16 August 2021

Macro Weekly

Week 33/2021

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

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

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

Last week

The virus

- Most countries are still reporting **growth in new virus cases**, thanks to the Delta variant. However, growth has slowed in several countries past 4 weeks, and in some countries the no. of new cases has fallen sharply, and it has flattened other places
- In Europe, **hospitalisation & death rates** (CFRs) have fallen sharply and are at low levels, there are no widespread capacity problems at hospitals
- That has not been the case in the **US**, suggesting diverging testing policies as the no. of hospitalisation & deaths have increased far more than in Europe. The good news: growth in cases & hospitalisations is actually slowing in the US as well
- **Norway** reports a substantial increase in new cases. Still there are very few hospitalised patients (25), and at the current pace of vaccination the Delta variant will very likely be defeated before hospitals are filled up
- **Mobility** has flattened/declined marginally last weeks. It may be due to the spread of the Delta variant

The economy, part I

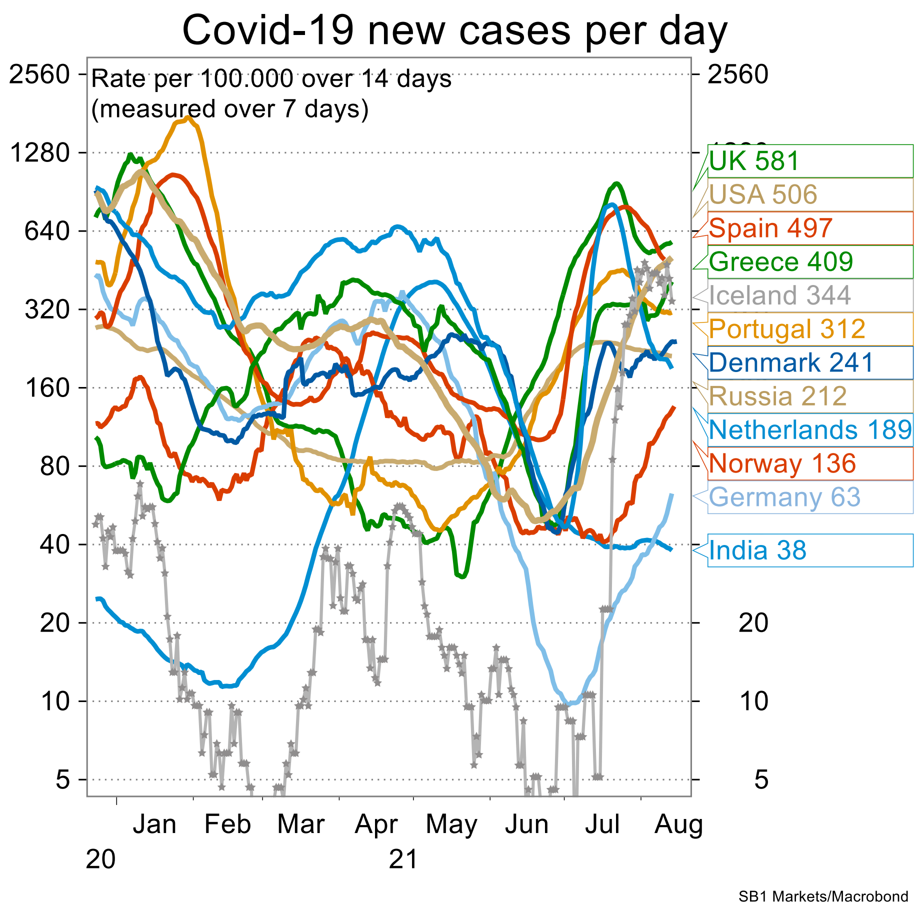
- **China**
  - » **July industrial production, retail sales, investments** all surprised significantly at the downside this morning – and house prices stagnated. Monthly growth rates (which are the relevant) were all weak too and both retail sales and investments were once more revised down. Underlying growth in retail sales are less than 2%. Housing and other construction starts are down 12 – 20% recent months, and steel & cement production is cut by 10 – 12%. Steel prod. is cut in order to reach 2030 (!) CO_2 emission targets, at least that's the official story. The covid virus may explain some of the weakness in July (following an OK, and better than expected June)
  - » **Credit growth** is still slowing, mostly due to lower growth in credit outside banks – and the credit impulse is negative. However, the slowdown is not that harsh, and the authorities may already have turned the policy around, at least vs. banks by cutting the reserve requirement (in July) Still, overleveraged real estate developers and shadow banks will probably not get any support in the near time
  - » A major Chinese **port** is closed down due to one – 1 – positive covid-19 case among the workers at the port. Some more supply chain disruptions, but probably not long lasting

Last week: The economy, part II

- **USA**
  - » **CPI growth** m/m slowed in July, and at 0.3% lower than expected for core prices, as 2nd hand auto prices finally stabilised (but they are up an incredible 42% y/y, and the price level is very likely not sustainable). Energy and auto prices explain most of the hike in annual inflation recent months, but there are signs of broadening, and surveys are 'crazy' vs. planned price increased. Producer prices rose far more than expected in July, signalling a continued pressure on CPI prices. However, crude material prices may be peaking. From the cost side, **unit labour costs** rose moderately in Q2, and they are flat y/y – from a very high level last year, during the pandemic. Thus, the cost level is still high vs the pre-pandemic level, while the price impact has been dampened by government subsidies (and not lower profits). The number of unfilled vacancies rose to a new ATH in June, equalling 6.5% of employment – and the correlation to wage inflation is tight. Wage indicators have been mixed but one of the two laggards, **Atlanta Fed's wage tracker**, is now reporting a steep increase in median wages. In sum, not a reassuring wage/price environment – and however measured, the price level already higher than implied by Fed's 2% over time inflation target
  - » The **USD 1 trl bn infrastructure plan** (550 in net increased spending, mostly over 5 years, 0.5% of GDP) was approved in the Senate, and the deal is back to the House. In addition, the Senate approved a sketch of another **3.5 trl USD 10 y green/welfare/education budget package**, now to be debated in the House. Nothing is final yet but the infrastructure deal is most likely sealed
- **EMU**
  - » **Industrial production** fell marginally in June, as expected, and the trend is downwards. The contrast to surveys and order inflow is unpresented
- **UK**
  - » **GDP** rose by 4.8% in Q2 (21% annualised ☺), but the level is still 4.4% below Q2-19. In June, the gap had narrowed to 2.2% in June. Services gained the most in Q2 but hotels, restaurants, entertainment and others still have a way to go
- **Sweden**
  - » **No inflation here**: Core CPI just up 0.5% y/y in July, down from 0.9% in June. However, a steep (too steep?) rise is expected the coming months
- **Japan**
  - » **GDP** rose by 1.3% in Q2 (0.3% not annualised), slightly better than expected (0.8%) but did not recover much of the 5.1% Q1 loss. GDP is down 1.5% vs. (a low) Q4-19 level
- **Norway**
  - » **Core CPI inflation** fell by 0.3 pp to 1.1% in July, in line with consensus but below Norges Bank's and our forecast. Food prices surprised on the downside, and they are down 0.6% y/y (just like in our neighbour countries). Total inflation rose to 3%, due to higher electricity prices. Since 2010 Norges Bank's signal rate has been uncorrelated with actual core (or total) inflation
  - » The register based (a-ordningen) **number of employees** rose by 0.8% m/m in June, but is still 42' or 1.6% below the Feb-20 level – and Q2 was unch. vs Q1. Excluding foreign workers on short term stay (not immigrants), the decline vs. early 2020 is just 10' or 0.4%, not far from the LFS employment estimate, which is based on workers living in Norway permanently. Reported lack of workers is no doubt impacted by the decline in foreign temporary employees
  - » **Norges Bank's Q2 lending survey** did not report any important changes but banks are easing lending standards. However, banks abroad are more aggressive
  - » **Manufacturing production** rose by 0.7% in June, as we expected. The trend is up
  - » **Sales of new homes** is sagging but the level is far from low

The Delta variant is not exploding: the UK, the Netherl. down, others flattening

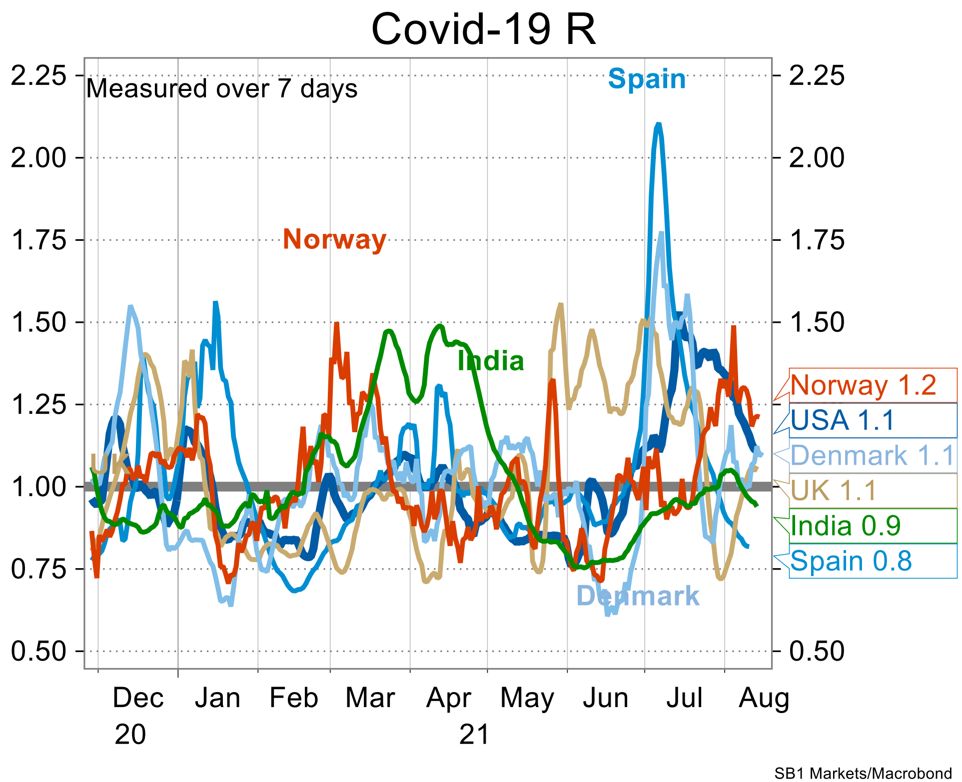
And growth has slowed somewhat most other places

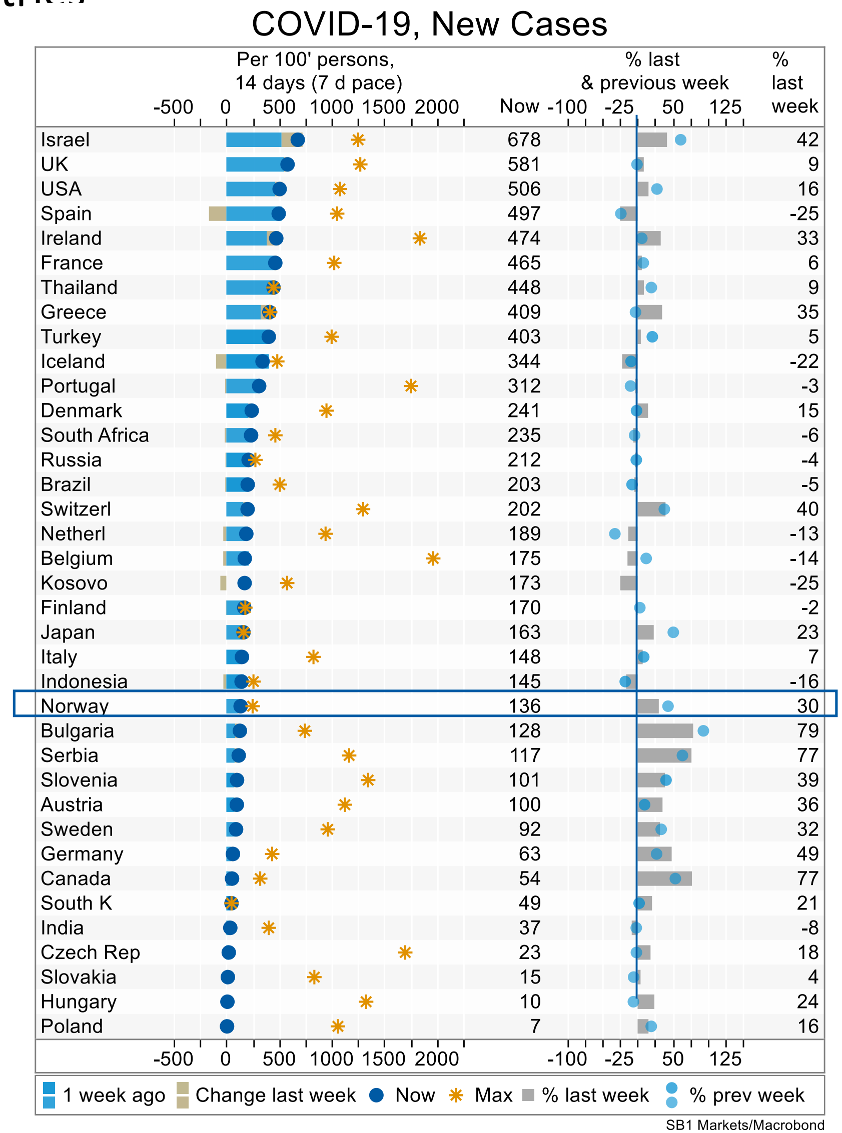


- In **Europe**, the Delta outbreak has led to more hospitalisations and deaths, but as hospitalisation/death rates have fallen sharply there is not any health crisis yet – and we doubt there will be
  - » Netherlands has reported a close to 75% decline over the past 3 weeks
  - » UK was down almost 50% and is now heading just slowly up
  - » However, vaccines are far from perfect, check Iceland!
  - » Vaccines are not perfect, but some Norwegian data implies a 85% efficiency vs cases and some 90% vs. hospitalisations
- The outlook is a bit more uncertain in the **US** where hospitalisation & death rates are much higher than in Europe (probably because the real no. of positive cases is underreported). In some regions, hospital have run out of beds again. However, growth is slowing, also in hospitalisations
- The challenge is of course much larger in many **Emerging Markets** but even there the no. of new cases has peaked in some countries
- **Norway** is reporting a sharp increase in new cases and the number of hospitalised has doubled from the through, but the level is still very low
  - » At the present growth rate in new cases, 30% per week, it will take many weeks before we have serious trouble in the hospitals
  - » In meantime, the vaccines are being rolled out rapidly, and a sufficient immunity rate will very likely be reached before that happens

The Delta variant is not combatted – new cases are still on the rise most places

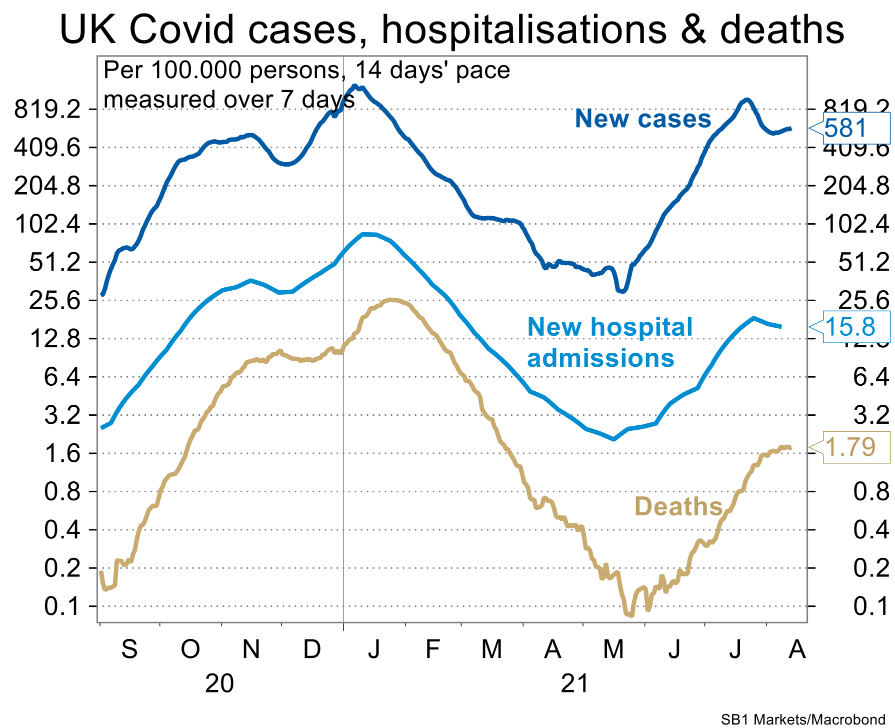
The UK, Netherlands sharply down, but a majority of countries still on the way up. Spain at the top but has flattened

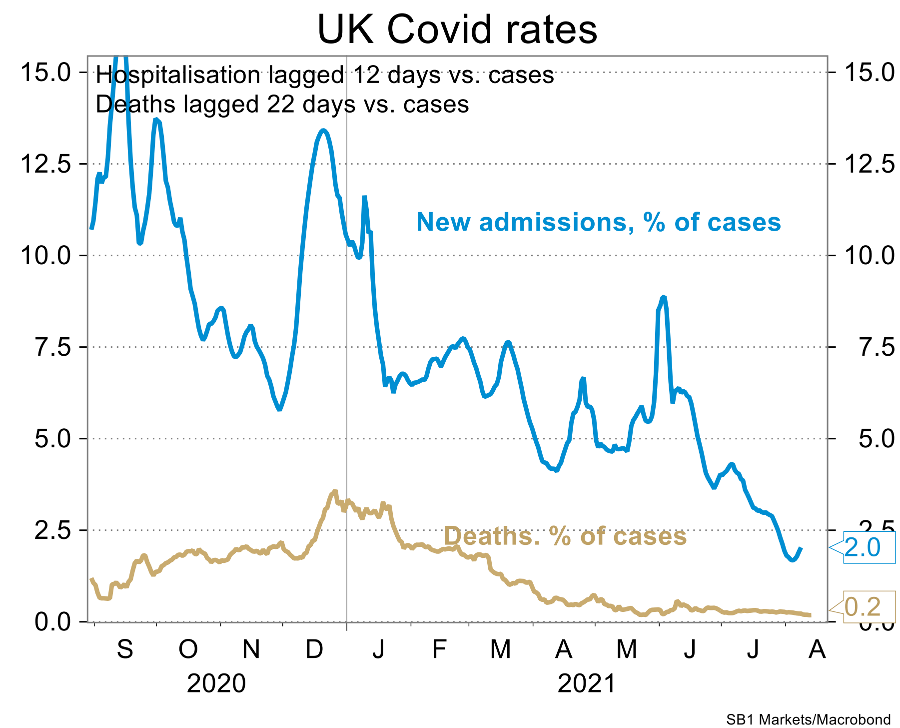




UK: Still a low level of hospital admissions & deaths – and has peaked?

The no. of new cases is increasing again but slowly – and the level is well down from the peak

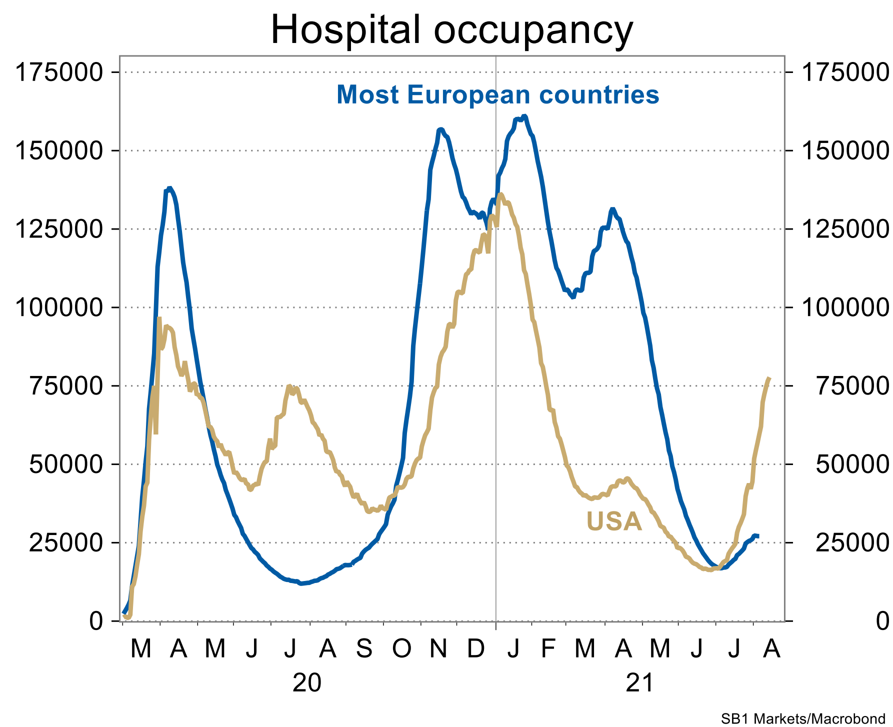


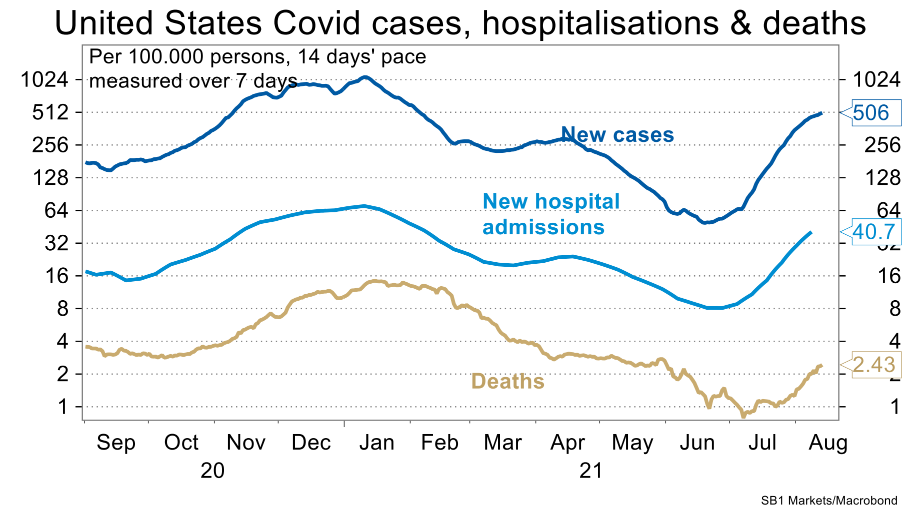


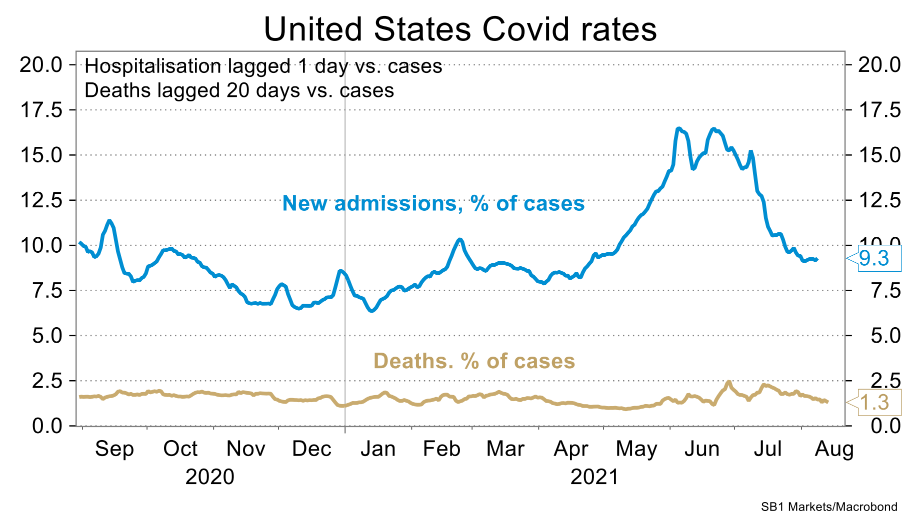
- The no. of **new cases per day** peaked before it reached the Jan top, then fell 50% during less than couple of weeks. Now it is heading slowly up
- The no. of daily hospital admissions has increased 9 times from the bottom in May, but the level is just above 1/5th of the peak in Jan, and the no. admissions has declined the past two weeks. The no. of death is up more than 16 times, still at just 6% of the Jan level
  - » The **hospitalization rate** has fallen sharply as both old persons and other risk groups are vaccinated, to 2% from 8%
  - » The **case fatality rate** (of those tested positive) has fallen even more, to 0.2% from close to 3% in Jan/Feb
- **Implication:** The Delta variant has spread 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 – and now the curve has turned down. Perhaps because 93% of the adult brits have antibodies
- Other European countries are reporting low hospitalisation & deaths rate, while the US is not (probably because testing is far below European levels), check next page

US may run into problems but stricter policies, more vaccinations will help?

Far more hospitalisations/deaths, but growth in cases, hospitalisations & deaths is now slowing



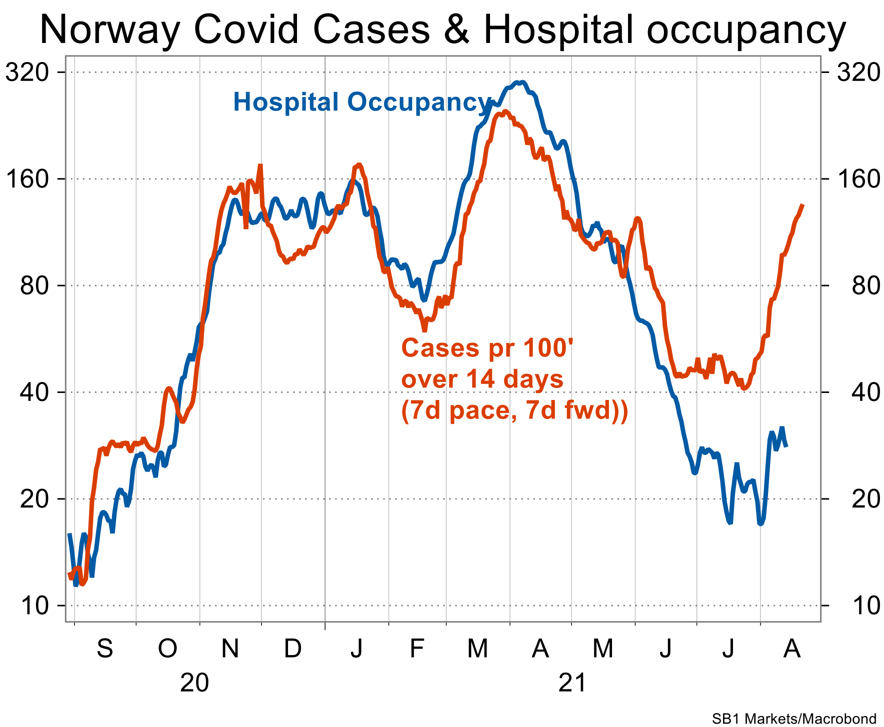


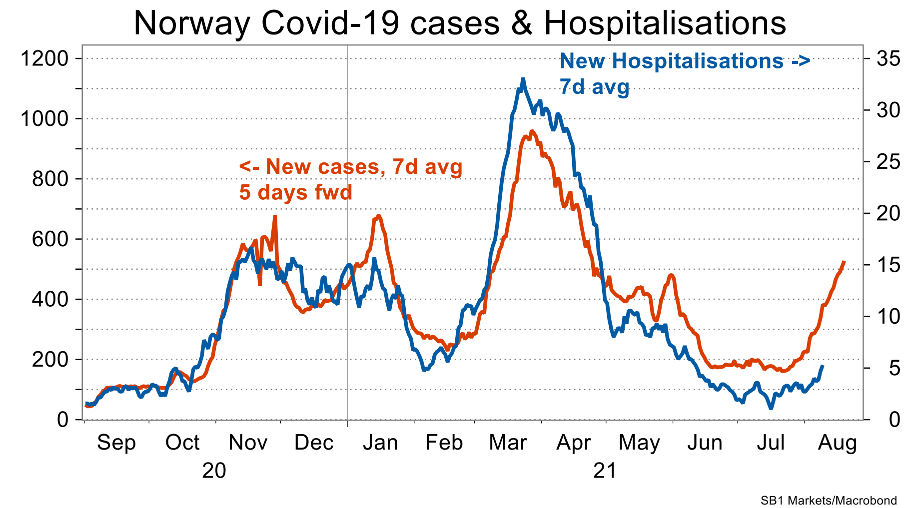


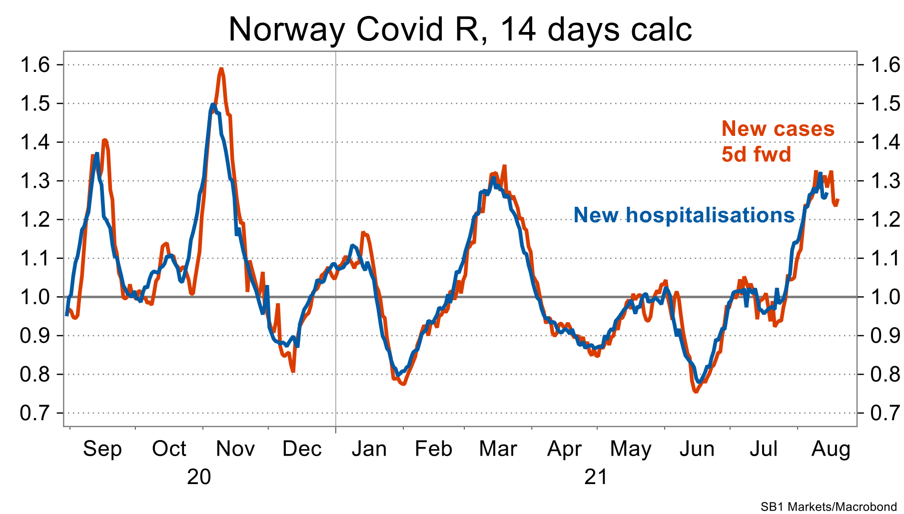
- The hospitalisation rate is far higher than in Europe
- The death rate (Case Fatality Rate) is 2 – 8 times higher
- Thus, the no. of cases is very likely underreported vs. Europe
- However, growth in the (official, though) number of new cases has slowed substantially recent days – and growth in hospitalisations has slowed as well

Norway: More cases, more hospitalisations but the level is still very low

Given the present vaccination rate, Norway will probably not run into hospital capacity trouble







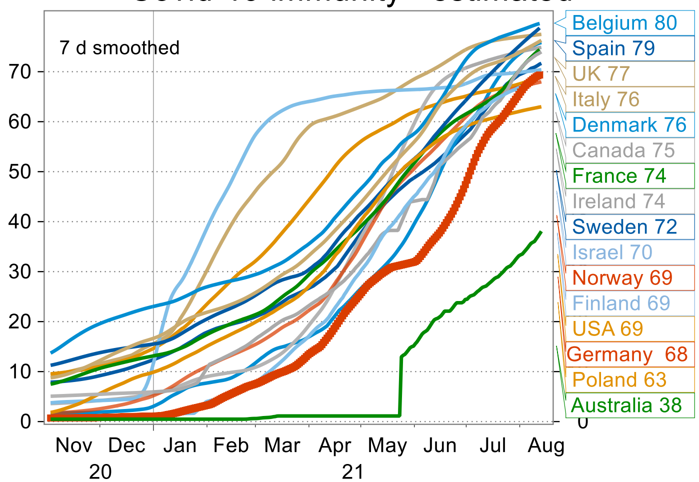
- No more than 25 patients are hospitalised, even the peak level at 300 was very low compared to peaks in most other countries
  - » The number will very likely increase the coming days
- Growth in new cases has slowed slightly, like in most other countries

SpareBank 1 MARKETS

Vaccinations: EU/Norway are keeping the pace up better than the US/UK

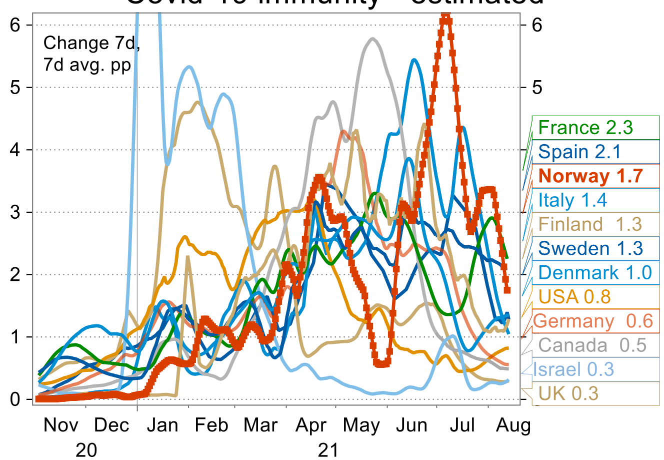
Even with high vaccination rates, the Delta variant is spreading rapidly. More vaccines needed

Covid-19 immunity - estimated



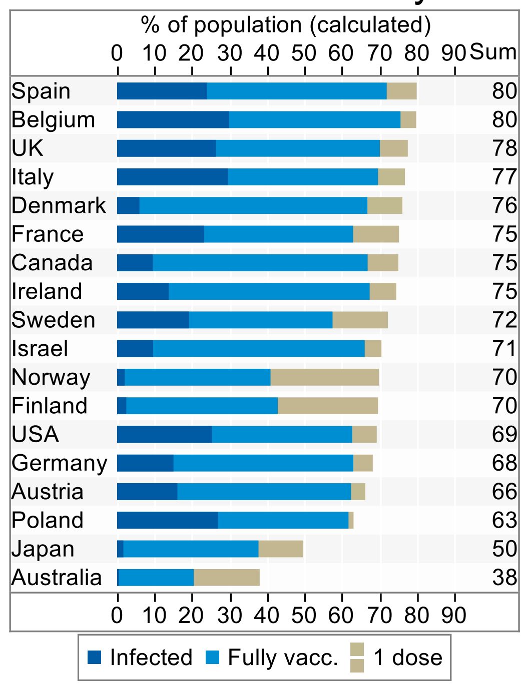
SB1 Markets/Macrobond

Covid-19 immunity - estimated



SB1 Markets/Macrobond

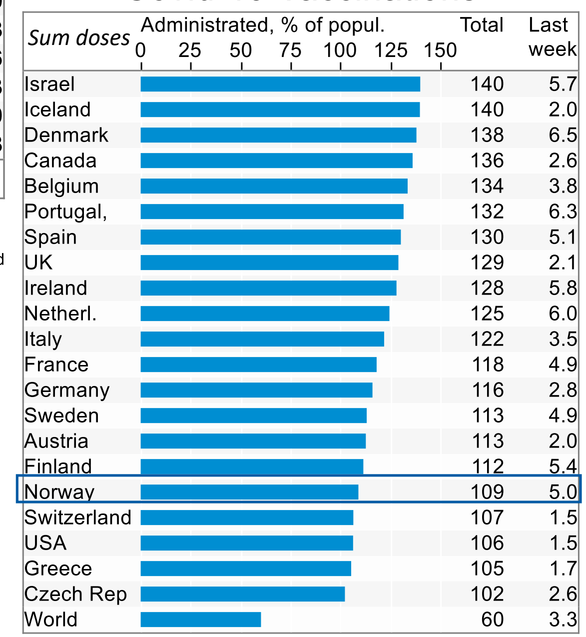
Covid-19 Immunity



SB1 Markets/Macrobond

The weekly **antibody survey in the UK report a** 93% rate among the adult part of the population. The high immunity rate may at least partly explain the unexpected decline in the spread of the virus the past two weeks

Covid-19 Vaccinations

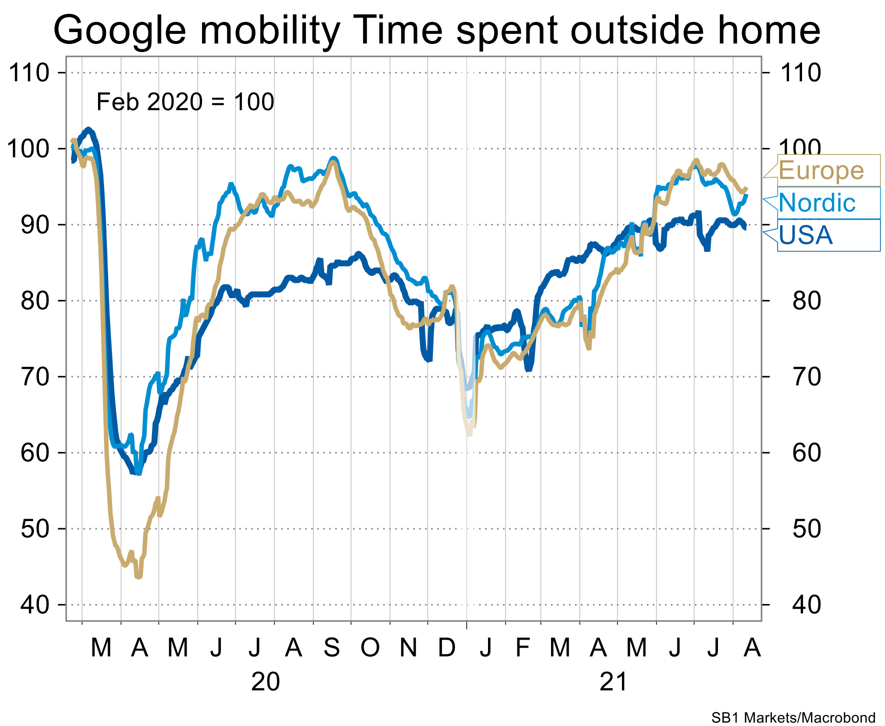


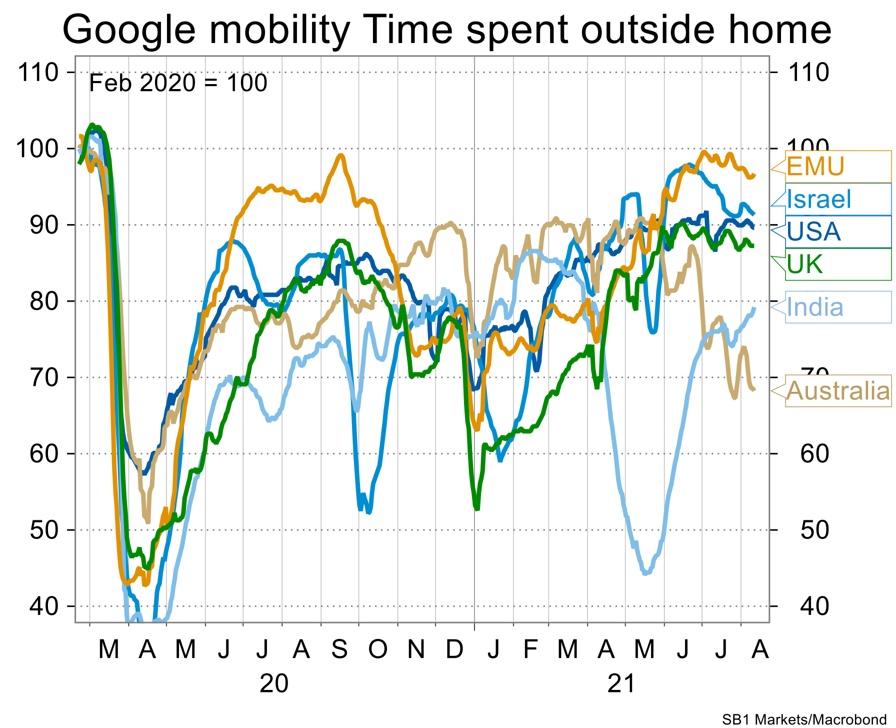
SB1 Markets/Macrobond

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)

Are we seeing some impact of the Delta on mobility? Trends have flattened

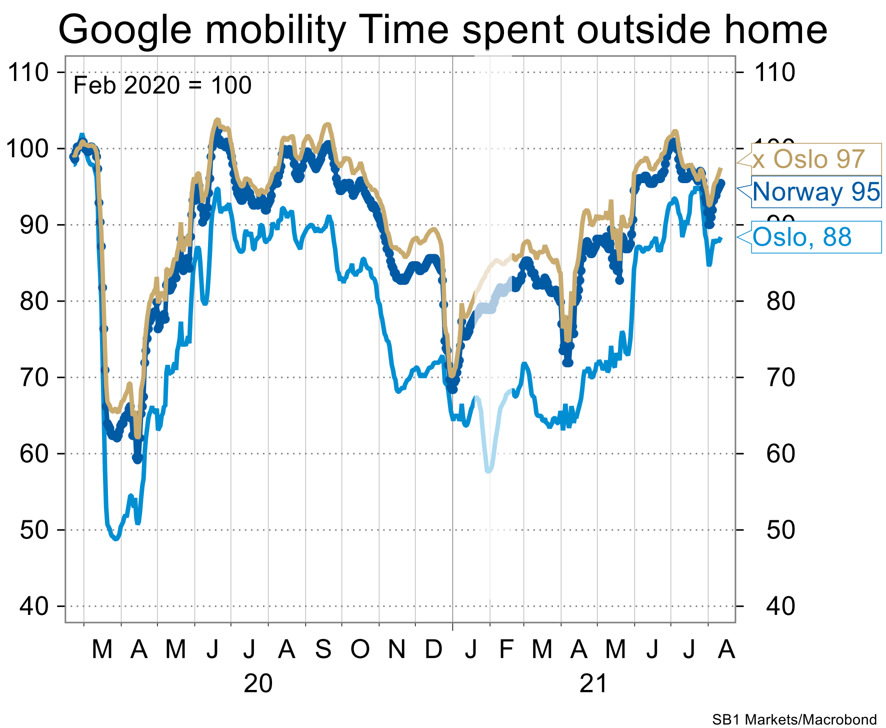
Mobility sharply down in Australia after being attacked by the Delta virus

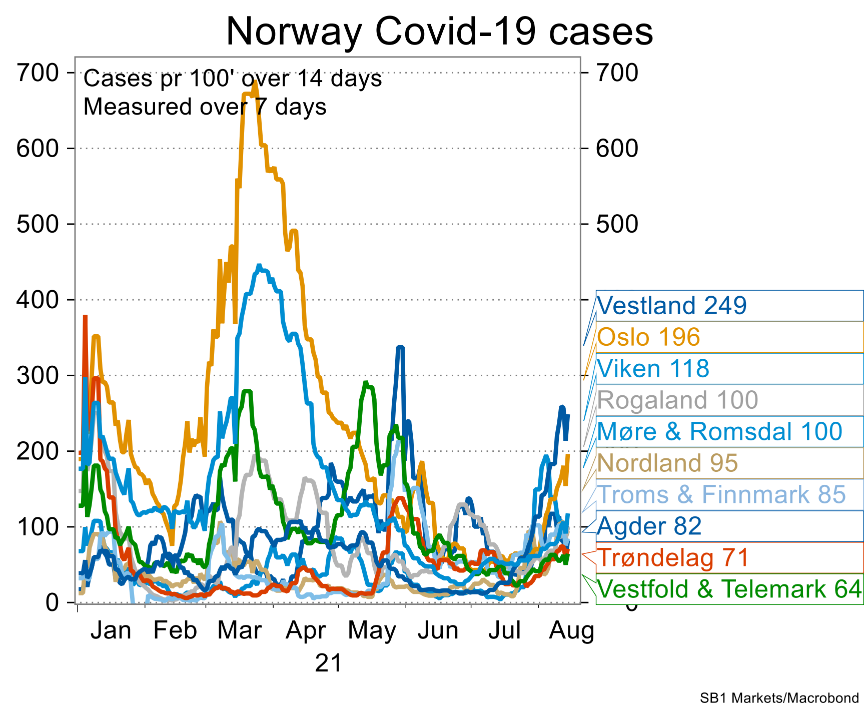




'Some' local cases – and sum cases further up last week too

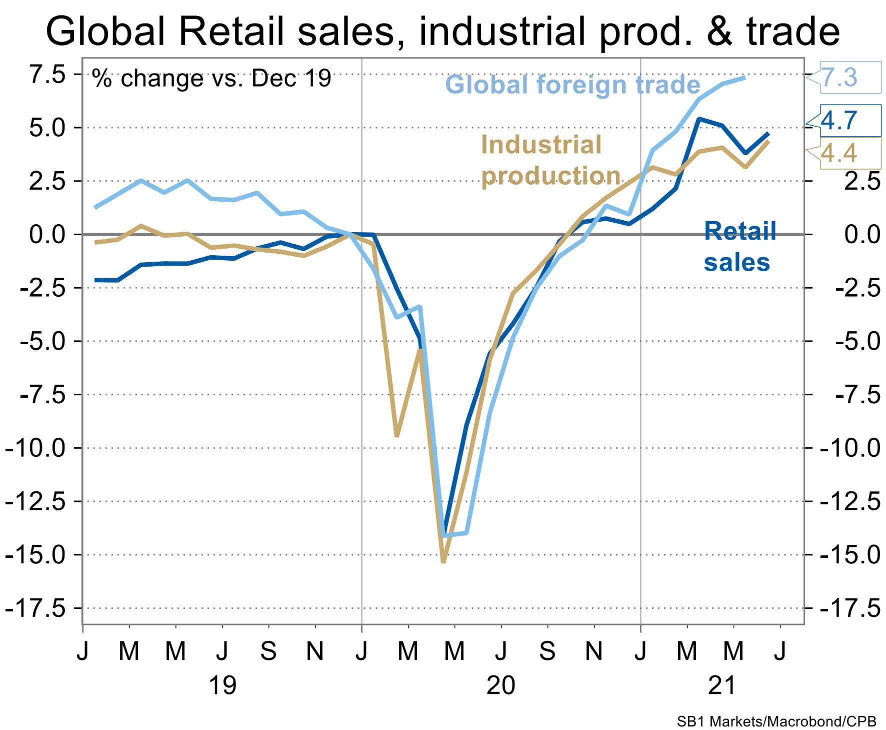
Mobility further down last week, we doubt the Delta virus is to blame (but we are far from sure)

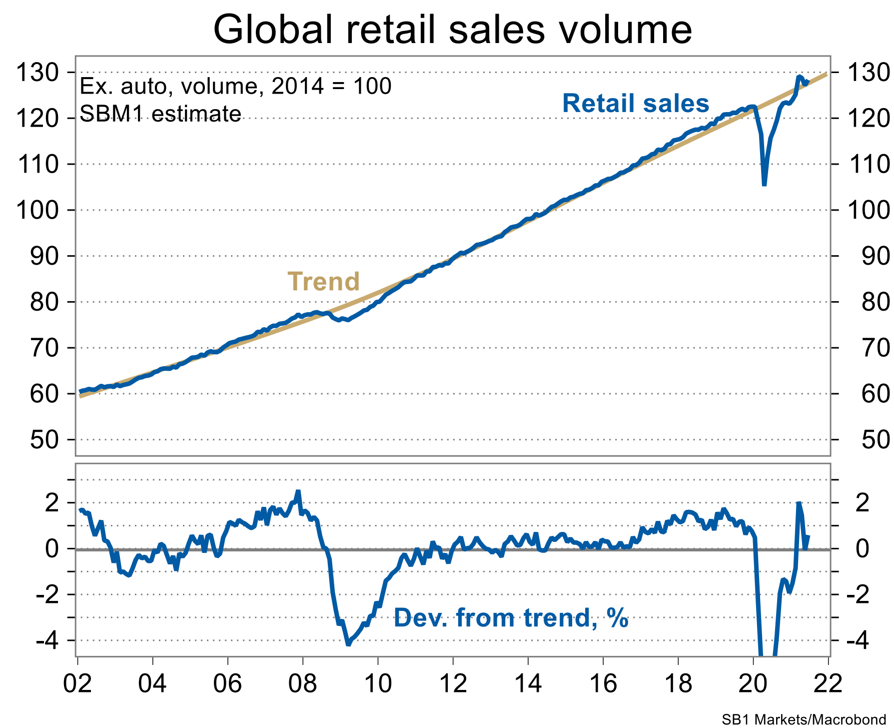




Global retail sales & manufacturing production up in June but has flattened

The setback in some Emerging Mkts due to Covid/Delta partially to blame. And DM demand peaks?



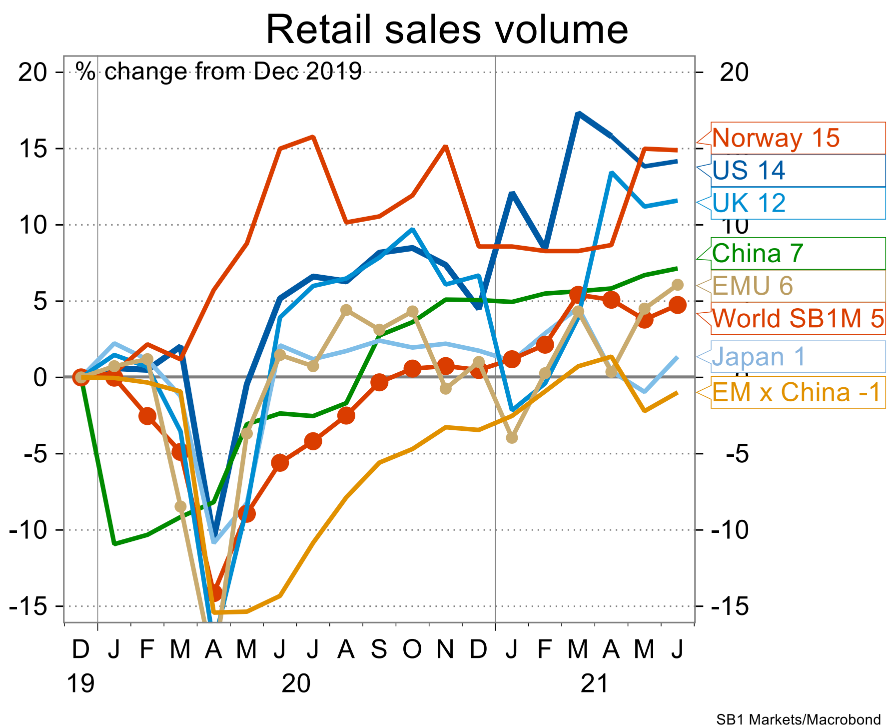


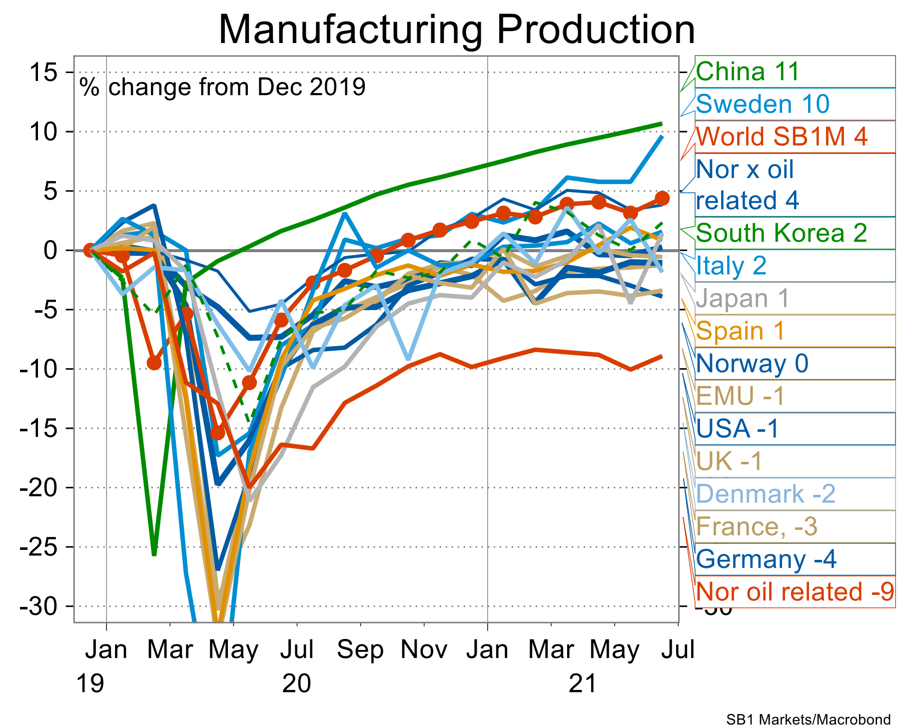
- **Retail sales** probably rose in June, according to our very preliminary forecast – but sales have flattened recent months, partly due to an assumed setback in India. The level is approx. 5% up vs the pre-pandemic level
- **Manufacturing production** probably rose too (a very preliminary estimate) – and may still be trending upwards. The level is some 4% above the pre-pandemic level. Trouble in India and in the auto industry globally have contributed on the downside
- **Global foreign trade** rose further in May, to 7.3% above the pre-Covid level, according to CBP in Netherlands – and the trend is straight upwards

SpareBank 1 MARKETS

So far, mostly good news in June, both for retail sales & manufacturing prod.

However, growth has clearly slowed for both



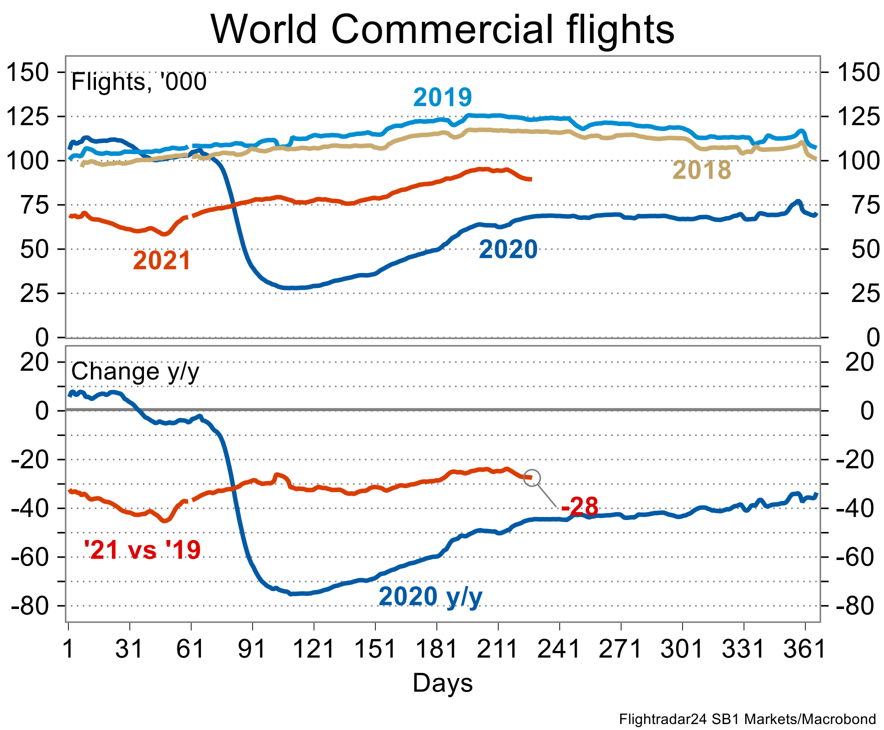


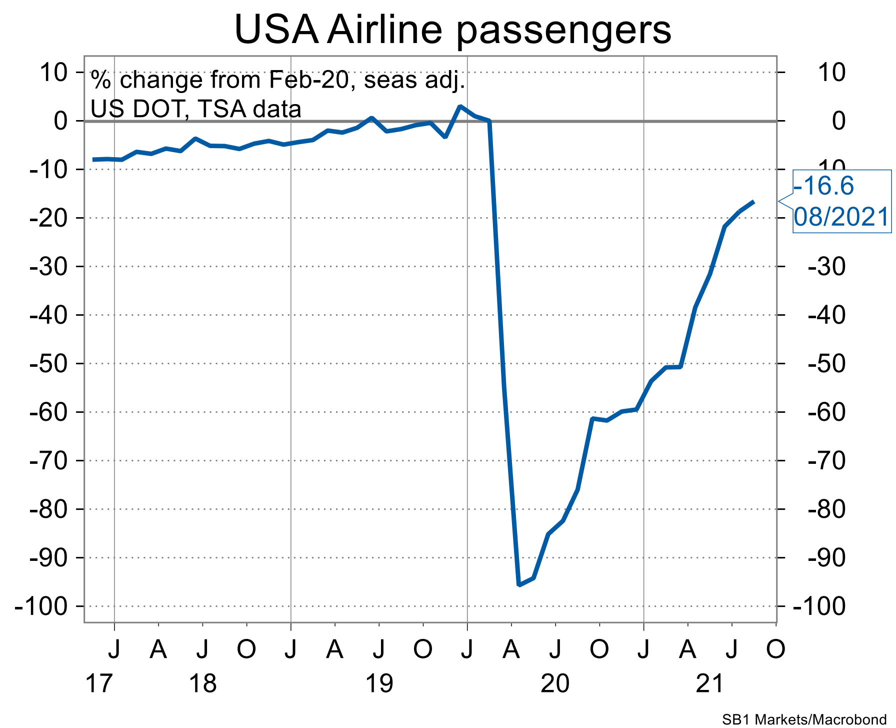
- Retail sales in emerging markets x China is the laggard – and not just due to (an assumed) weakness in India recent months

SpareBank 1 MARKETS

Global airline traffic has fallen 4% past 3 weeks, the virus to blame, once again

Probably mostly in Emerging Markets. In the US, airline passenger traffic is still on the way up

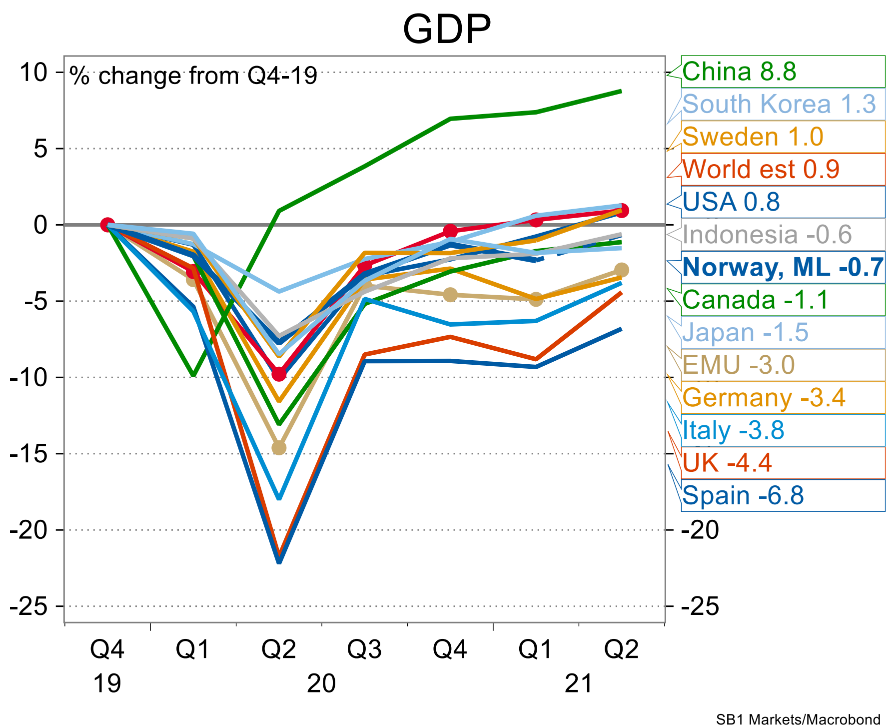


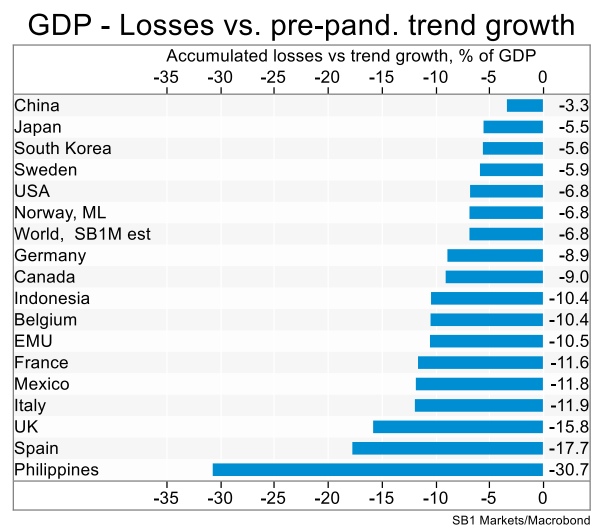


SpareBank 1 MARKETS

Global GDP probably slowed in Q2

… as we assume slower growth in Emerging Markets (which have not yet reported)



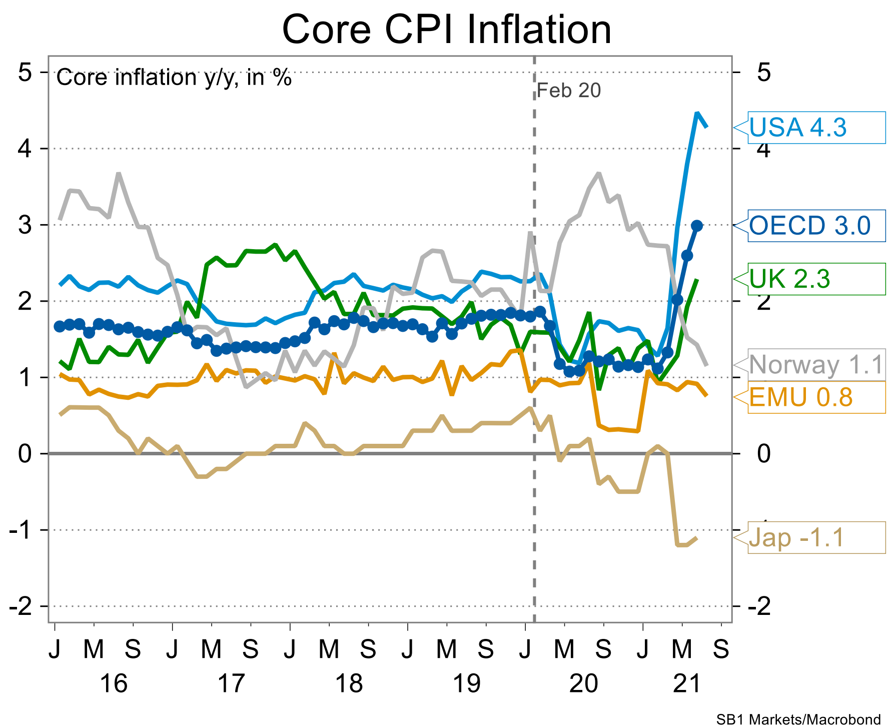


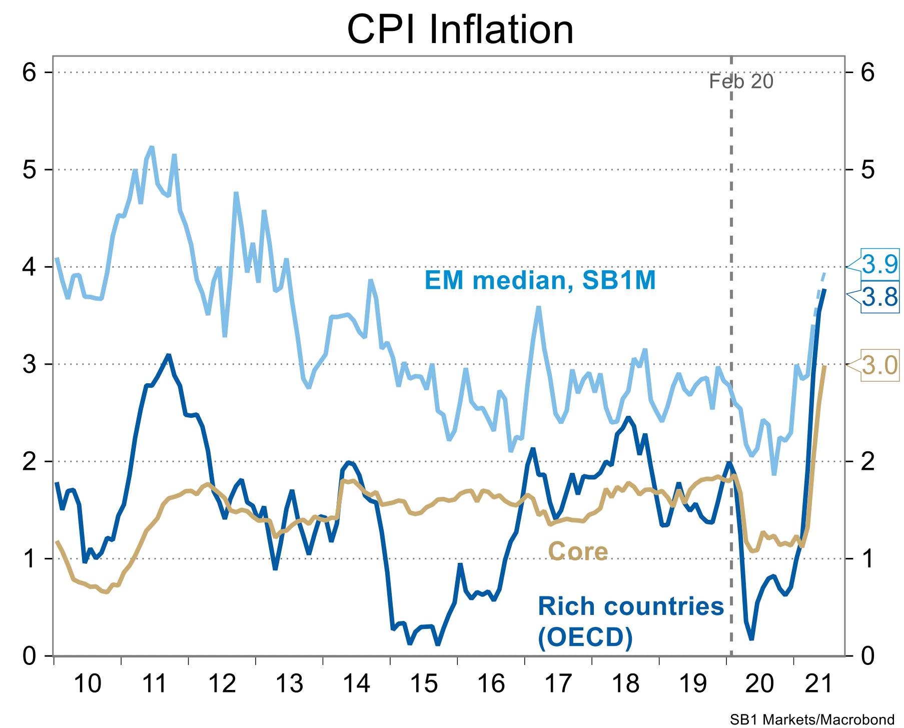
- Our <u>preliminary</u> estimate is a 2.4% **global growth pace in Q2** (0.6%), down from 0.8% in Q1
  - The uncertainty is larger than normal due to the Covid outbreak in many Emerging Markets that so far has not reported (especially India)
- The global GDP is close to 1% above **the pre-pandemic level**, but still approx. 3% below the p-p trend growth path
- Norwegian Q2 GDP at the charts at this page is our forecast

- The **global accumulated loss vs the pre-pandemic growth trend** is some 7% of 1 year's GDP
  - **China** is in the lead, with the smallest loss, 3.3%
  - **US** is down 7% (which is among the smallest losses in a US recession since WWII)
  - **EMU** is down 11%; Germany -9%, Spain -18%. UK is down 16%
  - Sweden -6%, Norway -7%

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

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

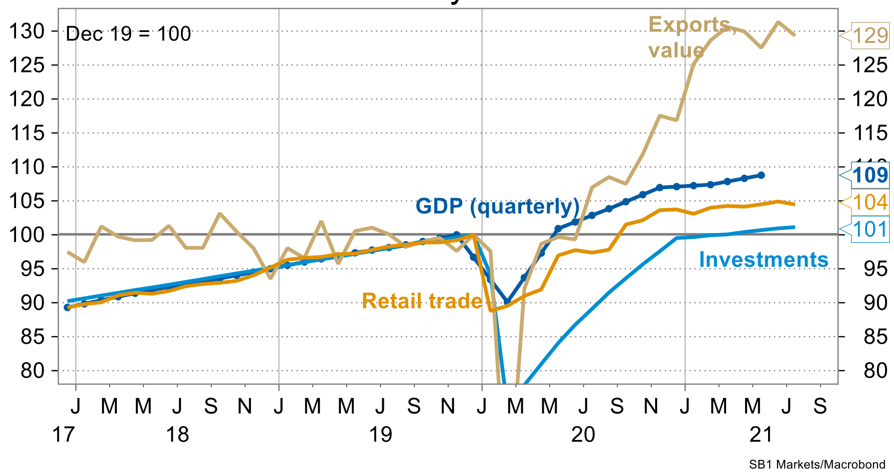




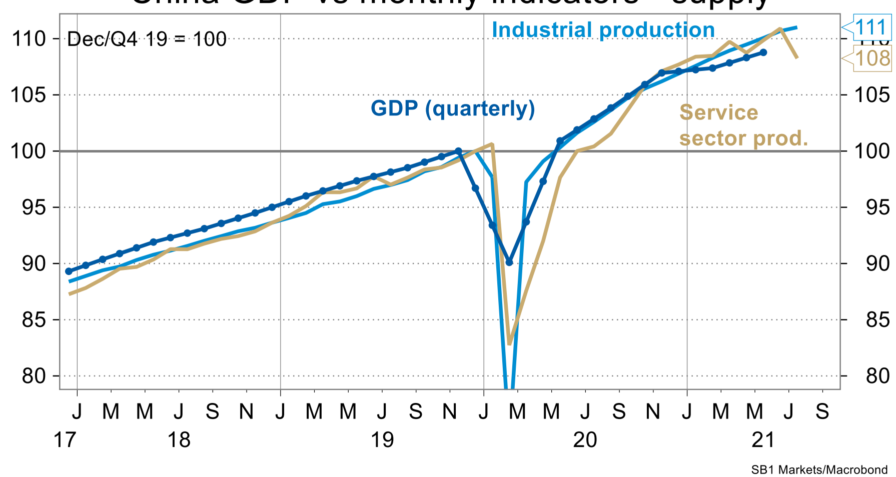
July data far weaker than expected, following at better than expected June

All major data surprised on the downside – the Delta virus and tighter policy has contributed

China GDP vs monthly indicators - demand



China GDP vs monthly indicators - supply

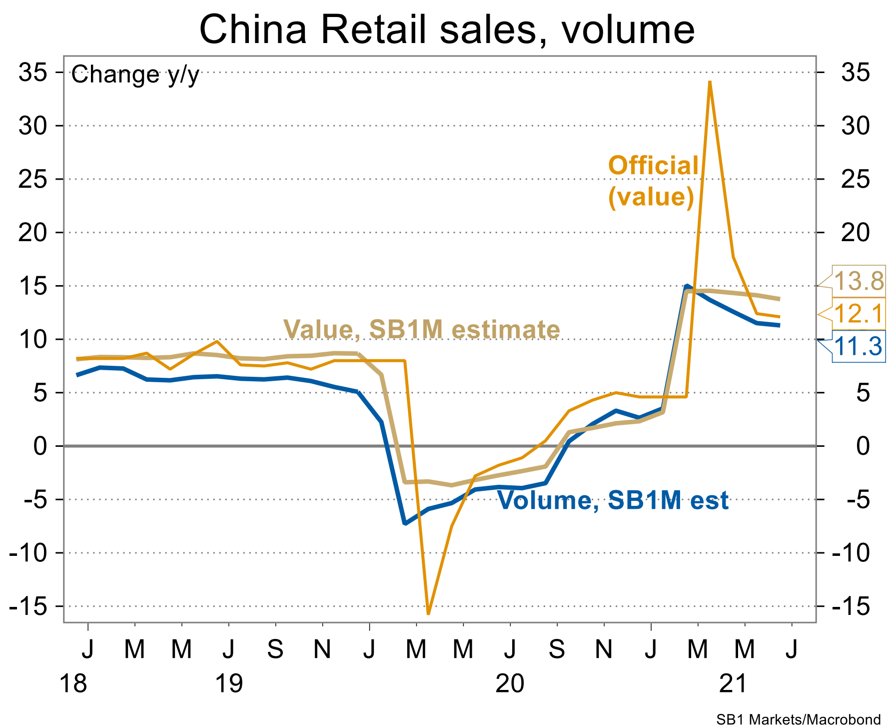


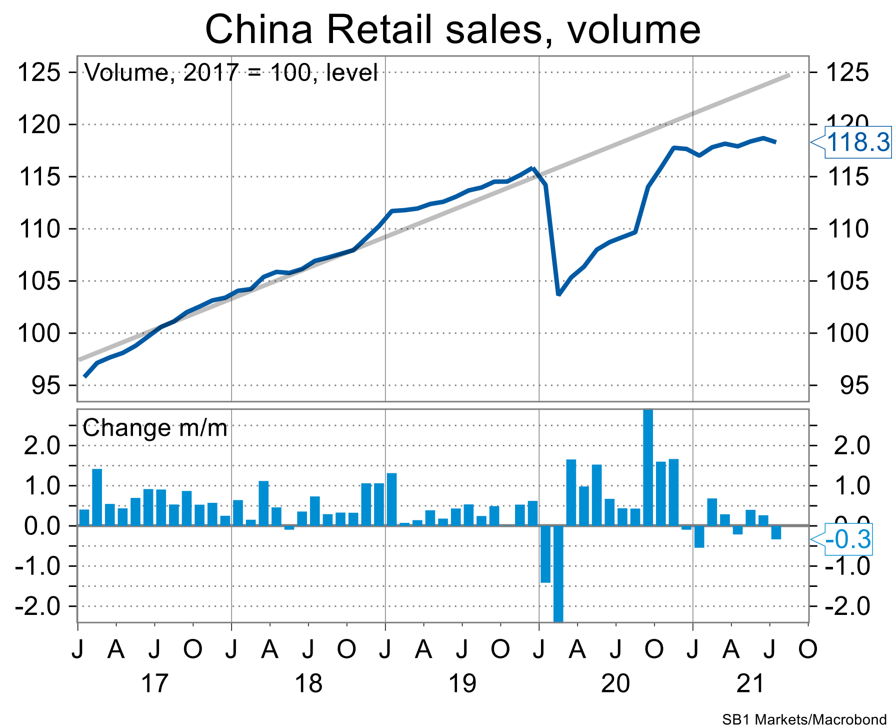
- **Industrial production** fell by 0.3% in June, down from 0.6%. Measured y/y, production is up 6.4%, 1.4 pp below expectations. Production is 3% above the pre-corona trend path but growth has finally slowed to the pre-pandemic level, as we expected. Steel & cement down 10 – 12% past 3 months, partly due to 'CO2' restrictions but construction activity is falling too. Surveys are not signalling weak growth ahead
- **Service sector production** fell by 2.4% in July, more than reversing growth the prev. 2 months, even if surveys were OK. No doubt virus related. The level is still just some 2% below the pre-pandemic trend growth path.
- **Retail sales volumes** fell by 0.3% in volume terms (our est.) in July, and the previous months were once more revised down. Since last Nov, sales have grown by less than a 2% pace, far below the pre-p 6% path. Sales were up 8.5% y/y, 2.9 pp below expectations
- **Investments** grew by just 0.2% in July, half the previously reported pace in June (which was revised down, together with the previous months). The level is 6% below the pre-pandemic trend growth path. The (still useless) accumulated annual growth rate was 10.3% in July, 0.9 pp below expectations. Housing and other construction starts have fallen 15 – 20 % recent months. **New home sales** fell further sharply in July, and **existing home** prices stagnated in July
- **Credit growth** slowed a tad in July, and the the trend is clearly down, and the credit impulse fell further. In July, the authorities surprisingly cut banks' reserve requirements, signalling that a further credit tightening is not warranted (just some overleveraged companies have to be sorted out
- **Last week:**
  - **Exports rose and imports both fell** slightly in July (not in this report). Both are levelling out, in volume terms, at high levels
  - **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 slowing, and most likely not mainly due to the virus outbreak. Policy has contributed too, and a maturing global cycle in goods

Retail sales has almost flattened since last November, underlying growth >2%!

Sales far weaker than expected in July, volume down 0.3% m/m

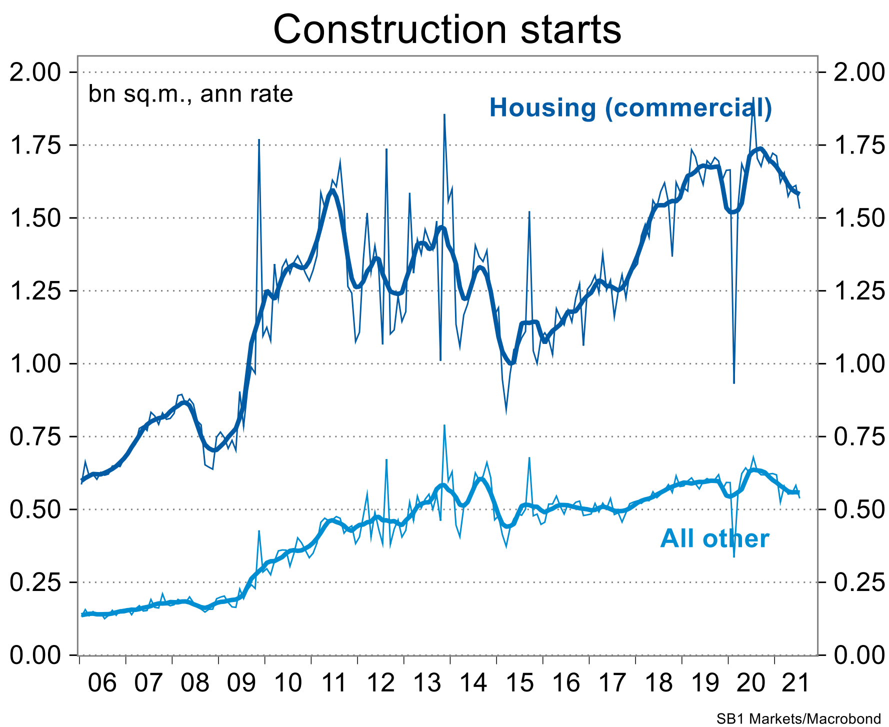


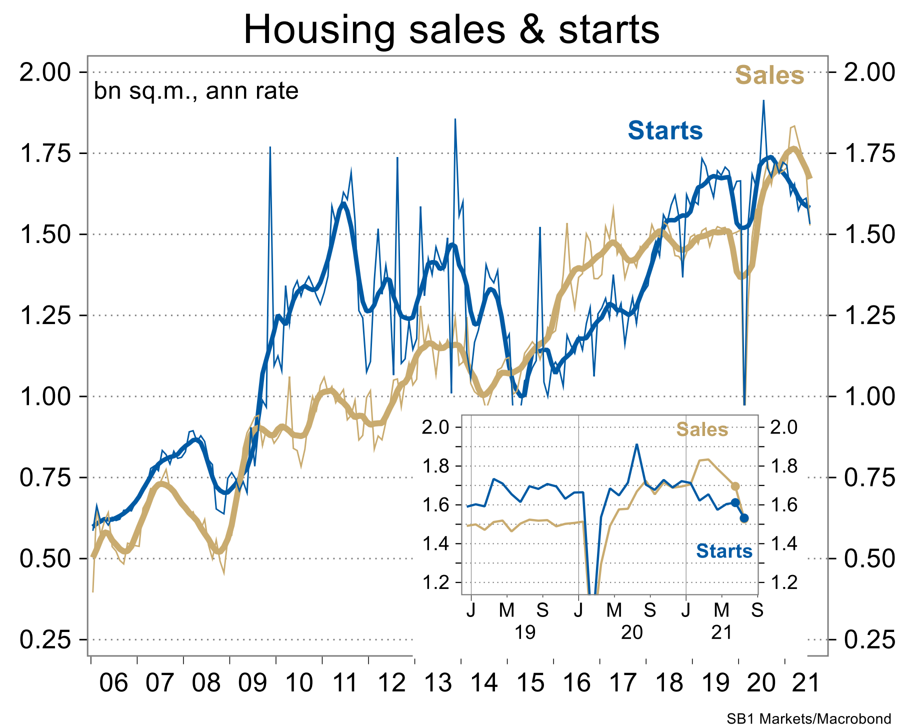


- **Nominal retail sales** were up 8.5 y/y in July, down from 12.6% in June, and far below market expectations at 11.4%. (These annual growth rates are close to useless due to the base effect, the low sales level last spring/summer)
- In nominal terms sales fell by 0.1% m/m in June, we assume by 0.3% in **volume terms**
  - » Since last November the underlying volume growth rate has been less than 2%, following the 3rd downward revision over the past 4 – 5 months (if we can trust today's numbers). Before the pandemic growth equalled some 6% p.a – and we are very likely probably witnessing a sharp downshift in consumption growth (even if irrelevant annual growth rates are still strong at 8.5% nominally, check the level!)
- Sales volumes are 5% below the pre-pandemic trend path (we estimated -3% in June) – and underlying growth is very low

Construction activity down in July, and the trend is clearly down

New home sales fell sharply in July, are down >15% from the early 2021 level

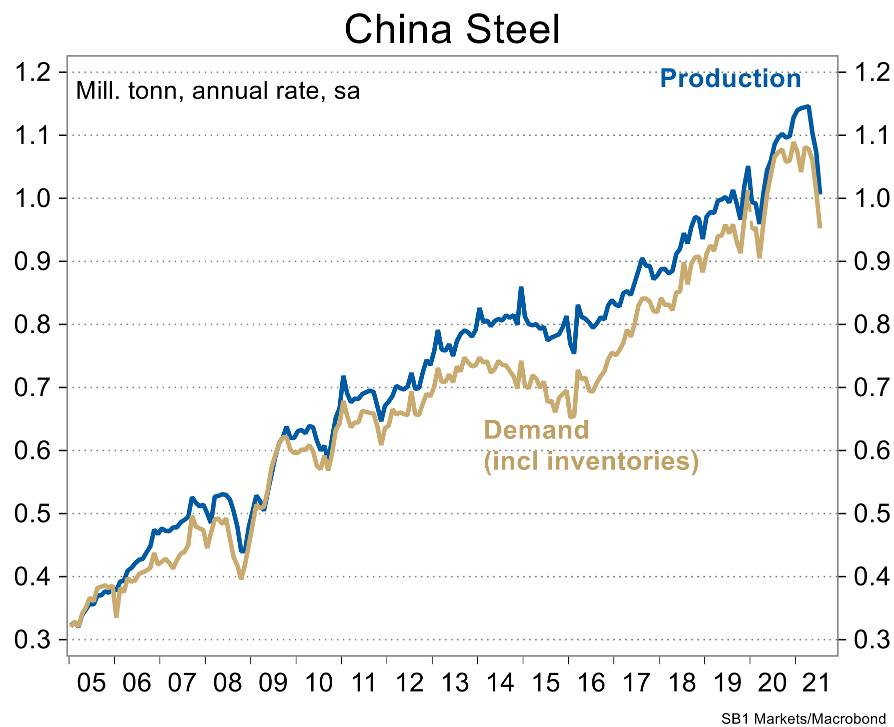




- The rise in **new home sales** from Feb-20 to Mar-21 was spectacular but sales have fallen sharply recent months – but not further down than actual housing starts in July. The fight against the Delta virus may explain some of the weakness in July
- **Housing starts** fell by some 6% in July, and are down 12% vs the late 2020 level. That is not a dramatic downturn, but significant vs the ‘minor’ Chinese construction contractions
- **Non-residential construction** fell in July as well, and is down 20% from last summer’s ATH level
- **In sum, construction starts** are slowing. Look up for demand (or supply??) for steel, *check next page*

Construction activity is sagging following the post-corona crisis surge

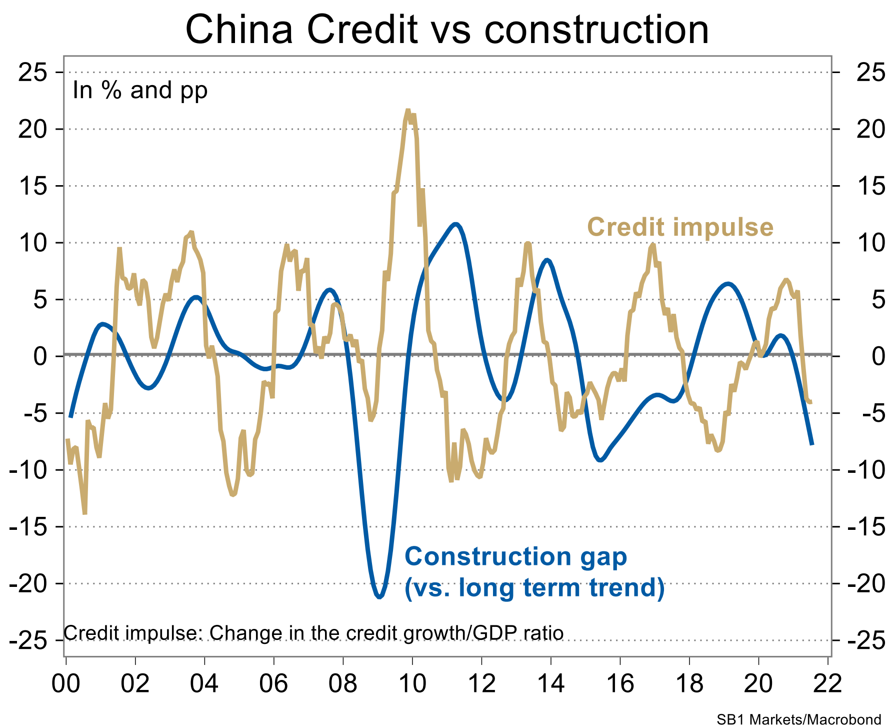
In addition, the authorities have decided to curb steel production in order to meet 2030 (!) CO2 targets



- The authorities have decided that 2021 steel production should not exceed the 2020 level, and as H1-21 production was well above the 2020 level – production must be cut in H2 (some 12%)
  - » Both production and demand (including inventories) are down 10 - 12% the past 3 months
- We assume there are more reasons for the cut than the 2030 CO2-target, like local pollution, fear of overbuilding, and too rapid credit expansion, especially among heavily indebted real estate developers (read: Evergrande)

Credit growth has slowed– and construction is on the way down

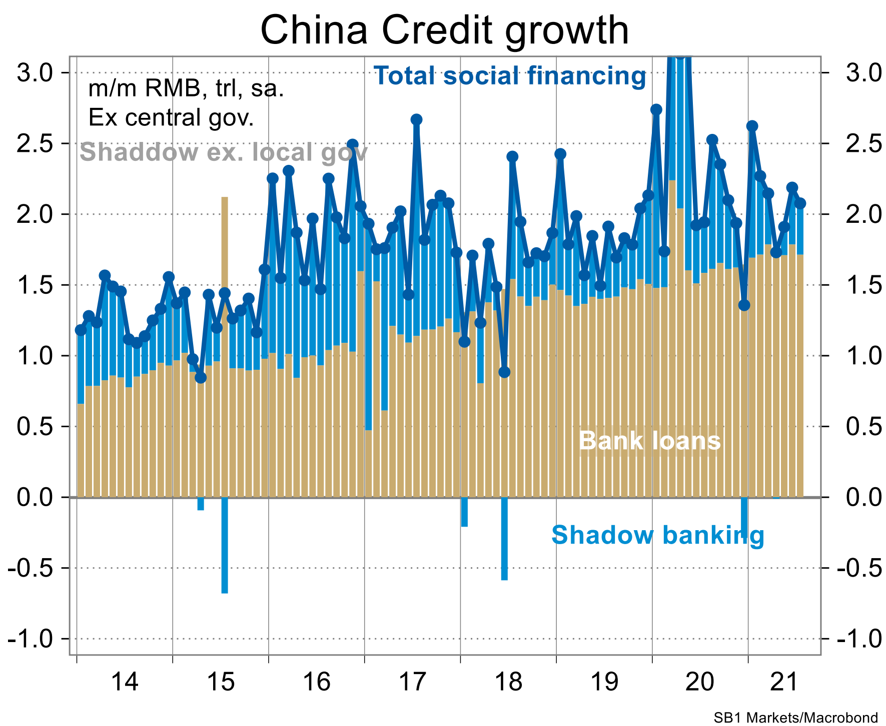
The two are dancing together, but not closely (and it varies who takes the lead too)

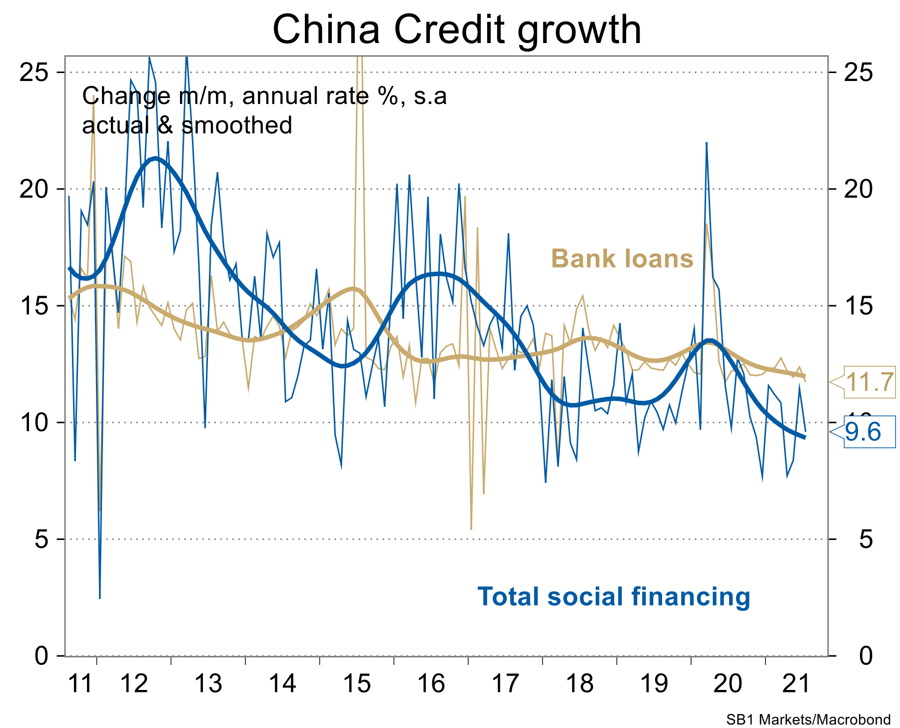


- … still they are at least normally at the same floor
- The recent credit tightening may have had some impact at the property market – but basically the slowdown in construction started 'too early' this time
- The credit tightening signals some downside risk for construction, raw materials & steel
- … at least until the credit indicator turns up again. In July, the authorities cut reserve requirement for banks 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

Subpar (but far from low) credit growth in July, the credit impulse further down

… but authorities are now probably changing tack; reserve requirements are cut, rates are discussed

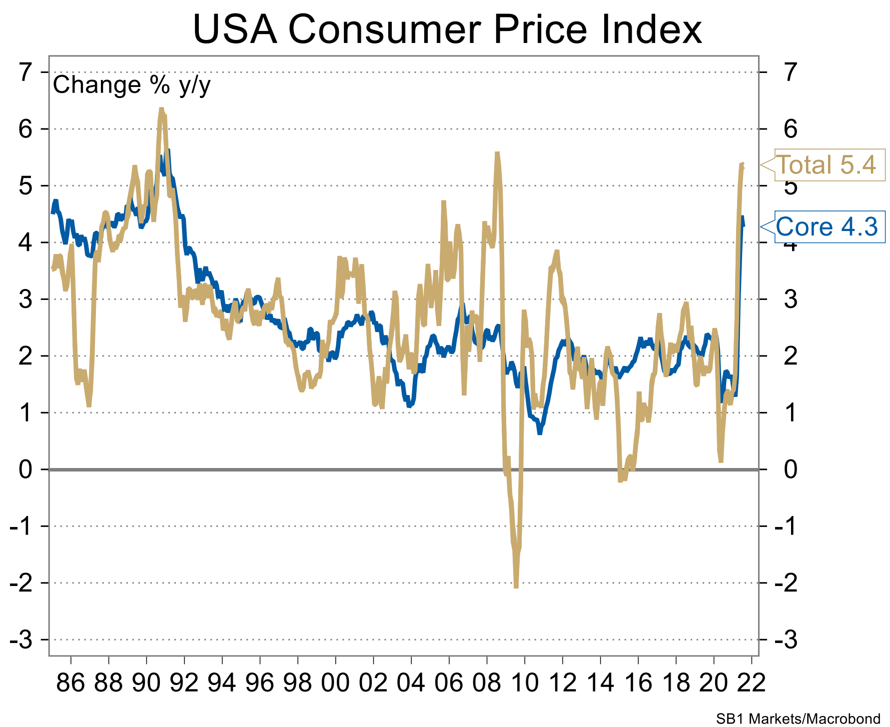


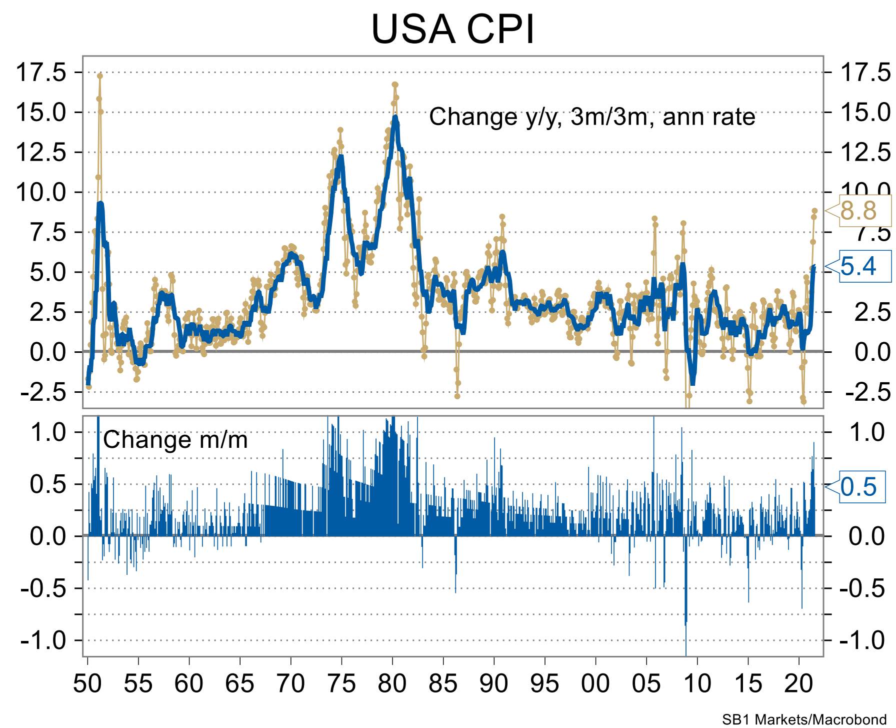


- **Total credit** grew at an 9.6% rate in July (m/m, seas. adj. annualised), up down from 11.5% in June. Smoothed, the underlying rate may be 9% - 10%, down from 13% during last spring (and >15% during some months). The underlying growth rate is still marginally above the trend growth in nominal GDP
  - **Total credit** rose by RMB 0.9 trl, expected 1.7 trl (not seas. adj., total social financing, including central & local government bond, and corporate equities). Seas. adj. the core total social credit (total ex central gov bonds & corporate equites) grew by 2.1 trl, down from almost 2.5 trl in June
  - **Bank loans** rose by RMB 1.7 trl, seas adjusted, or at a 11.7% annualised pace - and less than expected. Growth is slowly, slowing, from a 13% rate last spring. Loans are up 12.7% y/y
  - **Shadow banking credit** rose by RMB 0.4 trl in July (s.a). Growth has slowed sharply, underlying to 4%, from 13% last summer – the lowest growth rate on record. Excluding local government bonds, 'private' shadow credit is now declining – and faster than ever
- **The credit impulse has turned negative**, like it usually does every 4th year or so. The ramification may be felt in many markets
- **The slowdown has been by purpose**, as authorities have tightened, especially vs. credit supply outside banks. However, the authorities may shift the foot to the accelerator again – as they always have done after tightening too hard. In July, PBoC cut banks' reserve requirements, and now rate cuts are discussed

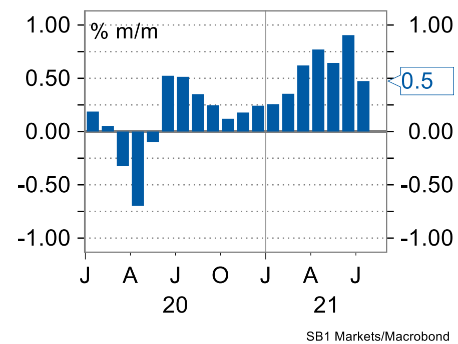
Peak CPI inflation? The m/m increases slowed in July, annual rates remain high

It may still be transitory (and most of it is) but the risk for higher inflation for longer has increased





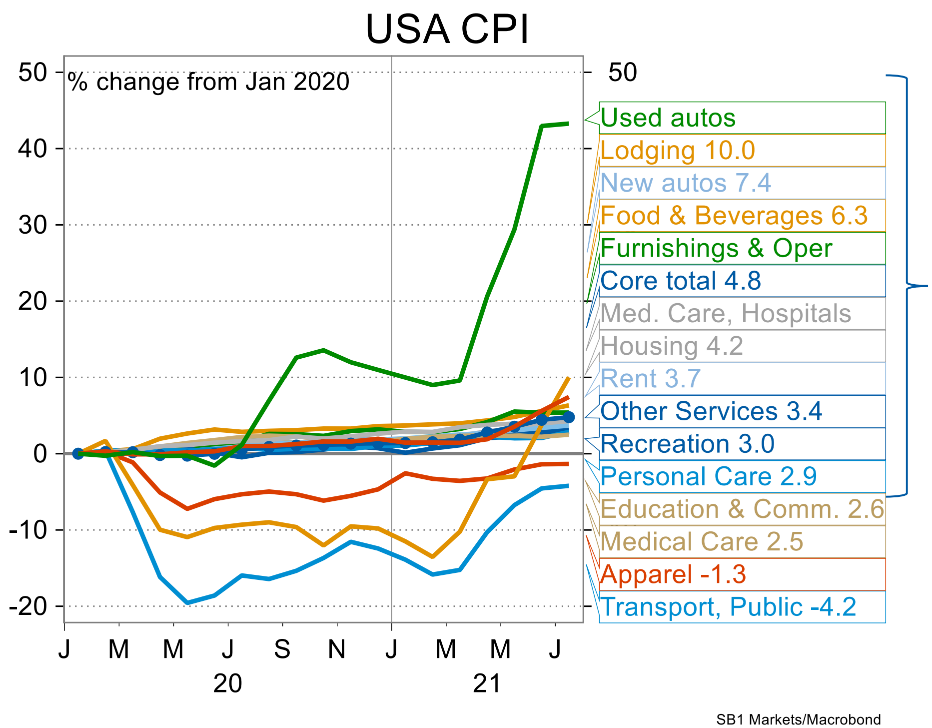
- **Headline CPI** rose 0.5% m/m in July, as expected. The annual rate climbed was stable at 5.4%. <u>These is the 2nd highest headline CPI y/y print since 1990</u>
- **Prices have been accelerating** m/m since last October, and the 3m/3m rate is now up to 8.8%, highest since 1980
- In all surveys, companies reported that they have or expect to lift prices sharply, some faster than ever before
- Recent days **several FOMC members** have signaled that the Fed's monetary policy should soon be tightened. Powell might signal that he (or the rest of the FOMC) agrees at the central bank conference in Jackson Hole at the end of August, or the bank can wait until the September meeting, where new forecasts, dot plots etc will be published. We think the latter is most likely, at least it is 'formally' a more correct way of doing it. Some smoke signals may still be sent from Jackson Hole… and tapering will start from the end of the year

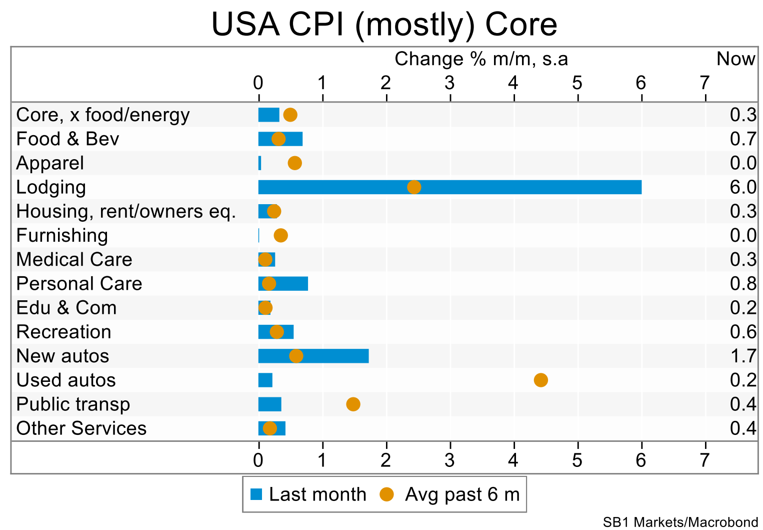


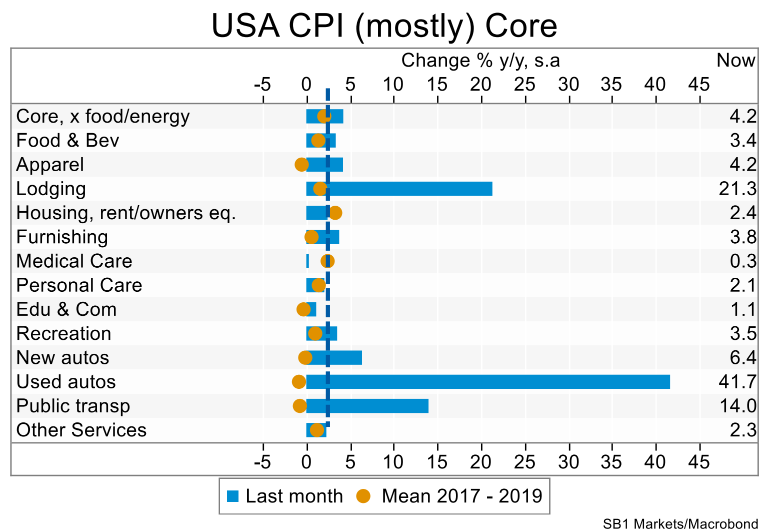
SpareBank 1 MARKETS

Used auto prices finally flattened but goods/services are still on the way up

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



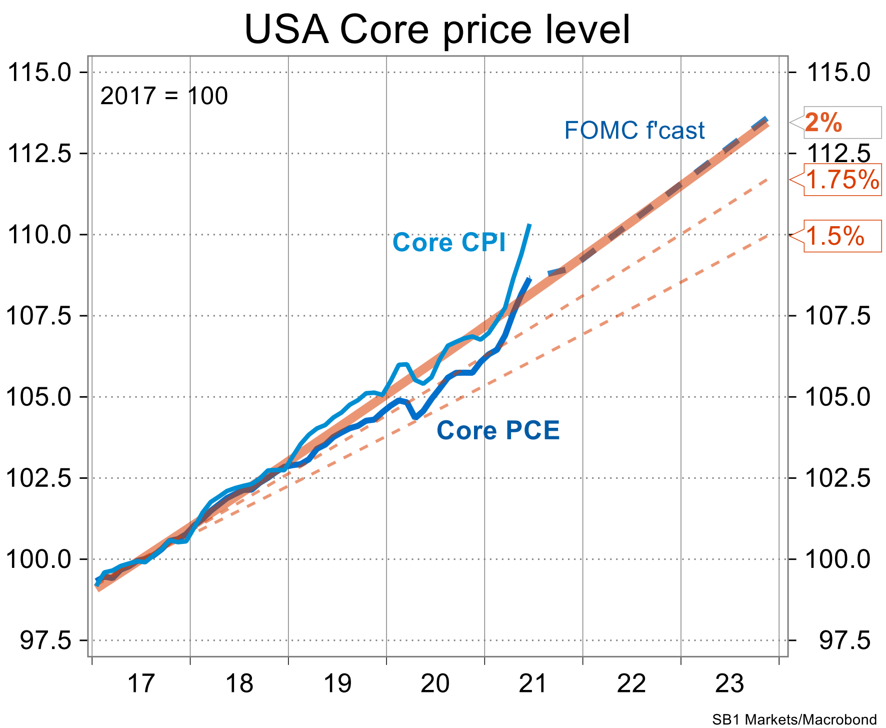


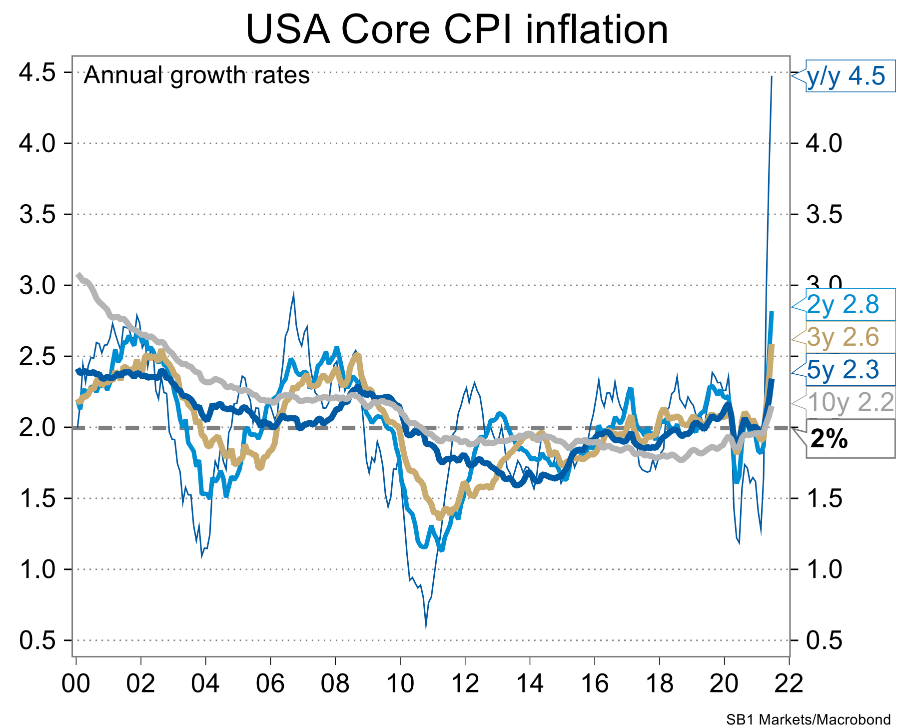


- Just some few CPI components contributed to the setback last spring: **Public transport** (airline tickets) **lodging** away from home (hotels ect), and **apparel**. Other components of the CPI did not slow significantly
  - » Now these sectors have more or less recovered, except public transport (apparel prices are below Feb-20)
- **Used auto prices** have been on the way up since last summer but rose just marginally in July. These prices are up 42% y/y, due to lack of new cars (which are up 6.4%). More on these prices 2 pages fwd

Anyway: The price level target is met

The employment target is still up for debate – but a tapering of the QE program is coming closer

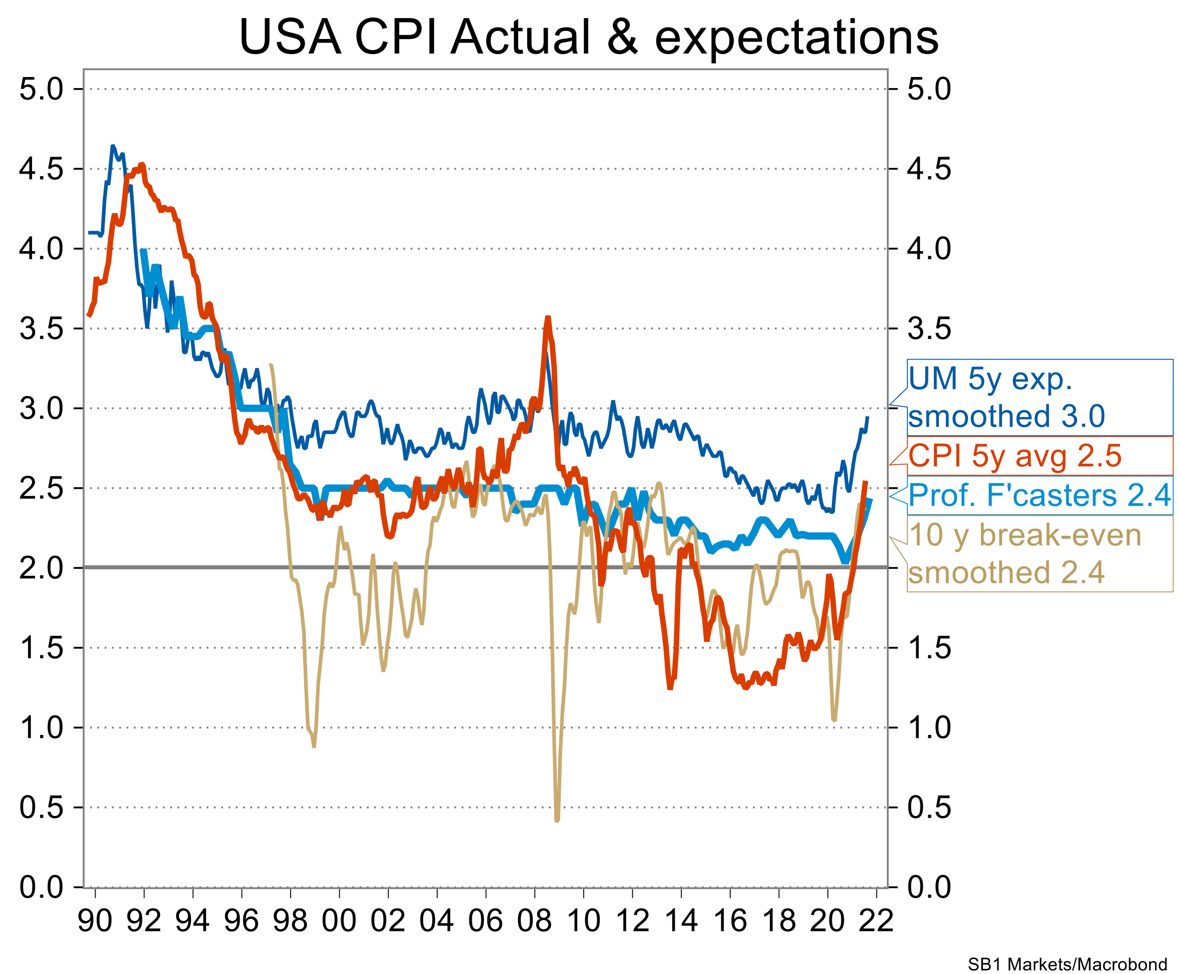




- The Fed has not defined its time horizon but the price level target is met, whatever time horizon the Fed chooses
  - » **Measured vs. the CPI**, the average core inflation is at or well above 2%, whatever period we check. **The core PCE deflator** is above 2%, whatever horizon
- **Inflation expectations** 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 is being turned off

Inflation expectations are drifting up but are not yet worryingly high

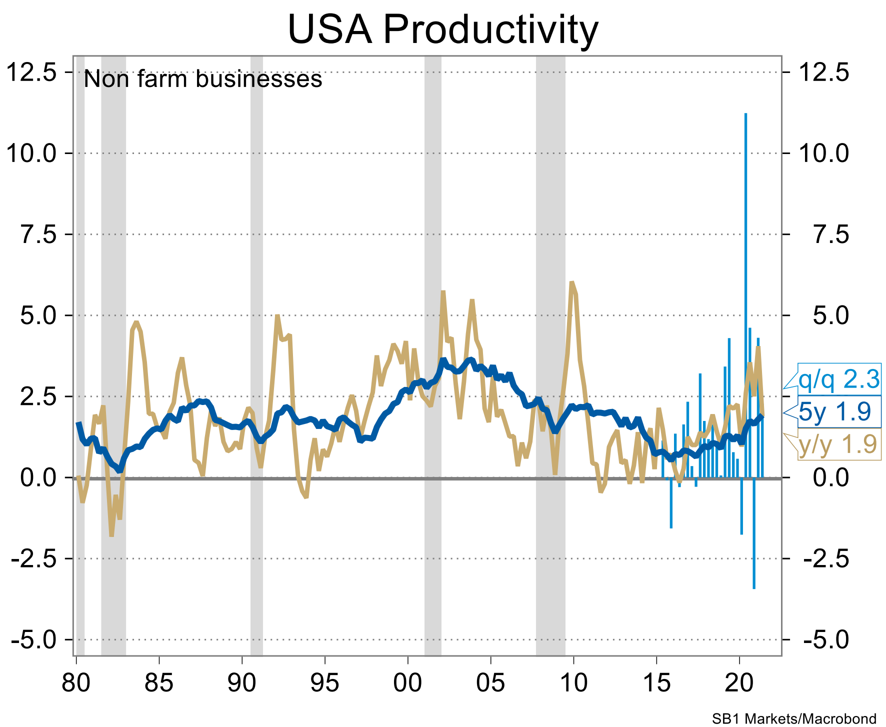
Univ. of Mich survey 5 y inflation expectations have climbed to 3.0 % from 2.5%

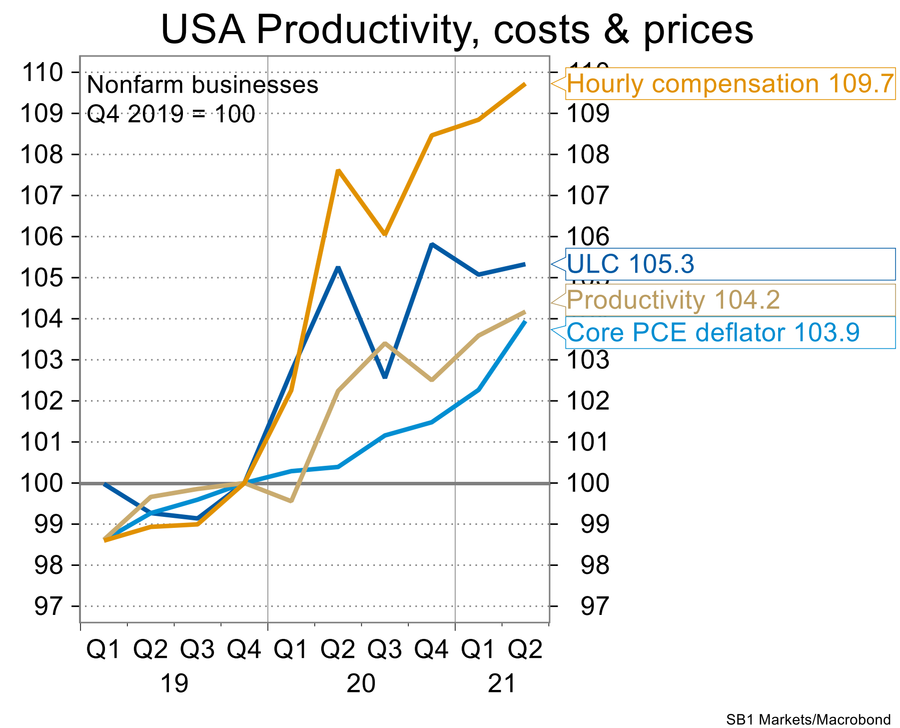


- **The UM's survey's** 3.0% rate is close to the highest in 10 years, and it is 0.5 pp higher than before the pandemic (2.5%)
  - » Still the level is not far above the past 10-year average – but it is a sign for the Fed, of course
  - » The UM short term inflation expectation at 4.6% is the highest since 2011, up 0.9% from March. These expectations usually correlated to recent changes in energy prices – like now
- **Professional Forecasters** expect a 2.4% 10 y rate of inflation, according to Philadelphia Fed's Q3 survey, up from 2.0% in Q4-20. The Q4 level was the lowest ever, and 2.4% 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. Still, above 2.0%
- The 10 y **break-even (CPI) inflation expectation** has come down from the local peak in the spring but is still at 2.4%, a tad too high vs Fed's long term 2% inflation target

Wild productivity & labour cost data; still challenging to decipher…

The facts: Productivity rose 2.3% in Q2, less than expected but compensation grew less. ULC flat y/y!

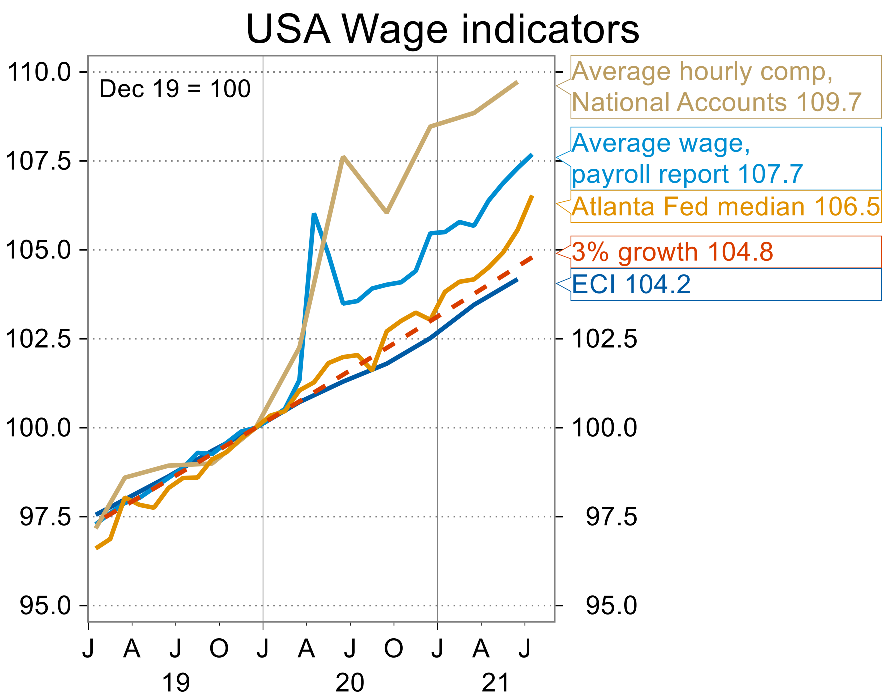


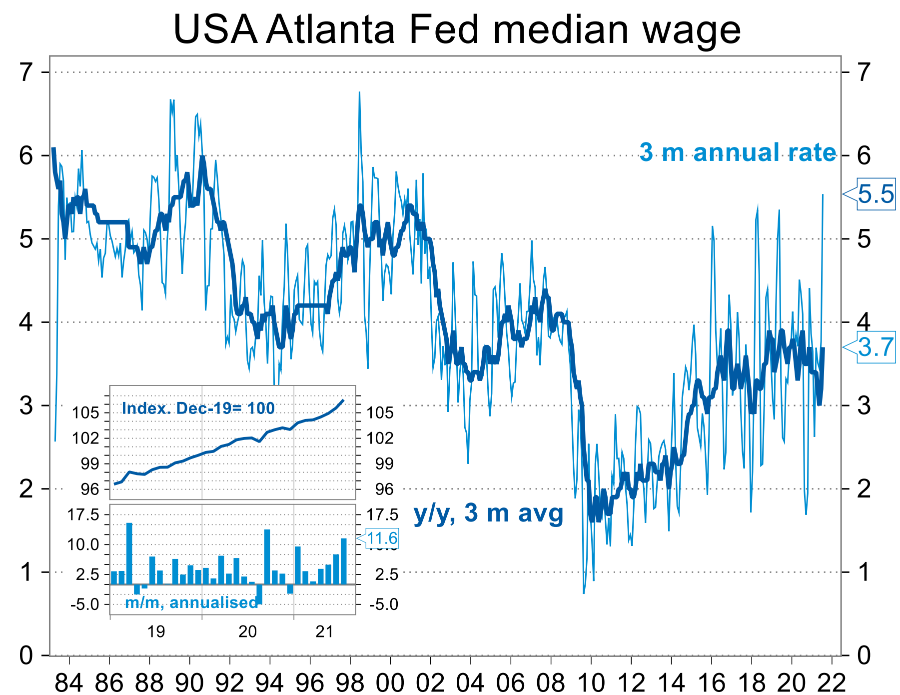


- **Productivity growth** has accelerated through the pandemic, up to a 2.8% pace sine Q4-19. The underlying trend is probably lower, but well above the lows during 2015 - 2017
- **Hourly (wage++) compensation** grew at a 3.3% pace in Q2. The annual rate fell to 2% from 6.4% in Q1. Since Q4-19 compensation has increased by 6.4% pace
- **Unit labour costs** (hourly compensation – productivity) grew by 1% in Q2, less than expected – and they are flat y/y. However, since Q4-19, ULC has grown at a 3.5% pace, far above a normal level

Wage indicators have been all over the place

But now just one remains at the station: The ECI. Even Atlanta Feds median wage index sharply up!

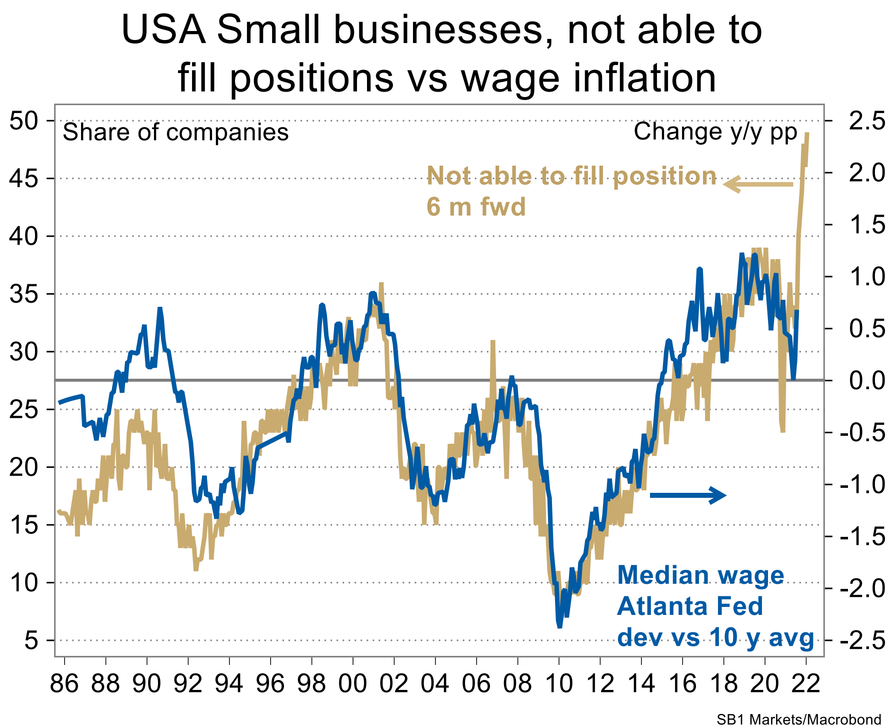


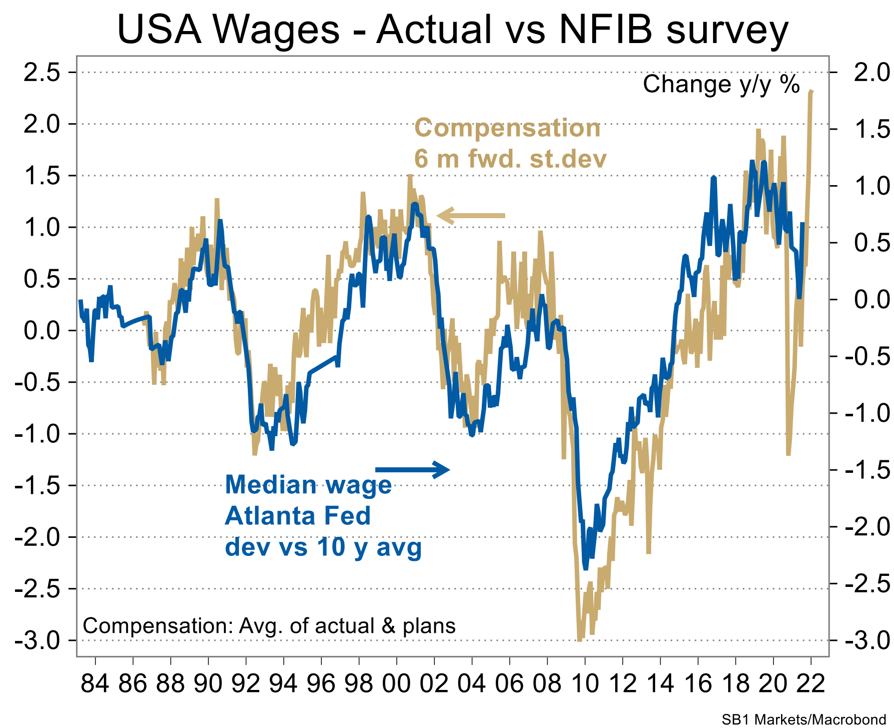


- **Average earnings in the monthly payrolls report** are up 7.7% in July vs.Dec-19, or at a 4.8% pace
- **Average hourly compensation as estimated by National Accounts** are up 9.7 % from Q4-19 or by a 6.4% pace. This measure is the most volatile – but over time the 'correct' result
- **Atlanta Fed's** survey of **median wages** are up 6.5% or a 4.1 % p.a rate – a significant acceleration through Q2 and further in July, up 4.5% y/y
  - » This measure, which is far less depended on the employment mix than the measures of average wages, has until now not reported higher wage inflation. Now even this measure confirm higher wage inflation. In June the median was up 4.5% y/y, the highest since 2017! The 3 m average rose 0.2 pp to 3.7%
- The only wage index now reporting significant increase in wage inflation, is the **Employment cost index.** It is up 4.2% vs. the Q4-19 level average, implying an average increase by less than 3% p.a
- Thus, it seems even more likely that wage inflation is on the way up – and possibly to an extent that is not consistent with a 2% inflation target

Wages do respond to demand for labour, and now demand is really strong

Companies report record high no. of unfilled vacancies and unprecedented problems filling them

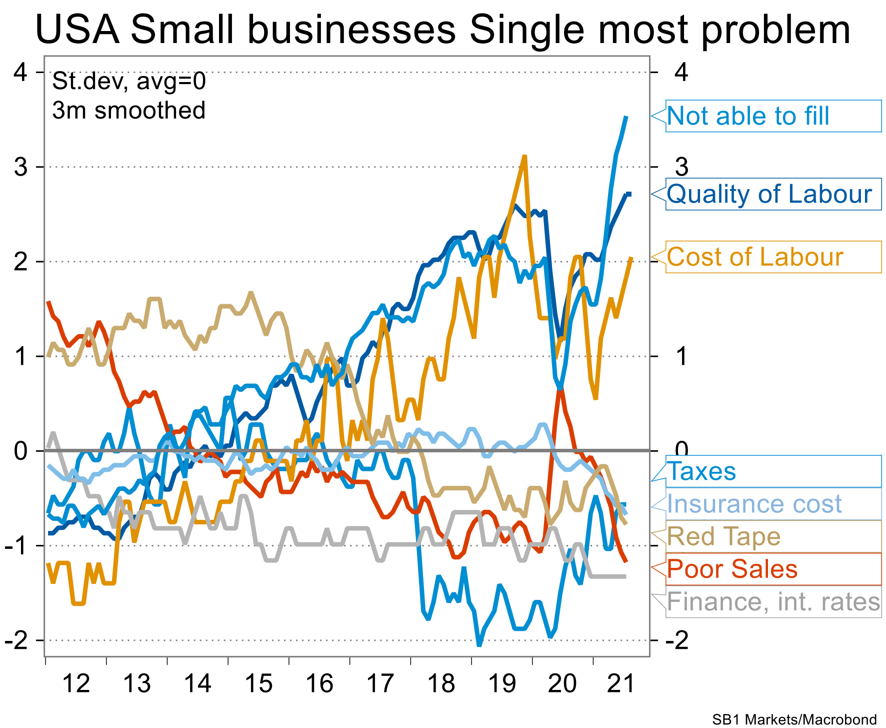


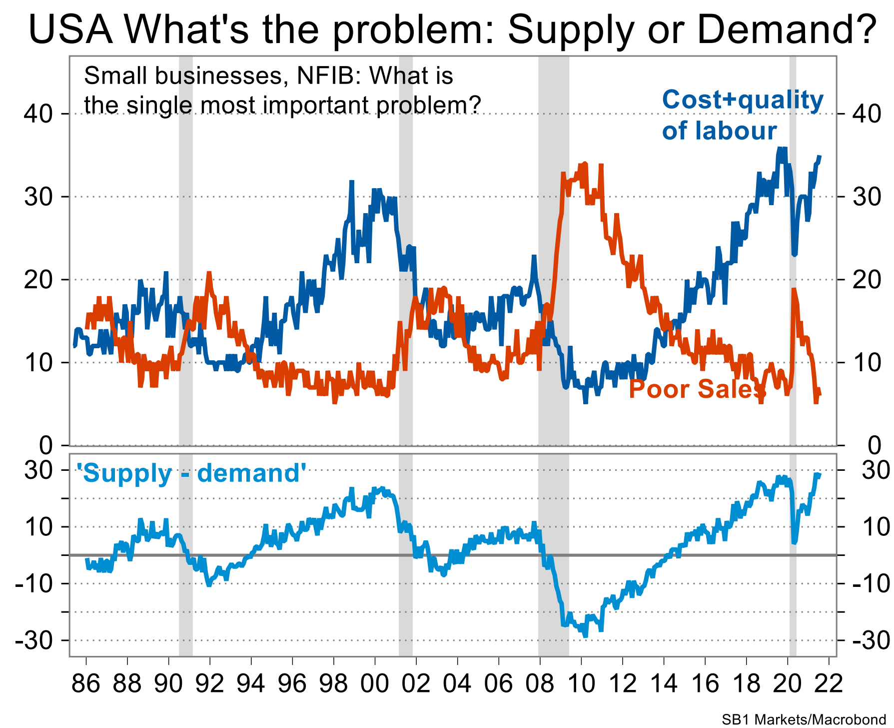


- .. And more companies than ever say they plan to increase compensation
- Can wage inflation accelerate?

It's the supply side, stupid. (And not the demand side)

It's really looking like we are at peak of a cycle, and not coming out of recession (if you still believed that)

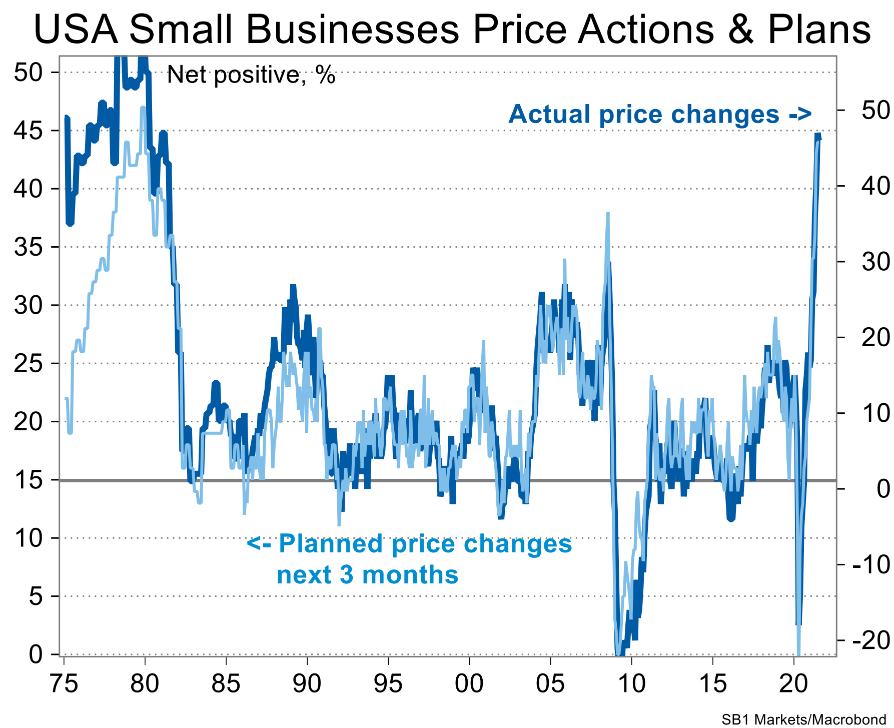


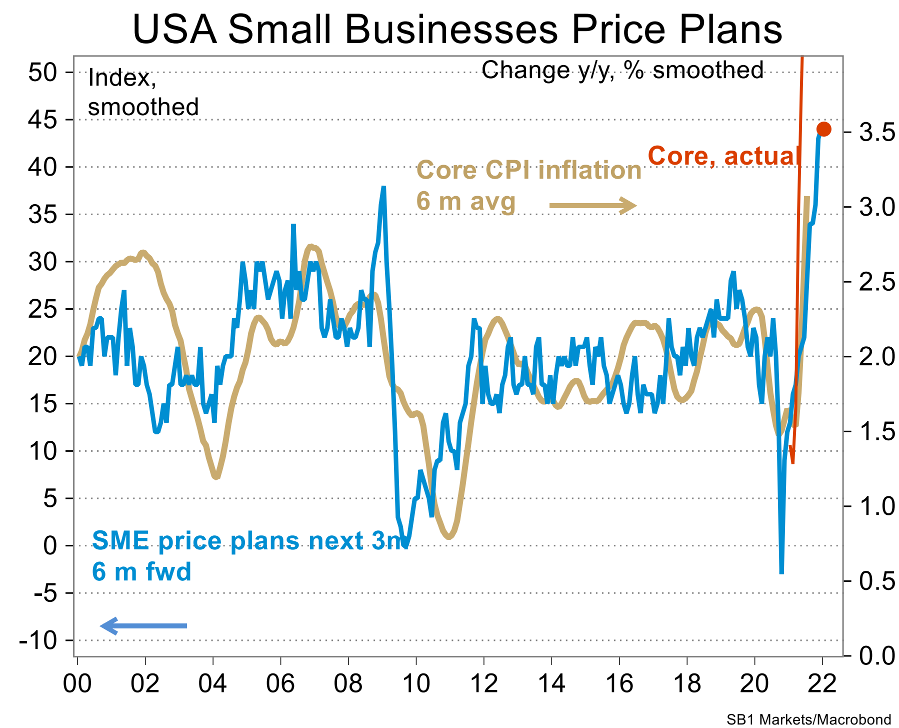


- While more businesses than normal stated **weak sales** as the major problem during the pandemic, there were never that many, and now a close to record low share of companies say than poor sales is the problem (and fewer than before the pand.
- **Availability, quality, and cost of labour** is a much more serious problem than normal, the share is now close to the record high recorded in late 2019
- Thus, companies report they are constrained from the supply side, not from the demand side
- Unusually few companies are complaining about **finance/interest rates** and about **taxes**

Another warning sign: SMBs say they plan to raise prices…

Like they (almost) never before have done

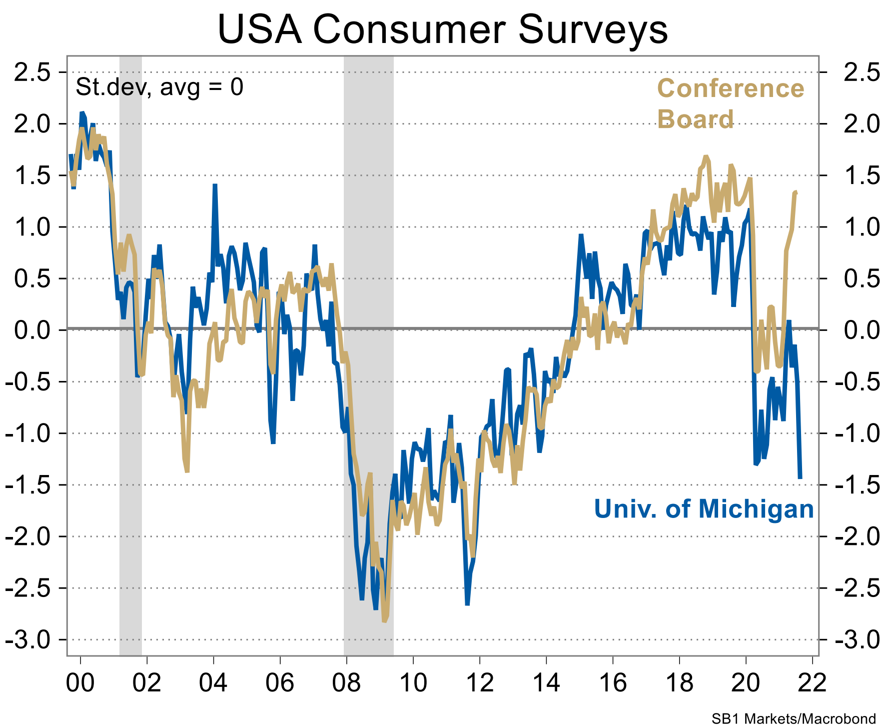




- It is long time since last time anyway, in December 1979, when price plans were as aggressive as today. *And it lasted just one month, now we have been up here two months in row*
- It is challenging to calibrate the SBM survey vs. actual inflation as the present print is so extremely far off the chart 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 higher input, costs or output prices
  - » **Atlanta Fed Business survey** reports a 3% expected growth in unit costs. Since 2013, the expectations have been stable at 1.75 – 2.25%

WT… Univ. of Mich consumer sentiment fell sharply, to below the Apr-20 level!

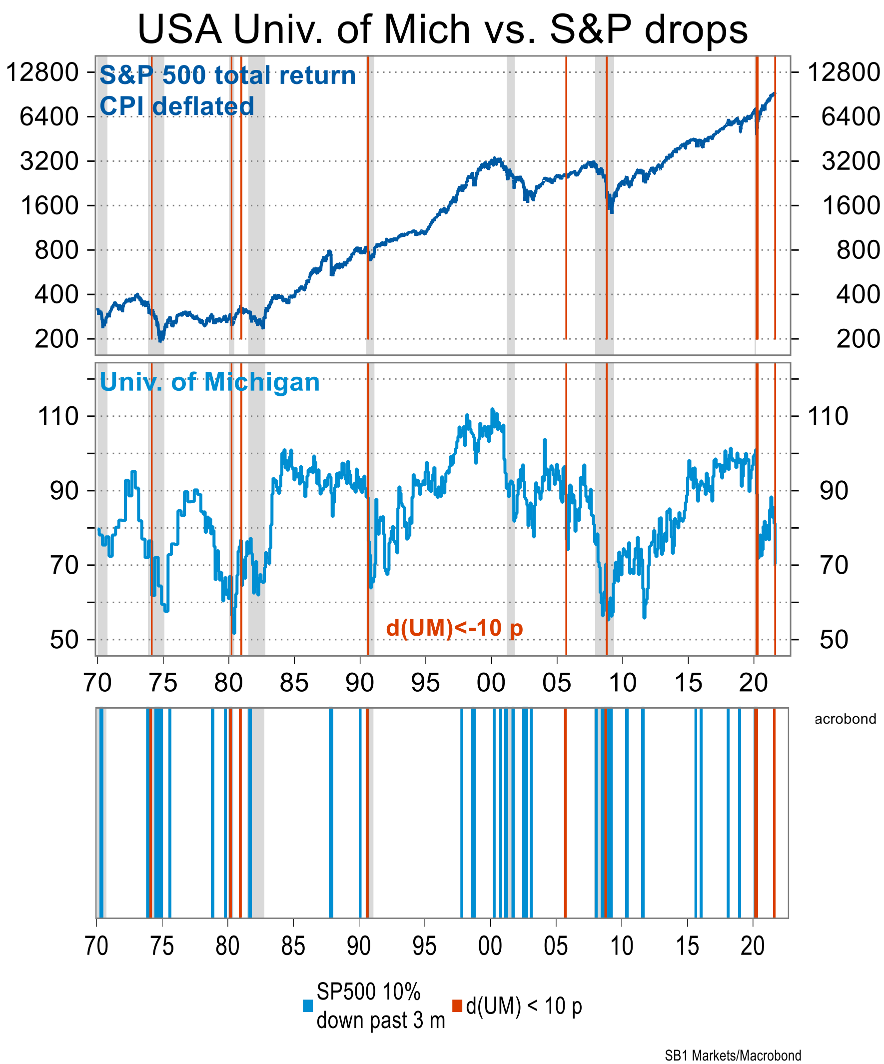
The current situation is deteriorating amid increasing (short term) inflation expectations



- **The UM sentiment index,** out of the, blue fell by 11 p to 70.2 in August, expected unchanged! (The lowest est. on Bloom was 78). The level is the lowest since 2011
  - » The decline equalled almost 1 st.dev, or ¼ of a 'normal cycle', one of the bigger monthly setbacks (the 7th ever). The level is 1.4 st.dev below par
  - » **Expectations** fell more than households assessment of the **current situation** but the latter still weaker than the former
- Why this sudden– and totally unexpected – drop in household sentiment?
  - » The **virus situation** has deteriorated in most states recent weeks, but nothing like the during previous 3 waves
  - » The **stock market** is OK, to put it mildly
  - » The **labour market** is recovering rapidly, and jobs are extremely plentiful (also according to households themselves)
  - » The **housing market** is still going strong, **mortgage rates** have fallen, and **credit** is available
  - » **Gasoline prices** are up but just marginally since April, and they are far from high in real terms
  - » **Inflation expectations** are well above a normal levels, but they did not (in sum) rise further in August, and cannot explain the sentiment shock
  - » **Republicans** lost confidence much more than Democrats, and the partisan divide is close to ATH, but there have been no political drama in early August?
  - » **Other surveys** have not recorded any sudden death – but just one other survey has published August data (IBD/TIPP). The gap between surveys is in reality the largest ever
  - » We do not have access to relevant all updated booklet details
- What to make out of it? To put it simple, we are not sure. The market? Bond yields fell. But equities rose, of course

Sentiment down -> the market down? Don't worry too much. But…

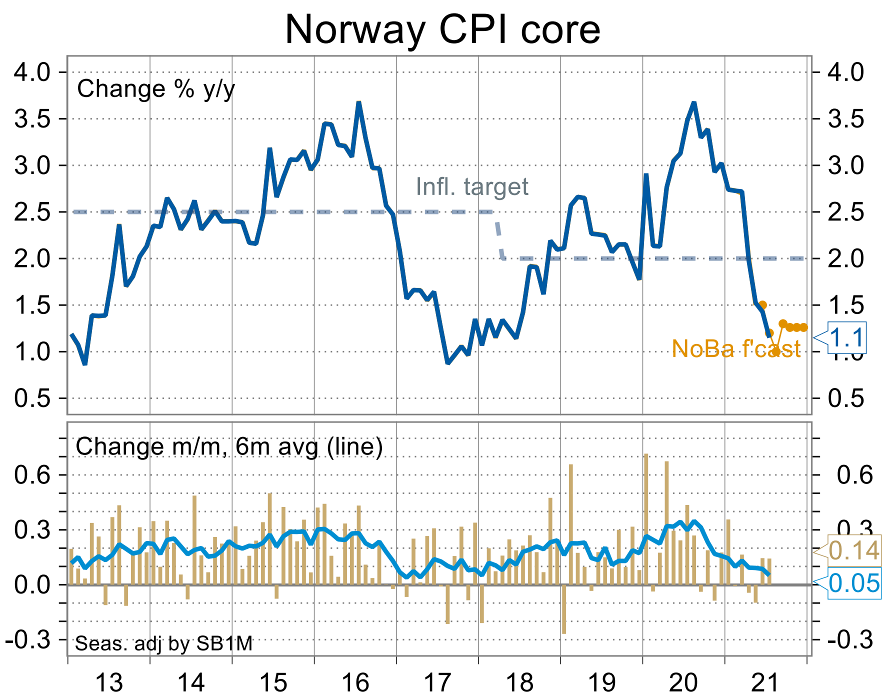
Consumer sentiment is correlated to the stock market

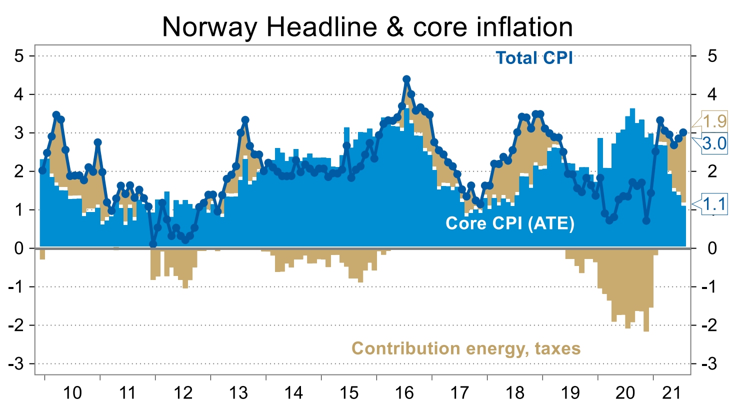


- Sentiment is hit during most corrections at the stock market – and sometimes the sentiment yields first
- The big drops in UM sentiment (> -10 p, red lines, 8 times since 1970) normally take place in periods with market/economic turmoil. So far, just 1 UM drop has taken place during calm times (2006) – but at that time the UM sentiment did not fall to 70
- However, most corrections at the stock market (10 % or worse) has taken place without large one-month declines in the sentiment index
- On the other hand, sentiment is always deteriorating amid all major stock market setbacks (bear markets, more than 20% down)
  - » Sentiment started to wane ahead of the large the market setbacks in 1973, 1990, 2000 and 2008

(Core) Inflation is not a problem in Norway: CPI-ATE down 0.3 pp to 1.1% y/y!

… And now due to domestic goods & services, not cheaper imports. Total infl. at 3.0%

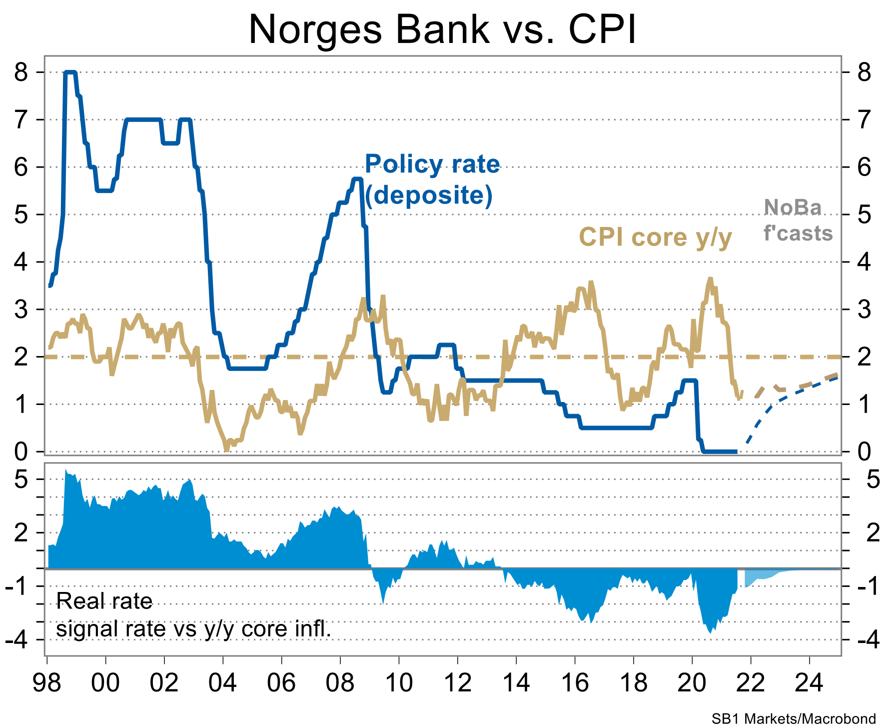


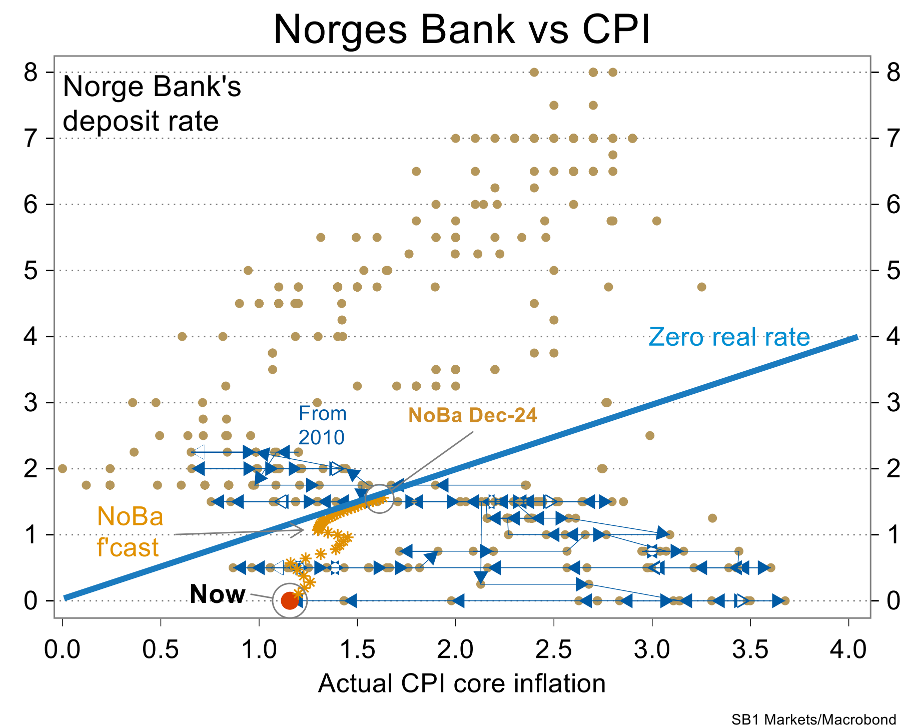


- **CPI-ATE** (ex. energy and taxes) inflation was down 0.3 pp to 1.1% in July; in line with consensus f'cast, 0.1 pp below Norges Bank's f'cast, and 0.2 pp below our estimate
  - » Prices were up 0.1% m/m (seas adj), equal to the June print
  - » Inflation is below 2% for housing, clothing, food, alcohol, communication, transportation, and airline tickets – others are still above
  - » The main misses (vs our f'cast) on the downside were food and airline tickets, while clothing surprised on the upside
  - » Prices on imported goods rose in June, but annual inflation is trending down
  - » In addition, domestic inflation has slowed substantially to 1.2%
- **Total inflation** rose 0.1 pp to 3.0%, 0.2 pp above our f'cast
- **The outlook**
  - » **Inflation may slow** somewhat more the coming quarters. Wage inflation remains moderate (if not low). Demand for goods will have to decline from a very high level. <u>Upside risk: Higher raw material prices/global price pressures but the spill-over to the Norwegian CPI is not that significant</u>
  - » <u>Anyway, CPI inflation will not have any material impact on Norges Bank's monetary policy</u> the coming months. It's all about the post Covid-19 recovery – and the housing market

Norges Bank has not been an inflation nutter (since 2010, at least)

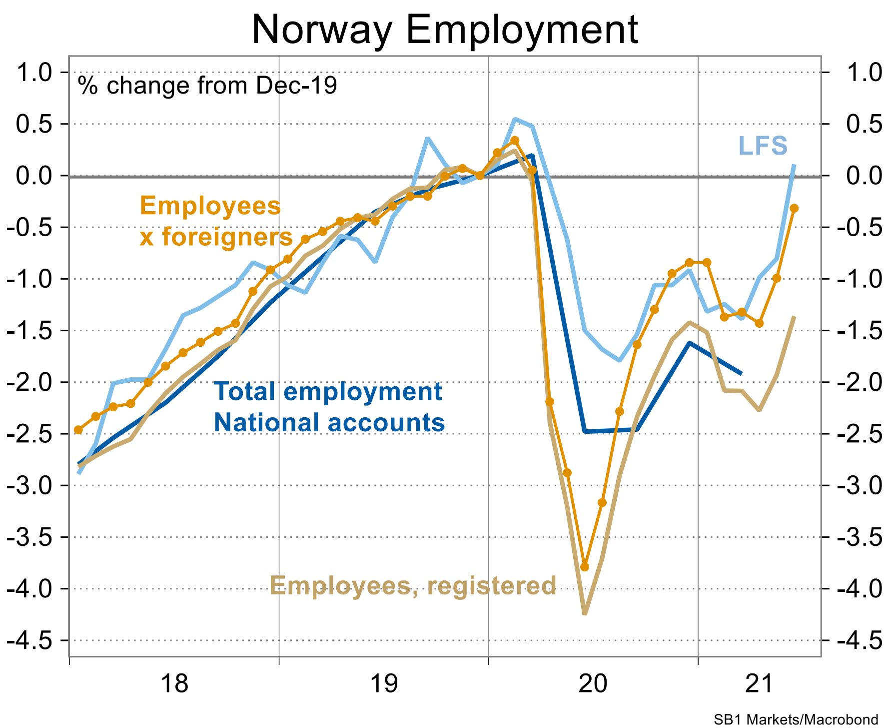
Actual inflation has not been correlated to interest





Register employment data confirms the strong LFS employment report

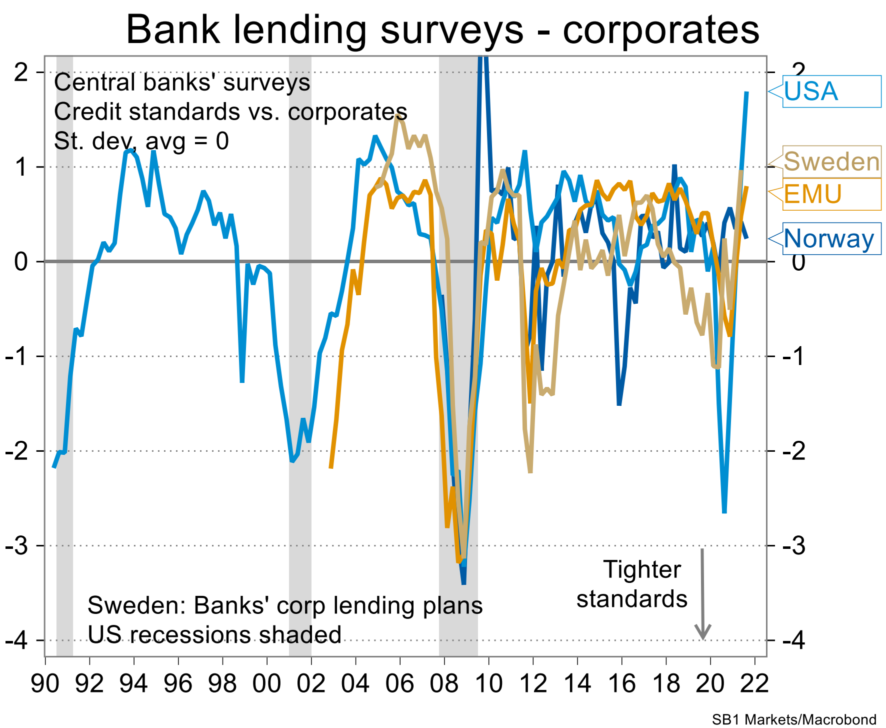
The no. of employees rose by 0.8% m/m in June, but remains 1.4% below Dec-19 level. However…

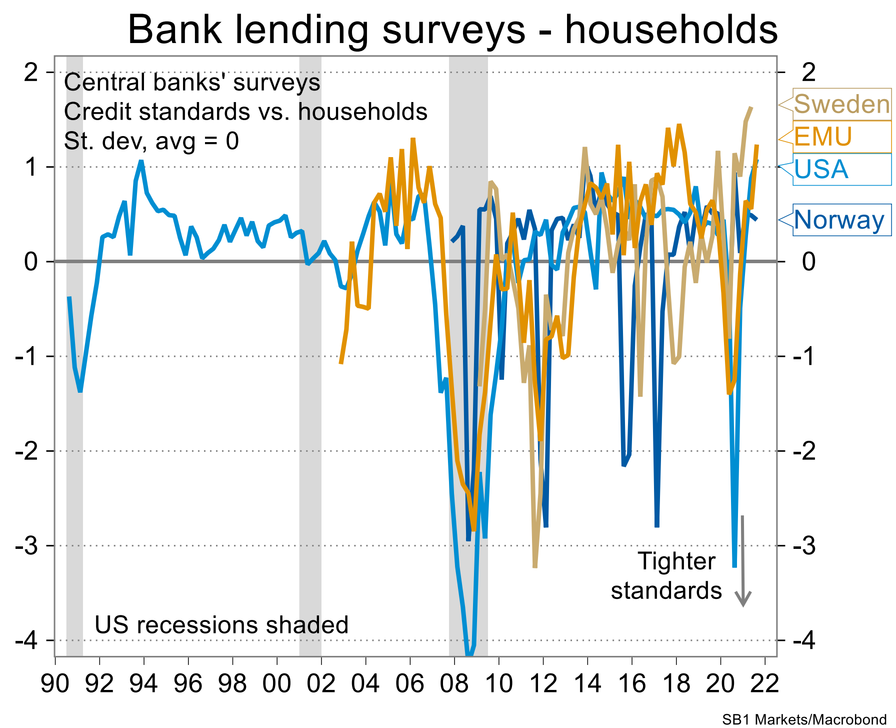


- … **excluding foreign workers** on short term stay (not immigrants) the no. of employees (living in Norway) is just 0.3% below the pre-pandemic level
- **The LFS** (survey) employment data are more volatile than other measures. In May (avg April – June) LFS employment rose 1.6% vs. February, and it was up 0.1% vs. Dec. 19 (and 0.4% below the Feb-20 level)
- **National Accounts** will report Q2 data this week. These data includes foreign workers on short term stay, as well as self employed
- **Average monthly wages** are up 2 – 2.5% y/y – no signs of higher wage inflation (check next page)

Global view: Risk on, banks in large parts of the world are loosening policies

Norwegian banks a little less so…

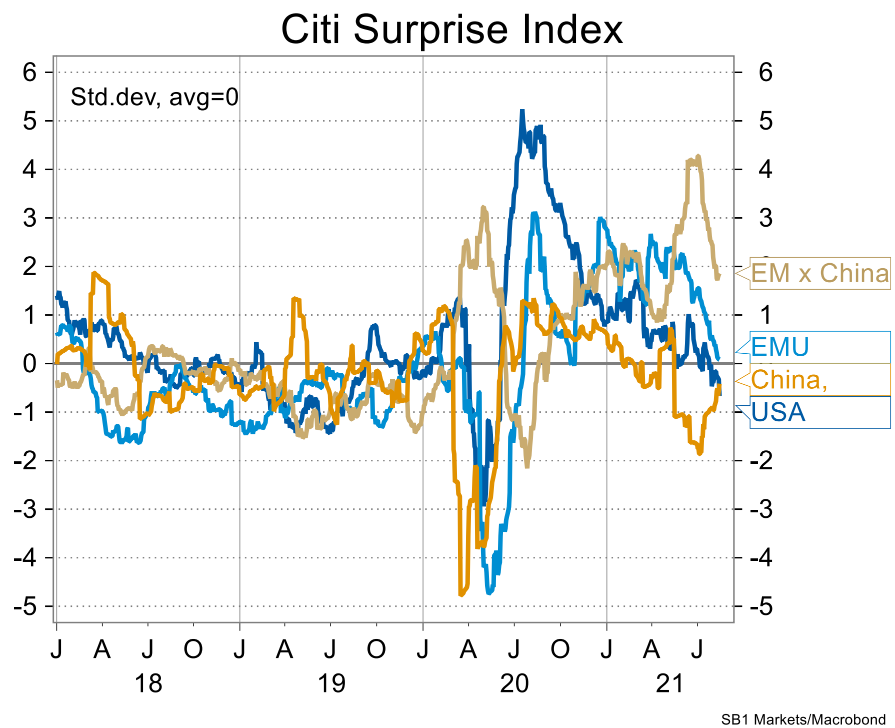


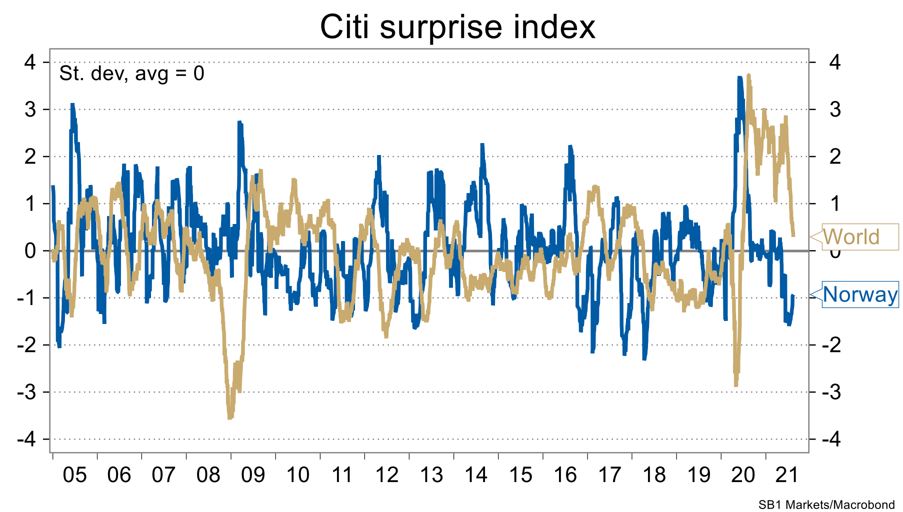


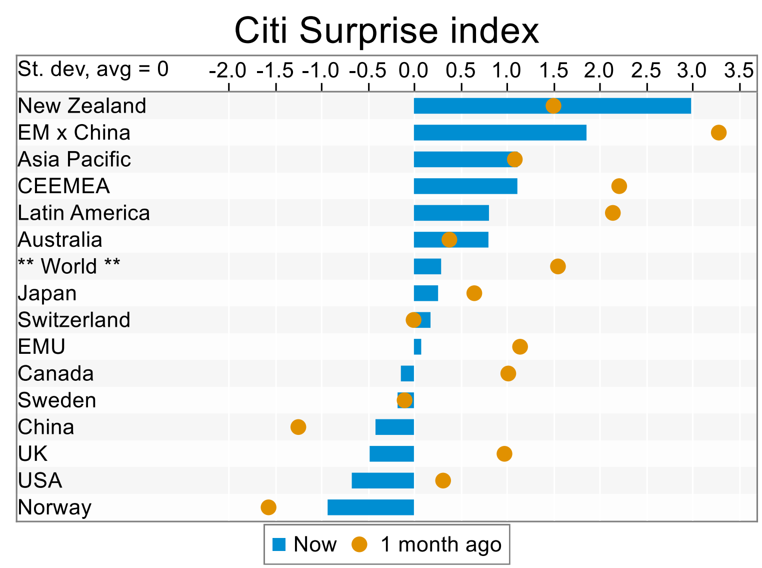
- **US banks** are signalling loosening standards, and quite a bit towards the corporate sector. Credit spreads in the corporate bond market are among the lowest past two decades
- **European banks** are also reporting an easing vs both households and businesses
- **Swedish banks** are reporting easing standards vs. households and no change vs businesses

Growth surprises still on the upside but many countries are heading down

… according to Citi's surprise index. The US has fallen to below par; Sweden, China & Norway well bel.







- **China** has recovered somewhat due to better than expected Q2/June data. This morning's weak July data will take the surprise index sharply down
- **Emerging Markets x China** are reporting better data than expected, but the positive surprise is diminishing rapidly
- The **EMU** is approaching the zero line, from above
- The **US** surprise has fallen to below average, and fell further last week
- **Norway** has surprised sharply on the downside recent weeks

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

The Calendar: US & UK retail sales, US ind. prod, FOMC Minutes. GDP, NoBa here

Time	Count.	Indicator	Period	Forecast	Prior
Monday Aug 16					
08:00	NO	Trade Balance	Jul		25.0b
14:30	US	Empire Manufacturing	Aug	26.3	43
Tuesday Aug 17					
08:00	UK	Weekly Earnings ex Bonus	Jun	7.4%	6.6%
09:30	SW	Unemployment (AKU)	Jul		9.2%
11:00	EC	GDP SA QoQ, revision	2Q P	2.0%	2.0%
14:30	**US**	**Retail Sales Advance MoM**	**Jul**	**-0.30%**	**0.60%**
14:30	US	Retail Sales Control Group	Jul	-0.30%	1.10%
15:15	US	Industrial Production MoM	Jul	0.5%	0.4%
15:15	**US**	**Manufacturing (SIC) Production**	**Jul**	**0.7%**	**-0.1%**
16:00	US	Business Inventories	Jun	0.8%	0.5%
16:00	US	NAHB Housing Market Index	Aug	80	80
Wednesday Aug 18					
08:00	UK	CPI Core YoY	Jul	2.1%	2.3%
11:00	EC	CPI YoY	Jul F	2.2%	2.2%
11:00	EC	CPI Core YoY	Jul F	0.7%	0.7%
14:30	US	Building Permits	Jul	1610k	1598k
14:30	US	Housing Starts	Jul	1605k	1643k
20:00	**US**	**FOMC Meeting Minutes**	**Jul-28**		
Thursday Aug 19					
08:00	**NO**	**Investm. survey, oil, 2021 NOK**	**Q3**	**182**	**182**
08:00	**NO**	**Investm. survey, oil, 2022 NOK**	**Q3**	**150**	**143**
08:00	NO	Housing starts	July		34k
08:00	NO	Population growth	Q2		
08:30	NO	Consumer Confidence, Finans N	3Q	(12)	2.5
10:00	**NO**	**Norges Bank deposit rate**	**Aug-19**	**0.00%**	**0.00%**
14:30	US	Initial Jobless Claims	Aug-14		375k
14:30	US	Philadelphia Fed Business	Aug	24.2	21.9
16:00	US	Leading Index	Jul	0.8%	0.7%
Friday Aug 20					
08:00	**NO**	**GDP Mainland MoM**	**Jun**	**1.3% (1.5)**	**1.8%**
08:00	**NO**	**GDP Mainland QoQ**	**2Q**	**1.7% (1.7)**	**-1.0%**
08:00	UK	Retail Sales	Jul	0.3%	0.5%
16:00	US	State employment/unempl.	Jul		

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

- **USA**
  - **Retail Sales** were very strong in June, and at a level 16% above that before the pandemic, but the trend is down for goods as service consumption increases. A July decline is expected
  - **Manufacturing production** was weaker than expected in June, largely due to a fall in auto-related production. Production is still 1% below the pre-pandemic level. A strong recovery and even stronger surveys point to production picking up in July and the coming months
  - **Minutes from the last FOMC meeting** will probably not give any further clue on when Fed will announce a QE tapering. While the Fed changed it's message to a more positive tone, noting that improvement to the economy indeed has been made, a precise message will not be 'hidden' in the minutes. Next week, the Jackson Hole summit may be an occasion but the September meeting is a more appropriate arena, we think
  - **State employment data** could reveal if states that left the extra federal unemployment programs are experiencing better employment growth than those who have not
- **EMU**
  - The preliminary headline **inflation** number came in at 2.2% two weeks ago, but with the core at 0.7% and ECB's more flexible inflation targeting, inflation is currently not a problem here
- **UK**
  - BoE maintains that the higher **inflation** seen recently is transitory (albeit with a far higher peak than previously anticipated), while at the same time covering their bases and signalling a tighter policy. They could be right, but the both the core and the headline numbers surged in June, and the price increases were widespread. Look out for the m/m figure, as prices were up 0.75% last July – and the annual rate will no doubt decline. And next month, prepare for a surge in the annual rate
- **Norway**
  - We expect **Mainland GDP** to make another leap upwards in June, as restrictions were lifted. A 1.5% growth in June will yield a 1.7% Q2 growth rate. If so, June GDP will be 0.8% above the Feb-19 level
  - We expect **oil companies** to revise their 2022 investment forecast sharply up in August vs the May f'cast. Still, the 2022 estimate will be far below the likely 2021 outcome
  - The upcoming **Norges Bank** meeting will a non event. The signals rate will stay at 0, and comments to be neutral vs. the June MPR report. Also no MPR at this 'mid' meeting
  - Expect Finans Norge's **Consumer confidence survey** to recover further from the still low level in Q2. Opinion's monthly survey has been far more positive since the middle of last year, and has moved up 1 st.dev since the last Finans Norge Q2 survey

Highlights

The world around us

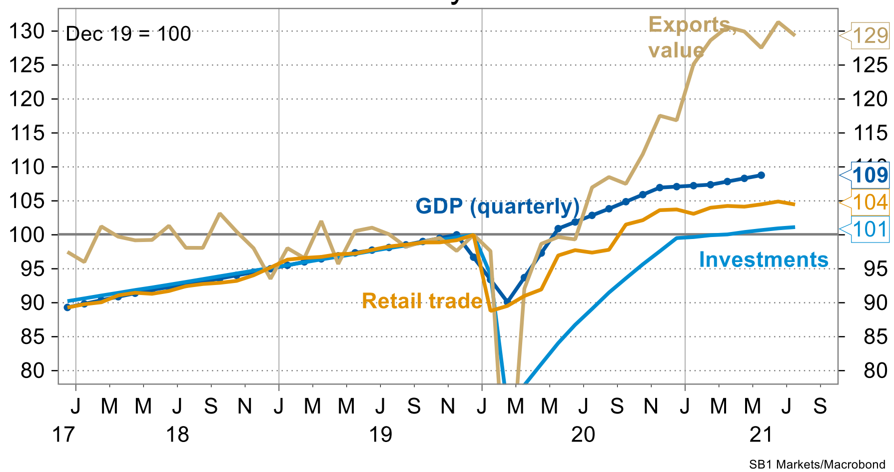
The Norwegian economy

Market charts & comments

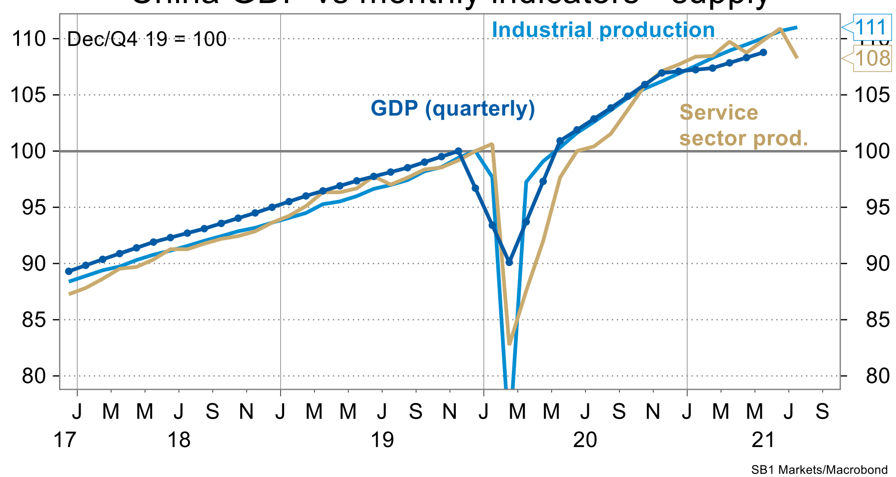
July data far weaker than expected, following at better than expected June

All major data surprised on the downside – the Delta virus and tighter policy has contributed

China GDP vs monthly indicators - demand



China GDP vs monthly indicators - supply

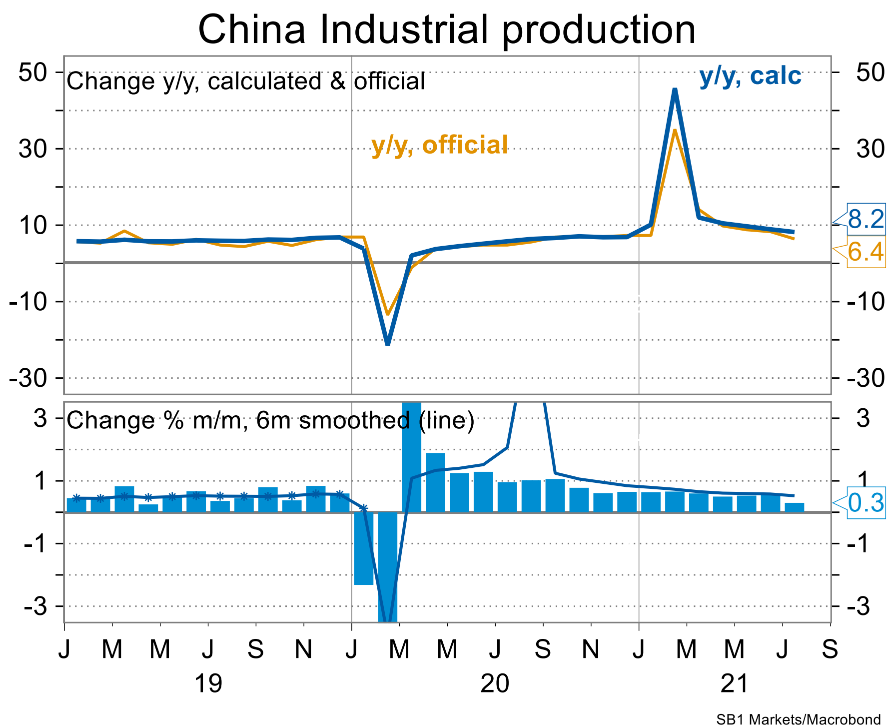


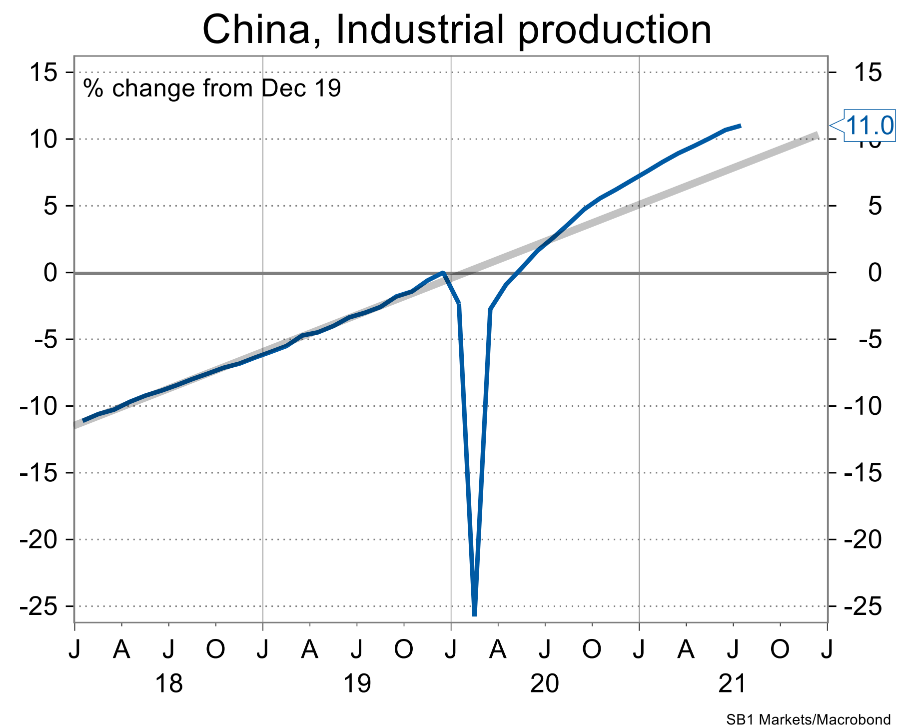
- **Industrial production** fell by 0.3% in June, down from 0.6%. Measured y/y, production is up 6.4%, 1.4 pp below expectations. Production is 3% above the pre-corona trend path but growth has finally slowed to the pre-pandemic level, as we expected. Steel & cement down 10 – 12% past 3 months, partly due to 'CO2' restrictions but construction activity is falling too. Surveys are not signalling weak growth ahead
- **Service sector production** fell by 2.4% in July, more than reversing growth the prev. 2 months, even if surveys were OK. No doubt virus related. The level is still just some 2% below the pre-pandemic trend growth path.
- **Retail sales volumes** fell by 0.3% in volume terms (our est.) in July, and the previous months were once more revised down. Since last Nov, sales have grown by less than a 2% pace, far below the pre-p 6% path. Sales were up 8.5% y/y, 2.9 pp below expectations
- **Investments** grew by just 0.2% in July, half the previously reported pace in June (which was revised down, together with the previous months). The level is 6% below the pre-pandemic trend growth path. The (still useless) accumulated annual growth rate was 10.3% in July, 0.9 pp below expectations. Housing and other construction starts have fallen 15 – 20 % recent months. **New home sales** fell further sharply in July, and **existing home** prices stagnated in July
- **Credit growth** slowed a tad in July, and the the trend is clearly down, and the credit impulse fell further. In July, the authorities surprisingly cut banks' reserve requirements, signalling that a further credit tightening is not warranted (just some overleveraged companies have to be sorted out
- **Last week:**
  - **Exports rose and imports both fell** slightly in July (not in this report). Both are levelling out, in volume terms, at high levels
  - **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 slowing, and most likely not mainly due to the virus outbreak. Policy has contributed too, and a maturing global cycle in goods

Industrial production up just 0.3% in July, down from the 'normal' 0.6%

Annual growth 6.4%, down from 8.3%, well below the expected 7.8%

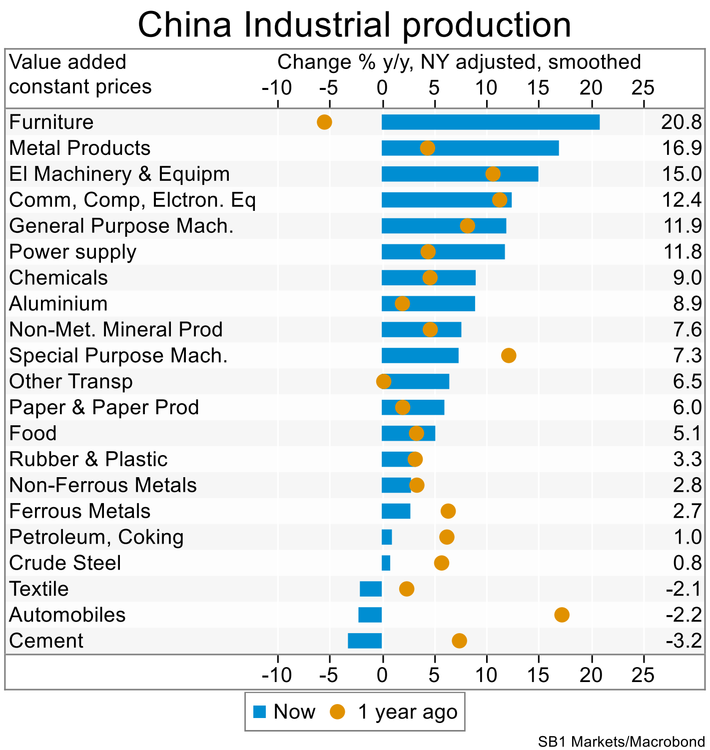




- **The official data**: Production is up 6.4%% y/y, down 1.9 pp and 1.4 pp pp below expectations
- **Production** grew by 0.3% m/m, half the speed of June and the previous months. Sharp productions cuts in steel and cement have contributed to the slow monthly growth
- Production is 11% above the Dec '19 level and some 3% above a reasonable pre-corona growth path. Not bad
- **Both supply and demand** factors may be limiting factors the coming months – supply side probably most important short term. Business surveys signal somewhat slower growth, but no sharp downshift

Steel, cement sharply down in May – July

Both down 10% - 12% (after at 10% downward revision of cement production in both May and June!)



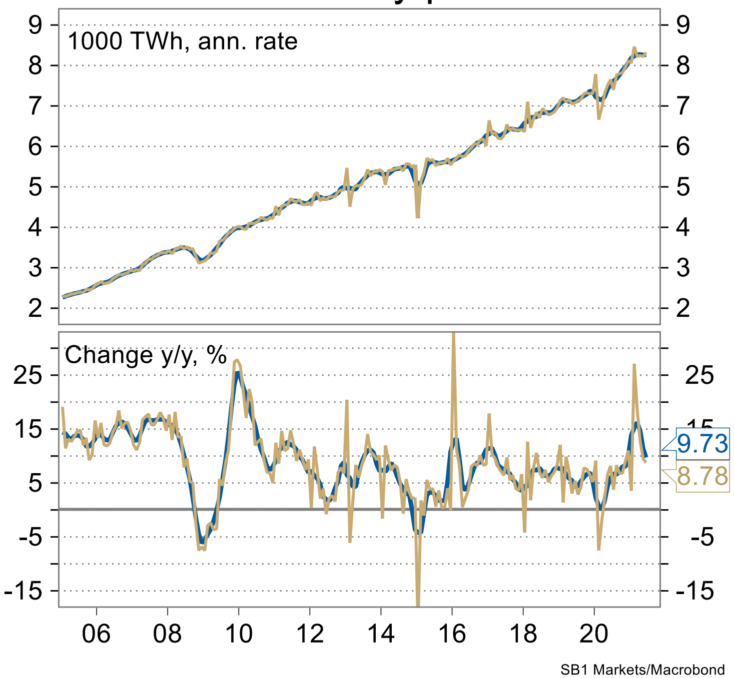
- The authorities have decided that 2021 steel production should not exceed the 2020 level, and as H1-21 production was well above the 2020 level – production must be cut in H2 (some 12%)
  - Both production and demand (including inventories) are down 10 - 12% the past 3 months
  - Other 'construction related' sectors like aluminium, copper and plate glass have kept up far better – but copper and aluminium has flattened
- We assume there are more reasons for the cut than the 2030 CO2-target, like local pollution, fear of overbuilding, and too rapid credit expansion, especially among heavily indebted real estate developers (read: Evergrande)

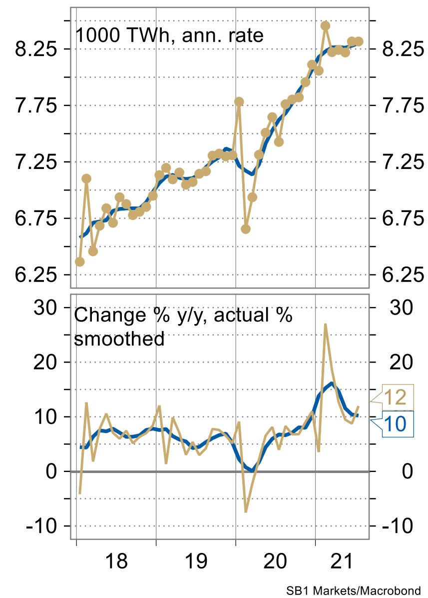
SpareBank 1 MARKETS

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

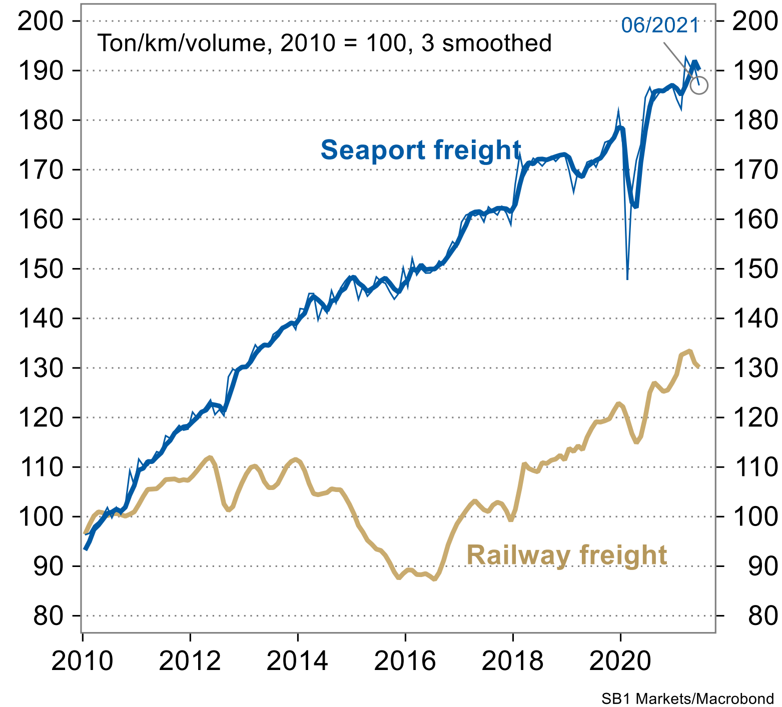
Transport may have slowed somewhat, data just through June

China Electricity production



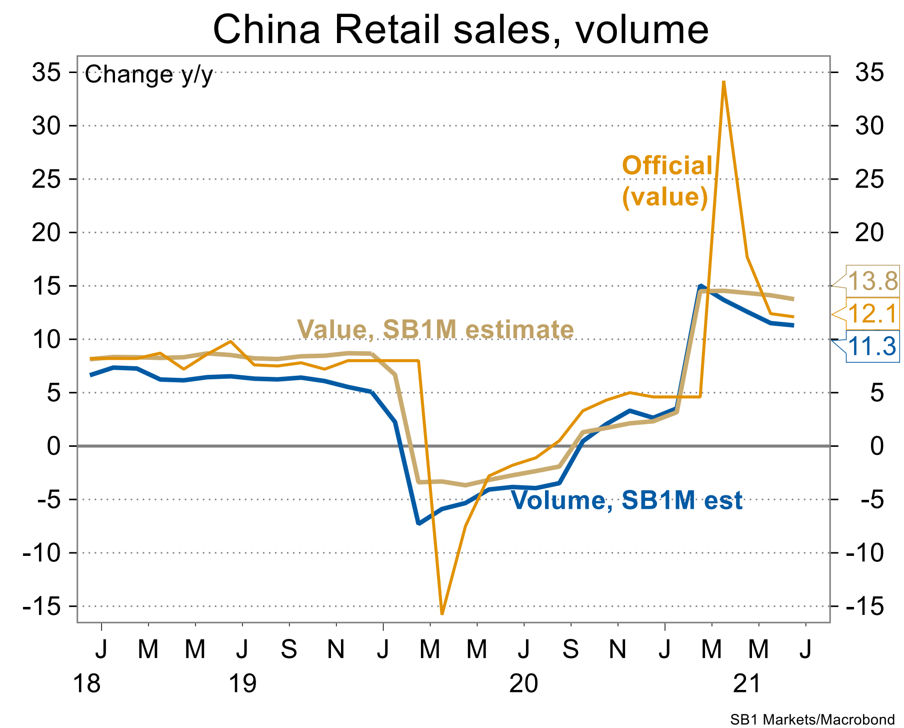


China Trade and transport



Retail sales has almost flattened since last November, underlying growth >2%!

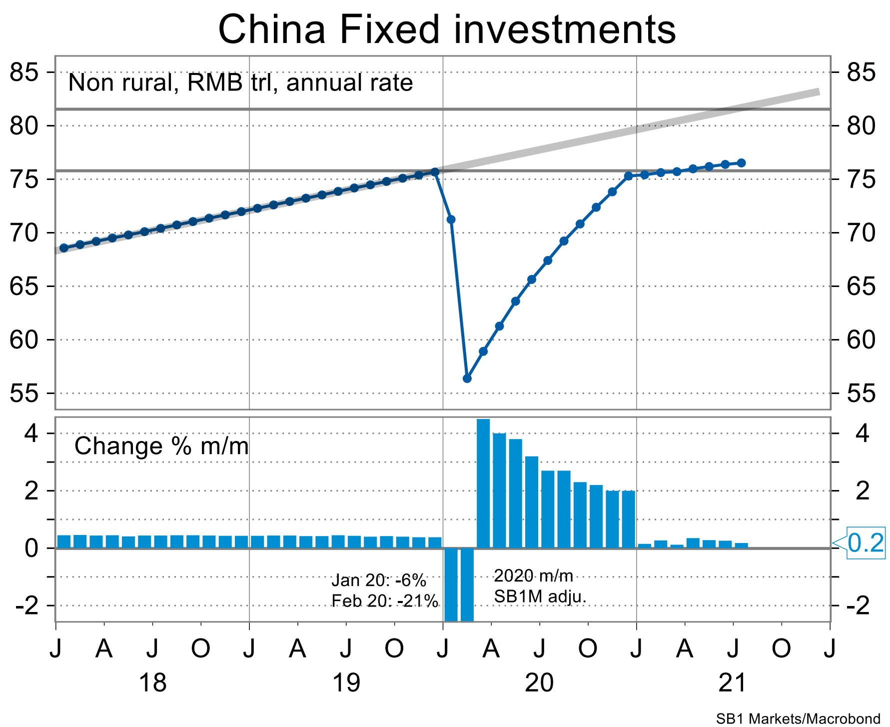
Sales far weaker than expected in July, volume down 0.3% m/m



- **Nominal retail sales** were up 8.5 y/y in July, down from 12.6% in June, and far below market expectations at 11.4%. (These annual growth rates are close to useless due to the base effect, the low sales level last spring/summer)
- In nominal terms sales fell by 0.1% m/m in June, we assume by 0.3% in **volume terms**
  - » Since last November the underlying volume growth rate has been less than 2%, following the 3rd downward revision over the past 4 – 5 months (if we can trust today's numbers). Before the pandemic growth equalled some 6% p.a – and we are very likely probably witnessing a sharp downshift in consumption growth (even if irrelevant annual growth rates are still strong at 8.5% nominally, check the level!)
- Sales volumes are 5% below the pre-pandemic trend path (we estimated -3% in June) – and underlying growth is very low

Investments growth is slowing, and was weaker than expected in July

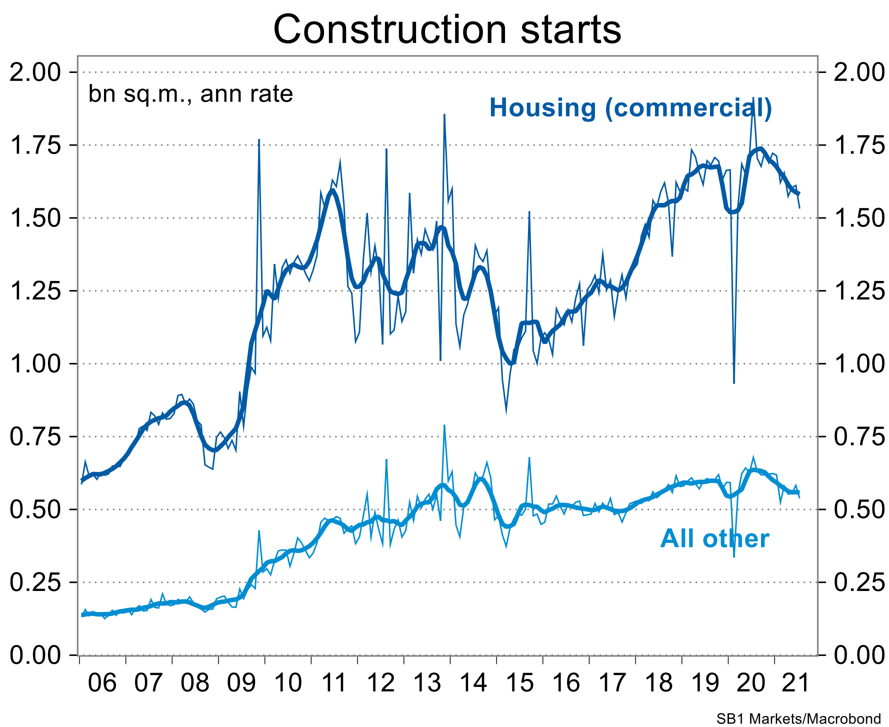
Monthly growth down to 0.2%, history revised down – and level is 6% below p-p trend

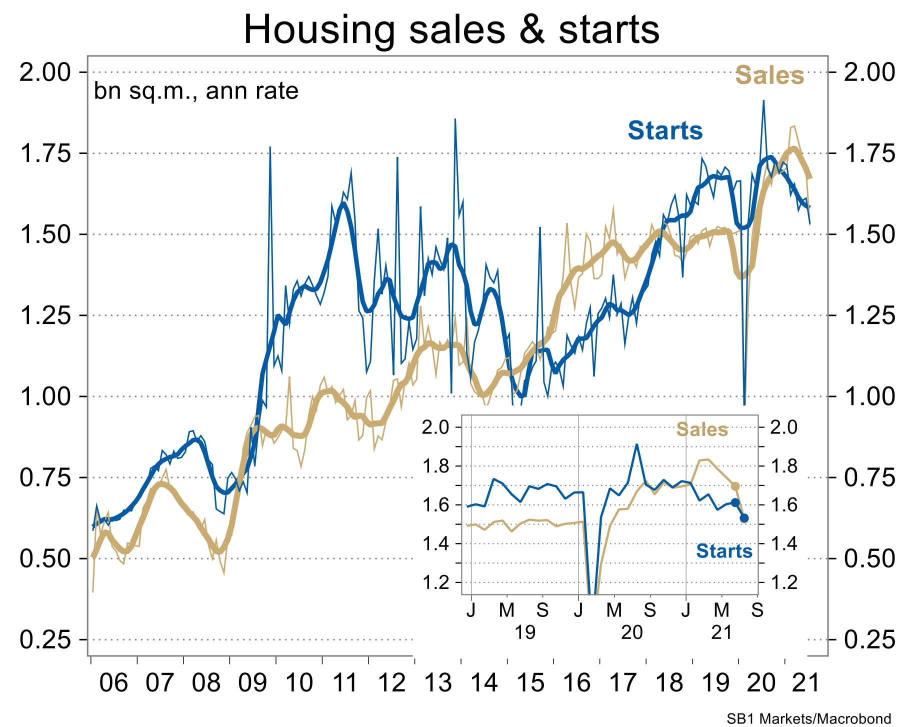


- **Measured YTD**, nominal investments rose 10.3% in July (still a silly number, due to the setback last spring/summer), down from 12.6% in June, <u>0.9% weaker than expected</u>.
- **Growth m/m** was once more revised down (for the 3rd month in row), and growth in July was just 0.2%, well below the 'normal' 0.4% growth before the Covid crisis last spring.
- The **investment level** is 6% below the pre-pandemic growth trajectory – and the gap is off course not closing now. The only positive twist: The level is above the Dec-19 level

Construction activity down in July, and the trend is clearly down

New home sales fell sharply in July, are down >15% from the early 2021 level

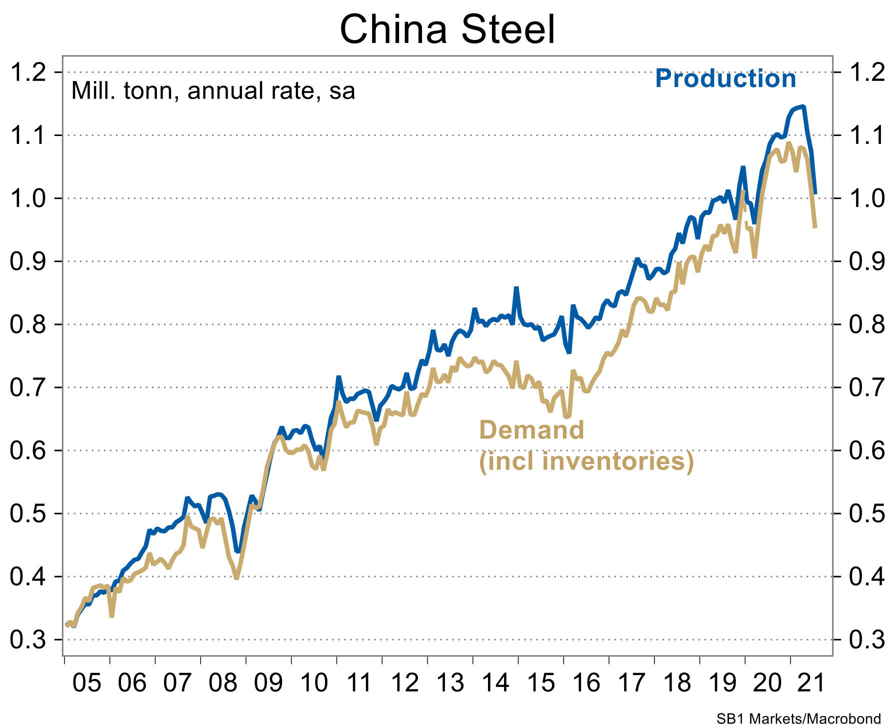




- The rise in **new home sales** from Feb-20 to Mar-21 was spectacular but sales have fallen sharply recent months – but not further down than actual housing starts in July. The fight against the Delta virus may explain some of the weakness in July
- **Housing starts** fell by some 6% in July, and are down 12% vs the late 2020 level. That is not a dramatic downturn, but significant vs the 'minor' Chinese construction contractions
- **Non-residential construction** fell in July as well, and is down 20% from last summer's ATH level
- **In sum, construction starts** are slowing. Look up for demand (or supply??) for steel, *check next page*

Construction activity is sagging following the post-corona crisis surge

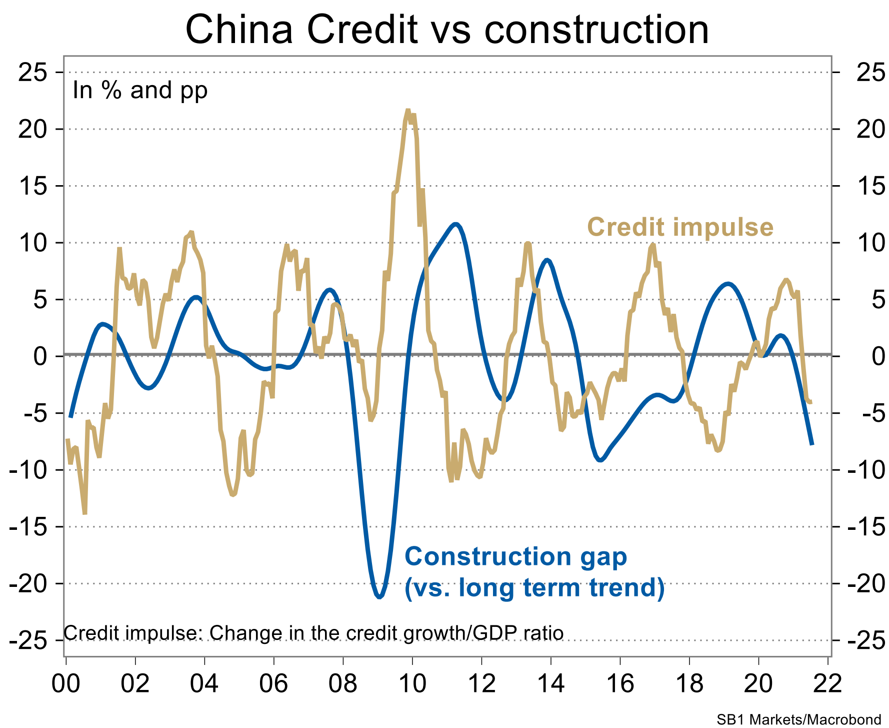
In addition, the authorities have decided to curb steel production in order to meet 2030 (!) CO2 targets



- The authorities have decided that 2021 steel production should not exceed the 2020 level, and as H1-21 production was well above the 2020 level – production must be cut in H2 (some 12%)
  - » Both production and demand (including inventories) are down 10 - 12% the past 3 months
- We assume there are more reasons for the cut than the 2030 CO2-target, like local pollution, fear of overbuilding, and too rapid credit expansion, especially among heavily indebted real estate developers (read: Evergrande)

Credit growth has slowed– and construction is on the way down

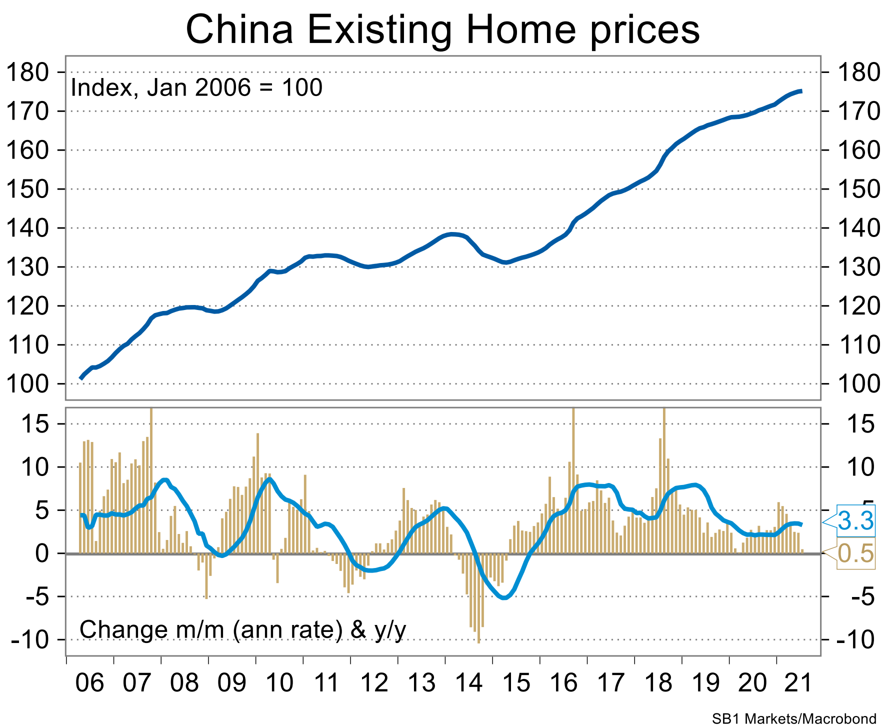
The two are dancing together, but not closely (and it varies who takes the lead too)

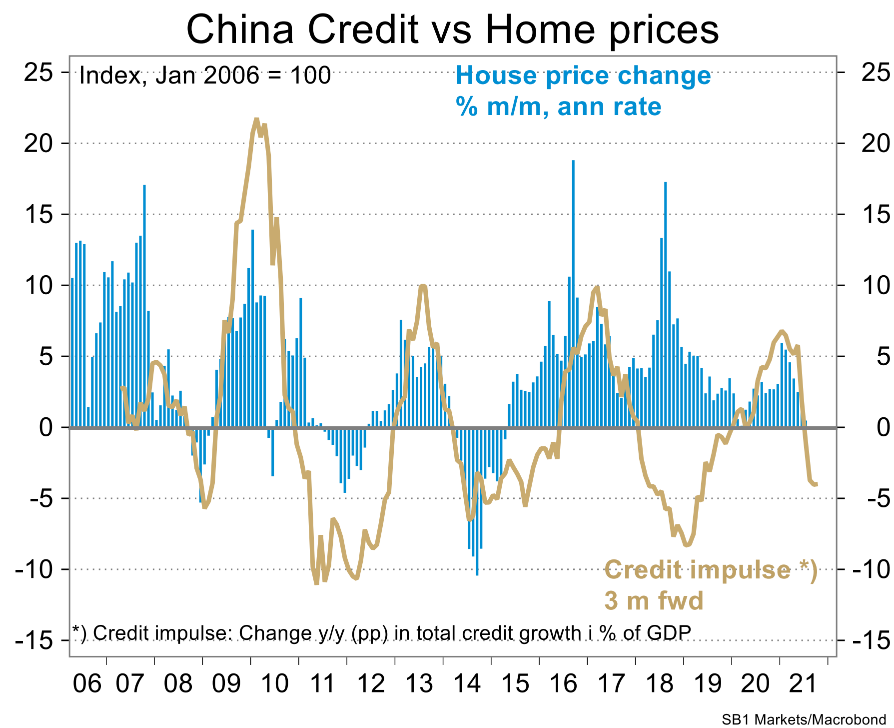


- … still they are at least normally at the same floor
- The recent credit tightening may have had some impact at the property market – but basically the slowdown in construction started 'too early' this time
- The credit tightening signals some downside risk for construction, raw materials & steel
- … at least until the credit indicator turns up again. In July, the authorities cut reserve requirement for banks 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 was brought to an halt in July

Prices up ‘just’ at 0.5% % m/m annualised pace in July (annualised)

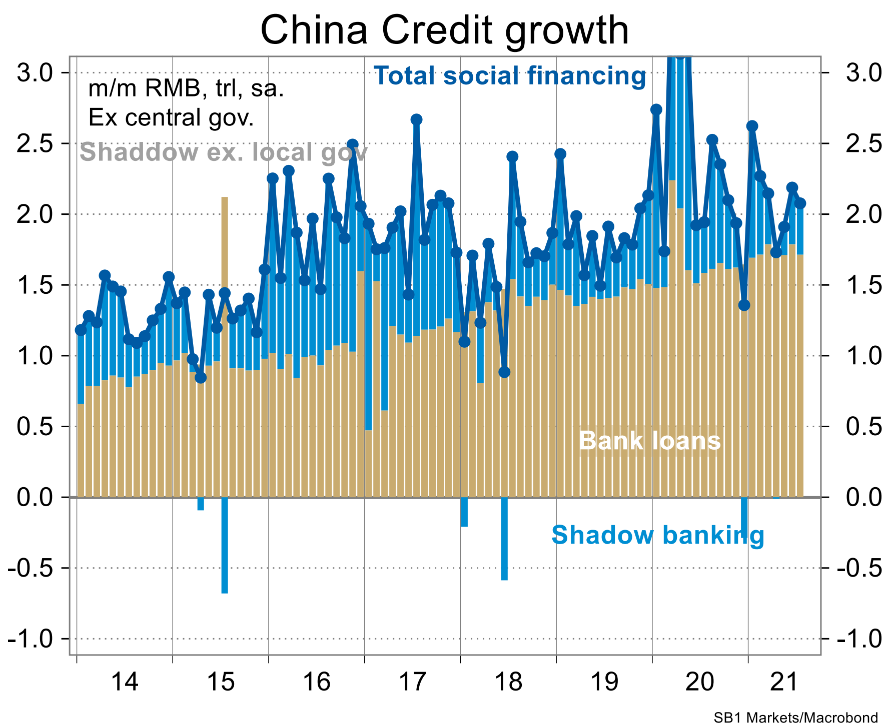


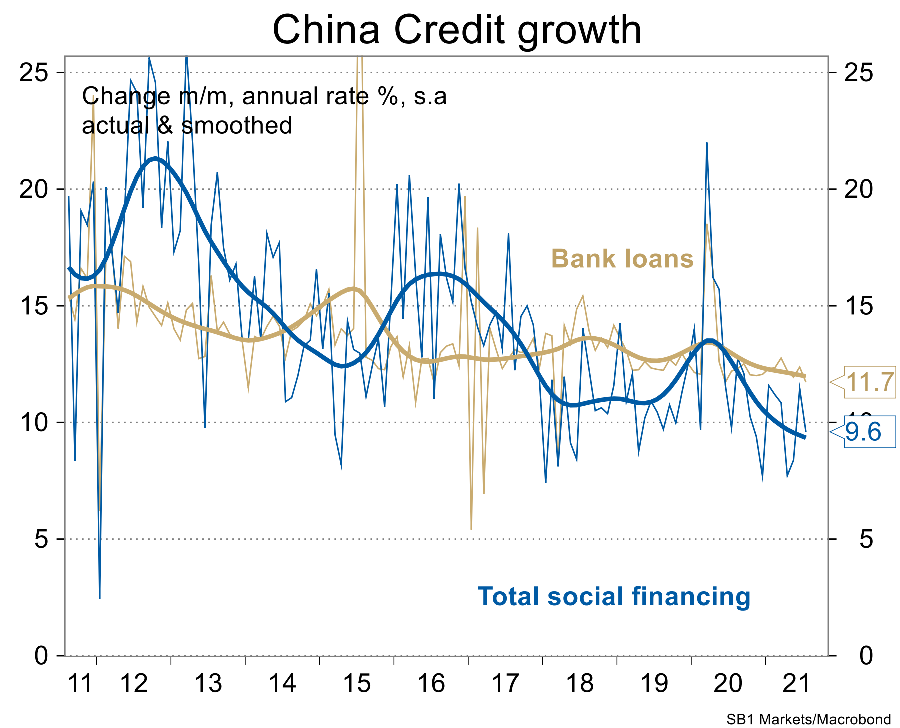


- Existing home prices rose at the slowest speed since last spring – well down from the 6% pace recorded in early 2021
  - » The annual rate is still at 3.3%
- Credit policy was tightened last autumn and the credit growth has slowed (= a negative credit impulse)
- The correlation to house prices is far from tight but there is ‘something’ there

Subpar (but far from low) credit growth in July, the credit impulse further down

… but authorities are now probably changing tack; reserve requirements are cut, rates are discussed

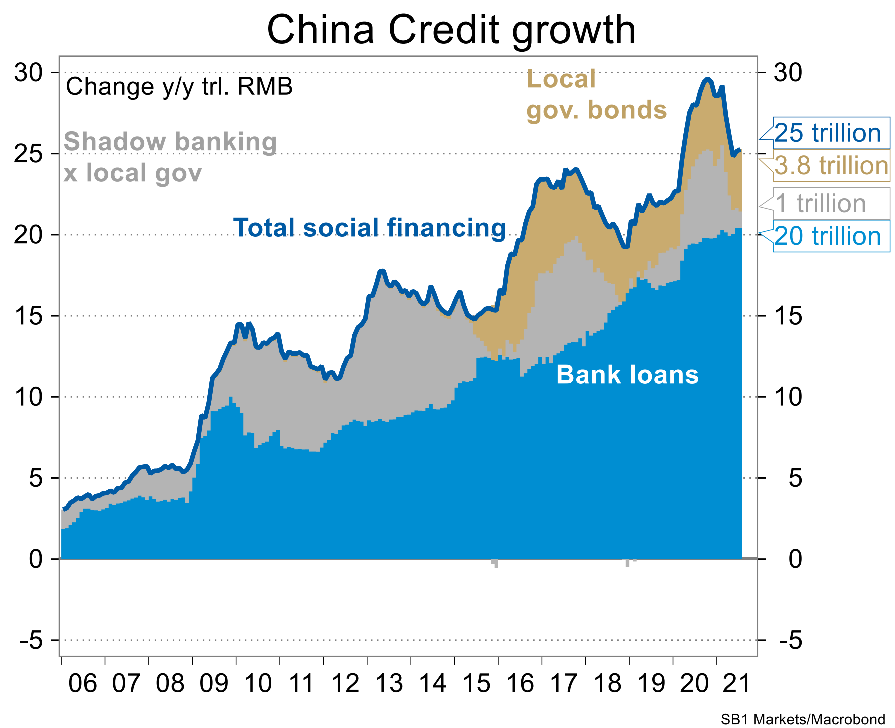


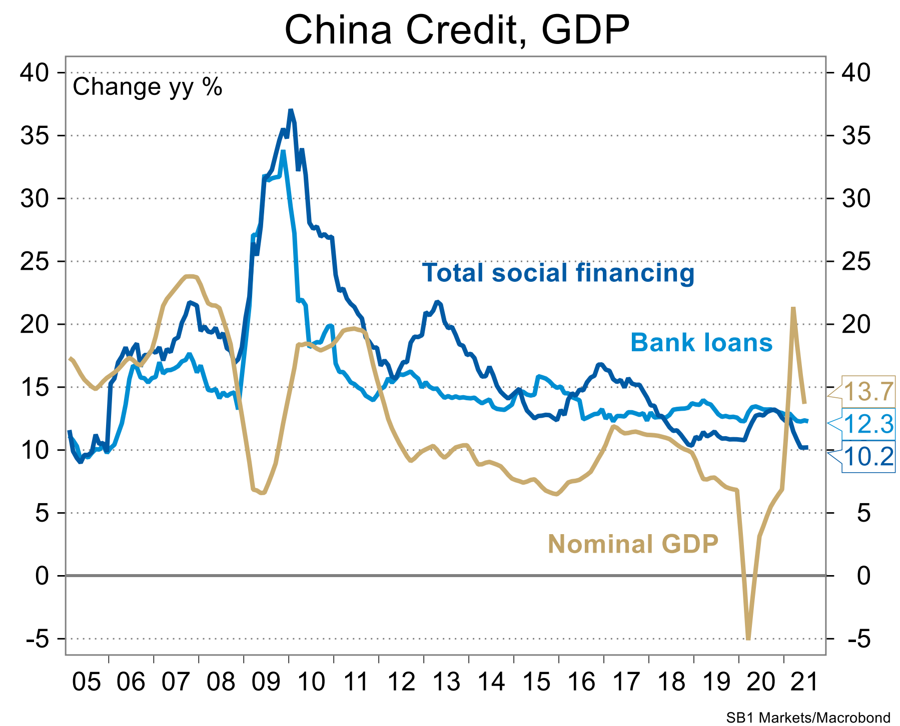


- **Total credit** grew at an 9.6% rate in July (m/m, seas. adj. annualised), up down from 11.5% in June. Smoothed, the underlying rate may be 9% - 10%, down from 13% during last spring (and >15% during some months). The underlying growth rate is still marginally above the trend growth in nominal GDP
  - **Total credit** rose by RMB 0.9 trl, expected 1.7 trl (not seas. adj., total social financing, including central & local government bond, and corporate equities). Seas. adj. the core total social credit (total ex central gov bonds & corporate equites) grew by 2.1 trl, down from almost 2.5 trl in June
  - **Bank loans** rose by RMB 1.7 trl, seas adjusted, or at a 11.7% annualised pace - and less than expected. Growth is slowly, slowing, from a 13% rate last spring. Loans are up 12.7% y/y
  - **Shadow banking credit** rose by RMB 0.4 trl in July (s.a). Growth has slowed sharply, underlying to 4%, from 13% last summer – the lowest growth rate on record. Excluding local government bonds, 'private' shadow credit is now declining – and faster than ever
- **The credit impulse has turned negative**, like it usually does every 4th year or so. The ramification may be felt in many markets
- **The slowdown has been by purpose**, as authorities have tightened, especially vs. credit supply outside banks. However, the authorities may shift the foot to the accelerator again – as they always have done after tightening too hard. In July, PBoC cut banks' reserve requirements, and now rate cuts are discussed

Credit growth turned south, just as asked for by the authorities

As they usually do, every 4th year or so. Until the growth is curbed too much. Like now??

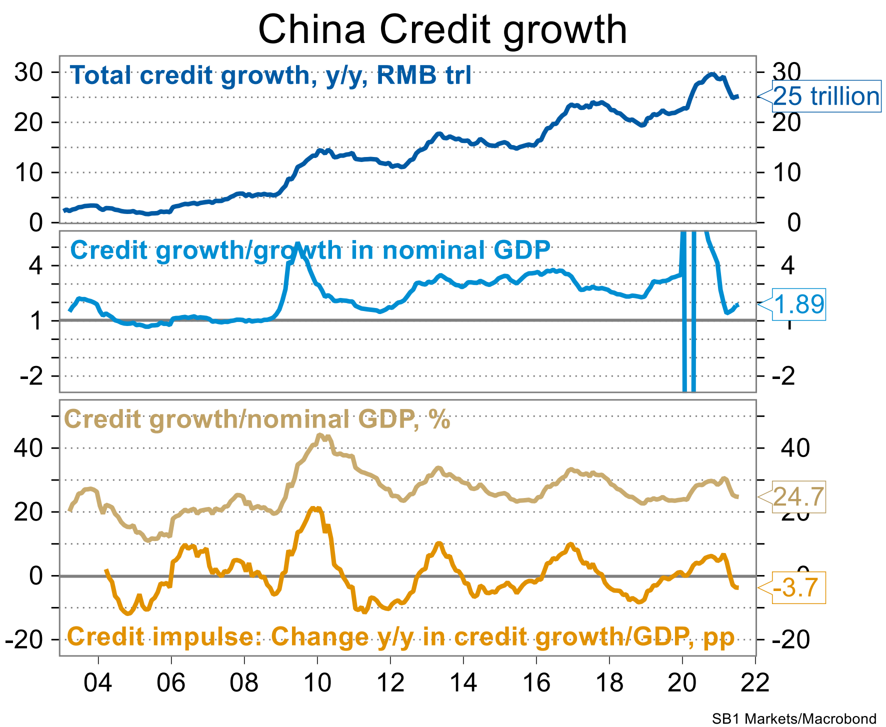


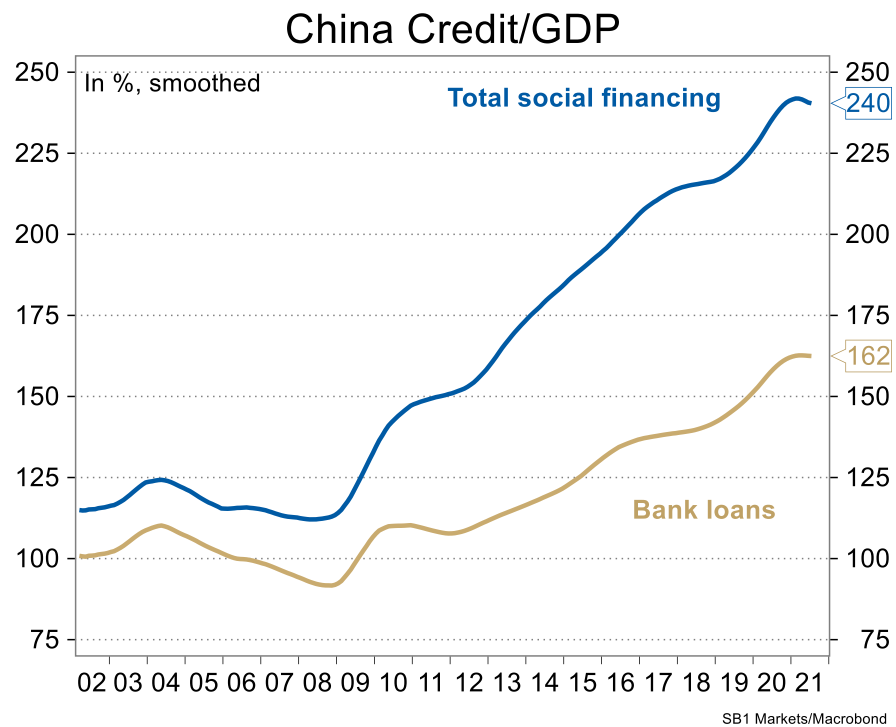


- Over the past year, **total credit** has expanded by CNY 25 trl, equalling 25% of annual GDP, down from CNY 30 trl at the peak
- **Banks** supplied CNY 20 trl of the y/y increase
- **Local governments** have not yet accelerated their borrowing by much, at least not in the bond market, still up 3.8 bn y/y
- Other credit – via the **shadow credit market** x local gov bonds has slowed to RMB 1 trl from 5 (and is actually falling m/m recent months)
- **Total credit** growth was unch. at 10.2% y/y, the slowest pace since 2005, but still above nominal GDP growth before the pandemic. Underlying growth in credit recent months is even lower, down to below 10%

The credit impulse has turned negative, no big drama yet

Credit growth is slowing following the significant support early last year to fend of the corona crisis



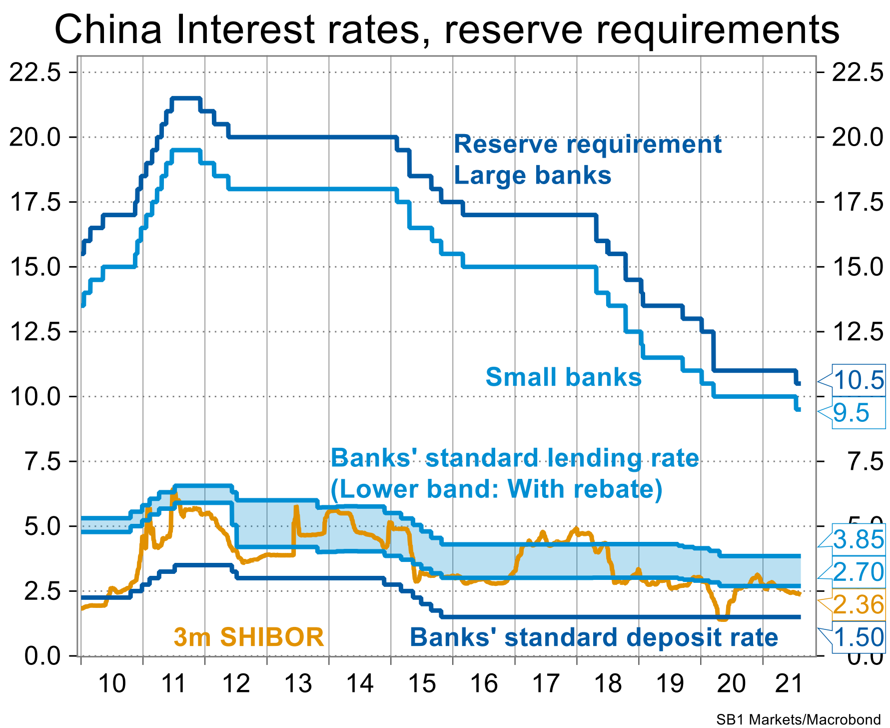


- A positive **credit impulse** implies that the credit growth/GDP ratio is increasing (the 2nd derivative of credit vs the GDP level)
  - » A negative credit impulse indicates credit tightening (or weaker demand) and has been associated with slowdowns in the Chinese economy, which have had impacts at other markets
- The **credit impulse** (here measured as the 12 m change the 12 m credit growth/GDP ratio) bottomed in late 2018, turned positive one year later, peaked last autumn, fell into negative territory in May, and is now at -3.8%
- Are authorities worried that they have tightened too much? *Check next page*

GDP is smoothed in the calculations in the charts above

More easing in the cards?

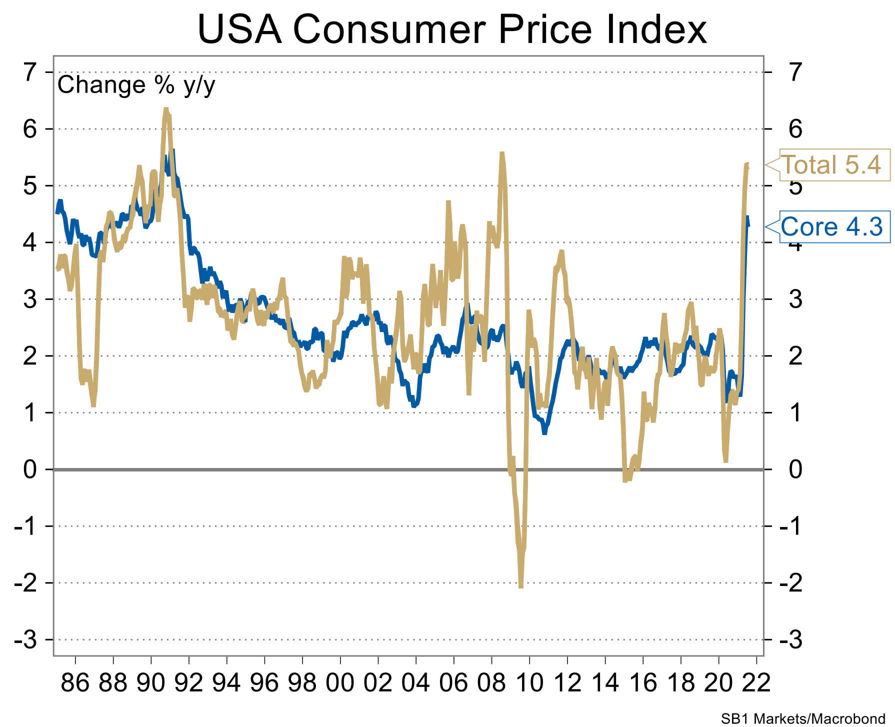
The reserve requirement ratio was cut in July, interest rate cuts are discussed (due to Delta)

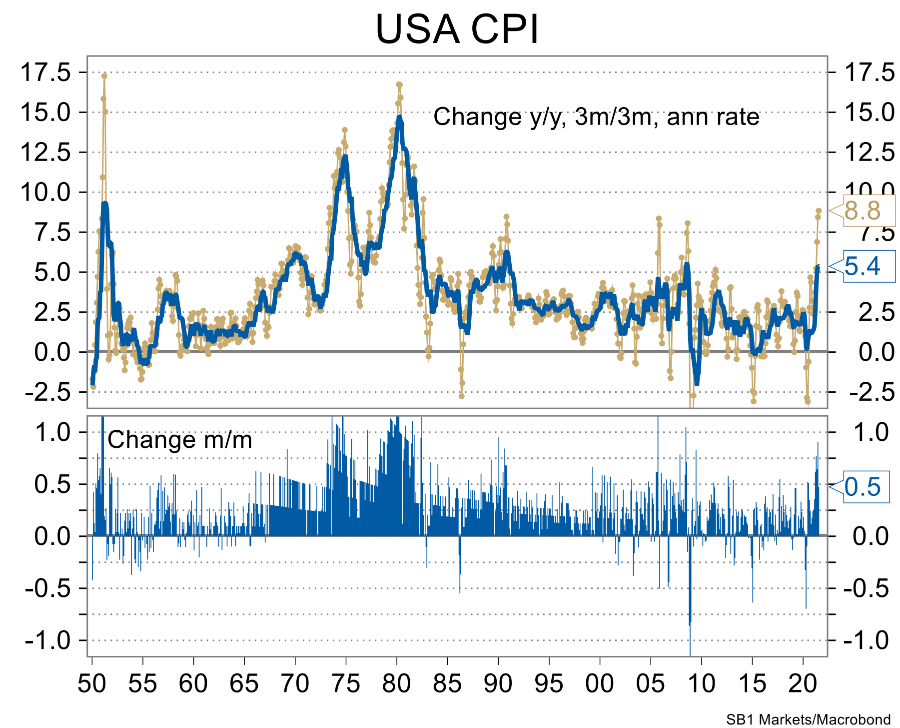


- In July, the reserve requirement was cut by 0.5 pp to 10.5% for large banks and to 9.5% for smaller banks
- The cut will free up some RMB 1 trl in lending capacity in the banking system, equaling 3 weeks' growth in credit supply from banks. No more, no less
- Still, the measure signals that authorities do not want credit tightening to go too far, even if they at the same time are worried that credit has grown too fast for too long, bringing the debt/income ratio too high, increasing the risk for financial instability. The authorities may still want to curb credit to some highly indebted sectors, like property developers
- Such change of tack in credit/monetary policy is rather common in China – as in many other countries

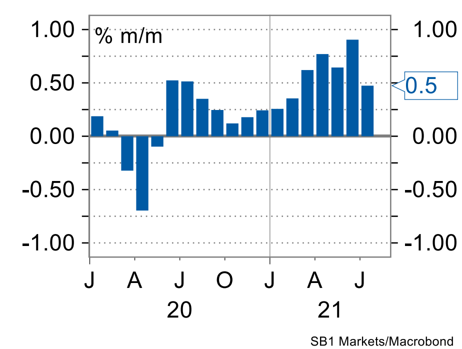
Peak CPI inflation? The m/m increases slowed in July, annual rates remain high

It may still be transitory (and most of it is) but the risk for higher inflation for longer has increased



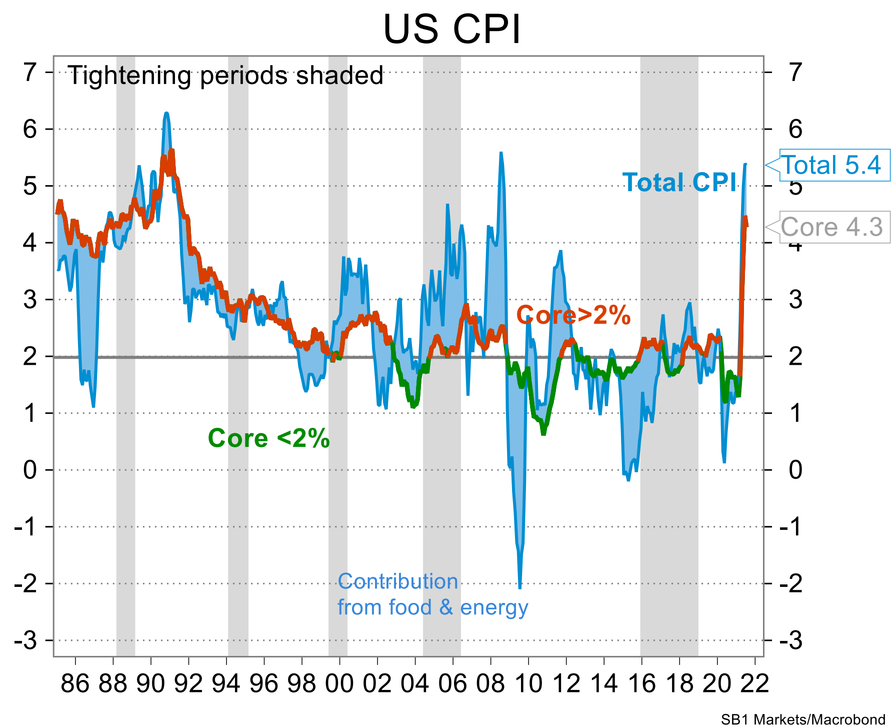


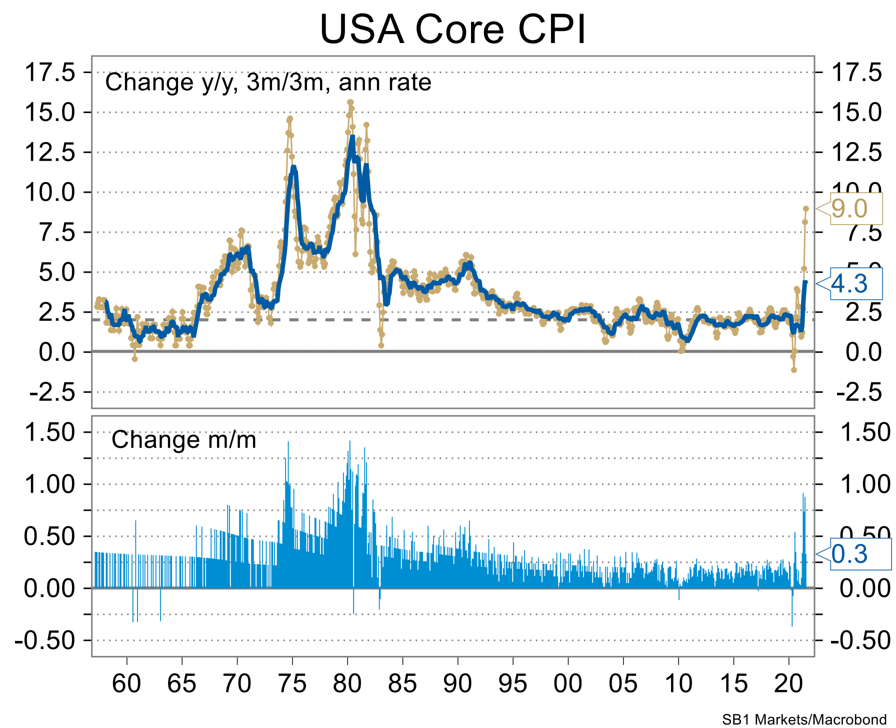
- **Headline CPI** rose 0.5% m/m in July, as expected. The annual rate climbed was stable at 5.4%. These is the 2nd highest headline CPI y/y print since 1990
- **Prices have been accelerating** m/m since last October, and the 3m/3m rate is now up to 8.8%, highest since 1980
- In all surveys, companies reported that they have or expect to lift prices sharply, some faster than ever before
- Recent days **several FOMC members** have signaled that the Fed's monetary policy should soon be tightened. Powell might signal that he (or the rest of the FOMC) agrees at the central bank conference in Jackson Hole at the end of August, or the bank can wait until the September meeting, where new forecasts, dot plots etc will be published. We think the latter is most likely, at least it is 'formally' a more correct way of doing it. Some smoke signals may still be sent from Jackson Hole… and tapering will start from the end of the year



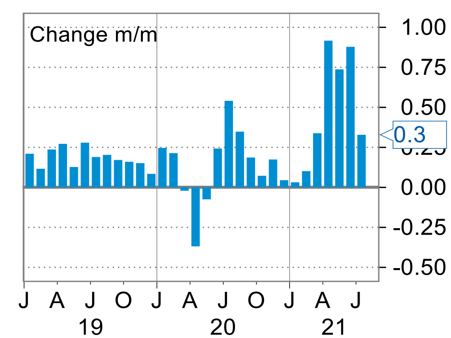
Core inflation slowed more than expected

Prices +0.3% m/m in June, expected 0.4%, the annual rate down 0.2 pp to 4.3%



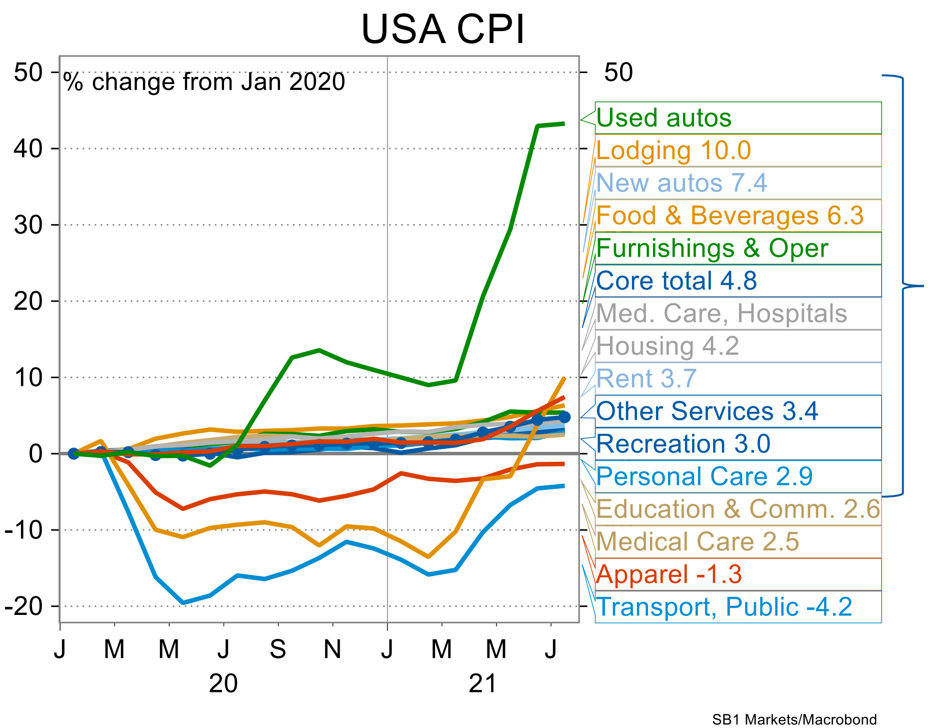


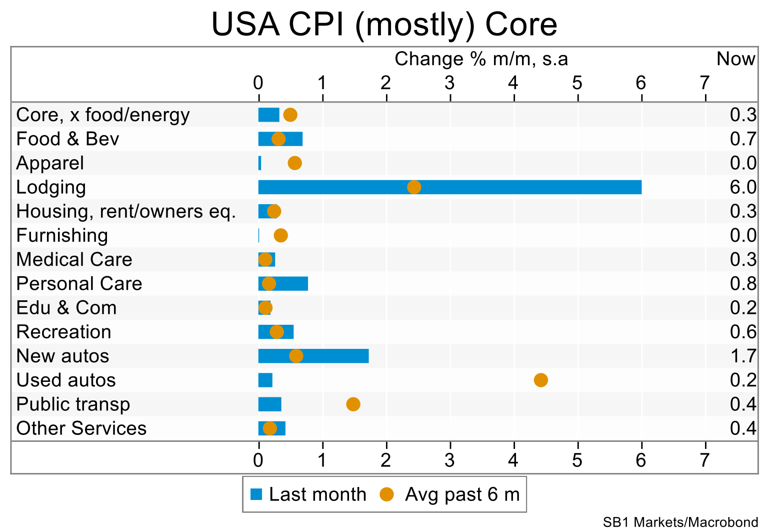
- **Core prices climbed rapidly m/m April – June but slowed in July, but 0.3% is still almost 4% annualized.**
  - » In April, the 3m/3 rate was at 1.2%, now it is at 9 %, the highest pace since 1982 – during the reopening of the economy
- The price hikes in the last three months are at least partly 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

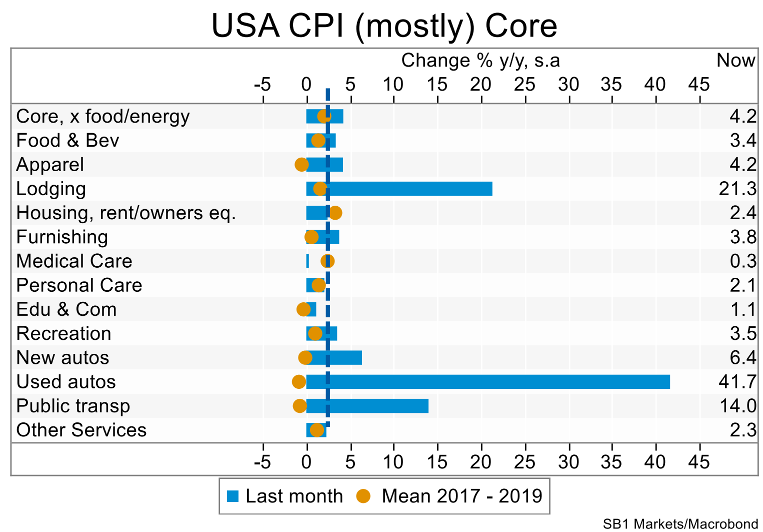


Used auto prices finally flattened but goods/services are still on the way up

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



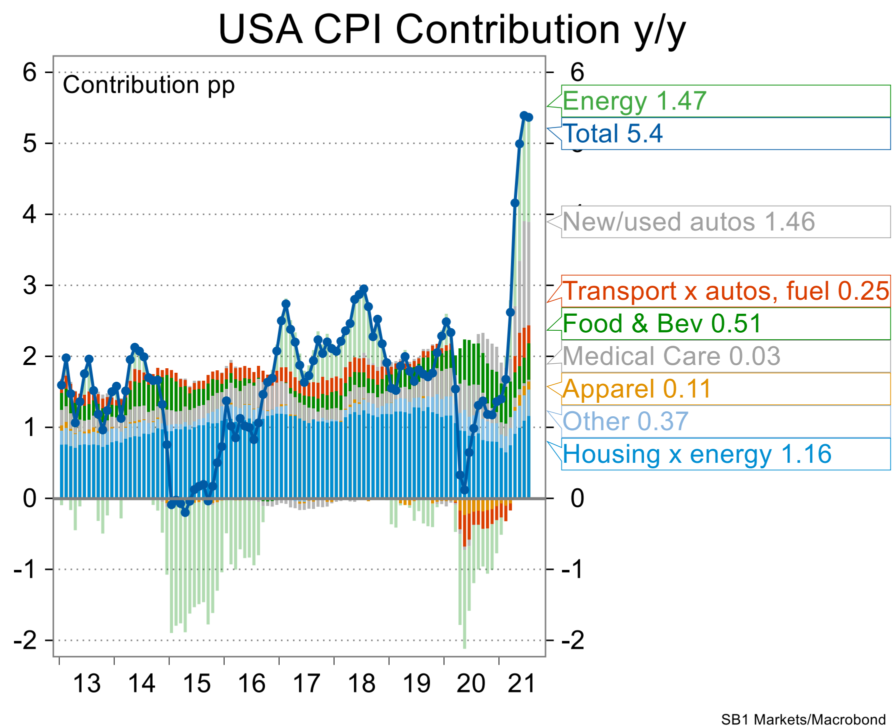


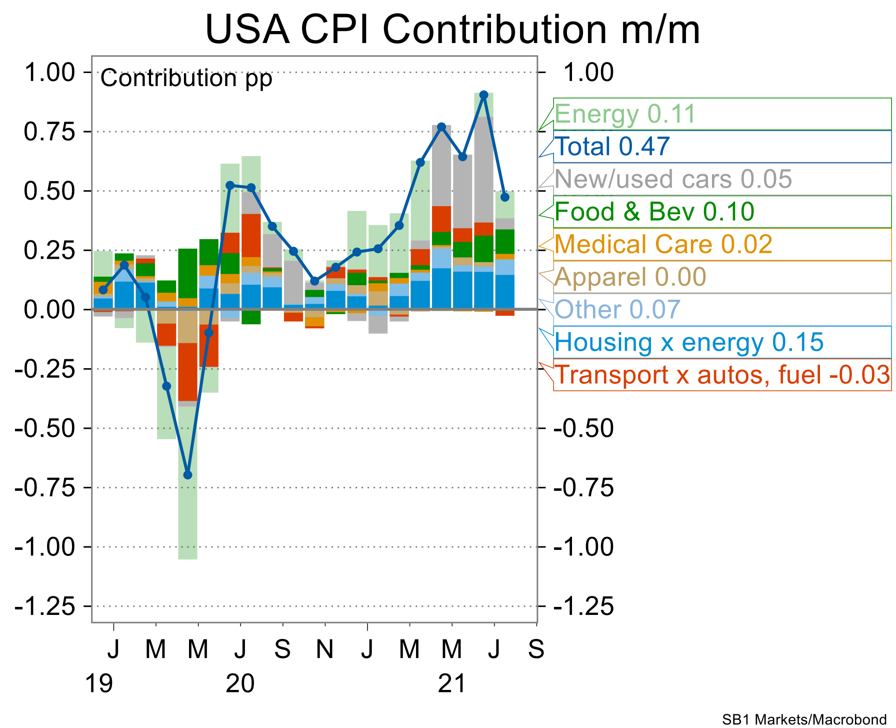


- Just some few CPI components contributed to the setback last spring: **Public transport** (airline tickets) **lodging** away from home (hotels ect), and **apparel**. Other components of the CPI did not slow significantly
  - » Now these sectors have more or less recovered, except public transport (apparel prices are below Feb-20)
- **Used auto prices** have been on the way up since last summer but rose just marginally in July. These prices are up 42% y/y, due to lack of new cars (which are up 6.4%). More on these prices 2 pages fwd

Transport & energy explain 3.45 pp of the 5.4% lift in total CPI

... Of which 1.5 pp from both energy and new/used autos



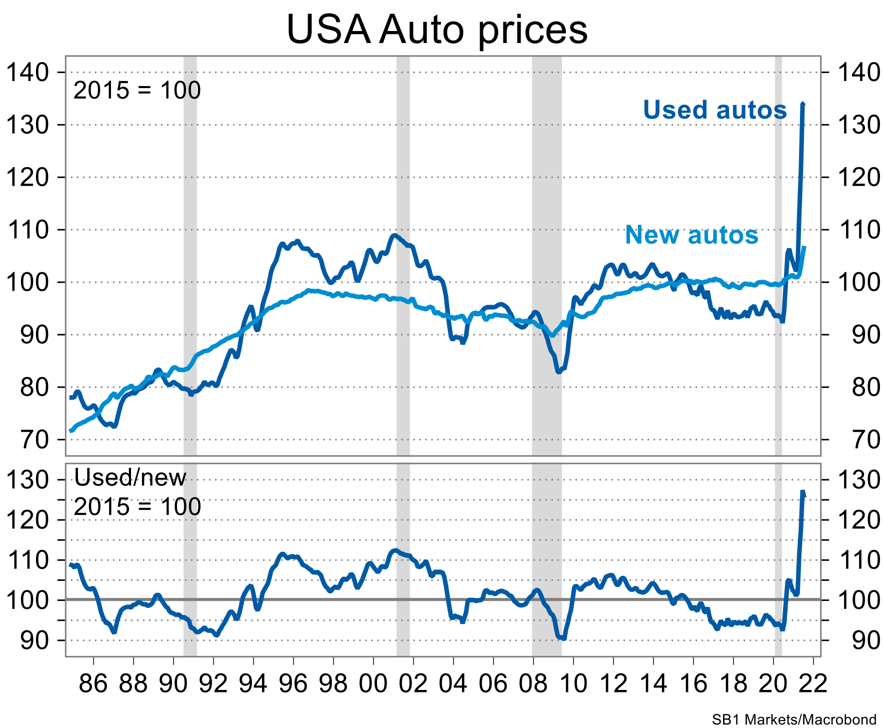


- **Energy** has lifted the headline CPI by 1.5 pp in the past year (but was only to blame for 0.1 pp of the lift in July). If the oil price does not skyrocket from here, the contribution to the annual growth rate from energy will quickly fade (see more here)
- As **used car prices** flattened in July, the contribution declined to 0.05 pp, from the extreme 0.4 pp print in June
- In July prices **ex energy, new/used cars and other transport elements** rose a tad faster than over previous 3 months as energy + cars contributed far less than in the period April – June, and those 'supercore' prices have climbed faster than normal since March
- Excluding the 3.4 pp **contribution the headline CPI from energy & transport**, "remaining" inflation is still well above 2%. In addition, a far higher part 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, check next page)

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?

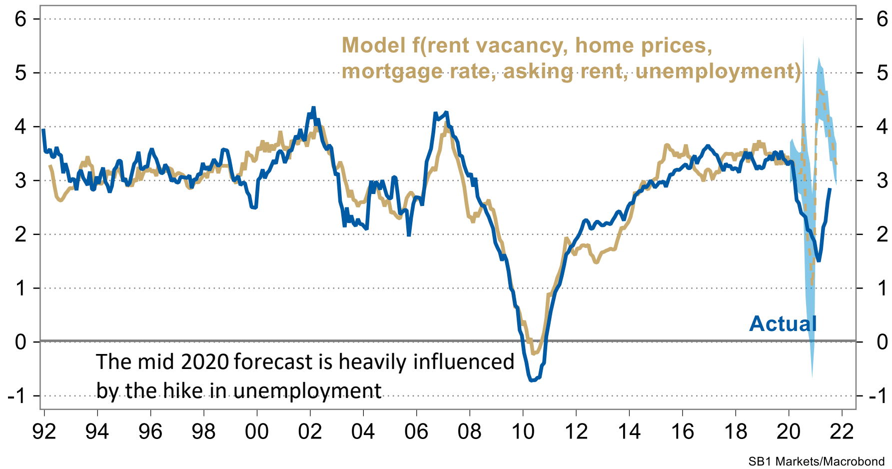
Very likely. But they were too cheap before the pandemic too?



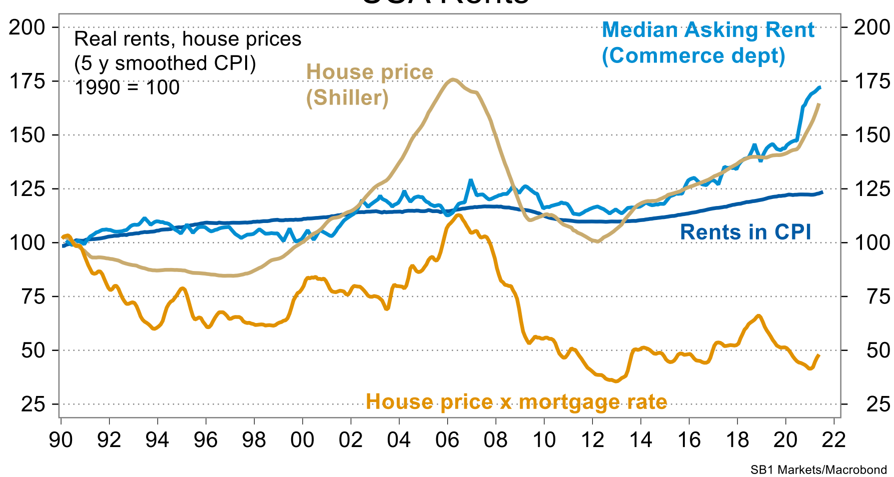
- By the way, prices for **new autos** are up 3% since 1996, quality adjusted, that is. And until the recent price hikes in a very tight US auto market, 2nd hand prices were down 10% the past 25 years (quality adjusted)
- It is impossible from these data to be sure if there is an equilibrium between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

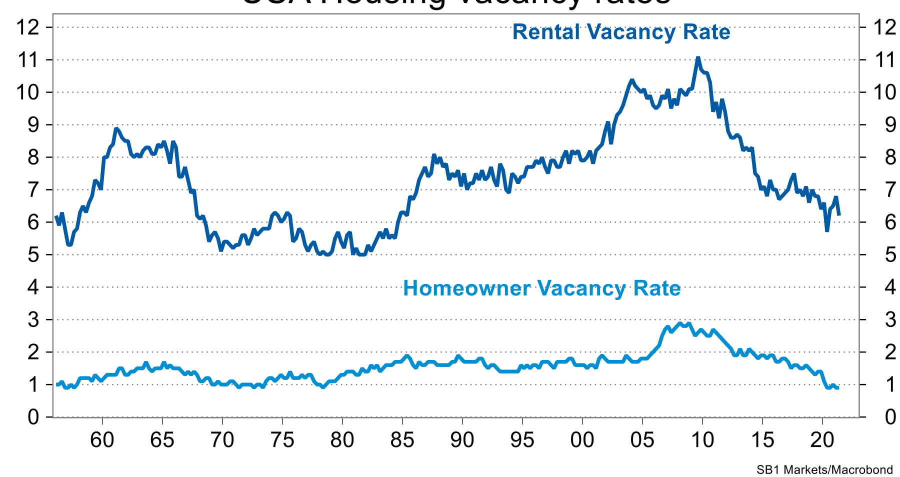
A tight rental market – a possible threat – even if mortgage rates are low

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



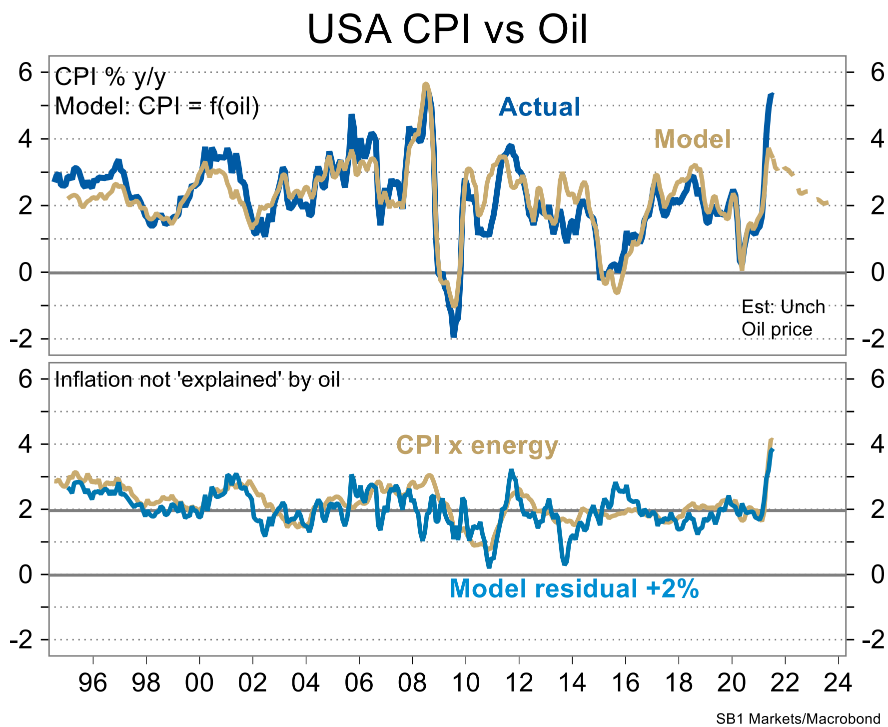
- **Vacancy rates** may have bottomed (more investors are entering the housing market) but are still low. Few owned homes are vacant too
- **Rent inflation** has been far lower than traditional models explain during the pandemic
  - » However, the pandemic was a special happening, in the rental market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

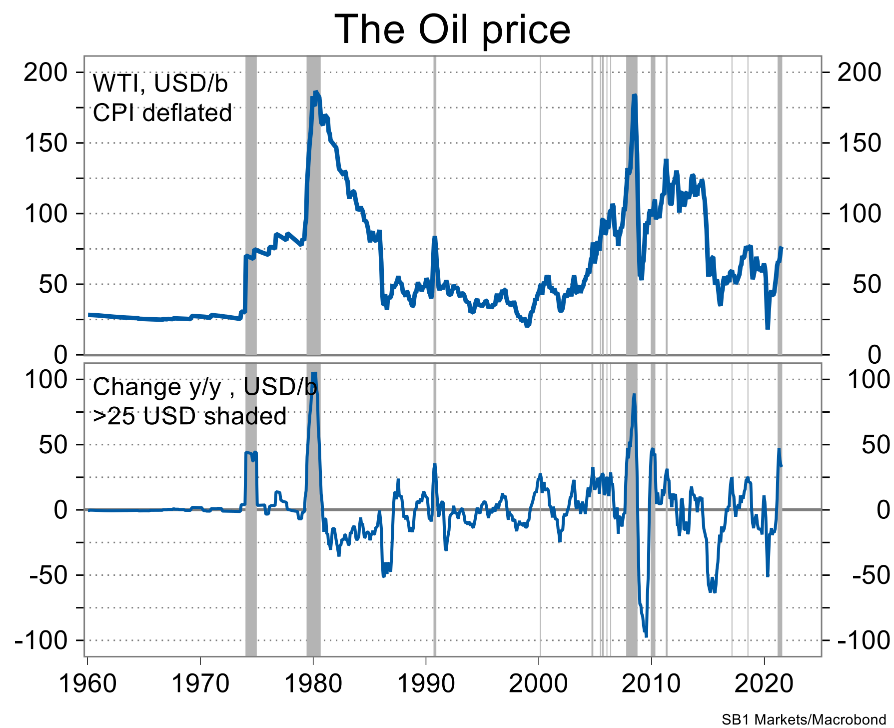




The oil price moves the CPI as usual – but now there is something else too

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

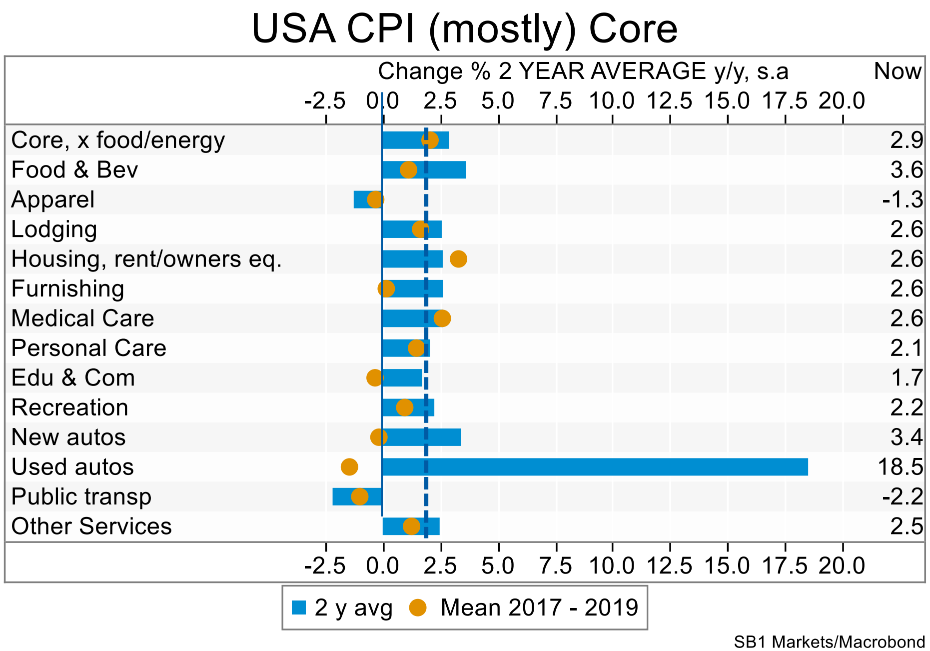


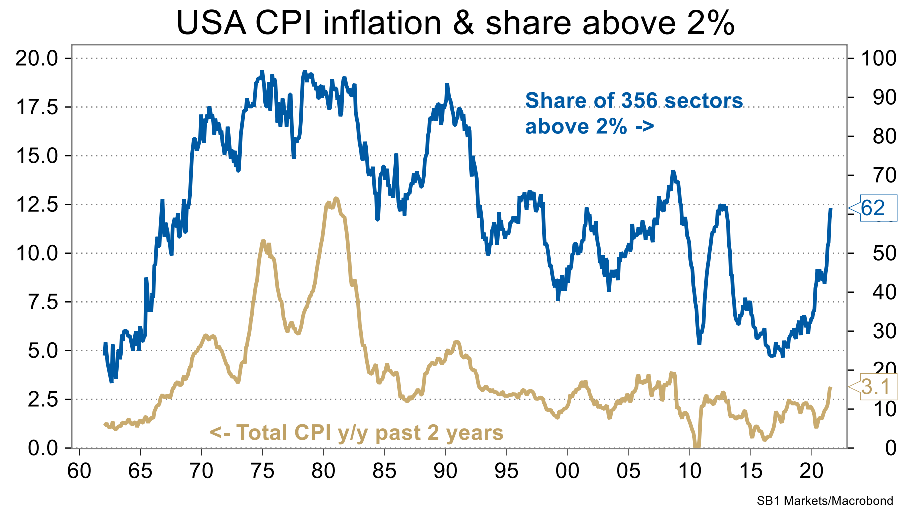


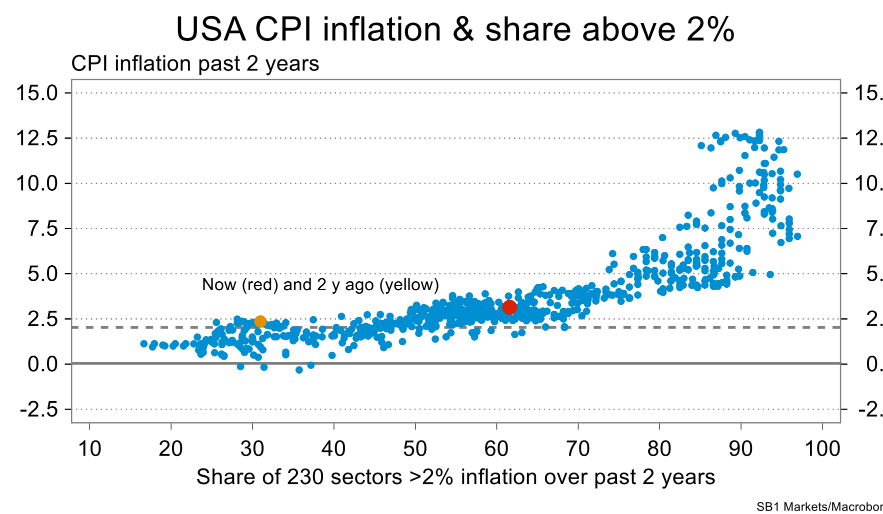
- **Oil price cycles** have explained some 80% of the changes in CPI growth the past 30 years
  - » In our model we incorporate all indirect impacts from changes in the oil prices – as well as the impact from other factors that influenced inflation which correlates to the oil price
  - » If the oil price stabilises at the current level, the impact on the CPI will gradually fade the coming quarters
- 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. 10 sectors >2%, 3 below

2 y avg core inflation 2.9%, up from a 2.1% average in 2017 – 2019 – and broadening



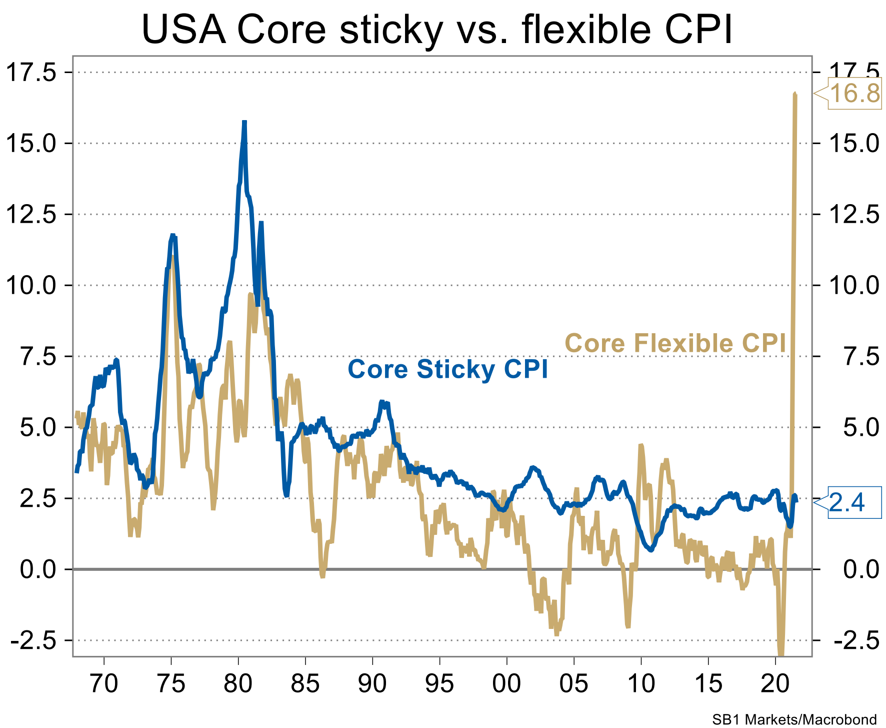


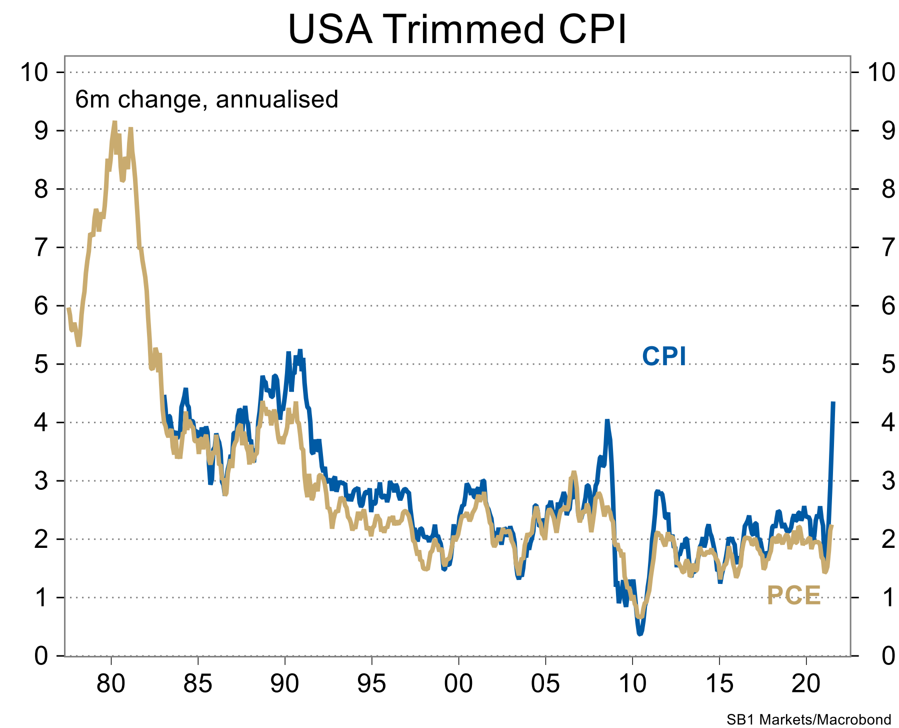


- Of the 13 main sectors, 10 are up more than 2% per year since July 2019, and 3 are below the 2% line
- Over the past 2 years vs the 2017-19 average, inflation has accelerated in 9 sectors, and slowed in 4 sectors
- Of 350 sub-sectors, 62% are up more than 2% over the 2 past years, normally signalling an inflation rate at least at 2.5%

There are still some possible (and not unreasonable) excuses…

Price increases are still quite concentrated – but more prices are on the way up

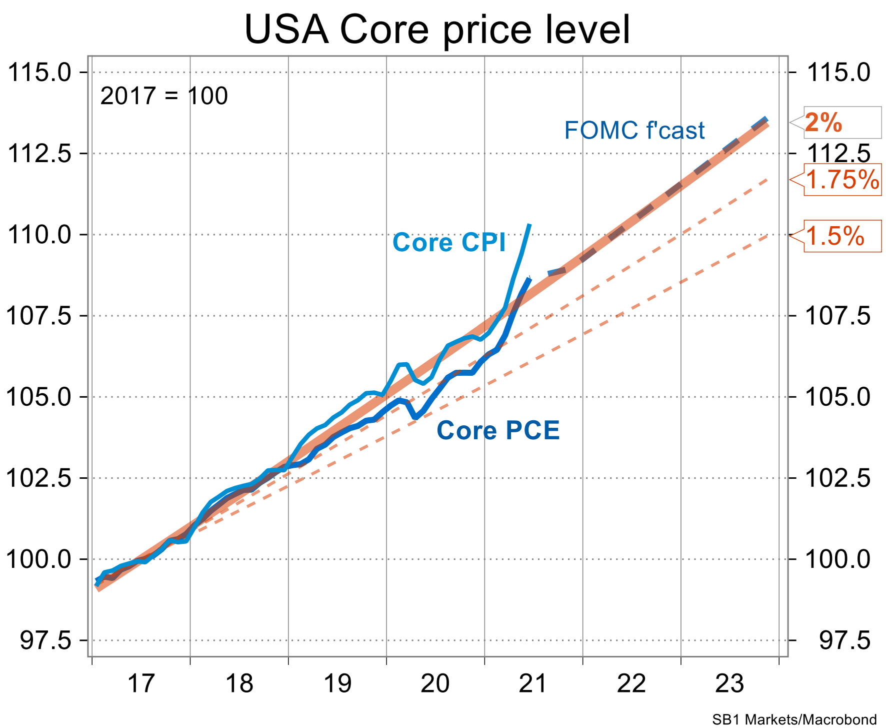


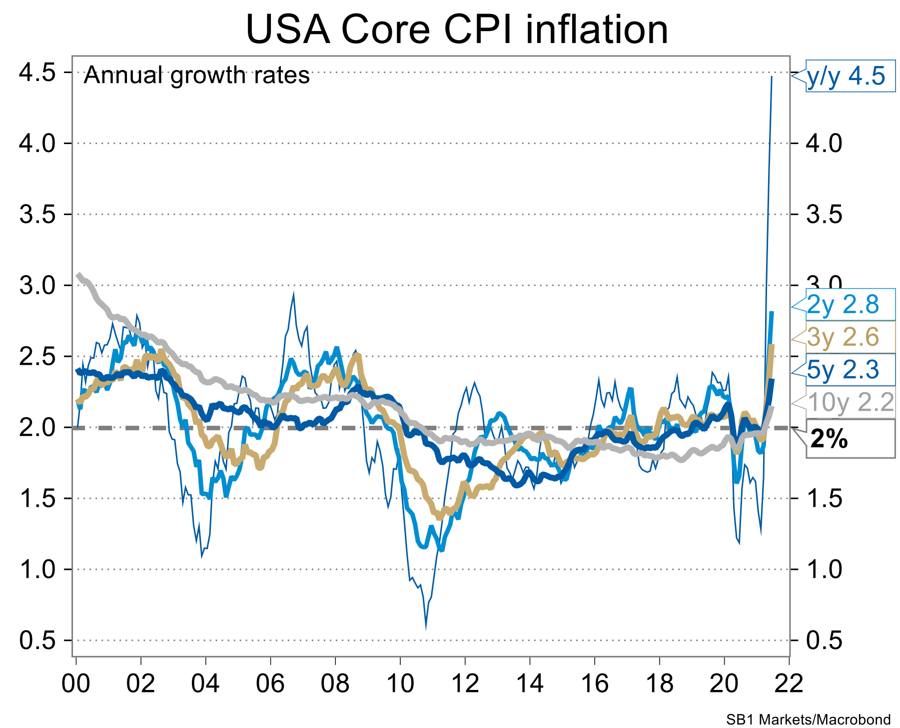


- In the CPI, almost all of the lift in core CPI has been due to prices of good & services that often fluctuate, with rapid price increases followed by deep price cutes – these prices are **flexible**, and represent some 10% of the core CPI. These prices are now <u>more up than ever before</u>, with a substantial contribution from 2nd hand auto prices. However, these prices are flexible both ways, and the cycles are normally short lived
- The **sticky components** (90 % of the core CPI) is up 2.4%, approx. at <u>average during recent years</u>. For inflation to really take hold, these sticky prices have to accelerate (like from 1973).
- On the other hand: The flexible component has contributed substantially to keep inflation low the past 8 years
- **Trimmed mean CPI** (Cleveland Fed) and **trimmed PCE** (Dallas Fed) has also accelerated, the CPI measure by the most

Anyway: The price level target is met

The employment target is still up for debate – but a tapering of the QE program is coming closer

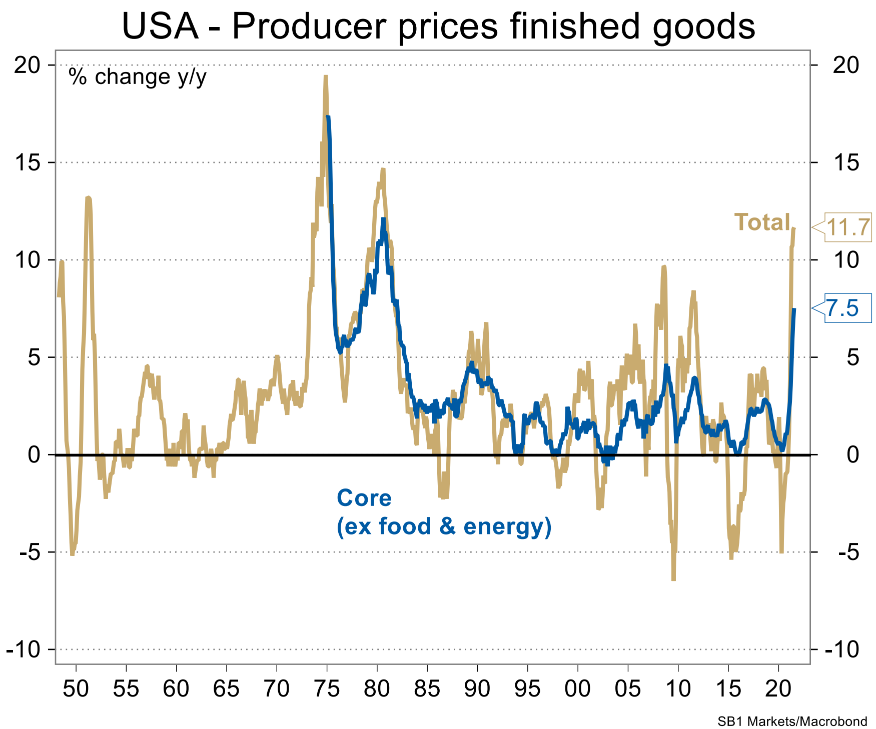


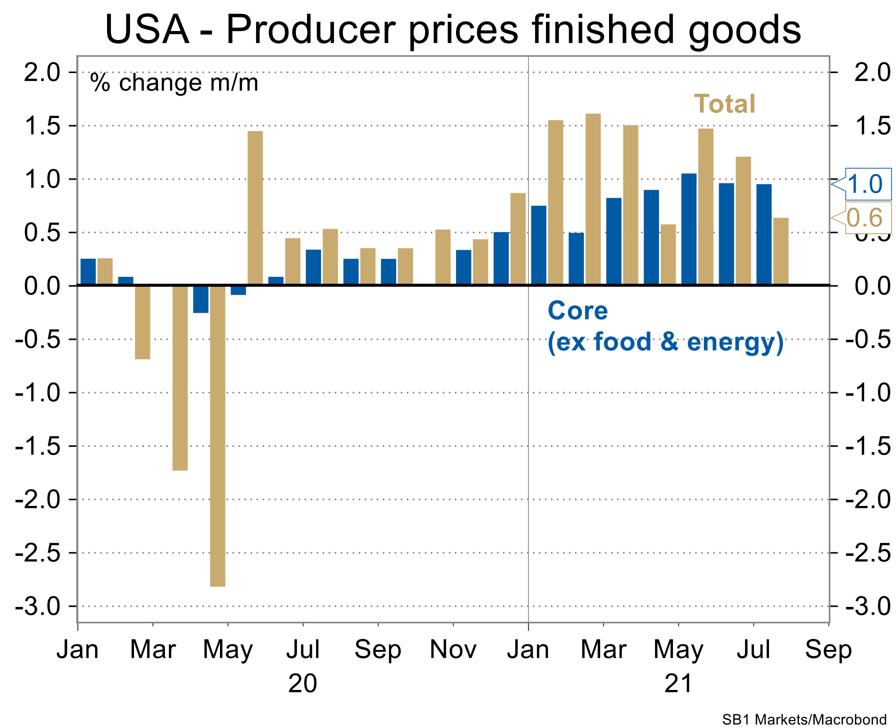


- The Fed has not defined its time horizon but the price level target is met, whatever time horizon the Fed chooses
  - **Measured vs. the CPI**, the average core inflation is at or <u>well above 2%,</u> whatever period we check. **The core PCE deflator** is <u>above 2%</u>, whatever horizon
- **Inflation 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 is being turned off

A mixed PPI: Core well above expectations but crude material prices are slowing

Total goods PPI slowed m/m in July, but the core up another 1% - annual rates the highest since 1982

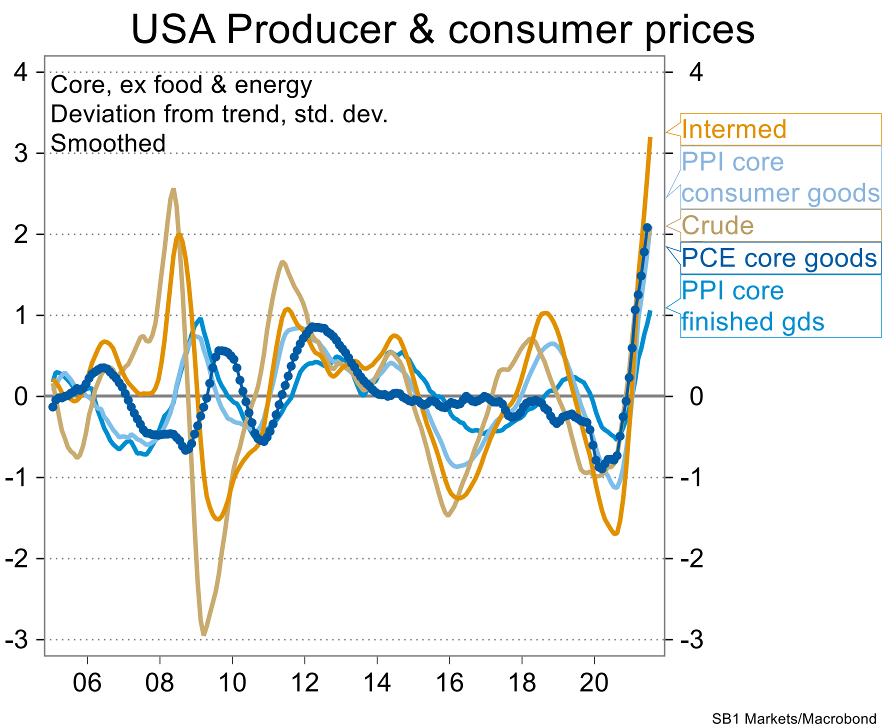


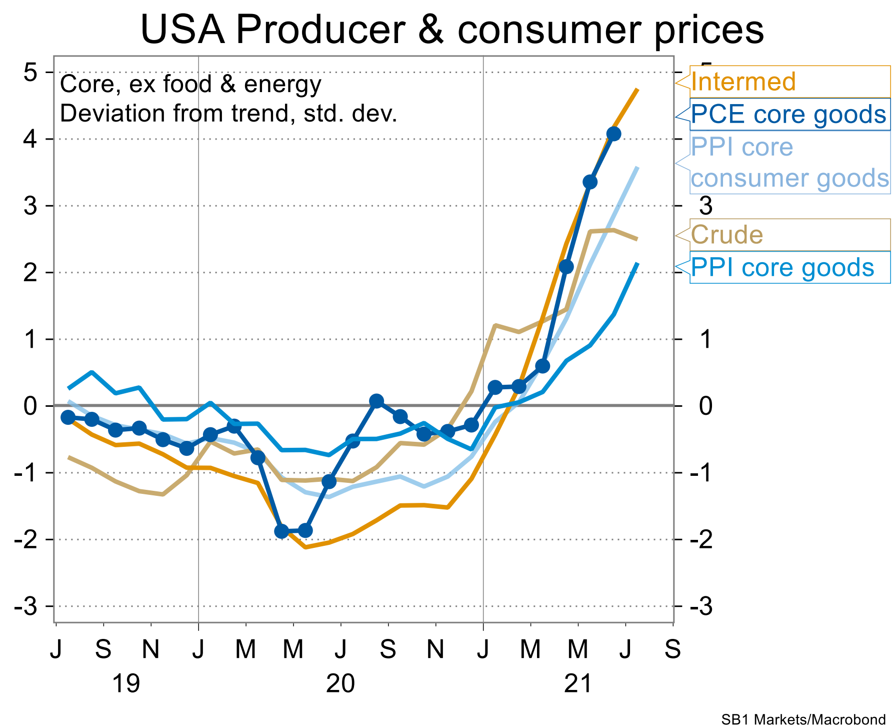


- **Core finished goods x food & energy** PPI rose 1.0% in July, as in May – twice as fast as expected. The annual growth rate accelerated 0.6 pp to 7.5%, the highest level since 1982
- **Headline finished goods PPI** rose 0.6% m/m, as energy prices contributed on downside. The annual rate was up 0.1 pp to 11.7%% - highest since 1982 too
- **Crude material prices** may have peaked, a first positive sign. In addition, core CPI goods prices have already climbed more than usual vs. PPI prices (due to 2nd hand auto prices), limiting the upside risk
- **The 'official' total final demand PPI**, including **services**, rose by 1%, expected 'just' 0.6%. The index is up 7.7% y/y, signalling a CPI growth above 6%

Have crude materials peaked? But pressure from the supply chains is still strong

… However, core consumer prices have been rising earlier and more than normal vs. PPI prices

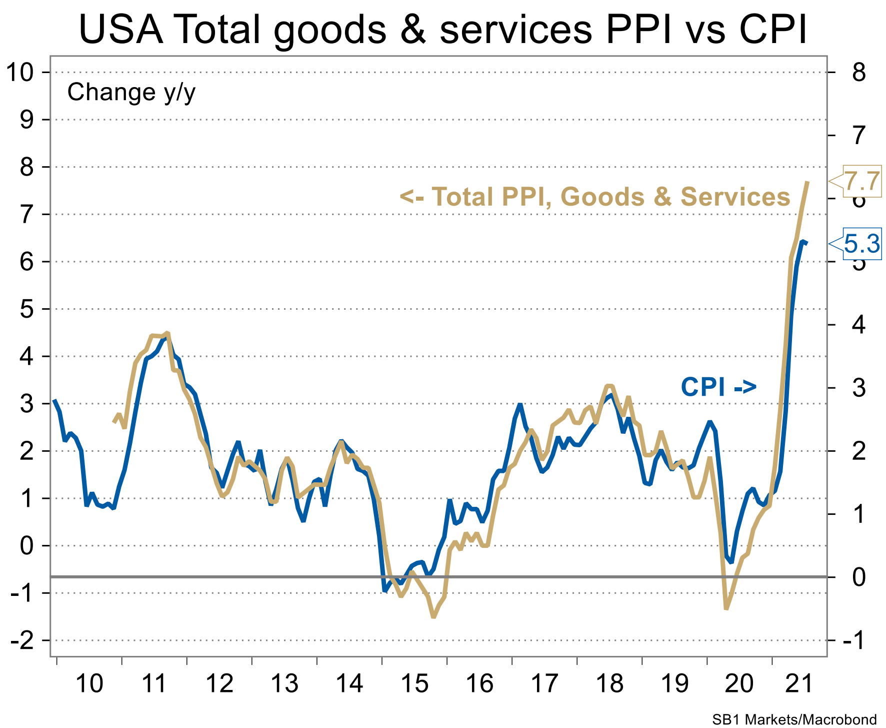


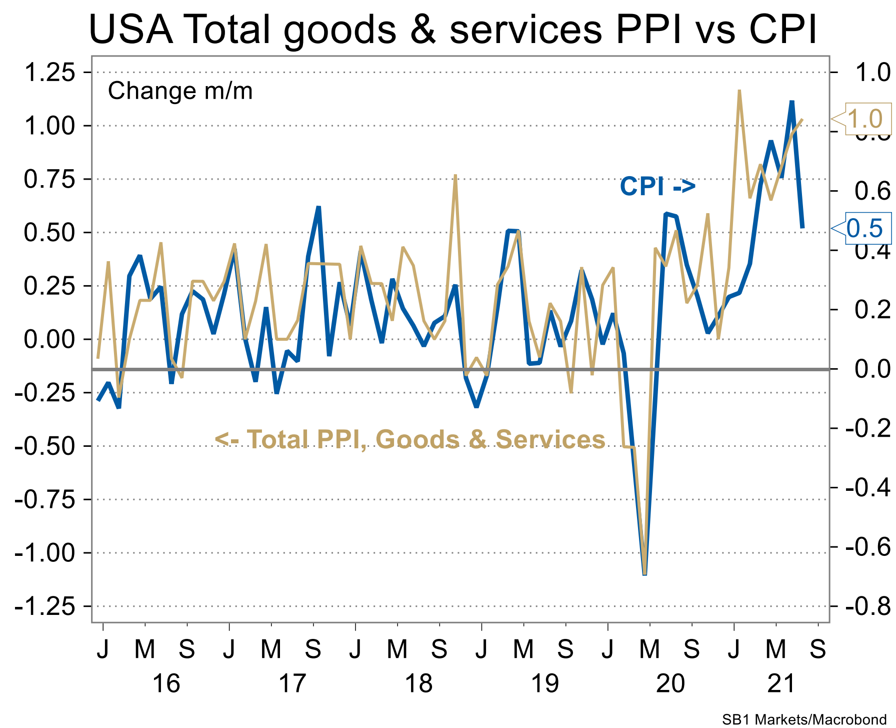


- Crude goods prices are leading intermediate goods by 4 months, and consumer prices by 12 months – and crude prices may now have peaked (see chart to the right) .However, intermediate prices have not yet yielded – and they will push finished goods prices up the coming months
- Some comfort: Prices at the consumer level have responded to earlier and more than normally vs the PPI core consumer goods index. That is very likely 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 may be limited the coming months

Bottom line: Total PPI (services included) is still signaling higher CPI growth

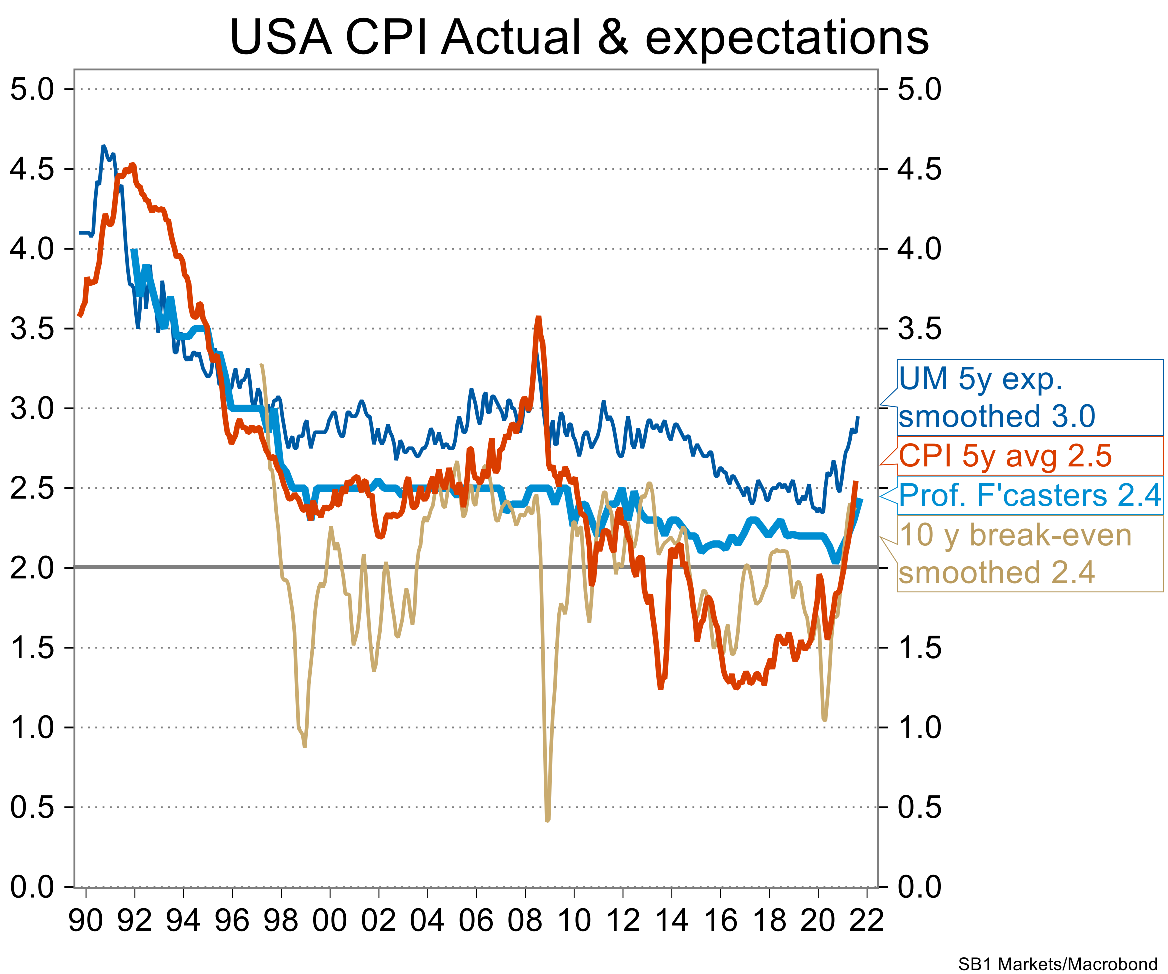
The 'new' total PPI rose 1% m/m in July too (expected 0.6%), and is up 7.7% y/y. Signals CPI up >6%!





Inflation expectations are drifting up but are not yet <u>worryingly</u> high

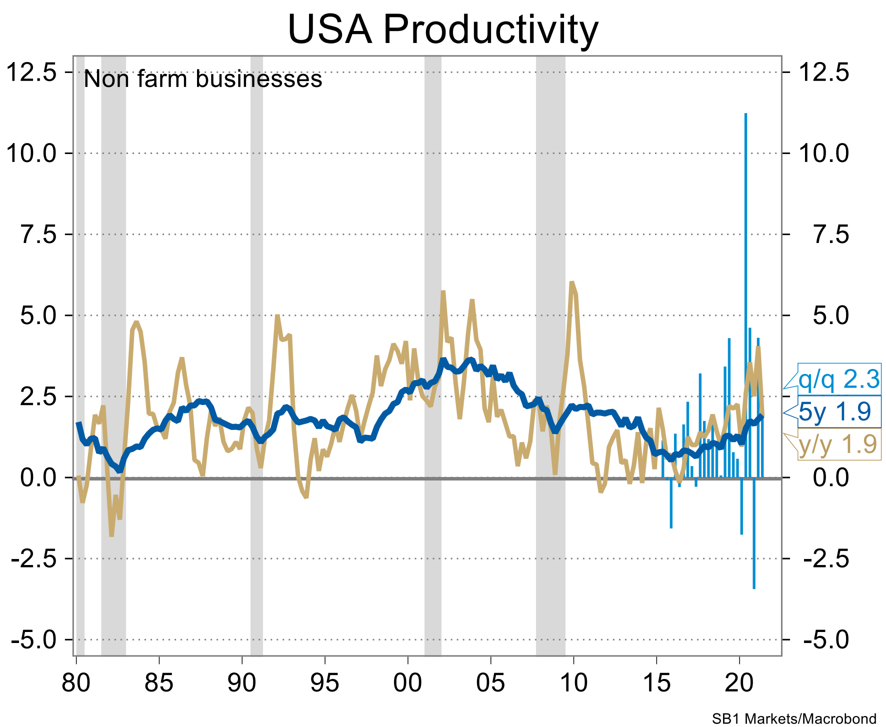
Univ. of Mich survey 5 y inflation expectations have climbed to 3.0 % from 2.5%

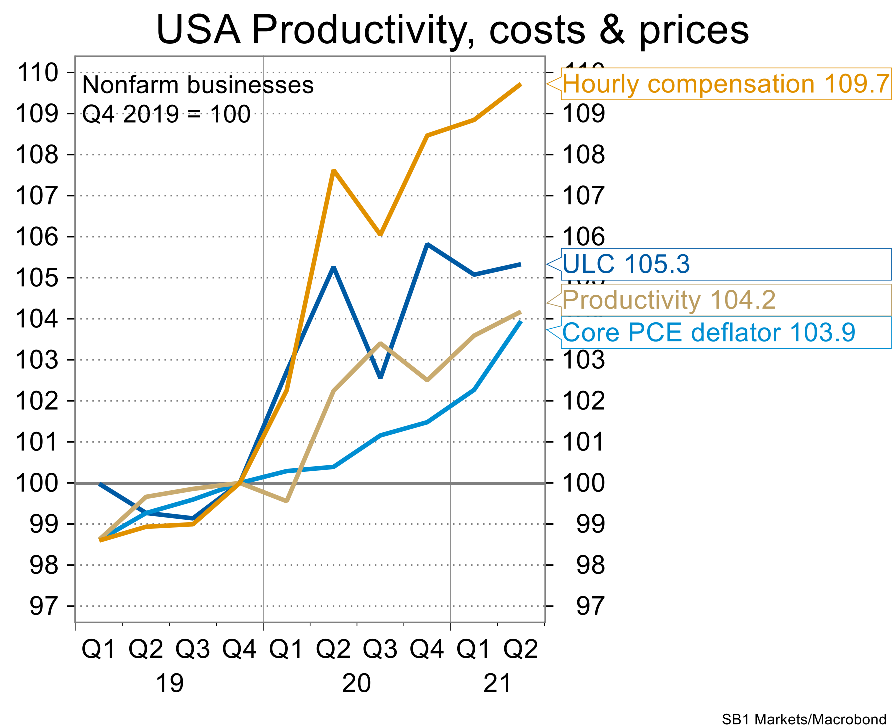


- **The UM's survey's** 3.0% rate is close to the highest in 10 years, and it is 0.5 pp higher than before the pandemic (2.5%)
  - » Still the level is not far above the past 10-year average – but it is a sign for the Fed, of course
  - » The UM short term inflation expectation at 4.6% is the highest since 2011, up 0.9% from March. These expectations usually correlated to recent changes in energy prices – like now
- **Professional Forecasters** expect a 2.4% 10 y rate of inflation, according to Philadelphia Fed's Q3 survey, up from 2.0% in Q4-20. The Q4 level was the lowest ever, and 2.4% 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. Still, above 2.0%
- The 10 y **break-even (CPI) inflation expectation** has come down from the local peak in the spring but is still at 2.4%, a tad too high vs Fed's long term 2% inflation target

Wild productivity & labour cost data; still challenging to decipher…

The facts: Productivity rose 2.3% in Q2, less than expected but compensation grew less. ULC flat y/y!

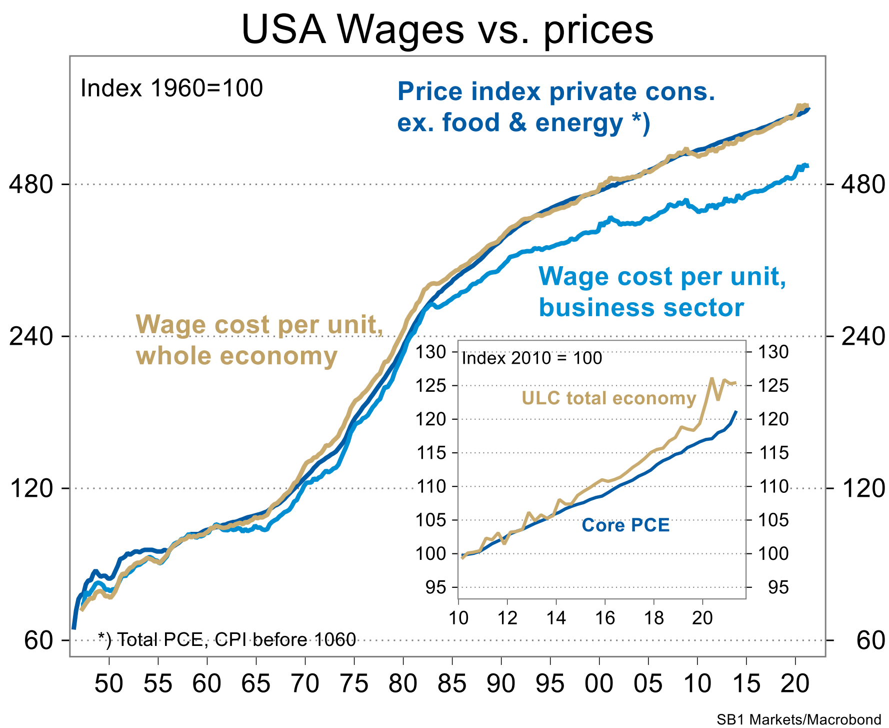


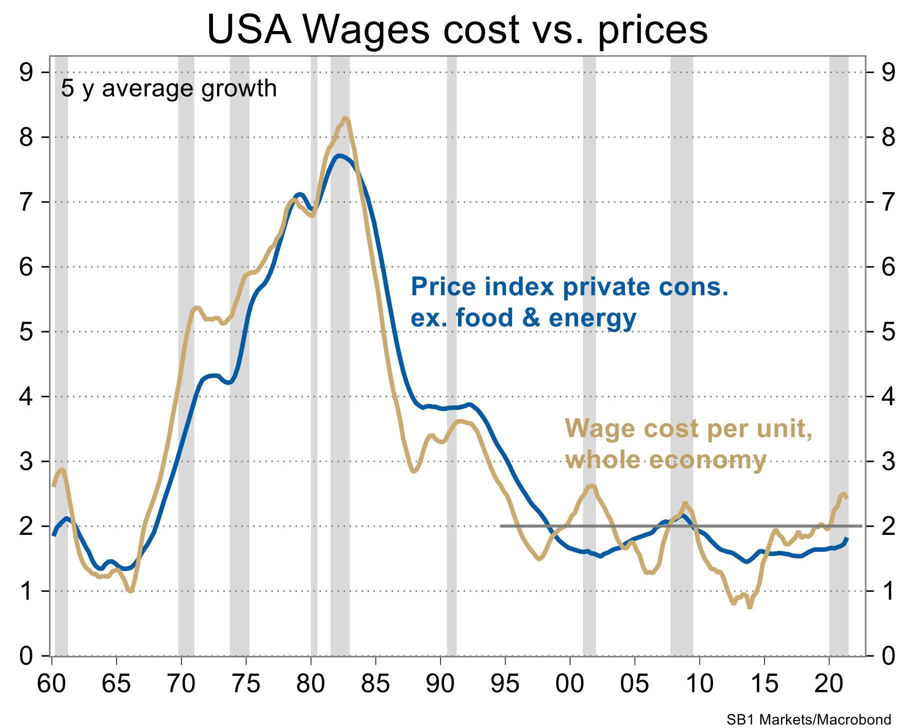


- **Productivity growth** has accelerated through the pandemic, up to a 2.8% pace sine Q4-19. The underlying trend is probably lower, but well above the lows during 2015 - 2017
- **Hourly (wage++) compensation** grew at a 3.3% pace in Q2. The annual rate fell to 2% from 6.4% in Q1. Since Q4-19 compensation has increased by 6.4% pace
- **Unit labour costs** (hourly compensation – productivity) grew by 1% in Q2, less than expected – and they are flat y/y. However, since Q4-19, ULC has grown at a 3.5% pace, far above a normal level

A substantial lift in production costs, still risk for further price lifts?

There wasn't cost inflation before Covid. Now the cost level has increased more than prices

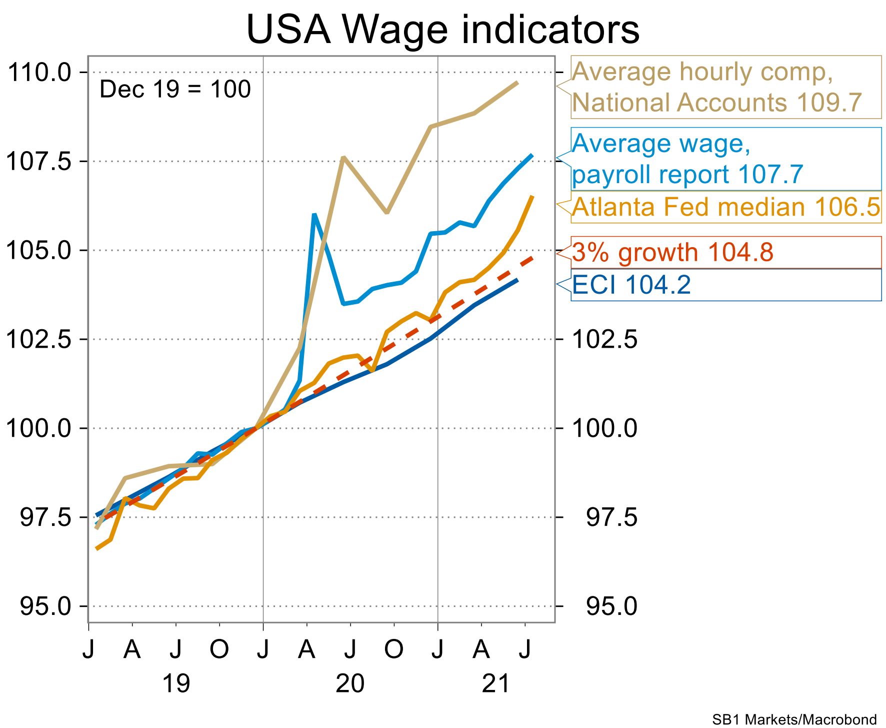


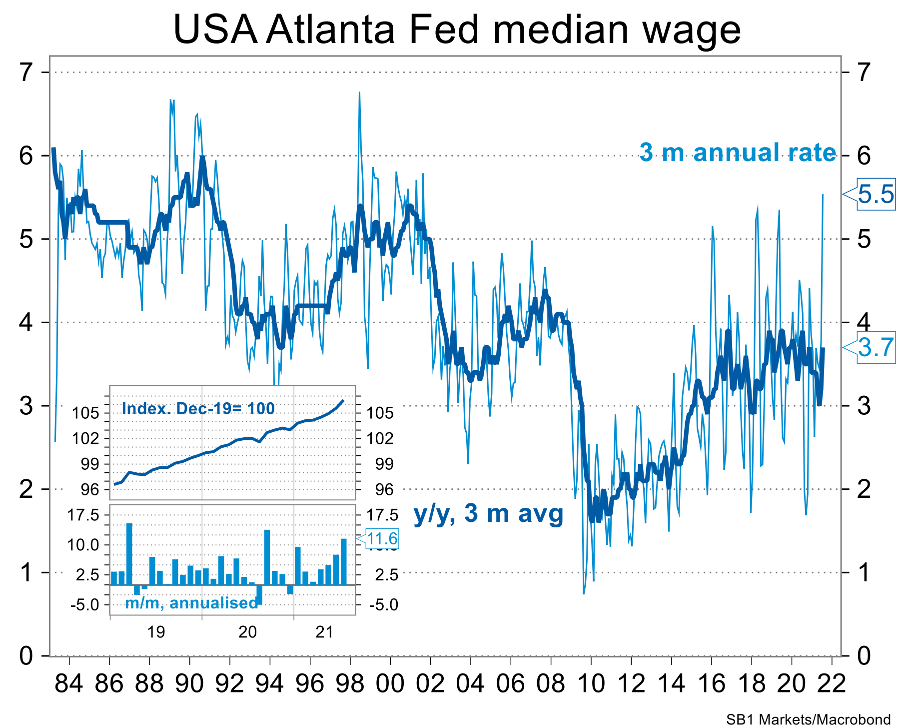


- **Unit labour cost (ULC)** is the main driver for inflation long term but is very volatile, short term
  - » Short term, the price level is far more stable than the labour cost per unit produced
  - » Over time however, they are close to equal (barring changes in direct taxes/subsidies, import/export prices). They have to – if not, operating profits would become 'too' high or 'too' low
- The recent lift in ULC poses a risk vs. further price increases – that so far have been partially kept in check due to large government support to the corporate sector during the pandemic

Wage indicators have been all over the place

But now just one remains at the station: The ECI. Even Atlanta Feds median wage index sharply up!

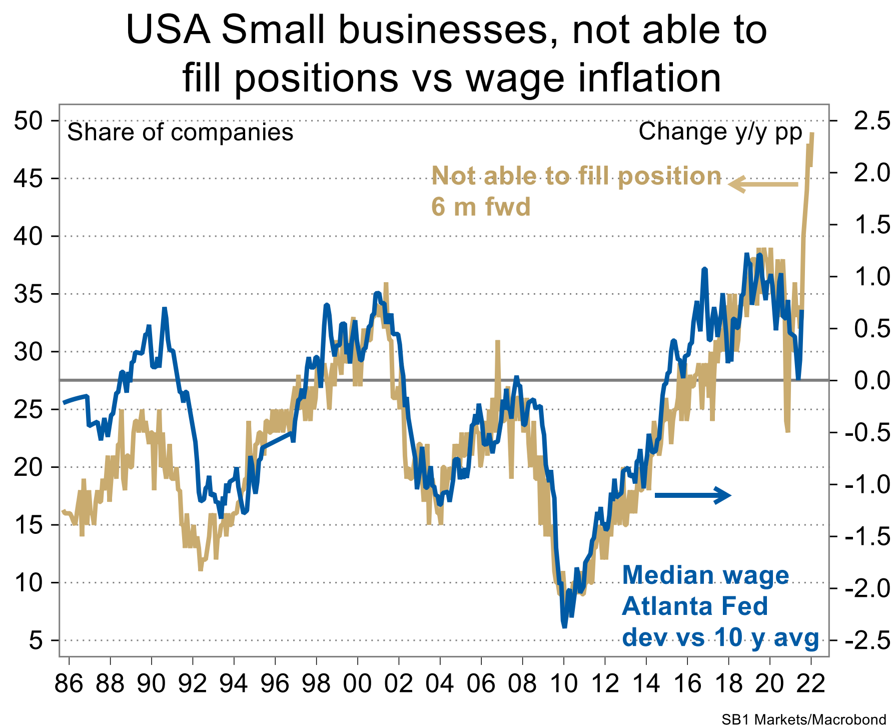


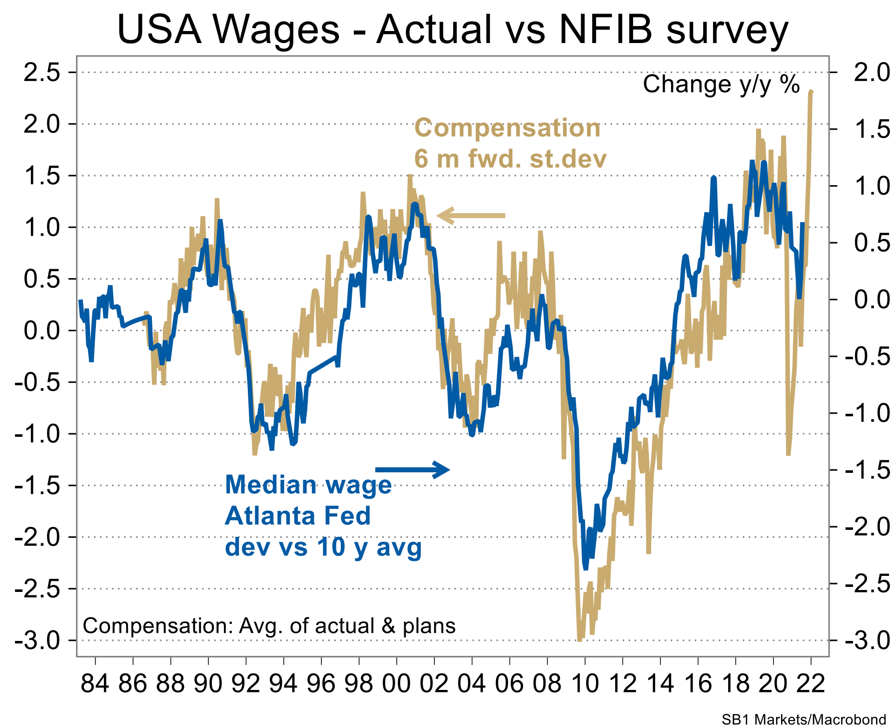


- **Average earnings in the monthly payrolls report** are up 7.7% in July vs.Dec-19, or at a 4.8% pace
- **Average hourly compensation as estimated by National Accounts** are up 9.7 % from Q4-19 or by a 6.4% pace. This measure is the most volatile – but over time the 'correct' result
- **Atlanta Fed's** survey of **median wages** are up 6.5% or a 4.1 % p.a rate – a significant acceleration through Q2 and further in July, up 4.5% y/y
  - » This measure, which is far less depended on the employment mix than the measures of average wages, has until now not reported higher wage inflation. Now even this measure confirm higher wage inflation. In June the median was up 4.5% y/y, the highest since 2017! The 3 m average rose 0.2 pp to 3.7%
- The only wage index now reporting significant increase in wage inflation, is the **Employment cost index.** It is up 4.2% vs. the Q4-19 level average, implying an average increase by less than 3% p.a
- Thus, it seems even more likely that wage inflation is on the way up – and possibly to an extent that is not consistent with a 2% inflation target

Wages do respond to demand for labour, and now demand is really strong

Companies report record high no. of unfilled vacancies and unprecedented problems filling them

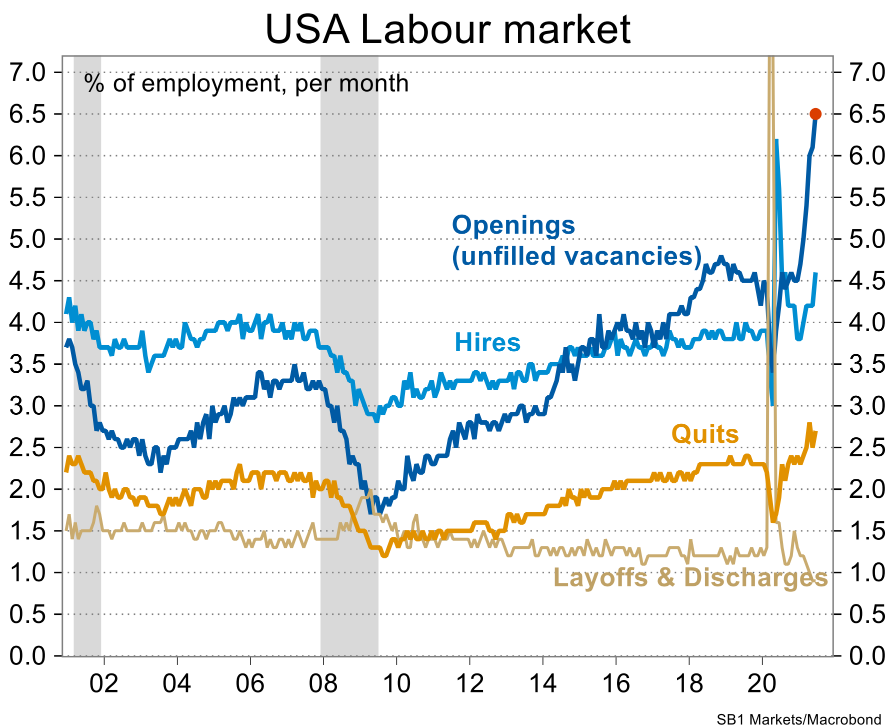




- .. And more companies than ever say they plan to increase compensation
- Can wage inflation accelerate?

The vacancy rate hits a fresh record in June, beating forecasts. And 'no' layoffs!

The vacancy rate rose to 6.5%, but even if businesses are hiring at a fast pace - workers are quitting

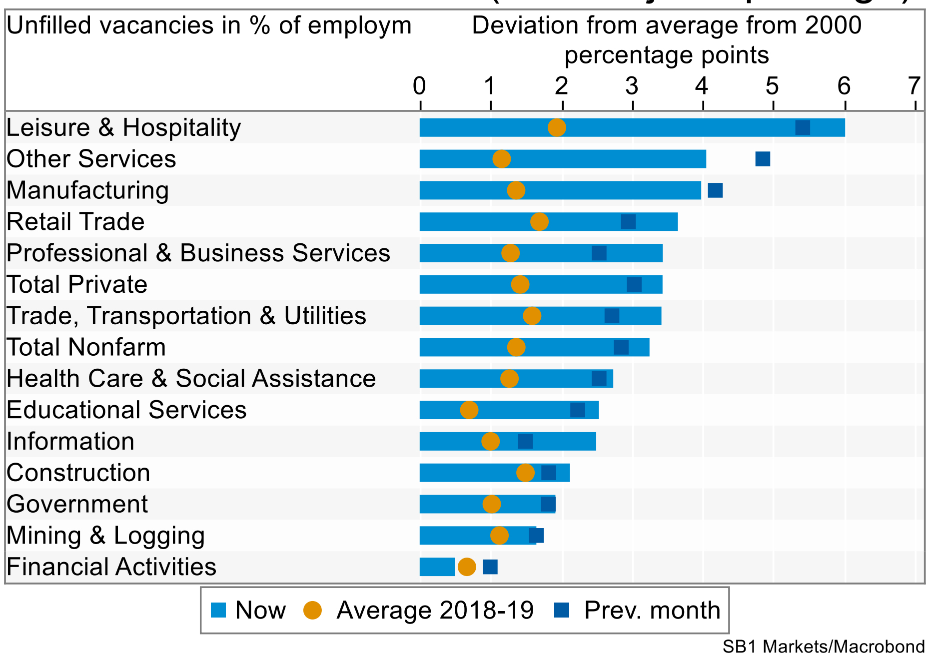


- The no. of **unfilled vacancies** increased by 600' from May and is at record high, both in the actual number (10.1 mill) and in % of employment (6.5%, from 6.1% in May). The highest rate before corona was 4.8%, in 2018 (and 3.5% before the financial crisis)
- **Hiring increased** 697' to 7 mill in June, to 4.6% up from 4.2% in May, only beaten by the first part of the recovery last year. July data also showed that payrolls increased by close to 950', so we expect strong hiring data when the JOLTS data for July is published
- The rate of **voluntary quits** increased to 2.7% in June, from 2.5% in May. The level is the 2nd highest ever, and a sign of a tight labour market as workers are leaving their jobs voluntarily to get at better job, which is harder in bad times. As with unfilled vacancies, quits are closely correlated to wage inflation – for obvious reasons
- **Layoffs** fell to the lowest level ever in June. Thus, it is strange that the inflow of new jobless claims remain above normal levels
- **In sum:** As last month, the report confirms an extremely tight labour market

All sectors are reporting more vacancies than before the pandemic

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

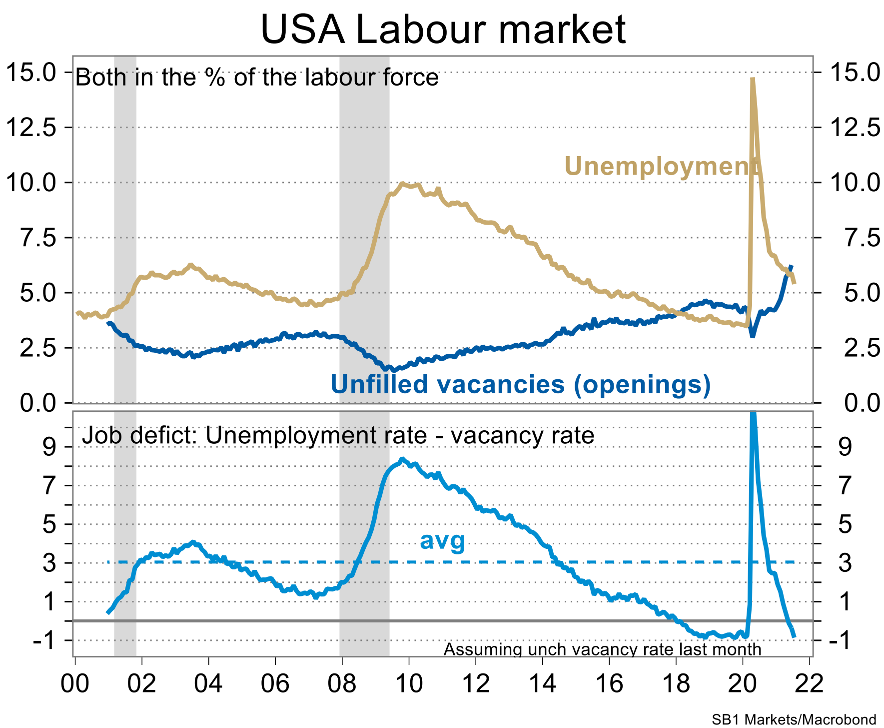
USA Unfilled vacancies (JOLTS job openings)

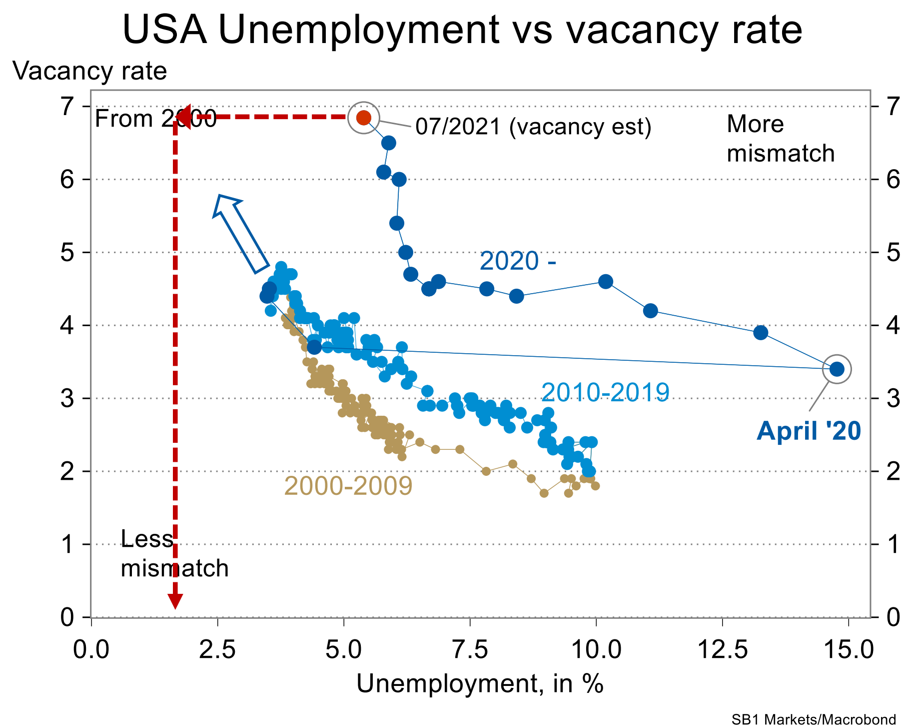


- … but also in manufacturing and retail trade
  - » The Government and the financial sector have more unfilled vacancies than normal, but not by much
- Have previous active workers
  - » Left the labour market temporary, due to corona?
  - » Left these low paid sectors for better jobs elsewhere?
  - » Or are they staying outside the labour market because unemployment benefits are too generous due to the temporary USD 300/week extra federal support?
  - » .. Or have too many just left the labour market? More workers than normal has retired during the pandemic
- Surveys indicate that a large proportion of workers that have been laid off are not planning to return to the same sector. Will they be absorbed in other parts of the economy?
- In addition, many workers state whey want teleworking permanently
- Both locally and regionally the pandemic may have created new mismatches in the labour market

More unfilled vacancies than unemployed workers, even if unemploym. is 'high'

The vacancy rate would normally 'generate' a 2.5% unemployment rate. It is still at 5.4%



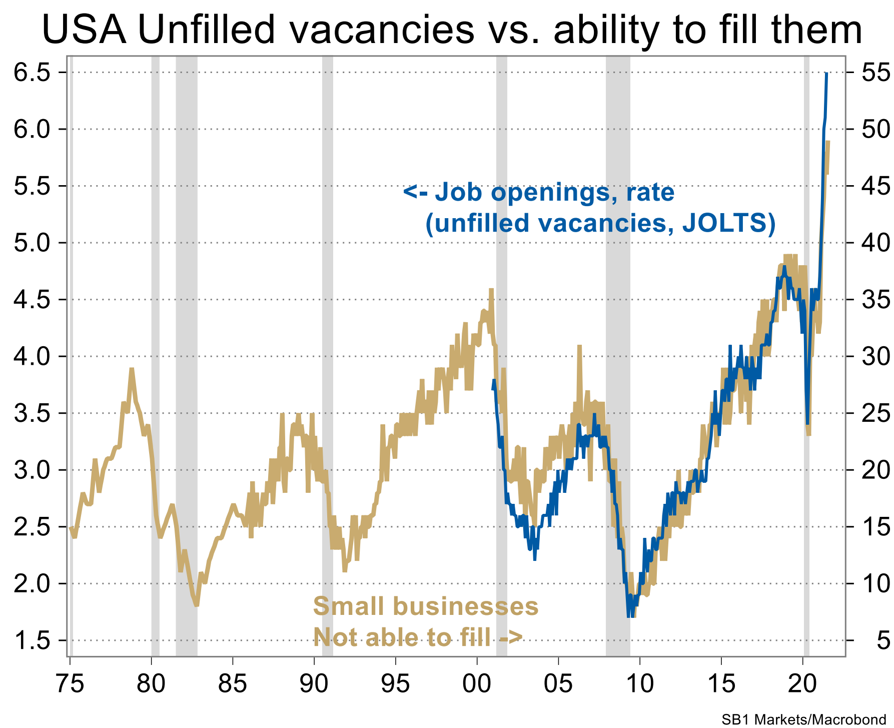


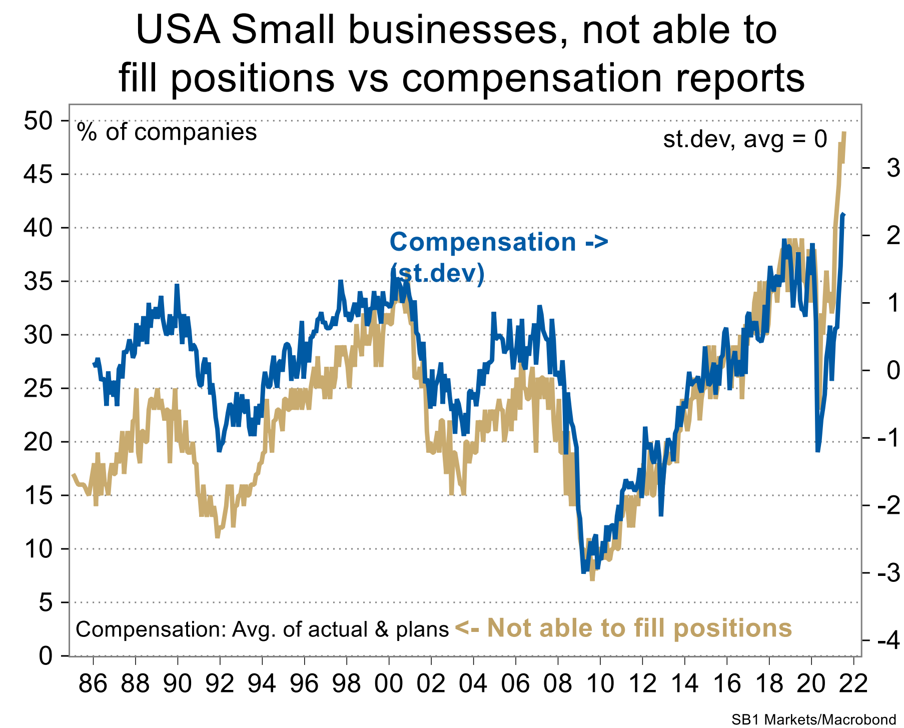
The 'Beveridge' curve has shifted sharply up/to the right – signalling more mismatch at the labour market

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

Official vacancy data confirm NFIB survey data (almost perfectly)

… And we have never seen anything like this before. The correlation to wage inflation is close

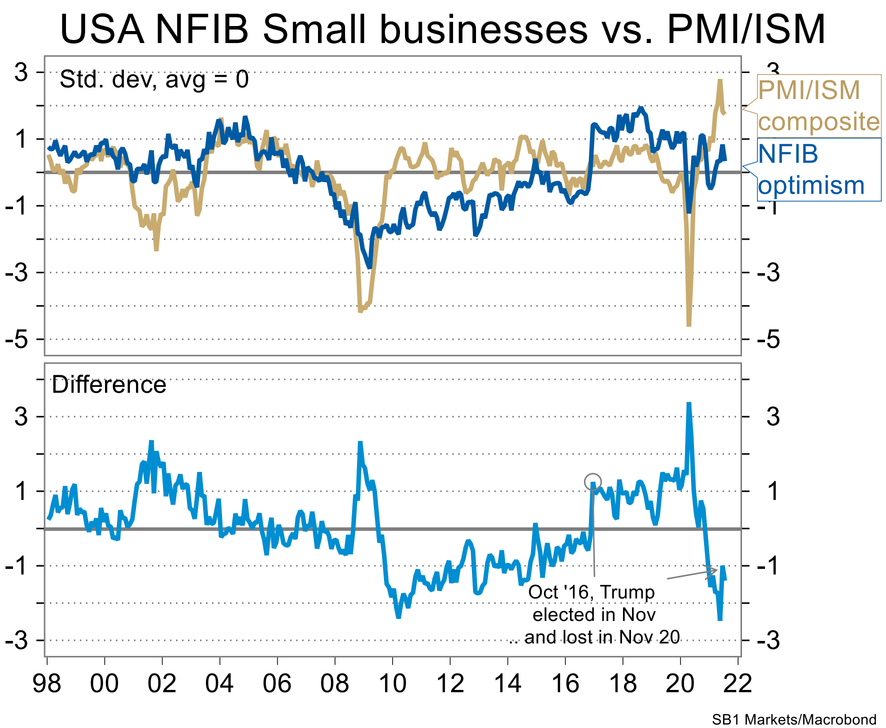


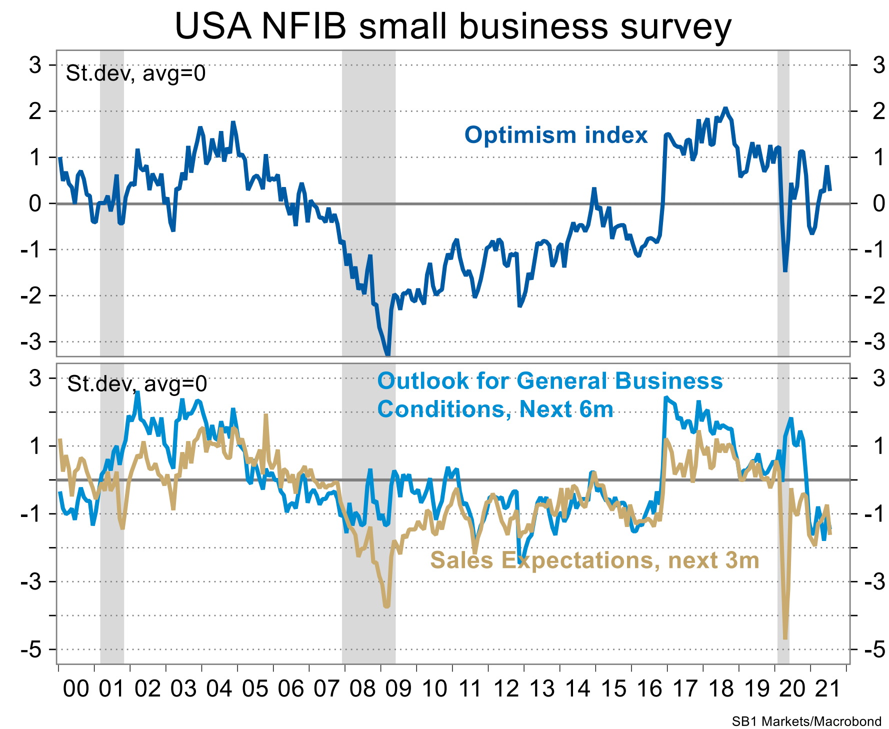


- The SMBs are reporting record high wage increases, both actual and planned
- Wage indices are mixed – and the best of them have not yet reported any worrisome acceleration (check here)

Small businesses optimism reverses last month's gains as labour shortages persist

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

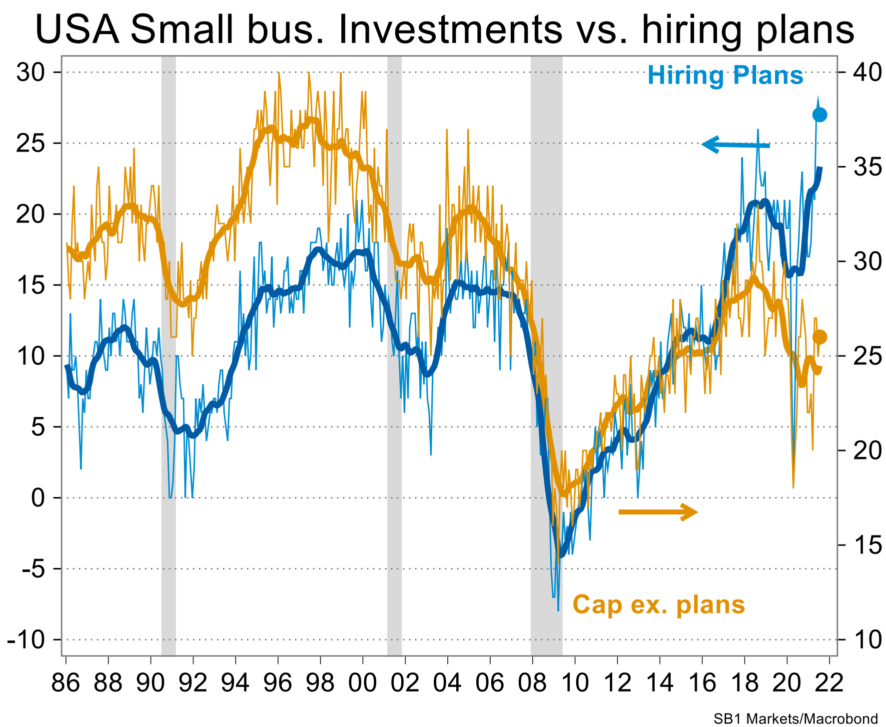


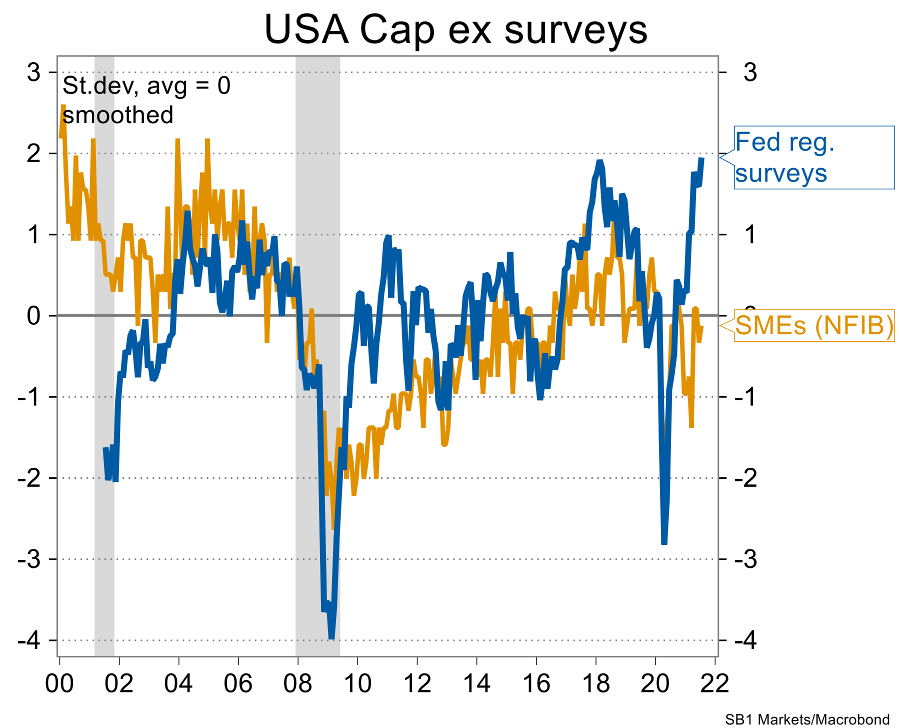


- The **NFIB optimism index** fell to 99.7 in July from 102.5 (expected down to 99.5). 6/10 components declined, while 3/10 improved. The index is still above an average level but far behind the PMI/ISMs, and all other surveys
- **The outlook for the next 6 months** also decreased in July and is currently 1.5 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 up but are still below an average level
- **Hiring plans** decreased 1 p in July from superhigh ATH in June. However, the SMEs are not able to **fill their vacancies.** And even more businesses say they plan to raise **labour compensation** (at ATH, data since 2006)
- **Actual & planned price increases** are soaring – like we have never seen before (barring 1 month in 1979…, see more here). Supply is the problem, not demand

Hiring plans lower but still sky high, and companies are not able to fill positions

Investment plans increased but are well below average

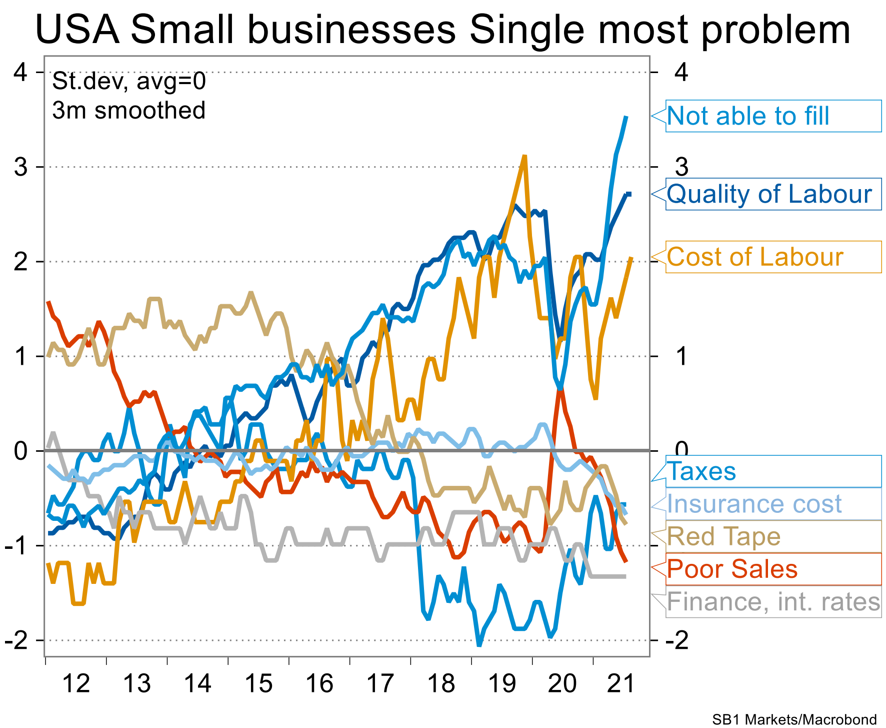


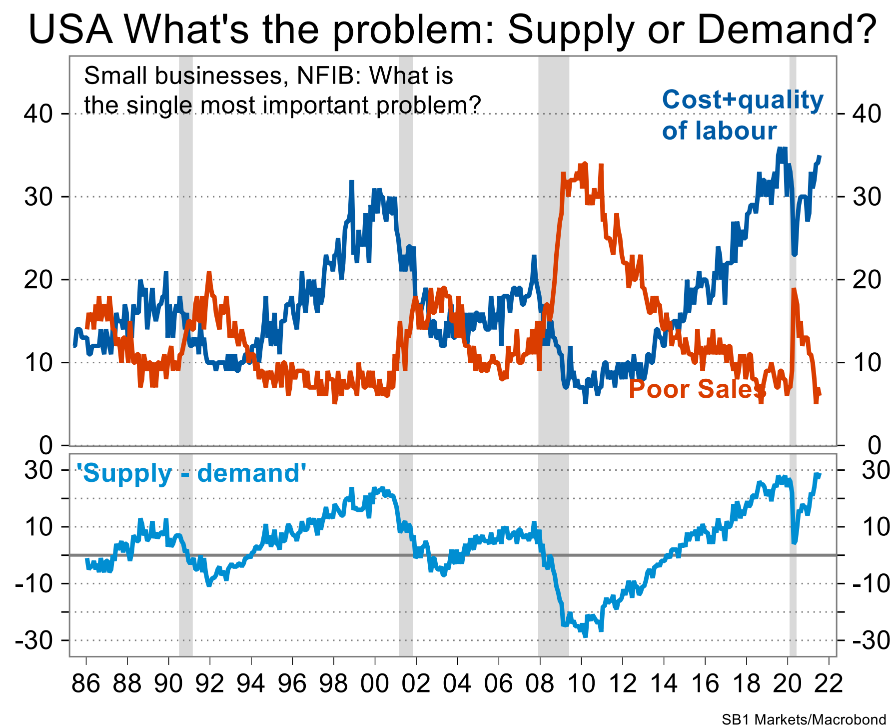


- Other investment surveys are more upbeat than the small business survey

It's the supply side, stupid. (And not the demand side)

It's really looking like we are at peak of a cycle, and not coming out of recession (if you still believed that)

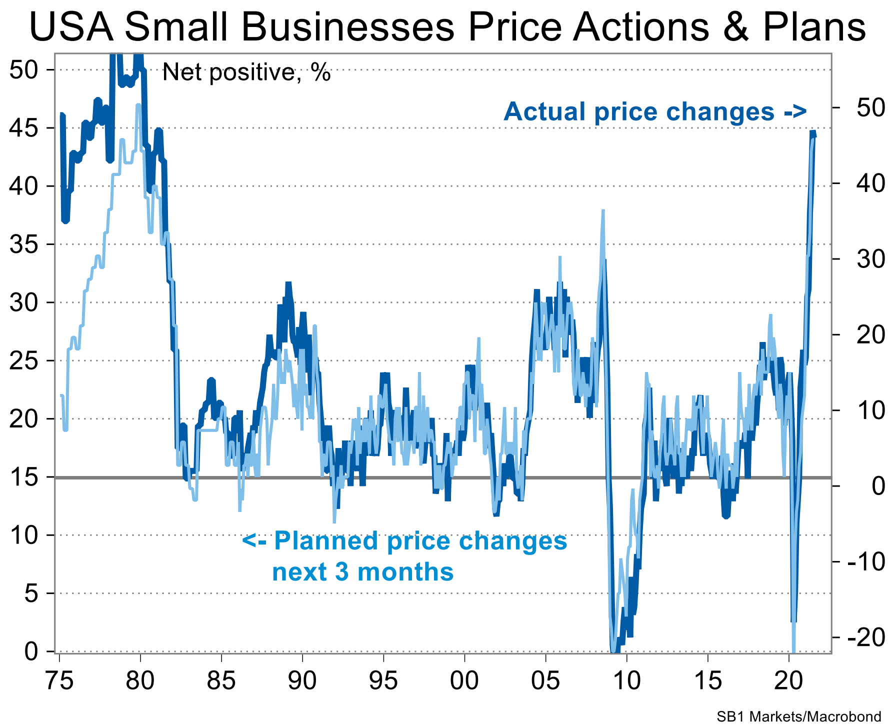


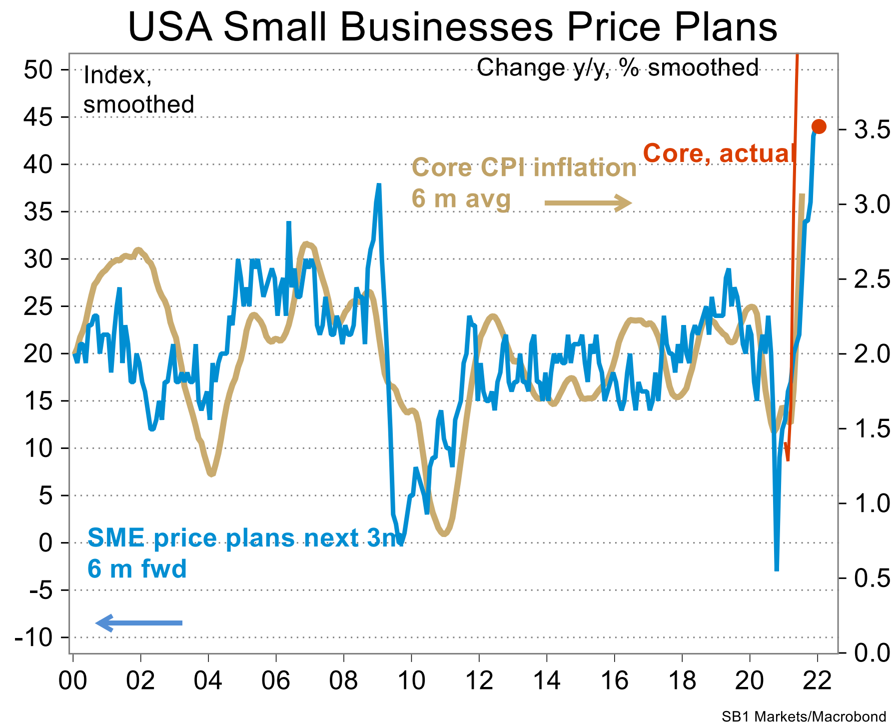


- While more businesses than normal stated **weak sales** as the major problem during the pandemic, there were never that many, and now a close to record low share of companies say than poor sales is the problem (and fewer than before the pand.
- **Availability, quality, and cost of labour** is a much more serious problem than normal, the share is now close to the record high recorded in late 2019
- Thus, companies report they are constrained from the supply side, not from the demand side
- Unusually few companies are complaining about **finance/interest rates** and about **taxes**

Another warning sign: SMBs say they plan to raise prices…

Like they (almost) never before have done

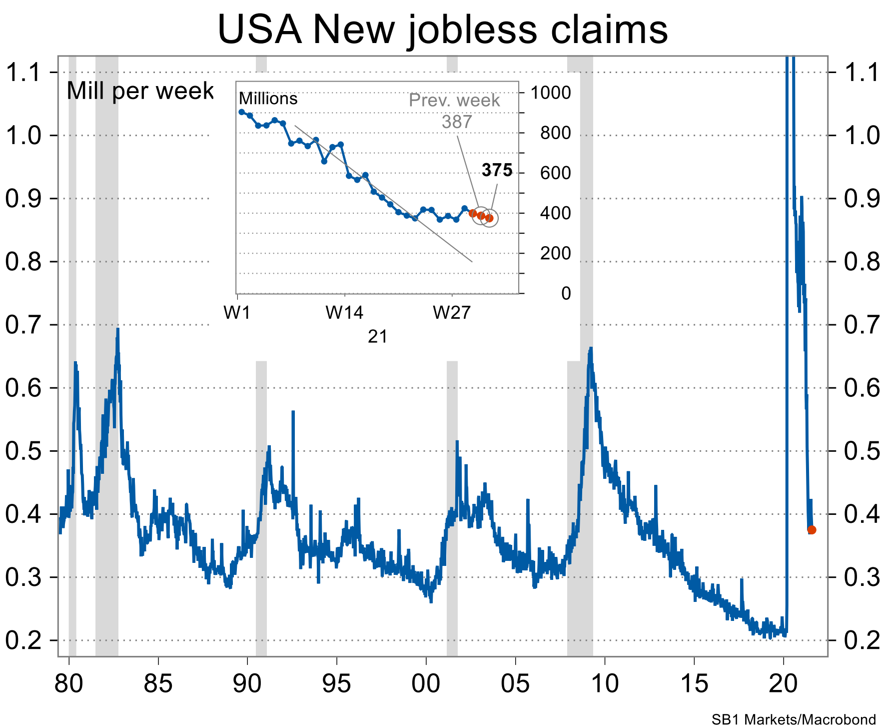


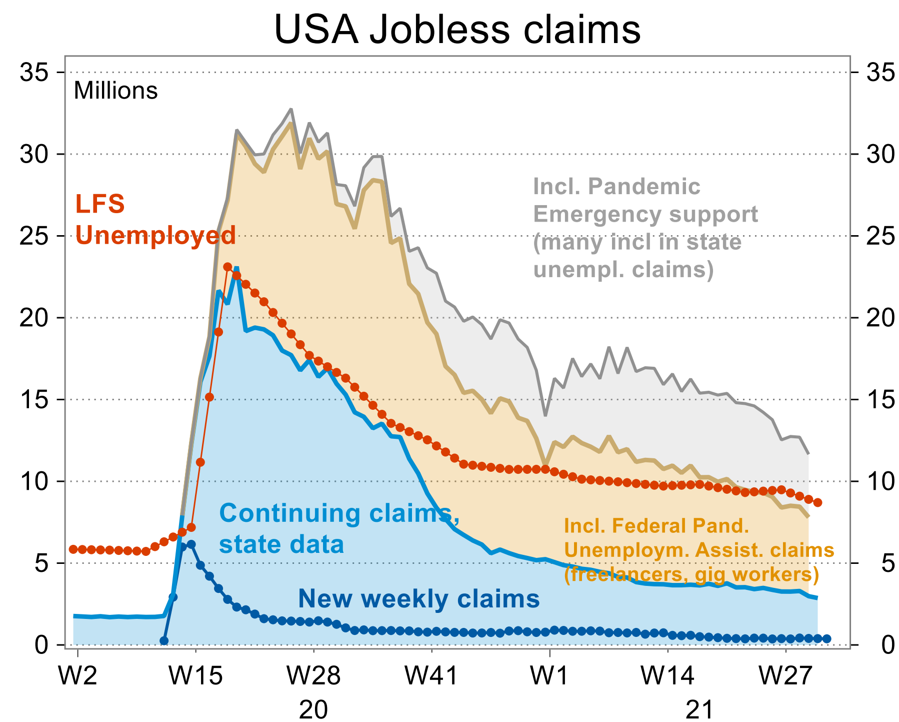


- It is long time since last time anyway, in December 1979, when price plans were as aggressive as today.
  And it lasted just one month, now we have been up here two months in row
- It is challenging to calibrate the SBM survey vs. actual inflation as the present print is so extremely far off the chart 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 higher input, costs or output prices
  - **Atlanta Fed Business survey** reports a 3% expected growth in unit costs. Since 2013, the expectations have been stable at 1.75 – 2.25%

New jobless claims keep moving slowly, slowly down. Rather strange

... at least vs. the low no. of layoffs, and the rather low unemployment rate

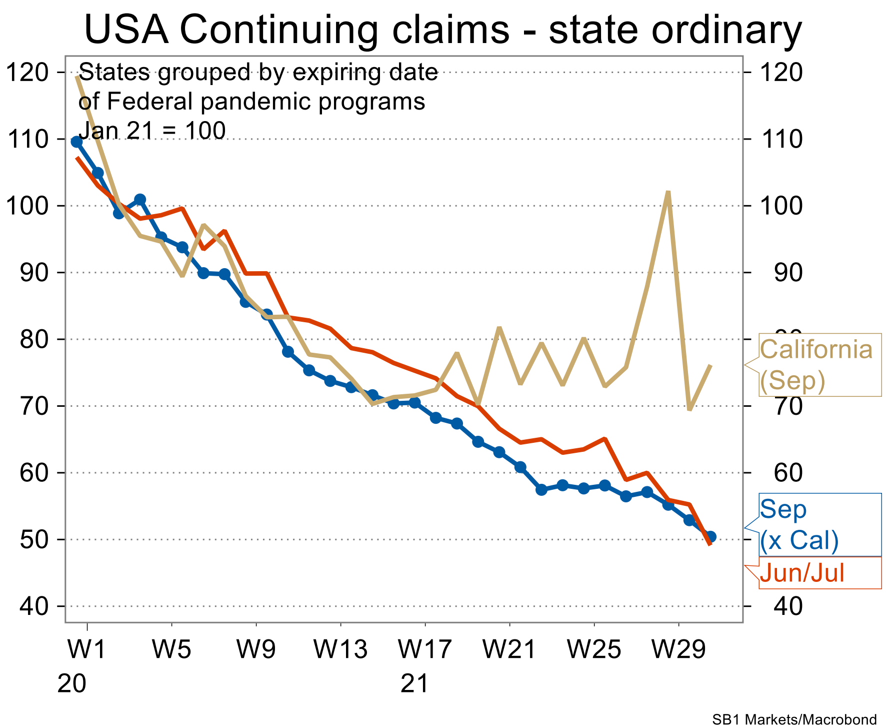




- **New jobless claims** fell by 12' last week (week 31) to 375' – and higher than expected, once more. The inflow is still high given all other indicators of demand for labour – and far above the rapidly declining trend which ruled until 2 months ago
- **Ordinary continuing claims** fell sharply the previous week (week 30), by 144' to 2.87 mill. Over the past 3 months, the no of recipients have fallen by ¾ mill.
- The number of recipients of benefits from the **two temporary federal pandemic programs** fell sharply in week 29, by 730' to mill to 8.7 mill. More than 3 mill of those recipients have left the past 3 months– and many more will lose their support every week as half of the states have abolished these programs – and all will lose their support by the end of September. What will they do then? Many have very likely already returned to work as employment is up by 2.5 mill the last 3 months – but we do yet have data indicating that the early leaver states have seen a faster growth in employment. July state employment data will be out soon

Will the cancelling of pandemic federal benefit programs lift employment?

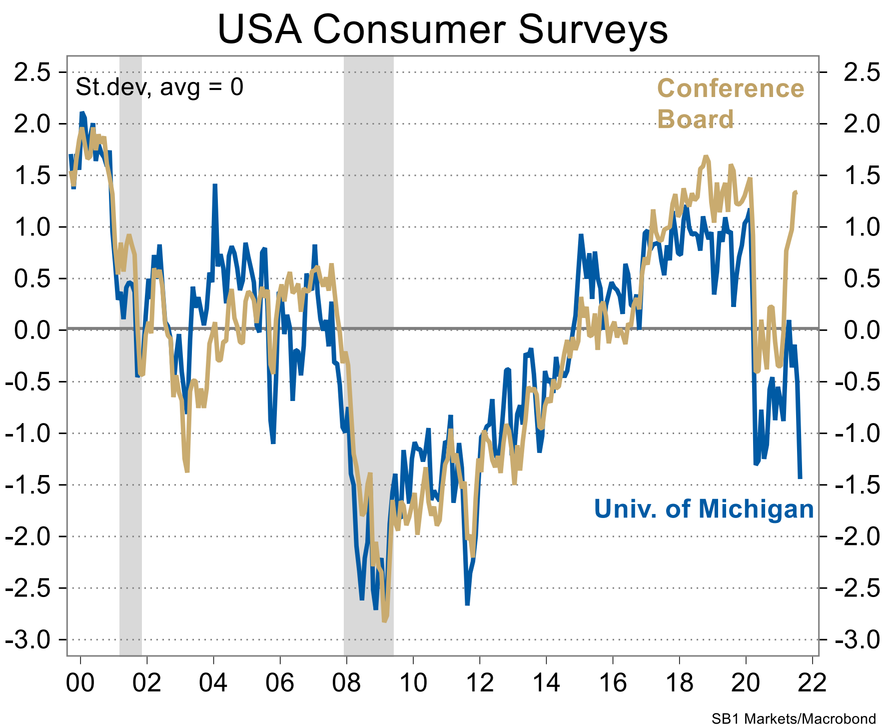
Still not big difference in no. of receivers of ordinary state unemployment benefits between states



- 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 (week 27). The no. of recipients has fallen by 3 mill persons past 3 months
- We do not know what these former recipients do now – are they employed or not
- If we pool the 'early leavers' states in one group, there has been a reduction in number of recipients of ordinary state benefits the past weeks which may imply that those who lost their federal support also leave the dole. However, barring the volatile Californian data, the decline is more or less than same in those states that have not opted to leave before the programs expires, in September

WT... Univ. of Mich consumer sentiment fell sharply, to below the Apr-20 level!

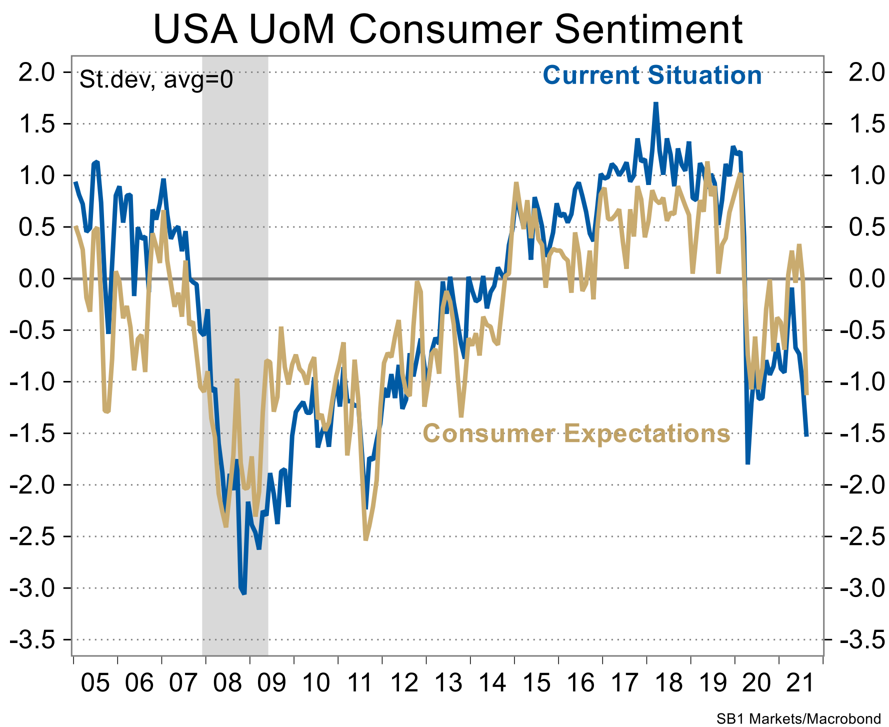
The current situation is deteriorating amid increasing (short term) inflation expectations

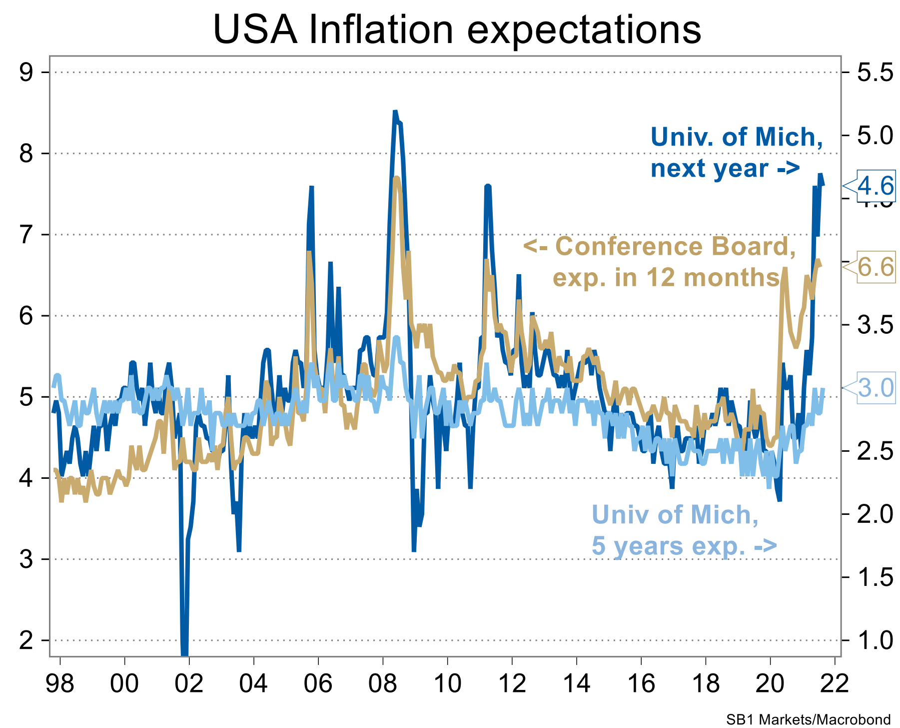


- **The UM sentiment index,** out of the, blue fell by 11 p to 70.2 in August, expected unchanged! (The lowest est. on Bloom was 78). The level is the lowest since 2011
  - » The decline equalled almost 1 st.dev, or ¼ of a 'normal cycle', one of the bigger monthly setbacks (the 7th ever). The level is 1.4 st.dev below par
  - » **Expectations** fell more than households assessment of the **current situation** but the latter still weaker than the former
- Why this sudden– and totally unexpected – drop in household sentiment?
  - » The **virus situation** has deteriorated in most states recent weeks, but nothing like the during previous 3 waves
  - » The **stock market** is OK, to put it mildly
  - » The **labour market** is recovering rapidly, and jobs are extremely plentiful (also according to households themselves)
  - » The **housing market** is still going strong, **mortgage rates** have fallen, and **credit** is available
  - » **Gasoline prices** are up but just marginally since April, and they are far from high in real terms
  - » **Inflation expectations** are well above a normal levels, but they did not (in sum) rise further in August, and cannot explain the sentiment shock
  - » **Republicans** lost confidence much more than Democrats, and the partisan divide is close to ATH, but there have been no political drama in early August?
  - » **Other surveys** have not recorded any sudden death – but just one other survey has published August data (IBD/TIPP). The gap between surveys is in reality the largest ever
  - » We do not have access to relevant all updated booklet details
- What to make out of it? To put it simple, we are not sure. The market? Bond yields fell. But equities rose, of course

Univ. of MI: Both the assessment of the current situation & expectations down

Inflation expectations are elevated but did not (in sum) worsen in August



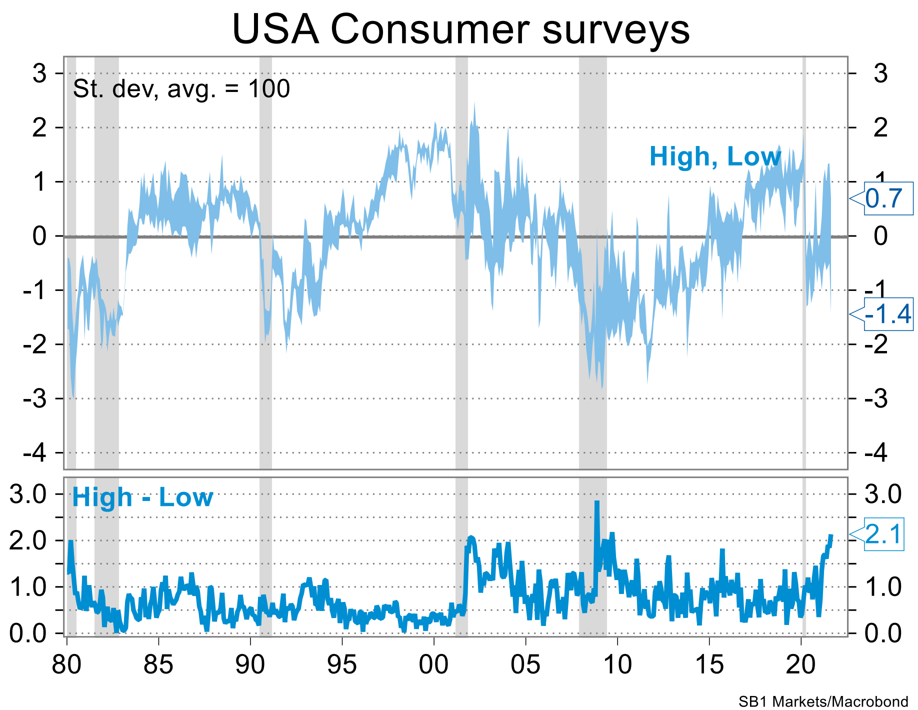


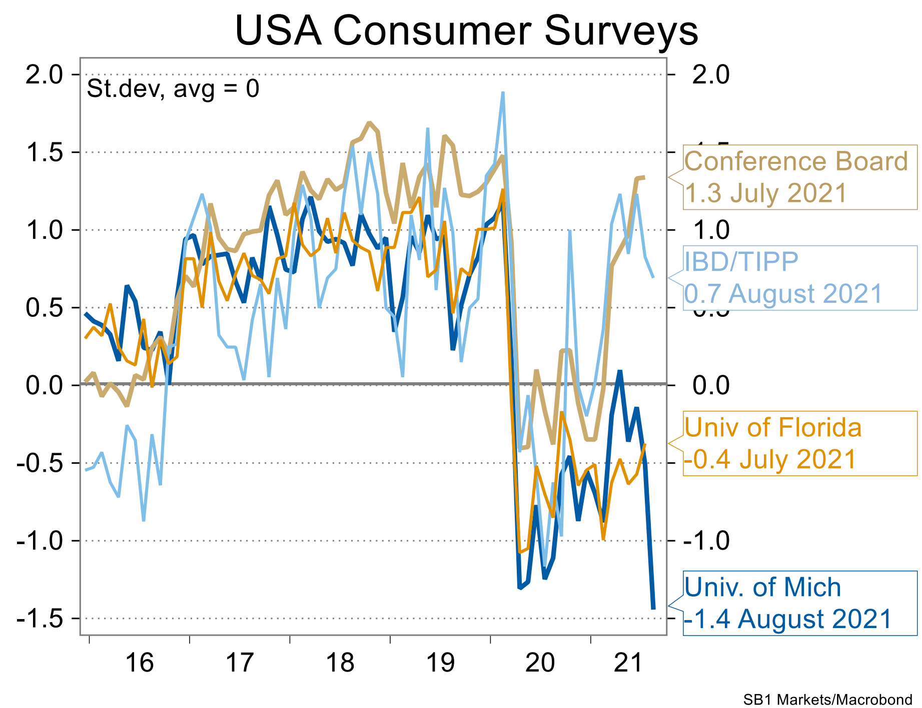
- The index is an equally weighted index of personal finances business conditions, and buying conditions. We do not have access these August data from the 'booklet'
- The 12 m inflation f'cast dropped one tenth to 4.6%, while the 5 y expected rose 0.2 pp to 3.0%, to the same level as in 3.0%
- Both are well above level the recent years, but the change in August can not explain the large drop in overall sentiment

SpareBank 1 MARKETS

Wait for the other surveys but the gap between them is close to record high

Just Nov-08 substnatially ‘worse’ but then the IBD/TIPP survey shot up ‘without reason’

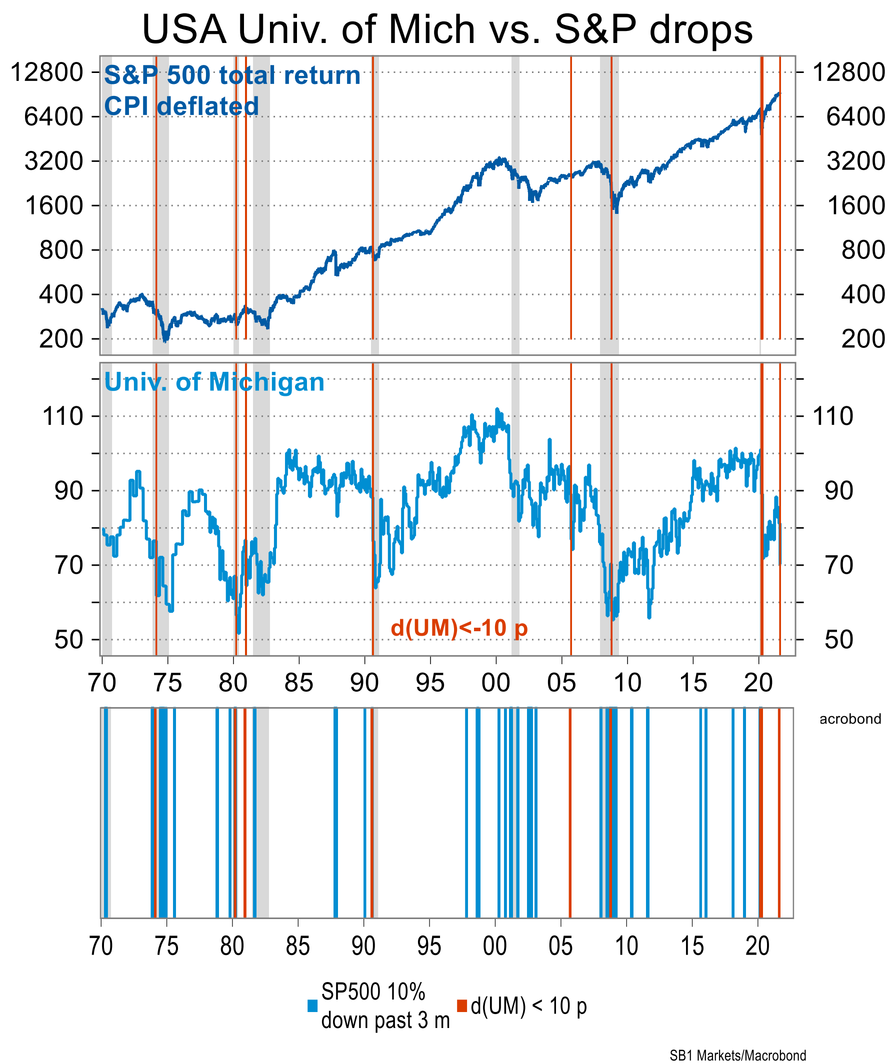




- Sure, the Univ. of Mich. August print could turn out to be a wild shot too – but the UM is far less volatile than the IBD/TIPP survey. University of Florida’s survey has been at the weak side since the start of the pandemic, just like Michigan’s survey (but no August data yet)
- Conference Board will publish its August survey next week

Sentiment down -> the market down? Don't worry too much. But…

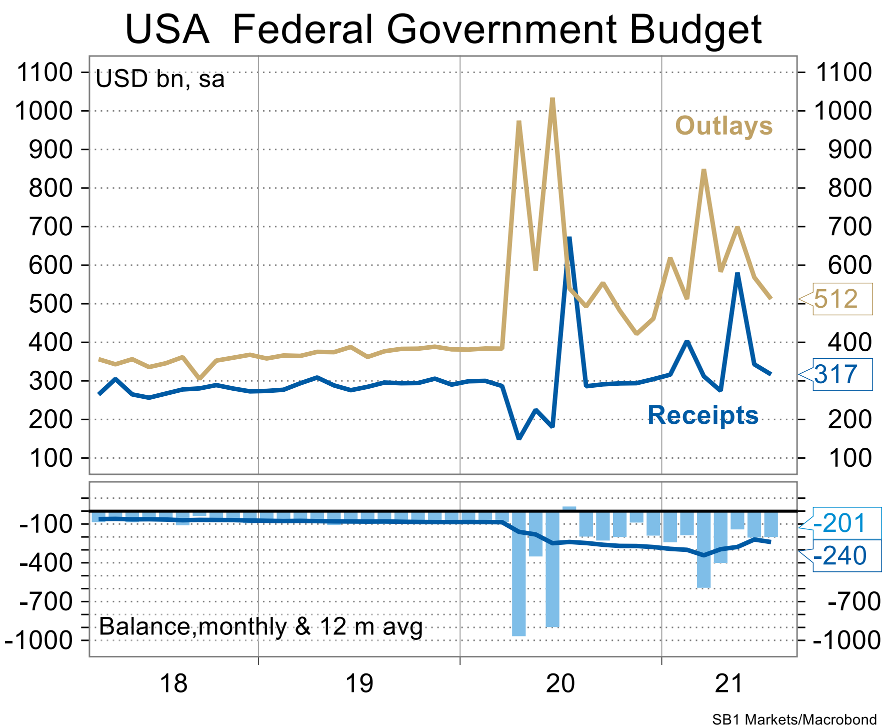
Consumer sentiment is correlated to the stock market

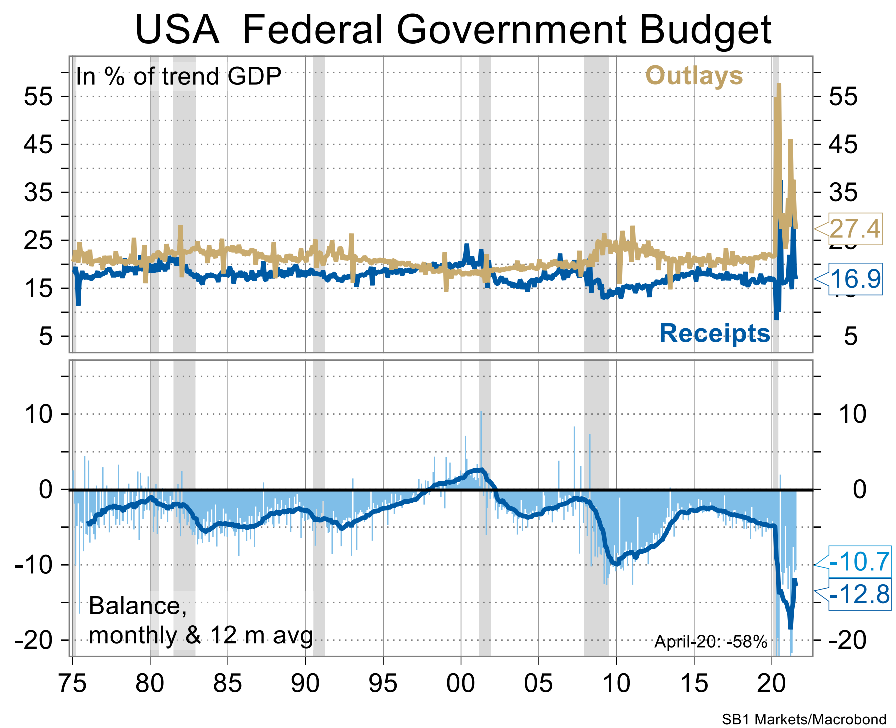


- Sentiment is hit during most corrections at the stock market – and sometimes the sentiment yields first
- The big drops in UM sentiment (> -10 p, red lines, 8 times since 1970) normally take place in periods with market/economic turmoil. So far, just 1 UM drop has taken place during calm times (2006) – but at that time the UM sentiment did not fall to 70
- However, most corrections at the stock market (10 % or worse) has taken place without large one-month declines in the sentiment index
- On the other hand, sentiment is always deteriorating amid all major stock market setbacks (bear markets, more than 20% down)
  - » Sentiment started to wane ahead of the large the market setbacks in 1973, 1990, 2000 and 2008

Budget deficit narrowed in July, still at 11% of GDP

Deficit has now exceeded 2.5 trl for the fiscal YTD – embrace for the debt ceiling debate… again

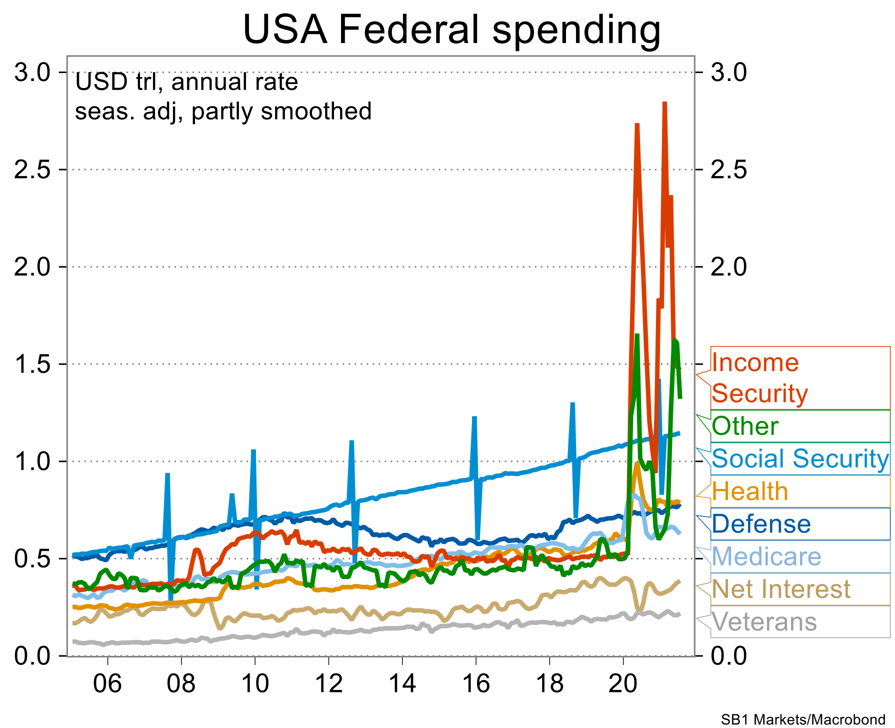


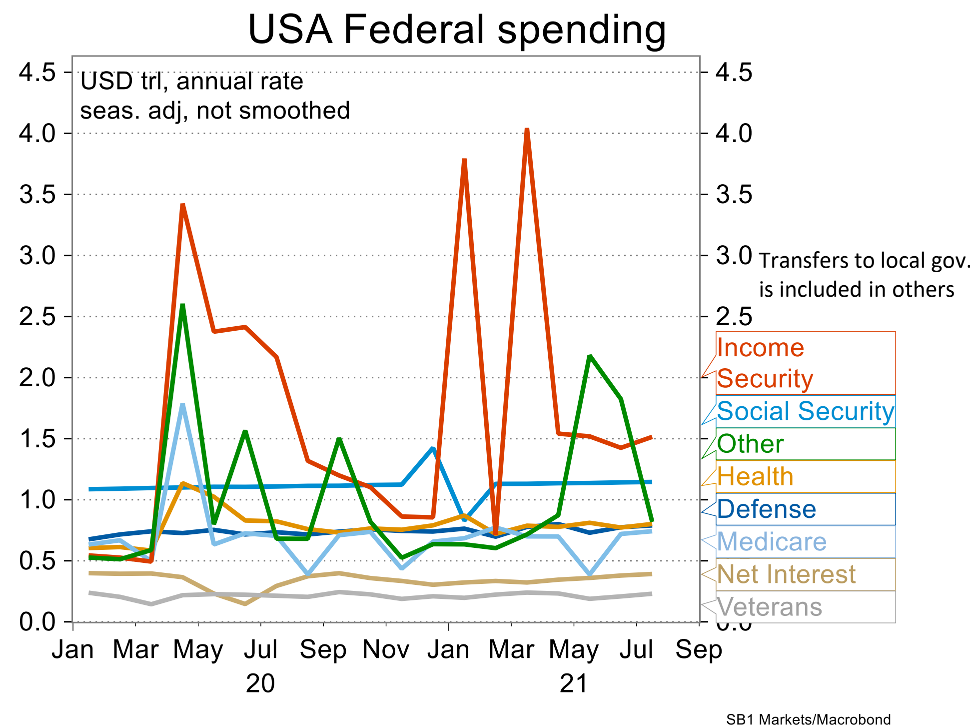


- **Federal expenses** fell in July, by USD 78 bn to 512 bn (seasonally adjusted), equalling 27% of (monthly) GDP, as state transfers decreased (and may fall further in the coming months)
- **Federal income** was also down, by a total of USD 25 bn 317 bn, 17% of GDP – and covering just 62% of the expenses, as household tax payments decreased (from a high level)
- The actual **deficit** was at USD 302 bn in July, expected USD 307 bn, the discrepancy very likely due to the hike in household taxes. The seas. adj deficit equalled USD 201 bn or 11% of GDP. Over the past 12 months the Federal deficit has equalled 13% of GDP
- The **Federal Reserve** is still 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 and Covid stimulus

Federal spending will still be a topic – USD 1 trillion infrastructure bill was just passed in the Senate

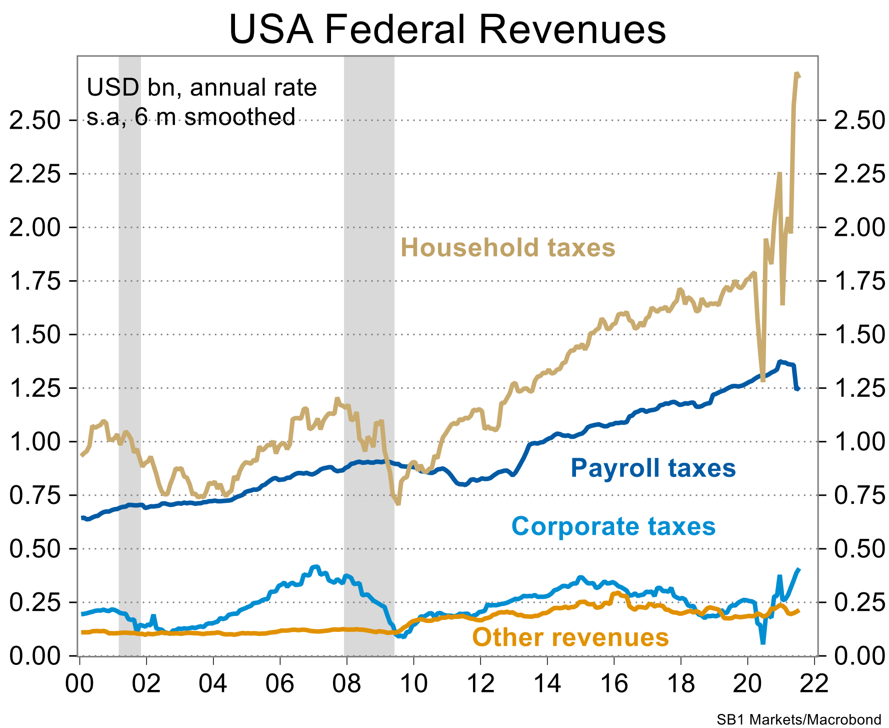


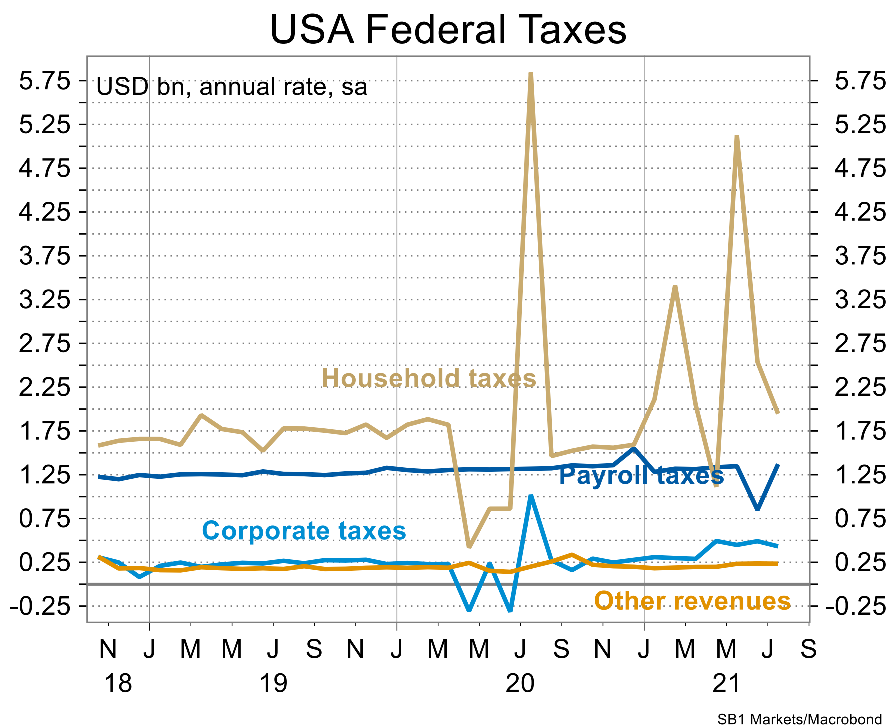


- However, there will still be federal spending on increased unemployment benefits, larger child tax credit, vaccine distribution, health care, food assistance programs, support for businesses, aid to local governments over next several months
  - » Of the total **USD 900 (Trump) + 1.900 bn (Biden)** stimulus package decided, some 57% 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 been agreed upon in the Senate, though scaled down to USD 1 trl (550 bn in new spending) over the next decade (but most will be spent the coming 5 years, equalling 0.5% GDP)
- Another **budget framework** (a 1-pager) with USD 3.5 trl in increased spending on green/welfare/education over 10 years, partly offset by corporate taxes/taxes on wealthy Americans was approved by the Senate. It will now be debated in the House, together with the infrastructure plan. Most likely, the infrastructure plan will be approved in the House as well

Household taxes further down in July, still above a normal level?

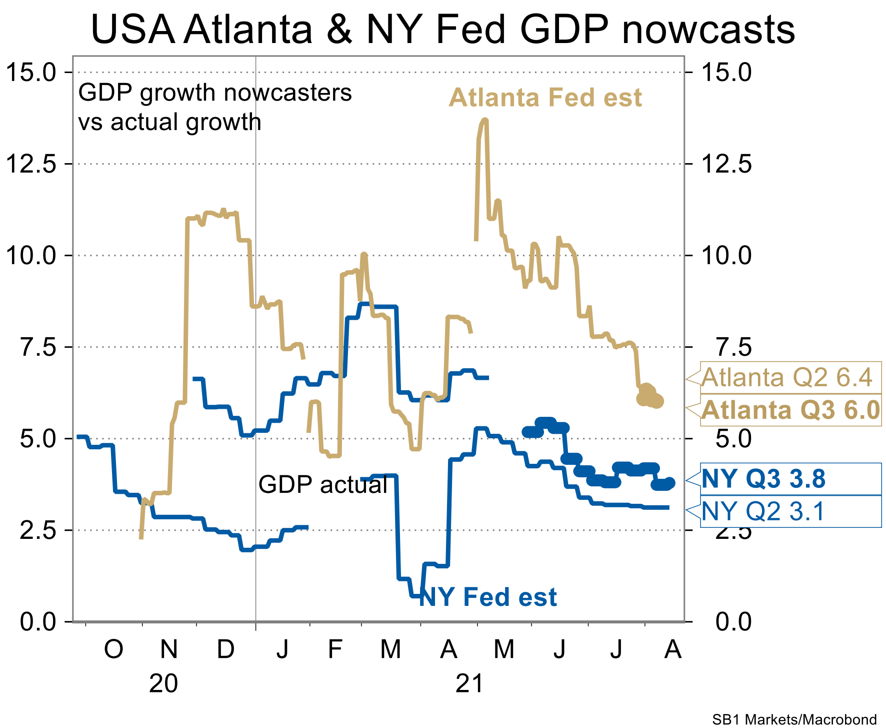
Monthly tax payments have become extremely volatile during the pandemic

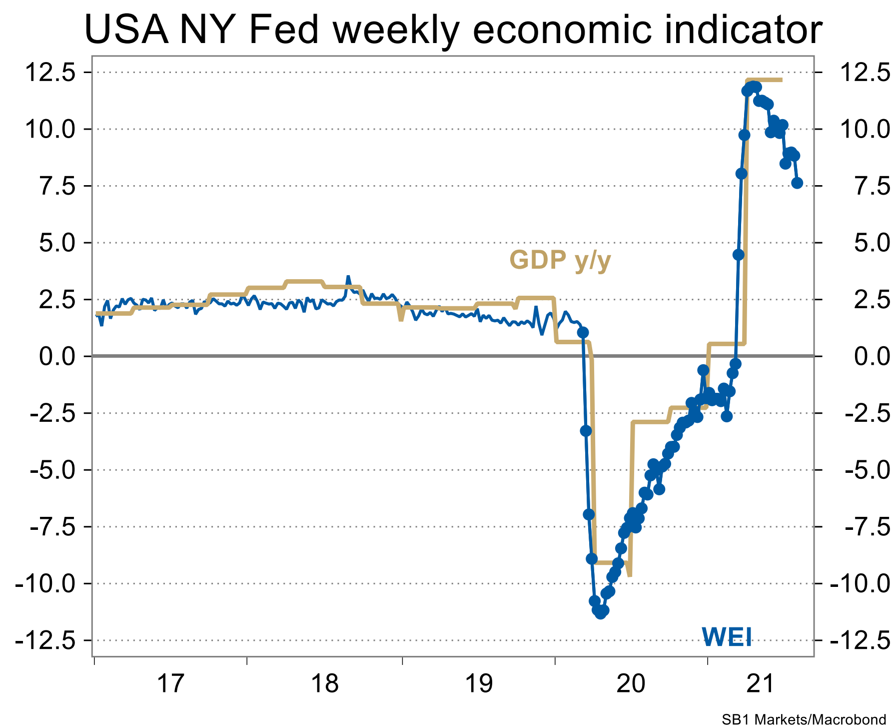




- **Household taxes** fell by USD 580 mill, while payroll taxes increased by USD 520 mill, as a result of a deferred tax deadline

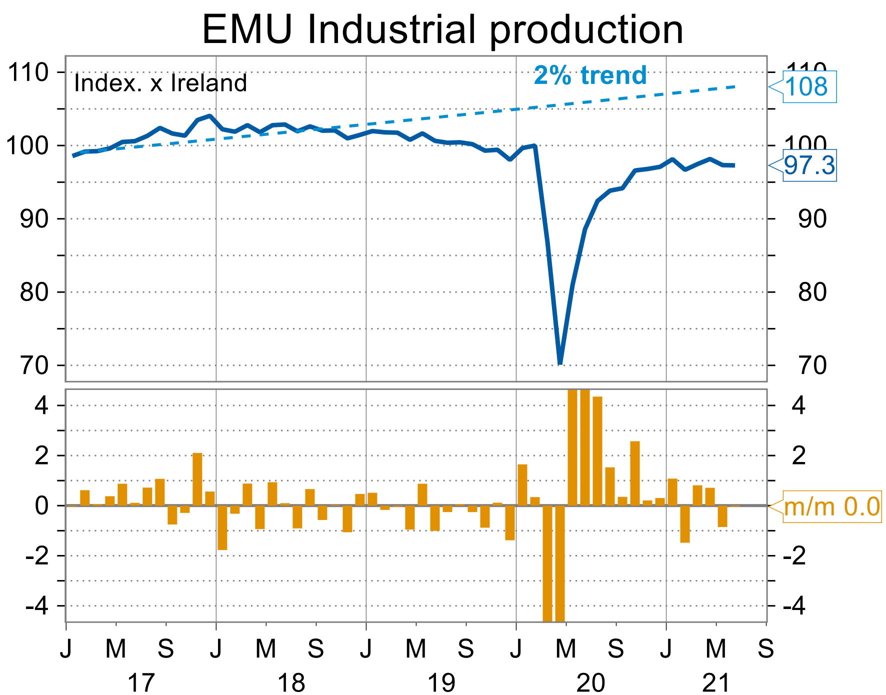
The nowcasters still signal 4% to 6% GDP growth in Q3 – but are trending down

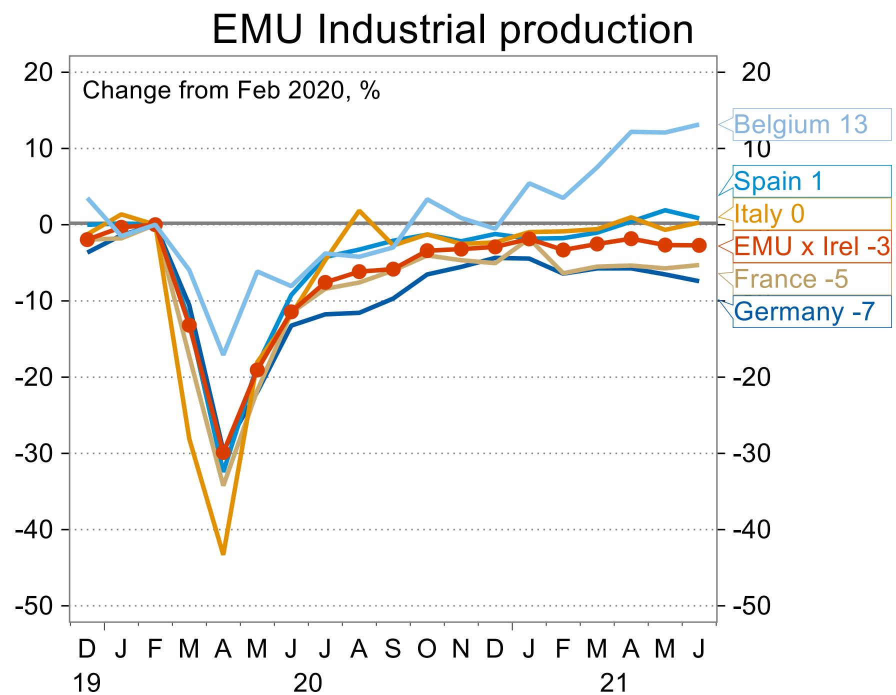




Industrial production in the EMU (ex. Ireland) flat in June

Production is still 2.7% below the pre-pandemic level

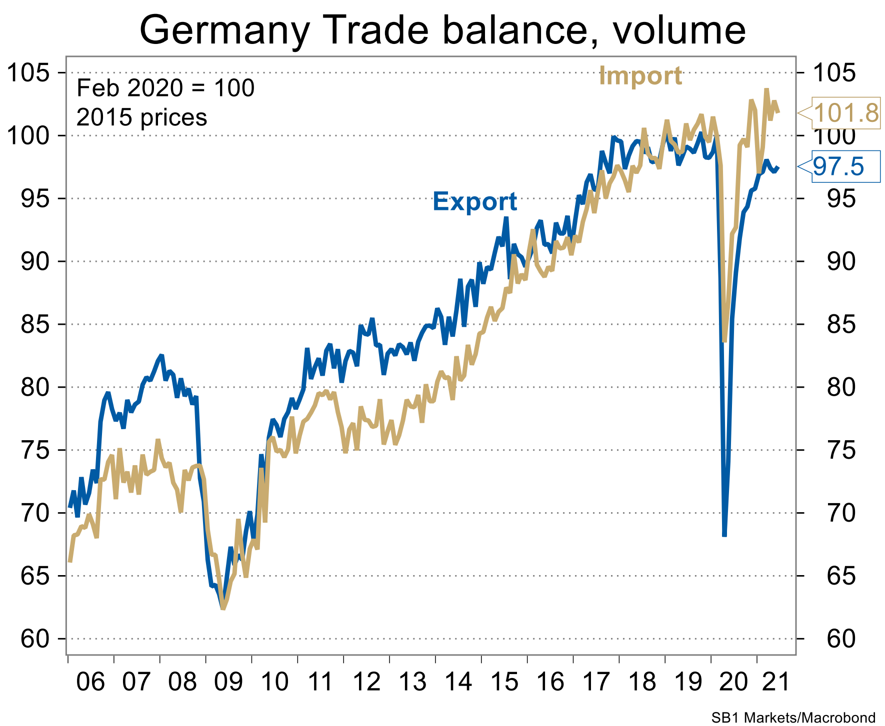


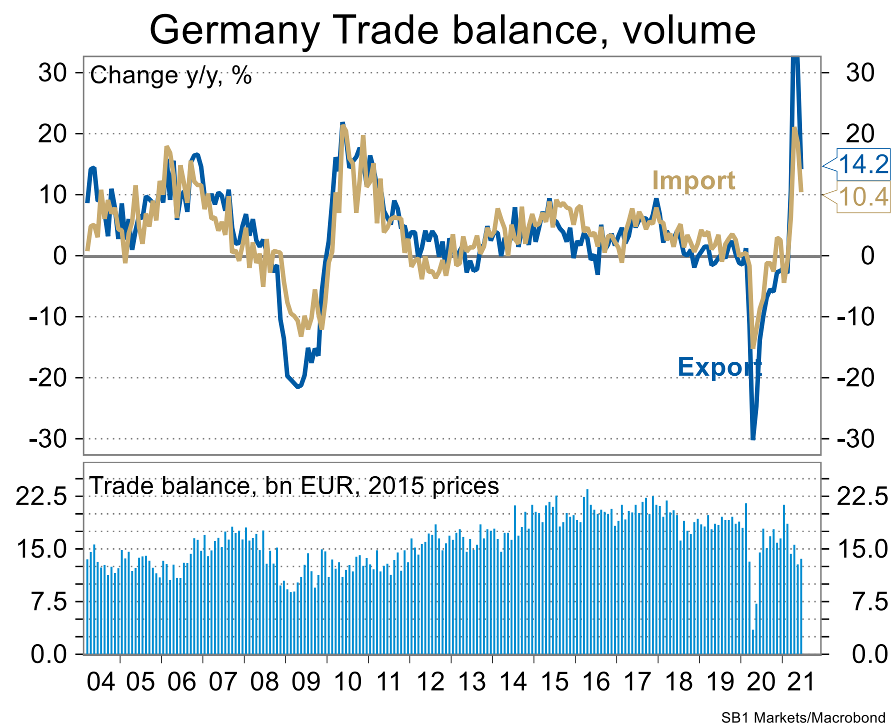


- **Industrial production** was flat in June, in spite of a 1% fall in Germany and a decline in Spain as well. France and Italy (and Belgium) reported small gains. (We have removed Ireland from our charts because the Irish data have been far to volatile (tax driven). These data are now undergoing a review. The official figure, incl. Ireland, was a 0.3% m/m fall in production
  - » Auto production very likely contributed substantially on the downside in June too (like in Germany)
- **Order inflow** indicates higher production the coming months
- **Surveys** are also signalling continued strong growth

Exports increased by 0.5% in June – still 2.5% below the pre-Covid level

Imports were down 1% but are back on the pre-pandemic growth path

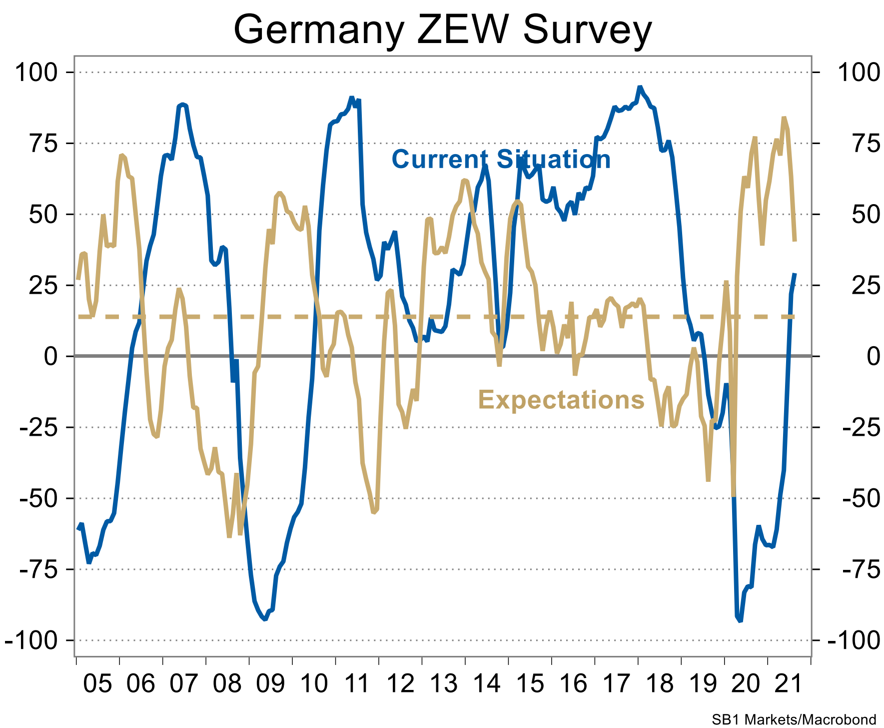




- Export volumes rose 0.5% m/m in June, while imports fell by 1%
- The German trade surplus shrank rapidly during the corona crisis in the spring, to the lowest levels in 20 years. Since August last year, the surplus has been almost back to normal. The surplus in May was EUR 13.6 bn, whereas the average before the pandemic was approx. EUR 19 bn/ month (seas. adj.)

ZEW analyst/investor sentiment further down in August, still at decent level

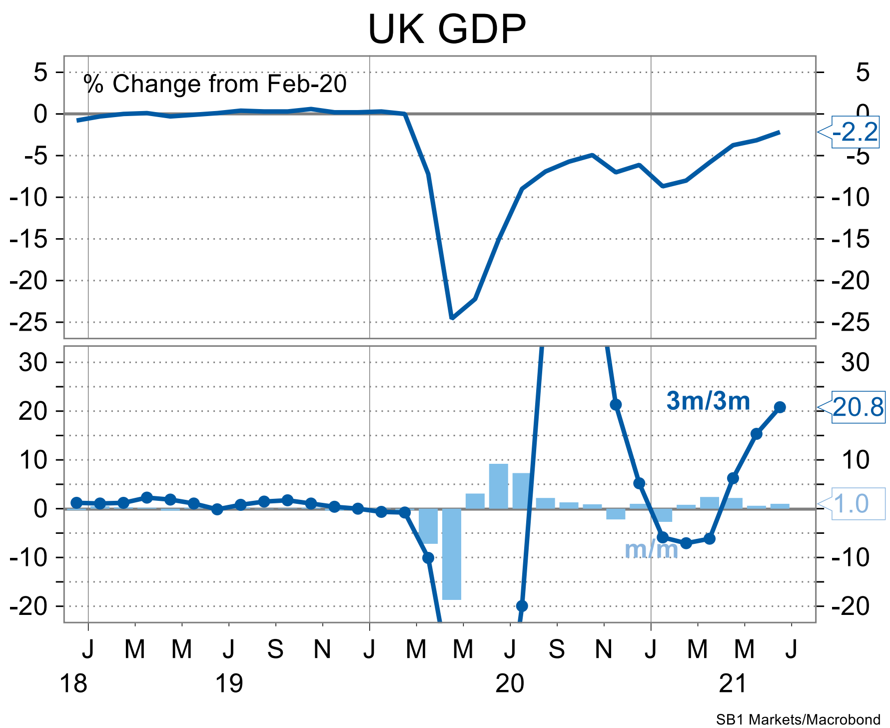
– signals very strong GDP growth

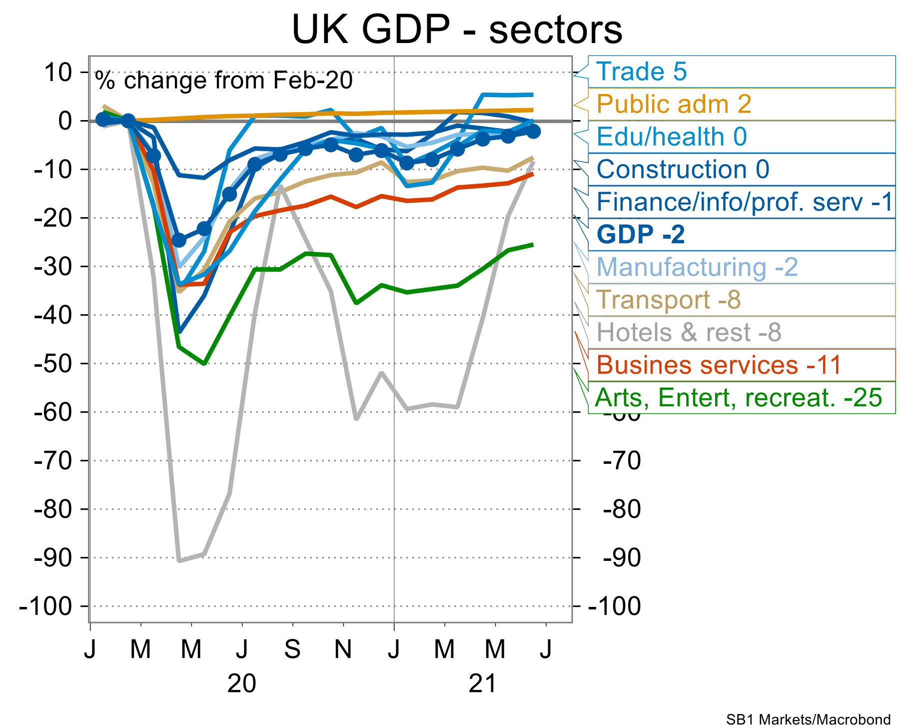


- The ZEW expectation index fell 22.9 p to 40.4 in August, far below expectations at 56.7. The index is now 0.45 st.dev above average (down from 1.7 st.dev above average at the top in May)
  - » Investors and analysts are just pretty sure that the economy recover the coming months, just less sure following the surge of the Delta variant and continued supply shortages… Which is reasonable
- Assessment of current situation sharply improved in July (up 7.4 p), as more restrictions have been lifted and vaccinations are increasing. The level is now above average

Q2 GDP up 4.8%, confirming a robust recovery, but still down 4.4% vs pre-p

GDP increased by 1% in June, and the level is down 2.2 vs. Feb-20 – but some 4 - 5% below trend

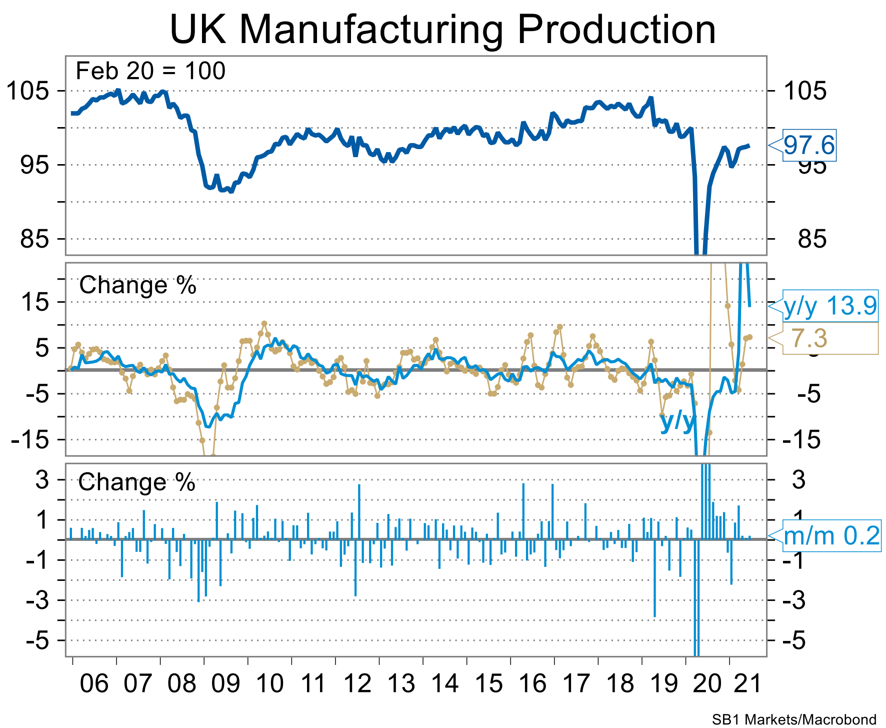


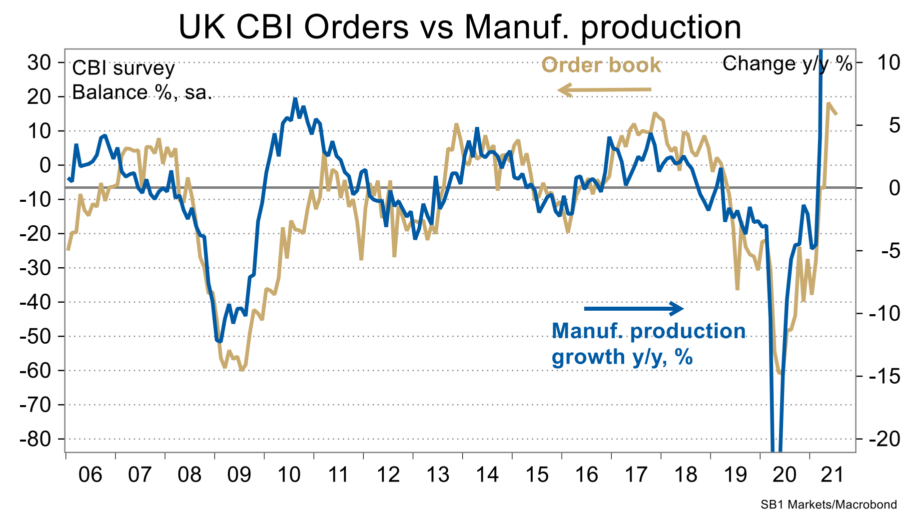


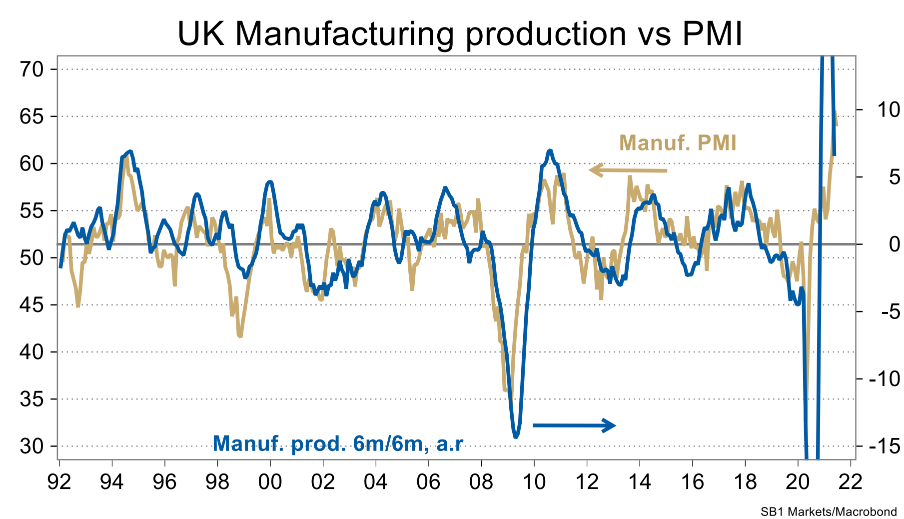
- **The recovery in GDP** is still on track – and the pace picked up in June by a 1% growth, 0.2 pp above consensus. However, may was revised down by 0.2 pp to 0.6%. GDP is still 2.2% below the pre-pandemic level
- **Services** rose 5.7% q/q, **hotel and restaurants** were up 88% q/q (with some help from the Euro 2020), and is now only down 8% (in June vs Feb-20), while **culture/entertainment** rose 11% in Q2 but is still down 15%
- **Manufacturing** was up 1.8% q/q (still 2% down), while **construction** added 3% in Q2, and is now on par with the pre-pandemic level

Manufacturing production up 0.2% in June, driven by auto production

… the activity is still 2.4% below the pre-pandemic (low) level



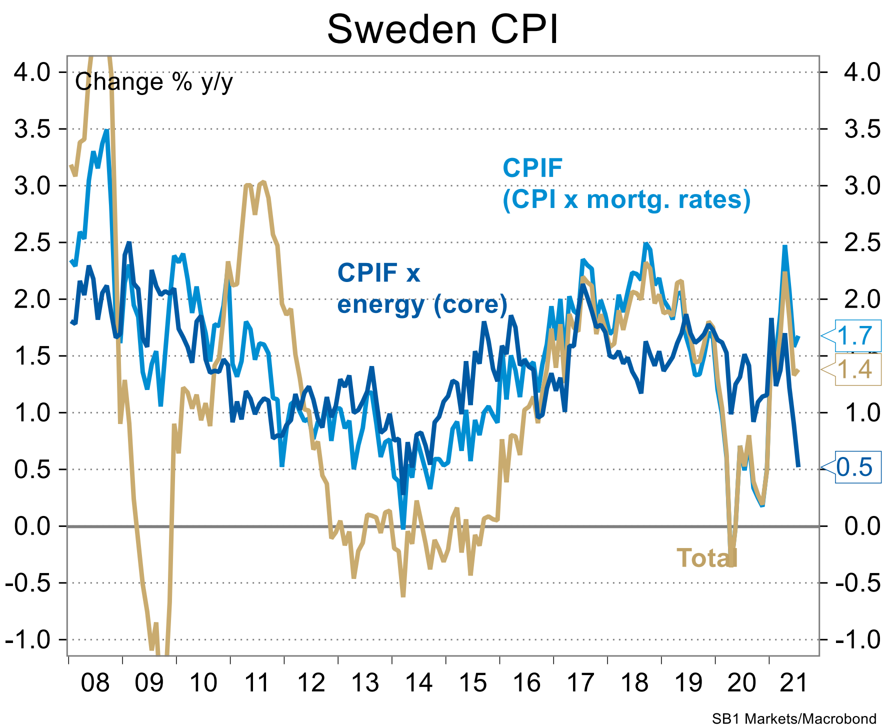


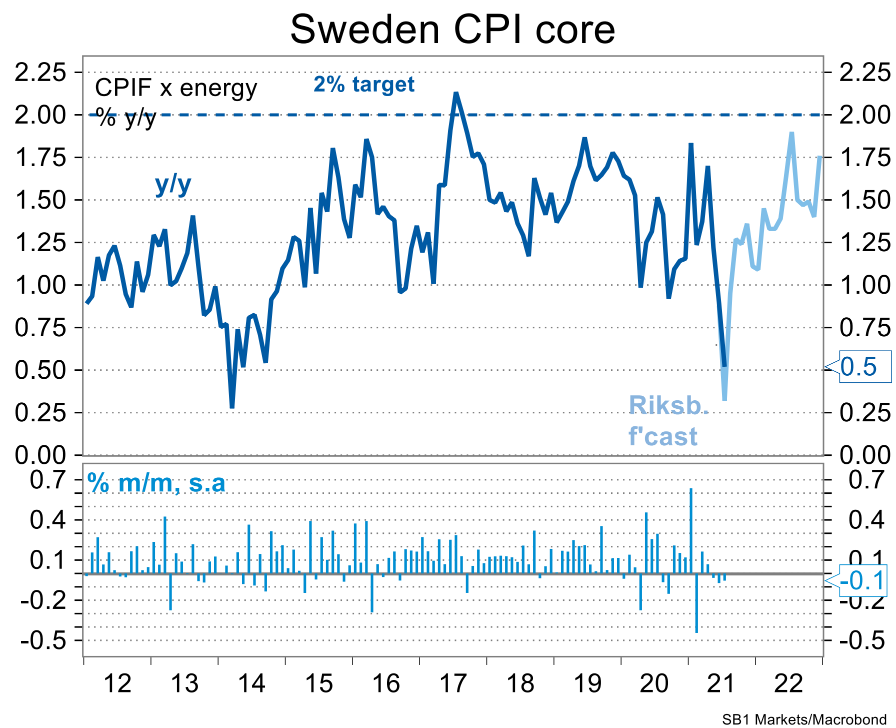


- On a the bright side: PMIs and other surveys are at the best levels ever – and signalling terrific growth the coming months. If businesses have enough materials, labour of course…

No inflation in Sweden either, core down 0.4 pp to 0.5% in July! Total at 1.4%

The decline in the core rate (CPI x mortgage rates, energy) as expected – and probably temporary



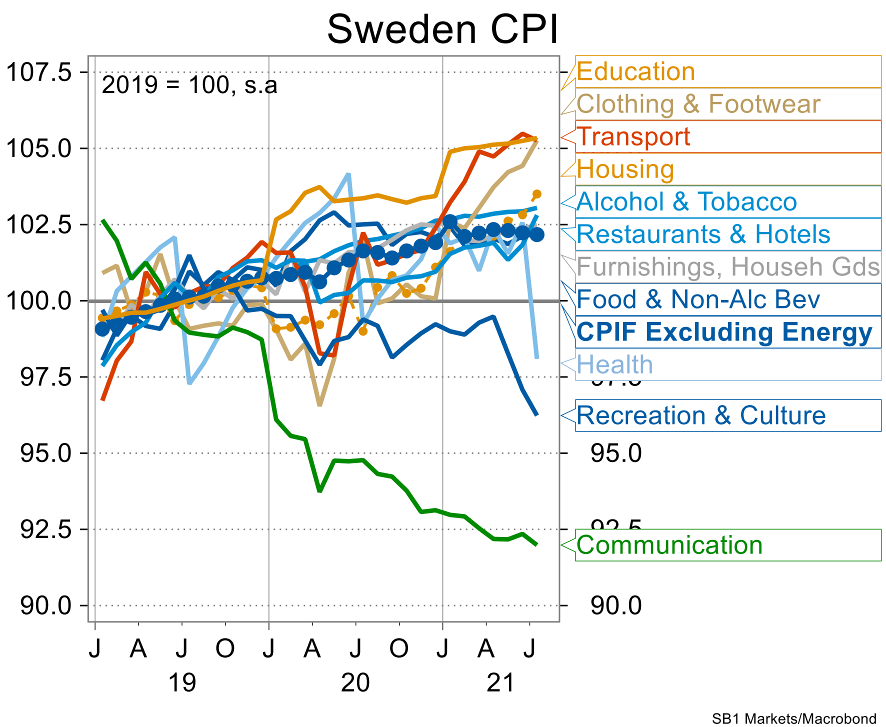


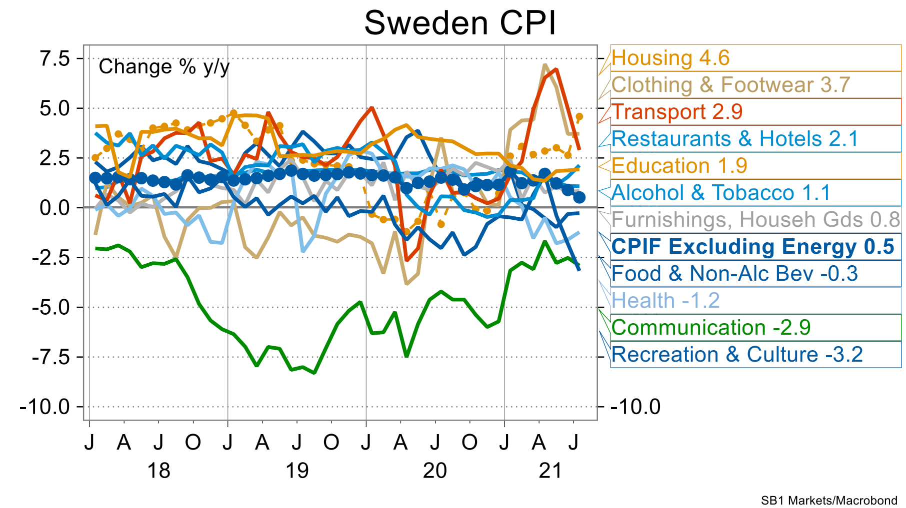
- **Headline inflation** accelerated 0.1 pp to 1.4% y/y in July, 0.1 pp above expectations
- **The CPI-F**, the constant interest rate inflation (CPI x mortgage rates) was up 0.1 pp to 1.7% y/y in June, also 0.1 pp above expectations
- **CPI-F x energy, the 'real core'** was down 0.1% m/m, and the annual rate fell by 0.4 p to 0.5% y/y, as expected
- The Riksbank expect a steep decrease in the core y/y rate in August, without any special base year impact. Strange
- The decrease in inflation was largely driven by decrease in food, clothing, and furnishing, whereas transport was the biggest contributor on the upside

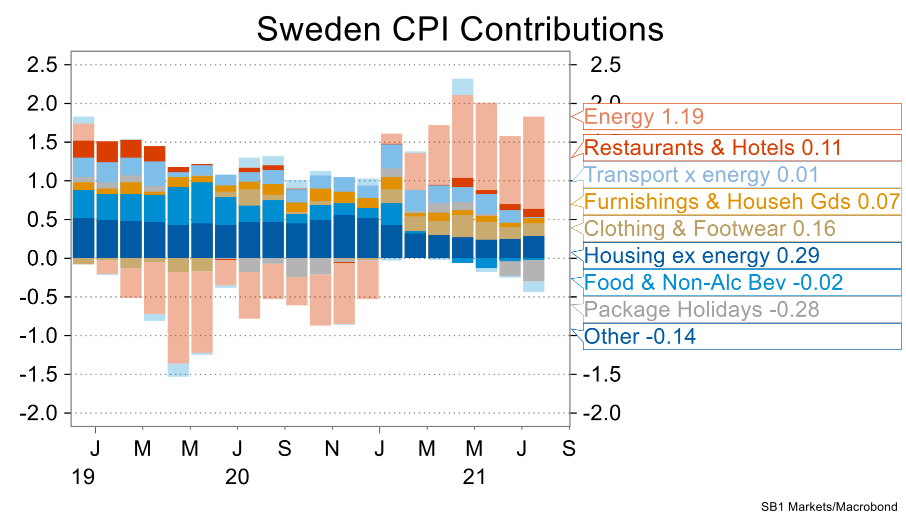
SpareBank 1 MARKETS

Huge sectoral differences: Housing, clothing up in July, recreation, health down

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

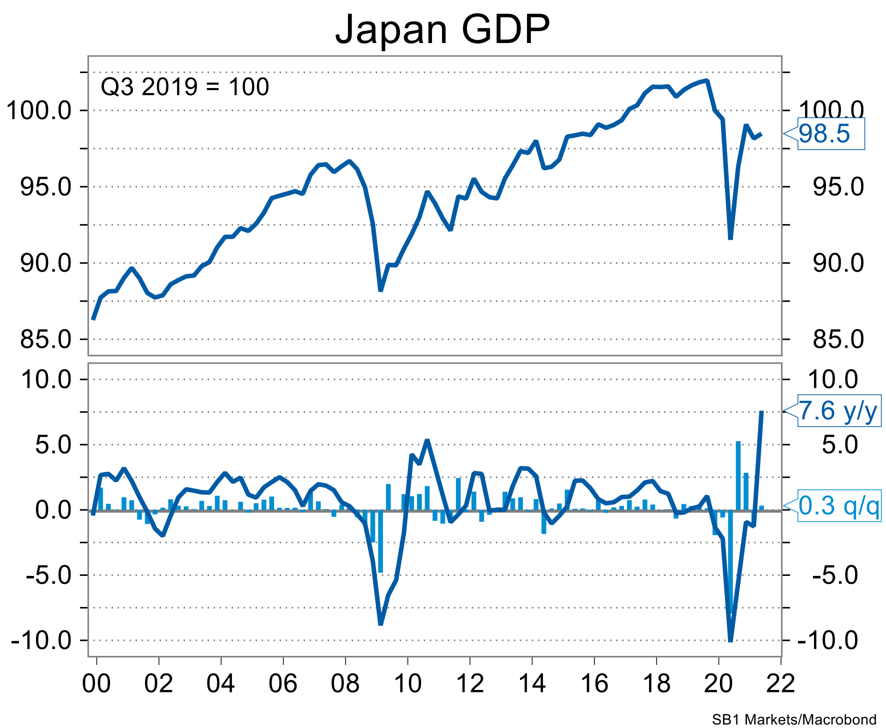


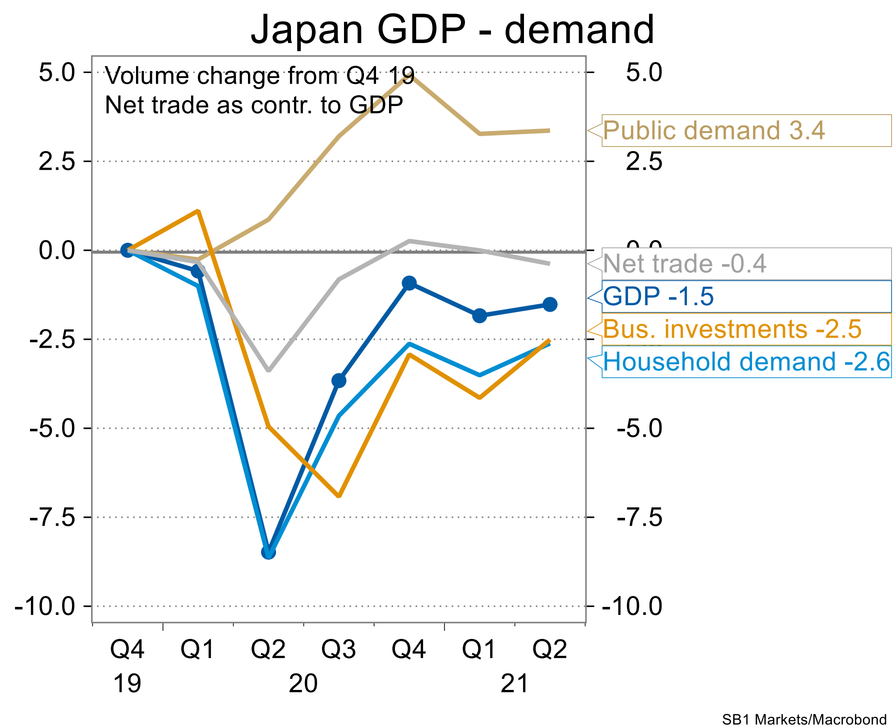




GDP up 1.3% in Q1 (0.3% not annualised), a tad better than expected

However, just ¼ of the Q1 contraction was reversed, and the GDP level remains 1.5% below Q4-19

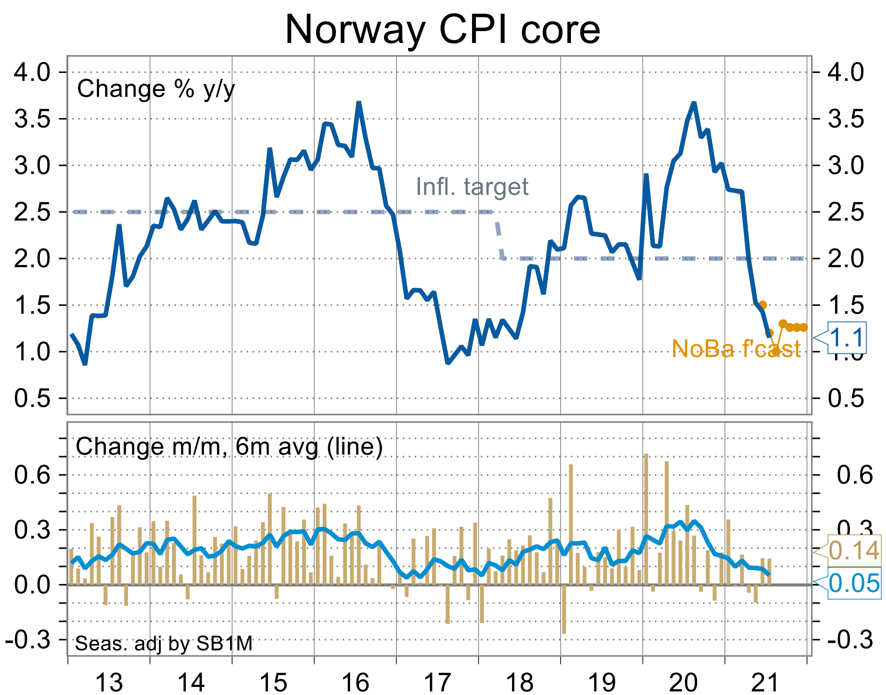


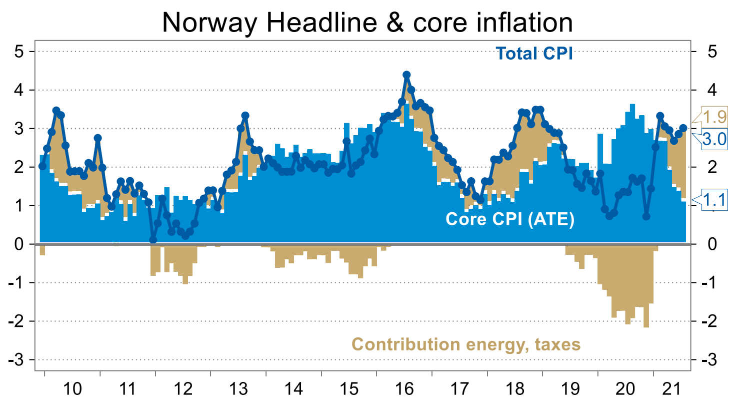


- … and Q4-19 was 2% below the Q3-19 level, mostly due to a rise in the VAT rate. Thus, Q2-21 is in 'reality' down 3.5% vs the 'pre-pandemic' level
- Household contributed most on the upside business investments were up in Q2. Net exports fell for the 2nd quarter in row, but the net exports are back to the Q4-19 level. Private demand is still well below, public demand is well above
- Short term indicators do signal any brisk recovery in Q3 – and the virus is still around

(Core) Inflation is not a problem in Norway: CPI-ATE down 0.3 pp to 1.1% y/y!

… And now due to domestic goods & services, not cheaper imports. Total infl. at 3.0%





- **CPI-ATE** (ex. energy and taxes) inflation was down 0.3 pp to 1.1% in July; in line with consensus f'cast, 0.1 pp below Norges Bank's f'cast, and 0.2 pp below our estimate
  - » Prices were up 0.1% m/m (seas adj), equal to the June print
  - » Inflation is below 2% for housing, clothing, food, alcohol, communication, transportation, and airline tickets – others are still above
  - » The main misses (vs our f'cast) on the downside were food and airline tickets, while clothing surprised on the upside
  - » Prices on imported goods rose in June, but annual inflation is trending down
  - » In addition, domestic inflation has slowed substantially to 1.2%
- **Total inflation** rose 0.1 pp to 3.0%, 0.2 pp above our f'cast
- **The outlook**
  - » **Inflation may slow** somewhat more the coming quarters. Wage inflation remains moderate (if not low). Demand for goods will have to decline from a very high level. Upside risk: Higher raw material prices/global price pressures but the spill-over to the Norwegian CPI is not that significant
  - » Anyway, CPI inflation will not have any material impact on Norges Bank's monetary policy the coming months. It's all about the post Covid-19 recovery – and the housing market

SpareBank 1 MARKETS

Lower food and transportation prices than we expected

		Change m/m, seas. adj			Change y/y			Contribution, pp		
Jul-21	Weight	Out-	SB1M	Dev.	Last	Out-	SB1M			Dev. vs
CPI ATE	%	come	f'cast	pp	month	come	f'cast	m/m	y/y	f'cast
Food, non alc bev	13.0	-0.5	0.1	-0.6	0.1	-0.8	0.3	-0.06	-0.10	-0.07
Alcohol, tobacco	4.3	0.1	0.2	-0.1	0.9	0.6	0.7	0.00	0.03	-0.00
Clothing, footwear	4.9	1.4	0.0	1.4	-2.9	-1.2	-5.5	0.07	-0.06	0.07
Housing x. energy	20.5	0.2	0.2	0.1	1.3	1.6	1.4	0.04	0.32	0.01
Furnishing	6.8	0.2	0.3	-0.1	3.6	3.3	3.1	0.01	0.23	-0.00
Health	3.2	0.1	0.3	-0.1	3.3	3.2	3.4	0.00	0.10	-0.00
Transp. ex. gas, airl. tick	12.0	-0.7	0.1	-0.8	1.4	0.0	1.1	-0.08	0.01	-0.10
Airline tickets	1.0	2.1	5.0	-2.9	-20.1	-15.8	-13.5	0.02	-0.16	-0.03
Communication	2.5	0.1	0.2	-0.1	2.5	1.9	2.1	0.00	0.05	-0.00
Recreation, culture	11.2	0.1	0.3	-0.2	3.8	3.2	3.7	0.01	0.36	-0.03
Education	0.5	-	-	-	2.1	2.1	2.1		0.01	0.00
Restaurants, hotels	5.9	1.3	0.4	0.9	3.5	4.0	3.0	0.08	0.23	0.05
Other	8.7	0.4	0.2	0.2	2.3	2.2	1.9	0.04	0.19	0.02
CPI-ATE	94	**0.1**	**0.2**	-0.12	**1.4**	**1.1**	**1.3**			-0.11
Norges Bank est.			0.1		1.5		*1.2*			
Imported	34	0.4	0.1	0.3	1.0	0.9	0.5	0.14	0.31	0.09
Domestic	60	-0.0	0.3	-0.3	1.4	1.2	1.3	-0.03	0.70	-0.20
Energy, housing	4	4.4	2.0	2.4	69.0	83.6	77.0	0.16	2.99	0.08
Energy, transport	2	3.3	2.0	1.3	10.0	10.9	8.5	0.07	0.22	0.03
CPI Total	100	**0.5**	**0.3**	0.2	**2.9**	**3.0**	**2.8**	0.52	3.01	0.19

Change m/m based on seasonally adjusted data (calc by SB1M)

Sum of parts does not necessarily add up to totals

Norges Bank m/m s.a. estimate is implied, calc by SB1M

- **Food** prices fell by 0.5%, and well below our f'cast. Prices are down 0.8% y/y!
- **Clothing** prices were up for the 2nd month, by 1.4% m/m, but are down 1.2% y/y
- **Furniture/hardware/equipm.** Are up 0.2% m/m
- **Transport ex. gas/airline** – fell 0.7%, we exp +0.1%
- **Airline ticket** prices rose by 2.1% m/m, we expected a larger increase over the summer. Still down 16% y/y
- **Recreation** was up 0.1% m/m, we expected +0.3%
- **Restaurant/hotel** prices are now up 4.0% y/y

- **CPI-ATE up 1.1% y/y, 0.2 pp below our expectations, consensus had 1.1% & NoBa f'casted 1.2%**

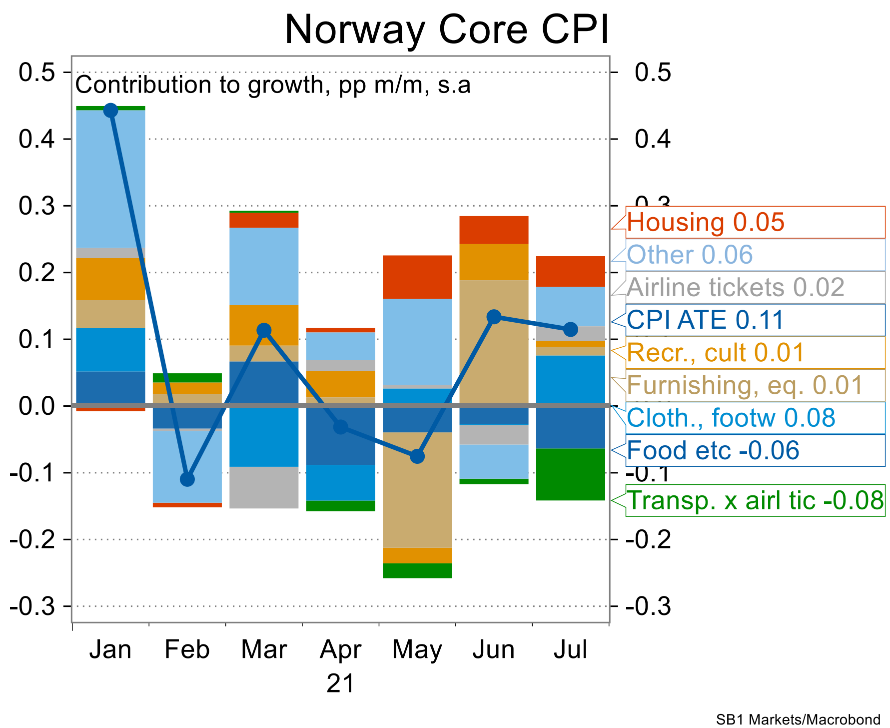
- Prices on **imported goods** was up by 0.4% m/m
- Prices on **domestically produced** goods & services were unchanged. The annual rate at 1.2% is low, according to Norwegian standards
- **Electricity** prices rose more than expected and is up 84% y/y
- **… and the headline inflation came in at 3.0%**

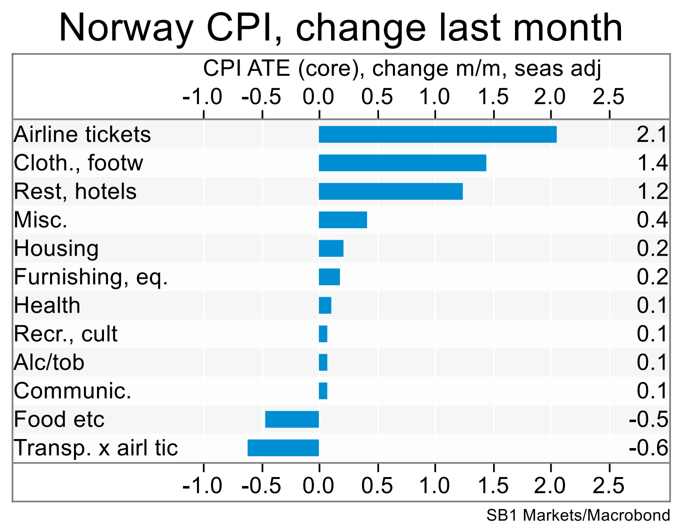
Monthly changes are seasonally adjusted by SB1 Markets. The weighted sum of the components does not necessarily sum exactly up to the total, and deviations m/m and y/y do not necessarily add up. Norges Bank m/m s.a. estimate is implied, calculated by us. Sources: SSB, Norges Bank, SB1 Markets calculations

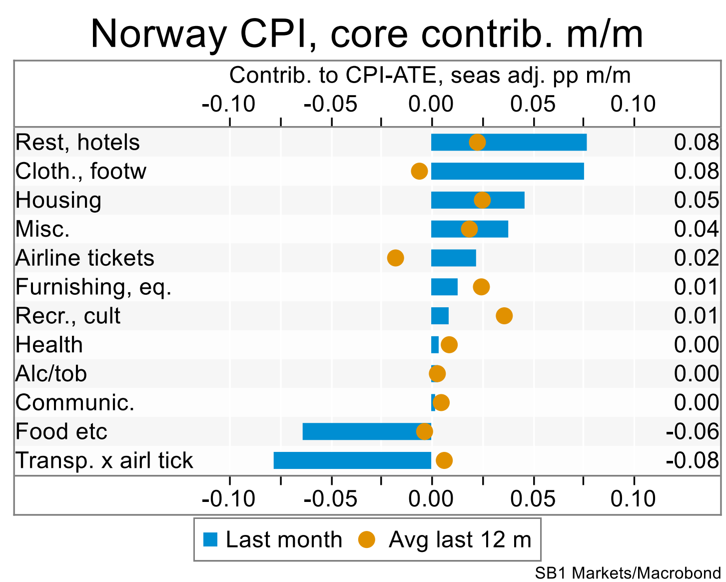
SpareBank 1 MARKETS

Food and transport (x airline tickets) prices biggest downside contributors in July

Restaurants/hotels contributed most at the upside

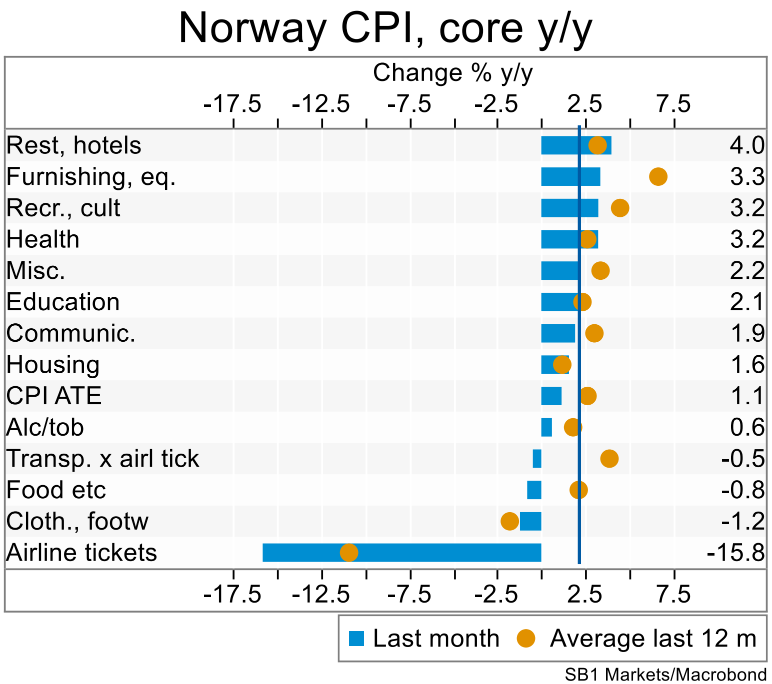


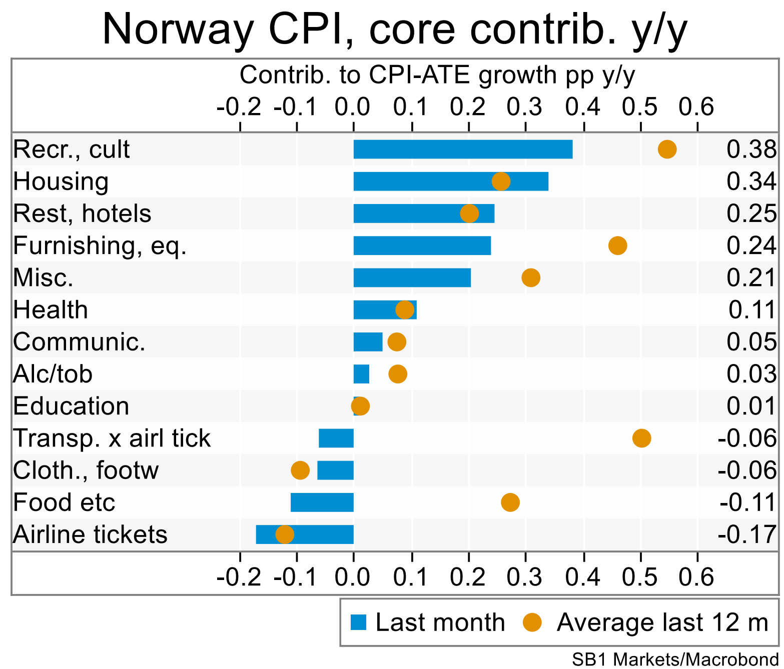




5 sectors report inflation above 2%, 2 are close to 2%, 6 clearly below

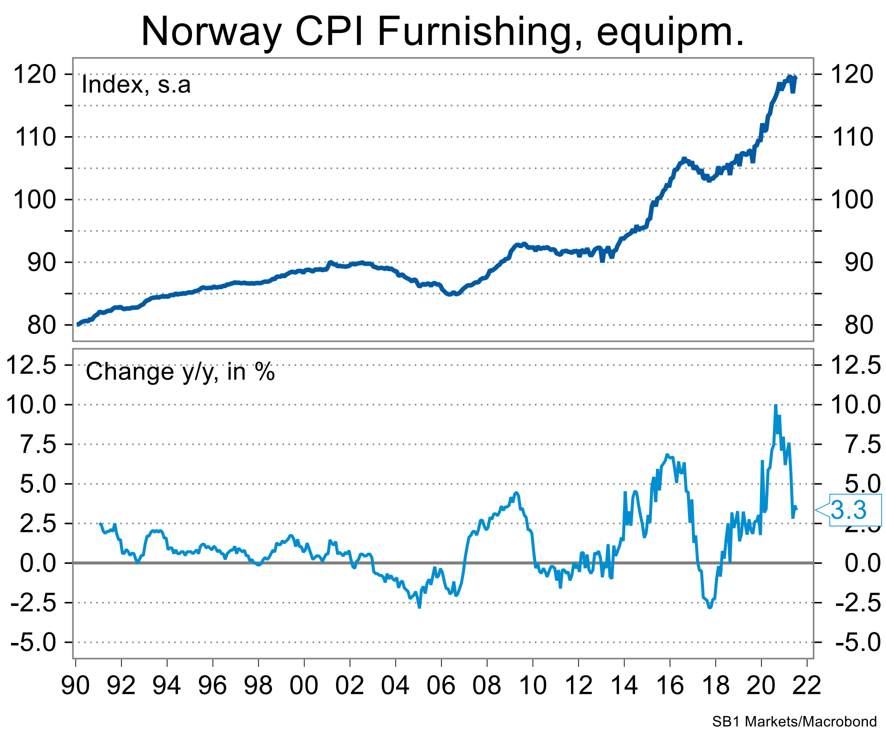
Food inflation down to -0.5%; Clothing, rents, alcohol, communication & airfares << the 2% infl. target

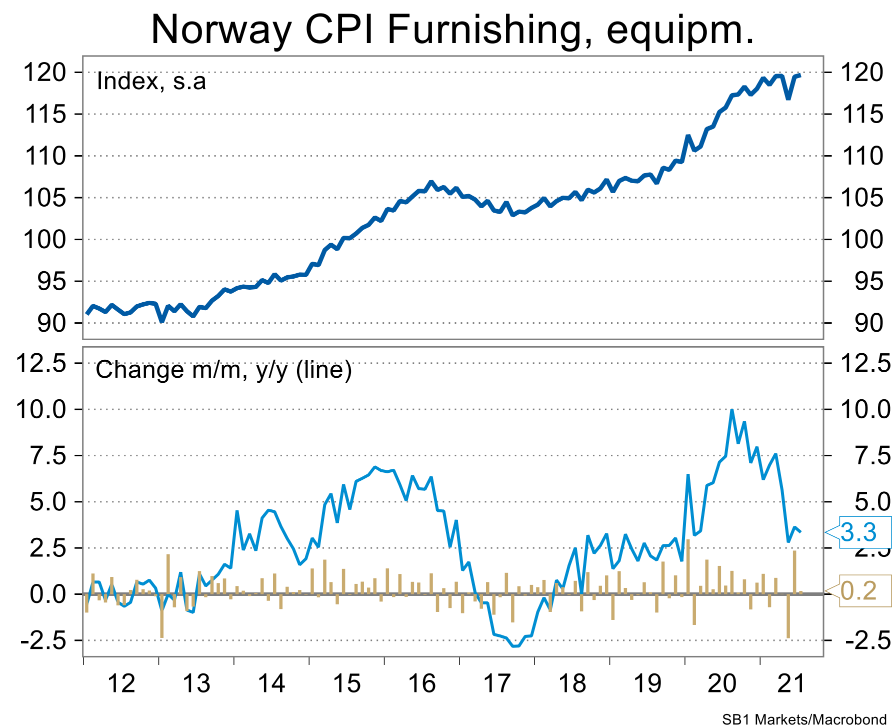




Norway

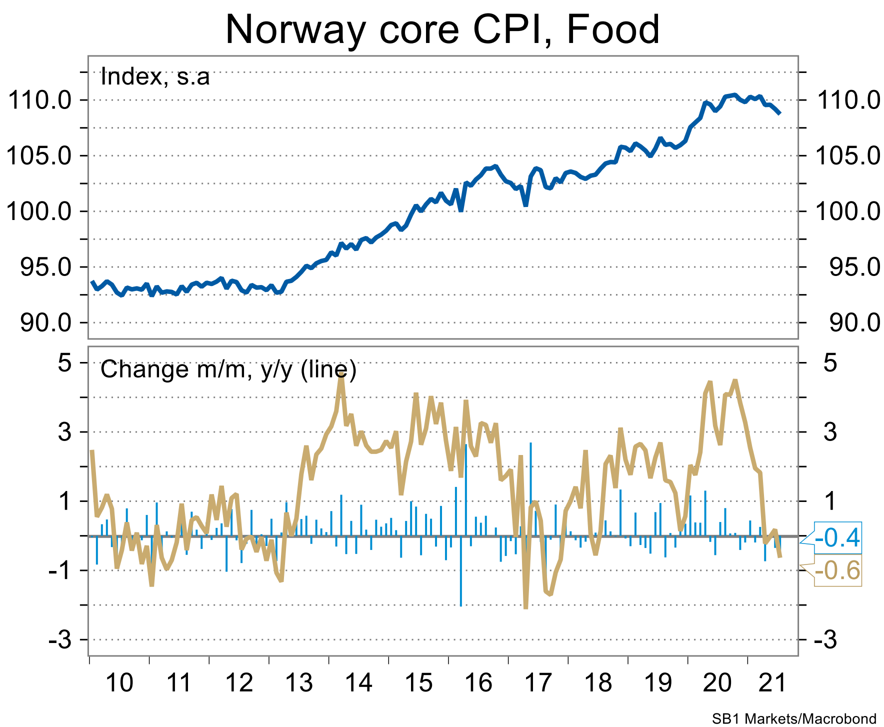
Furnishing prices up by 0.2% in July, the annual rate has fallen to 3.3% from 10%

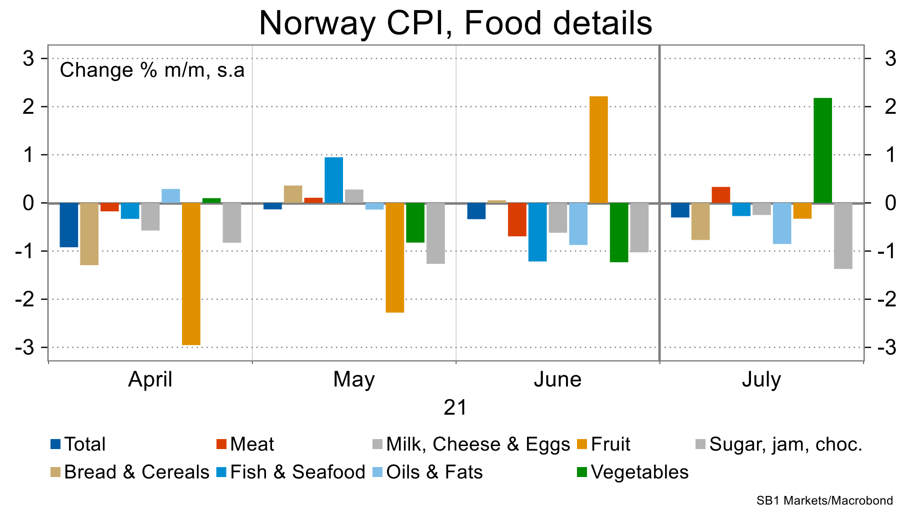


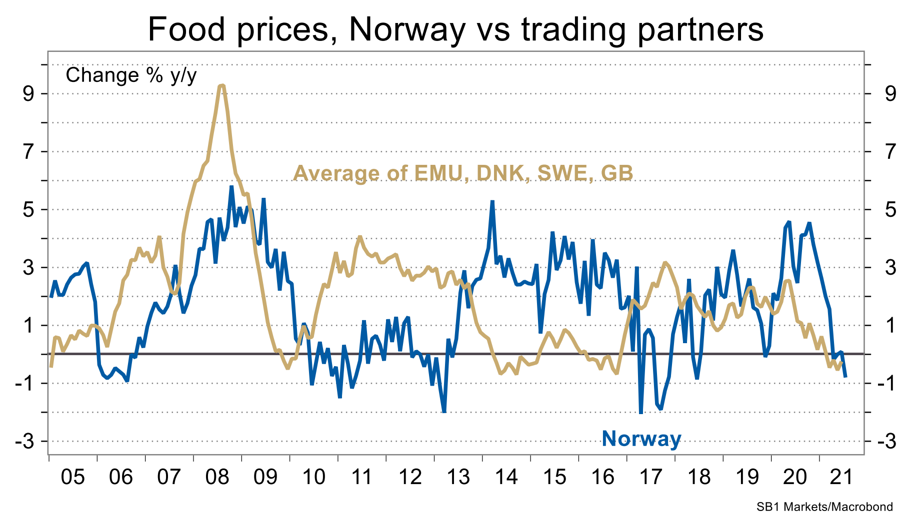


Food prices fell for the 4th month

Prices fell 0.4% m/m and the annual rate fell to -0.6%. Just as among our neighbors



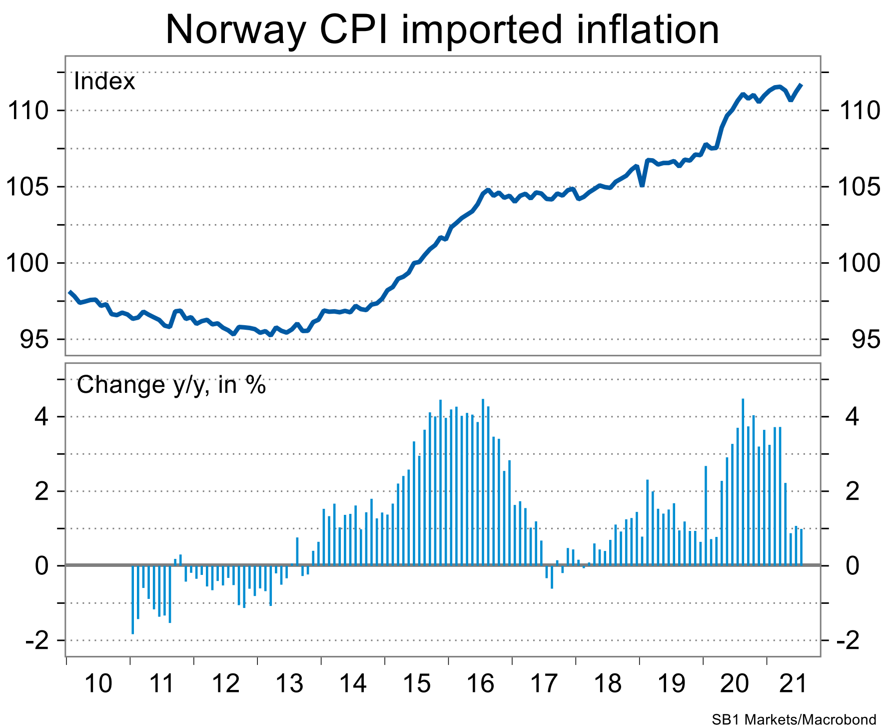


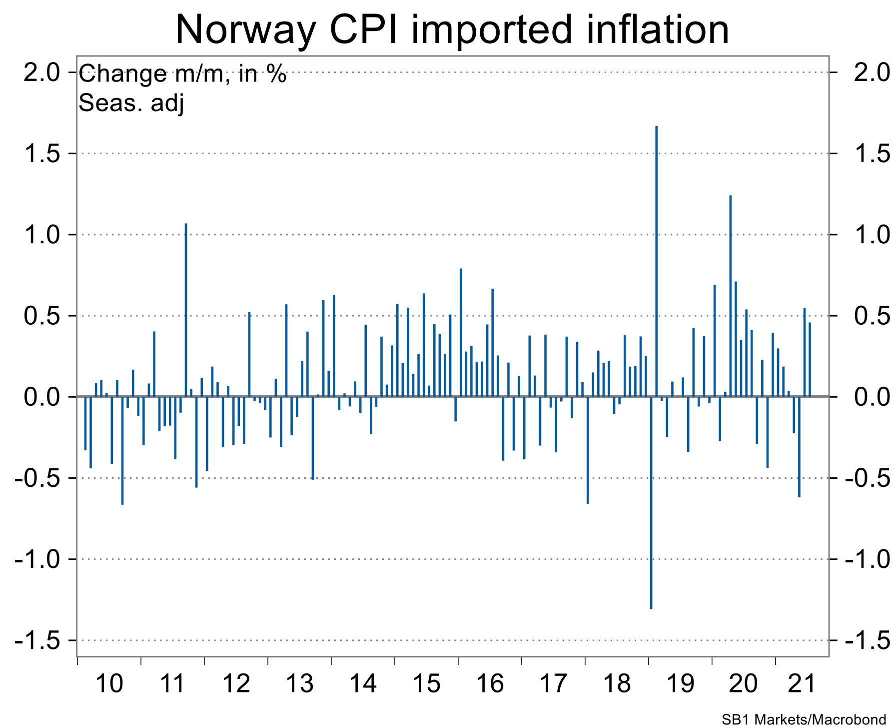


- Prices have fallen for the past four months, but the decreases in June and July were more widespread. The price of vegetables was the only area of significant price increase in July
  - » Sugars, oils and fats were down the most
- Food prices are now slowing at the same pace as in our neighbouring countries, despite lifts in some agricultural commodities

Imported goods prices have seen a small uptick the past couple of months

Annual imported inflation was 1% y/y in July – and will remain low

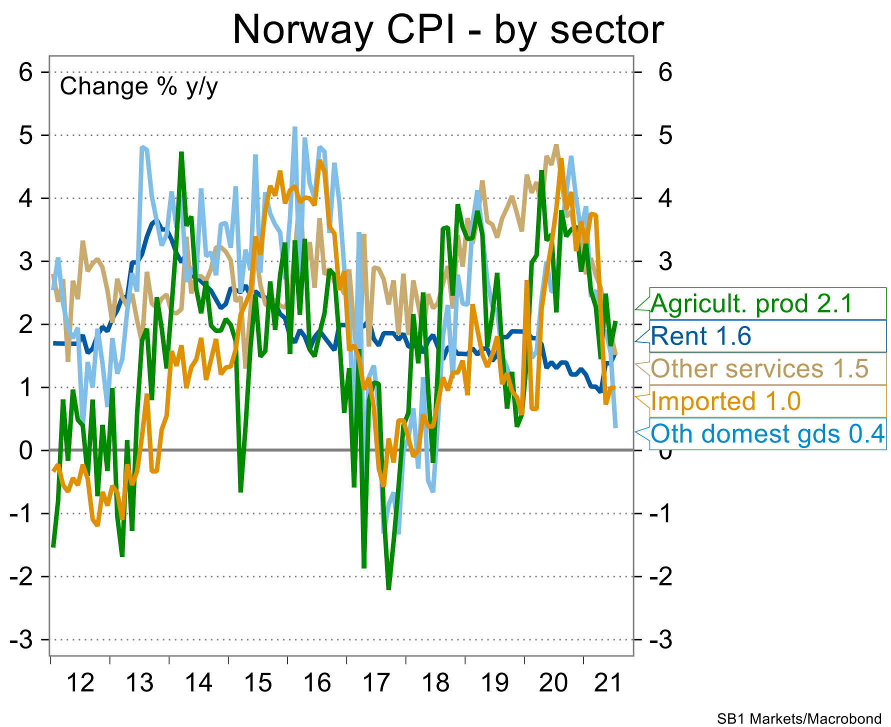


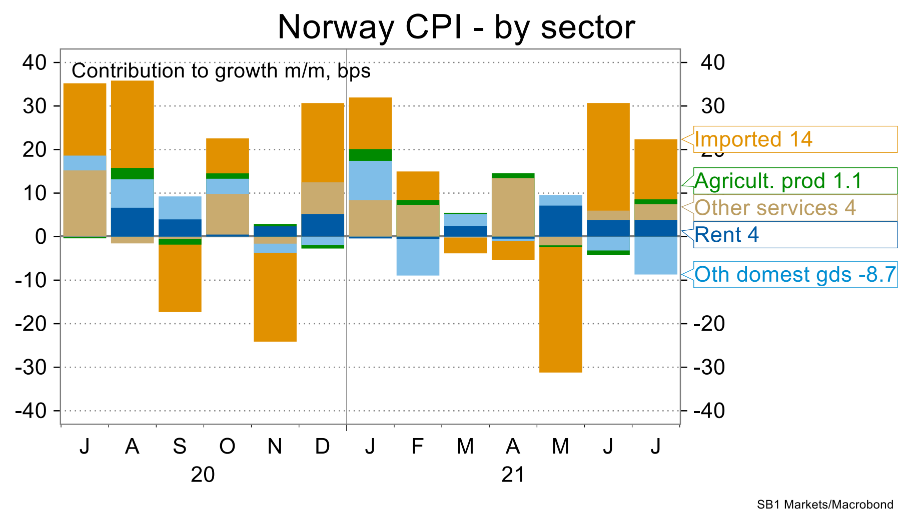


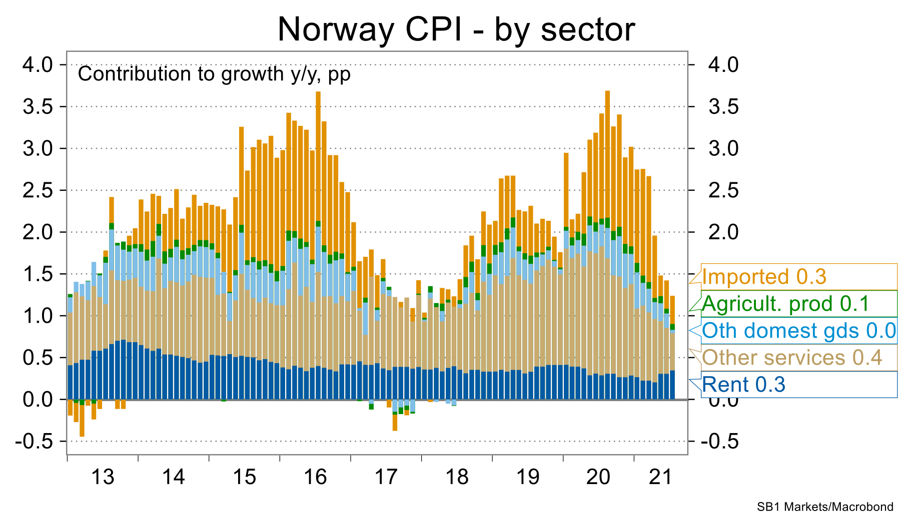
- The contribution to overall inflation in July was 0.14 pp

SpareBank 1 MARKETS

A broad decline in inflation – it is not just imported goods



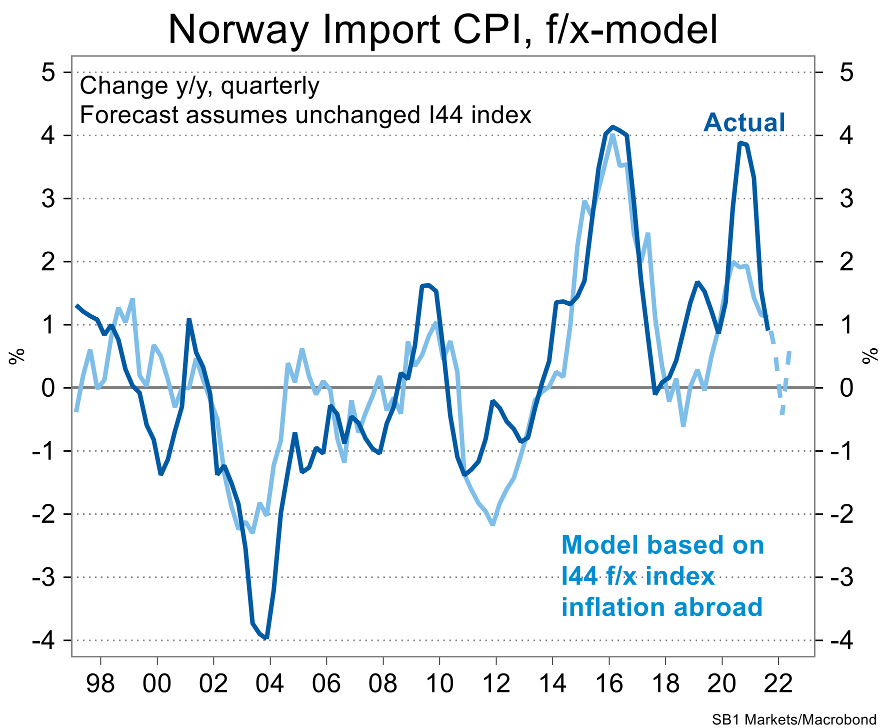


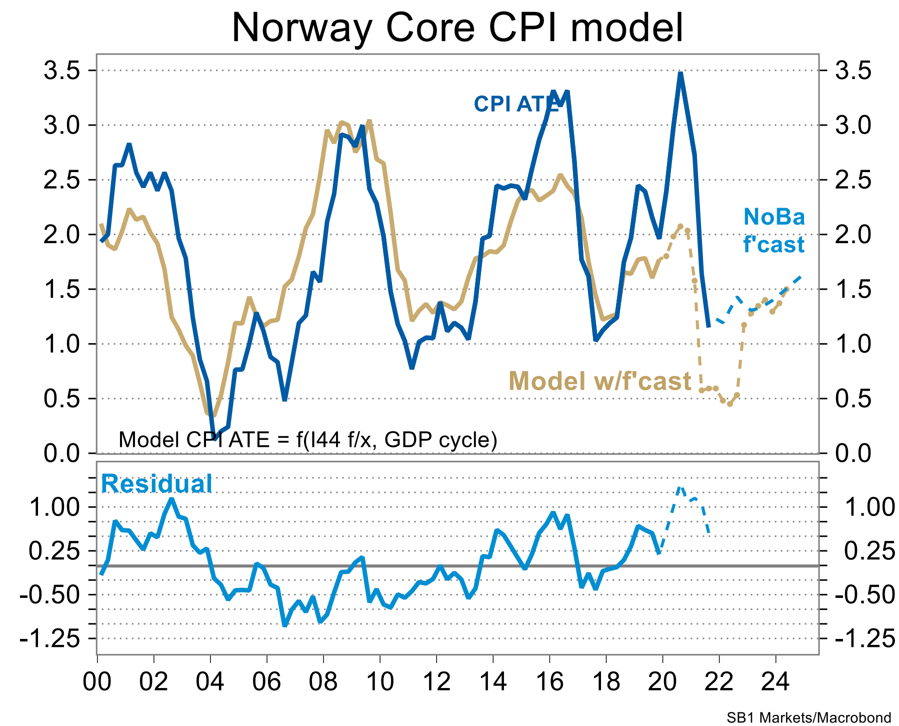


- **Domestic services inflation** has slowed sharply during the corona crisis, and not just only the cheaper airline tickets
  - » We expect some reversal the coming months
- **Rent inflation** has slowed but has picked up marginally past three months

Imported goods prices: Finally on the way down

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

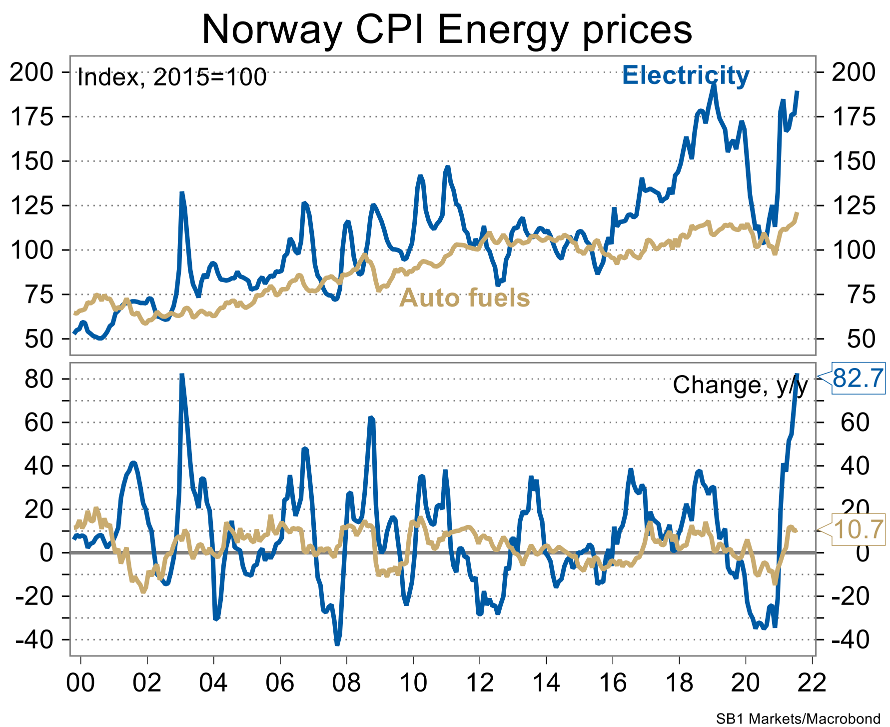


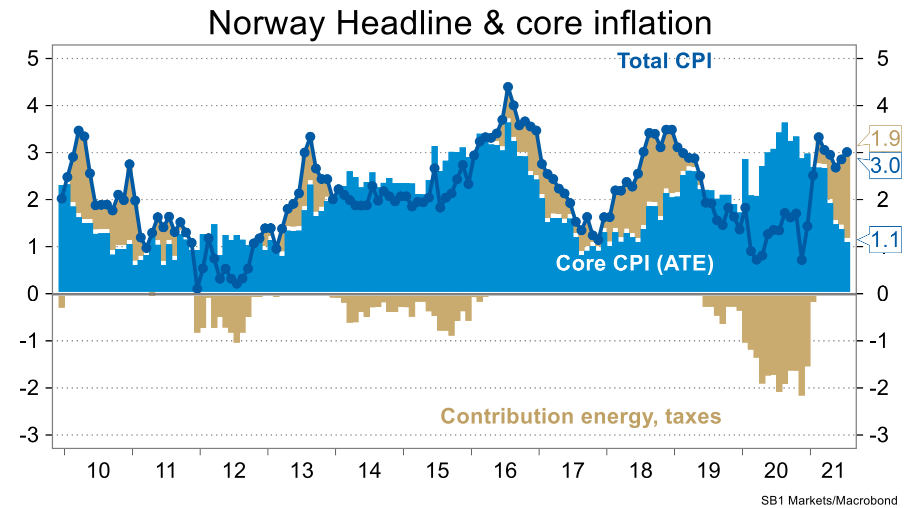


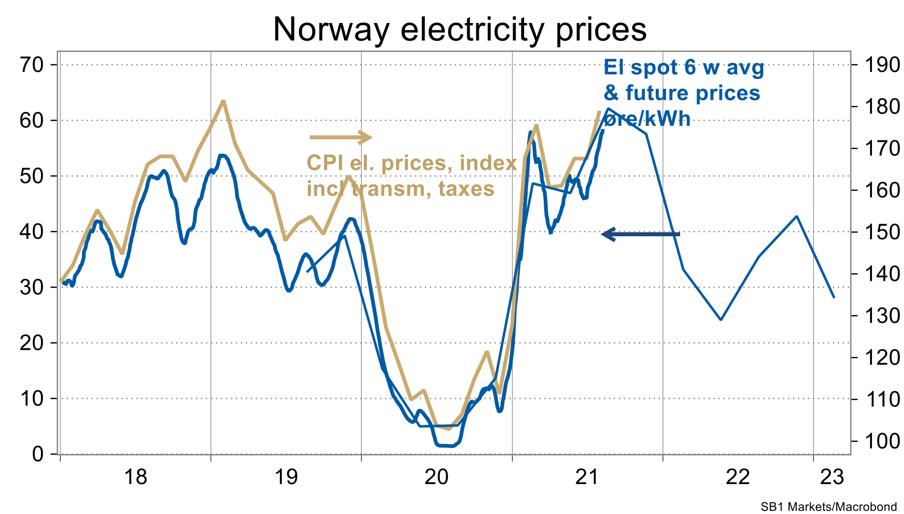
- **The NOK steep depreciation** in early 2020 no doubt drove **imported inflation** up last year. Closed borders/supply chain challenges due to Covid-19 may have contributed to the lift in import prices too, and more importantly: the strong growth in demand for some goods (like sport equipment/furniture)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

Electricity prices sharply up y/y, and further up in July

Electricity prices are adding 3 pp to total y/y inflation



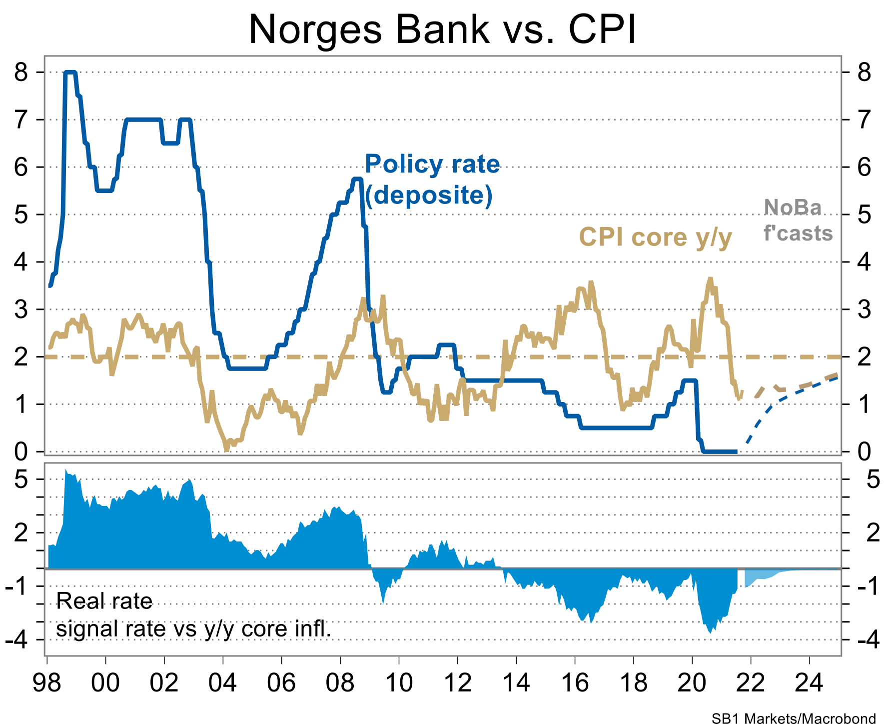


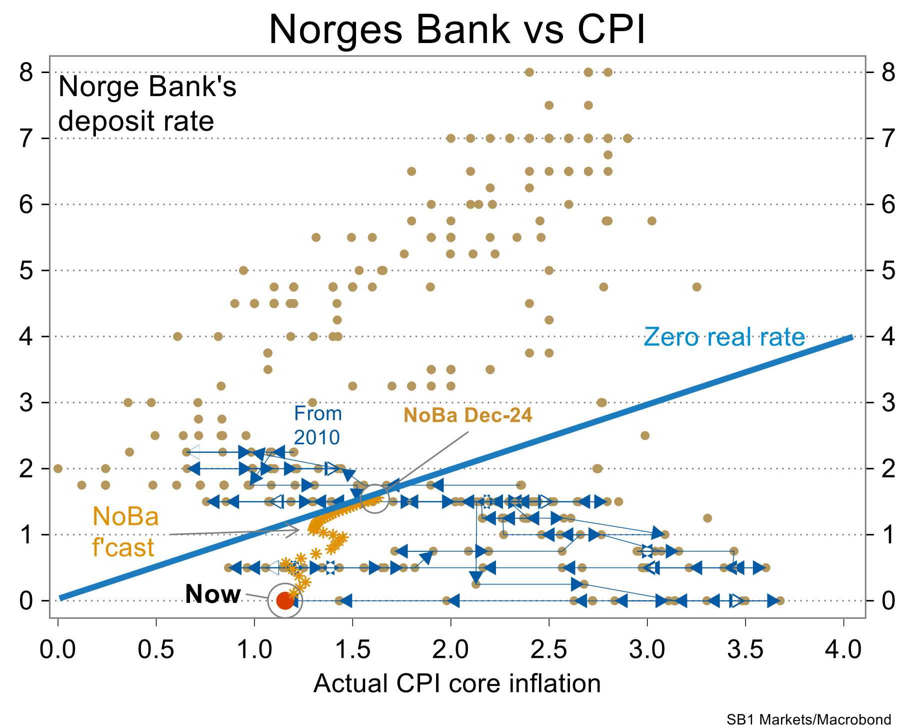


- Electricity prices are volatile, and explains much of the volatility in headline Norwegian CPI
- Last year electricity prices collapsed alongside oil prices. Now both have recovered – which pushes CPI up by 3.2 pp (with a small contribution from gasoline prices)
- Electricity futures signal higher spot prices the coming months – and a substantial decline next year

Norges Bank has not been an inflation nutter (since 2010, at least)

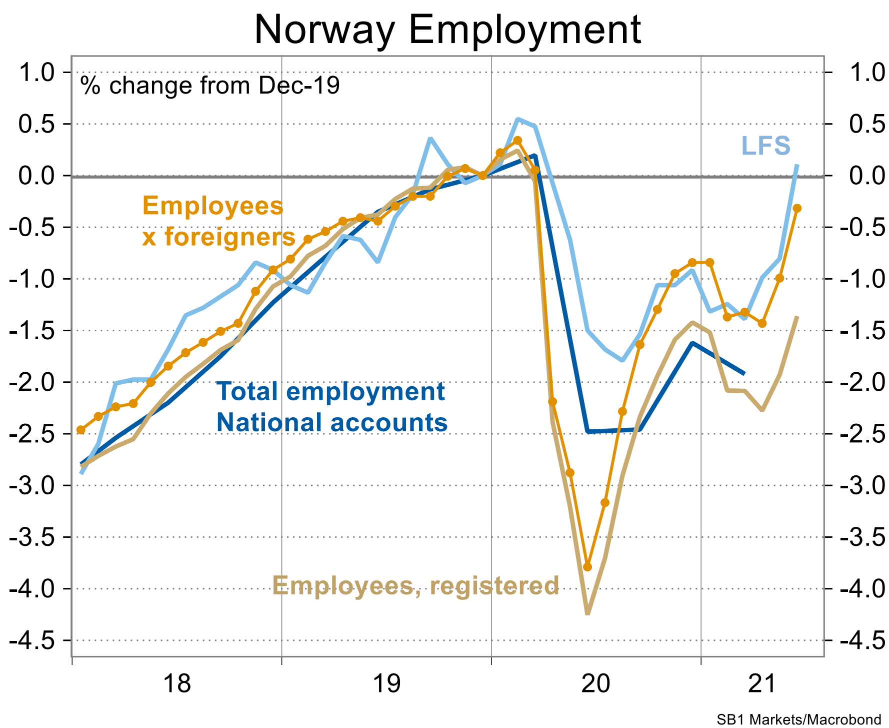
Actual inflation has not been correlated to interest





Register employment data confirms the strong LFS employment report

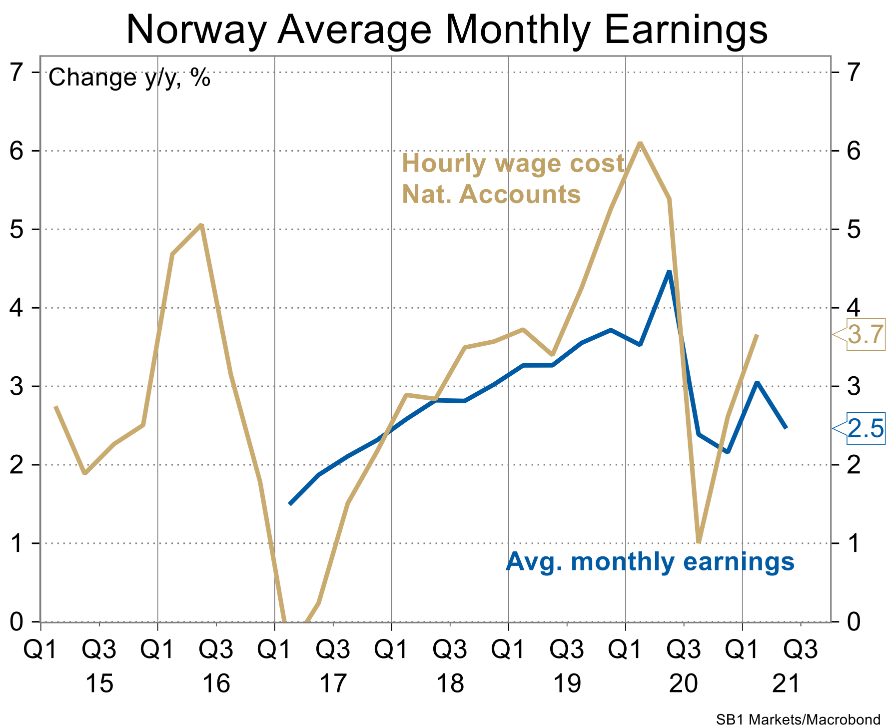
The no. of employees rose by 0.8% m/m in June, but remains 1.4% below Dec-19 level. However…

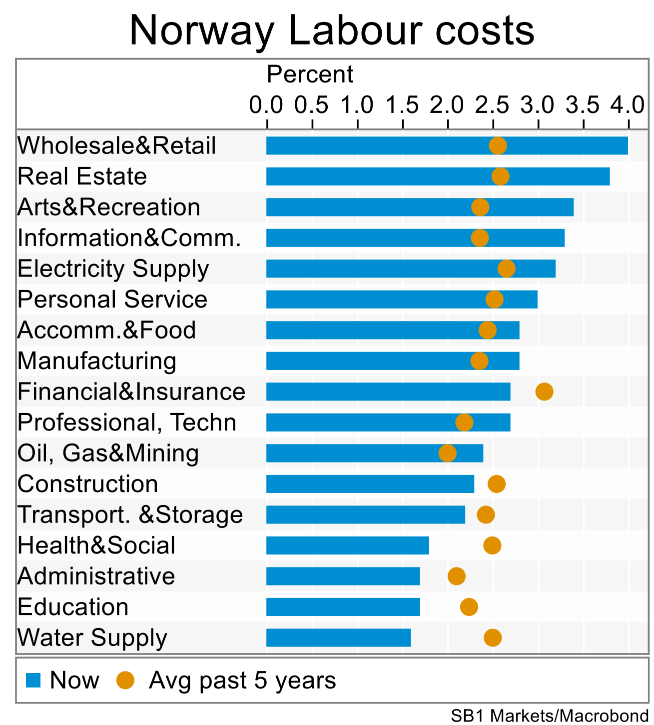


- … **excluding foreign workers** on short term stay (not immigrants) the no. of employees (living in Norway) is just 0.3% below the pre-pandemic level
- **The LFS** (survey) employment data are more volatile than other measures. In May (avg April – June) LFS employment rose 1.6% vs. February, and it was up 0.1% vs. Dec. 19 (and 0.4% below the Feb-20 level)
- **National Accounts** will report Q2 data this week. These data includes foreign workers on short term stay, as well as self employed
- **Average monthly wages** are up 2 – 2.5% y/y – no signs of higher wage inflation (check next page)

Wage inflation is not accelerating

SSB reported average monthly wage earnings up 2.5% y/y, in line with growth the prev. 3 quarters

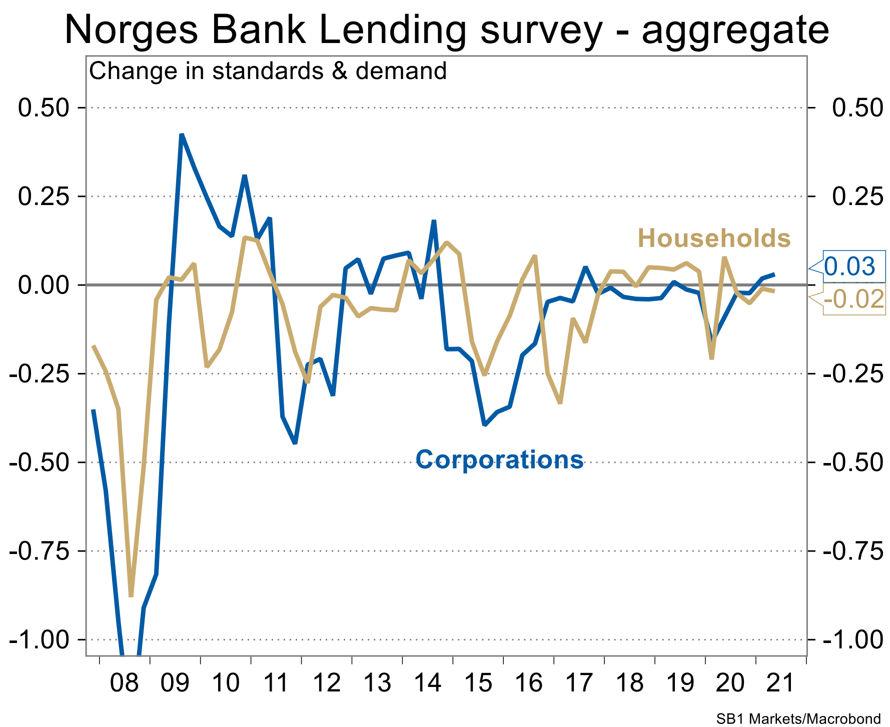


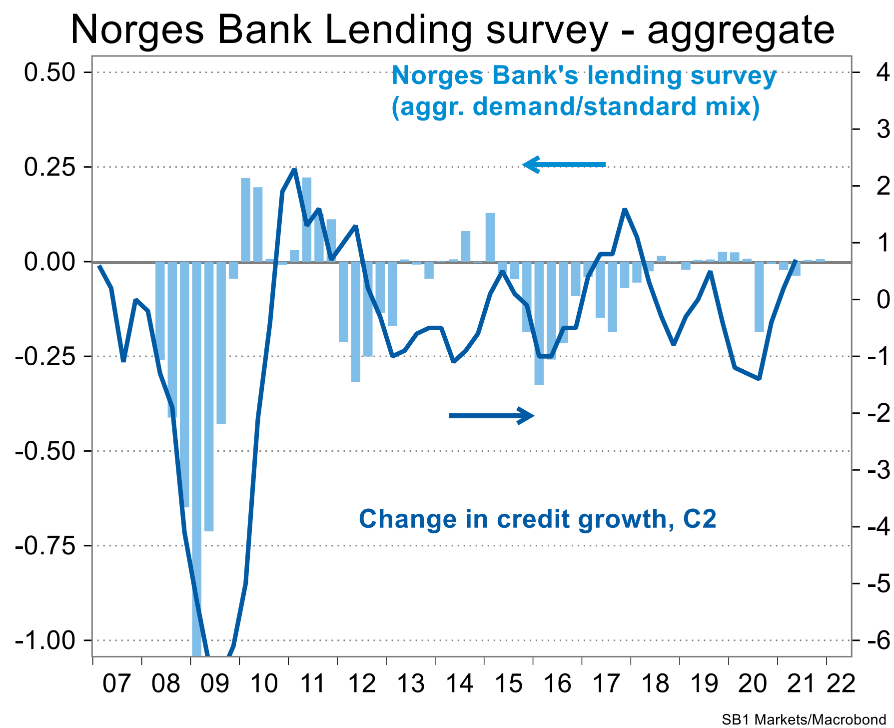


- Monthly earning have accelerated from a 2.6% pace one year ago
  - » At the chart above, we have not smoothed the Nat.Acc. Hourly wage cost, as on the previous slide (yielding a 3.5% rate)
- Labour costs are accelerating in most sectors, with accommodation & food in the lead. The data above are from Q2

Bank lending survey indicates no change in credit standards or demand

NoBa's Q2 survey signal close to normal demand for loans, and no expectations of future changes

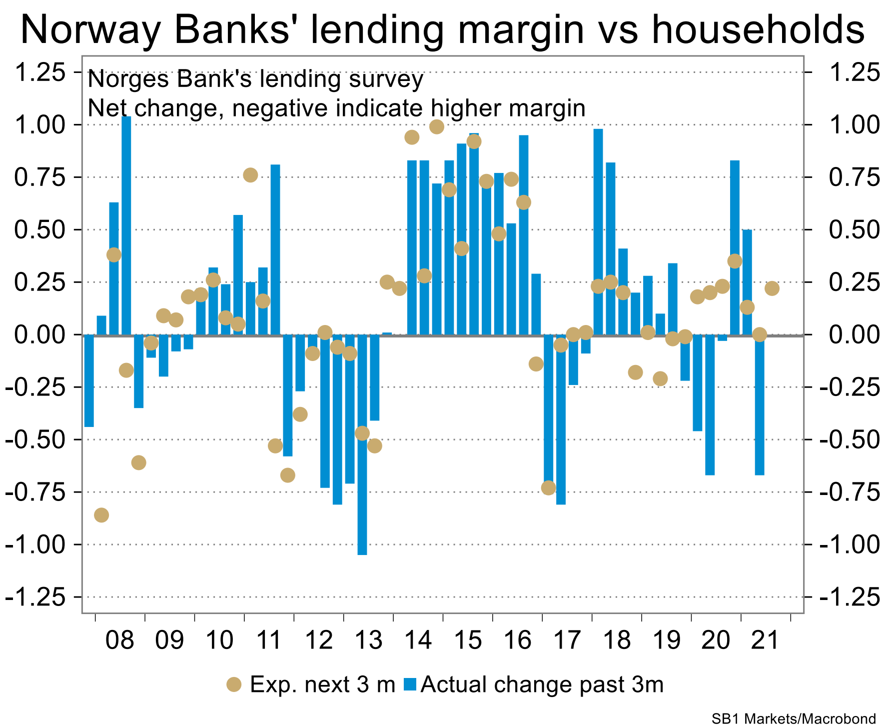


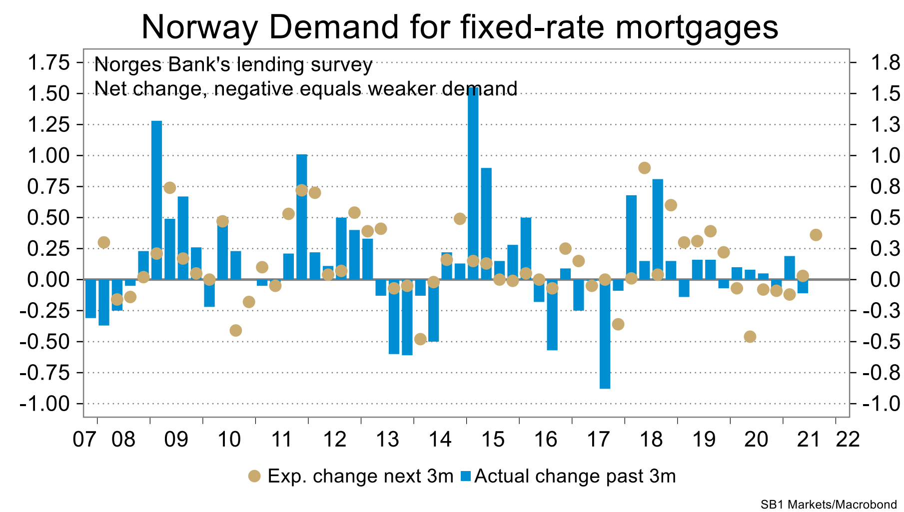


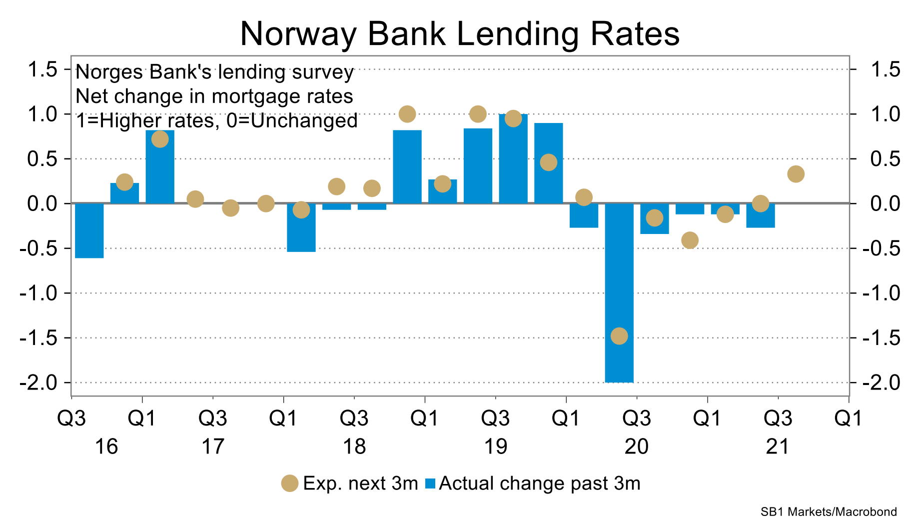
- There was virtually no change in demand nor lending standards for corporate credit, and banks do not expect any changes in Q3 either. However, margins were lower in Q2 and are expected to fall further in Q3
- Also, banks are not expecting any changes to demand or lending standards in Q3
- Lending margins to households increased in Q2, but are expected to fall in Q3

Data in this section are seasonally adjusted

Banks increased their lending margins in Q2, expect tighter margins in Q3



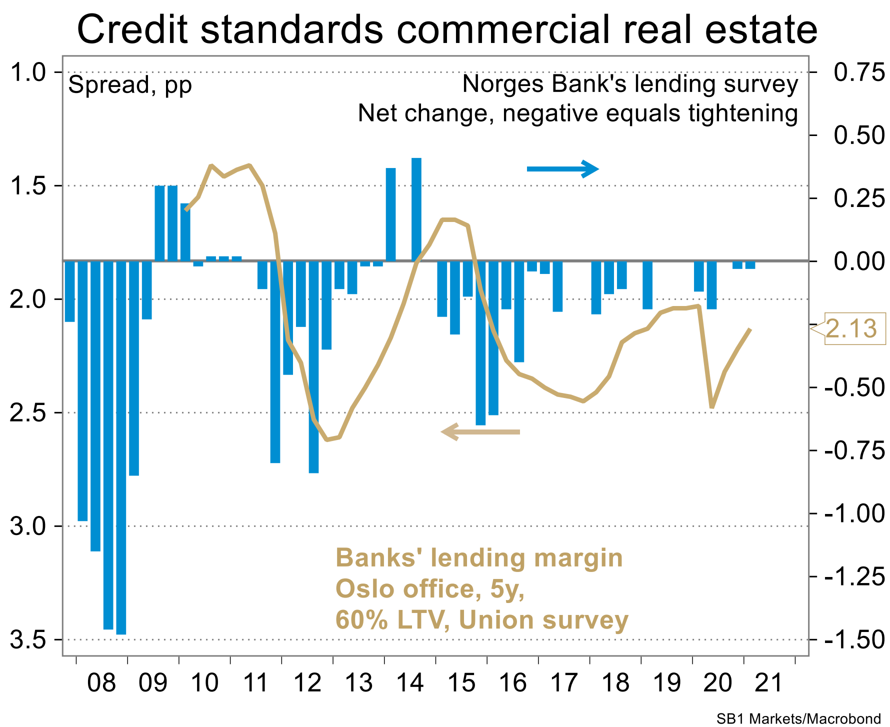


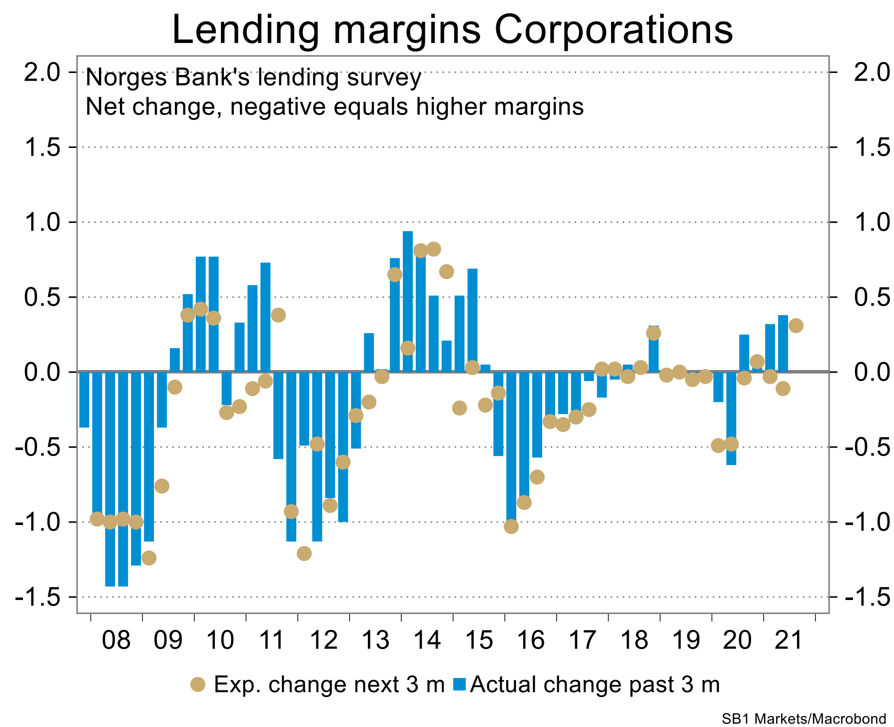


- No demand for fixed-rate mortgages, of course

Real estate loan standards flat, margins too, according to banks

Lending margins to corporations were lower in Q2 and are expected to decline further in Q3

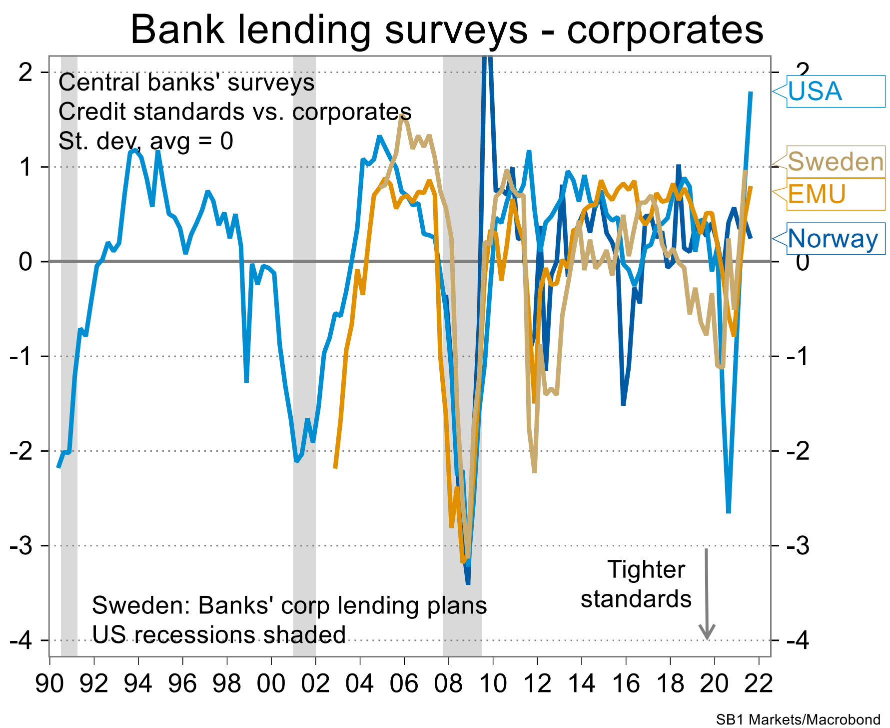


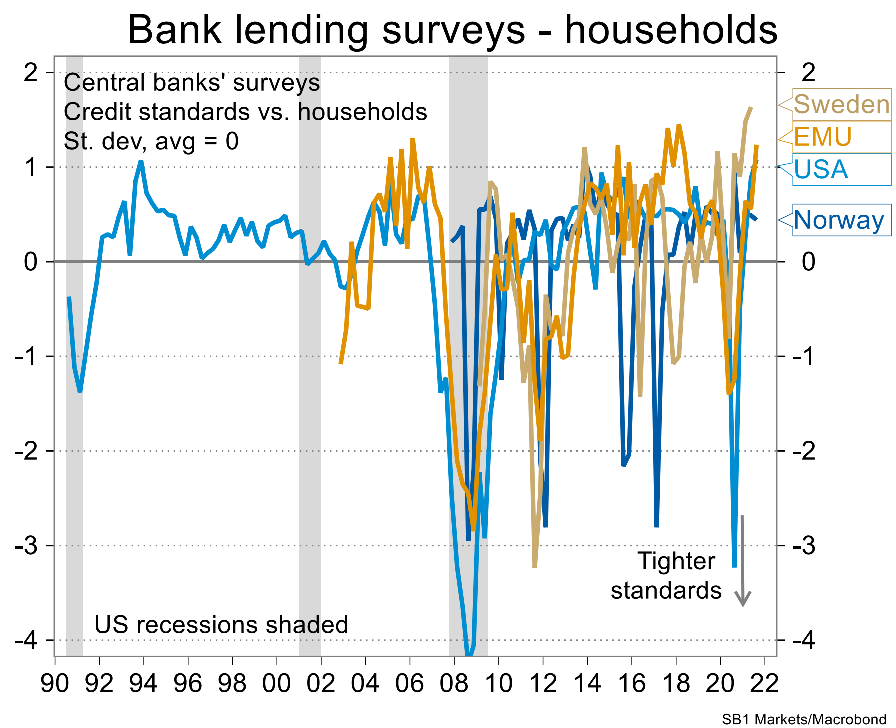


SpareBank 1 MARKETS

Global view: Risk on, banks in large parts of the world are loosening policies

Norwegian banks a little less so…

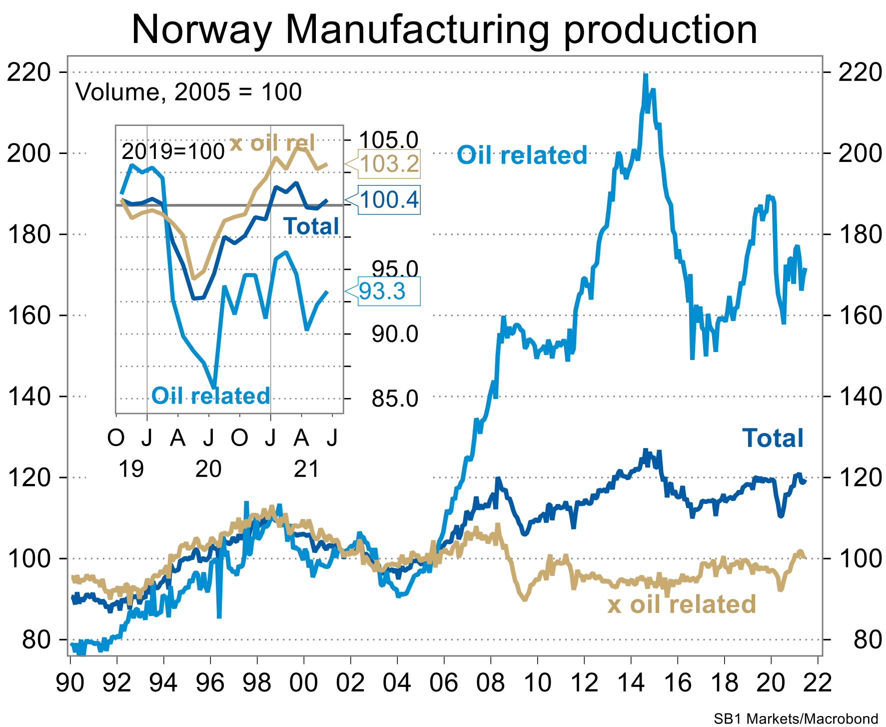


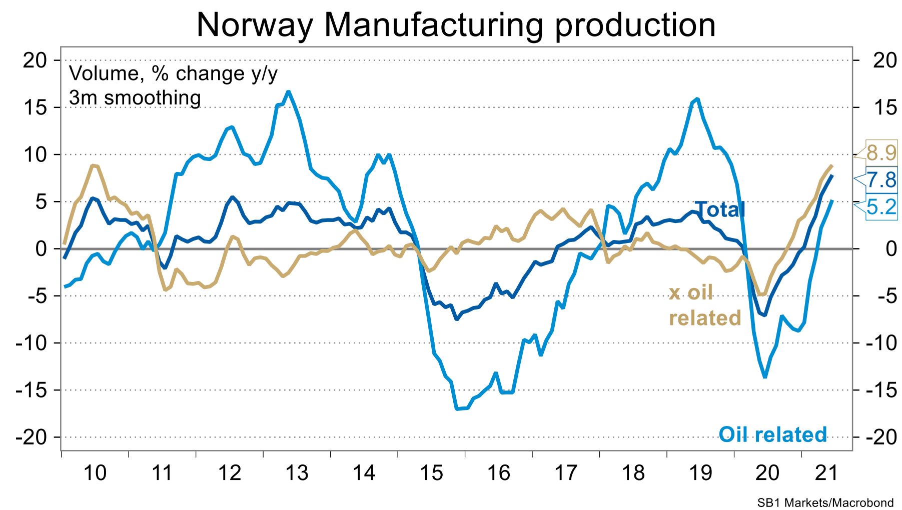


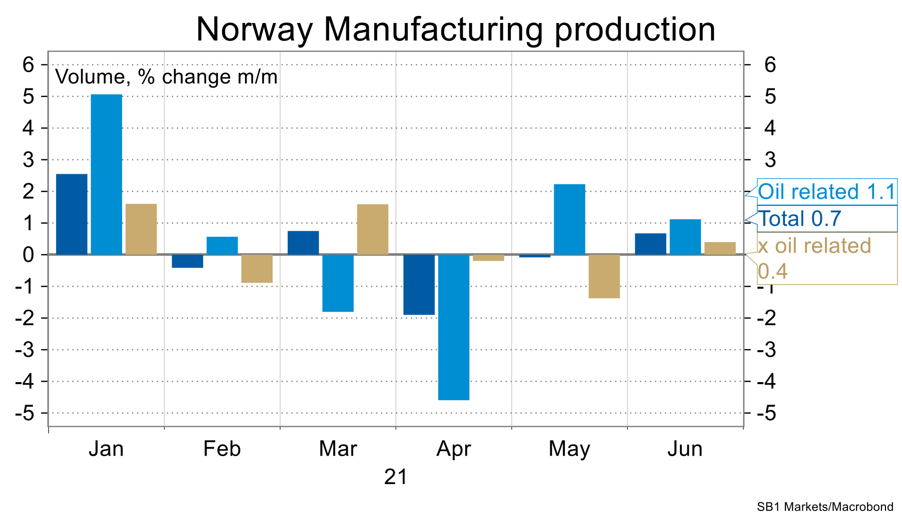
- **US banks** are signalling loosening standards, and quite a bit towards the corporate sector. Credit spreads in the corporate bond market are among the lowest past two decades
- **European banks** are also reporting an easing vs both households and businesses
- **Swedish banks** are reporting easing standards vs. households and no change vs businesses

Manufacturing production rebounded in June

Total production up 0.7% m/m in volume terms (spot on our estimate), oil related up 1.1%



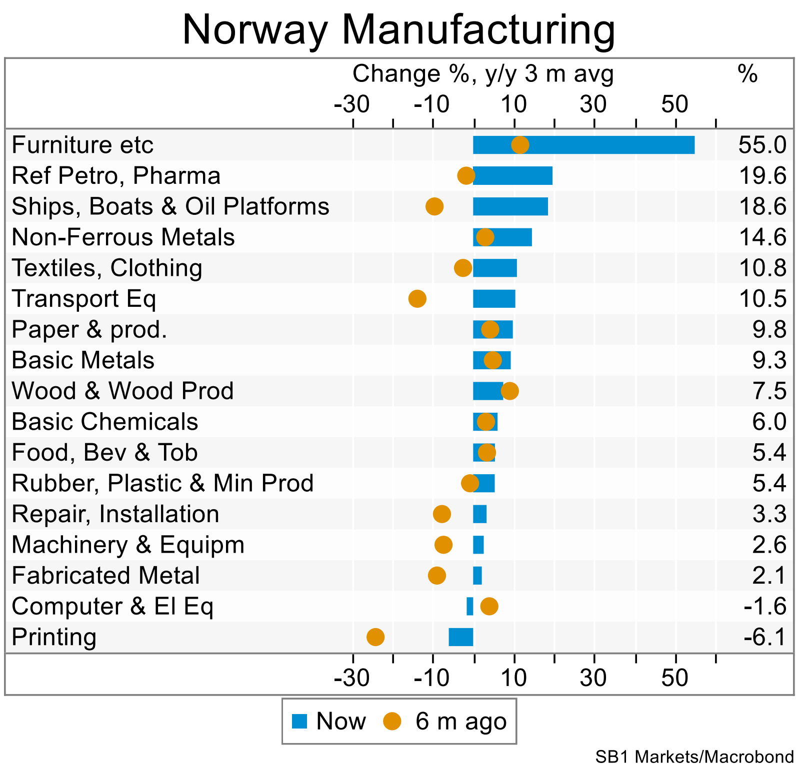


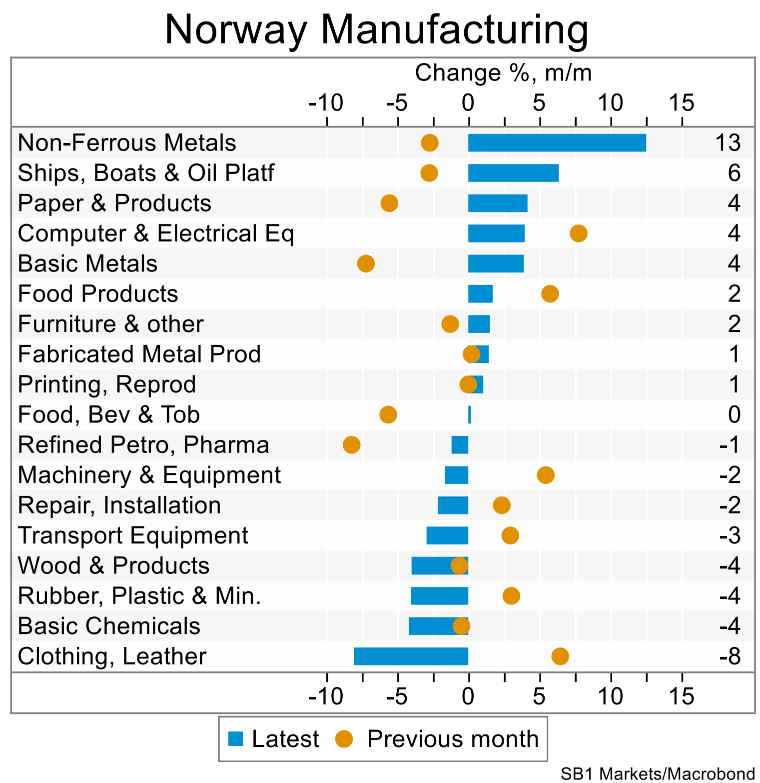


- Production rose by 0.7% in June, after falling by 0.1% in May
  - » Oil related manufacturing production rose by 1.1% other sectors were up 0.4%, mostly due to metals, ships and platforms
- As manufacturing surveys are signalling strong growth in activity, we expect decent production numbers the coming months
- Production x oil related sectors are well above the pre-pandemic level, a the peak level the past 12 years

Mixed between sectors m/m, and now 15 of 17 are up y/y (from a low level last spring)

50% of the sectors are up m/m

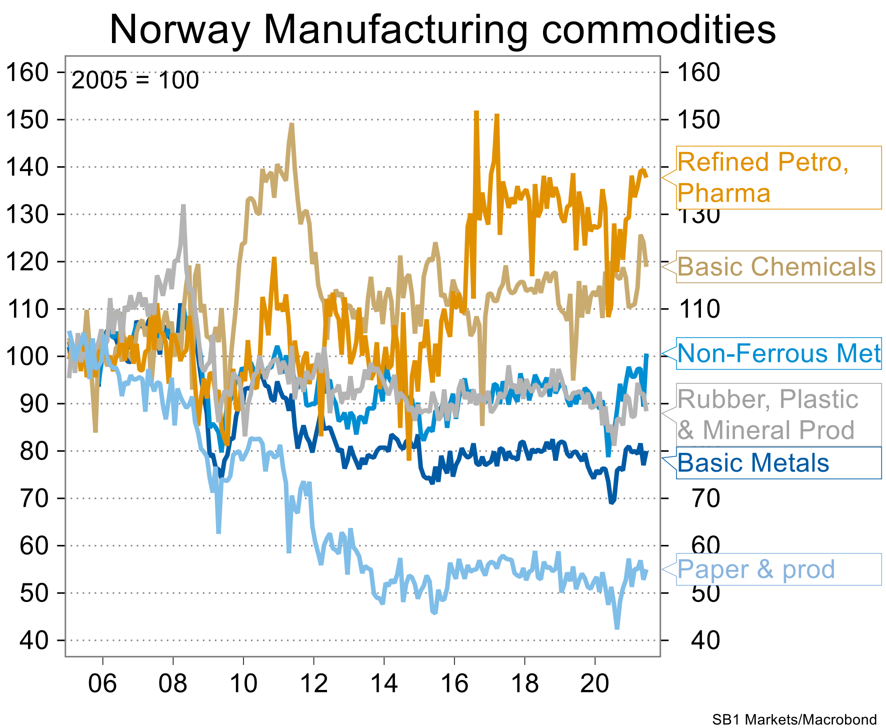


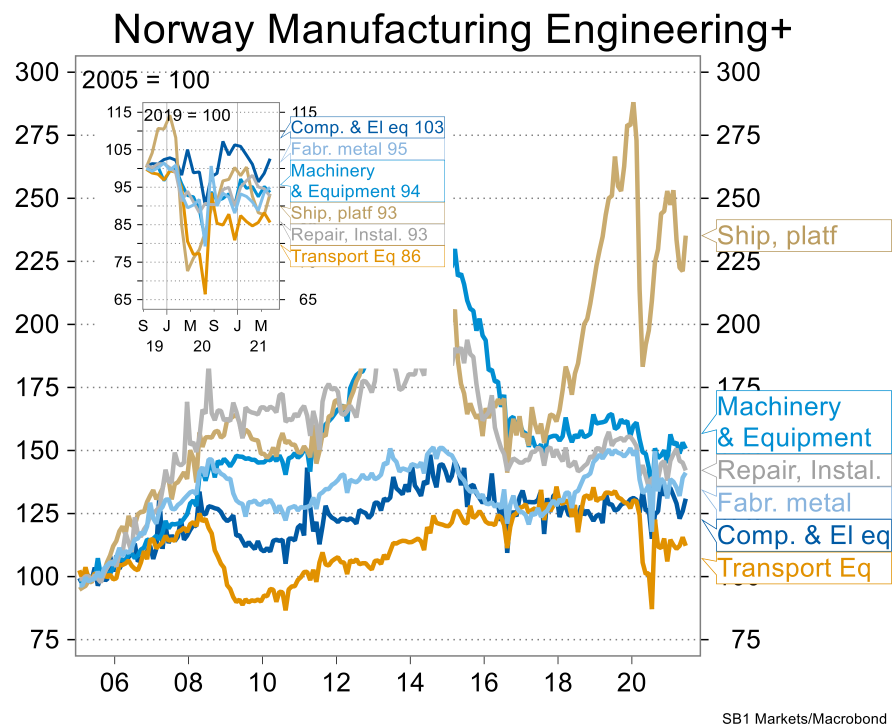


SpareBank 1 MARKETS

Metals stronger in June, chemicals weaker

Engineering (and oil related) industries are still operating below normal levels – though up in June

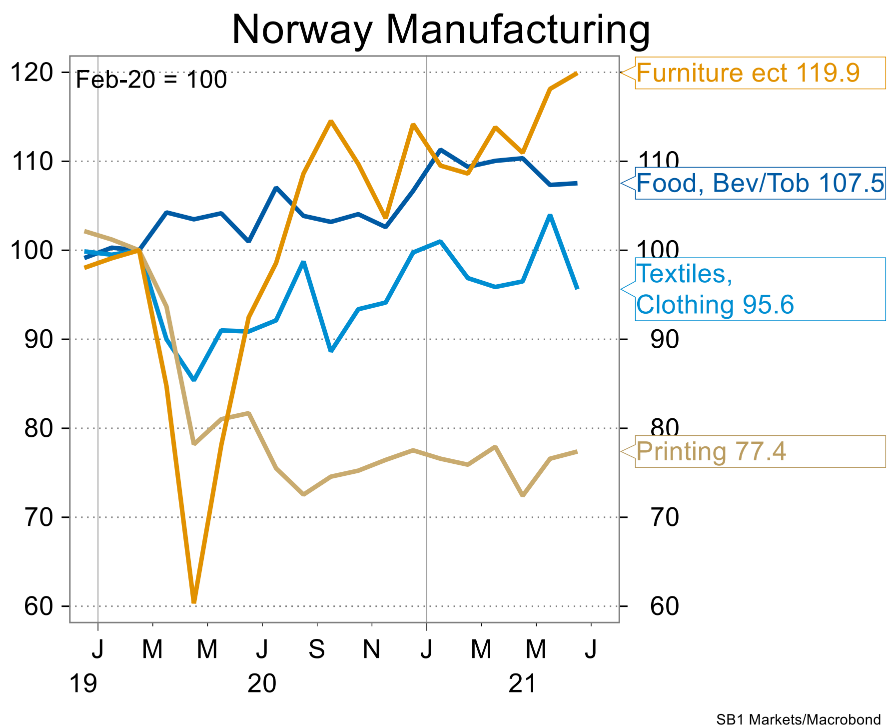




- **Production of ships & platforms** was incredibly strong in 2018/19, then fell 30% in H1 last year but has now recovered sharply since last summer
  - » Corona measures (lack of foreign labor, contacts with foreign vendors/customers), supply chain challenges probably explained parts of the recent drop
- **Commodities** are on the way up, and were strong in June

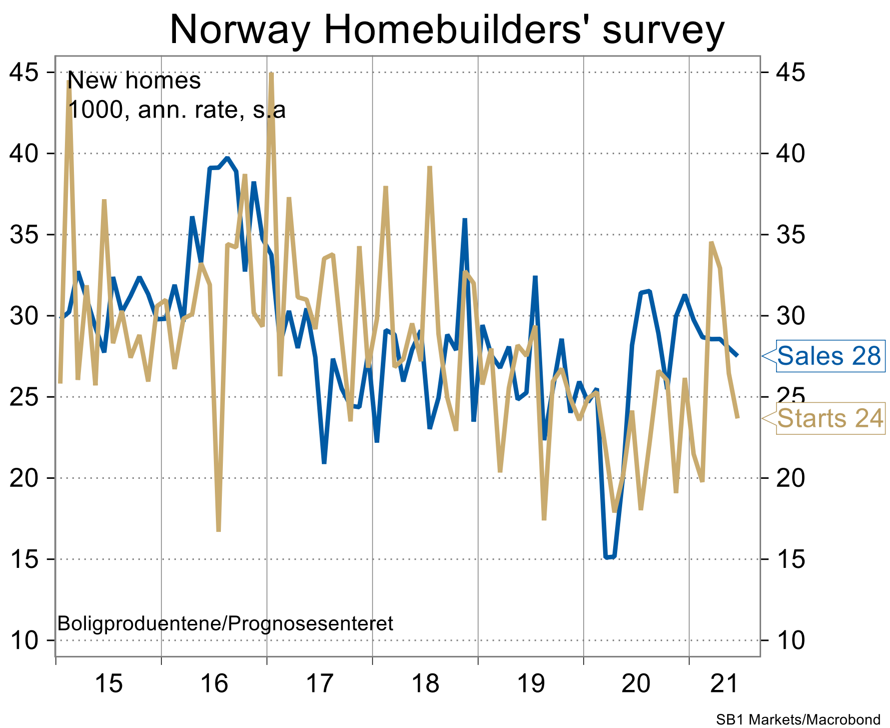
Furniture production up 20% vs pre corona!

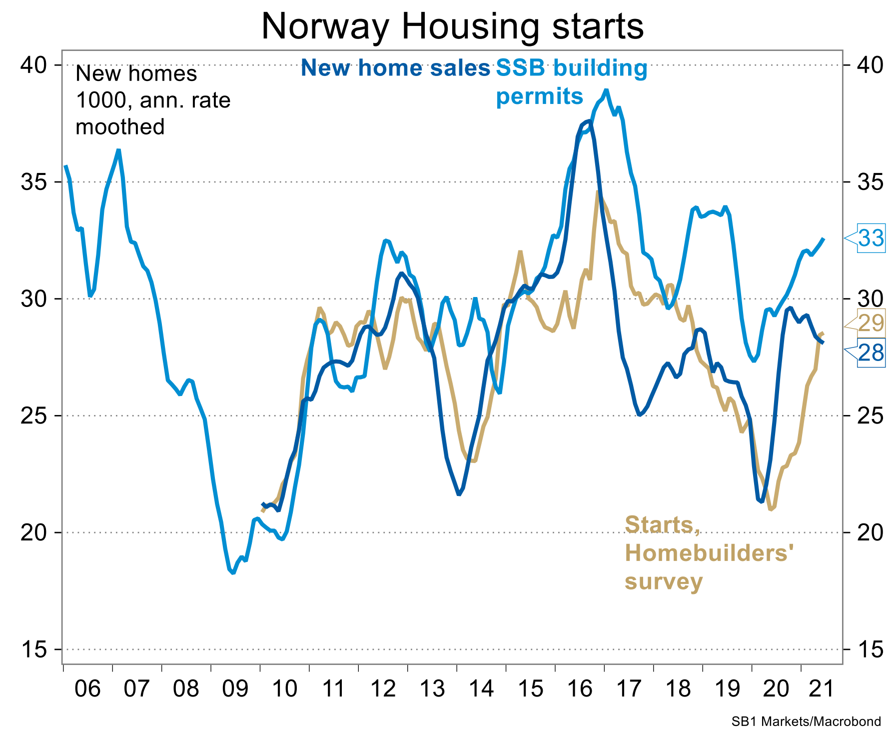
Food production is supported by closed borders, + 8%



New home sales are sagging somewhat, volatile starts are trending up

June sales at 28’ are still at at ‘normal’ level. Starts at 24’ below par but recent months are OK





- Both **sales and starts** have recovered from the sharp downturn in March/April last year, which ended the gradual decline since 2017. Activity is now well above the 2019 level
- Homebuilders report of some delays in projects due to travel restrictions for foreign workers and thereby lack of trained personnel
- In addition, increasing lumber prices is also a concern, at least for detached & semidetached houses
- SSB is still reporting an upward drift in building permits, which also includes student homes, as well as nursery homes

Highlights

The world around us

The Norwegian economy

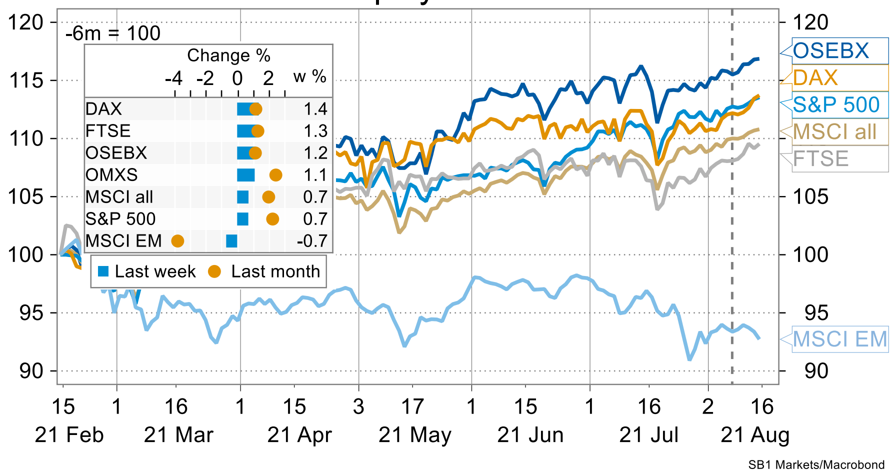
Market charts & comments

SpareBank 1 MARKETS

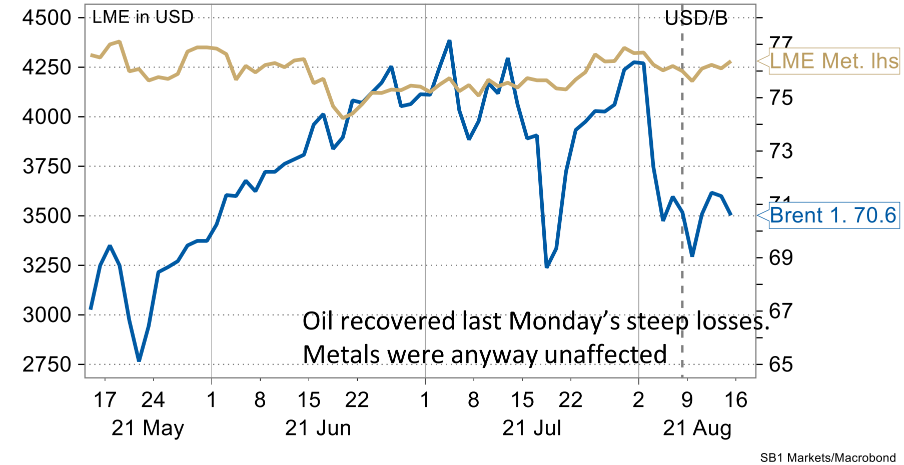
EM equities down, others up, several new ATHs. Oil, metals slightly up

Bond yields mostly up, but US down. NOK finally the winner. From a low level, though

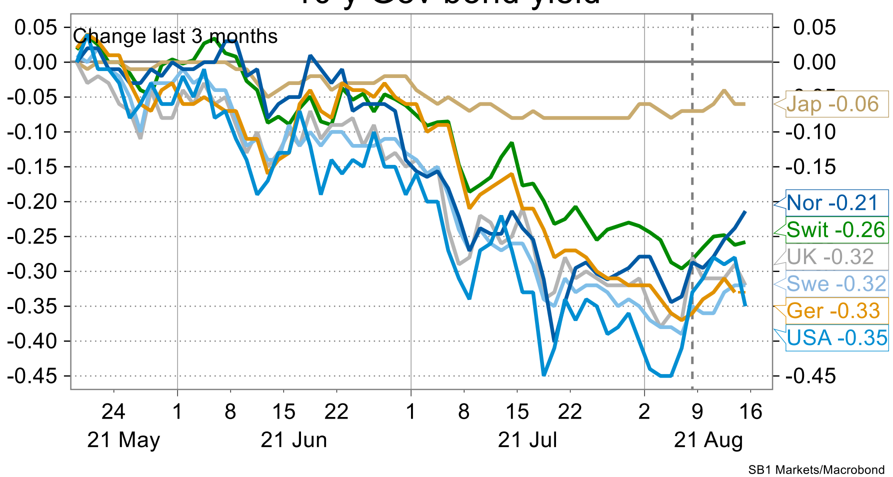
Equity Indices



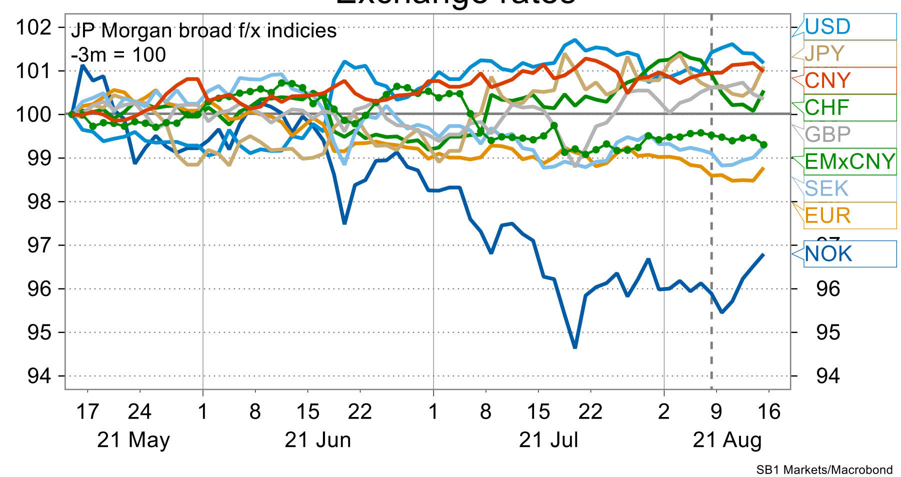
Oil vs. metals



10 y Gov bond yield

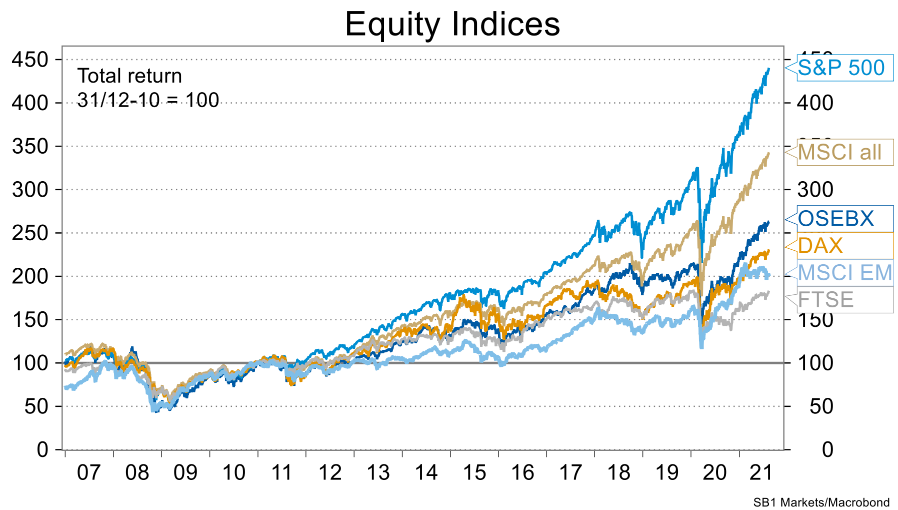


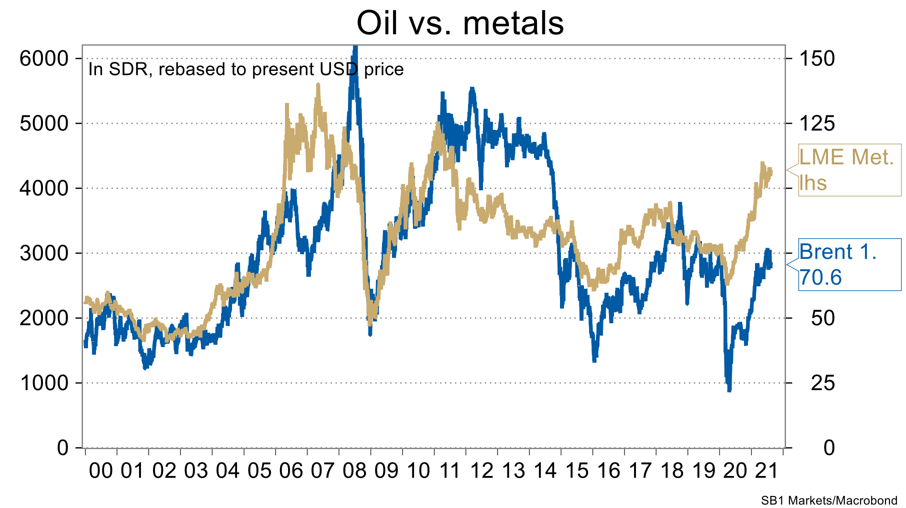
Exchange rates

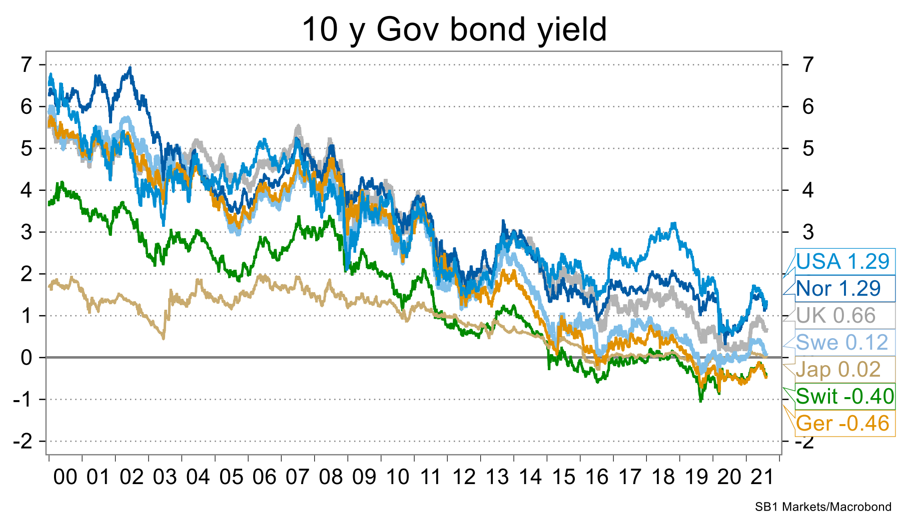


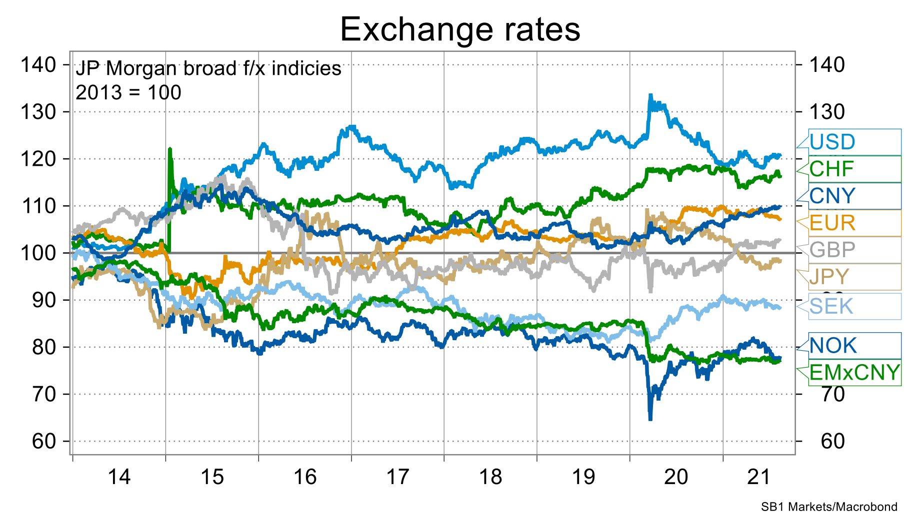
The big picture: Strong stock & commodity markets

Still, yields are heading down everywhere. The CNY is steady climbing, other EM f/x & NOK weak



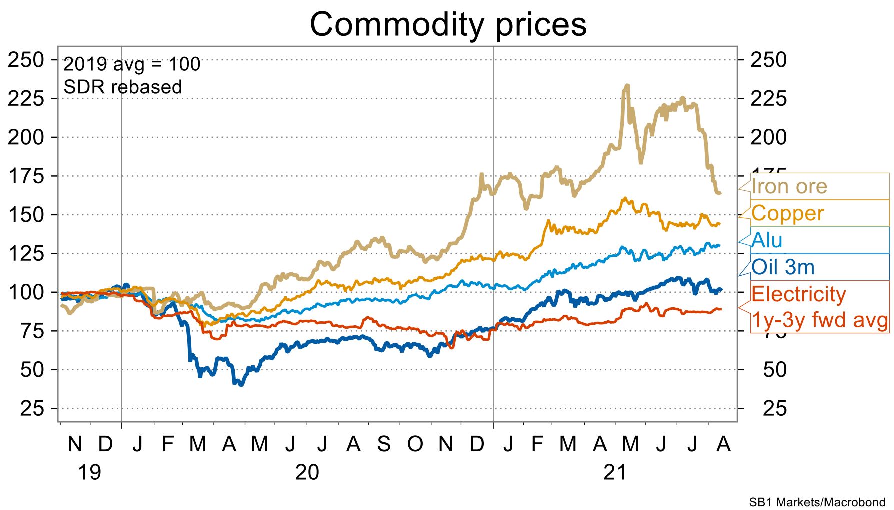


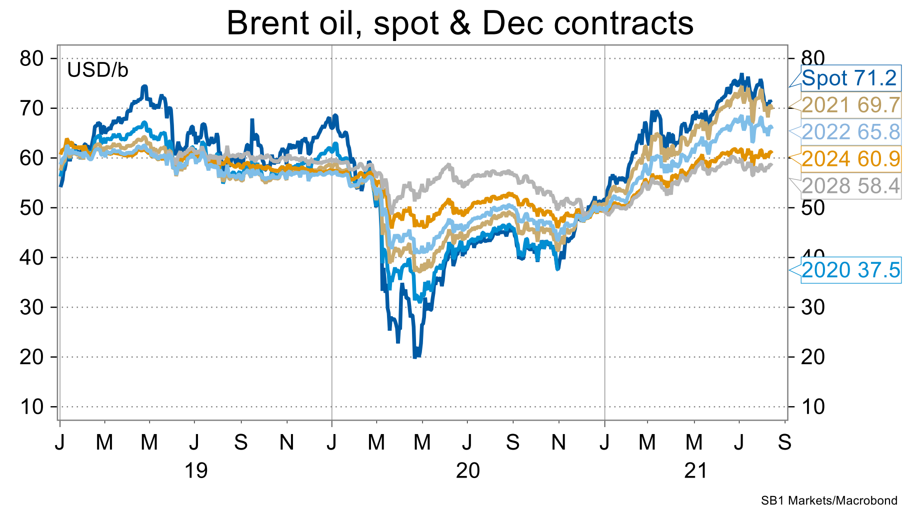


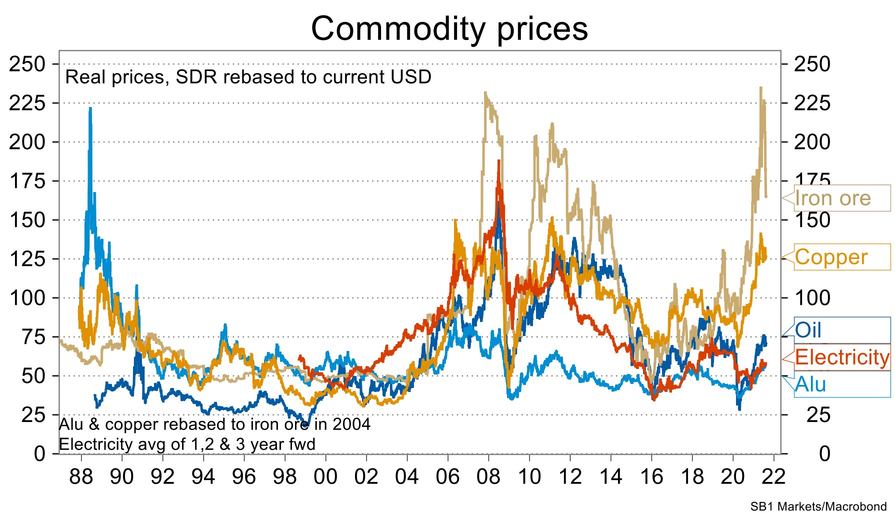


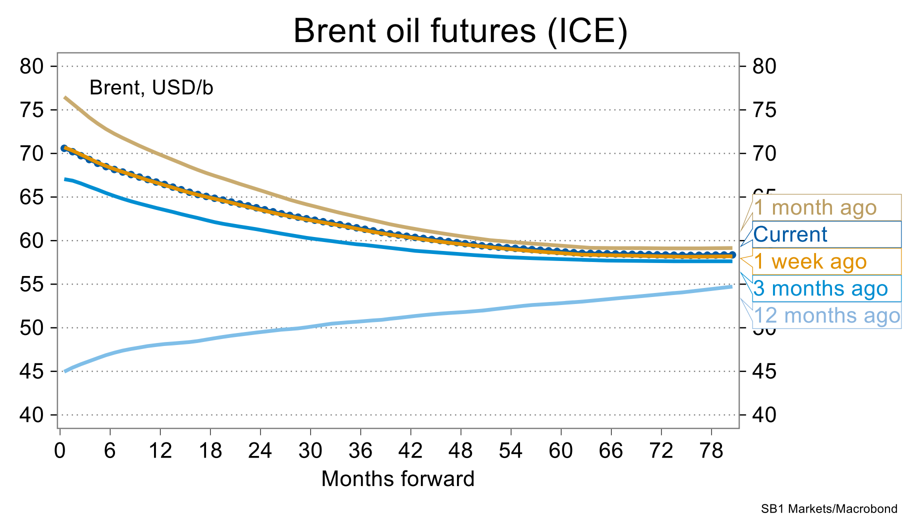
Iron ore prices further down as China tries to slow steel production

Copper has flattened – and the oil price has stabilised following the Delta fear decline





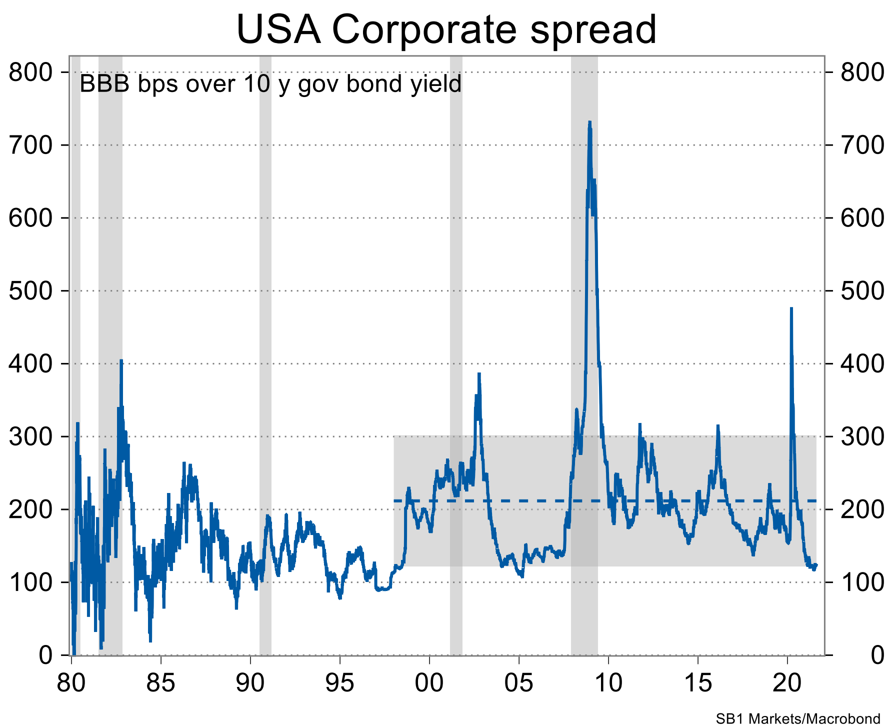


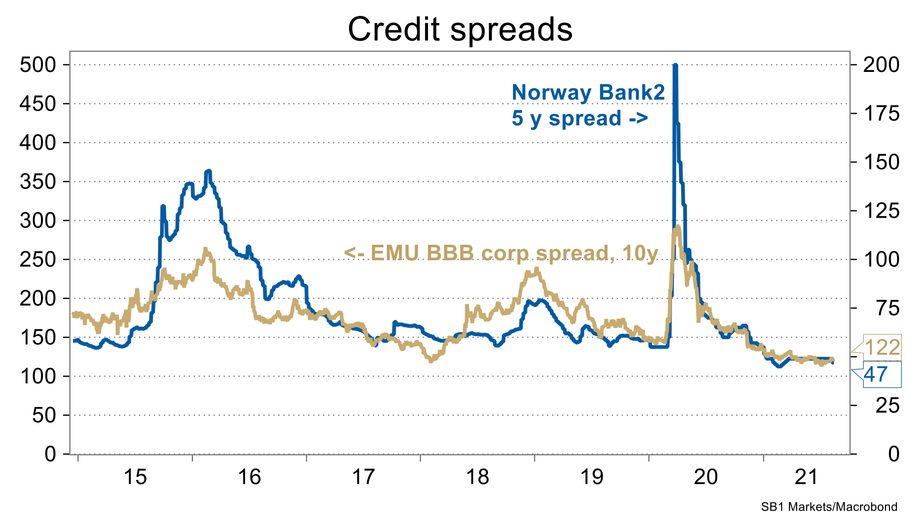


SpareBank 1 MARKETS

The US BBB credit spread slowly, slowly up

While the Norwegian Bank 2, 5 y bond yield fell 2 bps after being flat as long as we can remember

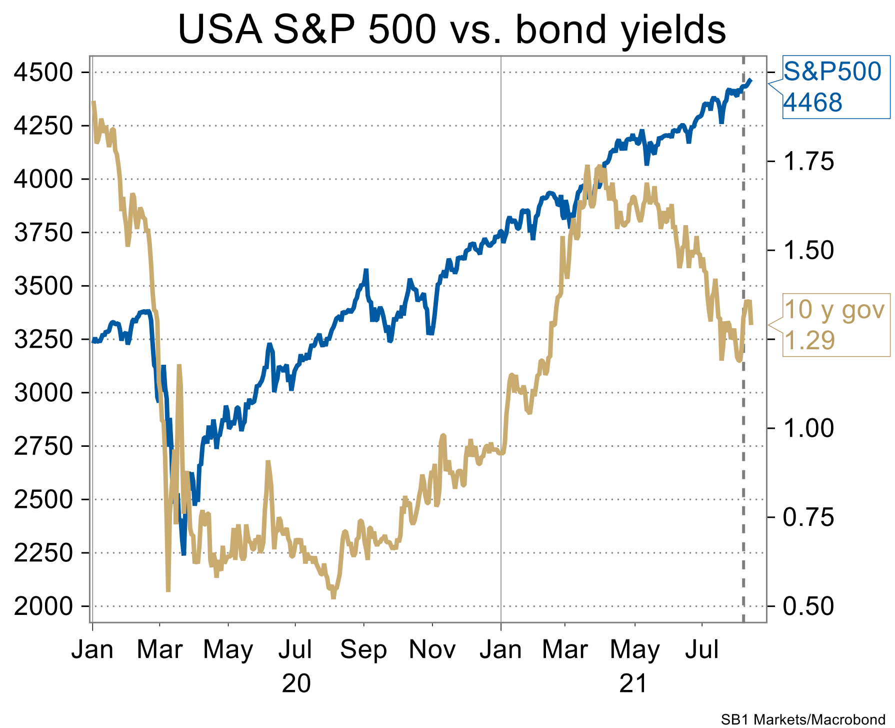


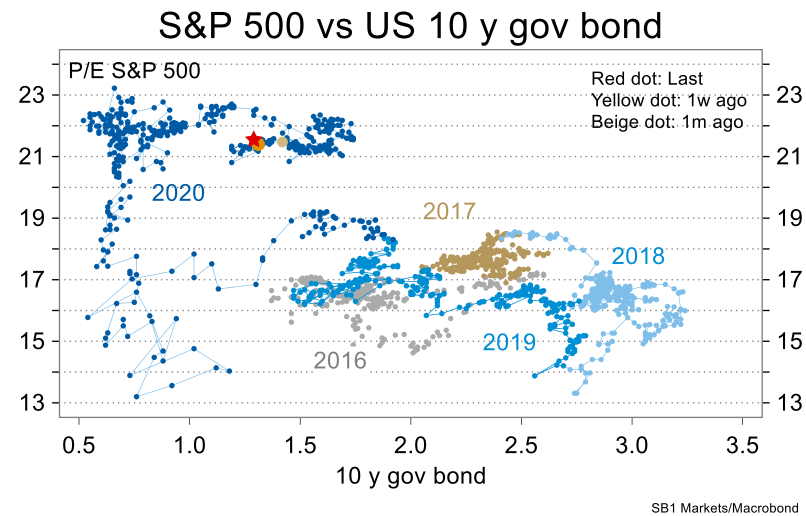


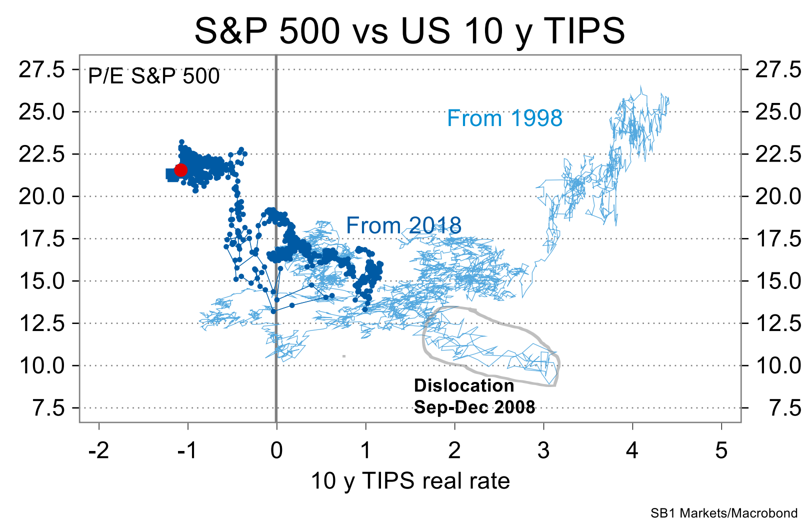
SpareBank 1 MARKETS

Another S&P 500 record, up 0.7%. The 10 y bond yield down 2 bps to 1.29%

A weak University of Mich. sentiment report lowered yield on Friday. But lifted stocks, of course

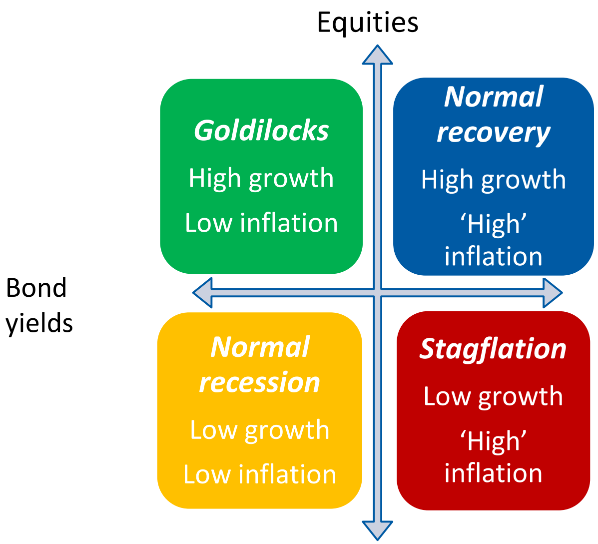


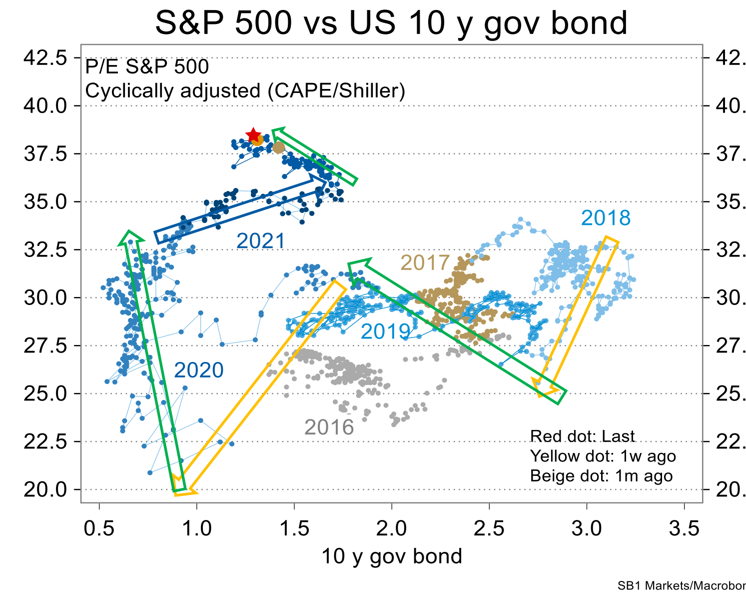




Still well into the 'Goldilocks corner'

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

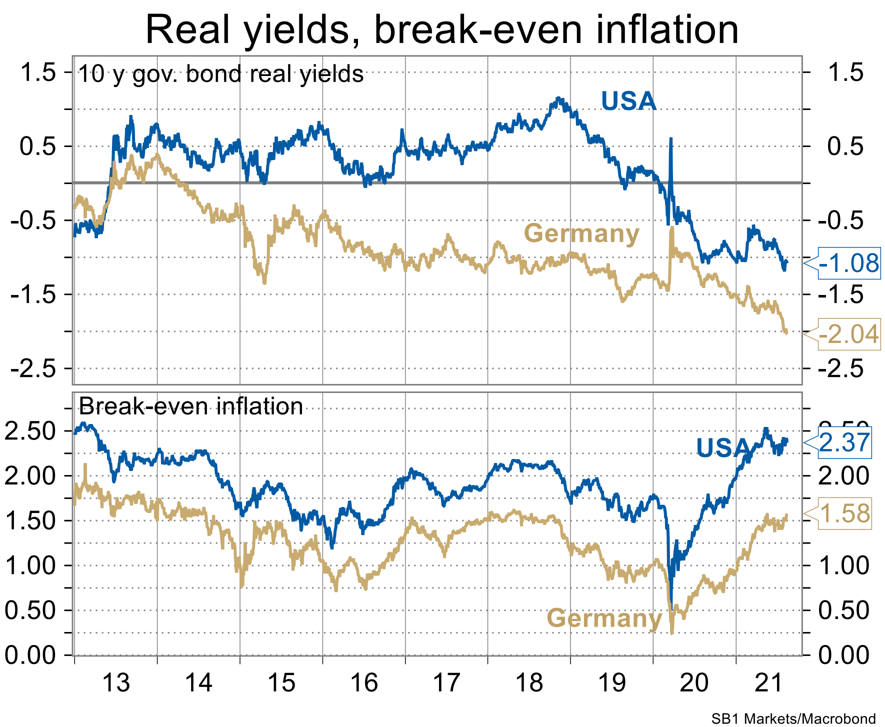


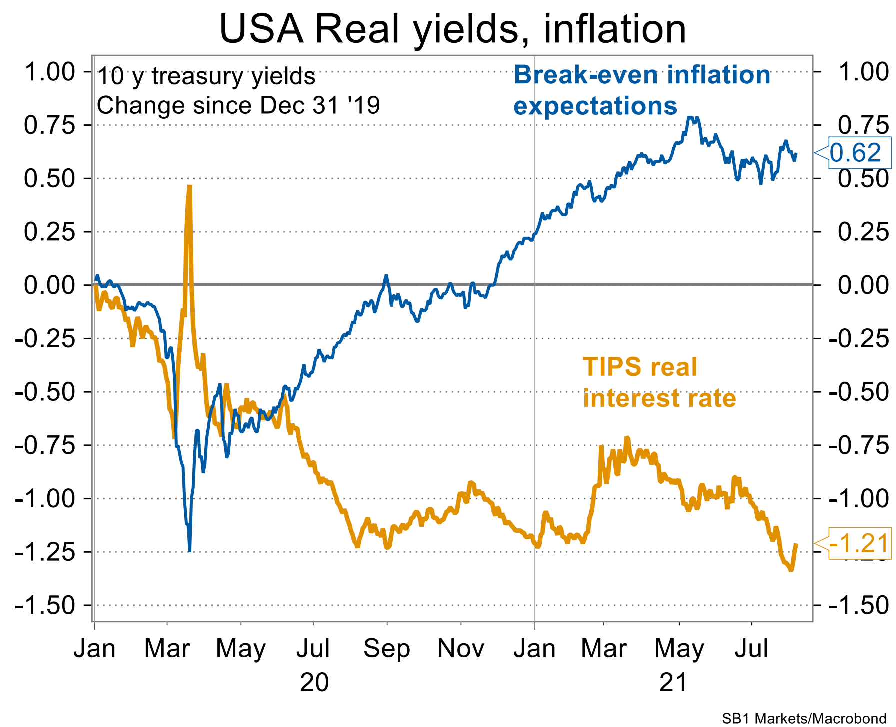


- Usually, we have associated drifts towards the 'green corner' - low inflation and solid growth at the same time - as a temporary sweet spot for markets
  - » Interest rates have climbed 100 bp+, and stock valuations have kept up or climbed (like the Shiller PE). Still, we deem the current yield level to qualify for the "Goldilocks" corner (especially the real bond yield, check the chart on the previous page). Where to go from here?
- The inflation/growth mix will decide:
  - » If 'nothing' happens, we can stay in this Green quadrant. Raw material prices 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

Small changes in real rates/inflation expect. last week. Real rates extremely low

The German real rate is falling further, to ATL at -2.04% (10 y gov)





US & Germany 10 y Gov bond yield

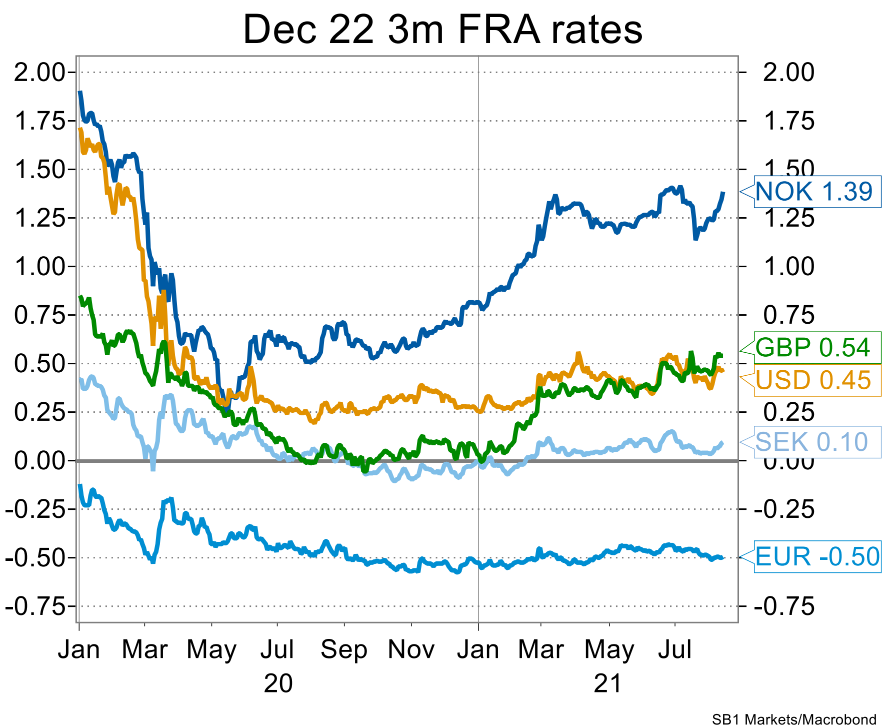
	Yield	Change 1w	Change 1m	Min since April-20
USA nominal treasury	1.29	-0.02	-0.13	0.52
.. break-even inflation	2.37	0.00	0.01	1.06
.. TIPS real rate	-1.08	-0.02	-0.14	-1.19
Germany nominal bund	-0.46	0.03	-0.16	-0.65
.. break-even inflation	1.58	0.07	0.13	0.40
.. real rate	-2.04	-0.04	-0.29	-2.04

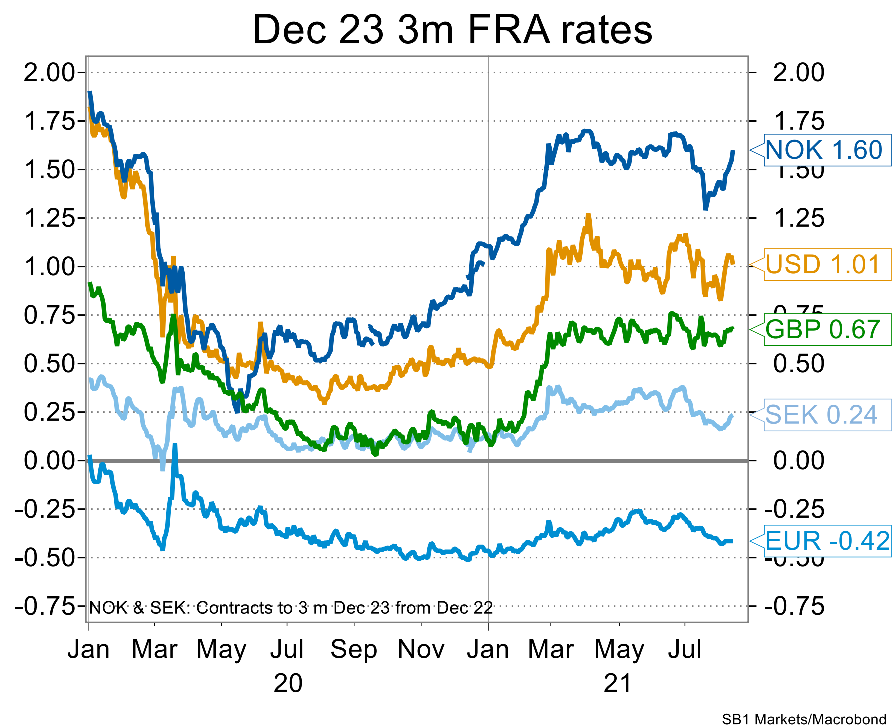
SB1 Markets/Macrobond

SpareBank 1 MARKETS

FRAs: Up almost everywhere last week, and the most in Norway

Without any specific reason



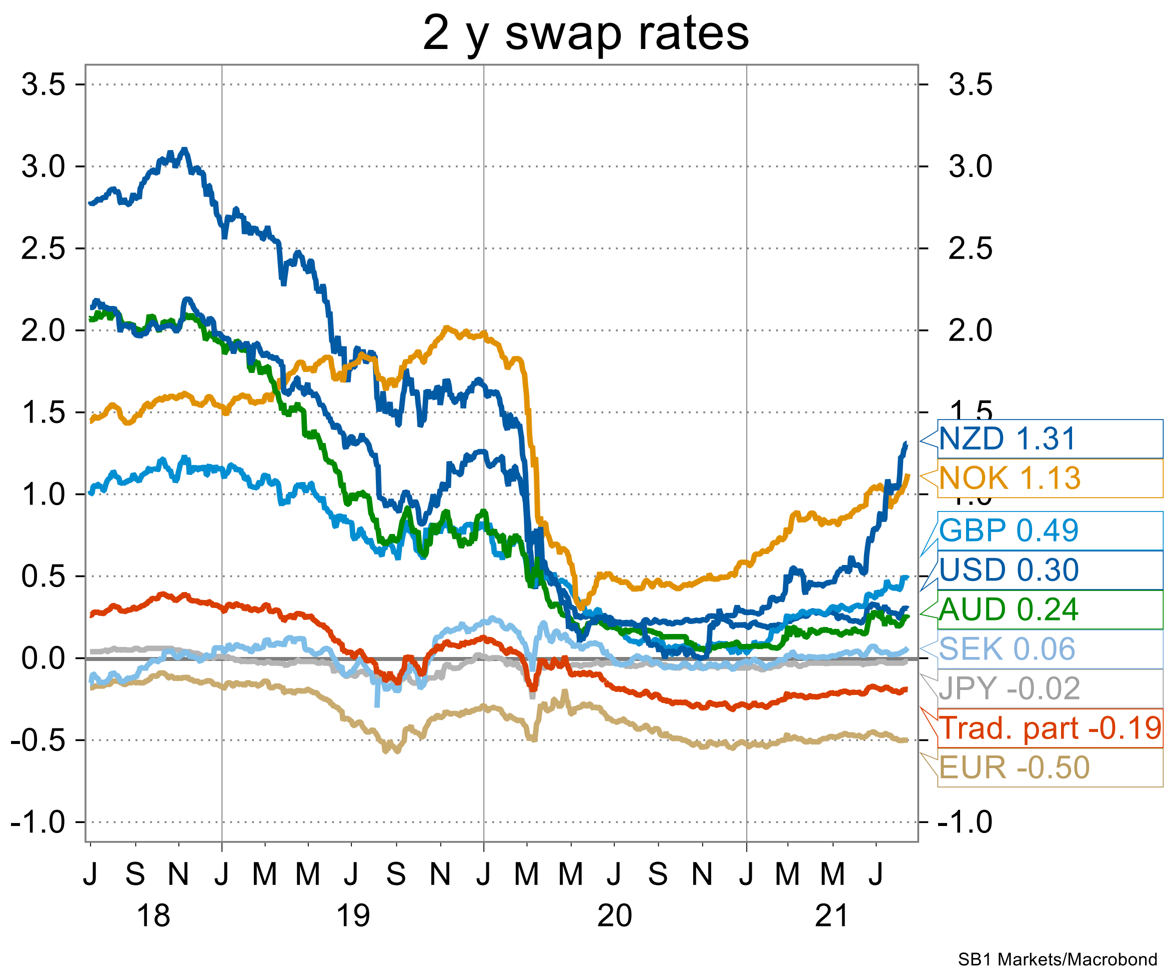


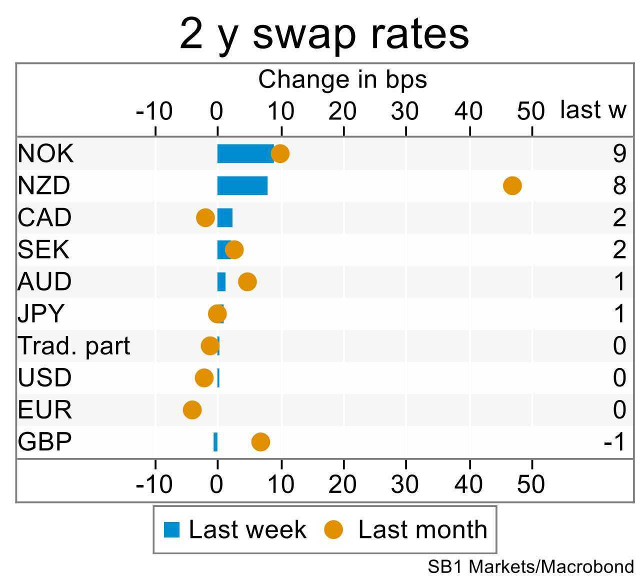
- The market expects both **BoE** and the **Federal Reserve** to hike next year
- Even if the Norwegian housing market has flattened, and economists are discussing whether **Norges Bank** will og should hike in September the market is fully discounting the Bank to start hiking

SpareBank 1 MARKETS

Short rates flat or up almost everywhere last week

NOK and NZD in the lead last week and last month (followed by GBP last month). Flat in USD/EUR

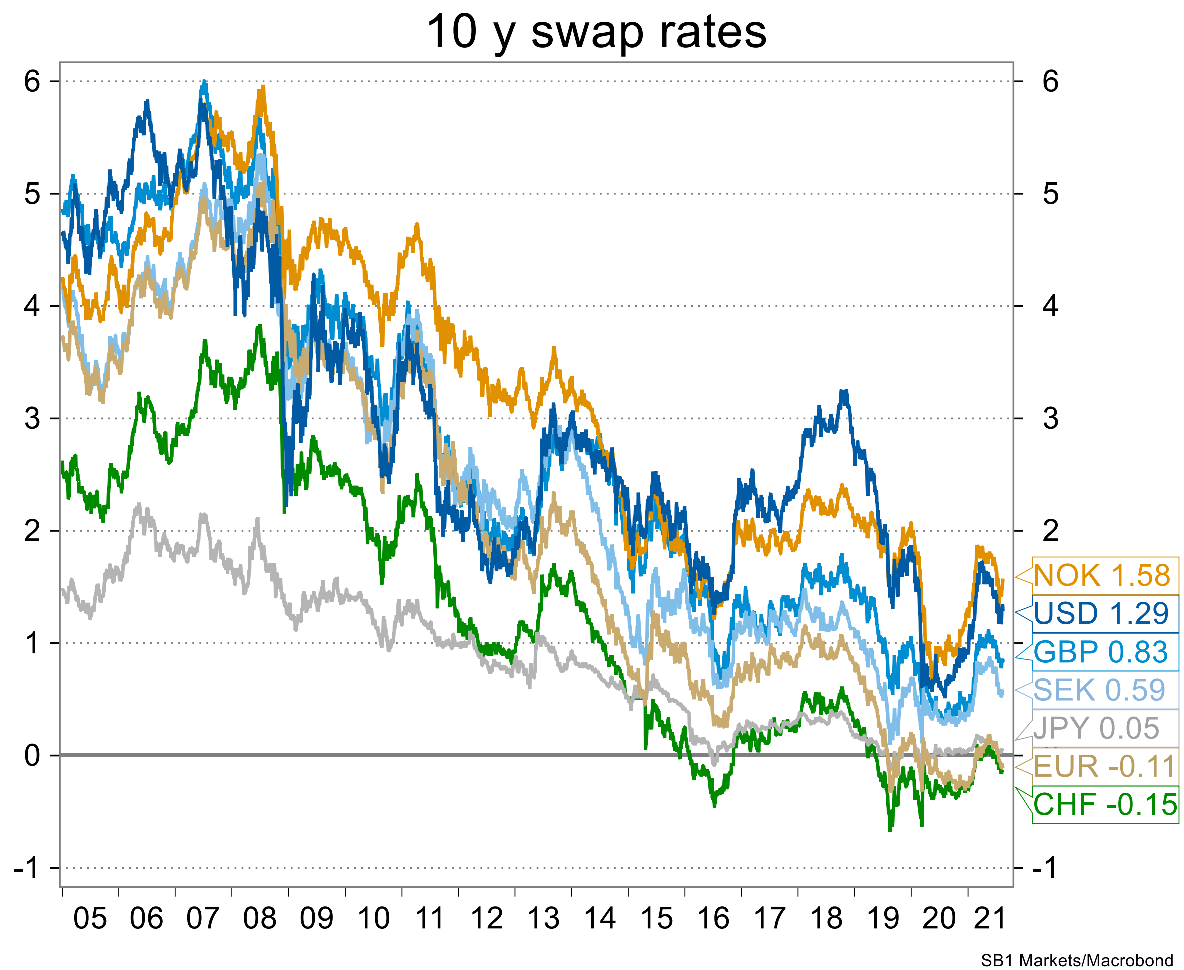


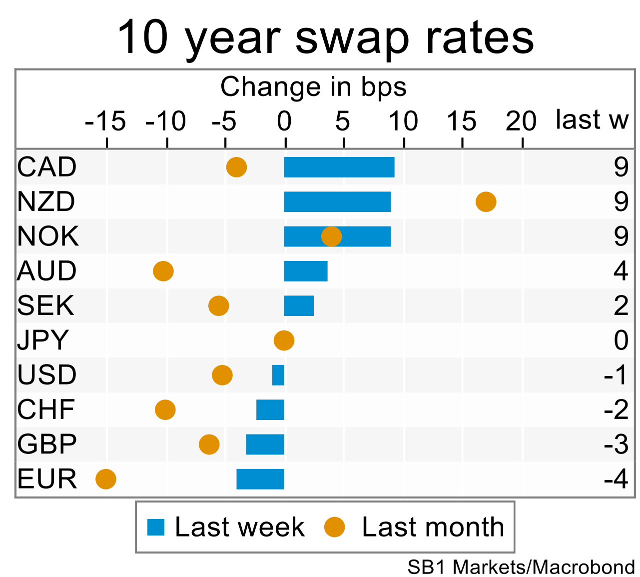


SpareBank 1 MARKETS

The long end of the curve mixed

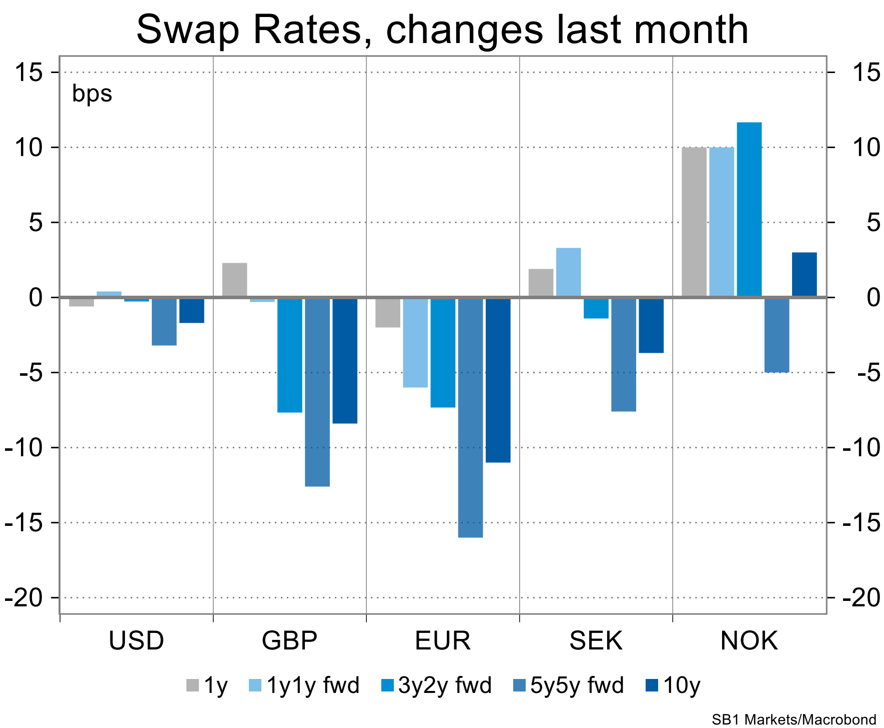
The supercyclicals (AUD, CAD, NOK, SEK – and we include the NZD) sharply up, most other down

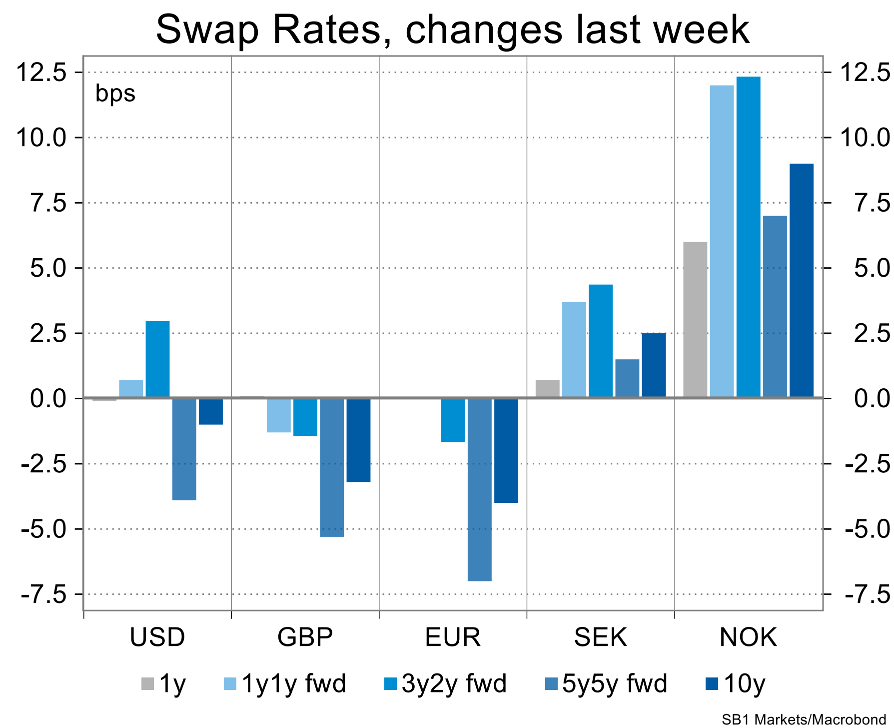




A sharp increase in NOK rates – all over the curve

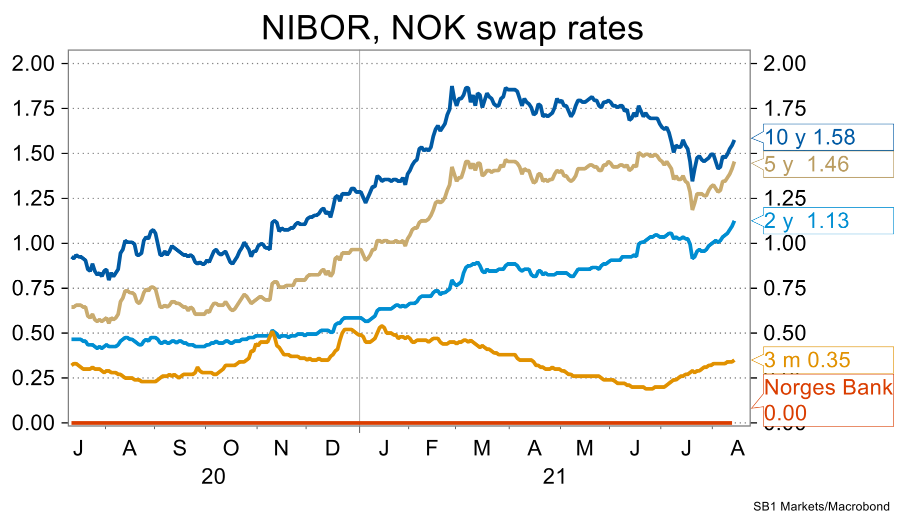
… without support from out trading partners (but in tandem with other ‘raw material’ currencies

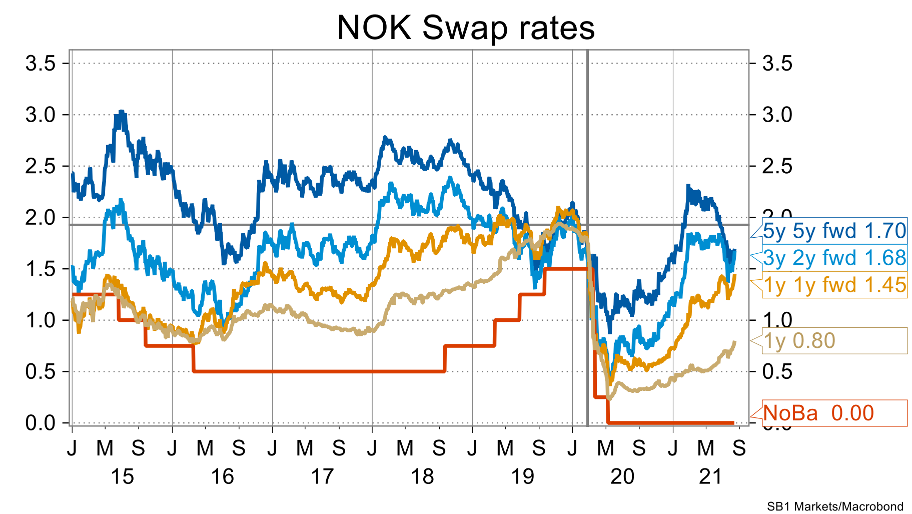


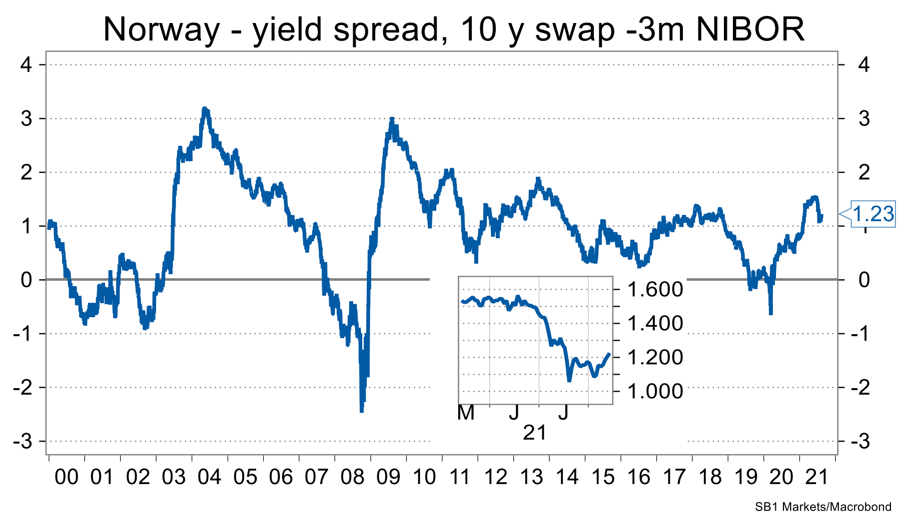


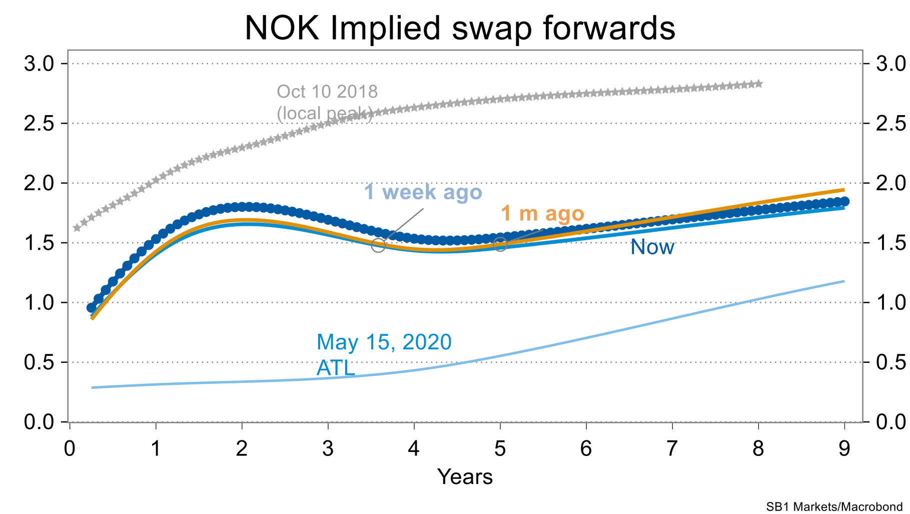
- No net changes in the EUR last week (first down, then equally up)

Up all over the curve, most at the first half



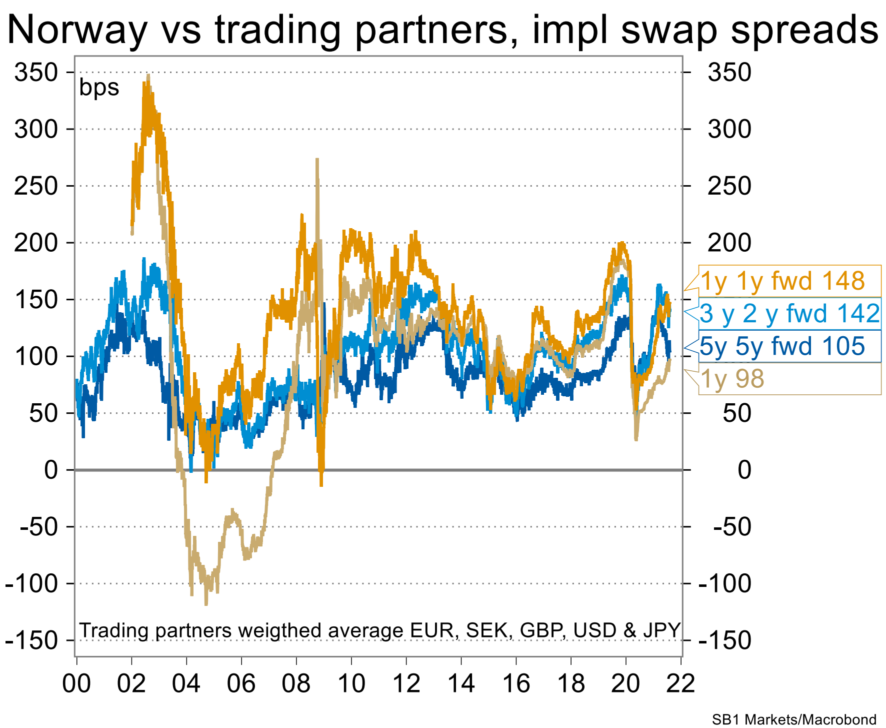


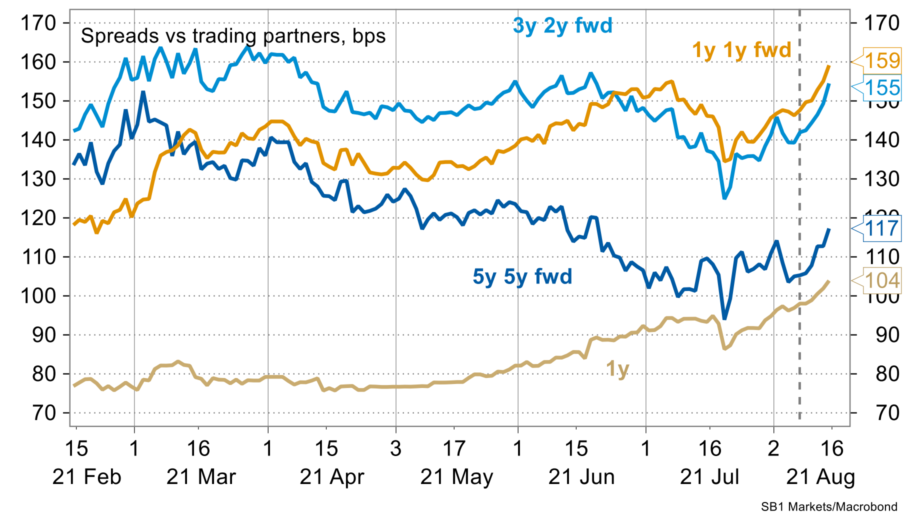


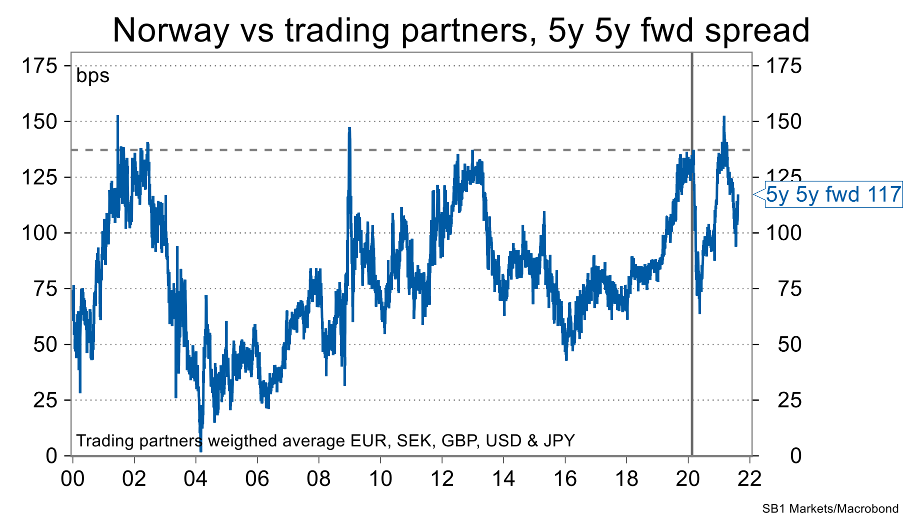


Forward spreads vs trading partners up 8 – 17 bps, most in the short end

Without any strong Norwegian macro data

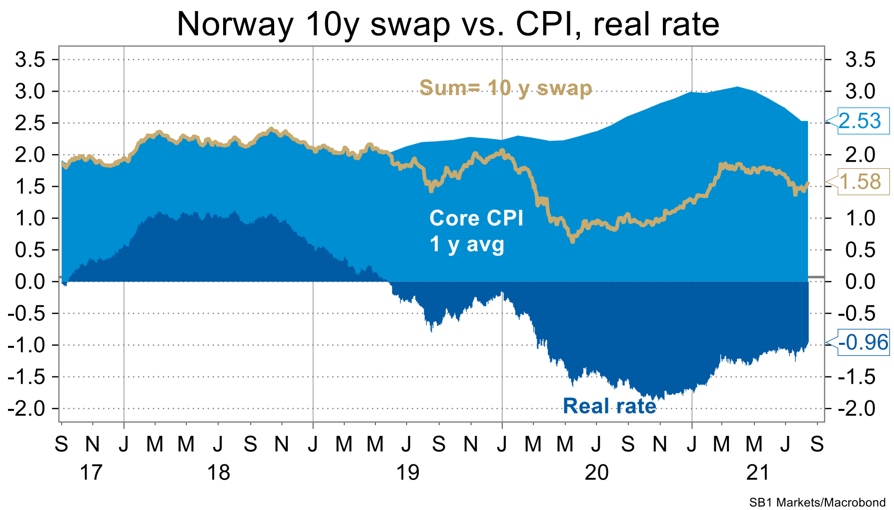






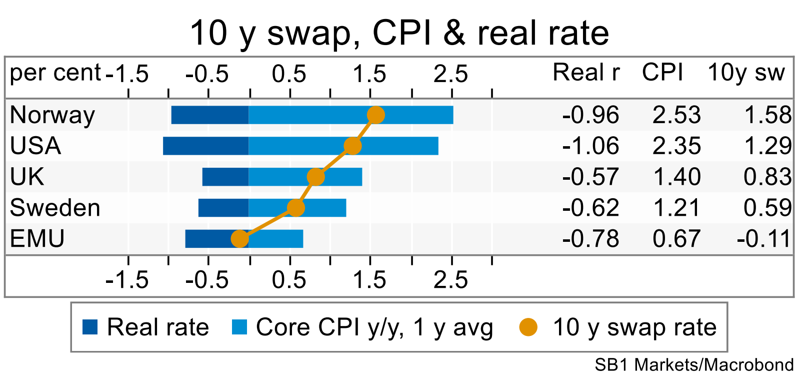
SpareBank 1 MARKETS

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



NOK 10 y swaps have flattened

- The **10y NOK swap** rate up 9 bp to 1.58% - but the trend has been down since March
- **The actual real rate**, after deducting a 2.5% average core CPI inflation over the 2 past years equals -1.0%
  - » 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 do 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

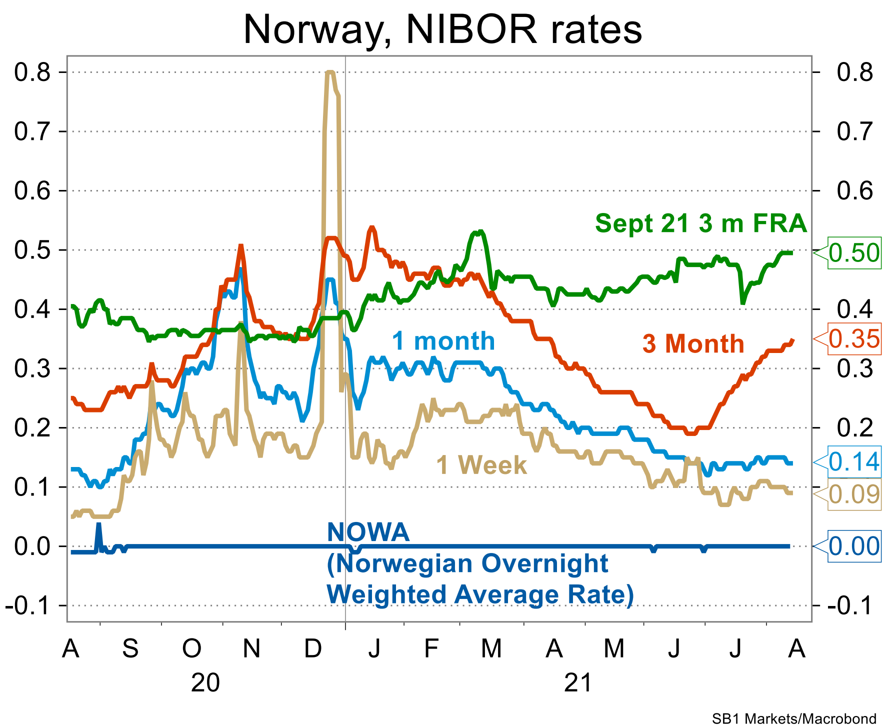


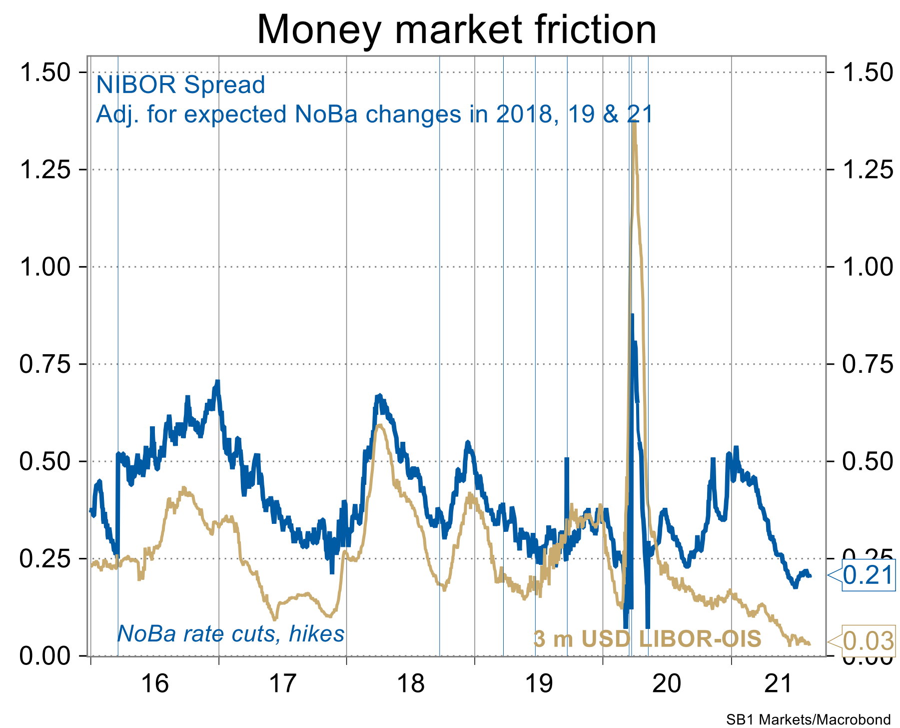
The NOK real rate not the lowest anymore

- **Inflation** among main trading partners varies between 0.7% to 2.4% (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 -1.1% measured vs. the 10 y swap rate and core inflation over the past two years
- **Thus, the Norwegian real rate at -1.0% is among the lowest – but not the lowest anymore – US is in the 'lead'**

3 m NIBOR 2 bp up to 0.35%, the 'real' NIBOR spread probably stabilised

The market is still fully discounting a NoBa hike in September

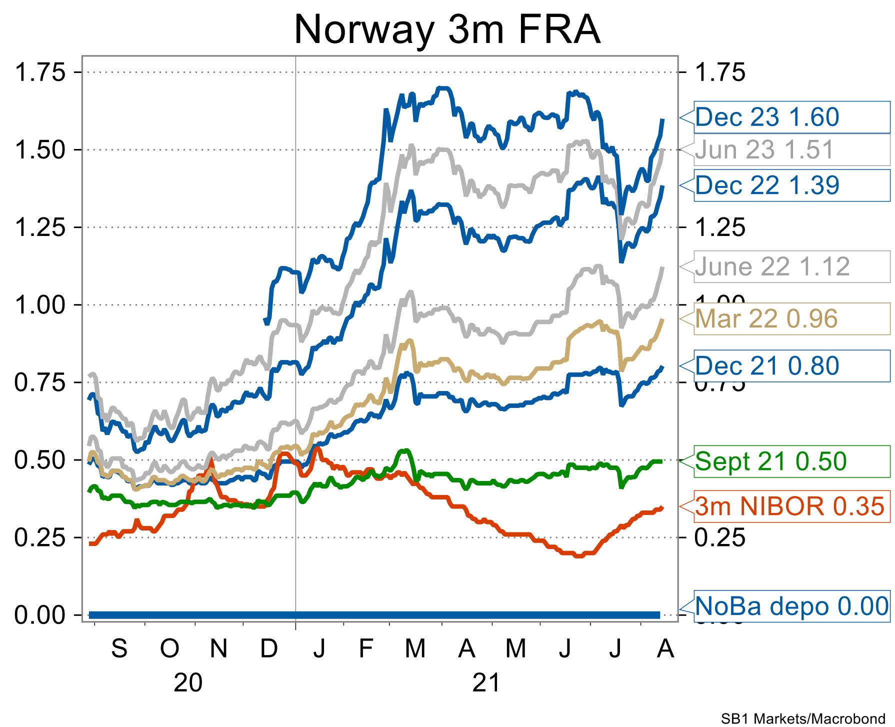


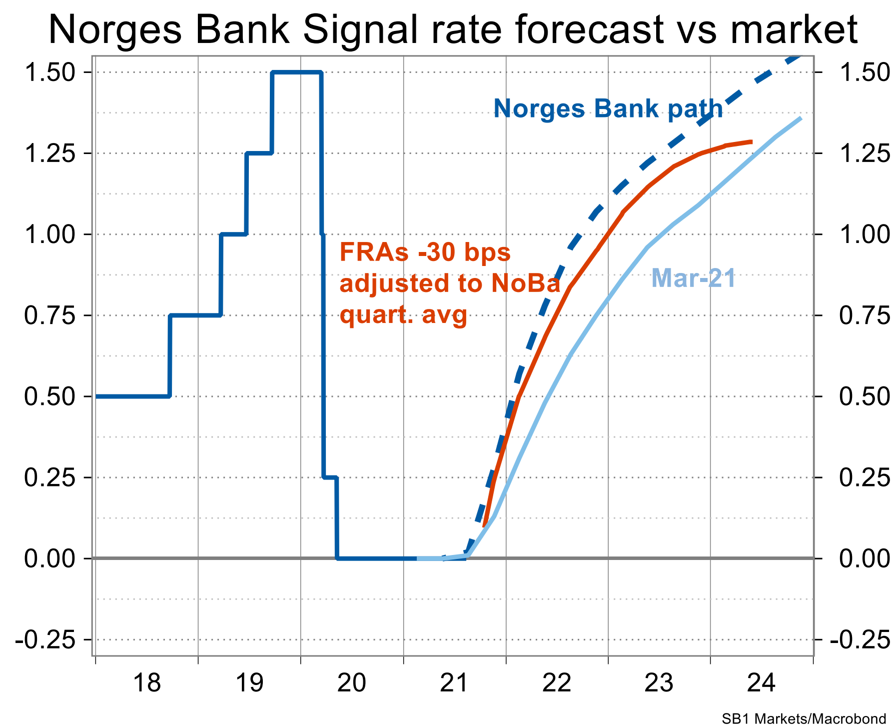


- The **USD LIBOR OIS spread** is still low, and it has fallen a couple of bps even if the Fed has tried to mop up excess liquidity in the money market by heavy use of reversed repos
- The **Sept-21 3 m FRA contract** at 0.50% bps (+3 bps last week) is 15 bps above the current 3 m NIBOR, implying an almost 4 bps expected increase in the 3 m NIBOR the coming weeks. Thereafter the 3 m NIBOR will climb by 2 bps per week until NoBa stops hiking the signal rate by 25 bps per quarter (if the low NIBOR spread remains unchanged)
- Last week **the 'real' NIBOR spread** was stable at 21 bps, as we assume the market is fully discounting a NoBa hike in September. We expect the spread to drift upwards the coming months

3m FRA rates up by up to 13 bps, still somewhat below NoBa's June path

A 2nd hike in December is deemed very likely, barring a steep increase in the NIBOR spread

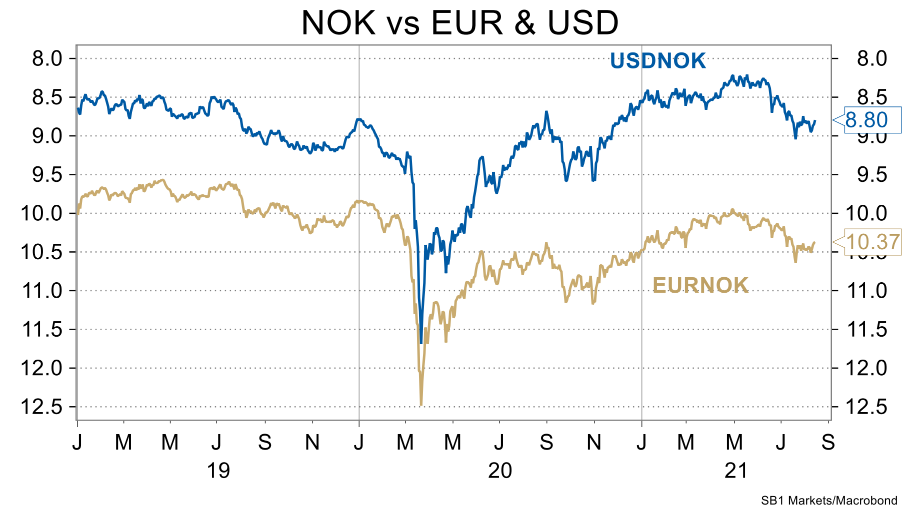




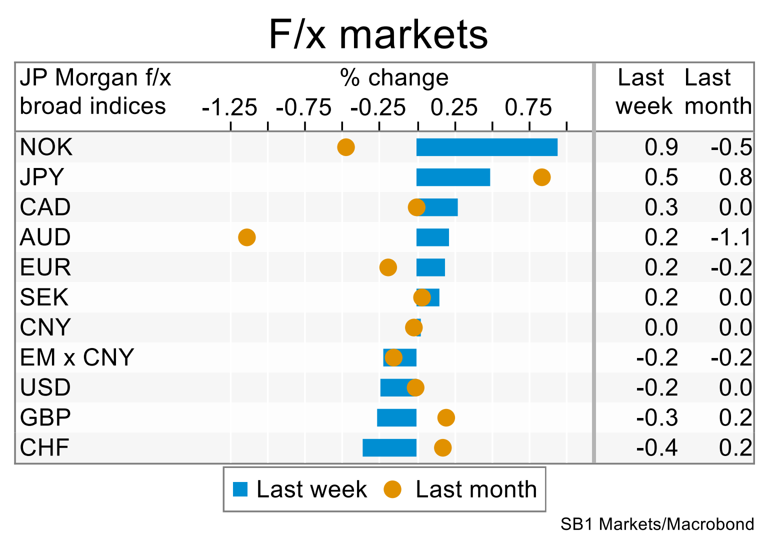
- The market is still betting on a NoBa hike in Sept – and more than fully if the NIBOR spread remains at 0.21 bps. If a 30 bps spread is assumed, the implied probability falls to 88%
- The Dec-21 FRA at 0.80%, after deducting a Q4 liquidity premium at 7 bp, implies an 100% probability for a 2nd hike in December even if the NIBOR spread widens 23 bps. It the spread widens to 30 bps, the probably is still more than 70%

NOK the f/x winner last week – just out of the blue

Still the loser (together with the AUD) last month. USD down, EUR

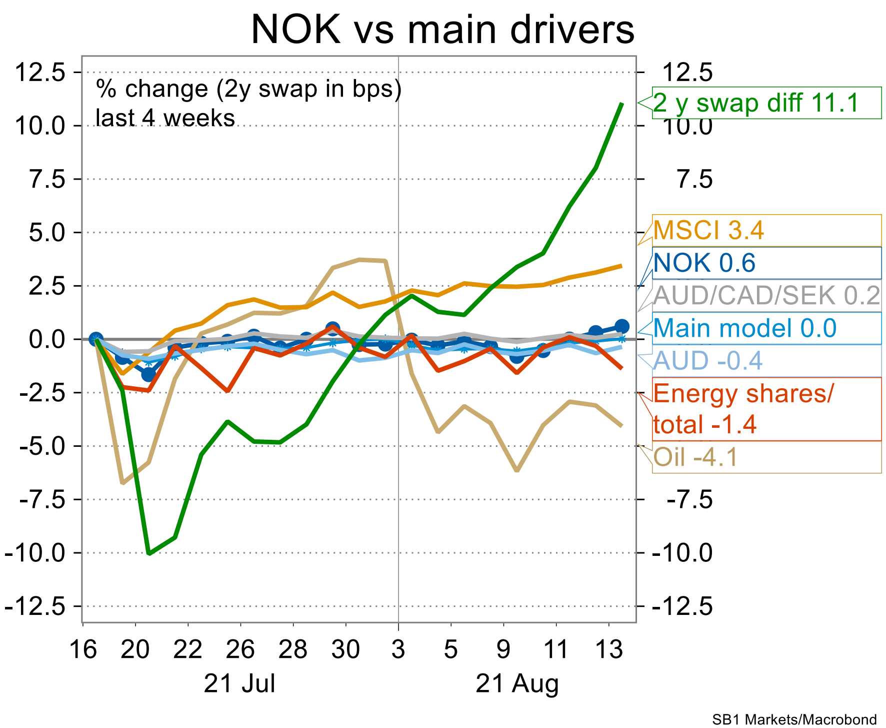


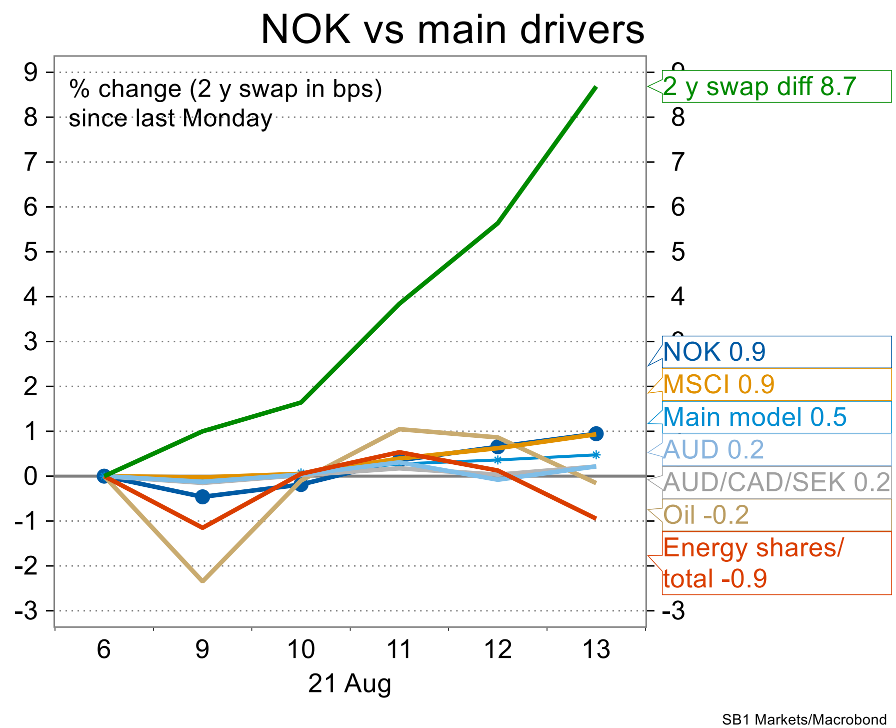
- The GBP rose further, supported by the hawkish Bank of England



NOK up 0.9%, better than our model's forecast

Our model said 0.5% supported by a higher interest rate differential but global stocks rose as well





The status vs. the normal drivers:

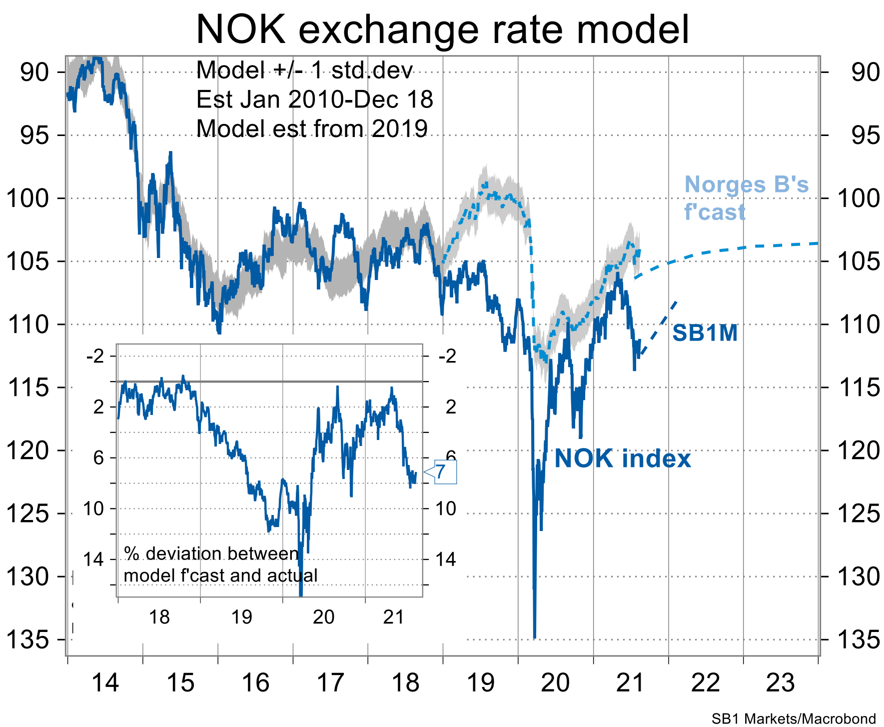
- ***The NOK is 7% weaker than suggested by our standard model (from - 8)***
- The NOK is 6.5% 'weaker' than the global stock market vs the correlation between the two since beg. of 2020 (from 7)
- The NOK is 10% weaker than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts (unch)
- NOK is far (9%) stronger than a model which includes global energy companies equity prices (vs the global stock market) (unch)

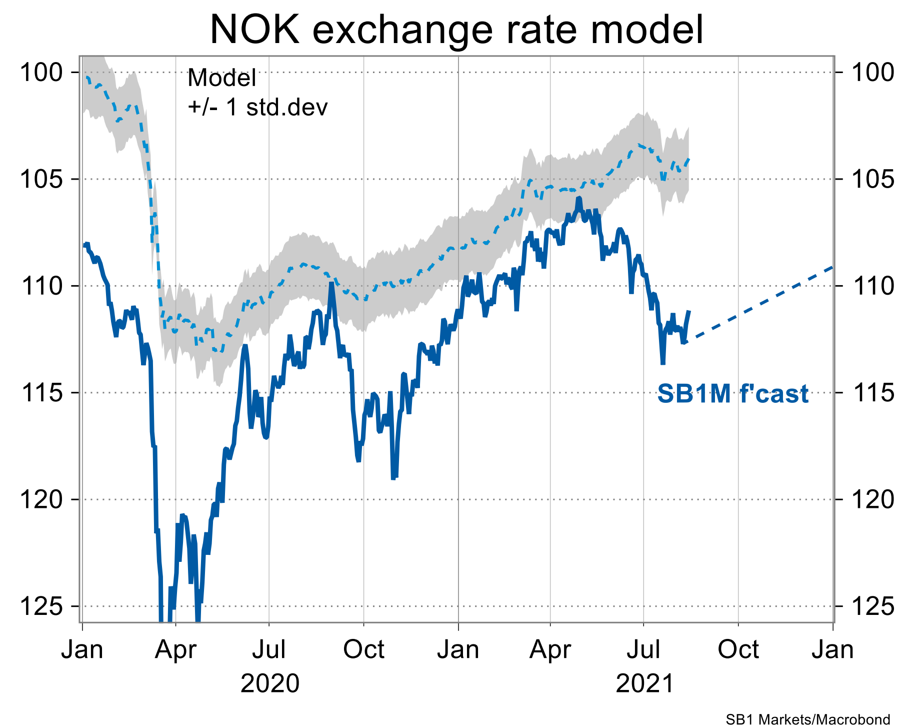
After been neutral vs NOK from May, we turned positive in early July, as the gap vs. our models had widened. *So far without any success*

At this and the following pages we have swapped Norges Bank's I44 index for JP Morgan's broad NOK index and rebased it to the current index value for the I44. 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. There are no substantial difference between these two indices over time

NOK 7% below our model estimate

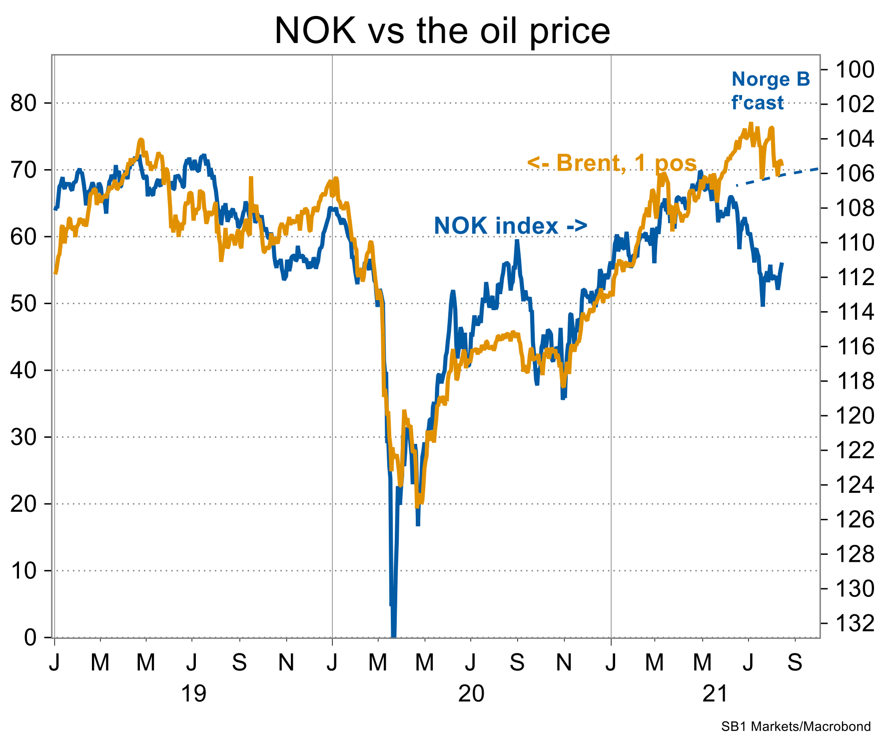
But the gap narrowed last week

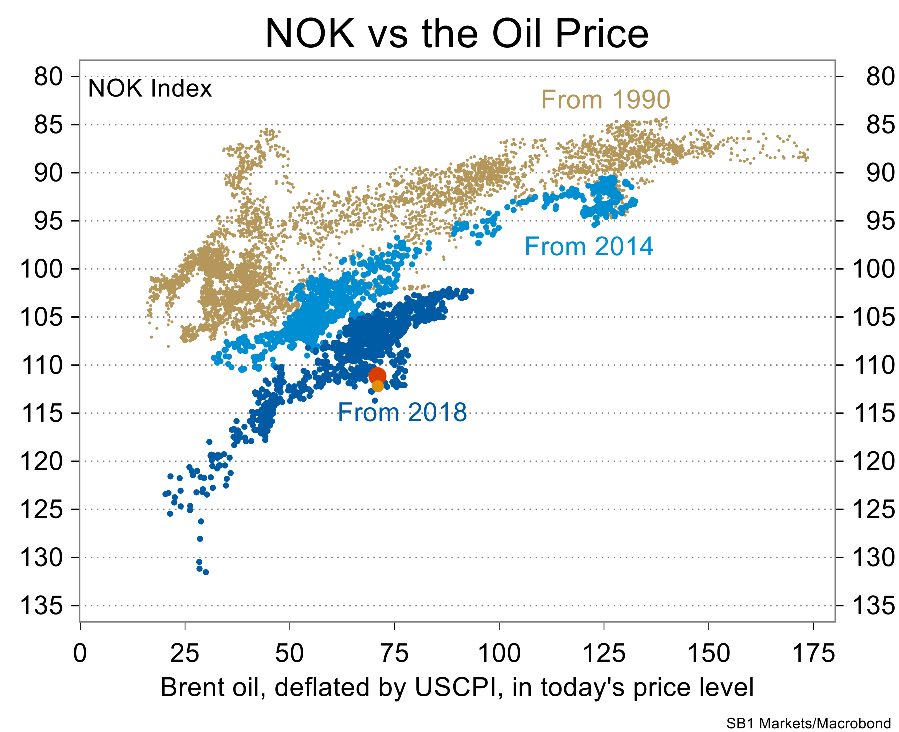




Oil marginally down, the NOK up

NOK is still on the weak side vs the oil price

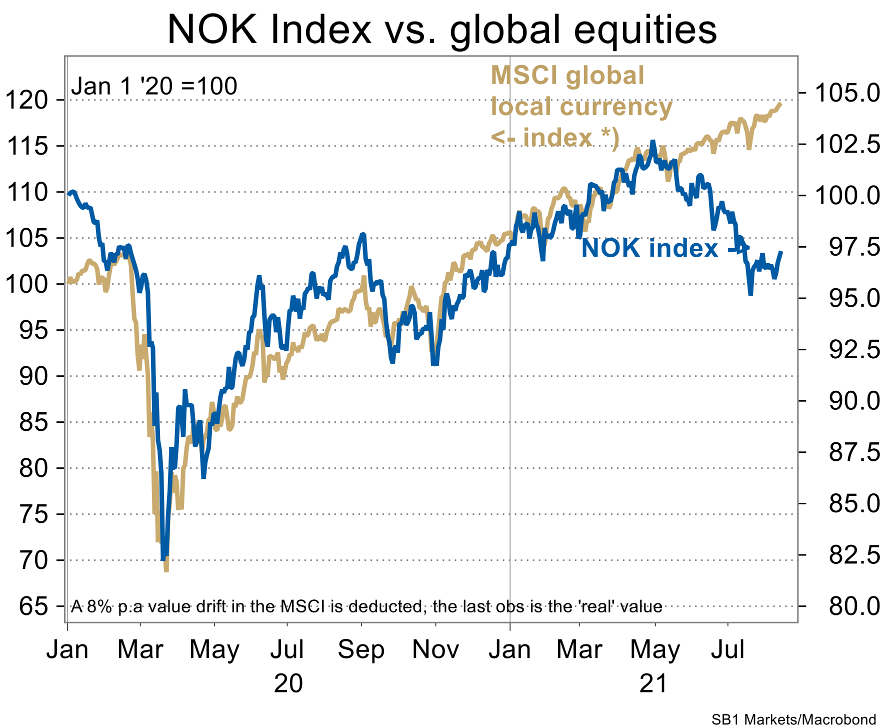


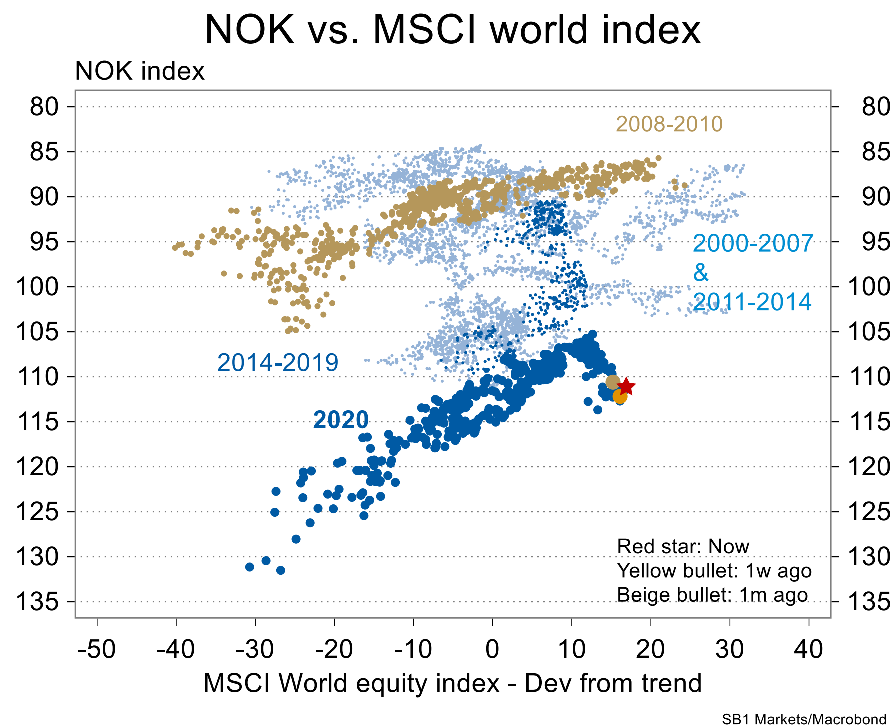


- NOK is still correlating quite closely to the oil price but at a lower level than before 2018 – and now the NOK is weak even vs the past 3 years' relationship
- A USD 10 drop in the oil price weakens the NOK by some 2.5%, as a partial effect. Within a broader model, the impact is somewhat smaller

The global stock market up, the NOK followed suit

NOK has lost some 6% vs. global stocks over the past months/weeks, another short term high



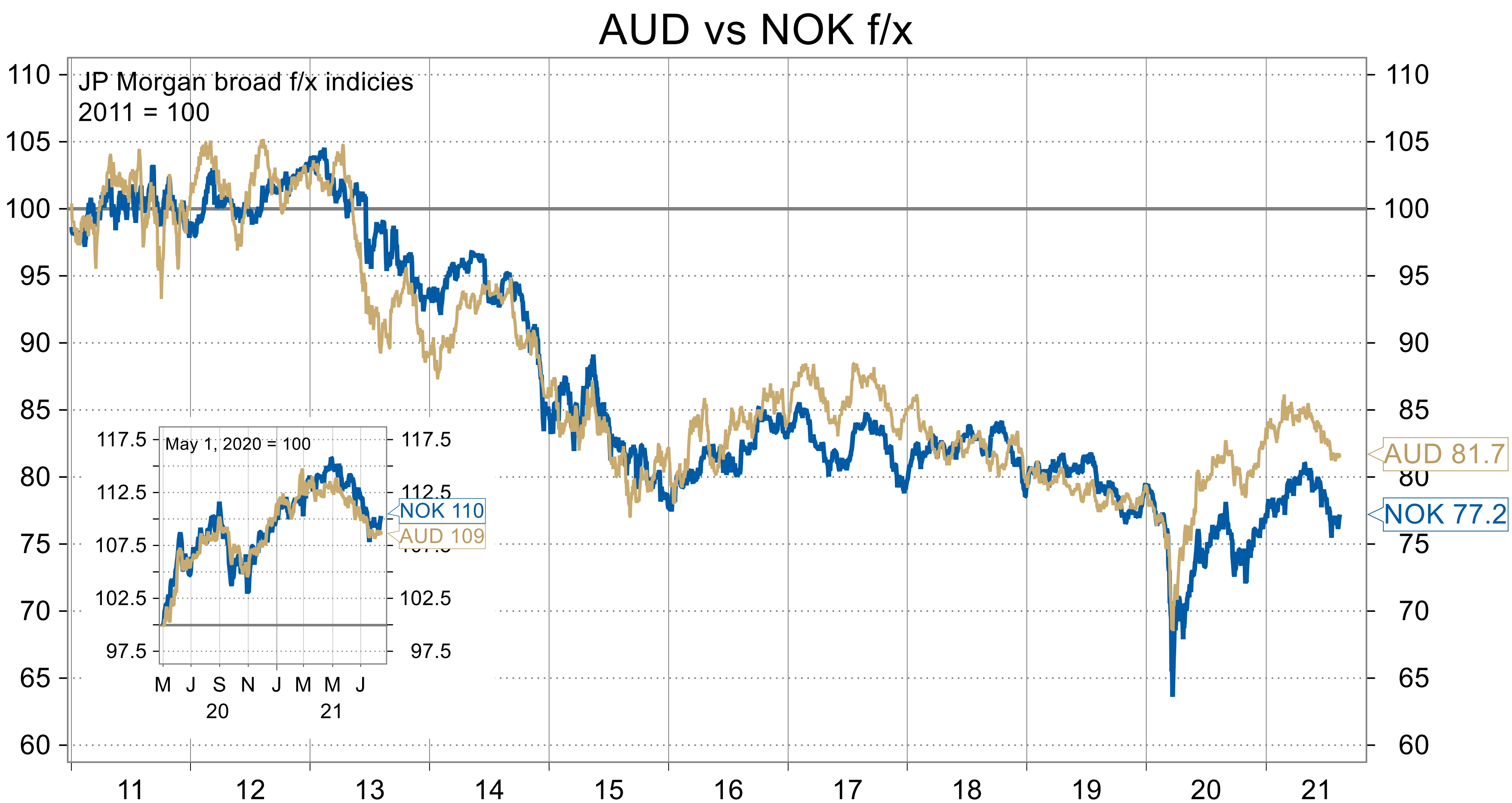


- Over time, there has not been a stable correlation between NOK and stock markets (the Oslo Stock Exchange, S&P 500 or the MSCI, the global equity index. (At the chart to the right, we have detrended the stock market as equities are drifting upwards, while NOK (hopefully) is stationary. However, the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

SpareBank 1 MARKETS

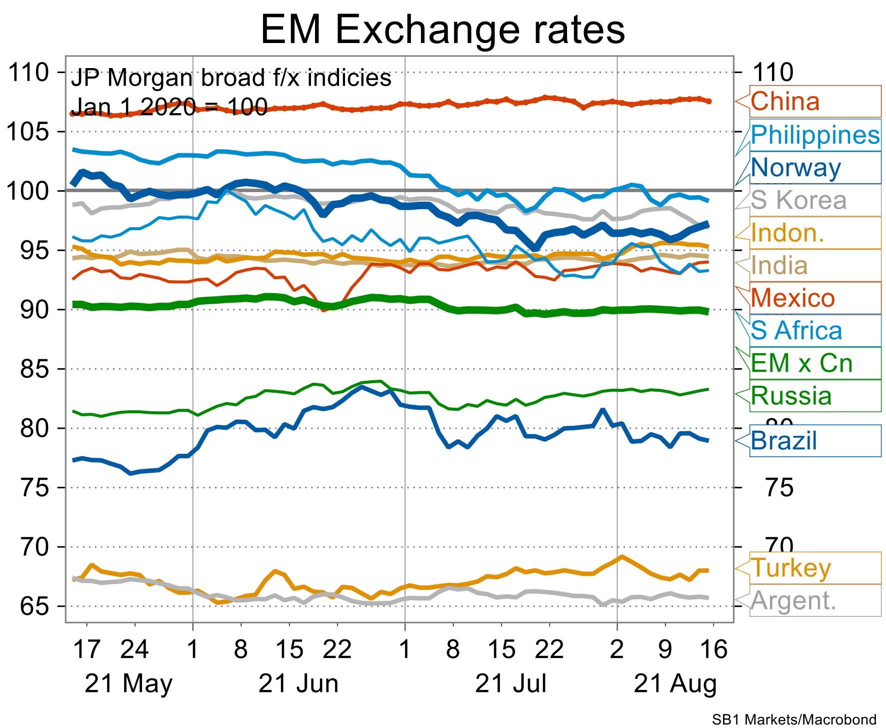
NOK & AUD still dancing extremely tight

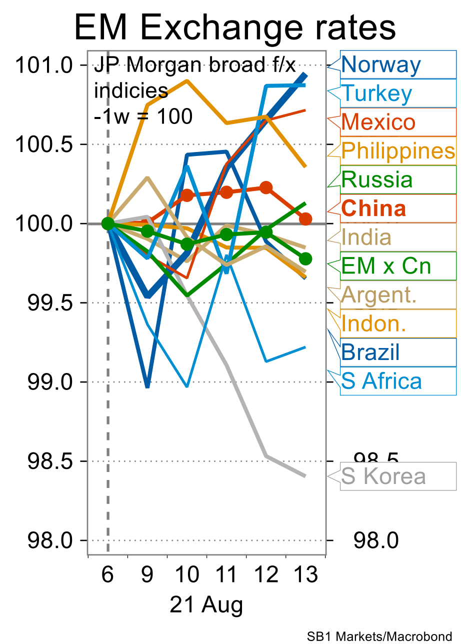
…but the NOK is still 5.5% weaker than AUD since last spring

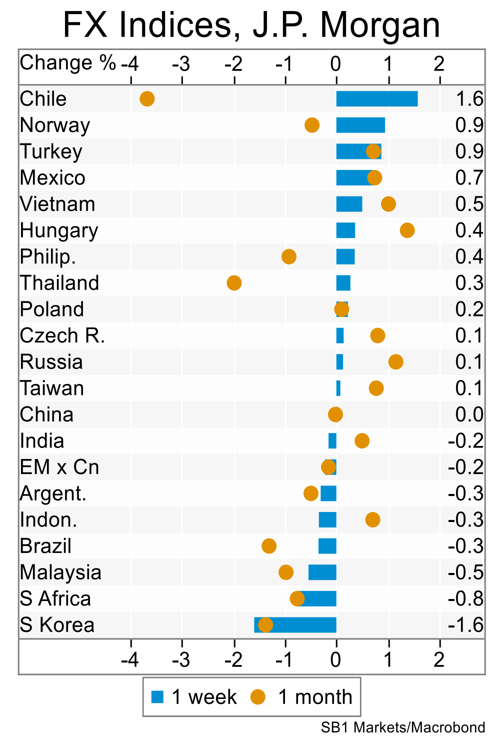


SB1 Markets/Macrobond

EM x China f/x are sliding slowly down







DISCLAIMER

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

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

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

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

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

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

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

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

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