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Macro Weekly

Week 38/2021

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Highlights, corona update

The world around us

The Norwegian economy

Market charts & comments

Last week

The virus

- Most countries are still reporting a decline in **new Covid-19 cases**
- The no. of **hospitalisations** has flattened or are falling almost everywhere – and even in the USA, from an elevated level there. Elsewhere in the rich part of the world, the pressure on the health system has been modest. In Norway just 19/mill are hospitalised (flattened last week), vs 100+ in the UK, and almost 300/mill in the US
- In the West, **mobility** has not come down during the Delta outbreak, signalling that economic consequences are mild. The only remaining Covid-19 risk is another mutation that are resistant vs. vaccines. Some sectors have still reported a slowdown, like restaurants and travel
- In the East, mobility is on the way up everywhere. **India** is back at full speed, following the May disaster. **China** have probably already beaten down the last (very limited) outbreak – though at substantial cost for services in July & August

The economy, part I

- **China**
  - **August data** surprised on the downside, at least partly due to fight against virus. If so, some positive news should be expected the coming months
  - **Industrial production** rose just 0.3% m/m, half a normal pace, and the annual growth rate was down 1.1 pp, 0.5 pp below expectations. Still production is 3% above the pre-pandemic trend path.
  - The **service sector** contracted by 1.7%, following the 2.4% July drop, very likely due to the fight against corona. A substantial upside the coming months, from the present 4% below p-p trend path level.
  - **Retail sales rose** by 0.3%, following the 0.3% decline in July (volume, our est). Sales have expanded at just a 2% pace since November, and is 5% below the p-p trend. Nominal sales values grew just 2.5% y/y, down from 8.5%, and 4.5 pp below expectations!
  - **Investments** are growing at a slow pace too, and both residential and commercial construction is down 13% – 20% recent months – in tandem with a steep decline in steel and cement productions, amid some financial challenges for the largest Chinese builder, Evergrande…
  - Earlier, strong **export** and decent **import** data have been reported, as well as a continued slowdown in **credit** expansion – which remains above trend growth in nominal incomes though

Last week: The economy, part II

- **USA**
  - In August, **employment** clearly grew less in states which left the temporary federal unemployment benefit programs in June and early July than in those states that kept them open until these programs expired in early September. The unemployment still fell less in the early-leaver states, so the participation rate must have increased somewhat, a positive sign. However, the impact is very limited (0.2 pp, vs the 3% of working age population paid by these federal programs) and the employment did not respond. It is still to early to tell how many of those 7.5 mill. workers that have now lost their USD 300/week support will return to the labour market but so far the news are not that upbeat
  - **CPI** grew less than expected in August but both the headline annual rate (5.3%) and the core (4.0%) remain unusually elevated. Energy prices are now flattening, and used auto prices fell - and will very likely normalise (down some 25%) when new car production recovers – which may still take some time. In August, hotels and travel were hit by lower demand due to the virus, and it is far to early that price inflation has peaked here, even if prices fell last month
  - **Retail sales** were much stronger than anticipated in August, even after adjusting for a substantial downward revision of sales in July. Still, the trend is down – albeit from a still terrific level; Core sales are still up 18% vs. the Feb-20 level. The downside is huge!
  - **Manufacturing production** expanded 0.2% in August, and less than expected, and production is just 1% above the pre-pandemic level. Auto production is down 13%, and not due to weak demand. Capacity utilisation is well above average, according to the Federal Reserve while the ISM survey reported a record high rate of capacity utilisation already in H1.
  - The first two **regional manufacturing surveys** were much better than expected in September, both rose substantially! Small businesses do not complain about sales, but access to labour is the worst ever. They report almost unprecedented plans for price hikes. As we where close to the top of a business cycle?? (But Univ. of Michigan reports that consumers are really pessimistic in September, as in August)
- **EMU**
  - **Manufacturing production** rose far more than expected in July, due a continued uptick in Belgium. Still, production remains 1.4% below the pre-pandemic level – and Germany is down 6%. Sometimes it's hard to be an auto producer, activity is cut by 40% (and by 24% in the EMU)!!
  - **HICP (CPI)** annual inflation was confirmed sharply up – but just to the VAT cuts and other corona measured implemented last August. Energy is the main culprit behind the 3% headline rate but some other goods contributed as well. Still, the core HICP is up just 1.6% y/y
  - **Labour cost inflation** remains too low for the ECB to reach the new 2% target. Over the past 2 years Labour Cost Index is up just 1.7% p.a
- **UK**
  - **Retail trade** fell further in August, and back to the pre-pandemic growth path, possibly partly due to lack of supply (domestic distribution, Brexit challenges). **CPI inflation** rose sharply, due to tax cuts/subsidies introduced last August. However, in Aug this year, core prices rose 0.3%, and prices are accelerating somewhat. **Wage inflation** is still too high, but has slowed recent months
- **Norway**
  - **Norges Bank's Regional network** expects a further recovery the coming 6 months, but the growth forecast as well as their assessment of growth over the past 3 months are way too downbeat – and not useful taken at face value. However, it seems more realistic that most sectors now expect a growth slowdown, just commercial services expects faster growth. More companies are reporting capacity constraints, and labour shortages have not been more common since 2008. Estimates of wage inflation is ticking upwards, for good reasons
  - **Homebuilders** are reporting a gradual slowdown in **new home sales**, and **starts** have peaked too**. Material costs** are partly to blame – SSB's index is up 23% y/y, with lumber up >100%. We think the peak is very near (but probably not the end)

The Calendar: FOMC to taper (or not); BoE, Rix meeting + a NoBa hike; Sept PMIs, NOR LFS

Time	Count.	Indicator	Period	Forecast	Prior
Monday Sept 20					
16:00	US	NAHB Housing Market Index	Sep	74	75
Tuesday Sept 21					
06:00	SW	HOX Home-Price Index	Aug		
09:30	SW	LFS unemployment Rate SA	Aug		8.4%
11:00	OECD	OECD Publishes Interim Outl.			
14:30	US	Housing Starts	Aug	1550k	1534k
14:30	US	Building Permits	Aug	1600k	1635k
14:30	US	Current Account Balance	2Q	-$190.0b	-$195.7b
Wednesday Sept 22					
16:00	US	Existing Home Sales, prices	Aug	5.88m	5.99m
16:00	EC	Consumer Confidence	Sep A	-5.9	-5.3
20:00	**US**	**FOMC Rate, Outlook, tapering**	**Sep-22**	**0.25%**	**0.25%**
Thursday Sept 23					
08:00	NO	Unemployment Rate AKU	Jul	(4.6)	4.8%
09:15	FR	Manufacturing PMI	Sep P	56.3	56.3
09:15	FR	Services PMI	Sep P	55.8	55.9
09:30	GE	Manufacturing PMI	Sep P	61.4	62.6
09:30	GE	Services PMI	Sep P	60.3	60.8
10:00	EC	Manufacturing PMI	Sep P	60.4	61.4
10:00	**EC**	**Services PMI**	**Sep P**	**58.5**	**59.0**
10:00	**EC**	**Composite PMI**	**Sep P**	**58.5**	**59.0**
10:00	**NO**	**Norges Bank, deposit rate**	**Sep-23**	**0.25%**	**0.00%**
		.. Interet rate path, max change		**(+18 bp)**	**+33 bp**
10:30	UK	Manufacturing PMI	Sep P	60.8	61.1
10:30	UK	Services PMI	Sep P	55.0	55.1
13:00	**UK**	**Bank of England Bank Rate**	**Sep-23**	**0.1%**	**0.1%**
14:30	US	National Activity Index	Aug	0.50	0.53
14:30	US	Initial Jobless Claims	Sep-18	320k	332k
15:45	US	Manufacturing PMI	Sep P	61.0	61.1
15:45	**US**	**Services PMI**	**Sep P**	**55.0**	**55.1**
16:00	US	Leading Index	Aug	0.5%	0.9%
18:00	US	Flow of Funds	2Q		
Friday Sept 24					
02:30	JN	Jibun Bank Japan PMI Mfg	Sep P		52.7
02:30	JN	Jibun Bank Japan PMI Services	Sep P		42.9
10:00	GE	IFO Expectations	Sep	96.5	97.5
16:00	US	New Home Sales	Aug	710k	708k

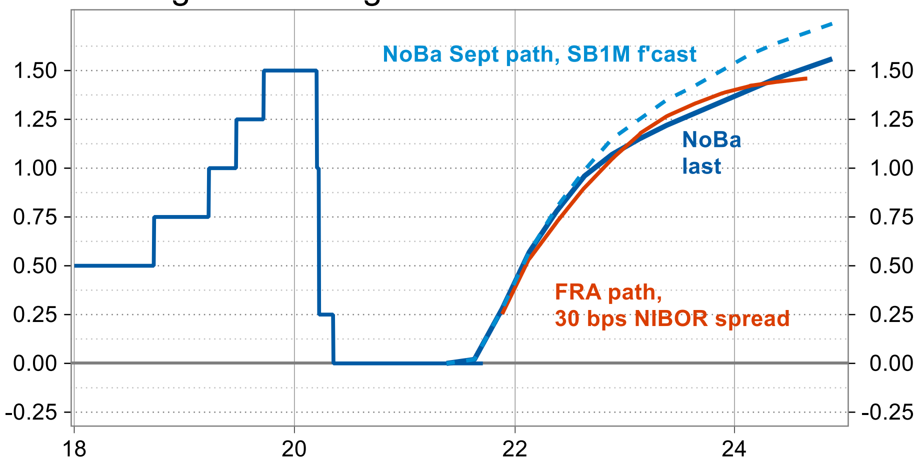
Sources: Bloomberg. SB1M est. in brackets. Key data are highlighted, **the most important in bold**

- **PMI**
  - The August **Global PMI** was weaker than expected due to a sharp decline in service sector PMIs in US, UK, Japan and in China, very likely due to the Delta outbreaks. It may be to early to expect a recovery in Sept but it is not unlikely, given that the no. of Covid cases/hospitalised persons are falling most places. (China is not reporting flash PMIs)
- **USA**
  - To formally signal **tapering** now, or wait until the Delta is beaten down and the impact on the labour market from the termination of extra unemployment benefits for 7.5 mill workers can be assessed, that's the question for the FOMC meeting at Wednesday. There are good arguments for both alternatives but given the impact of very low rates in a booming economy, the bank should have decided a late 2021 tapering start now. Still, we doubt it will, but no big deal if the decision is postponed to the next meeting. The 'dot-plot', the FOMC members individual rate outlook, will very likely be shifted upwards, and a majority will signal that the first hike is most likely in 2022, and some will even assume two or more hikes. Some doves will still think 2023 is the likely timing
  - The **housing market** is still tight but higher construction costs is a challenge. Starts, new and existing home sales and prices, as well as the home builder's index out this week
- **UK**
  - The **BoE** has signalled a more hawkish stance, and an earlier tapering has been announced. Still, the BoE is probably not prepared to hike anytime soon – but the market is contemplating 2 – 3 hikes next year, and the Bank will now have to 'respond' to these expectations
- **Sweden**
  - **The Riksbank** is still conducting a very expansionary monetary policy, while the economy is booming. Most other banks have signalled a change of tack recent months, and the Riksbank is always (a late though) follower of fashion. So, the bank should soon join in. A higher CPI print is perhaps not the best argument but it may be used. The mortgage backed QE program must be especially exposed for a tightening now
- **Norway**
  - **Norges Bank** will no doubt lift the signal rate to 0.25%. We think the interest rate path will be lifted once more, but just by half as much as in June, and the adjustment will kick in from late 2022. *More next page*
  - The **LFS survey** has reported a rapid growth in employment, and the employment rate is back to the pre-pandemic level! An even faster, and for us surprisingly rapid increase in the participation rate, is responsible for the still high unemployment at 4.8%. We expect the unemployment rate to decline the coming months

Ahead of Norges Bank: Lift off – and a steeper interest rate path

A 25 bp hike is given. We expect the interest rate path to be lifted by another 15 – 20 bps

Norges Bank Signal rate forecast vs market

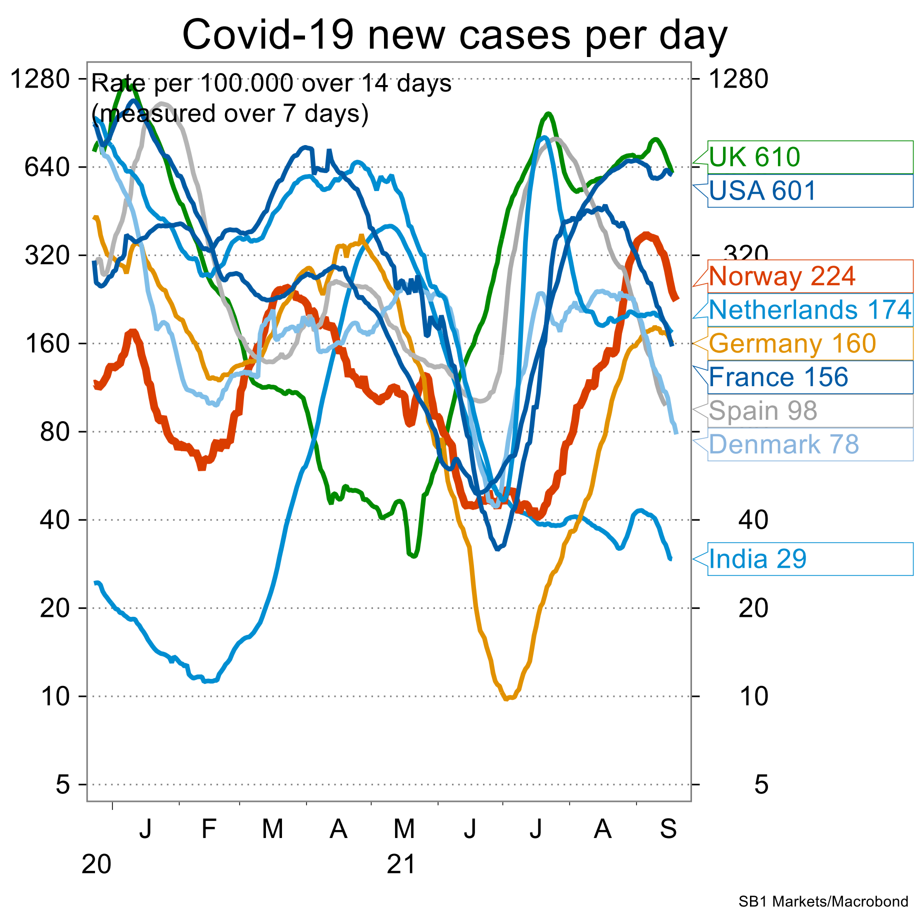


Changes in the interest rate path from the June NoBa meeting	Impact bps
Domestic demand (incl oil price), capacity util.	8
Money Market (money market, lending spreads)	0
Prices, wages	10
Foreign factors	2
NOK	13
Judgement (surveys, fin. stab, global risk etc)	-15
Sum	**18**
Changes in NOK Dec-22 FRA since after June m.	12
Change in the interest path 1 1/2 - 2 years from now	

- **On the upside vs. the June interest rate path**
  - » A substantial weaker NOK
  - » A higher oil price
  - » Wage inflation is drifting upwards (confirmed by the Regional Network)
  - » Unemployment has fallen faster than expected, at least at NAV
  - » The network is reporting higher capacity utilisation
- **On the downside**
  - » Housing investments will be revised down
  - » House prices are below the June f'cast
  - » Credit growth is lower than estimated
- **Neutral or close to neutral**
  - » Growth, interest rates abroad
  - » Norwegian surveys, Norges Bank's network (at least vs. growth)
  - » CPI inflation: Core at track. Electricity prices are surging, but future prices are down. The impact on household disp. income the coming year is not that large
  - » Money market, mortgage spreads
- **The market**
  - » The FRA-curve has gained substantial height recent weeks, and last week it climbed above NoBa's June path (in 2023). We do not think a 15 – 20 bp lift by NoBa will materially change market rates – <u>but they will not decline, stay short</u>

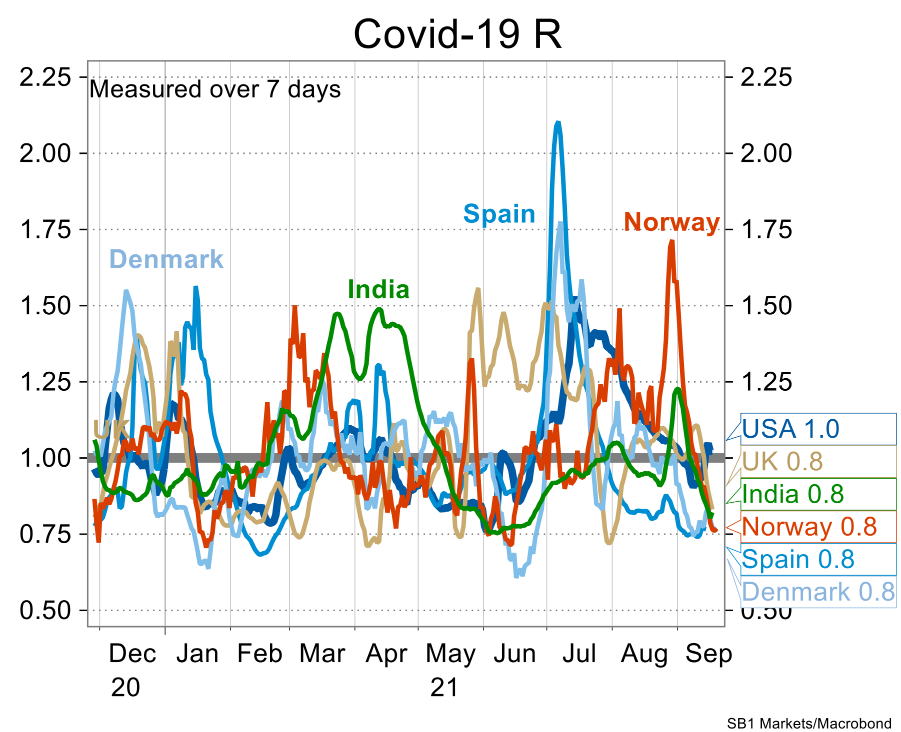
Most countries are reporting fewer Covid cases

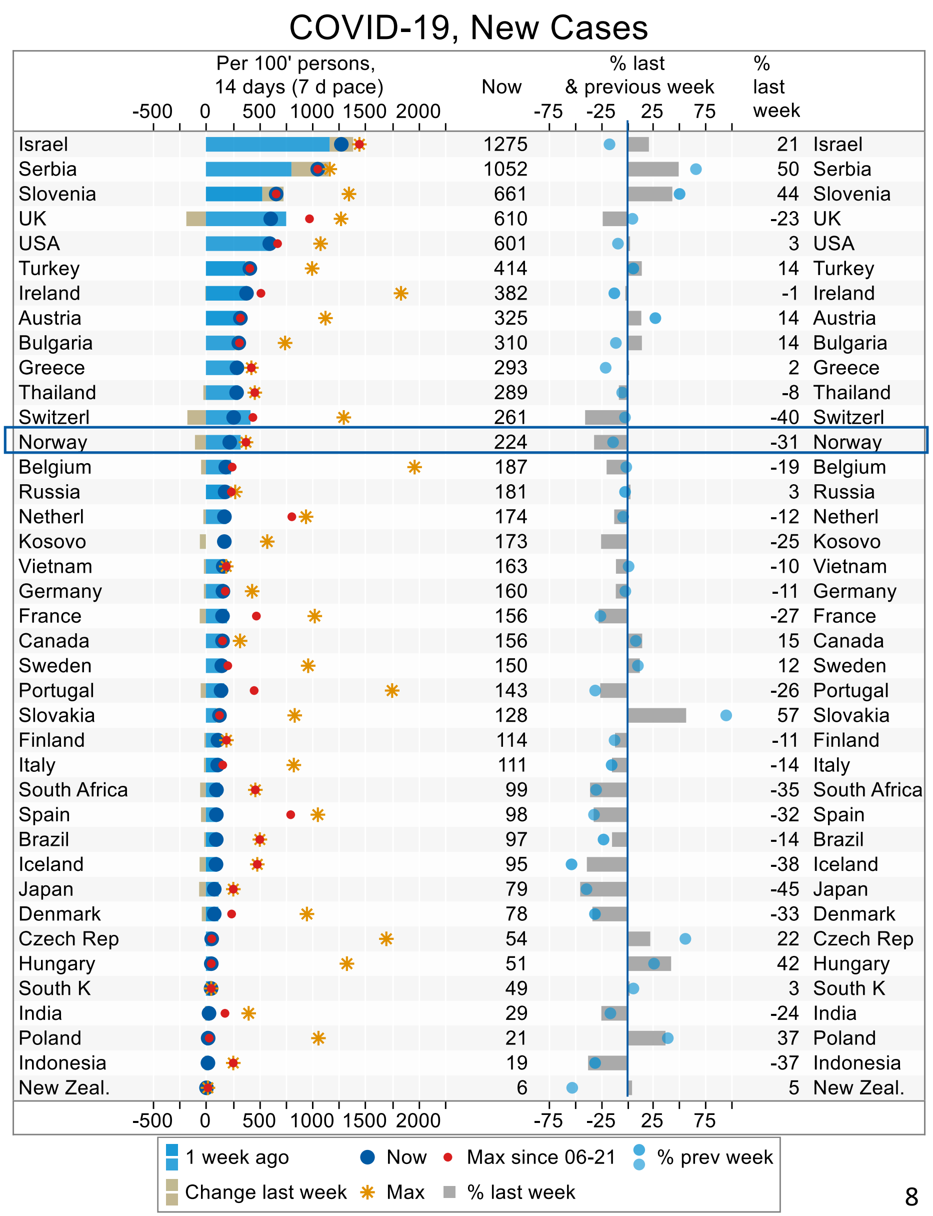
The only risk now: A vaccine resistant virus variant



- 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 <u>we very much doubt there will be. The no. of cases is falling in most countries, and the no. of hospitalised has flattened</u>
- Growth in new cases, hospitalisations & deaths have peaked in the **US** – in due time as the serious illness/death rate have been far higher than in Europe, and the no. of hospitalised rose to a high level again. <u>Now, the number of hospitalised patients is falling rapidly</u>
- The situation has been even more challenging in many **Emerging Markets,** but even there the no. of new cases has peaked in most countries, and growth has slowed in others. Few new cases are reported in **India** – and in **China** close to none
- **In Norway,** the no. of new cases is now falling rapidly, and the no. of hospitalised have flattened at a low level, equalling 19 per mill, vs 100+ in the UK, and almost 300 in the US). Just 0.6% of those who have tested positive are hospitalised, vs 8% in the US!
  - » <u>It seems very unlikely that the Norwegian health system will run into any sort of capacity problems</u>

The no. of new cases falling in most countries





- The red dots on the chart to the right indicate the peak in new cases since June (India's peak was in May). When these dots are in 'free air', cases are down vs the recent peak - which is the case in 29 of 38 countries (from 31 last week)
- Last week the no. of new cases grew in just 12 countries (from 8)
- *Disclaimer: Testing policies/capacities may have changed (and they differ vastly between countries)*

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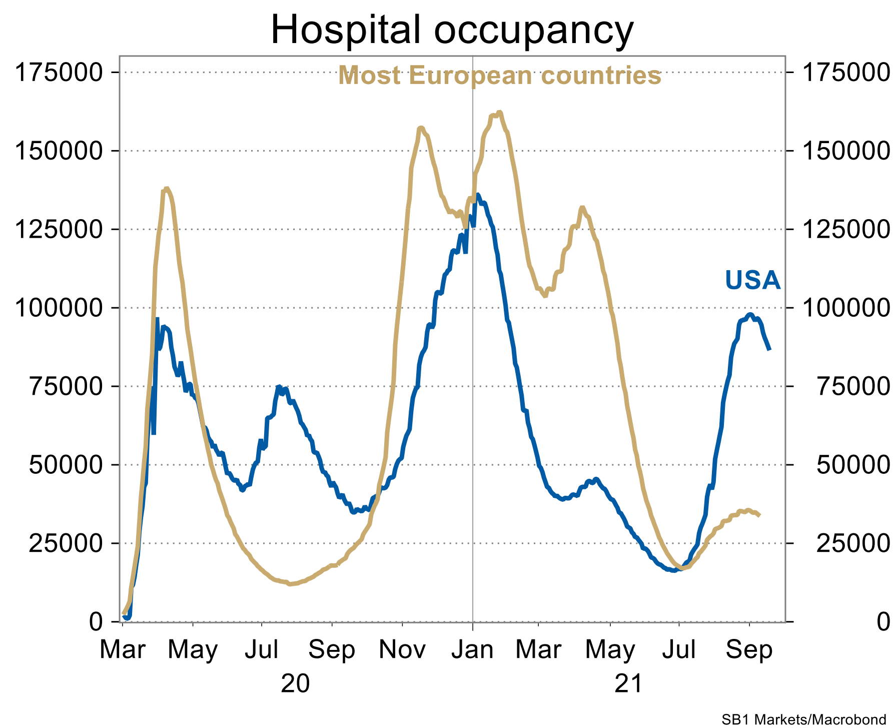
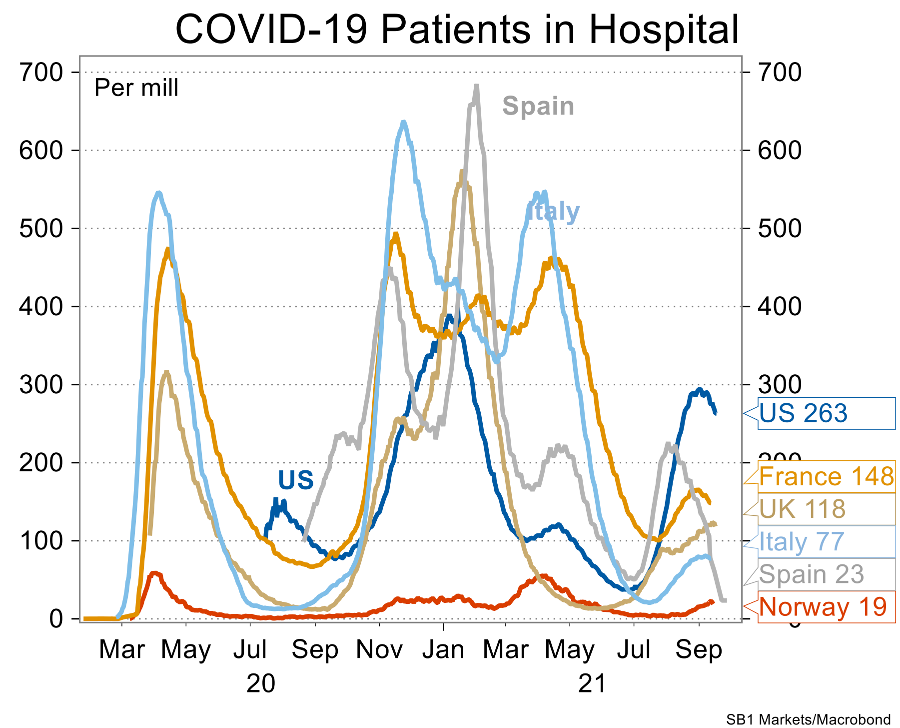
The no. of patients admitted to hospitals due to Covid is flattening/falling

Just the US reached troublesome a level the past weeks the no. of patients have clearly fallen





- The number of hospitalised persons in Norway has increased substantially but remains at a very low level – and seems to have flattened

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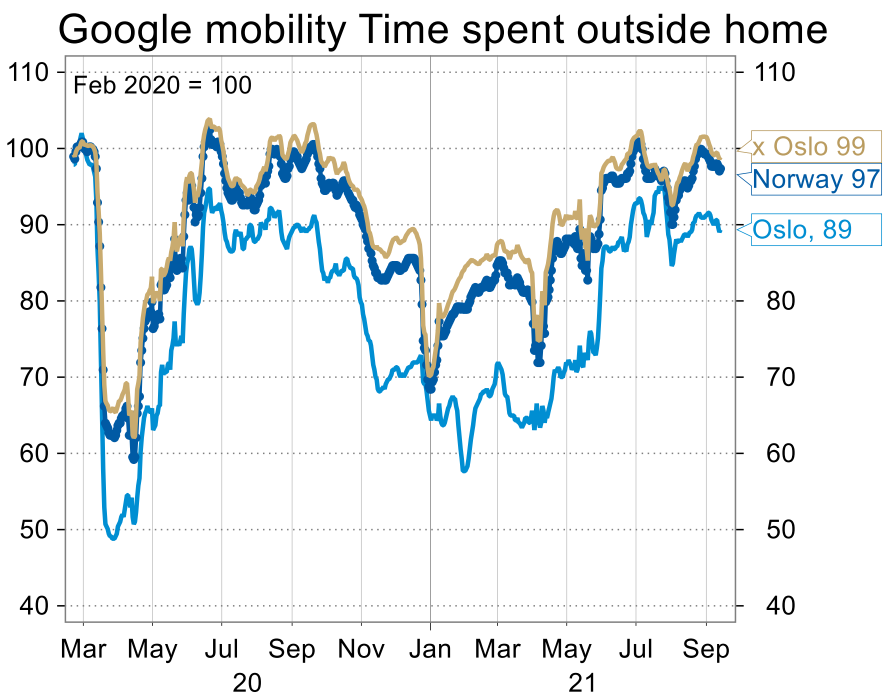
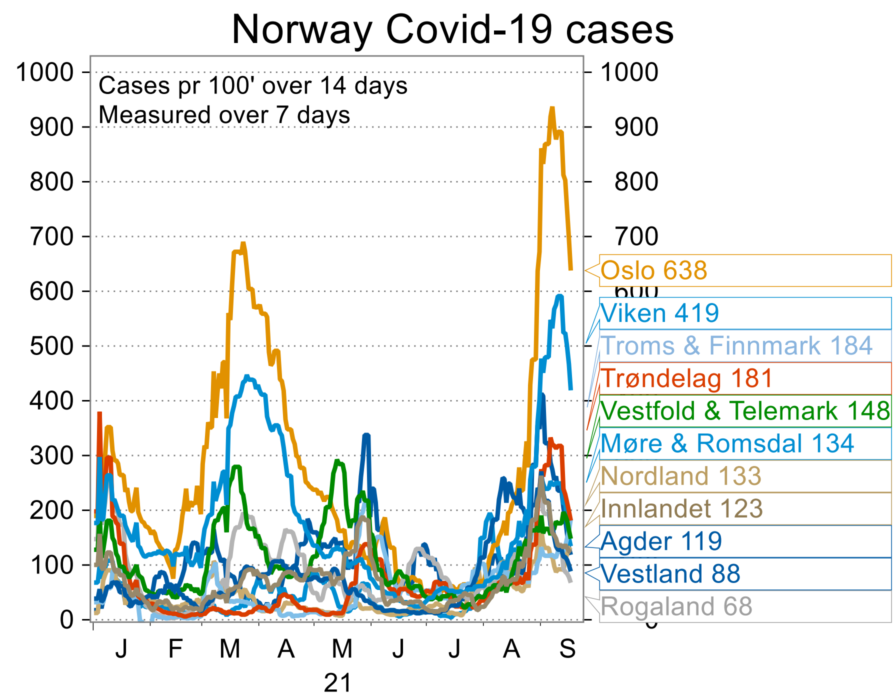
Norway: New cases on the way down everywhere

Mobility has slowed marginally so far in September but we doubt Delta is to blame



SB1 Markets/Macrobond



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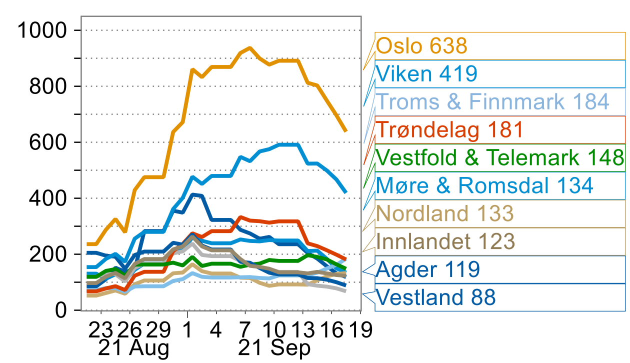
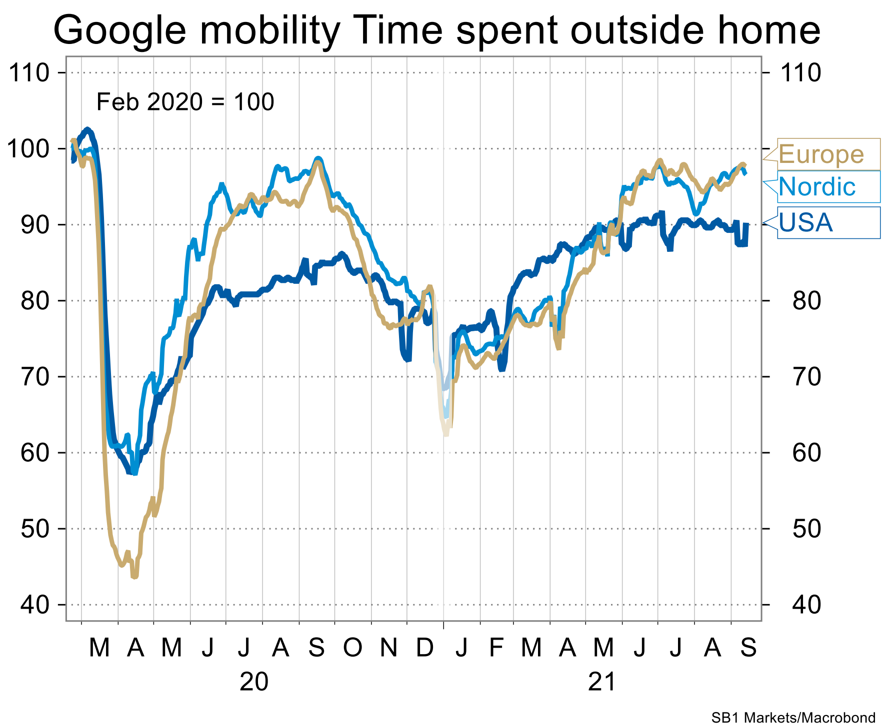
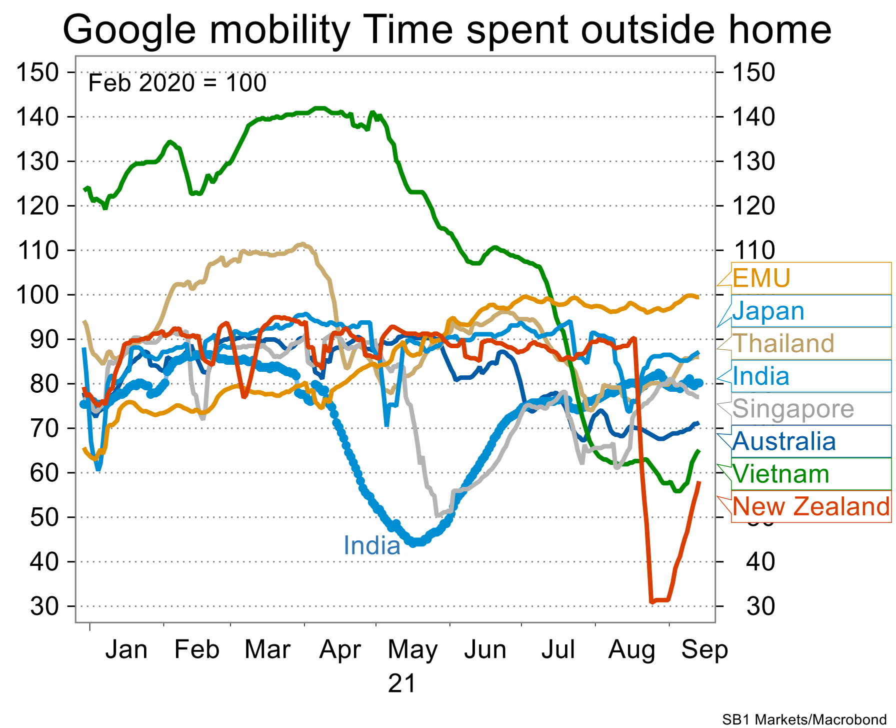


In the West, no sign of reduced mobility during the Delta attack

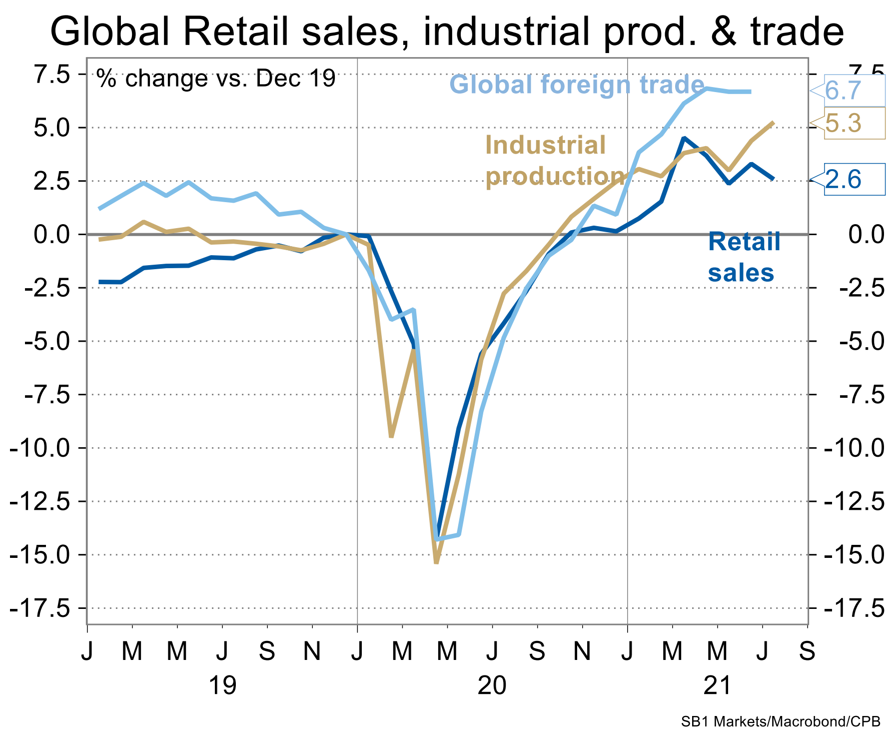
Still challenges in the East but mobility has bottomed everywhere

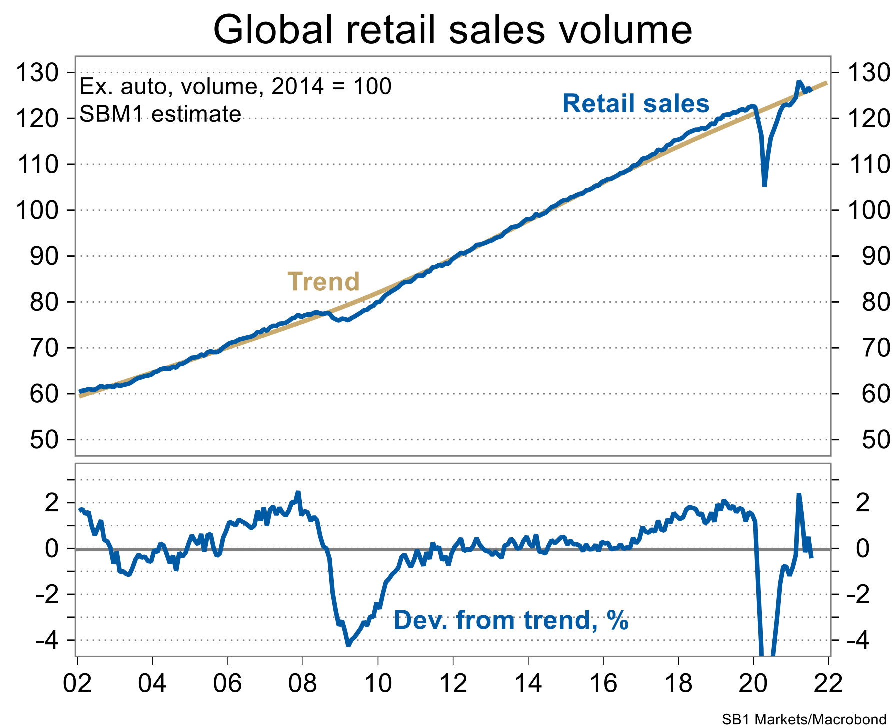




Activity in the goods sector is flattening

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

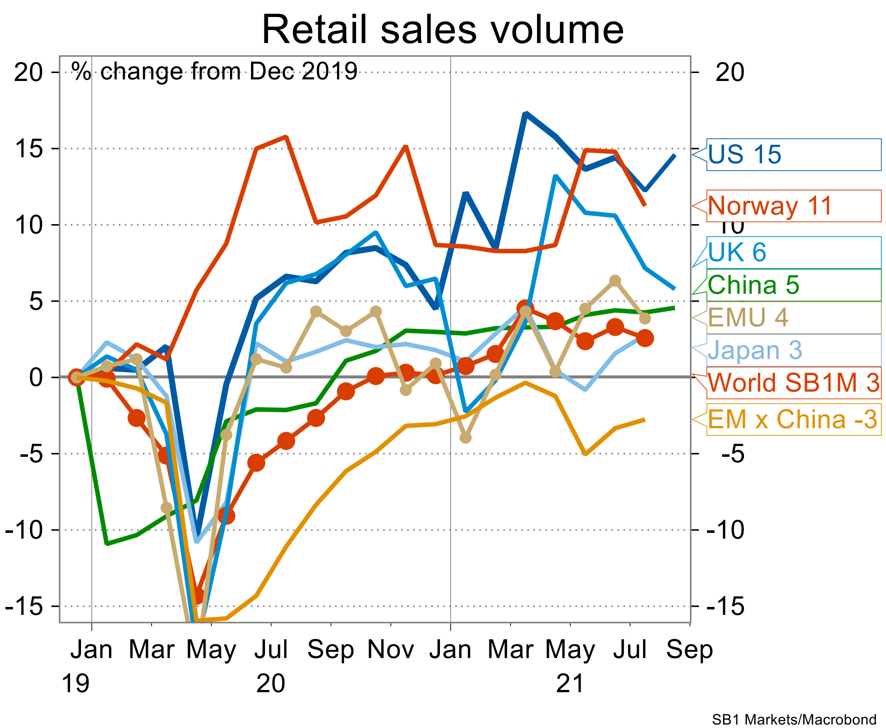


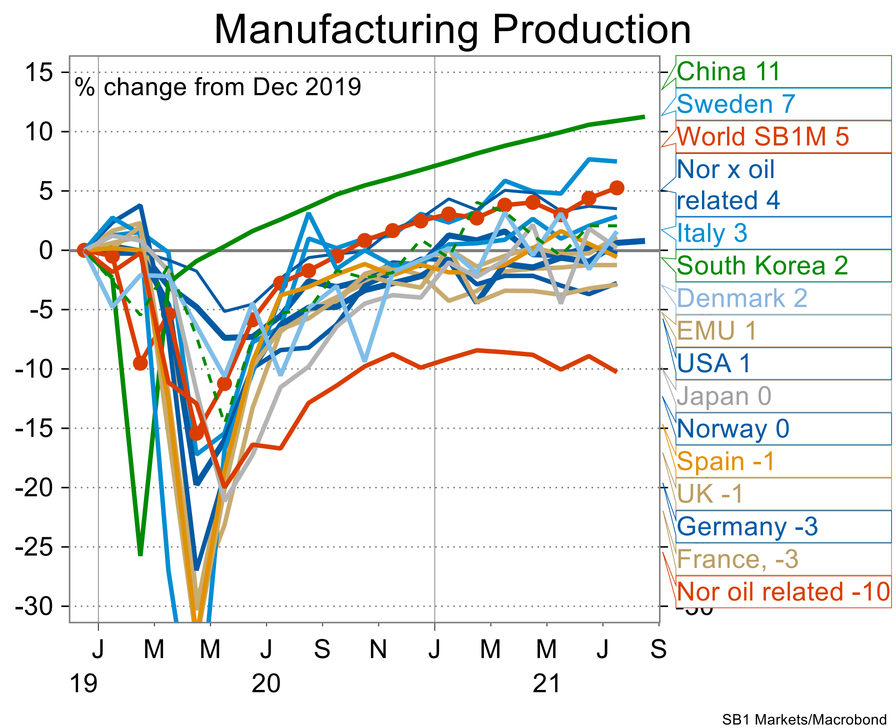


- **Retail sales** rose in June but fell in July, and sales have flattened recent months, partly due to the India but also a downward trend in rich part of the world. The level is approx. 2½ % up vs the pre-pandemic level
- **Manufacturing production** rose in June, and continued upwards in July. The level is some 5% above the pre-pandemic level. Trouble in India and in the auto industry globally have contributed on the downside recent months
- **Global foreign trade** flattened in May (was originally reported up), and was stable in June as well. The level is close to 7% above the pre-Covid level, according to CBP in Netherlands

DM demand for consumer goods have peaked, and EM has been weak lately

The upside potential is large for Emerging Markets, but the Delta variant is hampering activity

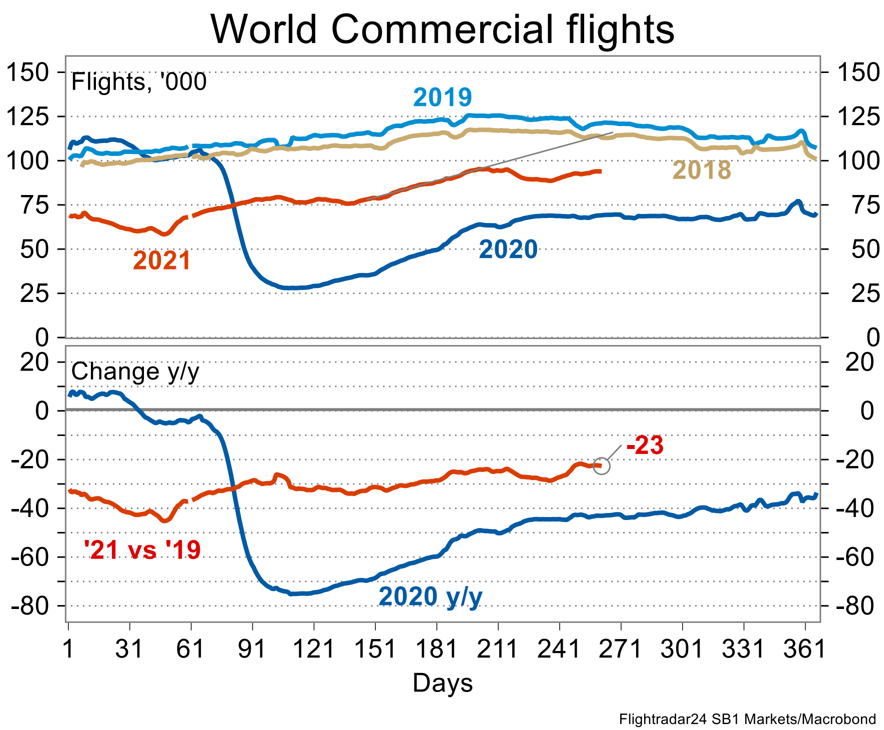


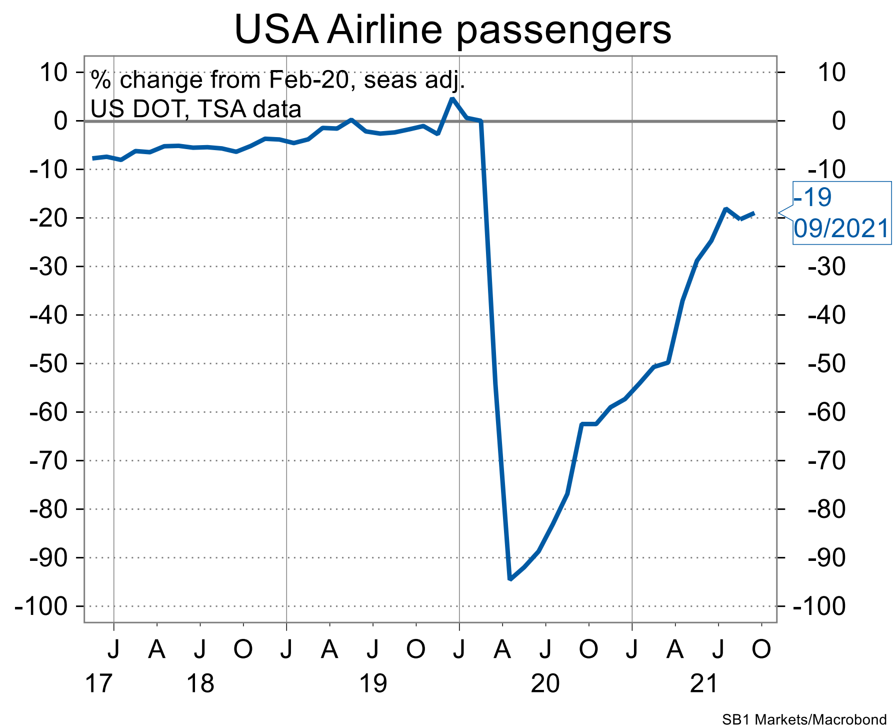


- Retail sales in Emerging Markets x China were weak before the summer due to the setback in demand in India. Now a substantial recovery is underway in India, but now other Asian countries have run into problems
- Manufacturing production is still drifting upwards, everywhere. The manufacturing PMIs are still strong
- Norwegian oil-related manufacturing production is down 10% vs the pre-pandemic level – non-oil sectors are up 4%, one of the better results in the rich part of the world (but behind Sweden, +7%). The Norwegian PMI and other surveys are signalling very strong growth (among the best in the world)

Global airline traffic further up last week, the gap to 2019 at 23%

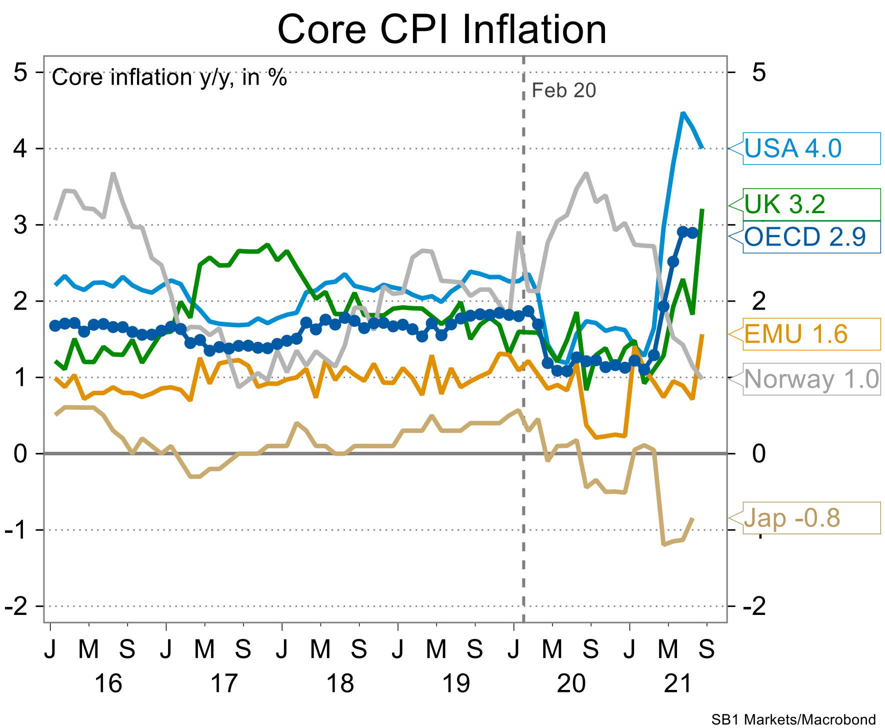
In the US, traffic flattened in August but the first half of September marginally better

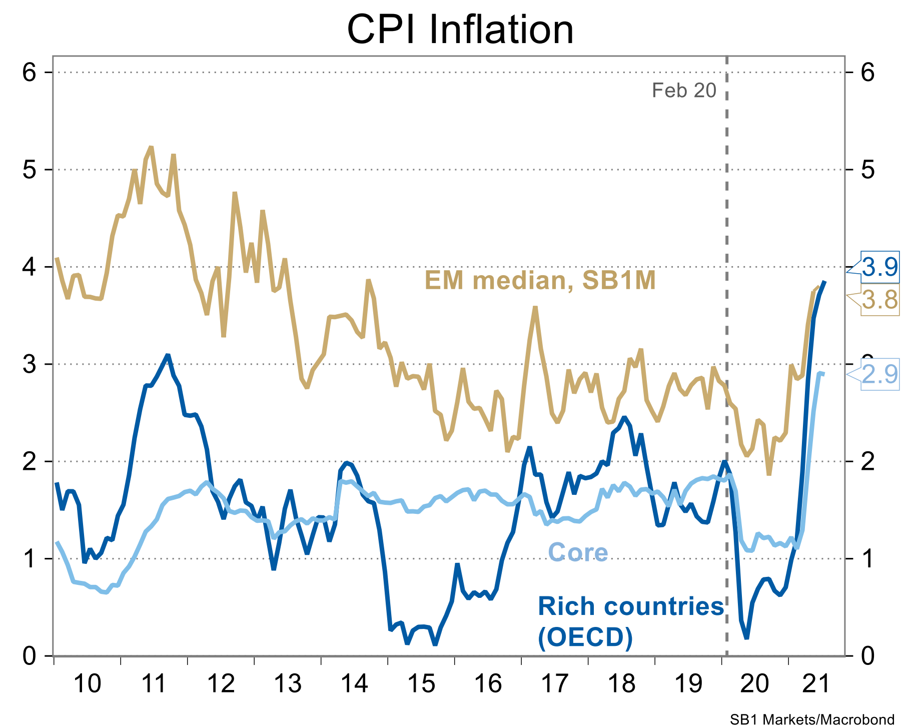




Inflation on the way up most places

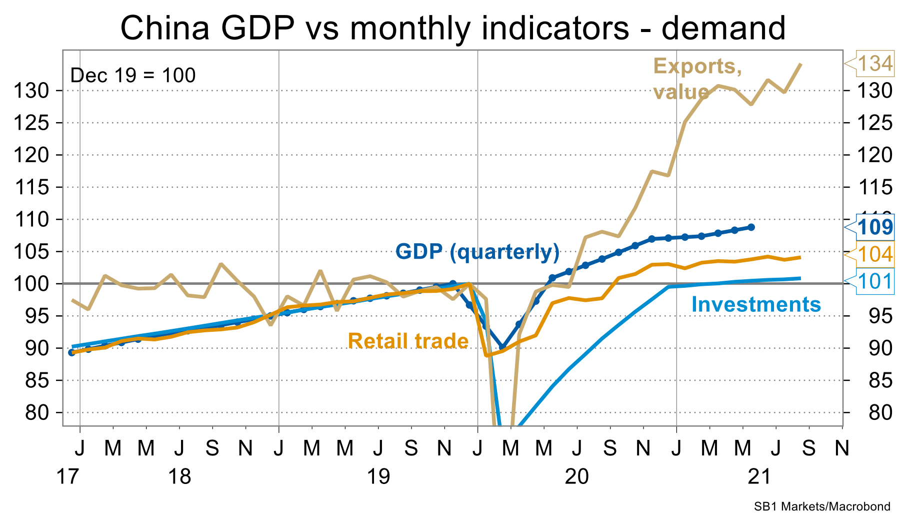
Energy prices the main culprit, core inflation not much up outside the US and UK (so far)

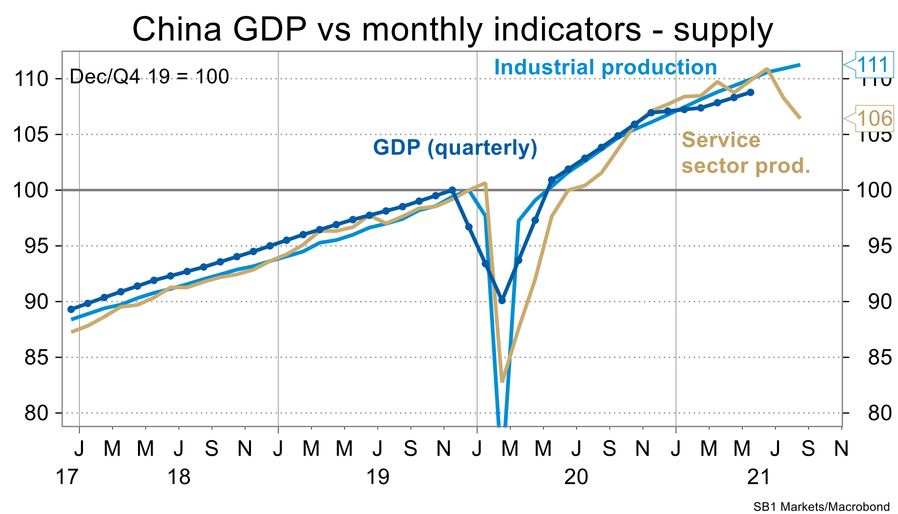




August data weaker than expected too – Delta at least partly to blame

However slow retail sales, investments & and a decline in construction/steel in place well before Delta



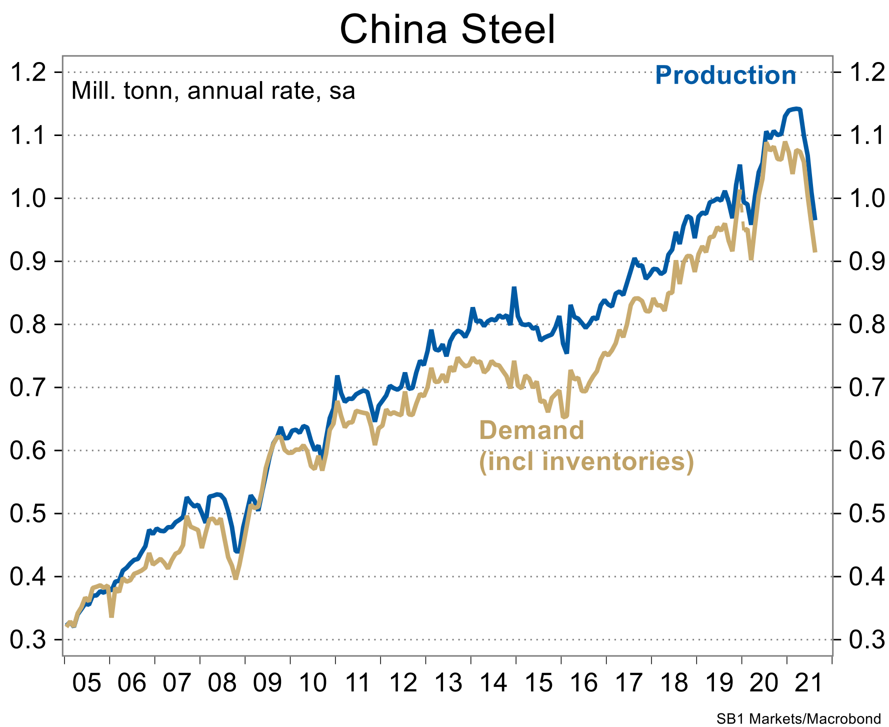


- **Industrial production** rose by just 0.3% in August, as in July, half the 'normal' growth rate. Measured y/y, production is down 1.1 pp 5.3%, 0.5 pp below expectations. Production is still 3% above the pre-corona trend path but growth has slowed, and more than we had assumed. Cement down 10%, steel 16% recent months, partly (they say) due to 'CO_2' restrictions but demand (at least construction activity) is falling too. Surveys are down but are signalling growth well north of the 0.3% per month rate
- **Service sector production** fell by 1.7% in August, following the 2.4% July drop, in sum an unusual decline (although far less than Jan/Feb last year), confirming the weak service PMIs. The level is some 4% below the pre-pandemic trend growth path. No doubt virus related, and thus temporary.
- **Retail sales volumes rose by** 0.3% in volume terms (our est.) in Aug, reversing the July decline but sales have been growing less than at a 2% pace since last Nov, far below the pre-Covid 6% pace, and the level is some 5% below the pre-Covid growth path. Sales were up 2.5% y/y, down from 8.5%, and 4.5 pp (!) below expectations. Auto sales are a part of the story. We doubt the underlying trend is that weak
- **Investments** grew by just 0.2% in Aug, and July was revised down to 0.1% (these data are now routinely revised down!) The level is 7% below the pre-pandemic trend growth path. The (still useless) accumulated annual growth rate was 8.9% in Aug, down from 10.3%, 0.2 pp below expectations. Housing and other construction starts fell further, and have fallen 15% – 20 % recent months. **New home sales** fell further too
- **The previous week**
  - » **Credit growth** is slowed further too, and the credit impulse is negative, as normal approx. every 4th year
  - » **Exports** rose sharply Aug. and are 15% above the pre-Covid growth path! Imports rose as well, and are some few % above the pre-Covid path
  - » 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, but the extra weakness in July/Aug is probably mostly due to the virus outbreak. Policy tightening has contributed too, and as will soon a maturing global cycle in goods. A crash is probably still unlikely

Construction activity is sagging following the post-corona crisis surge

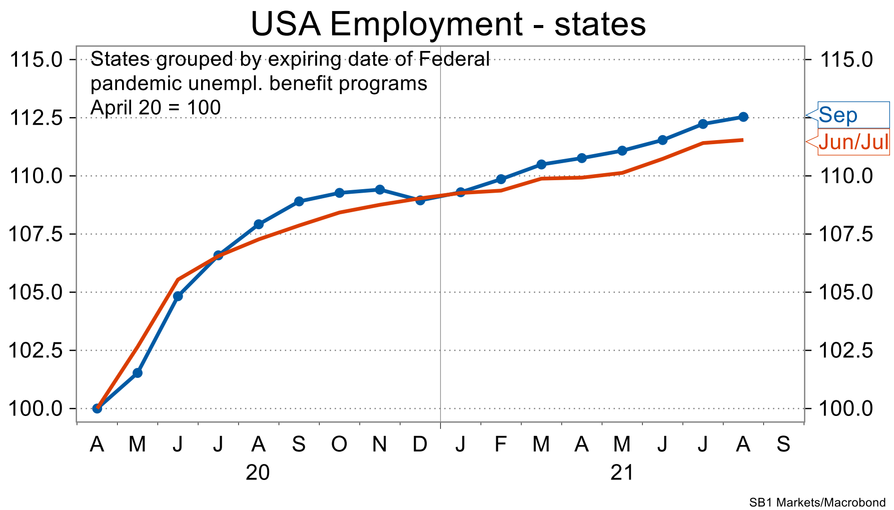
In addition, the authorities have decided to curb steel production in order to meet 2030 (!) CO2 targets

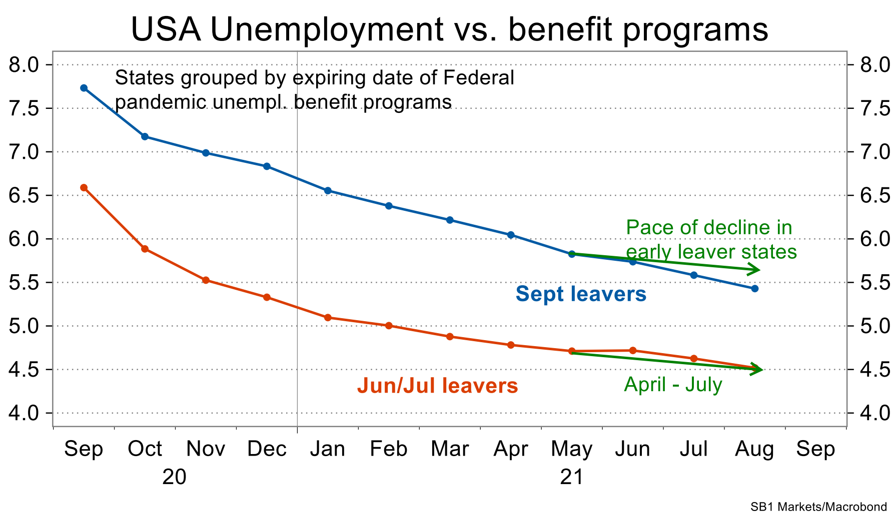


- The authorities have decided that 2021 steel production should not exceed the 2020 level, and as H1-21 production was well above the 2020 level – production must be cut in H2 (some 12%)
  - » Both production and demand (including inventories) are down 10% - 12% the past 3 months
- We assume there are 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)

Slower growth in employment in early Federal UI leaver states in August

However, unemployment has fallen slower in those states, as more workers are searching for jobs



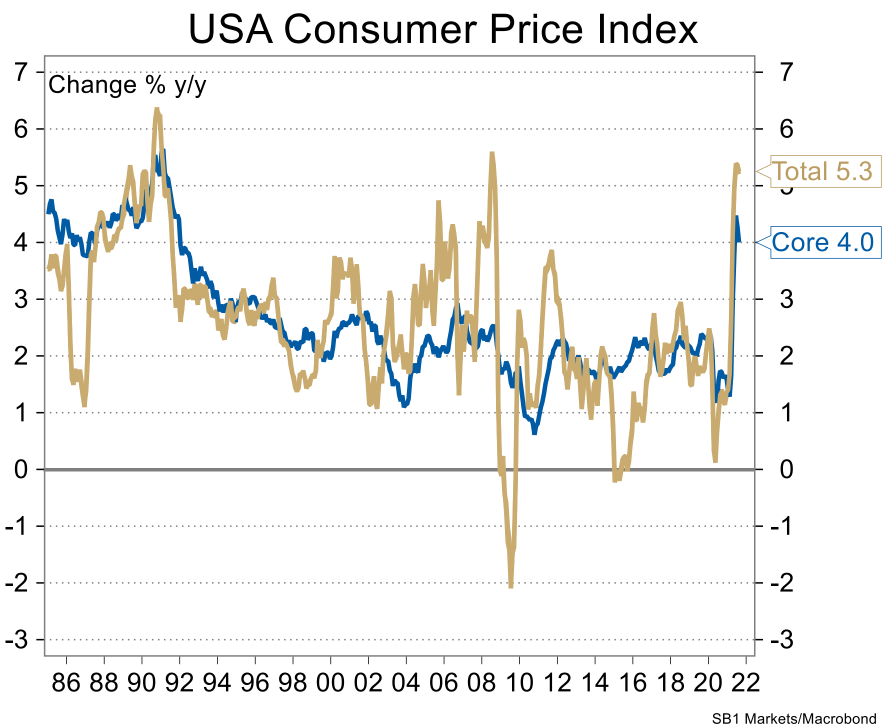


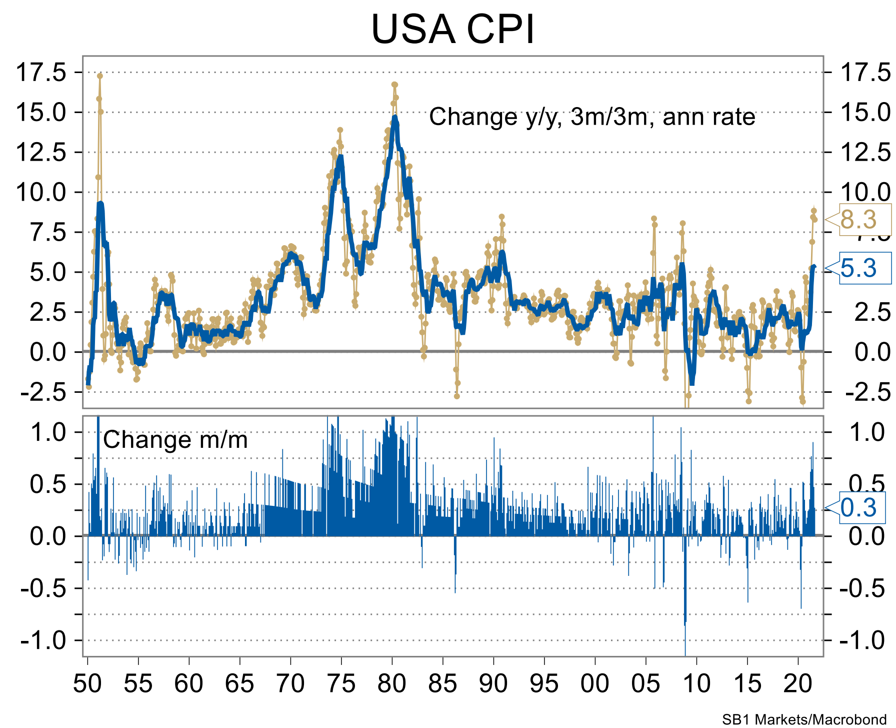
- Half of the states left the two temporary federal unemployment benefit programs in June and early July, so far without any significant differences in employment growth the past 2-3 months
  - In August, employment rose by 0.1% in the early-leaver states, and by 0.3% in the rest of the country, a 'wrong' sign
  - In July, growth was equal in the two groups of states.
  - In June early lavers states reported a somewhat higher employment growth than the others
- State participation rates are not published but we have an indication that participation has increased marginally in the early-leaver states
  - The unemployment rate has fallen by has fallen by 0.2% In the early-leaver states vs by 0.4 pp in the rest of the country
  - The employment rate has increased more or less by the same amount (state employment rates are not published, and we have not bothered calculating them).
  - If so, the participation rates in the early-leaver states must have increased by 0.2 pp more than in the other states since April
- Given that some 3% of the working age population were enrolled on the temporary pandemic unemployment benefit programs that now have been abolished, a 0.2 pp lift in the participation (in the early-leaver states after two months) is not that impressive
- In addition, since employment has not increased, which is the real test, these August data are far from encouraging for those who are expecting a tsunami of willing and able workers into the labour market the coming weeks and months

SpareBank 1 MARKETS

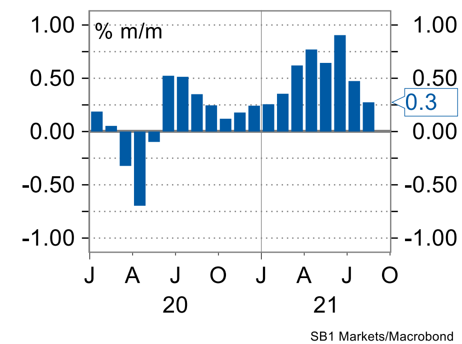
Peak CPI inflation? The m/m increases slowed further in Aug, more than expect.

Used auto prices finally yielded. So, is it transitory? Well, time will tell, Delta explains the Aug slowd.?



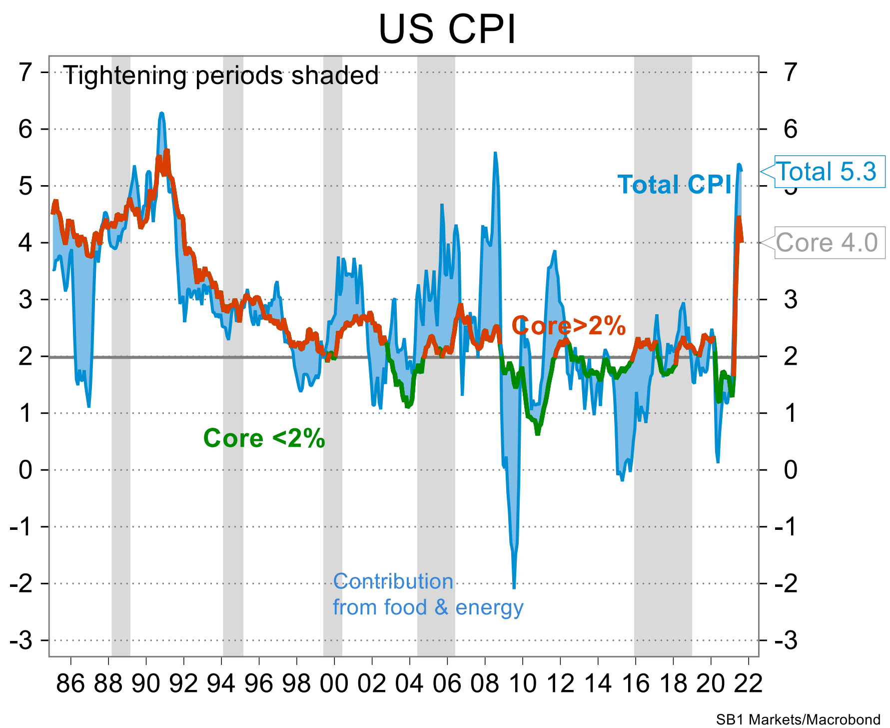


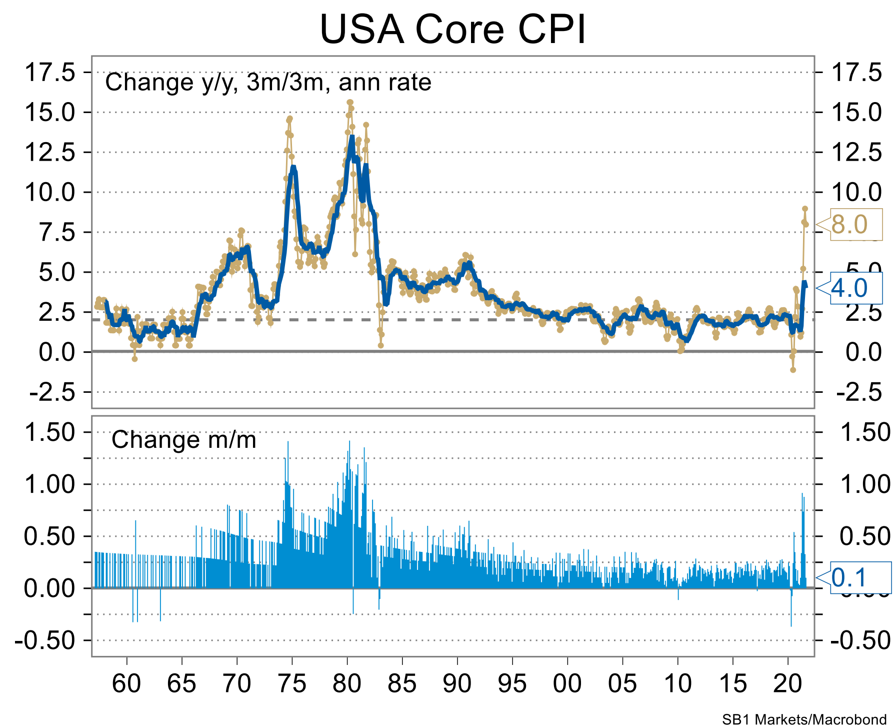
- **Headline CPI** rose 0.3% m/m in August, 0.1 pp below expectations. The annual rate slowed marginally to 5.3%. This is still a high CPI y/y print in a historical perspective
- **Prices have been accelerating** m/m since last October, and the 3m/3m rate is still at 8.3%
- In all surveys, companies reported that they have or expect to lift prices sharply, some faster than ever before
- In August, lodging and airline tickets become cheaper, very likely due to the air pocket created by the Delta outbreak
- It is far to early to celebrate the transitory camp's victory



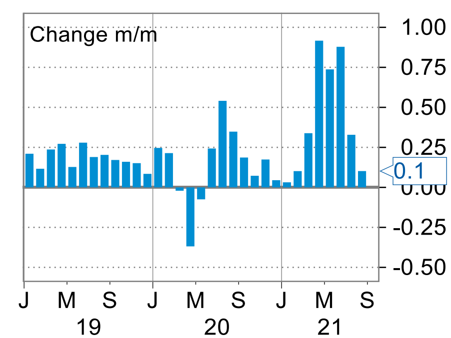
Core inflation slowed more than expected

Prices +0.1% m/m in August, expected 0.3%, the annual rate down 0.3 pp to 4.0





- **Core prices climbed rapidly m/m April – June but slowed in July, to 0.3% and further to 0.1% in Aug**
- 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) are candidates on the downside, and used auto prices fell in Aug
  - » 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

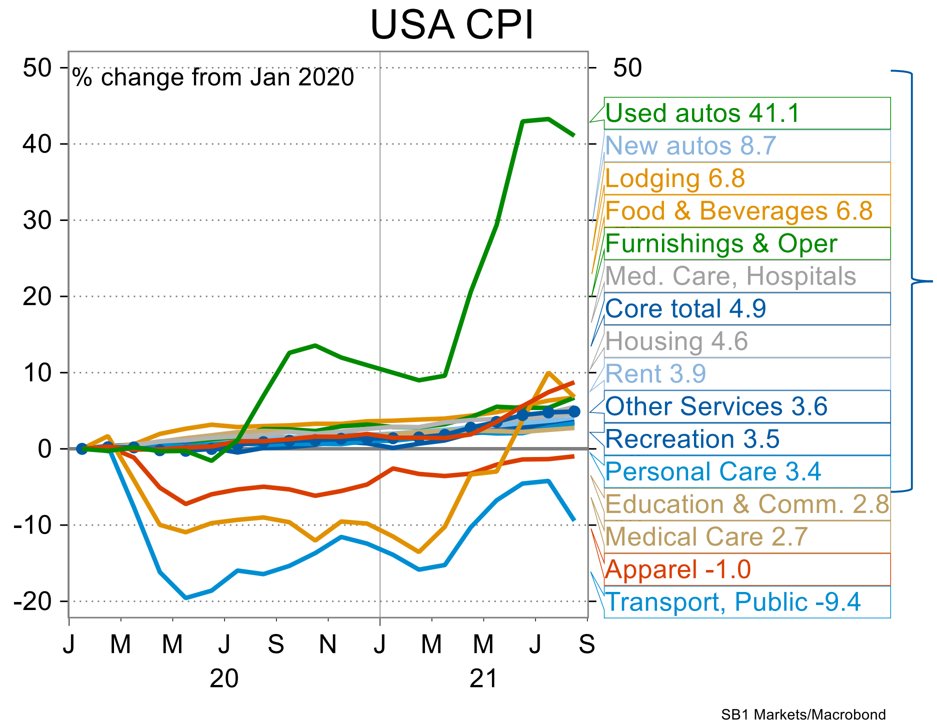


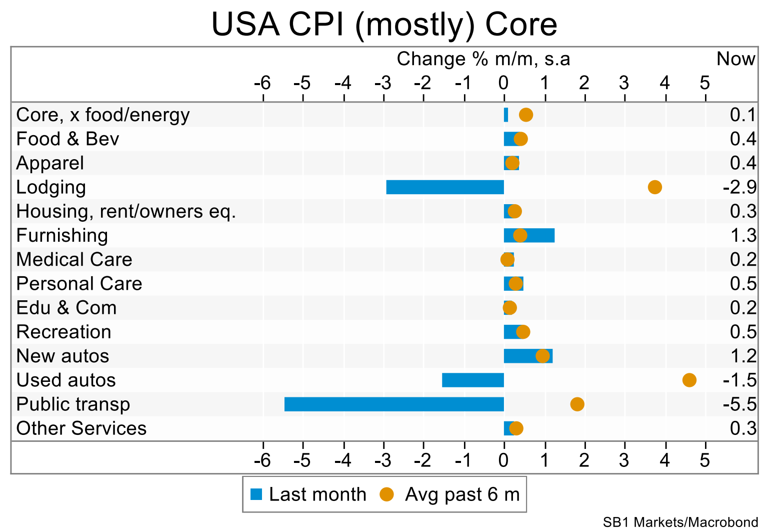
SpareBank 1 MARKETS

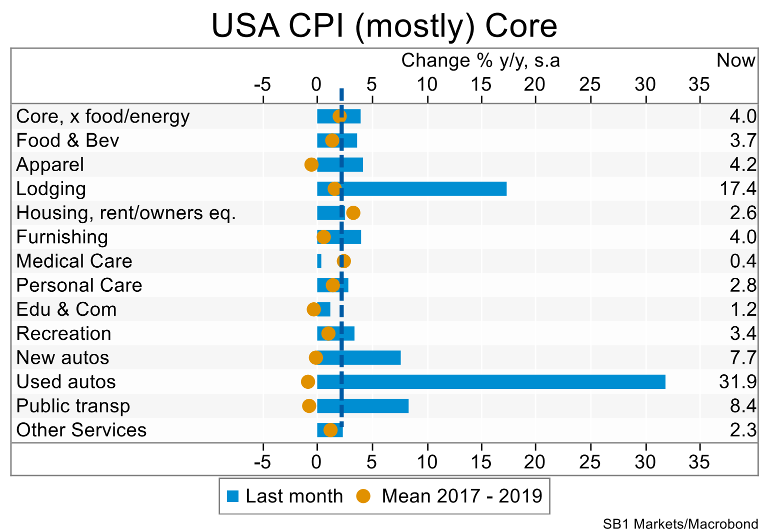
Used auto prices down in Aug, and lodging, public transport price fell as well

The lower hotels, transport prices corona related, most likely not permanent

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



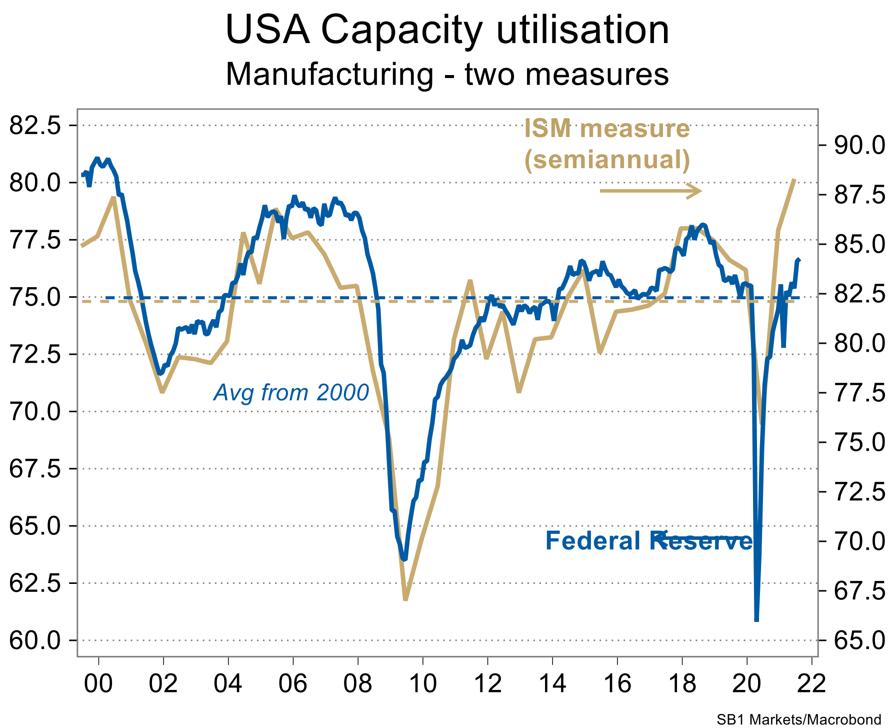




- Just some few CPI components contributed to the setback last spring: **Public transport** (airline tickets) **lodging** away from home (hotels ect), and **apparel**. Other components of the CPI did not slow significantly
  - » Now lodging is full back but both transport and apparel prices are still below the Feb-20 level
- **Used auto prices** have been on the way up since last summer, but fell 1.5% in Aug, but prices are still up 32% y/y, due to lack of new cars (which are up 7.7%). More on these prices 2 pages fwd

Is capacity utilisation just somewhat above a normal level, or record high?

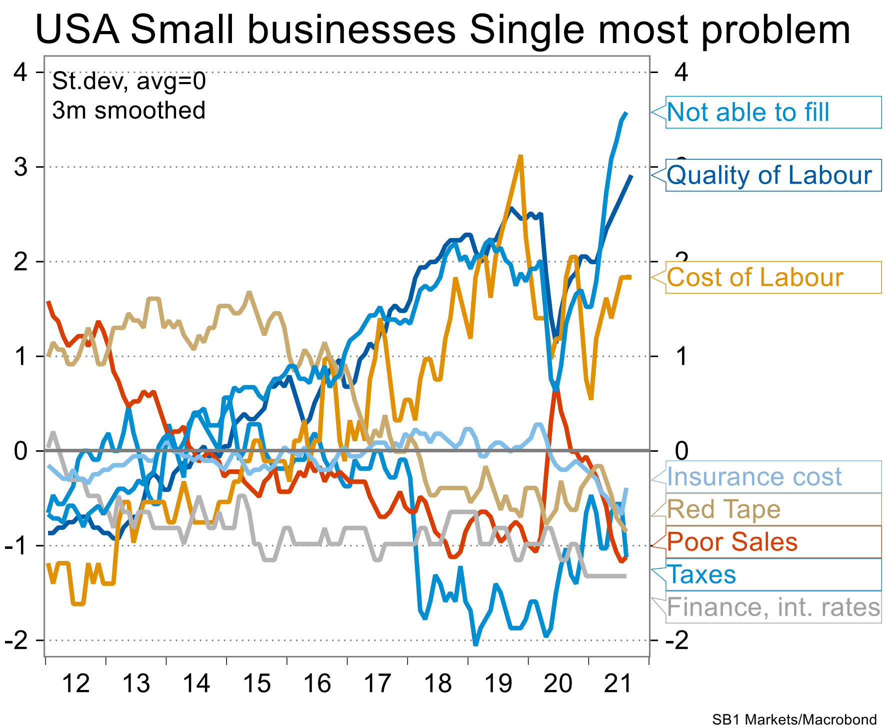
Not an irrelevant question

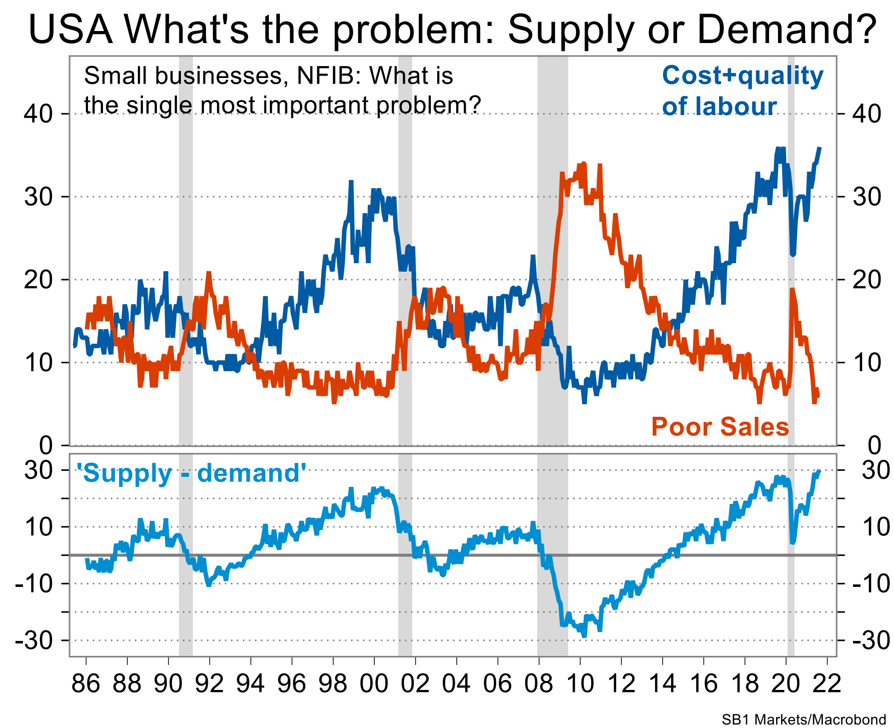


- **The Federal Reserve's** measure now yields capacity utilisation at 76.5%, vs. the long term average at 75%
- **ISM's semi-annual** survey reported a further sharp increase H1/May, the highest level ever, 88 vs the average at 82.5%.
  - » These two measures have not been 100% correlated but the current discrepancy is very large – and quite important when assessing the growth outlook
- The Fed's estimate is model based, while the ISM survey is based on companies assessment of their own capacity
- Given reports on labour shortages, material shortages, prices, the ISM survey seems to give the most reasonable result

We've said it before: It's the supply side! (… so no need to stimulate demand)

It's really looking like we are close to peak of a cycle, and not coming out of recession

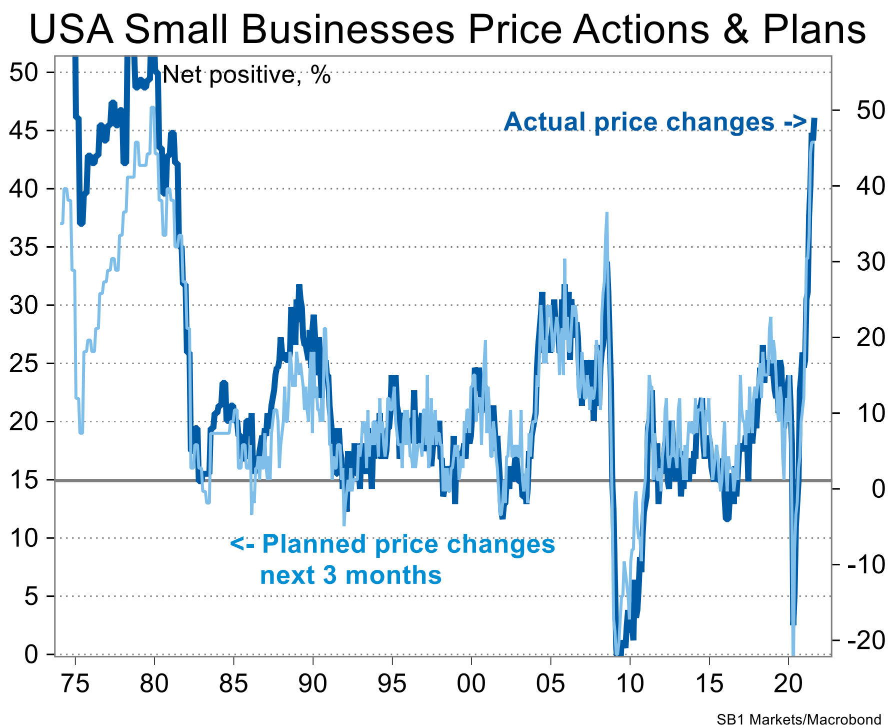


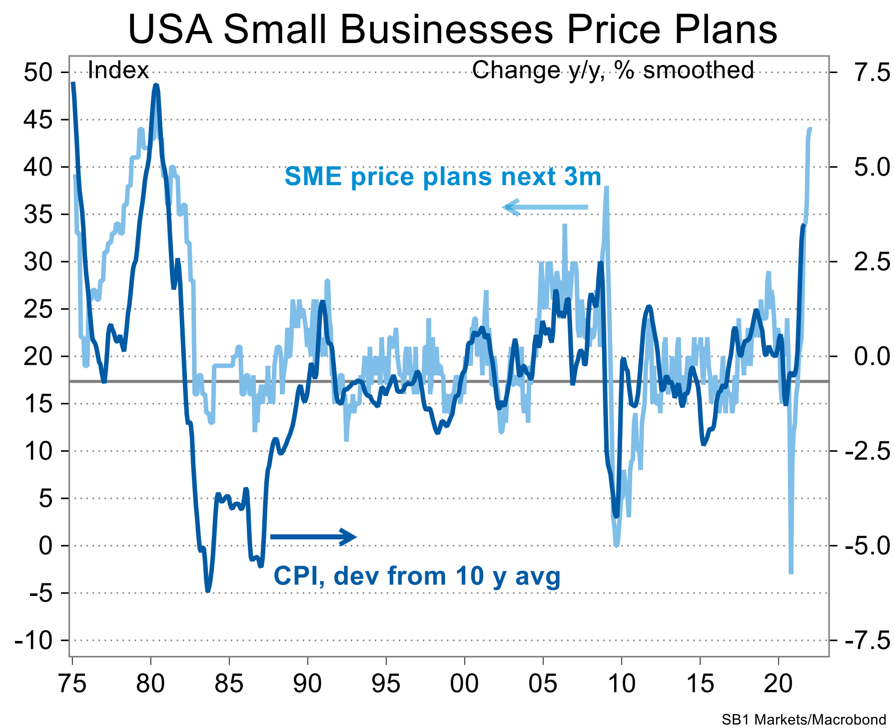


- While more businesses than normal stated **weak sales** as the major problem during the pandemic, there were never that many, and now a close to record low share of companies say than poor sales is the problem (and fewer than before the pand.)
- **Availability and quality of labour** is a much more serious problem than normal, and at ATHs. For **cost of labour,** the share is far above a normal level
- 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: A record high no. of SMBs still say they plan to raise prices

The share has been higher just one month, in December 1979

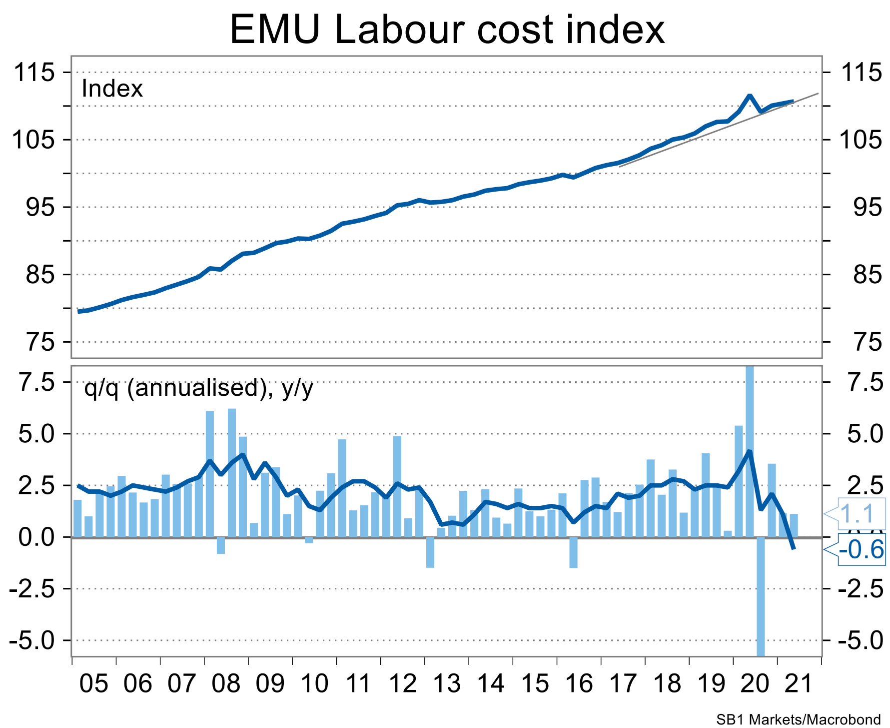


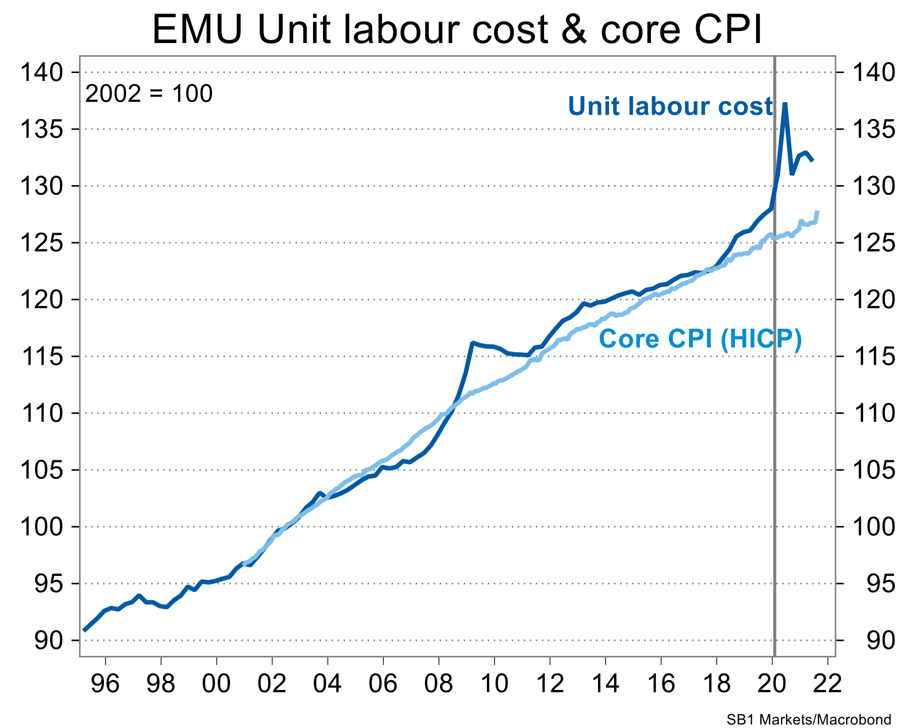


- Back in 1979, it lasted just one month; now we have been up here four months in a row
- It is challenging to calibrate the SBM survey vs. actual inflation, as the present print is so extremely far off the chart vs. the past 35 years experience. But surely, it tells us something. We have made at try at the chart above to the right, a second chart on the next page. Inflation may stay up here for still several months (but it may still be labelled 'transitory', of course)
- 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 still** reports a 3% expected growth in unit costs. Since 2013, the expectations have been stable at 1.75% – 2.25%

Labour cost back on track. Unit cost seems to moderate

Labour cost rose just 1.1% q/q (annualised) in Q2, as in Q1 – and is down 0.6% vs. Q2-20



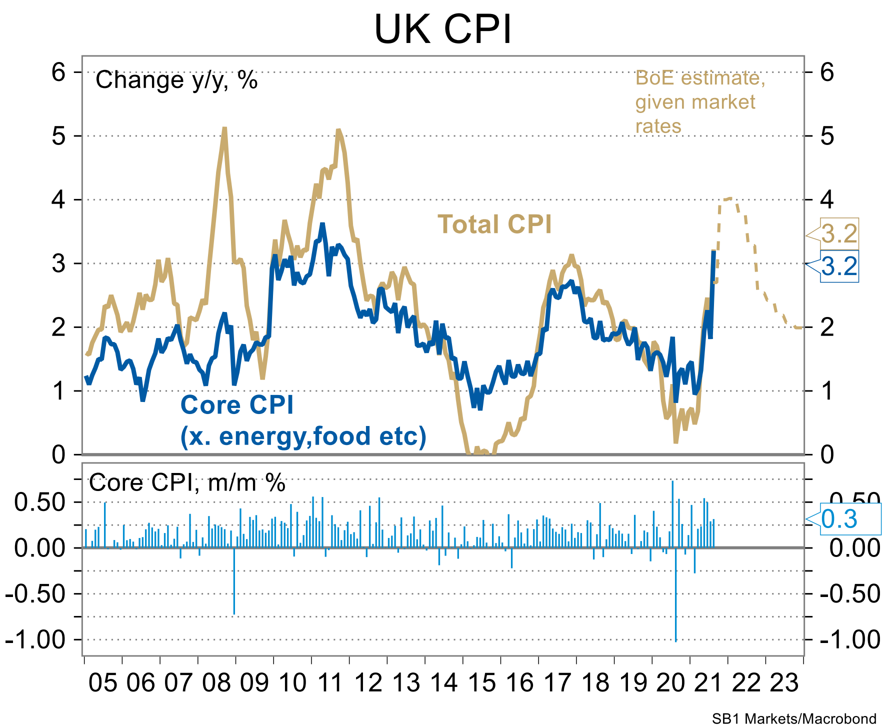


- Measured over the 2 past years, hourly labour costs are up 1.7% per year on average, which is far to little to generate inflation at 2% over time
- **Unit labour cost** has jumped up during the pandemic as productivity as productivity has fallen
  - » Unit labour cost have climbed less than in the US, and far less than in UK during the pandemic
- We expect a sharp reversal in unit costs when these economies reopens. If not…

SpareBank 1 MARKETS

Inflation sharply up in Aug, as last year's tax cuts no longer influenced y/y growth

Total inflation up 0.7 pp to 3.2% & core up 0.3 to 3.2%, both 0.3 pp above expectations

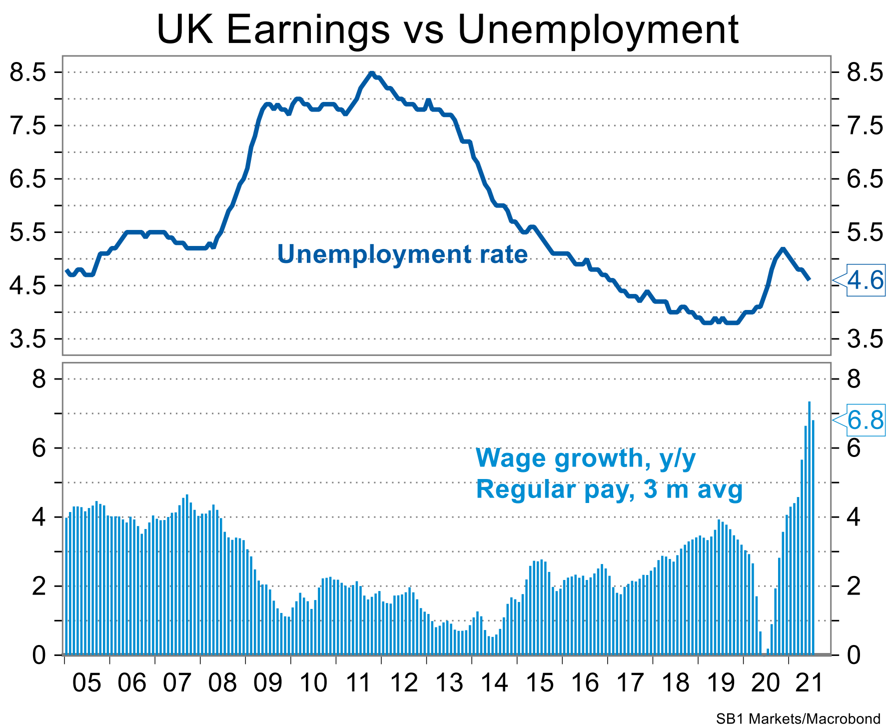


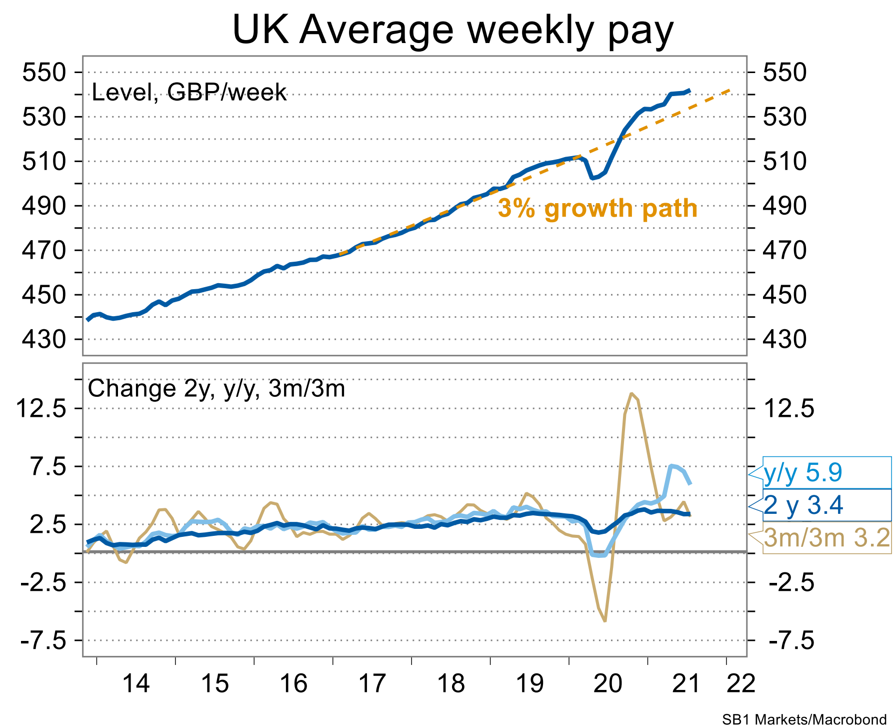
- In August last year, a subsidy scheme lowered prices in hotels and restaurants sharply, lowering the CPI by 1% m/m. So, in August this year the impact of these cuts fell out of the y/y calculation – and annual CPI rate accelerated by 0.7% to 3.2%. We feared a 1 pp lift, consensus was for a 0.4% lift, a strangely low estimate
  - » The whole 0.7 pp lift in the annual rate was due to the lift in annual hotels & restaurant prices to August from July
- In August, hotels & restaurant prices and food prices contributed the most on the upside m/m, while clothing prices fall
- Since last February, second-hand auto prices have climbed 22% - and they rose 4.9% m/m in August. New autos are up 5.5%
- Measured y/y transport (gasoline & auto prices) explains 1/3 of the 3.2% lift in the total price level
- Unit labour costs have soared during the pandemic, as most other places. We expect as substantial reversal the coming quarters

SpareBank 1 MARKETS

Wage inflation down 0.5 pp, and the underlying growth has fallen below 4%

The annual rate is still high, at 5.9% (incl. bonuses, 6.8% x bon). Unemployment is sliding down

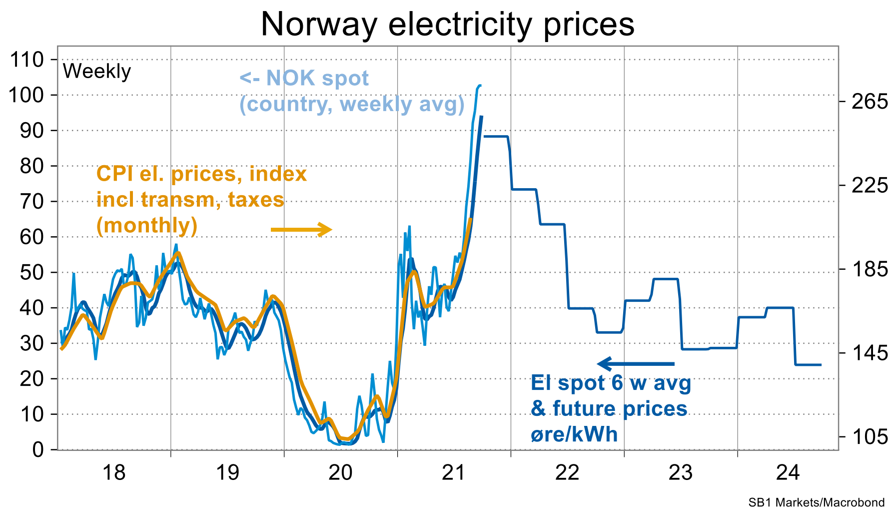


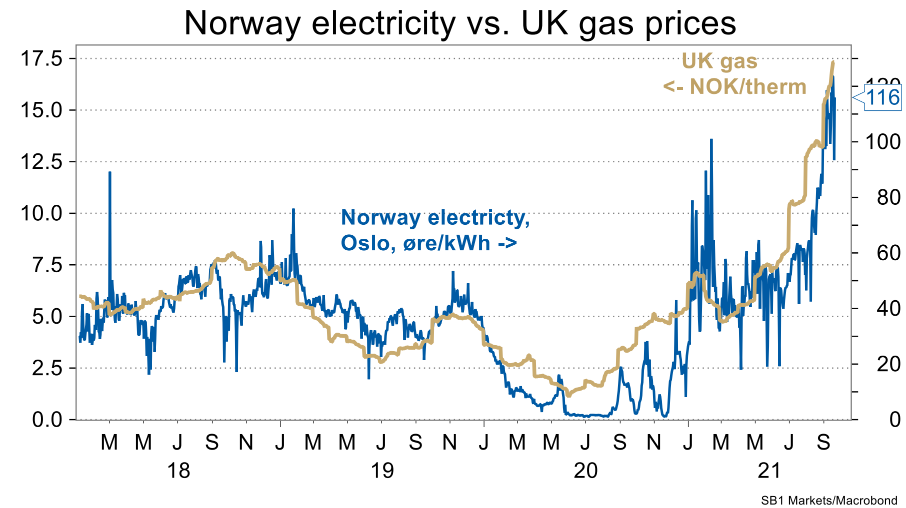


- Wage growth (regular pay) decreased to 6.8% y/y in July, down from 7.3% in June (revised down from 7.4%)
  - » However, the annual rate is boosted by the sharp contraction in wages last year. Total weekly pay is up 3.4% over the past 2 years
  - » The underlying wage growth the recent months have slowed to some 3.2% (3m/3m), which is in line the growth pace ahead of the pandemic, but well above the average over the past 10 years

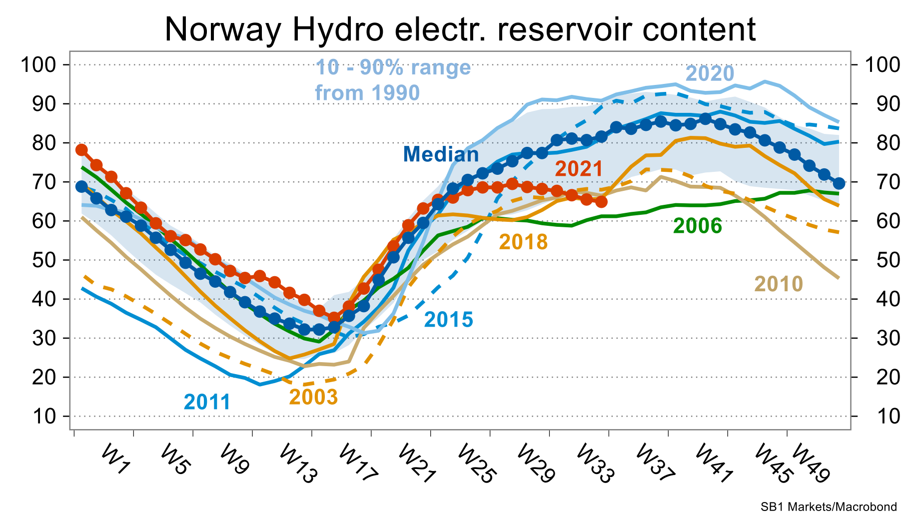
The heat is on: Gas, electricty prices are soaring

The interconnected Europen energy market is stressed, too little supply of gas, too little wind, rain ++



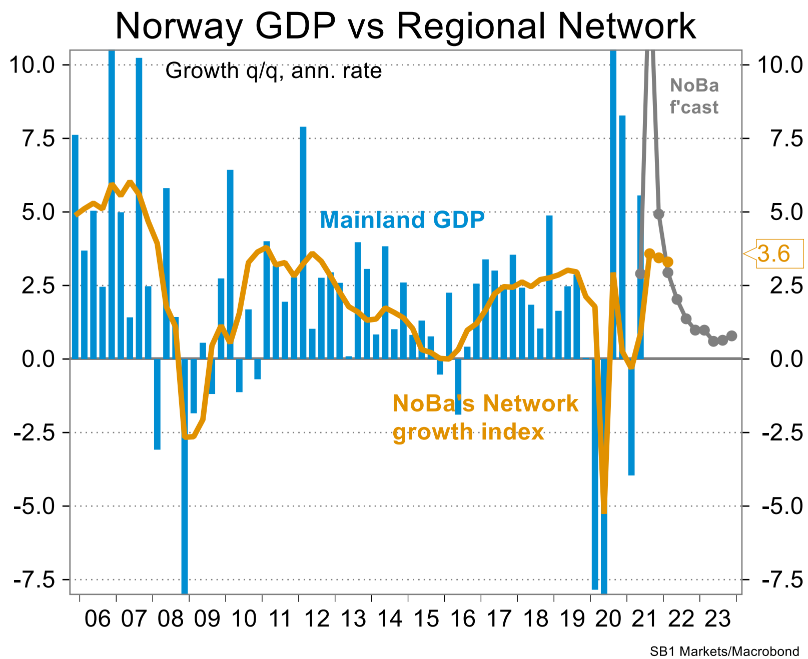


- Norwegian hydro reservoirs have been substantially depleted past 2 months vs the normal trajectory as the summer/ autumn has been drier than normal in southern Norway. The loss vs. the normal refilling at this time of the year equals 15% of the reservoir capacity, and has never taken place before – and the reservoir level is the 2nd lowest on record
  - » Last week, electricity prices more or less stabilised – but they remain at record high levels (at least if measured over some few days)
- Given the forward electricity price curve, which implies a gradual but substantial decline in spot prices the coming quarters, the cost shock for Norwegian households should be manageable: Compared to the average electricity bill over the past years, the cost will rise some 40%, from Q3 this year until next summer. If so, households' disposable income will be cut by 1¼ - 1½%. This amount equals approx. 1/10th of the excess household savings during the pandemic
- <u>The risk: The future electricity/gas market may be dead wrong</u>



Norges Bank's Network expects a continued recovery but is still unable to calibrate

Capacity utilisation is increasing rapidly, more widespread reports of lack of labour

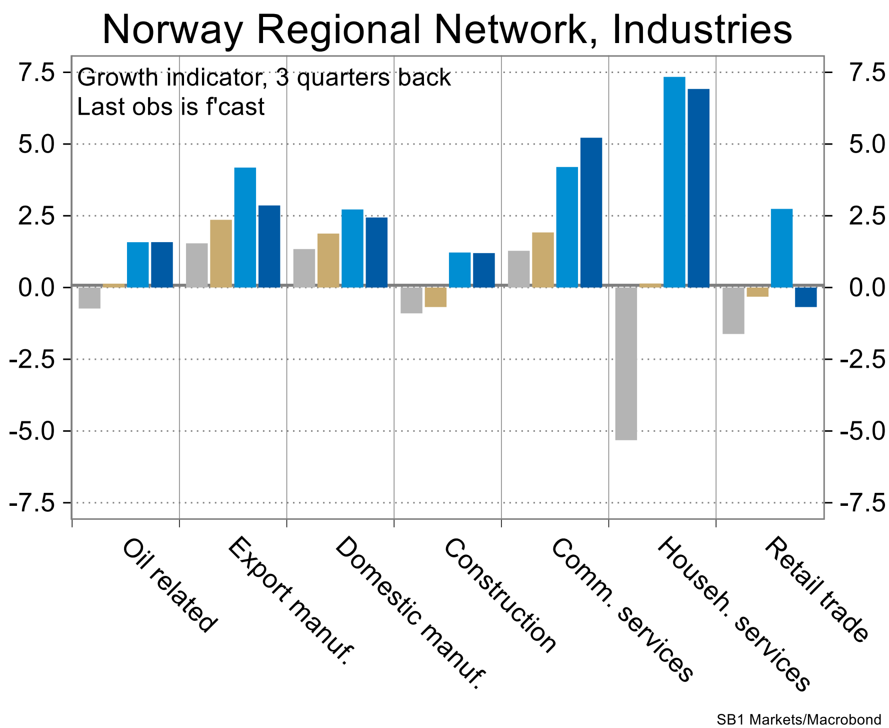


- **Implications**
  - » In reality, the Regional Network' 6 m growth outlook is weak – and far below NoBa's and our GDP forecasts – given the low activity level in several service sectors. However, the survey has not been able to calibrate its growth forecasts well during the pandemic, for understandable reasons – and we do not take it literally
  - » We assume the Bank will put more emphasis on data like capacity utilisation and labour shortages when adjusting its short term forecasts
  - » Anyway, this week's rate hike is a done deal

- **Activity the past 3 months**
  - » The Network reports a 3.6% growth pace in May-July from Feb-Apr, close to the Network's expectation 3 months ago. However, actual growth was 10%, according to Nat. accounts. Capacity utilisation & labour shortages are now well above average levels
- **Expectations for the coming months**
  - » The Network expect at 3.3% growth pace the next 6 months. We expected a 3.6% signal. In June, Norges Bank assumed an 8% - 9% growth pace over the next 6 months, from July. We think the network is underestimating growth the coming months
    - Just one sector expects higher growth the next six months, commercial services (we guess due to downbeat business services sector)
    - All other sectors are reporting stable or lower growth:
      - Retail trade expect a contraction (goods consumption will to come down now)
      - Household services expects a slight slowdown (from a high level recent months, 7% growth still expected).
      - Both domestically and export oriented industries report slower the coming 6 months – but growth is still decent, at 2.5%+
      - Both construction and oil related industries report stable growth, at a rather modest level, some 1%
  - » **Investment** plans are revised further up
  - » **Wage inflation** is revised up 0.2 pp to 2.9%,
  - » Companies expect to **lift prices** vs households

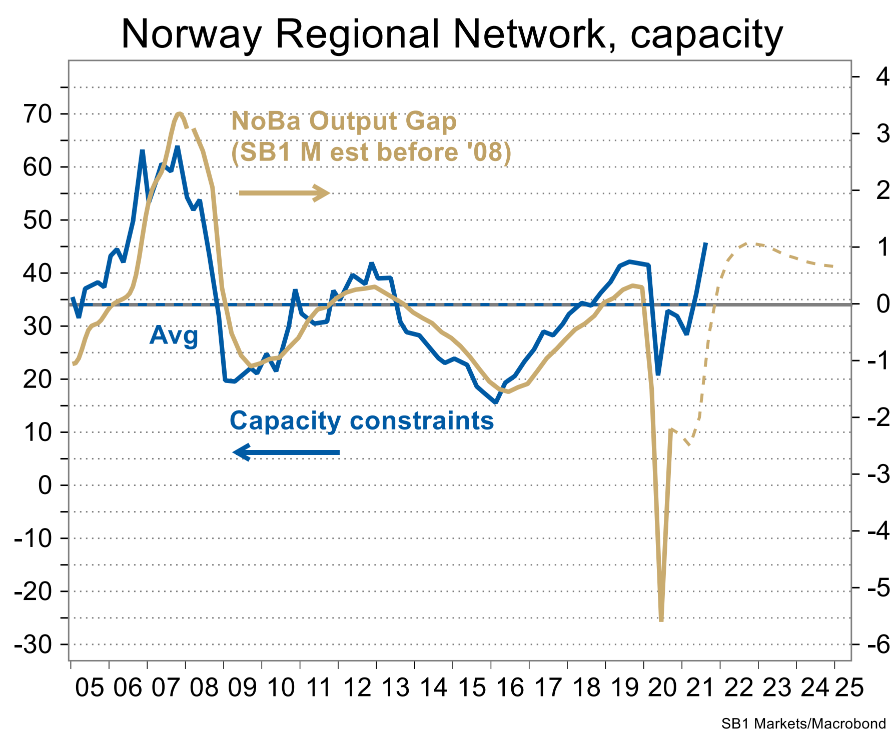
Growth is peaking: most sectors expect a slowdown or stable growth

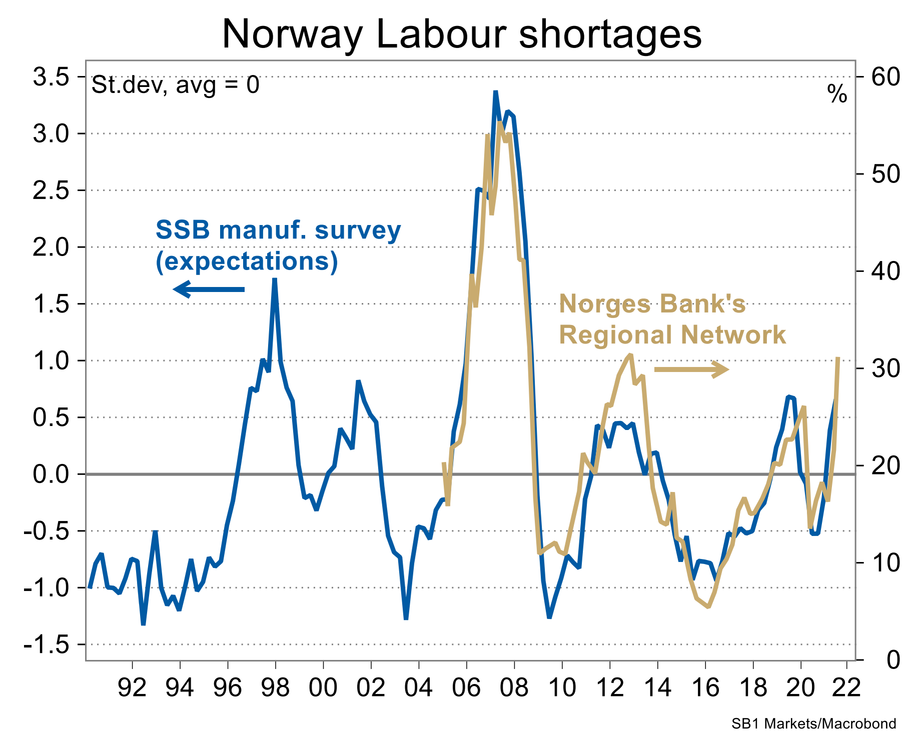
Just retail trade expect lower activity



Capacity constraints sharply up, and is high vs. NoBa's output gap estimate

Labour shortages are increasing rapidly – to the highest level since 2009, and far above average

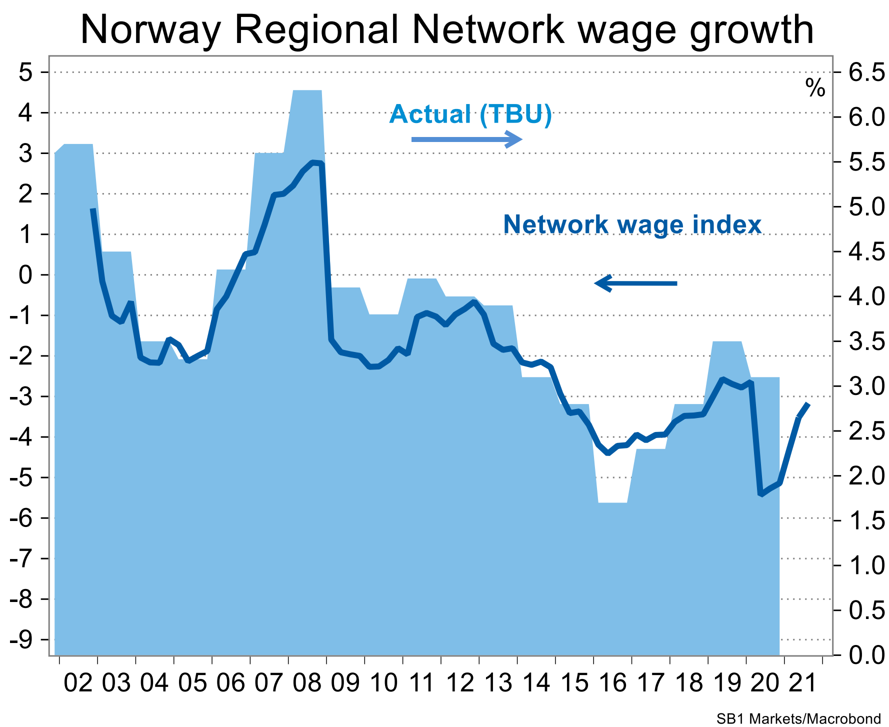


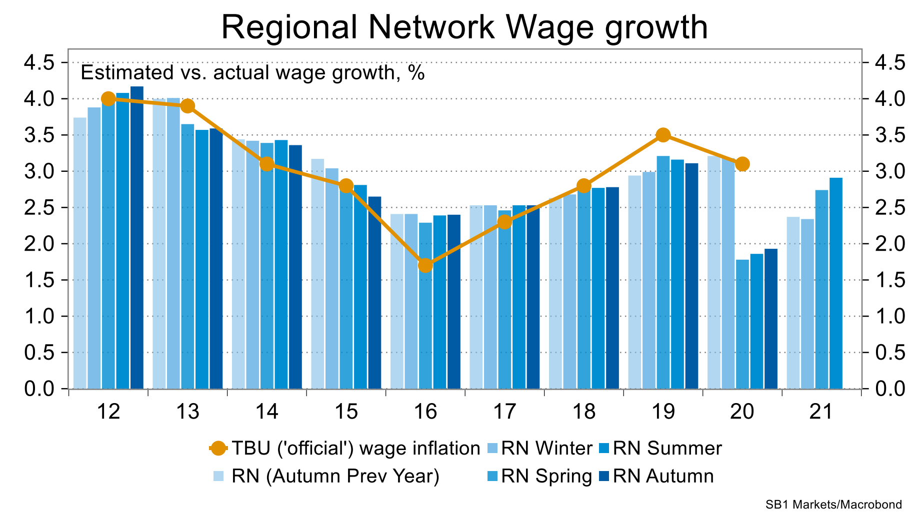


- We think a broad range of economic statistics and Norges Bank's output gap estimate is a better gauge of activity level in the Norwegian economy than the network report's capacity constraints indicator. Still, companies are now facing more capacity constraints
- Labour supply shortages eased sharply last spring but have increase somewhat since before corona, and rose to well above an average level in August. We expect more to come

The Network revised its wage growth expectations for 2021 up 0.2 pp to 2.9%

… up from below 2% last year. There is a risk for 2022? The labour market is tightening, CPI-inf. is high

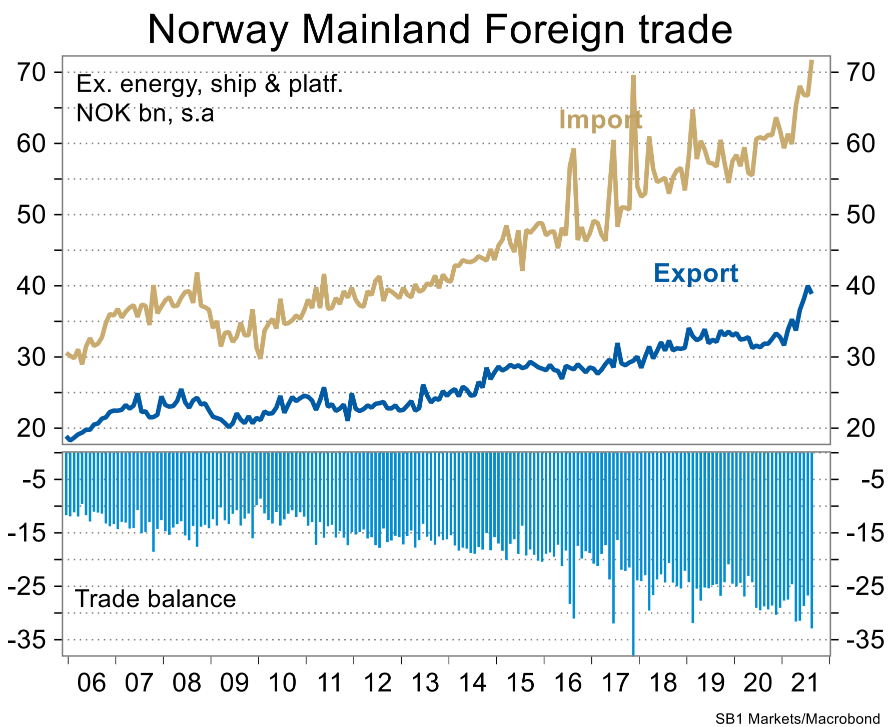


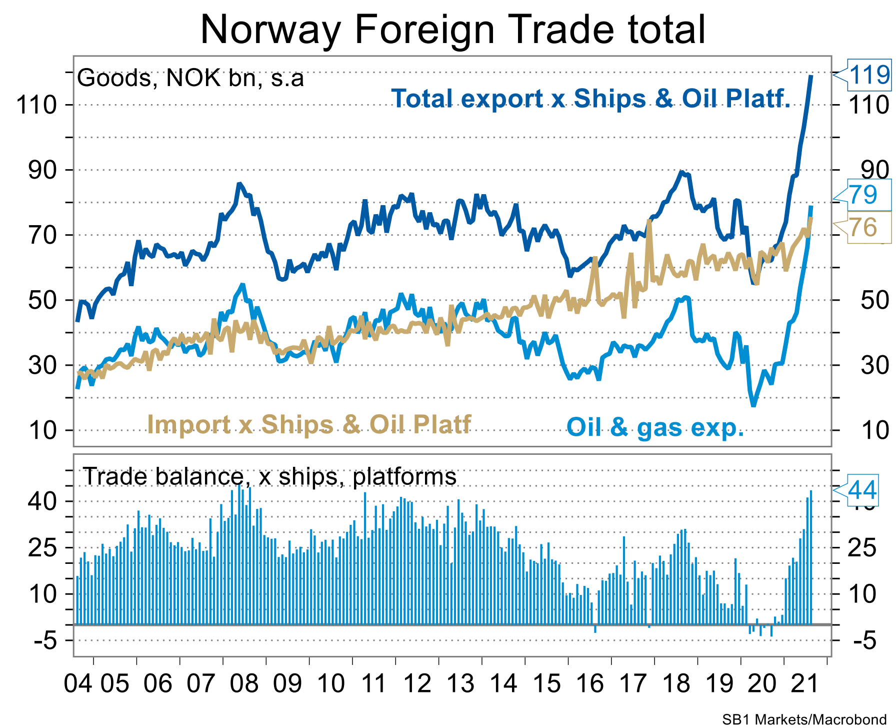


- **The negotiations between LO and NHO** yielded a 2.7% wage lift in 2021 vs 2020 on average (based assumptions on local wage drift). This guideline has been accepted by other parties in the private sector
  - » There were some minor conflicts in the public sector, and some have been rewarded 0.1 – 0.4 pp extra, but that's all
- **In Norges Bank Q3 expectation survey**, economists in trade unions & employers associations forecasted a 3.1% wage growth, and 3.2% in 2022
- **Norges Bank** assumed a 2.8% wage growth in 2021 and 2.9% in 2022 in its June MPR
  - » We expect Norges Bank to once more revise its inflation forecasts upwards – but not sufficient to bring its inflation forecast up to 2% before by the end of the forecast horizon (from below 2% in the June report)

Mainland trade deficit sharply in August, as imports surged

Total balance surplus up in August, to close to record high (2008), as gas exports surged

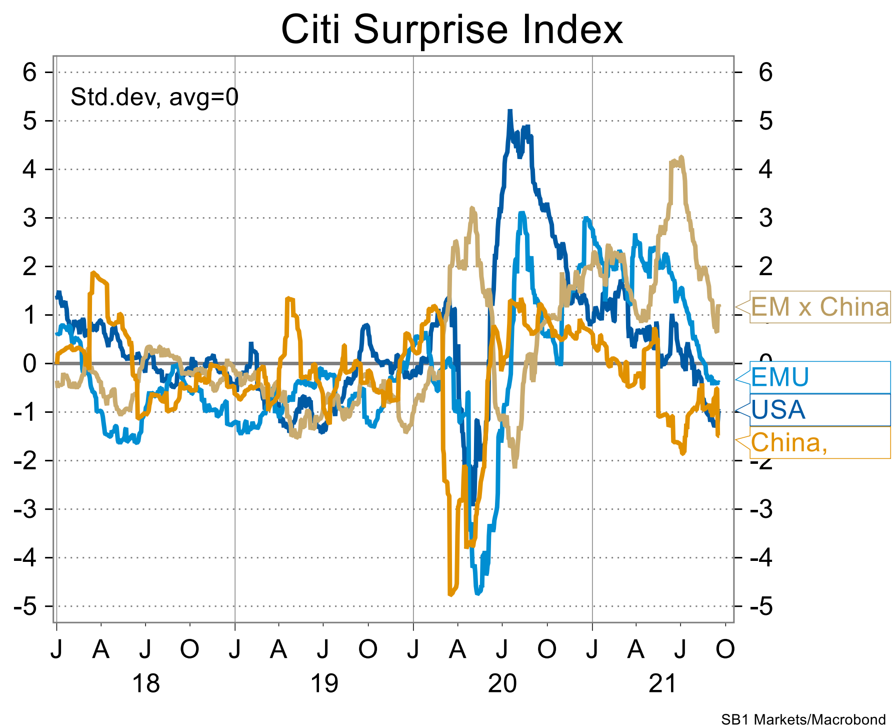


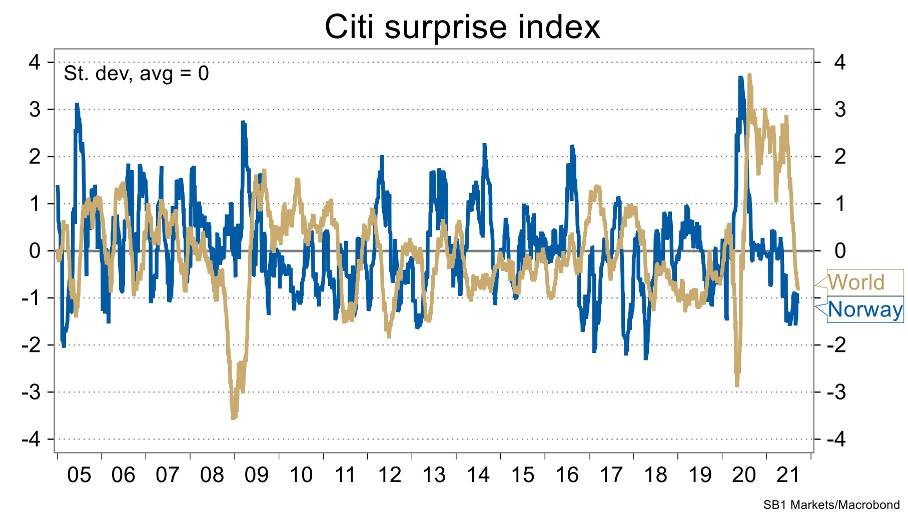


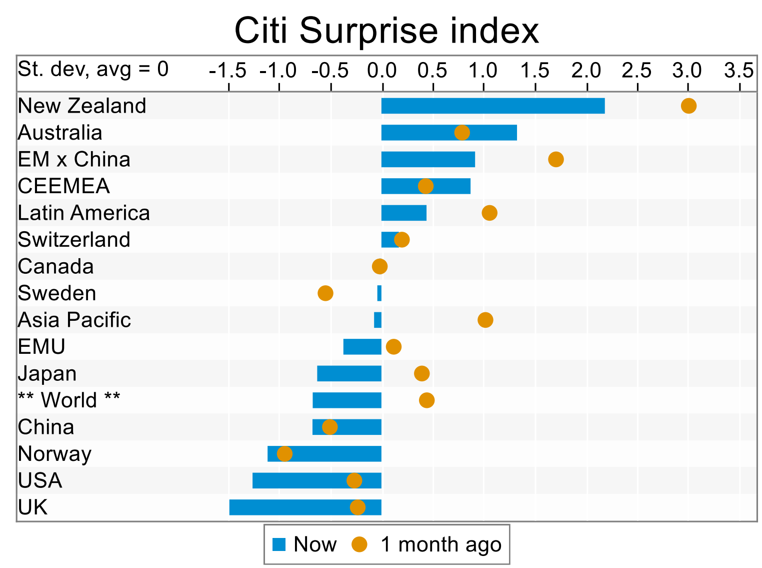
- **The Mainland (non energy) trade deficit in goods** decreased sharply in August, by NOK 6.1 bn
- **Non-energy exports were** reached yet another ATH in August. The main contributors on the upside for exports were metals and fish
- **Imports** increased sharply in August, due to higher import of machinery and vehicles
- **Export of oil and gas**, helped by higher prices, is well above pre-corona levels, totalling 79 bn in July (+14 bn m/m), bringing the total trade surplus to 44 bn, or some 16% of Mainland GDP. In nominal terms, the highest level since 2008, close to all time high. We are not broke, yet

More negative surprises – China contributed the most last week

And US surprised less on the negative side, EMU flattened







- The **US** surprise has fallen further below average, but rose last week
- The **EMU** has been below the zero line the two past weeks – but stabilised last week
- **China** dropped on the weak August data published last week
- **Emerging Markets x China** are still reporting better data than expected, and following a downturn, a tad up last week
- **Norway** has surprised sharply on the downside recent weeks, so has the UK

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

Highlights

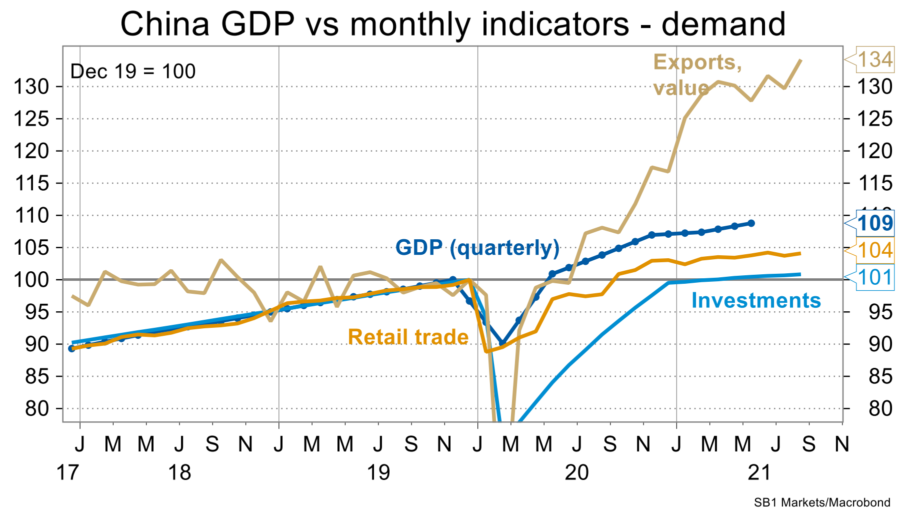
The world around us

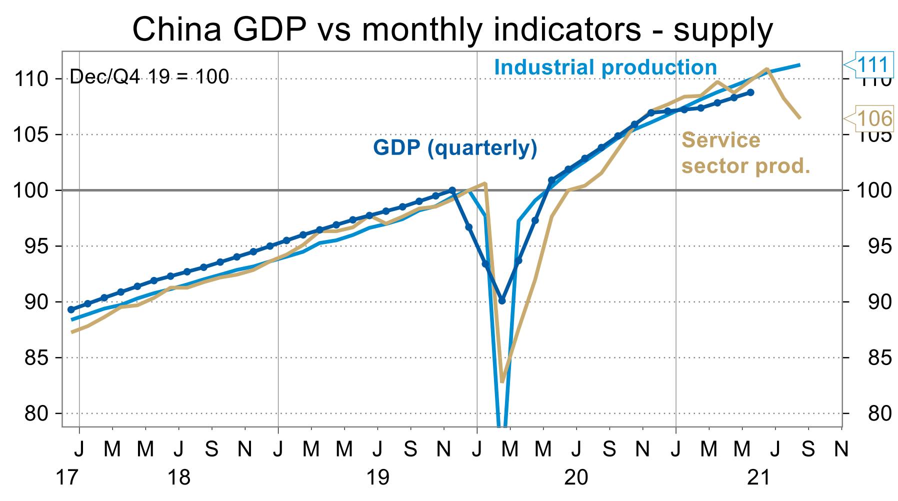
The Norwegian economy

Market charts & comments

August data weaker than expected too – Delta at least partly to blame

However slow retail sales, investments & and a decline in construction/steel in place well before Delta



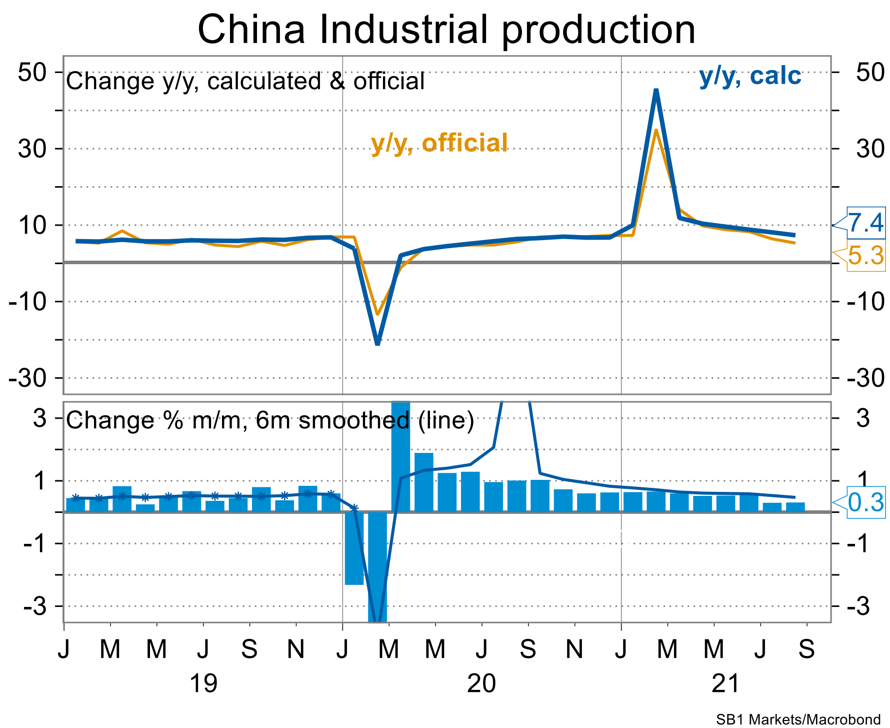


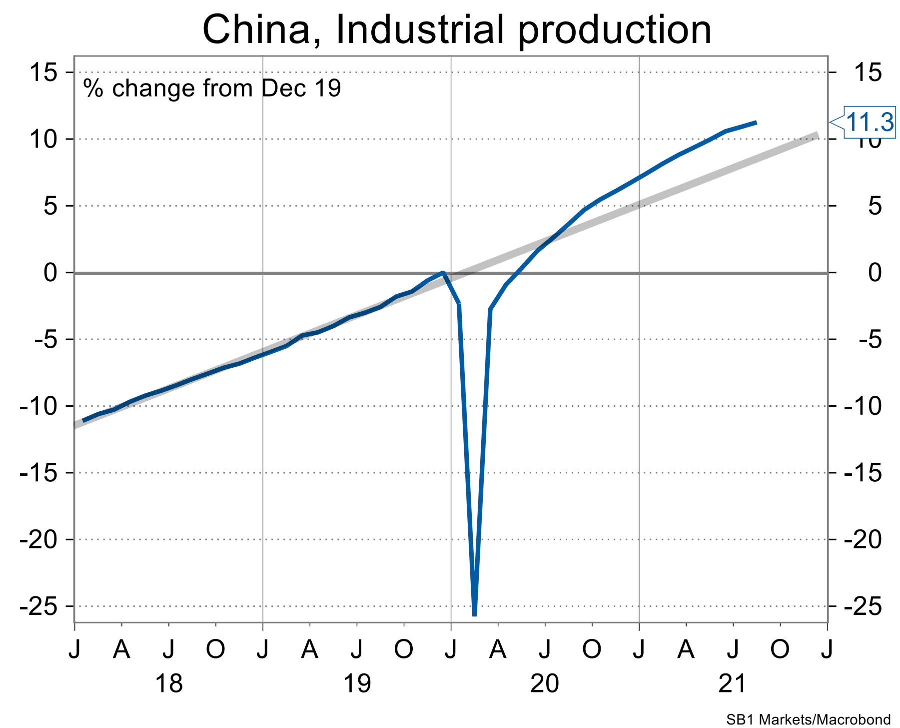
- **Industrial production** rose by just 0.3% in August, as in July, half the 'normal' growth rate. Measured y/y, production is down 1.1 pp 5.3%, 0.5 pp below expectations. Production is still 3% above the pre-corona trend path but growth has slowed, and more than we had assumed. Cement down 10%, steel 16% recent months, partly (they say) due to 'CO_2' restrictions but demand (at least construction activity) is falling too. Surveys are down but are signalling growth well north of the 0.3% per month rate
- **Service sector production** fell by 1.7% in August, following the 2.4% July drop, in sum an unusual decline (although far less than Jan/Feb last year), confirming the weak service PMIs. The level is some 4% below the pre-pandemic trend growth path. No doubt virus related, and thus temporary.
- **Retail sales volumes rose by** 0.3% in volume terms (our est.) in Aug, reversing the July decline but sales have been growing less than at a 2% pace since last Nov, far below the pre-Covid 6% pace, and the level is some 5% below the pre-Covid growth path. Sales were up 2.5% y/y, down from 8.5%, and 4.5 pp (!) below expectations. Auto sales are a part of the story. We doubt the underlying trend is that weak
- **Investments** grew by just 0.2% in Aug, and July was revised down to 0.1% (these data are now routinely revised down!) The level is 7% below the pre-pandemic trend growth path. The (still useless) accumulated annual growth rate was 8.9% in Aug, down from 10.3%, 0.2 pp below expectations. Housing and other construction starts fell further, and have fallen 15% – 20 % recent months. **New home sales** fell further too
- **The previous week**
  - » **Credit growth** is slowed further too, and the credit impulse is negative, as normal approx. every 4th year
  - » **Exports** rose sharply Aug. and are 15% above the pre-Covid growth path! Imports rose as well, and are some few % above the pre-Covid path
  - » 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, but the extra weakness in July/Aug is probably mostly due to the virus outbreak. Policy tightening has contributed too, and as will soon a maturing global cycle in goods. A crash is probably still unlikely

Industrial production up 0.3% in August too, far below the 'norm'

Official y/y growth rate down 1.1 p to 5.3%, 0.5 pp below expectations

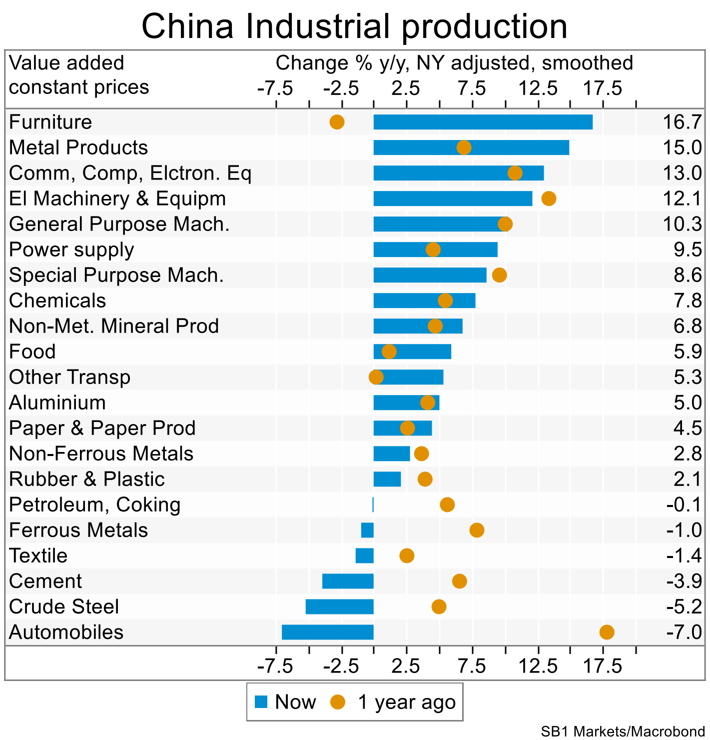




- **Our calculation** suggest a smaller decline in the annual rate, to 7.4%
- **Production** grew by 0.3% m/m, the same speed as in July, but half the normal rate of expansion. Sharp production cuts in steel and cement have contributed to the slow monthly growth
- Production is 11% above the Dec '19 level and some 3% <u>above</u> a reasonable pre-corona growth path. <u>Not bad</u>
- **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 & aluminum sharply down since April (Thanks to Xi Jinping & co.)

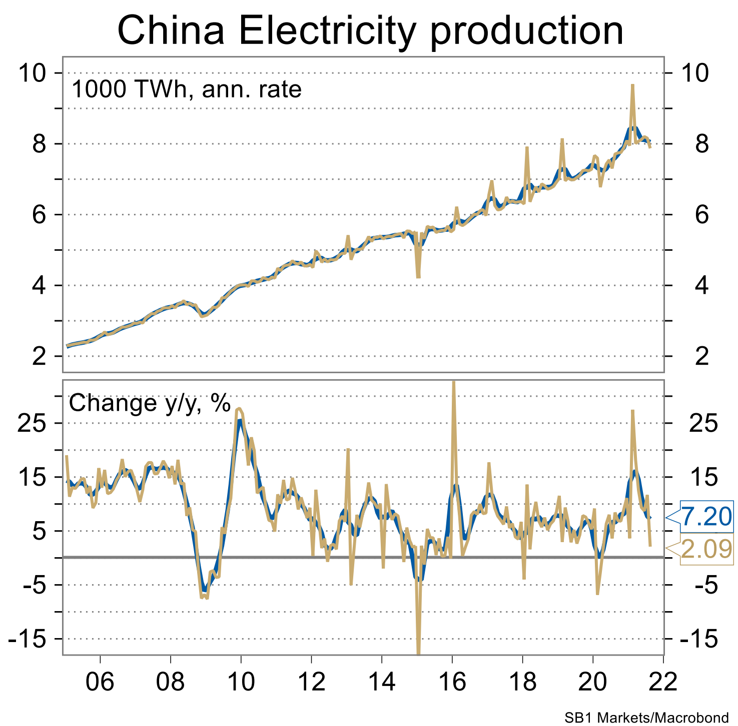
All down 6% - 14% (after at 10% downward revision of cement production in both May and June!)

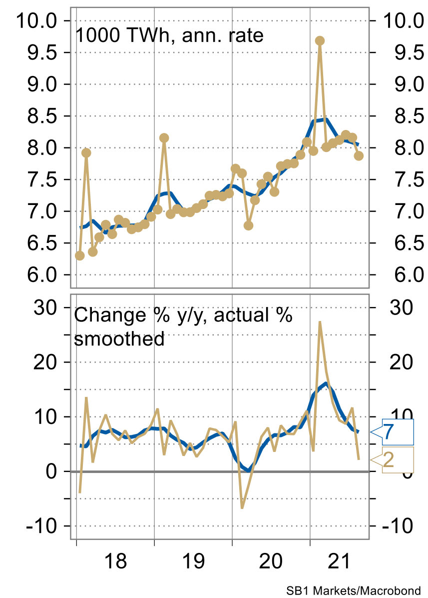


- The authorities have decided that 2021 steel production should not exceed the 2020 level, and as H1-21 production was well above the 2020 level – production must be cut in H2 (some 12%)
  - » Both production and demand (including inventories) are down 10% - 12% the past 3 months
  - » Other 'construction related' sectors like copper and plate glass have kept up far better
  - » 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)

Electricity production has come down recent months, level still above p-p trend

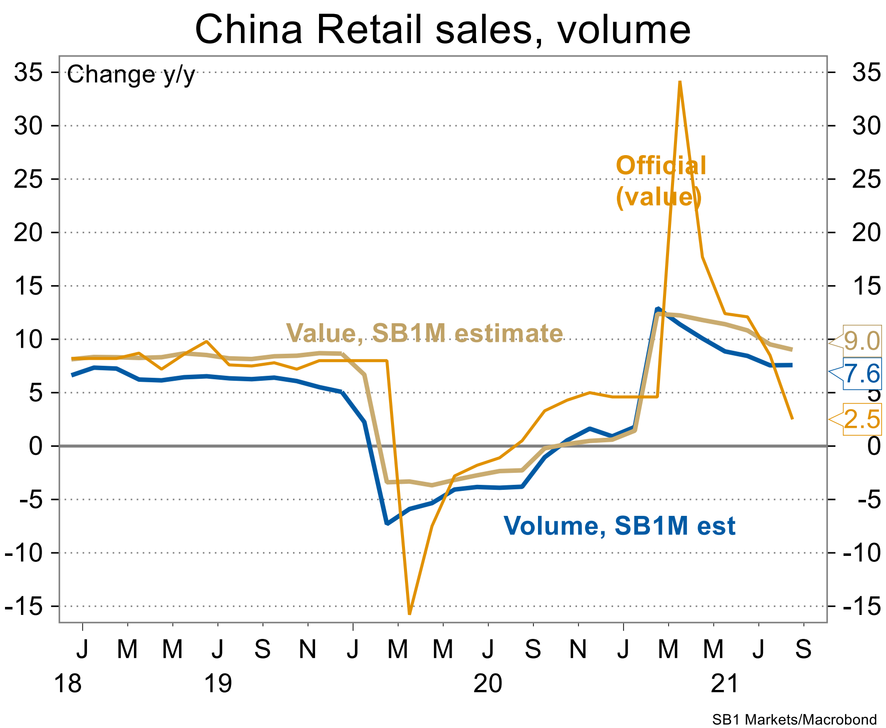
Transport may have slowed somewhat – partly Covid related (data just through July)

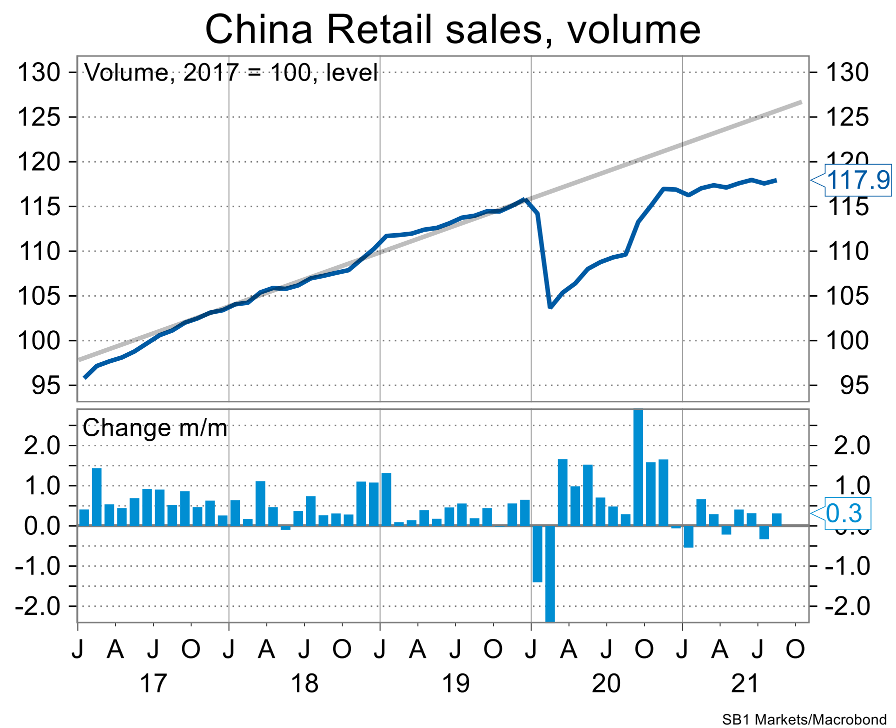




Retail sales surprise sharply on the downside – likely affected by virus restrictions

Sales far weaker than expected in August, volume up 0.3% m/m, following the 0.3% drop in Aug

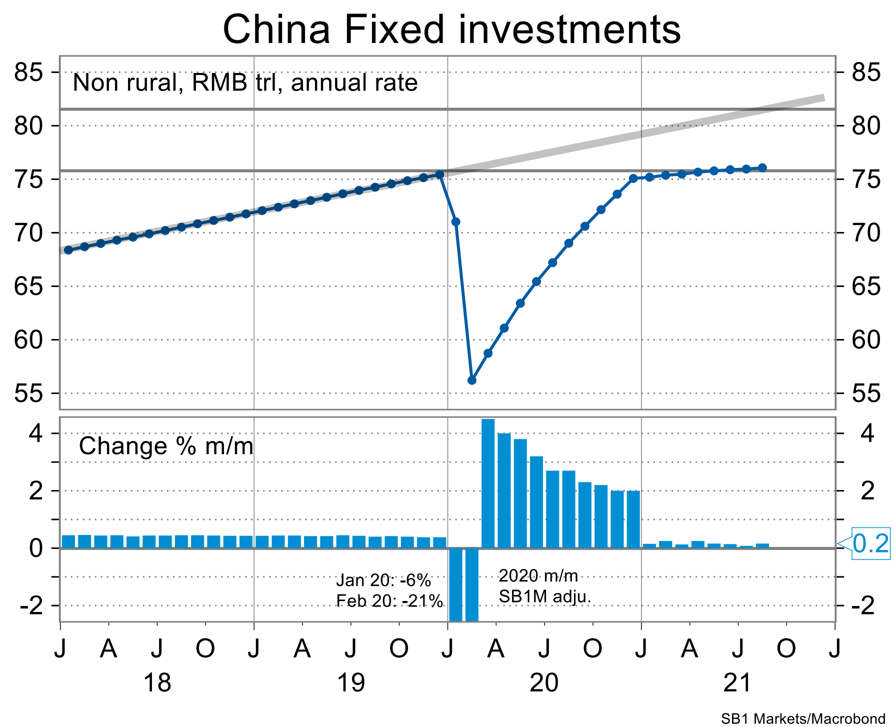




- **Nominal retail sales** were up 2.5 y/y in August, down from 8.5% in July, and <u>far below market expectations</u> at 7%. (These annual growth rates are close to useless due to the base effects, the low sales level last spring/summer)
- In nominal terms sales fell by 0.2% m/m in August, we assume it rose by 0.3 % in **volume terms**
  - » <u>Since last November the underlying volume growth rate has been less than 2%.</u> Before the pandemic growth equalled some 6% p.a – <u>and we are very likely probably witnessing a sharp downshift in consumption growth</u> (even if irrelevant annual growth rates are still strong at 8.5% nominally, check the level!). July and August may be influenced by the recent virus measures but these months are no outliers
- <u>Sales volumes are 5% below the pre-pandemic trend path – and underlying growth is very low</u>

Investments on a new and a much slower growth path

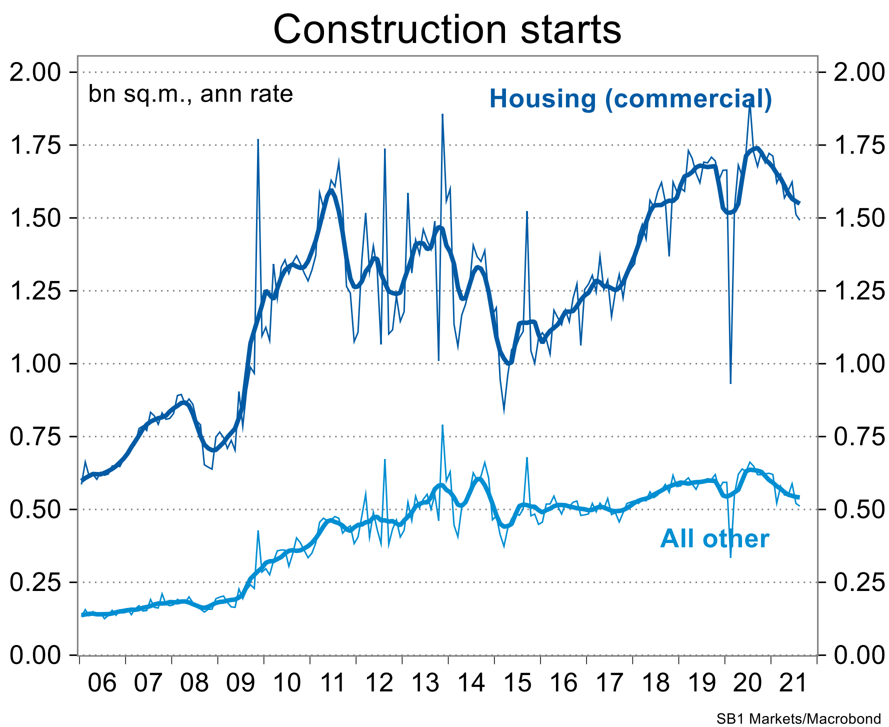
Monthly growth at 0.2%, history revised down, again – and level is 7% below pre-Covid trend

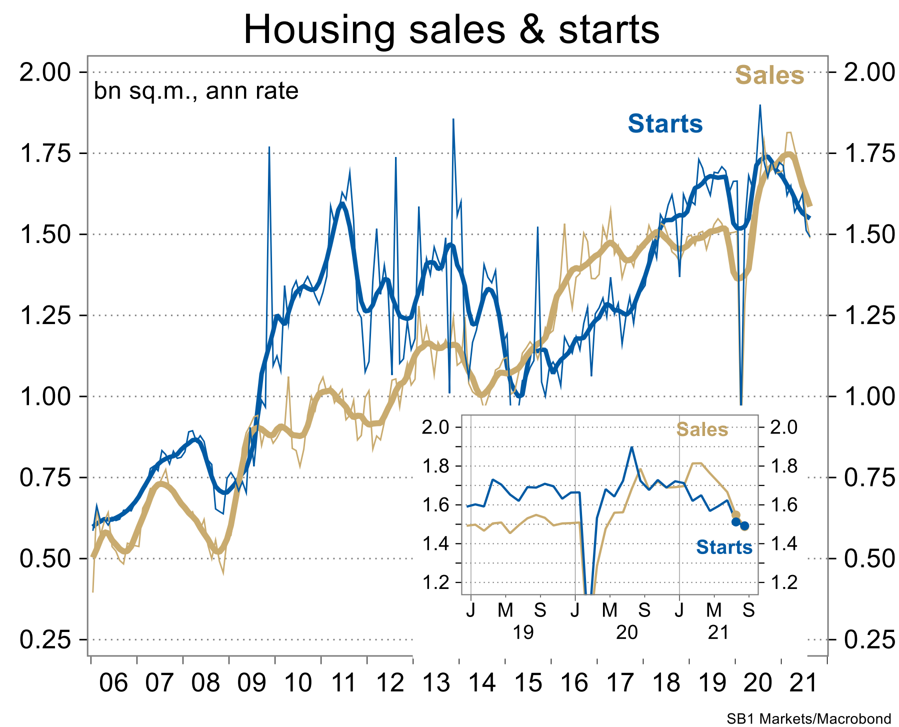


- **Measured YTD**, nominal investments rose 8.9% in August (still a silly number, due to the setback last spring/summer), down from 10.3% in July, 0.1% weaker than expected
- **Growth m/m** was once more revised down (for the 4th month in row), and growth in August was just 0.2%, well below the 'normal' 0.4% growth before the Covid crisis last spring (and July was revised down to 0.1% from 0.2%)
- The **investment level** is 7% 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 further down in August

New home sales have fallen 18% since the spring – starts are slowing too

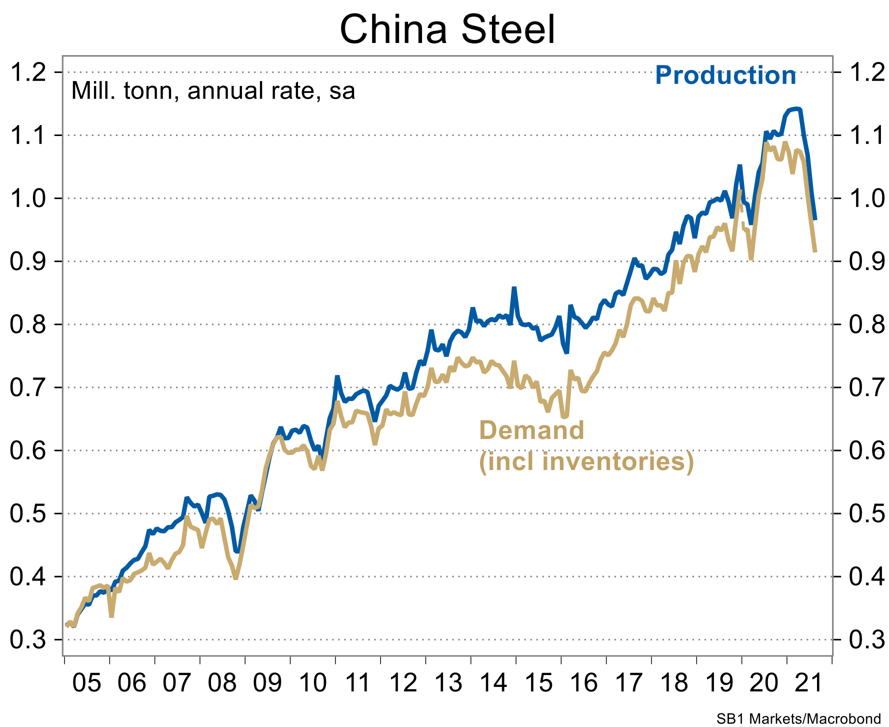




- The rise in **new home sales** from Feb-20 to Mar-21 was spectacular but sales have fallen sharply recent months – but not further down than actual housing starts in August. The fight against the Delta virus may explain some of the weakness during the summer
- **Housing starts** fell just marginally in August, and are down 13% vs the late 2020 level. That is not a dramatic downturn, but significant vs the 'minor' Chinese construction contractions
- **Non-residential construction** fell in August as well, and is down 20% from last summer's 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

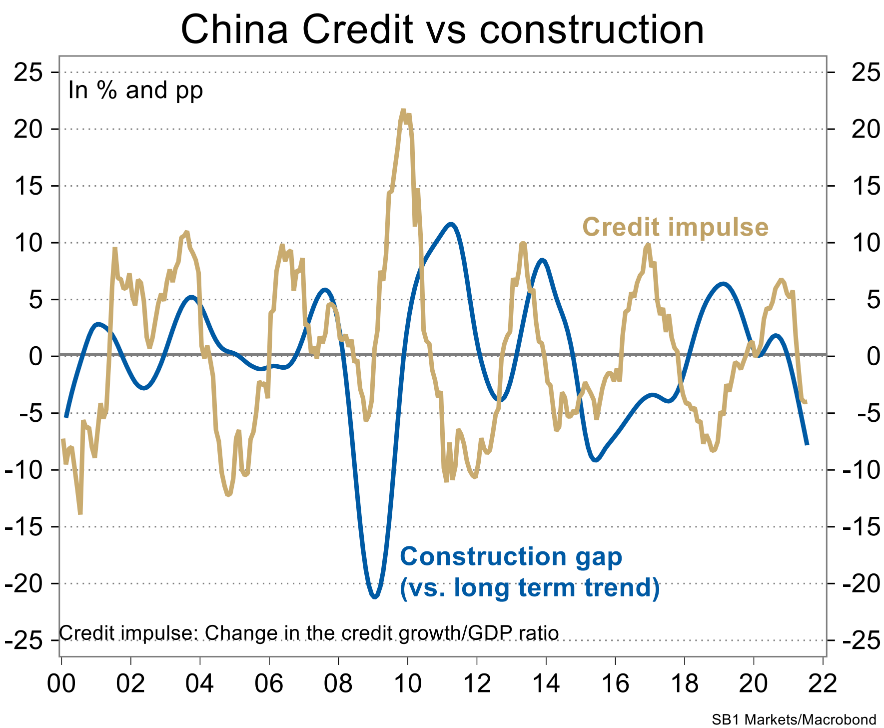
In addition, the authorities have decided to curb steel production in order to meet 2030 (!) CO2 targets



- 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

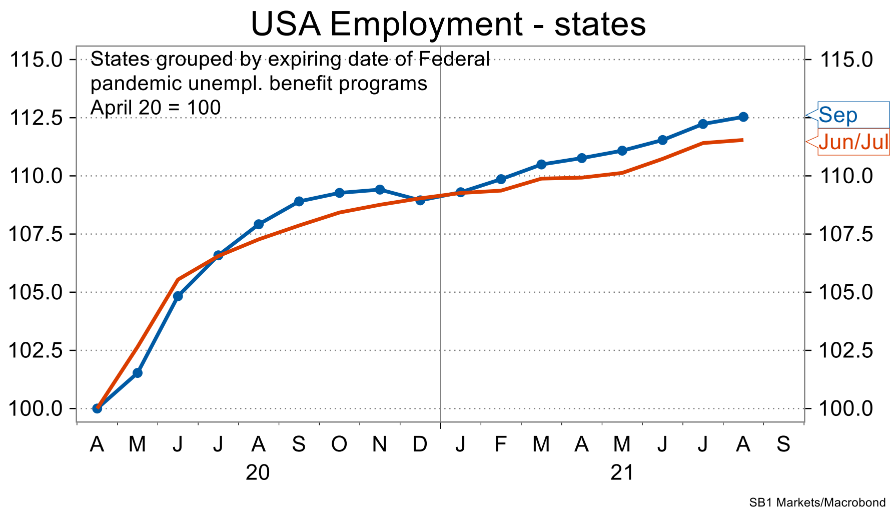
The two are dancing together, but not closely (and it varies who takes the lead too)

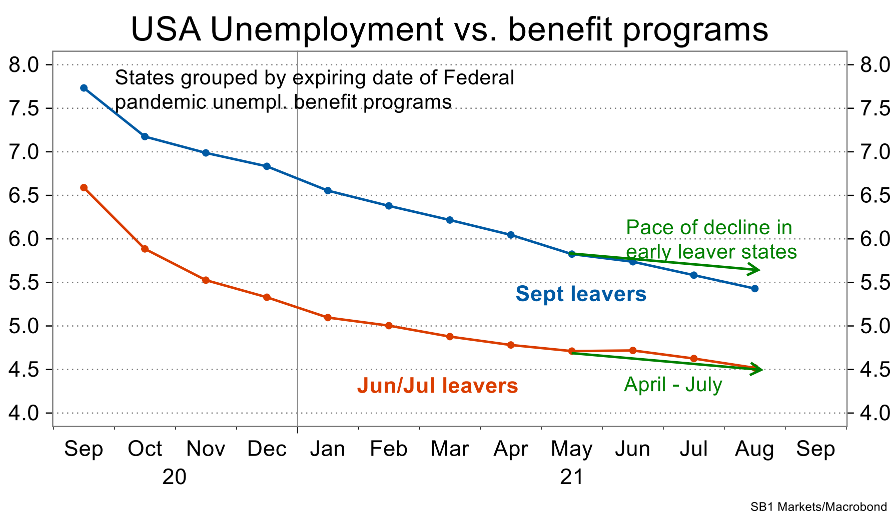


- … still they are at least normally on the same floor
- The recent credit tightening may have had some impact on the property market – but basically the slowdown in construction started 'too early' this time
- The credit tightening signals some downside risk for construction, raw materials & steel
- … 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 around as well

Slower growth in employment in early Federal UI leaver states in August

However, unemployment has fallen slower in those states, as more workers are searching for jobs

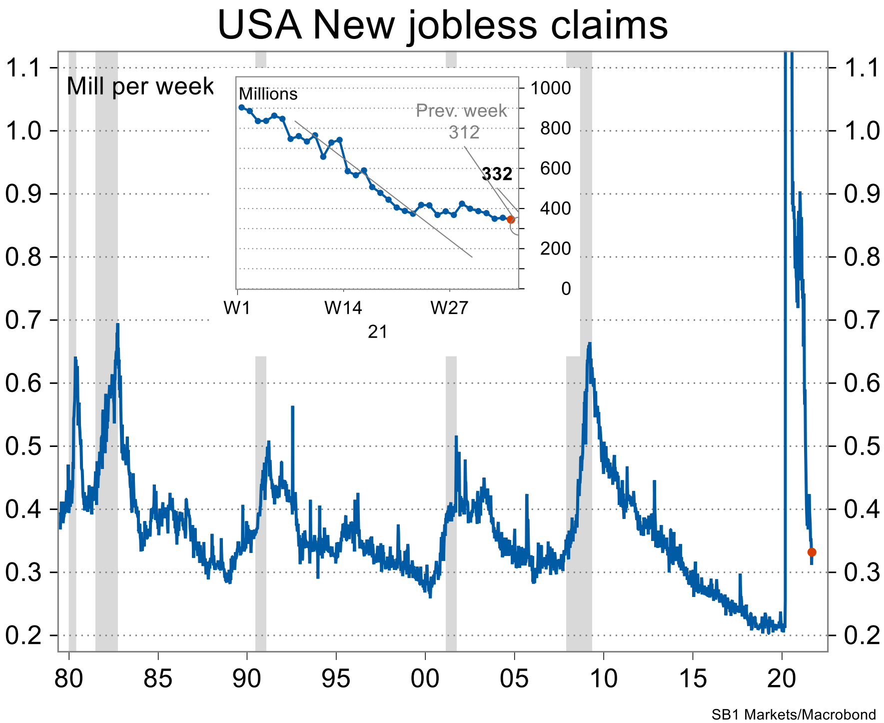


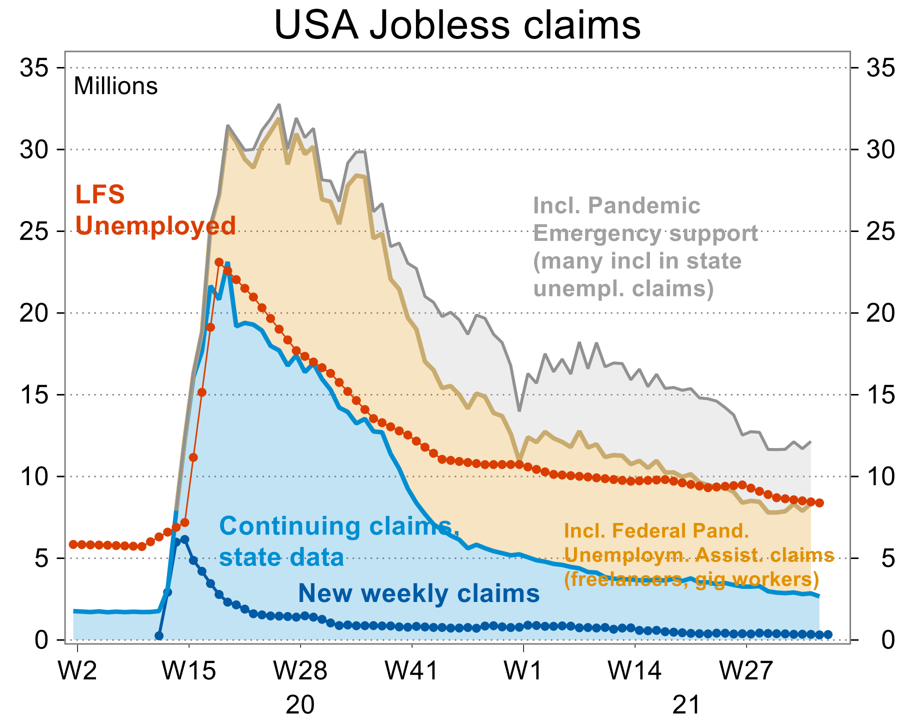


- Half of the states left the two temporary federal unemployment benefit programs in June and early July, so far without any significant differences in employment growth the past 2-3 months
  - » In August, employment rose by 0.1% in the early-leaver states, and by 0.3% in the rest of the country, a 'wrong' sign
  - » In July, growth was equal in the two groups of states.
  - » In June early lavers states reported a somewhat higher employment growth than the others
- State participation rates are not published but we have an indication that participation has increased marginally in the early-leaver states
  - » The unemployment rate has fallen by has fallen by 0.2% In the early-leaver states vs by 0.4 pp in the rest of the country
  - » The employment rate has increased more or less by the same amount (state employment rates are not published, and we have not bothered calculating them).
  - » If so, the participation rates in the early-leaver states must have increased by 0.2 pp more than in the other states since April
- Given that some 3% of the working age population were enrolled on the temporary pandemic unemployment benefit programs that now have been abolished, a 0.2 pp lift in the participation (in the early-leaver states after two months) is not that impressive
- In addition, since employment has not increased, which is the real test, these August data are far from encouraging for those who are expecting a tsunami of willing and able workers into the labour market the coming weeks and months

Jobless claims increased more than expected

... and most in the area hit by hurricane Ida

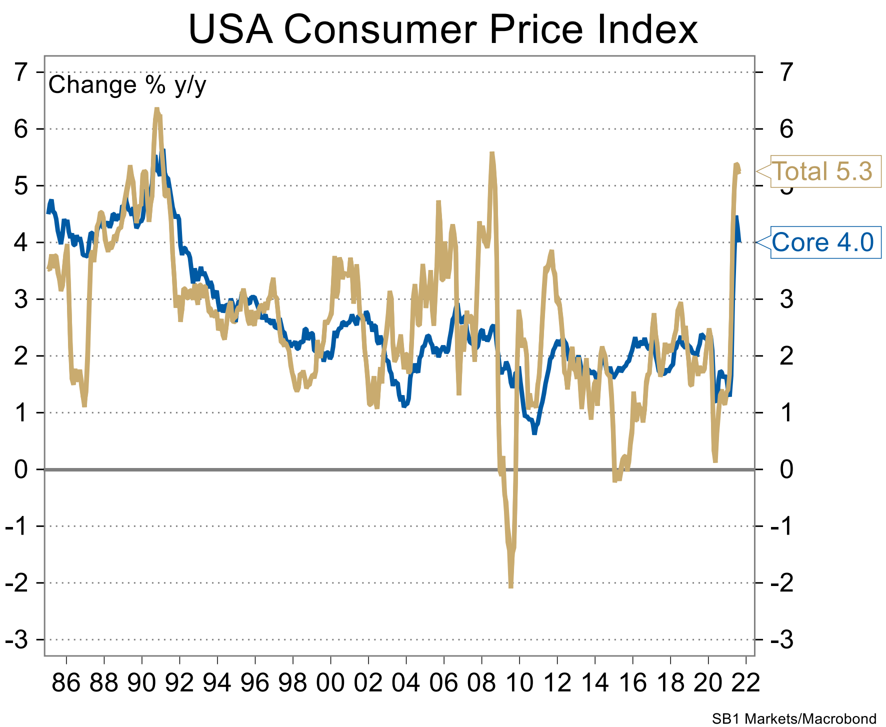


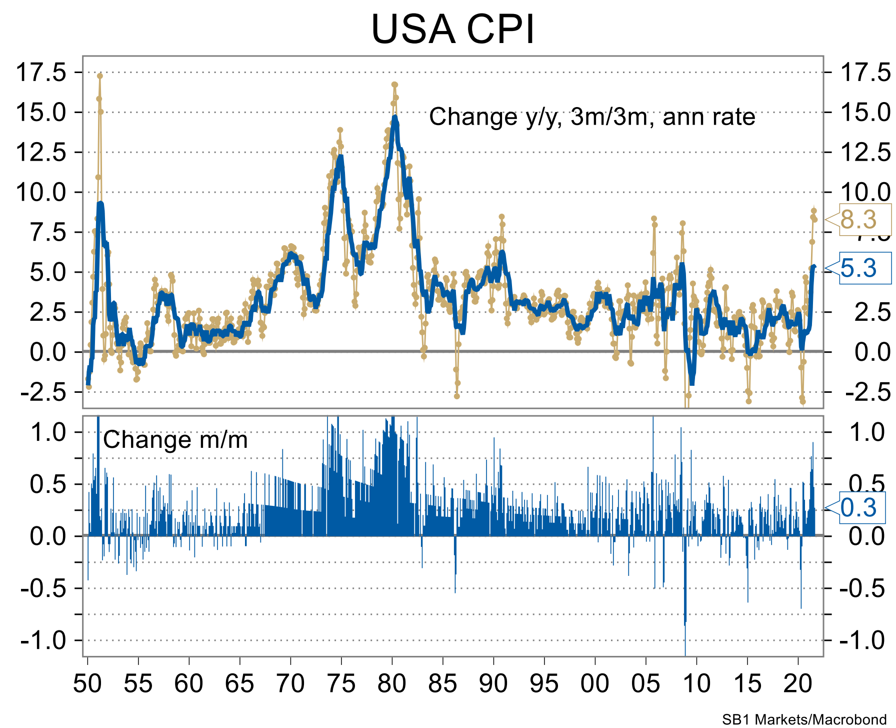


- **New jobless claims rose** by 20' to 332' in week 36 – slightly above expectations at 330'. The inflow is still high given all other indicators of demand for labour – and far above the rapidly declining trend which ruled until 3 months ago
- **Ordinary continuing claims** fell the previous week (week 35), by 187' to 2.67 mill. (the previous week's no. was revised up by 69') Over the past 3 months, the no. of recipients have fallen by ¾ mill.
- The **two temporary federal pandemic programs** decreased in week 34, by 397' to mill to 9.2 mill – one week before the termination of these programs at Sept 6. What are these 7.5 – 9 mill workers doing now? More than 3 mill recipients have left these programs the the past 3 months. Many of these workers have probably returned to work as employment is up by 2.5 mill the past 3 months. However, employment has so far not grown faster in the early leaver states than in the stayer states – but unemployment has fallen slower in these states, implying that some few of those who left the dole at least are searching for work

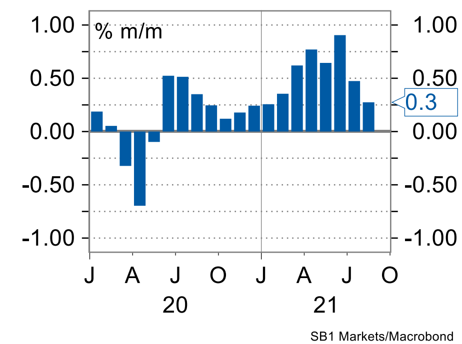
Peak CPI inflation? The m/m increases slowed further in Aug, more than expect.

Used auto prices finally yielded. So, is it transitory? Well, time will tell, Delta explains the Aug slowd.?



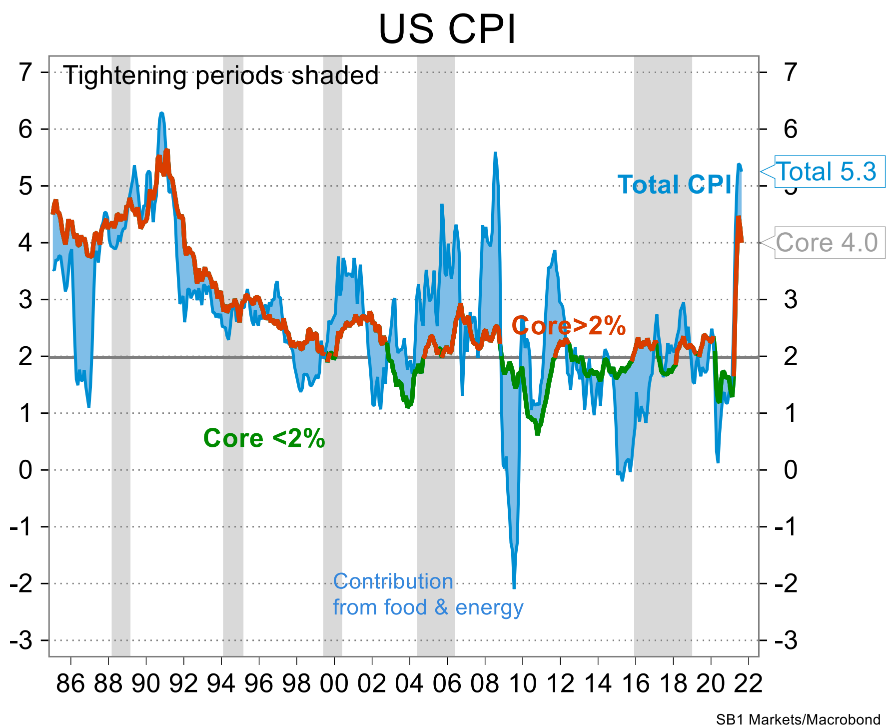


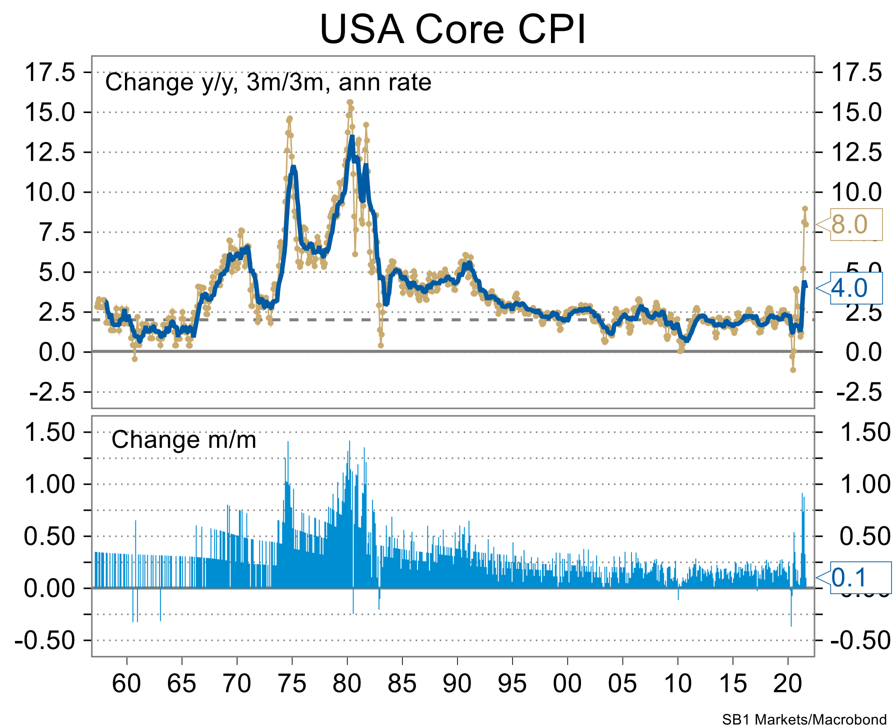
- **Headline CPI** rose 0.3% m/m in August, 0.1 pp below expectations. The annual rate slowed marginally to 5.3%. This is still a high CPI y/y print in a historical perspective
- **Prices have been accelerating** m/m since last October, and the 3m/3m rate is still at 8.3%
- In all surveys, companies reported that they have or expect to lift prices sharply, some faster than ever before
- In August, lodging and airline tickets become cheaper, very likely due to the air pocket created by the Delta outbreak
- It is far to early to celebrate the transitory camp's victory



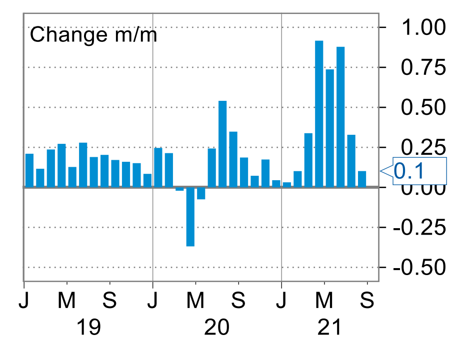
Core inflation slowed more than expected

Prices +0.1% m/m in August, expected 0.3%, the annual rate down 0.3 pp to 4.0





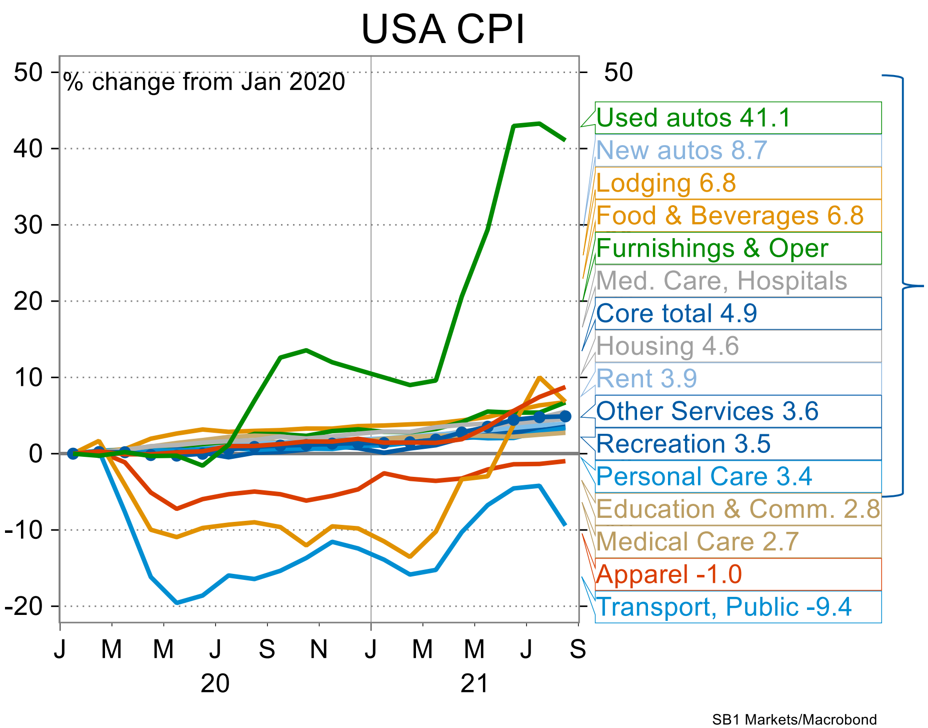
- **Core prices climbed rapidly m/m April – June but slowed in July, to 0.3% and further to 0.1% in Aug**
- The price hikes in the last three months are at least partly due to one-offs which will not be repeated, or will be reversed
  - » Used auto prices (and auto rental prices) are candidates on the downside, and used auto prices fell in Aug
  - » 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

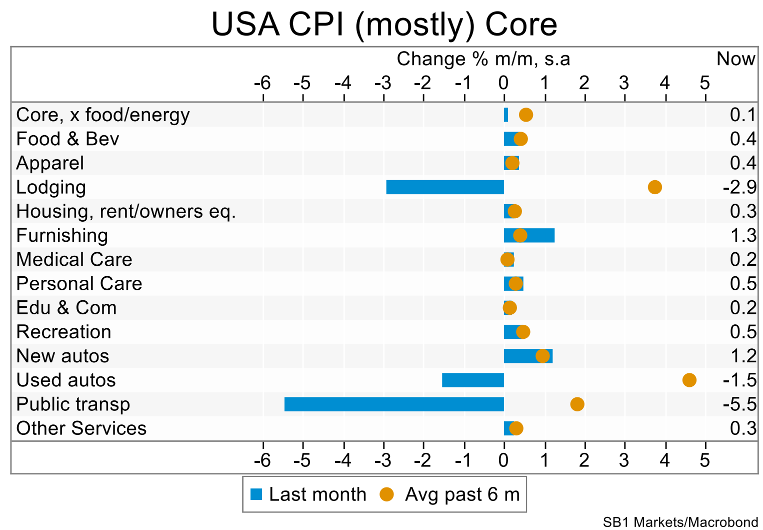


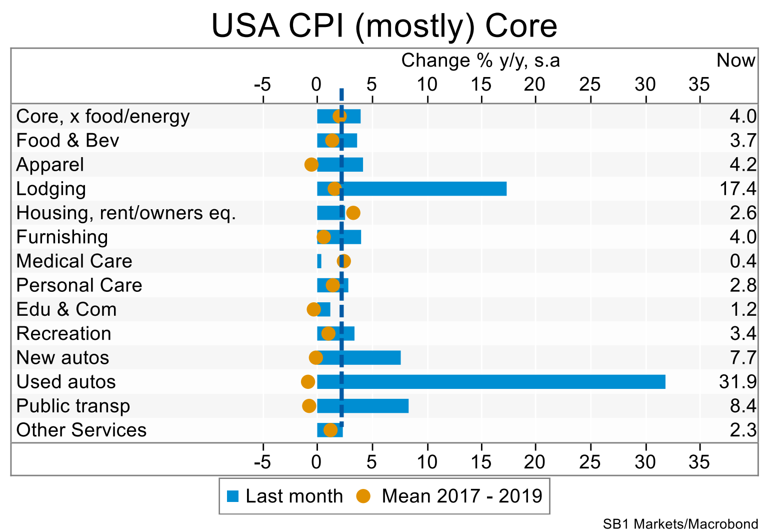
Used auto prices down in Aug, and lodging, public transport price fell as well

The lower hotels, transport prices corona related, most likely not permanent

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



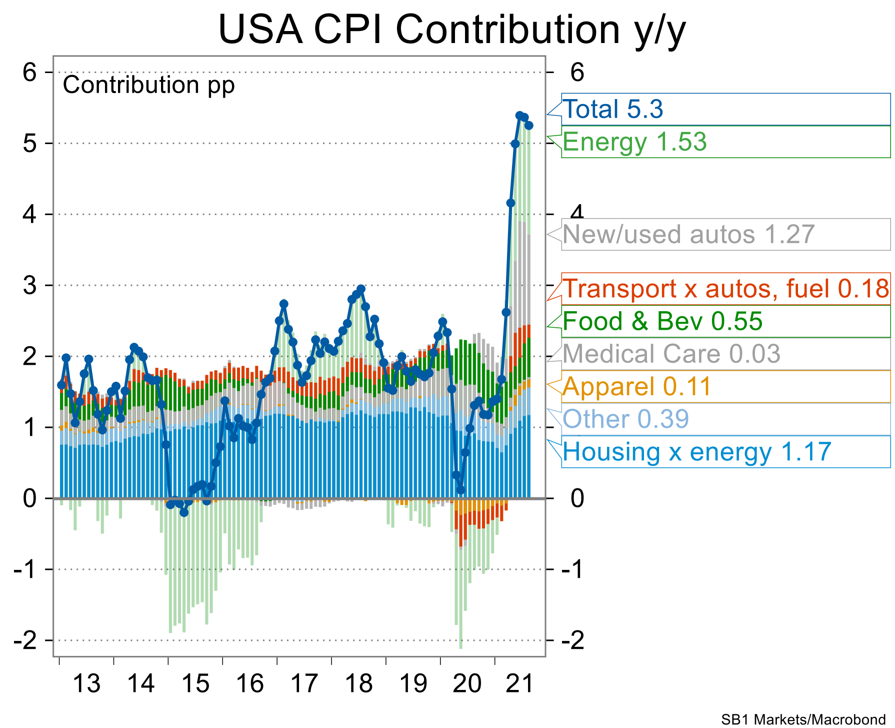


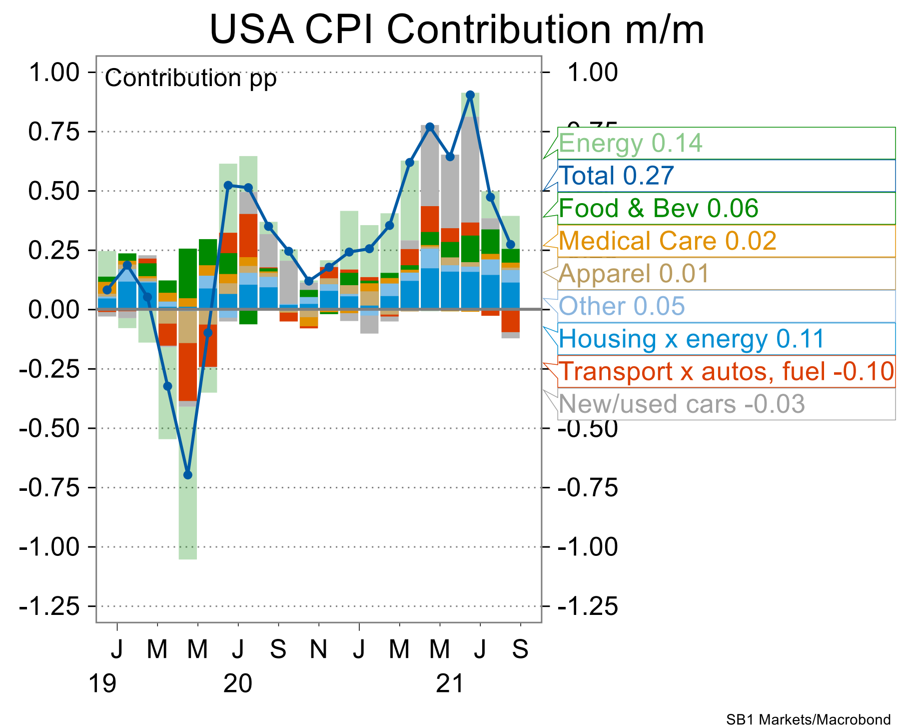


- Just some few CPI components contributed to the setback last spring: **Public transport** (airline tickets) **lodging** away from home (hotels ect), and **apparel**. Other components of the CPI <u>did not slow significantly</u>
  - » Now lodging is full back but both transport and apparel prices are still below the Feb-20 level
- **Used auto prices** have been on the way up since last summer, but fell 1.5% in Aug, but prices are still up 32% y/y, due to lack of new cars (which are up 7.7%). More on these prices 2 pages fwd

Transport & energy explain 3.0 pp of the 5.3% lift in total CPI

... Of which 1.5 pp from both energy and 1.3 pp from new/used autos



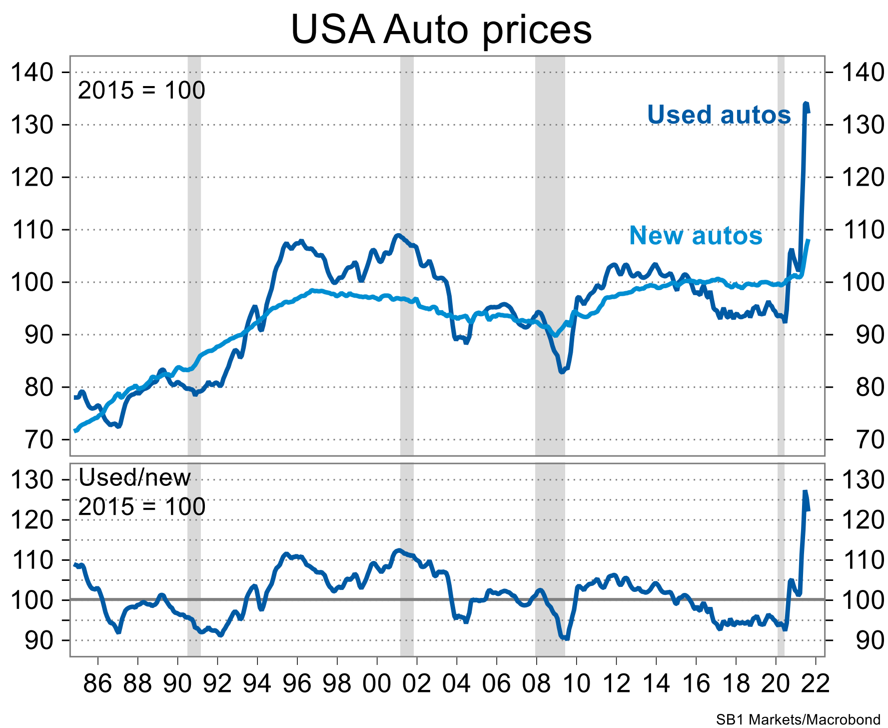


- **Energy** has lifted the headline CPI by 1.5 pp in the past year. If the oil price do not skyrocket from here, the contribution to the annual growth rate from energy will quickly fade (see more here)
- As **used car prices** flattened in July and fell in August – and a small negative contribution to CPI was recored. Transport services prices fell, very likely corona related
- Excluding the 3.0 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?

No doubt at all. The downside is substantial as soon as new car production recovers

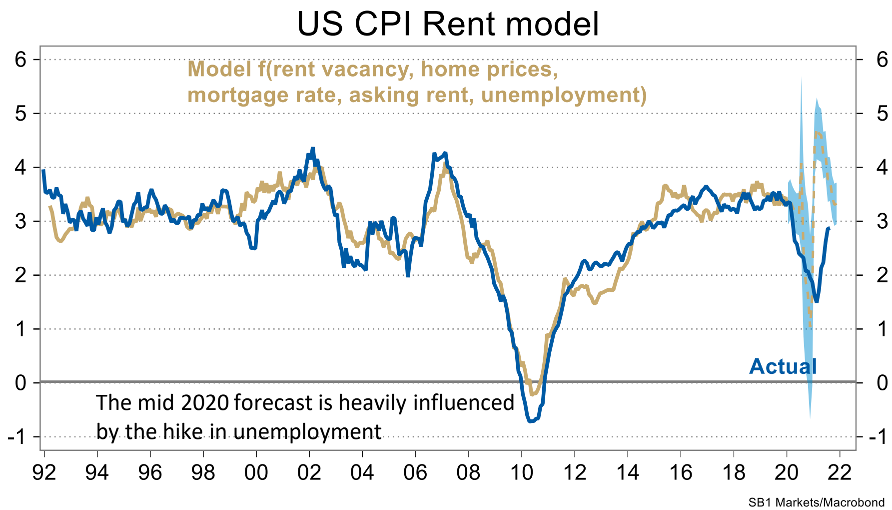


- Used auto cars may have been too low
  - Prices for **new autos** are up 12% since 1996, quality adjusted, that is. Until the recent price hikes in a very tight US auto market, 2nd hand prices were down 10% the past 25 years (quality adjusted)
  - So it is impossible from these data to be sure if there 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 as soon as the supply of new autos recovers

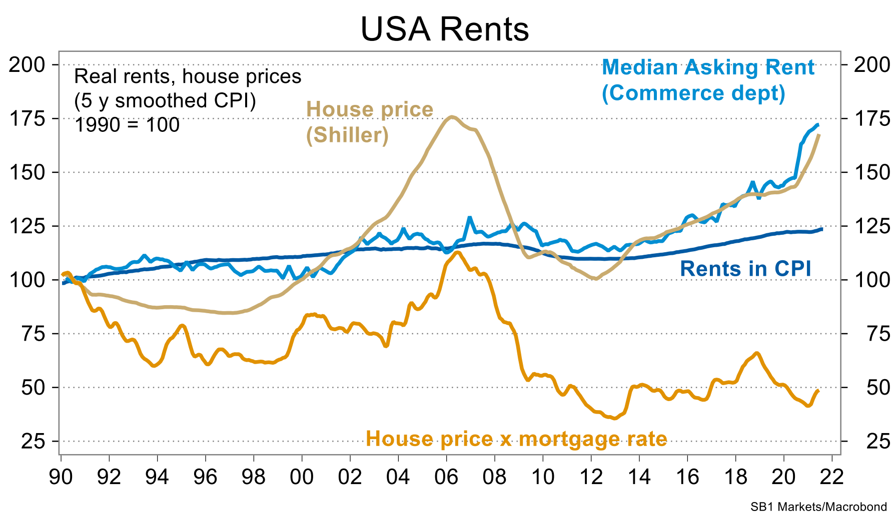
SpareBank 1 MARKETS

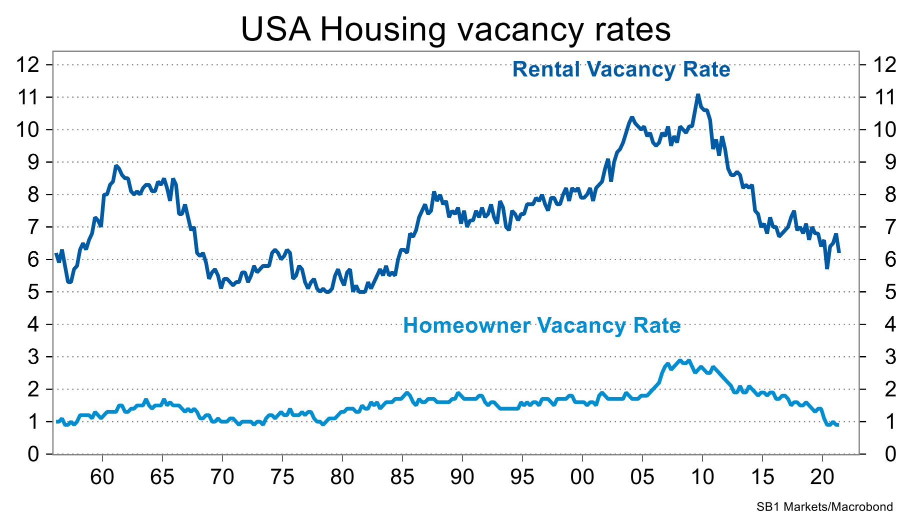
A tight rental market a possible inflation threat – even if mortgage rates are low

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



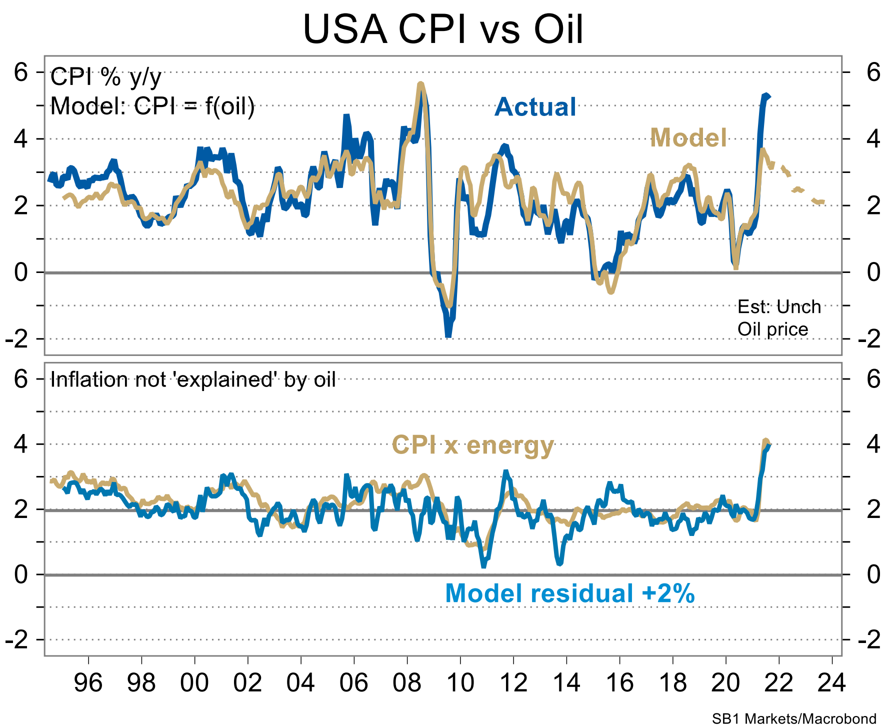
- **Vacancy rates** may have bottomed (more investors are entering the housing market) but are still low. Few owned homes are vacant too
- **Rent inflation** has been far lower than traditional models explain during the pandemic
  - » However, the pandemic was a special happening, in the rental market too – but the pandemic is now receding
- **The official (Commerce dept) rental asking price** index reports a 17% 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 at far lower, and single digit levels
- **Our model:** A significant increase in rental inflation is not unlikely at all, say by 1 – 1½ pp, which will just lift rent inflation up to a 'normal' level at 3 – 3½%. <u>The impact on headline CPI would be substantial, 0.3 – 0.5 pp</u>

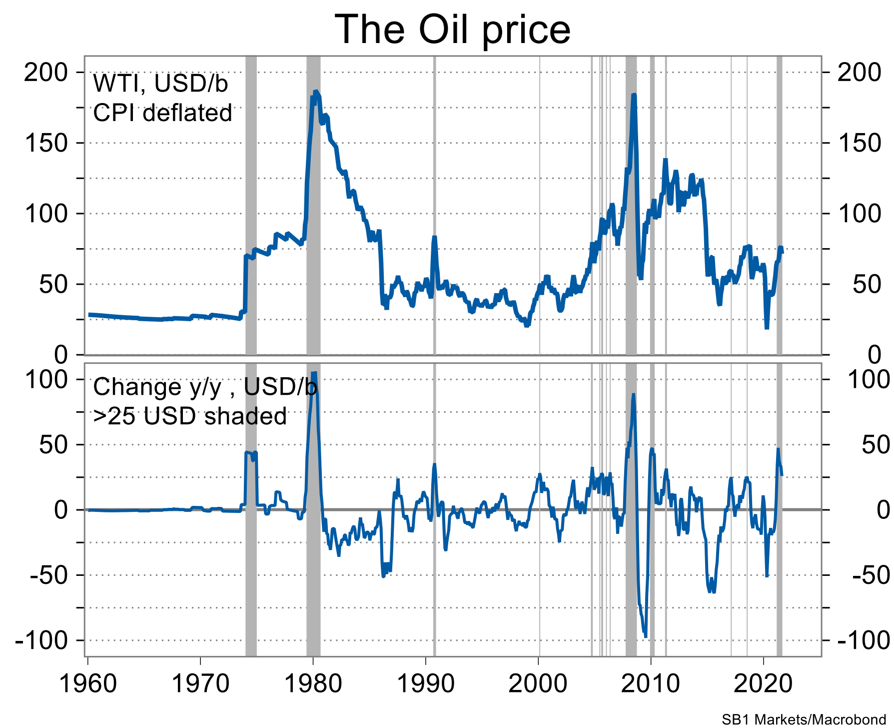




The oil price moves the CPI as usual – but now there is something else too

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

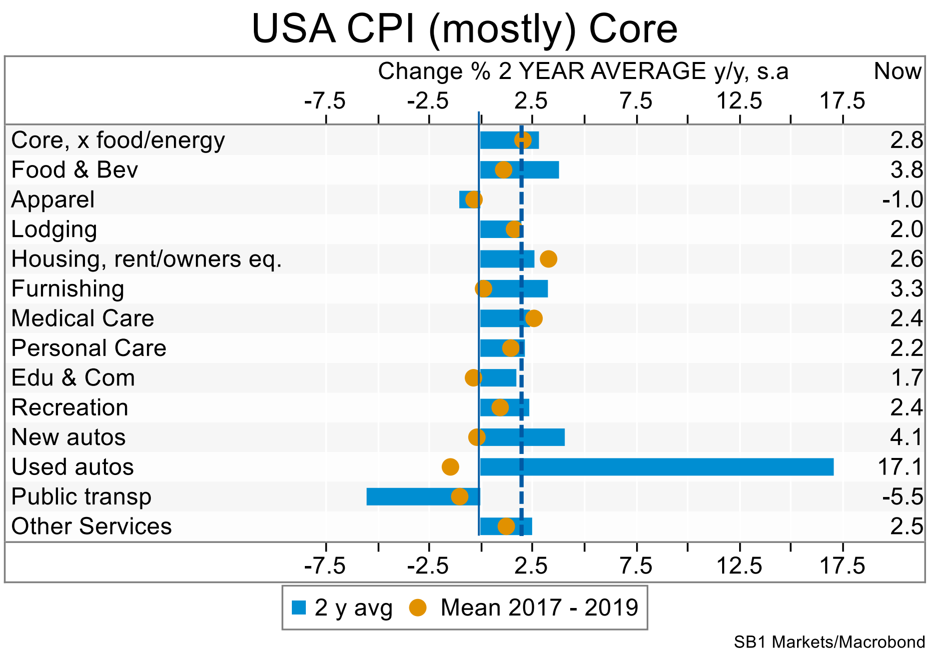


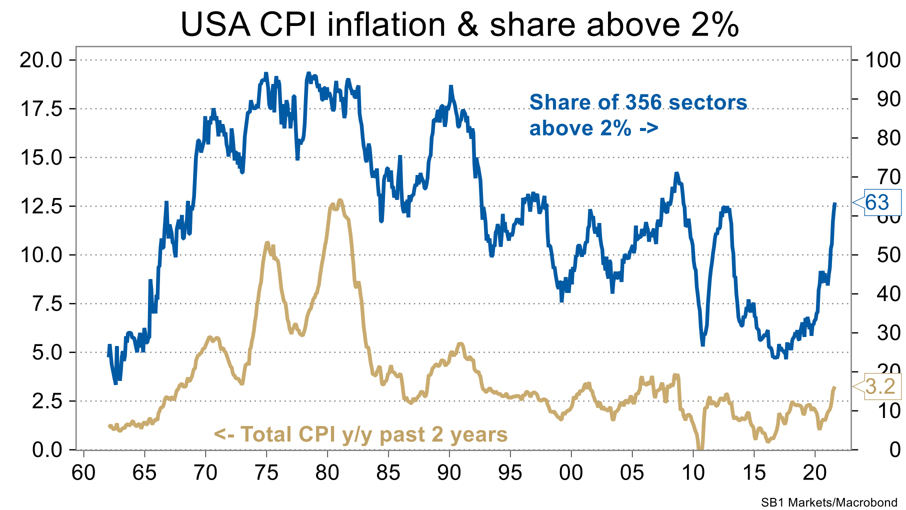


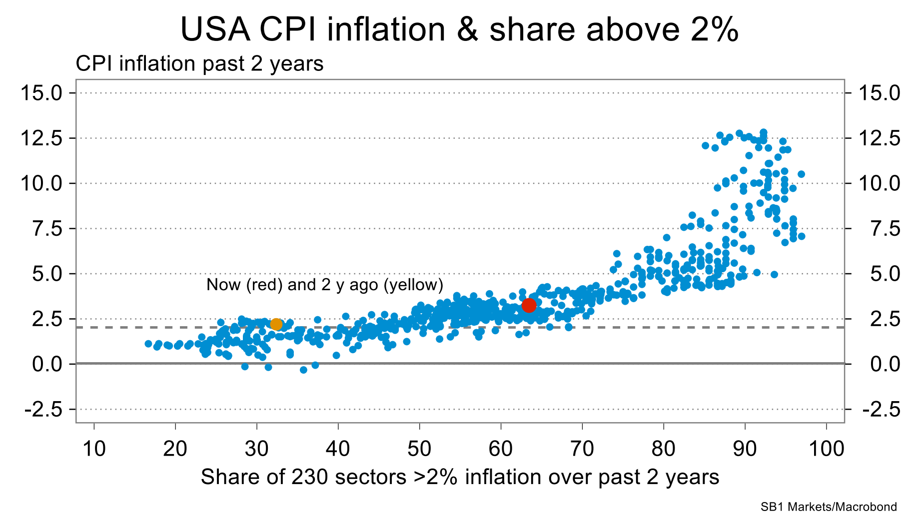
- **Oil price cycles** have explained some 80% of the changes in CPI growth the past 30 years
  - » In our model we incorporate all indirect impacts from changes in the oil prices – as well as the impact from other factors that influenced inflation which correlates to the oil price
  - » If the oil price 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 2.8%, up from a 2.1% average in 2017 – 2019 – and broadening



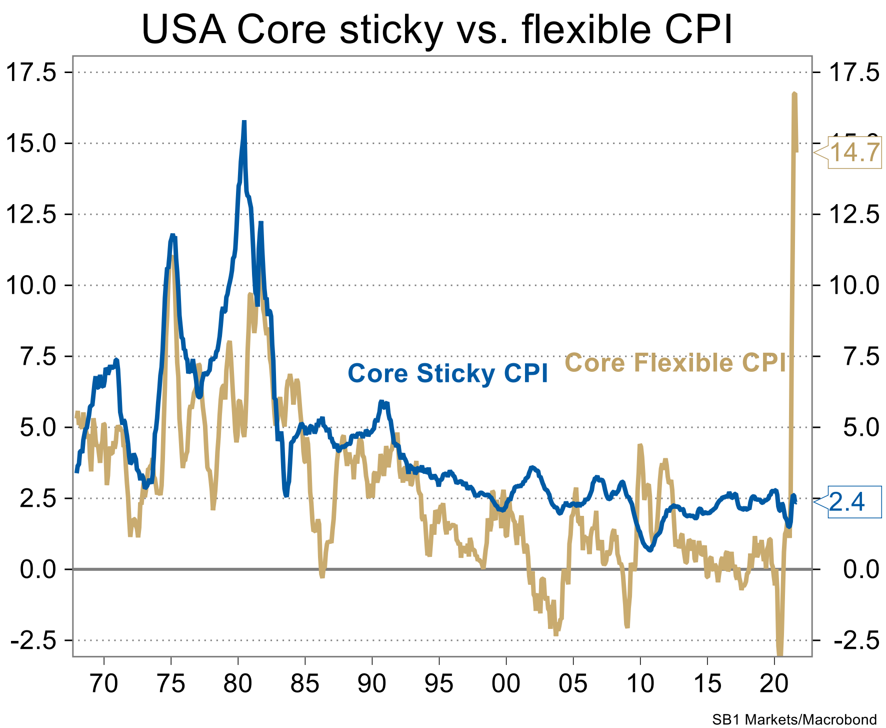


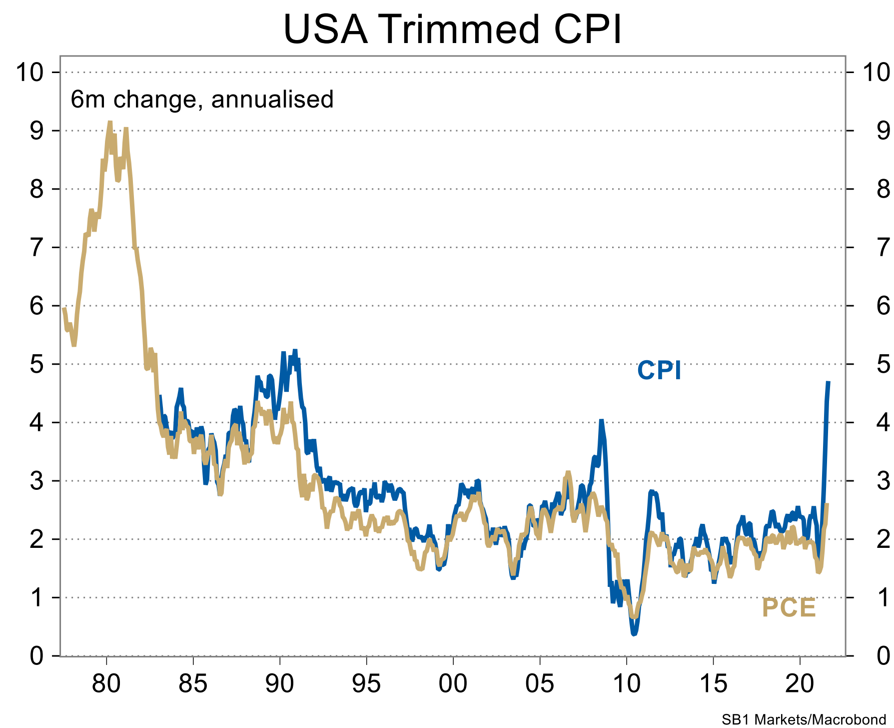


- Of the 13 main sectors, 10 are up more than 2% per year since July 2019, and 3 are below the 2% line
- Over the past 2 years vs the 2017-19 average, inflation has accelerated in 9 sectors, and slowed in 4 sectors
- Of 350 sub-sectors, 63% are up more than 2% over the 2 past years, normally signalling an inflation rate around 3%

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

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

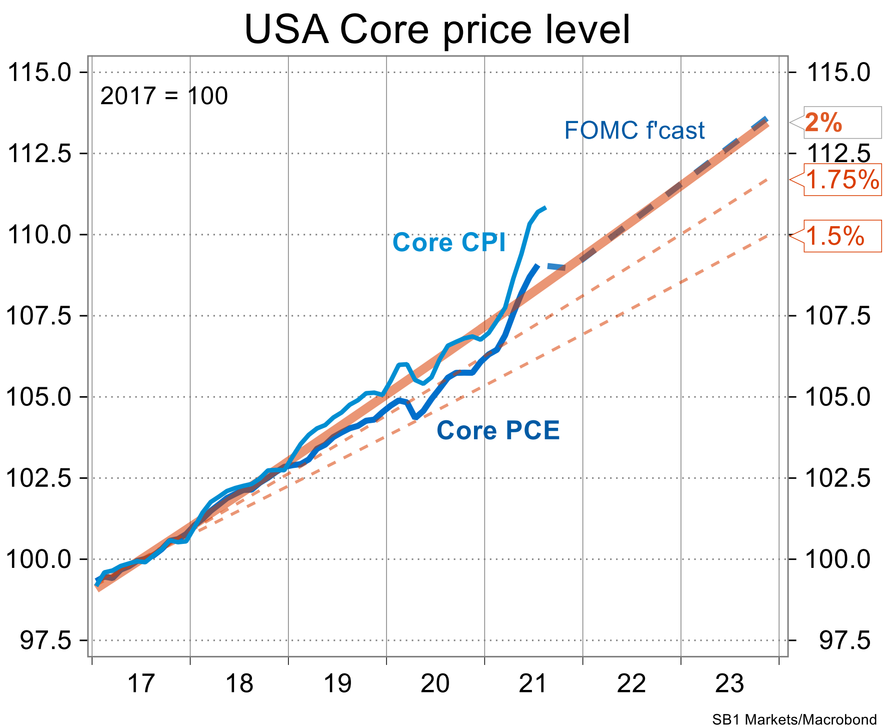


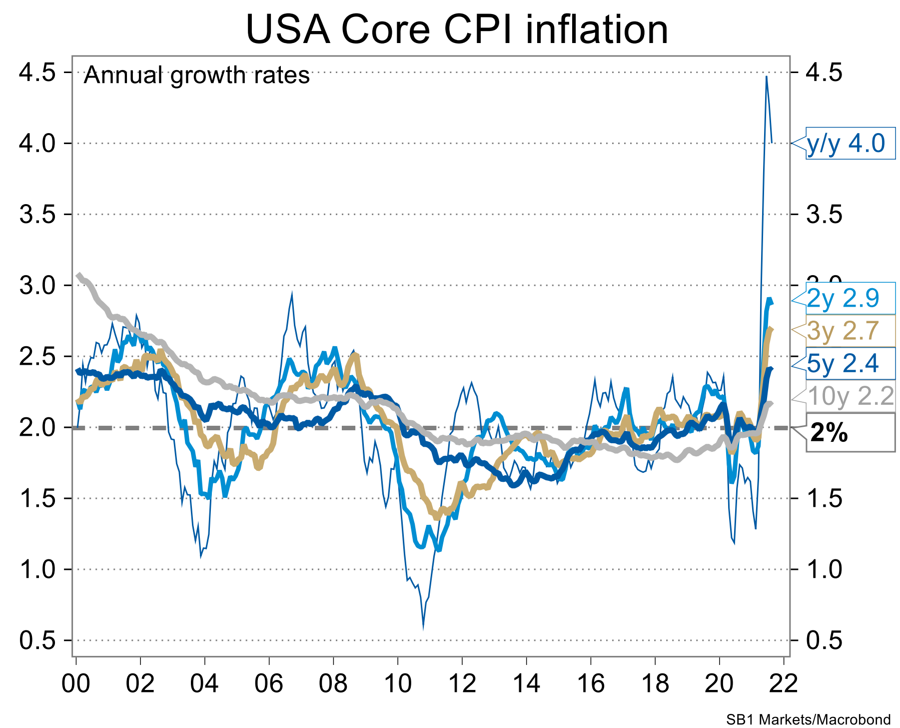


- In the CPI, almost all of the lift in core CPI has been due to prices of good & services that often fluctuate, with rapid price increases followed by deep price cutes – these prices are **flexible**, and represent some 10% of the core CPI. These prices are now more up than ever before, with a substantial 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 average during recent years. 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, prices have been stable
- **Trimmed mean CPI** (Cleveland Fed) and **trimmed PCE** (Dallas Fed) has also accelerated, the CPI measure by the most

The price level target is met, no matter how you choose to look at it

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

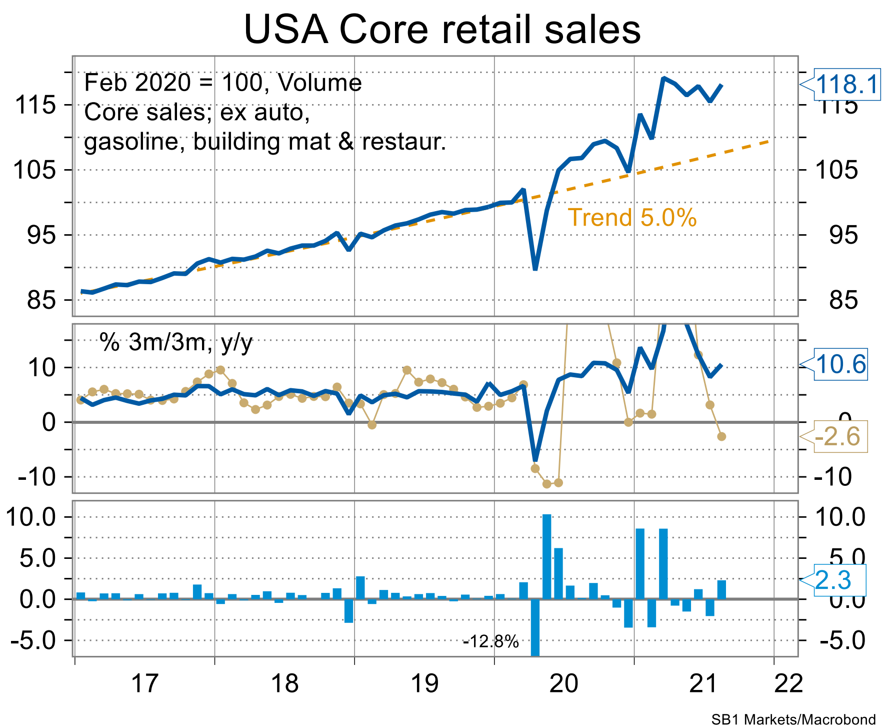


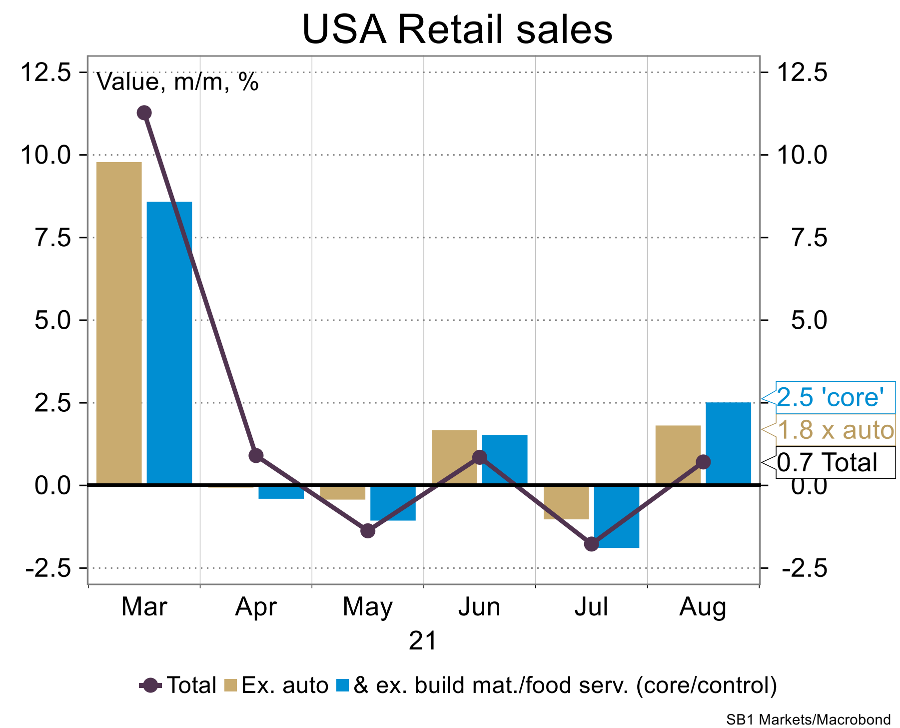


- The Fed has not defined its time horizon but the price level target is met, whatever time horizon the Fed chooses
  - **Measured vs. the CPI**, the average core inflation is at or <u>well above 2%,</u> whatever period we check. **The core PCE deflator** is <u>above 2%</u>, whatever horizon
- **Inflation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

Retail sales surprised on the upside in the Delta August month

Core sales volume up >2%, and is still 18% above the pre-pandemic level!

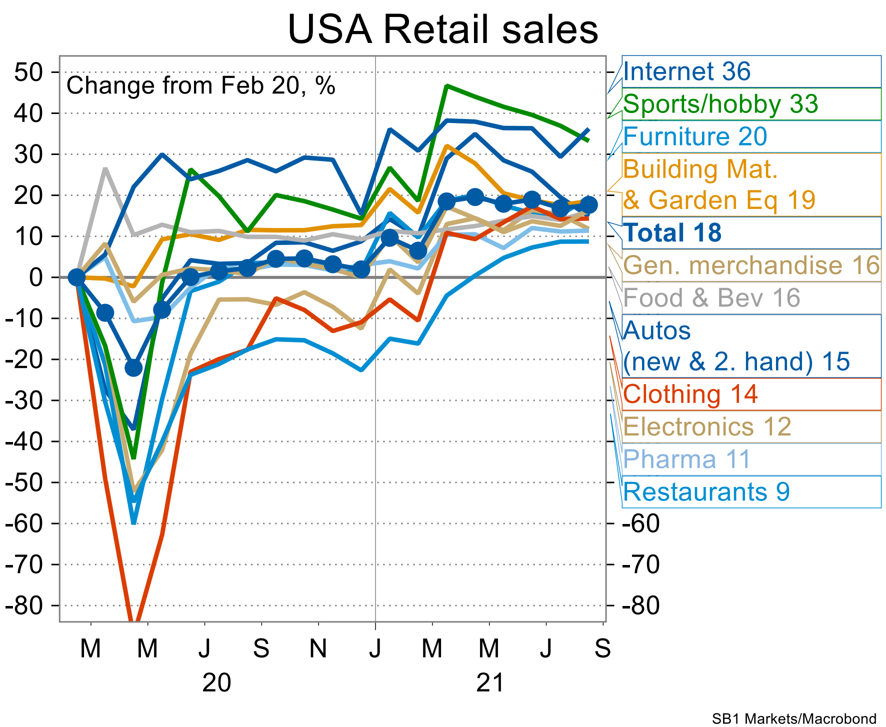


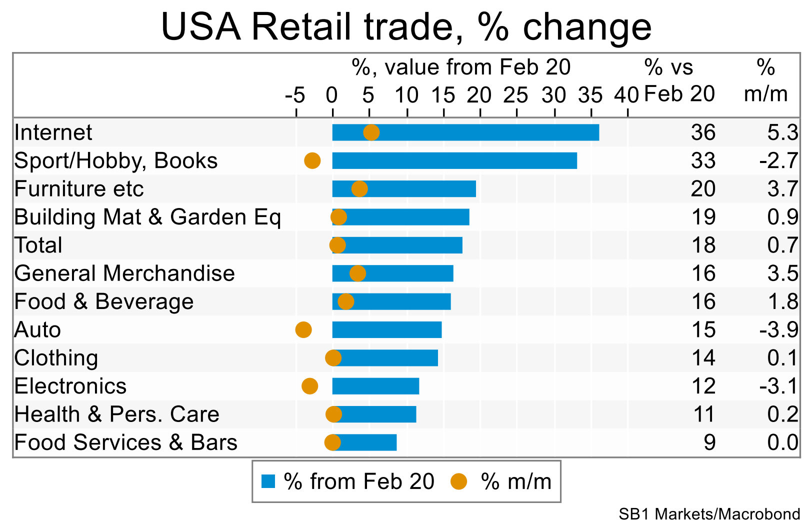


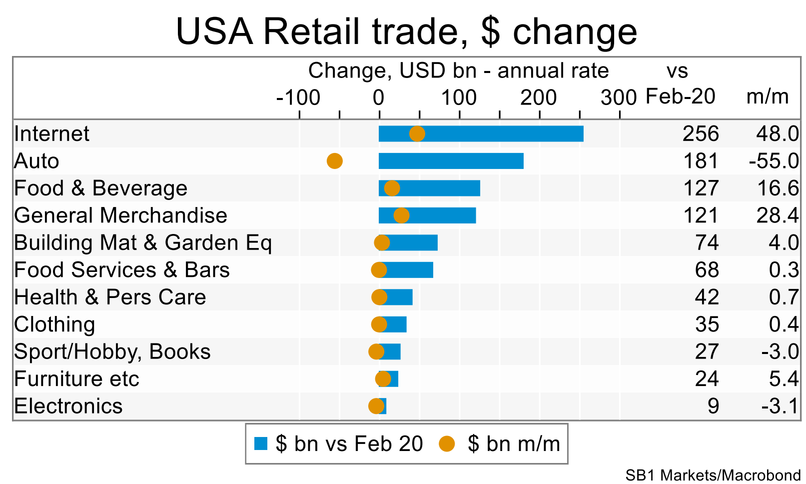
- **Total nominal sales** rose by 0.7 % in August, down 0.2%. However, sales fell 1.8% in July, 1.4 pp more the than the previously reported 0.4%. Sales are up 18% vs the pre-pandemic level
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) rose by 2.5% in August, far above the expected 0.2% decline! Even if July was revised down to -1.8% from -1.1% - and the Aug level is well above expectations. In volume terms, we assume sales rose somewhat above 2% - and sales are 18% above the Feb-20 level
- Sales in restaurants & bars flattened in August – at 9% above Feb-20 level
- Consumption of goods is very likely far above a sustainable level, and we still expect sales to decline the coming months/quarters

Mixed between sectors: Net sales up (Delta?), restaurants flat (still +9% vs. p-p)

Auto, sports equipment, electronics down – while other sectors reported growth in August







Last month

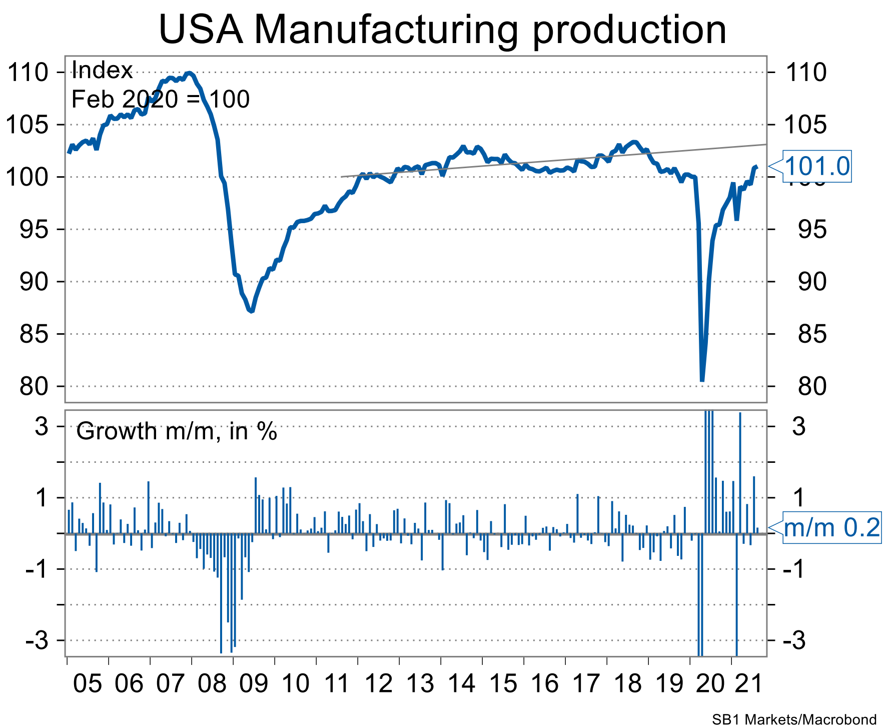
- 8 out of 11 main sectors reported growth in sales in Aug, reversing a weaker July

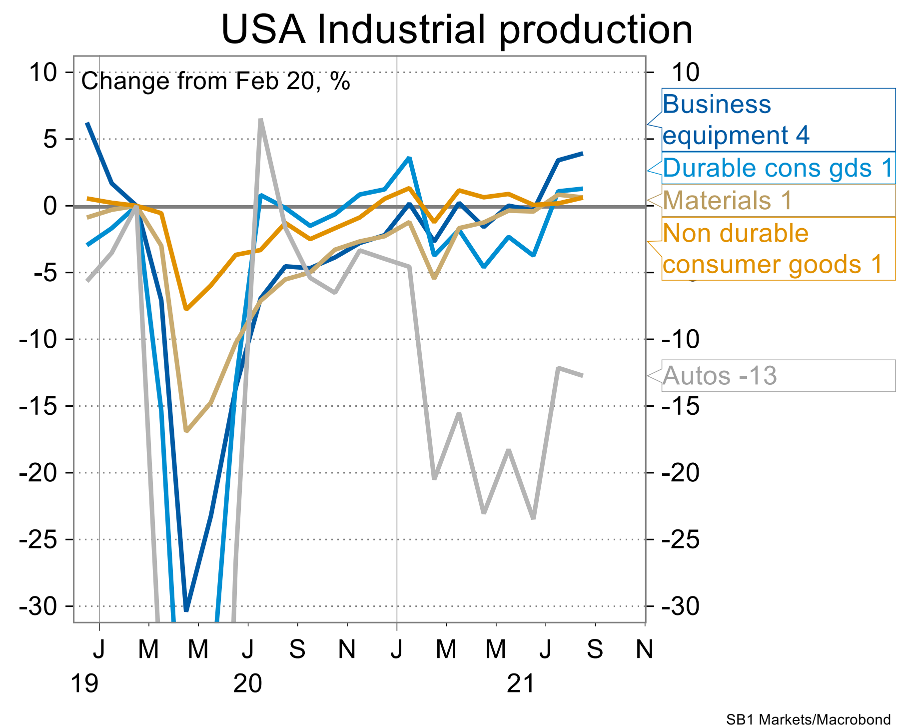
Since pre corona: All sectors up

- **Restaurants** are now 9% above the pre-Covid level
- **Clothing** are on the way up, are up 14% vs. Feb-20
- **Sports equipment** (+hobby/books) is up 33%, while auto sales are +26%
- **Net** sales up 36%

Manufacturing production up 0.2% in August, 0.2 pp below consensus

Production now 1% above the pre-pandemic level. Auto production is still down

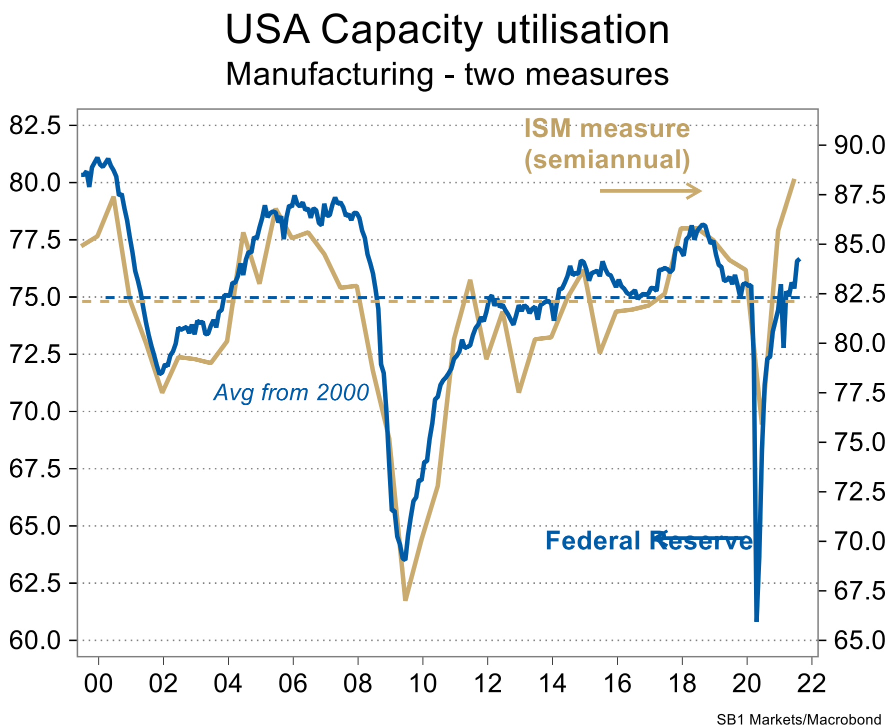




- **Manufacturing production** increased 0.2% in August, expected up 0.4% (July was revised up by 0.2 pp to 1.6%)
  - » Production is now growing quite strong pace, the 3m/3 m rate is at 5%
- Just production of **materials** fell (and just slightly), the other main sectors contributed on the upside. From Feb-20, **business investments** are up 4%, all main groups are above. Production of **autos** are still down 13% vs the Feb-20 level.
- **Total industrial production**, including utilities, mines/oil production rose by 0.4%, in line with expectations (July print revised down 0.1 pp to 0.8%)
- **PMI/ISM and all other surveys** signal a continued strong recovery

Is capacity utilisation just somewhat above a normal level, or record high?

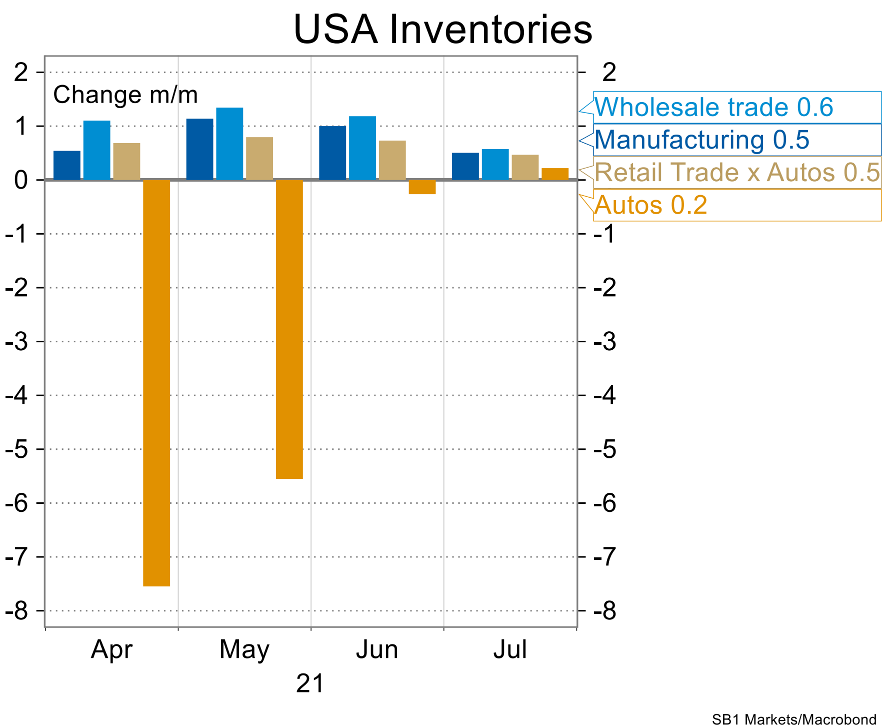
Not an irrelevant question

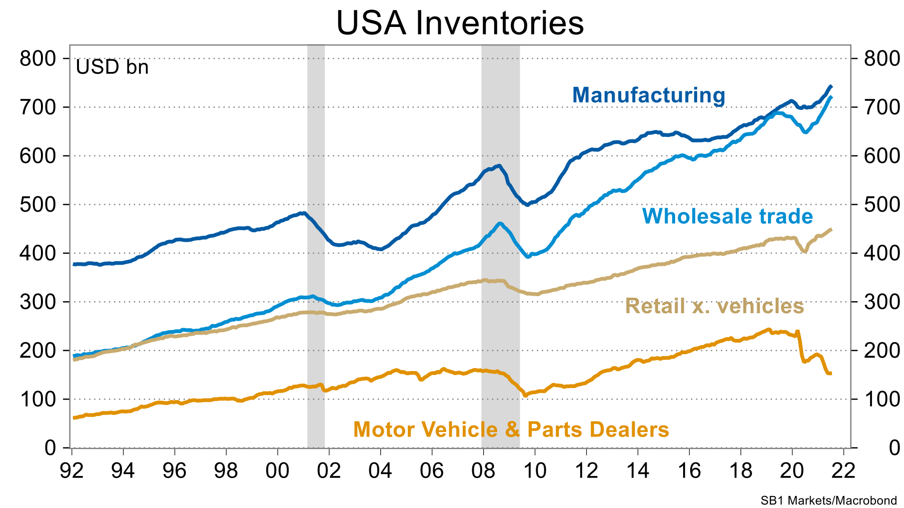


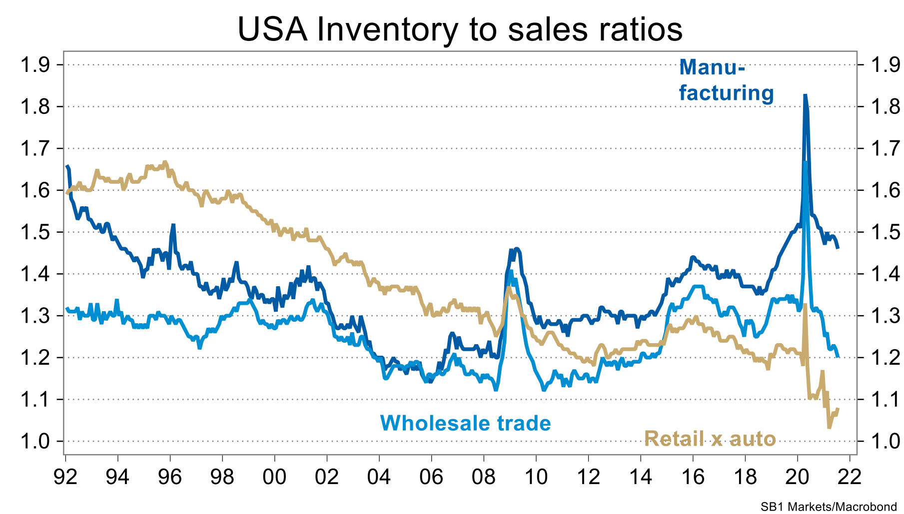
- **The Federal Reserve's** measure now yields capacity utilisation at 76.5%, vs. the long term average at 75%
- **ISM's semi-annual** survey reported a further sharp increase H1/May, the highest level ever, 88 vs the average at 82.5%.
  - » These two measures have not been 100% correlated but the current discrepancy is very large – and quite important when assessing the growth outlook
- The Fed's estimate is model based, while the ISM survey is based on companies assessment of their own capacity
- Given reports on labour shortages, material shortages, prices, the ISM survey seems to give the most reasonable result

Inventories on the way up, but less than sales, except in retail x autos

The inventory is rather large vs. sales in manufacturing, not in wholesale/retail trade



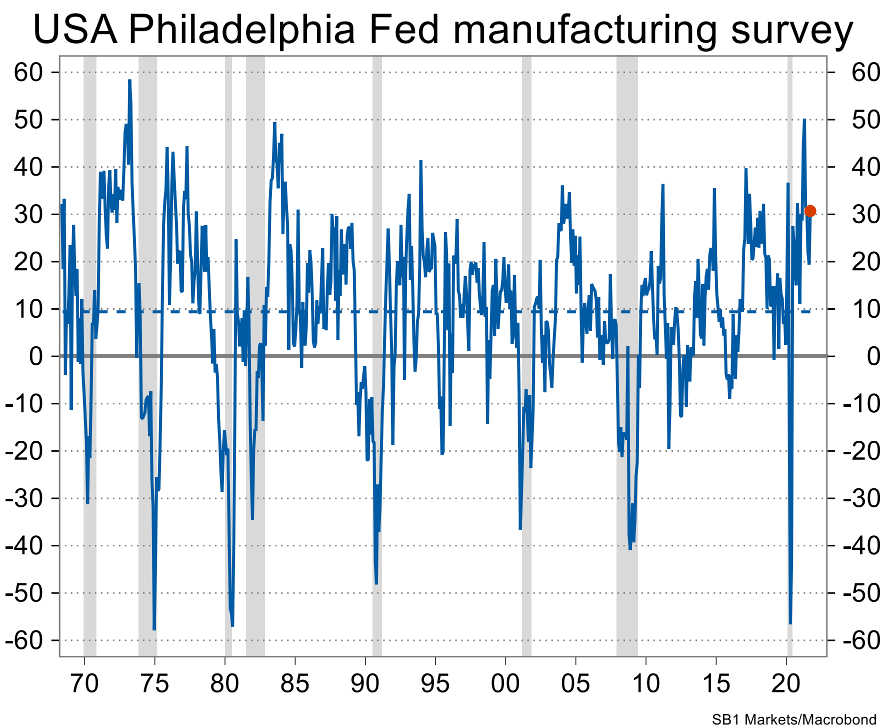


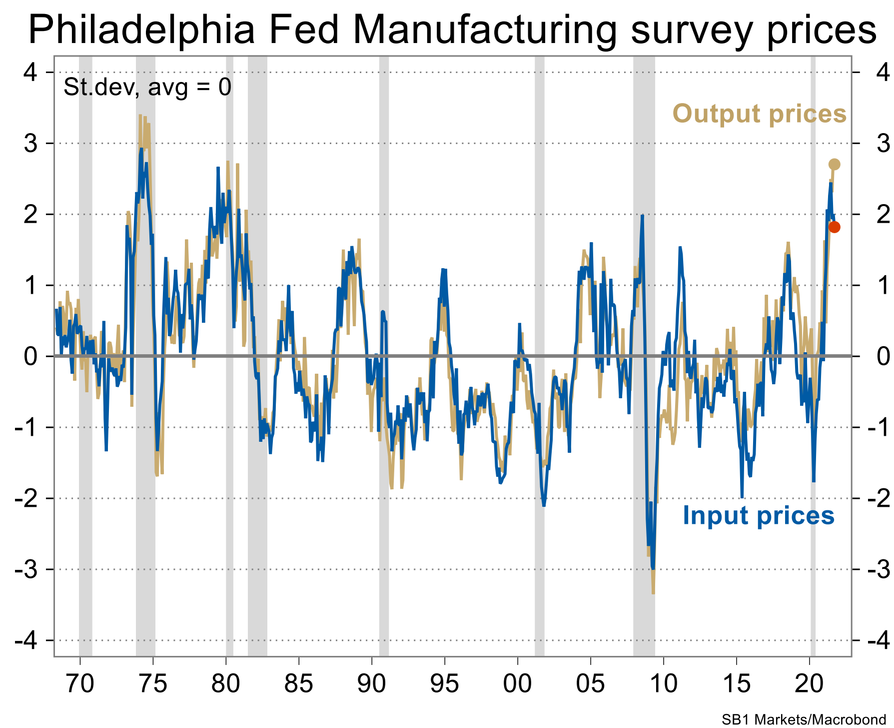


- **Auto inventories** have been slashed during the pandemic but has stabilised at a low level over the past two months
- In sum, we assume inventories are at too low levels now

Philly Fed survey up again in September

And output prices are increasing even faster

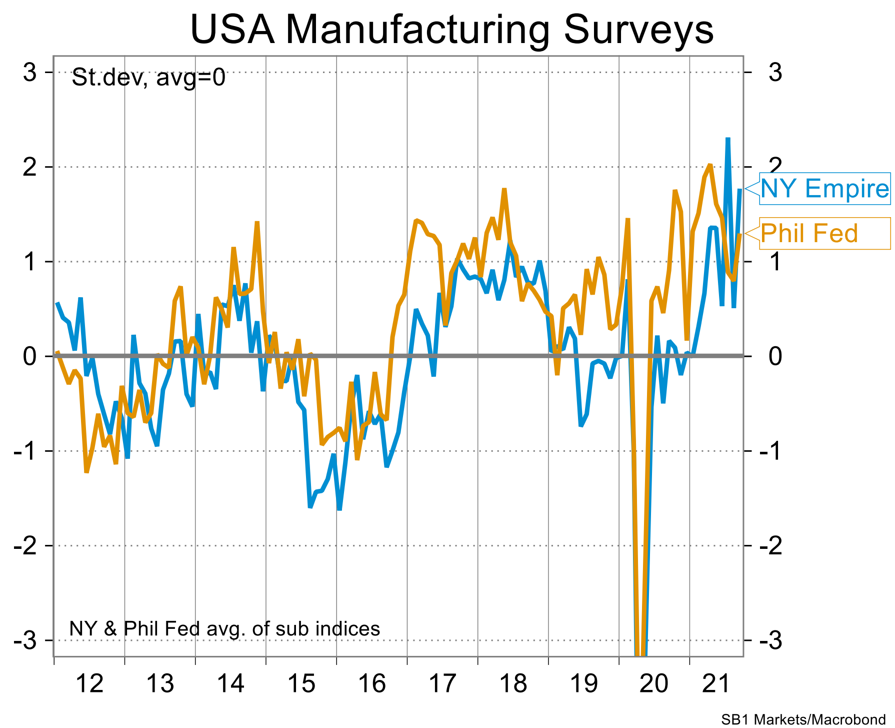


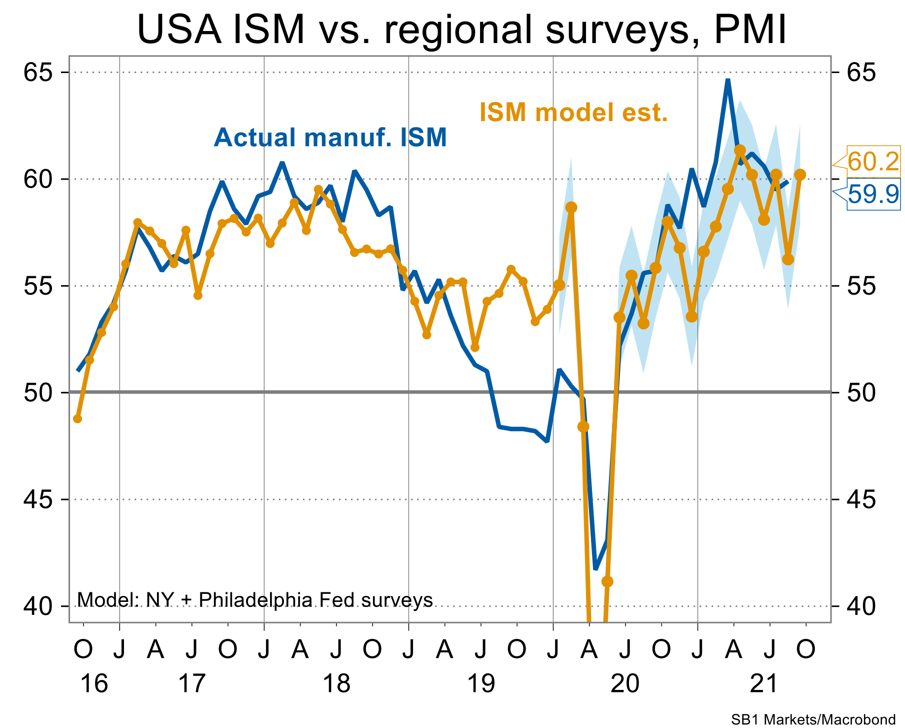


- The main index rose to 30.7 in September from 19.4 in August, expected close to unchanged. The level is far above average (at 10)
  - » An average of the most relevant sub-indices is at 1.3 st. dev above average (up from 0.9) – signaling growth above average
  - » These sub-indices were mixed, order inflow slowed, and delivery times slowed. A steep increase in the inventory component contributed the most to the lift in our average (which consists of the same components as the total ISM & PMI indices)
- **Input prices** are still rising fast but a tad slower in August, **output prices are still growing the fastest pace since 1981**
- New orders, prices paid and received, number of employees, and average workweek sub-indices all increased

The NY Fed manuf. survey reversed most of the Aug decline, up to +1.8 st.dev!

The two regional surveys indicate a strong ISM in September too

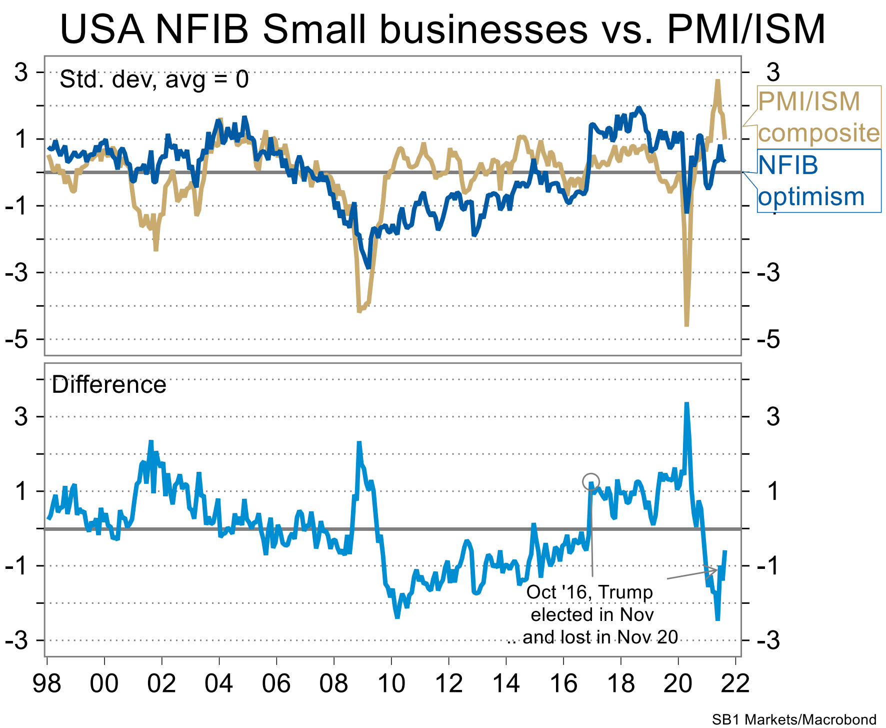


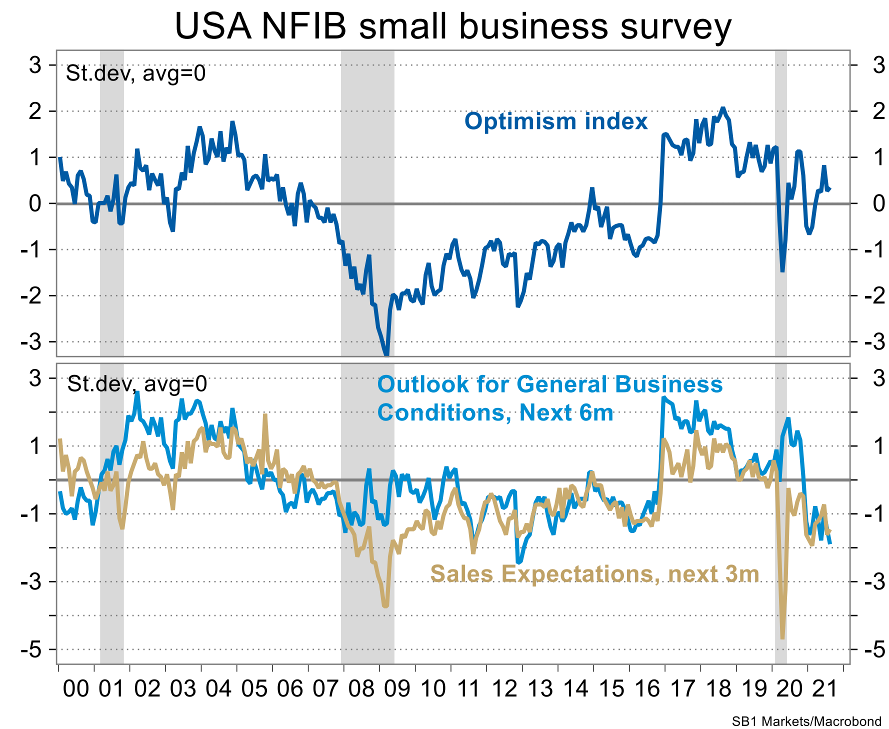


- NY Fed's manufacturing rose to survey shot up to 34.3 from 18.3, expected down to 17!
  - » The average of 'ISM component' in the Phil Fed survey is 1.3 st.dev above avg, the NY Empire is up 1.8, the 2nd best print since 2006, just July ('21) was better!
- These – and all other – surveys, still signal growth well above trend in manufacturing production

Small businesses optimism marginally up in August, but outlook worsens

Small businesses cannot find workers and are raising compensation… <u>and selling prices</u>

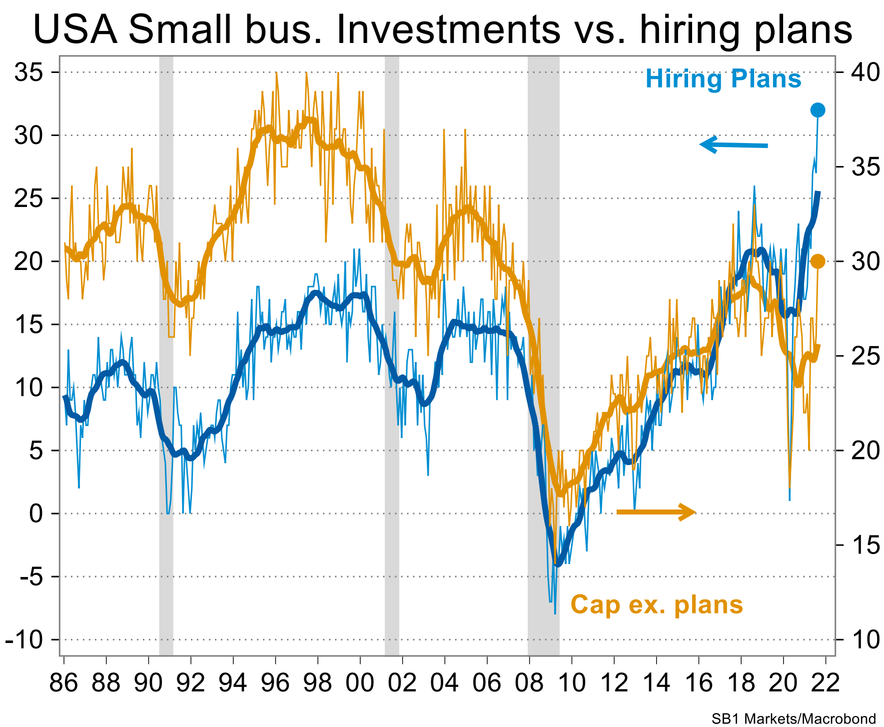


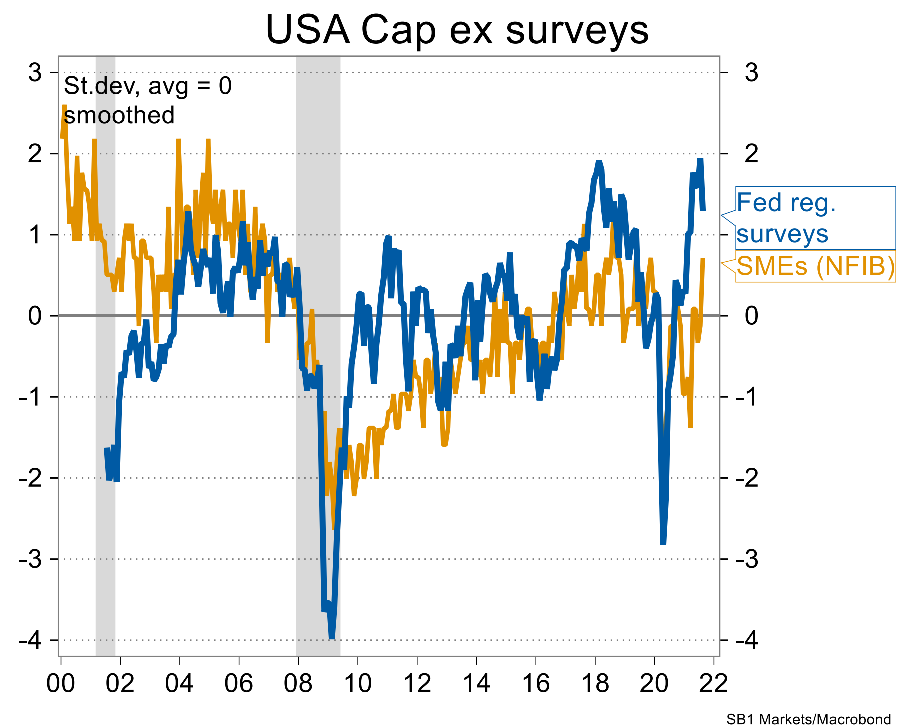


- The **NFIB optimism index** rose to 100.1 in August from 99.7 (an invisible increase, expected down to 99). 5/10 components improved. The index is still above an average level but lower than the PMI/ISMs, and most other surveys. However, the gap is now far smaller than some months ago
- **The outlook for the next 6 months** worsened substantially in August and is currently <u>1.9 st.dev below</u> par, not far above all time low. Lack of qualified labour, inflation worries, and the Delta variant rattle small businesses
- Still, **investment plans** increased sharply to above an average level
- **Hiring plans** rose sharply to ATH in Aug, by far. However, the SMEs are not able to **fill their vacancies.** Slightly fewer (and just marginally below ATH) of <u>businesses say they plan to raise</u> **labour compensation**, and the proportion of companies that have increased compensation rose to ATH
- **Actual & planned price increases** are soaring – like we have never seen before (barring 1 month in 1979…, <u>see more here</u>). <u>Supply is the problem, not demand</u>

Hiring plans to a new ATH, and companies are not able to fill positions

Investment plans also revised upwards, to above par

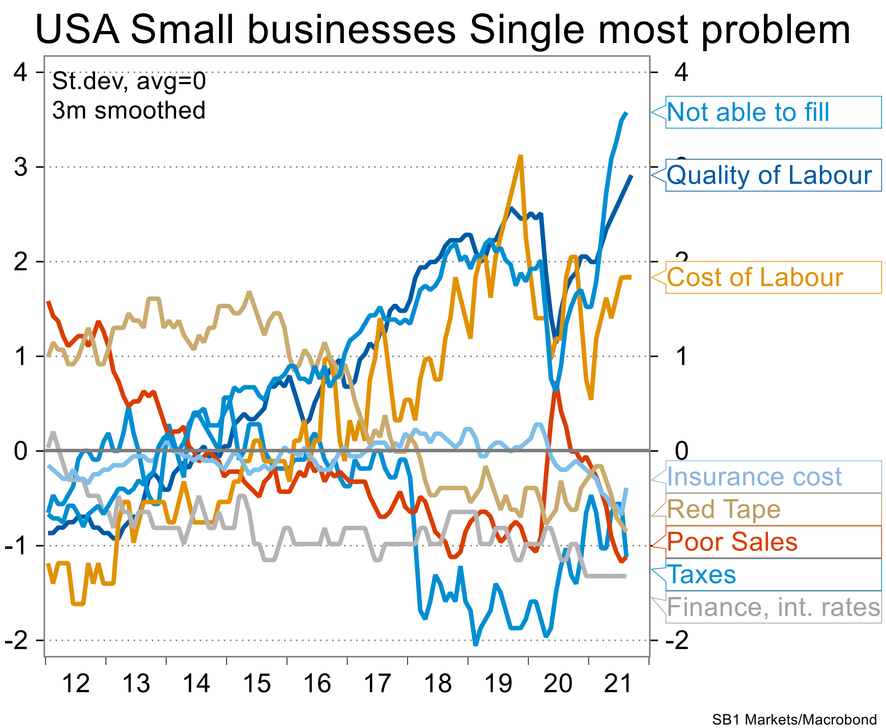


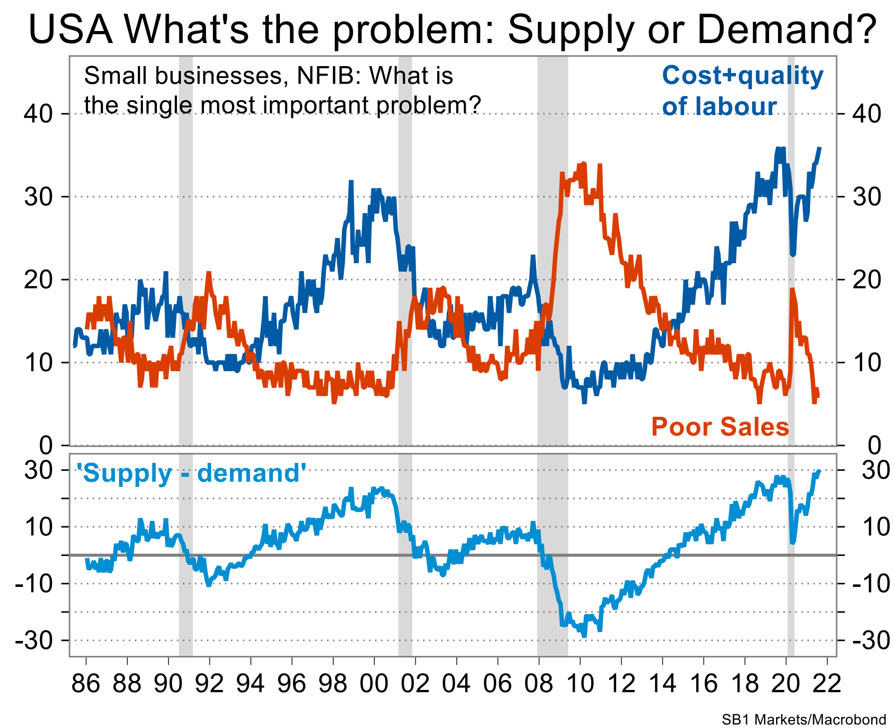


- Other investment surveys are still more upbeat than the small business survey

We've said it before: It's the supply side! (… so no need to stimulate demand)

It's really looking like we are close to peak of a cycle, and not coming out of recession

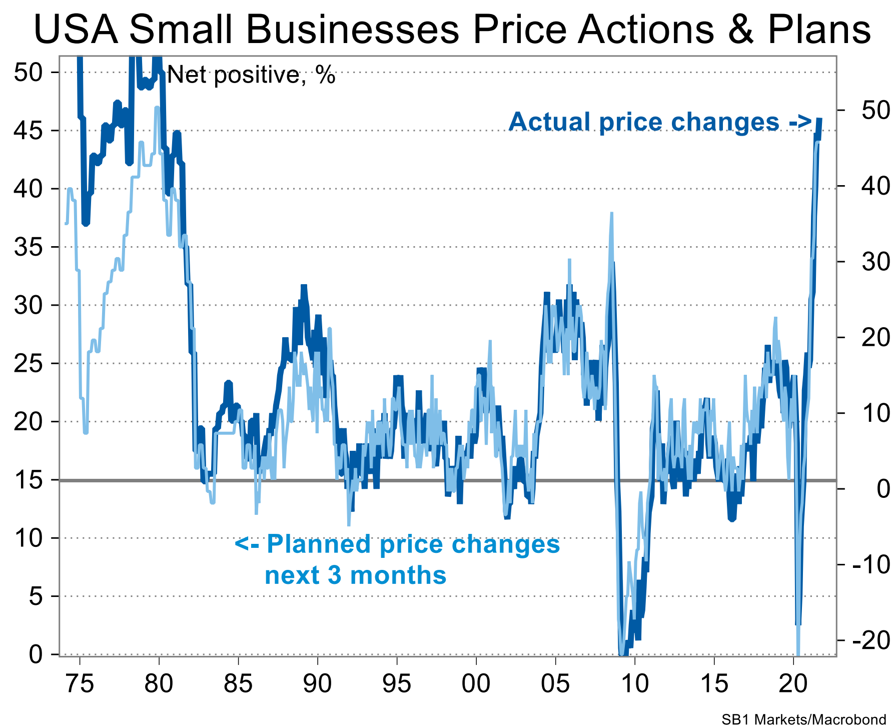


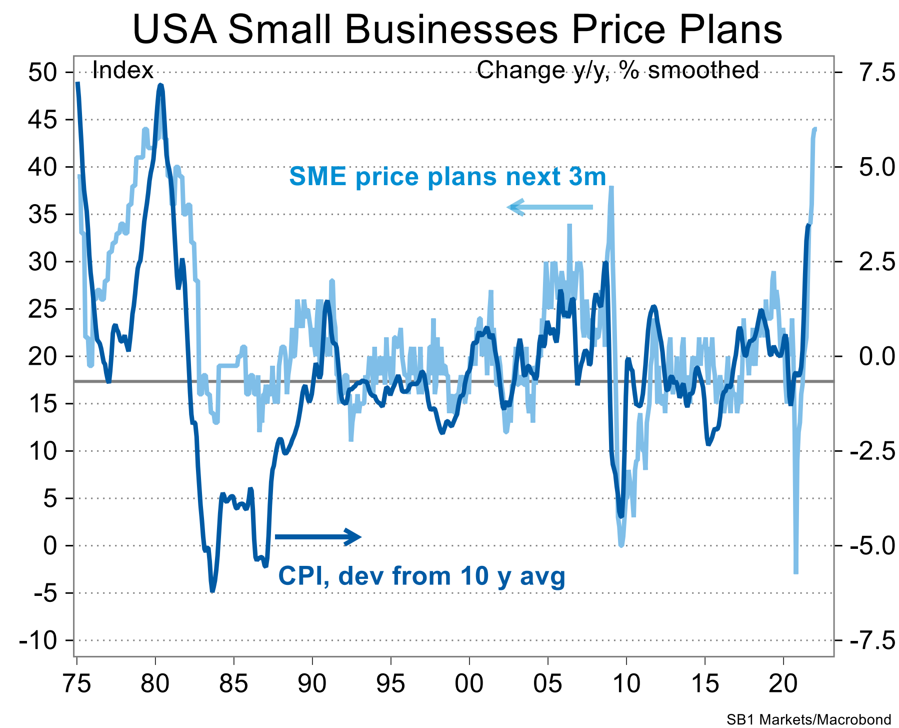


- While more businesses than normal stated **weak sales** as the major problem during the pandemic, there were never that many, and now a close to record low share of companies say than poor sales is the problem (and fewer than before the pand.)
- **Availability and quality of labour** is a much more serious problem than normal, and at ATHs. For **cost of labour,** the share is far above a normal level
- 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: A record high no. of SMBs still say they plan to raise prices

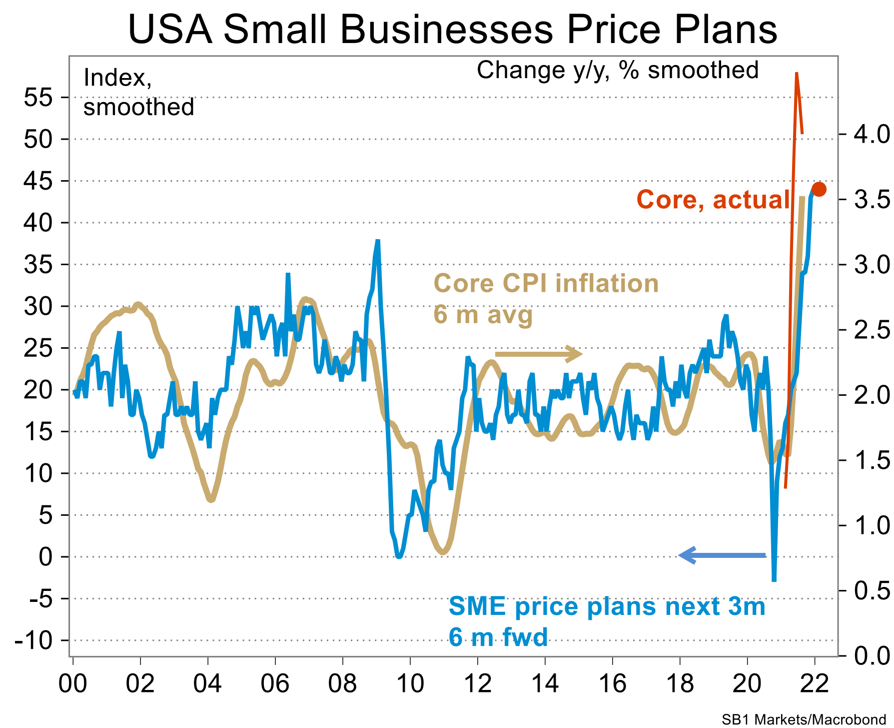
The share has been higher just one month, in December 1979





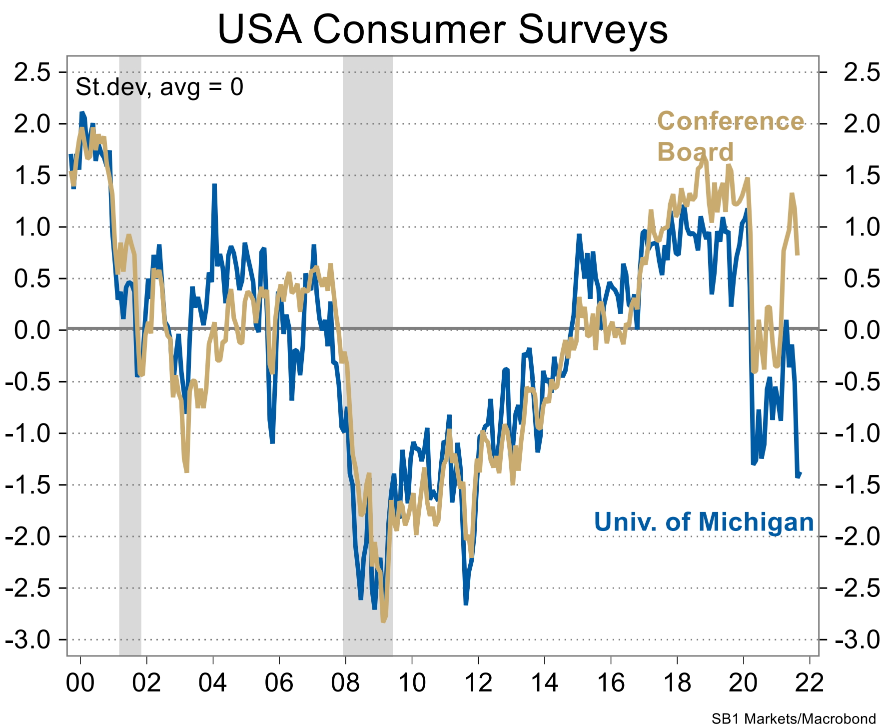
- Back in 1979, it lasted just one month; now we have been up here four months in a row
- It is challenging to calibrate the SBM survey vs. actual inflation, as the present print is so extremely far off the chart vs. the past 35 years experience. But surely, it tells us something. We have made at try at the chart above to the right, a second chart on the next page. Inflation may stay up here for still several months (but it may still be labelled 'transitory', of course)
- 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 still** reports a 3% expected growth in unit costs. Since 2013, the expectations have been stable at 1.75% – 2.25%

Still (some until further notice) lasting inflation risk?



Univ. of Mich. consumer sentiment stabilised in September, at a very low level

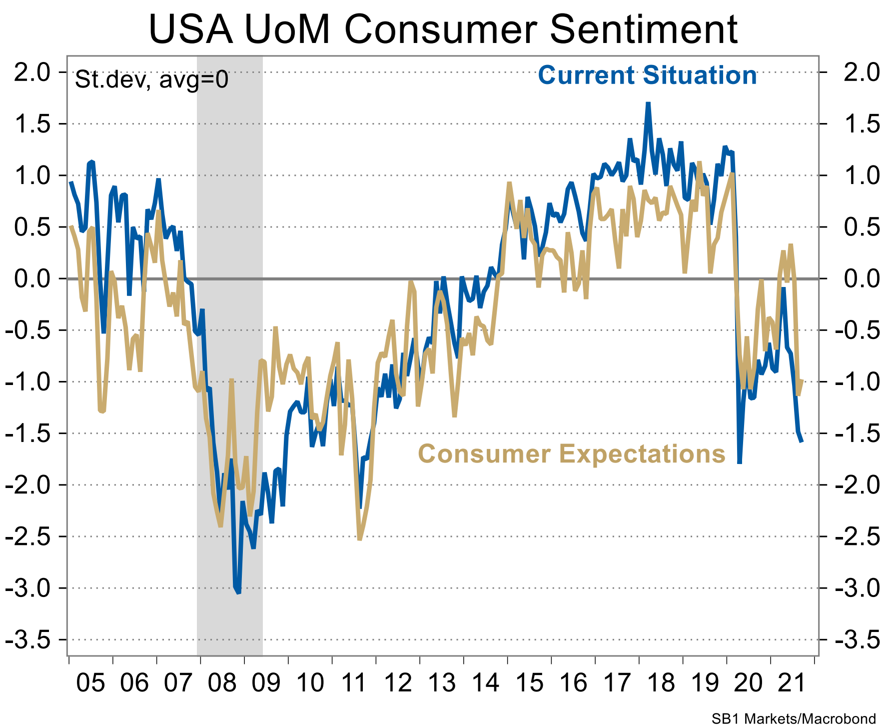
Other surveys are also sagging, but UM is still in the 'lead'. Why so pessimistic now? We don't know

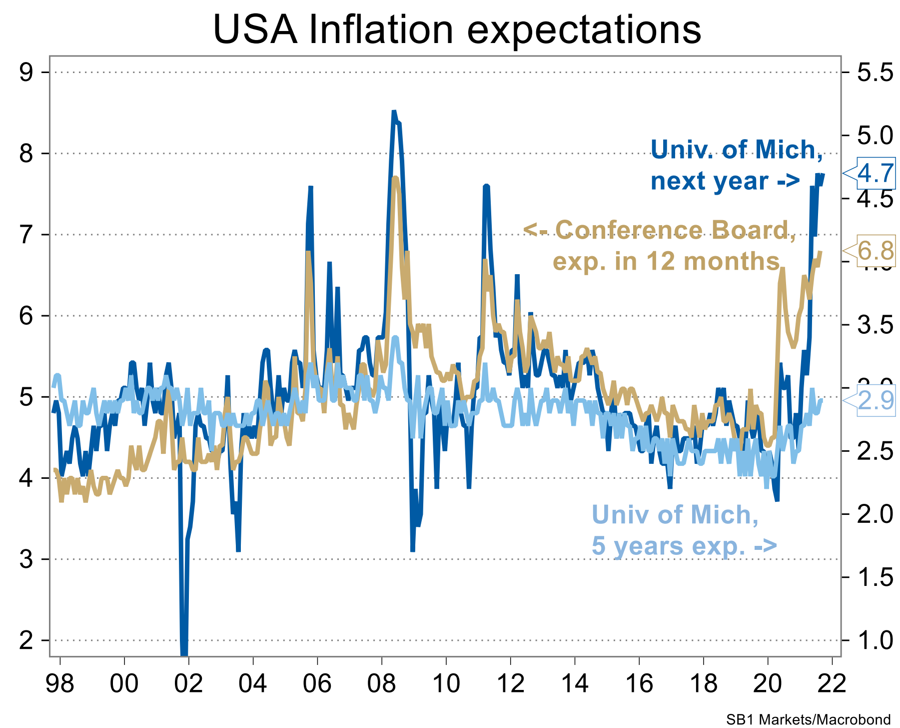


- In August, the UM sentiment index fell 11 p to 70.2 (almost -1 st.dev to -1.4 st.dev below avg), to the lowest level since 2011
- In September, the index rose just marginally to 71.0, expected up to 72
  - » **Expectations** rose slightly while households' assessment of the **current situation** continued downwards
- Other surveys also fell in August but less than the UM survey and not to the same level. The IBD/TIPP fell sharply in September, but just to -0.3 st.dev below avg.
- The Delta virus attack may explain the sudden decline in consumer confidence but hardly that sentiment to a level below April/May last year, and far below the level during the outbreaks in between, where the no. of hospitalised were higher than now
  - » 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), and even if employment growth slowed in August, the labour market is still tight
  - » 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 Aug/Sept, and cannot explain the sentiment shock
  - » **Politics**? The escape from **Kabul**?
- What to make out of it? To put it simple, we are still not sure

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

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

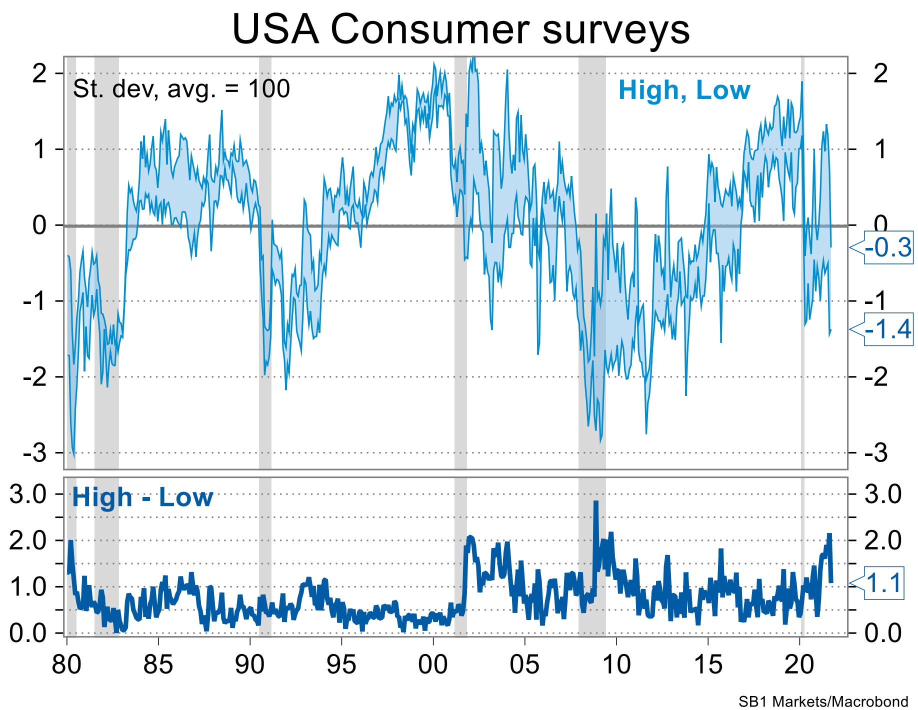


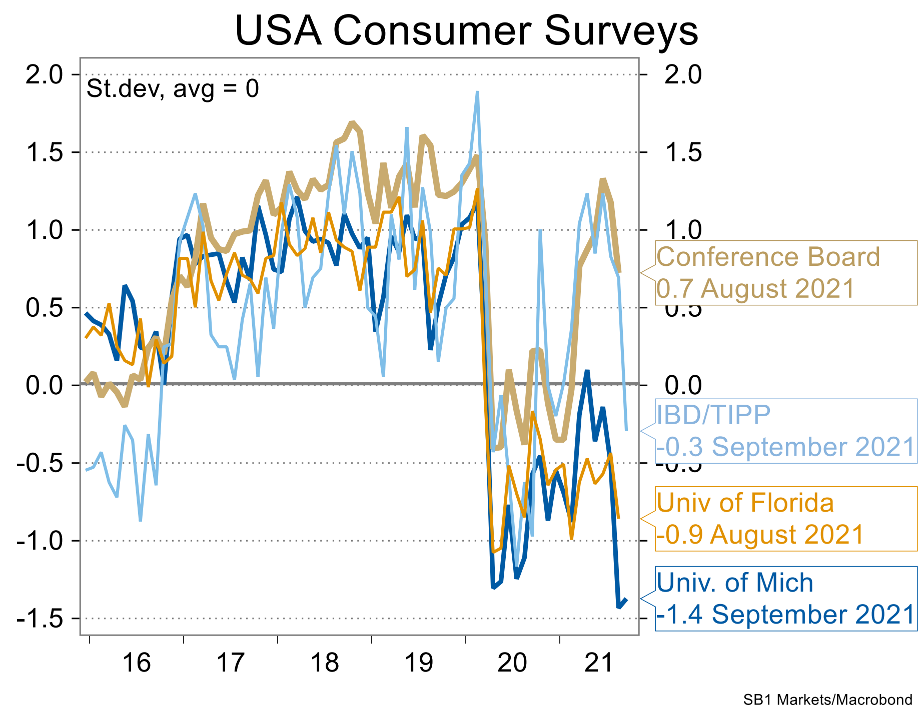


- The expectation component rose slightly in September, while the current situation assessment fell further – which could be impacted by the virus situation – even if previous virus waves have to led to such a decline
- The 12 m inflation f'cast rose one tenth to 4.7%, back to the July level, while the 5 y expected inflation was unch. at 2.9%. Both are at elevated levels of course, but has not climbed further in Aug/Sept, when the overall sentiment nosedived

The IBD/TIPP survey has (partly) tanked too – to below average

In August, the gap between the various consumer surveys was close to record high

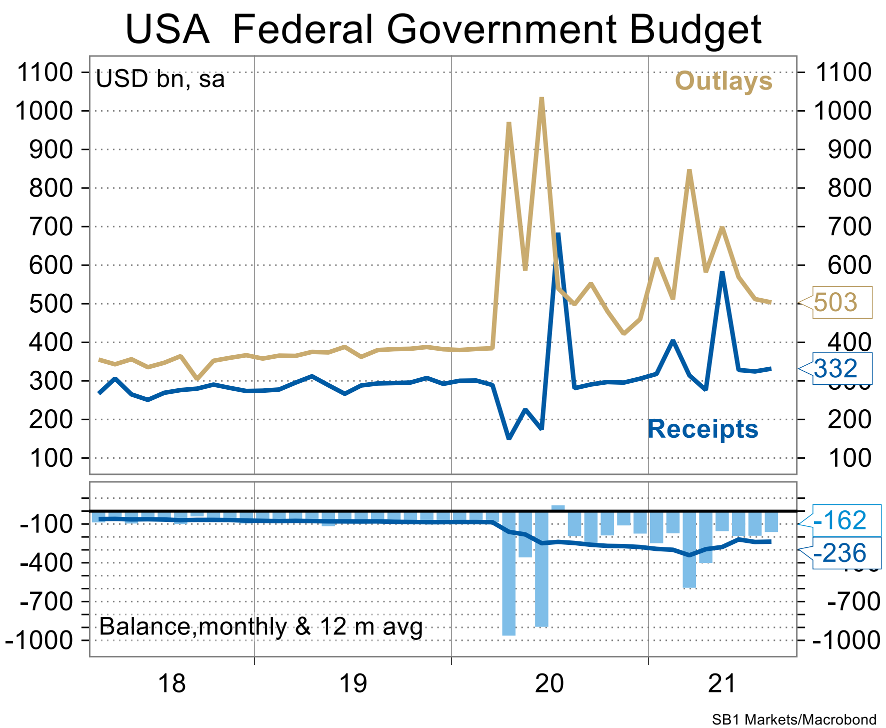


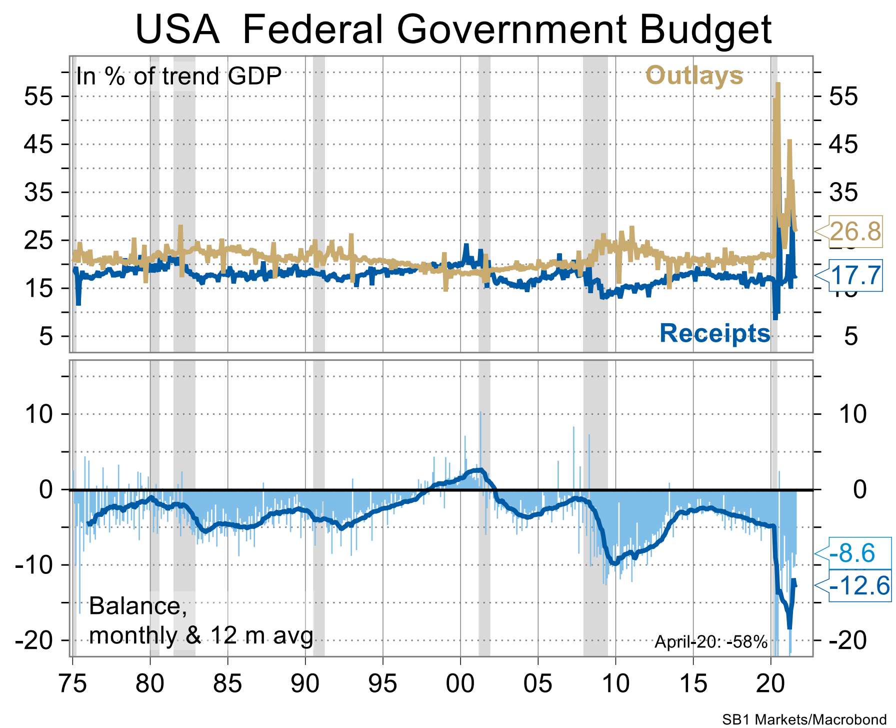


- The IBD/TIPP survey fell to 0.3 st.dev below in September, from 0.7 above the average in August. This survey is more volatile short term than the other surveys. University of Florida's survey fall to -0.9 st.dev in August and have been on the weak side during the pandemic
- Conference Board's confidence survey fell more than expected August, but was still at 0.7 p above average, far above the -1.4 st.dev below average Univ. of Michigan survey. The UM survey has been below par (barring one month) during the pandemic, while Conference Board and IBD/TIPP have been far above from early 2021, when the vaccines arrived

Budget deficit slightly narrowed in August, still at 9% of GDP

And now the Government is running out of cash, the debt ceiling is not lifted

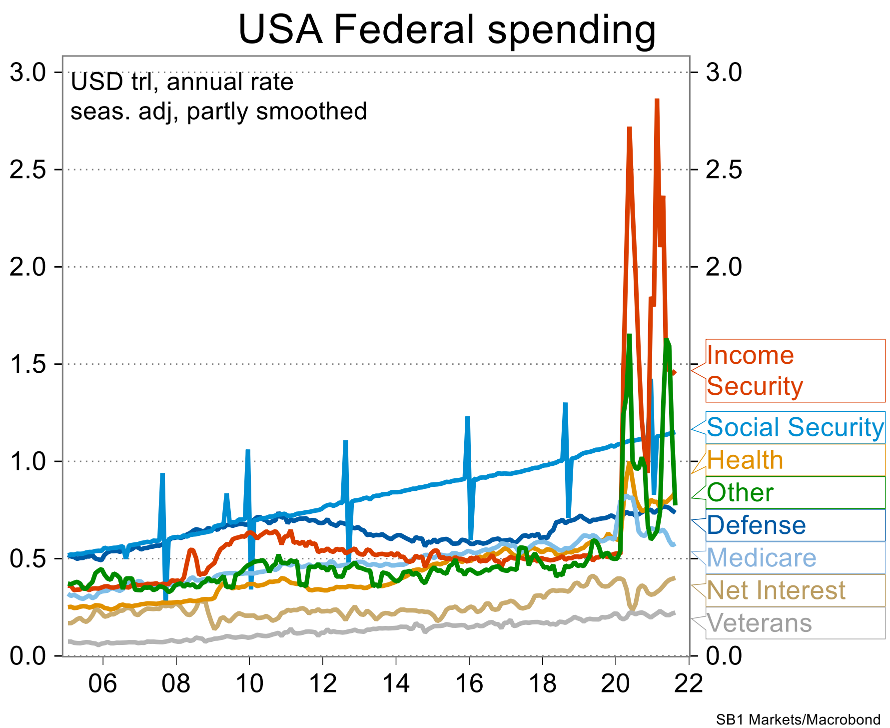


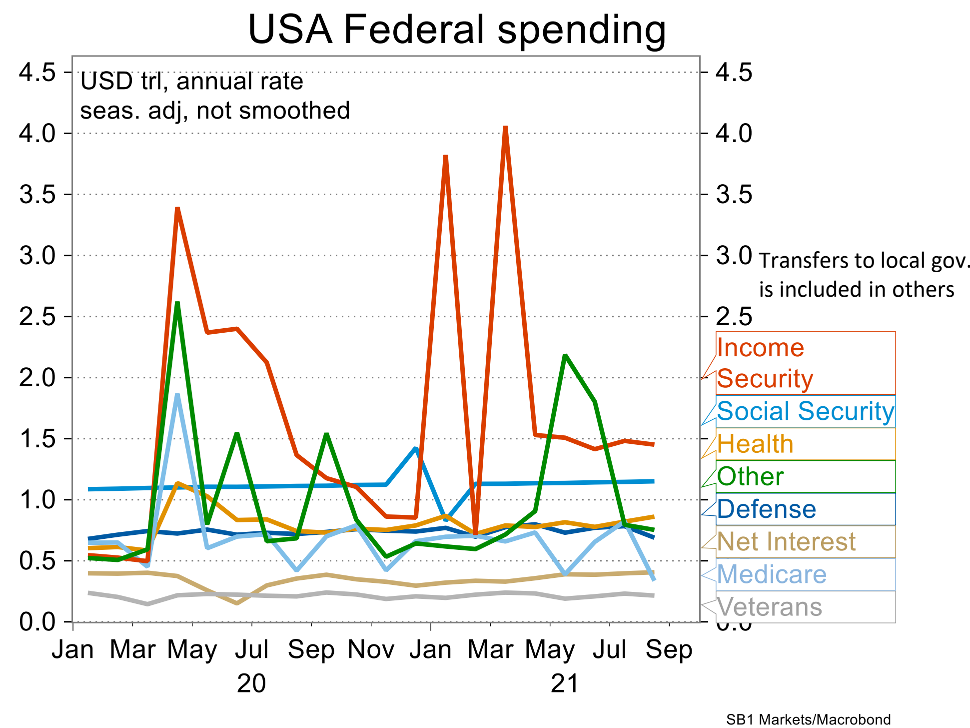


- **Federal expenses** fell marginally to USD 503 bn in August bn (seasonally adjusted), equalling 27% of (monthly) GDP
- **Federal income rose just as marginally, to 332 bn**, 18% of GDP – and covering just 66% of the expenses
- The actual **deficit** was at USD 171 bn in Aug, expected USD 225 bn. The seas. adj deficit equalled USD 161 bn or 9% of GDP. Over the past 12 months the Federal deficit has equalled 12.6% 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 (except that actual printing has slowed recently)

Small changes in expenditures in August – but Medicare spending 'too low'

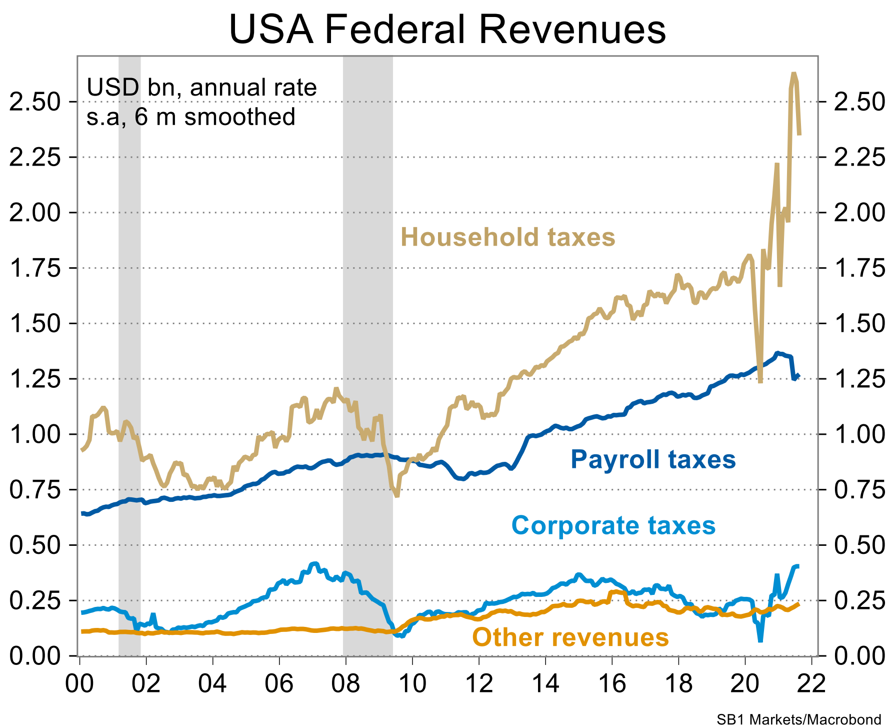
The infrastructure deal is not yet finalised, and 'welfare' reform is far from decided

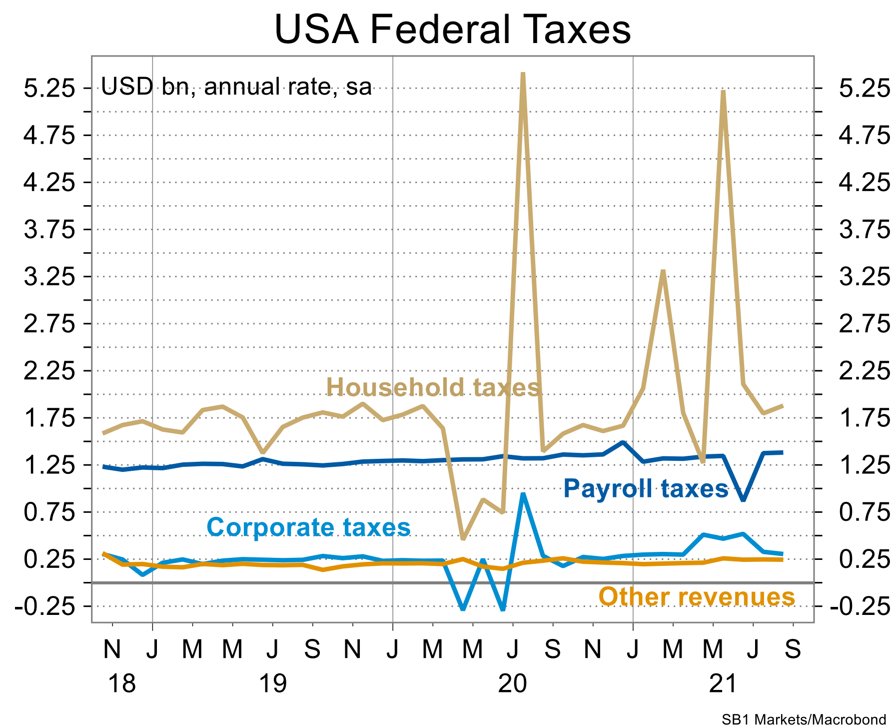




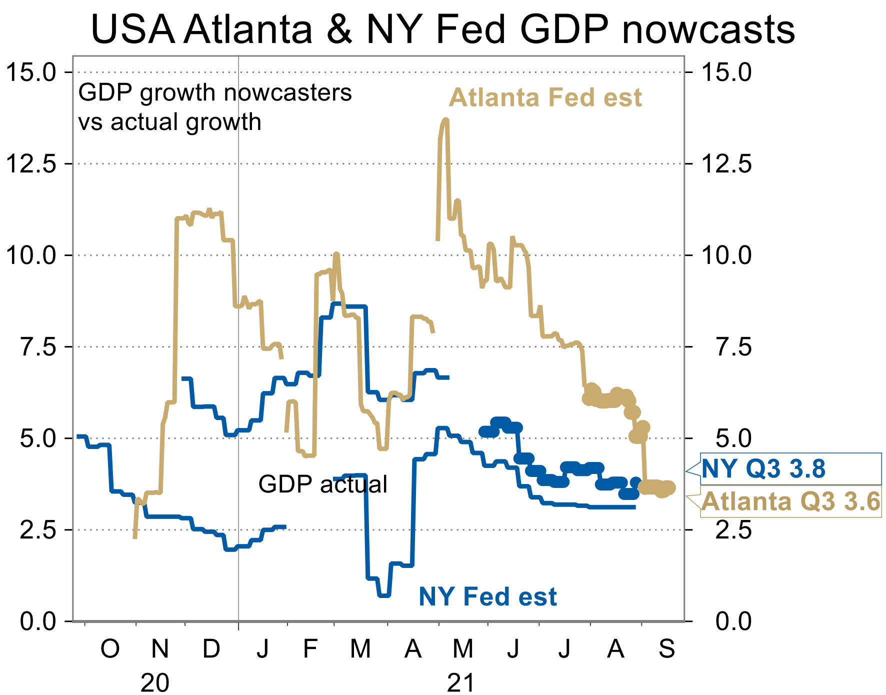
- Federal spending on income security will decline in September, when the pandemic unemployment benefit programs. However parts of the relief package decided in spring is not yet full distributed (larger child tax credit, vaccine distribution, health care, food assistance programs, support for businesses)

Tax revenues have normalised - and were stable in August

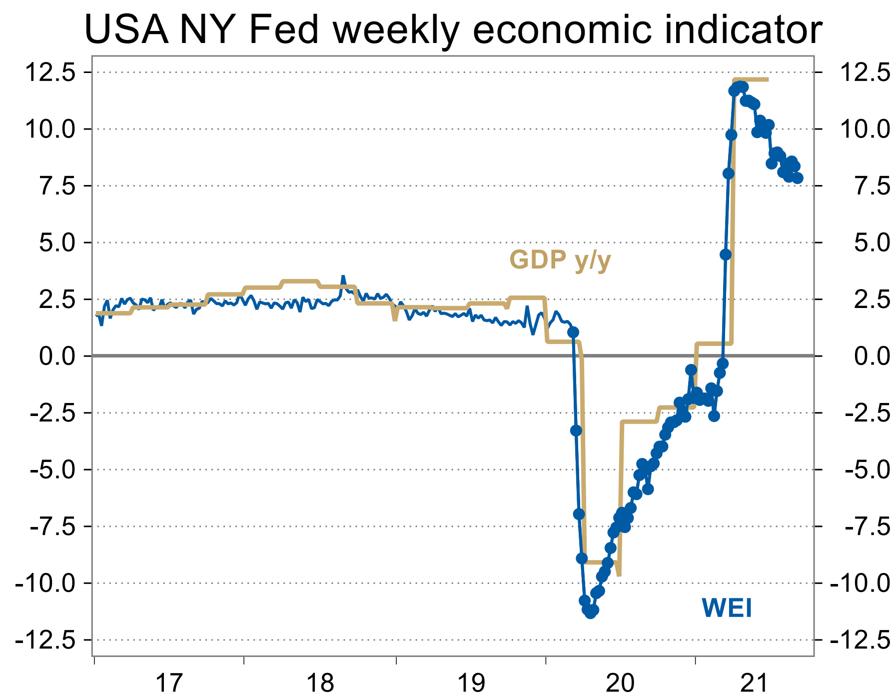




The nowcasters still signal 3 to 4% GDP growth in Q3 as estimates slows



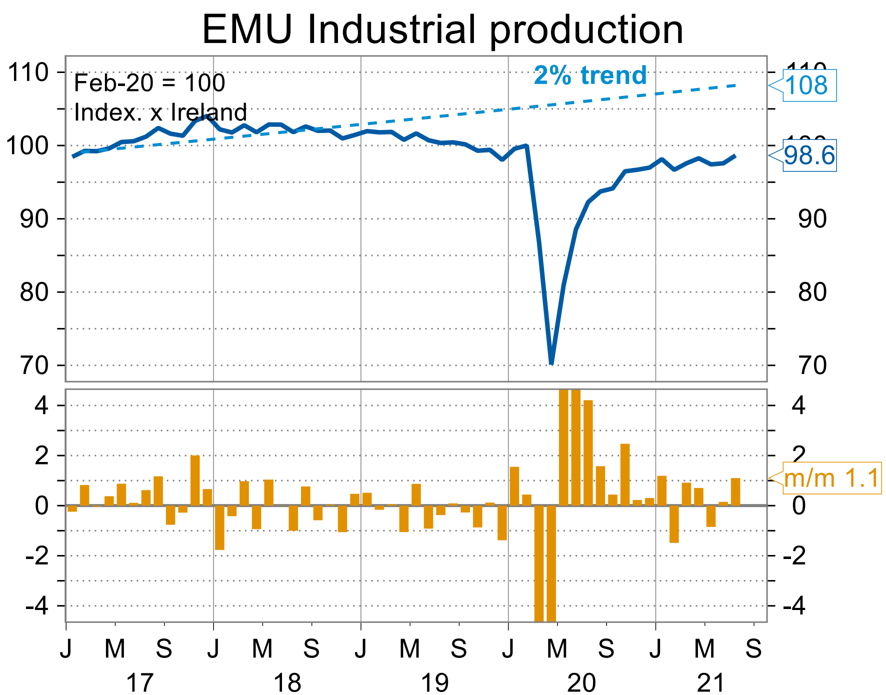
SB1 Markets/Macrobond

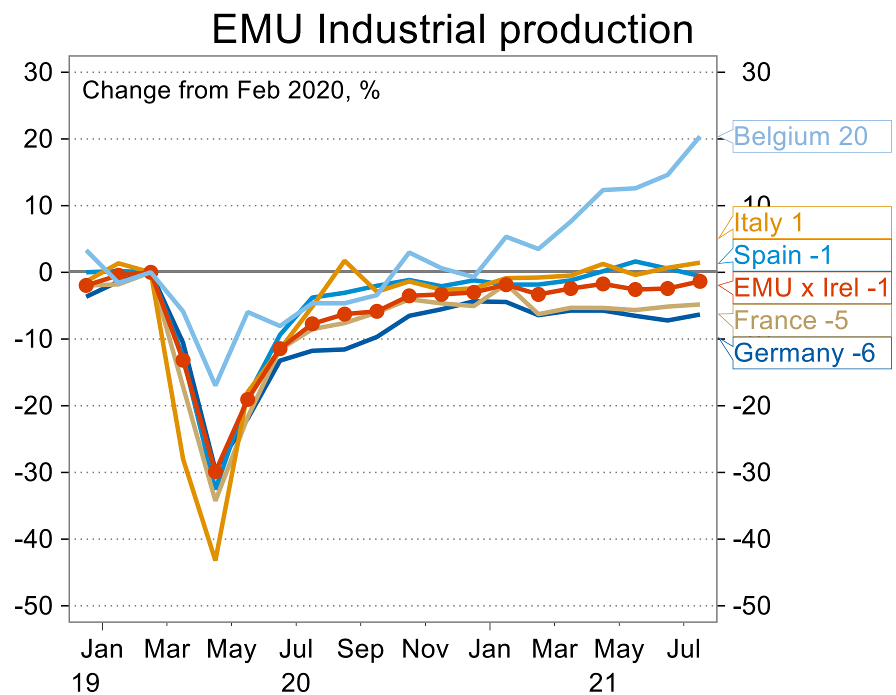


SB1 Markets/Macrobond

Manufacturing production up by 1.1% in July, far better than expected

… as Belgium saved the day. Level 1.4% below Feb-20, as auto production is down 24%!



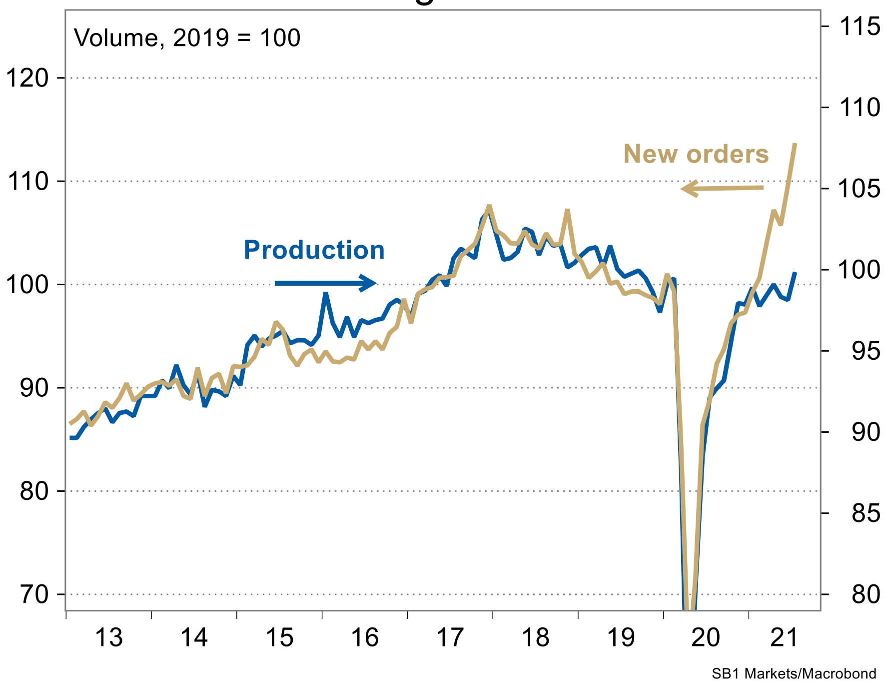


- Production is just slowly moving upwards even of orders (check next page) are surging, and surveys are close to record high levels
- Production in Italy is higher than in Feb-20, in the other big 3 are down
  - » Germany is the laggard, down 6.3%. From time to time, auto production is not what you wish you had…
  - » Belgium is up 20, the Netherlands 4%
  - » The only country in which production is down from a year ago is Portugal
- Ireland is not included in our calculation due to huge volatility (probably tax related). Including Ireland, production was up 1.5% m/m, 0.9 pp above expectations

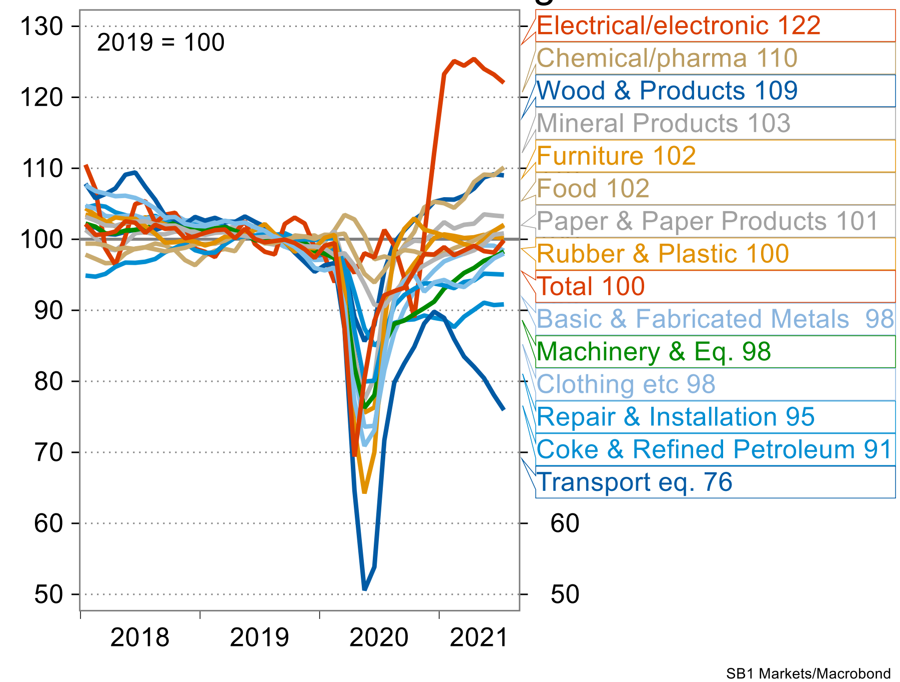
Orders suggest that there is some upside to production ☺

Sector wise: The auto industry is the weakest link in the chain, down 24% vs. 2019 level

EMU Manufacturing orders & Production

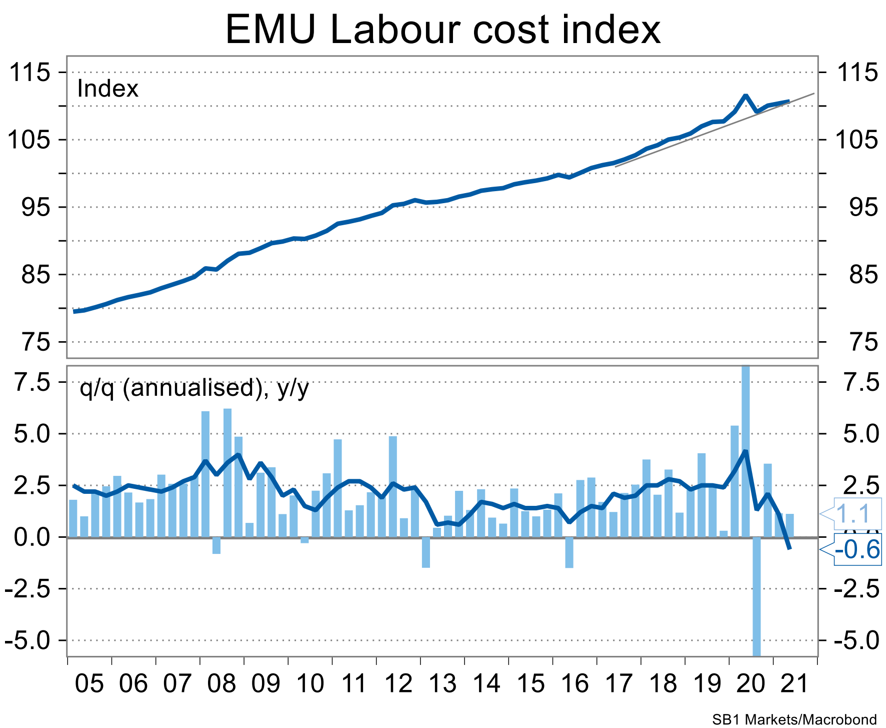


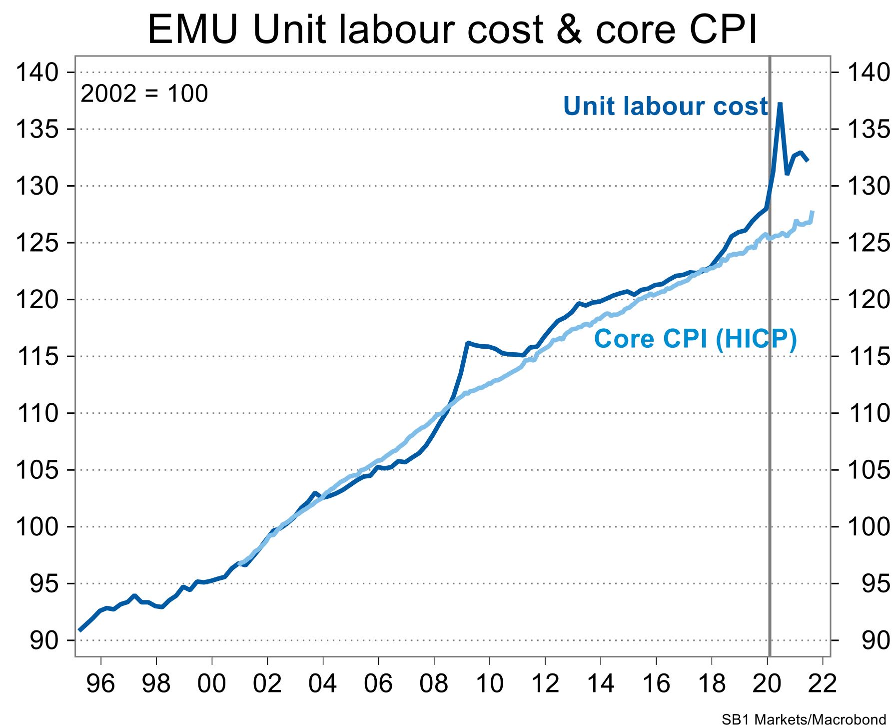
EMU Manufacturing - sectors



Labour cost back on track. Unit cost seems to moderate

Labour cost rose just 1.1% q/q (annualised) in Q2, as in Q1 – and is down 0.6% vs. Q2-20

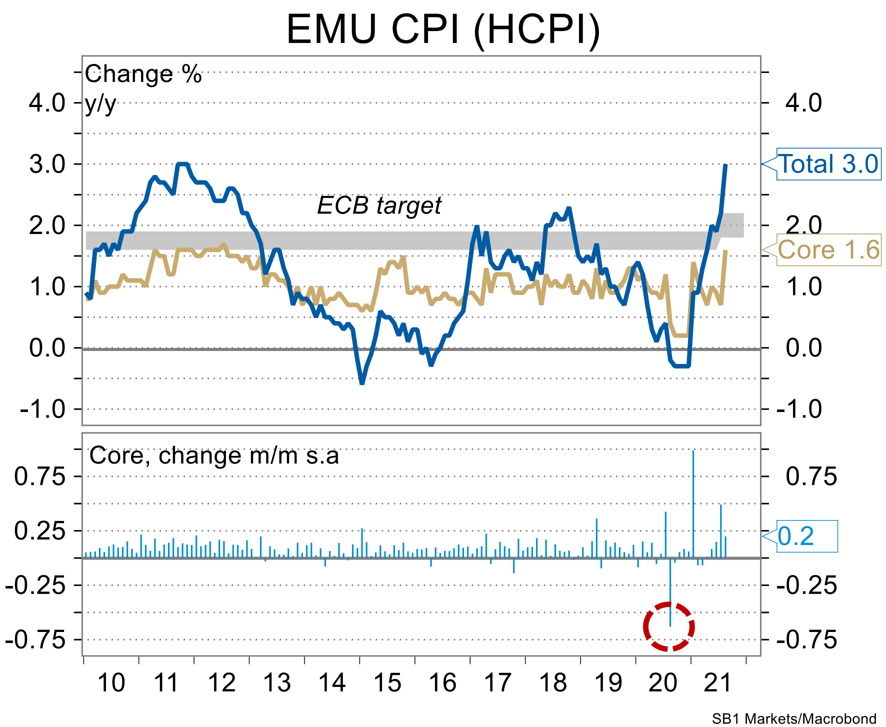


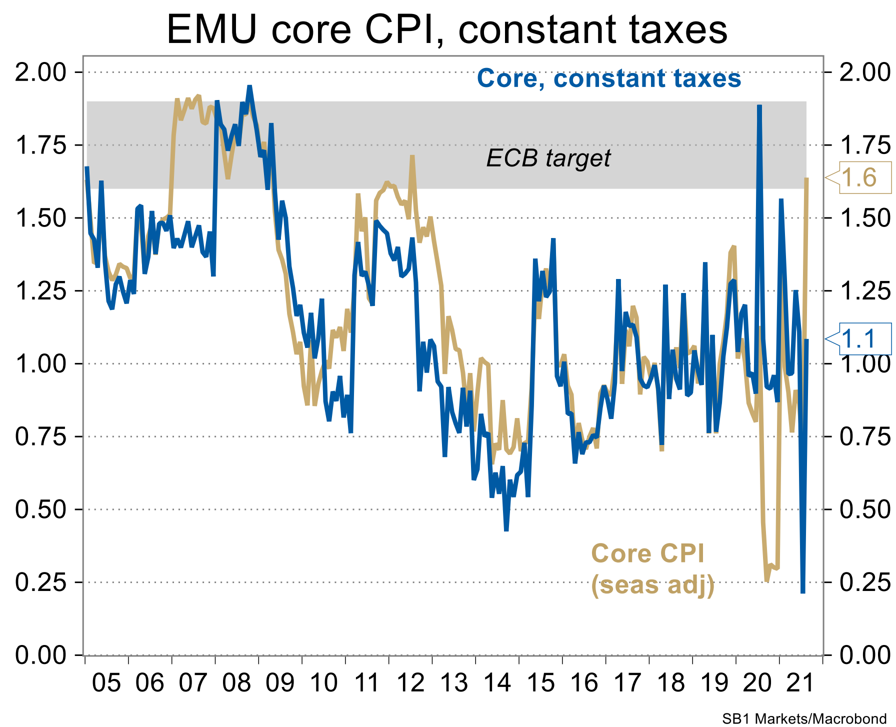


- Measured over the 2 past years, hourly labour costs are up 1.7% per year on average, which is far to little to generate inflation at 2% over time
- **Unit labour cost** has jumped up during the pandemic as productivity as productivity has fallen
  - » Unit labour cost have climbed less than in the US, and far less than in UK during the pandemic
- We expect a sharp reversal in unit costs when these economies reopens. If not…

Eurozone core inflation confirmed up 0.9 pp to 1.6% in August

Total inflation up to 3% as a result of sky high energy prices

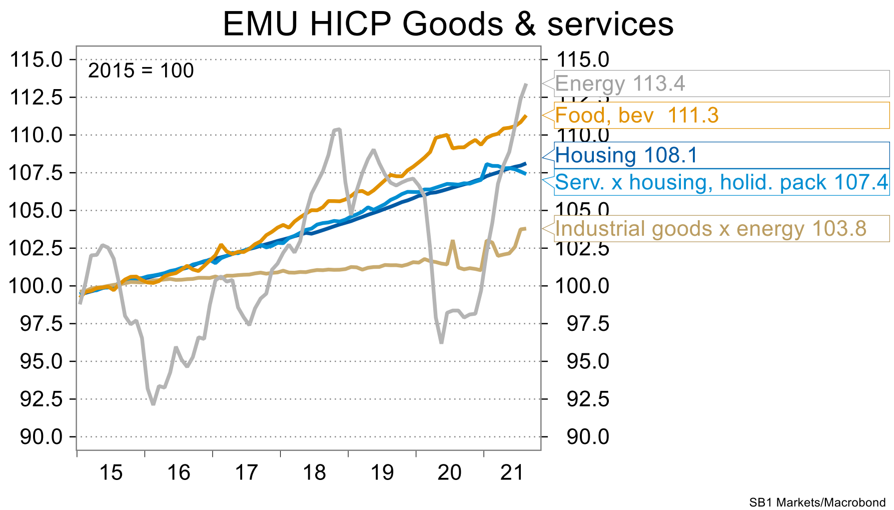


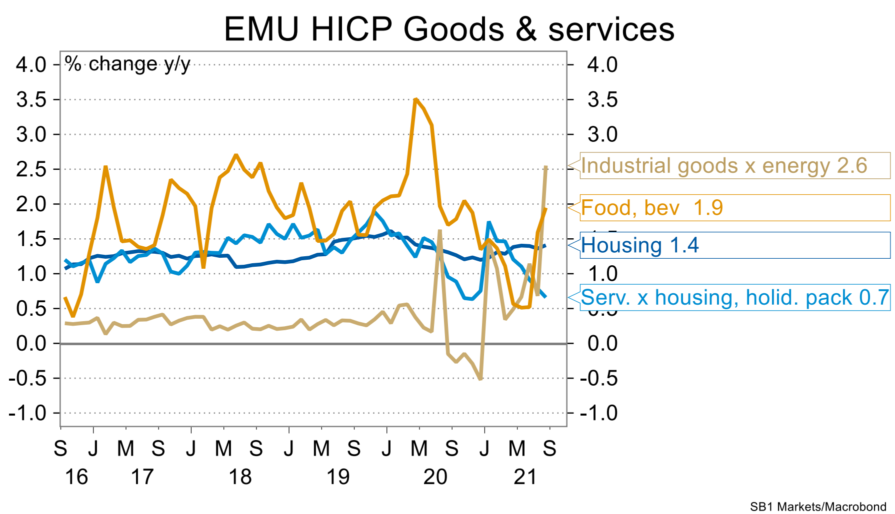


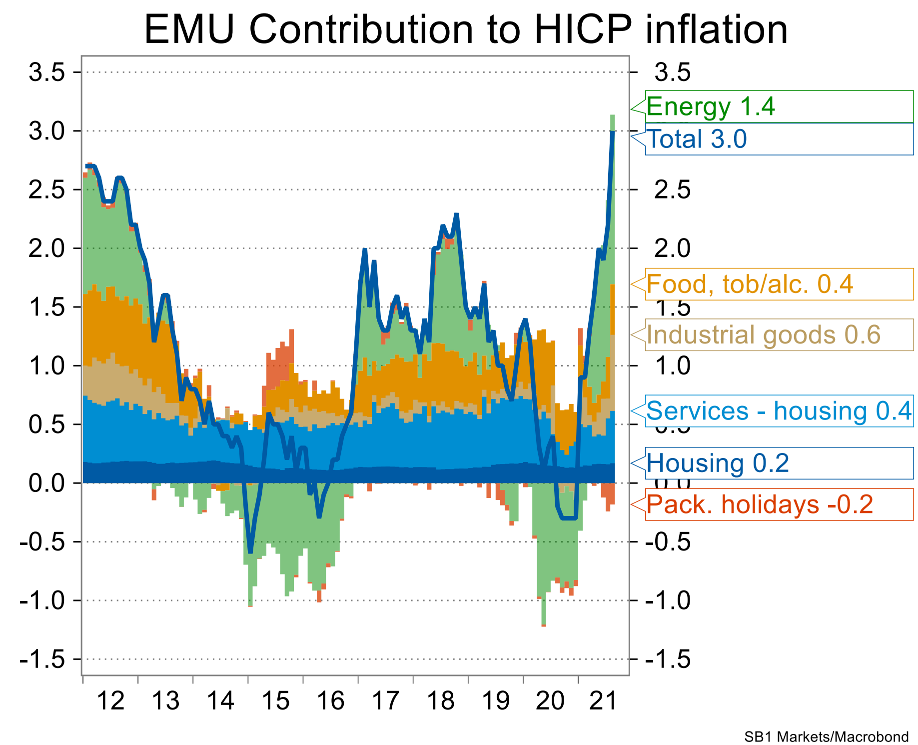
- **Core prices** were confirmed up 0.1% m/m. Still the annual rate shot up 0.9 pp to 1.6% as prices fall by 0.7 pp last August, when VAT rates were cut in some countries, and other measures introduced in order to stimulate the economy
  - **Adjusted for changes in taxes**, the core was at 1.1% y/y in August, according to Eurostat, up from 0.2% in July. Over the past year this calculation has been very volatile and we are skeptical this calculus is correct now
  - The core CPI rate will probably decline substantially in Jan-22, as prices rose 1% m/m in Jan-21
  - Food and beverage prices rose 0.4% m/m, while services were down 0.2%
- **Headline inflation** was up 0.8 pp to 3.0% in August
- Core inflation has been at approx. 1% on average past 8 years. A leaked ECB staff memo states that the inflation goal at 2% will be reached around 2025… Food for thought

Energy was the main culprit again, and services prices are declining

Energy prices were up 0.9% m/m and contributed 1.4 pp to headline inflation y/y



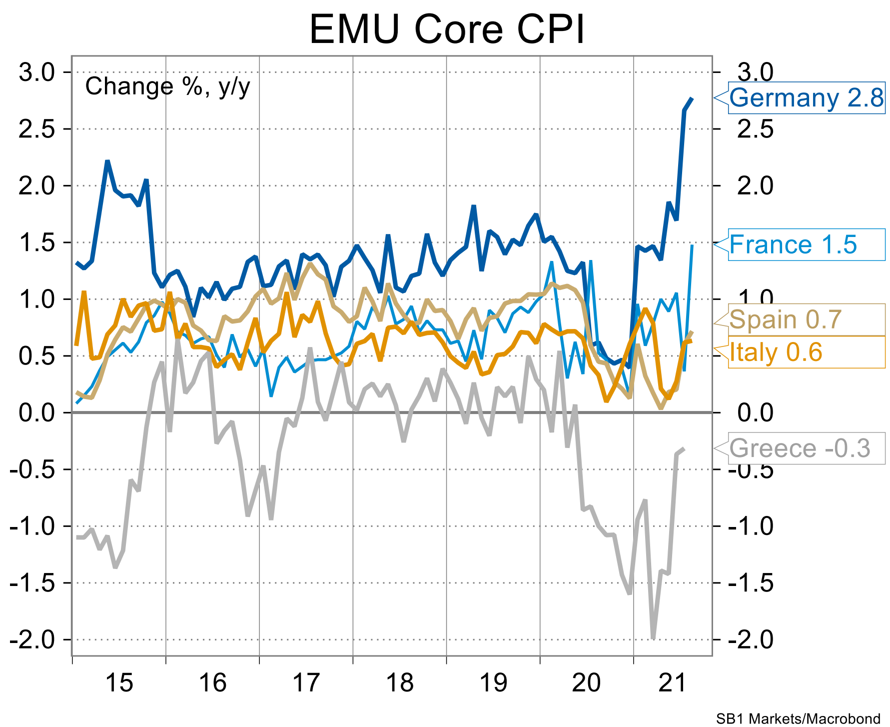


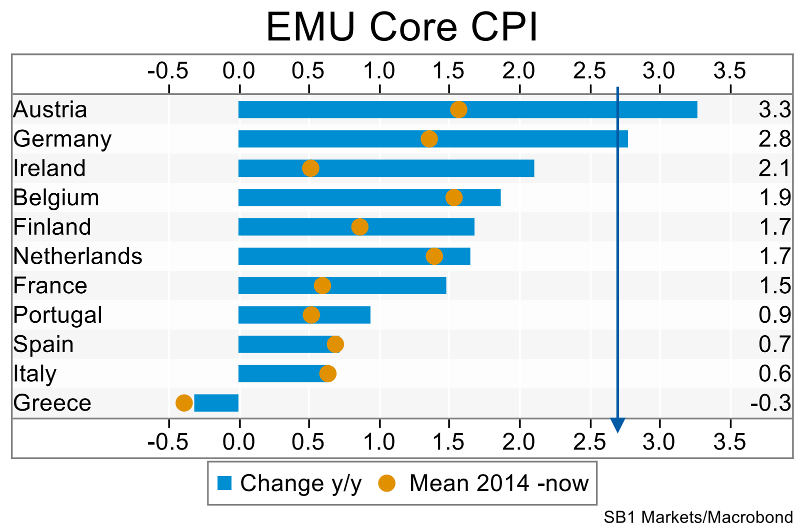


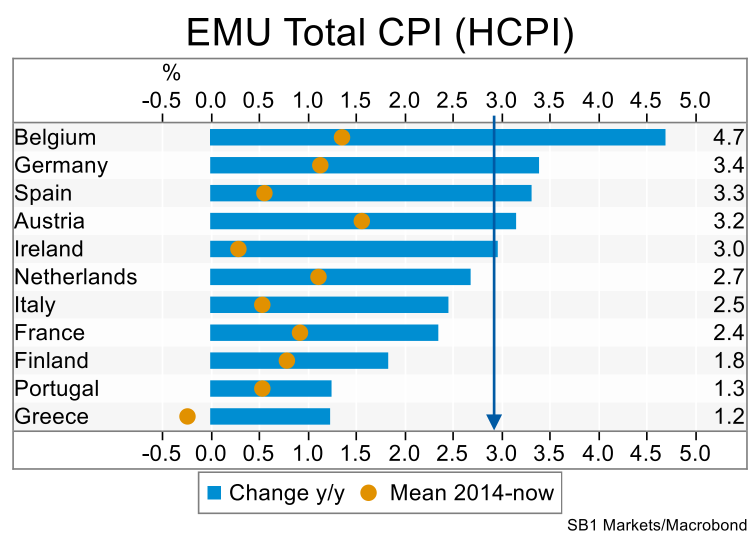
- The steep rise industrial goods x energy prices are due to higher food prices, clothing, building materials, cars
- Still, the main – and almost only – culprit for the high headline CPI print is the lift in energy prices

Core inflation below 2% almost everywhere – total inflation above many places

In Germany, inflation sharply up to 3.4% (total) 2.8% (core) – as last years' VAT cut impact fell out

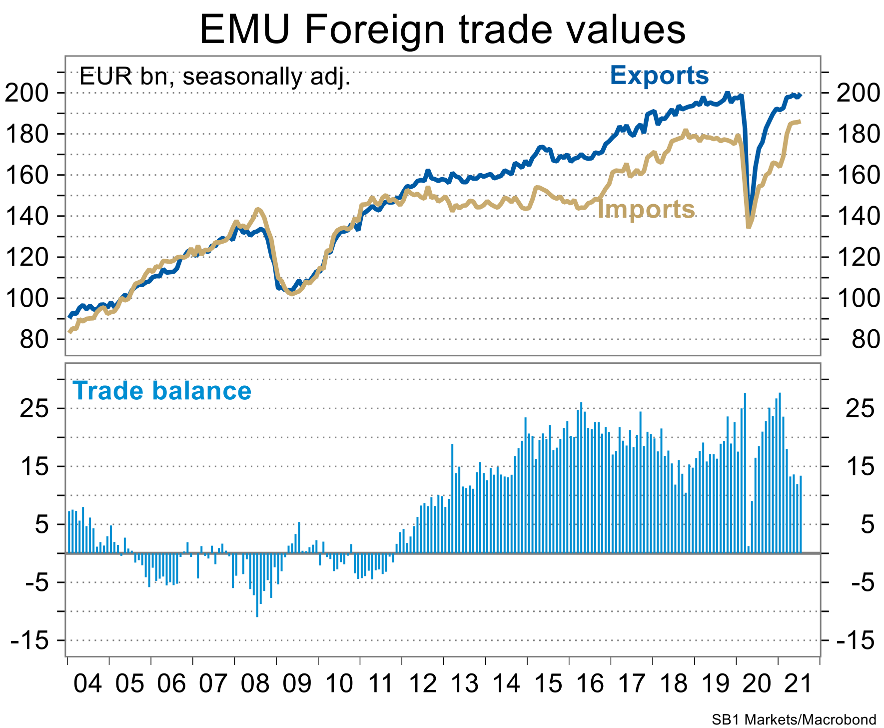


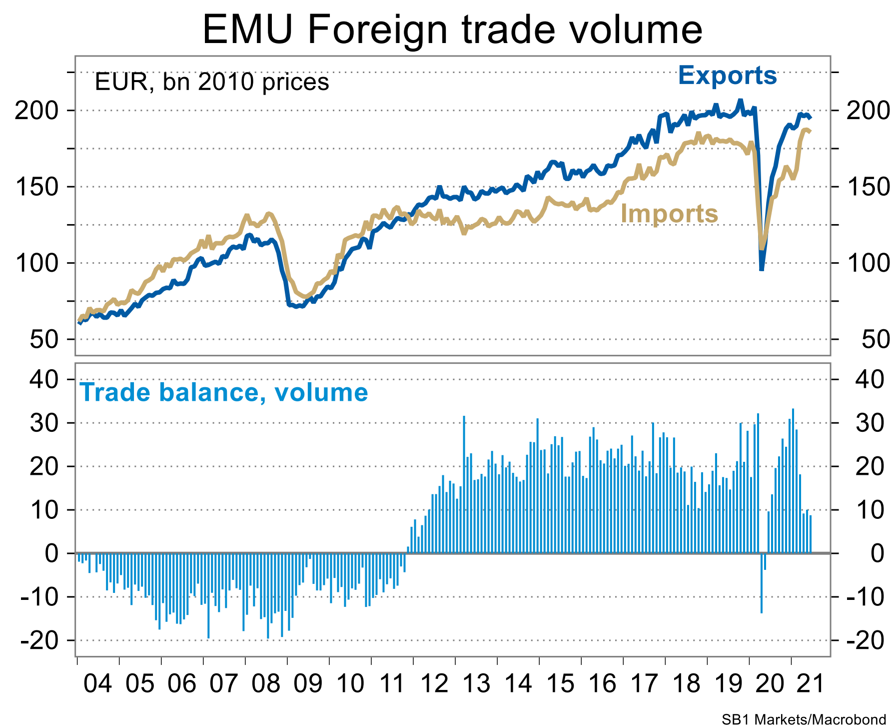




Exports have recovered back to the pre-pandemic level. Imports are up 6%

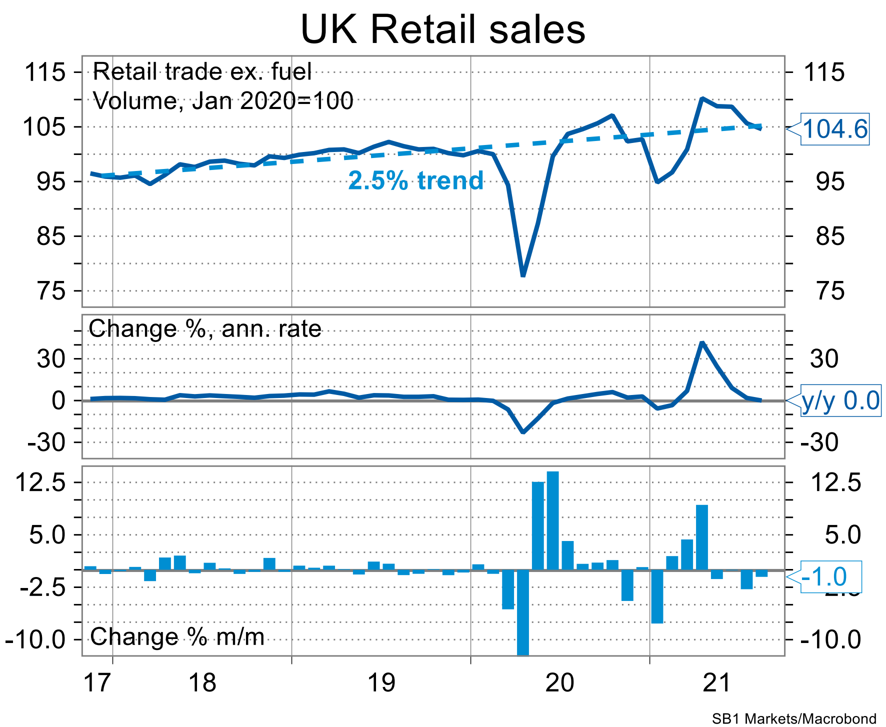
The deficit is slimmer than before the pandemic, at 'just' 1.3% of GDP

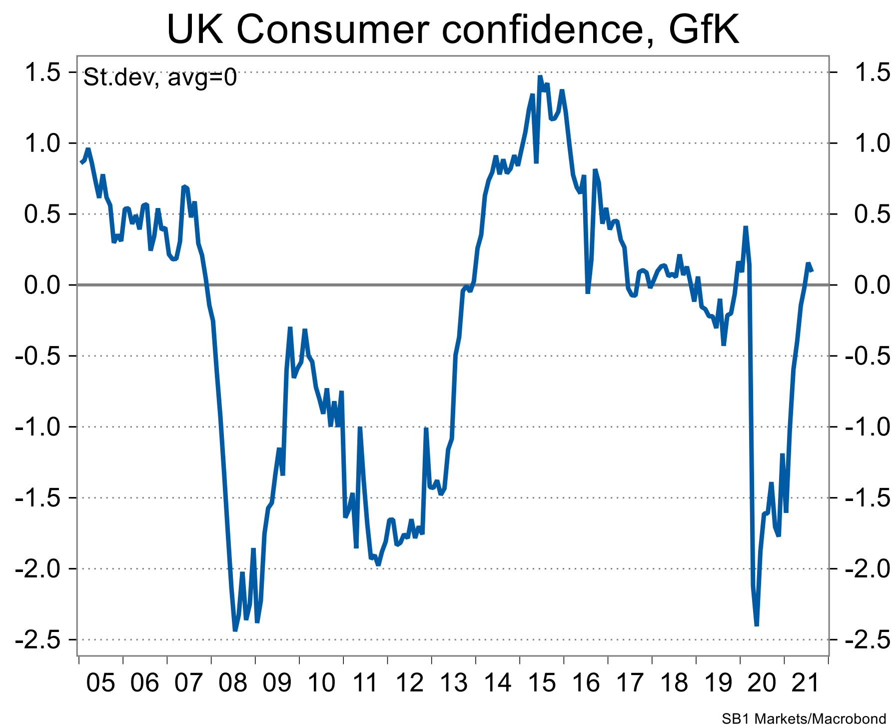




Retail sales fell for the 4th month, down 1% in August – down to pre-Covid trend

Sales were expected up 0.5%, and June revised down by 0.3 pp to -2.8%

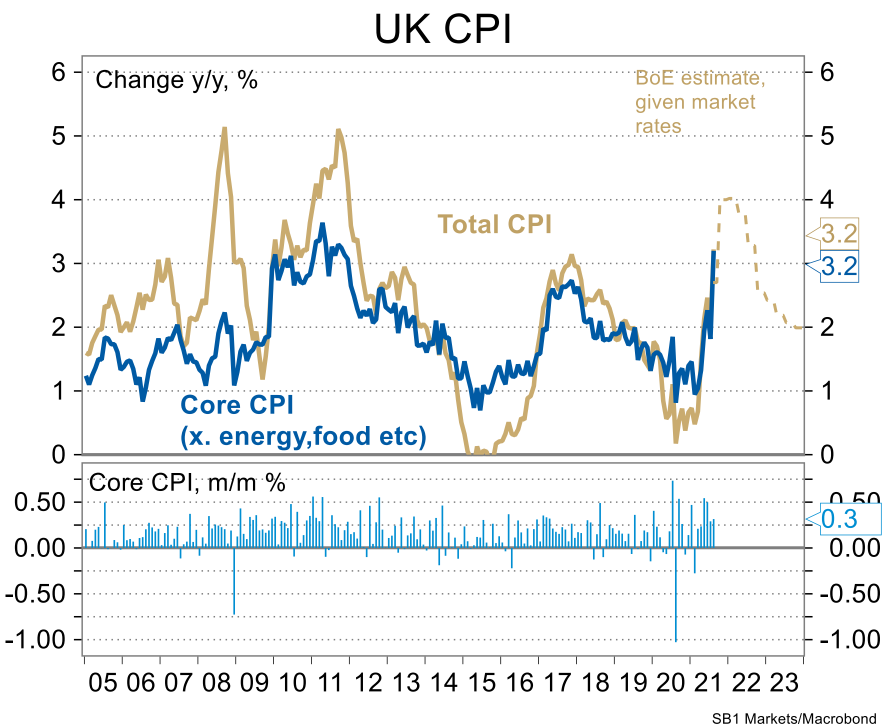




- **Retail sales** peaked in April, and the gradual decline has brought sales almost down to the pre-pandemic 2.5% growth path
  - » The outbreak of the Delta virus may explain some of the weakness over the past couple of months. However, a gradual normalisation of sales seems anyway was inevitable when spending on services could return towards a more normal level
- **Consumer confidence** fell marginally in August, following to a surge the precious since early 2021, according to the GfK survey, and it is better than the 2019 average – although below a local spike just before the pandemic

Inflation sharply up in Aug, as last year's tax cuts no longer influenced y/y growth

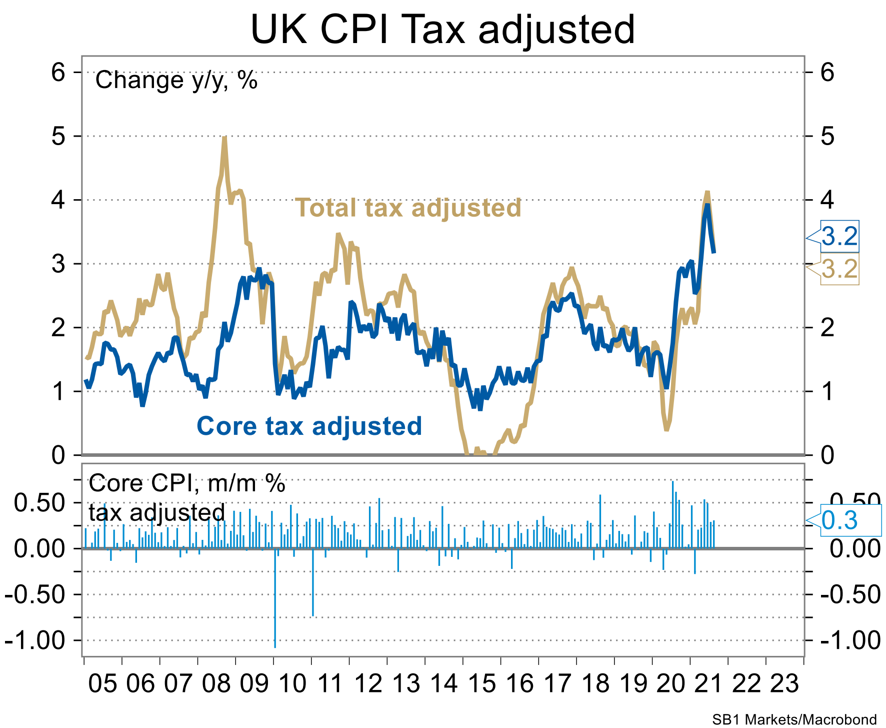
Total inflation up 0.7 pp to 3.2% & core up 0.3 to 3.2%, both 0.3 pp above expectations

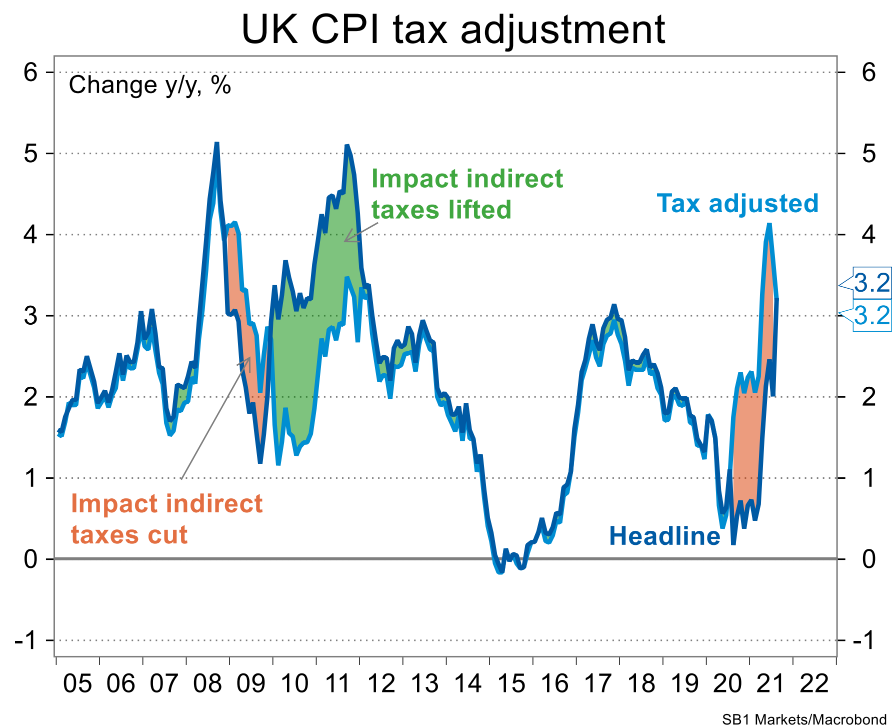


- In August last year, a subsidy scheme lowered prices in hotels and restaurants sharply, lowering the CPI by 1% m/m. So, in August this year the impact of these cuts fell out of the y/y calculation – and annual CPI rate accelerated by 0.7% to 3.2%. We feared a 1 pp lift, consensus was for a 0.4% lift, a strangely low estimate
  - » The whole 0.7 pp lift in the annual rate was due to the lift in annual hotels & restaurant prices to August from July
- In August, hotels & restaurant prices and food prices contributed the most on the upside m/m, while clothing prices fall
- Since last February, second-hand auto prices have climbed 22% - and they rose 4.9% m/m in August. New autos are up 5.5%
- Measured y/y transport (gasoline & auto prices) explains 1/3 of the 3.2% lift in the total price level
- Unit labour costs have soared during the pandemic, as most other places. We expect as substantial reversal the coming quarters

Last year's tax cuts out of the 12 m growth rate, the 3.2% inflation is 'for real'

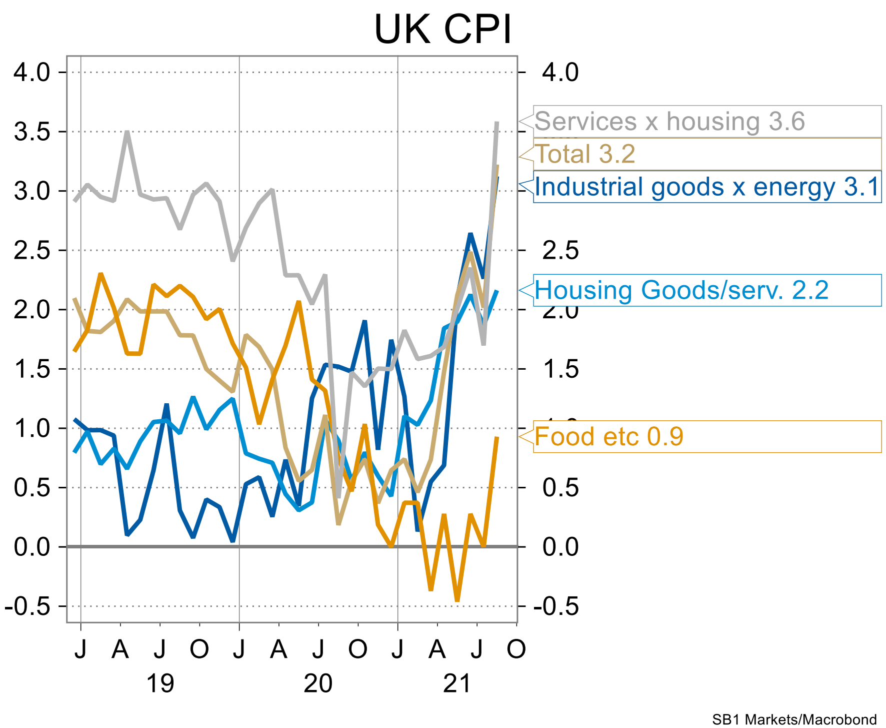
Corona measures cut prices sharply last August – and the 'bill' has become visible now

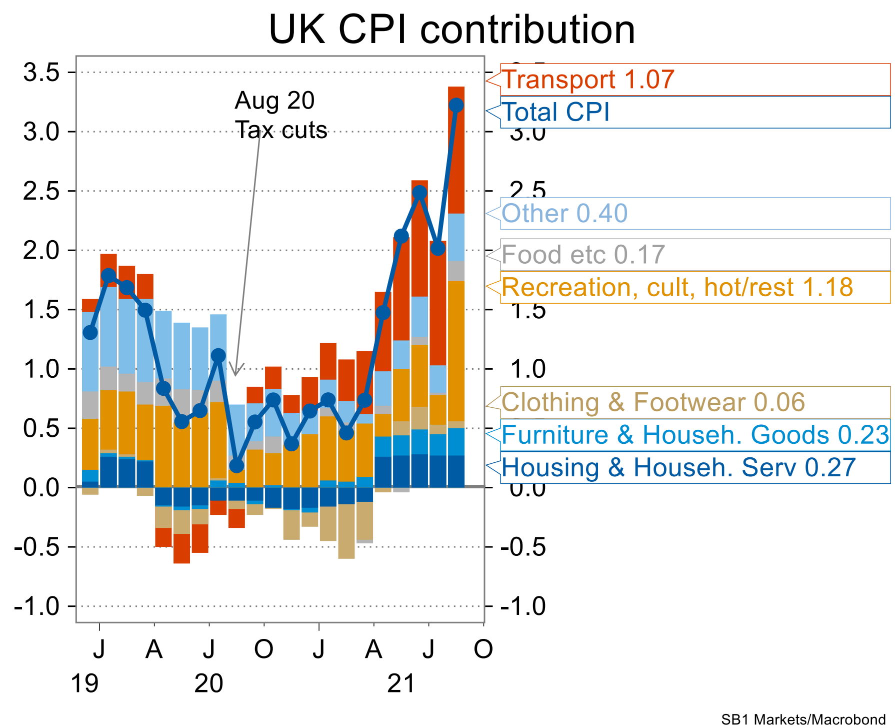




- The corona measures (Eat Out to Help Out Scheme and some other support programs implemented last August) equalled 1.6% of CPI. Prices fell less than that m/m (vs a normal price increases at that time, which though were very volatile m/m, most likely because restaurants etc. kept some of the subsidy themselves). Thus, the impact on the annual CPI may was (as we assumed) somewhat smaller than 'technically' assumed – and the tax adjusted y/y rate fell by 0.9 pp, to 3.2% from 4.1% in July

Transport, housing, recreation/hotels/restaurants the main contributors



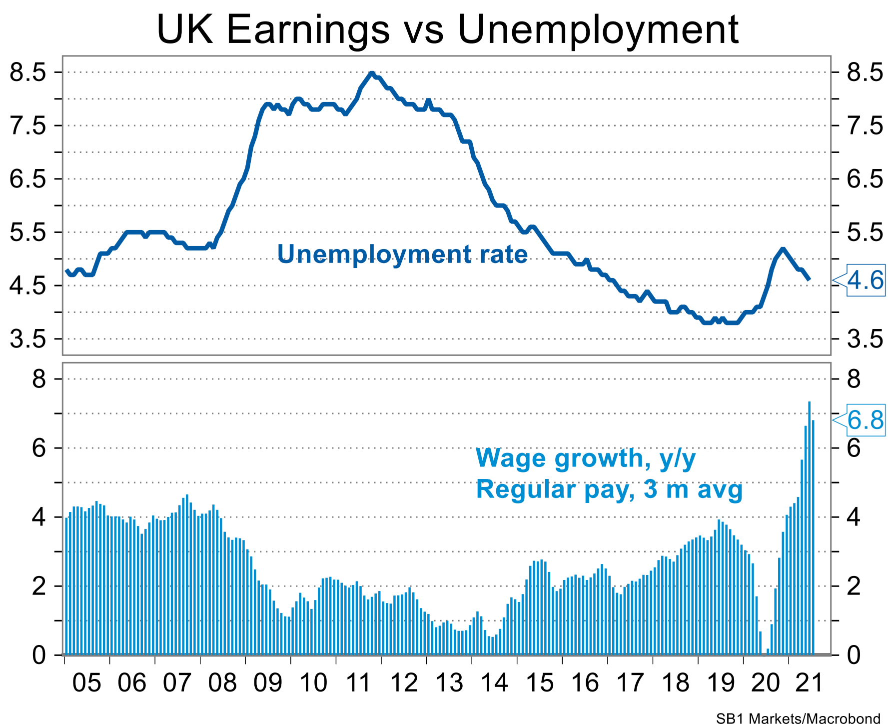


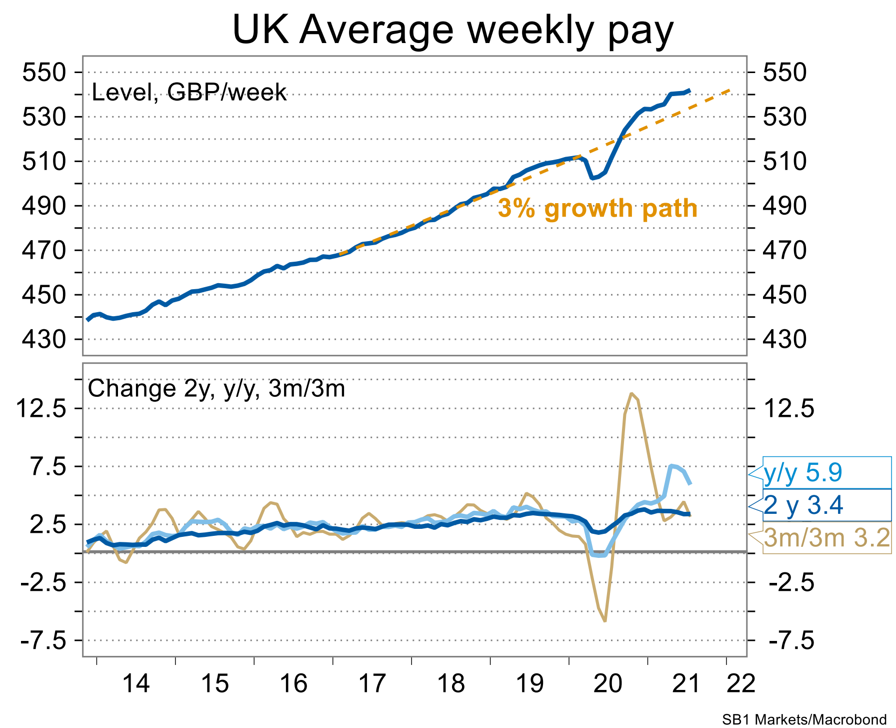
- Energy prices are up 10% y/y, rather modest vs. the lift in spot prices. UK household must have entered long term contracts
- Energy is included in housing in the charts above

SpareBank 1 MARKETS

Wage inflation down 0.5 pp, and the underlying growth has fallen below 4%

The annual rate is still high, at 5.9% (incl. bonuses, 6.8% x bon). Unemployment is sliding down



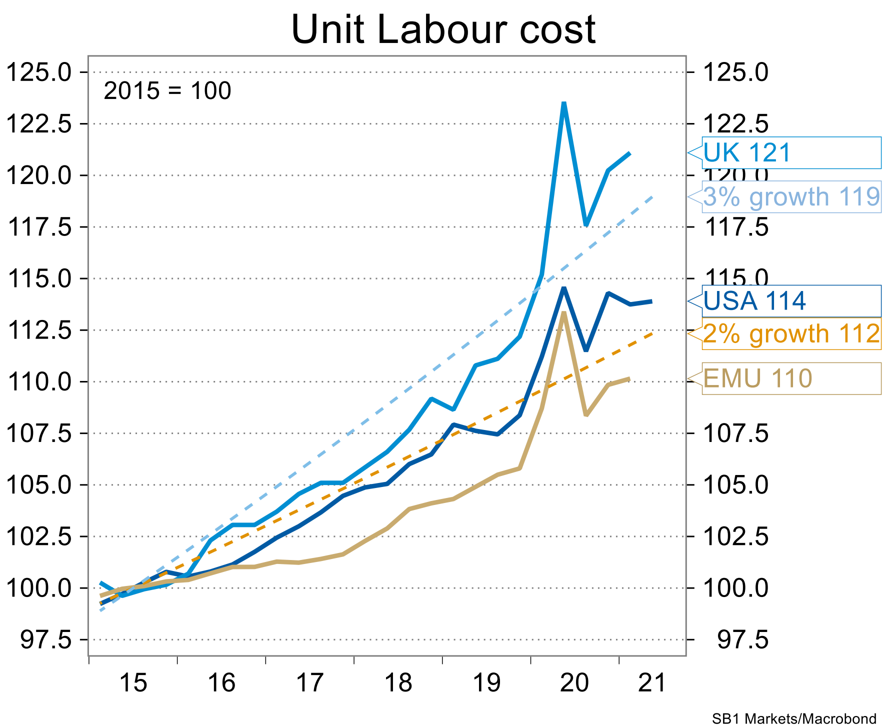


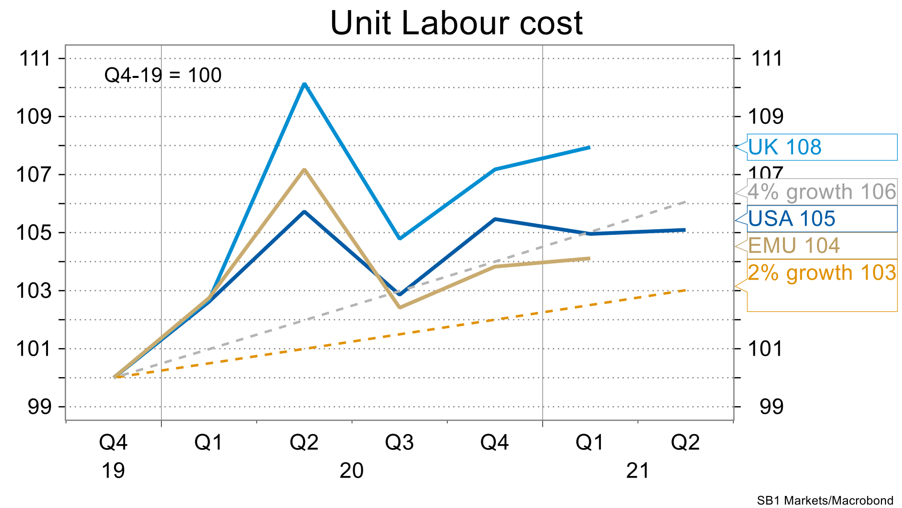
- Wage growth (regular pay) decreased to 6.8% y/y in July, down from 7.3% in June (revised down from 7.4%)
  - However, the annual rate is boosted by the sharp contraction in wages last year. Total weekly pay is up 3.4% over the past 2 years
  - The underlying wage growth the recent months have slowed to some 3.2% (3m/3m), which is in line the growth pace ahead of the pandemic, but well above the average over the past 10 years

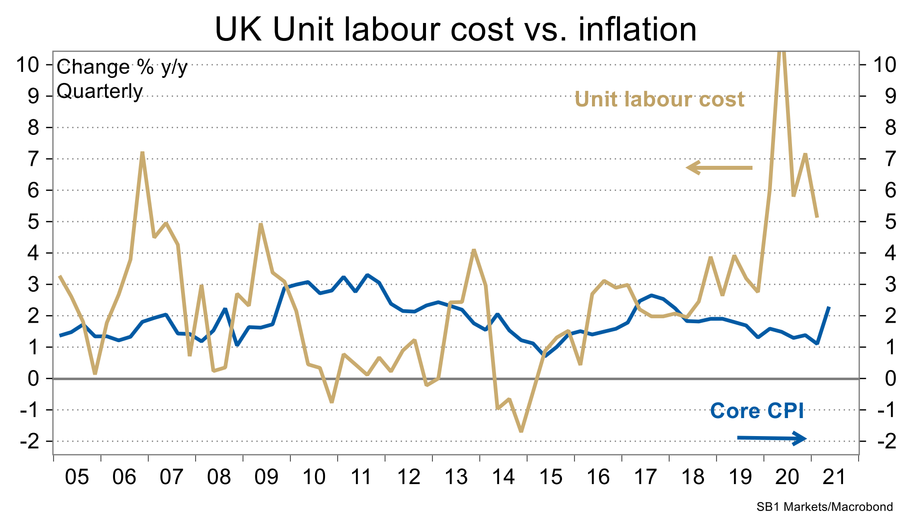
SpareBank 1 MARKETS

Somewhat high cost inflation in the UK? Unit labour costs up 3% – 4%

Which is not compatible with 2% inflation over time



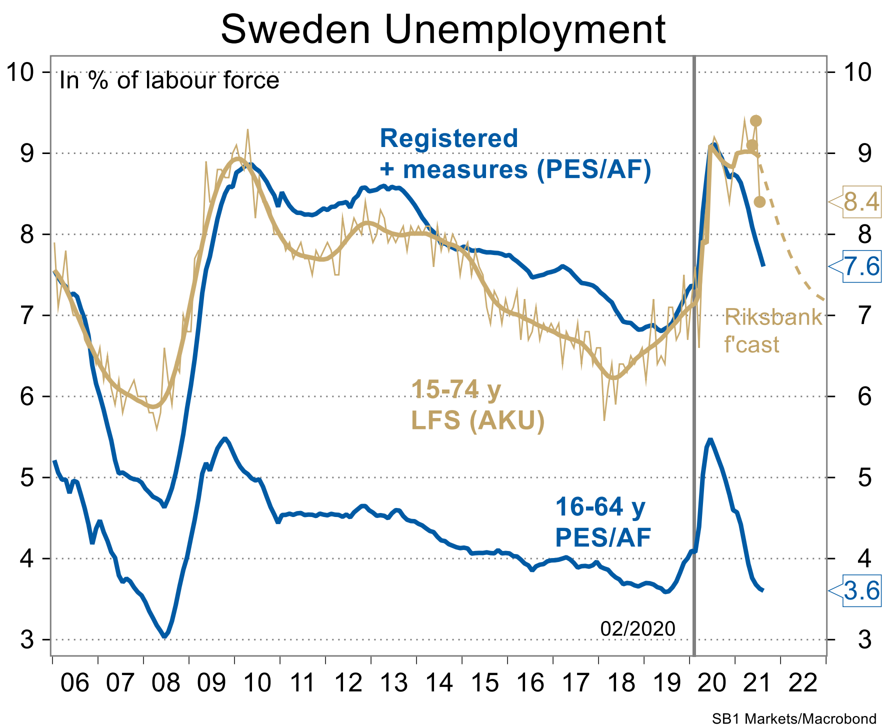


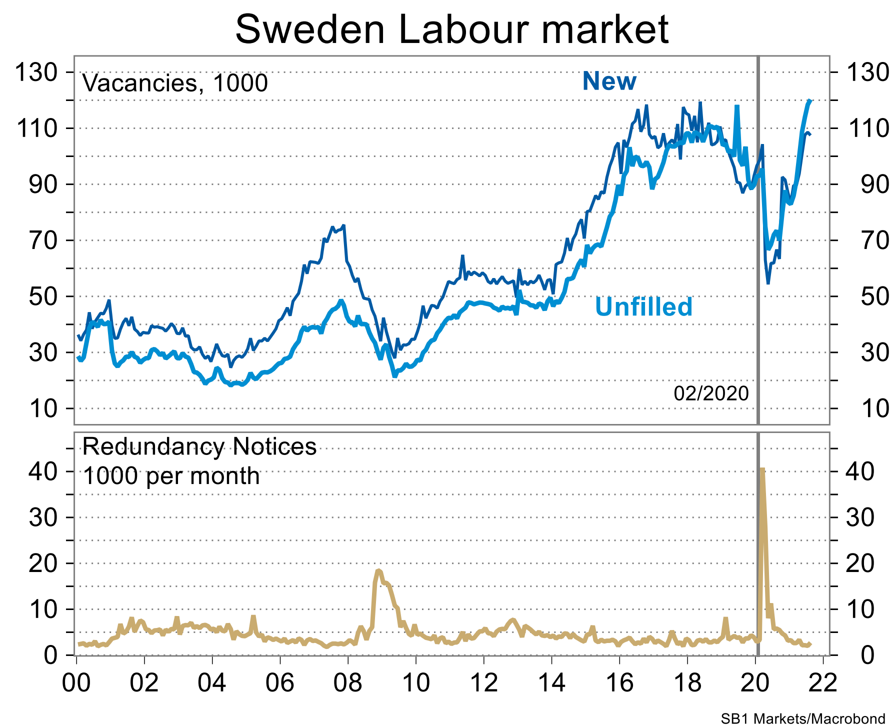


- However, the correlation between ULC & CPI is not that precise over just some few years

Total unemployment down 0.2 pp to 7.6% in August, open just at 3.6% > p-p level

LFS (AKU) unemployment rate has also retreated, currently at 8.4% (July data)

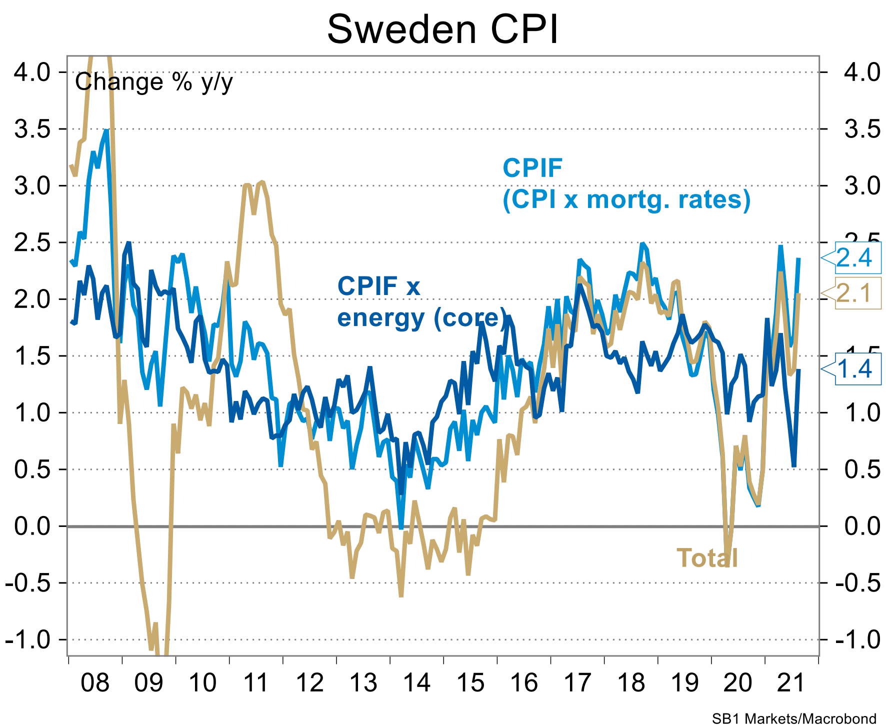


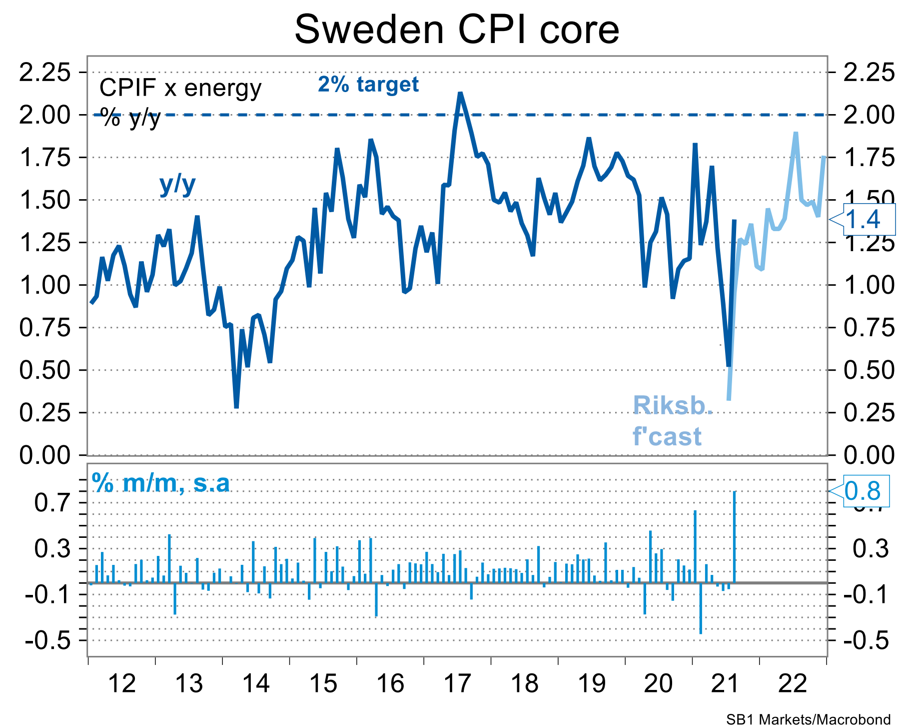


- **Registered 'open' unemployment** (PES/AF) has fallen rapidly since last June, and currently stands at 3.6%, unchanged from July (at the first decimal), and below the pre-pandemic level at 4.1%
- **Incl. labour market measures**, PES/AF unemployment is falling rapidly too - but less than open unemployment. The rate fell by 0.2 pp to 7.6%, but the level is still 0.3 pp above the early 2020 level
- The **LFS (AKU) unemployment** fell 1 pp in July, to 8.4% -and the level is up 1.2 pp higher than in early 2020. (However, this survey is heavily revised, and we are not sure the Swedes have made data comparable)
- The number of **new vacancies** rose further and **layoffs** were up, while **unfilled vacancies** were down in August. The inflow of new vacancies are equal to the pre-pandemic level, while the no. of unfilled vacancies is higher!

Swedish inflation up in August. Core still low at 1.4%, and total just at 2.1%

Even if energy prices have soared over the past year, lifting the CPI by 1.3 pp



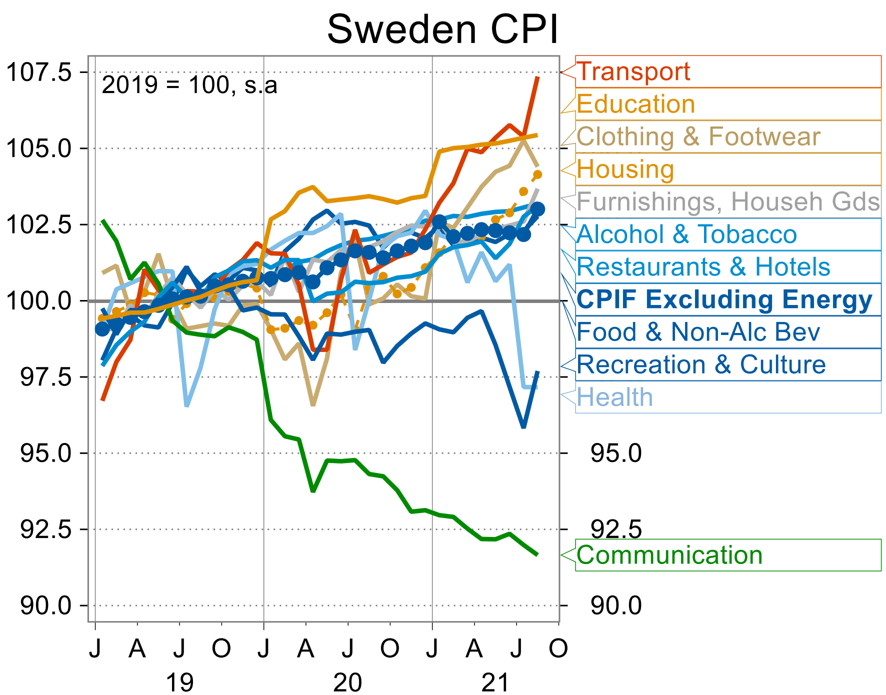


- **Headline inflation** accelerated 0.7 pp to 2.1% y/y in August, 0.4 pp above expectations
- **The CPI-F**, the constant interest rate inflation (CPI x mortgage rates) was up 0.7 pp to 2.4% y/y, 0.5 pp above expectations
- **CPI-F x energy, the 'real core'** was up 0.8% m/m, and the annual rate rose by 0.9 p to 1.4% y/y. The Riksbank expected 1.3%
- The increase in inflation was largely driven by an increase in energy, clothing, and hotel & restaurant prices

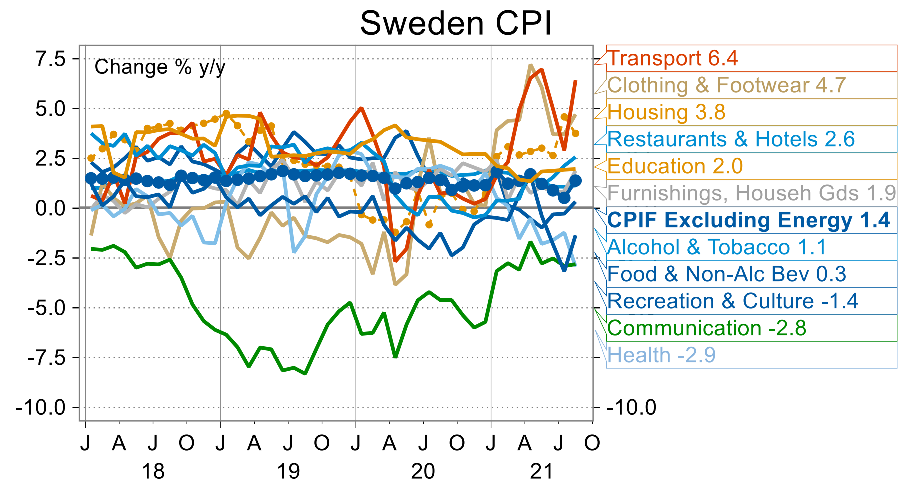
SpareBank 1 MARKETS

Energy, clothing, restaurant & hotel prices biggest contributors on the upside

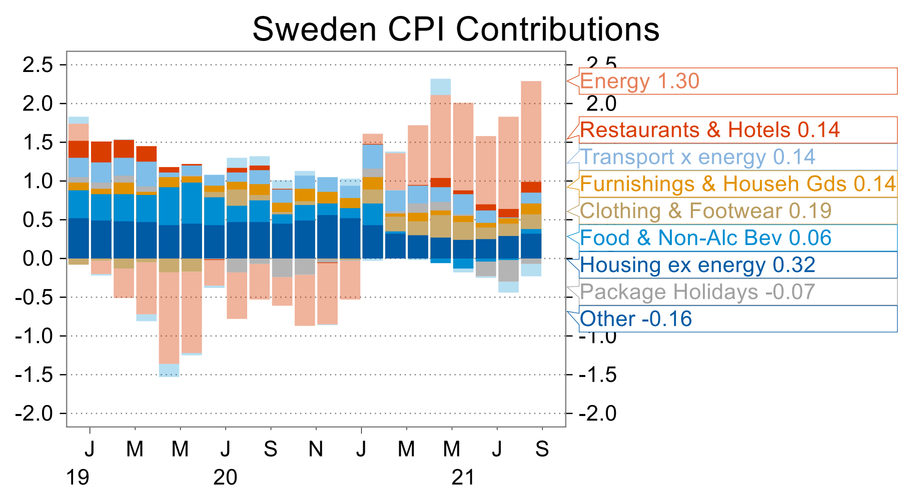
…and clothing is up 2.3% m/m



SB1 Markets/Macrobond



SB1 Markets/Macrobond



SB1 Markets/Macrobond

Highlights

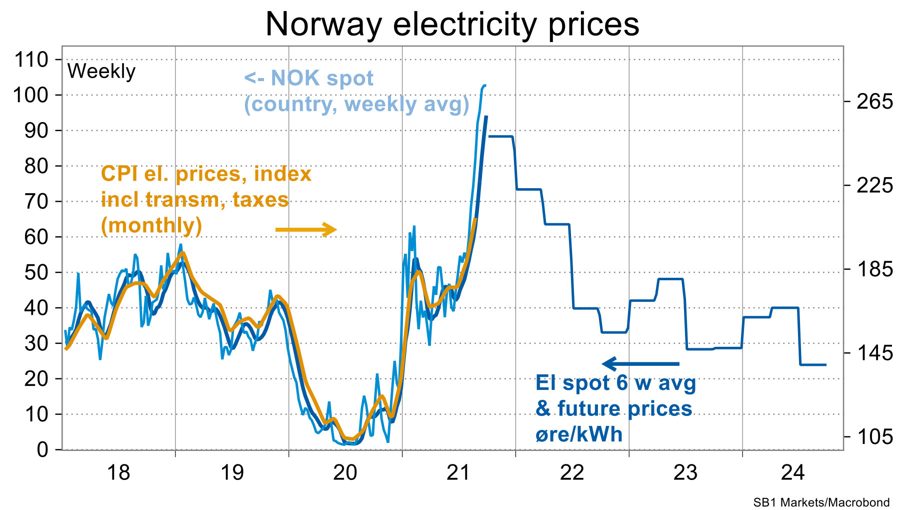
The world around us

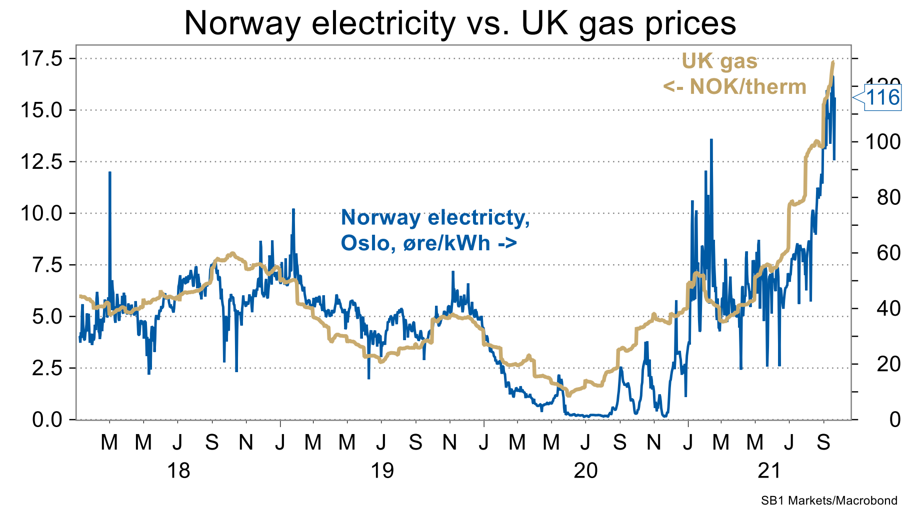
The Norwegian economy

Market charts & comments

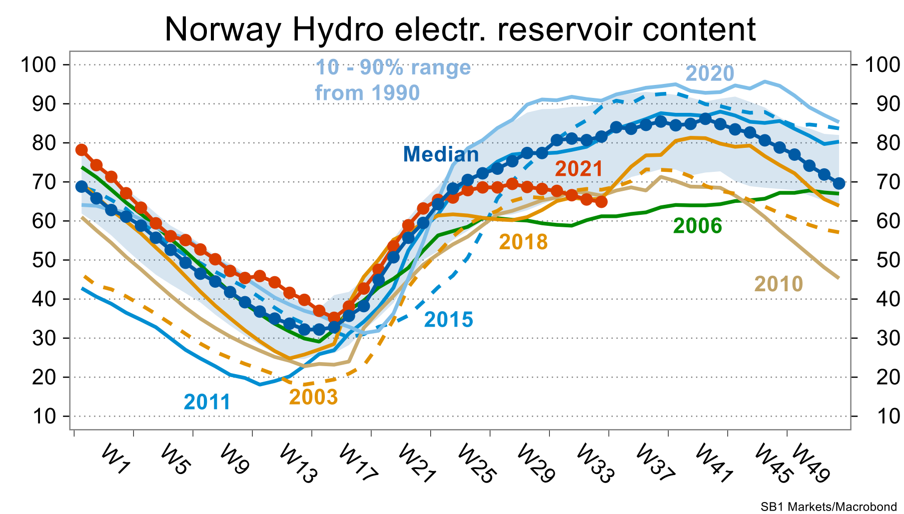
The heat is on: Gas, electricty prices are soaring

The interconnected Europen energy market is stressed, too little supply of gas, too little wind, rain ++



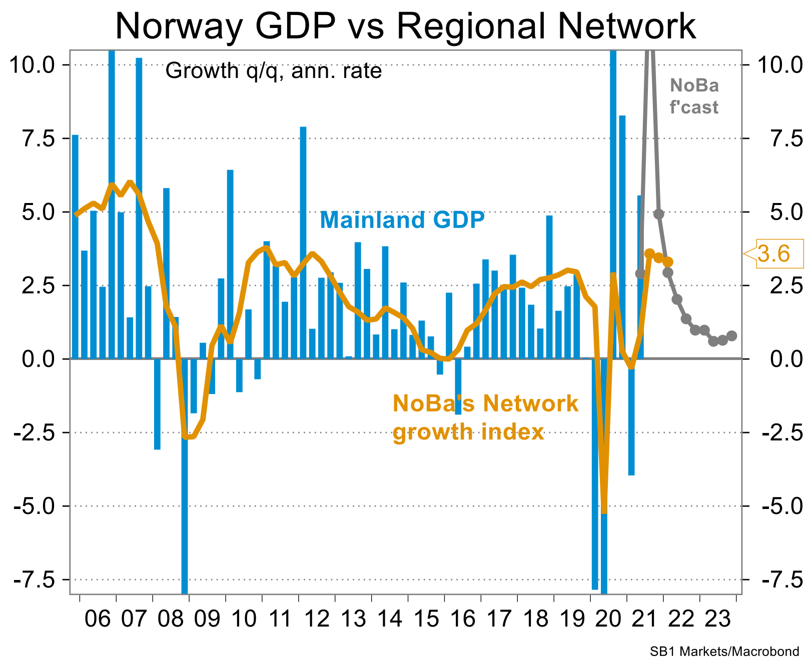


- Norwegian hydro reservoirs have been substantially depleted past 2 months vs the normal trajectory as the summer/ autumn has been drier than normal in southern Norway. The loss vs. the normal refilling at this time of the year equals 15% of the reservoir capacity, and has never taken place before – and the reservoir level is the 2nd lowest on record
  - Last week, electricity prices more or less stabilised – but they remain at record high levels (at least if measured over some few days)
- Given the forward electricity price curve, which implies a gradual but substantial decline in spot prices the coming quarters, the cost shock for Norwegian households should be manageable: Compared to the average electricity bill over the past years, the cost will rise some 40%, from Q3 this year until next summer. If so, households' disposable income will be cut by 1¼ - 1½%. This amount equals approx. 1/10th of the excess household savings during the pandemic
- <u>The risk: The future electricity/gas market may be dead wrong</u>



Norges Bank's Network expects a continued recovery but is still unable to calibrate

Capacity utilisation is increasing rapidly, more widespread reports of lack of labour

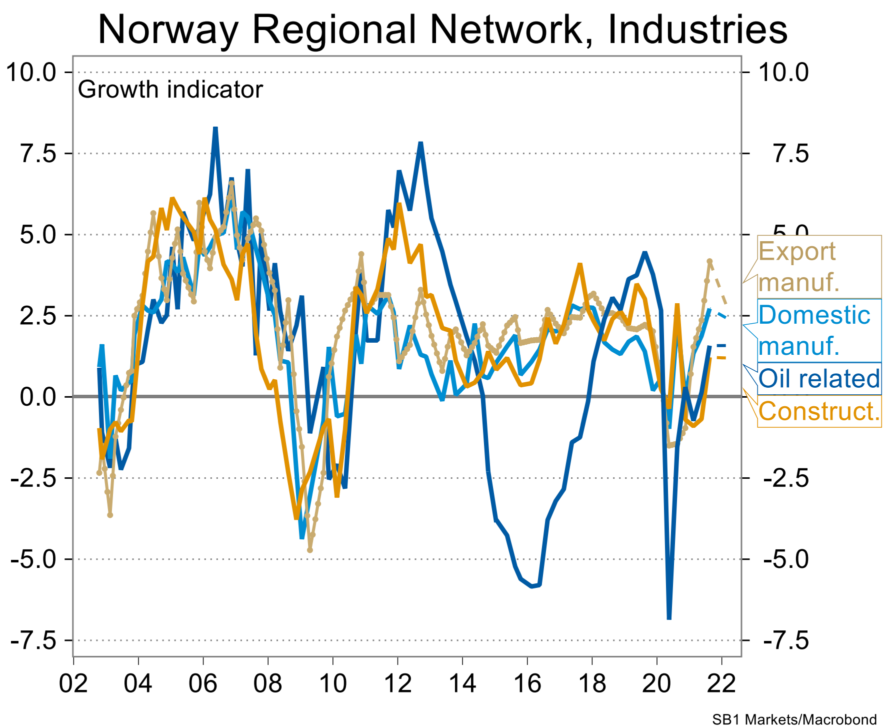


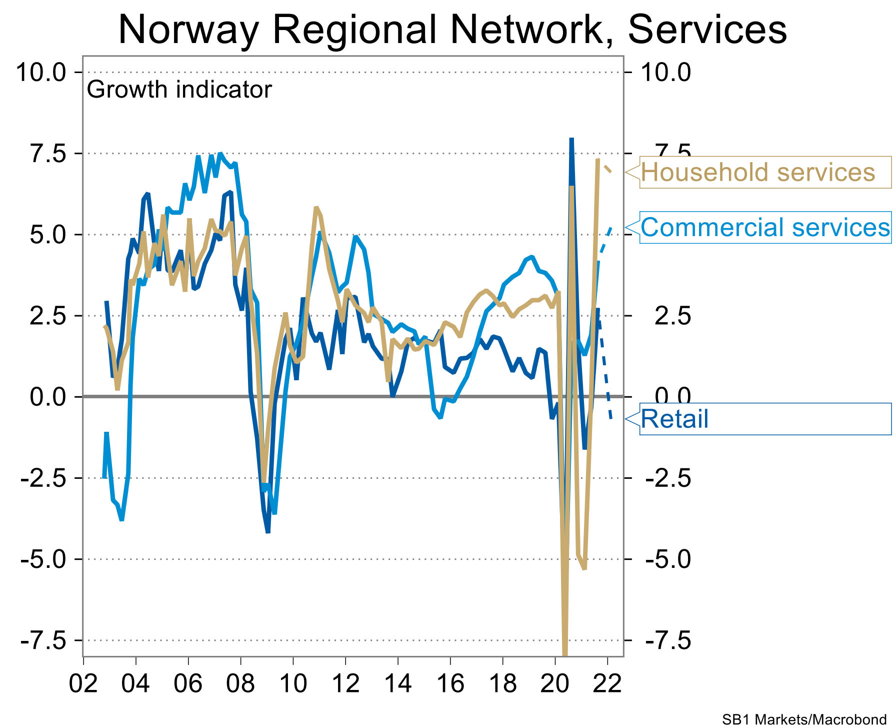
- **Implications**
  - » In reality, the Regional Network' 6 m growth outlook is weak – and far below NoBa's and our GDP forecasts – given the low activity level in several service sectors. However, the survey has not been able to calibrate its growth forecasts well during the pandemic, for understandable reasons – and we do not take it literally
  - » We assume the Bank will put more emphasis on data like capacity utilisation and labour shortages when adjusting its short term forecasts
  - » Anyway, this week's rate hike is a done deal

- **Activity the past 3 months**
  - » The Network reports a 3.6% growth pace in May-July from Feb-Apr, close to the Network's expectation 3 months ago. However, actual growth was 10%, according to Nat. accounts. Capacity utilisation & labour shortages are now well above average levels
- **Expectations for the coming months**
  - » The Network expect at 3.3% growth pace the next 6 months. We expected a 3.6% signal. In June, Norges Bank assumed an 8% - 9% growth pace over the next 6 months, from July. We think the network is underestimating growth the coming months
    - Just one sector expects higher growth the next six months, commercial services (we guess due to downbeat business services sector)
    - All other sectors are reporting stable or lower growth:
      - Retail trade expect a contraction (goods consumption will to come down now)
      - Household services expects a slight slowdown (from a high level recent months, 7% growth still expected).
      - Both domestically and export oriented industries report slower the coming 6 months – but growth is still decent, at 2.5%+
      - Both construction and oil related industries report stable growth, at a rather modest level, some 1%
  - » **Investment** plans are revised further up
  - » **Wage inflation** is revised up 0.2 pp to 2.9%,
  - » Companies expect to **lift prices** vs households

Retail trade expects a contraction, for good reasons

All other sector expect stable or slower growth – except for commercial services

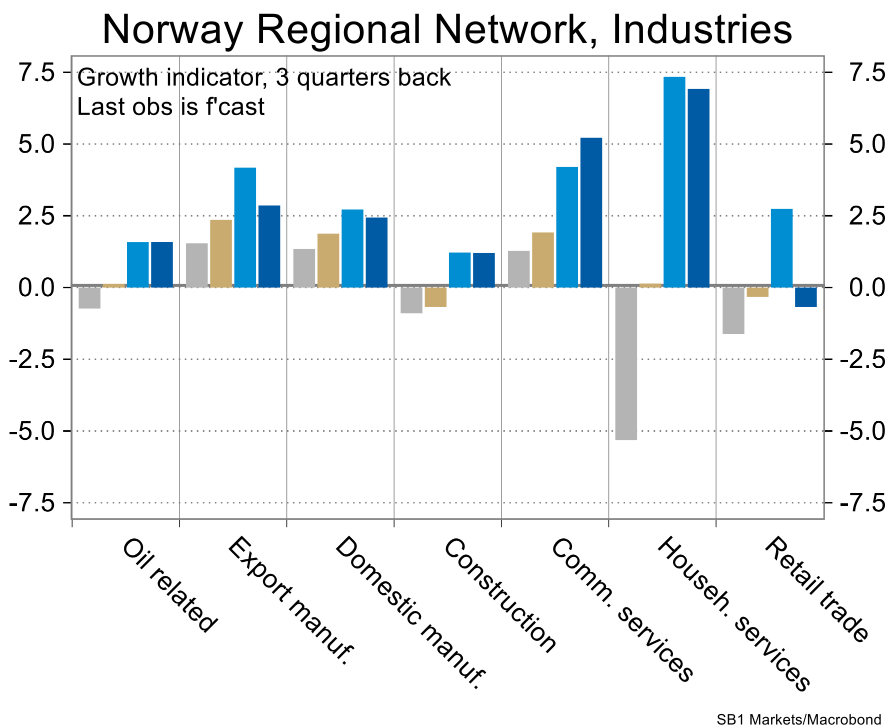




- Both household and commercial services expects strong growth – with household services in the lead (but still a tad slower growth in household related)
- The decline in expected growth in export oriented manufacturing was a surprise, even if it came from a high level

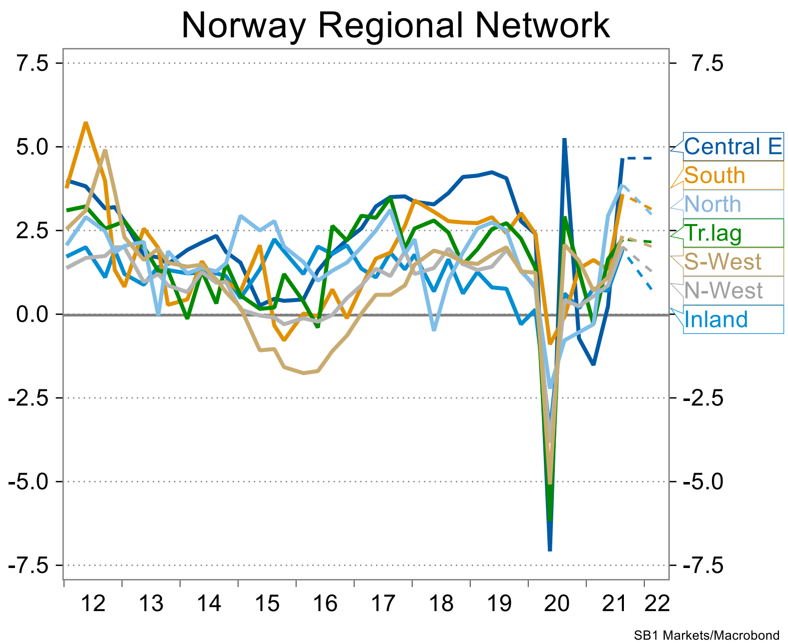
Growth is peaking: most sectors expect a slowdown or stable growth

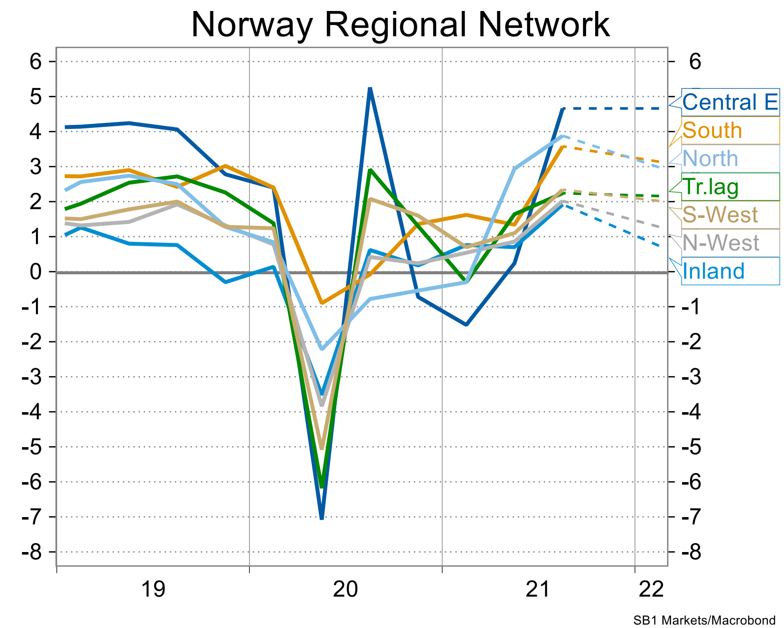
Just retail trade expect lower activity

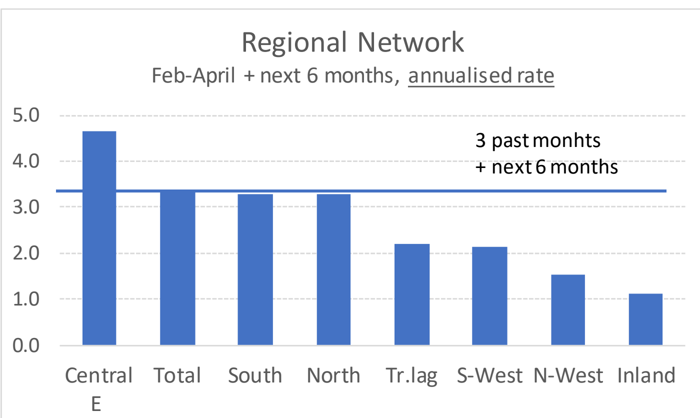


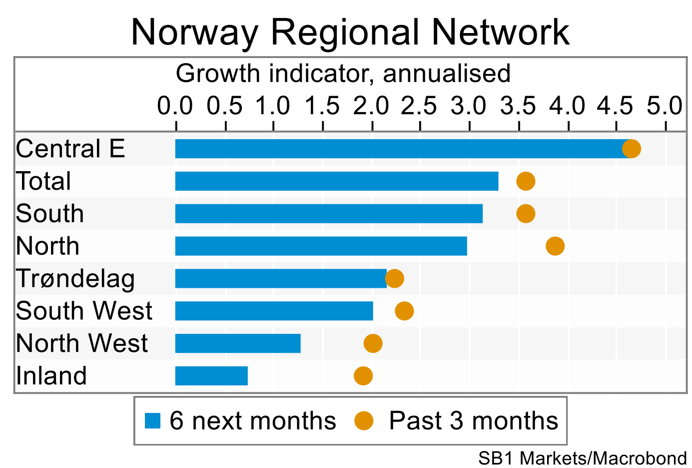
Regions: Central East in the lead, after having suffered the most

South slows but still expect strong growth, as to the North. North West, Innlandet at the bottom



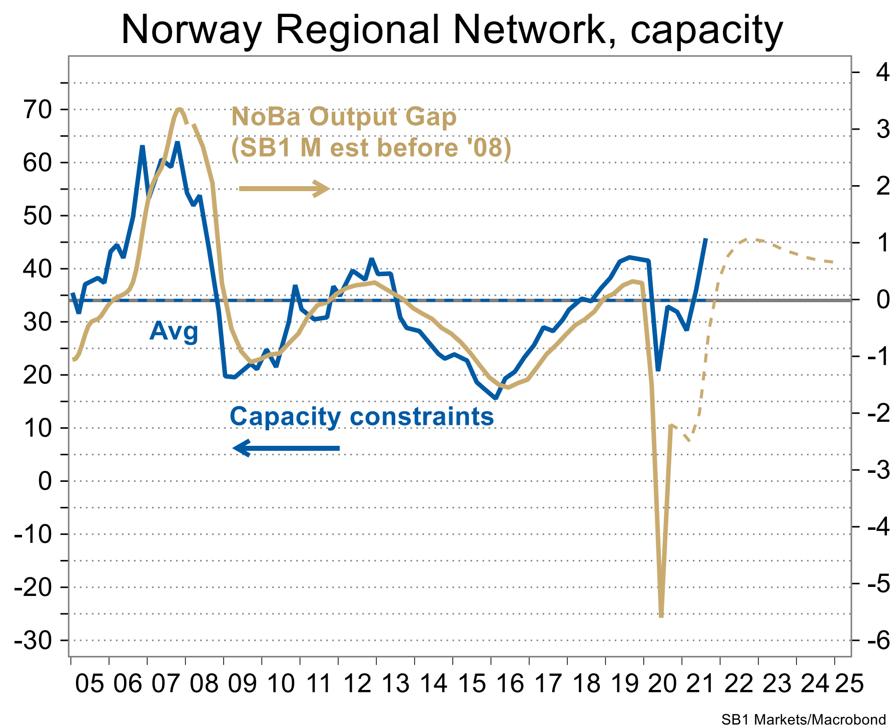


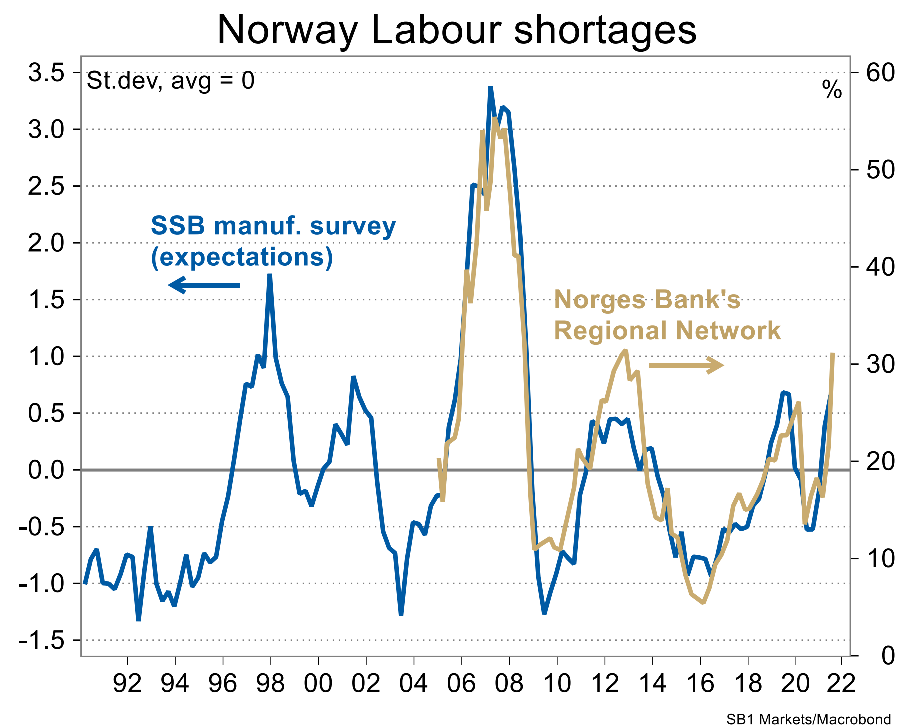




Capacity constraints sharply up, and is high vs. NoBa's output gap estimate

Labour shortages are increasing rapidly – to the highest level since 2009, and far above average



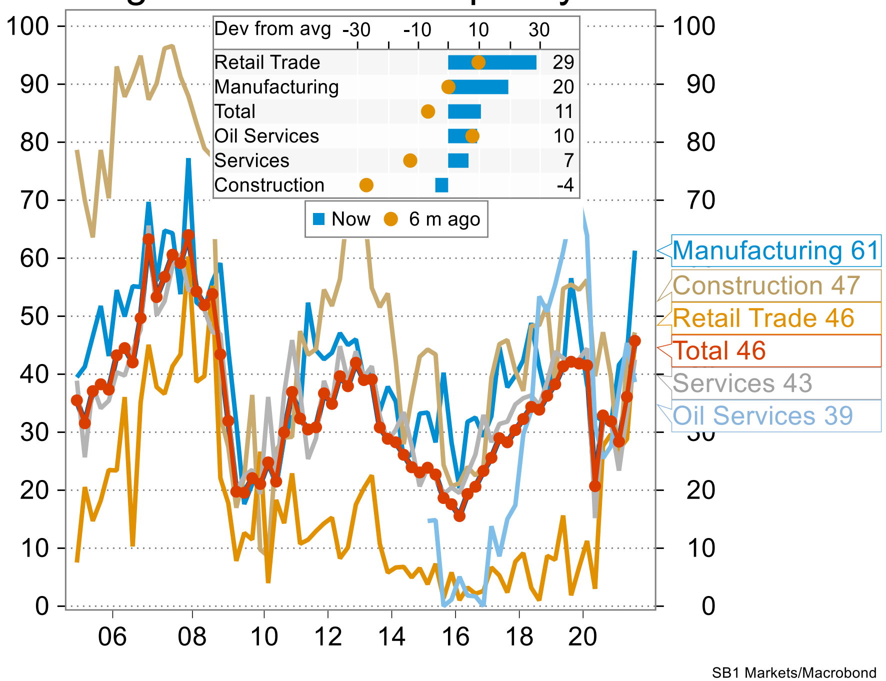


- We think a broad range of economic statistics and Norges Bank's output gap estimate is a better gauge of activity level in the Norwegian economy than the network report's capacity constraints indicator. Still, companies are now facing more capacity constraints
- Labour supply shortages eased sharply last spring but have increase somewhat since before corona, and rose to well above an average level in August. We expect more to come

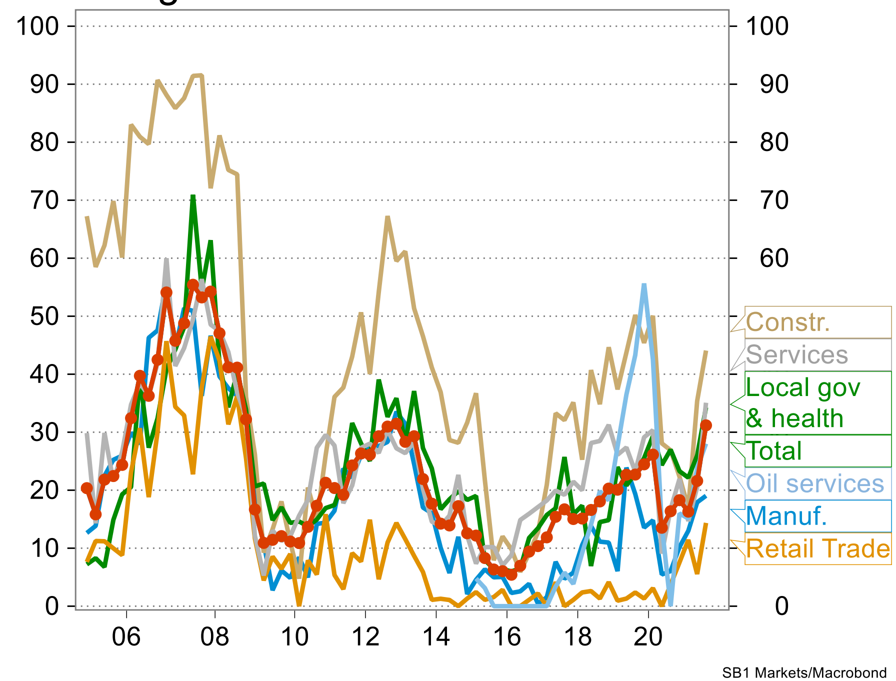
More companies are reporting capacity constraints than since 2008

Vs. normal conditions, retail trade & manuf. report the most serious problems. Construction the least

Regional Network Capacity Contstraints



Regional Network Labour Constraints

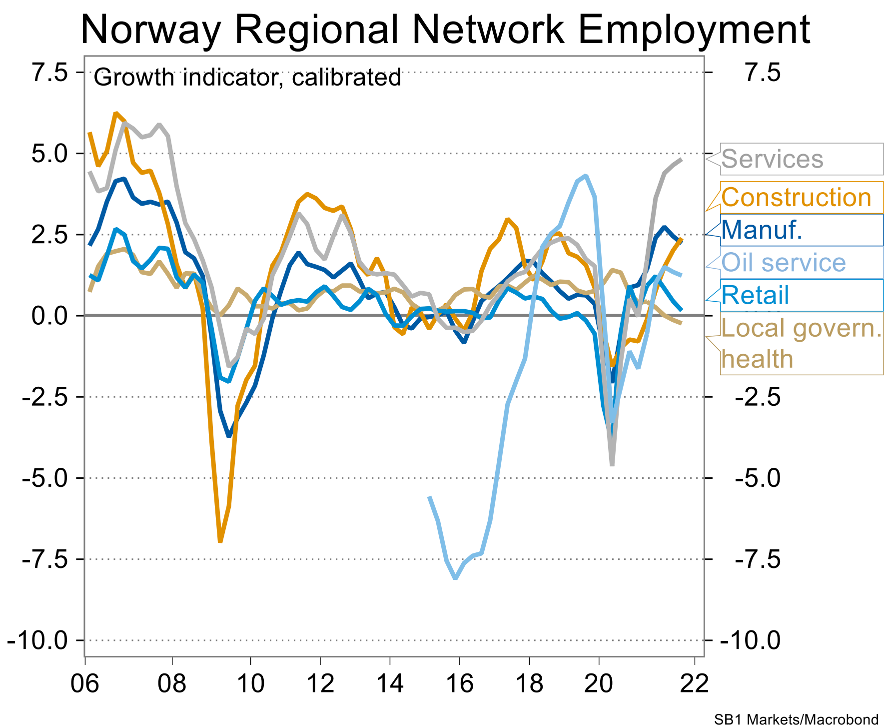


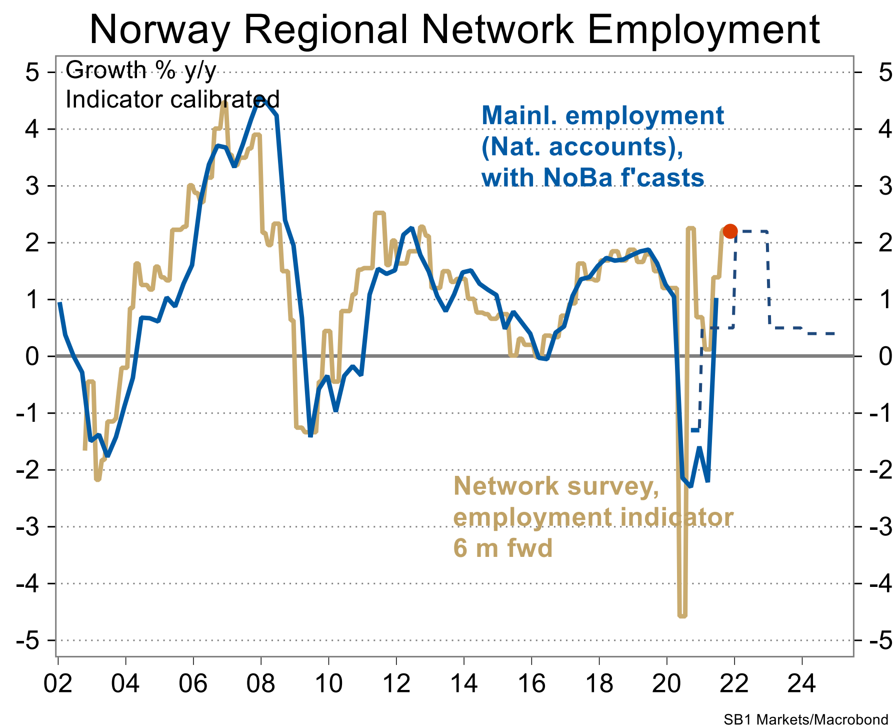
- All sectors are reporting more labour shortages
- However, all sectors report of labour shortages, partly due to lack of foreign workers
- Lack of raw materials and delivery problems have also (of course) increased

SpareBank 1 MARKETS

The network reports & expects rapid employment growth

A 2% growth is expected

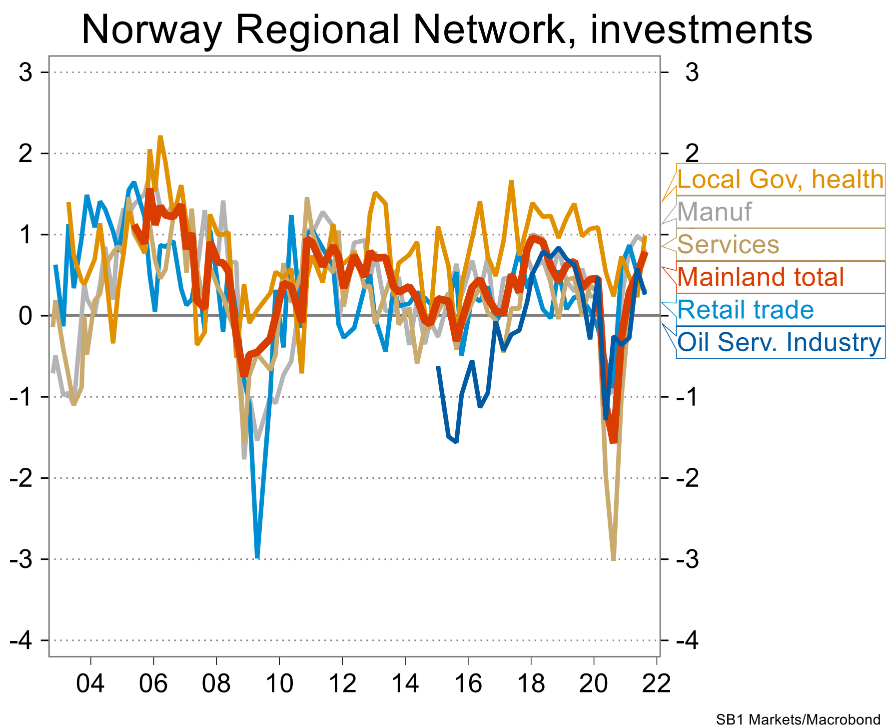


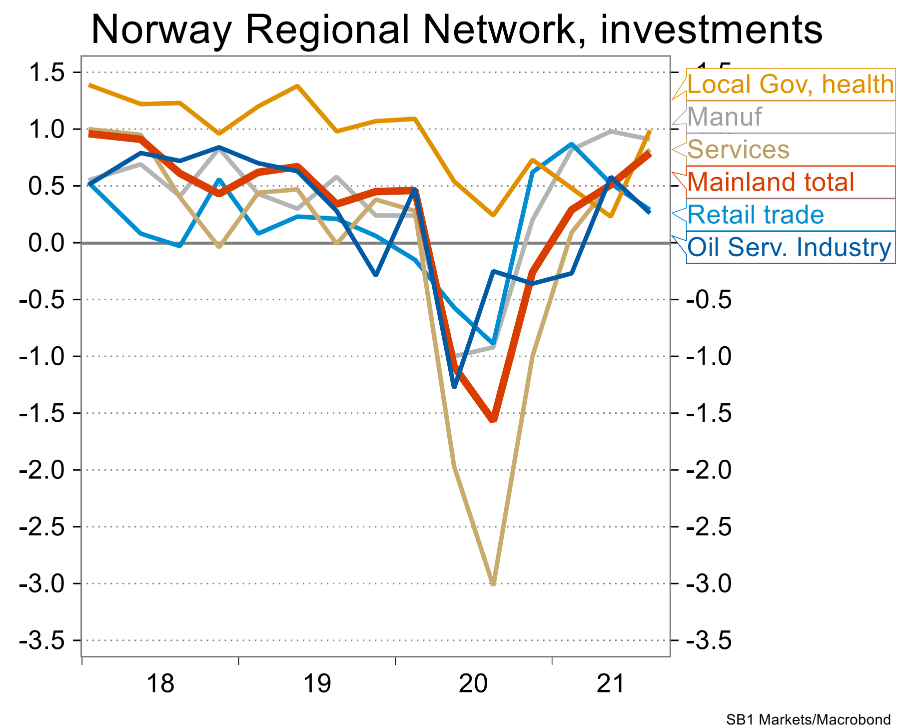


- Services & construction in the lead, we assume both are Covid related
- The NoBa forecast on the chart to the right represents the bank's annual averages

The Network signals faster, and solid growth in Mainland investments!

Businesses revised their investment estimates further upwards, not far below peaks past 10 years

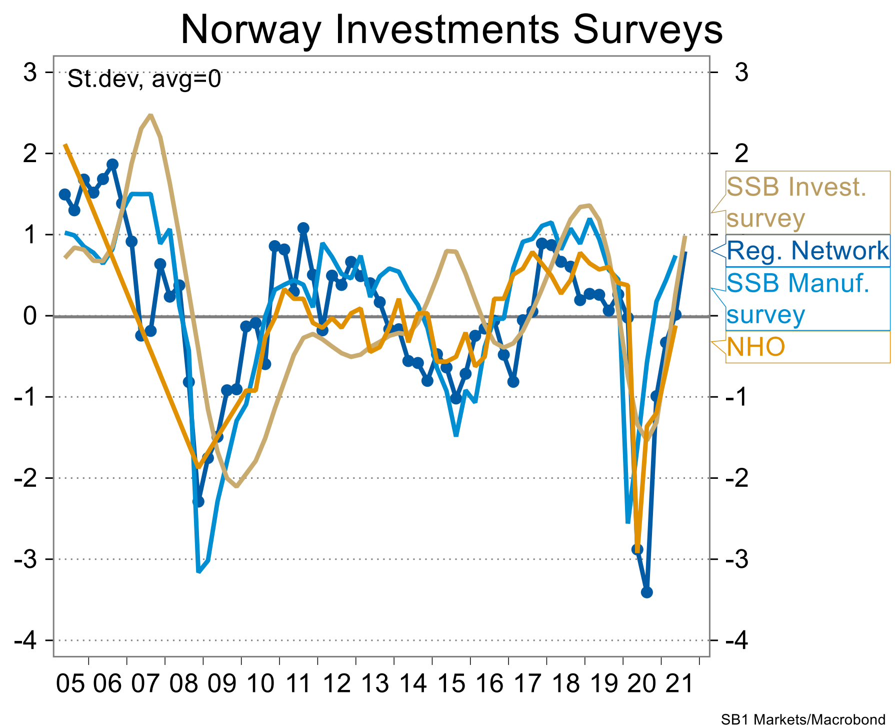


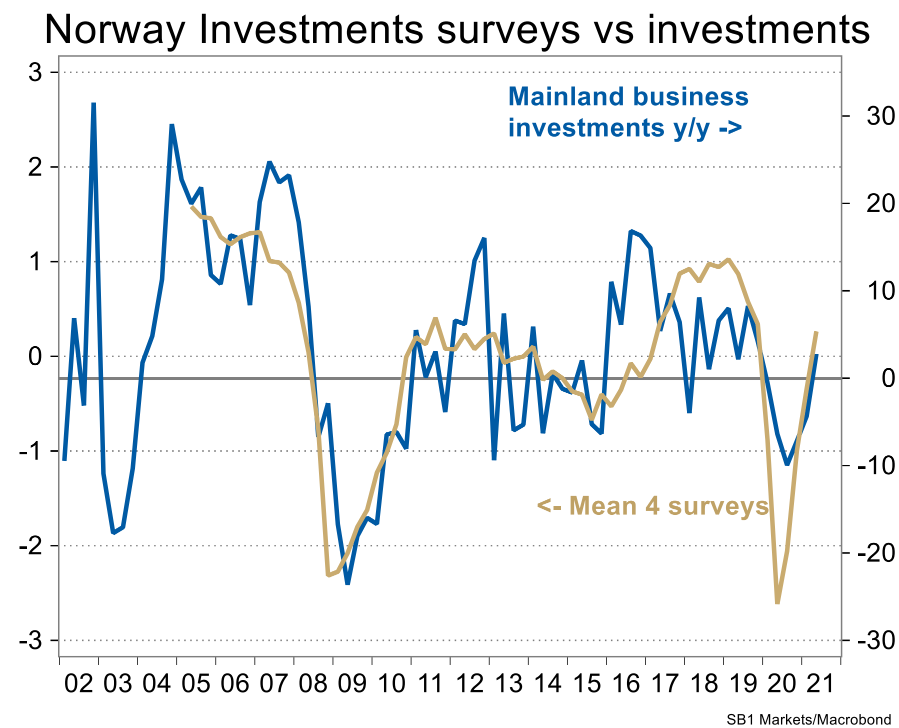


- Services, which represents almost 50% of Mainland non-residential investments, were signalling unprecedented, dramatic cuts one year ago. Now the plans are far above normal – and rose further in August
- Oil services companies (not the oil companies) (9% of total) and manufacturers revised down their investment plans over the coming year. The same goes for retail trade (7%)
- Local governments (22%) have revised their investments plans upwards
- <u>The total Mainland investments index climbed further from the Q2 survey – signalling growth far above average</u>

Other investment surveys tell the same story: a stronger outlook

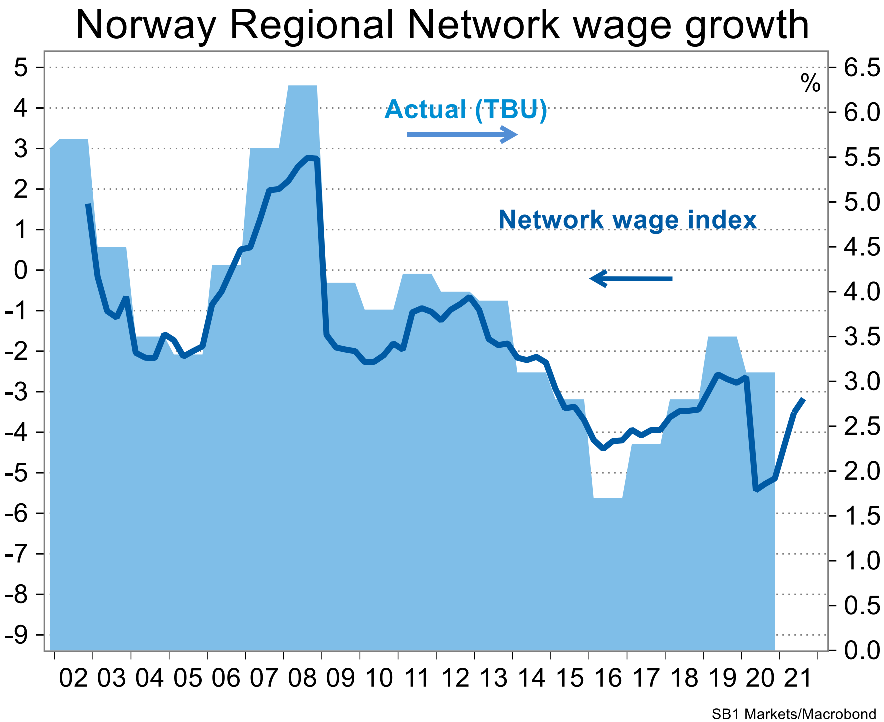
All are signal growth at trend – or better

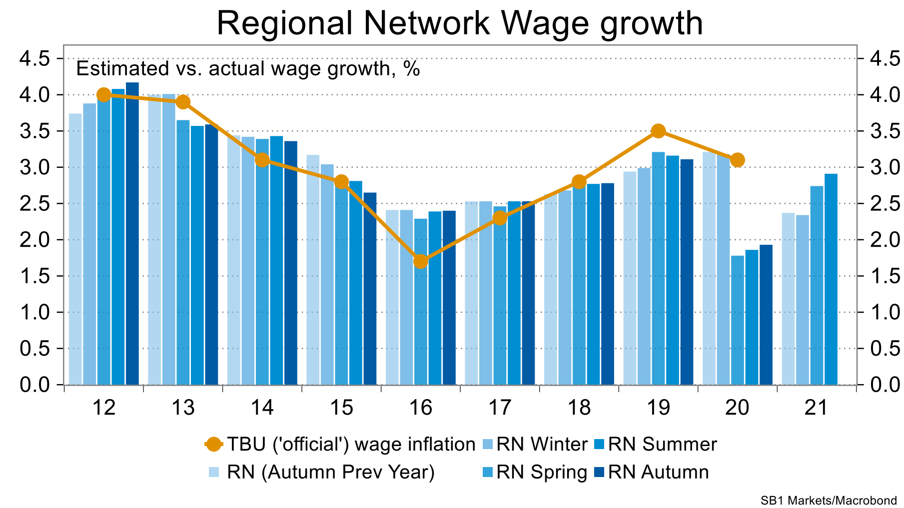




The Network revised its wage growth expectations for 2021 up 0.2 pp to 2.9%

… up from below 2% last year. There is a risk for 2022? The labour market is tightening, CPI-inf. is high

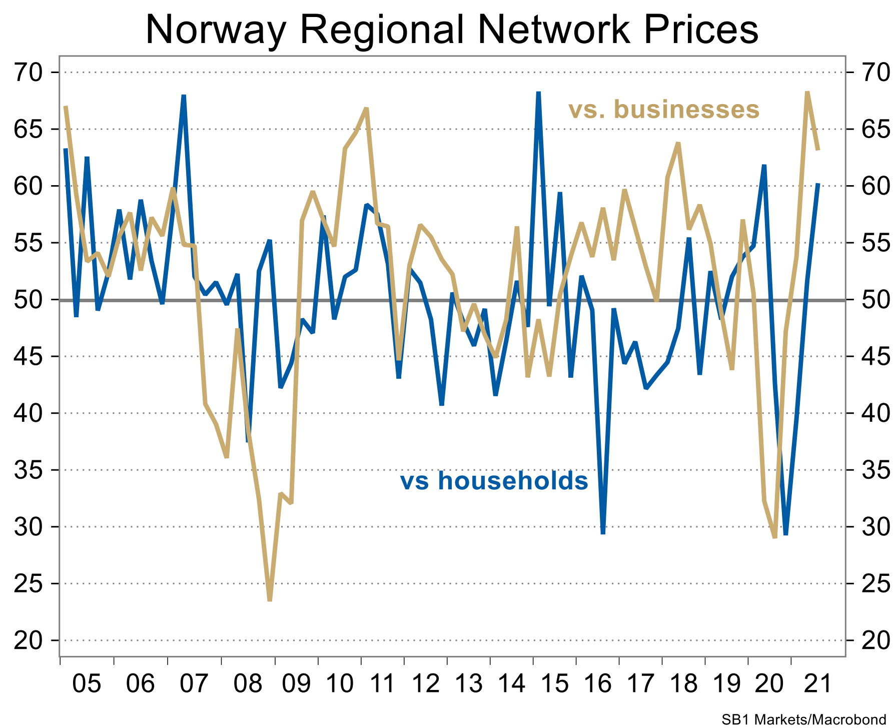




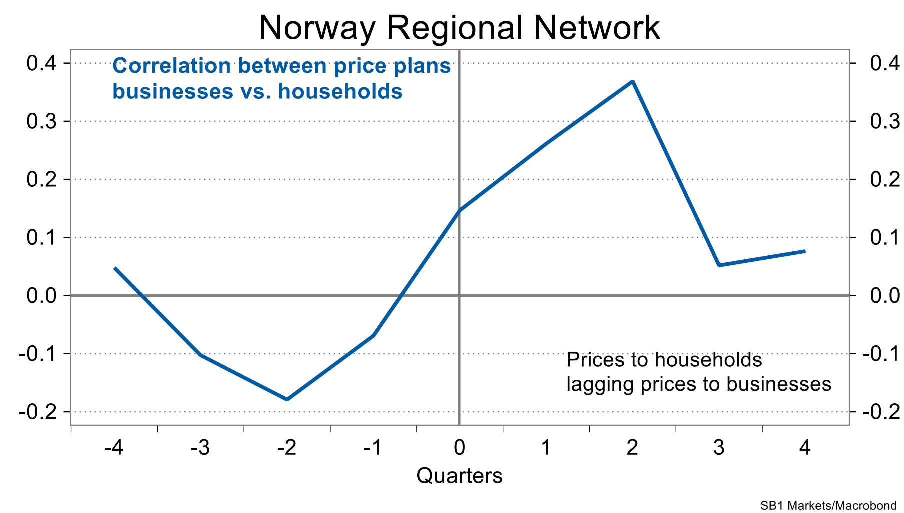
- **The negotiations between LO and NHO** yielded a 2.7% wage lift in 2021 vs 2020 on average (based assumptions on local wage drift). This guideline has been accepted by other parties in the private sector
  - » There were some minor conflicts in the public sector, and some have been rewarded 0.1 – 0.4 pp extra, but that's all
- **In Norges Bank Q3 expectation survey**, economists in trade unions & employers associations forecasted a 3.1% wage growth, and 3.2% in 2022
- **Norges Bank** assumed a 2.8% wage growth in 2021 and 2.9% in 2022 in its June MPR
  - » We expect Norges Bank to once more revise its inflation forecasts upwards – but not sufficient to bring its inflation forecast up to 2% before by the end of the forecast horizon (from below 2% in the June report)

The network signals higher output prices to households

Expected price hikes vs. businesses is lower than in the last report, but still at historically high levels

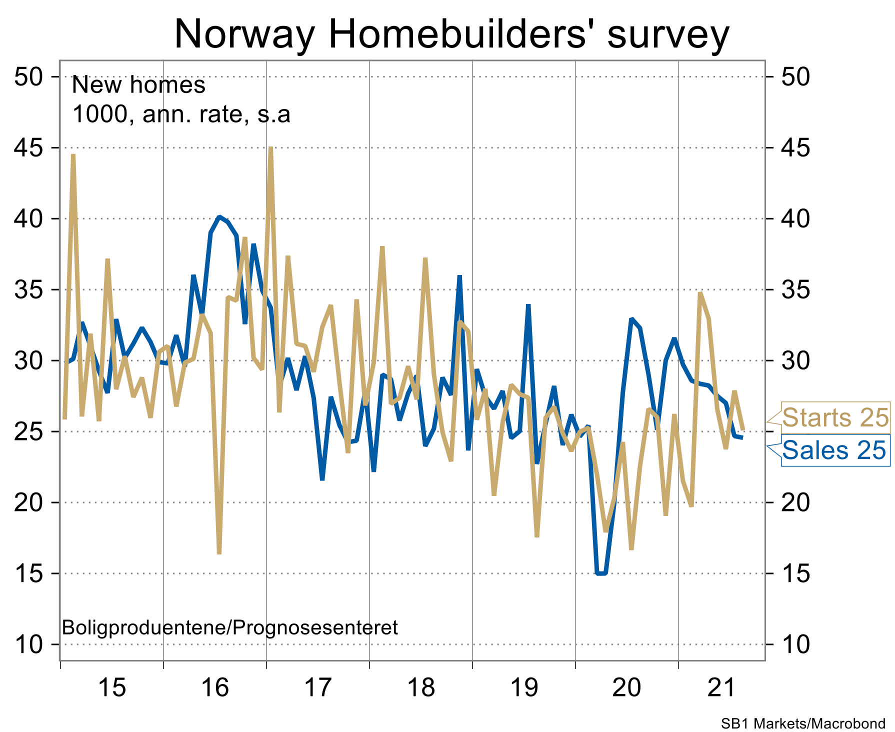


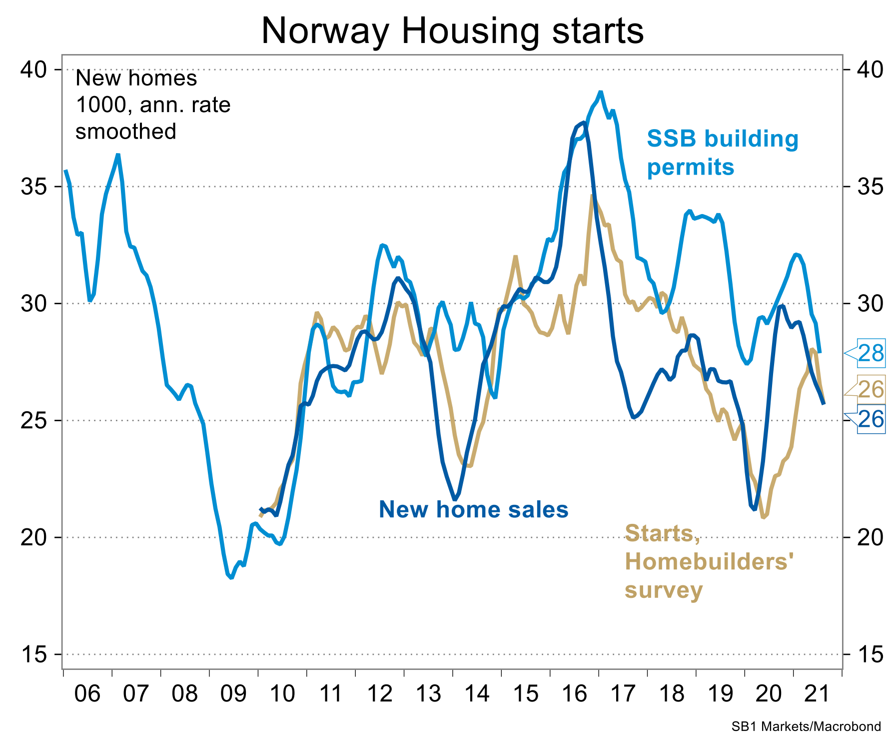
- Higher cost of raw materials, freight, and labour are putting a pressure on margins and leading to increased output prices (though not an option for all sectors)
- On the other hand, business price plans are leading plans vs hiking prices for household goods & services



New home sales are sagging, not yet low. Starts weaker too, also according to SSB

August sales equaled 25', down from 30' in early 2021. Starts are at the same level

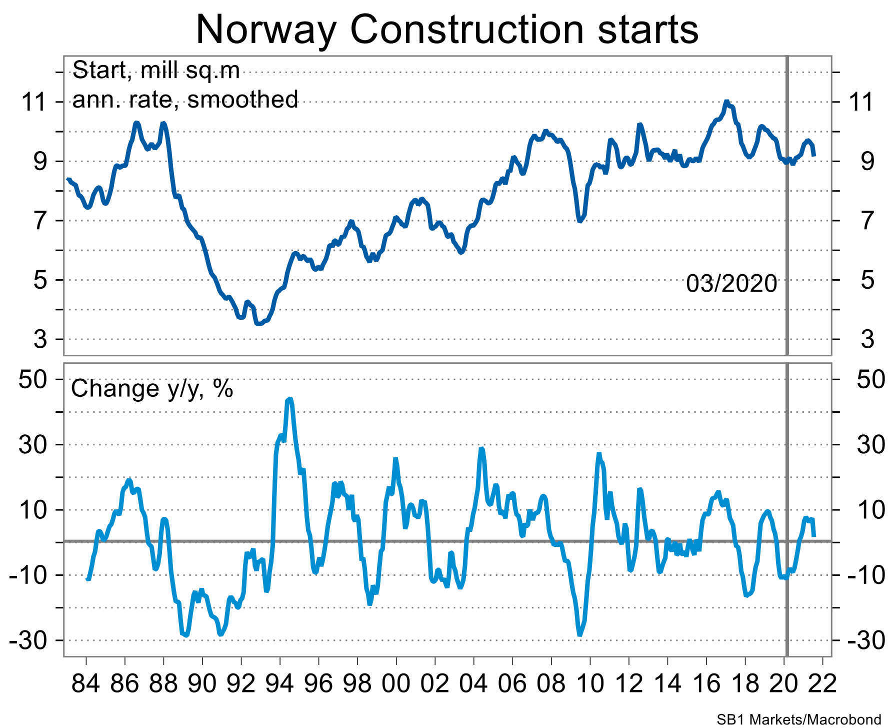


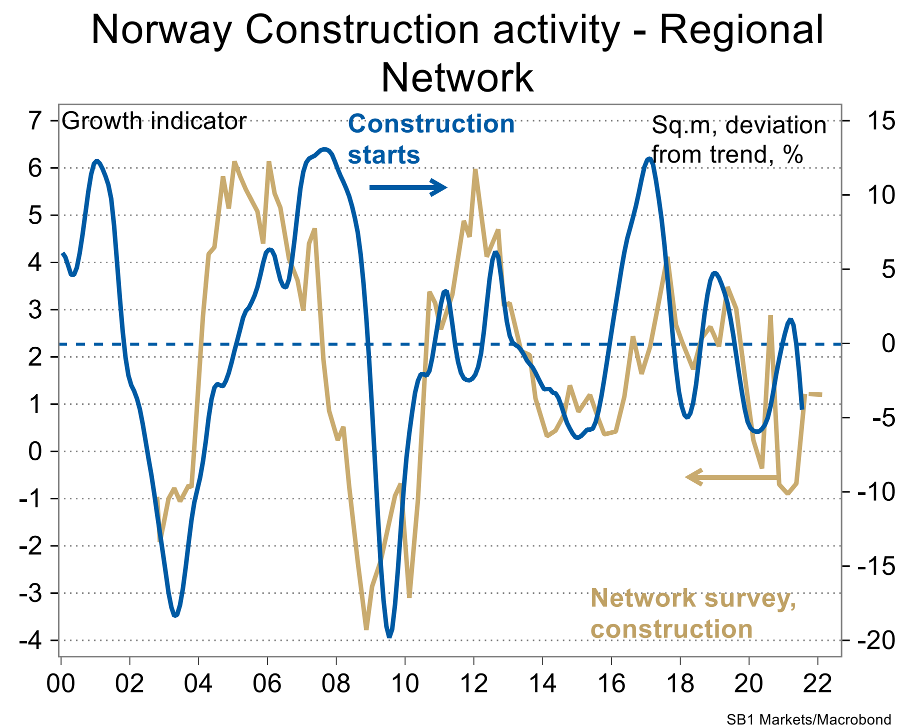


- Home builders blame higher material cost for the decline in sales, not an unreasonable hypothesis. However, as existing home prices are substantially up over the past year, new homes are probably still competitive – at least if land costs are adjusted
- In addition homebuilders report of some delays in projects due to travel restrictions for foreign workers and thereby lack of trained personnel
- Lower sales and starts implies lower housing investments
- SSB is still reporting an upward drift in building permits, which also includes student homes, as well as nursery homes

The Q3 NoBa Regional Network signals muted construction activity

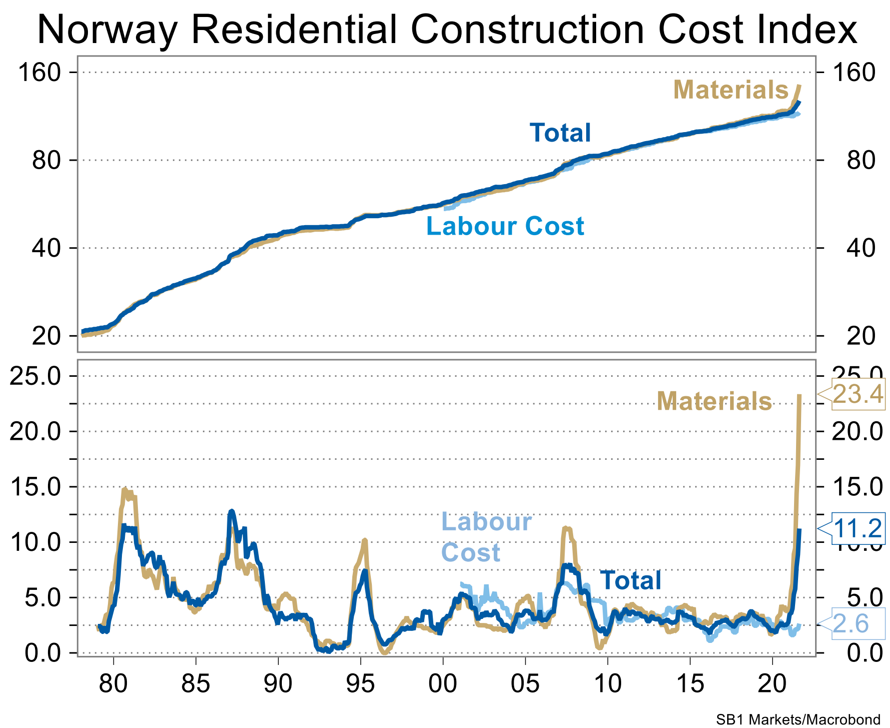
… and new starts are slowing somewhat (residential + other)

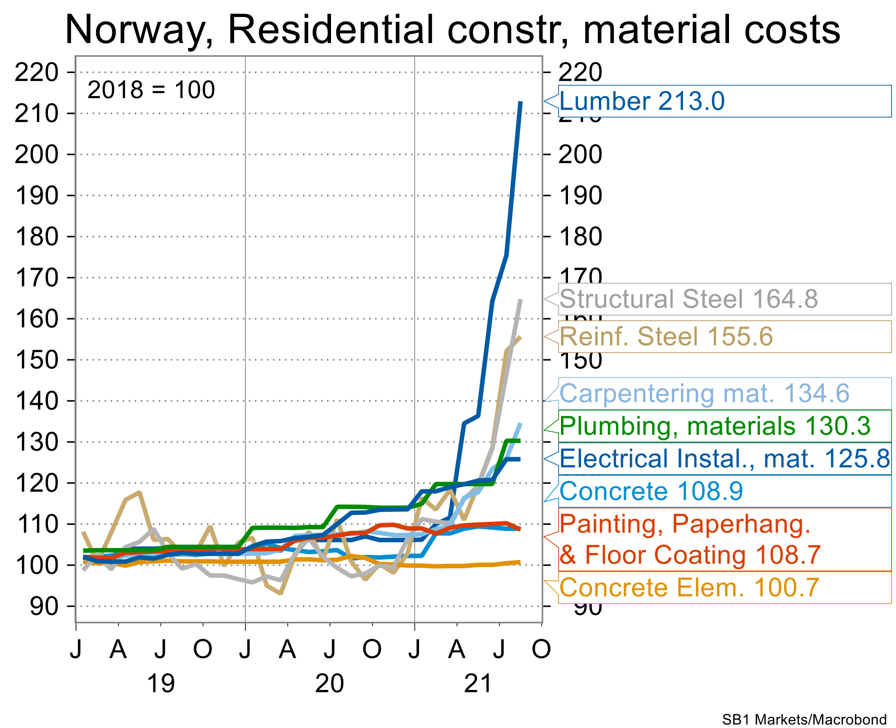




Building material costs are soaring, lumber in the lead, up 100%

But the peak is close?

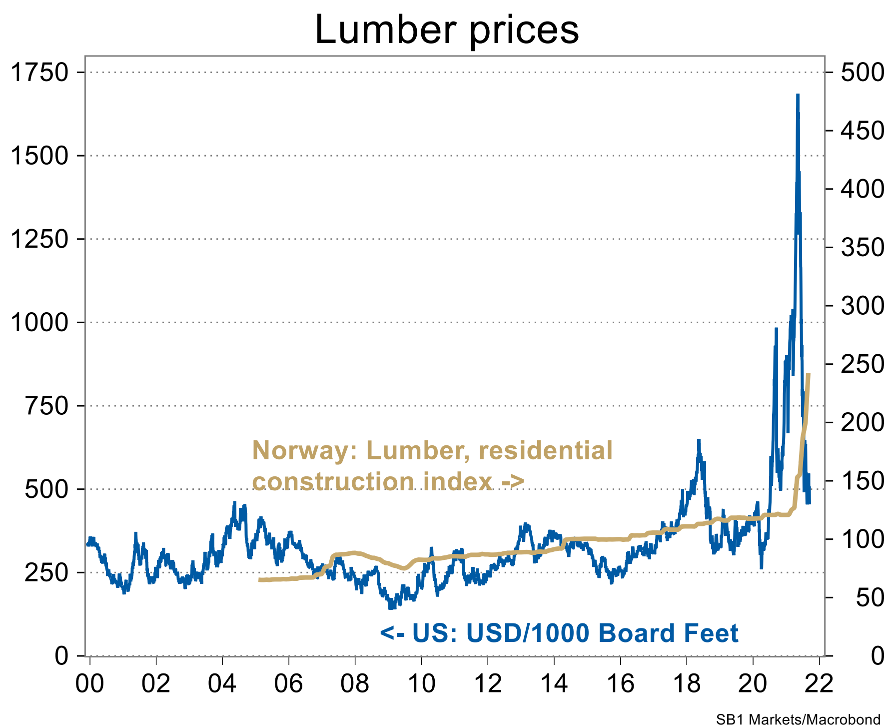




- Material prices in the residential construction index are up 23.4% y/y, ATH by far.
  - » The 100% lift in lumber prices over the past few months is unprecedented
  - » Steel prices are sharply us well by some 60%. Carpeting materials (not lumber) is up 30%, as are plumbing materials
  - » Concrete is up just 9%, in line with painting etc. No price increases for concrete elements!
- Including labour costs, the total building cost index is up by 11.2%, the highest print since 1987
- Lumber price have collapsed and media report sharp decline in European prices as well. We expect Norwegian prices to follow suit pretty soon

In the US, the lumber bubble has burst

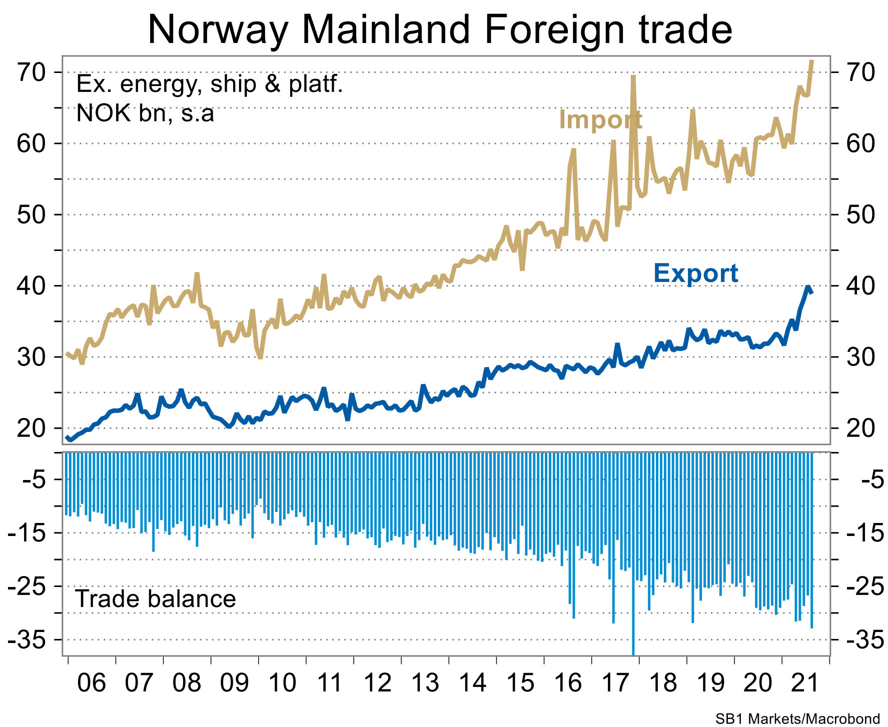
Raw material price cycles are normally not long lasting

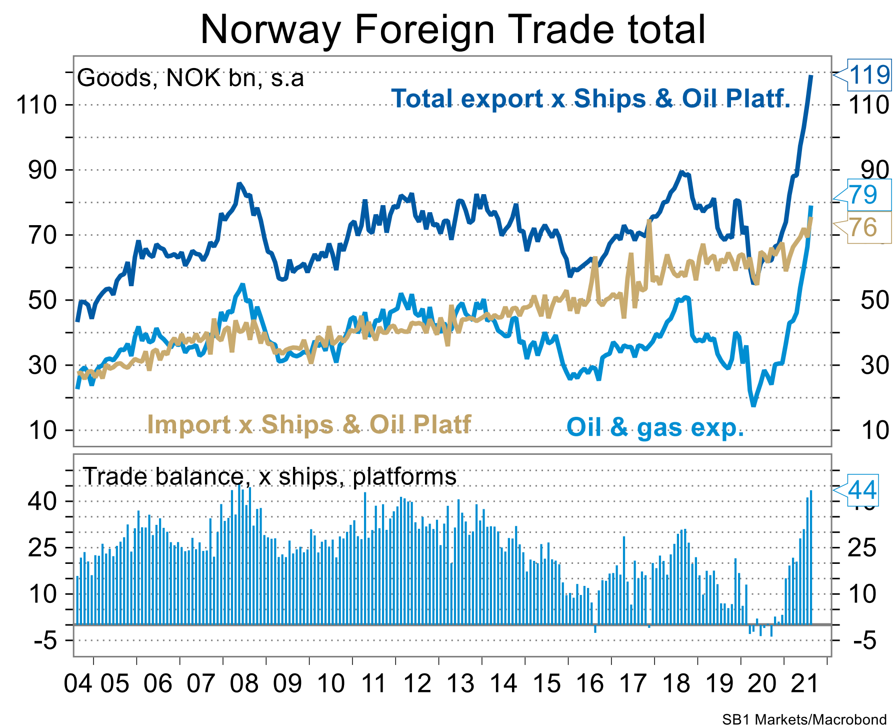


- .. And they are normally not important for the serious inflation cycles
  - » But they always initiate them
- Media report indicate than lumber prices in Europe is also on the way down (and German prices peaked in July) – and we expect Norwegian lumber prices to follow suit

Mainland trade deficit sharply in August, as imports surged

Total balance surplus up in August, to close to record high (2008), as gas exports surged

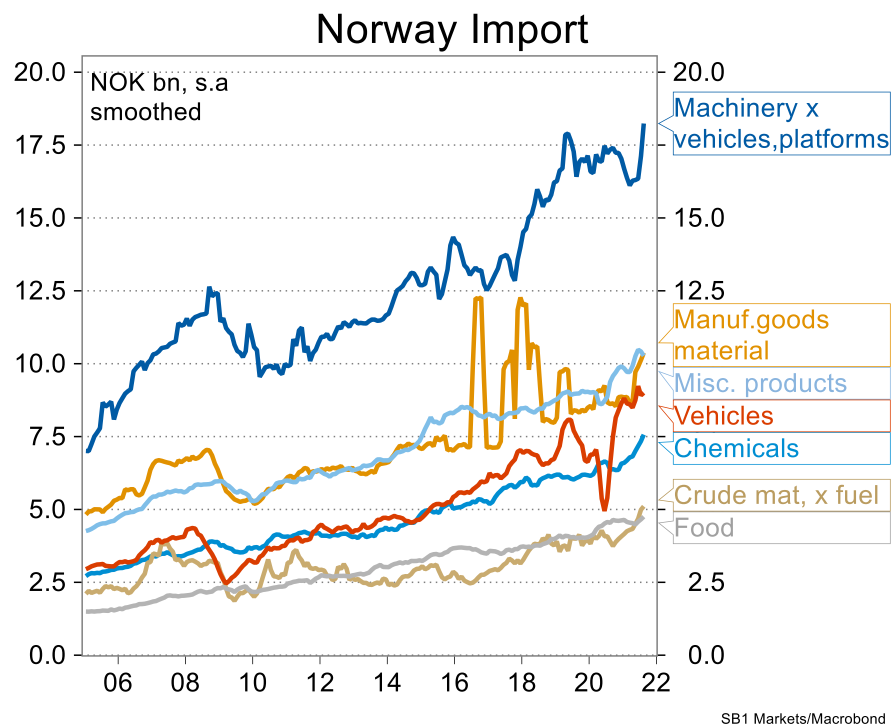


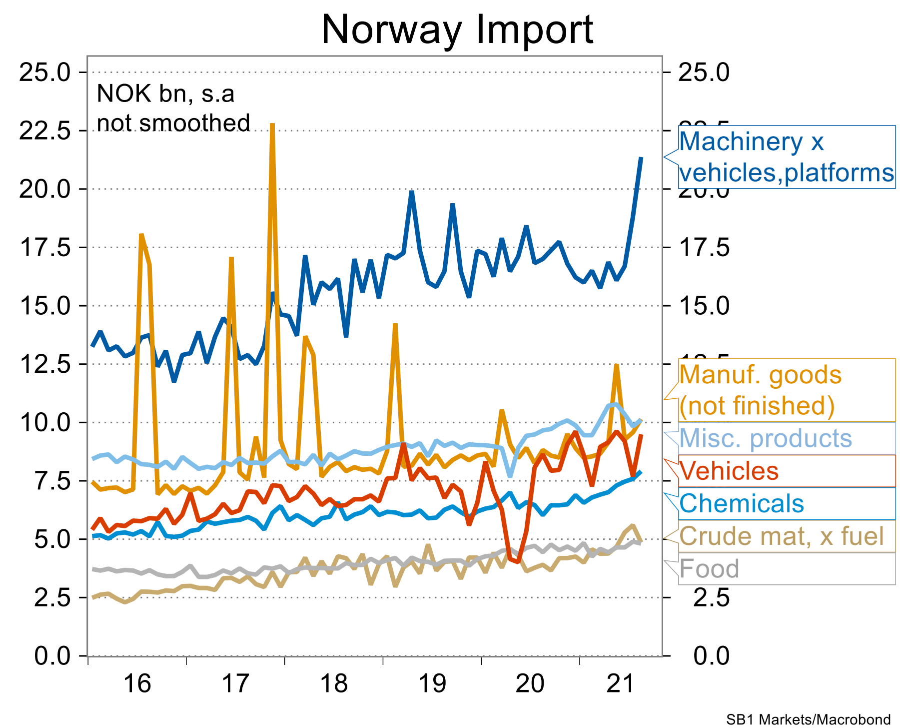


- **The Mainland (non energy) trade deficit in goods** decreased sharply in August, by NOK 6.1 bn
- **Non-energy exports were** reached yet another ATH in August. The main contributors on the upside for exports were metals and fish
- **Imports** increased sharply in August, due to higher import of machinery and vehicles
- **Export of oil and gas**, helped by higher prices, is well above pre-corona levels, totalling 79 bn in July (+14 bn m/m), bringing the total trade surplus to 44 bn, or some 16% of Mainland GDP. In nominal terms, the highest level since 2008, close to all time high. We are not broke, yet

Machinery imports sharply up in August too, up 14% m/m

Import of vehicles also up by 23%

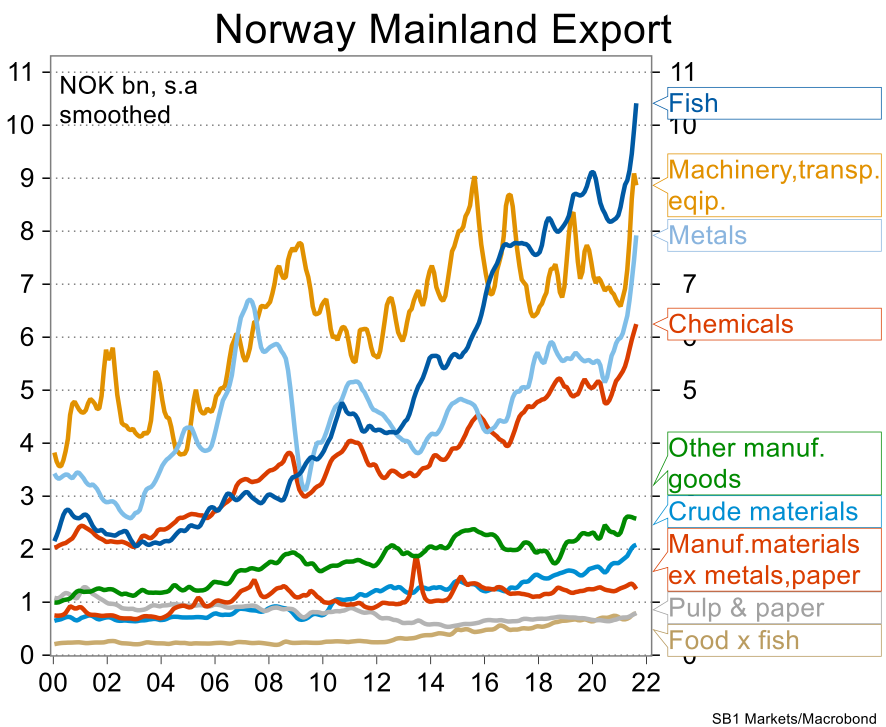


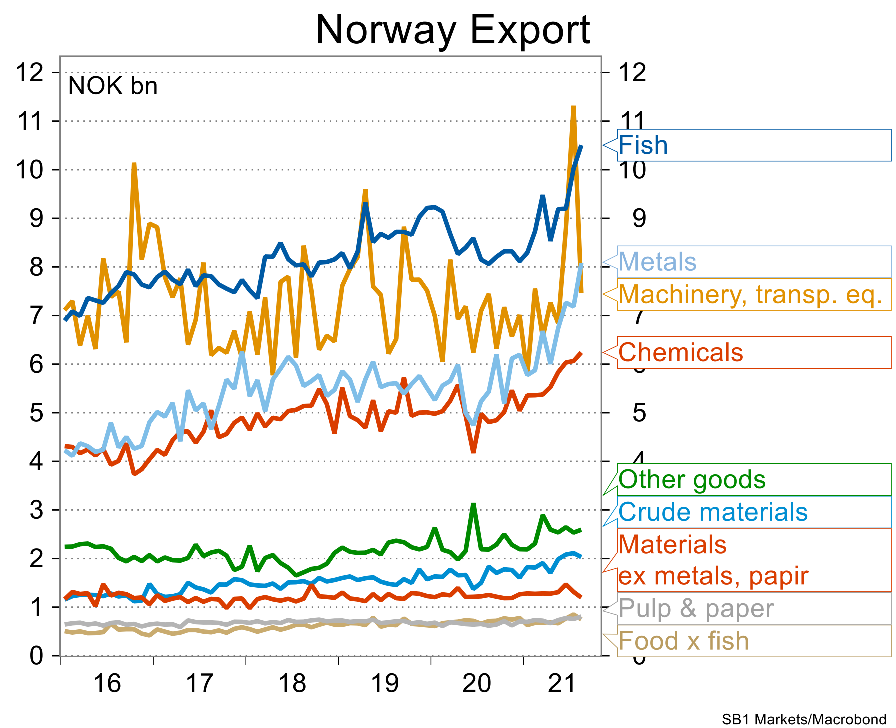


- Imports have increased since August last year for all sort of goods, and only imports of crude materials were down in August
- Vehicle imports slowed rapidly in H2 2019 and early 2020, along with auto sales. In May, imports were at the highest level ever, but declined during the summer. The level is now back above that of August ‘20, after increasing 23% m/m

Steep decrease in exports of machinery & transp. equipment Aug, as expected

All exports up y/y

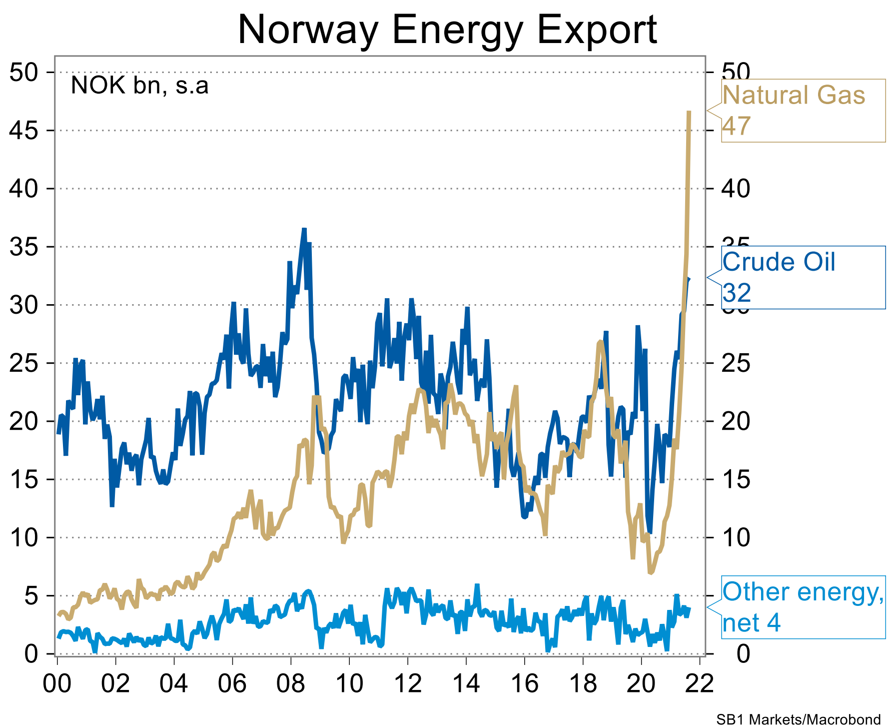


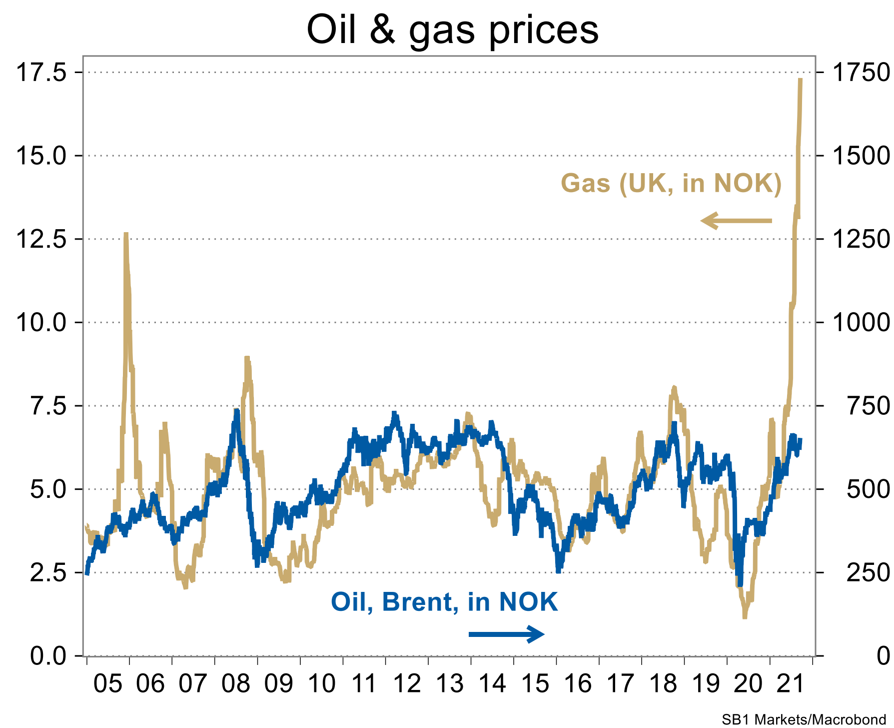


- Exports of machinery and transport equipment (of which much is related to oil activities abroad) decreased by 34% in August, down to an average level, as expected. The 27% increase in July was mostly driven by a 139% m/m increase in the export of ships
- Fish exports continue to be strong, and are up 5% m/m and 30% since August last year, most of which can be attributed to increased prices and larger export volumes of salmon

Gas exports soared at gas prices soared, naturally…

Thank you, Putin! Oil prices are back to a rather high level too





- **Crude oil** exports (in NOK bn) fell rapidly in March and April 2020 as the oil price dropped and global demand subsided. Exports have turned up since then, with the oil price, and exports have recovered. In July and August '21, the value of crude exports were the highest since Aug 2008, and it is the highest exported volume since Oct 2008
- **British gas** prices have skyrocketed past weeks – to 3½ times the average level over the previous years (and 5 times since last Aug), to all time high by a wide margin. Gas prices are now totally uncorrelated to oil prices, which is rather unusual (but is has happened before, like in late 2005). In August, Norwegian gas exports had risen fivefold since last year (in value terms) of which 15% in volume terms. Gas prices have since increased further due to tighter supply in Europe and increased demand in Asia

Highlights

The world around us

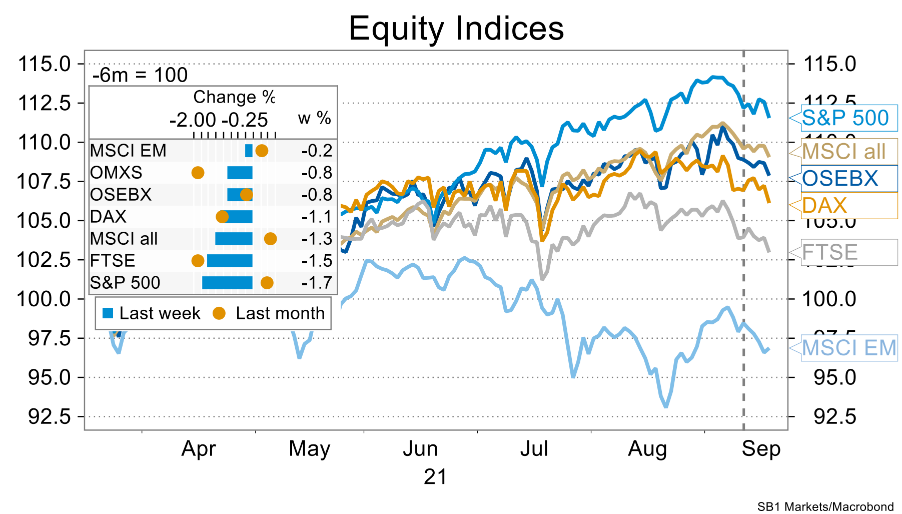
The Norwegian economy

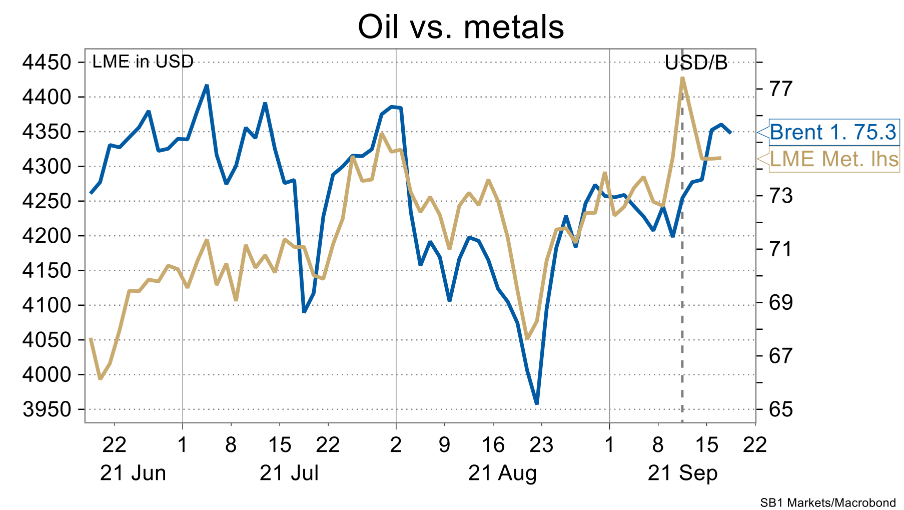
Market charts & comments

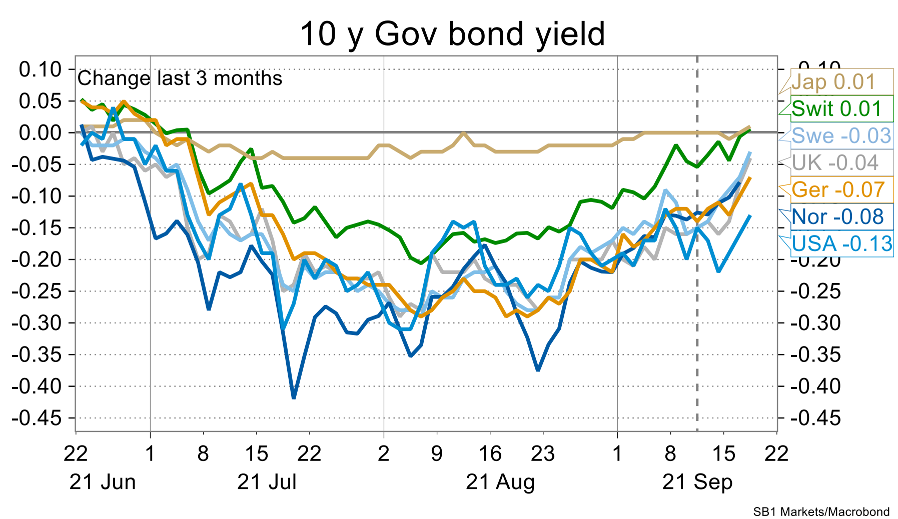
SpareBank 1 MARKETS

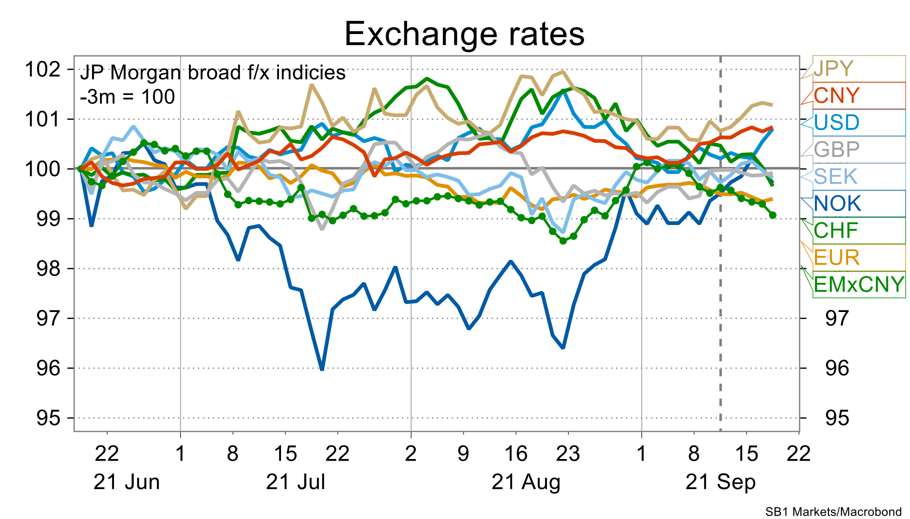
Equites down, metals down, bond yields up everywhere

However, the oil price rose to USD 75/b, perhaps with some support from record high European gas prices





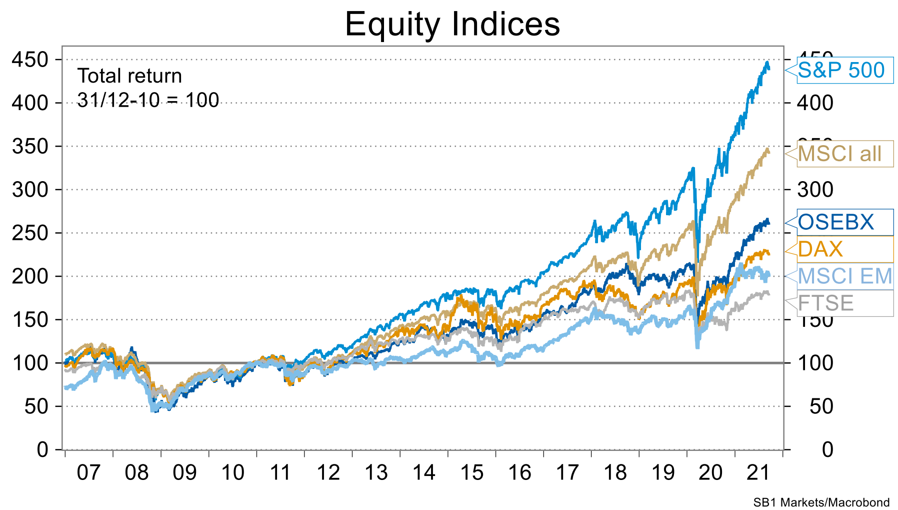


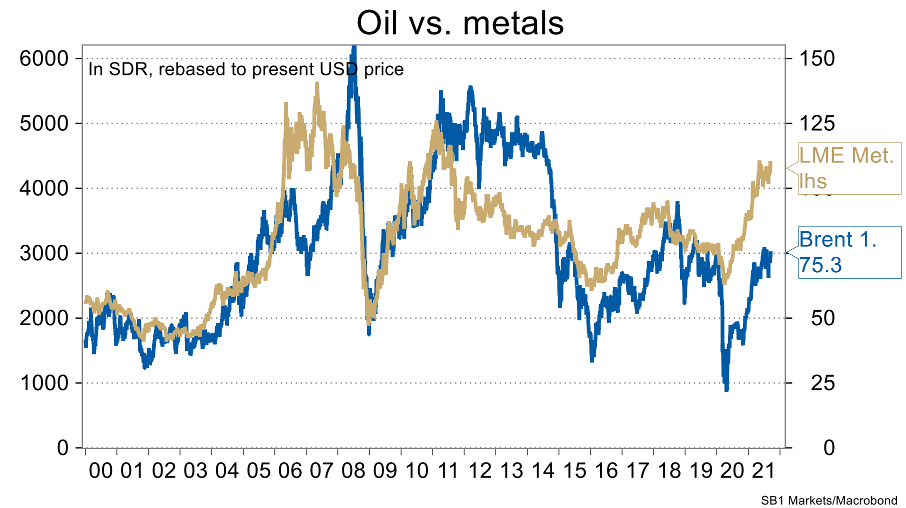


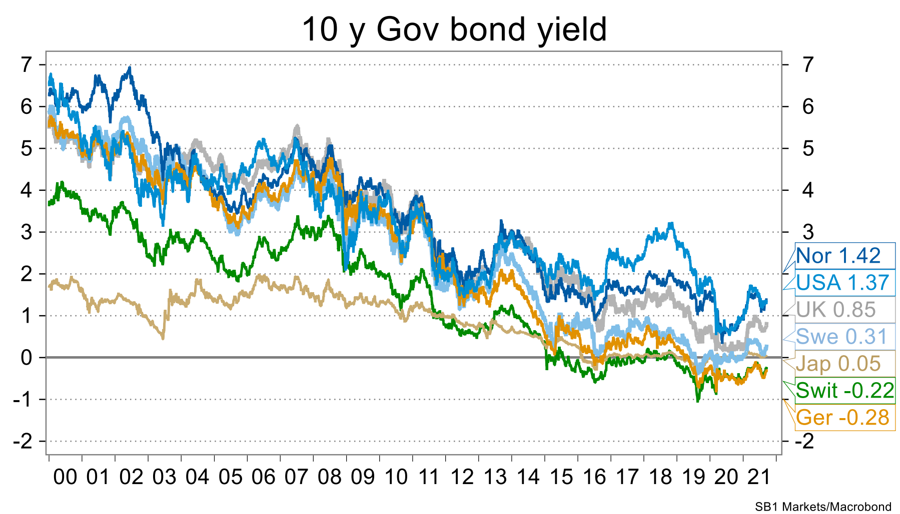
SpareBank 1 MARKETS

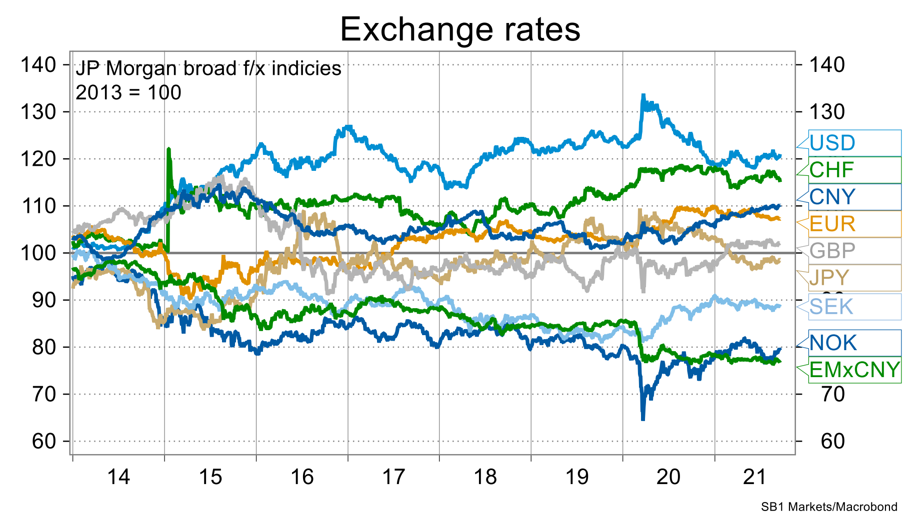
The big picture: Strong stock markets, commodities have taken a breather

Yields have turned up recently but yields are low. The EUR is drifting down, the CNY up



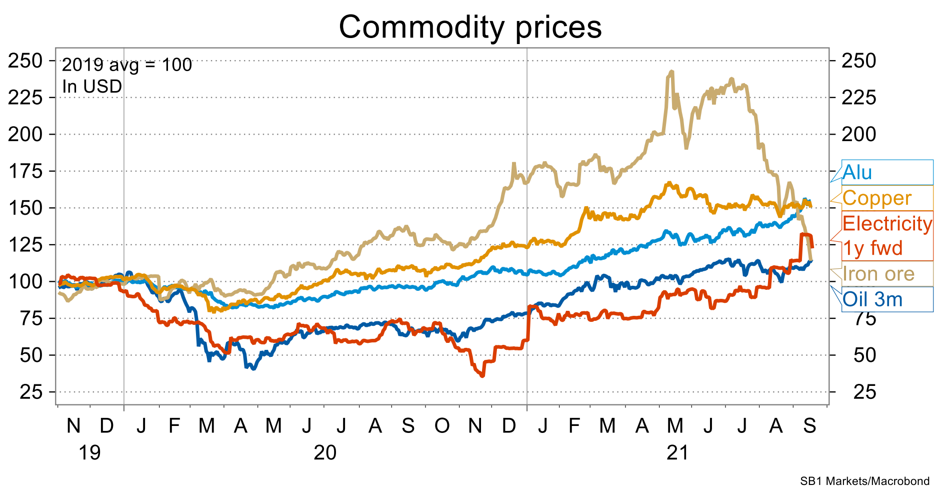


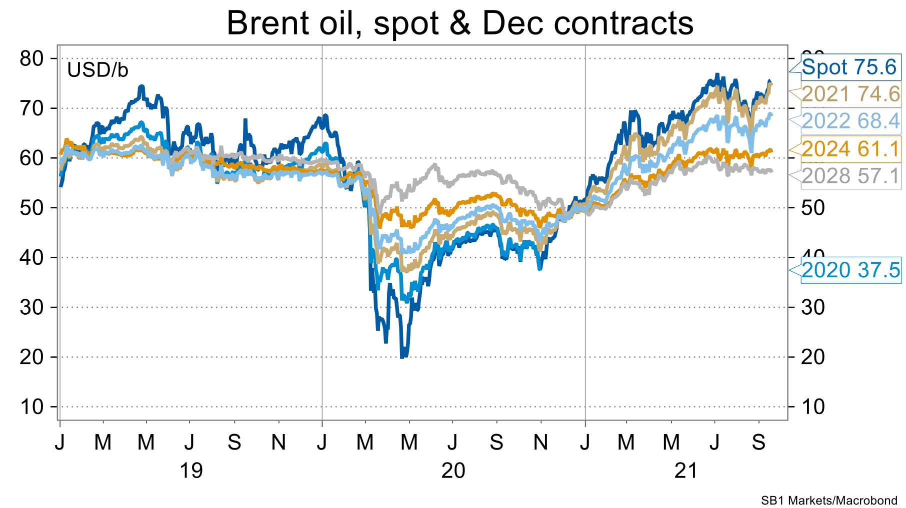


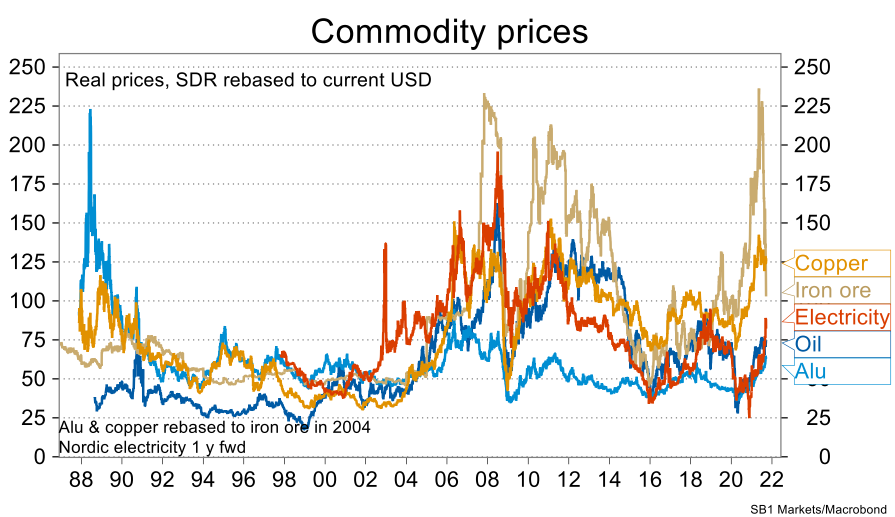


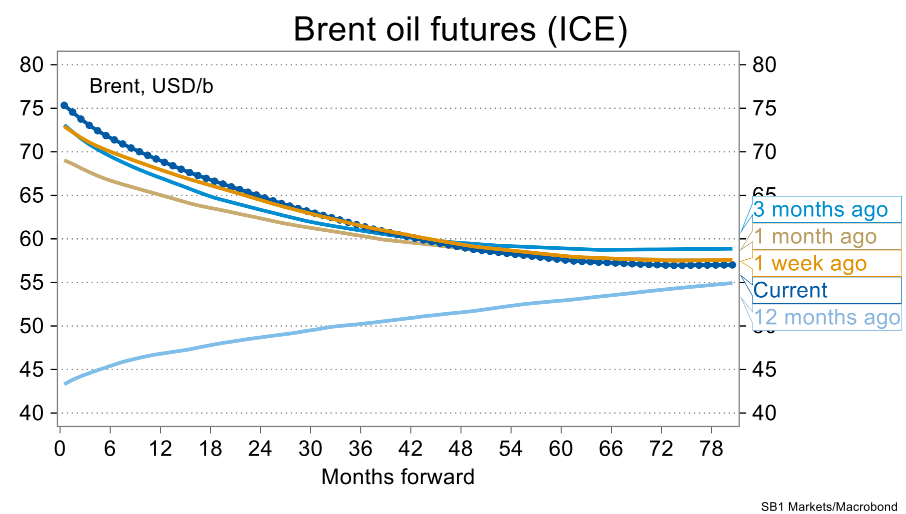
Mixed commodity prices, iron ore down 50% from July – still not that low

However, oil (and gas, electricity) prices rose, at least on the short end of the price curve



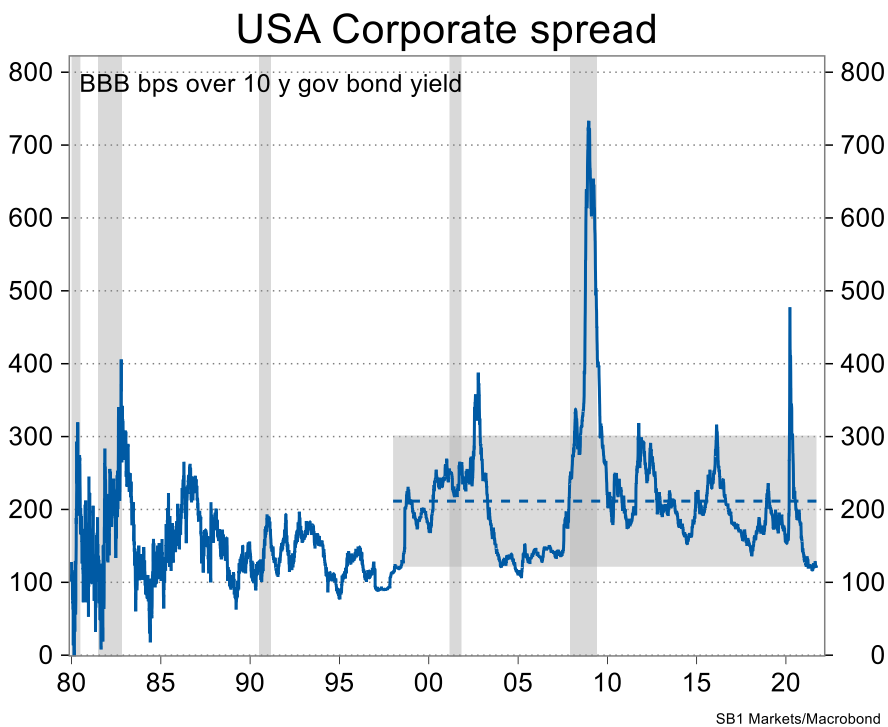


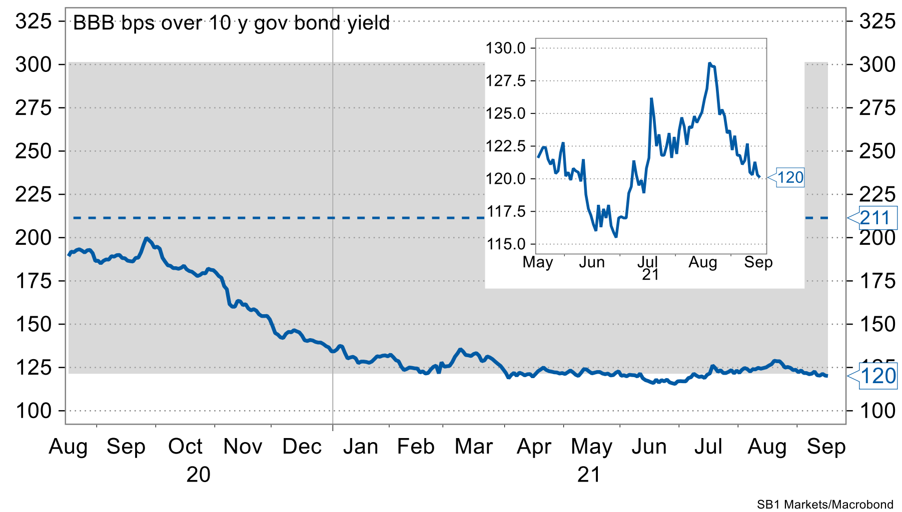


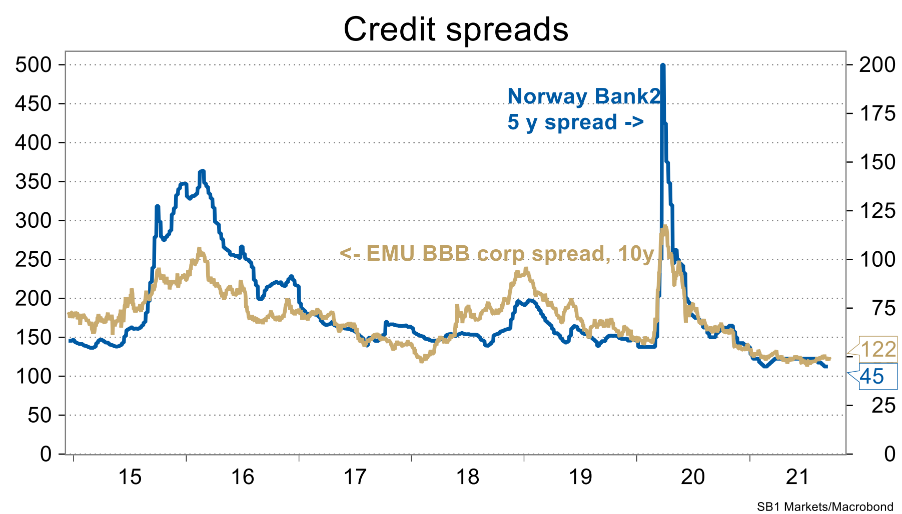


Credit markets are calming down again, >half of a marginal spread rise reversed

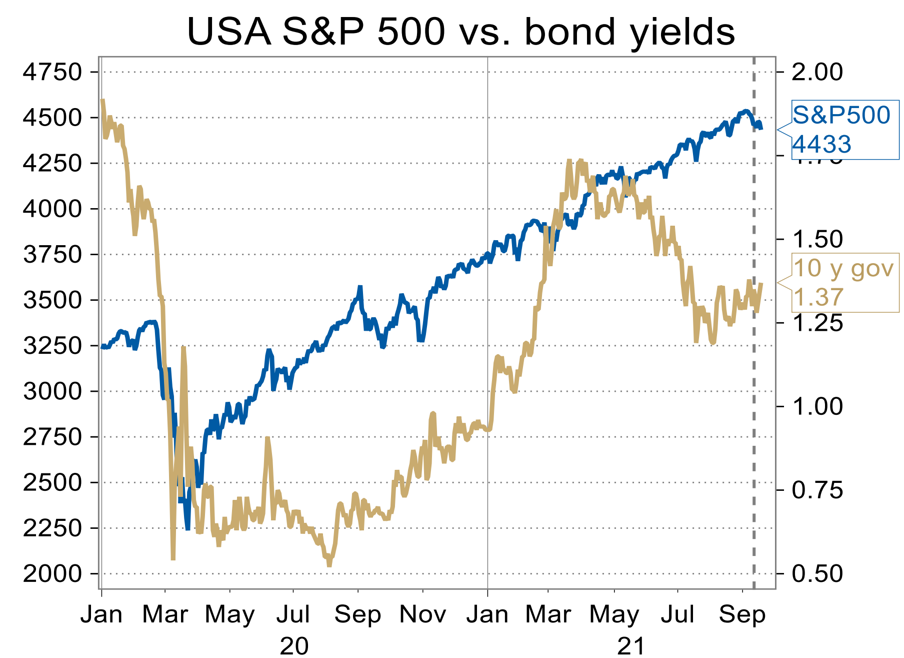
In Norway, bank spreads have fallen recent weeks, to the lowest level since before the Fin. Crisis

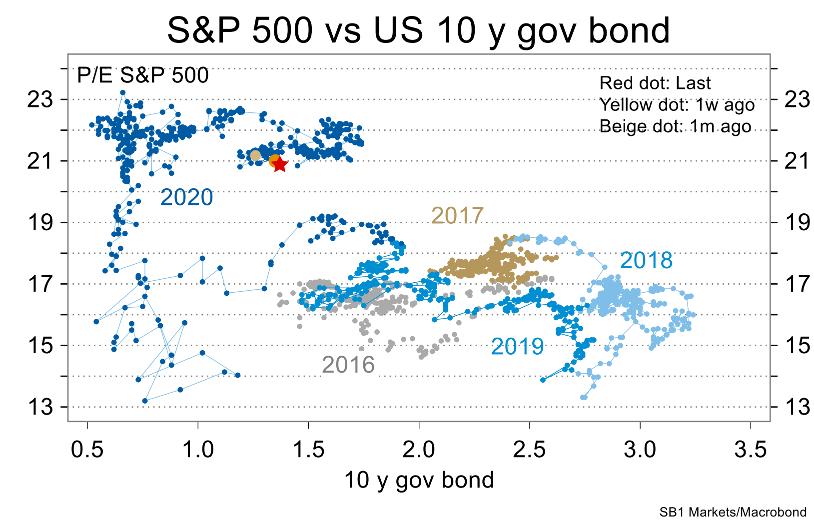


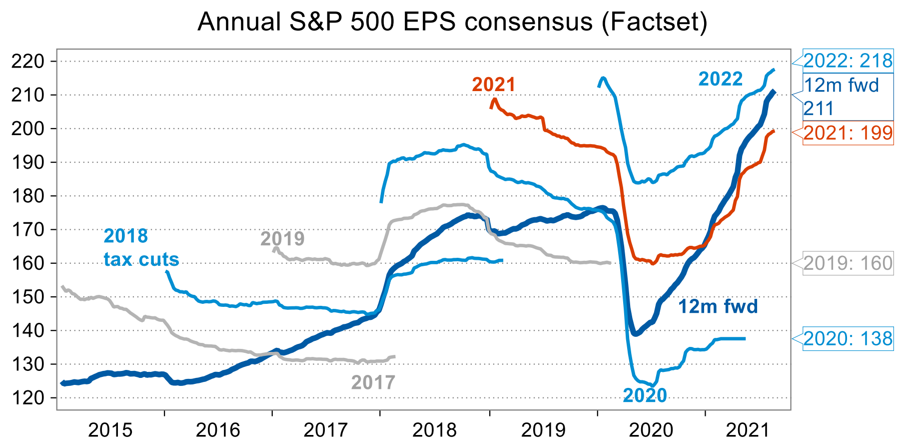


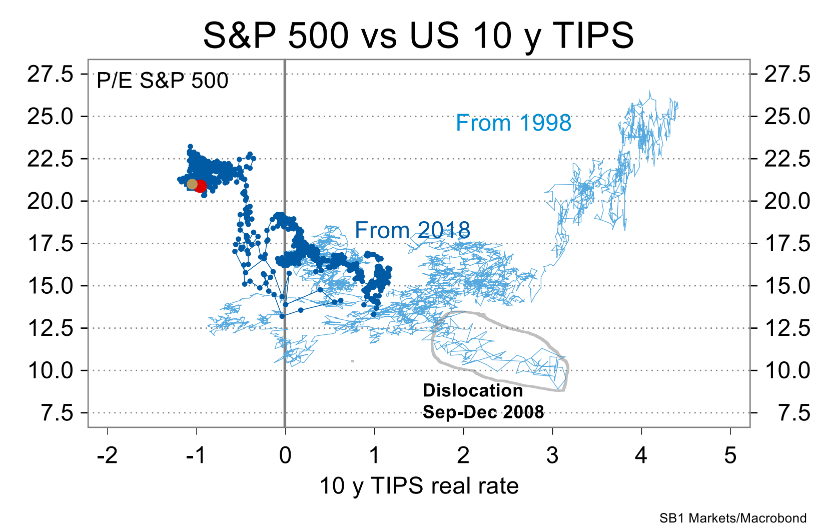


S&P 500 down 0.6%. Bond yields up 2 bps – and they are drifting upwards again





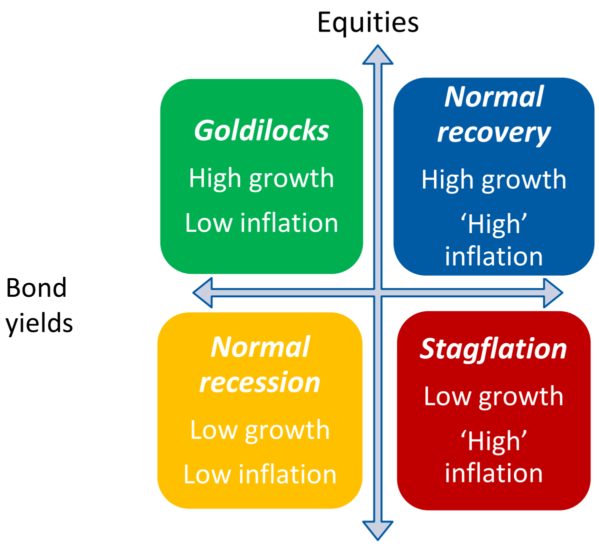


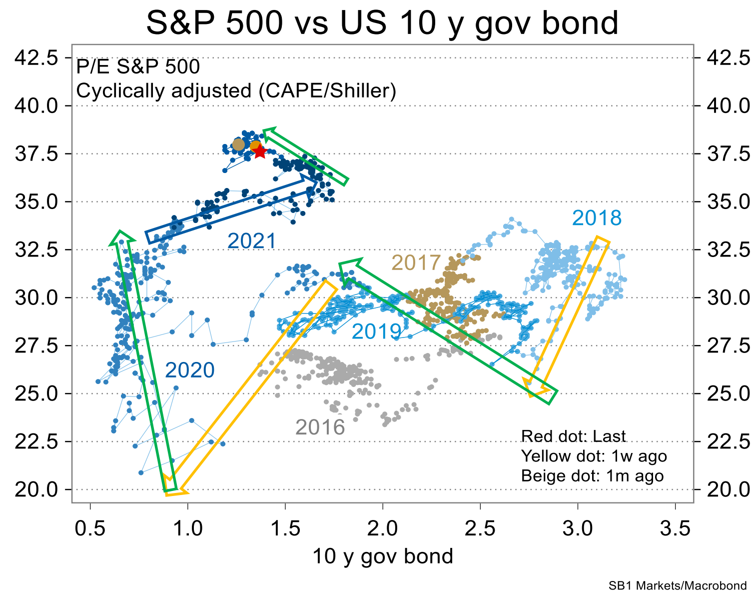


SpareBank 1 MARKETS

Still well into the 'Goldilocks corner'

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



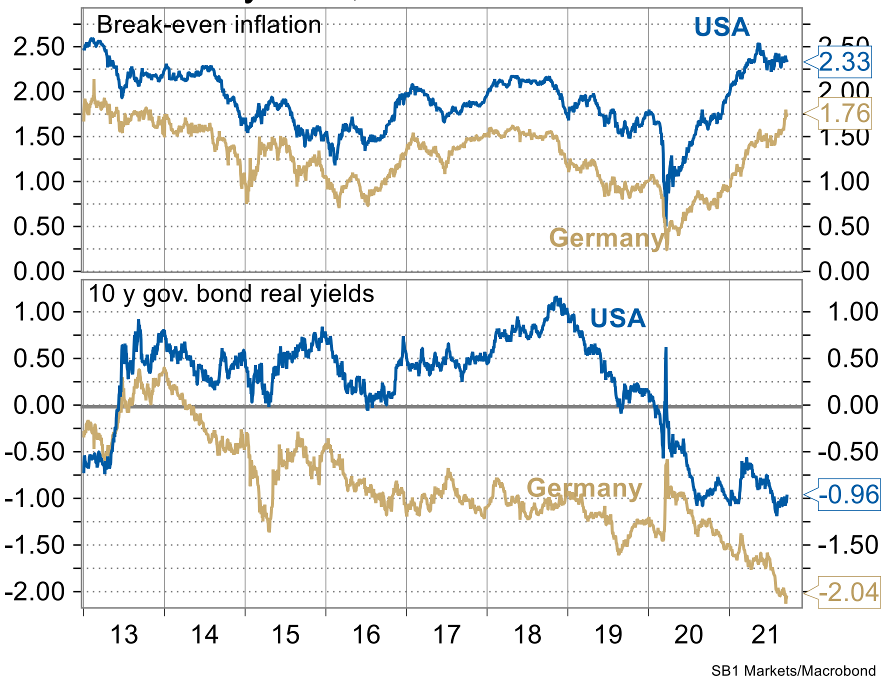


- Usually, we have associated drifts towards the 'green corner' - low inflation and solid growth at the same time - as a <u>temporary</u> sweet spot for markets
  - Interest rates have climbed 100 bp+, and stock valuations have kept up or climbed (like the Shiller PE). Still, we deem the current yield 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
    - <u>If companies are able to increase their selling prices</u>, 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)
    - <u>If companies are not able to increase their selling prices</u>, inflation will be kept in check but profits will decline rapidly. A 2% lift in wages, cuts profits by well above 10%. That's the Yellow corner

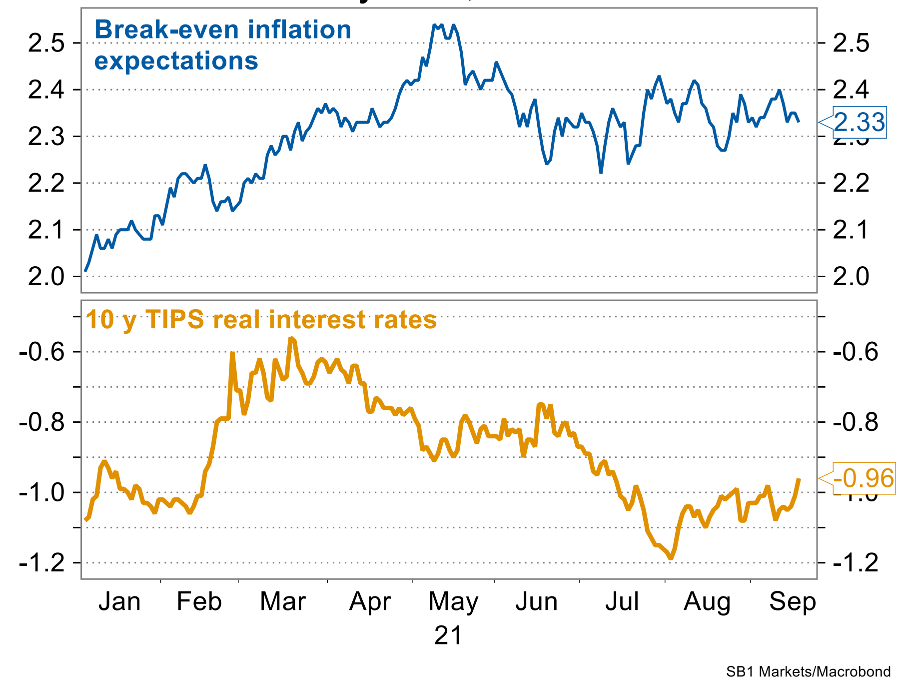
Real yields are drifting upwards in the US, still very low

10 y TIPS +9 bp, inflation expectations down 7 bps. German yields up, both real & inflation expectations

Real yields, break-even inflation



USA TIPS Real yields, break-even inflation



US & Germany 10 y Gov bond yield

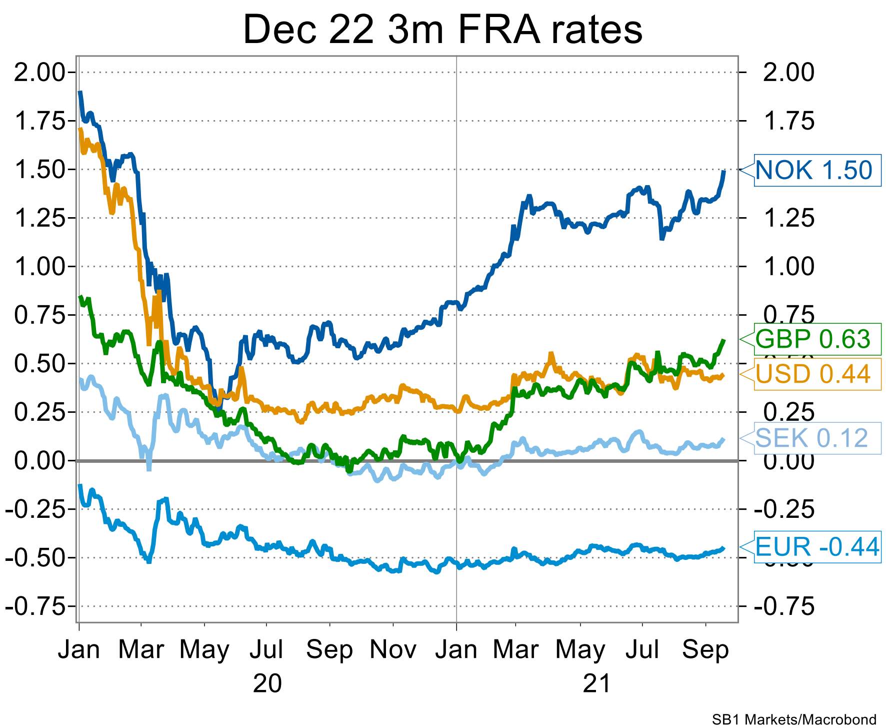
	Yield	Change 1w	Change 1m	Min since April-20
USA nominal treasury	1.37	0.02	0.11	0.52
.. break-even inflation	2.33	-0.07	0.00	1.06
.. TIPS real rate	-0.96	0.09	0.11	-1.19
Germany nominal bund	-0.28	0.07	0.22	-0.65
.. break-even inflation	1.76	0.04	0.21	0.40
.. real rate	-2.04	0.03	0.01	-2.13

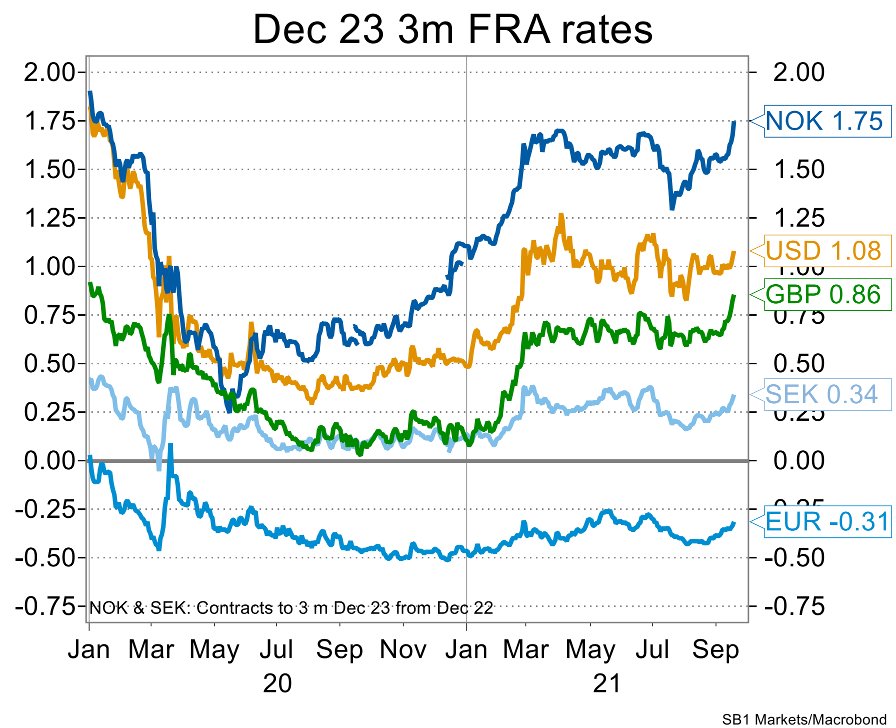
SB1 Markets/Macrobond

- German real yields are still close to record low, the 10 y at -2.04%
- German inflation expectations are steady on the way up, up to 1.76%, still below ECB's new 2% target – but among the highest prints the past decade. Is ECB finally gaining some traction in its fight to get inflation up?

FRAs: Up everywhere, an the most in Norway

GBP rates rose almost as much at NOK rates, Dec-23 +14 and 18 bps resp.

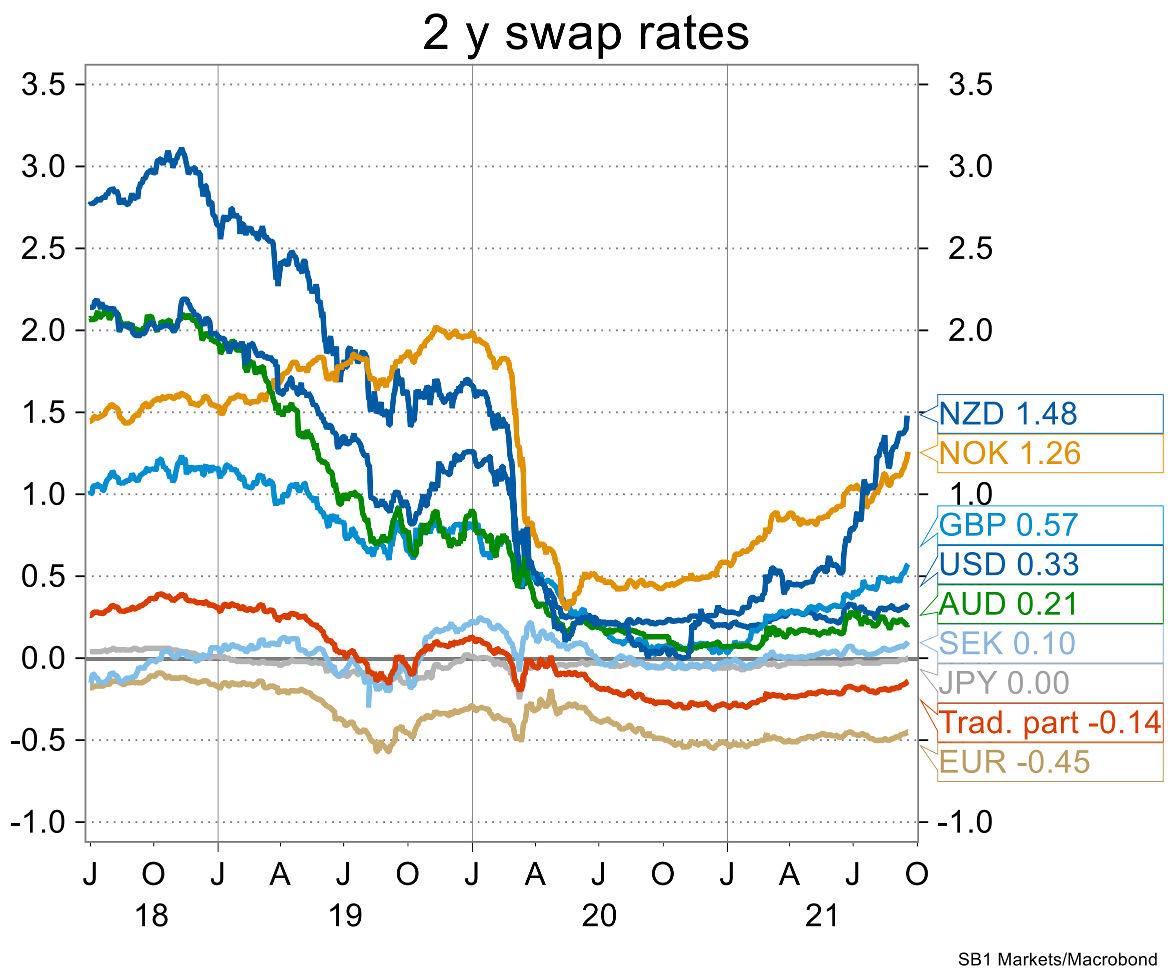


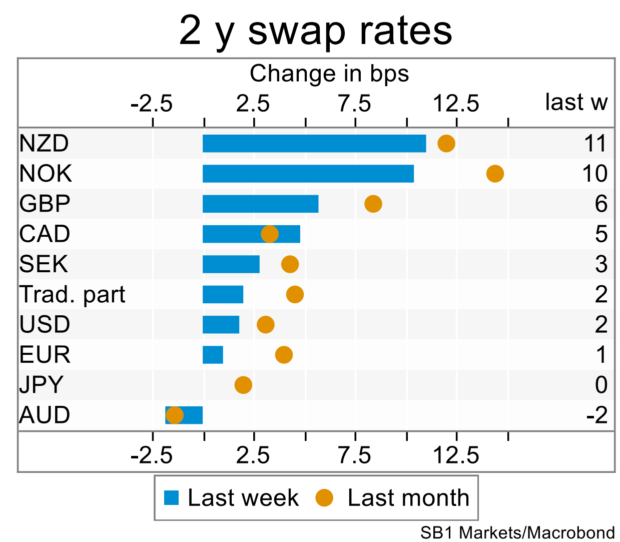


- The market expects both **BoE** and the **Federal Reserve** to start hiking next year – and now 2 – 3 hikes in the UK
  - » In UK the spread between the 3 m money market rate and BoE key signal policy rate (the Bank rate) is close to zero

Up, almost everywhere – except AUD rates

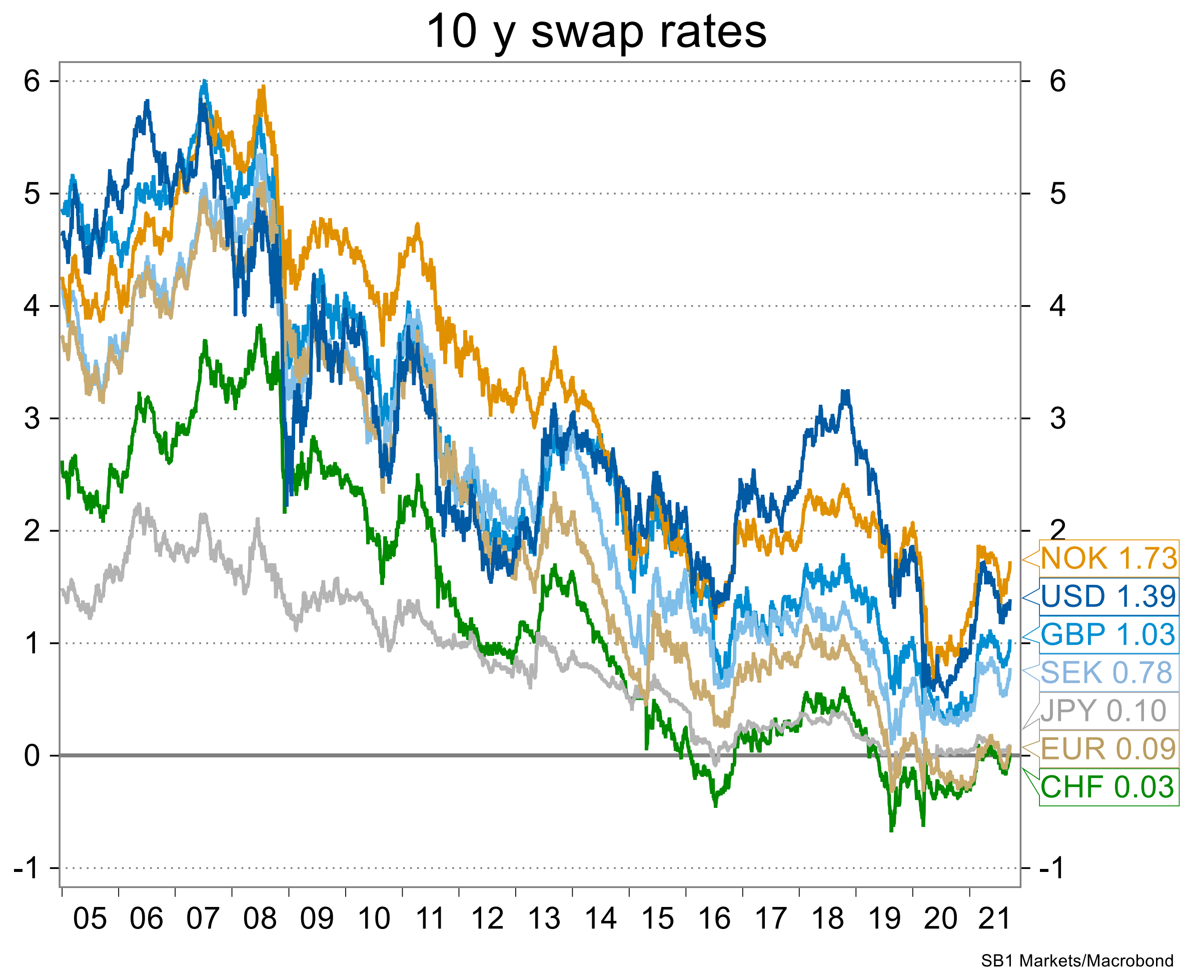
The AUD is a bit depressed too, due to the crash in the iron ore market?

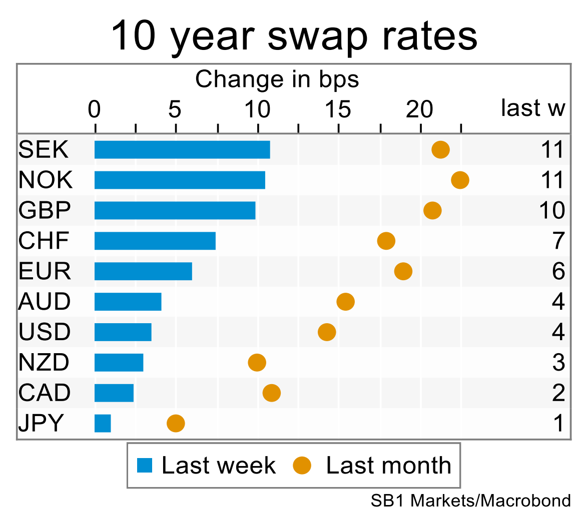




A further lift in rates, for the 4th week in row

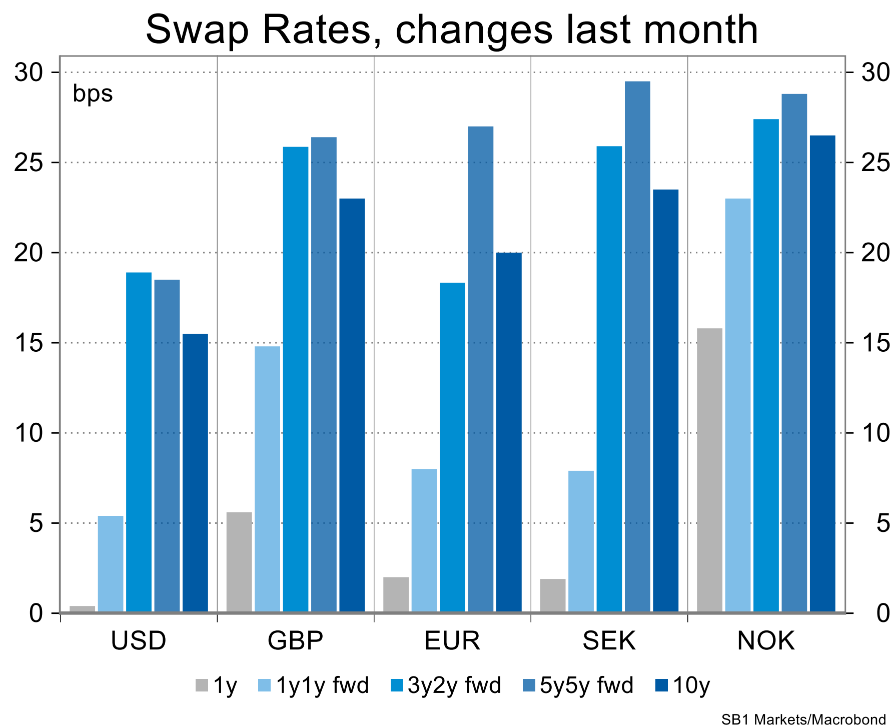
EUR rates are up 18 bps past 4 weeks, as there is more talk about tapering. NOK 10 y +25 bps

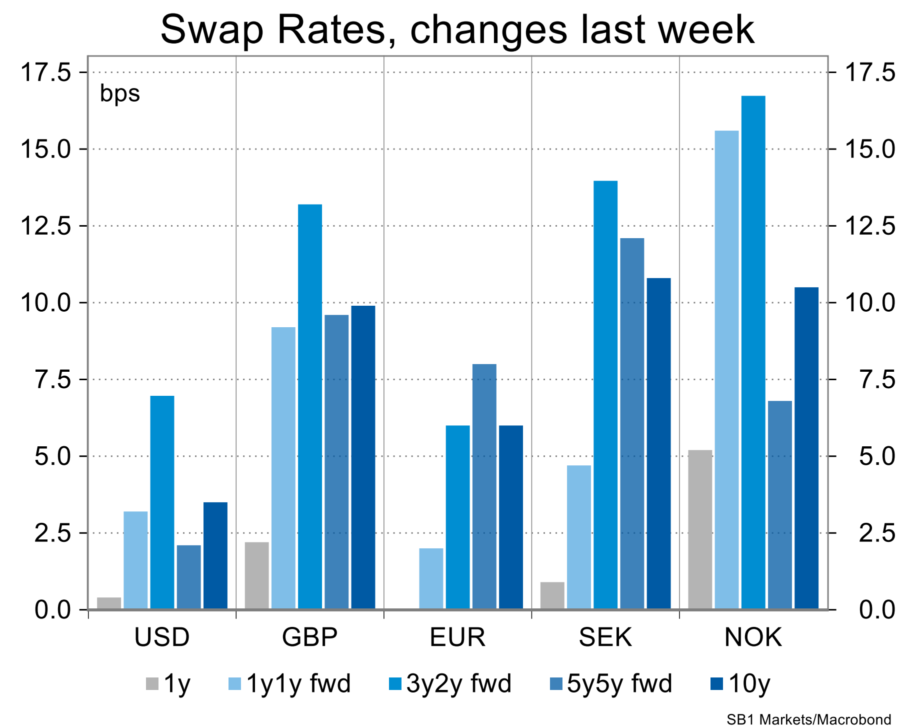




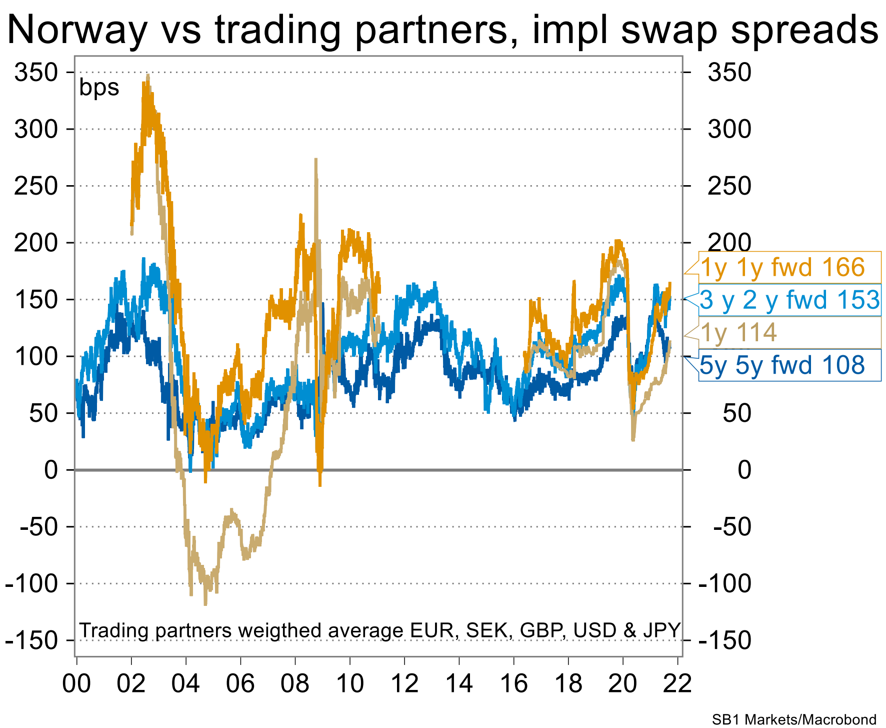
Rates up everywhere, and more in Norway than elsewhere, barring 5y 5y fwd

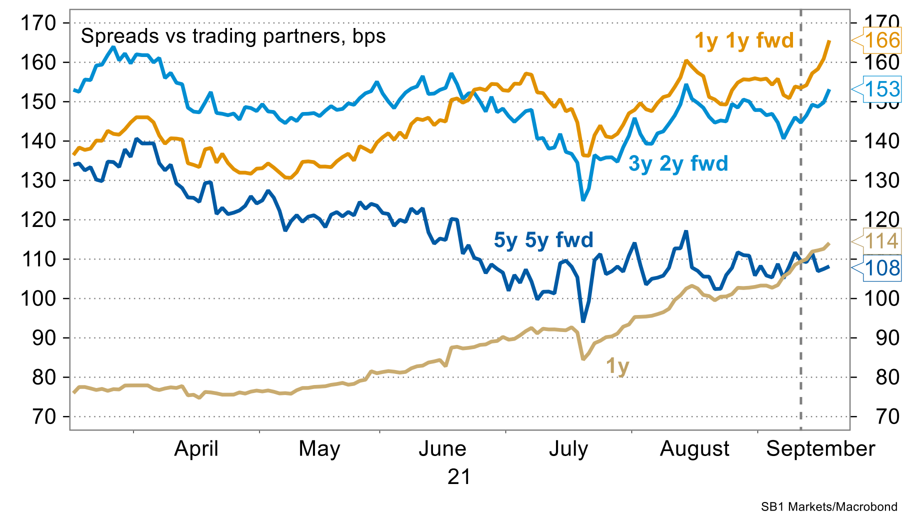
US rates the least up last week



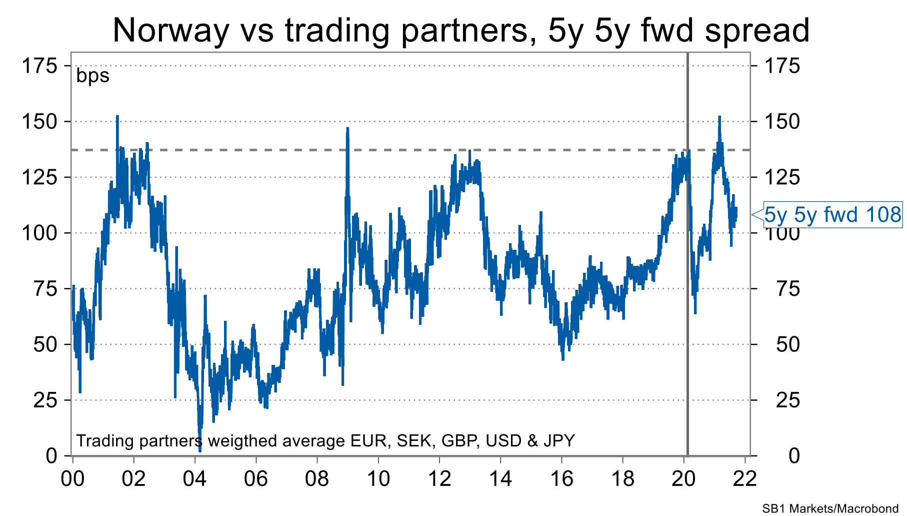


Forward spreads vs trading partners down on the mid curve, up in both ends

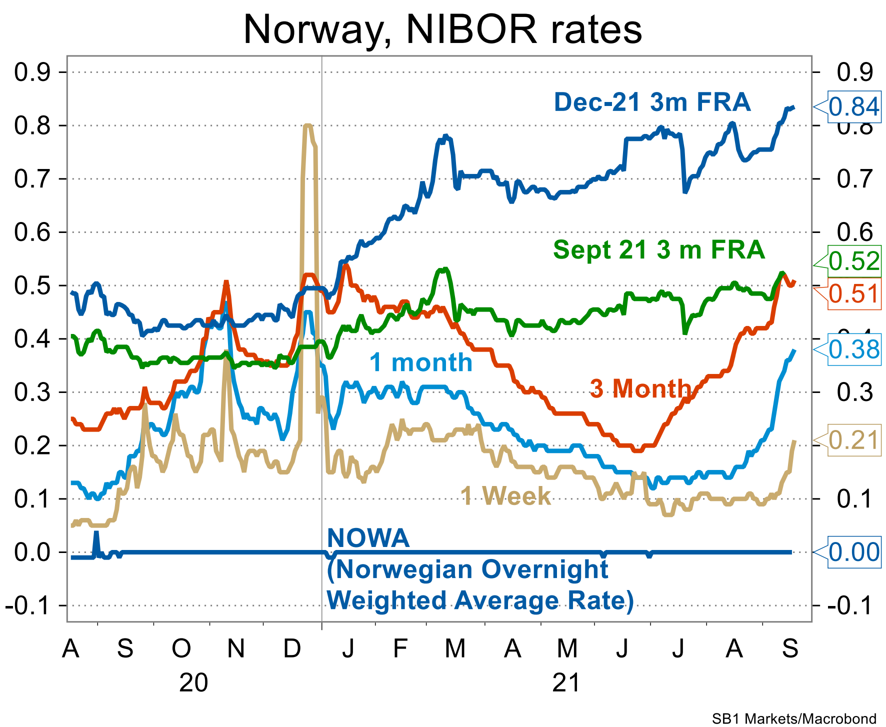


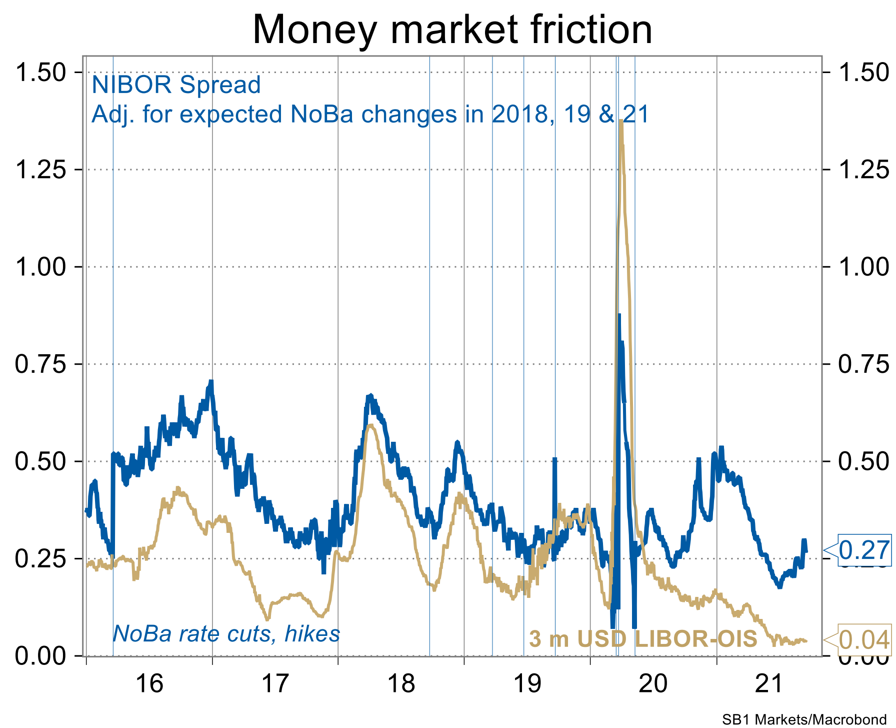


- The 5 y 5y fwd spread is still in the upper part of the historical range



3 m NIBOR 1 bp down to 0.51%, the NIBOR spread still 'OK' -3 bps to 27





- The **USD LIBOR OIS spread** is still low, even if the Fed has tried to mop up excess liquidity in the money market by heavy use of reversed repos

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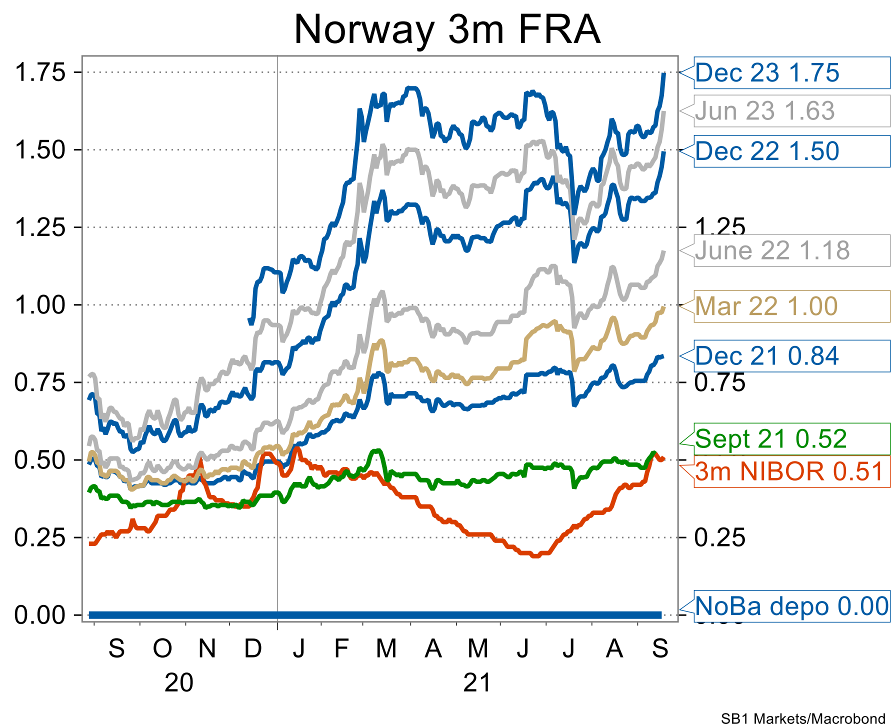
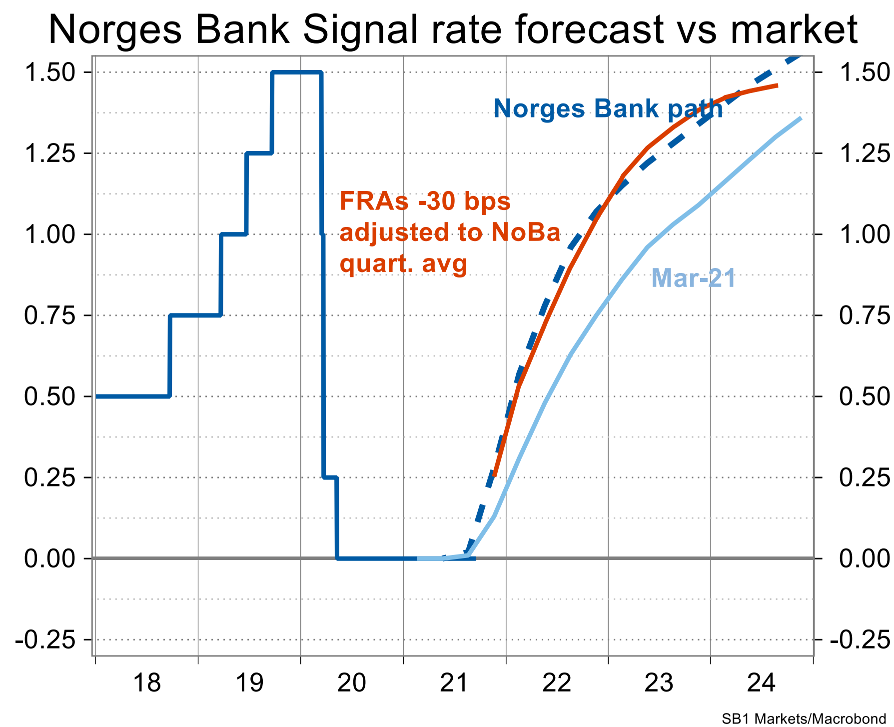
The FRA curve up 6 – 18 bps – to above the NoBa path (which will be lifted)

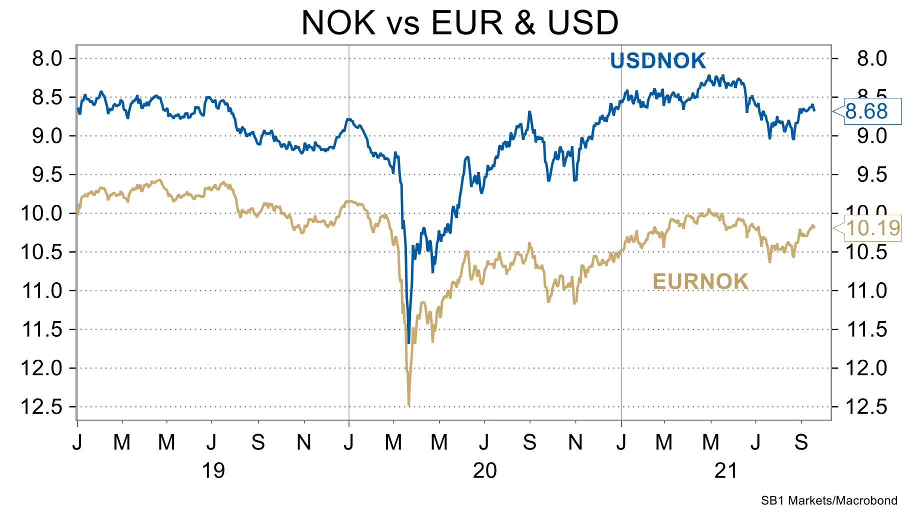
Without any strong Norwegian data, a substantial lift in the FRA-curve, new ‘post’-pandemic peaks



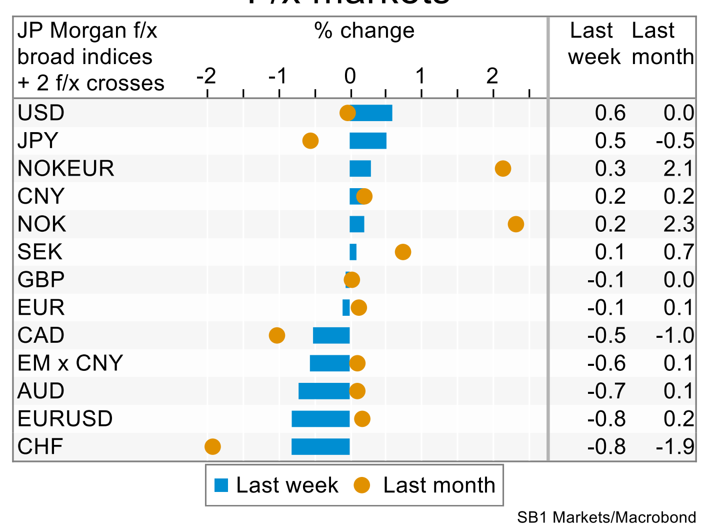


- A **NoBa hike next week** is fully discounted, even if the NIBOR spread is clearly widening as well
- The Dec-21 FRA at 0.83%, after deducting a Q4 liquidity premium at 7 bp, and assuming a 30 bps NIBOR spread, implies a 86% probability for a **2nd hike in December**
- The Mar-22 FRA at 1.00% implies 80% probability for a 3rd NoBa hike in March, given a 2nd hike in December (given a 30 bps spread), up from 56% one week ago!
- In 2023, the FRA-path is above Norges Bank June interest rate path. We expect the bank to lift its forecast 15 – 20 bps, so why not?

The USD is last week's winner, NOK up too. EUR & our super-cyclical peers down



F/x markets



JP Morgan f/x broad indices + 2 f/x crosses	Last week	Last month
USD	0.6	0.0
JPY	0.5	-0.5
NOKEUR	0.3	2.1
CNY	0.2	0.2
NOK	0.2	2.3
SEK	0.1	0.7
GBP	-0.1	0.0
EUR	-0.1	0.1
CAD	-0.5	-1.0
EM x CNY	-0.6	0.1
AUD	-0.7	0.1
EURUSD	-0.8	0.2
CHF	-0.8	-1.9

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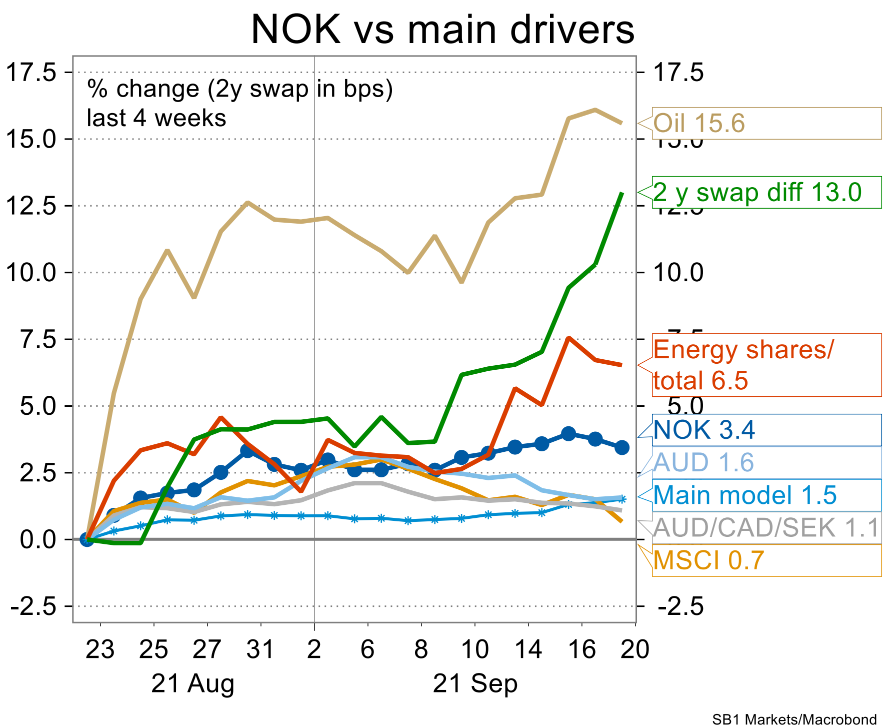
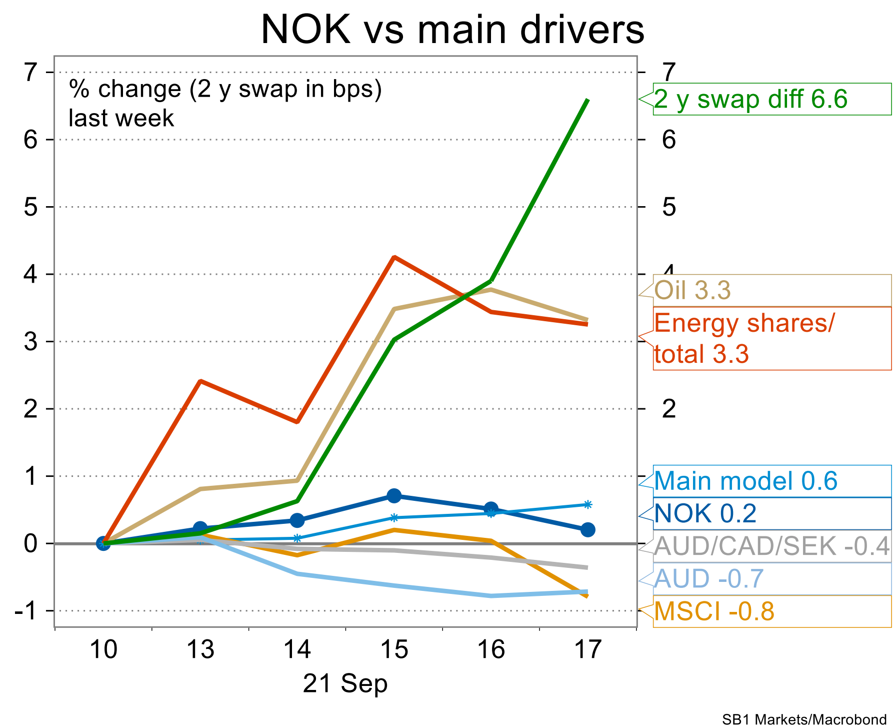
NOK up 0.2%, our model said +0.6% as the oil price, NOK rates rose

Our super-cyclical peers, and global equities fell last week





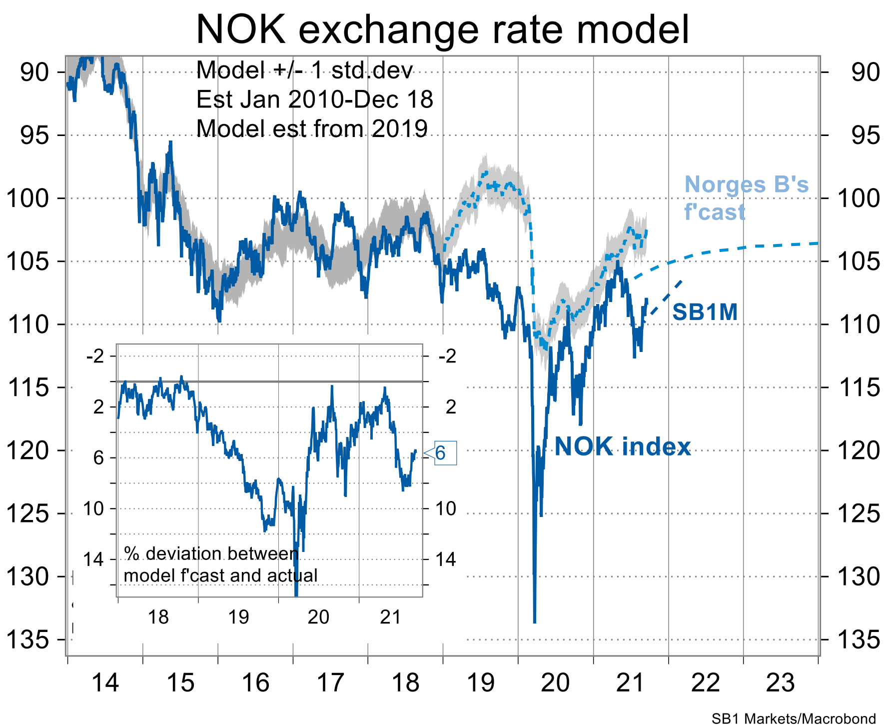
The status vs. the normal drivers:

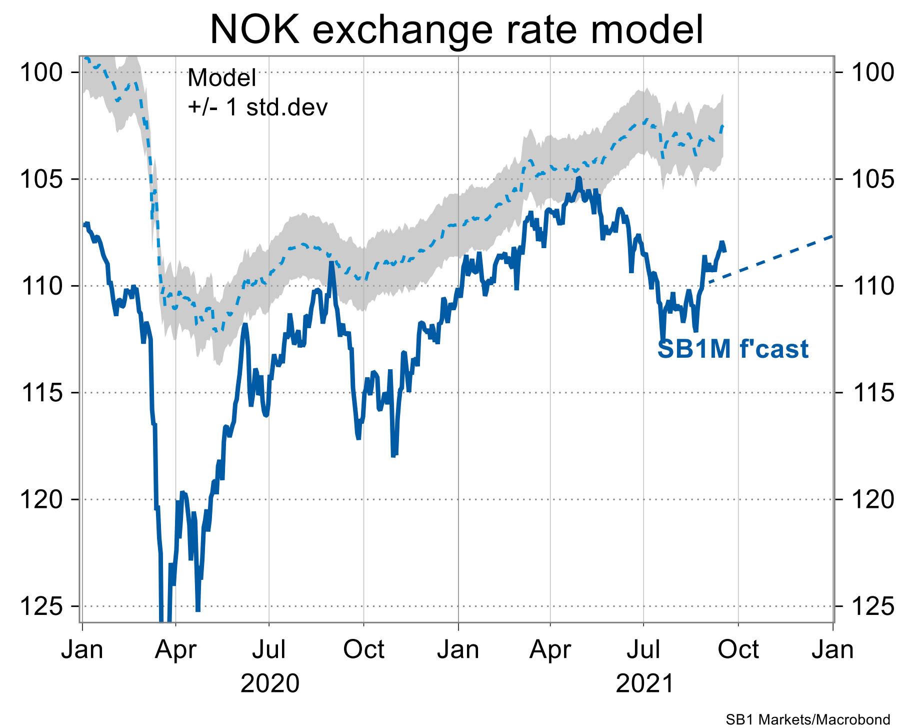
- ***The NOK is 6% weaker than suggested by our standard model (unch)***
- The NOK is 5% ‘weaker’ than the global stock market vs the correlation between the two since beg. of 2020 (from -6%)
- The NOK is 6% weaker than our AUD/CAD/SEK-model, our ‘super-cycle peers’, predicts (from -7%)
- NOK is far (10%) stronger than a model which includes global energy companies equity prices (vs the global stock market) (from +11)

For September, we repeated our NOK buy recommendation

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. There are no substantial difference between these two indices over time

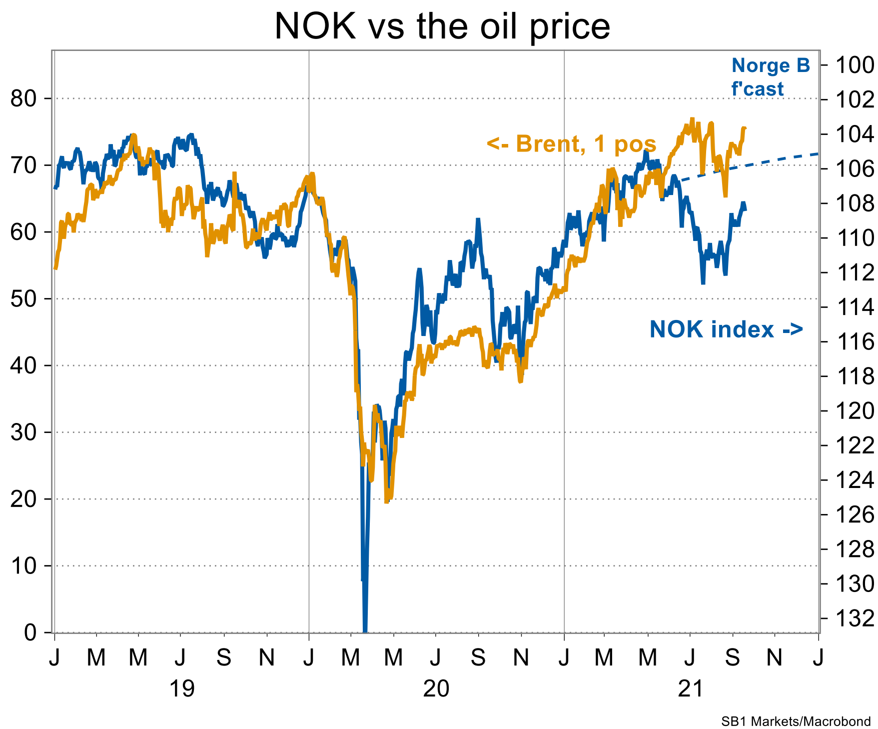
NOK still 6% below our workhorse model

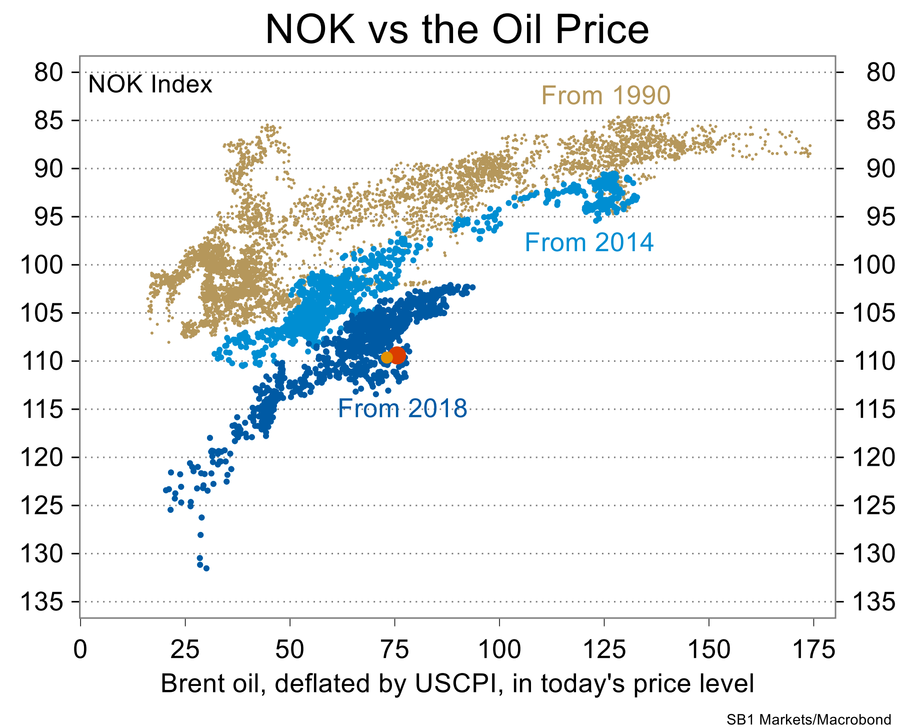




Oil up, NOK marginally up

The 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

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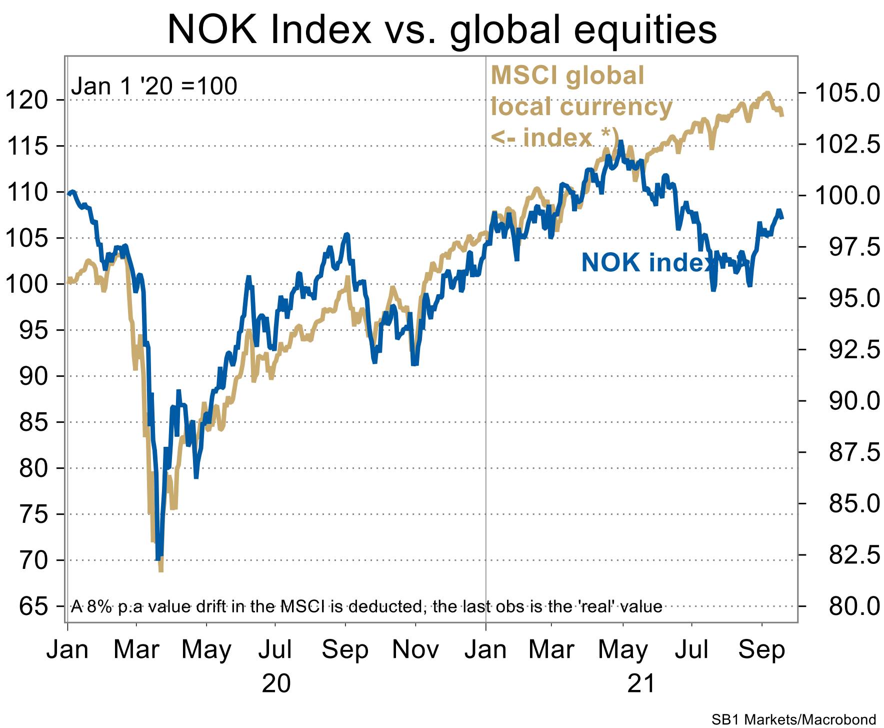
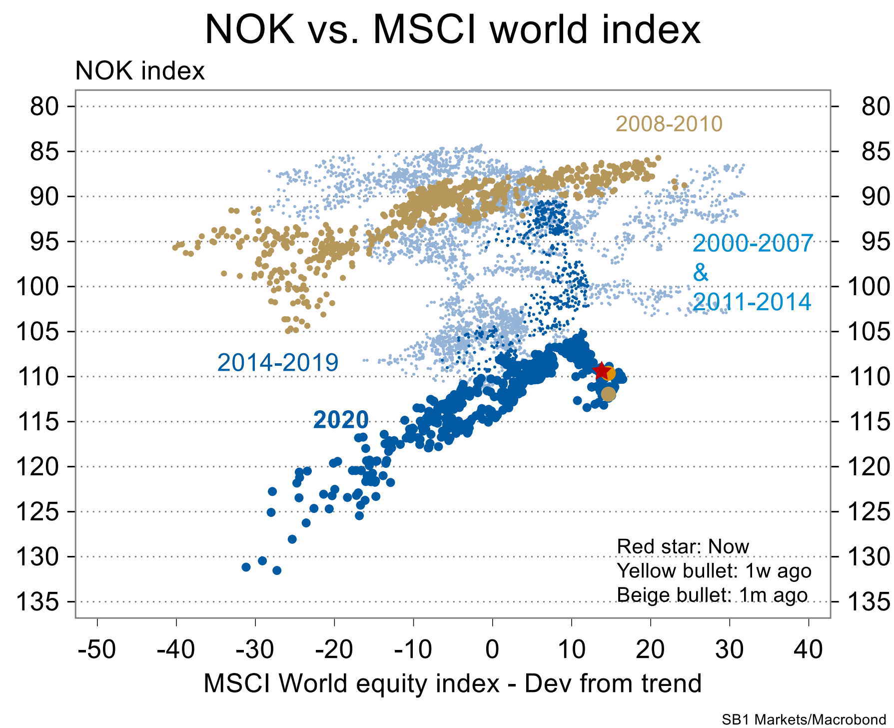
The global stock market further down, NOK still up last week!

However, the NOK has lost 5% vs. global stocks since May

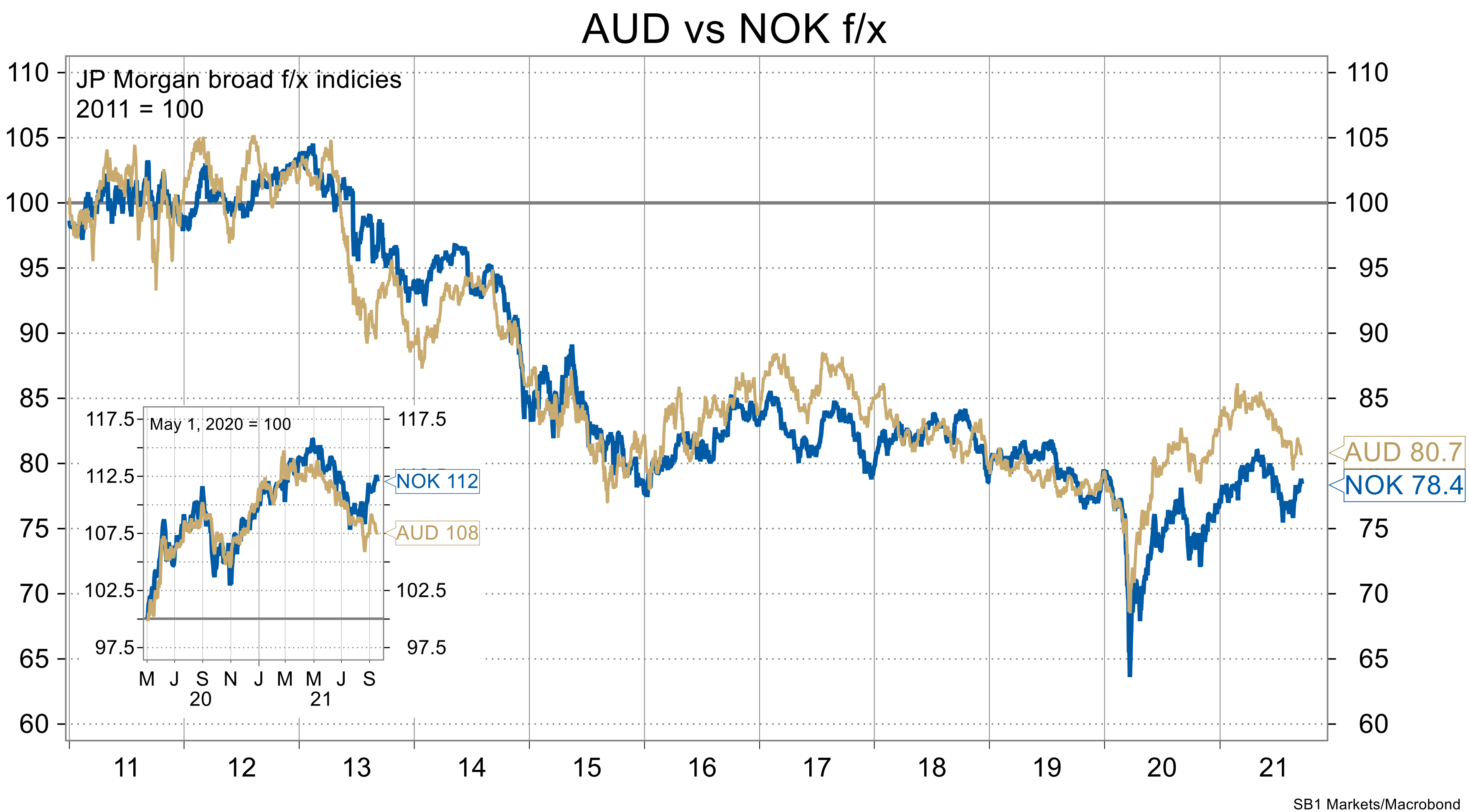




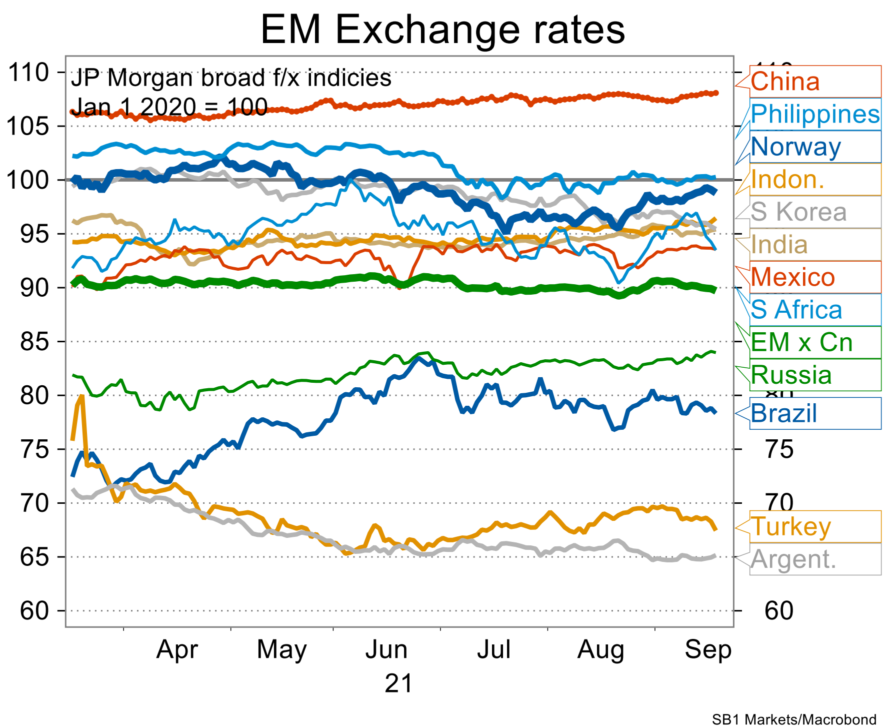
- Over time, there has not been any stable correlation between NOK and stock markets (the Oslo Stock Exchange, S&P 500 or the MSCI, the global equity index. (On the chart to the right, we have detrended the stock market as equities are drifting upwards, while NOK (hopefully) is stationary. However, the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

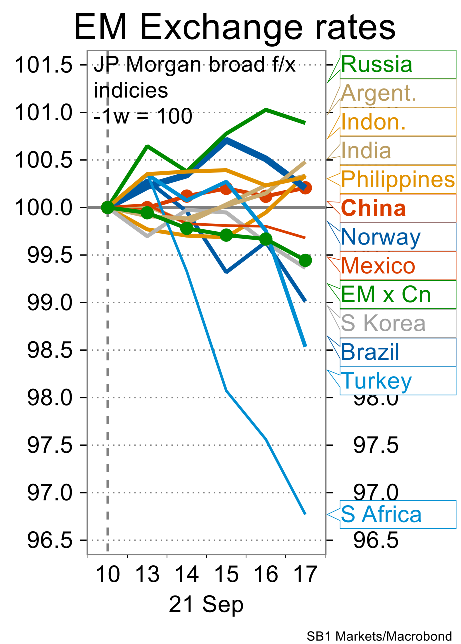
NOK is closing in on the AUD as iron ore prices collapse, gas prices surge

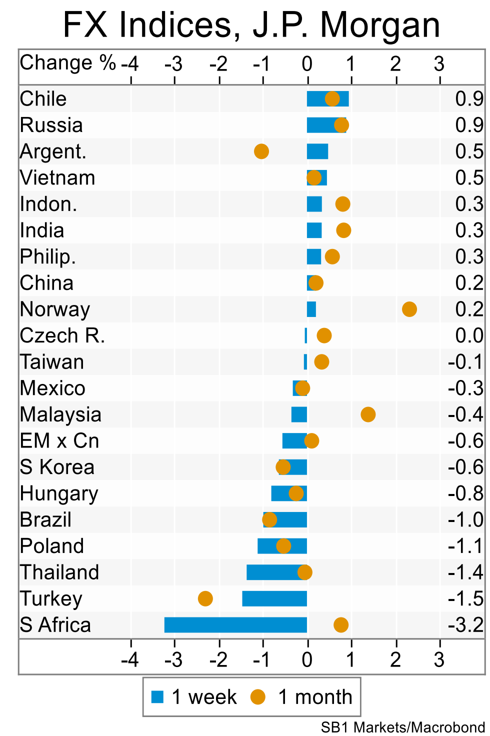
NOK still 2% vs the pre-pandemic 'parity' but the gap is reduced by 4% recent weeks!



EM x China further down, the CNY still on the way up







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