
21 June 2021

# Macro Weekly

## Week 25/2021

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Highlights, corona update

The world around us

The Norwegian economy

Market charts & comments

# Last week

## The virus

- **The delta variant** is gaining market shares, rapidly. In **UK and Portugal**, the delta is found in 96% – 98% of new cases, and the no. of cases in rising rapidly, even if 70% of the population UK is vaccinated (or have been infected). A second dose seems to be needed. Hospital admissions & deaths are up too, but not by much and the level (and rates vs. new cases) is still low
- **Elsewhere**, the no. of cases is falling most places. **Norway** may be flattening out, at a low level.
- **Mobility** is rising everywhere in DM as the negative drag from corona restrictions/cautious behaviour is easing – even in the UK

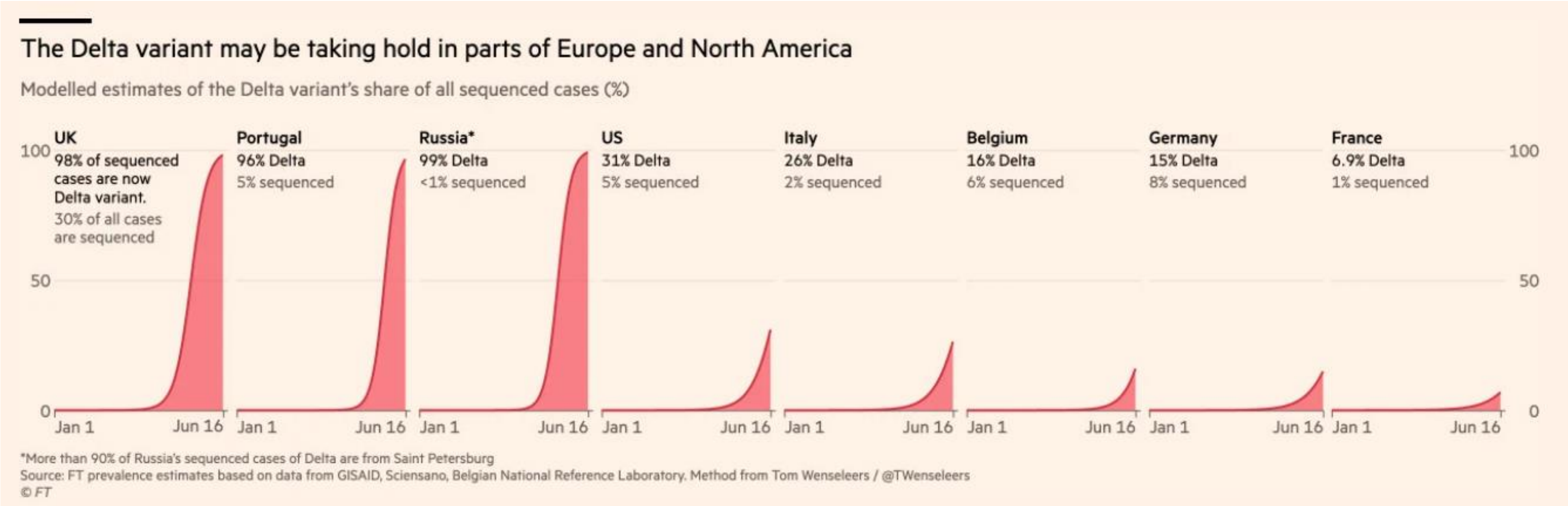
## The economy, part I

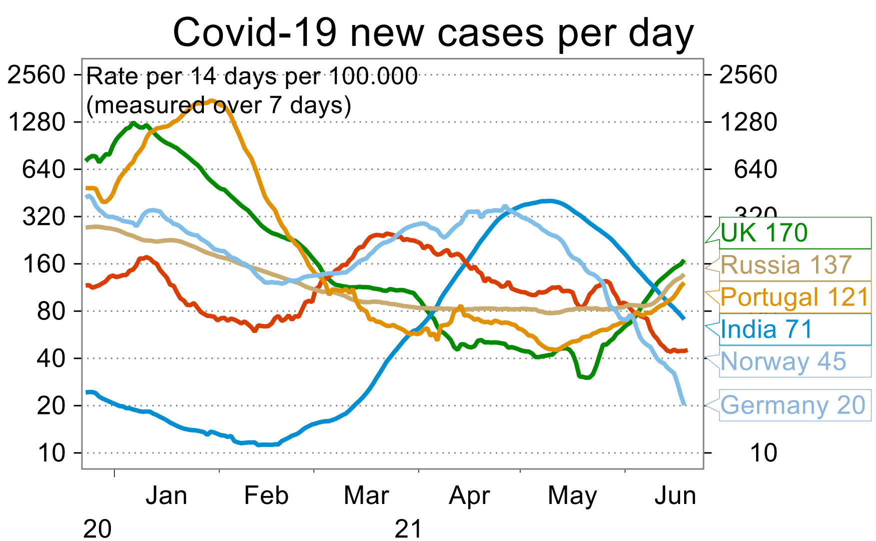
- **China**
  - » **May data** were weaker than expected, and growth in very likely slowing. A tighter credit policy, and a slowdown in credit growth may explain the slowdown, as can perhaps supply chain challenges (but this argument does not sit that well). Both investments, which were revised down, construction starts, and retail sales have slowed. Manufacturing production is still going strong, growth has just slowed to a pre-pandemic pace – while staying well above the pre-pandemic growth track. Imports have been strong too, and the recent weakness in exports is from an extreme high level
- **USA**
  - » **The members of Federal Reserve's FOMC** lifted their individual interest rate forecasts substantially, and the median member expects two hikes before Q4-23 (from none), and some members several more hikes – and almost half assume rates should be hiked in 2022. Growth forecasts were lifted marginally, and inflation forecasts substantially, at least for the 'transitory' 2021. We interpret inflation forecasts to be in line with Fed' new price level target, 2% inflation, as an average, over time. Governor Powell sounded more dovish than these forecasts, and said that *'we are still a ways from our goal of substantial further progress'*, even if he acknowledged that the economy has strengthened. The big uncertainty is how much spare capacity there is at the labour market. The Fed does not know, and neither do we. The next few months will yield extremely important new information. is at the labour market. The Fed does not know, and neither do we. The next few months will yields extremely important new information. Powell says the FOMC will announce well on beforehand before starting tapering (yes, they talked about it!). The short end of the curve rose sharply. When the dust had settled, the long end of the curve fell marginally (and implied rates 5 y 5y fwd fell sharply). A firmer Fed sent inflation expectations down, and real rates slightly up. The USD rose 2% last week (a 2.5 st.dev move). Stock markets did not enjoy the outlook for higher short term rates. But what about lower long bond yields?
  - » **Retail sales** fell more than expected May but April was revised up even more, in sum better than assumed/expected. Goods sales are far above a reasonable long term level. **Restaurant sales** finally climbed above the pre-pandemic level – and should grow substantially from here. **Housing starts/permits** have peaked, and **NAHB's Housing Market Index** declined further, and do not signal a new uptick in sales.
  - » **Manufacturing production** is trending upwards, and is now close to a (sharply downward) pre-pandemic level. The first **June manufacturing surveys** signal slower growth ahead (but far from slow!)

# Last week: The economy, part II

- **USA cont.**
  - The **producer price index** rose sharply, and more than expected. Not the best omen for consumer prices the coming months
  - **Household bank accounts** are swelling like never before, and over the recent years they have invested heavily in **equities and fund shares** too (which have been seen at parts of the market…). **Household debt** is rising faster, while growth in **corporate credit** is slowing, following the large jump last spring – but their **liquid assets** soared too
- **EMU**
  - **Inflation** is still muted, the core at 1.0% (revised up 0.1 pp). Total inflation is at 2%, mostly due to higher energy prices – and they will not rise forever
  - **Labour cost** levels have normalised, and underlying growth in moderate. However, the unit cost level has soared during the pandemic – but will hopefully be reversed the coming quarters.
- **UK**
  - **Annual inflation** rose sharply in May, both due to a price decline m/m last May, and a lift in prices in m/m now. The core climbed 0.6% to 1.9%, the headline to 2.1%. Inflation may decrease the coming two months (base effect) but we suspect a substantial lift in August, due to the base effect from last year's subsidy scheme
  - **Retail sales** fell 1.4% in May, expected +1.6%. However, since sales rose by 9.2% in April, and the may level is 9% above the Jan-20 level, we are not too worried
- **Sweden**
  - **House prices** are still soaring m/m and are up 18% y/y. And Sweden is not the only place, prices are up in **all OECD countries**, and have accelerated in 21 of 26 countries, vs. the pre-pandemic rate of appreciation. Sweden, Canada, UK, Norway and New Zealand has accelerated the most. We assume the impact of last year's cut in interest rates soon will fade
- **Norway**
  - **Norges Bank** kept the signal rate at zero, but that's all what markets got right. The Bank lifted the interest rate path even more than we expected, and far above the FRA-rates ahead of the meeting. NoBa signals close to 4 hikes the before June next year, and 2 more before until mid 2024, following an up to 33 bps lift of the rate path. The economic outlook is strengthened, broadly, oil is up, and wage inflation is once more revised up. NoBa will hike rates even if inflation is, and is expected to remain below 2% because the activity level is expected to be well above normal and in order to reduce the risk for (further) build-up of financial imbalances. House price inflation is expected to come to a halt. Norges Bank is the most flexible inflation targeter of all central banks. Will others follow? Some should… FRA rates rose sharply but are still well below NoBa's new path
  - **Home builders** report still decent new home sales & starts

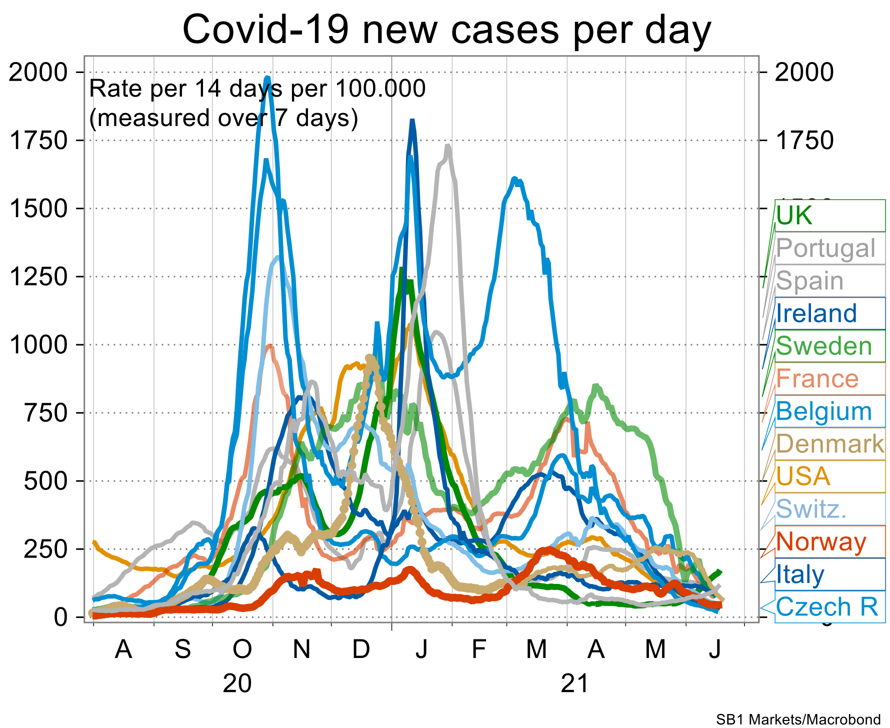
# The delta virus will take the market everywhere, and it may come a challenge

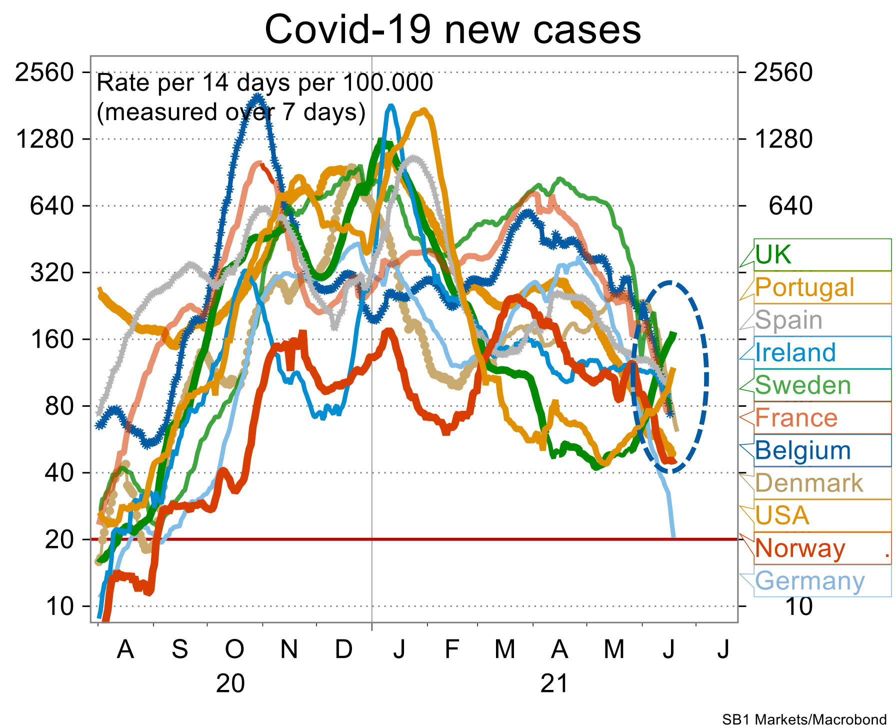



Source: SB1 Markets/Macrobond

# So far, cases in most other countries are rapidly on the way down

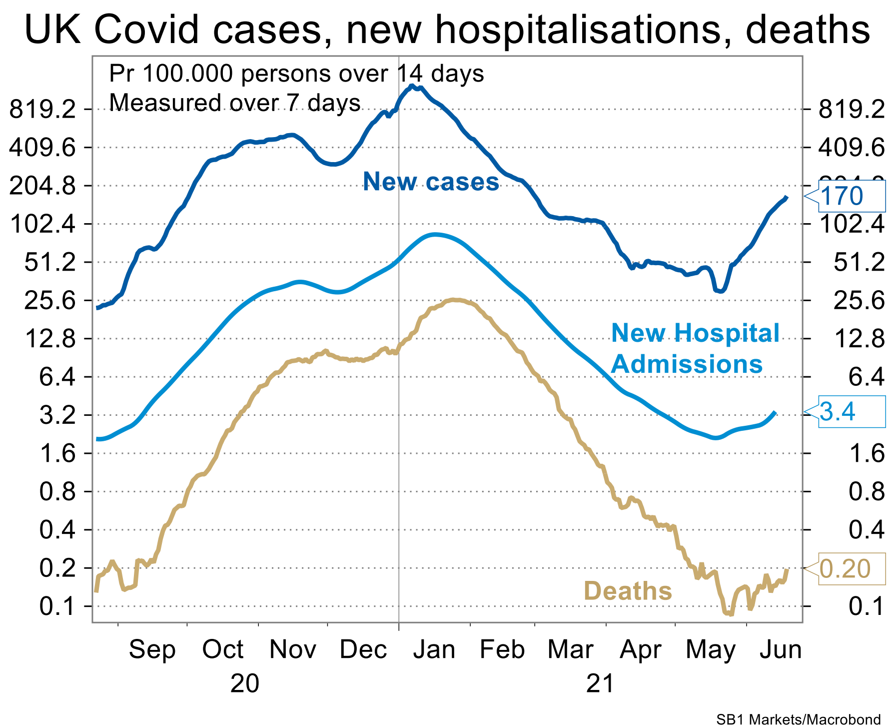


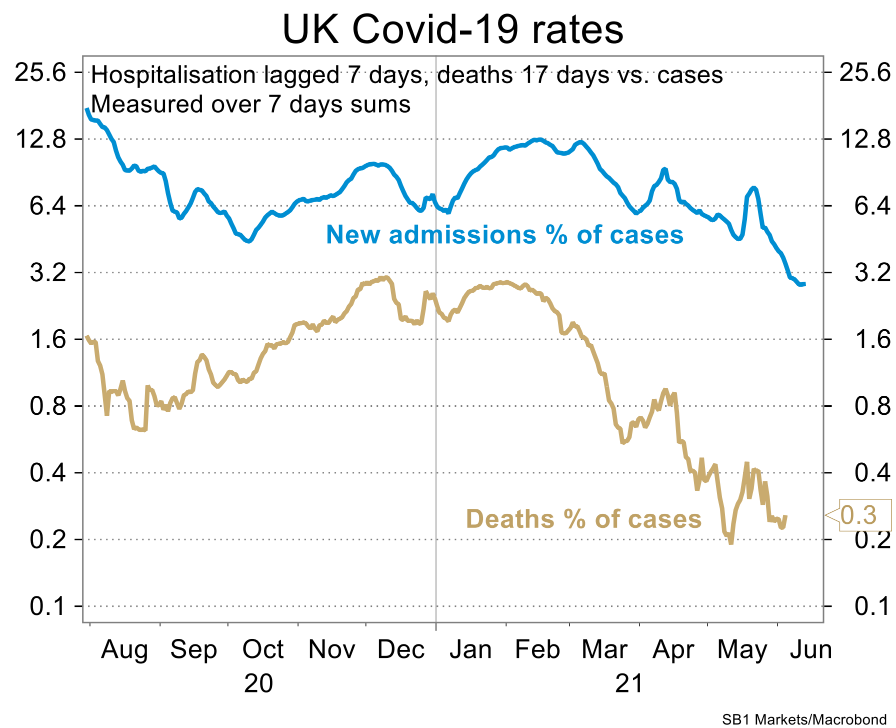




- **The UK** has reported a sharp increase in new infections, at least partly due to the new Indian mutant, which in some few weeks has gained a 98% 'market share'. The new variant is far more contagious (some now say 60%) than the British variant (which was substantially more contagious than the original 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 (but down to 1.2 last week). Portugal is reporting rapid increase to (and have 96% delta share). More on hospitalisations next page
- Will the delta virus spread to all countries? Most likely, but Demark has been able to contain it, so far
- **Other corona virus news are good**: Cases down all other places. That have not yet have a large share of the delta variant…
- 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: Still a moderate increase in new hospital admissions, deaths

... And from very low levels, compared to before the vaccination process




- If current hospitalisation/death rates are sustained, UK could live with a substantial increase in new cases before any serious health crisis occurs
  - » New cases are still at 1/8 of the level from early January – it will take 7 weeks to get to the same level, at the current growth pace
  - » If so (and we do not think it is that likely), the no. of hospital patients may be 1/3, and deaths 1/10 vs the January levels
- However, both hospitalisations & deaths numbers (and rates) are lagging, so surprises are still possible

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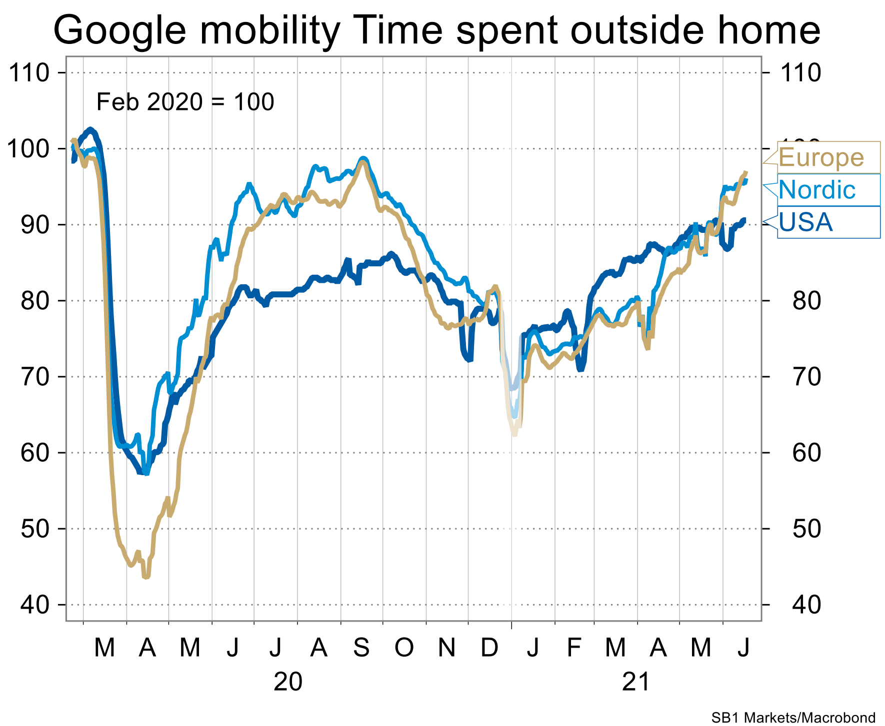
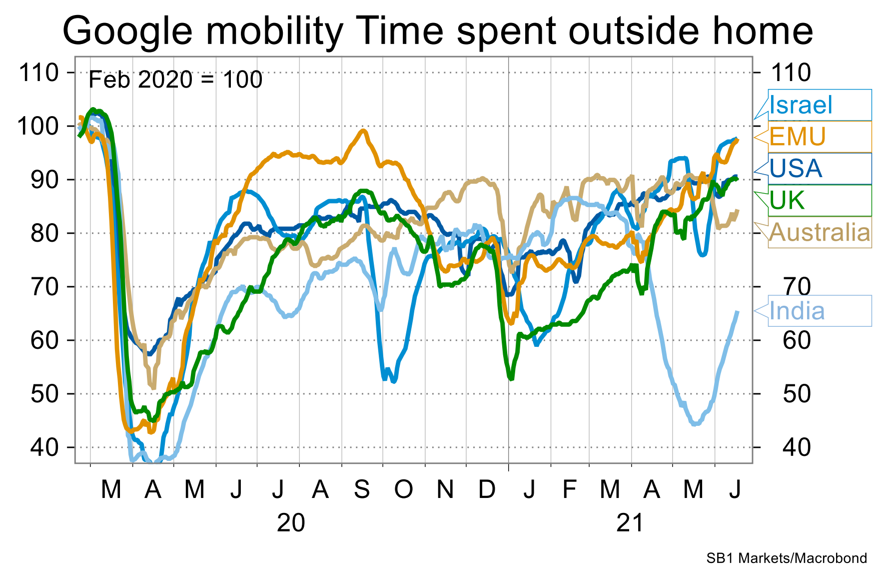
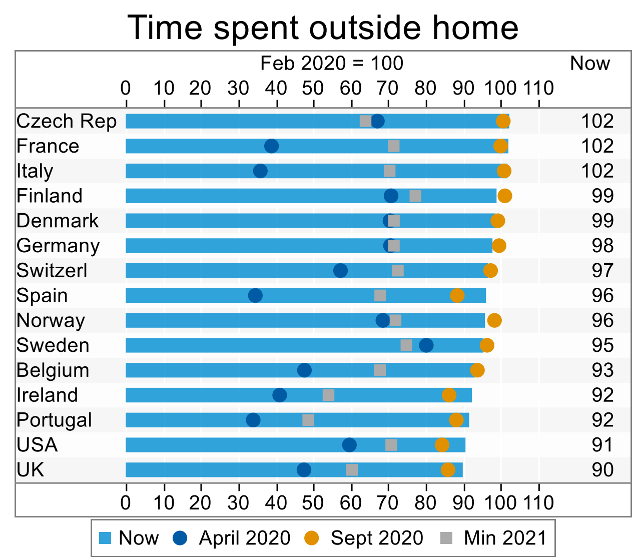
# Mobility on the way back to a normal level – sharply up in Europe (Nordics incl.)

Even India turned up in the past two weeks



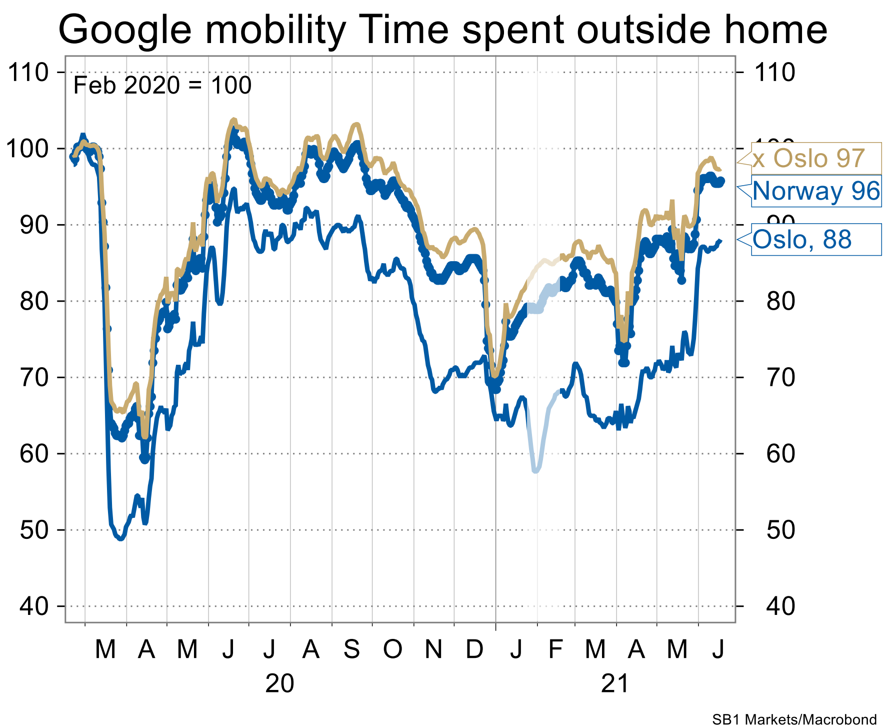



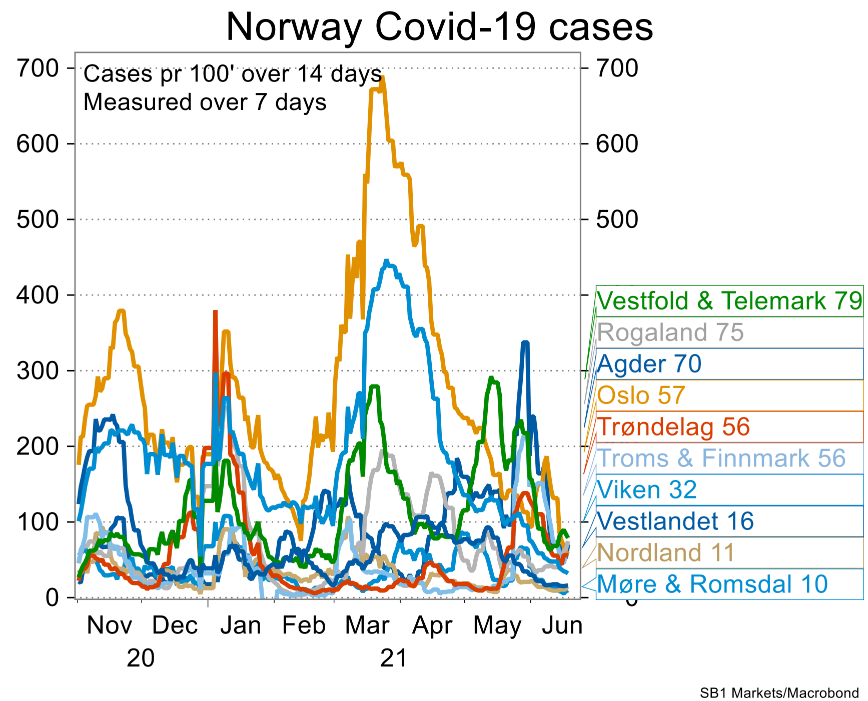




- Mobility still some 5% - 10% below par – still more some upside left

# Summer in the air – mobility almost as normal most places in Norway

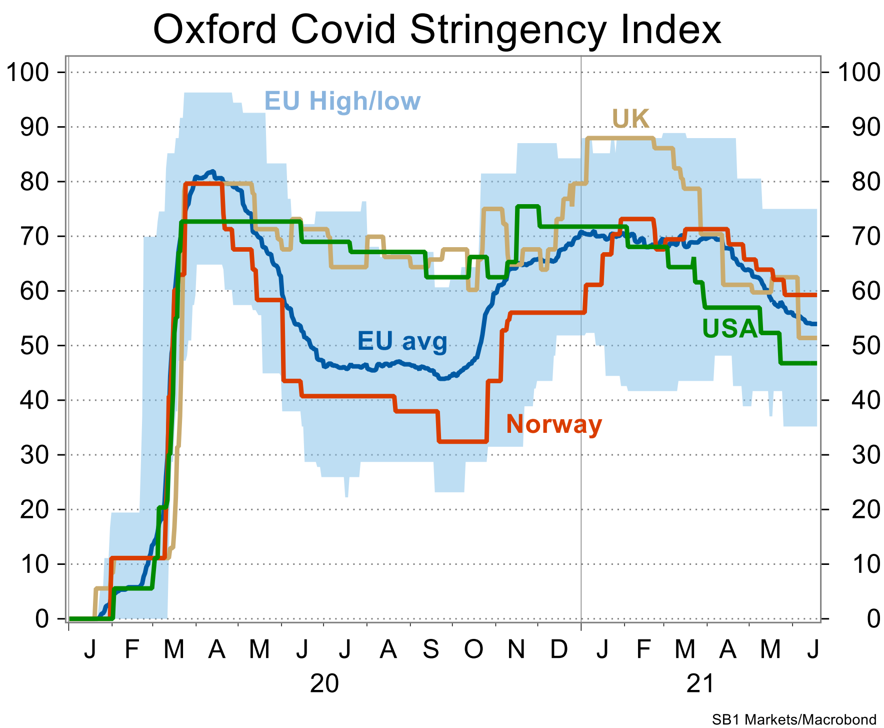
Oslo still 12% down, according to Google. Low level of infections everywhere (county aggregated)



# Restrictions are eased but most are still in place

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

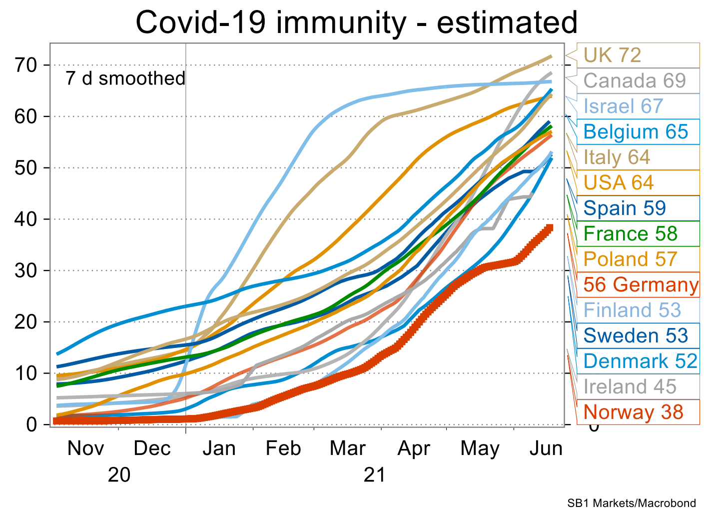


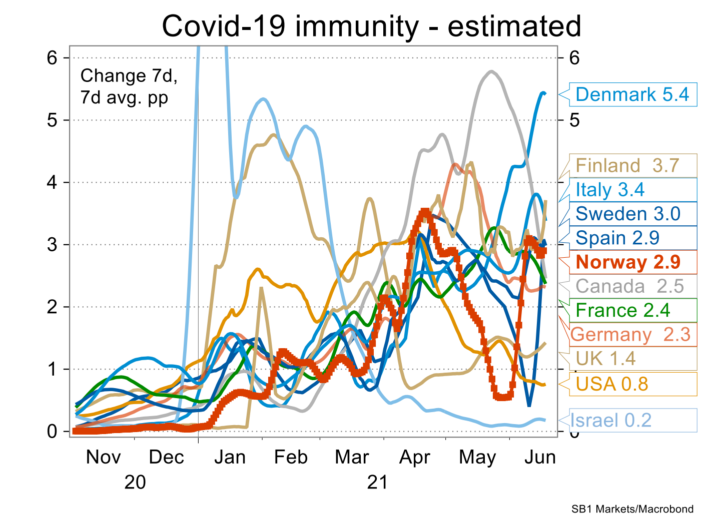

- The removal of restrictions are quite parallel among rich countries – but the UK has tightened marginally amid the 'delta' attack
- The remaining measures will be eased when the immunity rate is sufficiently lifted to keep even mutated viruses at bay

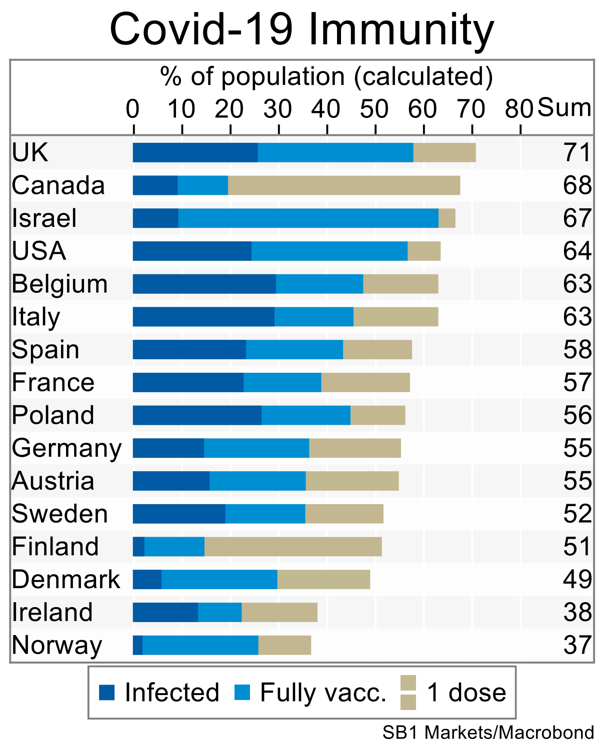
- Data are from the Oxford Covid stringency project, that at least are the best at hand

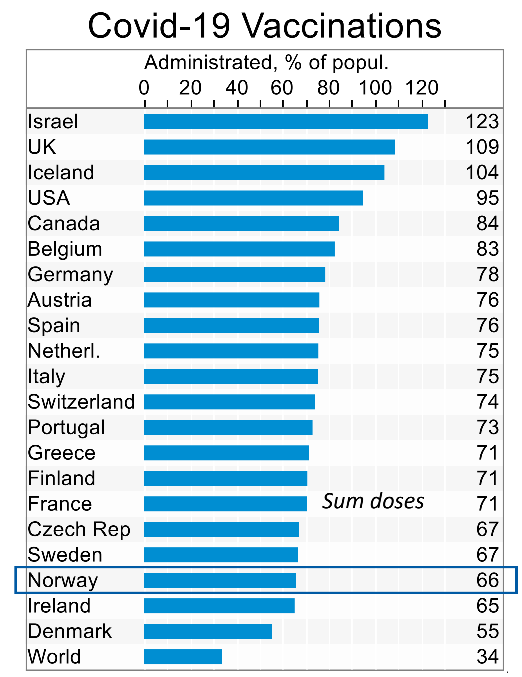
# Vaccinations: On the way up, UK is speeding up again, for good reasons

## Norway is a laggard, as we not use AstraZeneca or Johnson & Johnson's vaccines




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. Denmark not fully updated

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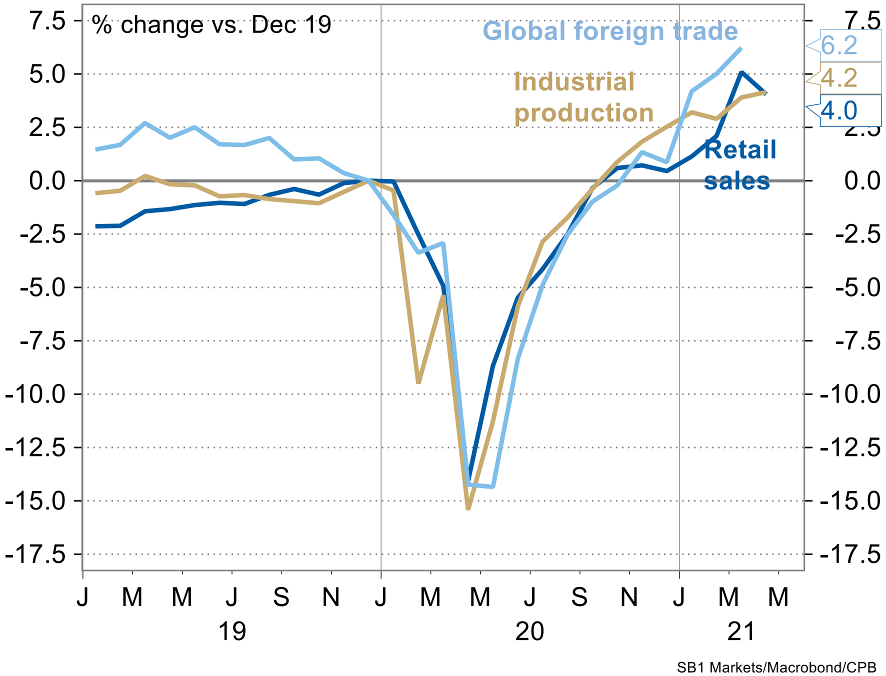
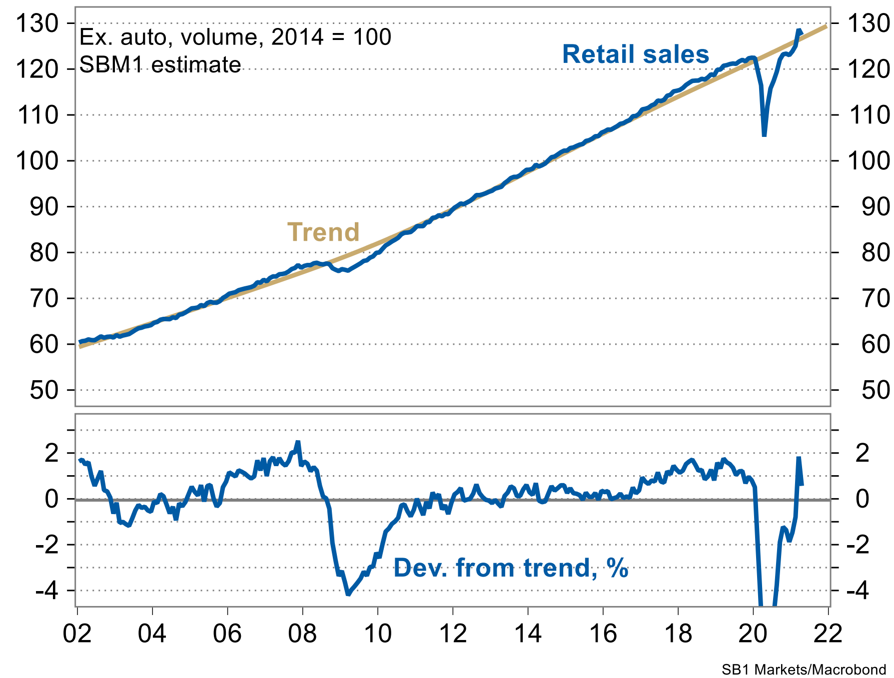
# The recovery in the goods sector continues – level up 4% vs pre Covid

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

Global Retail sales, industrial prod. & trade



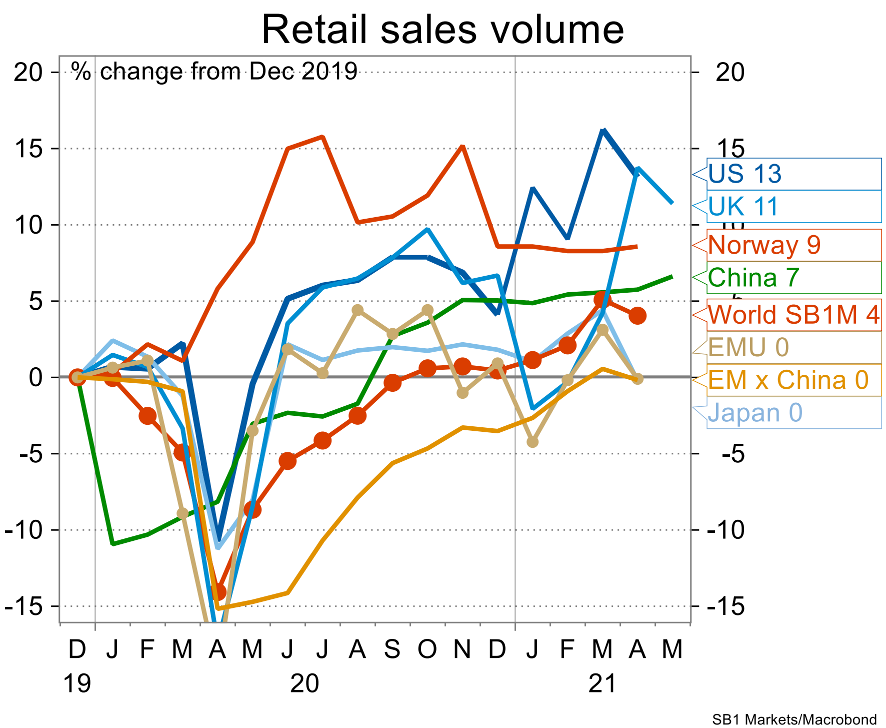

Global retail sales volume

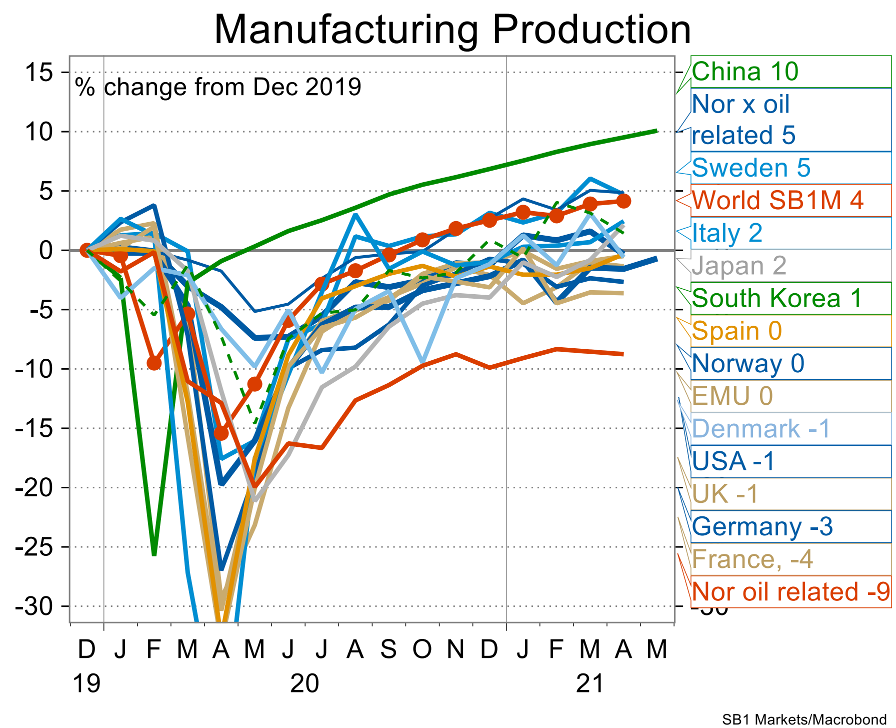



- **Retail sales** rose almost 3% in March, mostly due to the lift in US and partly also EMU retail sales. Our April estimate implies a 1%+ decline, due to lower sales in the US and (more than we assumed) in EMU, and very likely in India. Global sales are almost 4% above the pre-pandemic level
- **Manufacturing production** rose more than 1% in March, and another 0.5% in April – and is +4.2% 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

.. At least until we can spend more money on services



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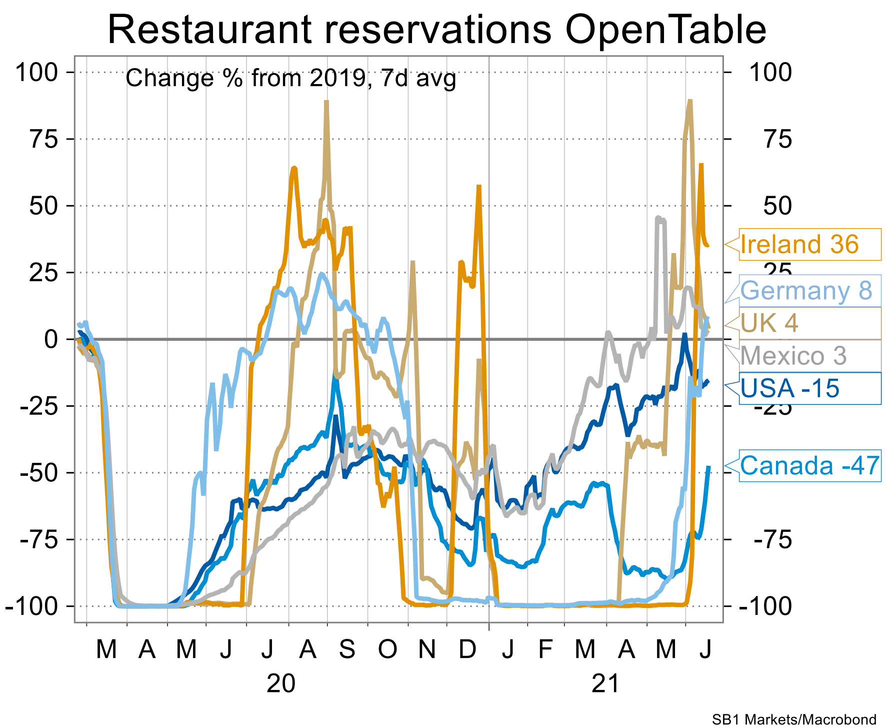
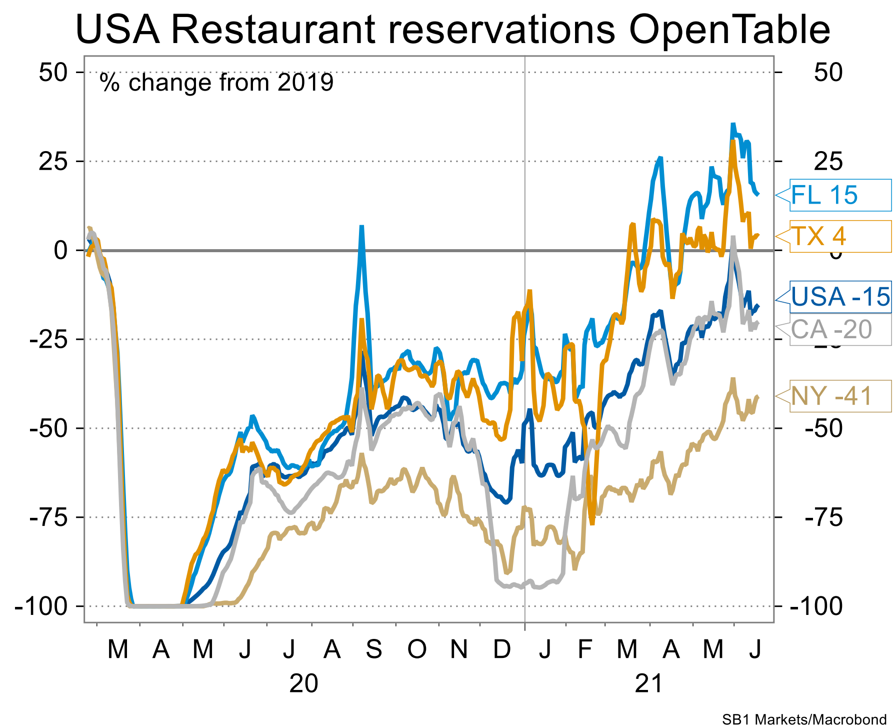
# Sill, no 'delta lockdowns' to be seen

People return to restaurants as soon as it is possible!

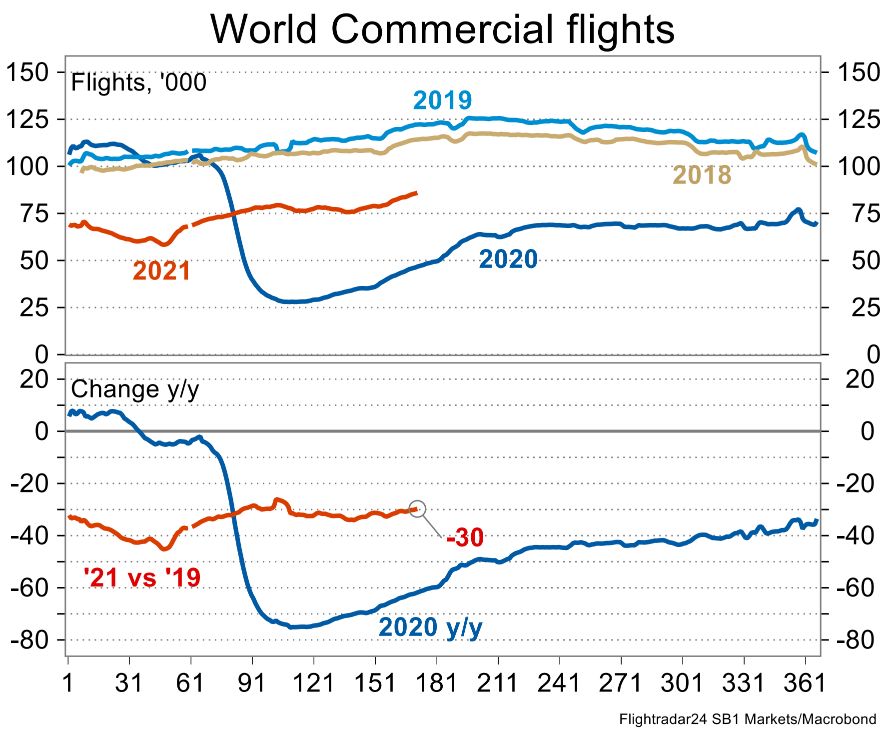


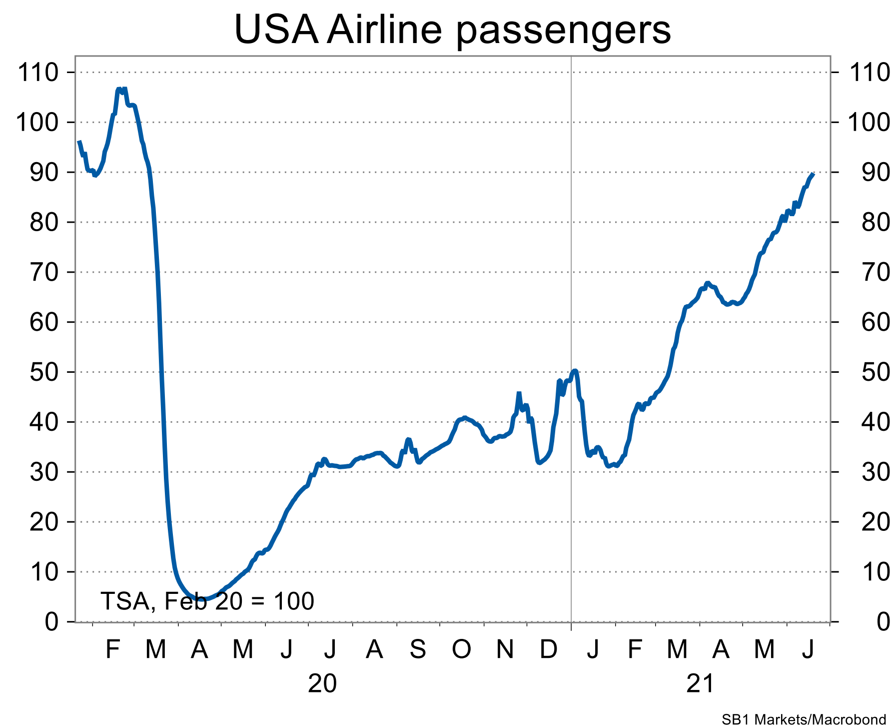




- Sales in restaurants in the US were up 2% in April vs. the Feb-20 level, far better than indicated by OpenTable data (at least in value terms)

# Global airline traffic on the way up again. US straight up, just 10% below par

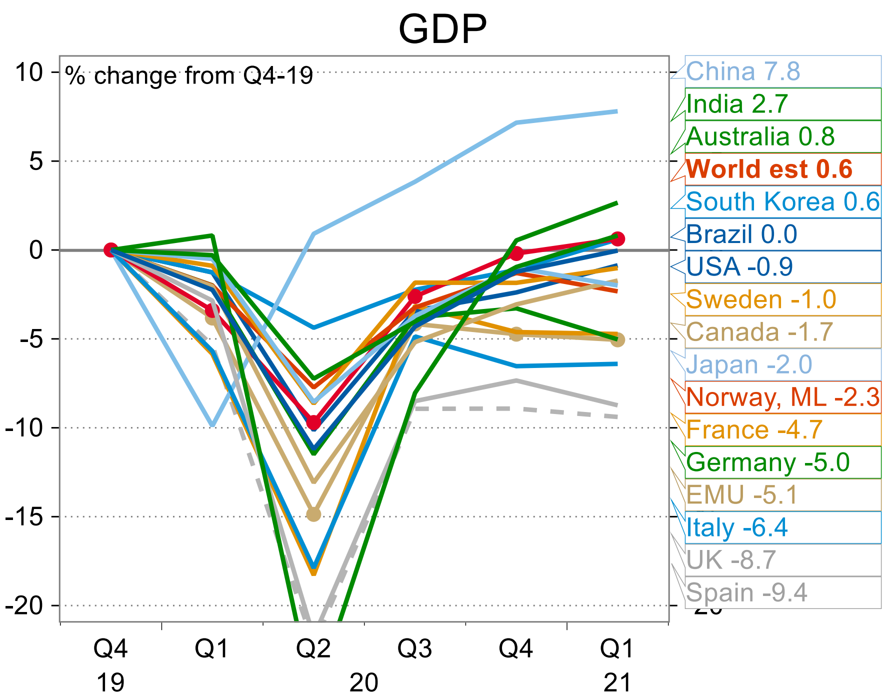
… even if international traffic is still in the doldrums

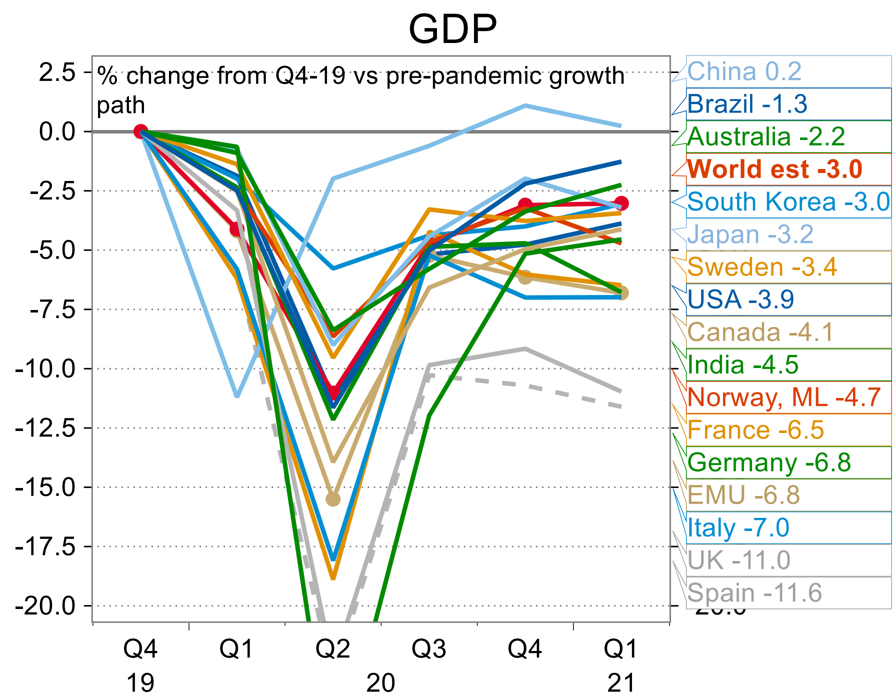


# A 3%+ global GDP growth pace in Q1, level 0.6% above Q4-19

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



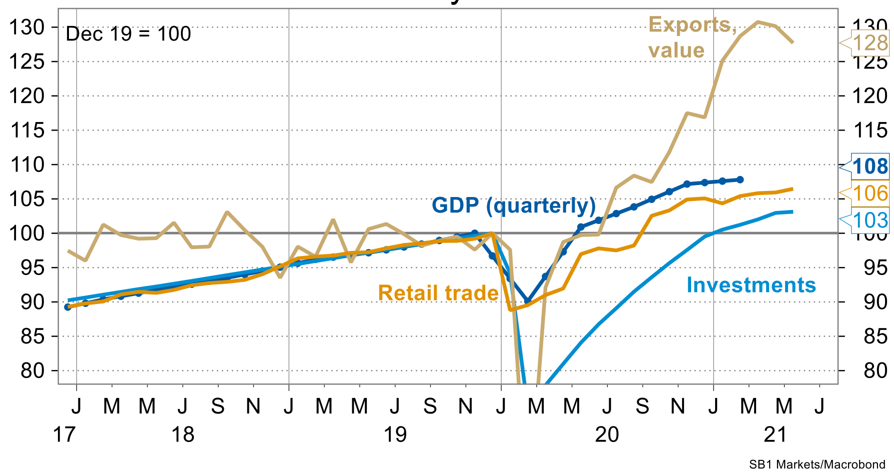

- Following an 8% growth pace in Q4, we estimate 3.2% growth through Q1 (0.8% not annualised)
  - GDP growth in **China** slowed to a 'trickle' (a 2.4% pace…) in Q1, and GDP in the **EMU** contracted further
  - In the **US**, GDP grew at a 6.4% pace in Q1, up from 4.3% in Q4 – and the level is just 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% 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)

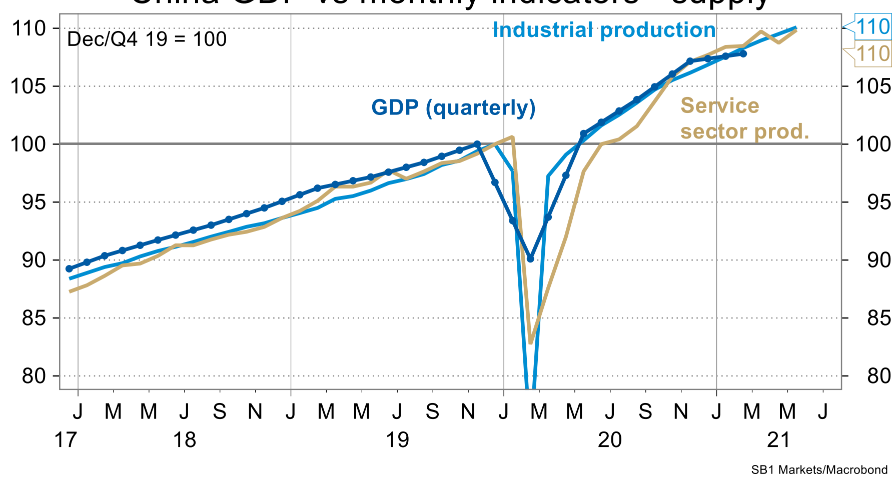
# May data signalling a growth slowdown

## All major data surprised on the downside. May be due to the credit tightening

China GDP vs monthly indicators - demand




China GDP vs monthly indicators - supply

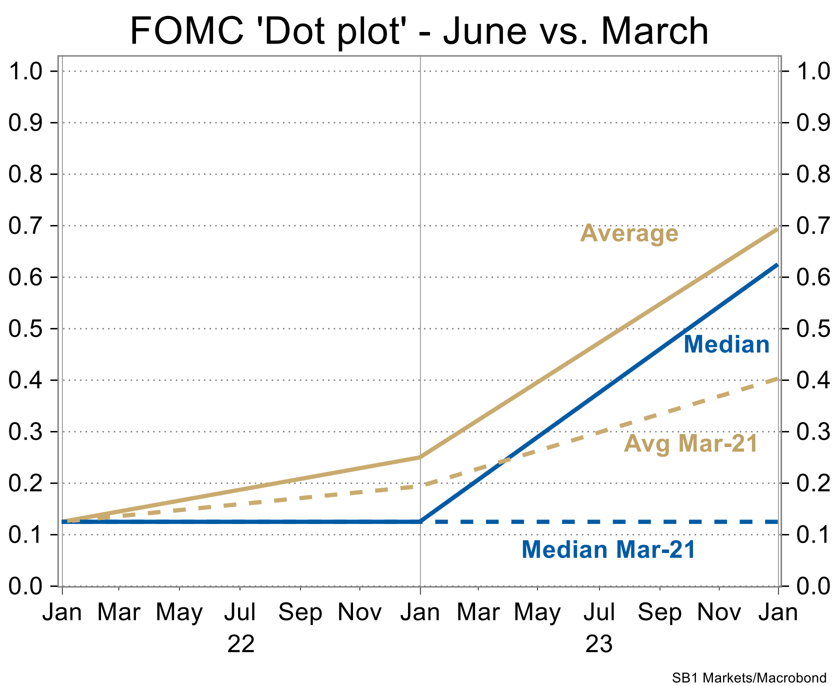



- **Industrial production** rose 0.5% in May, unch. from April. Measured y/y, production is up 8.8%, 0.2 pp below expectations Production is 3% above the pre-corona trend path but growth has finally slowed to the pre-pandemic level, as we expected
- **Service sector production** recovered the surprising April low, rising 1.0%. In sum, growth has been some 5% the past 6 months, in line with growth ahead of the pandemic, after slowing through 2018 and '19. The level is back on track vs the pre-Covid trend path
- **Retail sales volumes** rose 0.5% in volume terms (our est.), from zero in April, and a decent growth rate, and in line with the pre-Covid growth pace. However, sales have on average been growing slower since November, at just a 2.5% annualised rate. Sales were 1.6 pp below expectations (12.4% y/y, vs 13.8%)
- **Investments** were revised down since December, by 1 pp per month to below 1%, and investments grew just 0.2% in May. The level is suddenly 3% below the pre-pandemic trend growth path (we assumed the gap was closed in April, but that was not the case. The (useless) accumulated annual growth rate was 15.9% in May, 0.5 pp lower than expected. Housing and other construction starts have fallen 5% – 10% since last summer, and the downward revision was not that surprising. New home sales may have peaked too but remain well above housing starts, signalling an inventory drawdown
- **Last week: Credit growth** was a tad higher in May than in April, but the trend is clearly down, and the credit impulse has turned definitively negative
- **CPI inflation** is on the way up, but is still moderate. Producer prices are soaring (which is felt more outside China than inside)
- **Imports** remained strong in May but exports have slowed somewhat past two months, however the level is sky high

**In sum: China is probably slowing, and we are not sure we can blame some local Covid outbreaks**

# Growth and even more inflation forecasts revised up

## …and the FOMC members now expects to raise rates two times in 2023



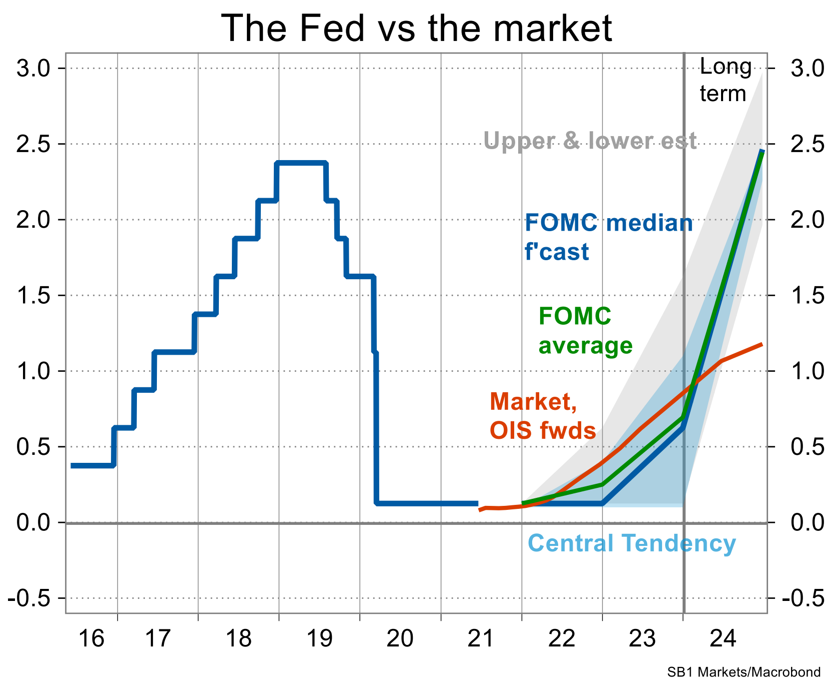

The market is pricing in the first hike in the signal rate at the end 2023

- The FOMC left the **target rate** unchanged at 0-0.25%. No change on the **QE volume** either, USD 120 bn per month in Treasury bonds (80 bn) and mortgage bonds (40 bn) – everything as all expected
- The FOMC acknowledged *'Amid considerable progress on vaccinations, the unwinding of social distancing, and strong policy support, participants assessed that risks to the outlook were no longer as elevated as in previous months.'* In addition the wording that '*the pandemic is weighing on the economy'* has been removed, but the committee still remarks that the pandemic remains a risk
- **Growth estimates** were revised further up, albeit not as much as at the previous meetings. However, the **inflation forecast** for the present year was revised sharply upwards, the core up to 3% from the 2.2% March forecast. The 2022 inflation forecast was nudged up by 0.1 pp to 2.1%. The **unemployment forecast** was close to unch, at 4.5% in Q4-21 and 3.8% in Q4-22. The long term 'natural' rate is assumed to be 4%. 'Mechanically' – measured by the unemployment rate – maximum unemployment could be reached in H2-2022
- As a consequence, the **dot-plot**, the individual members' estimate for the future fed funds rate, changed substantially
  - » 7 of 18 members (from 4) expected fed funds to be lifted in 2022 (median zero, the average 12,5 bps)
  - » 13 members expected the fed funds rate to be lifted 2023, up from 7 in March. Of these 13, 11 assumed more 2 hikes or more. 2 hikes is the median estimate, 8 expected 3 or more hikes and 2 members assumed 6 hikes (BTW slightly more than NoBa assumes ☺)
- At the press conference, governor Powell sounded far more dovish than these estimates suggests. He even downplayed the dot-plot as way of communicating expectations. '*They're not a Committee forecast, they're not a plan. And we did not actually have a discussion of whether lift-off is appropriate at any particular year, because discussing lift-off now would be highly premature, wouldn't make any sense'* (The future interest rate path) '*is highly uncertain.. So dots should be taken with a big grain of salt'*
  - » Powell is most likely right. But how should central banks then communicate? Probably like Powell does, by stating the bank's objectives and response function, and decisions depending on data – rather on dates based on 'highly uncertain' assumptions of the future

More next page..

# This was the talking about talking about tapering meeting

## … but we are still a ways from our goal of substantial further progress, Powell says

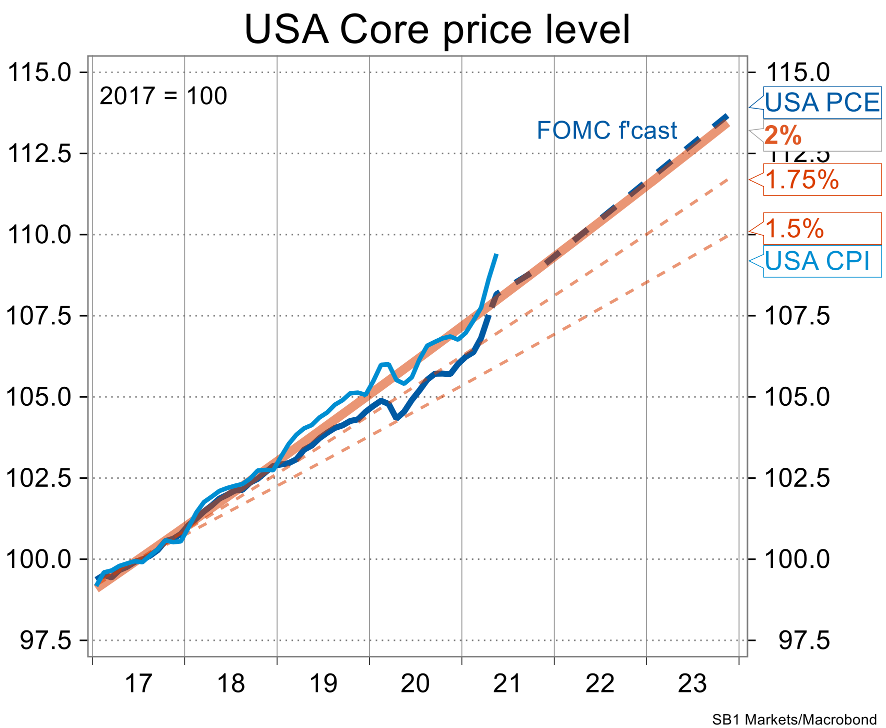


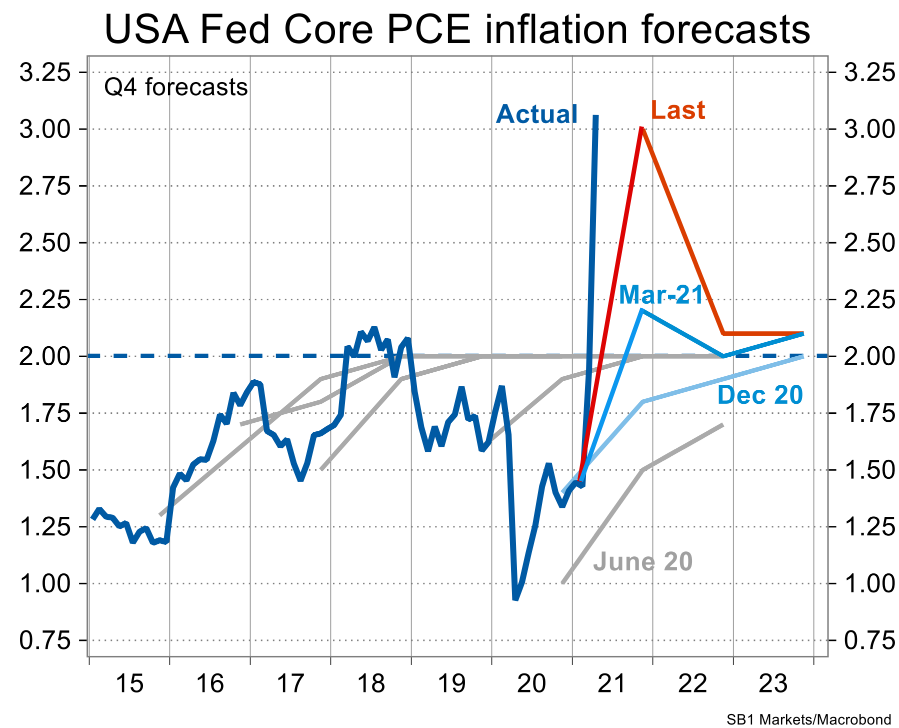

The market is pricing in the first hike in the signal rate in late Q3 or Q4-22. In addition two more hikes are discounted by end of Q4-23

- *You can think of this meeting as the 'talking about talking about' meeting, if you like. . . . The economy has clearly made progress, although we are still a ways from our goal of substantial further progress. . . . Assuming that is the case, it will be appropriate to consider announcing a plan for reducing our asset purchases at a future meeting"* , Powell said at the press conference
- More formally, Powell reiterated the FOMC '*continue to expect that it will be appropriate to maintain the current 0 to ¼ percent target range for the federal funds rate until labor market conditions have reached levels consistent with the Committee's assessment of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time*'
- Well, **inflation** is well above 2% and the FOMC expect to remain above for a while (but still transitory above). Fed has not stated for how long or by how much inflation should stay above 2% for this goal to be achieved. Powell's comment suggest that the target is not yet met even if inflation measured over 2, 3 or 5 years now is close to 2% (and that the target in fact is met). In the Q&A, he stressed the need for discretion when assessing whether inflation on average has been close to 2% or not
- **On the employment side,** Powell recognised some uncertainty vs how far away the FOMC was from its maximum employment target but emphasises that likely bottlenecks as the economy reopened most likely would sort out over time, like when covid-19 retreats, and the temporary unemployment benefit programs will expire from now until September. However, more people had retired, lowering the participation rate for a longer period
- On the other hand, Powell assured there should be no doubt that the Fed will use its tools should inflation start to creep up above the long-term target
- **Powell** promises to announce well on beforehand before any policy shift takes place
- **The timing of both tapering and lift off in rates** is moved forward but the timing is still uncertain (of course). The range of views inside the FOMC are wide – and we look forward to read the minutes in two weeks time
- **We** still think that actual inflation data are not the most important for the Fed than the labour market & wage inflation. It is still too early to know the balance in the labour market in late Q3 or into Q4. If a tsunami of workers have not turned up, policy will rapidly have to change course. The need for stimulating the housing market by buying USD 40 bn in mortgage backed bonds per month is hard to see anyway – and here some sort of tapering could take place pretty soon (but still well announced)
- **Markets rates rose sharply, and the market discounts 3 hikes before end of 2023**

# Fed lifts the 2021 inflation forecast sharply – and core PCE will remain above 2%

## Q4-21 inflation expected +0.8 pp to 3%, ’22 up just 0.1 pp to 2.1%

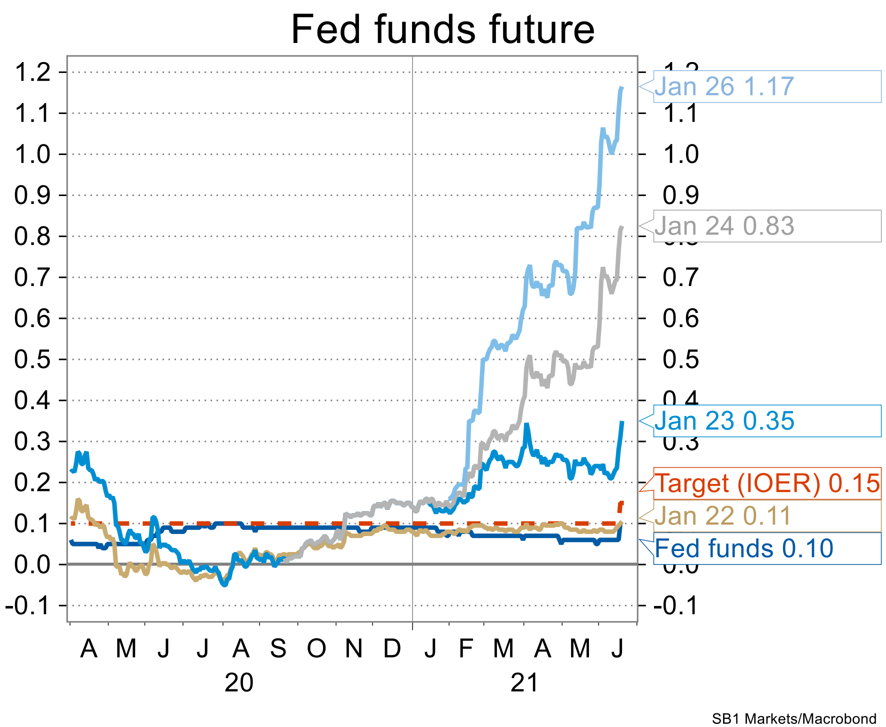


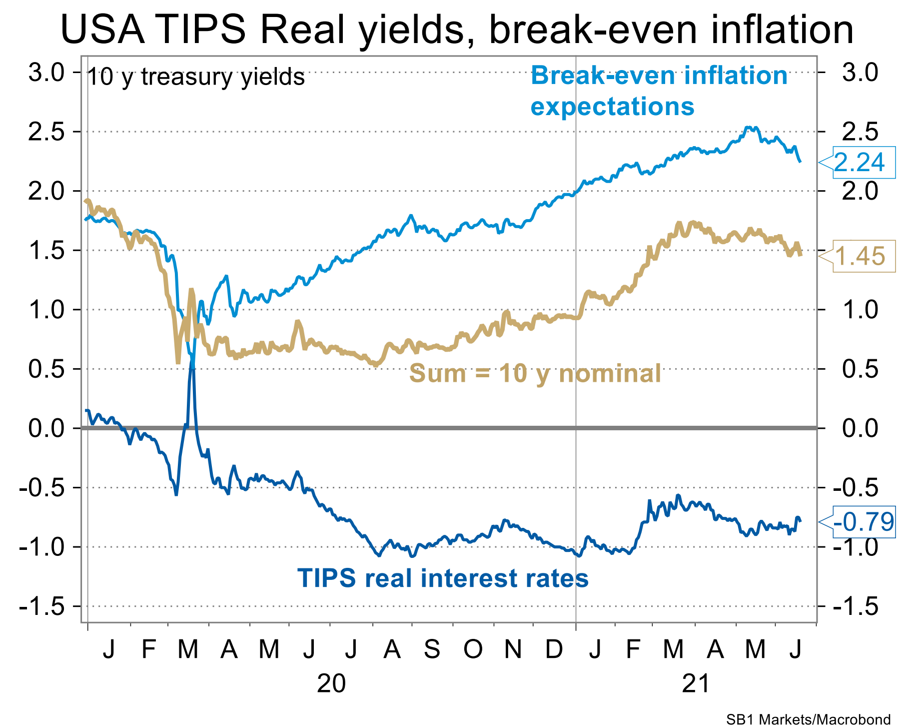




- Last year the FOMC introduced its new price level target. The bank aims to reach an average rate of inflation of 2% over time. If inflation has been below 2%, annual inflation should be allowed to stay above 2% in order lift the price level up to the long term 2% path
- The FOMC members (median) now expects core inflation to overshoot 2% in 2021, by estimating 3% y/y in Q4. Still, the core PCE price level will be in line with a reasonable long term 2% per year price target path (if starting in 2017 or 2018), and remain close to even in price inflation stays at 2.1% through 2022 and 2023. (It the 2% price level paths starts in 2019 the price level would be slightly above target). The Q4-21 estimated is based on an assumption of 0.13% m/m price growth from June, lower than the average 0.18% forecast for the following two years.
- Powell was not willing to tell how many years back the FOMC started its calculation of the proper price level, he would rather make discretionary assessments on when the target is met

# Now we are talking! The short end of the curve up by 15 bps!

The market is now discounting the <u>first hike late Q3-22, and 2 more hikes in 2023</u>




- .... In the long end of the curve yields fell – due to a further decline in inflation expectations, in total by 8 bps last week (10 y gov). Since March, inflation exp. are down by 30 bps! The Fed has turned less dovish
- Real interest rates rose by 6 bps, as the market now expects a slightly less dovish Fed. Still, the 10 y real rate is at -0.79 bps. And the 5 y rate is at -1.48%, though up from ATL at -1.91% in early May (just before the first 'tapering' signal came from the Federal Reserve (in the minutes from the April FOMC meeting)

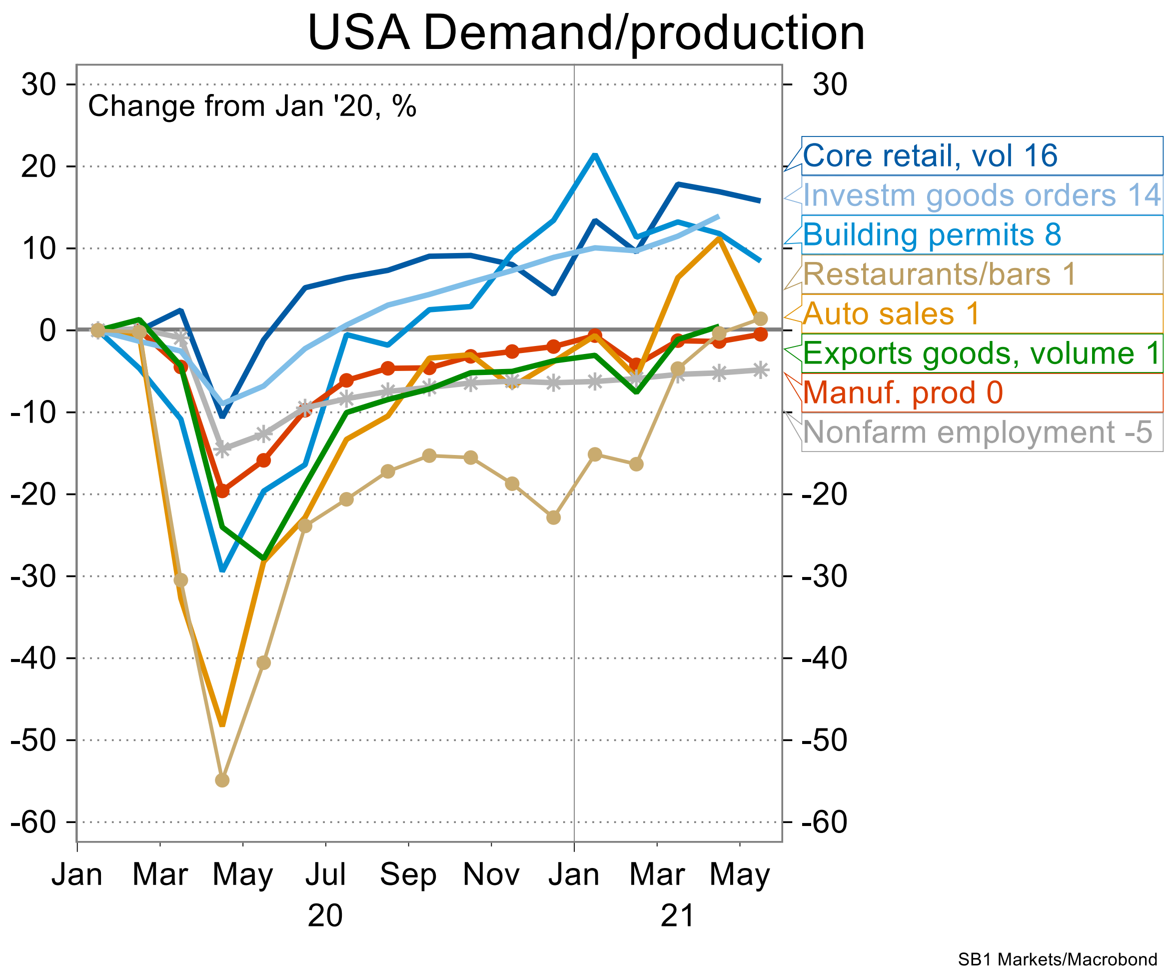
US & Germany 10 y Gov bond yield

| | Yield | Change 1w | Change 1m | Min since April-20 |
|---|---|---|---|---|
| **USA nominal treasury** | 1.45 | -0.02 | -0.19 | 0.52 |
| .. break-even inflation | 2.24 | -0.08 | -0.28 | 1.06 |
| .. TIPS real rate | -0.79 | 0.06 | 0.09 | -1.08 |
| | | | | |
| **Germany nominal bund** | -0.20 | 0.09 | -0.09 | -0.65 |
| .. break-even inflation | 1.46 | 0.01 | -0.11 | 0.40 |
| .. real rate | -1.66 | 0.09 | 0.02 | -1.76 |

SB1 Markets/Macrobond

# Growth is not accelerating

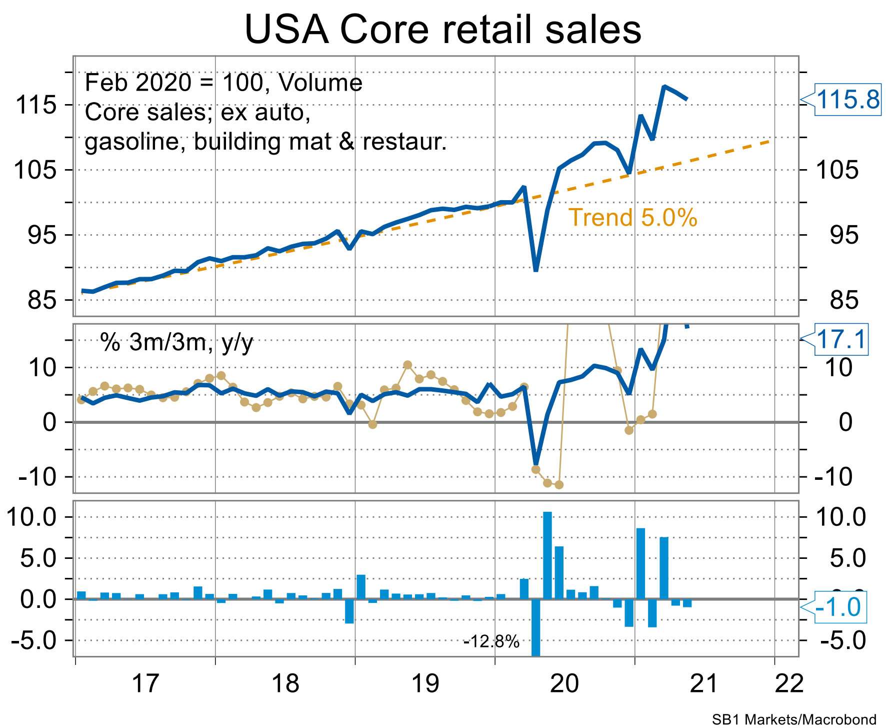
Retail sales, building permits have slowed, from high levels

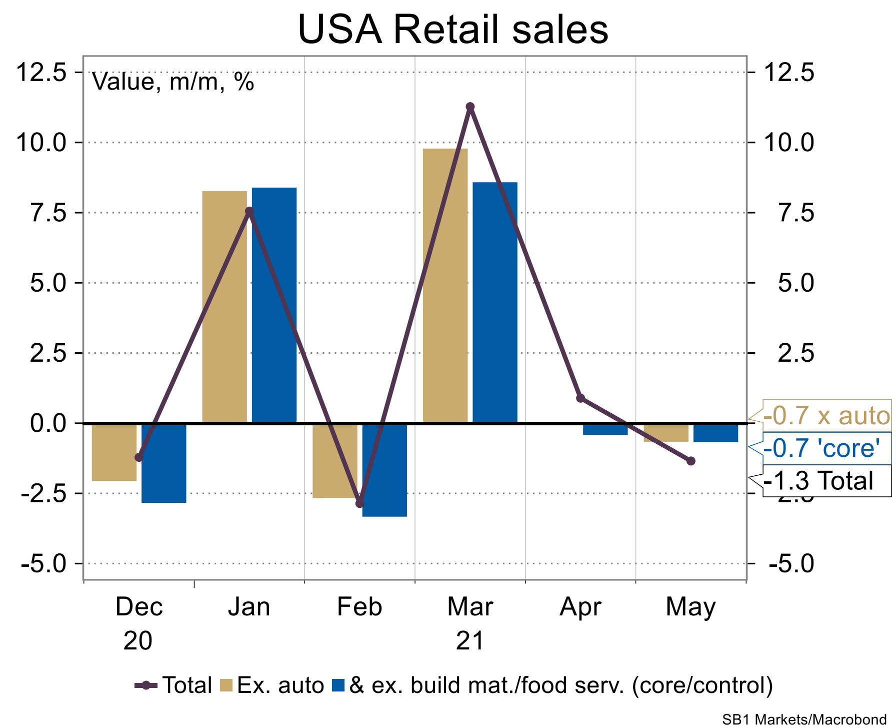



- **Retail sales** of 'core' goods fell in both April and May but in sum less than expected, as April was revised substantially up
- **Restaurant sales** finally crossed the pre-pandemic level, in value terms
- **Building permits** have trended down since the January peak, but remains strong
- **Manufacturing production** is back to the Jan/Feb-20 level
- **Investment orders** are still on the way up, and far above the p-p level (data until April)
- **Exports** are climbing too, and are finally above the p-p level too
- **Employment** growth still strong, but not given the low employment level and the the unprecedented number of unfilled jobs

# (Real) Retail sales down in May too but still incredibly strong!

## We expect a further decline the coming months, sales volumes are still 16% above the Feb-20 level!

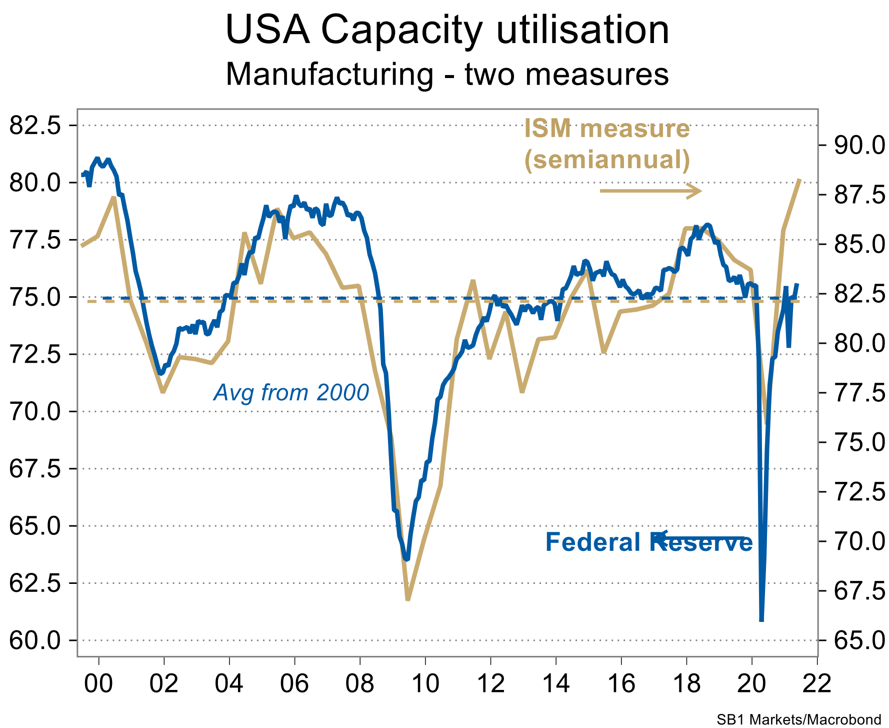



- **Total nominal sales** fell by 1.3% in May, expected down 0.8%. However, April was revised up to +0.9% from zero, and the level in May was well above expectations, and April + May even more so – signalling a very robust growth in private consumption in Q2. Nominal sales are up 18% vs. the pre-pandemic level!
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) fell 0.6% in May, expected down 0.7% but April was revised up by 1.1% to a 0.4% decline. We assume a 1% volume decline in May (2nd–hand autos are not included). Core sales are up 16% vs. the pre-pandemic level. The downside is substantial the coming months/quarters
- Sales in restaurants & bars rose 1.8% m/m and is 2% above the Feb-20 level! Most other sectors were down
- Retail sales – and other consumption – have received a real boost from the **two rounds of stimulus cheques**, the first distributed in January and the second in March and April. Just a fraction of the received amounts have so far been spent – and savings have increased substantially

# Is capacity utilisation at average or at ATH?

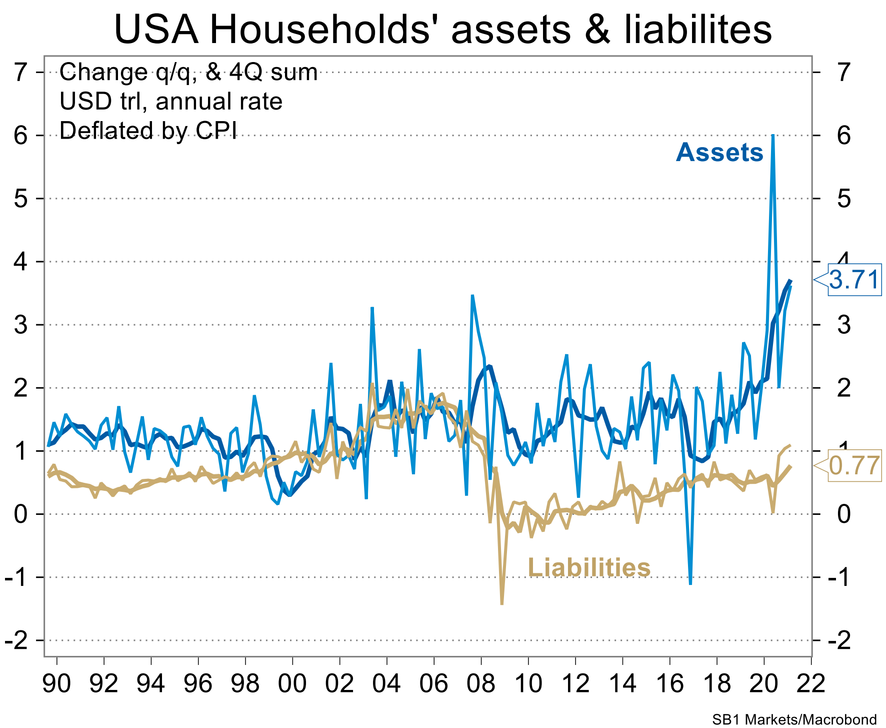
## Not an irrelevant question

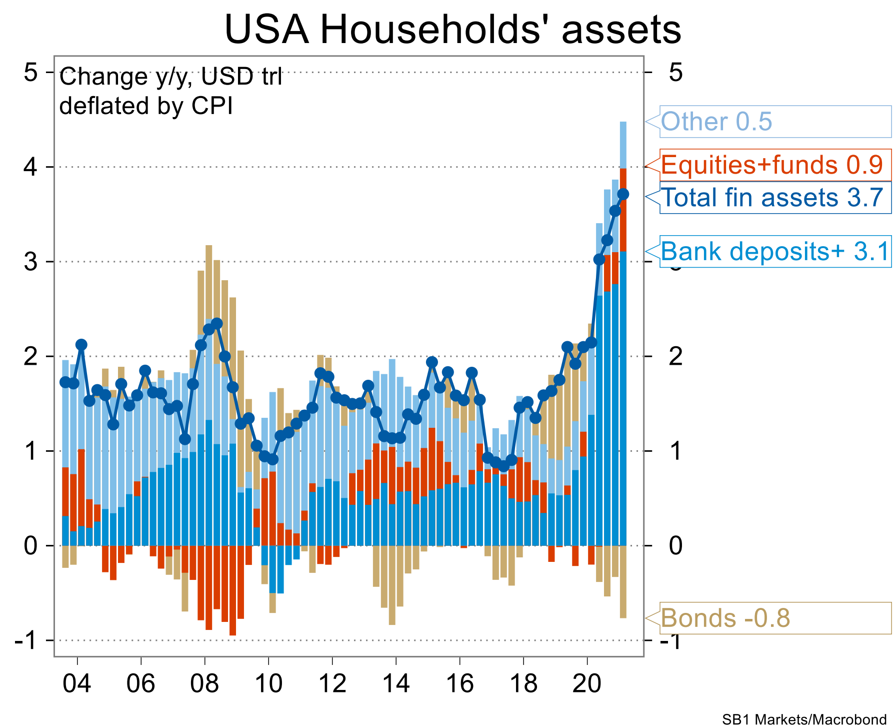



- **The Federal Reserve's** measure now yields a slightly above normal capacity utilisation rate, in line with the pre-pandemic level
- **ISM's semi-annual** survey reported a further sharp increase in May, the highest level ever – however with data just back to year 2000. These two measures have not been 100% correlated but the current discrepancy is very large – and quite important when assessing the growth outlook
- The Fed's estimate is model based, as far as we know, while the ISM survey is based on companies assessment of their own capacity
- Given reports on labour shortages, material shortages, prices, the ISM survey seems to give the most reasonable result

# Flow of funds: Where are the saved money invested?

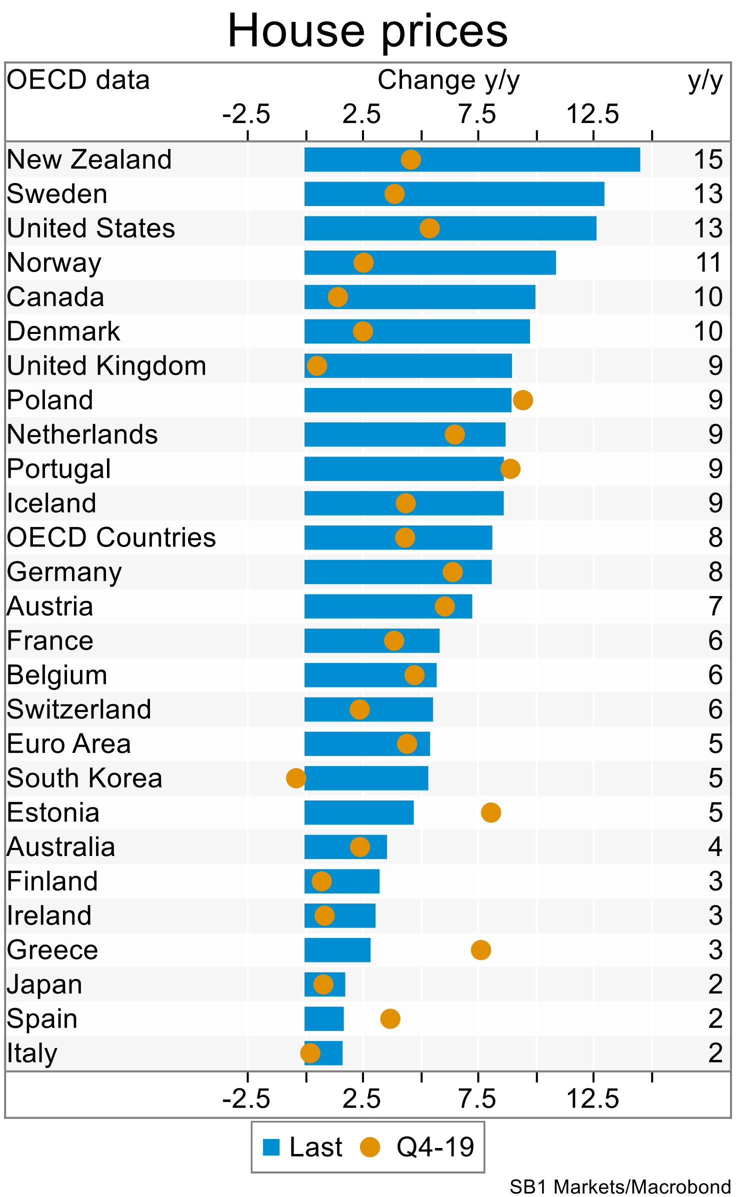
85% in bank deposits, and past quarters more in stocks & fun(ds) more than ever (in USD)




- **Households have increased their financial assets** by USD 3.7 trl over the past year, 2.5 x more than 'normal', as the saving rate has exploded – and **debts have not been repaid**. In Q2 alone, assets grew at the same pace (but up from Q4 and Q1, mostly due to payment of stimulus cheques. Debt is increasing faster – no debt repayment, so
  - **Bank accounts** have swelled by USD 3.1 trl, or by almost 85% of the total increase in assets
  - Over the past 4 quarters, households have bought **equities and fund shares** for USD 900 bn (net), a new record high! Which may explain some of the retail 'activity' at the stock market recently…
  - Households have (net) sold **bonds** at an close to unprecedented pace over the past year
- How much of the extra savings in bank accounts will stay there, how much will be spent? That will important for the USA economy (and Federal Reserve's policy stance)

# House prices up everywhere, and have accelerated in 21 of 26 countries

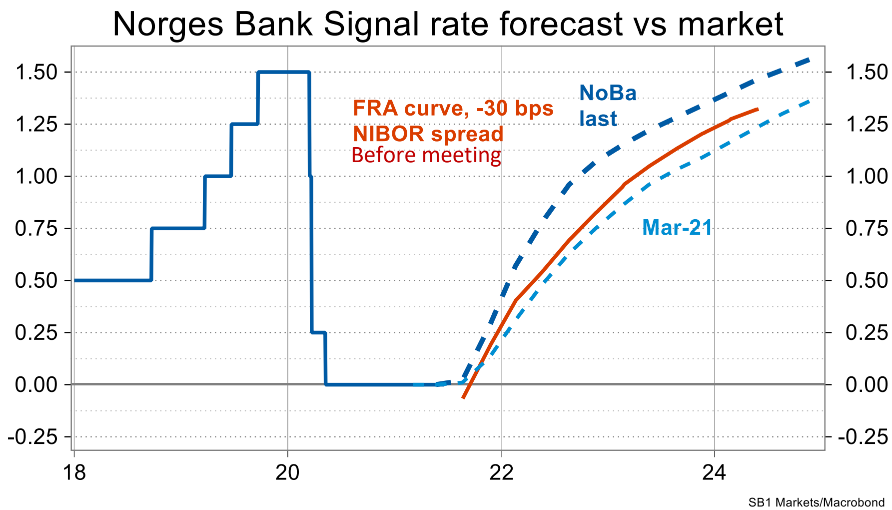



- The average price appreciation in the OEDC area has been 8%, up from 5% one year ago – and twice the average pace since year 2000
- Canada, UK and Norway have reported the steepest acceleration vs. pre-corona growth rates
- Price inflation has slowed the most in Greece, for good reasons – the tourist country has been through a harsh downturn

OECD quarterly data, the last quarter Q4-20 or Q1-21

# Norges Bank more hawkish than expected – will hike in Sept, Dec, March, etc…

## According to the bank, the policy rate will reach 1.5% (6 hikes) by end of 2024




**Interest rate paths**

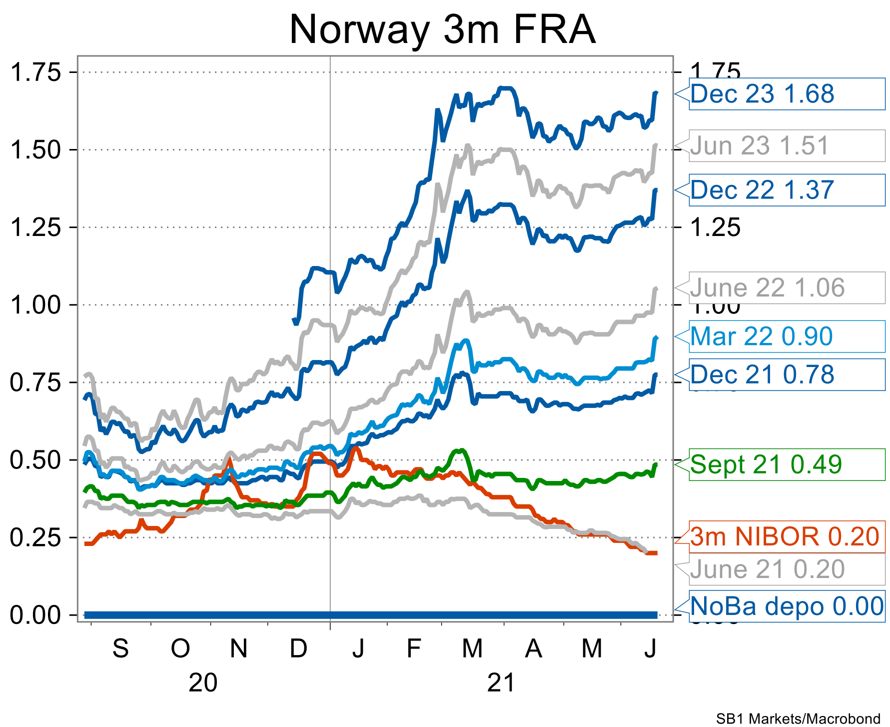
| | Path 1-21 | **Path 2-21** | Change bps | SB1M f'cast | Fair FRA * @IMM, NB | FRA pre meet | NoBa -FRA |
|---|---|---|---|---|---|---|---|
| Q2 21 | 0.00 | **0.00** | **0.00** | **0.00** | 0.23 | | 0.23 |
| Q3 21 | 0.01 | **0.02** | **0.01** | **0.01** | 0.54 | **0.45** | 0.10 |
| Q4 21 | 0.13 | **0.28** | **0.15** | **0.19** | 0.83 | **0.65** | 0.18 |
| Q1 22 | 0.31 | **0.57** | **0.26** | **0.39** | 1.05 | **0.82** | 0.23 |
| Q2 22 | 0.48 | **0.78** | **0.30** | **0.58** | 1.23 | **0.98** | 0.26 |
| Q3 22 | 0.63 | **0.96** | **0.33** | **0.75** | 1.35 | **1.11** | 0.24 |
| Q4 22 | 0.75 | **1.07** | **0.32** | **0.89** | 1.44 | **1.23** | 0.21 |
| Q1 23 | 0.86 | **1.15** | **0.29** | **1.00** | 1.51 | **1.34** | 0.17 |
| Q2 23 | 0.96 | **1.22** | **0.26** | **1.10** | 1.57 | **1.43** | 0.15 |
| Q3 23 | 1.03 | **1.28** | **0.25** | **1.17** | 1.63 | **1.50** | 0.14 |
| Q4 23 | 1.09 | **1.34** | **0.25** | **1.23** | 1.69 | **1.56** | 0.14 |
| Q1 24 | 1.16 | **1.40** | **0.24** | **1.30** | 1.75 | **1.62** | 0.14 |
| Q2 24 | 1.23 | **1.46** | **0.23** | **1.37** | 1.80 | **1.66** | 0.15 |
| Q3 24 | 1.30 | **1.51** | **0.21** | **1.44** | 1.85 | | |
| Q4 24 | 1.36 | **1.56** | **0.20** | **1.50** | 1.86 | | |

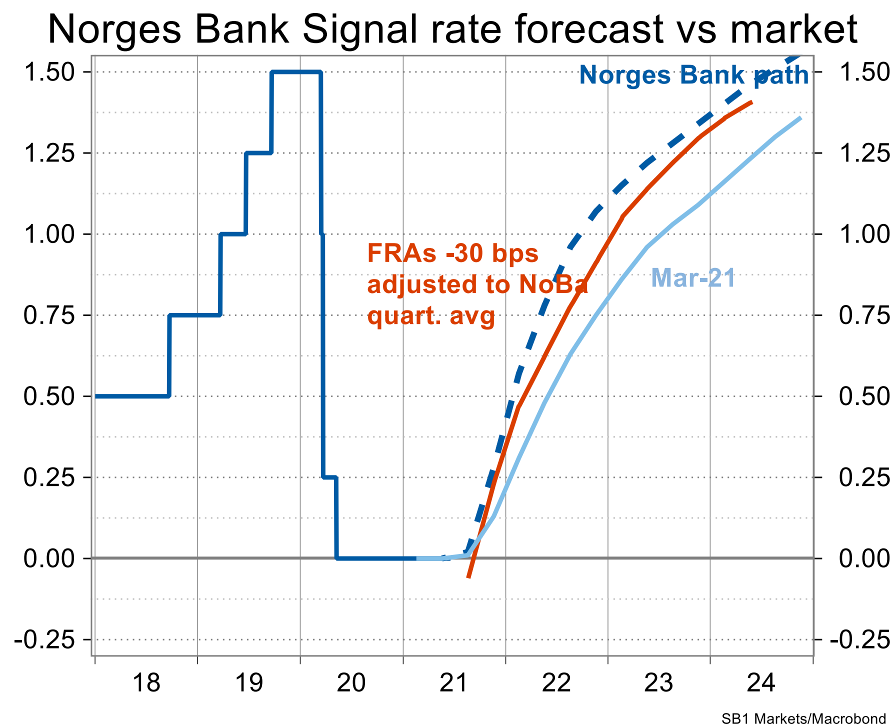
**) Assuming a 30 bps NIBOR spread from Q3-21*
Q4 FRAs adjusted for liquidity prem

- **Key policy rate** was left unchanged
- **Policy rate path** revised upwards by as much as 33 bps, quite a big move
  - » We expected the bank to take a more gradual approach, by lifting some 15 bps now – but the move was no doubt (in our mind) the right decision
- According to comments from Governor Olsen, and the bank's rate path, a **September hike is very likely, and for further hikes in December, and in March & June**
  - » Subsequently, **one more rate hike in 2022** – and one hike per year thereafter
- The key policy rate will be back at **1.5% by the summer of 2024**
- **Norges Bank's rate path was up to 25 bps above the FRA market rates – and these rates rose sharply after the meeting, for good reasons – but remains below** (more on market response here)
- The **NOK** immediately gained 0.5%, but the gain was quickly reversed and the NOK actually weakened – as a lot other things happened in the f/x market

# FRA rates rose sharply last week – up to 15 bps

but they are still well below NoBa's new path

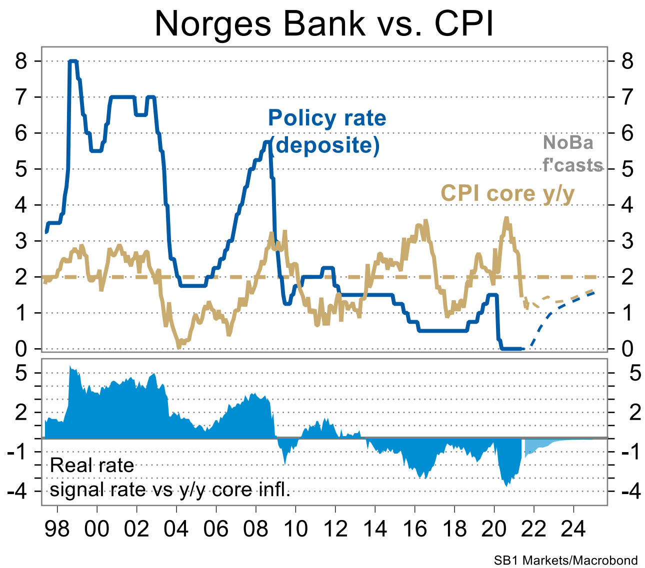


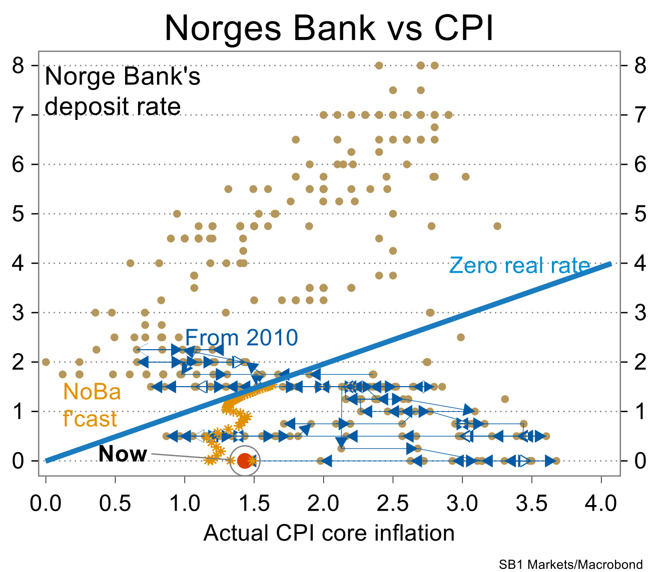



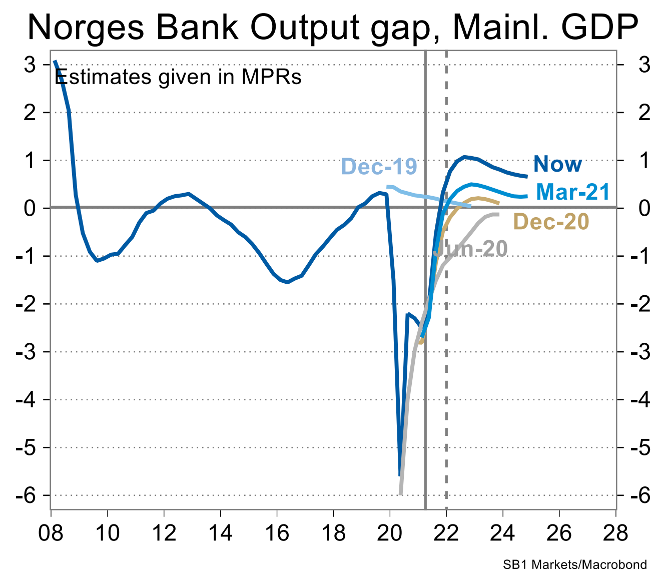

- The NIBOR spread is now at 20 bps. Norges Bank assumes 35 bps spread going forward, we expected the Bank to pencil a 30 bps spread. We stick to our 30 bps estimate until further notice
- The FRA-rates are anyway well below NoBa's new path – and we expect a further upside drift, barring an arrival of really bad delta virus news
- The market is discounting almost a 90% prob. for NoBa to hike in September and December. However, from there the FRA-path is not as steep as NoBa's, and just a 40% probability for a March is assumed, given a hike in both Sept & Dec. NoBa say 100%

# NoBa takes the lead: The most flexible inflation targeter

Hikes rates even if inflation is below target. Because the altnative is more risky. Will others follow?




**Inflation is expected to stay below the 2% inflation target** over the whole forecasting period, the next 3½ years. Even so, Norges Bank expects to hike its signal rate 5 times. Why? Here is our take:

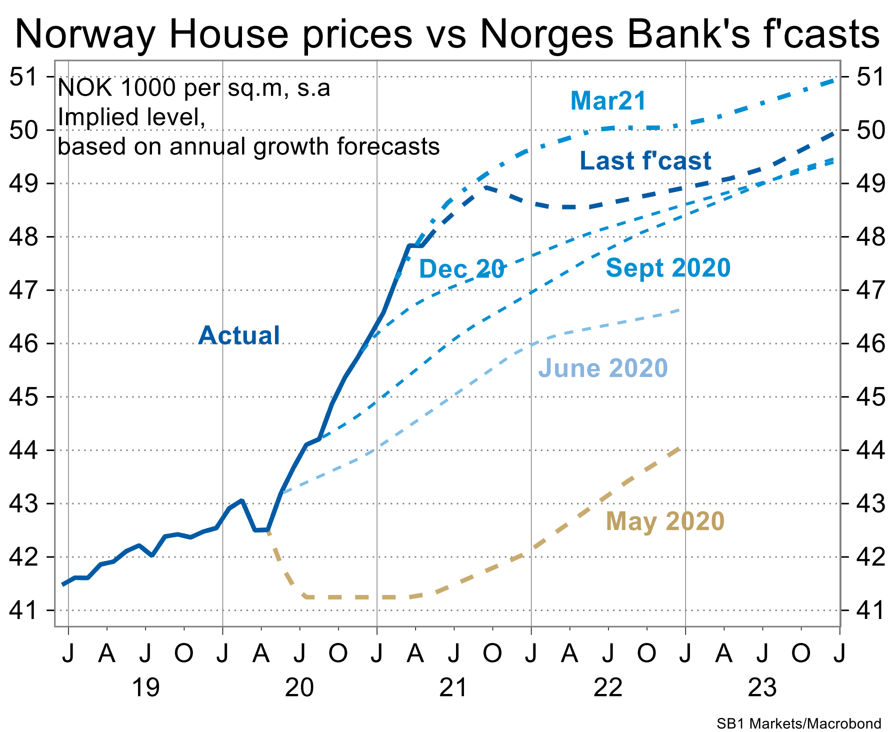
- **Norges Bank has not been an inflation nutter the past 10 years**. If anything, there is a negative correlation between actual core inflation and the signal rate since 2010. From 2021, both inflation and the signal rate is expected to move together 'in the right direction', both upwards.
- **The real policy rate is expected to stay negative for 1½ more years** (it has not been positive since late 2013!). Norges Bank assumes neutral policy rate slightly below zero (the real 3 m NIBOR at zero). Policy remains expansionary, albeit less so over time, as the interest rates climbs faster than inflation
- **Norges Bank assumes capacity utilisation** is turning positive in late Q3, early Q4-21. Thereafter the estimated output gap is positive – by up to 1%, and the unemployment rate is lower than average.
- No doubt, **risks for (further) build-up of financial imbalances** would increase significantly if the bank kept the signal rate at zero in order to push up inflation, in an even stronger economy than the one projected

**Norges Bank is no doubt the most flexible inflation targeter** among central banks today. We think this policy is wise, and we expect other central banks to follow suit the coming two years as the present policy mix most likely will not foster stability, long term

SpareBank 1 MARKETS

# Norges Bank expect house prices just to flatten/decline marginally

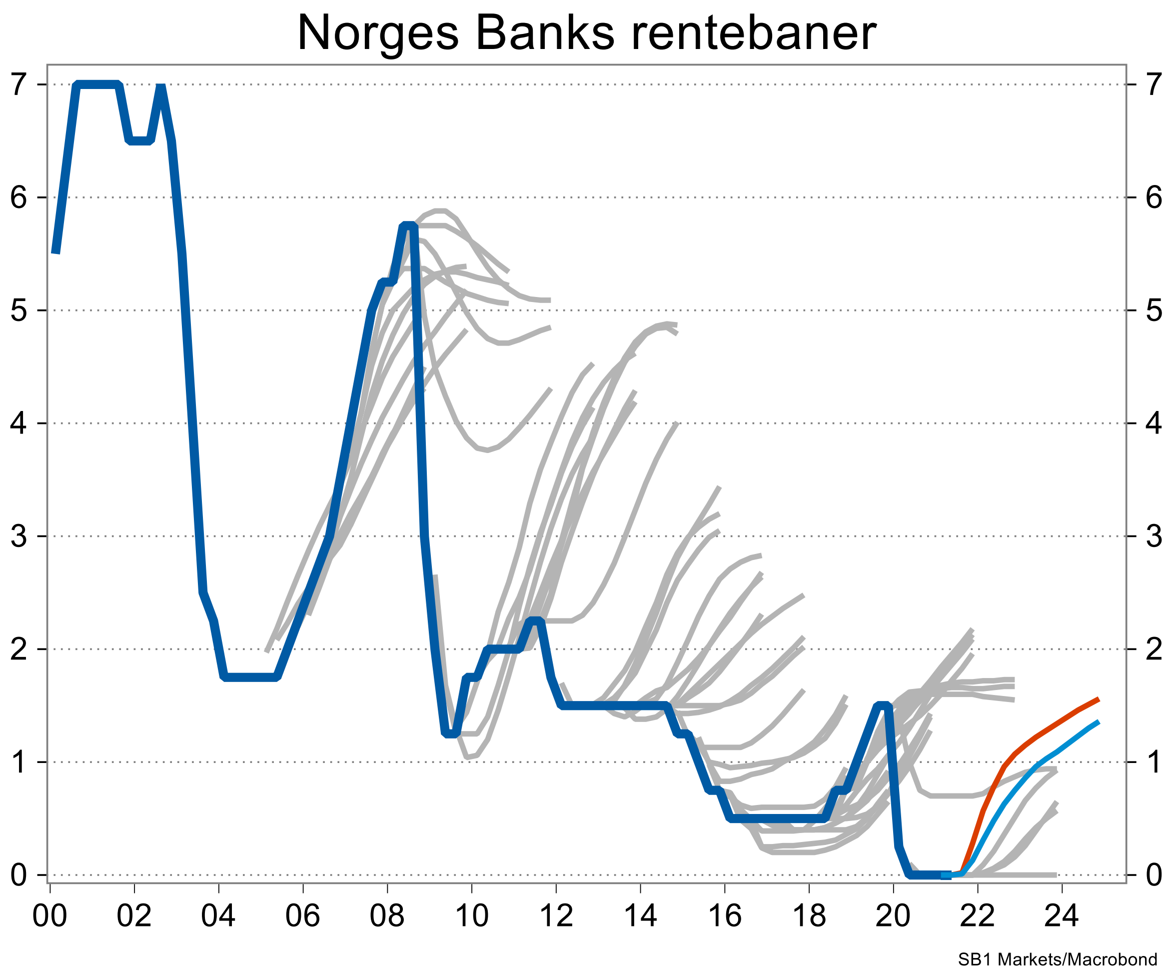
... even if most of the 2020 cut in mortgage rates are reversed

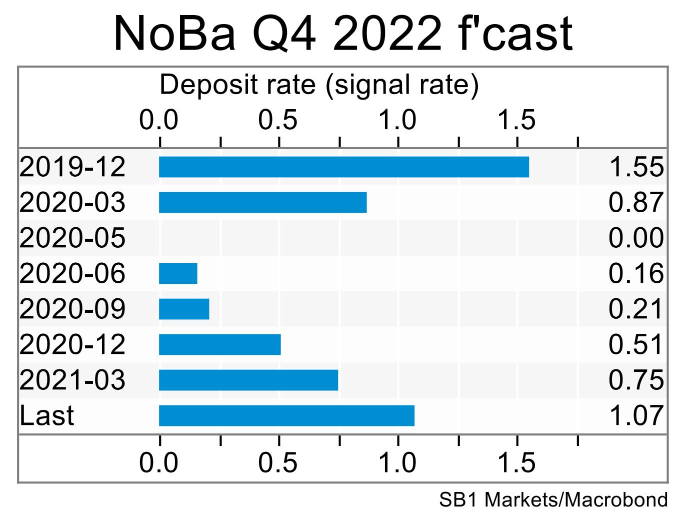



- Norges Bank expect prices to increase until the first hike, in the autumn
- Debt growth is expected to slow just moderately
- The risks may be on the downside

# Never forget this one!

The bank  has never done as it said it would. Because something unexpected turned up, of course!

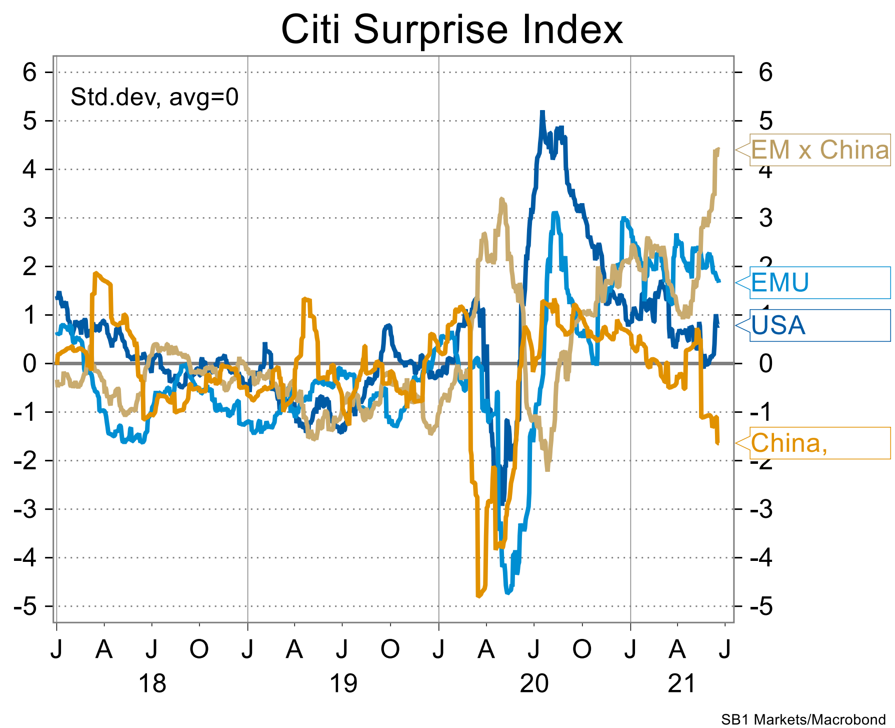


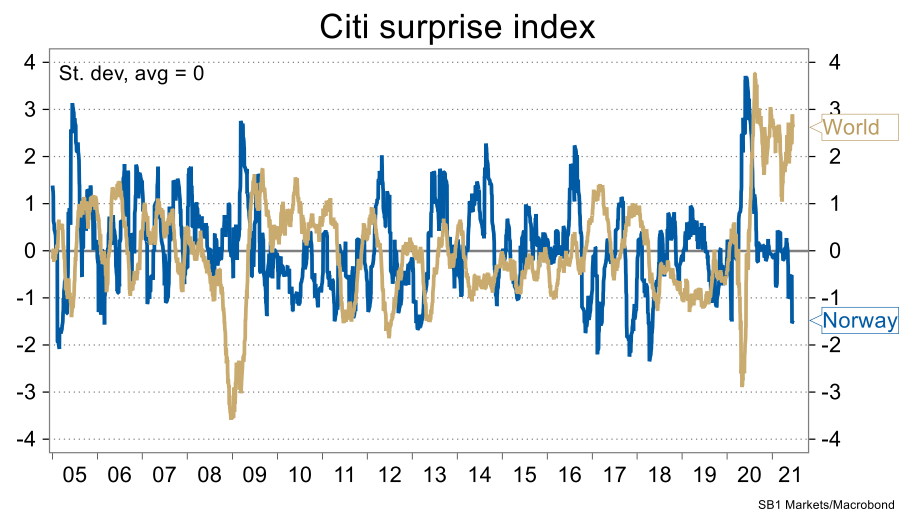



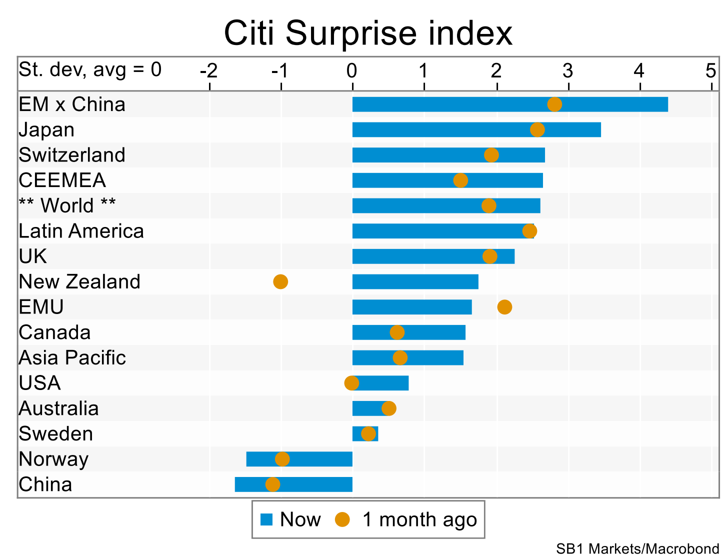

The last path in red, the previous in light blue

# China is surprising sharply on the downside, other EMs on the upside

## … according to Citi's surprise index. EMU and the US also in positive territory. Norway not




- **China** slides down, to well below neutral, alongside a credit tightening
- **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 2 weeks ago
- **Norway** has surprised on the downside

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

# The Calendar: The first June PMIs. US spending & inflation

| Time | Count. | Indicator | Period | Forecast | Prior |
|---|---|---|---|---|---|
| **Monday June 21** | | | | | |
| 08:00 | NO | Housing starts | May | | |
| 14:30 | US | Chicago Fed Nat Activity Index | May | 0.88 | 0.24 |
| **Tuesday June 22** | | | | | |
| 09:30 | SW | Unemployment Rate SA | May | | 9.1% |
| 12:00 | UK | CBI Trends Total Orders | Jun | | 17 |
| 16:00 | EC | Consumer Confidence | Jun A | -3.5 | -5.1 |
| 16:00 | US | Existing Home Sales | May | 5.72m | 5.85m |
| **Wednesday June 23** | | | | | |
| 02:30 | JN | PMI Manufacturing | Jun P | | 53 |
| 09:15 | FR | PMI Manufacturing | Jun P | 59.8 | 59.4 |
| 09:15 | FR | PMI Services | Jun P | 59.2 | 56.6 |
| 09:30 | GE | PMI Manufacturing | Jun P | 63.2 | 64.4 |
| 09:30 | GE | PMI Services | Jun P | 55.3 | 52.8 |
| **10:00** | **EC** | **PMI Manufacturing** | **Jun P** | **62.2** | **63.1** |
| **10:00** | **EC** | **PMI Services** | **Jun P** | **57.5** | **55.2** |
| 10:00 | EC | Markit Eurozone Composite PMI | Jun P | 58.3 | 57.1 |
| 10:30 | UK | PMI Manufacturing | Jun P | 64 | 65.6 |
| 10:30 | UK | PMI Services | Jun P | 63.9 | 62.9 |
| 14:30 | US | Current Account Balance | 1Q | -$207.1b | -$188.5b |
| **15:45** | **US** | **PMI Manufacturing** | **Jun P** | **61.8** | **62.1** |
| **15:45** | **US** | **PMI Services** | **Jun P** | **69.9** | **70.4** |
| 16:00 | US | New Home Sales | May | 875k | 863k |
| **Thursday June 24** | | | | | |
| 10:00 | GE | IFO Expectations | Jun | 103.8 | 102.9 |
| **13:00** | **UK** | **Bank of England Bank Rate** | | **0.10%** | **0.10%** |
| 14:30 | US | Initial Jobless Claims | Jun-19 | | 412k |
| 14:30 | US | Advance Goods Trade Balance | May | -$88.2b | -$85.2b |
| 14:30 | US | Durable Goods Orders | May P | 3.0% | -1.3% |
| 14:30 | US | Cap Goods Orders Nondef Ex Air | May P | | 2.2% |
| **Friday June 25** | | | | | |
| 14:30 | US | Personal Income | May | -2.7% | -13.1% |
| **14:30** | **US** | **Personal Spending** | **May** | **0.3%** | **0.5%** |
| **14:30** | **US** | **PCE Core Deflator MoM** | **May** | **0.6%** | **0.7%** |
| 14:30 | US | PCE Core Deflator YoY | May | 3.5% | 3.1% |
| 16:00 | US | U. of Mich. Sentiment | Jun F | 86.8 | 86.4 |

- **PMI**
  - In May the **global PMI** reported the highest growth rate since 2006, as the manufacturing sector kept growing at record high pace, while services almost everywhere reported higher activity, and some places a record high growth pace. Growth in manufacturing sector may now be close to a peak, while services, at least in Europe, should report even higher growth, at least in June. Preliminary June reports from Japan, EMU, UK & US are the main macro events this week
- **USA**
  - We 'know' the **annual PCE inflation** accelerated further in May (3.5% is expected), and the figure must be disastrous to change the market's perception on inflation or Fed actions. **Personal income** will now return to more normal levels, while **spending** on services will increase further, taking the savings rate down
  - **Durable orders** are expected up again in May, following a small decline in April. The level is very high, following an impressive surge since last summer
- **EMU**
  - **Consumer confidence** has recovered rapidly recent months, as is back to the pre-pandemic level
- **UK**
  - **Bank of England** will not hike the bank rate, and will continue buying bonds. But at some stage, tapering will be needed, here too
- **Norway**
  - No big news

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

Highlights

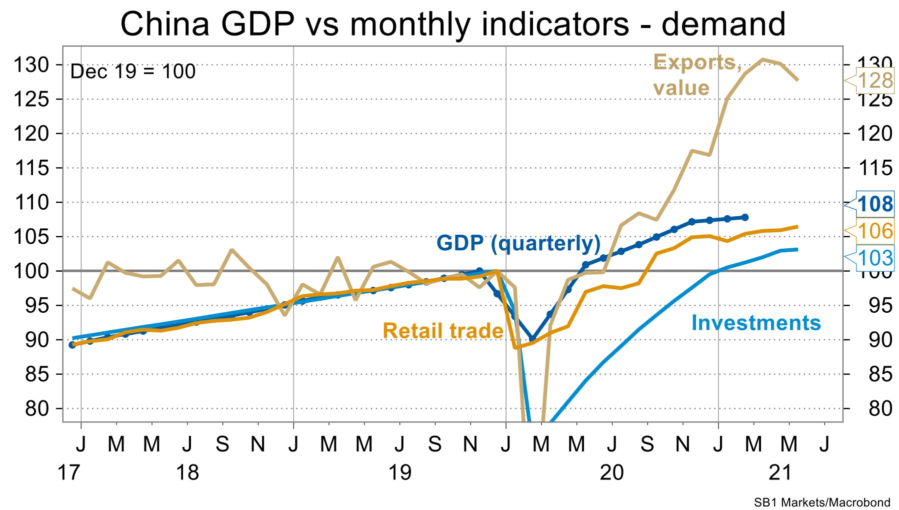
The world around us

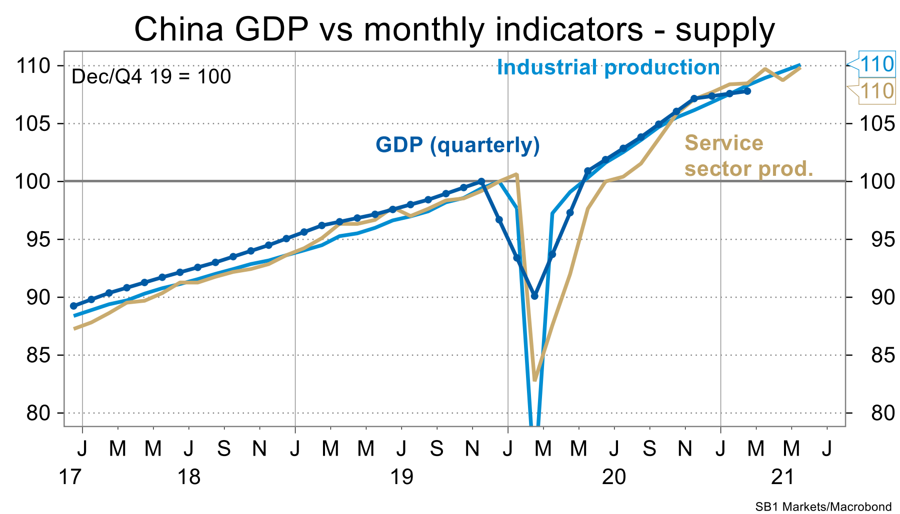
The Norwegian economy

Market charts & comments

# May data signalling a growth slowdown

## All major data surprised on the downside. May be due to the credit tightening



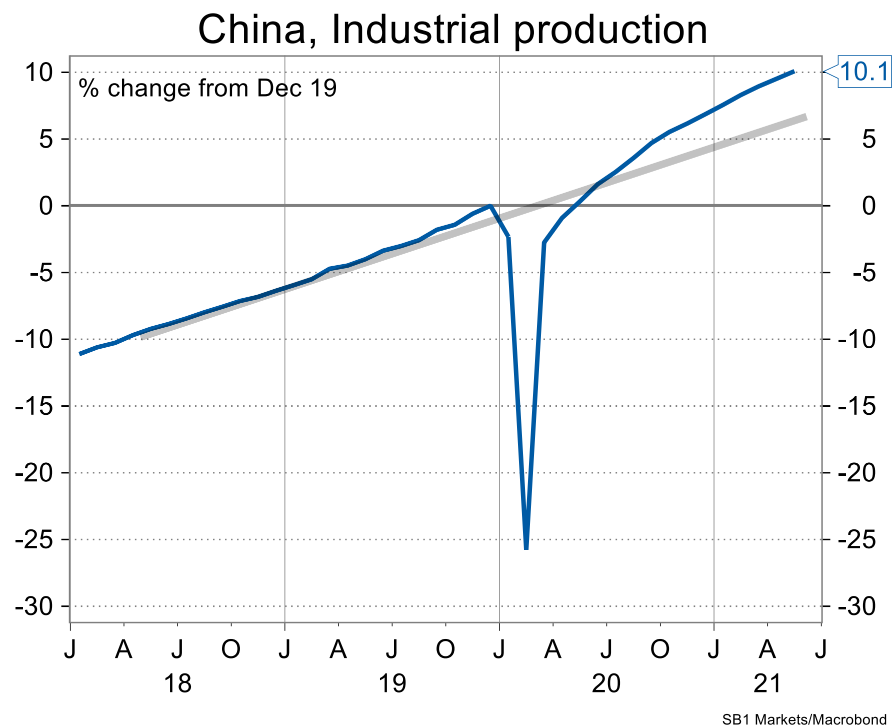




- **Industrial production** rose 0.5% in May, unch. from April. Measured y/y, production is up 8.8%, 0.2 pp below expectations Production is 3% above the pre-corona trend path but growth has finally slowed to the pre-pandemic level, as we expected
- **Service sector production** recovered the surprising April low, rising 1.0%. In sum, growth has been some 5% the past 6 months, in line with growth ahead of the pandemic, after slowing through 2018 and '19. The level is back on track vs the pre-Covid trend path
- **Retail sales volumes** rose 0.5% in volume terms (our est.), from zero in April, and a decent growth rate, and in line with the pre-Covid growth pace. However, sales have on average been growing slower since November, at just a 2.5% annualised rate. Sales were 1.6 pp below expectations (12.4% y/y, vs 13.8%)
- **Investments** were revised down since December, by 1 pp per month to below 1%, and investments grew just 0.2% in May. The level is suddenly 3% below the pre-pandemic trend growth path (we assumed the gap was closed in April, but that was not the case. The (useless) accumulated annual growth rate was 15.9% in May, 0.5 pp lower than expected. Housing and other construction starts have fallen 5% – 10% since last summer, and the downward revision was not that surprising. New home sales may have peaked too but remain well above housing starts, signalling an inventory drawdown
- **Last week: Credit growth** was a tad higher in May than in April, but the trend is clearly down, and the credit impulse has turned definitively negative
- **CPI inflation** is on the way up, but is still moderate. Producer prices are soaring (which is felt more outside China than inside)
- **Imports** remained strong in May but exports have slowed somewhat past two months, however the level is sky high

**In sum: China is probably slowing, and we are not sure we can blame some local Covid outbreaks**

# Industrial production up 0.5% in May, close to the pre-pandemic growth pace

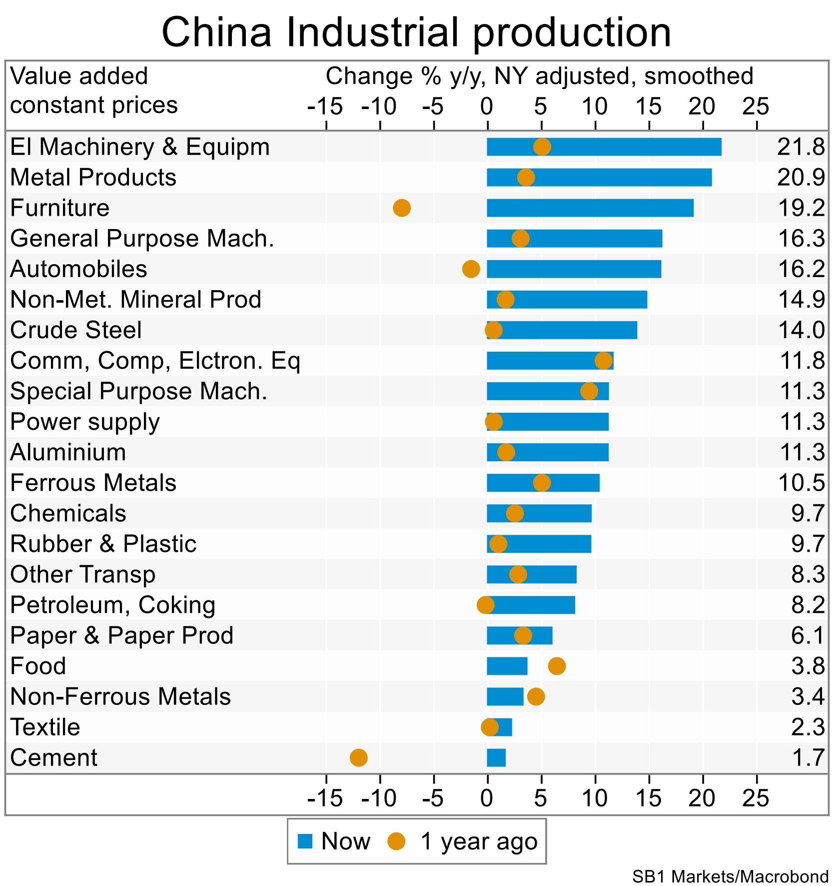
… And production is 3% above the pre-pandemic trend growth path!

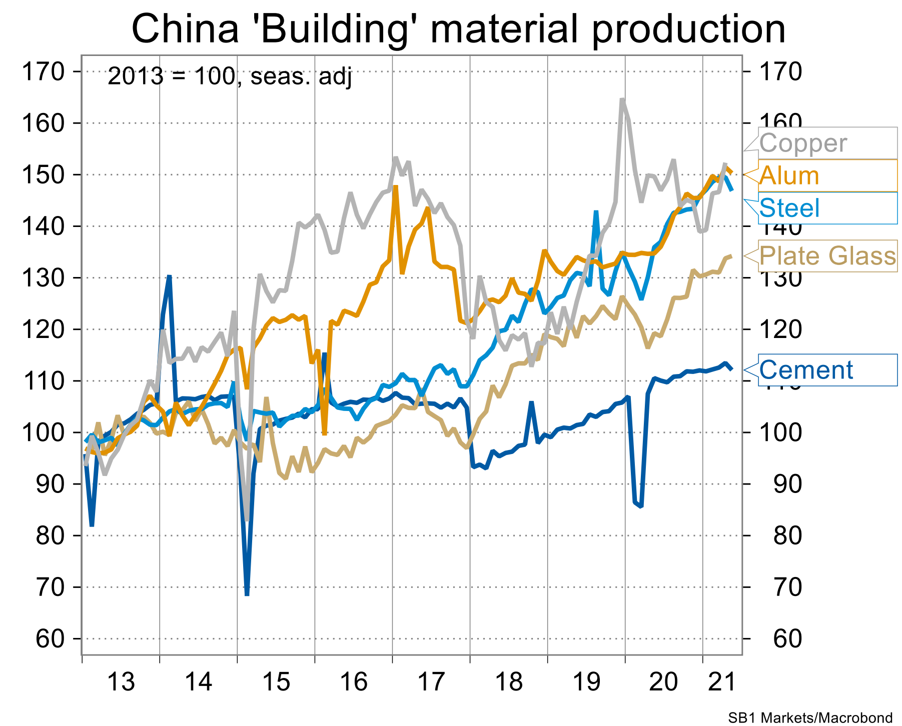




- **The official data**: Production is up 8.8% y/y, 0.2 pp below expectations
- **Production** grew by 0.5% m/m, as in April. Over the recent months, growth has slowly approached the pre-pandemic pace, some 6% annually – as we have assumed.
- Production is 10% above the Dec '19 level and some 3% <u>above</u> a reasonable pre-corona growth path. <u>Impressive!</u>
- Both supply and demand factors may be limiting factors the coming months – supply side probably most important short term. Business surveys do not signal any downshift in growth

# Annual growth rates have normalised as base effect from lockdown fades

## Still, strong underlying growth in many sectors




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

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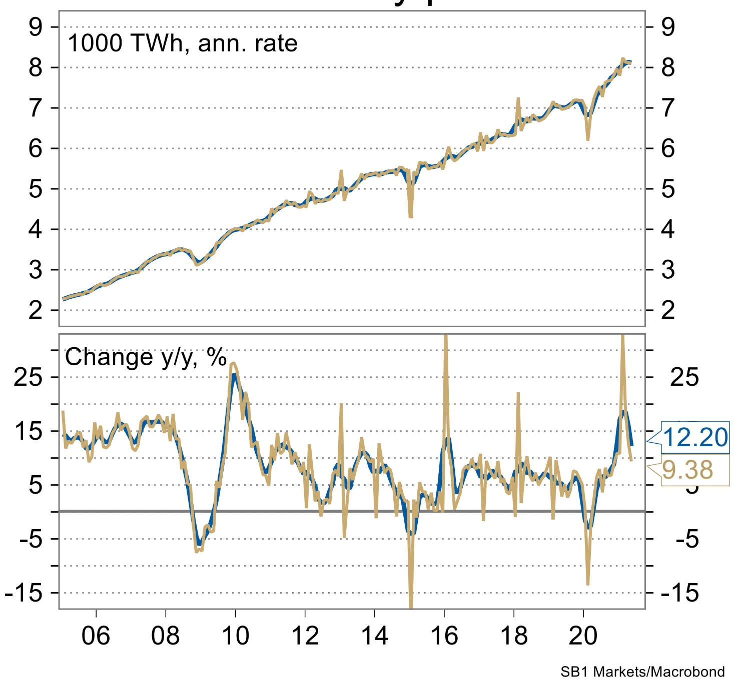
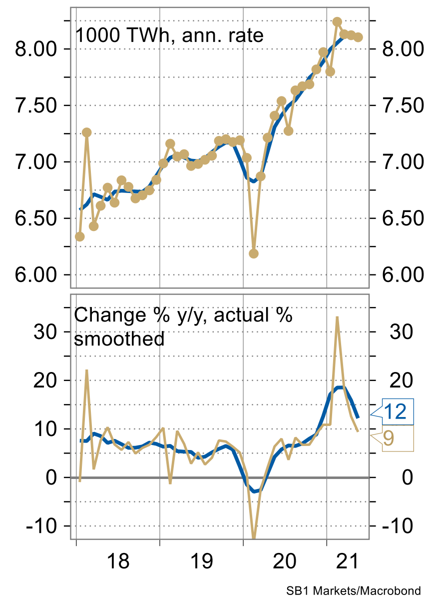
# Very strong electricity production data, up 16% vs. the pre-pandemic level

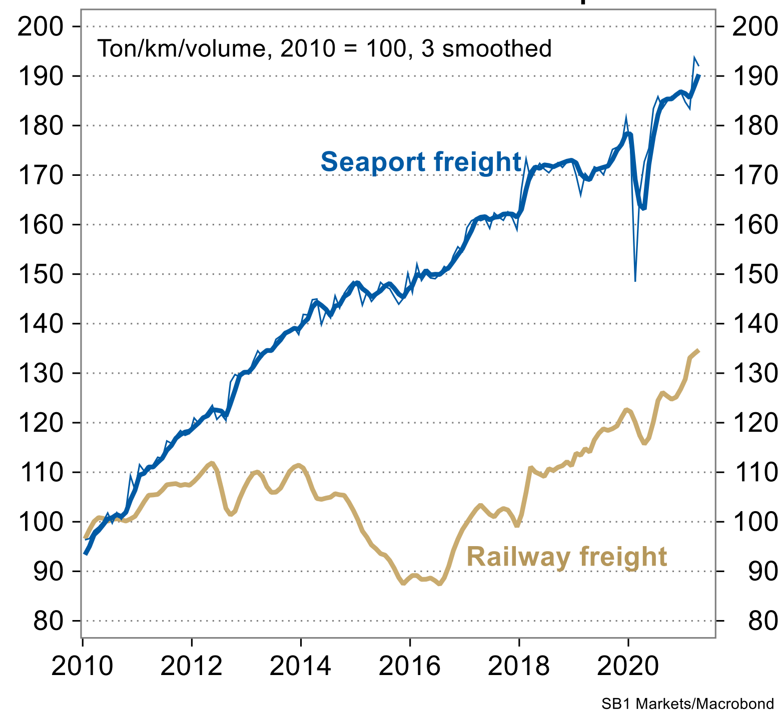
Transport activity robust too

## China Electricity production



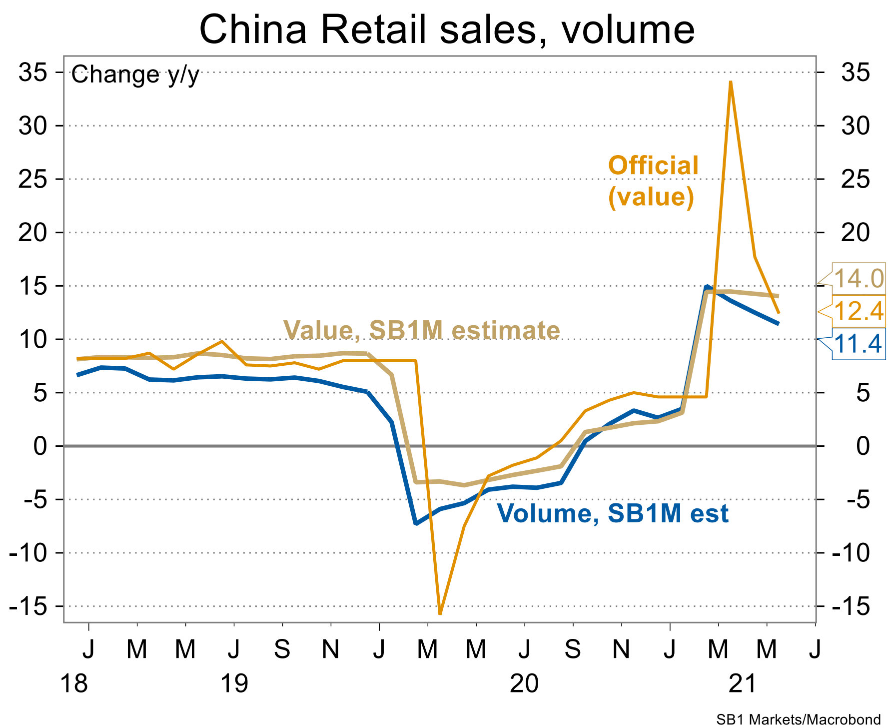



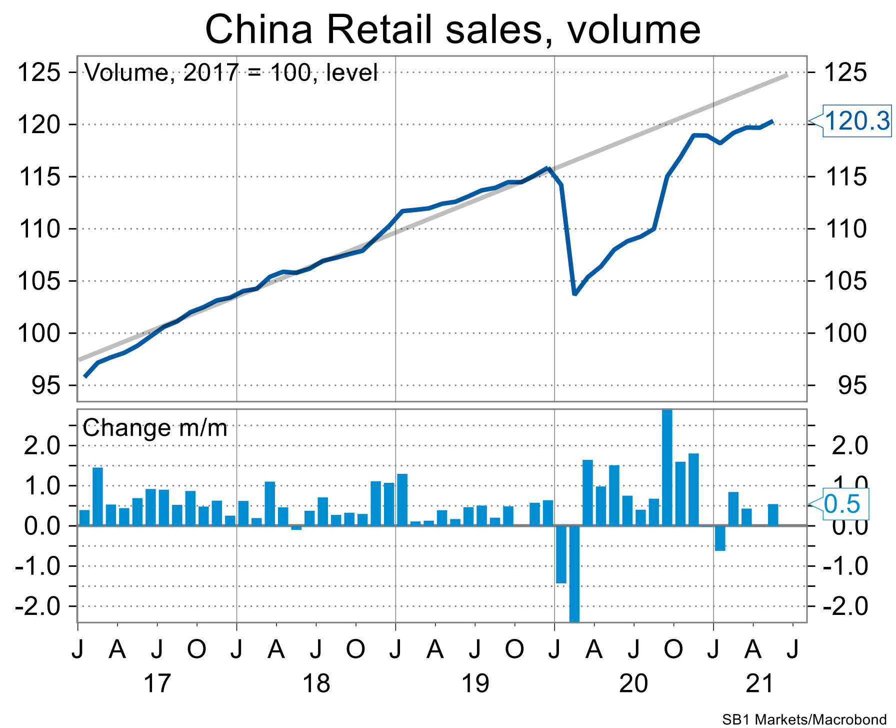

## China Trade and transport



# Retail sales up May, but growth is moderate

Sales up 0.5 in volume terms, following a flattish April, a growth pace at 2.5% since last November

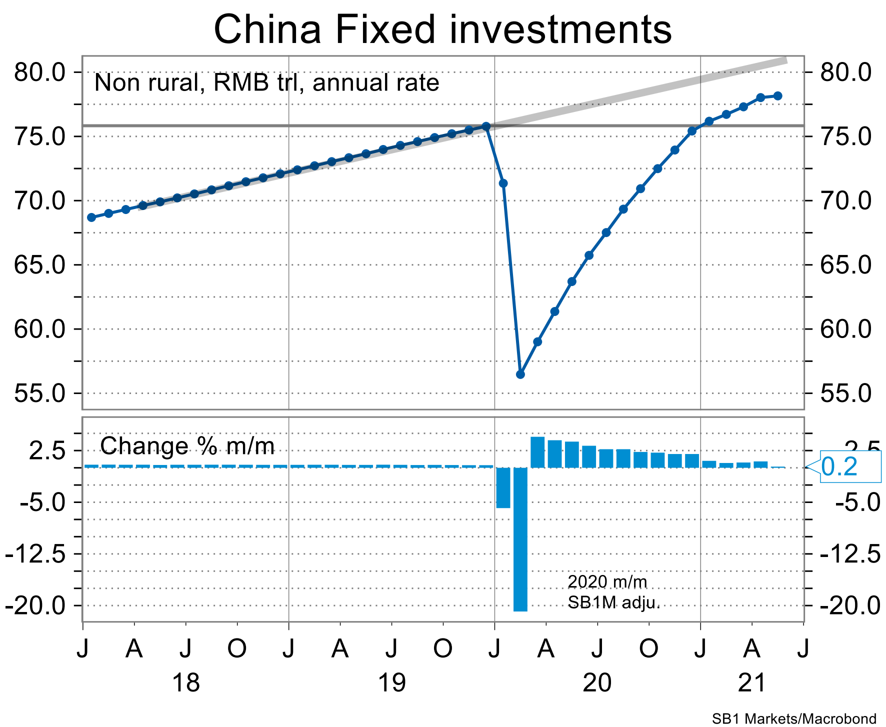



- **Official figures** showed that retail sales were up 12.4% y/y in May, whereas the market expected +13.6%. These annual growth rates are close to useless due to the base effect, the low sales last spring
- **Our calculated m/m volume data** indicate a normal monthly in May (0.5%, a 6% annualised pace, like ahead of the pandemic). However, the recovery has slowed to a 2.5% growth pace since November – if these data are to be trusted (and we are far from sure we can, following 2 – 3 revisions and some obvious 'impossible' data, which we have adjusted for)
  - » According to our calculation, sales volumes are 3% below the pre-pandemic trend path

# Investments revised down, and growth is slowing

## The previous months revised down by 1 pp per month, and investments grew by only 0.2% in May

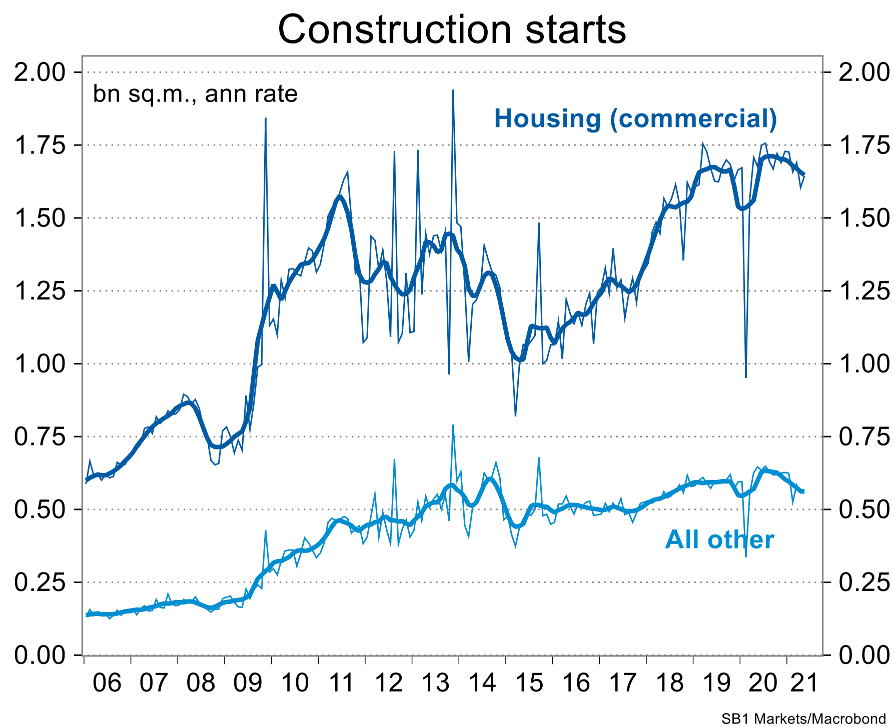


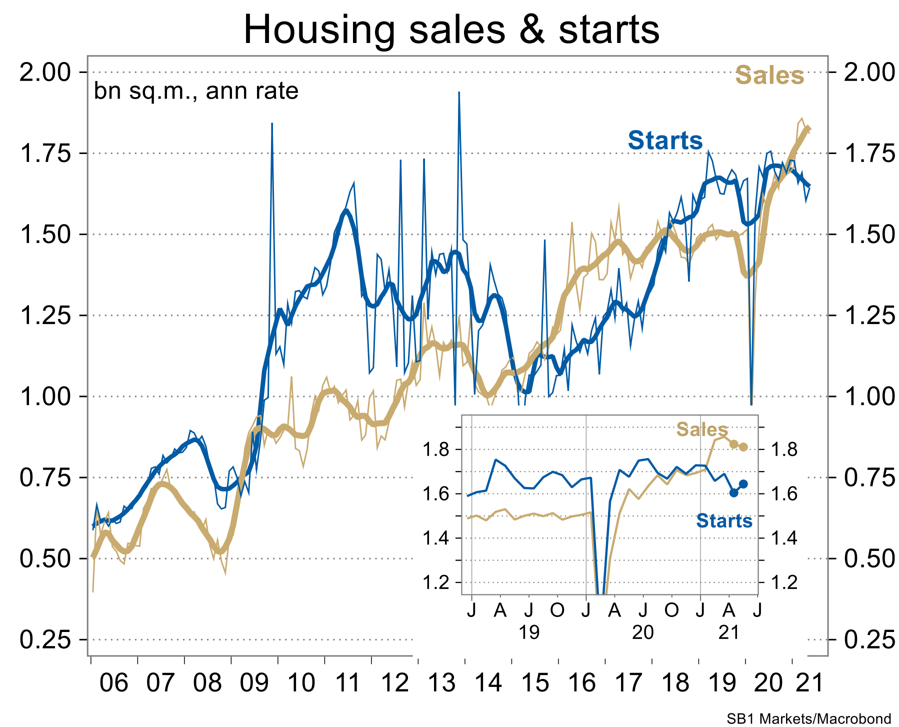


- **Measured YTD**, investments are up by silly digits y/y – which are not useful for analysis
  - » The figures: YTD + 15.4%, expected 16.9% down from 19.9% in April
- **Growth m/m** has gradually slowed since the recovery started last March, down to slightly below 2.5% by the end of last year. Growth the 4 first months in 2021 was reported at approx. 2% per month. Now the 2021 growth rate is revised down to less than 1%, and in May growth fell to 0.2%. In April, we estimated that investments had returned to the pre-pandemic trend path, now there is a 3% shortfall! Given the large investment/GDP share, a substantial change – but not unsurprising given the recent weakness in construction starts (next page)

# Construction activity is clearly slowing, both residential & other

New home sales have been strong, at least until now




- The rise in **new home sales** has been spectacular since last spring (+, and not driven by strong growth in new home prices. Sales have fallen somewhat since March but is far from weak, and substantially above housing starts
- **Housing starts** rose in May but are still down 5% from record high level last summer – which is not a dramatic downturn, but still visible
- **Non-residential construction** is declining too, and faster, down by well above 10%
- **In sum, construction starts** are slowing. Look up for demand for steel (if this version of Chinse construction data are the correct ones, in April they were heavily revised down)

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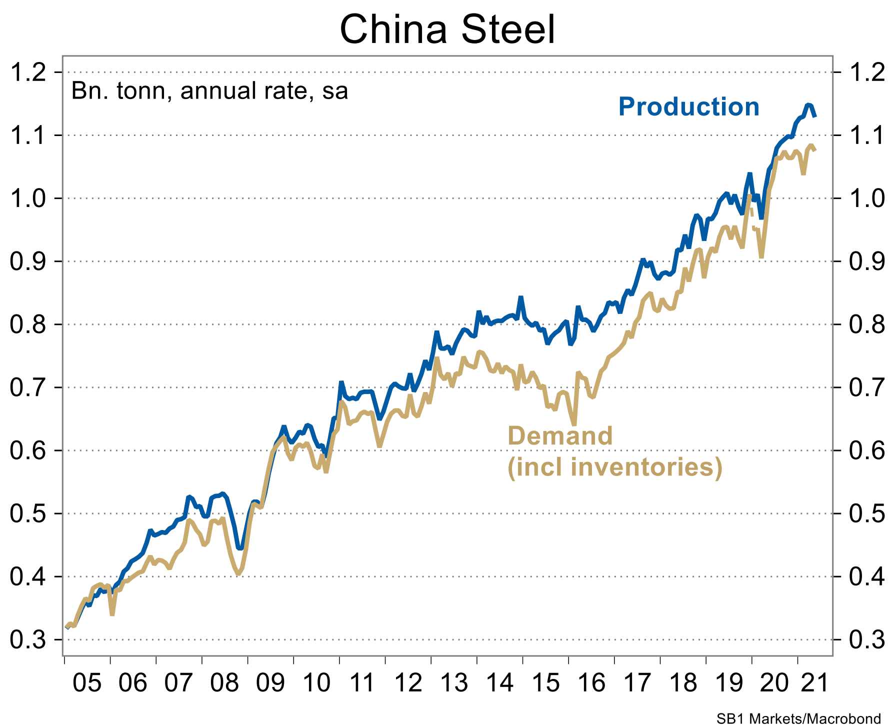
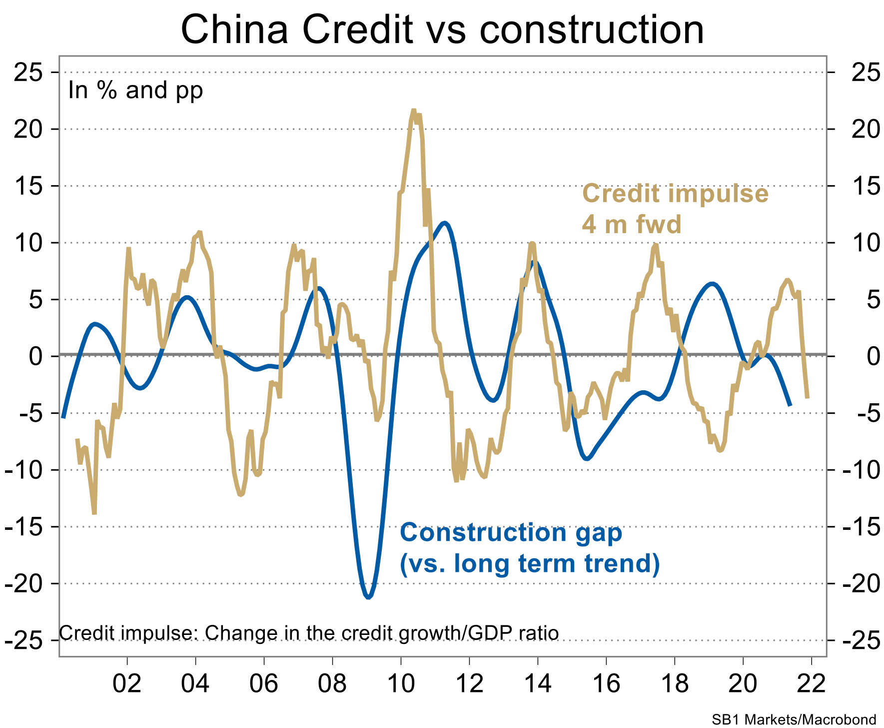
# Construction activity is sagging following the post-corona crisis surge

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




# Credit growth is slowing sharply – and construction slowly (so far)

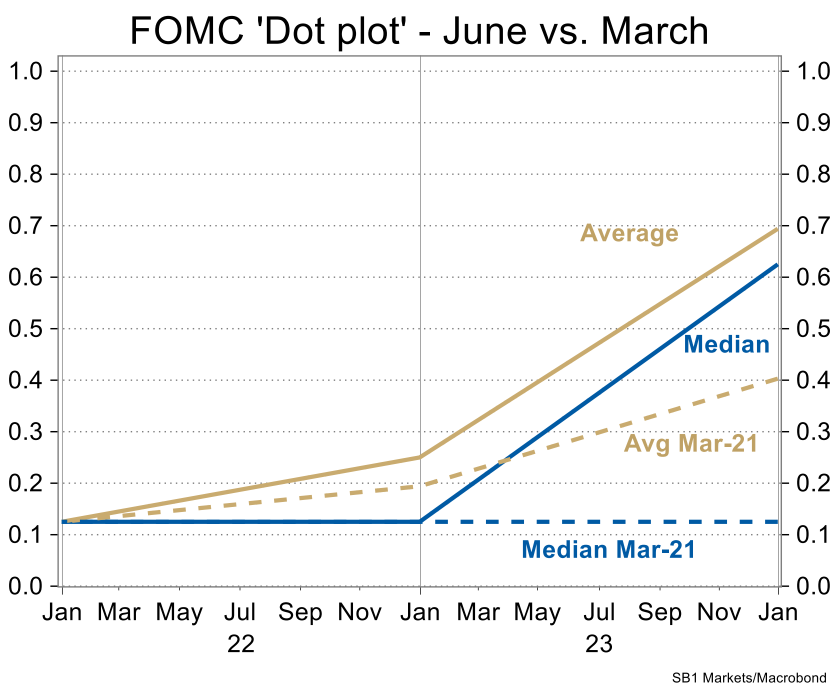
## The pas de deux between credit and construction is easy to decode




- … And there is not any tight correlation between the two
- The recent credit tightening may have had some impact at the property market – but basically the slowdown in construction started 'too early' this time
- Signals some downside risk for construction, raw materials & steel

# Growth and even more inflation forecasts revised up

## …and the FOMC members now expects to raise rates two times in 2023

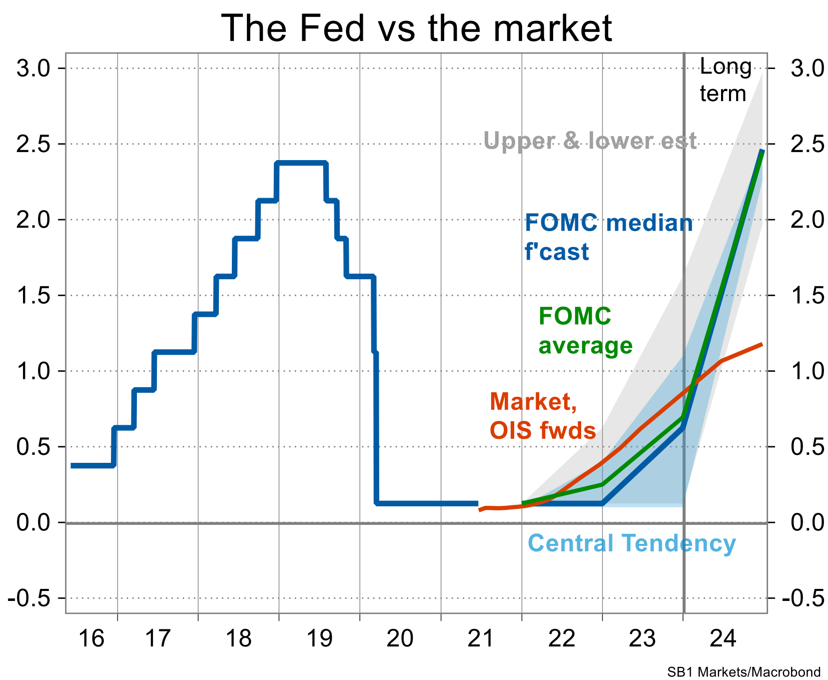



The market is pricing in the first hike in the signal rate at the end 2023

- The FOMC left the **target rate** unchanged at 0-0.25%. No change on the **QE volume** either, USD 120 bn per month in Treasury bonds (80 bn) and mortgage bonds (40 bn) – everything as all expected
- The FOMC acknowledged *'Amid considerable progress on vaccinations, the unwinding of social distancing, and strong policy support, participants assessed that risks to the outlook were no longer as elevated as in previous months.'* In addition the wording that '*the pandemic is weighing on the economy'* has been removed, but the committee still remarks that the pandemic remains a risk
- **Growth estimates** were revised further up, albeit not as much as at the previous meetings. However, the **inflation forecast** for the present year was revised sharply upwards, the core up to 3% from the 2.2% March forecast. The 2022 inflation forecast was nudged up by 0.1 pp to 2.1%. The **unemployment forecast** was close to unch, at 4.5% in Q4-21 and 3.8% in Q4-22. The long term 'natural' rate is assumed to be 4%. 'Mechanically' – measured by the unemployment rate – maximum unemployment could be reached in H2-2022
- As a consequence, the **dot-plot**, the individual members' estimate for the future fed funds rate, changed substantially
  - » 7 of 18 members (from 4) expected fed funds to be lifted in 2022 (median zero, the average 12,5 bps)
  - » 13 members expected the fed funds rate to be lifted 2023, up from 7 in March. Of these 13, 11 assumed more 2 hikes or more. 2 hikes is the median estimate, 8 expected 3 or more hikes and 2 members assumed 6 hikes (BTW slightly more than NoBa assumes ☺)
- At the press conference, governor Powell sounded far more dovish than these estimates suggests. He even downplayed the dot-plot as way of communicating expectations. '*They're not a Committee forecast, they're not a plan. And we did not actually have a discussion of whether lift-off is appropriate at any particular year, because discussing lift-off now would be highly premature, wouldn't make any sense'* (The future interest rate path) '*is highly uncertain.. So dots should be taken with a big grain of salt'*
  - » Powell is most likely right. But how should central banks then communicate? Probably like Powell does, by stating the bank's objectives and response function, and decisions depending on data – rather on dates based on 'highly uncertain' assumptions of the future
    More next page..

# This was the talking about talking about tapering meeting

## … but we are still a ways from our goal of substantial further progress, Powell says




The market is pricing in the first hike in the signal rate in late Q3 or Q4-22. In addition two more hikes are discounted by end of Q4-23

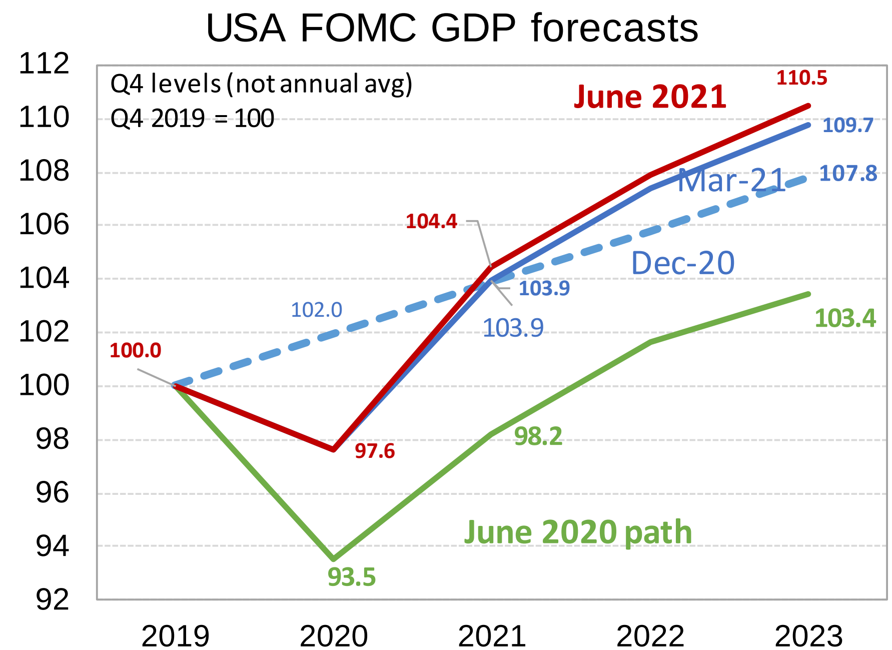
- *You can think of this meeting as the 'talking about talking about' meeting, if you like. . . . The economy has clearly made progress, although we are still a ways from our goal of substantial further progress. . . . Assuming that is the case, it will be appropriate to consider announcing a plan for reducing our asset purchases at a future meeting" ,* Powell said at the press conference
- More formally, Powell reiterated the FOMC '*continue to expect that it will be appropriate to maintain the current 0 to ¼ percent target range for the federal funds rate until labor market conditions have reached levels consistent with the Committee's assessment of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time*'
- Well, **inflation** is well above 2% and the FOMC expect to remain above for a while (but still transitory above). Fed has not stated for how long or by how much inflation should stay above 2% for this goal to be achieved. Powell's comment suggest that the target is not yet met even if inflation measured over 2, 3 or 5 years now is close to 2% (and that the target in fact is met). In the Q&A, he stressed the need for discretion when assessing whether inflation on average has been close to 2% or not
- **On the employment side,** Powell recognised some uncertainty vs how far away the FOMC was from its maximum employment target but emphasises that likely bottlenecks as the economy reopened most likely would sort out over time, like when covid-19 retreats, and the temporary unemployment benefit programs will expire from now until September. However, more people had retired, lowering the participation rate for a longer period
- On the other hand, Powell assured there should be no doubt that the Fed will use its tools should inflation start to creep up above the long-term target
- **Powell** promises to announce well on beforehand before any policy shift takes place
- **The timing of both tapering and lift off in rates** is moved forward but the timing is still uncertain (of course). The range of views inside the FOMC are wide – and we look forward to read the minutes in two weeks time
- **We** still think that actual inflation data are not the most important for the Fed than the labour market & wage inflation. It is still too early to know the balance in the labour market in late Q3 or into Q4. If a tsunami of workers have not turned up, policy will rapidly have to change course. The need for stimulating the housing market by buying USD 40 bn in mortgage backed bonds per month is hard to see anyway – and here some sort of tapering could take place pretty soon (but still well announced)
- **Markets rates rose sharply, and the market discounts 3 hikes before end of 2023**

# GDP for 2021 revised up. Inflation a lot more, of course

## Since last June the FOMC has lifted its GDP path by 5%

Percent

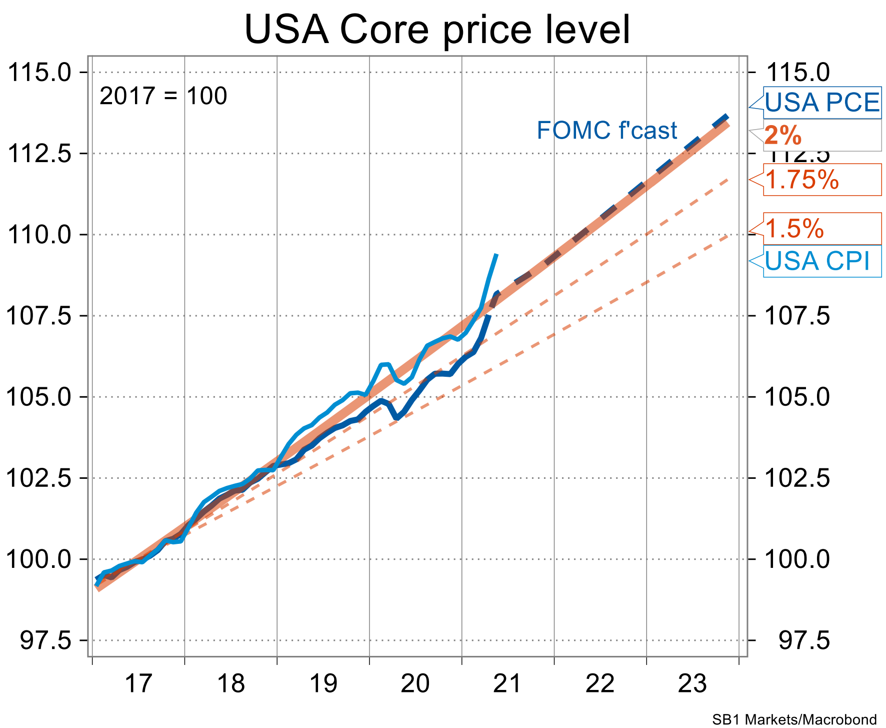
| Variable | Median[1] | | | |
|---|---|---|---|---|
| | 2021 | 2022 | 2023 | Longer run |
| Change in real GDP | 7.0 | 3.3 | 2.4 | 1.8 |
| March projection | 6.5 | 3.3 | 2.2 | 1.8 |
| Unemployment rate | 4.5 | 3.8 | 3.5 | 4.0 |
| March projection | 4.5 | 3.9 | 3.5 | 4.0 |
| PCE inflation | 3.4 | 2.1 | 2.2 | 2.0 |
| March projection | 2.4 | 2.0 | 2.1 | 2.0 |
| Core PCE inflation[4] | 3.0 | 2.1 | 2.1 | |
| March projection | 2.2 | 2.0 | 2.1 | |
| Memo: Projected appropriate policy path | | | | |
| Federal funds rate | 0.1 | 0.1 | 0.6 | 2.5 |
| March projection | 0.1 | 0.1 | 0.1 | 2.5 |

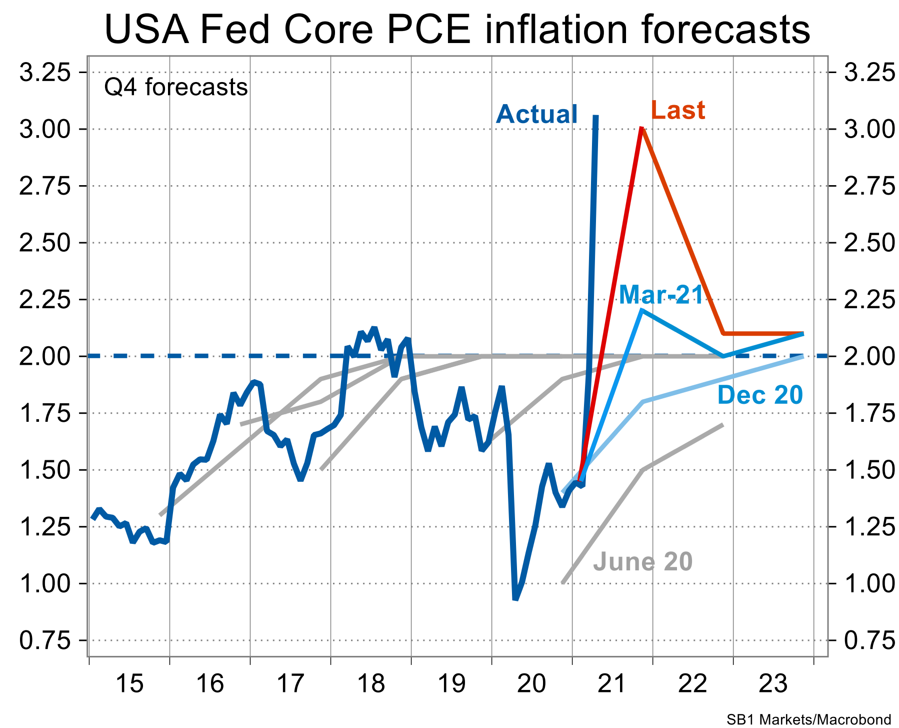



- The **'21 GDP f'cast** was revised upward by 0.5%, after having been revised up 2.3% in March. Q4 GDP is not forecasted to be higher than the FOMC assumed back in Dec-19, that is above the pre-pandemic growth path. Not bad. **Unemployment** in Q4-22 was revised down by 0.1 pp to 3.8%, and is expected to decline further to 3.5% 2023, lower than the assumed NAIRU at 4.0%
- **PCE core inflation** is expected accelerate to 3.0% by Q4-21, and then to decline to 2.1% in 2022. These forecasts signal that the Fed is serious vs. its aim to average inflation at 2% over time, by allowing inflation to stay above 2%, if it has been below the target. In addition, Powell continued to 'promise' <u>not to hike on forecasts of higher inflation</u> but will wait until actual inflation has come up to 2%, and is assumed to remain above 2% (<u>however, Powell did not tell us that the average inflation rate over the past 2,3,4 & 5 years already has come up to 2%</u>)
- **The long term neutral Fed funds rate is assumed to be 2.5% (unch). Thus, the bank plans a substantial monetary stimulus the coming years**

# Fed lifts the 2021 inflation forecast sharply – and core PCE will remain above 2%

Q4-21 inflation expected +0.8 pp to 3%, '22 up just 0.1 pp to 2.1%

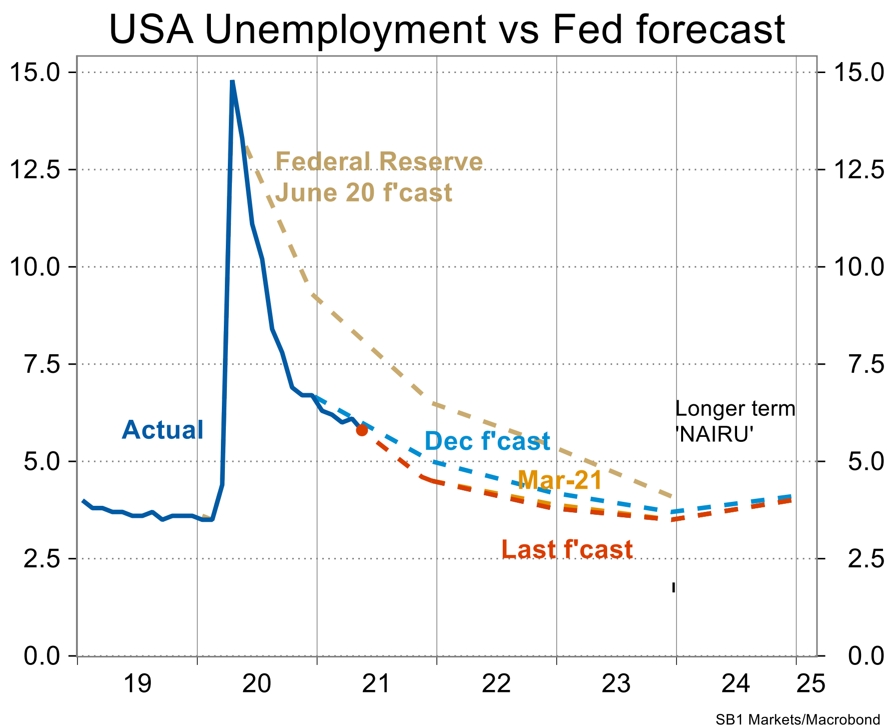



- Last year the FOMC introduced its new price level target. The bank aims to reach an average rate of inflation of 2% over time. If inflation has been below 2%, annual inflation should be allowed to stay above 2% in order lift the price level up to the long term 2% path
- The FOMC members (median) now expects core inflation to overshoot 2% in 2021, by estimating 3% y/y in Q4. Still, the core PCE price level will be in line with a reasonable long term 2% per year price target path (if starting in 2017 or 2018), and remain close to even in price inflation stays at 2.1% through 2022 and 2023. (It the 2% price level paths starts in 2019 the price level would be slightly above target). The Q4-21 estimated is based on an assumption of 0.13% m/m price growth from June, lower than the average 0.18% forecast for the following two years.
- Powell was not willing to tell how many years back the FOMC started its calculation of the proper price level, he would rather make discretionary assessments on when the target is met

# Unemployment just marginally revised down

.. by 0.1 pp in Q4 2022

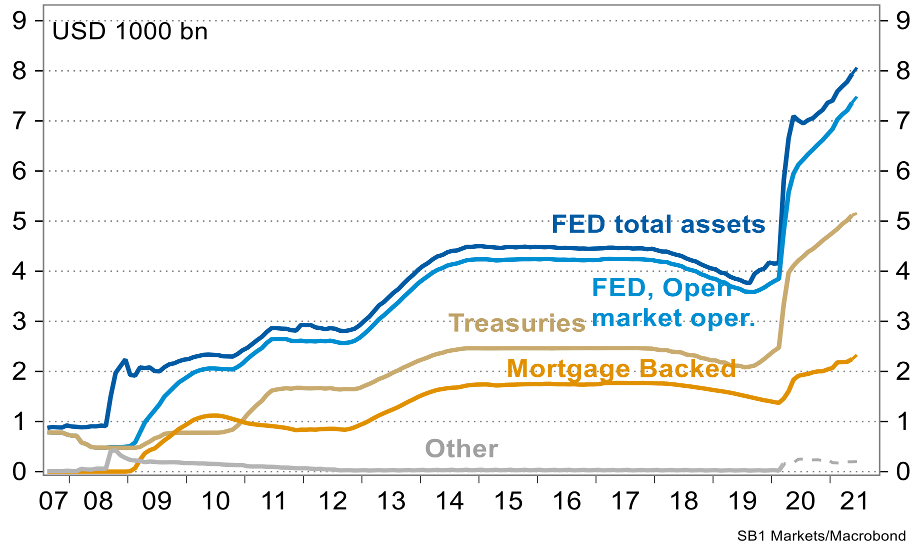



- The FOMC member expects (the median) an unemployment rate at the end of 2021 at 4.5%, unchanged from the March f'cast – and then down to 3.5% in 2023, close to the level in 2019
  - » The longer term 'neutral' unemployment rate is assumed to be 4% - a well known number for the FOMC members
- The Q4-23 unemployment forecasts have been quite similar from June last year, even if the GDP forecast has been revised up by 5%. The longer run trend growth is still assumed to be the same, at 1.8% per year
  - » Either the FOMC deems there is much more spare capacity in the US labour market than it thought last June (or in December)…
  - » …or that **productivity growth** will surge the coming 3 years, by some 1.7% more per year than the bank assumed 12 months ago - and then slow afterwards
  - » Or of course a combination of the two alternatives
  - » ***We think both alternatives are rather optimistic***

# FOMC: We have started talking about talking…

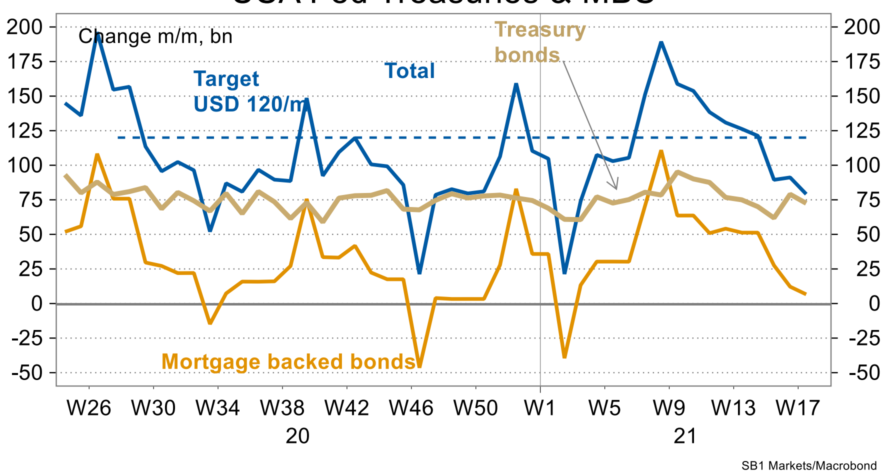
## The large QE program continues but will not run forever, of course

USA Federal Reserve balance

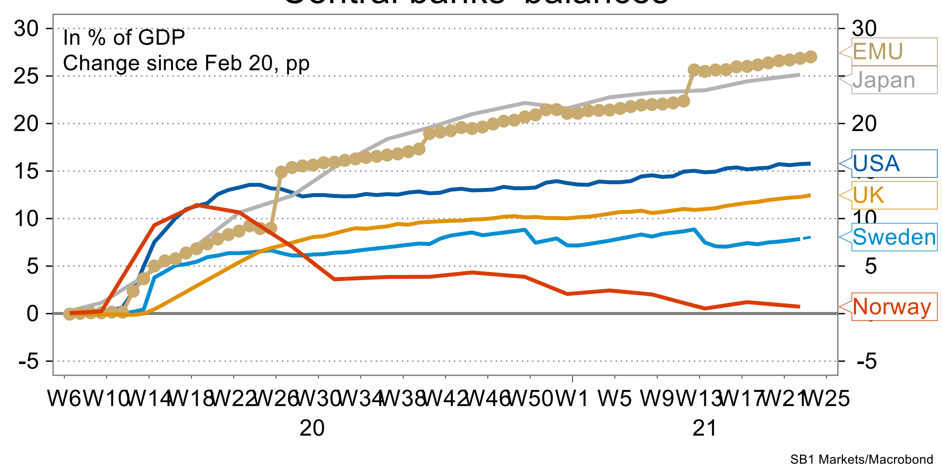



- Federal Reserve will increase its holdings of Treasury bonds and agency mortgage-backed bonds by USD 120 bn/month (80 + 40), which has been the pace so far in 2021
- USD 120 bn/month equals 7% of GDP per year, a substantial share of the net increase in government og mortgage-backed bonds. Since last February, the Fed's balance sheet has increased by 16% of GDP (and now equals an unprecedented more than 35% of GDP)
- <u>Powell acknowledged that tapering may have come closer but promises to tell us all well in advance before reducing the pace of bond buying</u>
  - » Just so you know: *In the land of the free, and home of the brave, it is the central bank that is securing funding of the housing market – even if this market is booming. <u>Something will soon have to give…</u>*

USA Fed Treasuries & MBS



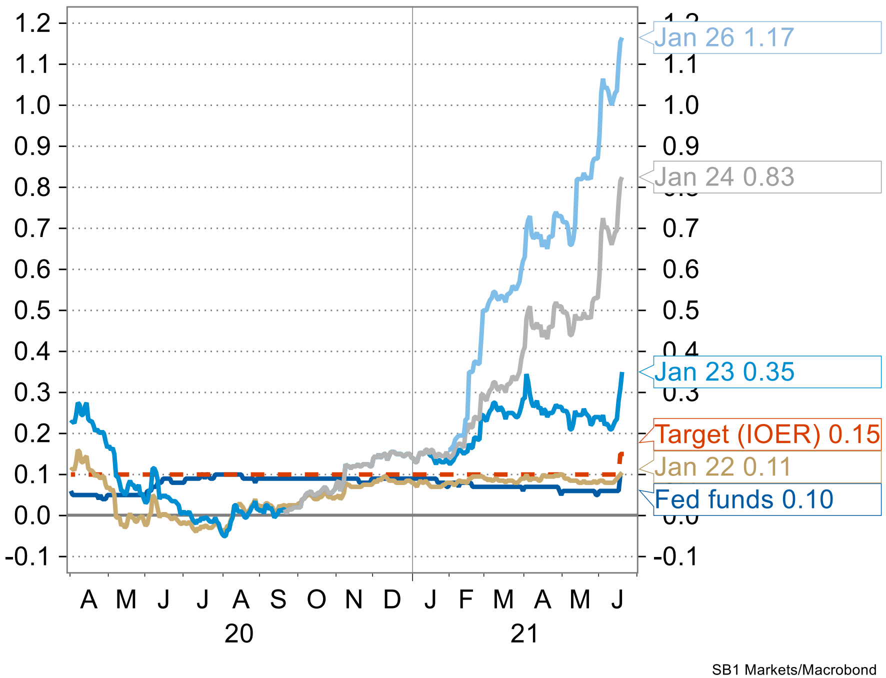

Central banks' balances



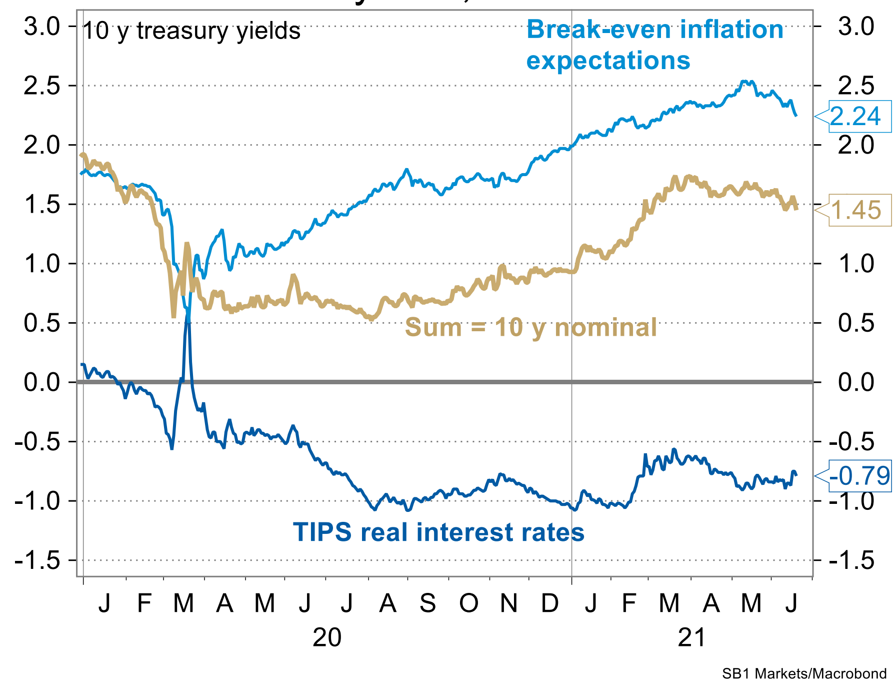
# Now we are talking! The short end of the curve up by 15 bps!

The market is now discounting the <u>first hike late Q3-22, and 2 more hikes in 2023</u>

Fed funds future




USA TIPS Real yields, break-even inflation




- .... In the long end of the curve yields fell – due to a further decline in inflation expectations, in total by 8 bps last week (10 y gov). Since March, inflation exp. are down by 30 bps! The Fed has turned less dovish
- Real interest rates rose by 6 bps, as the market now expects a slightly less dovish Fed. Still, the 10 y real rate is at -0.79 bps. And the 5 y rate is at -1.48%, though up from ATL at -1.91% in early May (just before the first 'tapering' signal came from the Federal Reserve (in the minutes from the April FOMC meeting)

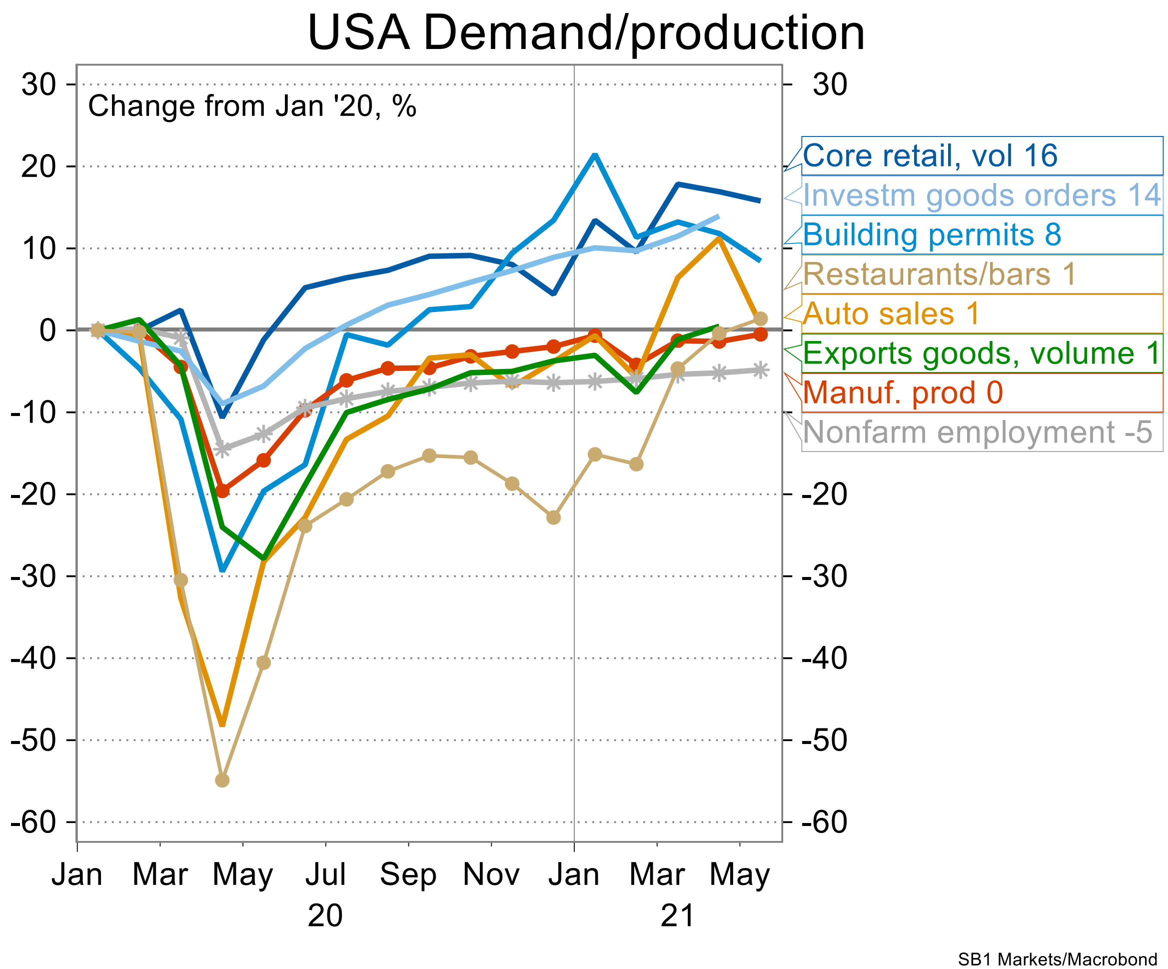
US & Germany 10 y Gov bond yield

| | Yield | Change 1w | Change 1m | Min since April-20 |
|---|---|---|---|---|
| **USA nominal treasury** | 1.45 | -0.02 | -0.19 | 0.52 |
| .. break-even inflation | 2.24 | -0.08 | -0.28 | 1.06 |
| .. TIPS real rate | -0.79 | 0.06 | 0.09 | -1.08 |
| | | | | |
| **Germany nominal bund** | -0.20 | 0.09 | -0.09 | -0.65 |
| .. break-even inflation | 1.46 | 0.01 | -0.11 | 0.40 |
| .. real rate | -1.66 | 0.09 | 0.02 | -1.76 |

SB1 Markets/Macrobond

# Growth is not accelerating

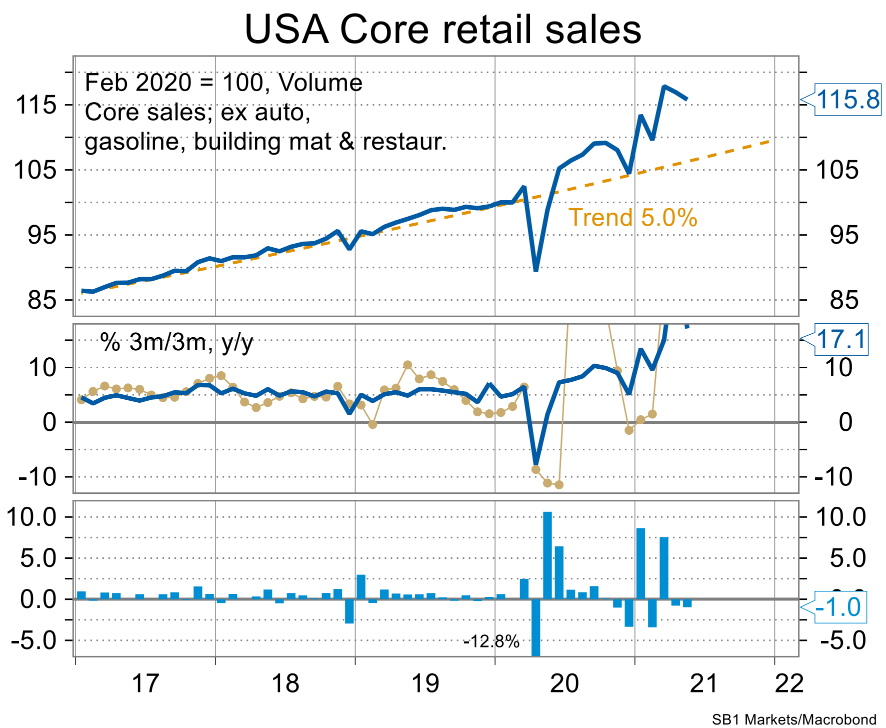
## Retail sales, building permits have slowed, from high levels

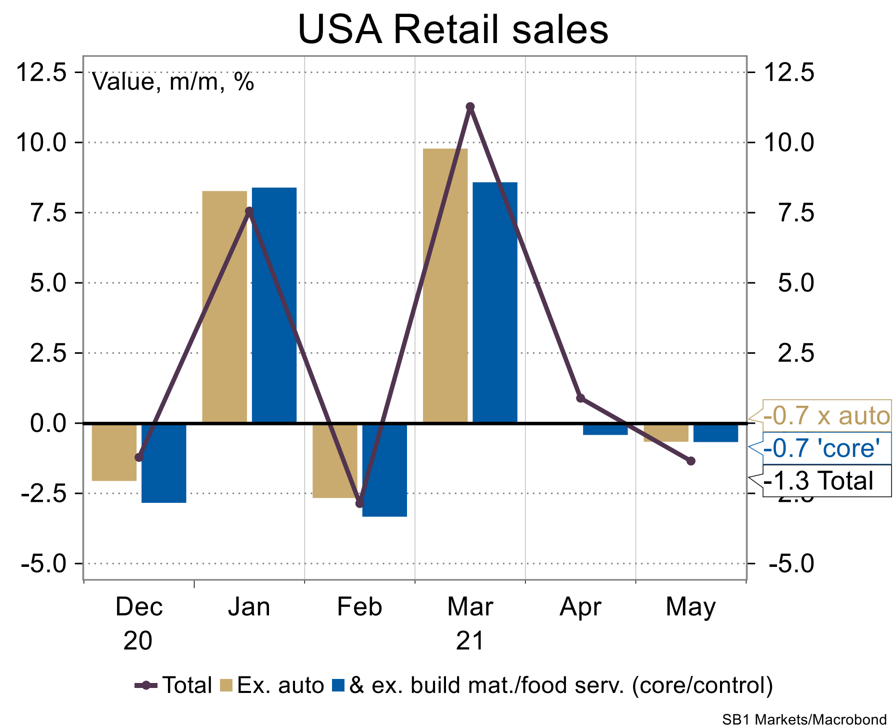



- **Retail sales** of 'core' goods fell in both April and May but in sum less than expected, as April was revised substantially up
- **Restaurant sales** finally crossed the pre-pandemic level, in value terms
- **Building permits** have trended down since the January peak, but remains strong
- **Manufacturing production** is back to the Jan/Feb-20 level
- **Investment orders** are still on the way up, and far above the p-p level (data until April)
- **Exports** are climbing too, and are finally above the p-p level too
- **Employment** growth still strong, but not given the low employment level and the the unprecedented number of unfilled jobs

# (Real) Retail sales down in May too but still incredibly strong!

## We expect a further decline the coming months, sales volumes are still 16% above the Feb-20 level!




- **Total nominal sales** fell by 1.3% in May, expected down 0.8%. However, April was revised up to +0.9% from zero, and the level in May was well above expectations, and April + May even more so – signalling a very robust growth in private consumption in Q2. Nominal sales are up 18% vs. the pre-pandemic level!
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) fell 0.6% in May, expected down 0.7% but April was revised up by 1.1% to a 0.4% decline. We assume a 1% volume decline in May (2nd–hand autos are not included). Core sales are up 16% vs. the pre-pandemic level. The downside is substantial the coming months/quarters
- Sales in restaurants & bars rose 1.8% m/m and is 2% above the Feb-20 level! Most other sectors were down
- Retail sales – and other consumption – have received a real boost from the **two rounds of stimulus cheques**, the first distributed in January and the second in March and April. Just a fraction of the received amounts have so far been spent – and savings have increased substantially

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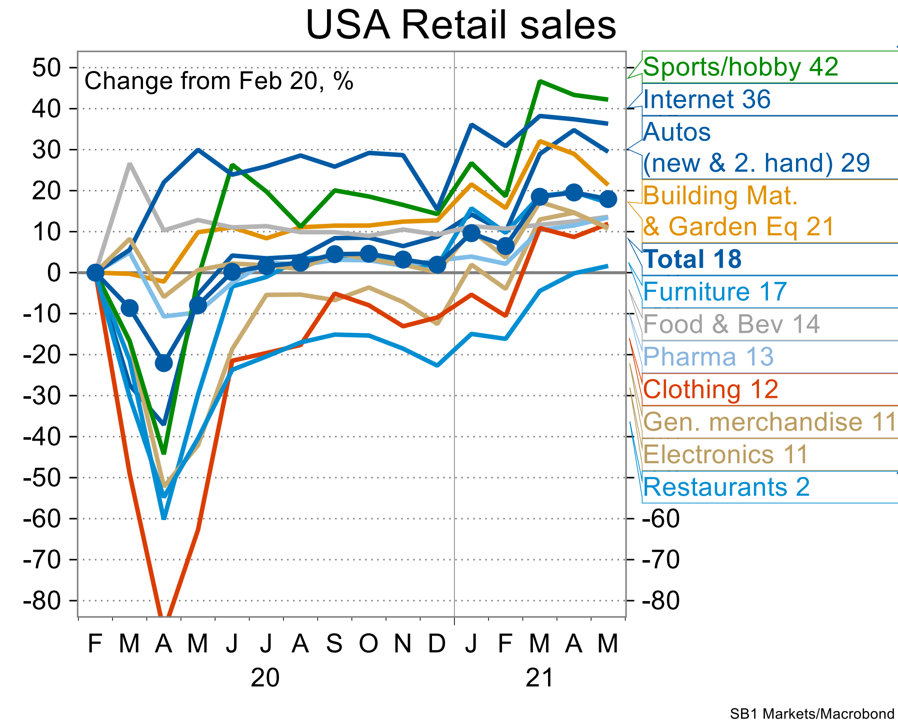
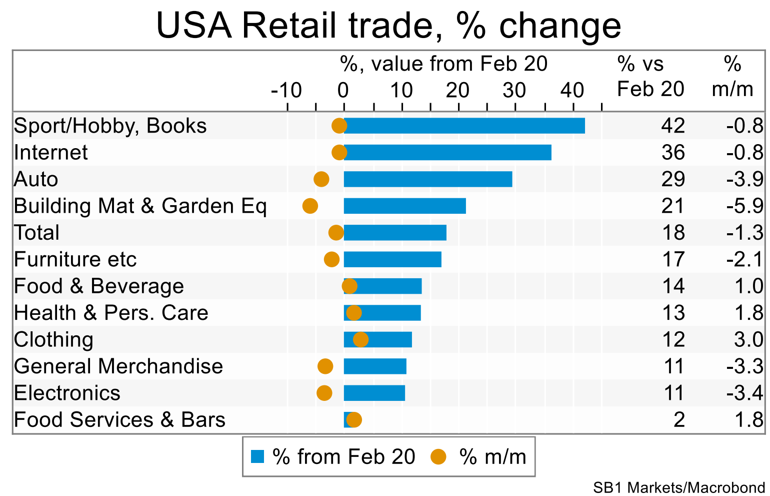
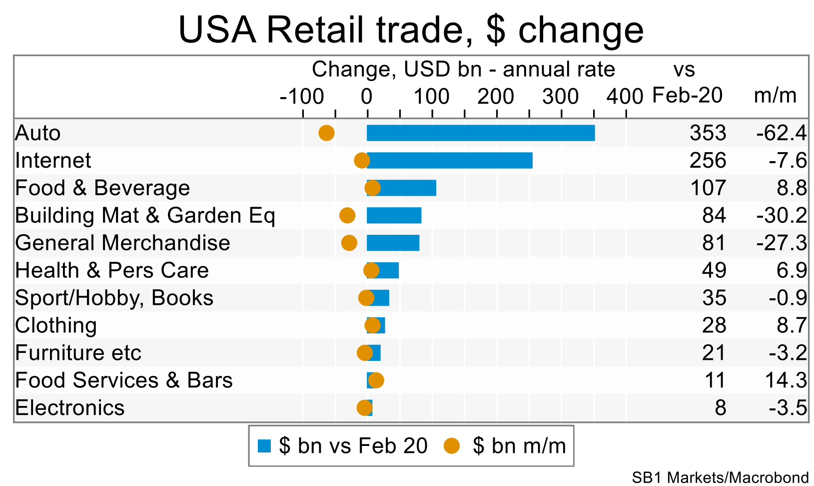
# Most sectors down in May – but restaurants +2%, to 2% above the Feb-20 level!

## Sales of Auto and building materials/garden mat. fell the most but remains 20% – 30% above Feb-20




**Last month**

- 7 out of 11 main sectors reported a decline in sales in May. Solid upward revisions of April sales in many sectors

**Since pre corona**

- **Restaurants** are finally above the pre-pandemic level, at least in nominal terms (but still down in volume terms)
- **Clothing** are on the way up, are up 10% vs. Feb-20, was down until March!
- **Sports equipment** (+hobby/books) is up 42%! Auto sales 29%

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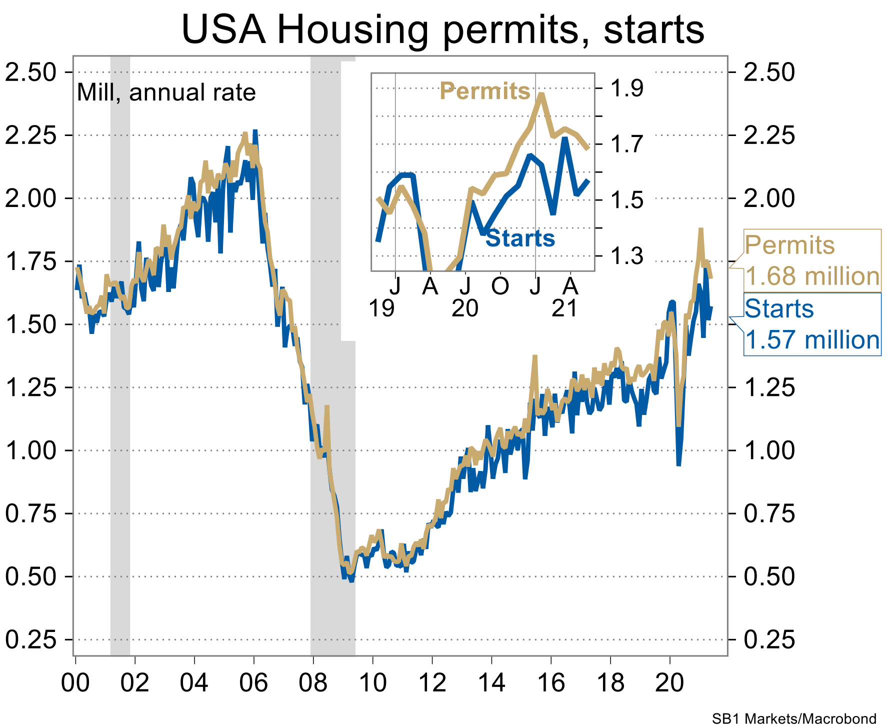
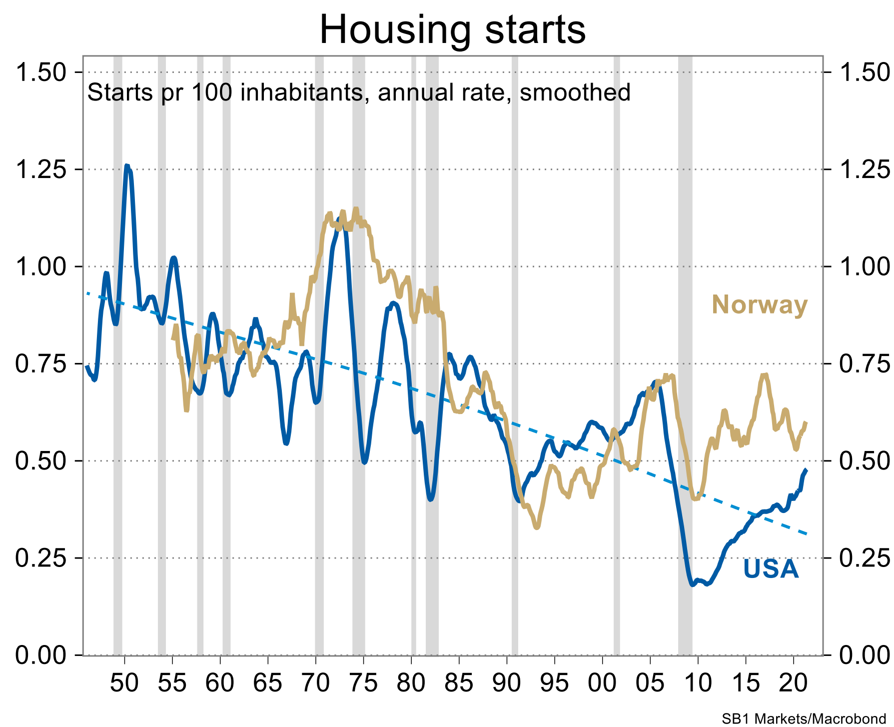
# Housing starts up, permits marginally down up in May, levels high

Both starts and permits have flattened recently, even if the existing home market has been red hot

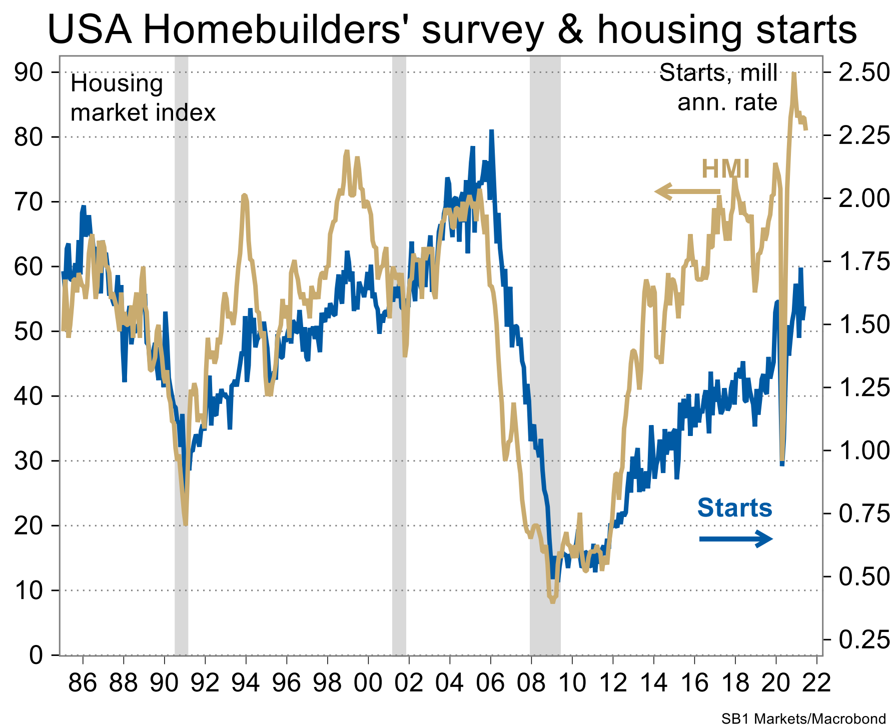


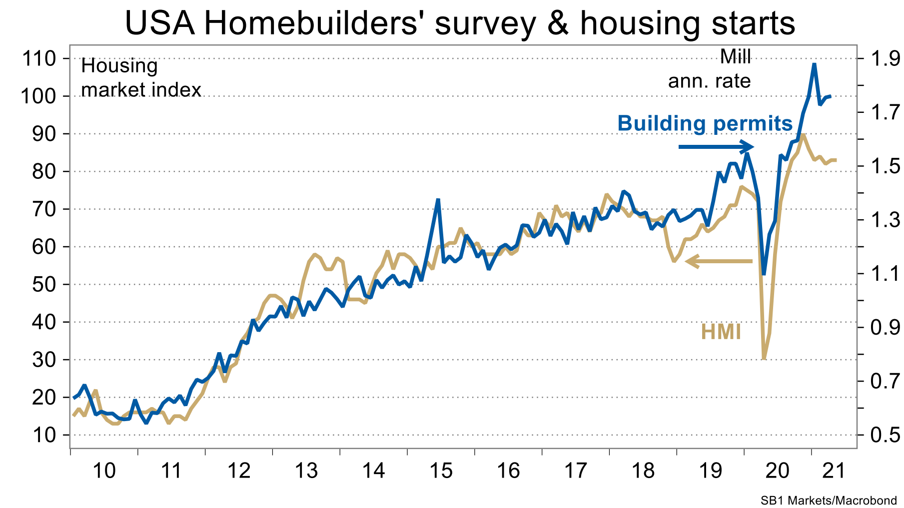

- **Housing starts** rose to 1.57 mill in May, while April was revised down to 1.52 mill (from the same 1.57 mill), expected up to 1.64 mill. The trend is flattish – at a rather high level
- **Building permits** fell to 1.68 mill from 1.73 mill in April, expected 1.73 mill. Permits have fallen since January but the level is still high – though 20% below the late 2005 local peak
- Are housing starts flattening due to **lack of demand or lack of supply?** Surely, material availability & costs is a challenge for the industry. Lumber prices have fallen substantially recent weeks but remain far above normal levels, However, there are some signs of less demand too, probably because prices have been increasing. Households do not deem the buying conditions to be good at all, check the two next pages

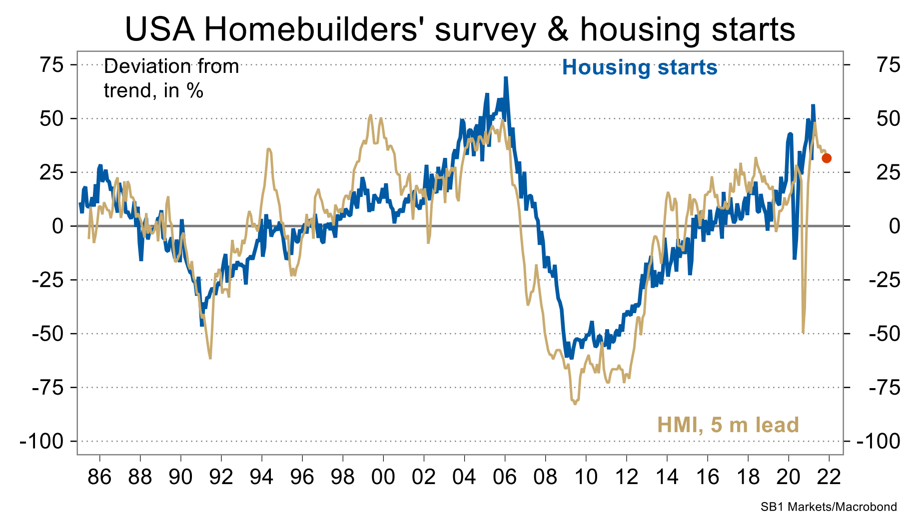
# Home builders market index a small tick down in June too. Some cooling?

The HMI is still at a very high level, but is sliding slowly down. Both supply & demand concerns



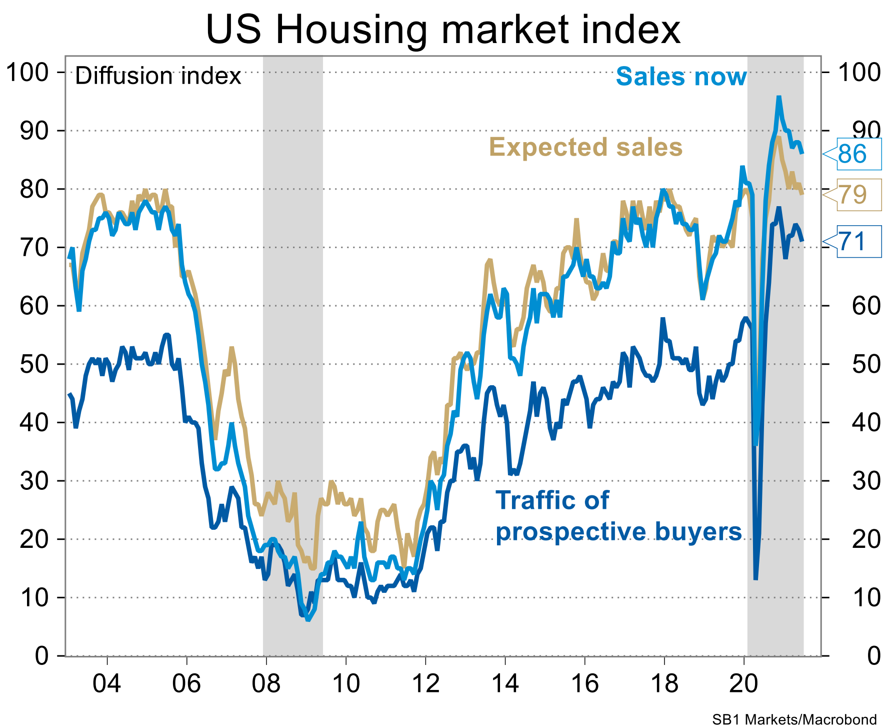

- **The Home Builders Housing Market Index** fell 2 p to 81 in June, expected unch. The level is sky high but still down from 90 last Nov. Actual/expected sales & interest from buyers are all down
- **Rising material prices and supply chain shortages** are creating challenges for the home builders, according to the NAHB. At the same time, traffic from prospective buyers have fallen somewhat
- <u>Even if the level is very high, the HMI signals that the surge in starts probably is behind us (check the 'cycle model' bottom right)</u>

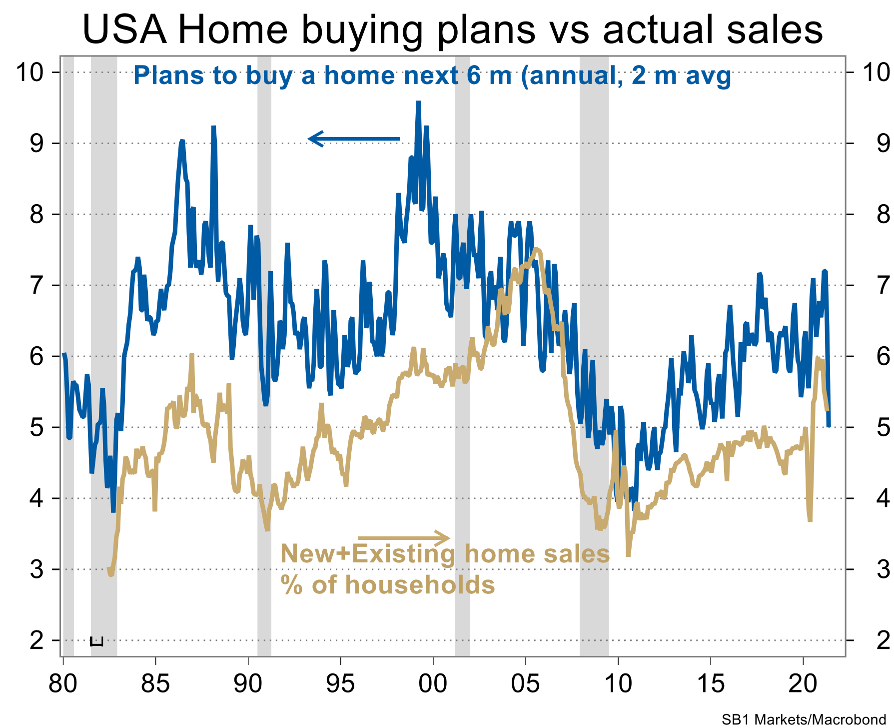


# Home builders report a little less interest from buyers

… and home buying plans are down, households report to the consumer confidence survey

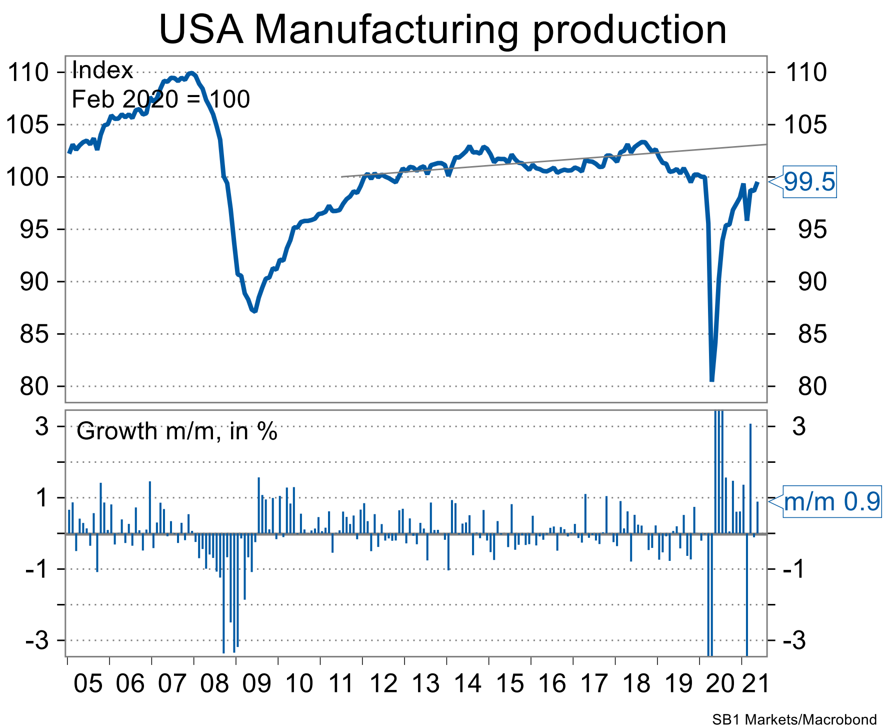


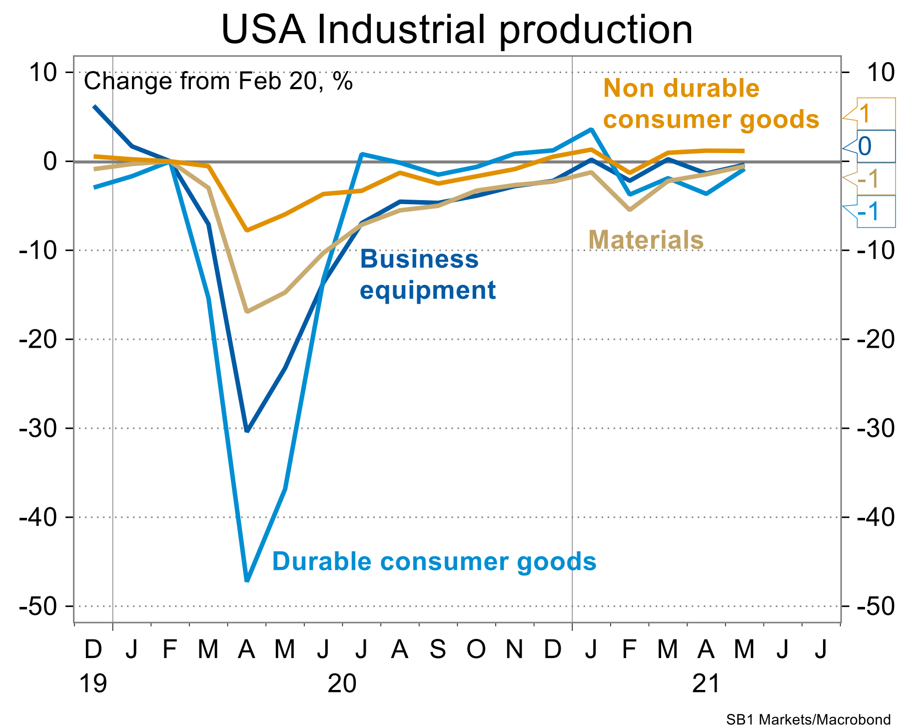




- University of Michichan sentiment survey reports that households deem buying conditions to be poor, due to the high price level. However, in April respondents expected prices to climb, at a very rapid pace the coming year, and above average the coming 5 years. So no panic yet

# Manufacturing production up 0.9% in May, down just 0.5% vs. Feb-20

## Auto production rose 6.7% (following a 5.7% April drop) – less supply problems?

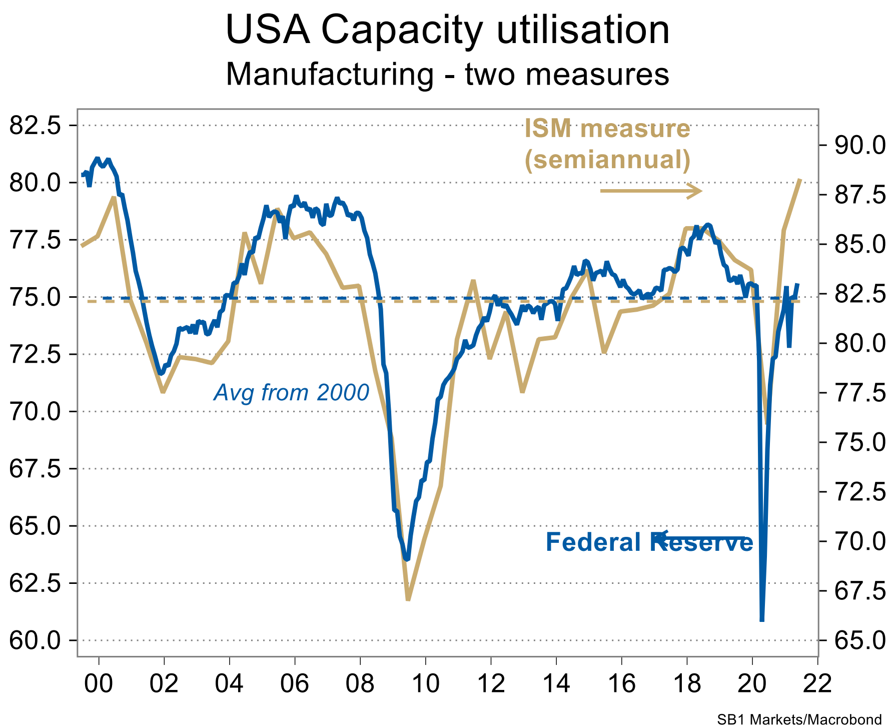



- **Manufacturing production** rose 0.2 pp more than expected but April was revised down by 0.3 pp to -0.1%
  - An annual revision has lifted production by 0.7% vs. Feb-20, and production is now just 0.5% down. However production over the previous years has been revised significantly downwards, by 5% since 2015 (that is the present production level is 5% lower than assumed vs. the production level in 2015 (or 2005) - a major revision
- Non-durable consumer goods were flat in May, the other main sectors reported higher production
- **Total industrial production**, including utilities, mines/oil production rose by 0.8%, expected 0.6%. April was revised to -0.1% from originally +0.7%
- **PMI/ISM and all other surveys** signal a continued, exceptional strong recovery – way above the current growth rates

# Is capacity utilisation at average or at ATH?

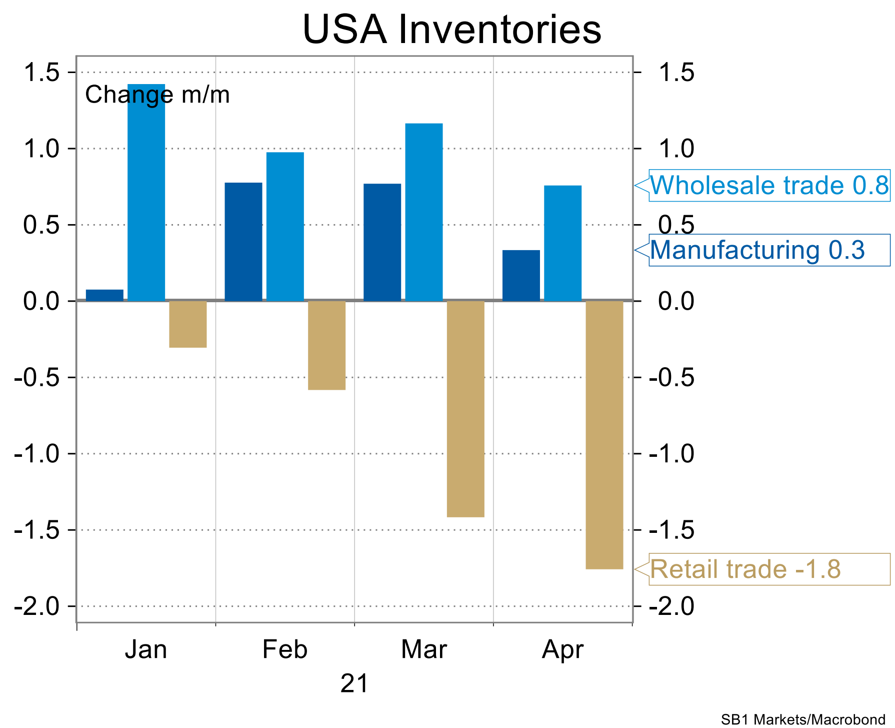
## Not an irrelevant question

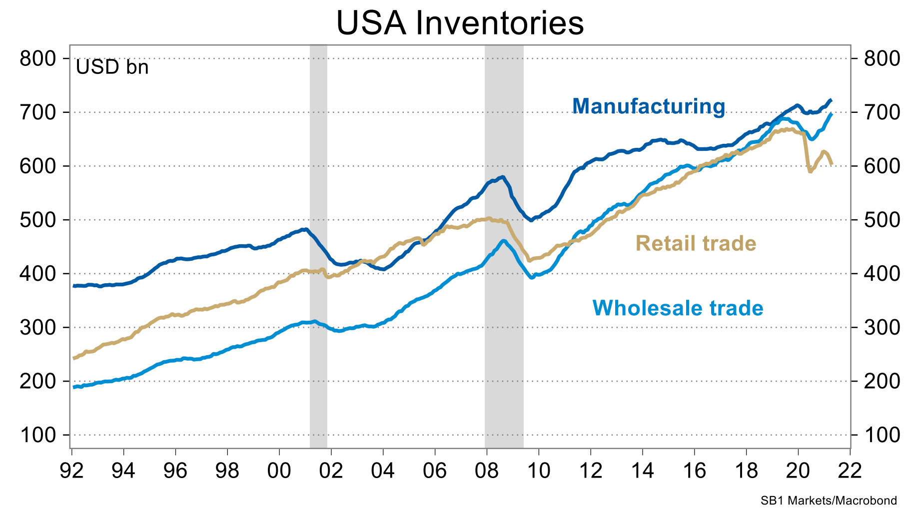


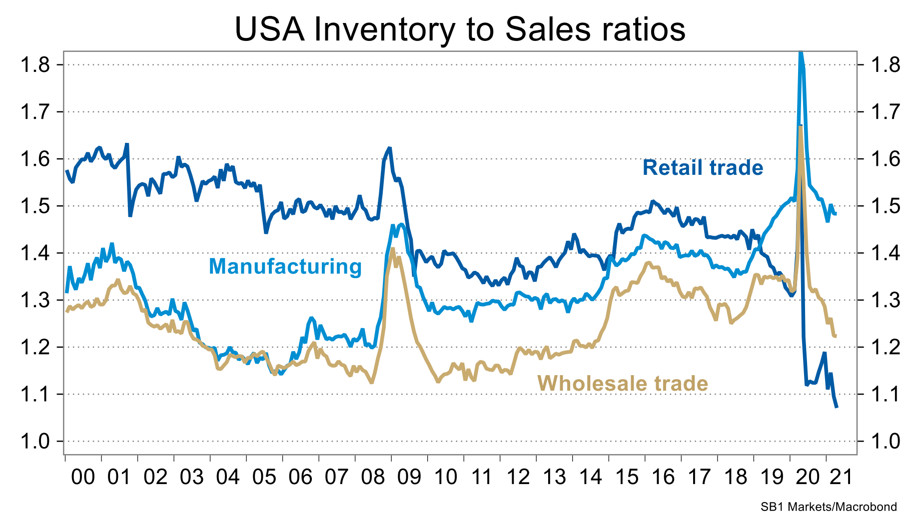

- **The Federal Reserve's** measure now yields a slightly above normal capacity utilisation rate, in line with the pre-pandemic level
- **ISM's semi-annual** survey reported a further sharp increase in May, the highest level ever – however with data just back to year 2000. These two measures have not been 100% correlated but the current discrepancy is very large – and quite important when assessing the growth outlook
- The Fed's estimate is model based, as far as we know, while the ISM survey is based on companies assessment of their own capacity
- Given reports on labour shortages, material shortages, prices, the <u>ISM survey seems to give the most reasonable result</u>

# Inventories were down 0.2% in April as material shortages increased

## Retail inventories fell 1.8% due to a drop in auto inventories



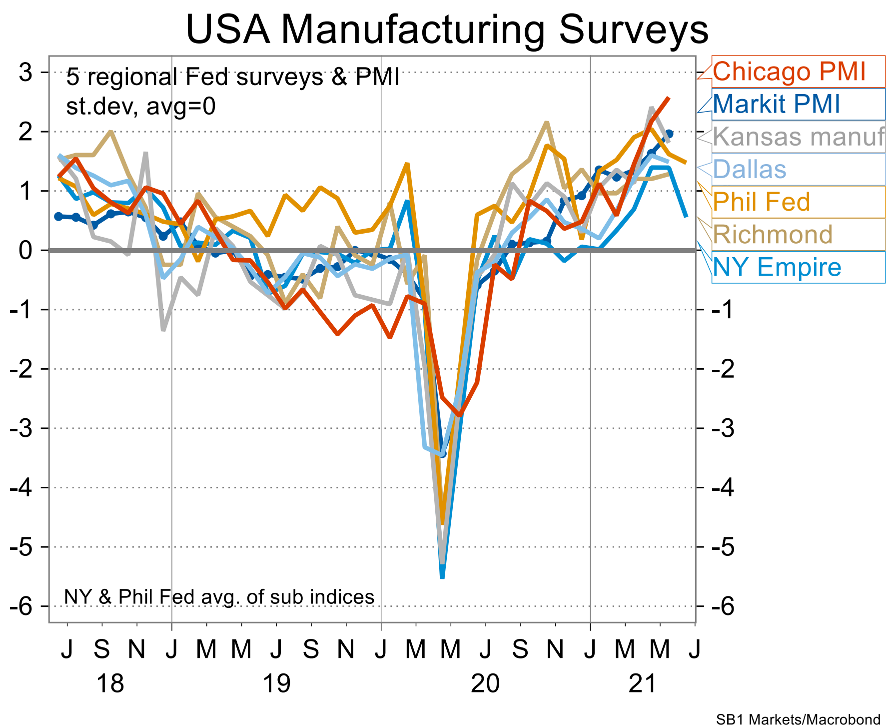



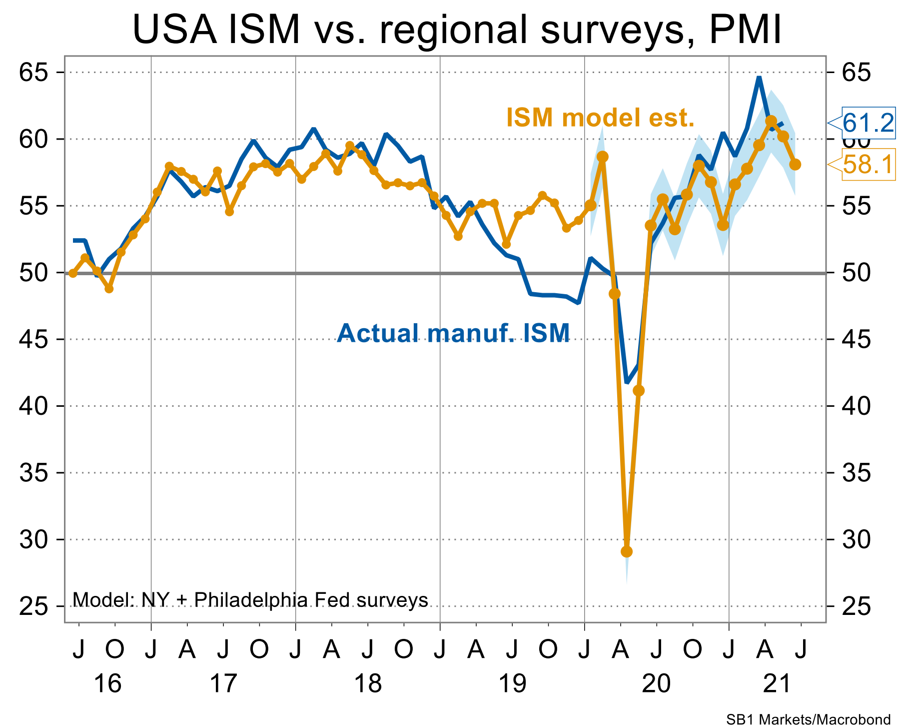




- Retail trade inventories are record low vs. record high sales but they are low in value terms as well
- Inventories were up in wholesale trade in April, but are probably too low as well
- A bit surprising, manufacturing inventories are on the way up – and they are not specifically low
- In sum, we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

# Peak growth? Both Phil & NY Fed manufacturing surveys down in June

## ... and signalling a decline in ISM – from a very high level

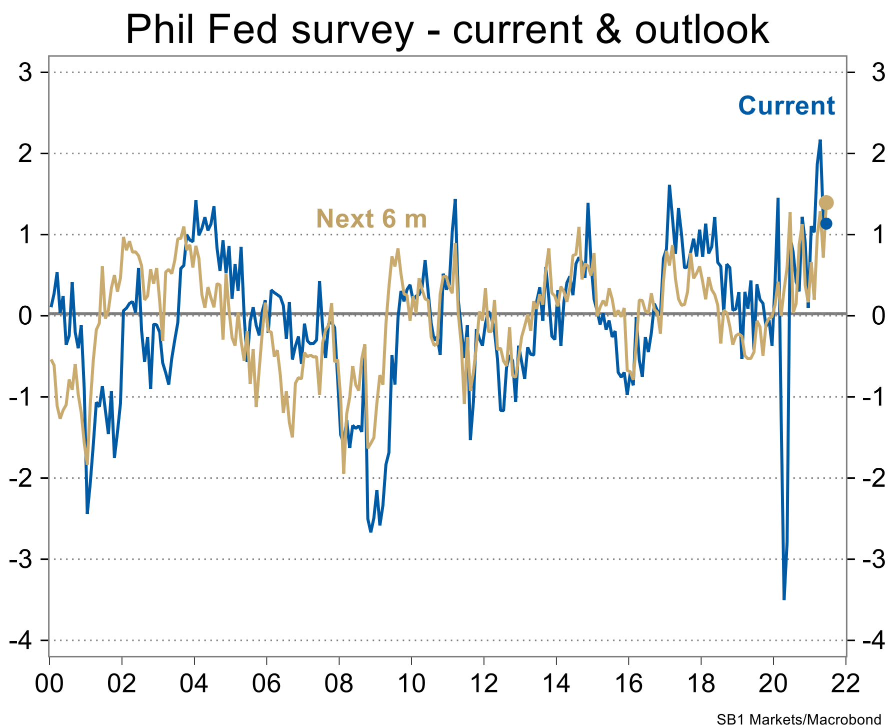


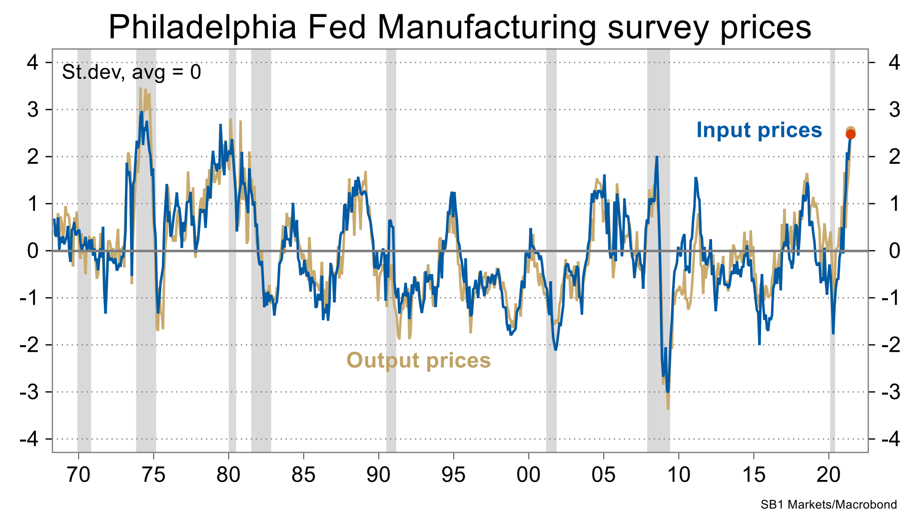




- The average of the most relevant subcomponents of both Philadelphia & NY Fed manufacturing surveys fell in June
  - » Growth in orders fell in both surveys, and delivery times slowed somewhat. Shipments rose in the Phil Fed index
- The Phil Fed headline index was close to unch., as expected, while the NY Fed index fell to 17.4 from 24.3, expected 23

# Philly Fed survey still at high level, prices are soaring

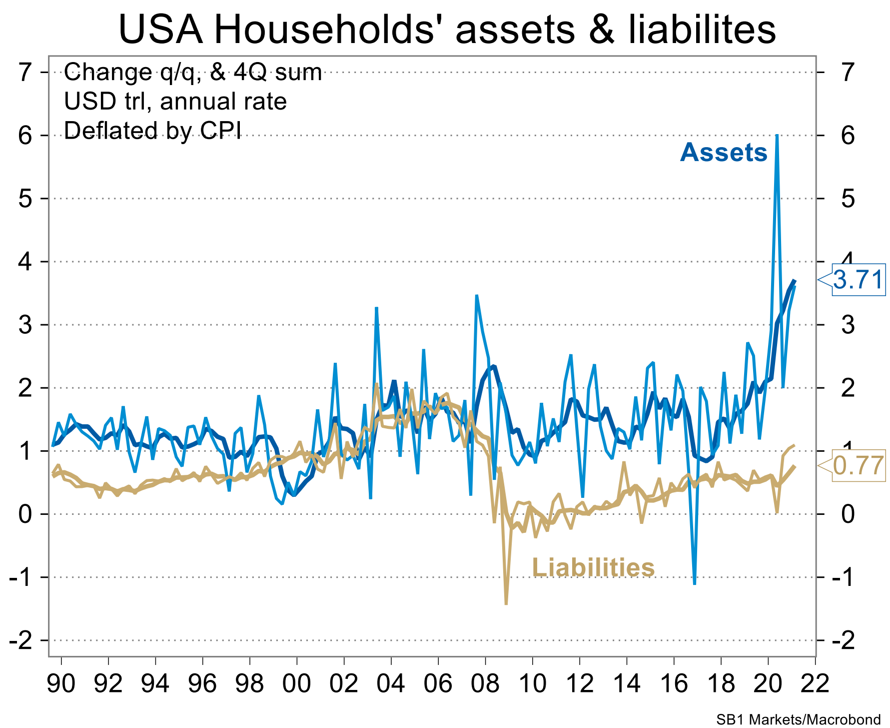
The outlook for the next 6 months is the best in 30 years

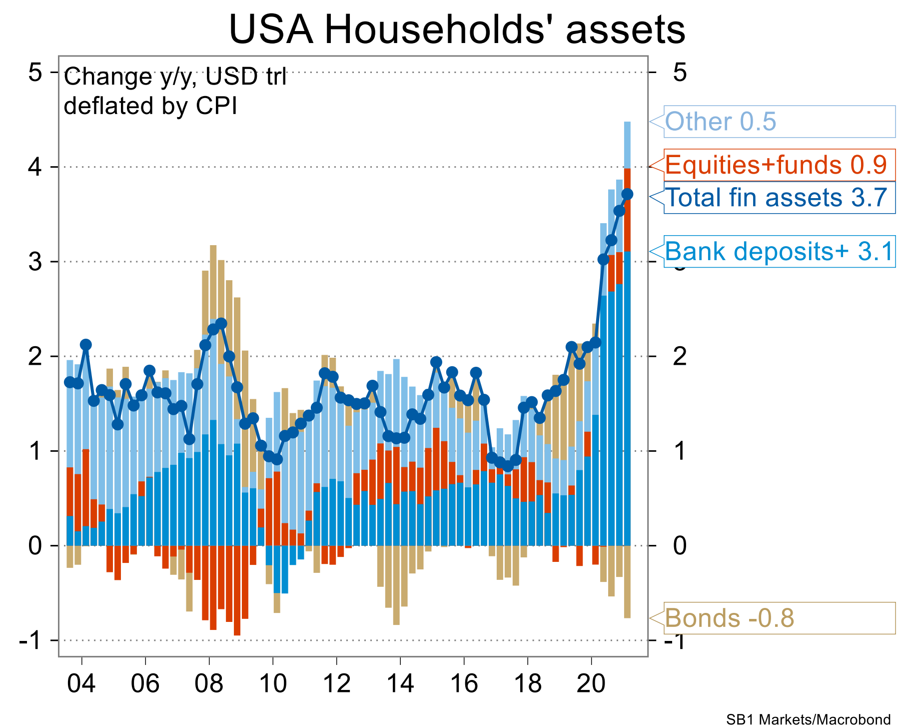


# Flow of funds: Where are the saved money invested?

## 85% in bank deposits, and past quarters more in stocks & fun(ds) more than ever (in USD)




- **Households have increased their financial assets** by USD 3.7 trl over the past year, 2.5 x more than 'normal', as the saving rate has exploded – and **debts have not been repaid**. In Q2 alone, assets grew at the same pace (but up from Q4 and Q1, mostly due to payment of stimulus cheques. Debt is increasing faster – no debt repayment, so
  - » **Bank accounts** have swelled by USD 3.1 trl, or by almost 85% of the total increase in assets
  - » Over the past 4 quarters, households have bought **equities and fund shares** for USD 900 bn (net), a new record high! Which may explain some of the retail 'activity' at the stock market recently…
  - » Households have (net) sold **bonds** at an close to unprecedented pace over the past year
- How much of the extra savings in bank accounts will stay there, how much will be spent? That will important for the USA economy (and Federal Reserve's policy stance)

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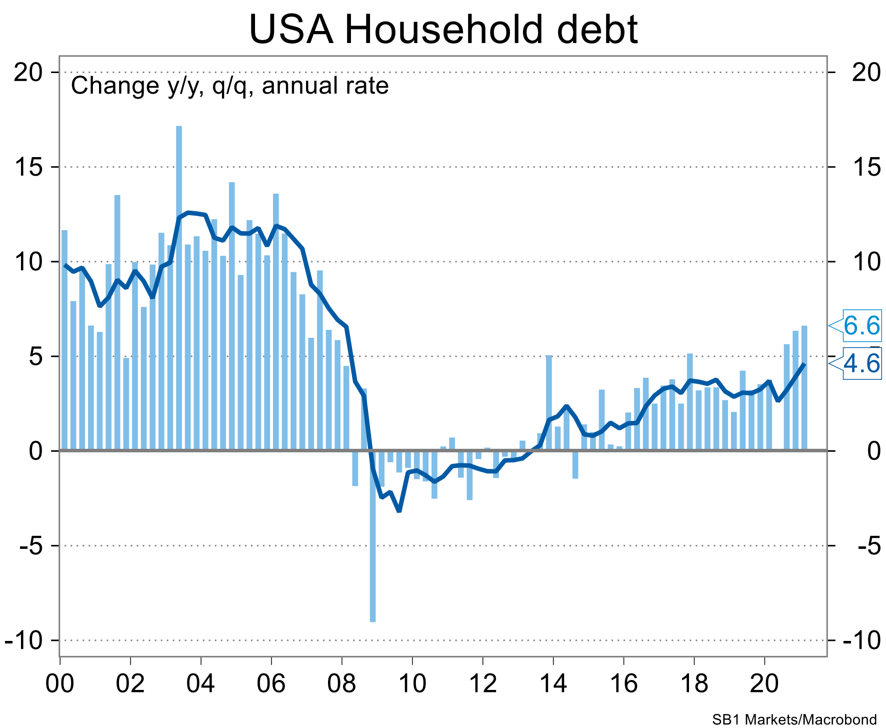
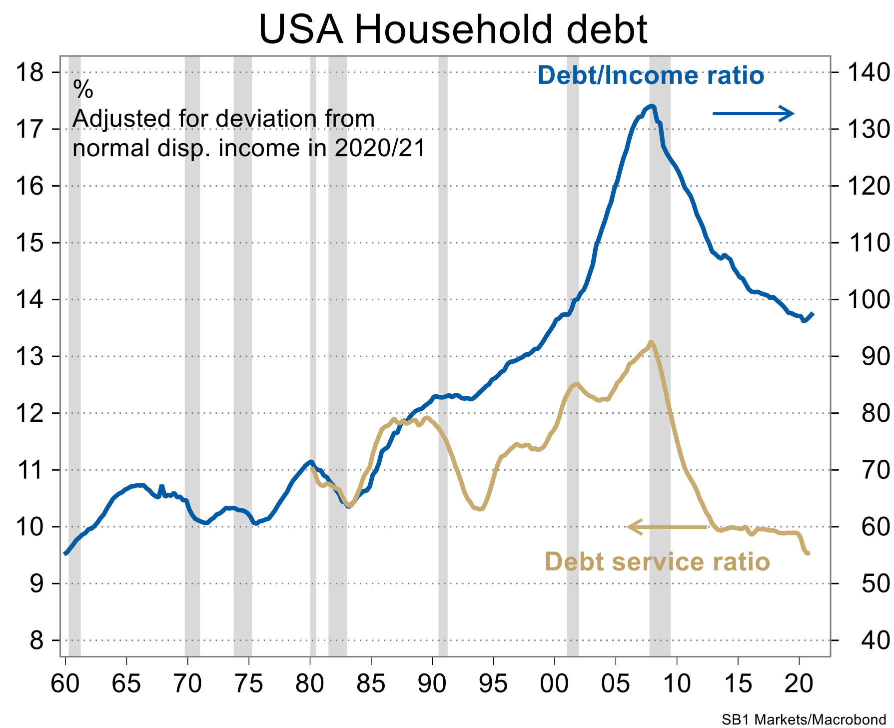
# Household credit growth is accelerating, but still not high

And the debt/income ratio is growing again, from a far below the pre-financial crisis level

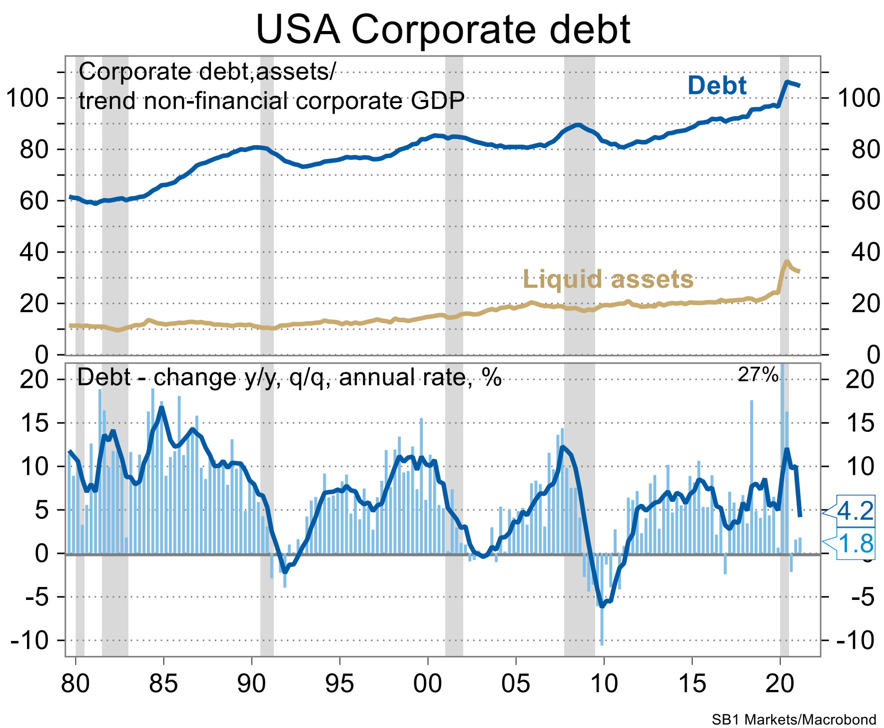


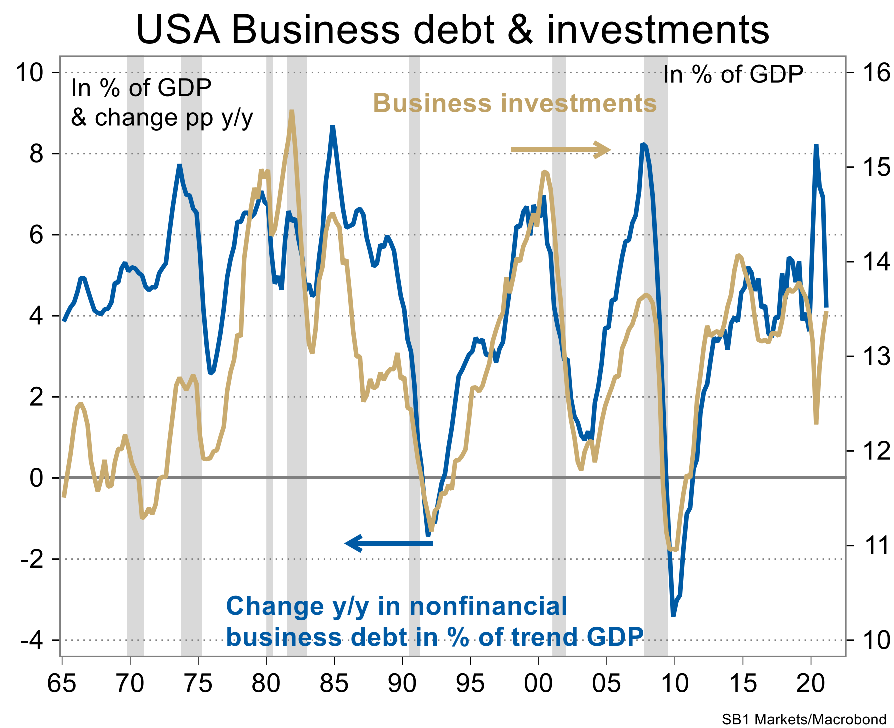




- Households have reduced their debt burden in an unprecedented way past 12 years
- Now, this process may have come to an end – and debt growth has been accelerating, and it is now growing faster than the underlying income growth
- The debt/income debt service ratio is record low, due to the low mortgage rate

# Corporate debt growth has slowed, following the Q1-20 hike

However, the debt level is high. However over the past year, a surge in liquid assets too!



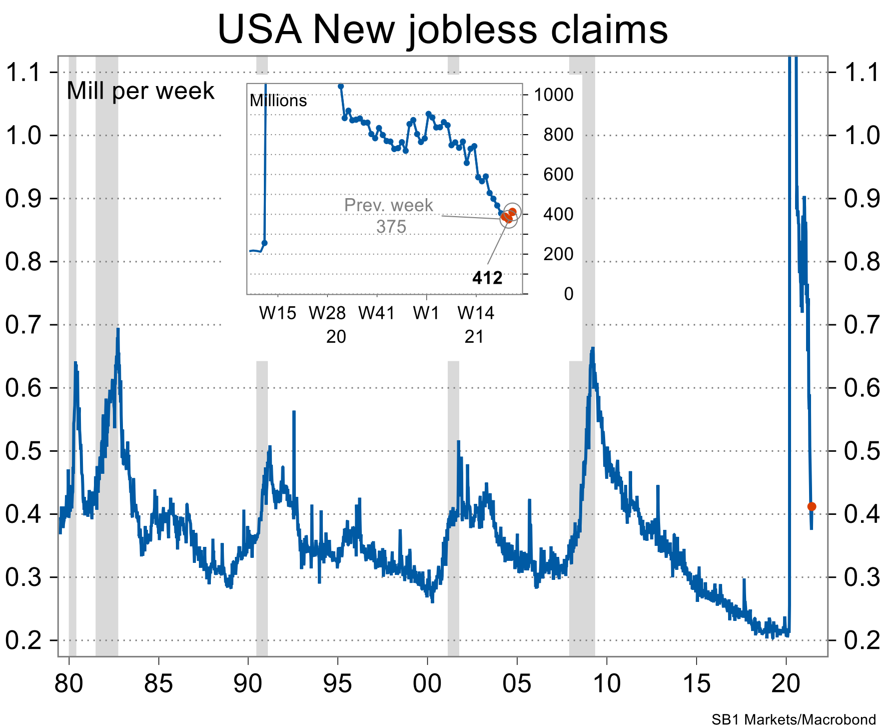



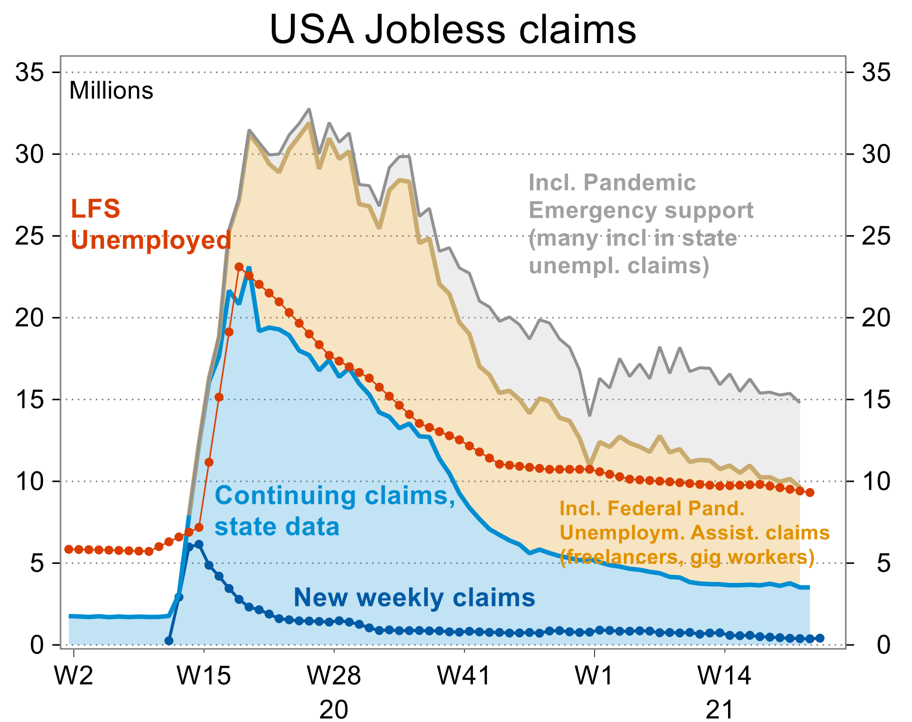

- In sum, companies still have some capacity to further lift their investments – even if the profit cycle has turned south

USA

# Jobless claims <u>rose</u> for the first time in 7 weeks

## The trend is still down

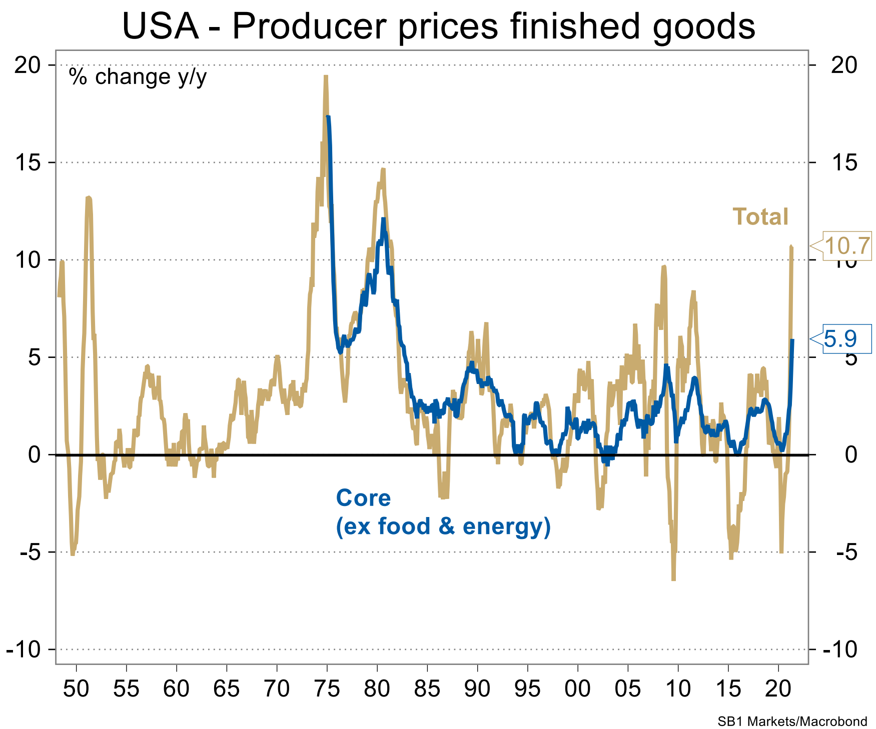


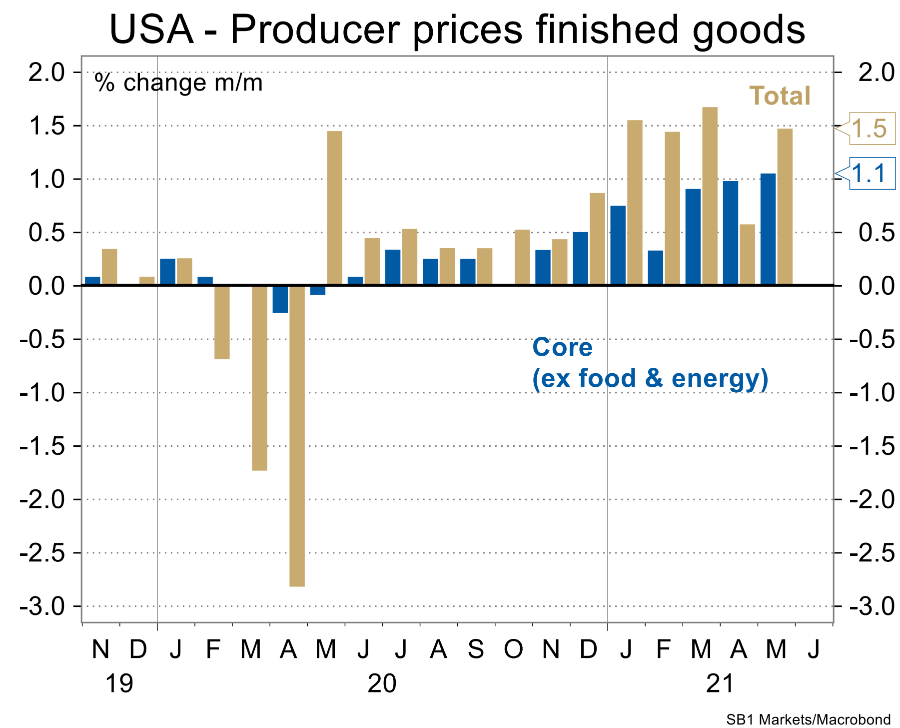




- **New claims** at rose to 412’ from 375’ (revised down from 376’) the previous week, expected 359’.
- **Ordinary continuing claims** was close to unch, while the no. of receivers of the Pandemic Emergency Support Program (52 weeks instead of 26, and USD 300 extra/week) and the no. of receivers of the Pandemic Assistance Program (gig & freelancers) both fell – and both are trending down. Still, the level is still high, at 6.2 mill and 5.1 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, 24 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? It will take a couple of weeks to get the first indications

# Producer prices further up of course, and more than expected

Prices rises more than in 40 years, both m/m recent months, as well as the y/y growth rate

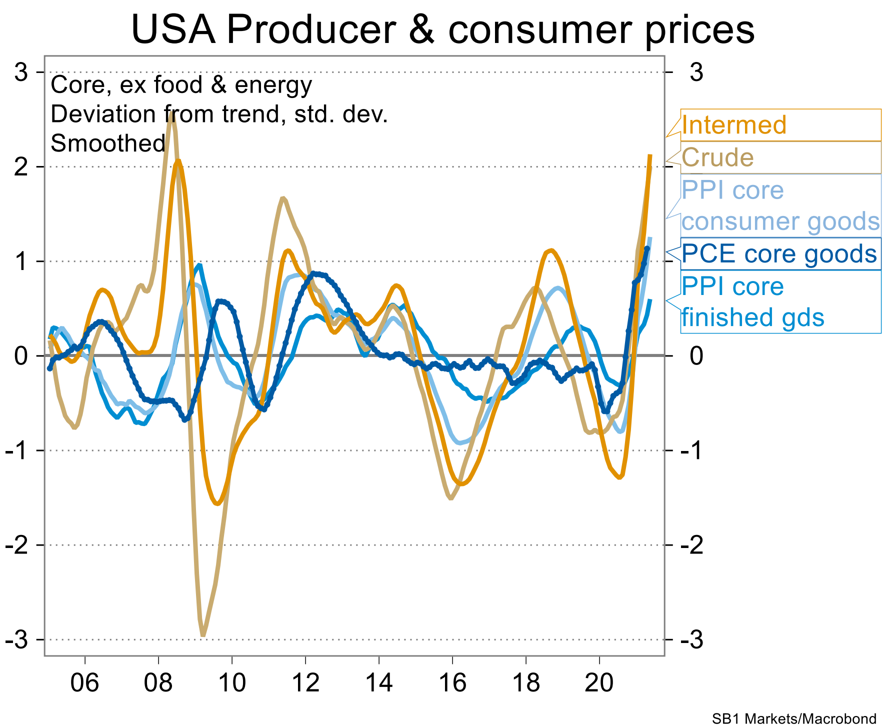


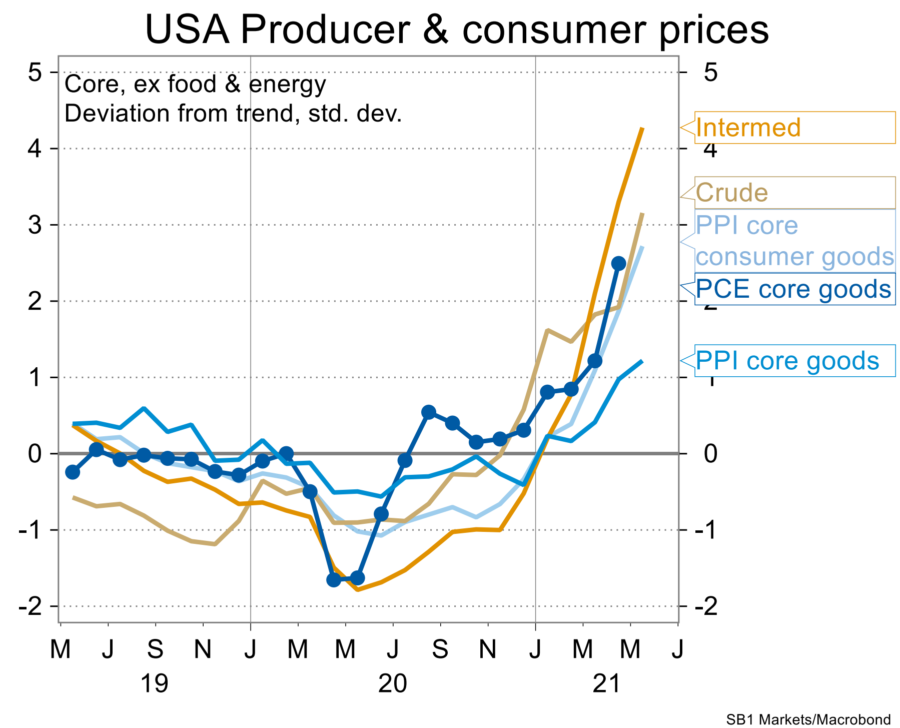




- **Core finished goods x food & energy** PPI rose 1.1% in May, up from 0.9% in March. The annual growth rate accelerated 1.2 pp to 4.9%, the highest level since 1982
- **Headline finished goods PPI** rose 1.5% m/m, as energy prices contributed on the upside again, in line with the monthly growth recent months. The annual rate was flat at 10.7% - highest since 1982 too
- **The 'official' total final demand PPI**, including **services**, rose by 0.7%, expected 'just' 0.4%. The index is up 6.5% y/y
- The PPI confirm what business surveys have told us; No more, no less

# It’s not brewing, it’s boiling: And it is getting even hotter

Core crude & intermed. goods prices are still on the way up: expect more pressure on finished goods

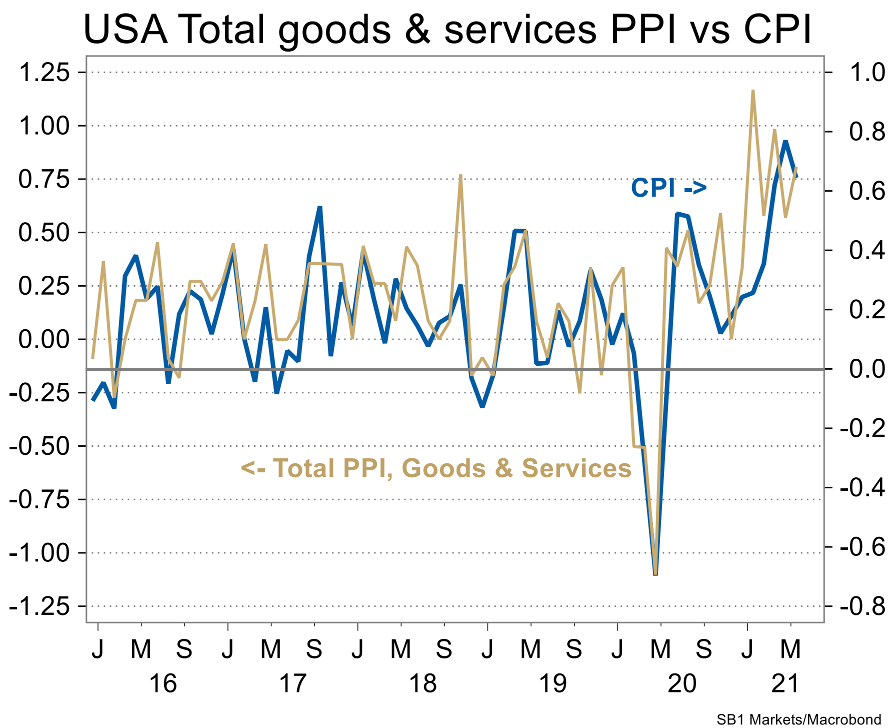


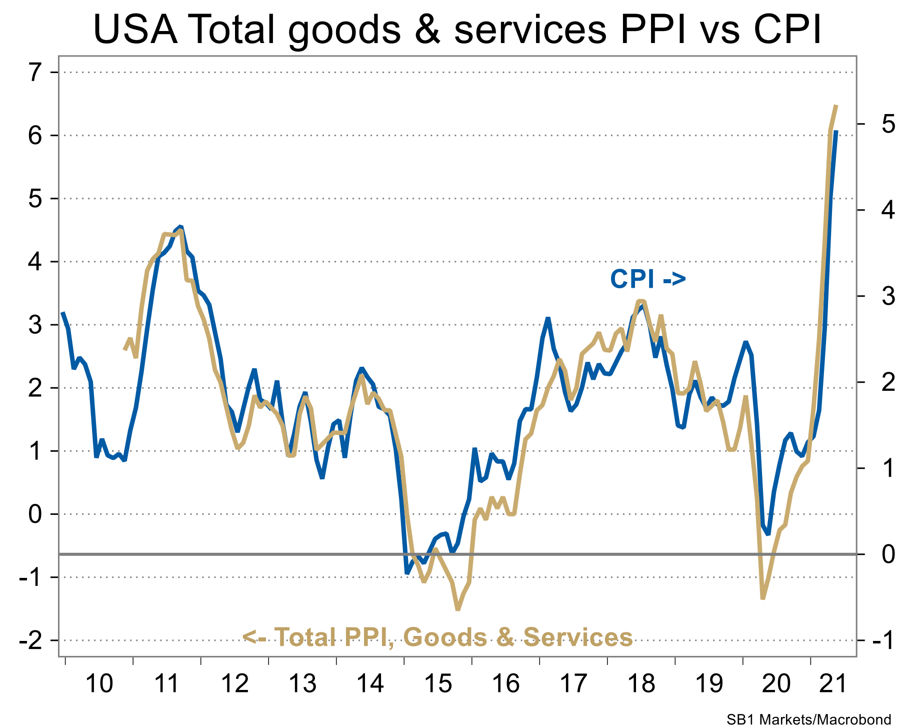




- Delivery times & prices are on the way up – and production is increasing rapidly. Hmm…
- It seems likely that finished goods PPI will climb further, given the continued increases in crude & intermediate goods
- Crude goods prices are leading intermediate goods by 4 months, and consumer prices by 12 months – and crude prices have not yet peaked
- Some comfort: Prices at the consumer level have responded to the hike in producer prices earlier than normally vs the PPI core consumer goods index, we assume due to the unprecedented (and very likely not permanent hike in 2nd hand cars which are not a part of the PPI index). Thus the upside risk for the core goods component of the PCE from here may not be that large, vs the rise in core consumer goods

# PPI including services confirm high CPI growth

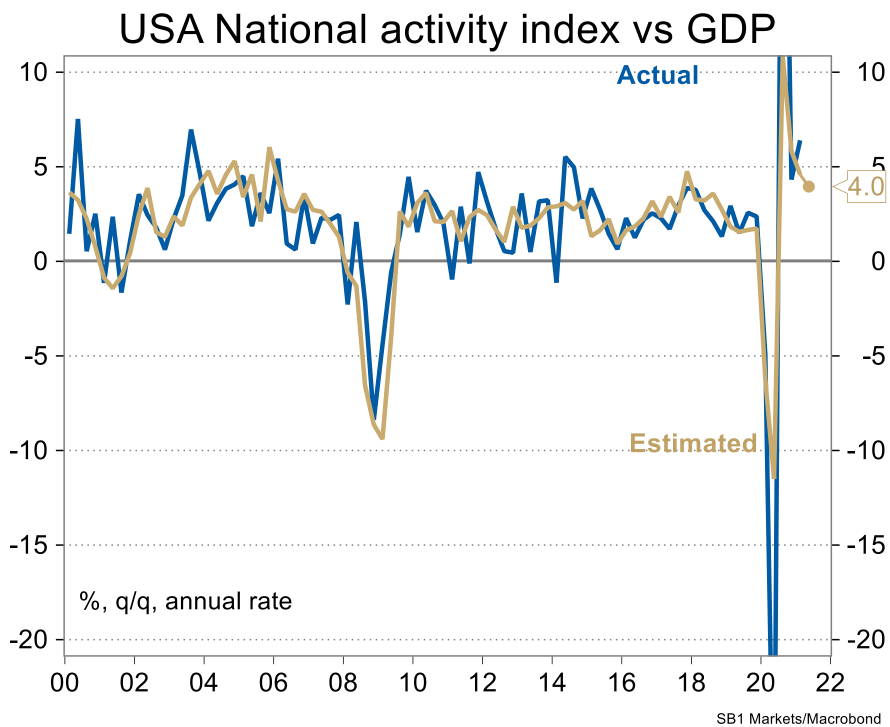
The total 'new' total PPI rose 0.7% m/m, and is up 6.5% y/y, signalling a 5%+ CPI growth

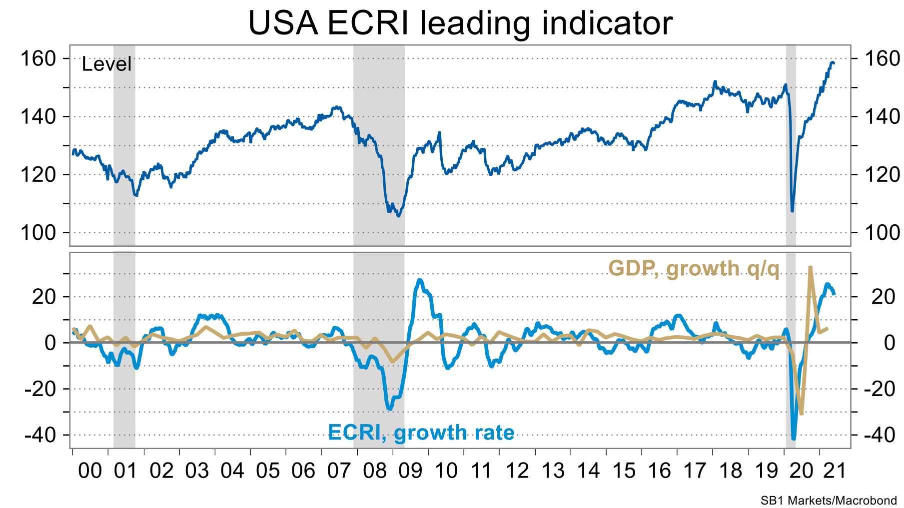


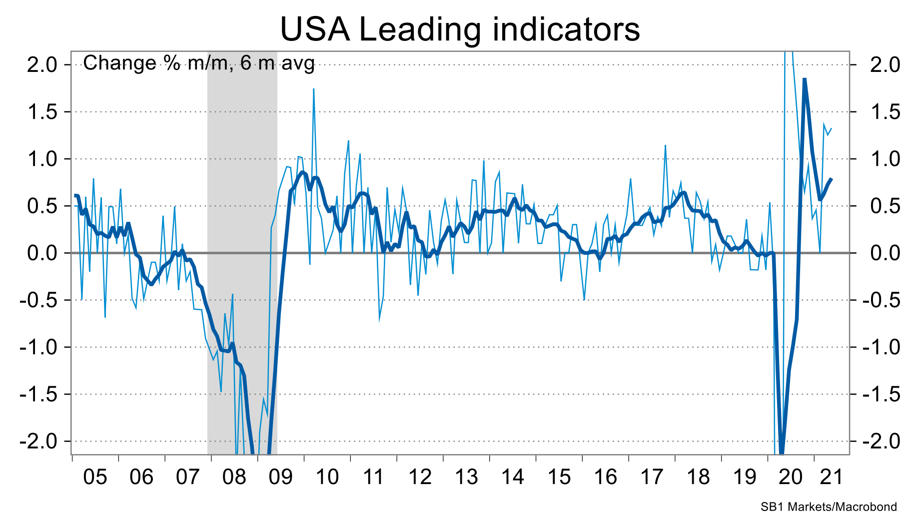



# The nat. activity index, ECRI leading indicator and LEI all confirm strong growth

No signs of growth slowing at the end of Q1

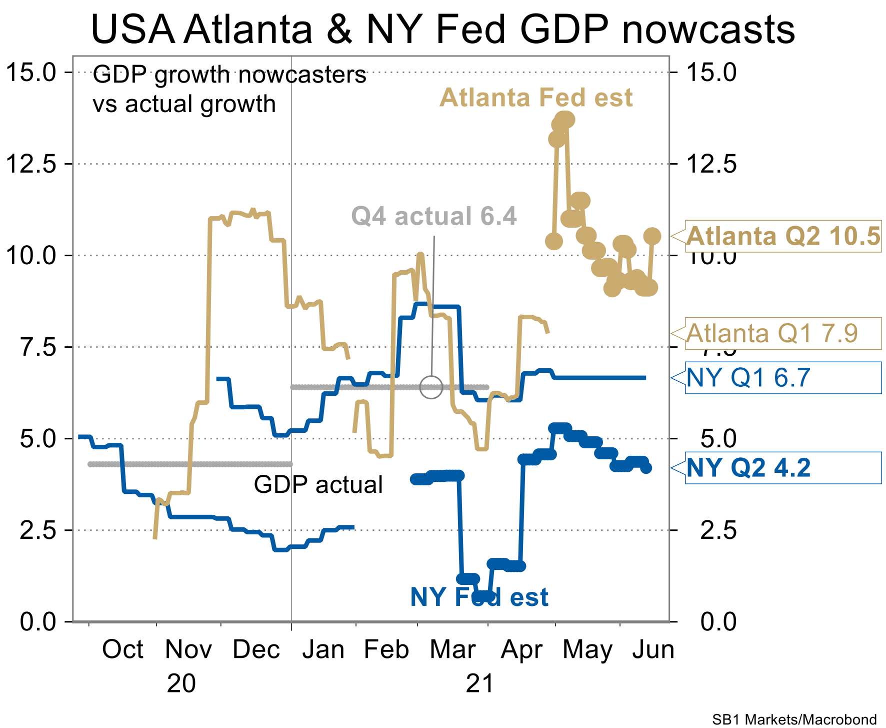


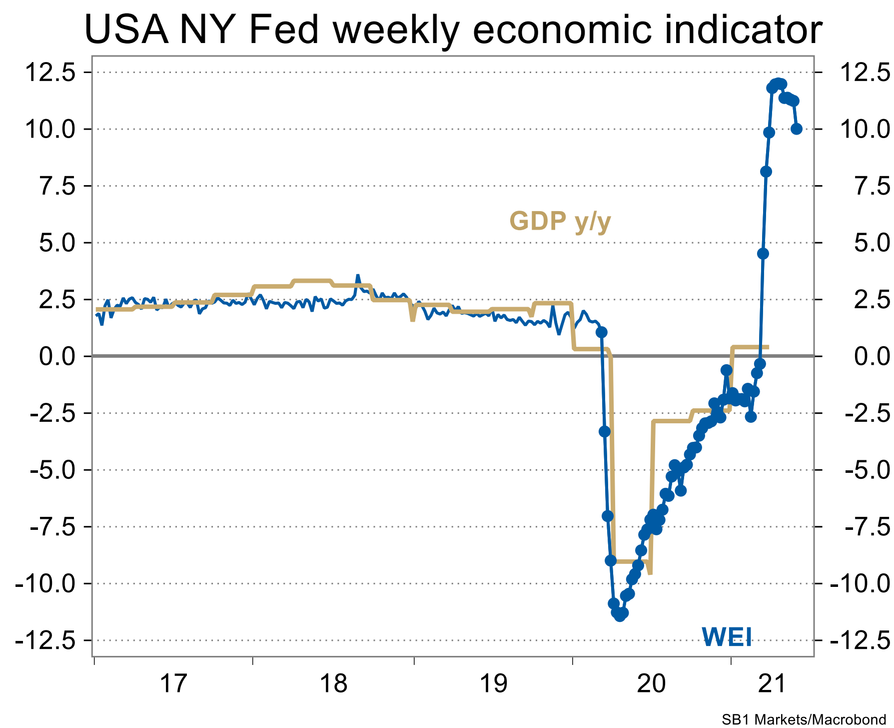



# The nowcasters signal 4% to … 9% GDP growth in Q2

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



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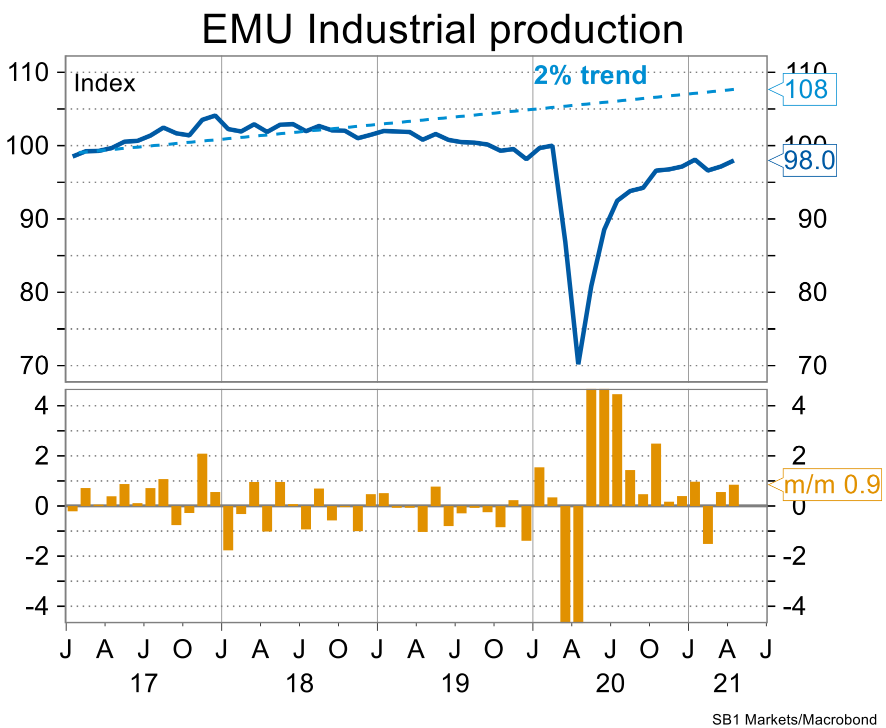
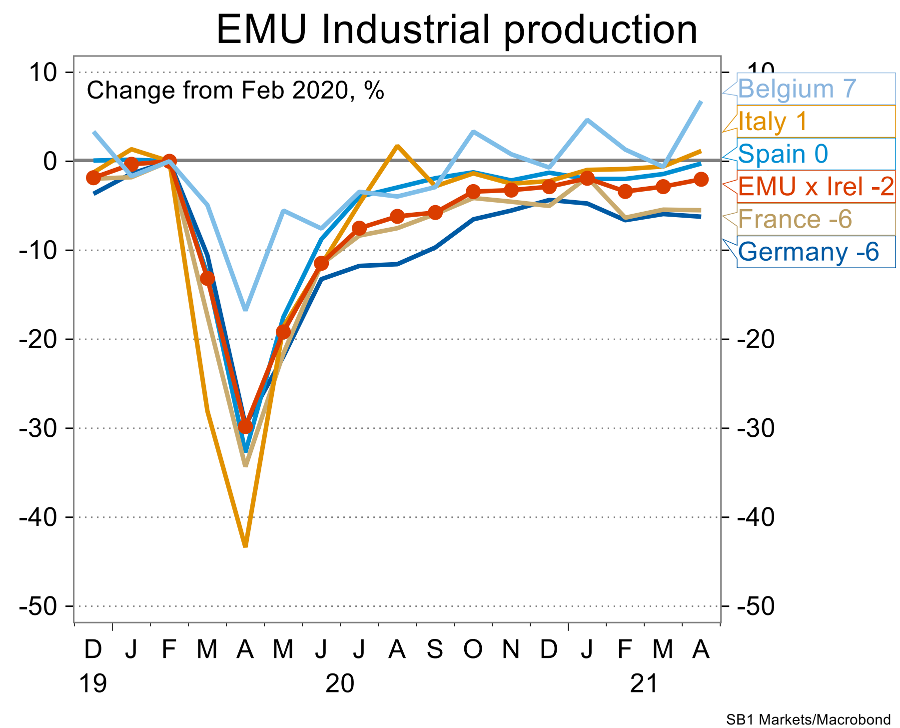
# Industrial production up 0.9% in April, better than expected. 2% below Feb-20

Production is still 2% below the pre-pandemic level

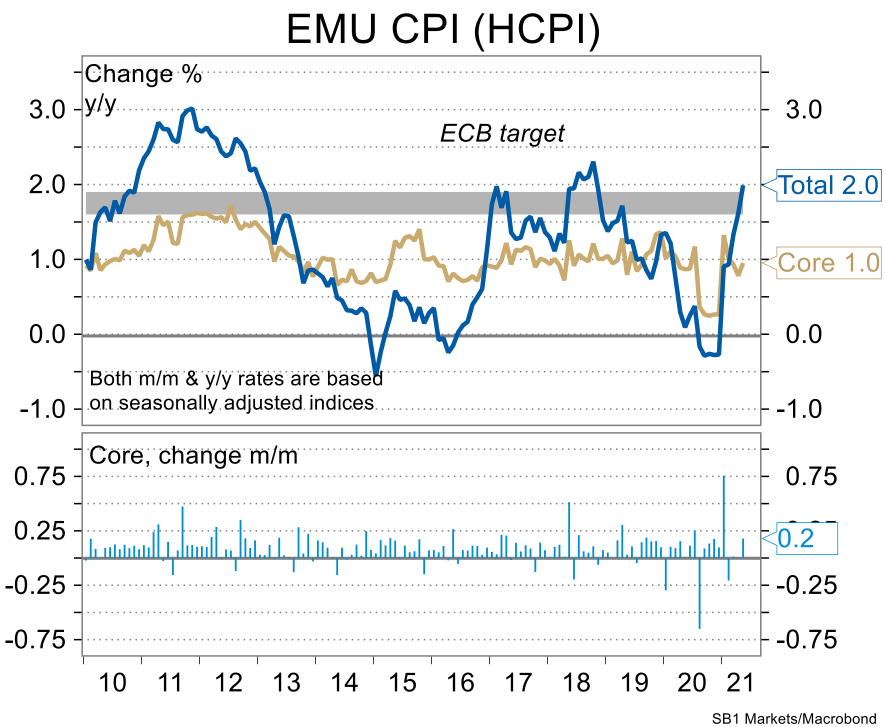


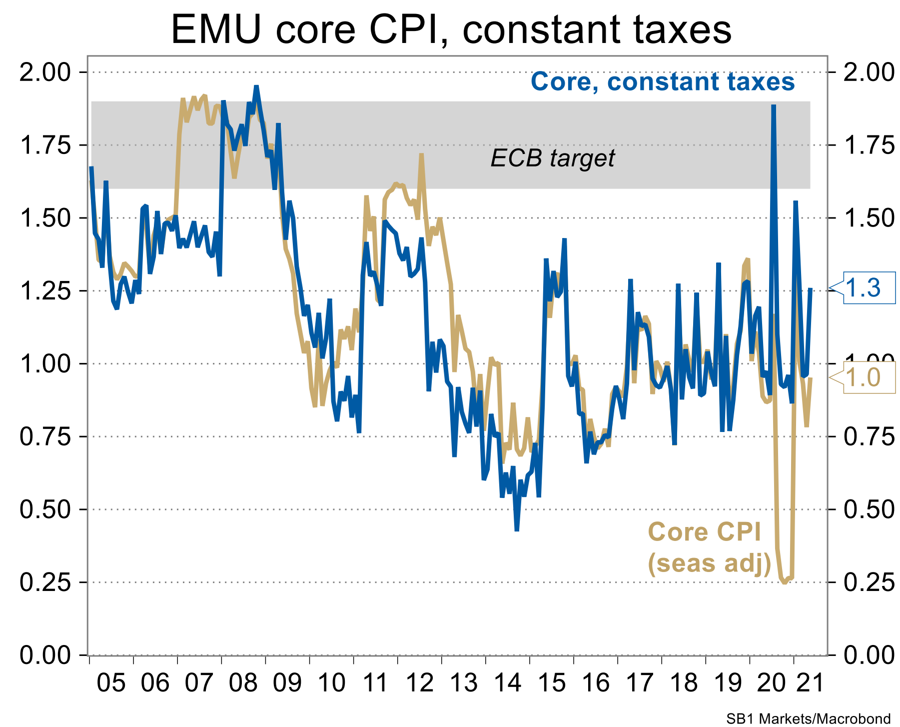




- **Industrial production** 'officially' rose by 0.8% m/m in April, expected 0.4%. Our 0.9% figure refer to EMU x the extremely volatile Ireland industrial data (though without making trouble in May).  Production us 2% below the Feb-20 level (however in line with Dec-20)
  - » Production rose by 0.5% in March, revised up. In March we reported a 3.3% shortfall vs. the pre-pandemic level. Manufacturing production rose 0.4% (energy production rose 3%, taking industrial production up)
- Production rose in Spain, Italy and Belgium, was flat in France and fell slightly in Germany (due to weakness in the auto sector)
- **Surveys** are signalling strong growth the coming months (if put goods are delivered, we suppose)

# Eurozone core inflation revised up slightly, still just at 1% y/y. Headline at 2%

Core inflation at 1.0% is still far below ECB's inflation target, while is marginally above target




- **Core prices** were up 0.2% m/m and the annual rate rose 0.3 pp to 1.0%, initially reported at 0.9%
- **Headline inflation** was up 0.4 pp to 2.0% in May, formally slightly above ECBs price target (below but not far below 2%). However, the ECB is not worried at all
  - » Energy and services prices were the biggest contributors to the increase in headline inflation. There are some base effect for the headline number (not the core), as the total CPI fell in May last year (they increased again in June & July, before falling sharply in August, due to tax cuts)
- **Adjusted for changes in taxes**, the core was at 1.3% y/y in May. The 'supercore' index is at just 0.8% y/y
- Greece is still in deflationary territory, while the headline inflation is at or above 2% in many of the member countries, including Germany, Belgium, Finland and Spain (Although central banks usually targets core inflation, and this number is more sticky)

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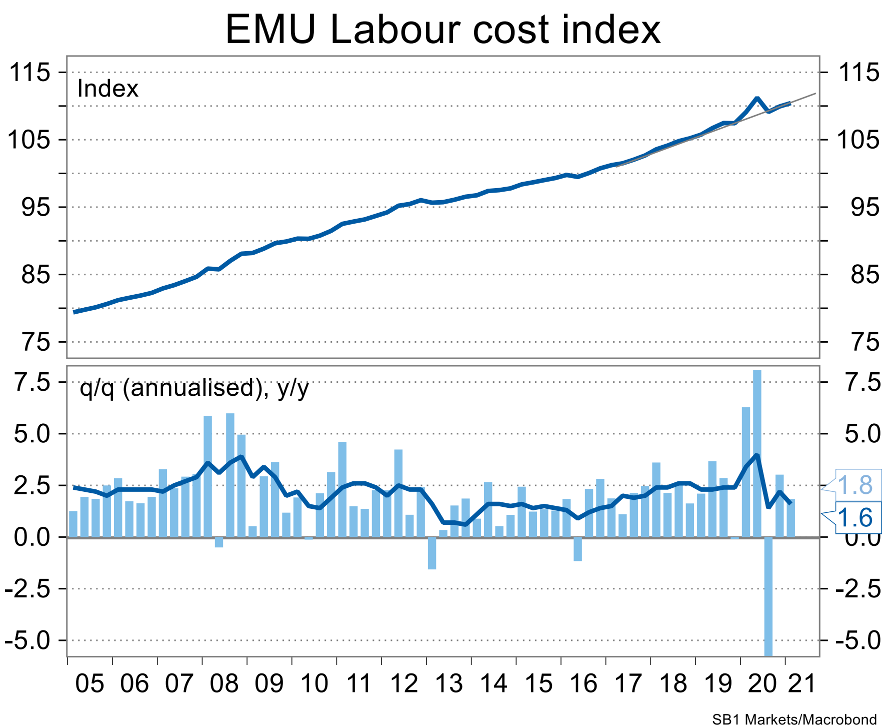
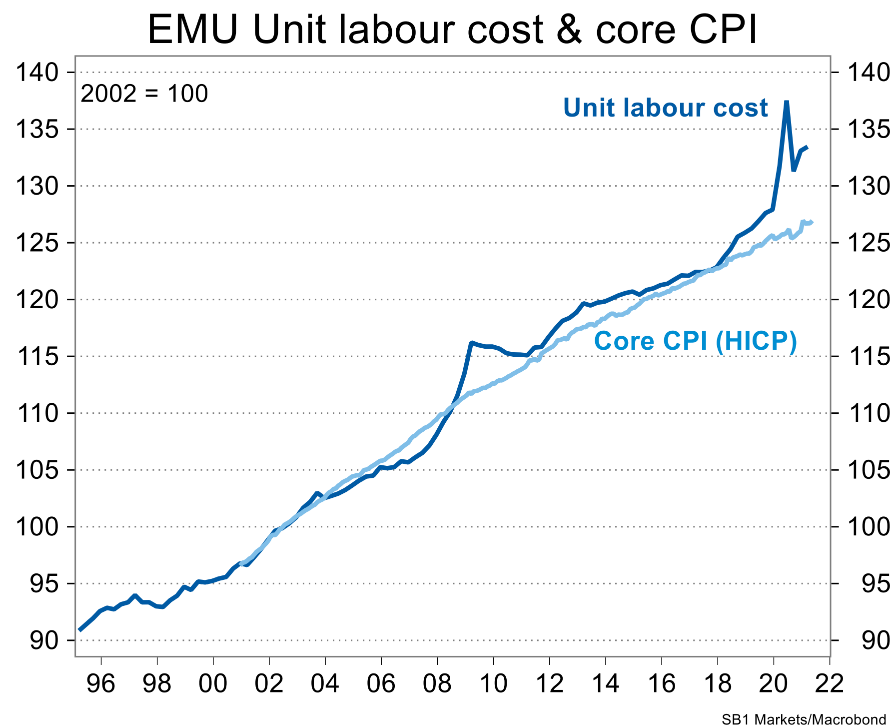
# Labour cost back on (a moderate) track. But are unit costs??

Labour cost are up just 1.6% y/y after being higher during the first part of the pandemic

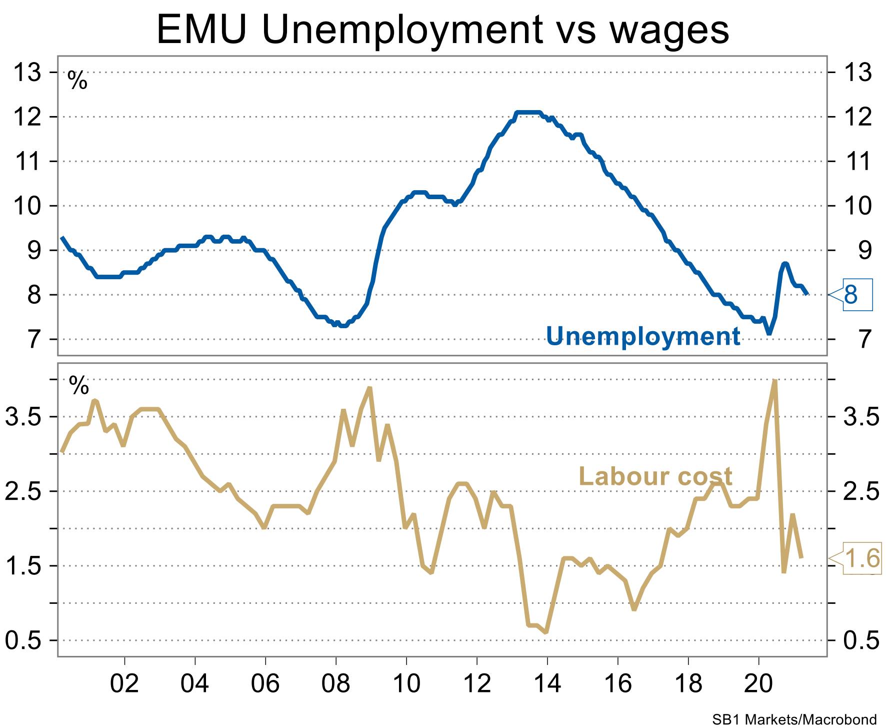


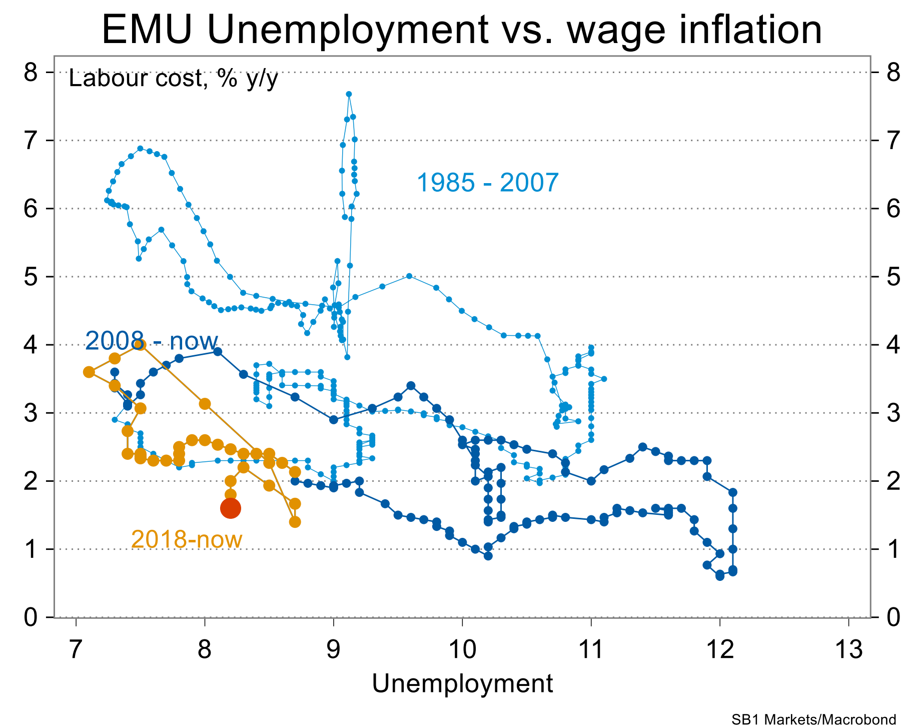




- These labour costs are measured per employee
- Unit labour cost has jumped up during the pandemic as productivity per employee has fallen sharply (it is well per hour, but the number of hours per employee has fallen sharply
  - » Unit labour cost have climbed more in the US, and far more in the UK during the pandemic
- We expect a sharp reversal when these economies reopens. If not…

# The Phillips curve is not completely dead

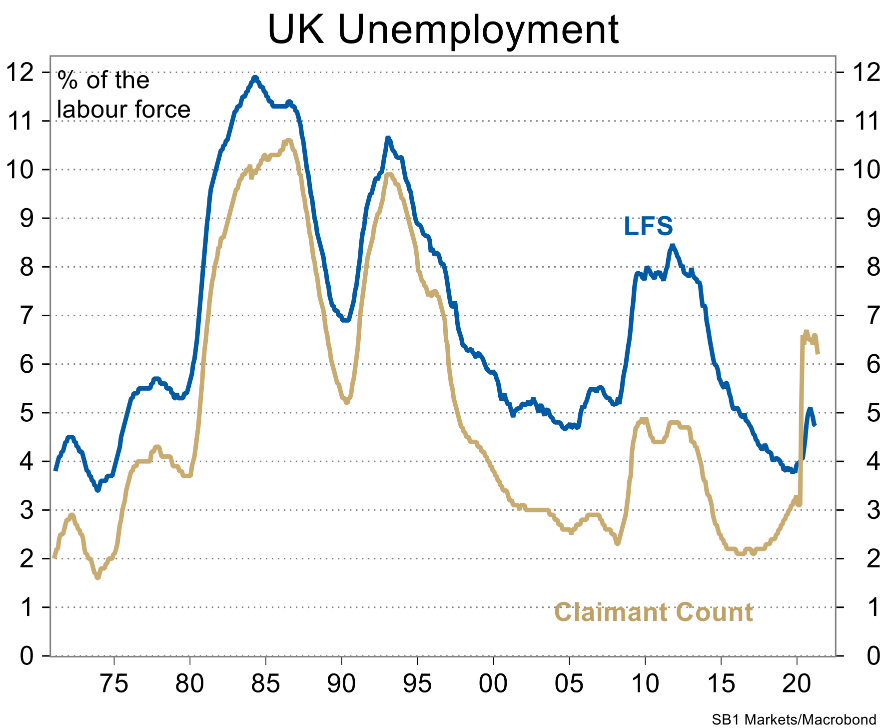
... At least now since 2008. Since 2018, however, it has been rather flat

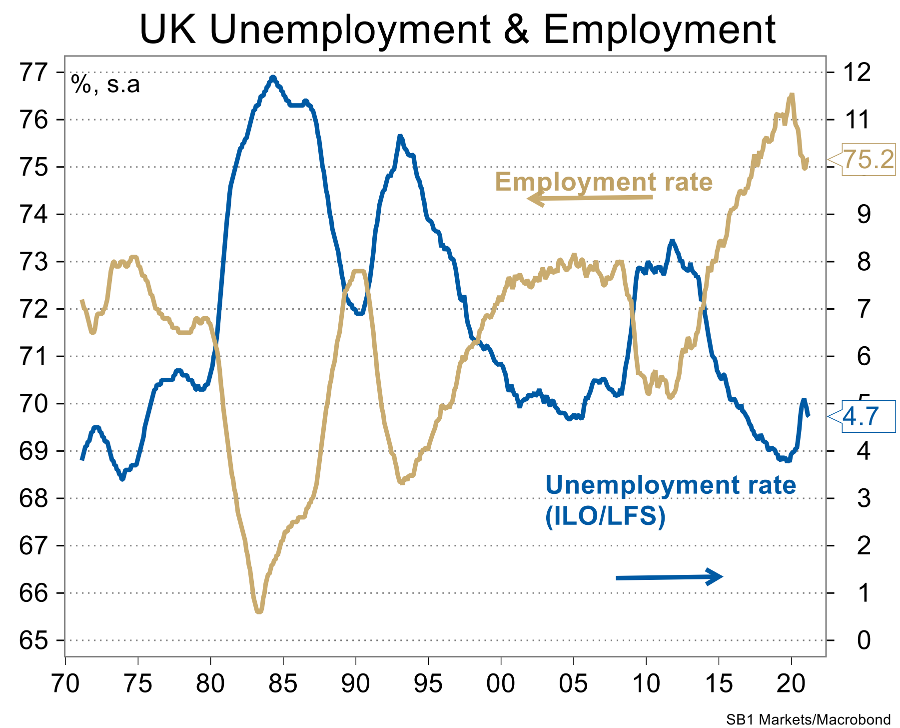


# ‘Open’ unemployment at 6.2% in May

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

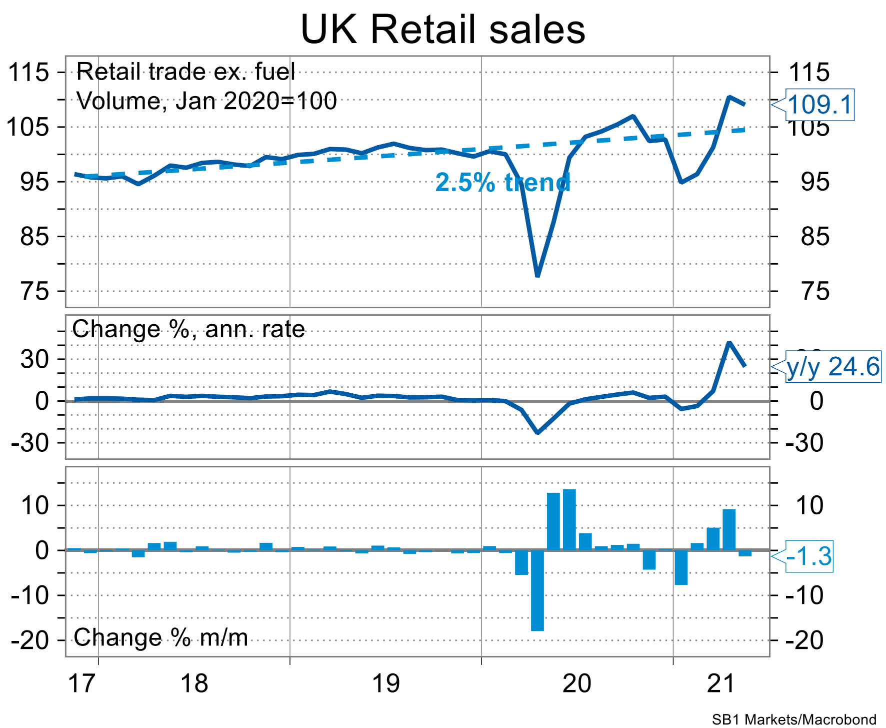


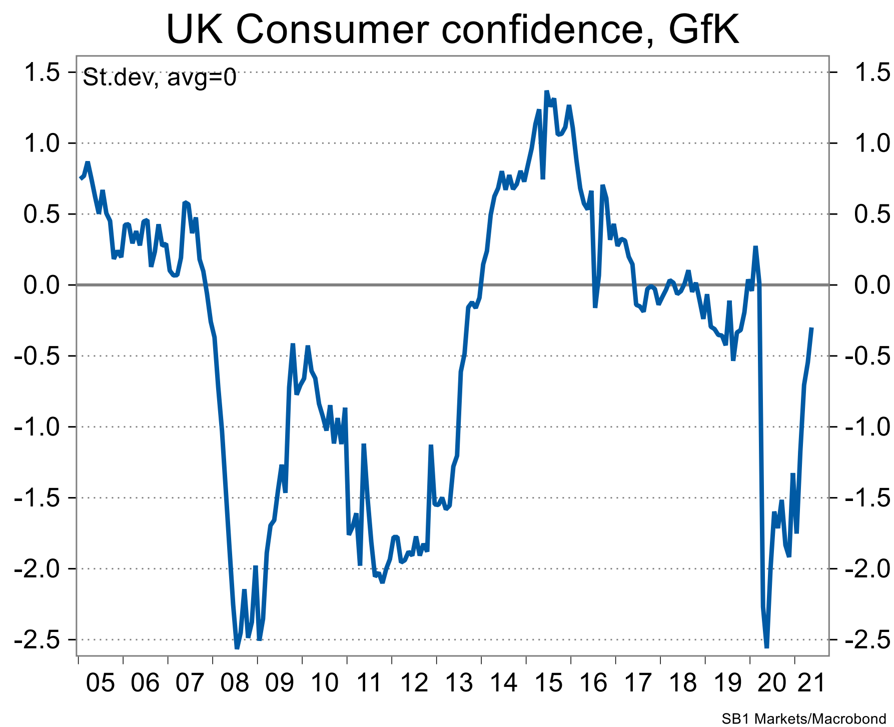




- The ILO/LFS unemployment rate was 4.7% in April, down 0.1 pp since March, and in line with expectations. This measure does not include furloughed/temporary laid off workers until after 3 months. On the other hand, payrolls and the no. of vacancies increased sharply in May
- According to the claimant count data (registered unemployment), the unemployment rate is now running at 6.2%, up from 3.4% before corona. Still, compared to many other Western countries, the upturn has been limited. This is probably related to the generous rescue program for businesses, as the UK government has compensated businesses for a share of workers salaries. The decline in GDP has been among the largest among rich countries, just Spain has lost more, due to tourism (which is far less important for UK)

# Retail sales down as people are eating out as restaurants reopened

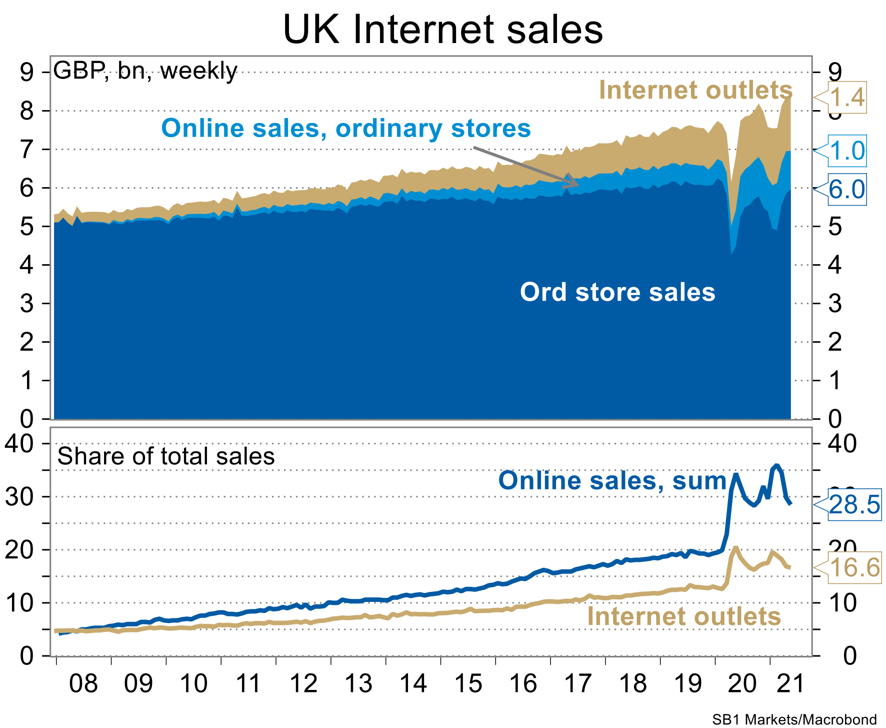
Sales down 1.4% m/m in May, expected +1.6% (after an increase of 9.2% in April)

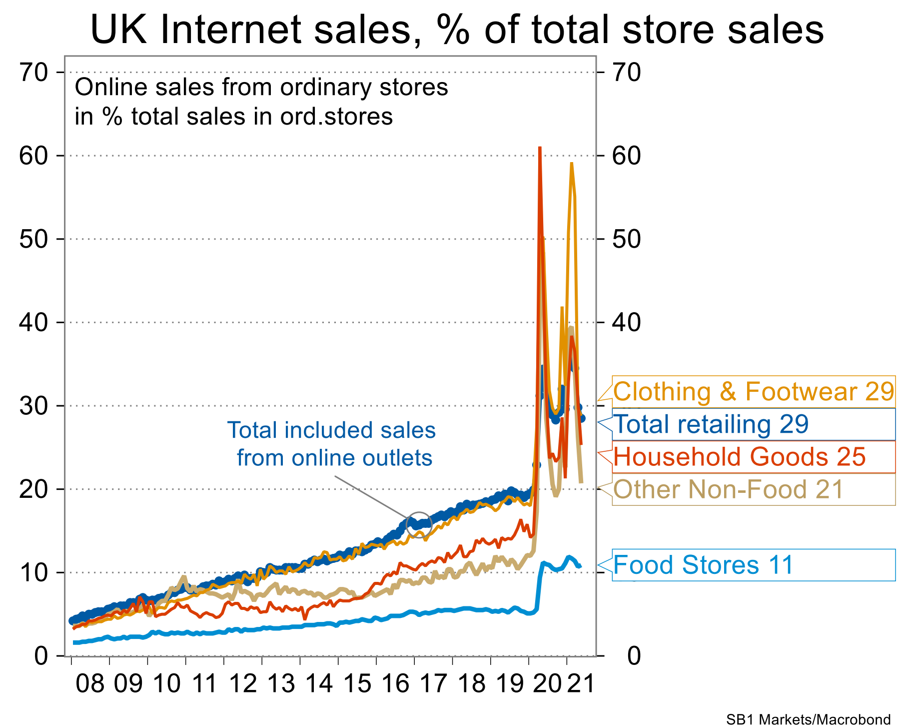



- **Lockdowns were lifted**, and people were finally allowed to spend on services again. We believe this contributed to the drop in retail sales in May, and that sales will slow further in the coming months. Sales are still 9% above the pre-pandemic level,
  - » Food sales were down 5.7% (as meals were consumed at the restaurants!), while non-food store sales increased by 2.3%. Online sales were down 1.3 pp to 28.5% of total sales
- **Consumer confidence** continued up in May, according to the GfK survey. The level is still below normal – but the direction is set. Other surveys a signalling a higher confidence level

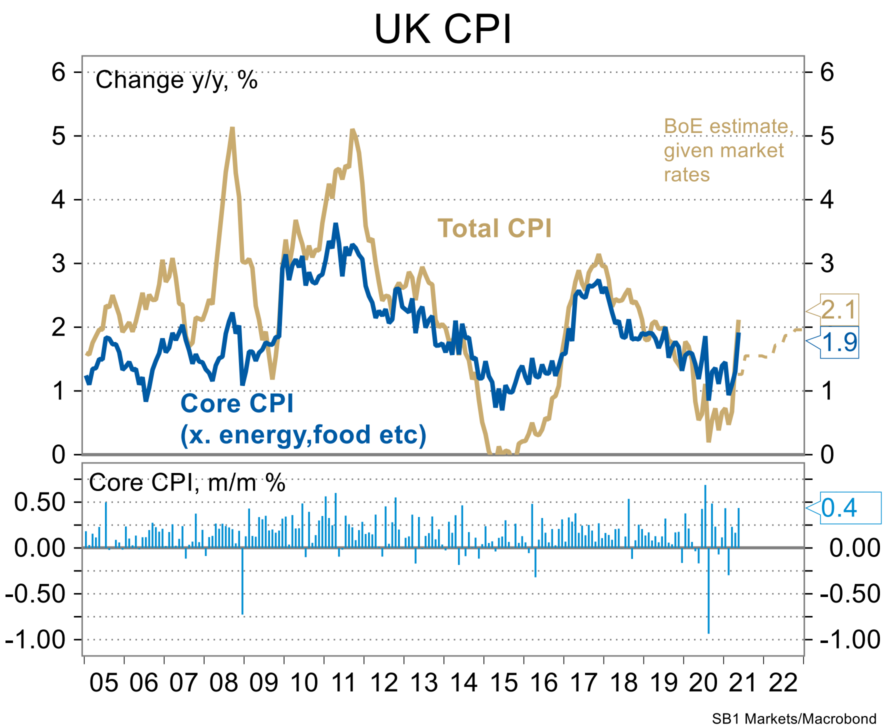
# Online sales are still high, but declining as people are allowed in stores again



# Inflation surged in May both due to base effect and price hikes now

CPI inflation up to 0.6 pp 2.1% y/y – 0.3 pp above expectations. Core up by the same amount to 1.9%

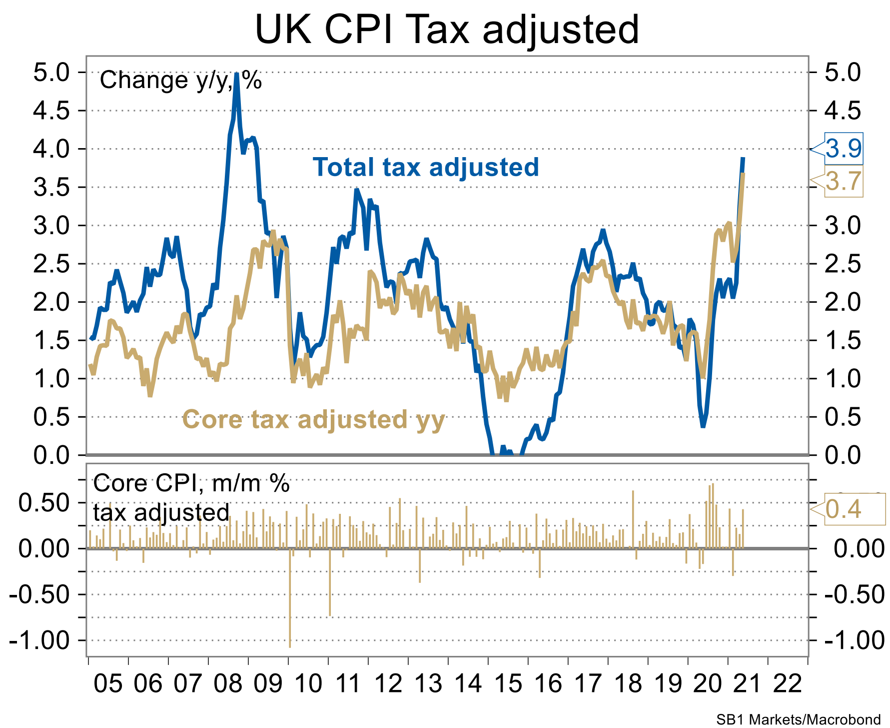


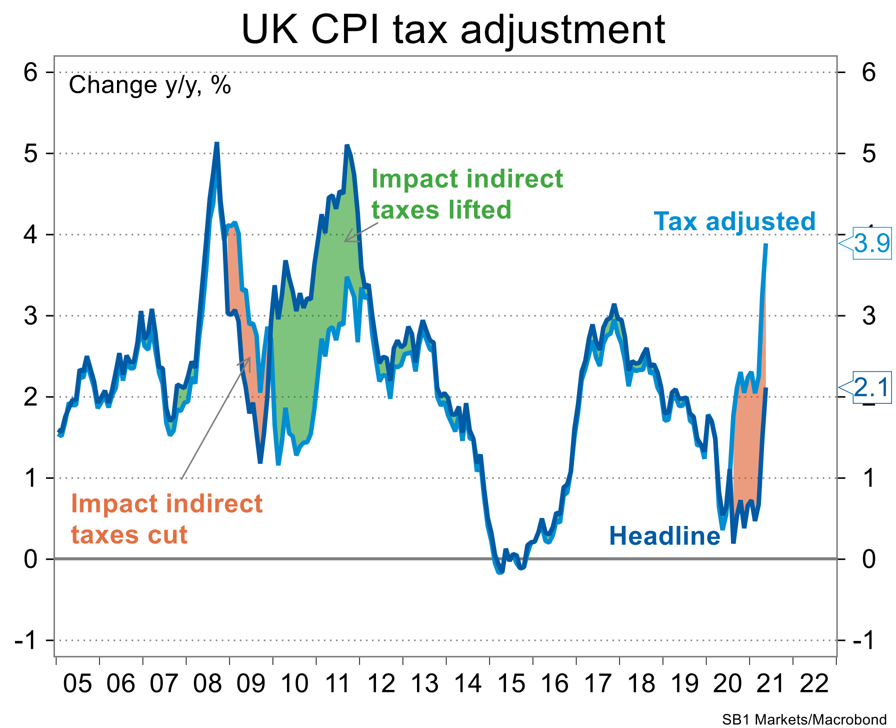

- The largest contributions were from transport, fuels, <u>restaurants</u>, <u>recreational goods</u>, and <u>clothing</u>, while food prices fell
- In May last year, the core price index fell by 0.2% - but that was of course well known. Now, prices rose by 0.4%, and the annual growth rate accelerated by 0.6 pp, 0.3 pp more than expected
  - » The reopening may have contributed to the surprising lift in prices m/m in May
- Last year, core prices rose by 1.2% in June and July (in total). The average price increase the past 3 months has been 0.3%, and a decline in the annual rate is likely (however, in August… check next page)
- Annual **CPIH** (including housing rents) inflation, accelerated by 0.6 pp too, to 2.1% in May
- Unit labour costs have soared during the pandemic, as most other places. We expect as substantial reversal the coming quarters

SpareBank 1 MARKETS

# Tax adjusted inflation close to 4%

## Corona measures cut prices sharply last August – and the ‘bill’ will become visible soon

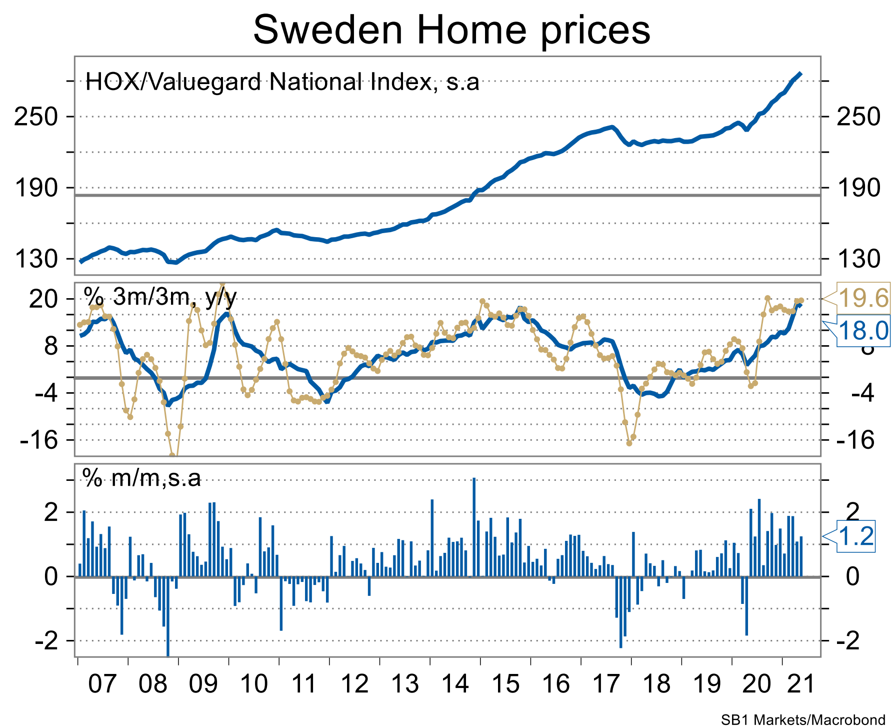


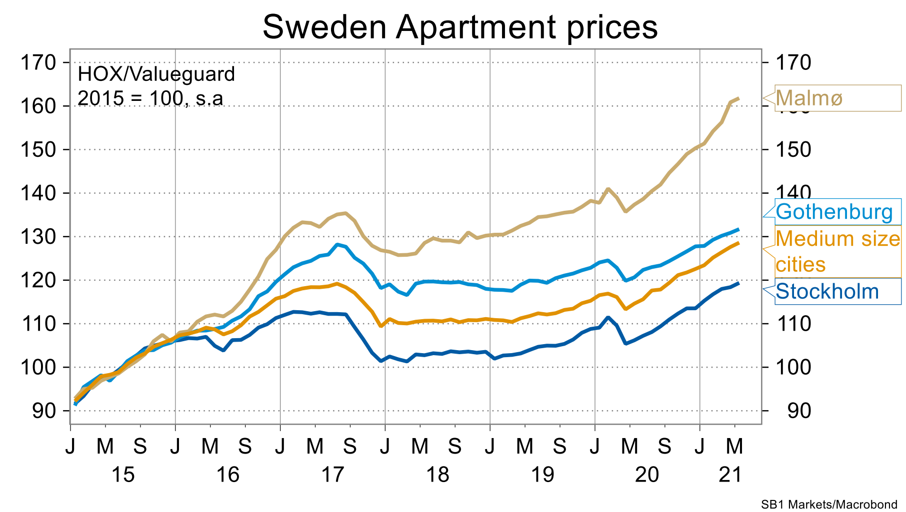



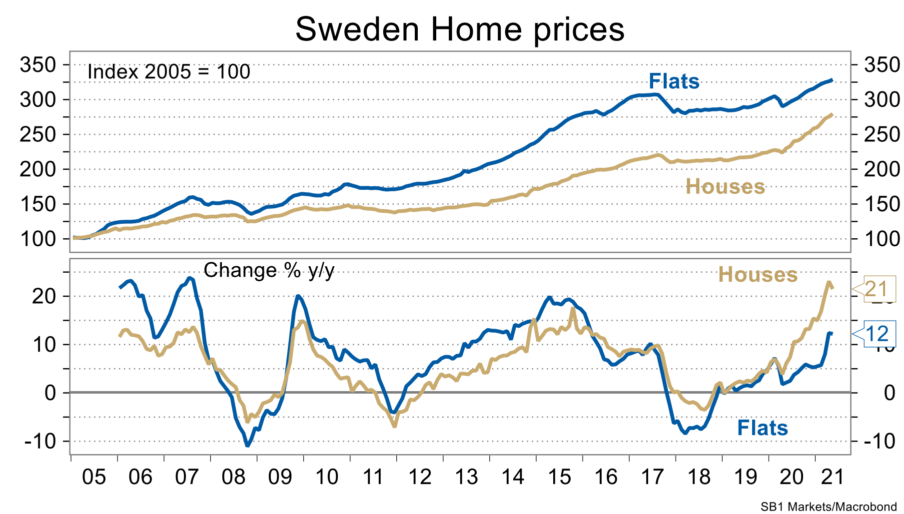

- The corona measures (Eat Out to Help Out Scheme and some other support programs implemented last August) equalled 1.6% of CPI. Prices fell less than that m/m (vs a normal price increases at that time, which tough were very volatile m/m, most likely because restaurants etc. kept some of the subsidy themselves). Thus, the impact on the annual CPI may be somewhat smaller than ‘technically’ assumed
- If the technical assumption holds, the ‘real’, tax adjusted annual CPI inflation runs far above the published headline, at 3.9% vs. 2.1%. The discrepancy in the core CPI is very likely at the same level
- We assume the inflation rate will climb some 1 pp in August, but the y/y rate could calm down somewhat before that, as prices rose sharply in June & July last year (see the previous page)

# Swedish house prices up 1.2% m/m in May – up 18% y/y

Prices are rising everywhere – and houses (21%) MUCH faster than flats (12%)!

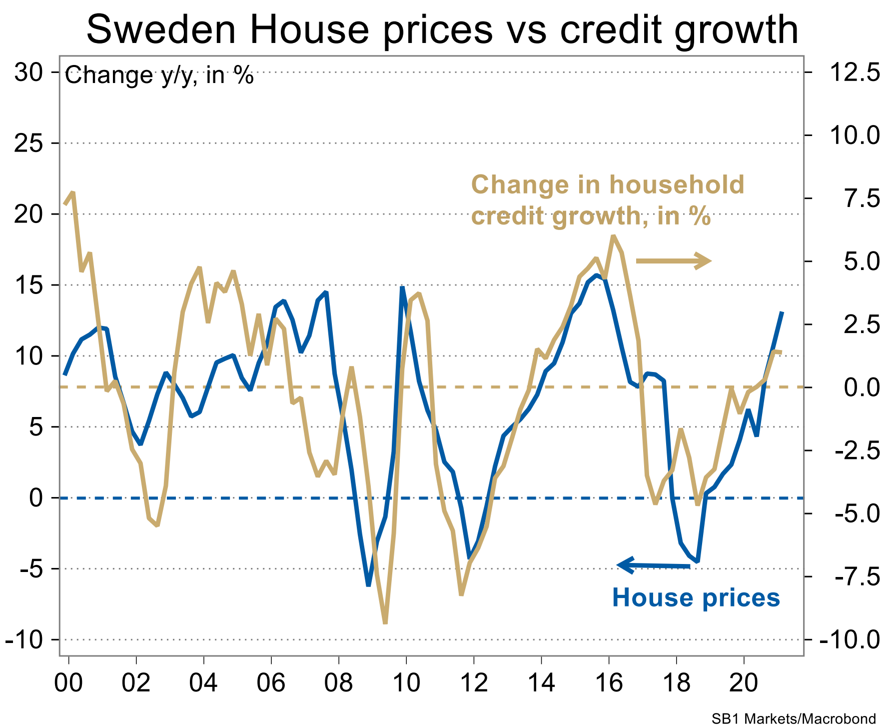


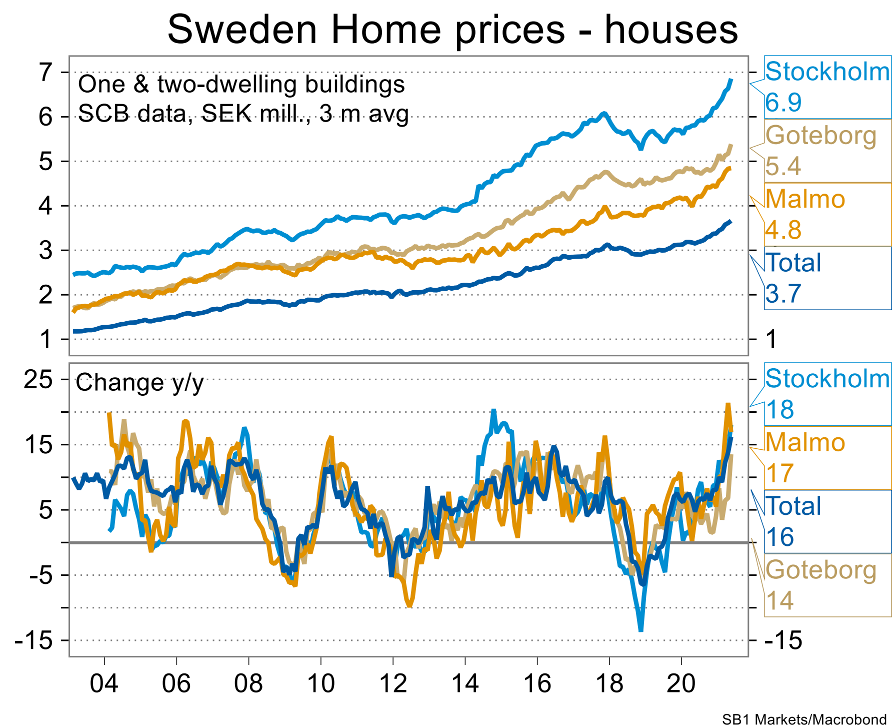




- The rapid increase in house prices vs. flats is broad based (in all sub regions). A corona impact – a flight to the suburbs or/and larger homes?
  - » Price growth 3m/3m is rather stable at approx. 20%
- At one stage, the housing market will become a matter for the Riksbank (as it already has for Norges Bank), that so far has signalled that rates will stay at zero at least until 2024 (!). The Rix may be right, if the economy collapses

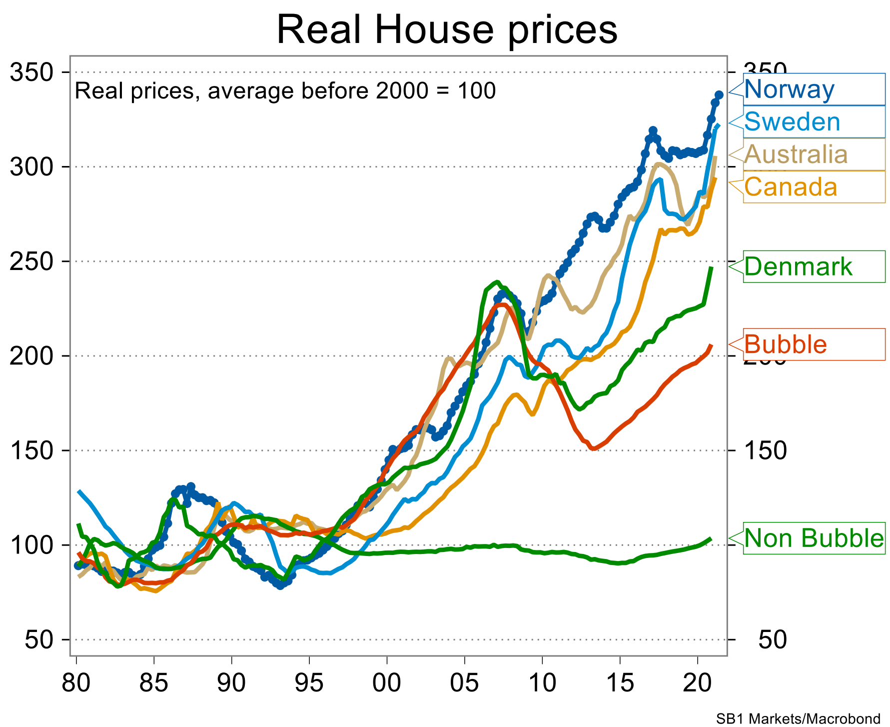
# House prices inflation accelerates, as does credit growth. As usual

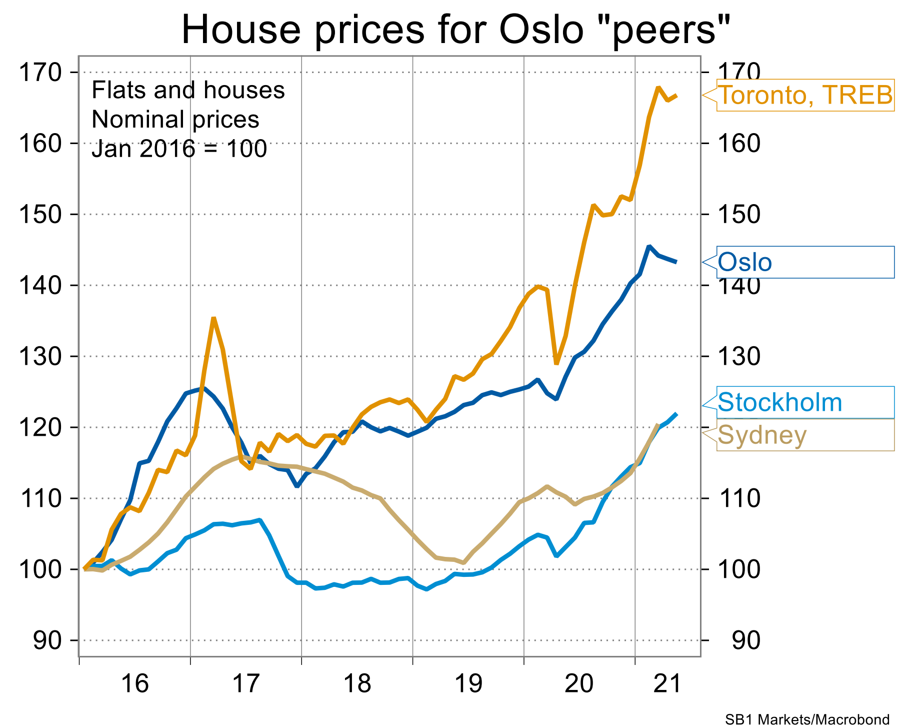


# Zero-interest rates are just wonderful! At least for a while

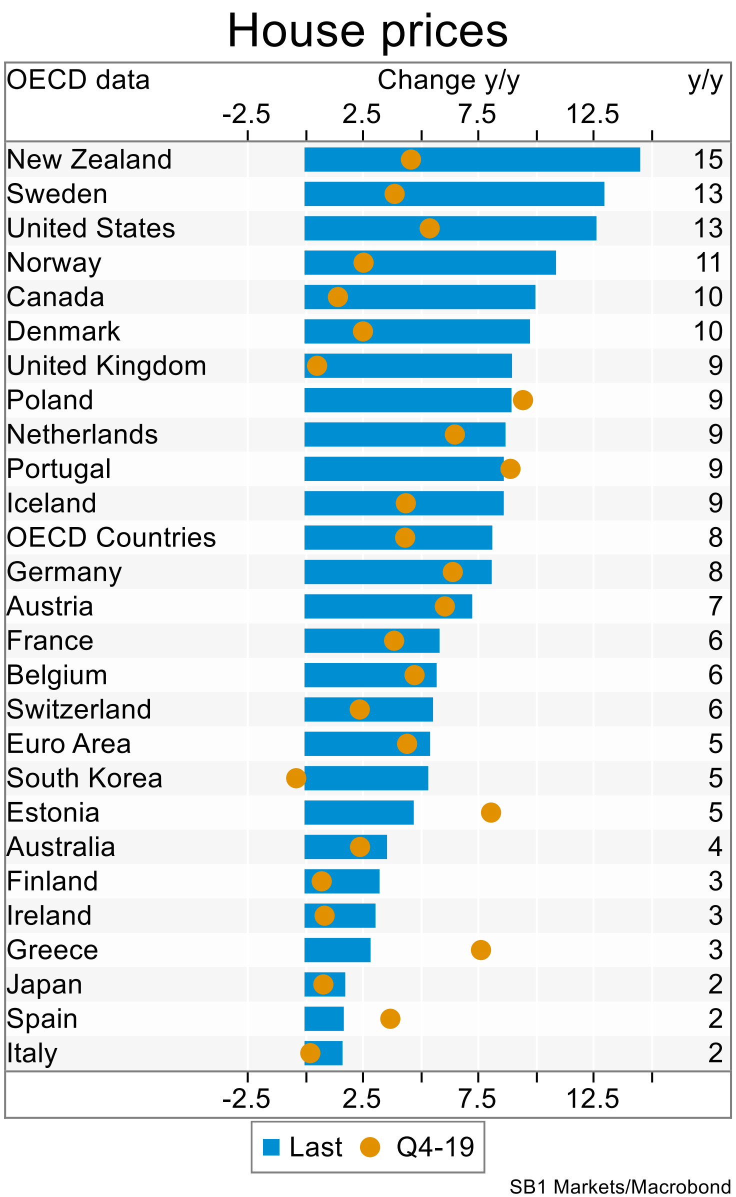
Prices have been soaring in many countries – with the 'super-cycle' countries in the lead




- Real house prices are at high levels in both Australia, Canada, Norway, and Sweden
- Home prices in the capitals are mixed recent months, as Oslo and Toronto has taken a break
- For more countries, check next page

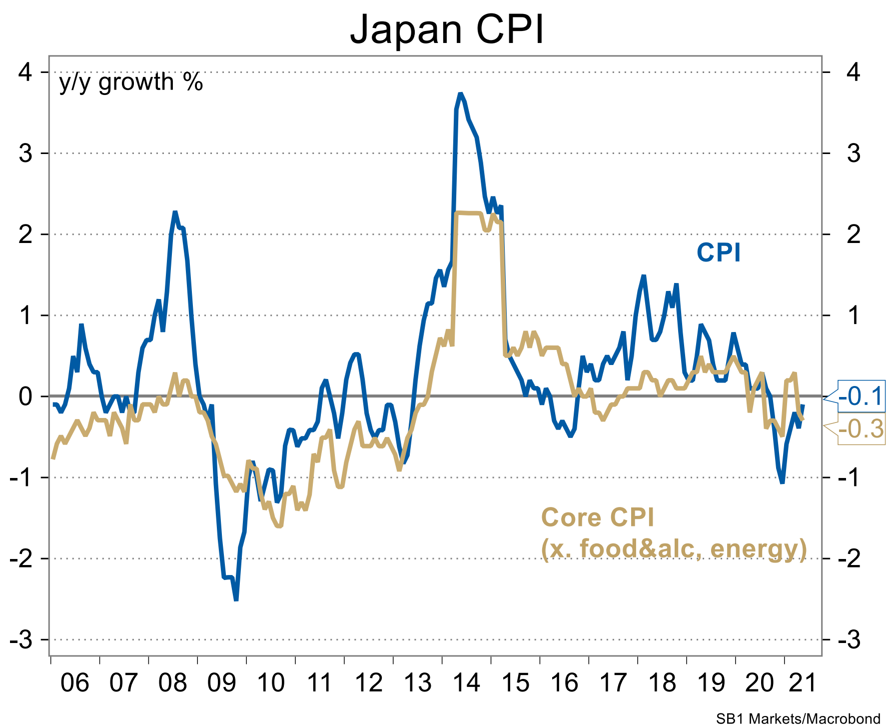
# House prices up everywhere, and have accelerated in 21 of 26 countries

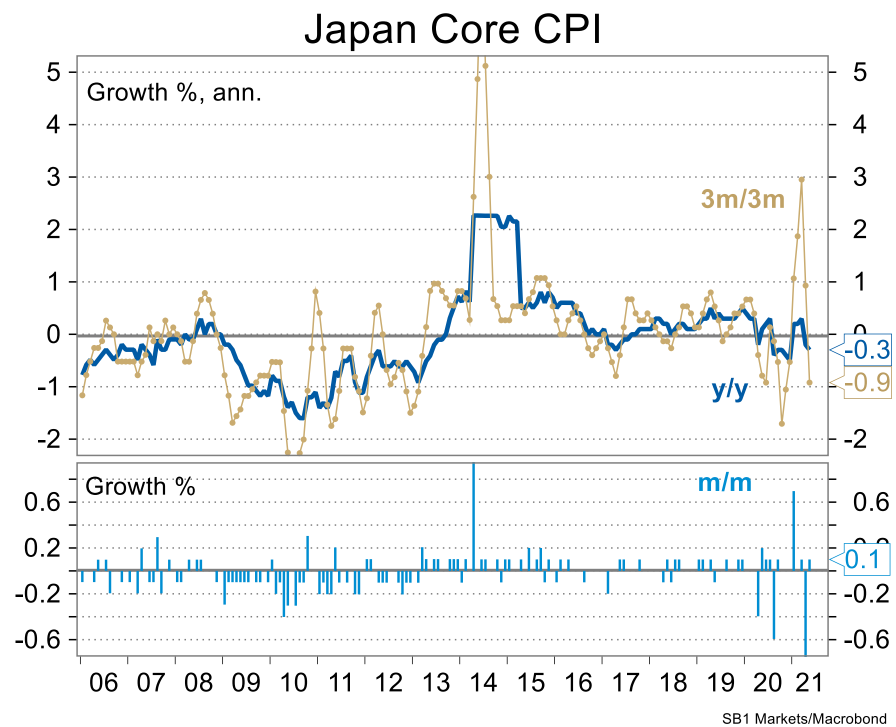



- The average price appreciation in the OEDC area has been 8%, up from 5% one year ago – and twice the average pace since year 2000
- Canada, UK and Norway have reported the steepest acceleration vs. pre-corona growth rates
- Price inflation has slowed the most in Greece, for good reasons – the tourist country has been through a harsh downturn

OECD quarterly data, the last quarter Q4-20 or Q1-21

# Inflation inching up m/m, but still in negative territory y/y. 2% not even on the horizon




- Core CPI (ex food, energy) was up 0.1% m/m, and the y/y rate was down to -0.3% from -0.2%
- Total CPI was up by 0.3% m/m, down 0.1% y/y
- Anyway, Bank of Japan has not succeeded in bringing inflation up to the 2 % target…

Highlights

The world around us

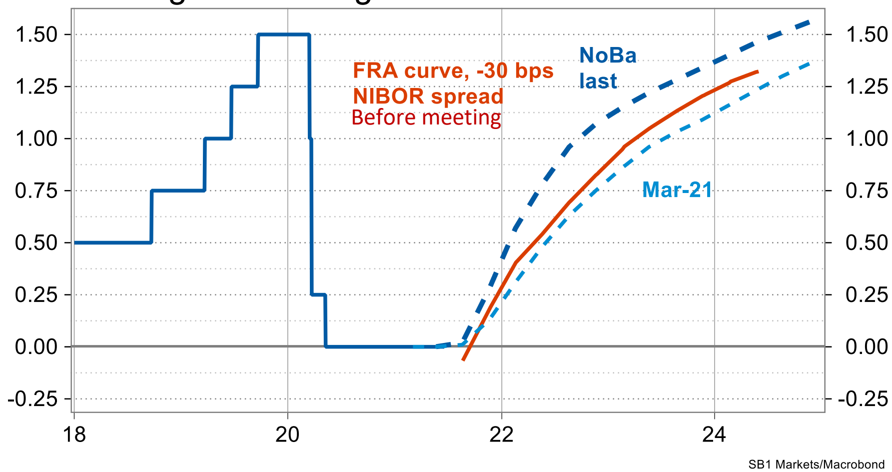
The Norwegian economy

Market charts & comments

# Norges Bank more hawkish than expected – will hike in Sept, Dec, March, etc…

## According to the bank, the policy rate will reach 1.5% (6 hikes) by end of 2024

Norges Bank Signal rate forecast vs market




**Interest rate paths**

| | Path 1-21 | **Path 2-21** | Change bps | SB1M f'cast | Fair FRA * @IMM, NB | FRA pre meet | NoBa -FRA |
|---|---|---|---|---|---|---|---|
| Q2 21 | 0.00 | **0.00** | **0.00** | **0.00** | 0.23 | | 0.23 |
| Q3 21 | 0.01 | **0.02** | **0.01** | **0.01** | 0.54 | **0.45** | 0.10 |
| Q4 21 | 0.13 | **0.28** | **0.15** | **0.19** | 0.83 | **0.65** | 0.18 |
| Q1 22 | 0.31 | **0.57** | **0.26** | **0.39** | 1.05 | **0.82** | 0.23 |
| Q2 22 | 0.48 | **0.78** | **0.30** | **0.58** | 1.23 | **0.98** | 0.26 |
| Q3 22 | 0.63 | **0.96** | **0.33** | **0.75** | 1.35 | **1.11** | 0.24 |
| Q4 22 | 0.75 | **1.07** | **0.32** | **0.89** | 1.44 | **1.23** | 0.21 |
| Q1 23 | 0.86 | **1.15** | **0.29** | **1.00** | 1.51 | **1.34** | 0.17 |
| Q2 23 | 0.96 | **1.22** | **0.26** | **1.10** | 1.57 | **1.43** | 0.15 |
| Q3 23 | 1.03 | **1.28** | **0.25** | **1.17** | 1.63 | **1.50** | 0.14 |
| Q4 23 | 1.09 | **1.34** | **0.25** | **1.23** | 1.69 | **1.56** | 0.14 |
| Q1 24 | 1.16 | **1.40** | **0.24** | **1.30** | 1.75 | **1.62** | 0.14 |
| Q2 24 | 1.23 | **1.46** | **0.23** | **1.37** | 1.80 | **1.66** | 0.15 |
| Q3 24 | 1.30 | **1.51** | **0.21** | **1.44** | 1.85 | | |
| Q4 24 | 1.36 | **1.56** | **0.20** | **1.50** | 1.86 | | |

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

Q4 FRAs adjusted for liquidity prem

- **Key policy rate** was left unchanged
- **Policy rate path** revised upwards by as much as 33 bps, quite a big move
  - » We expected the bank to take a more gradual approach, by lifting some 15 bps now – but the move was no doubt (in our mind) the right decision
- According to comments from Governor Olsen, and the bank's rate path, a **September hike is very likely, and for further hikes in December, and in March & June**
  - » Subsequently, **one more rate hike in 2022** – and one hike per year thereafter
- The key policy rate will be back at **1.5% by the summer of 2024**

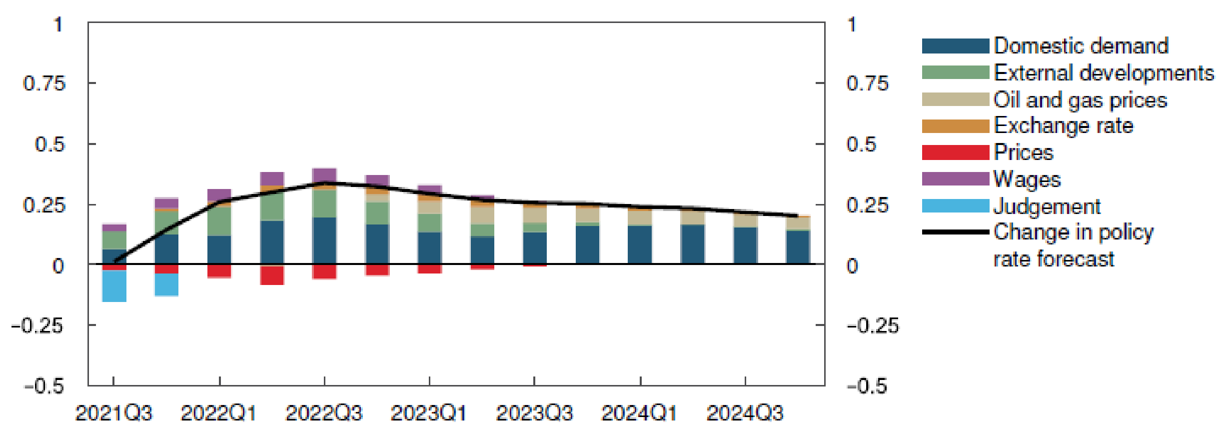
- **Norges Bank's rate path was up to 25 bps above the FRA market rates – and these rates rose sharply after the meeting, for good reasons – but remains below** (more on market response here)

- The **NOK** immediately gained 0.5%, but the gain was quickly reversed and the NOK actually weakened – as a lot other things happened in the f/x market

# Reasons for rate path revision: The economy is improving, at home & abroad

Somewhat lower inflation was the only contributor on the downside

Cumulative contribution. Percentage points




Source: Norges Bank

## Upside contributions:

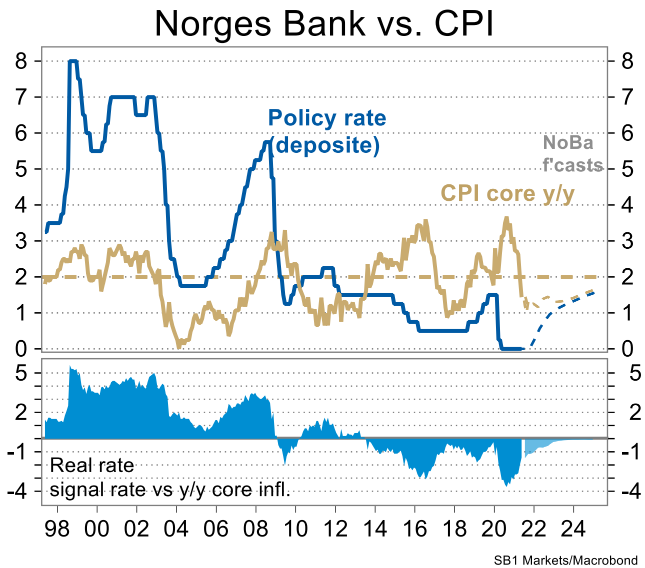
- **Vaccinations** have increased and society is opening up at a faster pace
- **Domestic demand** is recovering faster than assumed in the previous MPR, especially private consumption and investments
- Higher economic activity and higher inflation **abroad**
- **The oil price** is up by 5-6 USD/b since March
- **Wage inflation** is yet again on the way up (and Norges Bank may even be a bit cautious in their f'casts)

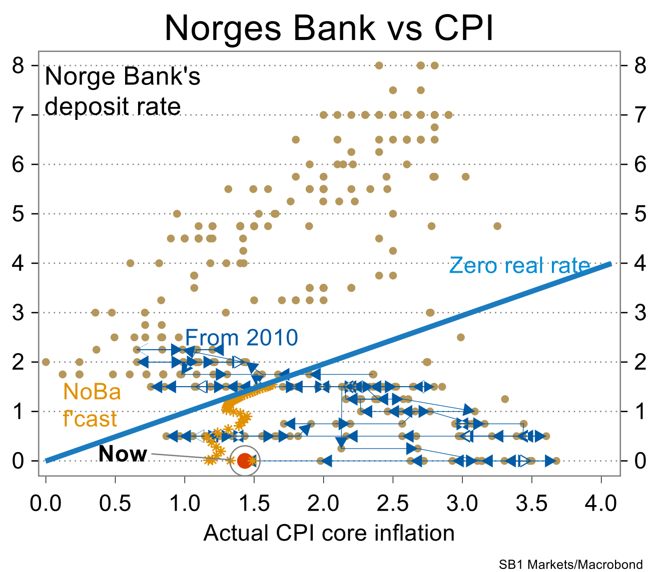
## Downside contributions:

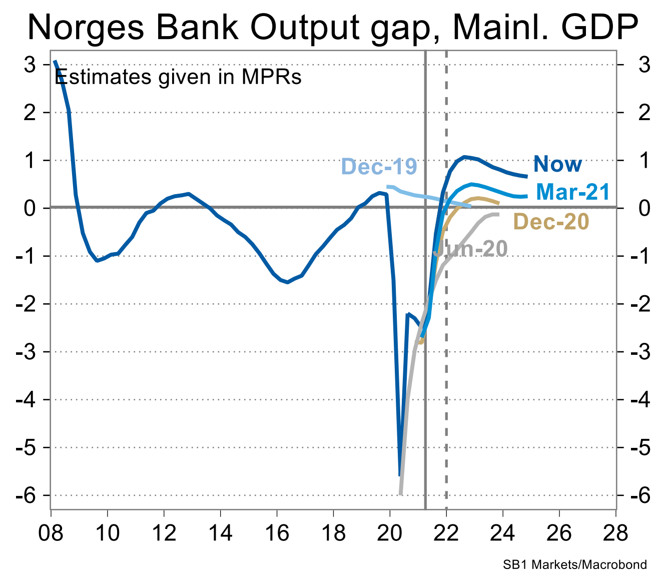
- **Lower inflation**
- Projected **stronger NOK**
- Judgement!! Without judgement, the rate path would have been hiked by another 13 bps in the very short end – and NoBa could have hiked by as much as 50 bps in one go in Sept

# NoBa takes the lead: The most flexible inflation targeter

## Hikes rates even if inflation is below target. Because the altnative is more risky. Will others follow?




**Inflation is expected to stay below the 2% inflation target** over the whole forecasting period, the next 3½ years. Even so, Norges Bank expects to hike its signal rate 5 times. Why? Here is our take:

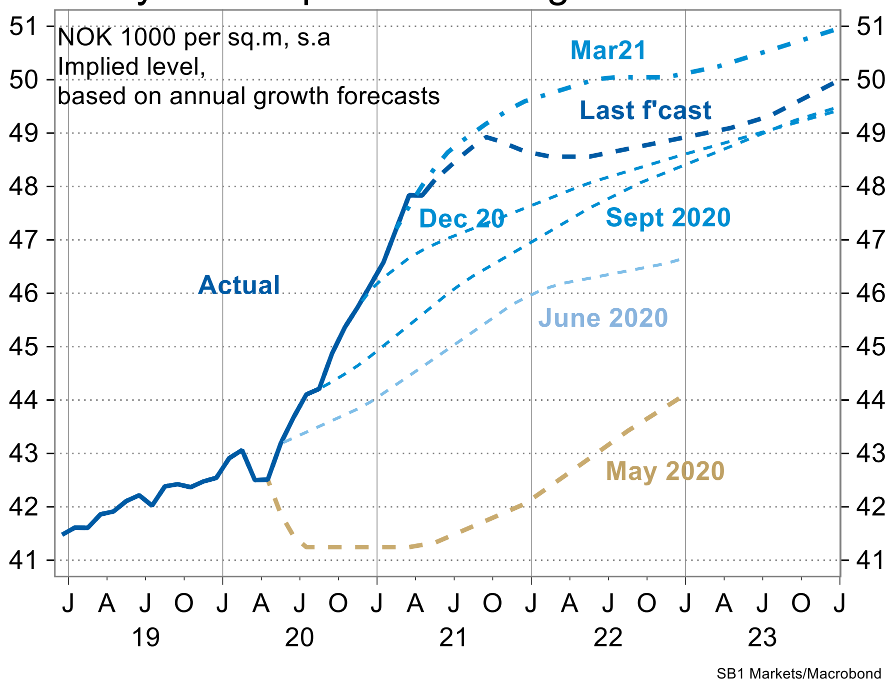
- **Norges Bank has not been an inflation nutter the past 10 years**. If anything, there is a negative correlation between actual core inflation and the signal rate since 2010. From 2021, both inflation and the signal rate is expected to move together 'in the right direction', both upwards.
- **The real policy rate is expected to stay negative for 1½ more years** (it has not been positive since late 2013!). Norges Bank assumes neutral policy rate slightly below zero (the real 3 m NIBOR at zero). Policy remains expansionary, albeit less so over time, as the interest rates climbs faster than inflation
- **Norges Bank assumes capacity utilisation** is turning positive in late Q3, early Q4-21. Thereafter the estimated output gap is positive – by up to 1%, and the unemployment rate is lower than average.
- No doubt, **risks for (further) build-up of financial imbalances** would increase significantly if the bank kept the signal rate at zero in order to push up inflation, in an even stronger economy than the one projected

**Norges Bank is no doubt the most flexible inflation targeter** among central banks today. We think this policy is wise, and we expect other central banks to follow suit the coming two years as the present policy mix most likely will not foster stability, long term

# Norges Bank expect house prices just to flatten/decline marginally

... even if most of the 2020 cut in mortgage rates are reversed

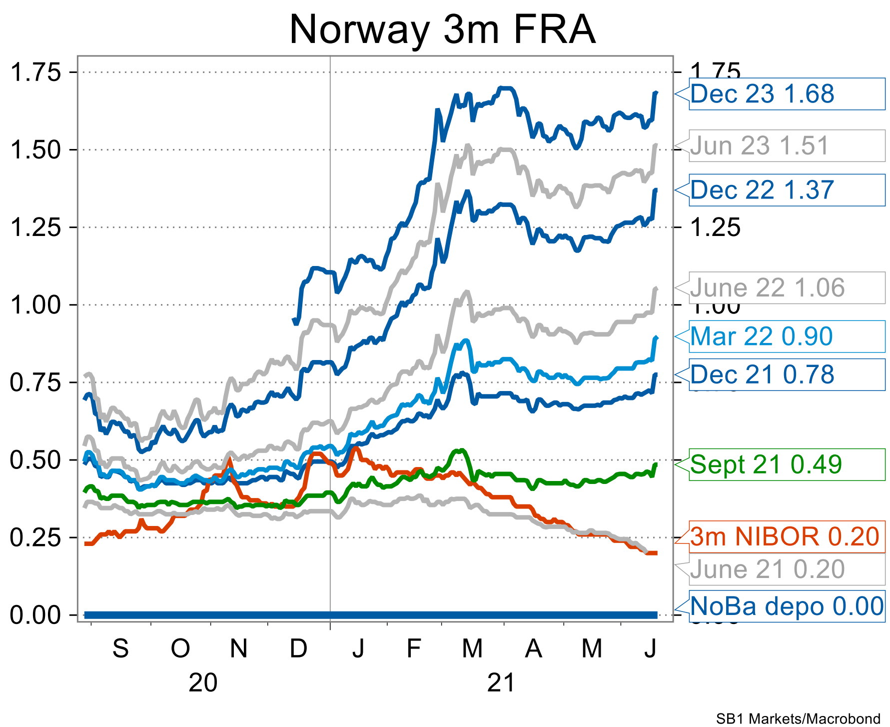
Norway House prices vs Norges Bank's f'casts

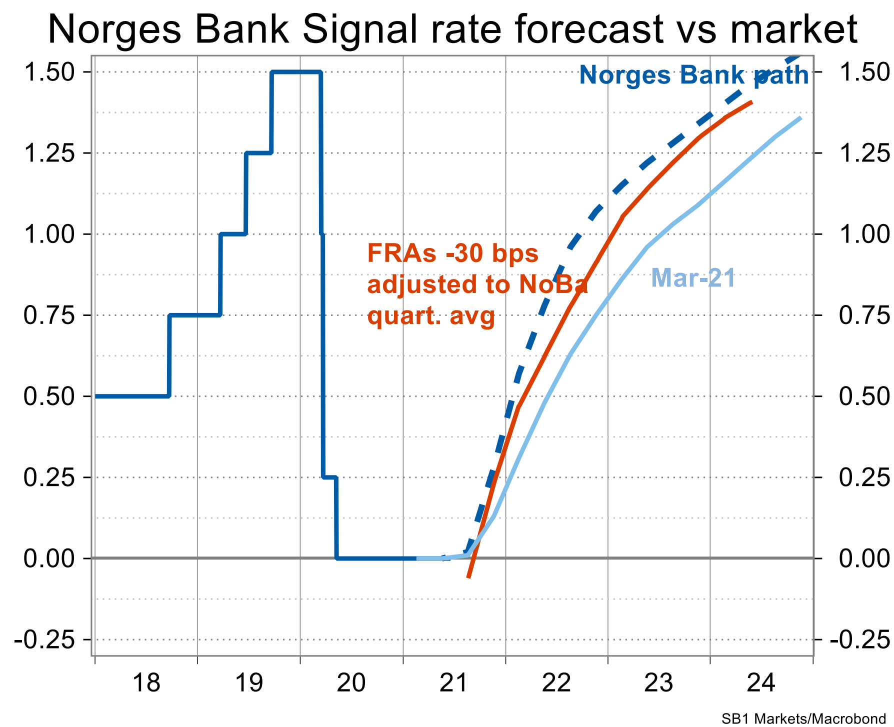



- Norges Bank expect prices to increase until the first hike, in the autumn
- Debt growth is expected to slow just moderately
- The risks may be on the downside

# Norges Bank lifted the interest rate path much more than expected

... and FRA rates rose sharply last week – up to 15 bps – but they are still well below NoBa's new path

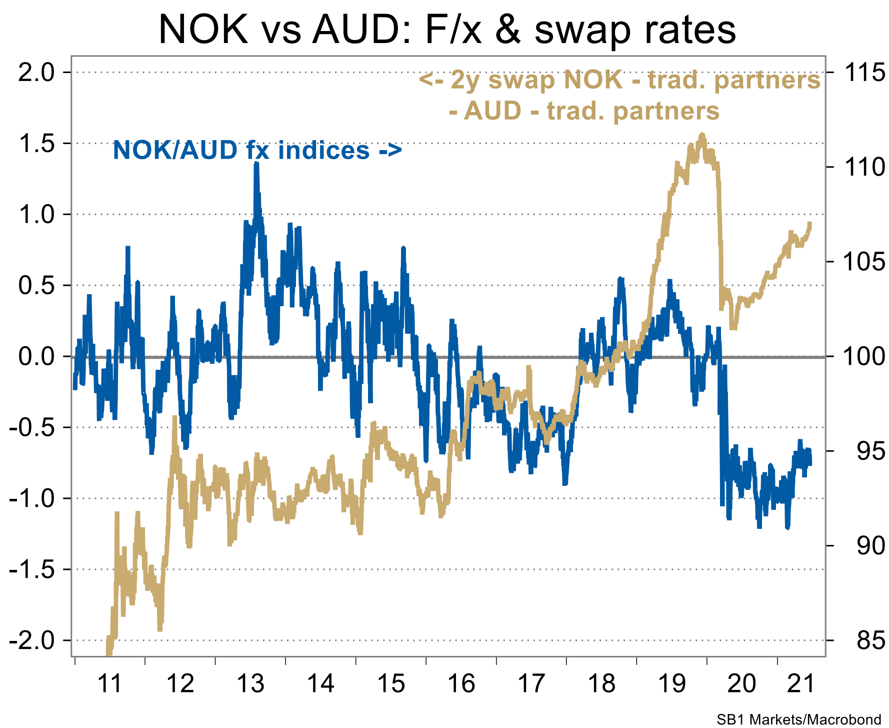


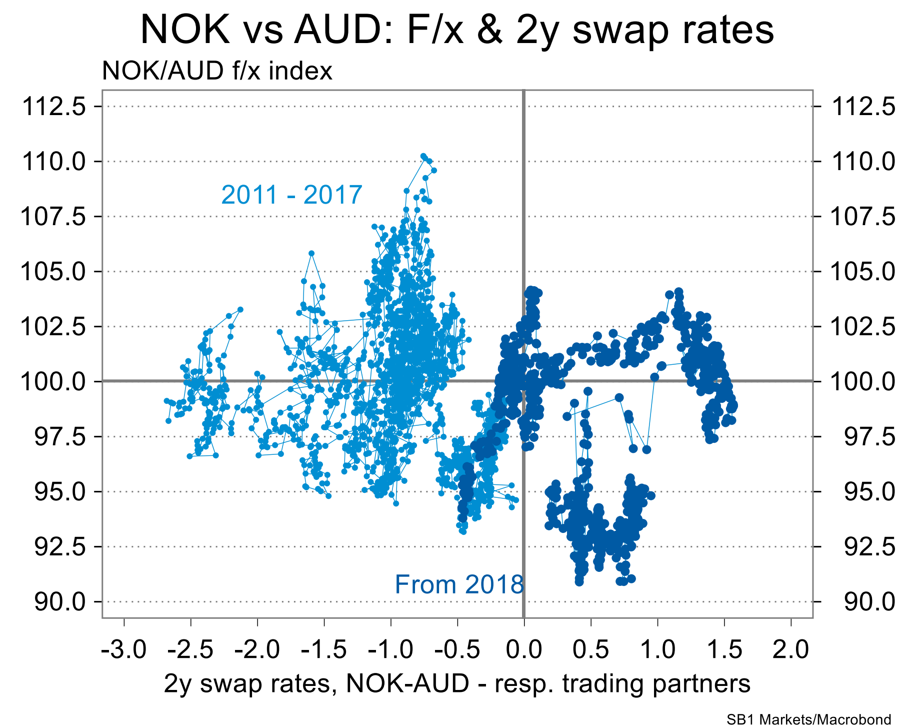




- The NIBOR spread is now at 20 bps. Norges Bank assumes 35 bps spread going forward, we expected the Bank to pencil a 30 bps spread. We stick to our 30 bps estimate until further notice
- The FRA-rates are anyway well below NoBa's new path – and we expect a further upside drift, barring an arrival of really bad delta virus news
- The market is discounting almost a 90% prob. for NoBa to hike in September and December. However, from there the FRA-path is not as steep as NoBa's, and just a 40% probability for a March is assumed, given a hike in both Sept & Dec. NoBa say 100%

# Can Norges Bank walk the walk alone?

## Or will the NOK become too strong? A simple test: How important are interest rates, by themselves?

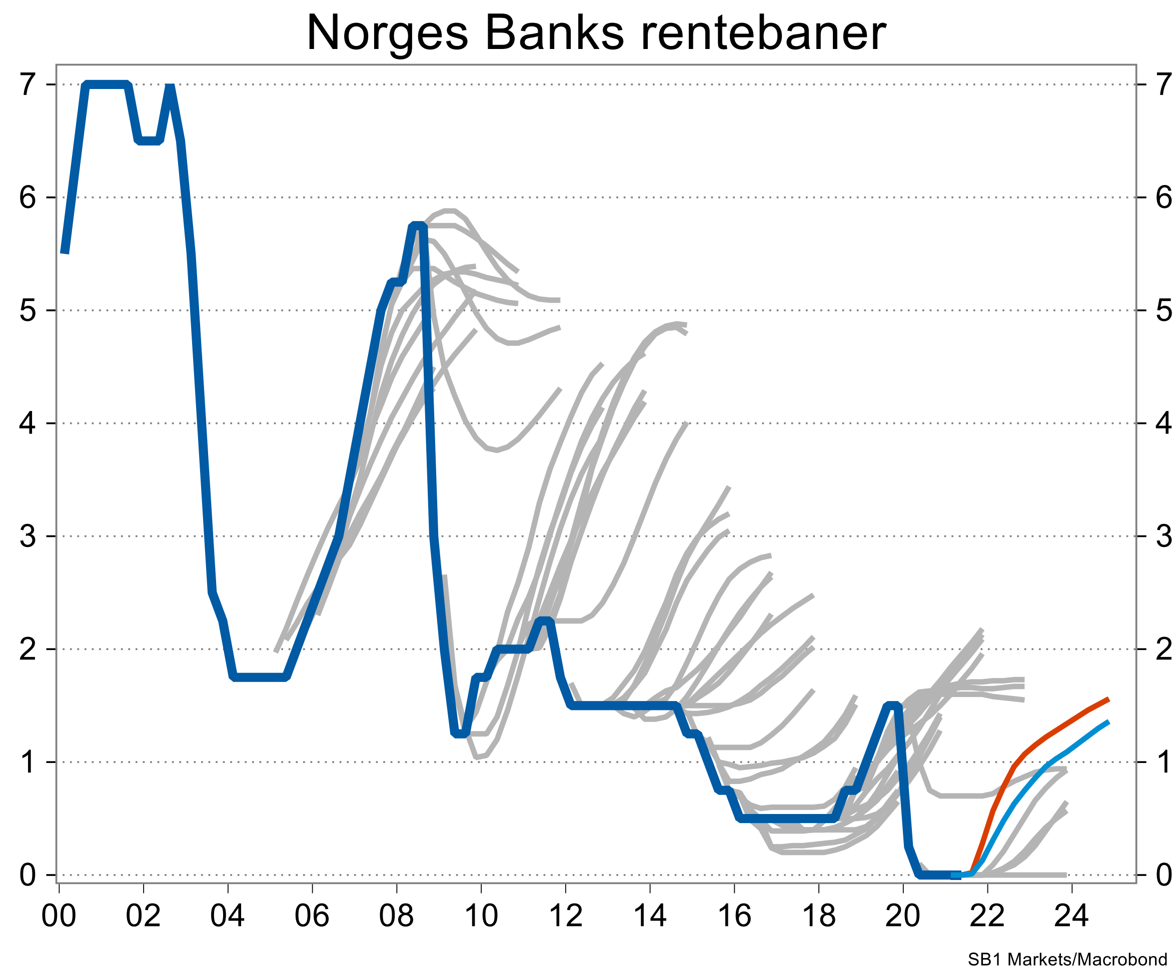


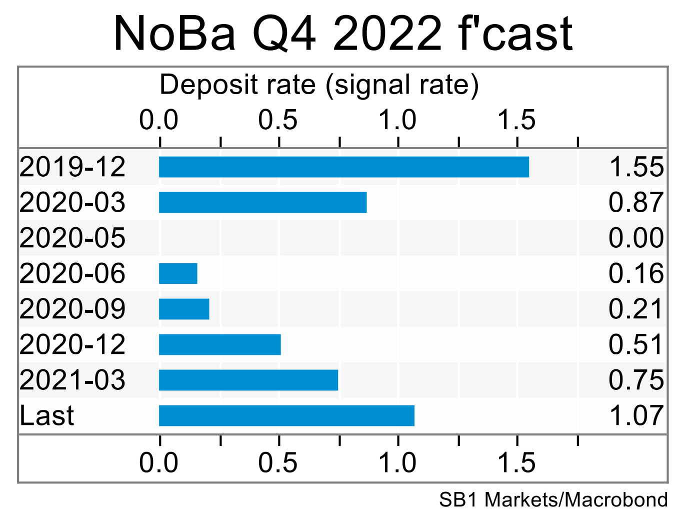




**A simple test**
- AUD and NOK f/x indices are very closely correlated
- Can differences in interest rates between the two currencies vs their respective trading partners explain the rather small discrepancies between the two? No
- Can Norges Bank go solo, without pushing NOK strongly up (vs other currencies we correlate closely to)? Probably YES
- **What happened last week:** NOK fell alongside the AUD, even if the interest rate differential vs. trading partners (also compared to AUD's rate differential) rose as Norges Bank turned

# Never forget this one!

The bank has never done as it said it would. Because something unexpected turned up, of course!

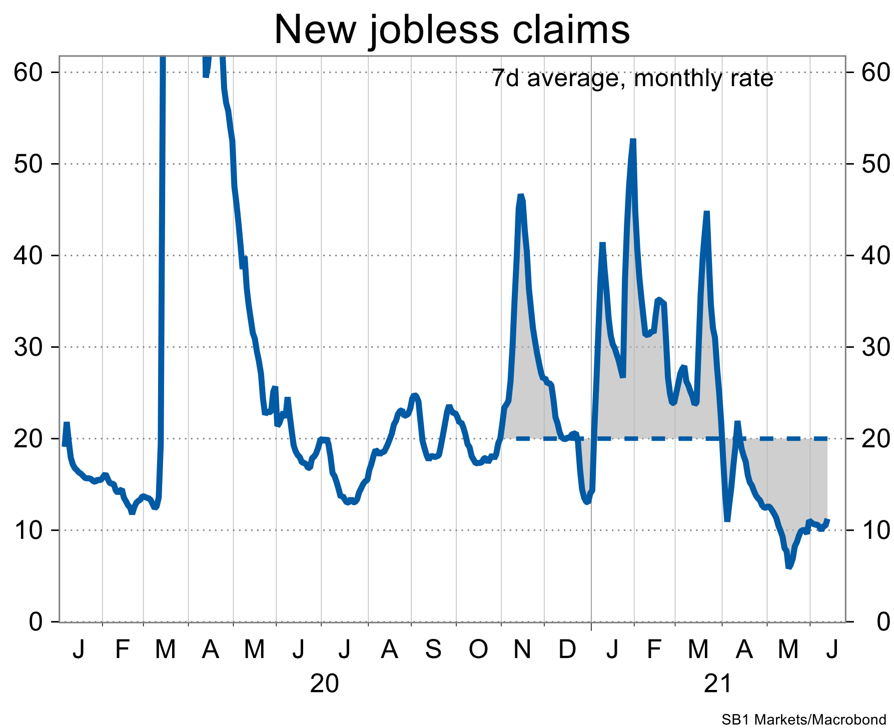


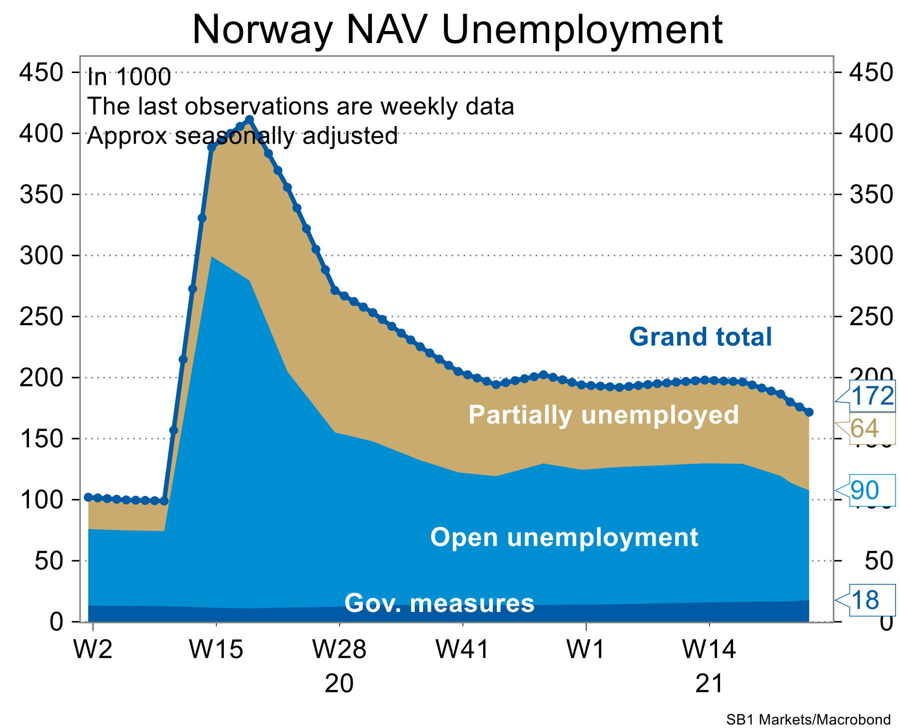




The last path in red, the previous in light blue

# ‘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

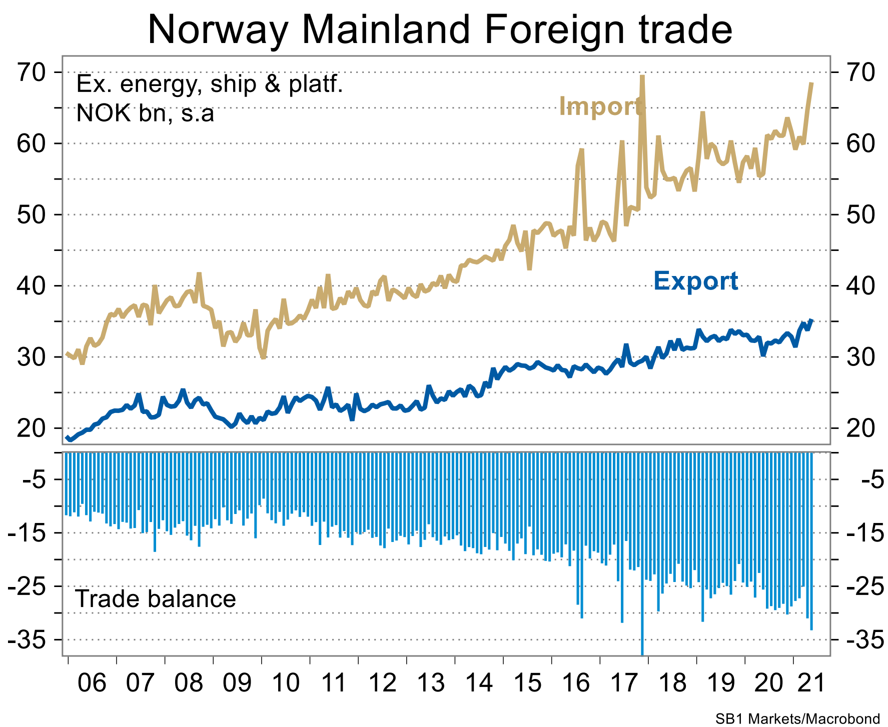


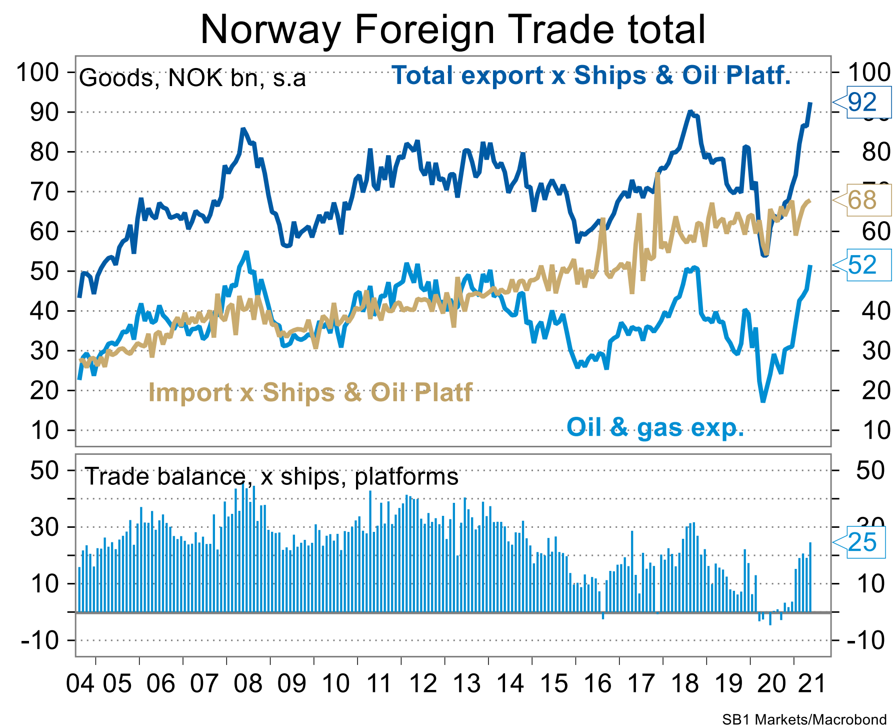




- We expect a rapid decline in unemployment the coming weeks/months as well

# Mainland trade deficit higher in May as imports increased by 9.5%

## Total balance surplus up in May, equaling 11% of GDP

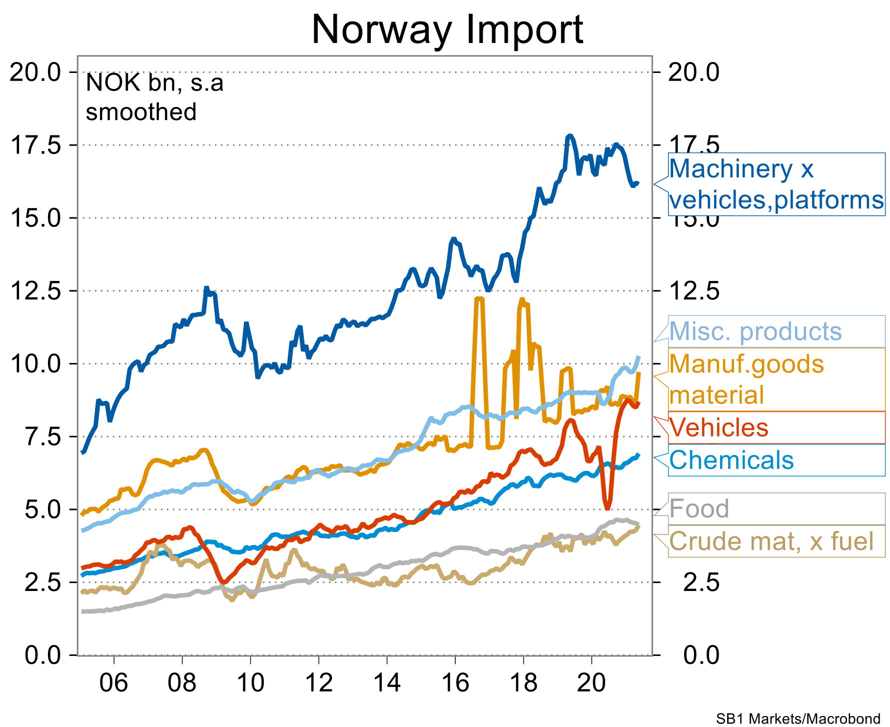


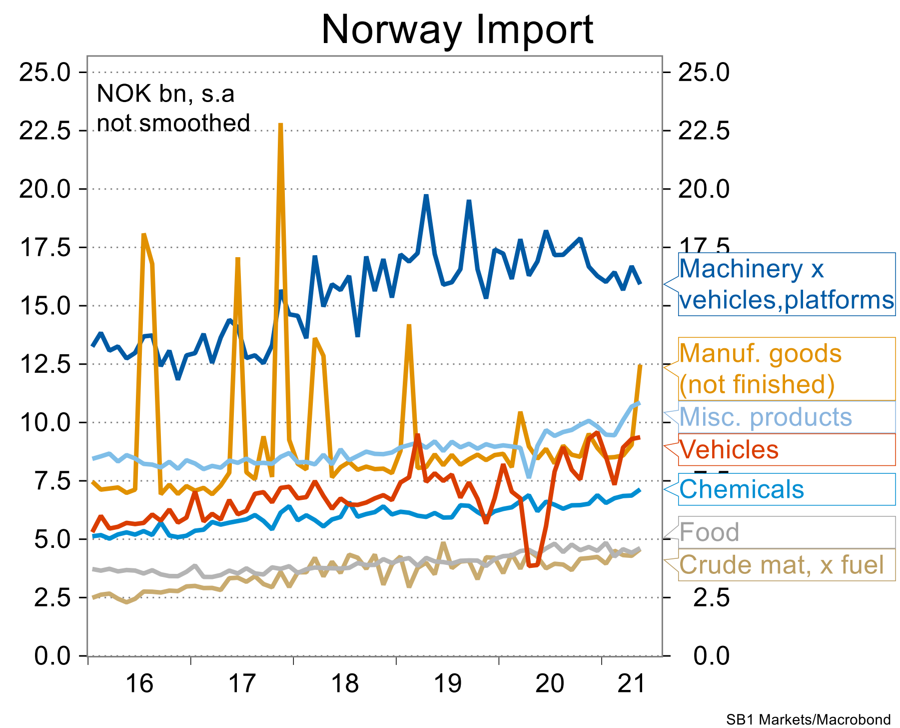




- **The <u>Mainland (non energy) trade deficit</u>** <u>in goods</u> rose quite a bit again in May, after the jump in April.
- **Non-energy exports were** again at ATH in May. The main contributors on the upside for exports were crude materials, metals, chemicals, and other manufactured goods
- **Import** rose sharply of which a substantial part (almost 50%) of the 9.5% increase in imports are due to a likely one-off, ‘manufactured goods, not finished’, probably a ship or a platform. The underlying trend for import
- **Export of oil and gas**, helped by higher prices, is well above pre corona levels, totalling 52 bn in May (+7 bn m/m), bringing the total trade surplus to 25 bn, or some 11% of GDP. We are not broke, yet

# Machinery imports down in May, all others up – signalling OK domestic demand

## Manufactured goods up 38% m/m, probably platform or a ship not yet finished

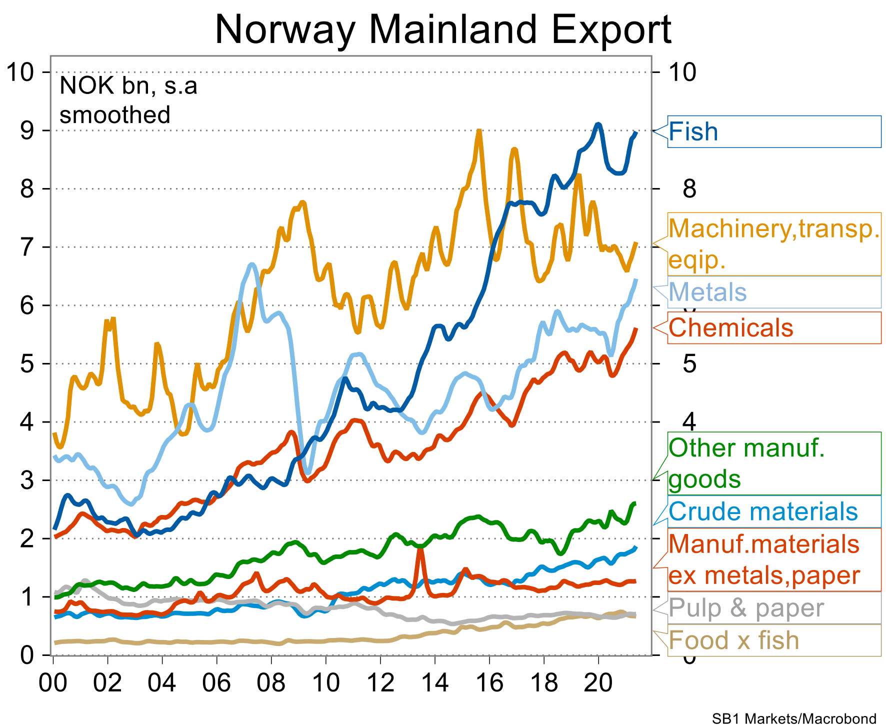


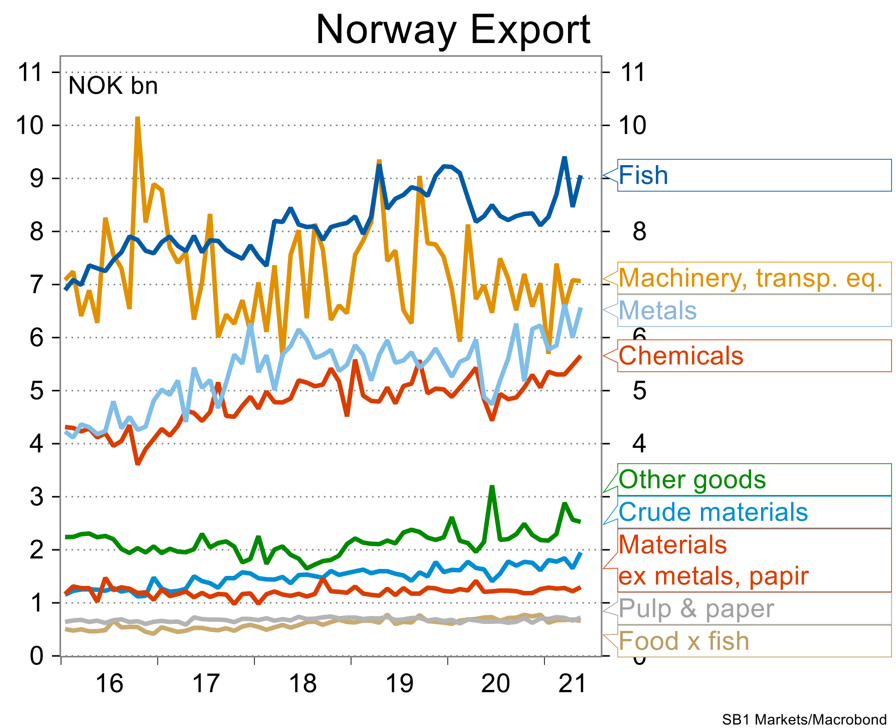




- Imports of chemicals, crude materials, and food have all increased y/y. Machinery imports are down 7% from May last year. Manufactured materials exports had been virtually unchanged for some time, before increasing 38% last month
- Vehicle imports slowed rapidly in H2 2019 and early 2020, along with auto sales. Since April '20, imports have shot up to the highest level ever, but was only marginally up in May

# Most exports higher in May

## Just machinery exports are struggling

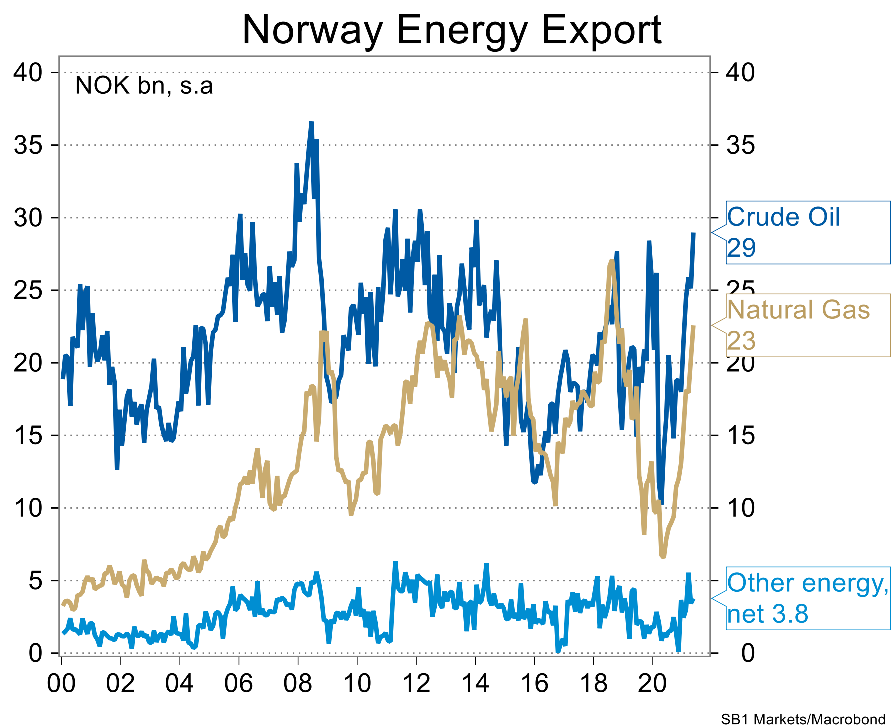


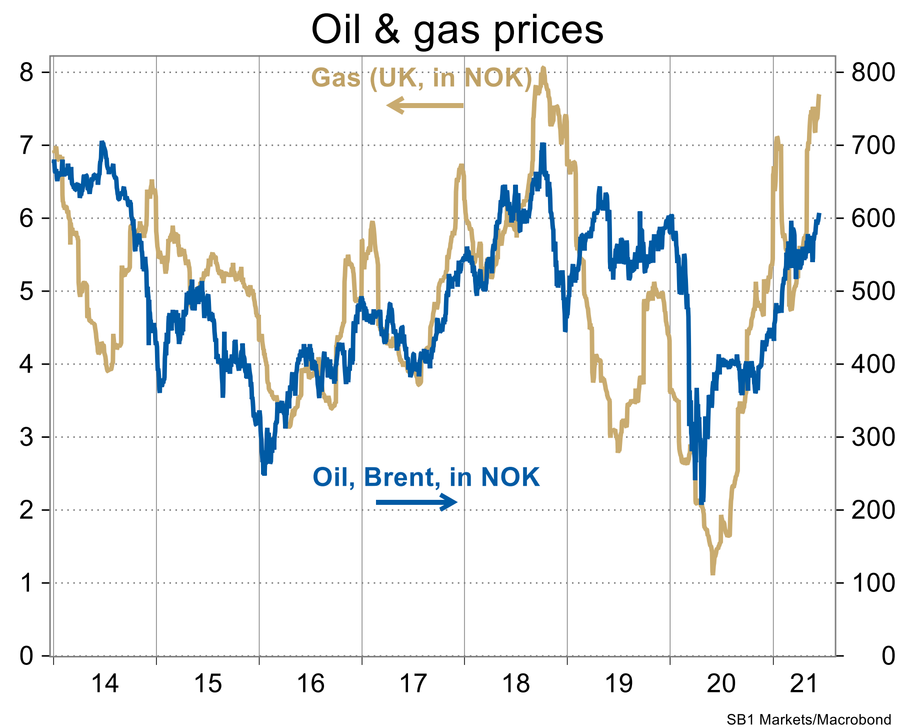




- Exports of machinery and transport equipment (of which much is related to oil activities abroad) is trending down, very likely due to lower oil sector investments abroad
- The main contributors to the m/m increase in mainland exports were crude materials, metals, chemicals, other manufactured goods, and fish

# It's stating the obvious: Oil & gas exports increased as prices increased

Oil exports up 247% in value terms from last year, while only marginally up volume terms

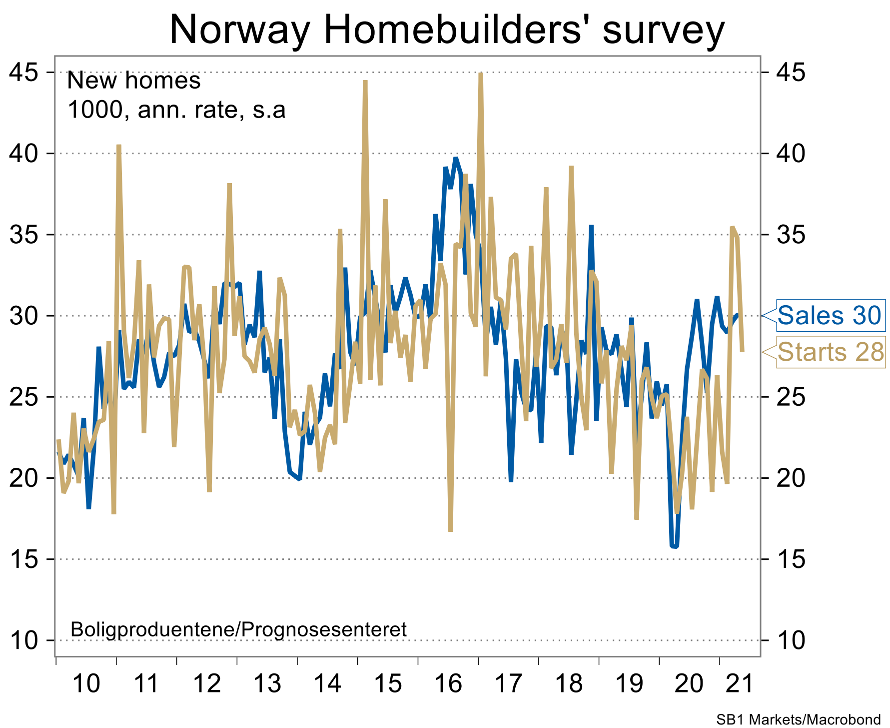


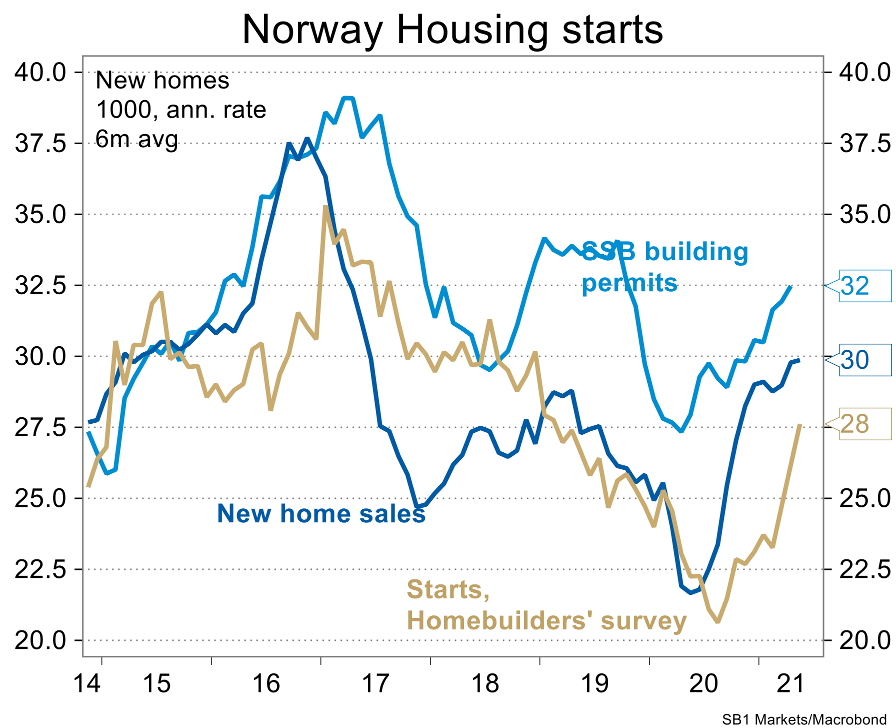




- **Crude oil** exports (in NOK bn) fell rapidly in March and April 2020 as the oil price dropped and global demand subsided. Exports have turned up since then, with the oil price, and exports have recovered
- **Gas** export values fell sharply during H1-20 but has recovered to above pre-corona level as gas prices recovered substantially during H2 last year, and in January. Gas prices then fell in February before increasing again from March onwards. Export volumes are up over 10% y/y

# New home sales at 30', starts at the same level, according to the Homebuilders

## Starts are even more volatile than their sales data – both now at 'normal' levels



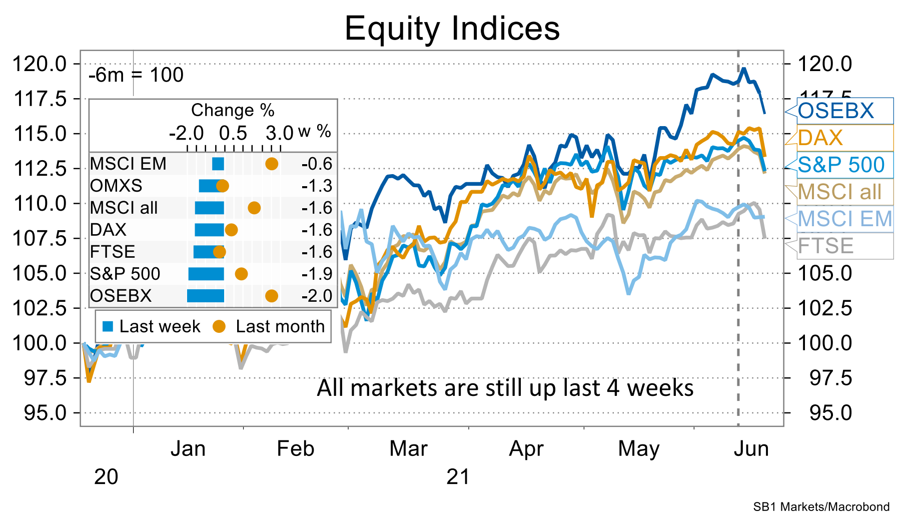



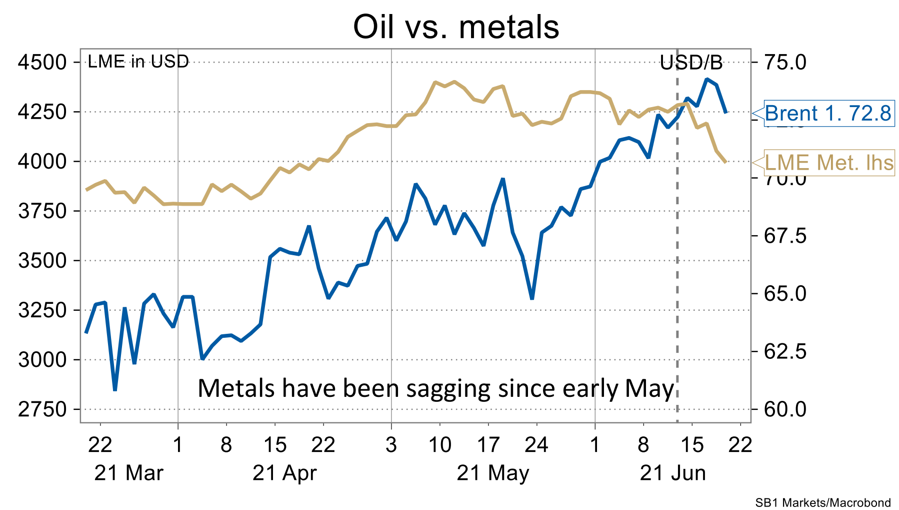

- **Home builders: New home sales flat at** in May. Sales have stabilised around 30' recent months (annualised rate)
- **Starts** dropped to 28 from 35'. Until the past 3 months, starts have been running way below sales for a while, and 'something' had to give – and as we assumed, starts yielded
- Homebuilders report of some **delays in projects** due to travel restrictions for foreign workers and they are complaining about material costs/shortages – like everybody else these days
- **SSB will report its April data next week XXXX**
- The conclusion is still rather robust: **Housing investments** (in National accounts) will continue to rise

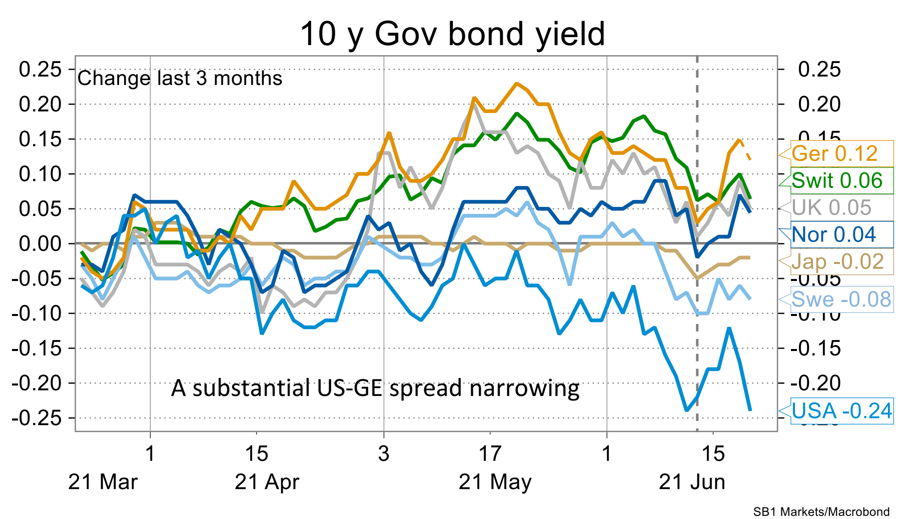
SpareBank 1 MARKETS

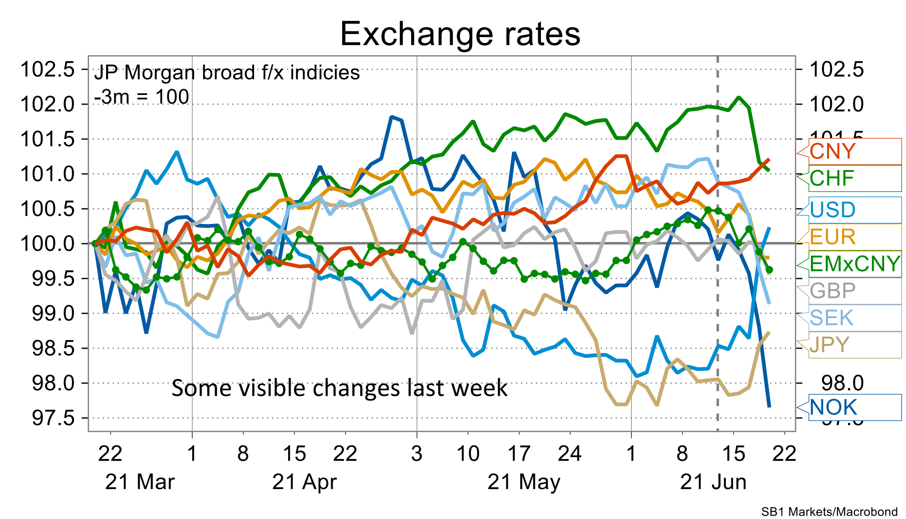
# Equities down everywhere, metals down. Oil up on the week, down Frid.

## Fed's week: USD up 2% (2.5 st.dev!). EUR down 1%, NOK 2%! US long bond yields down, up elsewhere



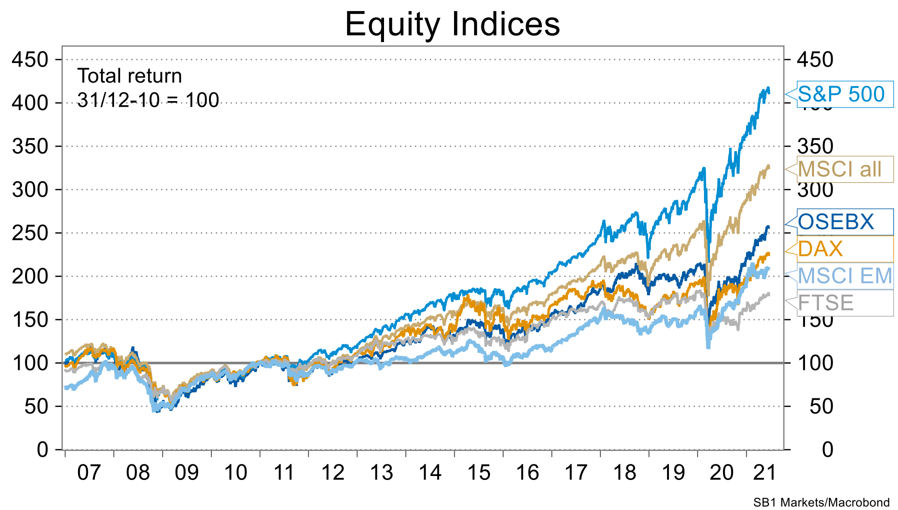



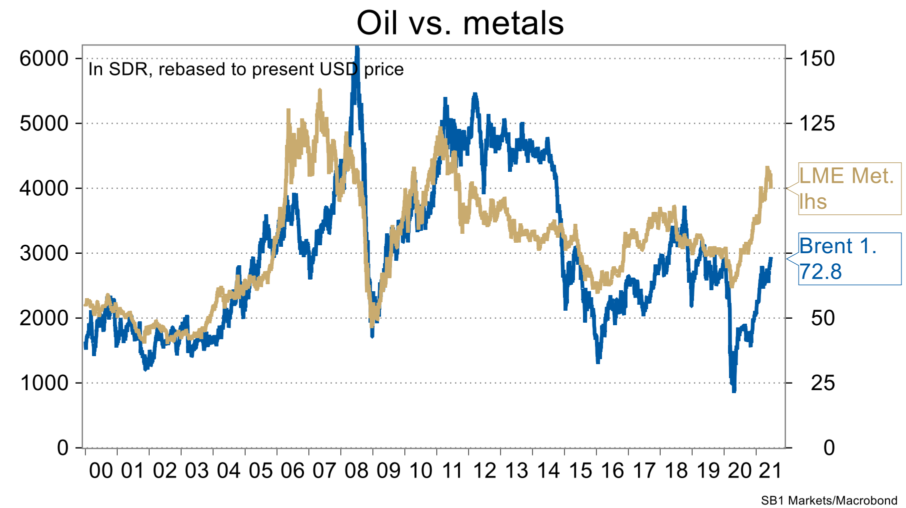



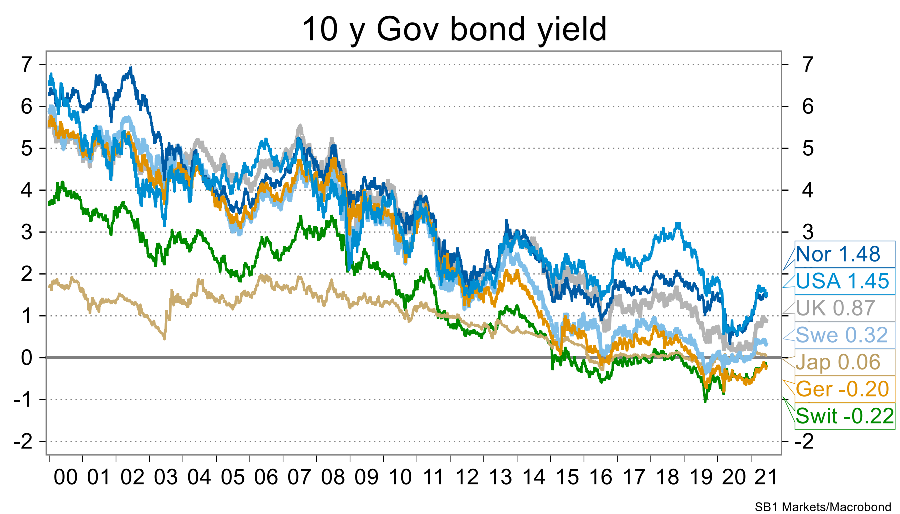



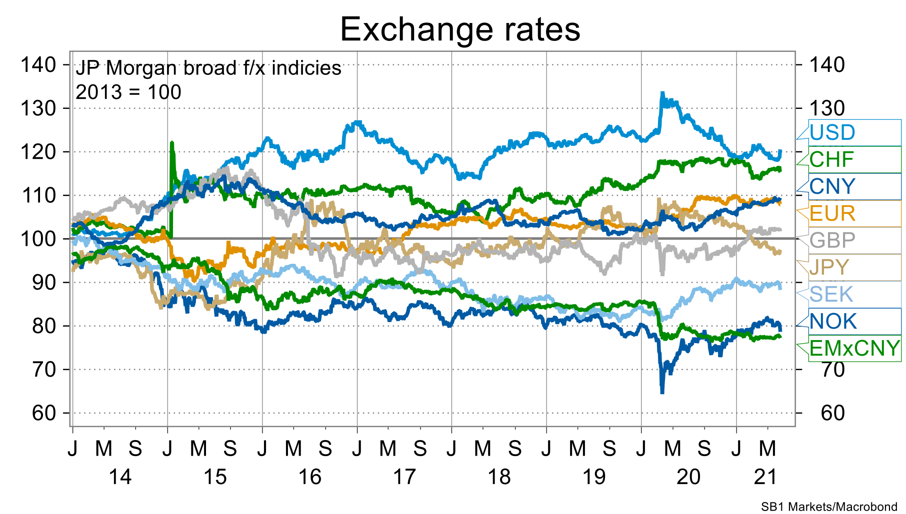
# The big picture: Strong stock & commodity markets. USD trend is still down

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



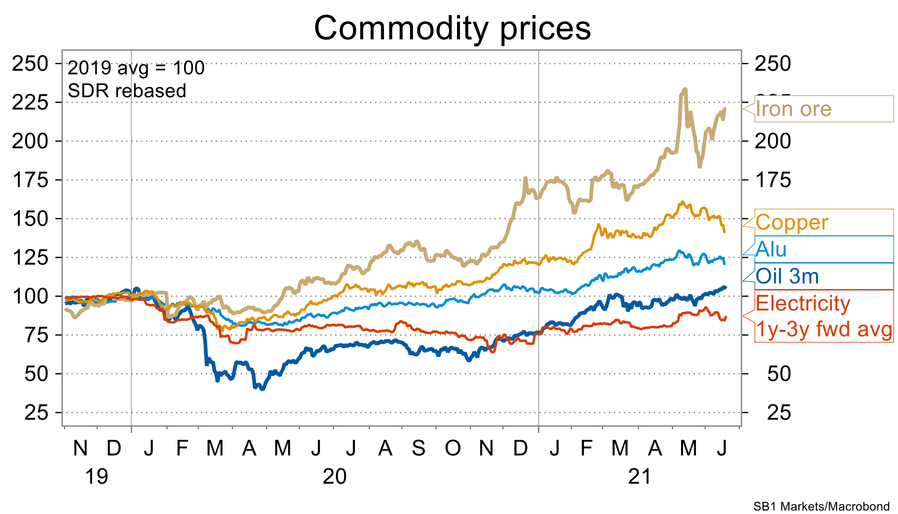



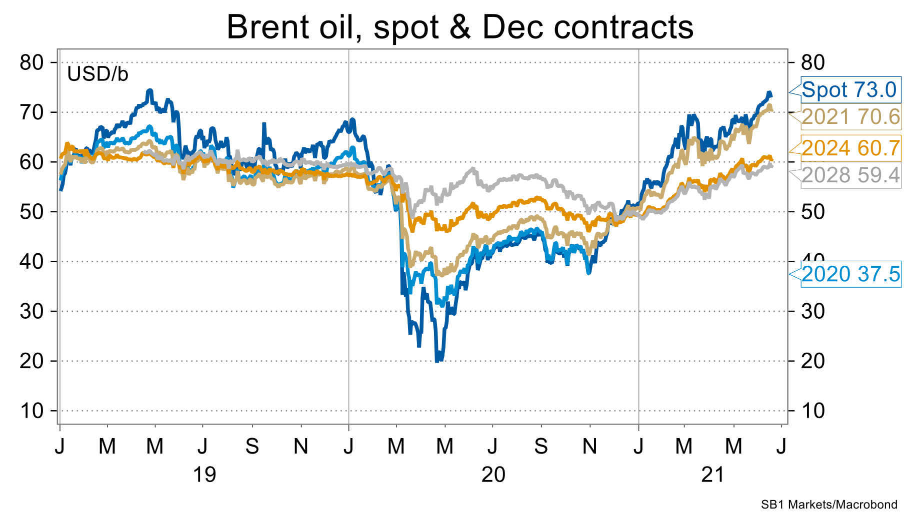



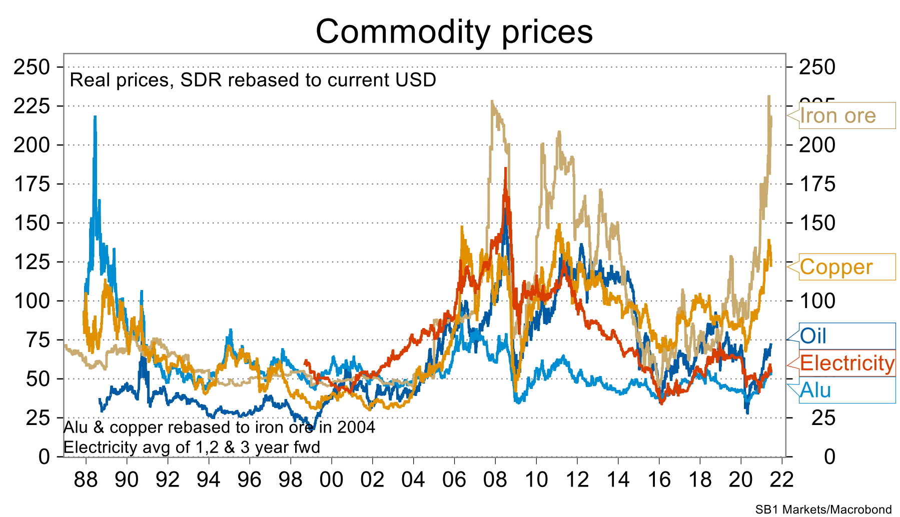



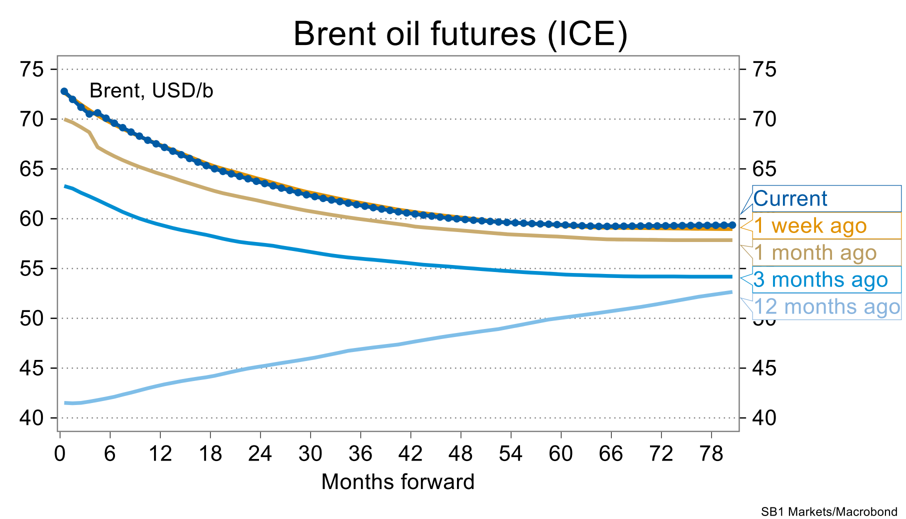
# Iron ore has recovered 2/3 of May losses, oil still trends up from USD 70/b

## However, metals have been weak recently – copper sharply down last week (as is lumber)



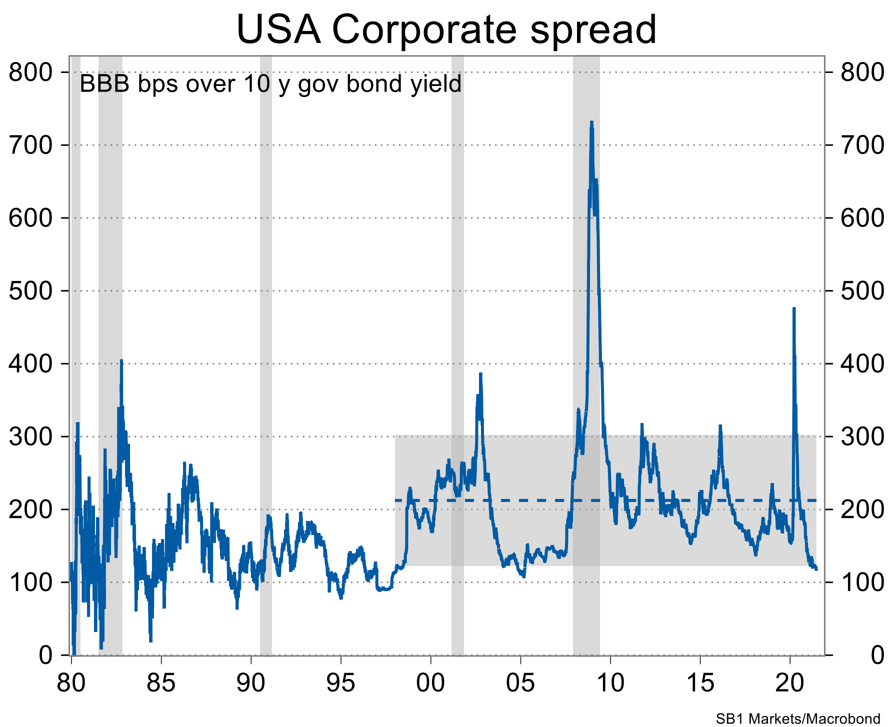



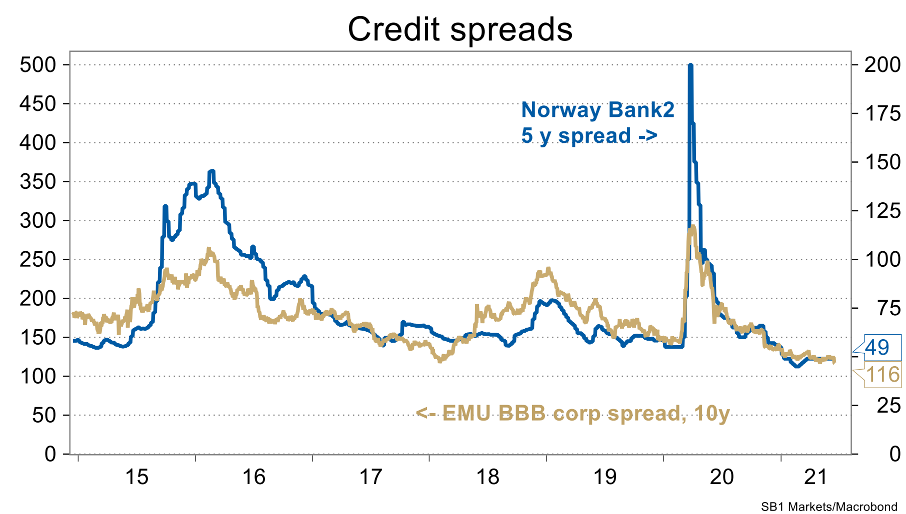



# No worry at all, not anywhere – credit spreads remain very low

... and some fell further last week

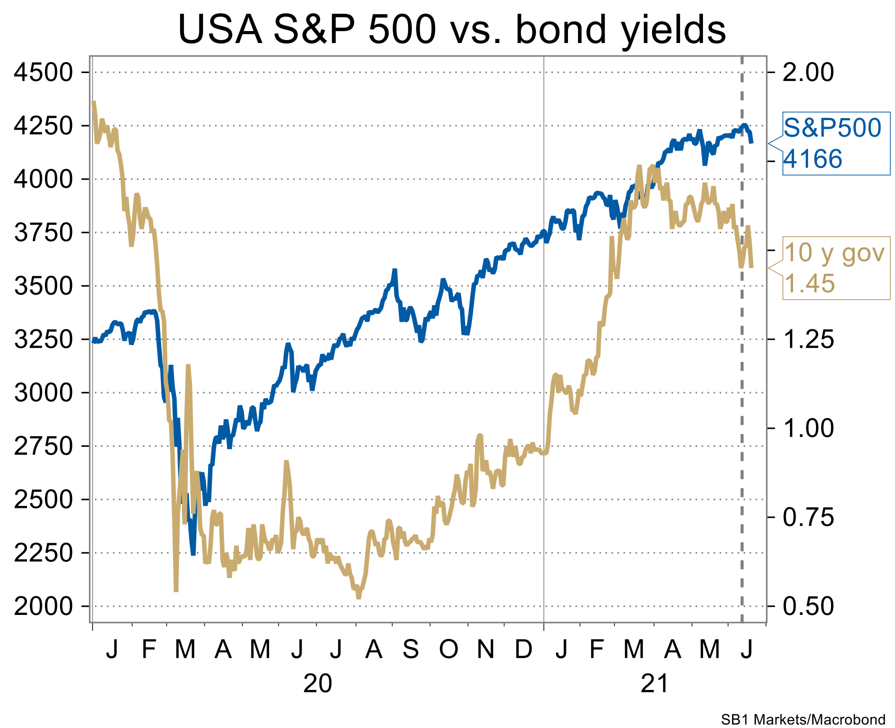


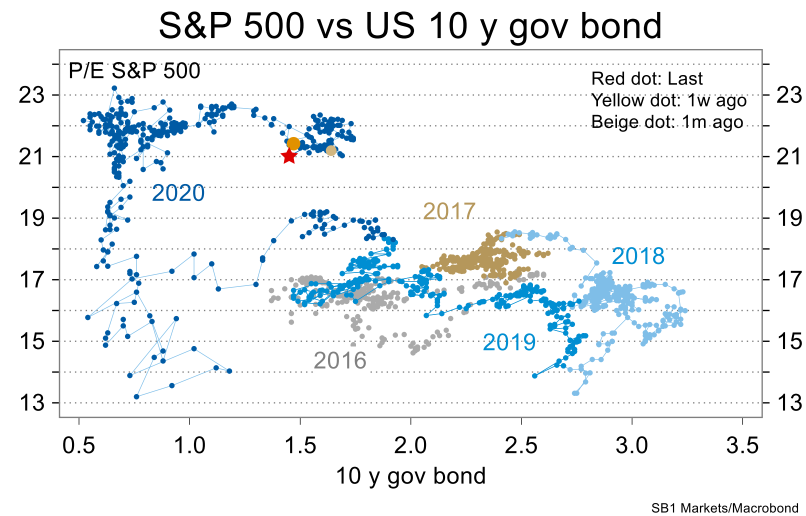


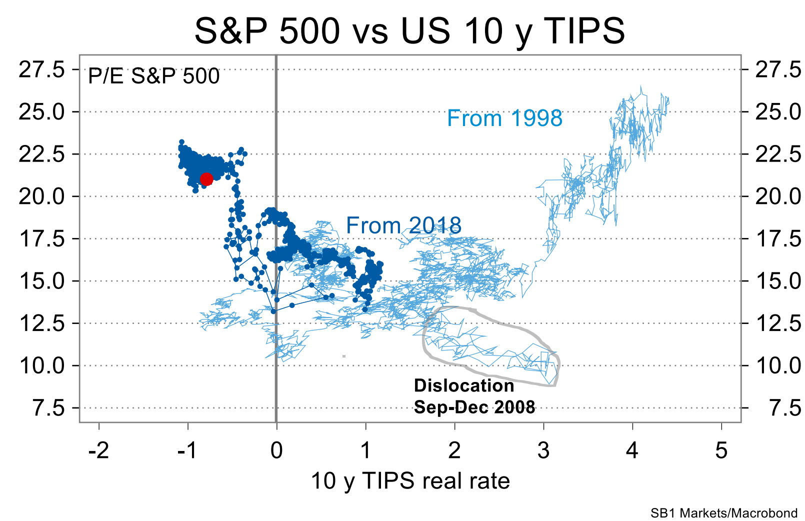


# S&P 500 down 1.9% from ATH, the 10 y bond yield down 2 bps, to 1.45%

… as Fed showed that it might have some muscles left

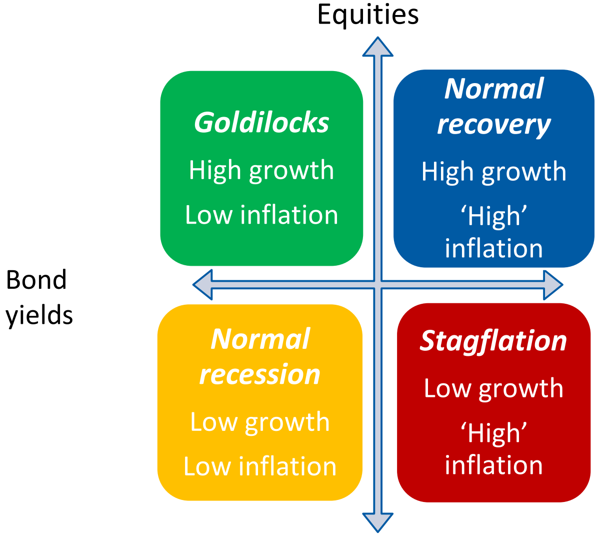


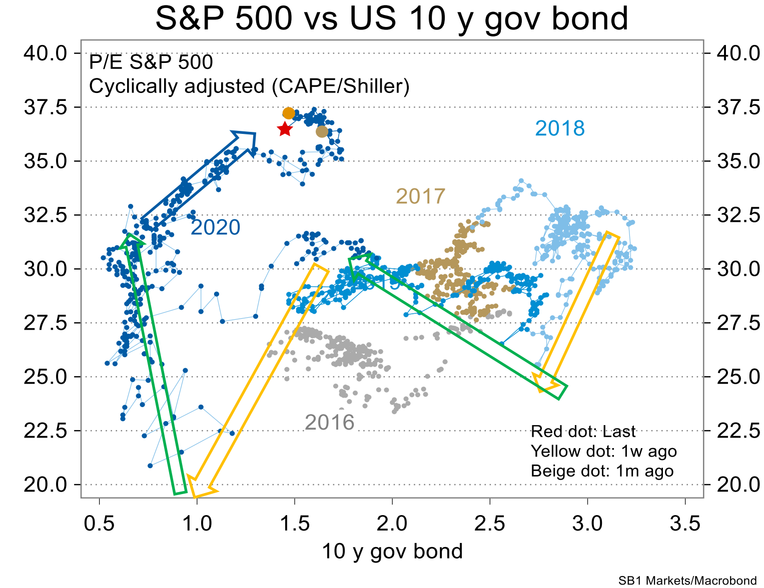



# Still well inside the 'Goldilocks corner'

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

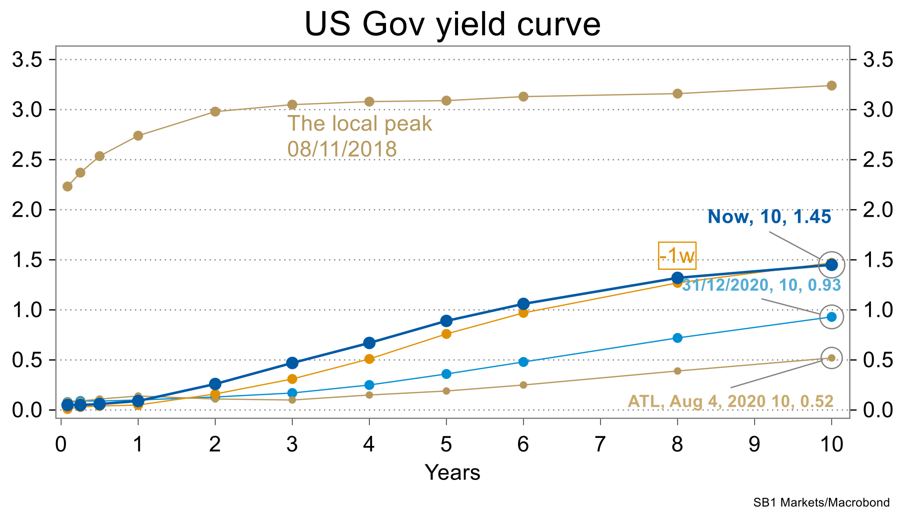


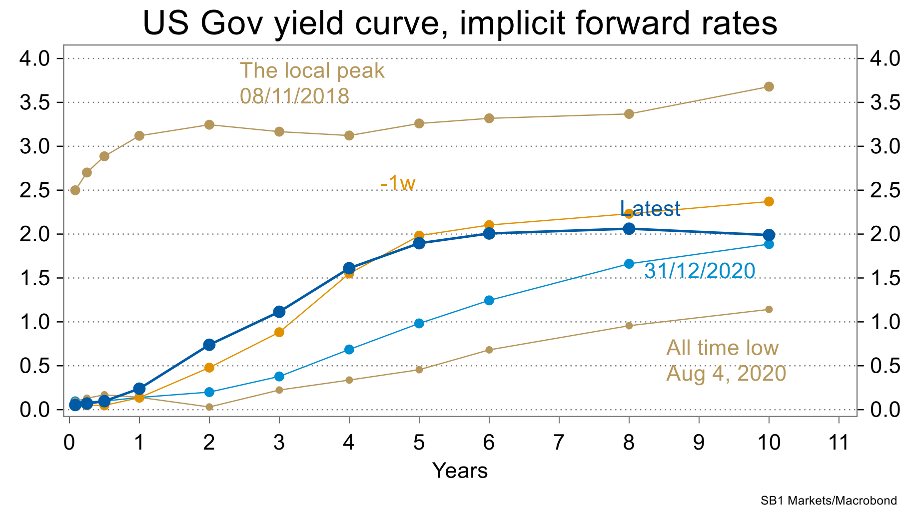



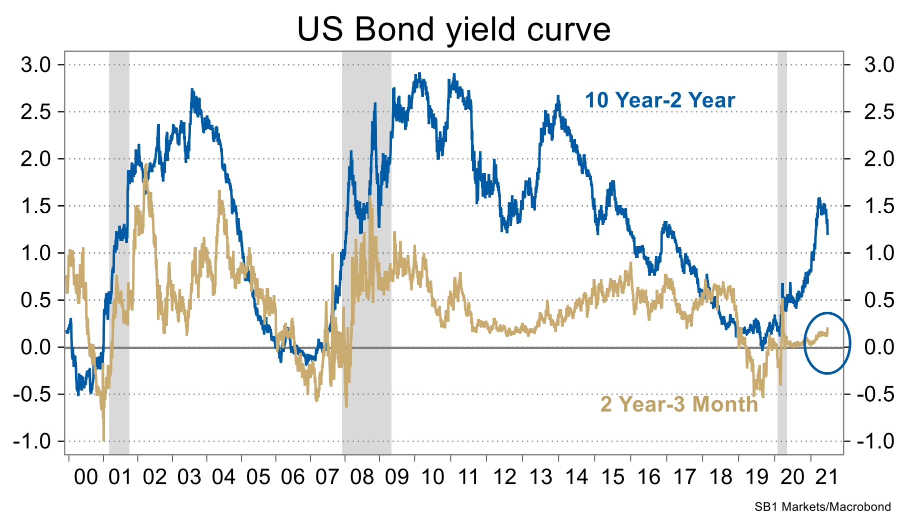

- Usually, we have associated drifts towards the 'green corner' - low inflation and solid growth at the same time - as a temporary sweet spot for markets
  - » Interest rates have climbed 100 bp+, and stock valuations have kept up or climbed (like the Shiller PE). Still, we deem the current yield level 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

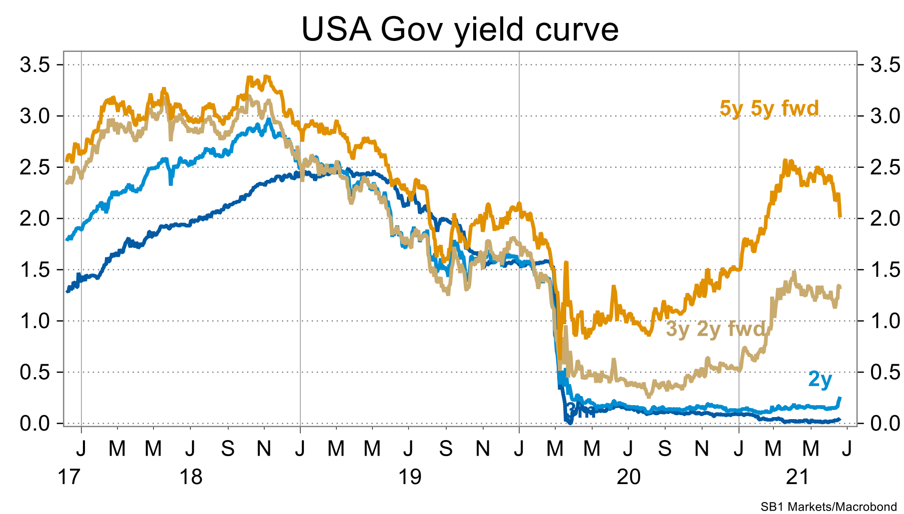
# After Fed: Shorter rates up, longer rates down, at least implied

A large decline in 5 y 5 y fwd. More confidence in the Fed the most likely explanation



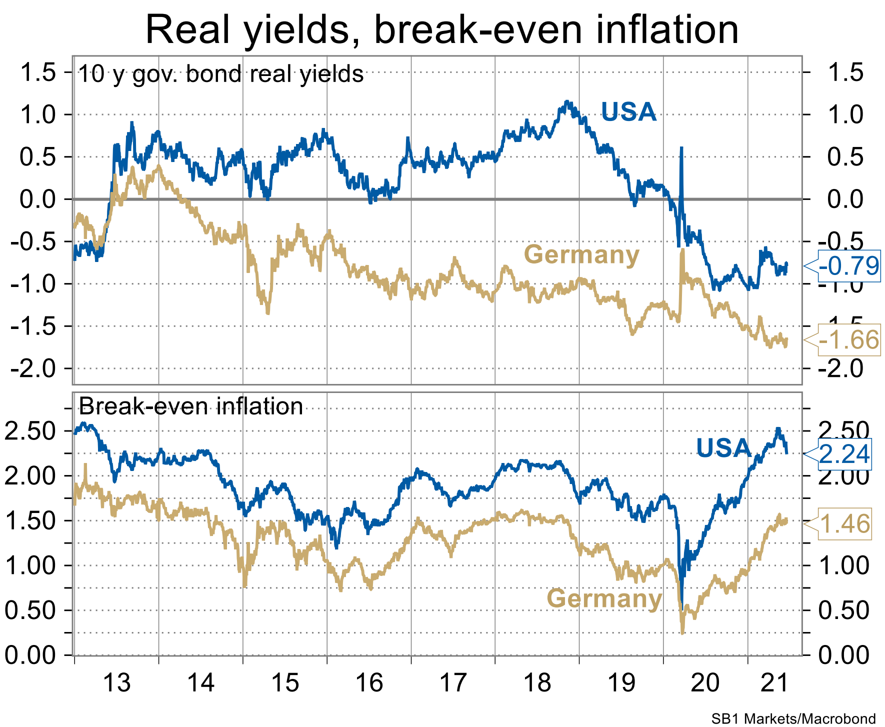



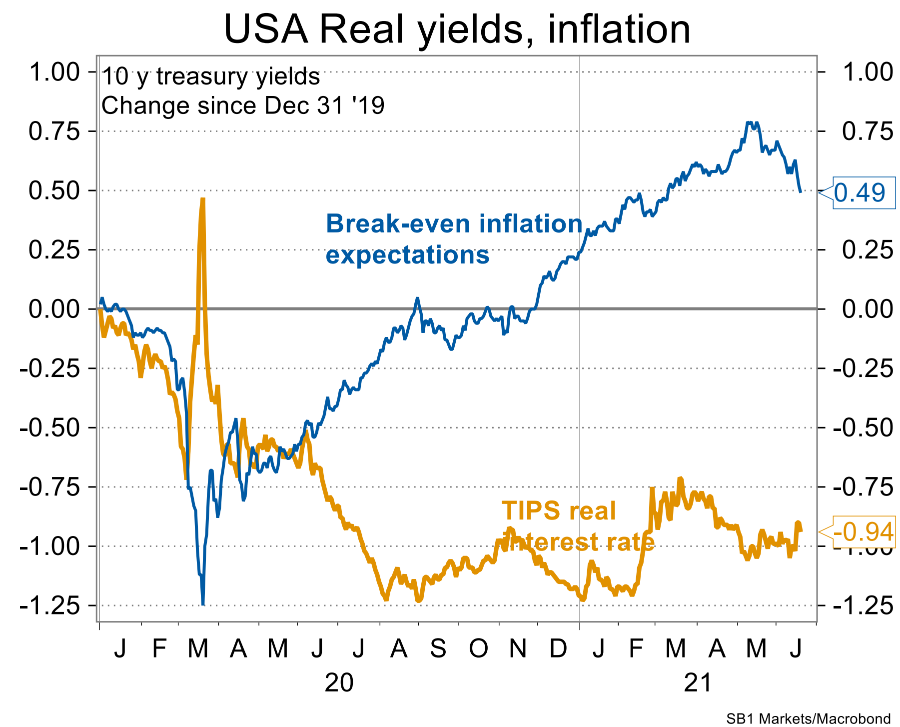



# Inflation expectations further down, real rates up – but still very low

## Fed strengthened its inflation credibility – at just a marginal cost, real rates just marginally up




US & Germany 10 y Gov bond yield

| | Yield | Change 1w | Change 1m | Min since April-20 |
|---|---|---|---|---|
| **USA nominal treasury** | 1.45 | -0.02 | -0.19 | 0.52 |
| .. break-even inflation | 2.24 | -0.08 | -0.28 | 1.06 |
| .. TIPS real rate | -0.79 | 0.06 | 0.09 | -1.08 |
| | | | | |
| **Germany nominal bund** | -0.20 | 0.09 | -0.09 | -0.65 |
| .. break-even inflation | 1.46 | 0.01 | -0.11 | 0.40 |
| .. real rate | -1.66 | 0.09 | 0.02 | -1.76 |

SB1 Markets/Macrobond

- US 10 y inflation expectations fell by 8 bps last week too, down to 2.24%, an they are down 30 bps from the peak in March. The real rate + 6 bp, to -0.79%
- German yields rose last week, due to higher real rates (which are still at -1.66%, the coming 10 years)

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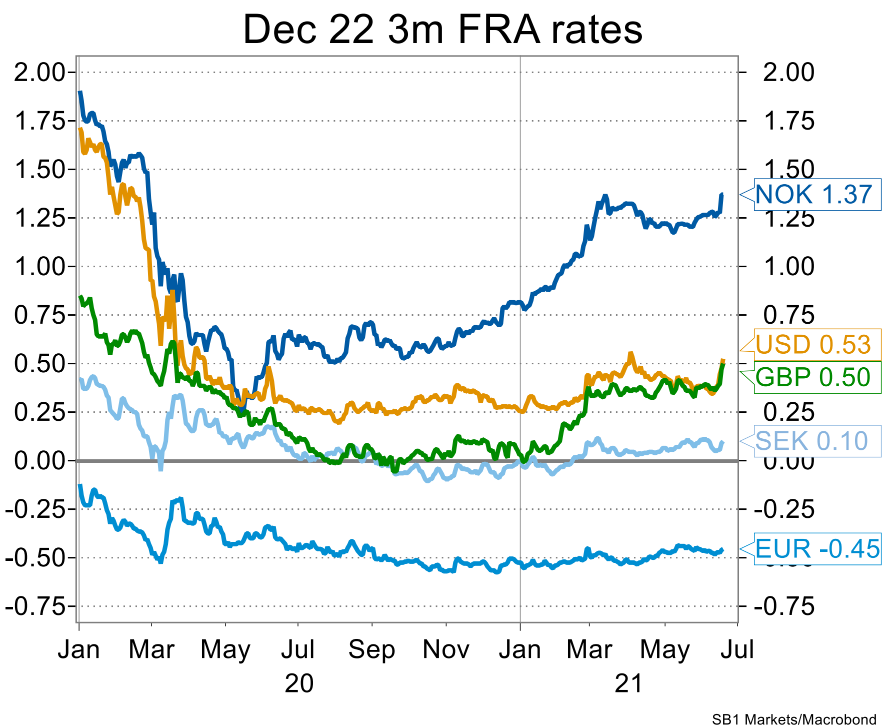
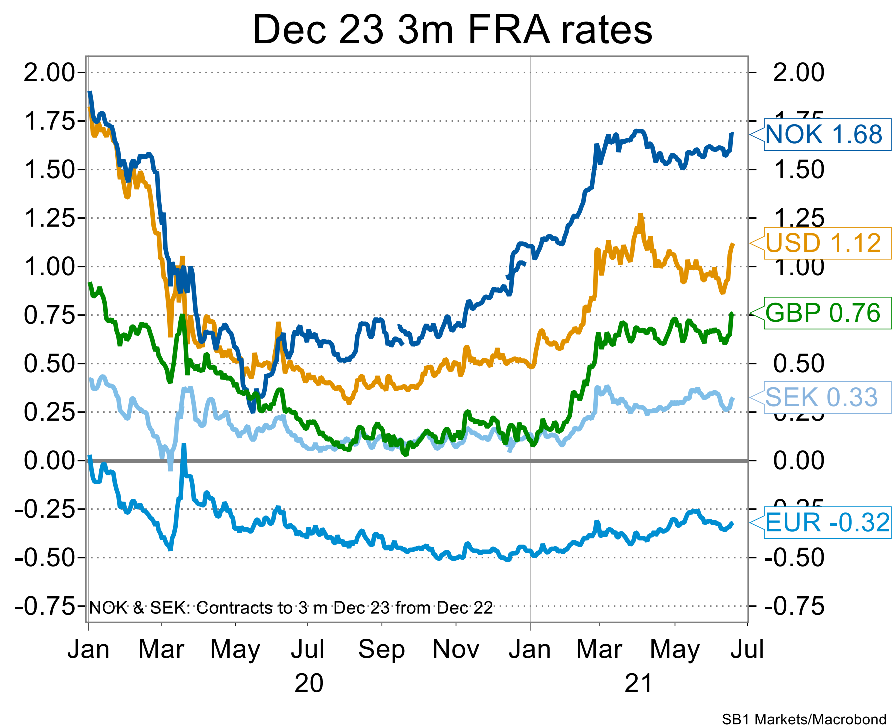
# FRAs: Sharply up in NOK, USD, GBP. Fed can take credit, and NoBa here, of course

The US curve is discounting the first Fed hike in Q3/Q4-22 – and 2 more in 2023



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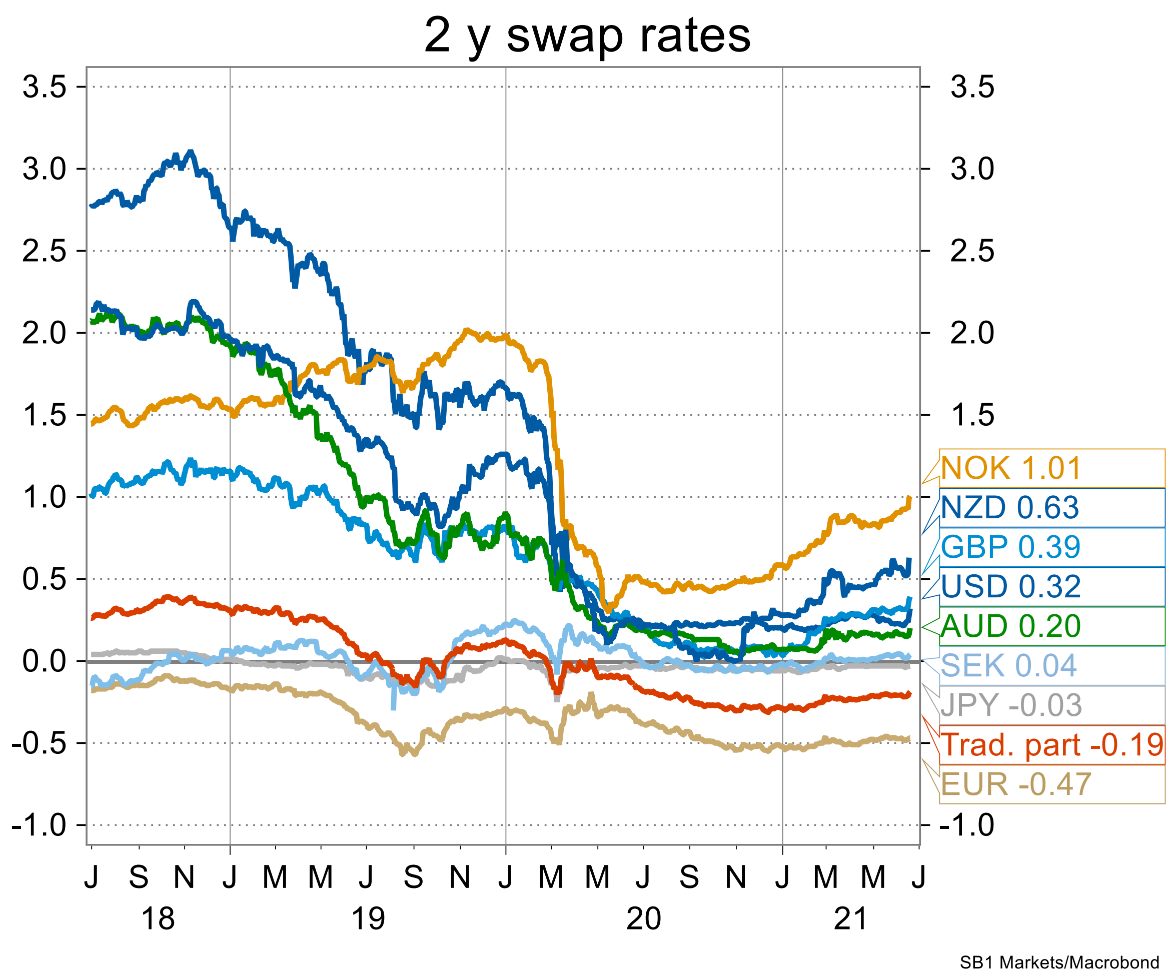
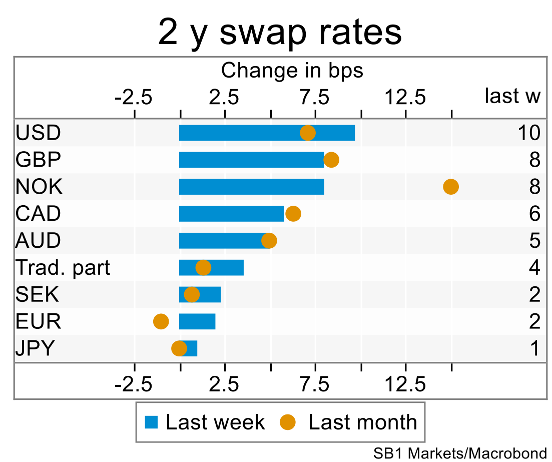
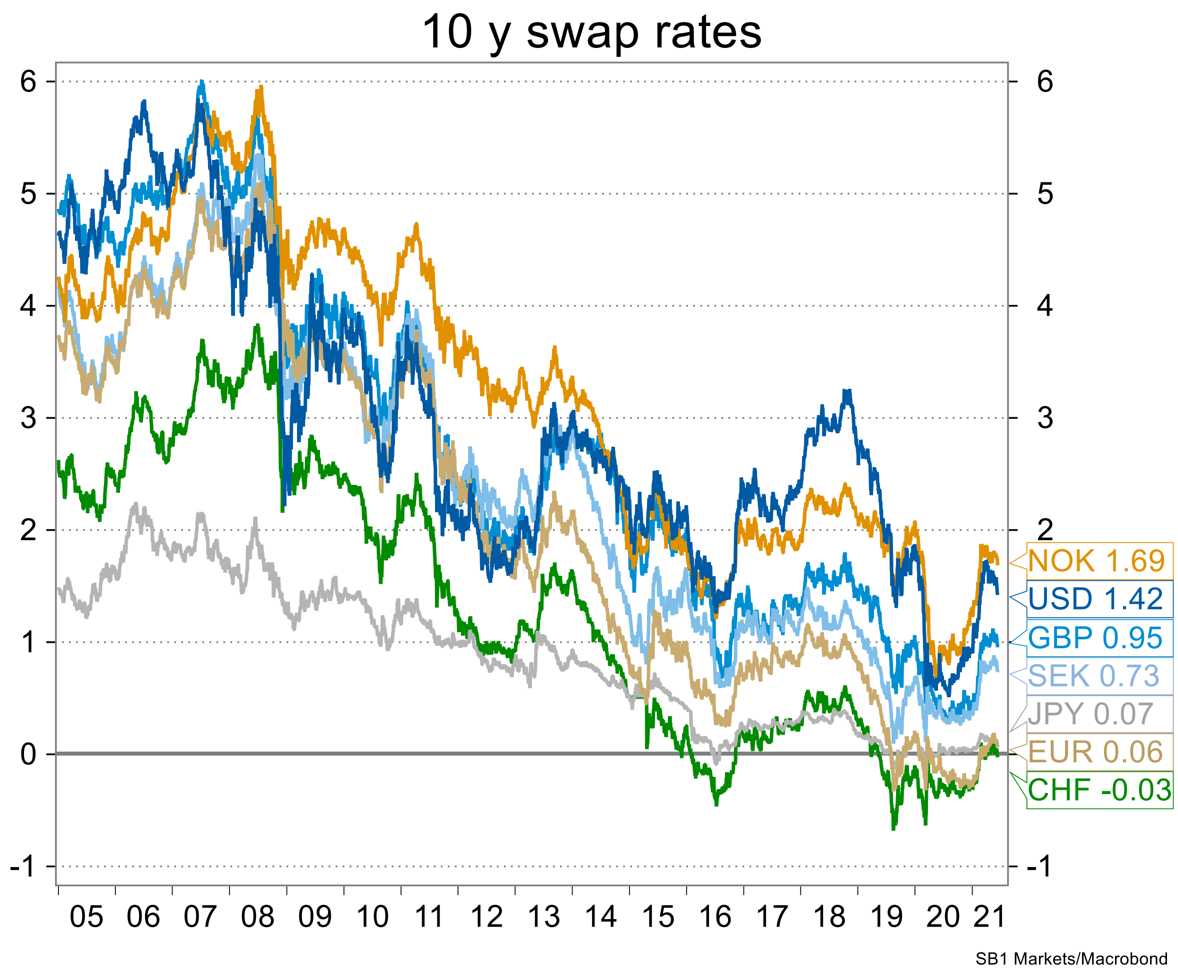
# The short end up everywhere, the Fed set the tone

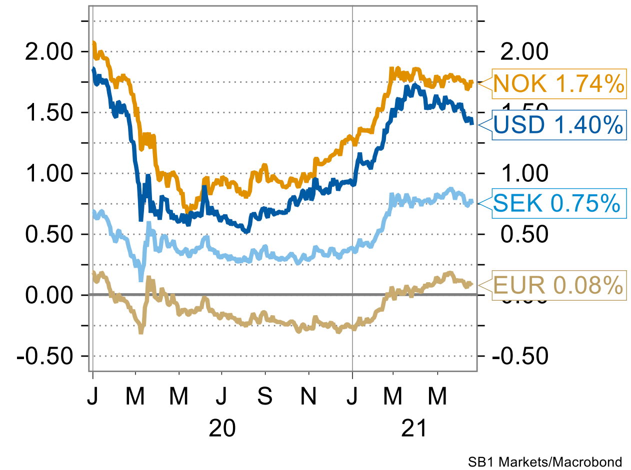
..and Norges Bank surprised markets on the upside

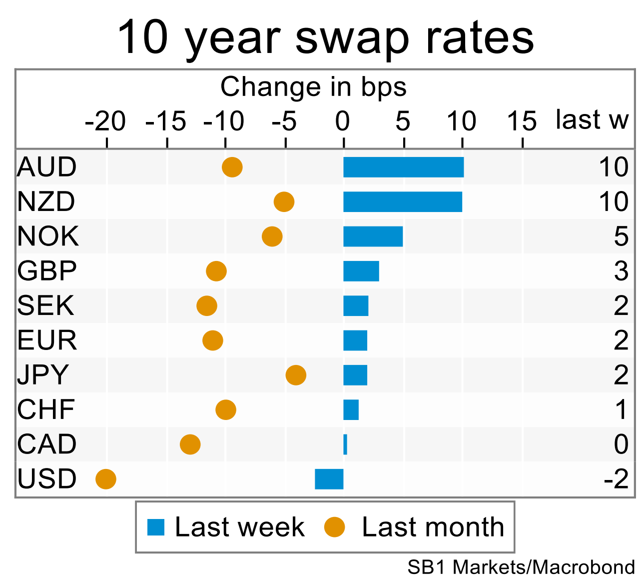


# Mostly up – but not in the US



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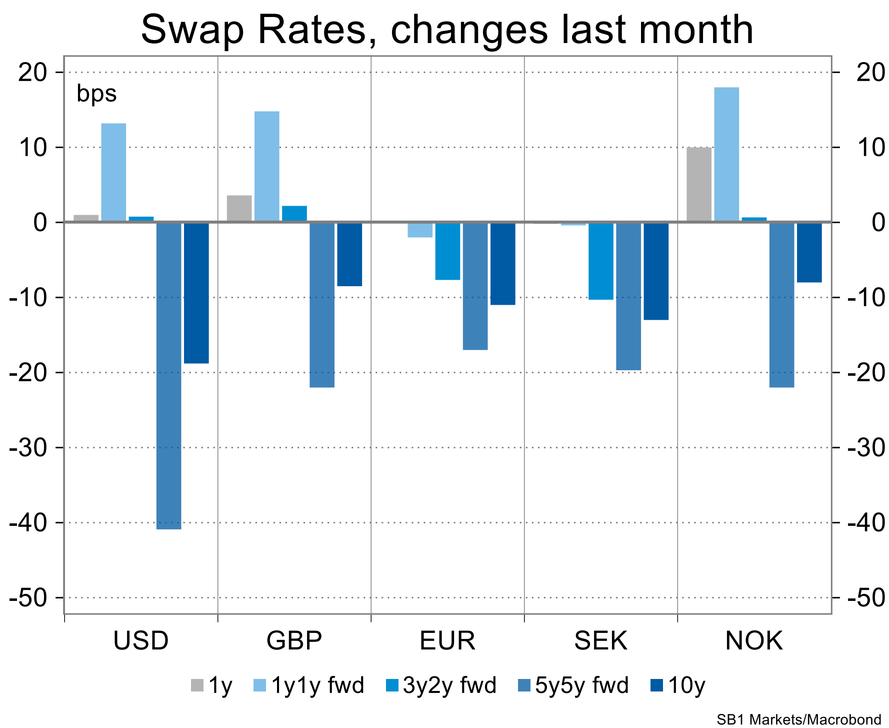
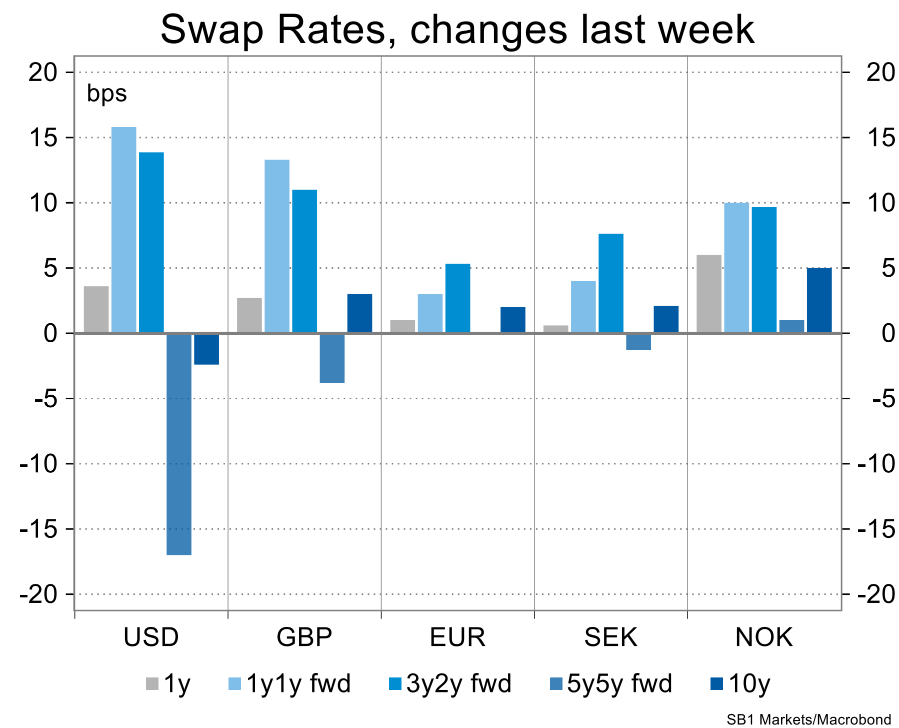
# Almost like operation twist in the US: Short rates sharply up, and long rates down

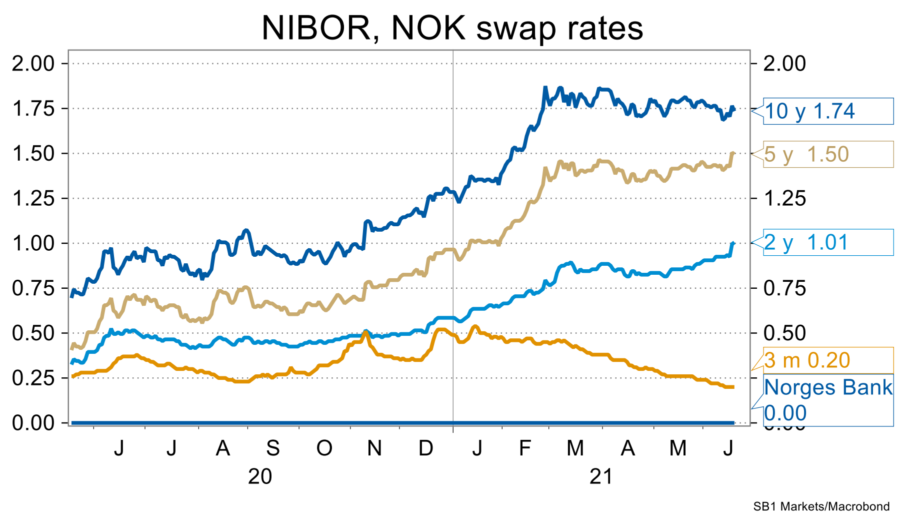
However, long rates rose elsewhere – and the whole curve in Norway rose (but 5y 5y fwd just marg.)

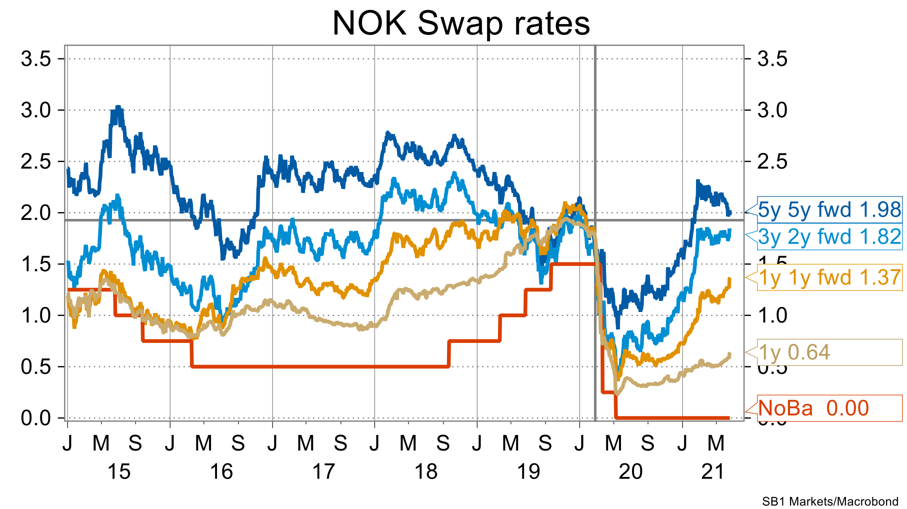


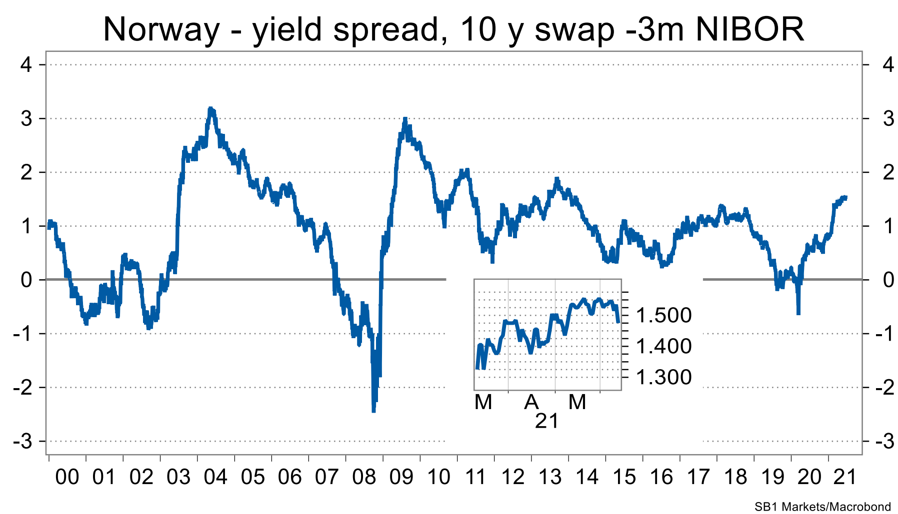



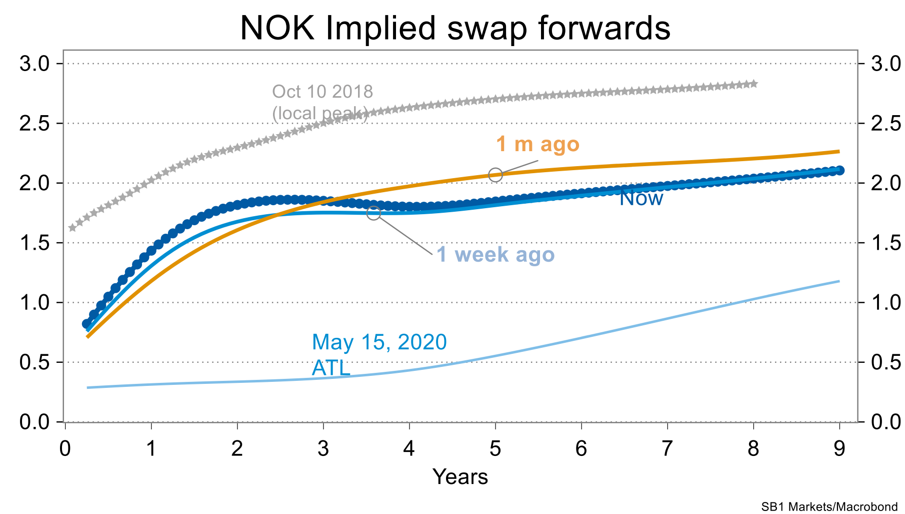
# NoBa had a visible impact: A steeper curve, at the 1st half (implied)

## No decline in implied rates further out: No premium for a 'hawkish' NoBa

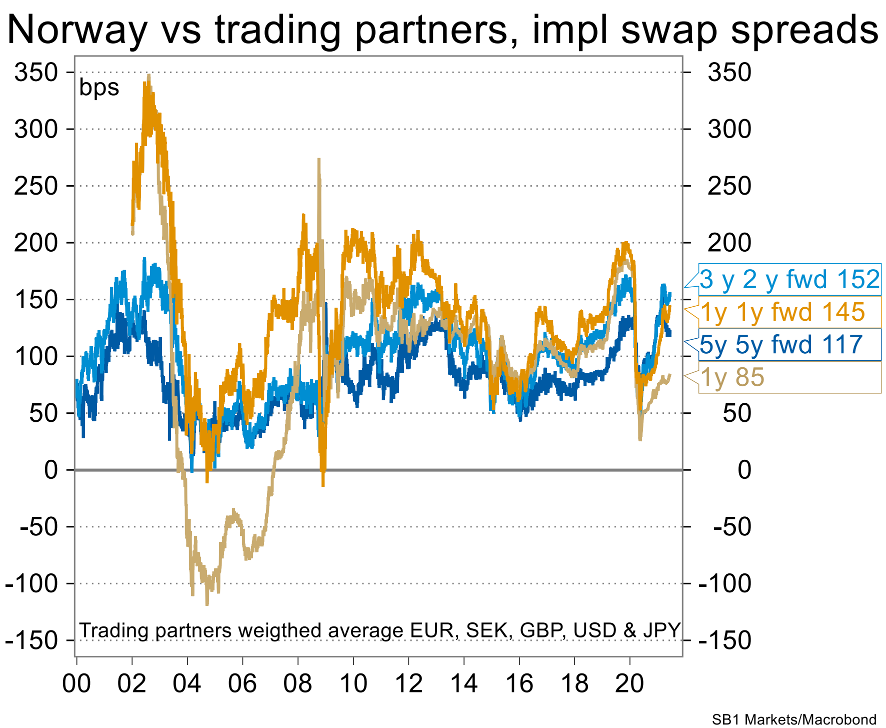


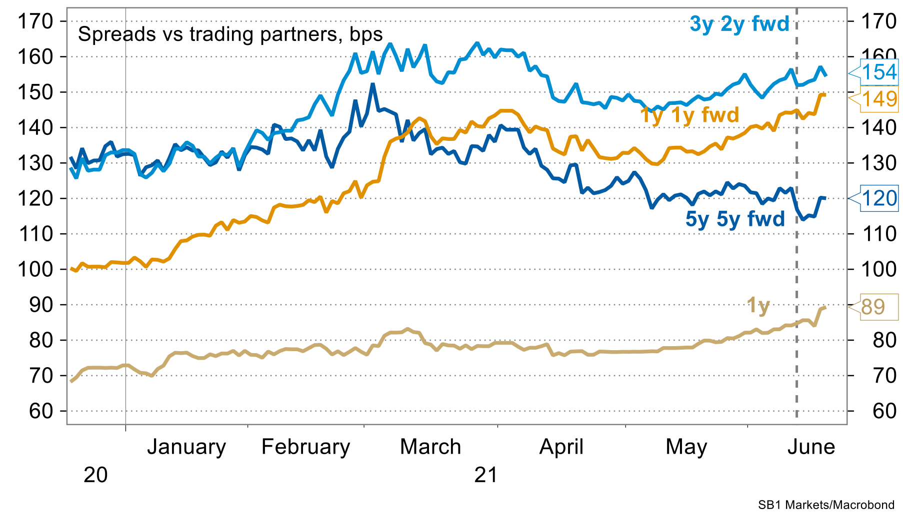



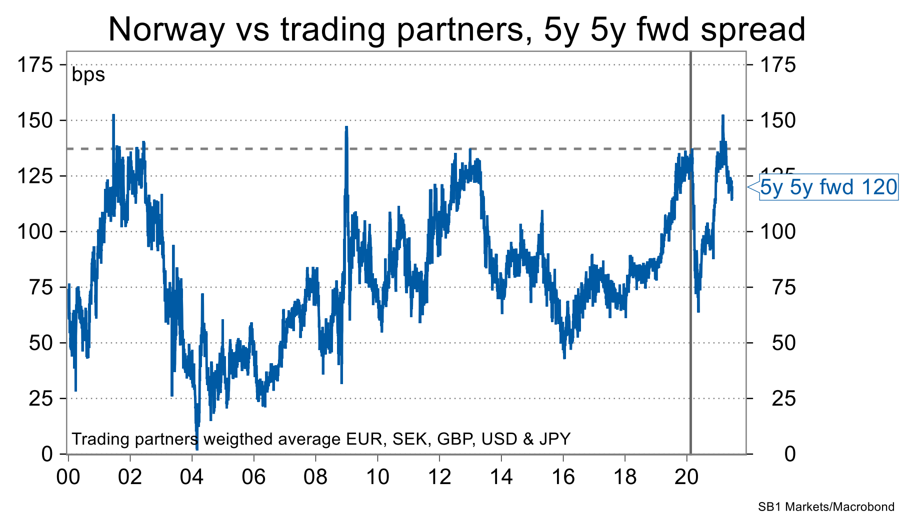



# Forward spreads up all over the curve, most in the short end, of course



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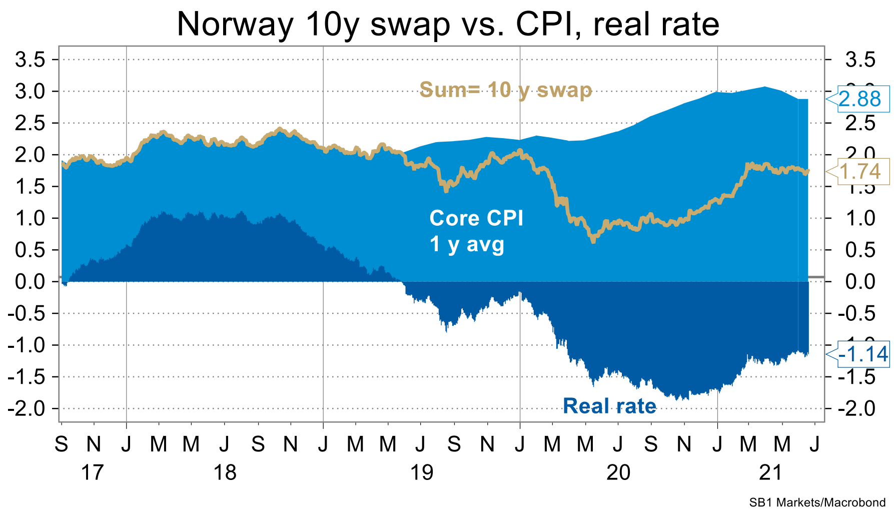
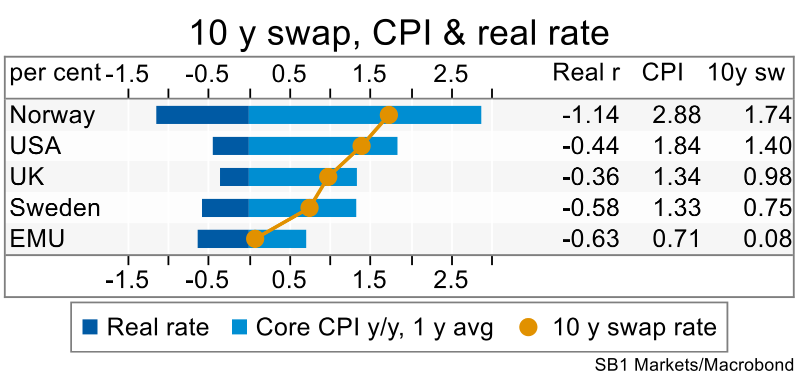
# Negative (actual) real interest rates most places – NOK at the bottom




## NOK 10 y swaps have flattened

- The **10y NOK swap** rate up 5 bps to 1.74%
- **The real rate**, after deducting 2.9% an average core CPI inflation over the 2 past years equals -1.1%
  - » 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

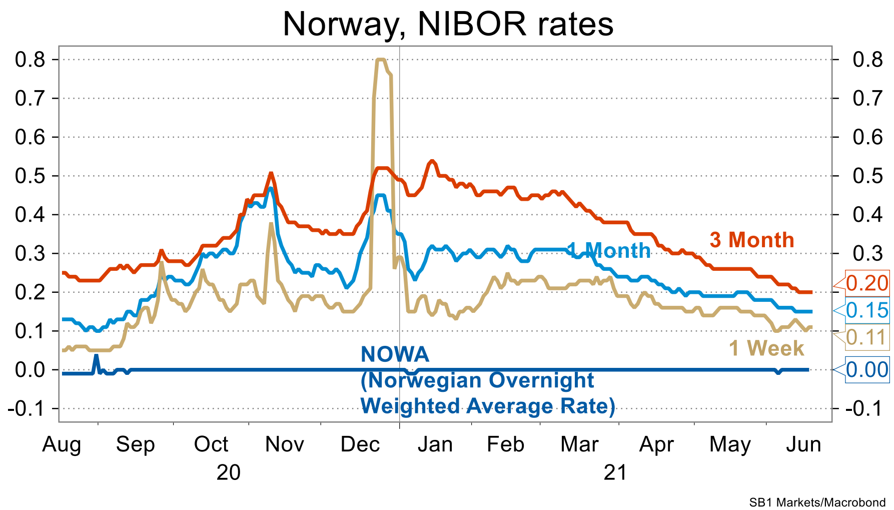


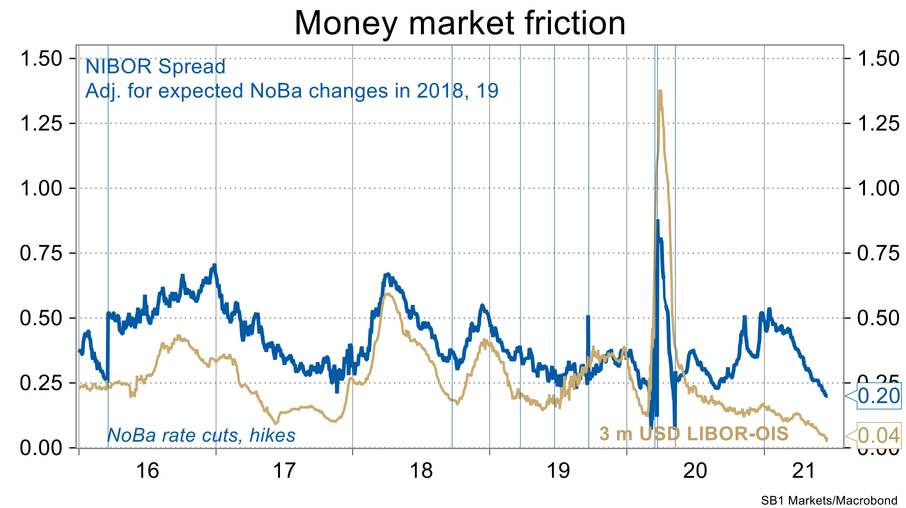

## NOK real rates among the lowest, as inflation is at the top

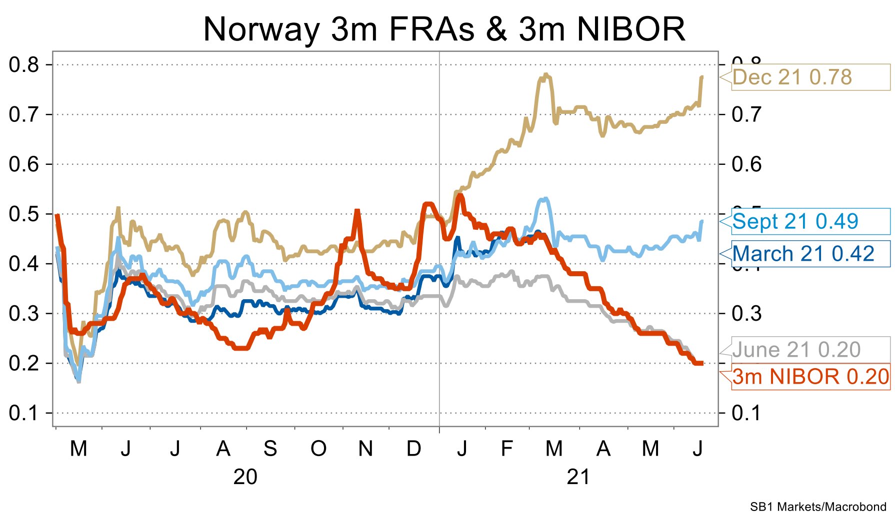
- **Inflation** among main trading partners varies between 0.7% to 1.8% (here again measured by actual annual core inflation, smoothed over 12 months). EMU at the bottom, US at the top, the latter will climb rapidly the coming months
  - » Other measures of inflation trends, looking backward or including forward expectations yields the same ranking
- **Real rates** among our trading partners, and ranging between -0.4% and -0.6% measured vs. the 10 y swap rate and core inflation over the past two years
- **Thus, the Norwegian real rate at -1.14% is still an outlier on the downside, even if the nominal rate is the highest**

# The US LIBOR/OIS money market spread has taken the NIBOR spread down

## ... And the 3m NIBOR has fallen to just 20 bps, ATL!



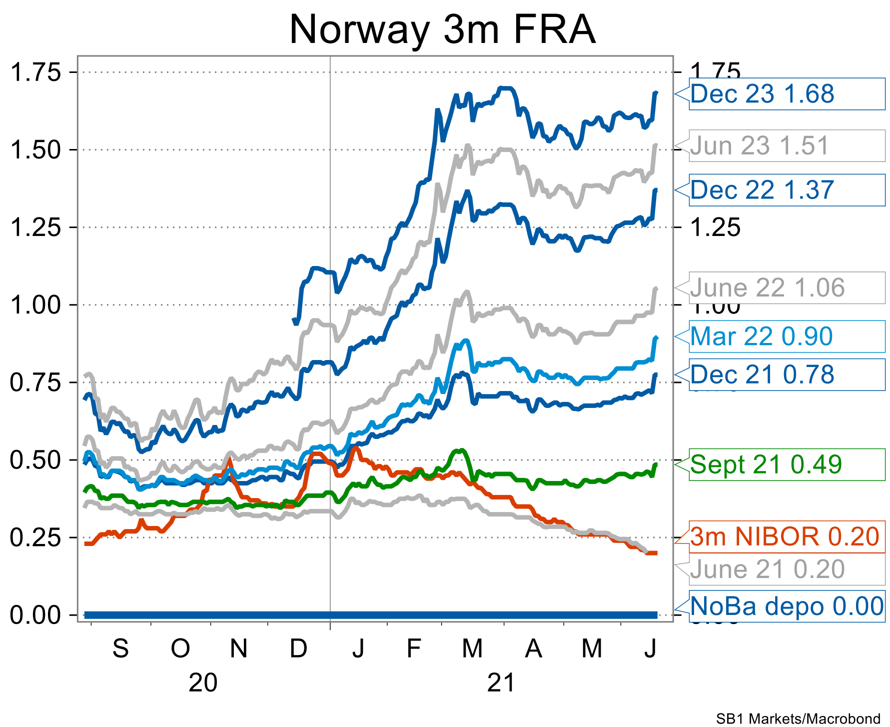



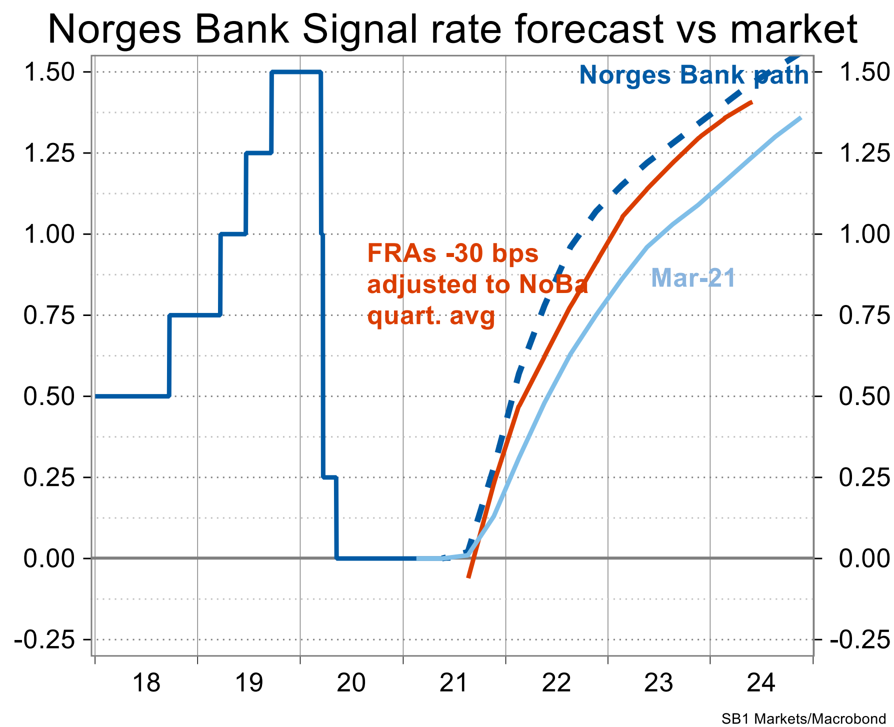

- The US money market is flooded with liquidity, possibly is a consequence of at generous liquidity support from the Federal Reserve – even if the surged started as late as April
- The Fed lasts week decided of offer an 0.05% interest compensation on their reversed repos in order to prevent market rates to fall below zero – and even more banks placed their excess liquidity at the central bank

SpareBank 1 MARKETS

# Norges Bank lifted the interest rate path much more than expected

… and FRA rates rose sharply last week – up to 15 bps – but they are still well below NoBa's new path

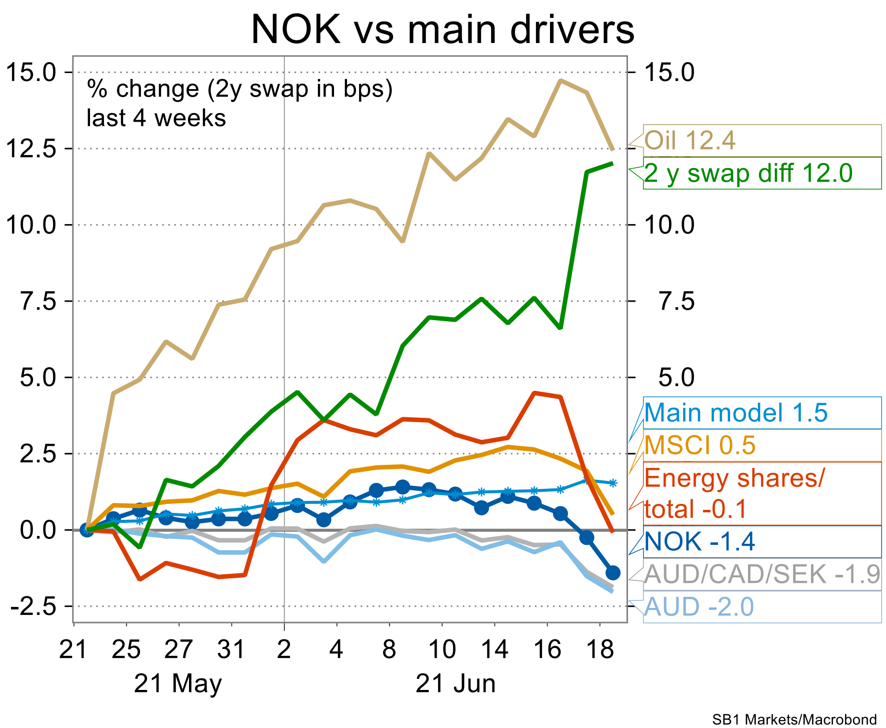


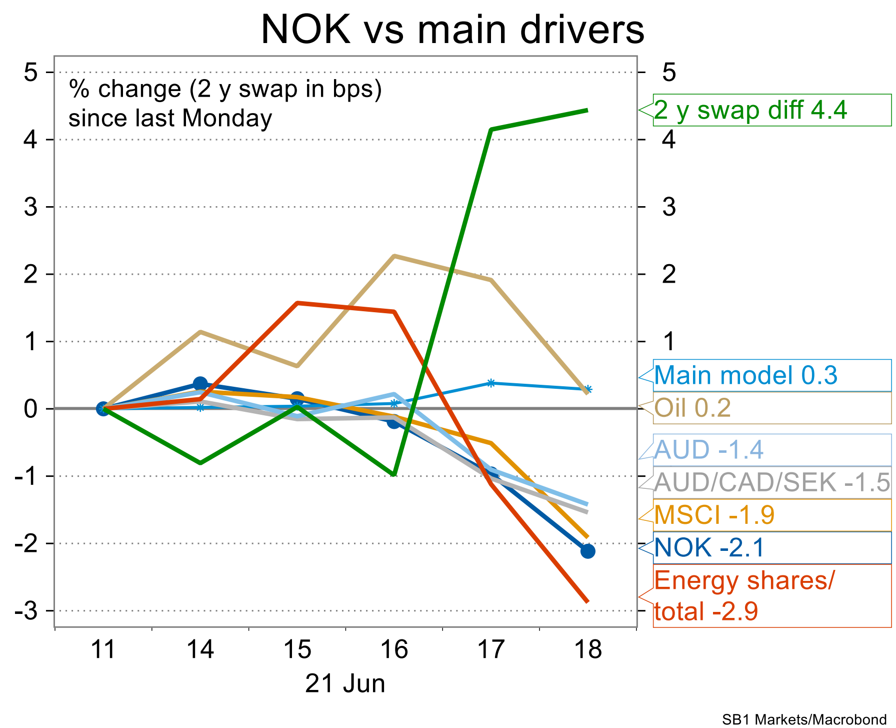




- The NIBOR spread is now at 20 bps. Norges Bank assumes 35 bps spread going forward, we expected the Bank to pencil a 30 bps spread. We stick to our 30 bps estimate until further notice
- The FRA-rates are anyway well below NoBa's new path – and we expect a further upside drift, barring an arrival of really bad delta virus news
- The market is discounting almost a 90% prob. for NoBa to hike in September and December. However, from there the FRA-path is not as steep as NoBa's, and just a 40% probability for a March is assumed, given a hike in both Sept & Dec. NoBa say 100%

# The NOK down 2.1%, our model said +0.3%. Oil up 0.2%, equities down

## Our f/x peers fell sharply too. The interest rate spread rose sharply, in vane




The status vs. the normal drivers:

- ***The NOK is 7% weaker than suggested by our standard model (calculated from Friday's data, from -4)***
- The NOK is 7% 'weaker' than the global stock market vs the correlation between the two since beg. of 2020 (from -5)
- The NOK is 9% weaker than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts (from 8)
- On the other hand, the NOK is far (9) stronger than a model which includes global energy companies equity prices (vs the global stock market) (from -10)

From early of May we have been neutral vs. NOK (from buy). The recent decline may have created a short term trading opportunity (we said 2% 'ago')

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

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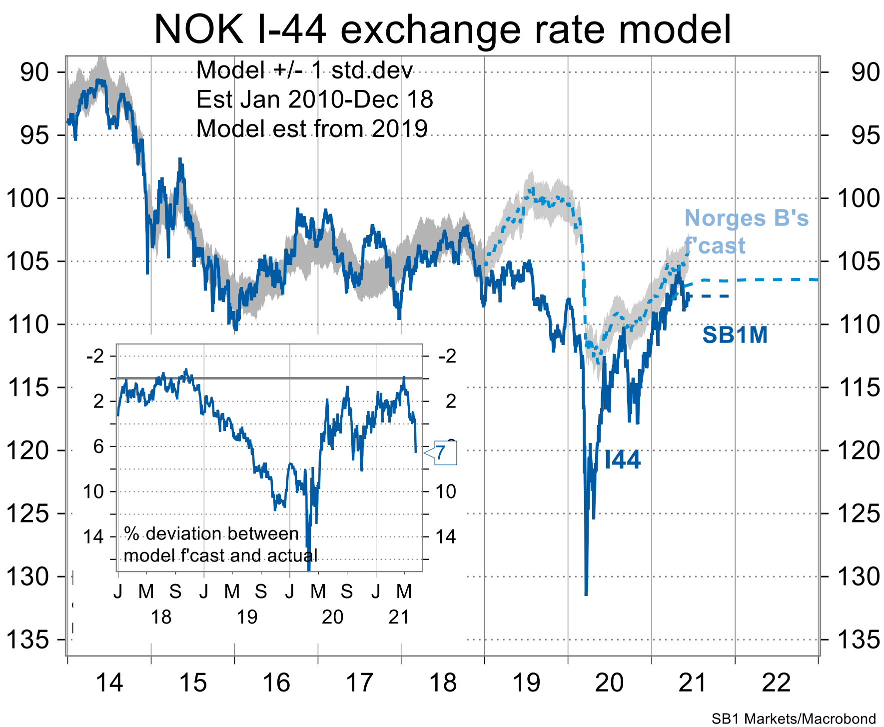
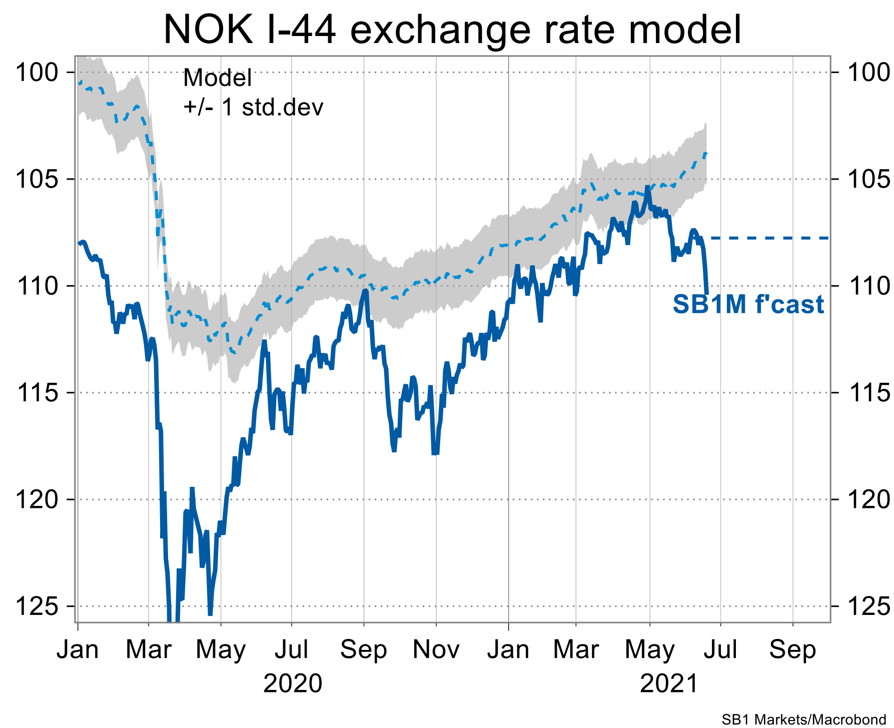
# A steep NOK drop – for no good reason? At least not oil or 'domestic' factors

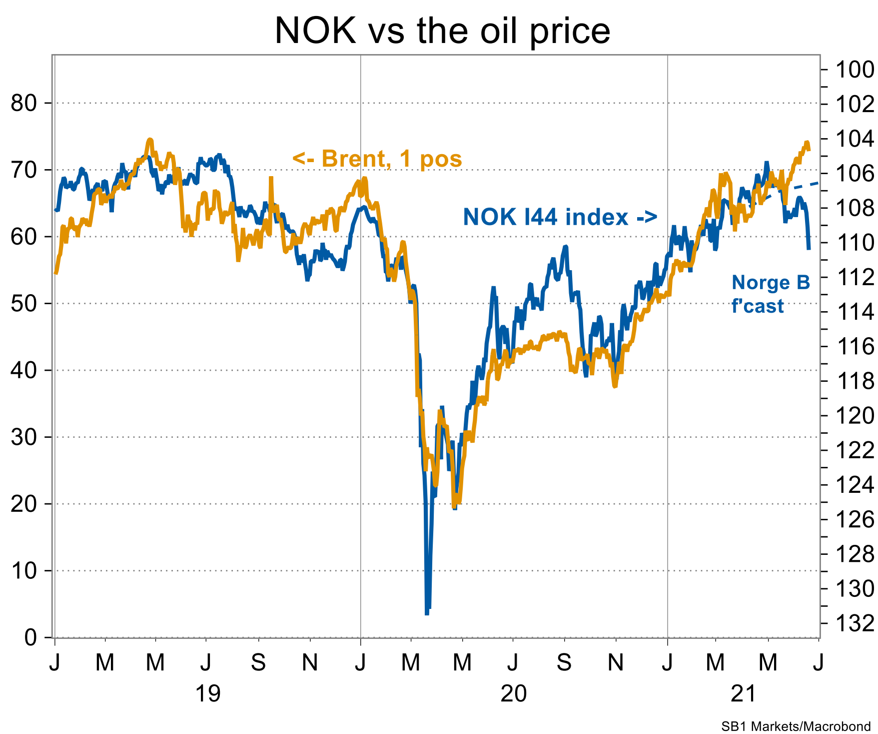
The discrepancy vs. our model at 7% is the largest since last autumn

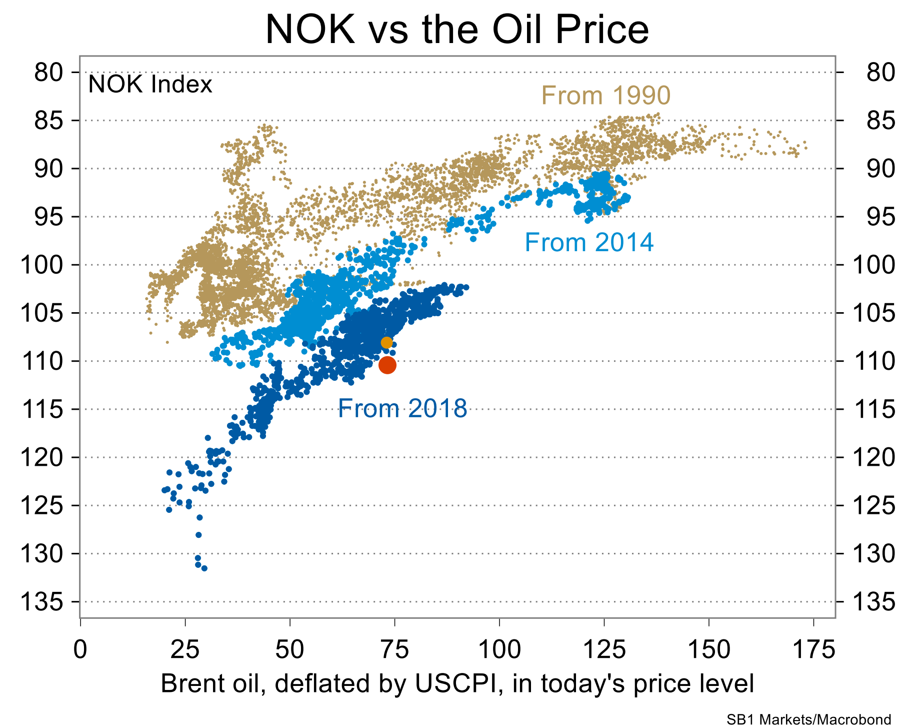


# Oil has left NOK far behind – NOK is now clearly on the weak side vs the oil price

Even vs the correlation between the two since 2018

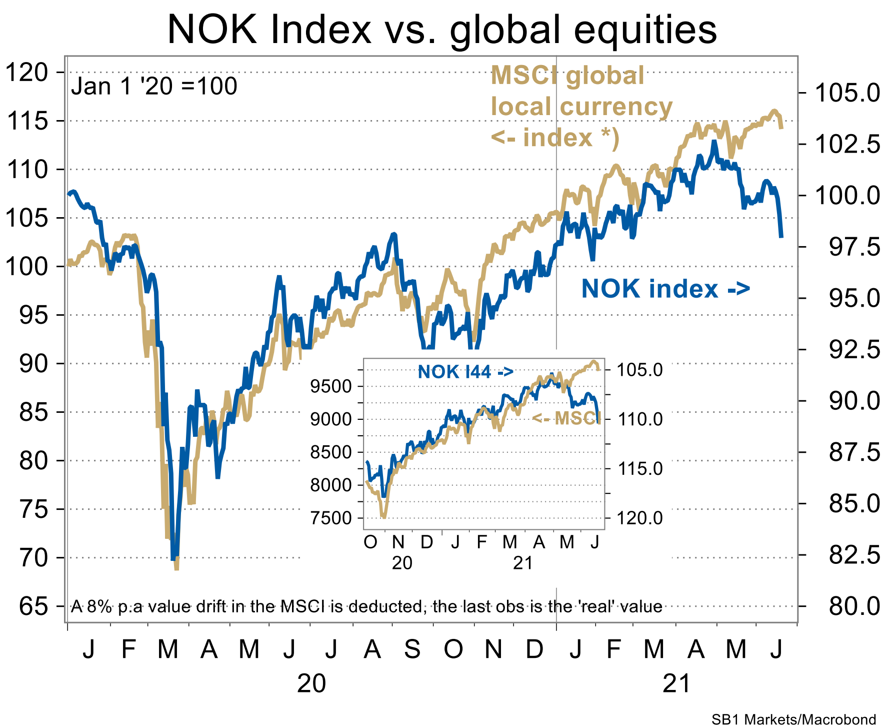


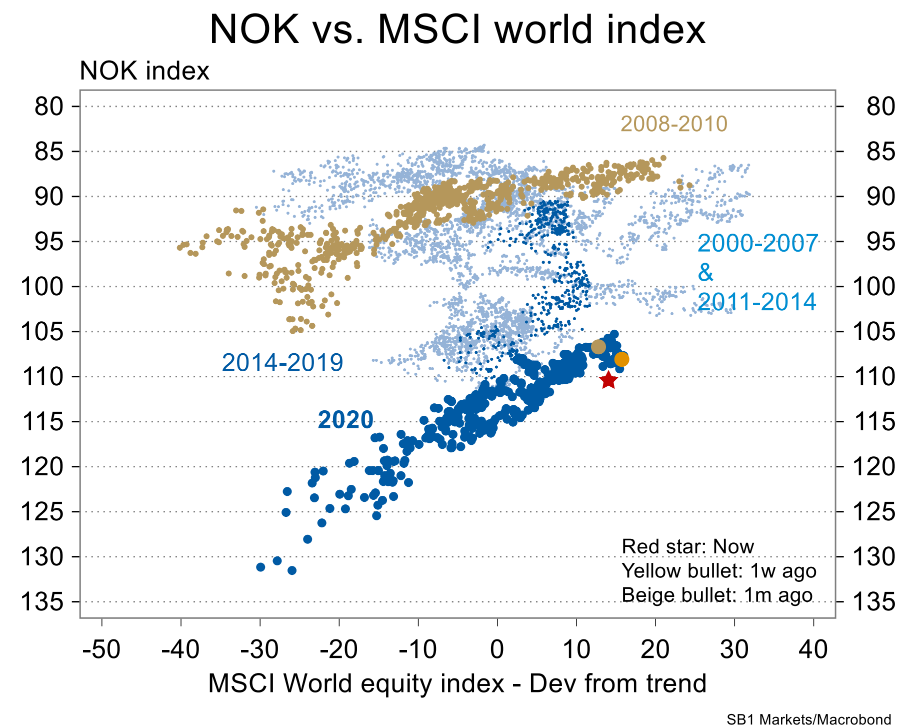




- NOK is still correlating quite closely to the oil price but at a lower level than before 2018
- A USD 10 drop in the oil price weakens the NOK by some 2.5%, as a partial effect. Within a broader model, the impact is somewhat smaller

# Global stock markets down, NOK even more

## NOK has lost some per cent vs. global stock since early May – some 5%, and 7% since last spring




- 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

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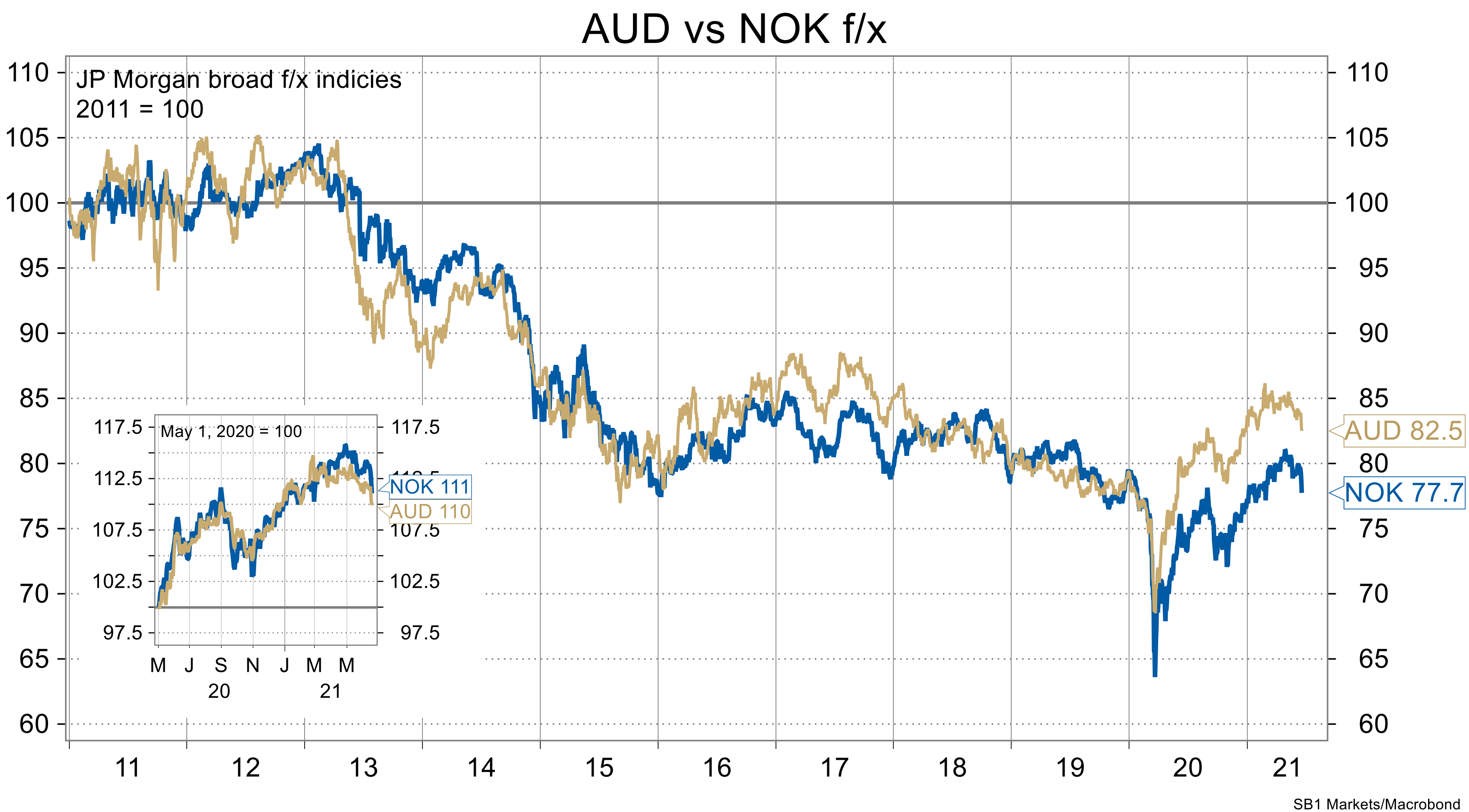
# NOK & AUD still in tandem – the AUD fell slightly more than the NOK last week

Both are up 10% - 11% since May 1st '20 – but the NOK still 6% weaker than AUD since last spring



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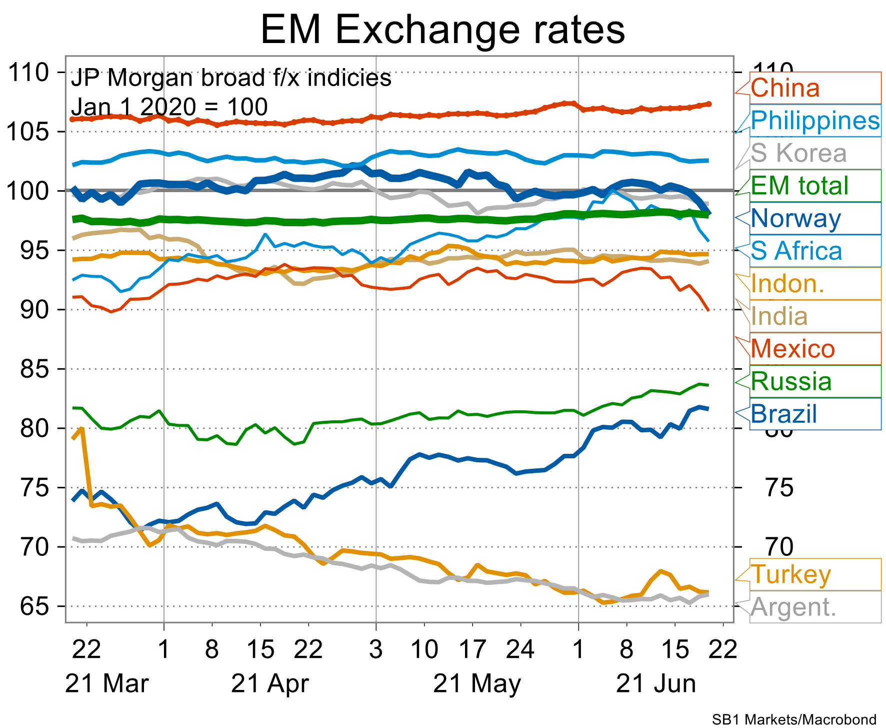
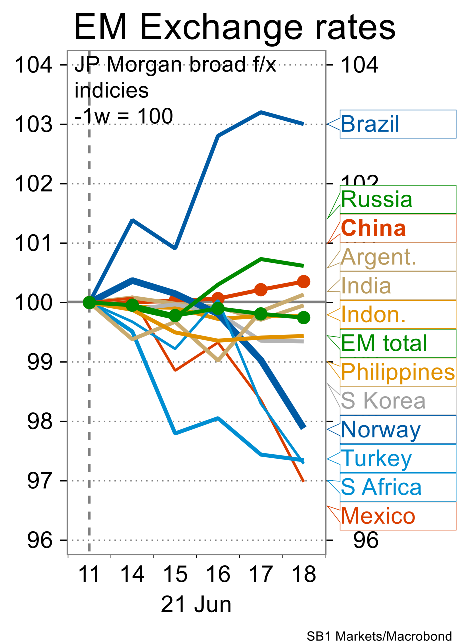
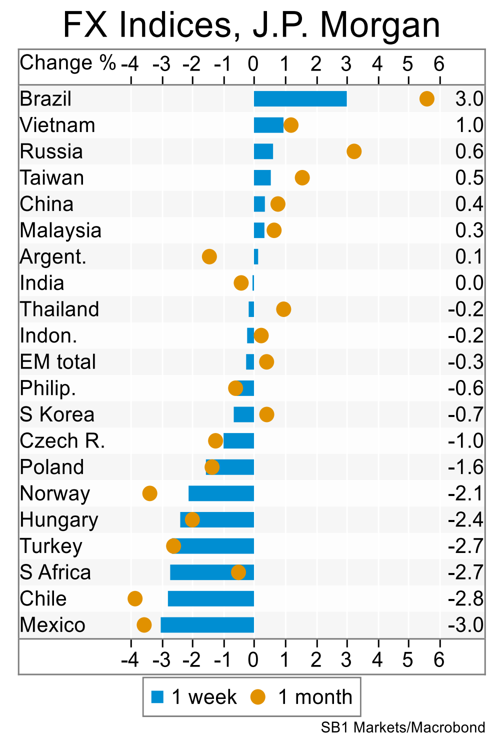
# Less support from a (until now) dovish Fed? EM currencies on avg down last week

Raw material prices fell too (but Brazil was not hurt). The CNY appreciated too. (And the USD by 2%)



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