19 July 2021

Macro Weekly

Week 29/2021

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Highlights, corona update

The world around us

The Norwegian economy

Market charts & comments

Last week

The virus

- **A large majority of countries** are once again reporting an increase in number of new Covid-19 cases, thanks to the Delta variant. In rich countries, where old & exposed people are vaccinated, hospitalisation & death rates are still very low and it will most likely take 2- 3 months before serious health challenges turn up again. However, if nothing changes, in the end they probably will before herd immunity is reached by more people being infected, as the no. of hospitalised & deaths are rising rather rapidly. Hopefully, the pace of vaccinations could pick up again where it has fallen to a low level, and new restrictions be avoided. Regrettably, that's not the option for most poor countries. New mutants will very likely turn up. There is still some downside virus risk left
- **Norway** is reporting fewer cases again, and less than 20 persons are hospitalised
- **Mobility** flattened/declined marginally last two weeks. It may be due to the spread of the Delta variant

The economy, part I

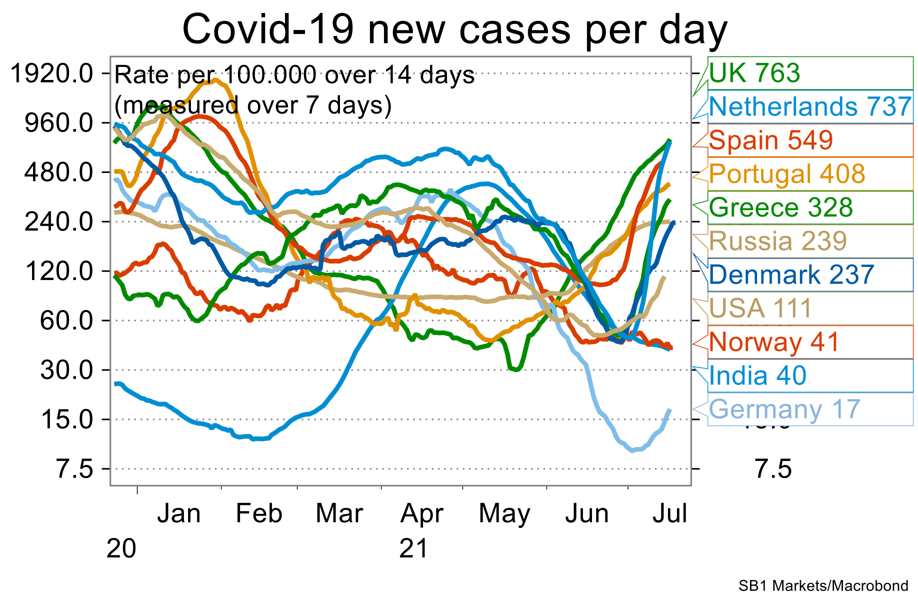
- **Global auto** sales fell just marginally in June as Indian (wholesale) sales almost fully recovered from the 60% slump during the Covid-19 outbreak in May. Preliminary media reports had signalled just a limited recovery. Global sales are still down 10% vs the pre-pandemic level, we assume some half due to lack of supplies (data chips), half due to the lack of demand (in several European countries)
- **Opec+ members** yesterday agreed upon lifting oil production by 0.4 mill/month, starting in August. Opec expects its production to have normalised sometime in H1-22probably. The decision signals that Opec members are satisfied with the current oil price. Following the drop in the oil price to USD 73/b from 76,5/b last Wednesday on expectations of a deal, the price has not fallen further

Last week: The economy, part II

- **China**
  - **GDP** accelerated to 1.3% (5.3% annualised) in Q2, 0.1 – 0.3 pp more than expected, from a downward revised 0.4% (-0.2 pp, 1.6% annualized) pace in Q1. June indicators were better than expected too, both for **exports/imports, retail sales and investments**. **Manufacturing** production rose by 0.6%, and service sector production by 1.0%. Still, growth has been slowing in H1-21, we assume due to the moderate credit tightening (which now might come to an end, following the previous week's cut in banks' reserve requirements), some slowing in growth in demand for goods in many rich countries, and perhaps also due to lack og supplies. In addition, the activity level in Q4-20 was above the pre-pandemic growth path – and now the level is back on that track
- **USA**
  - **CPI** accelerated more than expected once more, the headline up to 5.4% (exp. -0.1 pp to 4.9%) and the core 4.5% (exp. +0.2 pp to 4.0%). Both indices shot up 0.9% m/m. The prices increases are still not that wide-spread, energy and auto prices explains 3.4% of the 5.4%, and these prices will very likely slow not before to long. However, businesses are reporting the 2nd most aggressive price hikes plans (just one month in 1979 above, and wage pressures are building, also according to Fed's beige book. **PPI** surprised at the upside too, of course. The hike in inflation may still turn out to be transitory – as Fed's Powell argued twice at the Capitol Hill last week – but the risks for something more is substantial. We doubt this risk is prices into bond yields – which fell again last week
  - **Retail sales** were stronger than expected in June but May was revises substantially down. The trend is very likely down from here, core sales of goods are 13% above the pre-pandemic level
  - **Manufacturing production** was weaker than expected (-0.1% vs exp. +0.3%), mostly due to a large decline in auto production, no doubt due to lack of components
  - Univ. of Michigan consumer confidence fell sharply in July – as inflation expectations rose further, especially for the coming year
- **EMU**
  - **HICP (CPI) inflation** was confirmed at 1.9% (total) and 0.9% (core) – and the core rate is far below ECB's new 2% (and symmetric) inflation target. No devils in the details either
  - **Industrial production** fell more than expected in May (-1% vs exp. -0.2%) – and here too the auto industry was to blame
- **UK**
  - **CPI inflation** accelerated far more than expected, to 2.5% (total) and 2.3 (core) and several sectors contributed. Still, the increase in CPI is so far not that broad based
- **Sweden**
  - **CPI inflation** is still well behaved, the headline down 0.5 pp to 1.3%, and the core ex. energy down 0.3 pp to 0.9%, both as expected

The number of cases rapidly on the way up agian

Sorry but we have to added more countries to the spaghetti chart (and could have added many more)



- The **Delta virus** will is now dominating in many countries, and will very likely capture the corona virus market in most countries
- A large majority of countries are reporting a sharp increase in new cases, even where the vaccination/immunity rate is high. Still, vaccines are protecting very well against sickness & deaths (and the risk of being infected)
- On the other hand, while the no. of **hospitalisations,** and even more, **deaths** are on the way up in many of these countries, the level is still low, and the hospitalisation rates are still falling – and death rates (CFR) remains very low
- However, if the spread continues, several countries will run into health challenges that are comparable what they experienced in the Delta variant spreads like now (and it will, if nothing changes) in 2 – 3 months time. A more rapid increase in vaccinations will of course be the best remedy

Source: Financial Times, June 20

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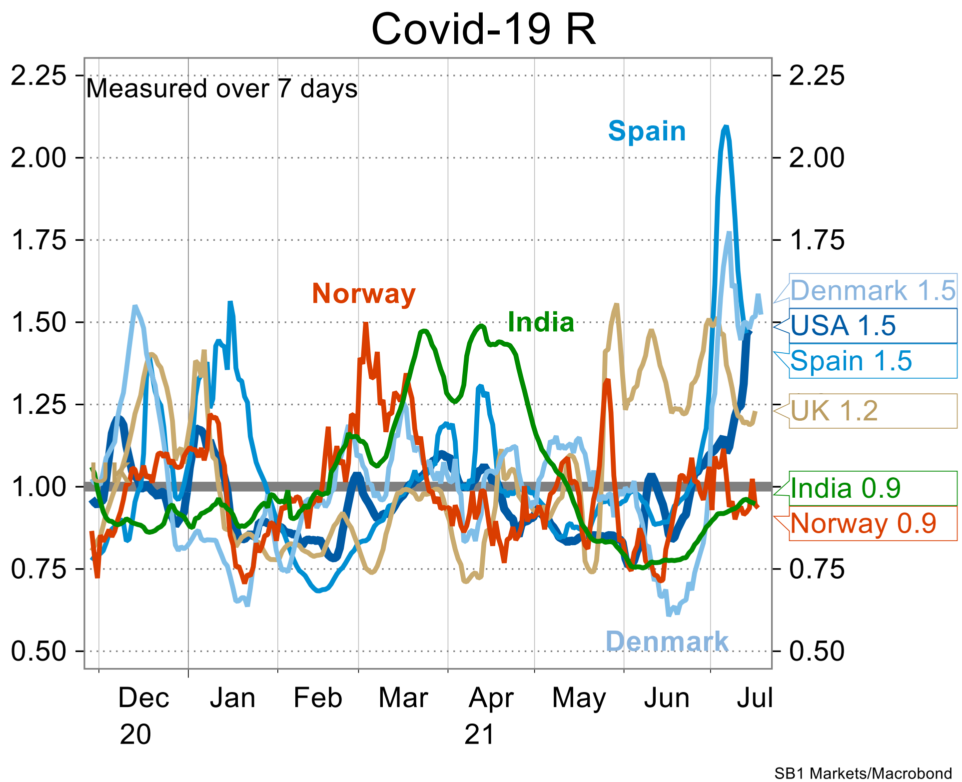
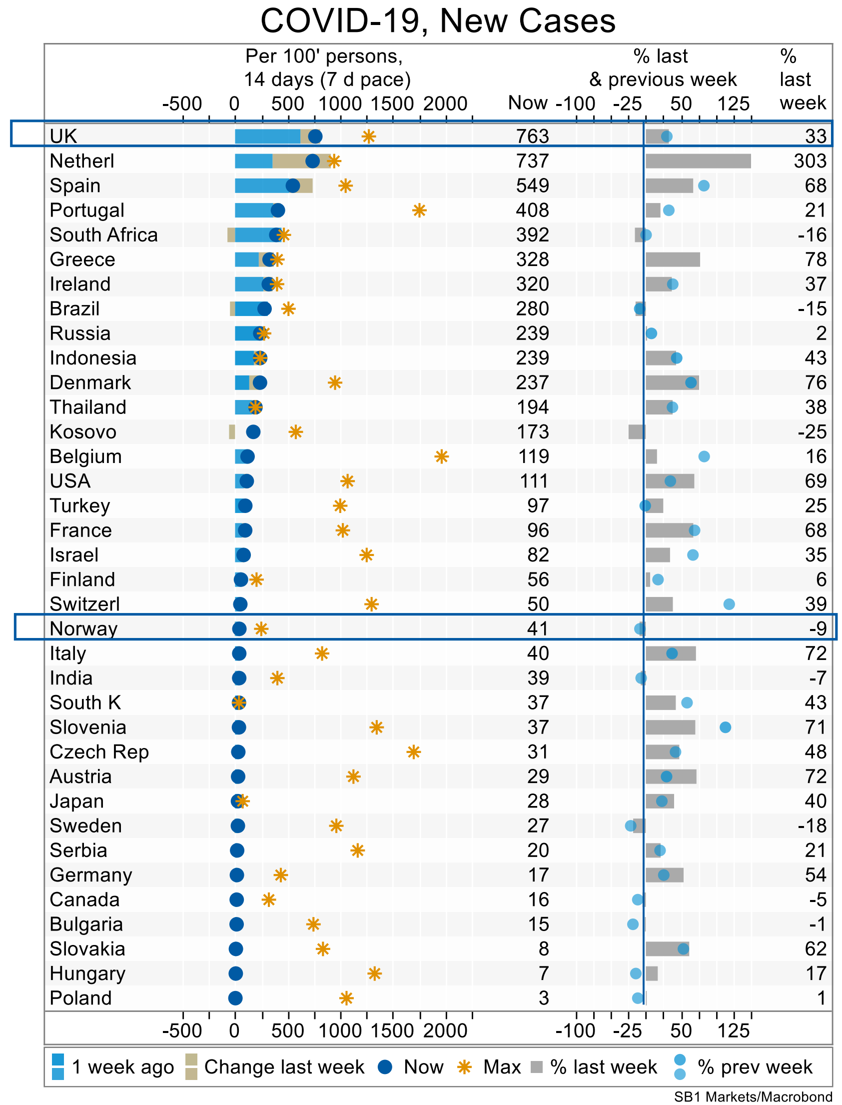
A large majority of countries are reporting more cases, the Delta to blame

UK at the top of the list, a dramatic surge in Netherlands

A sharp lift in the US as well. Norway down again





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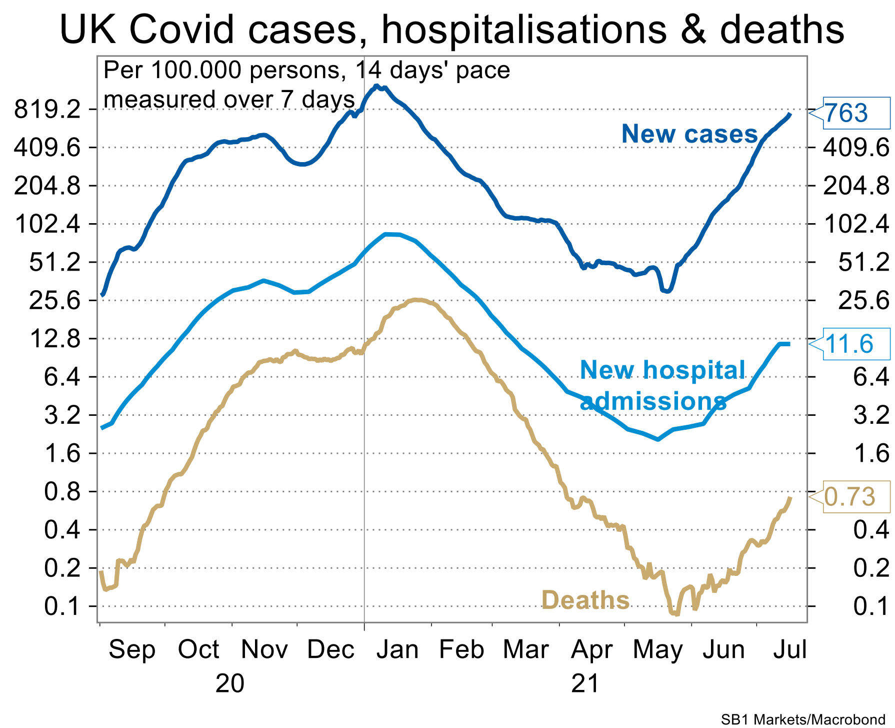
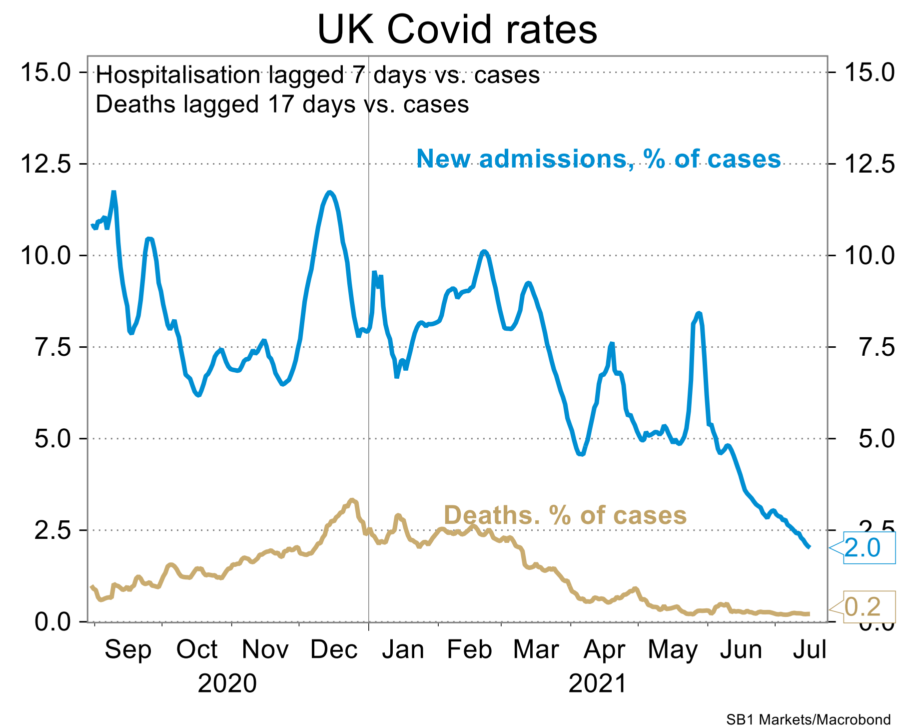
UK: Still a low level of hospital admissions, deaths but the direction is clearly up

Something will probably have to give before herd immunity is reached the natural way (by infections)





- The no. of **new cases per day** is steadily growing, by 40% - 70% per week (R=1.3 – 1.5), and will reach the January peak by the end of July
- The no. of hospitalised has increased 5-fold from the bottom in May, but the still just above 1/10th of the level in January. The no of death is up 7 times, still at 3% of the January level
- Thus, the **hospitalization rate** has fallen sharply as both old persons and other risk groups are vaccinated. The rate has fallen to 2% from approx. 8% in January – and it is still declining. On the other hand, UK hospitals will be filled up once more if nothing changes the coming months. Hopefully, vaccination will speed up again, from the present far below 1% of the population
- The **case fatality rate** (of those tested positive) has fallen even more, to 0.2% from close to 3% in Jan/Feb. The death rate is at less than 1/10th. Morgues will not be filled up again
- **Implication:** The Delta variant spreads like a wildfire but the number of infected will have to increase to very high levels before the UK will run into another health crisis. However, something will have to give the coming weeks/few months; either a speed up in vaccinations or changes in behaviour, voluntarily or by new restrictions

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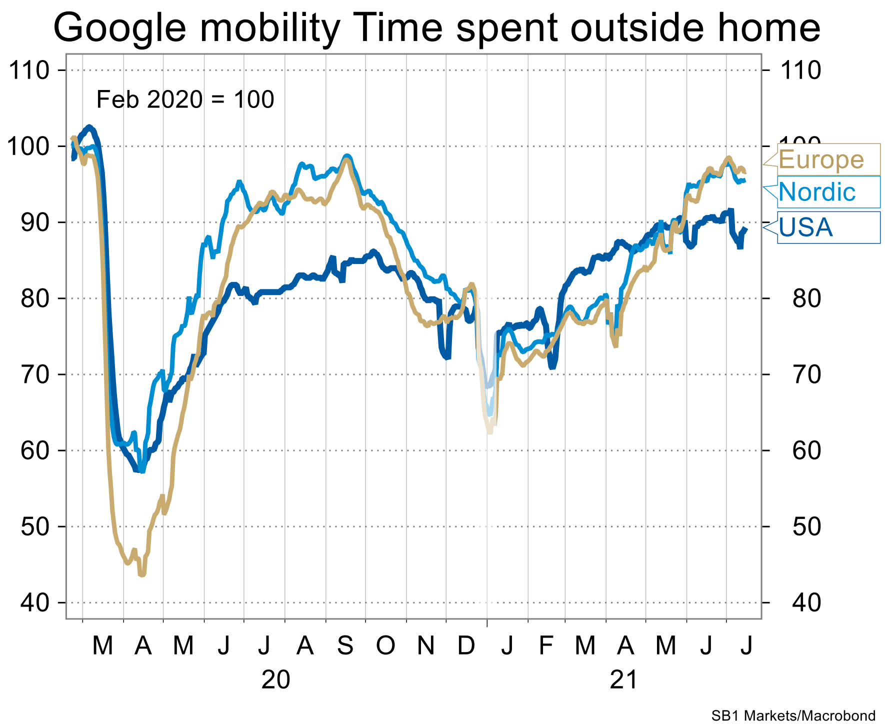
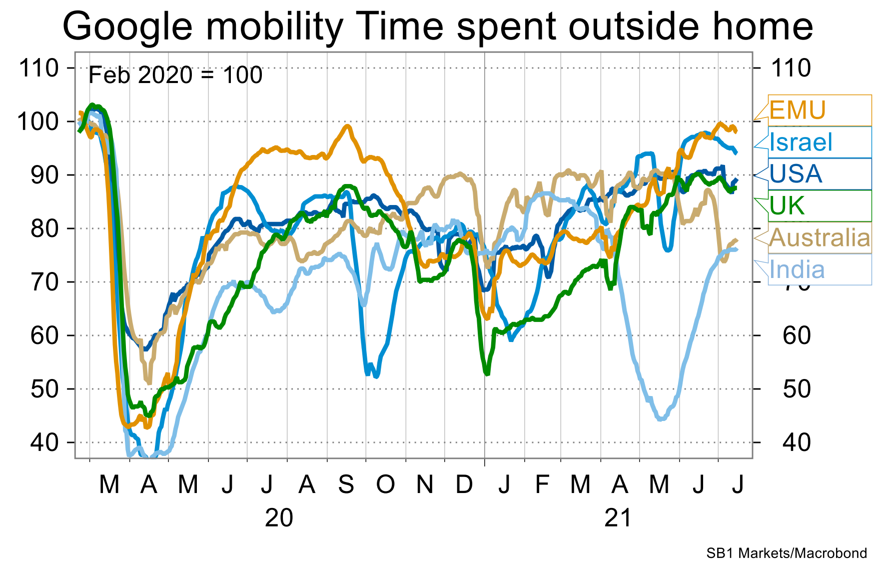
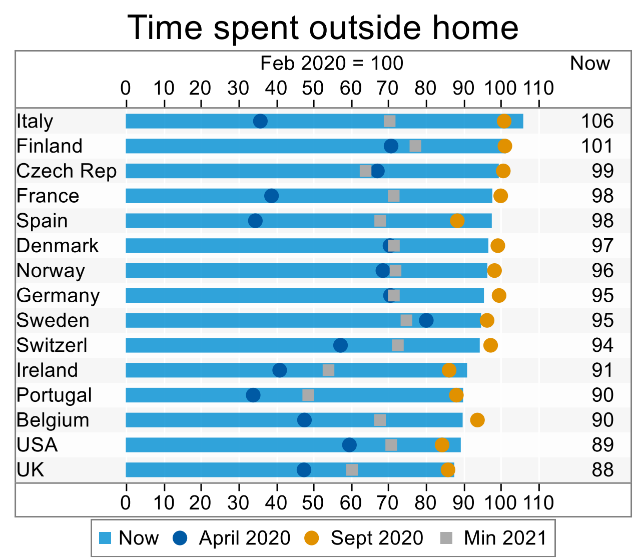
Are we seeing some impact of the Delta on mobility (outside India)?

Mobility sharply down in Australia, and UK is sliding?

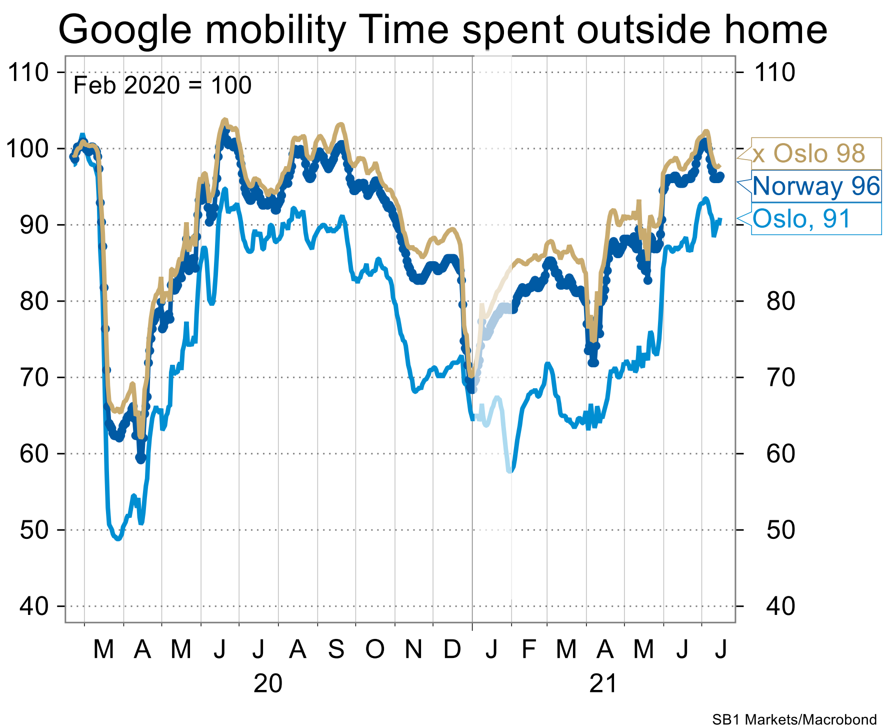


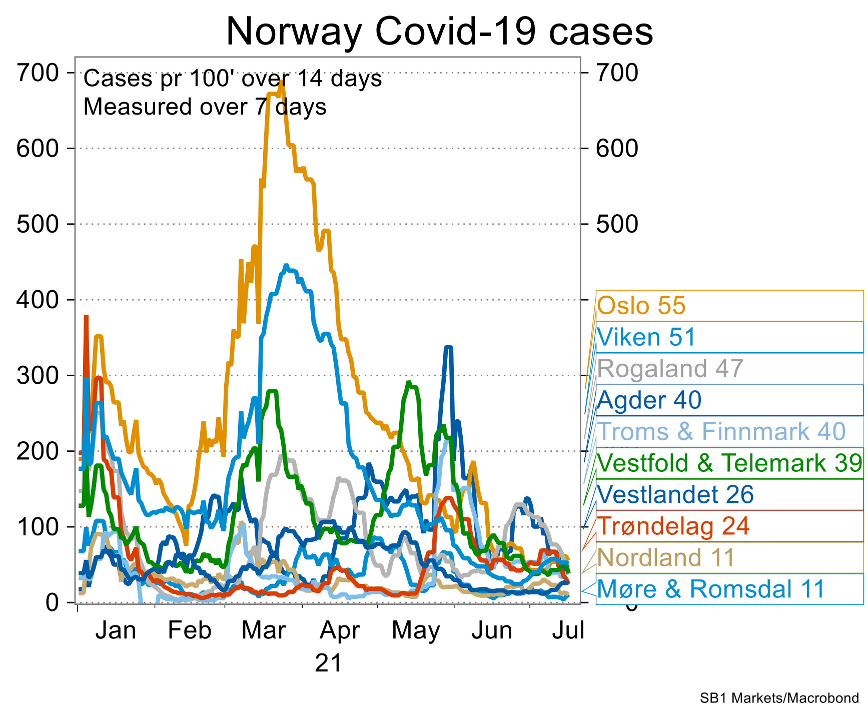




Mobility almost back to normal most places in Norway

Oslo still 13% down, according to Google. Some local outbreaks, …seems manageable





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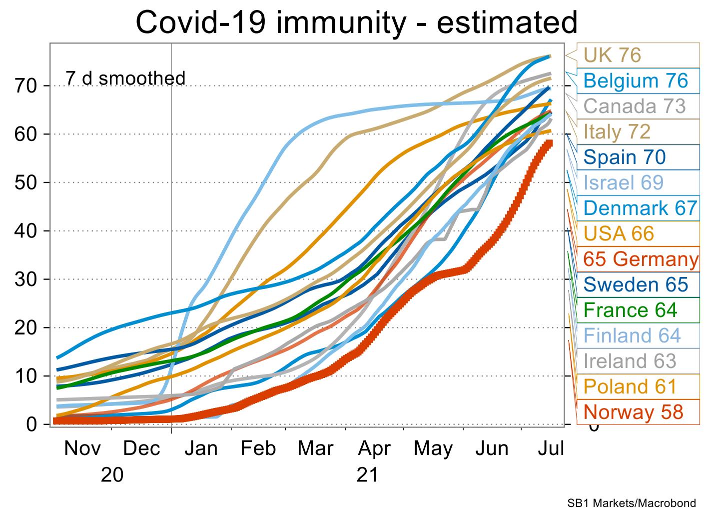
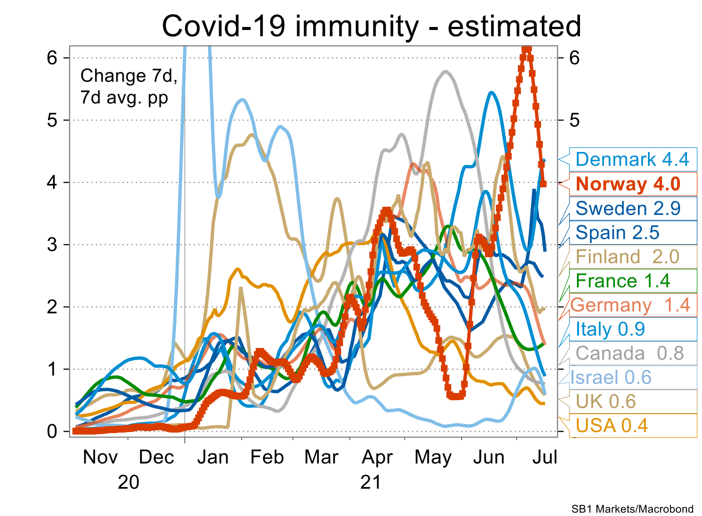
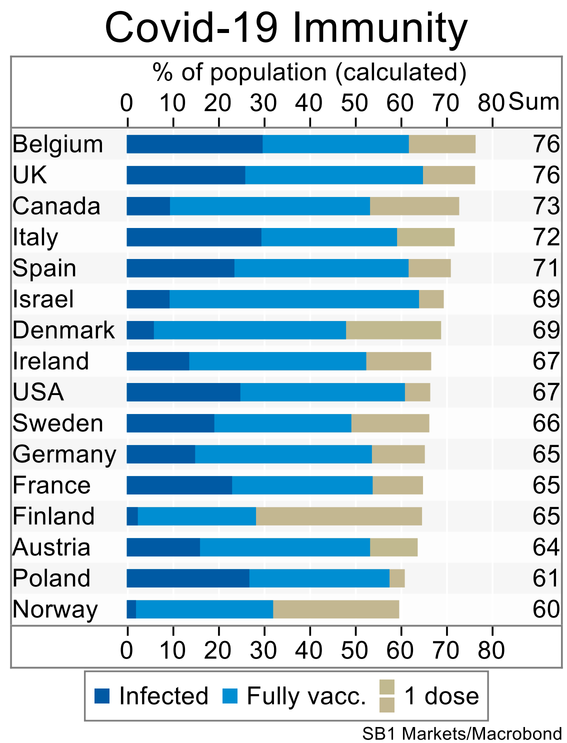
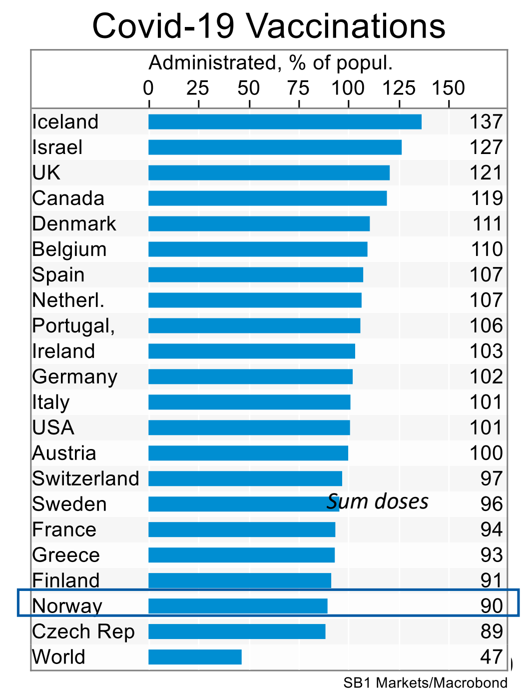
Vaccinations: EU/Norway are speeding up – and are surpassing US

However, Norway is a laggard vs the level, as we don't use AstraZeneca and J&J'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 (a conservative assumption)

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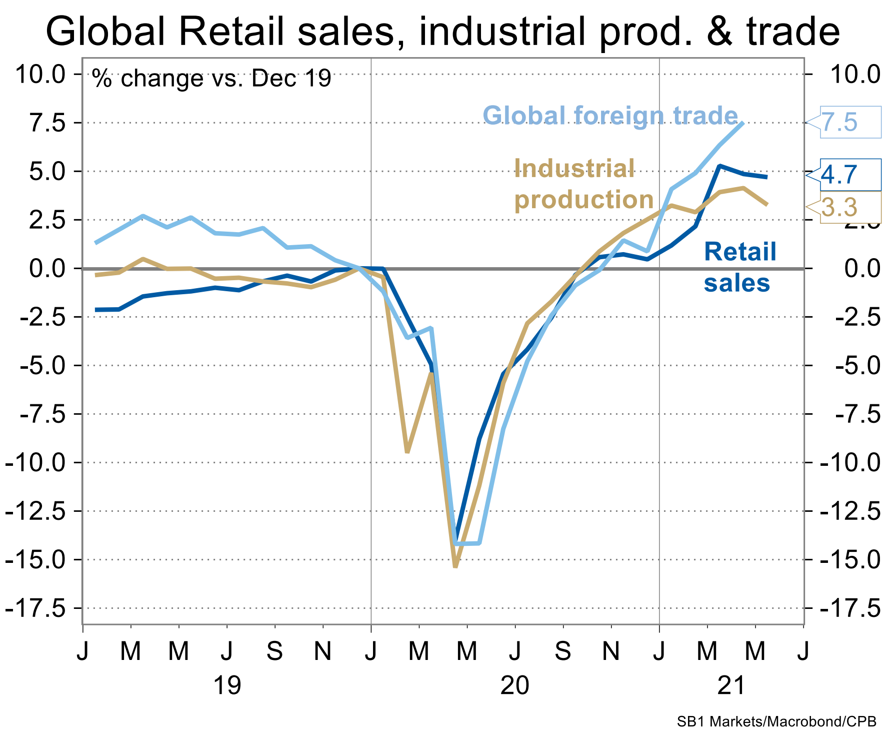
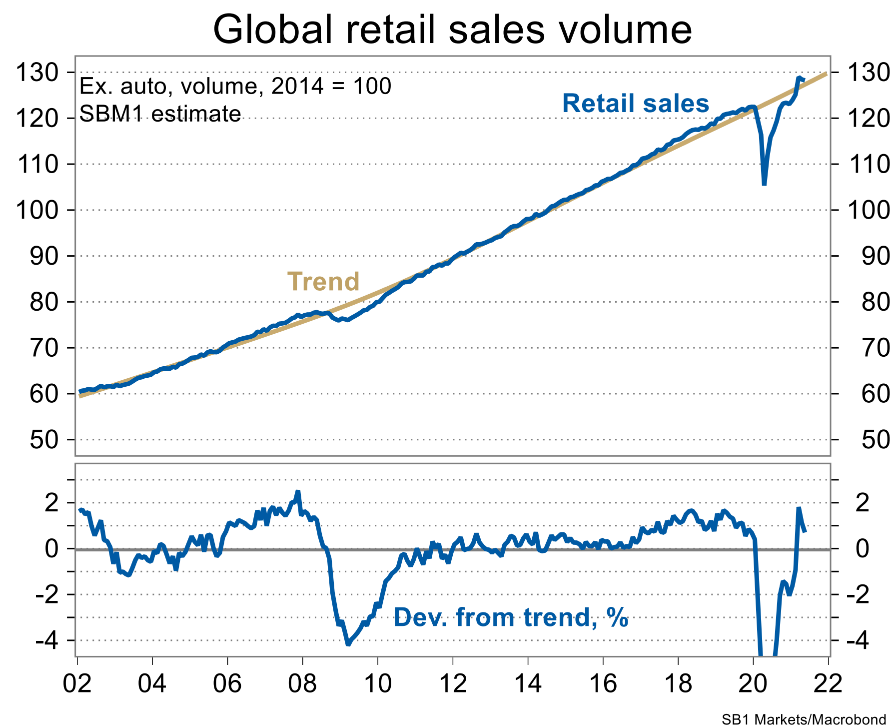
Global retail sales & manufacturing production have flattened

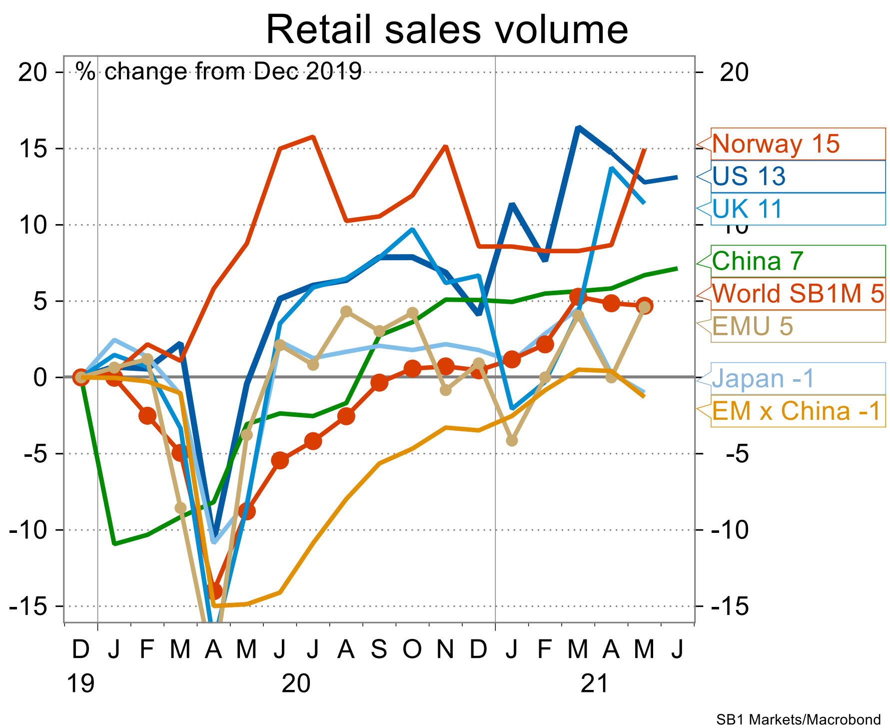


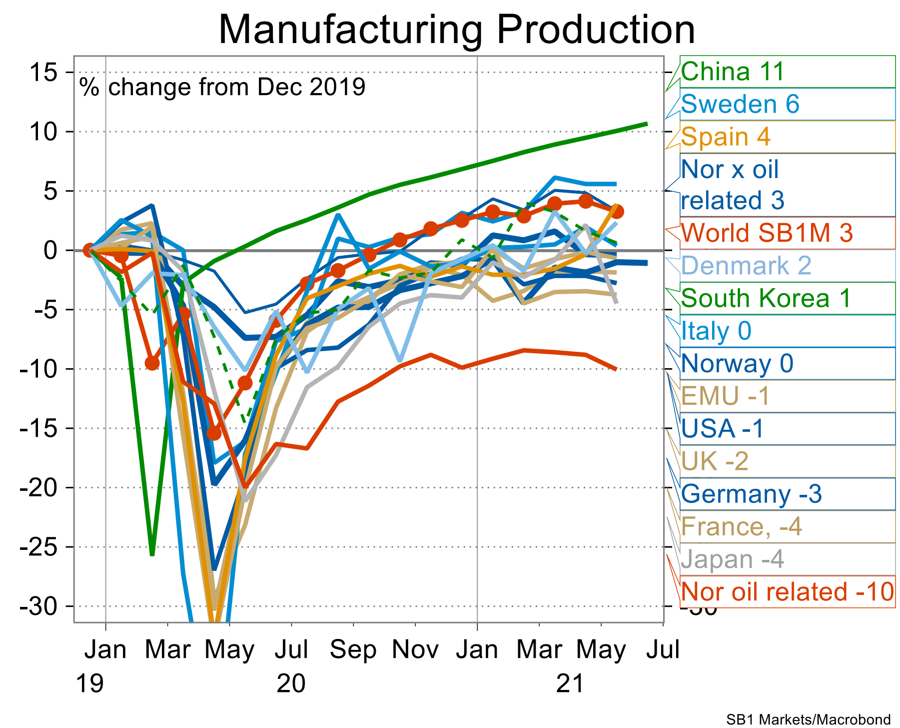


- **Retail sales** probably fell slightly in May too, even if EMU sales rose close to 5%. We assume demand fell sharply in India, and US contributed at the downside. The first June data points to growth
- **May manufacturing production** was far weaker than we assumed last week, as India reported a 12% setback, far weaker than implied by Indian surveys. Production in Japan fell by 6%, partly due to the specific problems in the auto sector
- **Global foreign trade** rose further in April, to 7.5% above the pre-Covid level, according to CBP in Netherlands – and the trend is straight upwards

Volatile retail trade data, but the trend is up

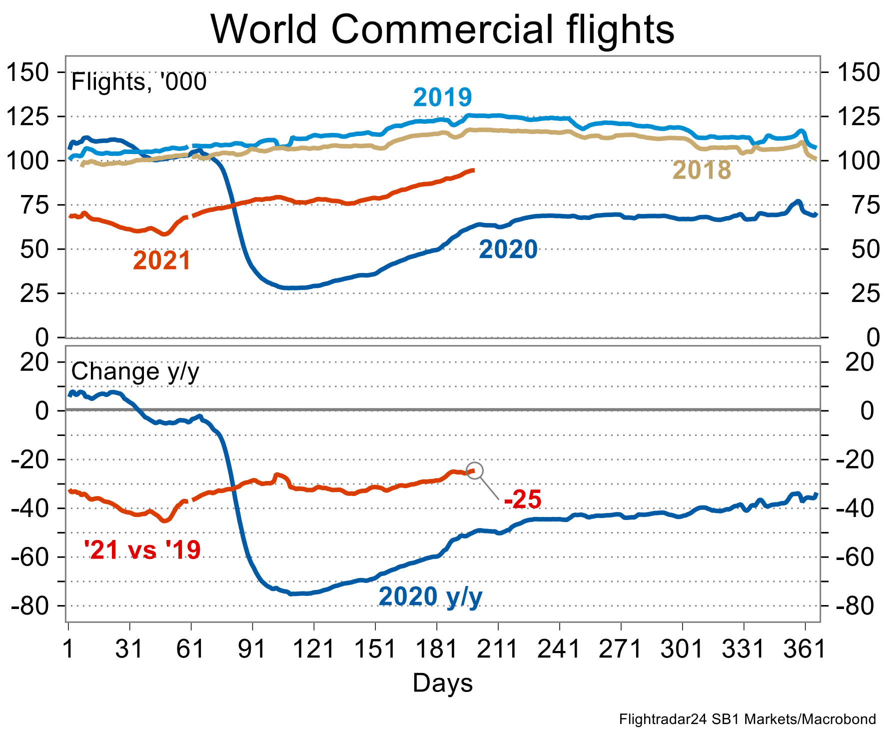
… At least until we can spend more money on services. Manufacturing is still trending up, but slower

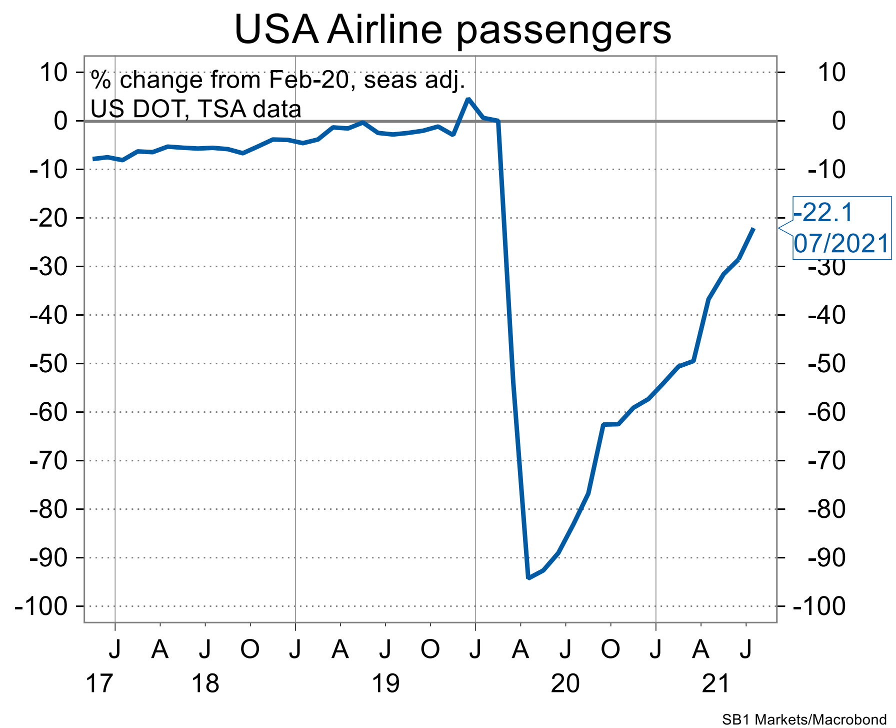




Global airline traffic on the way up again – still 25% below the 2019 level

US airline traffic straight up, but still 22% below par due to still little travel abroad





The Calendar: Preliminary PMIs, US housing, ECB & Norw. manuf. confidence

Time	Count.	Indicator	Period	Forecast	Prior
Monday July 19					
16:00	US	NAHB Housing Market Index	Jul	82	81
Tuesday July 20					
08:00	NO	Housing Starts	Jun		
14:30	**US**	**Building Permits**	**Jun**	**1700k**	**1681k**
14:30	US	Housing Starts	Jun	1590k	1572k
Wednesday July 21					
06:00	SW	Home-Price Index	Jun		
08:00	NO	Industrial Confidence	2Q	(12)	8.2
Thursday July 22					
12:00	UK	CBI Trends Total Orders	Jul	16	19
13:45	**EC**	**ECB Deposit Facility Rate**	**Jul-22**	**-0.5%**	**-0.5%**
14:30	US	Chicago Fed Nat Activity Index	Jun	0.3	0.29
14:30	US	Initial Jobless Claims	Jul-17	350k	360k
16:00	US	Existing Home Sales	Jun	5.9m	5.8m
16:00	EC	Consumer Confidence	Jul A	-2.5	-3.3
Friday July 23					
08:00	UK	Retail Sales MoM	Jun	0.2%	-1.4%
09:15	FR	PMI Manufacturing	Jul P	58.2	59.0
09:15	FR	PMI Services	Jul P	58.8	57.8
09:30	GE	PMI Manufacturing	Jul P	64.1	65.1
09:30	GE	PMI Services	Jul P	59.5	57.5
10:00	**EC**	**PMI Manufacturing**	**Jul P**	**62.5**	**63.4**
10:00	**EC**	**PMI Services**	**Jul P**	**59.5**	**58.3**
10:30	UK	PMI Manufacturing	Jul P	62.3	63.9
10:30	UK	PMI Services	Jul P	62.0	62.4
15:45	US	PMI Manufacturing	Jul P	62.0	62.1
15:45	US	PMI Services	Jul P	64.5	64.6

- **Preliminary July PMIs**
  - » We assume that peak growth is behind us but the PMIs will remain at very high levels in both the US and Europe in July, signalling growth above trend. It is not assumed that the Delta wave has dampened activity even in the European service sector, even if tourism is somewhat hampered by the outbreak
- **USA**
  - » **Housing starts/permits** have peaked, probably mostly due to lack of supply of timber, and partly employees. However, the high price level has also made a dent on the demand side. The expected uptick in the Housing Market Index seems optimistic to us
  - » Existing home sales has fallen somewhat too, and in May prices flattened (m/m, even if the annual rate shot up due to 4% price decline last May. (In June last year prices rose 1%, and by 6% in July, guess what will happen to the annual growth rate ☺)
- **EMU**
  - » **The ECB** will leave the signal rate unchanged and will not reduce the QE program. The inflation target is lifted to (symmetric around) 2%, and even if the bank now will take housing costs into consideration, the impact will be limited
- **Sweden**
  - » **House prices** have soared during the pandemic (even if floating mortgage rates are up!) but should at one stage slow down, if not in June
- **Norway**
  - » We expect **SSB's quarterly manufacturing survey** to report faster growth, higher capacity utilisation, and more companies reporting lack of labour

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

Highlights

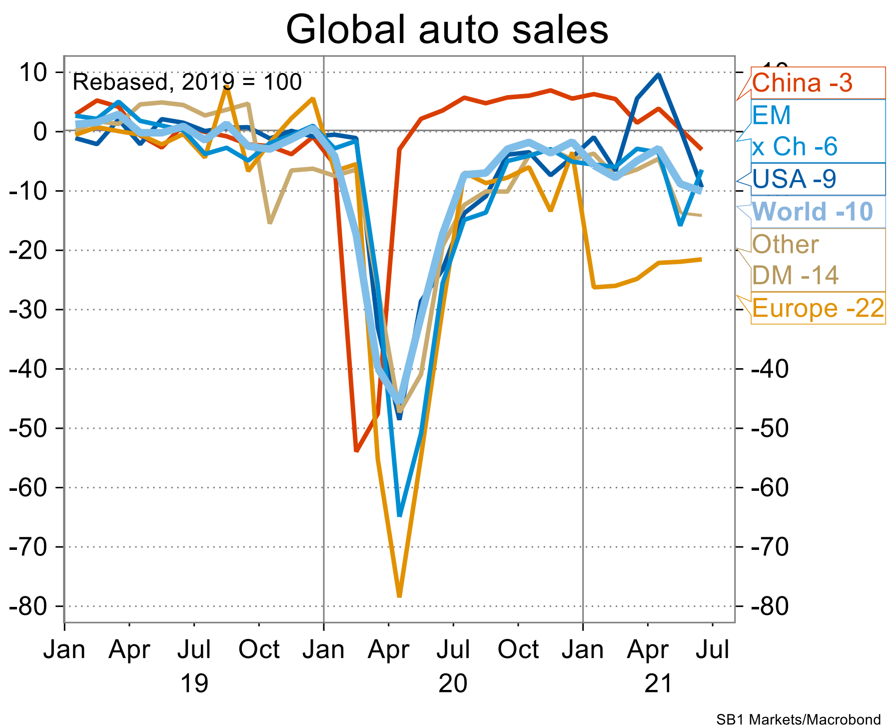
The world around us

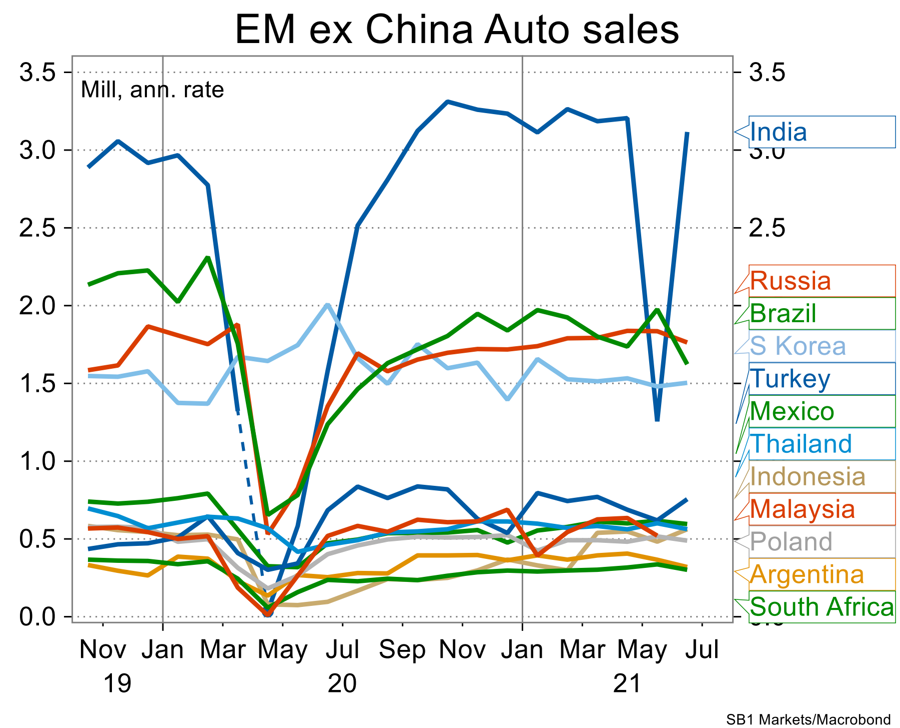
The Norwegian economy

Market charts & comments

Indian auto sales recovered the May losses in June

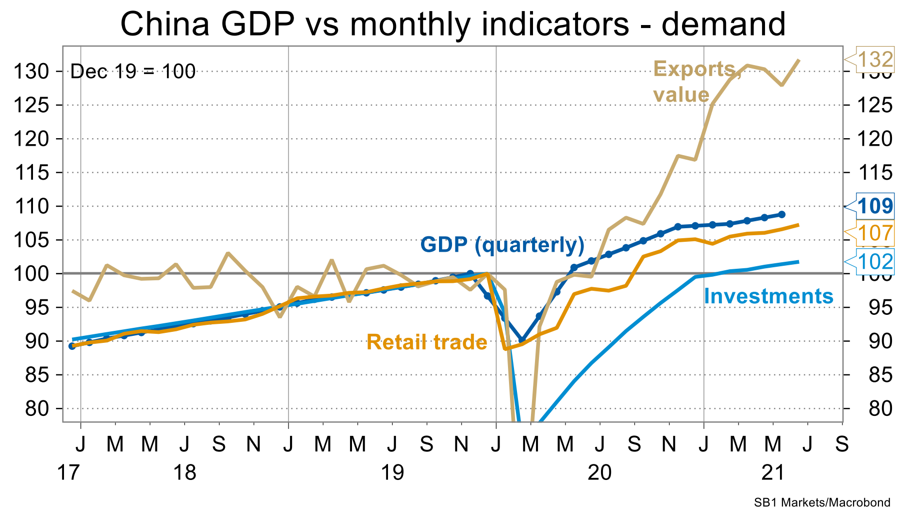
… which lifted our global June sales estimate. Global sales still fell, and they are 10% below 2019 avg

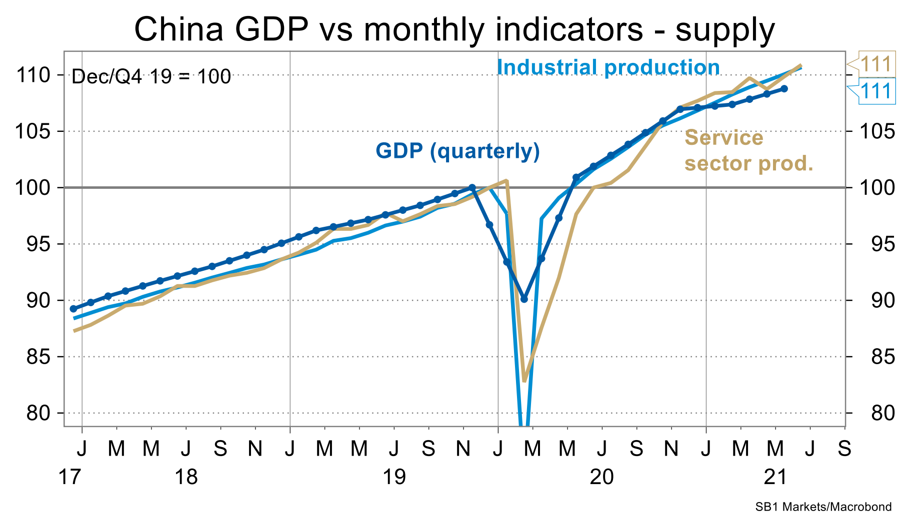




June data better than expected, and GDP accelerated to a 5.3% pace in Q2

All major data surprised on the upside – but growth has slowed



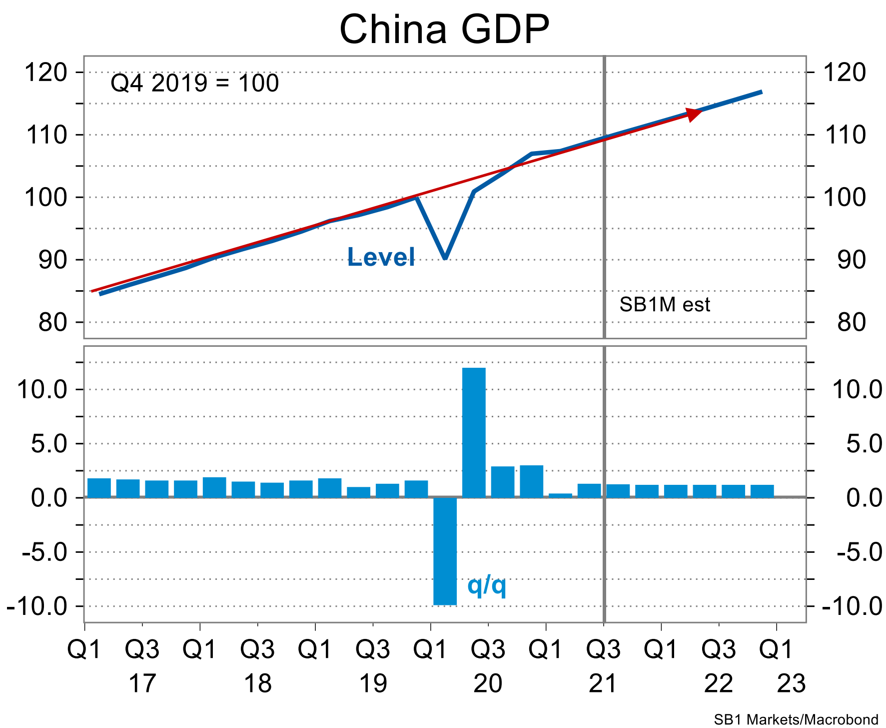


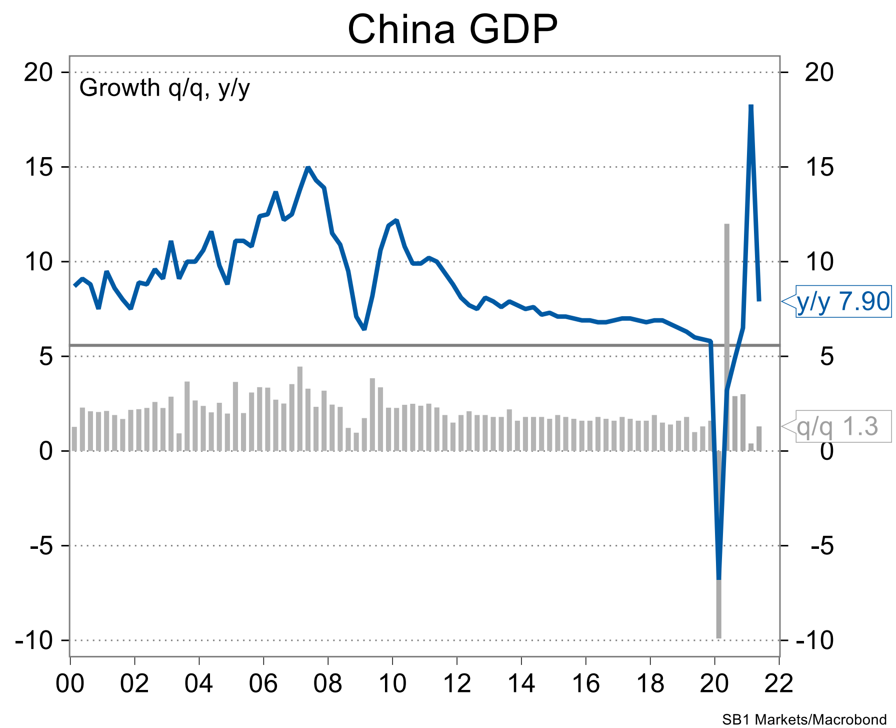
- **GDP** grew by 1.3% in Q2 (5.3% annualised), above expectations (1.0 - 1.3%), up from a 0.2 pp downward revised 0.4% (1.6% in Q1). Measured y/y, GDP grew by 7.9%, as expected. GDP is at or marginally above the pre-pandemic growth path
- **Industrial production** rose 0.6% in June, 0.1 pp faster than in May. Measured y/y, production is up 8.3%, 0.3 pp above expectations Production is 4% above the pre-corona trend path but growth has finally slowed to the pre-pandemic level, as we expected
- **Service sector production** rose by 1.0% in June, as in May, and is almost back to the pre-pandemic growth path
- **Retail sales volumes** rose 0.5% in volume terms (our est.) in June, as in May, and a decent growth rate, and in line with the pre-Covid growth pace. However, sales have on average been growing slower since last November, at just a 3% annualised rate and remain. Sales were up 12.1% y/y, 1.2 pp above expectations
- **Investments** grew 0.4% in June, as in May. The level is 5% below the pre-pandemic trend growth path but the growth rate is just marginally below the pre-pandemic pace. The (still useless) accumulated annual growth rate was 12.6% in June, 0.5 pp higher than expected. Housing and other construction starts have fallen 3% – 8% since last summer. New home sales fell further in June but the level is high remain well above housing starts, signalling an inventory drawdown. House prices rose 2.7% % m/m in June (annualised), quite a bit lower than the 6+% at the start of the year
- **Exports rose and imports fell** slightly in June. Both were 10% stronger than expected y/y. Export volumes may be flattening, at a level 15% - 20% (!) above the pre-pandemic growth path. Imports are still rising fast, and are 20 above the pre-Covid growth trajectory (!!)
- **Last week: Credit growth** was a tad higher in June than in May, but the trend is clearly down, and the credit impulse has turned definitively negative. The authorities surprisingly cut banks' reserve requirements, signalling that a further credit tightening is not warranted
- **CPI inflation** is on the way up, but is still moderate. Producer prices are soaring (which is felt more outside China than inside)

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

Q2 GDP up 1.3% q/q (5.3%), exp. 1.0 - 1.2%. Level back at the pre-pandemic trend

Q1 revised down by 0.2 pp to 0.4% (1.6% annualised)

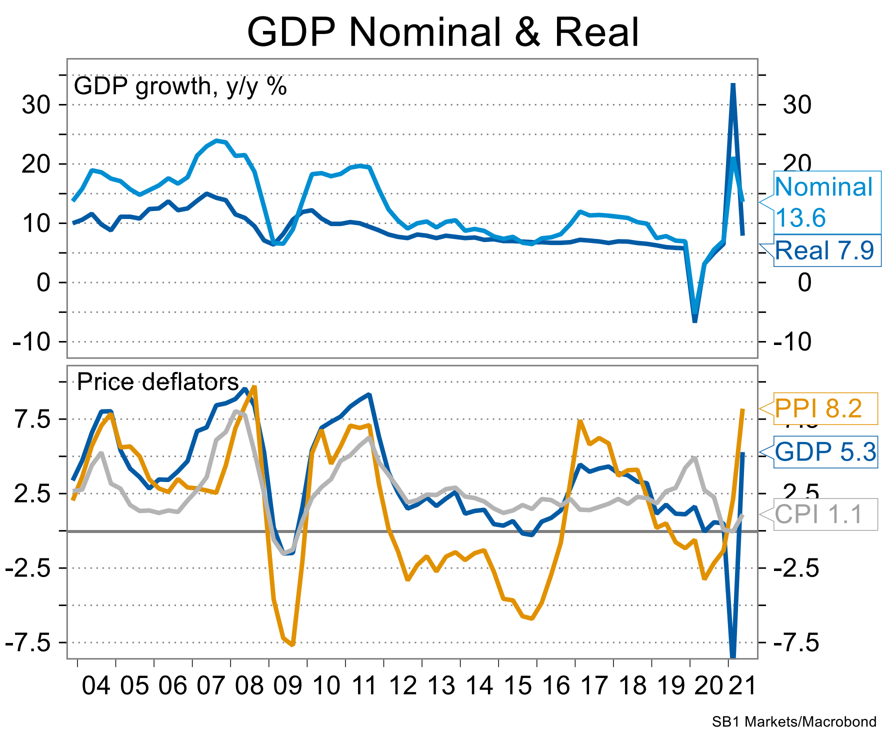




- A 1.2% q/q rate equals a 5.3% annualised growth pace, up from an downward revised 1.6% pace (from 2.4%) in Q1. Estimate varied between 1.0 and 1.2%. Potential GDP growth in China is somewhere between 5% - 7%, and Q1 was therefore far below this and Q2 at the lower end of the scale. Growth has slowed as the activity level has approached the pre-pandemic growth path
  - Industrial production and retail sales were on the strong side in June, but sales are still below the pre-Covid path, whereas production has remained strong since March '20. In addition, are we to interpret the latest signs from the PBoC (reserve requirement cuts), there are signs of weakness in the economy
  - The 7.9% annual rate was marginally below expectations, as Q1 was revised 0.2 pp down, while growth in Q2 was a tad higher than expected
- The annual GDP growth rate was sliding down before corona, to 6% in Q4-19. If the gradual decline in growth had continued – and corona had not happened – the annual growth rate would have been below 5.5% by now. The actual annual rate since Q4-19 at 5.8% is slightly <u>above</u> the pre-corona trend, measured that way

GDP price deflator up to 5.3%, from 2.4%

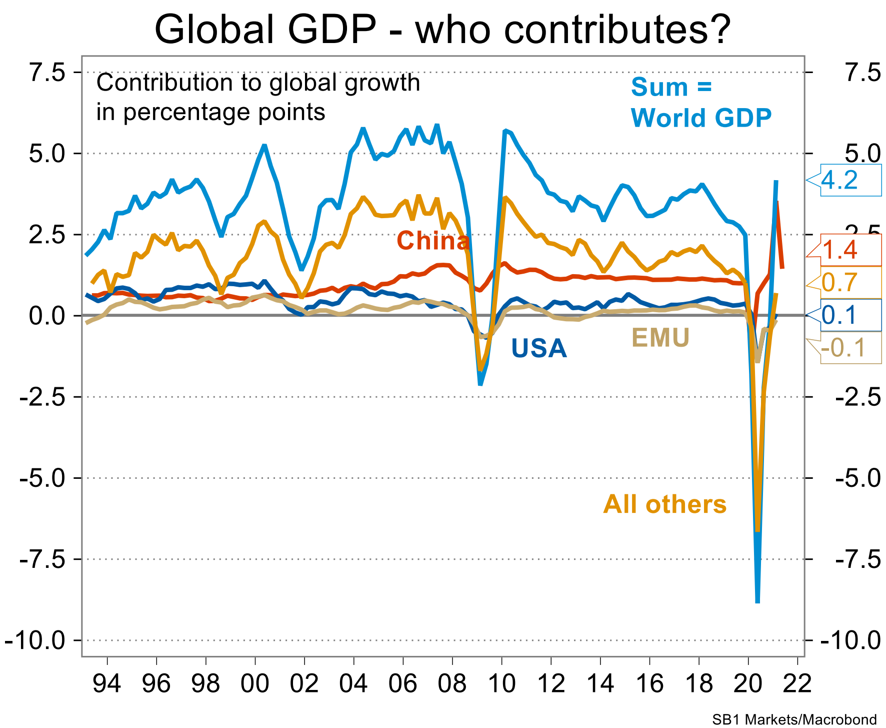
Nominal GDP up by 13.6% y/y

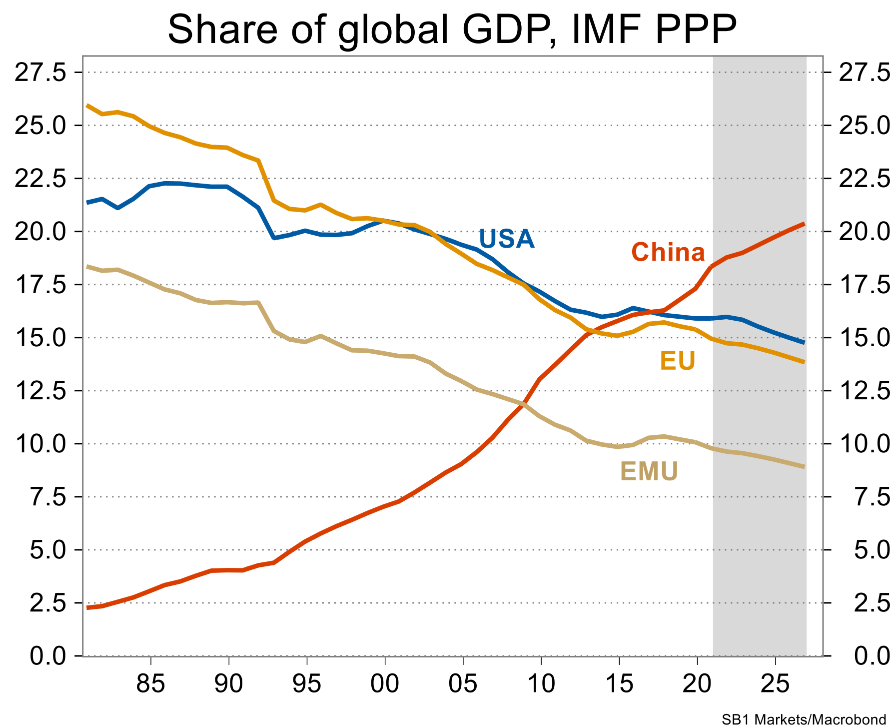


- Manufacturing producer prices (PPI) are up 8.2% y/y (quarterly avg), while CPI prices were up 1.1% y/y

We may blame China for many things. But it is not a drag on the global economy

Only China has reported Q2 data as of yet

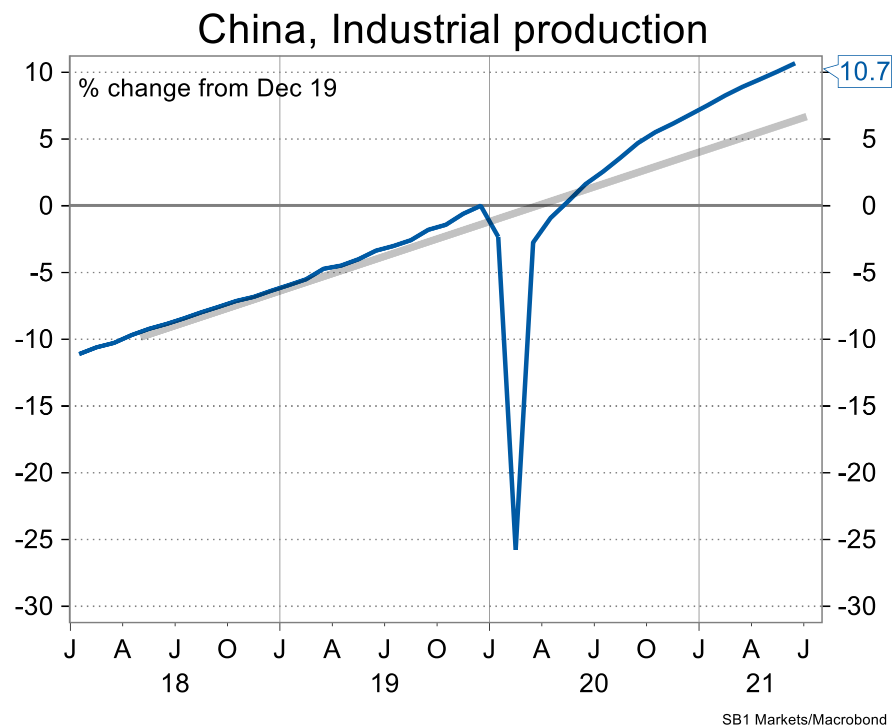




- Measured in purchasing parity adjusted prices, the Chinese GDP has been larger than the GDP in the US since 2017

Industrial production up 0.6% in June, close to the pre-pandemic growth pace

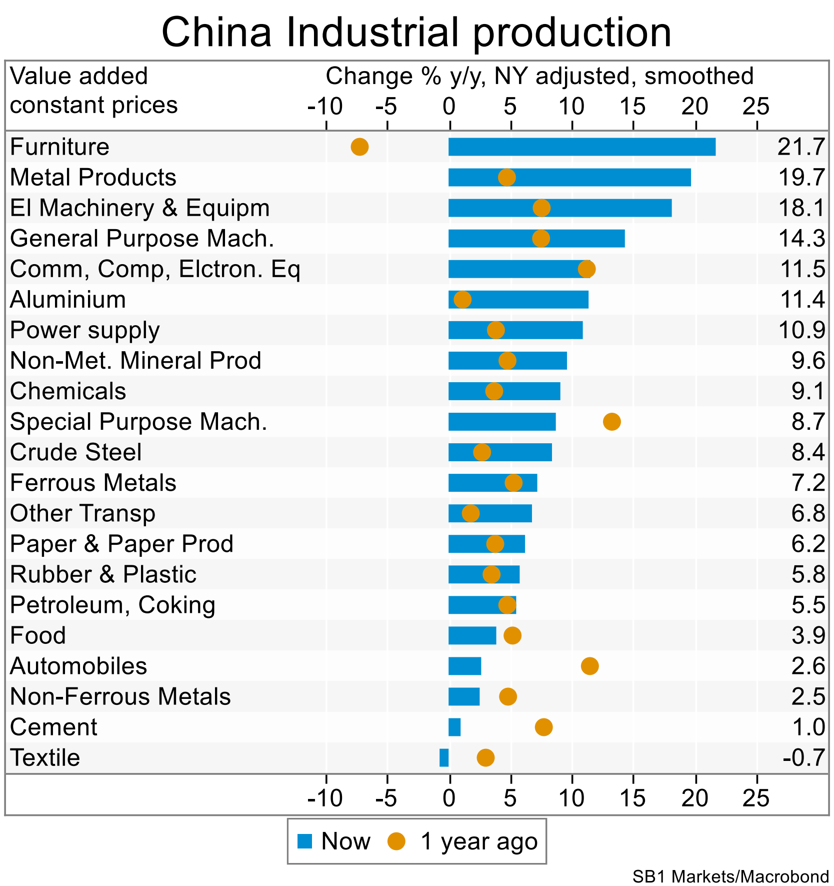
... And production is 4% above the pre-pandemic trend growth path!



- **The official data**: Production is up 8.3% y/y, 0.5 pp <u>above</u> expectations
- **Production** grew by 0.6% m/m, as in June. Over the recent months, growth has slowly approached the pre-pandemic pace, some 6% annually – as we have assumed.
- Production is 11% above the Dec '19 level and some 4% <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

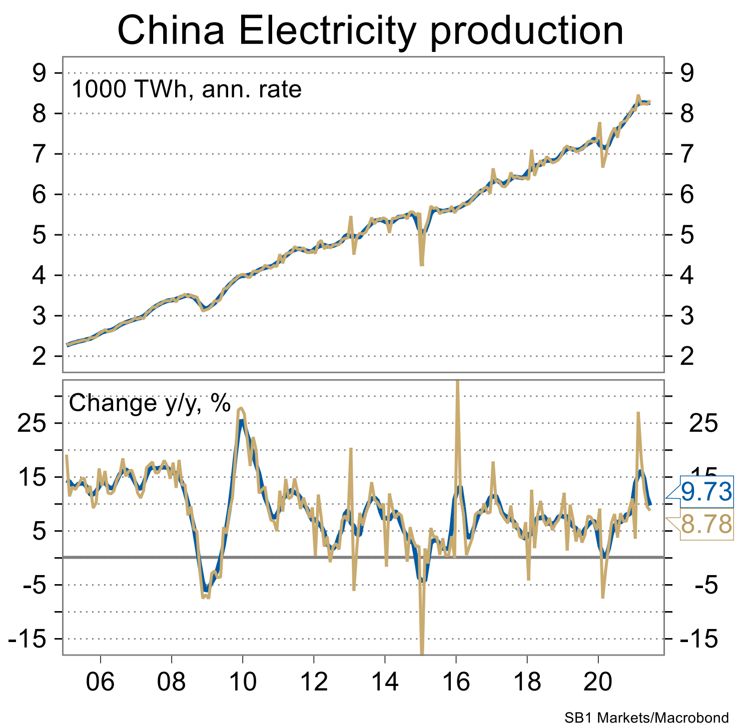
Still, strong underlying growth in many sectors

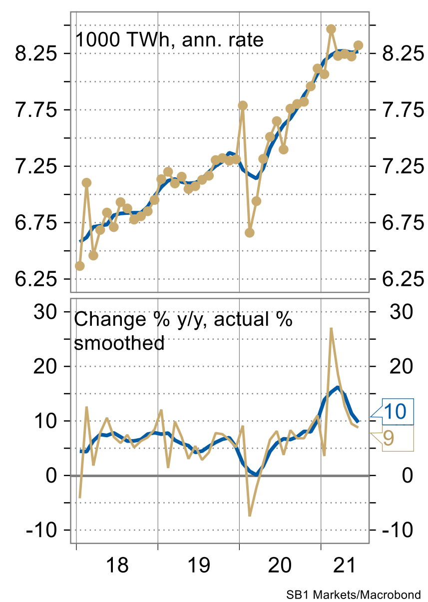


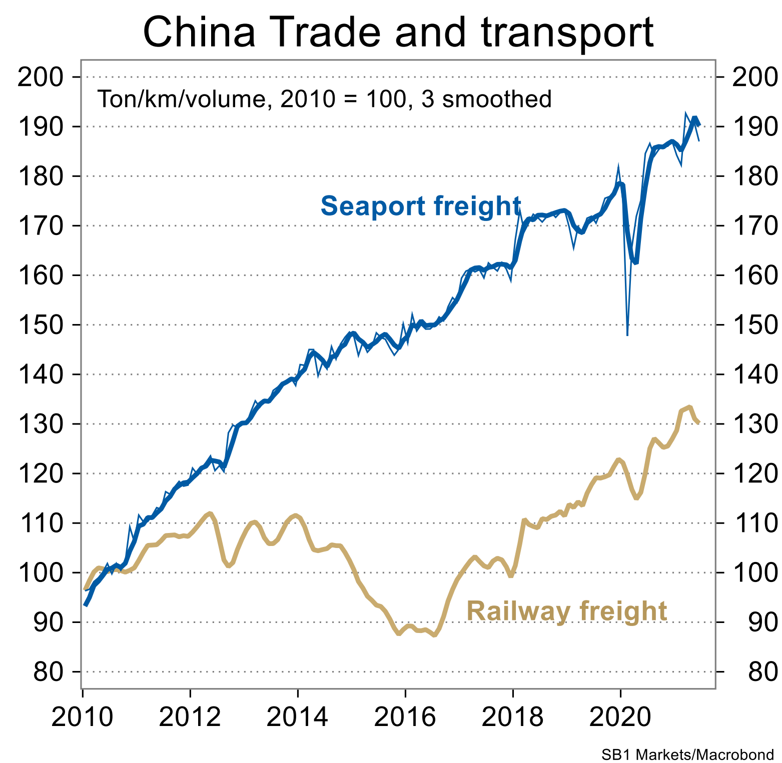
- **All construction inputs** are back on brisk pre-corona growth paths, except copper production (Steel production is also down 4.4% over the past two months)

Electricity production has flattened recent months, level very high +16% vs. p-p.

Transport activity robust too – but may have slowed somewhat too



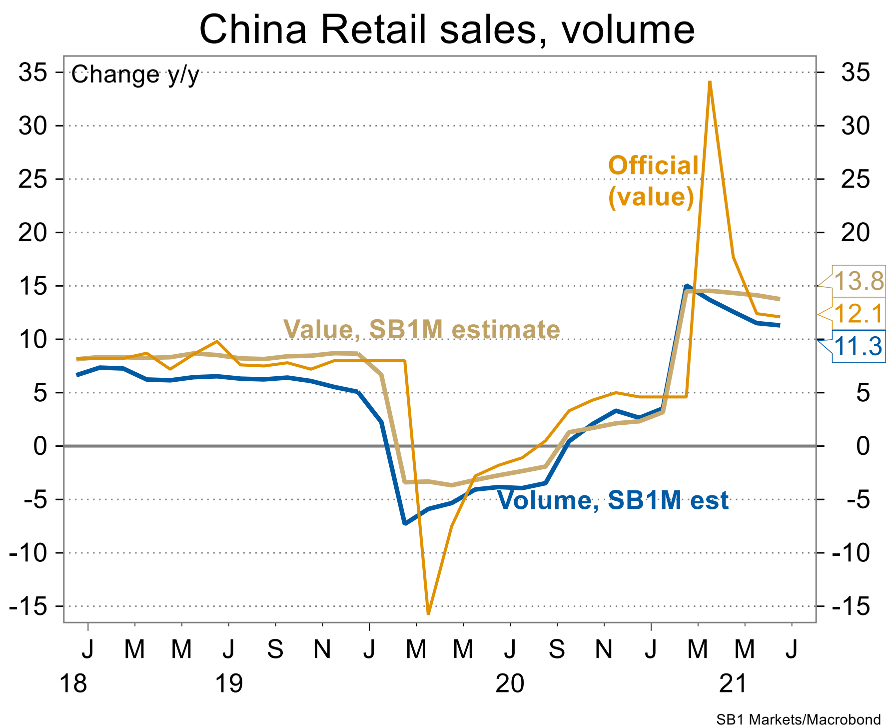




- Sales are higher

Retail sales up 0.5% June – and higher than expected y/y – still 3% below par

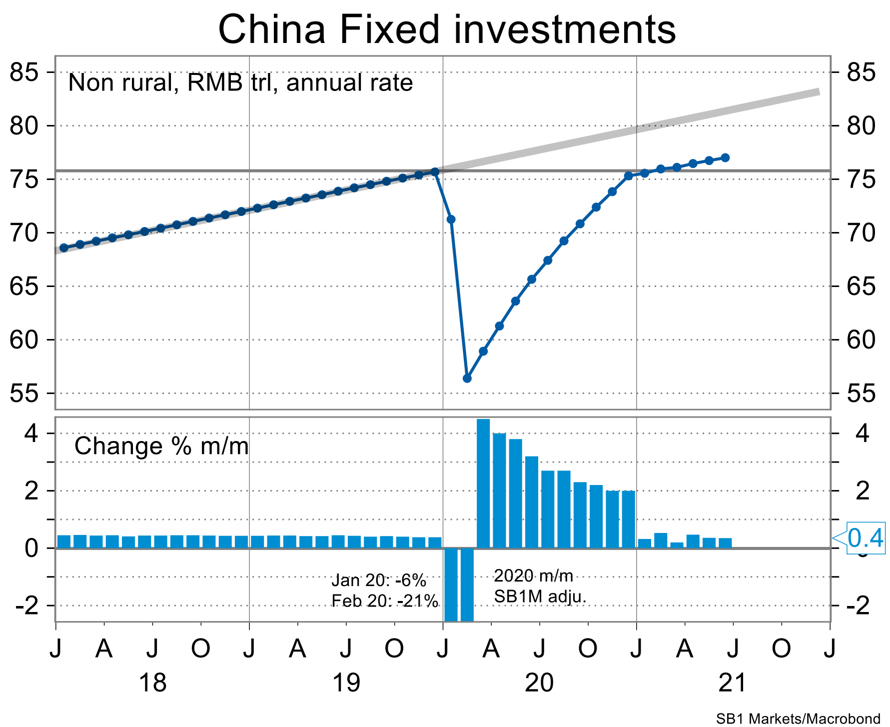
Sales up 0.5% in volume terms as in June – but the underlying trend is weaker than before corona



- **Nominal retail sales** were up 12.1% y/y in June, well above market expectations at 10.9%. These annual growth rates are close to useless due to the base effect, the low sales level last spring
- In nominal terms sales rose by 0.7% m/m in June, we assume by 0.5% in **volume terms**, as in May, equalling a 6.5% growth pace, like ahead of the pandemic).
  - » However, since last November the underlying volume growth rate has been closer to 3% (if we can trust these numbers, following a couple of revisions)
- Sales volumes are 3% below the pre-pandemic trend path, and is probably growing somewhat slower too

Investments growth has slowed but not further through Q2

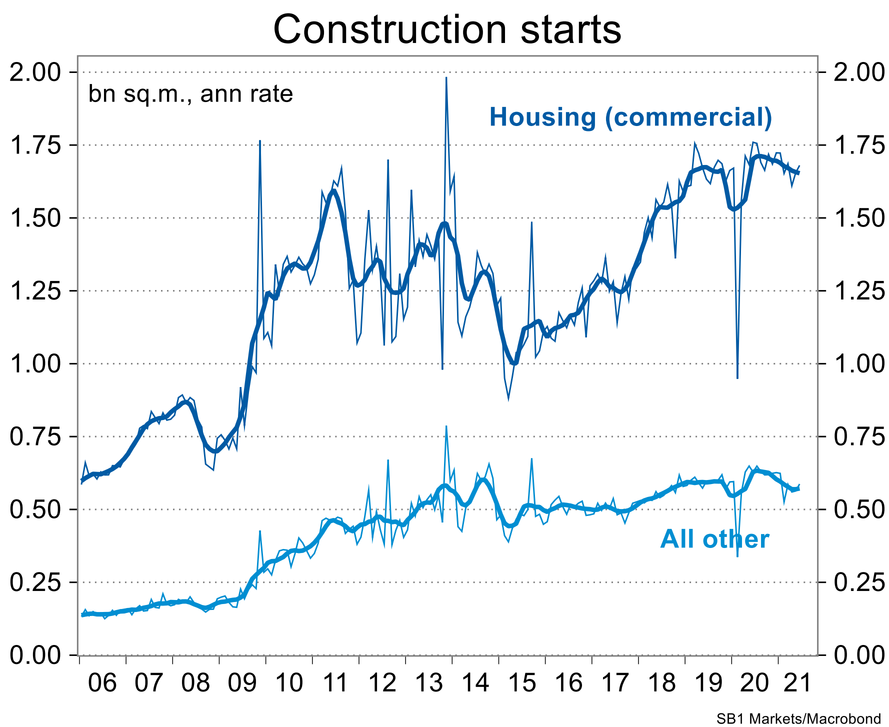
Monthly growth stable at 0.4%, level above Dec-20 but 5% below the pre-pandemic growth path

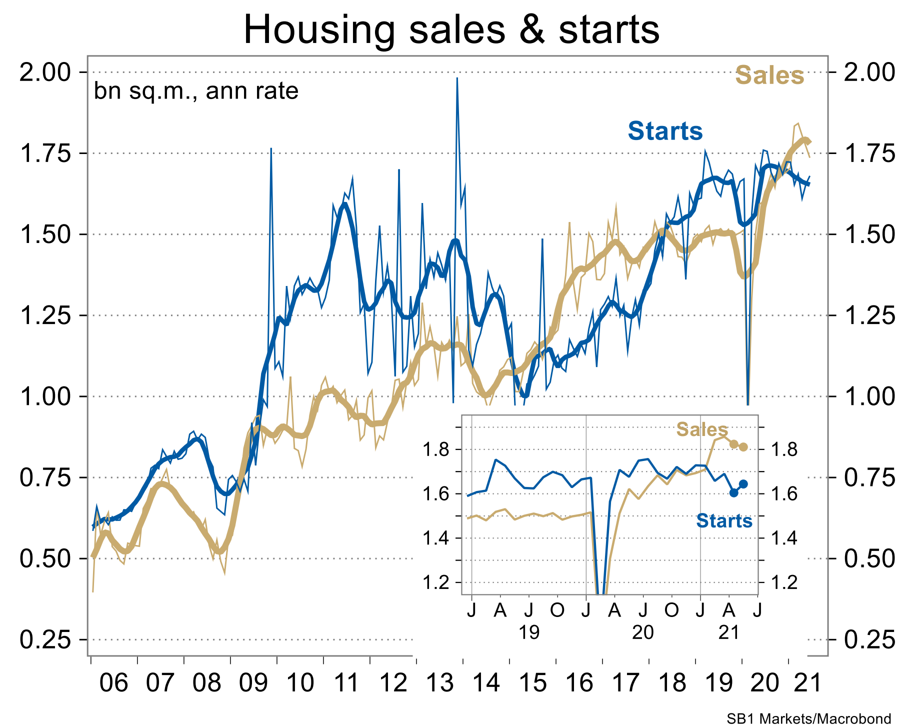


- **Measured YTD**, nominal investments rose 12.6% in June (still a silly number, due to the setback last spring), down from 15.4% in May, a tad better than expected. Measured y/y, investments were up 17% in June, but far less in real term (our calc)
- **Growth m/m** has stabilised at some 0.4% per month since the start of 2021, following a substantial downward revision a couple of months ago. This growth rate, equalling 5% annualised, is just marginally slower than before the pandemic - but of course far below the 10% – 30% growth rate over the previous decades
- The investment level is 5% below the pre-pandemic growth trajectory – and the gap is off course not closing now

Construction activity up in June, still trending down

New home sales fell further but remain at a very high level

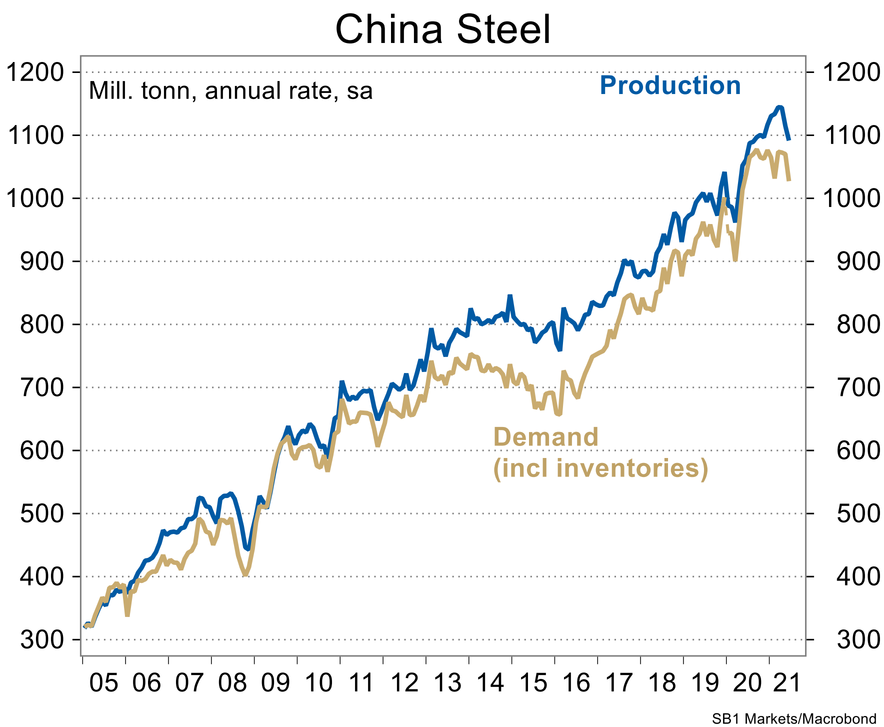




- The rise in **new home sales** has been spectacular since last spring and until the past two months were sales have fallen slightly. The level is still very high
- **Housing starts** rose in June but are still down some few per cent from the record high level last summer – which is not a dramatic downturn, but still visible
- **Non-residential construction** rose in June as well, but has fallen somewhat more since last summer
- **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)

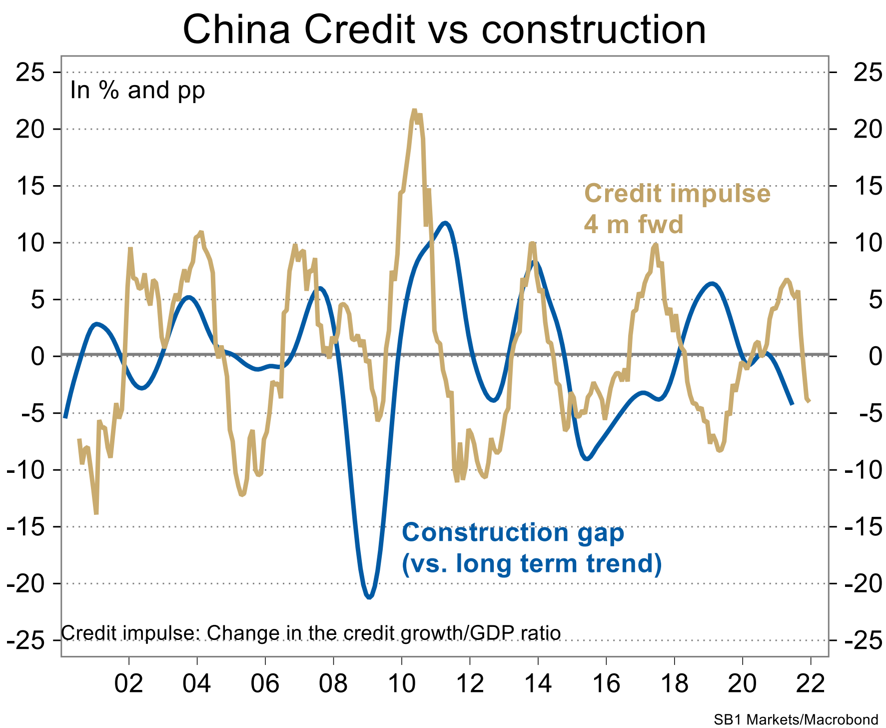
Construction activity is sagging following the post-corona crisis surge

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



Credit growth has slowed sharply – and construction slowly (so far)

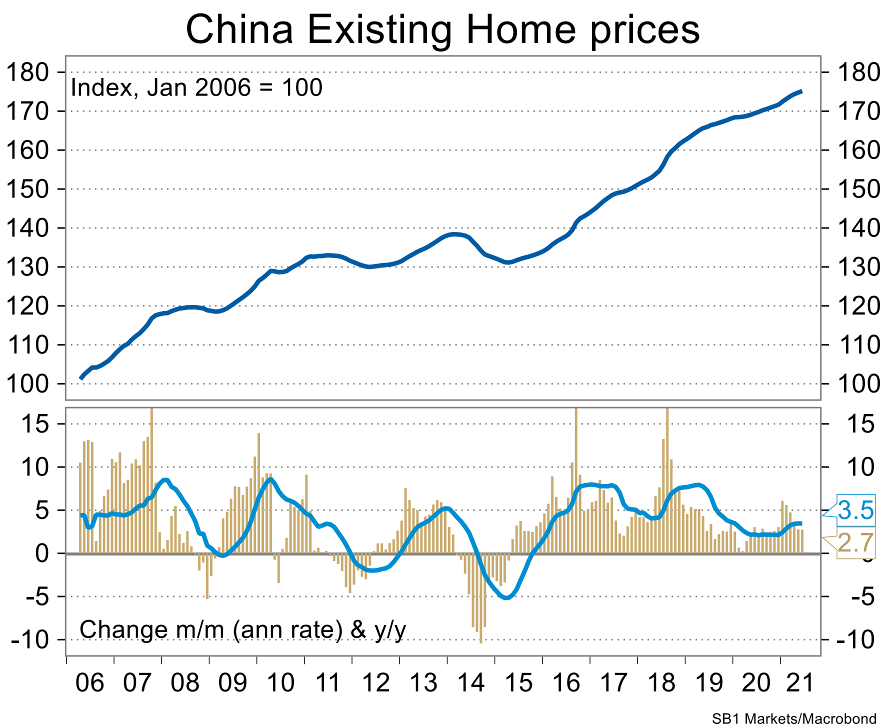
The two are dancing together, but not closely (and it varies who takes the lead too)

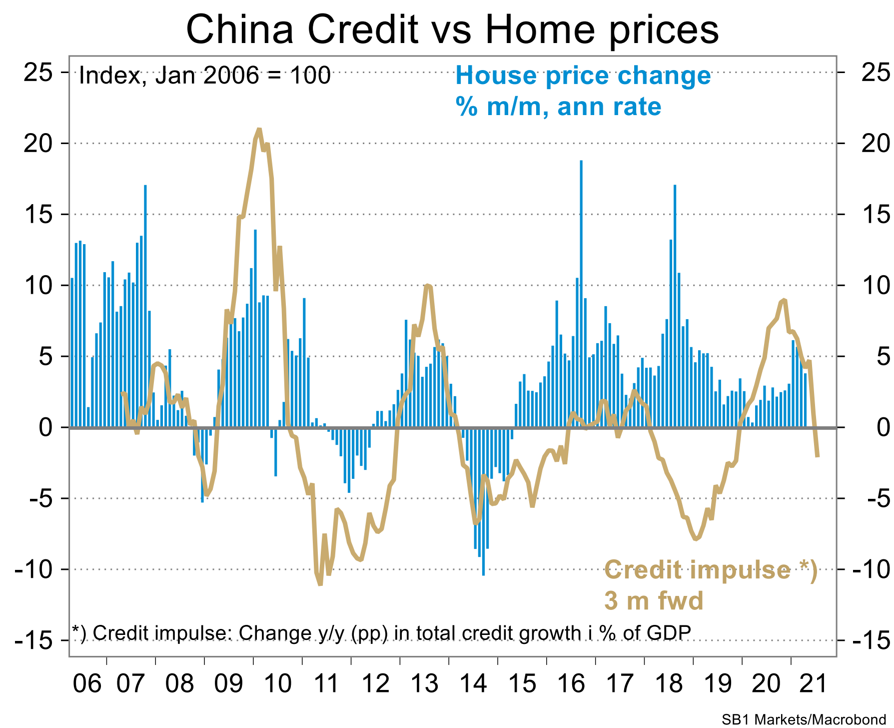


- … still they are at least on the same floor
- The recent credit tightening may have had some impact at the property market – but basically the slowdown in construction started 'too early' this time
- Signals some downside risk for construction, raw materials & steel
- … at least until the credit indicator turns up again. The authorities cut reserve requirement for banks the previous week in order to make them lend more, specifically towards SMBs. The 0.5 pp cut was modest by itself but is probably signalling a turning point in credit policy – which may work, this time again

House price inflation is slowing – amid the credit tightening?

Prices up ‘just’ 2.7% % m/m in June (annualised). Growth has slowed from >6% in January

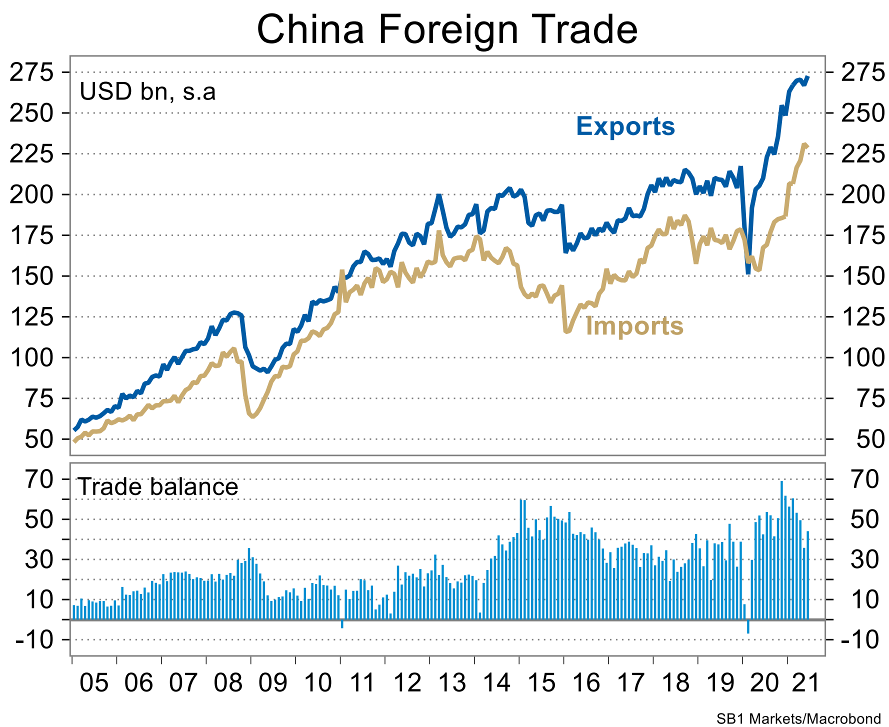


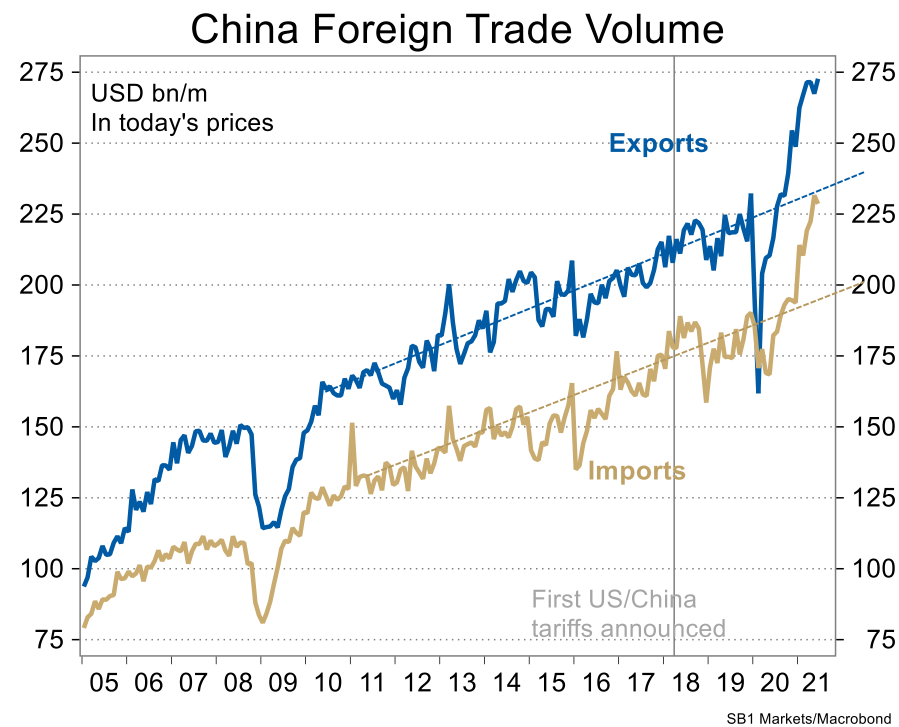


- Credit policy was tightened last autumn and the credit growth has slowed (= a negative credit impulse)
- The correlation to house prices is far from tight but there is ‘something’ there

Both exports and imports still strong in June – but exports may be flattening

So far no signs of any slowdown in the global or the Chinese economy

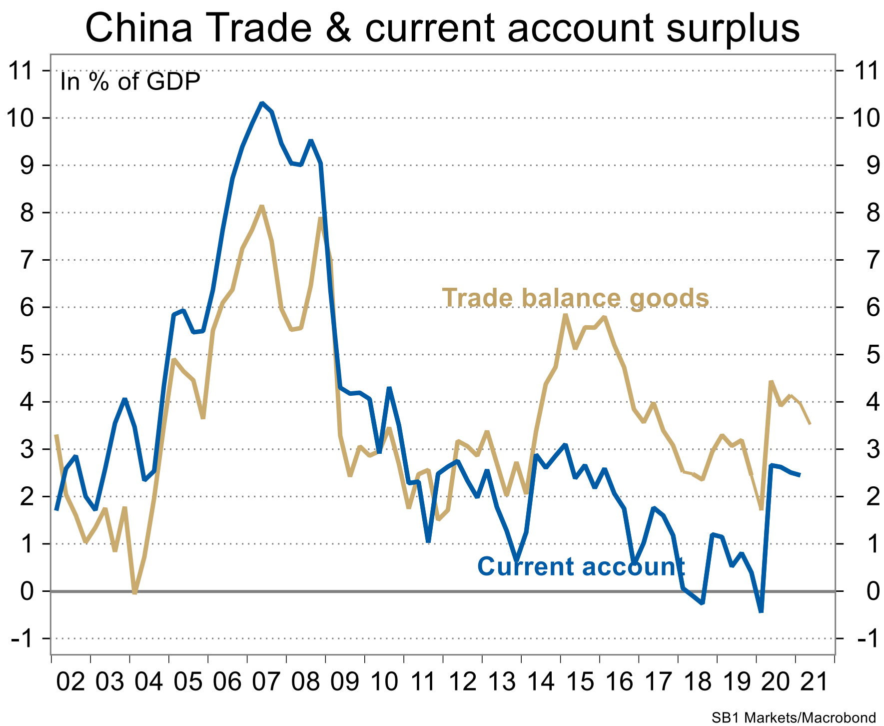


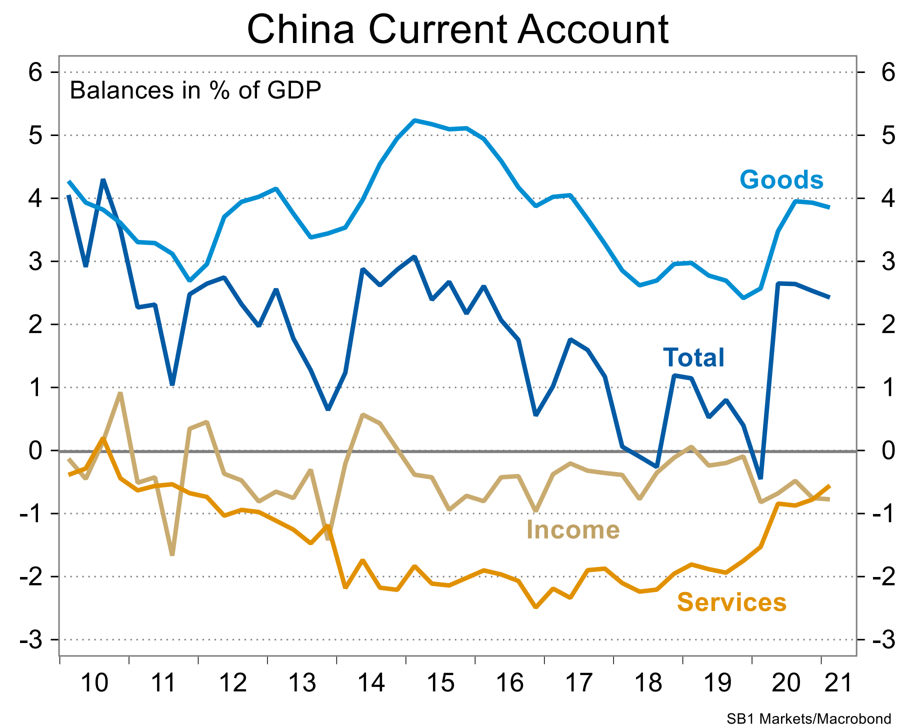


- **Exports** increased by 2.2% in USD terms in June. Exports are up 32% y/y, 9 pp more than expected (a silly estimate?). In **volume terms** exports very likely rose too, but may have flattened recent months – at a very high level, at least by 15% – 20% above the pre-pandemic trend growth. Global demand is strong
- **Imports** were down 1.1% in June from ATH in May, up 37% y/y, expected 27%. Import volumes very likely fell as well. However, import volumes are heading straight up, at 20% above the pre-pandemic trend growth path. Domestic demand is more than OK too
- The **trade surplus** increased in June, to approx. USD 44 bn (seas adj.), which is above the pre-pandemic level, but down from above USD 60 bn at the peak
- We expect growth in foreign trade volumes to slow substantially through rest of the year. Demand for goods in the rich part of the world will slow down when spending in services picks up, shortages of raw materials/intermediates will dampen production. Even if credit policy now may be turning expansionary, the lagged impact on the previous tightening may be felt in domestic demand

China runs a ‘modest’ surplus at the current account – at 2% - 3% of GDP

The C/A surplus was above 10% of GDP in 2007 – but close to zero before the pandemic





- The trade surplus in goods is now at 3% - 4% of GDP, slightly down in Q2
- In services, China runs a 0.5% deficit, down from -2% in 2015 – 2019 (but from zero 10 years ago). For the time being, the Chinese do not travel abroad (and we do not visit them either)
- China runs a marginal deficit in net (mostly capital) income from abroad, even if the country has a huge net + financial position
  - » China has invested much in low yielding US government bonds; foreigners are investing in profitable production capacity in China

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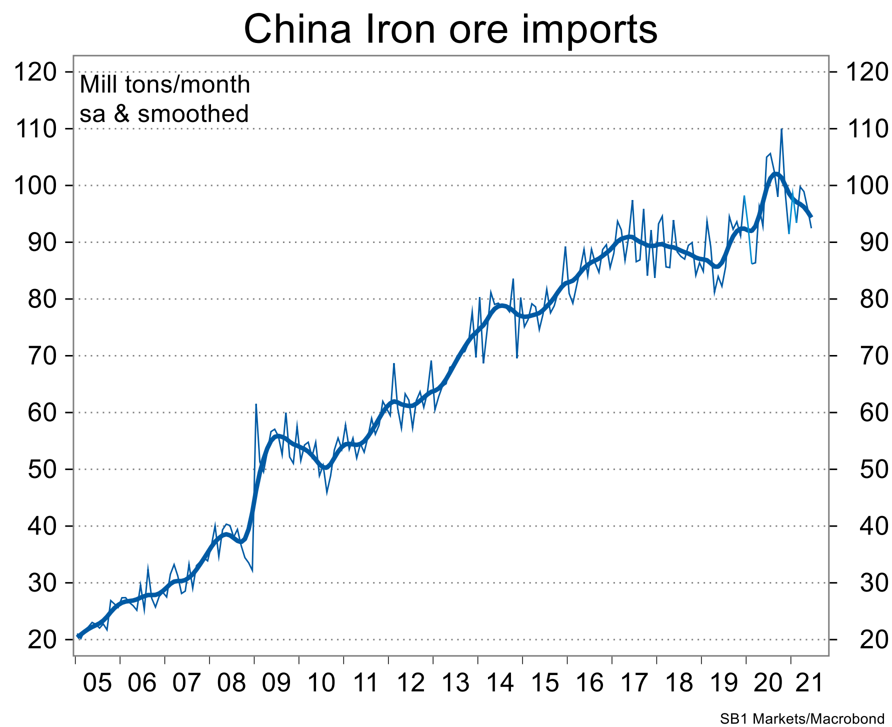
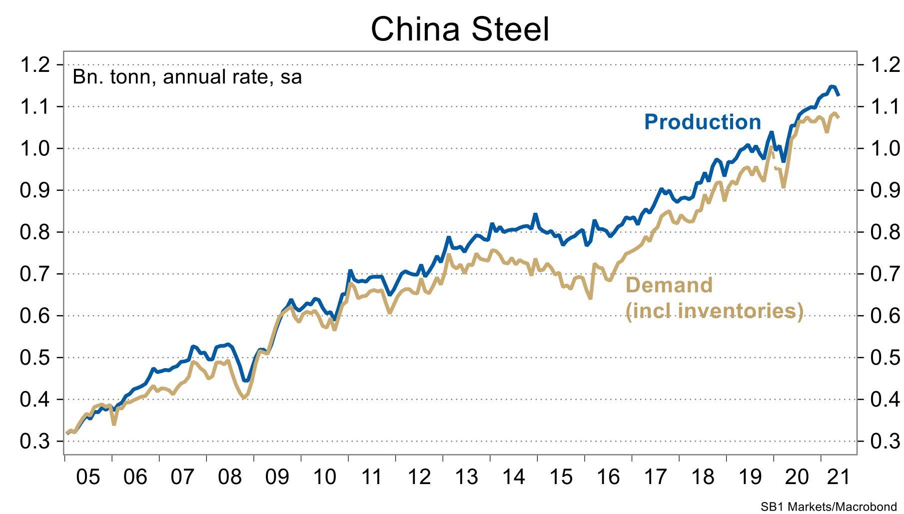
Iron ore imports have declined recent months, steel prod. down 2.5% in June

Growth in domestic demand has slowed, and net steel exports have strengthened

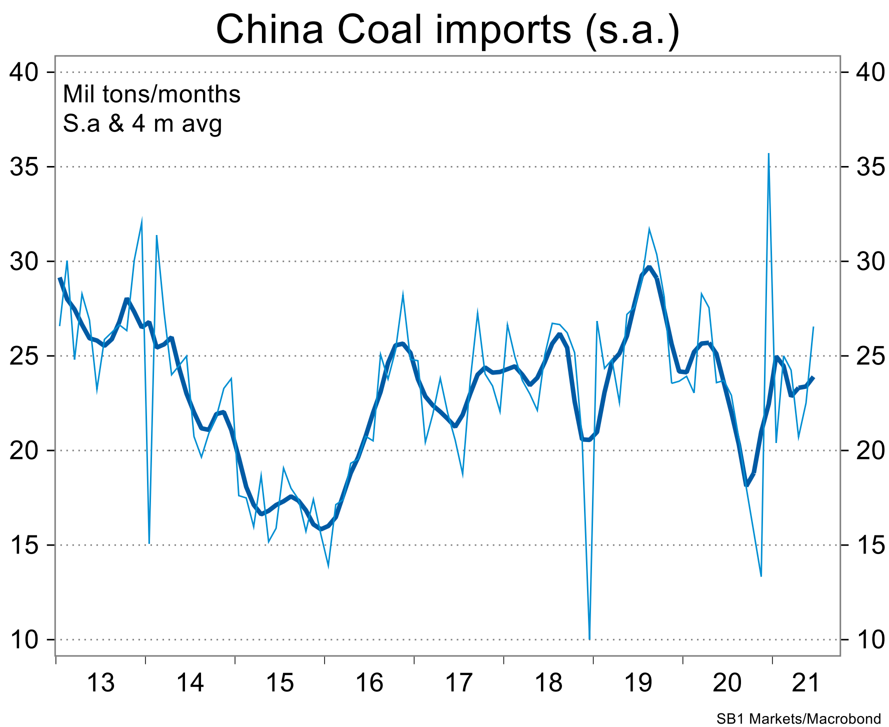


- We didn't think the increase in steel production was here to last, and we still believe the risk is on the downside



Coal imports have been trending flat since 2016

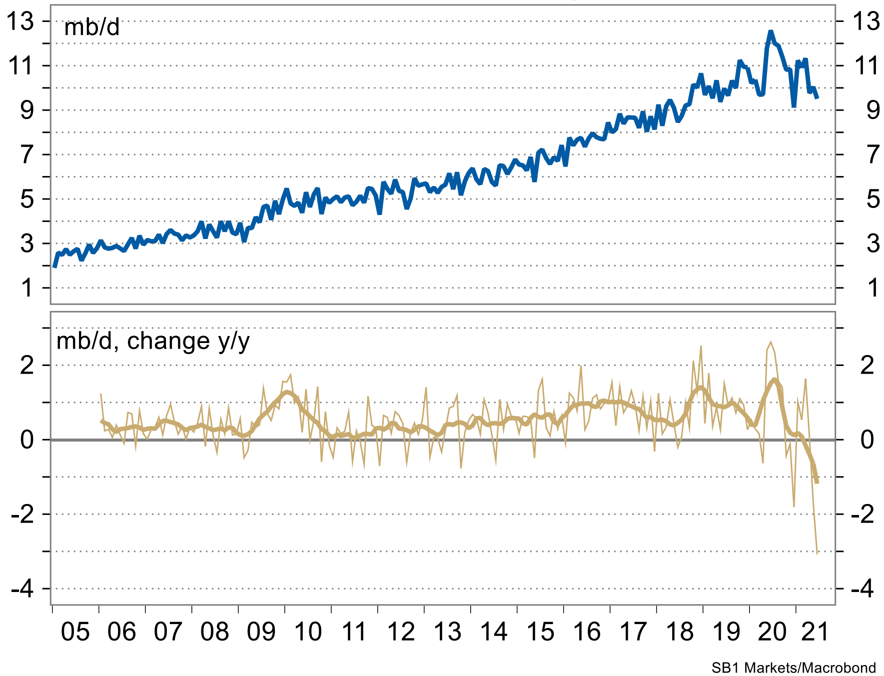
…and imports were marginally up in June



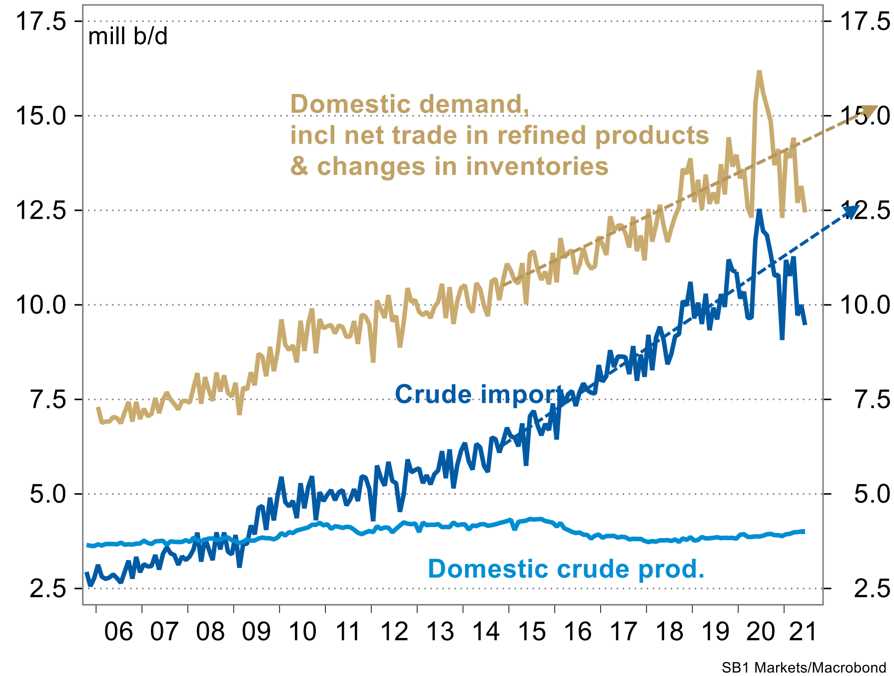
Oil imports far below pre-pandemic trend (and even level)

<u>Imports were low in both April, May, and June</u>, according to Chinese data

China Crude oil imports

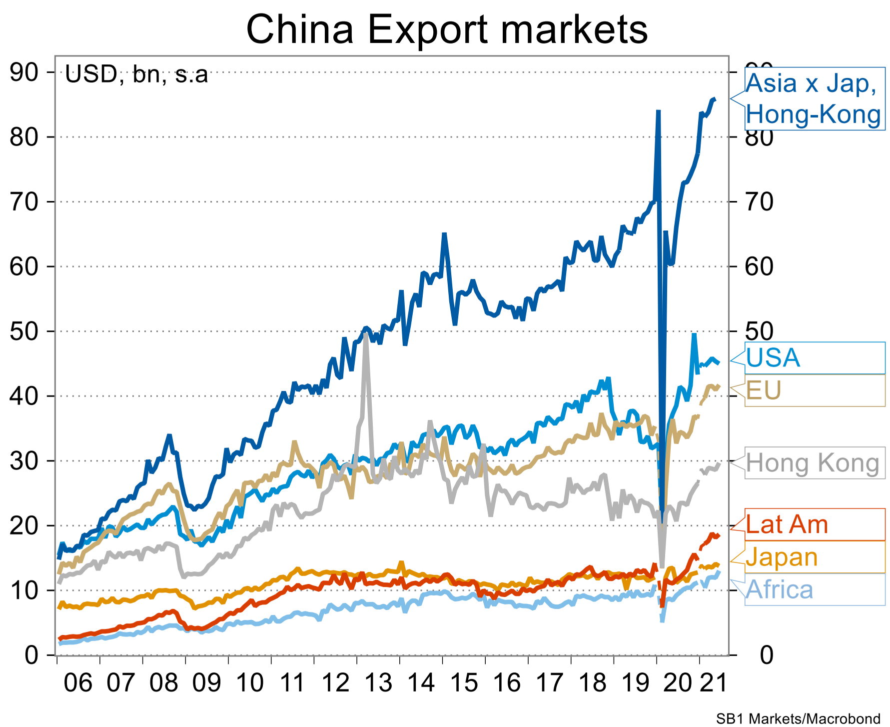


China Oil Production & demand



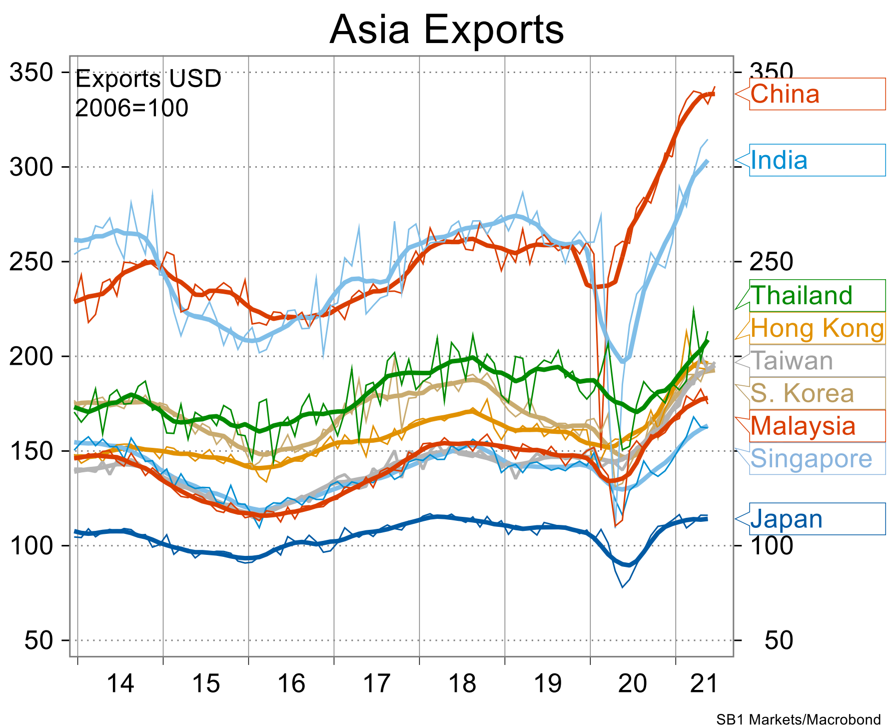
Chinese exports to 'all countries' up (but some signs of flattening to US/EU)

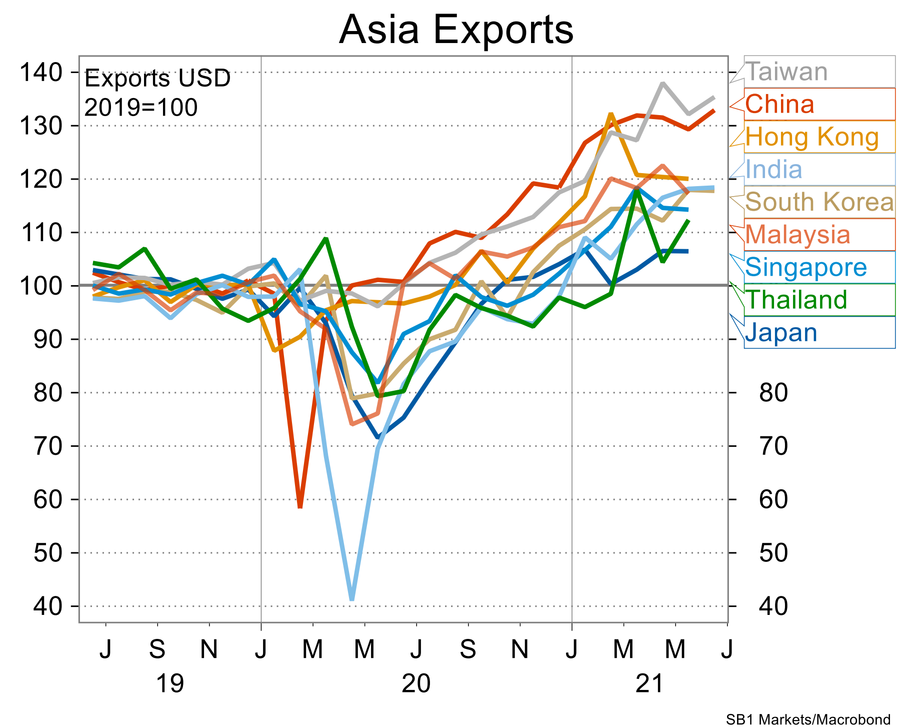
The recovery in exports through the pandemic has been impressive, strong growth in all directions



China is not alone: Asian exports are rapidly on the way up

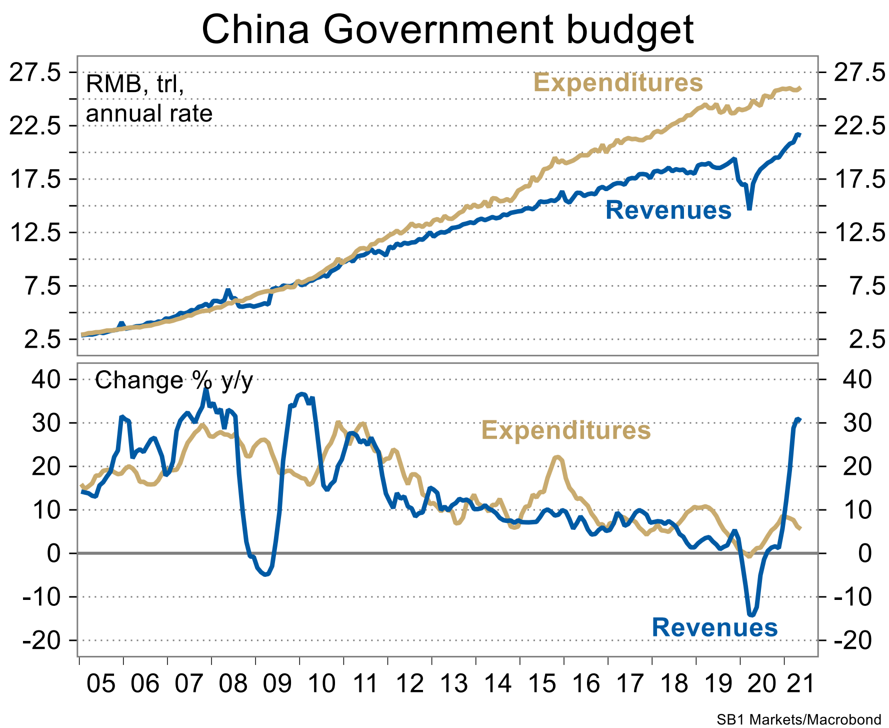
(except Japanese exports)

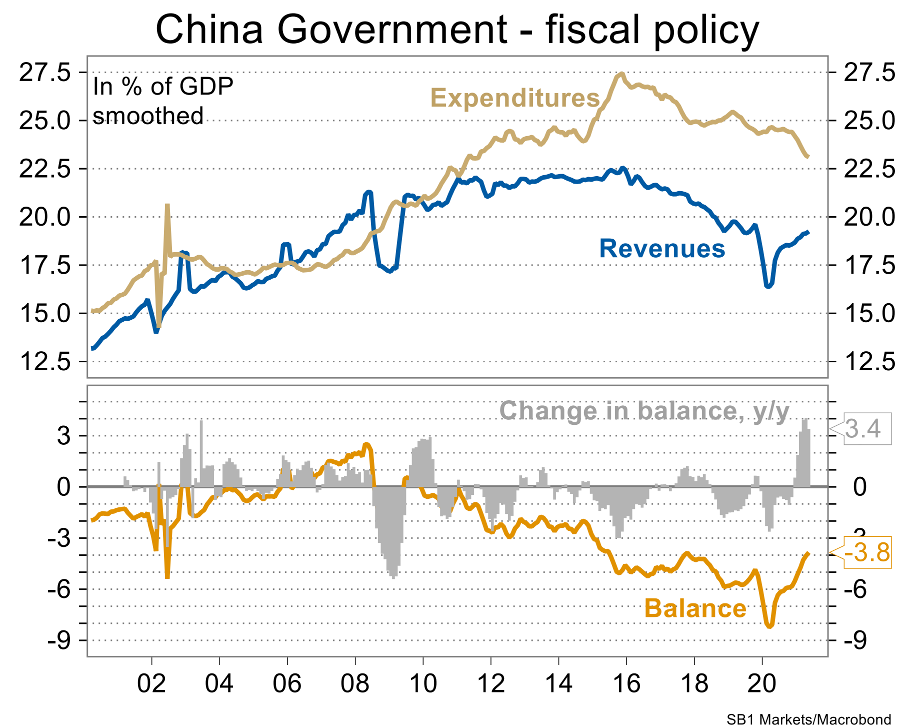




Fiscal policy is tightened, mostly trough the spending side

Revenues are normalising vs GDP, expenditures are falling sharply – and the deficit is falling rapidly

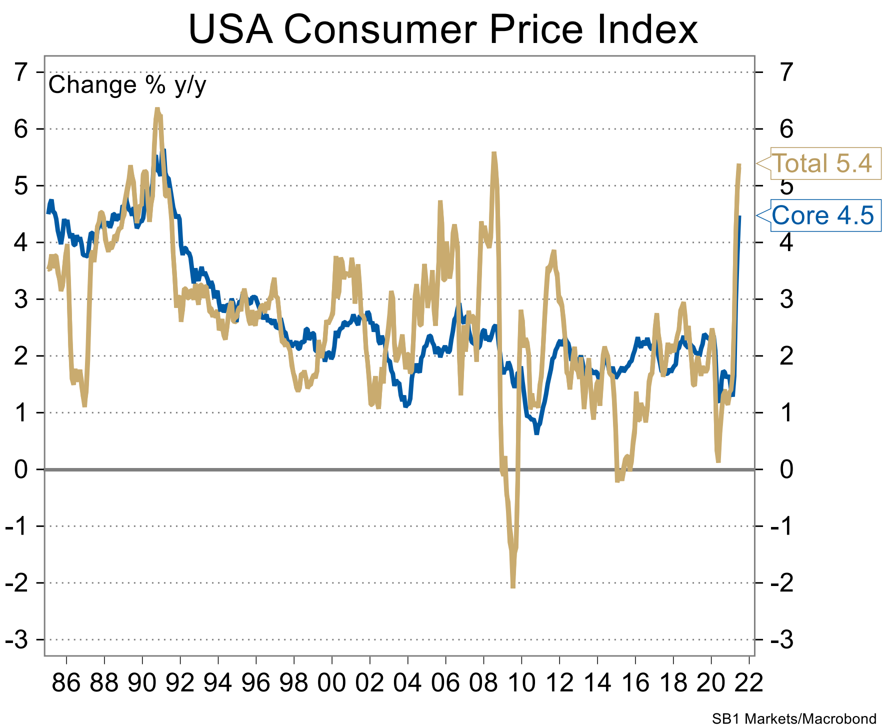


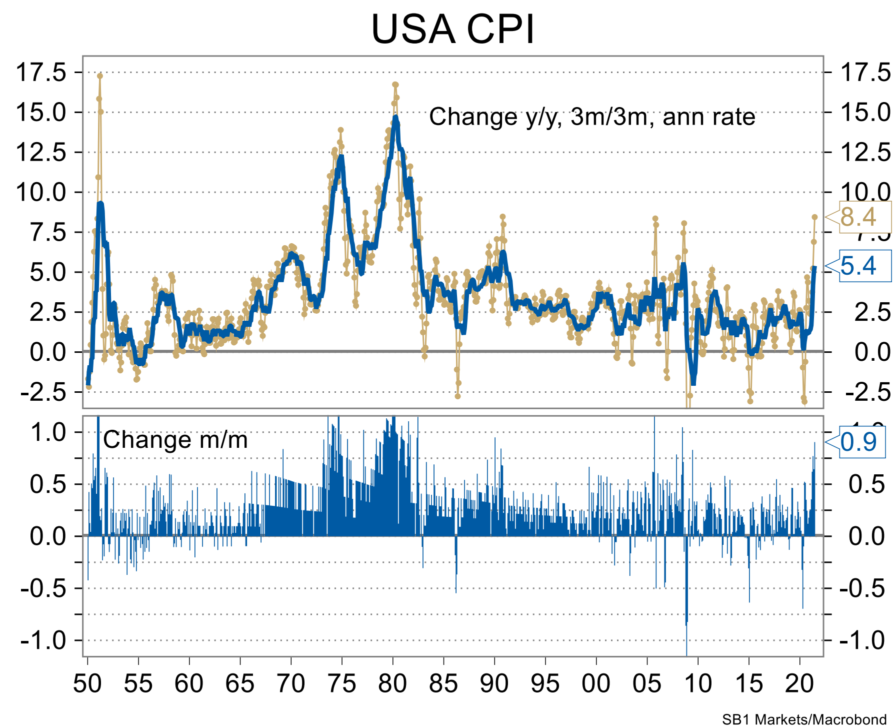


SpareBank 1 MARKETS

Yes, some of it is transitory, but inflation is above 2% for many sectors

The Fed just might have to react sooner – our bet is a tapering announcement in Sept

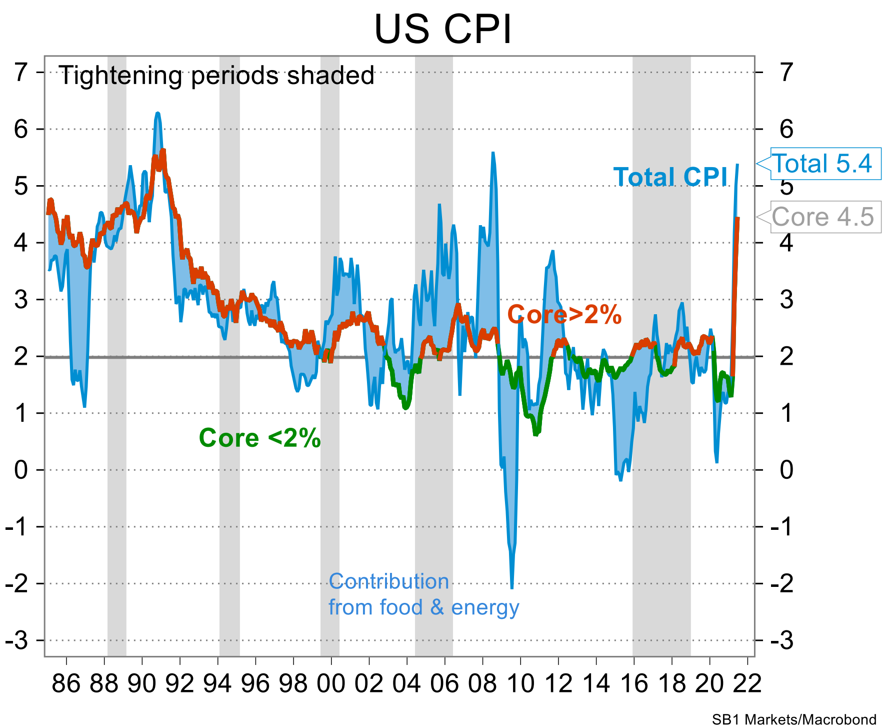


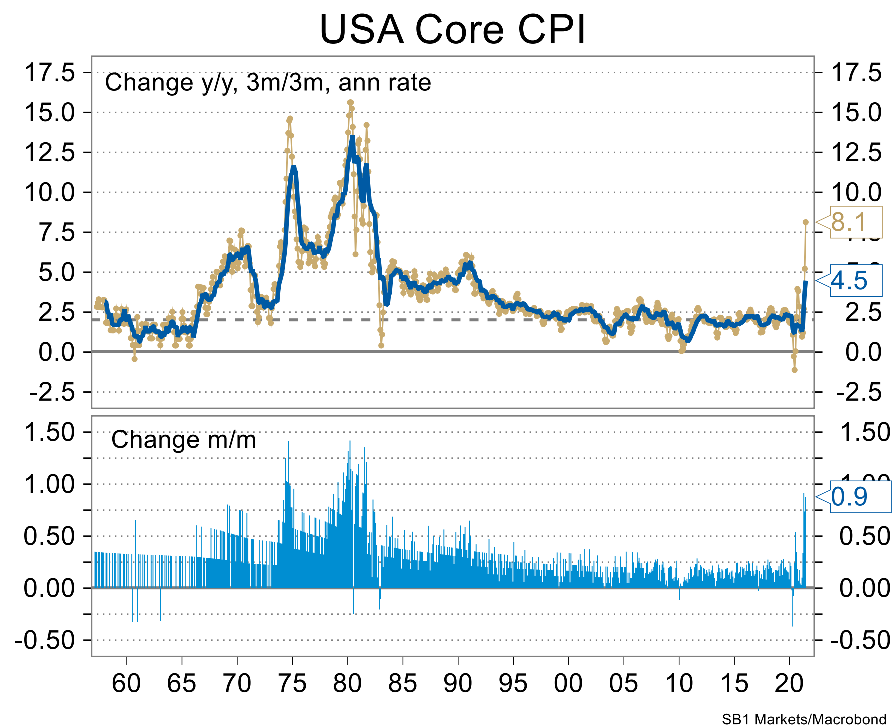


- **Headline CPI** rose 0.9% m/m in June, expected 0.4%. The annual rate climbed by 0.4 pp to 5.4%. And forget about base effects, as prices were up 0.5% last June. This is the 2nd highest headline CPI y/y print since 1990
- **Prices have been accelerating** m/m since last October, and the 3m/3m rate is now up to 8.4%, highest since 1990
- In June surveys, companies reported that they expect to lift prices sharply. We doubt all these planned price hikes are completed
- **The Federal Reserve** can still afford to wait and see, as there no doubt are many 'transitory' elements but the 2% average inflation 'over time' (or the price level target) is already reached and communication will have to become more nuanced, with more assessment of the upside risks on inflation than until now. The risk is that the Fed will have to react much sooner and with more ammunition than what is announced (and what is good for the market…)

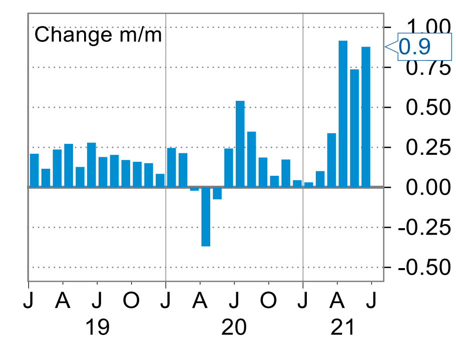
Core inflation sharply up too, the annual rate the highest in almost 30 years

Prices +0.9% m/m in June, expected 0.4%, the y/y rate jumped 0.7 pp to 4.5%. The 2 y avg. at 2.8%



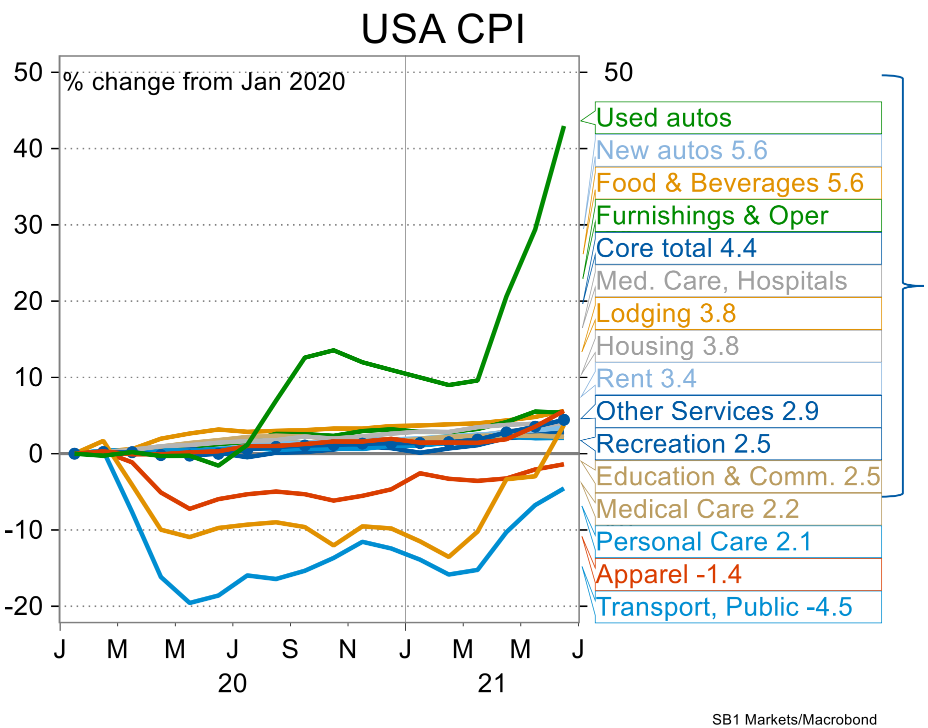


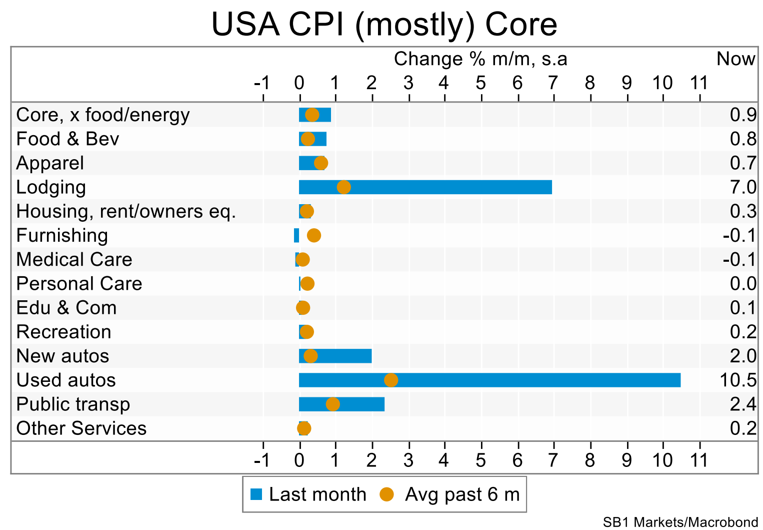
- **Core prices** rose 0.03 pp less than in April (which yielded the highest monthly increase since 1982)
  - » In April, the 3m/3 rate was at 1.2%, now it is at 8.1%, the highest since 1982 too
- The price hikes in the last three months are at least partly due to one-offs which will not be repeated, or will be reversed
  - » Used auto prices (and auto rental prices) seem to be a candidate on the downside
  - » Most of the 'reopening' sectors have lifted prices back up to a normal level, like lodging, recreation. Just airline tickets are still cheaper than normal
- Parts of the hike the annual rate recent months are due to falling prices last spring. However, the average inflation since June 2019 is 2.8% - and inflation has been above 2% whatever relevant starting point

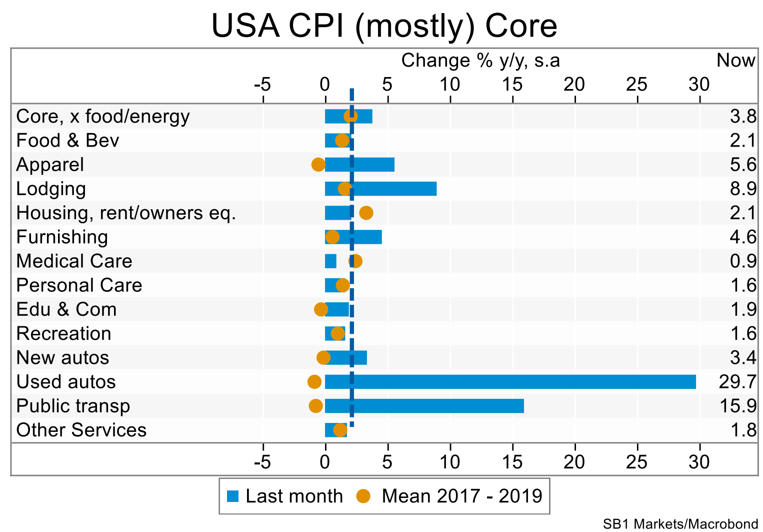


Used auto prices straight up in June, +10%, 40% y/y

14 main sectors up >2% y/y, just 2 are below



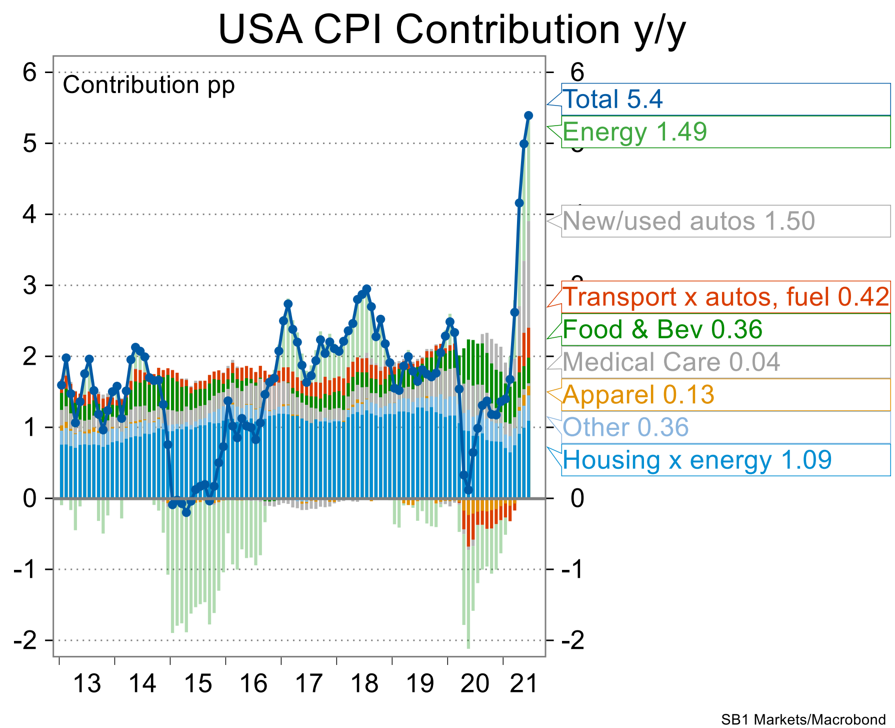


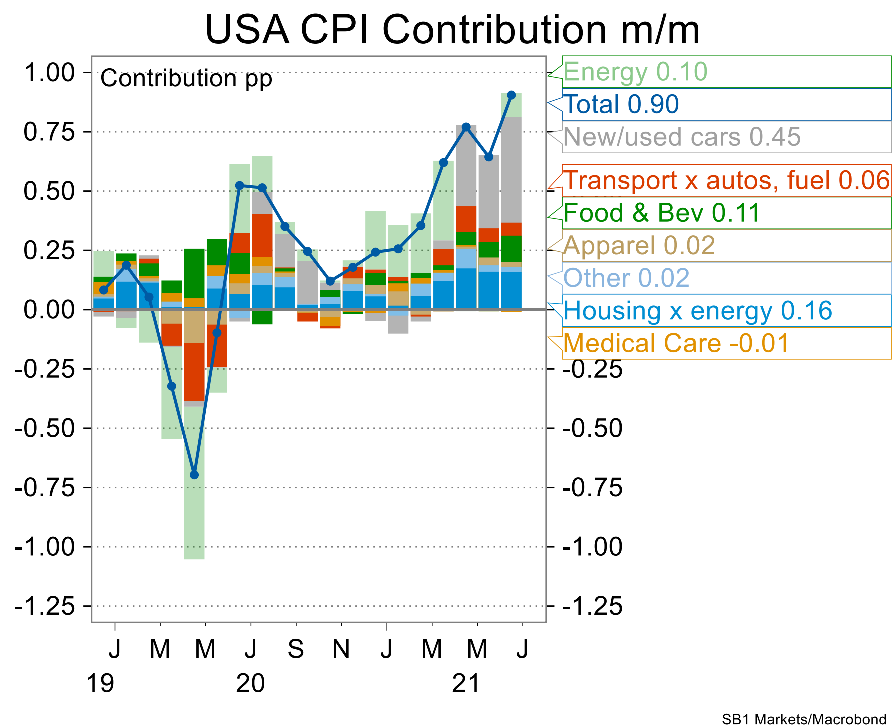


- Just some few CPI components contributed to the setback last spring: **Public transport** (airline tickets) **lodging** away from home (hotels ect), and **apparel**. Other components of the CPI did not slow significantly
  - » Now these sectors have more or less recovered, except public transport (apparel prices are below Feb-20 but are trending down)
- **Used auto prices** have been on the way up since last summer – and shot up almost 30% over the past 3 months, and by 40% y/y – as deliveries of new autos is hampered by lack of components. These prices are very likely above a normal level, if not by 40%

Transport & energy explain 3.4 pp of the 5.4% lift in total CPI

... Of which 1.5 pp from energy, but new/used vehicles & airline tickets are sharply up too





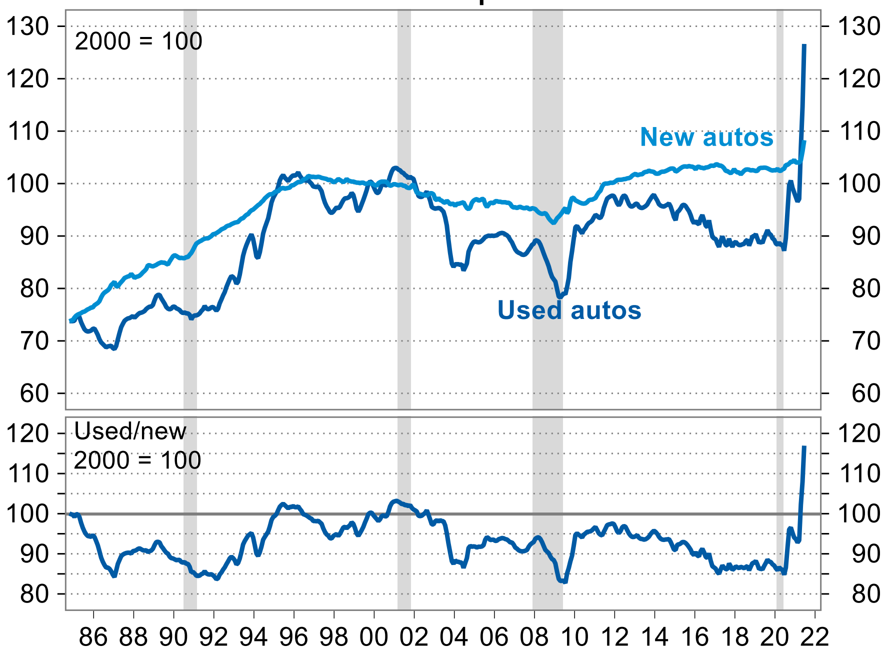
- In June (as in April and May), **new & used cars** explained half of the m/m lift in total CPI, and 1.5 pp of the 5.4% y/y growth in headline CPI
  - » Used car prices rose 10.5% in June, and are up 40% y/y. They are very likely too expensive now, but not necessarily by 40%. The upside must be limited, though (as we said two months ago…)
- **Energy** has lifted the headline CPI by 1.5 pp in the past year (but was only to blame for 0.1 pp of the lift in June). If the oil price does not skyrocket from here, the contribution to the annual growth rate from energy will quickly fade (see more here)
- Excluding the 3.4 pp **contribution the headline CPI from energy & transport**, "remaining" inflation is still well above 2%. In addition, a far higher parts of the CPI is now reporting growth above 2% (even measured as an average over 2 years, in order to adjust for the impact of price cuts last spring)

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

Are 2nd hand cars too expensive following the 40% lift?

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

USA Auto prices

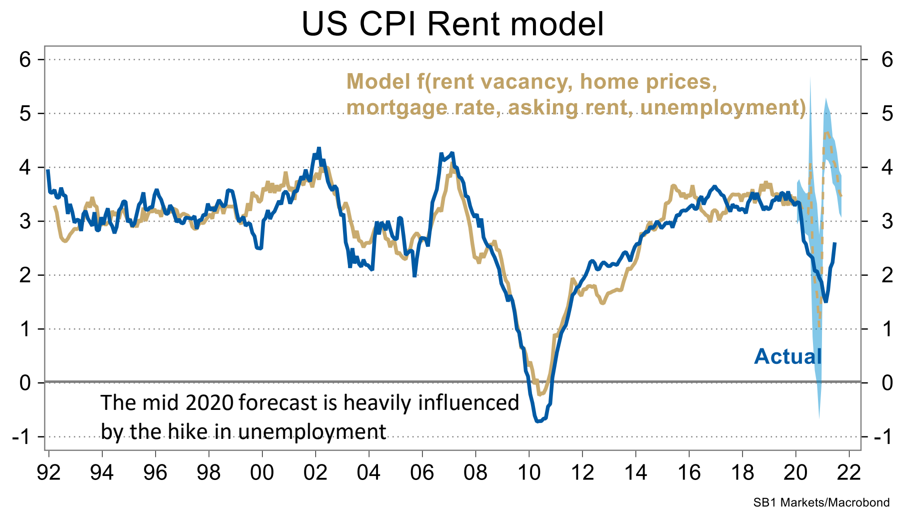


SB1 Markets/Macrobond

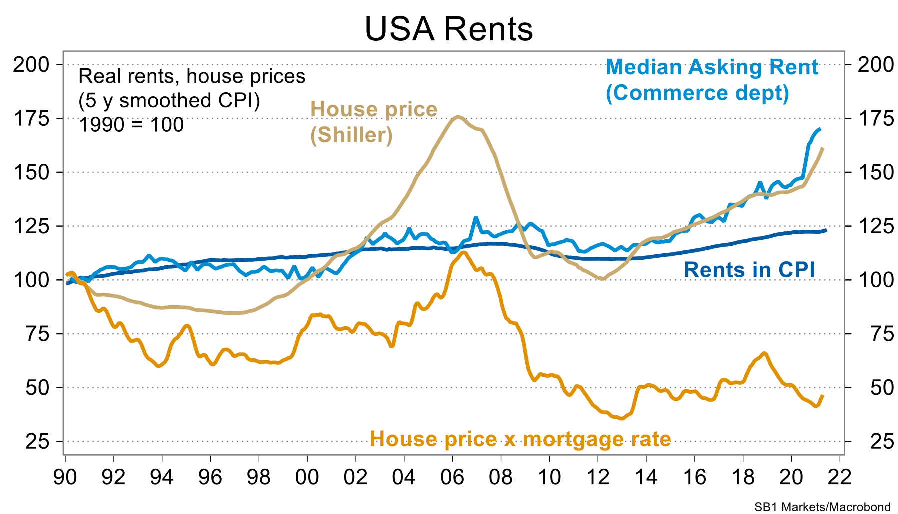
- By the way, prices for **new autos** are up 3% since 1996, quality adjusted, that is. And until the recent price hikes in a very tight US auto market, 2nd hand prices were down 10% the past 25 years (quality adjusted)
- It is impossible from these data to be sure if there is an equilibrium between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

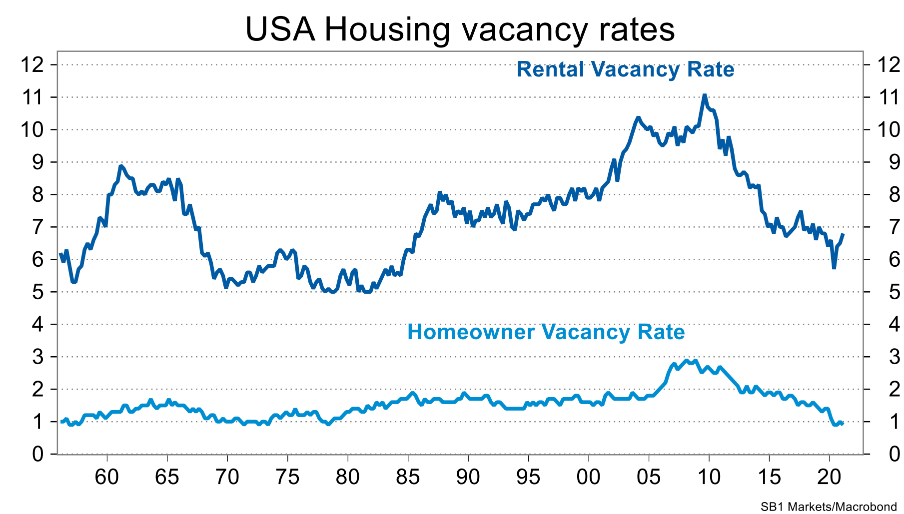
A tight rental market – a possible threat – even if mortgage rates are low

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



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

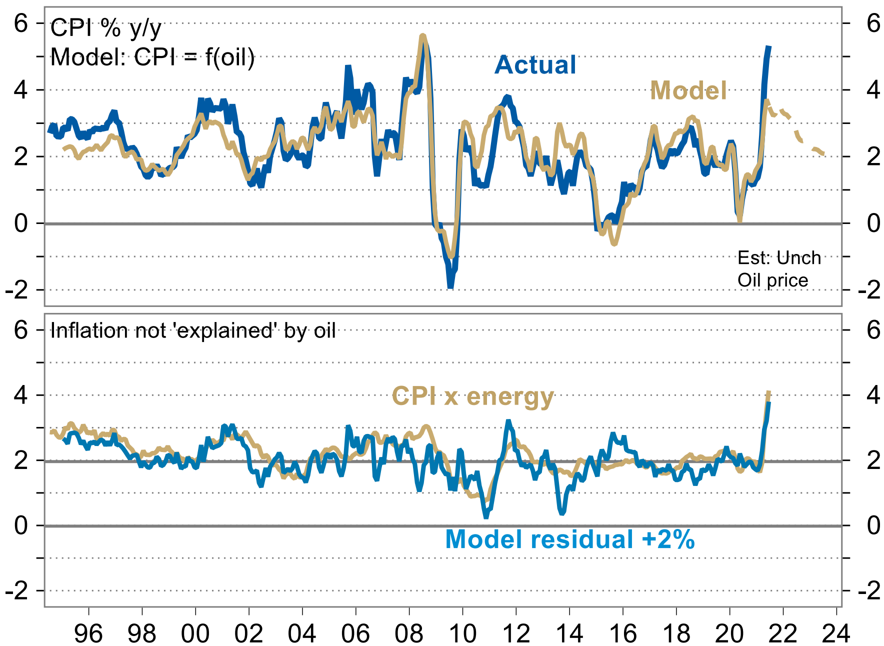




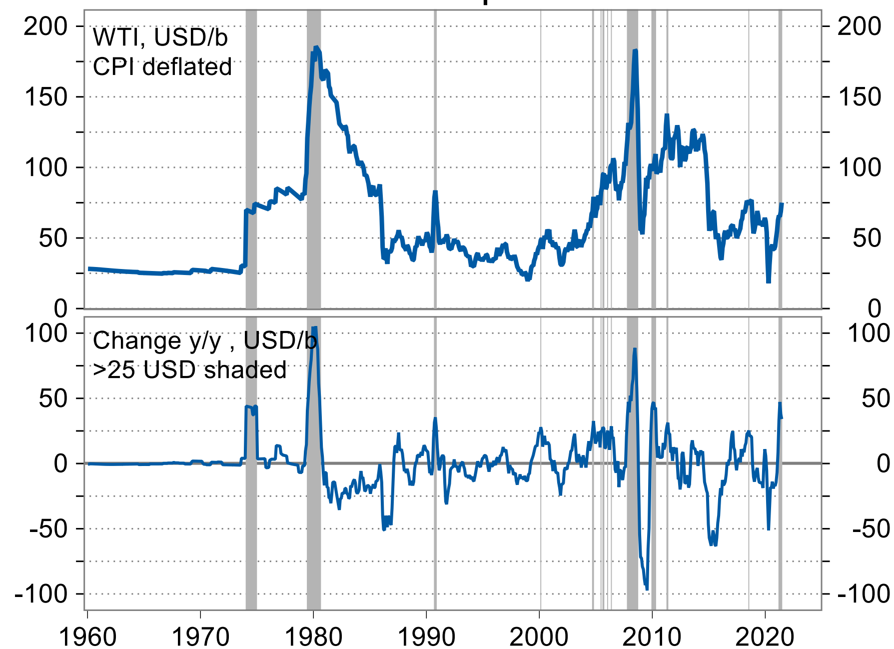
The oil price moves the CPI as usual – but now there is something else too

CPI is up almost 2 pp more than explained by the oil price, which is due to auto/airline ticket prices

USA CPI vs Oil



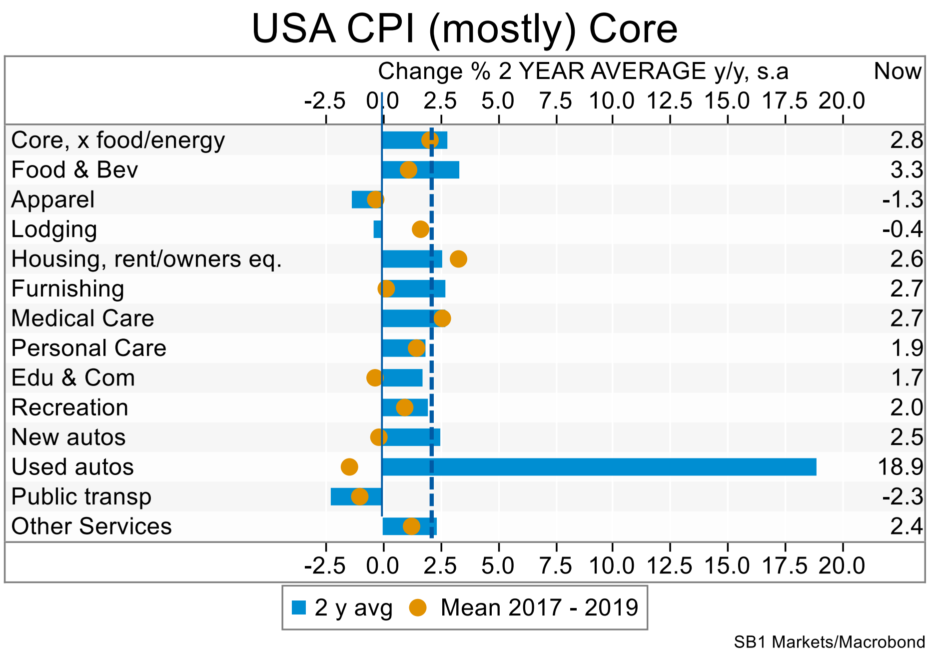
The Oil price

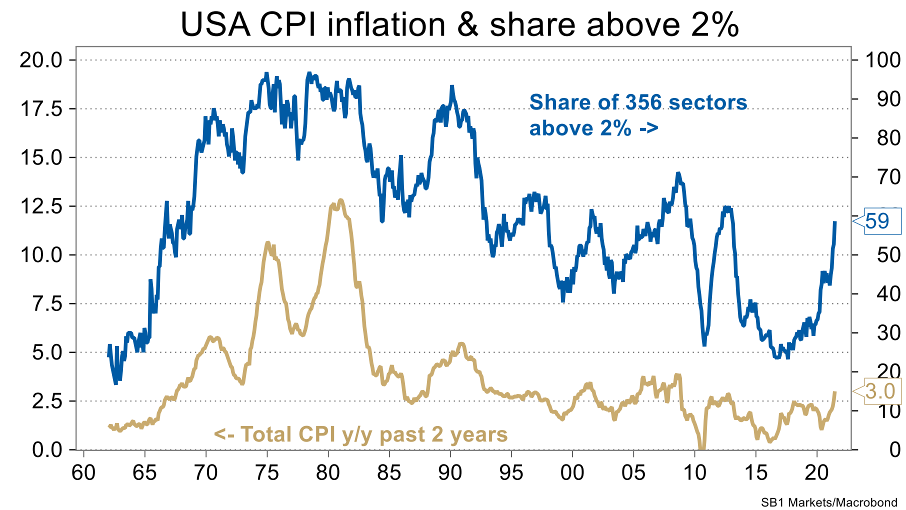


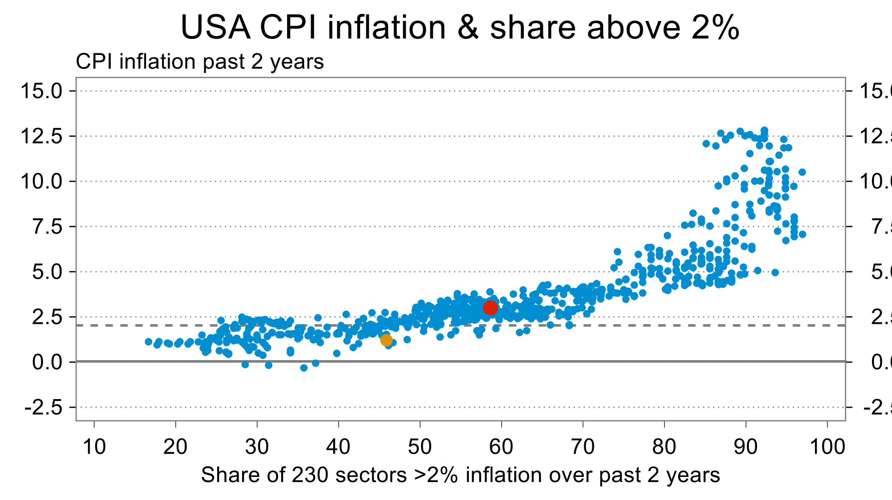
- **Oil price cycles** have explained some 80% of the changes in CPI growth the past 30 years
  - In our model we incorporate all indirect impacts from changes in the oil prices – as well as the impact from other factors that influenced inflation which correlates to the oil price.
  - If the oil price stabilises at the current level, the impact at the CPI will gradually fade
- From time to time, there are **substantial residuals**, like now: Headline inflation is almost 2 % above the model forecast, and the CPI x energy index (which is close to the core CPI) has climbed 2 pp. Why?
  - Auto prices (new and used) and airline ticket prices have lifted the CPI by 1.9 pp (a minor part of the lift in airline ticket prices may though be due to higher fuel prices). Thus: This model suggests that inflation pressures are not broadening

Inflation over the past 2 years: Some acceleration

Core inflation is up 2.8%, up from a 2.1% average in 2017 – 2019 – and some broadening



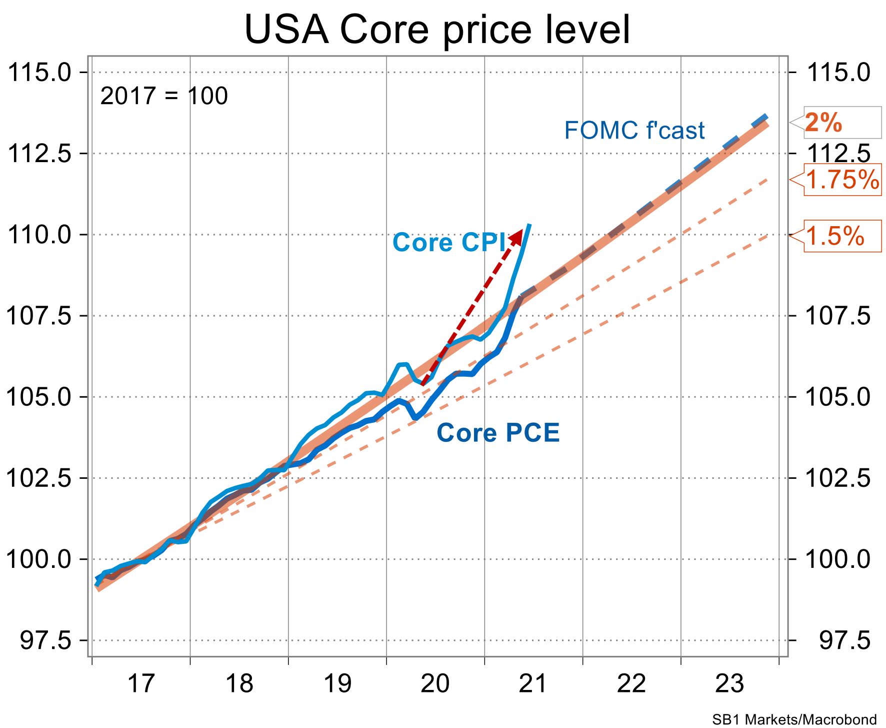


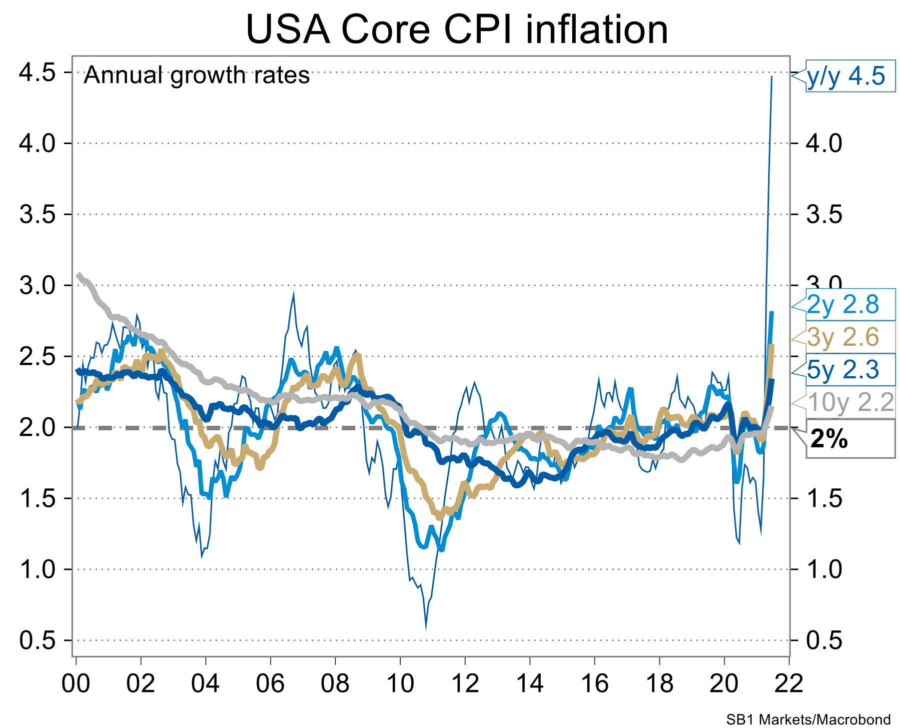


- Of the 13 main sectors, 7 are up more than 2% per year since May 2019, and 6 are below the 2% line
- Over the past 2 years vs the 2017-19 average, inflation has accelerated in 10 sectors, and slowed in 3 sectors
- Of 350 sub-sectors, 59% are up more than 2% over the 2 past years, normally signalling an inflation rate well above 2.5%

The price level target is met. The Fed might have to respond sooner…

…but the maximum employment target is not met, so how long will the Fed stay cool

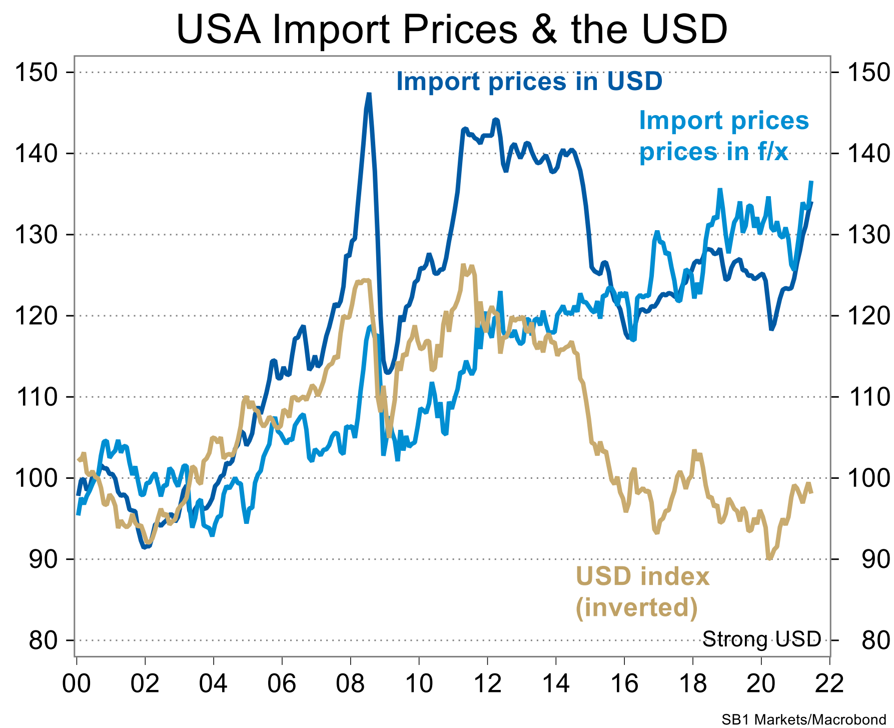


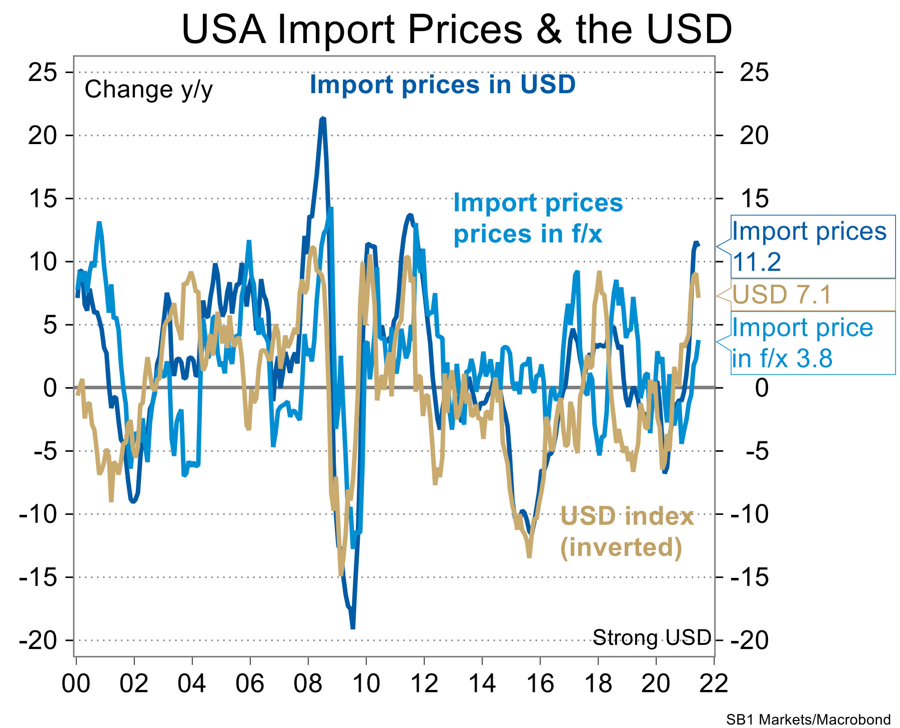


- The Fed has not defined its time horizon but the price level target is more or less met, whatever time horizon the Fed chooses
  - » **Measured vs. the CPI**, the average core inflation is at or well above 2%, whatever period we check. The core PCE deflator is <u>above</u> 2%, whatever horizon
- **Inflation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

No import price drama: Total import prices are up 11% - 'due to' a 7% USD decline

Measured in exporters' currencies, prices are just up 3.8%

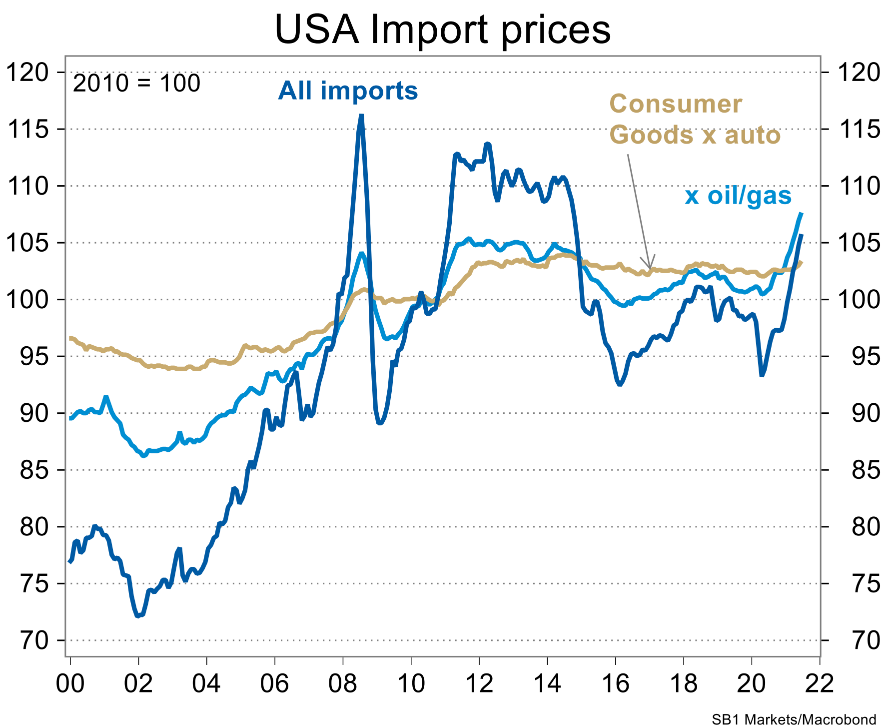


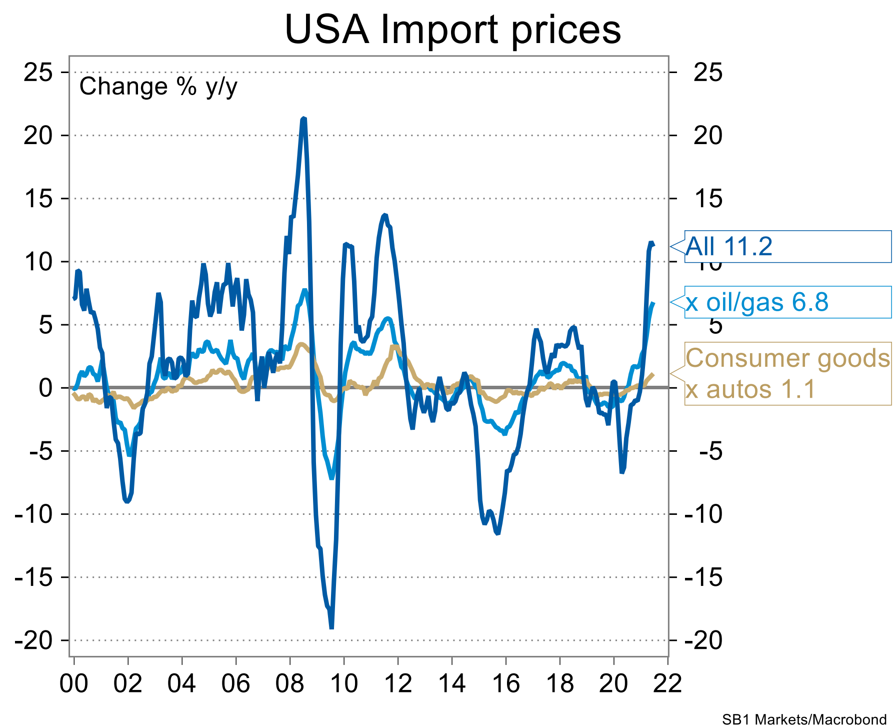


- Import prices, measured in sellers' currencies have been accelerating last months but the most of the lift in US import prices are due to a weaker USD over the past year
- However, a mild deflationary pressure in the US due to the USD appreciation (in average) in the 2012 – 2020 period has come to an end. The impact on domestic CPI is limited though

Still slow growth in imported consumer goods, even measured in a 7% weaker $

Total import prices up, also ex petroleum – but consumer goods prices are just marginally up

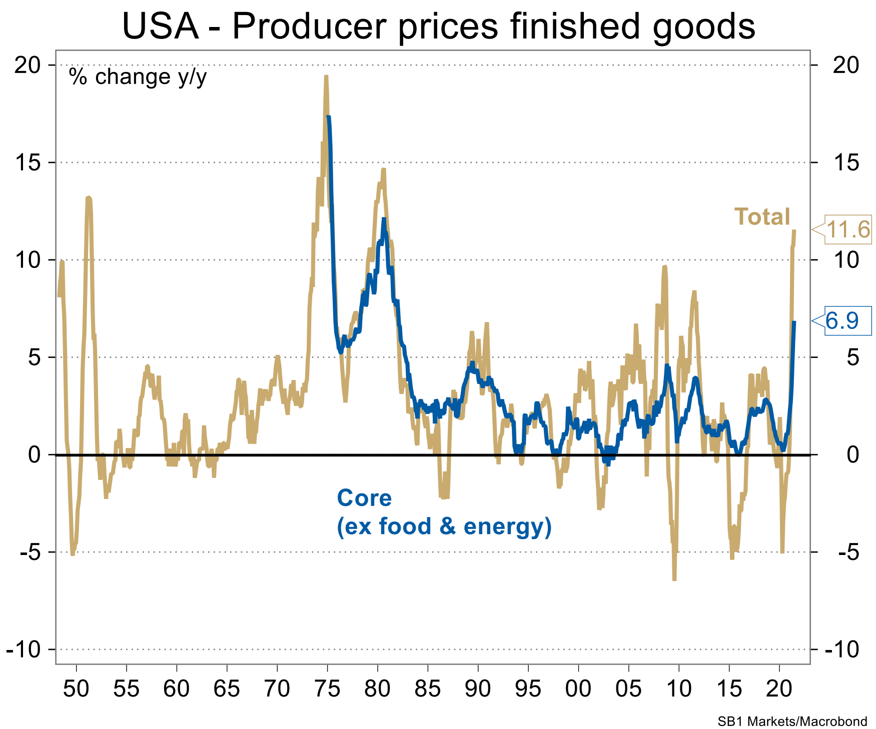


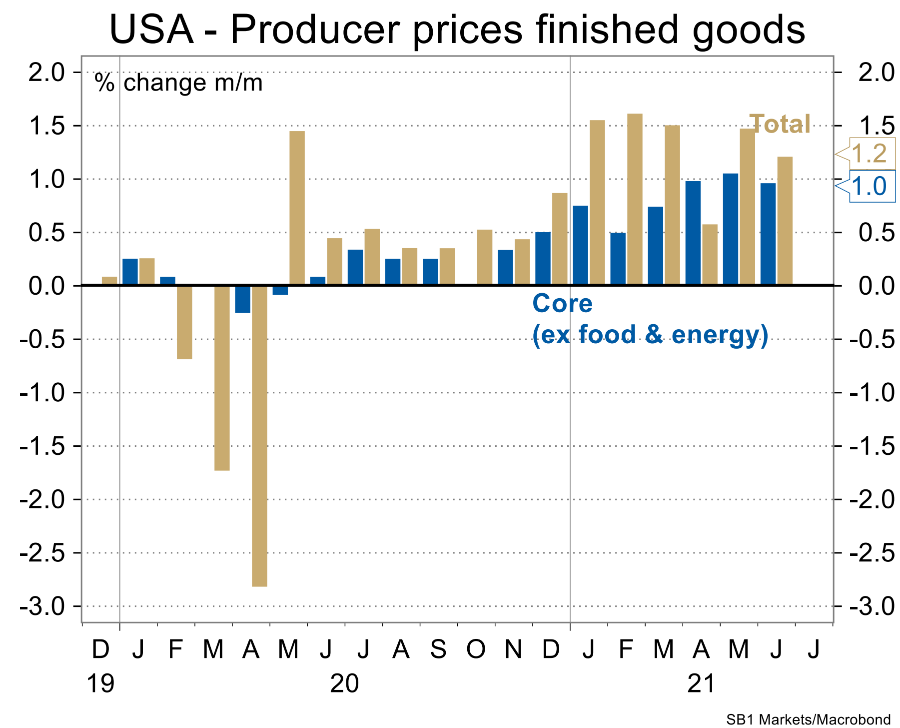


- Exporters in other countries have so far not been able to lift their prices for consumer goods when selling to the US – and they have had to cut prices, measured in their own currencies!

Producer prices further up of course, and yet again more than expected

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

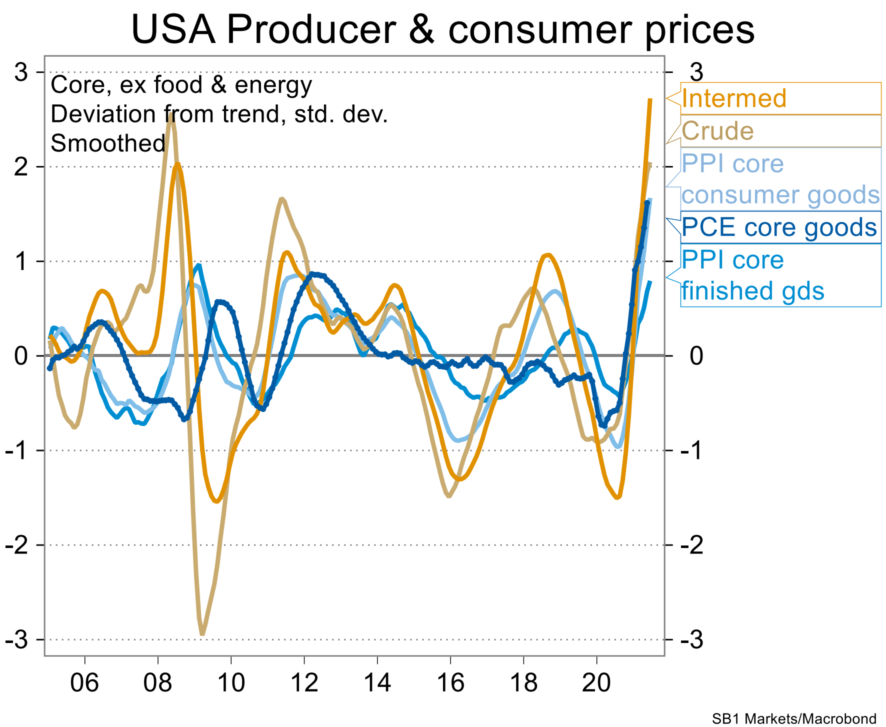


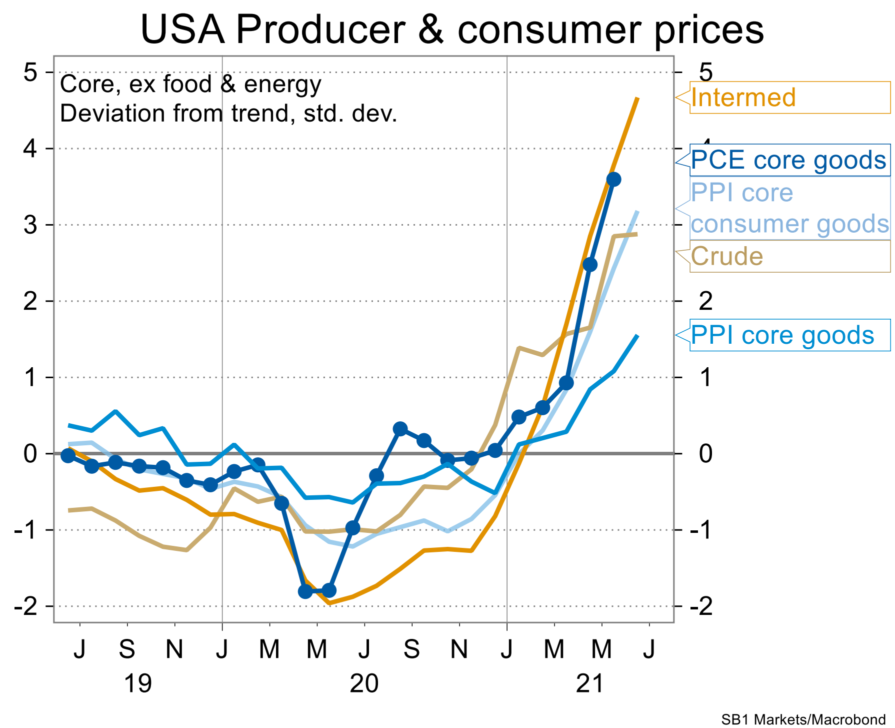


- **Core finished goods x food & energy** PPI rose 1.0% in June, from 1.1% in May. The annual growth rate accelerated 1 pp to 6.9%, the highest level since 1982
- **Headline finished goods PPI** rose 1.2% m/m, as energy prices contributed on the upside again, in line with the monthly growth recent months. The annual rate was up 0.9 pp to 11.6%% - highest since 1982 too
- **The 'official' total final demand PPI**, including **services**, rose by 1%, expected 'just' 0.6%. The index is up 7.3% y/y
- The PPI confirm what business surveys have told us; No more, no less

Price pressures are increasing sharply

…at some point costs will be passed on to a greater extent

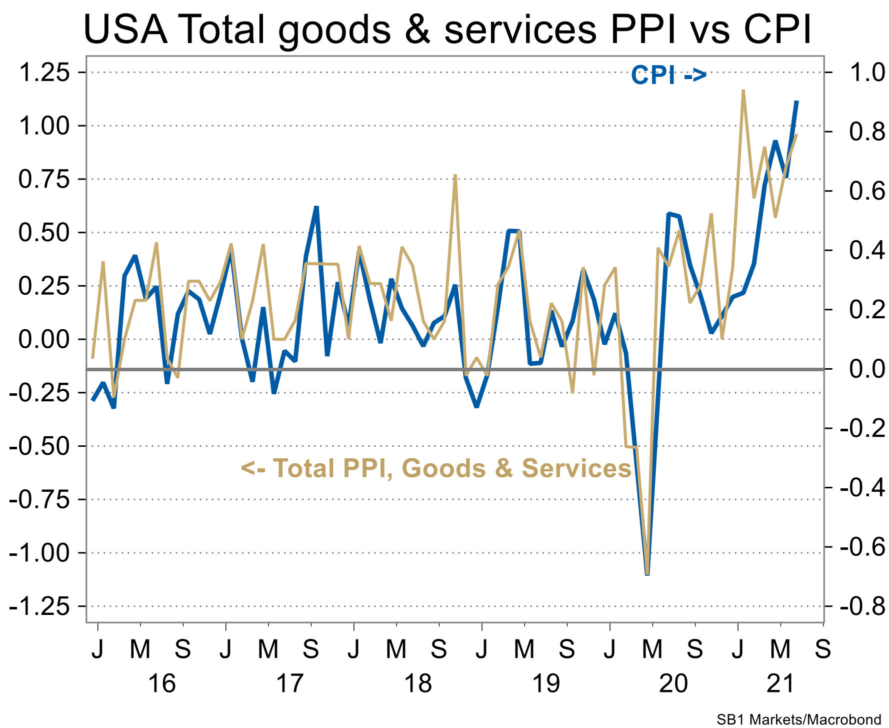


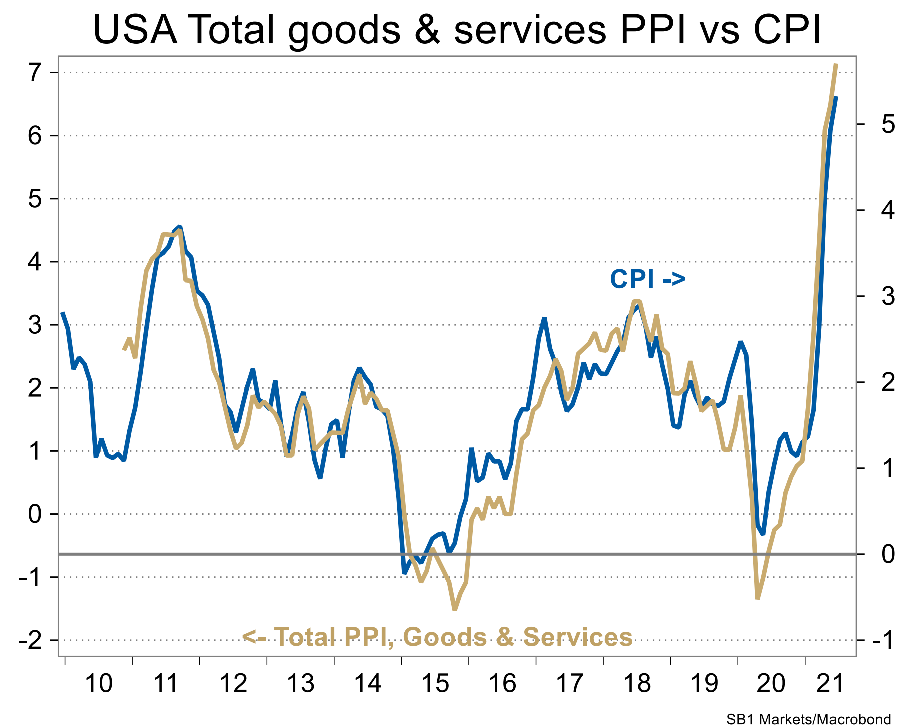


- Delivery times & prices are on the way up – and production is increasing rapidly. Hmm…
- It seems likely that finished goods PPI will climb further, given the continued increases in crude & intermediate goods
- Crude goods prices are leading intermediate goods by 4 months, and consumer prices by 12 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

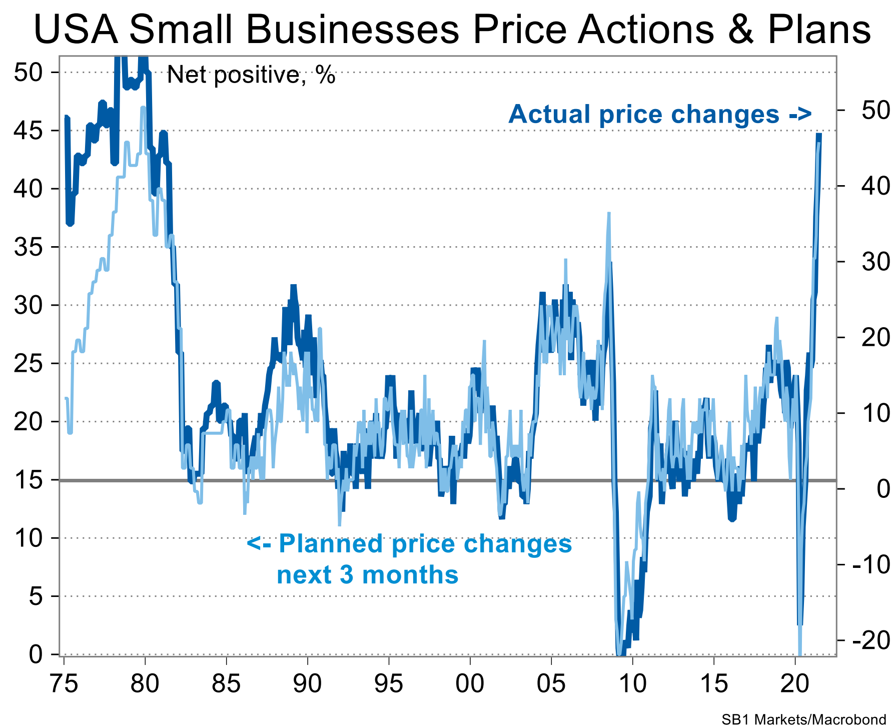
The total 'new' total PPI rose 1% m/m, and is up 7.3% y/y, signalling a 5.5%+ CPI growth

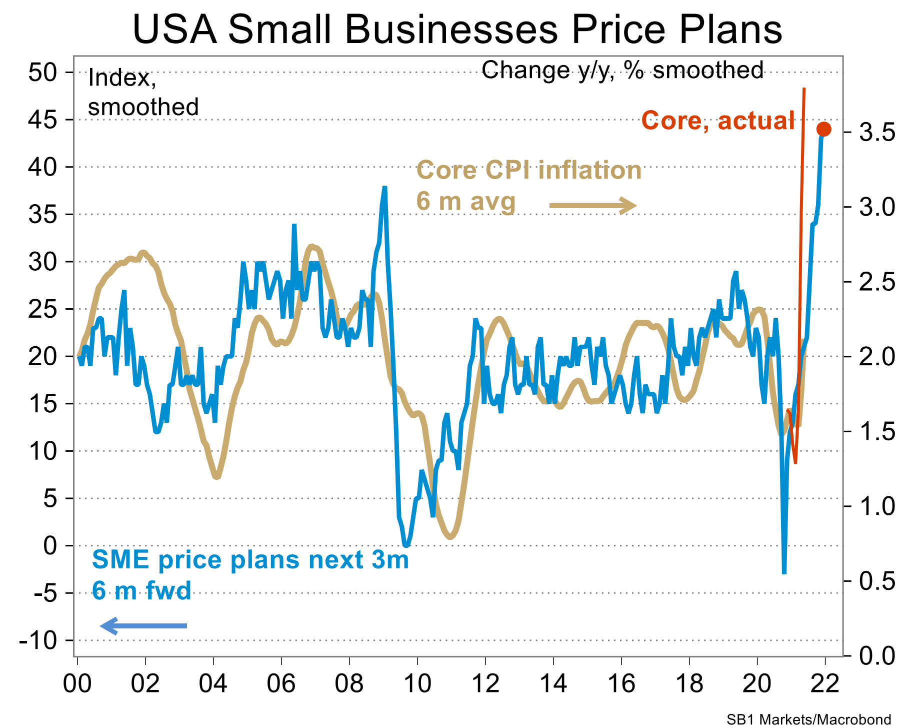




A warning sign: Even more (SMB) businesses say they plan to raise prices…

We hope you will never see anything like this again

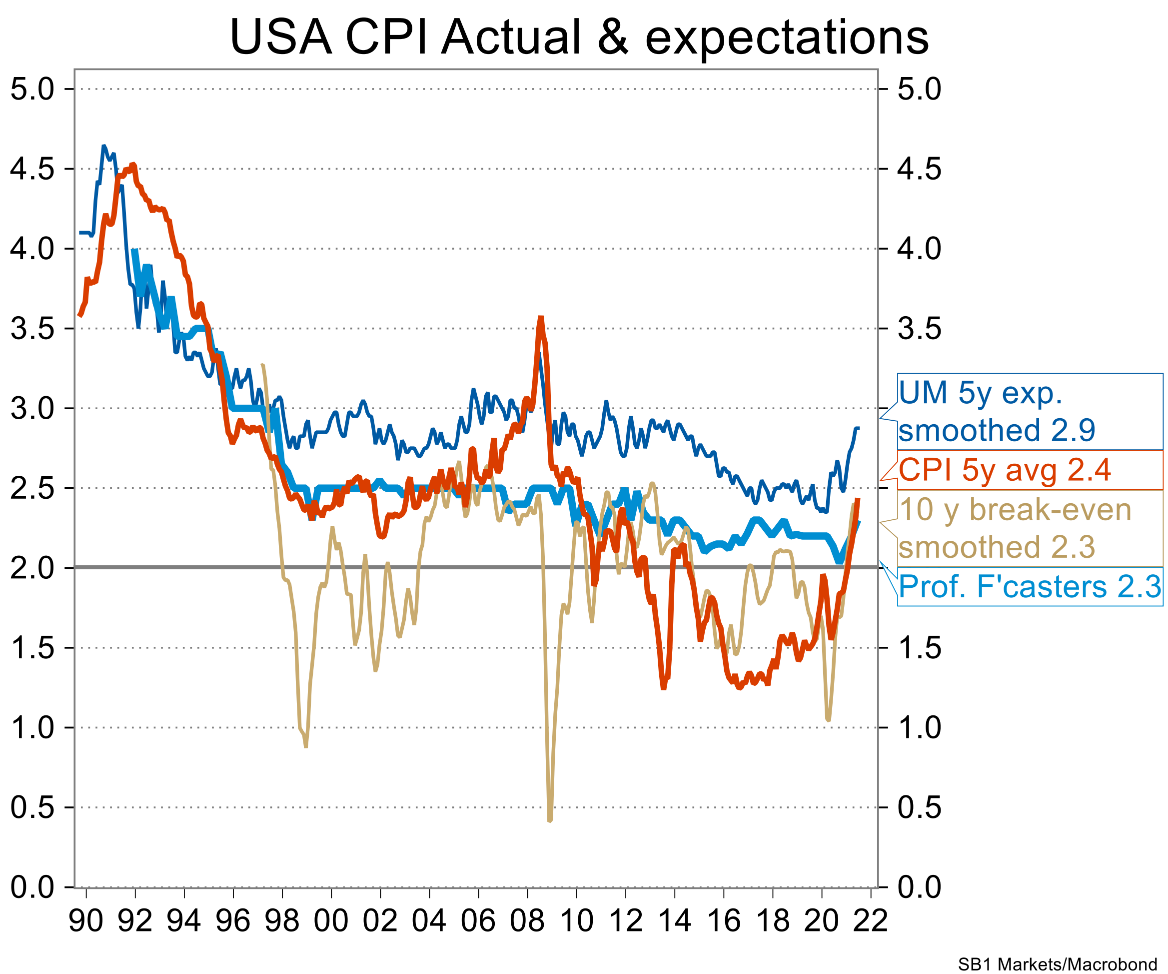




- It is long time since last time anyway, in December 1979, when price plans were as aggressive as today. *And it lasted just one month*
- It is challenging to calibrate the SBM survey vs. actual inflation as the present print is so extremely far off the chart vs. the past 35 years experience. But surely, it tells us something…
- Other business surveys confirm that something special is happening, more companies than in decades are reporting that they have increased and/or that the expected to increase their selling prices

Inflation expectations are drifting up but are not yet worryingly

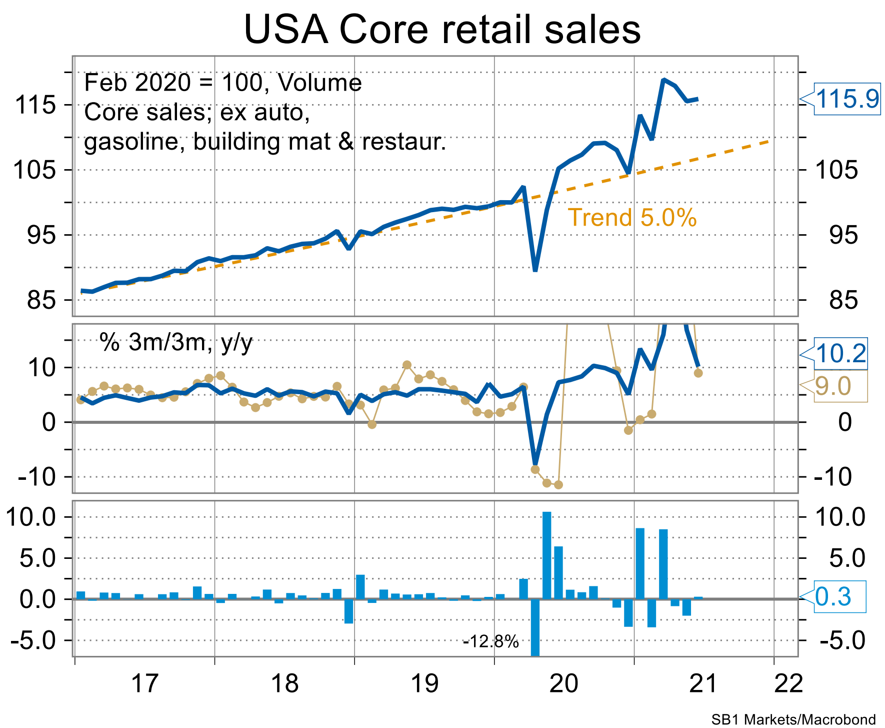
Univ. of Mich survey 5 y inflation expectations have climbed to 2.9% from 2.4%

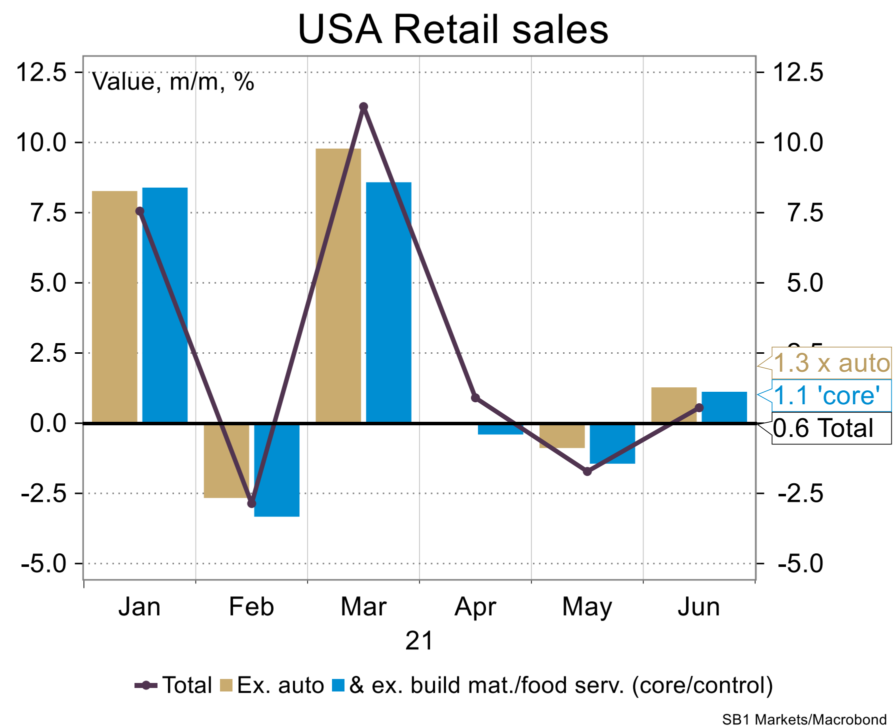


- **The UM's survey's** 2.% rate is close to the highest in 10 years (2.9% smoothed at the chart to the left), and it is 0.4 pp higher than before the pandemic (2.5%)
  - » Still the level is not far above the past 10-year average – but it is a sign for the Fed, of course
  - » The UM short term inflation expectation at 4.6% is the highest since 2011, up 0.9% from March. These expectations usually correlated to recent changes in energy prices – like now
- **Professional Forecasters** expect a 2.3% 10 y rate of inflation in Q2, according to Philadelphia Fed, up from 2.0% in Q4. The Q4 level was the lowest ever, and 2.3% is just marginally above the past 7 years average, and it refers to CPI, which over time grows 0.3 pp faster than Fed's referred inflation measure, the PCE
- The 10 y **break-even (CPI) inflation expectation** has fallen to 2.32% (not smoothed) from above 2.5%. Not too high for Federal Reserve

Retail sales back up again in June and incredibly strong!

Sales volumes are now 16% above the Feb-20 level!

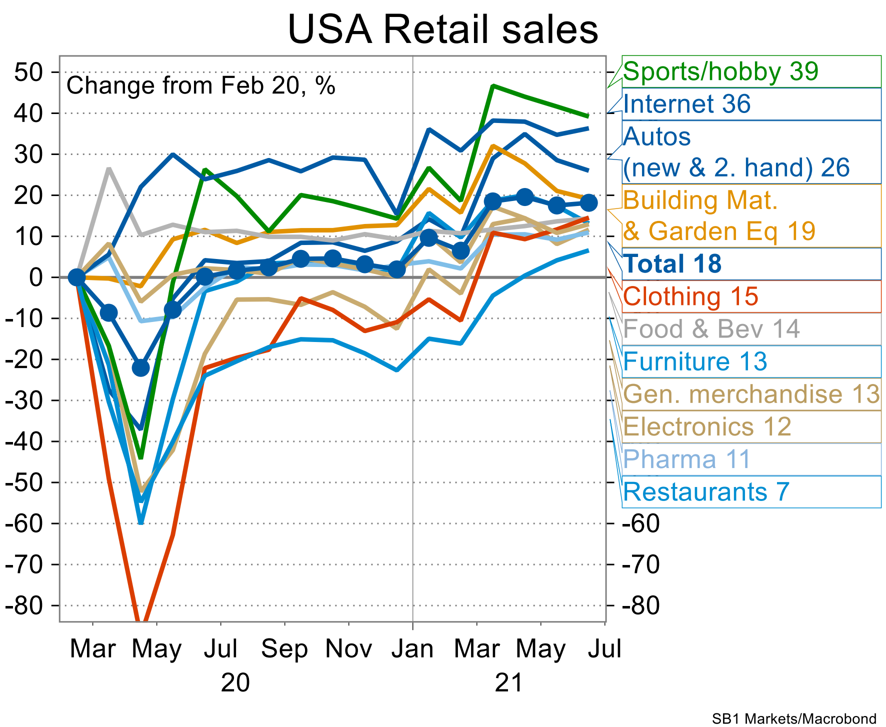


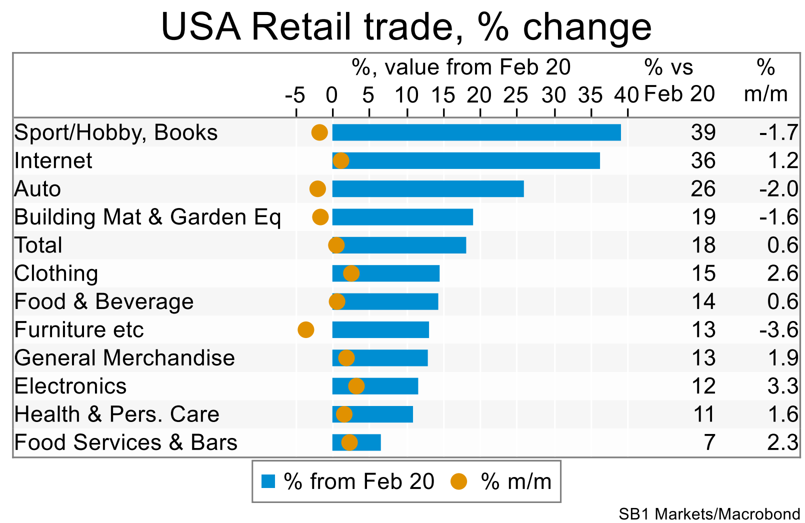


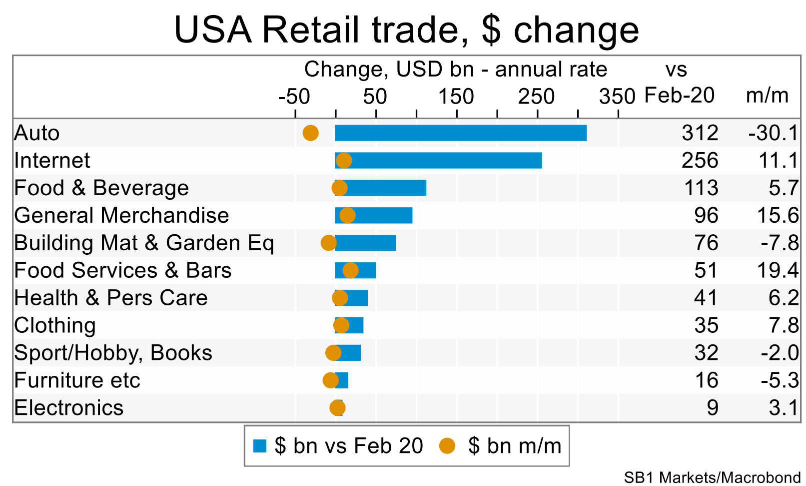
- **Total nominal sales** rose by 0.6% in June, expected down 0.3%. May sales were revised downward by 0.4 pp to -1.7%. Nominal sales are up 18% vs. the pre-pandemic level!
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) rose 1.1%% in June, expected up 0.4%, offset by a downward revision of May sales by 0.7 pp to -1.7%. The level is 16% above the Feb-20 level. The downside is substantial the coming quarters
- Sales in restaurants & bars rose 2.3% m/m and is 7% above the Feb-20 level! Sales of autos, sport equipment & furniture fell in June
- 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

Most sectors up in June – and restaurants are now 7% above the Feb-20 level!

Sales of furniture fell 3.6%, but remains 13% above Feb-20







Last month

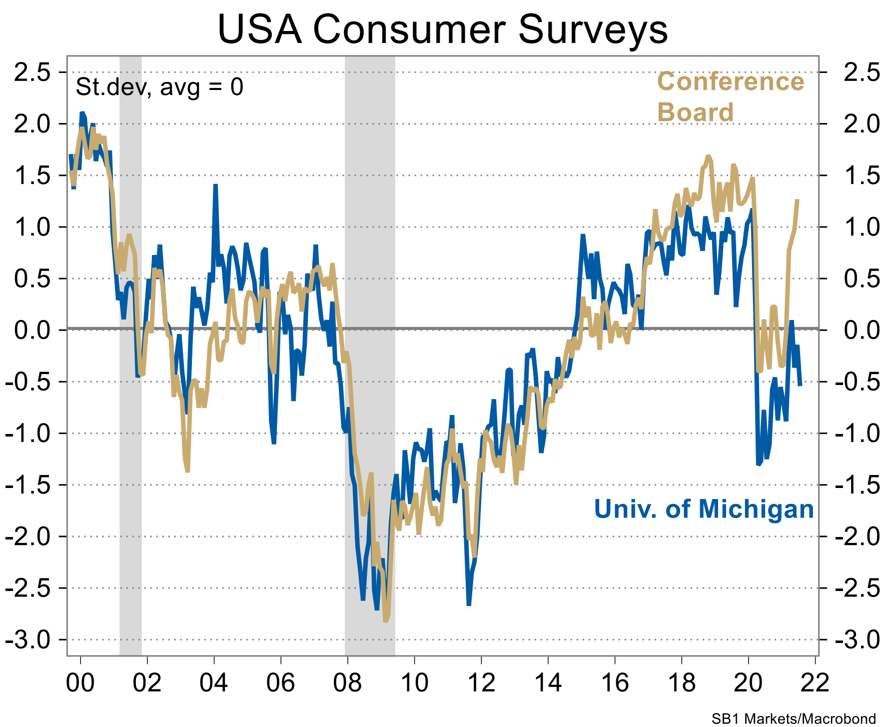
- 7 out of 11 main sectors reported a increase in sales in June. Downward revisions of May sales in many sectors

Since pre corona: All sectors up

- **Restaurants** are now 7% above the pre-Covid level
- **Clothing** are on the way up, are up 15% vs. Feb-20, was down until March!
- **Sports equipment** (+hobby/books) is up 39%, while auto sales are +26%

Univ. of Michigan: Consumer sentiment sharply down in early July!!

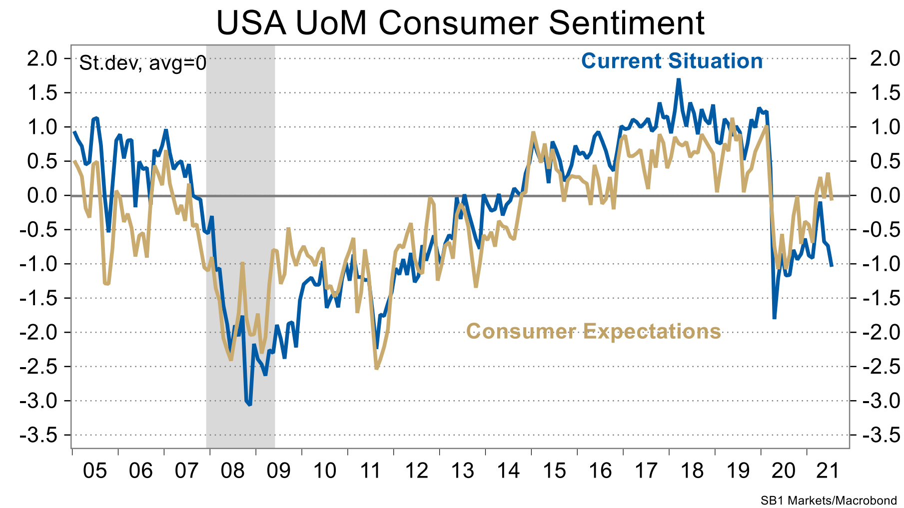
The current situation is deteriorating amid increasing (short term) inflation expectations

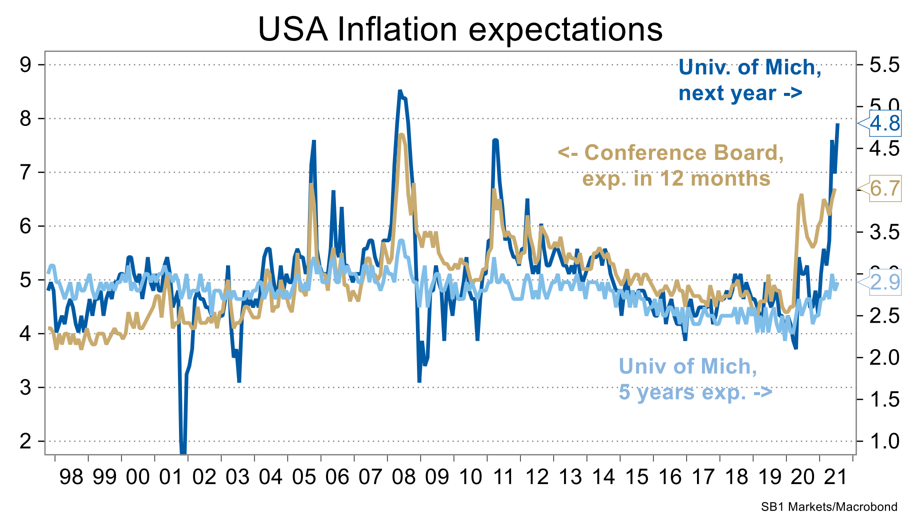


- **The UM sentiment index** fell to 80.8 in July, from 85.5 in June, expected up to 86.3. The decline equals 0.4 st.dev, the level is 0.5 st.dev below par, the lowest since February
  - The decline recent months are due to a decline in assessment of the current situation, while expectations are on par
  - The assessment of buying conditions for big items fell sharply in July – and the level is far below average
- **Inflation expectations** are have increased recent months, and rose sharply for the coming year, highest since 2008 (more next page)
- Until June at least, **Conference Board's Consumer Confidence survey** has moved rapidly upwards, to 1.3 st. dev. above average. The discrepancy is the largest in 40 years!
  - The IMD/TIPP survey is close to Conference Board's survey, while University of Florida agrees with Univ. of Michigan. Strange divergences
- **On average, available consumer surveys** are slightly above average and well below the pre-pandemic level
- The contrast to **consumer confidence in EMU** striking. Here confidence is far above an average level, and above the pre-pandemic level – even if the reopening of the economy has lagged months vs. US

Univ. of MI: Consumer sentiment sharply down in early July!!

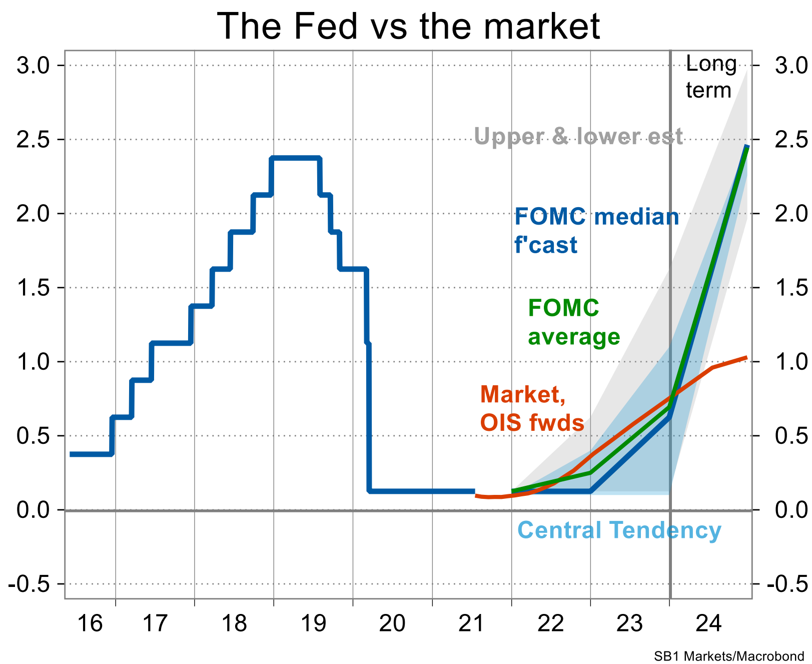
The current situation is deteriorating, (short term) inflation expectations are increasing





Beige book: Growth accelerated to a moderate to robust pace

Wage and price pressures increased further



- The debate has started within the Fed, also in public:
  - At the June meeting, FOMC members talked about the need for adjusting the Fed's stimulus programs if the recovery continued at a brisk pace. Inflation is the highest in 12 years and it is broad based (i.e. it is not all transitory), and although the Fed claims there is a way to go with regards to the job market, jobs growth has not been weak. At the current pace of economic and jobs growth, we believe a September tapering announcement is likely, as the Fed has promised the market an announcement in 'ample' time

- Growth accelerated to a **moderate to robust pace** in most districts past six weeks, according to the Fed's 12 district banks. Eased restrictions, and increased vaccination cited at reasons for increased activity and outlook
  - 6 districts reported strong growth (up from 3 districts 6 weeks ago)
  - 6 districts reported modest to moderate growth
- **Demand for leisure/hospitality services** have picked up as restrictions have been eased and vaccinations have continued. Both **retail sales** grew at a moderate pace, while auto sales were weaker due to supply-side issues
- **Manufacturing** reported above-average growth, despite supply chain challenges. Manufacturers reported of widespread shortages of both labour and materials. The **housing market** is still going strong. In fact, homebuilders are not able to meet demand due to capacity constraints. **House prices** are (of course) still climbing, as supply is limited
- Most sectors are reporting further growth in **employment** but growth is slowing – and difficulties attracting qualified workers persisted
- **Wage inflation** accelerated and many districts are seeing an upward pressure on wages, which is expected to increase over the coming months. A growing number of firms offered signing bonuses and increased wages
- **Input prices** increased sharply and the increases are broad. There are also widespread reports of **increased selling prices** as well.
- **In sum:** The reports out of the 12 districts keep getting more positive: the economy is recovering and although Powell stated that tapering is 'a ways away', an announcement in Sept does not seem unlikely…

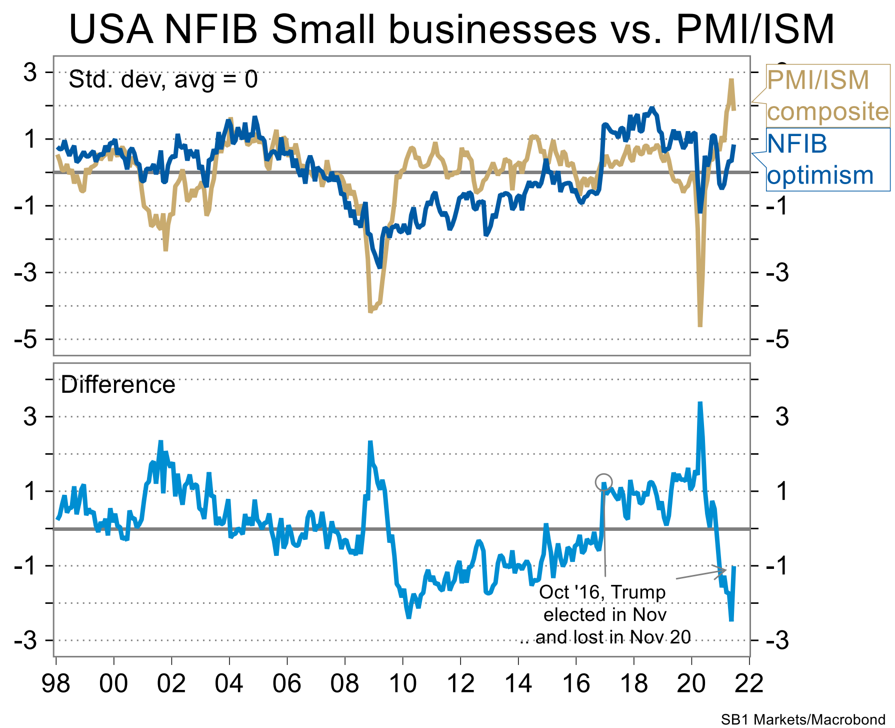
The Federal Reserve, the labor market, and the economy

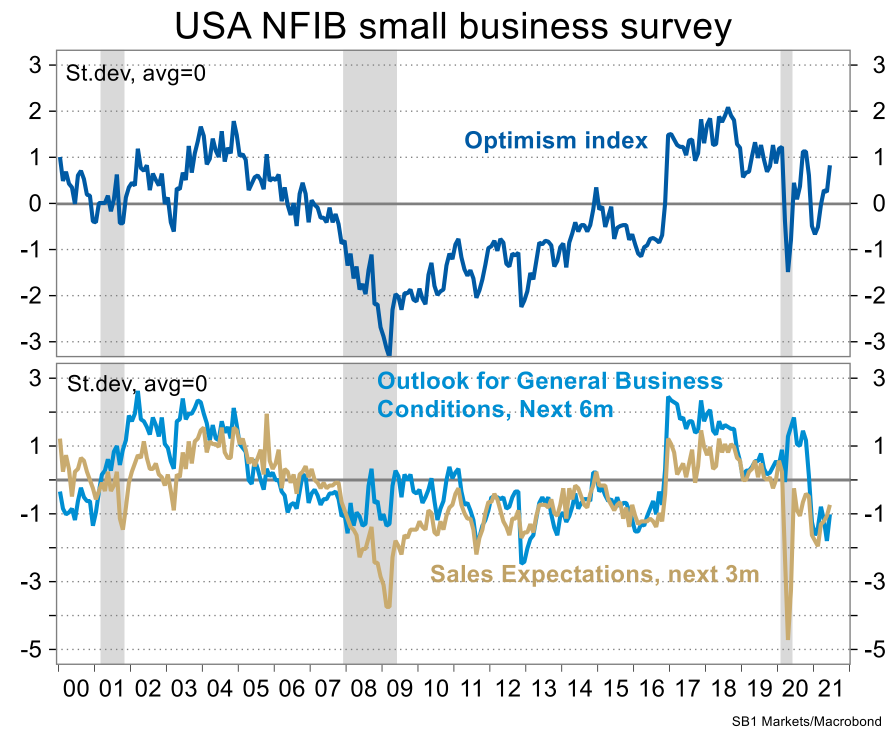
The economy is rebounding and prices are rising, but the tone from Powell remains soft

- **Powell is dovish, yet trying to assure that Fed will act in due time**
  - » Fed chair Jerome Powell spoke to Congress twice last week, and in his message he admitted that inflation had come in higher than what the Fed had expected, yet his tone was clearly dovish: *'We don't want to use our tools that risks the recovery',* citing that the risk to tightening policy prematurely are greater than the risk of doing so too late
  - » On inflation: *'This is a shock going through the system associated with the reopening of the economy and it's driven inflation well above 2%, and of course we're not comfortable with that' … ' "To the extent that it's temporary it wouldn't make sense to react to it'*
  - » On tapering: *'While reaching the standard of 'substantial further progress' is still a ways off, participants expect that progress will continue'*
- **Other Fed officials are more cautious**
  - » Mary Daly of the San Francisco Federal Reserve said in an interview with CNBC that *'It's appropriate to start talking about tapering our asset purchases, taking some of the accommodation we provided to the economy down'.* She also stated that the it is premature to talk about raising rates, and that the Fed just want to get through the fall and see how Covid develops
  - » James Bullard of the St. Louis Fed on Bloomberg: We're already above target on PCE inflation. Possibly going to raising inflations expectations – and we have made progress on the labor market. However, labor market is not fully healed. Committee is going to debate tapering at July meeting
- **While inflation is higher and it is broadening somewhat, and while several surveys show that businesses are continuing to raise prices and wages, Mr. Powell has a point: Many of the items experiencing price increases are due to base effects and temporary reopening factors, and employment is still 4.5% below the pre-Covid level. *Still, the risk for him being wrong is substantial***

Small businesses optimism to highest level since October last year

Small businesses cannot find workers and are raising compensation… and selling prices

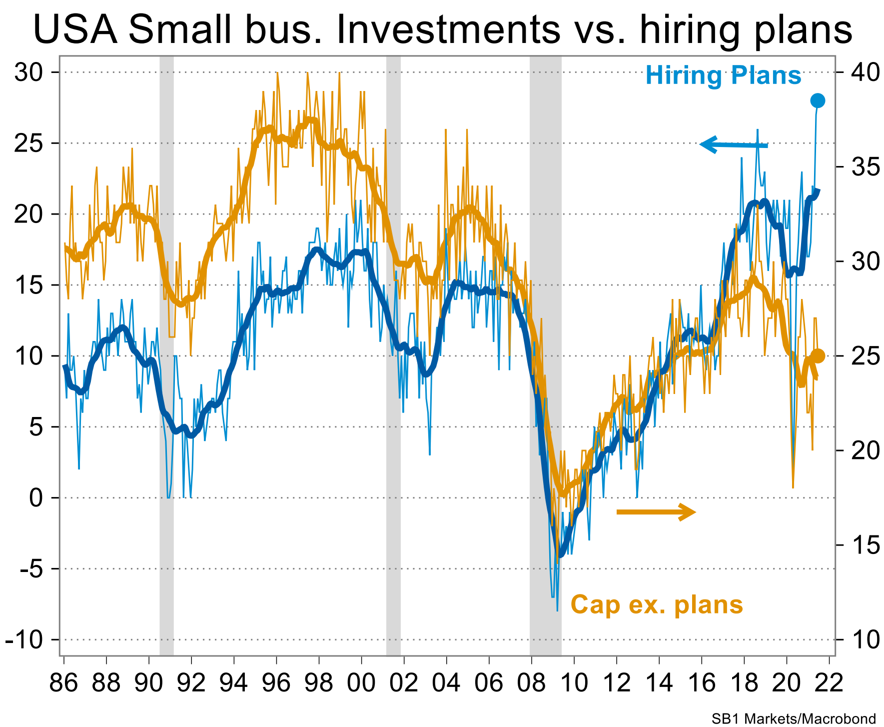


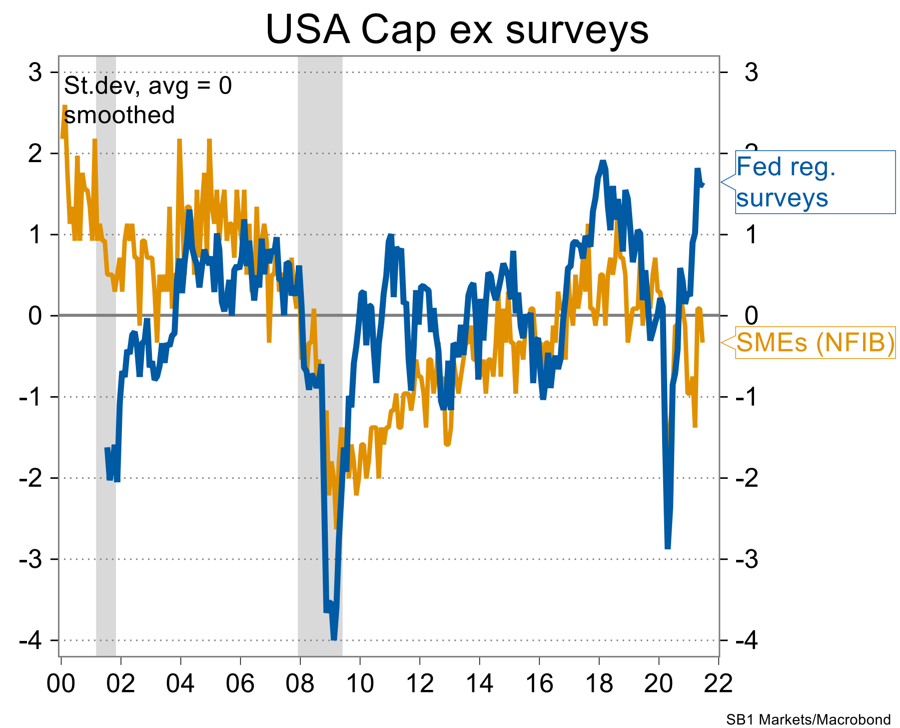


- The **NFIB optimism index** increased to 102.5 in June from 99.6 (expected down to 99.5). 7/10 components improved, while 3/10 fell. The index is above an average level but far behind the PMI/ISMs, and all other surveys
- **The outlook for the next 6 months** also increased in June and is currently 1 st.dev below par, which does not seem reasonable at all, amid the reopening of the US economy, but lack of qualified labour and inflation worries rattle small businesses
- **Investment plans** were down and are now below an average level
- **Hiring plans** increased 1 p in June and are at a sky high level. However, the SMEs are not able to **fill their vacancies. Even more businesses say they plan to raise prices…**
- **Actual & planned price increases** are soaring – like we have never seen before (barring 1 month in 1979…, see more here)

Hiring plans to new ATH, investment plans slightly down and below average

(but companies are not able to fill vacant positions)

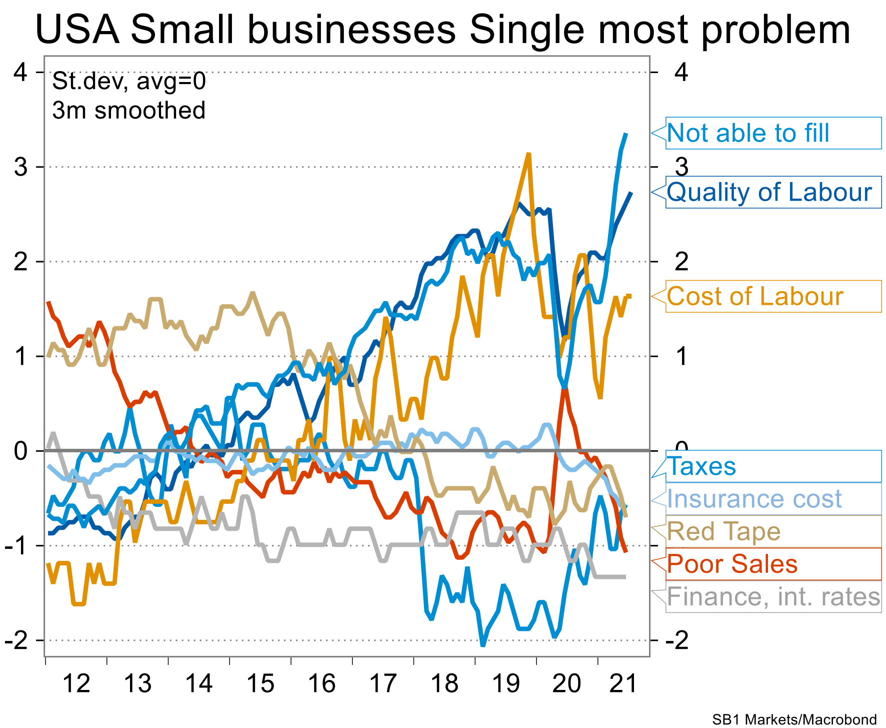


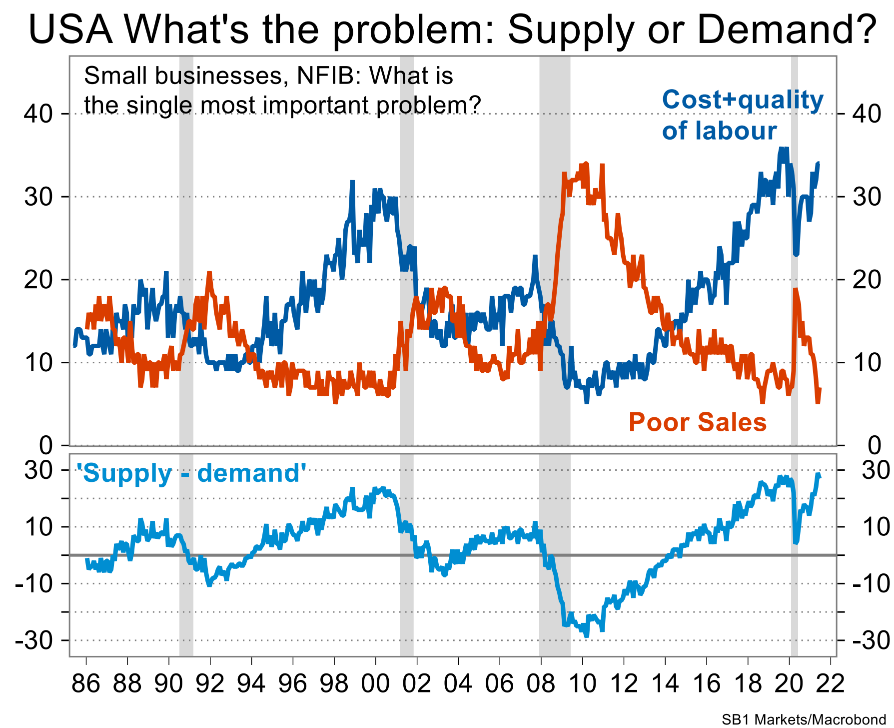


- Other investment surveys are more upbeat than the small business survey

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

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

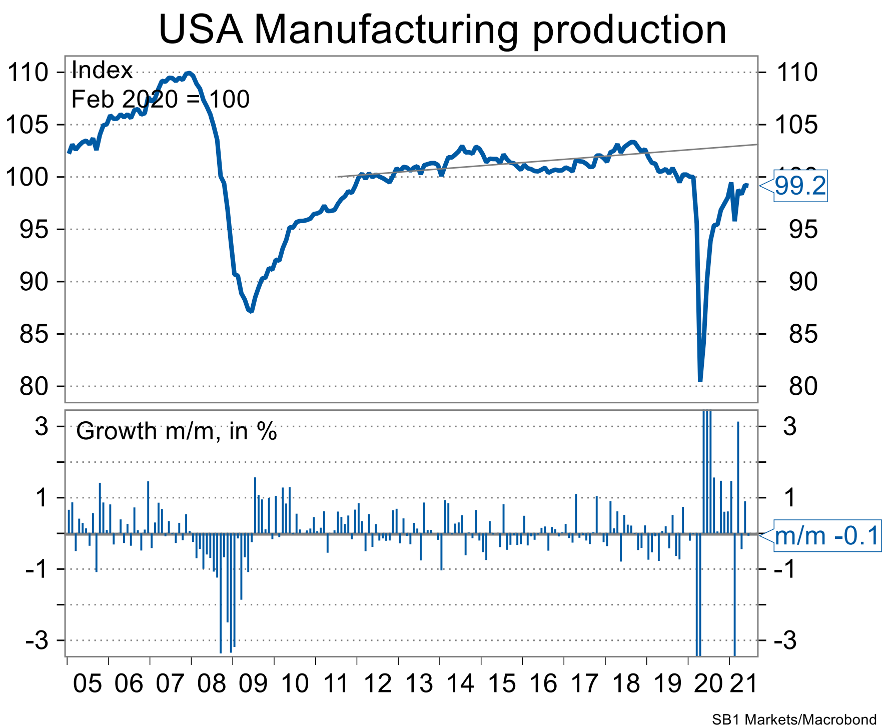


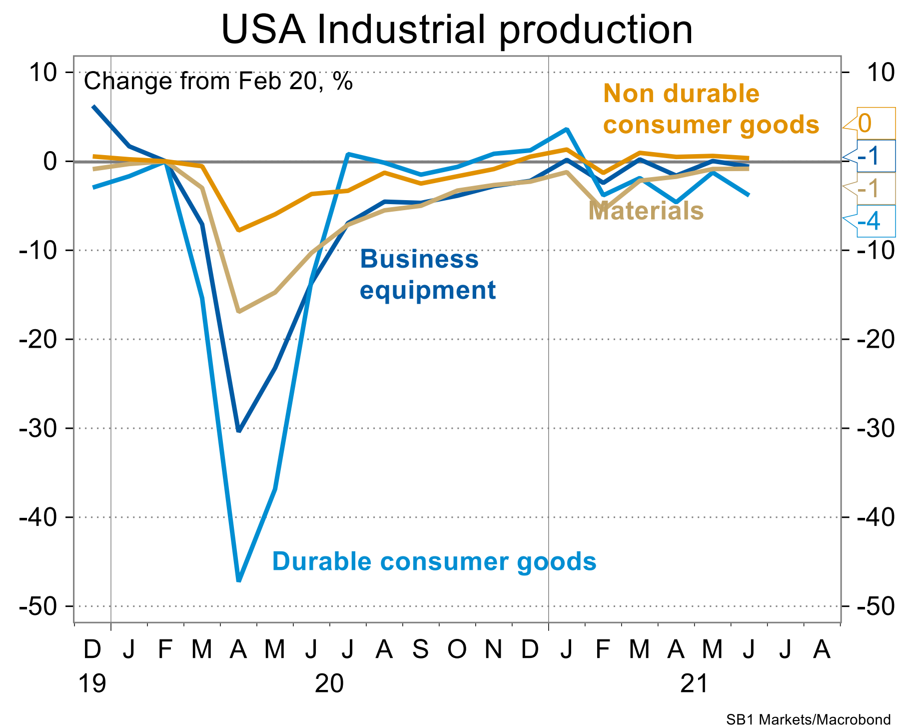


- While more businesses than normal stated **weak sales** as the major problem during the pandemic, there were never that many, and <u>now fewer than the average share of companies say than poor sales is the problem</u>
- **Availability, quality, and cost of labour** is a much more serious problem than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

Manufacturing production down 0.1% in June, down just 0.8% vs. Feb-20

Auto production again mostly to blame but other sectors do not shine either

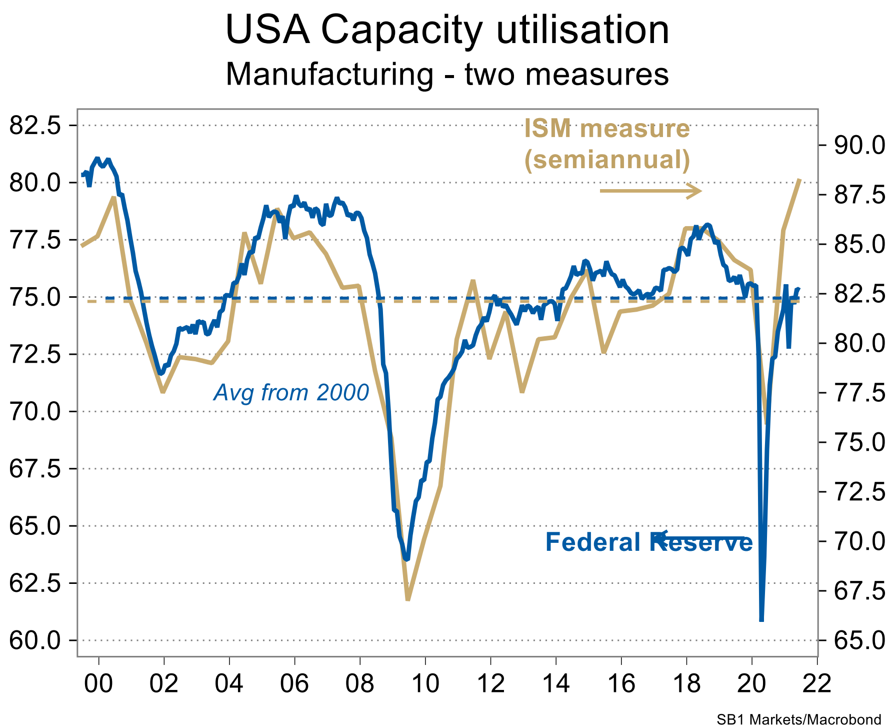




- **Manufacturing production** fell 0.1 pp in June, expected up 0.6%
  - » Auto production fell 6.6%, following a 7.3% lift in May. As a result, production of durable consumer goods & business equipment fell in June
  - » Ex motor vehicles (and parts) manufacturing production rose by 0.4%
- Production of **non-durable consumer goods** fell marginally in June, while production of **materials** continued upwards
- **Total industrial production**, including utilities, mines/oil production rose by 0.4%, expected 0.6%
- **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?

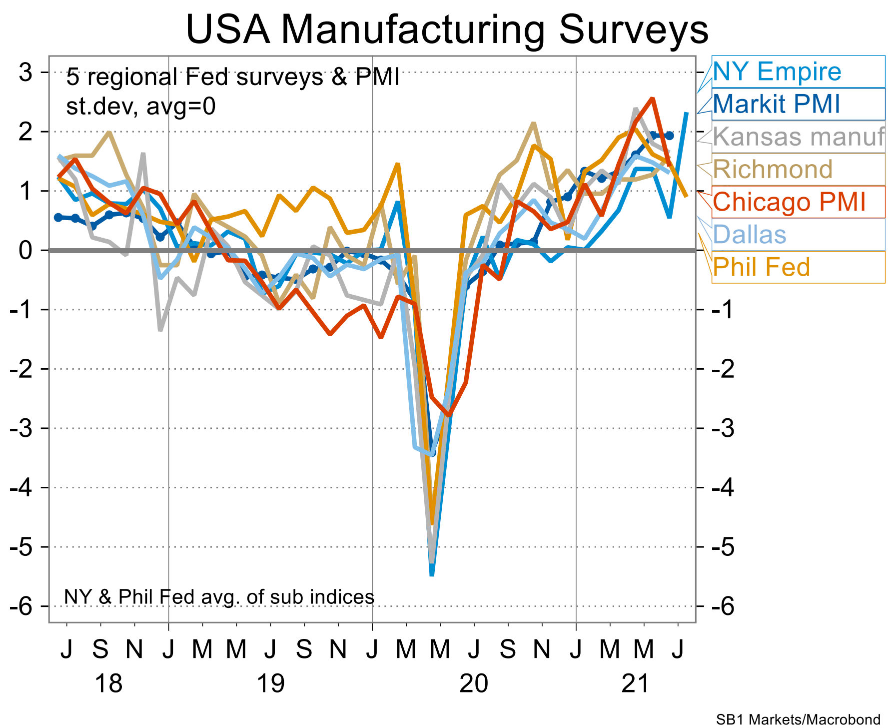
Not an irrelevant question

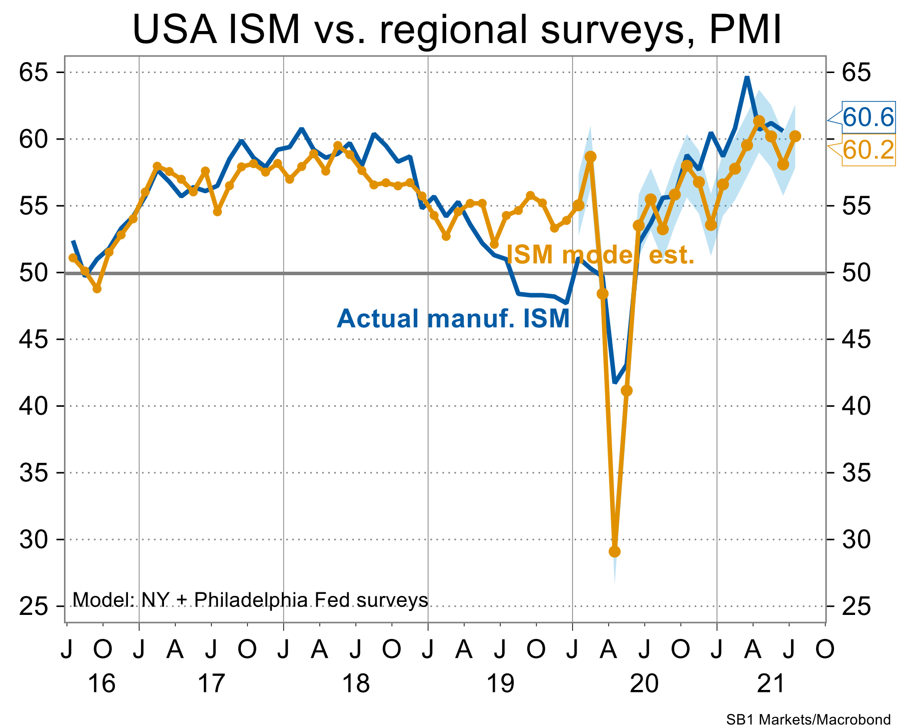


- **The Federal Reserve's** measure now yields a slightly above normal capacity utilisation rate, in line with the pre-pandemic level
- **ISM's semi-annual** survey reported a further sharp increase H1/May, the highest level ever – however with data just back to year 2000. These two measures have not 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, 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

NY Fed manufacturing survey surged in July

…while the Philly Fed survey was down

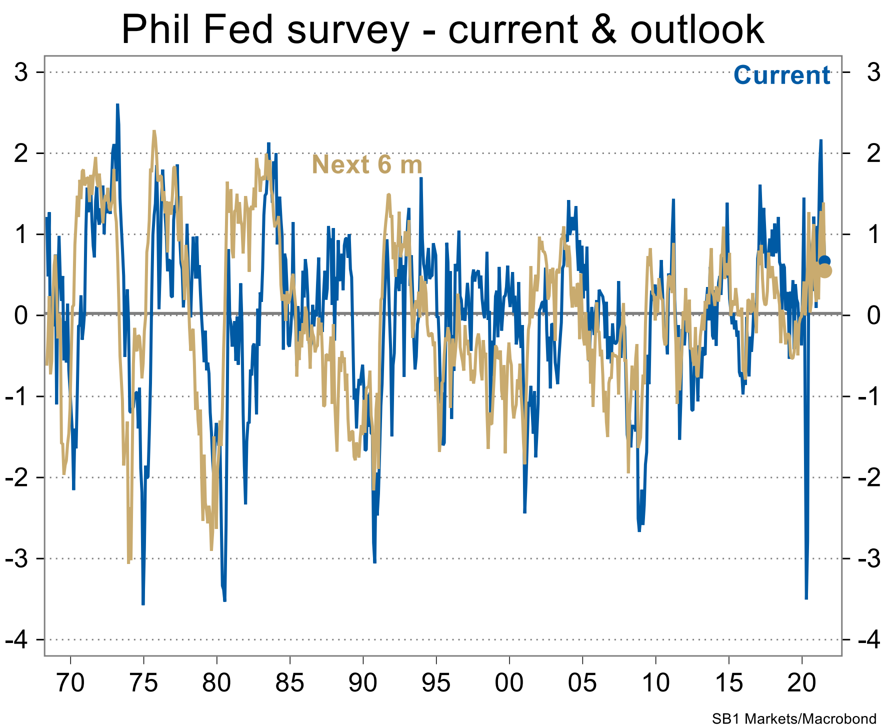


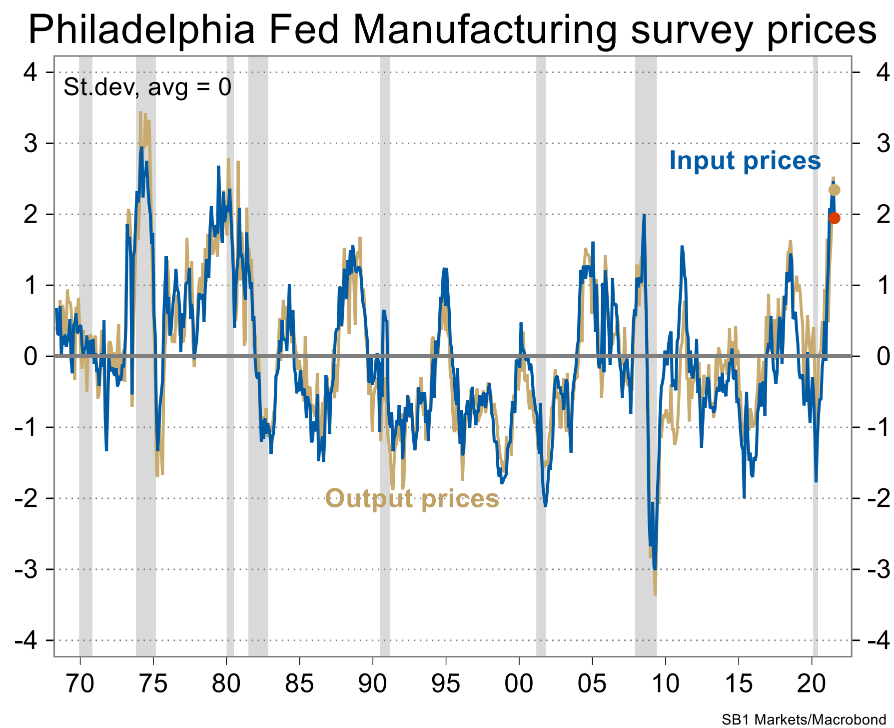


- Growth in orders fell in Philly Fed but rose in NY Fed's survey; same story for shipments and general activity. The one thing the two surveys could agree on is that price pressures and selling prices are continuing to increase
- The Phil Fed headline index was at 21.9 in July, down from 30.7, expected down to 28. The NY Fed index, on the other hand, rose to 43 from 17.4, expected 18
- Taken together the two regional indices signals strong manufacturing ISM in July too, if not necessarily even higher than in June

Philly Fed survey was down in July, but level still above average

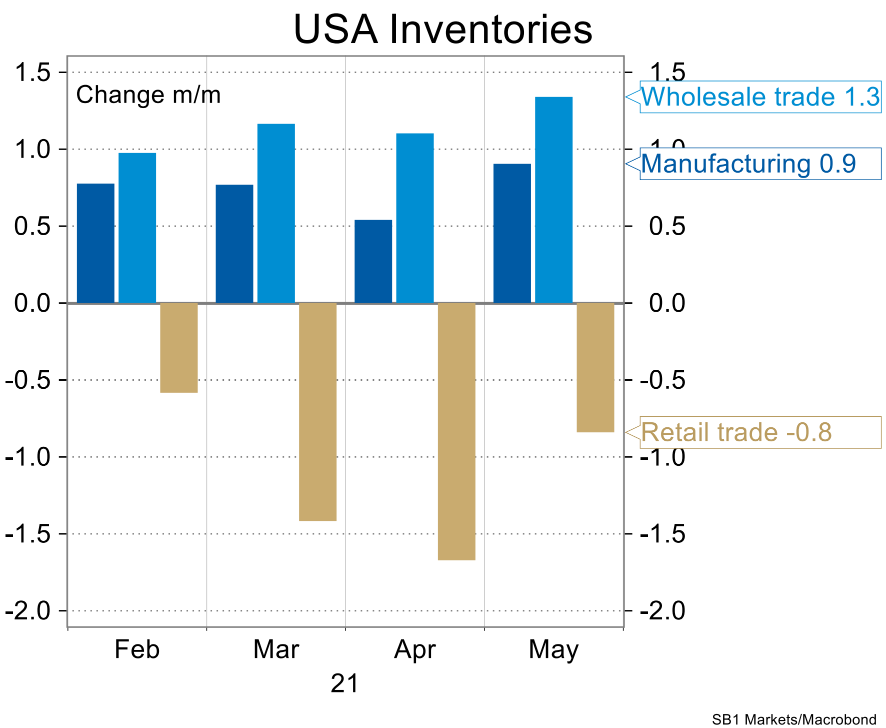
General activity, new orders, and shipments were all down. And prices are rising fast but not faster

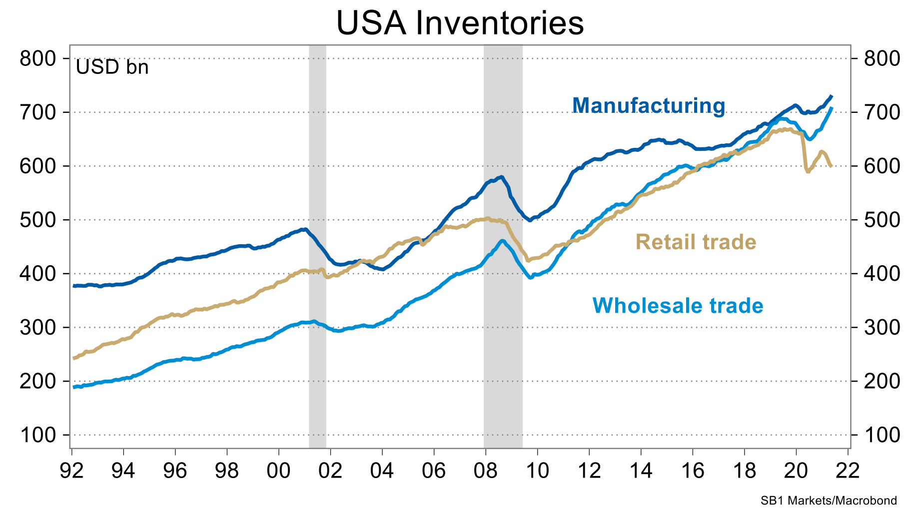


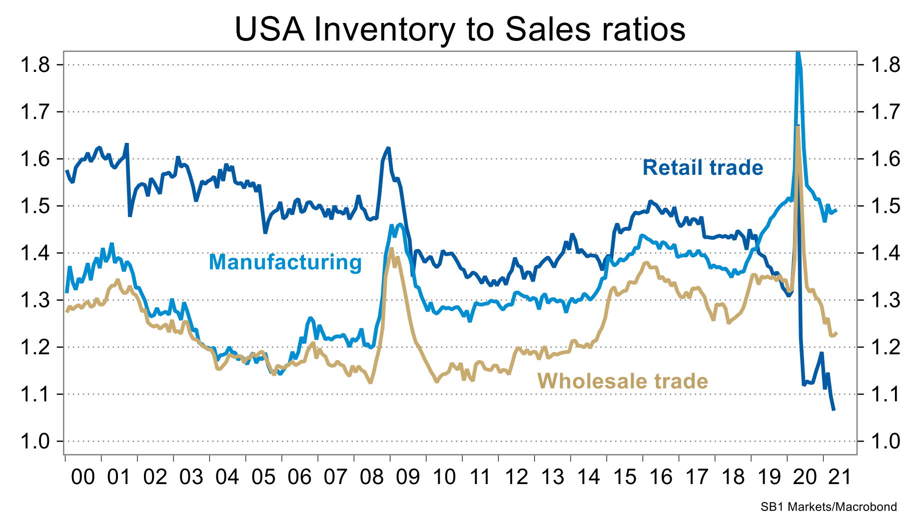


A further drawdown in retail inventories – but they are building elsewhere

Retail inventories fell 0.8% due to a further drop in auto inventories



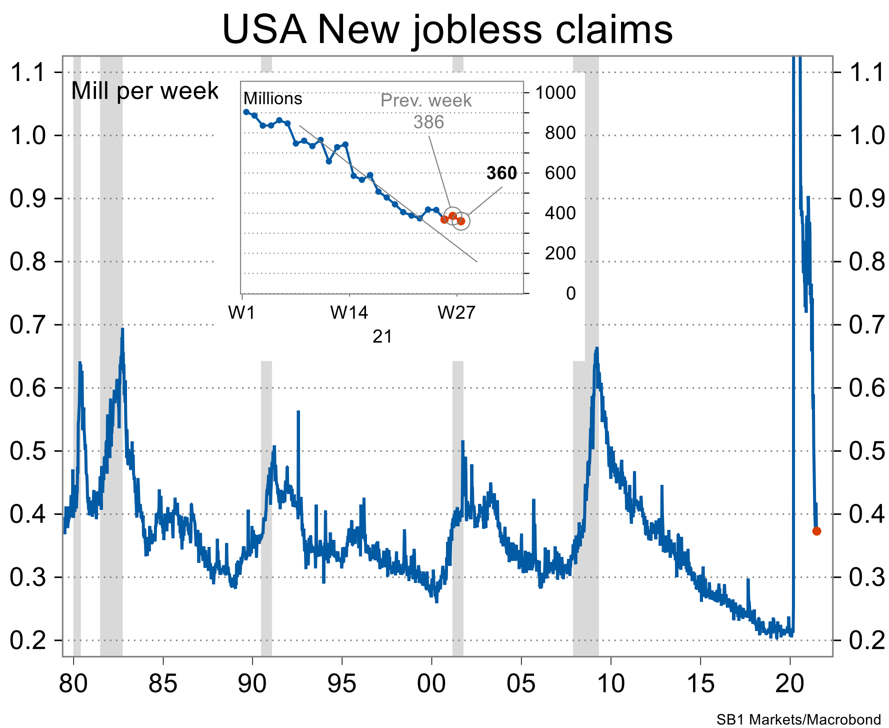


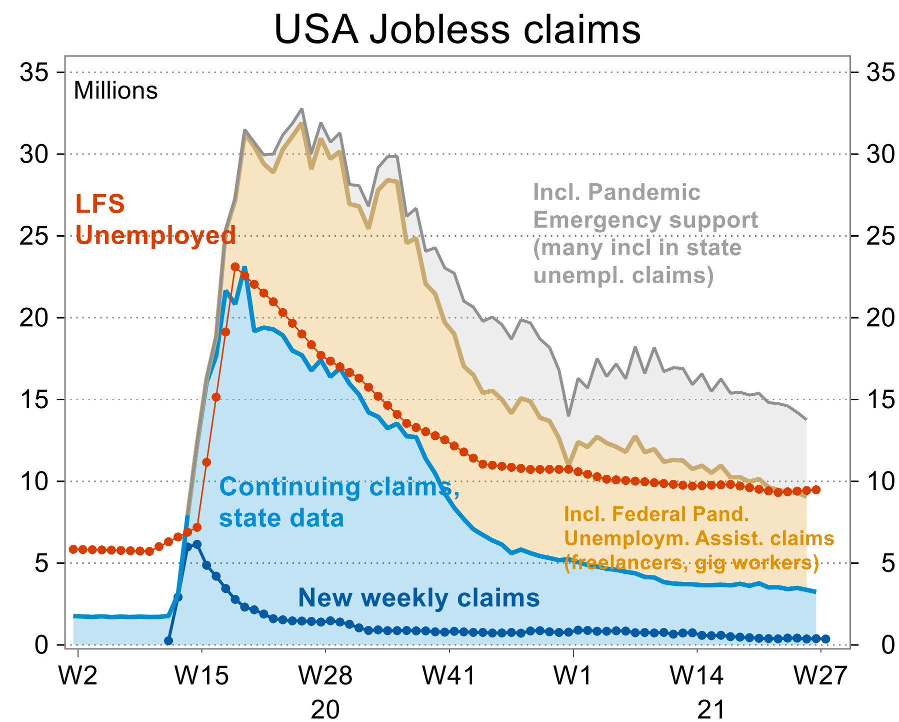


- **Retail trade** inventories are record low vs. record high sales but they are low in value terms as well
  - » Auto inventories fell sharply once more, by 5%, in total by more than 1/3rd since last spring
- Inventories were up in **wholesale trade** in May, but are probably too low as well
- A bit 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

New jobless claims fell to fresh low, but claims are now falling at a slower pace

New claims fell by 26’ to 360’ (previous week’s no. was also revised up by 13’), expected 360’

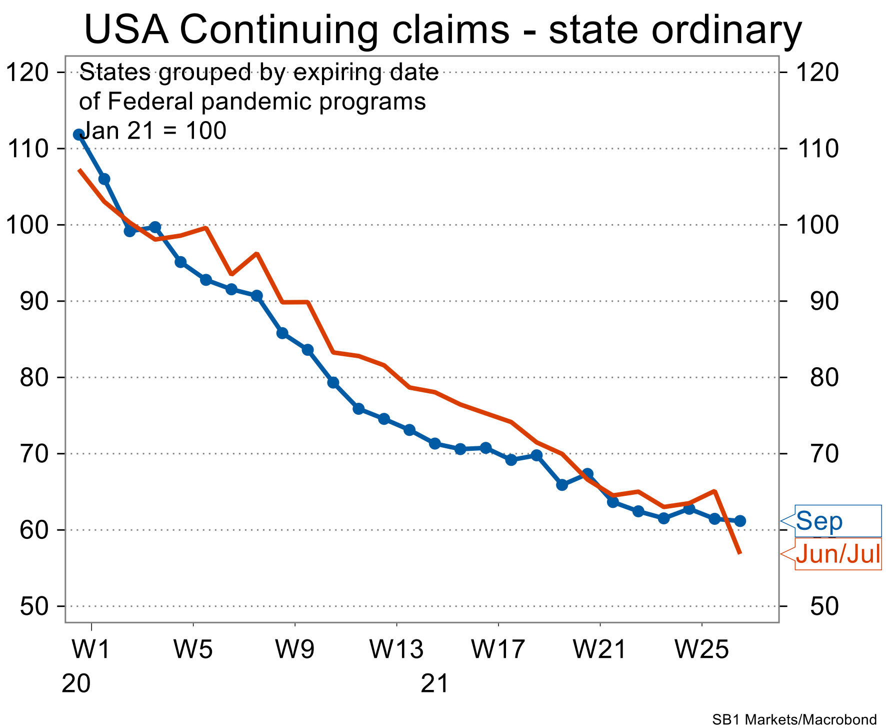




- **New claims** fell to 360’ from 386’ (revised up from 373’) the previous week, as expected. 6 weeks ago, just 375’ asked for a new benefits, and had the trend been intact, the weekly inflow should have been below 240’ by now. The decline in new claims has clearly stagnated. We know that businesses are saying that it is hard to find the right people, but with so many people out of work, the stickiness of the labour market is far greater than we had anticipated
- **Ordinary continuing claims** fell by 126’ to 3.24 mill, while the no. of receivers of the Pandemic Emergency Support Program (52 weeks instead of 26, and USD 300 extra/week) decreased by 198’ to 4.7 mill, and the no. of receivers of the Pandemic Assistance Program (gig & freelancers) fell by 138’ to 5.7 mill. The coming weeks these programs should be sharply scaled down as at least 25 states have opted out (see more next page)

Will the cancelling of pandemic federal benefit programs lift employment?

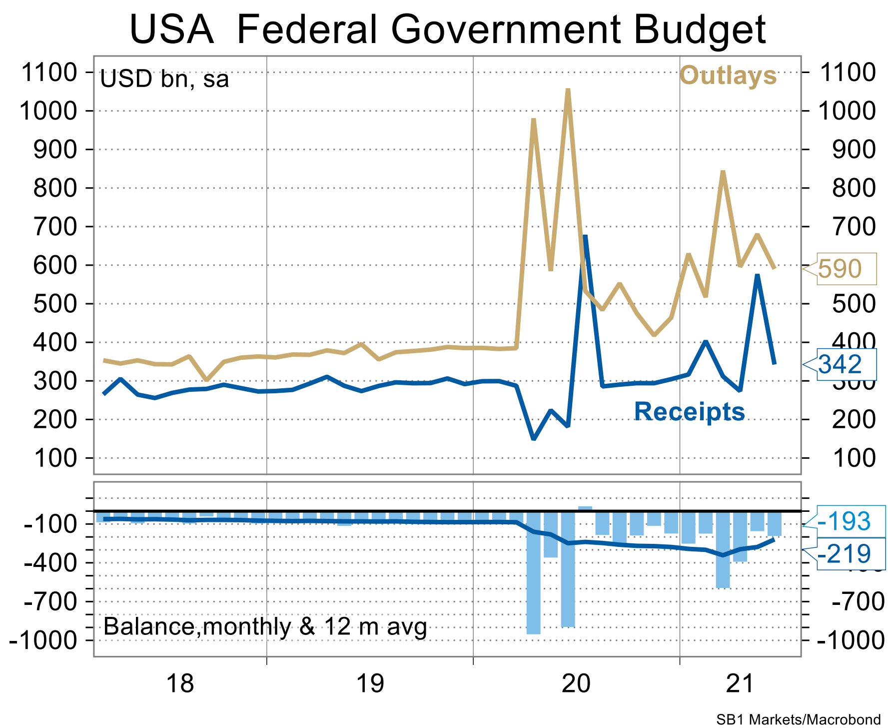
No clear message yet, state data are volatile

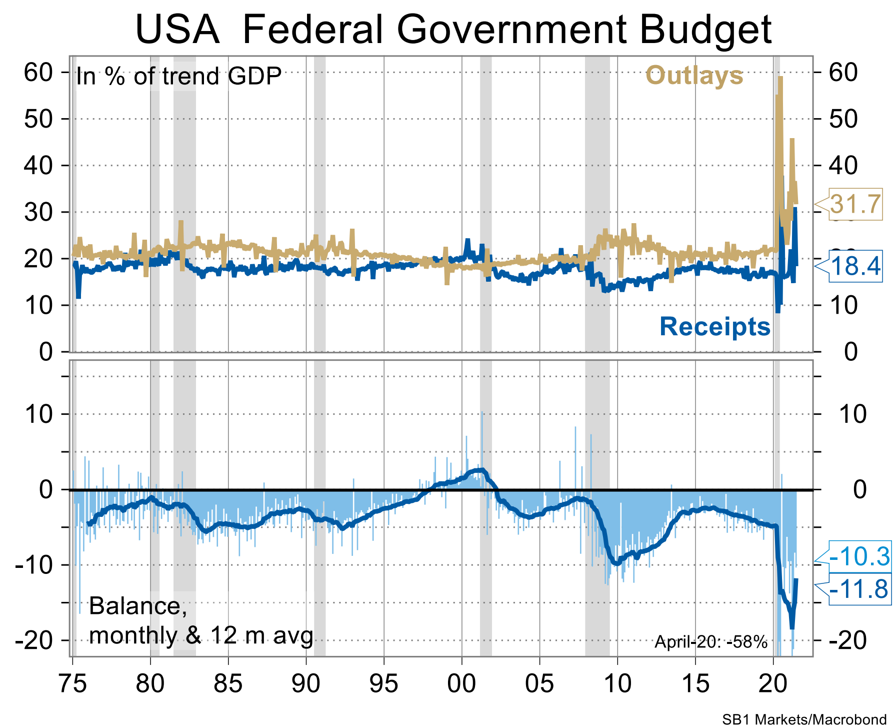


- 4 states dropped out of the federal unemployment benefit programs on June 12 (end of week 23), 8 states left June 19, and 10 states June 26, and 3 more states July 3 and 10 – which is the last week state unemployment benefit data are available
- We do not know what these former recipients do now – are they now trying to find a job?
- Media reports are mixed but there is no 'consensus' that employment has surges in the early leaver states
- If we pool the 'early leavers' in one group, we have not yet seen a significant reduction in the no. of recipients of ordinary state benefits among these states, but the no. fell sharply last week (following an increase the previous week)
- Most likely, we will have to wait for state employment data, which are published 2 – 3 weeks after the national payrolls report
  - » We doubt we will find much information in the June state employment data (date are gathered mid-month), but July data (published in August) could reveal some information whether labour supply increases or not. We think the odds of finding some impact are pretty good, if not already in July employment data

Budget deficit increased in June – deficit has now exceeded 2 trl for the fiscal YTD

The deficit was smaller than expected, but still equals 10% of GDP

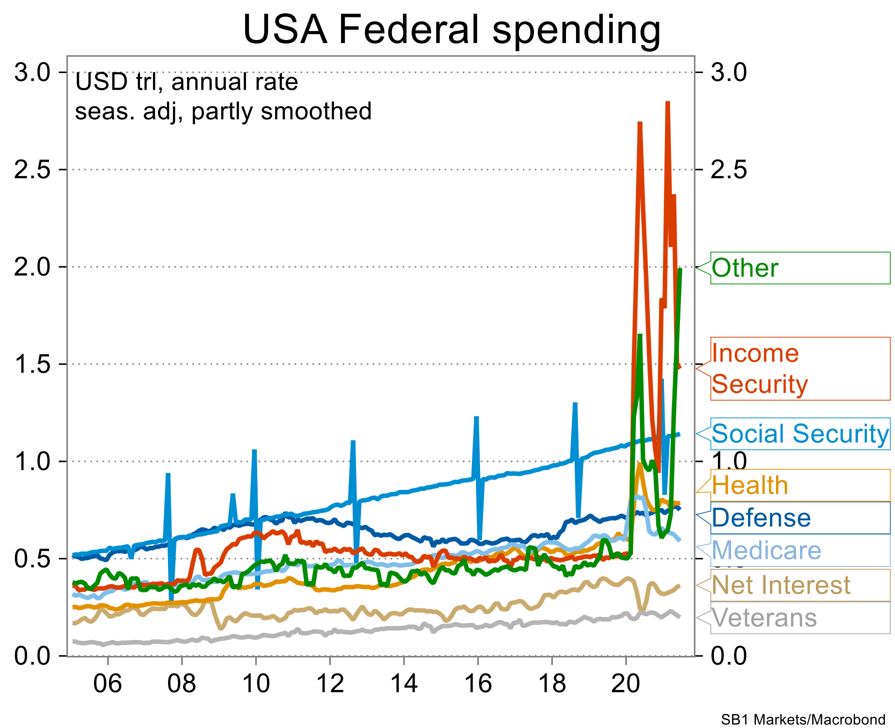


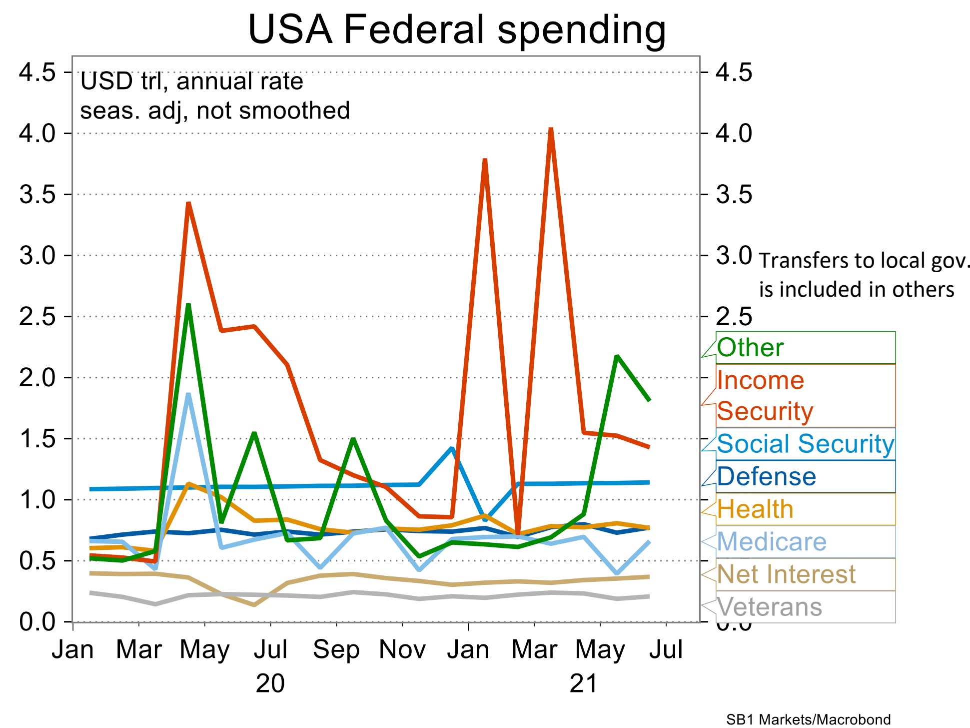


- **Federal expenses** fell in June, by USD 100 bn to 590 bn (seasonally adjusted), equalling 31% of (monthly) GDP, as state transfers decreased somewhat (and may fall further in the coming months)
- **Federal income** was also down, by a total of USD 103 bn 342 bn, 18% of GDP – and covering just 58% of the expenses, as household tax payments decreased (from a high level)
- The June actual **deficit** was at USD 174 bn, expected USD 294 bn, the discrepancy very likely due to the hike in household taxes. The seas. adj deficit equalled USD 193 bn or 10% of GDP. Over the past 12 months the Federal deficit has equalled 12% of GDP
- The **Federal Reserve** is buying gov bonds, but 'just' at a rate equalling 4.5% of GDP. So no lack of paper for the rest of us

Lower transfers to states reduced overall spending

Income security payments were also lower as fewer stimulus cheques were distributed

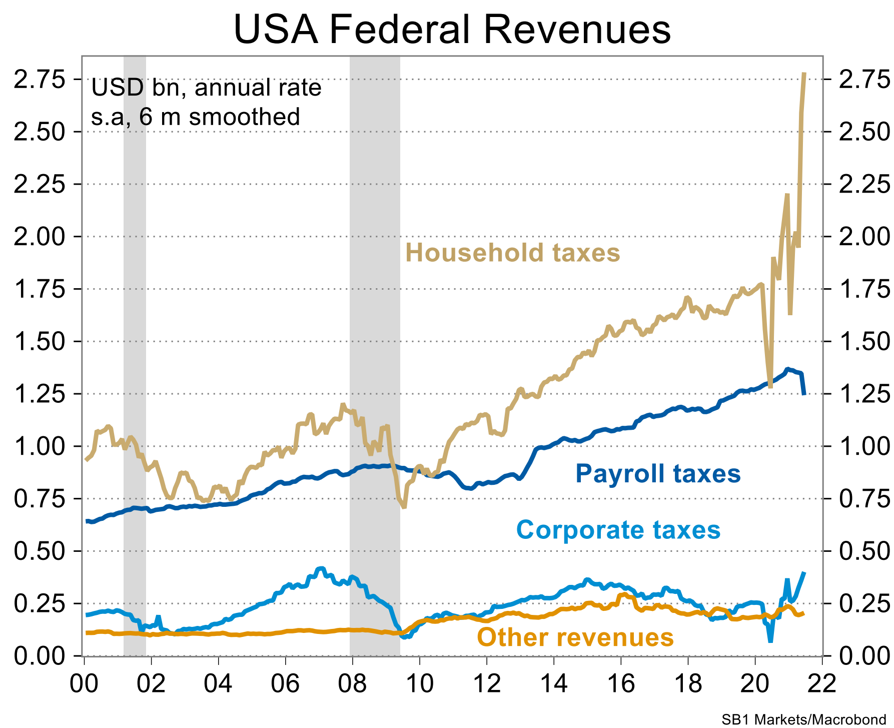


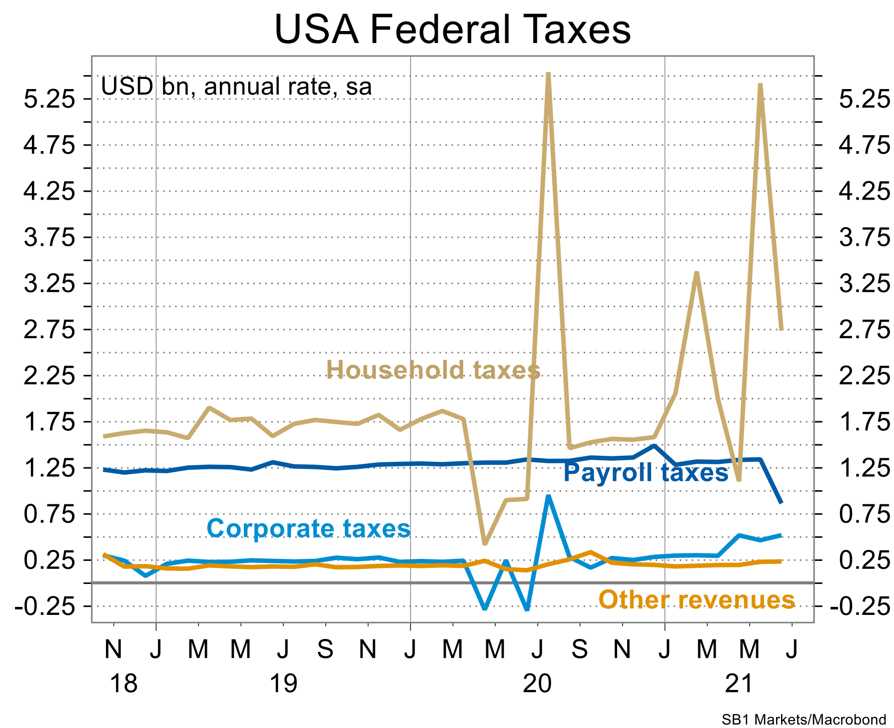


- However, there will still be federal spending on increased unemployment benefits, larger child tax credit, vaccine distribution, health care, food assistance programs, support for businesses, aid to local governments over next several months
  - Of the total **USD 900 (Trump) + 1.900 bn (Biden)** stimulus package decided, some 55% is distributed (our approx. estimate). So expenses will stay high over the next 6 – 9 months ☺, by some USD 200 bn per month – or 10% of GDP – above 'normal' spending (which in turn was 5% higher than revenues in % of GDP)
- Biden's **infrastructure (jobs) plan has (most likely) been agreed upon, though scaled down to USD 600 bn over the next decade, well below his USD 2.000 bn proposal. His USD 2.000 bn family support program** (welfare initiatives, sum over 10 years), is not agreed upon in Congress – and it will very likely not be as larges as the 2.000 proposal

Household taxes sharply down in June, still above a normal level?

Monthly tax payments have become extremely volatile during the pandemic

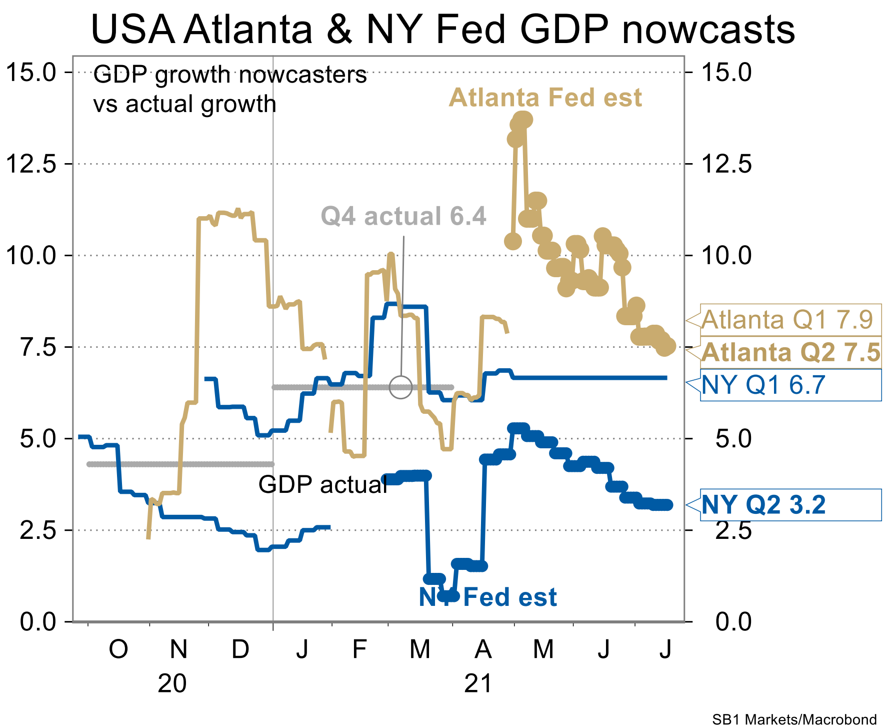


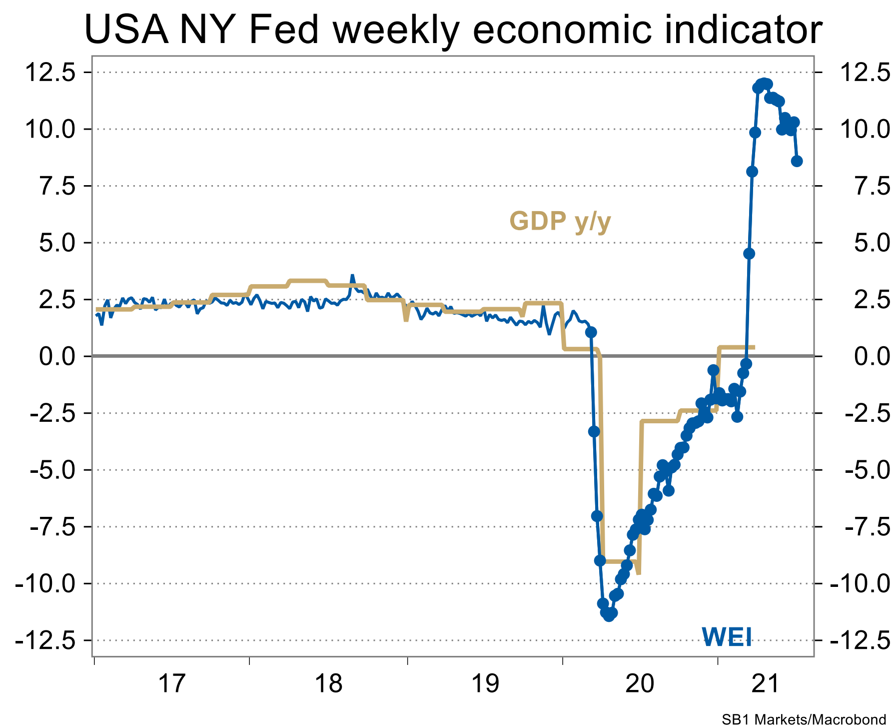


- **Household taxes** fell by USD 2.69 bn, and payroll taxes decreased by USD 470 mill. The latter will be recovered next month

The nowcasters signal 3% to 7.5% GDP growth in Q2

… as growth nowcasts have been gradually slashed past two months

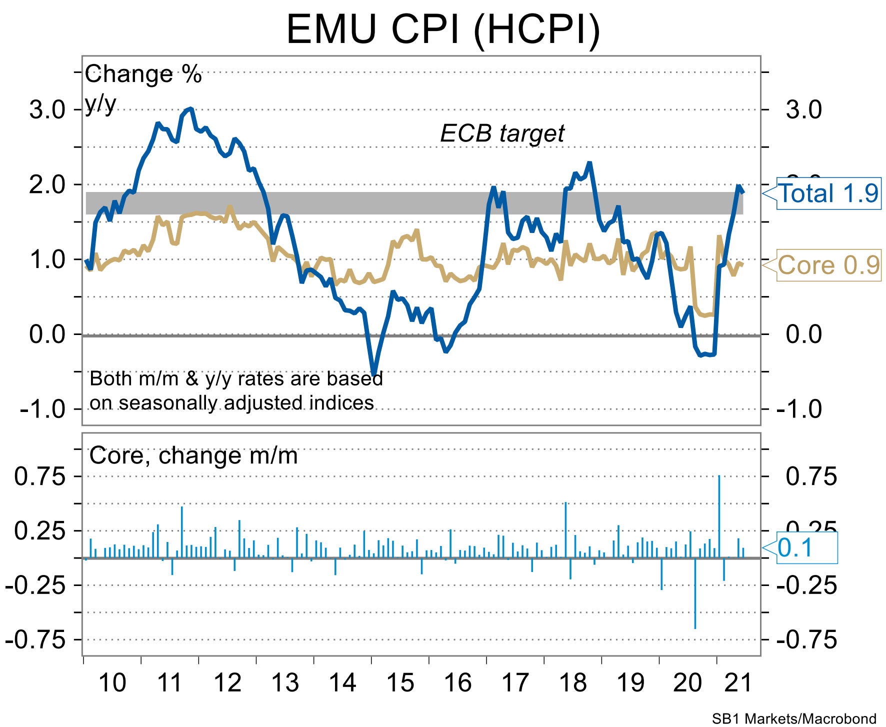


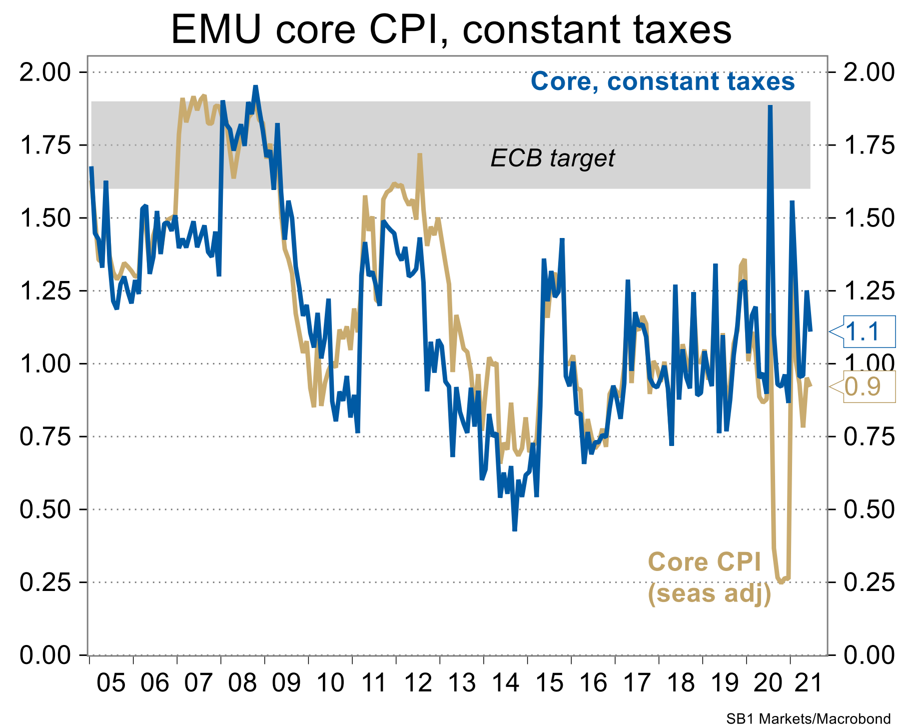


- Data will be published next week

Eurozone inflation confirmed at 1.9% (total) & 0.9% (core)

Even headline inflation is below the new 2% (and symmetric) inflation target



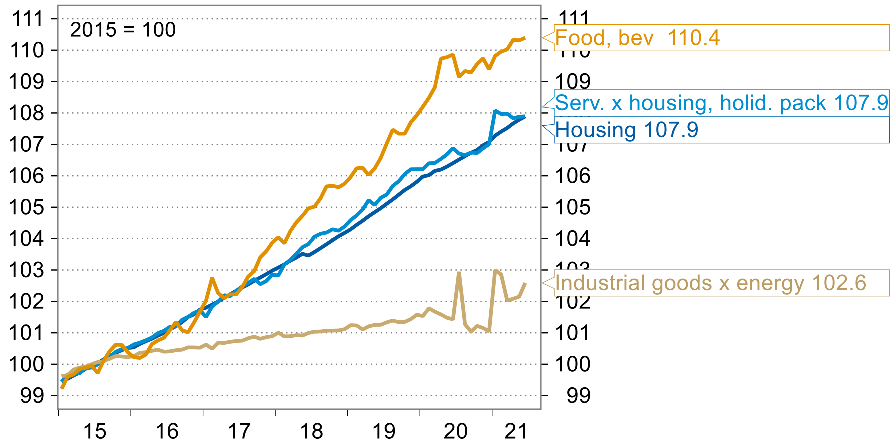


- **Core prices** were confirmed up 0.1% m/m and the annual rate fell 0.1 pp to 0.9%. Goods prices rose 0.4%, services were down 0.1%
- **Headline inflation** was down 0.1 pp to 1.9% in June
- **Adjusted for changes in taxes**, the core was at 1.1% y/y in June
- Greece is out of deflationary territory (0.6% y/y), while the headline inflation is at or above 2% in many of the member countries, including Germany, Belgium, Austria, Finland and Spain (Although central banks usually targets core inflation, and this number is more sticky)

So far, energy is the main story. In fact, the only one

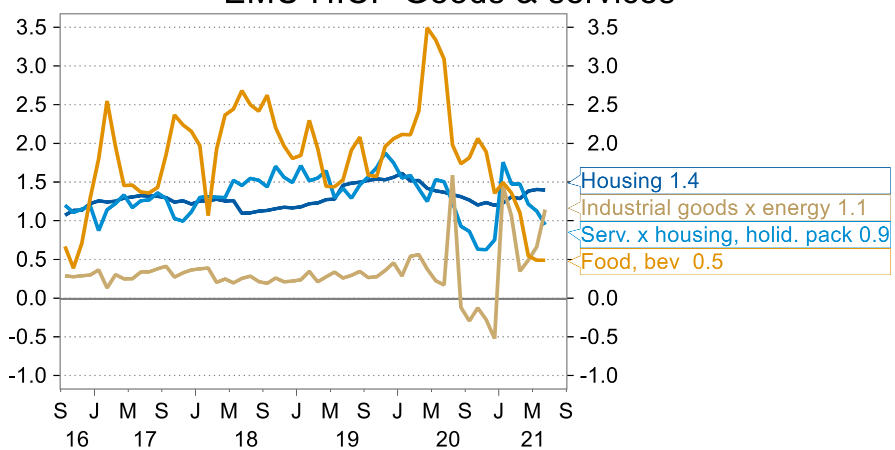
No signs of any broad uptick in inflation in the Euro zone

EMU HICP Goods & services



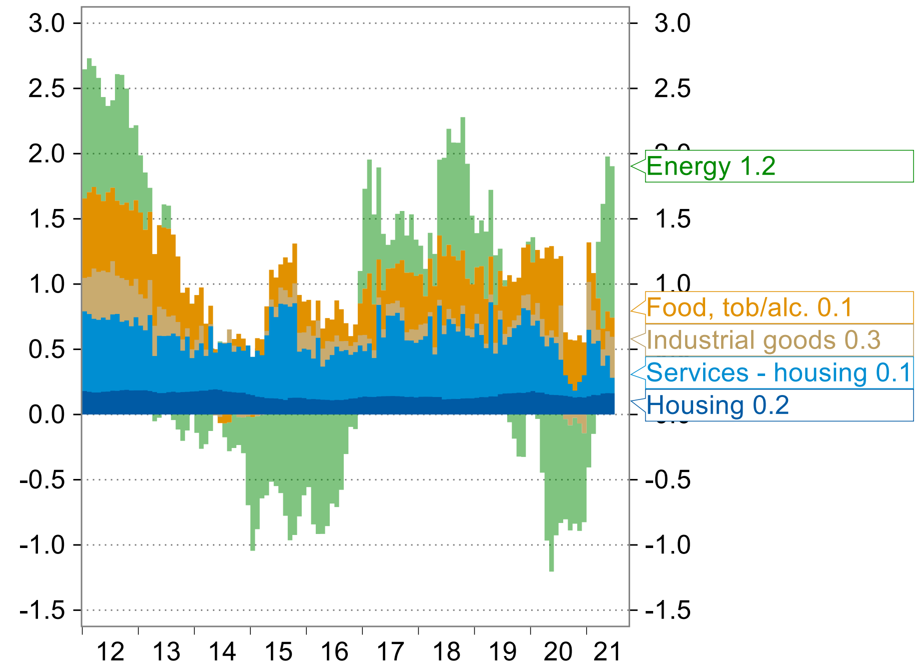
SB1 Markets/Macrobond

EMU HICP Goods & services



SB1 Markets/Macrobond

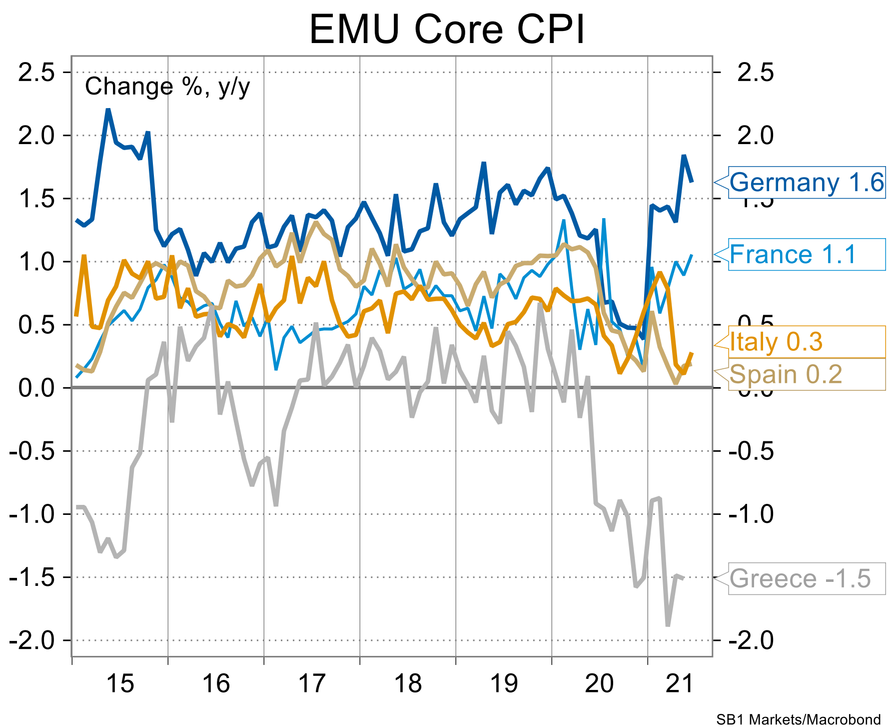
EMU Contribution to HICP inflation

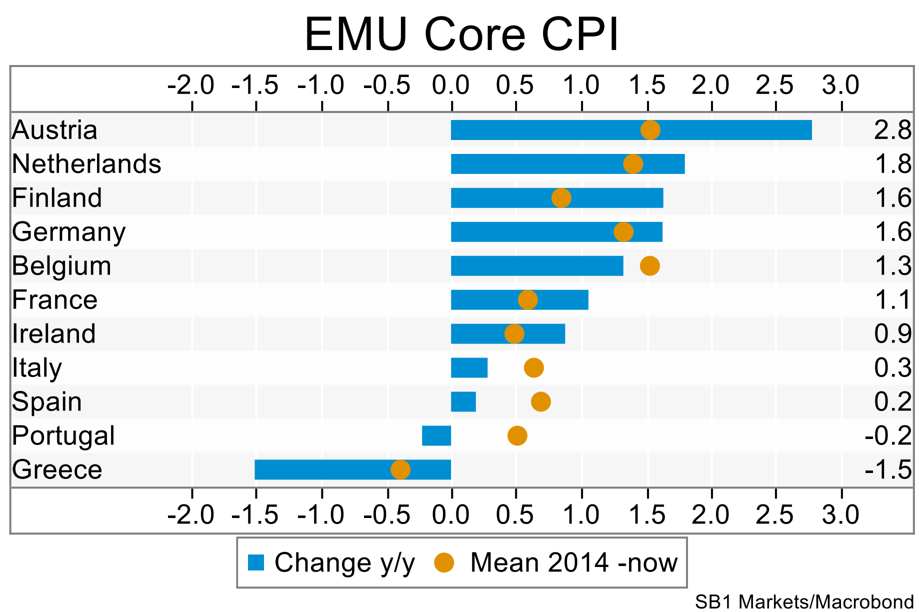


SB1 Markets/Macrobond

Core inflation below 2% almost everywhere

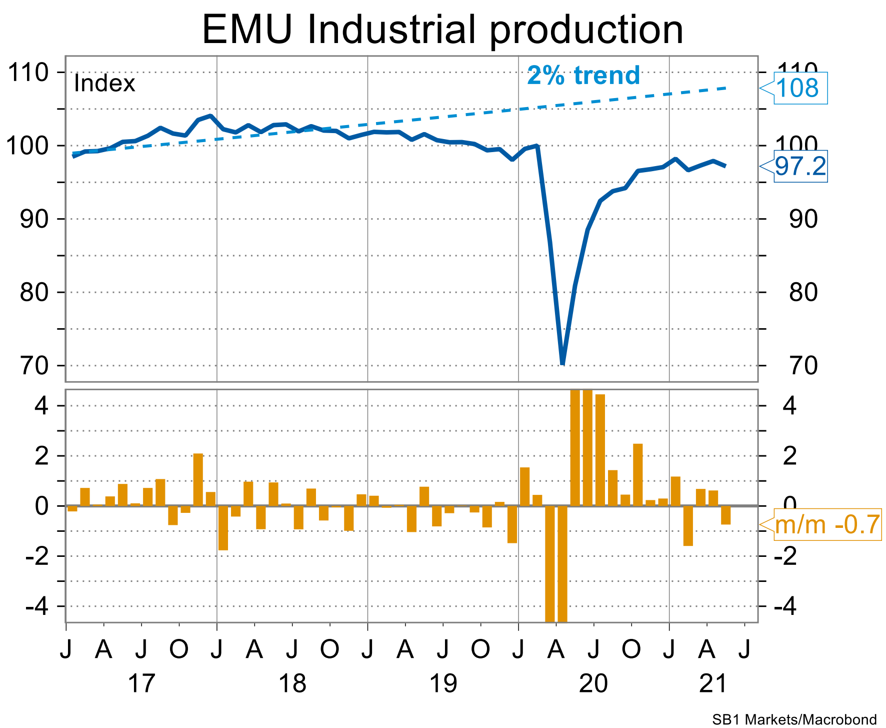
And in Greece, prices have been falling rapidly during the pandemic

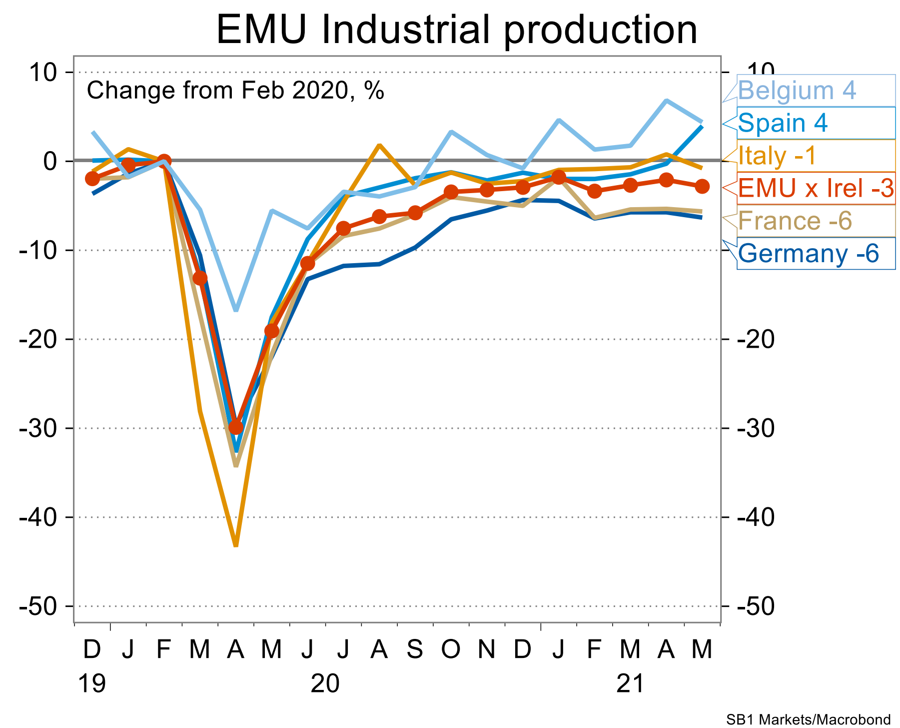




Industrial production down 1% in May, due to cuts in auto production

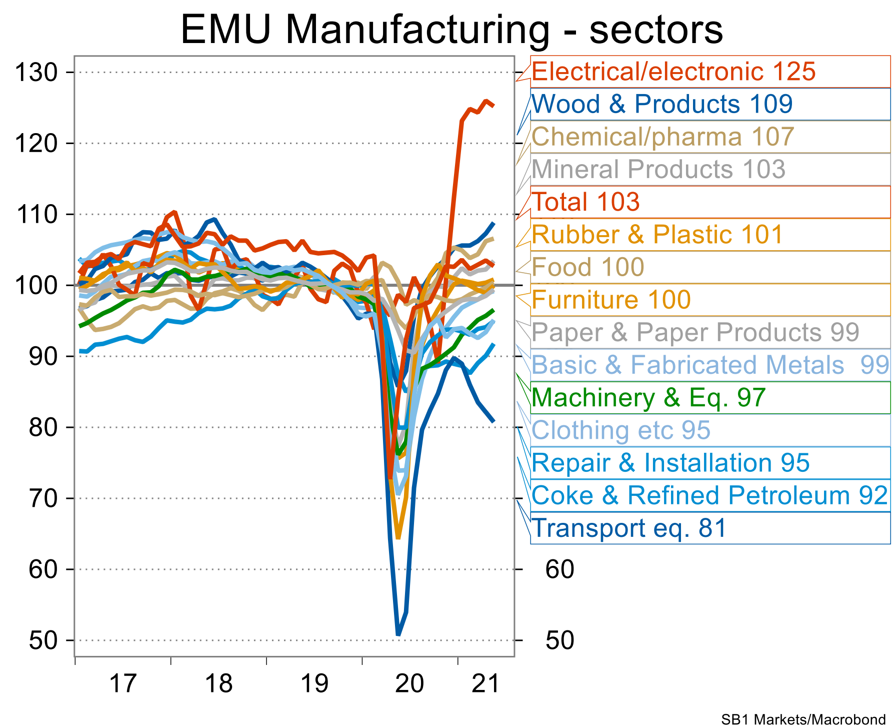
… and activity is still 3% below the pre-pandemic level

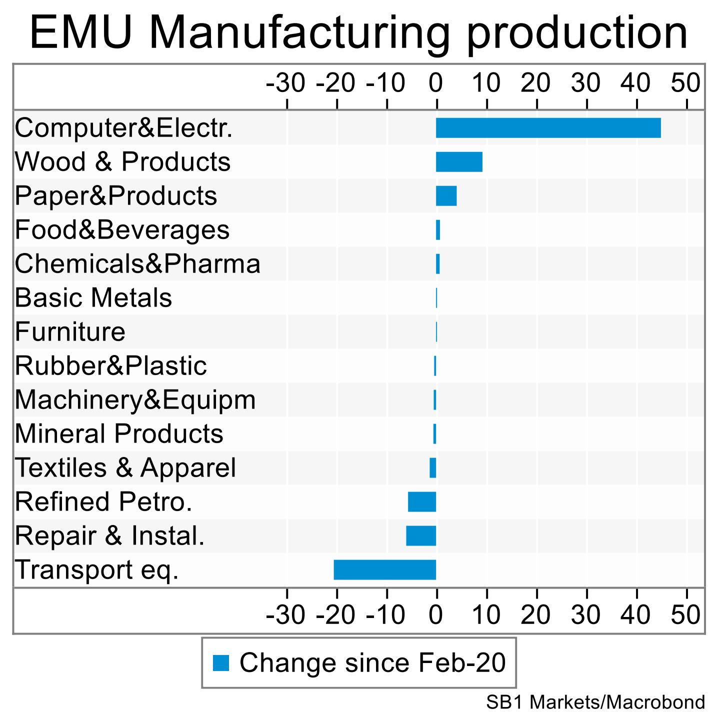




- **Industrial production** fell 1% in May, well below our and market expectations (-0.2%), as both Germany, France & Italy reported small declines, while Spain reported a sharp lift. The decline in the EMU x Ireland was 0.7% m/m.
- Auto production contributed substantially on the downside in May, as production of transport equipment fell by 8%, subtracting some 1% from total manufacturing production
- **Order inflow and surveys** indicate higher production the coming months

Transport equipment sharply down, mostly due to lack of components

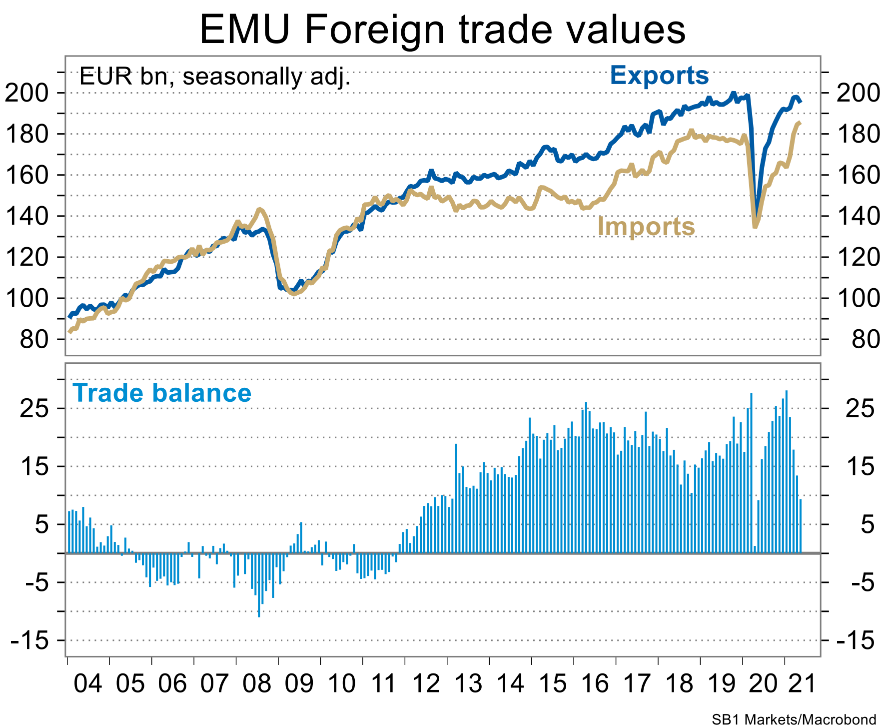




SpareBank 1 MARKETS

EMU foreign trade surplus decreased further in May

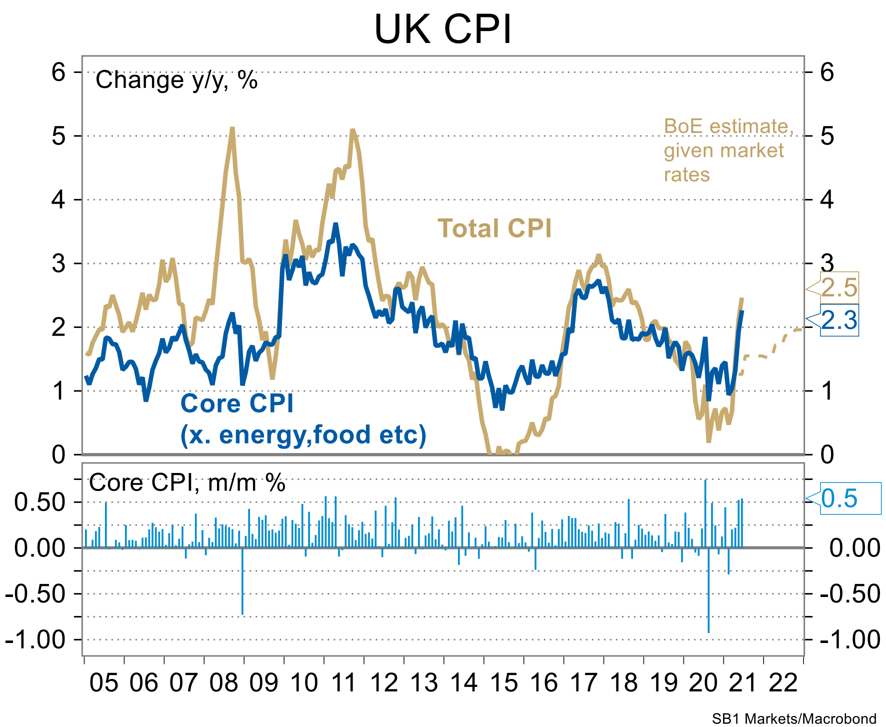
Imports are increasing rapidly, and more than exports



- The EMU has been running a substantial trade surplus since the euro crisis in 2012. The surplus stood at EUR 9 bn in May (seas. adj.)
  - » The trade surplus have fallen from more than EUR 25 bn since the start of 2021
- Exports fell much more than imports (both in value and volume terms) during the corona crisis
- Both have now recovered, but the value of exports are still below the pre-Covid level, whereas imports are now above the level before the virus hit

Inflation surged again in June - and the price increases were widespread

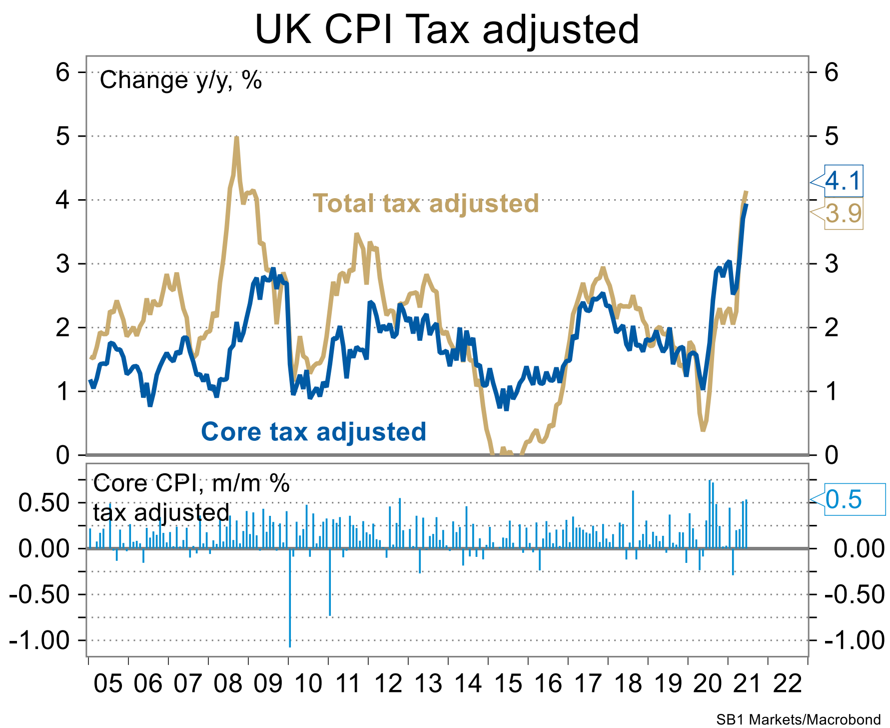
CPI inflation up 0.4 pp 2.5% y/y – 0.3 pp above expectations. Core up by the same amount to 2.3%

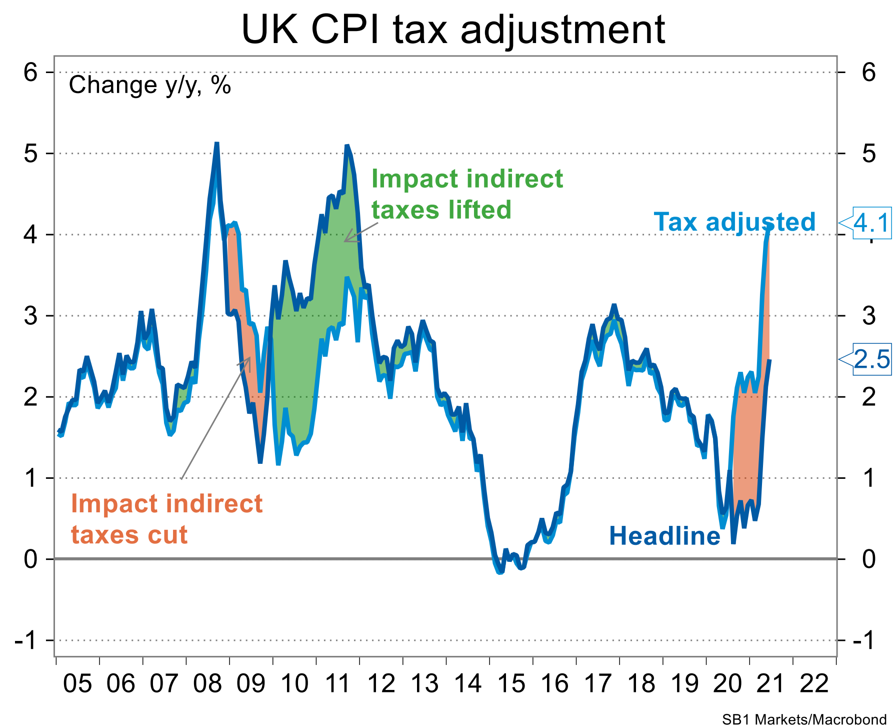


- The largest contributions were from transport, fuels, <u>restaurants</u>, <u>recreational goods</u>, <u>clothing</u>, while food prices fell marginally
- In June last year, the core price index was up by 0.2% (s.a). Now, prices rose by 0.5%, and the annual growth rate accelerated by 0.4 pp, 0.3 pp more than expected
  - » Like in the US, used car prices was the biggest contributor to inflation, and the reopening/auto production problems have no doubt contributed to the lift in prices m/m in June
- Annual **CPIH** (including housing rents) inflation, accelerated by 0.3 pp too, to 2.4% in June
- Unit labour costs have soared during the pandemic, as most other places. We expect as substantial reversal the coming quarters (and we do not dear to show you the actual data, they do not look pretty…)

Tax adjusted inflation at 4.1%

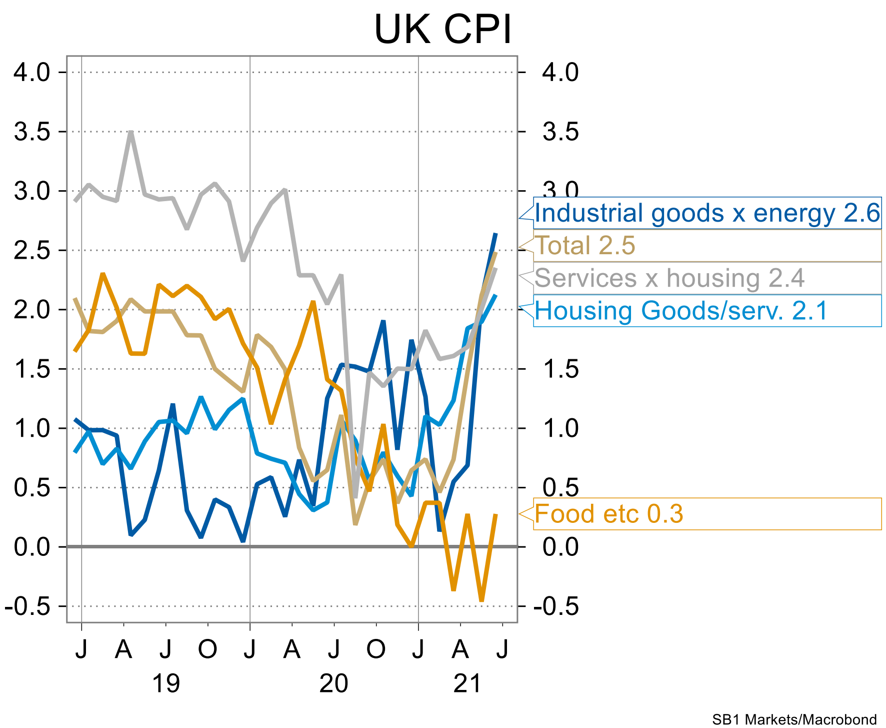
Corona measures cut prices sharply last August – and the 'bill' will become visible soon?

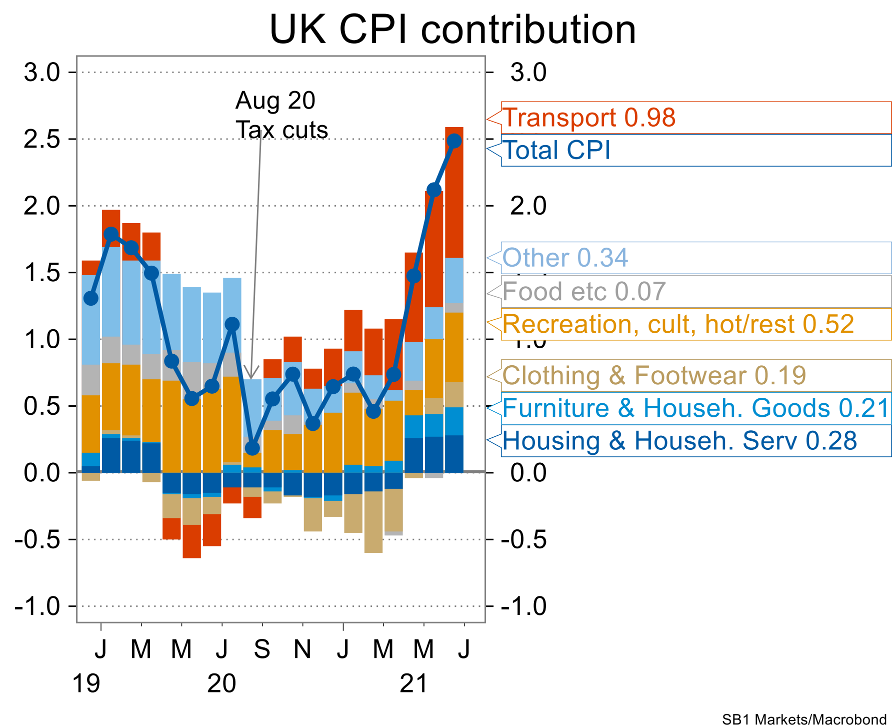




- The corona measures (Eat Out to Help Out Scheme and some other support programs implemented last August) equalled 1.6% of CPI. Prices fell less than that m/m (vs a normal price increases at that time, which tough were very volatile m/m, most likely because restaurants etc. kept some of the subsidy themselves). Thus, the impact on the annual CPI may be somewhat smaller than 'technically' assumed
- If the technical assumption holds (and the published tax adjustment data are correct), the 'real', tax adjusted annual CPI inflation runs far above the published headline, at 4.1% vs. 2.5%. The discrepancy in the core CPI is marginally higher
- 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 July last year

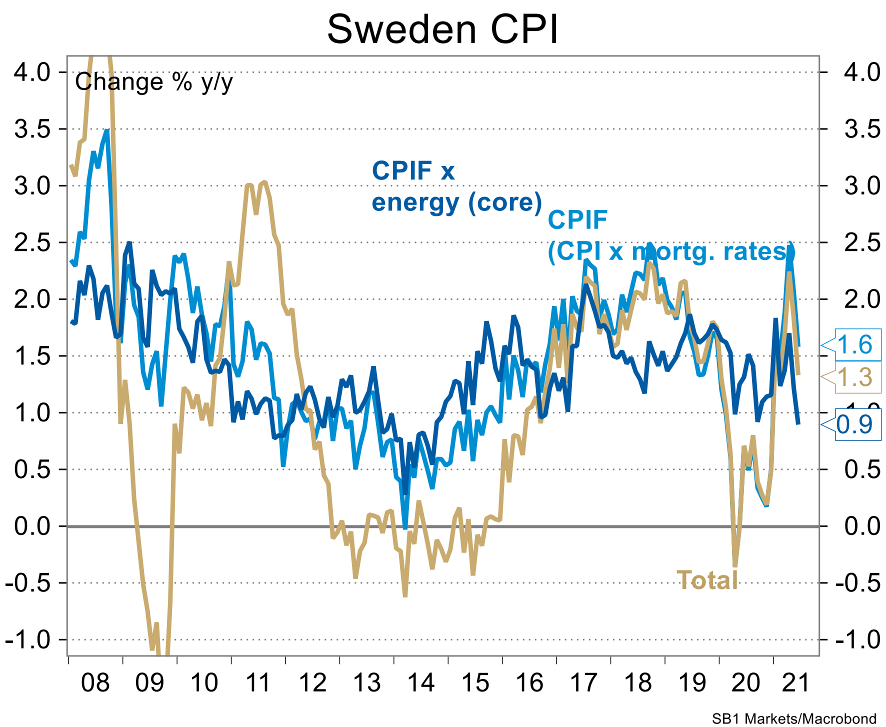
Transport & recreation/hotels/restaurants the main culprits

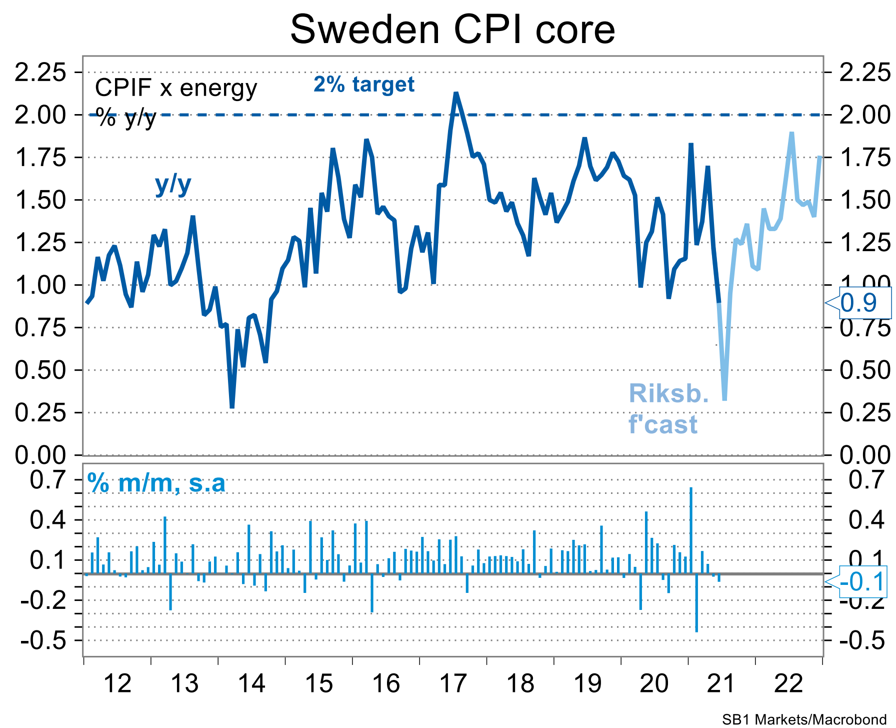




Core inflation down 0.1 pp to 0.9% in June

Core CPI in line with Riksbank and consensus estimates

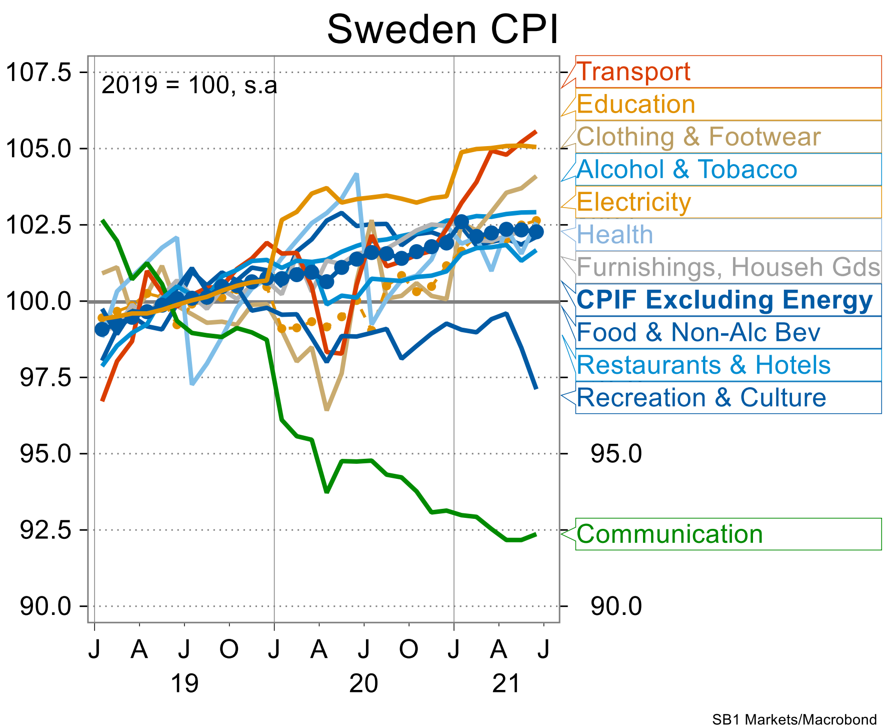


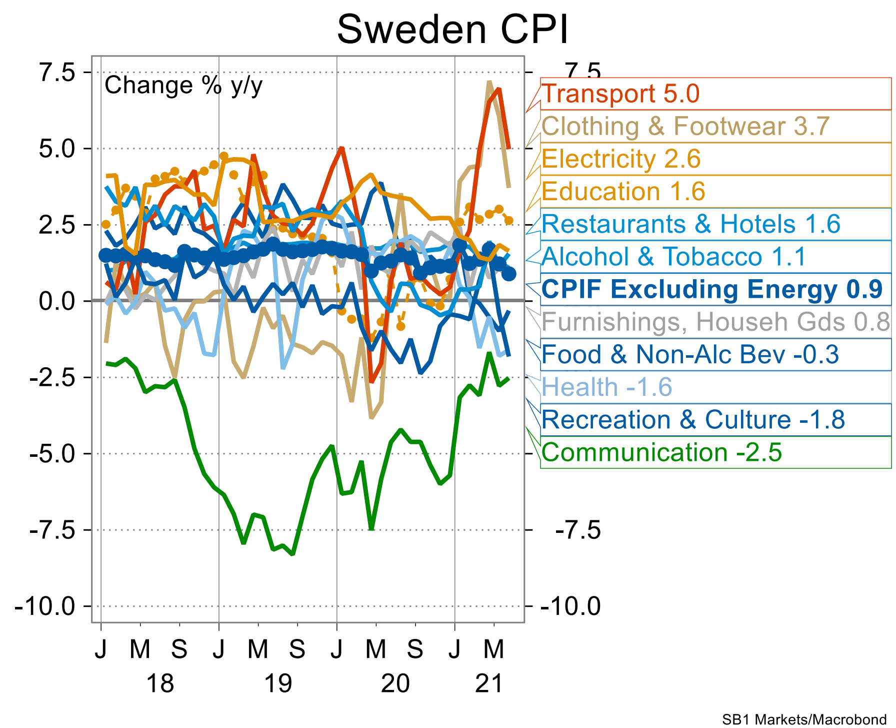


- **Headline inflation** fell to 1.3% y/y from 1.8% - in line with expectations
- **The CPI-F**, the constant interest rate inflation (CPI x mortgage rates) was down 0.5 pp to 1.6% y/y in June, 0.1 pp above expectations
- **CPI-F x energy, the 'real core'** was down 0.1% m/m, and the annual rate fell 01. p to 0.9% y/y
  - » The Riksbank expect a steep decrease in the core y/y rate in July, without any special base year impact
- The decrease in inflation was largely driven by decrease in food, clothing, and furnishing, whereas transport was the biggest contributor on the upside

Communication, healthcare, recreation & culture prices fell in May

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





Highlights

The world around us

The Norwegian economy

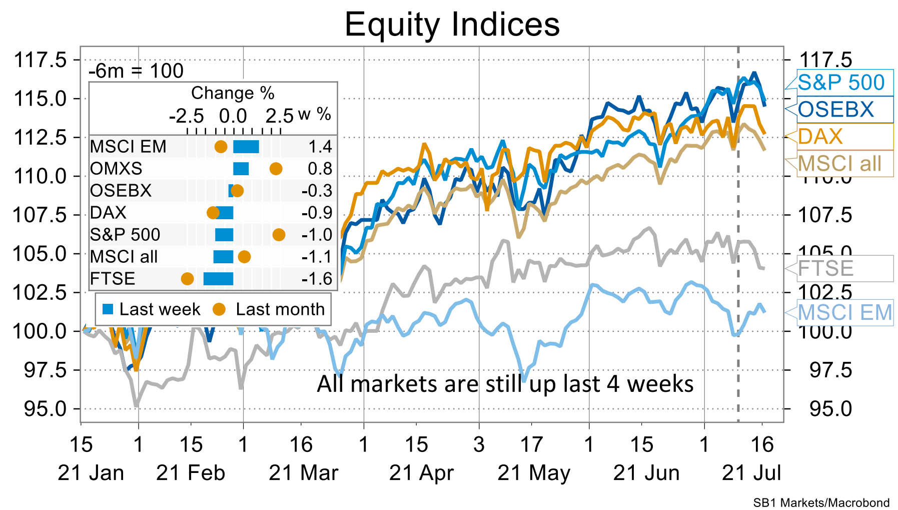
Market charts & comments

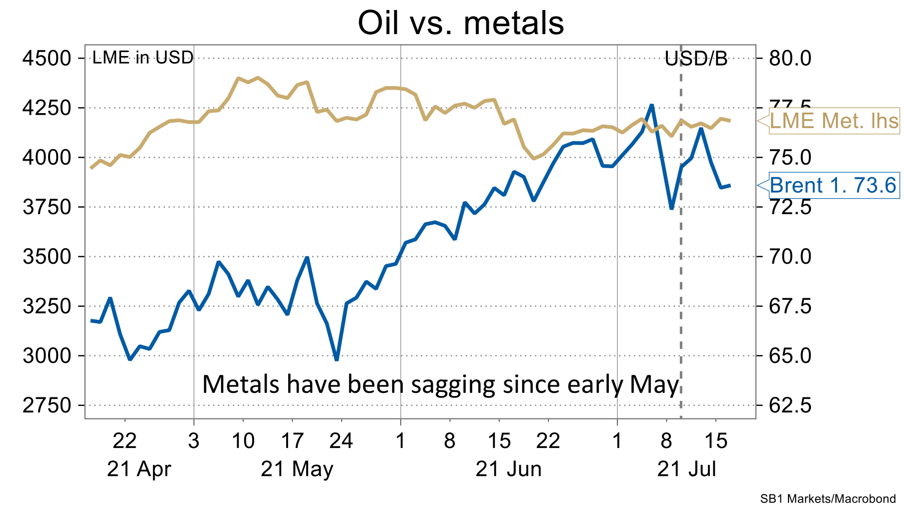
No news last week, and the weather was fantastic ☺

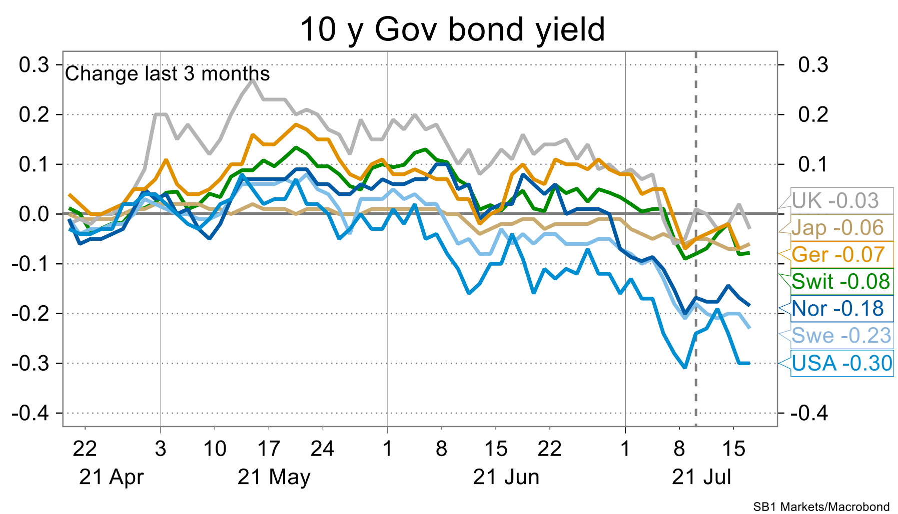
SpareBank 1 MARKETS

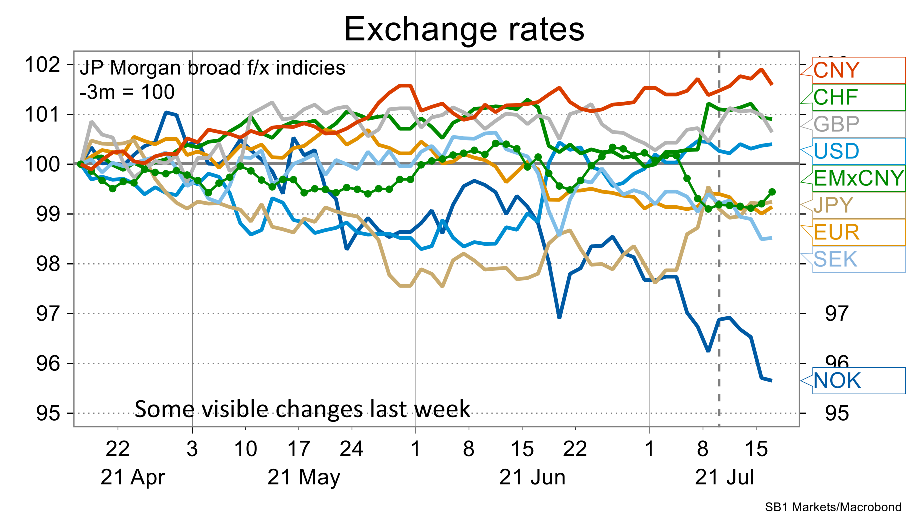
DM stock markets down, yields still down, commodities flat

The USD slightly up, the NOK sharply down. The oil price fell on the rumour of a Opec deal, flat on the fact



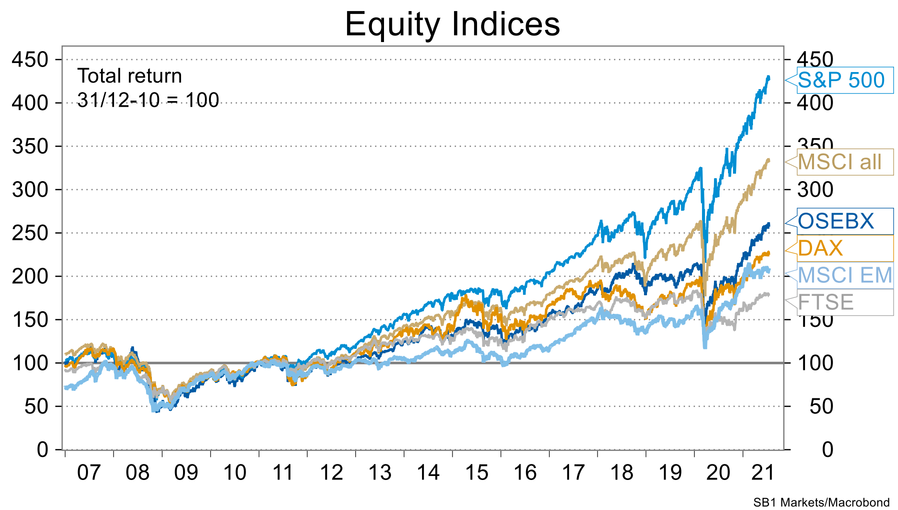


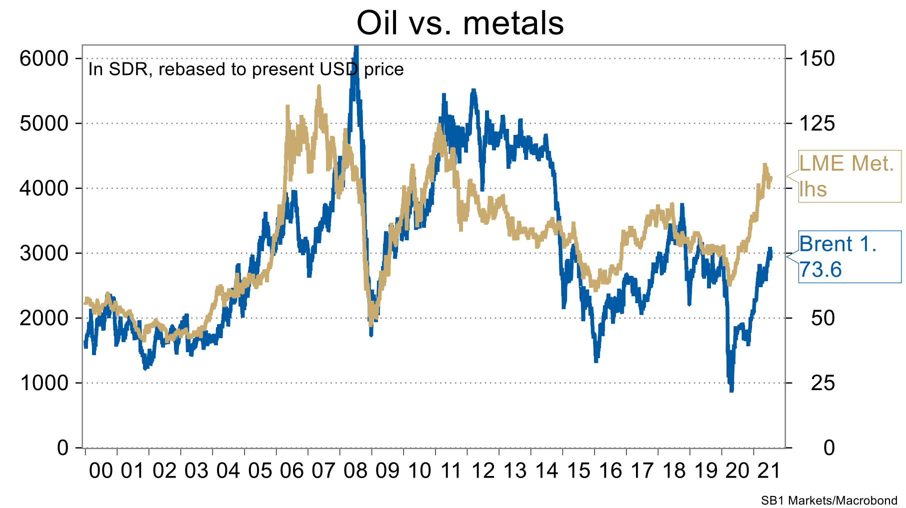


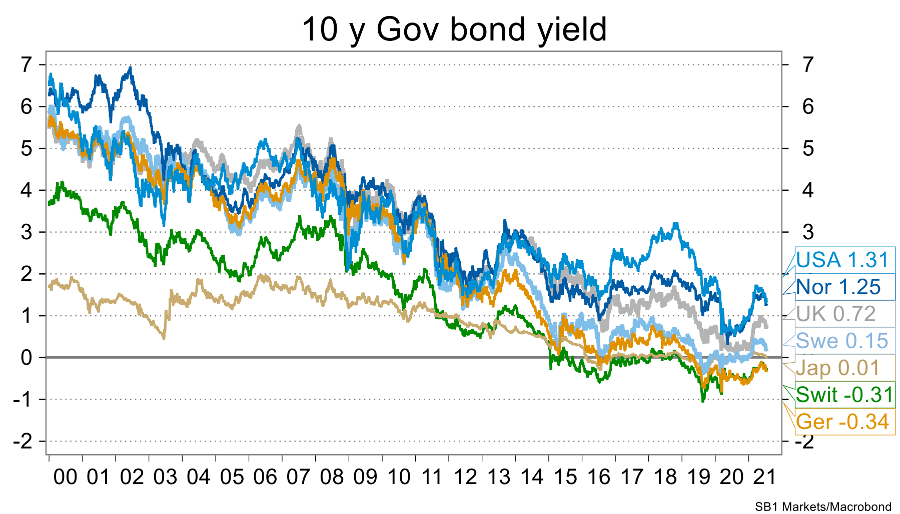


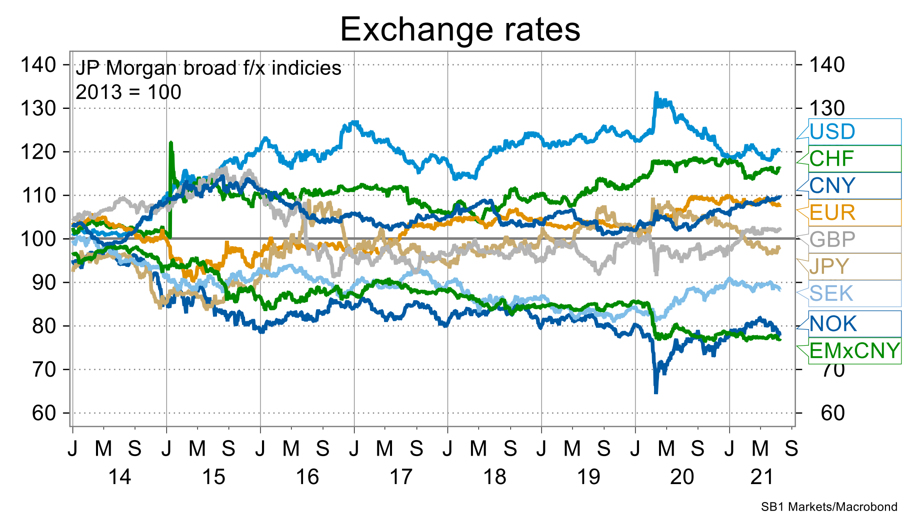
The big picture: Strong stock & commodity markets

Yields have lost their upward momentum in March

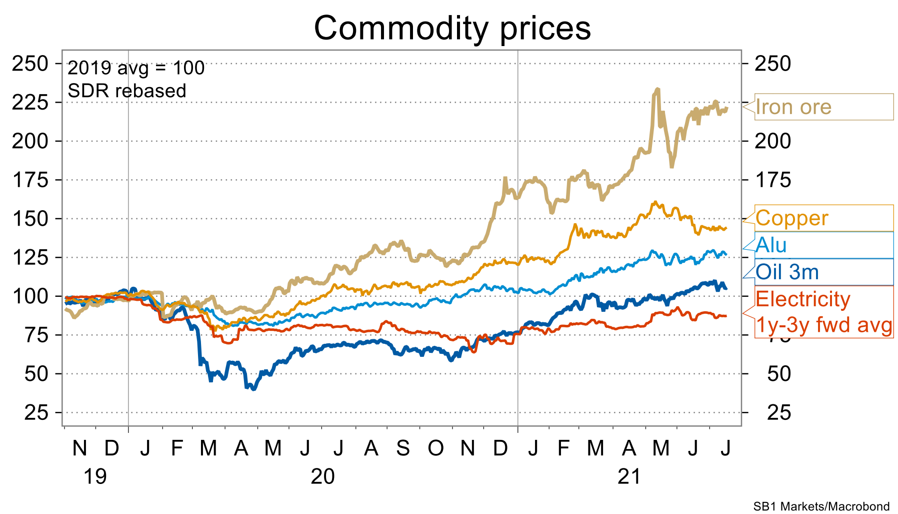


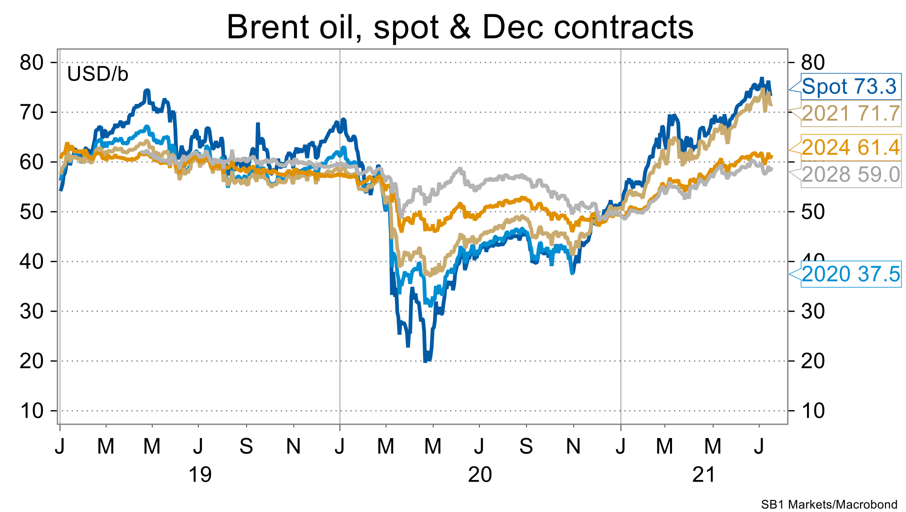


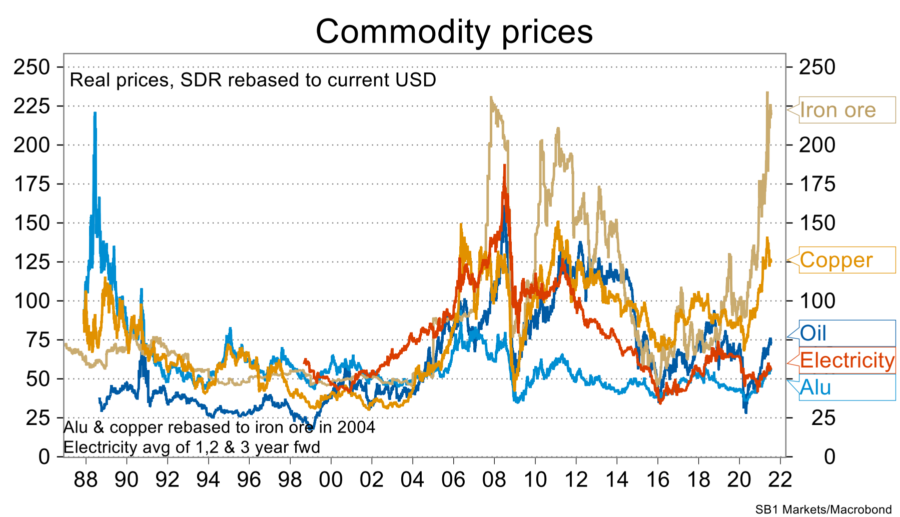


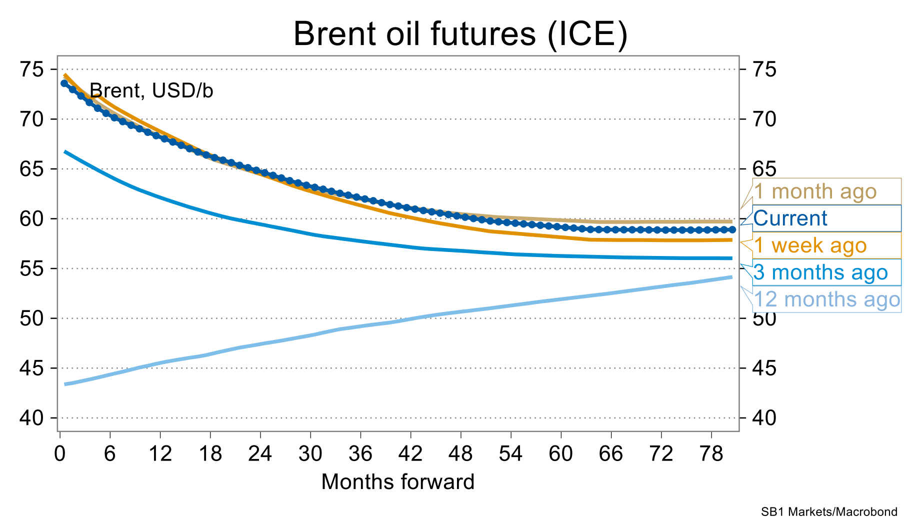


Flattish commodity markets last week/month







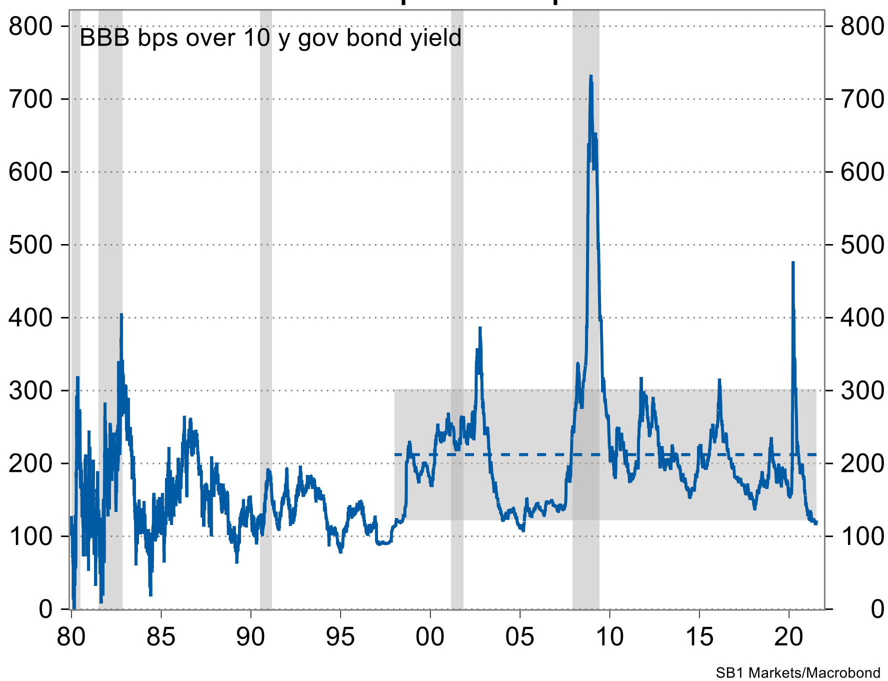


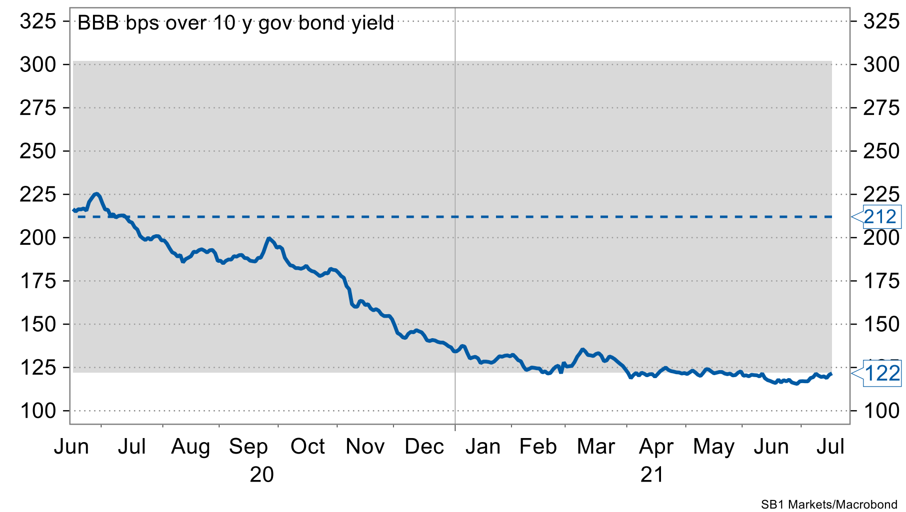
SpareBank 1 MARKETS

US credit spread further slightly up last week – still at very low levels

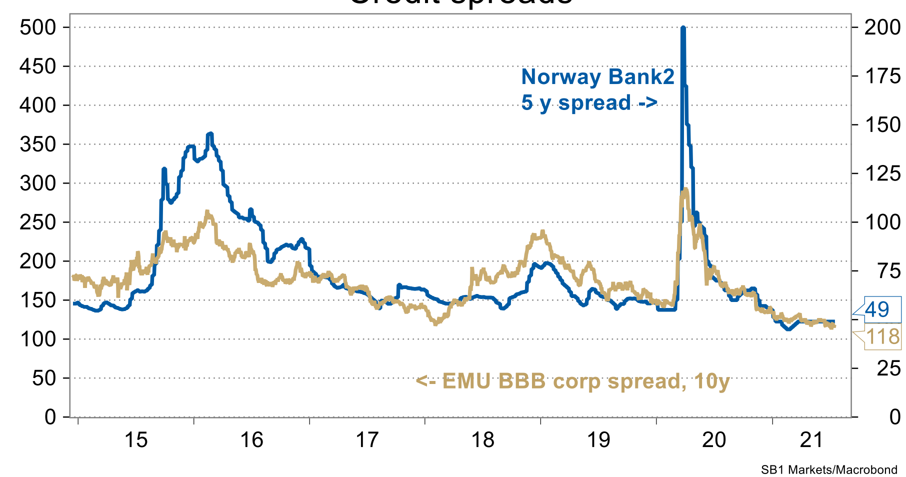
European/Norwegian spreads flat or down

USA Corporate spread



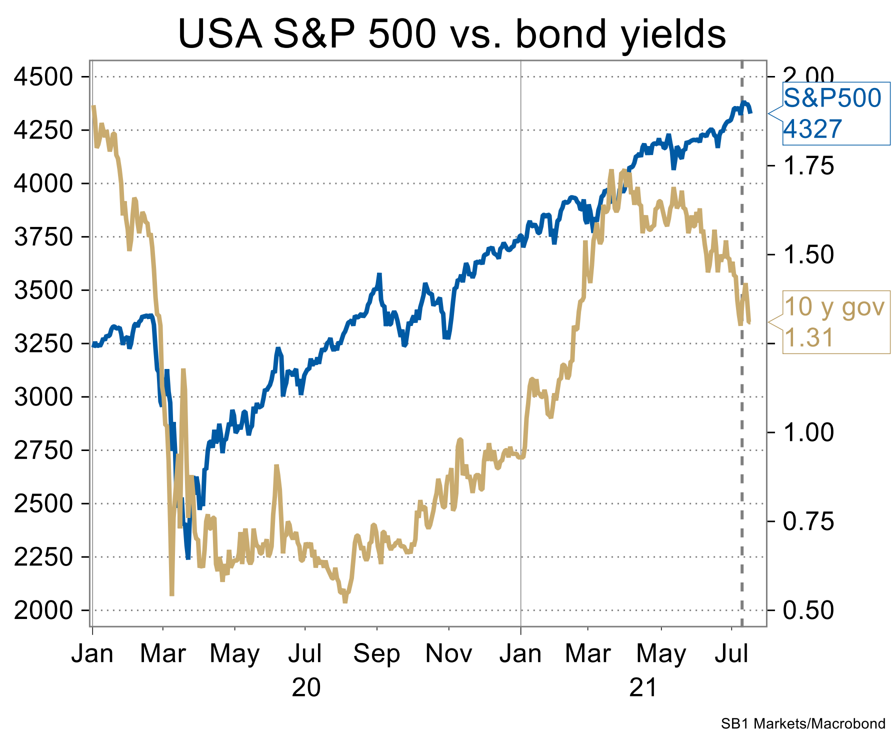


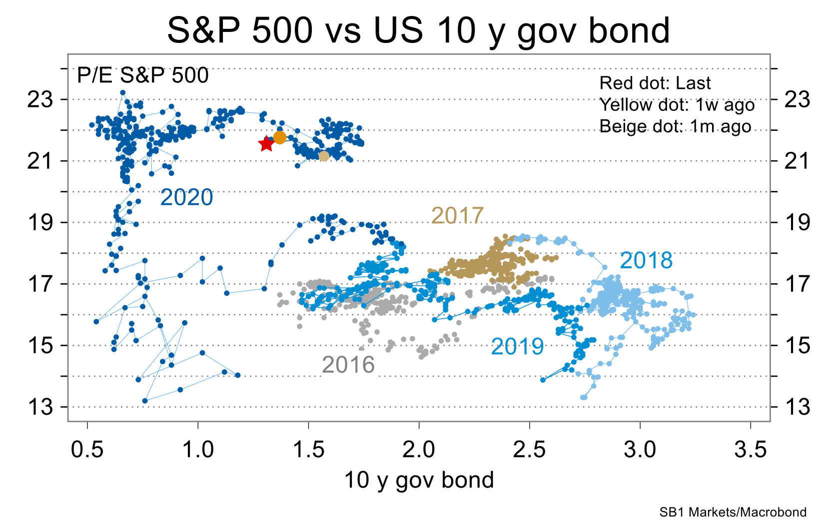
Credit spreads

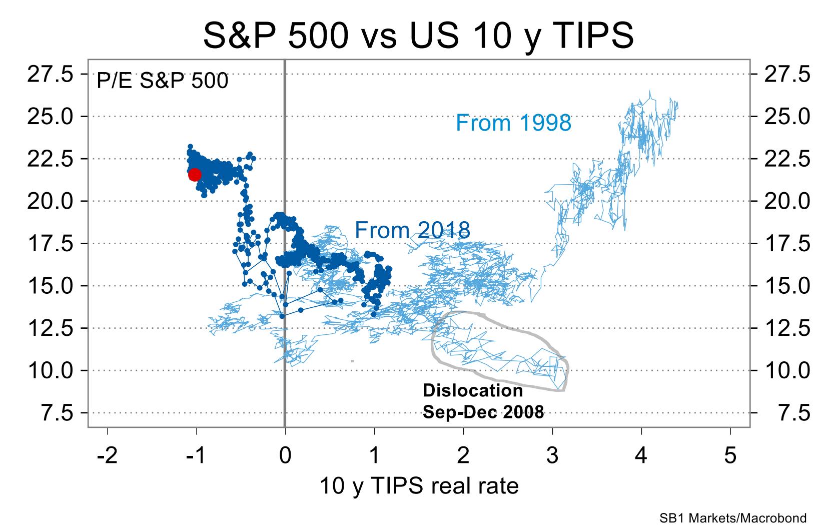


S&P 500 -1% last week (from ATH), 10 y bonds -6 bps to 1.31

… to the second lowest level since February

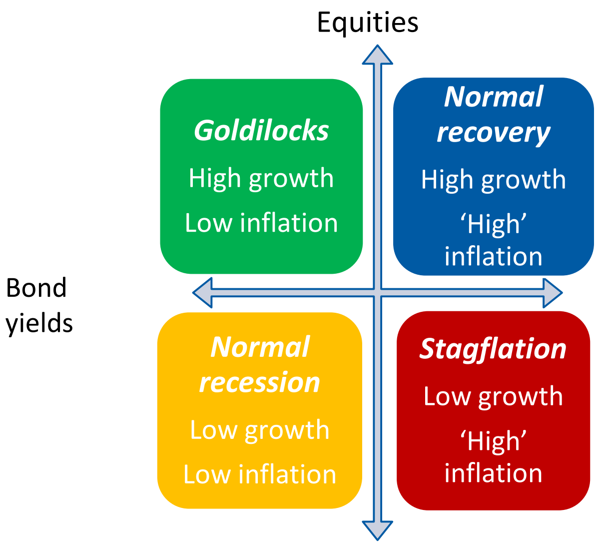


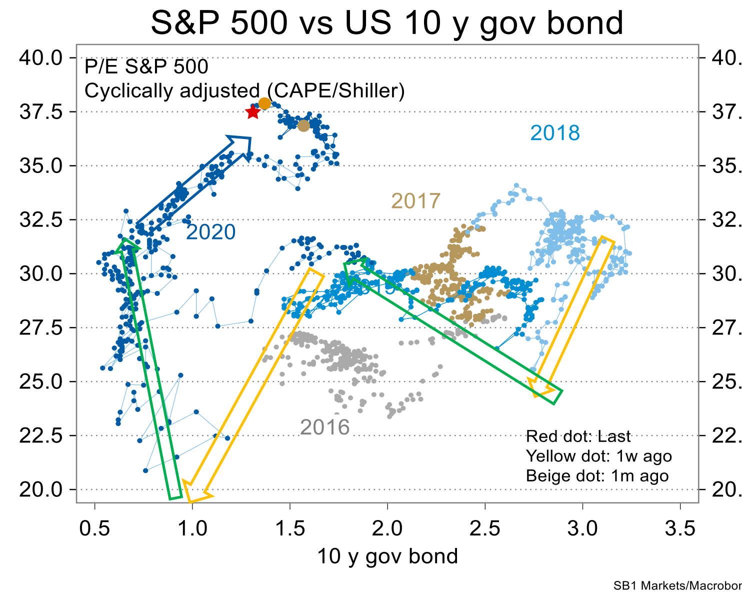




Further into the 'Goldilocks corner' (at least until last week)

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



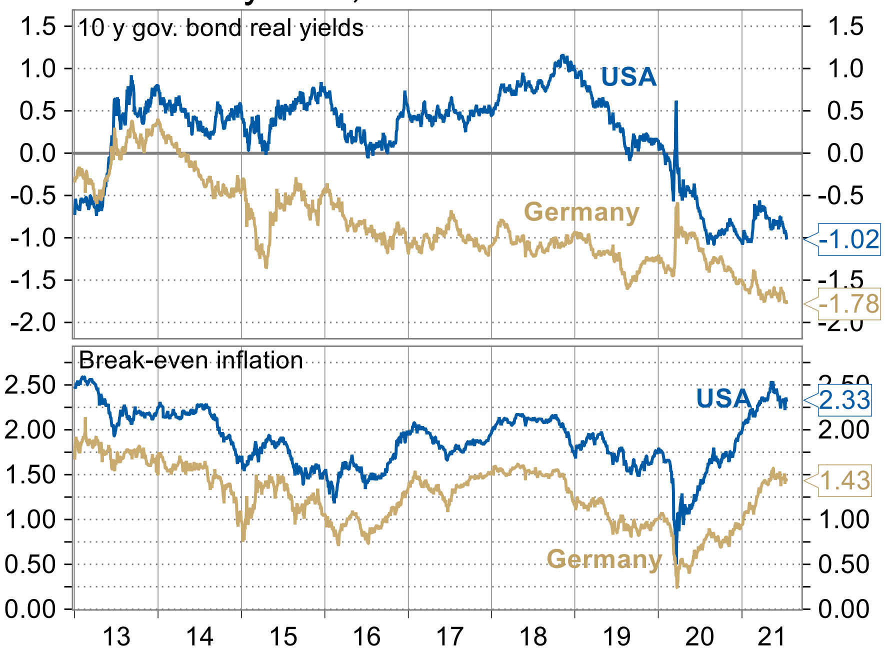


- Usually, we have associated drifts towards the 'green corner' - low inflation and solid growth at the same time - as a temporary sweet spot for markets
  - » Interest rates have climbed 100 bp+, and stock valuations have kept up or climbed (like the Shiller PE). Still, we deem the current yield level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

Real rates are nosediving in both Europe & US

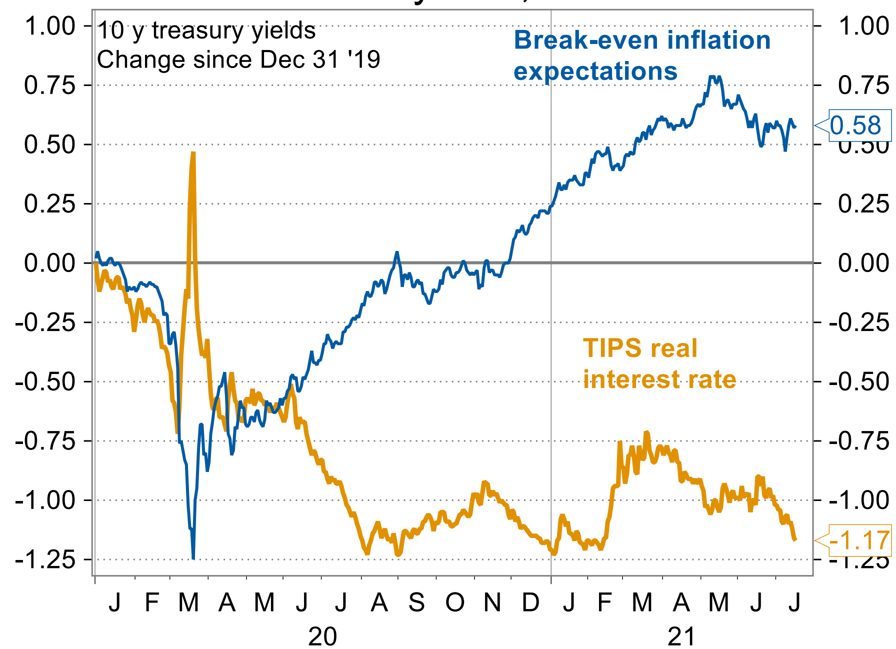
In Germany, the real rate is the lowest ever -1.78% p.a the next 10 years, US below -1% again!

Real yields, break-even inflation



SB1 Markets/Macrobond

USA Real yields, inflation



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US & Germany 10 y Gov bond yield

	Yield	Change 1w	Change 1m	Min since April-20
USA nominal treasury	1.31	-0.06	-0.26	0.52
.. break-even inflation	2.33	0.05	0.01	1.06
.. TIPS real rate	-1.02	-0.11	-0.27	-1.08
Germany nominal bund	-0.35	-0.03	-0.16	-0.65
.. break-even inflation	1.43	-0.01	-0.10	0.40
.. real rate	-1.78	-0.02	-0.06	-1.78

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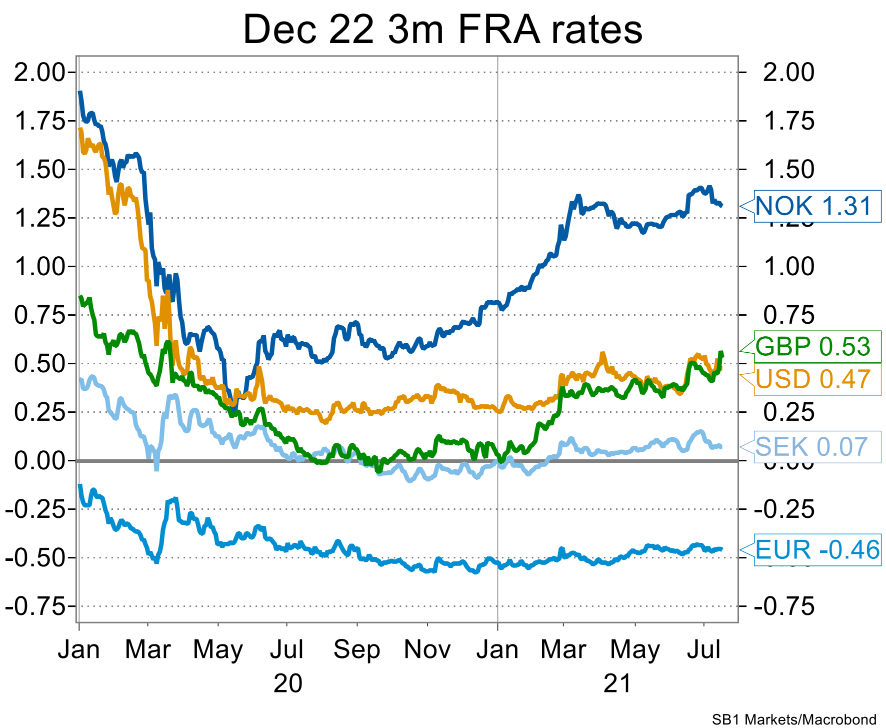
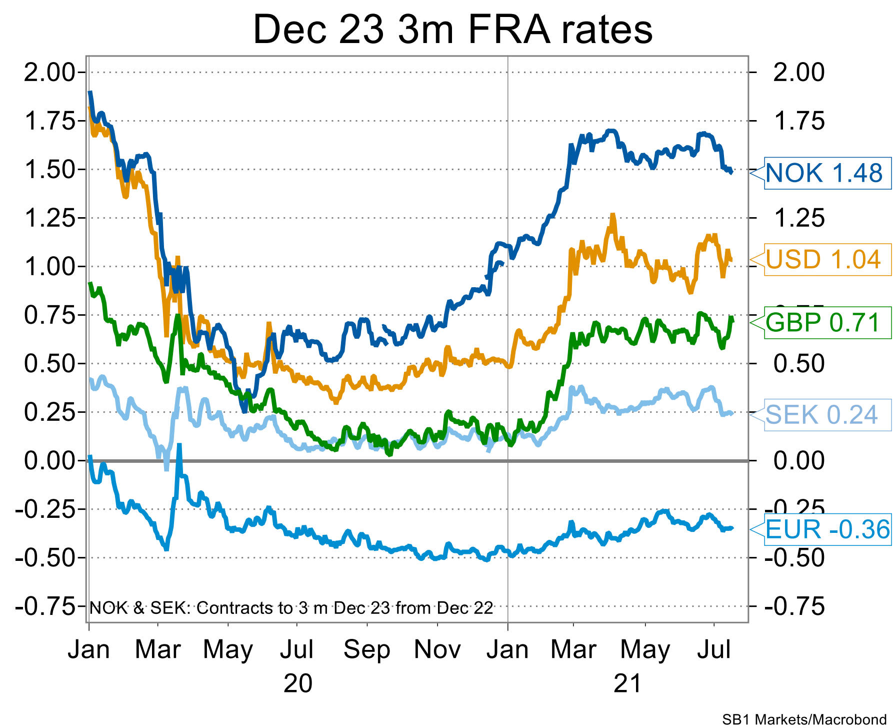
- Inflation expectations have stabilised – at ‘fair’ levels

FRAs: rates down up in UK & US, down elsewhere

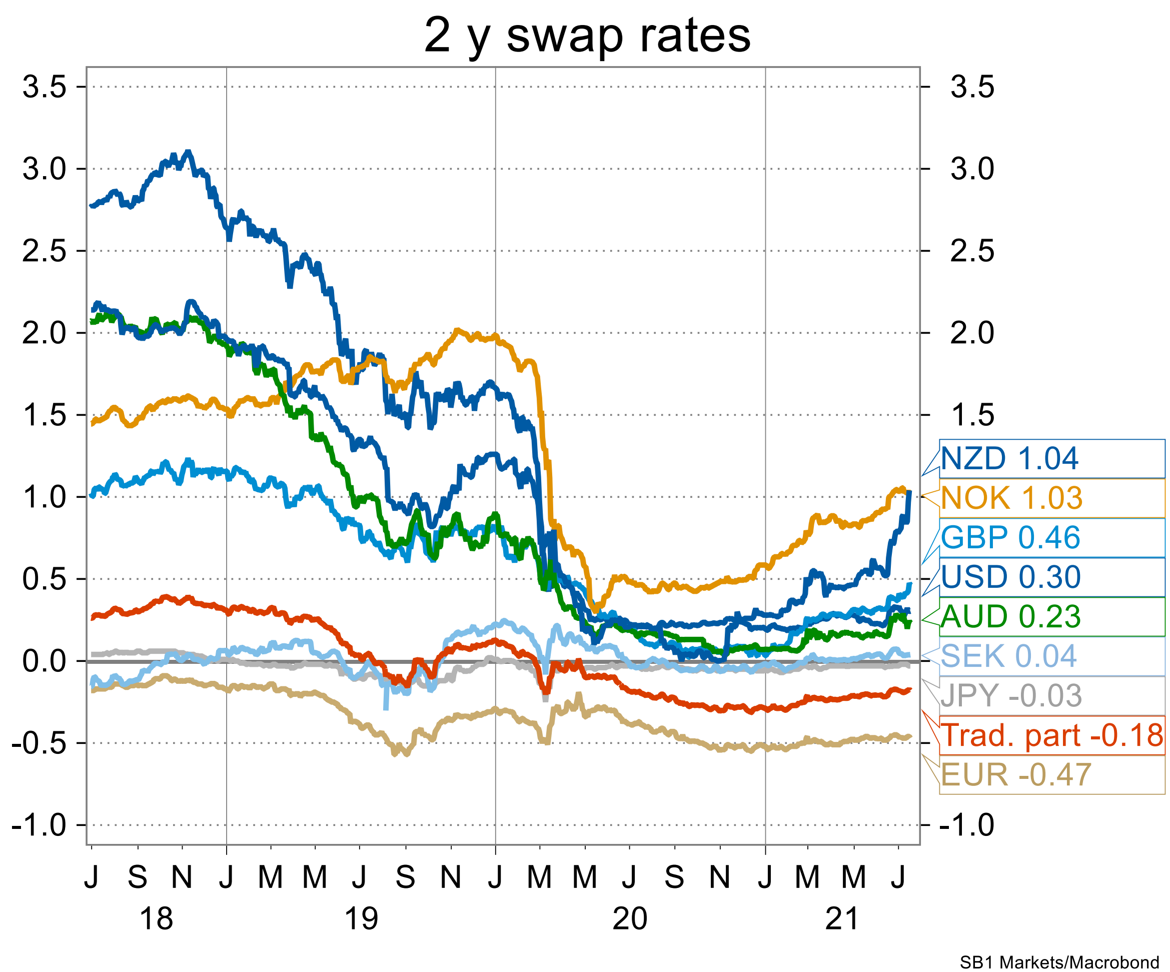
Still, the market discounts a first Fed hike in 2022

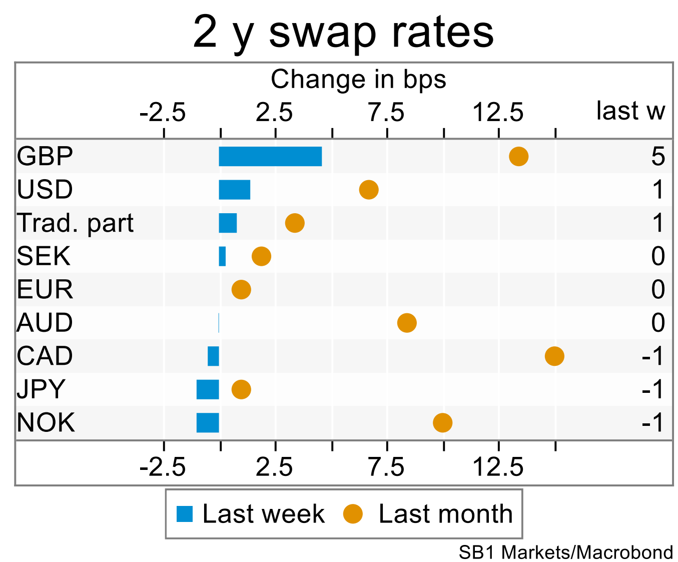




Mixed in the short end of the curve

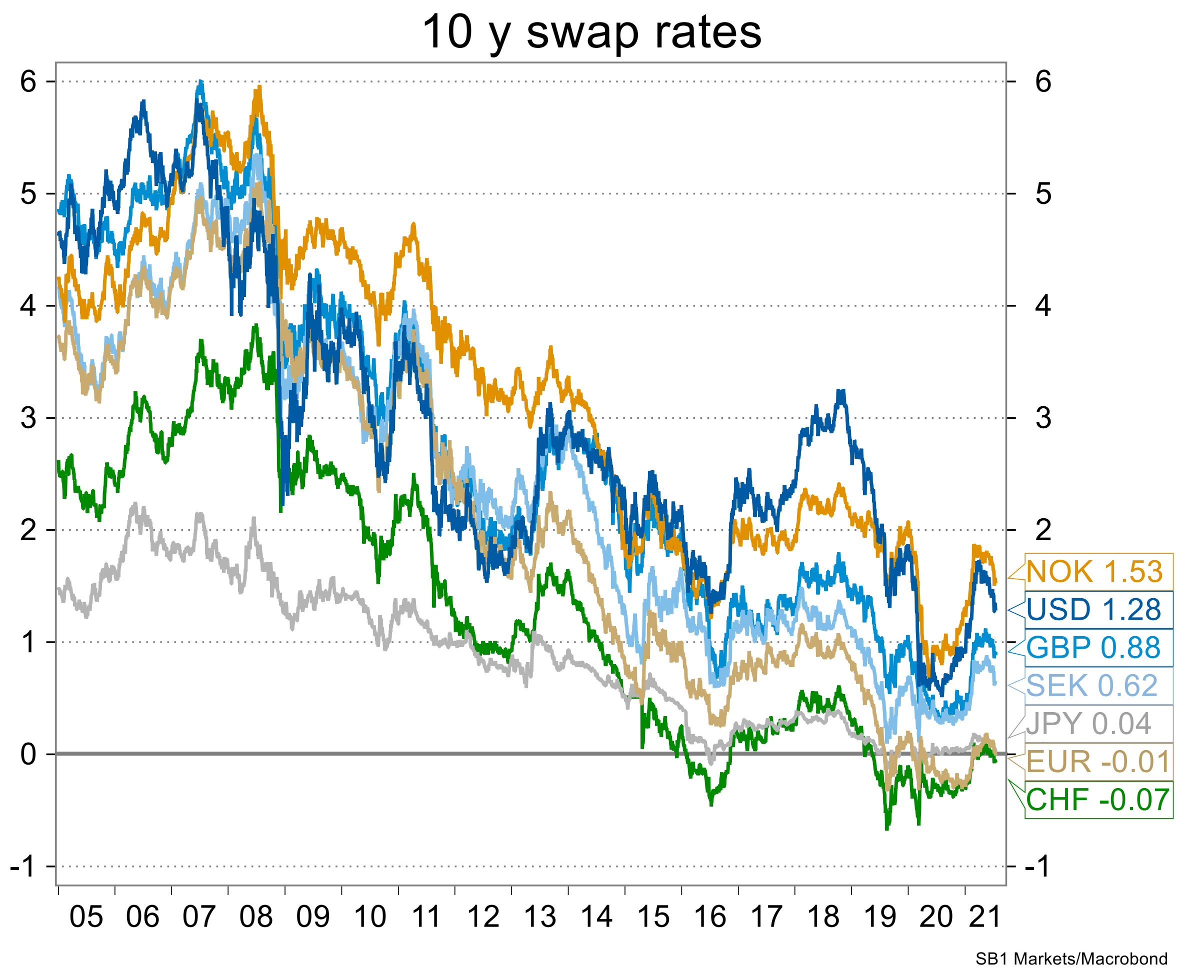
Another BoE MPC member supports tightening monetary policy

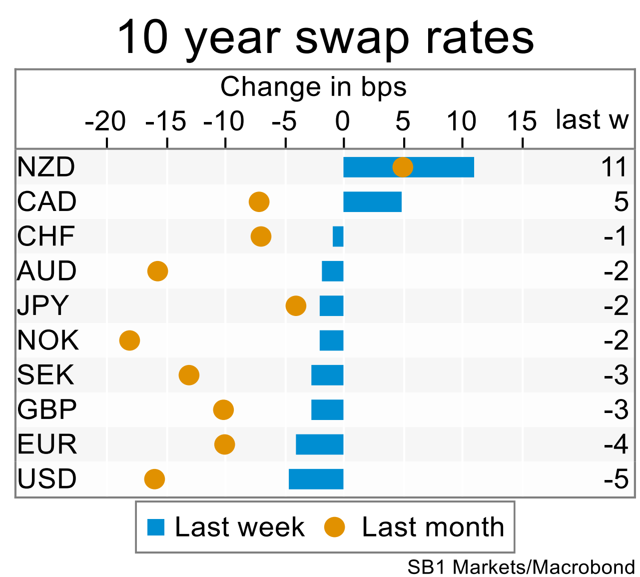




The long end of the curve down, most places

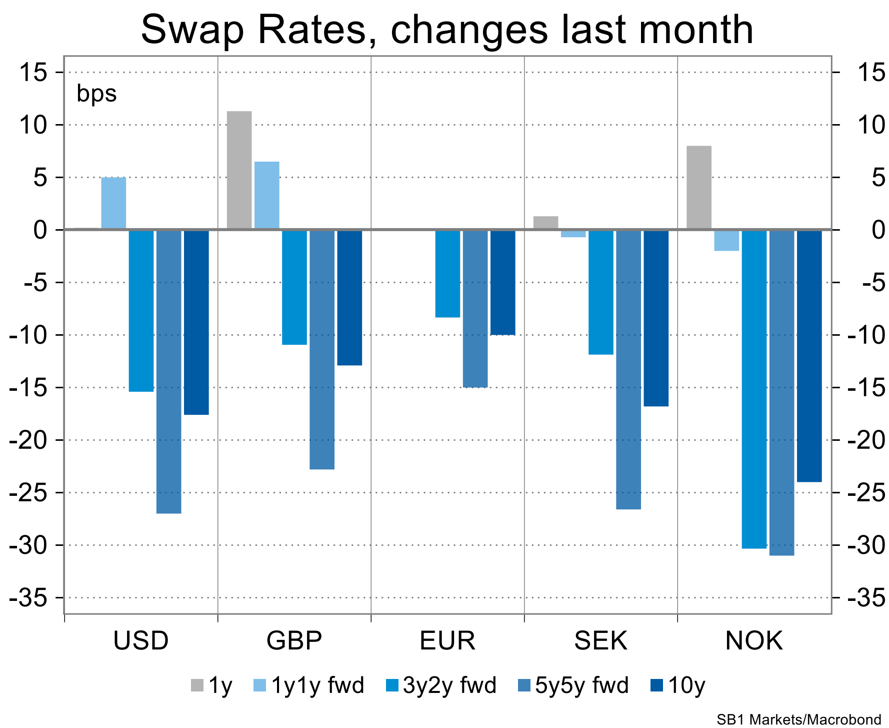
But not everywhere. BoC (Canada) decided to scale back the QE program further

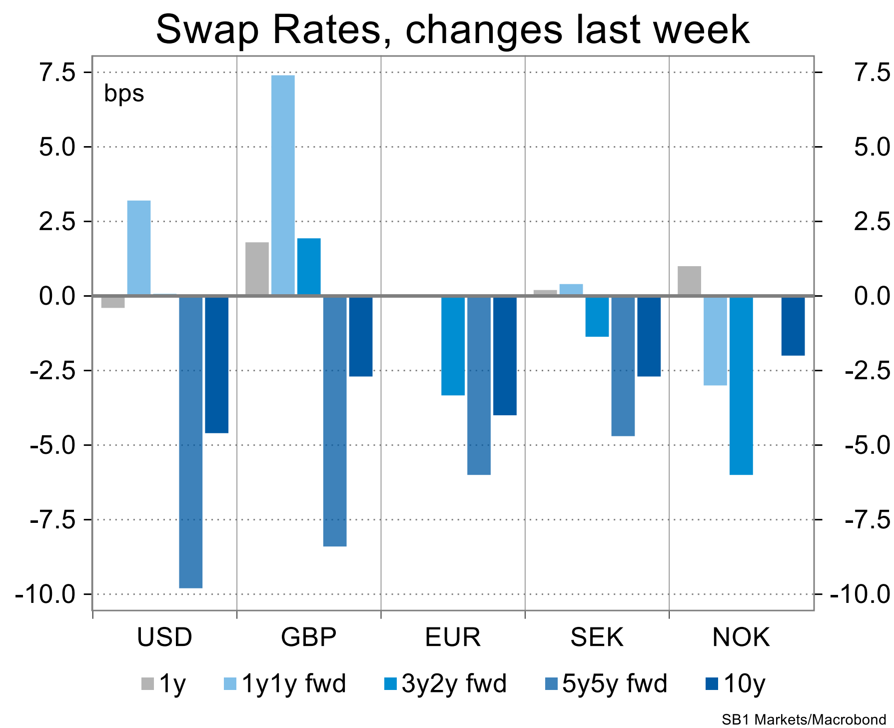




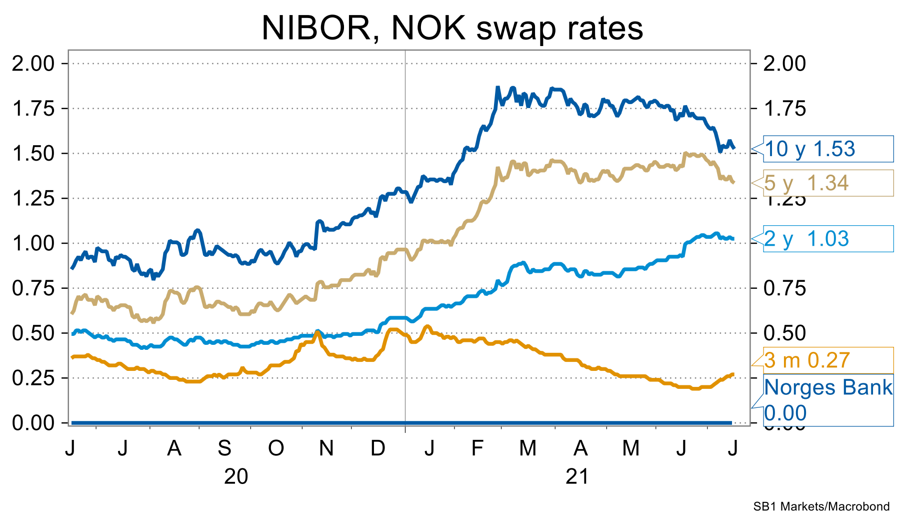
(Almost) all rates down everywhere

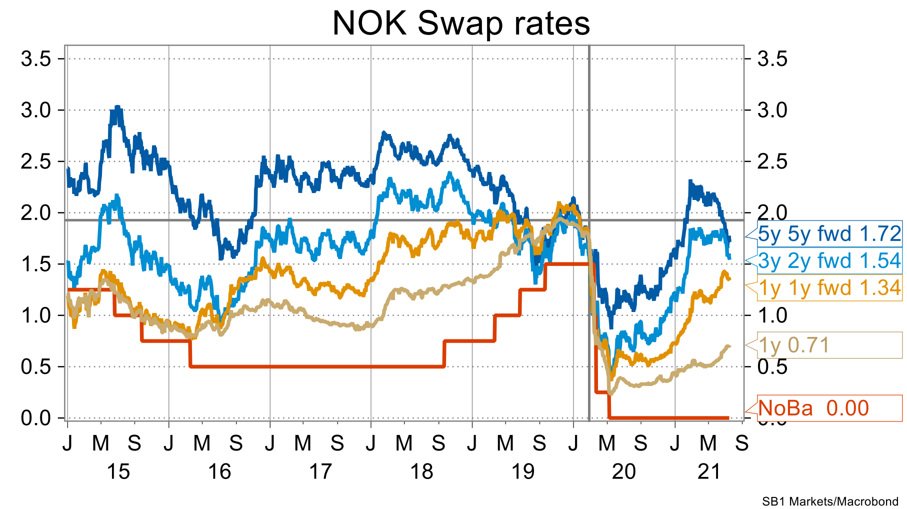
But the BoE is sending some smoke signals

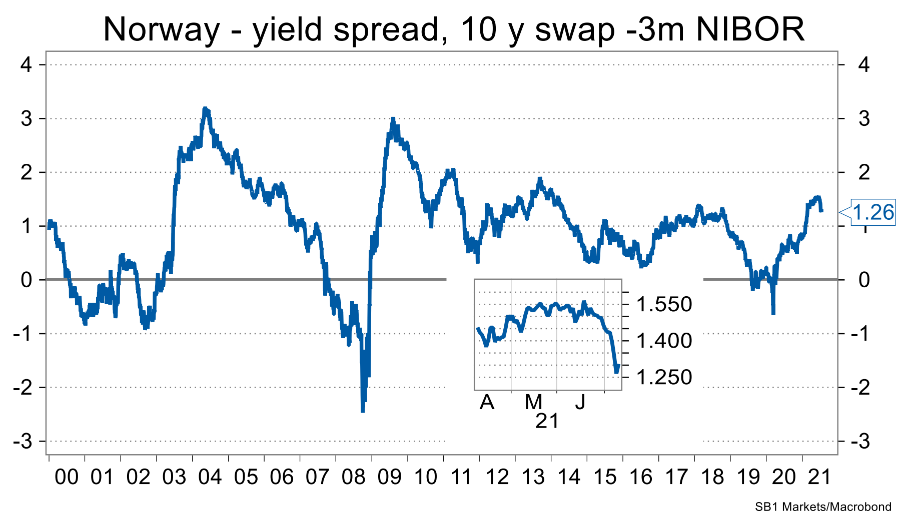


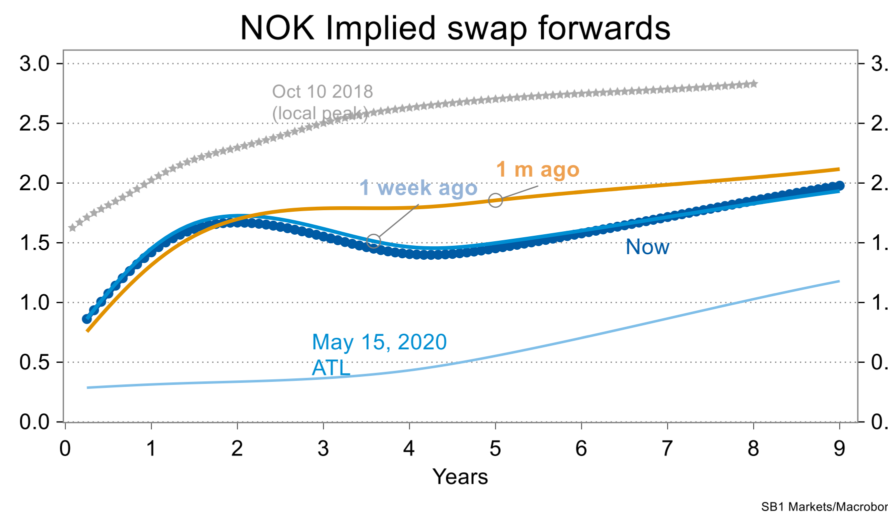


The curve is flattening – just the very short end on the way up

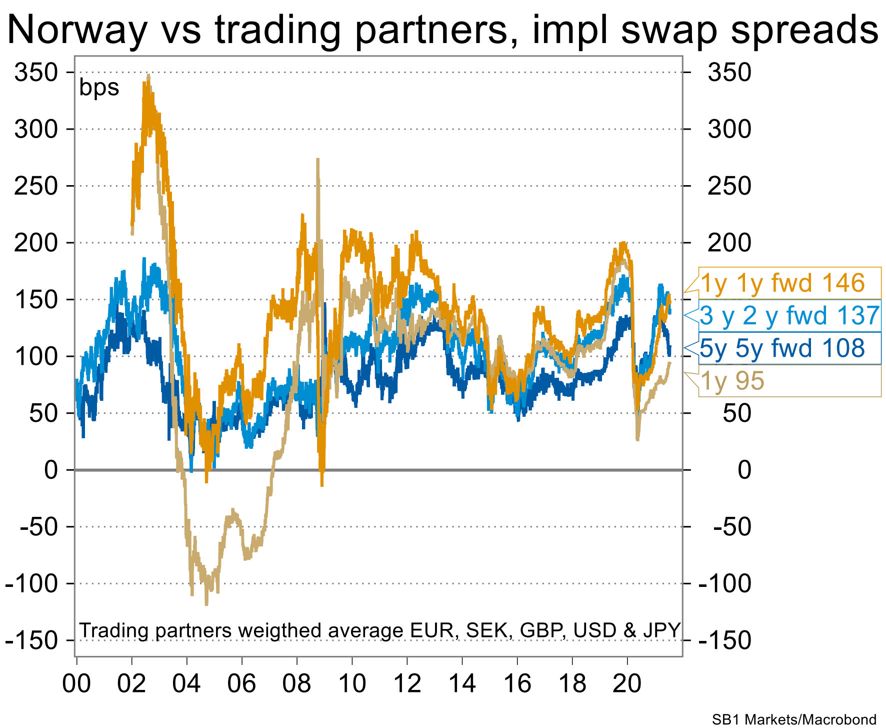


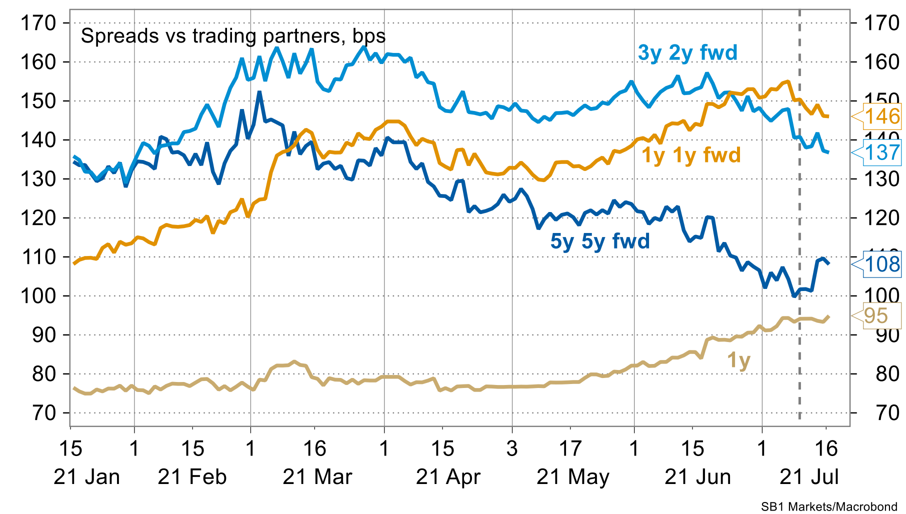


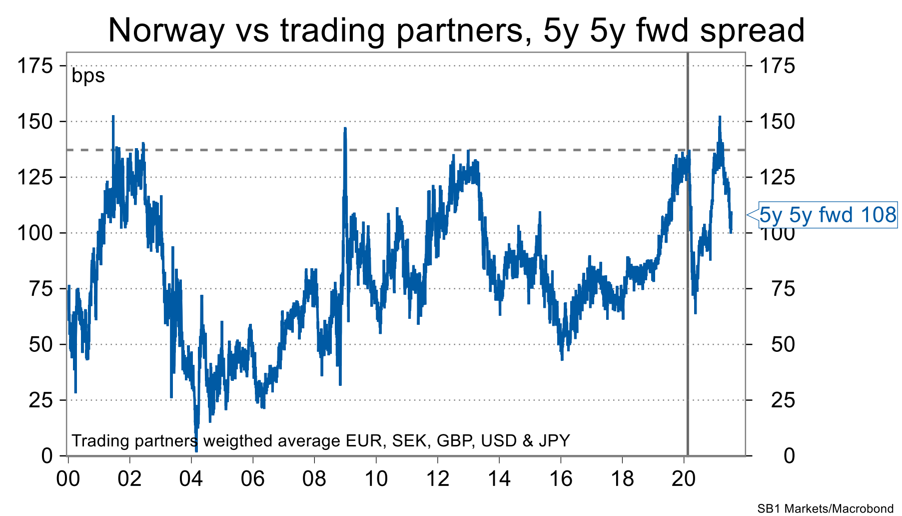




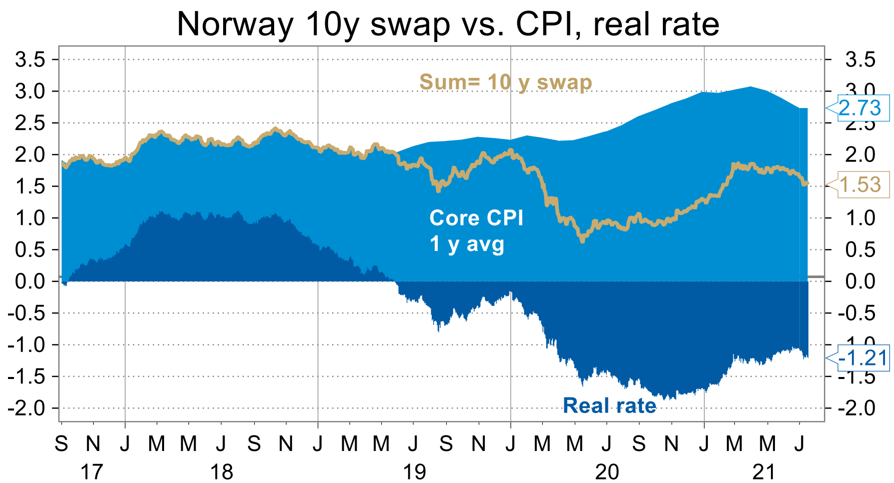
Forward spreads are broadly narrowing







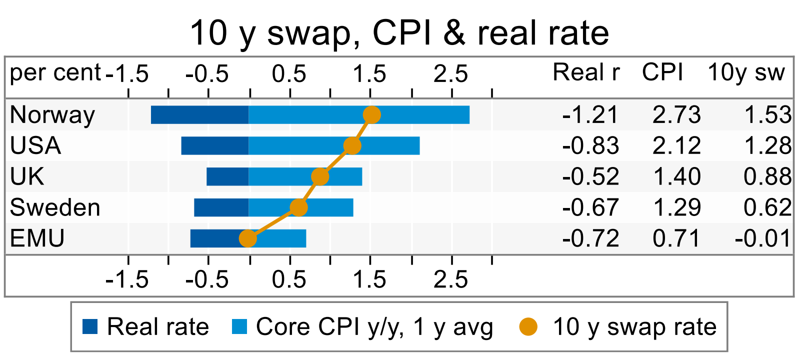
Negative (actual) real interest rates most places – NOK at the bottom



SB1 Markets/Macrobond

NOK 10 y swaps have flattened

- The **10y NOK swap** rate fell by 2 bps to 1.55% - and the trend has been down since March
- **The real rate**, after deducting 2.7%, an average core CPI inflation over the 2 past years equals -1.2%
  - » However, if we use a longer CPI inflation average, the real rate is higher, as the average rate of inflation has been lower than the current 2 y avg at 2.7%
  - » 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



SB1 Markets/Macrobond

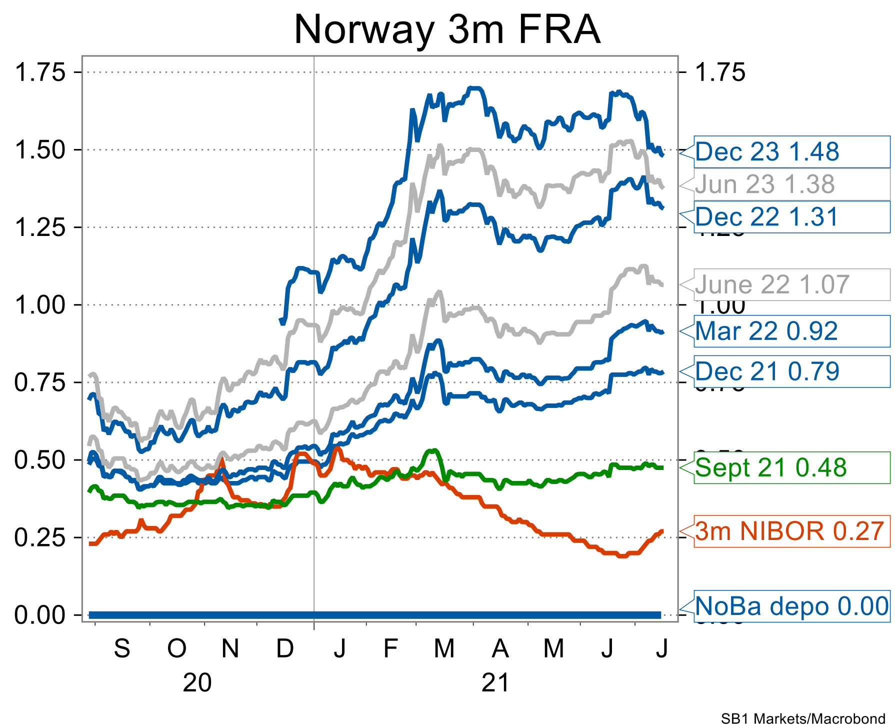
NOK real rates among the lowest, as inflation is at the top

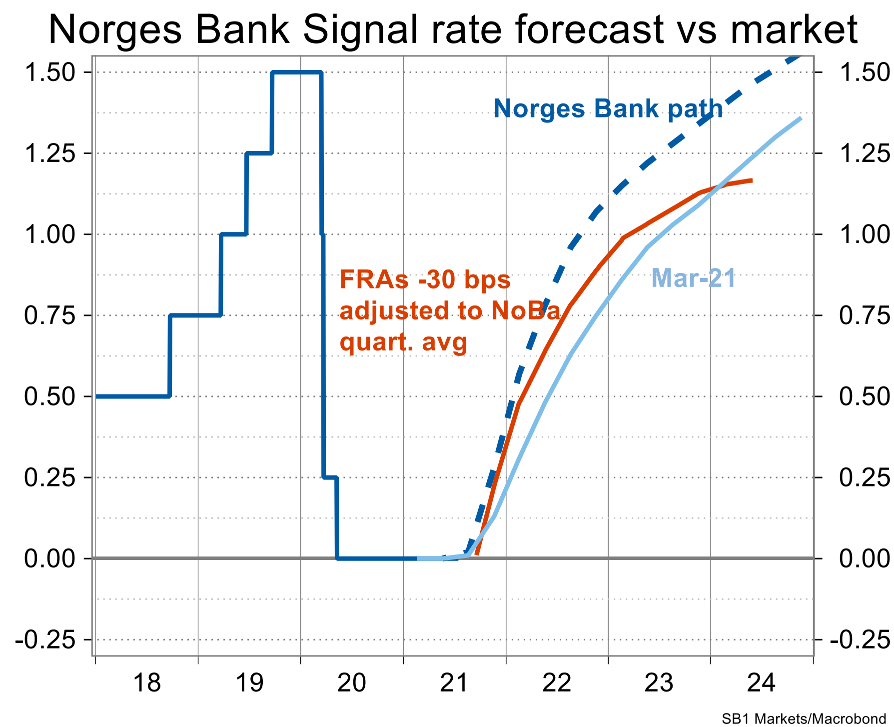
- **Inflation** among main trading partners varies between 0.7% to 2.1% (here again measured by actual annual core inflation, smoothed over 12 months). EMU at the bottom, US at the top, the latter is now climbing rapidly)
  - » Other measures of inflation trends, looking backward or including forward expectations yields the same ranking
- **Real rates** among our trading partners, and ranging between -0.5% and -0.8% measured vs. the 10 y swap rate and core inflation over the past two years
- **Thus, the Norwegian real rate at -1.2% is still an outlier on the downside, even if the nominal rate is the highest**

SpareBank 1 MARKETS

Longer dated FRAs further down last week too – like rates abroad

... but the 3 m NIBOR continues its long march upwards, up to 0.27%

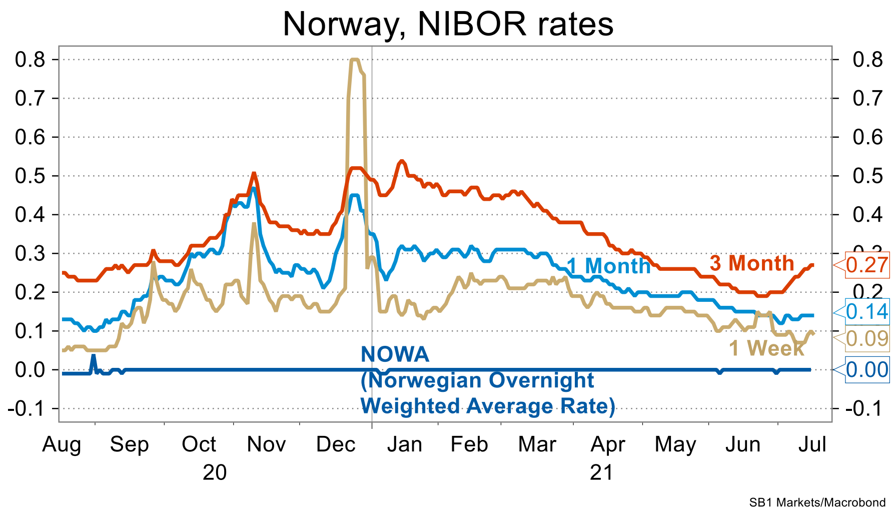


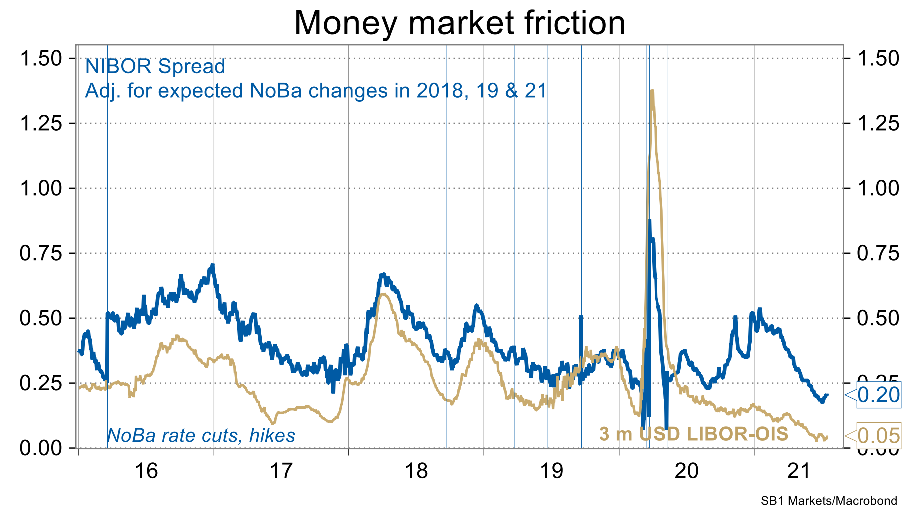


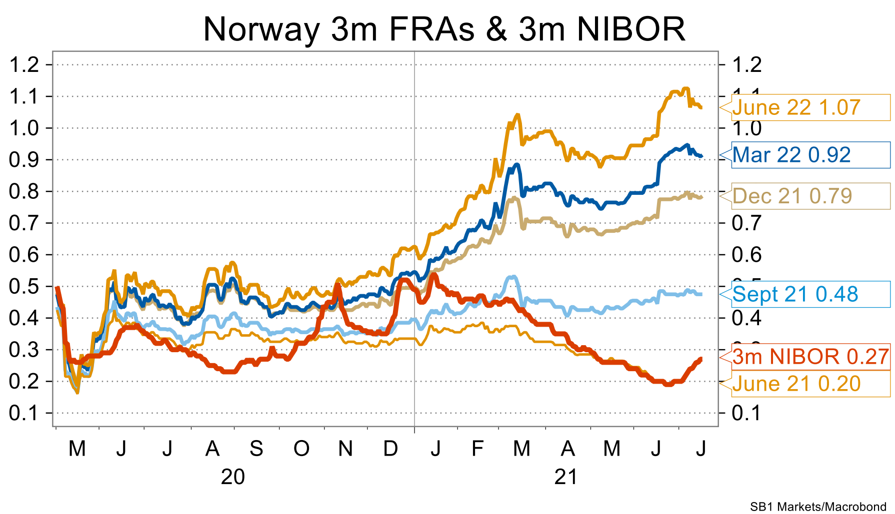
- The Dec 23 FRA rate is now well below the level before Norges Bank lifted the interest rate path more than expected in June
- The shorter FRAs are still above the pre-June meeting level but the market has lost some most of the confidence in the 4th hike, next June (if assuming a 'normal' 30 bps NIBOR spread)

3 m NIBOR 3 bp up to 0.27%, the 'real' NIBOR slightly up

As the 3 m NIBOR runs into the first NoBa hike, it will drift up by 2 – 3 bps per week

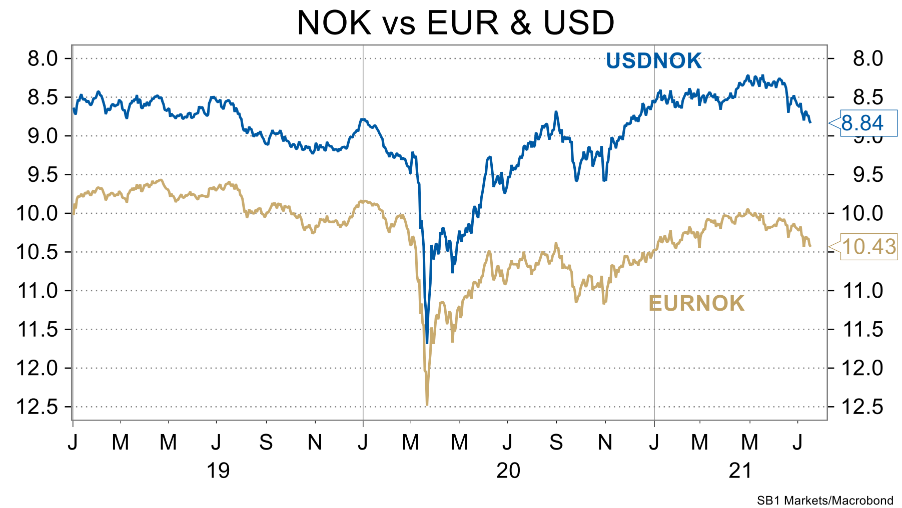


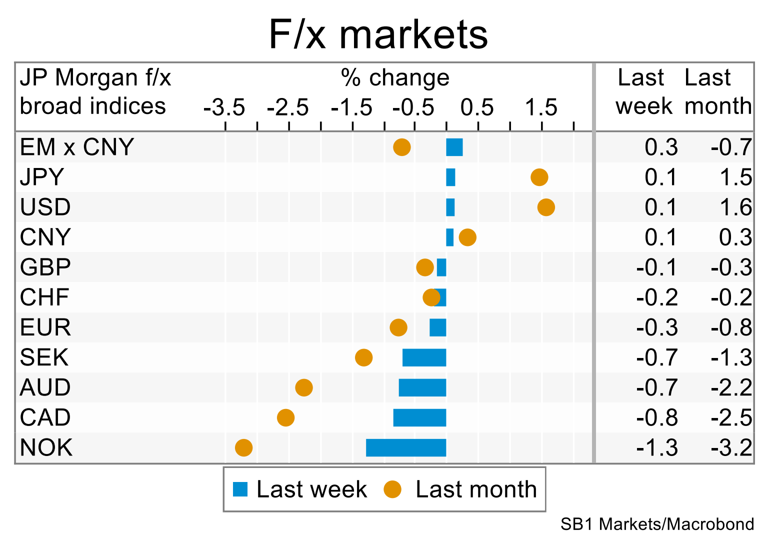




- The LIBOR OIS spread is still low – but has stabilised as the Fed offers 0.05% on excess bank liquidity (via reversed repos)
- The Sept-21 3 m contract at 0.48% bps is 21 bps above the current 3 m NIBOR. If the Sept contract remains unch., the 3 m NIBOR will climb by 2.5 bps pr week until 15 September and thereafter by 2 bps per week until NoBa stops hiking the signal rate by 25 bps per quarter (if the record low NIBOR spread remains unchanged).
- Last week the 'real' spread rose 1 bps to 20 bps. We expect the spread to drift upwards the coming months

NOK the biggest loser. USD slightly up

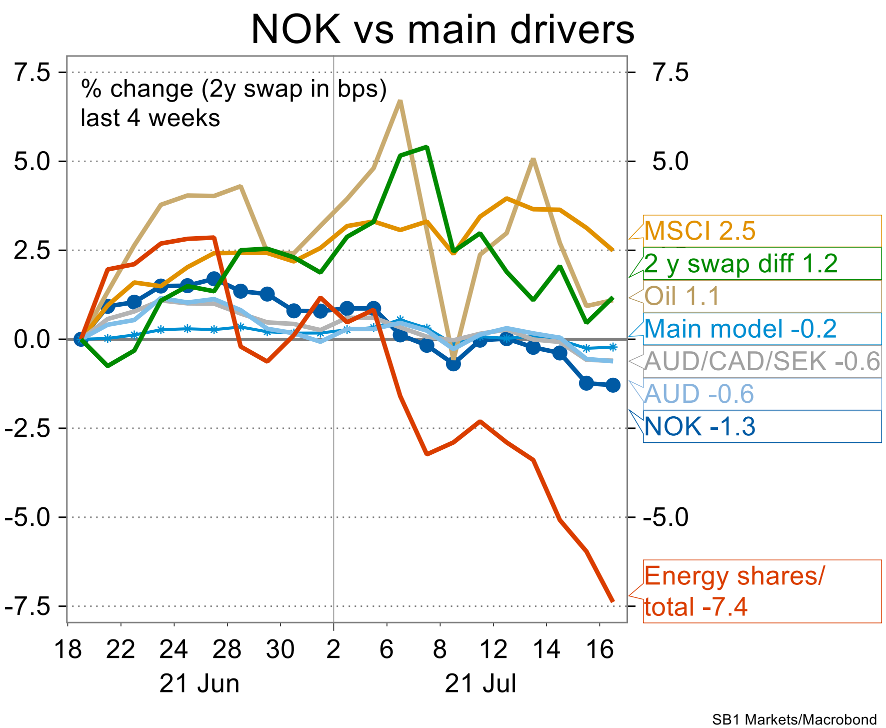


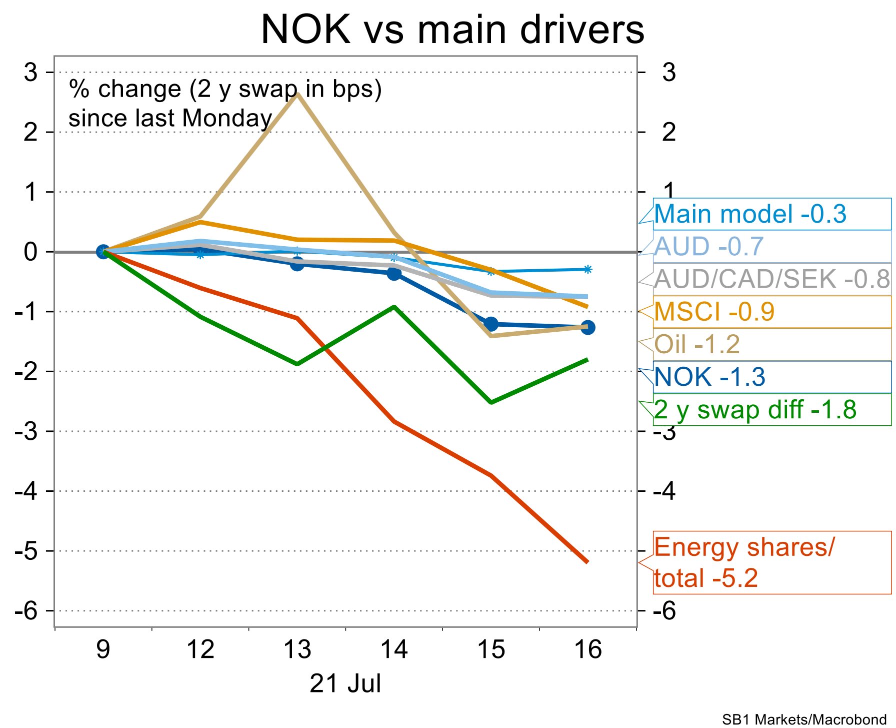


JP Morgan f/x broad indices	Last week	Last month
EM x CNY	0.3	-0.7
JPY	0.1	1.5
USD	0.1	1.6
CNY	0.1	0.3
GBP	-0.1	-0.3
CHF	-0.2	-0.2
EUR	-0.3	-0.8
SEK	-0.7	-1.3
AUD	-0.7	-2.2
CAD	-0.8	-2.5
NOK	-1.3	-3.2

'Everything' down last week – and NOK fell far more than it 'should'

Energy (oil) shares and NOK the big losers last week





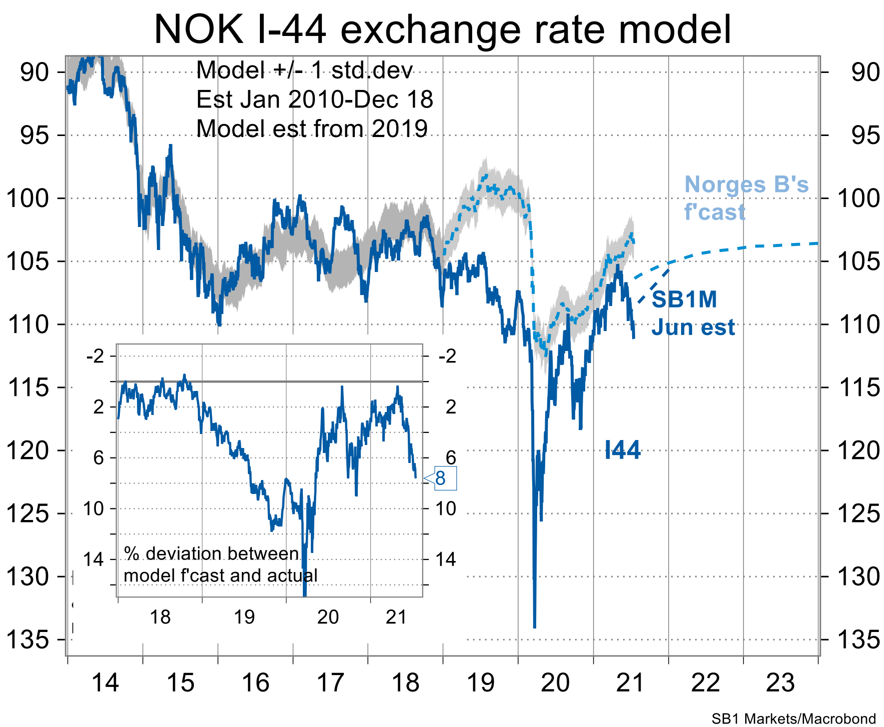
The status vs. the normal drivers:

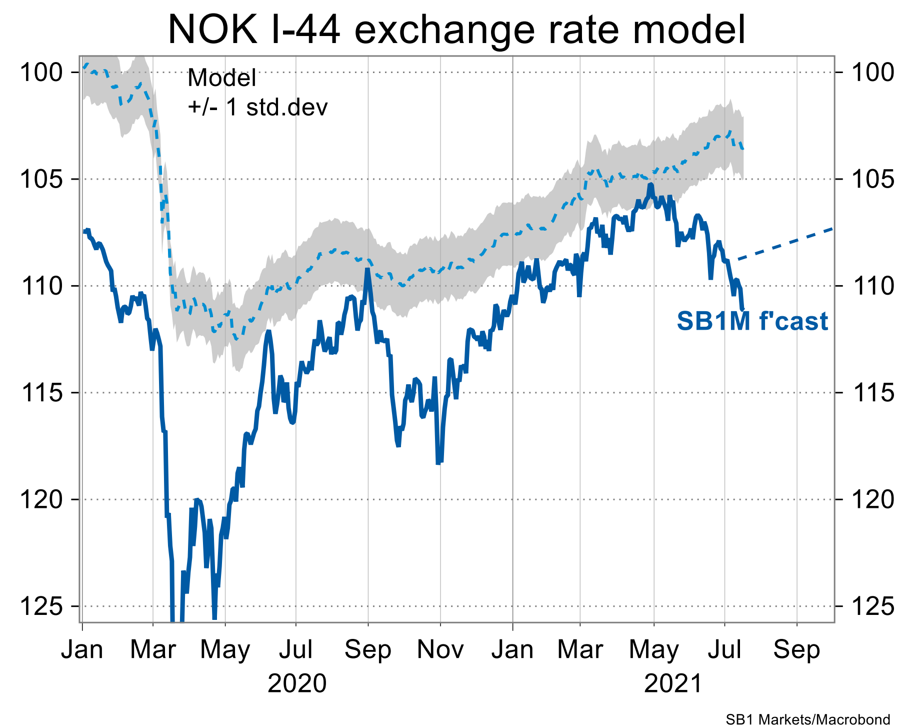
- ***The NOK is 8% weaker than suggested by our standard model (from -7%)***
- The NOK is 6% 'weaker' than the global stock market vs the correlation between the two since beg. of 2020 (unch)
- The NOK is 9% weaker than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts (unch)
- NOK is far (9%) stronger than a model which includes global energy companies equity prices (vs the global stock market) (unch)

After been neutral vs NOK from May, we turned positive in early July, as the gap vs. our models had widened. So far without any success

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

NOK now 8% below our model estimate!!

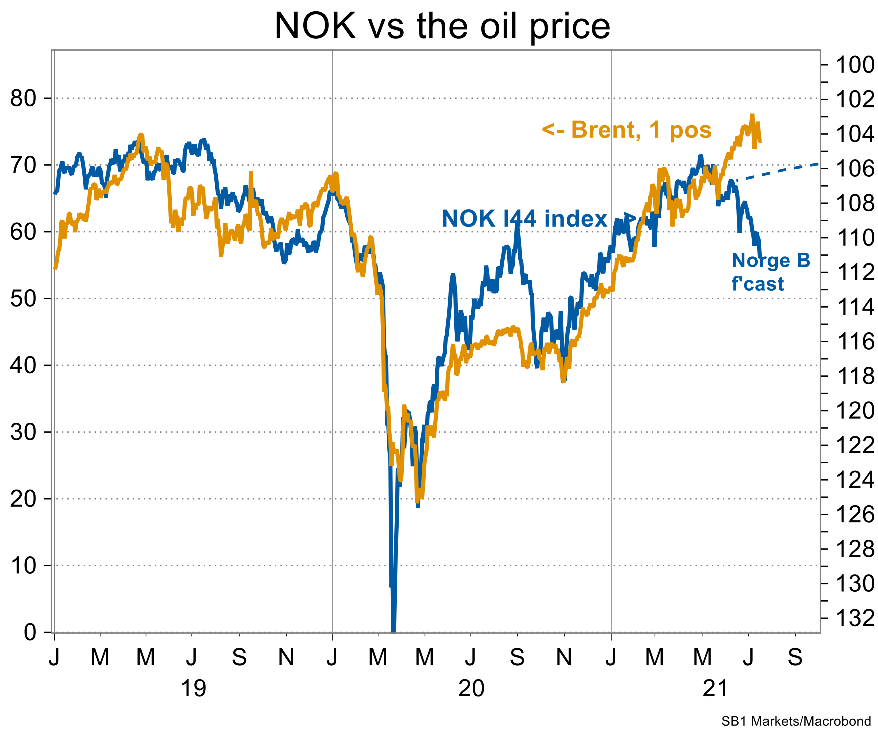


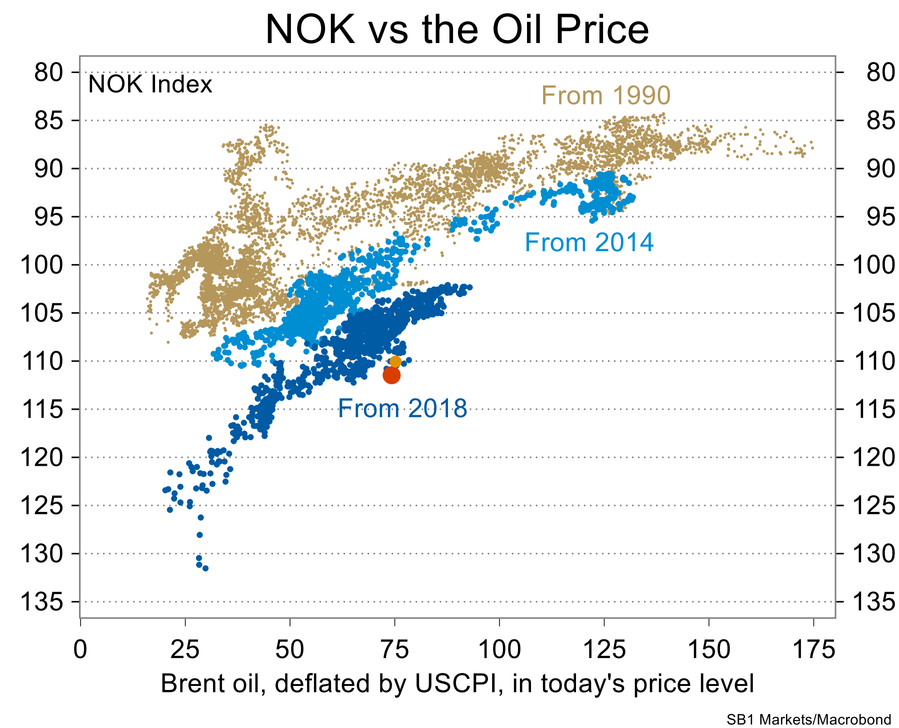


SpareBank 1 MARKETS

Oil down, NOK down – but NOK is unusually weak vs the oil price

Just March last year 'worse' than today

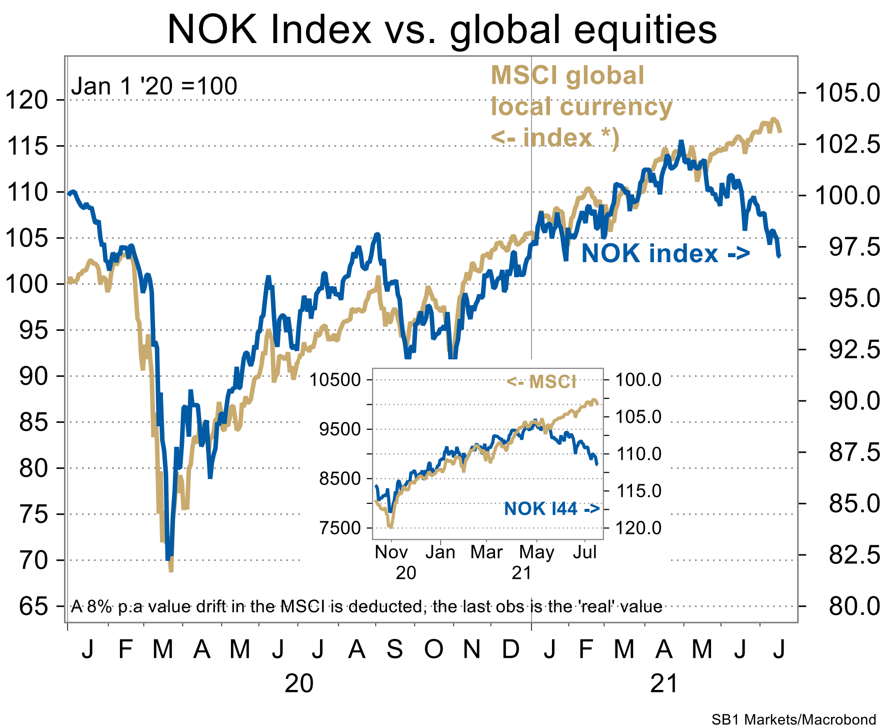


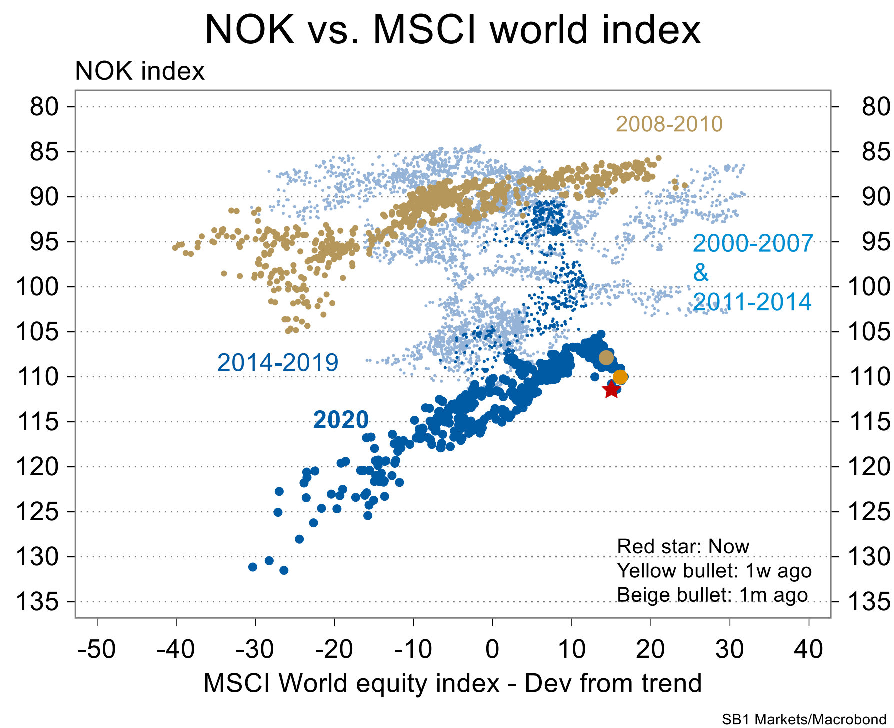


- NOK is still correlating quite closely to the oil price but at a lower level than before 2018 – and now the NOK is weak even vs the past 3 years' relationship
- A USD 10 drop in the oil price weakens the NOK by some 2.5%, as a partial effect.
  Within a broader model, the impact is somewhat smaller

Both stock markets & NOK down last week

NOK has lost some 6% vs. global stocks over the past months/weeks

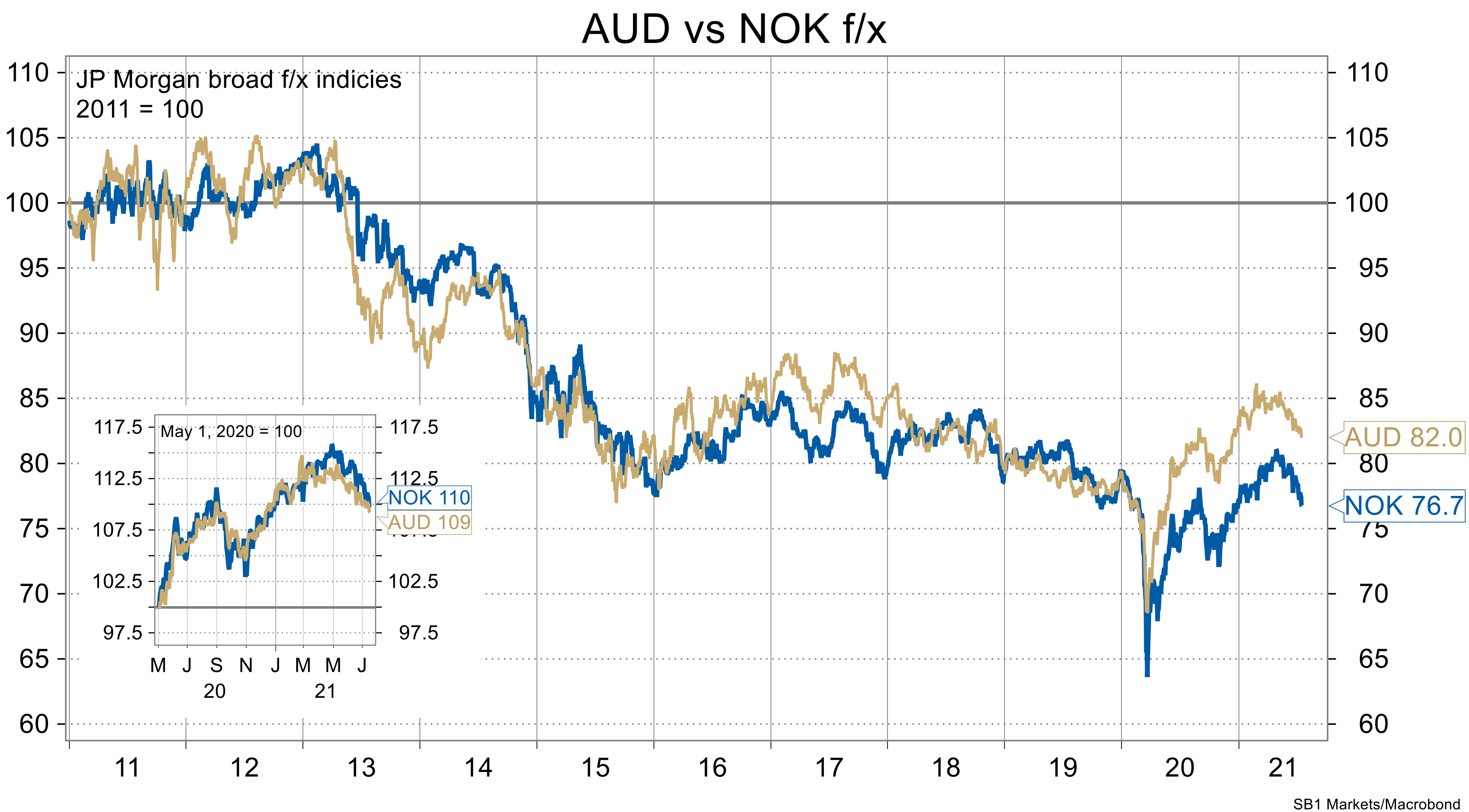




- Over time, there has not been a stable correlation between NOK and stock markets (the Oslo Stock Exchange, S&P 500 or the MSCI, the global equity index. (At the chart to the right, we have detrended the stock market as equities are drifting upwards, while NOK (hopefully) is stationary. However, the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

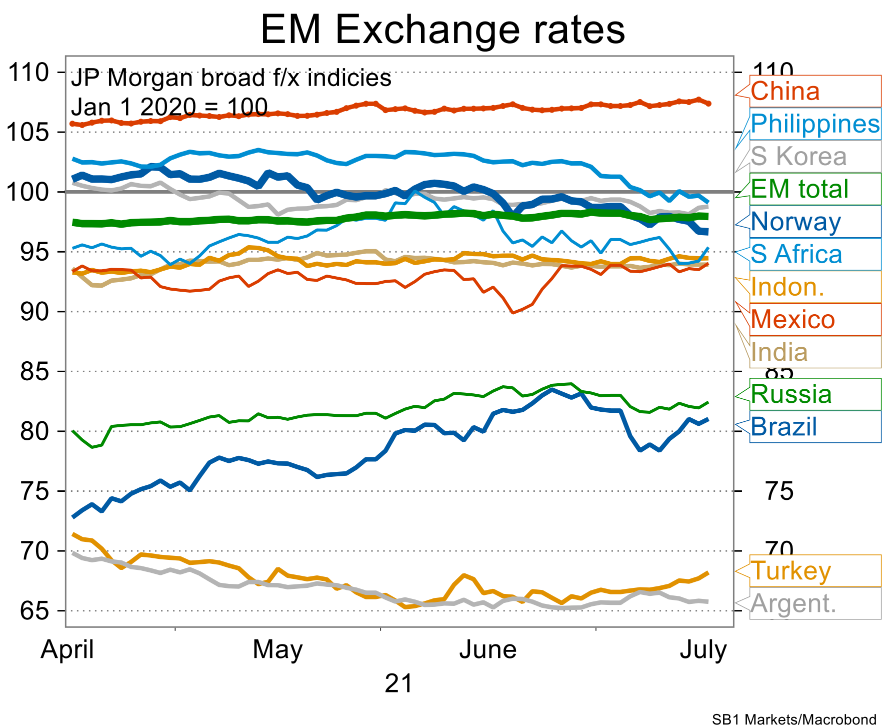
NOK & AUD still dancing extremely tight

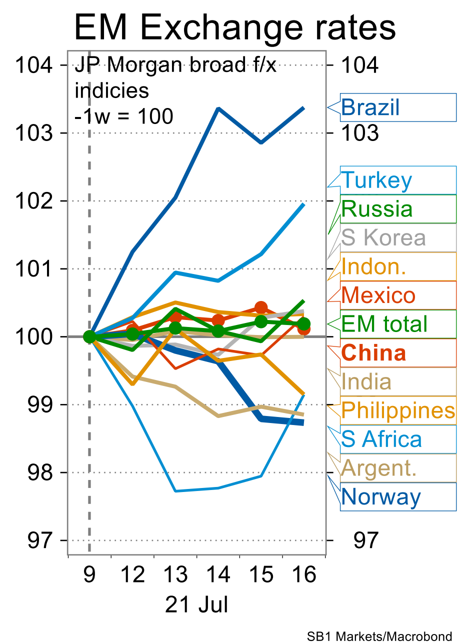
…but the NOK is still 6% weaker than AUD since last spring

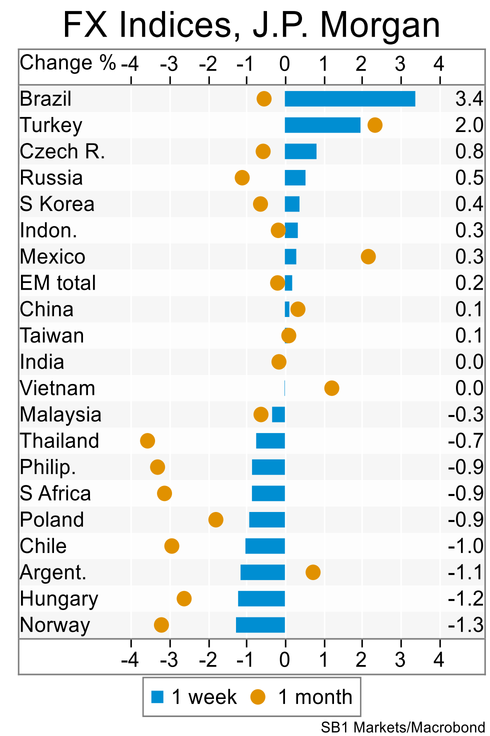


EM f/x more up than down, even if there is some growth uncertainty around

… but less fears of Fed tightening too







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