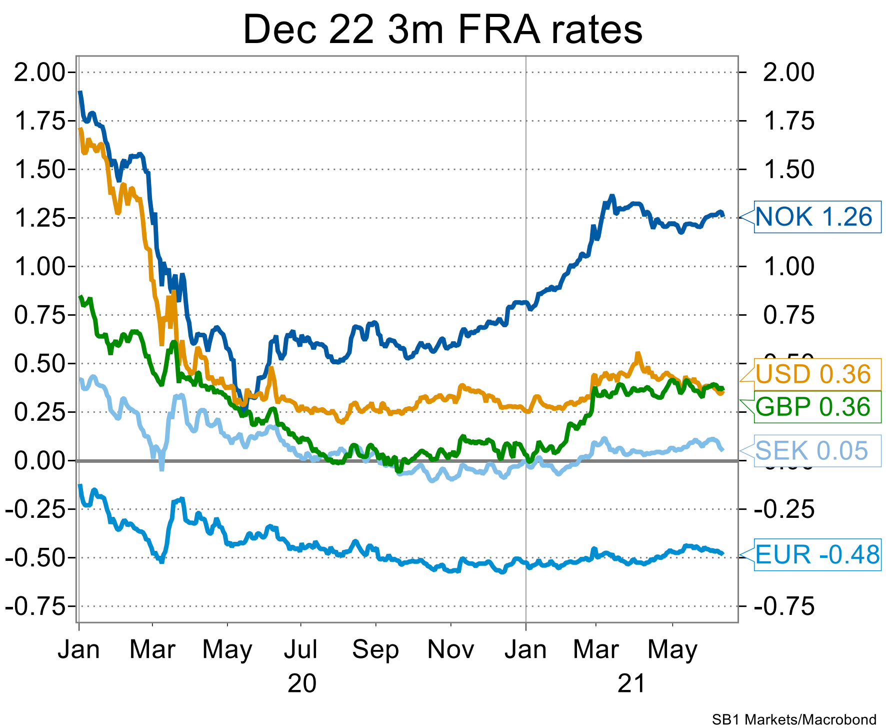
	Yield	Change 1w	Change 1m	Min since April-20
USA nominal treasury	1.47	-0.09	-0.17	0.52
.. break-even inflation	2.32	-0.08	-0.21	1.06
.. TIPS real rate	-0.85	-0.01	0.04	-1.08
Germany nominal bund	-0.27	-0.08	-0.10	-0.65
.. break-even inflation	1.48	-0.03	-0.05	0.40
.. real rate	-1.75	-0.05	-0.05	-1.76

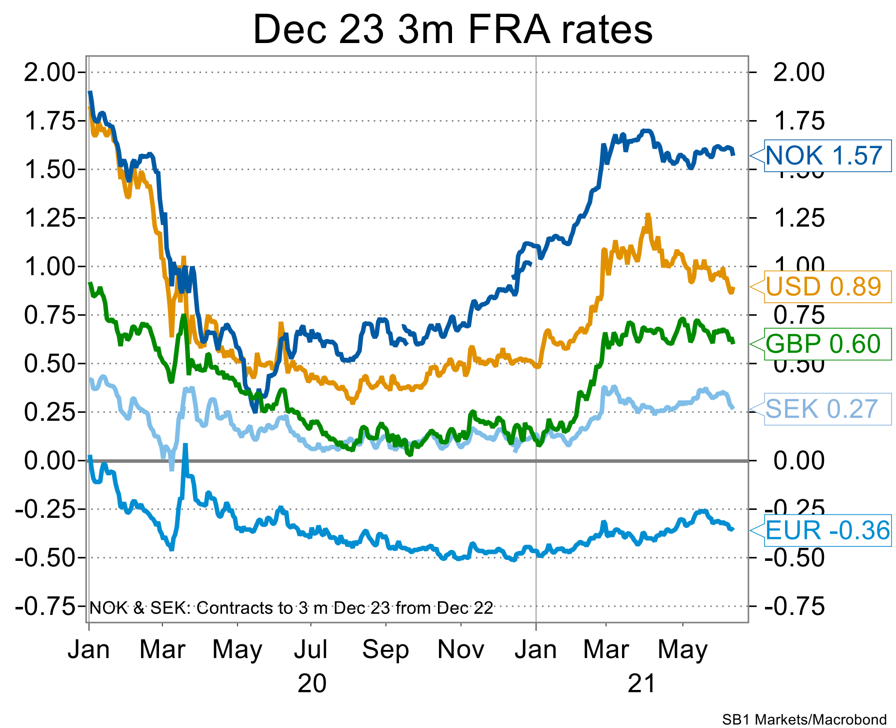
SB1 Markets/Macrobond

- Well, that is one possible story, and there are others…
- US 10 y inflation expectations fell by 8 bps last week and at 2.32% they are down 20 bps from the peak. At the same time, TIPS real rates have been flat, at very low level, now at -0.85%
- German yields fell sharply too, mostly due to lower real rates

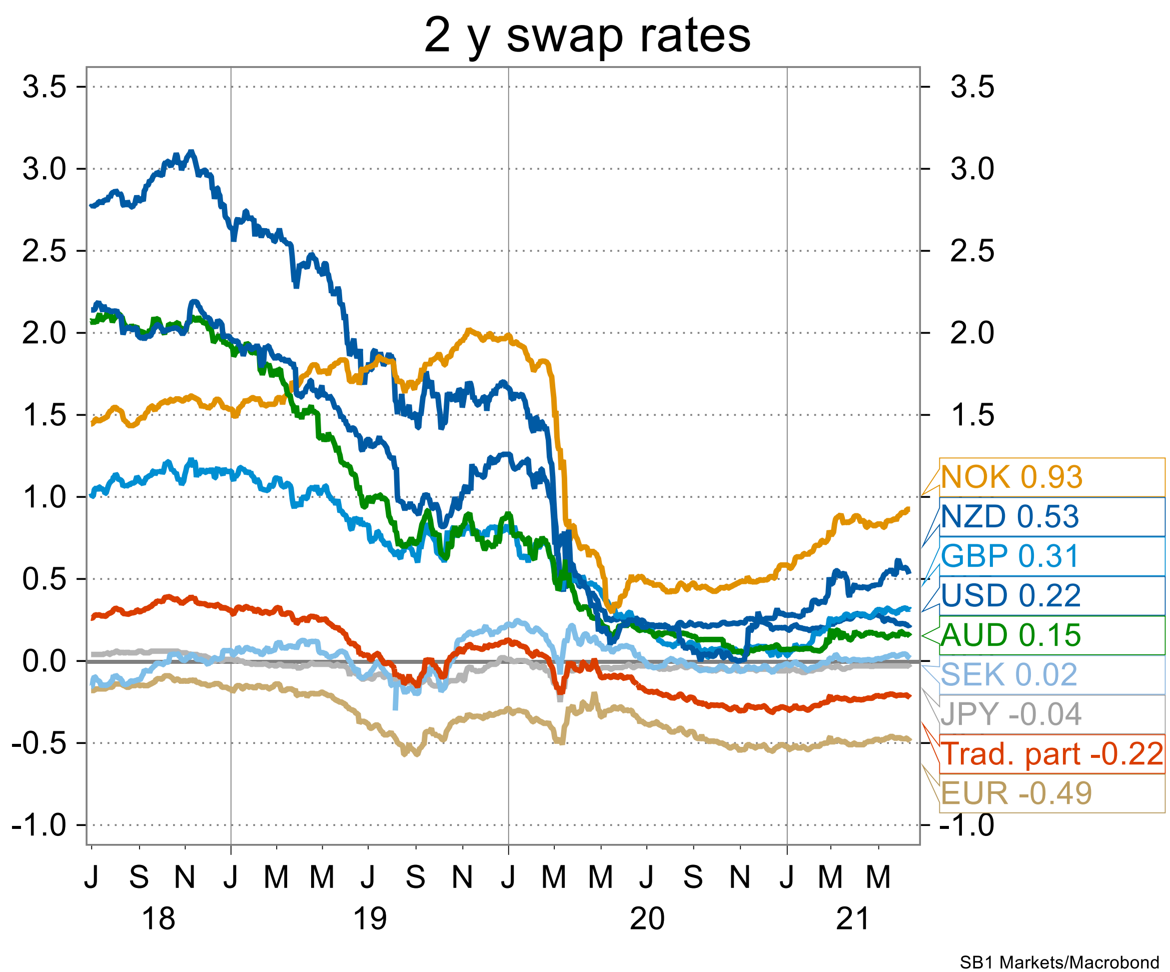
FRAs: NOK the last man standing? All others are yielding

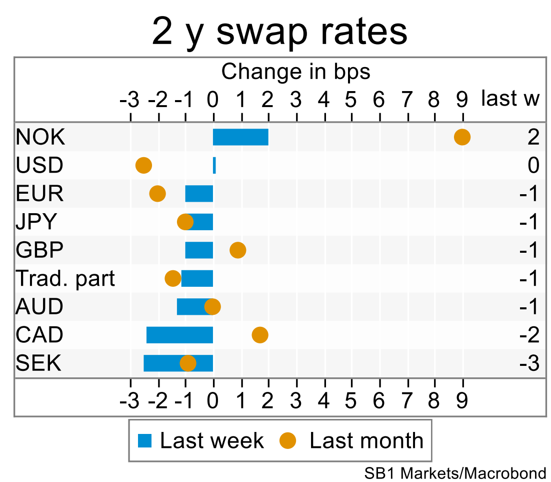
The US curve is still pricing in a hike next year, earlier than the Fed so far has signalled





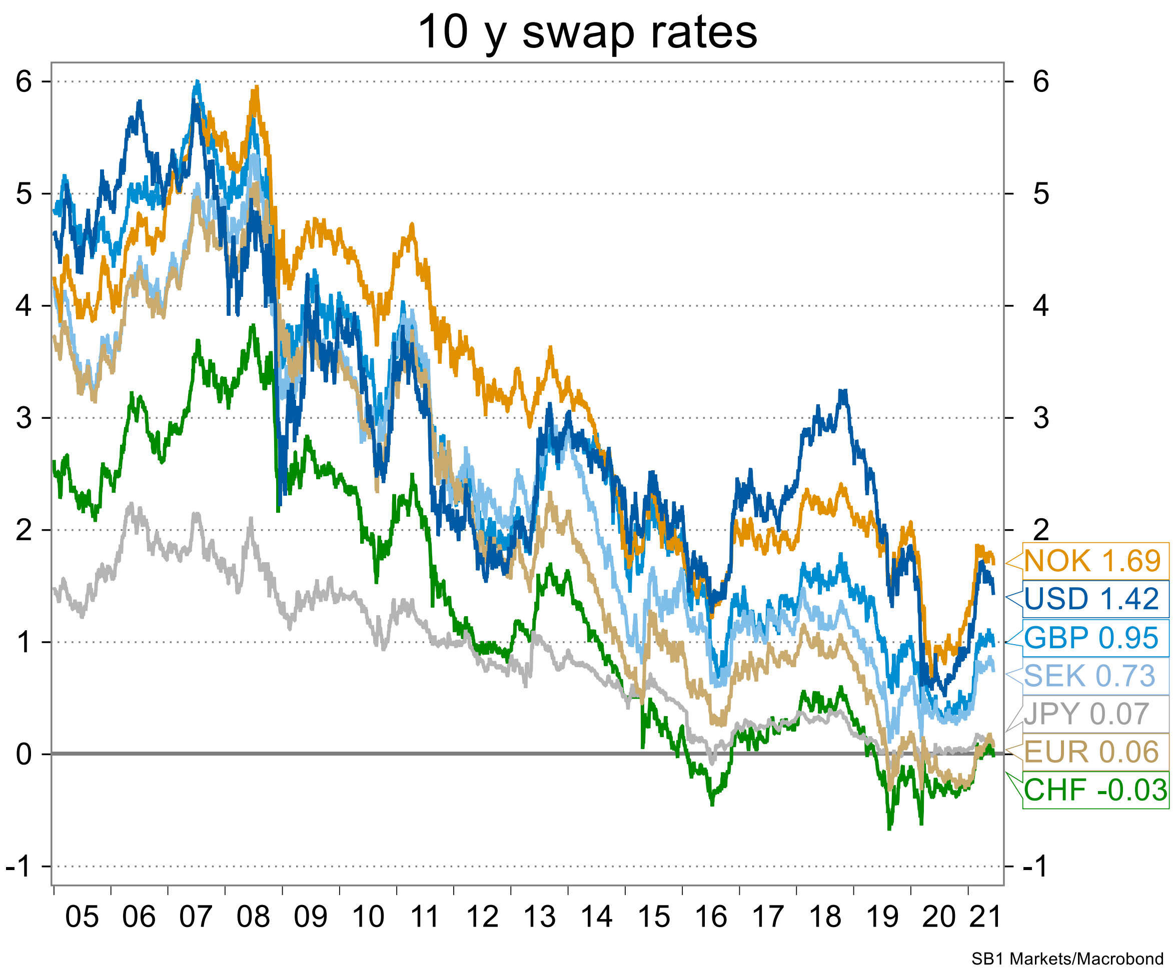
NOK rates up, all others down (except US rates which were flat last week)

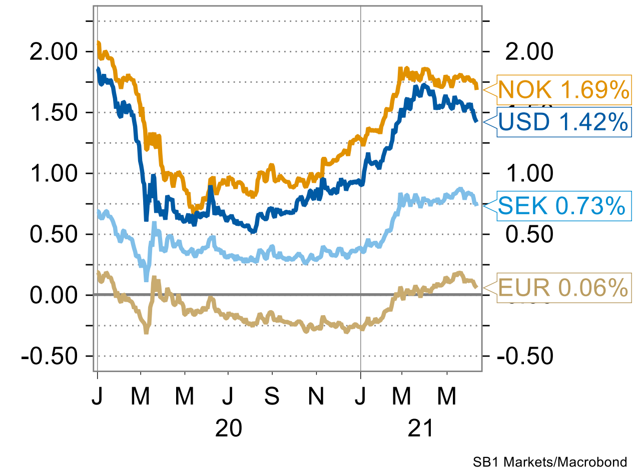


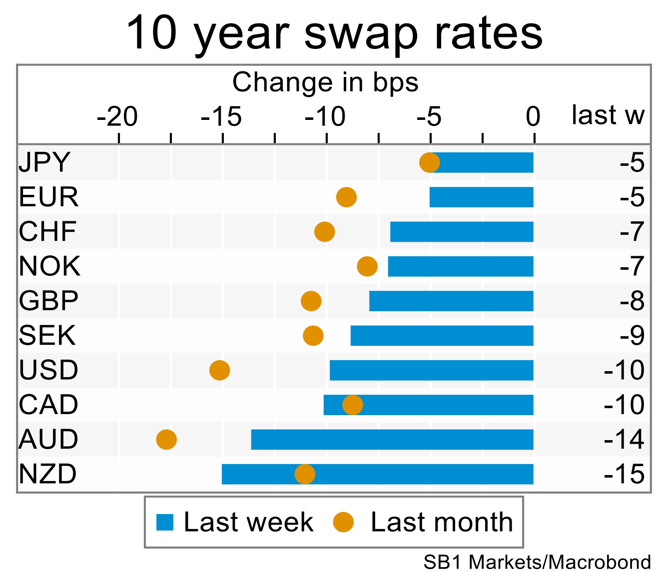


Down everywhere – but the US set the tone

EUR & SEK rates have kept up better than others

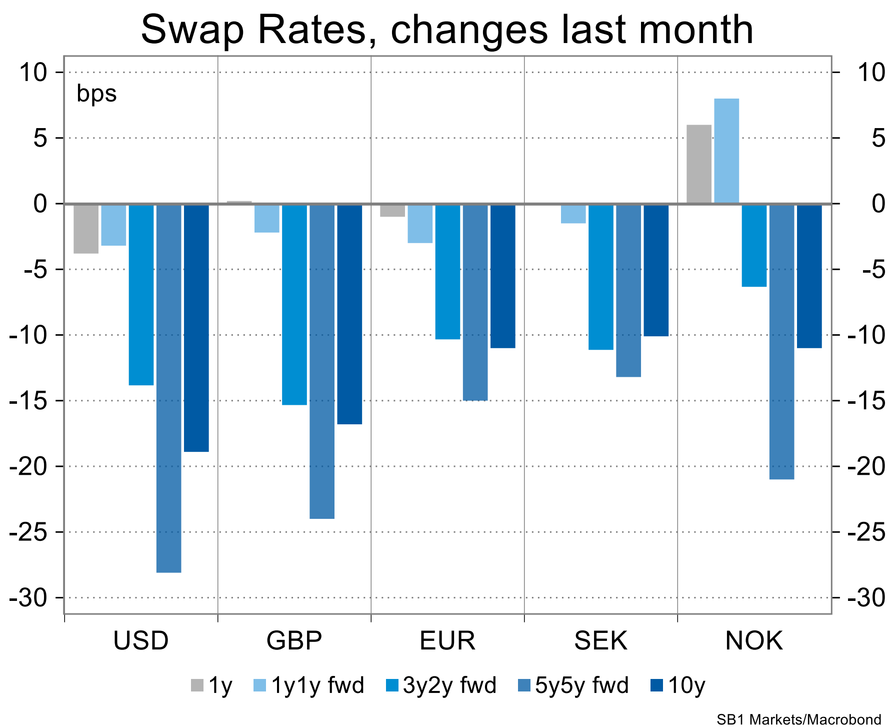


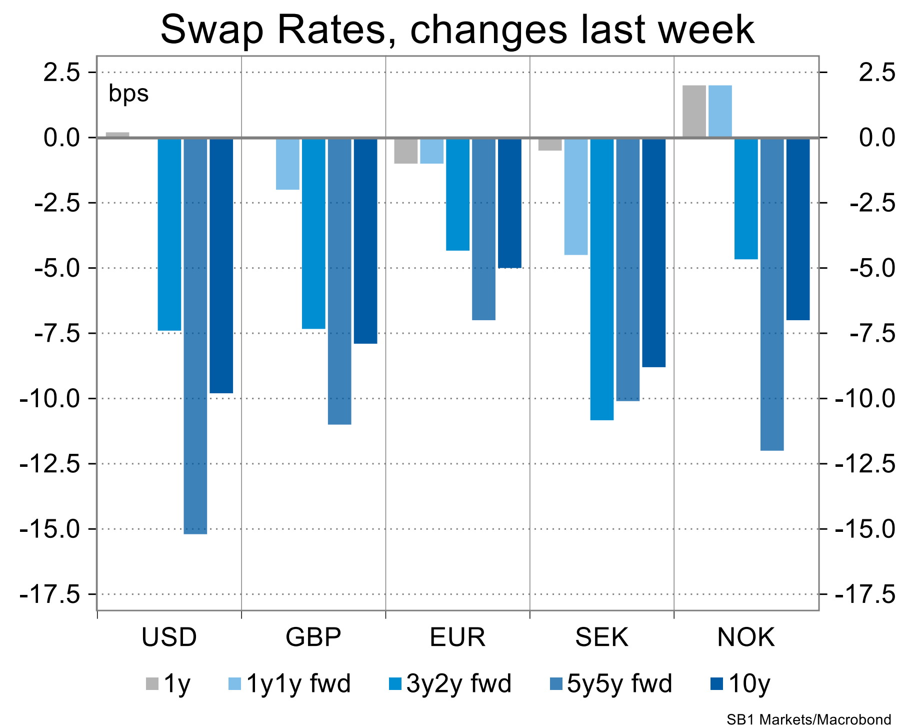




Down everywhere in the big inflation week – barring the short end in Norway

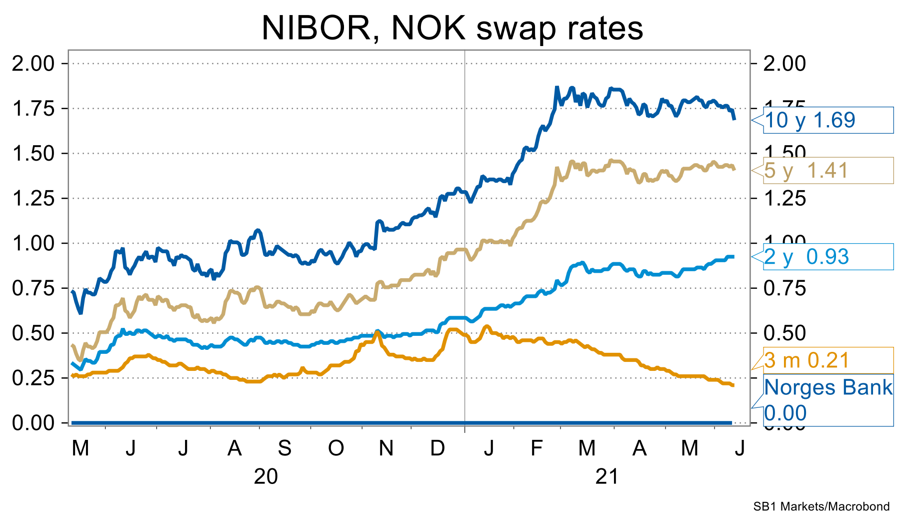
... and in Norway inflation surprised sharply on the downside ☺

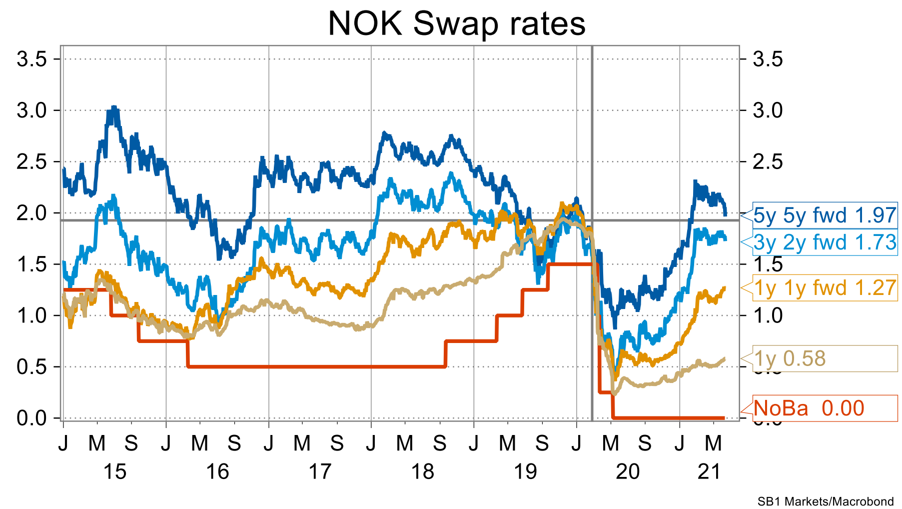


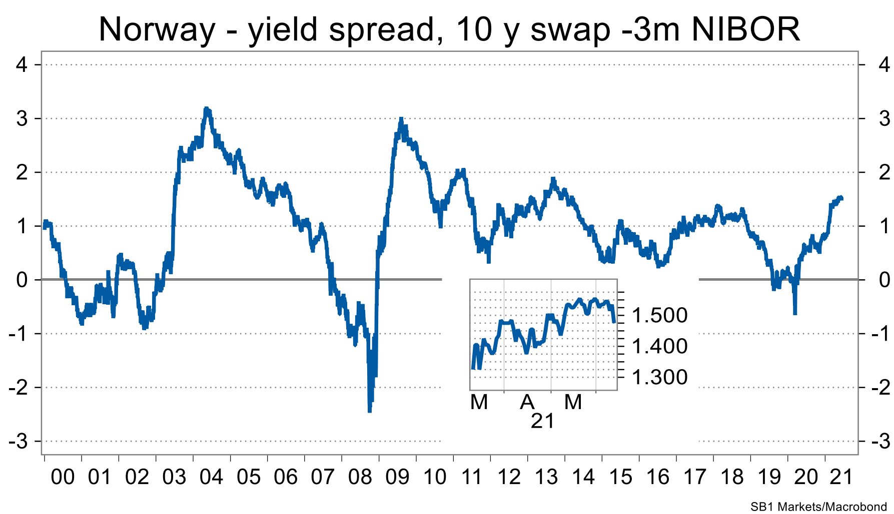


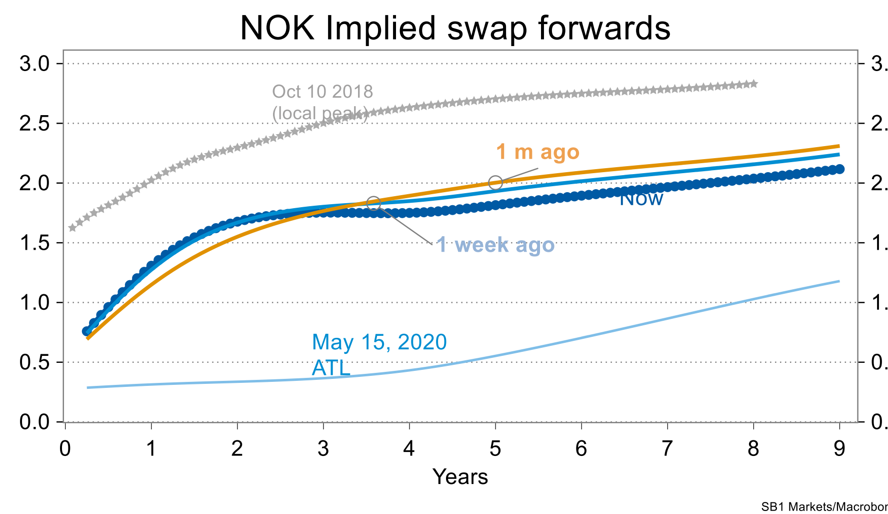
The very short end down (3m NIBOR at ATL at 0.21%), the mid segment up

… while the 10 y rate is trending down – alongside lower rates abroad





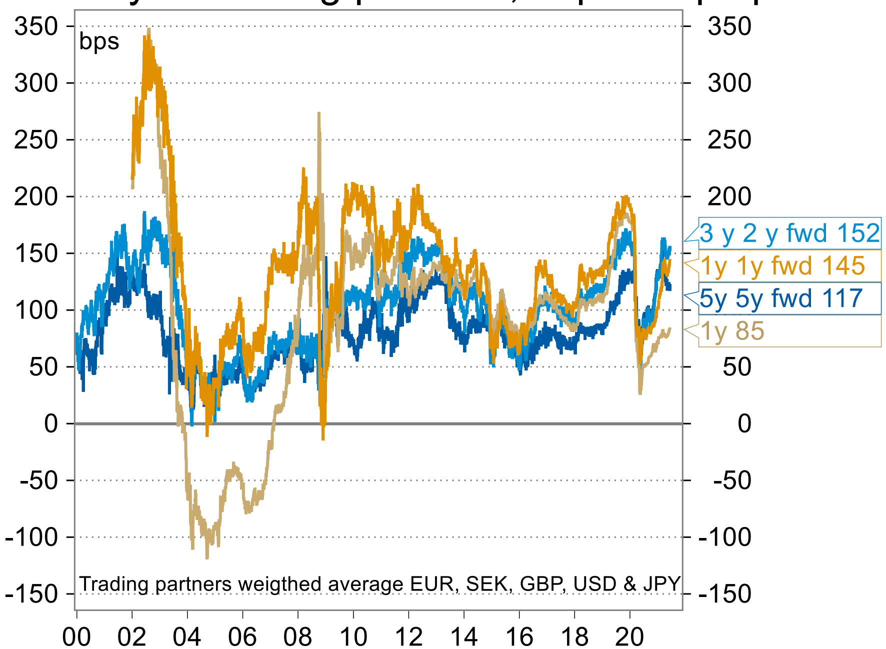




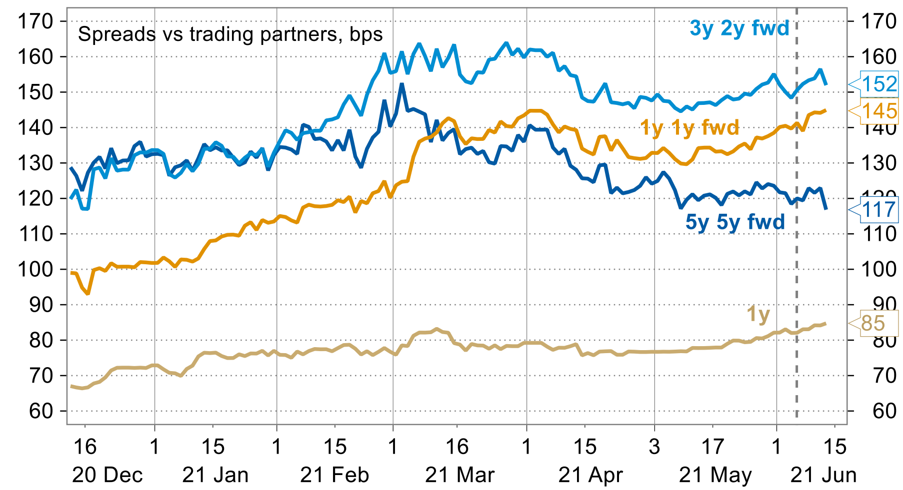
SpareBank 1 MARKETS

Forward spreads are trending up until 5 years, 5 – 10 years sliding down

Norway vs trading partners, impl swap spreads

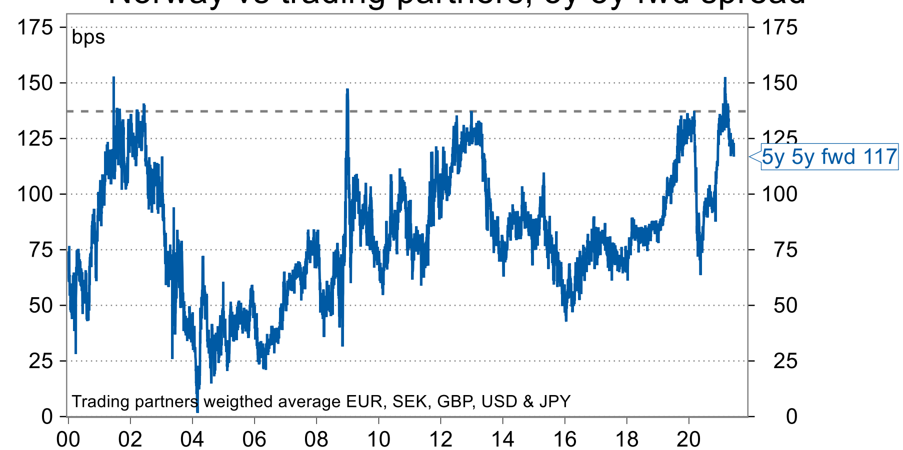


SB1 Markets/Macrobond



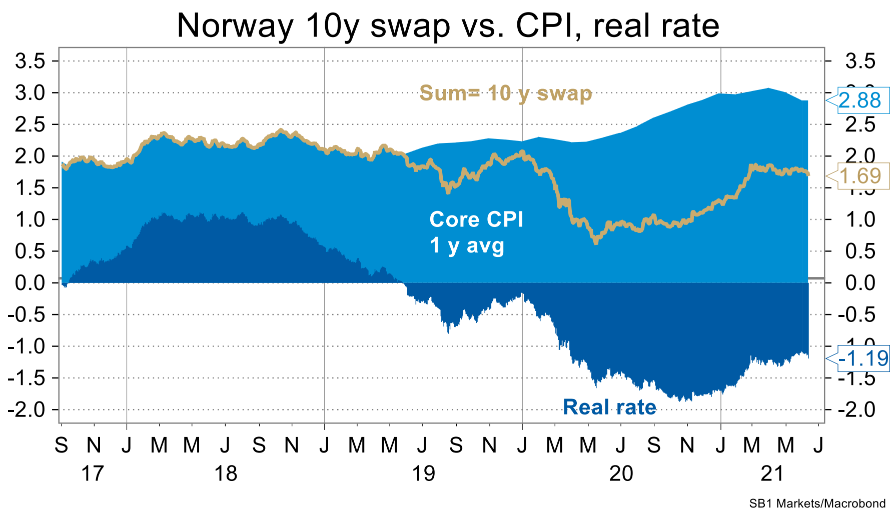
SB1 Markets/Macrobond

Norway vs trading partners, 5y 5y fwd spread



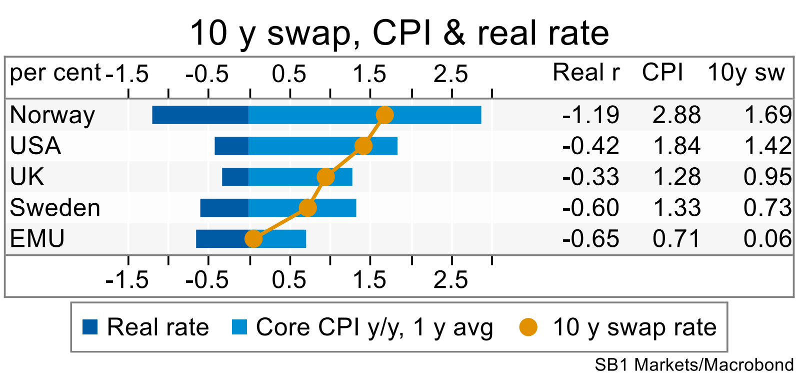
SB1 Markets/Macrobond

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



NOK 10 y swaps have flattened

- The **10y NOK swap** rate down 7 bps to 1.69%
- **The real rate**, after deducting 2.9% an 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 2 y avg at 2.9%
  - » On the other hand, barring economists' in academia & finance, nobody else believe in the 2% inflation target. Other economists say 2.5% as to leaders in labour market organisations, business leaders 3.5% and households 3.7% (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



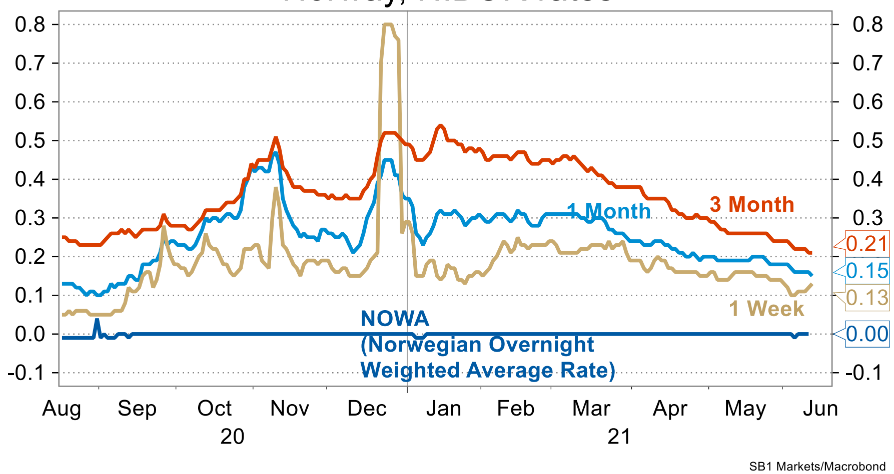
NOK real rates among the lowest, as inflation is at the top

- **Inflation** among main trading partners varies between 0.7% to 1.8% (here again measured by actual annual core inflation, smoothed over 12 months). EMU at the bottom, US at the top
  - » Other measures of inflation trends, looking backward or including forward expectations yields the same ranking
- **Real rates** among our trading partners, and ranging between -0.3% and -0.7% measured vs. the 10 y swap rate and core inflation over the past two years
- **Thus, the Norwegian real rate at -1.2% is still an outlier at the downside, even if the nominal rate is the highest**

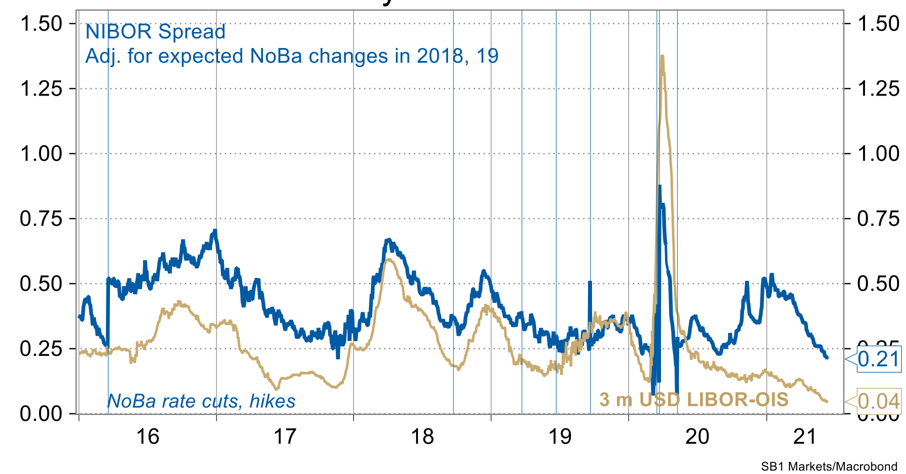
The US LIBOR/OIS money market spread is taking the NIBOR spread down

... And the 3 m NIBOR fell to 0.21%, the lowest level ever!

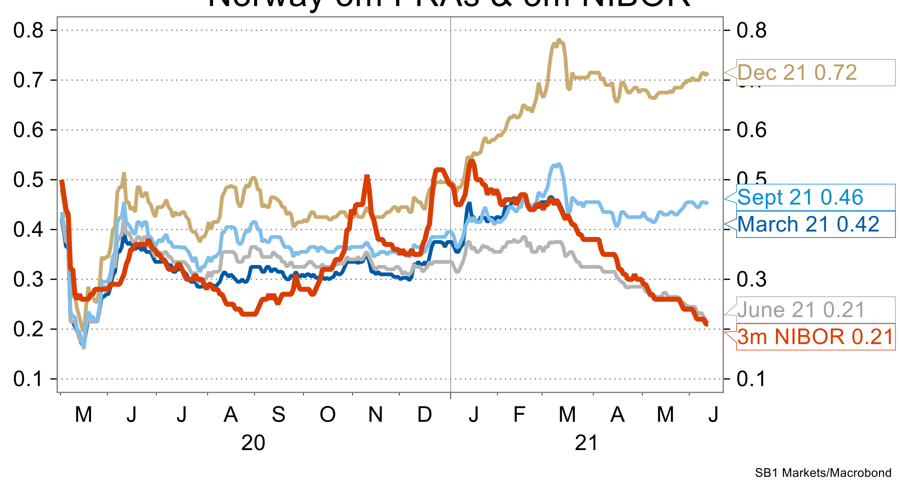
Norway, NIBOR rates



Money market friction



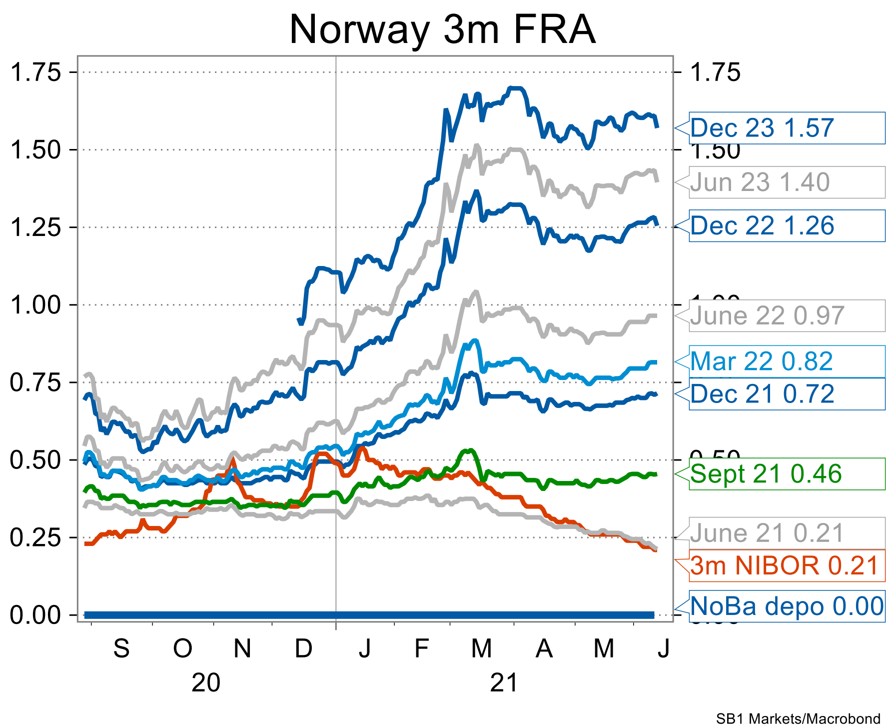
Norway 3m FRAs & 3m NIBOR

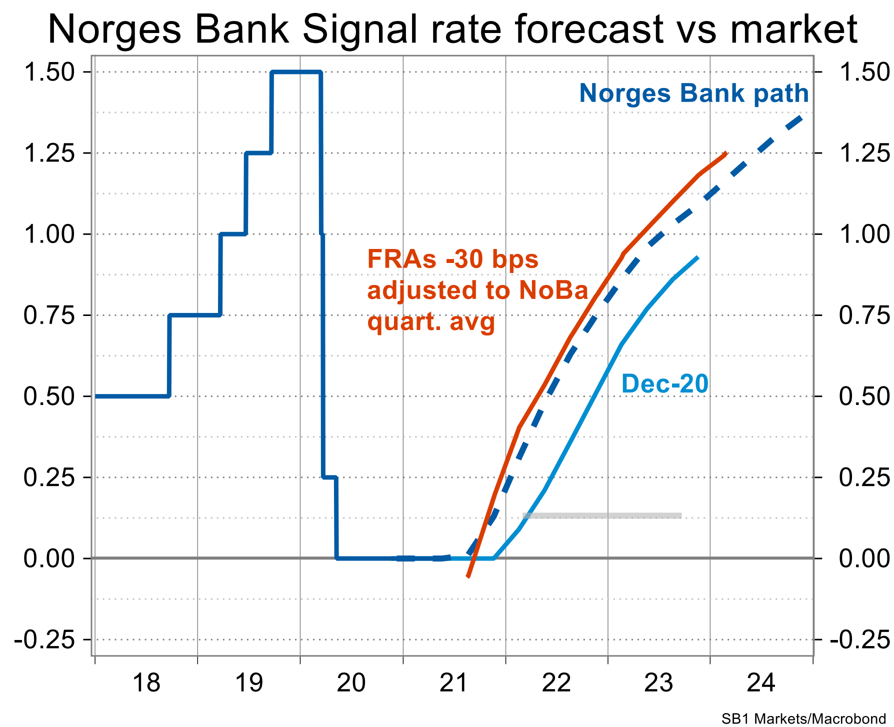


- The US money market is flooded with liquidity, possibly is a consequence of at generous liquidity support from the Federal Reserve

FRAs are tilting upwards, even if the NIBOR margin in short end is 'collapsing'

The longer dates FRAs fell, supported by lower rates abroad. The mid segment is waiting for NoBa!

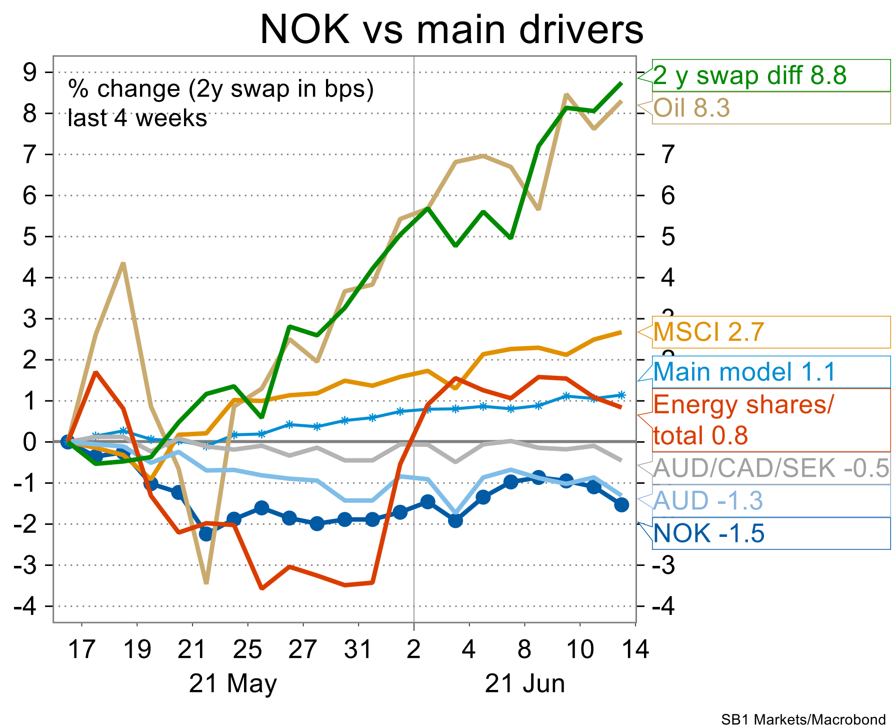


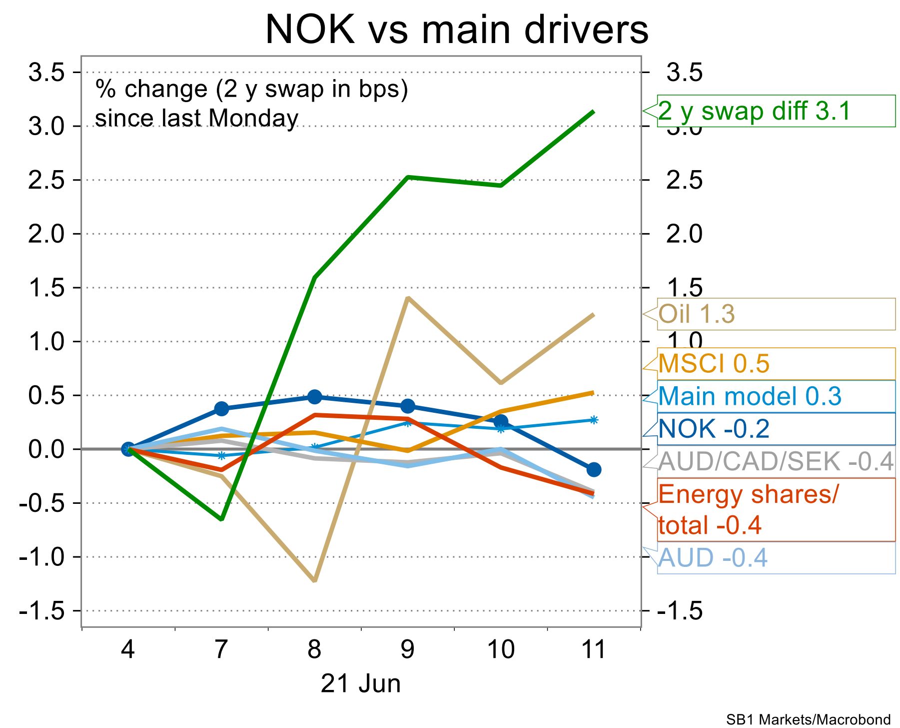


- The NoBa 23 Sept meeting is one weak after the Sept 3 m FRA IMM fixing date. If NoBa hikes to 0.25% on Sept 23, the average NoBa rate during the Sept-21 FRA contract period will be 0.23%. Assuming a 30 bps NIBOR spread the 0.46% Sep FRA-rate equals a 0.16% NoBa deposit rate. If so, a 70% probability for a Sept hike is discounted, more than NoBa signalled in its March MPR (50%). If a 25-bps NIBOR spread is assumed, there is an 90% probability for a Sept hike (and if the spread is 21 bps – 109% ☺).
- The Dec-21 FRA at 0.72%, and a 30-bps NIBOR spread, yields a 0.42% NoBa rate. However, the Dec FRA is normally some 5 – 8 bps 'too high' due to year end liquidity adjustments at banks. If so, market pricing implied a 50% for a 2nd hike in December. A second hike in March-22 (if not in Dec) is fully discounted

The NOK down 0.2%, our model +0.3%, supported by the oil price

The oil price rose, as did the int. rate differential & global stocks. However our f/x peers lost ground





The status vs. the normal drivers:

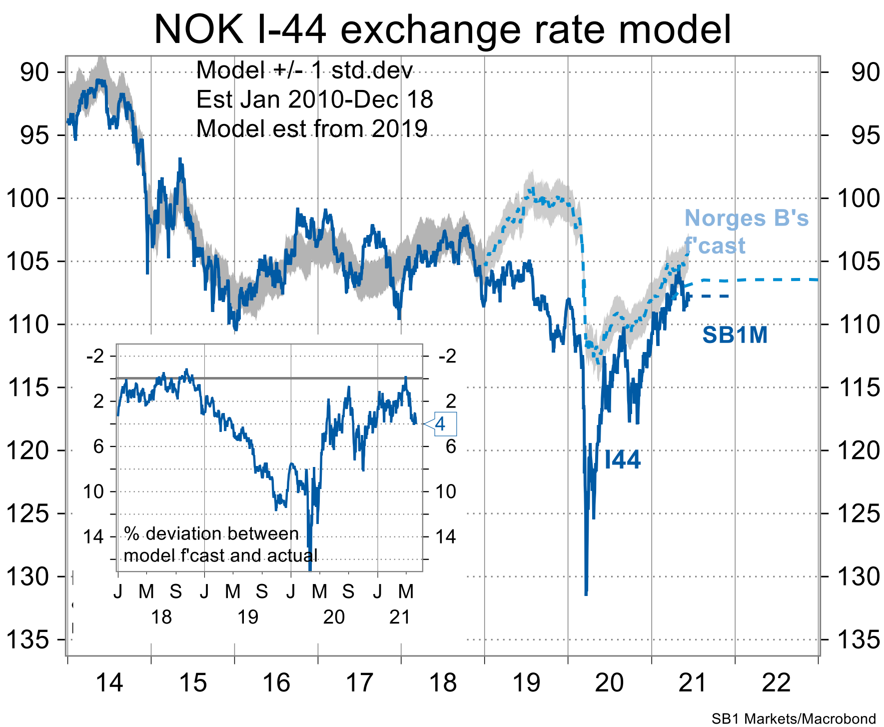
- The NOK is 4% weaker than suggested by our standard model (calculated from Friday's data, from -3)
- The NOK is 4% 'weaker' than the global stock market vs the correlation between the two since beg. of 2020 (from -2)
- The NOK is 8% weaker than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts (unch)
- On the other hand, the NOK is far (10%) stronger than a model which includes global energy companies equity prices (vs the global stock market) (from -12)

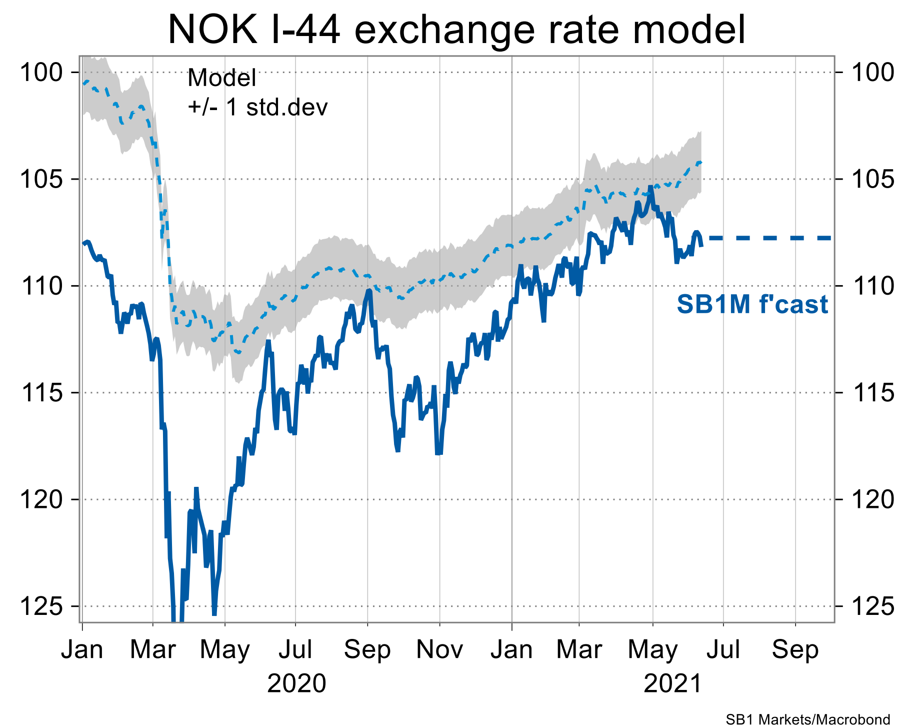
From early of May we have been neutral vs. NOK (from buy). The recent decline may have created a short term trading opportunity

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 4% below our main model estimate, still not cheap enough for a buy?

The main NOK risk: Global stock markets



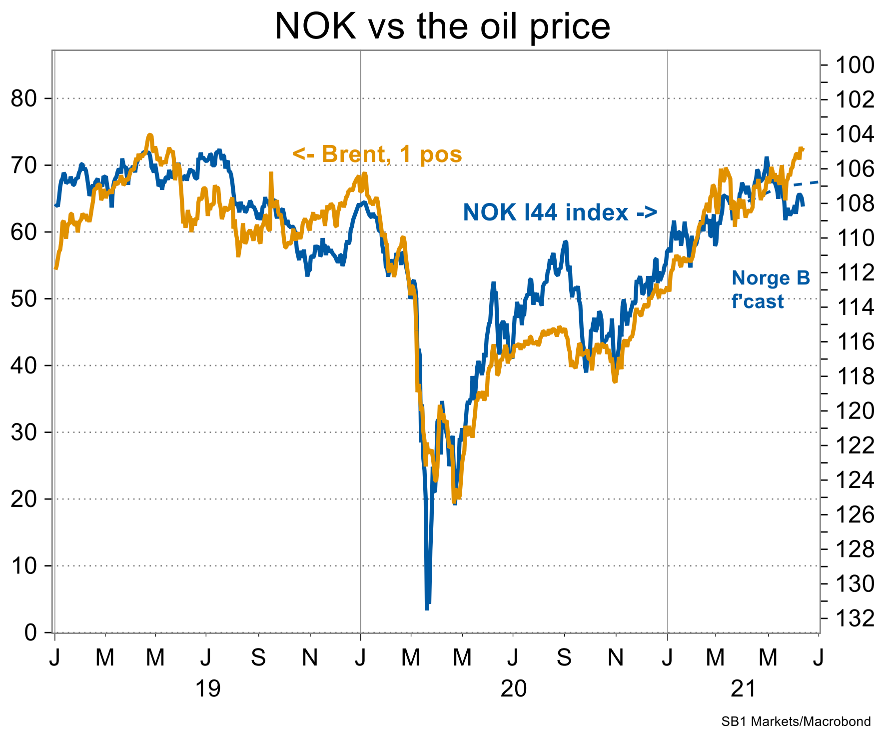


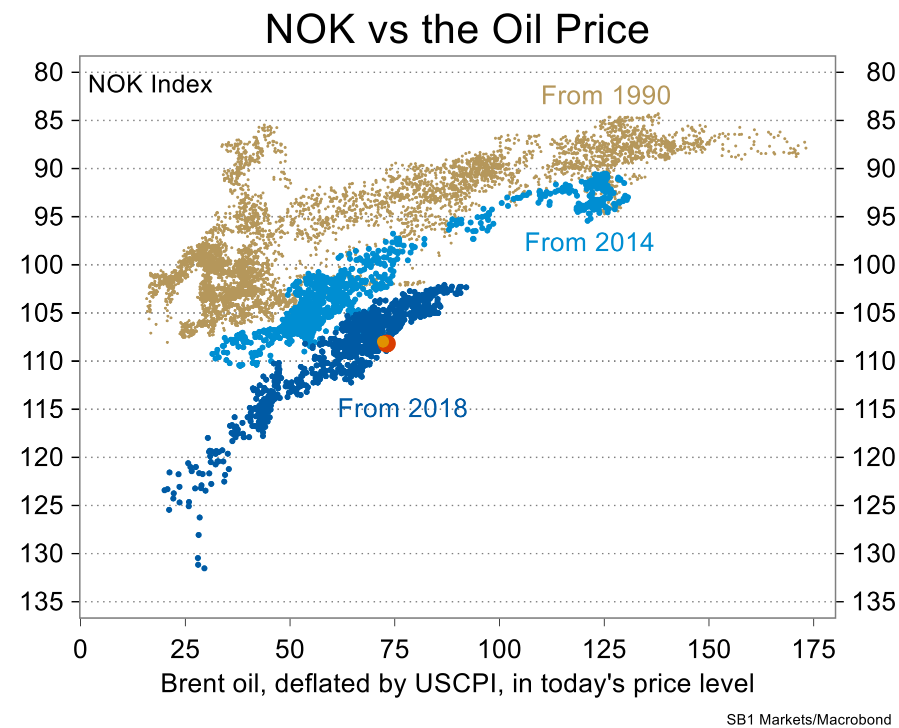
- The NOK is still above the pre-pandemic level and not that far below our workhorse model estimate

SpareBank 1 MARKETS

Oil has left NOK behind – and is now clearly on the weak side vs the oil price

Even vs the correlation between the two since 2018

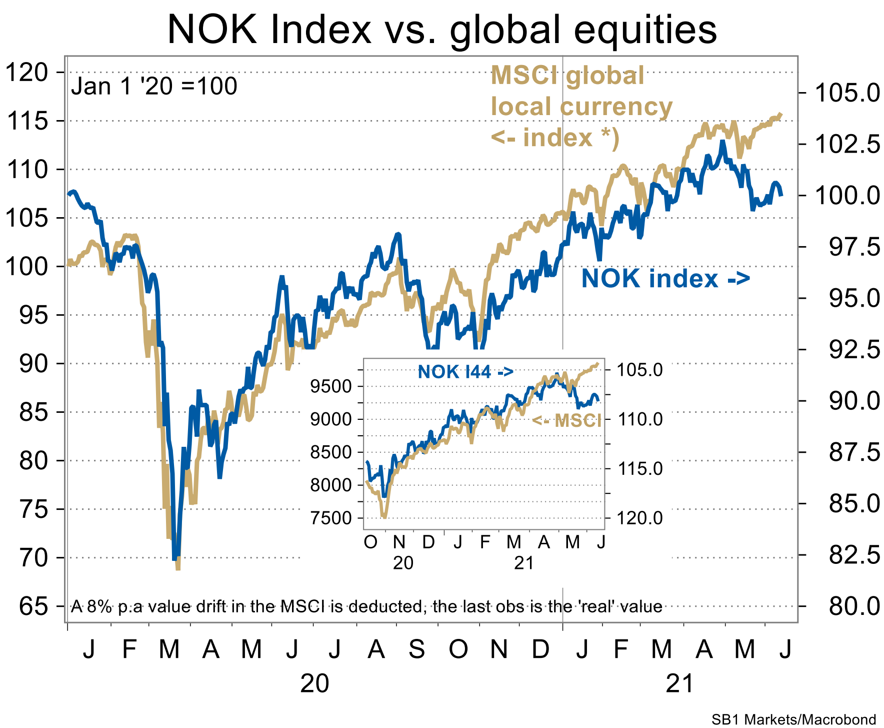


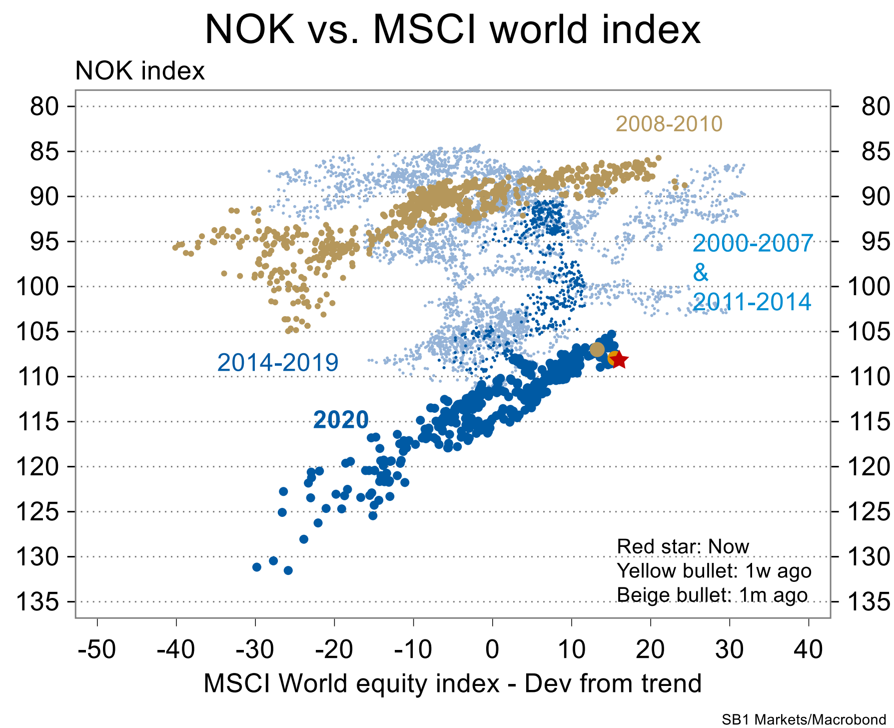


- NOK is still correlating quite closely to the oil price but at a lower level than before 2018
- A USD 10 drop in the oil price weakens the NOK by some 2.5%, as a partial effect. Within a broader model, the impact is somewhat smaller

Global stock markets further up, the NOK did not keep up

Except for Sept., NOK and global equities has been closely correlated since early last year

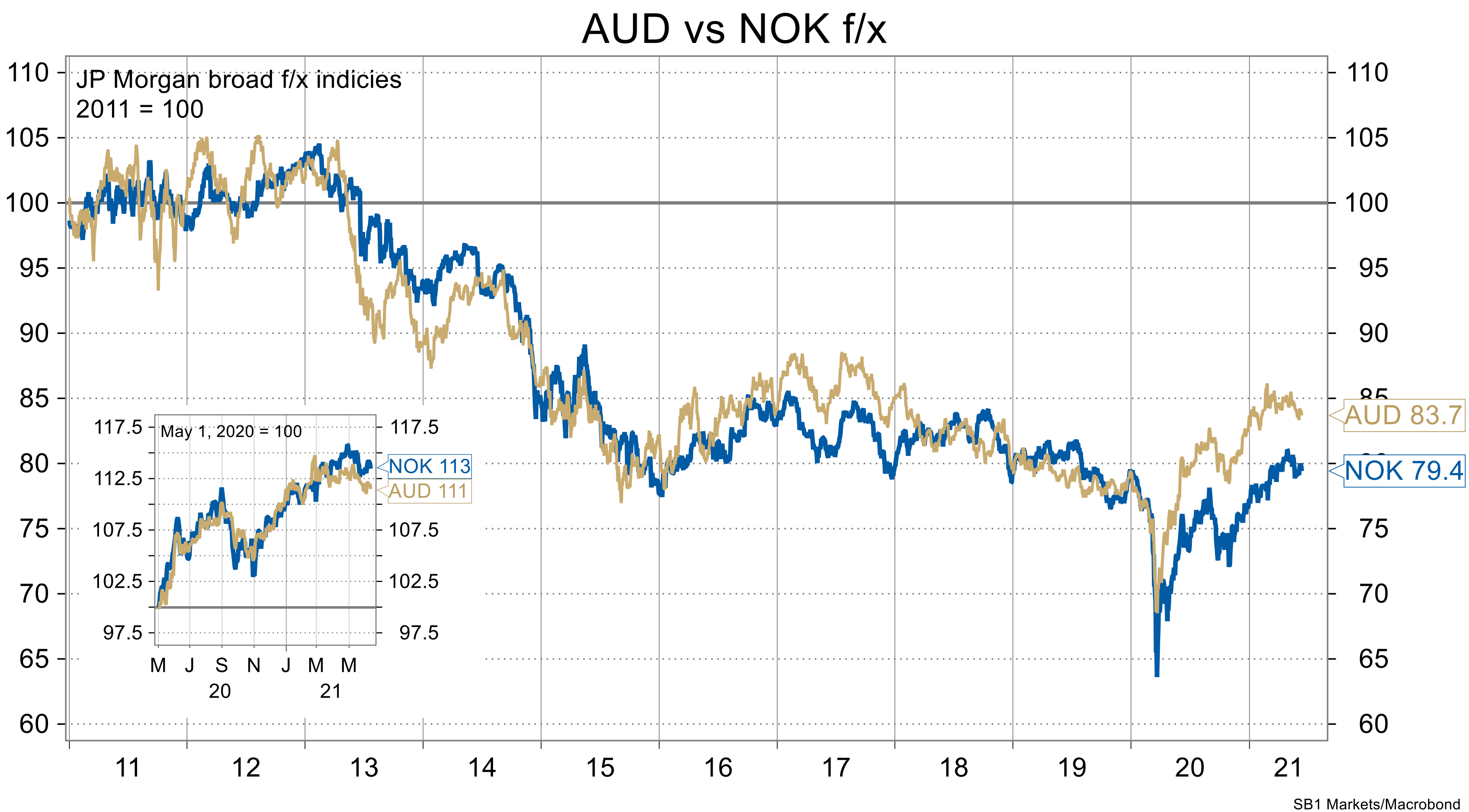




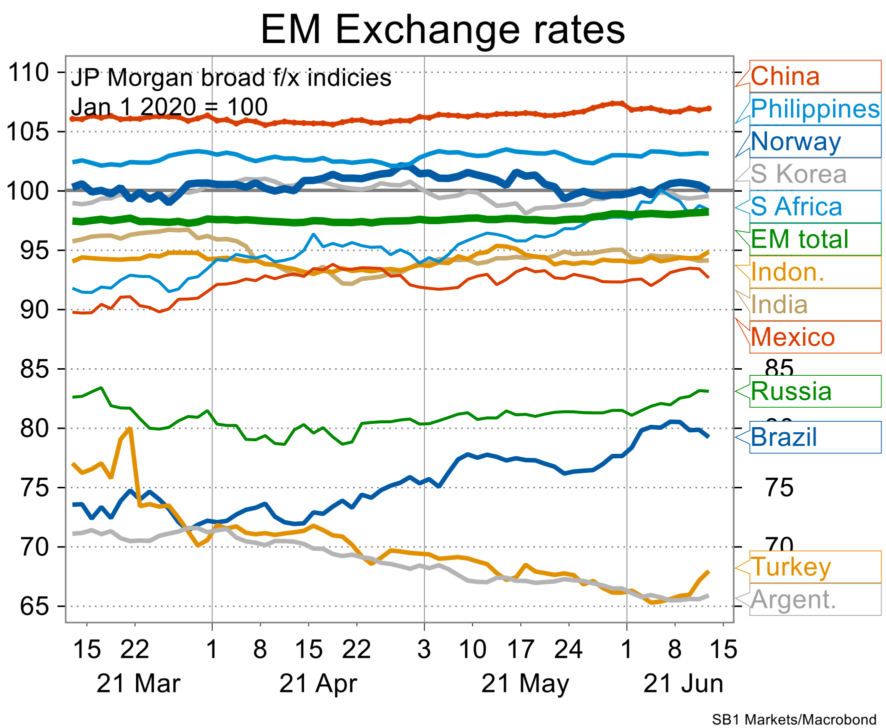
- Over time, there has not been a stable correlation between NOK and stock markets (the Oslo Stock Exchange, S&P 500 or the MSCI, the global equity index. (At the chart to the right, we have detrended the stock market as equities are drifting upwards, while NOK (hopefully) is stationary. However, the 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

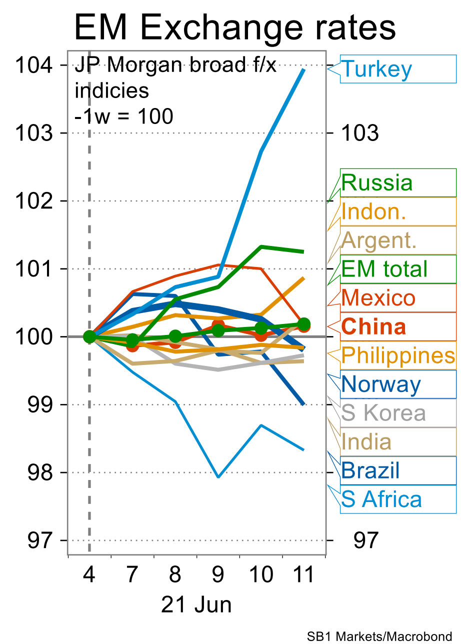
NOK & AUD still in tandem – the AUD fell slightly more than the NOK last week

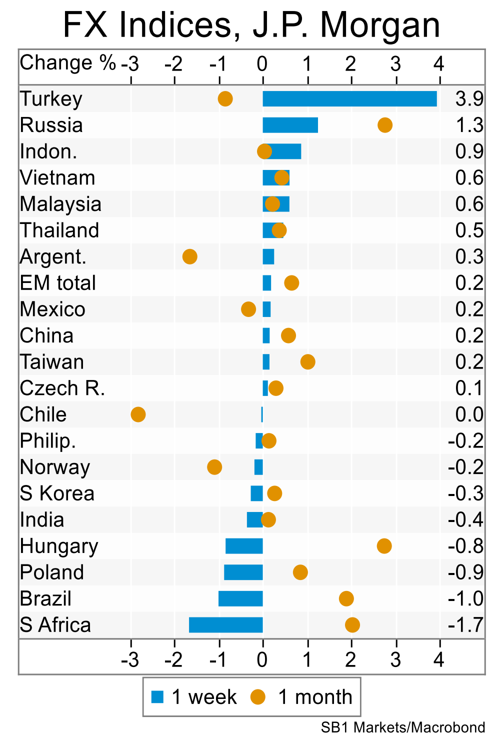
Both are up 11% - 13% since May 1st – but the NOK still 5% weaker than AUD since last spring



The EM f/x average up, probably supported by lower US bond yields







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