18 October 2021

Macro Weekly

Week 42/2021

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

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

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

Highlights

The world around us

The Norwegian economy

Market charts & comments

Last week

The (short) virus story

- The virus is on the retreat almost most places but more countries reported an increase past two weeks, including UK, France, Netherlands & Denmark. Still, the number of hospitalised patients are not increasing in these countries, and in sum the no. of hospitalised persons are falling rapidly in rich countries, in the US almost 50%, though from a high level 6 weeks ago
- In the West, mobility is back to normal (Europe) or on the way up (US), and it has recovered in most of Asia. Airline traffic did not rise further last week, but it is on the way up

The economy, part I

- **Global auto sales**
  - **Sales** fell 7% m/m in September. Chinese sales were down but far less than we assumed, and EMU sales rose marginally. Sales fell most places, in both the US, UK, Japan and most EMs. Sales are down 24% vs the 2019 level, no doubt due to lack of supply, not weak demand
  - However other sectors starts to feel the pain from the steep decline in auto production. Over the past months, that may have been rather convenient, what would have happened to raw materials, freight rates etc. if auto production had been, say 35% higher?
- **China**
  - **September/Q3: GDP, industrial production and investments** surprised at the downside. **Retail sales** were better than expected but trend is weak since last Nov (a 2% volume growth pace). Investments have almost flattened in nominal terms, and are falling in real terms. **Construction activity** is down 15% - 20%, so is **steel, cement and aluminium production**, and all fell further in September (but no meltdown). Both demand and supply problems to blame, we assume – but no. Exports are still very strong, while imports have slowed recent months, confirming a softening of domestic demand. Credit growth has slowed further but not faster. CPI inflation is muted

Last week: The economy, part II

- **USA**
  - Atlanta Fed reported another hike in **median wages,** the annual rate rose to 4.2% in Sept from 3.9% in Aug (and 3% in May), to 1 pp above the past 10 y average, which yielded a 2% pace of inflation. The acceleration is not surprising given the unprecedented level of **unfilled vacancies**, which though fell somewhat in August, to 6.6% from 7.0% (revised up from 6.9%). The SMB survey reported the previous week that an almost unprecedented share of the **companies plans to lift wages** the coming months (just Q4-79 above). In addition, they complain more than ever both about **cost & quality of labour**. At the same time fewer SMBs than ever say that **lack of sales** is their single most problem. Then it is perhaps not that surprising that more SMBs than ever reported they **plan to increase their selling prices** further the coming months. These wage & survey data does not signal that lack of demand is the main challenge facing the US economy now. The problem however, is that the Fed still behaves as though it is
  - **CPI inflation** remains at the high side, also measured m/m. However, some reopening price shock have flattened/reversed somewhat. The problem is that price inflation is clearly broadening. In Aug/Sept the Delta outbreak may also have dampened some prices temporarily, like leisure/hospitality & transport (airline tickets). An important risk now is **housing rents**, our model predicts a substantial lift the coming quarters. The best price news last week: A downward trend in **ex food/energy crude material prices** was confirmed in the **PPI report** – which normally signals less price pressure further up in the chains after some months
  - **CEO optimism** fell in Q3, but is still at a very high level, which signals no risk for the real economy nor the stock market. But could this time be different even for the best and brightest, as we exit the corona pause, and heads straight into something that looks like a mature cycle, which we have never have experience anytime before?
  - **Retail sales** once more surprised at the upside, up 0.5% (core goods volume, our est), following the 1.9% hike in August. Still, the trend is at best flat, and we are SURE that demand for goods will decline substantially the coming quarters as sale volume is up 19% vs Feb-20)
  - **Consumer sentiment** is the 2nd worst in a decade (just April-20 below), insists Univ. of Michigan, for the 3rd month in row. Strange, given the economy, and the gradual victory over the virus
- **EMU**
  - Manufacturing production fell 1.6% in August, as expected, still down 2.6% vs. Feb-20. Germany contributed most on the downside – and production is 10% down vs. Feb-20, due to a 60% decline in auto production (that is, in September)
- **Norway**
  - The outgoing centre/right government proposed to reduce the transfer from the Oil fund (= the structural budget deficit ex. oil revenues & cash returns in the Oil fund) to 9.5% of GDP in 2022, down from 12.3% in 2021. The transfer equals 2.6% of the assumed value of the Fund, less than the 3% long term budget rule. The economy is expected to recover further into 2022, and the output gap will be positive, as Norges Bank also assumes
  - **The new centre/left government** does not signal less respect for the spending rule but will lower taxes for those with income below NOK 0.75 mill, and increase taxes for those above, and the tighten up, and increase the wealth tax
  - **The trade surplus** was record high in September, equalling 16% of GDP, due to the surge in gas exports. October will be even better
  - **Headline CPI** inflation surged to 4.1% in September from 3.4%, due to the hike in electricity prices. Core inflation accelerated to 1.2% from 1.0%, in line with NoBa's f'cast

The Calendar: October PMIs, US housing, Beige Book. Norwegian manuf. surv

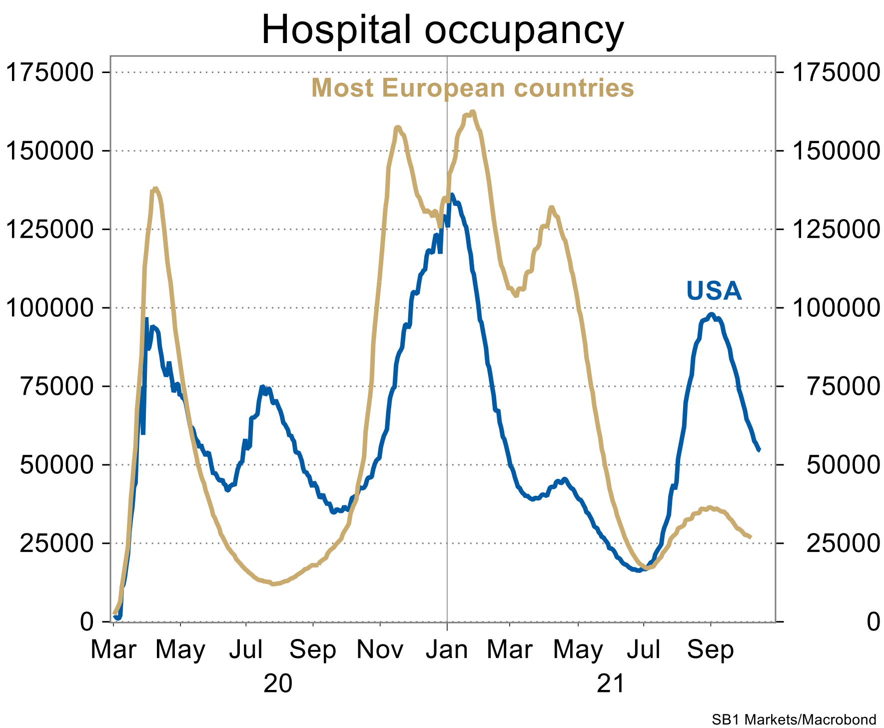
Time	Count.	Indicator	Period	Forecast	Prior
Monday Oct 18					
08:00	NO	Housing starts	Sep		
15:15	**US**	**Manufacturing (SIC) Production**	**Sep**	**0.2%**	**0.2%**
16:00	US	NAHB Housing Market Index	Oct	76.5%	76.4%
Tuesday Oct 19					
14:30	**US**	**Building Permits**	**Sep**	**1675k**	**1728k**
14:30	US	Housing Starts	Sep	1610k	1615k
Wednesday Oct 20					
03:30	**CH**	**New Home Prices MoM**	**Sep**		**0.2%**
08:00	UK	CPI YoY	Sep	3.2%	3.2%
08:00	UK	CPI Core YoY	Sep	3.0%	3.1%
11:00	EC	CPI YoY	Sep F	3.4%	3.0%
11:00	**EC**	**CPI Core YoY**	**Sep F**	**1.9%**	**1.9%**
20:00	US	Fed's Beige Book			
Thursday Oct 21					
06:00	SW	Home prices, HOX			
09:30	SW	Unemployment Rate SA	Sep	8.8%	8.8%
10:00	**NO**	**Lending survey, Norges Bank**	**Q3**		
12:00	UK	CBI Business Optimism	Oct	20	27
14:30	US	Initial Jobless Claims	Oct-16	302k	293k
14:30	US	Philadelphia Fed Business	Oct	24.5	30.7
16:00	US	Leading Index	Sep	0.5%	0.9%
16:00	US	Existing Home Sales	Sep	6.00m	5.88m
16:00	EC	Consumer Confidence	Oct A	-5	-4
Friday Oct 22					
02:30	JN	Manufacturing PMI	Oct P		51.5
02:30	JN	Services PMI	Oct P		47.8
08:00	**NO**	**Industrial Confidence**	**3Q**	**(12)**	**11.3**
08:00	UK	Retail Sales Inc Auto Fuel MoM	Sep	0.50%	-0.90%
09:15	FR	Manufacturing PMI	Oct P	54	55
09:15	FR	Services PMI	Oct P	55.6	56.2
09:30	GE	Manufacturing PMI	Oct P	56.6	58.4
09:30	GE	Services PMI	Oct P	55.3	56.2
10:00	**EC**	**Manufacturing PMI**	**Oct P**	**57**	**58.6**
10:00	**EC**	**Services PMI**	**Oct P**	**55.5**	**56.4**
10:00	**EC**	**Composite PMI**	**Oct P**	**55.2**	**56.2**
10:30	UK	Manufacturing PMI	Oct P	56	57.1
10:30	UK	Services PMI	Oct P	54.5	55.4
15:45	**US**	**Manufacturing PMI**	**Oct P**	**60.5**	**60.7**
15:45	**US**	**Services PMI**	**Oct P**	**55.1**	**54.9**
During the week					
	US	Monthly Budget Statement	Sep	-$180.0b	-$124.6b

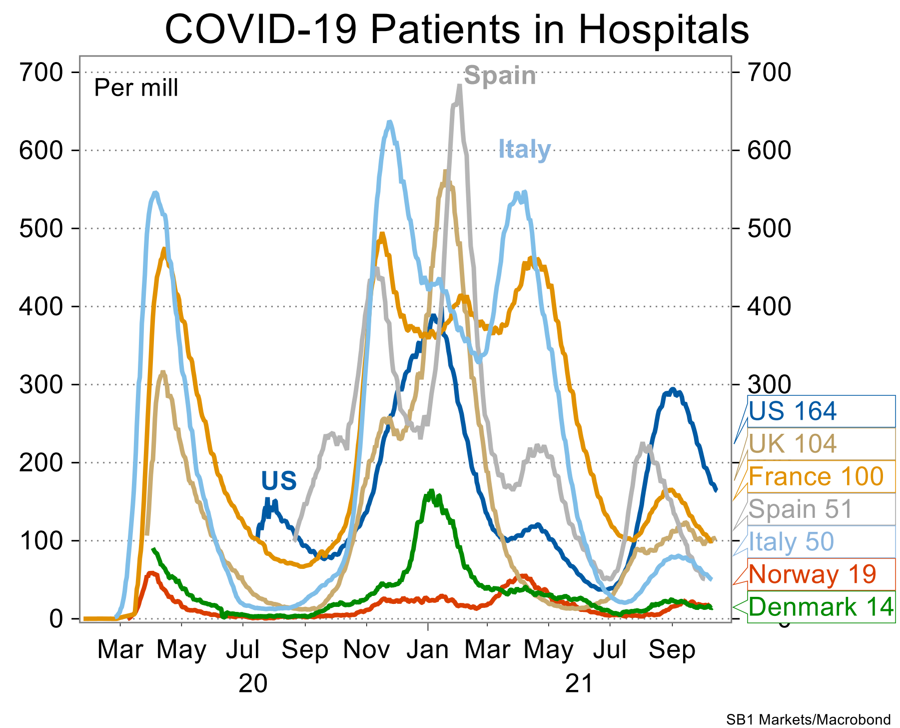
Sources: Bloomberg. SB1M est. in brackets. Key data are highlighted, **the most important in bold**

- **Preliminary October PMIs**
  - » Several DM countries report their PMIs at Friday (and not China). Europe is expected marginally down, US marginally up. The levels are still satisfactory, but down from the recent ATH peaks. The ongoing supply side challenges will at one stage have demand implications (like auto workers are (temporary) laid off, will cut back on spending), and other indirect impacts. However both delivery times & prices indices have not climbed further recent months
- **China**
  - » Most Sept data out already but **house prices** are of some interest these days
- **USA**
  - » **The housing market** is going strong, even in housing starts and existing home sales have retreated from high levels earlier in 2021. Lack of materials, workers – and existing homes for sale probably explain the decline but some buyers are aware of the very high price level too
  - » **Manufacturing production** has not been strong during the pandemic, even if demand for goods in the USA has been strong. Now lack of supplies is dampening activity even if but PMI/ISM surveys are still signalling rapid growth
  - » Check out **Fed's Beige book** (the regional network): Even more reports on material/labour shortages, wage pressures? We guess the FOMC members read the same text…
- **EMU**
  - » **Core CPI inflation** is expected unch at 1.9% y/y - below the inflation target. Producer prices hints an upside risk but wage inflation is still modest in the region – even if more aggressive wage claims are on the table
- **Norway**
  - » SSB's quarterly **manufacturing confidence survey** yields precise information on the activity in the sector (including the profit outlook). Signs of capacity constraints will be in focus
  - » **Norges Bank's lending survey** has been 'boring' recently, and we do not expect that banks will signal huge changes in demand or credit standards

New cases down almost most places, no. of hospitalisations is falling rapidly

The fight against the virus is won in the rich part of the world

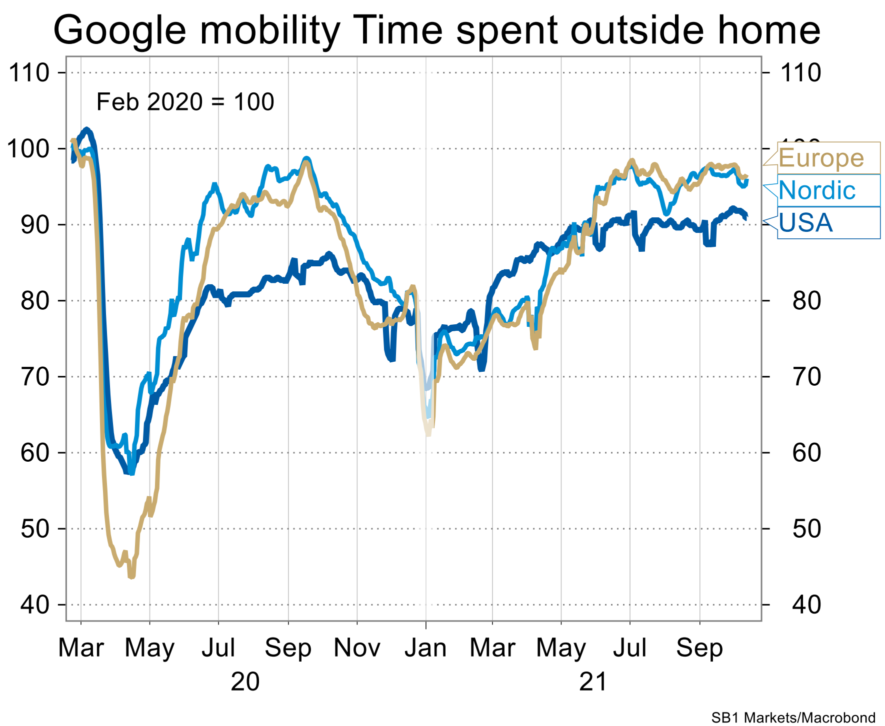


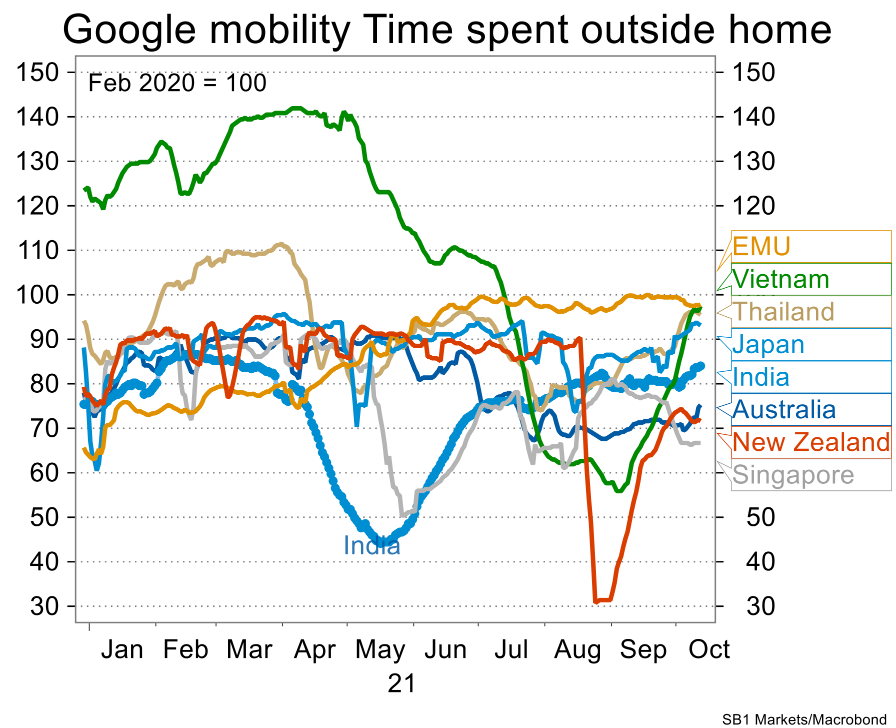


- The only risk now: A new vaccine resistant virus mutation

US mobility is recovering, Europe remains at a high level

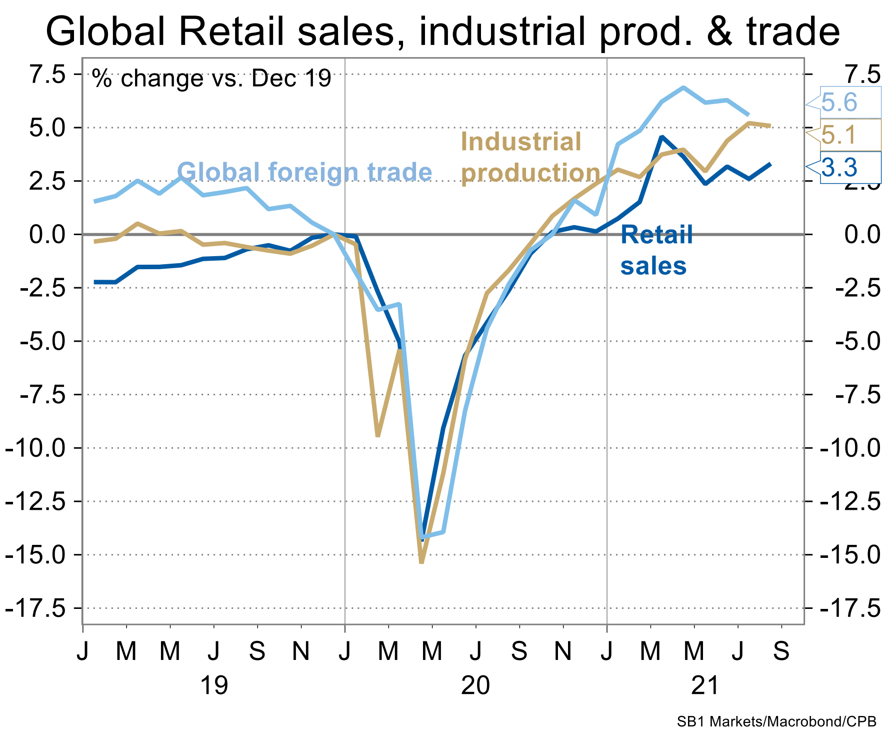
Asia on the way up too, and some countries are back at pre-Delta levels

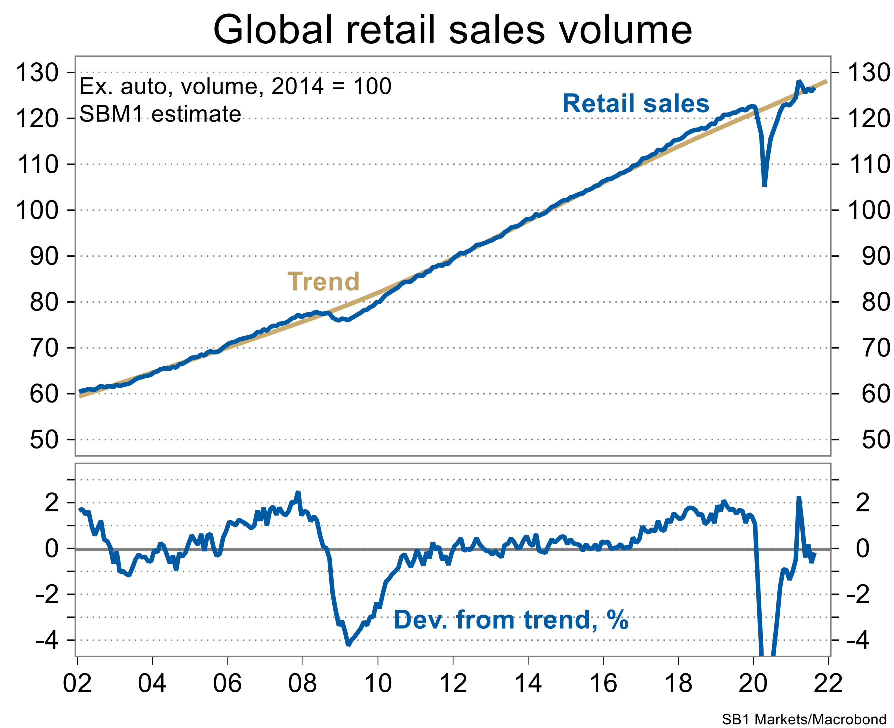




Global retail sales have flatted, global trade is declining

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



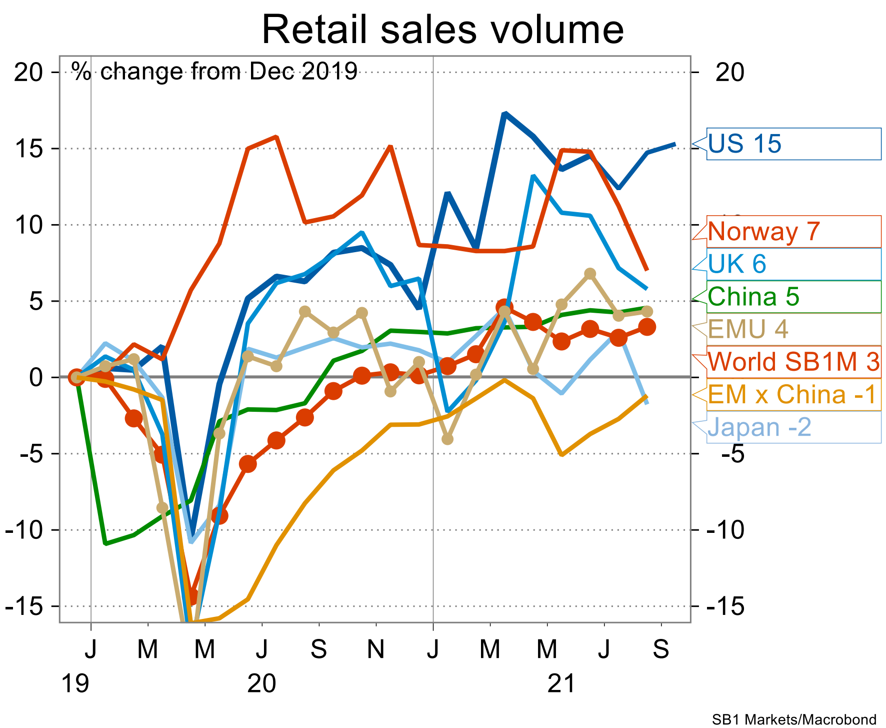


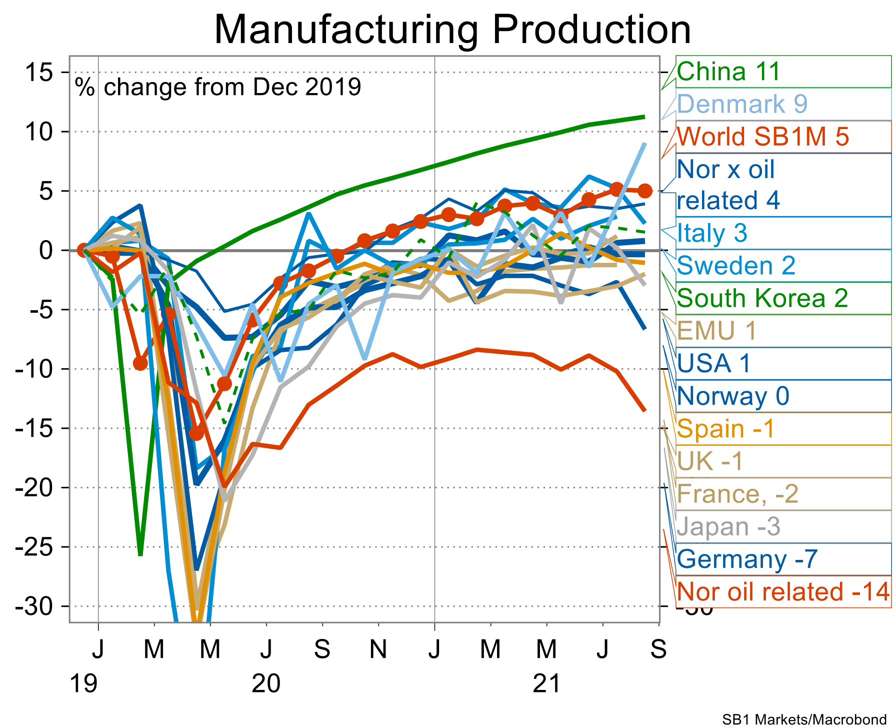
- **Retail sales** rose in August but has flattened since early spring as demand is on the way down in several DMs and EM is still fighting with the virus. The level is approx. 3½ % up vs the pre-pandemic level
- **Manufacturing production** stagnated in August. The level is some 5% above the pre-pandemic level
- **Global foreign trade** peaked in May and has fallen slightly thereafter. The level is still well above the pre-pandemic level

SpareBank 1 MARKETS

DM demand for consumer goods have peaked, EMs are recovering from a low lev.

The upside potential is large for Emerging Markets



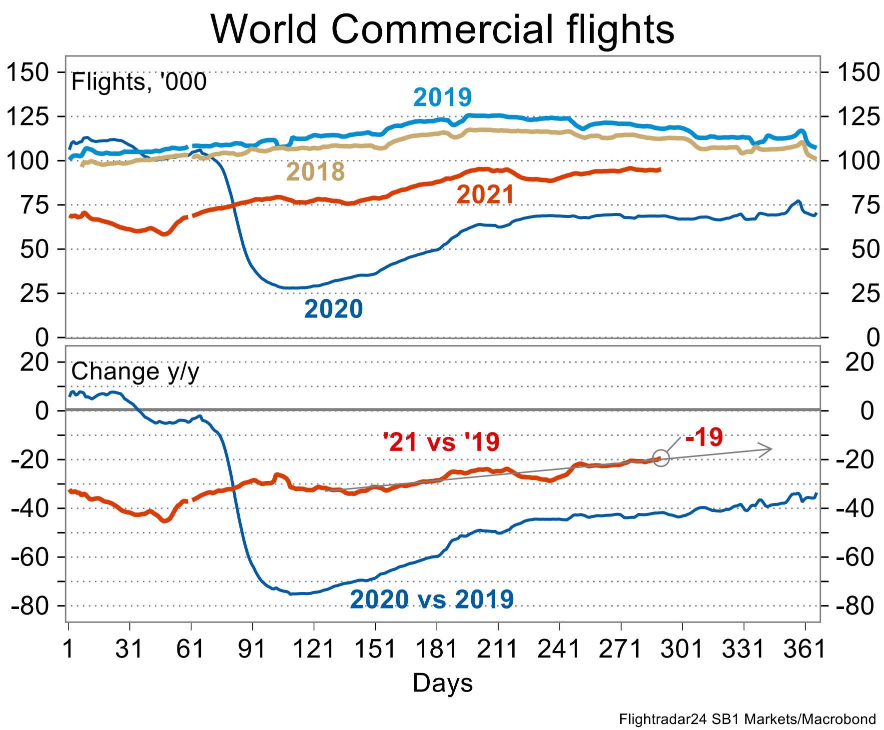


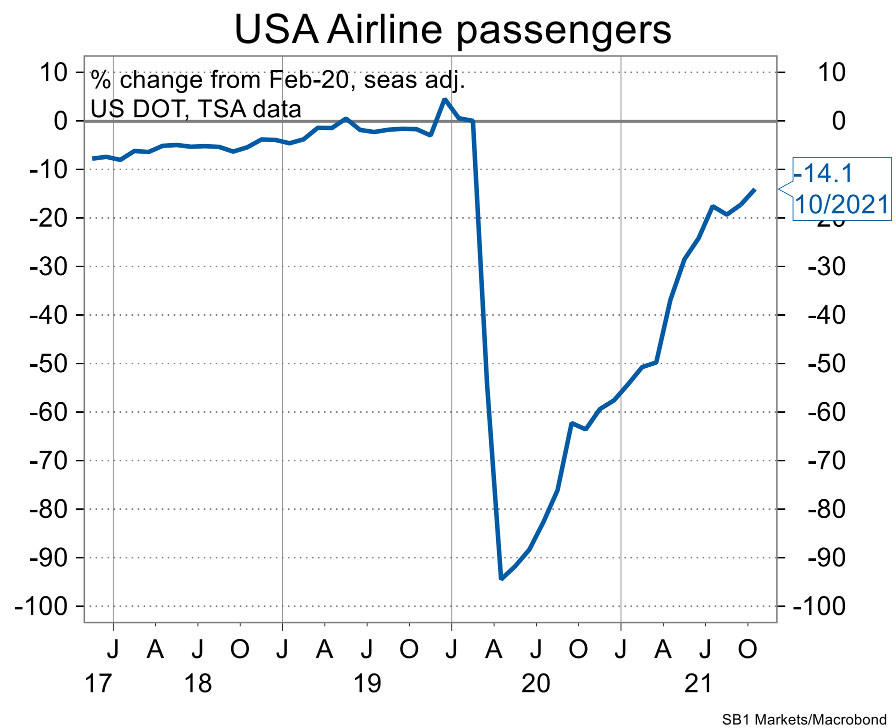
- **Retail sales** in Emerging Markets x China were weak before the summer due to the setback in demand in India, and thereafter in other parts of Asia. Now a substantial recovery is underway in India, and other Asian countries will follow suit
- **Manufacturing production** is still drifting upwards, most places. The manufacturing PMIs are still strong
- **Norwegian oil-related** manufacturing production is down 14% vs the pre-pandemic level – non-oil sectors are up 4%, one of the better results in the rich part of the world. The Norwegian PMI and other surveys are signalling strong growth (among the best in the world)

SpareBank 1 MARKETS

Global airline traffic stagnated last week, the gap to 2019 down to 19% (from 21)

In the US, traffic fell slightly in August but is now slowly recovering again – and its just down 14%!

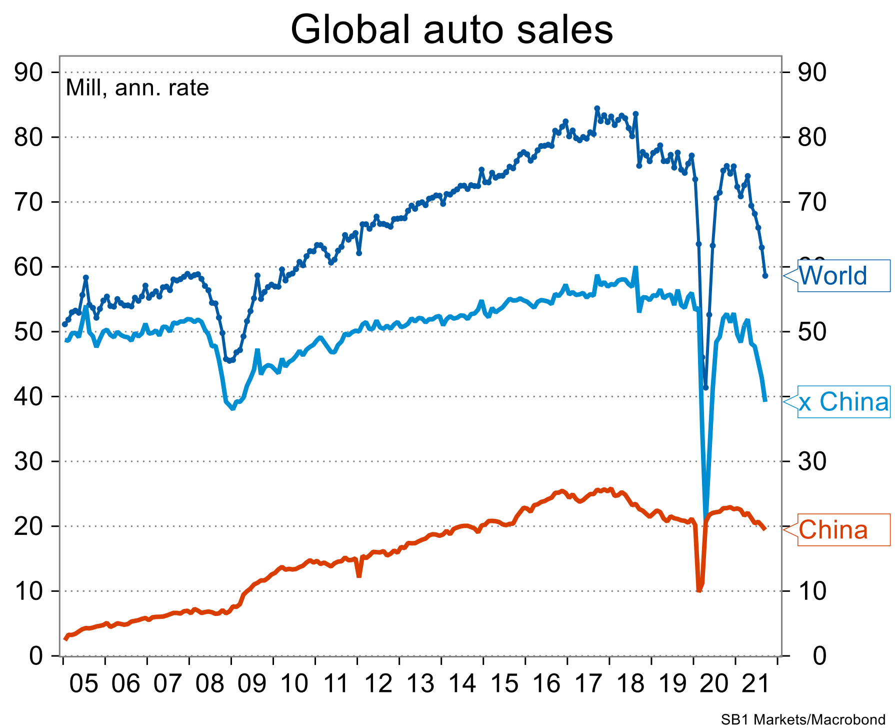


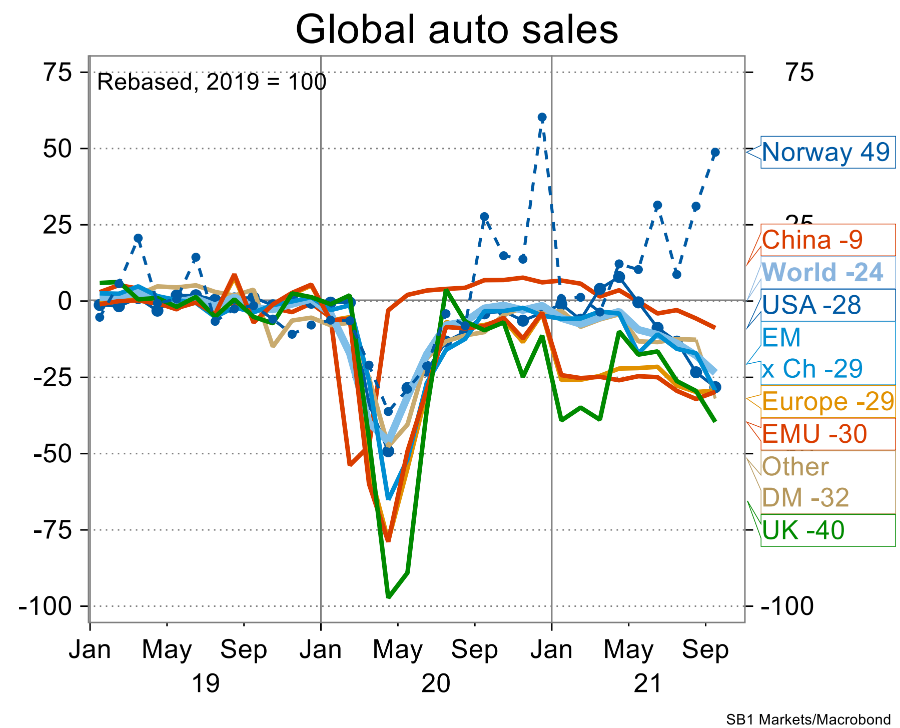


- Airline traffic normally drops some 10% from the peak summer season until the end of the year. Thus, a flattish development during this autumn implies a 1.7% ‘recovery’ per month – now the gap is declining by at least 1 pp per week
- Norwegian passenger traffic rose sharply in September, but is still down; Domestic traffic by 29%, international by 70%. October will probably be far better

Auto sales ‘confirmed’ down in September, the data chip shortage is serious

Sales fell by 7% (we estimated 8%) m/m, sales are down 24% vs. the 2019 average

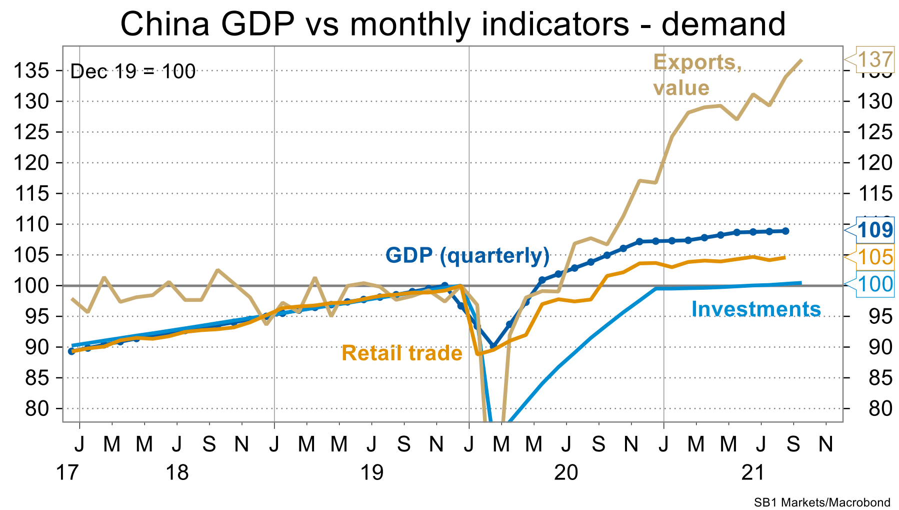


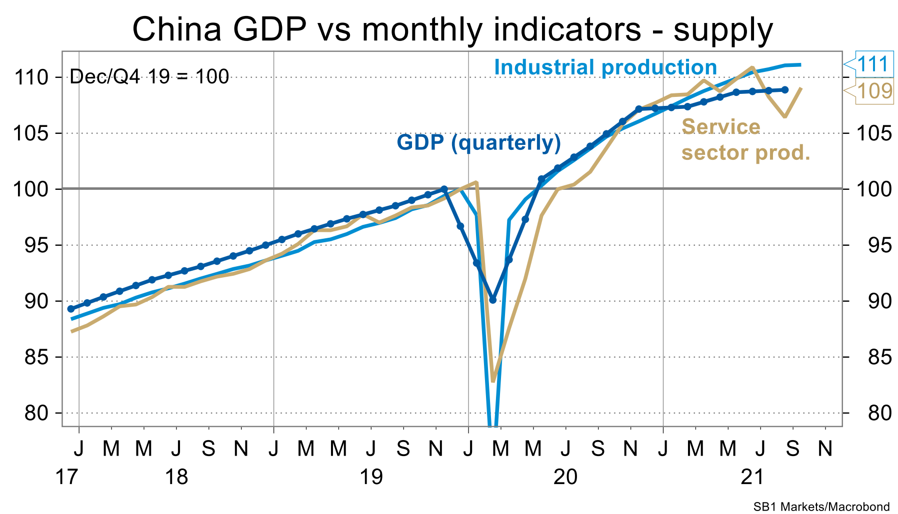


- Sales in China were significantly better than we assumed, down ‘just’ 3% - and are down 9% vs. 2019. Sales in India decreased even more than we assumed
- Sales fell sharply in **US** and the **UK**. **EMU** sales rose marginally, we assumed a further decline in **Europe**. Japanese sales fell sharply in Sept. UK sales are down 40%, EMU -30%, US -28% - all vs 2019
- Sales in **EM x China** fell further too – and are down 29% vs. 2019 – with almost countries on the downside in Aug/Sept
- **Norwegian** sales are soaring, because the margins are much better here than elsewhere??

September, Q3 weaker than expected. Corona only partly to blame

However exports, retail sales surprised at the upside in Sept, and services recovered ½ of July/Aug loss



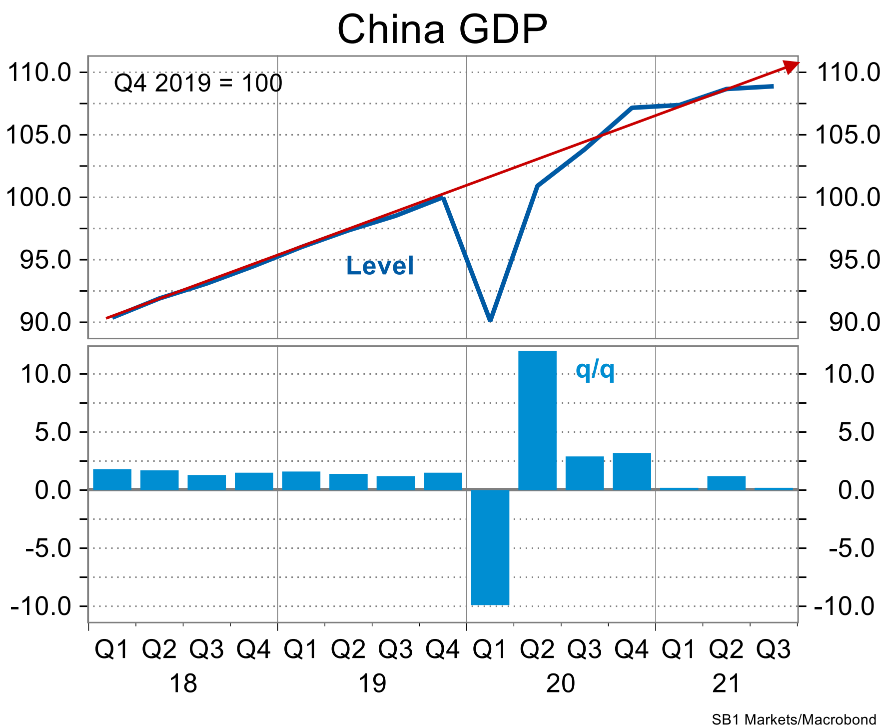


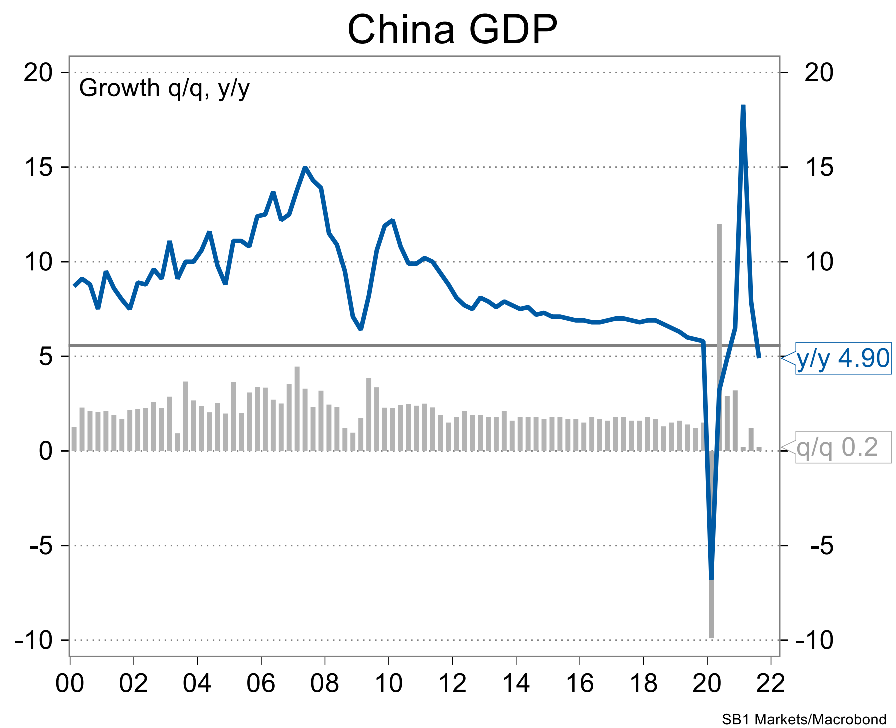
- **GDP** rose by 0.2% Q3 (0.8% annualised) down from 1.2% in Q2, expected 0.2%. The annual growth rate fell to 4.9% from 7.9%, expected 5.0% The GDP level to below the pre-pandemic trend path as growth from Q4-19 has been below 5% in average
- **Industrial production** rose by just 0.1% in Sept, down from 0.3%, the lowest growth rate since the setback in Jan/Feb last year. Measured y/y, growth slowed 2.2 pp to 3.1%, 0.7 pp below expectations Production is still 2% above the pre-corona trend path but growth has slowed. Steel, cement, aluminium and autos are down 10 – 20% from local peaks, due to a mix of demand and supply factors. Surveys are down but are signalling growth well north of the 0.1 per month rate (rather 0.4 m/m, 5% y/y)
- **Service sector production recovered** by 2.5% in Sept, following the 4.1% July/Aug drop – which no doubt was driven by the fight against the virus, and as the PMIs strongly signalled, Sept was far better. Still, the level is still below par, and well below the pre-pandemic trend growth path. Activity will probably recover further in October
- **Retail sales volumes rose by** 0.6% in volume terms (our est.) in Sept, the best since Feb. However, the trend is weak, from Nov last year at a 2% path, at the best. Annual growth accelerated to 4.4% from 2.5% in August, above the expected 3.4%. Auto sales are slowing, as elsewhere, but other sectors have also slowed in 2021
- **Investments** grew by 0.2% in Sept, as in August. The history was once more revised down, and nominal urban fixed investments are barely growing anymore! Prices are no doubt increasing – and in volume terms, investments are falling. The (still useless) accumulated annual growth rate was 7.3% in Sept, down from 8.9%, 0.6 pp below expectations. Housing and other construction starts as well as new home sales fell further – but not faster in September, and are down 15% – 20 % vs recent peaks.
- **Credit growth** is slowed further too, and the credit impulse is negative, as normal approx. every 4th year
- **Exports** rose sharply Sept, while import fell further, the latter signalling weaker domestic demand (as the Chinese data confirms). Export volume are 16% above the pre-pandemic growth path (and 30% above the p-p level. Imports are on par with the p-p trend path
- CPI inflation is still very low, 0.7% in total, the core at 1.2%

In sum: China is no doubt slowing, but some of the July/Aug (virus related) weakness in services was reversed, and exports are strong. The main risk: construction activity which has fallen 15 – 20% already

Q3 GDP up just 0.2% q/q, exp. 0.4%. Level below the pre-pandemic trend

Annual growth down to 4.9% form 7.9% in Q2, expected 5.0%

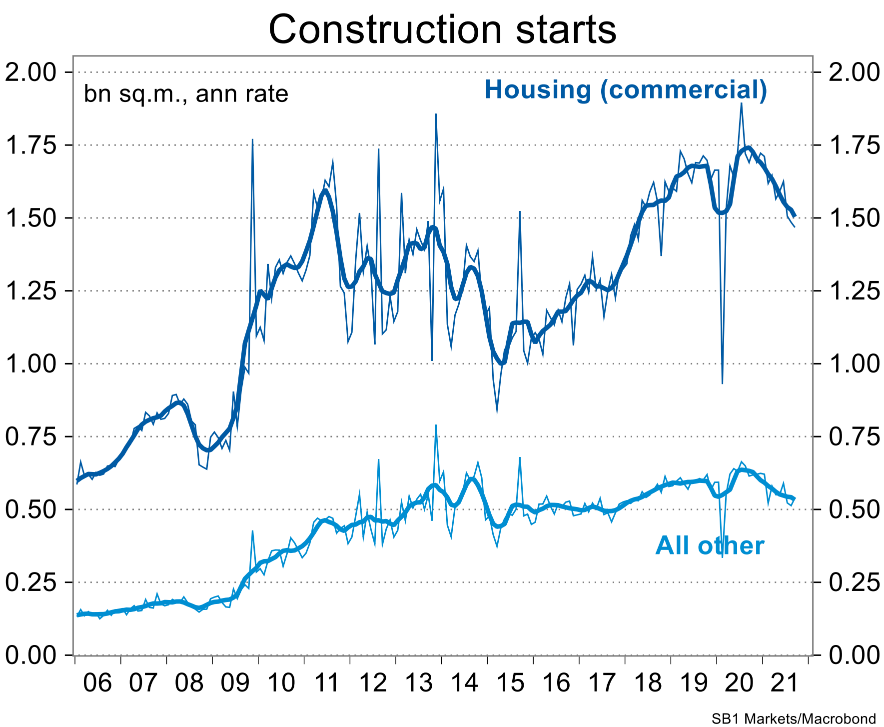


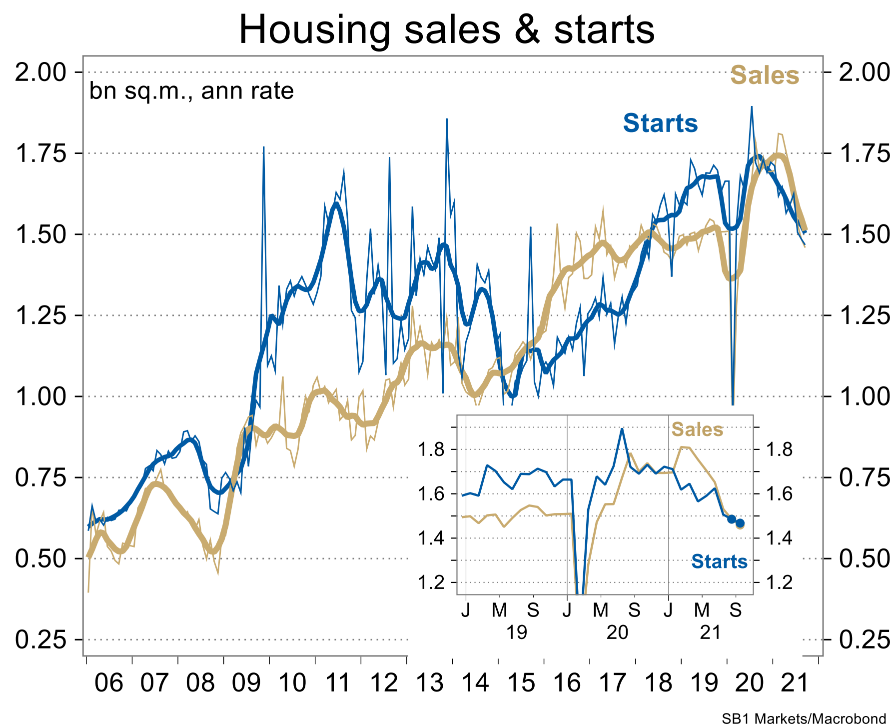


- A 0.2% q/q rate equals a 0.8% annualised growth pace, down from the 1.2% (5.3%) pace in Q2. Q1 was revised down by 0.2 pp once more to 0.2%, initially reported to +0.6%. Growth reached the pre-pandemic growth path in Q4-20 but as growth has slowed to a trickle 2 of the past 3 quarters, activity was below the old trend path in Q3
  - » The 4.9% annual rate was marginally below expectations
- The annual GDP growth rate was sliding down before corona, to 6% in Q4-19. If the gradual decline in growth had continued – and corona had not happened – the annual growth rate would have been below 5.5% by now. The actual annual rate since Q4-19 at 4.9% is slightly <u>below</u> the pre-corona trend, measured that way too. <u>However, corona was no doubt to blame for the weakness in Q3, witnessing the abrupt slowdown in services</u>

Construction activity further down in September but no acceleration

Both new home sales & starts down 1-2%, sales down 18% from Feb/March, starts down 15% from Q4

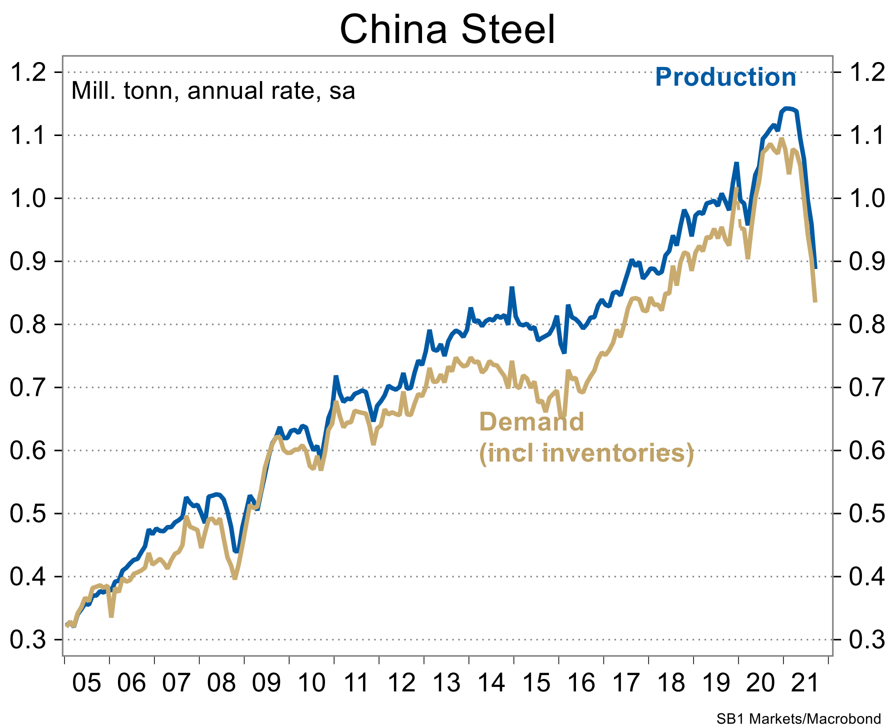




- **New home sales** have fallen almost 20% from early 2021, following the spectacular 30% increase from the low in early 2020. Sales are back to the pre-pandemic level – so no disaster, at least not yet – and sales fell 'just' 2% m/m in September
- **Housing starts** fell further too, and starts are now more than 10% below the pre-pandemic level. Starts have been running below sales most of 2021, signalling an inventory drawdown
- **Non-residential construction** rose a tad in September, but is down more than 15% since last summer, and the level is below the pre-p level. However, the decline is not accelerating
- **In sum, construction starts** are on the way down – and the downside risk has of course increased due to the 'financial stress' in the real estate sector. Look up for demand (or supply??) for steel, *check next page. Luckily, starts have already fallen substantially*

Construction & domestic demand for steel down, steel now -20%

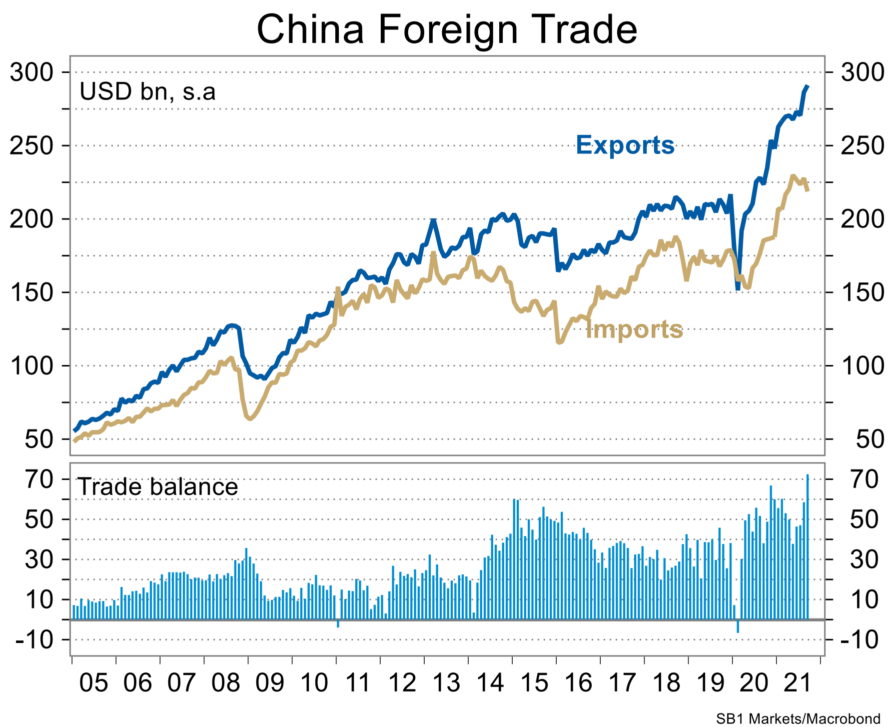
The reason may partly be the 'official' story on meeting 2030 CO2 targets but demand is down for real too?



- 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)

Exports are still surging, imports have slowed. And a record high trade surplus!

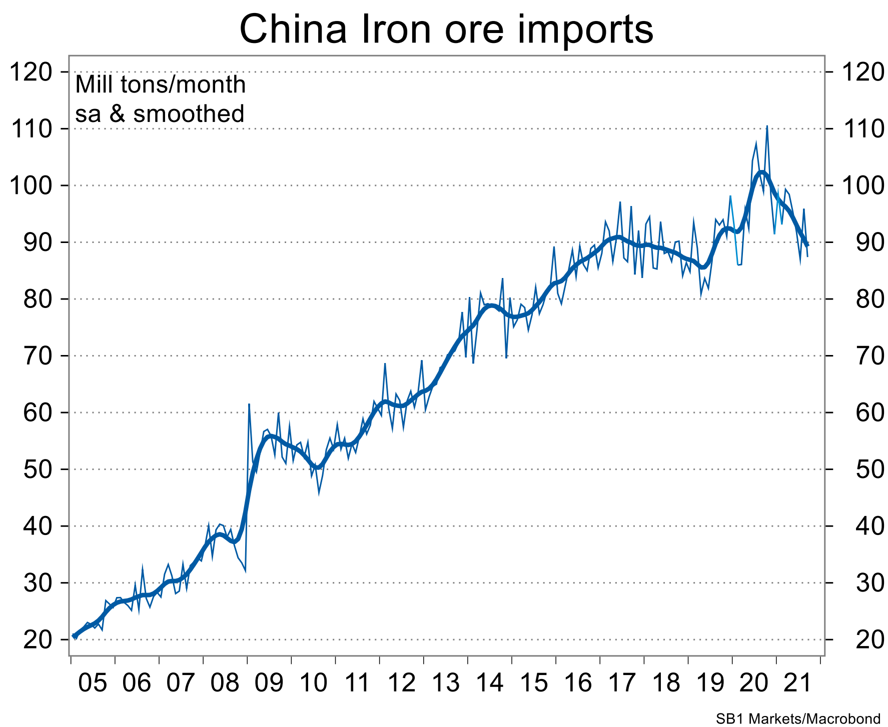
Exports 8% higher than expected, imports 4% lower

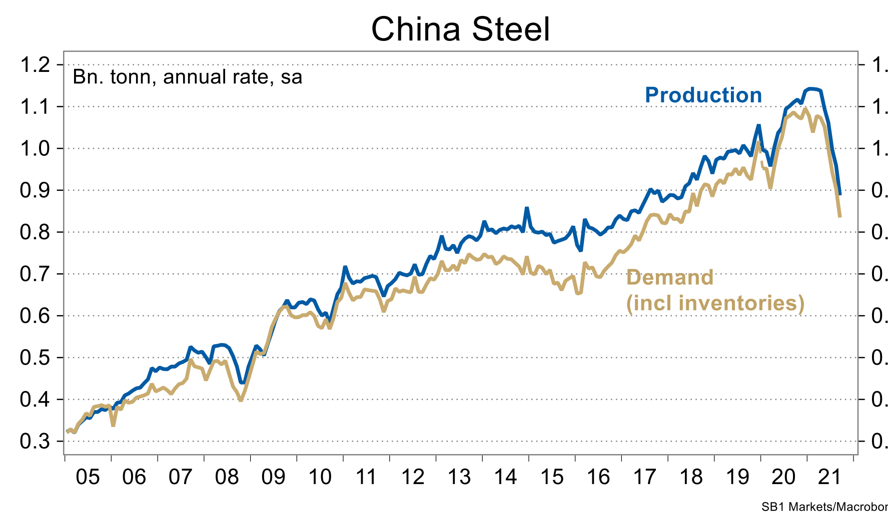


- **Exports** increased by 2% in USD terms in Sept and 30% y/y, up from 25% in Aug, expected down to 22%. Export volumes most likely rose too and the level is extremely high, up almost 30% vs the pre-pandemic level and 16% up vs. the pre-pandemic trend growth path! Signals still strong demand for goods. Prices are up 10% y/y (our est.)
- **Imports** values fell 4% m/m but are up 18% y/y, down from 30% in Aug, expected up 22%. Recent months import values have stalled, and as prices have climbed, import volumes some 7% since the spring – from a high level. Import volumes are back to the pre-pandemic trend growth path. Oil and iron ore imports were still weak in Sept, while coal imports rose sharply
- The **trade surplus** was sharply up in August, at USD 72 bn (seas adj) a new ATH.
- For some time we have expected an export slowdown in H2 due to lower demand for goods in the rich part of the world – but we have so far been wrong. The decline in imports may signal lower domestic demand. Even if credit policy now may be turning expansionary, the lagged impact on the previous tightening may be felt in domestic demand

Iron ore imports have fallen 10%+, and the trend is still down

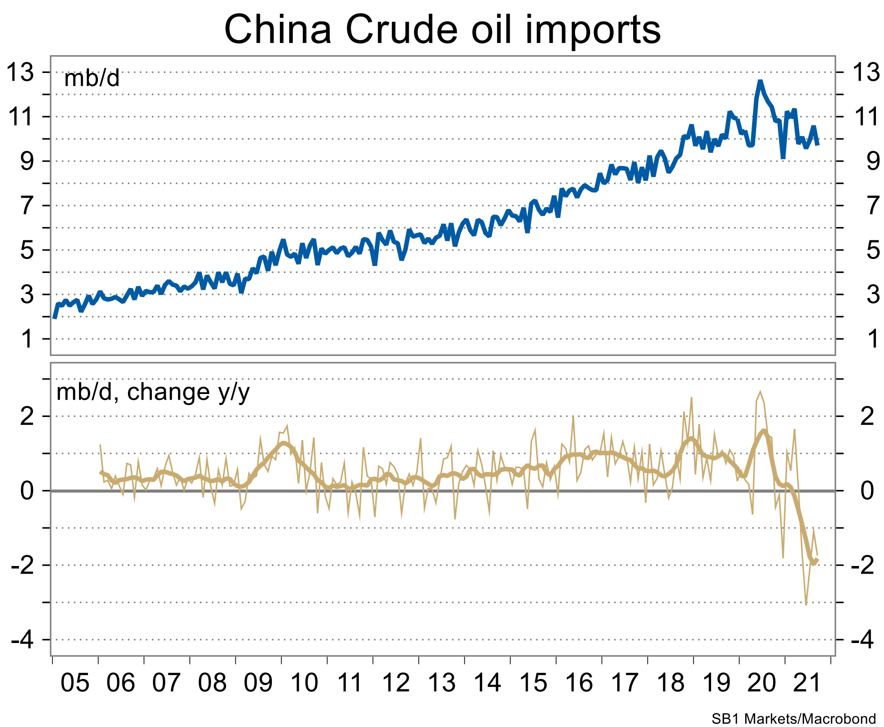
Authorities have curbed steel production in order to bring CO_2 emissions down (in 2030…). They say

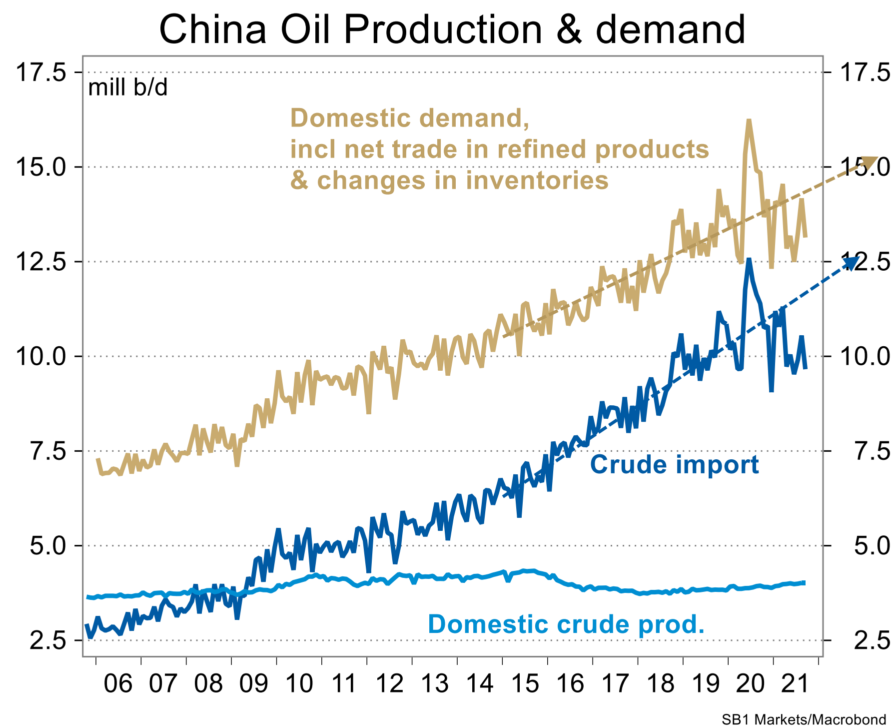




- Iron ore import have fallen more than 10% since late last summer, and fell in September, following an uptick in August
- Steel production has fallen sharply recent months, by more than 10%. Domestic demand is down, most likely due the decline in construction activity

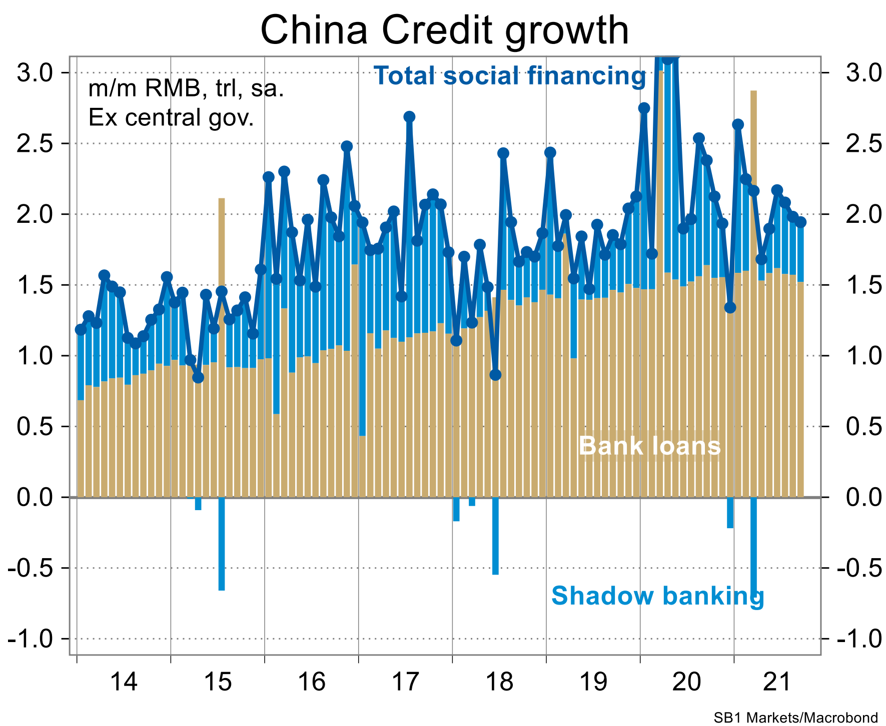
Oil imports flat since mid 2018, are down almost 20% (2 mb/d) since H1-20

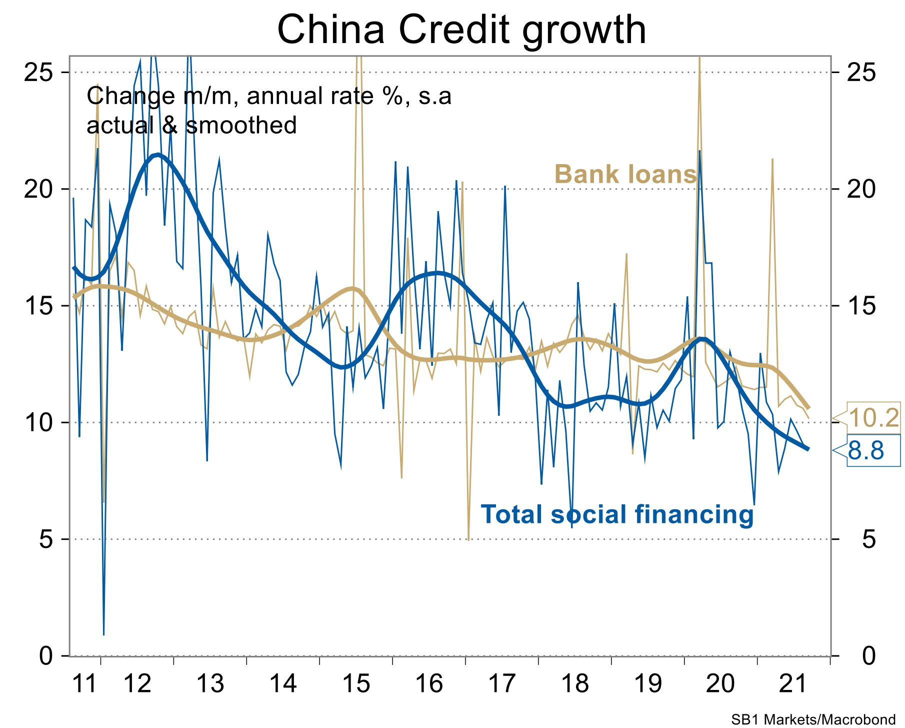




Credit growth is slowing – but no drama yet, and growth still > income growth

Authorities seem to choose a mixed approach: Keep credit up in some sectors, slow others

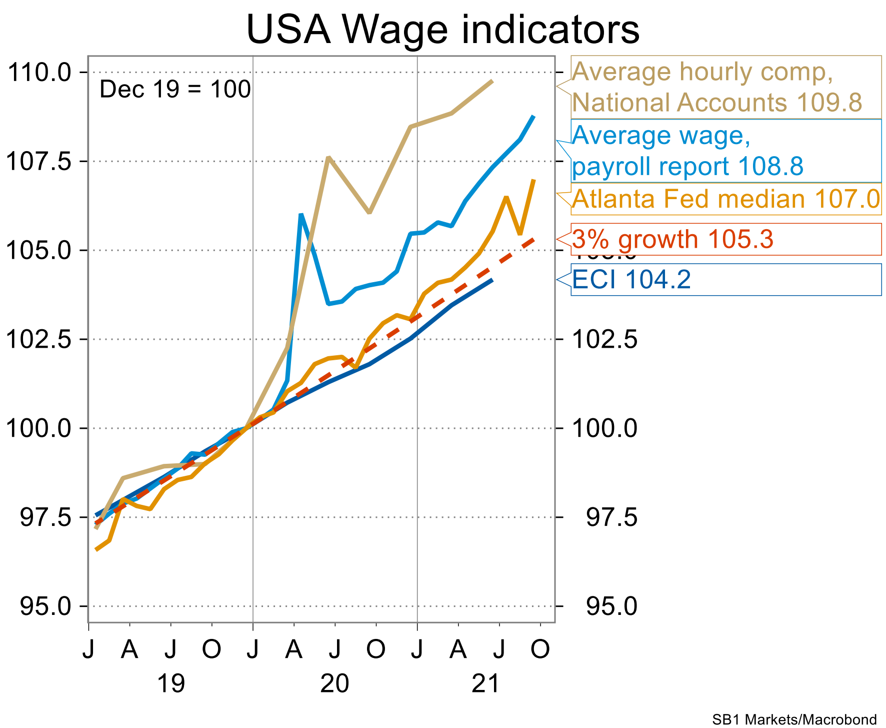


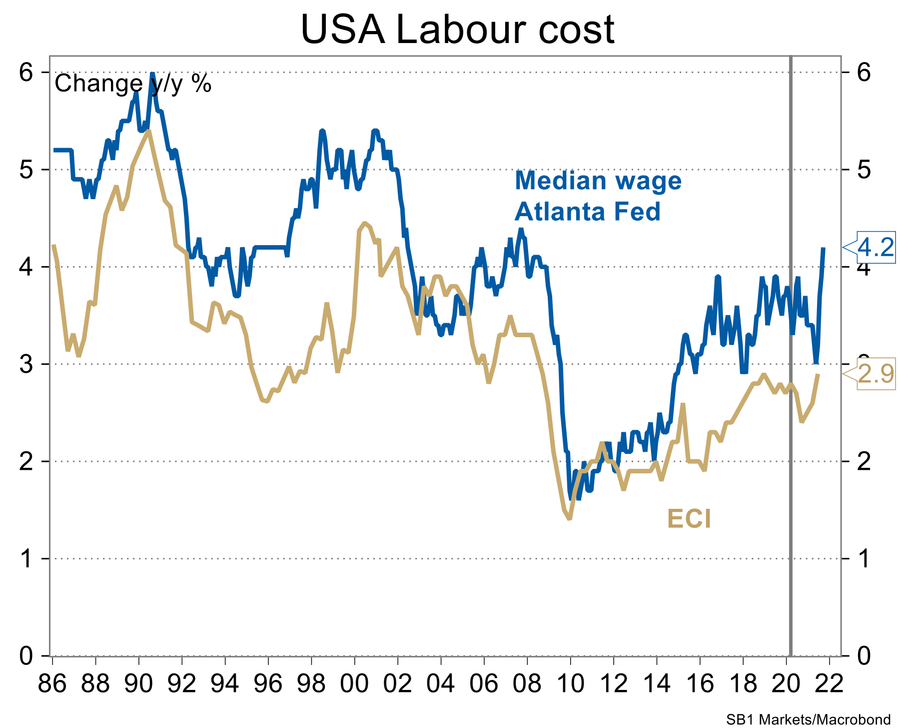


- **Total credit** grew at a 8.8% rate in Sept (m/m, seas. adj. annualised), down from 9.1 in August. Smoothed, the underlying rate may be at the same level, down from 13% during last spring (and >15% during some months). The underlying growth rate is still marginally above the trend growth in nominal GDP (say 5.5% real growth, 2% price inflation)
  - **Total credit** rose by RMB 2.8 trl, expected 3.1 trl (not seas. adj., total social financing, including central & local government bond, and corporate equities). Seas. adj. the core total social credit (total ex central gov bonds & corporate equites) grew by 1.9 trl, down from 2.0 trl in Aug. No credit supply chock following the Evergrande drama, at least not yet
  - **Bank loans** rose by RMB 1.5 trl, seas adjusted, or at a 10.2% annualised pace - and less than expected. Growth is gradually slowing, from a 13% rate last spring. Loans are up 11.8% y/y.
  - **Shadow banking credit** rose by RMB 0.4 trl, close to the level over the past 4 months (s.a). Growth has slowed sharply, underlying to 6%, from 13% last summer – the lowest growth rate on record. Excluding local government bonds, 'private' shadow credit is close to flat!
- **The credit impulse has turned negative**, like it usually does every 4th year or so. The ramifications may be felt in many markets
- **The slowdown has been by purpose**, as authorities have tightened, especially vs. credit supply outside banks, especially vs. the construction sector. However, the authorities have at least partially shifted the foot to the accelerator again – as they always have done after tightening too hard. In July, PBoC cut banks' reserve requirements

Atlanta Fed median wage growth the highest in 14 years

The median wage growth rate has accelerated to 4.2% from a dip down to 3.0% in May

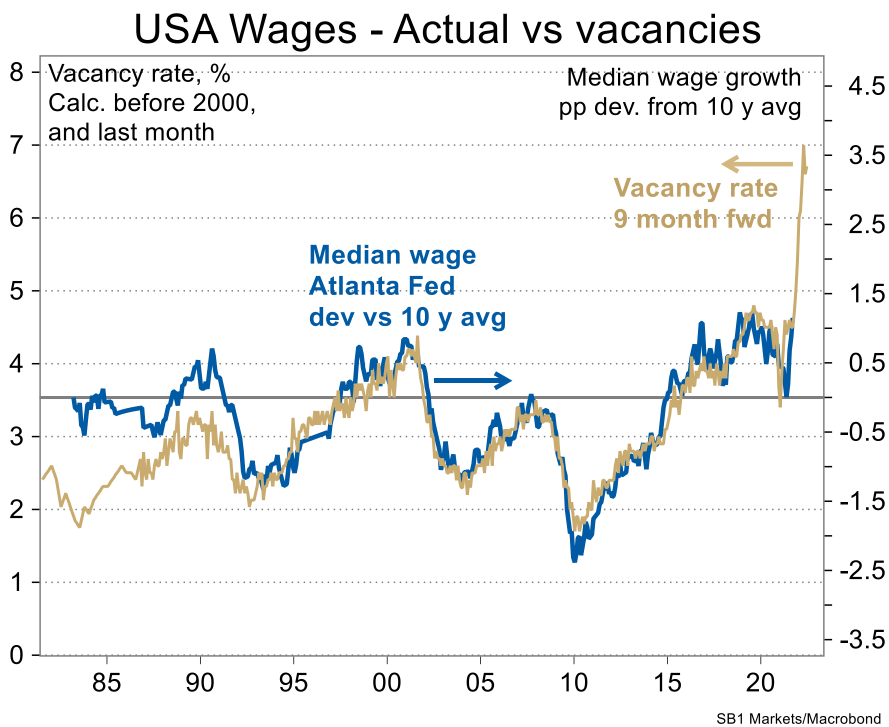


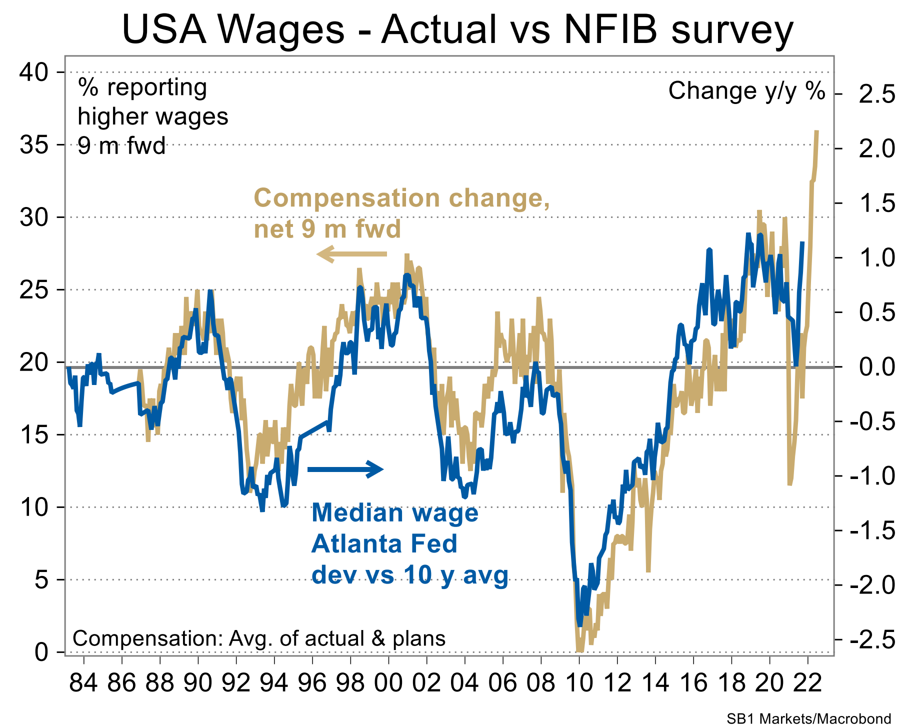


- The 4.2% rate (4.5% not smoothed) is equal to the highest rate since 2007 – but it may still be consistent with the 2% inflation target – if productivity growth is 2% or better. Before the pandemic the underlying productivity growth was some 1% – 1.5%. During the pandemic the underlying trend is harder to estimate
  - The real challenge: Inflation (even the core rate) has been above 2% on average the past 7 – 8 years (and well above measured over any shorter time horizon!) – even with an average median wage growth at 3.2%...
  - Job switchers report the highest wage growth in 20 years. Those paid hourly and with low education are also up more than in 20 years
- However, if wage inflation accelerates further, and just by a fraction of what is implied by the current labour shortages or what SMBs are reporting on compensation plans (check the next page), the inflation outlook is rather worrisome
- Other wage measures confirm accelerating wage growth, barring the Employment Cost Index (data through Q2)

Wage inflation could accelerate further…

The vacancy level & SMBs' compensation plans lead actual wage growth by ≈ 9 months. And now...

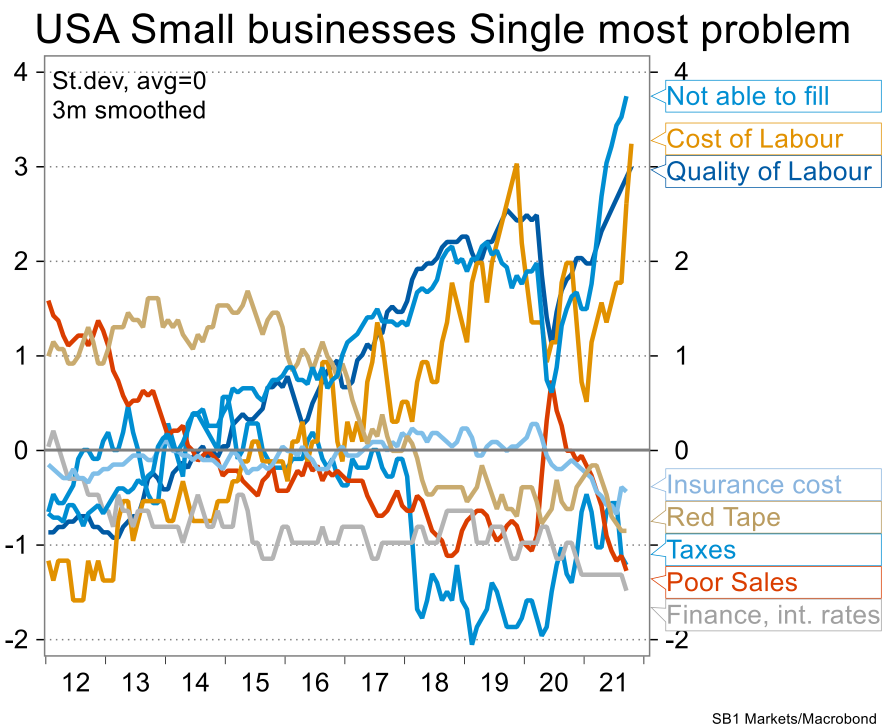


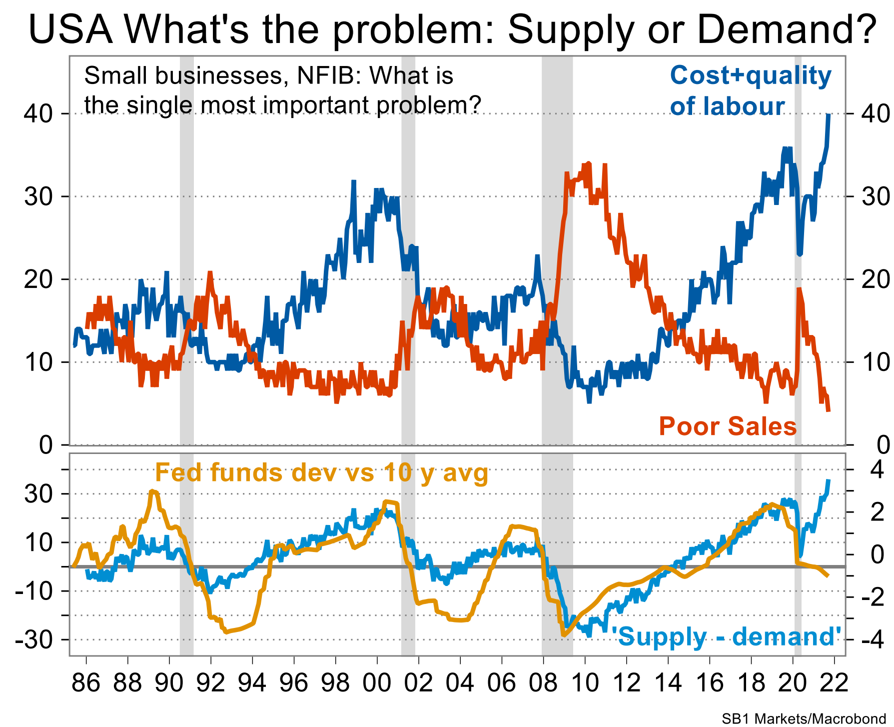


- More companies than ever before (data from 1986 though) are reporting that they have lifted or plans **to lift compensation** over the next months, as they never before have been so unable to fill positions (the correlation is incredible tight)
- The **vacancy rate** fell in August but remains extremely high
- The correlation between these two variables, and the median wage growth is rather close, with vacancies and plans leading by 6 – 12 months. IF this correlation holds, wage inflation will accelerate substantially from the present level – which already is high enough vs. the 2% inflation target
- We do not know FOMC's wage forecasts but we assume they are rather upbeat, as the bank expect inflation to remain above target the coming 3 years (and the price level to be deviate even more from a long term 2% path). However, the Bank could impossibly not have factored in a wage growth anything close to what companies now tell or even less what the current tightness of the labour market signals

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

Record few companies complain about poor sales, record many complain about cost/quality of labour





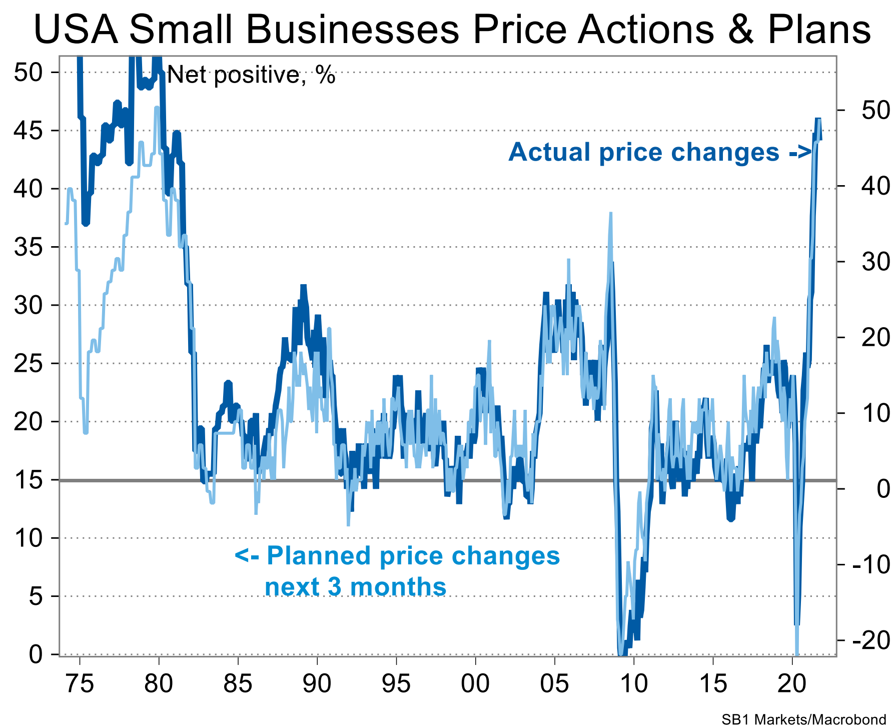
- Thus, companies report they are constrained from the supply side, not from the demand side
  - » In September, a much larger share of companies reported that cost of labour was the single most problem
- These data are really incredible, at least vs. the current monetary policy stance. Check the chart to the right

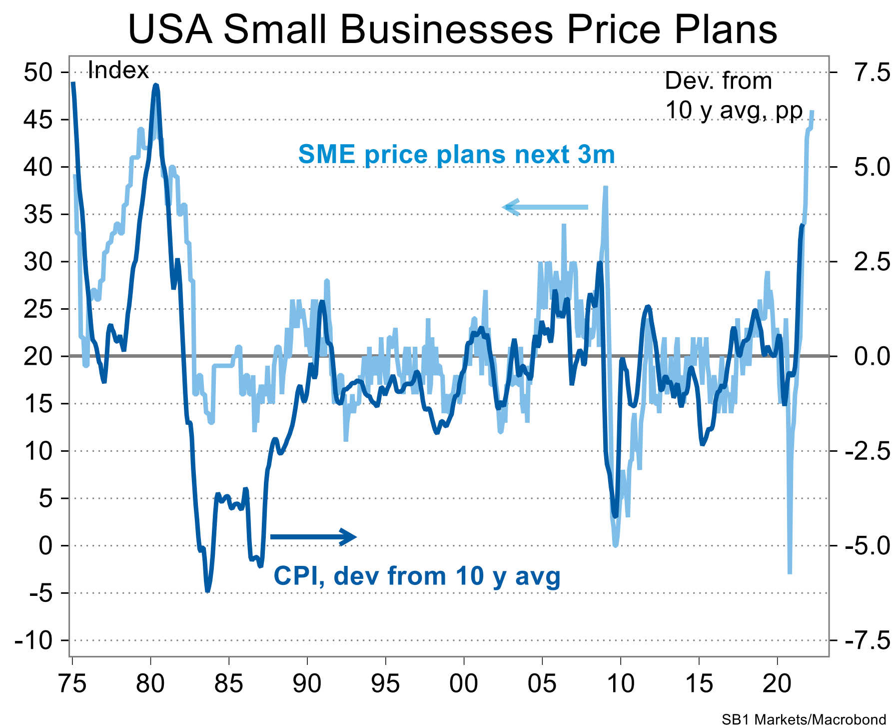
In the chart to the left, we have included the Not able to fill open positions, but that is not (rather strangely) not an alternative in the single-most-problem question in the survey. We still show it at the chart

SpareBank 1 MARKETS

Another warning sign: A record high no. of SMBs still say they plan to raise prices

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

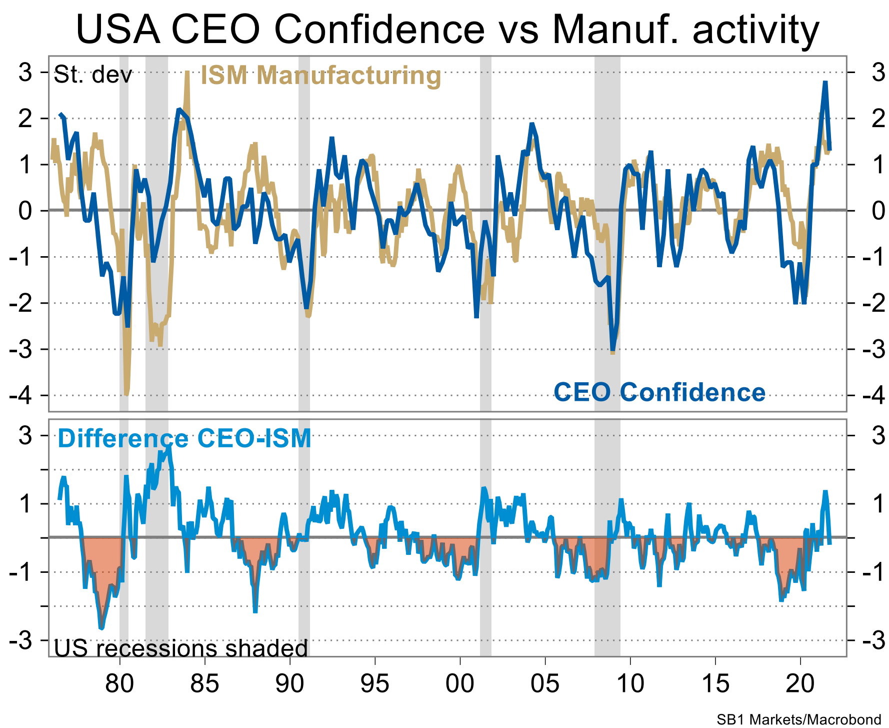


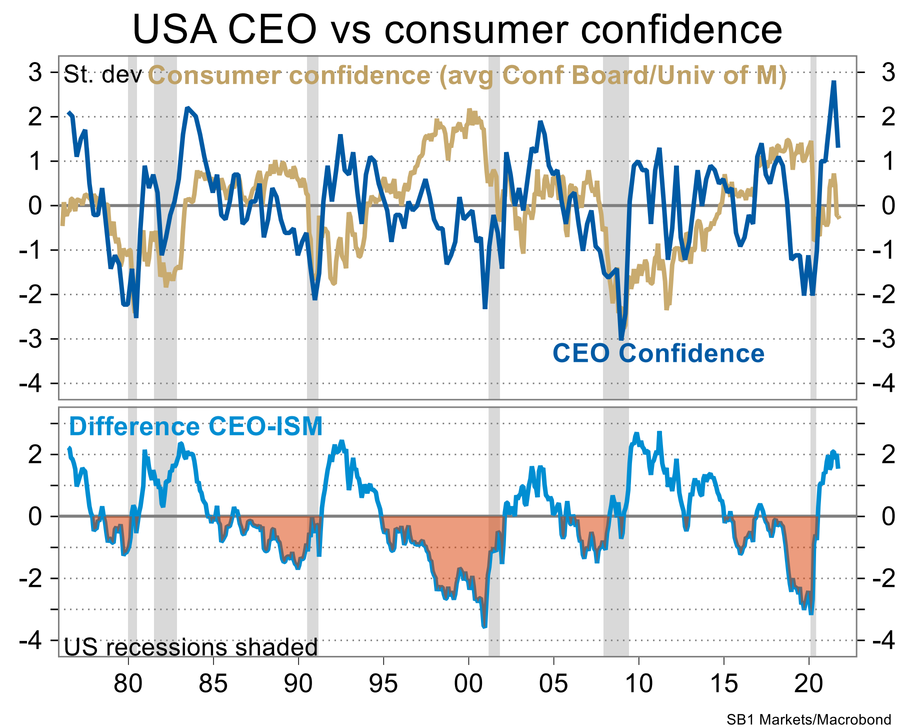


- Back in 1979, it lasted just one month; now we have been up here five months in a row
- It is challenging to calibrate the SBM survey vs. actual inflation, as the present print is so extremely far off the chart vs. the past 35 years experience. But surely, it tells us something. We have give it a go at the chart above to the right, and it does not look pretty vs. the short term outlook. Inflation may still stay up here for several months (but it may also 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 report a 3.1% expected growth in unit costs. Since 2013, the expectations have been stable at 1.75% – 2.25%

CEOs less but still unusually optimistic

.. and recessions have never turned up before well after the bosses have turned negative

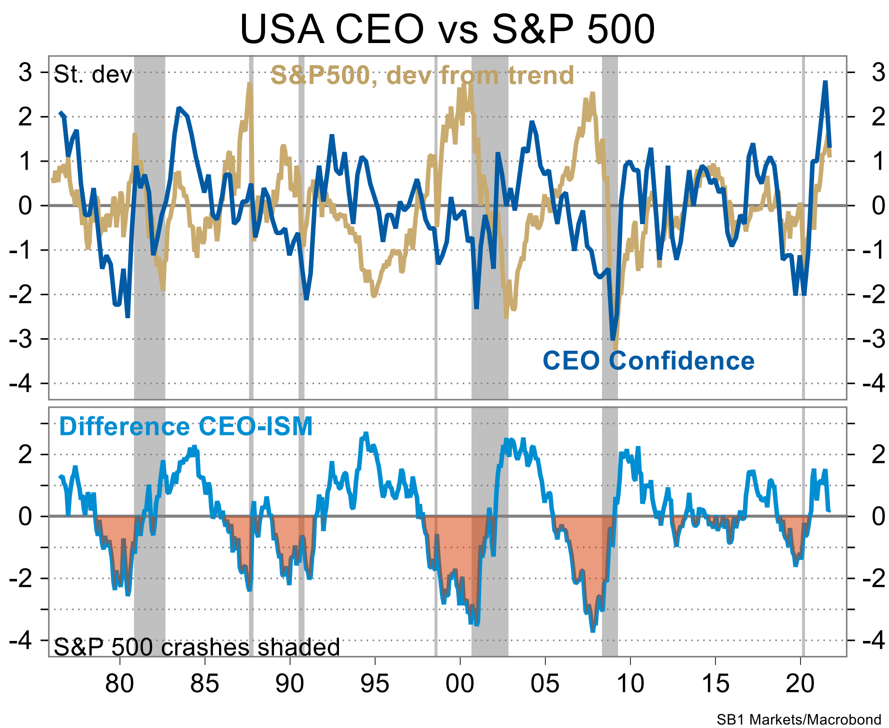




- … and not before the CEOs have been more negative than the ISM (the current situation) for a long period (left chart)
- In addition, the CEOs have always (barring the 1992 recession) turned negative years before households recognised that the party was over (right chart)
- However, the CEO survey is not a timing instrument, as it takes years from CEOs send a message to a recession hit

CEO confidence always wanes before the stock market loses its confidence

… before the stock market 'confidence' wanes. However, without stable lags (and some false signals!)

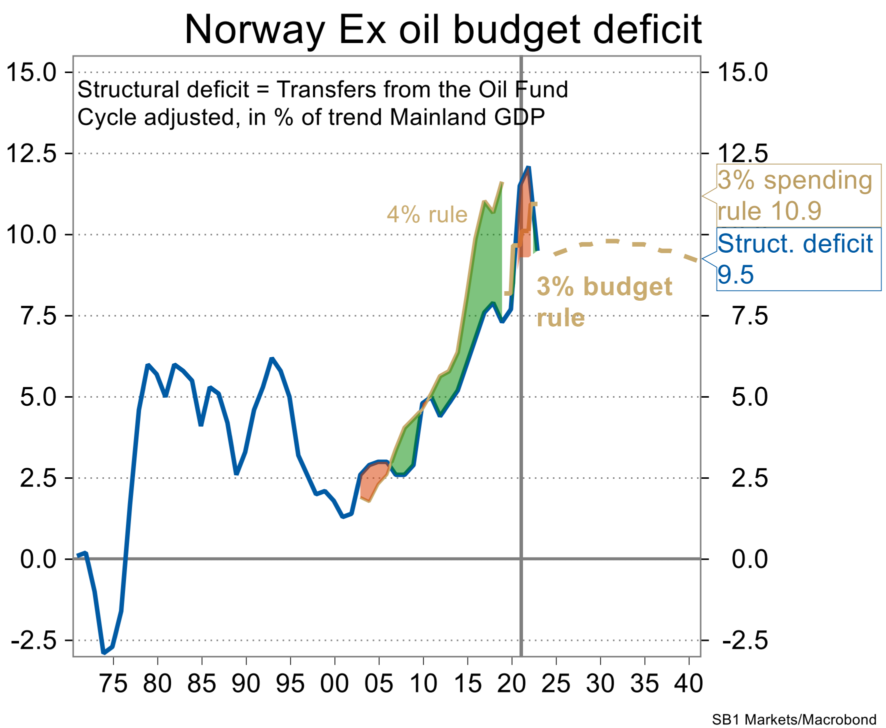


- ***Now: No warning signal from the bosses!***

An important disclaimer: This time IS different. We have NOT been through a NORMAL economic downturn, and we are now exiting the Covid-19 short break may be entering something than looks like a mature part of an economic cycle! Perhaps even not the best and brightest (or at least the best paid) have taken this unprecedented cycle properties into account?

Back on track – below the spending rule in a strong economy in 2022

‘20 & ‘21 were the exceptional years, of course. A transfer of 2.6% of the fund’s value proposed in ‘22

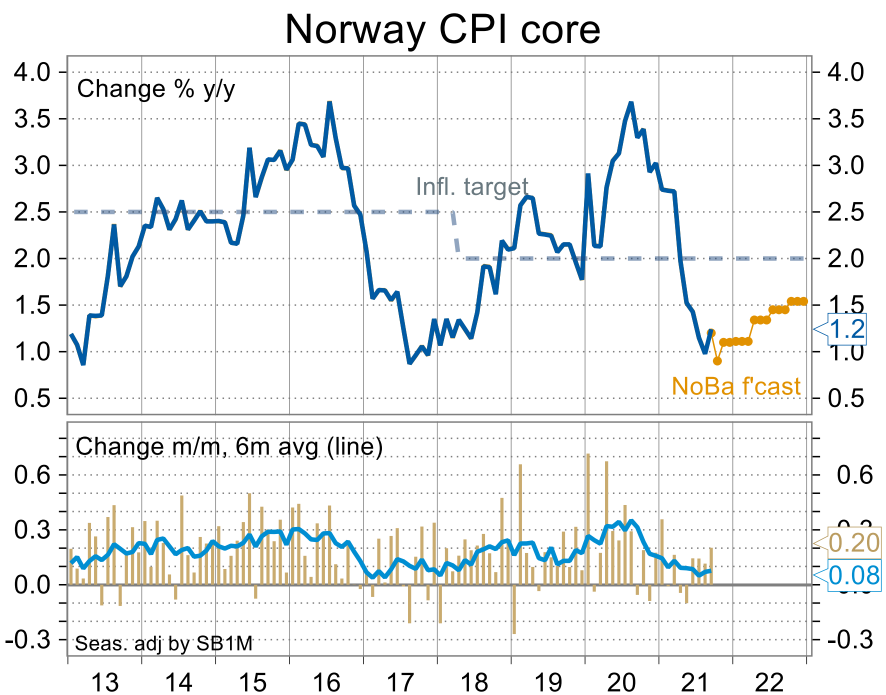


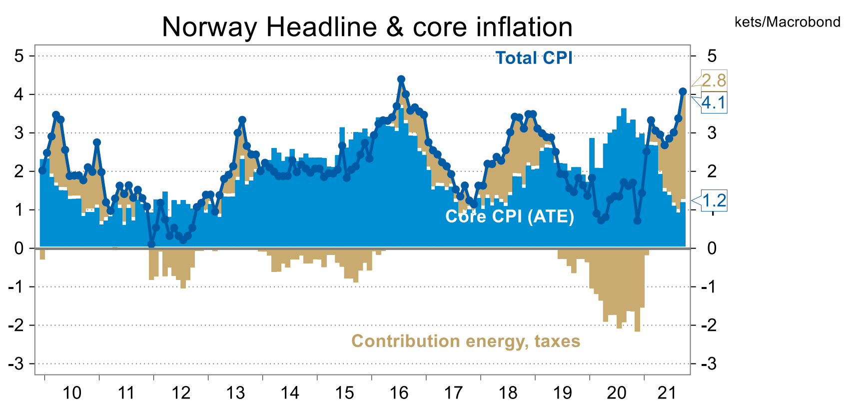
Fiscal indicators NOK bn, per cent	2019	2020	2021	2022
Actual surplus, incl. oil	277	-39	-31	203
Surplus ex. oil	-228	-371	-413	-300
Structural surplus ex oil	**-239**	**-369**	**-397**	**-322**
.. change in bn	-25	-130	-28	75
.. in % of GDP	**7.7**	**-11.7**	**-12.1**	**-9.5**
... Change (fiscal indicator)	**14.9**	**-19.4**	**-0.4**	**2.6**
.. in % of Oil Fund value	2.7	3.7	3.6	2.6
Spending rule, bn.	-261	-303	-327	-367
Deviation from rule, bn.	22	-67	-70	45
Pandemic measures	0	135	94	
Real growth in underlying spending	1.8	8.6	1.0	-3.4
Petroleum Fund, bn, ult.	10086	10907	12250	12918

- Fiscal policy will be tightened substantially, by 2.6% of Mainland GDP in 2022, as the need for stimulus will be reversed in an economy that is expected to operate above trend next year. That implies a transfer from the Oil Fund equalling 2.6% of the value of the Fund, below the 3% long term budget guideline). We expected a 3% transfer (based on a substantially lower estimated Fund value though, the Fund value has fallen sharply recent weeks)
- The fiscal stance should be evaluated vs. a ‘neutral’ starting point, 2019. The transfer from the Oil Fund has increased to 9.5% from 7.7% of GDP over these 3 years – though somewhat less than for which the increase in the Fund’s value would have allowed. A more detailed analysis confirm that the budget is somewhat expansionary to 2022 from 2019
- The surplus vs. the budget guideline equals 1% of GDP. Not many countries can match that. And not many have a 6% overall surplus in the budget, when (far too moderate estimated) oil og gas revenues are included. The real surplus may turn 20% of GDP, given current and forward oil and gas prices

Core inflation up to 1.2%, headline up to 4.1% - due to the electricity shock

Core inflation remains far below target but Norges Bank has not been an inflation nutter past 10 years

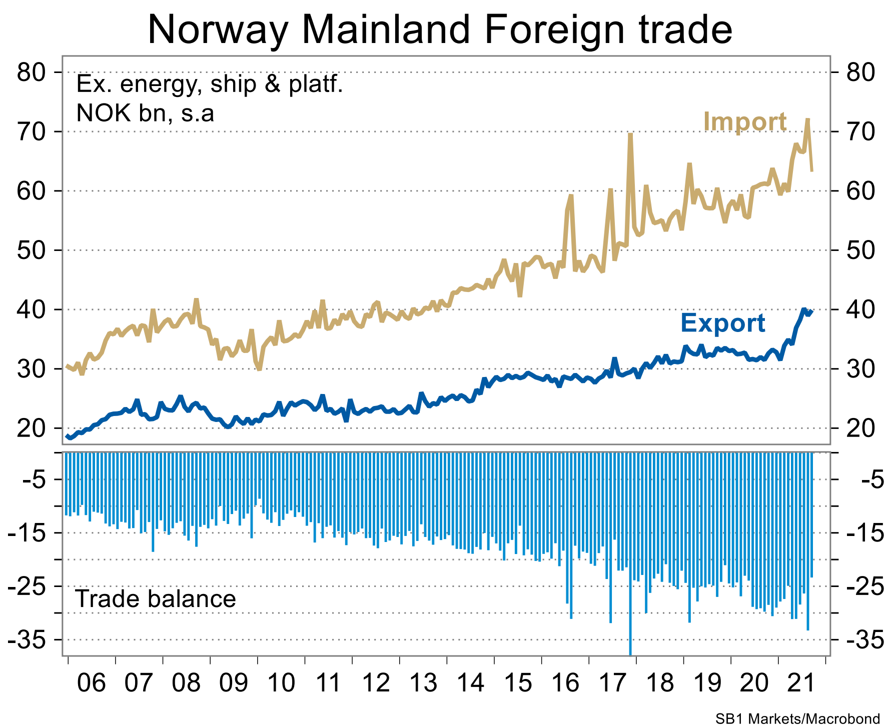


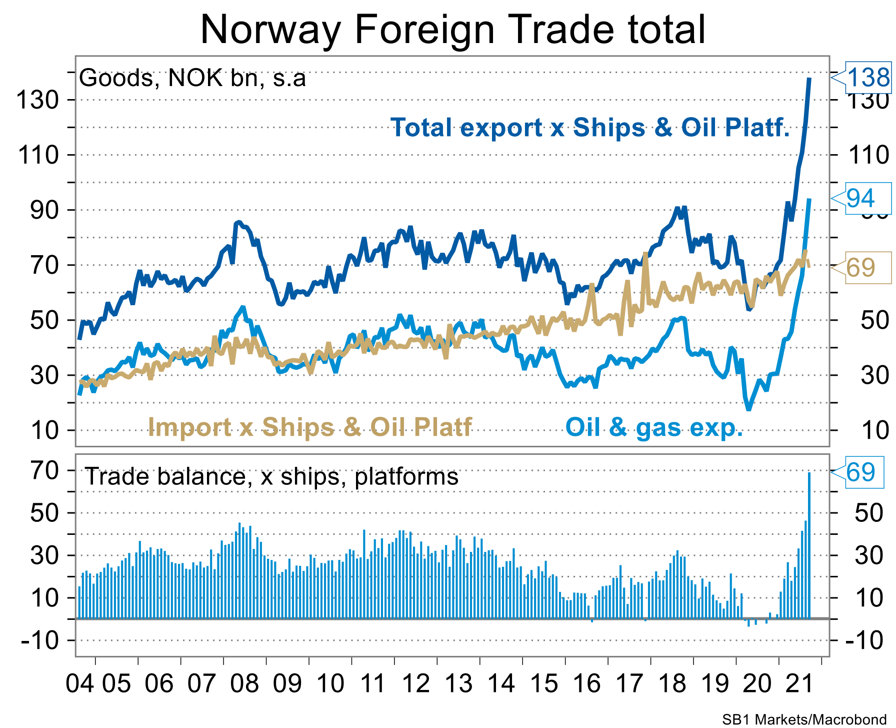


- **CPI-ATE** (ex. energy and taxes) inflation accelerated 0.2 pp to 1.2% in Sept; in line with Norges Bank's and our f'cast, marginally below consensus (1.2%)
  - » Prices were up 0.2% m/m (seas adj), the highest rate since Jan
  - » Core inflation is running above 2% in 5 sectors, but is below 2% in 8 sectors
  - » Prices on imported goods rose in September, the annual rate is at 0.9%
- **Total inflation** rose 0.7 pp to 4.1%, below our forecast. Electricity prices rose further (up 107% y/y!) – lowering house household real disposable income by 2.8%. However, if the future market is right, the average drag from summer-21 to next summer will by far lower, at 1¼ - 1½%
- **The outlook**
  - » **Core inflation have probably bottomed**. Strong growth at home and some impact from higher inflation abroad will contribute at the upside (even if the impact of the latter is not impressive, historically). A somewhat strong NOK will counterweigh higher prices abroad.
  - » The steep rise in electricity prices reduced households' real disposable income but given the still rich aggregate savings rate, consumption is probably not that exposed.

Some special gas exports, of course. And a small Mainland deficit too

Total surplus at NOK 69 bn, ATH, or 25% of (Mainland) GDP ☺☺



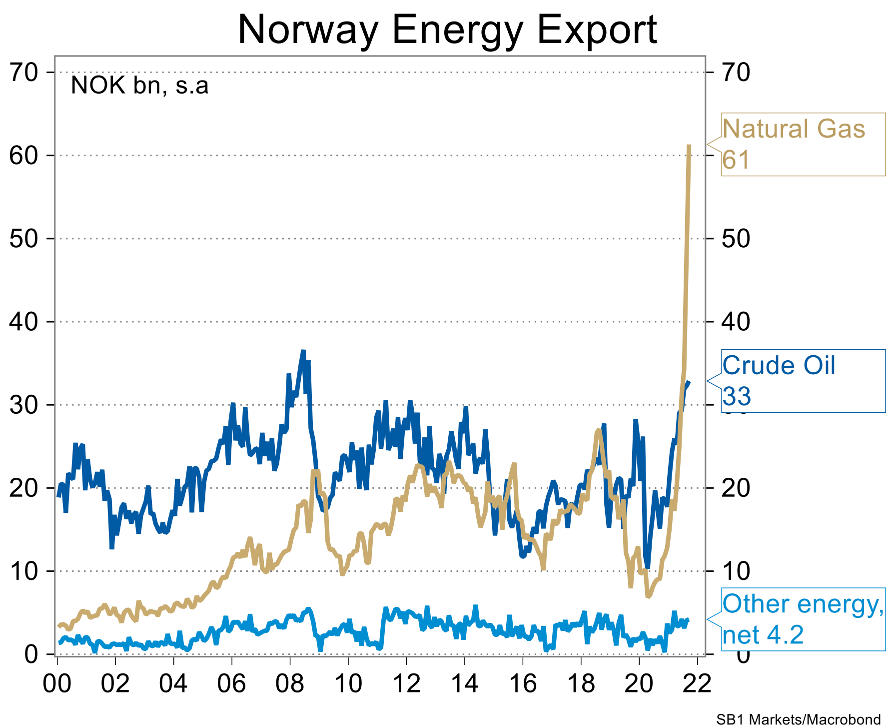


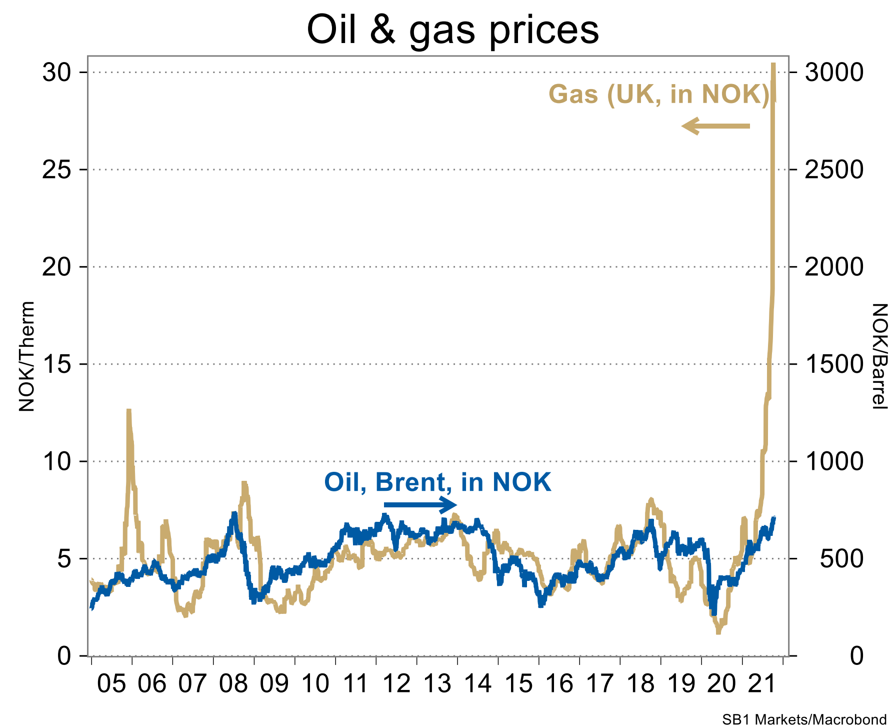
- **The <u>Mainland (non energy) trade deficit in goods</u>** decreased sharply September, by NOK 10 bn to 23 bn
- **Non-energy exports** were flat
- **Imports** fell sharply in August, due to steep decline in imports of machinery and vehicles
- **Export of oil and gas** surged to NOK 94 bn, from 80 bn in August, the highest petroleum export value ever, and far above a 'normal' NOK 40 bn/month level. Gas exports shot up to 61 bn! October will be far better as gas prices have climbed further
- **The trade surplus in goods** (ex ships/platforms) rose to NOK 69, an enormous amount – 25% of Mainland GDP in September, an all time high
- **The government's extra revenues** from oil and gas exports (and direct ownership) in Sept alone will be some NOK 50 bn, which will be transferred to the oil Fund. That's good news. But do not forget that the Fund's value have fallen some NOK 1.000 from the peak in August

SpareBank 1 MARKETS

Gas exports up to NOK 61 bn, 4x a normal level. October will be even better ☺

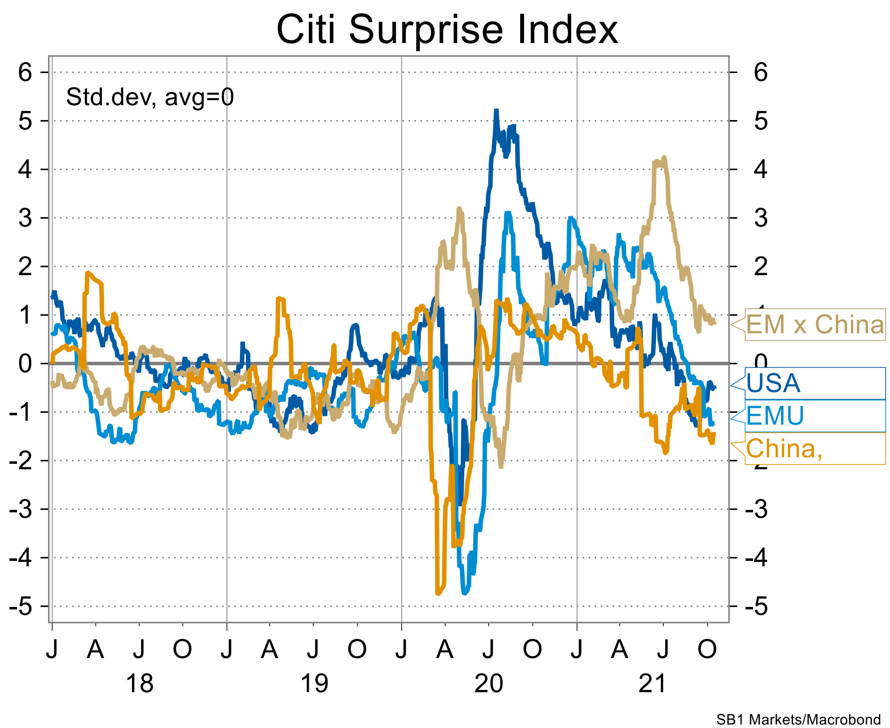
Oil export up to NOK 33 bn, the best since 2008

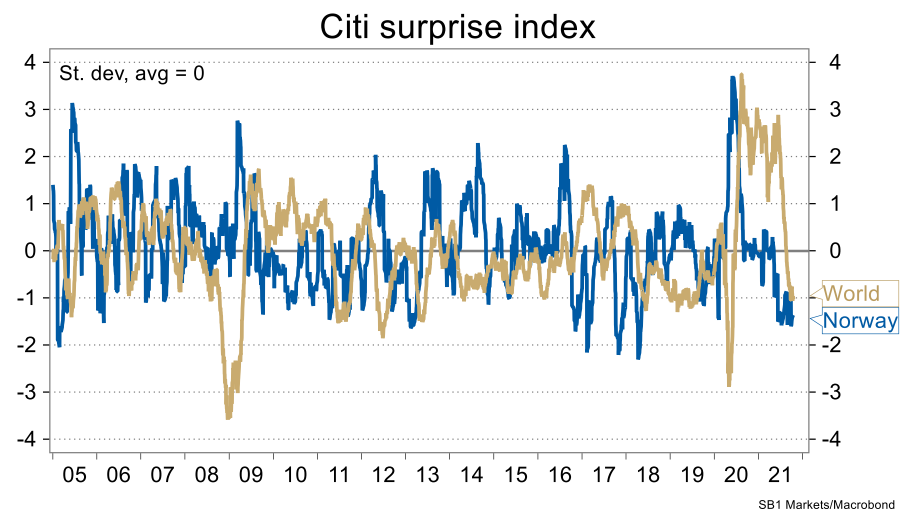


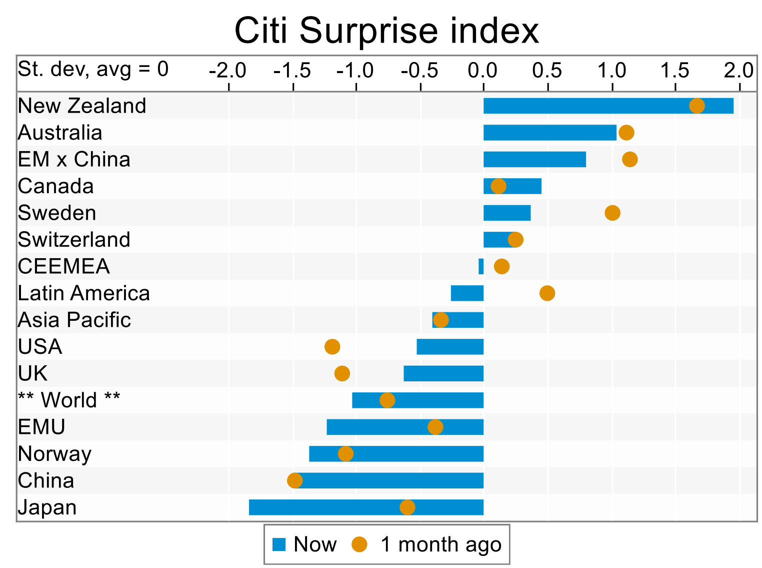


- **British gas** prices have skyrocketed past weeks, to all time high by a wide margin, 6x a 'normal' price level. Gas prices are now totally uncorrelated to oil prices, which is rather unusual (but is has happened before, like in late 2005). In September, the price average was GBP 1.47/therm (USD 20/BTU). Assuming an unch. price rest of October, this months average will climb to almost GDP 2.50/therm. So wait for even more crazy export revenues and trade surpluses in October!
- **Crude oil** exports rose marginally (in NOK bn) – to the best level since before the Financial crisis when just some few months recorded even higher export revenues
- **The government's extra revenues**, given the 78% marginal tax rate is NOK 40 – 45 bn in September, and it will be even more in October. And in… These extra revenues are all transferred to the Oil Fund – and through the budget rule. The long term budget rule 'allows' for 3% of the Funds value to be spent. So the revenues in just in September, leaves room for more than NOK 1.3 bn extra spending, per year- forever
- There are other and often much more important variables: Over some few weeks this autumn, the Fund's value fell by NOK 1.000 bn (8%). Bond yields rose and the NOK rose, stock markets fell. And more could come ☺

Still mostly negative surprises – but not more last week either







- The **US** surprises have become slightly less negative
- The **EMU** is well below zero, and further down last week
- **China** is well below normal but have stabilised. This morning's Sep/Q3 date were in sum at the downside, will lower the surprise index
- **Emerging Markets x China** are still reporting better data than expected
- **Norway** has surprised sharply on the downside, according to Citi

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

Highlights

The world around us

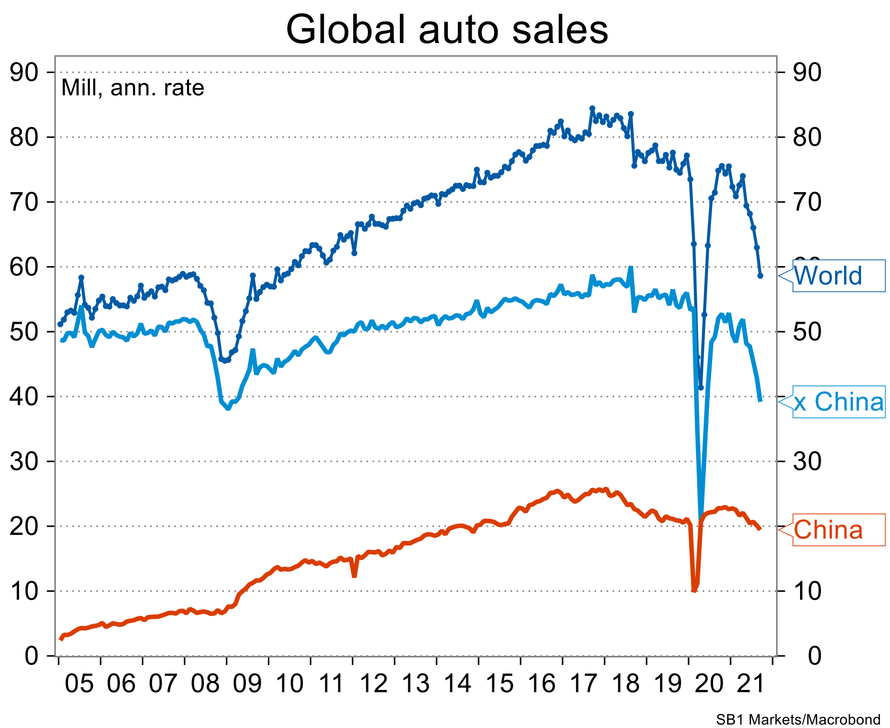
The Norwegian economy

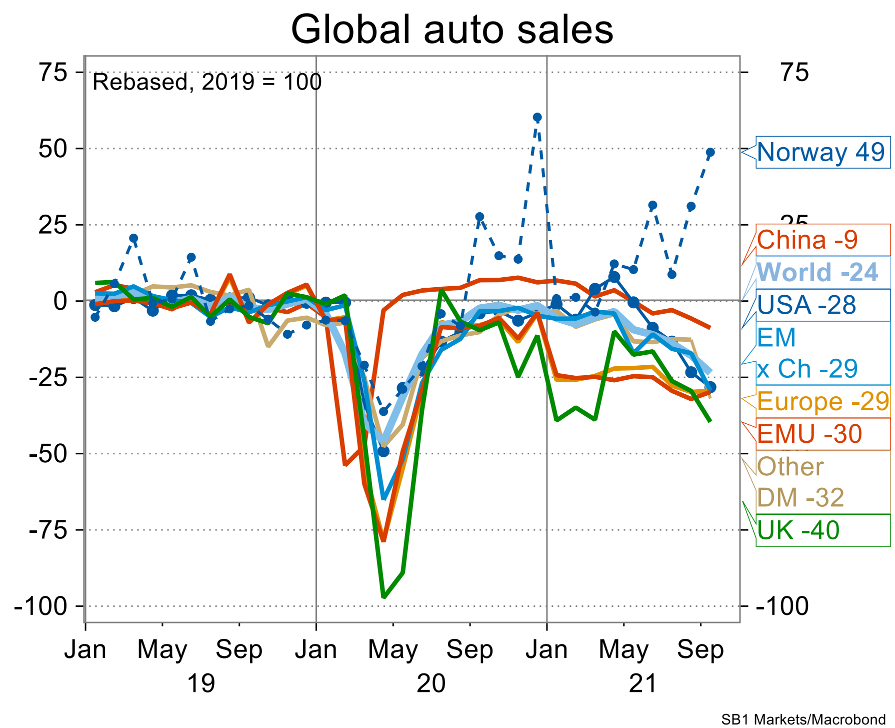
Market charts & comments

SpareBank 1 MARKETS

Auto sales 'confirmed' down in September, the data chip shortage is serious

Sales fell by 7% (we estimated 8%) m/m, sales are down 24% vs. the 2019 average



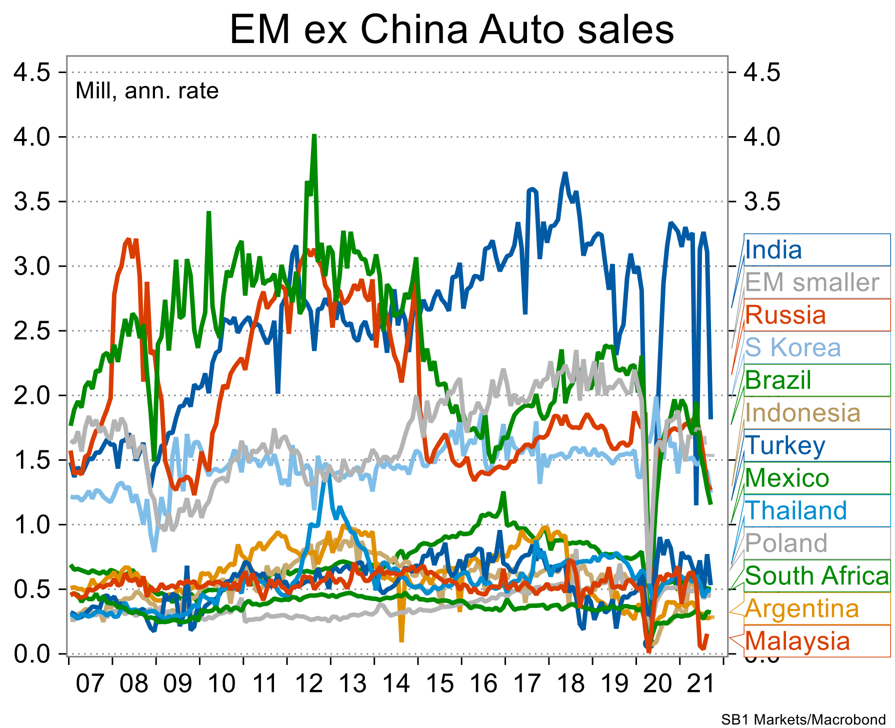


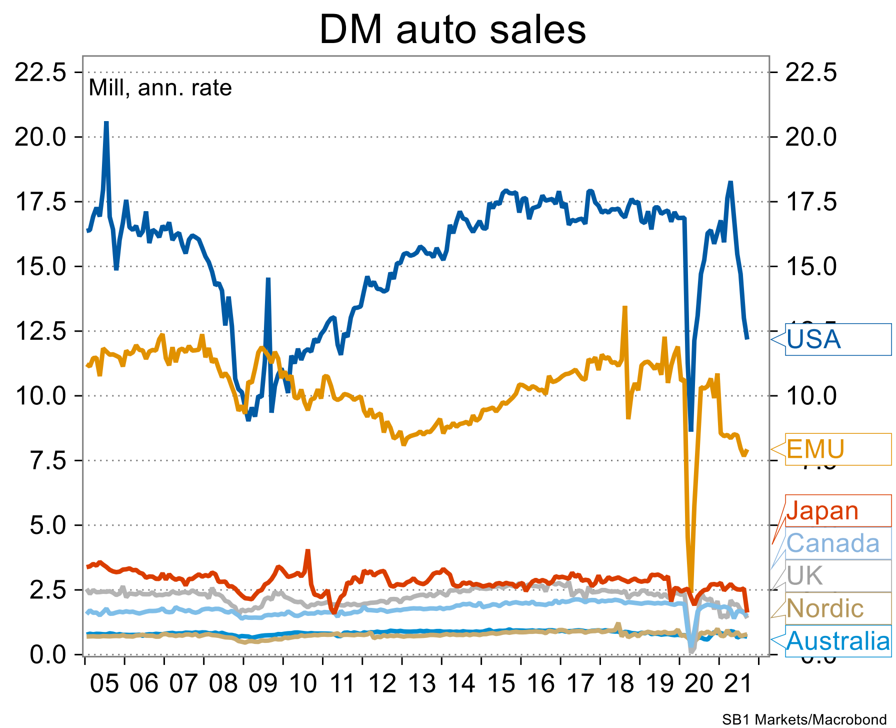
- Sales in China were significantly better than we assumed, down 'just' 3% - and are down 9% vs. 2019. Sales in India decreased even more than we assumed
- Sales fell sharply in **US** and the **UK**. **EMU** sales rose marginally, we assumed a further decline in **Europe**. Japanese sales fell sharply in Sept. UK sales are down 40%, EMU -30%, US -28% - all vs 2019
- Sales in **EM x China** fell further too – and are down 29% vs. 2019 – with almost countries on the downside in Aug/Sept
- **Norwegian** sales are soaring, because the margins are much better here than elsewhere??

SpareBank 1 MARKETS

Sharp setback in auto sales in most EMs x China too – and in rich countries

A sharp setback in India, and this time not due to closed auto shops (like in April/May)

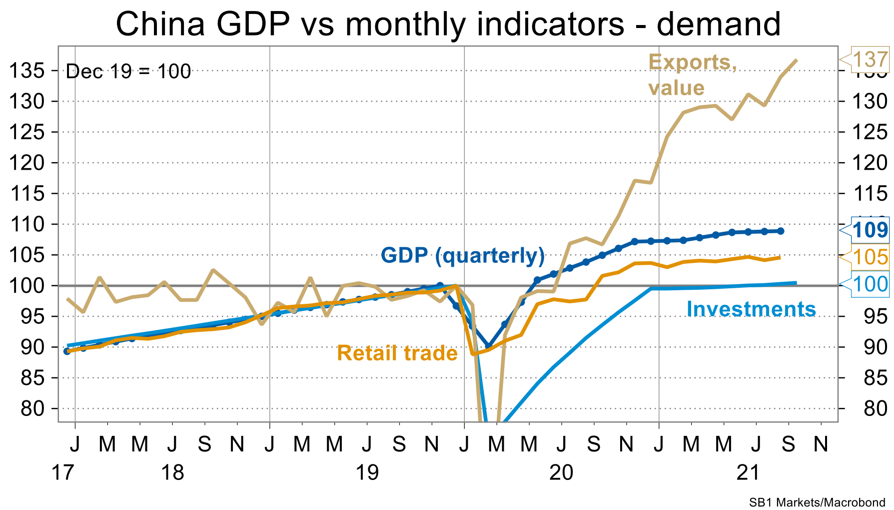


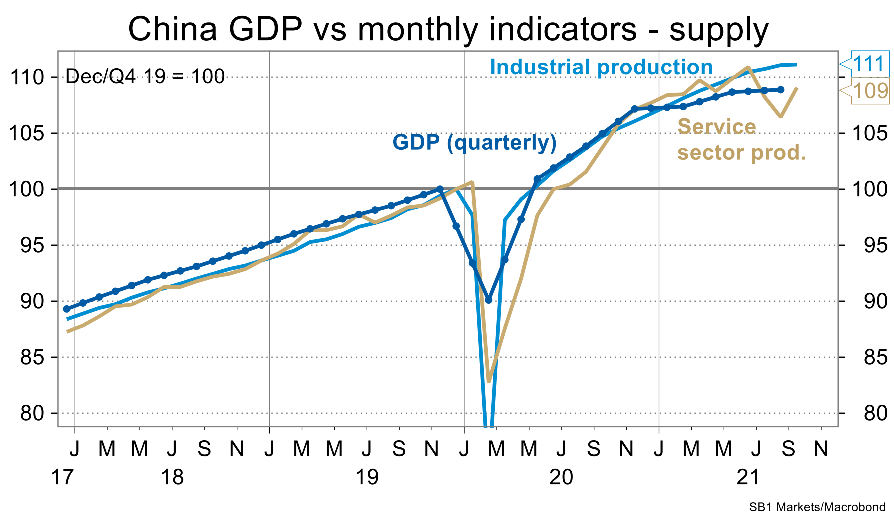


N

September, Q3 weaker than expected. Corona only partly to blame

However exports, retail sales surprised at the upside in Sept, and services recovered ½ of July/Aug loss



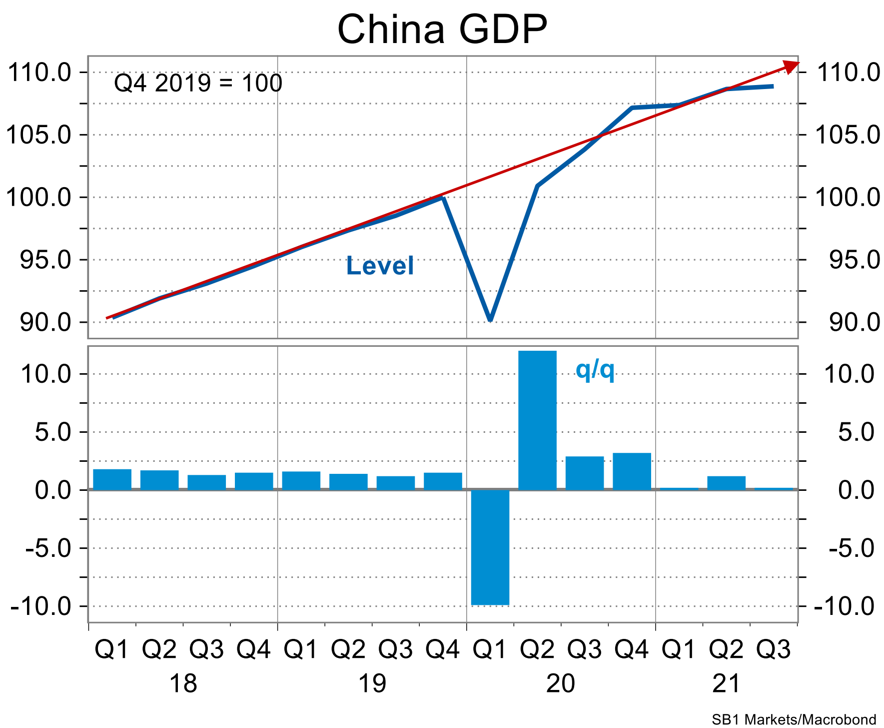


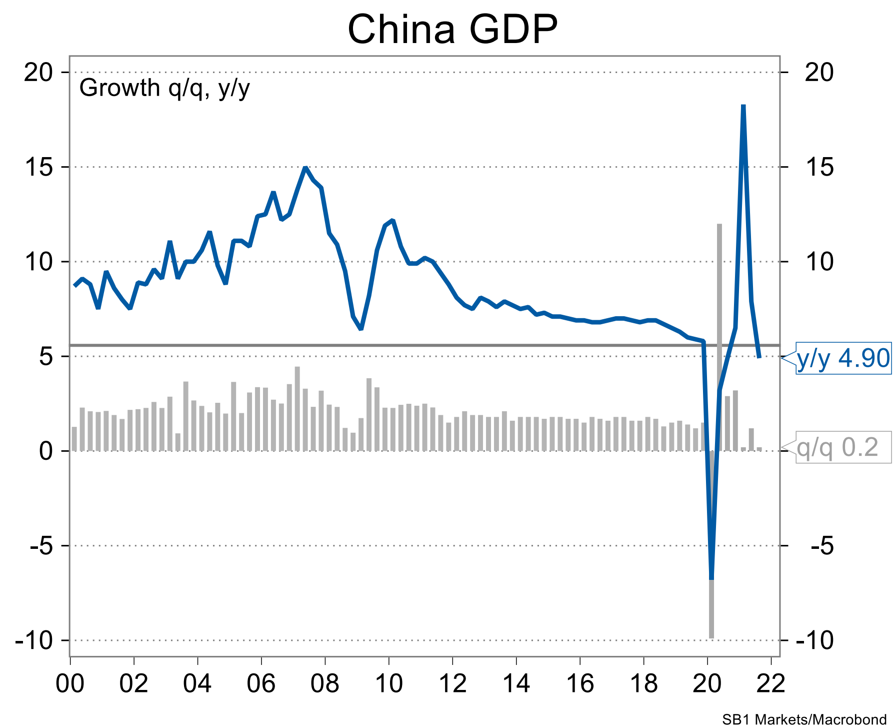
- **GDP** rose by 0.2% Q3 (0.8% annualised) down from 1.2% in Q2, expected 0.2%. The annual growth rate fell to 4.9% from 7.9%, expected 5.0% The GDP level to below the pre-pandemic trend path as growth from Q4-19 has been below 5% in average
- **Industrial production** rose by just 0.1% in Sept, down from 0.3%, the lowest growth rate since the setback in Jan/Feb last year. Measured y/y, growth slowed 2.2 pp to 3.1%, 0.7 pp below expectations Production is still 2% above the pre-corona trend path but growth has slowed. Steel, cement, aluminium and autos are down 10 – 20% from local peaks, due to a mix of demand and supply factors. Surveys are down but are signalling growth well north of the 0.1 per month rate (rather 0.4 m/m, 5% y/y)
- **Service sector production recovered** by 2.5% in Sept, following the 4.1% July/Aug drop – which no doubt was driven by the fight against the virus, and as the PMIs strongly signalled, Sept was far better. Still, the level is still below par, and well below the pre-pandemic trend growth path. Activity will probably recover further in October
- **Retail sales volumes rose by** 0.6% in volume terms (our est.) in Sept, the best since Feb. However, the trend is weak, from Nov last year at a 2% path, at the best. Annual growth accelerated to 4.4% from 2.5% in August, above the expected 3.4%. Auto sales are slowing, as elsewhere, but other sectors have also slowed in 2021
- **Investments** grew by 0.2% in Sept, as in August. The history was once more revised down, and nominal urban fixed investments are barely growing anymore! Prices are no doubt increasing – and in volume terms, investments are falling. The (still useless) accumulated annual growth rate was 7.3% in Sept, down from 8.9%, 0.6 pp below expectations. Housing and other construction starts as well as new home sales fell further – but not faster in September, and are down 15% – 20 % vs recent peaks.
- **Credit growth** is slowed further too, and the credit impulse is negative, as normal approx. every 4th year
- **Exports** rose sharply Sept, while import fell further, the latter signalling weaker domestic demand (as the Chinese data confirms). Export volume are 16% above the pre-pandemic growth path (and 30% above the p-p level. Imports are on par with the p-p trend path
- CPI inflation is still very low, 0.7% in total, the core at 1.2%

In sum: China is no doubt slowing, but some of the July/Aug (virus related) weakness in services was reversed, and exports are strong. The main risk: construction activity which has fallen 15 – 20% already

Q3 GDP up just 0.2% q/q, exp. 0.4%. Level below the pre-pandemic trend

Annual growth down to 4.9% form 7.9% in Q2, expected 5.0%

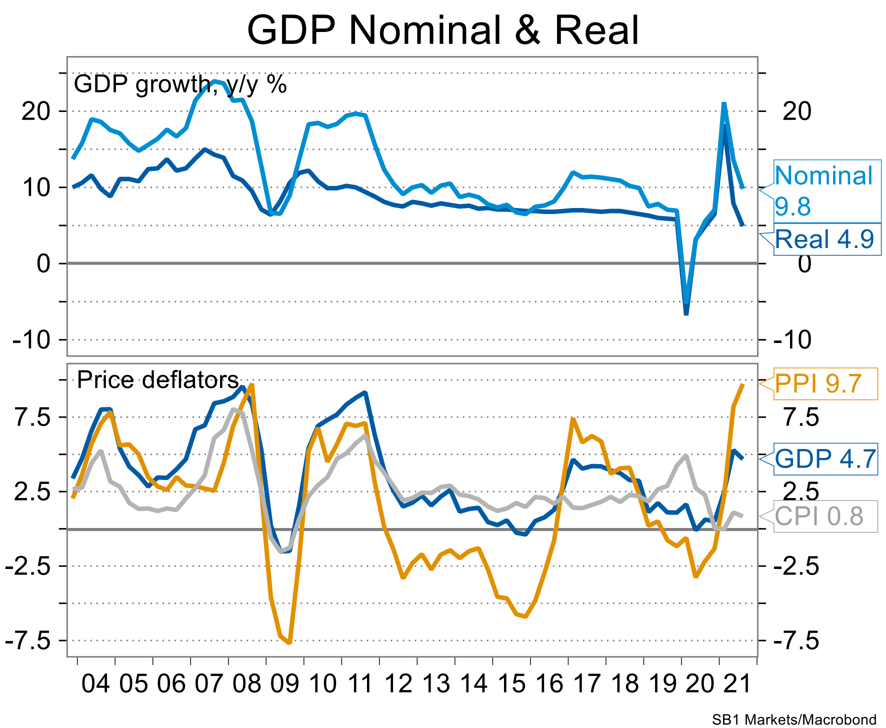




- A 0.2% q/q rate equals a 0.8% annualised growth pace, down from the 1.2% (5.3%) pace in Q2. Q1 was revised down by 0.2 pp once more to 0.2%, initially reported to +0.6%. Growth reached the pre-pandemic growth path in Q4-20 but as growth has slowed to a trickle 2 of the past 3 quarters, activity was below the old trend path in Q3
  - The 4.9% annual rate was marginally below expectations
- The annual GDP growth rate was sliding down before corona, to 6% in Q4-19. If the gradual decline in growth had continued – and corona had not happened – the annual growth rate would have been below 5.5% by now. The actual annual rate since Q4-19 at 4.9% is slightly below the pre-corona trend, measured that way too. However, corona was no doubt to blame for the weakness in Q3, witnessing the abrupt slowdown in services

GDP price deflator up to 4.7%, from 5.3%

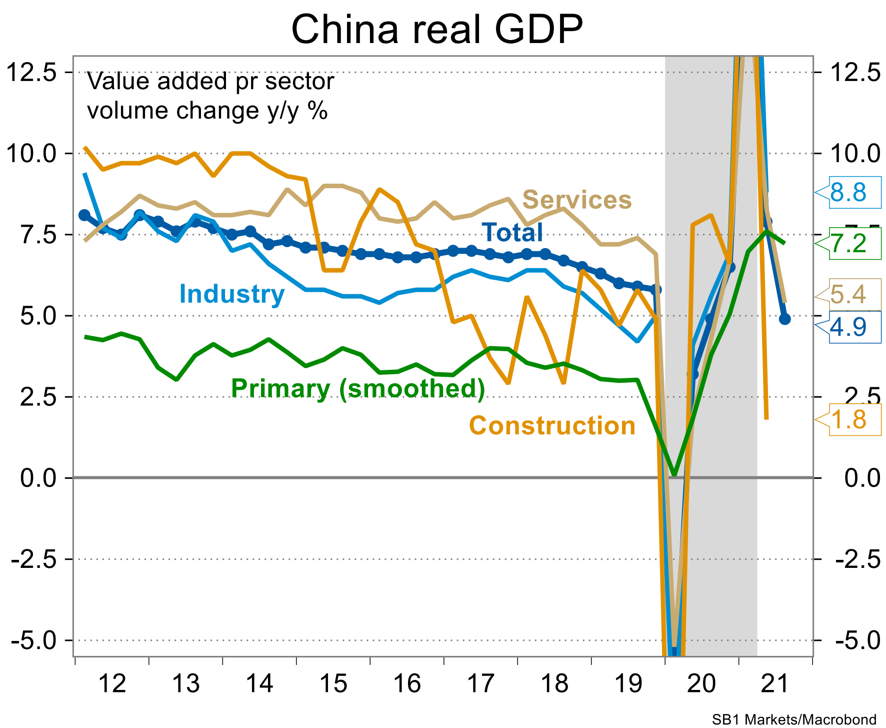
Nominal GDP up by 9.8% y/y

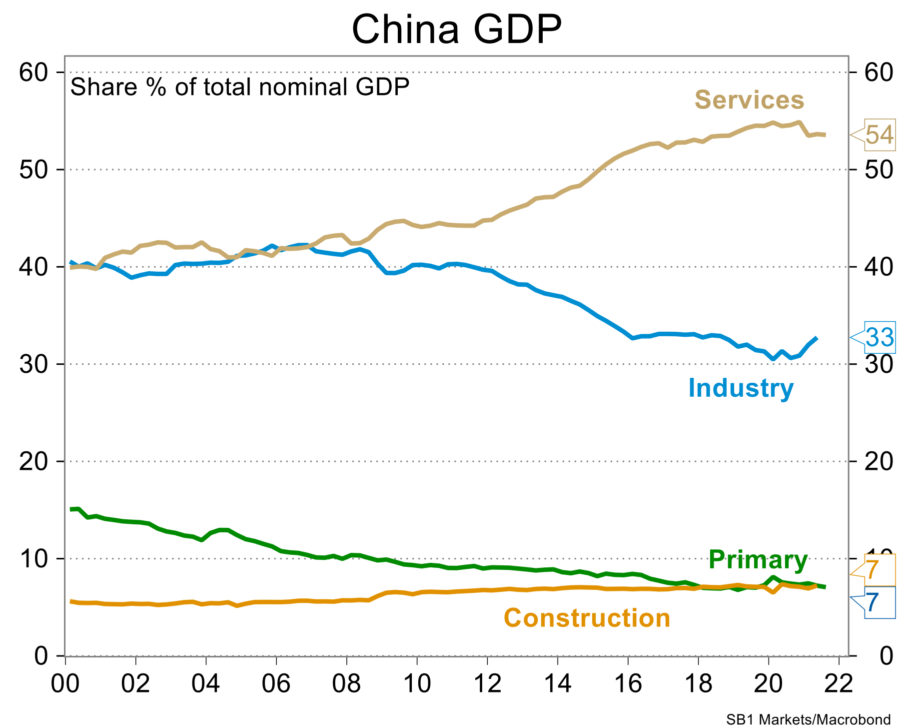


- Manufacturing producer prices (PPI) are up almost 10% y/y (quarterly avg), while CPI prices are up just 0.8% y/y

A service sector recovery is most likely ahead ('after' corona, like everywhere)

The steady rise of services as share of GDP is not re-established – but it soon will



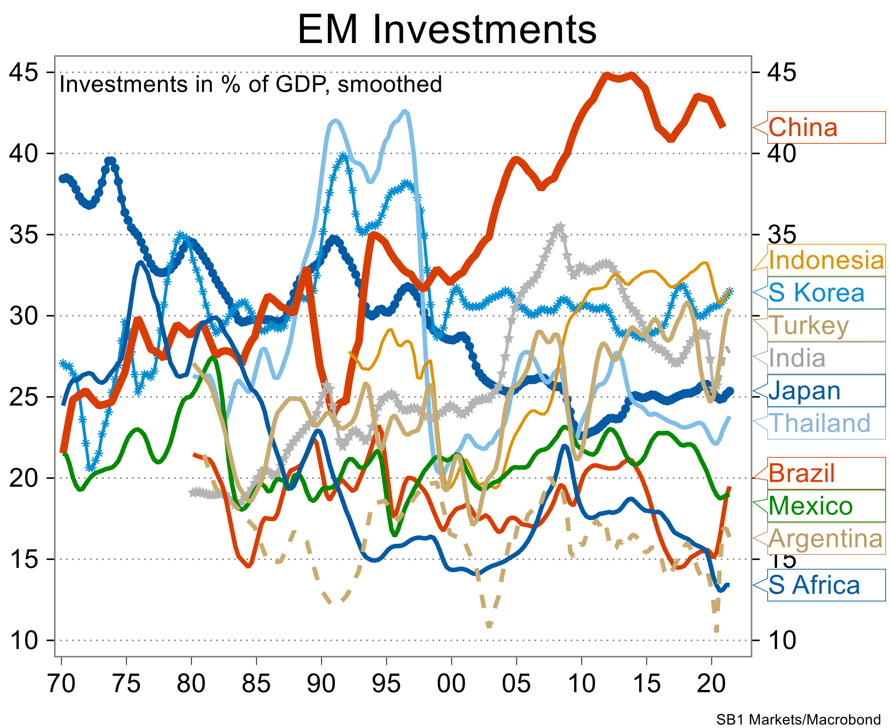


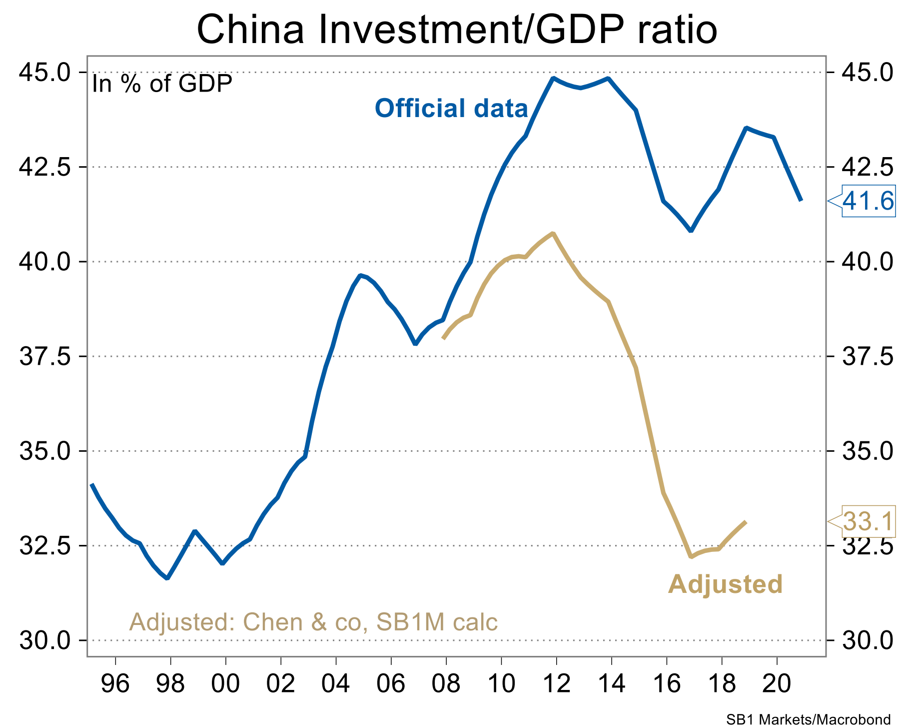
- Not all sectors have yet reported nominal Q3 data yet

Value added per sector (= sales – cost of purchases from other sectors)

The investment/GDP ratio is trending down but is still very high, above 40%

Just few countries have invested more than 35% of GDP for more than a short period



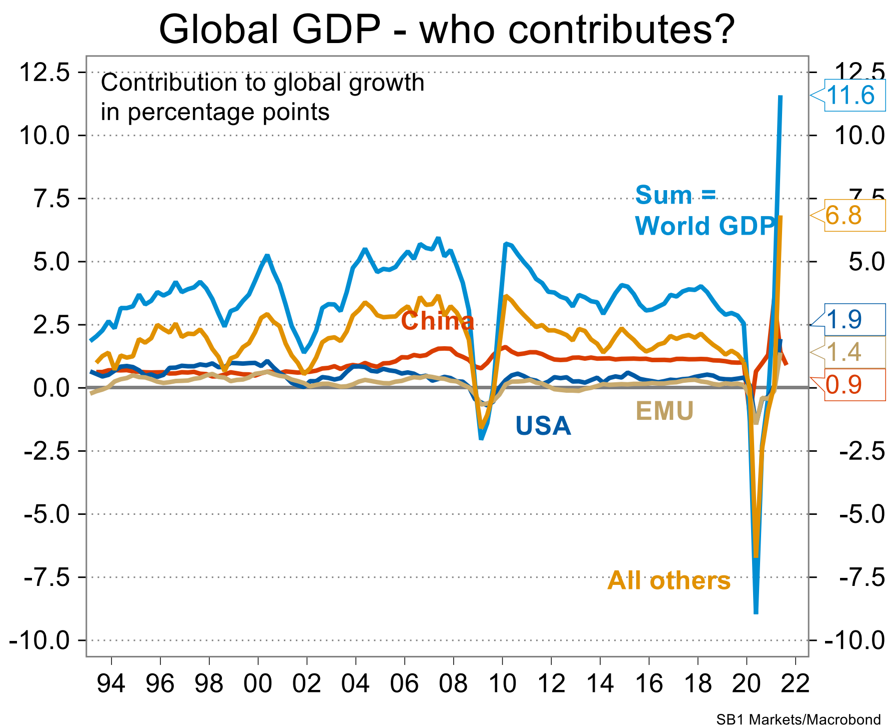


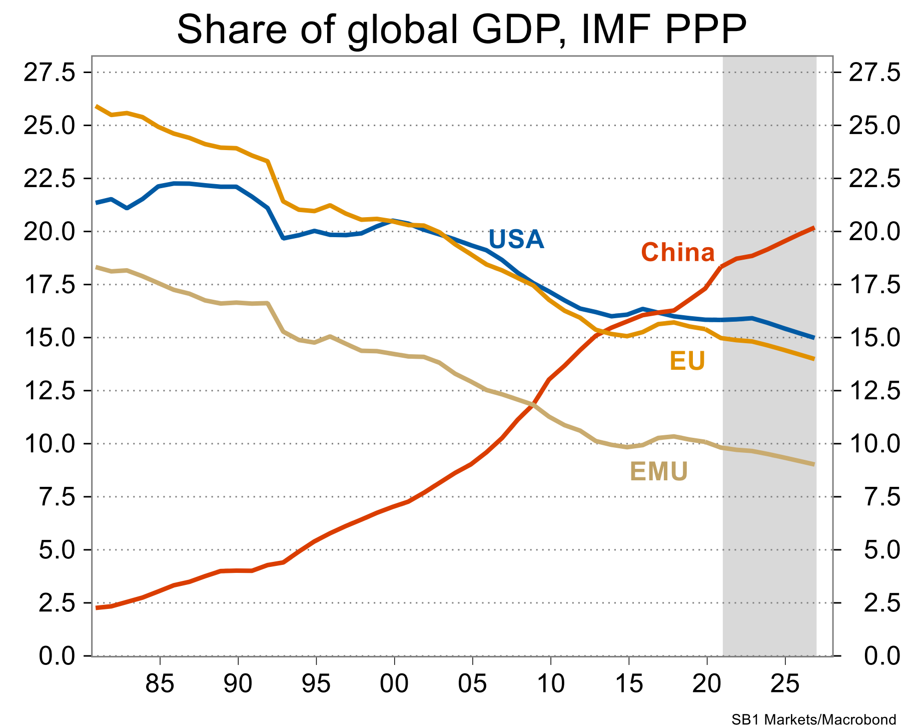
- Such a high investment level is no doubt a warning sign, the risk of overbuilding must be substantial. In several countries, periods with high investments, have been followed substantial setbacks (if investments contracts rapidly, like Thailand and South Korea) or a prolonged period of slow growth if the investment level declines over time (Japan)
- However, some researchers questions Chinese investment data. They are aggregated from local governments, and these regional data do not seem reasonable. A calculation *) indicates that the investment level is far lower than stated in the national accounts (and that GDP growth has been slower than official figures tell).

**) Wen Chen et al: A Forensic Examination: of China's National Accounts, Brookings, 2019*

We may blame China for many things. But it has not been a drag on the world ec.

The risk going forward: A substantial decline in construction activity

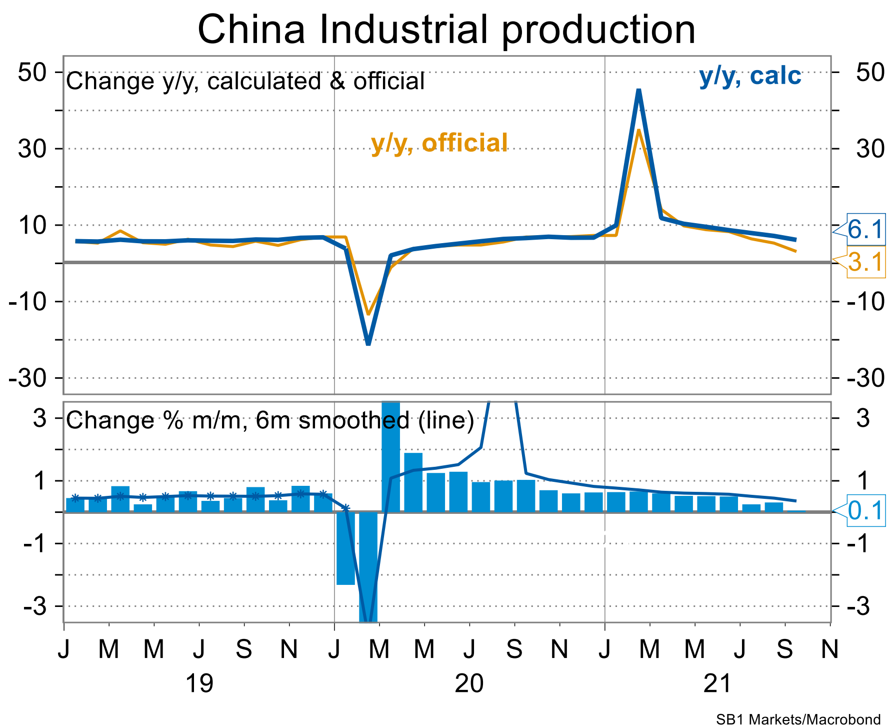


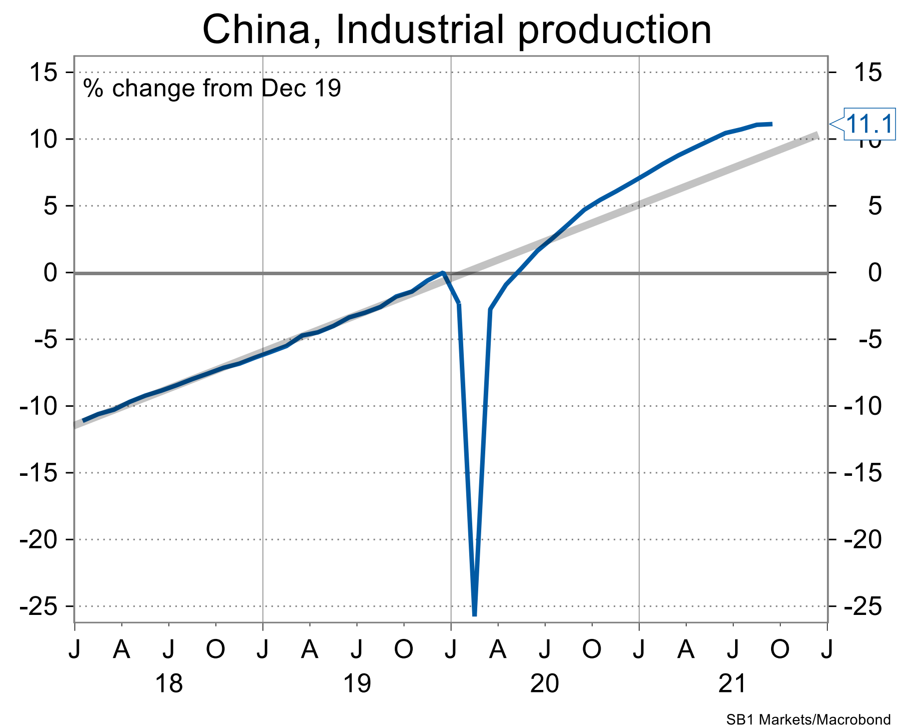


- Just China has so far reported Q3 data
- Measured in purchasing parity adjusted prices, the Chinese GDP has been larger than the GDP in the US since 2017

Industrial production up just 0.1% in Sept, far below the 'norm'

Official y/y growth rate down 2.2 p to 3.1%, <u>0.7 pp below expectations</u>. <u>Level still 2% above p-p trend</u>

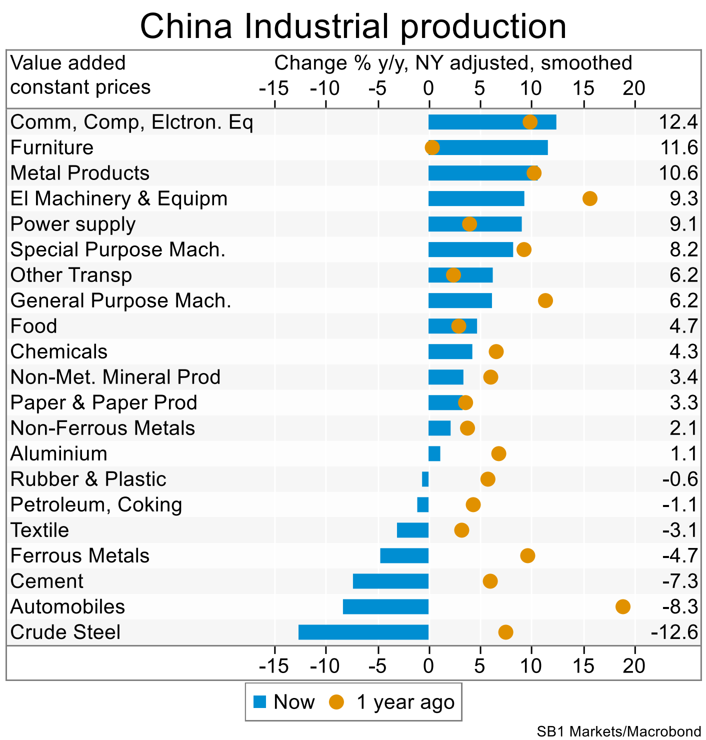




- **Our calculation** suggest a smaller decline in the annual rate, to 6.1%
- **Production** grew by 0.1% m/m, the weakest growth rate since during the sharp setback last Jan/Feb. Sharp production cuts in steel and cement, and now aluminium and autos (all down 10 – 20% from recent peaks) have contributed to the slow monthly growth
- Production is 11% above the Dec '19 level and 2% <u>above</u> a reasonable pre-corona growth path. <u>Not that bad</u>
- **Both supply and demand** factors may be limiting factors the coming months – supply side probably most important short term but construction poses a substantial risk on the demand side. Business surveys signal somewhat slower growth, and well above the 0.1% rate in September

Steel, cement & aluminum further down in September

All down 10% - 20%+ from the peaks in late 2020 or early 2021!

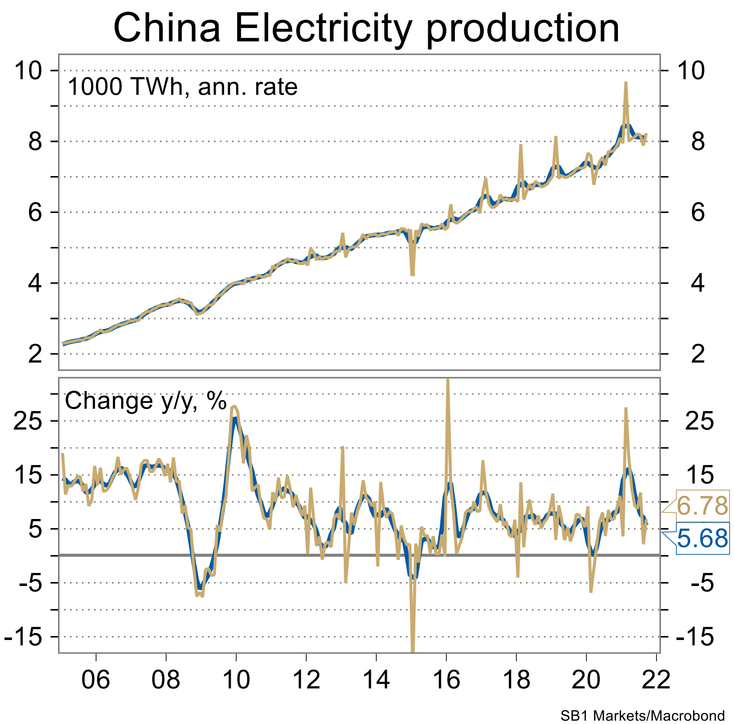


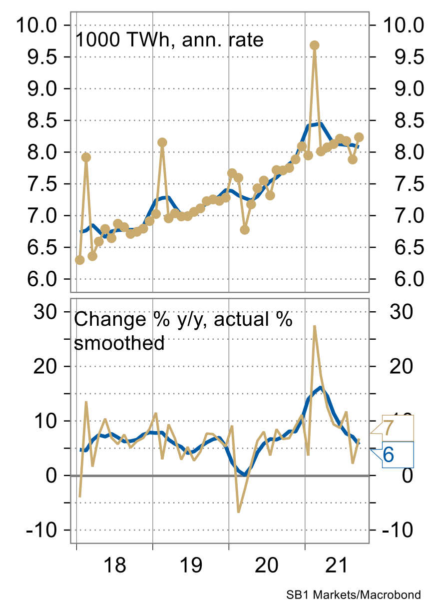
- The authorities have decided that 2021 steel production should not exceed the 2020 level, and as H1-21 production was well above the 2020 level – production must be cut in H2 (some 12%)
  - » Both production and demand (including inventories) are down more than 20%, alongside the decline in construction stars! We assume there are more reasons for the cut in steel production 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). Check the long term charts here
  - » Other 'construction related' sectors like copper and plate glass have kept up far better (but plate glass sharply down in Sept)
  - » Auto are yielding too, due to lack of components – as in the rest of the world
  - » Growth in still strong in electronics, furniture and metal products

SpareBank 1 MARKETS

Electricity production up in September but has almost flattened

Domestic transport may have slowed somewhat – partly Covid related (data just through Aug)

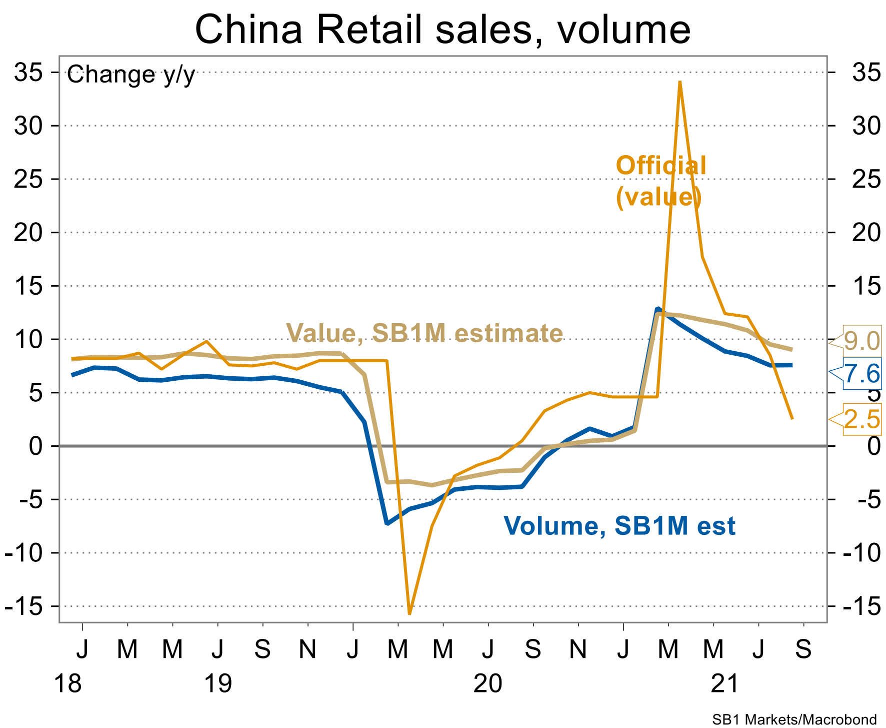


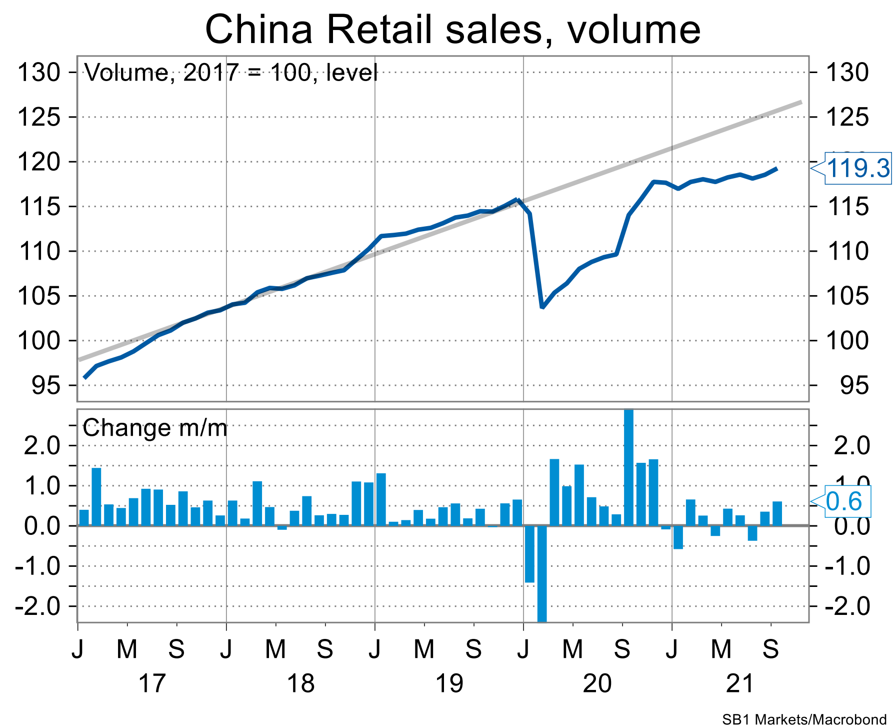


- Seaport traffic is not terrific either, somewhat strange given the surging exports (but imports have slowed)

Retail sales gained speed in September but the trend is not impressive at all

Real sales rose 0.6% in Sept (our calc), the best since Feb, the nominal y/y rate 4.4%, 1 pp above exp.

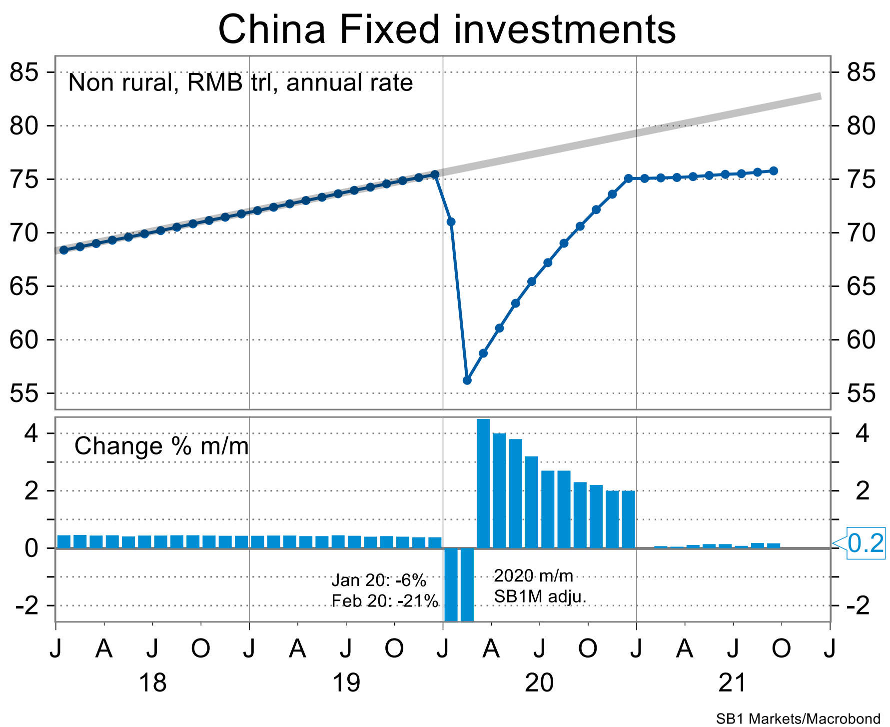




- **Nominal retail sales** were up 4.4 y/y in Sept, up from just 2.5% in August, and above market expectations at 3.4%. (These annual growth rates are close to useless due to the base effects)
- In nominal terms sales rose by 0.3% m/m in Sept, we assume it rose by 0.6 % in **volume terms**
  - » Since last November the underlying volume growth rate has been less than 2%. Before the pandemic growth equalled some 6% p.a, and the slowdown is dramatic. The fight against the virus may explain some of the slowdown, but it is probably more than that
- Sales volumes are 5% below the pre-pandemic trend path – and underlying growth is very low

Investments on a new, and a much slower growth path

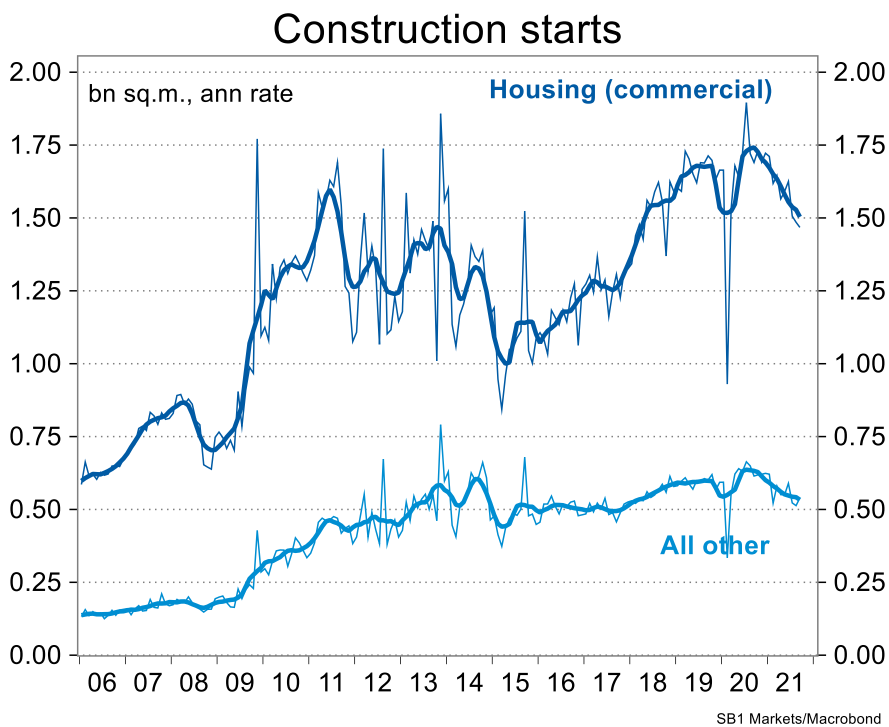
Monthly growth at 0.2% in Sep, history revised down, <u>again</u> – and level is 8% below pre-Covid trend!!

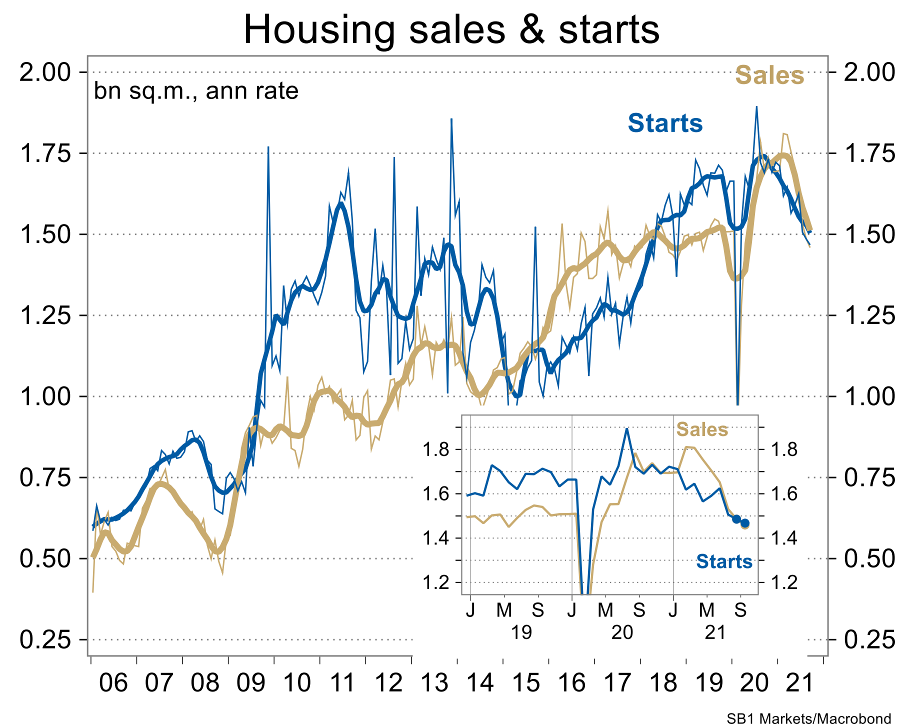


- **Measured YTD**, nominal urban investments rose 7.3% in September (still a silly number, due to the setback last spring/summer), down from 8.3% in August, <u>0.6 lower than expected</u>
- **Growth m/m** was just 0.2% in nominal terms in September, and the previous months was once more revised down (for the 5th month in row!). Growth was gradually slowing before the pandemic, to some 0.4% per month. Now growth is far slower, just 0.1% per month so far in 2021! As inflation has picked up, investments must be falling in real terms! We now even estimate a zero growth in real terms in September
- The **investment level** is 8% 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 September but no acceleration

Both new home sales & starts down 1-2%, sales down 18% from Feb/March, starts down 15% from Q4

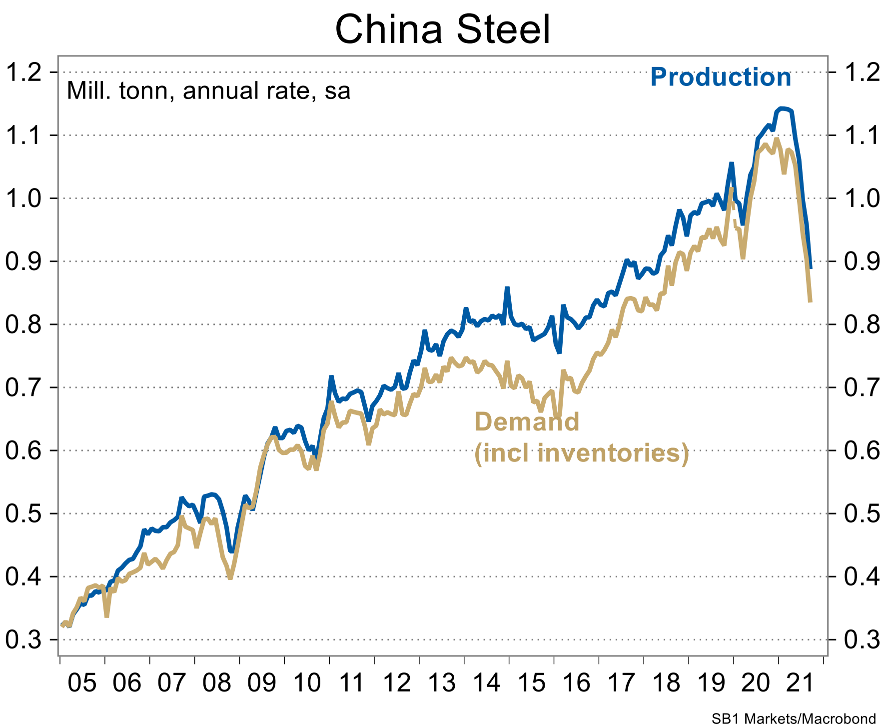




- **New home sales** have fallen almost 20% from early 2021, following the spectacular 30% increase from the low in early 2020. Sales are back to the pre-pandemic level – so no disaster, at least not yet – and sales fell ‘just’ 2% m/m in September
- **Housing starts** fell further too, and starts are now more than 10% below the pre-pandemic level. Starts have been running below sales most of 2021, signalling an inventory drawdown
- **Non-residential construction** rose a tad in September, but is down more than 15% since last summer, and the level is below the pre-p level. However, the decline is not accelerating
- **In sum, construction starts** are on the way down – and the downside risk has of course increased due to the ‘financial stress’ in the real estate sector. Look up for demand (or supply??) for steel, *check next page. Luckily, starts have already fallen substantially*

Construction & domestic demand for steel down, steel now -20%

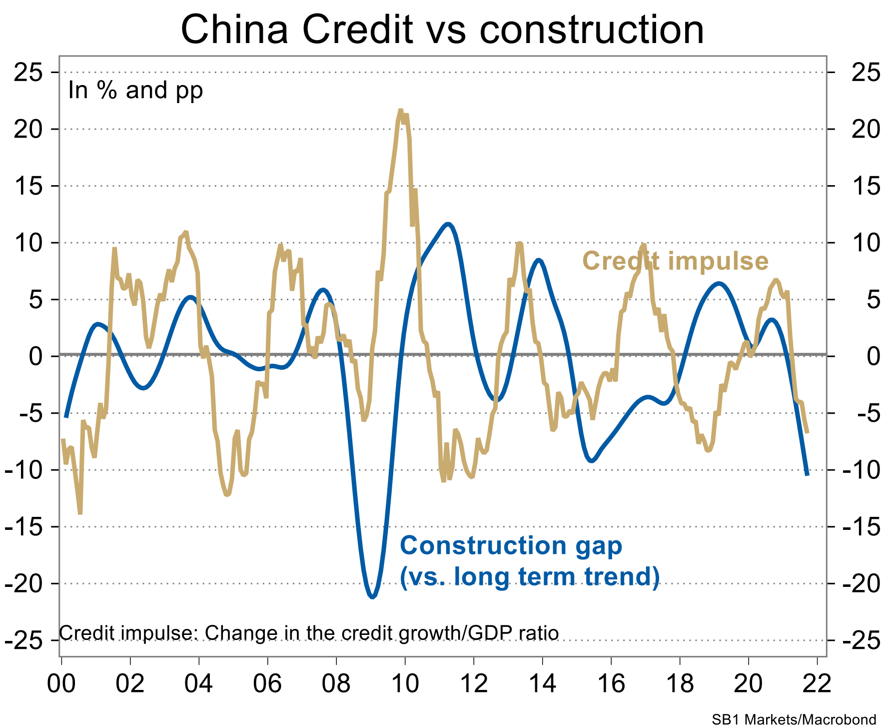
The reason may partly be the ‘official’ story on meeting 2030 CO2 targets but demand is down for real too?



- 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

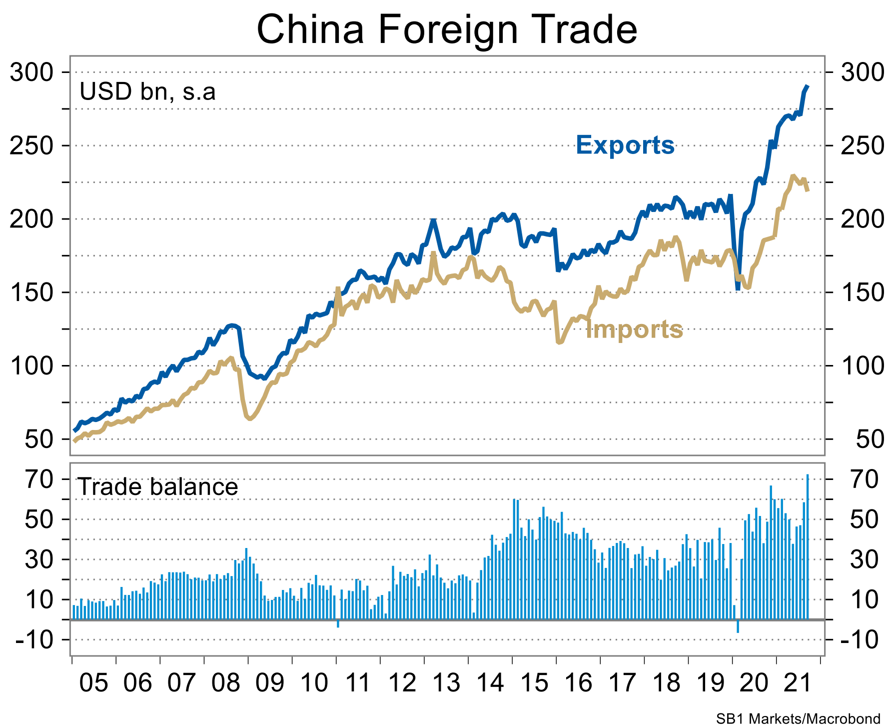
The two are dancing together, but not closely (and it varies who takes the lead too)



- … 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

Exports are still surging, imports have slowed. And a record high trade surplus!

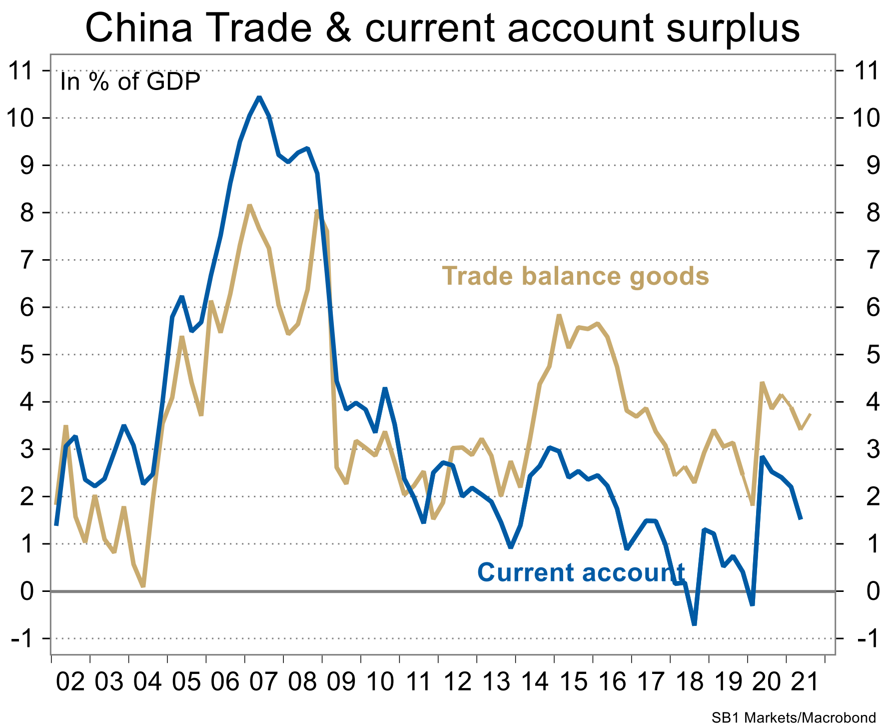
Exports 8% higher than expected, imports 4% lower

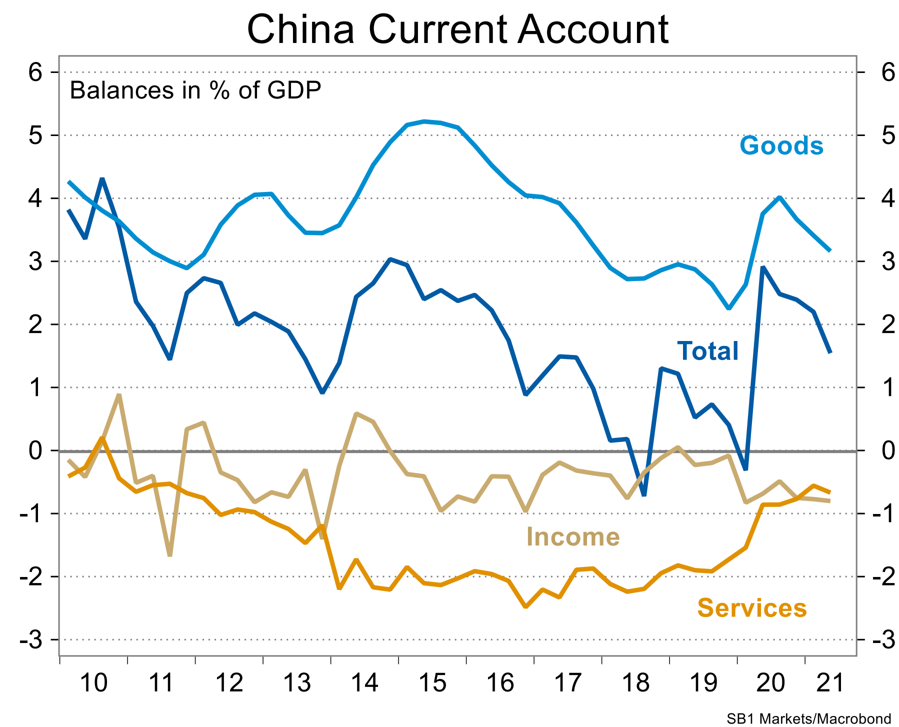


- **Exports** increased by 2% in USD terms in Sept and 30% y/y, up from 25% in Aug, expected down to 22%. Export volumes most likely rose too and the level is extremely high, up almost 30% vs the pre-pandemic level and 16% up vs. the pre-pandemic trend growth path! Signals still strong demand for goods. Prices are up 10% y/y (our est.)
- **Imports** values fell 4% m/m but are up 18% y/y, down from 30% in Aug, expected up 22%. Recent months import values have stalled, and as prices have climbed, import volumes some 7% since the spring – from a high level. Import volumes are back to the pre-pandemic trend growth path. Oil and iron ore imports were still weak in Sept, while coal imports rose sharply
- The **trade surplus** was sharply up in August, at USD 72 bn (seas adj) a new ATH.
- For some time we have expected an export slowdown in H2 due to lower demand for goods in the rich part of the world – but we have so far been wrong. The decline in imports may signal lower domestic demand. Even if credit policy now may be turning expansionary, the lagged impact on the previous tightening may be felt in domestic demand

China is running a substantial current account surplus

The C/A surplus was above 10% of GDP in 2007, fell to zero and is back to 2% again

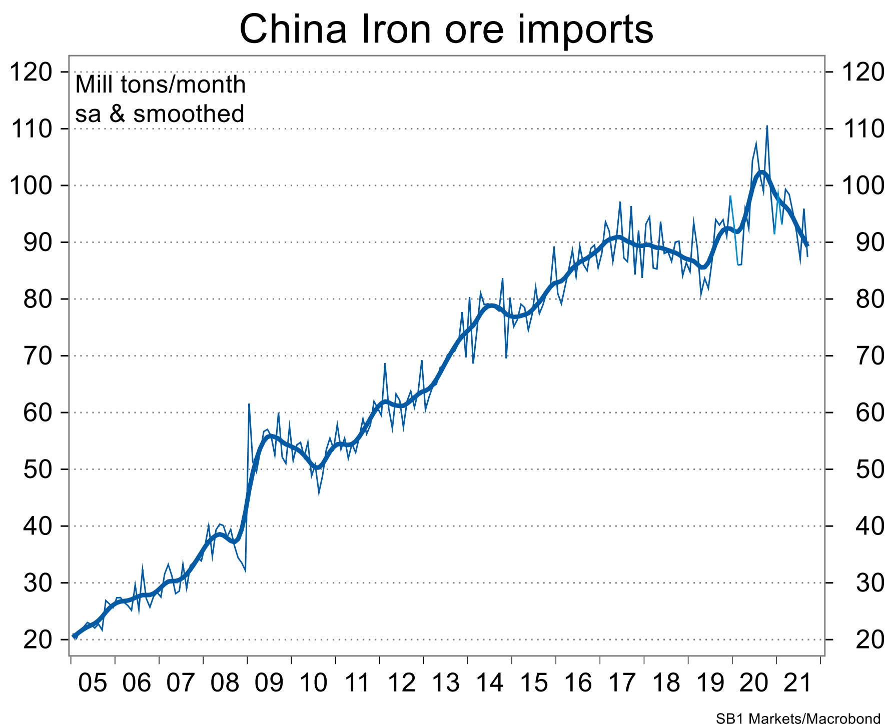


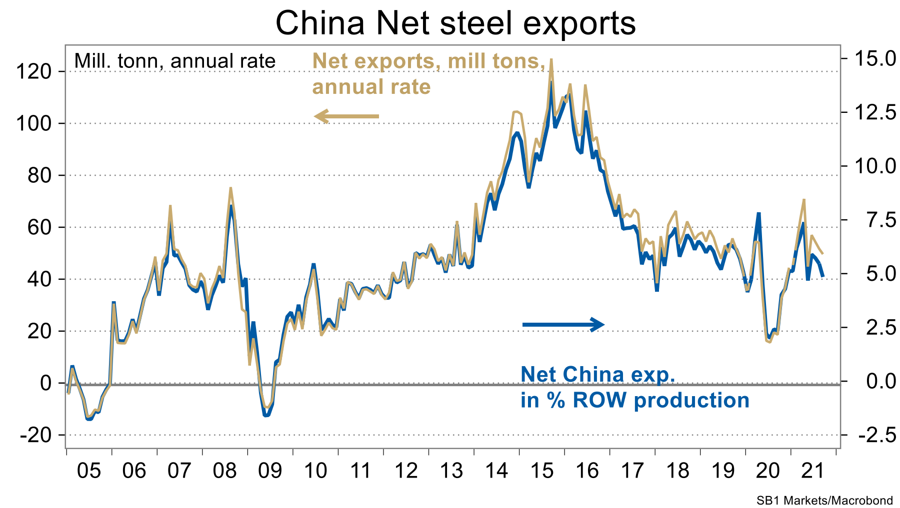


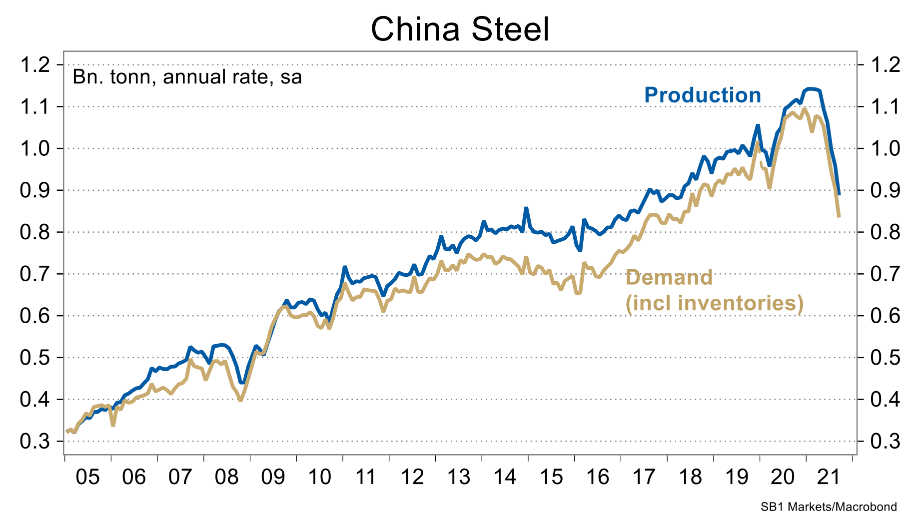
- The trade surplus in goods was some 3¾ % in Q3
- In services, China runs a 0.6% deficit (Q2), down from -2% in 2015 – 2019 (but from zero 10 years ago). For the time being, the Chinese do not travel abroad (and we do not visit them either)
- China runs a marginal deficit in net (mostly capital) income from abroad, even if the country has a huge net + financial position
  - » China has invested much in low yielding US government bonds; foreigners are investing in profitable production capacity in China

Iron ore imports have fallen 10%+, and the trend is still down

Authorities have curbed steel production in order to bring CO_2 emissions down (in 2030…). They say



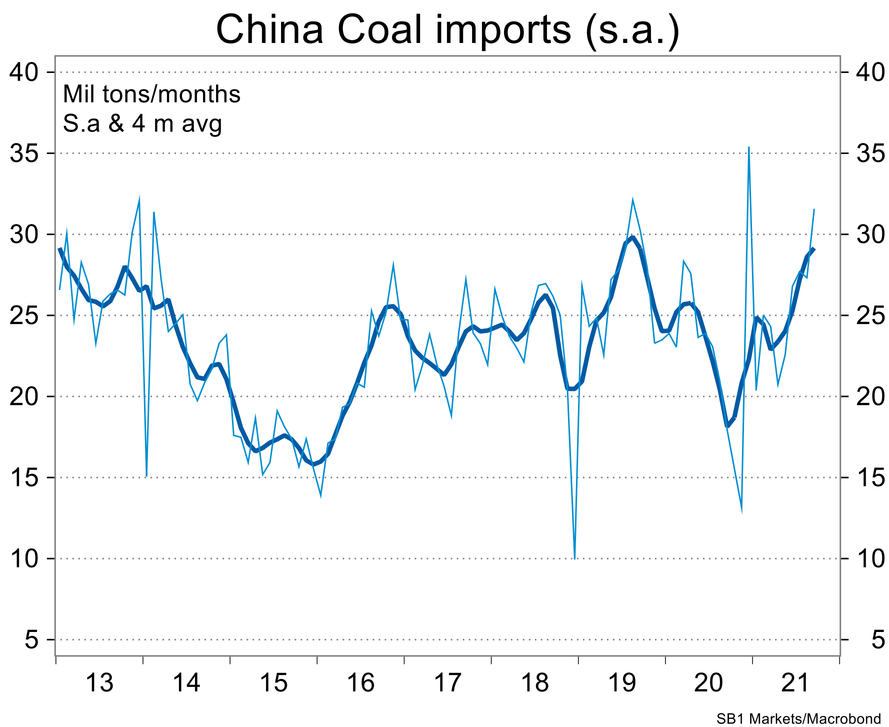


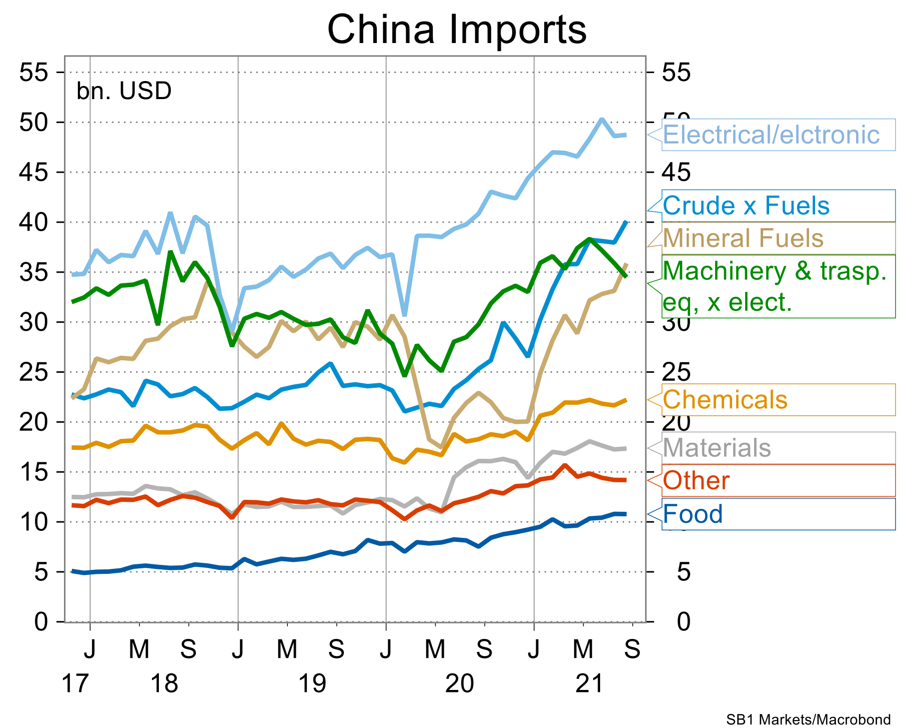


- Iron ore import have fallen more than 10% since late last summer, and fell in September, following an uptick in August
- Steel production has fallen sharply recent months, by more than 10%. Domestic demand is down, most likely due the decline in construction activity

Coal imports sharply up in September, up to one of the best months ever

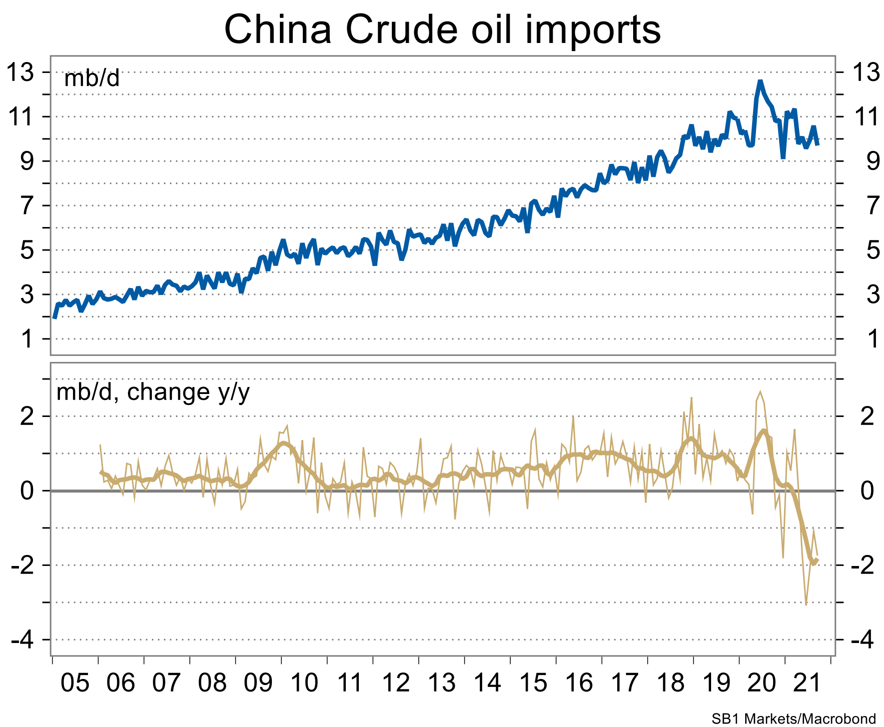
Guess they found out that they had too little of the dirty stuff

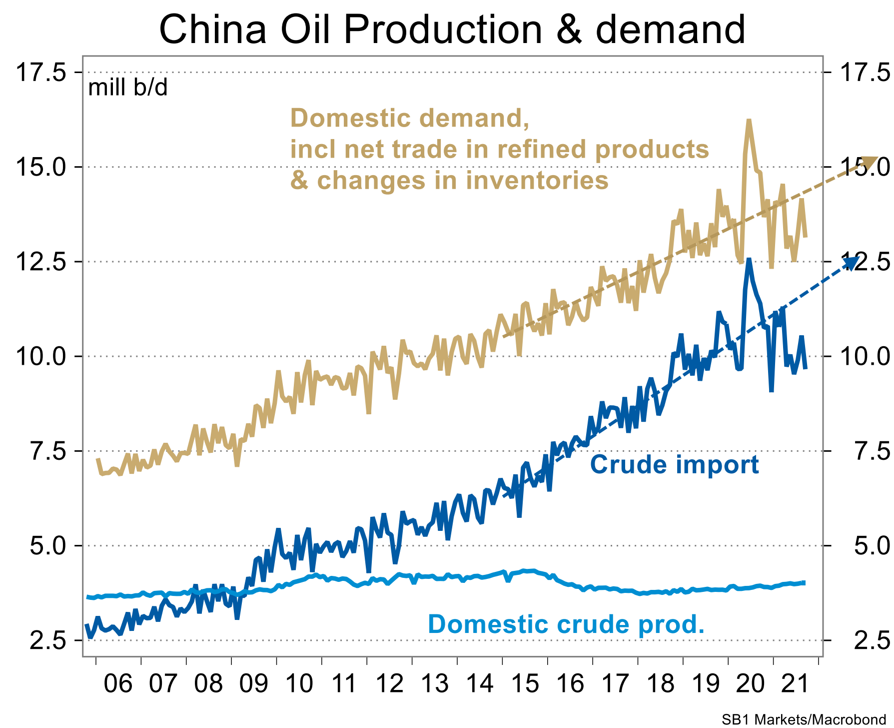




SpareBank 1 MARKETS

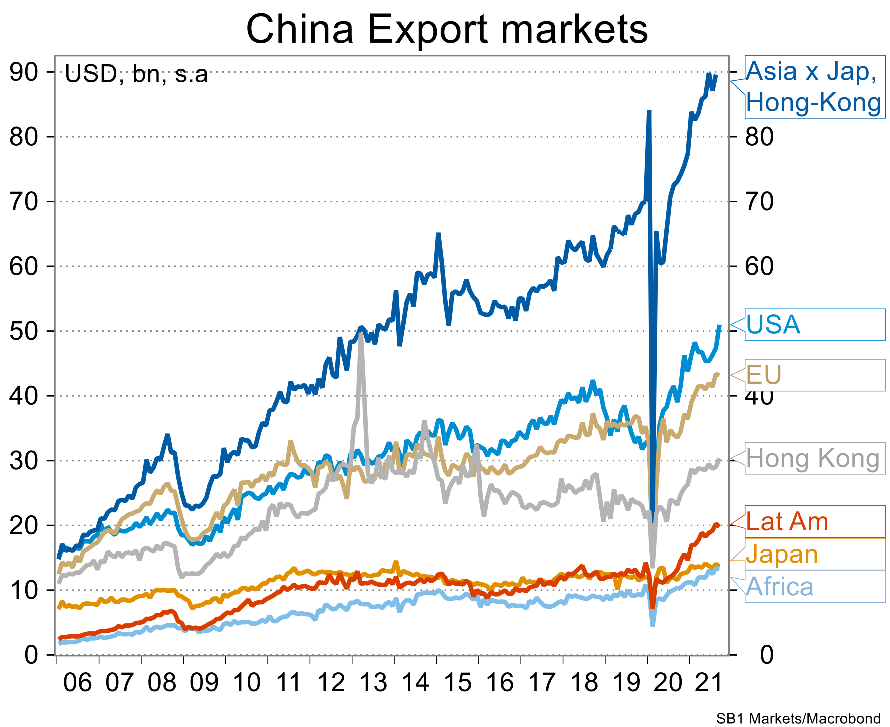
Oil imports flat since mid 2018, are down almost 20% (2 mb/d) since H1-20





Chinese exports to all corners of the world sharply up

The recovery in exports through the pandemic has so far been impressive

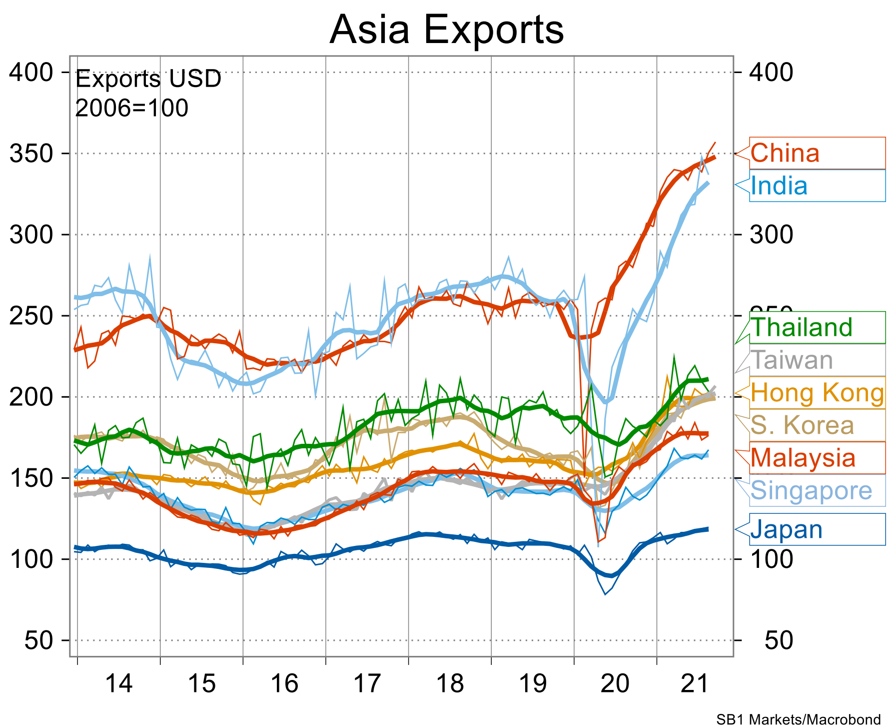


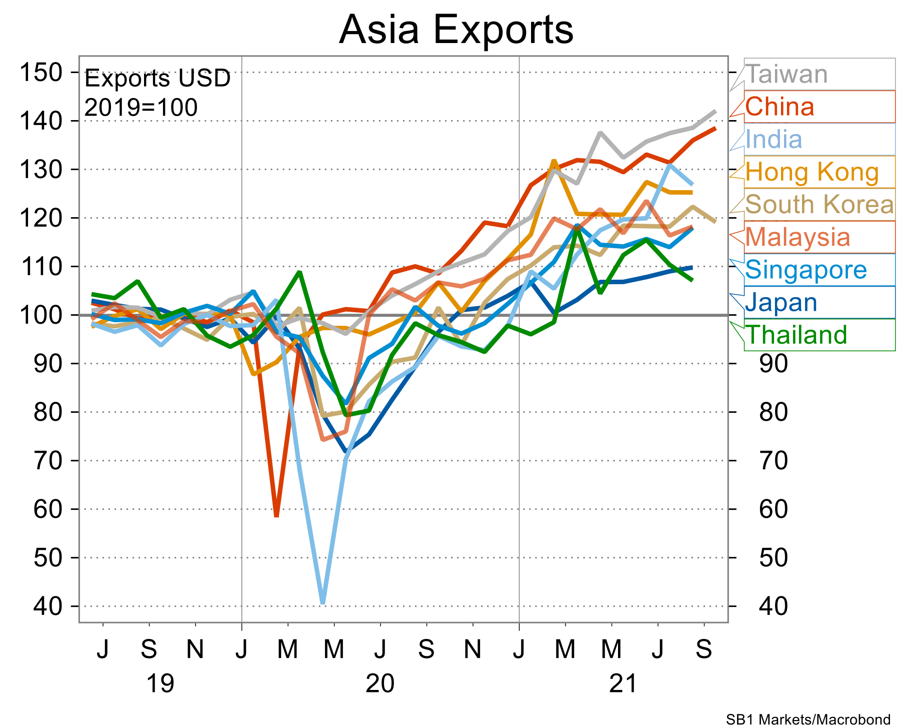
- Some slowing in exports to Hong Kong, Japan – and to rest of Asia

SpareBank 1 MARKETS

Exports from other Asian counties also on the way up. No Delta impact anywhere

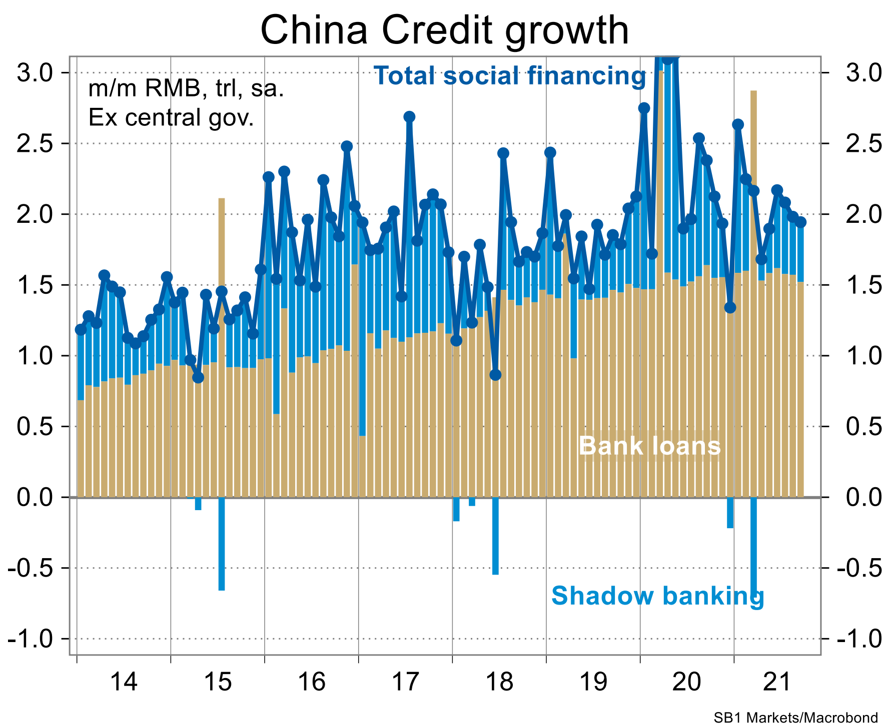
… but underlying growth is slowing everywhere

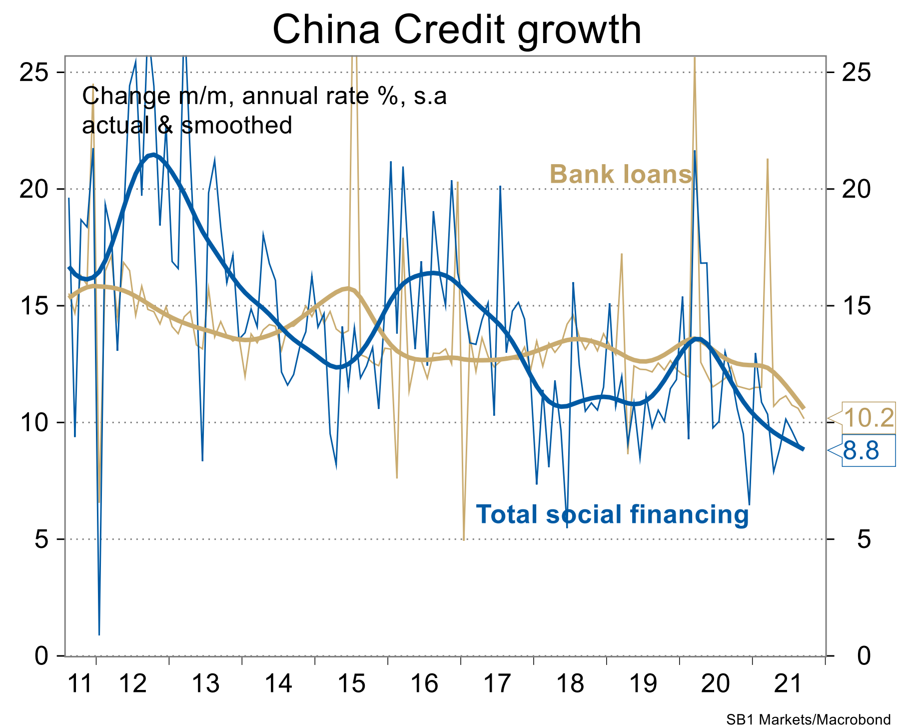




Credit growth is slowing – but no drama yet, and growth still > income growth

Authorities seem to choose a mixed approach: Keep credit up in some sectors, slow others

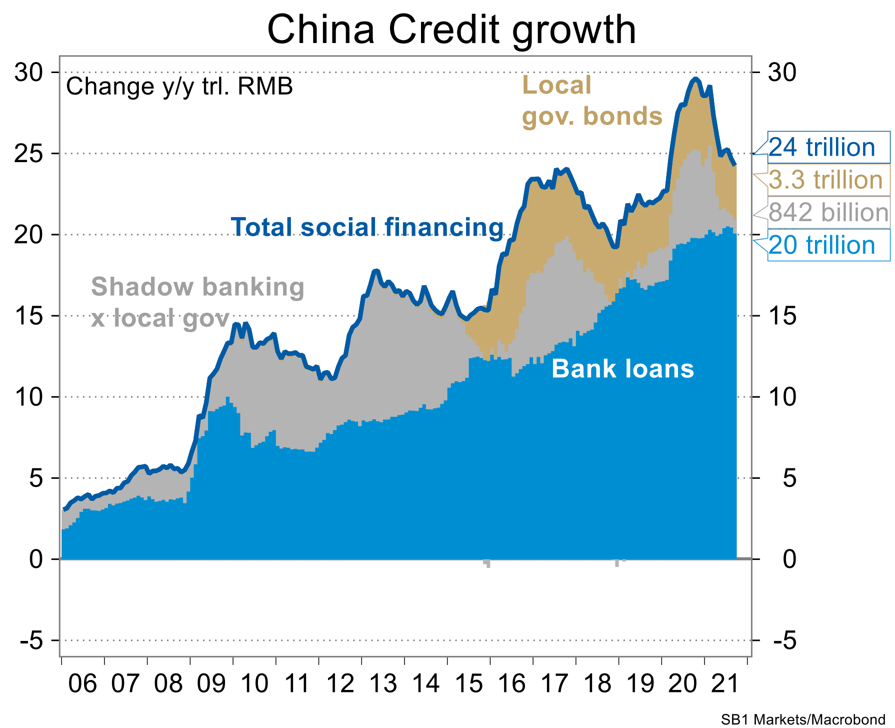


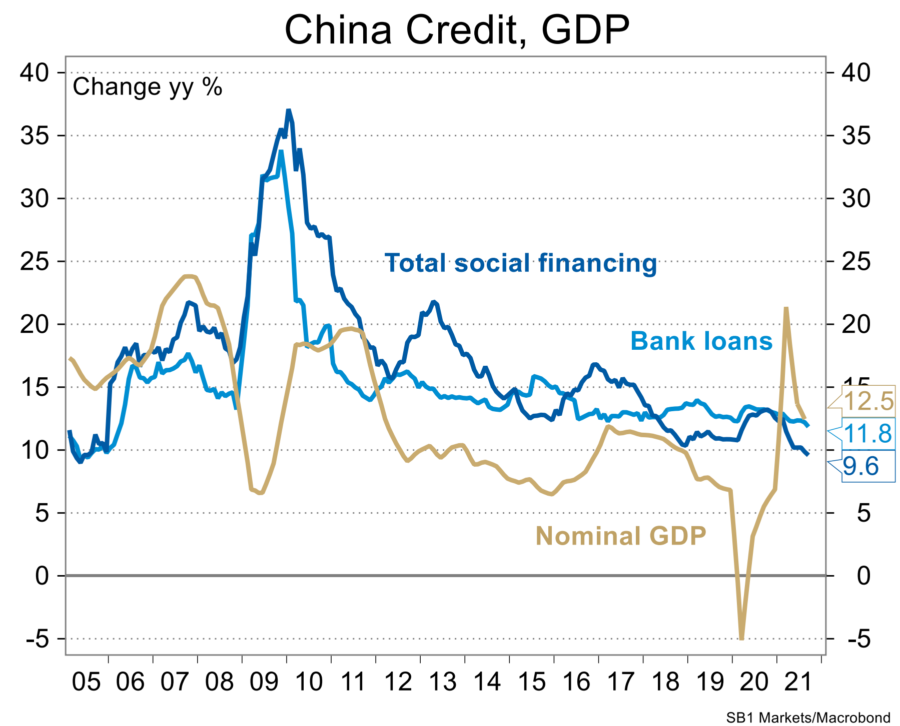


- **Total credit** grew at a 8.8% rate in Sept (m/m, seas. adj. annualised), down from 9.1 in August. Smoothed, the underlying rate may be at the same level, down from 13% during last spring (and >15% during some months). The underlying growth rate is still marginally above the trend growth in nominal GDP (say 5.5% real growth, 2% price inflation)
  - **Total credit** rose by RMB 2.8 trl, expected 3.1 trl (not seas. adj., total social financing, including central & local government bond, and corporate equities). Seas. adj. the core total social credit (total ex central gov bonds & corporate equites) grew by 1.9 trl, down from 2.0 trl in Aug. No credit supply chock following the Evergrande drama, at least not yet
  - **Bank loans** rose by RMB 1.5 trl, seas adjusted, or at a 10.2% annualised pace - and less than expected. Growth is gradually slowing, from a 13% rate last spring. Loans are up 11.8% y/y.
  - **Shadow banking credit** rose by RMB 0.4 trl, close to the level over the past 4 months (s.a). Growth has slowed sharply, underlying to 6%, from 13% last summer – the lowest growth rate on record. Excluding local government bonds, 'private' shadow credit is close to flat!
- **The credit impulse has turned negative**, like it usually does every 4th year or so. The ramifications may be felt in many markets
- **The slowdown has been by purpose**, as authorities have tightened, especially vs. credit supply outside banks, especially vs. the construction sector. However, the authorities have at least partially shifted the foot to the accelerator again – as they always have done after tightening too hard. In July, PBoC cut banks' reserve requirements

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

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

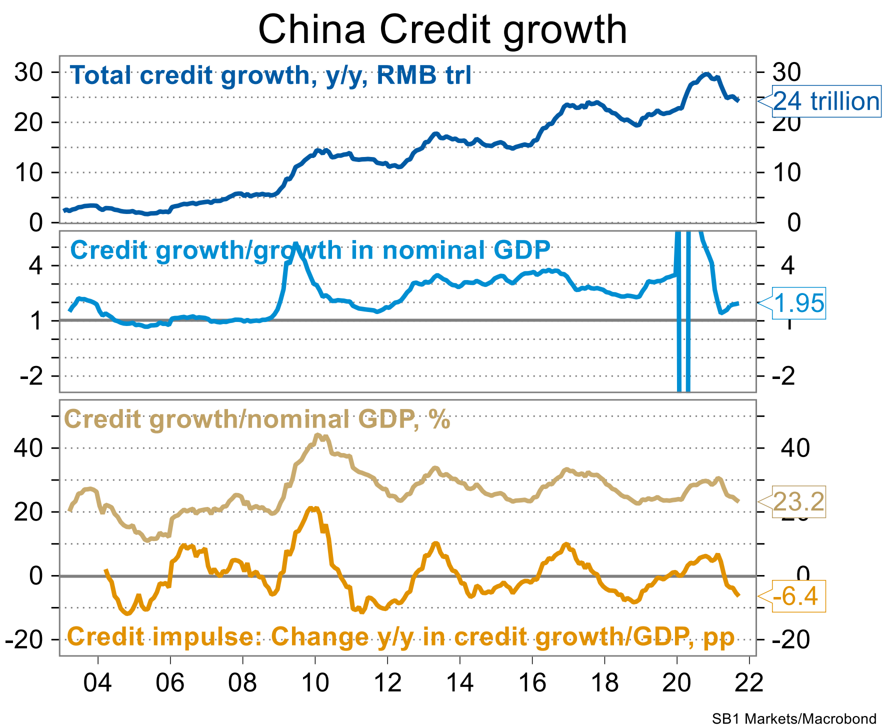


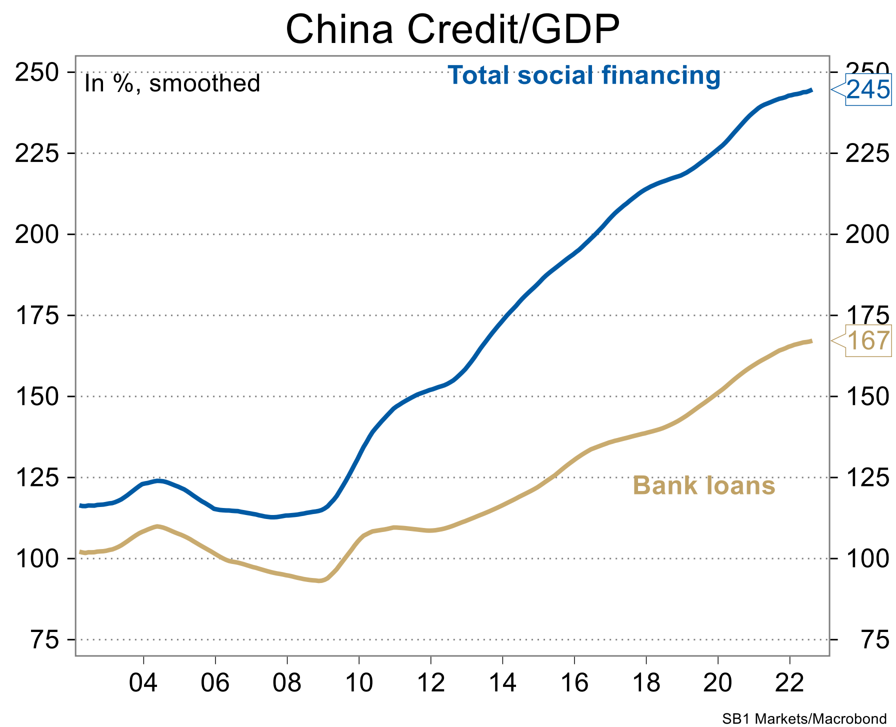


- Over the past year, **total credit** has expanded by RMB 24 trl, equalling almost 25% of annual GDP, down from RMB 30 trl at the peak in 2020
- **Banks** supplied RMB 20 trl of the y/y increase
- **Local governments** have not yet accelerated their borrowing by much, at least not in the bond market, still up 3.3 bn y/y
- Growth in other credit – via the **shadow credit market x local gov bonds** – has slowed to less than RMB 1 trl from 5 trl, a dramatic slowdown (like many times before) – and is up just 1.4% y/y
- **Total credit** growth fell 0.3 pp to 9.6% y/y, the slowest pace since 2005, but still above nominal GDP growth before the pandemic, and above our estimate of 5.5% potential GDP growth + a 2% rate of inflation. Underlying growth in credit recent months is even lower, down to 9%

The credit impulse is falling deeper into negative territory, still not record low

The slowdown in credit supply is substantial and well felt in parts of the Chinese economy



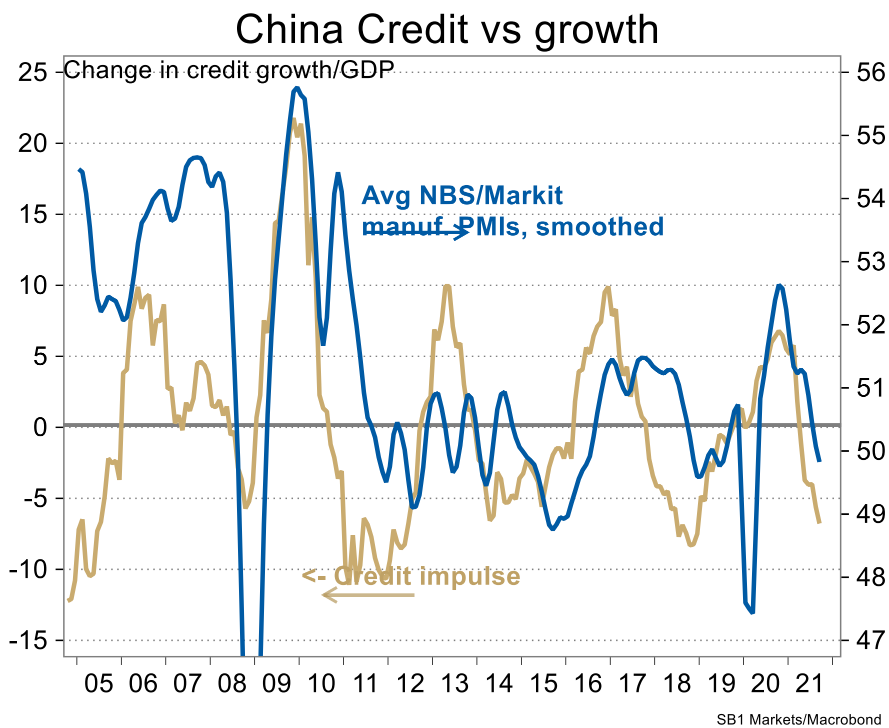


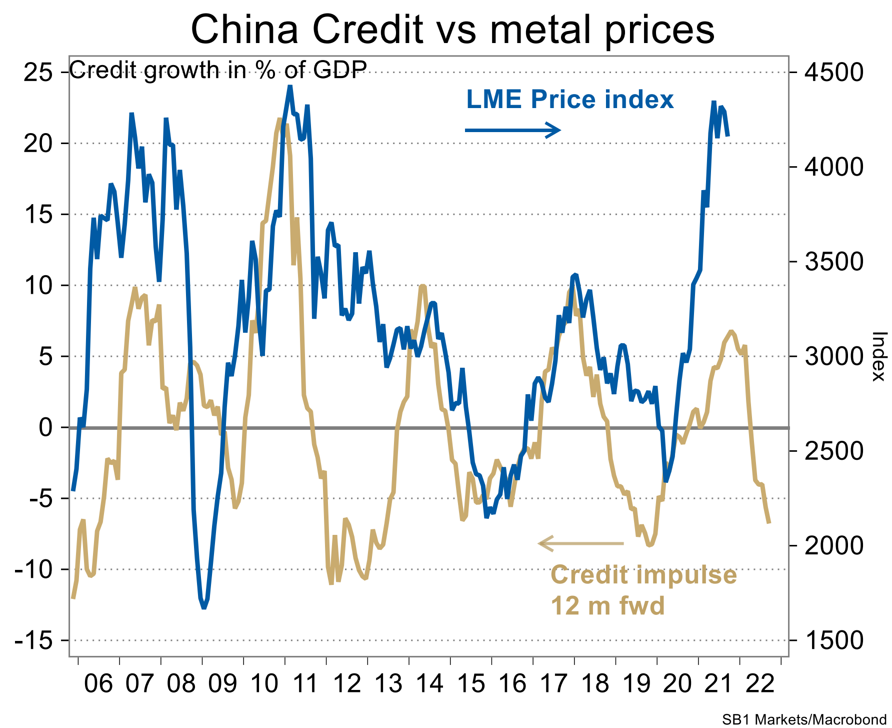
- A positive **credit impulse** implies that the credit growth/GDP ratio is increasing (the 2nd derivative of credit vs the GDP level)
  - » A negative credit impulse indicates credit tightening (or weaker demand) and has been associated with slowdowns in the Chinese economy, which have had impacts at other markets
- The **credit impulse** (here measured as the 12 m change in the 12 m credit growth/GDP ratio) bottomed in late 2018, turned positive one year later, peaked last autumn, fell into negative territory in May, and is now at -6.4%
- Are authorities worried that they have tightened too much, in sum? Probably not too much, yet. Reserve requirements for banks are cut, but not any policy rate.

GDP is smoothed in the calculations in the charts above

Credit impulse vs. PMI, metals prices

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

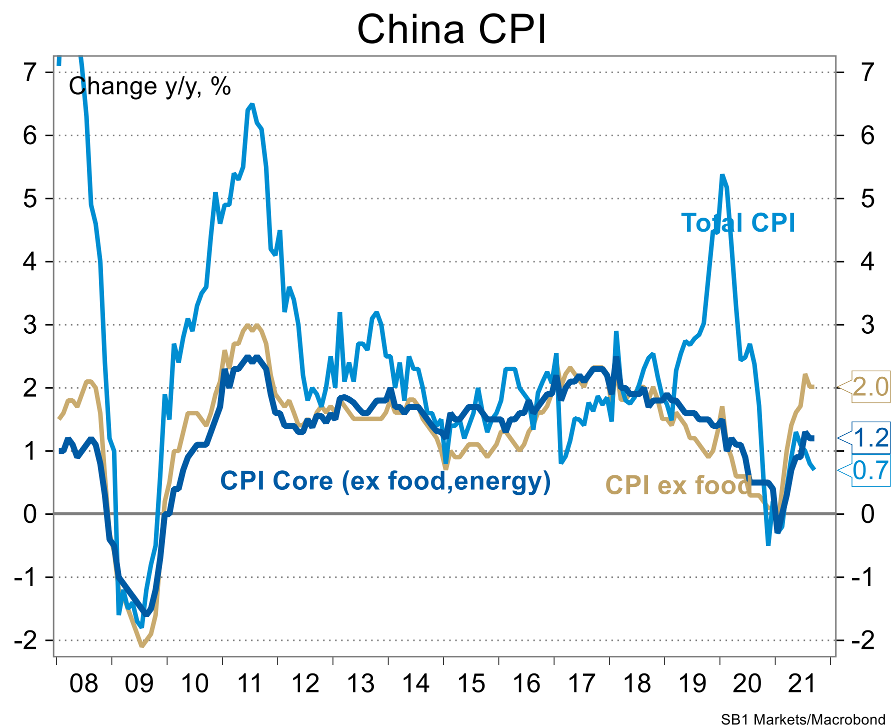


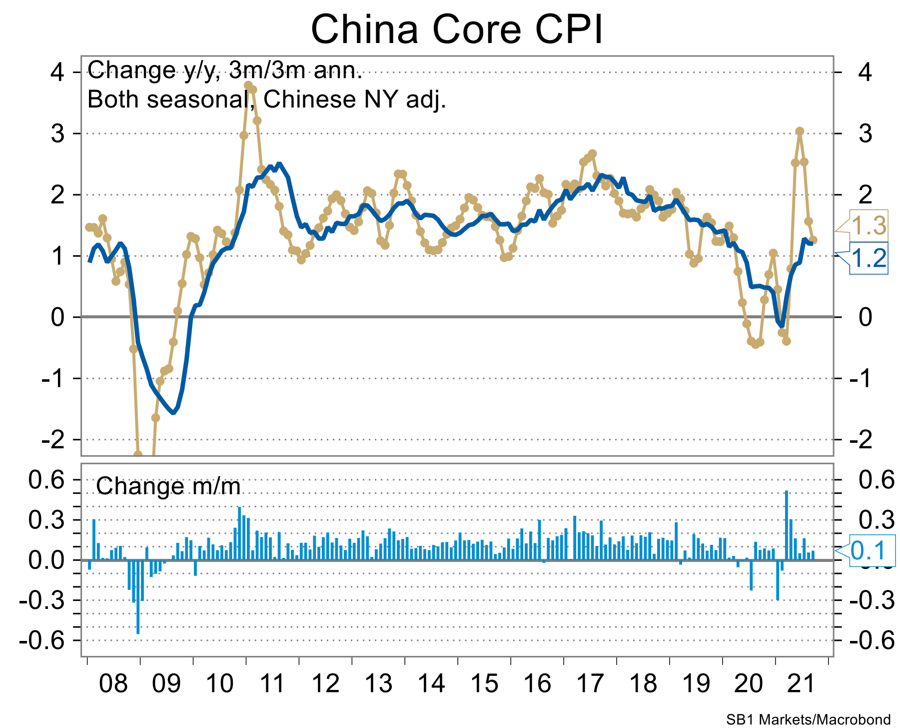


- ... by some few months
- And global metal prices (here the LME metal index) by almost a year in average. The correlation was weak before the Financial crisis – but somewhat higher the past 15 years (chart to the right above)

Chinese inflation suppressed by lower food prices. Headline inflation at 0.7%

The pork industry is recovering – and pork prices are normalising. Core unch. at 1.2% y/y



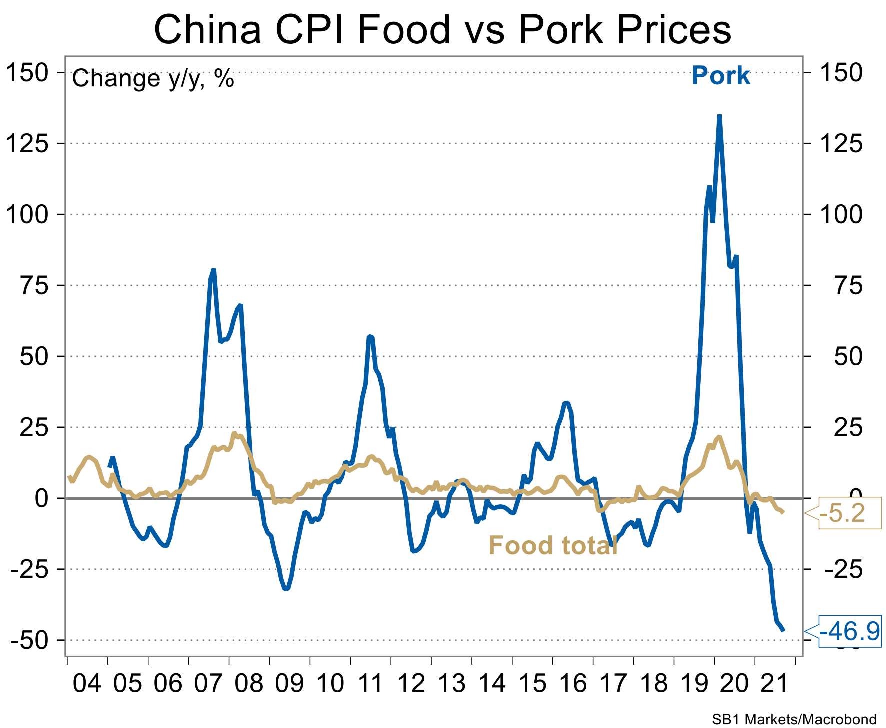


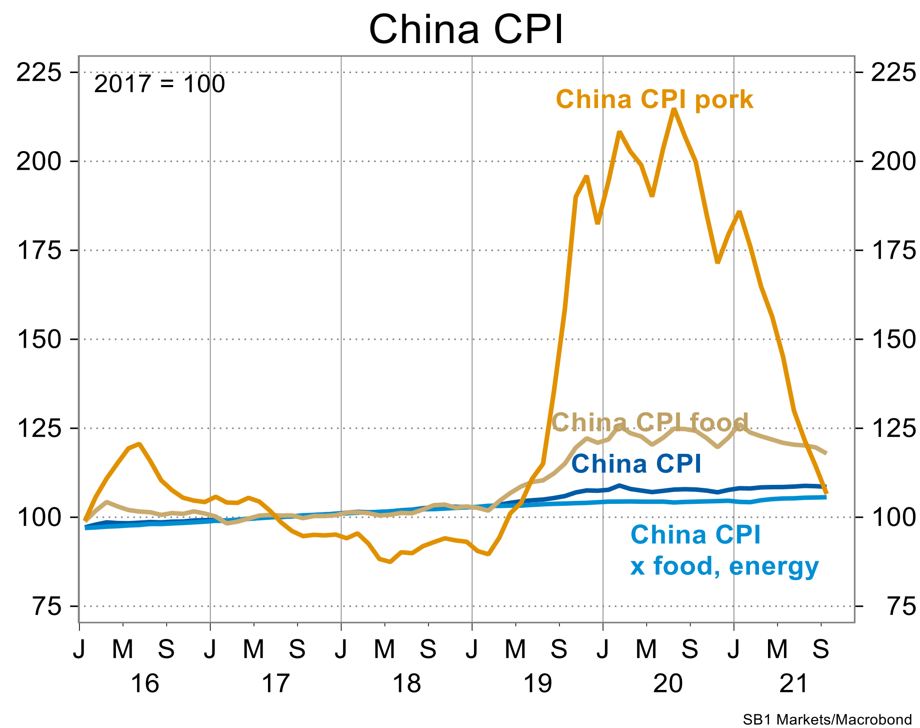
- **Total annual CPI** growth fell from above 5% in early 2020 to -0.2% in Feb. In September, CPI was up 0.7% y/y, down 0.1 pp from August, expected at 0.9%
- **Food prices** fell by 1.4% m/m, as if pork prices fell further by 7%. Food prices are down 5.5% y/y. Pork prices have fallen sharply following the doubling of prices due to the 'pig massacre' (swine flu) last year. Pork prices are more or less back to a normal level
- **Energy prices** are sharply up y/y, lifting the CPI by 0.8 pp
- **The core, ex food & energy price** index was up 0.1% m/m, and is up 1.2% y/y, unch. from August. Prices up 1.3% measured 3m/3m
- Inflation is low. **Monetary policy** will not respond to actual inflation data if inflation is not really high or low, the real economy and the credit market is more important

SpareBank 1 MARKETS

Pork prices down 6.8% m/m in September, resulting in 1.4% lower food prices

Pork prices are down 47%, from Sept '20. They are still 7% higher than before the swine flu



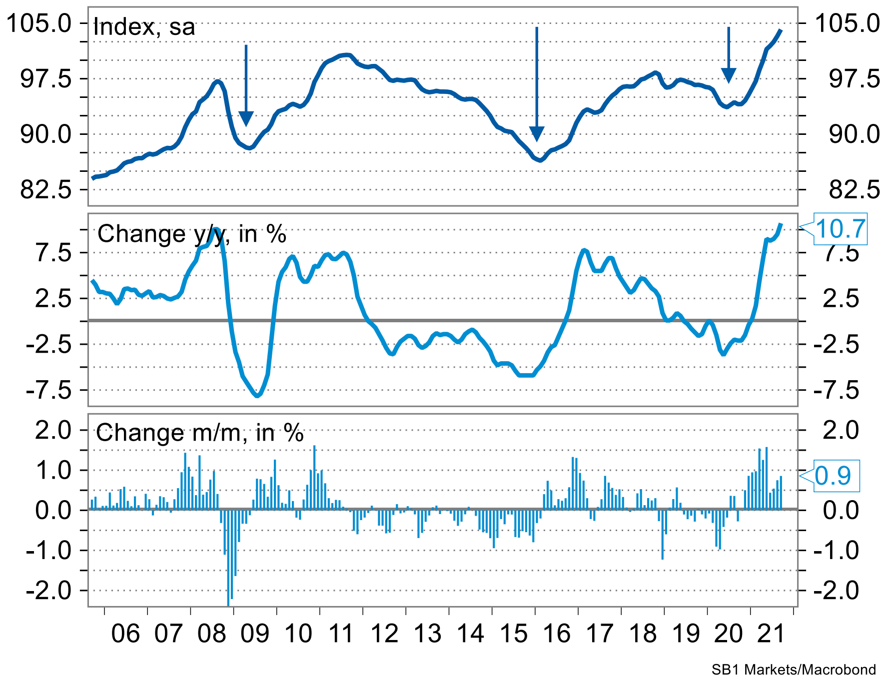


- Food prices fell by 1.4% m/m in September and are down 5.5% y/y – due to a 47% y/y decline in pork prices

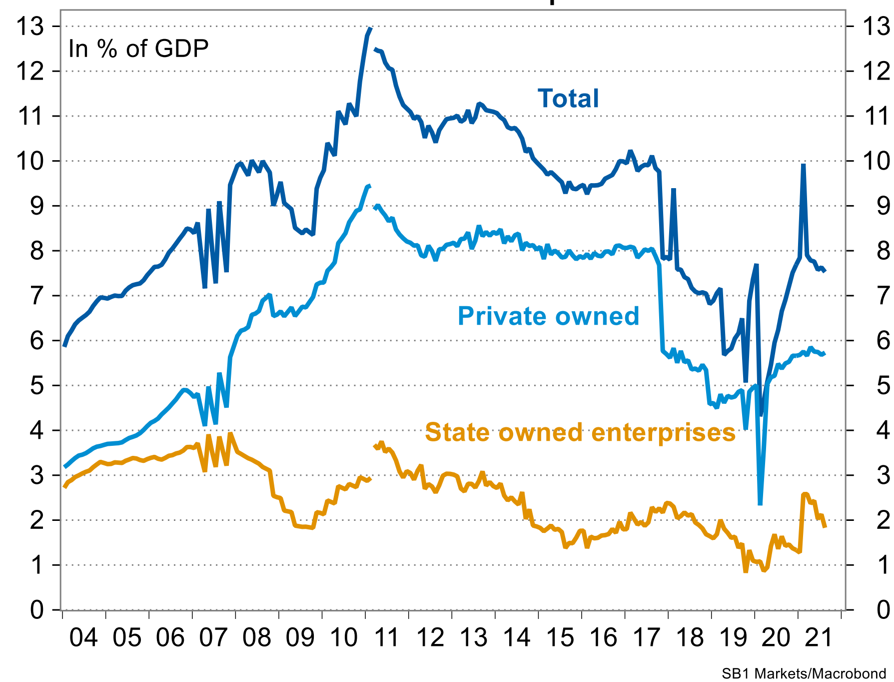
PPI keeps rising – will put further pressure on trade partners' inflation (but not Chinese CPI)

PPI up 0.9% m/m in September – and 10.7% y/y, 0.2 pp above expectations

China PPI



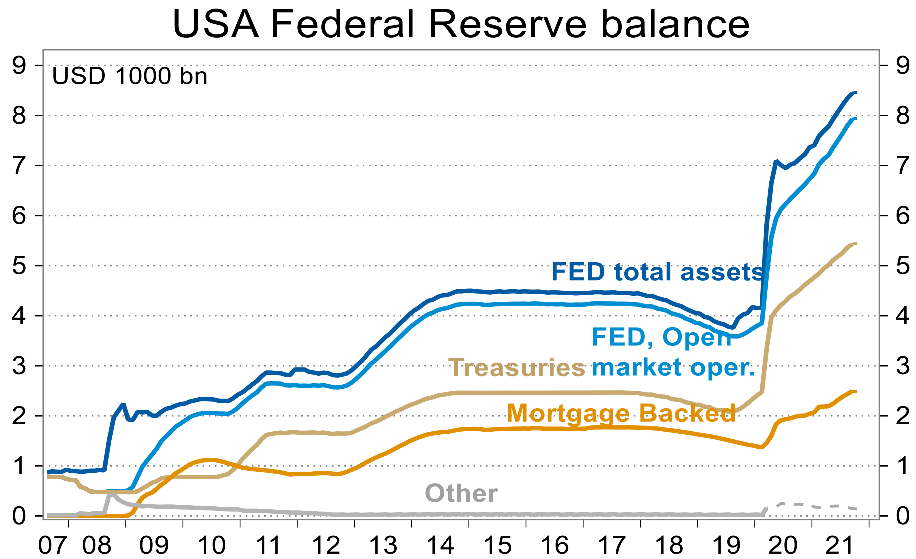
China Industrial profits

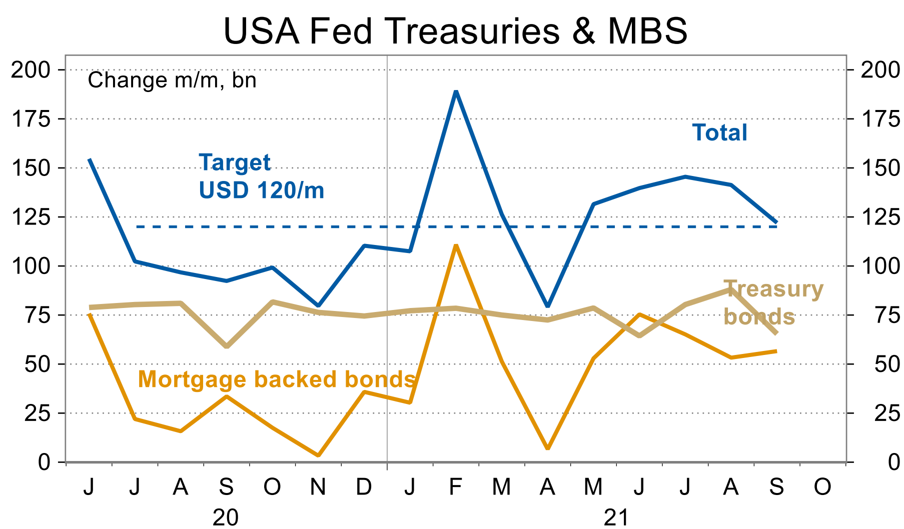


- **The rise in PPI** in the last few months can largely be contributed to an increase in commodities prices, and in September it was especially coal, metals and petro prices driving the inflation.
  - » The correlation to Chinese CPI is not that strong. It is more important for other countries, like the US CPI
- **Profits in privately owned industrial enterprises** fell by 50% in February '20. Profits rose to a normal level in April/May '20 – if we label the profit level in 2019 and early 2020 as normal – at 5% of GDP – and now it has climbed to 5.7%
- **Profits in state owned enterprises profits** are now around 1.8% of GDP

FOMC minutes: Tapering to start mid-November to mid-December

… as had been signalled by Powell and anticipated by the market – yields largely unchanged



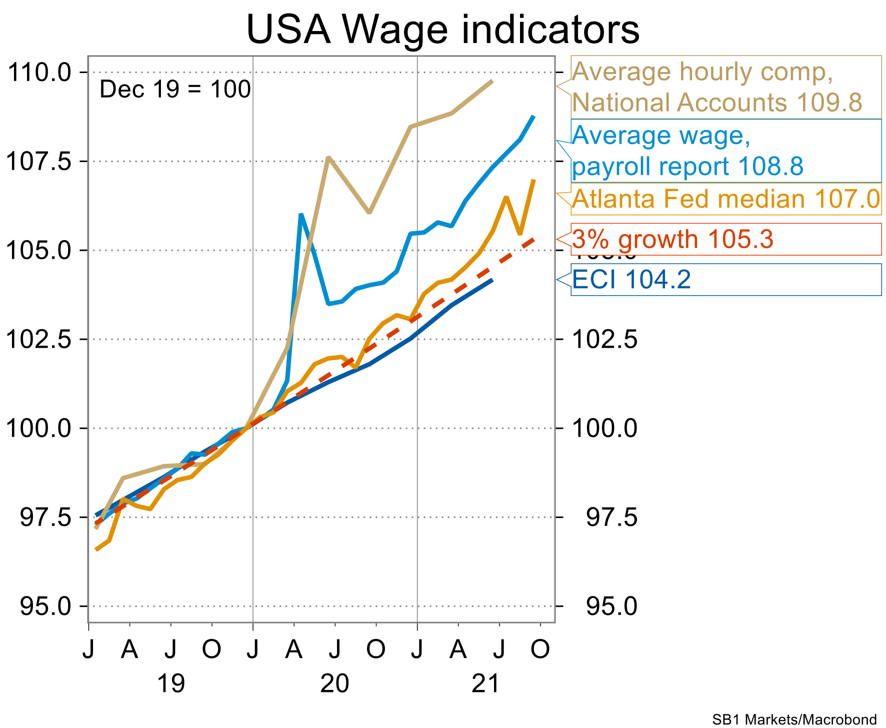


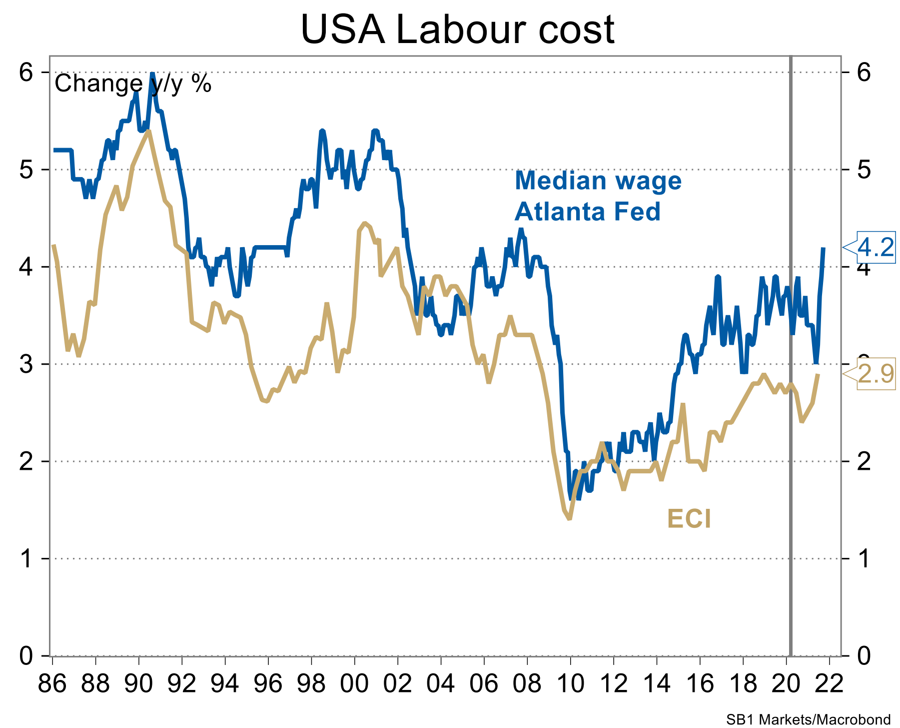
SB1 Markets/Macrobond

- As signalled by chairman Powell, the minutes from the mid-September FOMC meeting revealed that tapering is likely to be announced in November and start in mid-November to mid-December. The Fed would then taper at a pace of USD 10 bn reduction in Treasury purchases and USD 5 bn reduction in MBS purchases, such that the asset purchases would expire in July next year (after 8 months)
- The committee also noted that some members are concerned that the higher levels of inflation that we are currently experiencing will continue for longer if labour and supply shortages persist, raising the likelihood of a rate hike by the end of next year (half of the members assumed the Fed funds rate would be hiked nest year)
- "… a number of other participants indicated that they believed that the test of "substantial further progress" toward maximum employment had been met. Some of these participants also suggested that labor supply constraints were the main impediments to further improvement in labor market conditions rather than lack of demand. **They noted that adding monetary policy accommodation at this time would not address such constraints or that the costs of continuing asset purchases might be beginning to exceed their benefits.** All participants agreed that it would be appropriate … to relay the Committee's judgment that, if progress continued broadly as expected, **a moderation in the pace of asset purchases may soon be warranted…**"

Atlanta Fed median wage growth the highest in 14 years

The median wage growth rate has accelerated to 4.2% from a dip down to 3.0% in May

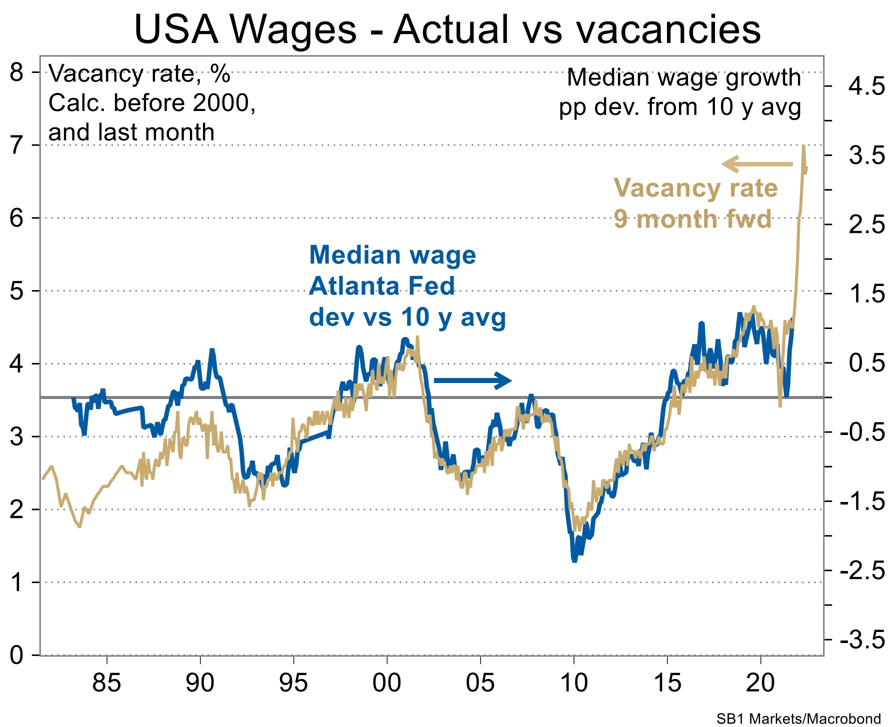


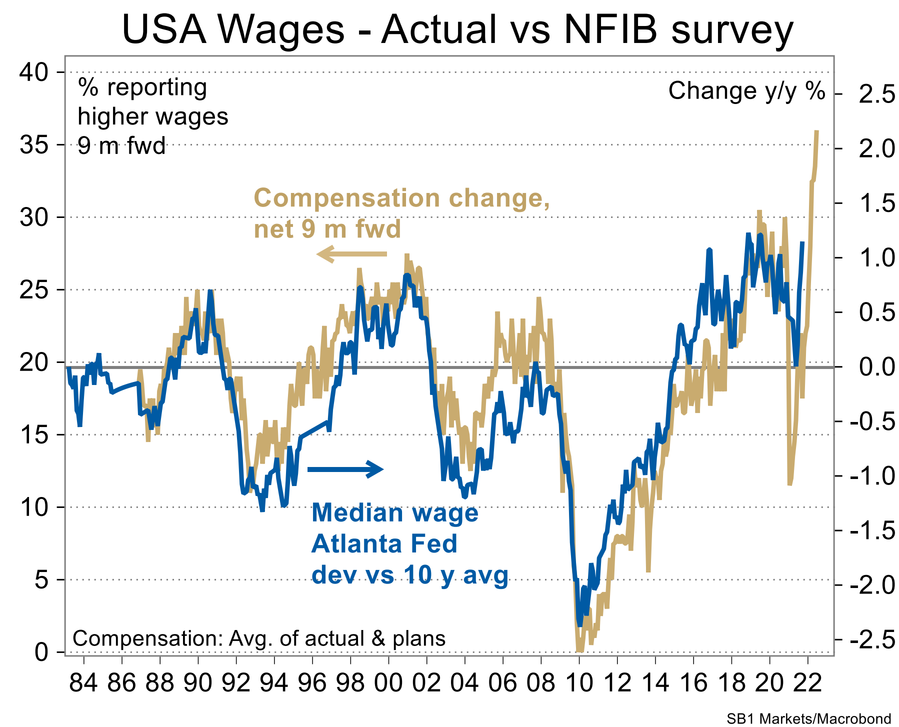


- The 4.2% rate (4.5% not smoothed) is equal to the highest rate since 2007 – but it may still be consistent with the 2% inflation target – if productivity growth is 2% or better. Before the pandemic the underlying productivity growth was some 1% – 1.5%. During the pandemic the underlying trend is harder to estimate
  - » The real challenge: Inflation (even the core rate) has been above 2% on average the past 7 – 8 years (and well above measured over any shorter time horizon!) – even with an average median wage growth at 3.2%...
  - » Job switchers report the highest wage growth in 20 years. Those paid hourly and with low education are also up more than in 20 years
- However, if wage inflation accelerates further, and just by a fraction of what is implied by the current labour shortages or what SMBs are reporting on compensation plans (check the next page), the inflation outlook is rather worrisome
- Other wage measures confirm accelerating wage growth, barring the Employment Cost Index (data through Q2)

Wage inflation could accelerate further…

The vacancy level & SMBs' compensation plans lead actual wage growth by ≈ 9 months. And now...

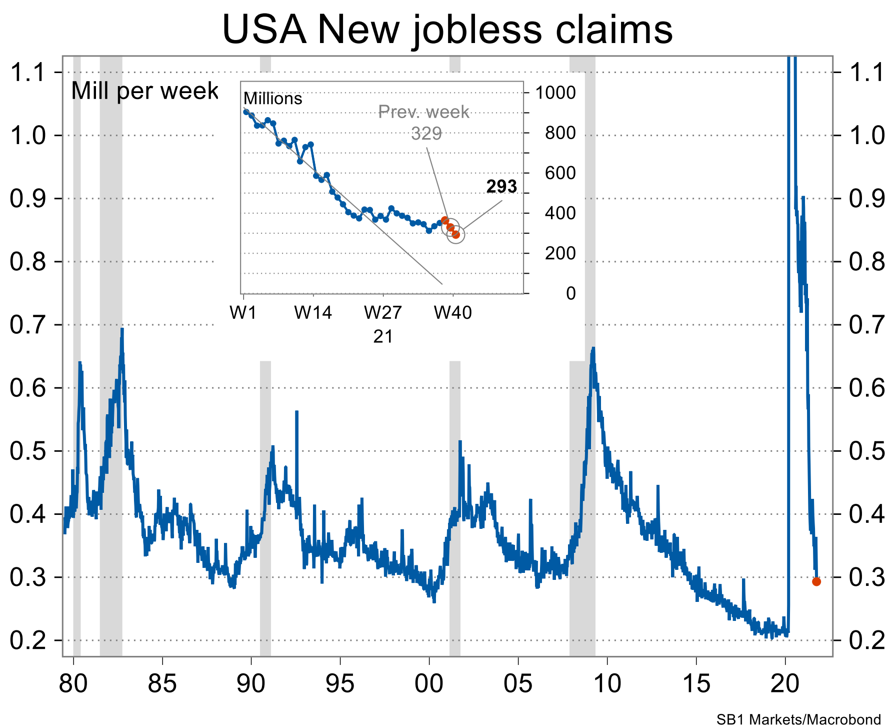


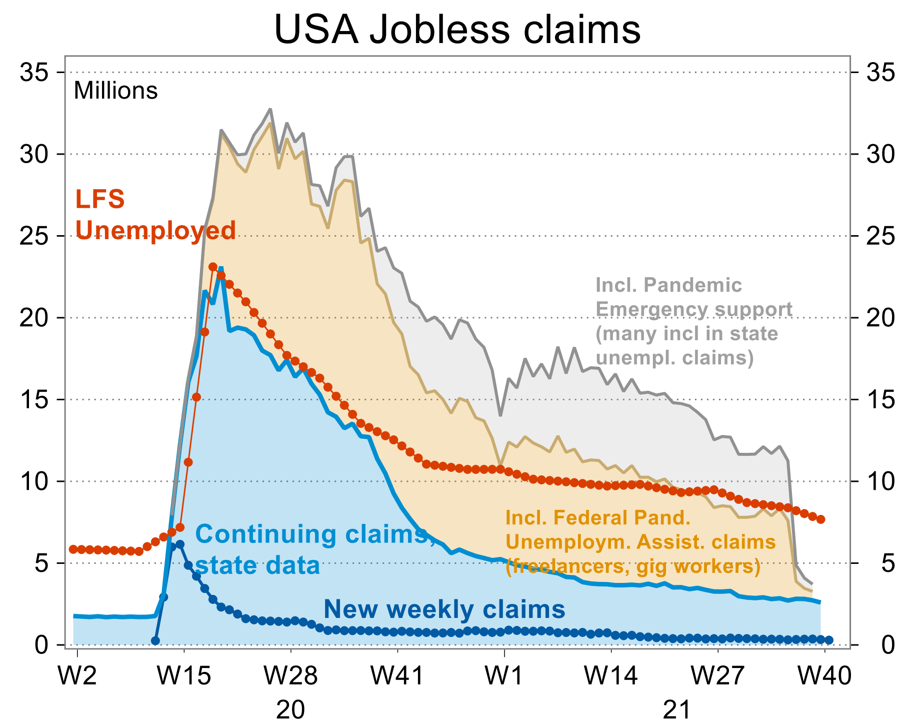


- More companies than ever before (data from 1986 though) are reporting that they have lifted or plans **to lift compensation** over the next months, as they never before have been so unable to fill positions (the correlation is incredible tight)
- The **vacancy rate** fell in August but remains extremely high
- The correlation between these two variables, and the median wage growth is rather close, with vacancies and plans leading by 6 – 12 months. IF this correlation holds, wage inflation will accelerate substantially from the present level – which already is high enough vs. the 2% inflation target
- We do not know FOMC's wage forecasts but we assume they are rather upbeat, as the bank expect inflation to remain above target the coming 3 years (and the price level to be deviate even more from a long term 2% path). However, the Bank could impossibly not have factored in a wage growth anything close to what companies now tell or even less what the current tightness of the labour market signals

New jobless claims finally below 300’

Another sign of a tighter labour market

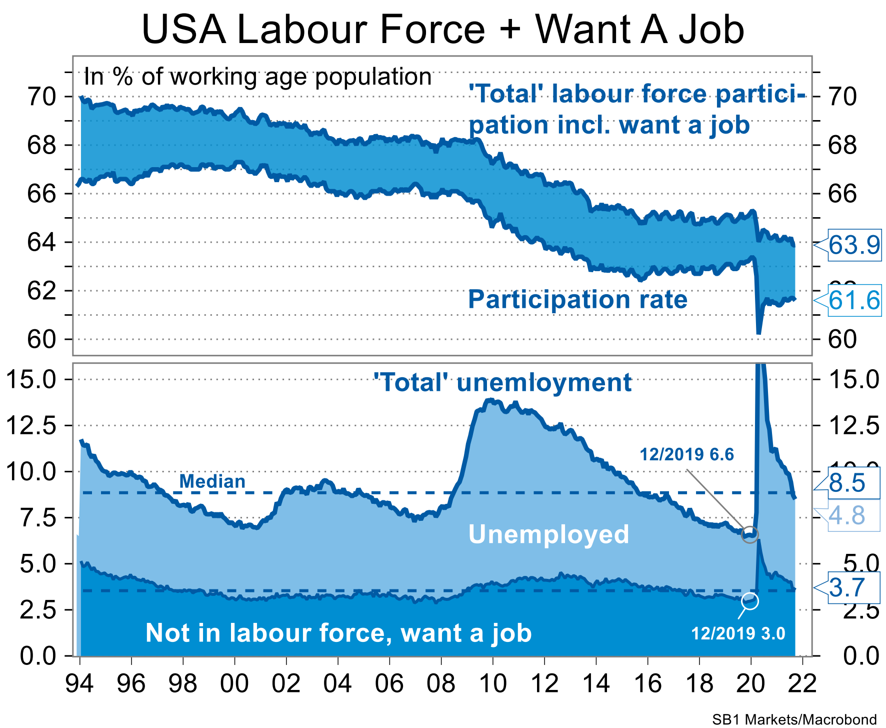


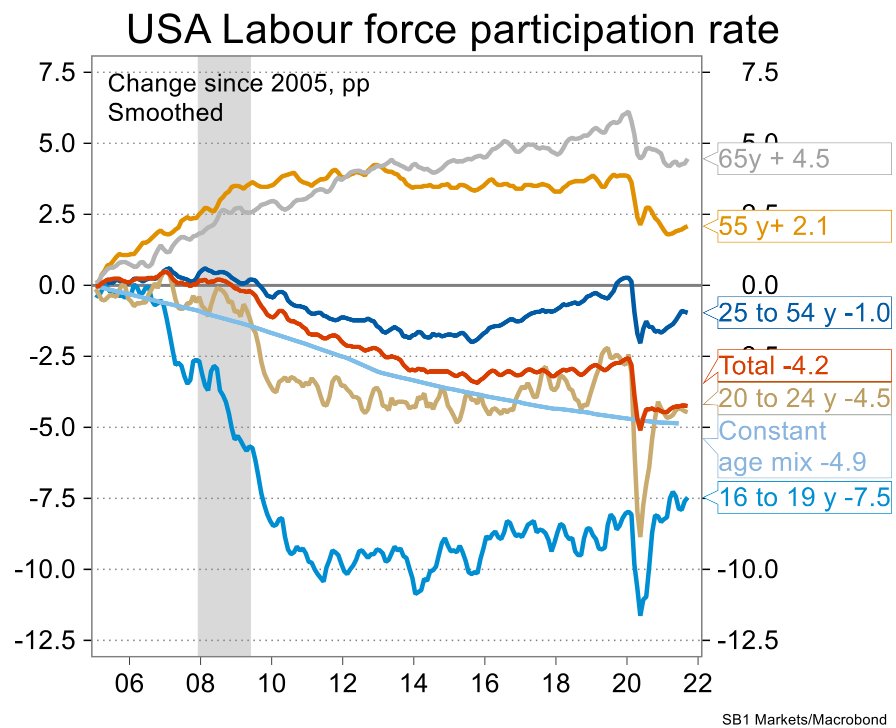


- **New jobless claims fell** by 36’ to 293 in week 40 – expected unch. The inflow fell by the same amount last week too
- **Ordinary continuing claims** decreased by 134’ to 2.59 mill in week 39. The trend is steadily downwards but the level still 0.9 mill > the Feb 20 level
- The **two temporary federal pandemic unemployment benefit programs** ended on September 6th, but states can still choose to offer this assistance through pandemic relief funds. The no. of recipients has fallen to 1 mill in week 38 from 9 mill in early Sept (and from 12 mill in March)
- What are those 8 mill workers doing now? Not many of them have found a job (cfr the employment report, the official vacancy report, and the SMB survey). They are searching for work either, at least not more than before the temporary programs were terminated. Will they show up at the labour market anytime soon? The labour market survey signals that the potential is limited (next page)

How much spare capacity in the labour market? Perhaps not that much?

The share of workers not in the labour force but still wants a job has fallen to an average level

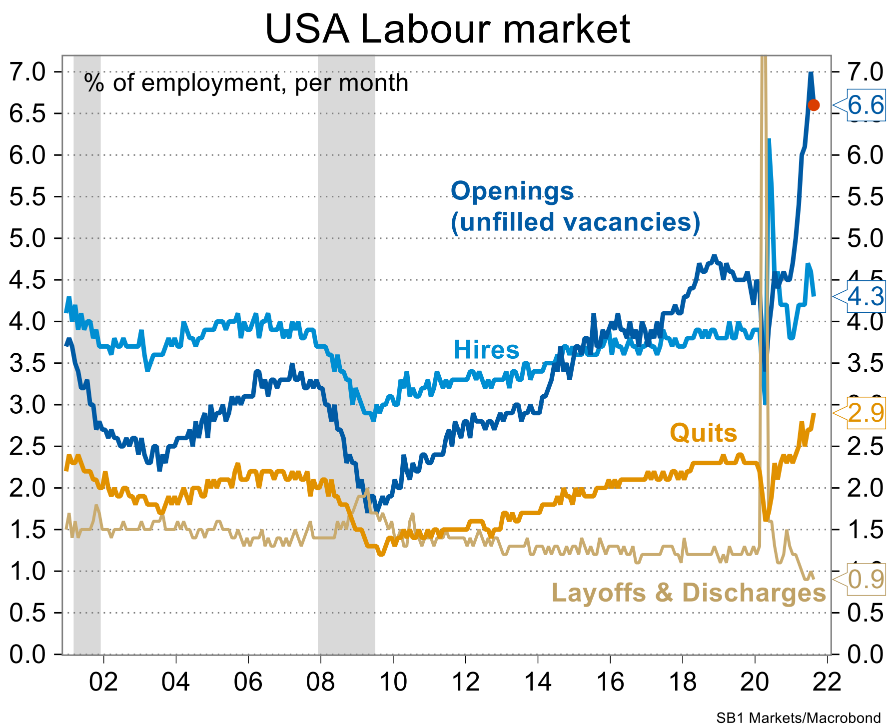




- We know that the unemployment rate has fallen to 4.8%, which is just 1 – 1¼ pp above the pre-pandemic very low level
- The participation rate is still far below what many assume is a 'normal' level, as there are many that have not returned even if they want a job. However the share of workers that not are in the labour force (employed or unemployed - that is actively searching for a job) is just 0.2 pp higher than average, and may decline by 0.7 pp it the labour market really tightens (like in 2019)
- Taken together, the spare capacity to 'maximum employment' may be rather limited, and very likely less than 2%. For the record, during the past 3 months, the unemployment rate fell by 1.1 pp
- Recent years, the working age population has grown substantially older, and old folks' participation rate is lower than among the younger. If participation rates for all age groups had been kept unchanged since 2005, the total participation rate would have fallen more than the actual rate

The vacancy rate finally a tad down in August (but could it just be the virus?)

The vacancy rate fell 0.4 pp to 6.6%, still the 2nd highest ever

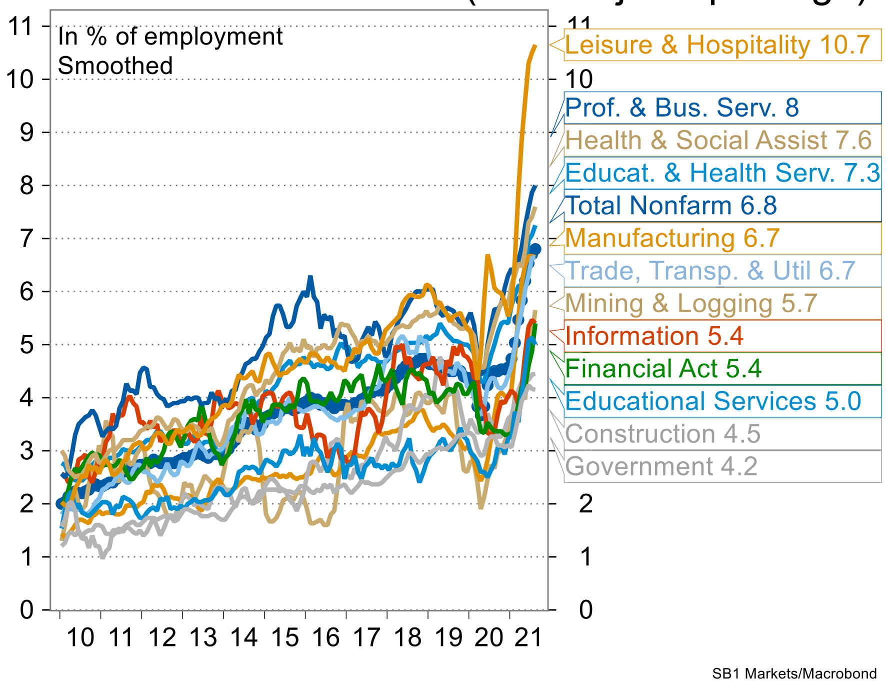


- The no. of **unfilled vacancies** declined by 0.7 mill to August from July, down to 10.4 mill, from an 0.2 mill upward 11.1 mill level in August. The print is the 2. highest ever. The vacancy rate was 6.6%, down from 7%. The highest print before the pandemic was 4.7%, and the rate was 4.5% just before the pandemic hit. The decline in August was broad (see next page)
  - » SMBs are reporting more trouble filling positions even in September. These two series are very closely correlated
- **New hires decreased** by 0.4 mill to August from July, to 6.3 mill, or to 4.3% of the no. of employed person, still an unusual high level
  - » The decline came in leisure & government (probably education), both due to the Delta wave
- The rate of **voluntary quits** rose by 0.2 pp to 2.9% in August, another ATH. Workers are leaving their current jobs voluntarily to get at better job, which is harder in bad times. As with unfilled vacancies, quits are closely correlated to wage inflation – for obvious reasons
- **Layoffs** fell back to the lowest level ever in August, as few companies are closing down/reducing capacity
- **In sum:** The vacancy rate & the hiring rates fell, but probably related to the Delta slowdown in some sectors. The levels are still anyway very high, confirming a very tight labour market

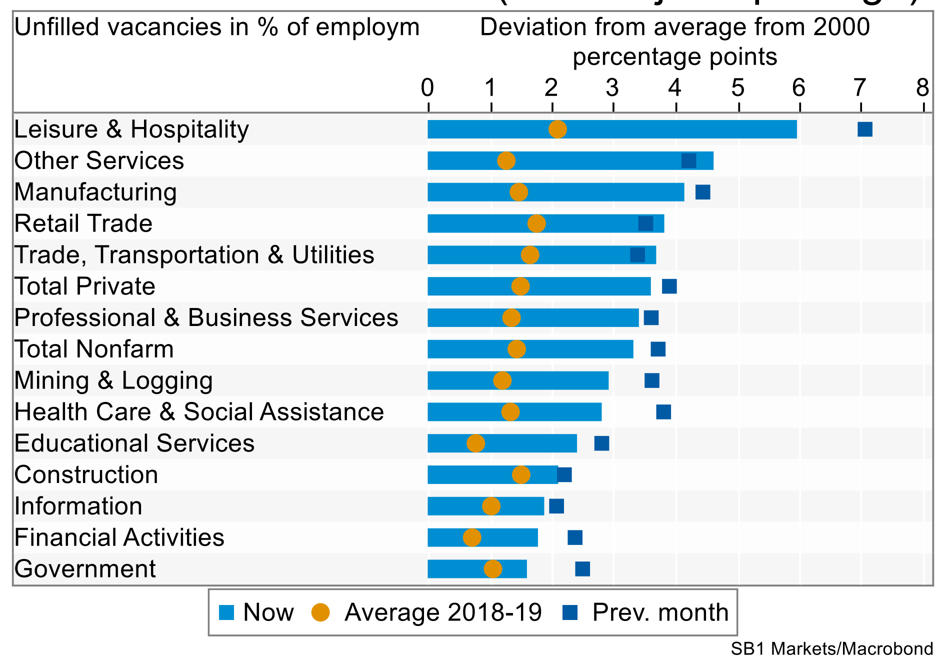
All sectors are reporting more vacancies than before the pandemic

But 12 out of 15 sectors reported fewer vacancies in August than in July

USA Unfilled vacancies (JOLTS job openings)



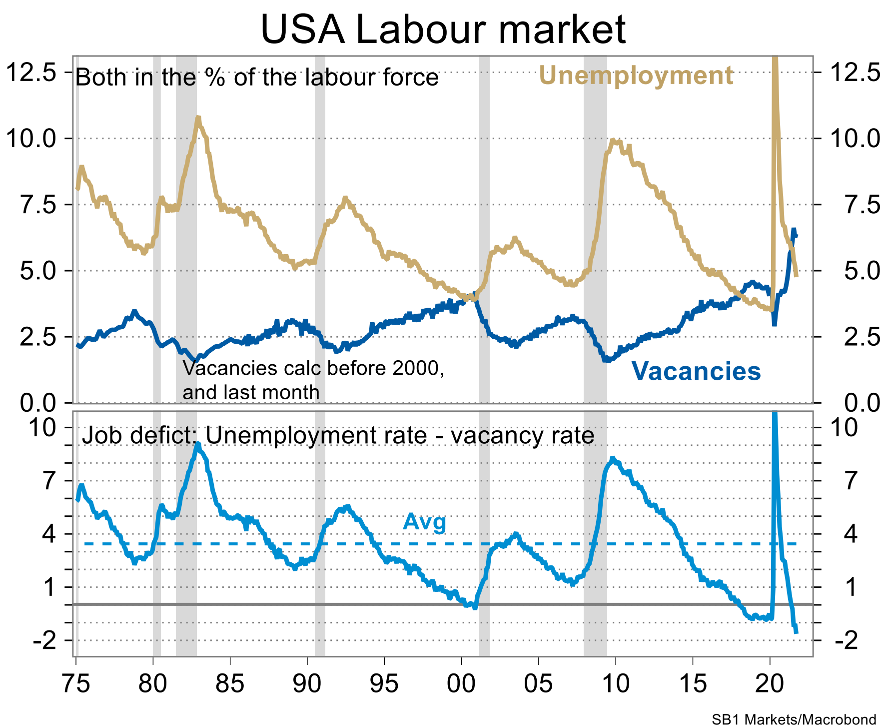
USA Unfilled vacancies (JOLTS job openings)

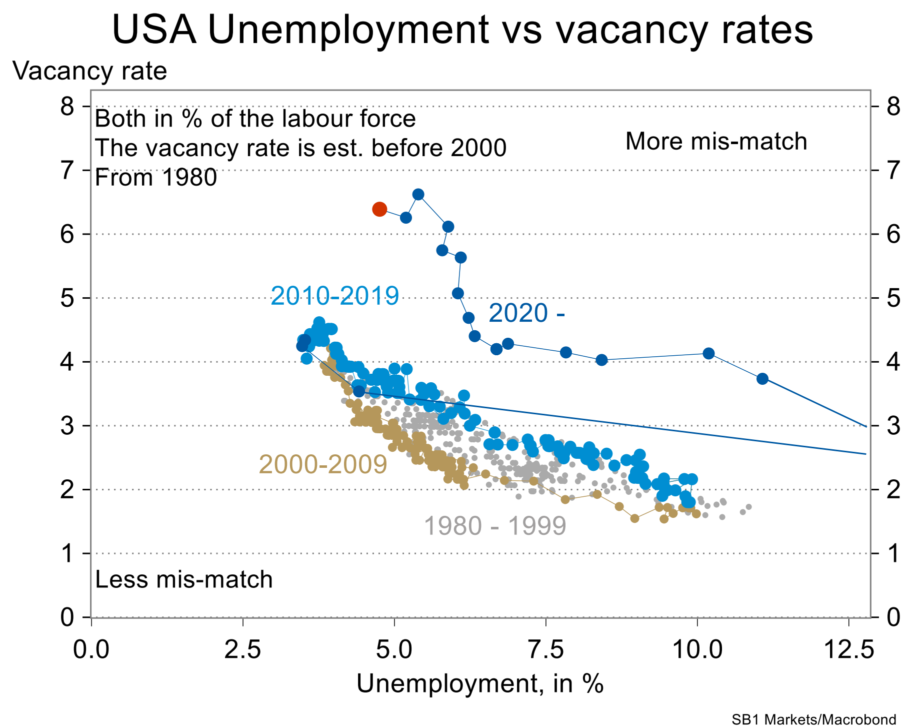


- A positive sign, even if levels still are very high, and some slack may be explained by the Delta outbreak than dampened activity at least in the hospitality sector

A strange mismatch in the labour market

Why don't more of the 7.7 mill unemployed get hired in order to fill the 10.5 mill vacant positions?

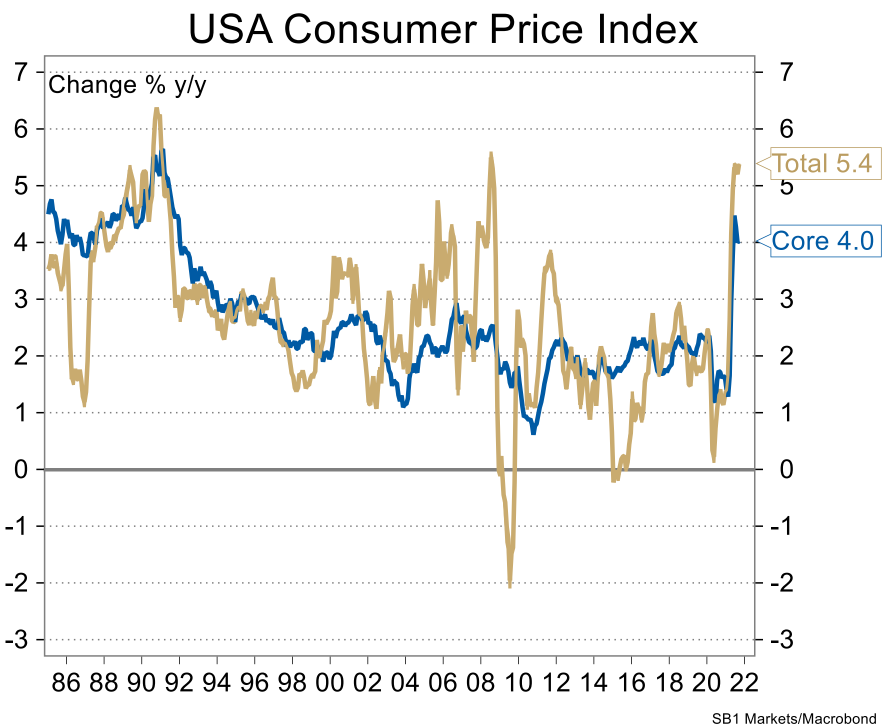


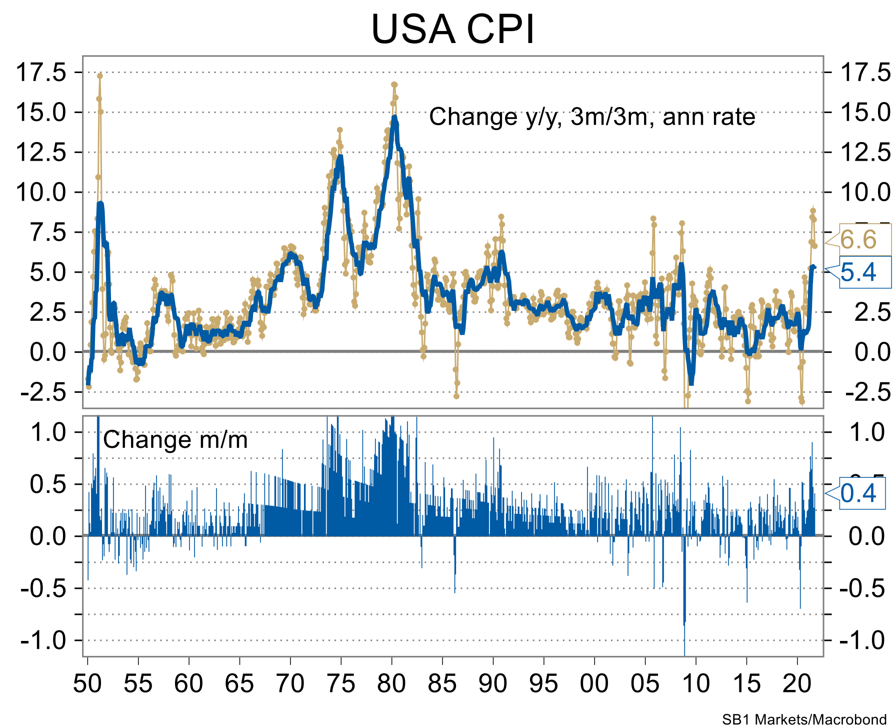


- 7.7 mill persons are unemployed - that is, they say they want a job and are actively search for a job but have not got a job
- At the same time, there are 10.5 mill unfilled, vacant positions
  - » During the 2010 – 2019 period, Unemployment/Vacancy curve (UV/Beveridge) had moved somewhat outwards, but the curve was not far above/to the right vs. the pre 2010-curve
- The unprecedented mismatch now may of course be mostly due to temporary (transitory?) impacts of the pandemic; different sectors have reopened at a different pace, perhaps even geographically, and it will take time to match the job seekers and the vacant jobs etc. However, there is a risk that some of the mismatch will turn out to be permanent, due to changes in qualification requirements, work preferences etc.

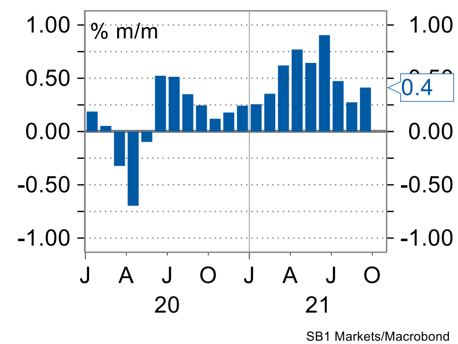
Peak CPI inflation? Monthly growth has slowed but is not yet low

It may still be a transitory spike but more prices are rising faster. The Fed is under increased pressure



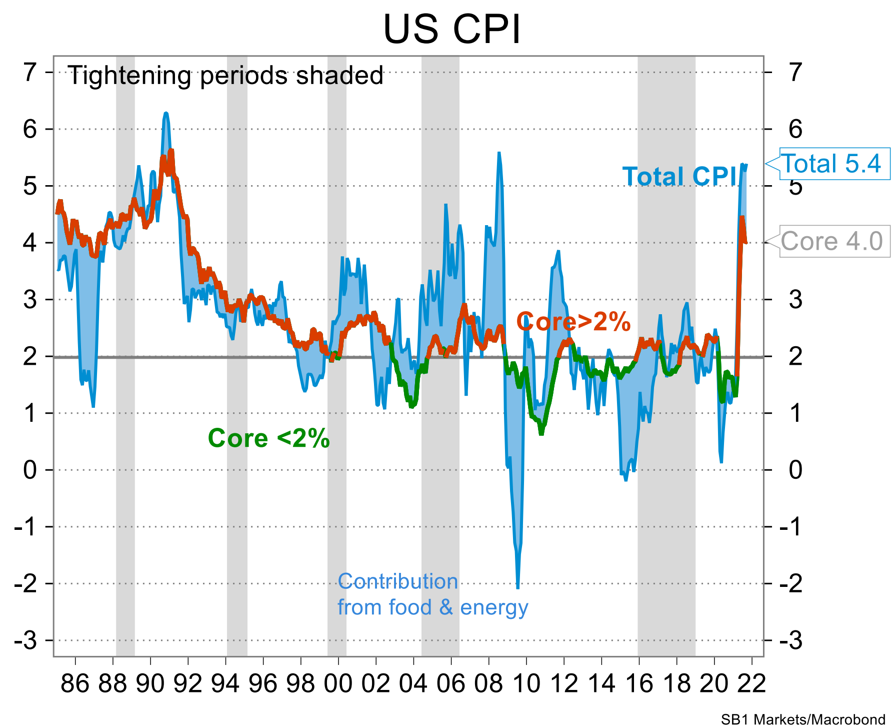


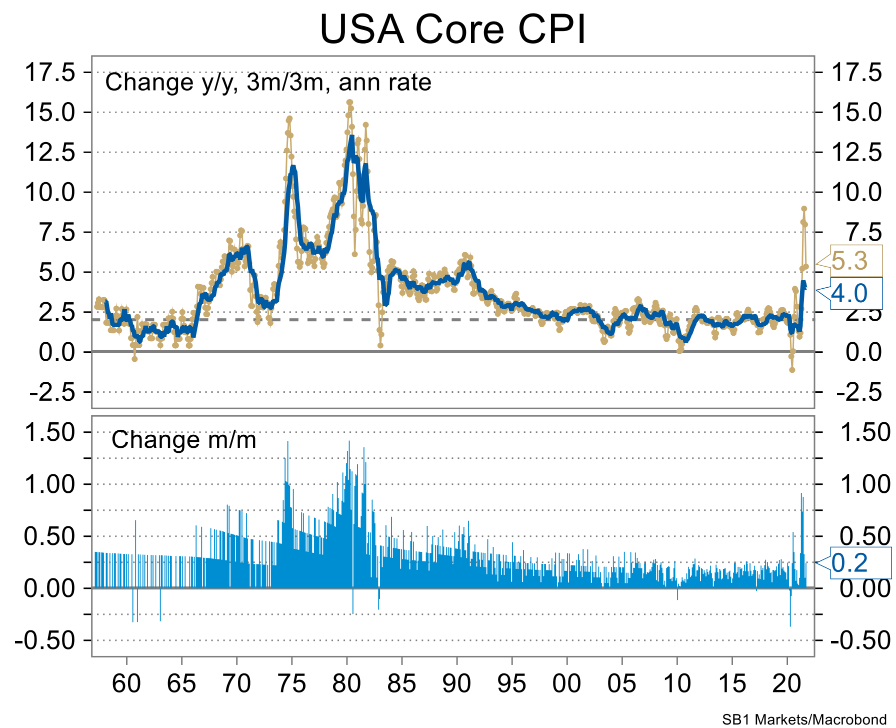
- **Headline CPI rose** 0.4% m/m in September, 0.1 pp higher than expected, and up from 0.2% in August. The annual rate rose 0.1 pp to 5.4%, expected 5.3%
  - » Monthly increases have slowed past 3 months, but the average at 0.4% equals a 4.7% annualised pace
- **The Delta outbreak** have very likely damped hotel & airline ticket prices in both Aug & Sept, but that is most likely transitory, and airline ticket prices seem to be too low. Used auto prices are finally yielding, and could fall sharply the coming quarters. If so, the annual inflation rate will slow substantially
- However, price increases are broadening, and inflation is up, even outside 'the special pandemic cases'. In addition, in all surveys, an unusual large share of companies report that they have or expect to lift prices. In the SMB survey, almost just as many as in Q4-79, check here. As the price level is above any 2% path that can be drawn, the Federal Reserve has some challenging months ahead!



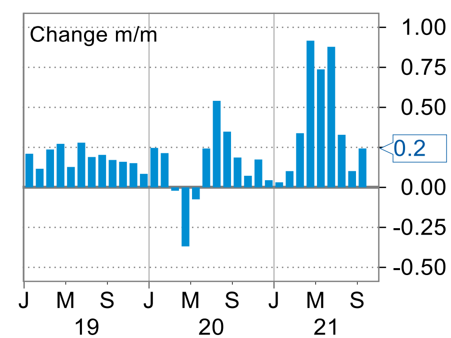
Core inflation marginally lower than expected

Prices +0.2% m/m in Sept, as expected, but the y/y rate was 0.1 pp lower than expected, at 4.0%



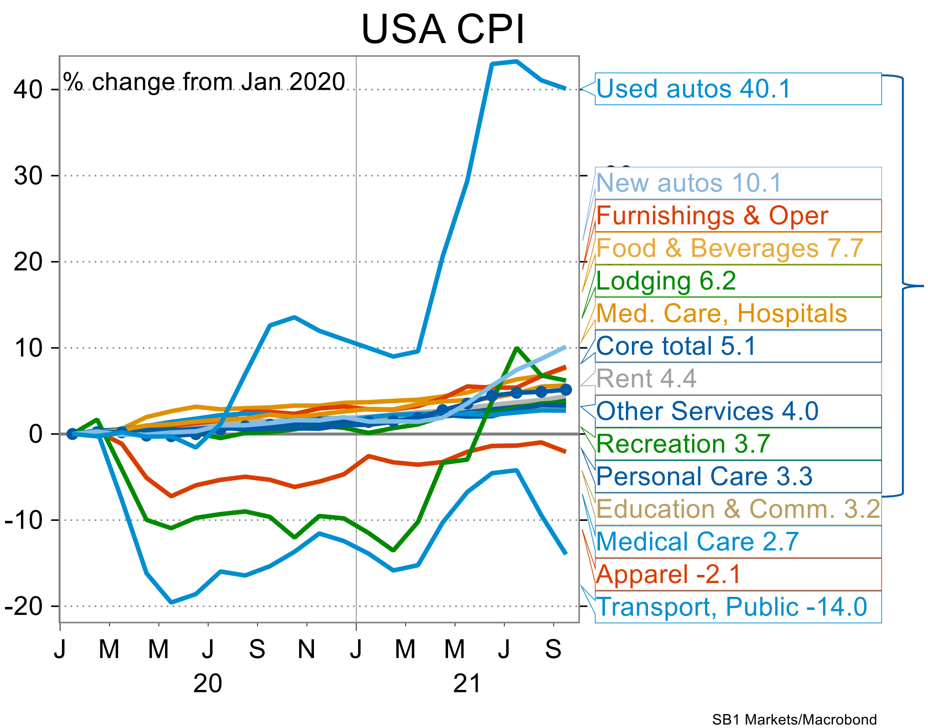


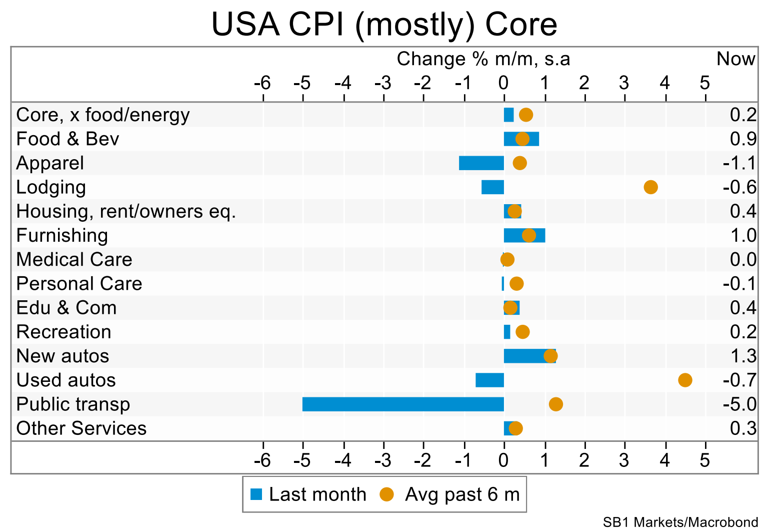
- **Core prices** climbed rapidly m/m April – June but has slowed to a 0.2% average pace from July – still a 2.5% annualised rate
  - » Most of the 'reopening' sectors have lifted prices back up to a normal level, like lodging, recreation. Just airline tickets are still cheaper than normal

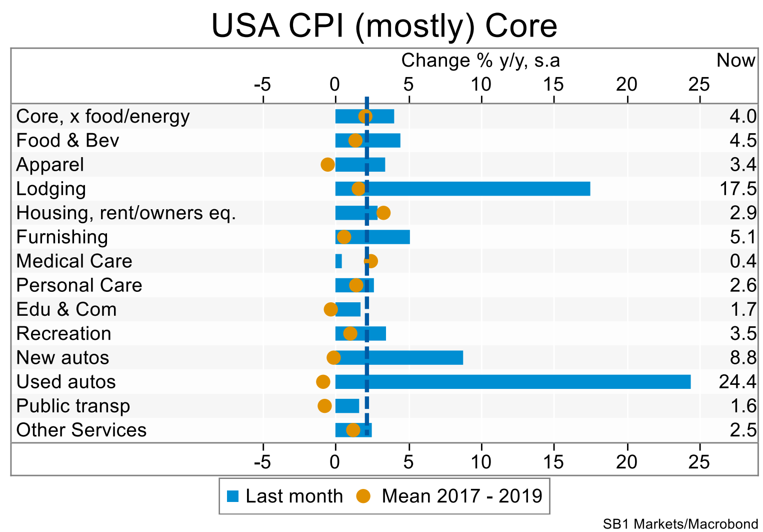


Used auto prices have peaked, and airline tickets, hotel prices down too

The latter no doubt due the last corona wave. At least airline ticket prices still too low



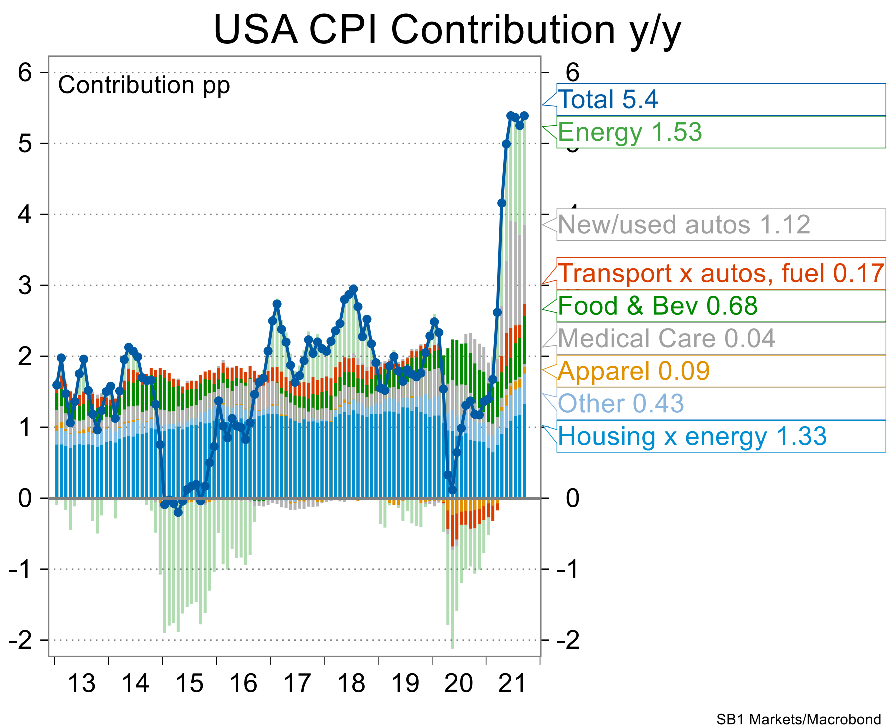


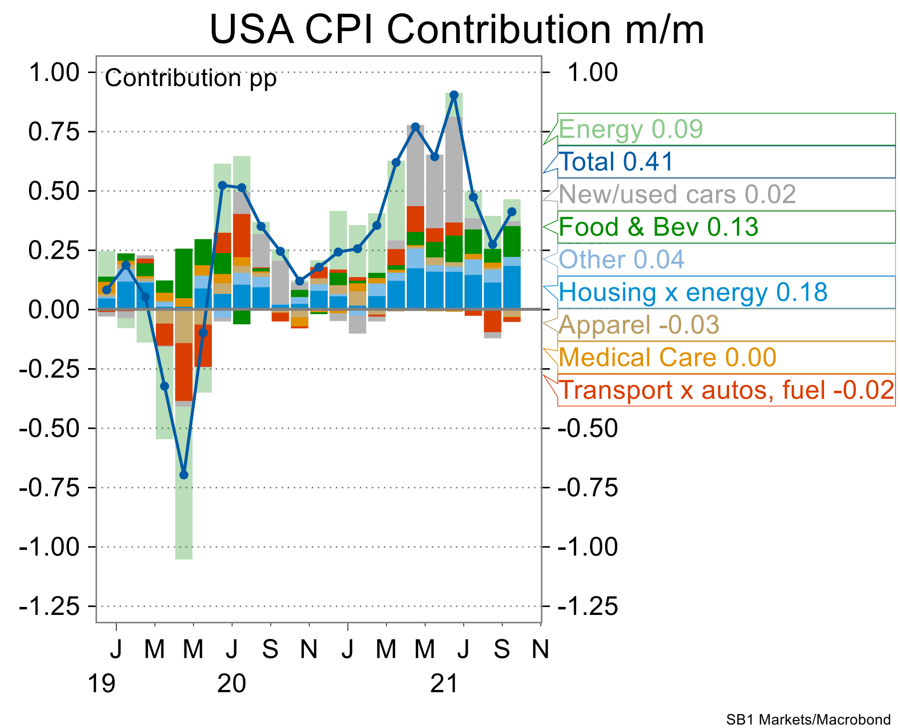


- A huge downside for used auto prices. Even new cars are probably above a long term ‘fair’ level. Check 2 pages fwd
- Most sectors report inflation above 2%, also measured over the 2 past years (see more 5 pages fwd)
- Almost all sectors now report higher annual inflation than in the two years before the pandemic

Transport & energy explain 2.7 pp of the 5.4% lift in total CPI

… but now other sectors are accelerating – and contributing more to the high rate of inflation



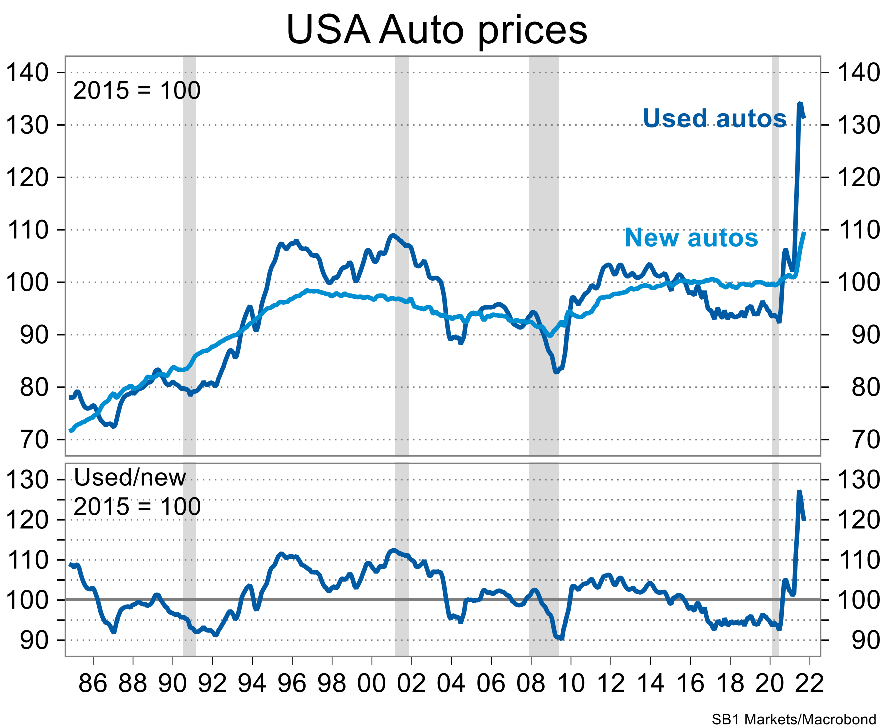


- **Energy** has lifted the headline CPI by 1.5 pp in the past year. If the oil price does not skyrocket from here, the contribution to the annual growth rate from energy will quickly fade – to zero (see more here)
- As **used car prices** has flattened since the summer – after an unprecedented 40% increase – due to lack of new autos
- Excluding the 2.7 pp **contribution the headline CPI from energy & transport**, "remaining" inflation is accelerating rapidly.
- Housing x energy is contributing by 1.3 pp, the highest rate in many years. Hotels (included in housing) contribute with almost 0.2 pp. Rents are now rather exposed (check 2 pages fwd)

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?

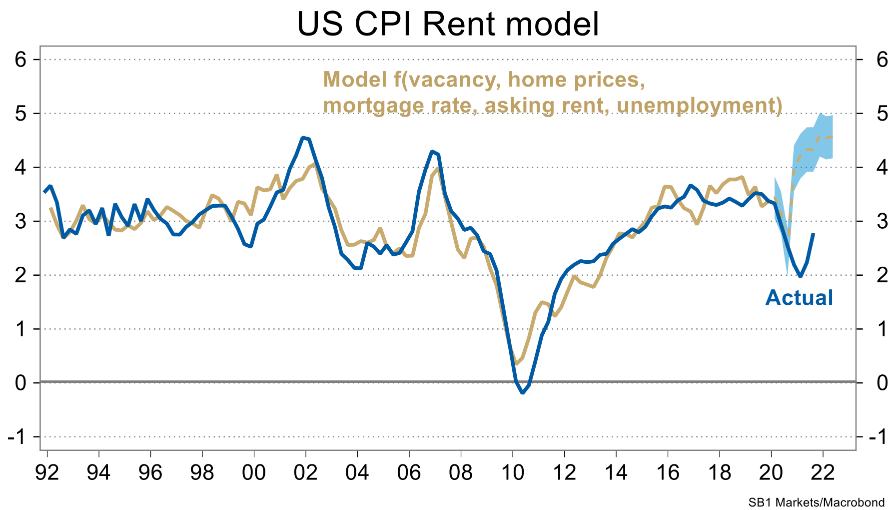
No doubt at all. The downside is substantial as soon as new car production recovers



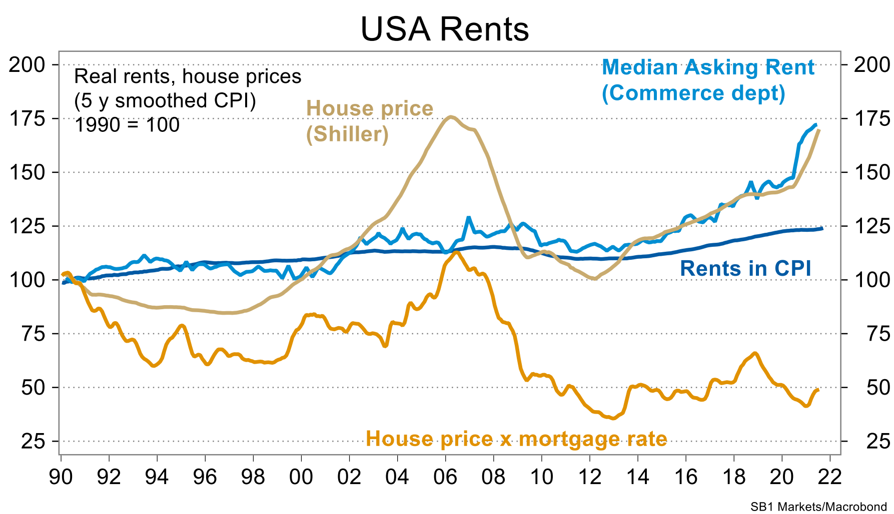
- Used auto cars may have been somewhat too low before the pandemic
  - » Prices for **new autos** are up 12% since 1996, quality adjusted, that is. Until the recent price hikes in a very tight US auto market, 2nd hand prices were down 10% the past 25 years (quality adjusted)
  - » So it is impossible 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
- New auto prices have also accelerated recent months – and they are up 10% vs. the pre-pandemic level
- Should new and used auto prices return to the pre-pandemic level over the next year (a bit optimistic of course), the total CPI annual growth rate will decline more than 2 pp

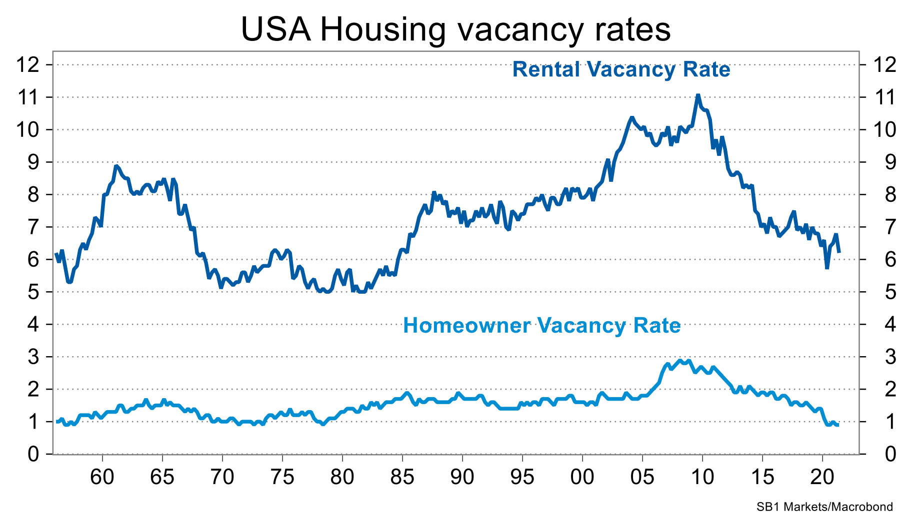
A tight rental market a possible inflation threat

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



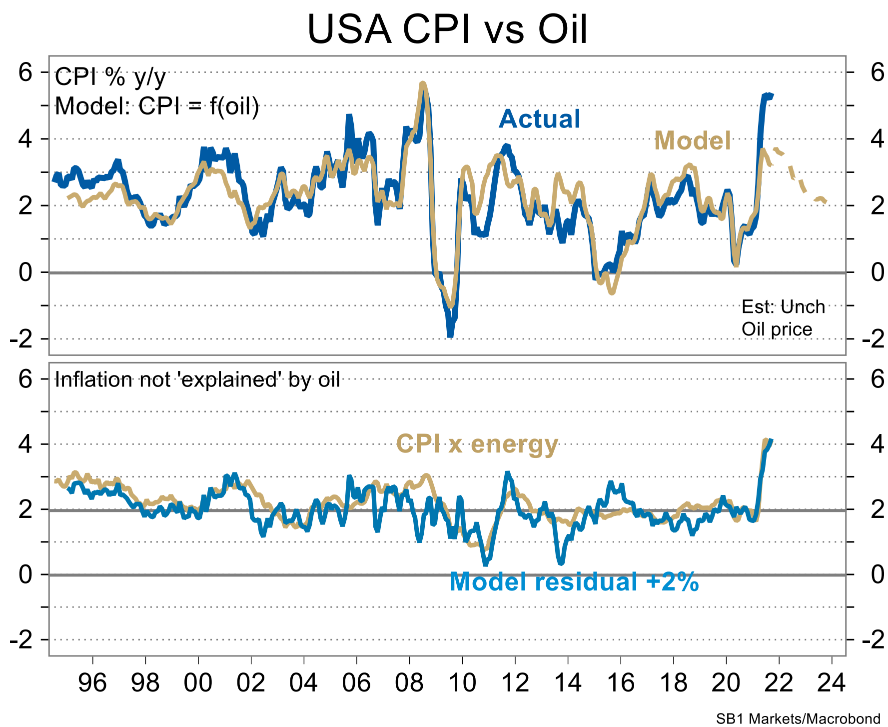
- **The official (Commerce dept) rental asking price** index reports a 19% increase y/y. However, other rental surveys yield far lower increases in rents, as rents in several metropolitan areas have been far weaker, and report an average growth at lower levels. **House prices** are up almost 20% y/y
- **Vacancy rates** may have bottomed (more investors are entering the housing market) but are still low. Few owned homes are vacant too
- **Rent inflation measured in the CPI** has recovered to 2.8% from 2%, but is still below the pre-pandemic rate at some 3.5%
- **Our model**, even assuming a market slowdown in rental asking price inflation and in house price inflation but adding a modest increase in mortgage rates, signals a sharp increase in rent inflation, as measured in the CPI, toward 5%, from the current 2.8% level. Total CPI inflation will accelerate 0.3 pp, per percentage point rent inflation climbs

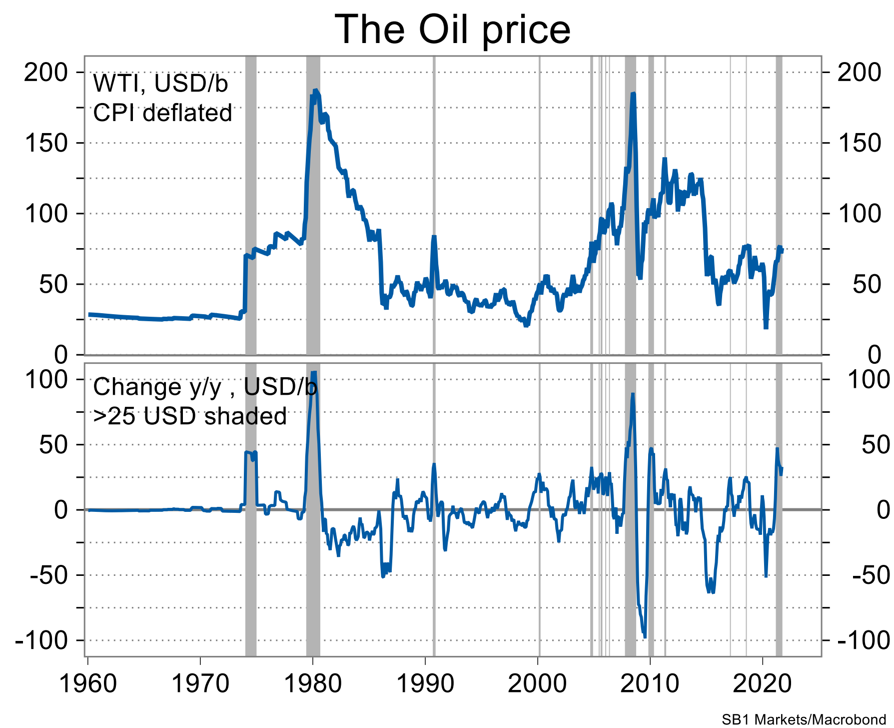




The oil price moves the CPI as usual – but now there is something else too

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



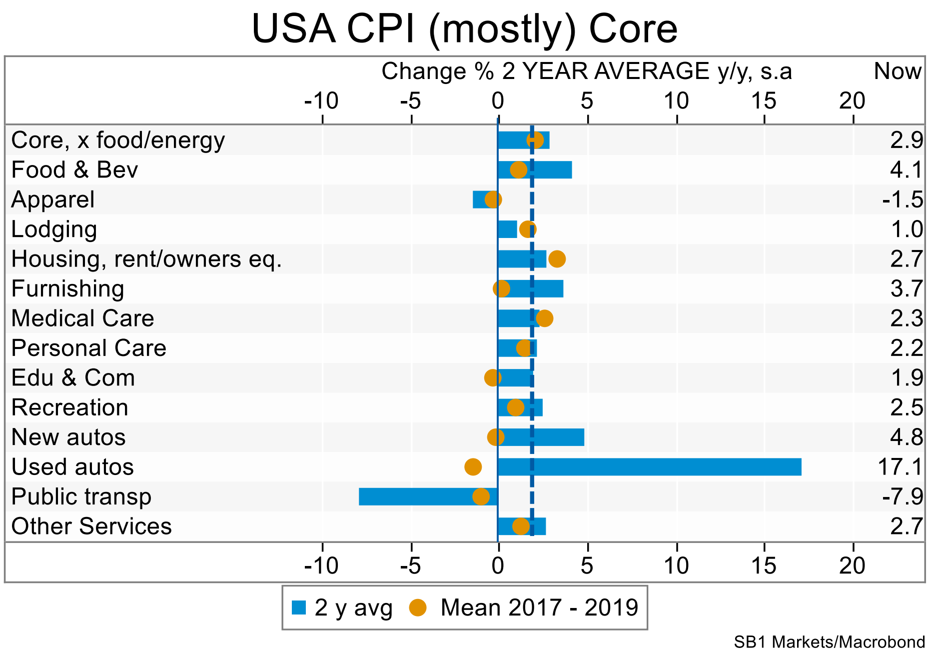


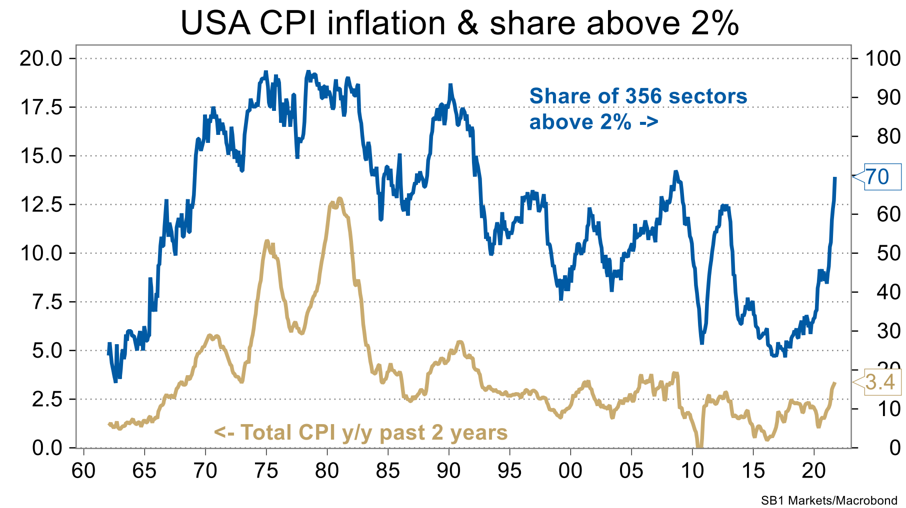
- **Oil price cycles** have explained some 80% of the changes in CPI growth the past 30 years
  - » In our model we incorporate all indirect impacts from changes in the oil price – as well as the impact from other factors that influenced inflation which correlates to the oil price
  - » If the oil price 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

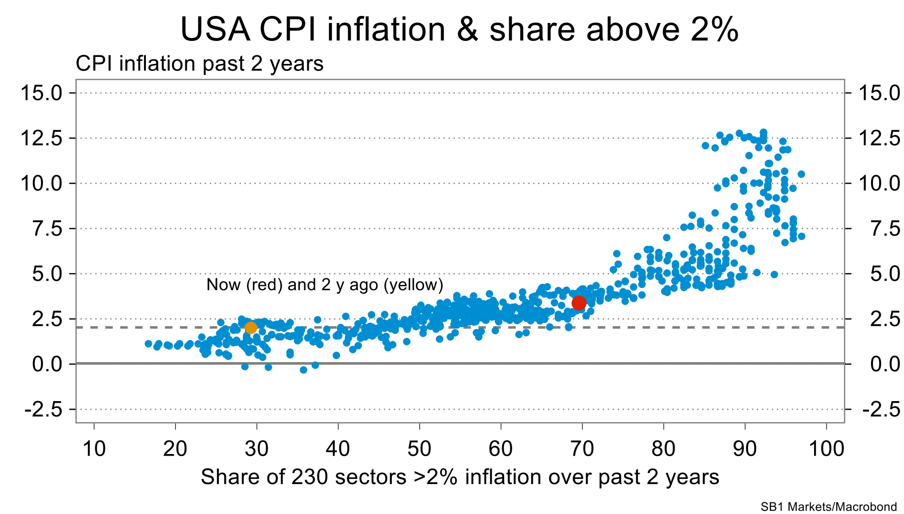
SpareBank 1 MARKETS

Inflation over the past 2 years: Some acceleration. 10 sectors >2%, 3 below

2 y avg core inflation 3.4%, up from a 2.1% average in 2017 – 2019 – and broadening, 70% up >2%



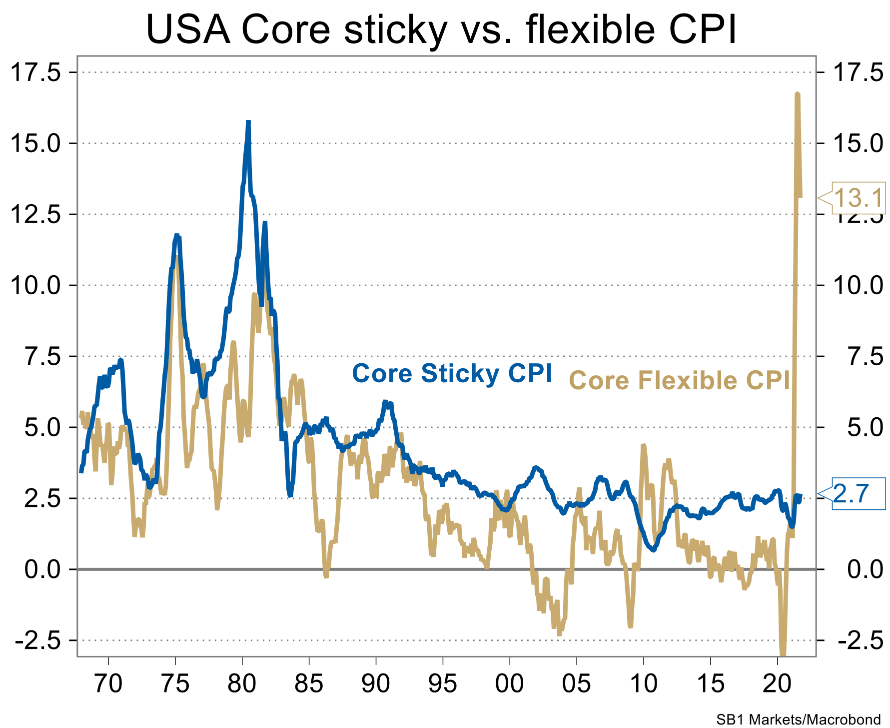


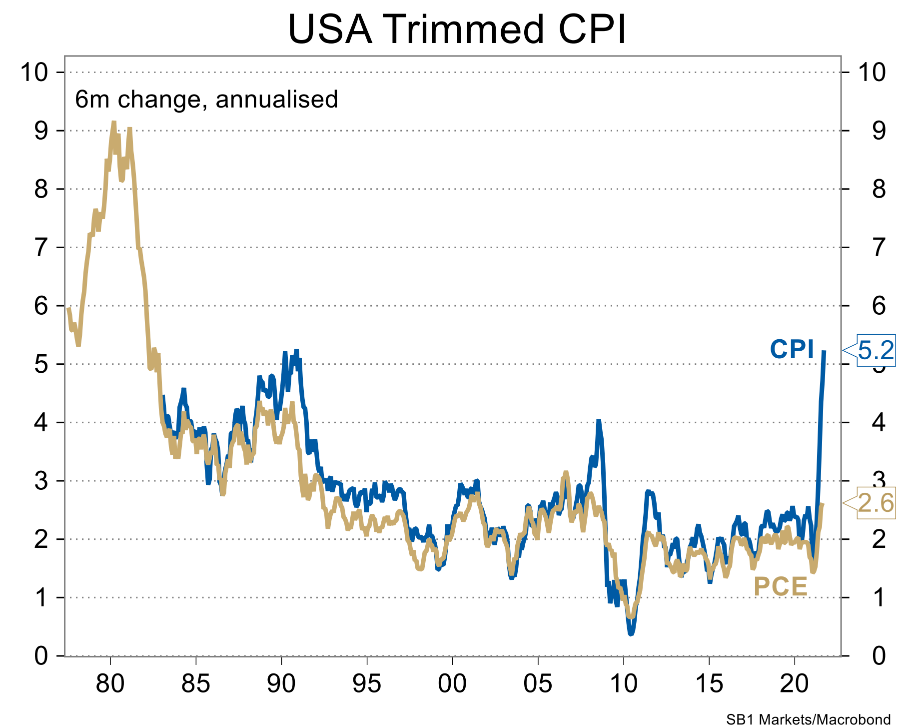


- Of the 13 main sectors, 10 are up more than 2% per year since Sept 2019, and 4 are below the 2% line
- Over the past 2 years vs the 2017-19 average, inflation has accelerated in 9 sectors, and slowed in 4 sectors
- Of 350 sub-sectors, 70% are up more than 2% over the 2 past years (from 63%), normally signalling an inflation rate above 3%

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

But price increase have become more wide-spread and CPI trimmed mean has exploded

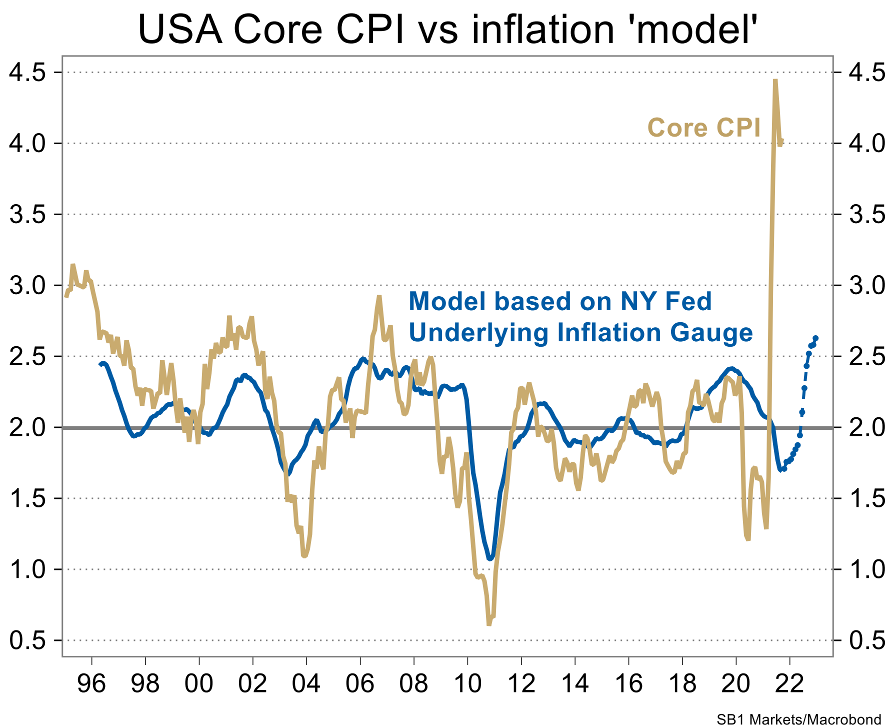




- The Cleveland Fed **trimmed mean CPI** is up more than 5% over the past six months, the highest print in the 40 years this series have been calculated. Dallas Fed's trimmed mean PCE was up 2.6% in August, the highest since the before the financial crisis (on the way up)
- In the CPI, almost all of the lift in core CPI has been due to prices of good & services that often fluctuate, with rapid price increases followed by deep price cuts – these prices are **flexible**, and represent some 10% of the core CPI. These prices are up 13%, down from 16% at the peak, 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 2.7%, slightly above the average during recent years but in line with the pre-pandemic level. 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

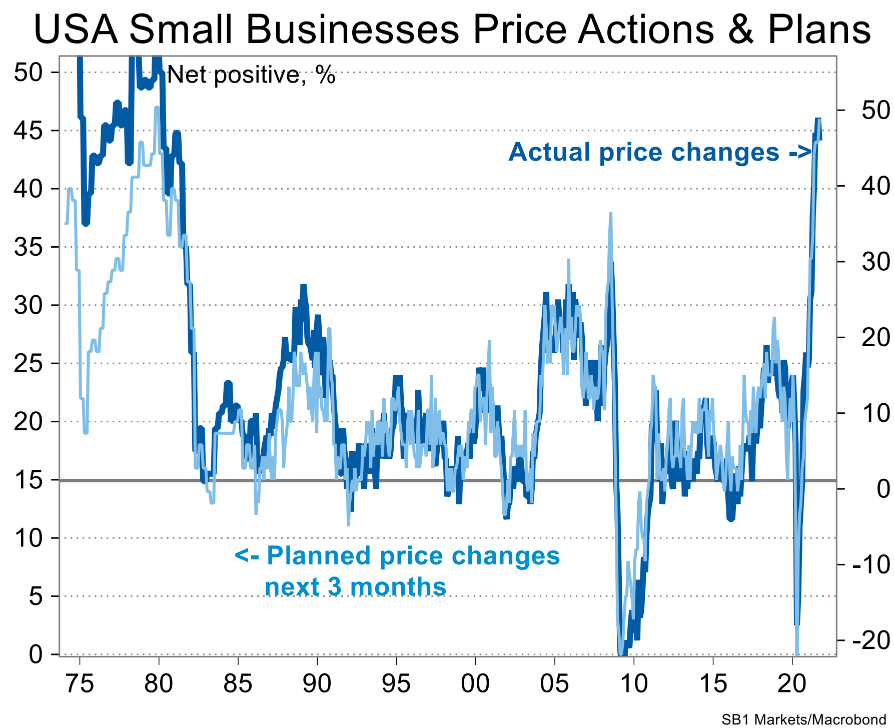
One of Fed's inflation models signal inflation above 2.5% by end of 2022

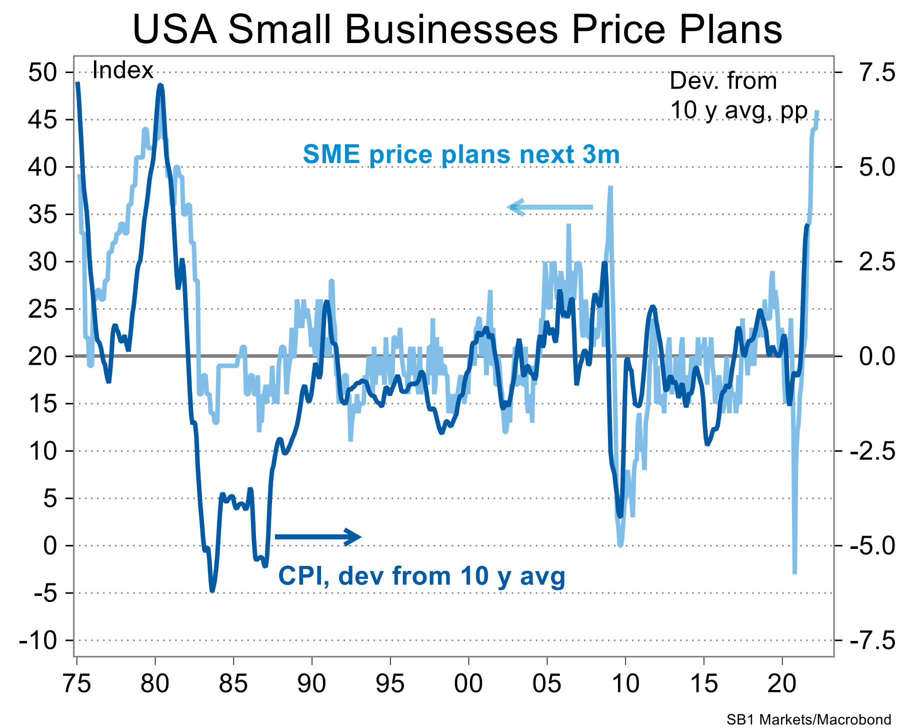
But the model did not warn of the current surge inflation, so should we trust it now?



Another warning sign: A record high no. of SMBs still say they plan to raise prices

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

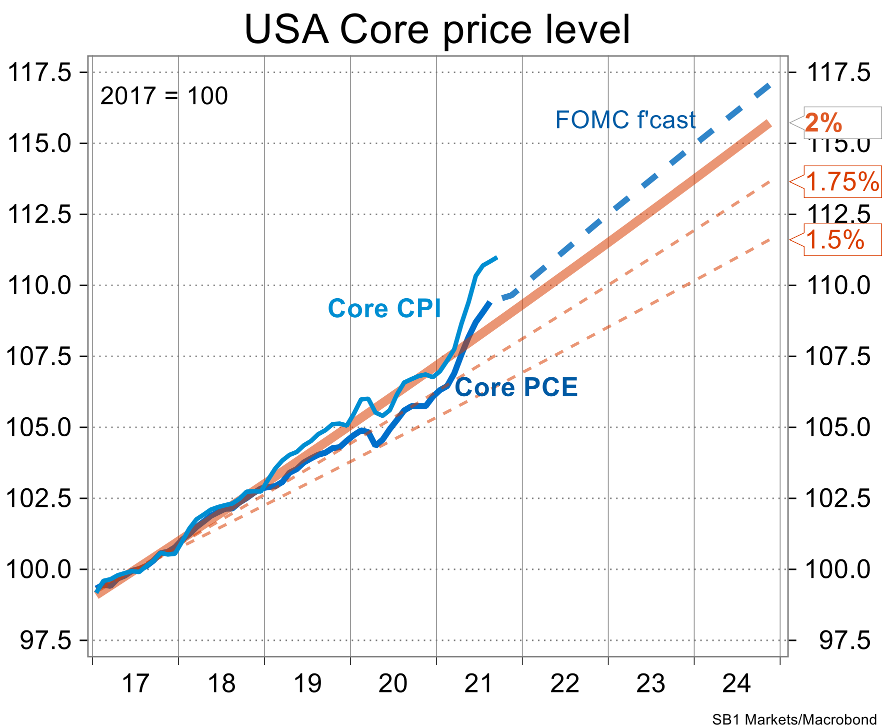


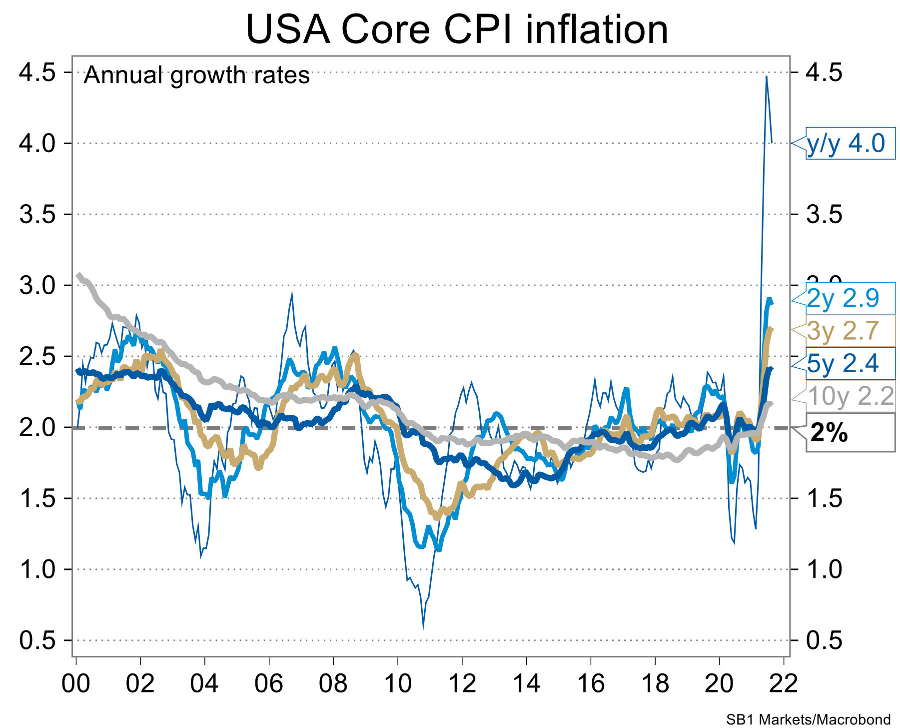


- Back in 1979, it lasted just one month; now we have been up here five months in a row
- It is challenging to calibrate the SBM survey vs. actual inflation, as the present print is so extremely far off the chart vs. the past 35 years experience. But surely, it tells us something. We have give it a go at the chart above to the right, and it does not look pretty vs. the short term outlook. Inflation may still stay up here for several months (but it may also 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 report a 3.1% expected growth in unit costs. Since 2013, the expectations have been stable at 1.75% – 2.25%

Inflation has overshot the 2%-over-time-target – and is expected to climb >2%

The FOMC revised its inflation forecast in September, will reach 'maximum employment'

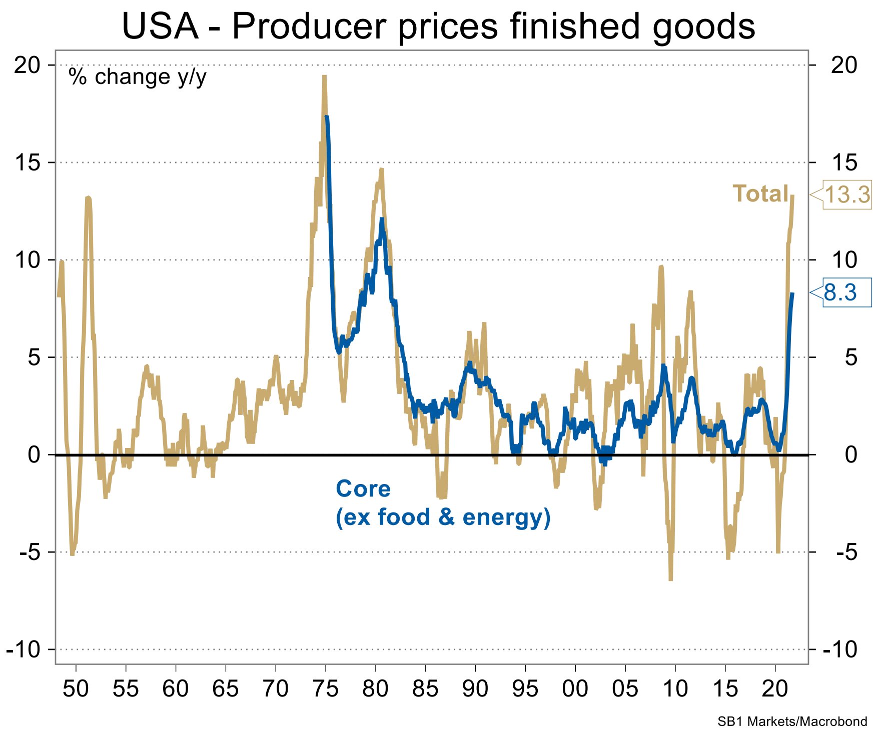


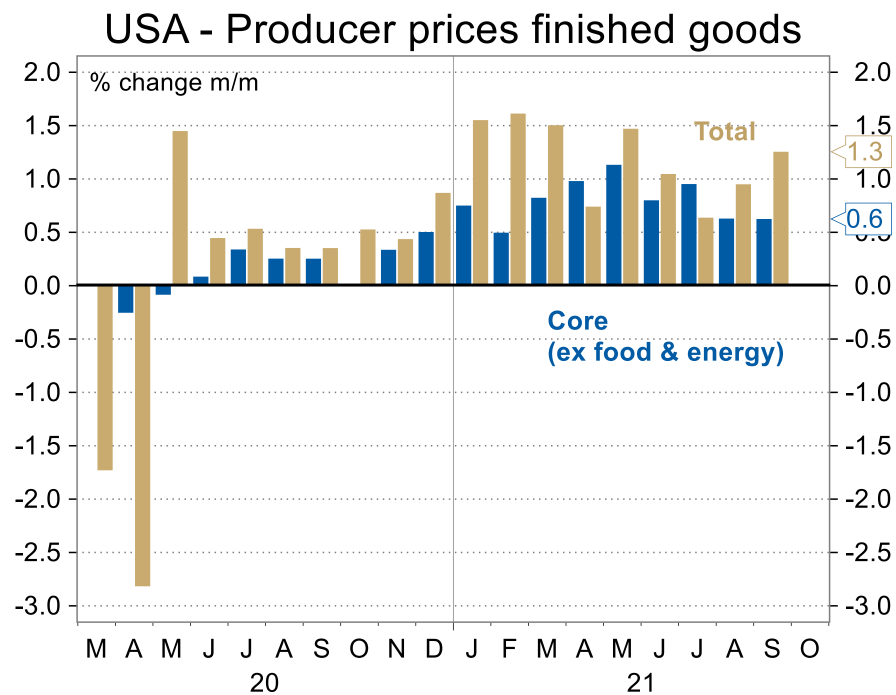


- The Fed has not defined its time horizon but actual inflation has been higher than the 2%-over-time target, whatever time horizon the Fed chooses
  - **Measured vs. the CPI**, the average core inflation is <u>well above 2%,</u> whatever period we check. **The PCE deflator**, which is Fed's preferred price measure, has been climbing faster than 2% in average at least the past 7 years. The Fed has delivered a higher price level than 'promised'
- **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? So far, few signs that the 8 mill persons who lost their unemployment benefits in early Sept have started working or are searching for work

PPI inflation further up in September, the highest y/y rates in 40 years

However, crude materials (ex energy) are now finally easing, normally a positive sign



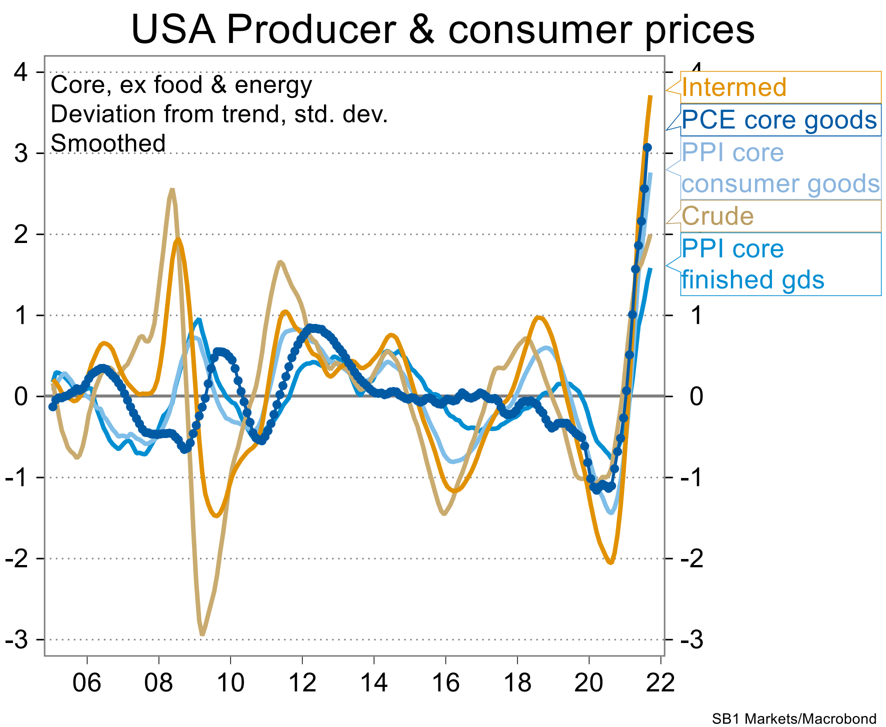


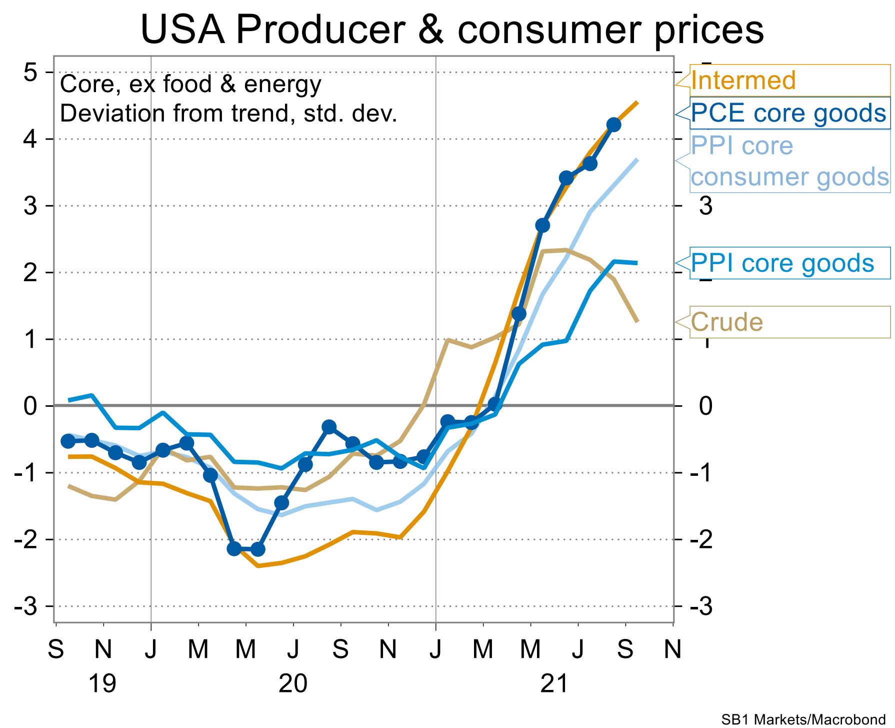
- **Core finished goods x food & energy** PPI rose 0.6% in Sept. The annual growth rate accelerated 0.4 pp to 8.3%, the highest level since 1982
- **Headline finished goods PPI** rose 1.3% m/m, as energy prices contributed on the upside again. The annual rate was up 1 pp to 13.3% - also the highest since 1982
- **Crude material prices** may have peaked, the first positive sign. In addition, core CPI goods prices have already climbed more than usual vs. PPI prices (due to 2nd hand auto prices), limiting the upside risk
- **The 'official' total final demand PPI**, including **services**, rose by 0.5%, less than the expected 0.6%. The index is up 8.3% y/y, signalling a CPI growth above 6% (from 5.3% now)

SpareBank 1 MARKETS

Crude materials have peaked. But pressure from supply chains is still strong

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

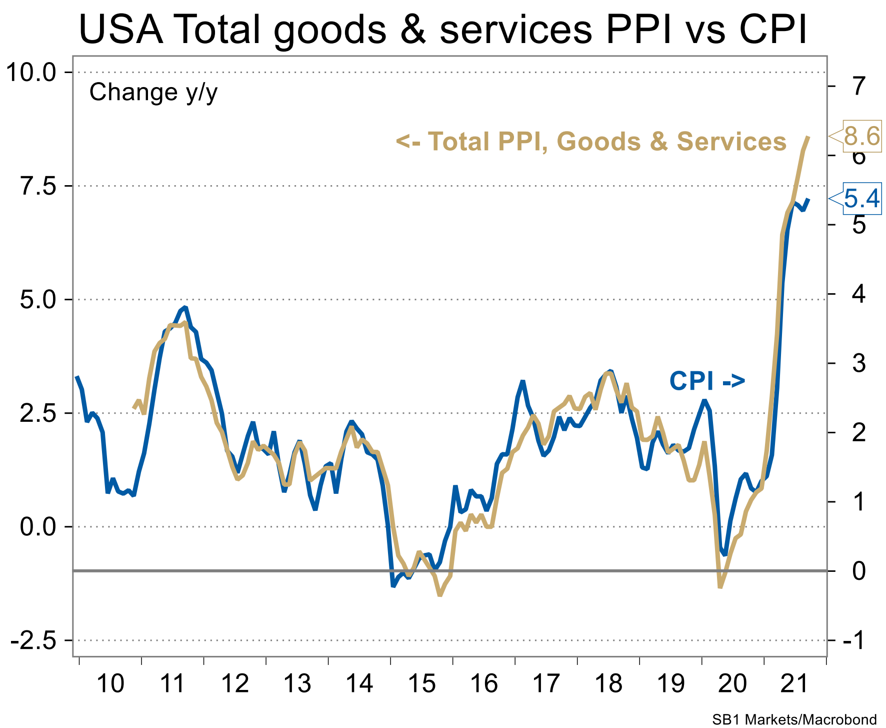


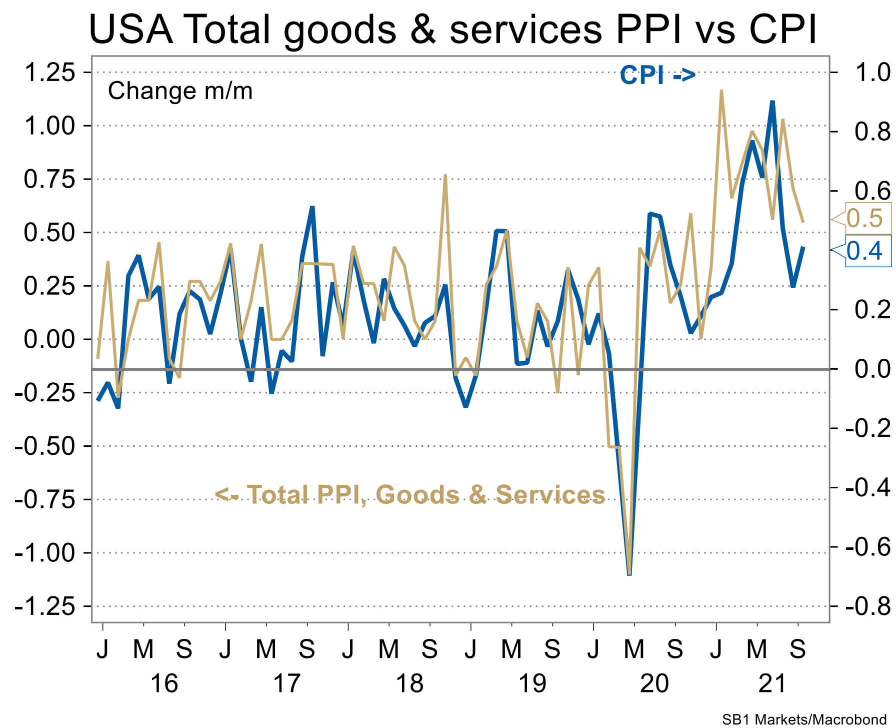


- Crude goods prices are leading intermediate goods by 4 months, and consumer prices by 12 months – and crude prices have clearly peaked (see chart to the right). However, intermediate prices have not yet yielded by much – and they will push finished goods prices up the coming months
- Some more comfort: Prices at the consumer level have responded earlier and more than normally vs the PPI core consumer goods index. That is very likely due to the unprecedented (and very likely not permanent) hike in 2nd hand cars which are not a part of the PPI index. Thus the upside risk for the core goods component of the PCE may be limited the coming months

Bottom line: Total PPI (services included) signals 6% CPI growth

The 'new' total PPI rose 0.5% m/m in Sept, lower than expected (0.6%), and is up 8.6% y/y

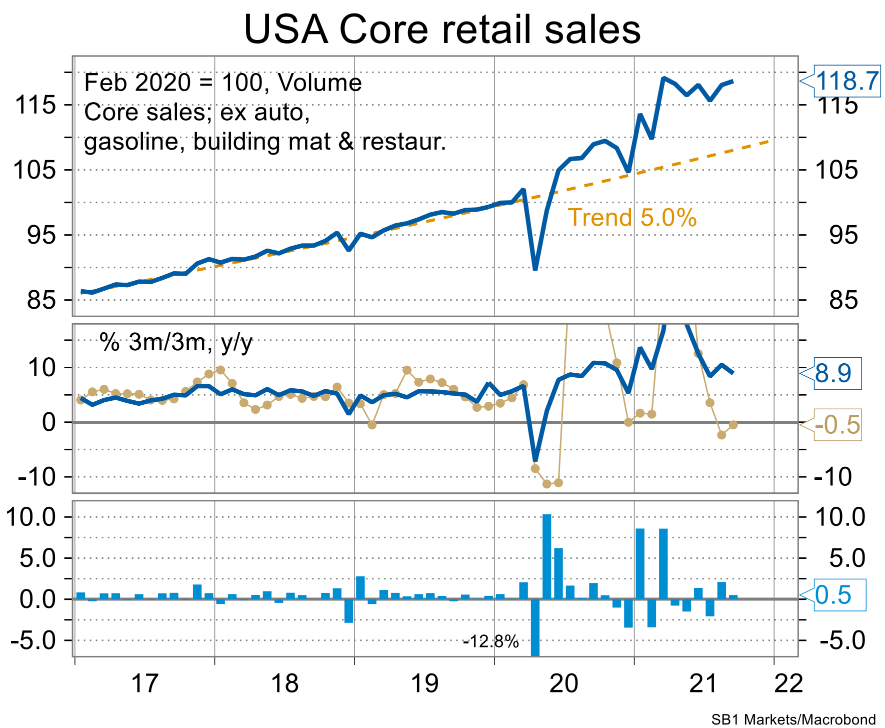


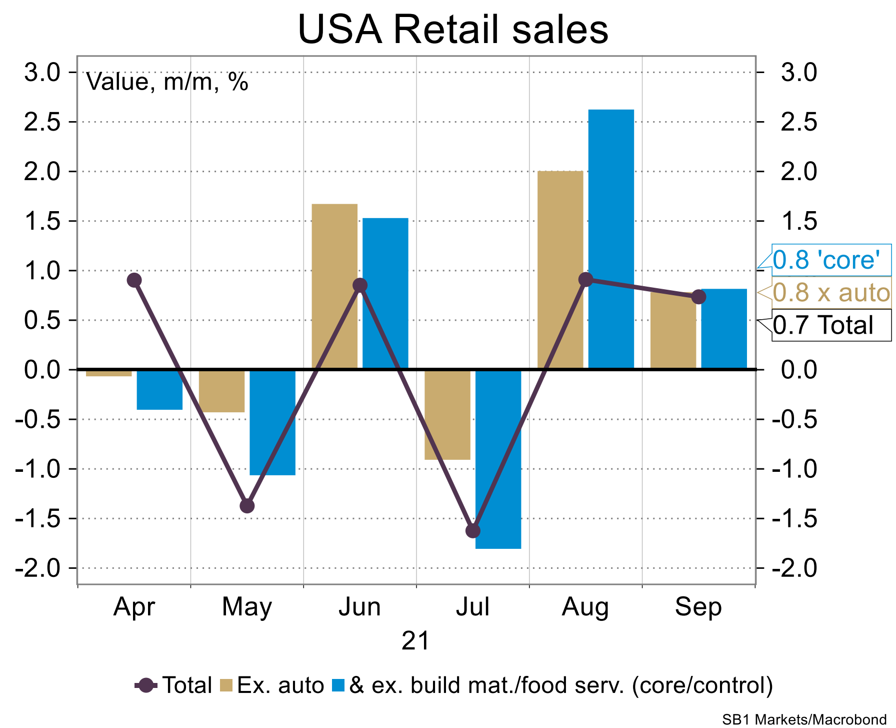


- The correlation between the 'new' total PPI, which includes all sort of services in addition to goods is pretty close. The current 8%+ annual growth rate in the PPI signals some 6% y/y growth rate in the CPI index, up from 5.3%

Retail sales surprised on the upside in September too

Core sales up 0.8% following the 2.6% August lift. Still volumes have flattened – and will come down!

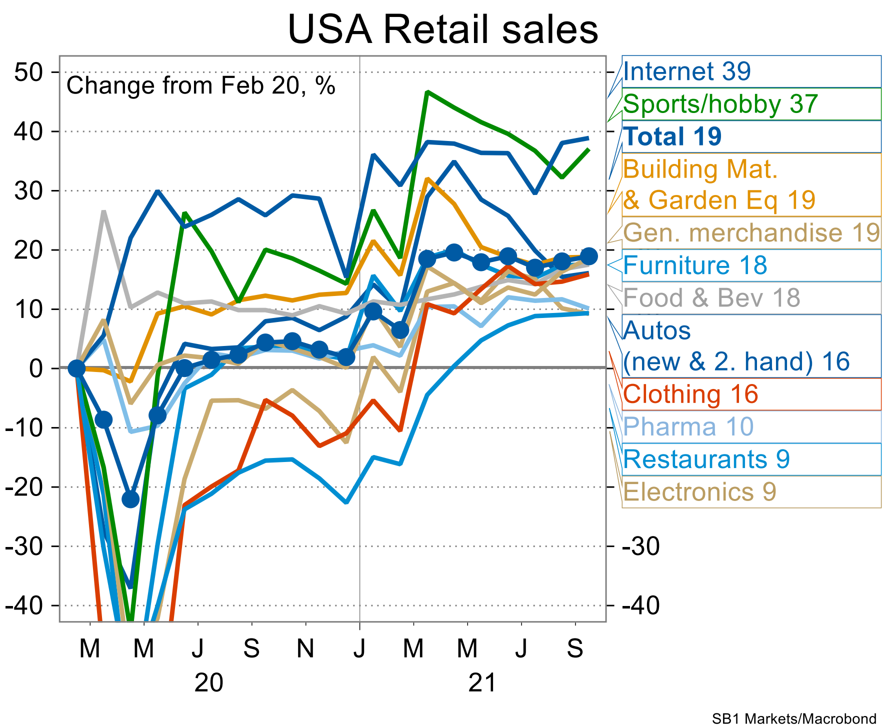




- **Total nominal sales** rose by 0.7 % in Sept, expected down 0.3%. In addition, sales in Aug were revised up to 0.9% from 0.7%. Sales are up 19% vs the pre-pandemic level
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) rose by 0.8% in Sept, expected up 0.3% following the 2.6% spike in August. In volume terms, we assume sales rose 0.5% - and sale volumes are 19% above the Feb-20 level. Even so, peak sales were in March, and the trend is definitely not upwards – though better than the downward trend we expected when services reopened.
- Sales in **restaurants & bars** flattened in August and rose just slightly in September – though up 9% vs the 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. And remember, no growth in consumption of goods the past 6 months!

Almost all sectors up in September, just health/pers. care, and electronics down

Auto sales sharply up, even if new auto sales fell

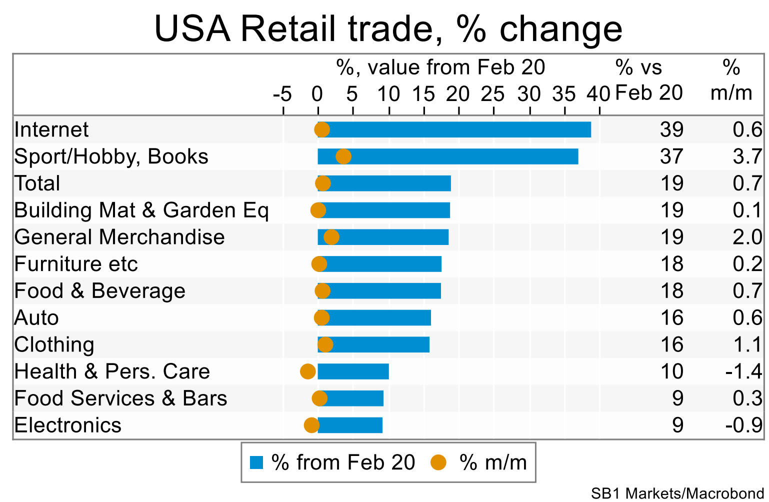


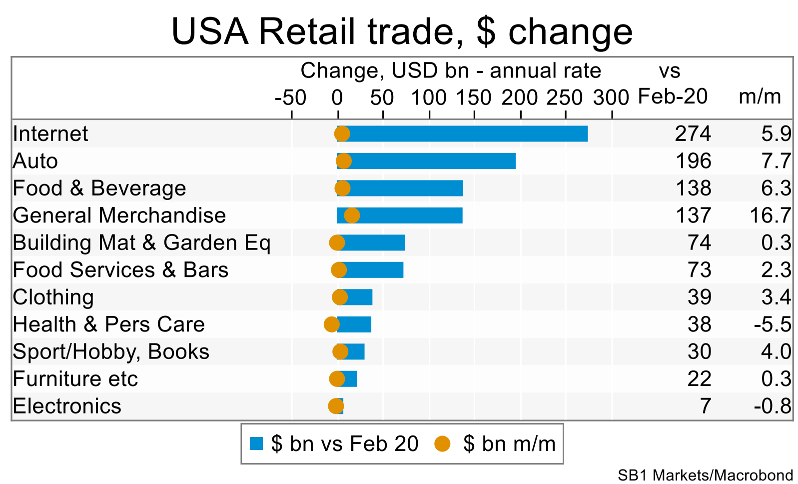
Last month

- 9 out of 11 main sectors reported growth in sales

Since pre corona: All sectors up, from 9 % and upwards – *in value terms*

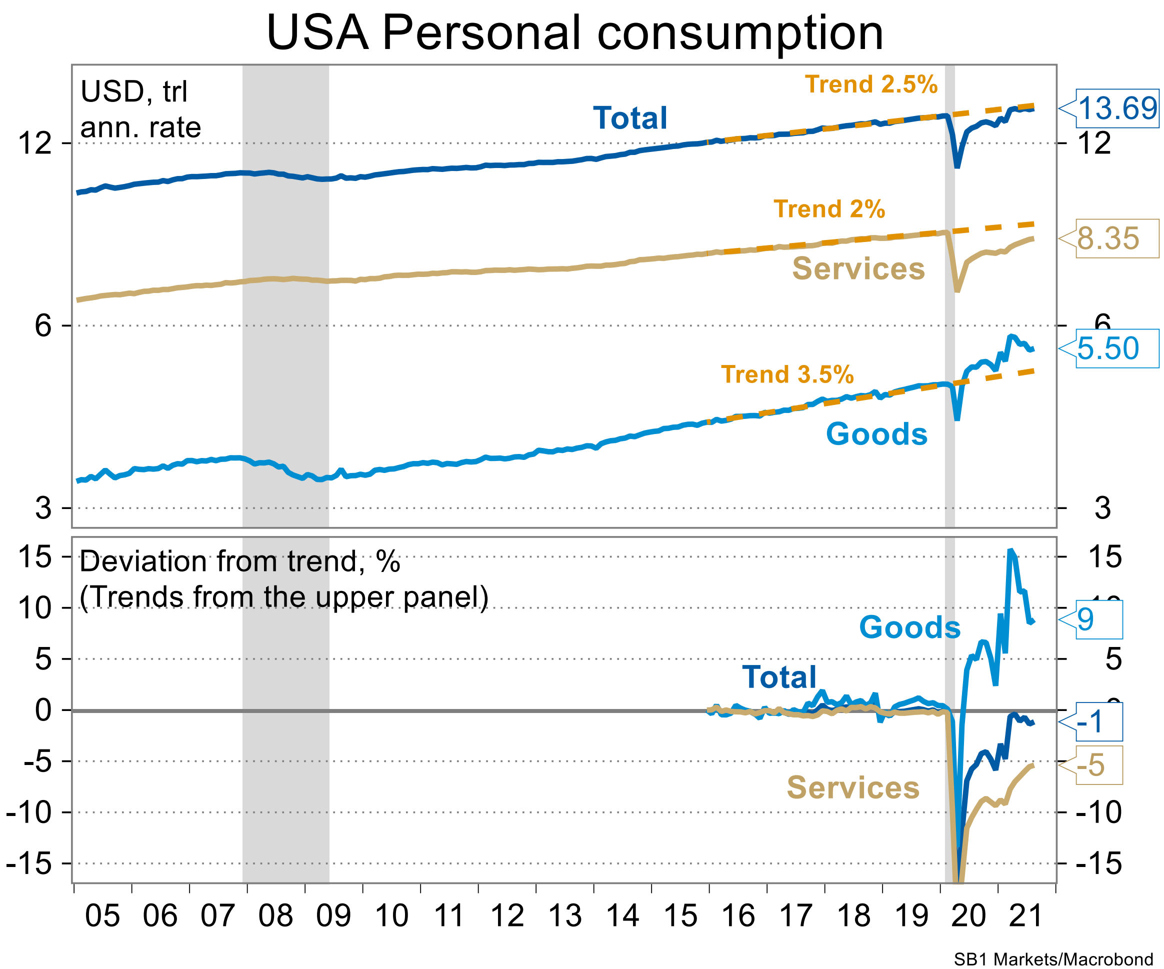
- **Restaurants** are 9% above the pre-Covid level
- **Clothing** is on the way up, is up 14% vs. Feb-20
- **Sports equipment** (+hobby/books) is up 37%, while auto sales are +16%, due to record high 2nd hand car prices
- **Net** sales are up 39%





Goods vs services – the big picture

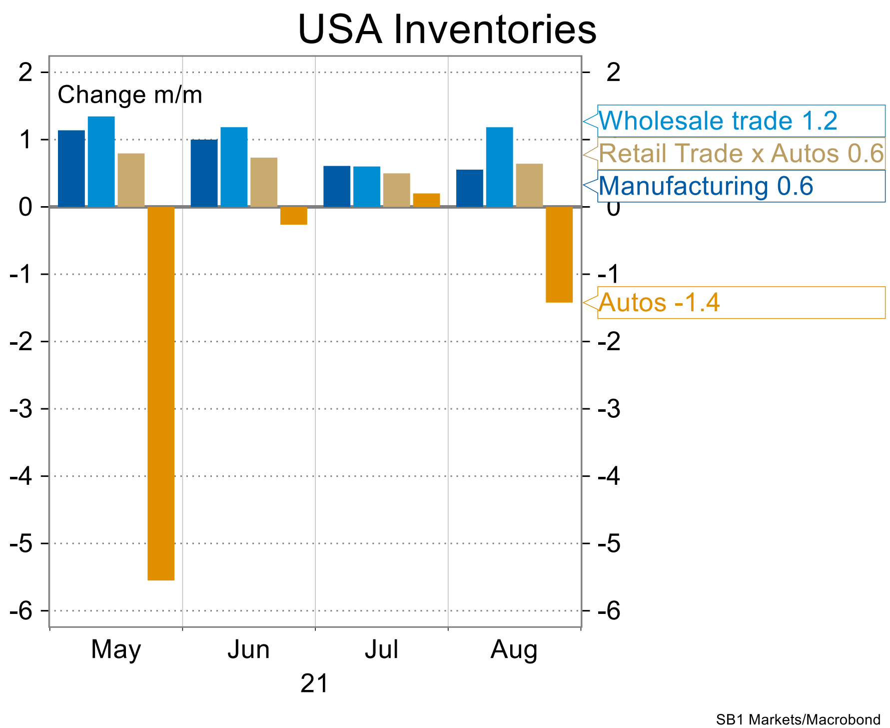
Goods are 9% above the pre-pandemic trend, services still 5% below

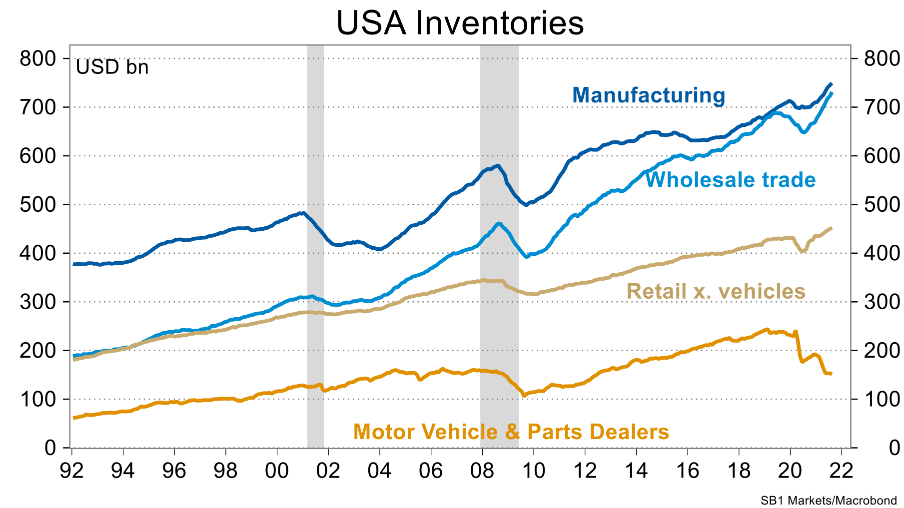


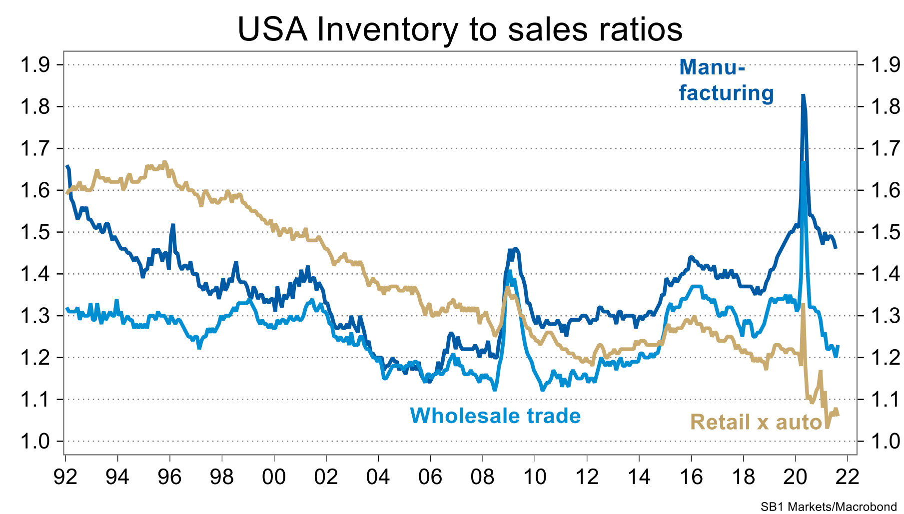
- The normalisation is underway but far from completed

Inventories on the way up, but less than sales

Inventories are probably too low vs sales, even is sales of goods should come down to normal levels



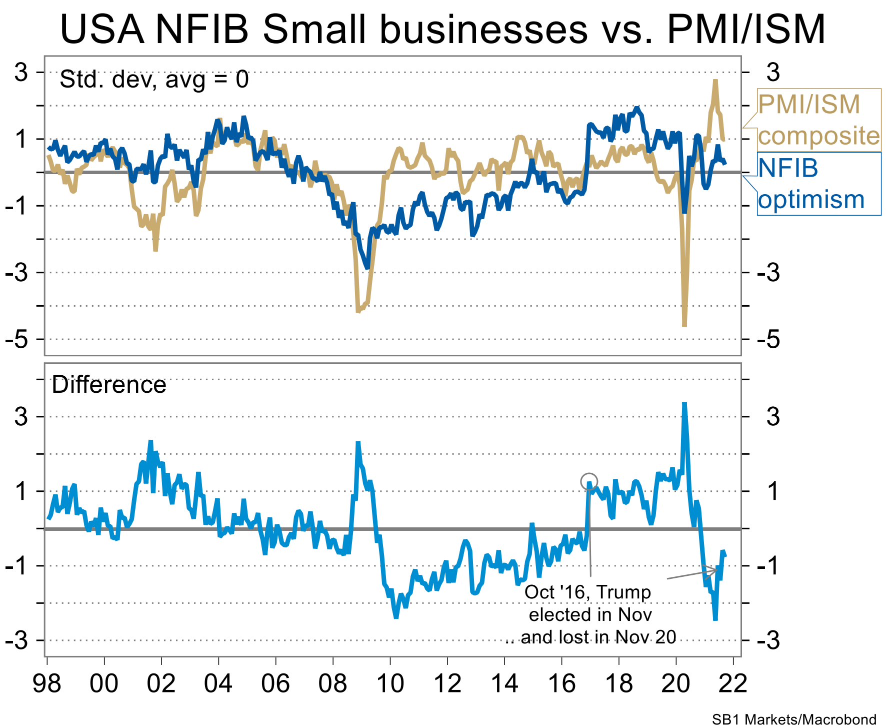


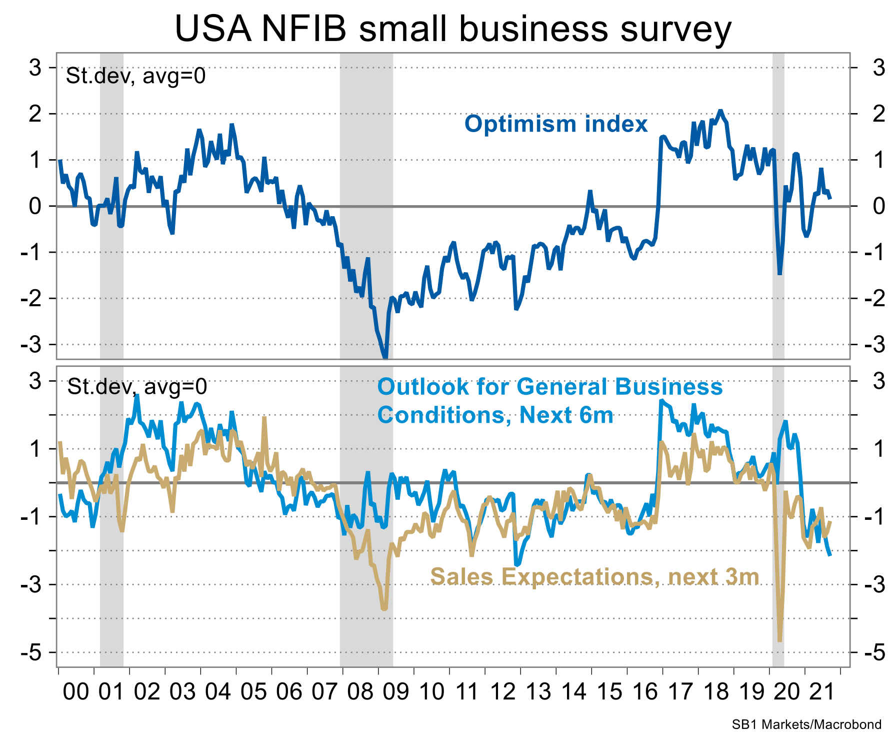


- The inventory is rather large vs. sales in manufacturing, not in wholesale/retail trade
- **Auto inventories** have been slashed during the pandemic but has stabilised at a low level over the past months

Small businesses optimism is inching down but slower than the PMIs/ISMs

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

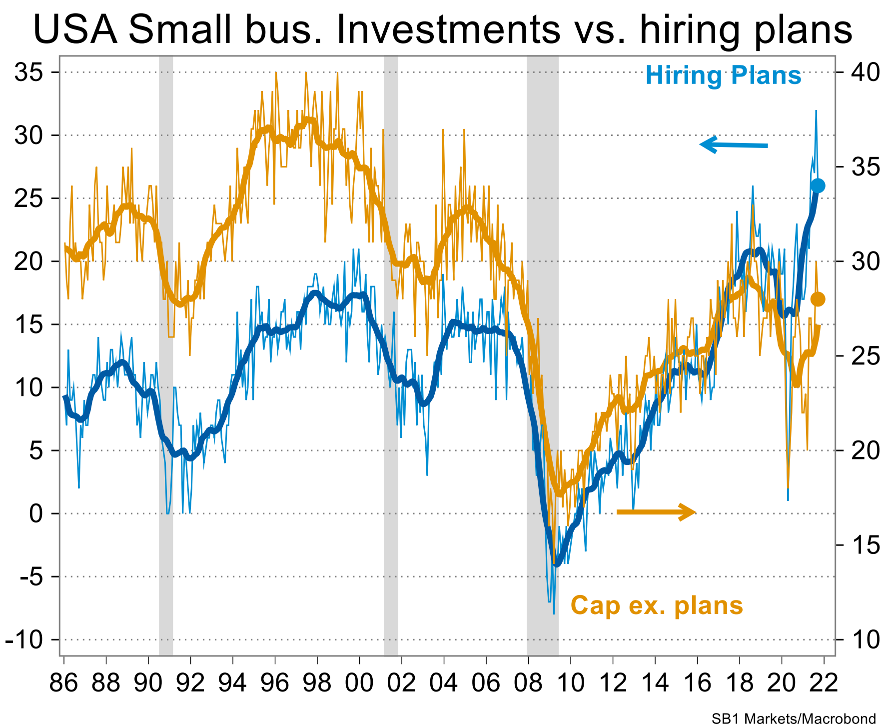


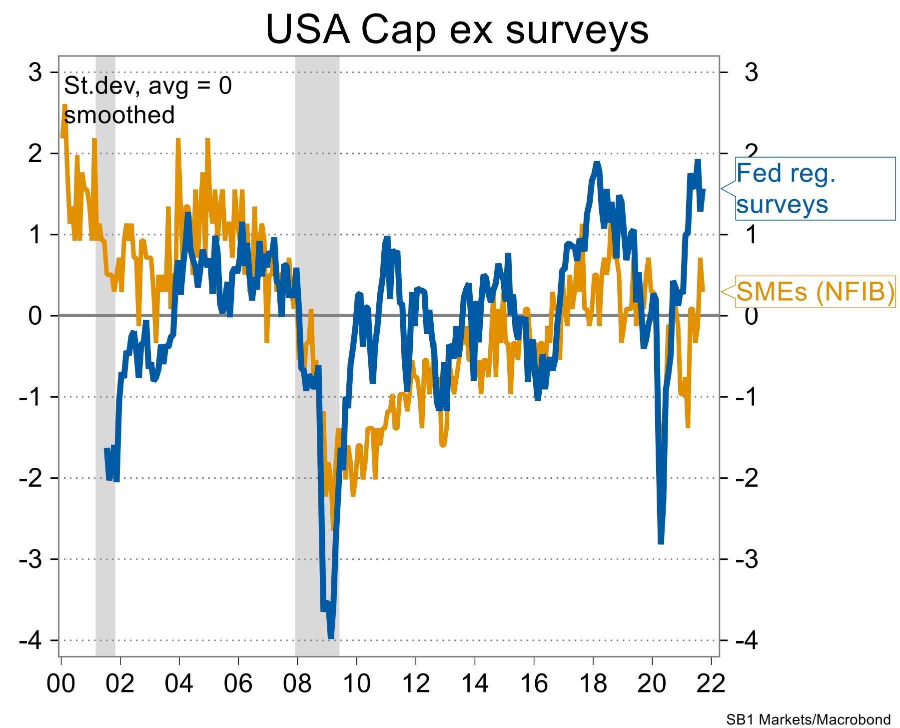


- The **NFIB optimism index** fell 1 p to 99.1 in Sept, expected down to 99.5. The index is still above an average level but lower than the PMI/ISMs, and most other surveys. However, the gap is now far smaller than some months ago
- **The outlook for the next 6 months** worsened substantially in Sept and is <u>2.1 st.dev below</u> par, not far above all-time low. Lack of qualified labour, labour costs, inflation worries, and the Delta variant rattle small businesses. Nobody is complaining about current sales, though. Still, **investment plans** are above par
- **Hiring plans** are still very high, just somewhat down from the ATH level in Aug. However, the SMEs are not able to **fill their vacancies.** More companies report actual & planned **compensation increases** (data out the previous week)
- A tad fewer companies have **increased their selling prices** in Sept, but the share is still very high. The share of companies planning to lift prices rose further, <u>and it is close to the peak level from Q4-1979, signalling a substantial upside price risk the coming months</u> (<u>check here</u>)

The SMBs want more workers and plans to invest more

However, both indices down in September

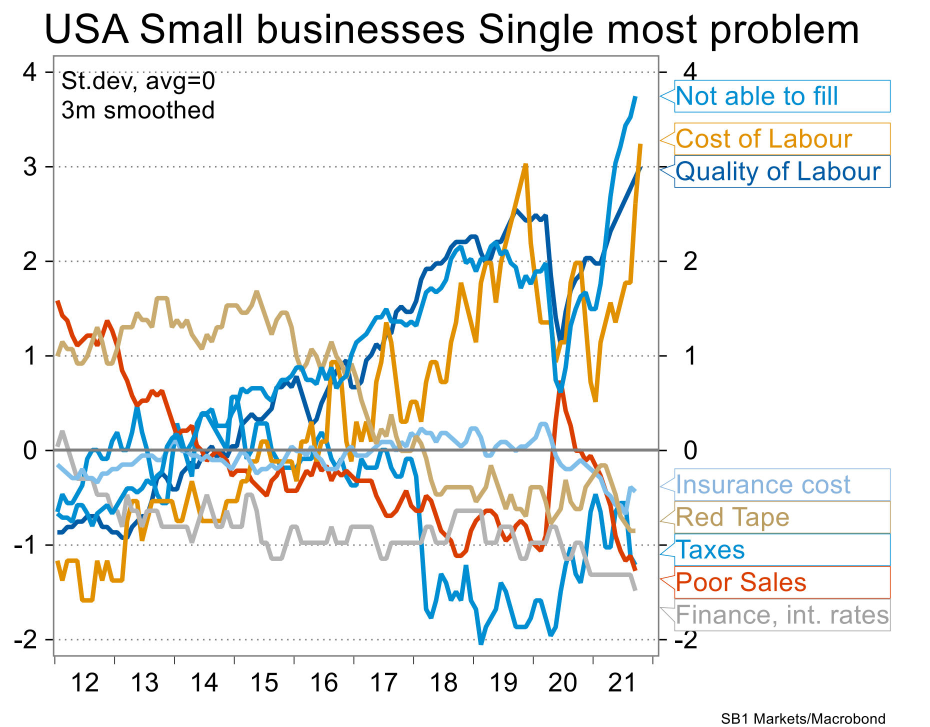


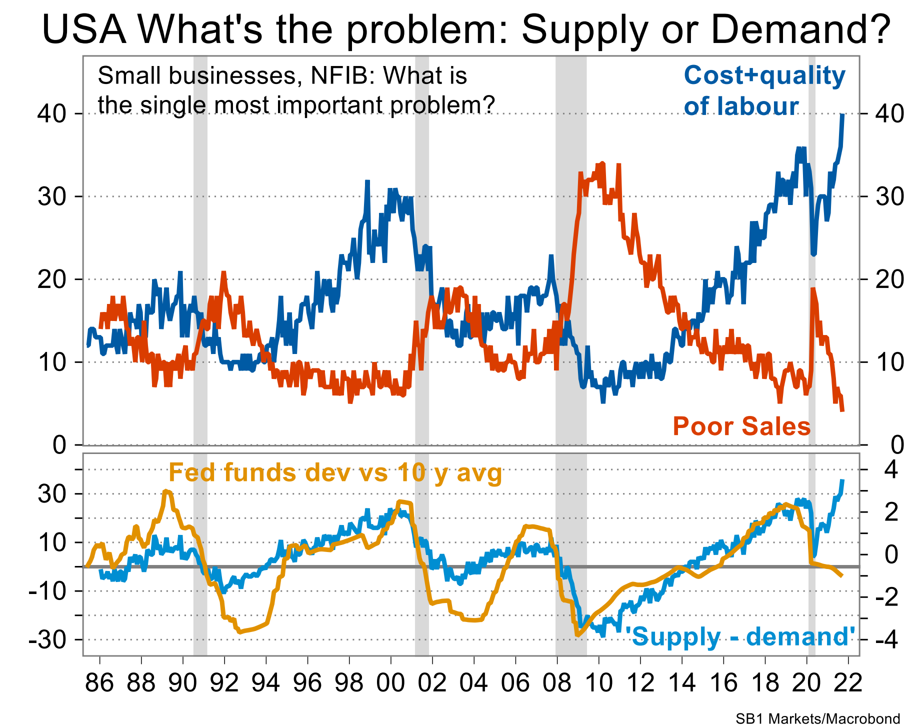


- Other investment surveys are still more upbeat than the small business survey

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

Record few companies complain about poor sales, record many complain about cost/quality of labour



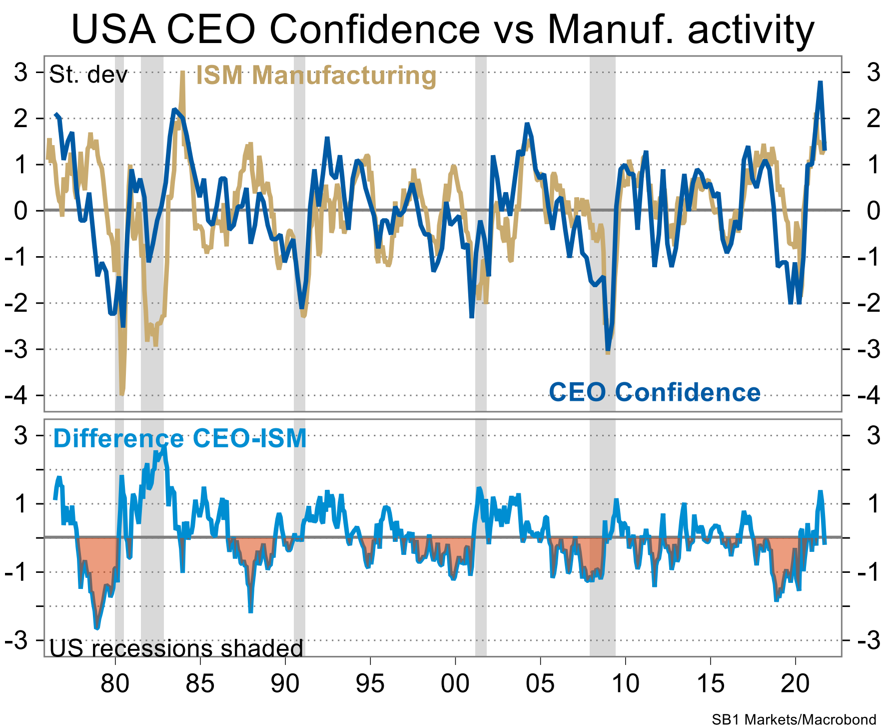


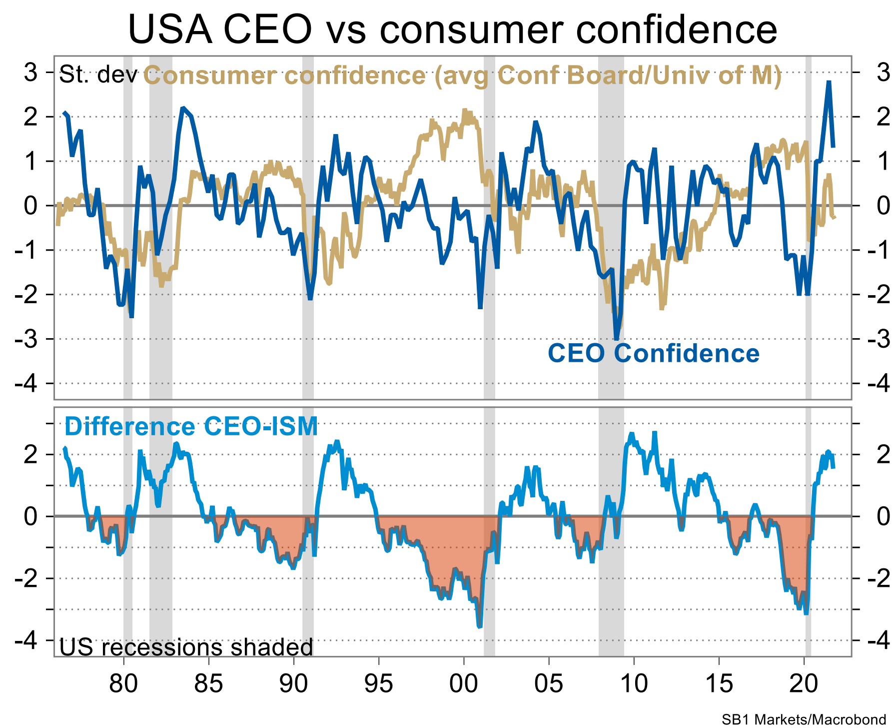
- <u>Thus, companies report they are constrained from the supply side, not from the demand side</u>
  - » In September, a much larger share of companies reported that cost of labour was the single most problem
- These data are really incredible, at least vs. the current monetary policy stance. Check the chart to the right

In the chart to the left, we have included the Not able to fill open positions, but that is not (rather strangely) not an alternative in the single-most-problem question in the survey. We still show it at the chart

CEOs less but still unusually optimistic

.. and recessions have never turned up before well after the bosses have turned negative



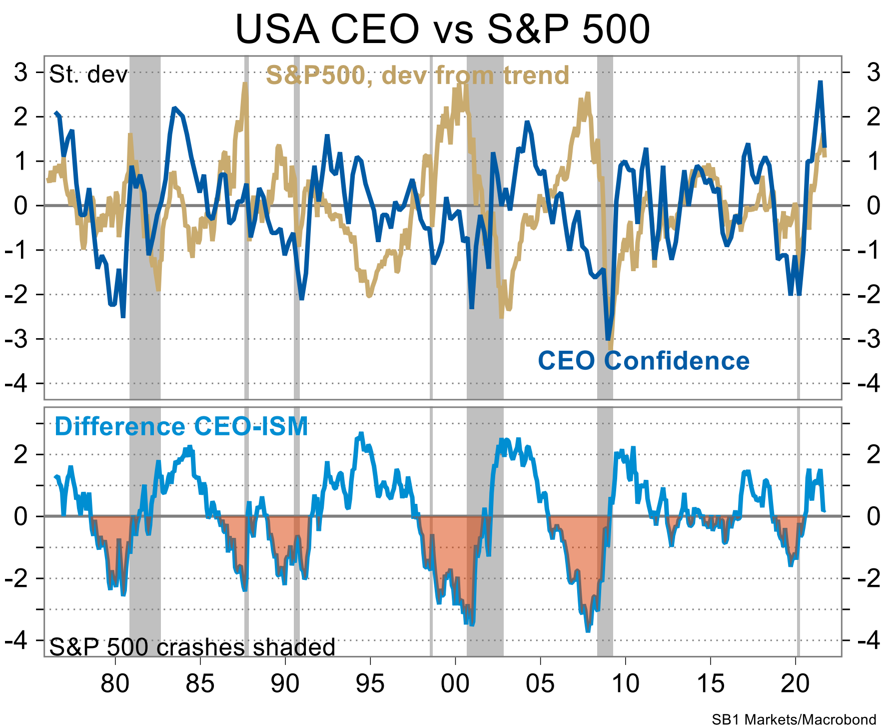


- … and not before the CEOs have been more negative than the ISM (the current situation) for a long period (left chart)
- In addition, the CEOs have always (barring the 1992 recession) turned negative years before households recognised that the party was over (right chart)
- However, the CEO survey is not a timing instrument, as it takes years from CEOs send a message to a recession hit

SpareBank 1 MARKETS

CEO confidence always wanes before the stock market loses its confidence

… before the stock market 'confidence' wanes. However, without stable lags (and some false signals!)

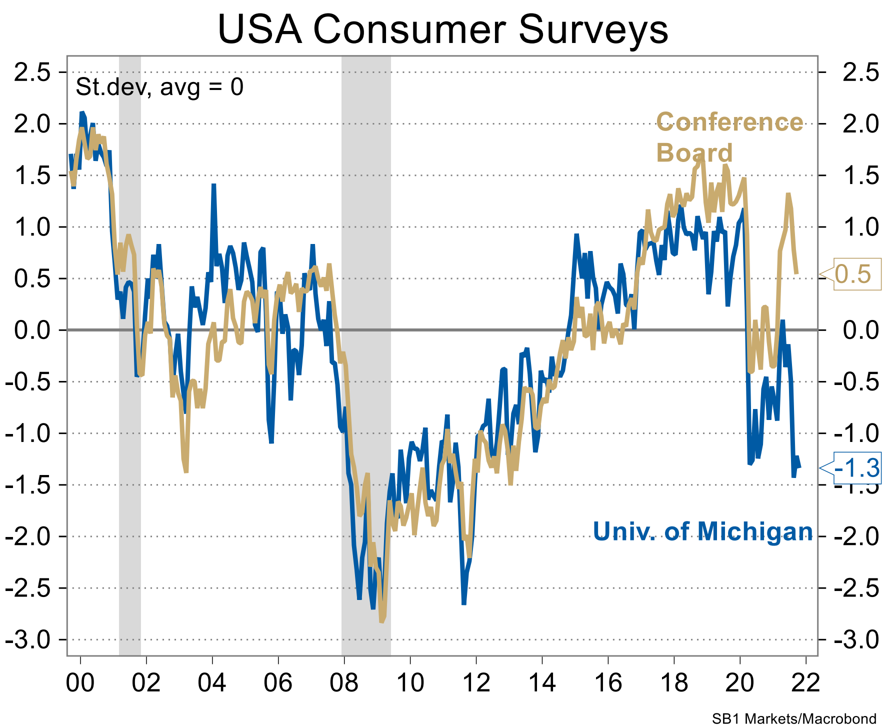


- ***Now: No warning signal from the bosses!***

An important disclaimer: This time IS different. We have NOT been through a NORMAL economic downturn, and we are now exiting the Covid-19 short break may be entering something than looks like a mature part of an economic cycle! Perhaps even not the best and brightest (or at least the best paid) have taken this unprecedented cycle properties into account?

Univ. of Mich. consumer sentiment still very weak in early October

All consumer surveys are down and just Conference Board's is above par

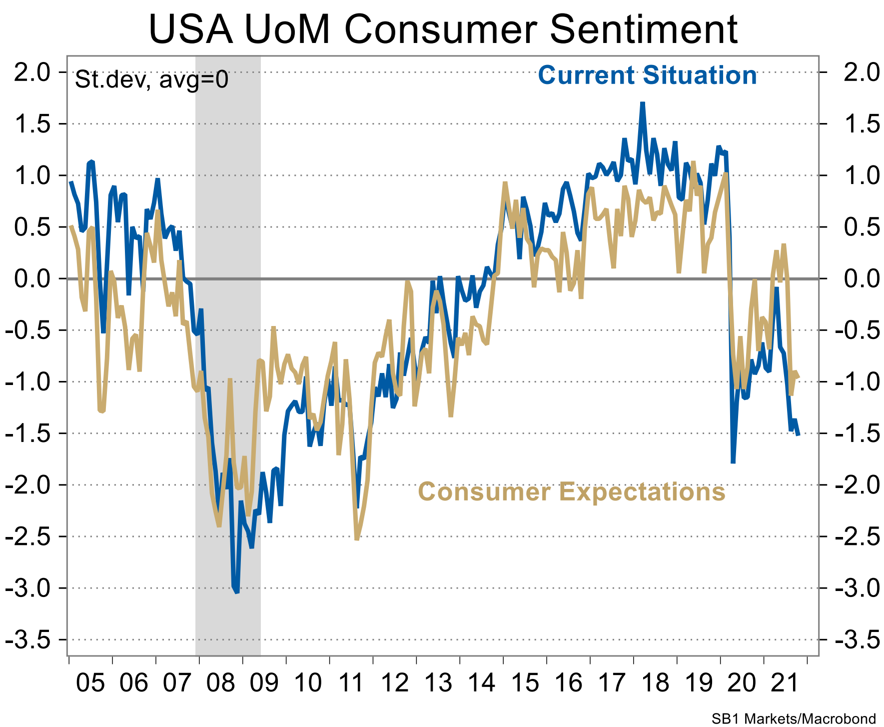


- UM' sentiment survey fell 72.8 to 71.4, expected up to 73, equalling -1.3 st.dev below average, and close to the level the past two months
  - » **Both expectations** and assessment of the **current situation** fell slightly
    - The current situation is 1.5 st.dev below average, the 2nd lowest in 10 years, just April-20 is below.
    - Expectations are 1 st.dev below par
  - » Besides inflation, and the current Delta outbreak, there are not many indicators that the economy is in a bad shape, and definitely not in a worse shape than say some months ago or during the 2nd Covid wave in Dec/Jan
    - Employment, unemployment, consumption, housing, the stock market have all moved in the right direction

    In addition
    - Inflation expectations have not risen further recent months
    - … and the Delta attack is now gradually brought under control, and the no. of hospitalised persons is down more than 40% since early September
- The 'problem' is that the UM survey often has been an early bird in the cycle, and that the survey may be 'right'

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

Inflation expectations are elevated but that outlook has not worsened recent months

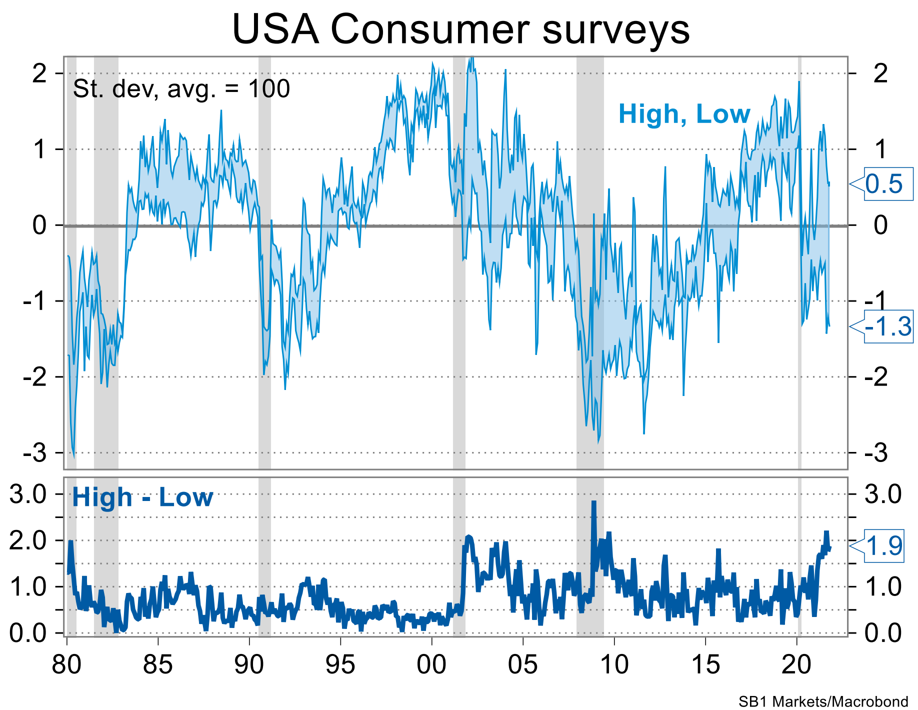


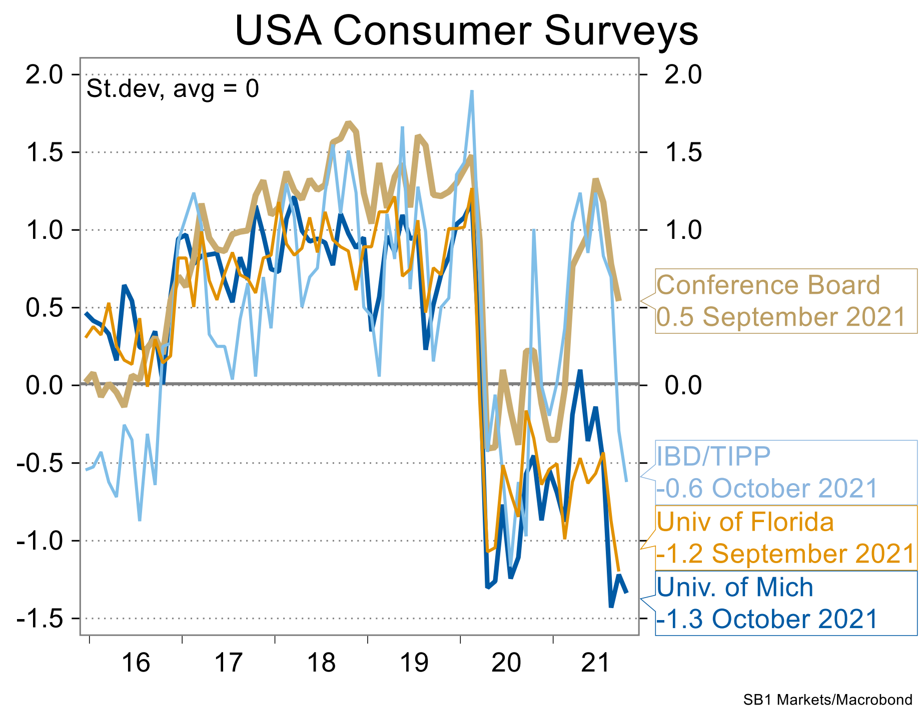
- The 12 m inflation f'cast rose one tenth to 4.8%, back to the July level, the highest level since 2008. The 5 y inflation expectation fell two tenths to 2.8%

SpareBank 1 MARKETS

All surveys are heading down, and Univ. of Florida's survey is in line with UM

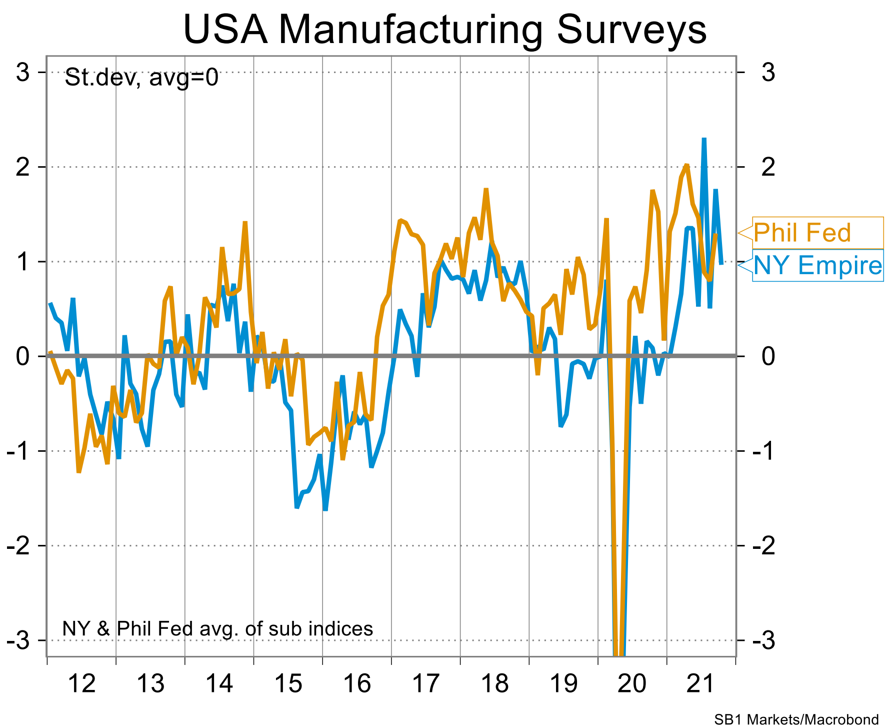
Even Conference Boards consumer confidence survey has yielded

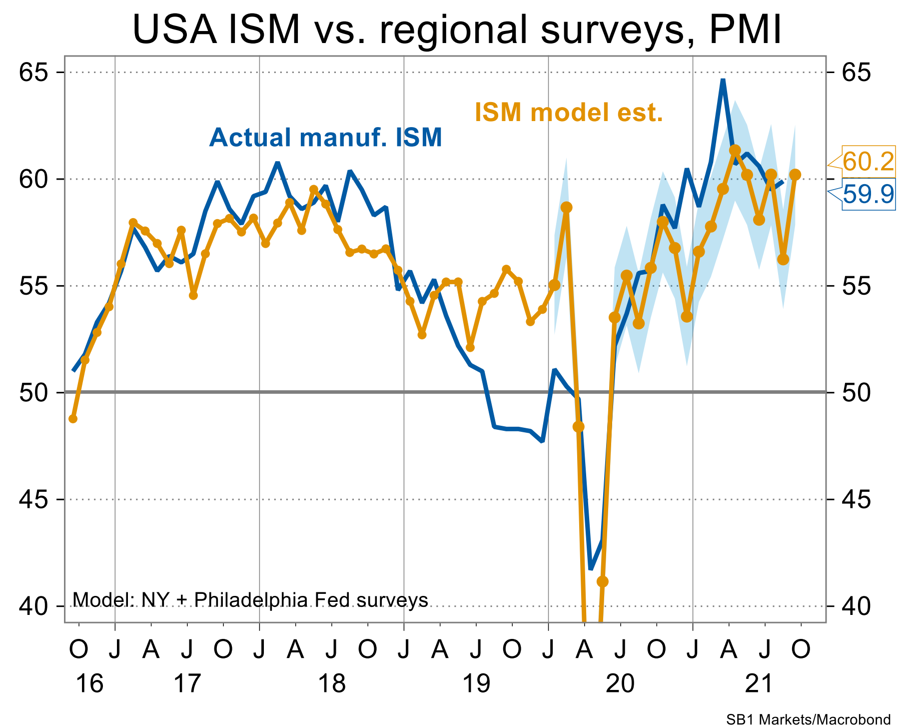




- The IBD/TIPP survey fell to 0.6 st.dev below in October, from 0.7 above the average in August. This survey is more volatile short term than the other surveys. University of Florida's survey fell to -1.2 st-dec in September.
- Conference Board's confidence survey fell in both Aug and Sept, but was still at 0.5 p above average, far stronger than the other surveys. The 'spread' between these surveys is among the largest ever

The NY Fed manuf. survey zigzagged down in October. Level still strong

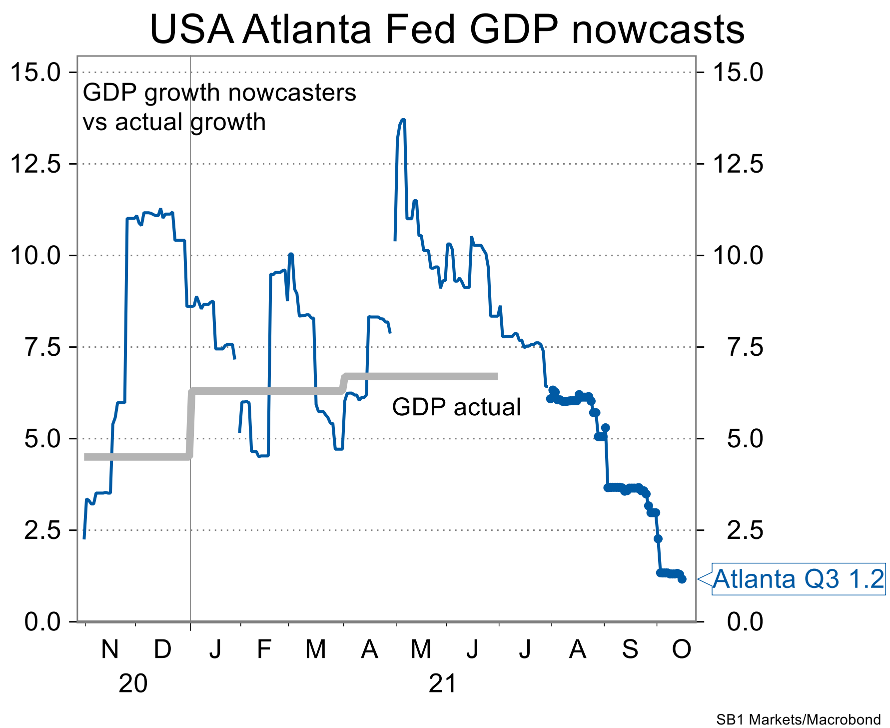


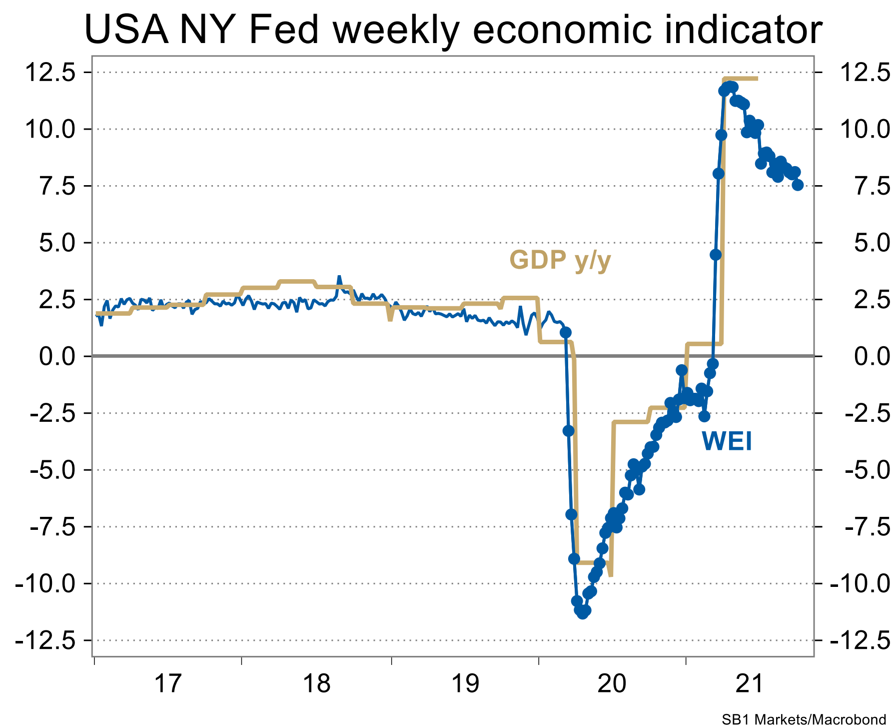


- NY Fed's manufacturing fell to 19.8 in October, from 34.3 in September, expected down to 25
  - » The average of the 'ISM components' in the NY Empire fell to 1 st.dev above average, down from 1.8 in Sept
- These – and all other – surveys, still signal growth well above trend in manufacturing production

Q3 growth slowed sharply, says Atlanta Fed's nowcaster

Recent data implies 1.2% GDP growth in Q3. The forecast started at 6%, in early August

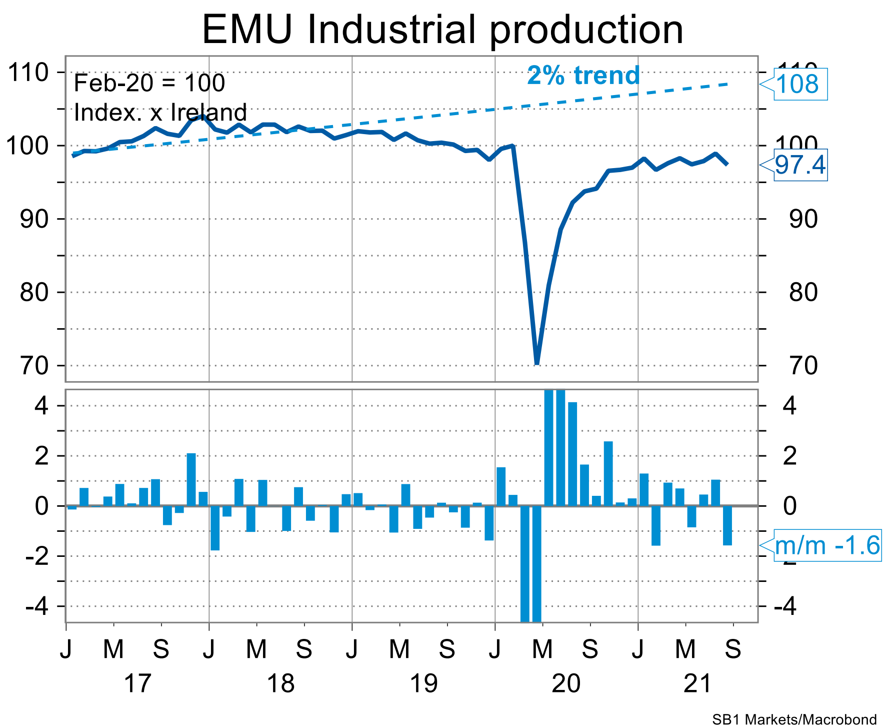


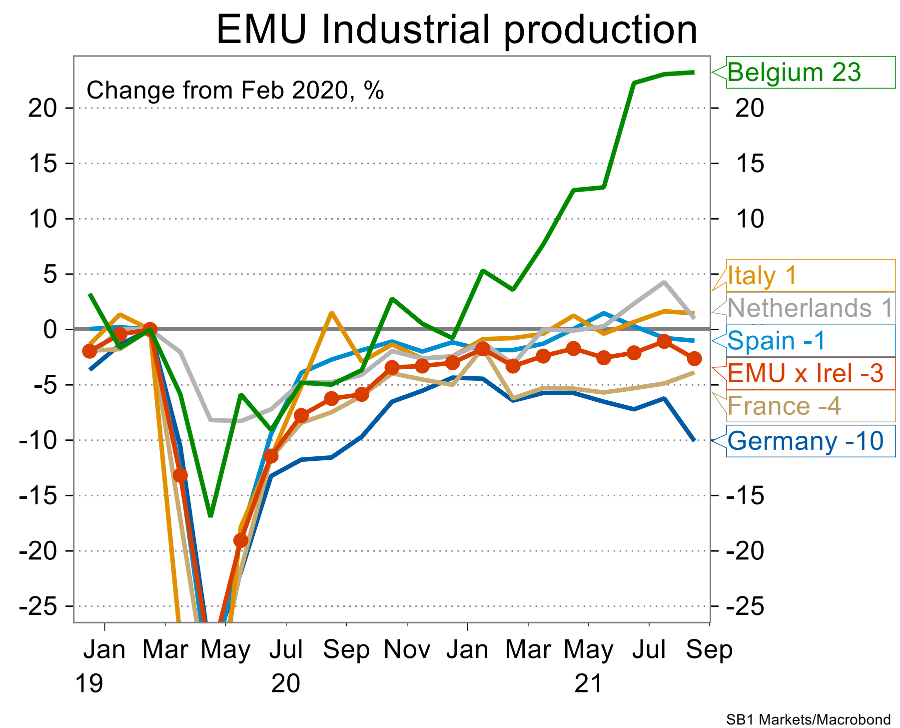


SpareBank 1 MARKETS

Manufacturing production down 1.6% in August, supply side trouble

Production is 2.6% below the Feb-20 level - with Germany the big laggard, down 10%

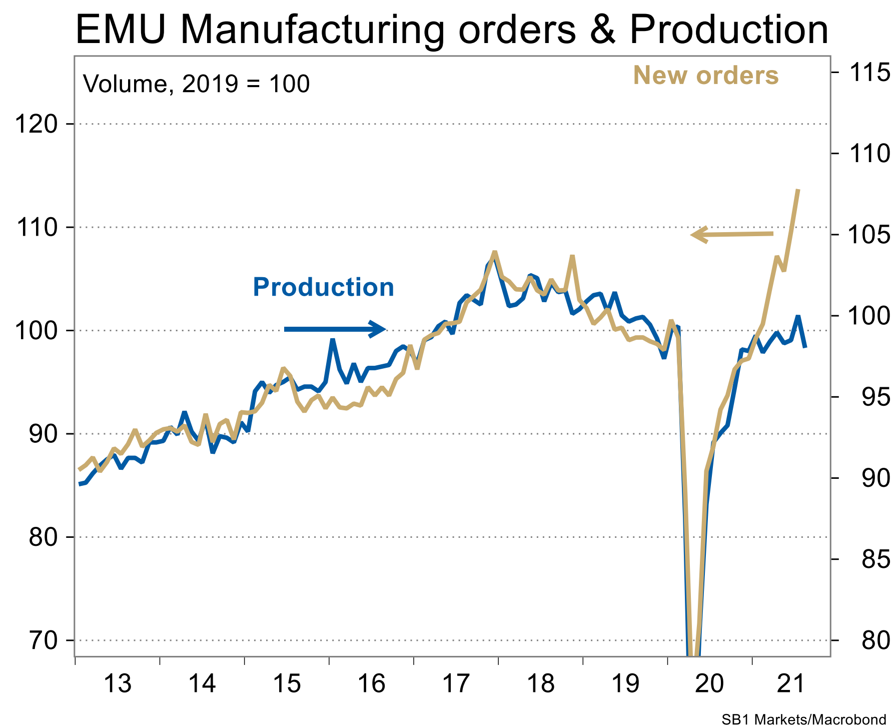


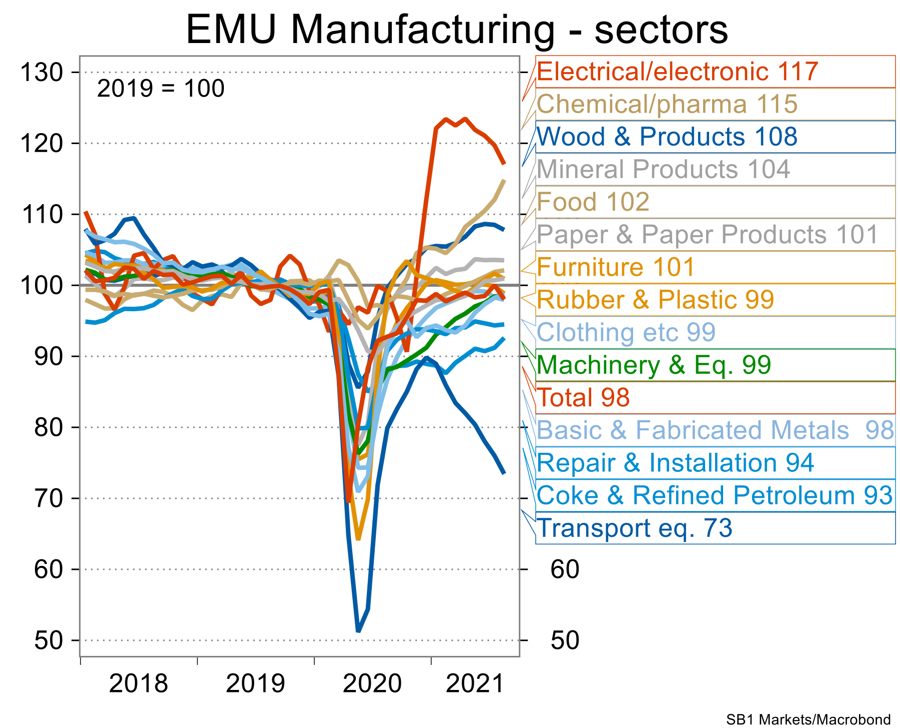


- Production is just very slowly moving upwards even if orders are surging, and surveys are close to record high levels
- Production in Italy is higher than in Feb-20, while production in the other big 3 is down
  - » Germany is the laggard, down 10%. From time to time, auto production is not what you wish you had…
  - » Belgium is up 20, the Netherlands 1%

Transport & electronics down, both probably due to supply challenges

So far, no reason to complain about the order inflow



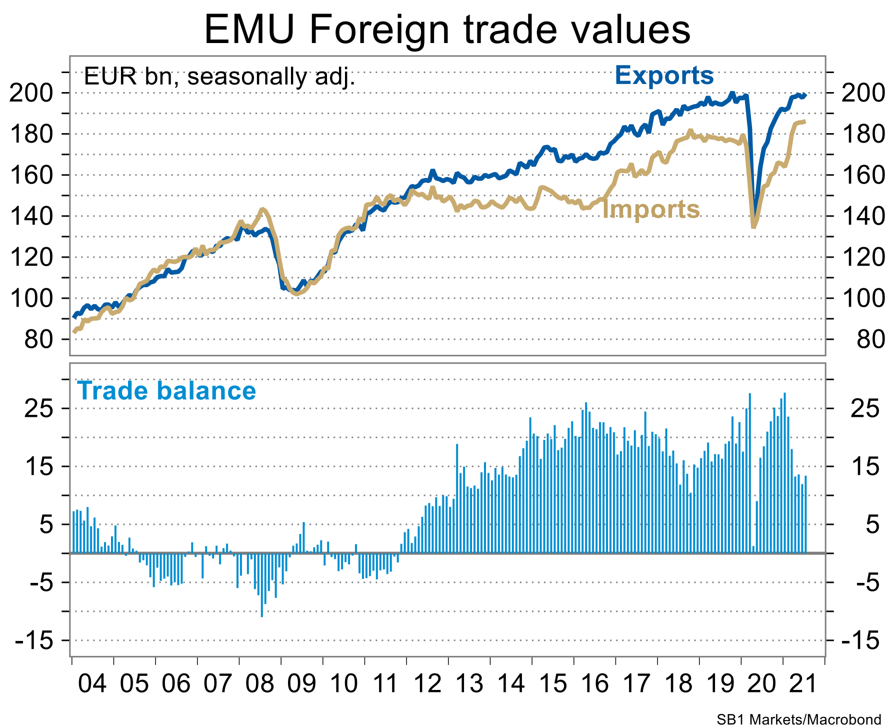


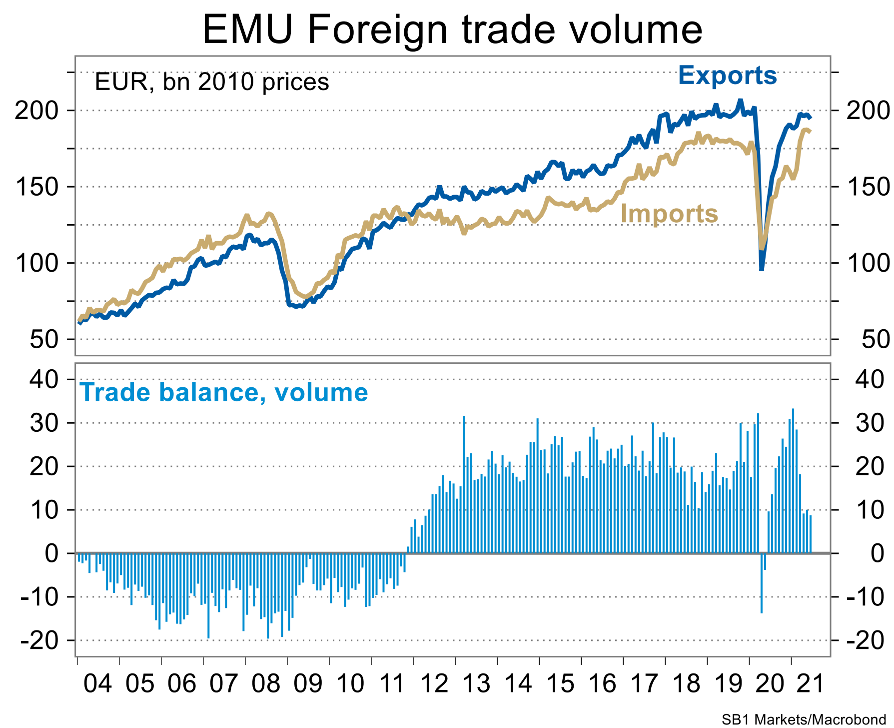
- The

SpareBank 1 MARKETS

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

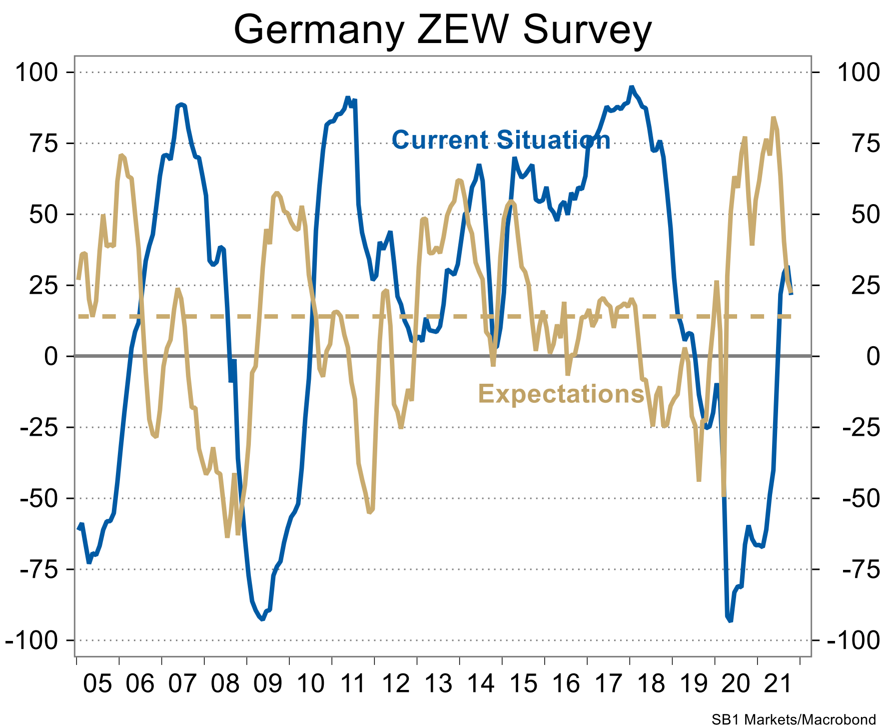




SpareBank 1 MARKETS

ZEW expectations keeps sliding, just marginally above average

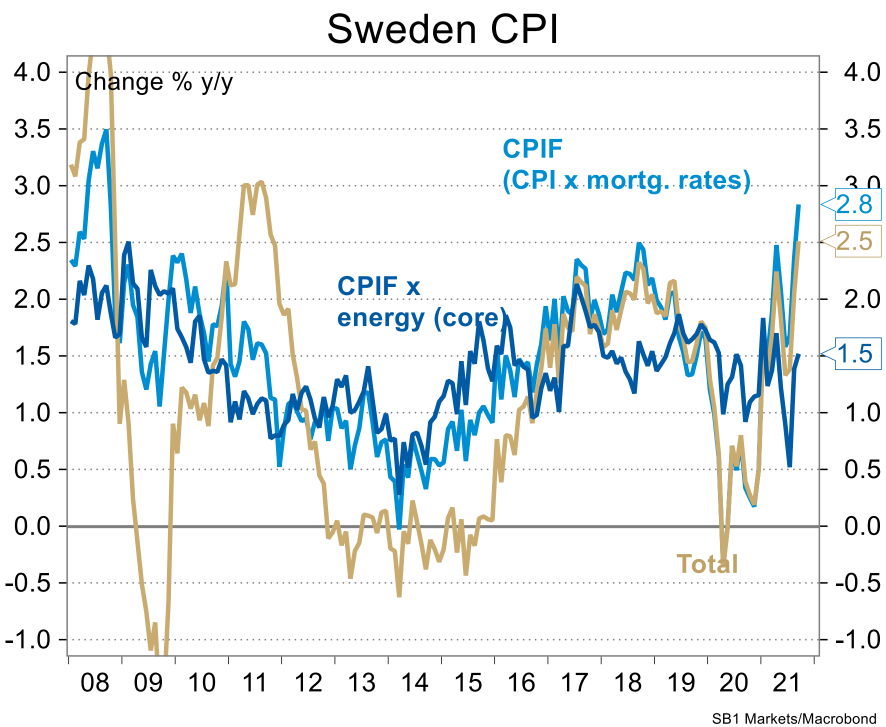
– signals slower growth, but at or above trend

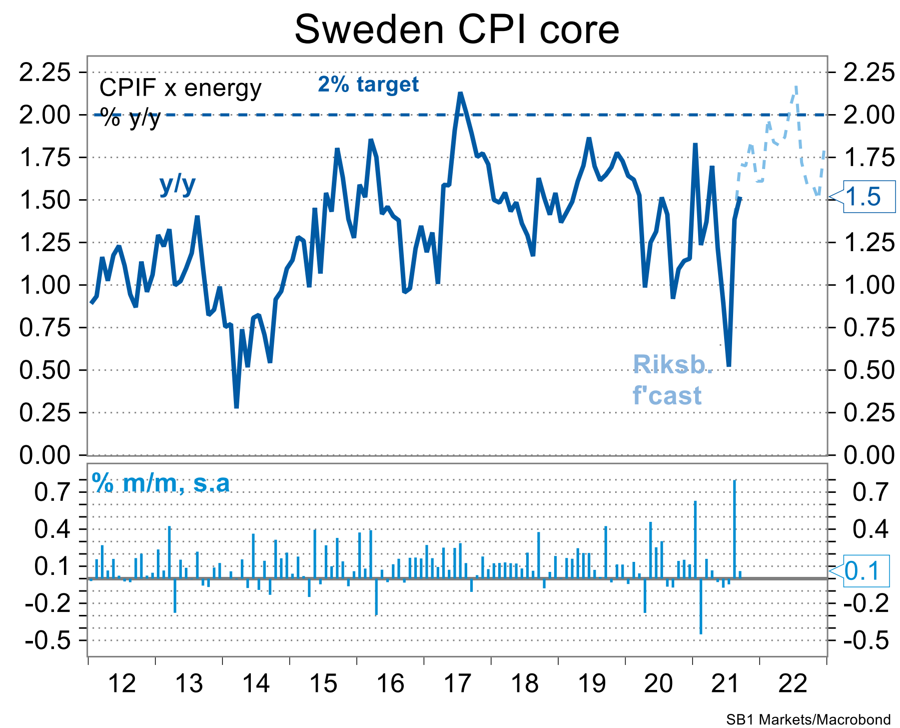


- The ZEW expectation index fell another 4 p to 22.3 in October, a tad more than expected. The index is now marginally above average
- Assessment of the current situation also yielded for the first time since early 2021. The level is still on the high side

Swedish inflation kept ticking up in September. Core still low at 1.5%

Even if energy prices have soared over the past year, lifting the CPI by 1.5 pp

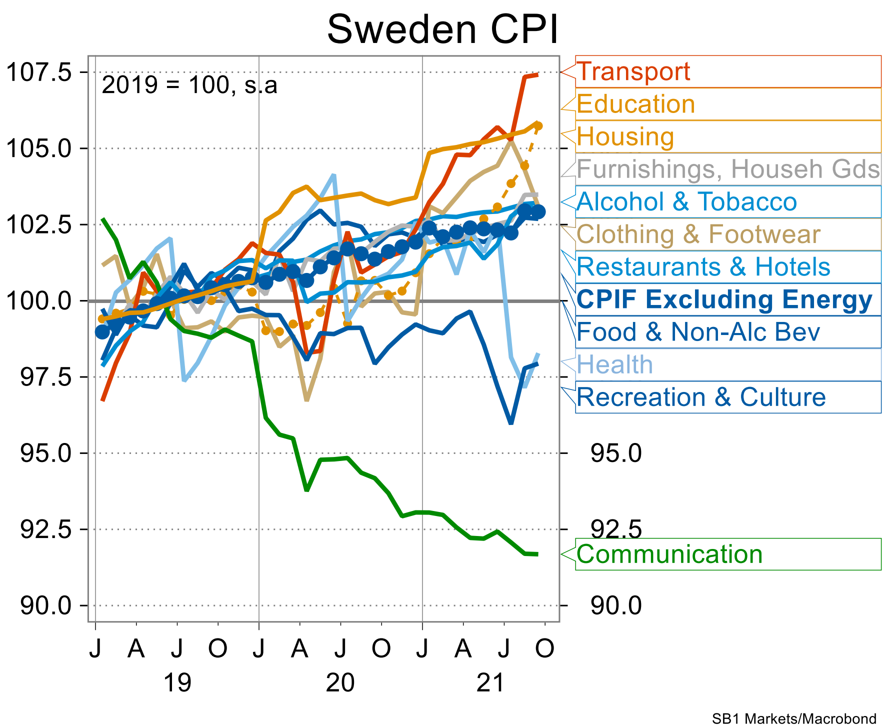


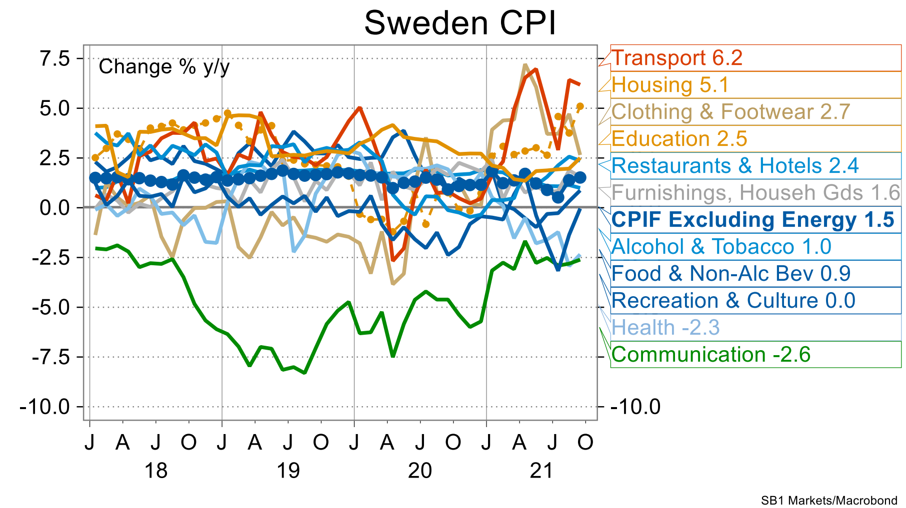


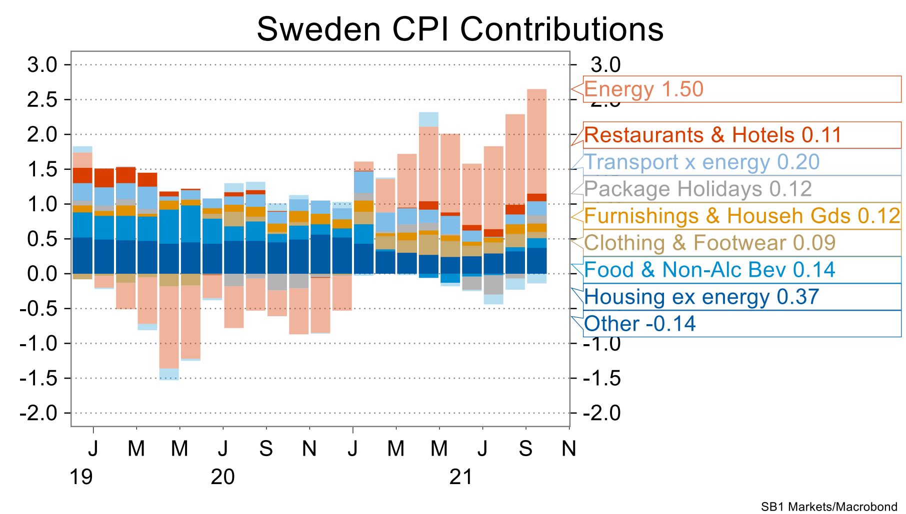
- **Headline inflation** accelerated 0.4 pp to 2.5% y/y in August, 0.2 pp below expectations
- **The CPI-F**, the constant interest rate inflation (CPI x mortgage rates) was up 0.4 pp to 2.8% y/y, 0.2 pp below expectations
- **CPI-F x energy, the 'real core'** was up 0.1% m/m, and the annual rate also rose by 0.1 pp to 1.5% y/y. The Riksbank expected 1.7%
- The increase in inflation was largely driven by an increase in energy, housing, and transport prices.

Energy, housing, and transport prices biggest contributors on the upside

In Sept, clothing prices fell sharply (1.2%) but most other sectors reported higher prices

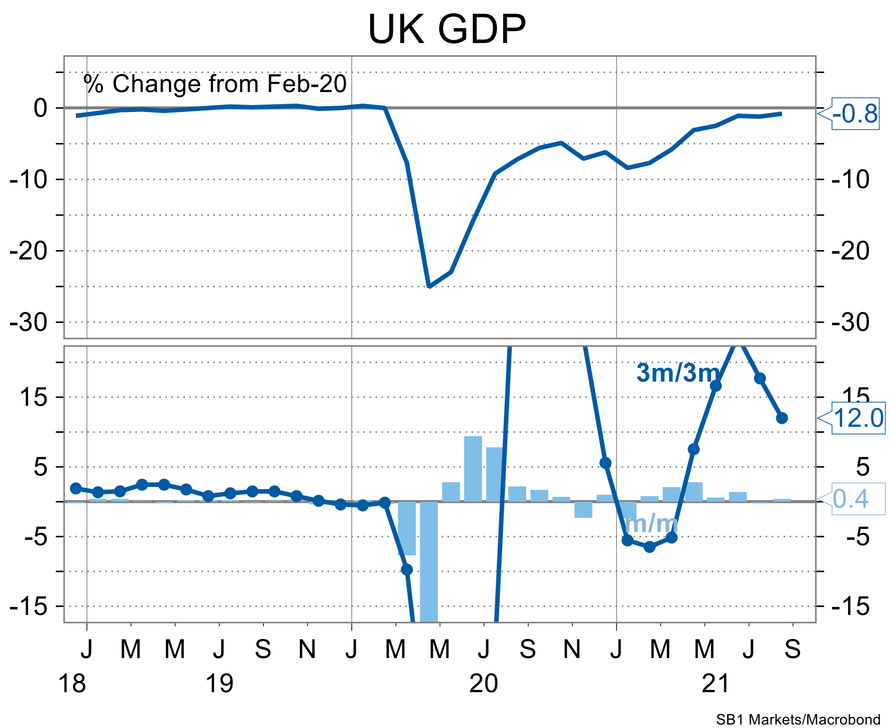


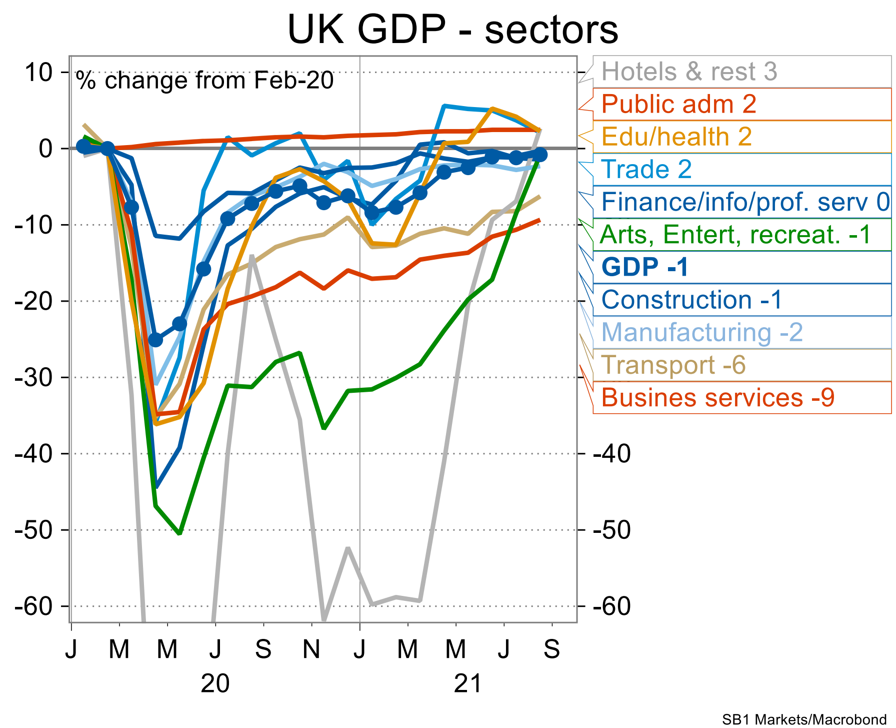




GDP up 0.4% in August, down 1% vs. Feb-20, below expectations and BoE

Trade and health biggest contributors on the downside, whereas hotels and restaurants were up 10%

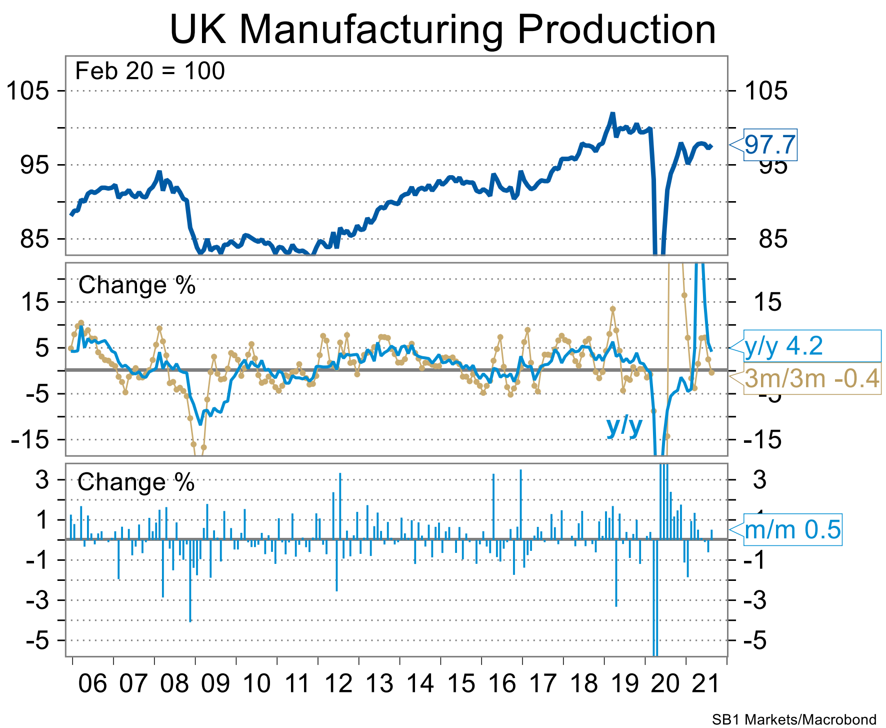


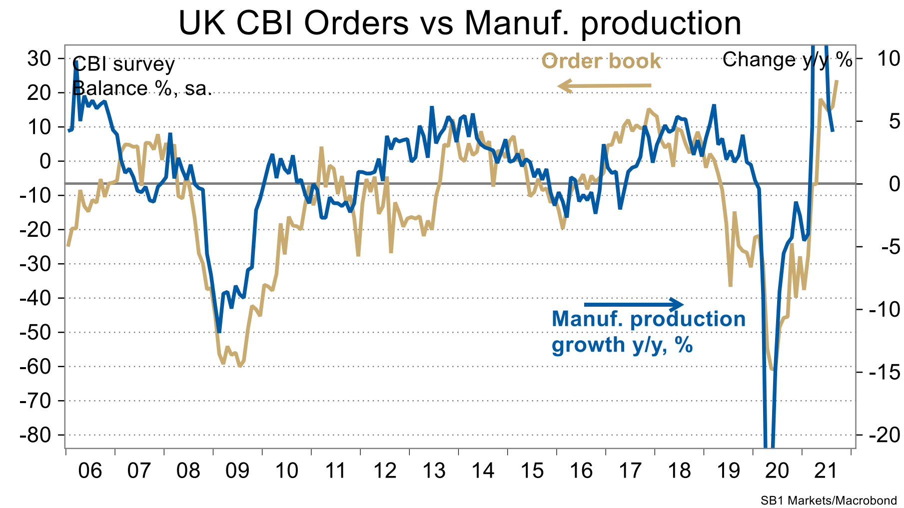


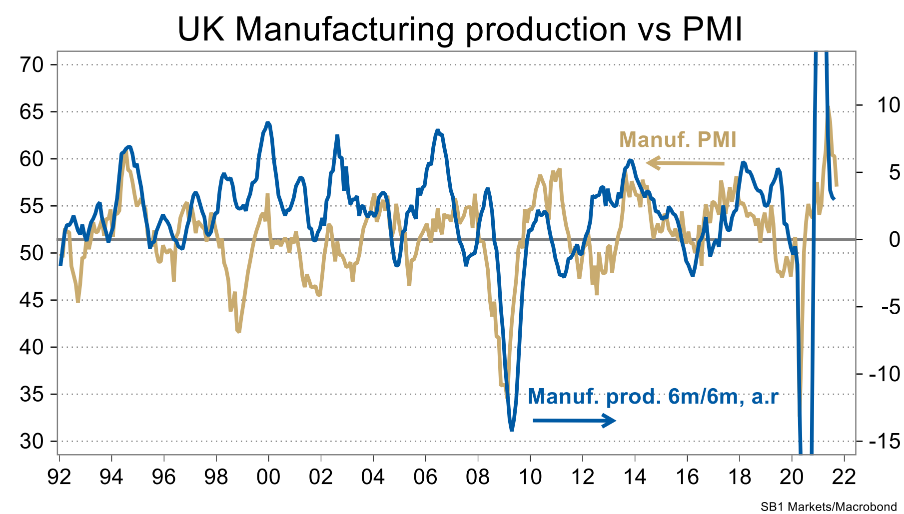
- **The recovery in GDP** is slowing, and the growth has surprised on the downside for the past couple of months. Very likely, the problems are occurring on the supply side (Brexit & Covid bottlenecks) rather than weaker demand
- **Services were up 0.3% in August**, much thanks to a 10% rise in hotels & restaurants and an 8.4% growth in arts & entertainment. Professional services and trade reported lower activity. Hotels & rest. are now up 3%, while transport is down 6%, and business services down 9% since Feb-20
- **Manufacturing, see next page**

Manufacturing production up 0.5% in August, expected 0.1%

Trend down recent months but surveys still signal growth the coming months - and orders are strong





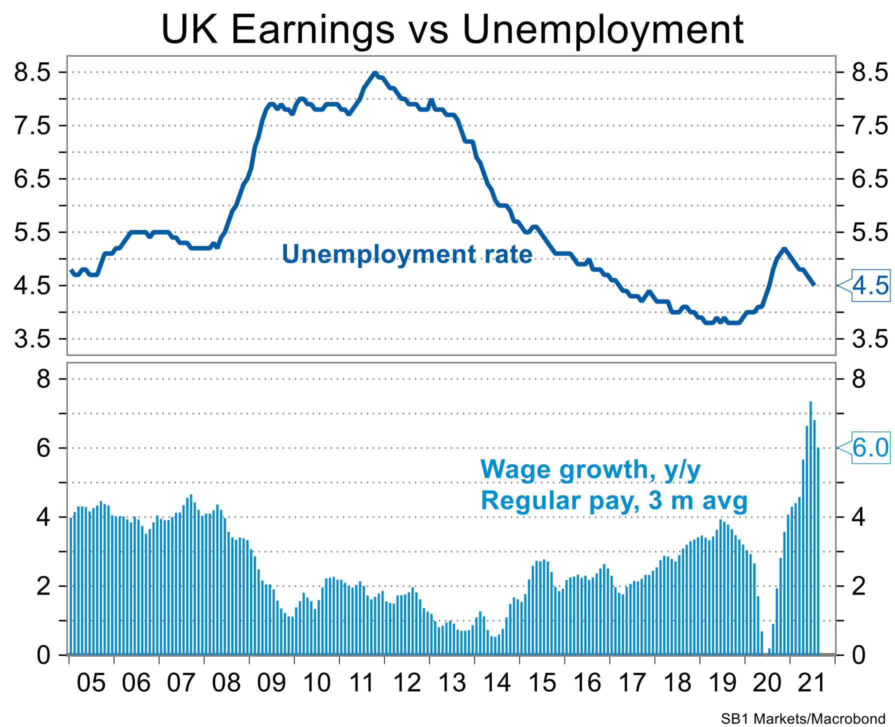


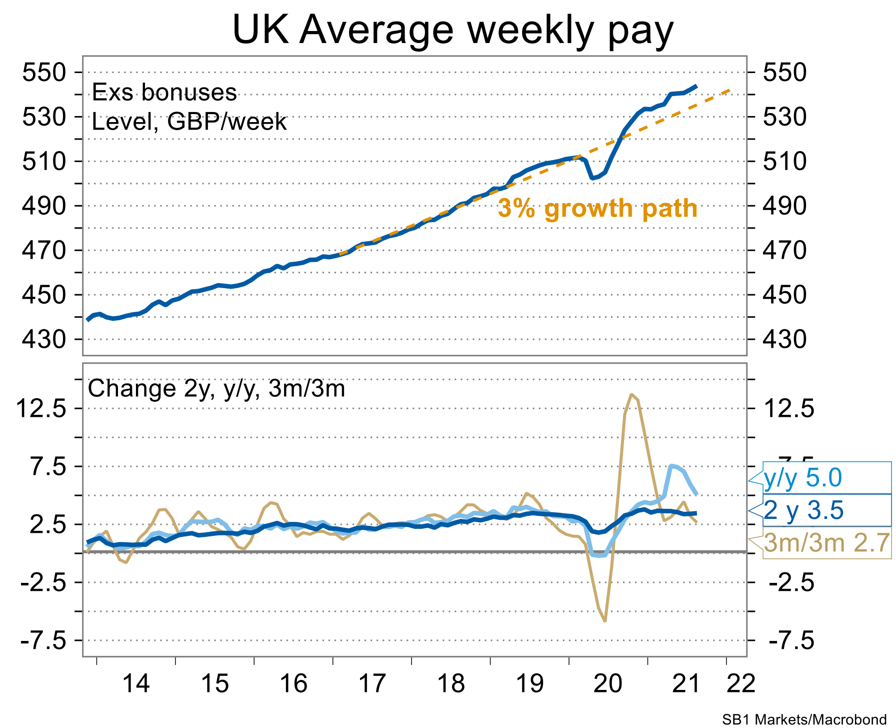
- August production beat expectations, but the July figure was revised down by 0.8 pp to -0.2%, so in sum not all that impressive
- Production of transport equipment (autos included) rose further in August (+3.9%) but the level is still down 24% vs. Feb-20.
- Total industrial production up 0.8% m/m

SpareBank 1 MARKETS

Underlying wage growth has slowed to below 3%, in spite of labour shortages

The annual rate at 5% is basically irrelevant, wage inflation is far below. Unempl. is falling steadily

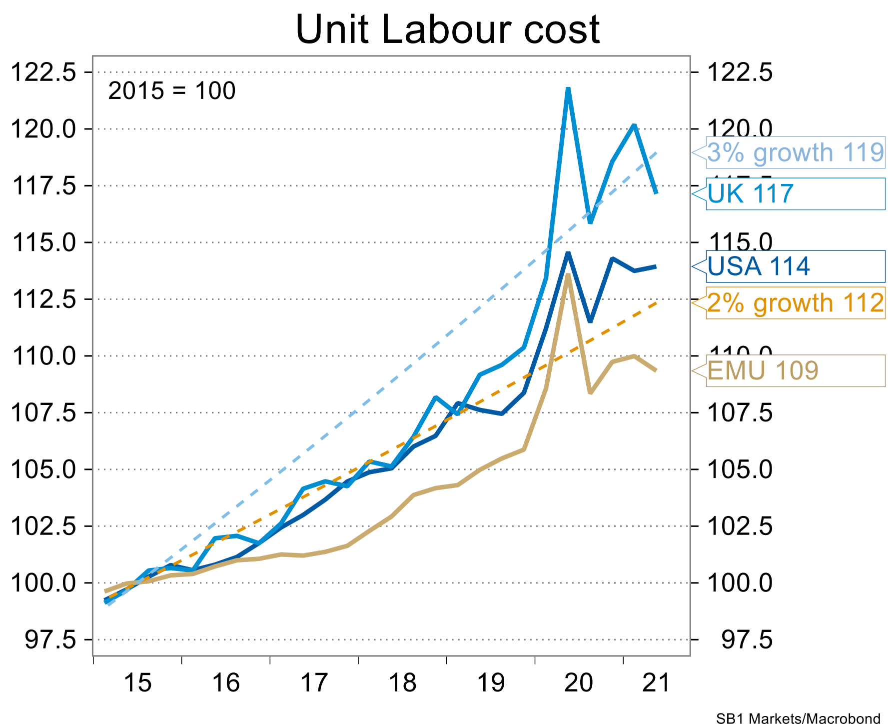


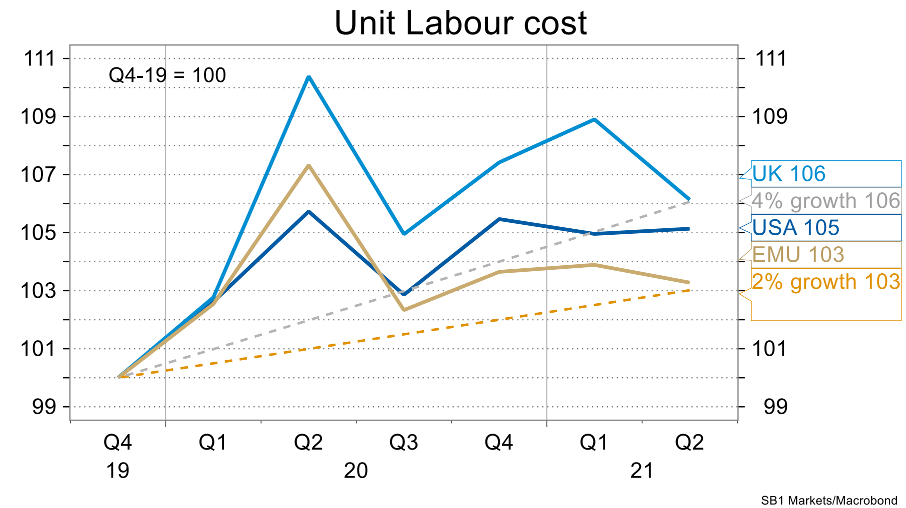


- Wage growth (regular pay) decreased to 5.0% in Aug from 5.9% in July. The 3 m avg fell to 6.0% from 6.8%, as expected
- However, the annual rate is boosted by the sharp contraction in wages last year. Total weekly pay is up 3.5% over the past 2 years – and just as important, the underlying 3m/3m pace has fallen to below 3%!
  - » That is still higher than the average over the past 10 years, but not high given reports of lack or labour in many sectors

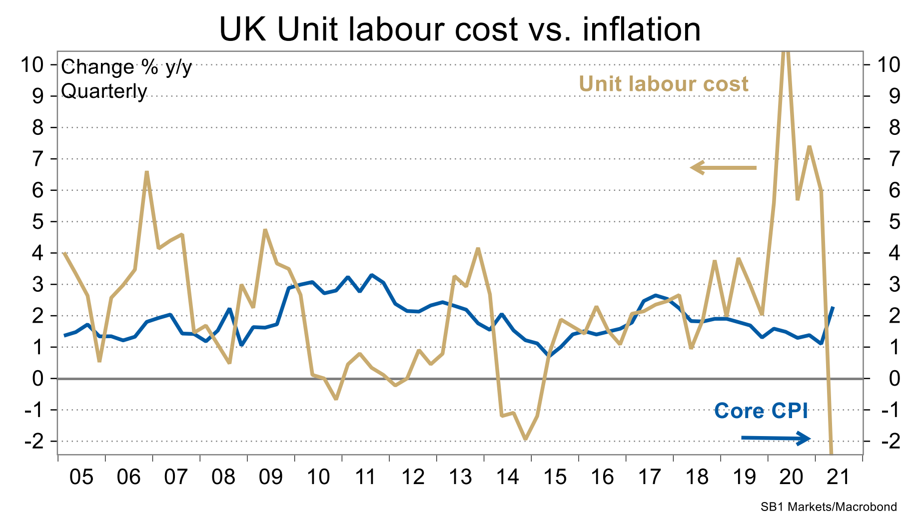
Volatile Unit Labour Cost data; level is somewhat too high – but now in check?

Unit costs fell sharply in Q2 but are still at a 4% path vs. the pre-pandemic level



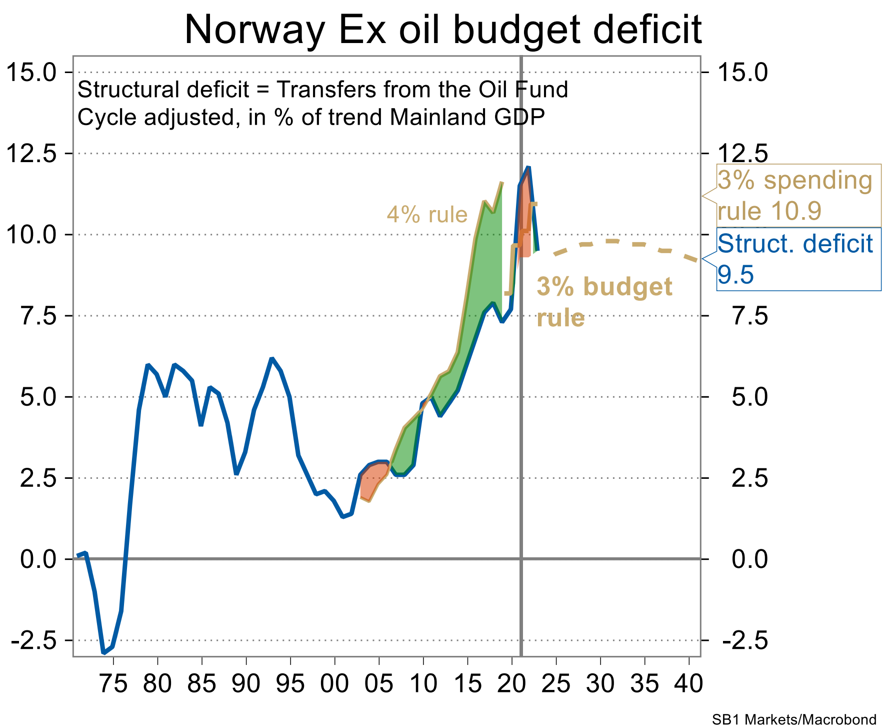


- However, the correlation between ULC & CPI is not that precise over just some few years



Back on track – below the spending rule in a strong economy in 2022

‘20 & ‘21 were the exceptional years, of course. A transfer of 2.6% of the fund’s value proposed in ‘22

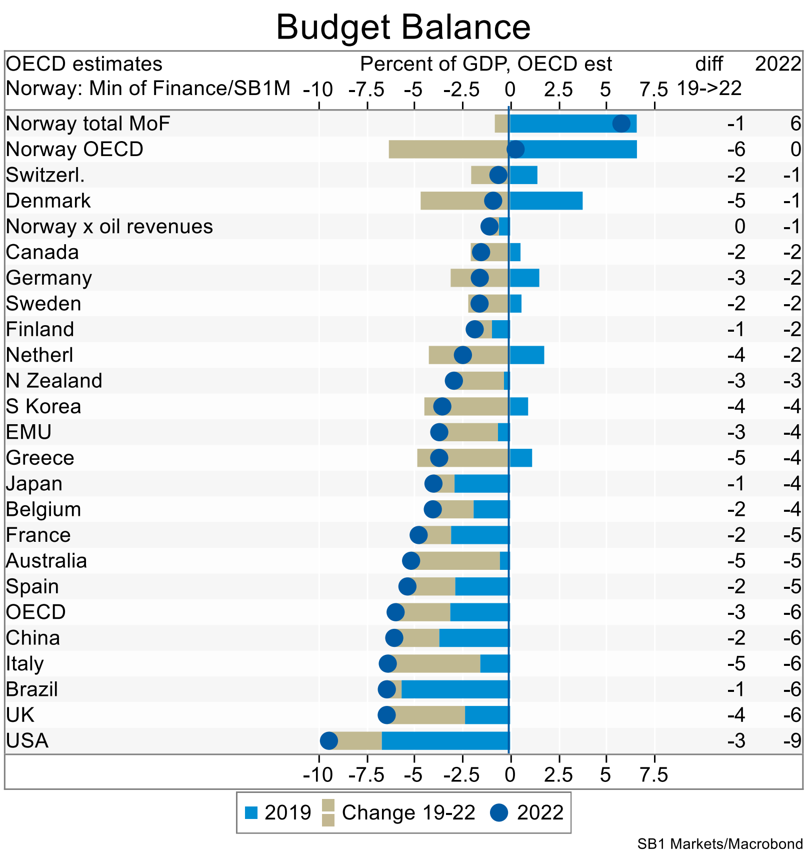


Fiscal indicators NOK bn, per cent	*2019*	*2020*	*2021*	*2022*
Actual surplus, incl. oil	*277*	*-39*	*-31*	*203*
Surplus ex. oil	*-228*	*-371*	*-413*	*-300*
Structural surplus ex oil	***-239***	***-369***	***-397***	***-322***
.. change in bn	*-25*	*-130*	*-28*	*75*
.. in % of GDP	***7.7***	***-11.7***	***-12.1***	***-9.5***
... Change (fiscal indicator)	***14.9***	***-19.4***	***-0.4***	***2.6***
.. in % of Oil Fund value	*2.7*	*3.7*	*3.6*	*2.6*
Spending rule, bn.	*-261*	*-303*	*-327*	*-367*
Deviation from rule, bn.	*22*	*-67*	*-70*	*45*
Pandemic measures	*0*	*135*	*94*	
Real growth in underlying spending	*1.8*	*8.6*	*1.0*	*-3.4*
Petroleum Fund, bn, ult.	*10086*	*10907*	*12250*	*12918*

- Fiscal policy will be tightened substantially, by 2.6% of Mainland GDP in 2022, as the need for stimulus will be reversed in an economy that is expected to operate above trend next year. That implies a transfer from the Oil Fund equalling 2.6% of the value of the Fund, below the 3% long term budget guideline). We expected a 3% transfer (based on a substantially lower estimated Fund value though, the Fund value has fallen sharply recent weeks)
- The fiscal stance should be evaluated vs. a ‘neutral’ starting point, 2019. The transfer from the Oil Fund has increased to 9.5% from 7.7% of GDP over these 3 years – though somewhat less than for which the increase in the Fund’s value would have allowed. A more detailed analysis confirm that the budget is somewhat expansionary to 2022 from 2019
- The surplus vs. the budget guideline equals 1% of GDP. Not many countries can match that. And not many have a 6% overall surplus in the budget, when (far too moderate estimated) oil og gas revenues are included. The real surplus may turn 20% of GDP, given current and forward oil and gas prices

Norway still (almost) a special case, even without ANY oil revenues

Norway runs a 6% of GDP surplus (MoF, it could easily become 20%). Ex oil revenues: In balance!

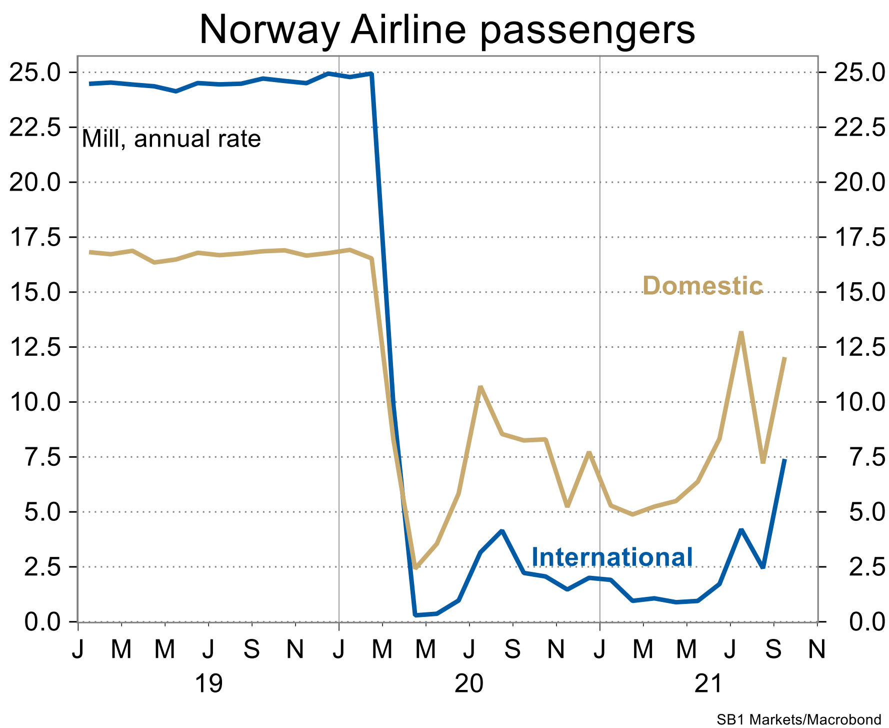


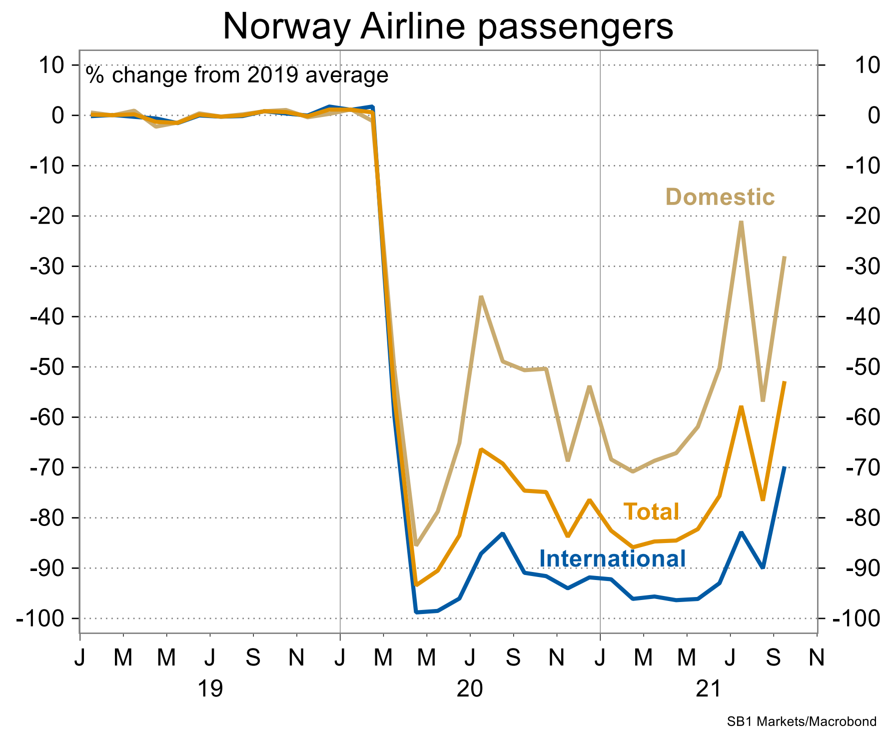
- **The government assumes a 6% public sector surplus next year**
  - » If the future markets are right, oil and gas revenues will be much higher than estimated, at the budget surplus could rise to 20% of GDP
- Even **excluding all revenues from the oil and gas sector** but including the cash returns from the Oil fund (coupons & dividends), Norway runs a budget deficit of just 1% of GDP, the same as in 2019. No country has seen a better fiscal performance to 2022 from 2019
  - » Part of this strong performance is due to the expected continued Mainland GDP recovery, which automatically strengthens the budget. The business cycle adjusted structural non-oil deficit (measured without cash revenues in the Fund) is up 1.8 % of Mainland GDP to 2022 from 2019
  - » Just for the record: Norway saves almost all the oil & gas revenues in the Oil fund
- Based on OECD estimates
  - » **EMU's** budget deficit has widened by 3 pp to -4%
  - » **UK's** is up 4 pp to -5%
  - » **USA's** deficit is up 3 pp to -9%
  - » OECD total up 3 pp to -6%
  - » **Sweden** is another good guy, up 2 pp to -2% of GDP!
  - » And Norway *ex oil revenues* unch at -1%, including oil revenues -1 to +6%
- The 2022 deficits are of course very uncertain, as budgets of course not are decided anywhere

Data for Norway at the chart above OECD estimates, for the total budget

Airline traffic sharply up in September, international cut losses to 70% from 90%

… vs the pre-pandemic level – so still a way to go. Domestic trips up to -29% from -56%

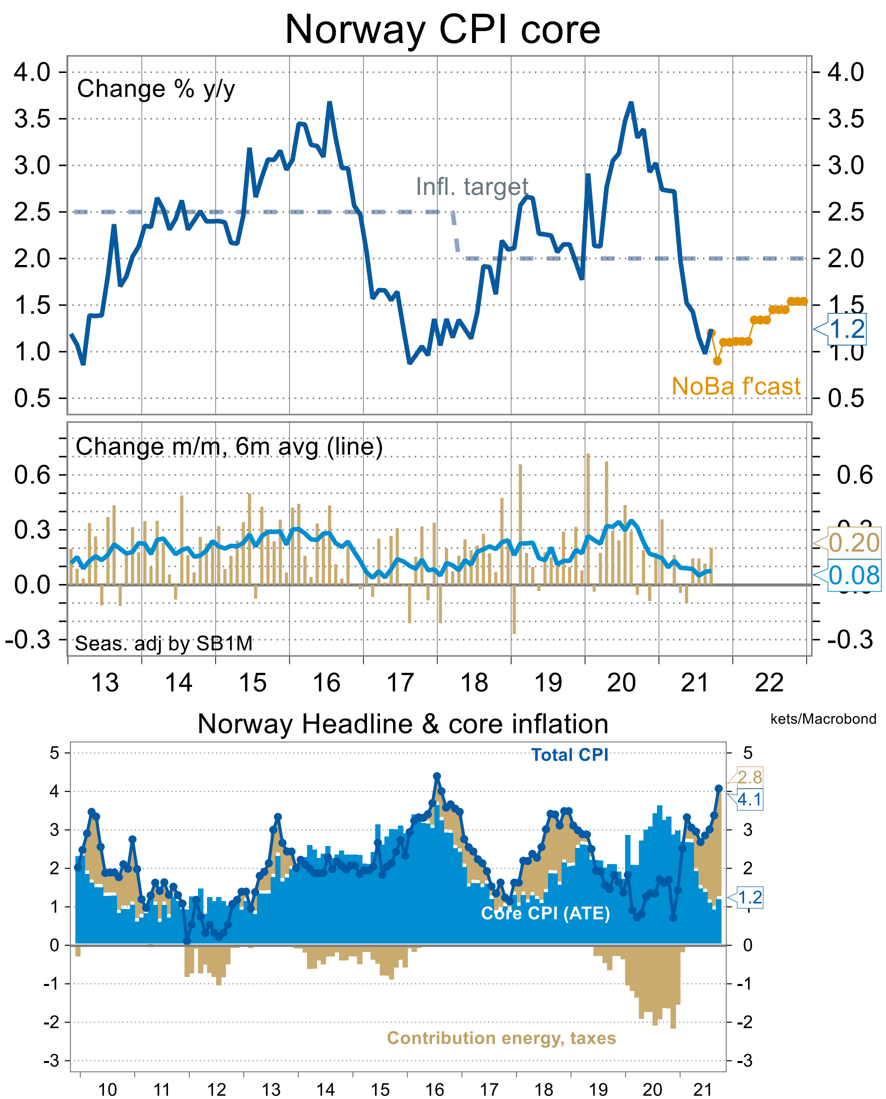




- Total traffic still down 53% - though from -76% in August. A couple more months with such growth, we are back ☺ (but it will no doubt take more time…)

Core inflation up to 1.2%, headline up to 4.1% - due to the electricity shock

Core inflation remains far below target but Norges Bank has not been an inflation nutter past 10 years



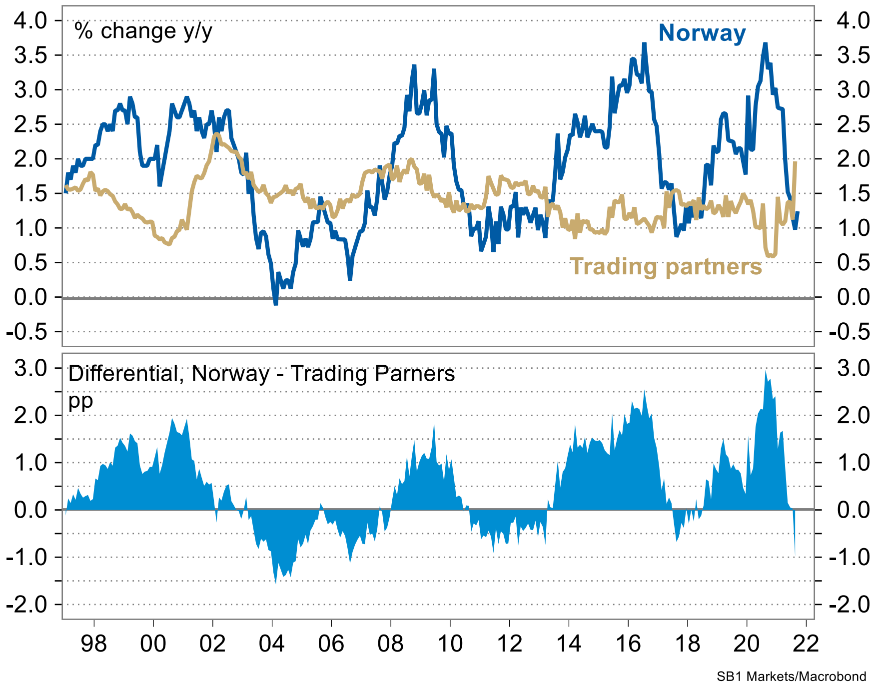
- **CPI-ATE** (ex. energy and taxes) inflation accelerated 0.2 pp to 1.2% in Sept; in line with Norges Bank's and our f'cast, marginally below consensus (1.2%)
  - » Prices were up 0.2% m/m (seas adj), the highest rate since Jan
  - » Core inflation is running above 2% in 5 sectors, but is below 2% in 8 sectors
  - » Prices on imported goods rose in September, the annual rate is at 0.9%
- **Total inflation** rose 0.7 pp to 4.1%, below our forecast. Electricity prices rose further (up 107% y/y!) – lowering house household real disposable income by 2.8%. However, if the future market is right, the average drag from summer-21 to next summer will by far lower, at 1¼ - 1½%
- **The outlook**
  - » **Core inflation have probably bottomed**. Strong growth at home and some impact from higher inflation abroad will contribute at the upside (even if the impact of the latter is not impressive, historically). A somewhat strong NOK will counterweigh higher prices abroad.
  - » The steep rise in electricity prices reduced households' real disposable income but given the still rich aggregate savings rate, consumption is probably not that exposed.

SpareBank 1 MARKETS

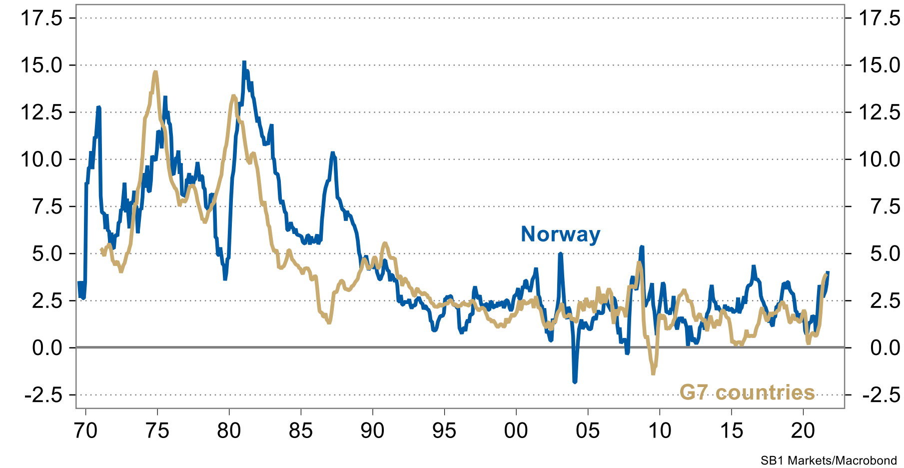
Norway vs ROW: Long term CPI 'regimes' have been correlated

But limited short term correlations, in the 'low inflation regime'

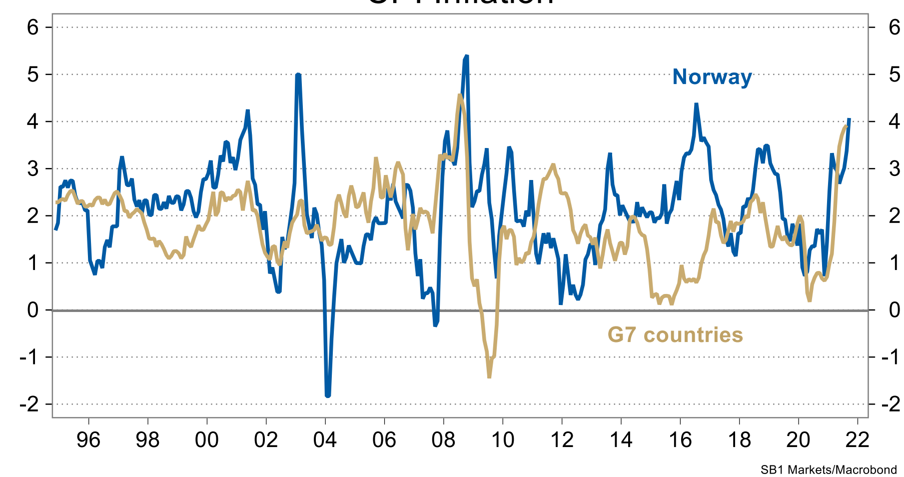
Core CPI



CPI Inflation



CPI Inflation



- Norwegian vs. trading partners' core CPI close to uncorrelated past 20 years. The headline CPIs have been somewhat better correlated, due to co-movements in energy prices
- During the '70s early '80s Norwegian headline inflation was correlated to the global (G7) CPI cycle (and mostly lagging)

SpareBank 1 MARKETS

Food prices, airline tickets on the downside, furnishing+ on the upside

Electricity prices rose further of course, but are not that high

		Change m/m, seas. adj			Change y/y			Contribution, pp		
Sep-21	Weight	Out-	SB1M	Dev.	Prev.	Out-	SB1M			Dev. vs
CPI ATE	%	come	f'cast	pp	month	come	f'cast	m/m	y/y	f'cast
Food, non alc bev	13.0	-0.6	0.1	-0.7	-0.8	-1.8	-0.9	-0.07	-0.23	-0.09
Alcohol, tobacco	4.3	0.2	0.1	0.1	0.9	1.1	1.0	0.01	0.05	0.01
Clothing, footwear	4.9	-0.5	0.2	-0.7	-1.4	0.1	1.0	-0.02	0.00	-0.03
Housing x. energy	20.5	0.2	0.2	0.0	1.3	1.4	1.3	0.04	0.28	0.01
Furnishing	6.8	1.7	0.2	1.6	0.3	2.7	0.5	0.12	0.18	0.11
Health	3.2	0.2	0.3	-0.0	2.5	3.0	2.9	0.01	0.10	-0.00
Transp. ex. gas, airl. tick	12.0	0.3	0.2	0.2	0.3	0.7	0.4	0.04	0.08	0.02
Airline tickets	1.0	-5.8	1.0	-6.8	-10.6	-15.9	-7.9	-0.06	-0.16	-0.07
Communication	2.5	0.2	0.2	-0.0	0.9	0.8	0.6	0.00	0.02	-0.00
Recreation, culture	11.2	-0.1	0.3	-0.4	3.0	2.4	2.9	-0.02	0.26	-0.04
Education	0.5	-	-	-	2.1	1.7	3.0		0.01	-0.01
Restaurants, hotels	5.9	0.9	0.3	0.6	3.7	4.6	3.8	0.05	0.27	0.04
Other	8.7	0.8	0.2	0.6	2.2	2.9	2.2	0.07	0.25	0.05
CPI-ATE	94	**0.2**	**0.2**	0.0	**1.0**	**1.2**	**1.2**			0.03
Norges Bank est.			*0.2*		*1.0*		*1.2*			
Imported	34	0.2	0.1	0.1	0.1	0.9	0.7	0.08	0.30	0.03
Domestic	60	0.2	0.2	-0.0	1.0	1.2	1.2	0.13	0.75	-0.01
Energy, housing	3.6	10.4	23.0	-12.6	98.2	107.3	132.7	0.37	3.84	-0.45
Energy, transport	2.0	0.4	-1.0	1.4	13.4	17.4	15.3	0.01	0.36	0.03
CPI Total	100	**0.5**	**1.0**	-0.5	**3.4**	**4.1**	**4.4**	0.51	4.07	-0.48

Change m/m based on seasonally adjusted data (calc by SB1M)
Sum of parts does not necessarily add up to totals
Norges Bank m/m s.a. estimate is implied, calc by SB1M

- **Food** prices down 0.4%, far below over forecast. Prices are down 1.8% y/y! A broad decline
- **Clothing** prices fell again and are flat y/y
- **Furniture/hardware/equipm** prices rose, following a decline the prev. month
- **Transport ex. gas/airline tickets**– up 0,2%, up just 0.7% y/y, New autos are down 0.1% y/y
- **Airline ticket** were cut by 6% m/m – and prices are down 16% y/y
- **Recreation** priced down 0.1%% m/m, less than we assumed – but up 2.4% y/y
- **Restaurant/hotel** prices are now up 4.6% y/y

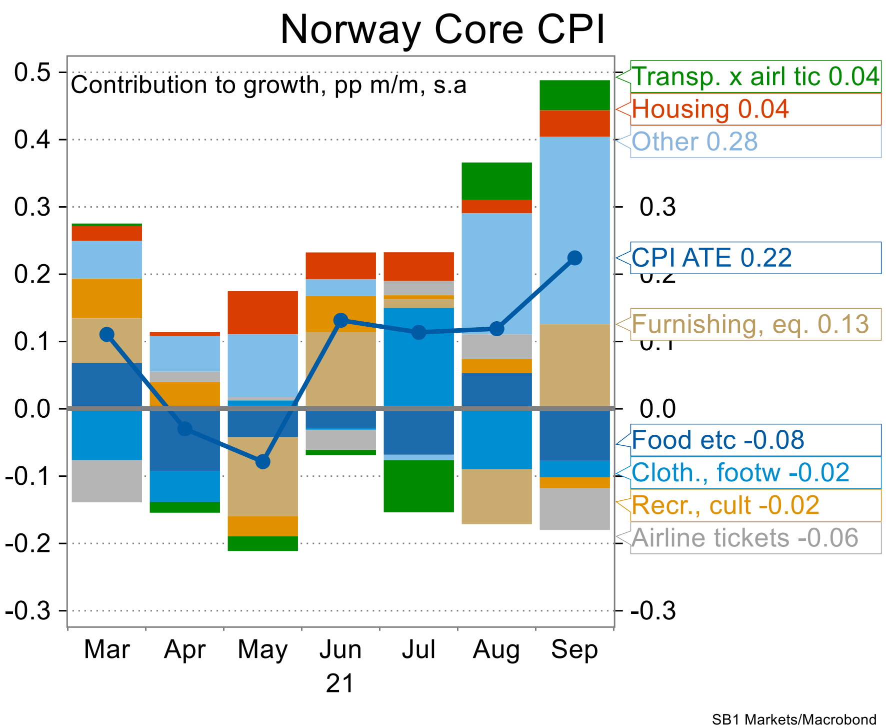
- **CPI-ATE up 1.2% y/y, in line with NoBa's and our f'cast. 0.1 above expectations**

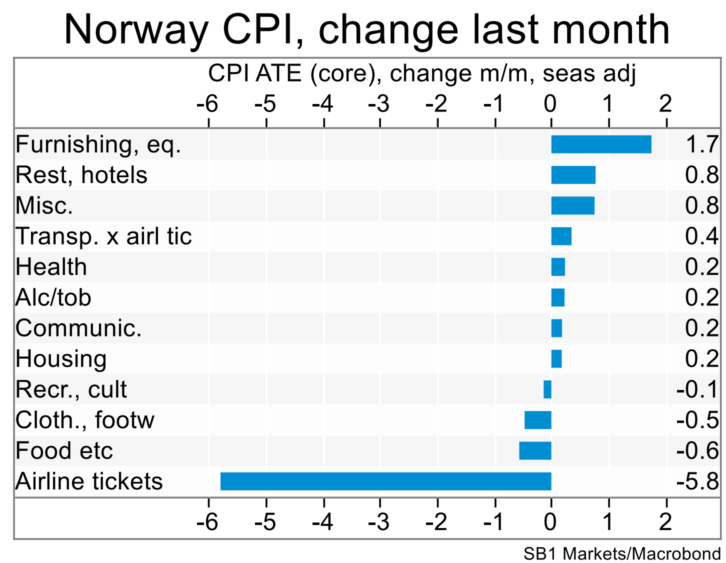
- Prices on **imported goods** were up by 0.2% m/m
- Prices on **domestically produced** goods & services were up 0.2% too. The annual rate at 1.2% is very low, according to Norwegian standards
- **Electricity** prices less than we assumed, but are still up 107% last year
- **… and the headline inflation came in at 4.1%, up from 3.4% in July**

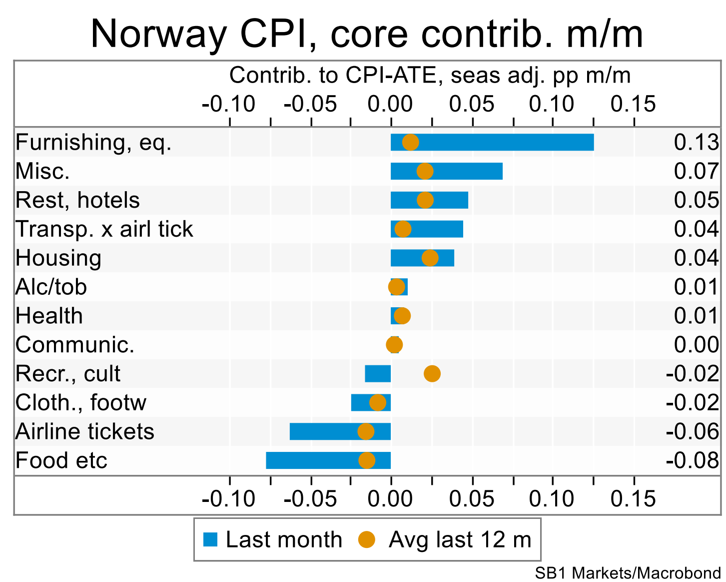
Monthly changes are seasonally adjusted by SB1 Markets. The weighted sum of the components does not necessarily sum exactly up to the total, and deviations m/m and y/y do not necessarily add up. Norges Bank m/m s.a. estimate is implied, calculated by us. Sources: SSB, Norges Bank, SB1 Markets calculations

Furnishing contributed most on the upside in September

Food & airline tickets at the downside

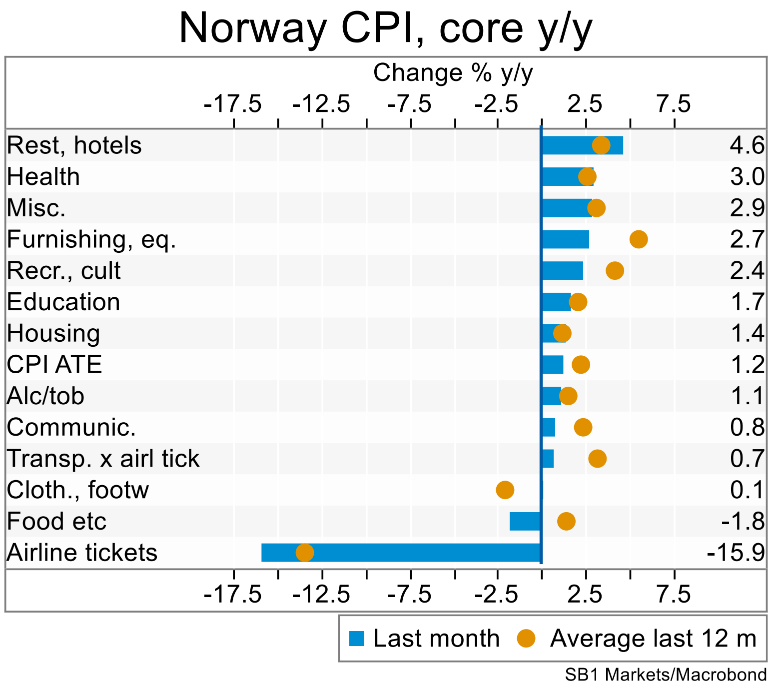


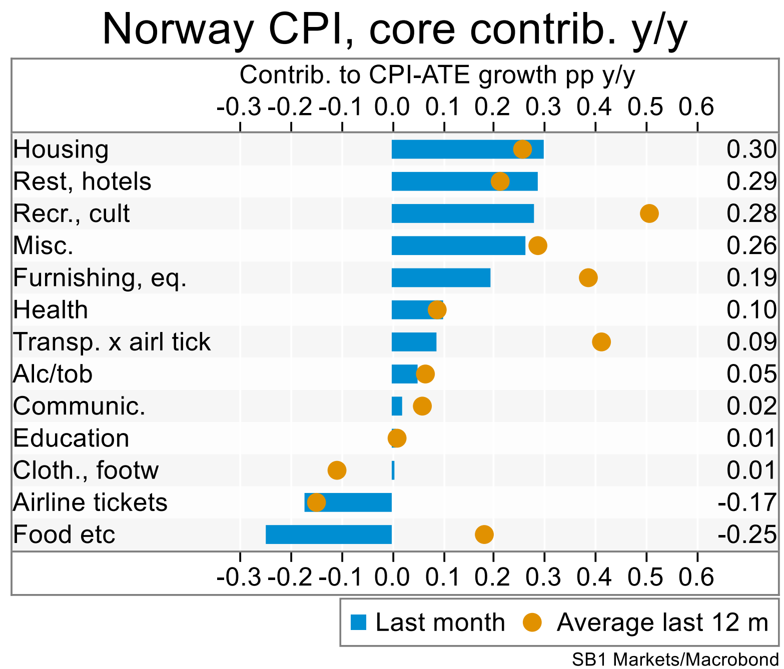




5 sectors report core inflation above 2%, 8 below! Food & airline tickets down

Over the past year housing ,restaurants/hotels & recreation/culture have done the heavy lifting

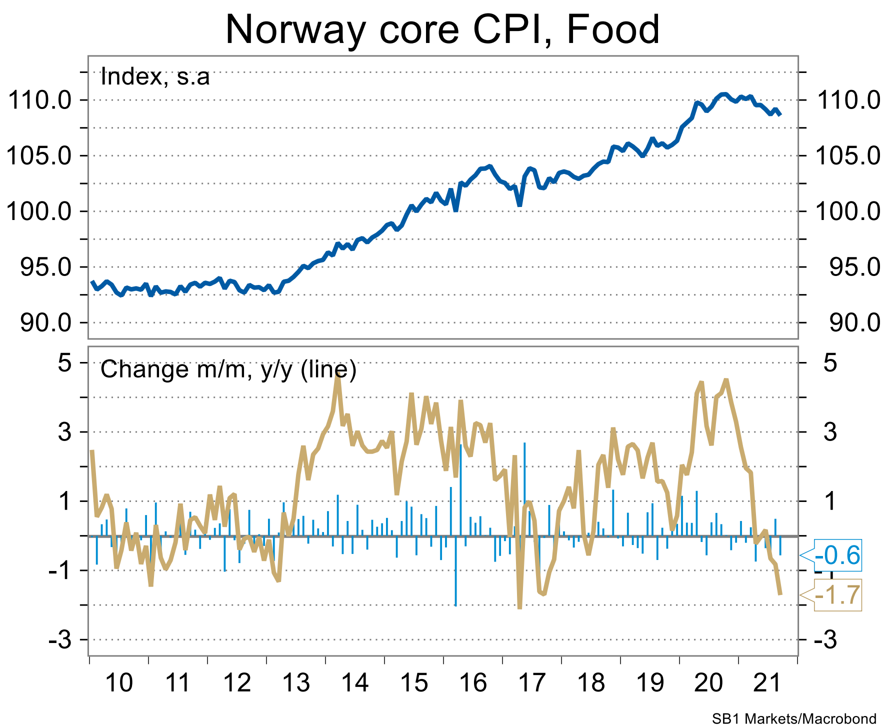


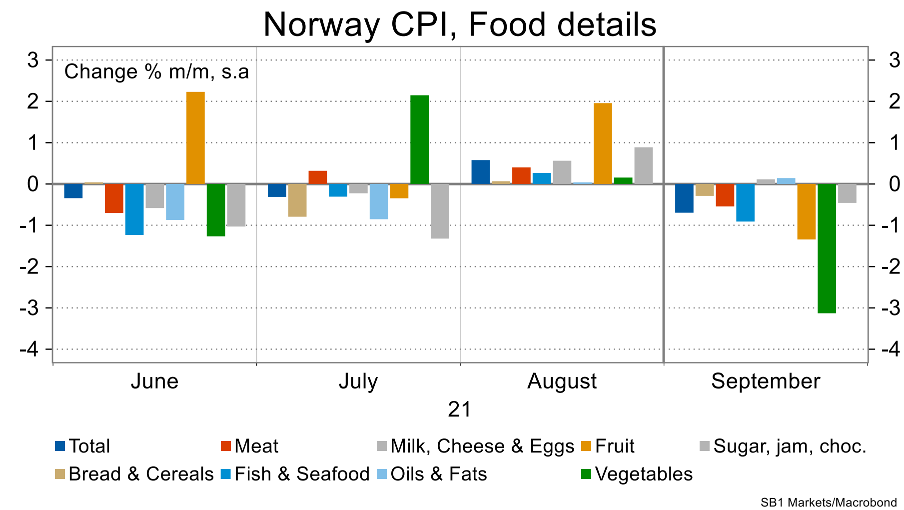


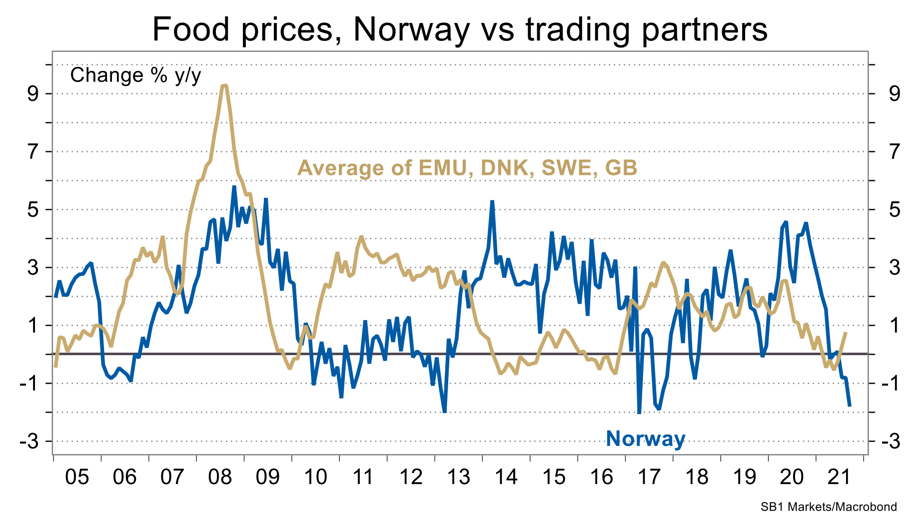
- Within recreation, books, garden equipment, hotels and restaurants contributed the most, partly due to price cuts last year

Food prices are still trending down

Prices down 0.6% m/m, and 1.7% y/y!! Food prices have been falling abroad too, now slightly up





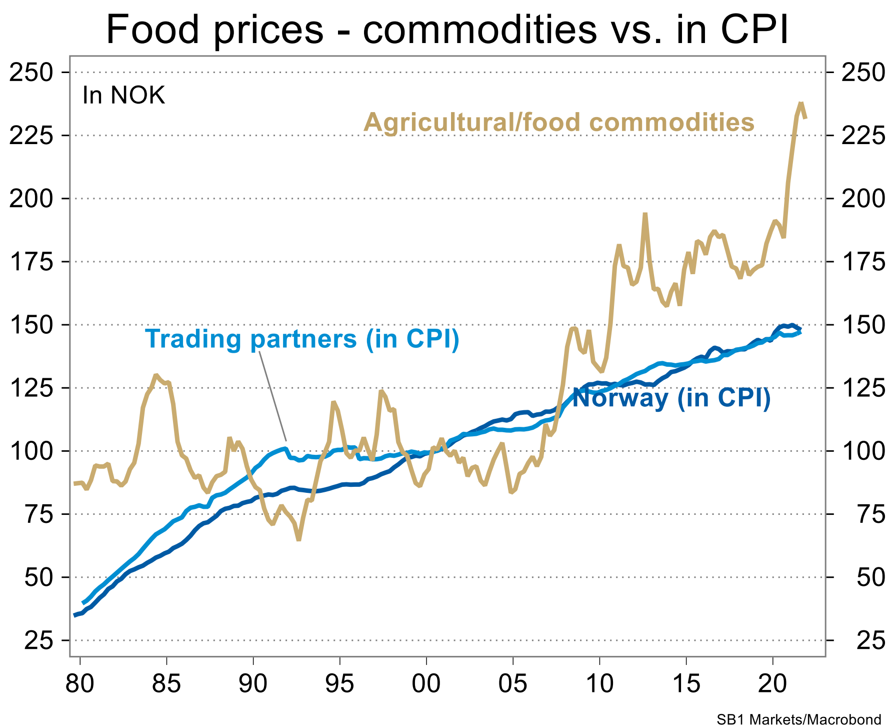


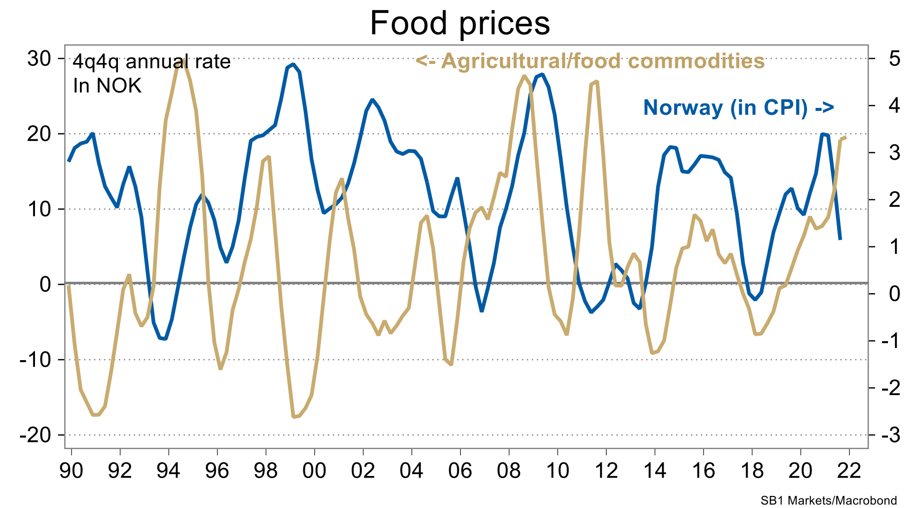
- Food prices have fallen since March
- Food prices have been kept in check among our European peers too, despite (moderate) lifts in agricultural commodities

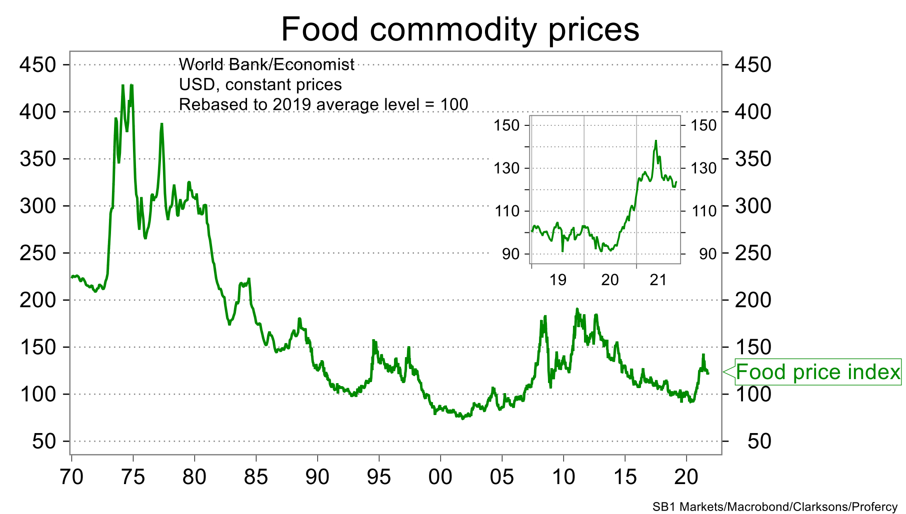
SpareBank 1 MARKETS

Food commodity prices: Very limited correlation to trading partners food prices

… And no stable correlation at all to Norwegian food prices (in the CPI)



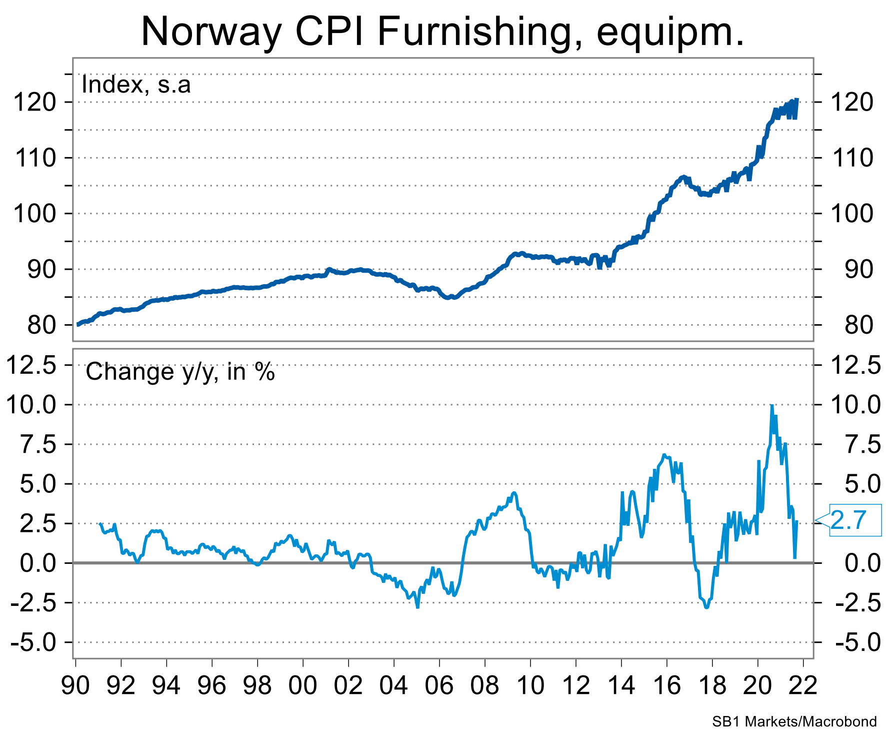


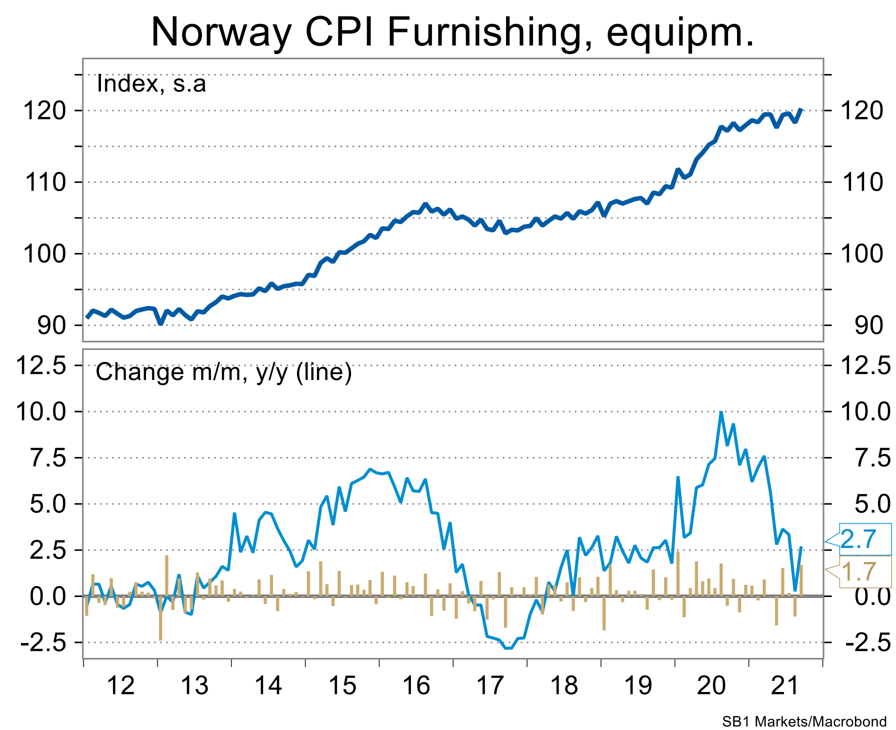


- Try to find a close correlation on the chart above to the right – there are some, over short periods but no consistency at all
- Agricultural/food commodity prices are sharply up from mid 2020 but far from dramatic vs. previous hikes, and the level is not high. Since May, prices have fallen sharply. Guess you didn't know?

Furnishing++ prices up again in September annual inflation still 'subdued'

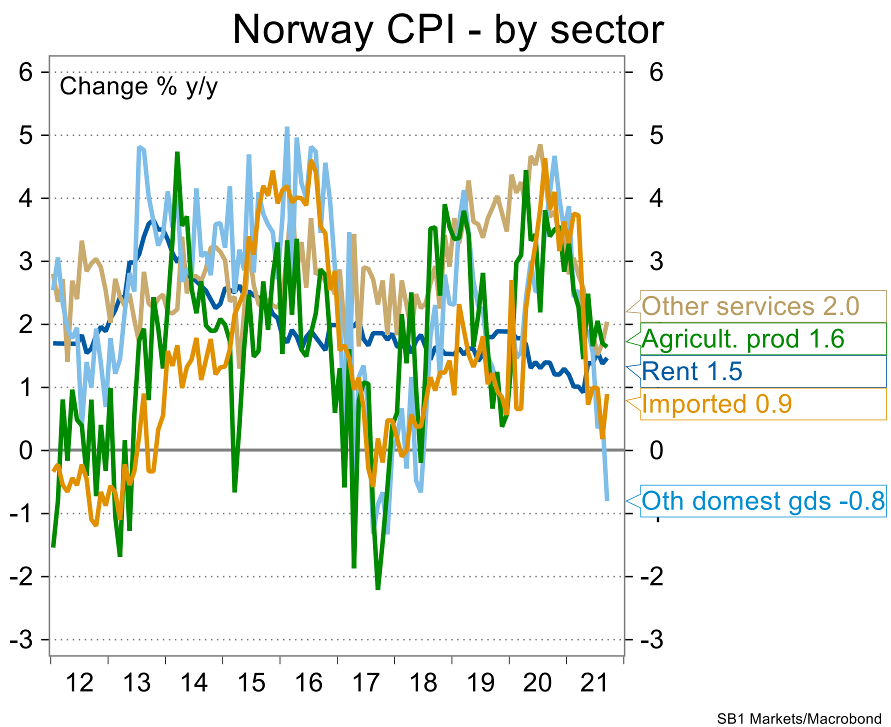
At least vs. the 10% spike last year – now below 3%

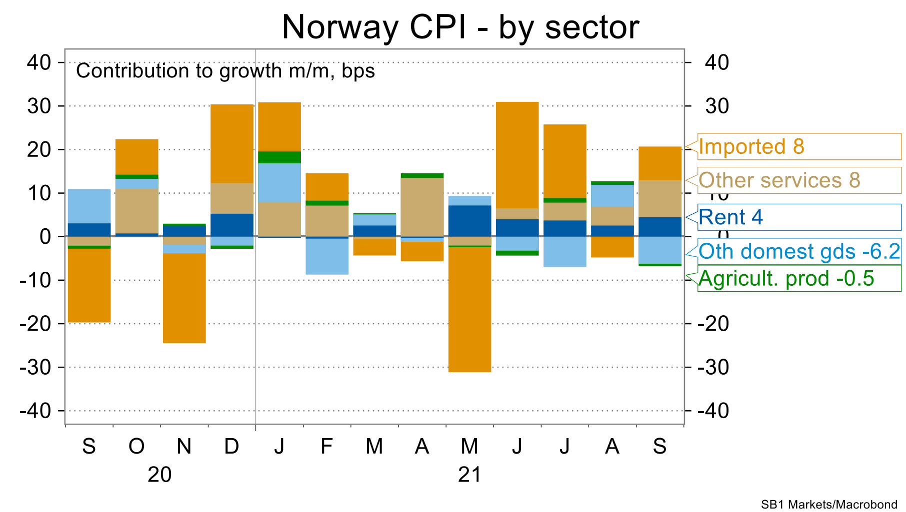


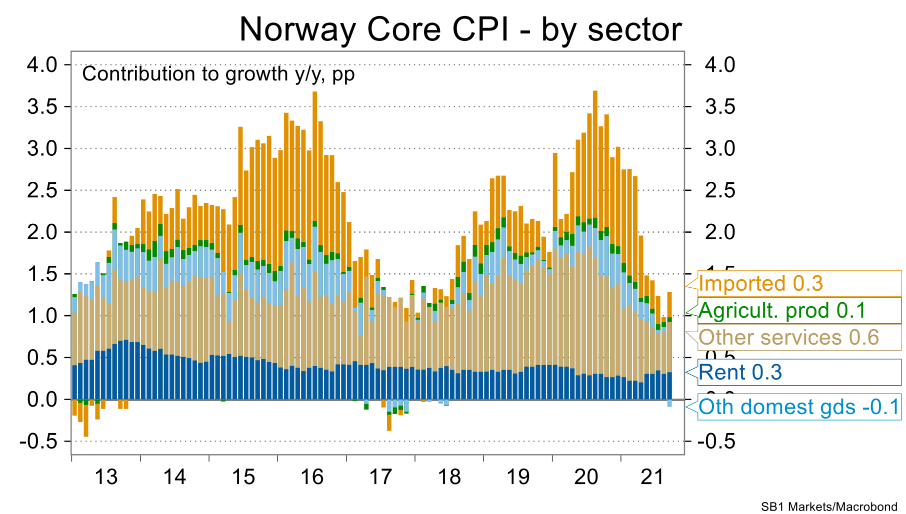


A broad decline in inflation (until now) – it is not just imported goods

Service inflation has slowed substantially, to 1.5% from close to 5% but is recovering now?





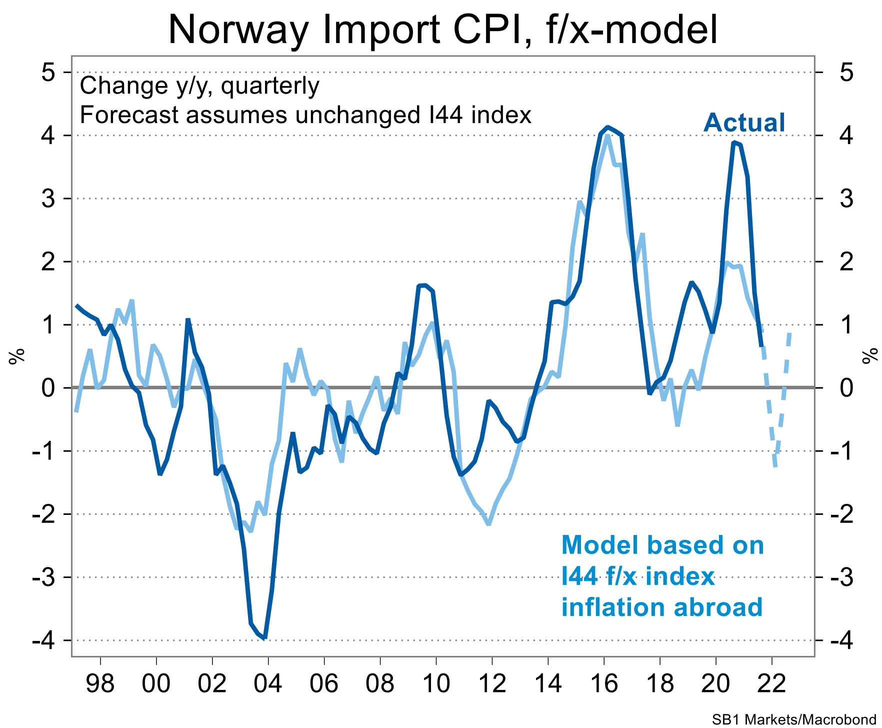


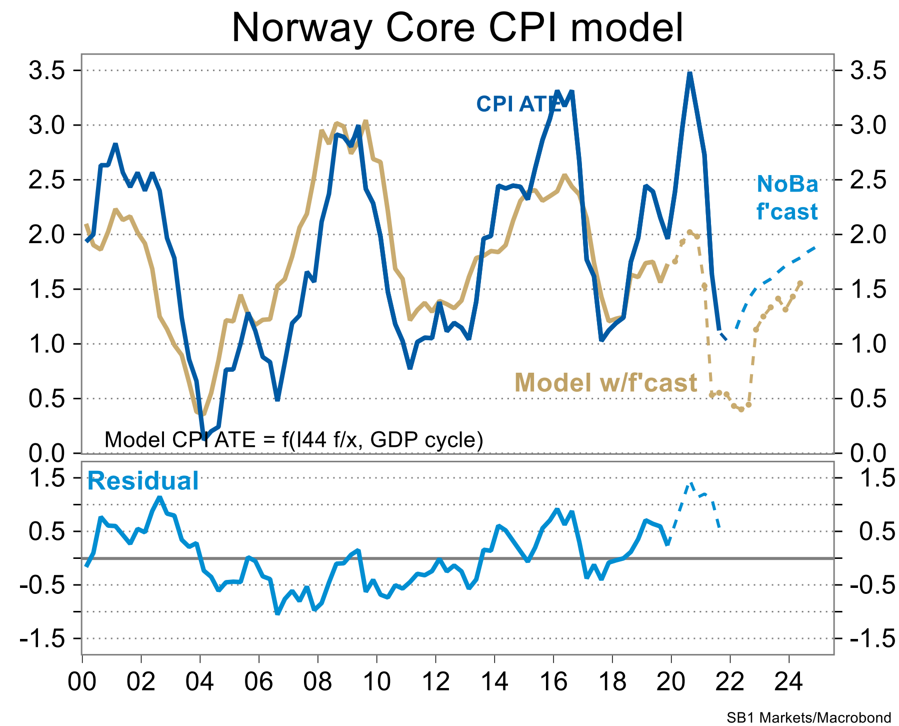
- **Domestic services inflation ex rents** slowed sharply during the corona crisis, and not just only due to cheaper airline tickets, other non-labour-intensive services have contributed as well
  - » The disinflation may have come to an end as prices are edging upwards again, and the annual rate has climbed to 2% from 1.5% at the bottom
- **Rent inflation** has accelerated to 1.5% from 1% recent months, but is still lower the 1.7% – 2% rate before corona
- **Other goods** than agricultural products are down 0.8% y/y, a bit surprising

SpareBank 1 MARKETS

Imported goods prices: Soon on the way down??

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



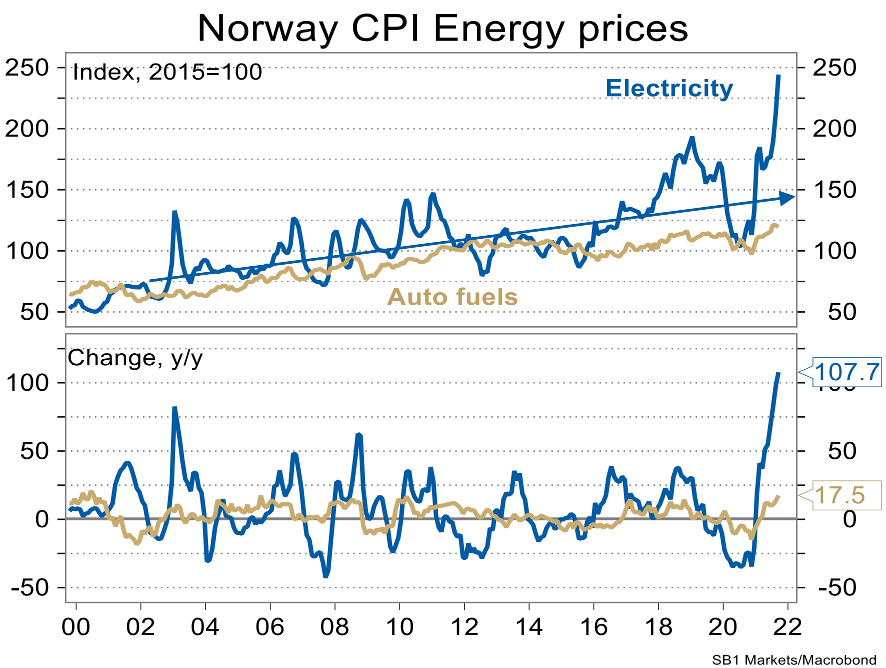


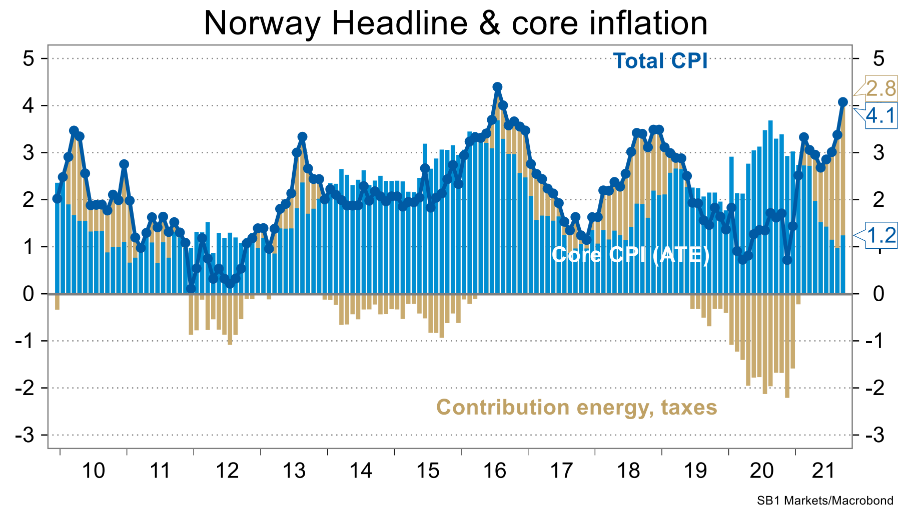
- **The NOK steep depreciation** in early 2020 no doubt drove **imported inflation** up last year. Closed borders/supply chain challenges due to Covid-19 may have contributed to the lift in import prices too, and more importantly: the strong growth in demand for some goods (like sport equipment/furniture) made it possible to increase prices. Now the NOK has recovered, and import price inflation is falling sharply - even if some price inflation abroad has accelerated (core goods prices included)
- **Domestic inflation** will be kept in check due to moderate wage inflation – and overall core inflation will be low the coming months

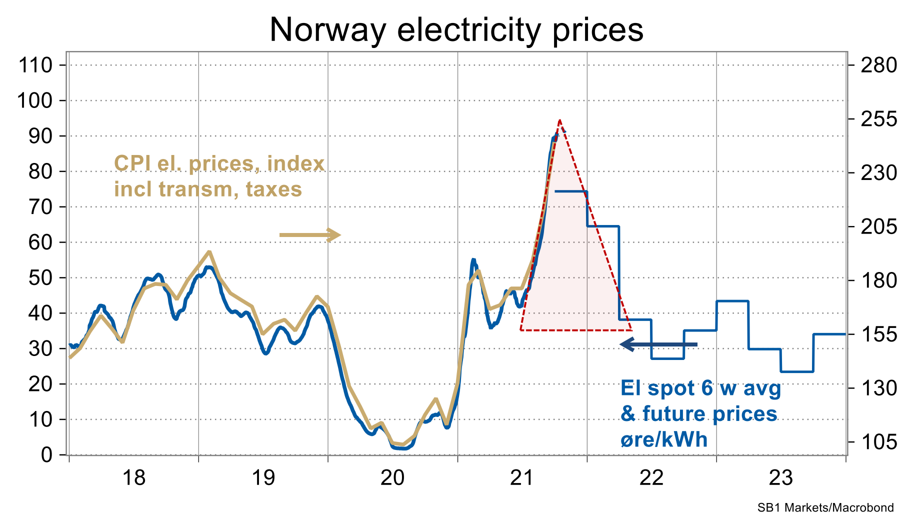
SpareBank 1 MARKETS

Electricity prices through the roof – but the limit is far below the sky ☺

Prices are 'just' 60% above a normal level, and markets expect a rapid reversal



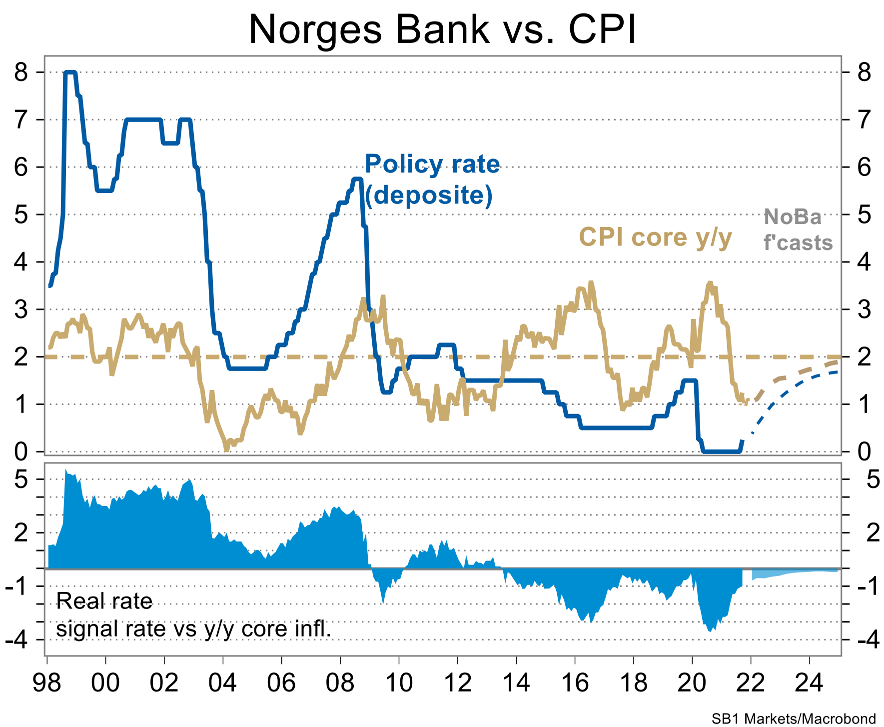


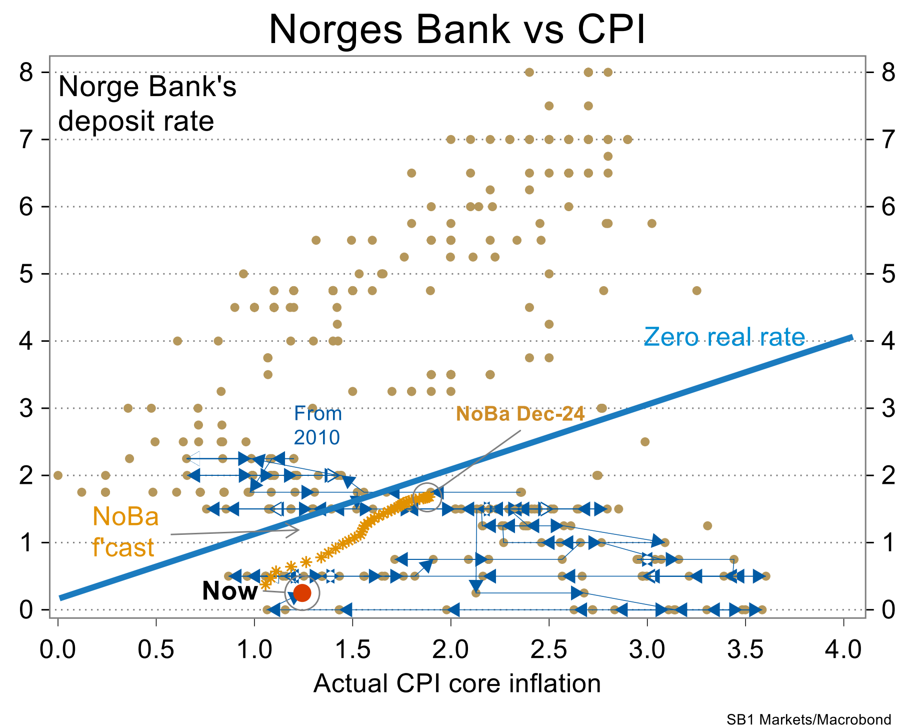


- **Electricity prices** have more than doubled y/y, and explains all of the lift in total CPI. The discrepancy between the headline CPI and the core index (CPI-ATE and the core without just electricity prices, CPI-AEL) is 2.8 pp! **Gasoline prices** are just marginally above normal
- If the **forward market** is anything close to right on prices the coming months and quarters, the impact on household disposable income will be limited indeed. Prices are expected back to a normal level – or even below next summer. The aggregated loss over a year with higher prices than normal will be no more than some 1¼ - 1½ % of annual disposable income – due to an average lift in the electricity bill of 30%
- **The risk:** Market prices may be dead wrong vs. the actual outcome
- **A tip:** If you like the forward path, enter a fixed price contract!

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

Actual inflation has not been correlated to interest rates

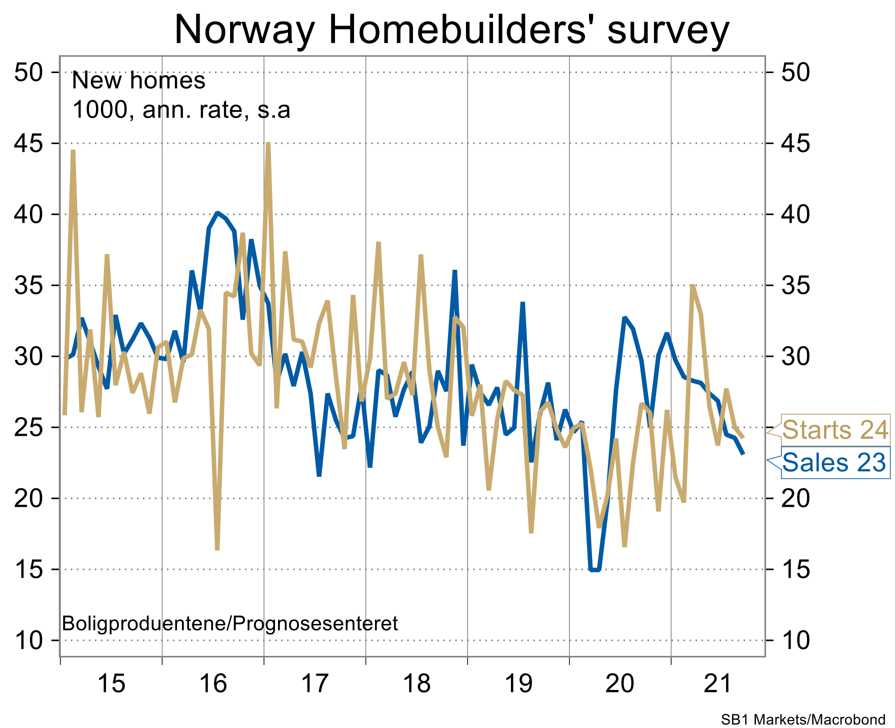


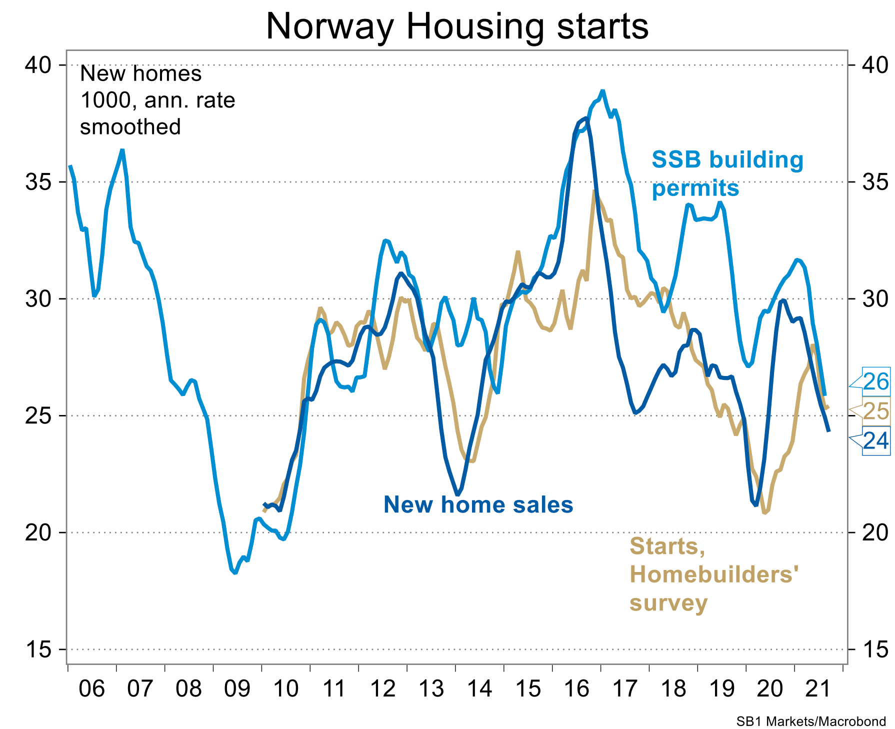


- Now, the Bank assumes the signal rate will be hiked gradually to approx 1.75%, while core inflation is expected to drift slowly up from the present level towards the 2% target in 2024

New home sales are sagging, now starts follow suit

September sales equaled 23', down from 30' in early 2021. Starts at the same level, say Homebuilders

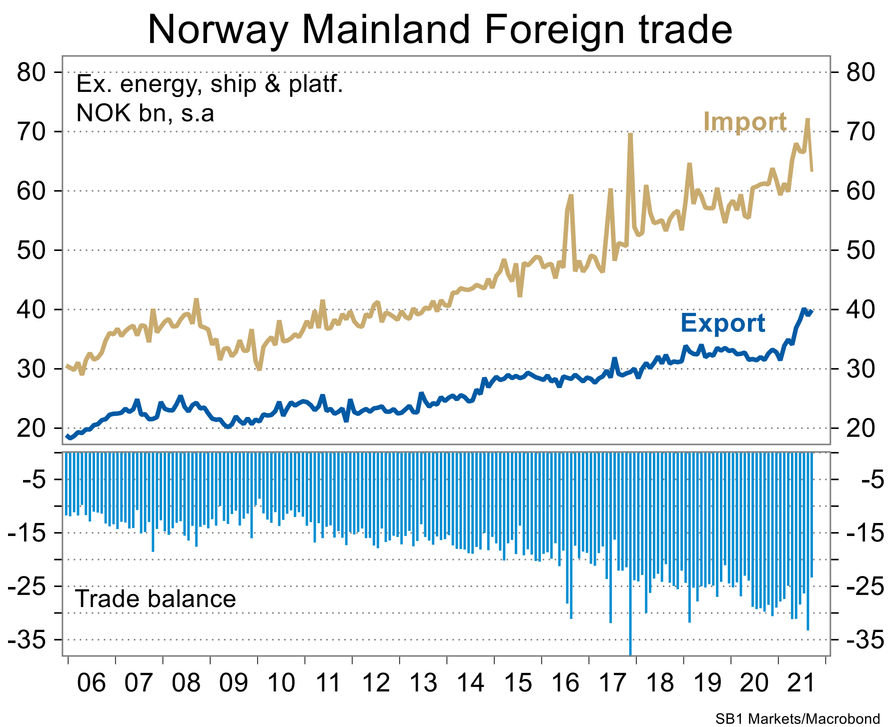


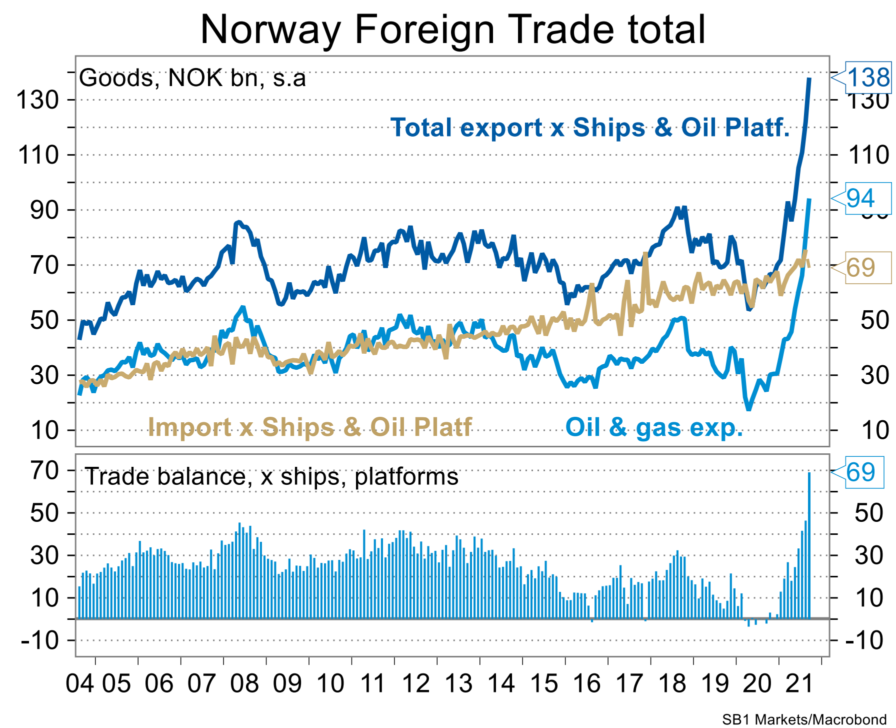


- **Boligprodusentene (Home builders)** blame higher material cost and now also high land costs for the decline in sales, not an unreasonable hypothesis (but higher interest rates were not mentioned). However, as existing home prices are substantially up over the past year, new homes are probably still competitive
  - » In addition homebuilders report of some delays in projects due to travel restrictions for foreign workers and thereby lack of trained personnel
- **SSB** has reported a decline in new home sales recent months – September data out this morning

Some special gas exports, of course. And a small Mainland deficit too

Total surplus at NOK 69 bn, ATH, or 25% of (Mainland) GDP ☺☺

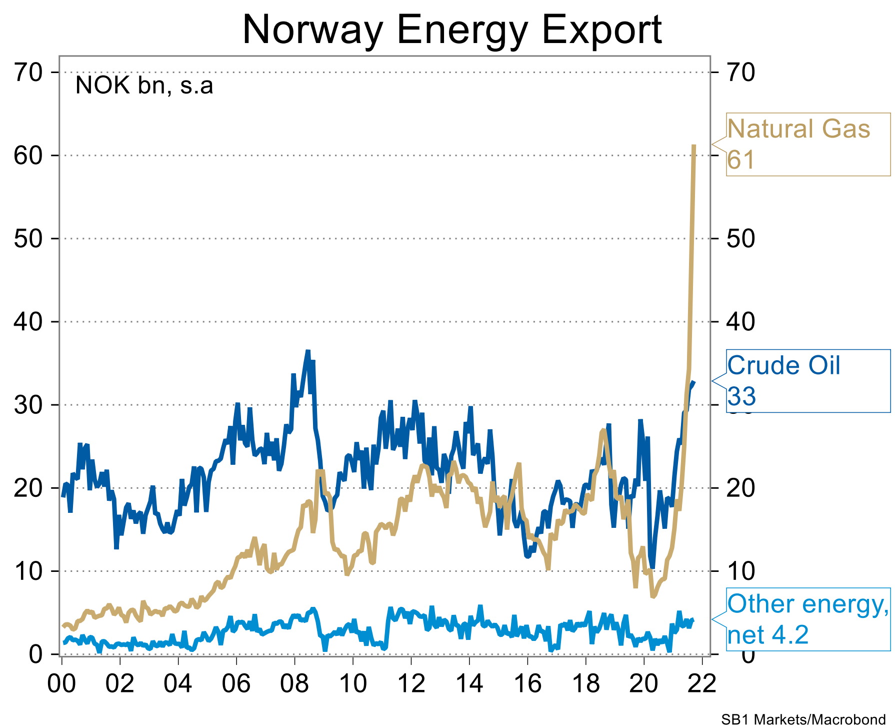


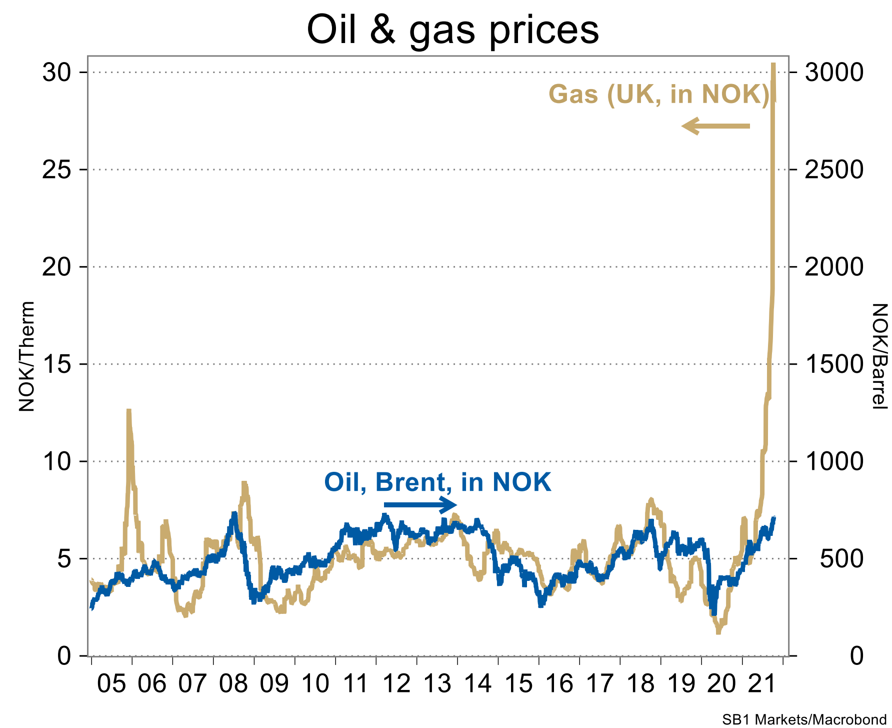


- **The <u>Mainland (non energy) trade deficit in goods</u>** decreased sharply September, by NOK 10 bn to 23 bn
- **Non-energy exports** were flat
- **Imports** fell sharply in August, due to steep decline in imports of machinery and vehicles
- **Export of oil and gas** surged to NOK 94 bn, from 80 bn in August, the highest petroleum export value ever, and far above a 'normal' NOK 40 bn/month level. Gas exports shot up to 61 bn! October will be far better as gas prices have climbed further
- **The trade surplus in goods** (ex ships/platforms) rose to NOK 69, an enormous amount – 25% of Mainland GDP in September, an all time high
- **The government's extra revenues** from oil and gas exports (and direct ownership) in Sept alone will be some NOK 50 bn, which will be transferred to the oil Fund. That's good news. But do not forget that the Fund's value have fallen some NOK 1.000 from the peak in August

Gas exports up to NOK 61 bn, 4x a normal level. October will be even better ☺

Oil export up to NOK 33 bn, the best since 2008

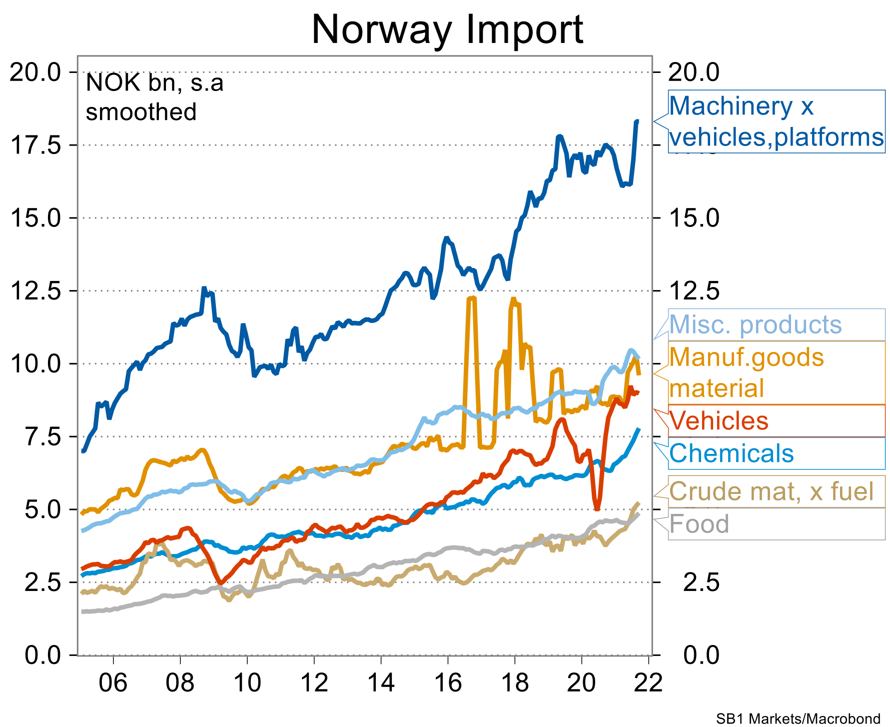


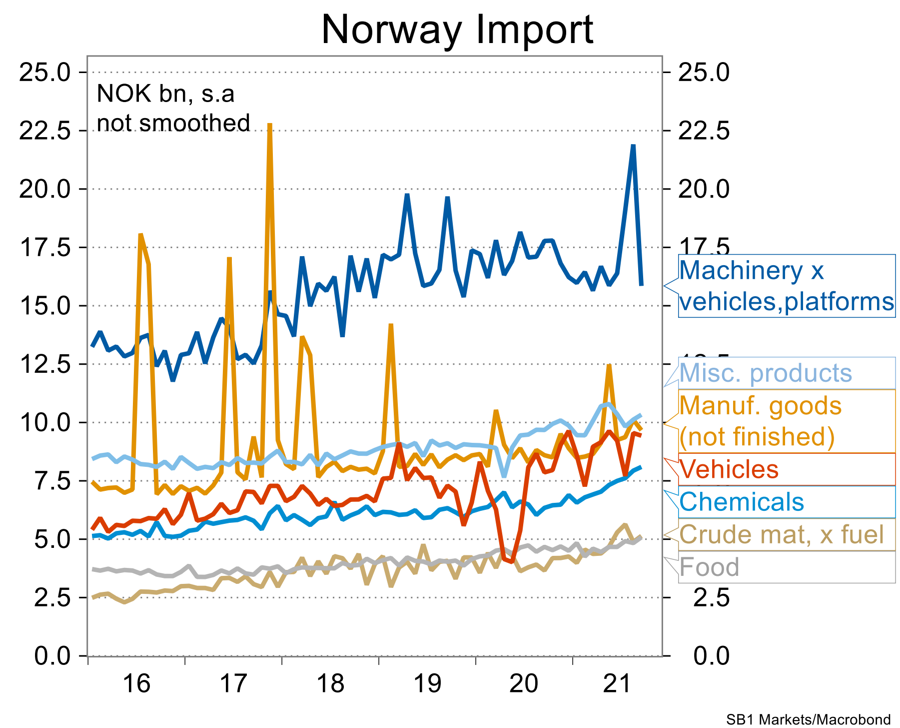


- **British gas** prices have skyrocketed past weeks, to all time high by a wide margin, 6x a 'normal' price level. Gas prices are now totally uncorrelated to oil prices, which is rather unusual (but is has happened before, like in late 2005). In September, the price average was GBP 1.47/therm (USD 20/BTU). Assuming an unch. price rest of October, this months average will climb to almost GDP 2.50/therm. So wait for even more crazy export revenues and trade surpluses in October!
- **Crude oil** exports rose marginally (in NOK bn) – to the best level since before the Financial crisis when just some few months recorded even higher export revenues
- **The government's extra revenues**, given the 78% marginal tax rate is <u>NOK 40 – 45 bn in September</u>, and it will be even more in October. And in… These extra revenues are all transferred to the Oil Fund – and through the budget rule. The long term budget rule 'allows' for 3% of the Funds value to be spent. So the revenues in just in September, leaves room for more than NOK 1.3 bn extra spending, per year- forever
- There are other and often much more important variables: Over some few weeks this autumn, <u>the Fund's value fell by NOK 1.000 bn</u> (8%). Bond yields rose and the NOK rose, stock markets fell. And more could come ☺

Machinery equipment imports sharply down in September

Imports are trending up, broad based



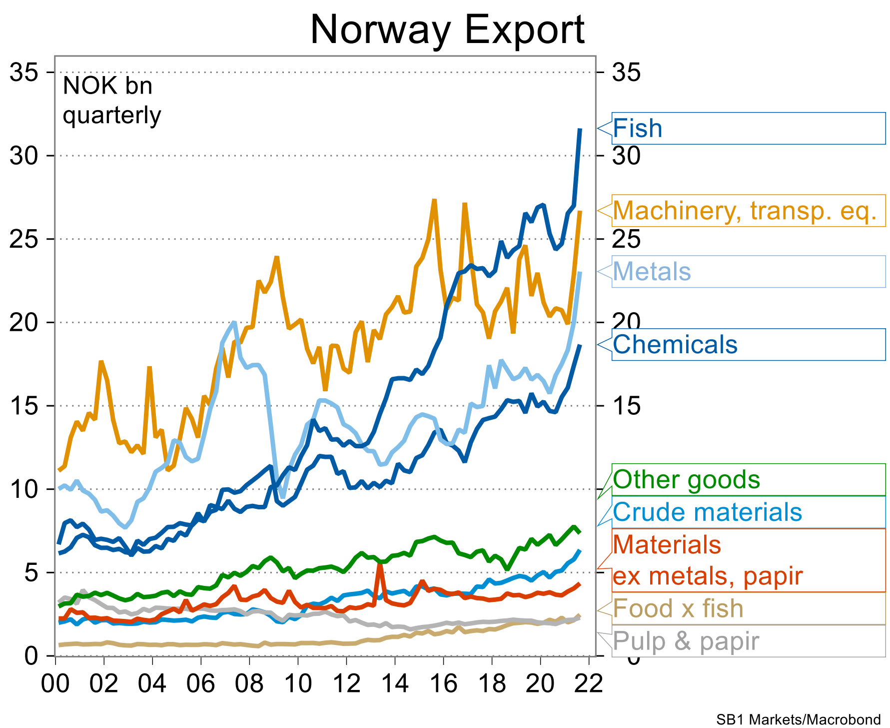


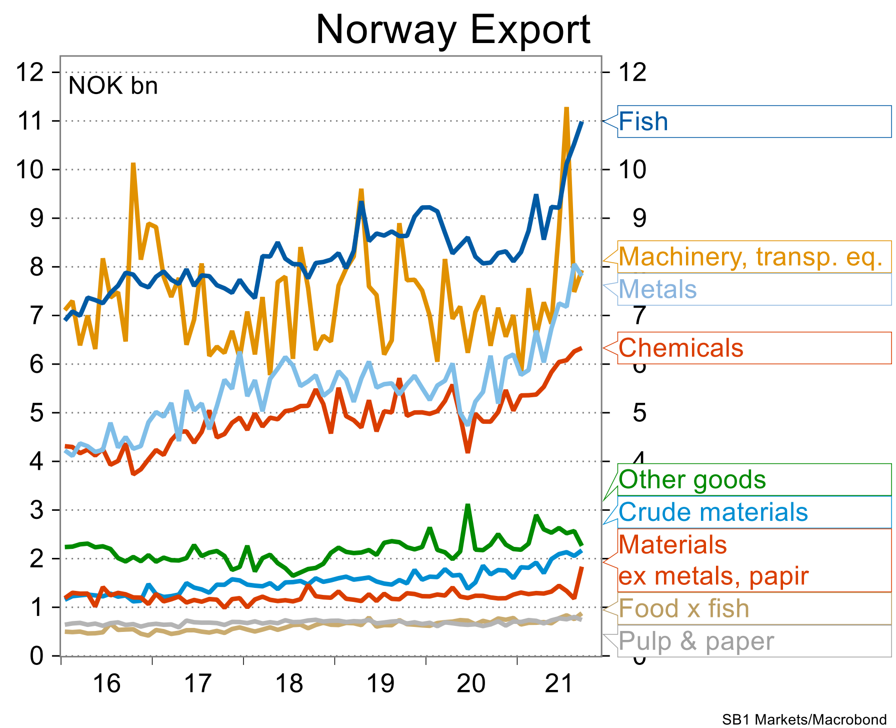
- The spikes in imports of manufactured goods are due to unfinished platforms or ships

SpareBank 1 MARKETS

Fish exports are surging, metals, chemicals too

Machinery & transport equipment on the way up too (but are much more volatile)





- Exports of machinery and transport equipment (of which much is related to oil activities abroad) decreased by 34% in August (following s similar spike in July, du to exports of ships (ferries) but stabilised in September. The short trend is upwards (but flattish from 2014, due to the setback in investments in the oil and gas industry)
- Metals, fish, machinery and chemicals are all up 30% – 40% y/y – almost entirely due to higher prices

Highlights

The world around us

The Norwegian economy

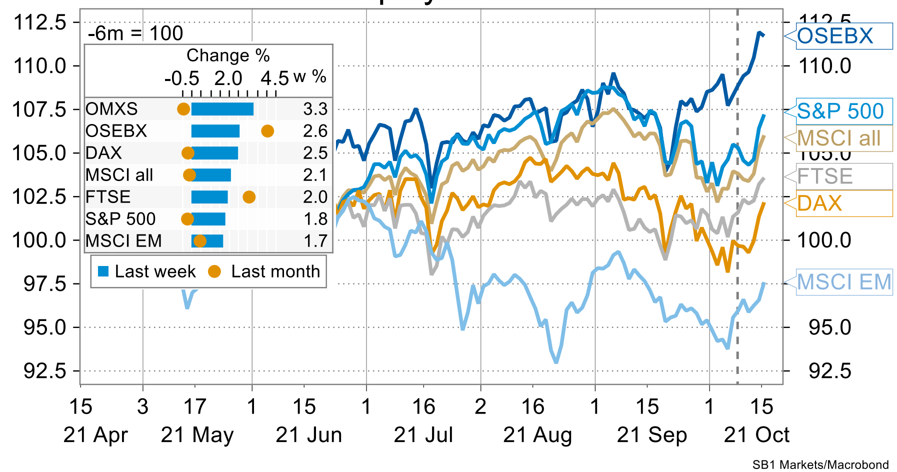
Market charts & comments

SpareBank 1 MARKETS

Risk ON! Equites up everywhere. Metals finally followed oil up, NOK up

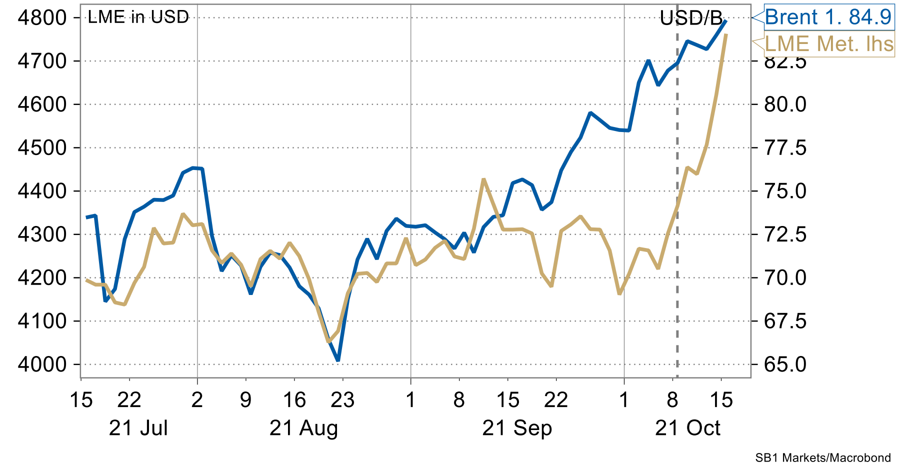
The short end of yield curves sharply up – but the long end fell for the first time in 8 weeks! Surprising

Equity Indices

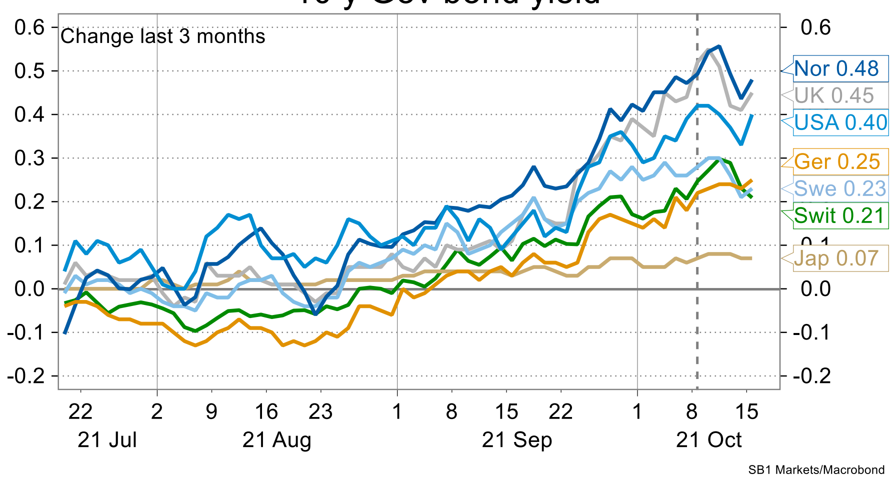


	Change %
OMXS	3.3
OSEBX	2.6
DAX	2.5
MSCI all	2.1
FTSE	2.0
S&P 500	1.8
MSCI EM	1.7

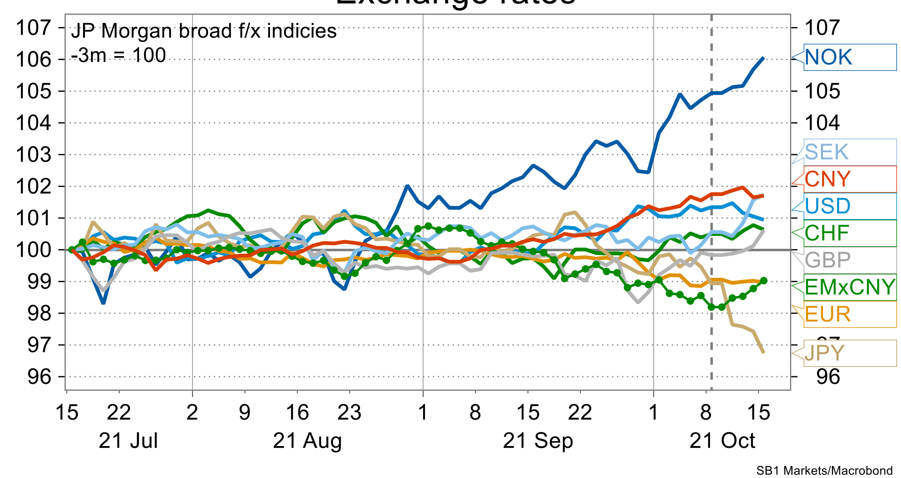
Oil vs. metals



10 y Gov bond yield

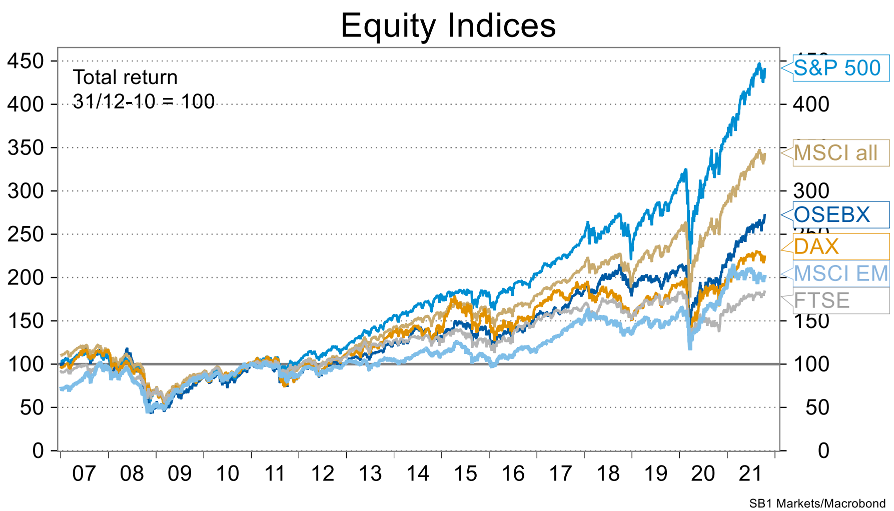


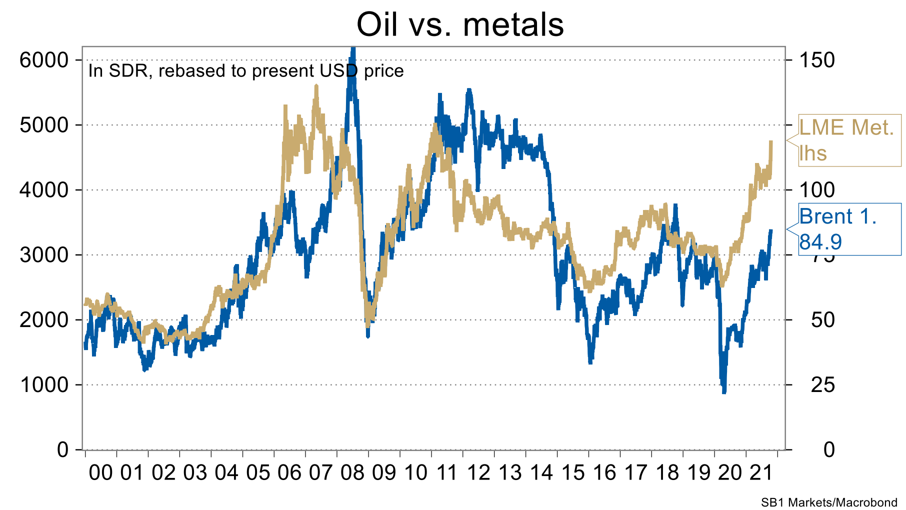
Exchange rates

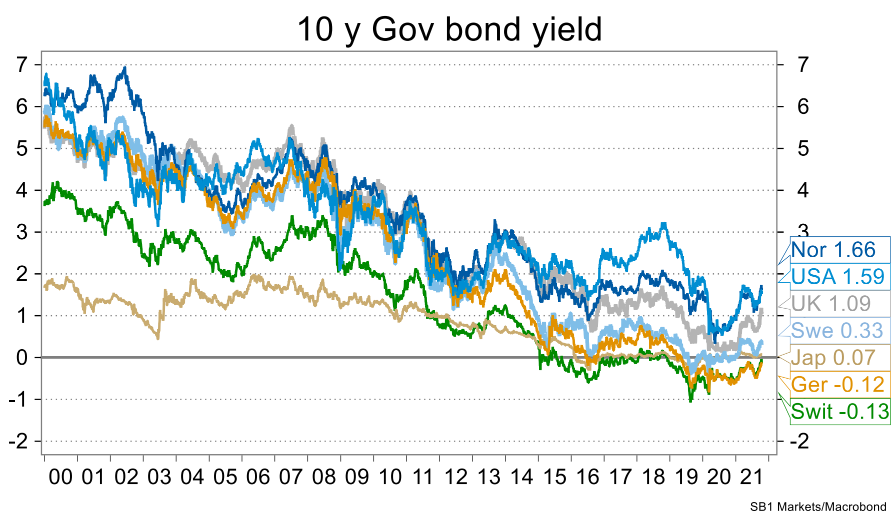


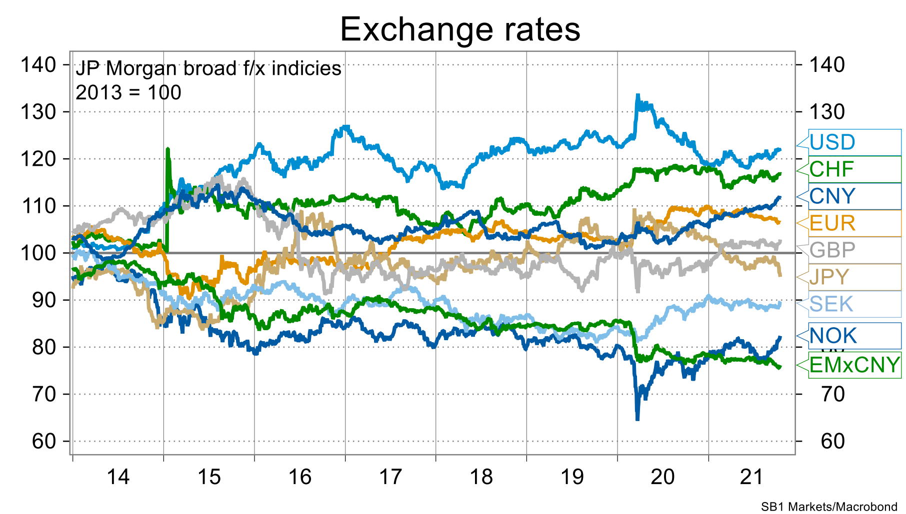
The big picture: The lift in metal prices is significant – growth optimism returned?

The CNY the f/x winner (among the majors), another sign of no fear of a Chinese constr. meltdown







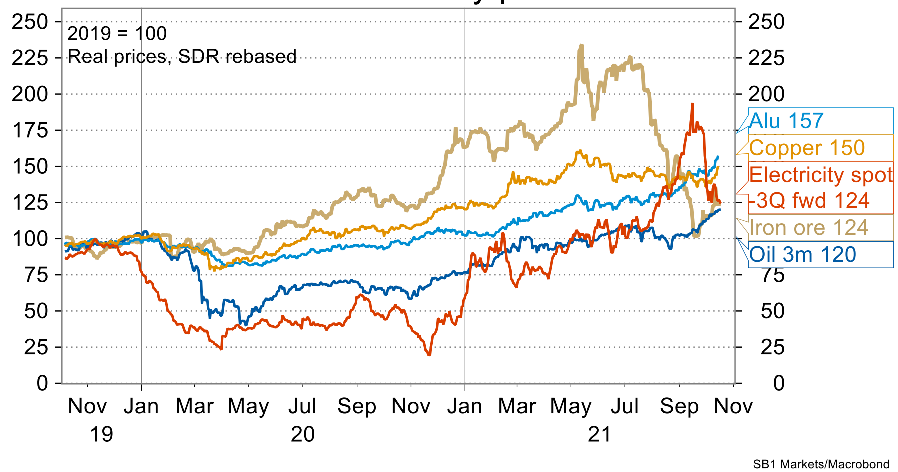


SpareBank 1 MARKETS

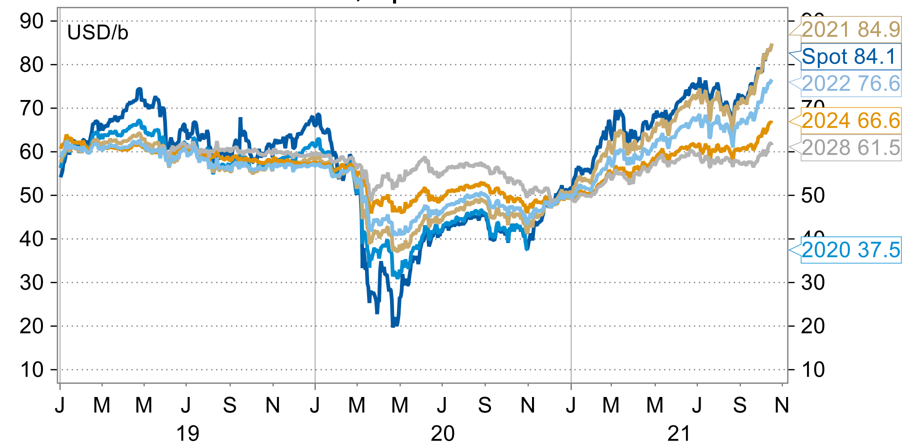
Gas, electricity down, other commodities up. Longer dated oil prices too

The oil curve up but not in the long end. Nordic electricity prices down, as are UK gas prices

Commodity prices

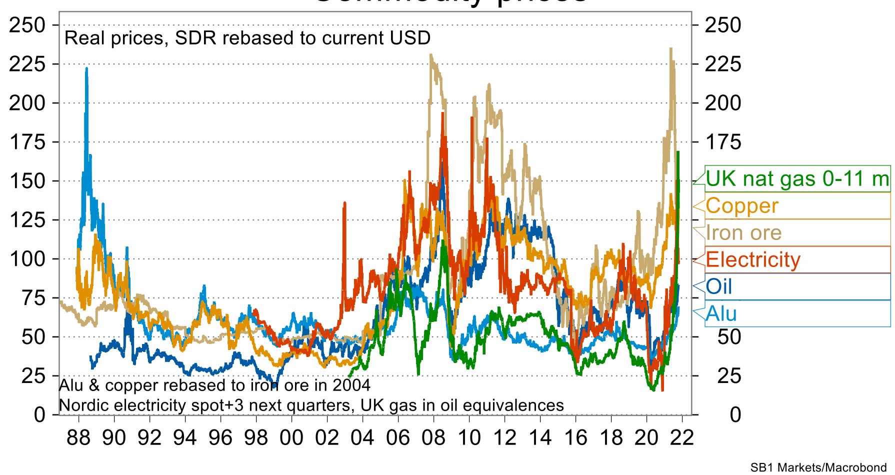


Brent oil, spot & Dec contracts



SB1 Markets/Macrobond

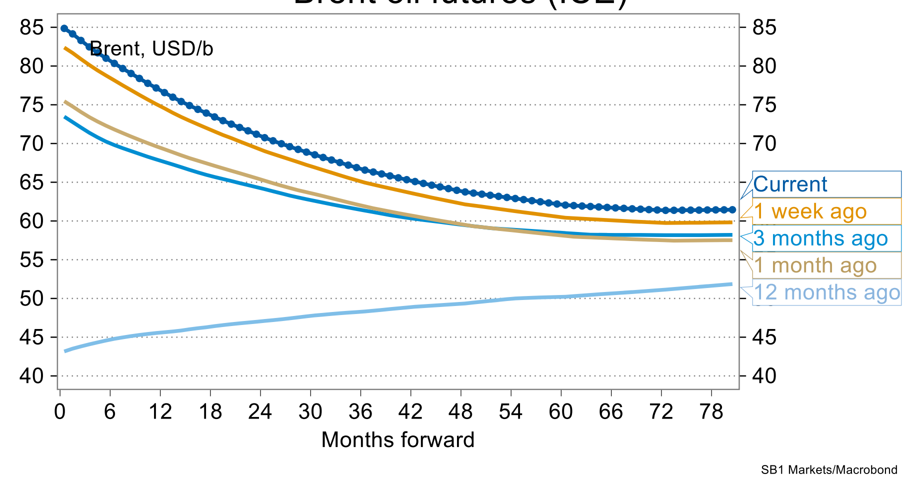
Commodity prices



Longer dated oil contracts are heading down

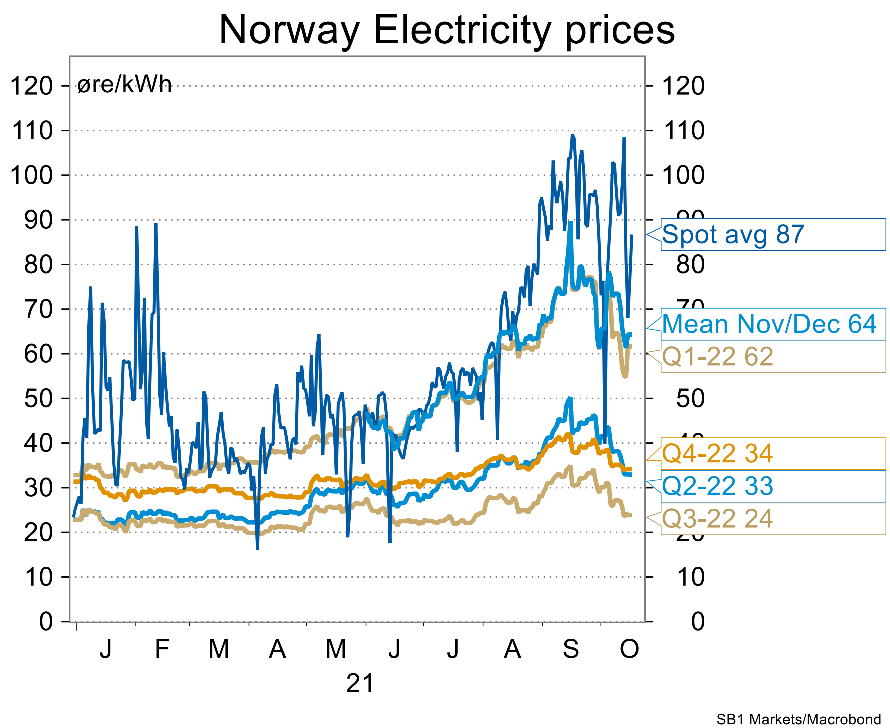
The short end of the curve sharply up recent weeks

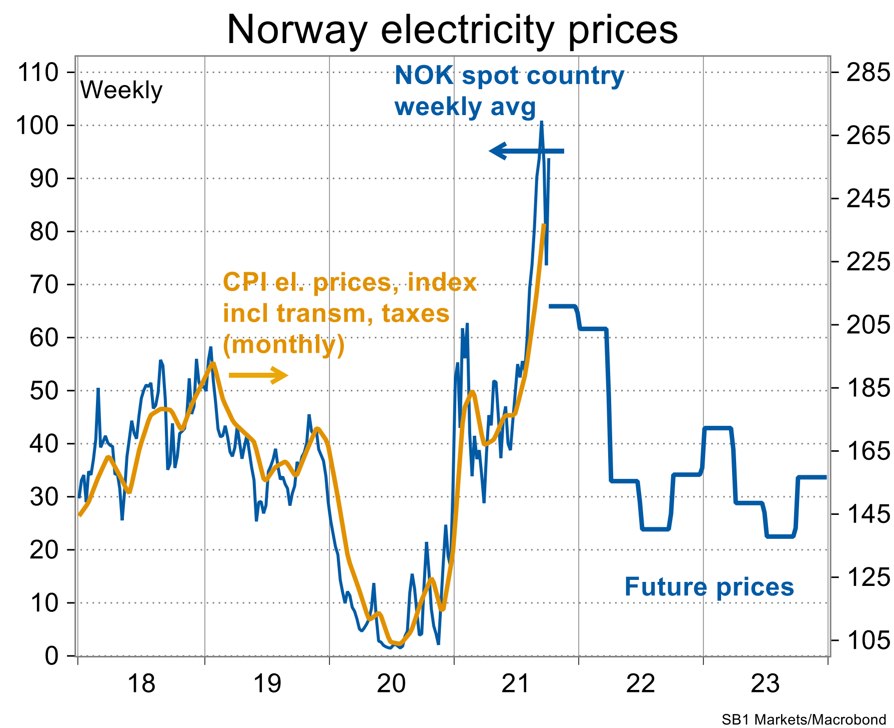
Brent oil futures (ICE)



Nordic electricity future prices further down

Markets are still volatile, depending on the weather, and over time European gas prices



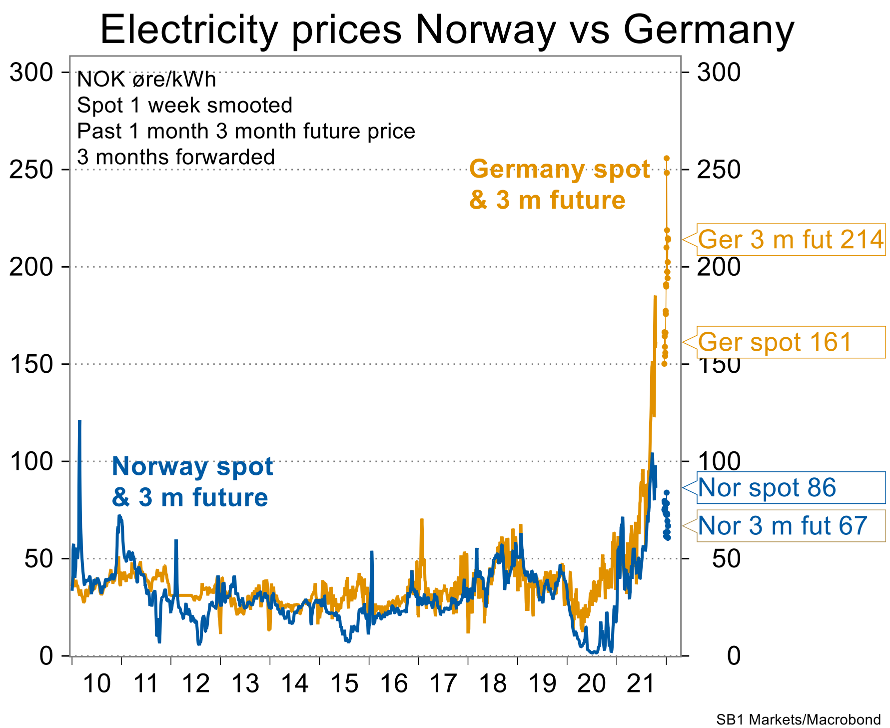


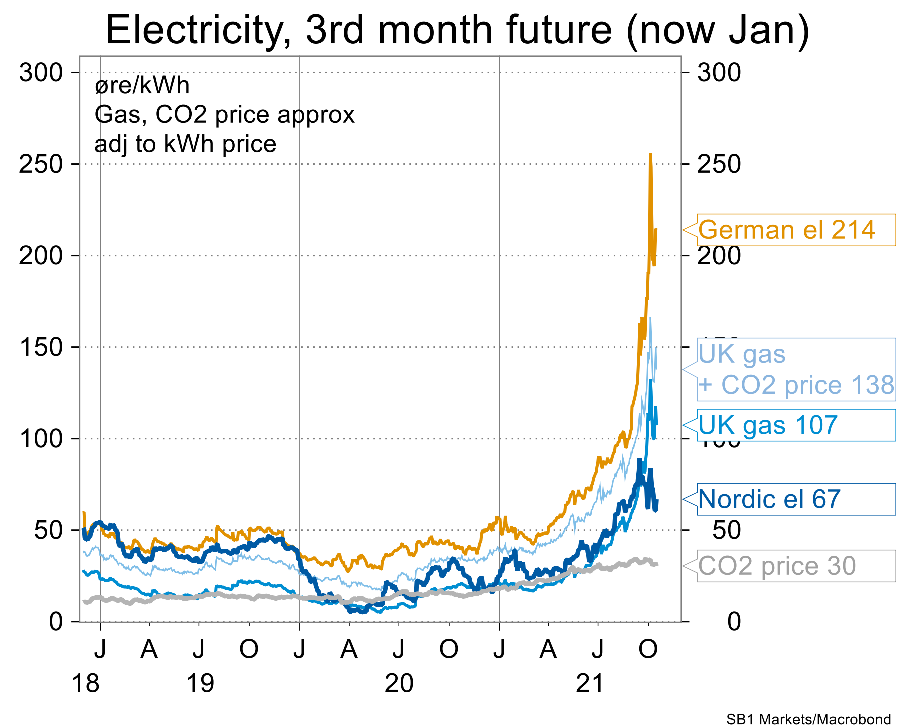
- Even when Norwegian electricity spot market prices soared in September, the future market was rather calm, at least from Q2 next year and onwards. Now, the market expect prices down to below 30 øre/kWh in Q3, below an average price
- Even Nov/Dec prices are significantly down, and at 62 øre/kWh 'just' some 30 øre above the long term average (down from above 70 last week). Further out, future prices also decreased last week

SpareBank 1 MARKETS

European electricity, gas prices down from the peak – still very high

The gap between the Nordic & German el. prices is unprecedented



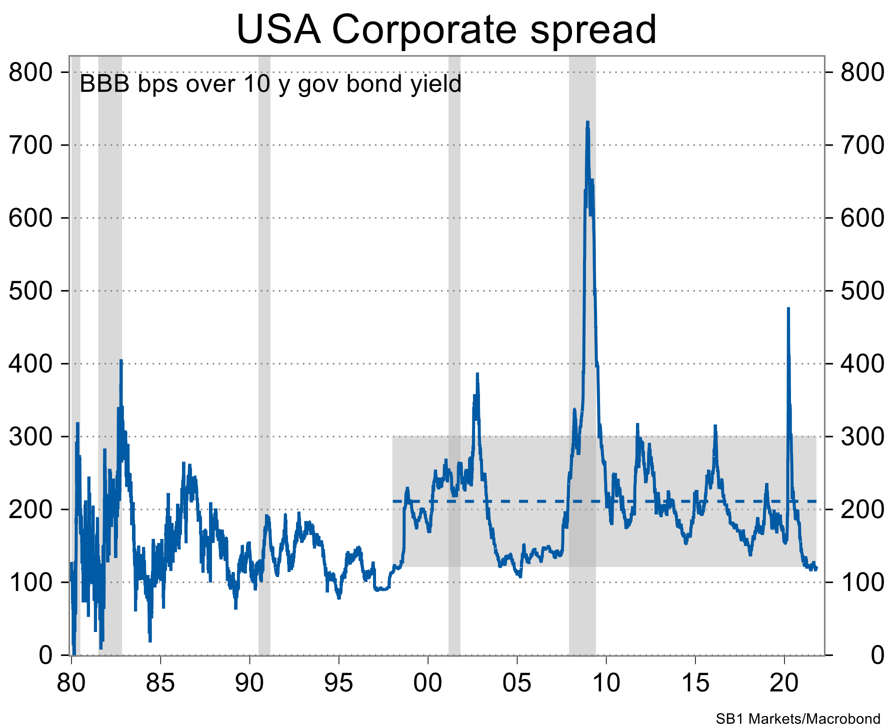


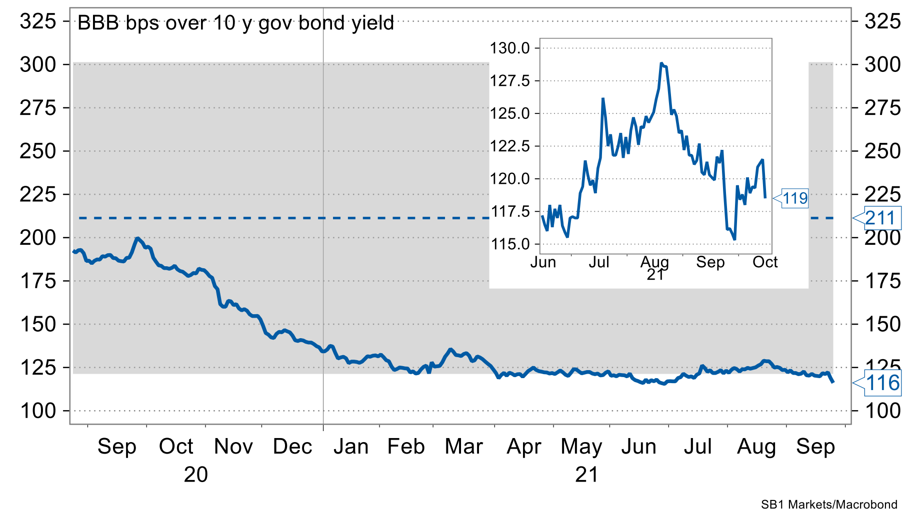
- Should we take a bet here on the 3 m future spread Germany at NOK 214 øre/kWh vs. Norway (Nordic) future at 67 øre/kWh? It seems so obvious??
- However, we think someone has tried a similar betting strategy before, and it did not end well for that trader, it could of course get even worse. (But why don't a German end user just buy the NOK el future?)

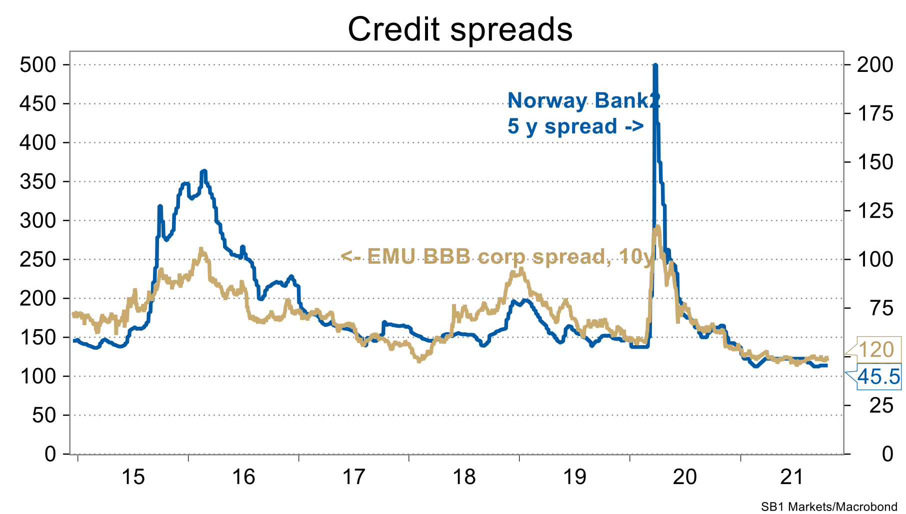
SpareBank 1 MARKETS

The US industrial BBB spread down again

(look away from the strange gyrations three weeks ago)

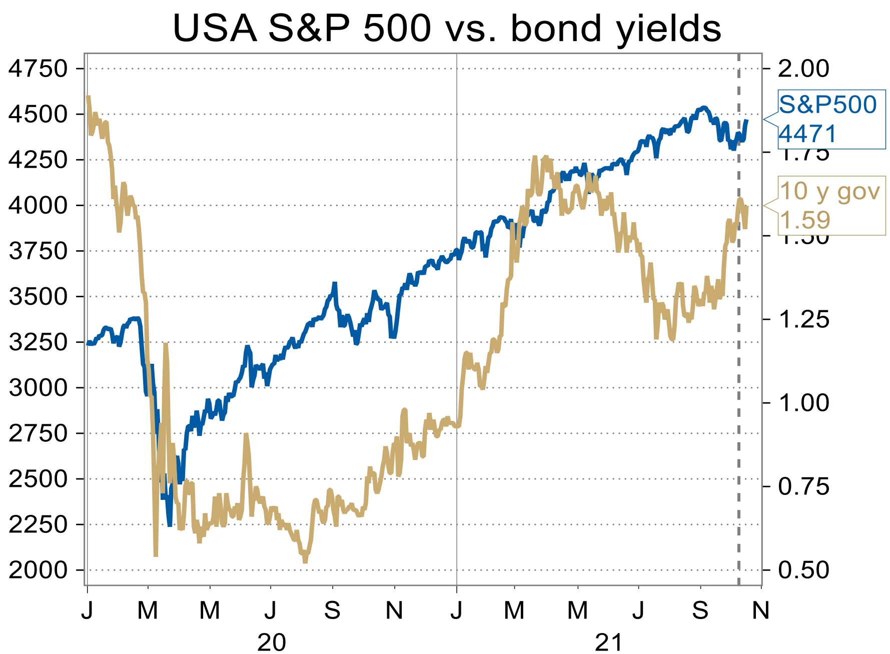


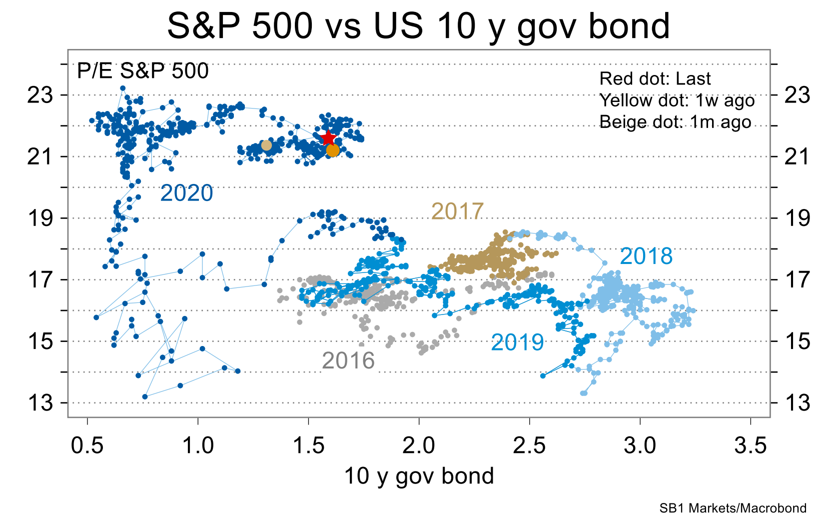


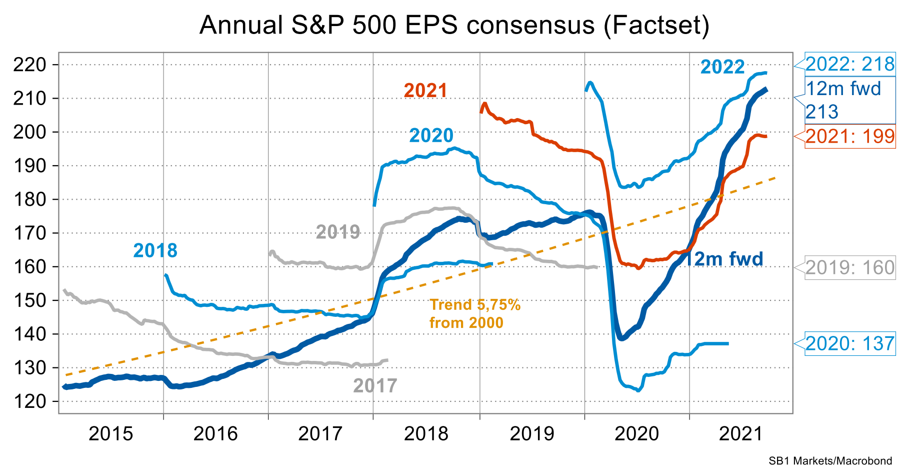


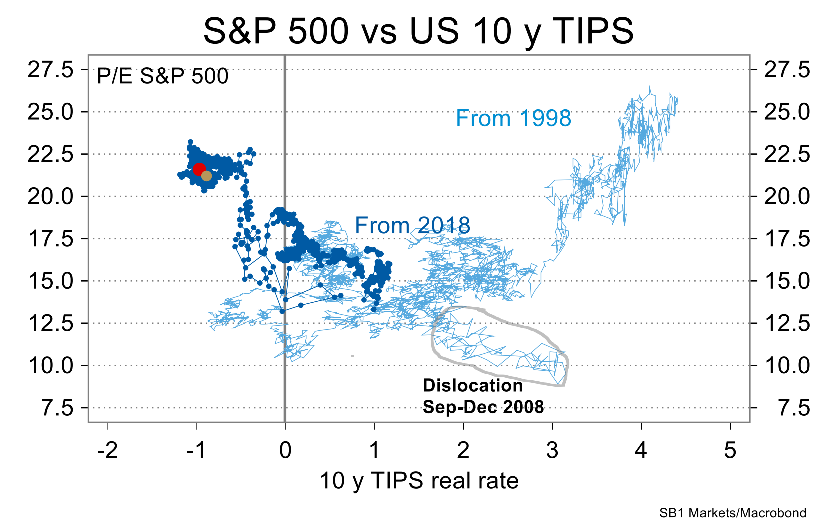
S&P 500 up 1.8%, not that far from ATH. 10 y gov down 2 bps

Growth in earnings expectations have moderated lately



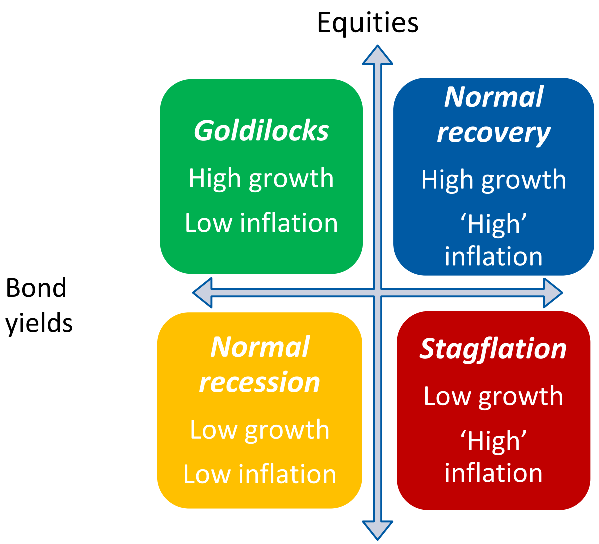


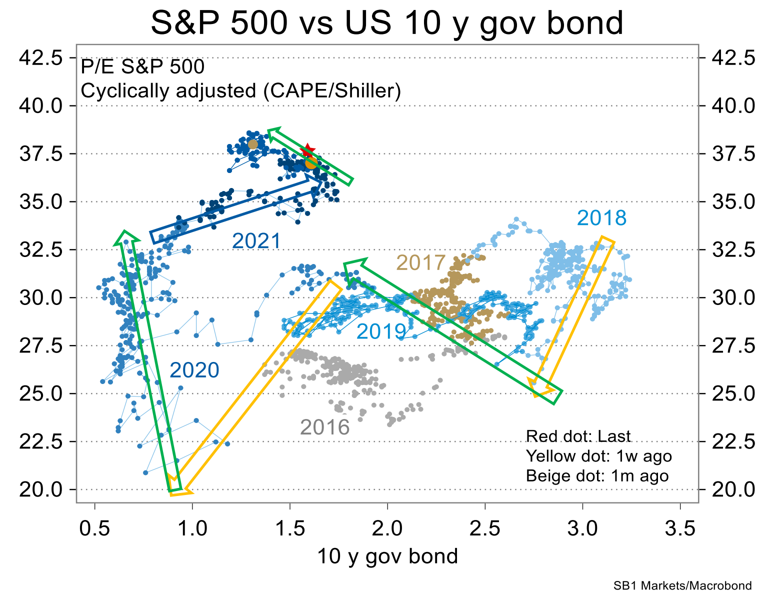




Still well into the 'Goldilocks corner' (but on the move??)

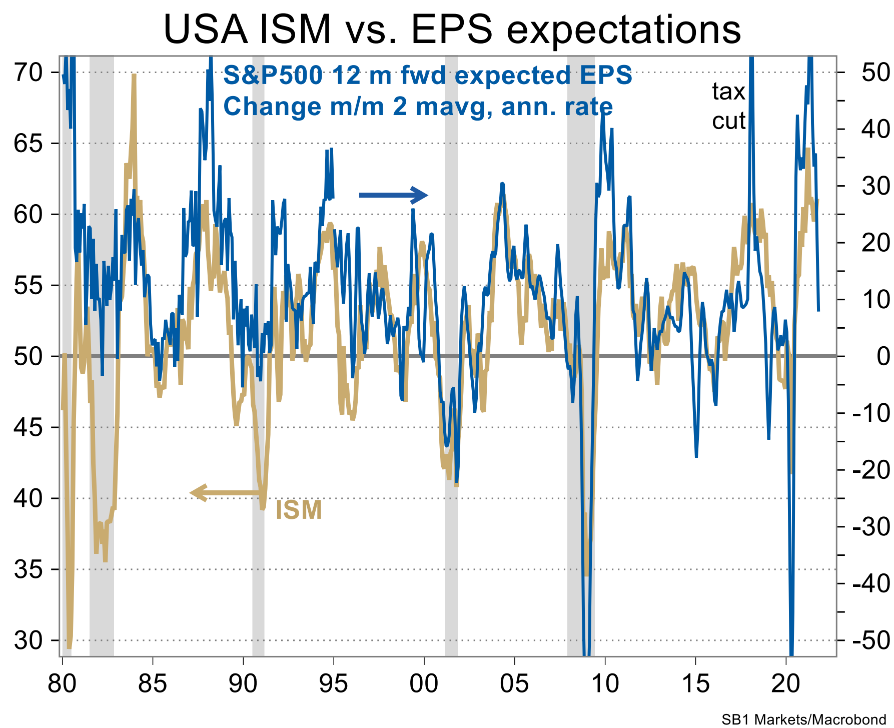
Wage/price inflation dynamics will in the end decide. And not the Fed…

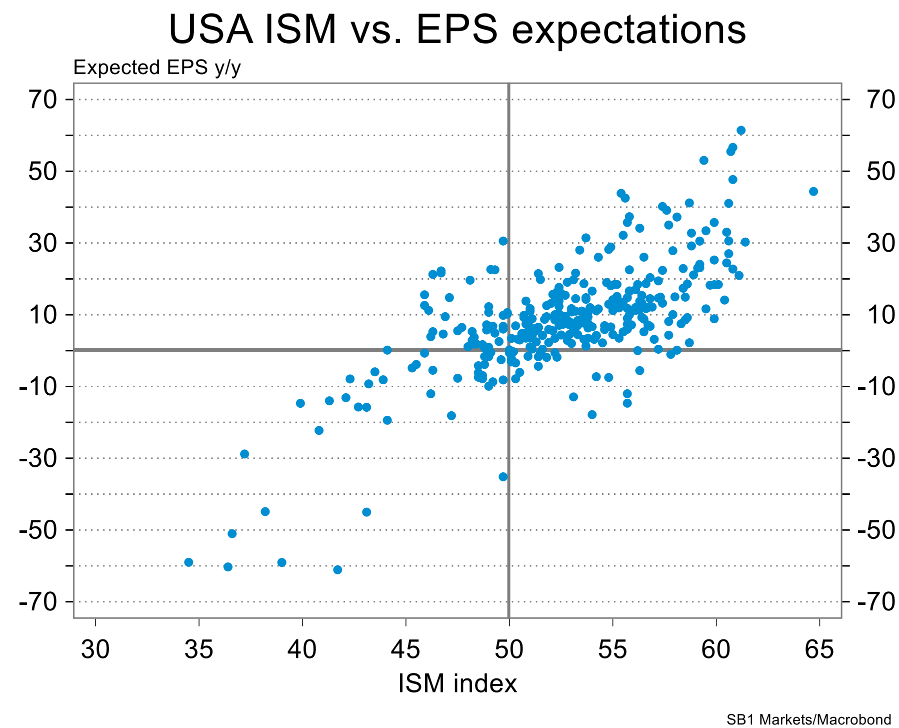




- Usually, we have associated drifts towards the 'green corner' - low inflation and solid growth at the same time - as a temporary sweet spot for markets
  - » Interest rates have climbed 100 bp+, and stock valuations have kept up or climbed (like the Shiller PE). Still, we deem the current yield level to qualify for the "Goldilocks" corner (especially the real bond yield, check the chart on the previous page). Where to go from here?
- The inflation/growth mix will decide:
  - » If 'nothing' happens, we can stay in this Green quadrant. Raw material prices normalise, wage inflation is kept in check because the US labour supply finally returns to normal. Inflation turned out to be transitory, profits are OK, yields remain low. No construction crisis in China
  - » If the labour supply in the US does not yield, wage inflation will very likely accelerate
    - If companies are able to increase their selling prices, profits will be kept up, but higher inflation well very likely push the Fed to tighten monetary policy, which is challenging for high multiples. Move to the blue quadrant. However, after a while profits will anyway come under pressure. The stock market will be rewarded with lower profits & lower multiples (it will resemble the Red corner, before moving to the Yellow)
    - If companies are not able to increase their selling prices, inflation will be kept in check but profits will decline rapidly. A 2% lift in wages, cuts profits by well above 10%. That's the Yellow corner

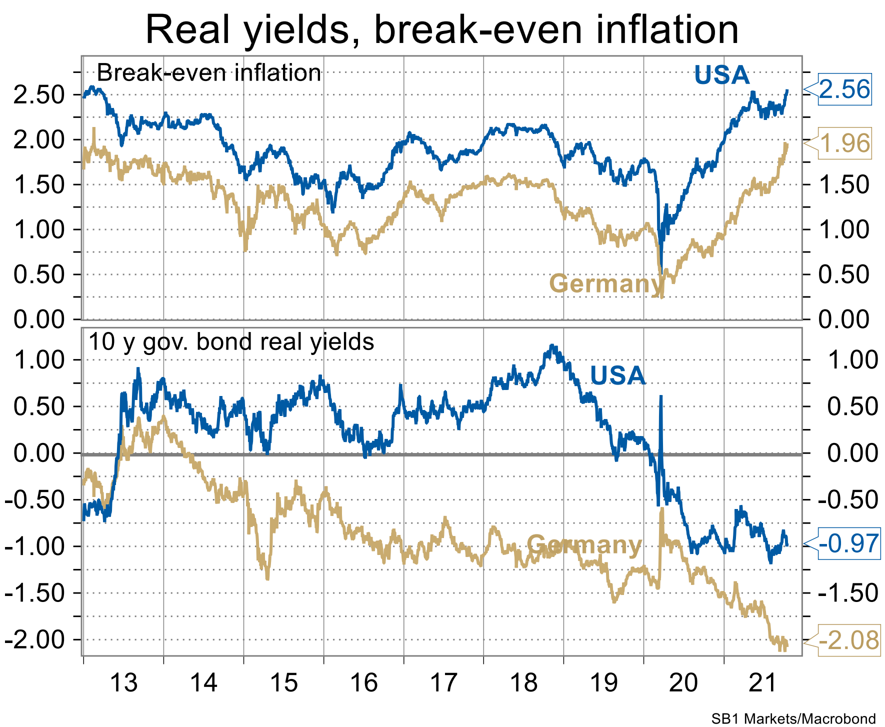
Expected earnings growth is slowing before surveys have sent the message

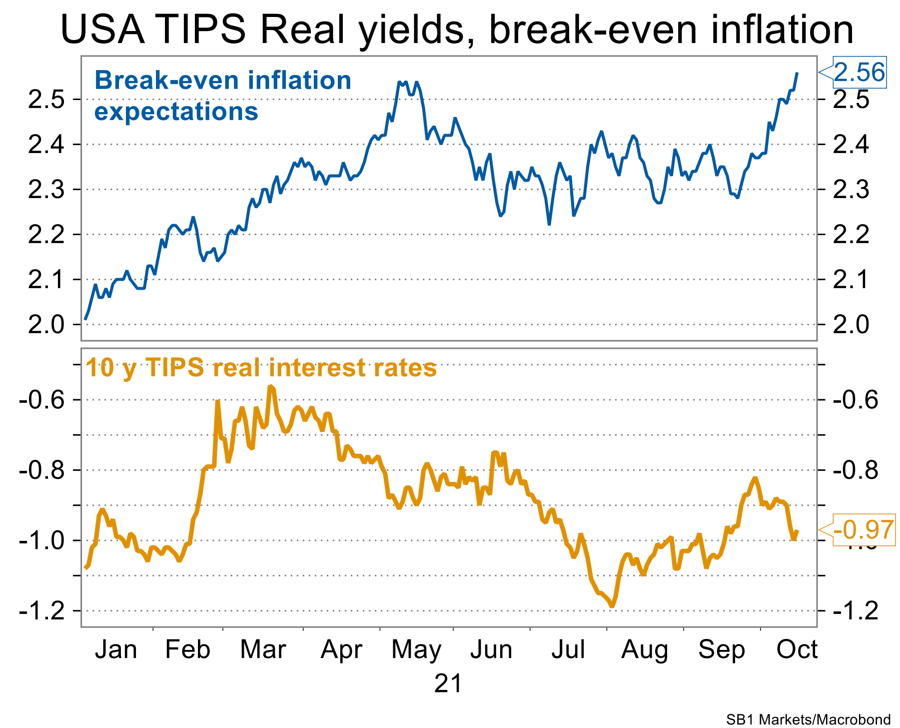




Real rates further down, inflation expectations on the rise

... While we expected the real rates to do the job. Inflation expectations in the US are not low anymore





US & Germany 10 y Gov bond yield

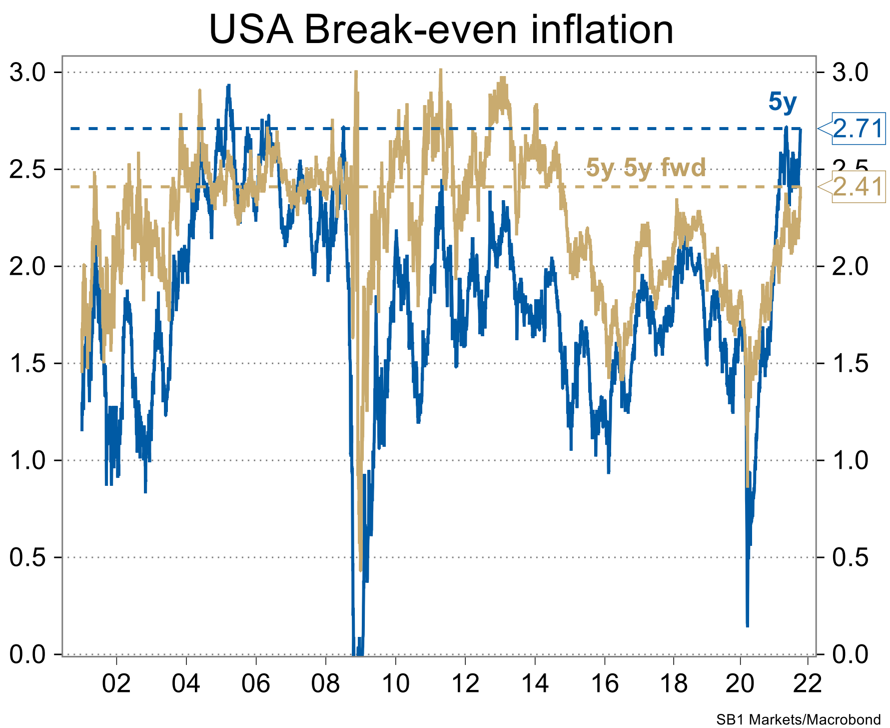
	Yield	Change 1w	Change 1m	Min since April-20
USA nominal treasury	1.59	-0.02	0.28	0.52
.. break-even inflation	2.56	0.06	0.21	1.06
.. TIPS real rate	-0.97	-0.08	0.07	-1.19
Germany nominal bund	-0.12	0.03	0.22	-0.65
.. break-even inflation	1.96	0.08	0.23	0.40
.. real rate	-2.08	-0.05	-0.01	-2.13

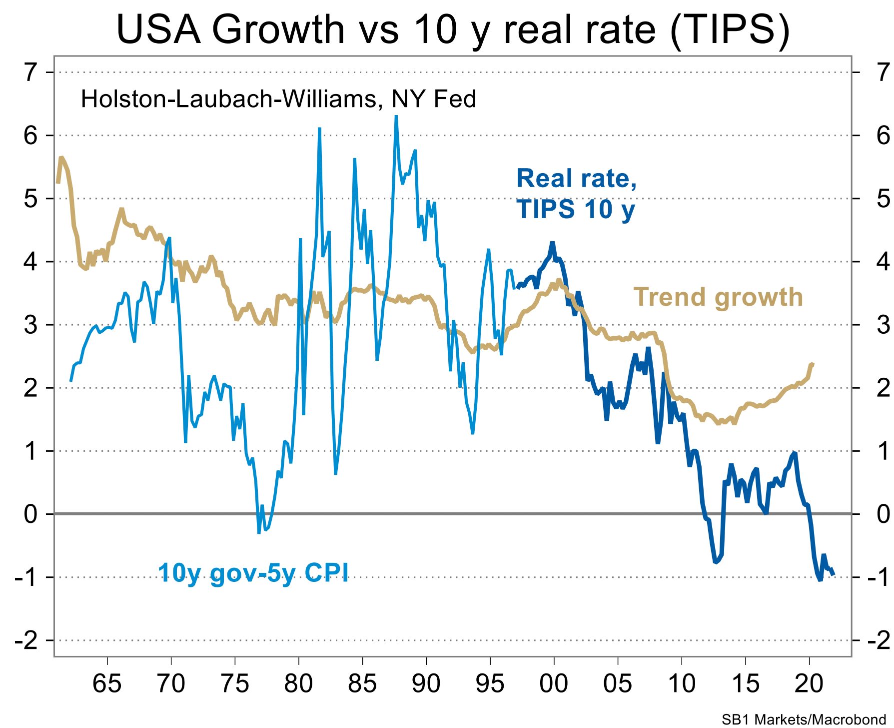
SB1 Markets/Macrobond

- The **US 10 y break-even** (inflation expectation component) has climbed to 2.56%, the highest print since 2013, and among the 4% top obs. since 2000. The first 5 years is at 2.71%, ‘somewhat’ above Fed’s 2% target even adjusted for the CPI-PCE spread (but the 5y 5y fwd at 2.41% is on the high side too)
  - » The 10 y real yield is at -0.97%
- In **Germany**, the break-even is approaching 2%. German real yields are close to record low, the 10 y at -2.03%

Some special data points: Inflation expectations record high, real rates record low

... while growth expectations are not that bad at all. Something will have to yield?



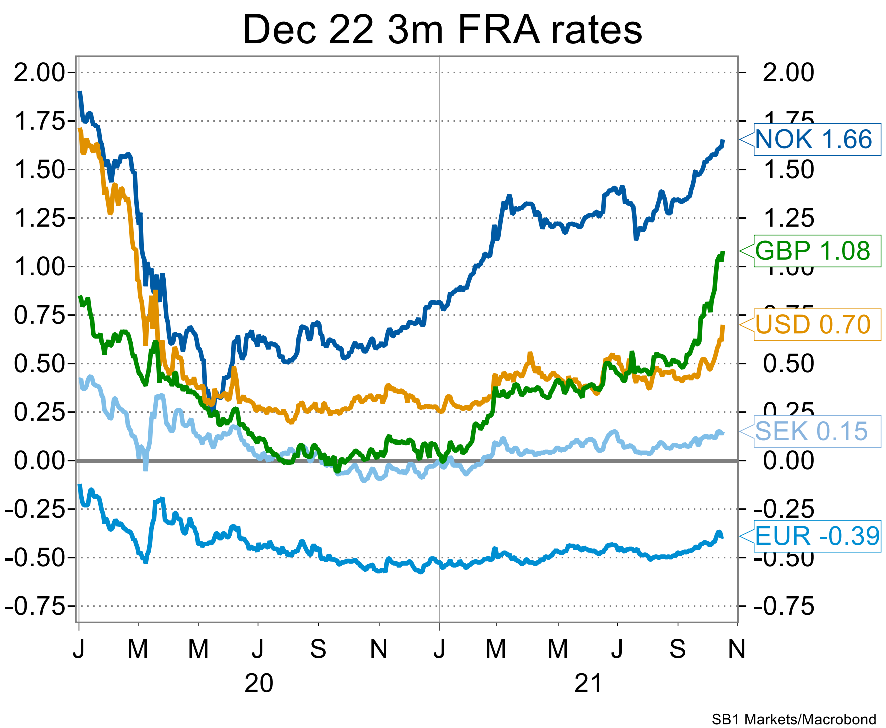


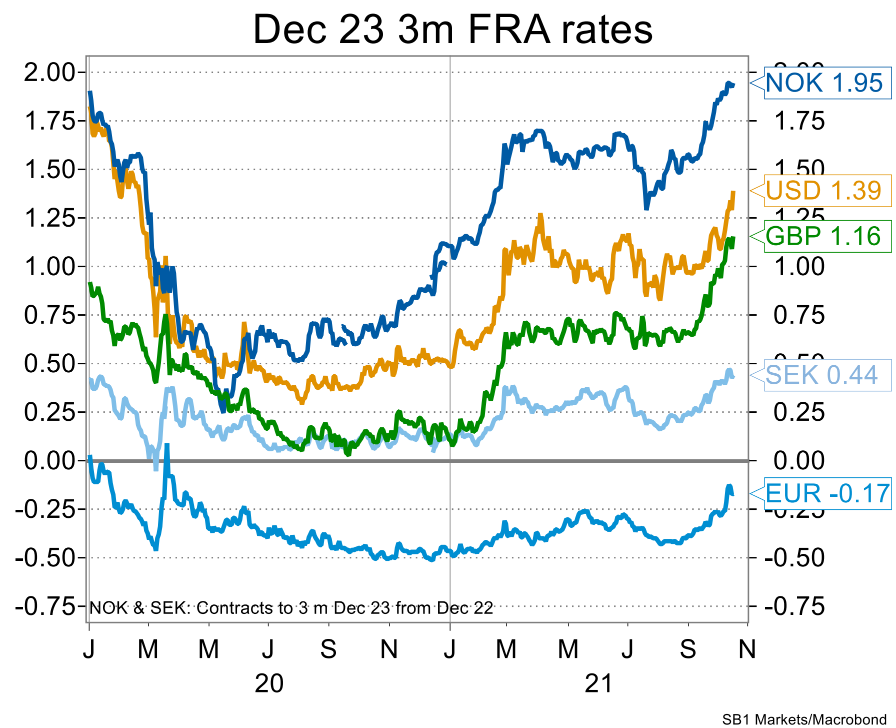
- We very much doubt the present -1% real rate vs. growth expectations at +2% – 3% is a long term equilibrium

SpareBank 1 MARKETS

FRAs: US, UK & NOK rate expectations are surging

The first Fed hike next summer? 1 hike in UK before Christmas, 3 more next year?

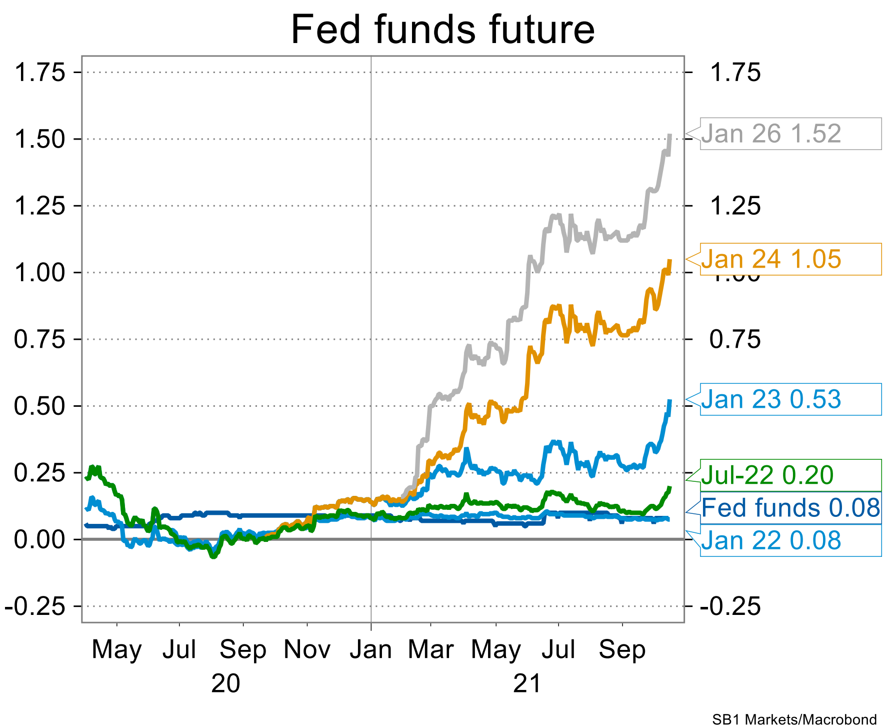




- Well, that's what the market is telling us!
- A Dec hike is not yet fully priced in but if not in December, then in January
- US OIS rates, FRAs up by up to 16 bps last week, a rather

Fed Fund future contracts sharply up

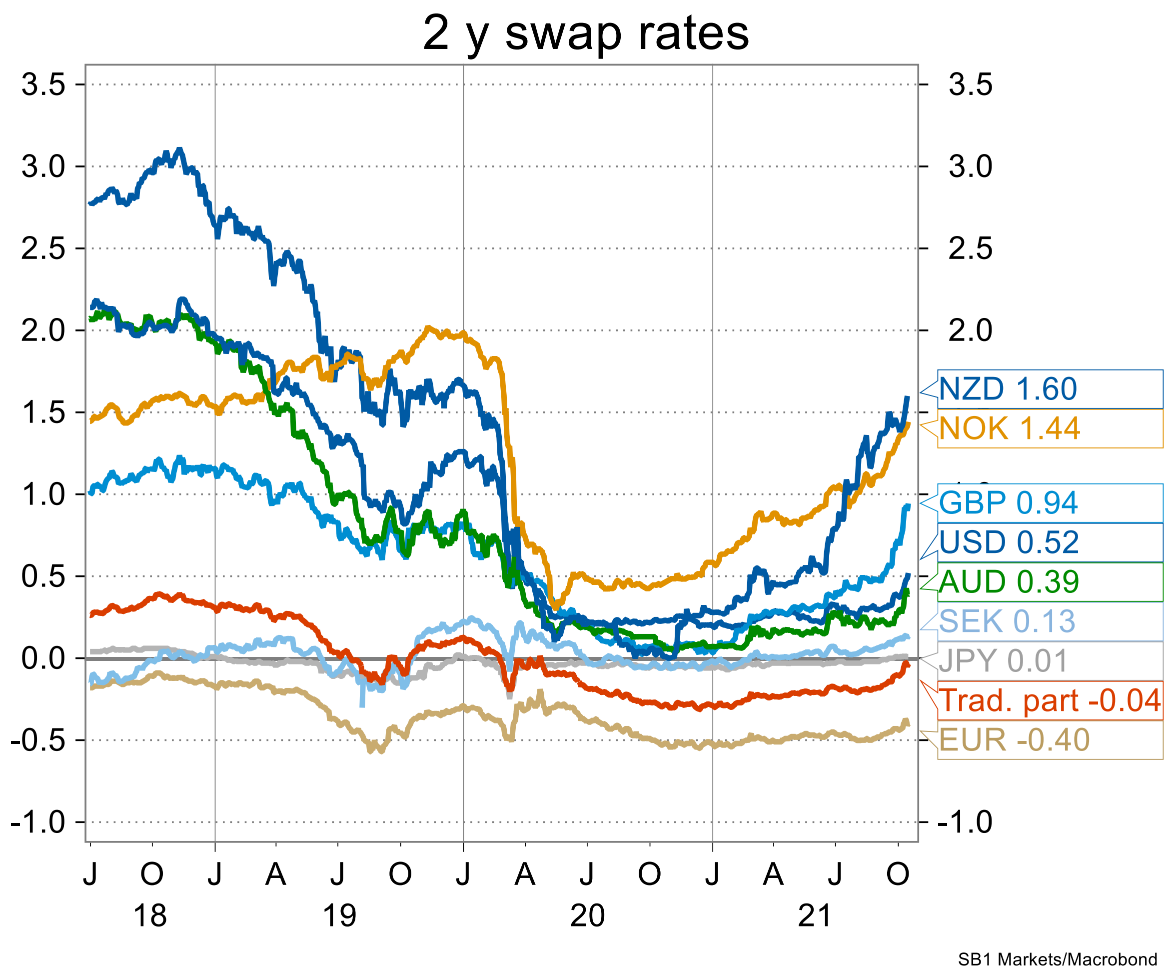
50/50 for a hike in Jun-20, and a 80% probability for 2 hikes before Dec-22

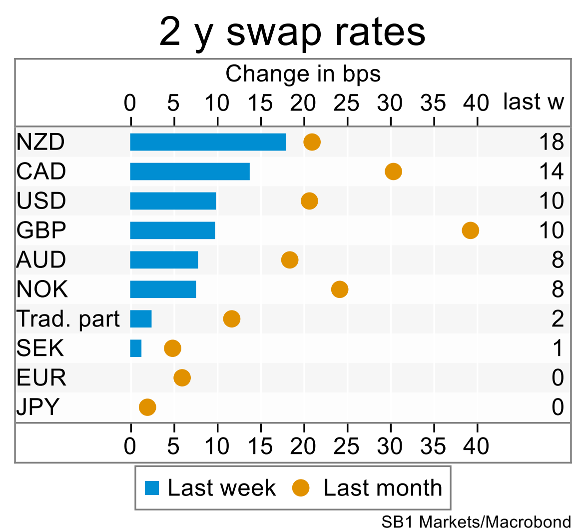


- Still note more than a 1% Fed funds rate by the end of 2024
  - » As a probably weighted average perhaps OK, but as the economy develops now, a deep negative signal rate for the coming 3 years is not the most likely outcome?

Anglo-Saxons + NOK rates sharply up last week too

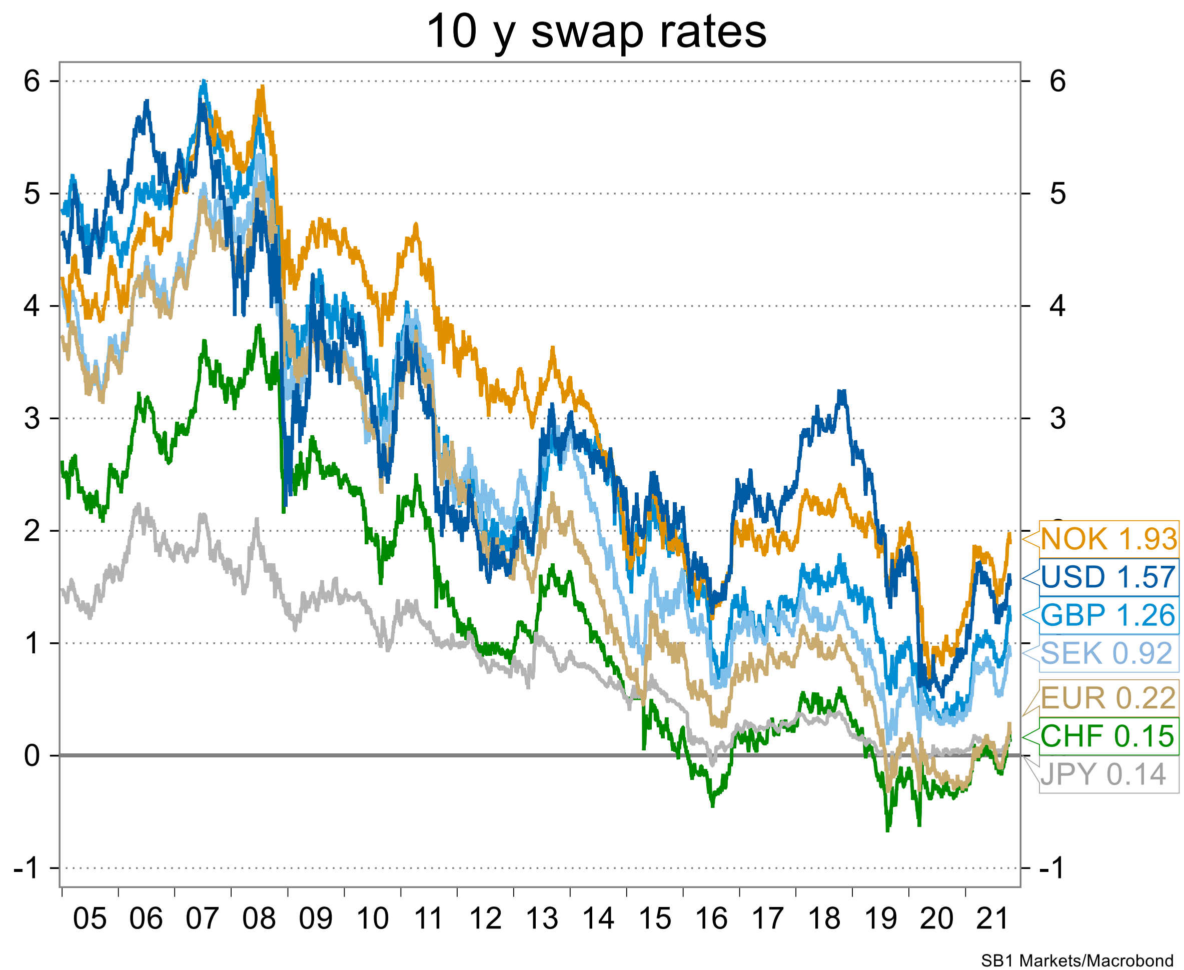
Central banks are on the move

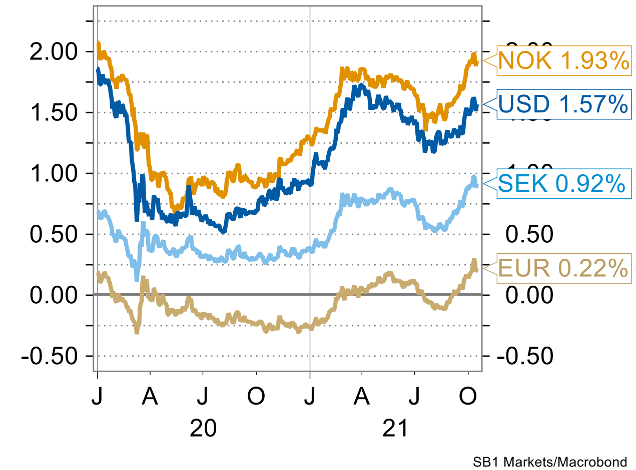


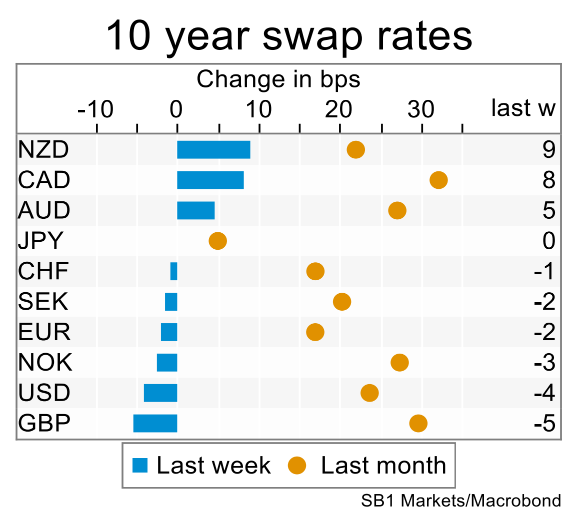


After 7 straight weeks up, a pause last week. Rates mostly down in the long end

... By some few basis points

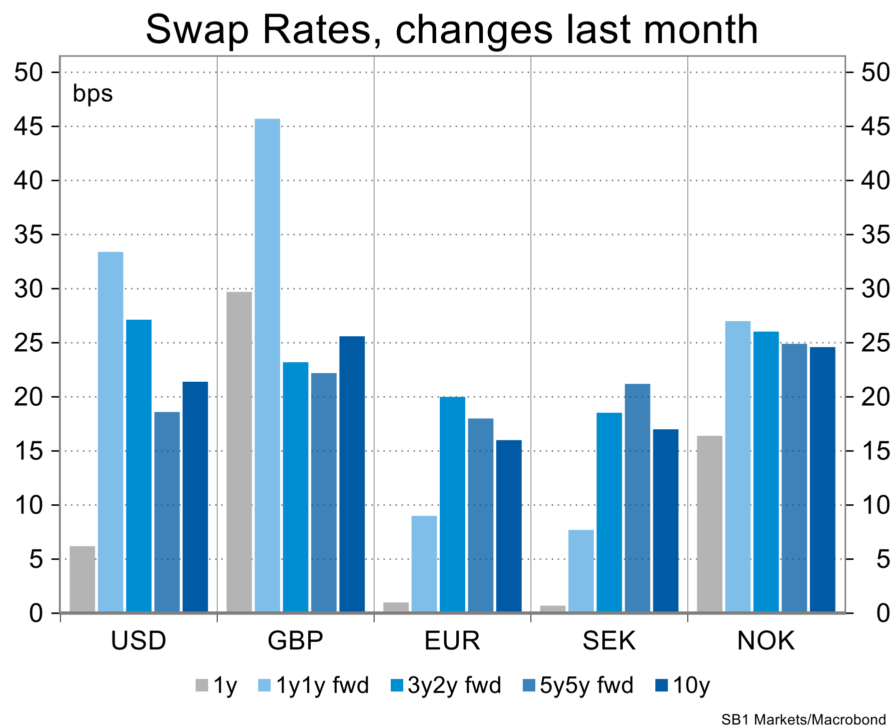


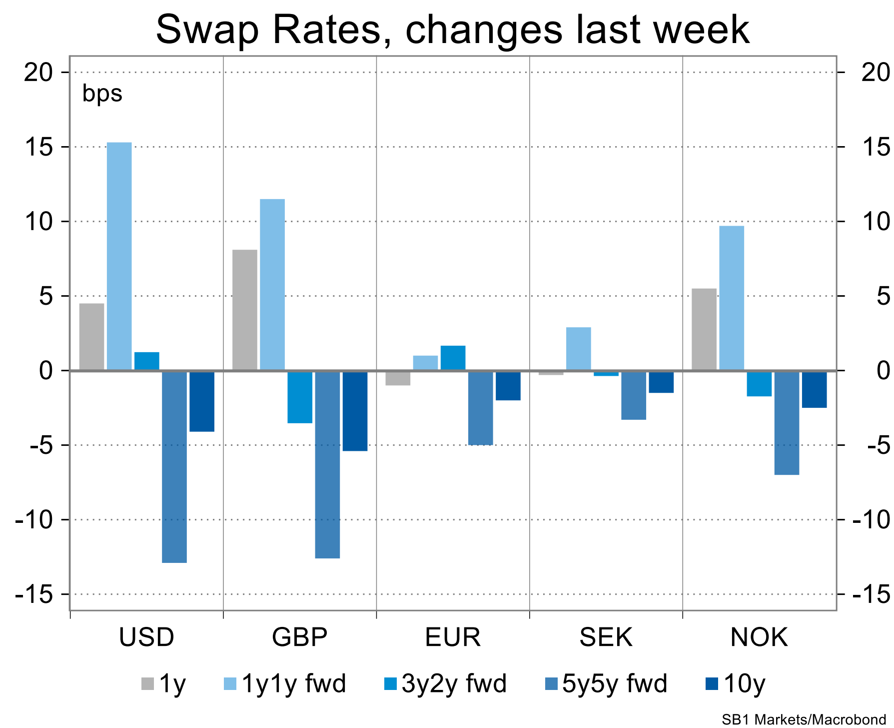




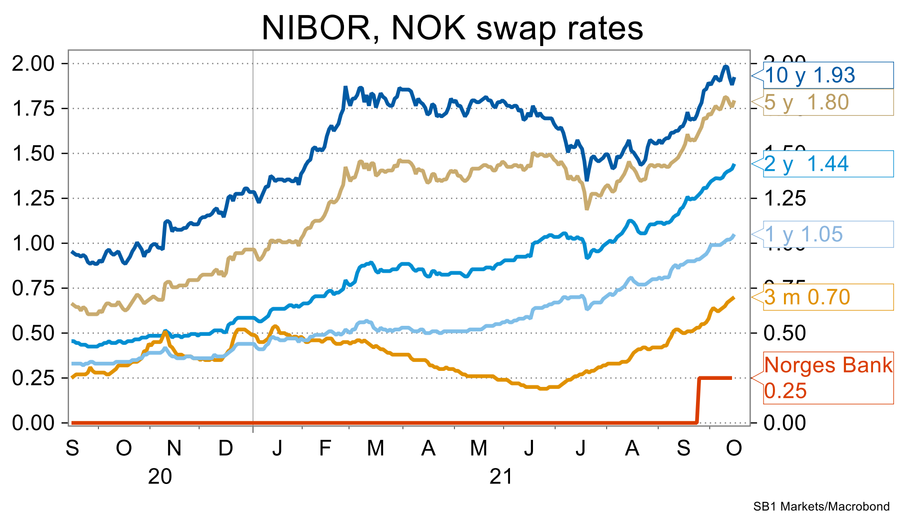
A substantial flattening of the curve: The short end up, the long end down

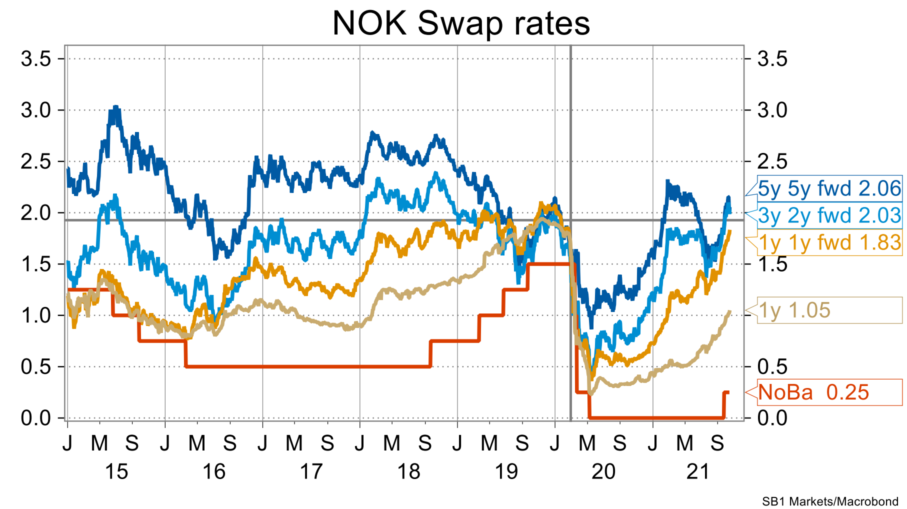
Signals belief in the central banks? More aggressive now, less need for more tightening later?

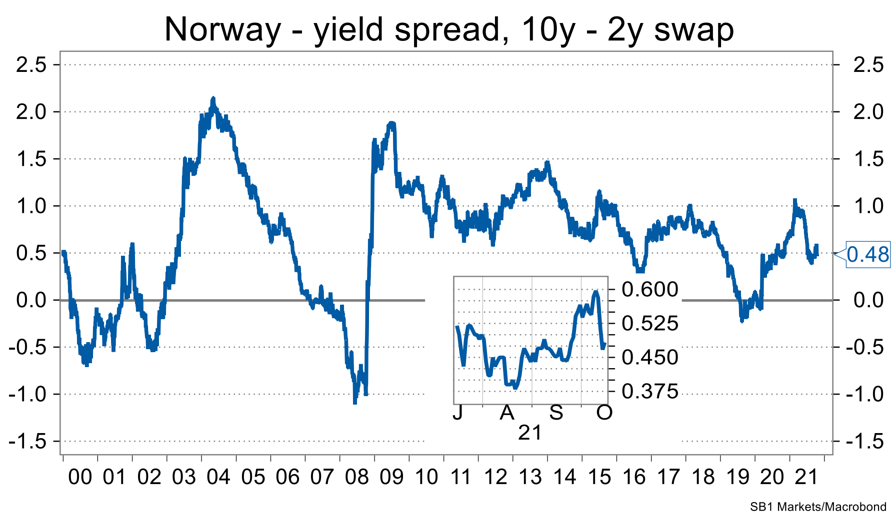


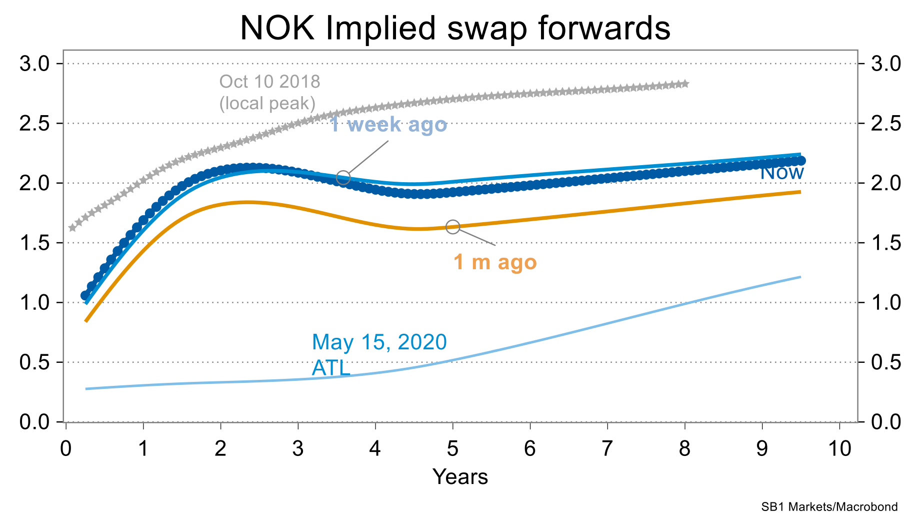


The short end up, rates from 2 y onwards (implied) down





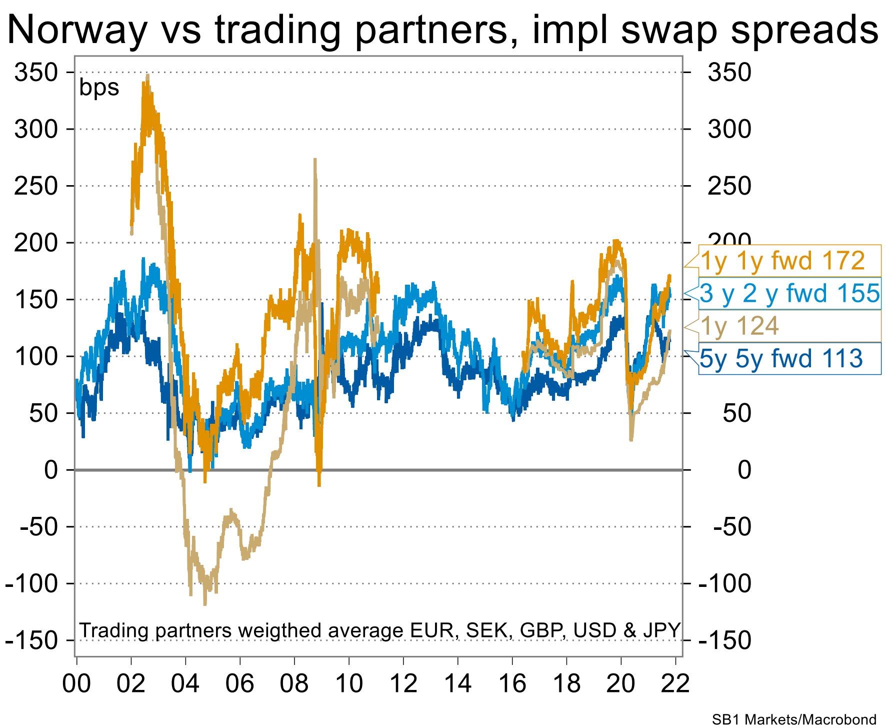


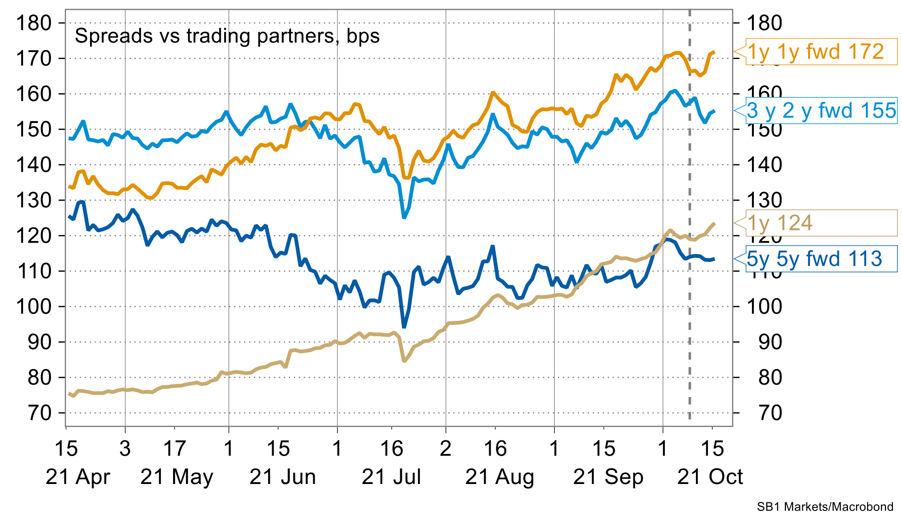


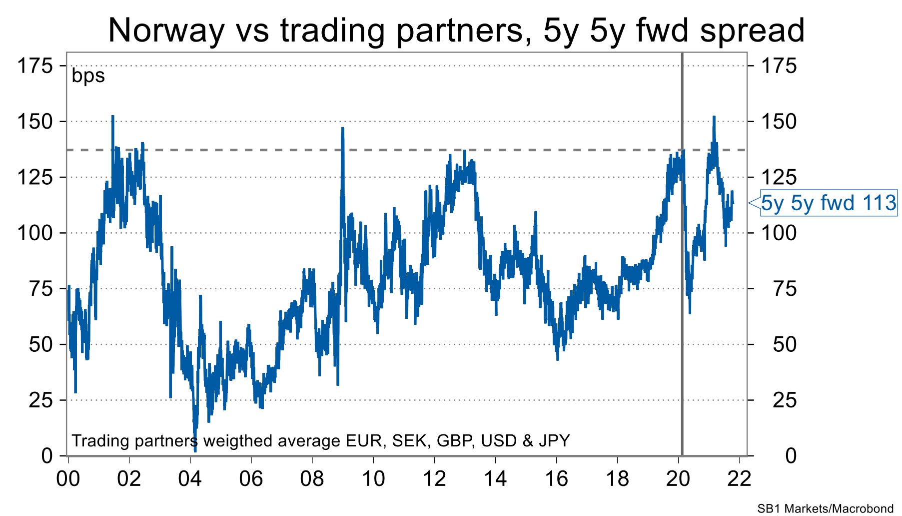
SpareBank 1 MARKETS

Forward spreads vs trading partners are drifting upwards again, all over the curve

Probably too early to make the call, but the upside potential for these spreads are not that large



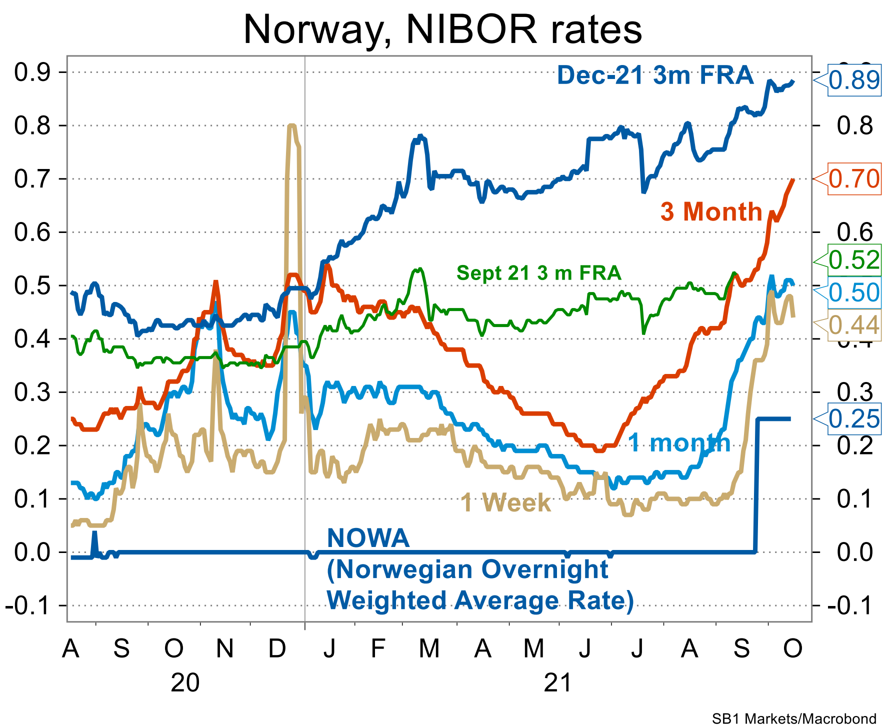


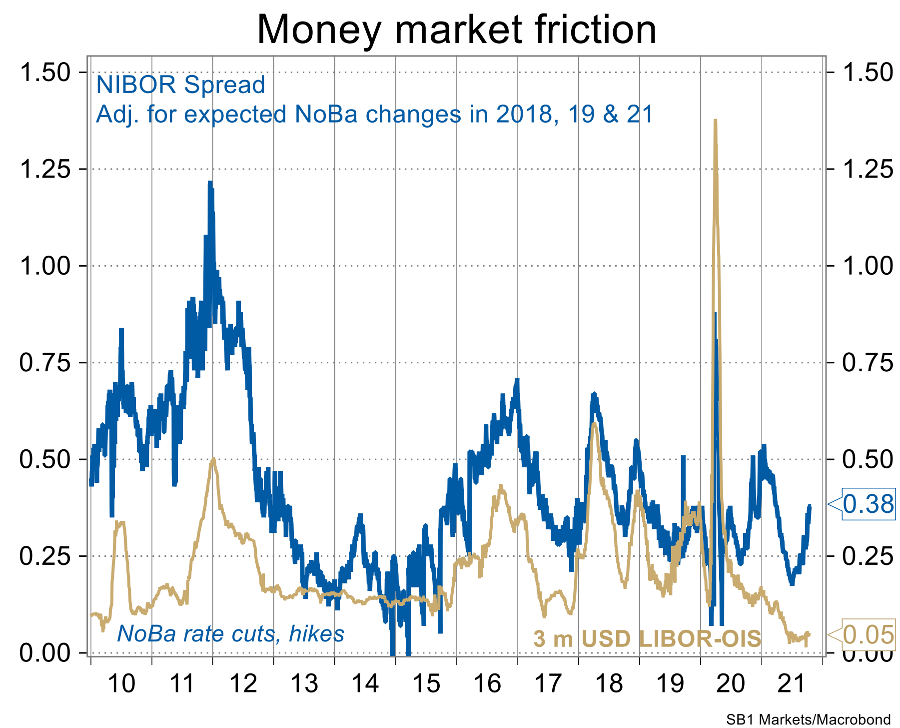


SpareBank 1 MARKETS

3 m NIBOR up 2 p 0.70%, the NIBOR spread is rapidly inching upwards

… up to 38 bps at Friday. Without any help from abroad



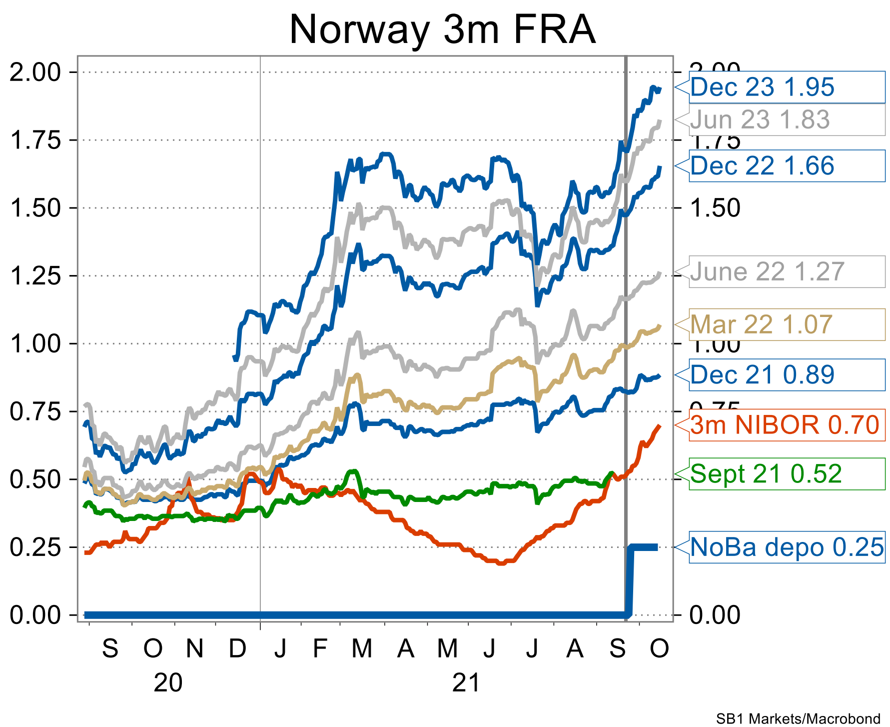


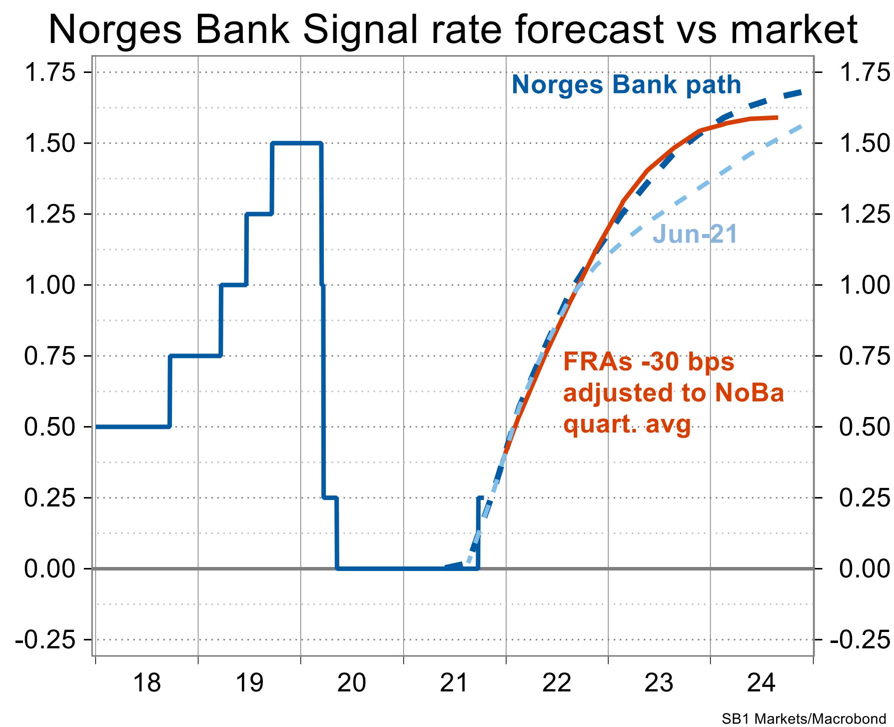
- Norges Bank assumed a 35 bps spread in the Sept MPR (as in the June report)

SpareBank 1 MARKETS

The FRA curve up by up to 8 bps – and is more aggressive than NoBa in '23?

Over the previous weeks, a substantial lift in the FRA curve

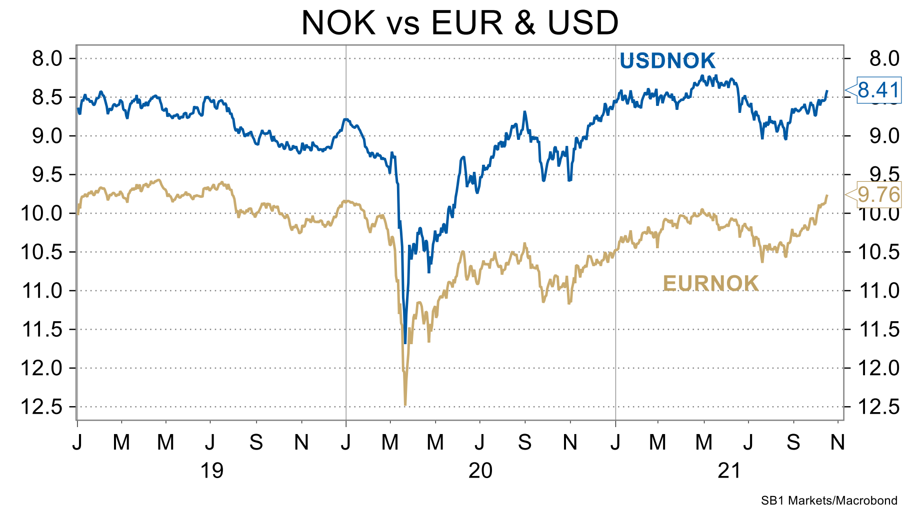


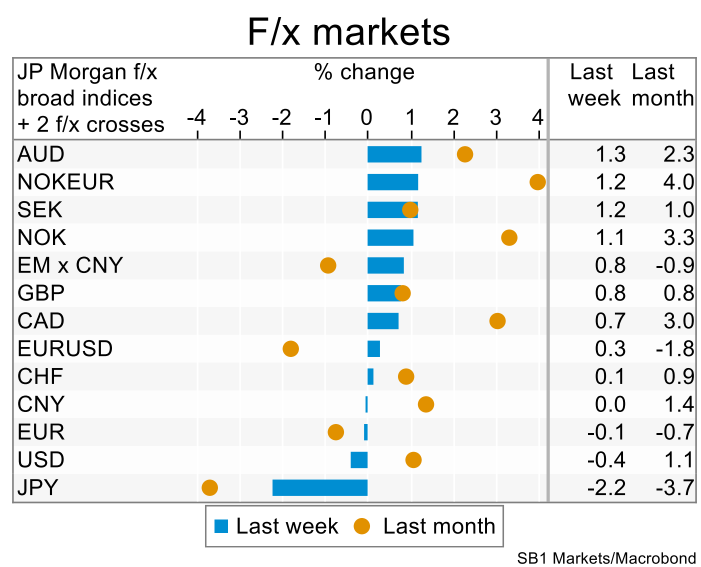


- We had revised our NIBOR spread estimate at the chart to the right to 35 bsp from 30. Still the curve is marginally above NoBa's (Sept MPR) path in 2023. Sure, the expected spread may be some basis points higher – and the two curves are spot on
- We assume the market is now fully discounting a hike in December, and very likely hikes in March and quite likely in June too. If NoBa hikes in both Dec and Mar, the June-23 FRA at 1.27%, and a NIBOR spread at 35 bps implies close to 70% for a 4th hike next summer

The super-cyclicals at the top last week – alongside GBP short term interest rates

JPY the big loser last week, as over the past month. BTW, NOK the winner last month

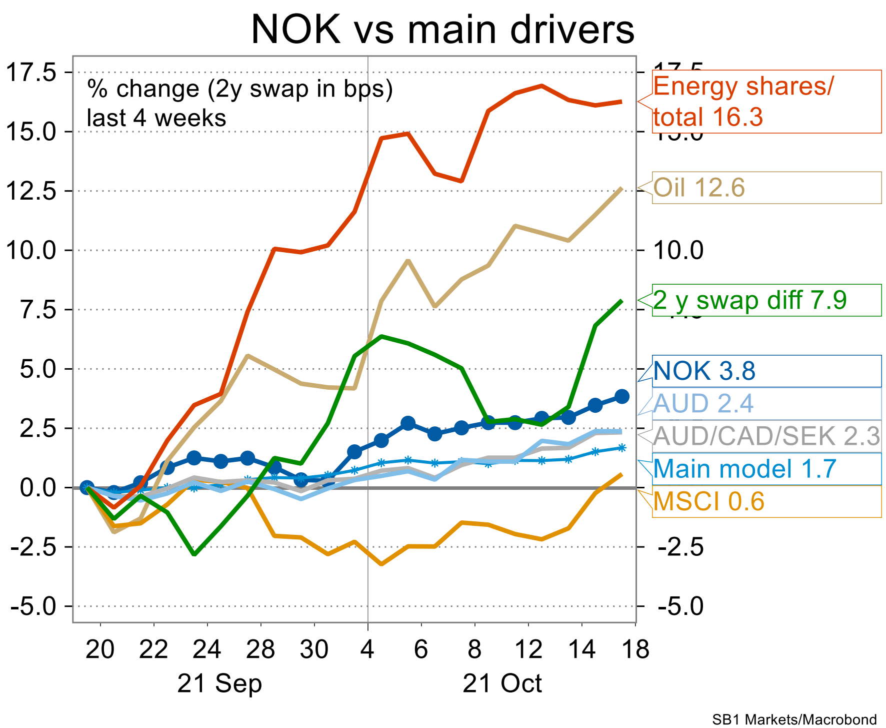


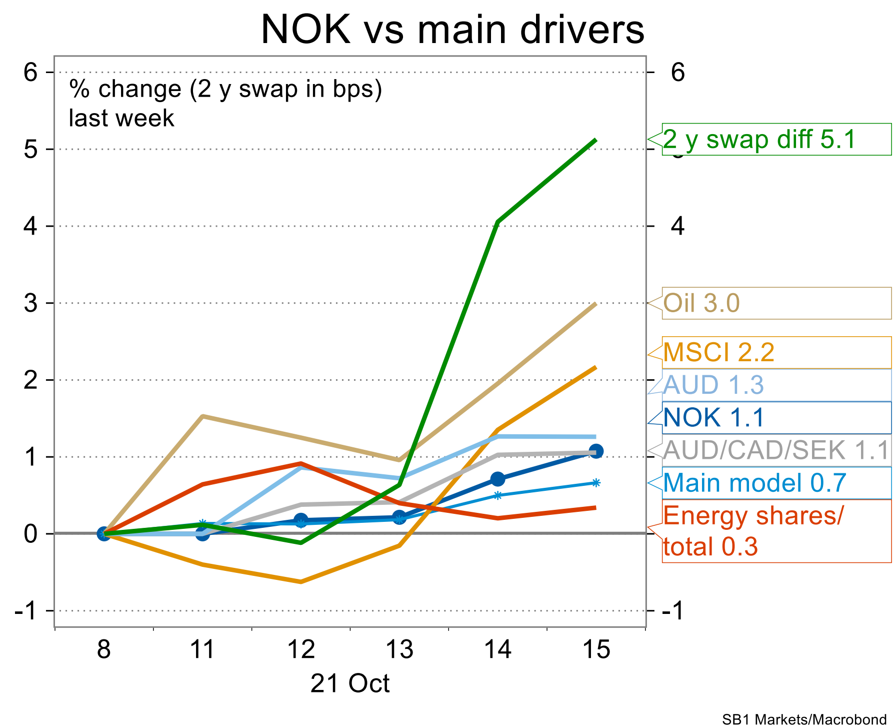


JP Morgan f/x broad indices + 2 f/x crosses	Last week	Last month
AUD	1.3	2.3
NOKEUR	1.2	4.0
SEK	1.2	1.0
NOK	1.1	3.3
EM x CNY	0.8	-0.9
GBP	0.8	0.8
CAD	0.7	3.0
EURUSD	0.3	-1.8
CHF	0.1	0.9
CNY	0.0	1.4
EUR	-0.1	-0.7
USD	-0.4	1.1
JPY	-2.2	-3.7

Up, up, up. The sun shines on the NOK, up another 1.1% last week

.. in line with our super-cyclical peers. Oil up 3%. NOK rates up, as were stock markets





The status vs. the normal drivers:

- ***The NOK is 1% stronger than suggested by our revised, green washed model (unch) (see more next page)***
- The NOK is less than 2 ‘weaker’ than the global stock market vs the correlation between the two since beg. of 2020 (unch)
- The NOK is 4% weaker than our AUD/CAD/SEK-model, our ‘super-cycle peers’, predicts (unch)
- NOK is far (10%) stronger than a model which includes global energy companies equity prices (vs the global stock market) (from 9)

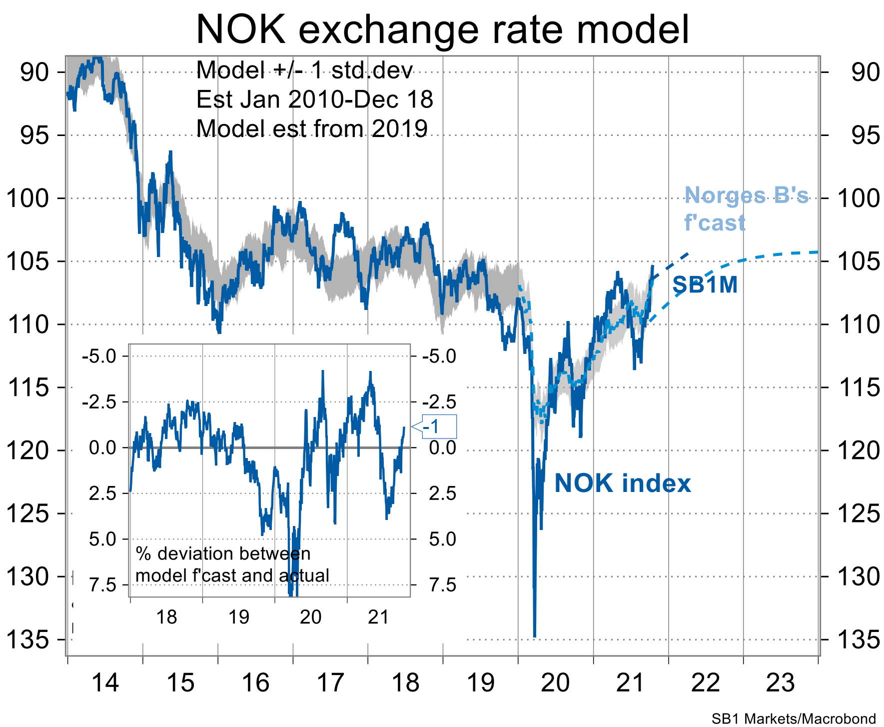
For October, we repeated our NOK buy recommendation, but less aggressively than for the previous months

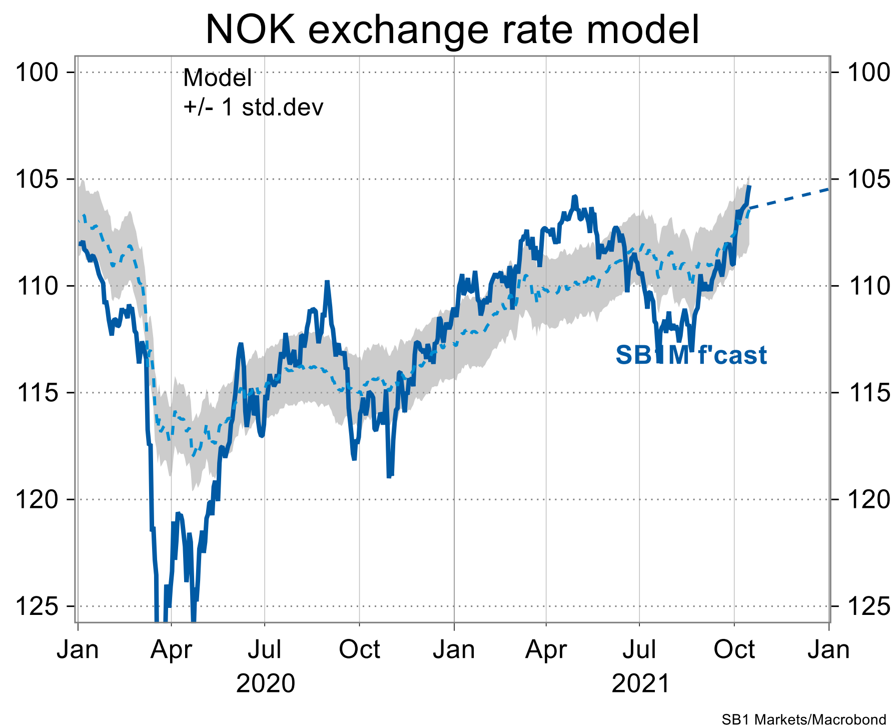
At this and the following pages we have swapped Norges Bank’s I44 index for JP Morgan’s broad NOK index and rebased it to the current index value for the I44. The I44 has an earlier closing time than the ‘official’ closing time for fx crosses. There are no substantial difference between these two indices over time

SpareBank 1 MARKETS

NOK 1% above our (new, green) workhorse model

We have adjusted our model due to the general reprising of fossil assets since early 2017



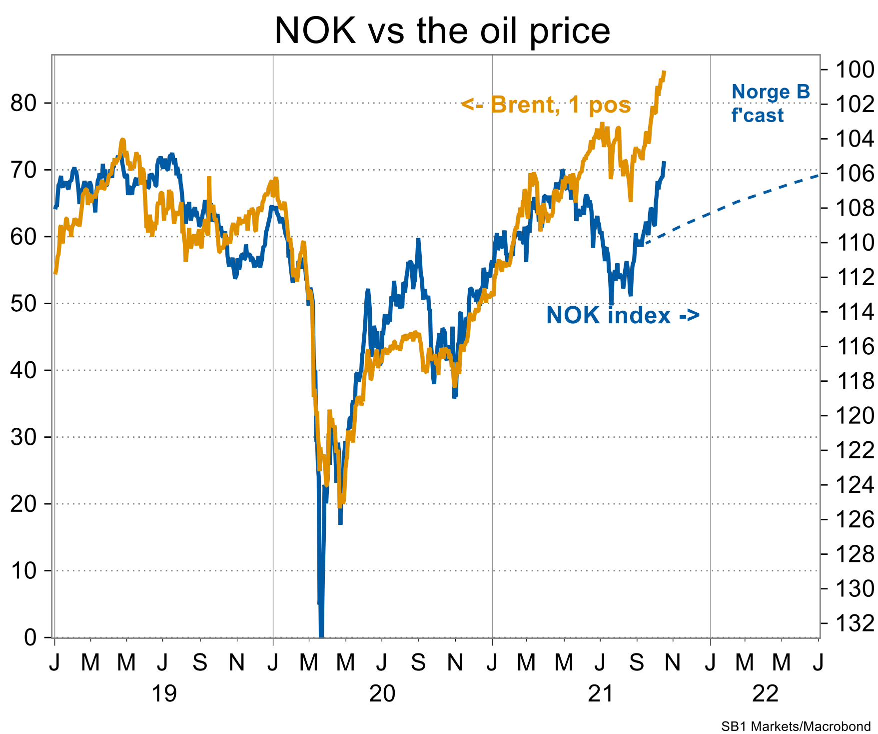


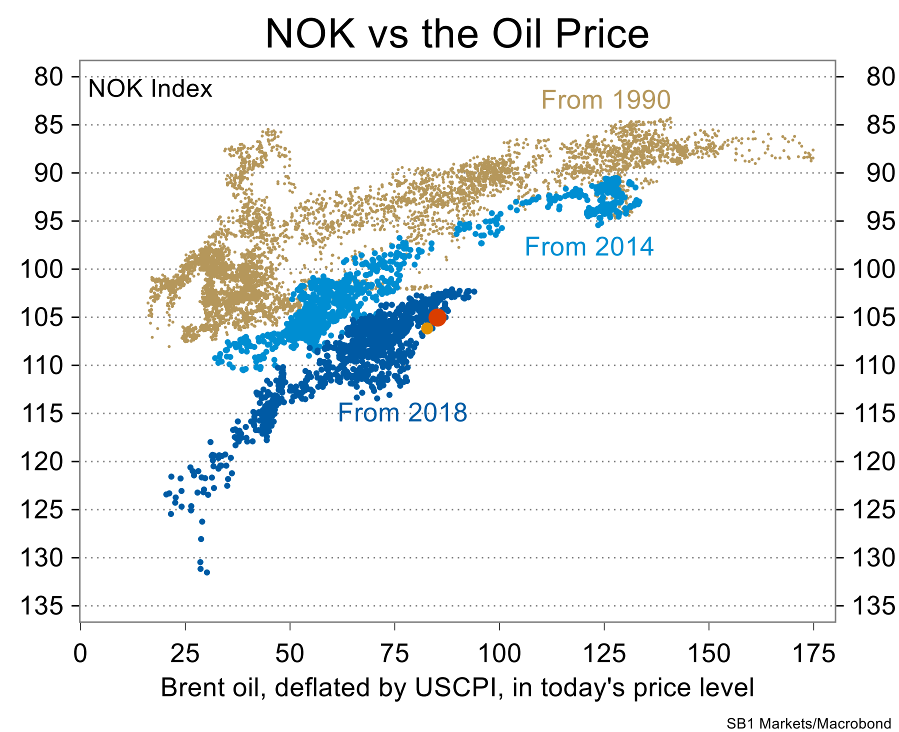
- We have long thought about this change, and our forecasts have been more than partly adjusted for the bias in our old model
- The model level is reduced by 7% from late 2019, in line with the weakening of the AUD, CAD and oil companies vs. the oil price
- It may now be that the current 'energy crisis' will bring the fossil industry and countries back in vouge, that is more than the rise in oil prices by itself explains, but be have not seen it so far

SpareBank 1 MARKETS

Oil and NOK up in tandem

The NOK is still on the weak side vs the oil price



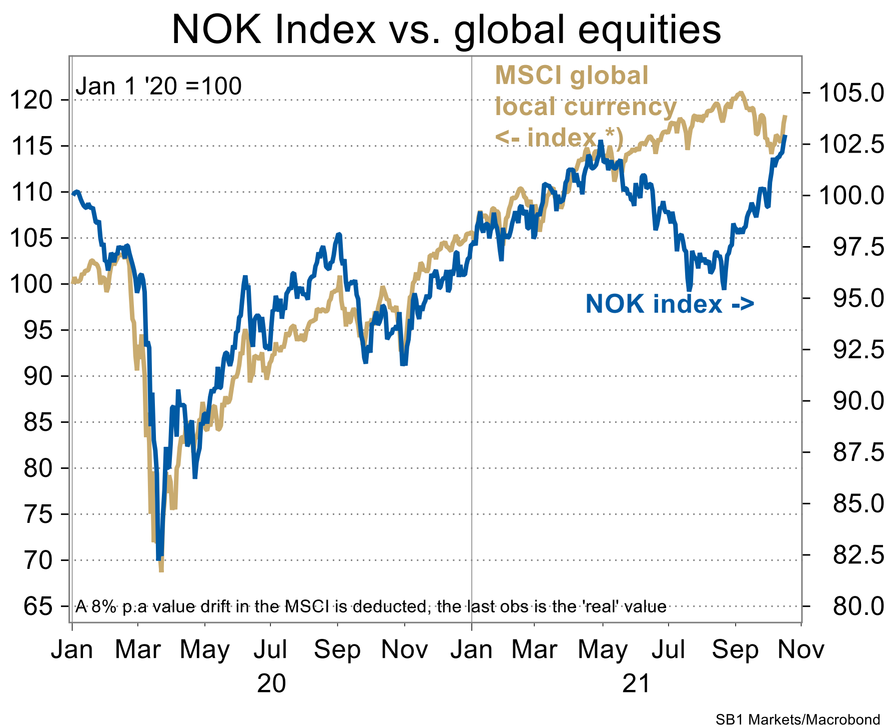


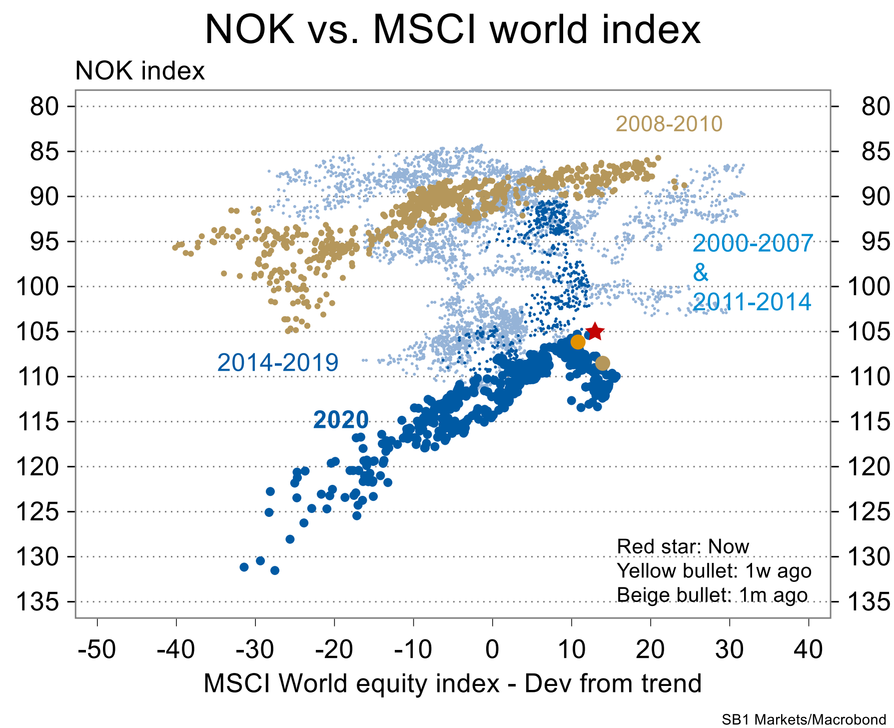
- NOK is still correlating quite closely to the oil price but at a lower level than before 2018 – and now the NOK is weak even vs the past 3 years' relationship
- A USD 10 drop in the oil price weakens the NOK by some 2.5%, as a partial effect. Within a broader model, the impact is somewhat smaller

SpareBank 1 MARKETS

The global stock market up, NOK up

The NOK has almost closed the ‘gap’ vs the stock marked – as the correlation broke down…

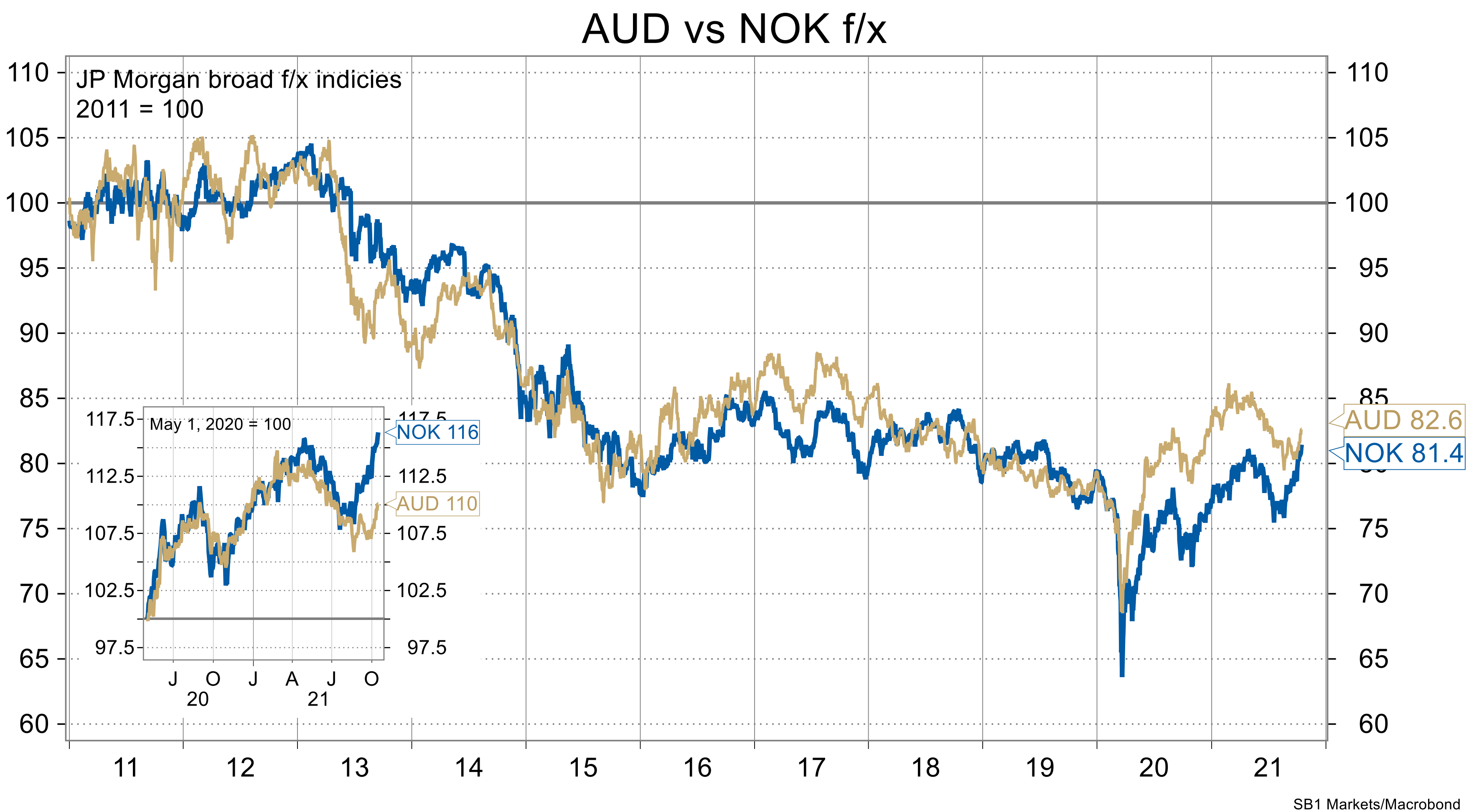




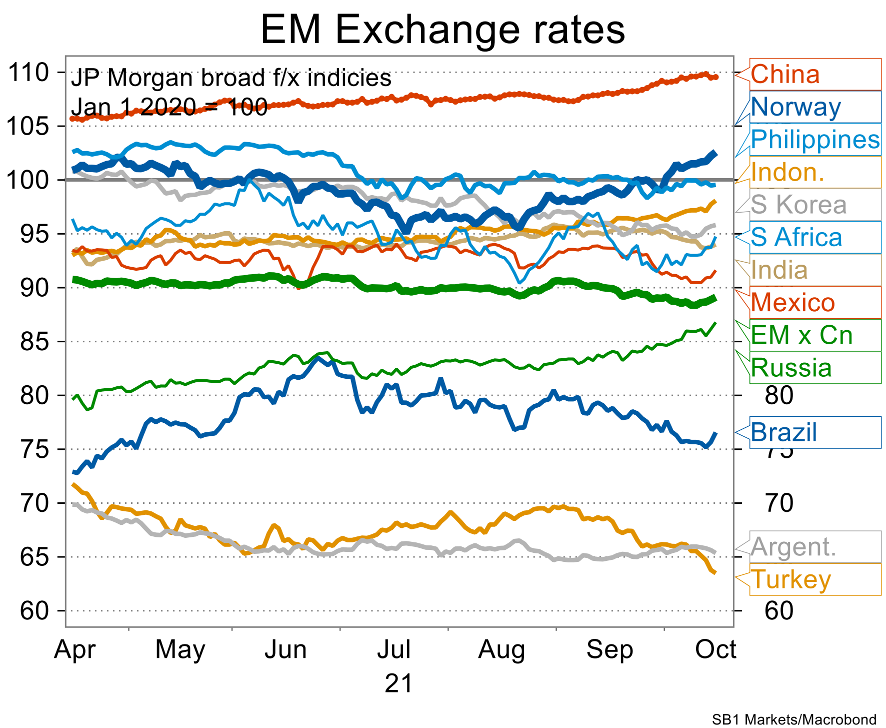
- Over time, there has not been any stable correlation between NOK and stock markets (the Oslo Stock Exchange, S&P 500 or the MSCI, the global equity index. (On the chart to the right, we have detrended the stock market as equities are drifting upwards, while NOK (hopefully) is stationary. However, the two has been pretty closely correlated from time to time
  - » Now, the NOK is close to par 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

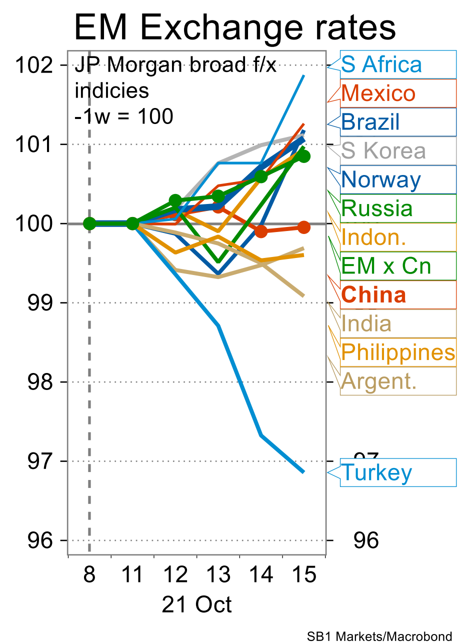
Both NOK and AUD up last week

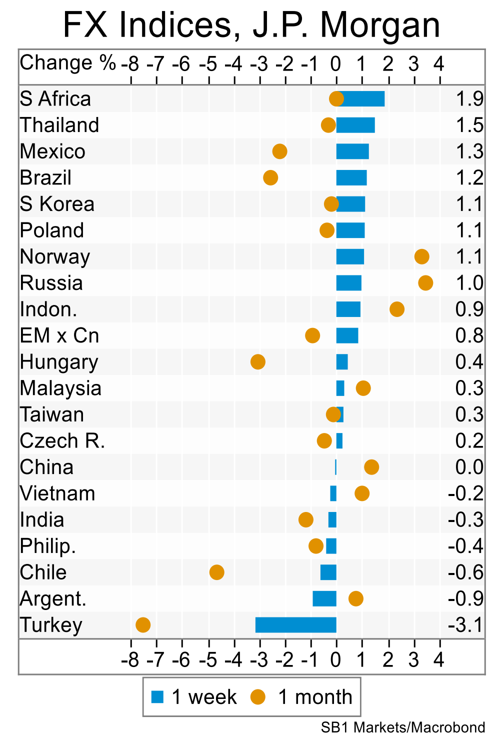
The two are almost back to the 2011 parity ☺ (from which they never since have deviated much)



EM x China recovered somewhat – and China flattened







DISCLAIMER

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

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

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

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

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

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

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

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

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