Macro Weekly

20 December 2021

Week 51/2021

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Highlights

The world around us

The Norwegian economy

Market charts & comments

Last week: The virus, part I

Still no consensus on the health consequences of the Omicron variant - and other data points are confusing too – 3 weeks into the 5th wave

South Africa

- Growth in new cases slowed further last week, and in the Gauteng province there is no growth at all, from incredible high growth rates the previous weeks. How come? Mobility is not that much reduced. Is herd immunity reached? What is the real infection rate with Omicron??
- Growth in hospitalisation slowed in both Gauteng and in S-A in total. The hospitalisation rate has fallen to 6% from some 20% in average during earlier waves (but data have been volatile). Of those hospitalised:
  - approx. 9% need treatment in a ICU unit, down from 15 – 20% - a 50% reduction
  - 3% need treatment in a ventilator, down from 7 – 10%, a 66% reduction
  - 14% are given oxygen, down from approx. 20%, a 40% reduction

  In sum, if 1/3 as many as hospitalised as with Delta, and 66% fewer of them need the most intensive care in a ventilator, the health risk when infected by Omicron may be some 1/10 of a that from a Delta infection
- **Death stats** confirm that Omicron creates less sickness in S-A, the CFR has fallen to 0.2%, less than 1/10 compared to earlier waves

Denmark

- Omicron cases are exploding:
  - Omicron cases up 11 x last week. 14' were infected, up from 1.200 – in a 'fully' vaccinated population
  - Other strains were up 1.2 x. 45' were infected last week, up from 37'
  - Late last week, Omicron approached some 35% of the virus market, and will very likely take it all in some few days as mobility falls due to restrictions/individual behaviour – but not sufficient to stop the Omicron from spreading rapidly
- Danish researchers report than 1% of those infected need hospital treatment, in line with the earlier strains (which though have reported higher rates) . If they are correct, a disaster of course, given the explosion of cases. Hospital data will be essential the coming week! So far, no explosion

Norway

- The no. of cases flattened last week. The spread of the Delta virus is very likely reduced by a substantial reduction in mobility. In number terms, the Omicron variant is not yet able to compensate for the decline in Delta cases. However if Omicron spreads like in Denmark (and it seems unreasonable to assume anything but that), growth in new cases will pick up again. New restrictions were imposed but far from a full lockdown

Elsewhere

- Several research projects confirm the hypothesis that Omicron seem to be less harmful as it attacks and stay in the upper respiratory system, not deep down in the lungs. At the same time, it spreads far easier
- Still, we have seen no reference to research stating that the risk for hospitalisation due to Omicron is significantly lower in the rich part of the world, even it that seems to be the case in South Africa
- Late last week, the Omicron 'came' to the US, at least as an important topic

Last week: Concerted central bank action, more hawkish than expected in UK/No

- **Federal Reserve** confirmed a more rapid tapering, and paved the way for a spring hike in the Fed Funds rate – the market says 50/50 for a March hike. The dot plot (the FOMC members interest rate paths) were lifted more than ever, by up to 70 bps, as the no. of hikes were doubled to 6 before end of 2023.Thus, a highly unusual policy shift but still not a surprise. Powell told us that he acknowledged that inflation was not transitory, and that policy had to be tightened more than 2 weeks ago (after been re-nominated…), and several FMOC member started weeks/months ago. (At the press conference Powell told us vividly about the indicators that came in, which literally (finally) brutally made him change his mind (the ECI, labour shortages, prices increases etc, a really memorable moment!). Powell also reasoned on when the maximum employment target is met: In the end, wage inflation will tell us, he said – just as we always have been stressing – and then he said that the labour market was tight, and the wages were rising faster…
  - » The very short end of the curve rose some few bps but from 2023 and onward, implied rates fell, and just technology stock struggled. (By end of week, stocks fell probably more due to Omicron worries, than fear of tightening)
  - » Even so, there a challenges ahead: The FOMC expect the price level to deviate sharply from the 2% path the coming years. At the same time, maximum employment target must more than fulfilled at least next year, as unemployment is expected to fall to 3.5% and stay there, at a level below the assumed 4% NAIRU rate. Thus, the Fed misses both of its two targets, at the 'same side'. That's not according to the textbook on flexible inflation targeting
  - » Wage inflation will not slow before demand for labour weakens substantially. So, expect more policy tightening, if the economy does not slow by itself. In fact, historically recessions have usually been the remedy for such problems. In addition, higher wage inflation will make a solid dent into profits the coming 2 years, as always when the labour market is too tight. The outcome for richly priced risk markets seems to be sealed whatever outcome, growth will slow substantially with or without higher rates
- **The ECB** decided to end the EUR 80 bn/month pandemic bond buying program (PEPP) by March, as indicated earlier. To compensate for the abrupt halt, the ordinary APP asset purchasing program will increase its buying by EUR 20 bn/month in Q2, and 10 bn/m in Q3, and then continue at the 'underlying' pace of EUR 20 bn/m in Q4. In sum, QE is scaled substantially back. Still QE will continue. Inflation has moved up at the agenda, but no interest rate hike is in the cards before 2023, Lagarde stressed. Wage and price inflation is far less of a problem in the EMU compared to the US. A far less expansionary fiscal policy explains at least some of the discrepancy
- **Bank of England** surprised the market by a 15 bps hike to 0.25%, even if Omicron worries are increasing by the day in the UK. Inflation is accelerating and the bank signals that monetary policy will have to be tightened. Markets expect the BoE to hike 4 times next year
- **Norges Bank** hiked the signal rate to 0.5% and lifted the interest rate path from early 2023. We expected a hawkish pause, no hike but a steeper interest rate path from H2 next year. If the bank had followed its main model results mechanically (which it should not at all times), our hawkish pause would have been the outcome, as almost all factors contributed at the upside. A much larger and longer lasting downward revision of 'domestic Mainland demand' than we assumed kept the interest rate outlook in check. We are not sure the drag will materialise. Thus the risk is still on the upside – as soon as the virus is gone, that is
- **A lot of EM central banks** hiked their signal rates, and in the EM x China universe, rates are in average back to the pre pandemic level. Just **Turkey** cut the policy rate, and the LIRA plunged another 15% last week. How dare the central bank accept a 6.3% negative real interest rate? They must be crazy!

Last week: The economy

- **Preliminary December PMIs**
  - » **The preliminary PMIs** were weaker that expected, and we forecast a 0.9 p decline to 53.9 – which is still above average, signalling almost 4% global GDP growth, well above trend. **The manufacturing PMI** rose marginally (the output index) while **services** reported slower growth everywhere – no doubt due to the virus challenges. **UK and Germany** was hardest hit. The delivery times index eased, as did prices indices in the manufacturing sector (however not in services), signalling the inflation may be close to peak too. Raw material prices/freight rates have also flattened/declined somewhat
- **China**
  - » **November data** confirmed underlying slower growth but no further slowdown. **Investments and retail sales** have entered new growth paths, far below the pre-pandemic trajectories. **Construction starts (and sales)** rose somewhat following the 20 – 25% setback during 2021 but it may just be white noise. **Home prices** are falling but just at a measured pace and no buyers' strike is to be seen. We think 'investor' demand for (mostly) empty homes is biggest China risk, as real estate developers cant be taken care of (restructured) as long as somebody want to buy the stuff. **Industrial production** is growing at a slower pace but remains above the pre-pandemic growth path, supported by incredible strong exports (supported by incredible strong demand for Chinese goods, especially in the US). Steel production stabilised in November
- **USA**
  - » **Retail sales** surprised at the downside, and core goods volumes probably fell – but they remain 19% above the pre pandemic level! **Housing starts** were better than expected. **Manufacturing production** is recovering and just auto production is still low, 14 below the pre pandemic level
  - » Small businesses are rather pessimistic vs the outlook, but NOBODY complains about sales/competition and everybody complains about labour shortages, cost & quality. Never before have some many companies reported they plan to hike prises the coming months!
  - » The **PP**I reporting hilarious prices increases but there are some good news: **Crude prices ex food and energy** are easing, always the canary in the mine
  - » The Biden **Build Back Better** 'social infrastructure' plan have probably stranded, as senator Manchin (D) flagged he would not support it
- **EMU**
  - » **Labour cost inflation** may be higher than before, but the underlying trend is no more than 2¼ % (vs. 1%+ until 2017), still too low to generate 2% growth in Unit Labour Cost, or 2% CPI inflation over time
  - » **Inflation** has surged in the EMU too, but there are not many warning lights compared to the US. Base effects and energy explains the most of the current high annual growth rates
- **Norway**
  - » **NAV registered unemployment** fell further in the first part of December, and at 2.3% (unch at the 1st decimal), the rate was 0.2% below NoBa's f'cast. However, now companies within the hotel & restaurant sector may furlough many workers again as restriction and changes in consumer behaviour have sharply cut demand. A new wage compensation scheme, that was made much more attractive at Sunday night, might make the surge in real unemployment invisible at the NAV. New vacancies fell too – and the no. of new jobless claims rose too
  - » The **trade surplus** was fantastic in November too, guess you know why. BTW, Mainland exports are up almost 30% last year (but that is not the big contributor)
  - » **Consumer confidence** plunged in December, according to the Opinion survey. In Nov+Dec, a 3.5 st.deviation decline, a full cycle downturn to almost all time low. Seems like we not appreciate the high electricity prices nor the virus circumstances. For good reasons

The Christmas Calendar: Focus will still be at the Omicron variant

Time	Count.	Indicator	Period	Forecast	Prior
Monday Dec 20					
08:00	NO	Housing starts	Nov		
16:00	US	Leading Index	Nov	0.9%	0.9%
Tuesday Dec 21					
06:00	SW	Home prices			
09:00	SW	Economic Tendency Survey	Dec		118
09:00	SW	Consumer Confidence	Dec	99	99.7
16:00	EC	Consumer Confidence	Dec A	-8.1	-6.8
Wednesday Dec 22					
09:30	SW	Retail Sales MoM	Nov		0.4%
14:30	US	Chicago Fed Nat Activity Index	Nov	0.4	0.76
14:30	US	GDP QoQ, final est	3Q T	2.1%	2.1%
16:00	US	Conf. Board Cons. Confidence	Dec	111	109.5
16:00	US	Existing Home Sales	Nov	6.53m	6.34m
Thursday Dec 23					
08:00	**NO**	**Unemployment Rate AKU**	**Oct**	**(3.5%)**	**3.6%**
08:00	**NO**	**Payroll stats, wages**	**Nov**		
14:30	US	Initial Jobless Claims	Dec-18	205k	206k
14:30	US	Personal Income	Nov	0.5%	0.5%
14:30	**US**	**Personal Spending**	**Nov**	**0.6%**	**1.3%**
14:30	US	PCE Deflator YoY	Nov	5.7%	5.0%
14:30	**US**	**PCE Core Deflator MoM**	**Nov**	**0.4%**	**0.4%**
14:30	US	PCE Core Deflator YoY	Nov	4.5%	4.1%
14:30	US	Durable Goods Orders	Nov P	2.0%	-0.4%
14:30	US	Cap Goods Orders Nondef Ex Air	Nov P	0.7%	0.7%
16:00	US	New Home Sales	Nov	770k	745k
Christmas days					
Monday Dec 27					
00:50	JN	Retail Sales MoM	Nov		1.1%
08:00	**NO**	**Retail Sales W/Auto Fuel MoM**	**Nov**	**(-1.5%)**	**1.0%**
Tuesday Dec 28					
00:50	JN	Industrial Production MoM	Nov P	4.2%	1.8%
15:00	US	S&P CoreLogic CS 20-City YoY	Oct	18.5%	19.1%
Wednesday Dec 29					
10:00	EC	Credit growth	Nov		
14:30	US	Advance Goods Trade Balance	Nov	-$88.7b	-$82.9b
Thursday Dec 30					
14:30	US	Initial Jobless Claims	Dec-25		
Friday Dec 31					
02:00	CN	Services PMI	Dec		52.3
02:00	**CN**	**Manufacturing PMI**	**Dec**	**49.9**	**50.1**
During the next week					
	GE	Retail Sales MoM	Nov	-0.1%	-0.3%

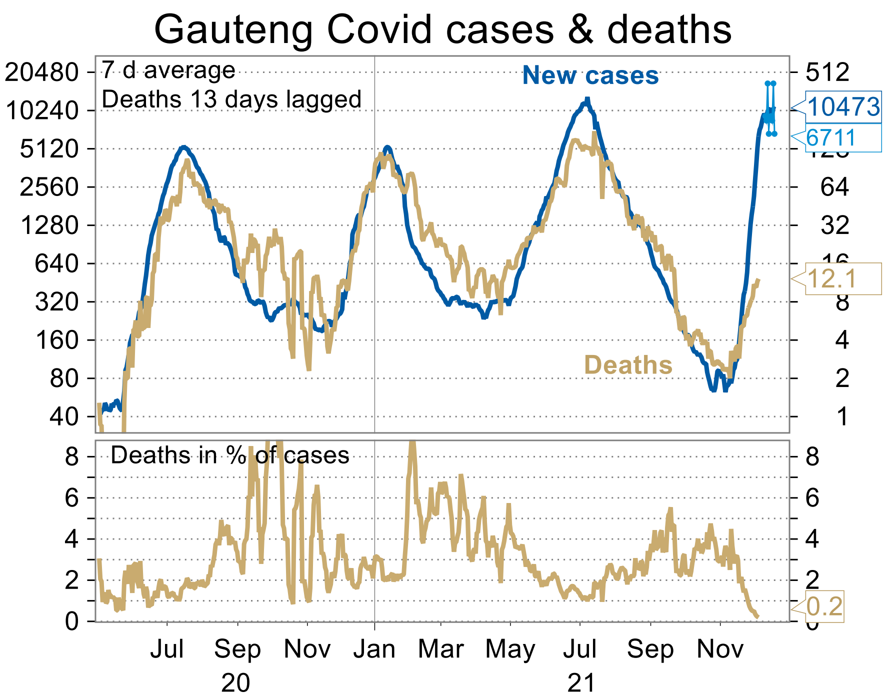
- **China**
  - On new year's eve, the Chinese **December PMIs**. So far they have signalled somewhat slower growth than normal but no abrupt slowdown, in line with real economy stats
- **USA**
  - **Personal spending** slowed in November, but probably remained above a decent **income growth** – and if so, the savings rate fell further, from a level equal the pre-pandemic position
  - **Durable orders** are still going strong, and surveys do not indicate any slowdown
  - **New and existing home sales** and well as the best 2nd hand **price indices** will probably reveal a still robust housing market. However, the mortgage spread (vs gov bonds) have widened by 60 bps (30y) from the bottom very likely as the tapering has become a reality, and the decline in the long bond rate has not been felt by homebuyers
- **EMU**
  - **Consumer confidence** has fallen somewhat, but nothing like we have seen in the US or Norway. December will turn out to be more troublesome? **Credit growth** is still modest
- **Norway**
  - **The LFS (AKU) unemployment** has fallen sharply recent months, and will probably decline further in October (avg Sept-Nov) – with no impact from the current lockdown in the hotel/restaurant industry. The **payrolls statistics** with wages will be published too, probably the best gauge for employment growth – which has impressive. Until 2nd half of December, that is
  - **Retail sales** rose in November but we are still confident the level above the long term trend

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

SpareBank 1 MARKETS

Gauteng, South Africa: New cases are slowing rapidly

Mobility is not much altered – is herd immunity reached? Is testing abolished?



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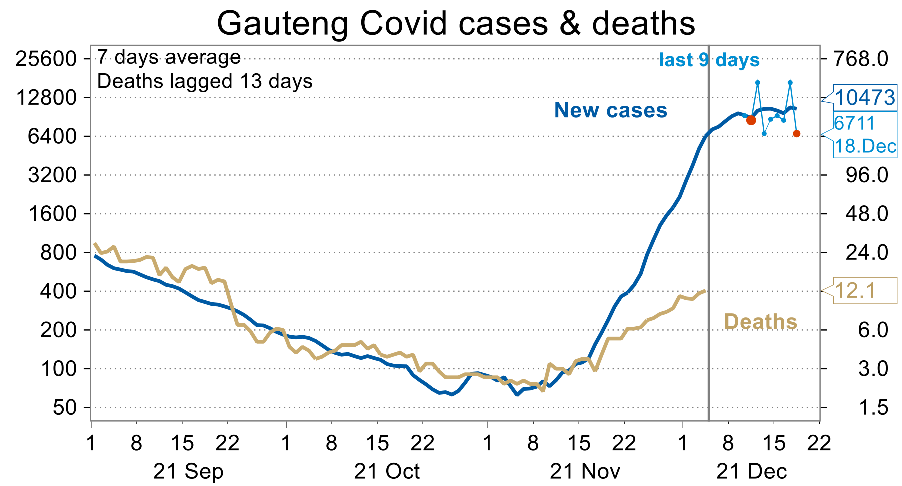

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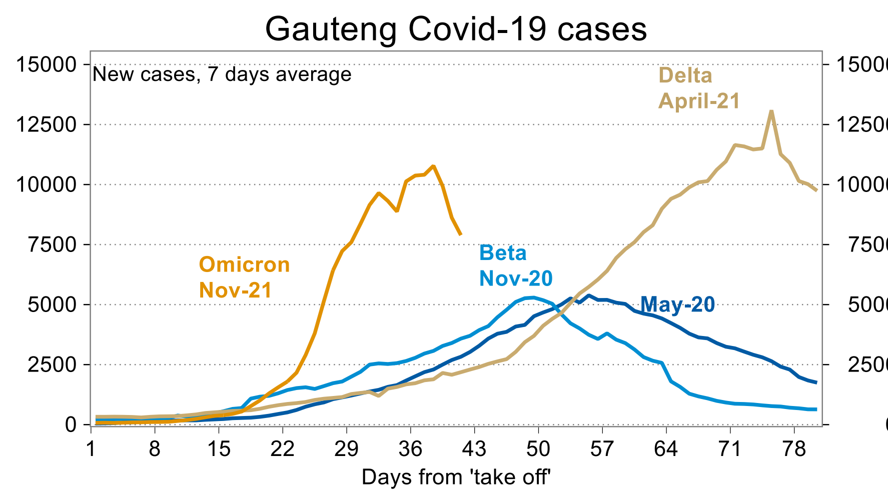

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- Mobility has not changed much in South Africa, like we have seen during previous virus waves – because the population recognises that Omicron is not that dangerous, health wise? (See more next page)
- Gauteng has typically reported a Case Fatality Rate at 3% but with huge variations, 1 – 8%. Now the CFR is at 0.2% and this number probably includes patients that have been hospitalised before being infected, or have had other health problems, in addition to a Covid infection

One outlier for both new cases and deaths are corrected

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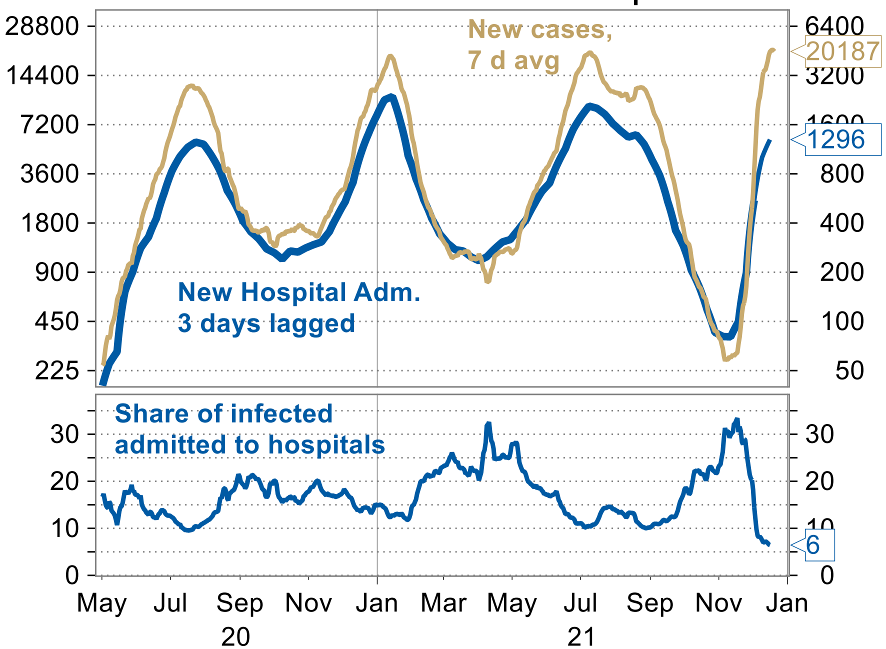
South Africa: Growth in new cases is slowing sharply

In addition, growth in new hospitalisation is slowing too – 6% of positive cases are admitted

South Africa Covid Cases & hospitalisations



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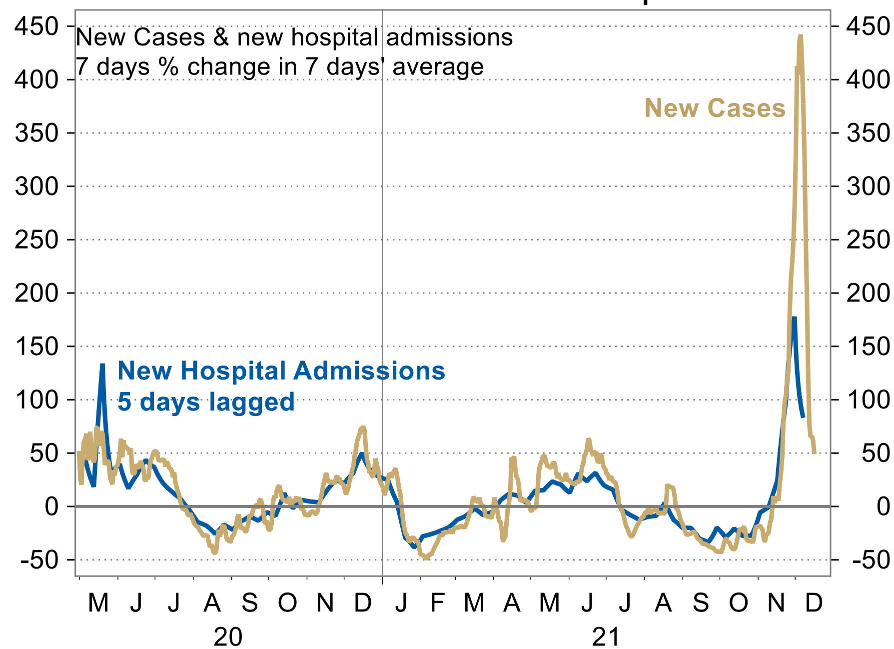
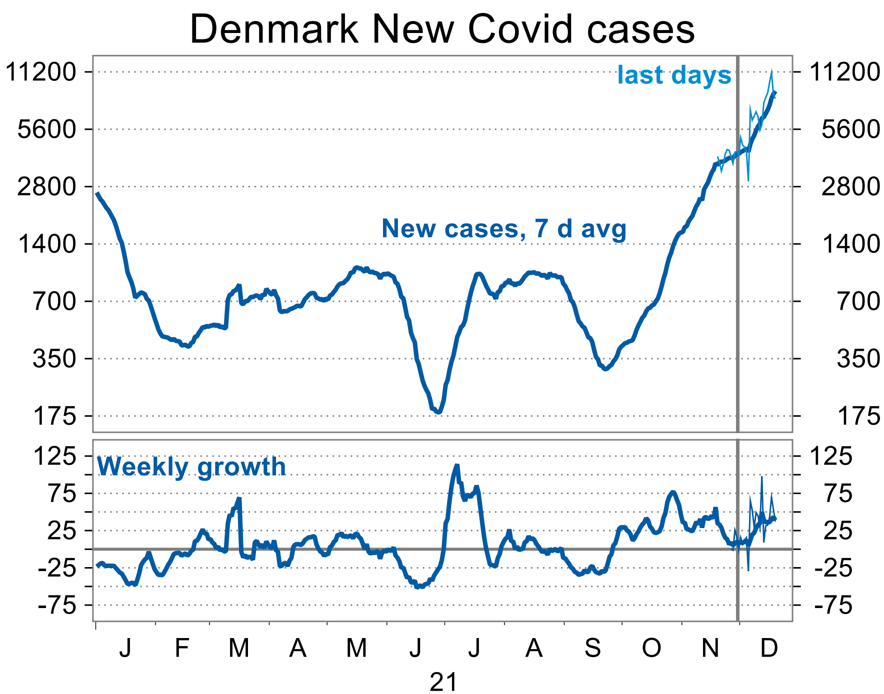
South Africa Covid Cases & hospitalisations

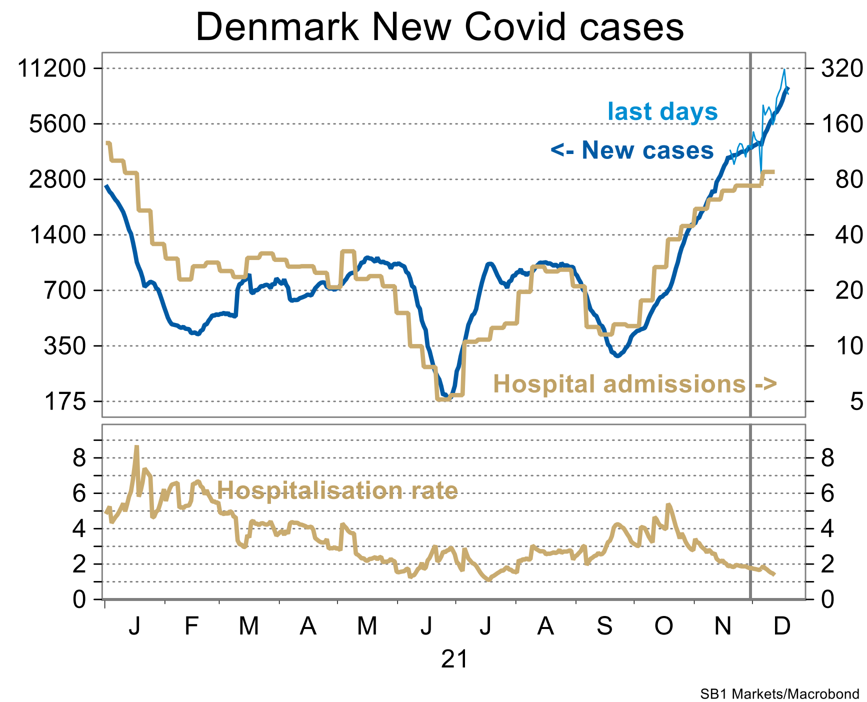


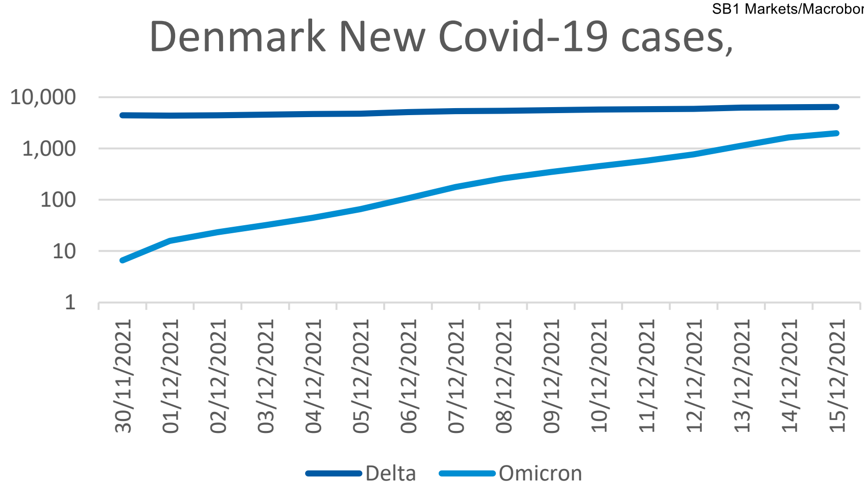
SB1 Markets/Macrobond

- The average hospitalisation rate have been some 20%, now its down to 6%. However, the rate has been rather volatile over time – but the present rate is the lowest ever measured
  - » The S-A health minister last week said that the hospitalisation rate was below 2%. We are not sure what figures he is referring too. We did not recognise any of the other data he presented either (we are using the official S-A NICD data)
- The no. of new admissions to hospitals rose by almost 90% last week (preliminary data), which is still lower than the growth in new cases some days earlier
- The no. of patients in hospital rose by 40% last week, which also is less than the growth in cases some days earlier. The no. of patients is approx. ½ vs. previous peaks
- So far in the 'Omicron wave', 175' persons have tested positive in the Gauteng region or 1.4% of the population (330' in whole S-A, 0,6%)
- **The 'only important' question now is of course what the real case number has been**. The real no. is much, much higher than the no. of positive test cases. If herd immunity is reached, though depending of the rate of previous infections, vaccinations etc) , it would of anyway of course be a terrific story – the virus is beaten down without serious problems in the hospital sector

Denmark is on the alert: Omicron up 11 x last week, Delta 1.2





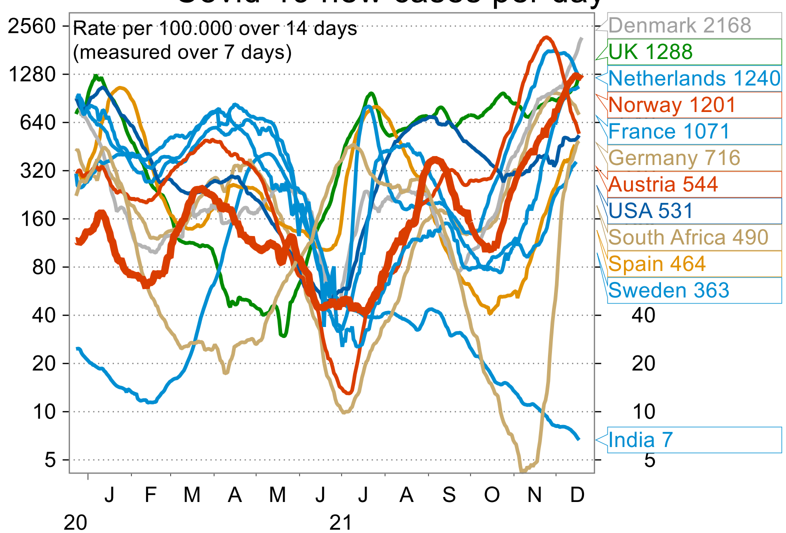


- Omicron cases are exploding:
  - » Omicron cases up 11 x last week. 14’ were infected, up from 1.200 – in a ‘fully’ vaccinated population
  - » Other strains were up 1.2 x. 45’ were infected last week, up from 37’
  - » Omicron will capture the virus market is just some few days, barring a miracle
- The hospitalisation rate has fallen somewhat, but the calculus is uncertain as the number of cases is growing rapidly. The rate is still above 1%. We will soon know the real hospitalisation rate of Omicron

Denmark at the top of the list!

- 16 countries were reporting more cases the last week up from 14 last week
- 25 countries reported fewer cases, down from 28 last week
- **Austria** is still reporting a ‘collapse’ in new cases, the R is <<1!
- **Denmark, UK, Iceland, Sweden, Canada, Italy, Spain** are reporting steep increase in cases, - and up to a record number in Denmark and UK, the epicentres for Omicron in Europe
- **Netherlands** decided a tougher lockdown, even the total no. of cases is falling – because Omicron is exploding from beneath
- **Norway** stabilised last week – but for how long will that last

Covid-19 new cases per day



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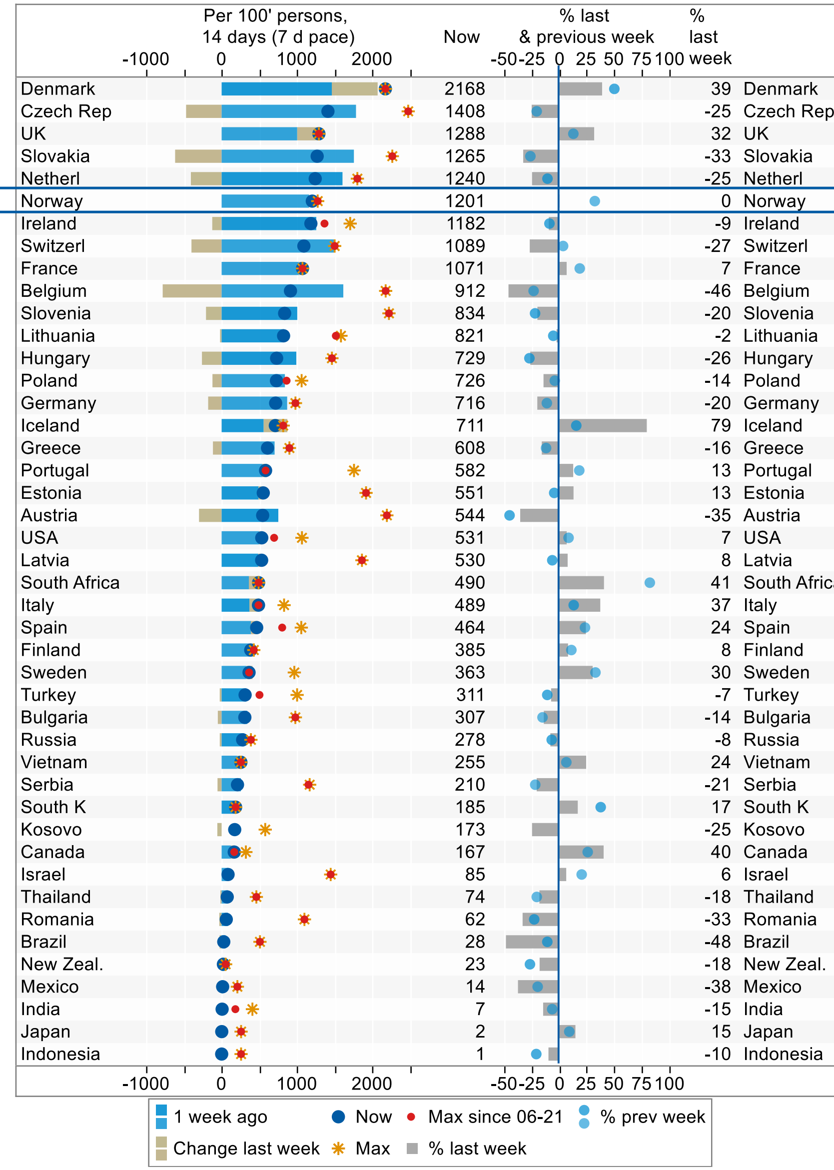
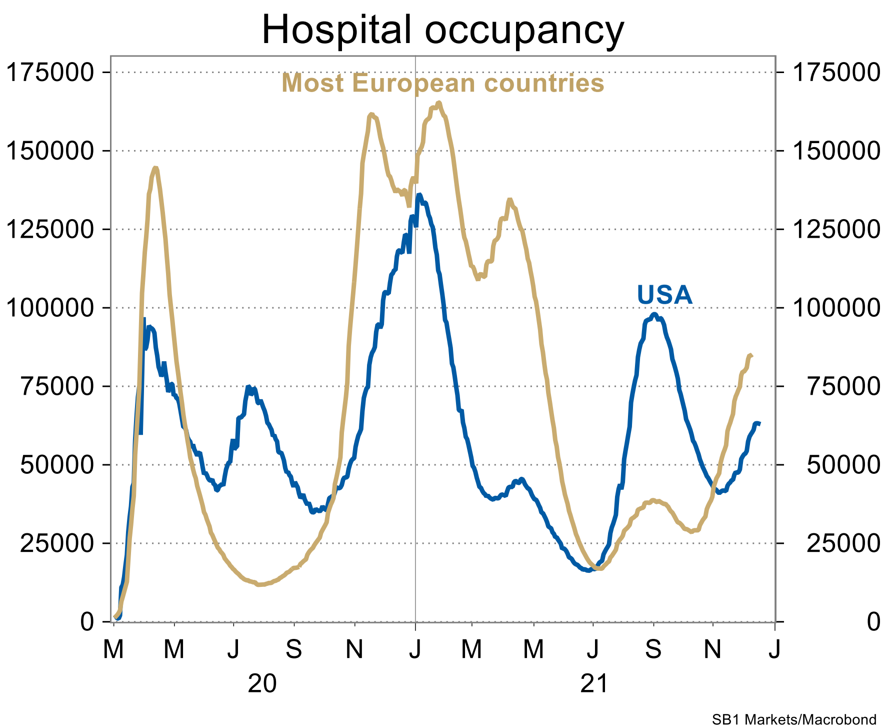
COVID-19, New Cases

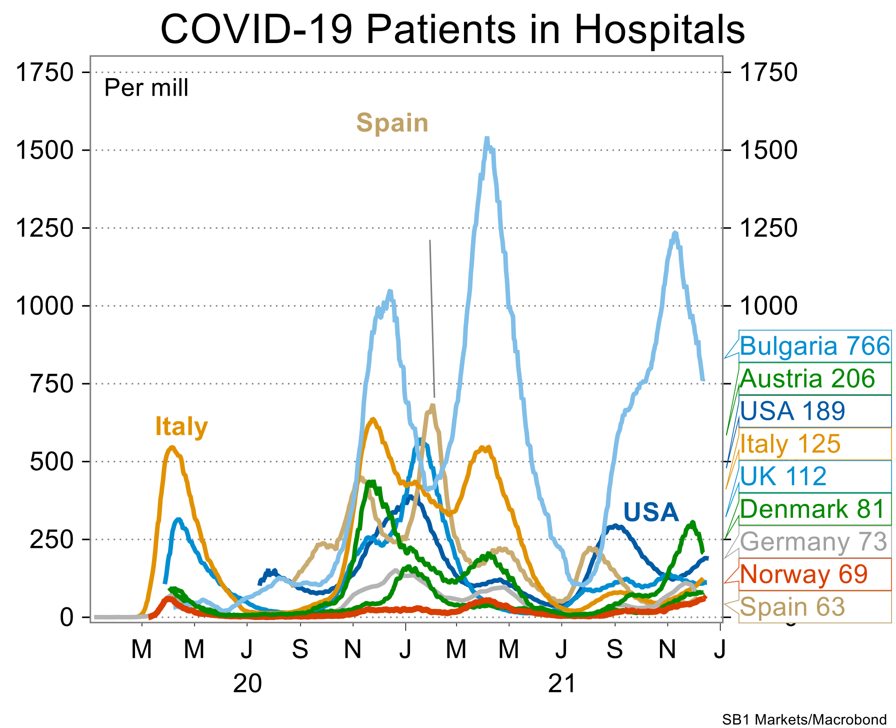


SB1 Markets/Macrobond

More hospitalisations in Europe, and the in the US as well

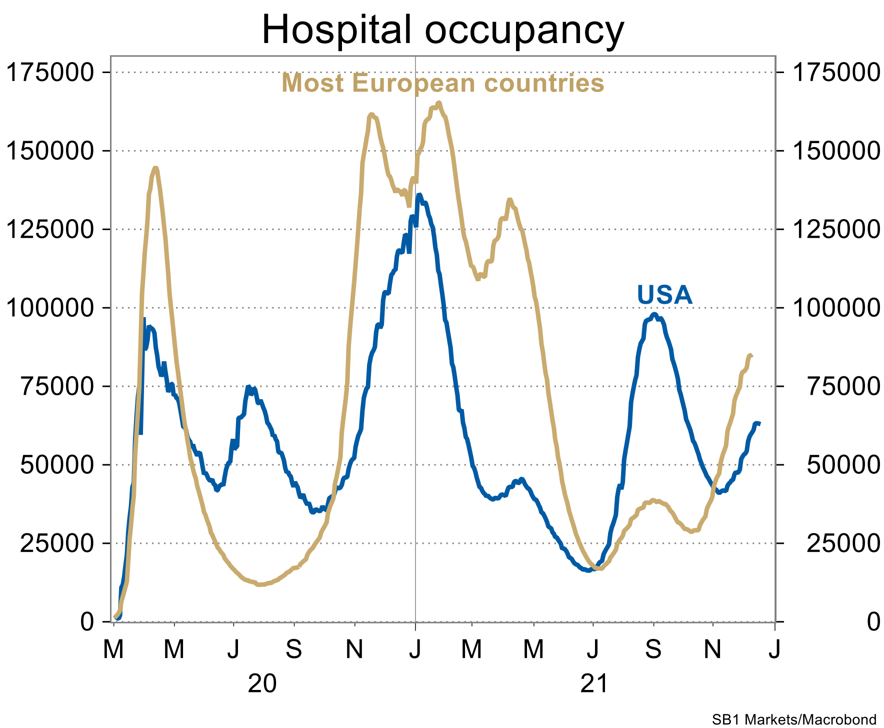
Levels are still not high vs earlier waves

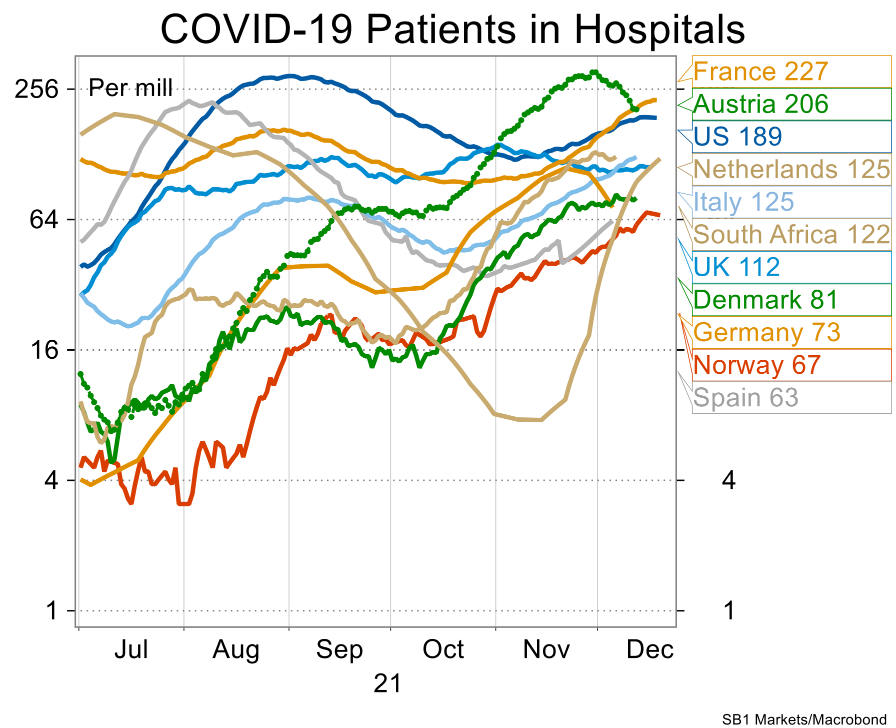




The number of hospitalisations down in Austria and Netherlands

.. And UK has flattened. Just a very moderate growth in Denmark (and faster in Norway)





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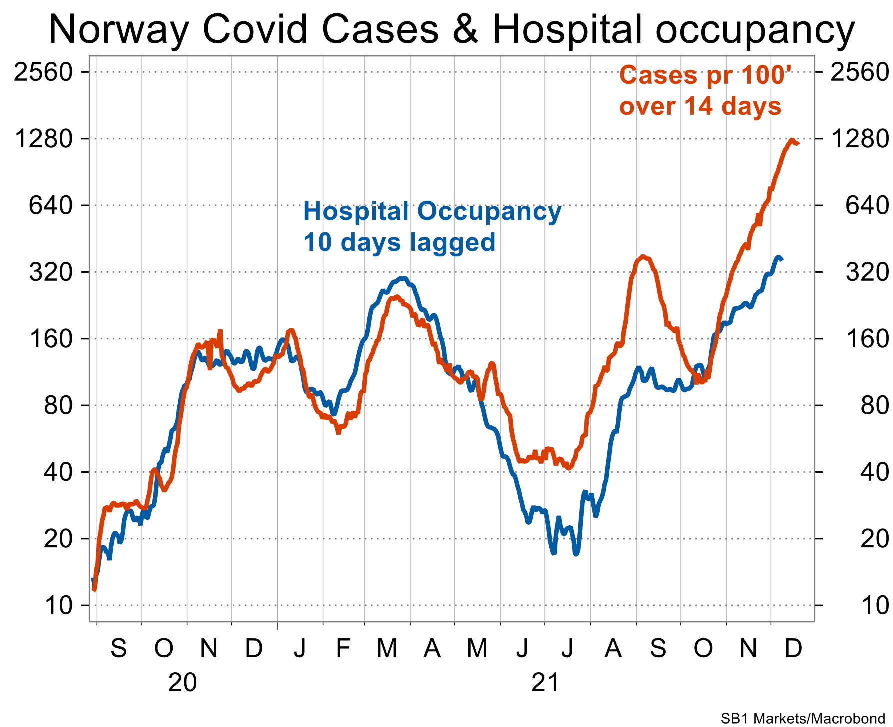
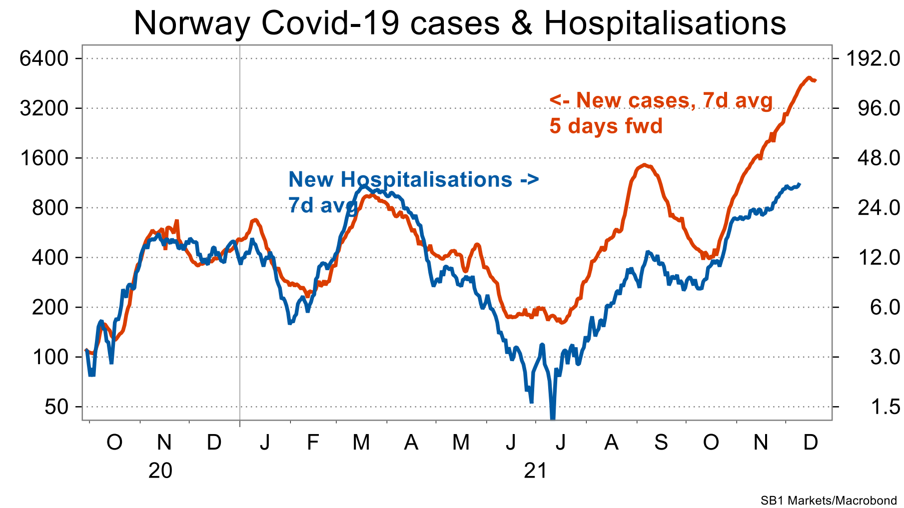
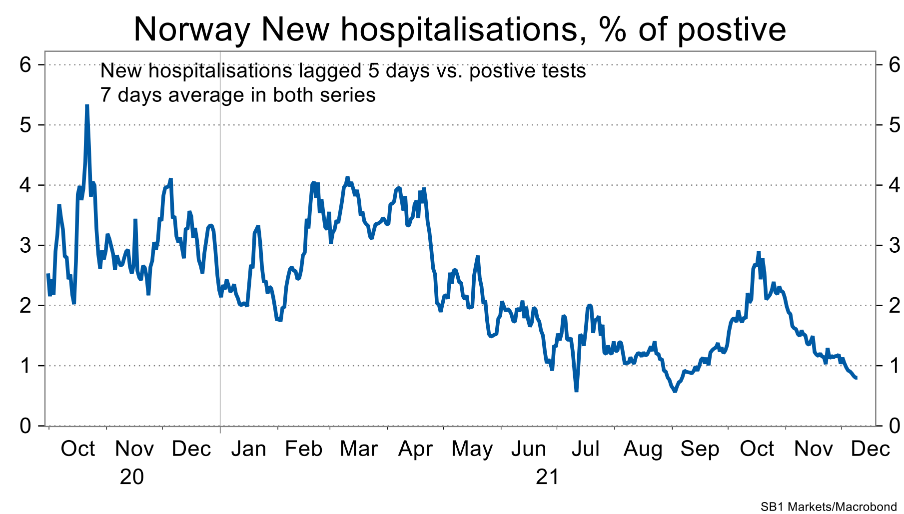
Norway: Growth in new cases suddenly slowed through last week

Hospitalisations (both flow & stock) is still on the way up, but growth is slowing somewhat



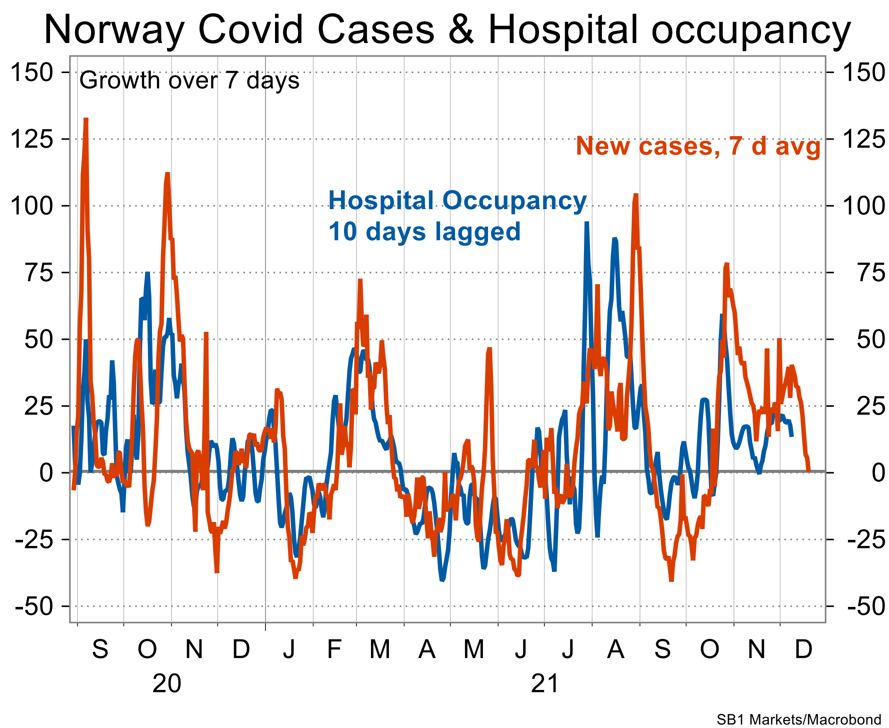
- Not easy to spot any Omicron impact, but behaviour is at the same time changed





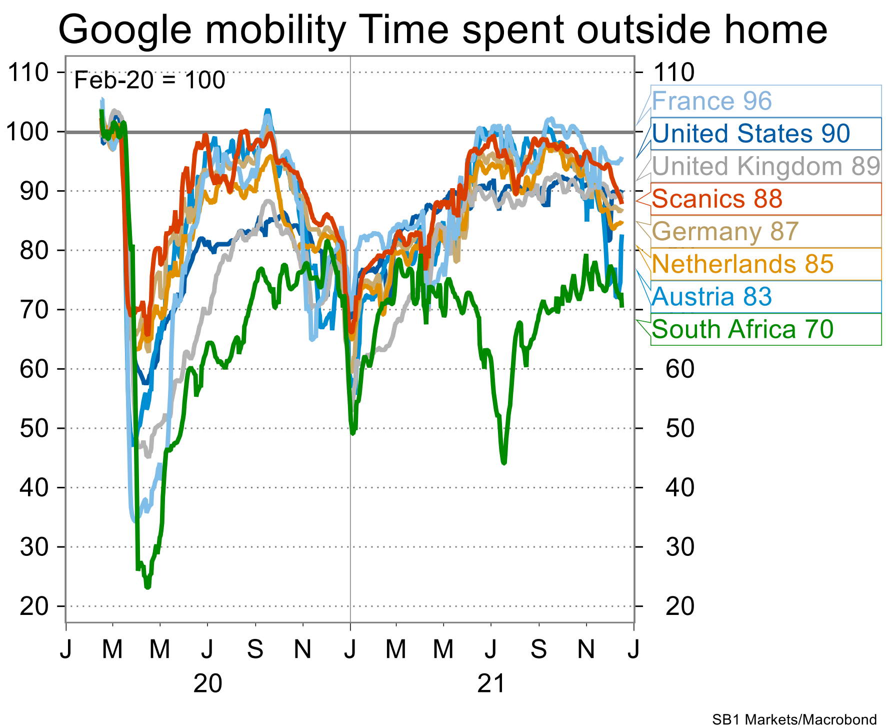
Suddenly, after mild changes in behaviour, cases have stabilised

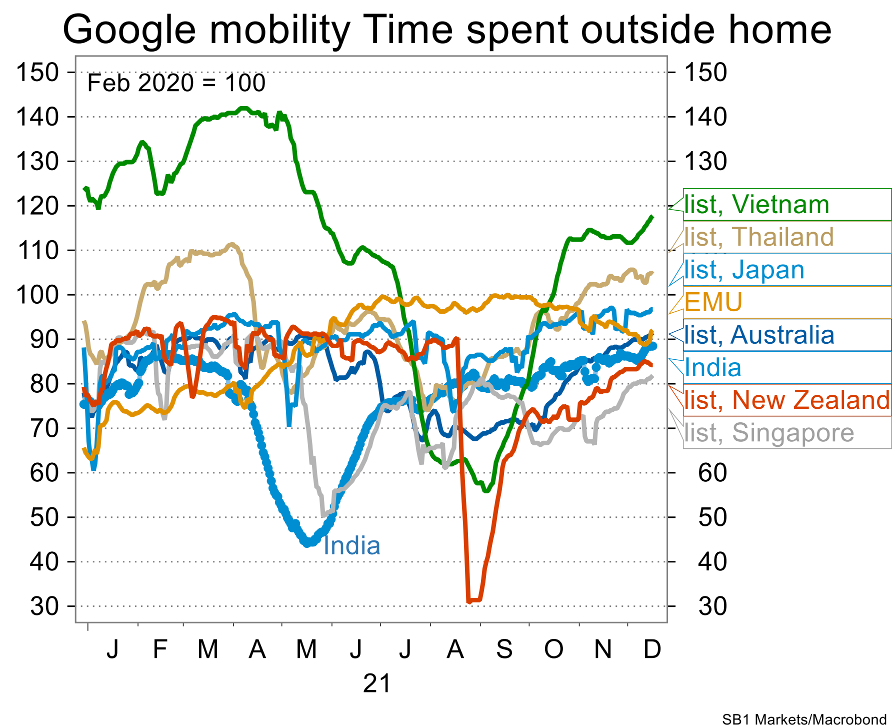
There may be more hidden cases than before. Growth in no. of hospitalised persons has slowed too



Austria is opening up, others are closing down

Total economic activity is probably not that munch hurt. Just a small reduction in mobility in South-A

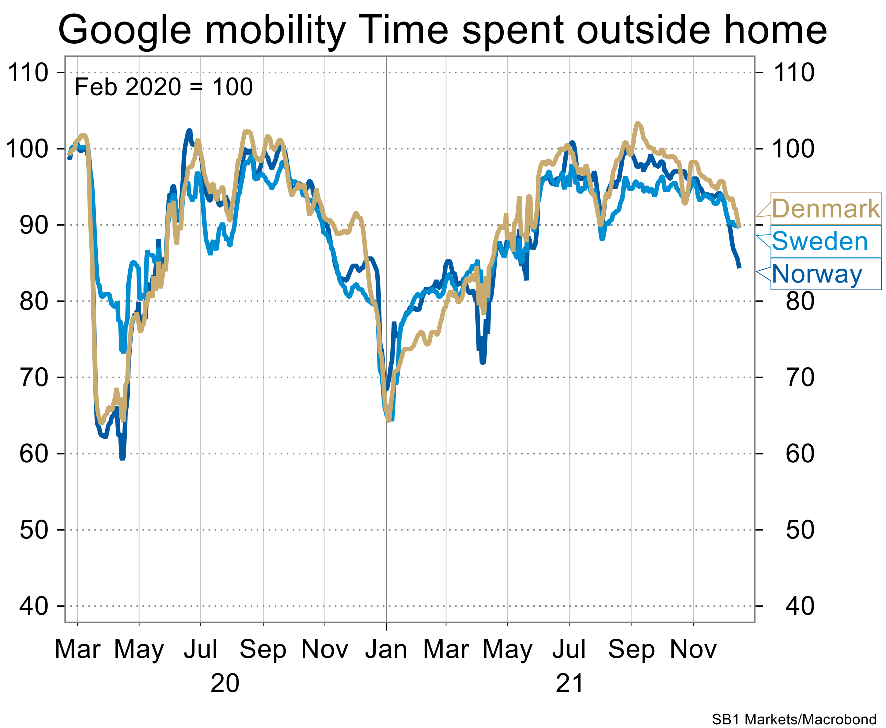


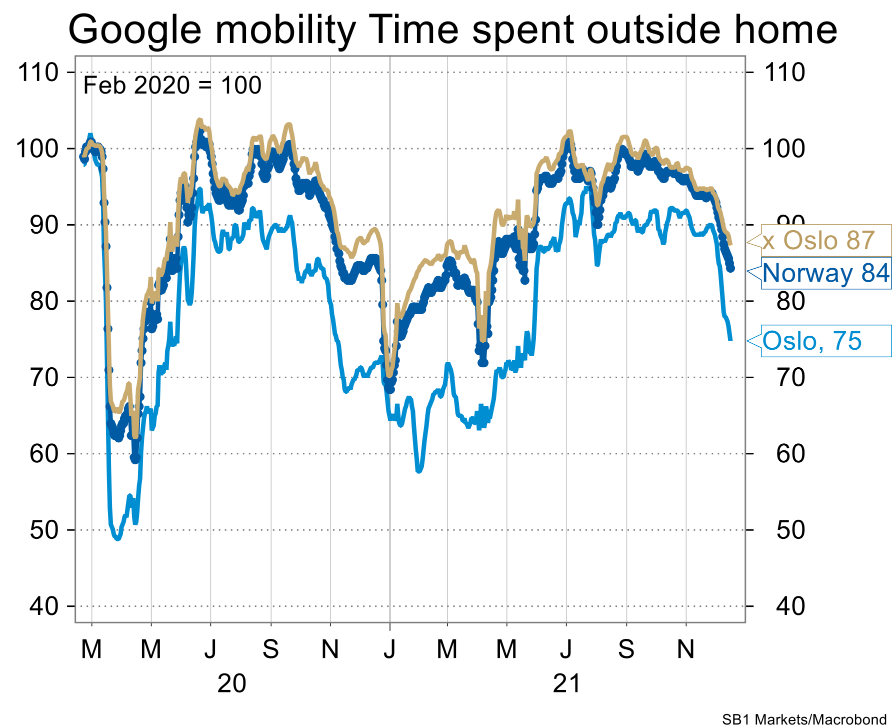


- The reduction in mobility is so less than during previous virus fights, at least outside Austria (were cases are falling rapidly)
- Mobility in Asia is on the way up, and some countries are back at pre-Delta levels

Here we go (or rather not go) again

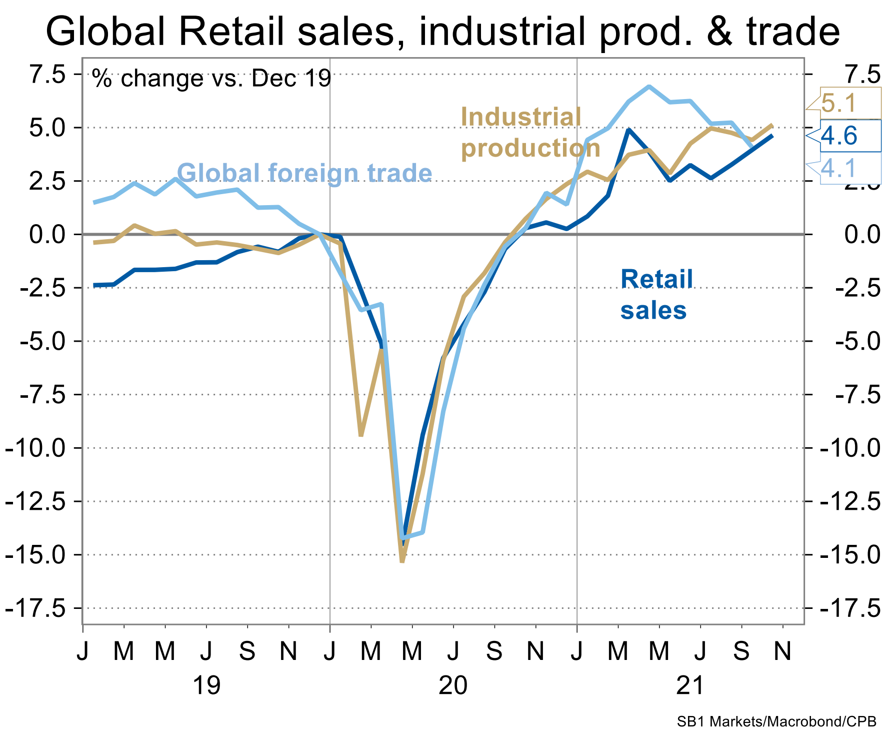
Mobility in Norway sharply reduced following the new restrictions/advices, especially in Oslo

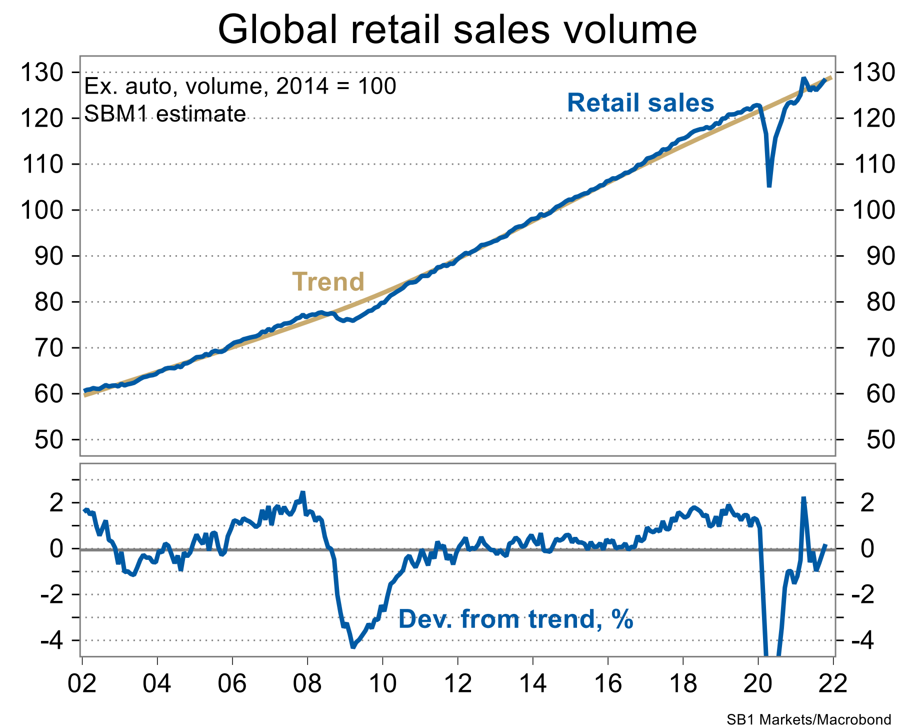




Global retail has strengthened recent months, global trade is sliding down

Manufacturing production has been flattened due to the problems in auto industry

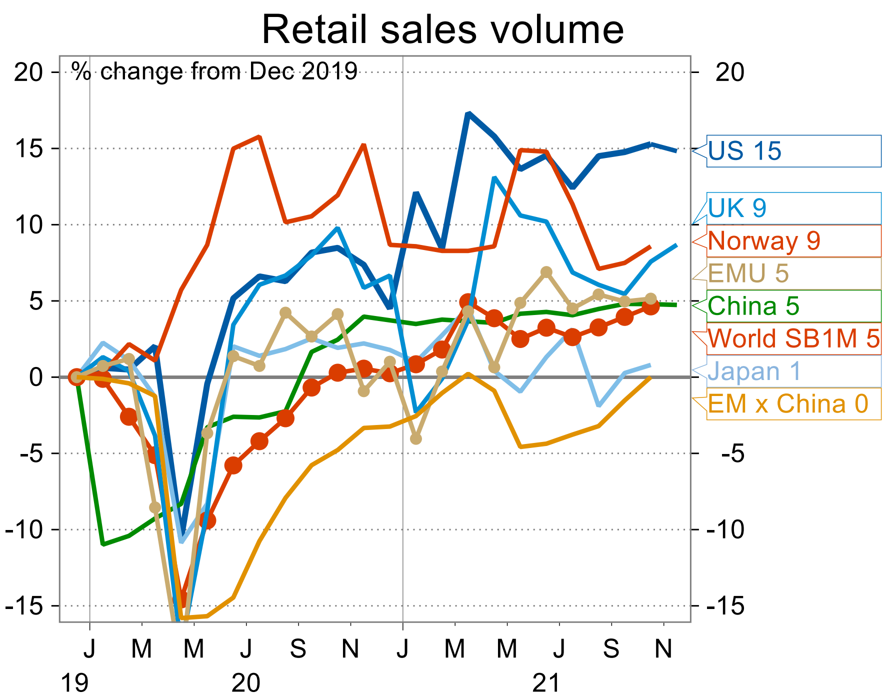


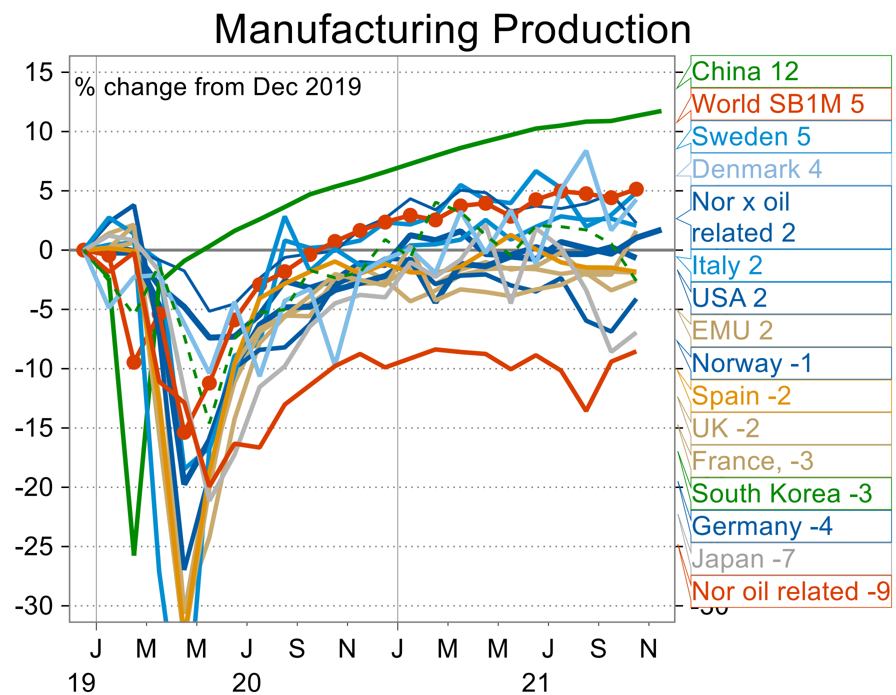


- **Retail sales** rose further in October and is 4½ % up vs the pre-pandemic level
- **Manufacturing production** has stagnated since Aug mostly due deep cuts in auto production. The level is some 5% above the pre-pandemic level in October
- **Global foreign trade** peaked in May and has fallen slightly thereafter. In September trade volumes fell more than 1%. The level is still more than 4% above the pre-pandemic level

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

The upside potential is large for Emerging Markets x China, and the recovery has started

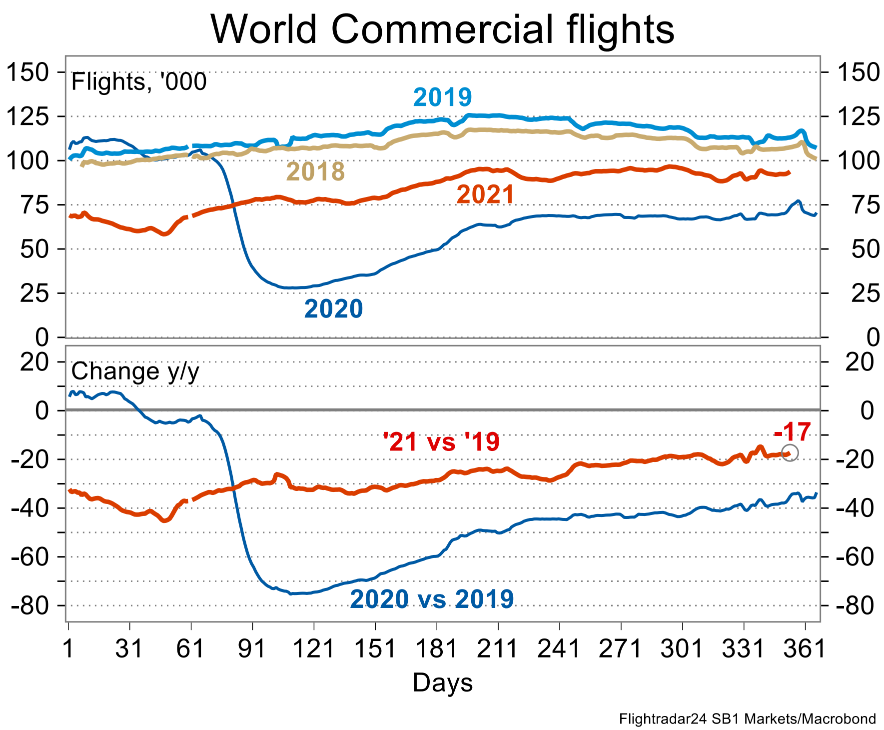


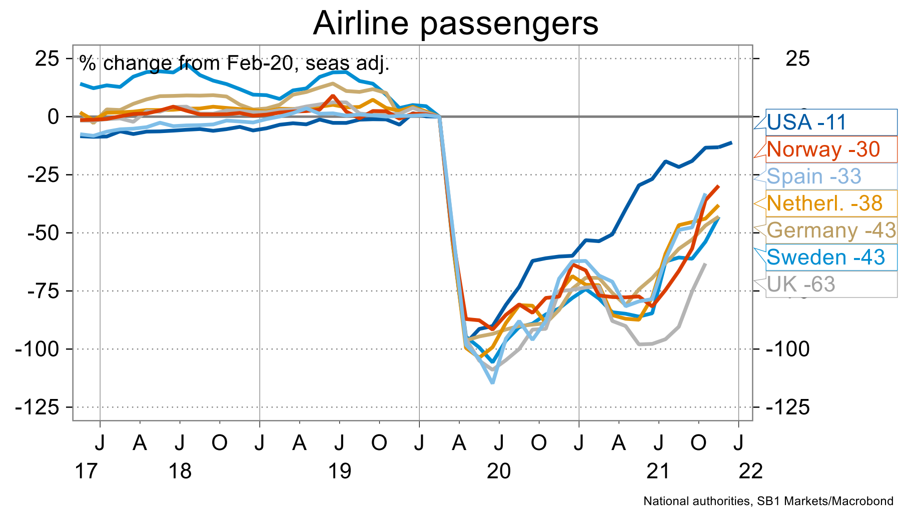


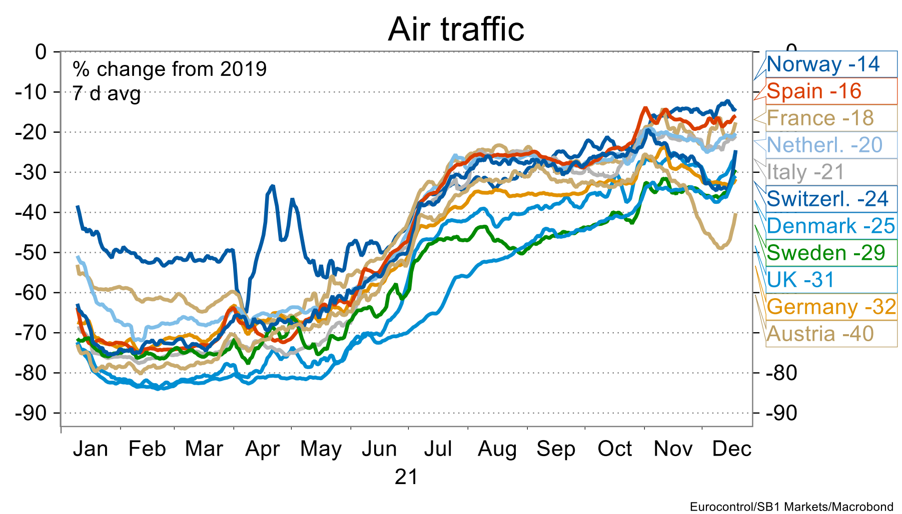
- **Retail sales** in Emerging Markets x China were weak before the summer due to the setback in demand in India, and thereafter in other parts of Asia. Now a substantial recovery is very likely underway
- **US retail demand is** still very strong, although marginally below the March peak
- **Manufacturing production** has been hampered by a deep decline in auto production. The manufacturing PMIs are still strong

Global airline traffic still gradually on the way up, still down 17% vs. 2019

Recent European traffic data somewhat better



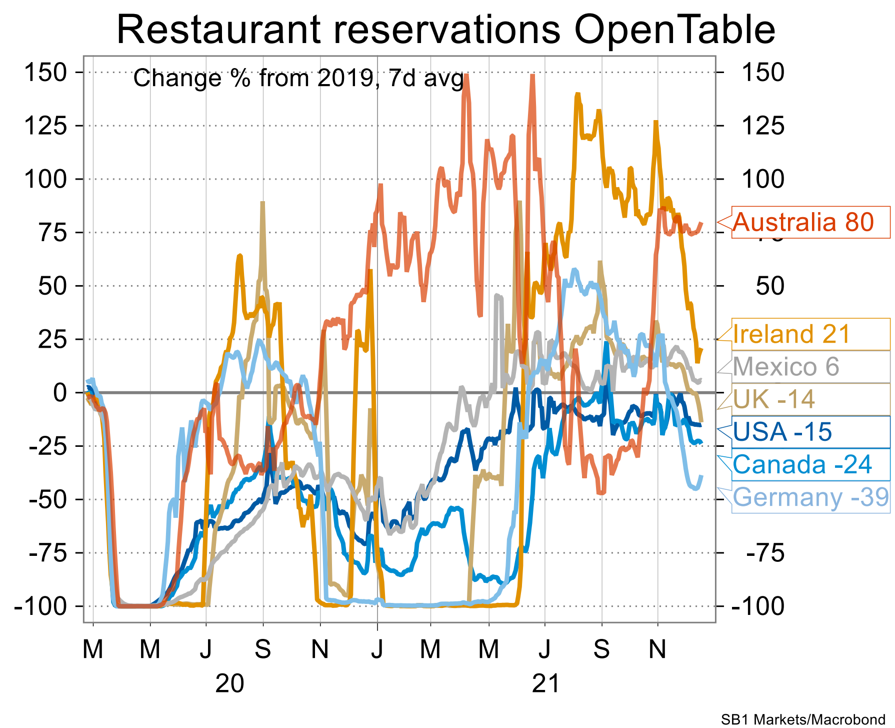


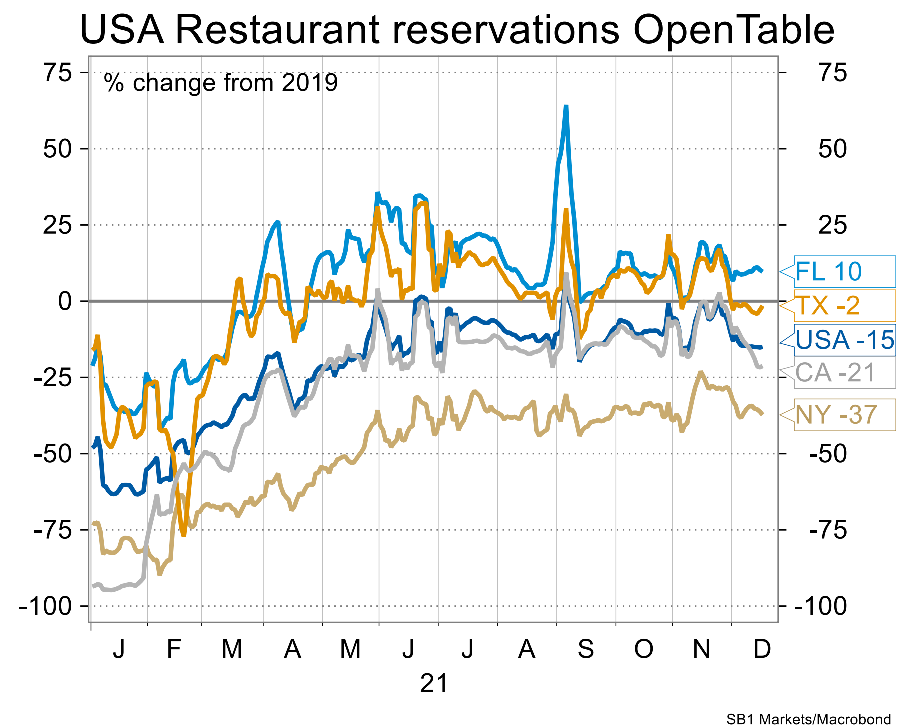


- Until November, strong growth in no. of passengers in Europe, and the gap vs the US was reduced
- The fight against the Delta has reduced aircraft movements in Europe, especially in Austria (lower chart to the right), at least until last week

Delta & Omicron create new challenges for the restaurant industry

At least in Germany – but somewhat also in UK (and Ireland) – and now in California too??

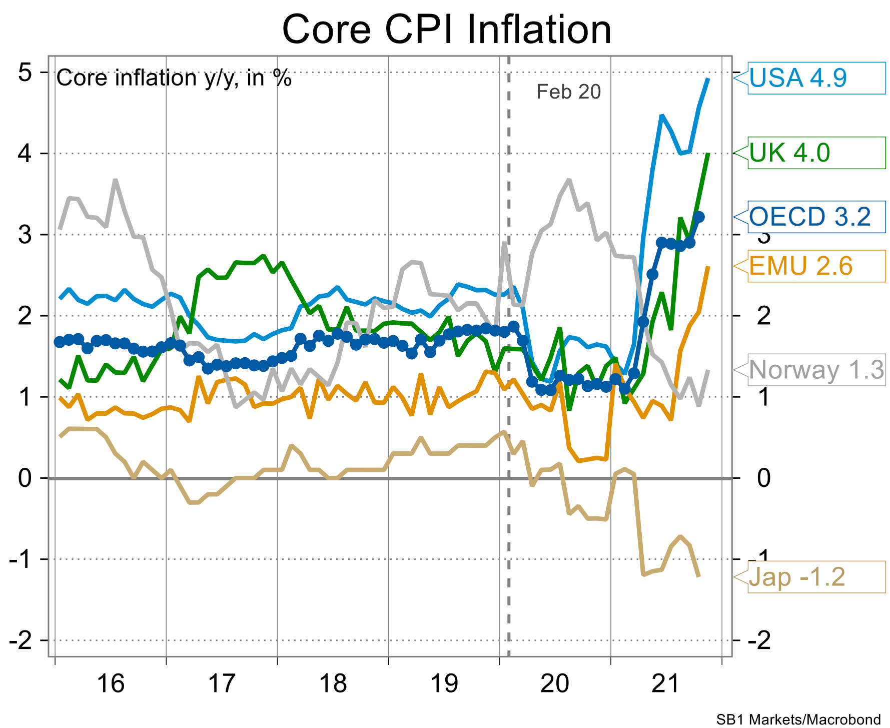


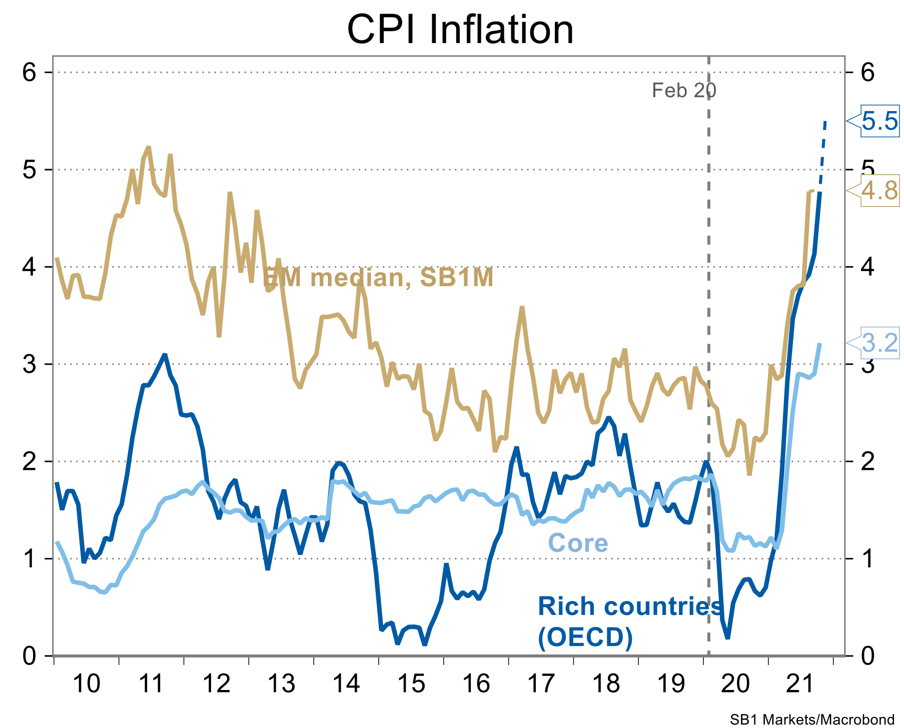


- Still, Europe is not locked down (at least not yet)

Inflation may be peaking ~~now~~ soon – at a high level

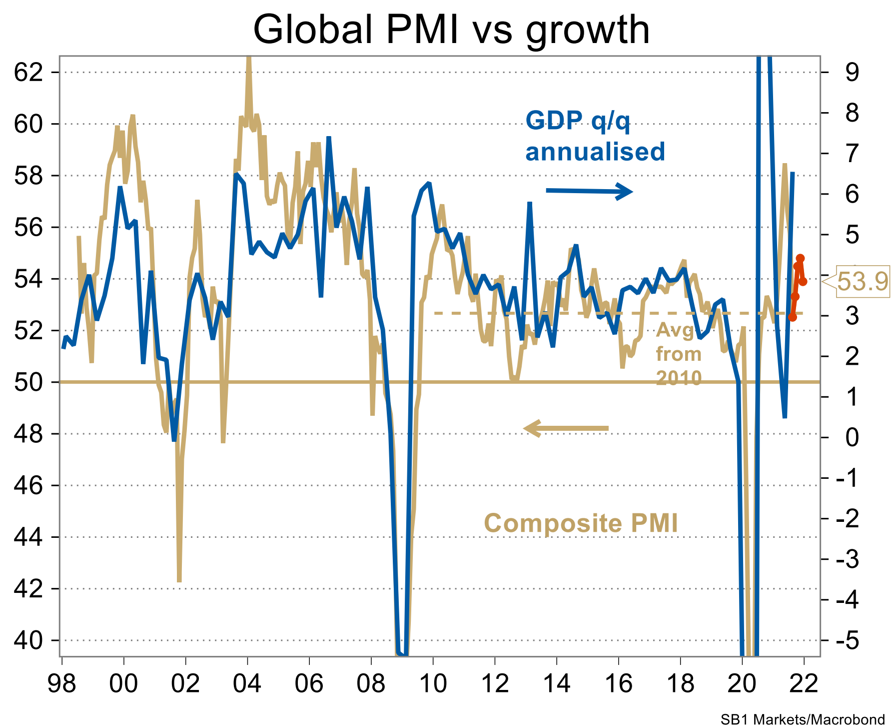
Energy prices the main culprit, but core inflation has turned up more places

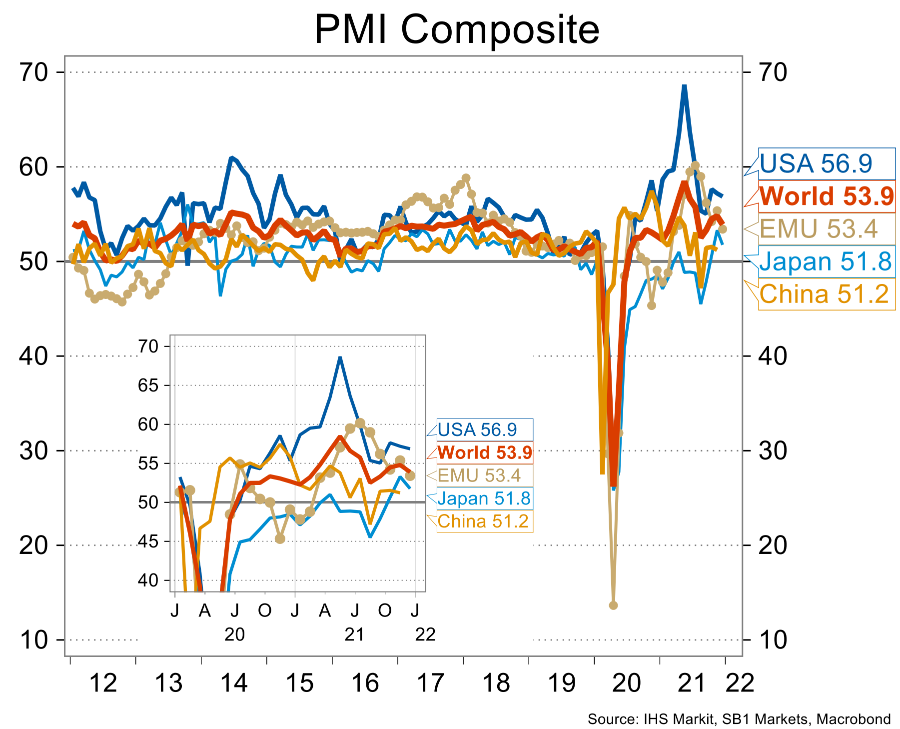




PMI down in December as services yielded – but growth > trend signalled

We estimate a 0.9 p decline in the global composite PMI to 53.9 – a 4% GDP growth pace signalled

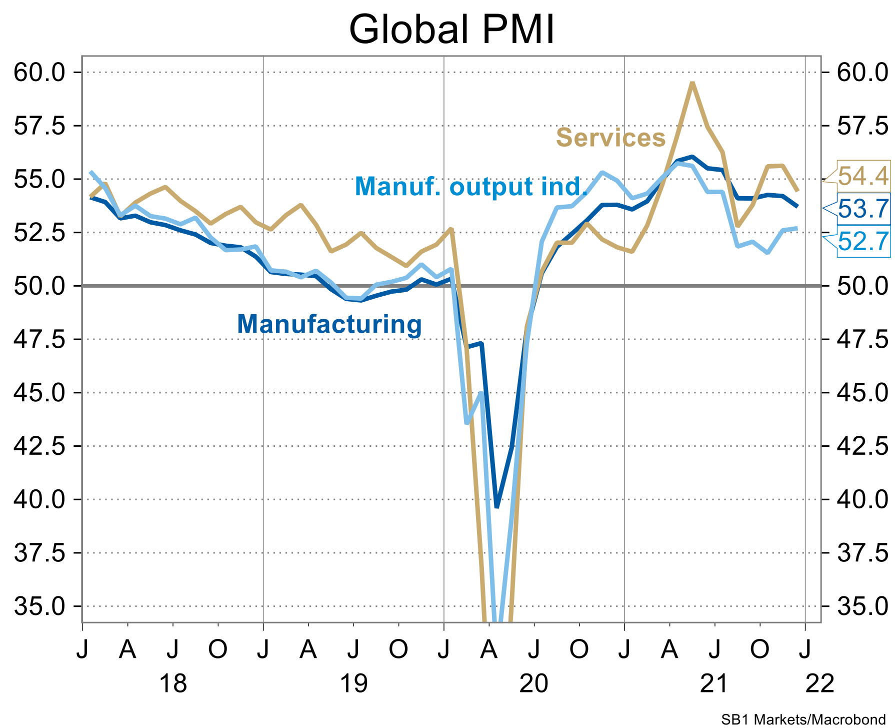


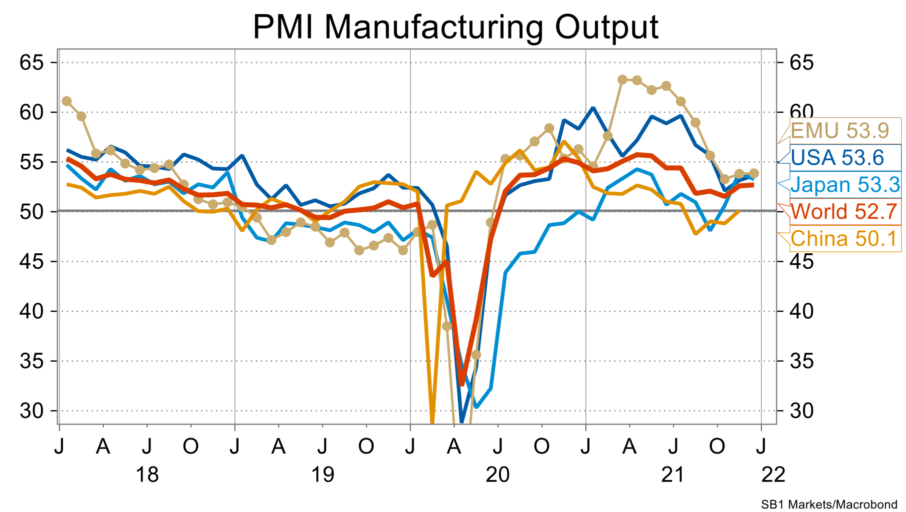


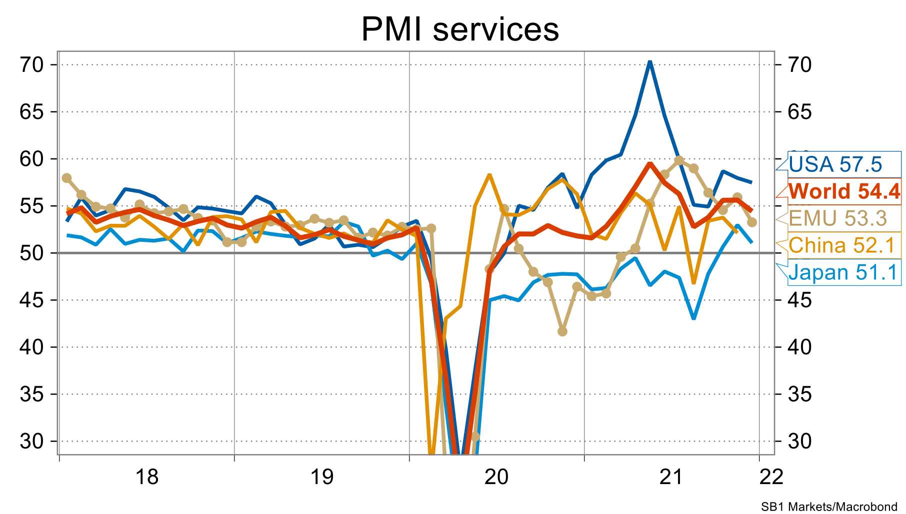
- **The flash composite PMI** December estimates fell and more than expected everywhere – and the most in EMU and UK where services reported substantially slower growth (with Germany as the laggard in the EMU, down to contraction mode). The virus outbreak is no doubt to blame!
  - » US is still in the lead, but both EMU, UK and Japan are reporting growth
  - » The manufacturing output index rose marginally, while the service index fell sharply
- **The delivery times index** fell for the 2nd month in row – and **price inflation slowed**. Growth may be moderating somewhat but orders are still growing faster than normal, also in the rich part of the world. We doubt a sudden corona related decline in demand explains the reduced pressure in the value chain but perhaps a gradual normalising of demand for goods in the rich part of the world an less hoarding after the Christmas season ease the supply chains bottleneck?

Our estimates are based on the preliminary PMIs from US, EMU, Japan UK, and Australia. The estimates are uncertain, but usually by less than 0.5 p

Manufacturing still going strong, services slowed visibly, and the most in EMU







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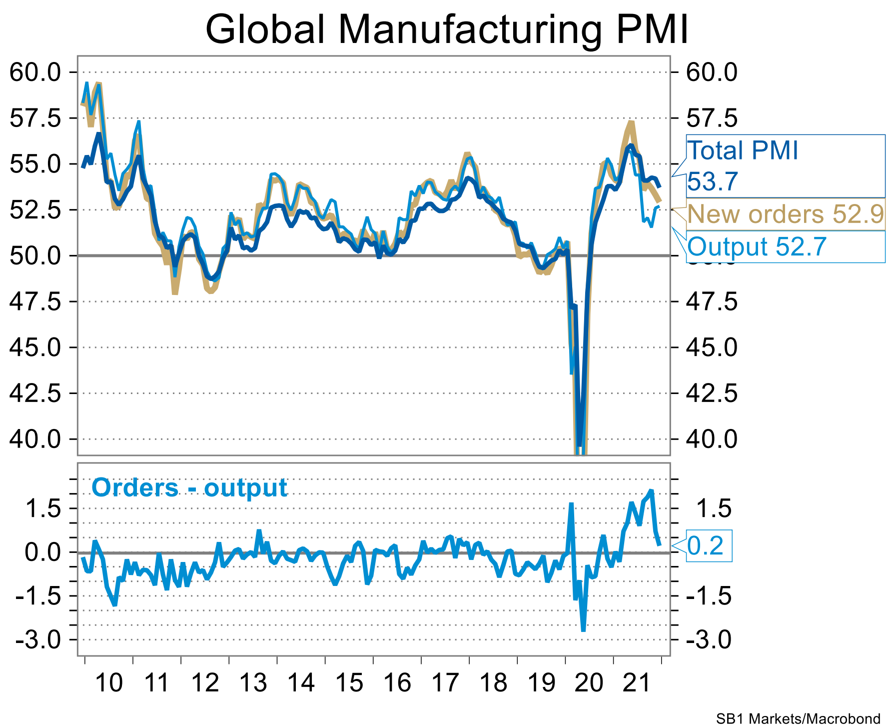
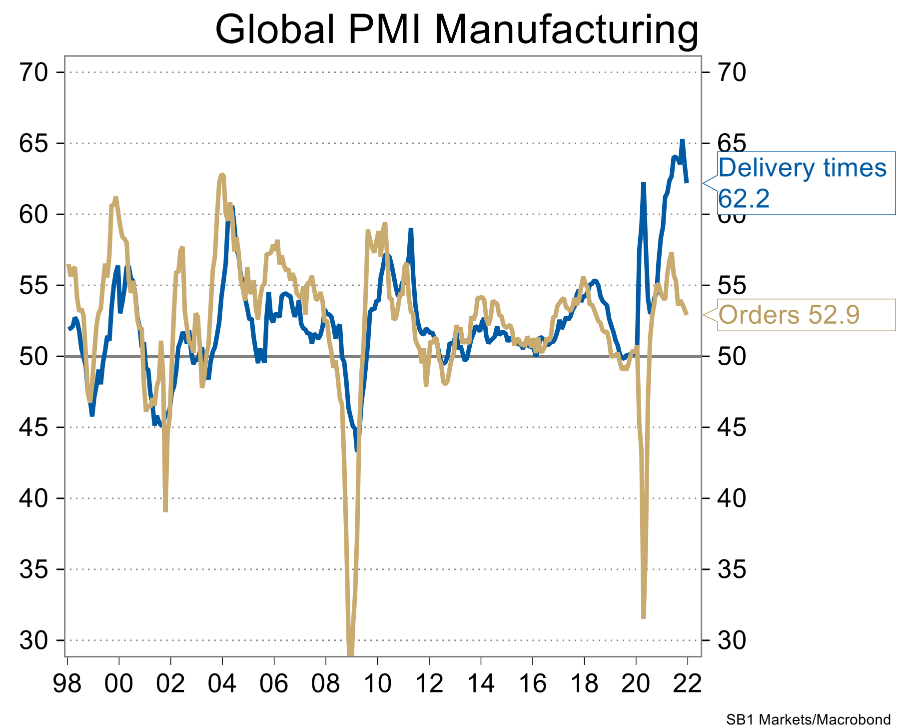
Growth in manufacturing orders are slowly slowing, are still growing above trend

The delivery times index fell further in December but remains at a very high level

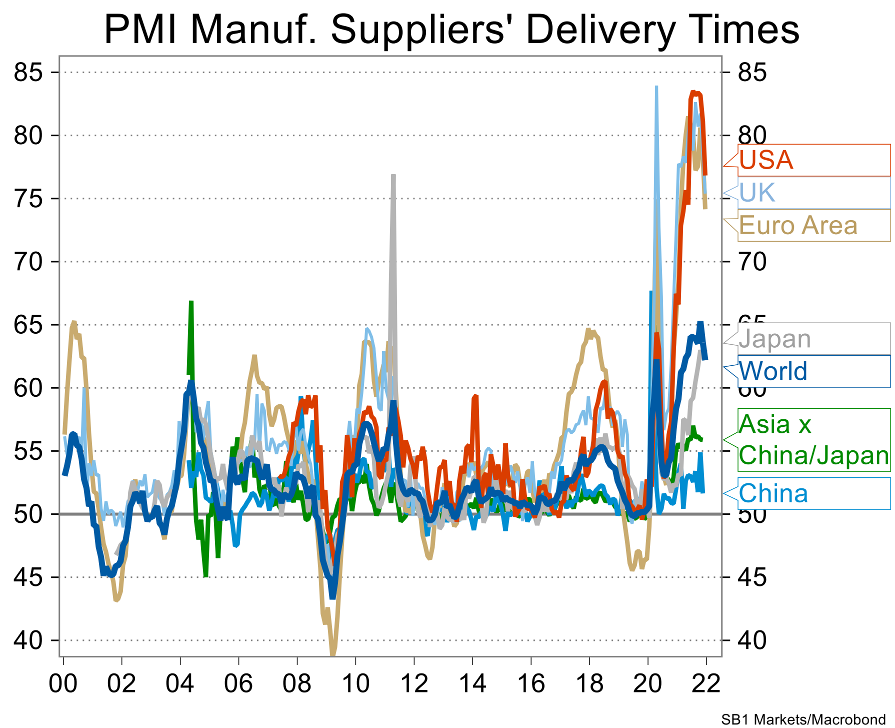


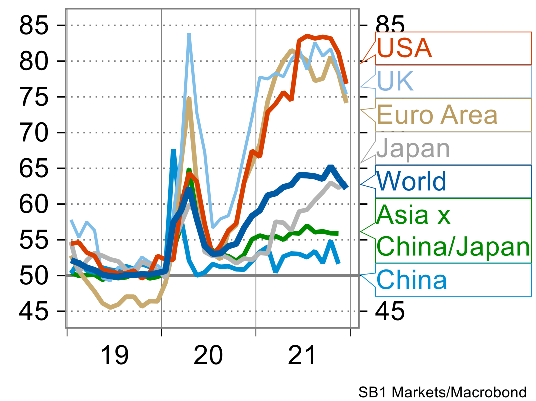


- **The current capacity in the manufacturing sector is more than reached**. The question is of course: How much is capacity (transitory) impaired by the fight against Covid-19? It is impossible to know before after the fact. Delivery times have increased more than growth in orders or production normally explain
- However, problems are most acute in Western countries where demand for goods have been much higher than normal. That may indicate the 'normal' capacity is not necessarily impaired but rather that the exceptional strong demand for goods – of course buoyed by exceptionally fiscal and monetary policy measures during the pandemic – is the main reason for the surge in delivery times and prices

Delivery times index further down in December

Are delivery times increasing less fast or are they slowing?



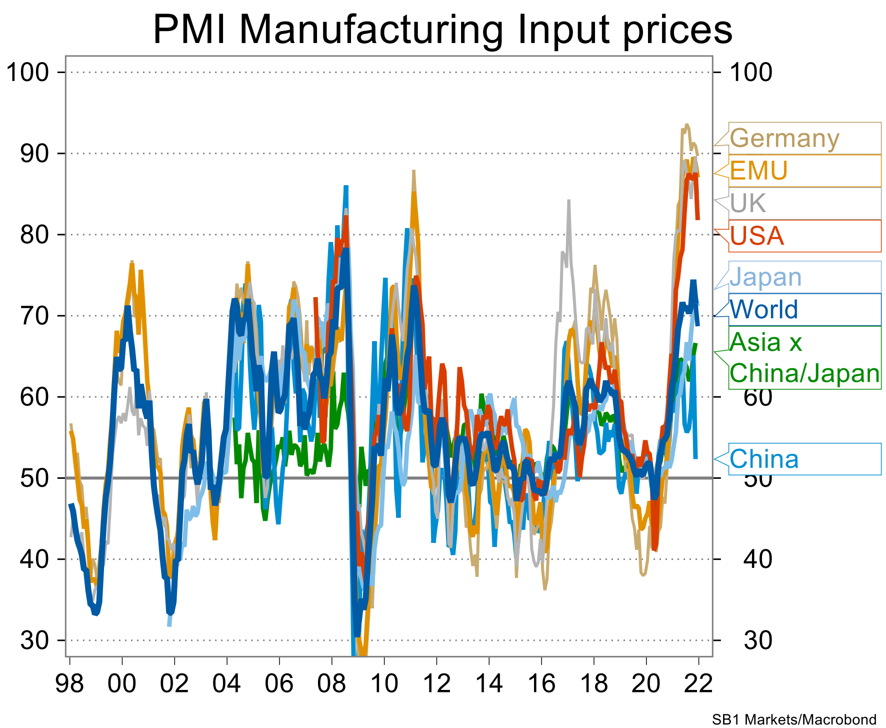


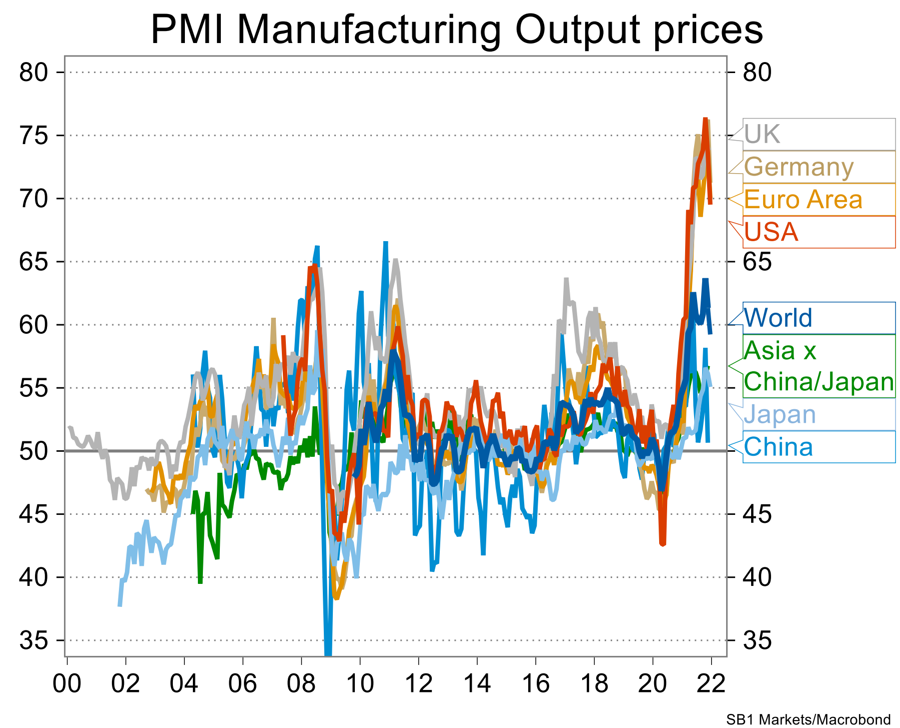
- Long delivery times have been a rich man's problem, while delivery times have not been that problematic in Emerging markets, China included

- **The global delivery times** PMI sub-index (changes in delivery times vs the previous month) inched down in both November and December, signalling some easing in congestion in the supply chains
- **The interpretation of this index is uncertain** – are companies really reporting changes in delivery times?
  - » This index as been above 50 most of the time (the past 20+ years), signalling longer delivery times. However, delivery times have not increased almost all the time – they have rather fallen! Companies may be reporting the level of delivery times. If so, delivery times are now contracting – while the index formally reports than delivery times are increasing at a marginally slower pace

Price indices have peaked – raw material prices have calmed down

However, companies are still reporting very rapid price growth in the rich part of the world





- Even so, some relief

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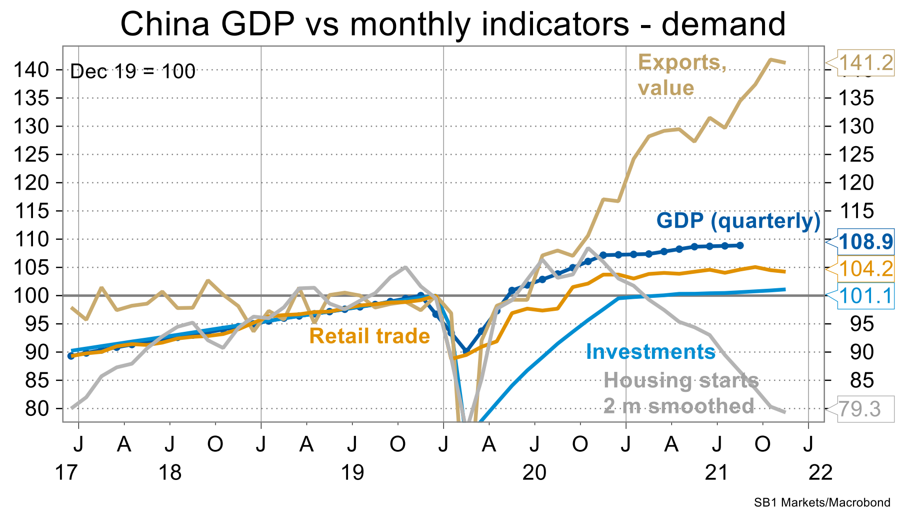
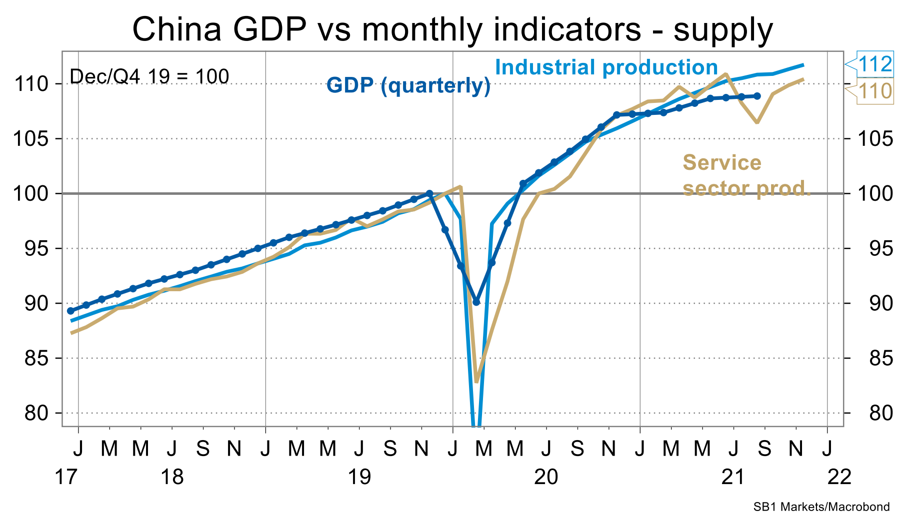
November data confirms a slowdown, not a sudden stop

Weak retail sales, construction stabilised after 20-25% decline, manuf. has slowed, services recover



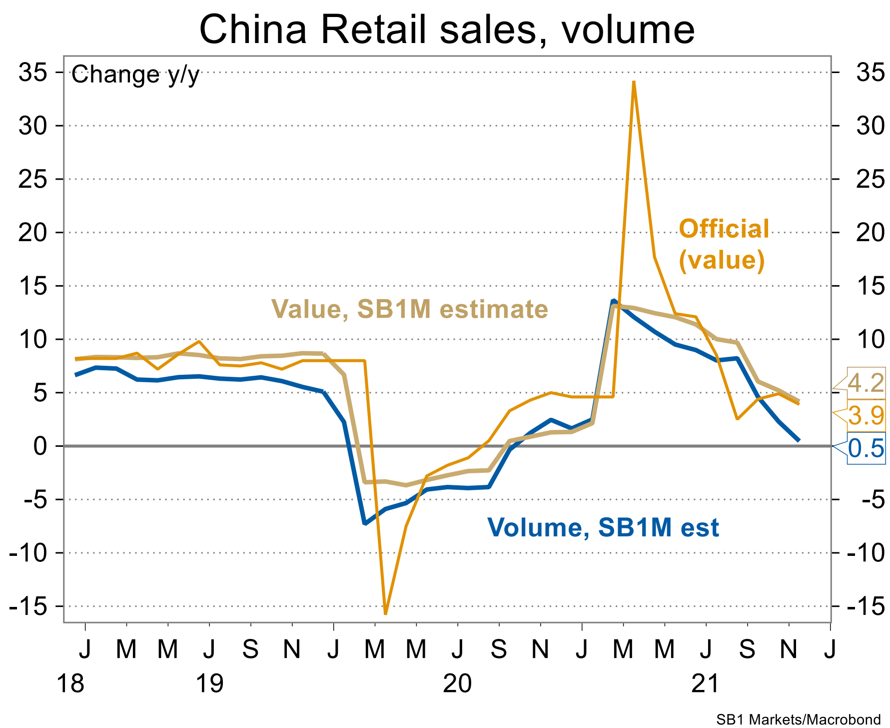


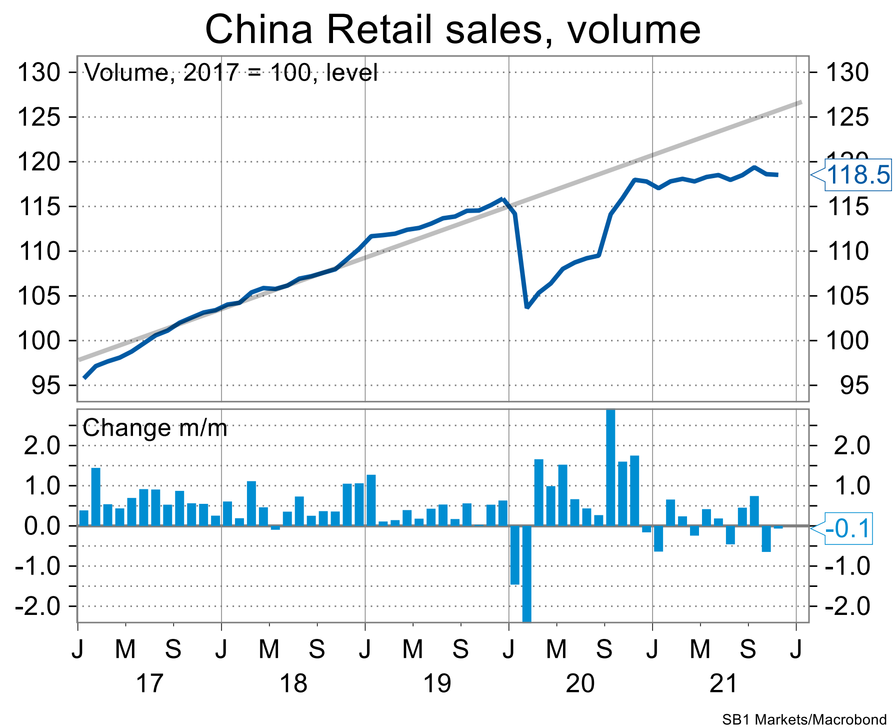
- **Industrial production** rose by 0.4% in Nov, as in Oct. Measured y/y, growth accelerated 0.3 pp to 3.8%, as expected. Production is still 2% above the pre-corona trend path. However, growth has slowed substantially, to 0.25% the past 5 months vs the normal 0.5%. Steel, cement, and autos are down 10 – 25% from local peaks, due to a mix of demand and supply factors. Surveys are down but are signalling growth above the pace the past 5 months
- **Service sector production rose 0.5%** but still remains 0.5% below the June level – which no doubt is due to the fight against the virus, which is not over yet. The level is just 2% below the pre-pandemic growth path
- **Retail sales volumes fell by** 0.1% in volume terms (our est. as prices rose sharply m/m, due to energy). The trend is weak, from Nov last year at a 2% path, at the best. Annual growth fell 1 pp to 3.9%, 0.9 pp below expectations. Auto sales are slowing, as elsewhere, but other sectors have also slowed in 2021
- **Investments** grew by 0.2% as the previous month. Prices are no doubt increasing – and in volume terms, investments are falling. The accumulated annual growth rate was 5.2%, down from 6.1%, as expected. **Housing and other construction** starts, and new home sales all recovered somewhat in Nov, but are still down 20 - 25% vs the recent peaks, a substantial setback! **New and existing house prices** have fallen the past 3 – 4 months, but so far not dramatic
- **Frome the previous week**
  - » **Credit growth** accelerated in Nov, as local governments like in Oct tapped the bond market (due to lack of revenues from land sales?), while growth in bank lending slowed further. PBoC eased its credit policy as banks' reserve requirement was cut
  - » Both **exports and imports** were strong in November, imports are back to the pre-pandemic trend path – and export are way above (corona logistics trouble, you know)
  - » **CPI inflation** accelerated in Nov to 2.3% but core slowed to 1.2%. No problem

In sum: Growth has slowed but not further in Nov. Some may be due to the virus, but NOT the large decline in construction and very likely not the slow growth in the retail sales either. **The main risk: construction activity which has fallen 20 - 25% already.** The supply side challenges can probably 'be fixed' (restructuring of property developers) but will 'property investors' (in empty homes) remain bullish forever?

Retail sales have almost flattened!

Real sales fell 0.1% in Oct, following the 0.6% drop in Oct. The nominal y/y rate 3.9%, <u>0.9 pp < exp</u>.

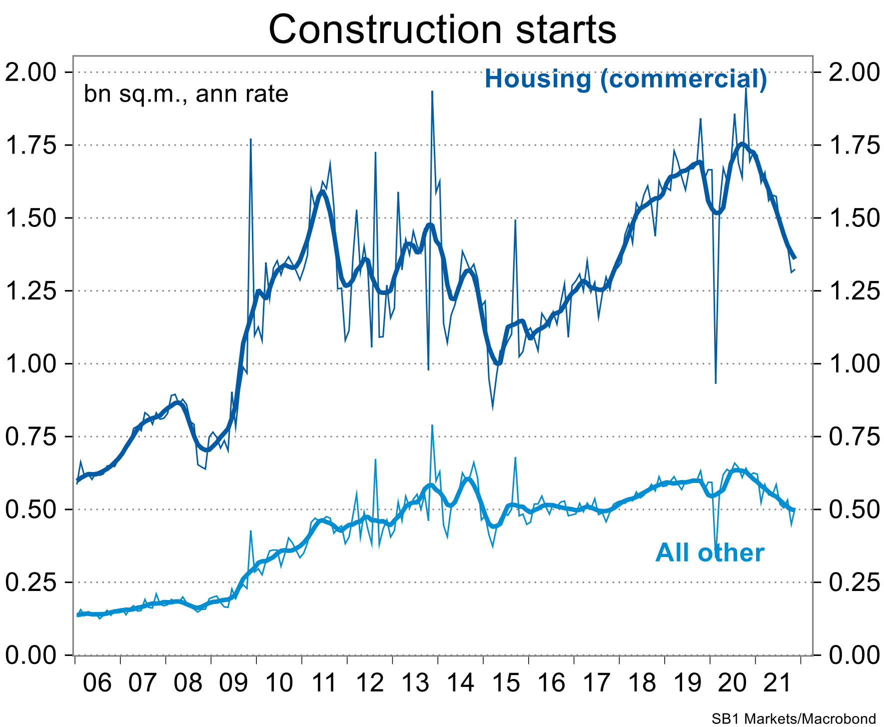


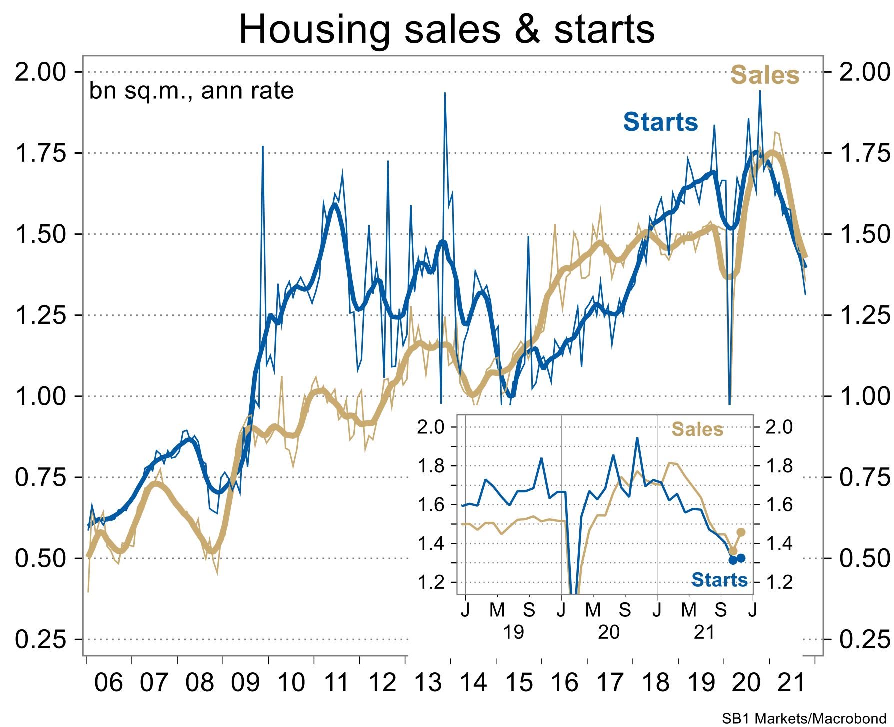


- **Official nominal retail sales** were up 3.9% y/y in Nov, down from 4.9% in Oct, expected just down to 4.8%
- In nominal terms sales rose by 0.2% m/m in Nov, but due to the lift in energy prices, we estimate a 0.2 % decline in **volume terms**, following the 0.6% volume decline in Oct.
  - » <u>Since last November the underlying volume growth rate has been less than 2%.</u> Before the pandemic growth equalled some 6% p.a, and <u>the slowdown is dramatic</u>. The fight against the virus may explain some of the slowdown, <u>but it is probably more than that</u>
- <u>**Sales volumes** are 6% below the pre-pandemic trend path</u>

New home sales and construction start slightly up in November, trends still weak

Following several months of sharp decline in sales and starts

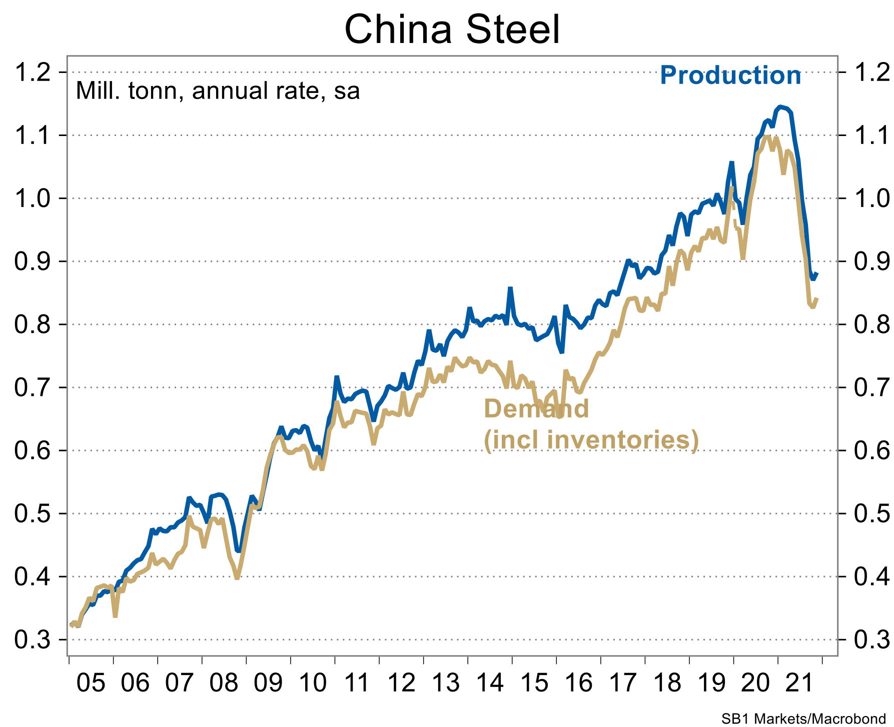




- **New home sales** have fallen 25% from early 2021, following the spectacular recovery after the pandemic last year. Sales are down more than 10% vs the pre-pandemic level - which was record high until then. Sales rose in November, back to the August level
- **Housing starts** are also down 25% vs. the early 2021 level, but stabilised in November. Sales have been running higher than tarts in most of 2021, indicating a slight rundown of inventories
- **Non-residential construction** fell 16% m/m in October, and recovered most of this decline in November. Starts are still down 20% since last summer, and the level is 15% below the pre-p level
- In sum, the decline in **construction starts** have been among the largest ever. Still, the downside is substantial as several property developers are struggling. Still, we think the main risk is at **the demand side**, the level in investment in buildings are high, and a substantial share of housing demand has been for investment purposes, often without any rental income. See more prices, 2 pages fwd. Look up for demand for steel, *check next page*

Construction & domestic demand for steel down, steel now more than 25%

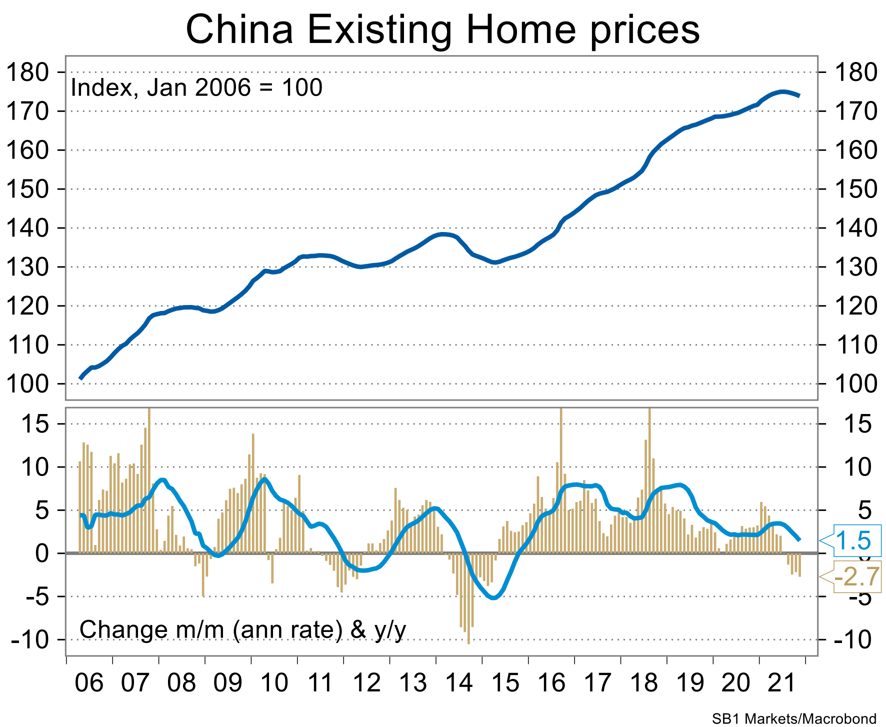
The reason may partly be the 'official' story on meeting 2030 CO2 targets but demand is down for real too?

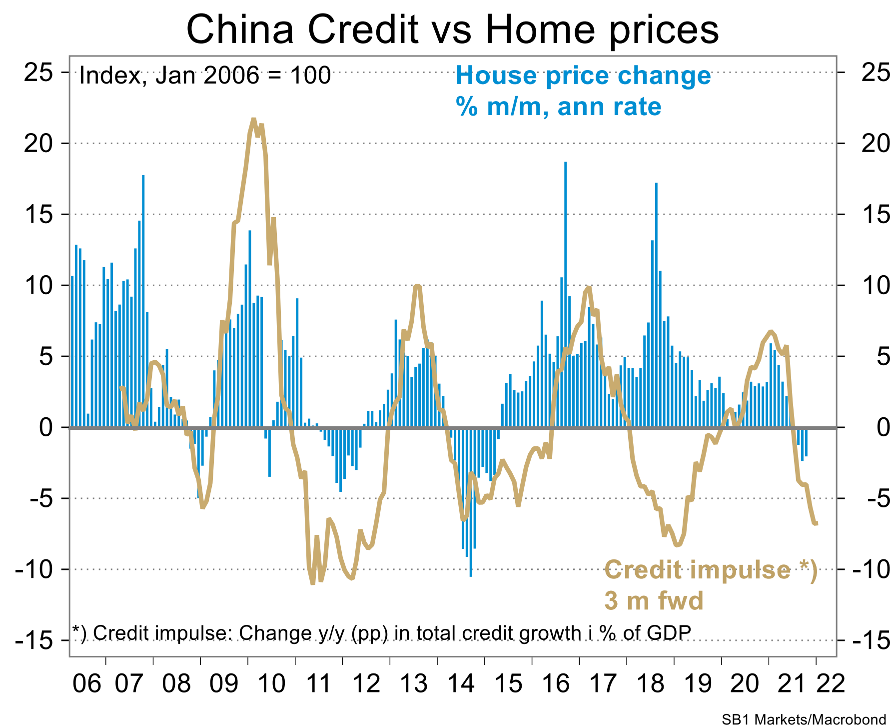


- The authorities have decided that 2021 steel production should not exceed the 2020 level, and as H1-21 production was well above the 2020 level – and production had to be cut in H2. So is the official story
- We assume there are more reasons for the cut in steel production, like local pollution, fear of overbuilding combined with too rapid credit expansion, especially among heavily indebted real estate developers (read: Evergrande++)
- Now demand for steel may be the most important reason for the decline in production, as construction activity has fallen substantially

House prices turn south, so far at a measured pace – still the main Chinese risk?

Prices fell for the 4th month in row but are still up 1.5% y/y

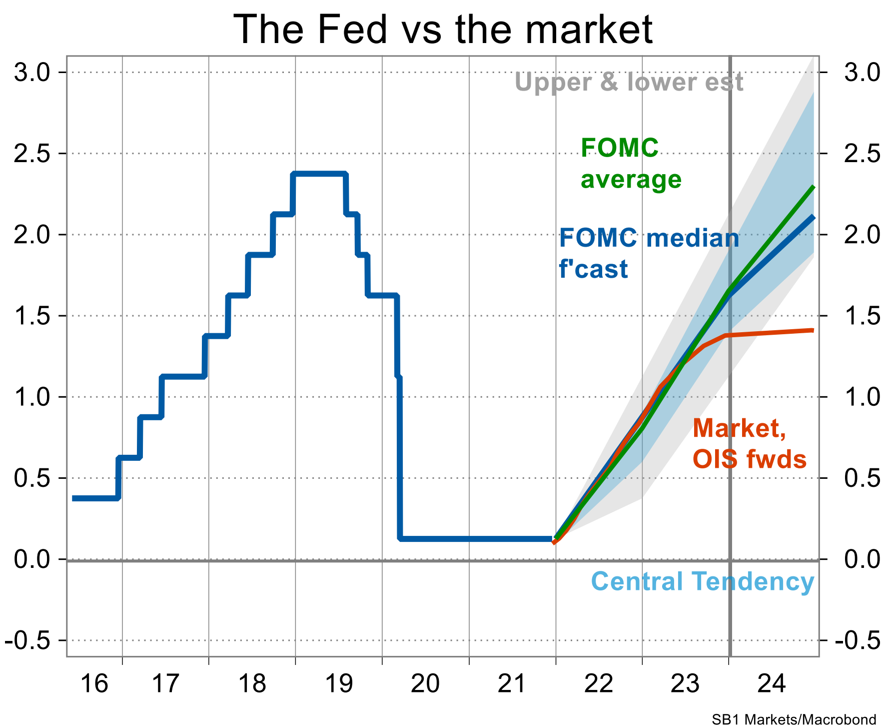




- **Existing home prices** peaked in July, and has fallen at a 2 pace since then. The decline is gradually accelerating, as prices fall at a 2.7% pace in Nov. The annual rate has fallen to 1.5%, from 3%
- **New home prices** peaked in August, and has fallen slower than existing home prices. So far, not any signs of distressed sales from 'bankrupt' property developers
- **Credit growth** as marginally accelerated the past two months, mostly due to increased borrowing from local governments. Still, credit growth has slowed – implying a negative 'credit impulse'
- **Several heavy indebted property developers** are struggling which surely poses a treat vs the housing market & construction activity. The builders may be restructured, with a helping hand from the authorities, who also can supply credit to bail out buyers, and support sales of buildings under construction.
- We think the **main risk is elsewhere**, that home buyers at one stage looses confidence is housing – even in empty homes – as safe and profitable investment. Several small setbacks in prices have so far not made a dent in the investment appetite, and the current modest setback in prices does not signal a buyers strike. Should that happen, a much harsher setback in construction activity would take place

A huge policy shift confirmed, inflation is a problem. The first hike in March?

The dot plot was lifted more than ever before, by 70 bps, 3 more hikes pencilled +a rapid tapering

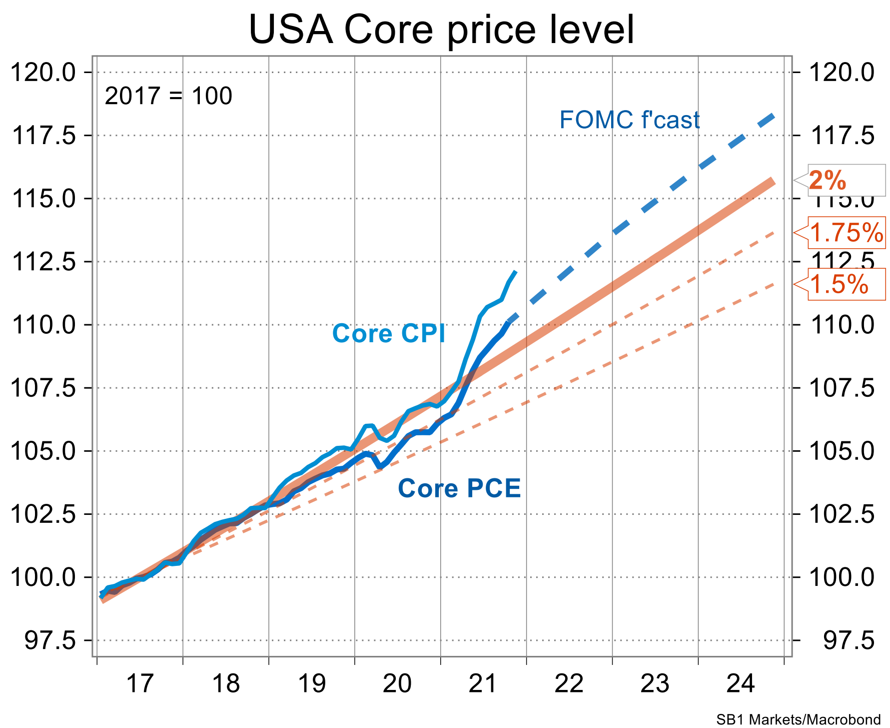


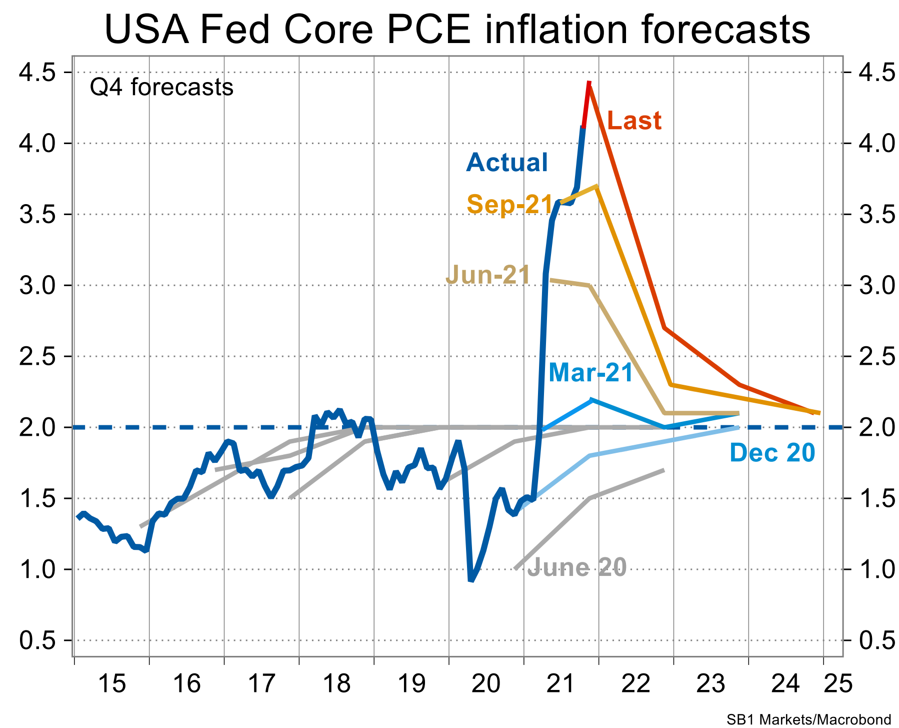
- **The unusual policy shift** was very well announced, and fully priced in before the meeting, at least judged by market responses. Two weeks earlier, Fed's Powell had to acknowledge (before the Congress committee) that inflation had become much higher than expected, and that transitory was not a proper description. He signalled that the bond buying program would be
- During November (and some started far earlier) several FOMC members, and then Powell's remarks at Congress, when he acknowledged that inflation had become much higher than expected, and that is was not just 'transitory' and that monetary policy had to be tightened
- The FOMC left the **target rate** unchanged at 0-0.25%.
- The FOMC decide to double the speed of tapering, ending QE buying in March. When asked why not stop buying now, Powell said market would not have liked it
- The description of the economy changes – and Powell's comments even more. He had experienced a grenade chock, hit by a series of economic news that revealed (for him, finally!) that inflation was not transitory after all
- When asked about criteria for maximum employment, he ended up (and correctly) concluding that wage inflation would tell you when the target is reached, whatever the other 20 indicators tell
- The FOMC members lifted their **inflation f'cast** substantially, and the expected trajectory is now well above Fed's 2%-over-time-target. **GDP growth** was revised marginally down. The **unemployment** estimate was lifted by 0.3 pp for Q4-22, but left unch for 22 and 23 (down to 3.5%)
- The average/median **dot-plot** interest rate path was lifted by 0.2 – 0.4, more than Norges Bank revised its path. Two members shifted the timing for the first hike to 2022 from '23, and 9 of 18 members favours next year
- Chairman Powell tried his best to convince the market that tapering and hiking rates are completely decoupled, but they can't be… According to the dot-plot, half of the members sees a hike in '22, and though Powell still claims inflation is transitory, the tone and projections suggest that the FOMC is in fact more worried about inflation
- **Market reactions: Interest rates rose 7 -13 bps, all over the curve. Real rates did the 'heavy' lifting**

SpareBank 1 MARKETS

The 2% price target is not ditched. But for the time being…

Will the Fed accept both the price and the max. employment target to be breached at the 'same side'?

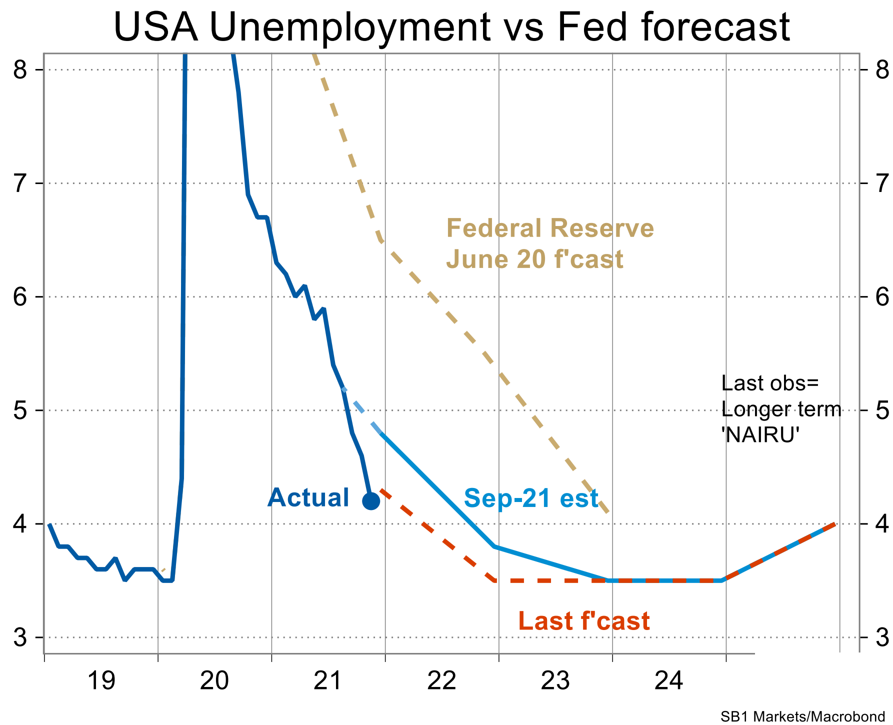




- I August 2020, the FOMC introduced its new **price level target**. The bank aims to reach an <u>average rate of inflation</u> of 2% over time. If inflation has been below 2%, annual inflation should be allowed to stay above 2% in order lift the price level up to the long term 2%-path.
- **The Q4-21 core PCE core inflation** estimate was lifted 0.7 pp from the Sept f'cast to 4.4% (and from the assumed 2.2% in March…). The estimates for '22 and '23 were lifted by 0.4 and 0.1 pp resp. and are expected at 2.6% and 2.3%. In 2024, 2.1%. <u>The price trajectory is now well above the 2%-over-time inflation target. The only reasonable argument for doing so – within a flexible inflation targeting model – is that the bank wants to close the output gap, or achieve maximim employment, which is Fed's 2nd target.</u> However, the bank is not sure how far away the economy is from max employment. Powell concluded that wage inflation in the end would signal if maximum employment is reached. And then he said that wage inflation had accelerated, and that he was chocked by the ECI Q3 growth.
- A not too unlikely scenario is that wage inflation will remain too high, signalling <u>that the max employment target is more than met too</u>. If so, <u>will the Fed run a policy openly breaching both targets at 'same side'</u>? We still think the Fed will chose the narrow path, and <u>be willing and able to the remove the punch bowl before the party becomes too wild, accepting the short term cost of getting inflation down before a wage/price spiral runs out of control</u>

Unemployment revised down to the below the ‘NAIRU’ rate for ‘22 – ‘24

The long term NAIRU *) rate is still assumed to be 4%, just 0.2 pp below the present level

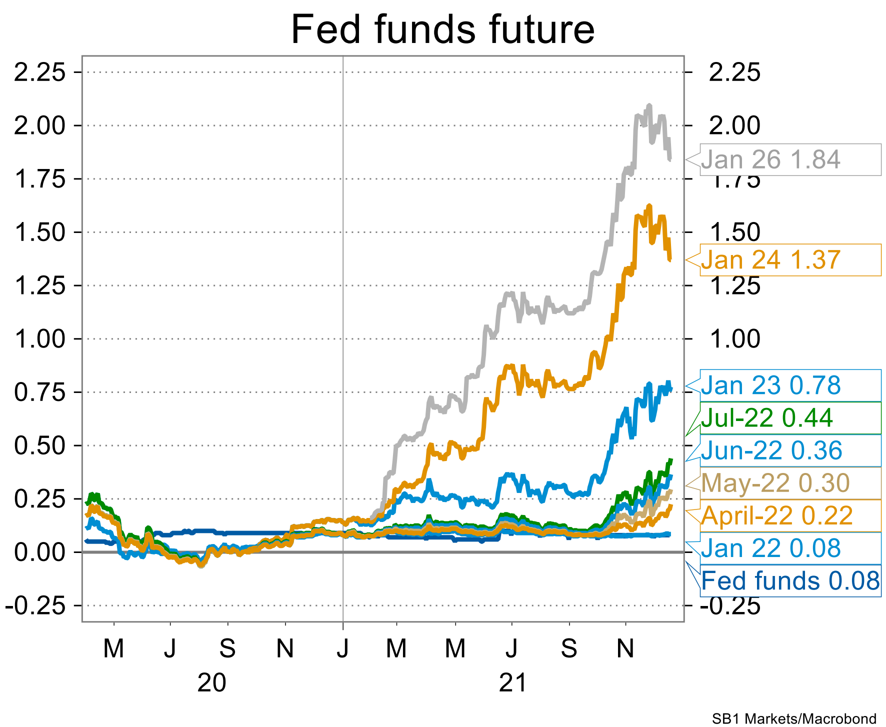


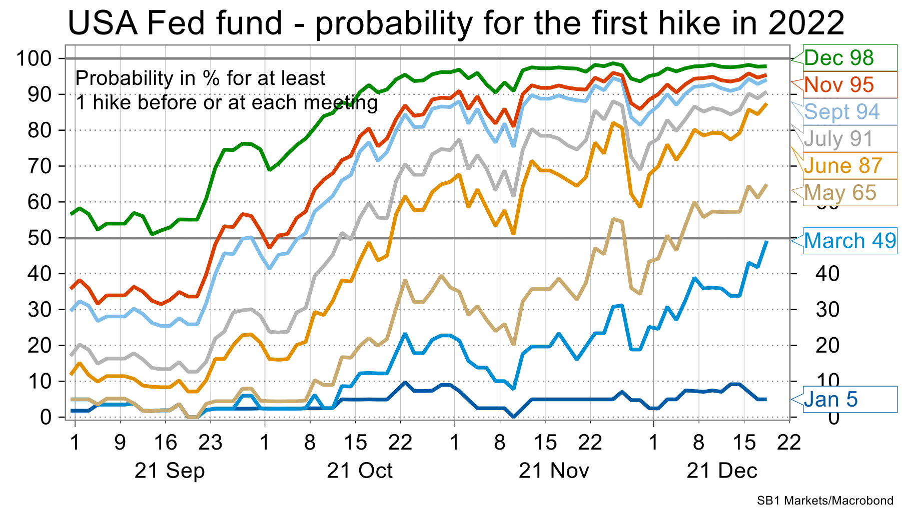
- The (median) FOMC member expects the unemployment rate to decline to 3.5% at the latest by the end of 2002, down from the current 4.2% level, and 0.3 pp lower than assumed in Sept.
  - » The bank expect the unemployment rate to stay at 3.5% the next two years
- The longer term ‘neutral’ unemployment rate is assumed to be 4%
  - » This is not the only piece of information for assessing it the ‘maximum employment’ target is met but still an important one
- So, to repeat the discussion from the previous page, the FOMC expect both inflation and employment to deviate from the long term targets at ‘the upside’ the coming years
  - » This policy mix will no doubt be heavily debated the coming months and years
  - » The risk is of course a more abrupt tightening after a while or a wage/price spiral that will require a massive monetary action at later stage to tackle, with an enormous cost for the whole society (except for those who short bonds, real estate and equities)

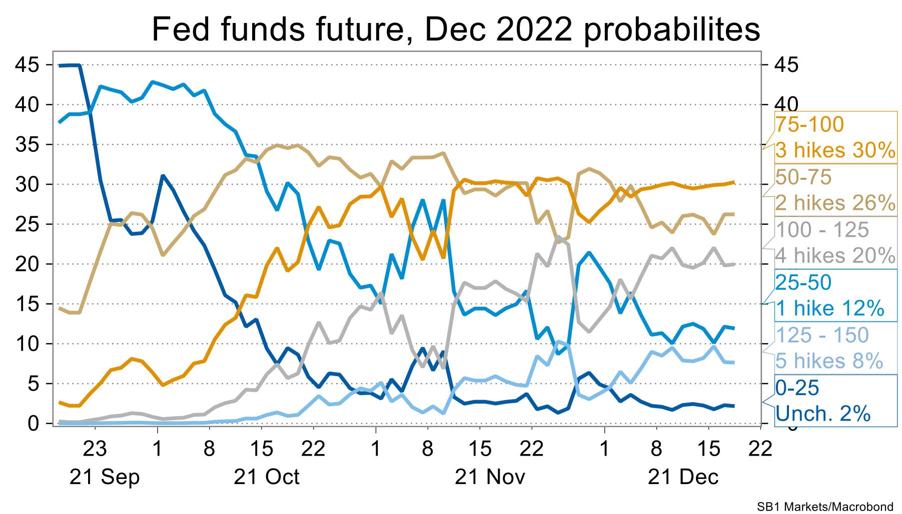
*) NAIRU: The Non-Accelerating Inflation Rate of Unemployment – an unemployment rate that balances the labour market. It is not stable, and it can be quantified only ‘after the fact’ but still a useful analytical concept.

A 49% prob. for a March hike? Why not. A hike before the summer a done deal

However, further out, US interest rate expectations fell rapidly last week



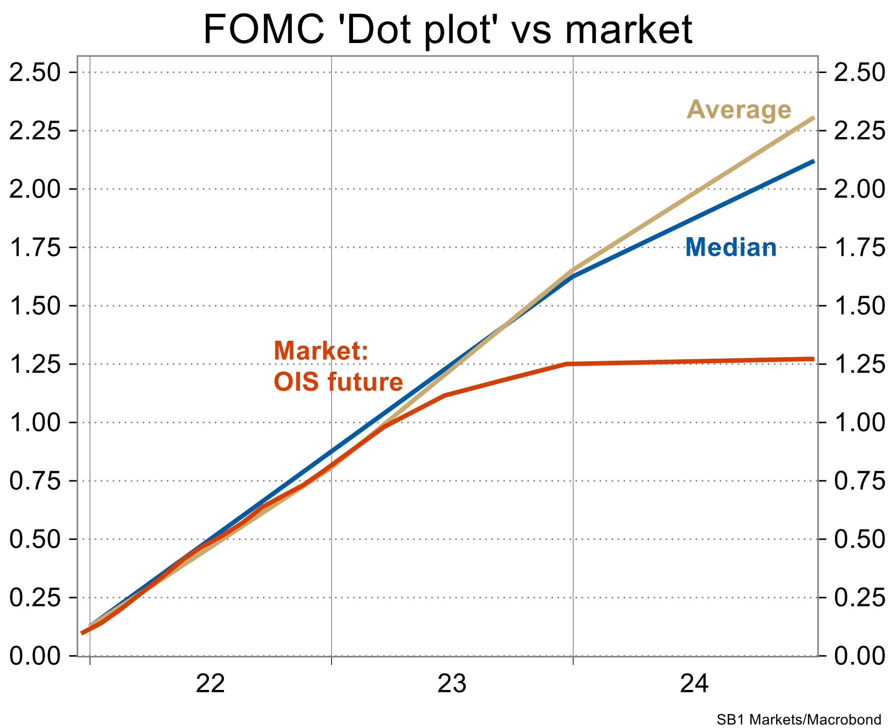


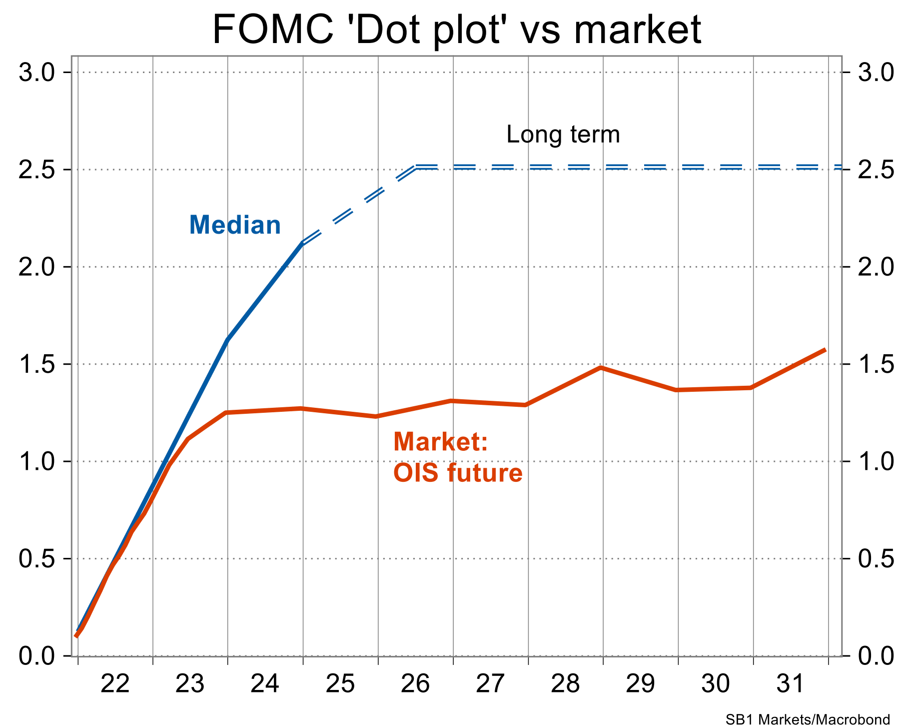


- Is a 1.75% - 2% Fed funds rate sufficient to create a recession when households are not in a down payment mode any more?
- We doubt, but the market seems to believe it –with some modifications, check the 2 next pages

Mind the gap: The market does not believe in Fed's est. of a neutral Fed funds rate

The market is satisfied with a 1.5% long term Fed funds rate, the FOMC says 2.5%

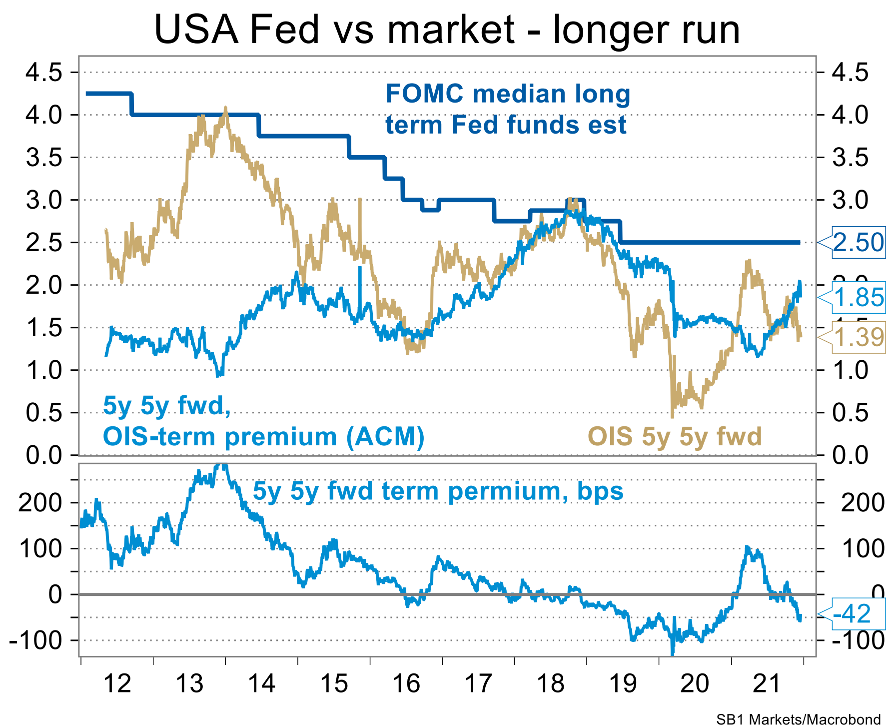




- The market accepts the first 4 Fed hikes, then the curve bends

May a negative term premium explain half of the gap between the market & Fed?

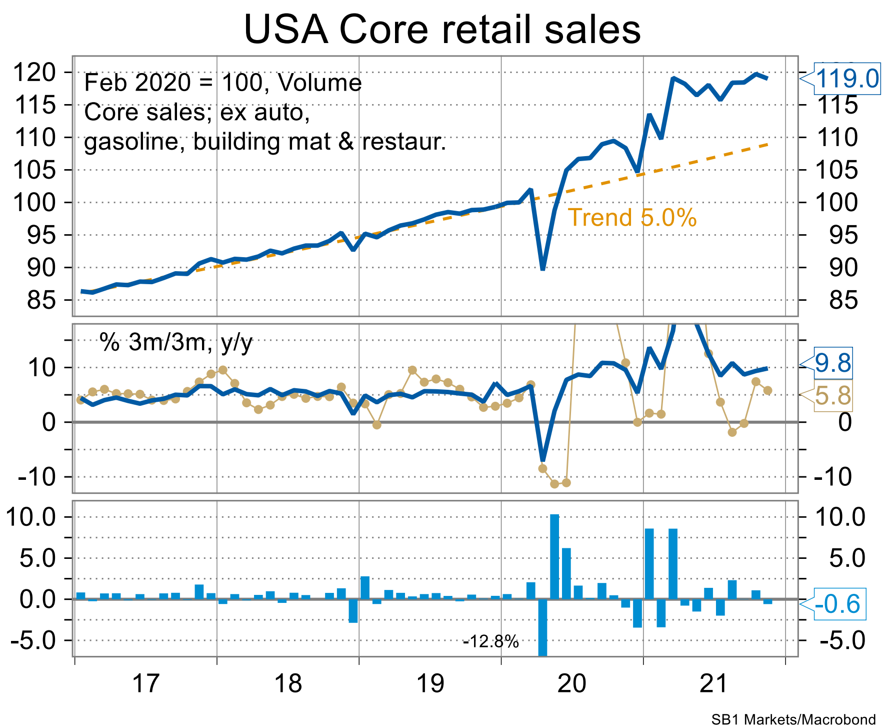
The (ACM) term premium has turned negative, implying that the market 'expects' a 2.1% long term FF

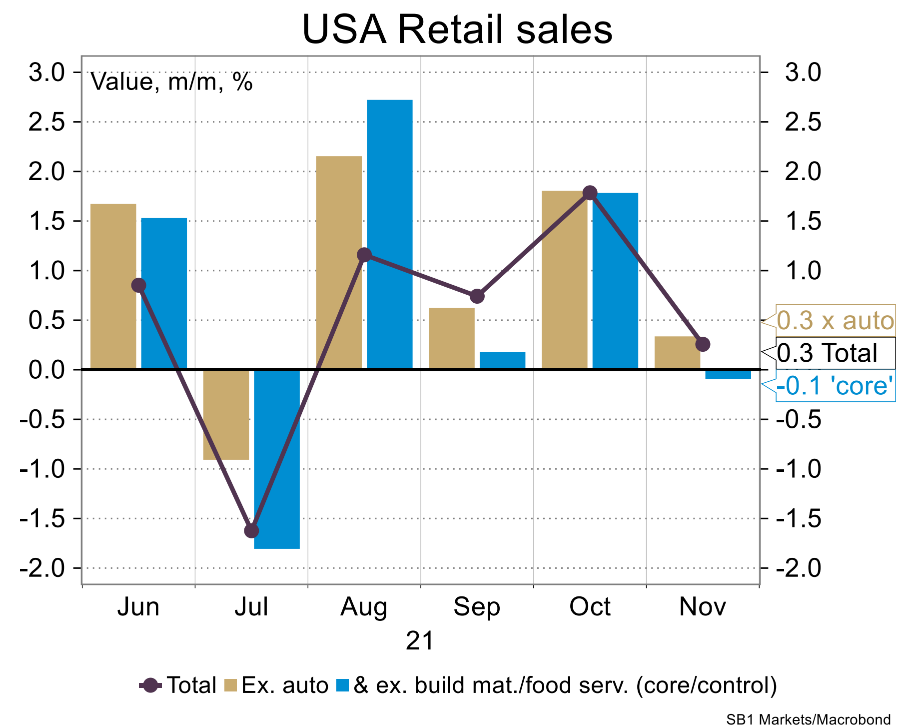


- The 5y 5 y fws OIS rate was at 1.39% (Friday), far below the 2.5% FOMC estimate of the long term nominal Fed funds rate
- The term premium in the yield curve (the difference between the actual bond yield and the expected short term rate over the same period) has fallen to below zero again, according to the ACM model
  - » Put the opposite way: The actual long term yield – the term premium expresses the market's expected short term rate
  - » The term premium has been drifting downwards since the 80'ies, and has been fluctuating around zero since 2016, according the ACM model (one of several term premium models)
- Adjusted for the term spread (calcated from the bond yield curve), the markets assumes a long term OIS rate at 1.85% (at Thursday), still far below the FOMC median estimate – but less than the 110 bps outright spread

Retail sales finally surprised on the downside!

Core goods volumes very likely fell – from an incredible high level

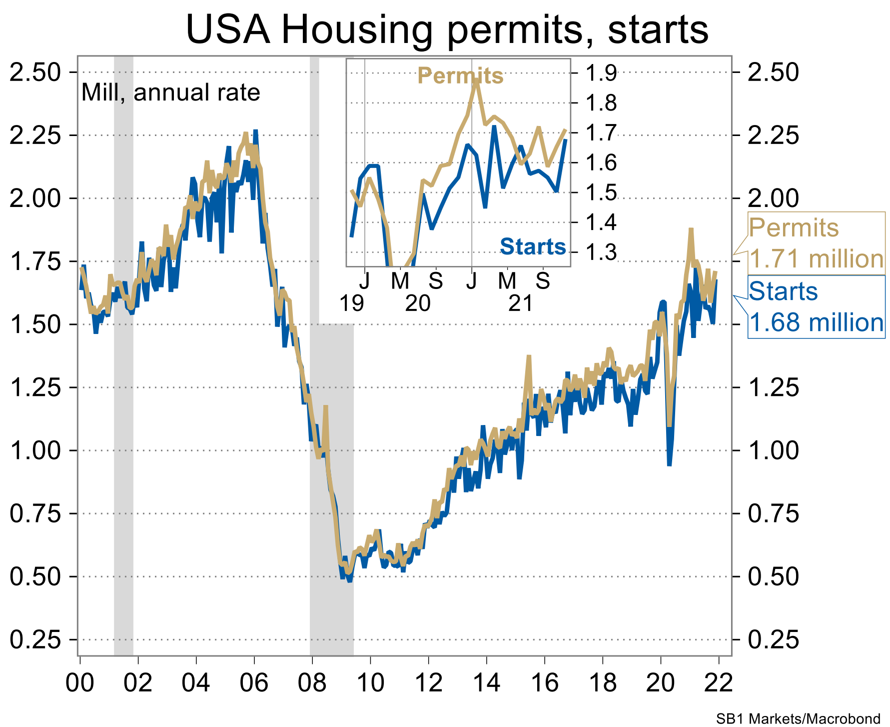


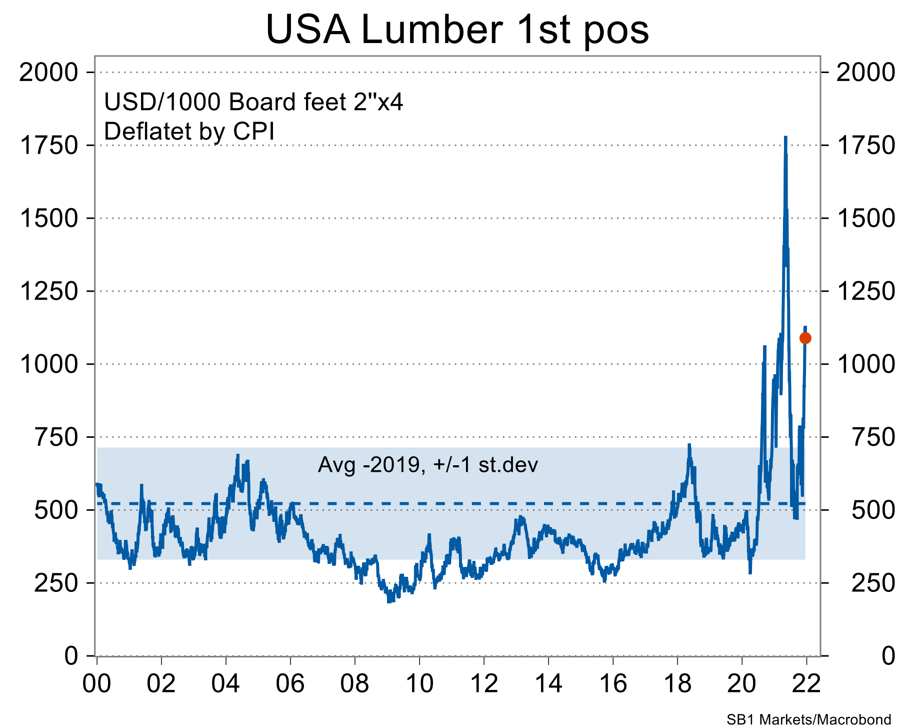


- **Total nominal sales** rose by just 0.3 % in Nov, expected up 0.8%. October sales were revised up by 0.1 p to 1.8%. Sales are up 22% vs. Feb-20 in value terms
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) fell by 0.1% in Nov, expected up 0.8%. In volume terms, we assume sales fell 0.5%. Still, sale volumes are 20% above the Feb-20 level, and sales the past two months are in line with sales before the recovery in services started in earnest, in March, and even if prices have soared in between time!
- Sales in **restaurants & bars** have flattened since July, and was unch in October– still 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 growth has not been strong since the spring!

Housing starts, building permits up again, as are lumber prices

Starts lower than the strong 2nd hand market normally would imply

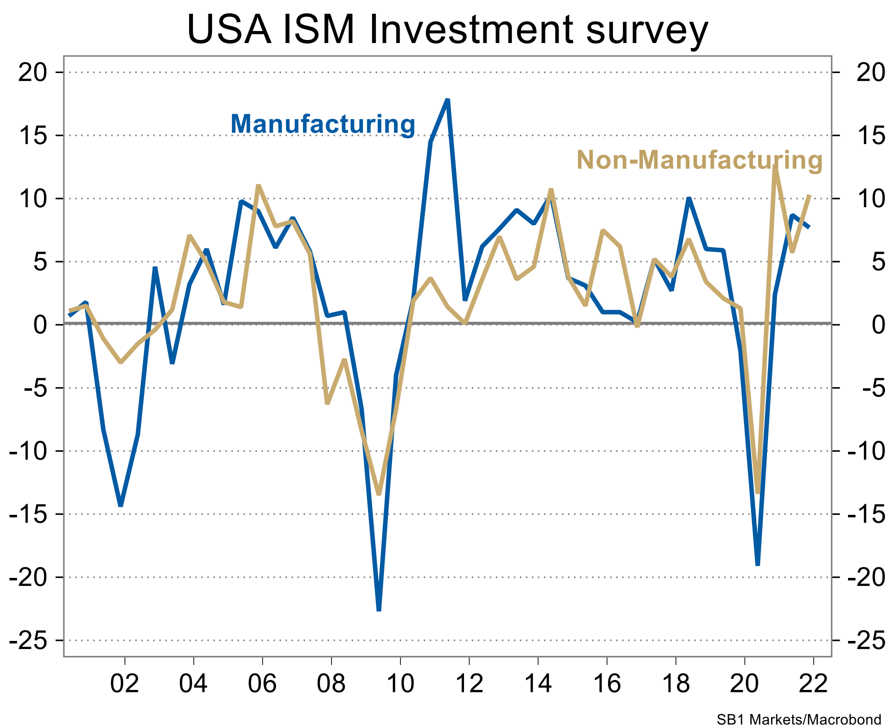


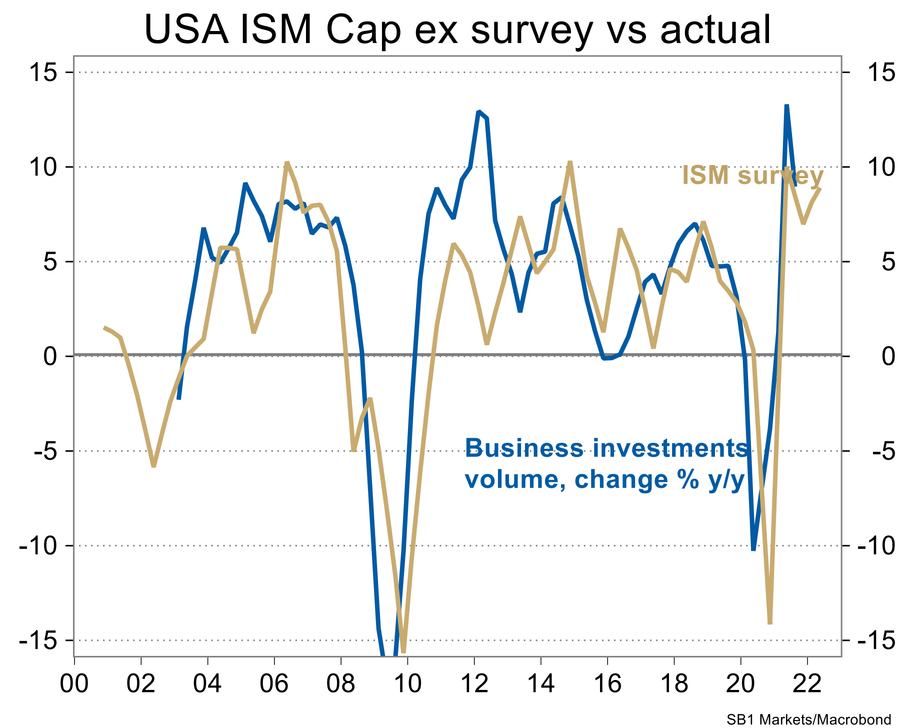


- **Housing starts** rose to 1.68 mill in November, from 1.52 mill in Oct, expected up to 1.57 mill
- **Building permits** rose to 1.71 mill, up from 1.65 in Oct, expected close to unch
- **Starts have flattened in 2021**, and barring some strong months late '20/early 21' the same goes for permits. The level is some 10% above the pre-pandemic level. However, given the incredible strong existing home market, and soaring prices, starts should normally have strengthened further, amid still very low mortgage rates and a recovering economy
- **Supply & capacity problems and higher cost** in the building sector may explain the lack of response. Lumber (2''x4) prices have doubled again recent week, from an average level. In May prices were 3.5 x higher than normal, and then 'collapsed'

ISM semi-annual investment survey: Among the best, ever

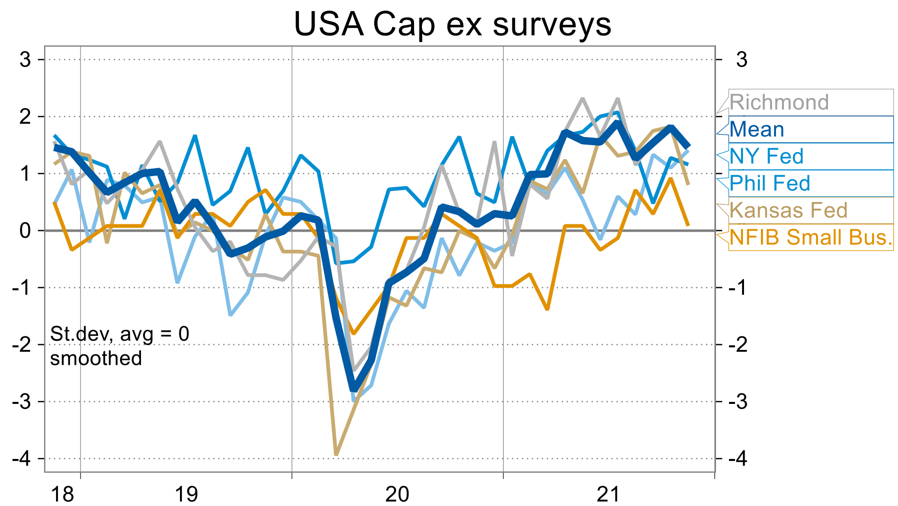
Businesses expect to increase their investments sharply the coming year, especially in services

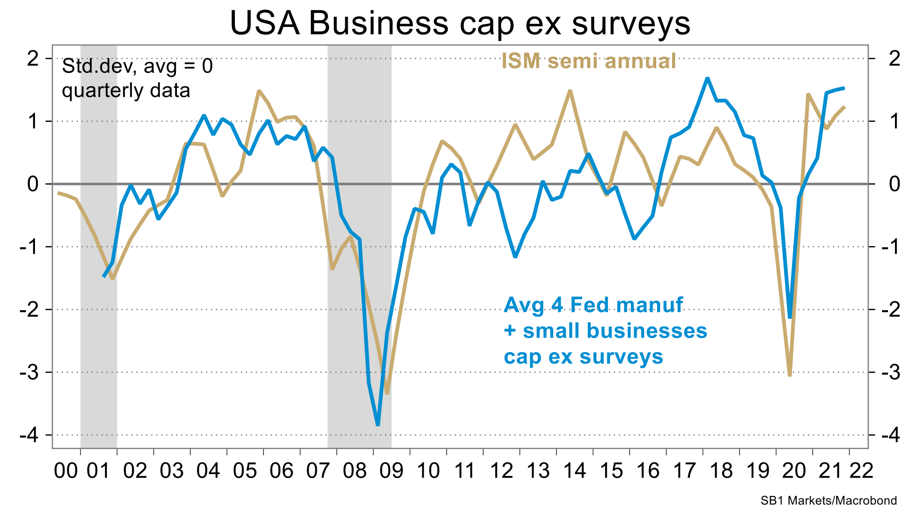


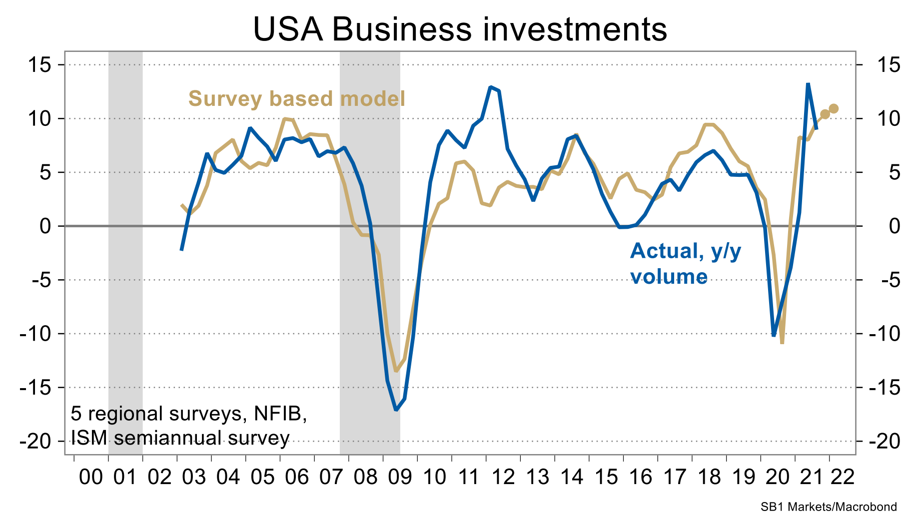


Other investment surveys also signal growth in business investments

Taken together, the most aggressive investment plans, ever – signaling 10% actual growth!

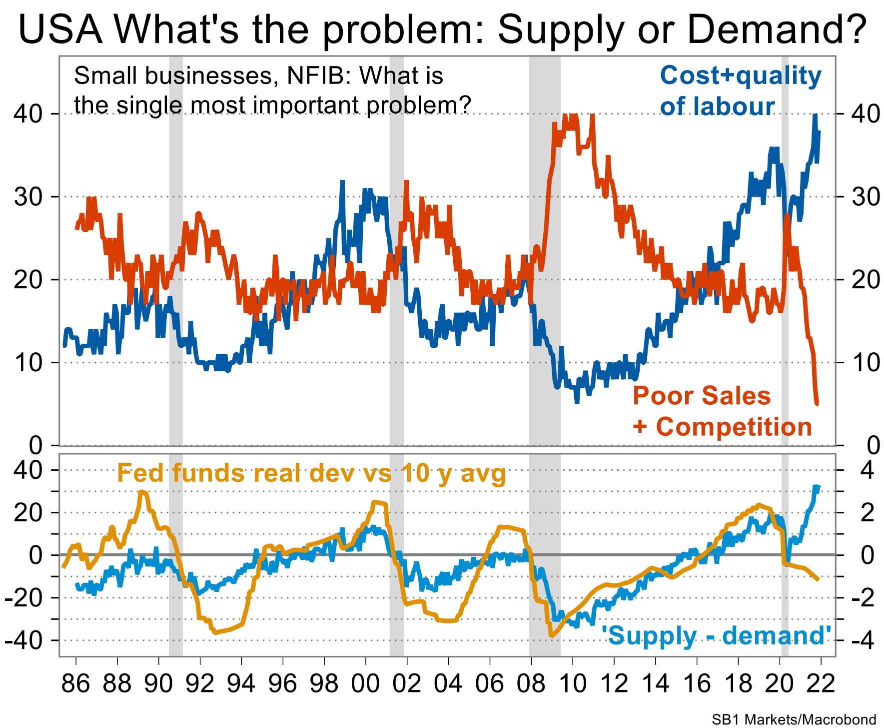


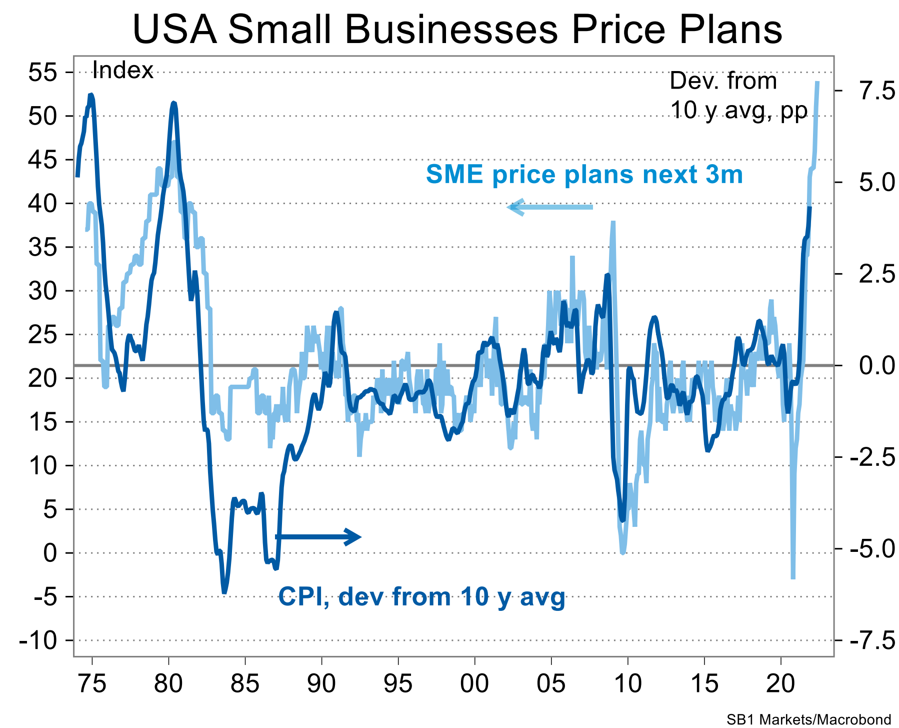




It's the supply side! And even more companies plan to lift their prices!

Last week, the Federal Reserve finally (officially) took notice.

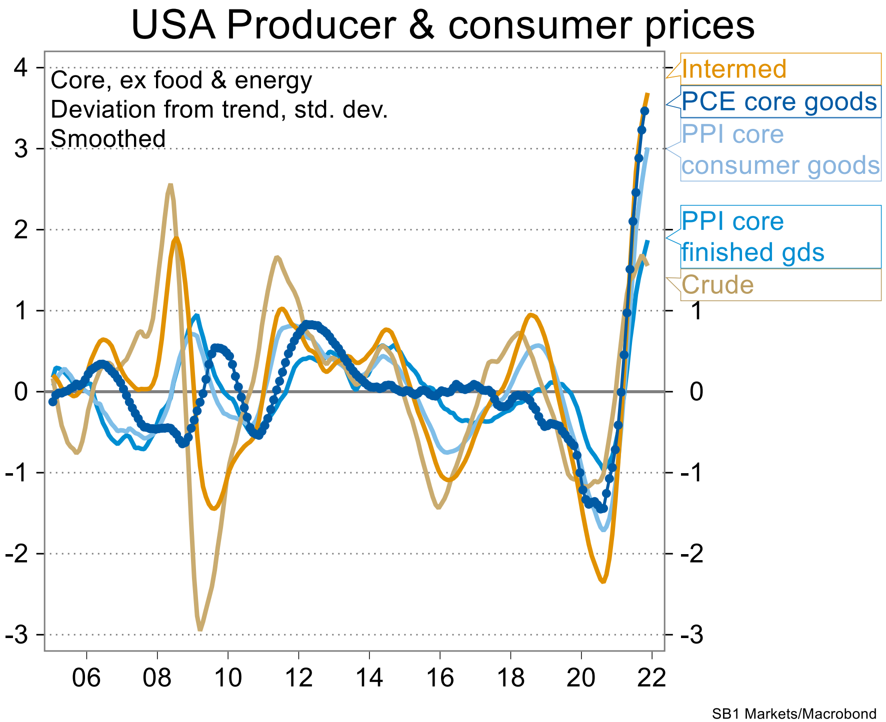


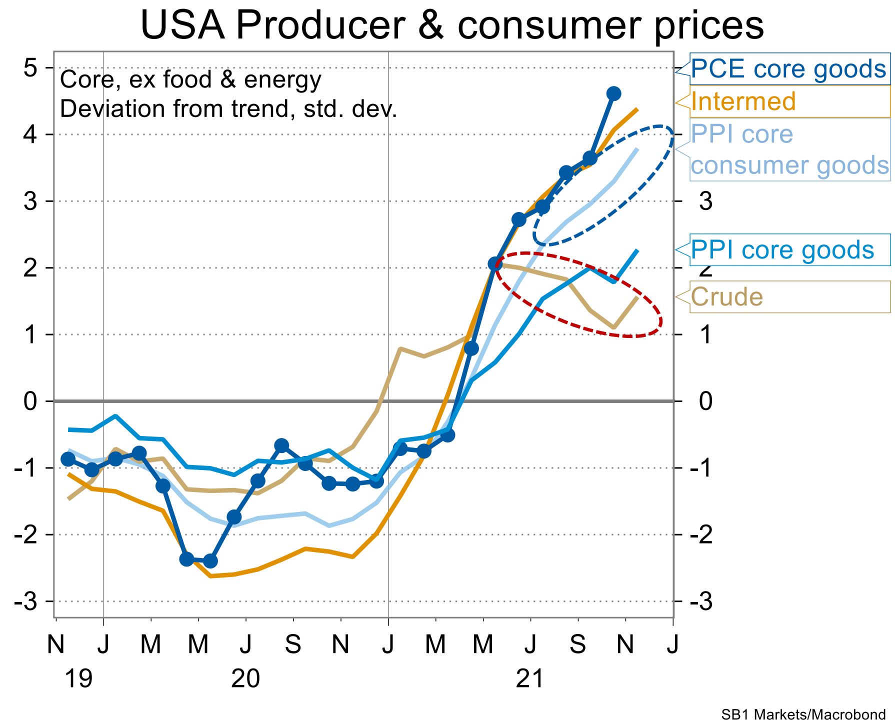


- More SMBs than ever plan to lift their **selling prices** than ever before, data from 1974
- In addition: 2 weeks ago a record share of companies reported they planned to **lift compensation** to workers
- This survey was mentioned by Powell, as one of several data points that finally made him change his mind
- The real challenge is though that the gap between the normal policy response to demand/supply changes, and the current stance is monumental. With today's demand/supply balance (which has anyway shot up into uncharted territory), Federal Reserve would normally have tightened substantially. Will it be possibly to get the labour and goods market in balance down without engineering a recession, by hiking rates much more than the FOMC so far signals?
  - » We have not seen that happen before. Perhaps Powell (the lawyer) knows something we others do not?
  - » BTW, the market believes it is possible too!

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

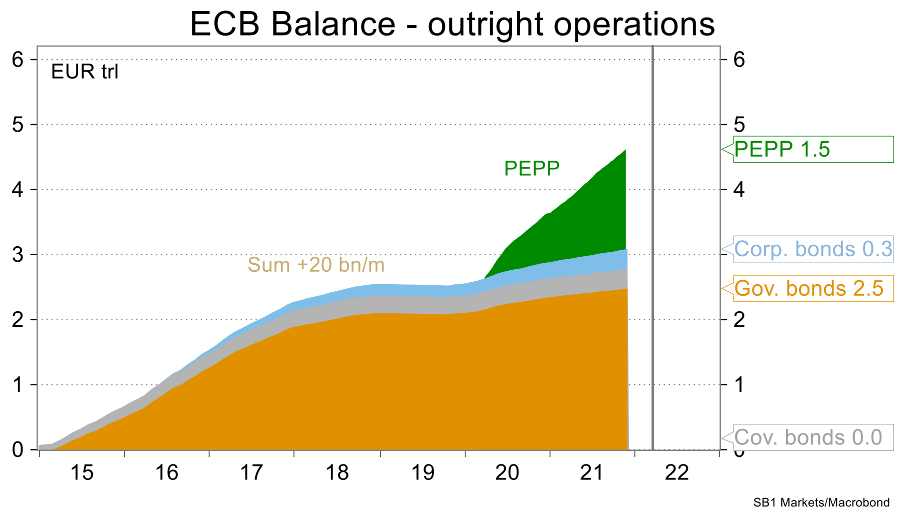
… However, core consumer prices have been rising earlier and more than normal vs. PPI prices

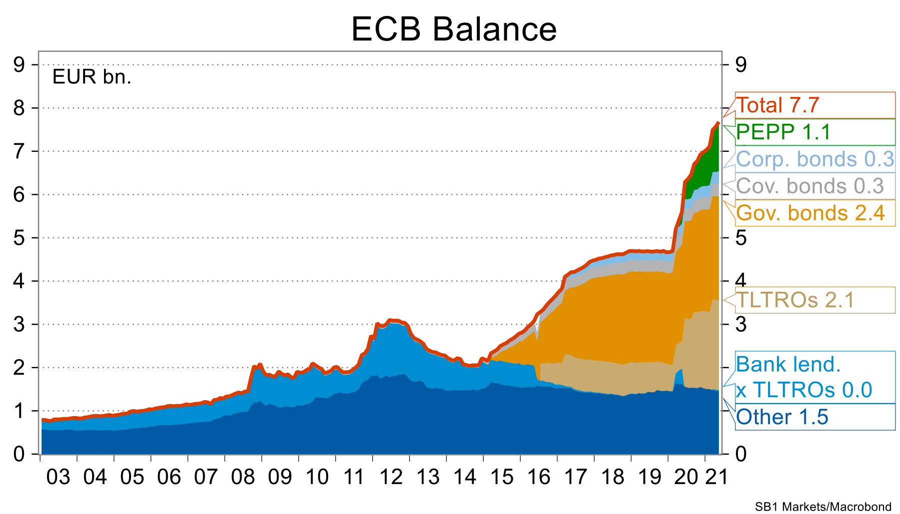




- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months – and crude prices have clearly peaked (see the red ellipse on the chart to the right). However, **intermediate prices** have not yet yielded by much – and they will push finished goods prices up the coming months
- Some more comfort: **Prices at the consumer level** (blue ellipse on the chart to the right) 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

ECB: Will reduced the QE program from March, no hike in sight

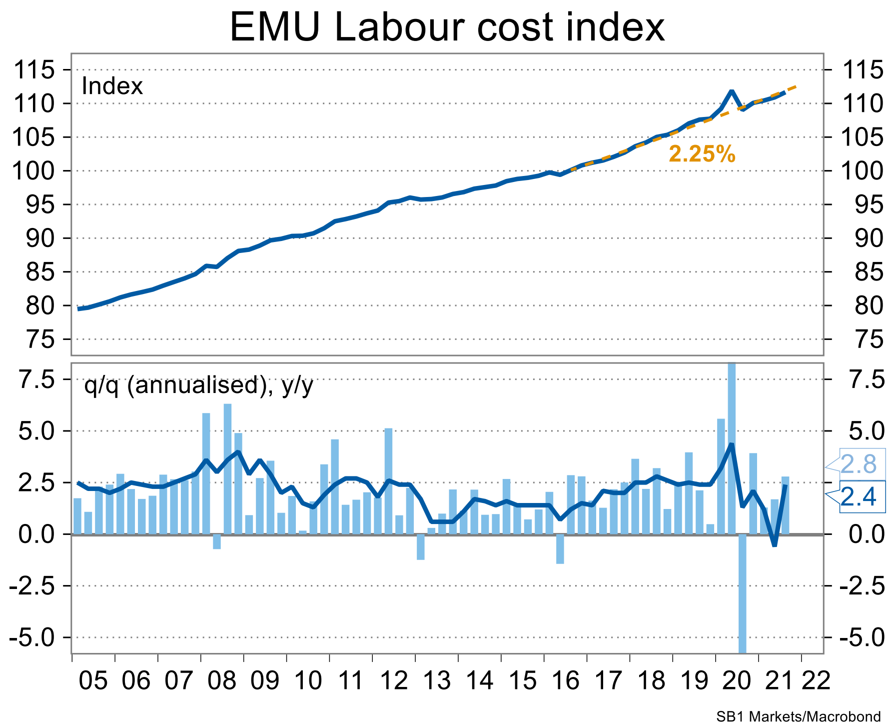


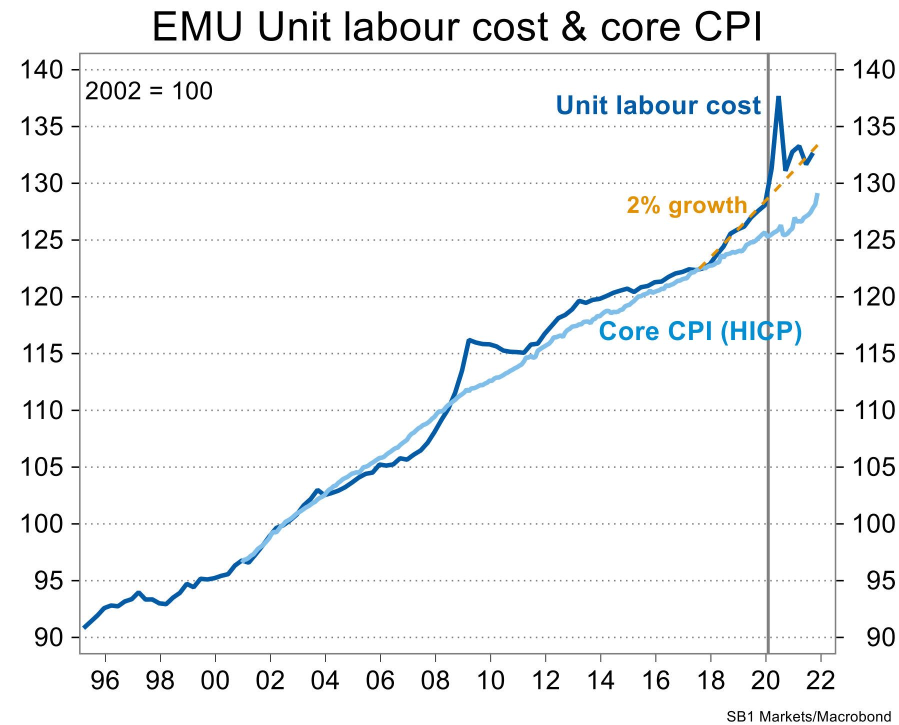


- **Inflation** has moved upwards on the agenda, but ECB is not as worried as the Federal Reserve, for good reasons. Underlying wage and price pressures are not comparable (and has not been for a decade)
- **The policy signal rate** remained at -0.5%, and Lagarde says the bank intent to keep it there for at least until 2023
- On the **QE programs – a 'rapid' (partial though) tapering**
  - » The Pandemic Emergency program (PEPP) will run until next March, then no more buying
  - » The 'ordinary' Asset Purchasing Program QE program will continue at approx. EUR 20 bn (government, corporate, covered bonds) will be expanded by 20 bn/month in Q2, and 10 bn/month in Q3 – and then back to the 'ordinary' EUR 20 bn in Q4
  - » The policy tightening was signalled at the previous board meeting (but not the actual figures)
- **ECB vs markets**
  - » Markets are questioning ECBs stance on rates, and the market is now discounting a first rate hike in late 2022

Labour cost back on track. Unit labour cost inflation has accelerated, to 2%

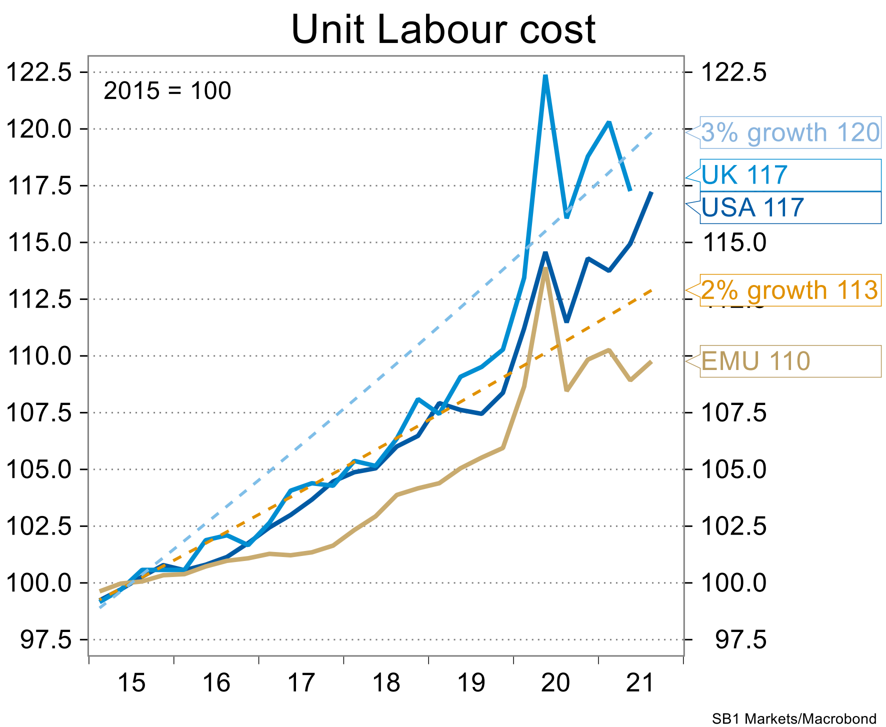
Labour cost rose 2.8% q/q (annualised) in Q3 – and is up 2.4% y/y. Trend growth still just at 2.25%

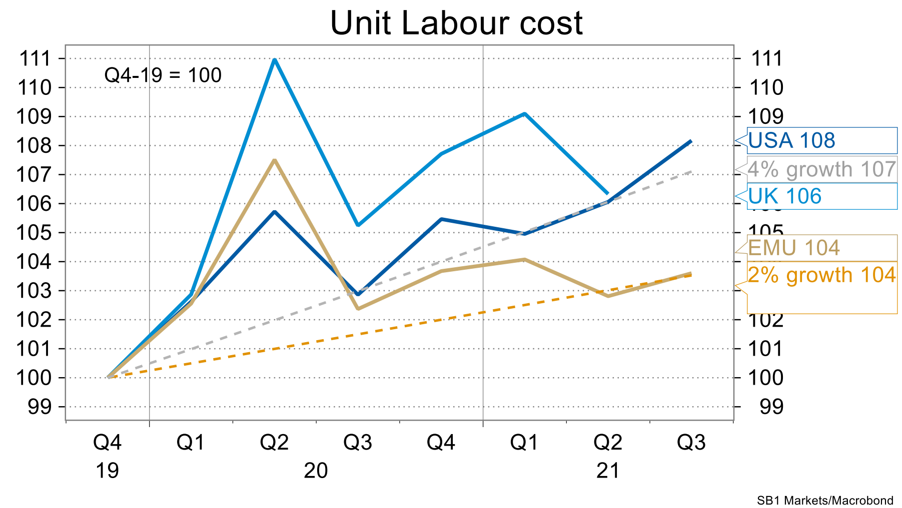




- Measured over the 3 -4 years, **hourly labour costs** are up 2% per year on average, which normally too little to generate inflation at 2% over time
- **Unit labour cost** (labour cost per unit produced = wage cost/production volume, growth in UCL= wage growth – productivity growth) has jumped up during the pandemic as productivity because employment was not cut as in the US but wage case not. However, as employment normalises, the ULC is normalising too – it has fallen sharply from the peak in Q2 last year
  - However, in the 3 years before the pandemic – and through the pandemic so far – ULC has accelerated to 2% from 1%. The 1% growth in unit cost corresponded to the long term growth in core rate of inflation – and a 2% ULC inflation will over time yield a 2% CPI inflation
  - In addition: Costs have been running faster than price inflation since 2017, keeping a lid on corporate profits. If demand is strong, businesses could (and should) restore profits by hiking prices to 'close' the gap vs ULC – helping the ECB to reach its inflation target

Volatile Unit Labour Cost data; US, perhaps UK have a problem, EMU not



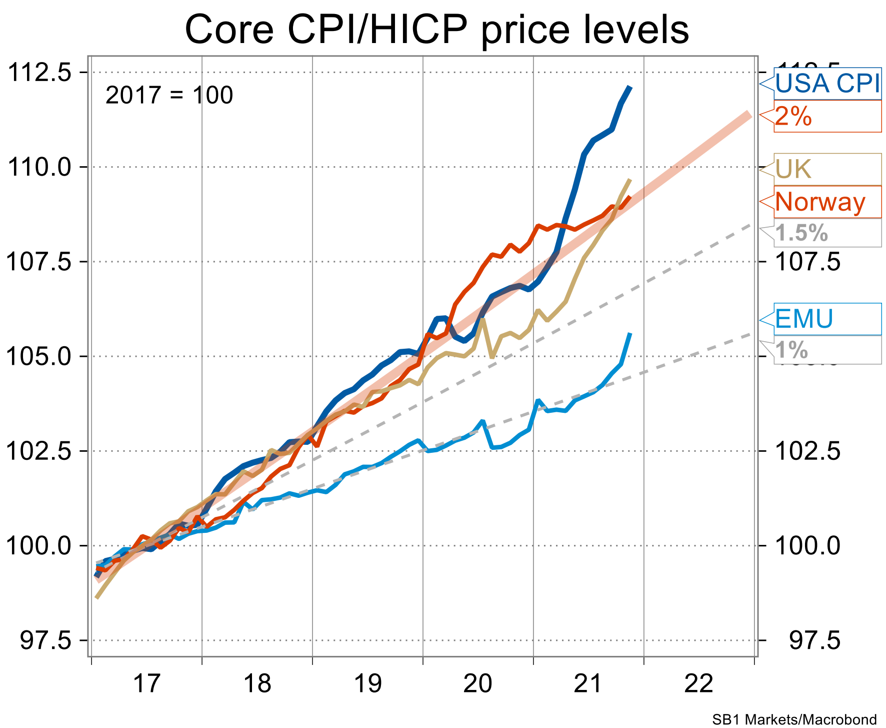


- US labour costs were revised upwards two weeks ago

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

The EMU & the ECB do not have the same challenges as USA & the Fed

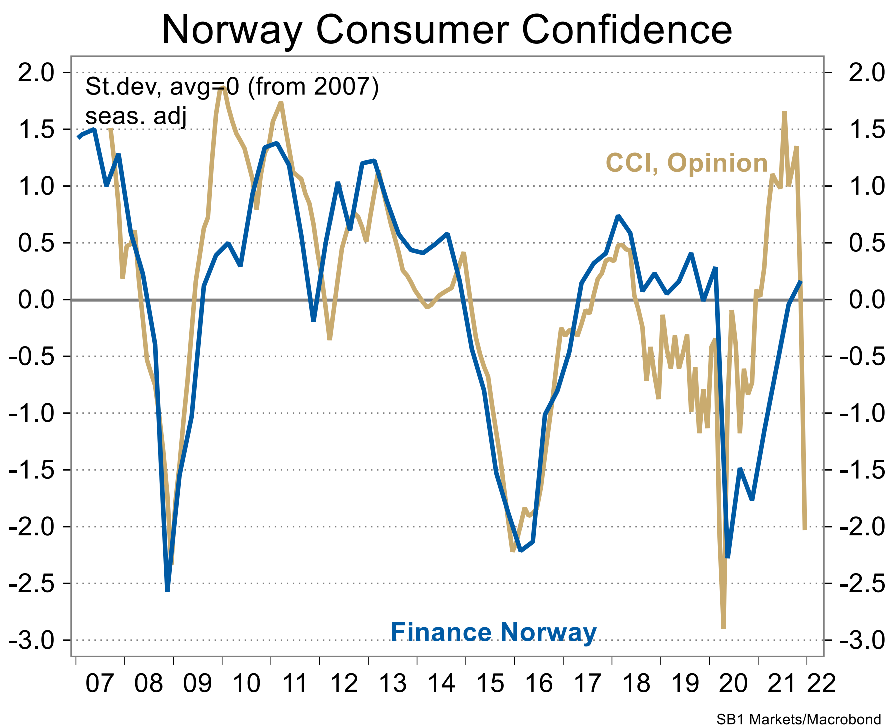
While UK may be positionend inbetween.



- Spot the huge difference between EMU and the others (here USD, UK & Norway)

No confidence left! From top to bottom in just 2 months!

Opinion's CCI down 2 st.dev in Dec, following -1.5 st.dev in Nov. Covid-19 & electricity prices to blame

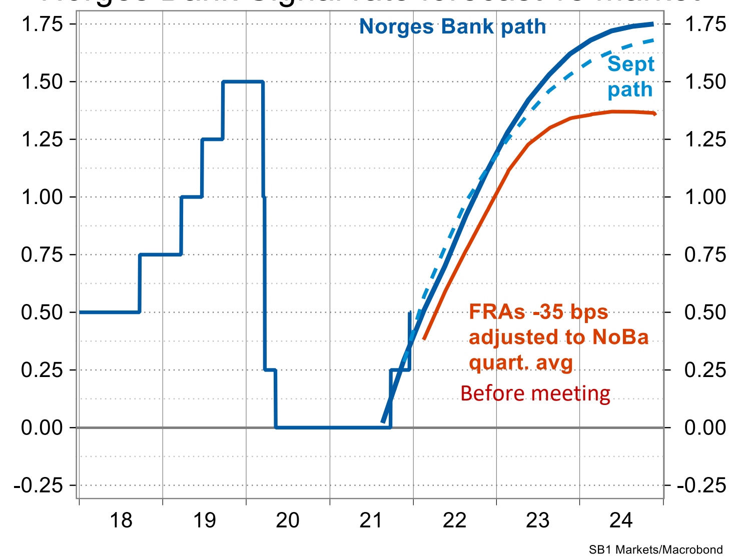


- This decline is even larger than the setback in confidence in March and April last year – we have never seen anything like this before!
- What has happened? We have just 3 candidates
  - » The return of the virus
  - » The surge in electricity price
  - » Interest rates on the way up
- We are quit confident that the two first candidates must take the blame, not the first Norge Bank hike in mid September (that did not lower confidence in late September or in October)

NoBa delivered the 2nd hike, more to come as soon as the virus is gone

The Bank lifted its interest rate path but not before 2023 and just by 9 bps, we expected more, earlier

Norges Bank Signal rate forecast vs market



Interest rate paths	Path 3-21	**Path 4-21**	Change bps	SB1M f'cast	Fair FRA * @IMM, NB	FRA pre meet	NoBa -FRA
Q4 21	0.28	**0.29**	**1**	0.25			
Q1 22	0.57	**0.51**	**-6**	0.34	1.02	**0.93**	9
Q2 22	0.78	**0.70**	**-8**	0.66	1.24	**1.10**	13
Q3 22	0.98	**0.92**	**-6**	0.98	1.43	**1.28**	15
Q4 22	1.12	**1.11**	**-1**	1.22	1.60	**1.45**	16
Q1 23	1.25	**1.28**	**3**	1.40	1.75	**1.58**	17
Q2 23	1.36	**1.42**	**6**	1.56	1.86	**1.67**	20
Q3 23	1.46	**1.53**	**7**	1.66	1.96	**1.71**	24
Q4 23	1.53	**1.62**	**9**	1.73	2.02	**1.73**	29
Q1 24	1.59	**1.68**	**9**	1.79	2.06	**1.75**	31
Q2 24	1.63	**1.72**	**9**	1.83	2.09	**1.75**	34
Q3 24	1.66	**1.74**	**8**	1.86	2.10	**1.75**	35
Q4 24	1.68	**1.75**	**7**	1.88	2.11		

**) Assuming a 35 bps NIBOR spread from Q1-22*

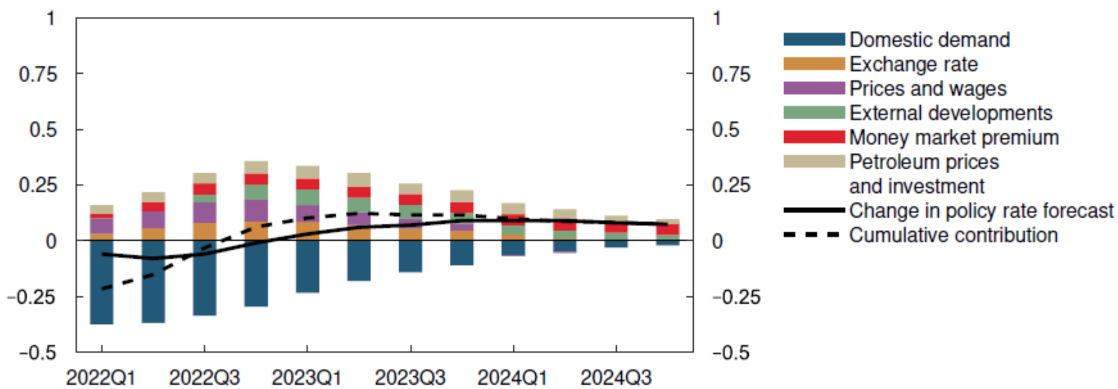
Q4 FRAs adjusted for liquidity prem

- **Key policy rate** was hiked by 25 bps. We expected the bank to wait and see 6 weeks, until the next meeting. The market was split, but the short end of the curve rose approx. 10 bps
- **The policy rate path** was revised down in 2022, as the possibility for another hike in January was removed, and the probability for a hike in March was reduced to some 75%. From early 2023, the path was revised upwards by up to 9 bps
  - » We expected the path to be revised upwards from H2-22 and by more than the 9 bps in 2023
  - » The bank's NEMO model suggested an interest rate path closer to ours, lower in the front, higher thereafter – as all but one factor – domesic demand – were signaling higher rates (check next page)
- NoBa started earlier than the other DM central banks due to **financial stability concerns** but even here the language on **inflation risk** has entered the vocabular.
  - » But the main argument for hiking is simply that the economy is operating at close to a normal activity level, more companies are reporting high capacity utilization and labour shortages and growth is strong barring assumed short lived virus problems. So there is no need for keeping the policy rate miles below what the bank assumes is the neutral rate
- **FRA rates** rose, and the **NOK** strengthened somewhat – but fell 0.1% during the week, just like the AUS, and the RBA did not hike

Reasons for the rate path lift: Everything, barring a (suspicious) weak domestic d.

The Banks main model argued for not hiking now – and for lifting the path faster thereafter

Chart 4.7 Higher price and wage inflation pulls up the rate path
Cumulative contribution. Percentage points



Source: Norges Bank

Our pre-meeting forecast was pretty close to the model output but we expected somewhat higher rates in in H2-22 onwards

Upside contributions:

- The NOK has been weaker than expected
- Wage and cost inflation is revised upwards
- The NOK has weakened
- Higher growth, higher rates abroad
- Oil price, oil investments

Downside contributions:

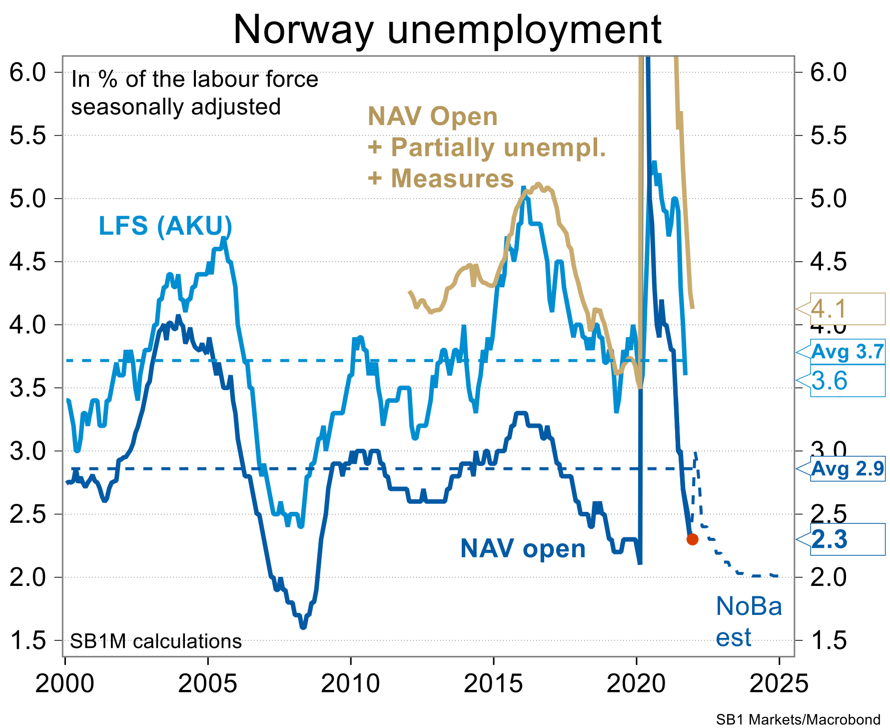
- Weaker Mainland domestic demand, not only in Q1/Q2, which could be expected due to corona risks, but all the way out to 2024
- We are not sure about that forecast

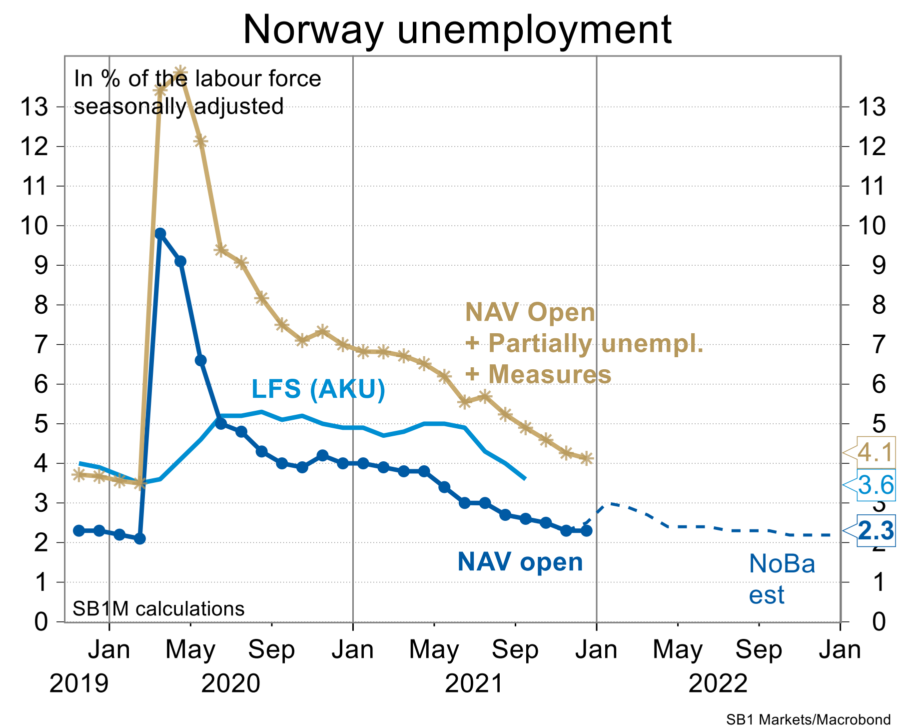
The board's adjustment

- In the last report, the MPC overruled the NEMO model, as it suggest a 50 bps hike
- Now, the committee prefers to hike, even if the model 'suggested' to wait and see
- In addition, the MPC lifted the interest rate path less than 'recommended' in Q4-22 and through 2003

NAV unemploym. further down in Dec, but more new claims, new vacancies down

Open unemployment down in number of persons but unch 2.3%, still 0.2 pp below NoBa's f'cast

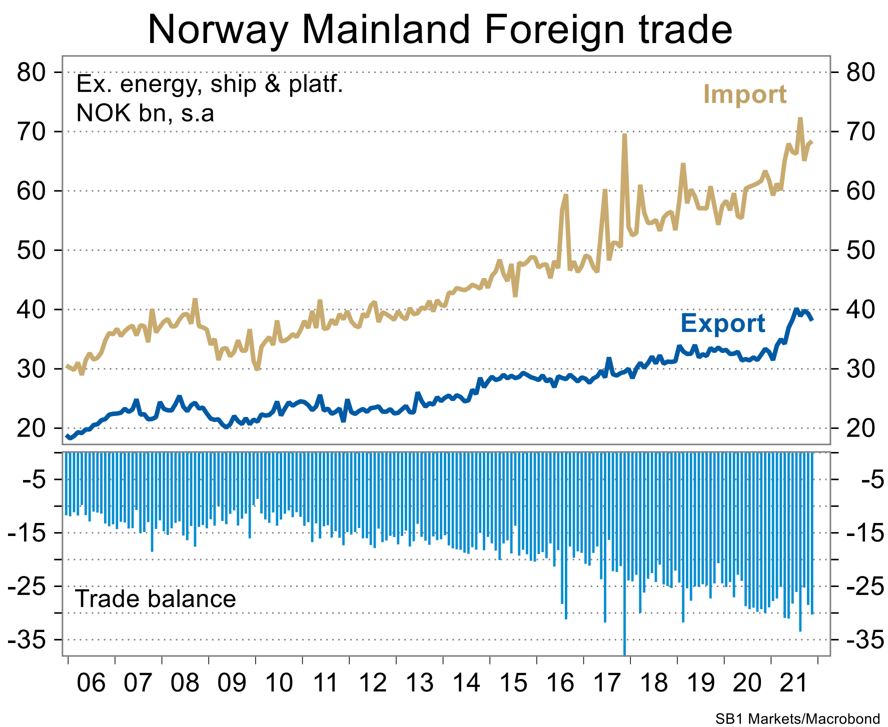


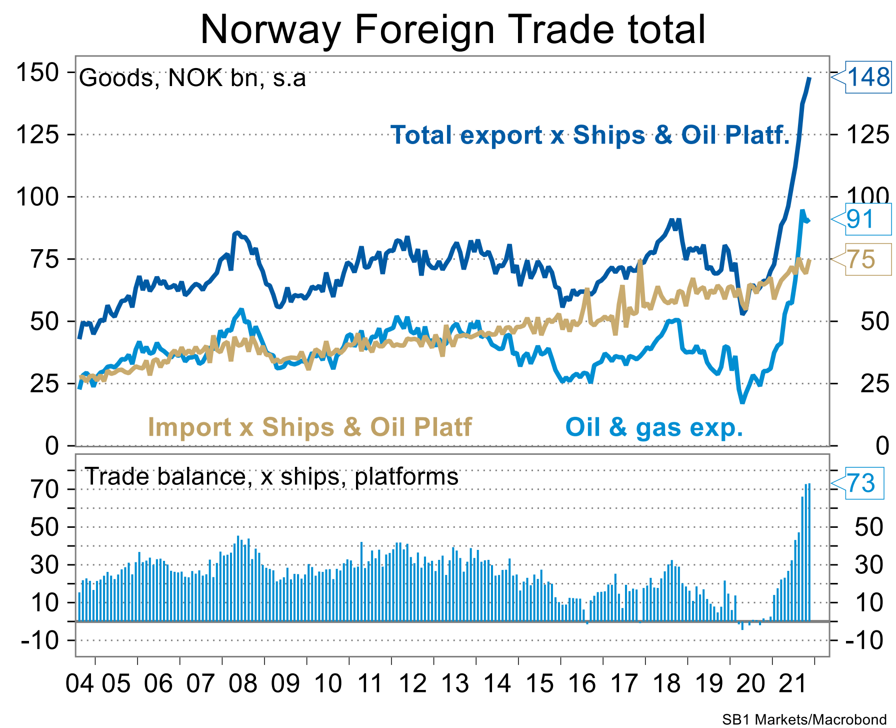


- **The 'full time' open NAV unemployment**, which includes furloughed workers, fell by 1.4' in September (seas. adj) to 65' we expected unchanged. The rate was unch at 2.3%, 0.2 pp below NoBa forecast from Thursday. (Unadjusted, the rate rose by 0.1 pp to 2.2%, as expected). The 2.3% rate is well below the 2000 – 2019 avg at 2.9%, and just 0.2 pp above the pre-pandemic level. Employment in travel/transport rose slightly, but fell elsewhere. Next month, expect a significant lift in unemployment in travel/transport – bur probably not in that many others!
- In addition, the number of **partially unemployed** (not included in the ordinary unemployment no.) fell even more, to by 2.5' to 39'. Incl. labour marked measures, the **total unemployment** fell by 4' to 119', to 19' above the pre-pandemic level. The rate is 4.1%, up from 3.5% in Feb-20
- The inflow of **new job seekers** rose , and the **inflow of new vacancies** fell from a very high level, both changes mostly due virus restrictions

Another ATH trade surplus, driven by gas exports

Total surplus at NOK 73 bn, or >25% of (Mainland) GDP



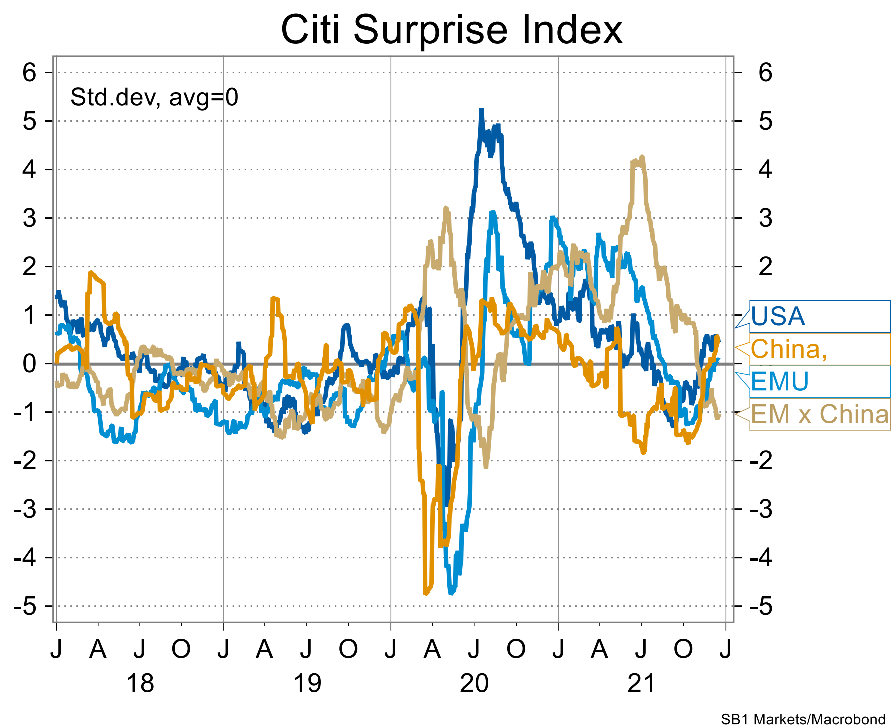


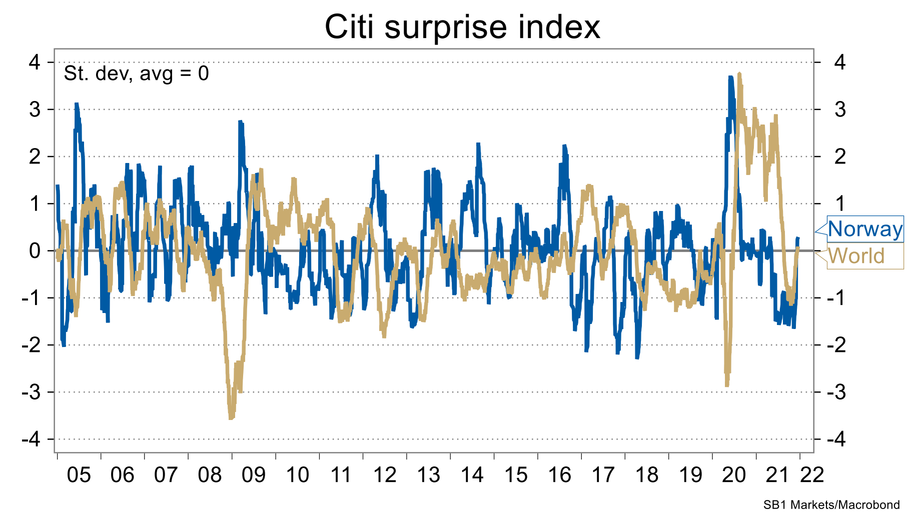
- **The <u>Mainland (non energy) trade deficit in goods</u>** rose to NOK 30 bn in Oct, up from 28 bn
- **Non-energy exports** fell – and the level has been flat since the summer – following a 30% lift since early 2021!
- **Imports** rose somewhat and is still at 10% growth path
- **Gas exports** fell slightly due a decline in gas prices. Oil exports rose marginally, and sum oil & fell slightly, seas. adjusted – fell slightly, to NOK 91 bn. So far in Dec, gas prices have climbed rapidly, and most likely the value of gas exports will grow substantially
- **The trade surplus in goods** (ex ships/platforms) was flat at NOK 73, an enormous amount – more than 26% of Mainland GDP!
- **The government's extra revenues** from oil and gas exports (and direct ownership) the past 3 months may equal NOK 150 bn, which will be transferred to the oil Fund

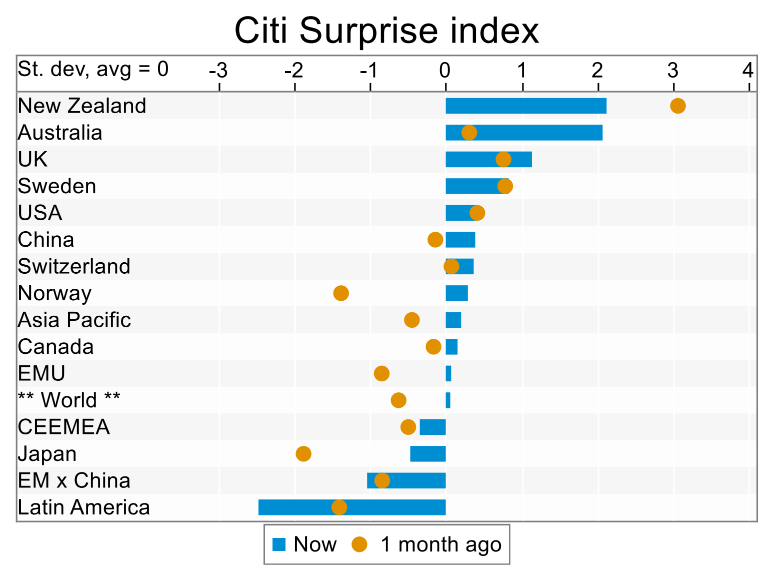
SpareBank 1 MARKETS

The global surprise index slightly above par – before Omicron hit

US above average, at China & the EMU crossed the line 3 weeks ago, Emerging x China still weak







- **Emerging Markets x China** have fallen to below par, after more than one year at the positive side. However, actual data from EM x China are not that bad, and the PMIs are recovering (at least until November)
- **Norway** has been surprising sharply on the downside, according to Citi. But 2 weeks ago week we crossed the zero line!

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

SB1 Markets/Macrobond

Highlights

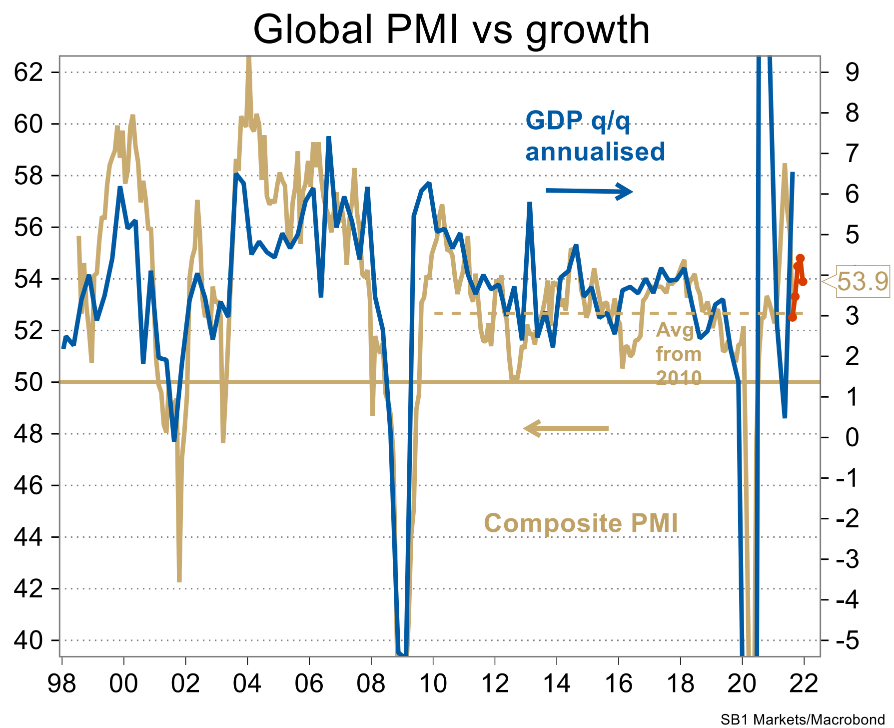
The world around us

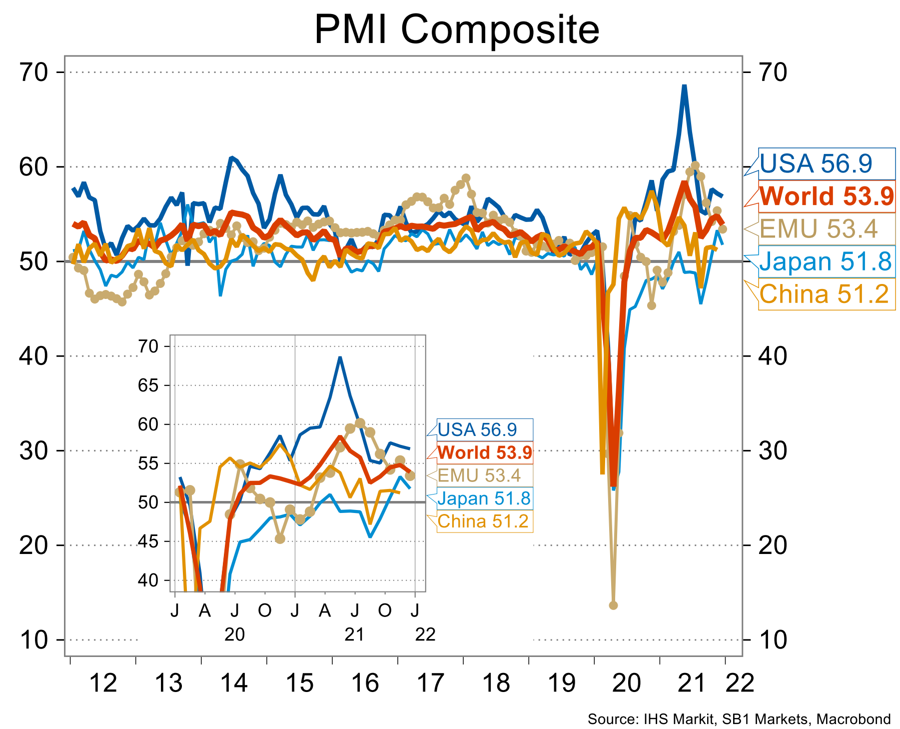
The Norwegian economy

Market charts & comments

PMI down in December as services yielded – but growth > trend signalled

We estimate a 0.9 p decline in the global composite PMI to 53.9 – a 4% GDP growth pace signalled

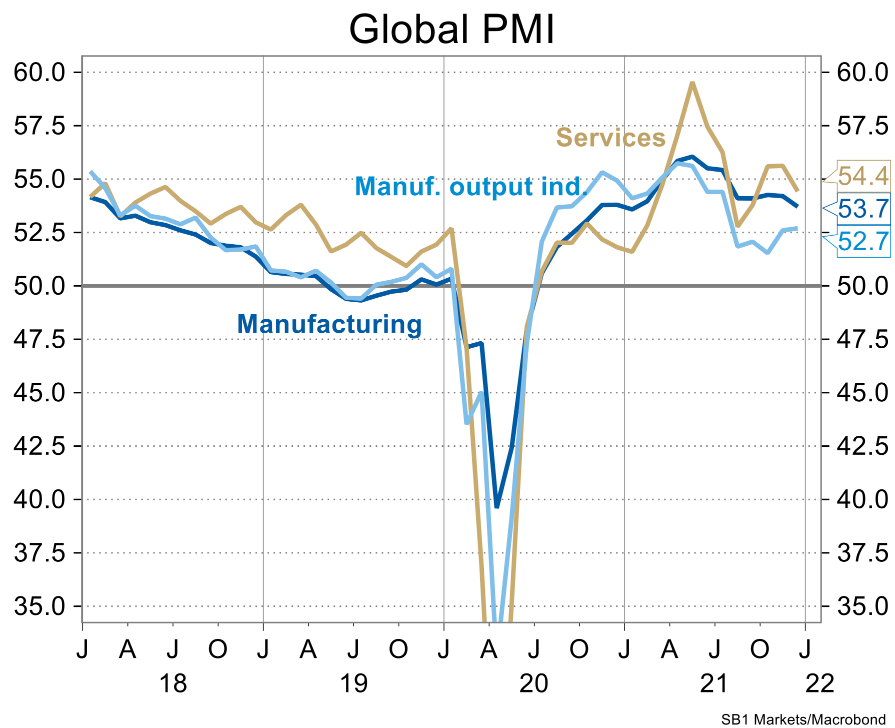


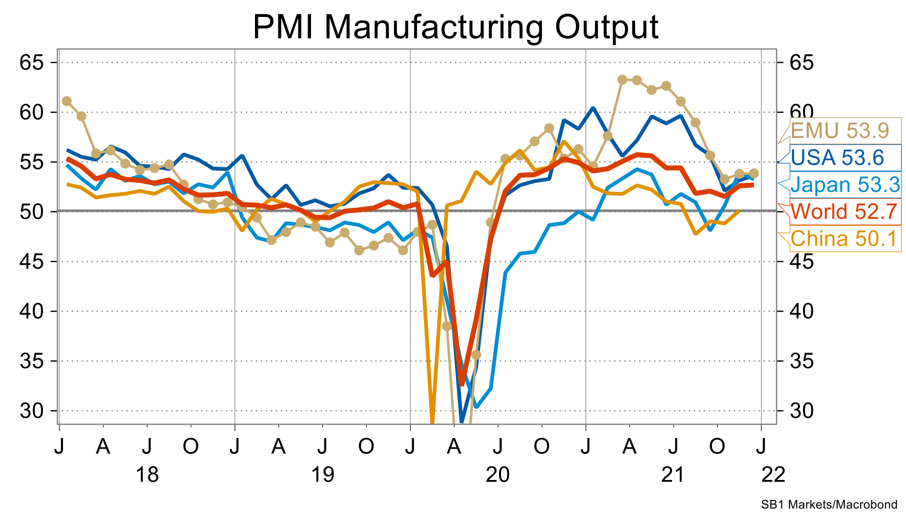


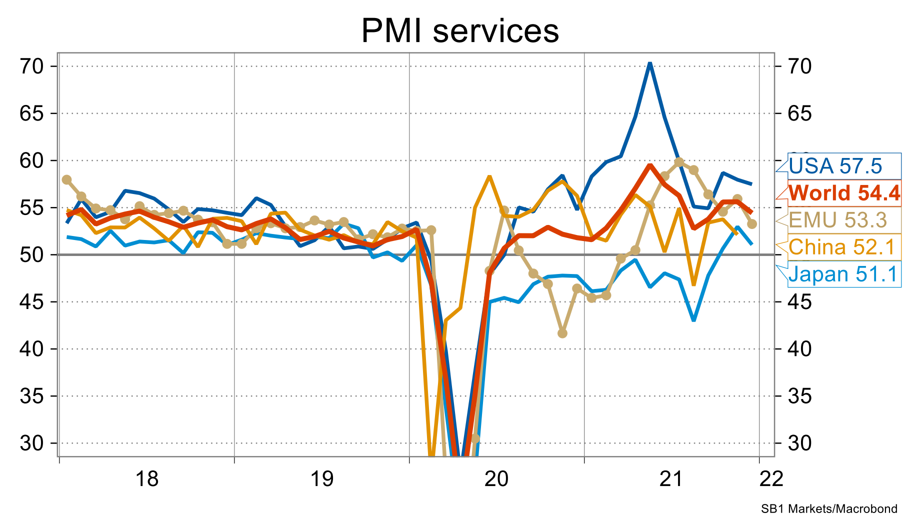
- **The flash composite PMI** December estimates fell and more than expected everywhere – and the most in EMU and UK where services reported substantially slower growth (with Germany as the laggard in the EMU, down to contraction mode). The virus outbreak is no doubt to blame!
  - US is still in the lead, but both EMU, UK and Japan are reporting growth
  - The manufacturing output index rose marginally, while the service index fell sharply
- **The delivery times index** fell for the 2nd month in row – and **price inflation slowed**. Growth may be moderating somewhat but orders are still growing faster than normal, also in the rich part of the world. We doubt a sudden corona related decline in demand explains the reduced pressure in the value chain but perhaps a gradual normalising of demand for goods in the rich part of the world an less hoarding after the Christmas season ease the supply chains bottleneck?

Our estimates are based on the preliminary PMIs from US, EMU, Japan UK, and Australia. The estimates are uncertain, but usually by less than 0.5 p

Manufacturing still going strong, services slowed visibly, and the most in EMU

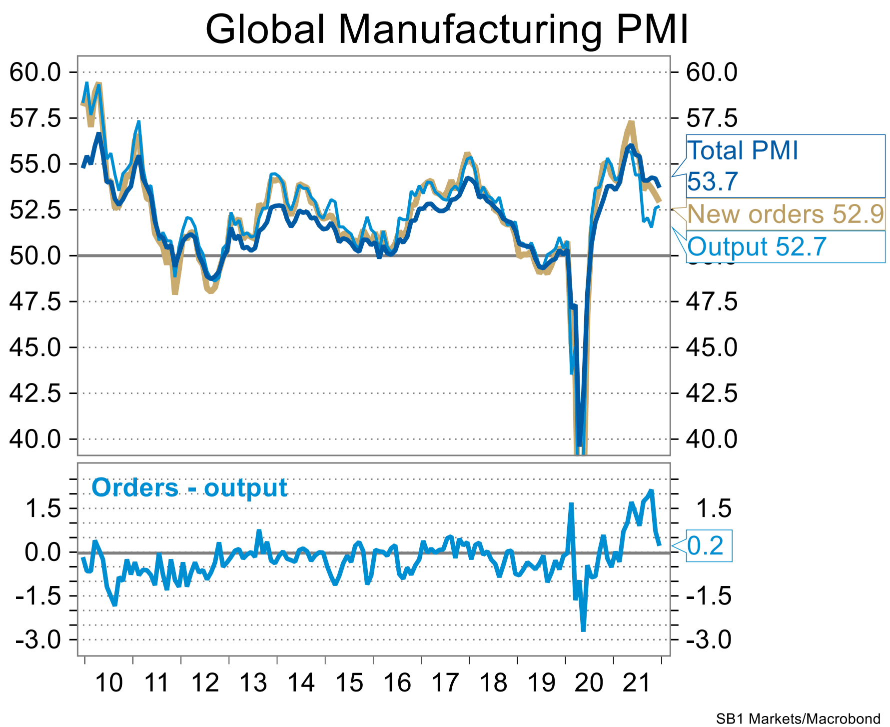


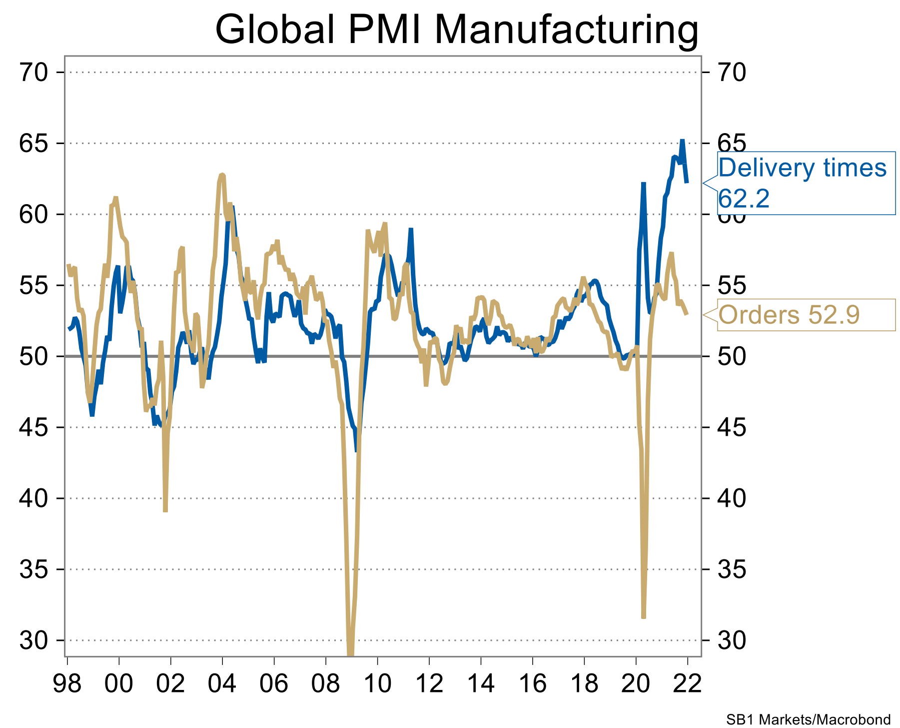




Growth in manufacturing orders are slowly slowing, are still growing above trend

The delivery times index fell further in December but remains at a very high level

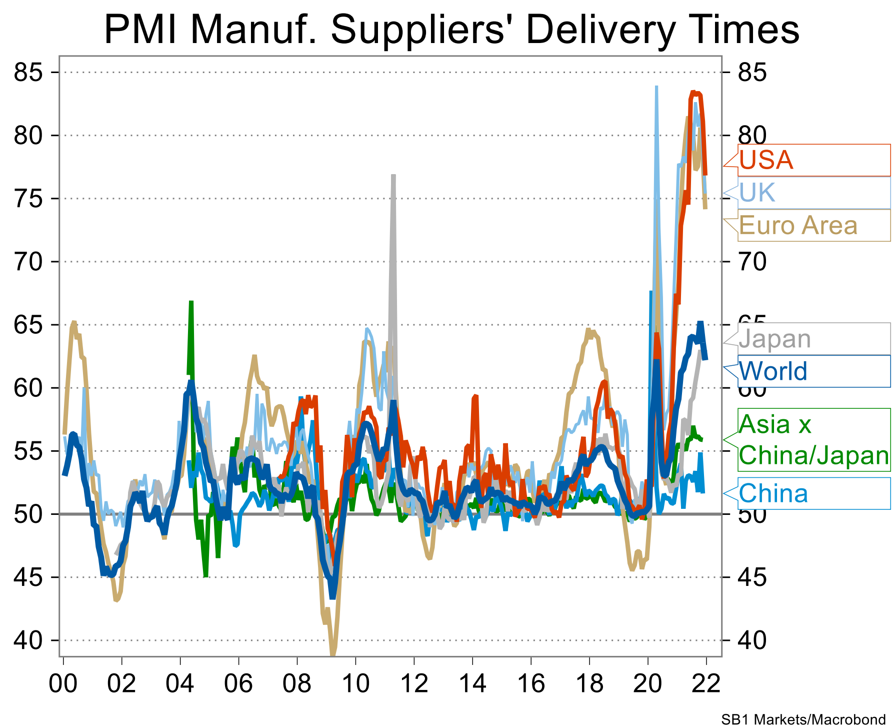


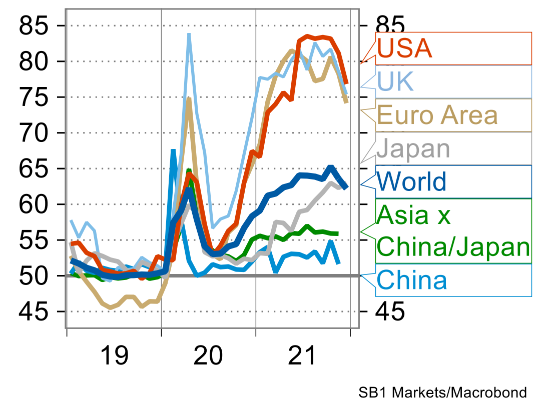


- **The current capacity in the manufacturing sector is more than reached**. The question is of course: How much is capacity (transitory) impaired by the fight against Covid-19? It is impossible to know before after the fact. Delivery times have increased more than growth in orders or production normally explain
- However, problems are most acute in Western countries where demand for goods have been much higher than normal. That may indicate the 'normal' capacity is not necessarily impaired but rather that the exceptional strong demand for goods – of course buoyed by exceptionally fiscal and monetary policy measures during the pandemic – is the main reason for the surge in delivery times and prices

Delivery times index further down in December

Are delivery times increasing less fast or are they slowing?



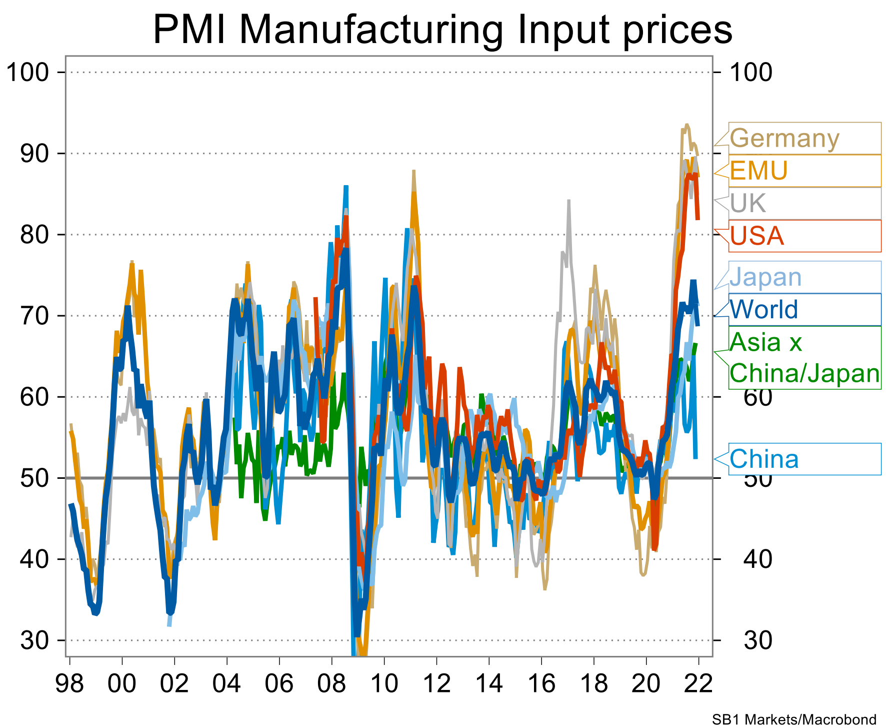


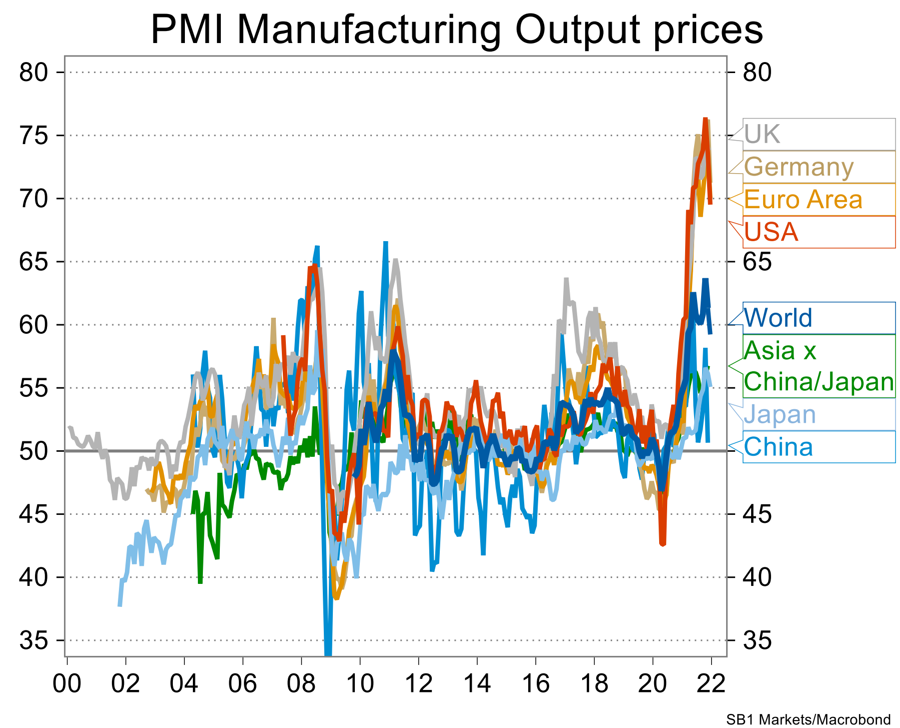
- Long delivery times have been a rich man's problem, while delivery times have not been that problematic in Emerging markets, China included

- **The global delivery times** PMI sub-index (changes in delivery times vs the previous month) inched down in both November and December, signalling some easing in congestion in the supply chains
- **The interpretation of this index is uncertain** – are companies really reporting changes in delivery times?
  - » This index as been above 50 most of the time (the past 20+ years), signalling longer delivery times. However, delivery times have not increased almost all the time – they have rather fallen! Companies may be reporting the level of delivery times. If so, delivery times are now contracting – while the index formally reports than delivery times are increasing at a marginally slower pace

Price indices have peaked – raw material prices have calmed down

However, companies are still reporting very rapid price growth in the rich part of the world

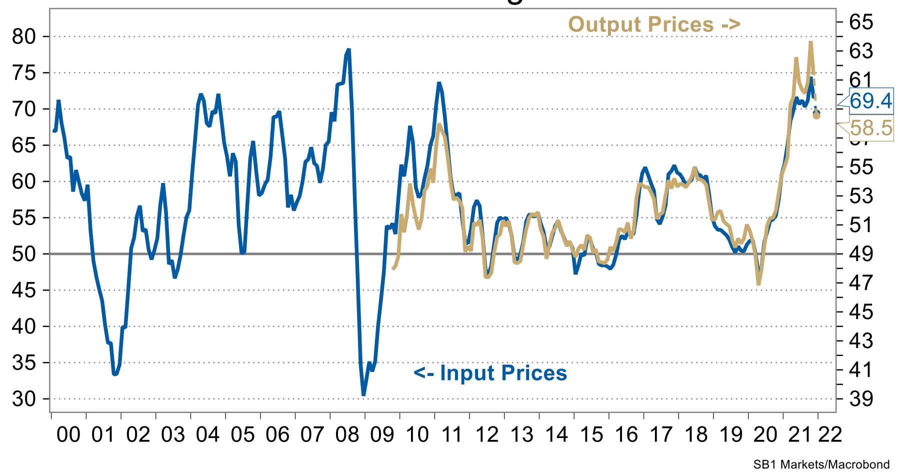


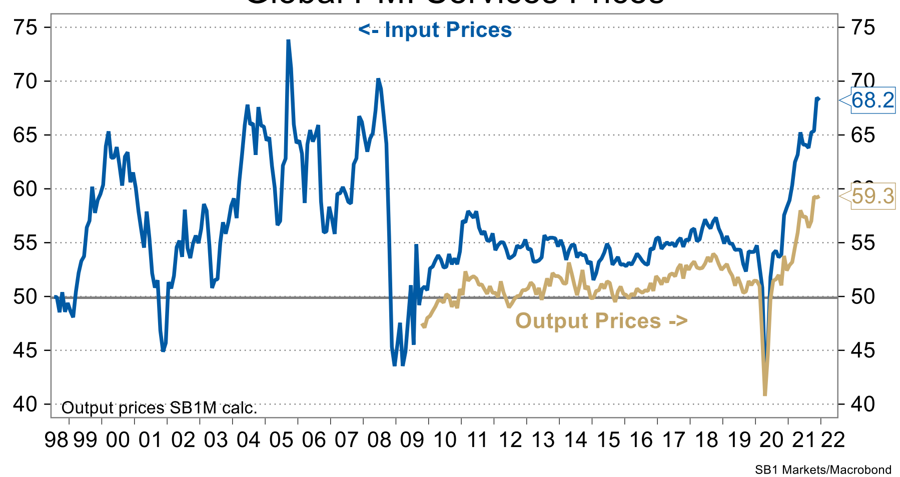


- Even so, some relief

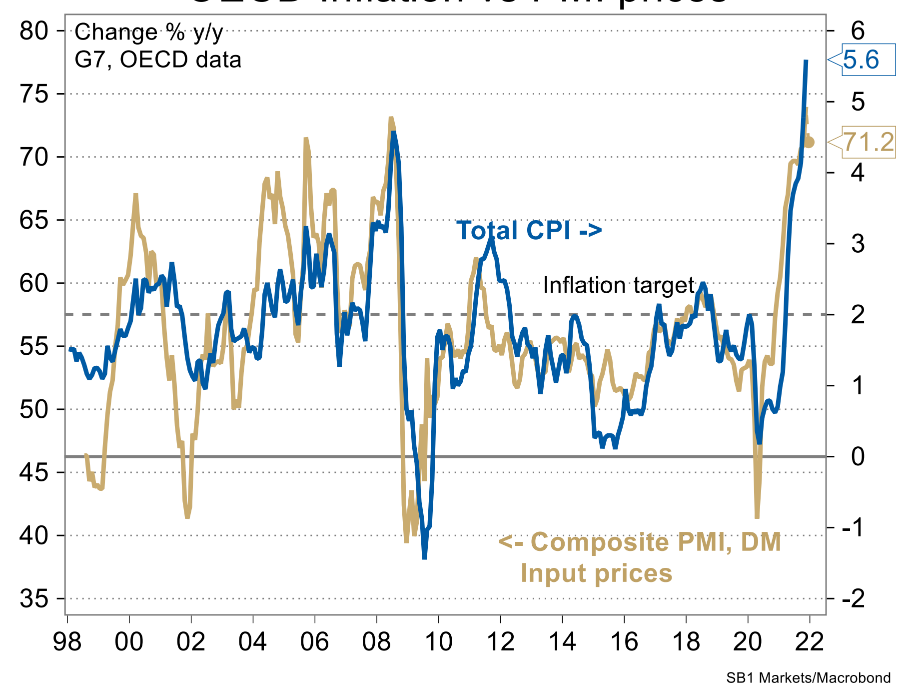
Price indices have peaked, at least in manuf. – but it remains high

However, as soon as energy & other commodity prices stop rising, inflation will retreat rapidly





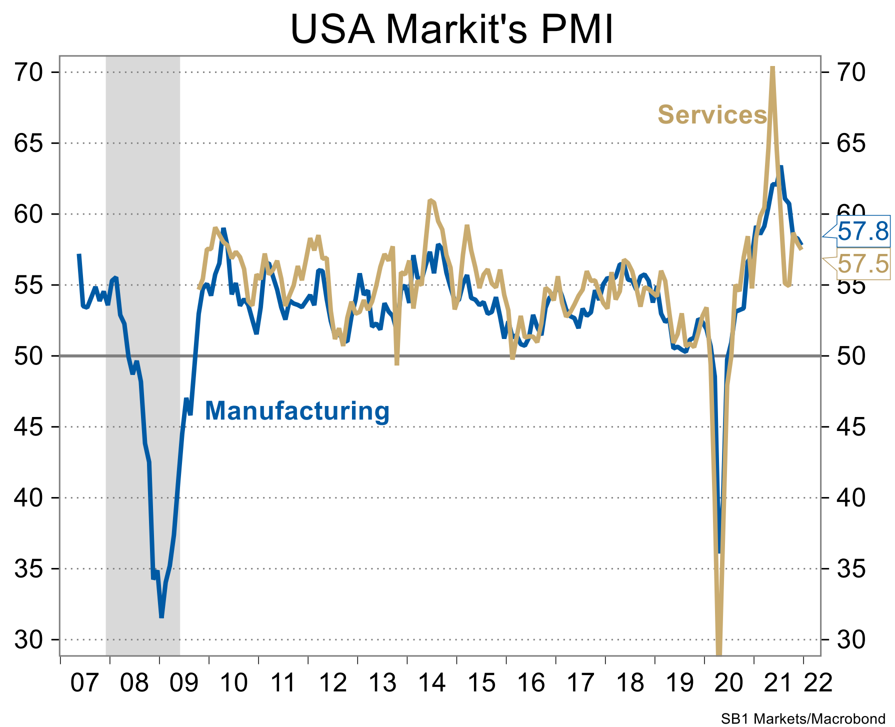
The last services PMI priced based on preliminary PMIs from EMU, Japan, UK, and the US

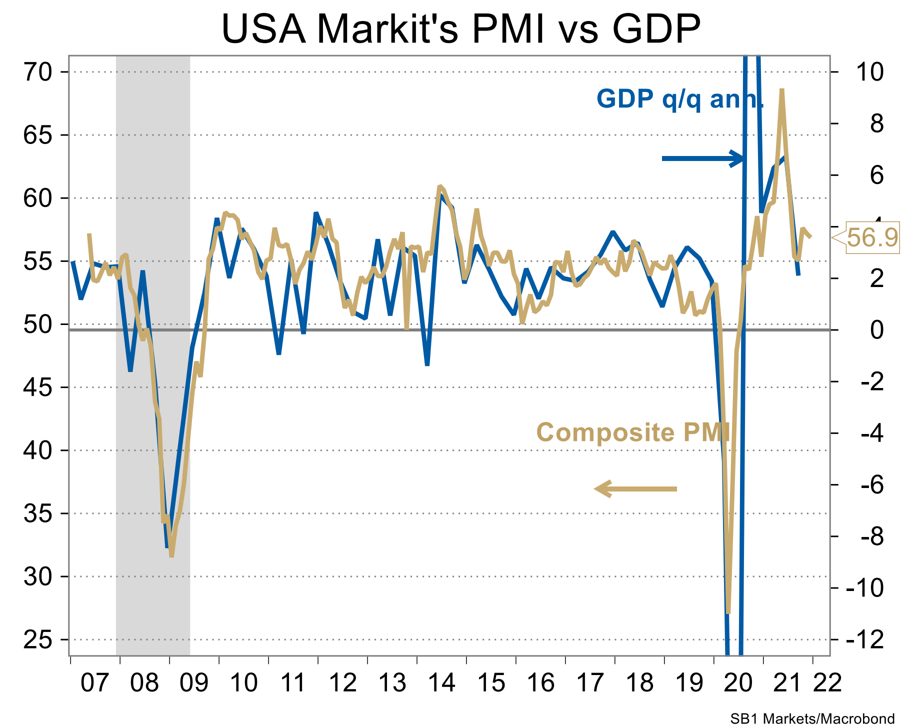


- In manufacturing, both input and output prices rose at a slower pace in November and December
- Prices have not yet eased in the service sector
- We are still much more concerned about wage inflation than the actual price inflation due to factors that most likely are transitory, like hikes in raw material prices, freight cost (which already may be yielding) or short lived margins expansion when demand is surprisingly strong. (BTW, Powell agreed last week, wage are the real challange)

The PMIs marginally down, signals 'just' 3.5% growth

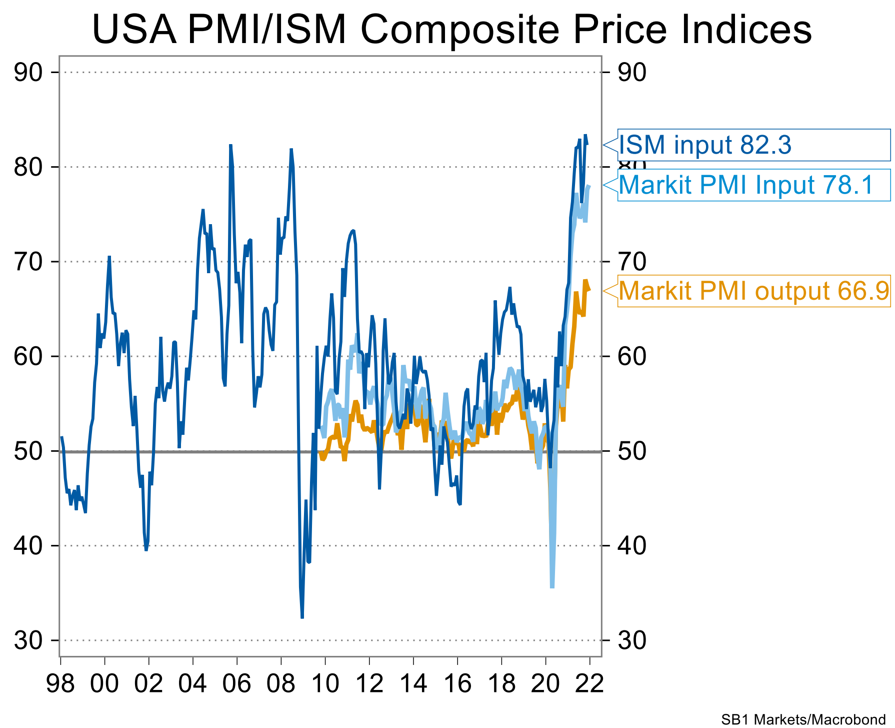
Both manufacturing and services reported a 0.5 p downtick, the composite down to 56.9





- **The PMIs** are still far above average levels, and thus indicating growth far above trend
- Companies report a moderate growth in **employment** – far below what they really want
- **Prices** are still soaring. The **input price** index rose to 78.1 the highest level. The **output price index** fell marginally from ATH in October
- The **delivery times index** fell sharply – but delivery times are still increasing rapidly (or at least still unusually stretched)

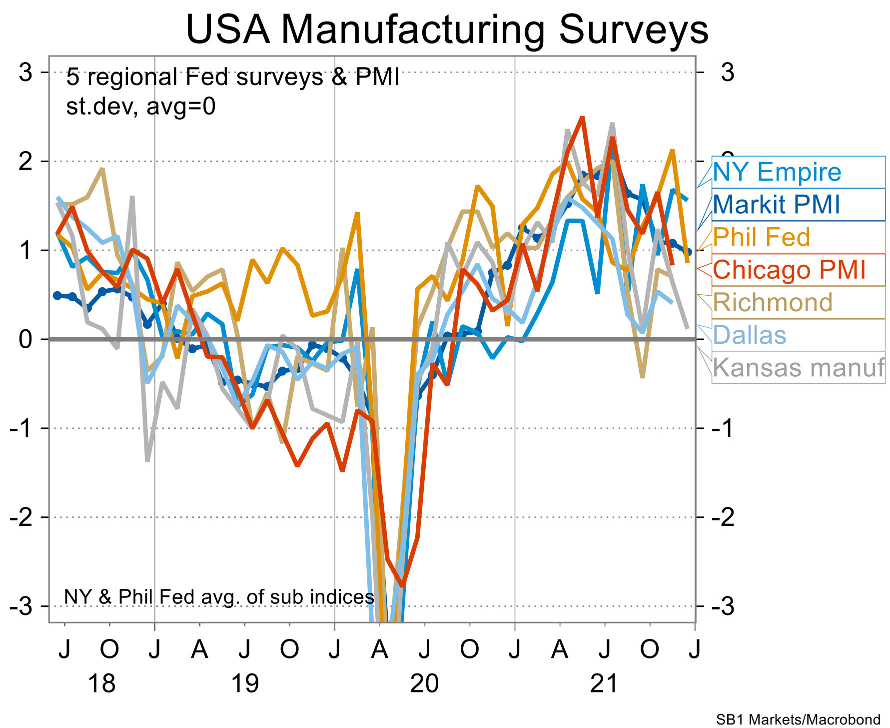
The US challenge: Prices are soaring all over the place

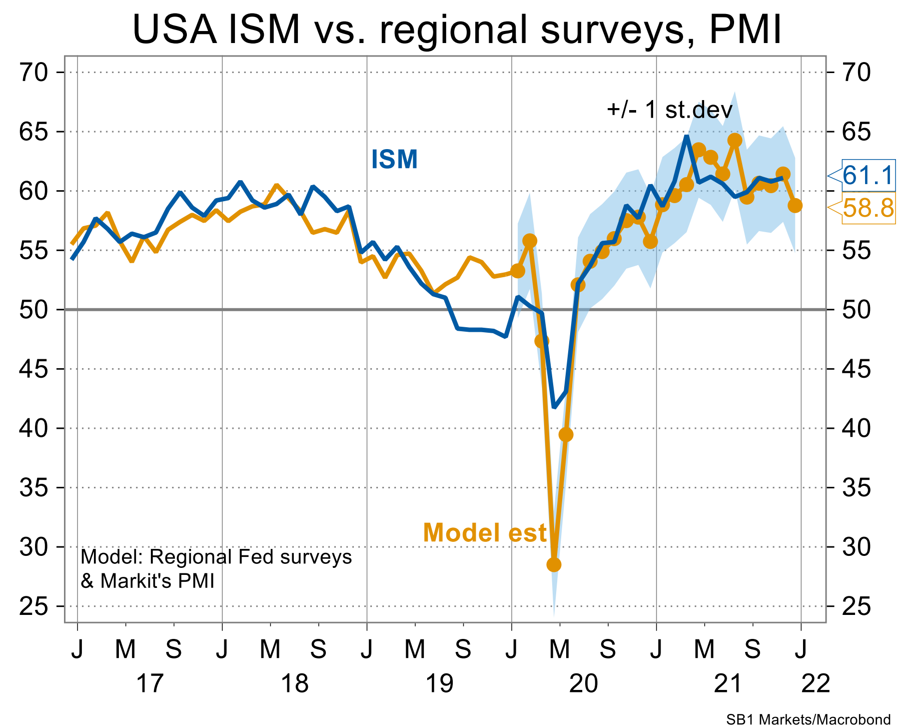


- ISM has not yet reported December data

4 out of 4 manufacturing surveys so far down in December

Substantial decline in the Phil Fed survey, as well as in the Kansas index. NY Fed, PMI down too

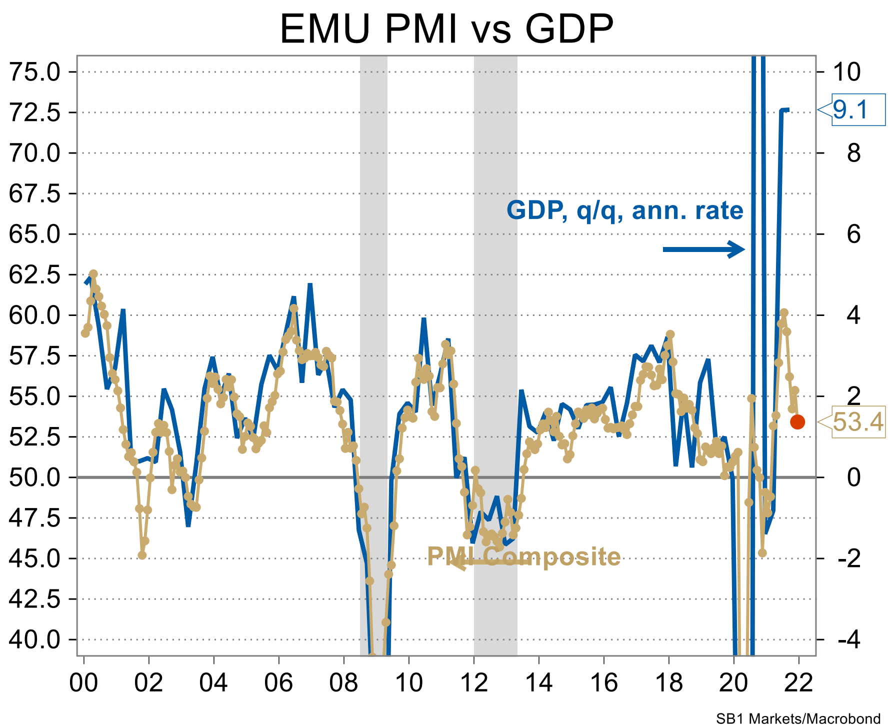


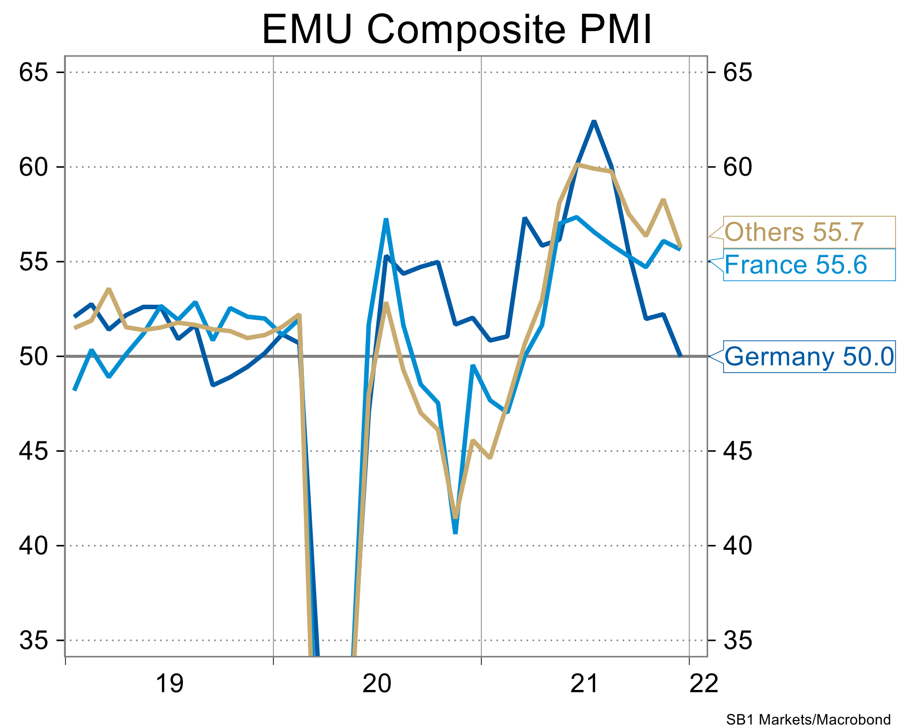


- In sum: a 2.3 p decline in the ISM, to 58.8 is so far signalled. If so, no crisis

The composite PMI down 2 p to 53.4, 1 p weaker than expected, 1% growth left?

Germany may have been brought to a stand-still due to a setback in services but growth elsewhere



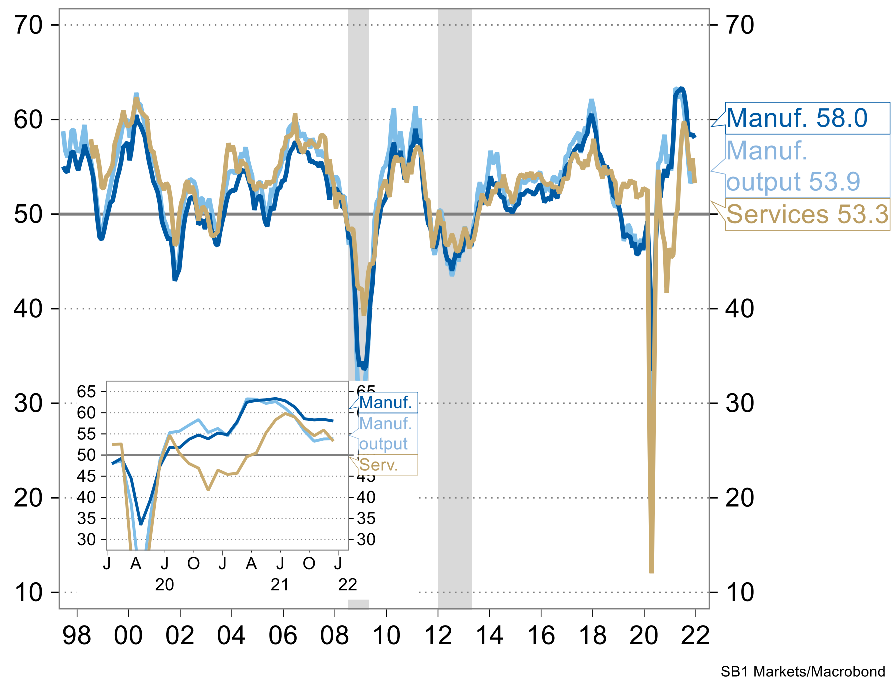


- More Covid measures (and individual changes in behaviour) may of course dampen activity more places the coming weeks
- The German PMI fell 2.2 p to 50.0
- The composite index fell in France too – but growth is still reported higher than in October

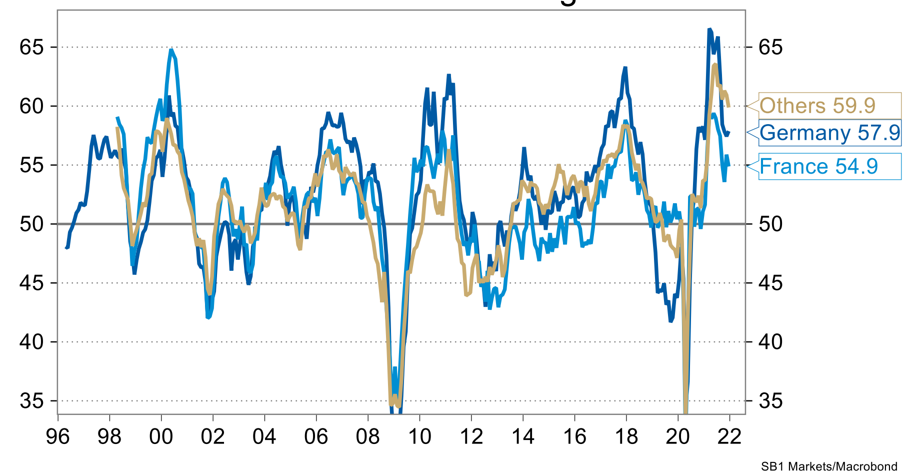
German services took the hardest hit, not that bad elsewhere (among the big 4)

Growth in manufacturing is still strong, while services slowed

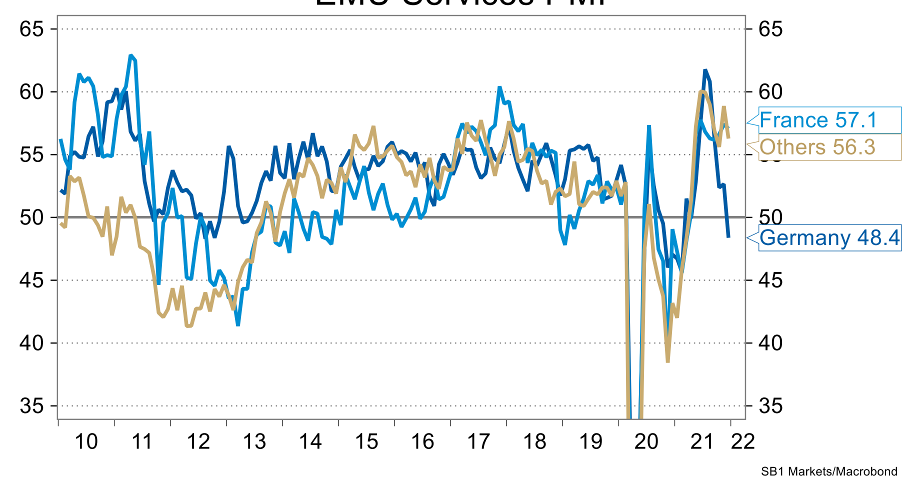
EMU PMI



EMU Manufacturing PMI



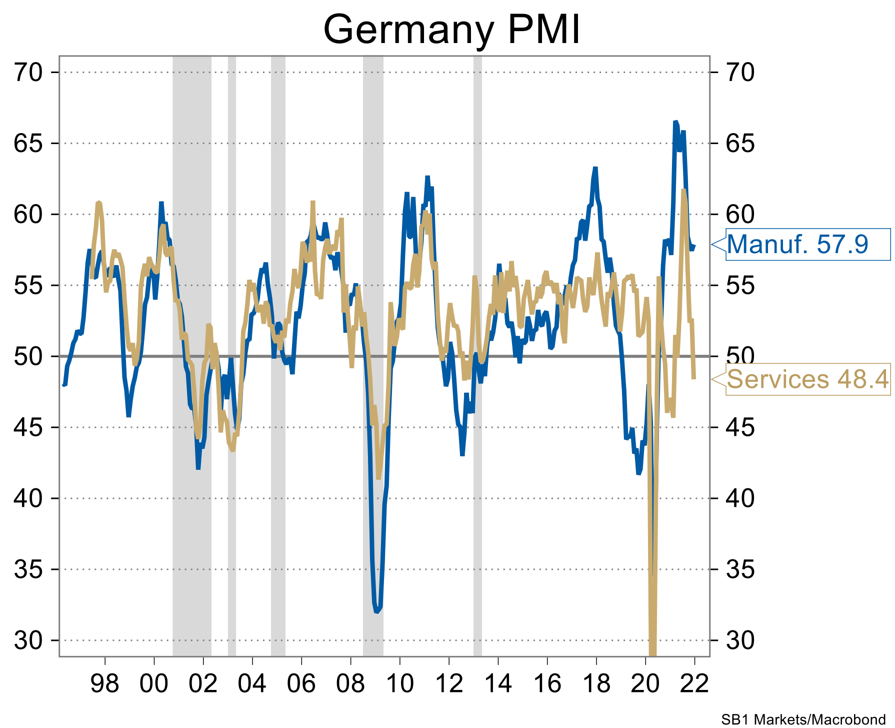
EMU Services PMI

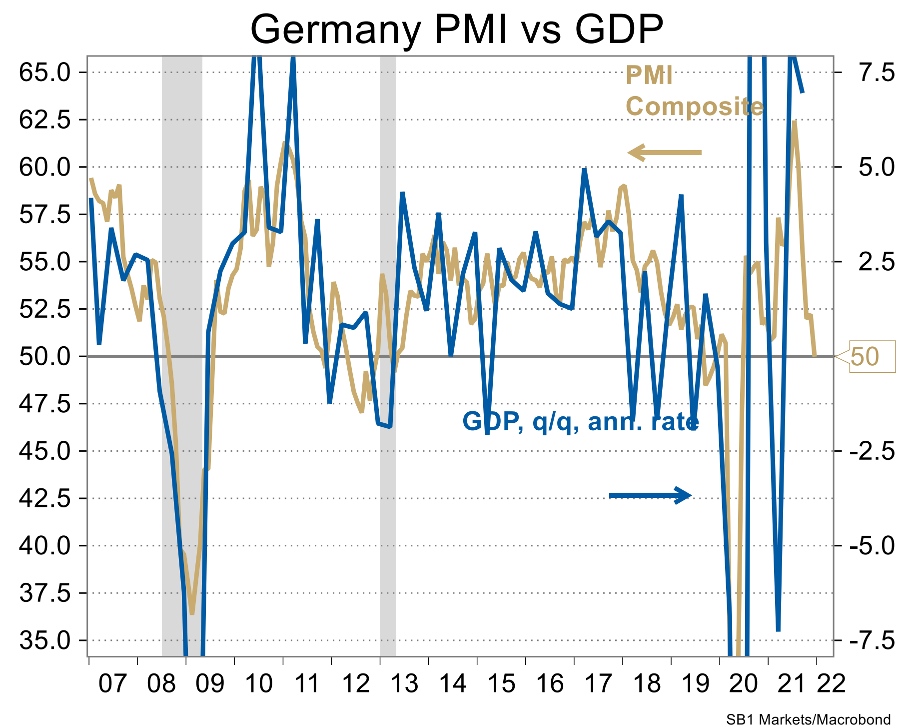


- The **service sector PMI lost 2.7 p to 53.3, expected down to 54.3**
- The **manufacturing PMI** subtracted 0.4 p to 58.0, expected down to 56.9. The **output index** is much weaker, at 53.9 (unch) as the total index is boosted by the delivery times index – which is not a signal of strength in production these days

Germany: The composite PMI down to 50, as services lock down

The service sector PMI down 4.4 p to 48.4, the composite index signal no growth





- **The composite PMI** lost 2.2 p, and fell to 50, expected down to 51.1
- **The manufacturing PMI** added 0.5 p, to 57.9, 1 p better than expected
- **However, the service sector PMI** fell sharply, and almost twice as much as expected due to corona measures

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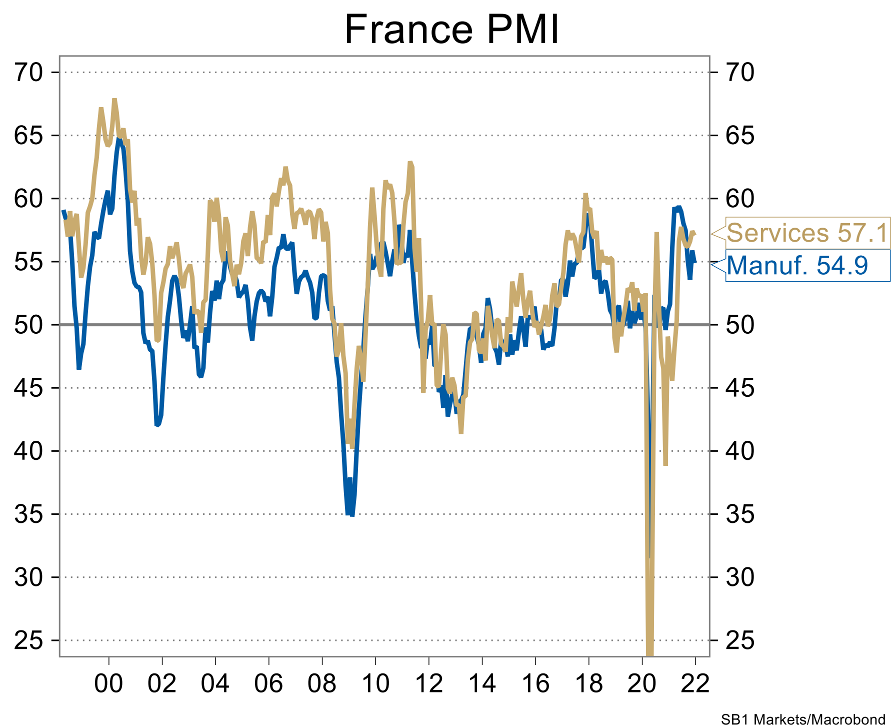
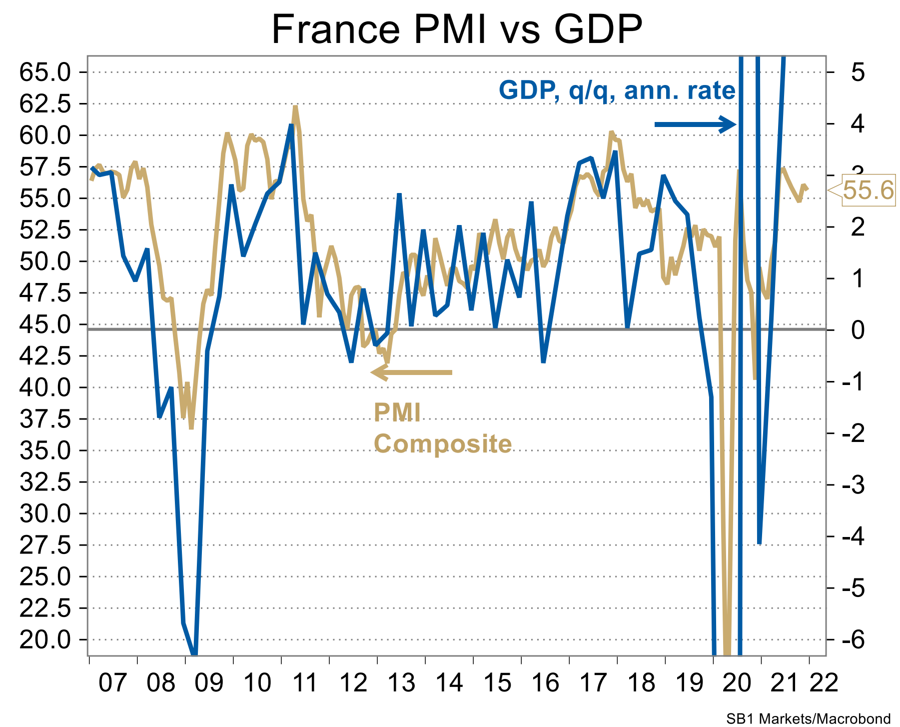
France: No Omicron fear, the PMIs kept well up

No signs of a virus slowdown – in the first part of December, that is

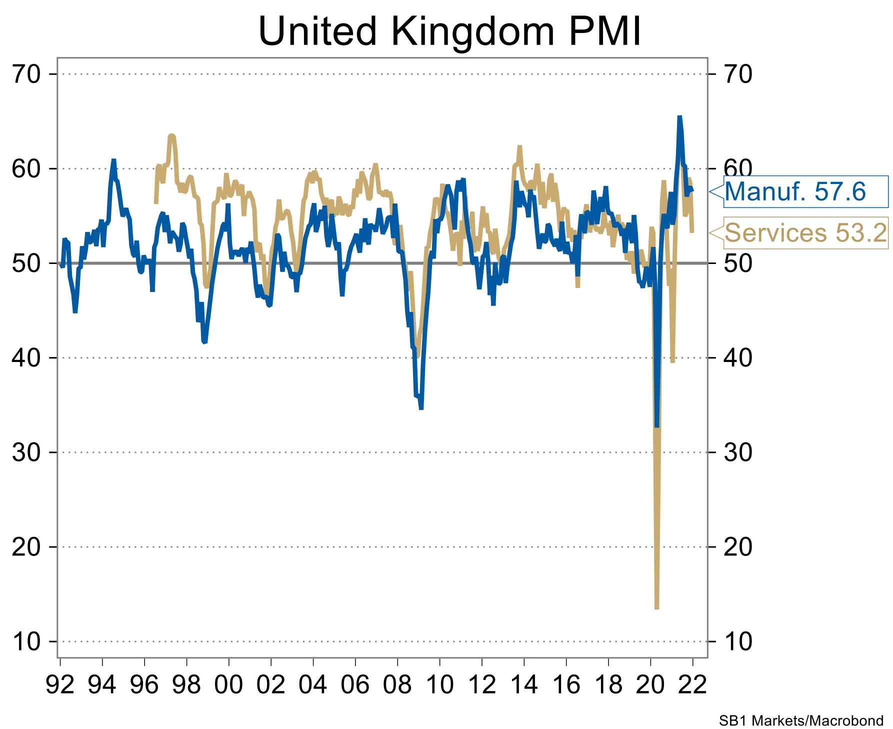


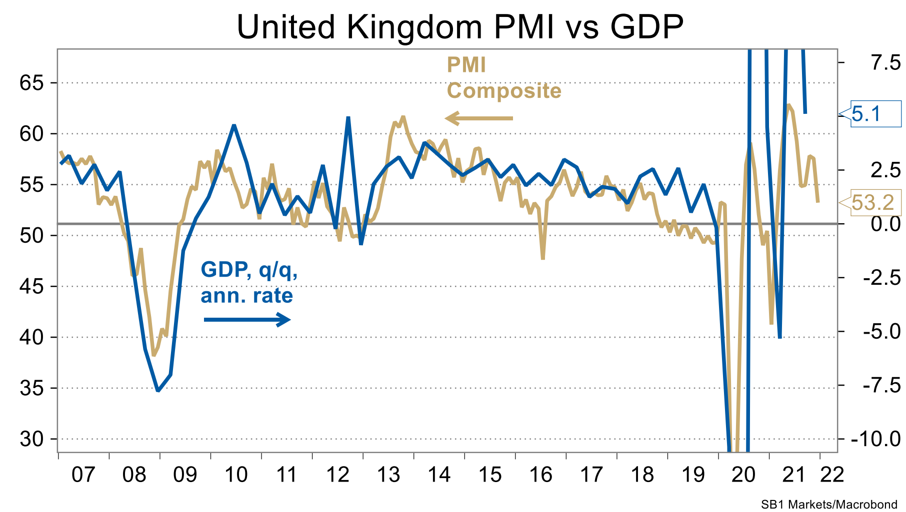


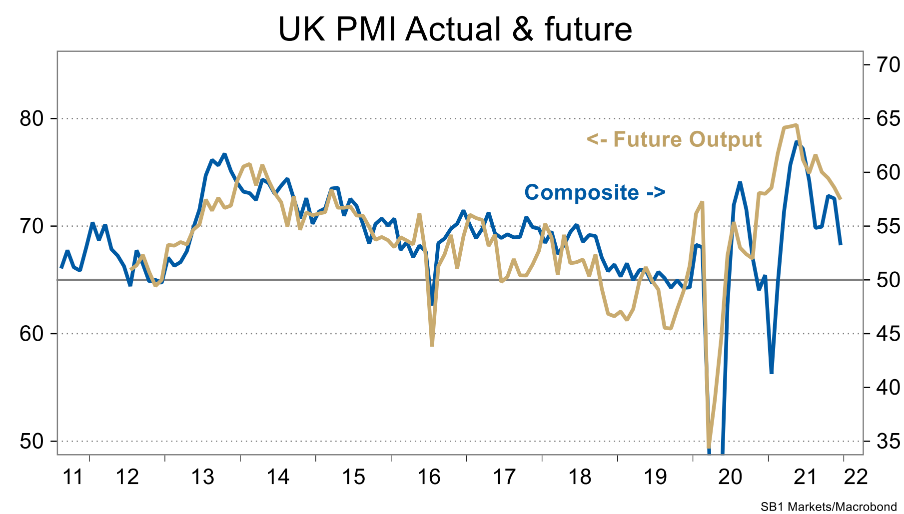
- The **composite index** fell 0.5 p to 55.6, signalling 3% growth, far above trend as the economy is still in a recovery mood. The index was expected down to 55.0
- The **services** PMI fell just 0.3 p to 57.1, expected down to 56, while the **manufacturing** PMI deducted 1 p to 54.9, 0.5 p weaker than expected

The service sector slowed sharply in December but is still reporting growth

Very likely, Omicron measures/adaptations is dampening household demand for services, manuf. OK



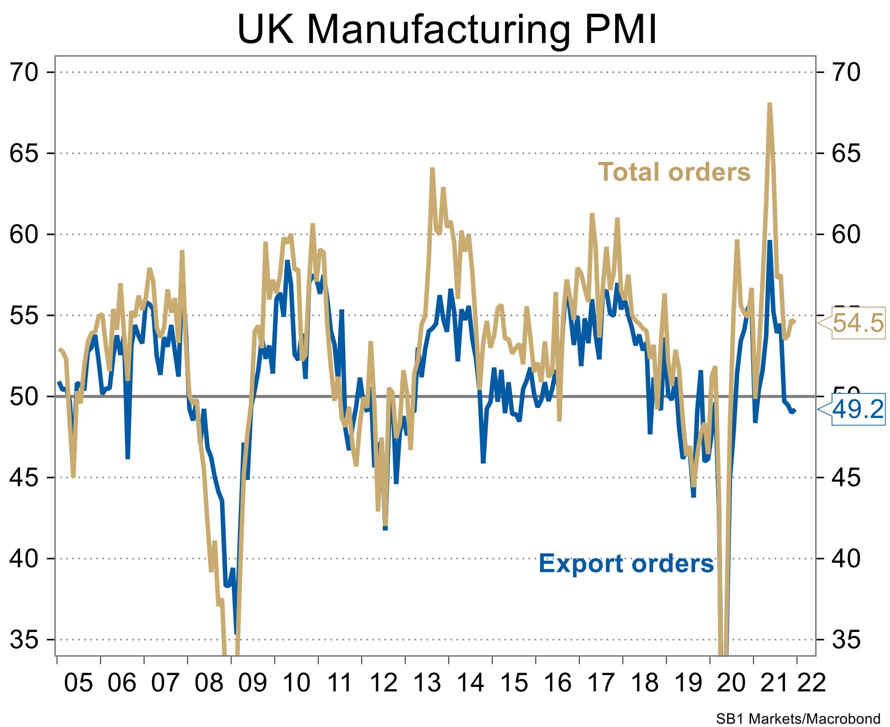


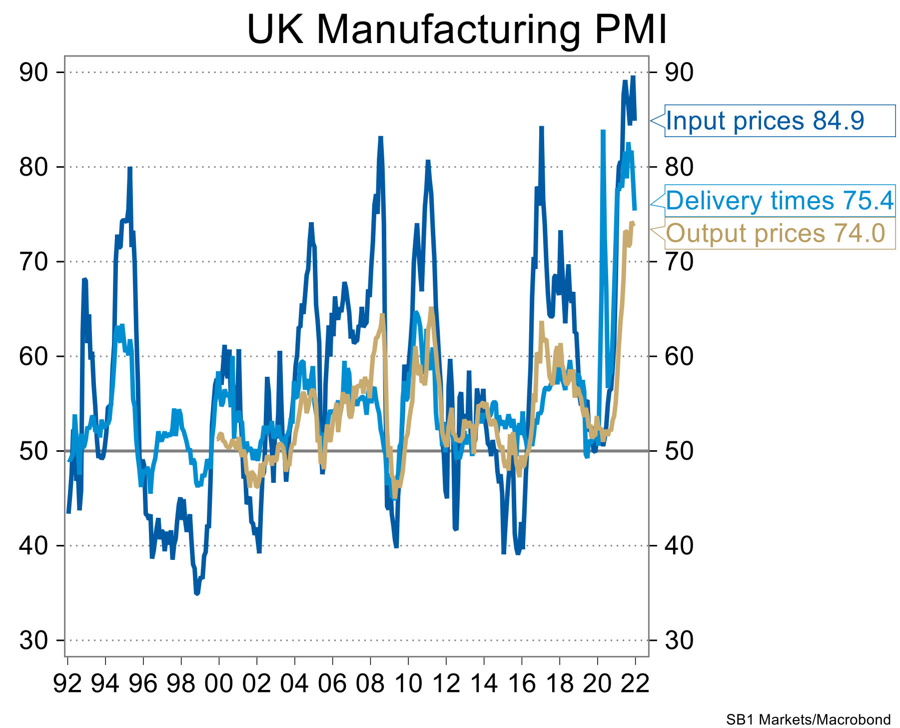


- **The composite PMI** fell by 4.4 p to 53.2, expected down 1.3 p to 56.3. The index signal 1% GDP growth
- **Services PMI** nosedived 5.3 p to 53.2, much weaker than expected (57)
- **The total manuf. PMI** was down 0.5 p to 57.6 , as expected (but the output component, included in the composite index, gained 0.6 p to 53.3)
- **The manuf. delivery times index** fell in December, formally signalling a slower growth in delivery times but we suspect it rather measures the actual delivery time. If so, they fell. **Input prices** rose at a slower pace, but still incredibly fast, and **output prices** rose the fastest ever. **Services** are also reporting broad based price increases, but these indices may have peaked

Strong (domestic) order inflow. Delivery times are easing, prices not

… at least not output prices!

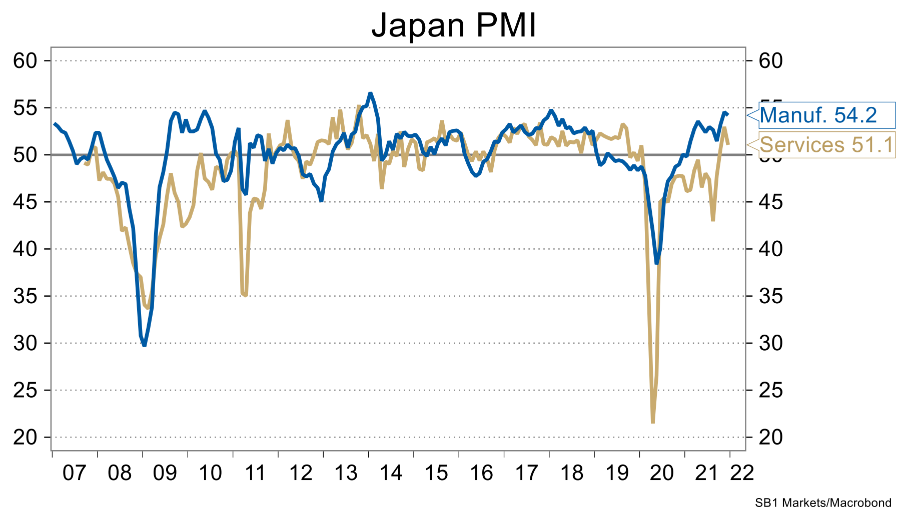


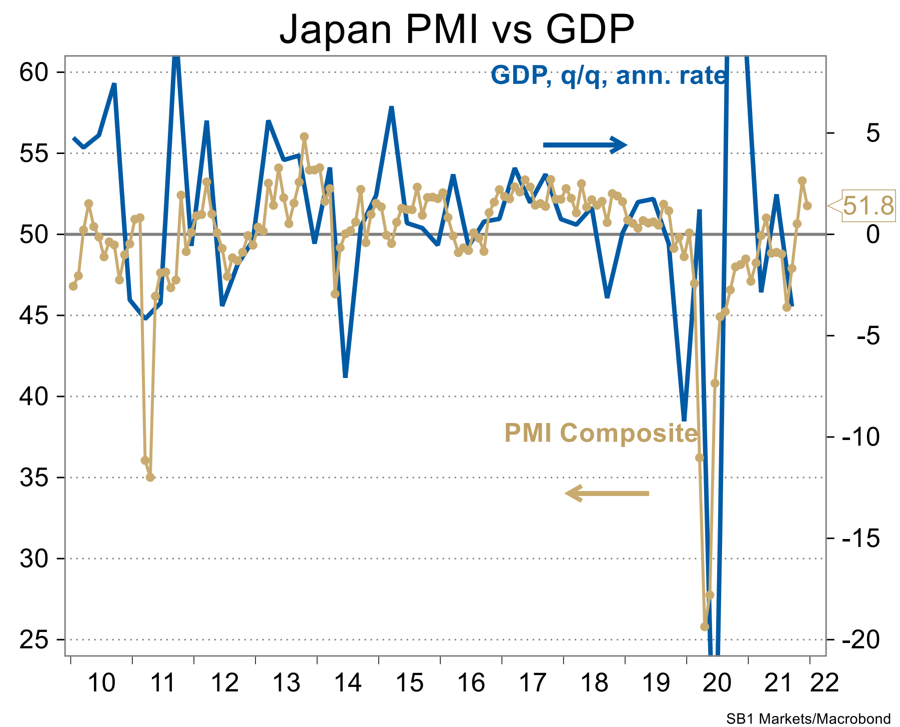


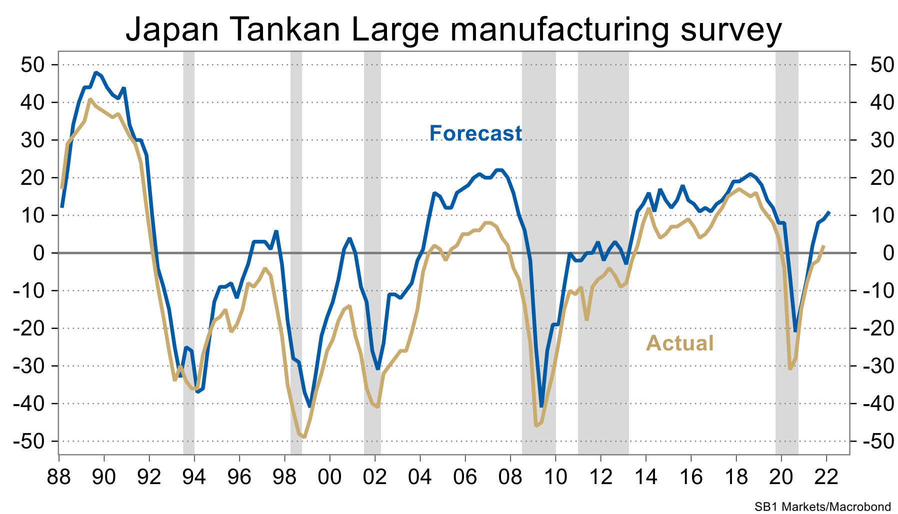
- A domestic orders index is not published but since export orders are stagnating and total orders are growing quite rapidly, domestic orders may be growing rapdily

Japan PMI down in December, services the most. OK growth still signalled

The composite PMI fell by 1.5 p to 51.8, normally yielding a 1% GDP growth. Which is at trend in Jp.



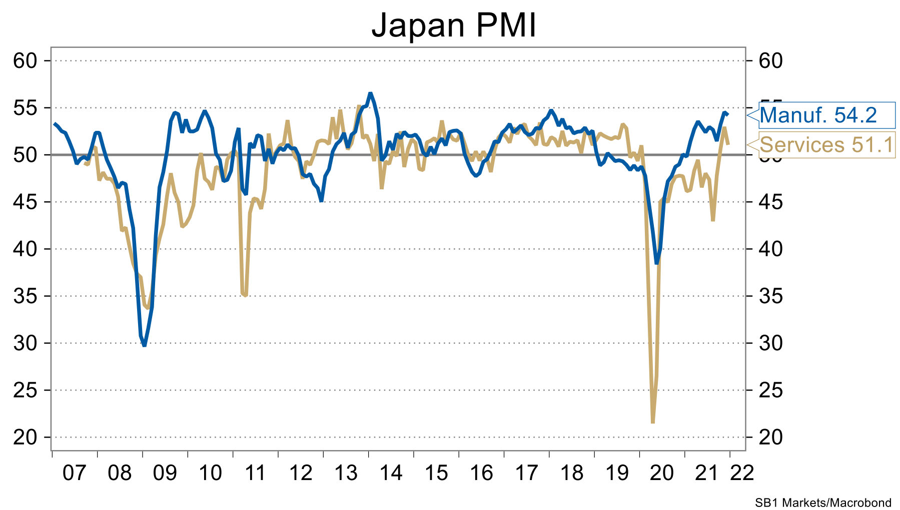


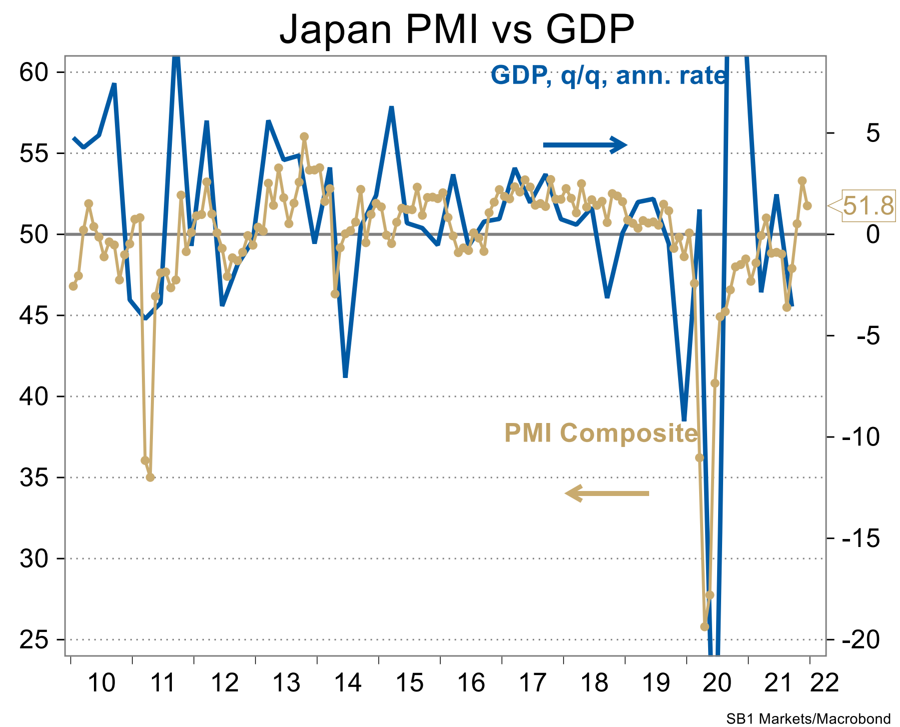


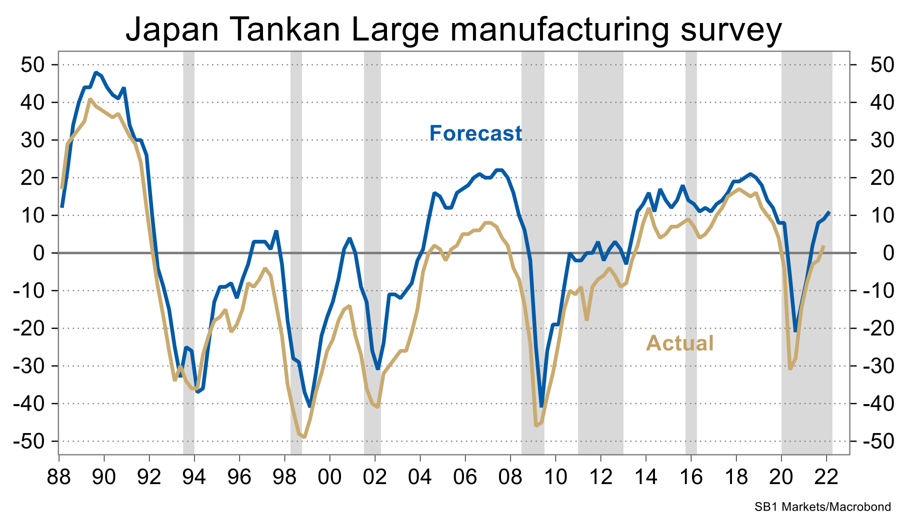
- The **composite PMI** is not that closely correlated to GDP growth but some hints are given
- **The manufacturing PMI fell just slightly XX prices XX delivery times**
- The **services PMI** fell 1.9 p to 51.1, without any setback in mobility, at least so far
- **Bank of Japan's tankan survey** strengthened in Q4

Japan PMI down in December, services the most. OK growth still signalled

The composite PMI fell by 1.5 p to 51.8, normally yielding a 1% GDP growth. Which is at trend in Jp.



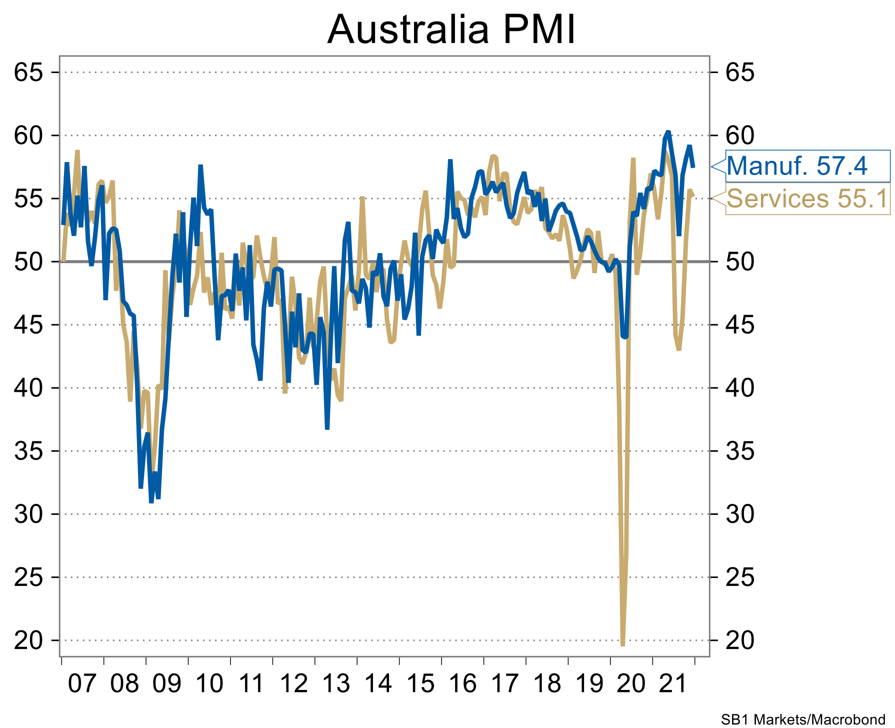


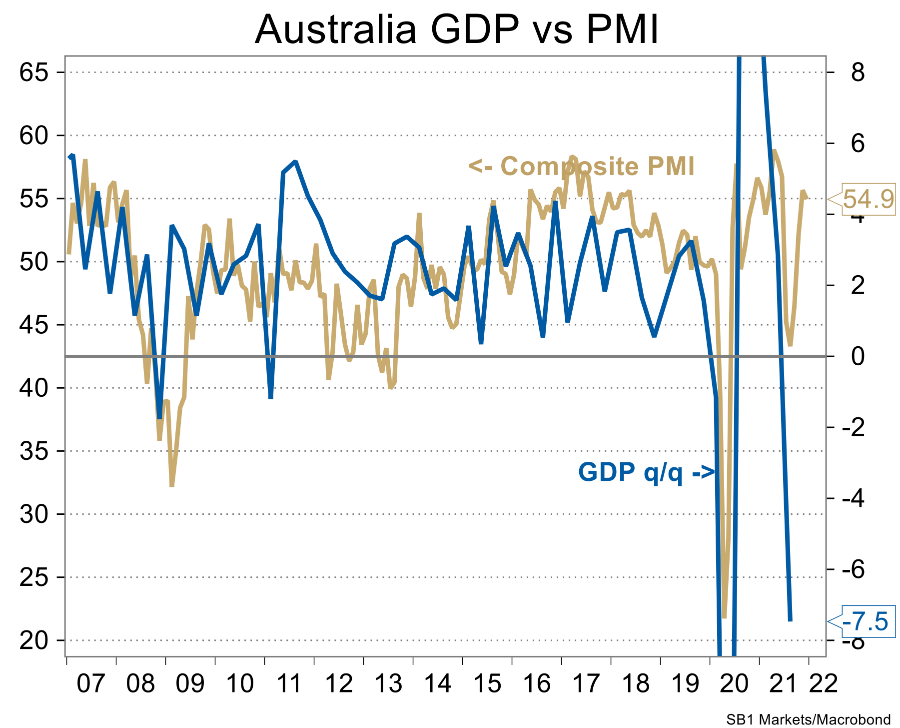


- The **composite PMI** was up 2.8 p to 50.7 and signals a marginal growth in GDP, but the correlation is not impressive
- **Manufacturing PMI** rose by 1.5 p to 53, and here too price pressures and supply issues are containing growth
- The **services PMI** continued the strong sentiment from September and was up 2.9 p to 50.7, as Covid cases are down and restrictions eased

Australia reports strong growth, following the Covid slowdown

The composite PMI slightly down in December, strong growth signaled, following the Q3 setback

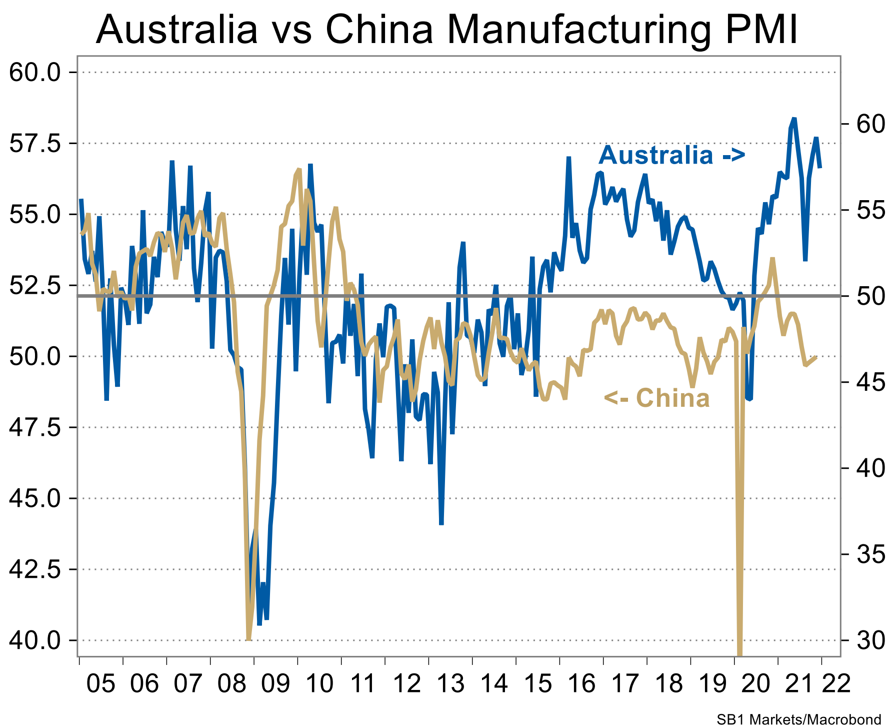




- **The composite index** fell by 0.8 p to 54.9, signalling some 4% GDP growth, following the 1.9 (7.5% annualised) setback during the lockdown 3rd quarter
  - » Both the manufacturing and the service sector PMIs fell magianlly
  - » The manufacturing PMI at 57.4 indicates strong activity, even in the Chinese economy is slowing somewhat

Australian and Chinese PMIs are correlated, with China in the lead, in average

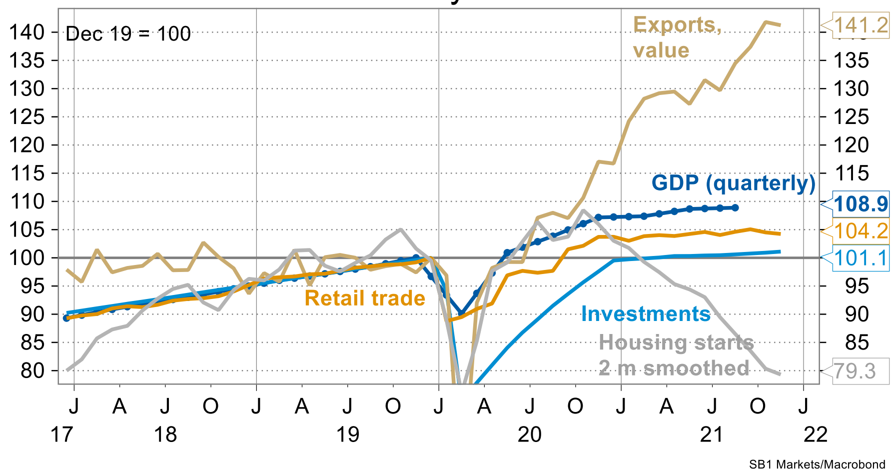
However, the correlation is not that close, and the Australian index have been stronger since 2015



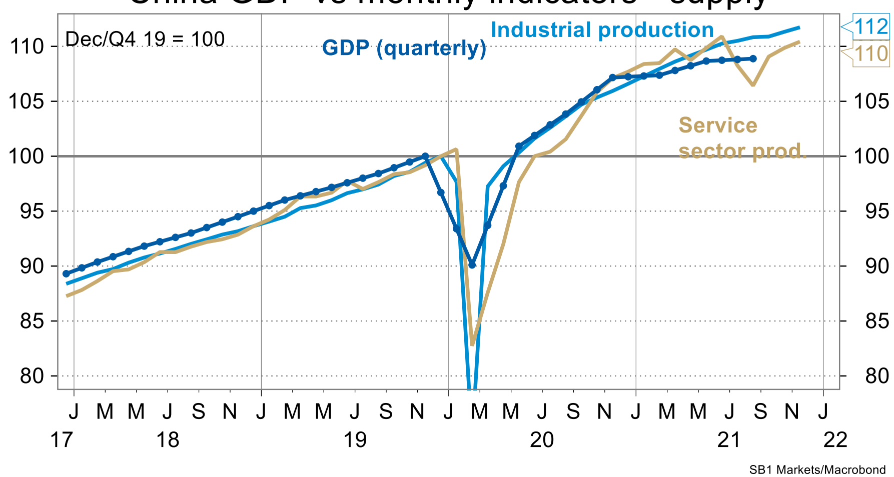
November data confirms a slowdown, not a sudden stop

Weak retail sales, construction stabilised after 20-25% decline, manuf. has slowed, services recover

China GDP vs monthly indicators - demand



China GDP vs monthly indicators - supply

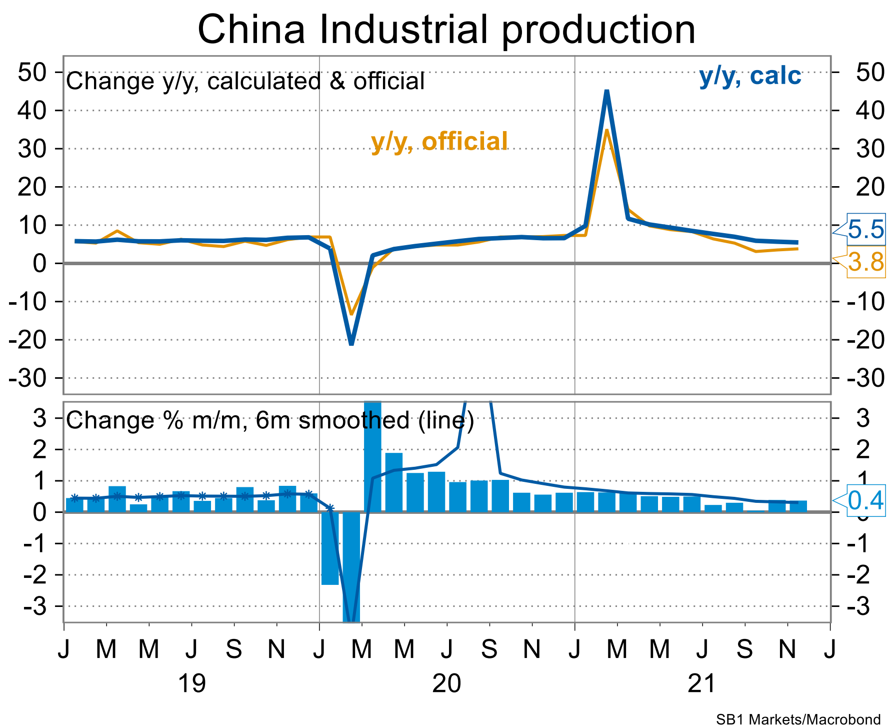


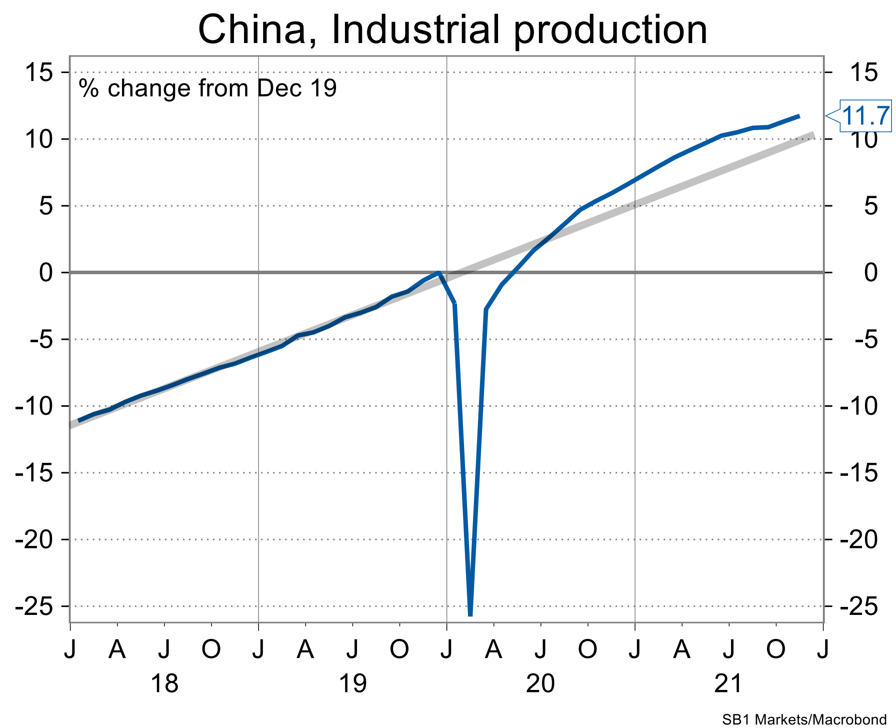
- **Industrial production** rose by 0.4% in Nov, as in Oct. Measured y/y, growth accelerated 0.3 pp to 3.8%, as expected. Production is still 2% above the pre-corona trend path. However, growth has slowed substantially, to 0.25% the past 5 months vs the normal 0.5%. Steel, cement, and autos are down 10 – 25% from local peaks, due to a mix of demand and supply factors. Surveys are down but are signalling growth above the pace the past 5 months
- **Service sector production rose 0.5%** but still remains 0.5% below the June level – which no doubt is due to the fight against the virus, which is not over yet. The level is just 2% below the pre-pandemic growth path
- **Retail sales volumes fell by** 0.1% in volume terms (our est. as prices rose sharply m/m, due to energy). The trend is weak, from Nov last year at a 2% path, at the best. Annual growth fell 1 pp to 3.9%, 0.9 pp below expectations. Auto sales are slowing, as elsewhere, but other sectors have also slowed in 2021
- **Investments** grew by 0.2% as the previous month. Prices are no doubt increasing – and in volume terms, investments are falling. The accumulated annual growth rate was 5.2%, down from 6.1%, as expected. **Housing and other construction** starts, and new home sales all recovered somewhat in Nov, but are still down 20 - 25% vs the recent peaks, a substantial setback! **New and existing house prices** have fallen the past 3 – 4 months, but so far not dramatic
- **Frome the previous week**
  - » **Credit growth** accelerated in Nov, as local governments like in Oct tapped the bond market (due to lack of revenues from land sales?), while growth in bank lending slowed further. PBoC eased its credit policy as banks' reserve requirement was cut
  - » Both **exports and imports** were strong in November, imports are back to the pre-pandemic trend path – and export are way above (corona logistics trouble, you know)
  - » **CPI inflation** accelerated in Nov to 2.3% but core slowed to 1.2%. No problem

In sum: Growth has slowed but not further in Nov. Some may be due to the virus, but NOT the large decline in construction and very likely not the slow growth in the retail sales either. **The main risk: construction activity which has fallen 20 - 25% already.** The supply side challenges can probably 'be fixed' (restructuring of property developers) but will 'property investors' (in empty homes) remain bullish forever?

Industrial production up 0.4% in Nov, has slowed in H2

Official y/y growth rate up 0.3 pp to 3.8%, as expected. Level still 2% above p-p trend

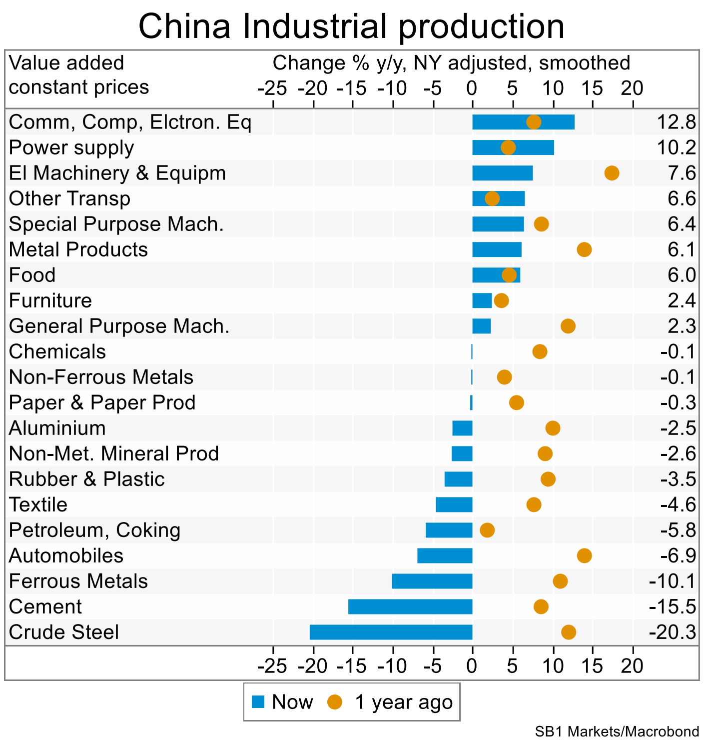




- **Production** growth has slowed from the normal (pre pandemic) 0.5% per month to some 0.25% in average the past 5 months (however up 0.4% in both Oct & Nov). Sharp production cuts in steel and cement, and now aluminium and autos (all down 10 – 20% from recent peaks) have contributed to the slow monthly growth
- Production is 11.7% above the Dec '19 level and 2% above a reasonable pre-corona growth path. Not that bad
- **Both supply and demand** factors may be limiting factors the coming months. The zero Covid strategy is challenging, and local lockdowns are still imposed (and Omicron may become a real challenge). According to surveys, delivery times/prices have not been a serious challenges so far. Construction is a substantial risk on the demand side. Business surveys signal somewhat slower growth than before the pandemic but faster than the average monthly growth the past 5 months

Steel stabilised in November, cement further down

Steel down almost 25%, cement almost 20% - in line with nosediving construction starts

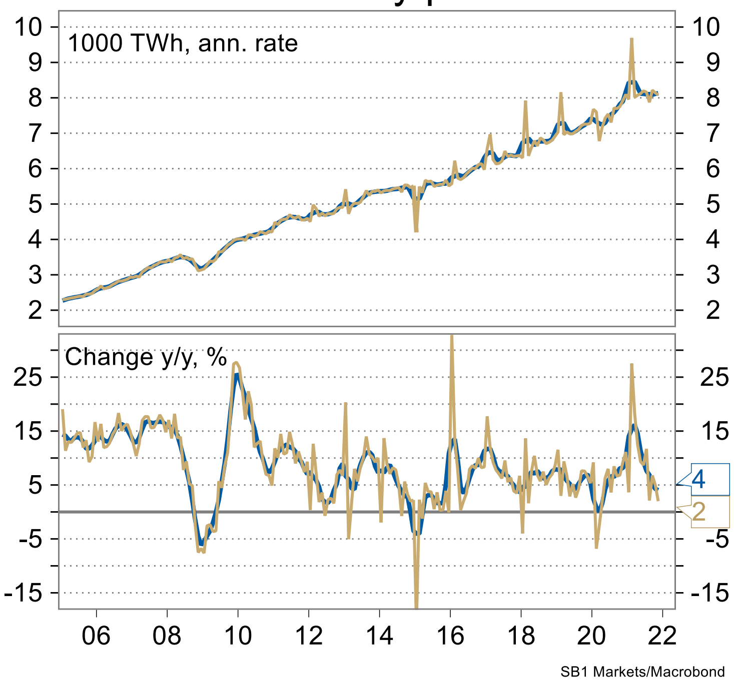


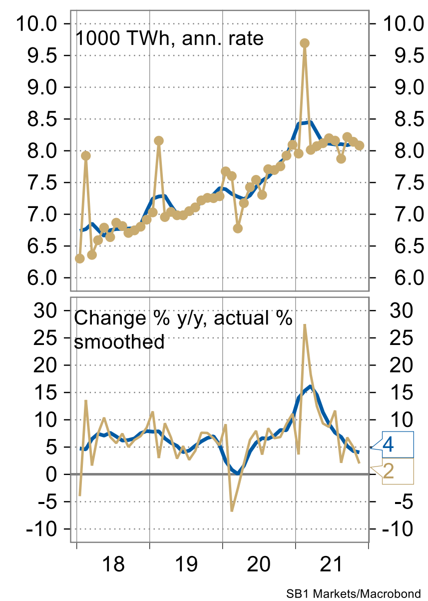
- Auto production is down 7%, more than sales have fallen

Electricity production has flattened recent months

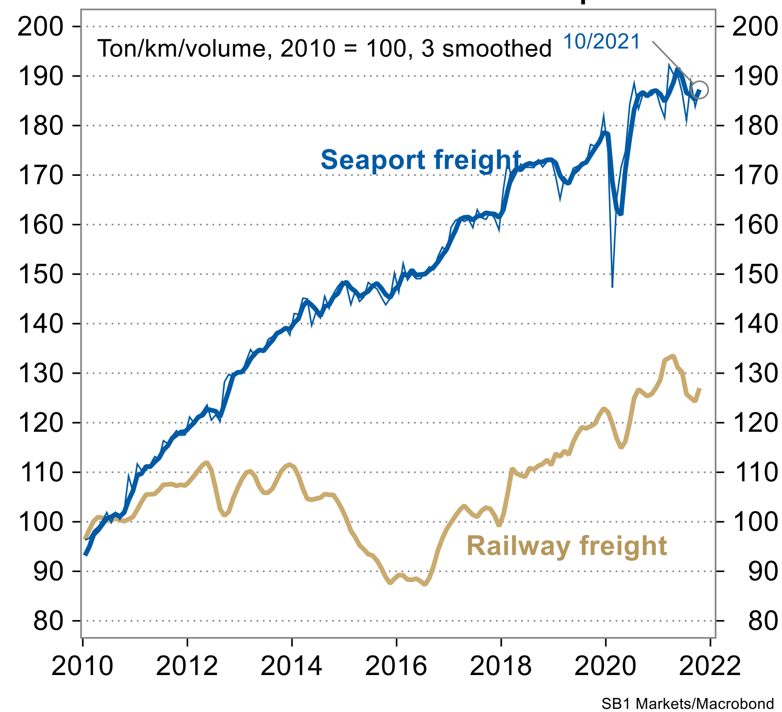
Transport activity may have slowed somewhat – partly Covid related (data just through Oct)

China Electricity production





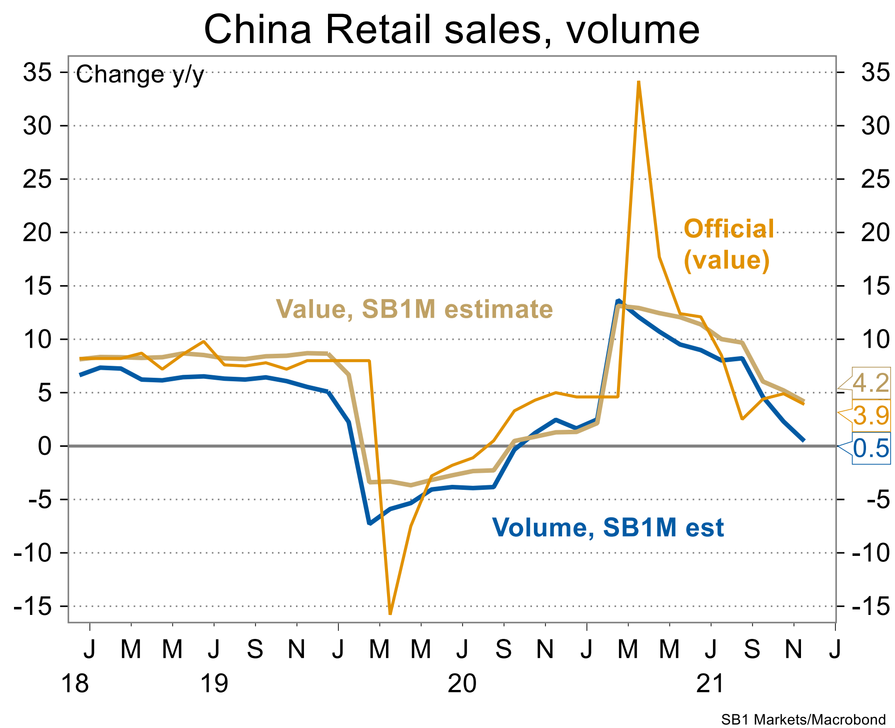
China Trade and transport



- Seaport traffic is not terrific either, somewhat strange given the surging exports and the recent recovery in import volumes

Retail sales have almost flattened!

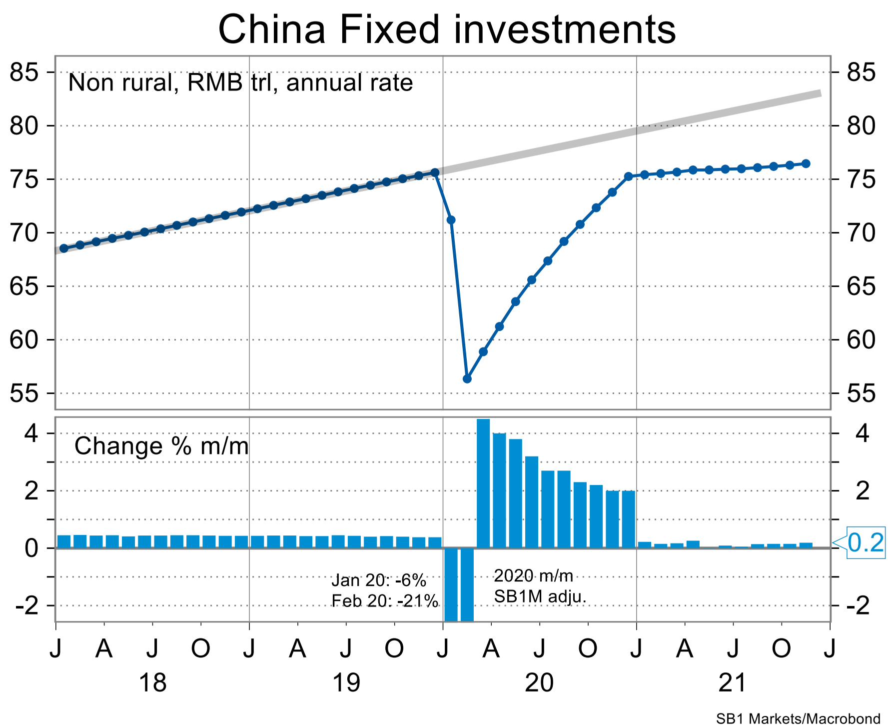
Real sales fell 0.1% in Oct, following the 0.6% drop in Oct. The nominal y/y rate 3.9%, 0.9 pp < exp.



- **Official nominal retail sales** were up 3.9% y/y in Nov, down from 4.9% in Oct, expected just down to 4.8%
- In nominal terms sales rose by 0.2% m/m in Nov, but due to the lift in energy prices, we estimate a 0.2 % decline in **volume terms**, following the 0.6% volume decline in Oct.
  - » 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 6% below the pre-pandemic trend path

Investments on a new, and a much slower growth path, is declining in real terms

Monthly growth has accelerated marginally but at 0.2% far lower than before the pandemic

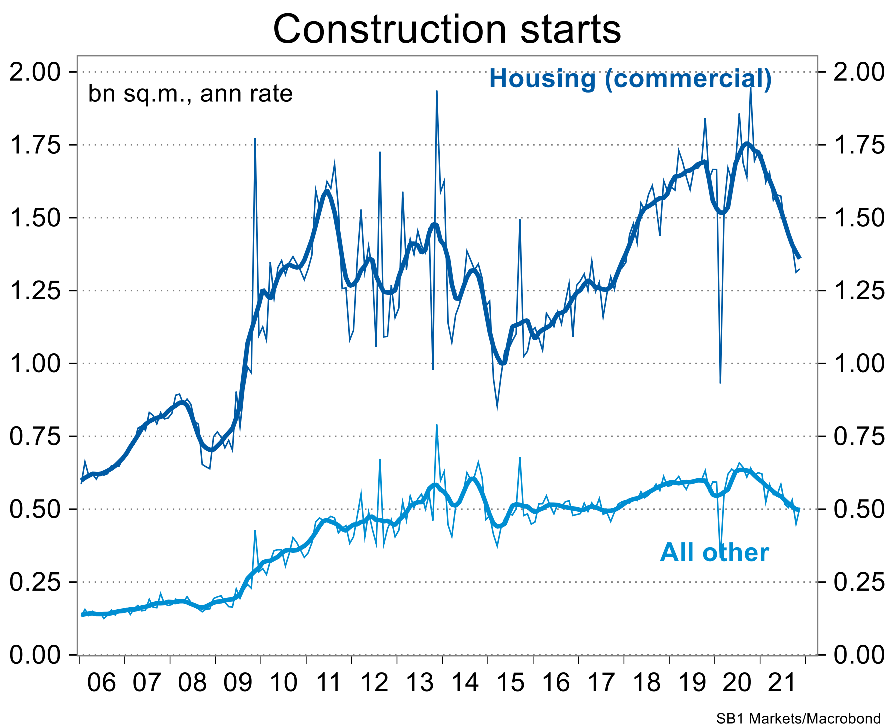


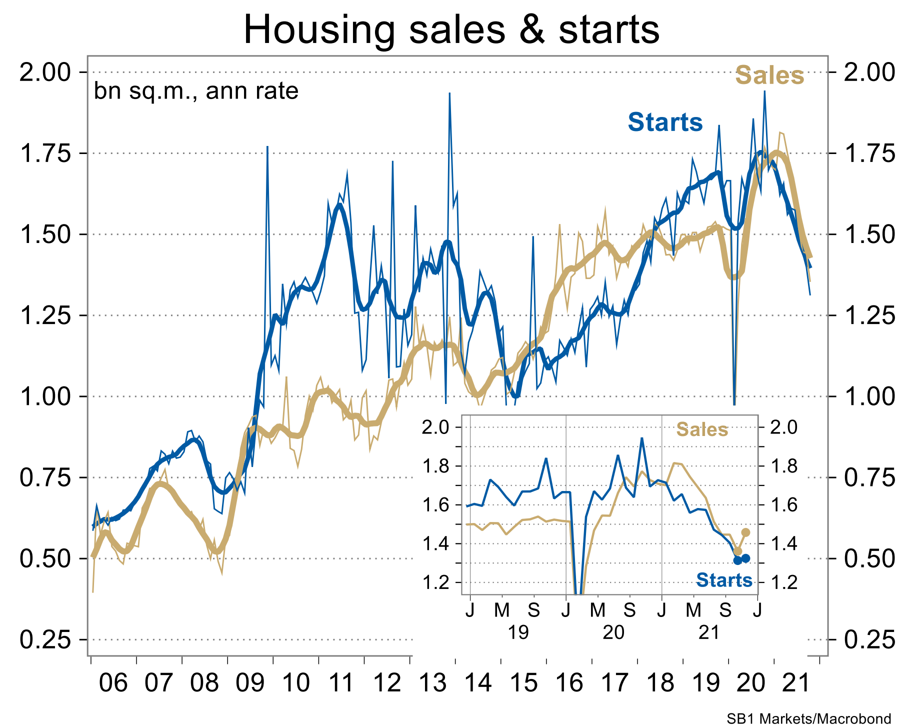
- **Measured YTD**, nominal urban investments rose 5.2% in November (still a silly number, due to the setback last spring/summer), down from 6.1% in September, as expected
- **Growth m/m** was just 0.2% in nominal terms m/m (but no further downward revision of the history, as has been the case in 6 months in row). Growth was gradually slowing before the pandemic, to some 0.4% per month. Now growth is far slower, just slightly above 0.1% per month so far in 2021! As inflation has picked up, investments must be falling in real terms!
- The **investment level** is 7.5% 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. The correlation to construction starts is not obvious. *Check next page*

SpareBank 1 MARKETS

New home sales and construction start slightly up in November, trends still weak

Following several months of sharp decline in sales and starts

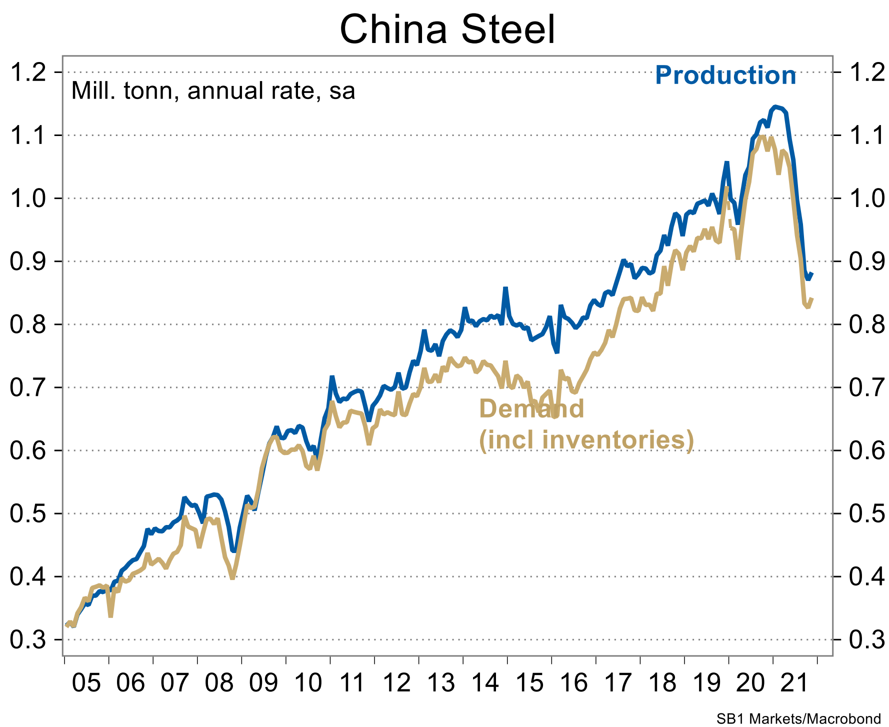




- **New home sales** have fallen 25% from early 2021, following the spectacular recovery after the pandemic last year. Sales are down more than 10% vs the pre-pandemic level - which was record high until then. Sales rose in November, back to the August level
- **Housing starts** are also down 25% vs. the early 2021 level, but stabilised in November. Sales have been running higher than tarts in most of 2021, indicating a slight rundown of inventories
- **Non-residential construction** fell 16% m/m in October, and recovered most of this decline in November. Starts are still down 20% since last summer, and the level is 15% below the pre-p level
- In sum, the decline in **construction starts** have been among the largest ever. Still, the downside is substantial as several property developers are struggling. Still, we think the main risk is at **the demand side**, the level in investment in buildings are high, and a substantial share of housing demand has been for investment purposes, often without any rental income. See more prices, 2 pages fwd. Look up for demand for steel, *check next page*

Construction & domestic demand for steel down, steel now more than 25%

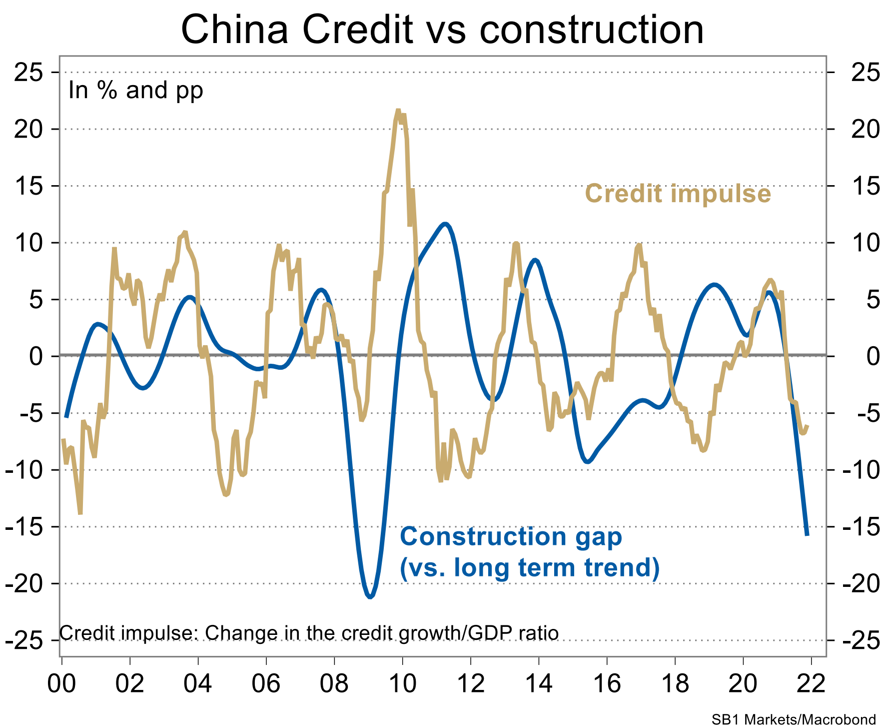
The reason may partly be the 'official' story on meeting 2030 CO2 targets but demand is down for real too?



- 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 – and production had to be cut in H2. So is the official story
- We assume there are more reasons for the cut in steel production, like local pollution, fear of overbuilding combined with too rapid credit expansion, especially among heavily indebted real estate developers (read: Evergrande++)
- Now demand for steel may be the most important reason for the decline in production, as construction activity has fallen substantially

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

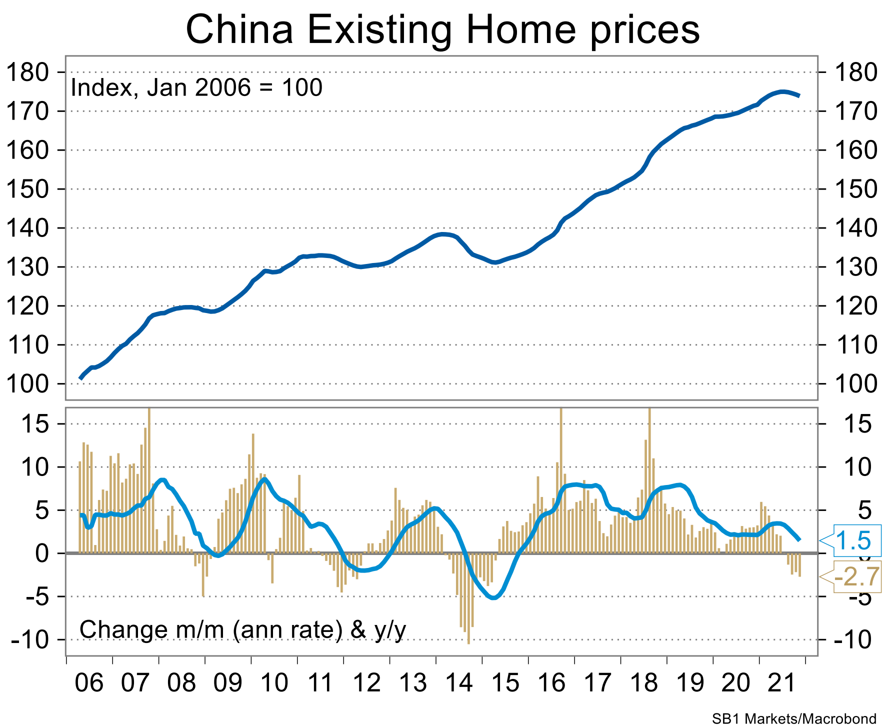
The two are dancing together but not that closely (and it varies who takes the lead too)

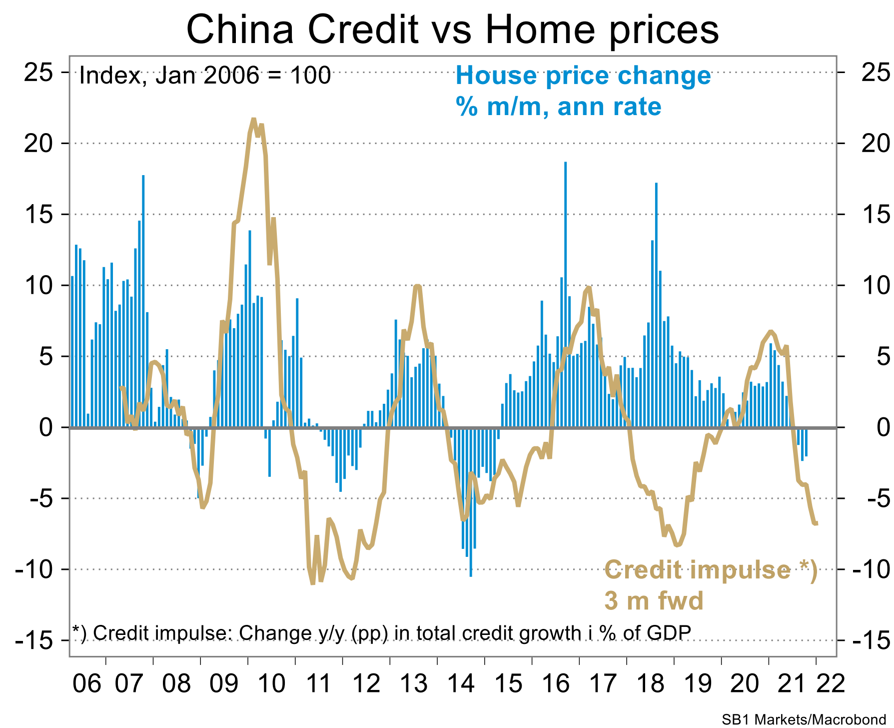


- … still they are at least normally on the same floor
- The recent credit tightening may have had some impact on the property market – but basically the slowdown in construction started ‘too early’ this time
- The credit tightening signals some downside risk for construction, raw materials & steel
- However, there is always a risk when construction and debt levels are high, especially if many are buying property for investment/speculation purposes

House prices turn south, so far at a measured pace – still the main Chinese risk?

Prices fell for the 4th month in row but are still up 1.5% y/y

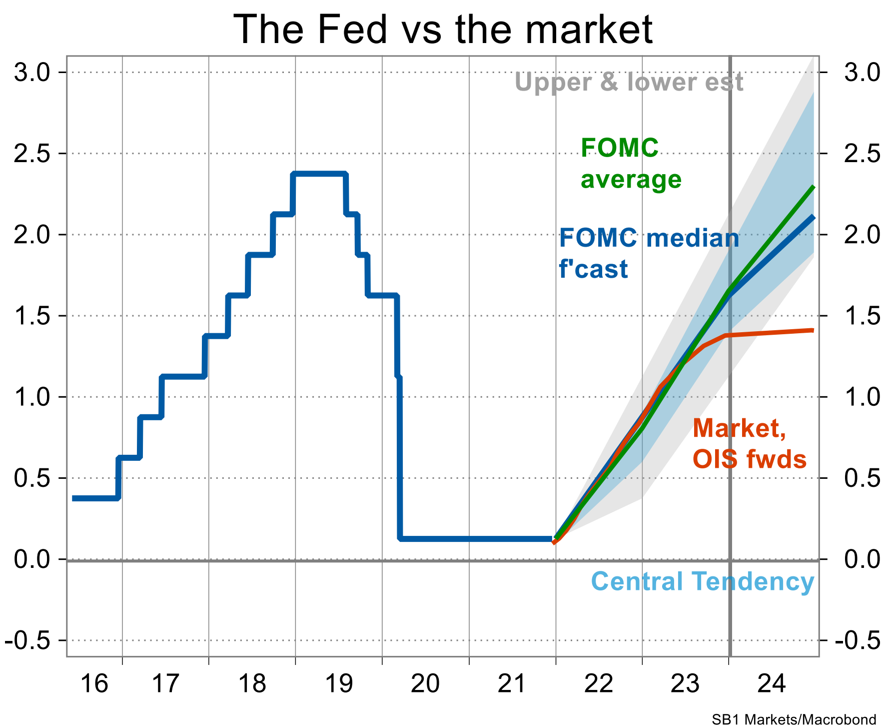




- **Existing home prices** peaked in July, and has fallen at a 2 pace since then. The decline is gradually accelerating, as prices fall at a 2.7% pace in Nov. The annual rate has fallen to 1.5%, from 3%
- **New home prices** peaked in August, and has fallen slower than existing home prices. So far, not any signs of distressed sales from 'bankrupt' property developers
- **Credit growth** as marginally accelerated the past two months, mostly due to increased borrowing from local governments. Still, credit growth has slowed – implying a negative 'credit impulse'
- **Several heavy indebted property developers** are struggling which surely poses a treat vs the housing market & construction activity. The builders may be restructured, with a helping hand from the authorities, who also can supply credit to bail out buyers, and support sales of buildings under construction.
- We think the **main risk is elsewhere**, that home buyers at one stage looses confidence is housing – even in empty homes – as safe and profitable investment. Several small setbacks in prices have so far not made a dent in the investment appetite, and the current modest setback in prices does not signal a buyers strike. Should that happen, a much harsher setback in construction activity would take place

A huge policy shift confirmed, inflation is a problem. The first hike in March?

The dot plot was lifted more than ever before, by 70 bps, 3 more hikes pencilled +a rapid tapering



- **The unusual policy shift** was very well announced, and fully priced in before the meeting, at least judged by market responses. Two weeks earlier, Fed's Powell had to acknowledge (before the Congress committee) that inflation had become much higher than expected, and that transitory was not a proper description. He signalled that the bond buying program would be
- During November (and some started far earlier) several FOMC members, and then Powell's remarks at Congress, when he acknowledged that inflation had become much higher than expected, and that is was not just 'transitory' and that monetary policy had to be tightened
- The FOMC left the **target rate** unchanged at 0-0.25%.
- The FOMC decide to double the speed of tapering, ending QE buying in March. When asked why not stop buying now, Powell said market would not have liked it
- The description of the economy changes – and Powell's comments even more. He had experienced a grenade chock, hit by a series of economic news that revealed (for him, finally!) that inflation was not transitory after all
- When asked about criteria for maximum employment, he ended up (and correctly) concluding that wage inflation would tell you when the target is reached, whatever the other 20 indicators tell
- The FOMC members lifted their **inflation f'cast** substantially, and the expected trajectory is now well above Fed's 2%-over-time-target. **GDP growth** was revised marginally down. The **unemployment** estimate was lifted by 0.3 pp for Q4-22, but left unch for 22 and 23 (down to 3.5%)
- The average/median **dot-plot** interest rate path was lifted by 0.2 – 0.4, more than Norges Bank revised its path. Two members shifted the timing for the first hike to 2022 from '23, and 9 of 18 members favours next year
- Chairman Powell tried his best to convince the market that tapering and hiking rates are completely decoupled, but they can't be… According to the dot-plot, half of the members sees a hike in '22, and though Powell still claims inflation is transitory, the tone and projections suggest that the FOMC is in fact more worried about inflation
- **Market reactions: Interest rates rose 7 -13 bps, all over the curve. Real rates did the 'heavy' lifting**

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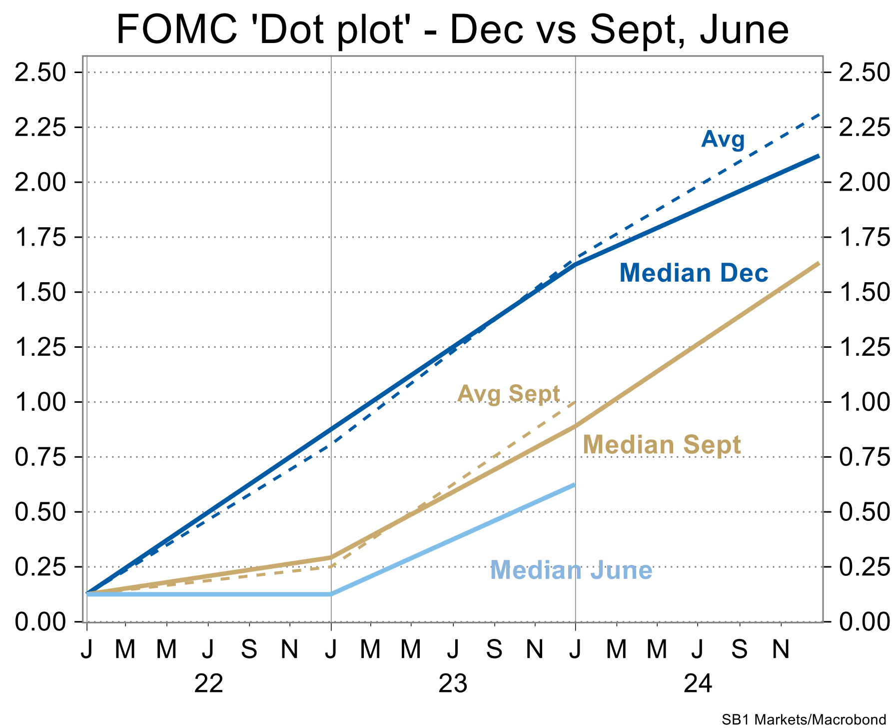
Inflation up, unemployment down. And the dot plot lifted more than ever before

3 more hikes baked into the dot plot

Percent

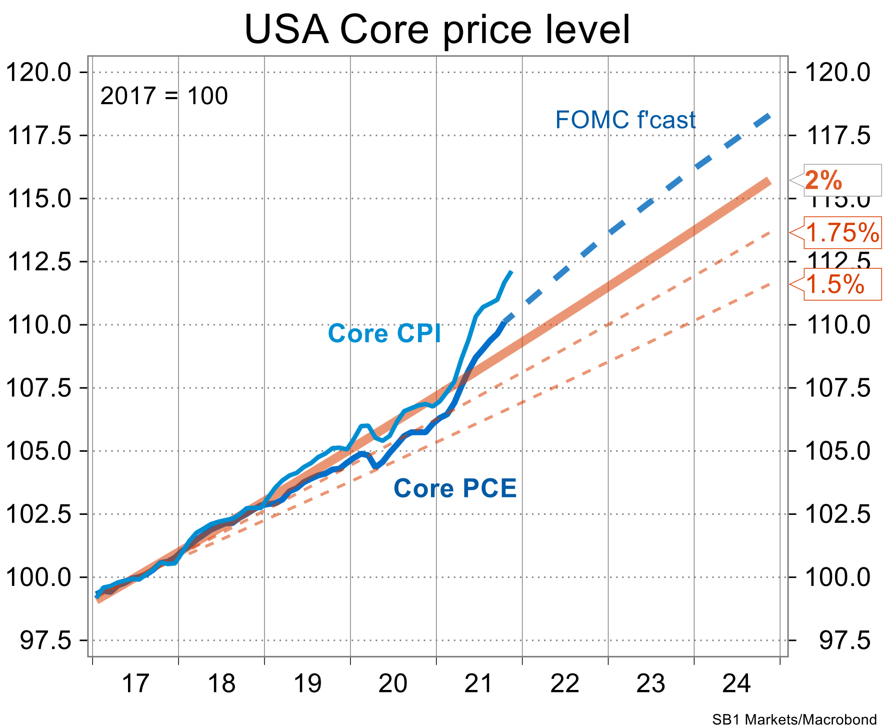
Variable	Median[1] 2021	2022	2023	2024	Longer run
Change in real GDP	5.5	4.0	2.2	2.0	1.8
September projection	5.9	3.8	2.5	2.0	1.8
Unemployment rate	4.3	3.5	3.5	3.5	4.0
September projection	4.8	3.8	3.5	3.5	4.0
PCE inflation	5.3	2.6	2.3	2.1	2.0
September projection	4.2	2.2	2.2	2.1	2.0
Core PCE inflation[4]	4.4	2.7	2.3	2.1	
September projection	3.7	2.3	2.2	2.1	
Memo: Projected appropriate policy path					
Federal funds rate	0.1	0.9	1.6	2.1	2.5
September projection	0.1	0.3	1.0	1.8	2.5

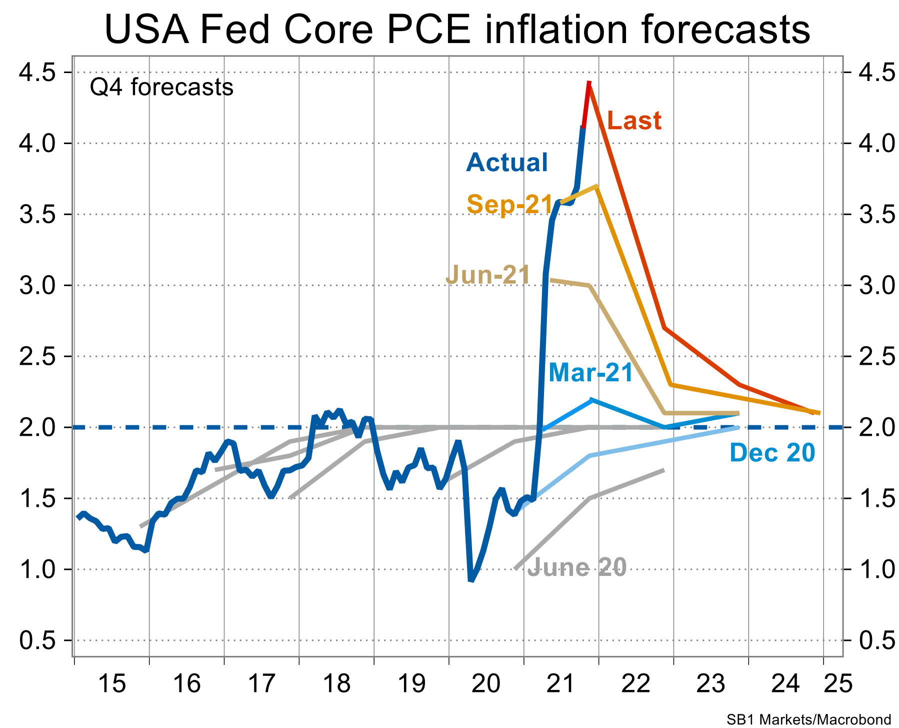


- The **'21 GDP f'cast** was revised down by 0.4 pp. **Unemployment** in '21 was revised down by 0.5 pp to 4.3% (q4 avg), but is expected and further down to 3.% the coming years, below the long term 4% NAIRU estimate. So maximum employment is reached, according to this criteria?
- **Inflation** was revised sharply up, the core price level in 2024 by 1.2% from a path that already was above the 2% path
- **The median dot plot**, the individual FOMC members interest rate forecasts, was revised up by 0.6 – 0.7 pp, the largest revision ever (dot plots have been published since 2012). All members voted for a hike next year, up from half of the committee in Sept. Now 3 hikes are signalled in 2022, and 3 more in 2023
- **The long term neutral Fed funds rate** is assumed to be 2.5% (unch), implying a (long term) 0.5% positive real rate. As the rate is assumed to stay well below 2% for the coming years, and inflation is expected to stay above 2%, at the same time as unemployment is assumed to stay below the long term NAIRU rate. Discuss…

The 2% price target is not ditched. But for the time being…

Will the Fed accept both the price and the max. employment target to be breached at the 'same side'?

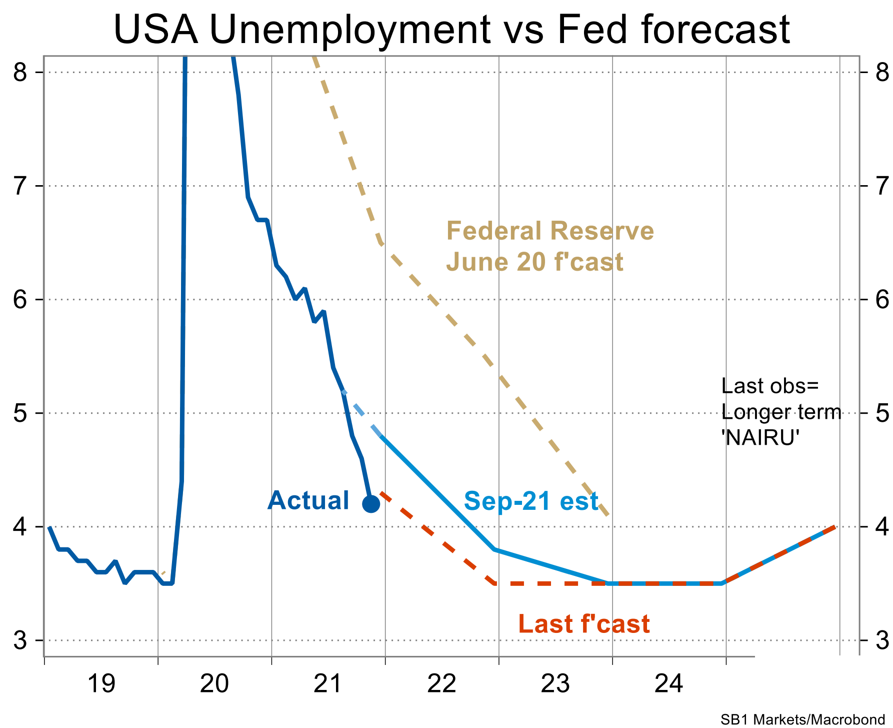




- I August 2020, the FOMC introduced its new **price level target**. The bank aims to reach an average rate of inflation of 2% over time. If inflation has been below 2%, annual inflation should be allowed to stay above 2% in order lift the price level up to the long term 2%-path.
- **The Q4-21 core PCE core inflation** estimate was lifted 0.7 pp from the Sept f'cast to 4.4% (and from the assumed 2.2% in March…). The estimates for '22 and '23 were lifted by 0.4 and 0.1 pp resp. and are expected at 2.6% and 2.3%. In 2024, 2.1%. The price trajectory is now well above the 2%-over-time inflation target. The only reasonable argument for doing so – within a flexible inflation targeting model – is that the bank wants to close the output gap, or achieve maximim employment, which is Fed's 2nd target. However, the bank is not sure how far away the economy is from max employment. Powell concluded that wage inflation in the end would signal if maximum employment is reached. And then he said that wage inflation had accelerated, and that he was chocked by the ECI Q3 growth.
- A not too unlikely scenario is that wage inflation will remain too high, signalling that the max employment target is more than met too. If so, will the Fed run a policy openly breaching both targets at 'same side'? We still think the Fed will chose the narrow path, and be willing and able to the remove the punch bowl before the party becomes too wild, accepting the short term cost of getting inflation down before a wage/price spiral runs out of control

Unemployment revised down to the below the 'NAIRU' rate for '22 – '24

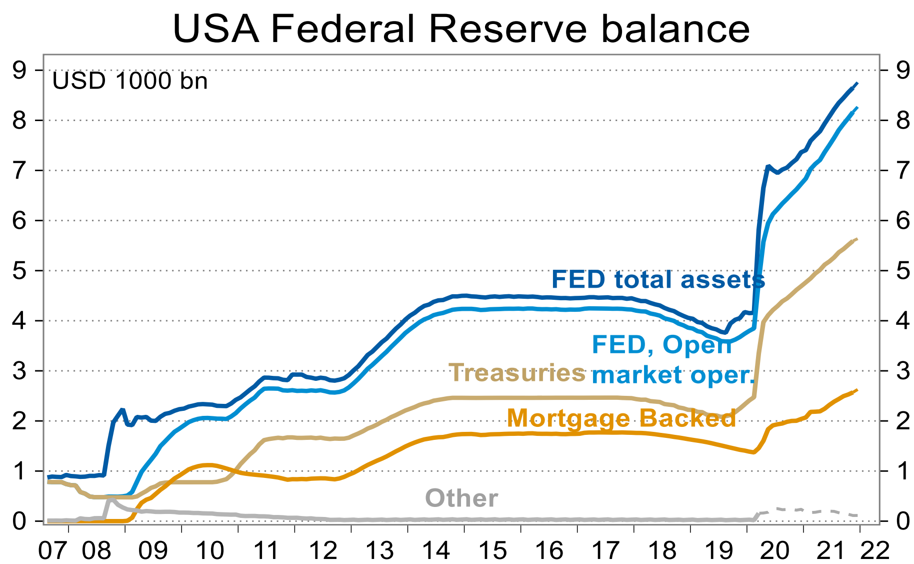
The long term NAIRU *) rate is still assumed to be 4%, just 0.2 pp below the present level

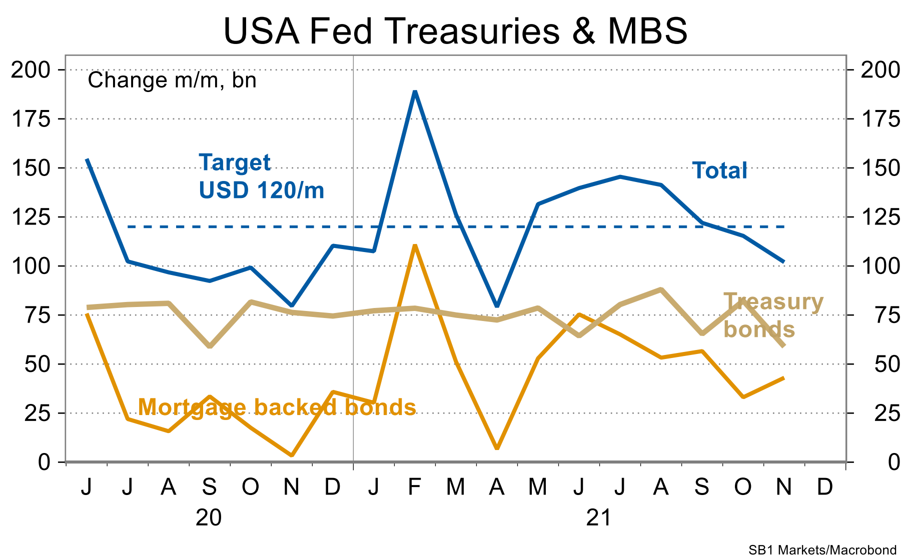


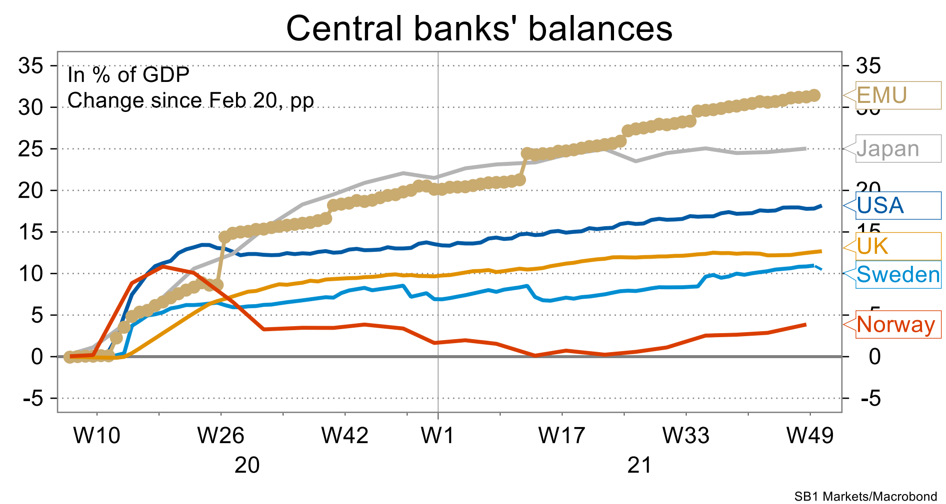
- The (median) FOMC member expects the unemployment rate to decline to 3.5% at the latest by the end of 2002, down from the current 4.2% level, and 0.3 pp lower than assumed in Sept.
  - » The bank expect the unemployment rate to stay at 3.5% the next two years
- The longer term 'neutral' unemployment rate is assumed to be 4%
  - » This is not the only piece of information for assessing it the 'maximum employment' target is met but still an important one
- So, to repeat the discussion from the previous page, the FOMC expect both inflation and employment to deviate from the long term targets at 'the upside' the coming years
  - » This policy mix will no doubt be heavily debated the coming months and years
  - » The risk is of course a more abrupt tightening after a while or a wage/price spiral that will require a massive monetary action at later stage to tackle, with an enormous cost for the whole society (except for those who short bonds, real estate and equities)

*) NAIRU: The Non-Accelerating Inflation Rate of Unemployment – an unemployment rate that balances the labour market. It is not stable, and it can be quantified only 'after the fact' but still a useful analytical concept.

FOMC: No more QE buying after March

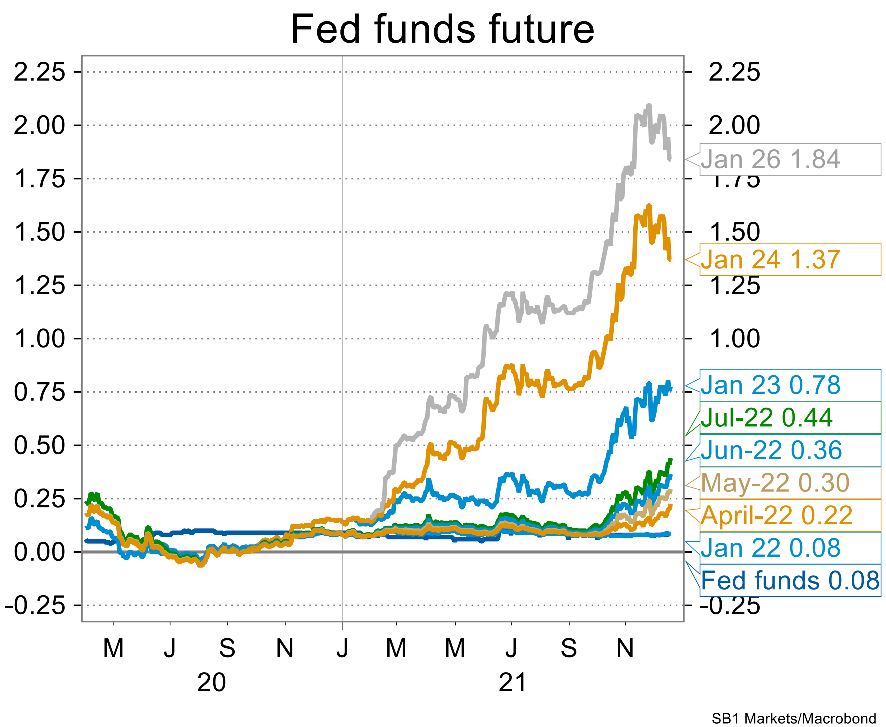


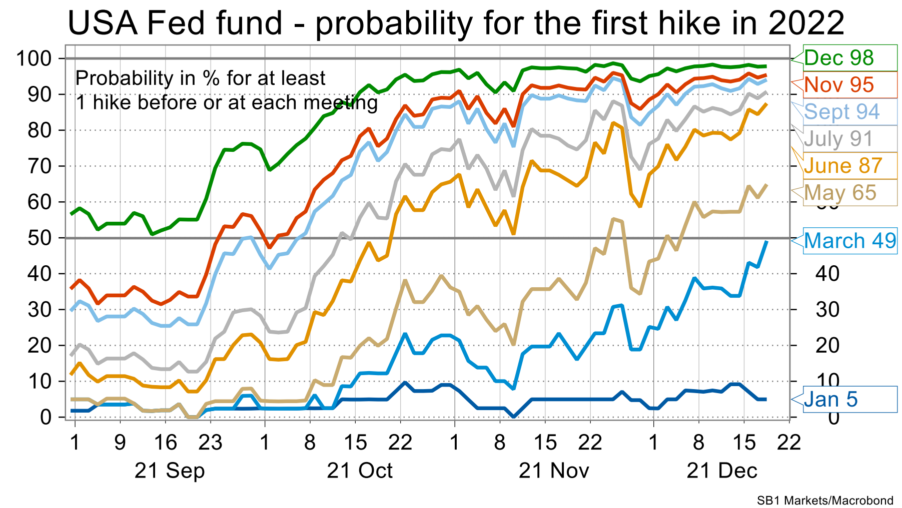


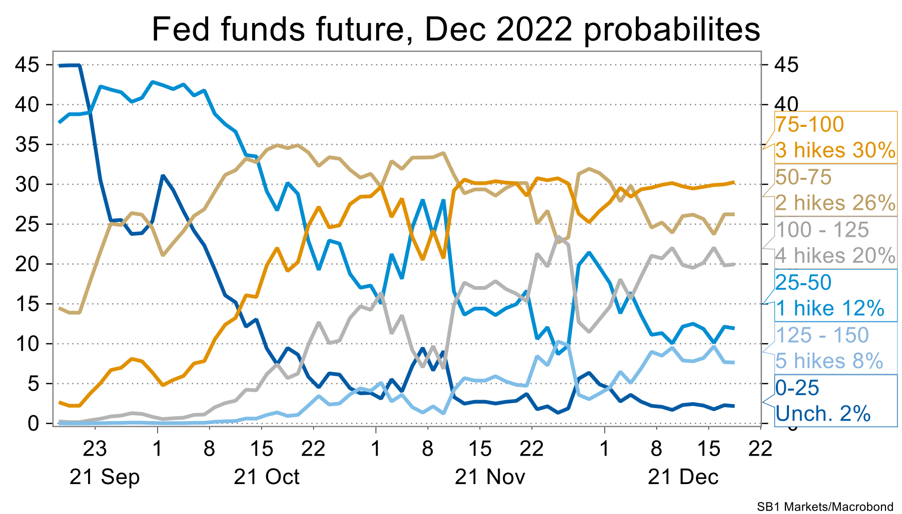


A 49% prob. for a March hike? Why not. A hike before the summer a done deal

However, further out, US interest rate expectations fell rapidly last week





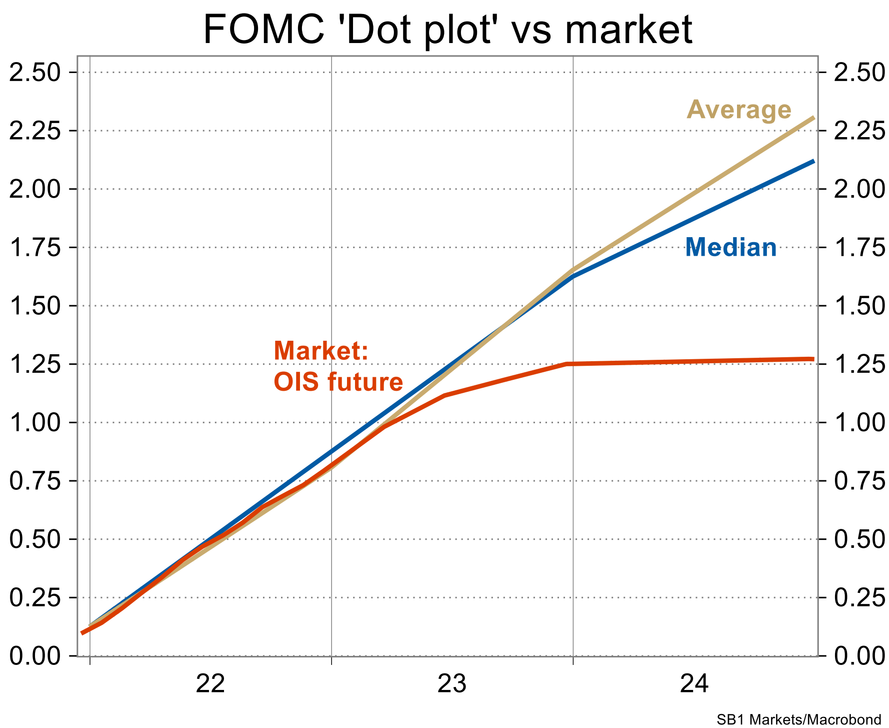


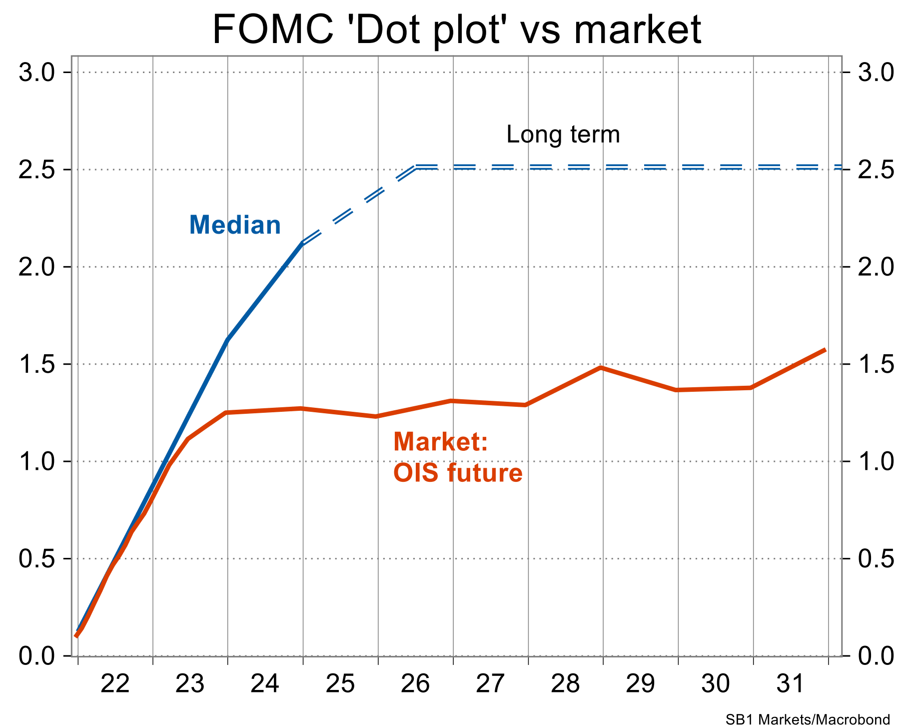
- Is a 1.75% - 2% Fed funds rate sufficient to create a recession when households are not in a down payment mode any more?
- We doubt, but the market seems to believe it –with some modifications, check the 2 next pages

SpareBank 1 MARKETS

Mind the gap: The market does not believe in Fed's est. of a neutral Fed funds rate

The market is satisfied with a 1.5% long term Fed funds rate, the FOMC says 2.5%

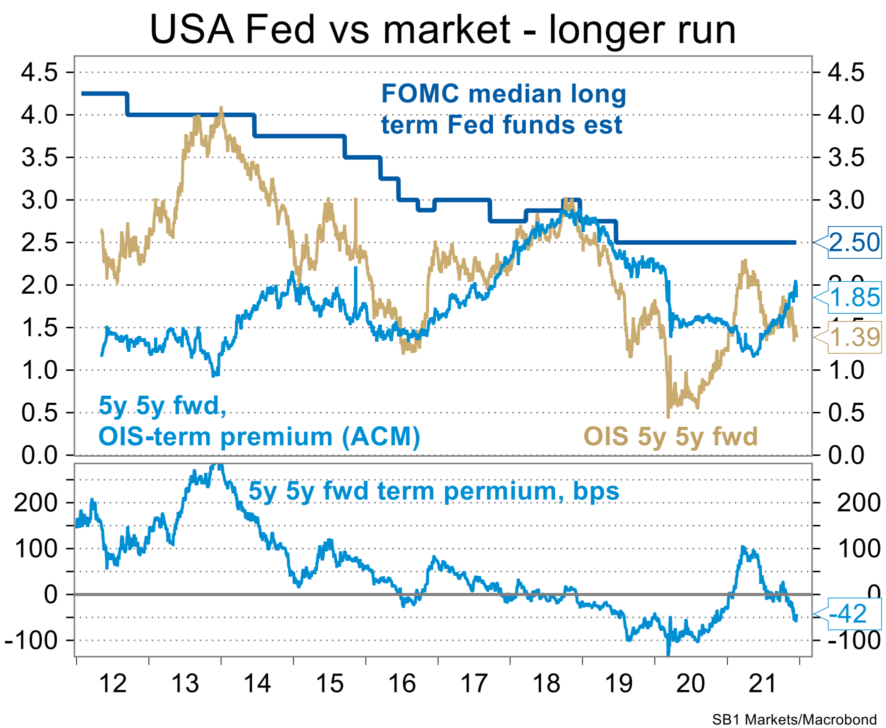




- The market accepts the first 4 Fed hikes, then the curve bends

May a negative term premium explain half of the gap between the market & Fed?

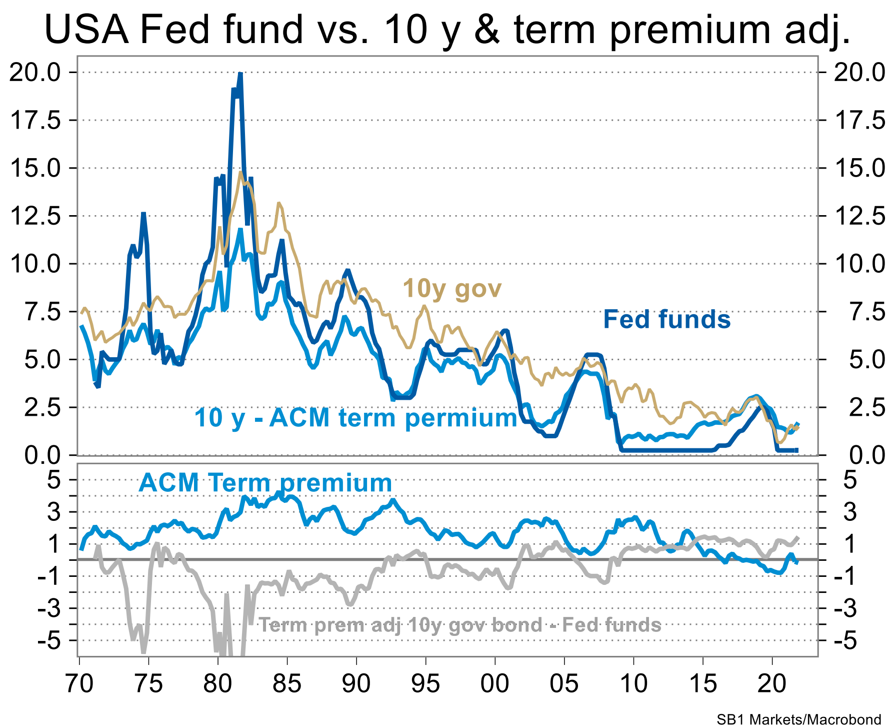
The (ACM) term premium has turned negative, implying that the market 'expects' a 2.1% long term FF

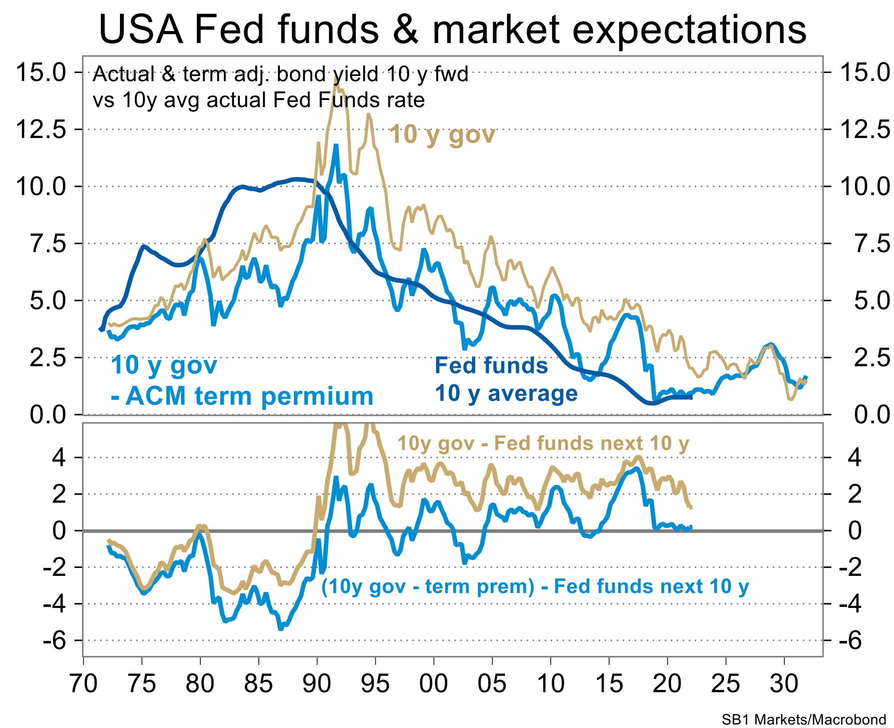


- The 5y 5 y fws OIS rate was at 1.39% (Friday), far below the 2.5% FOMC estimate of the long term nominal Fed funds rate
- The term premium in the yield curve (the difference between the actual bond yield and the expected short term rate over the same period) has fallen to below zero again, according to the ACM model
  - » Put the opposite way: The actual long term yield – the term premium expresses the market's expected short term rate
  - » The term premium has been drifting downwards since the 80'ies, and has been fluctuating around zero since 2016, according the ACM model (one of several term premium models)
- Adjusted for the term spread (calcated from the bond yield curve), the markets assumes a long term OIS rate at 1.85% (at Thursday), still far below the FOMC median estimate – but less than the 110 bps outright spread

The term premium adjusted bond yield better at predicting the Fed Funds rate

… than the actual bond rate?

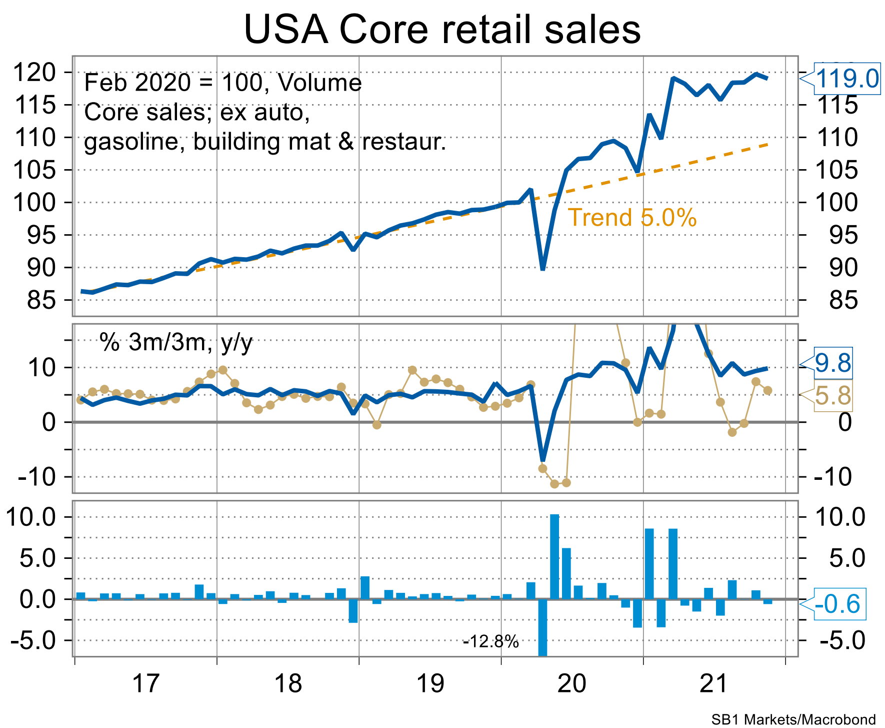


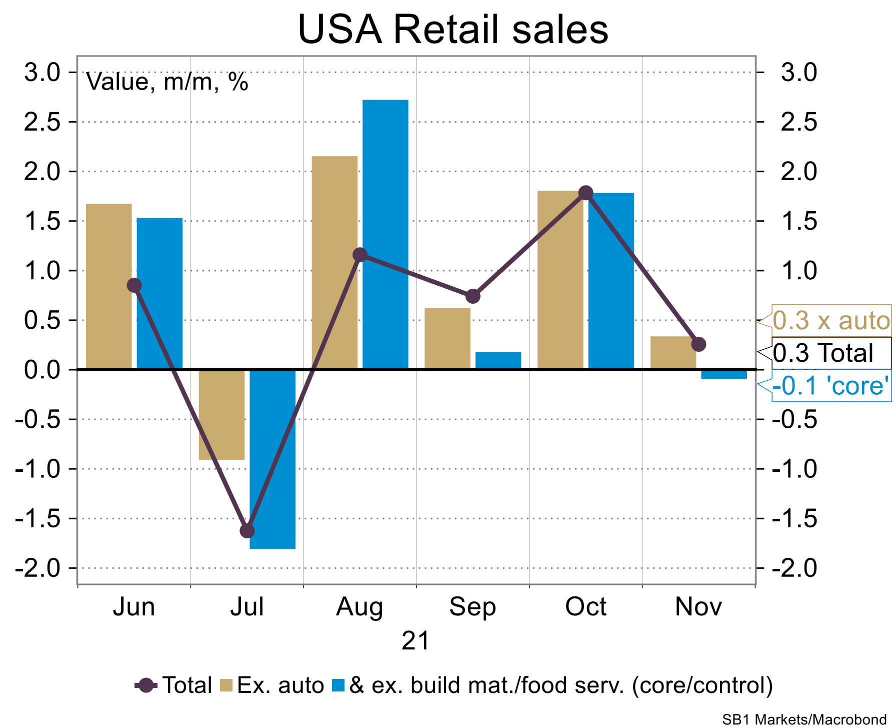


- The adjusted bond yield (10 y – term premium) has been more volatile, but has been closer to the actual Fed funds rate the next 10 years, in average, than the unadjusted bond yield.
  - » The term premium has been positive during the long term decline in interest rates/bond yield since the 80'ies
- The term premium adjusted bond yield is normally closely anchored to the actual Fed Funds rate (check chart to the left)
- Will the term premium adjusted bond yield now prove to be a good estimate of the future Fed funds rate? Yes but just within a +/- 200 – 300 bps rate, cfr the historical track record (chart to the right, bottom panel)
- Thus, we should all be permitted to share our ideas on future rates, acknowledging that no model nor any individual can predict it!

Retail sales finally surprised on the downside!

Core goods volumes very likely fell – from an incredible high level

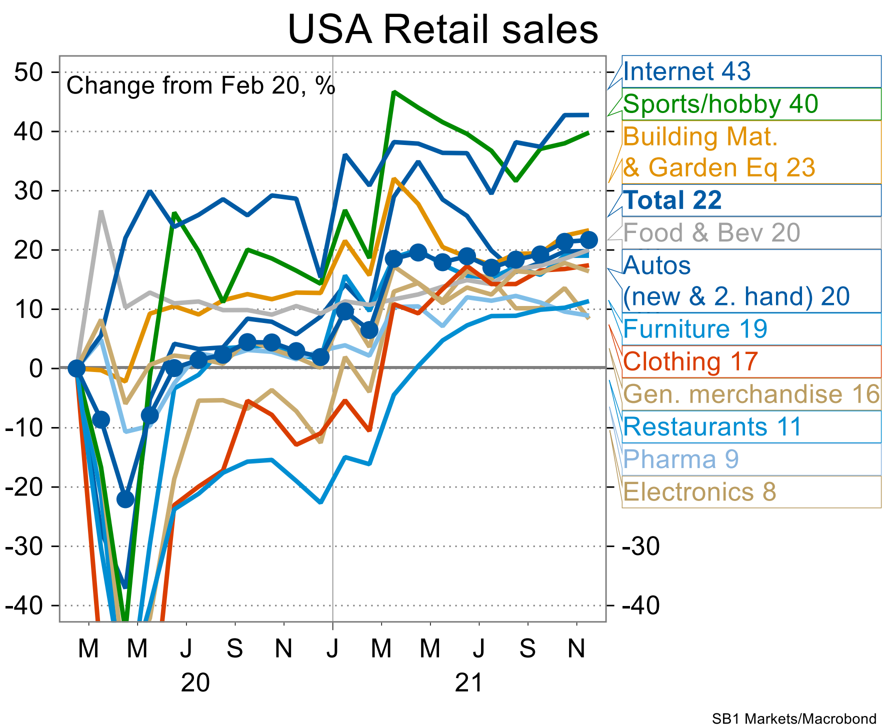


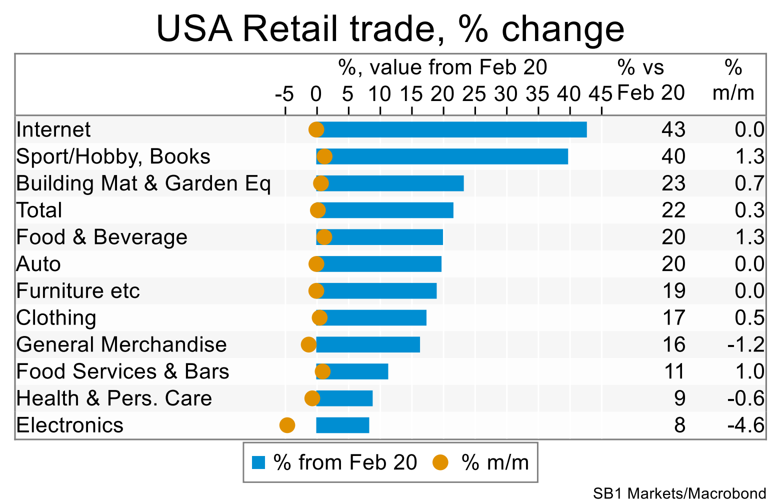


- **Total nominal sales** rose by just 0.3 % in Nov, expected up 0.8%. October sales were revised up by 0.1 p to 1.8%. Sales are up 22% vs. Feb-20 in value terms
- **Core sales of goods** (=control group, excludes auto, gasoline, building materials & restaurants) fell by 0.1% in Nov, expected up 0.8%. In volume terms, we assume sales fell 0.5%. Still, sale volumes are 20% above the Feb-20 level, and sales the past two months are in line with sales before the recovery in services started in earnest, in March, and even if prices have soared in between time!
- Sales in **restaurants & bars** have flattened since July, and was unch in October– still 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 growth has not been strong since the spring!

Electronics, health & general merchandise down in Nov

Auto sales, furniture, net sales flattened but growth in sports, food, clothing, restaurants





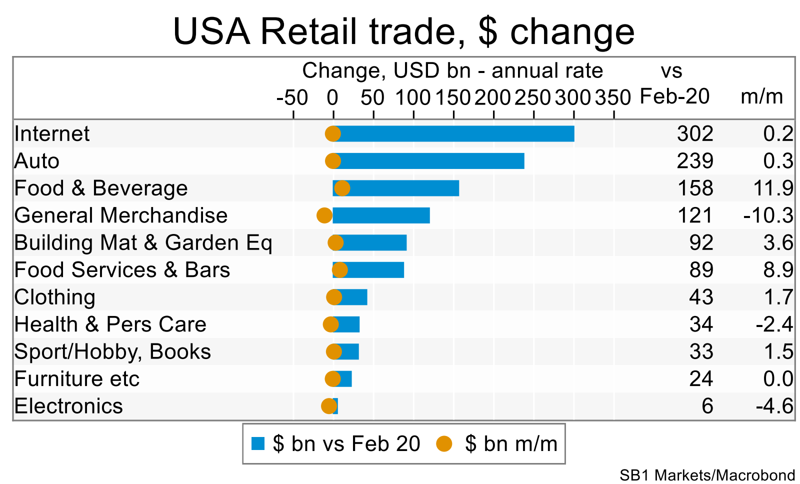
Last month

- 5 out of 11 main sectors reported growth in sales, 3 lower sales

Since pre corona: All sectors up, from 8 % and upwards – *in value terms*

- **Restaurants** are 11% above the pre-Covid level (from 9 in Oct)
- **Clothing** is on the way up, is up 17% vs. Feb-20
- **Sports equipment** (+hobby/books) is up 40%, while auto sales are +20%, due to record high 2nd hand car prices
- **Net** sales are up 43%

What a crisis, more demand desperately needed! Or go ask Fed's Powell, he got a brand new answer for you☺



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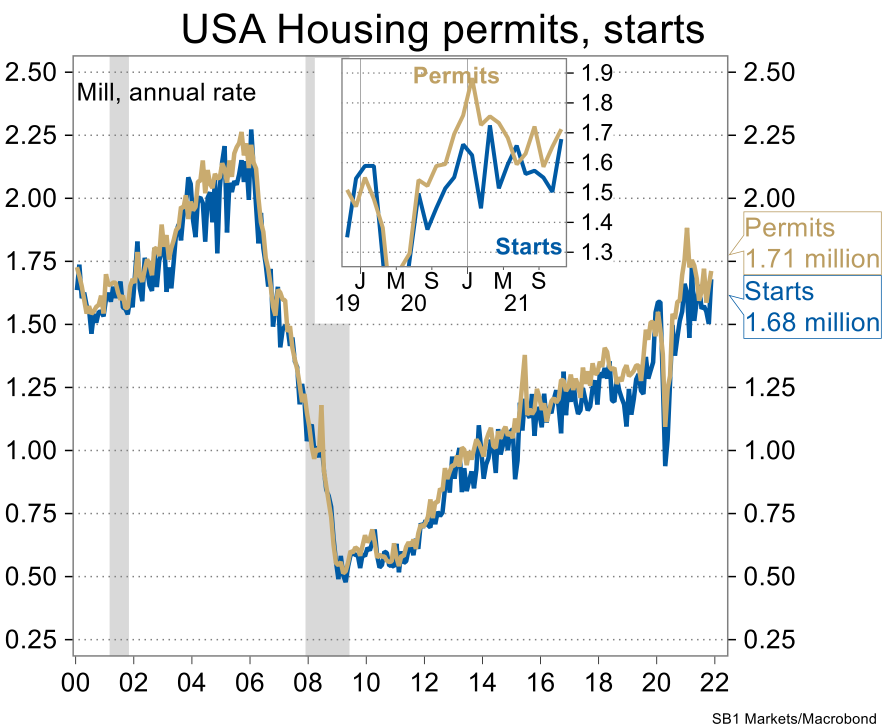
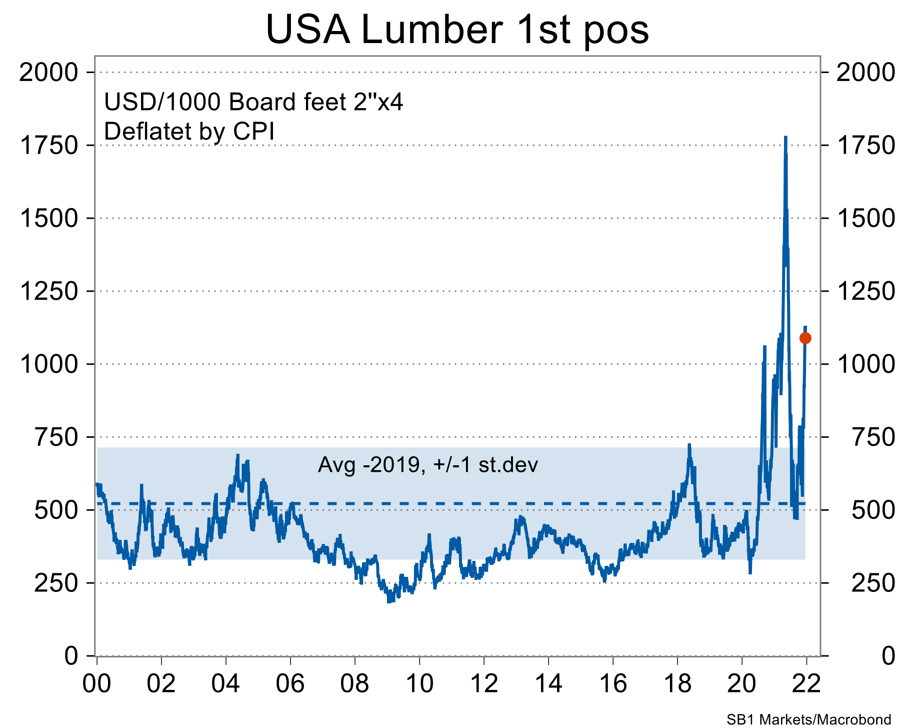
Housing starts, building permits up again, as are lumber prices

Starts lower than the strong 2nd hand market normally would imply

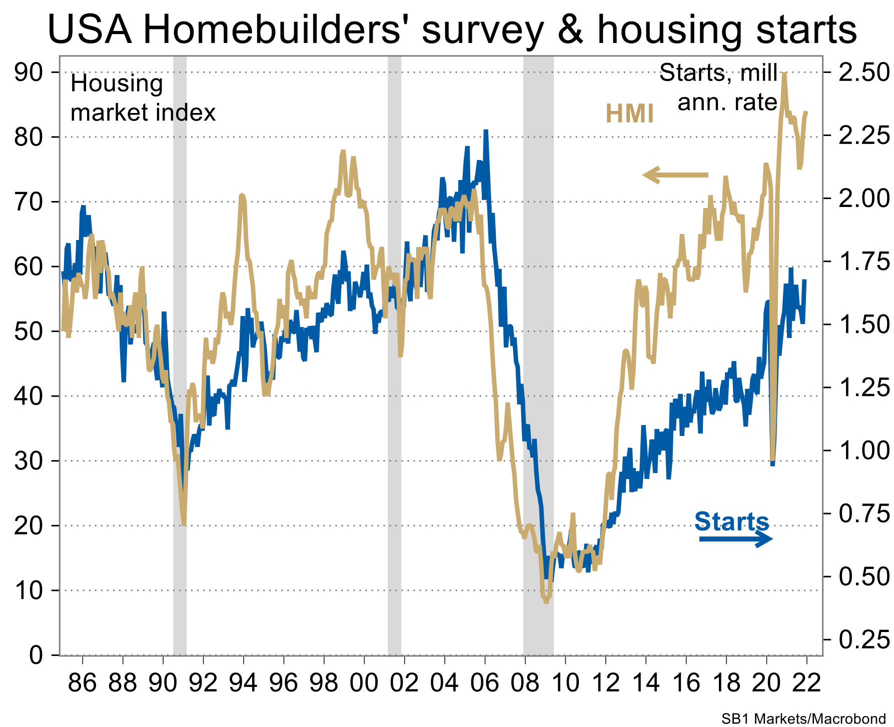


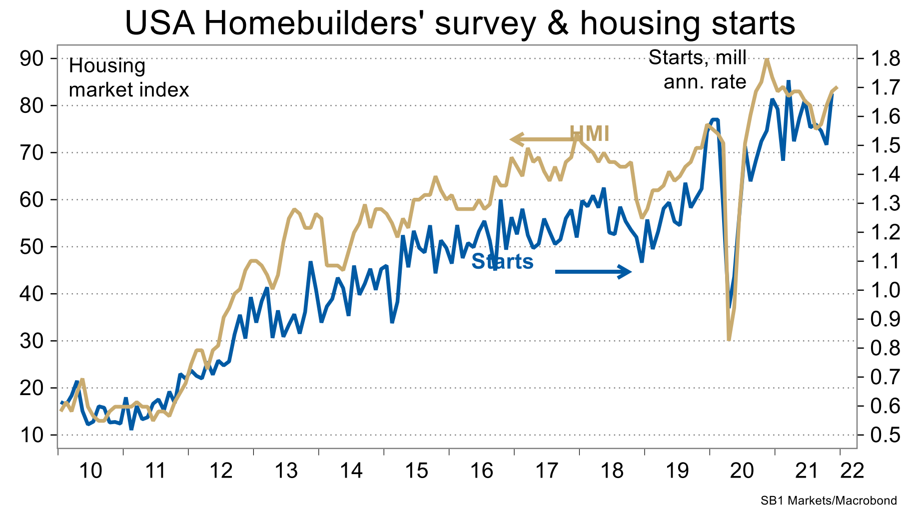


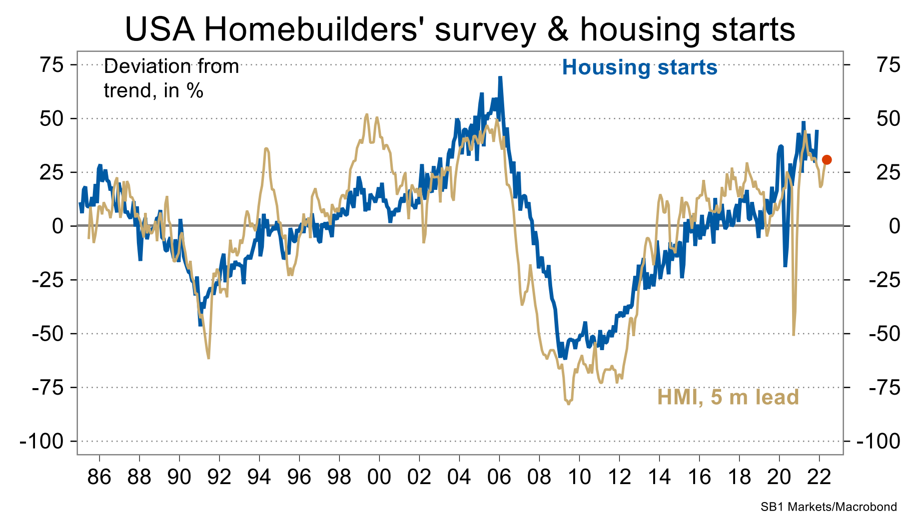
- **Housing starts** rose to 1.68 mill in November, from 1.52 mill in Oct, expected up to 1.57 mill
- **Building permits** rose to 1.71 mill, up from 1.65 in Oct, expected close to unch
- **Starts have flattened in 2021**, and barring some strong months late ‘20/early 21’ the same goes for permits. The level is some 10% above the pre-pandemic level. However, given the incredible strong existing home market, and soaring prices, starts should normally have strengthened further, amid still very low mortgage rates and a recovering economy
- **Supply & capacity problems and higher cost** in the building sector may explain the lack of response. Lumber (2’’x4) prices have doubled again recent week, from an average level. In May prices were 3.5 x higher than normal, and then ‘collapsed’

Homebuilders’ market index further up in December, the level is high

Demand is strengthening. Still, the index does not signal a surge in housing starts



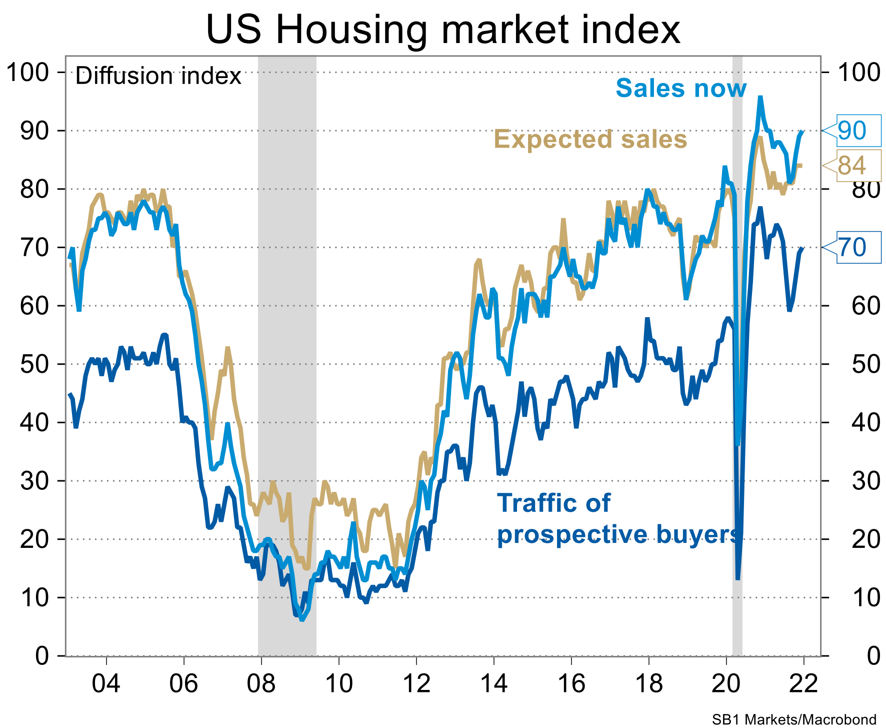


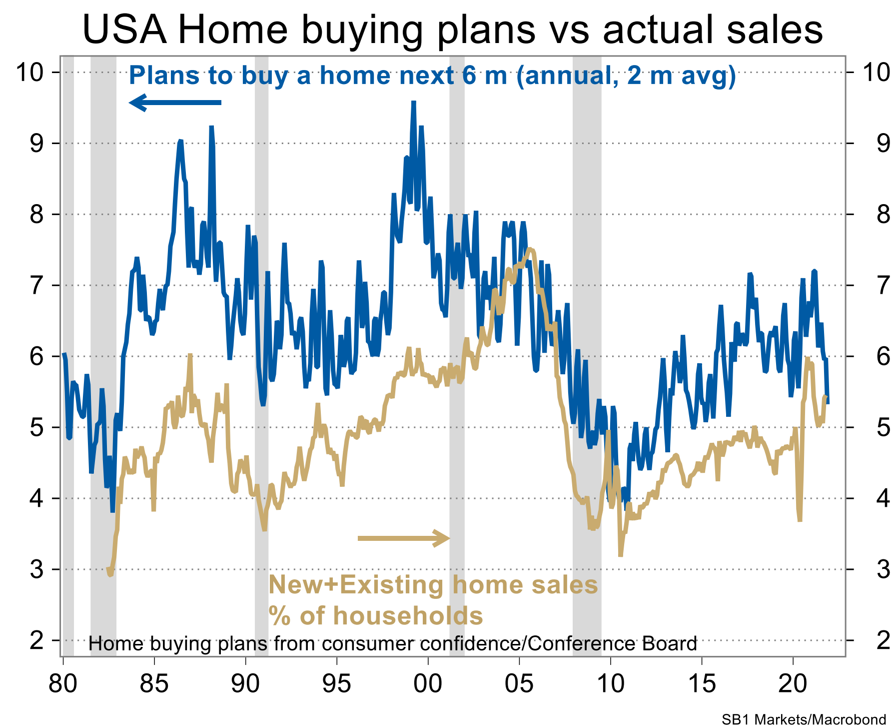


- **The Homebuilders’ Housing Market Index** gained 1 p to 84 in Dec, as expected. The level is high but still down from 90 last Nov
- **Rising material prices, supply chain and labour shortages are still** creating challenges for the home builders, according to the NAHB – but those shortages may have peaked (even of lumber prices are soaring again!)
- Even if the index level is very high, the HMI does not signal higher housing starts, ref. the chart on the bottom right

Home builders report more sales, more traffic of prospective buyers

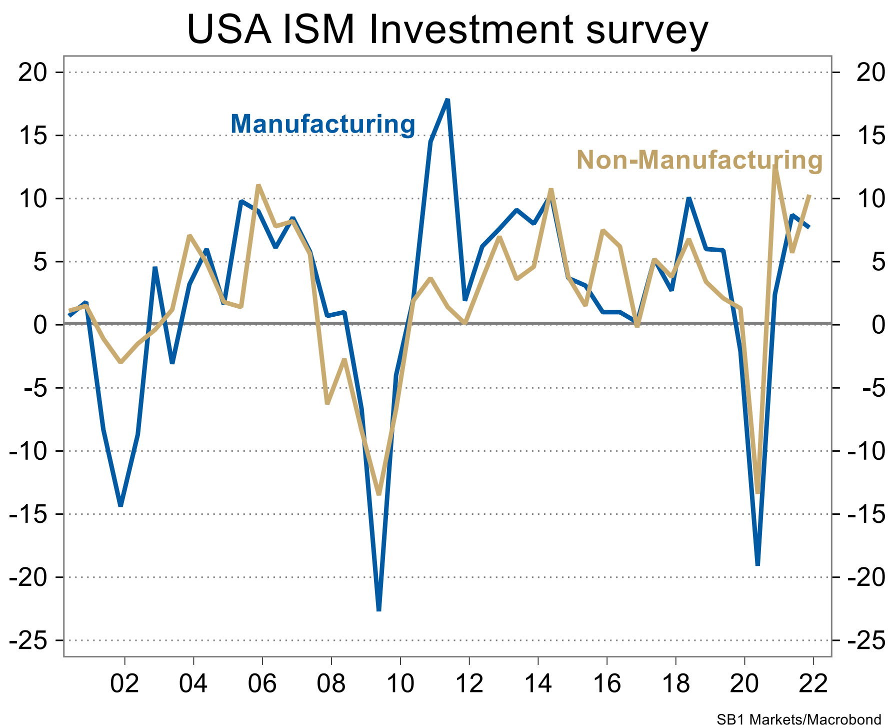
… while homebuying plans have fallen, according to Conference Boards consumer confid. survey

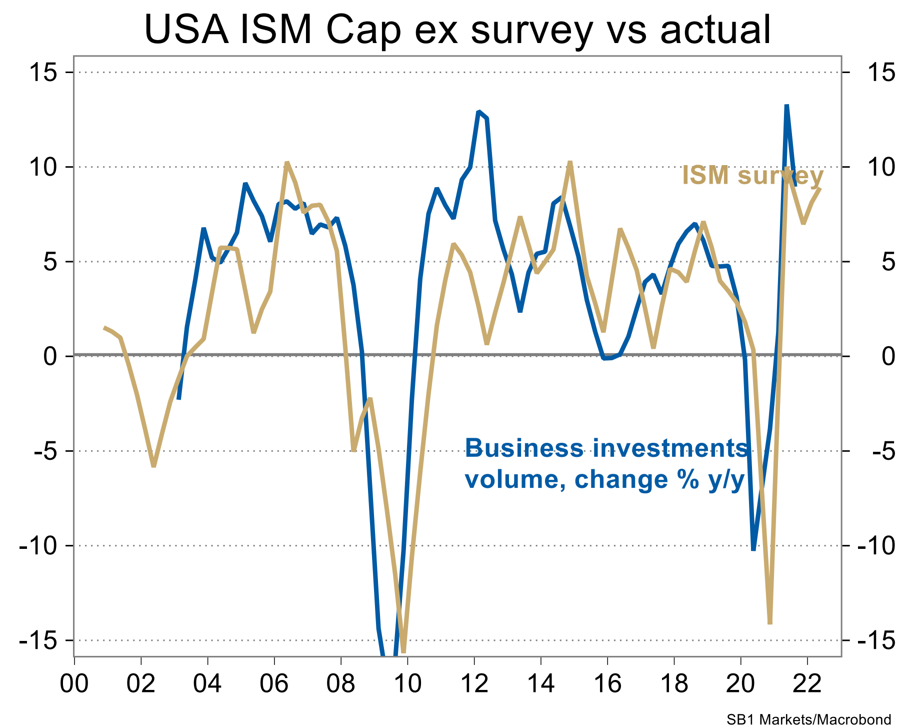




ISM semi-annual investment survey: Among the best, ever

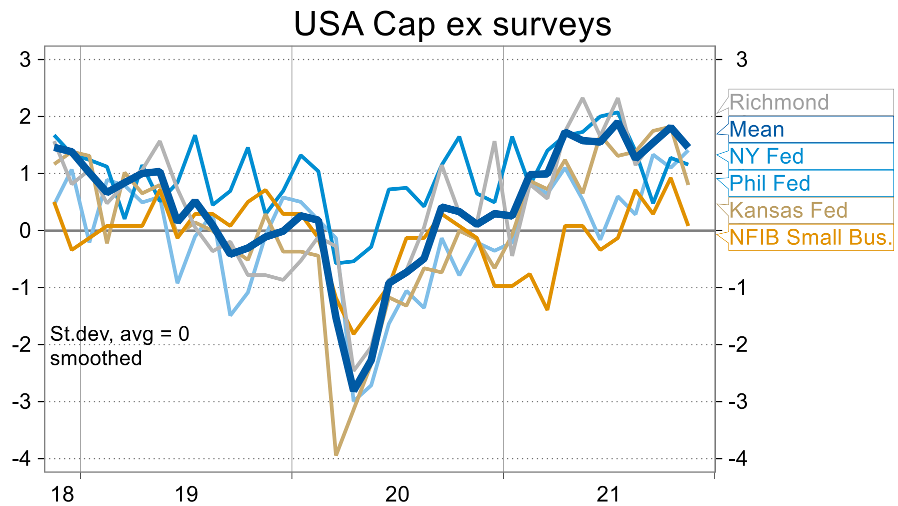
Businesses expect to increase their investments sharply the coming year, especially in services

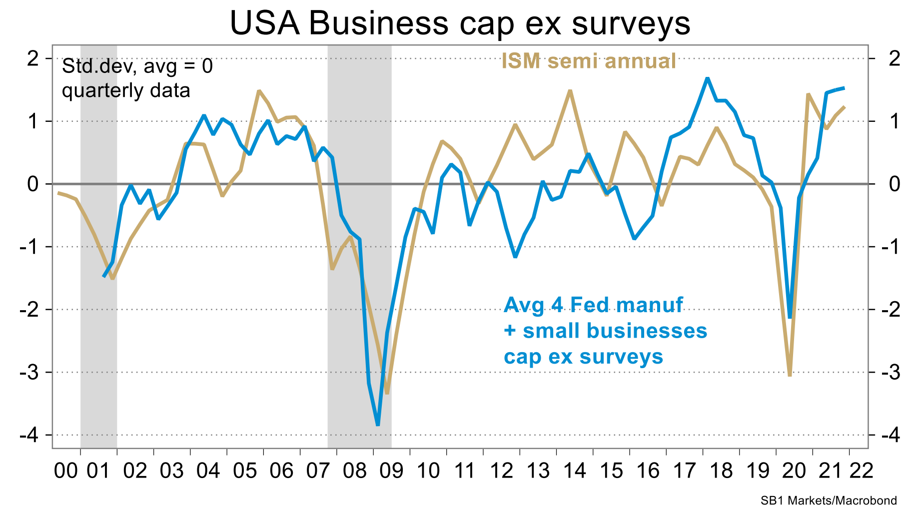


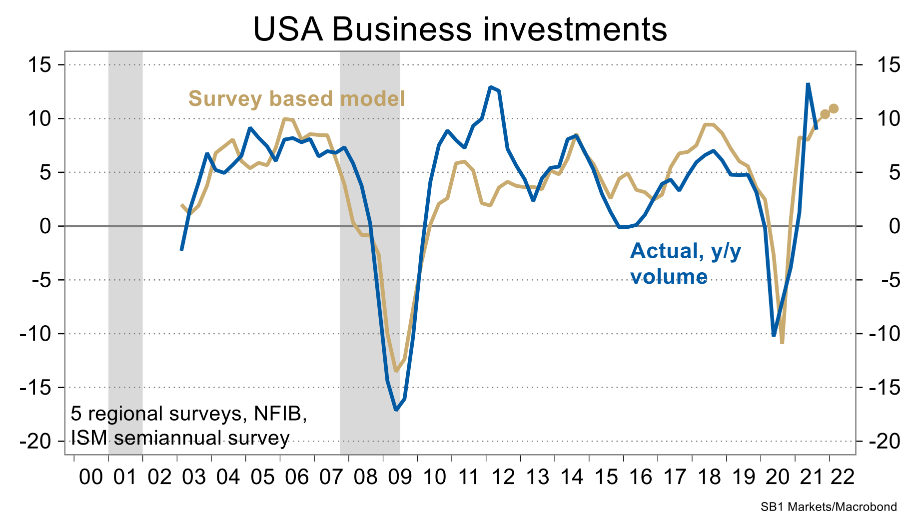


Other investment surveys also signal growth in business investments

Taken together, the most aggressive investment plans, ever – signaling 10% actual growth!

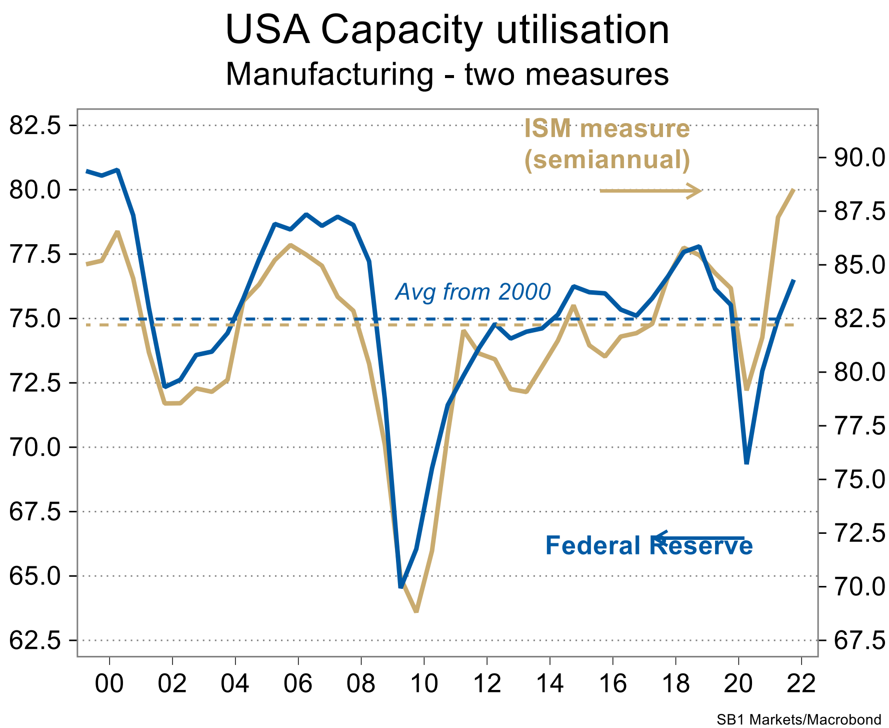


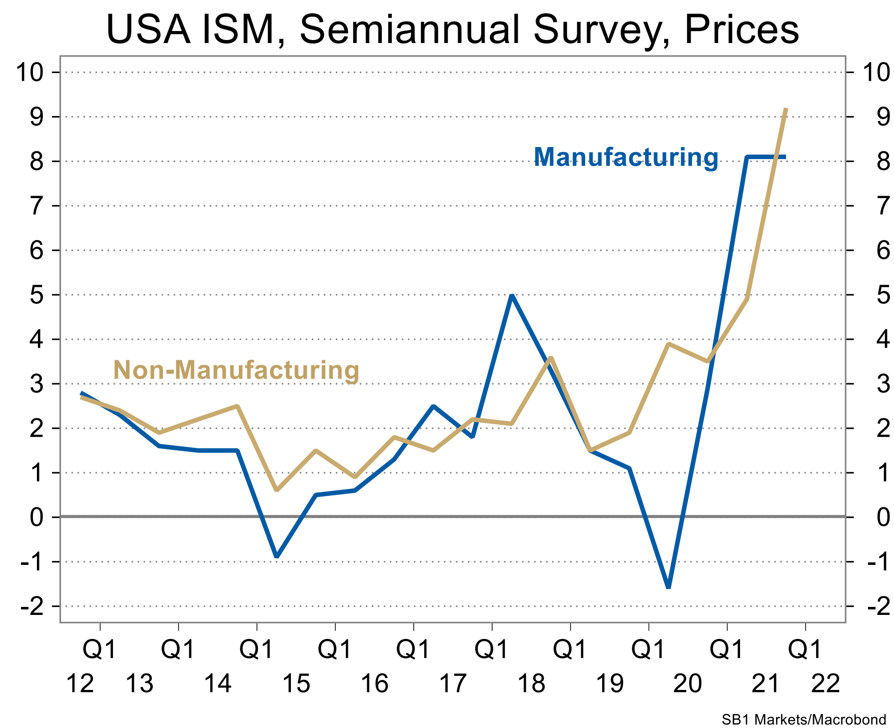




Is the capacity utilisation in manufacturing quite high or far above anything seen?

Fed's measure yields a somewhat above average result, ISM's survey further up to another ATH

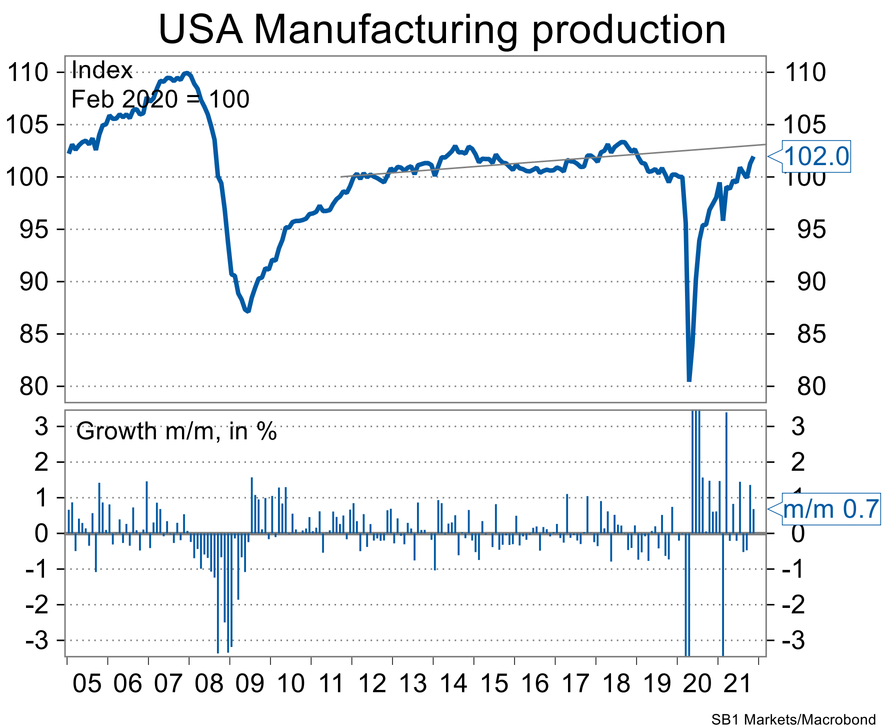


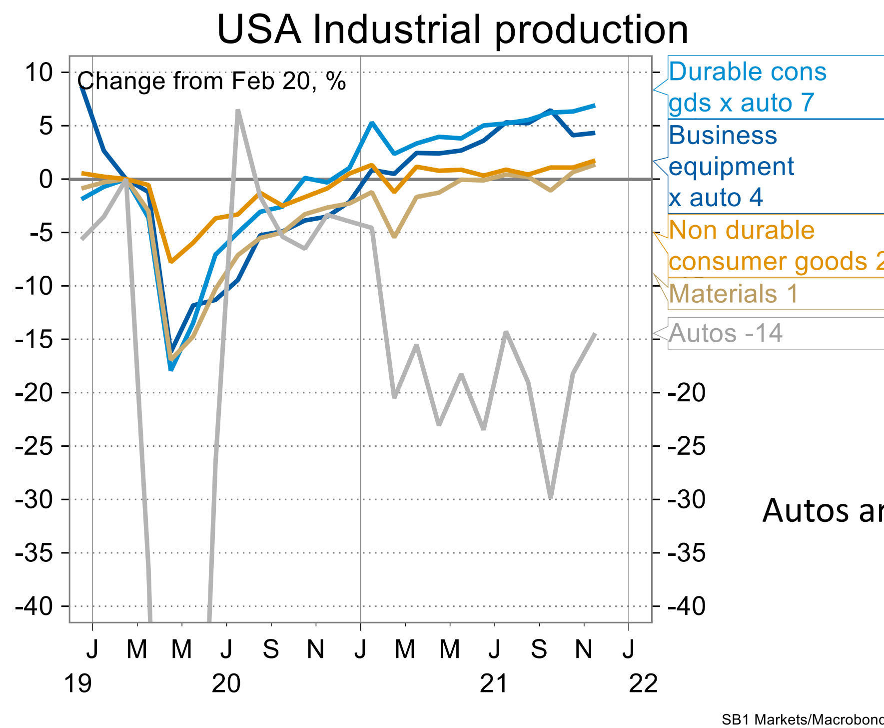


- In the **ISM's semi-annual survey**, the companies reported a utilisation at 88%, a new ATH – though with data just back to 1999 – 6 pp above average
- The **Federal Reserve's** estimates a 77% utilisation (so far in H2), 2 p above average. The gap between the two measures has never been larger
- In the ISM semi annual survey, companies in both manufacturing and non-manufacturing are reporting the highest expected prices increases ever – however with data just back to 2012. But is surely illustrates the price risk on the upside

Manufacturing production up 0.7% – to 2% above the Feb-20 level

Auto production rose further but is still 14% below the pre-p level. Other sectors are above



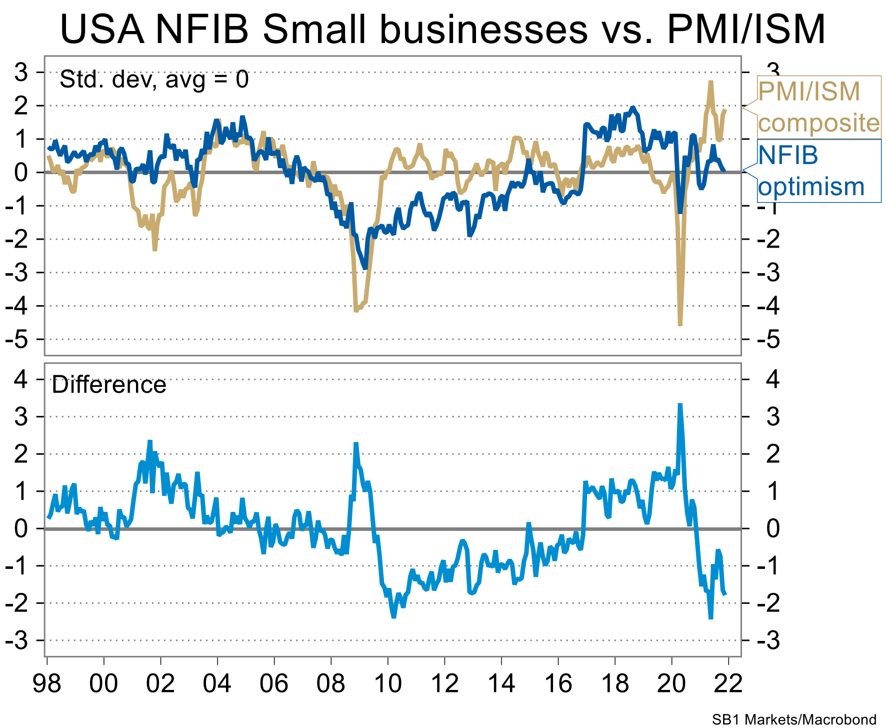


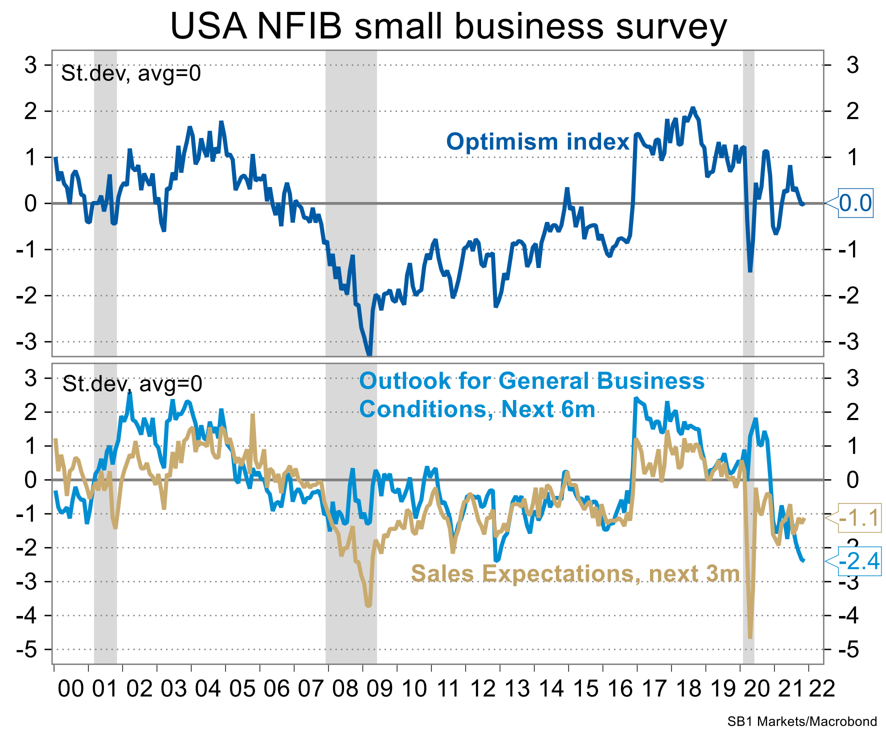
Autos are includ

- **Manufacturing production** rose 0.7%, as expected – and the trend is still strong – even if the level is not that impressive
  - » The steep decline in auto production has been a drag on overall production since early 2021
- **Total industrial production**, including utilities, mines/oil production rose 0.5% m/m, expected up 0.6%
- **PMI/ISM and all other surveys** signal a continued strong recovery
- **Capacity utilization** rose in October, and is above average. The ISM survey reports a record high utilization, *check the previous page*

Small businesses optimism flattened in November, more inflation worries

Small businesses cannot find workers and are raising compensation, selling prices, like never before

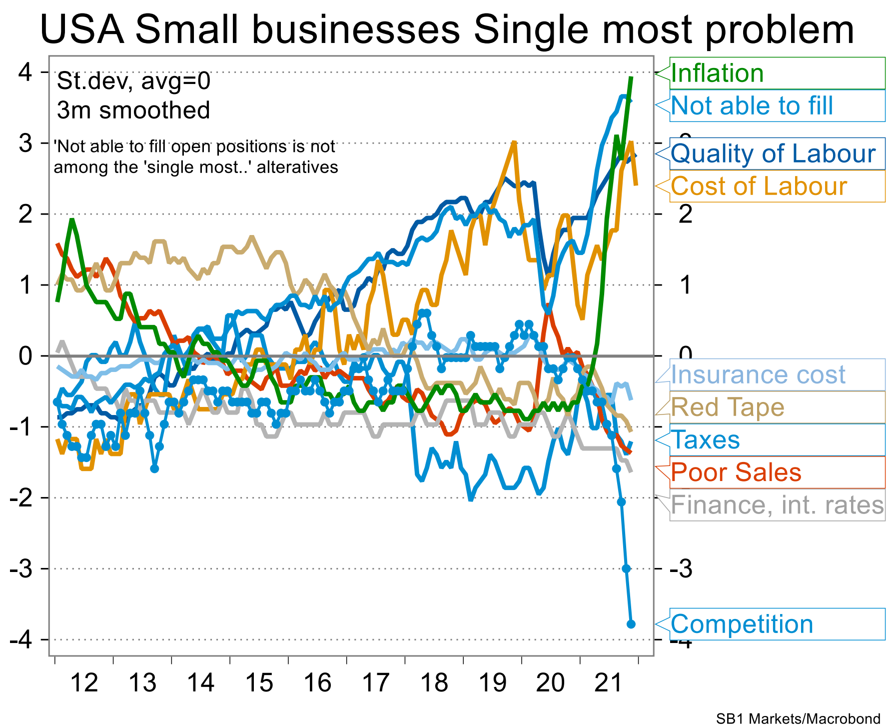


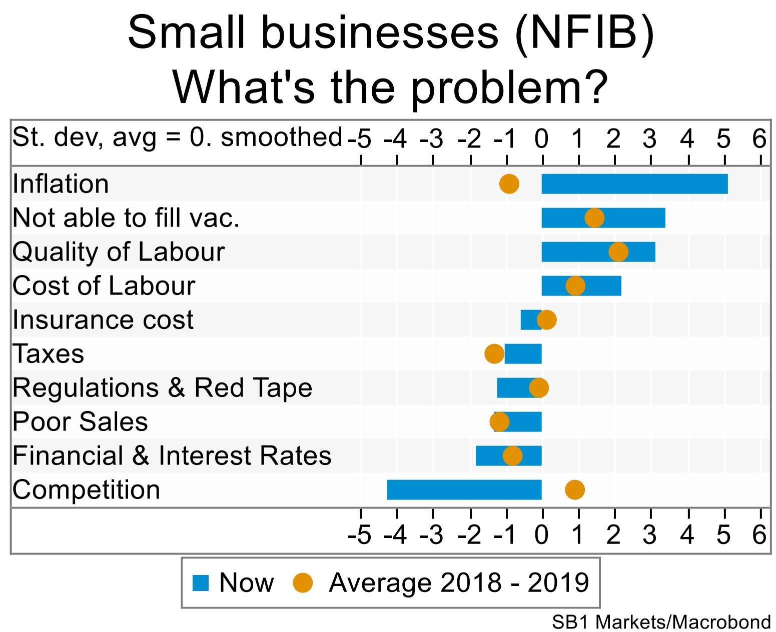


- The **NFIB optimism index** rose marginally to 92.5 in November, as expected. The index is close to average, and far lower than the PMI/ISMs, and most other surveys
- **The outlook for the next 6 months** declined marginally, at it is at an incredible low leve, 2.4 st.dev below par, close to all-time low, and well below the dark days of the Financial crisis. Lack of qualified labour, labour costs, inflation worries. 'Nobody' is complaining about current sales, though, **Investment plans** were revised down but is still above an average level!
- Old news (published 2 weeks ago): **Hiring plans** are still very high in Nov, just somewhat down from the ATH level in Aug. However, the SMEs are still not able to **fill their vacancies.** More companies report planned **compensation increases** than ever before
- The share of companies planning to lift prices rose further, to ATH (data from 1974). And they have usually done what they say they plan to do

Record few companies complain about poor sales & competition from large companies

Record many complain about cost/quality of labour. And inflation, even if they are 'selling it'



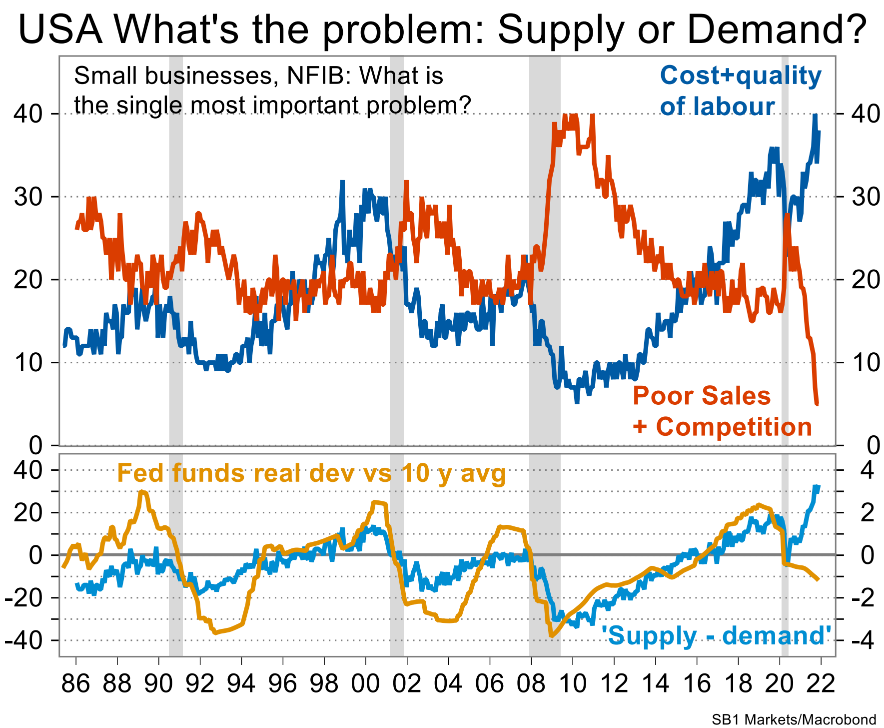


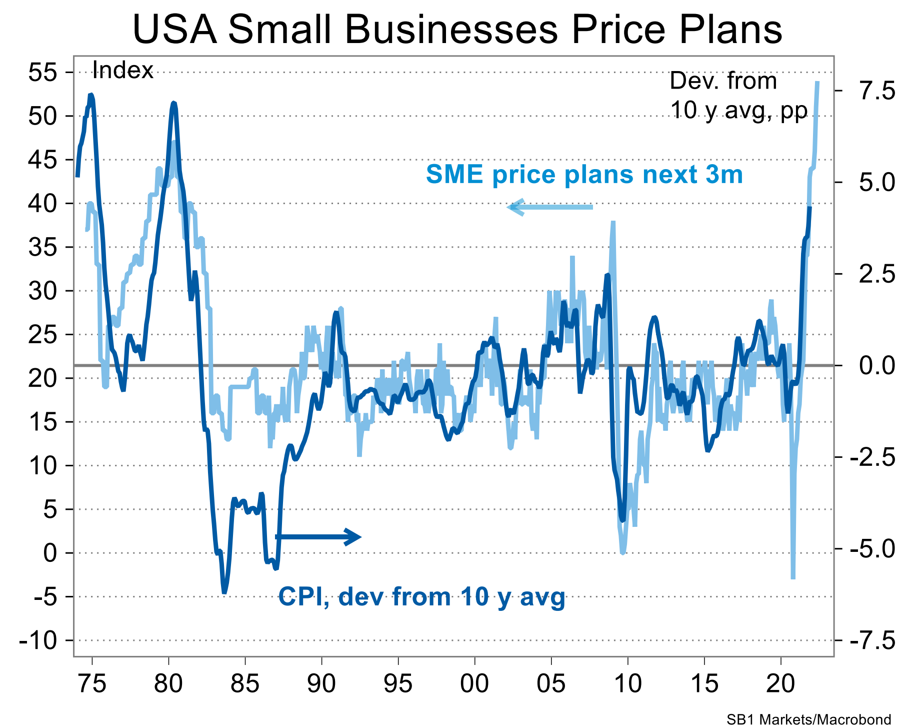
- Thus, companies report they are constrained from the **supply side**, not from the **demand side**
- In addition, inflation ia now quoted as the most important problem for the SMBs. However, the SMBs themselves are making the problem even larger – more companies than ever before plan to increase their selling prices
- These data are really incredible, at least vs the monetary policy stance that ruled until last Wednesday. *Check next page*

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

It's the supply side! And even more companies plan to lift their prices!

Last week, the Federal Reserve finally (officially) took notice.

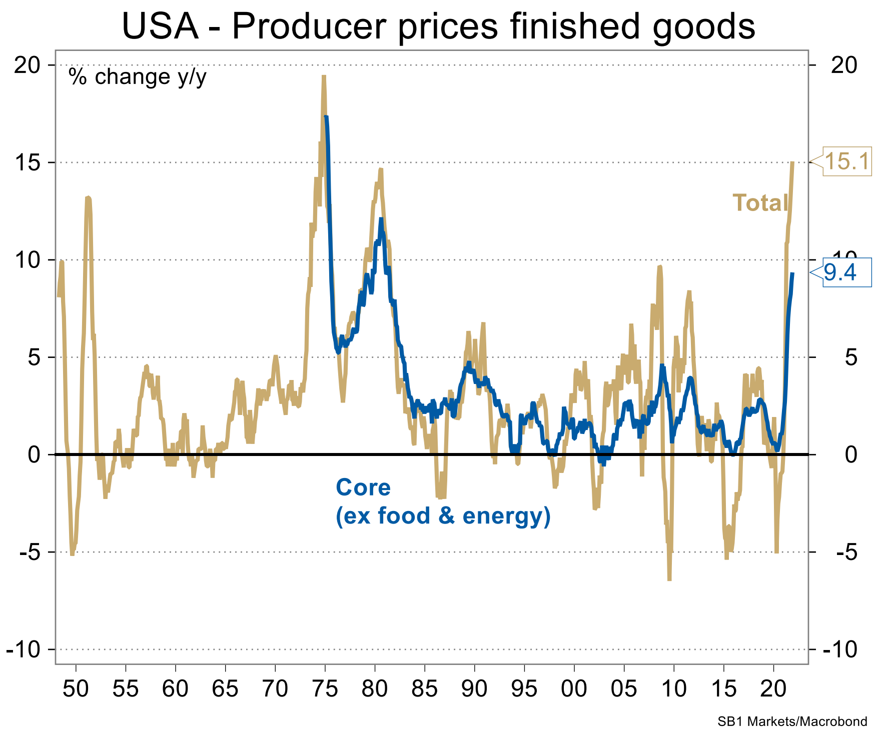


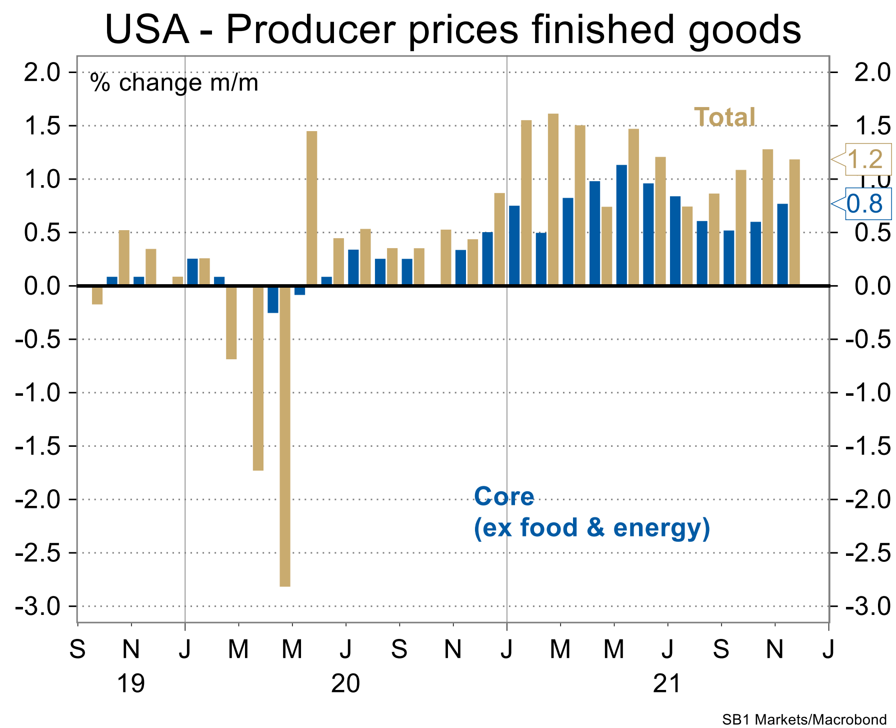


- More SMBs than ever plan to lift their **selling prices** than ever before, data from 1974
- In addition: 2 weeks ago a record share of companies reported they planned to **lift compensation** to workers
- This survey was mentioned by Powell, as one of several data points that finally made him change his mind
- The real challenge is though that the gap between the normal policy response to demand/supply changes, and the current stance is monumental. With today's demand/supply balance (which has anyway shot up into uncharted territory), Federal Reserve would normally have tightened substantially. Will it be possibly to get the labour and goods market in balance down without engineering a recession, by hiking rates much more than the FOMC so far signals?
  - » We have not seen that happen before. Perhaps Powell (the lawyer) knows something we others do not?
  - » BTW, the market believes it is possible too!

PPI inflation further up in November, has been higher just Sept-74 – Jan-75!

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



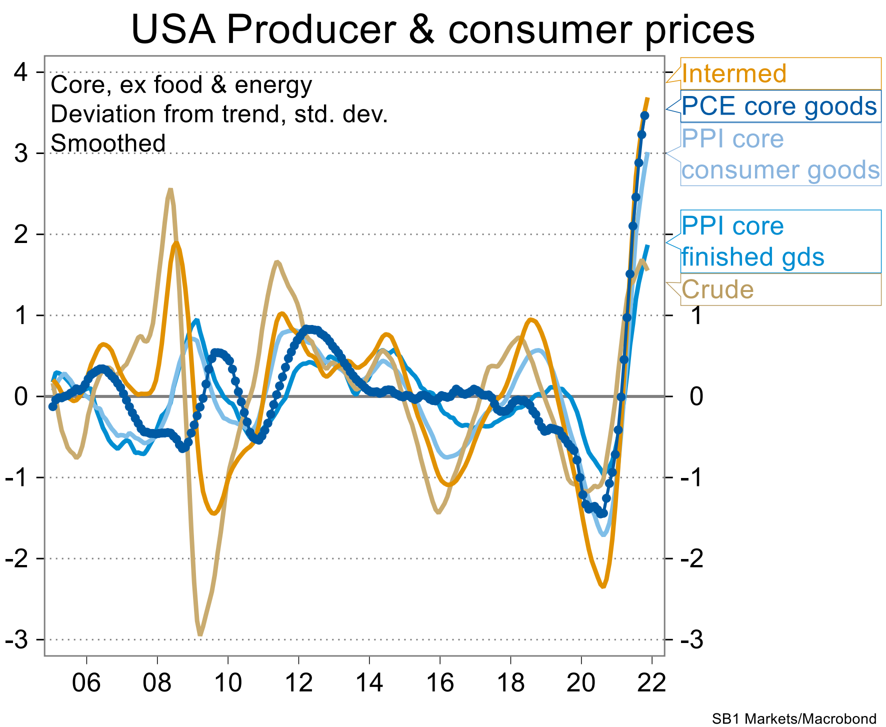


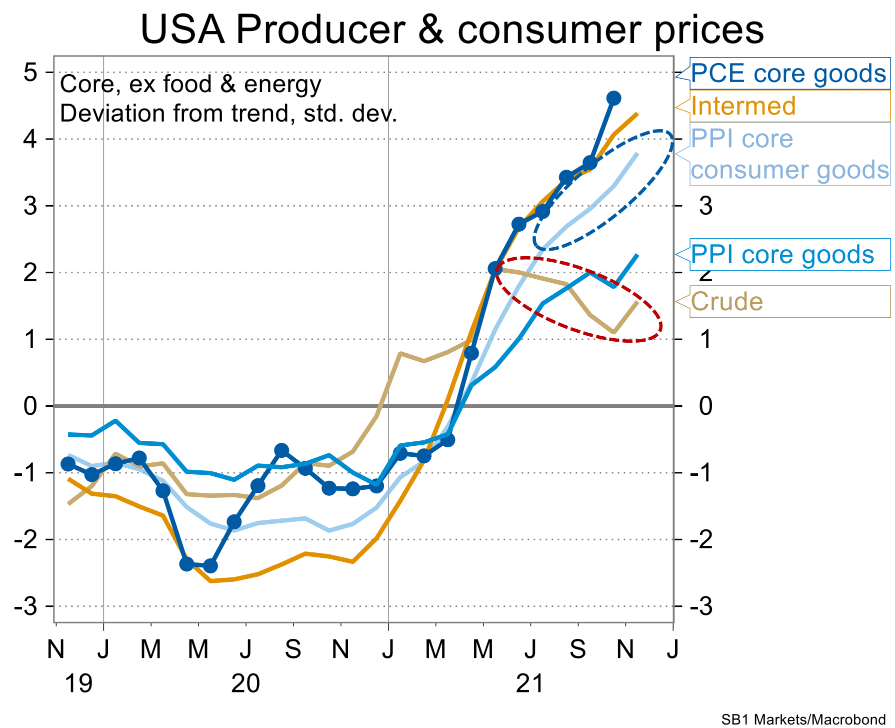
- **The headline finished goods PPI** rose 1.2% m/m in Nov, as energy prices contributed on the upside again. The annual rate was up 1 pp to 15.1% - the highest since 1982. In fact, annual inflation has been higher just once, in Sept-74 to Jan-75 during the oil price shock
- **Core finished goods x food & energy** PPI rose by 0.8%. The annual growth rate added 0.6 pp to 9.4%, also the highest level 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 0.8%, as expected. The index is up 9.7% y/y, signalling a CPI growth close to 7%. Just where we are now!

SpareBank 1 MARKETS

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

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

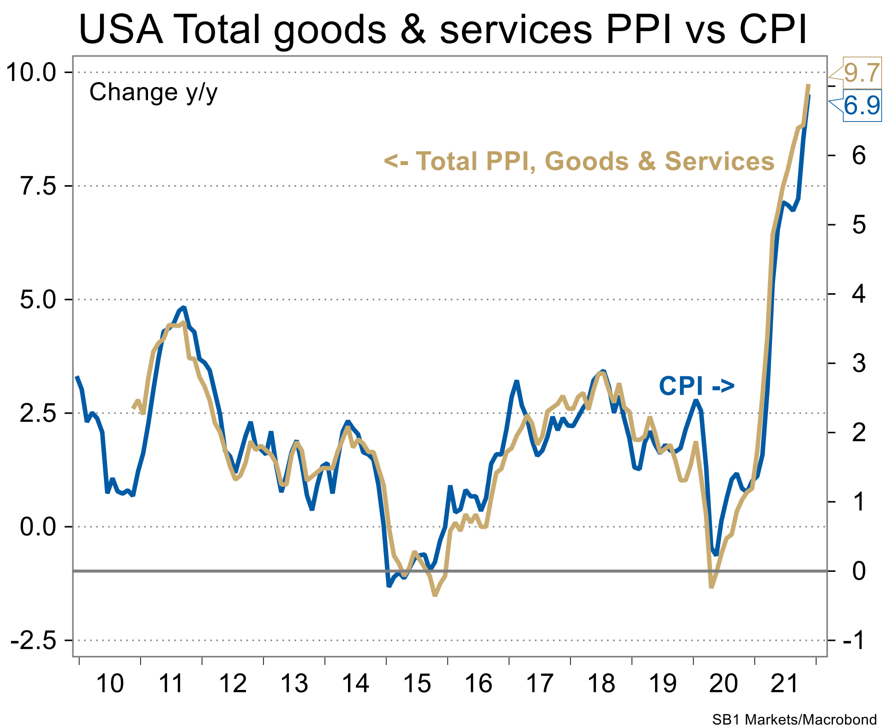


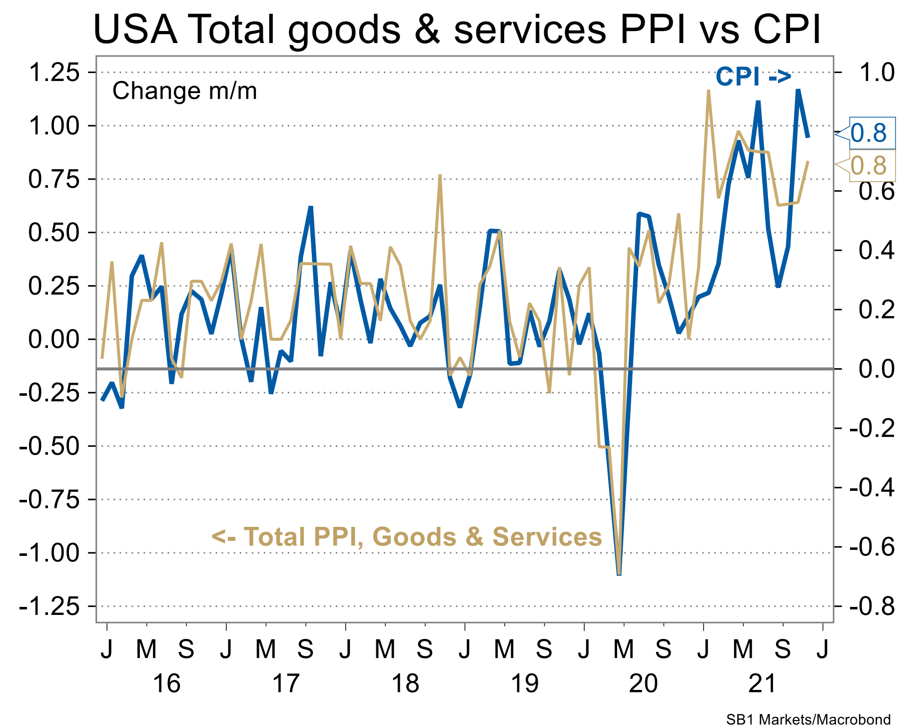


- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months – and crude prices have clearly peaked (see the red ellipse on the chart to the right). However, **intermediate prices** have not yet yielded by much – and they will push finished goods prices up the coming months
- Some more comfort: **Prices at the consumer level** (blue ellipse on the chart to the right) 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) confirms 7% CPI growth

The ‘new’ total PPI rose 0.6% m/m in Oct, 9.7% y/y

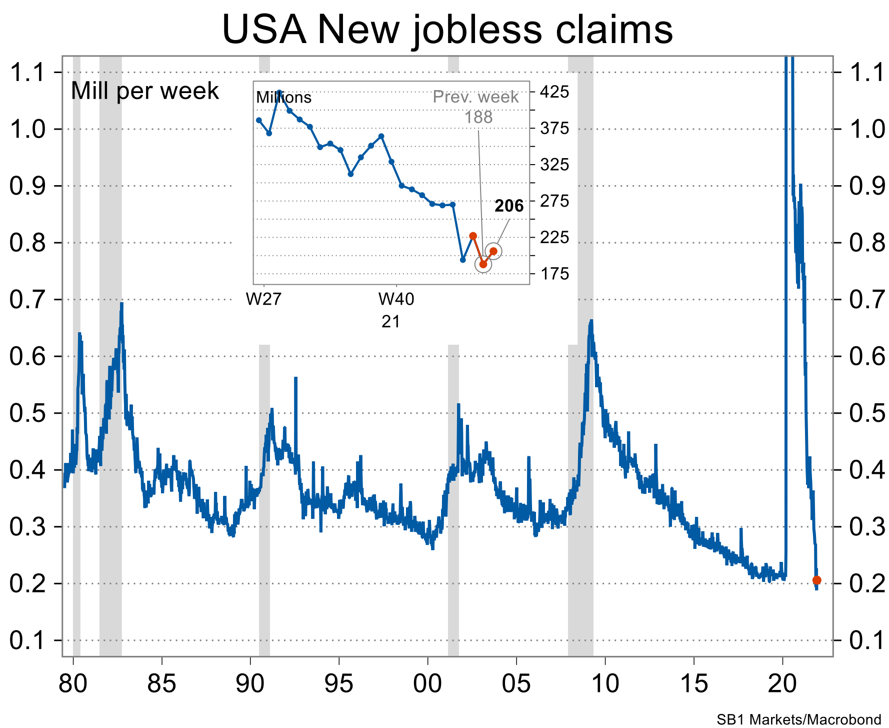


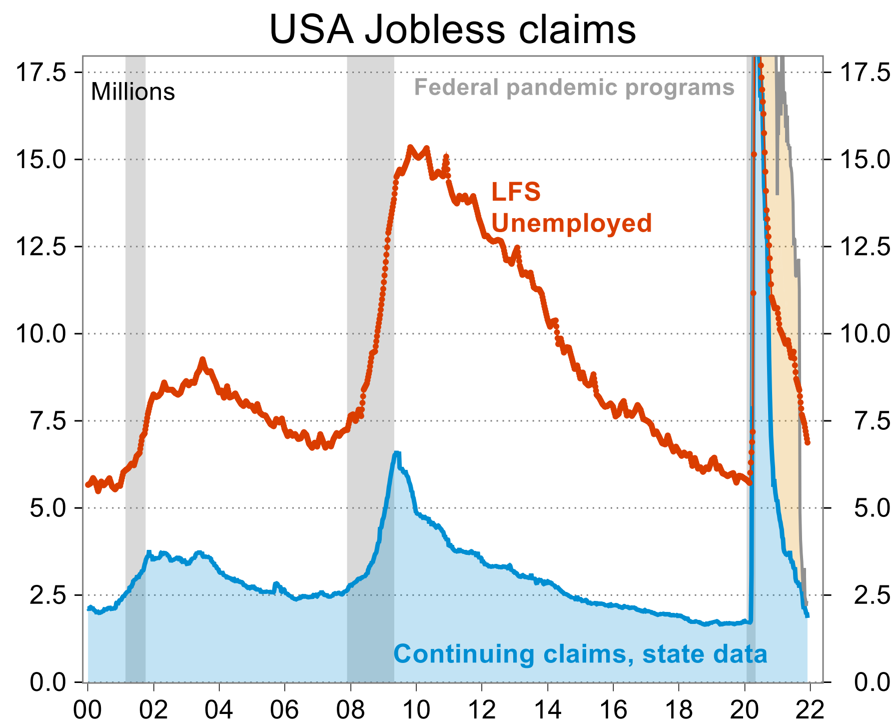


- The correlation between the ‘new’ total PPI, which includes all sort of services in addition to goods vs the CPI is pretty close. The current close to 10% annual growth rate in the PPI signals some 7% y/y growth rate in the CPI index. Which seems to be a precise estimate
  - » Regrettable, the PPI does not lead the CPI

New jobless claims remain close to ATL

No of continued jobless claims is rapidly declining too

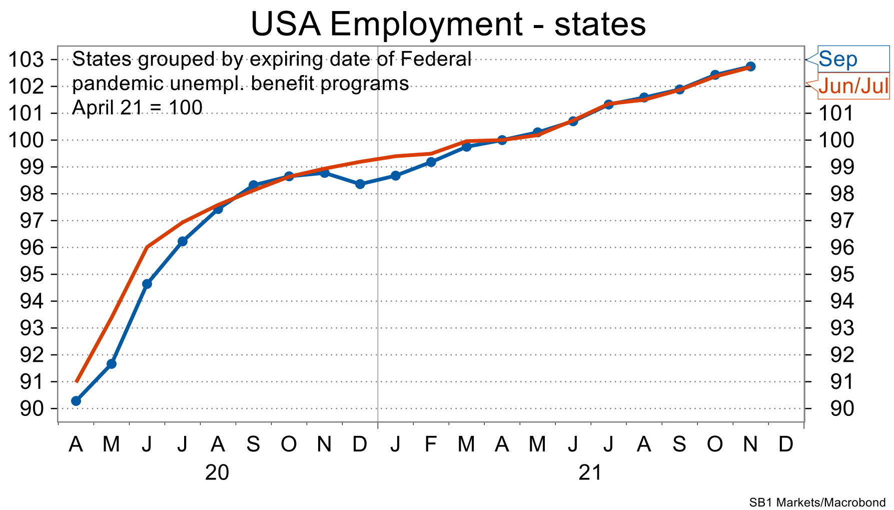


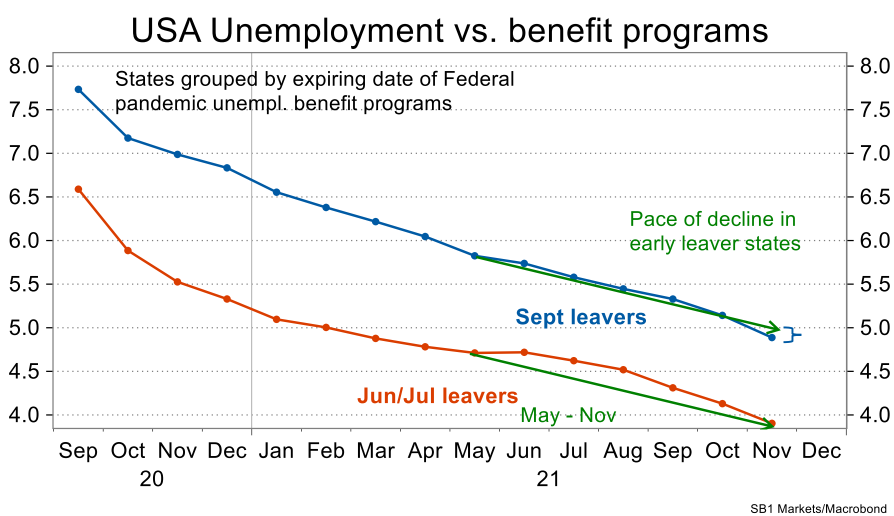


- **New jobless claims** rose by 18' to 206' in week 49, from time low the previous week, 6' more than expected
- **Ordinary continuing claims** declined 170' to 1.84 mill in week 48, just 130' above the pre-pandemic level! So next week??
- This report surely confirms an **extremely tight labour market**

No extra employment growth in states that left unempl. benefit programs early

Unemployment has fallen just marginally slower – thus <u>no surge in the participation rate either</u>

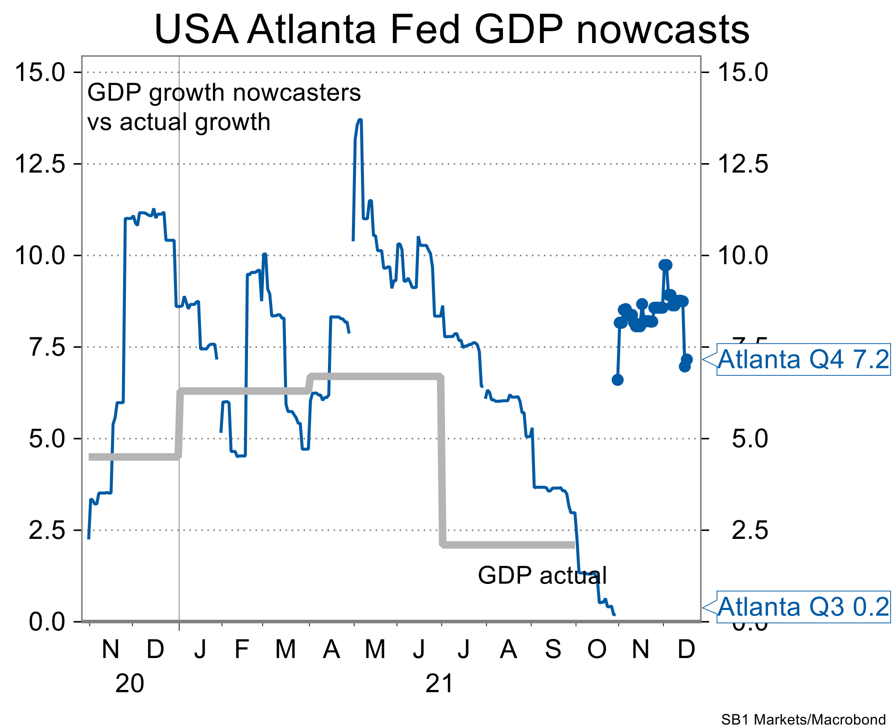


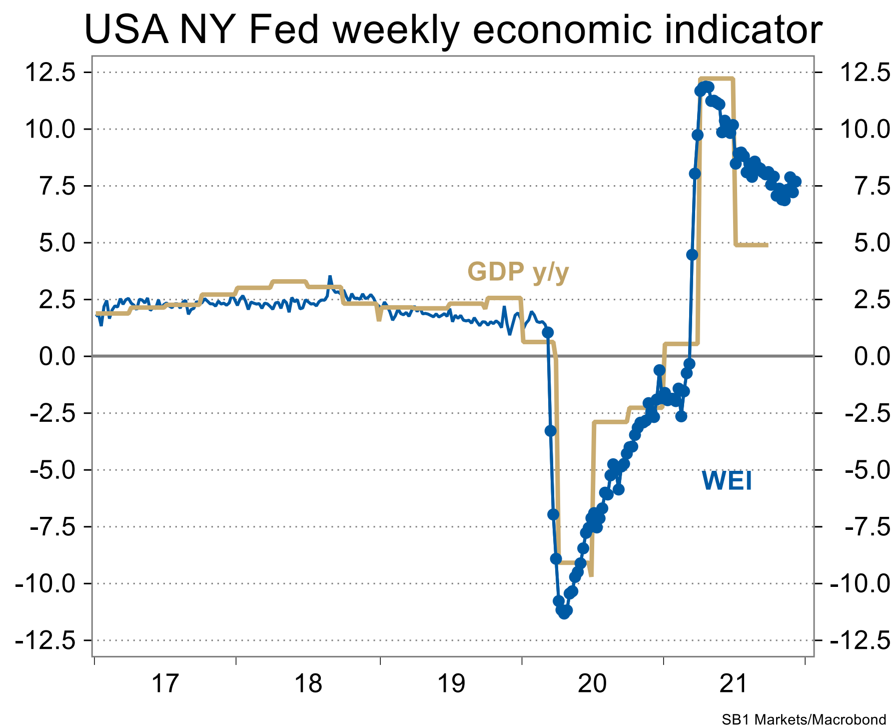


- Half of the states left the two temporary federal unemployment benefit programs in June and early July, that is before the programs were terminated everywhere in early September. There has been <u>no difference in **employment** growth in the two groups of states through November</u>
- State **participation rates** are not published but the unemployment rate has fallen <u>marginally slower</u> (0.1 pp) in the early-leaver states vs. the remaining states, signalling <u>just a marginal increase in the participation rate</u>, and not a tsunami of workers into the labour market to fill all the vacant positions
- A wonder may still happen – a surge in labour supply as workers recognise that they have to earn money or the virus one day is brought under full control so that nobody stay at home due to covid related problems

Atlanta Fed's nowcaster suggests 7% growth in Q4, down from 8+

Retail sales surprised at the downside





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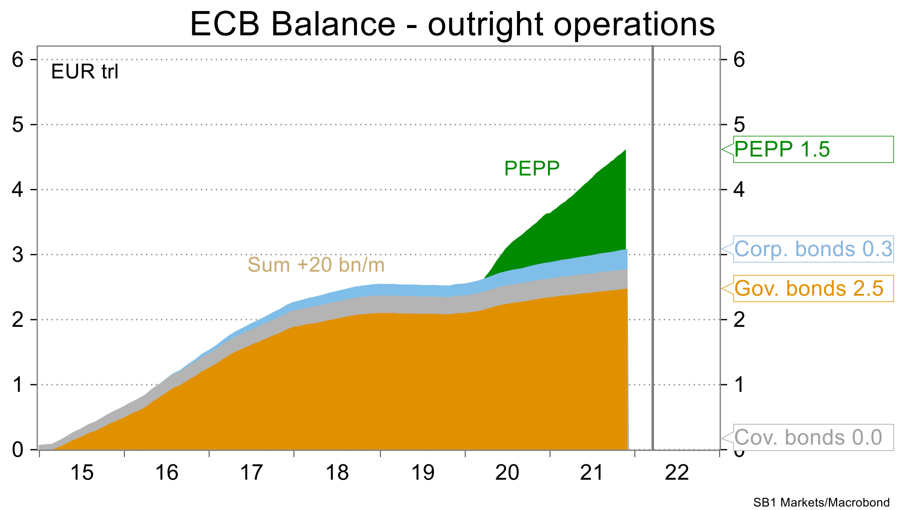
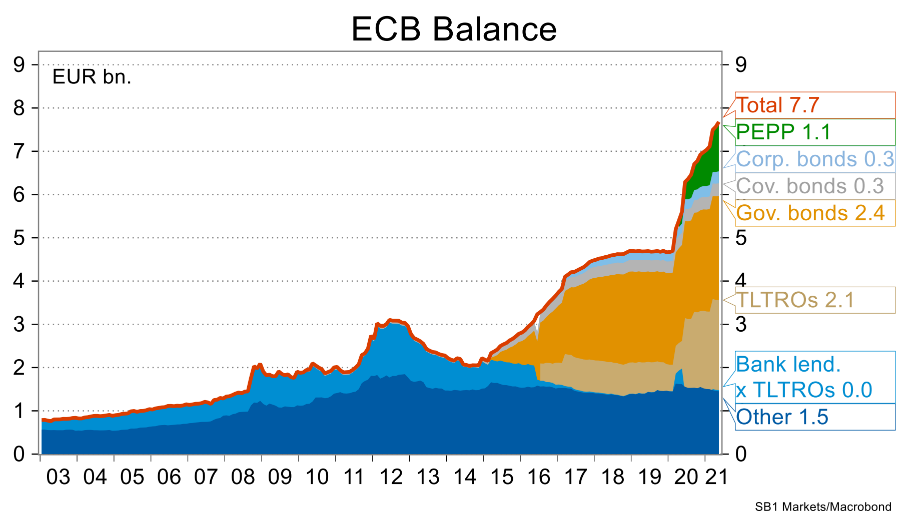
ECB: Will reduced the QE program from March, no hike in sight



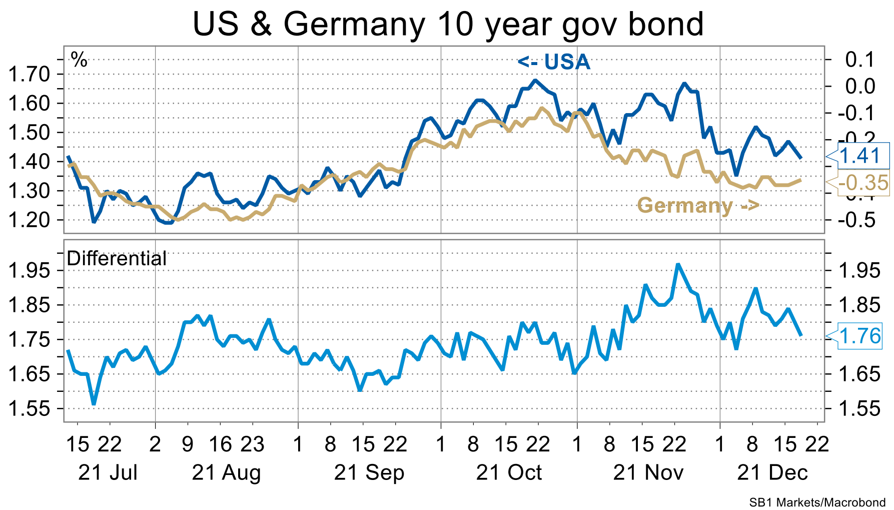


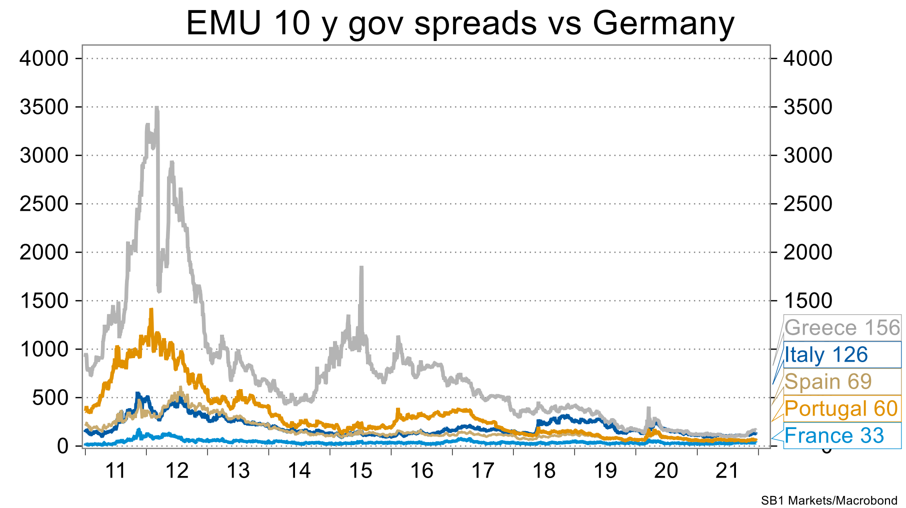
- **Inflation** has moved upwards on the agenda, but ECB is not as worried as the Federal Reserve, for good reasons. Underlying wage and price pressures are not comparable (and has not been for a decade)
- **The policy signal rate** remained at -0.5%, and Lagarde says the bank intent to keep it there for at least until 2023
- On the **QE programs – a 'rapid' (partial though) tapering**
  - » The Pandemic Emergency program (PEPP) will run until next March, then no more buying
  - » The 'ordinary' Asset Purchasing Program QE program will continue at approx. EUR 20 bn (government, corporate, covered bonds) will be expanded by 20 bn/month in Q2, and 10 bn/month in Q3 – and then back to the 'ordinary' EUR 20 bn in Q4
  - » The policy tightening was signalled at the previous board meeting (but not the actual figures)

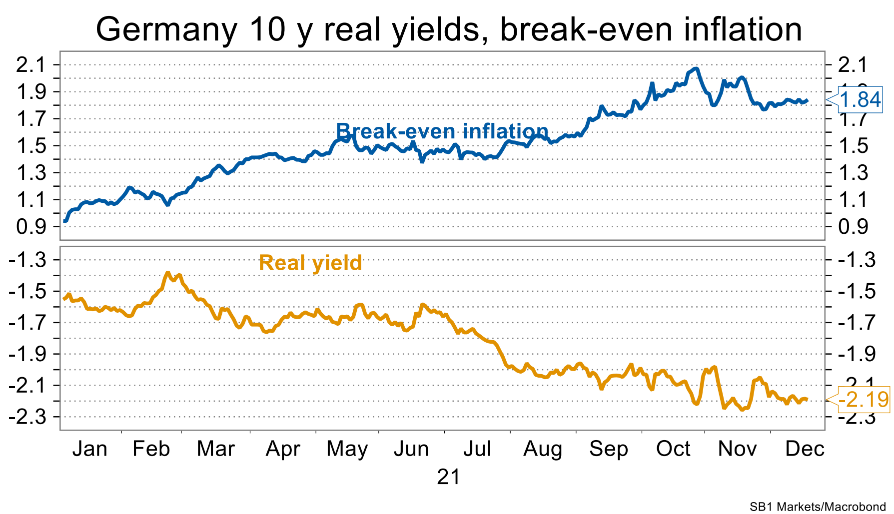
- **ECB vs markets**
  - » Markets are questioning ECBs stance on rates, and the market is now discounting a first rate hike in late 2022

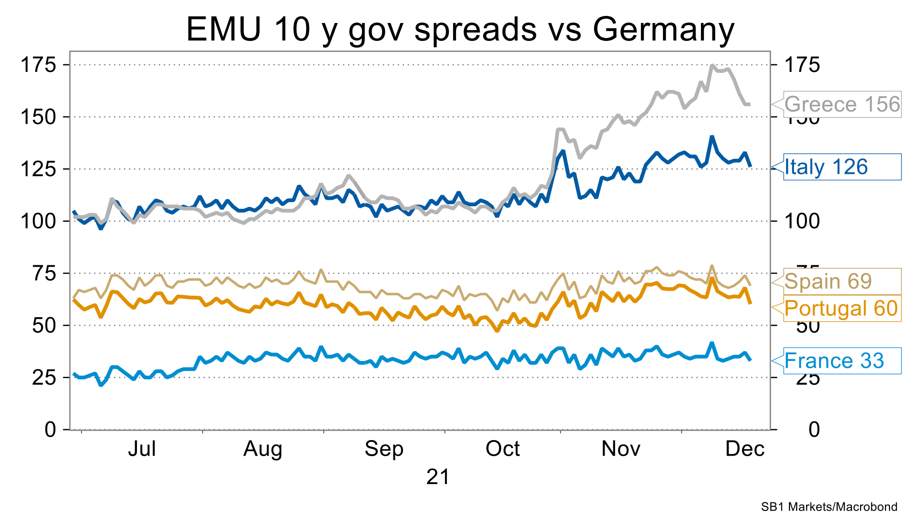
Quite at bond markets, EMU spread narrowed slightly

The market was well prepared for the tapering steps the ECB announced









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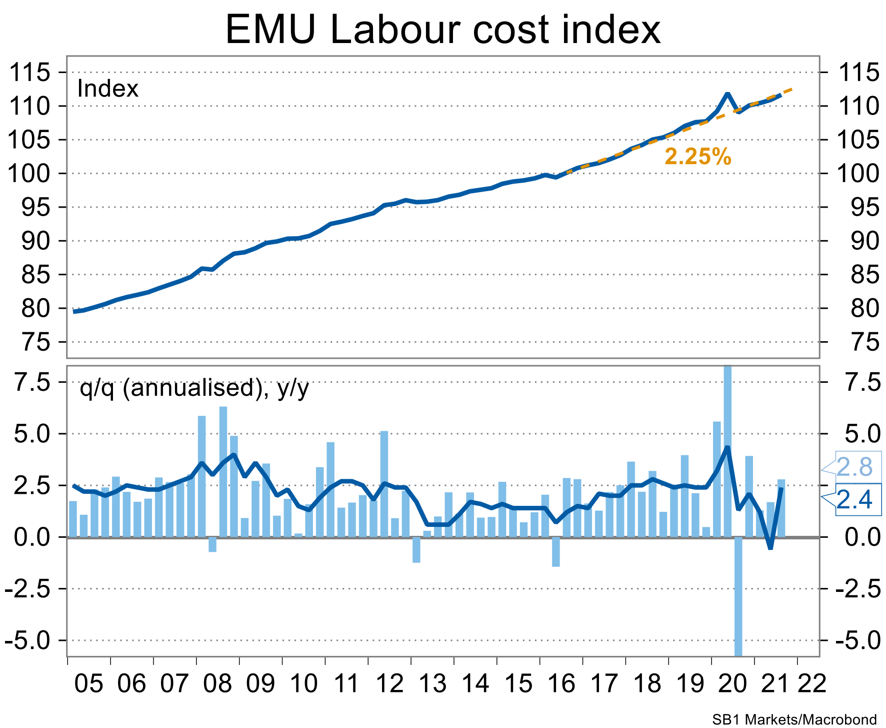
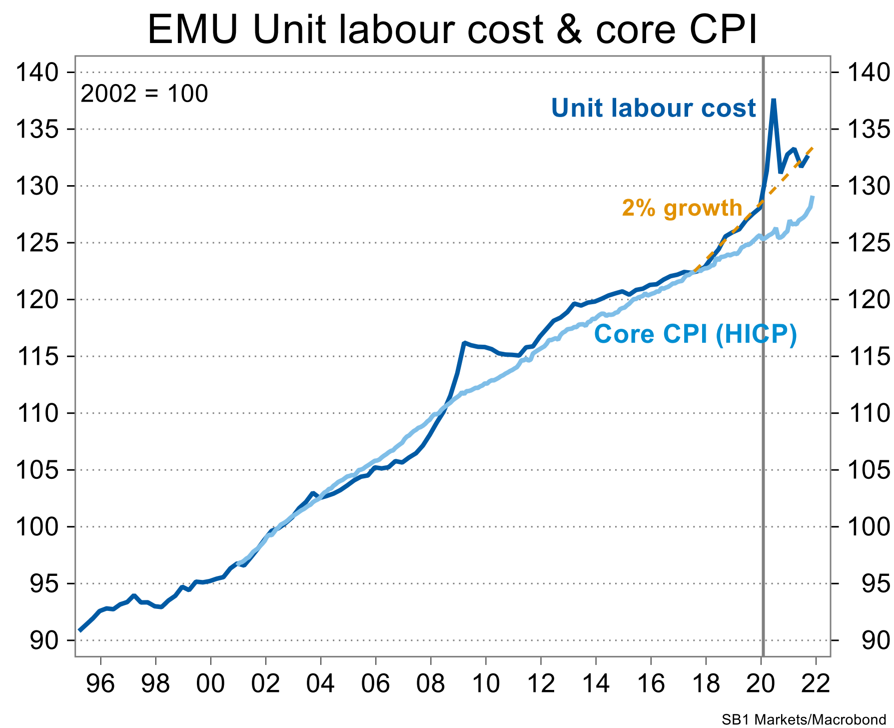
Labour cost back on track. Unit labour cost inflation has accelerated, to 2%

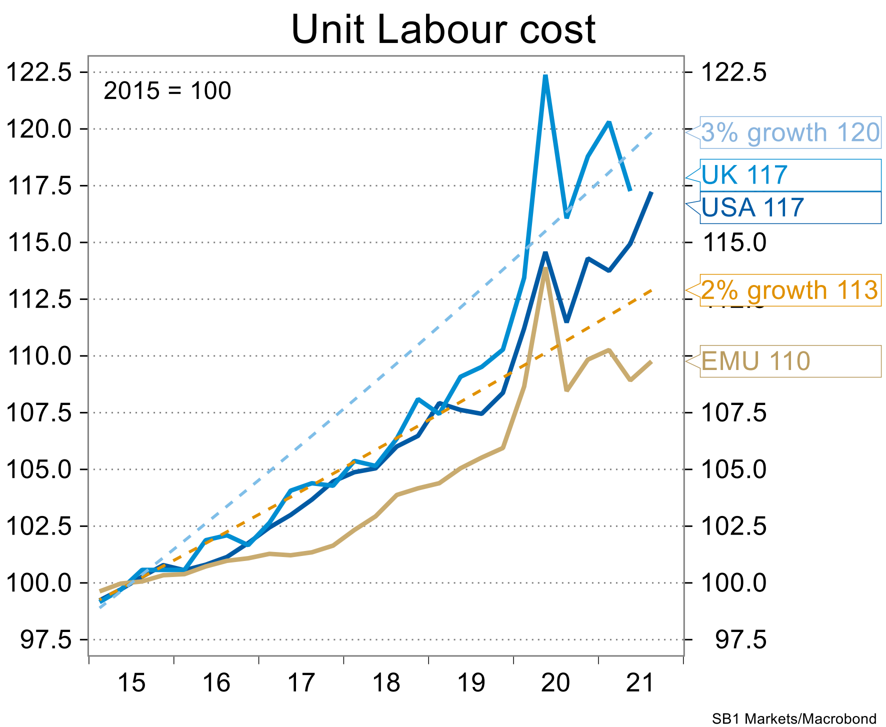
Labour cost rose 2.8% q/q (annualised) in Q3 – and is up 2.4% y/y. Trend growth still just at 2.25%



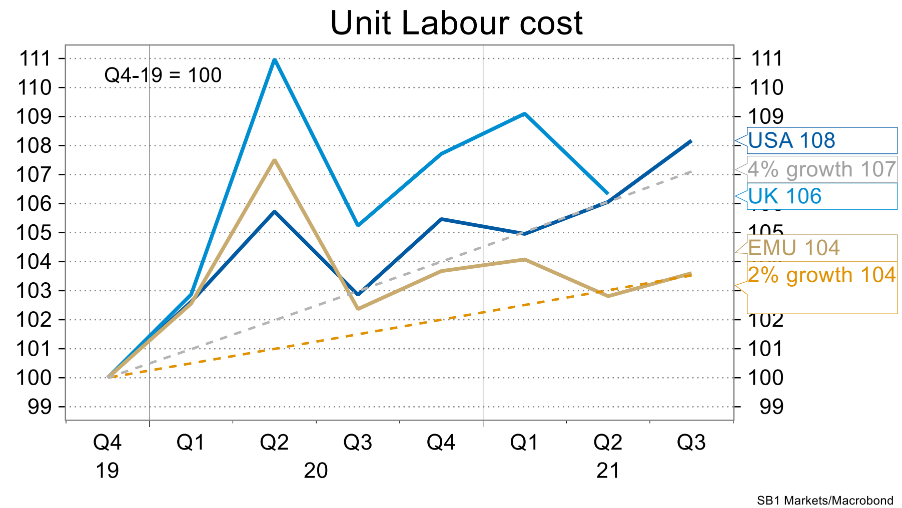


- Measured over the 3 -4 years, **hourly labour costs** are up 2% per year on average, which normally too little to generate inflation at 2% over time
- **Unit labour cost** (labour cost per unit produced = wage cost/production volume, growth in UCL= wage growth – productivity growth) has jumped up during the pandemic as productivity because employment was not cut as in the US but wage case not. However, as employment normalises, the ULC is normalising too – it has fallen sharply from the peak in Q2 last year
  - » However, in the 3 years before the pandemic – and through the pandemic so far – ULC has accelerated to 2% from 1%. The 1% growth in unit cost corresponded to the long term growth in core rate of inflation – and a 2% ULC inflation will over time yield a 2% CPI inflation
  - » In addition: Costs have been running faster than price inflation since 2017, keeping a lid on corporate profits. If demand is strong, businesses could (and should) restore profits by hiking prices to 'close' the gap vs ULC – helping the ECB to reach its inflation target

Volatile Unit Labour Cost data; US, perhaps UK have a problem, EMU not



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



- US labour costs were revised upwards two weeks ago

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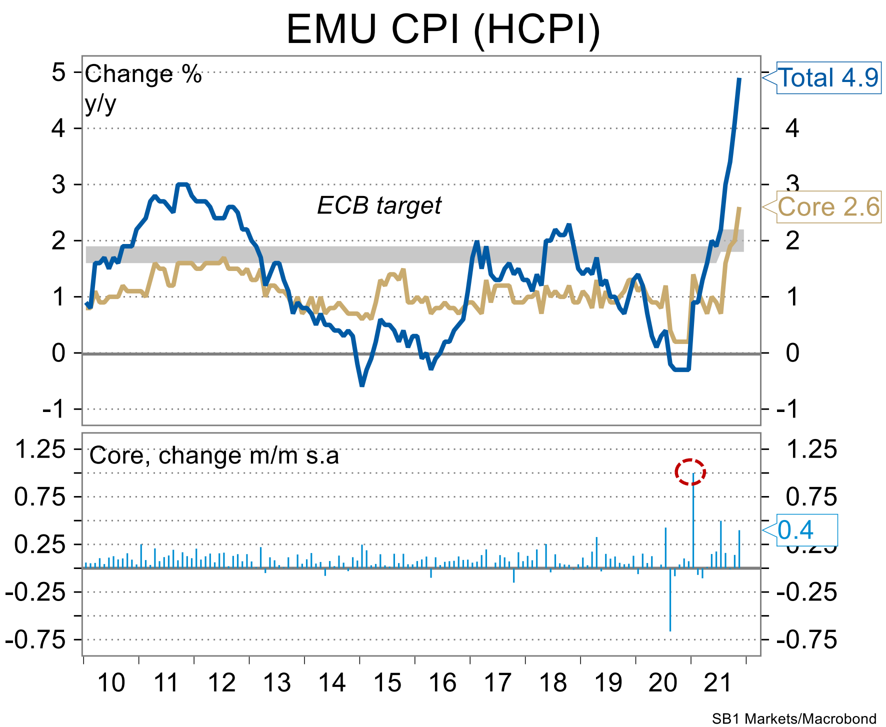
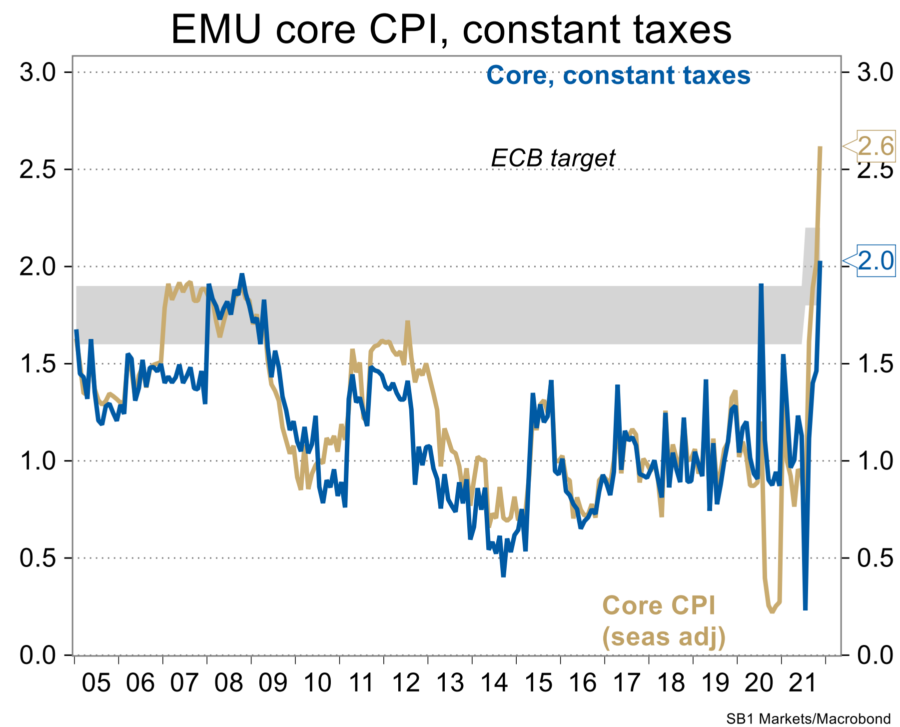
Eurozone inflation confirmed up 0.3 pp 4.9% in Nov – as energy prices soared

Core inflation up 0.6 pp to 2.6, partly due to vase effect, partly due to a 0.4% m/m Nov lift

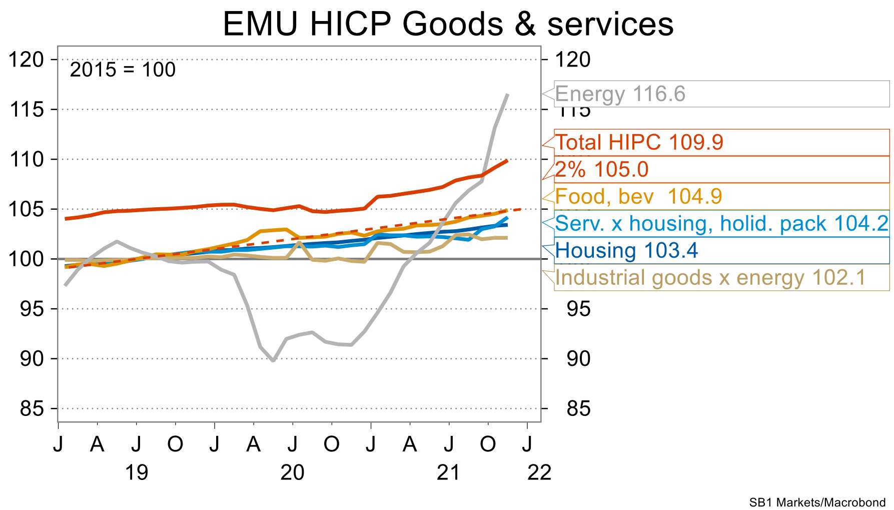


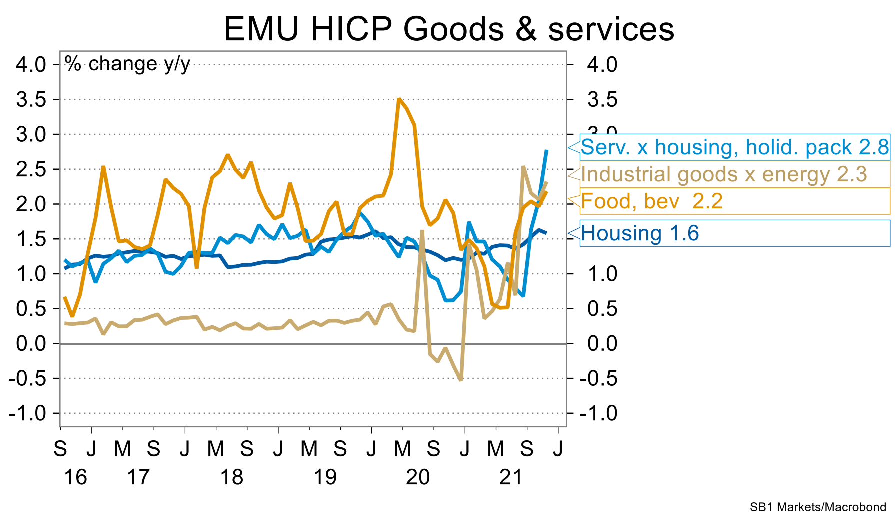


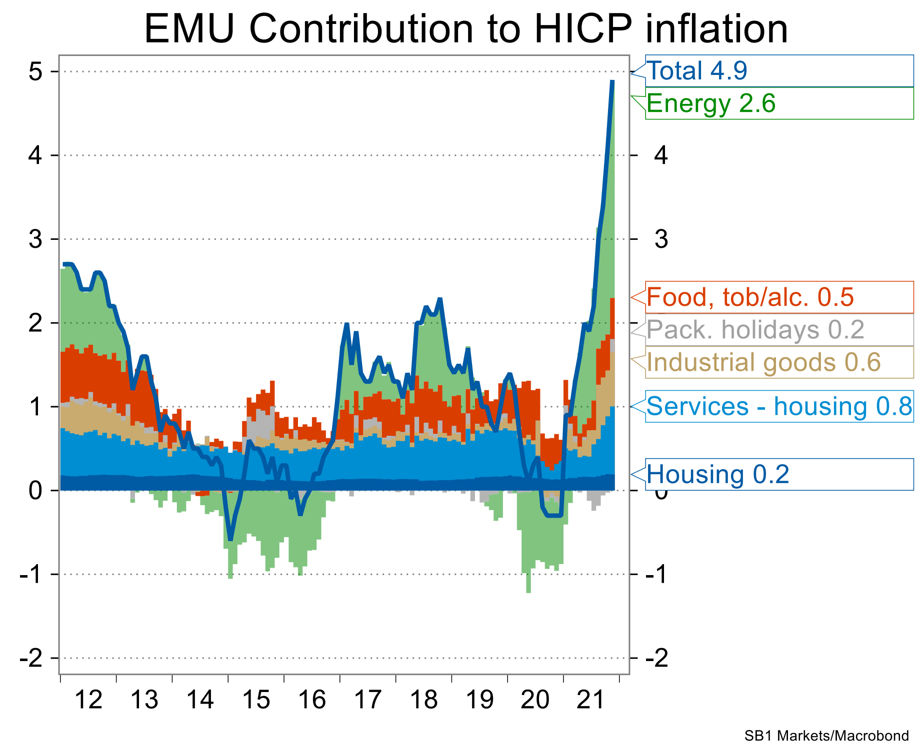
- **The headline HICP** rose 0.7% m/m, as energy prices rose sharply – and they are now up 27% y/y (but still 'just' up 16% above the avg 2019 level)
  - » The annual rate at 4.9% is far above ECB's inflation target – but prices are just up 2.3% over the past 2 years (in average). Last Nov the headline CPI was down 0.3% y/y
- **Core prices** rose 0.4% m/m, and the annual rate rose to 2.6%. Again, one year ago, annual inflation was just 0.2%, and the average over the past 24 months is just 1.4%
  - » The core CPI rate will decline substantially in Jan-22, as prices rose 1% m/m in Jan-21 (left chart, red circle)
  - » Food and beverage prices rose 0.4% m/m, while services added 0.8%, mostly due to the volatile package holidays & accommodation component
- **Adjusted for changes in taxes**, the core was at 2.0% y/y in Nov, according to Eurostat, up from 1.5% in Oct. Over the past year this index has been very volatile, and we are far from sure this calculus is correct now

Energy remains main culprit, not that much to worry about elsewhere

Other prices are up more than 2% y/y but mostly from a low level last autumn



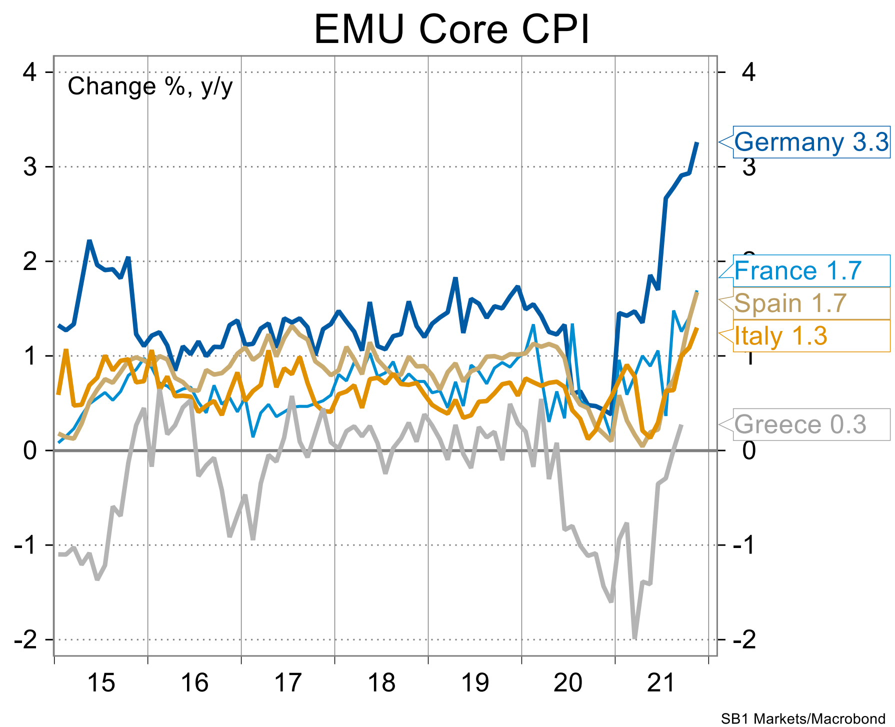


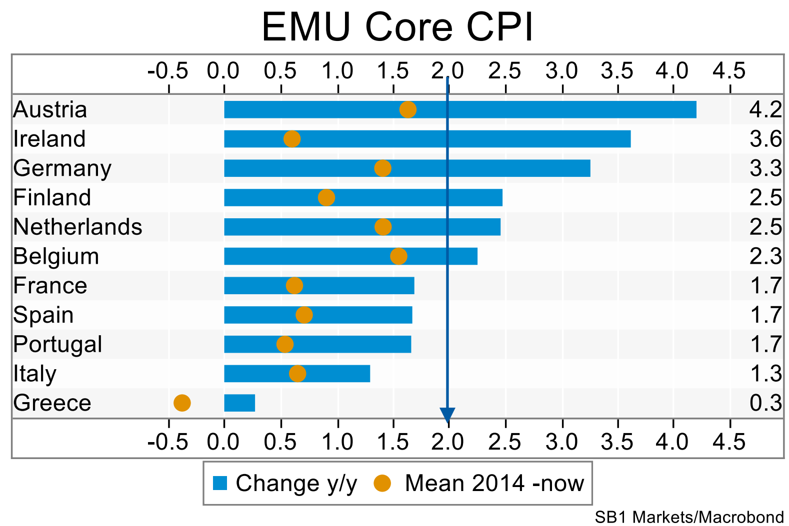


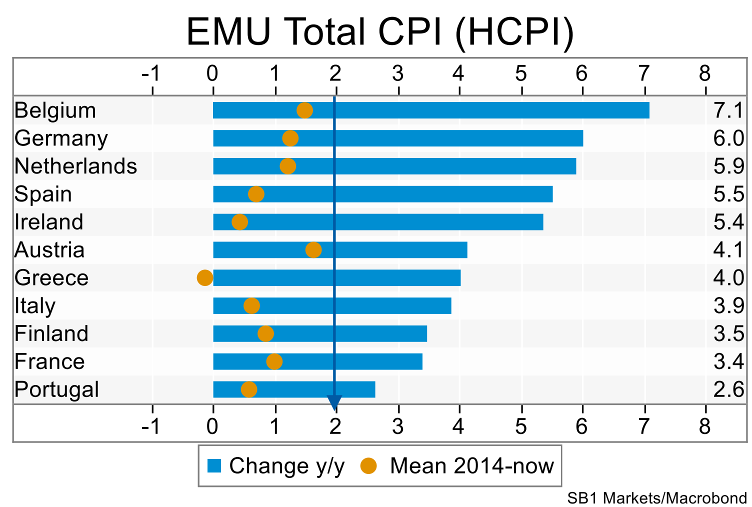
- Energy prices rose 3% m/m in Nov – and are up 27% y/y and Dec will be no better
- Some other prices are rising faster y/y too, but mostly due to dips in prices one year ago

Core inflation still below 2% in several countries -

In Germany, inflation sharply up to 4.6% (total) 2.9% (core)



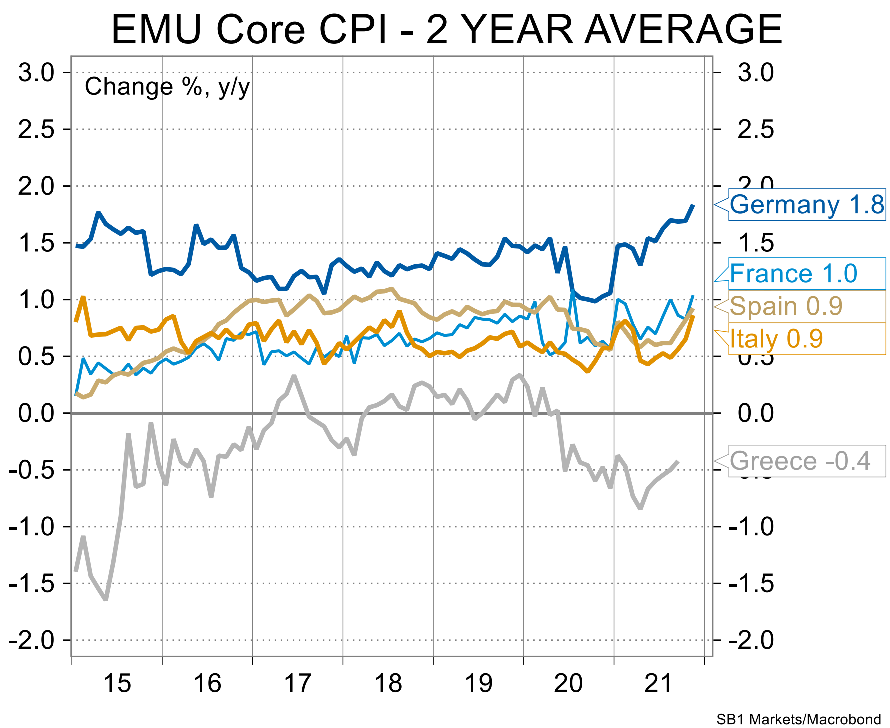


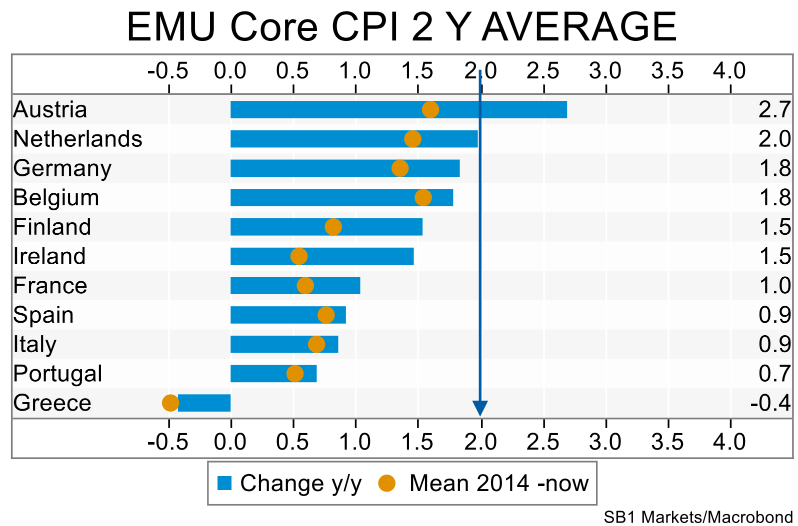


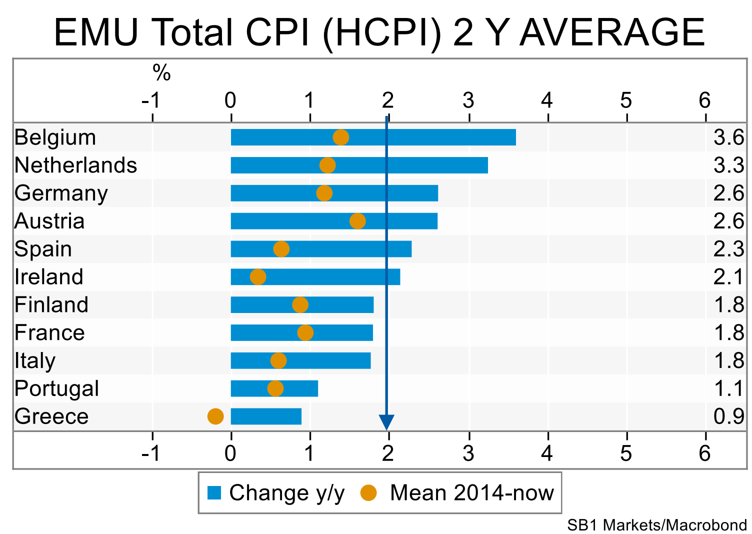
- The base effect is substantial: Check next page

Over the 2 PAST YEARS: A bit more nuanced picture!

Core inflation below 2% almost everywhere



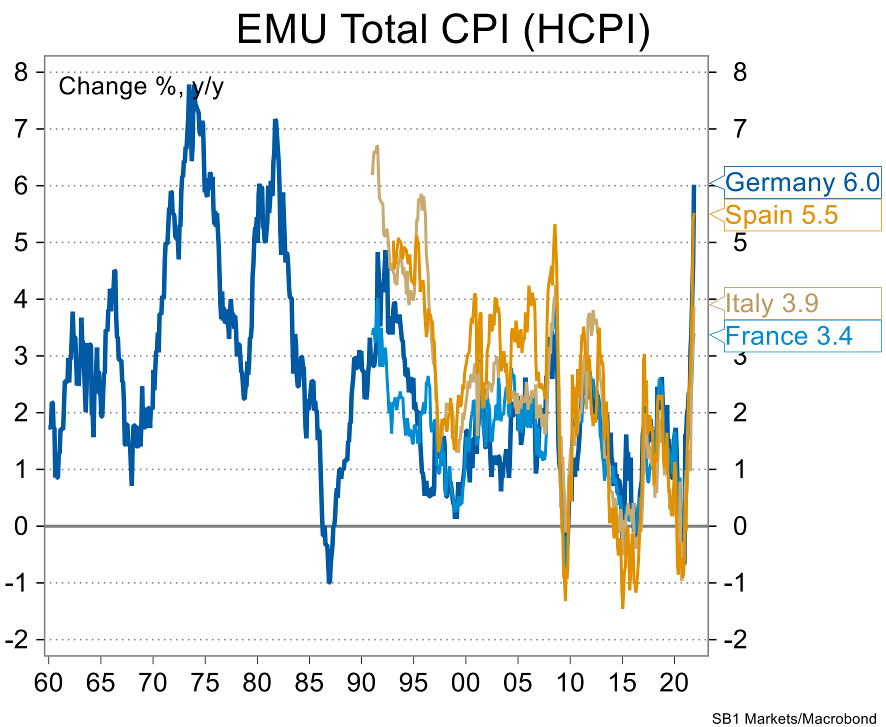


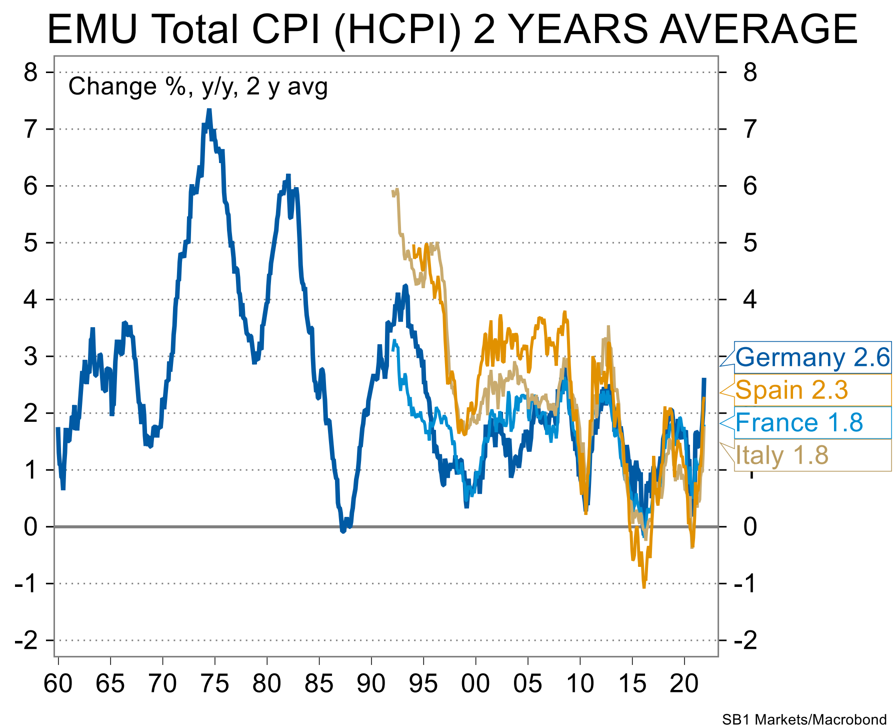


- The base effect is substantial. In Germany the average core inflation over the two past years is 1.8% - but total inflation is up 2.6% due to the lift in energy prices

German inflation is the highest since 1980 but not that dramatic over past 2 years

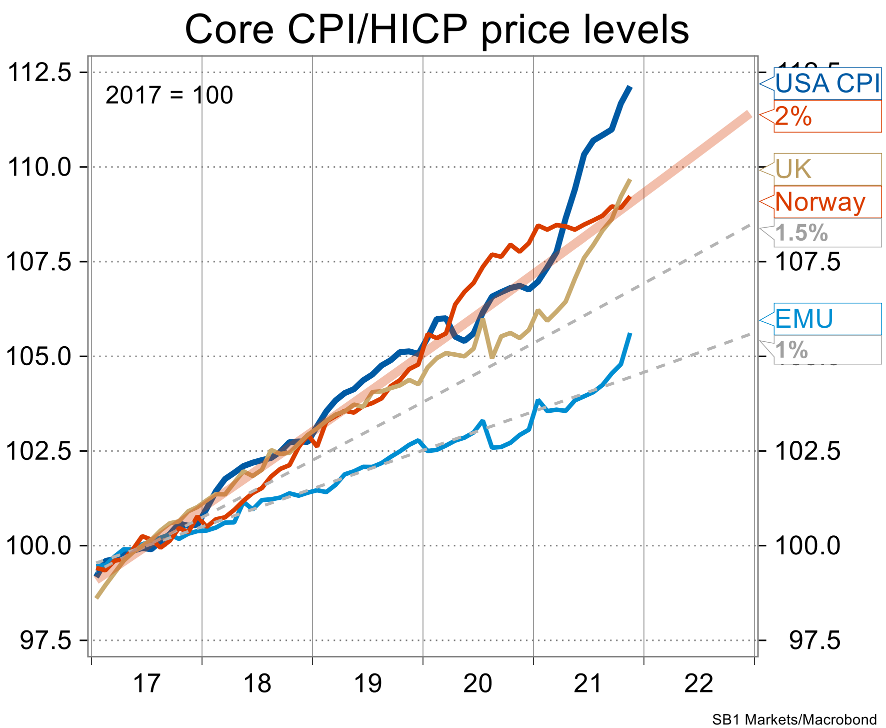
Still, the 6% inflation rate is making headlines in Germany





The EMU & the ECB do not have the same challenges as USA & the Fed

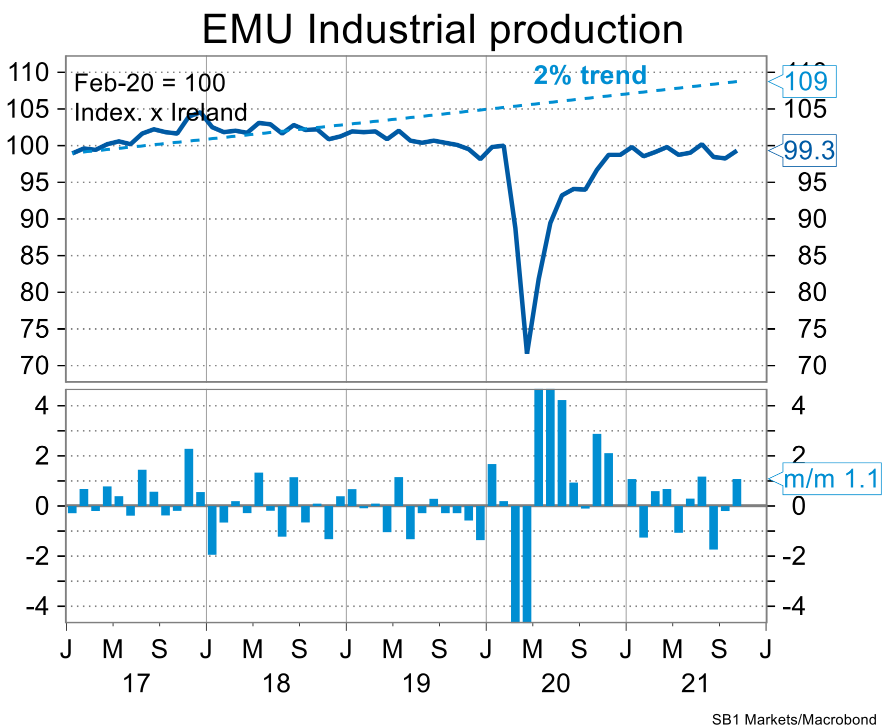
While UK may be positionend inbetween.

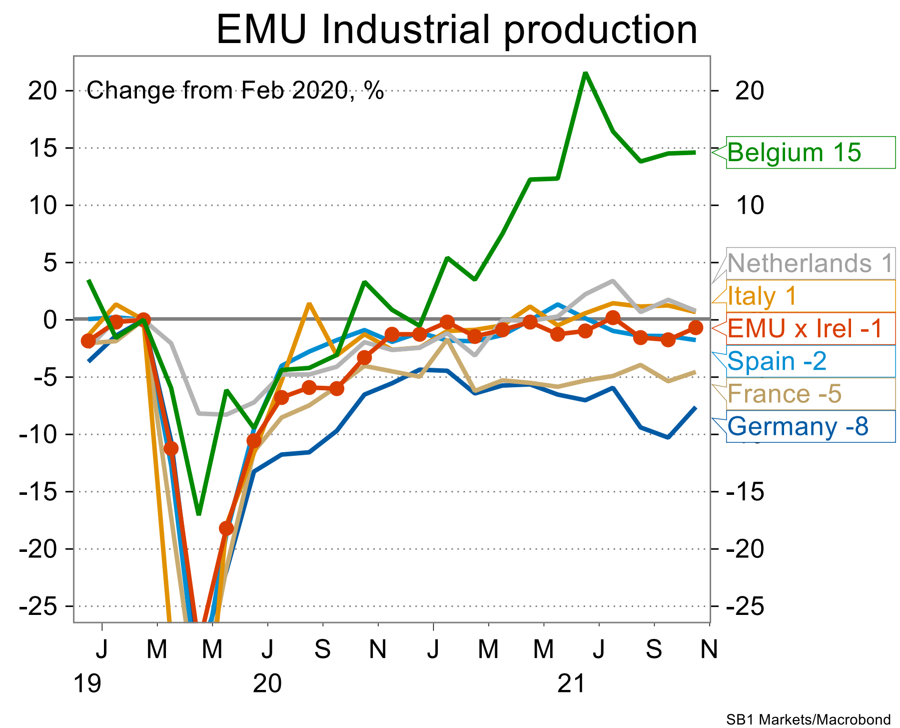


- Spot the huge difference between EMU and the others (here USD, UK & Norway)

Industrial production up 1.1% in Oct, level 0.7% below the Feb-20 level

Italy and Spain reported a slowdown but France an even more Germany contributed at the upside

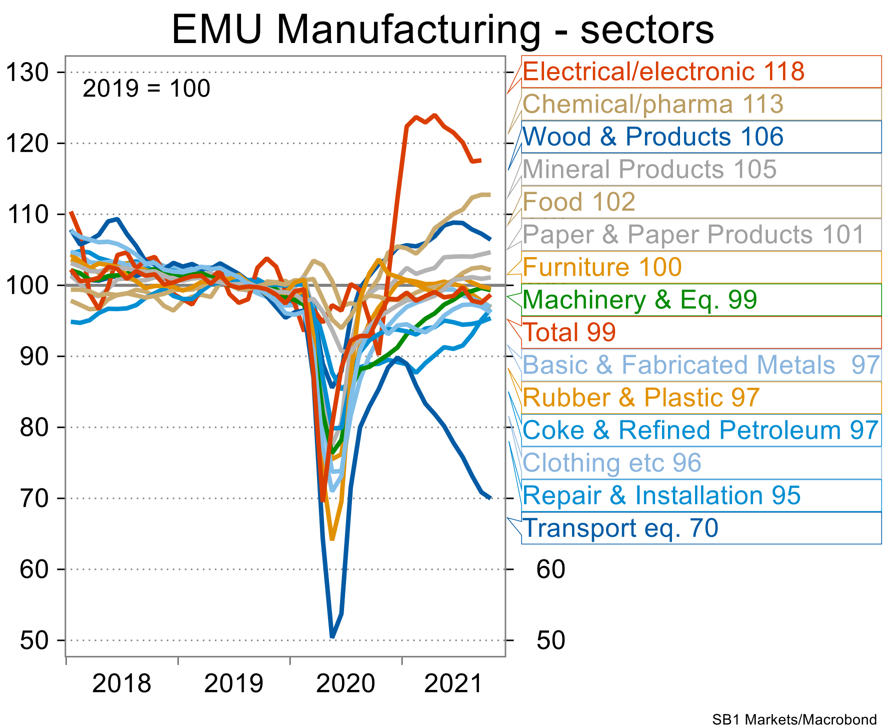


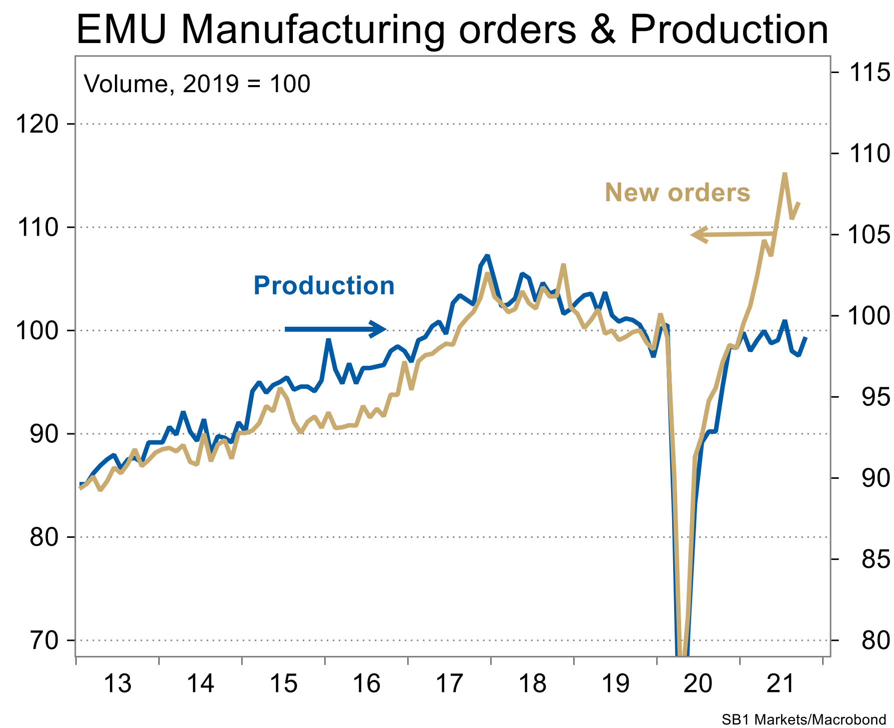


- In **Germany** production rose by 3%, and more than expected (1%) but the level remains low, down 8% vs. Feb-20
- **Production in the EMU** has trended flat so far in 2021, even if surveys have signaled more than decent growth. The sharp setback in auto production explains much of the overall 'weakness'

Transport/auto production the main drag at the downside

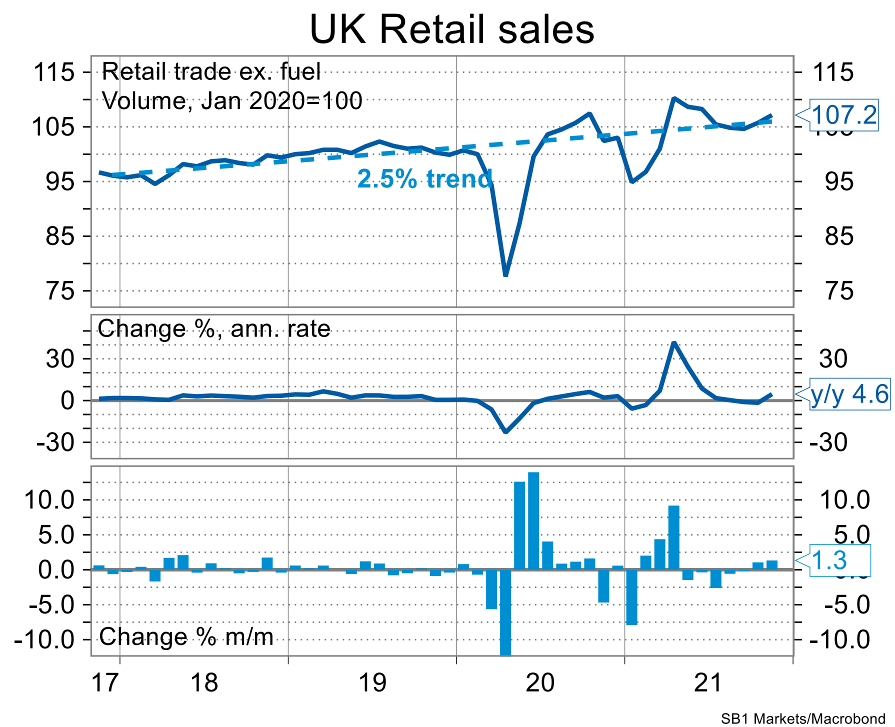
… order inflow signal potential for production growth

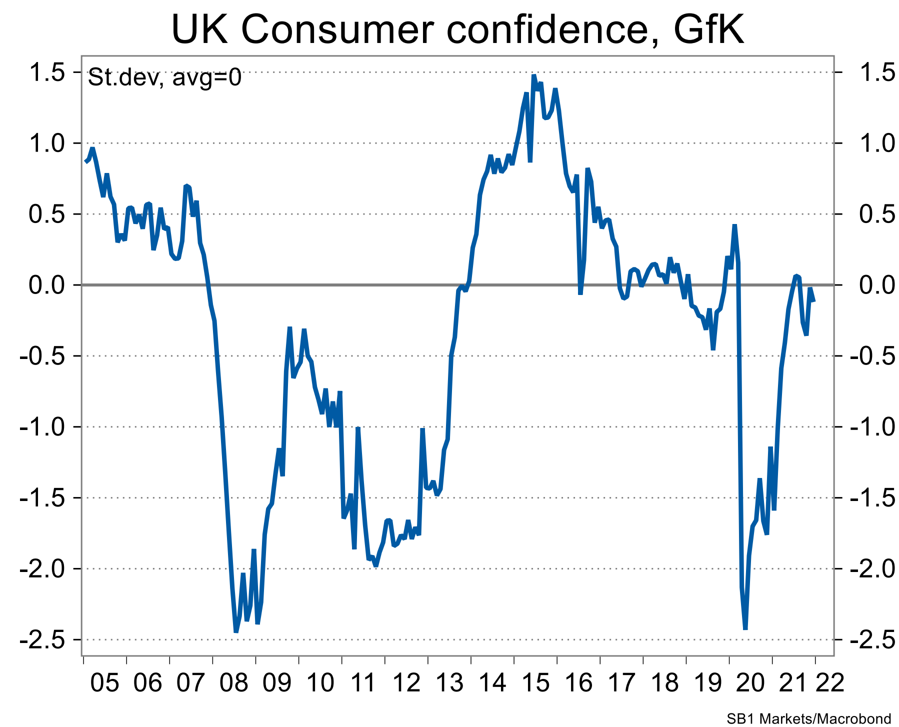




Retail sales at the 2.5% pre-pandemic trend, up 1.3% in November

Sales were expected up 0.5%

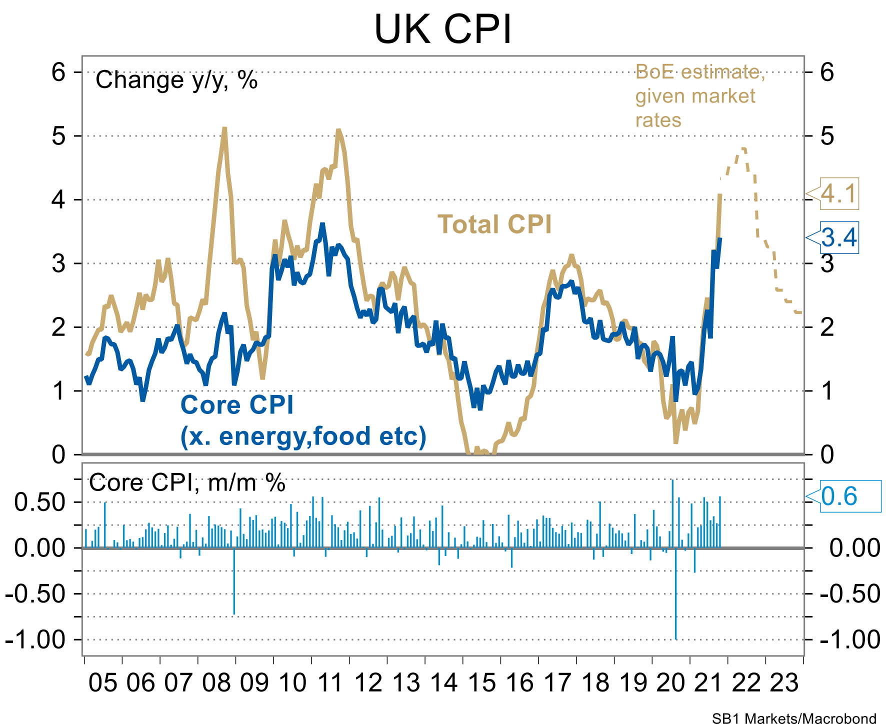




- **Retail sales** peaked in April, and the gradual decline has brought sales almost down to the pre-pandemic 2.5% growth path
  - » The outbreak of the Delta virus may explain some of the weakness over the past couple of months. Now, Omicron may create new challenges
- **Consumer confidence** has remained close to an average recent months – the last observation is early December. No collapse, as in US, and in Norway (check here)

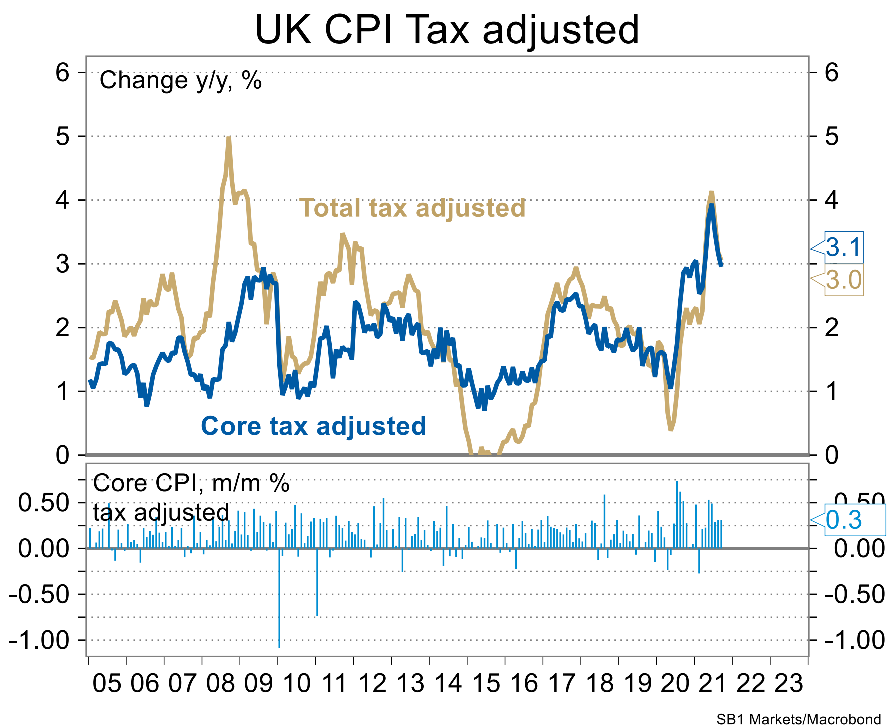
Inflation a tad down in September but monthly increase still too high

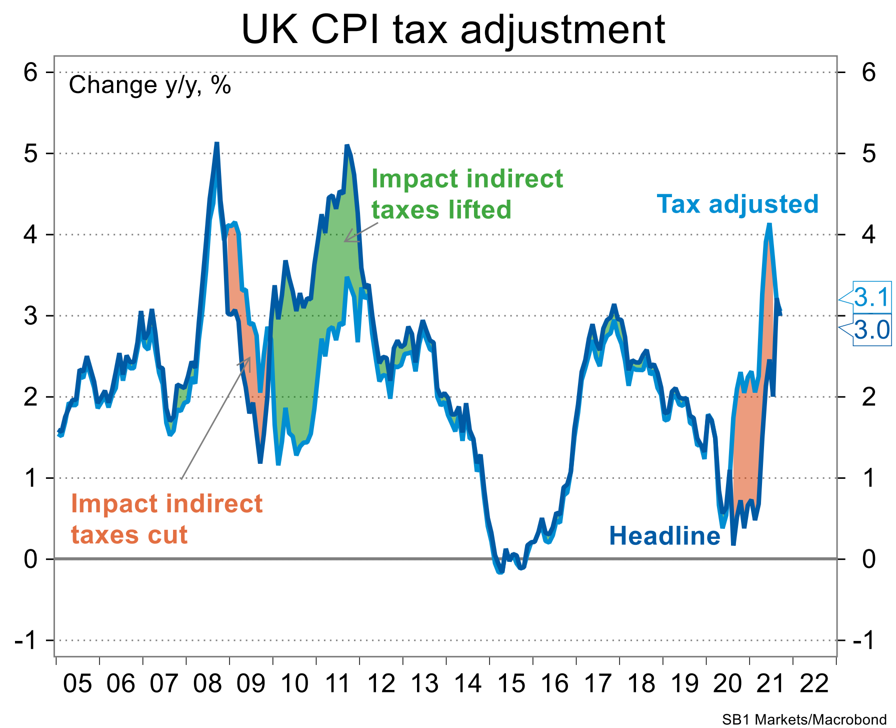
Total inflation down 0.2 pp to 3.0% & core down 0.1 to 2.9%; 0.1 – 0.2 pp below consensus



- Inflation is far above the 2% inflation target – following the steep rise in the annual rate when last year's subsidies fell out of the annual rate
- Transport has lifted CPI by 1.1 pp. 2nd hand cars are sharply up, as are fuel prices (both 18-19%)
- Residential energy prices are up just up 2.8% y/y, and the total energy bill is up just 10% - and prices are lower than in 2019
- However, other prices are on the way up – and Bank of England is worried and have clearly signalled than rates may soon be hiked

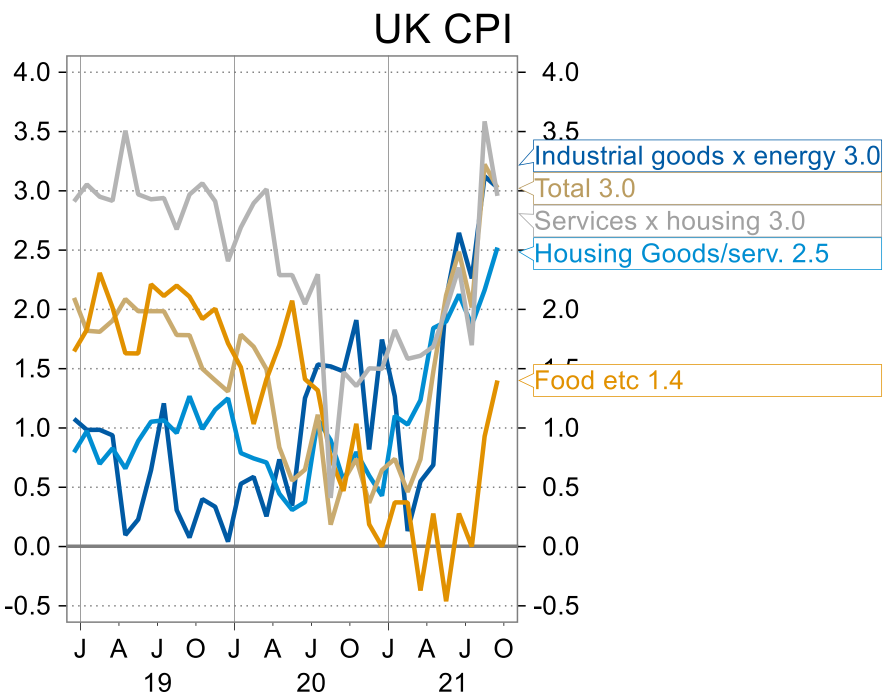
Tax cuts/subsidies out of the annual rate – and inflation is not low



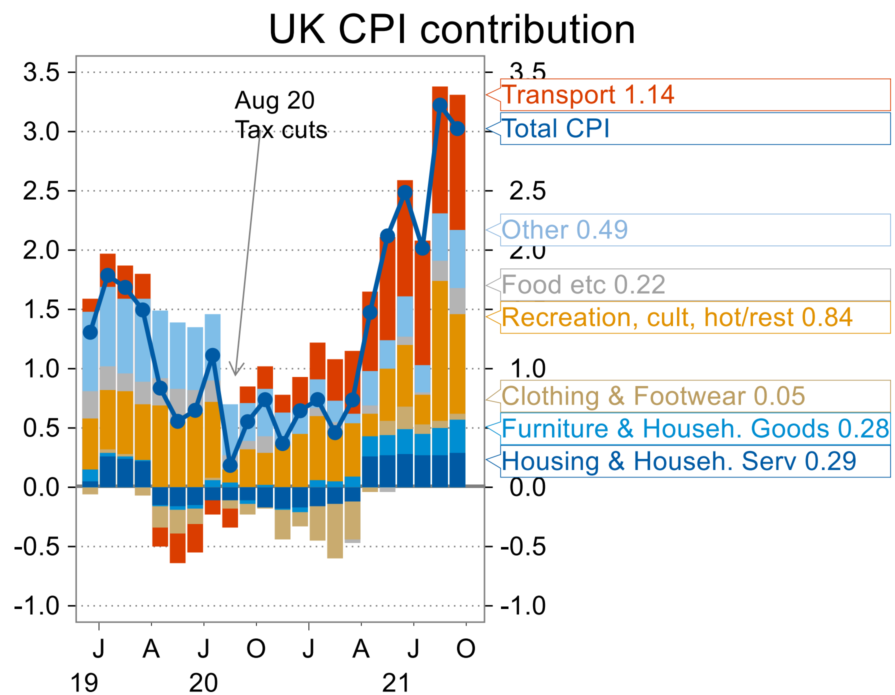


- The corona measures (Eat Out to Help Out Scheme and some other support programs implemented last August) equalled 1.6% of CPI. Prices fell less than that m/m (vs a normal price increases at that time, which though were very volatile m/m, most likely because restaurants etc. kept some of the subsidy themselves)

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



SB1 Markets/Macrobond



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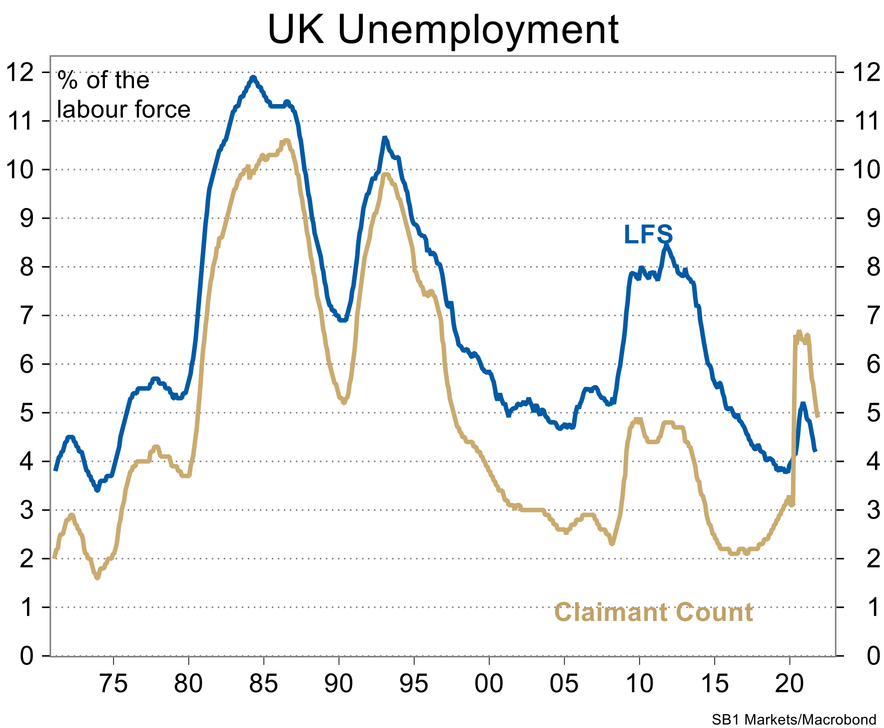
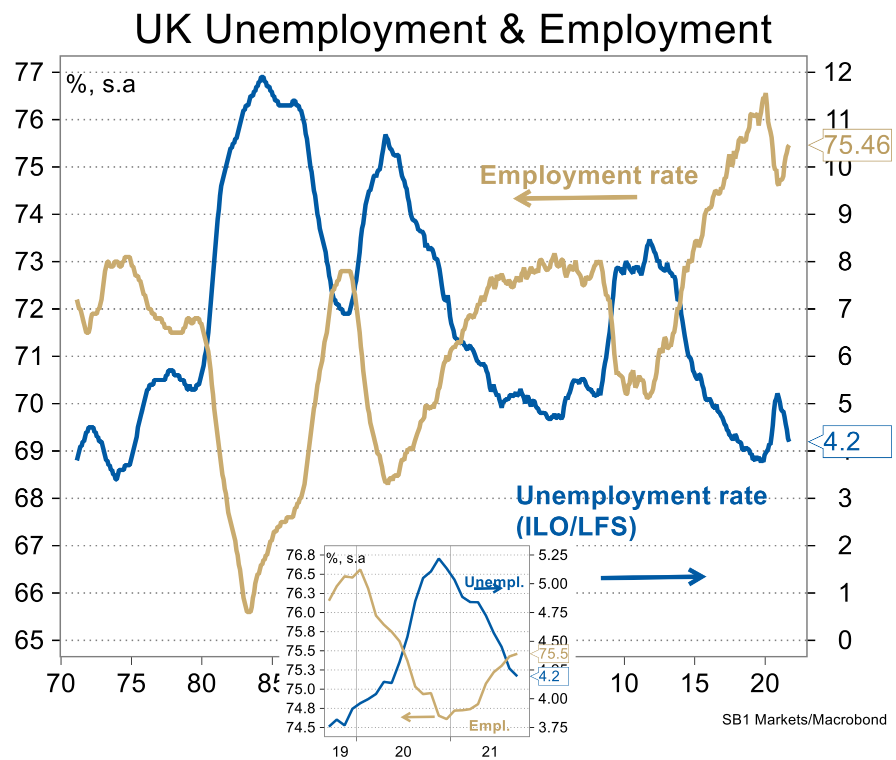
- **Energy prices** are up 10% y/y, rather modest vs. the lift in spot prices – and the energy bill in September was lower than during most of 2019. UK household must have entered long term contracts
  - » Residential energy is included in housing in the charts above

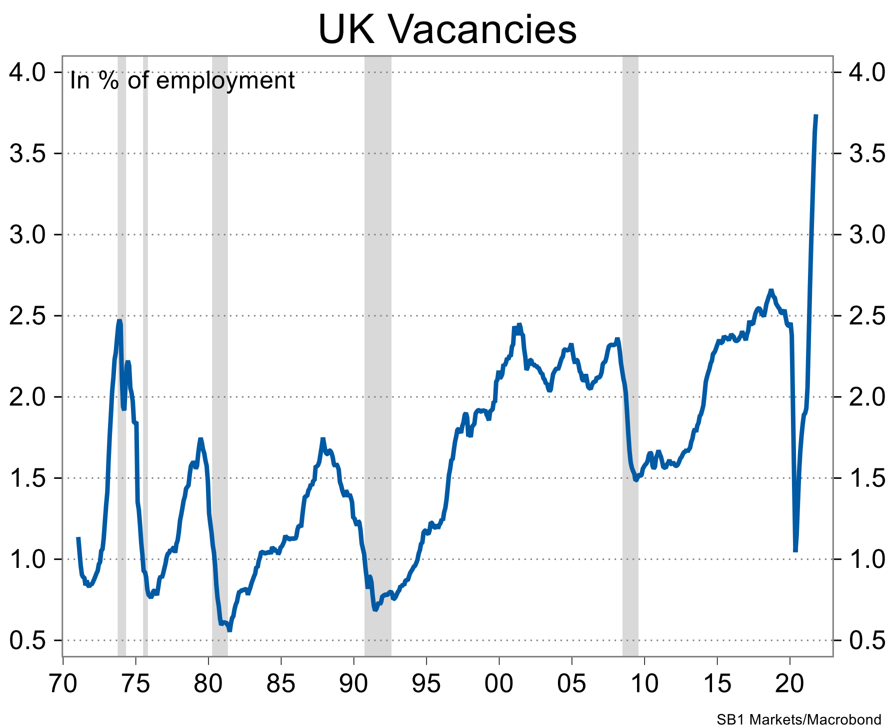
‘Open’ unemployment at 4.9%, sharply down since the spring but still ‘high’

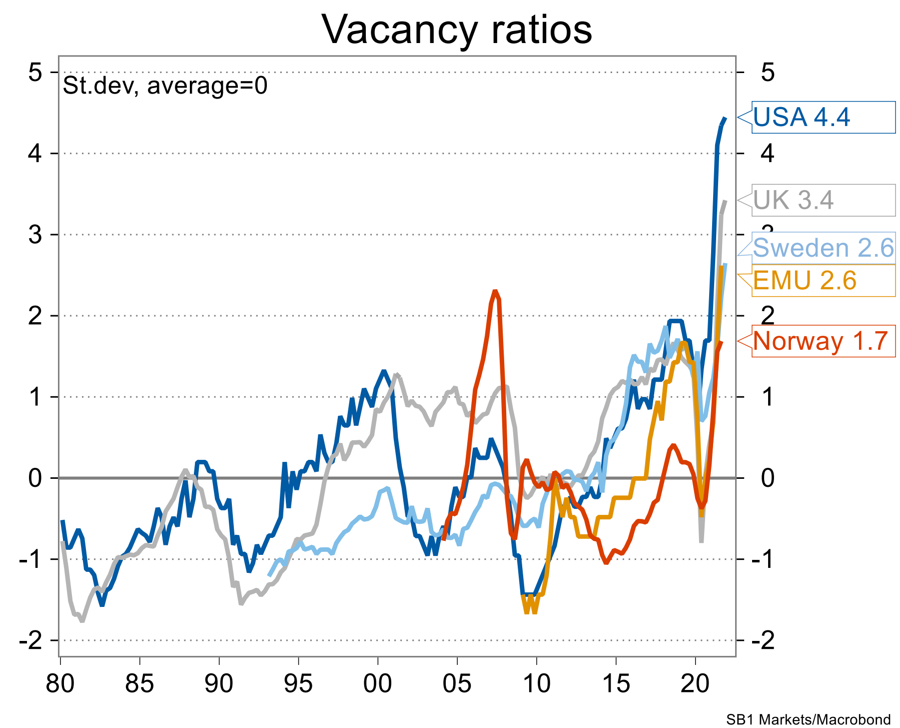
The LFS (ILO/AKU) unemployment rate has fallen to 4.2%. The employment rate is much too low





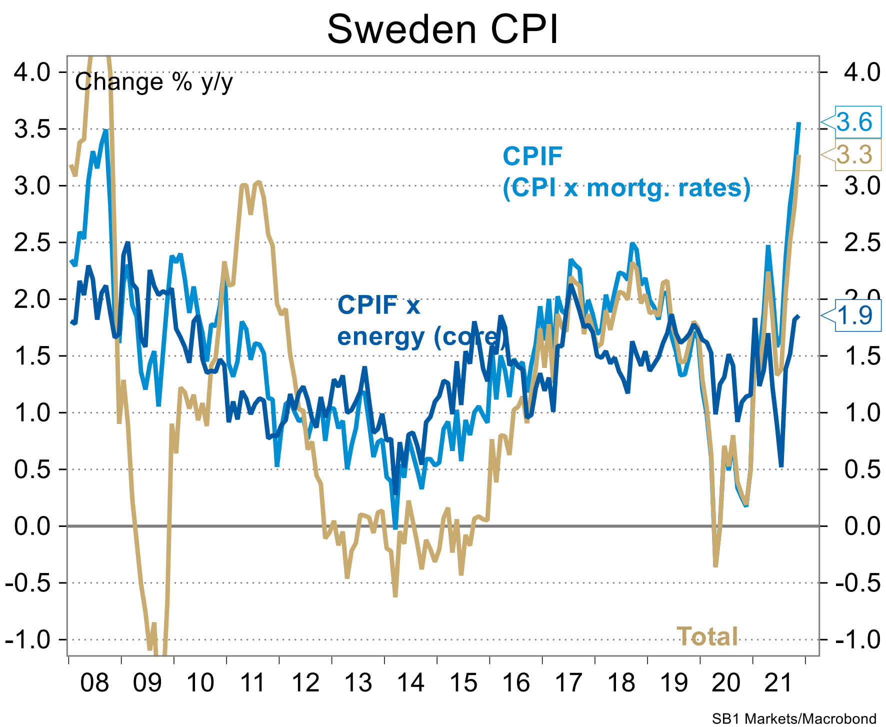
Vacancies have climbed to a record high – as most other places

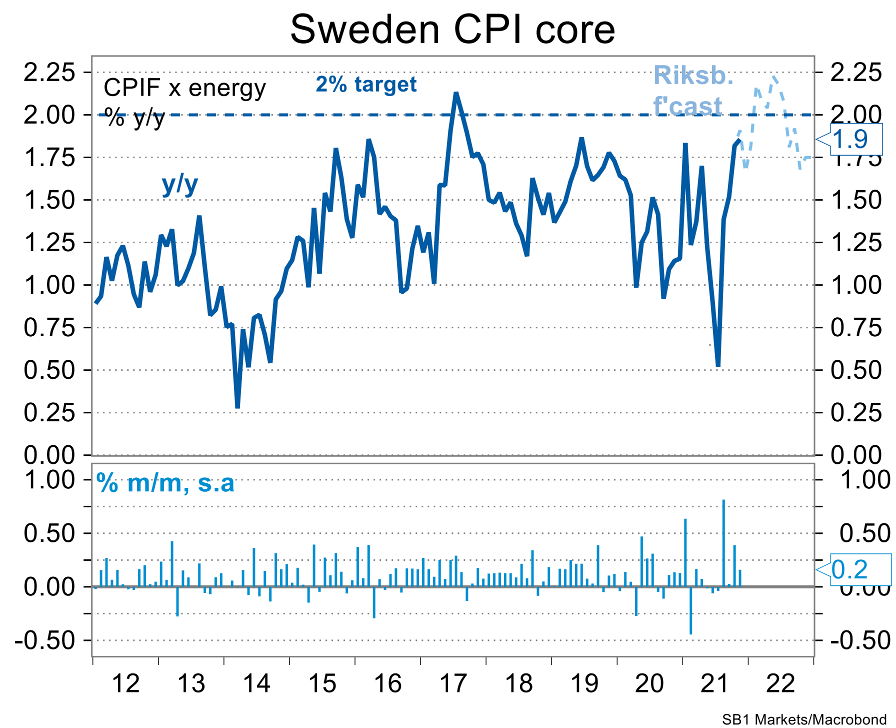




CPI inflation up in Sweden too – but the core still below 2%, trend at 1.5%

The core up 0.2% m/m, up to 1.9% y/y from 1.8%, as expected. Total up 0.5 pp to 3.3%

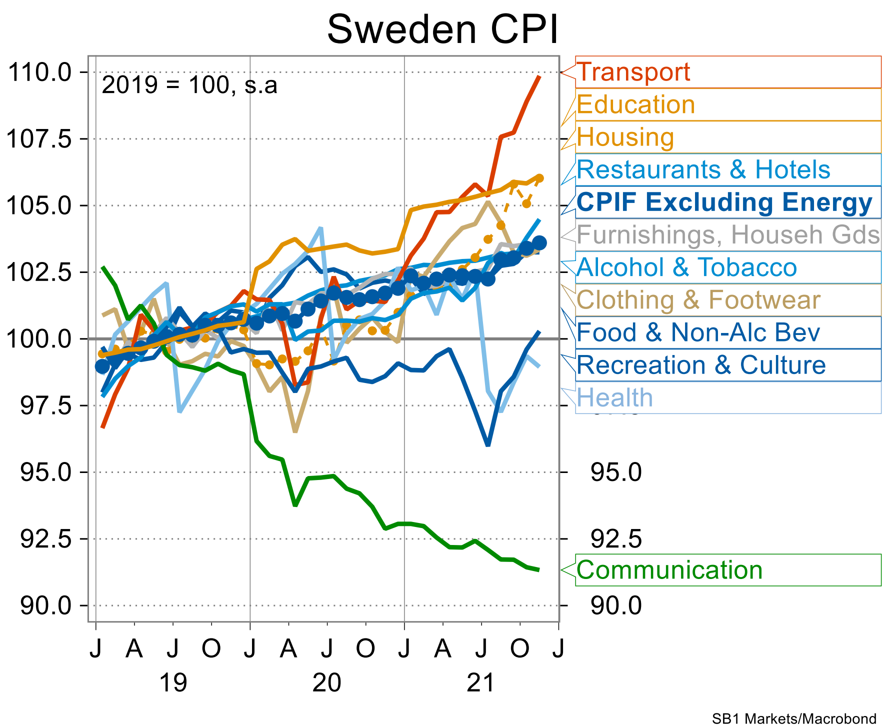


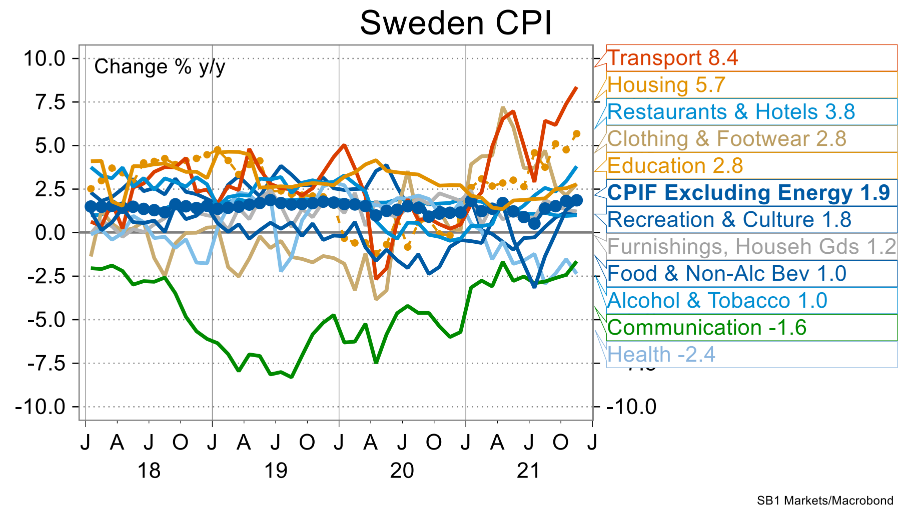


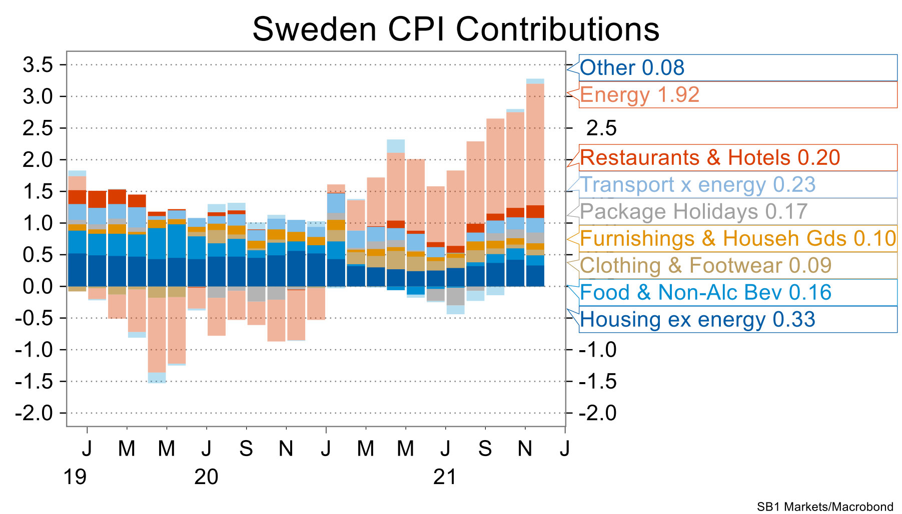
- **Headline inflation** accelerated 0.5 pp to 3.3% y/y in November, 0.1 pp more than consensus forecast
  - » The increase in inflation was largely driven by an increase in energy, housing, and transport prices
- **The CPI-F**, the constant interest rate inflation (CPI x mortgage rates) was up 0.6 pp to 3.6% y/y, 0.2 pp above expectations
- **CPI-F x energy, the 'real core'** was up 0.2% m/m, and the annual rate also rose by 0.1 pp to 1.9% y/y – in line with the Riksbank f'cast. Over the past 2 years core prices are up 1.5% annualized, well below the 2% forecast. There are reasons to start normalizing the signal rate but actual inflation is not

Energy in housing & transport explains almost the whole lift in inflation

Most sectors report inflation below 2%



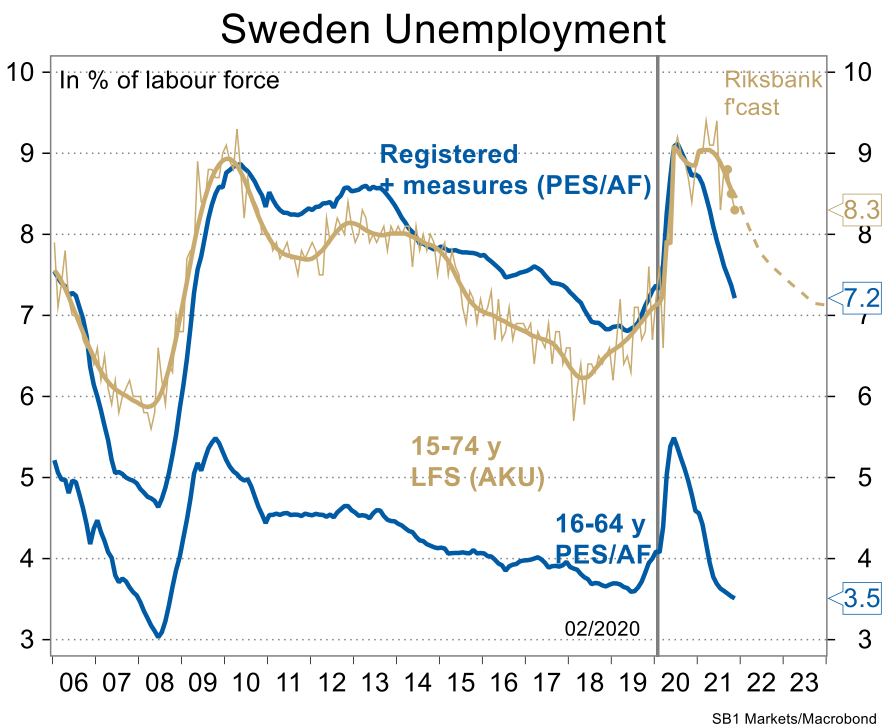


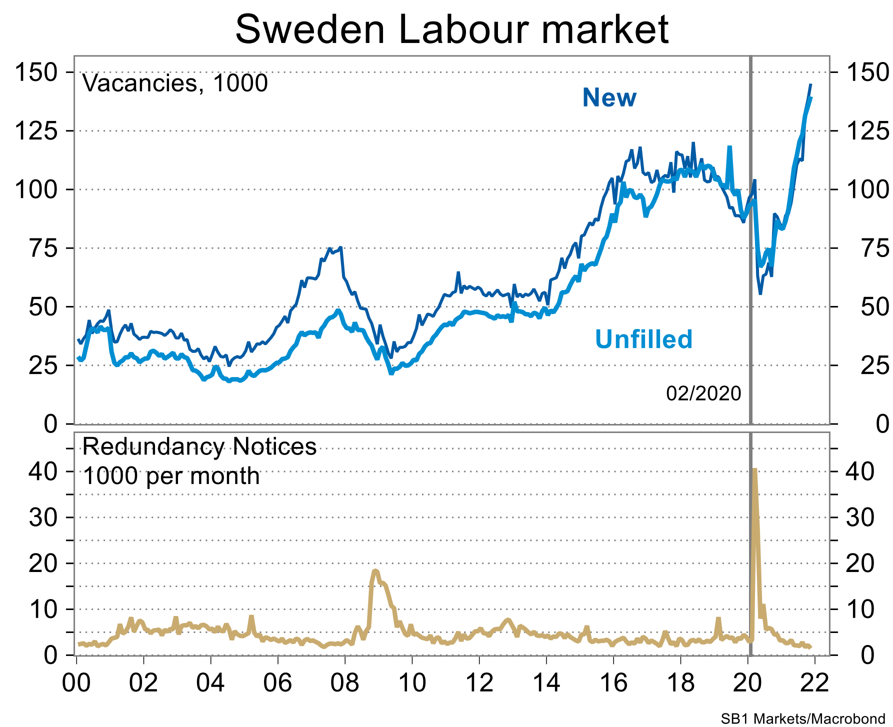


SpareBank 1 MARKETS

LFS unemployment is heading down, still at 8.5%, 1.3 pp above pre-p level

Open unemployment has fallen to 3.5%, to below the pre-pandemic level

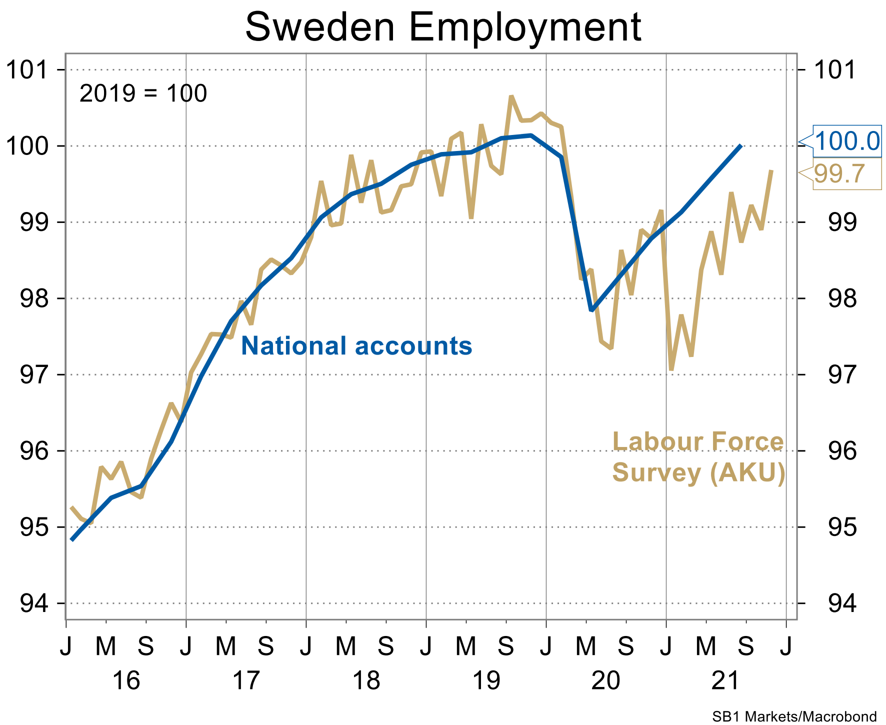


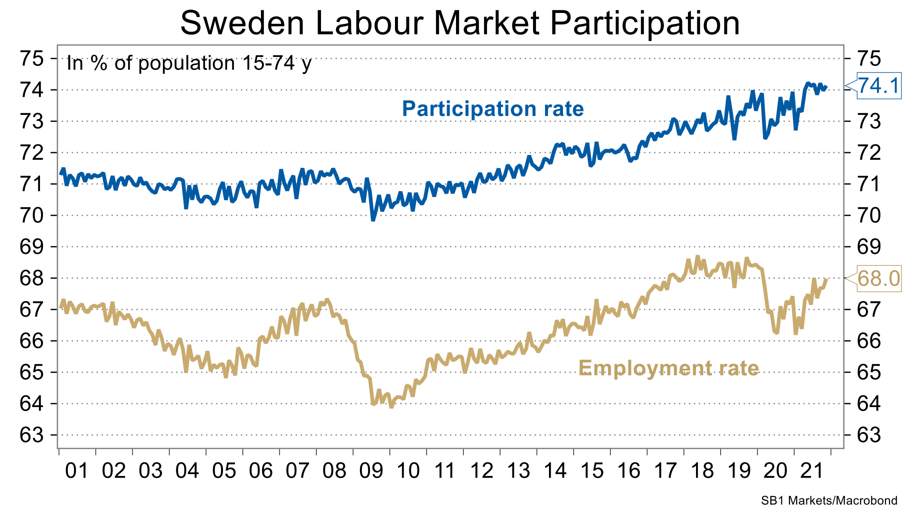


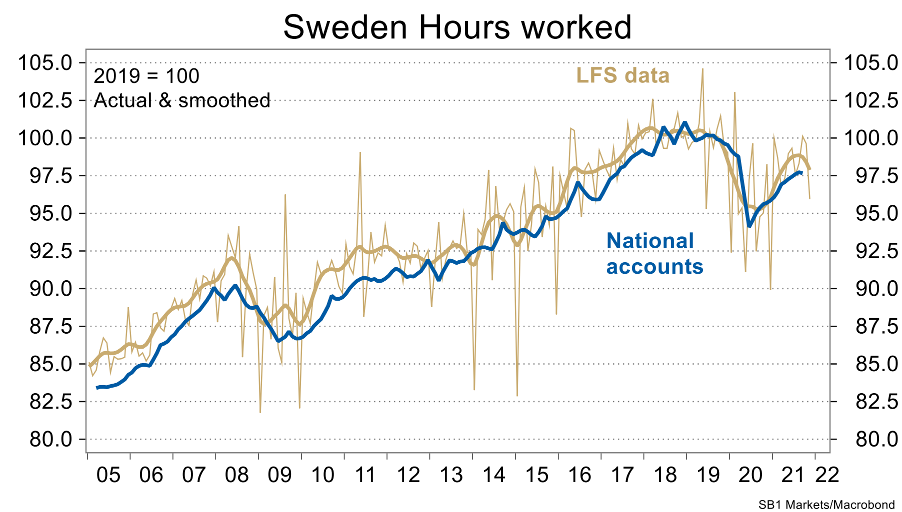
- The **LFS (AKU) unemployment fell 0.2 pp to 8.3%** in Nov, expected down to 8.4%. Unemployment is down 0.8% from the peak early 2021 but it remains 1.3 pp higher than in early 2020. (However, this survey is heavily revised, and we are not sure the Swedes have made data comparable)
- **Registered 'open' unemployment** (PES/AF) has fallen rapidly since last June but was unch at 3.5% (down 0.03 pp) in November. Registered unemployment is below the 4.1% pre-pandemic level
- **Incl. labour market measures**, PES/AF unemployment is falling too. The rate fell by 0.1 pp to 7.4%, but the level is still 0.1 pp above the early 2020 level (but 0.7 pp above the local trough in mid-19)
- The number of **new vacancies** and **unfilled vacancies** rose further in Nov, up to another ATHs! **Layoffs** were down in September.

Employment is back to the 2019 level but the employment rate is still below

The employment rate is down 0.6 (0.4 pp) vs. late 2019. The participation rate is up!







- The participation rate has fallen marginally the previous months but is close to the highest level ever
- Hours worked has recovered substantially vs last spring but is still down 2.5% vs the pre-pandemic level

Highlights

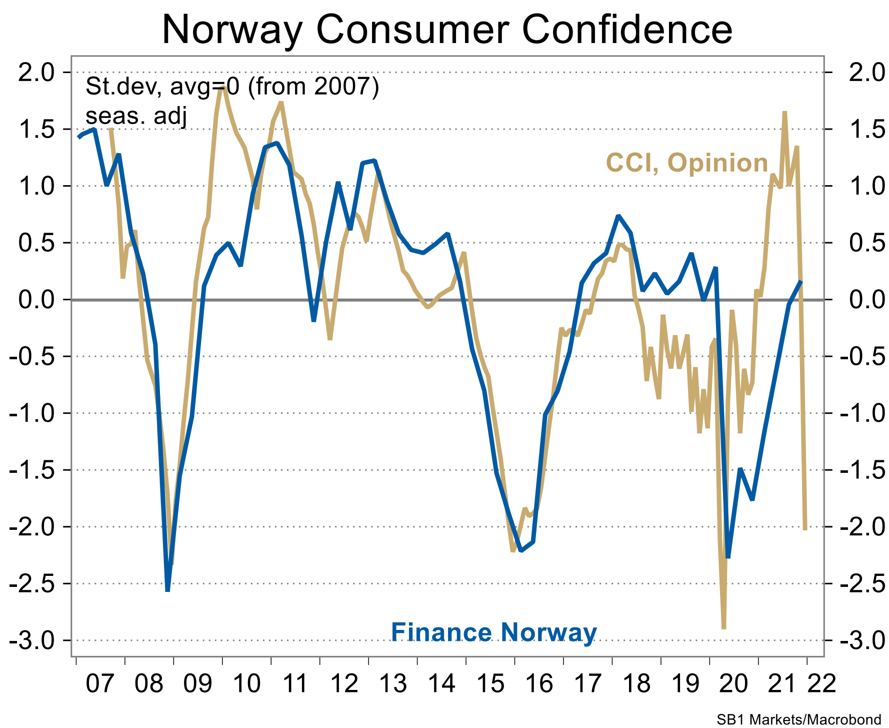
The world around us

The Norwegian economy

Market charts & comments

No confidence left! From top to bottom in just 2 months!

Opinion's CCI down 2 st.dev in Dec, following -1.5 st.dev in Nov. Covid-19 & electricity prices to blame

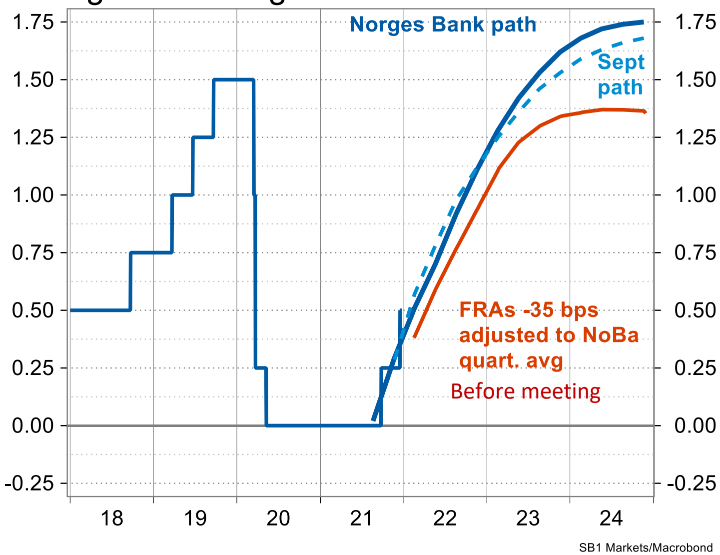


- This decline is even larger than the setback in confidence in March and April last year – we have never seen anything like this before!
- What has happened? We have just 3 candidates
  - » The return of the virus
  - » The surge in electricity price
  - » Interest rates on the way up
- We are quit confident that the two first candidates must take the blame, not the first Norge Bank hike in mid September (that did not lower confidence in late September or in October)

NoBa delivered the 2nd hike, more to come as soon as the virus is gone

The Bank lifted its interest rate path but not before 2023 and just by 9 bps, we expected more, earlier

Norges Bank Signal rate forecast vs market



Interest rate paths	Path 3-21	Path 4-21	Change bps	SB1M f'cast	Fair FRA * @IMM, NB	FRA pre meet	NoBa -FRA
Q4 21	0.28	**0.29**	**1**	0.25			
Q1 22	0.57	**0.51**	**-6**	0.34	1.02	**0.93**	9
Q2 22	0.78	**0.70**	**-8**	0.66	1.24	**1.10**	13
Q3 22	0.98	**0.92**	**-6**	0.98	1.43	**1.28**	15
Q4 22	1.12	**1.11**	**-1**	1.22	1.60	**1.45**	16
Q1 23	1.25	**1.28**	**3**	1.40	1.75	**1.58**	17
Q2 23	1.36	**1.42**	**6**	1.56	1.86	**1.67**	20
Q3 23	1.46	**1.53**	**7**	1.66	1.96	**1.71**	24
Q4 23	1.53	**1.62**	**9**	1.73	2.02	**1.73**	29
Q1 24	1.59	**1.68**	**9**	1.79	2.06	**1.75**	31
Q2 24	1.63	**1.72**	**9**	1.83	2.09	**1.75**	34
Q3 24	1.66	**1.74**	**8**	1.86	2.10	**1.75**	35
Q4 24	1.68	**1.75**	**7**	1.88	2.11		

**) Assuming a 35 bps NIBOR spread from Q1-22*

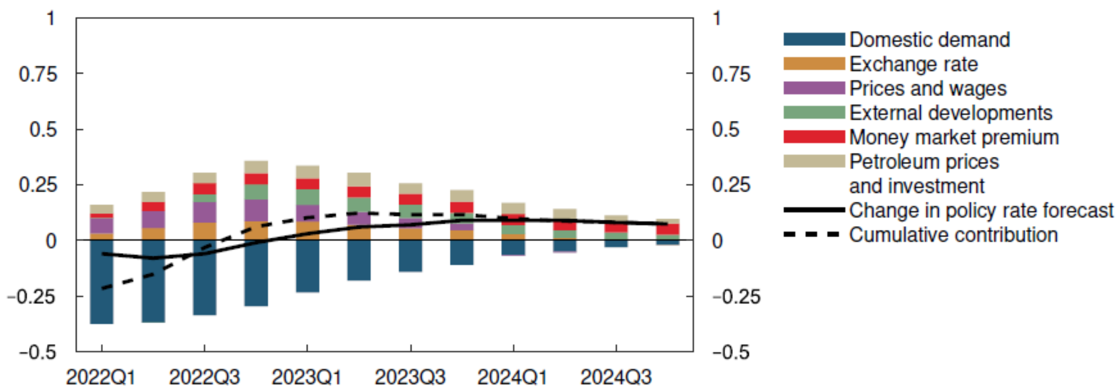
Q4 FRAs adjusted for liquidity prem

- **Key policy rate** was hiked by 25 bps. We expected the bank to wait and see 6 weeks, until the next meeting. The market was split, but the short end of the curve rose approx. 10 bps
- **The policy rate path** was revised down in 2022, as the possibility for another hike in January was removed, and the probability for a hike in March was reduced to some 75%. From early 2023, the path was revised upwards by up to 9 bps
  - » We expected the path to be revised upwards from H2-22 and by more than the 9 bps in 2023
  - » The bank's NEMO model suggested an interest rate path closer to ours, lower in the front, higher thereafter – as all but one factor – domesic demand – were signaling higher rates (check next page)
- NoBa started earlier than the other DM central banks due to **financial stability concerns** but even here the language on **inflation risk** has entered the vocabular.
  - » But the main argument for hiking is simply that the economy is operating at close to a normal activity level, more companies are reporting high capacity utilization and labour shortages and growth is strong barring assumed short lived virus problems. S<u>o there is no need for keeping the policy rate miles below what the bank assumes is the neutral rate</u>
- **FRA rates** rose, and the **NOK** strengthened somewhat – but fell 0.1% during the week, just like the AUS, and the RBA did not hike

Reasons for the rate path lift: Everything, barring a (suspicious) weak domestic d.

The Banks main model argued for not hiking now – and for lifting the path faster thereafter

Chart 4.7 Higher price and wage inflation pulls up the rate path
Cumulative contribution. Percentage points



Source: Norges Bank

Our pre-meeting forecast was pretty close to the model output but we expected somewhat higher rates in in H2-22 onwards

Upside contributions:

- The NOK has been weaker than expected
- Wage and cost inflation is revised upwards
- The NOK has weakened
- Higher growth, higher rates abroad
- Oil price, oil investments

Downside contributions:

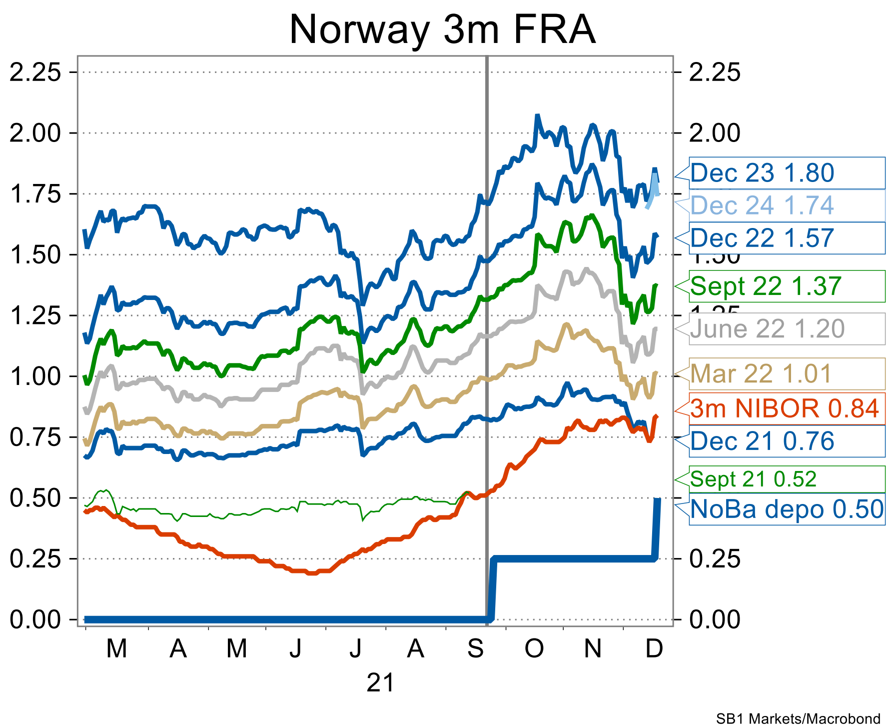
- Weaker Mainland domestic demand, not only in Q1/Q2, which could be expected due to corona risks, but all the way out to 2024
- We are not sure about that forecast

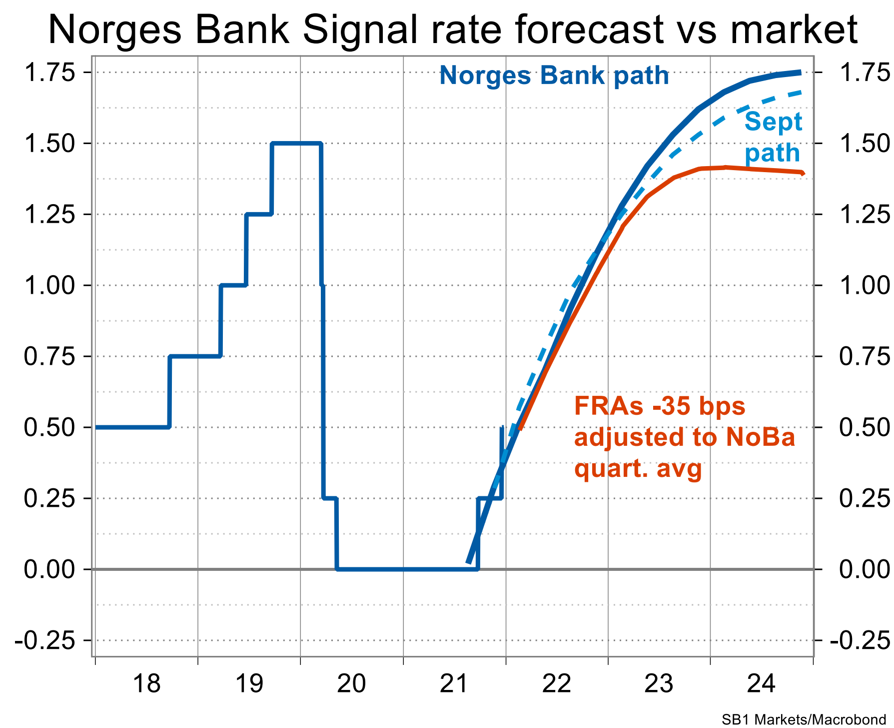
The board's adjustment

- In the last report, the MPC overruled the NEMO model, as it suggest a 50 bps hike
- Now, the committee prefers to hike, even if the model 'suggested' to wait and see
- In addition, the MPC lifted the interest rate path less than 'recommended' in Q4-22 and through 2003

FRAs climbed on NoBa's message but remains below the new path

And far below in the long end of the FRA curve – and the long end fell back at Friday (int. rates fell)



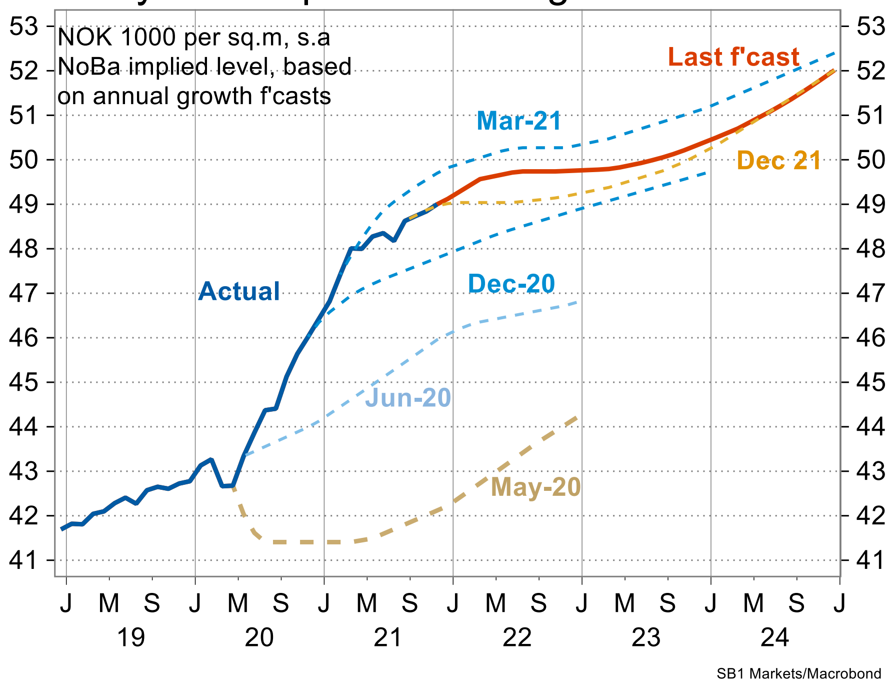


- See the market section for discussions in the likelihood for a March hike (NoBa: 75%, the market 70%)

Norges Bank revised its house price path upwards

Even if the interest rate path was lifted

Norway House prices vs Norges Bank's f'casts

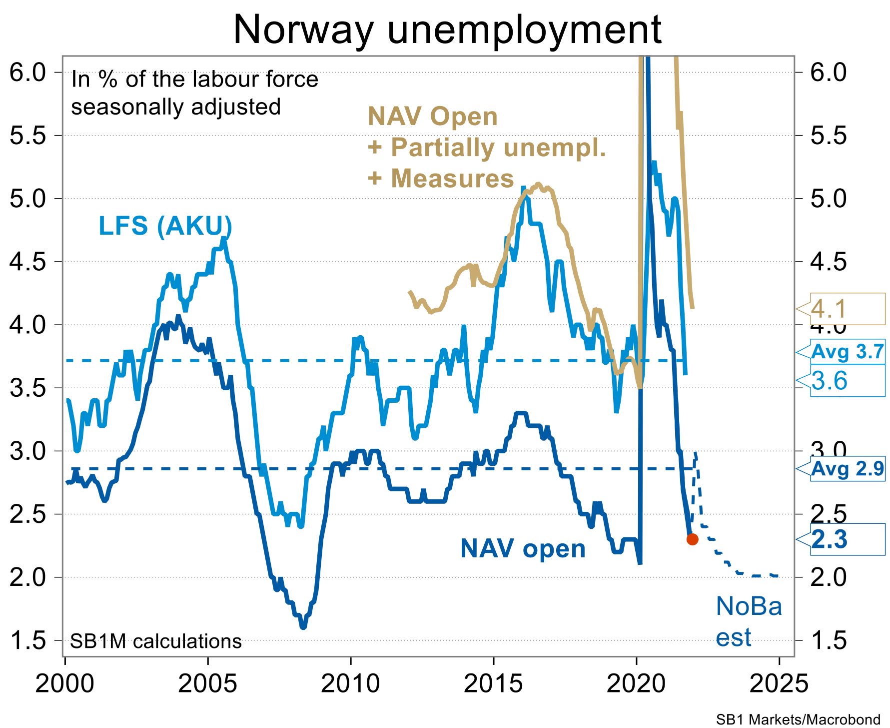


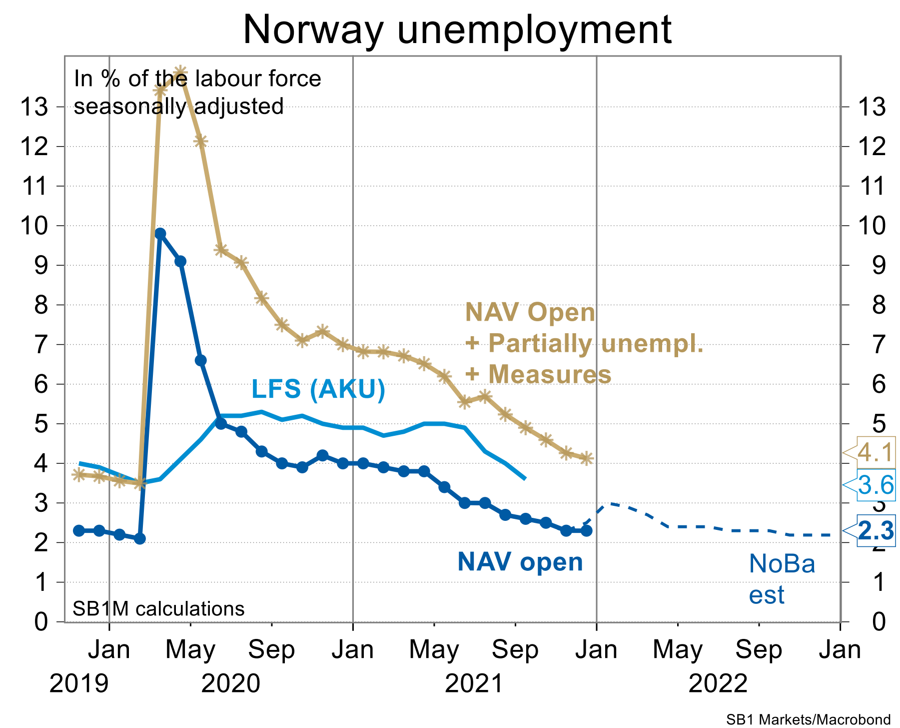
- NoBa expects house prices to appreciate less than income growth the coming years but not by much

- The price path is still lower than the March estimate

NAV unemploym. further down in Dec, but more new claims, new vacancies down

Open unemployment down in number of persons but unch 2.3%, still 0.2 pp below NoBa's f'cast

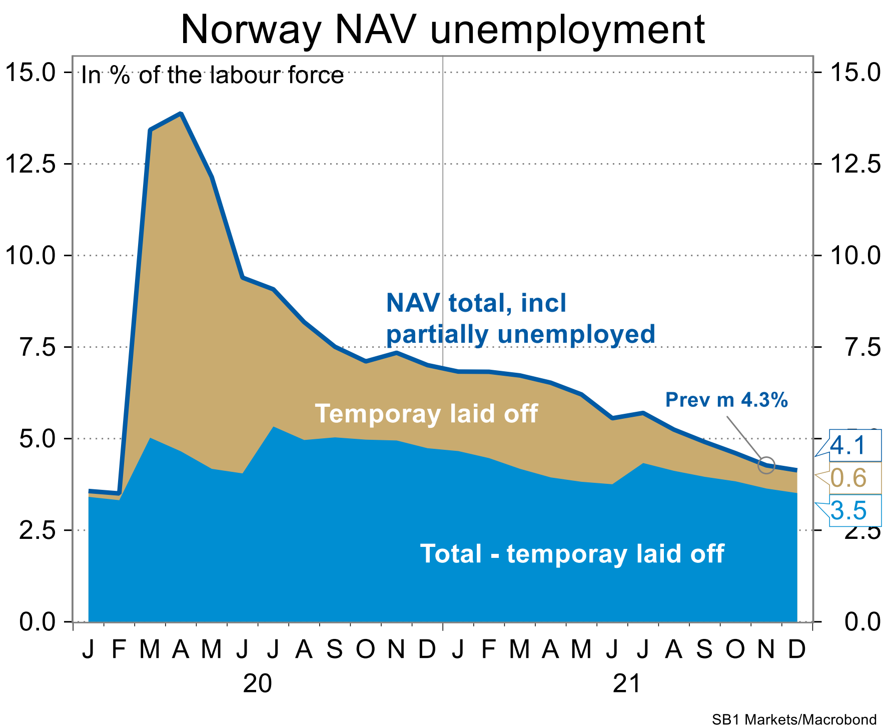


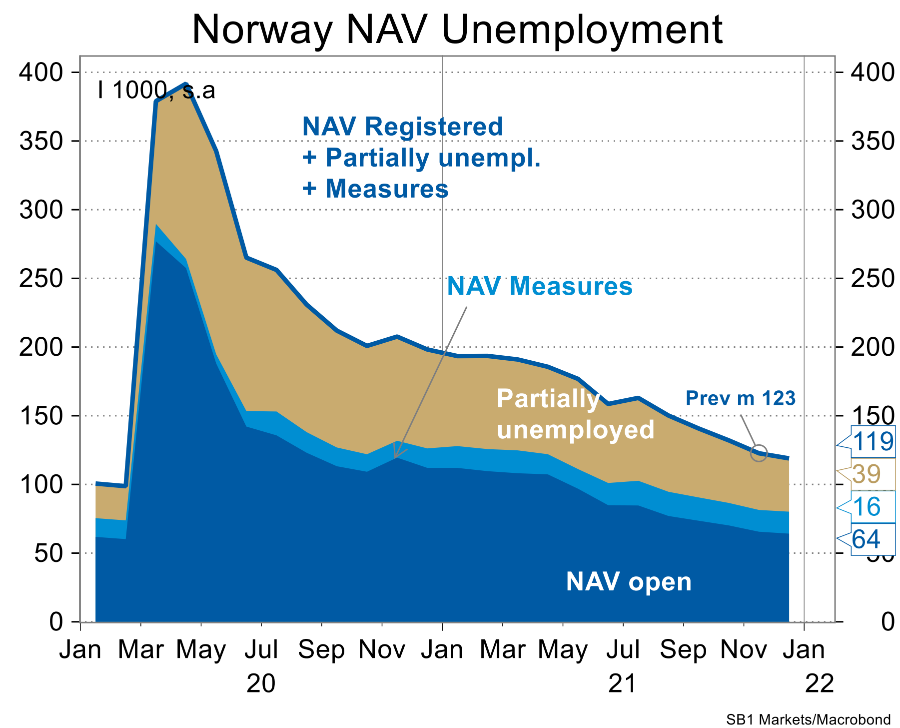


- **The 'full time' open NAV unemployment**, which includes furloughed workers, fell by 1.4' in September (seas. adj) to 65' we expected unchanged. The rate was unch at 2.3%, 0.2 pp below NoBa forecast from Thursday. (Unadjusted, the rate rose by 0.1 pp to 2.2%, as expected). The 2.3% rate is well <u>below</u> the 2000 – 2019 avg at 2.9%, and just 0.2 pp above the pre-pandemic level. Employment in travel/transport rose slightly, but fell elsewhere. <u>Next month, expect a significant lift in unemployment in travel/transport – bur probably not in that many others!</u>
- In addition, the number of **partially unemployed** (not included in the ordinary unemployment no.) fell even more, to by 2.5' to 39'. Incl. labour marked measures, the **total unemployment** fell by 4' to 119', to 19' above the pre-pandemic level. The rate is 4.1%, up from 3.5% in Feb-20
- The inflow of **new job seekers** rose , and the **inflow of new vacancies** fell from a very high level, both changes mostly due virus restrictions

All shades of unemployment further down in Dec, ex. the no of furloughed

Total unemployment down 0.2 pp to 4.1%

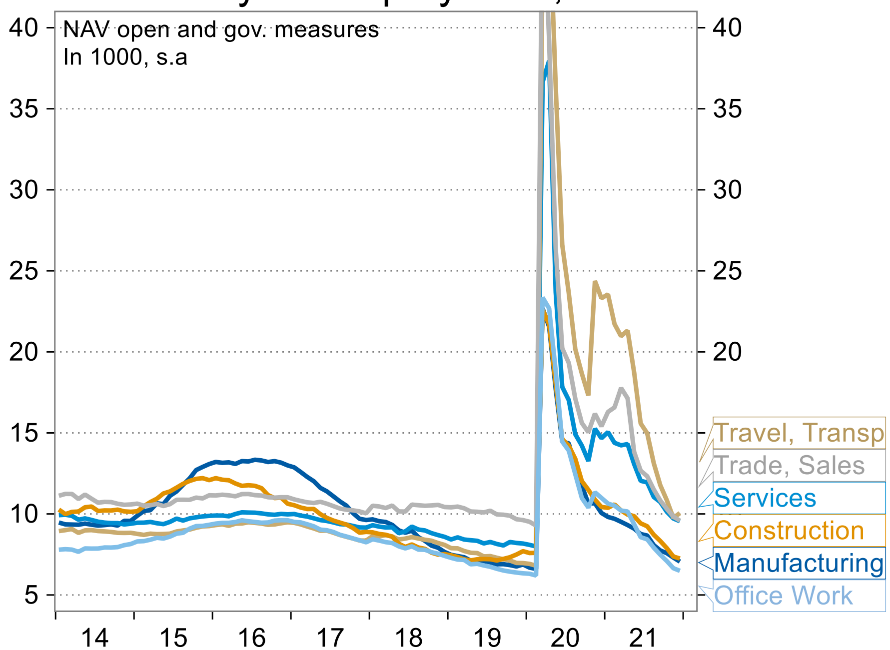




Some few more unemployed in travel/transport – all others sectors down

Employment has fallen in rapidly in all sectors until now

Norway Unemployment, blue collar



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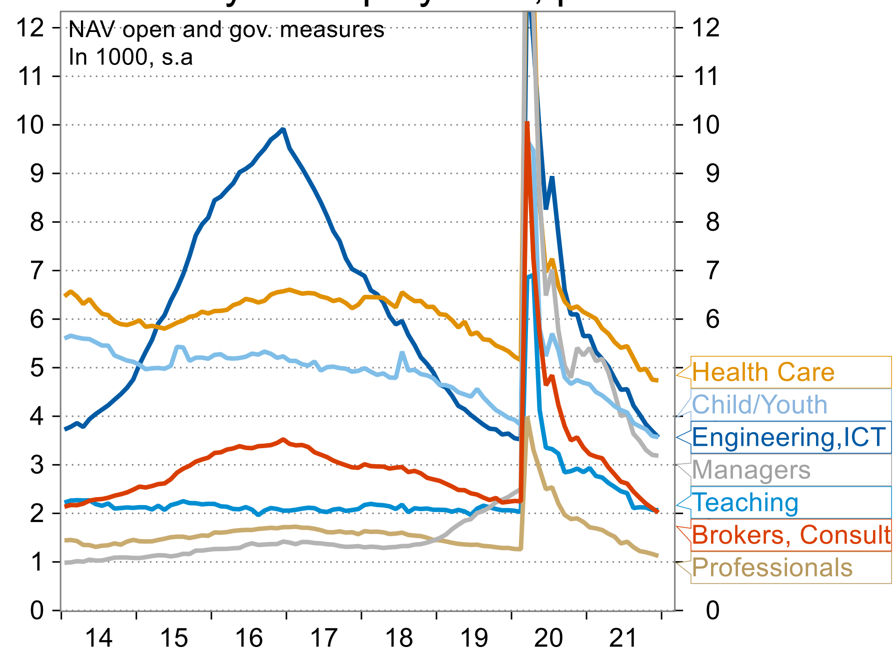
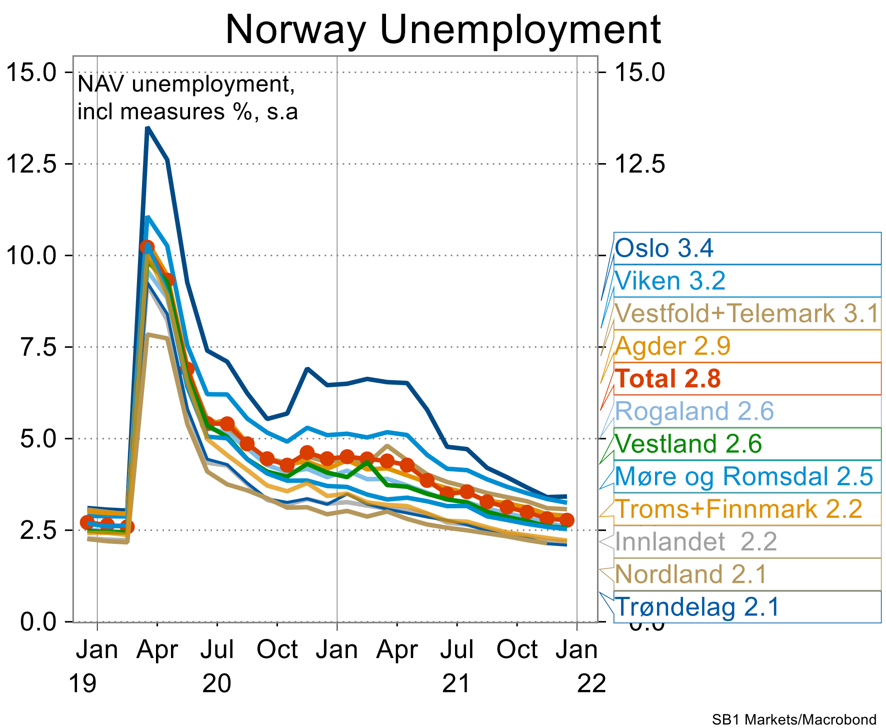
Norway unemployment, professionals

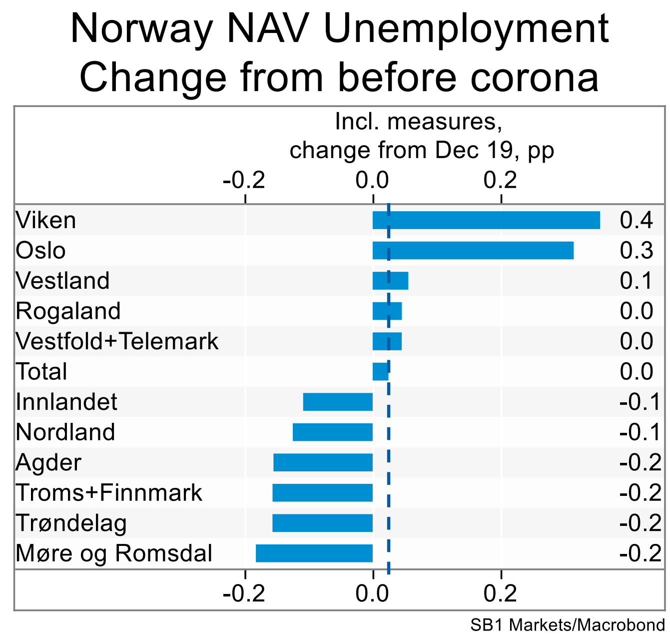


SB1 Markets/Macrobond

Unemployment down or flat in all parts of the country in December

Just Viken and Oslo is still reporting an unemployment rate at > 0.1 pp higher than before the pand.

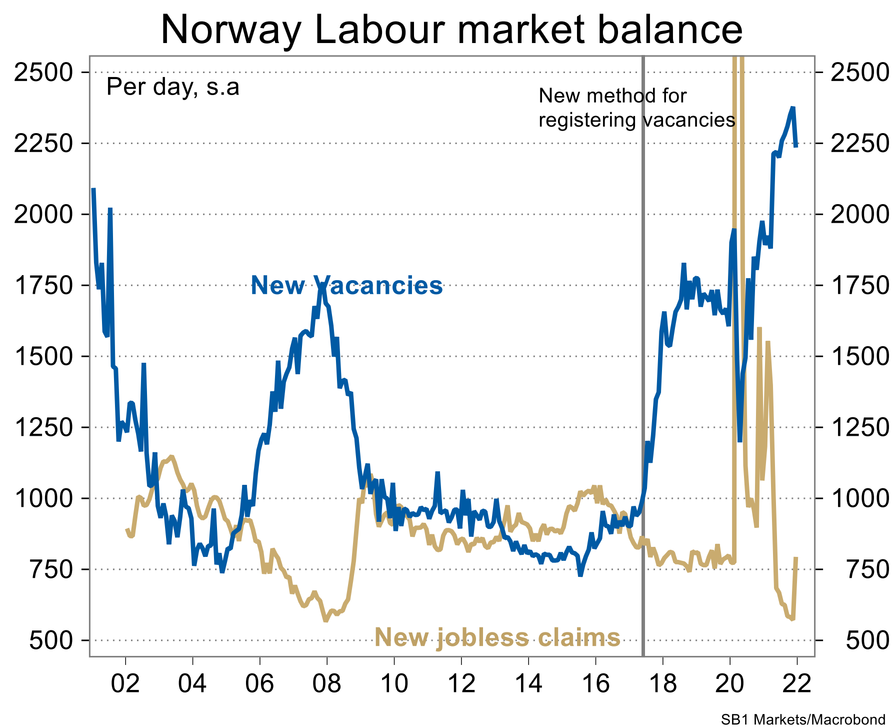


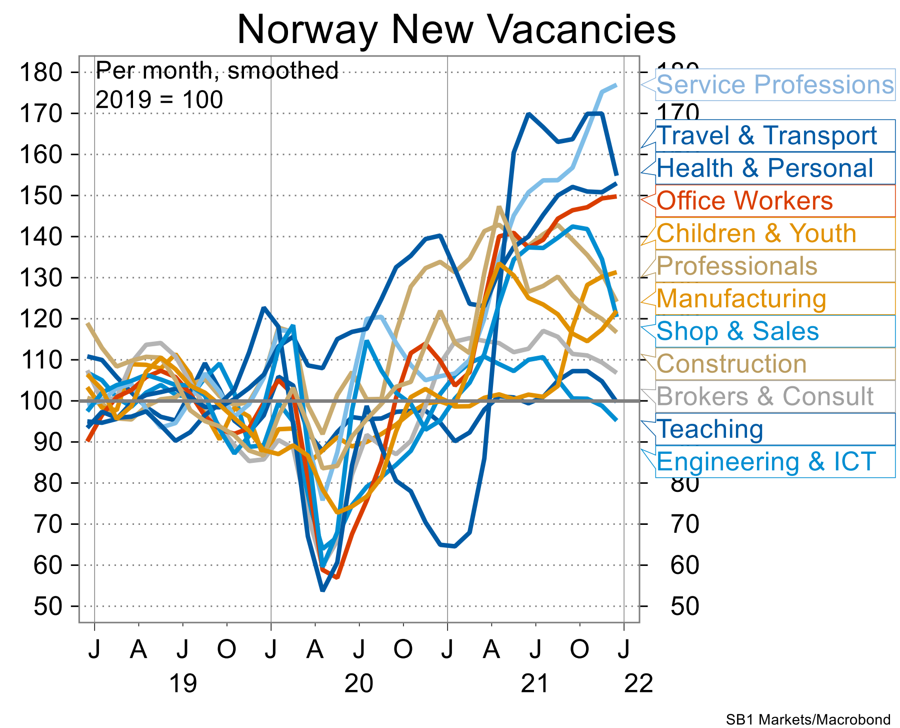


- **Oslo** has by far been the hardest hit county, both due to tighter restrictions and a large service sector – followed by Viken
- Ordinary unemployment (full time, temporary laid offs and measures included) falling everywhere – and it is approaching the pre-pandemic levels in most counties.

A decline in new vacancies in December, mostly in travel/transp & shops/sales

A visible lift in new jobless claims as well: The fight against the virus was felt in the first parts of Dec.





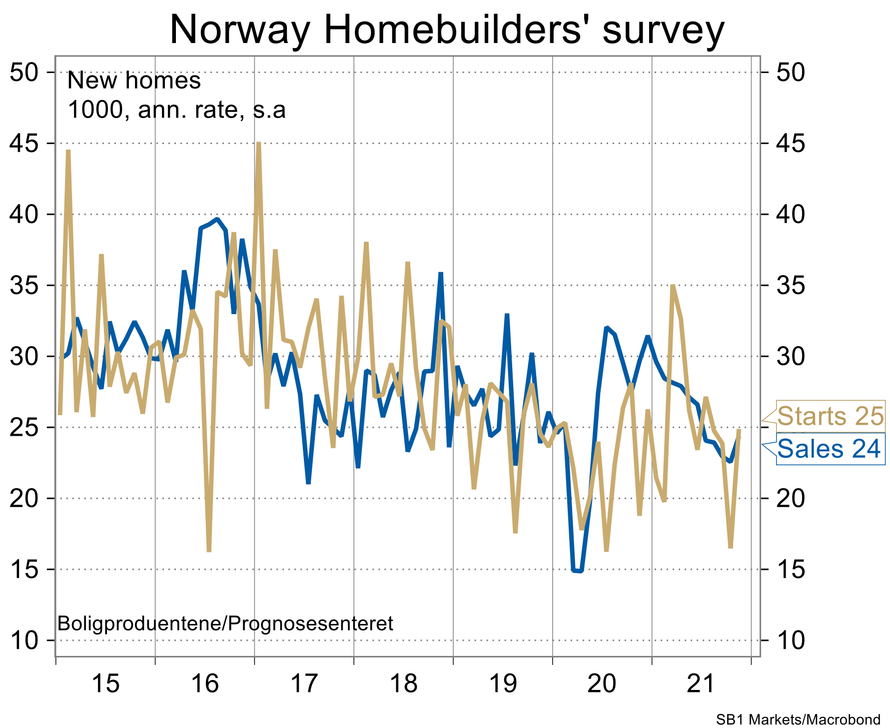
- Still, the no of NEW vacancies is among the highest ever – and jobless claims among the lowest ever

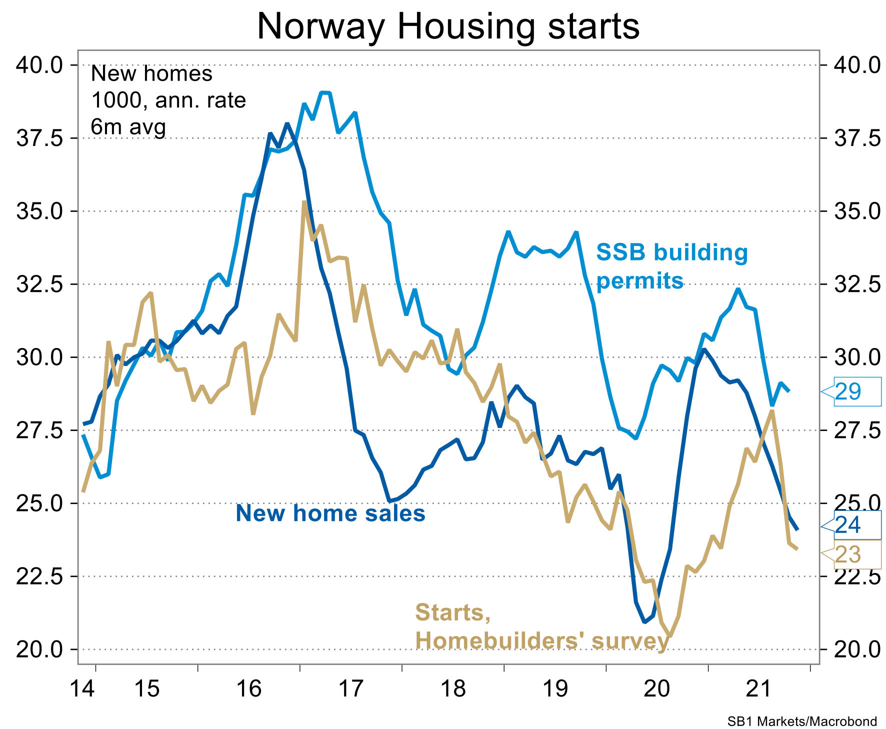
We have made a preliminary adjustment of the 2020 vacancy data due to a NAV reporting error which have led to under reporting of new positions through the year. NAV reports that the no. of new vacancies is at the same level in January 2021 as one year ago

SpareBank 1 MARKETS

New home sales & starts in November, both at 25’ (annual pace)

Sales are not far below at ‘normal’ level – and population growth has slowed substantially

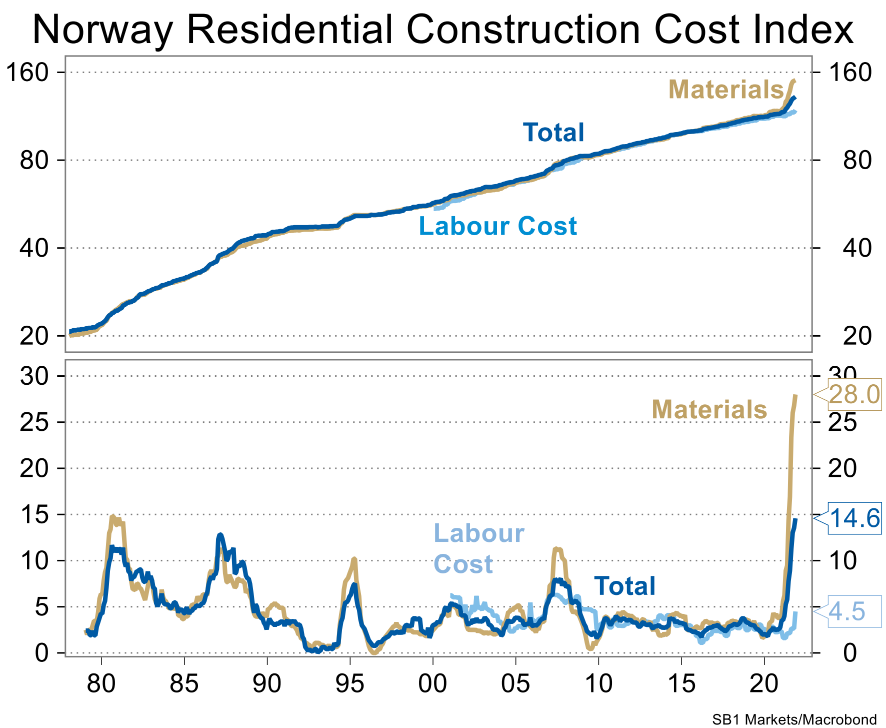


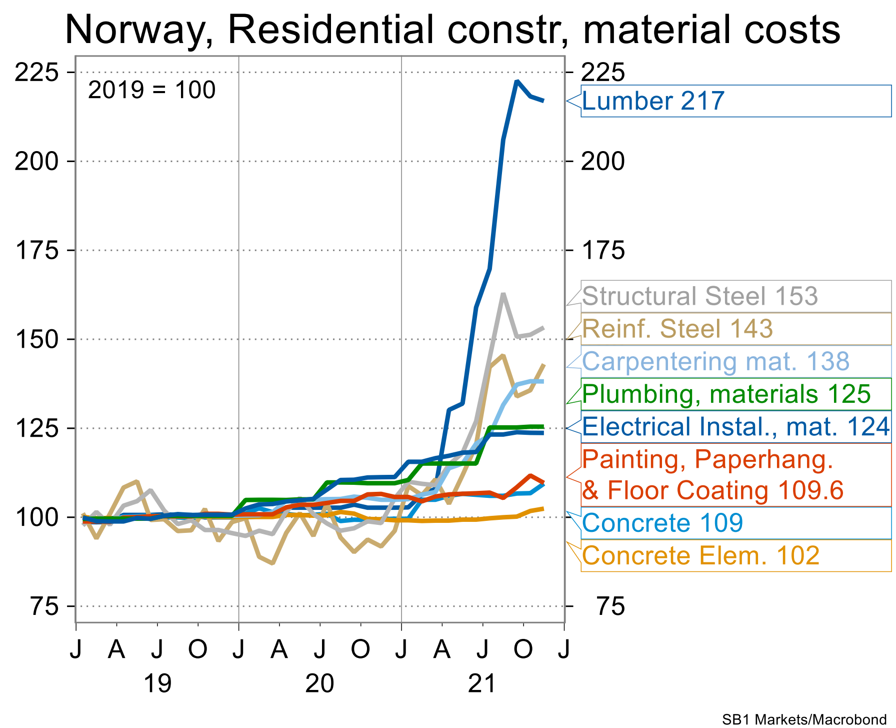


- **Boligprodusentene (Home builders)** blame higher material cost and now also high land costs for the decline in sales, not an unreasonable hypothesis (but strangely enough, higher interest rates were not mentioned). However, as existing home prices are substantially up over the past year, new homes are probably still competitive
- **SSB** does not agree – housing starts have not fallen recently. Check more the following pages

‘Some’ cost pressure in the construction sector but lumber prices has peaked

But ‘just’ from some materials; lumber & steel, plumbing & electrical materials

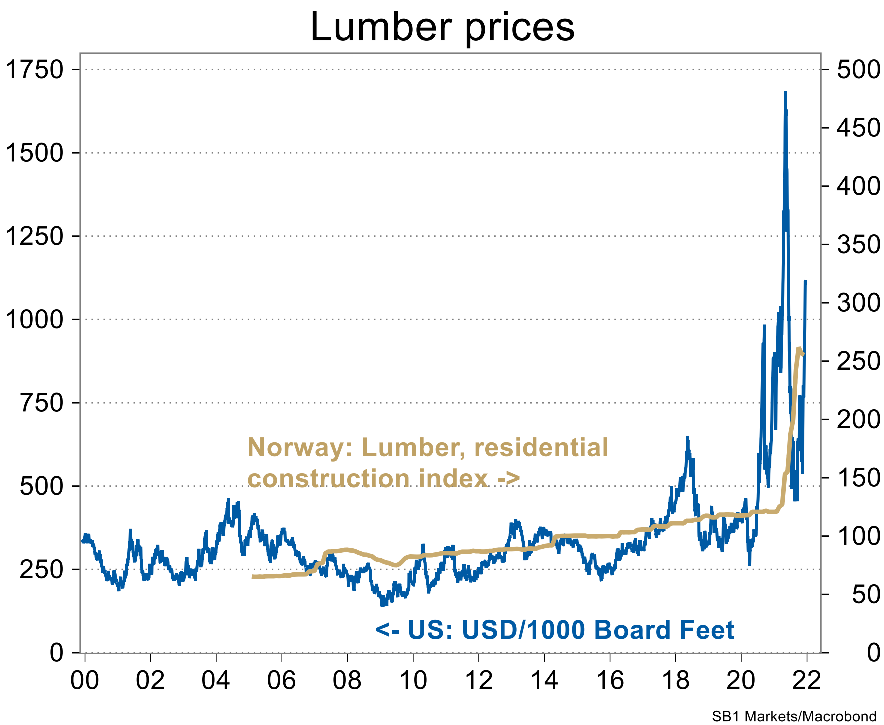




- Material prices are up 28% y/y but the peak is probably near, many prices are down from the peak or have flattened
  - » Lumber prices are more than doubled – but the past two prices have fallen marginally (but are prices abroad on the way up again?)
- Labour cost inflation accelerated in November, to the highest level since 2009, at 4.5% (hourly cost)
- Including labour costs, the total building cost index is up by 14.6%, the highest on record

In the US, the lumber bubble burst – but now prices shot up again!

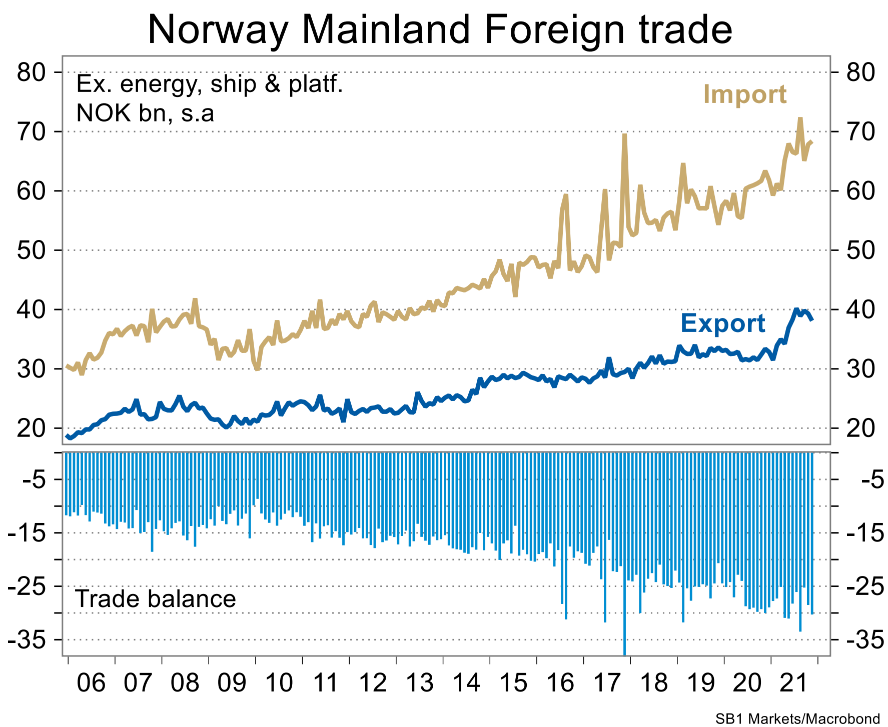
Anyway, raw material price cycles are normally not long lasting

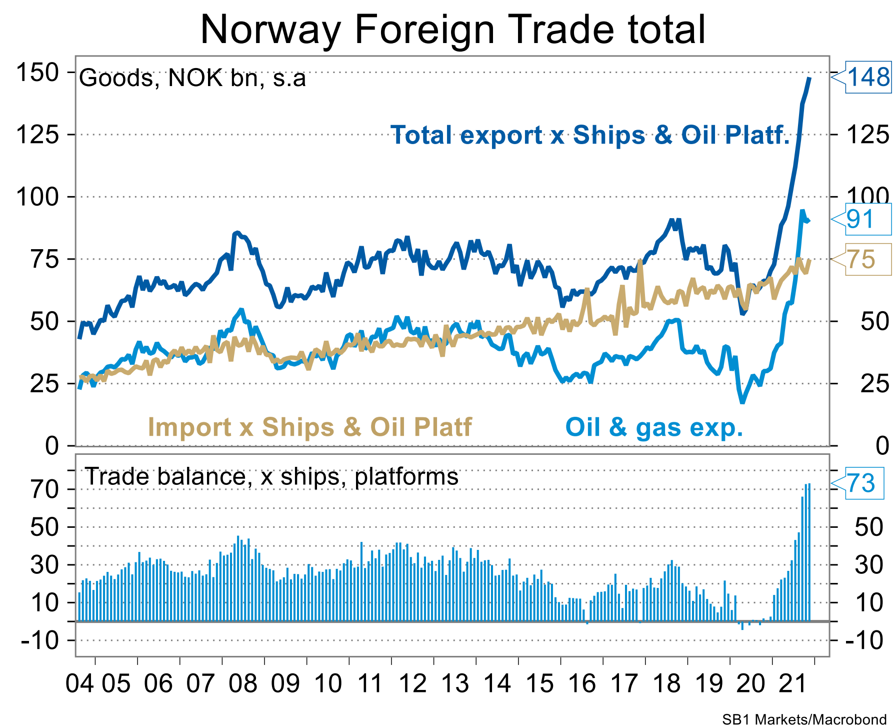


- .. And are not important for serious inflation cylces

Another ATH trade surplus, driven by gas exports

Total surplus at NOK 73 bn, or >25% of (Mainland) GDP

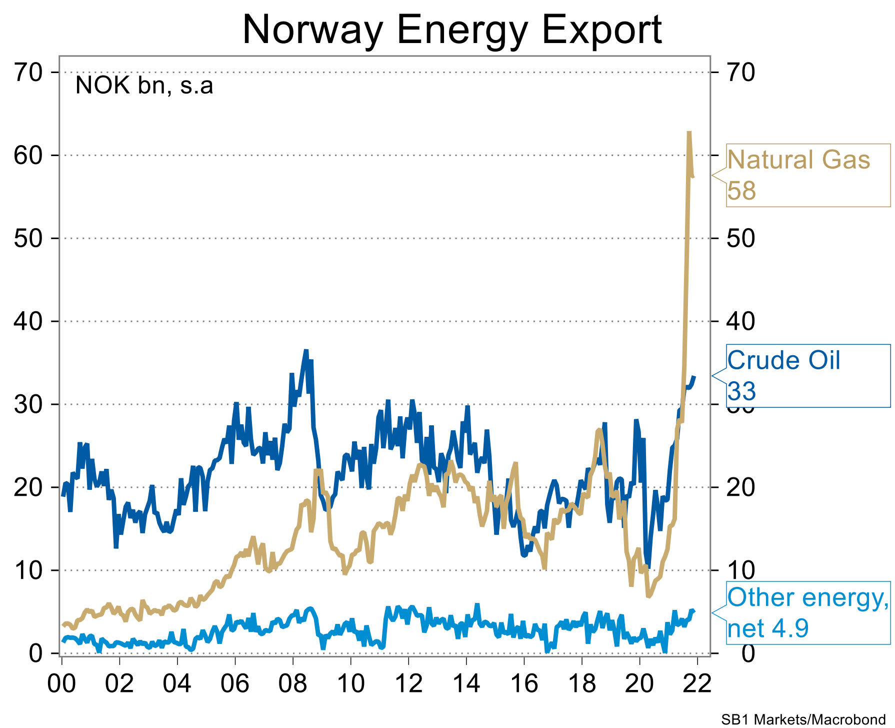


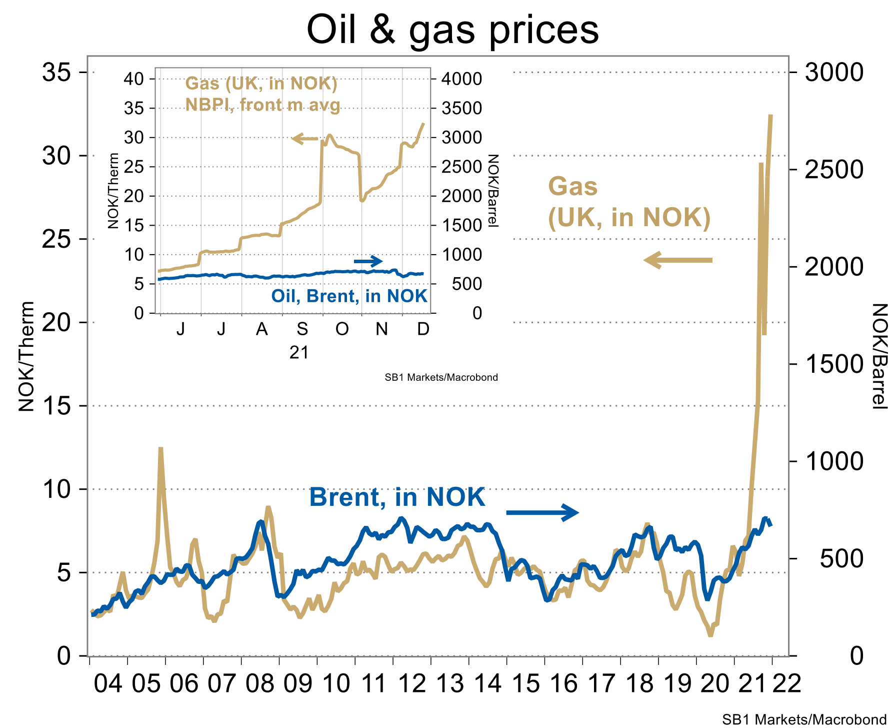


- **The <u>Mainland (non energy) trade deficit in goods</u>** rose to NOK 30 bn in Oct, up from 28 bn
- **Non-energy exports** fell – and the level has been flat since the summer – following a 30% lift since early 2021!
- **Imports** rose somewhat and is still at 10% growth path
- **Gas exports** fell slightly due a decline in gas prices. Oil exports rose marginally, and sum oil & fell slightly, seas. adjusted – fell slightly, to NOK 91 bn. So far in Dec, gas prices have climbed rapidly, and most likely the value of gas exports will grow substantially
- **The trade surplus in goods** (ex ships/platforms) was flat at NOK 73, an enormous amount – more than 26% of Mainland GDP!
- **The government's extra revenues** from oil and gas exports (and direct ownership) the past 3 months may equal NOK 150 bn, which will be transferred to the oil Fund

Gas exports slightly down in November but just wait for December

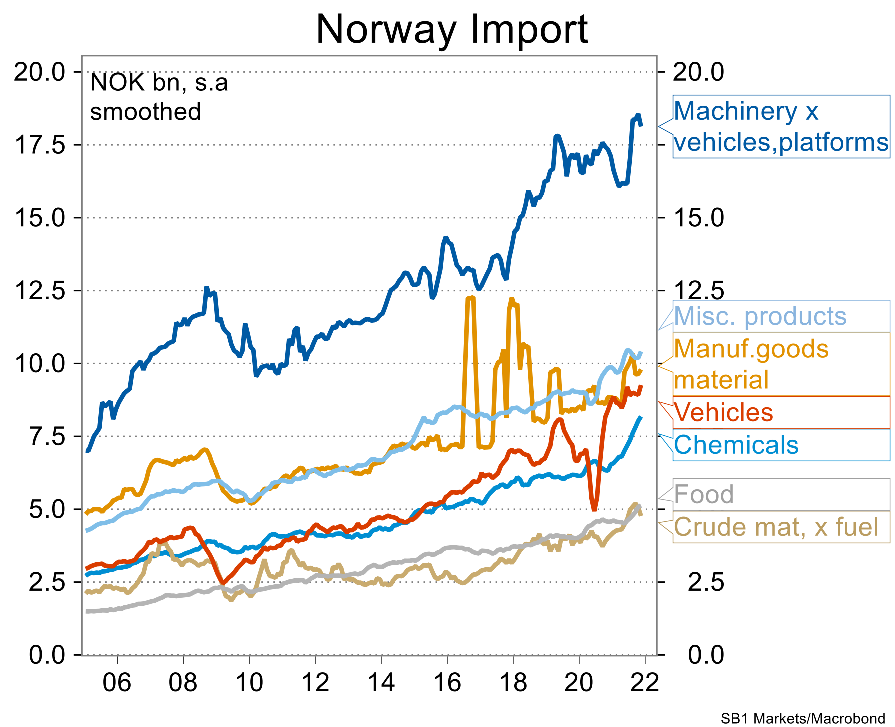
Gas exports are extreme, equalling more than 20% of GDP!

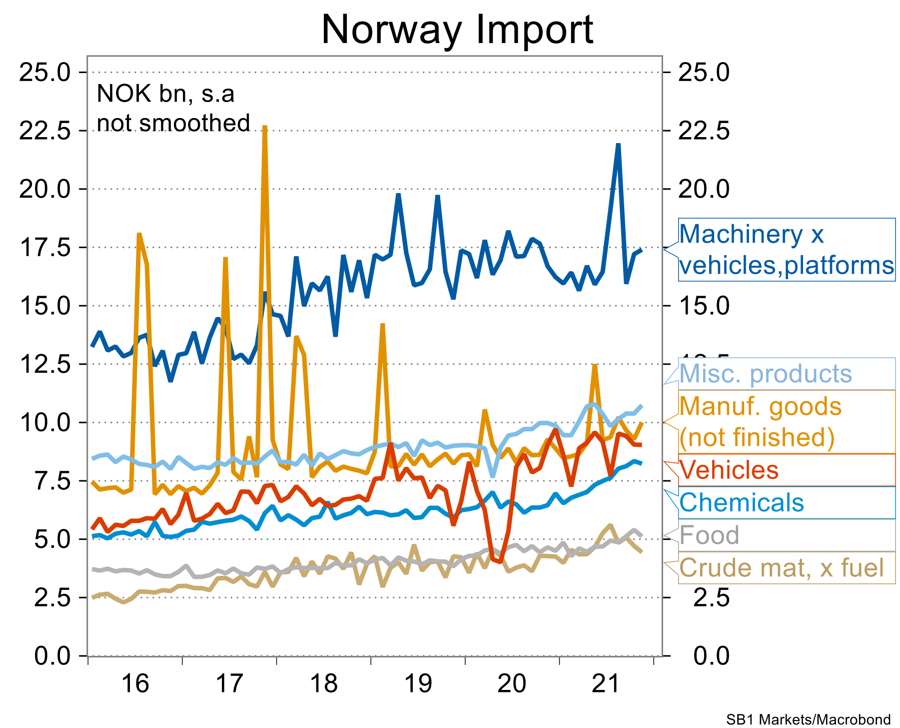




- **British gas** prices fell in Nov (the NBPI at the charts to the right, the average for each month, calculated from the start of the month, the front month). So far in Dec, prices are up by 1/3. The future market signals a decline through the spring. Gas prices are now totally uncorrelated to oil prices, which is rather unusual (but is has happened before, like in late 2005)
- **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

Most imports are trending upwards

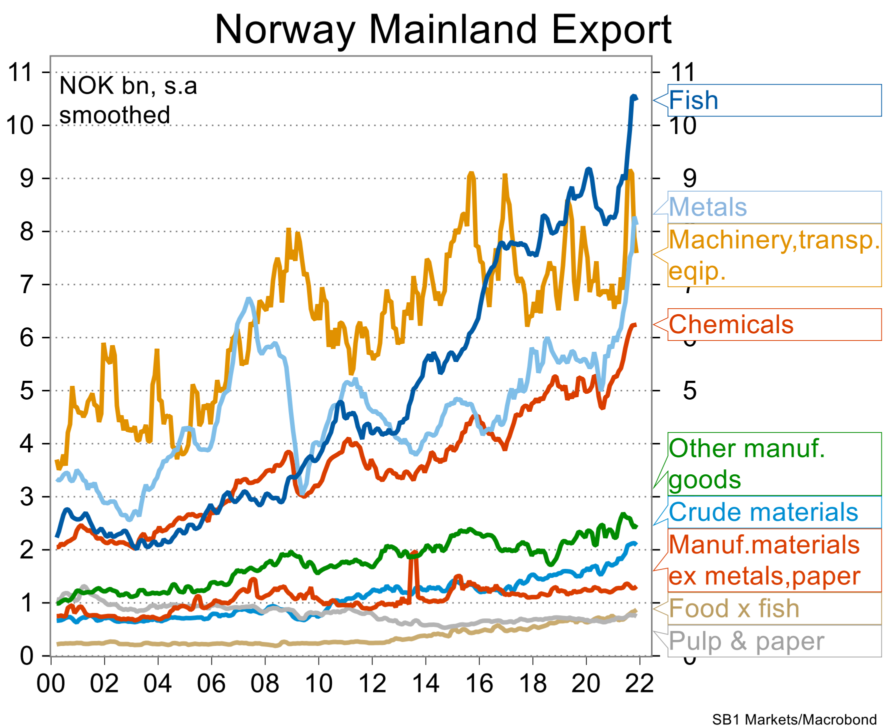


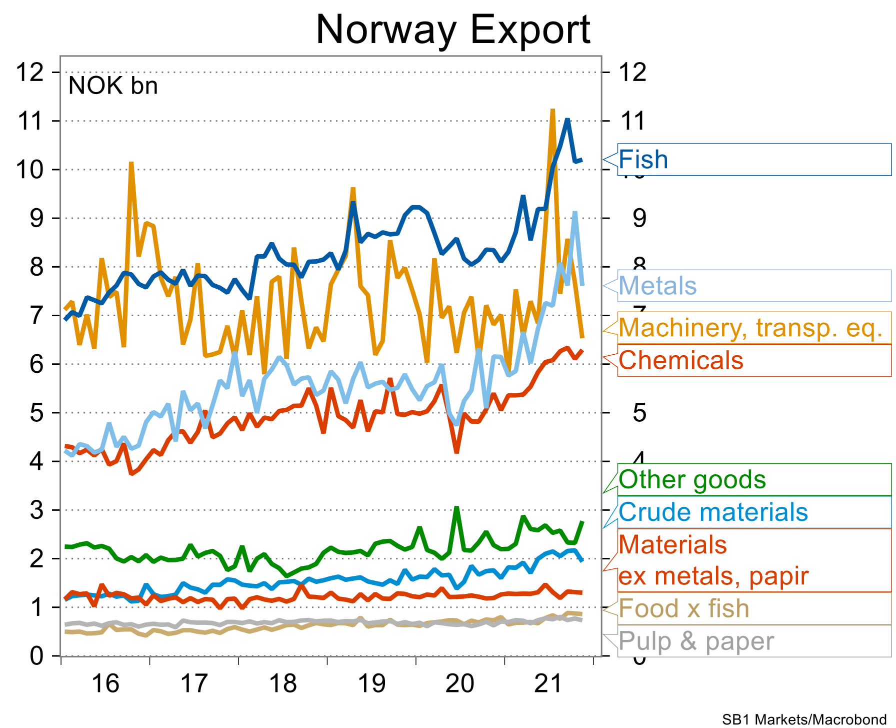


- The spikes in imports of manufactured goods are due to unfinished platforms or ships

Fish exports are surging, metals, chemicals sprinting upwards too

Machinery & transport equipment is underlying on the way up too

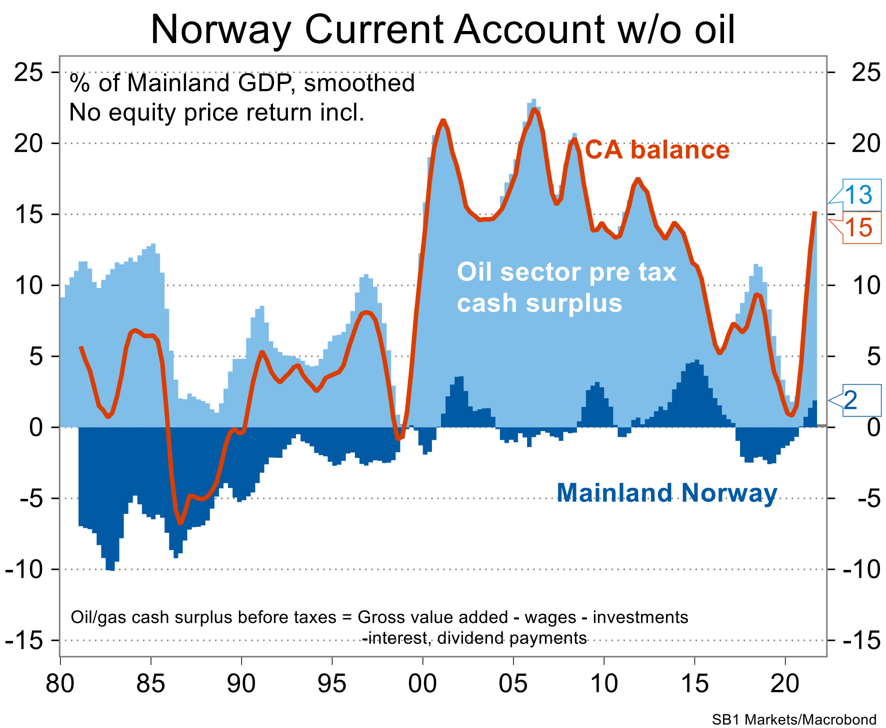


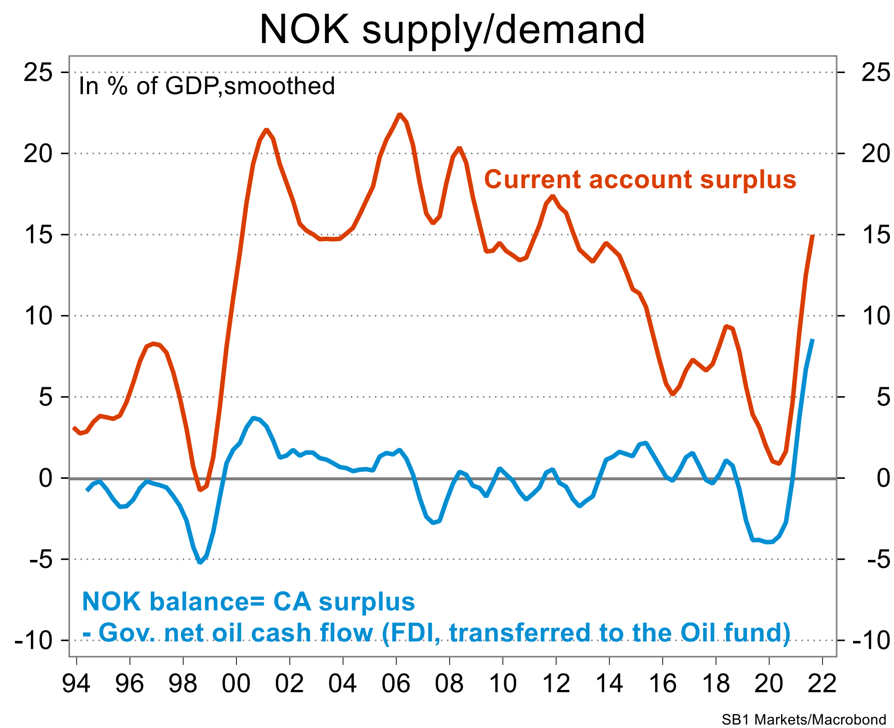


SpareBank 1 MARKETS

Norway is in plus, even the oil and gas sector. How come??

All imports to the oil sector is booked on the Mainland, no deliveries to oil booked as exports



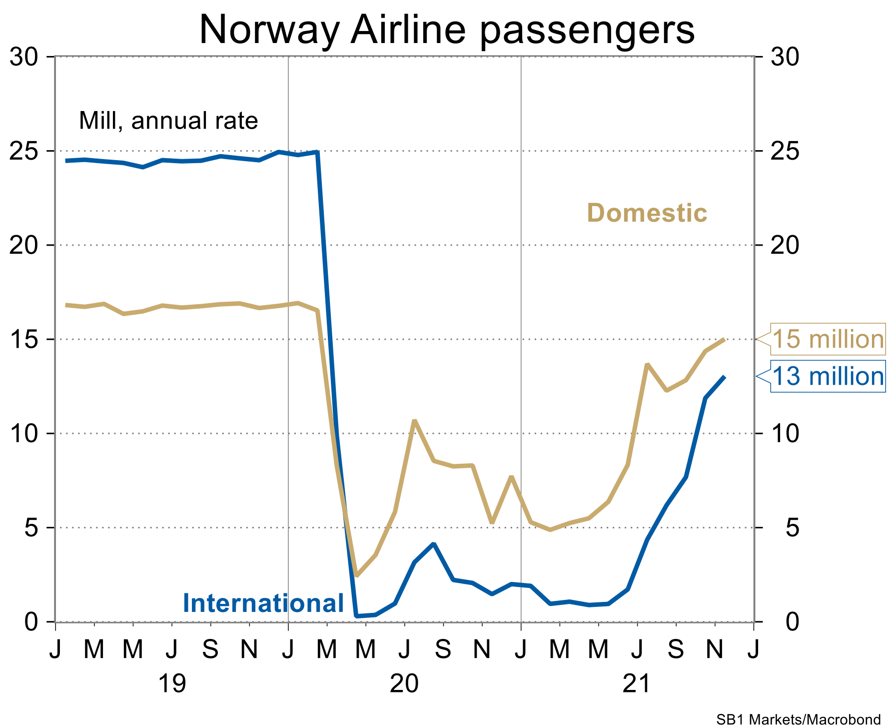


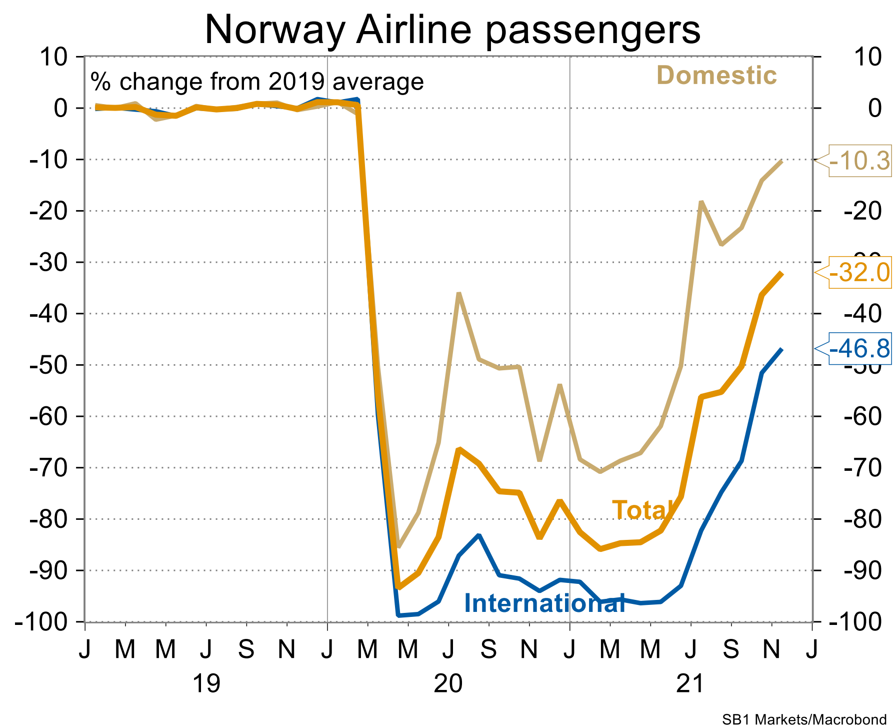
- The pre-tax cash surplus in the oil sector is far smaller than the value of oil and gas exports
  - » The sector has to pay op.ex (including wages), finance its cap.ex (investments) and pay interest rates and pay dividends, to Norway and abroad, in sum almost 10% of Mainland GDP. Investments alone equals some 5% of Mainland GDP
  - » From the other side of the equation: The Mainland trade balance 'charged' for most of the imported goods for use in the oil sector (and all oil related imports if the Mainland balance is defined as total balance – oil and gas exports, like on the previous page). In addition, sales (or 'exports') from Mainland businesses are not credited the Mainland!
- On the chart to the left above, the 'real' ex. oil balance is calculated – and is not that bad
  - » A MAIN CAVIAT: WE ASSUME THAT 'EXPORTS' TO THE OIL SECTOR CAN BE REPLACED 1:1 BY OTHER EXPORTS OR REDUCED IMPORT, if demand from the oil sector is cut down. That is very likely not the case, as companies will not have the same advantage when competing at other markets. In addition, we have not adjusted for reduced exports of oil related equipment to other countries, the rest of the world also decides to 'go green'. Still, this calculus explains the 'real' ex oil balance

SpareBank 1 MARKETS

Airline traffic further up in Nov – domestic just down 10%, international -47%

In total down 32% vs the pre-pandemic level. Now, the outlook is more uncertain again



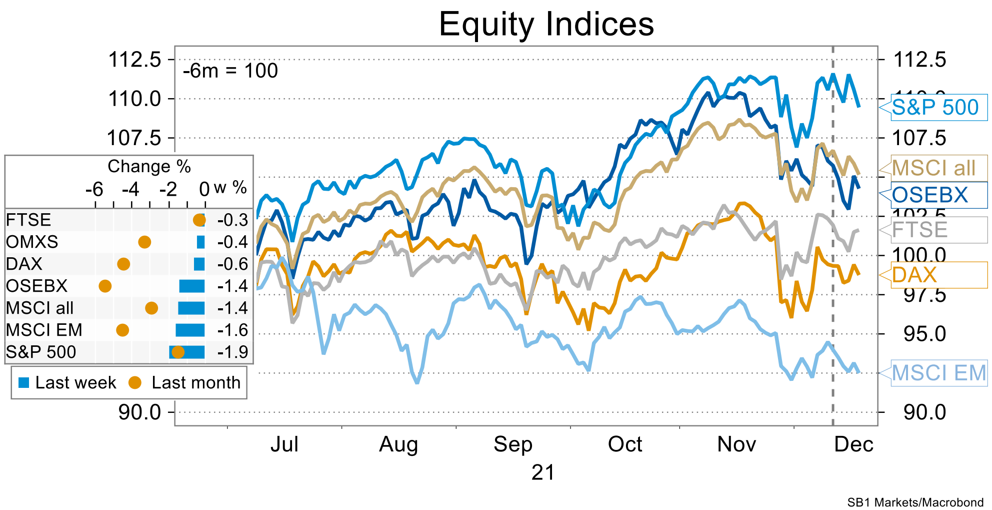


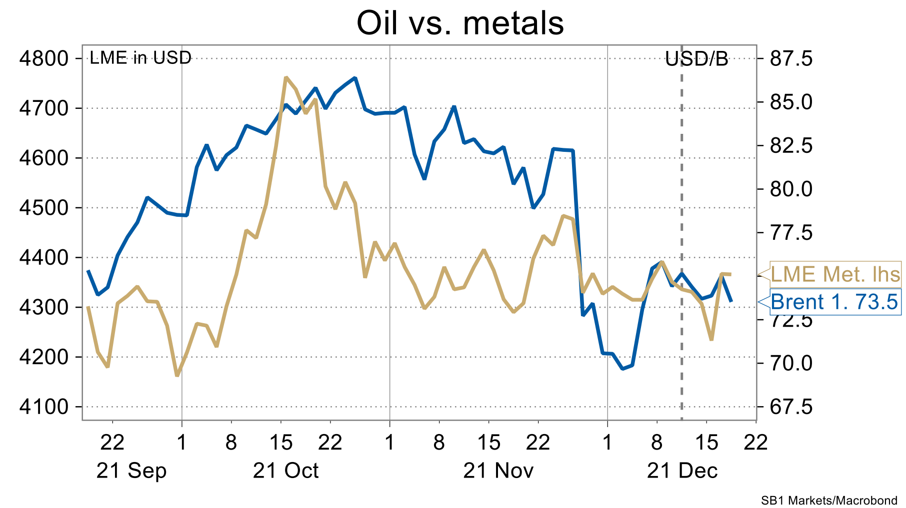
SpareBank 1 MARKETS

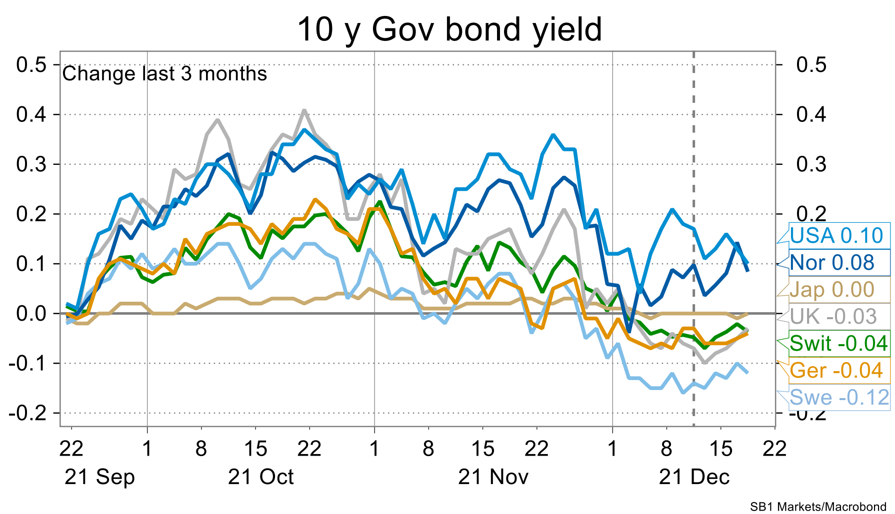
SpareBank 1 MARKETS

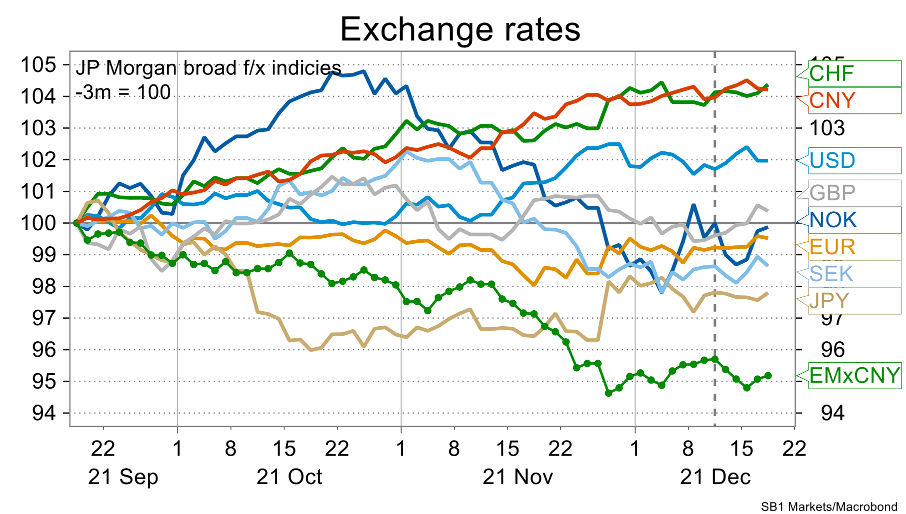
Equities down, bond yields down – and the oil price fell slightly

Central banks formalised their well communicated turnaround, interest rates not up. Still some growth angst?







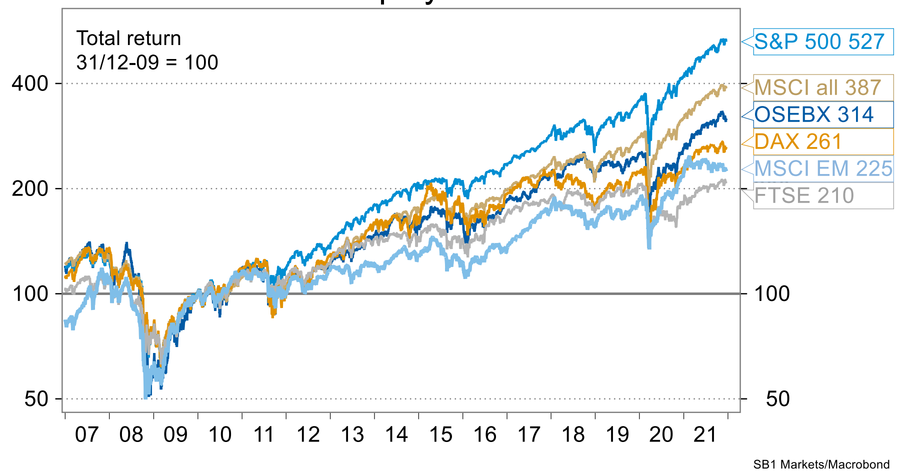


SpareBank 1 MARKETS

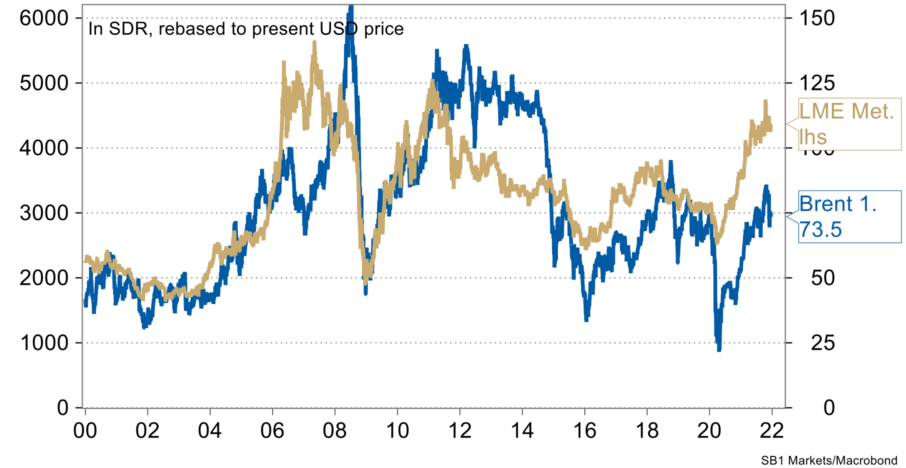
The big picture: Omicron may change everything but most likely not

.. At least not for long. The bull market is still intact – with a substantial medium term downside risk

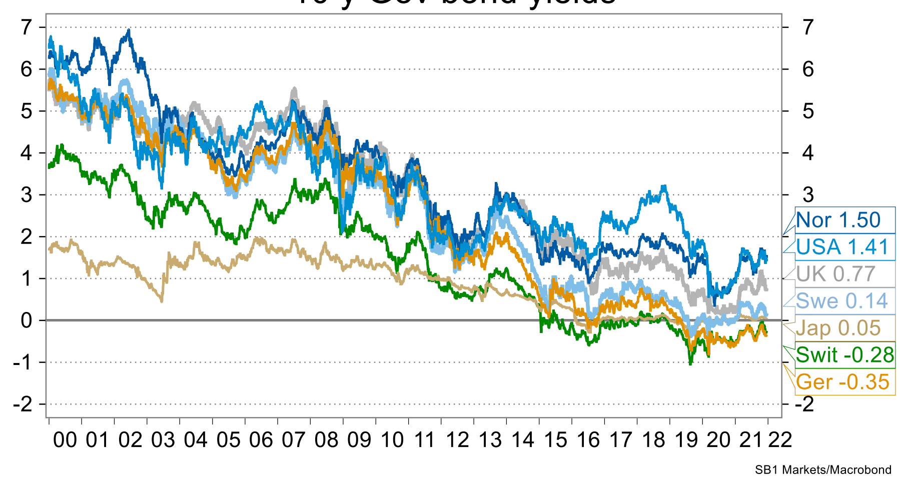
Equity Indices



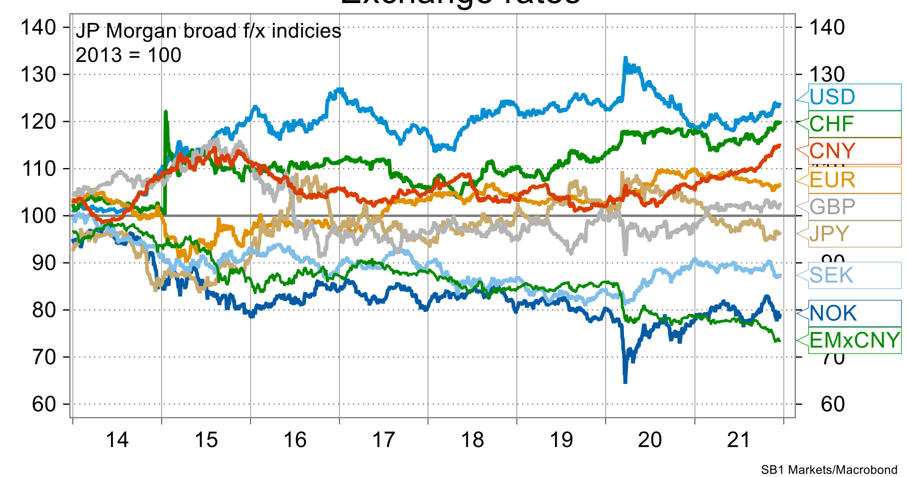
Oil vs. metals



10 y Gov bond yields



Exchange rates

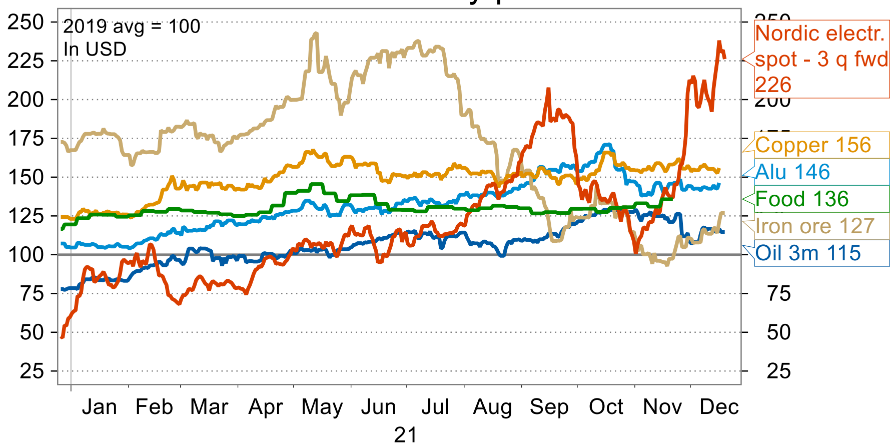


SpareBank 1 MARKETS

Metals have flattened. Iron ore, electricity further up last week

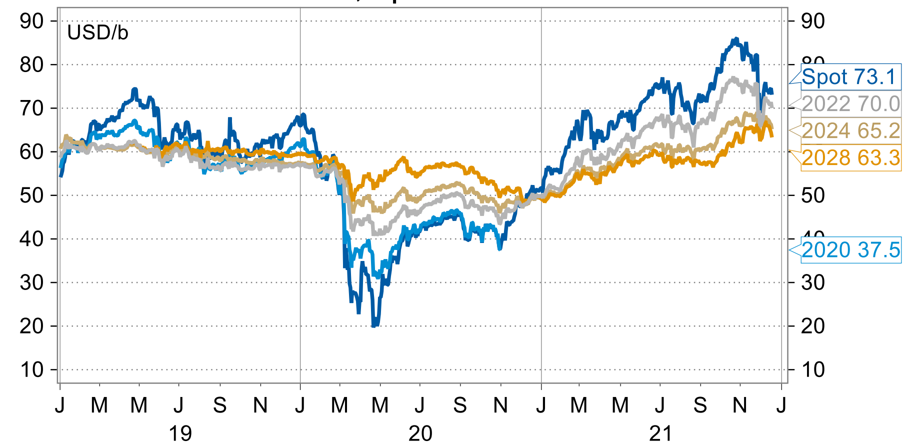
The oil curve fell sharply for last week, for longer dated contracts

Commodity prices



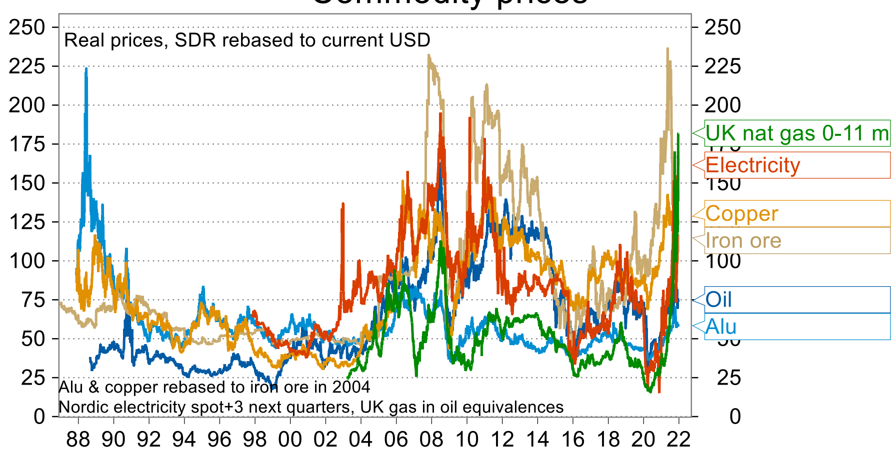
SB1 Markets/Macrobond

Brent oil, spot & Dec contracts



SB1 Markets/Macrobond

Commodity prices

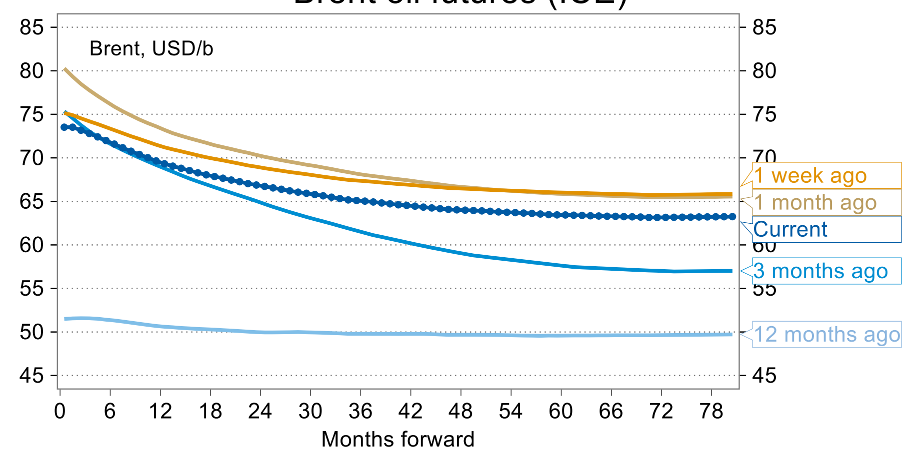


SB1 Markets/Macrobond

Longer dated oil contracts are heading down

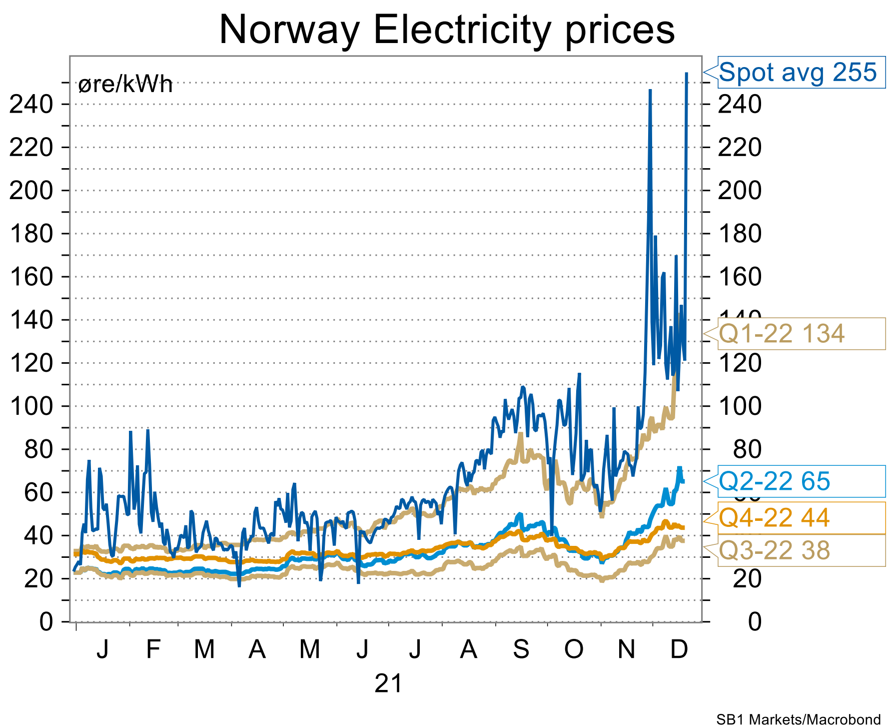
The short end of the curve sharply up recent weeks

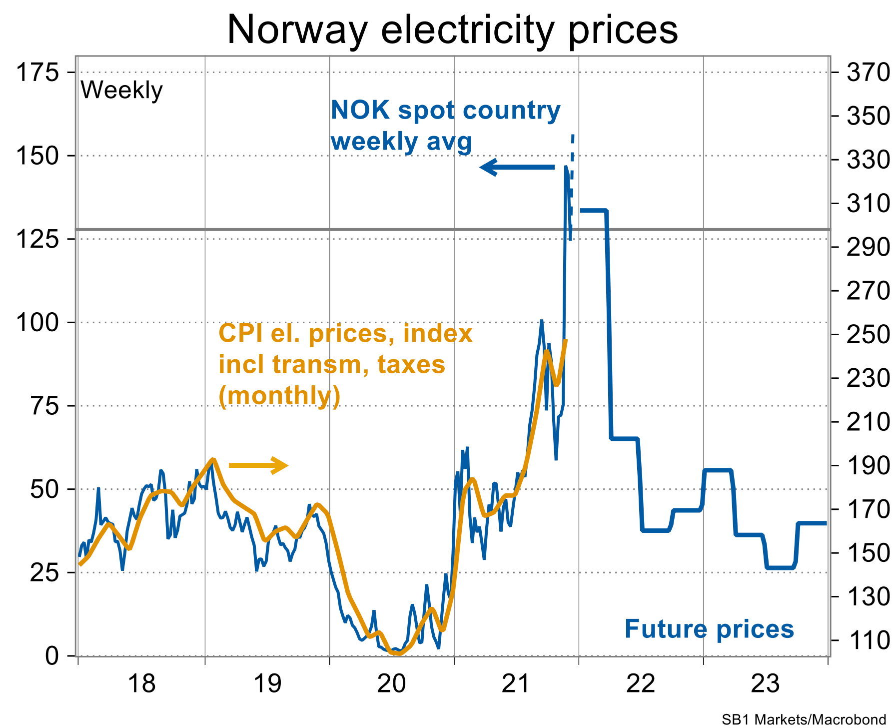
Brent oil futures (ICE)



SB1 Markets/Macrobond

Norwegian spot prices up to ATH today, and the Q1 contract surges, +40% last w.

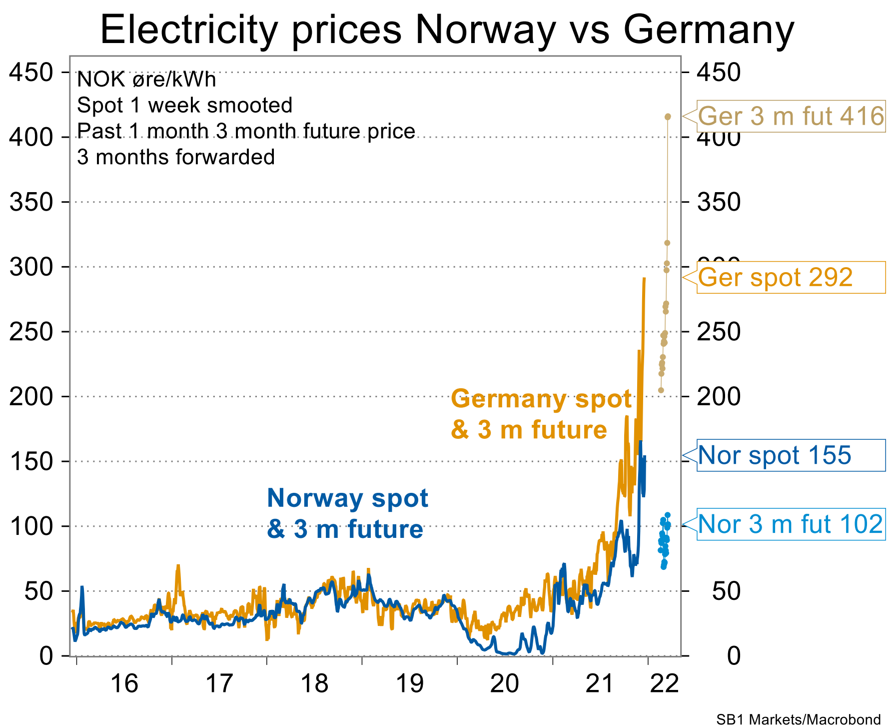


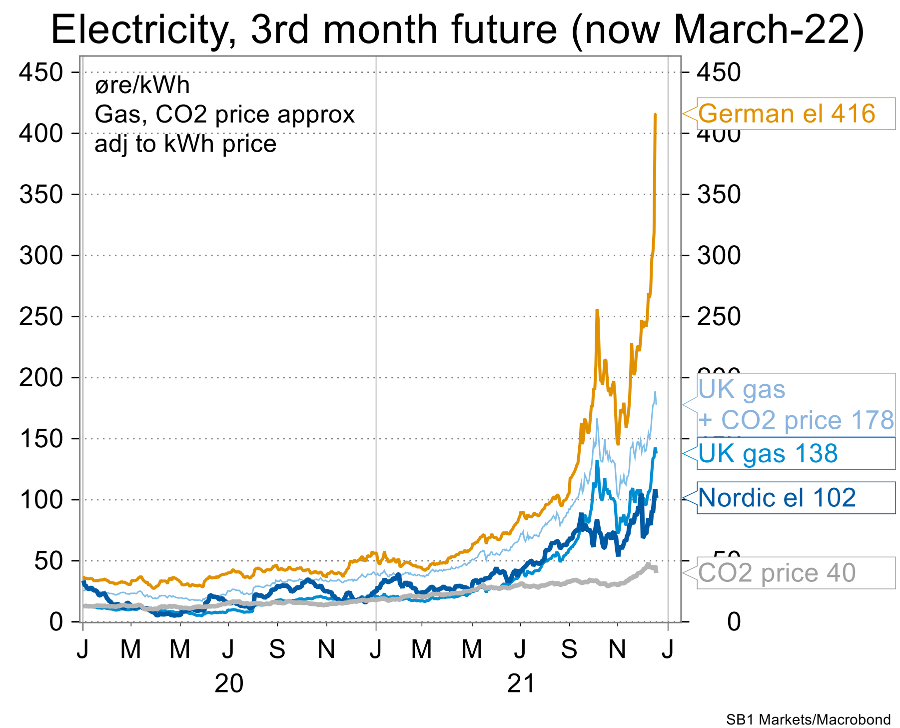


SpareBank 1 MARKETS

Fear of even less Russian gas pushes European gas, electricity prices sharply up

The gap between Nordic and German future prices have become extremely large

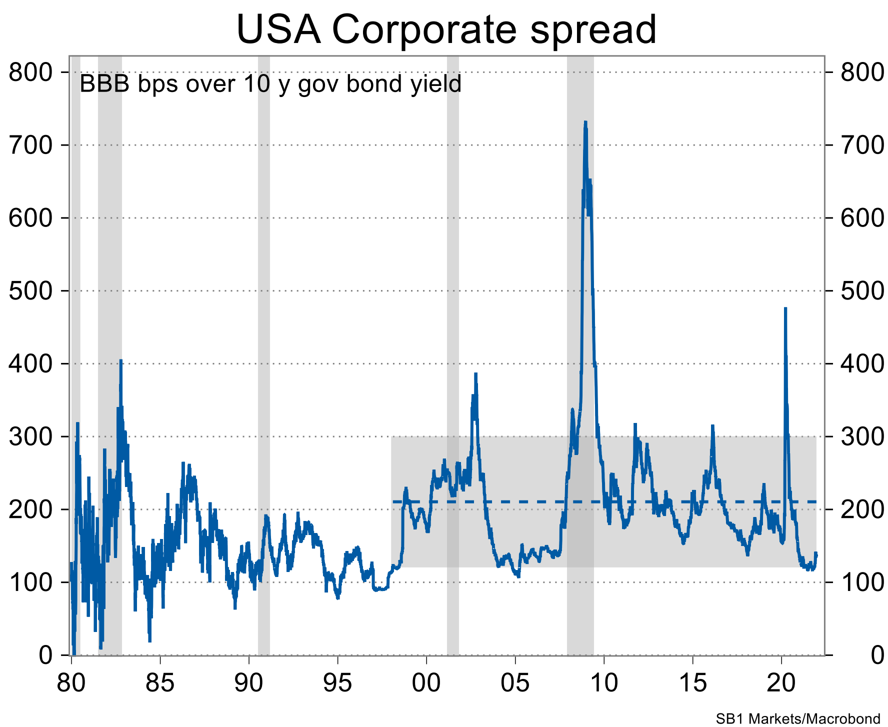


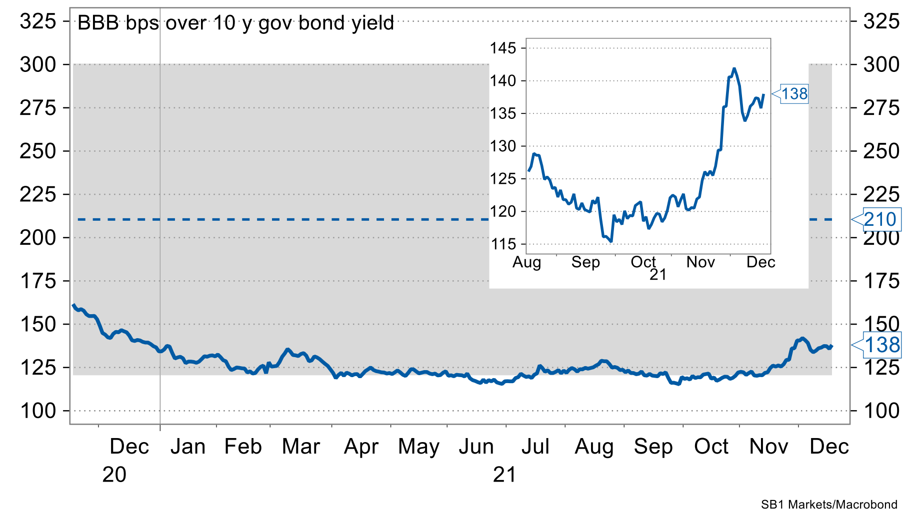


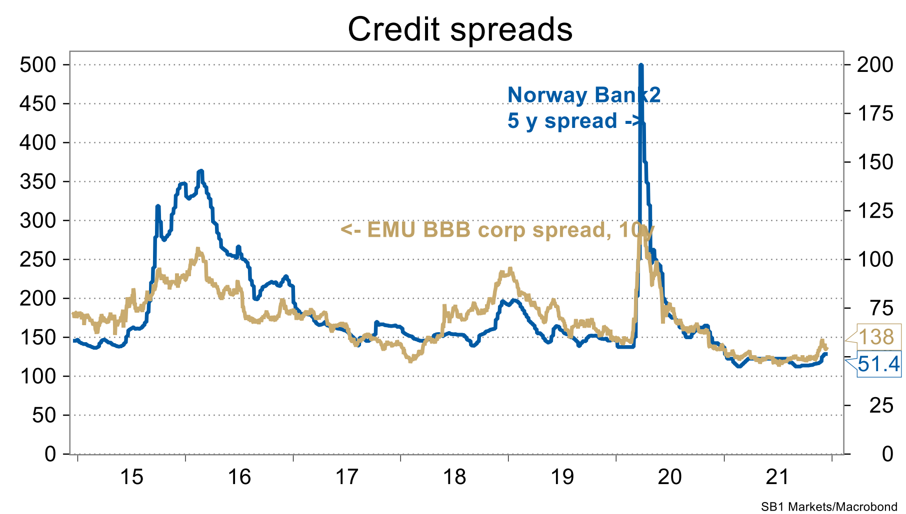
- Perhaps you should ask for an offer for a term contract from your electricity vendor
- Carbon quota prices fell slightly last week but remains high

Credit spreads abroad slightly up last week but not much up from the bottom

Norwegian bond spreads marginally up recent weeks







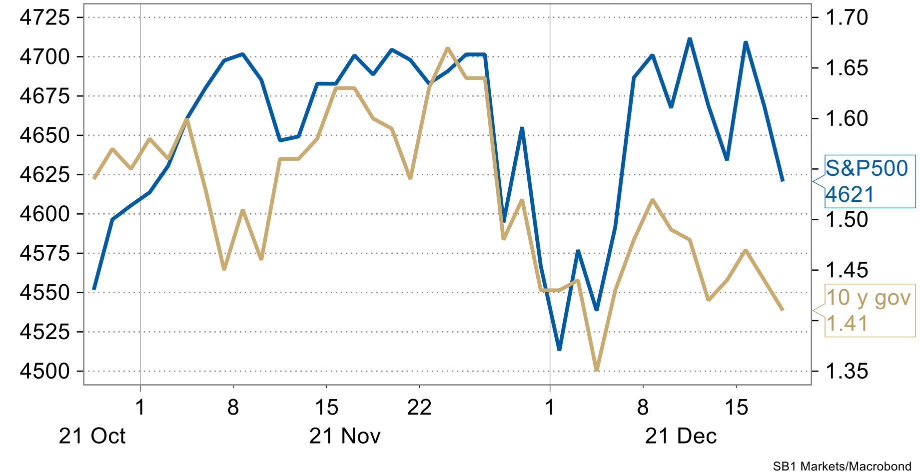
SpareBank 1 MARKETS

Some doubt, S&P500 down 1.9%, the 10y bond yield down 7 bp to 1.41%

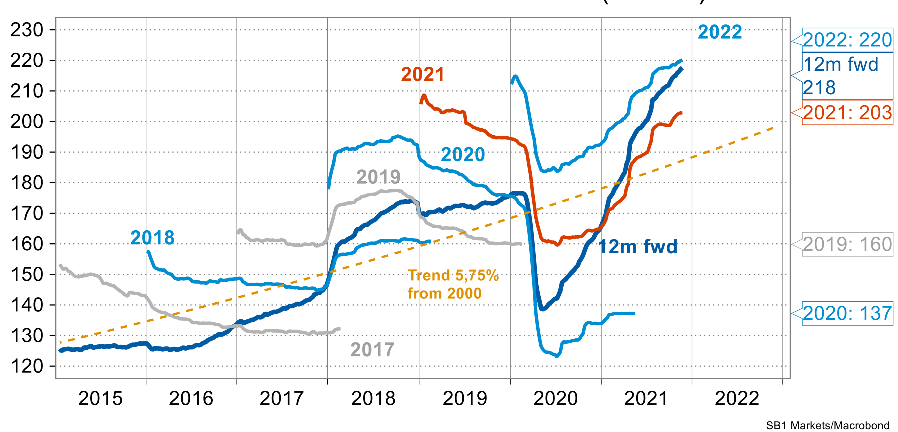
… as Fed formalised the policy turnaround. But Americans also suddenly recognised the Omicron virus

USA S&P 500 vs. bond yields

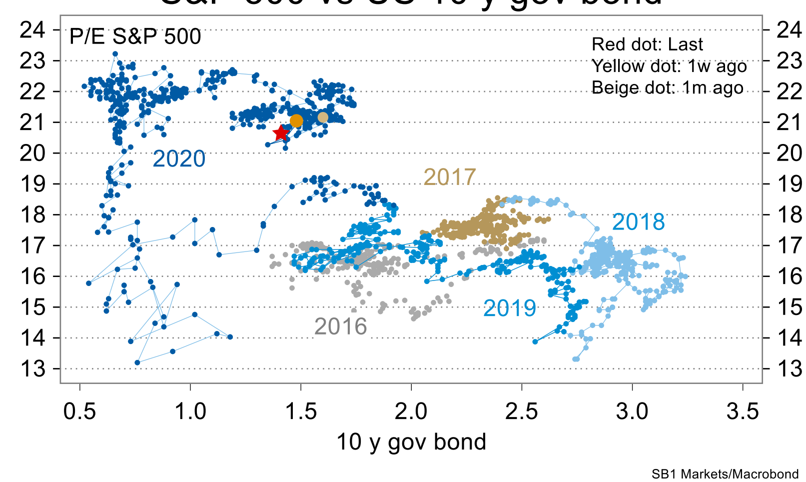
USA S&P 500 vs. bond yields



Annual S&P 500 EPS consensus (Factset)

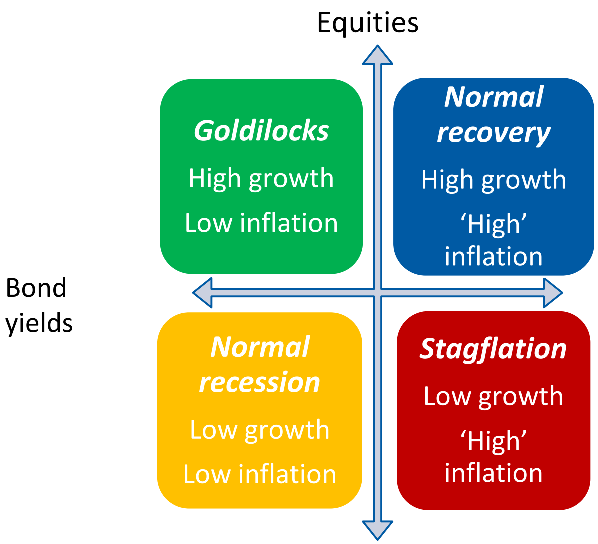


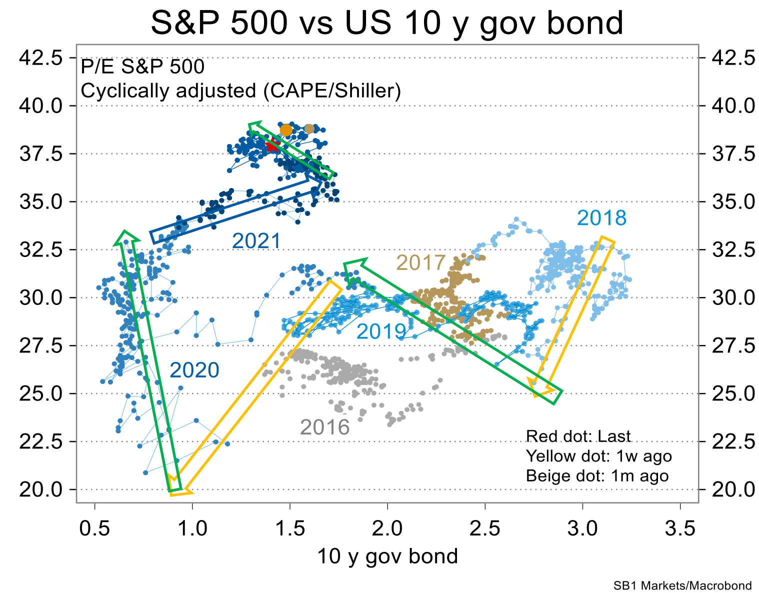
S&P 500 vs US 10 y gov bond



Still well inside the 'Goldilocks corner'!

Wage/price inflation dynamics will in the end decide. And not the Fed… Nor the virus



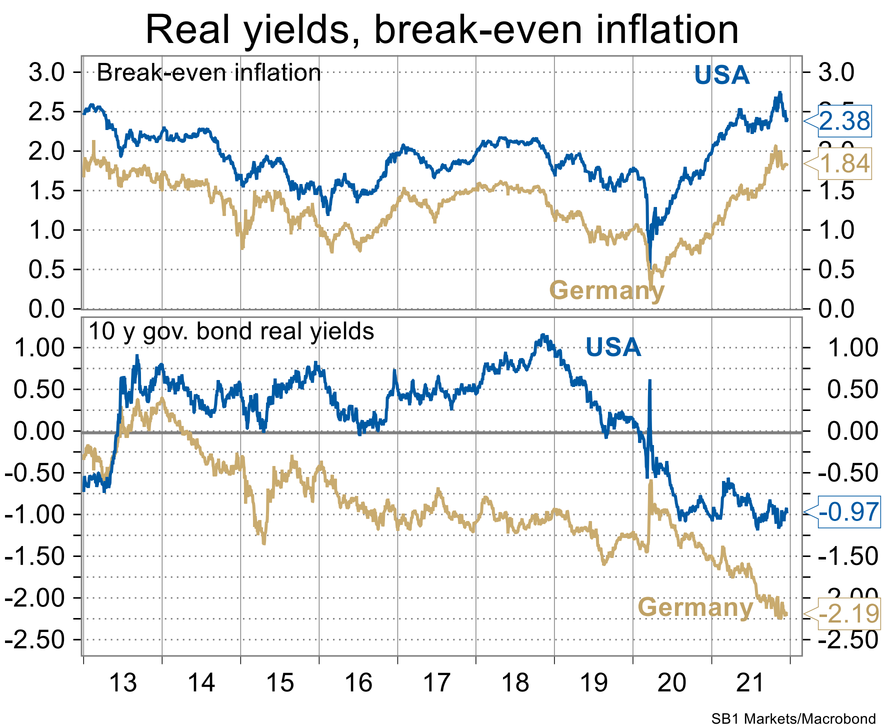


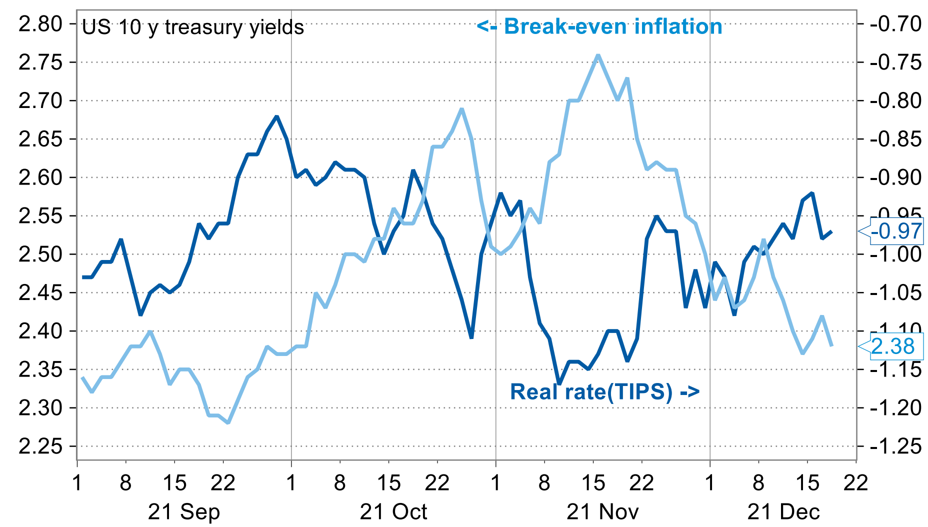
- Usually, we have associated drifts towards the 'green corner' - low inflation and solid growth at the same time - as a temporary sweet spot for markets
  - » Interest rates have climbed 100 bp+, and stock valuations have kept up or climbed (like the Shiller PE). Still, we deem the current yield level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

SpareBank 1 MARKETS

US inflation expectations are sliding down. No change in the TIPS rate laste week

However, real rates have climbed somewhat since mid Nov. Small changes in Germany last week





US & Germany 10 y Gov bond yield

	Yield	Change 1w	Change 1m	Min since April-20
USA nominal treasury	1.41	-0.07	-0.19	0.52
.. break-even inflation	2.38	-0.06	-0.32	1.06
.. TIPS real rate	-0.97	-0.01	0.13	-1.19
Germany nominal bund	-0.35	-0.01	-0.10	-0.65
.. break-even inflation	1.84	0.01	-0.17	0.40
.. real rate	-2.19	-0.02	0.07	-2.26

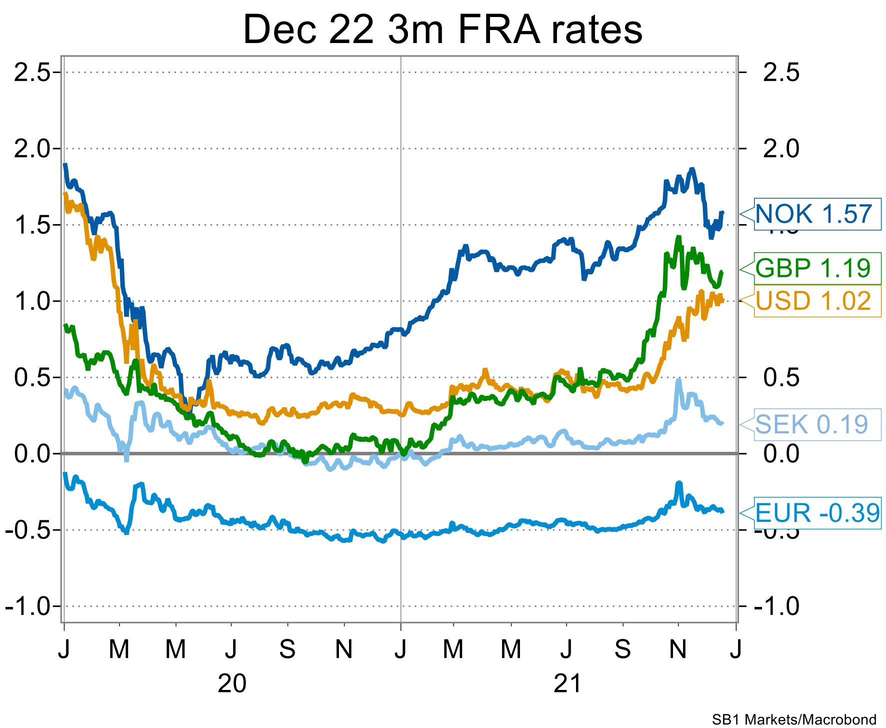
SB1 Markets/Macrobond

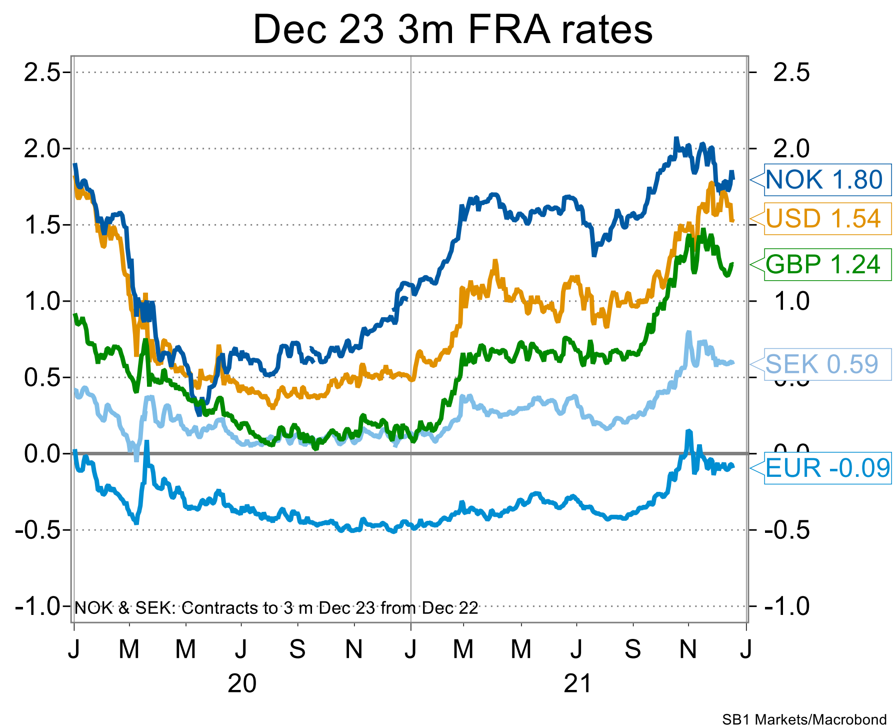
- Long term inflation expectations, 5y 5y fwd break-evens have fallen to 2.11%, from 2.4% at the peak

SpareBank 1 MARKETS

FRAs: Sharply up in GBP and NOK. 2023 expectations are falling in the US

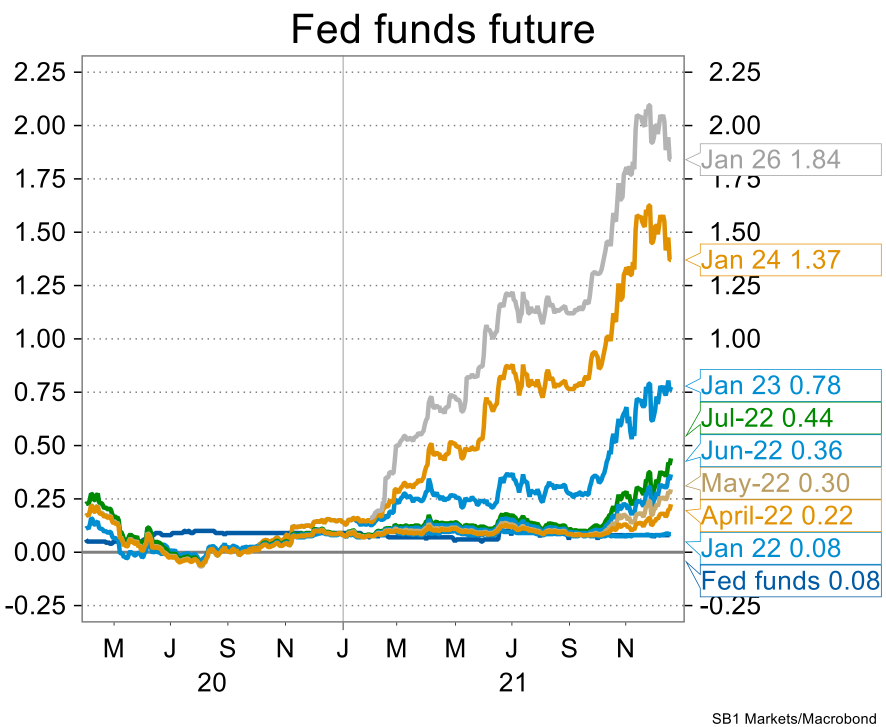
The market prices 4 x 25 bps in UK before end of next year. 3 more hikes in Norway

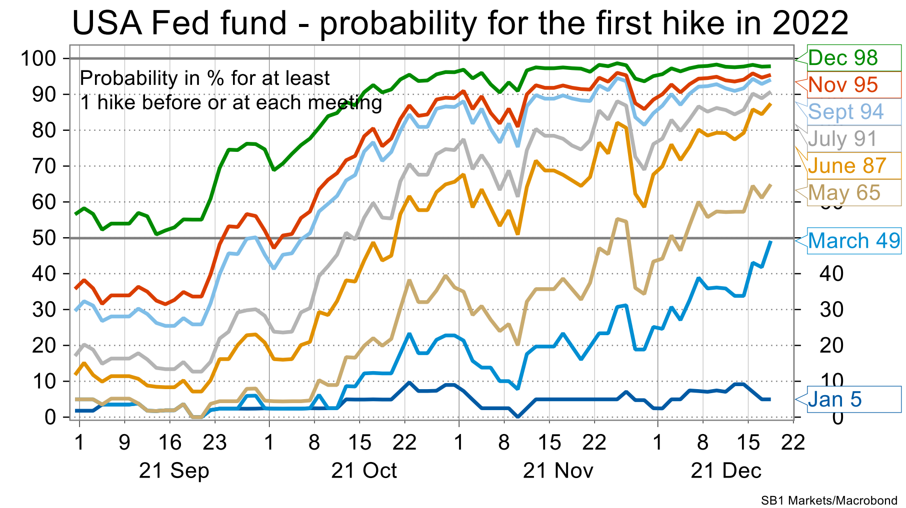


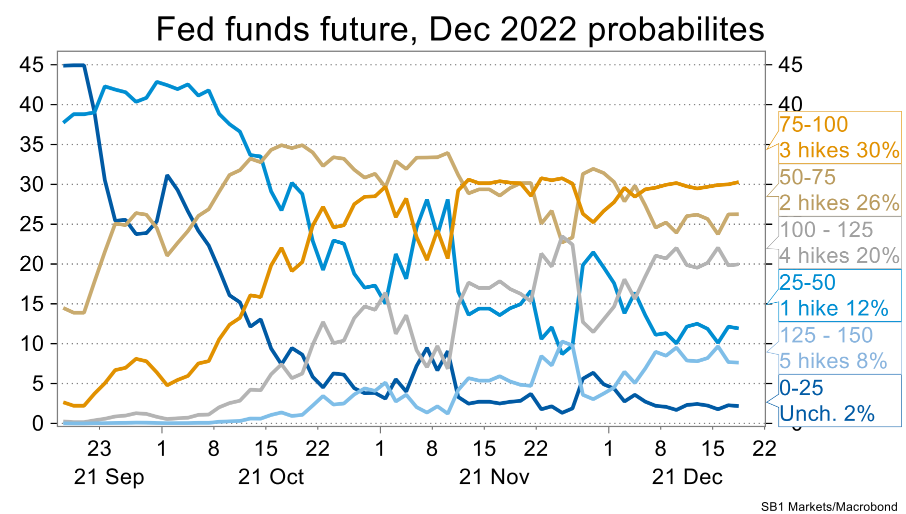


A 49% prob. for a March hike? Why not. A hike before the summer a done deal

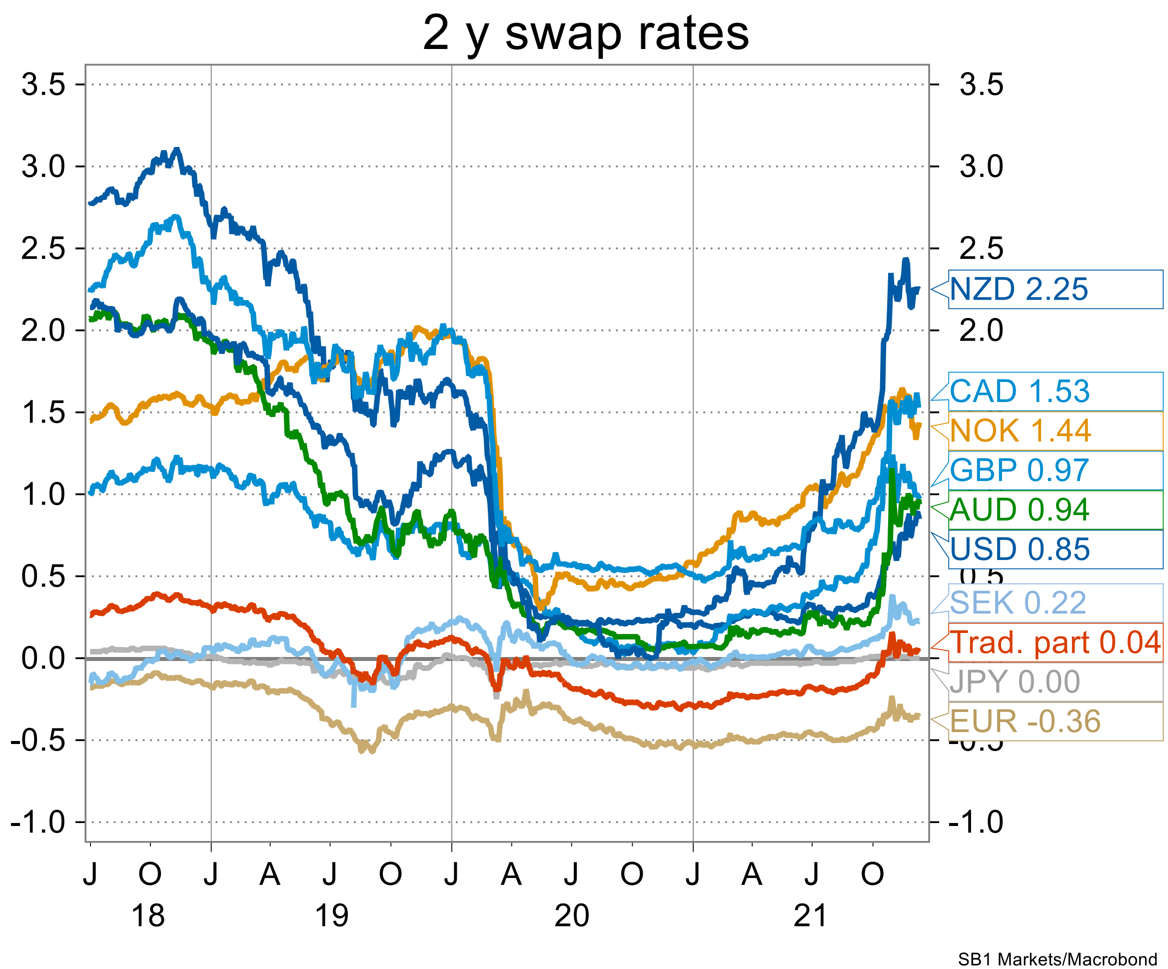
However, further out, US interest rate expectations are falling sharply!

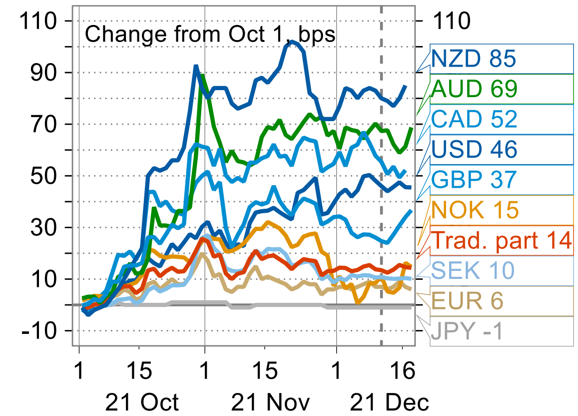


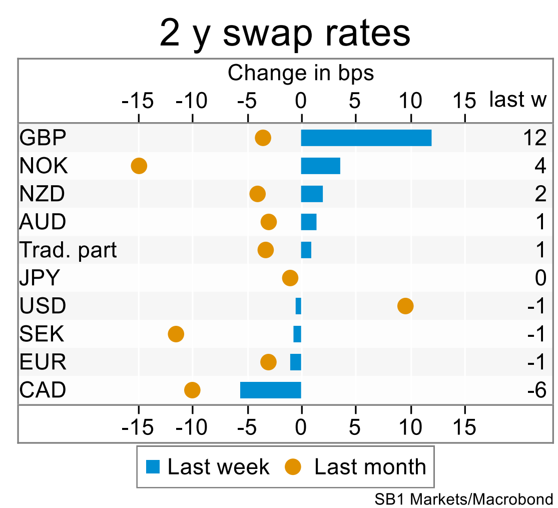




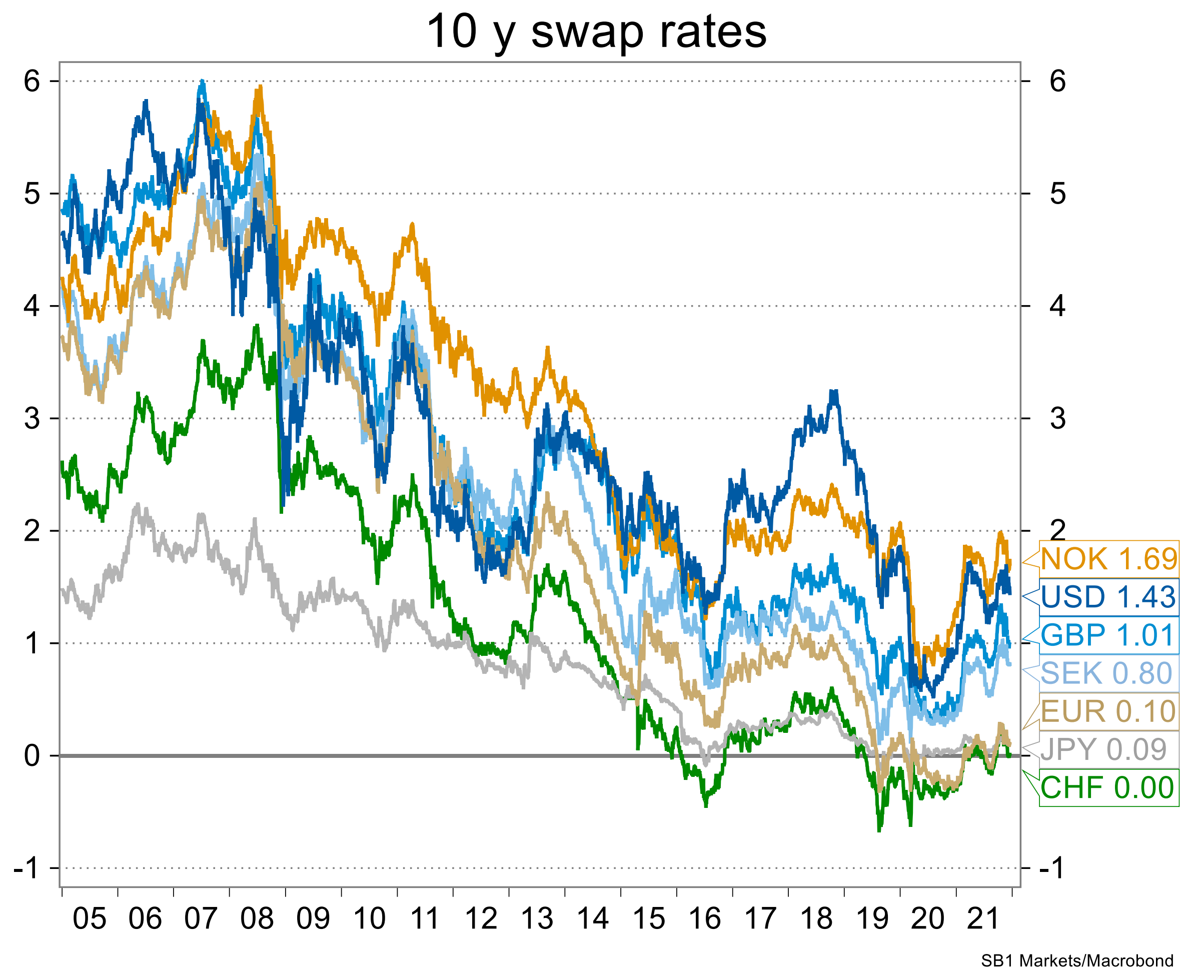
Mixed in the short end

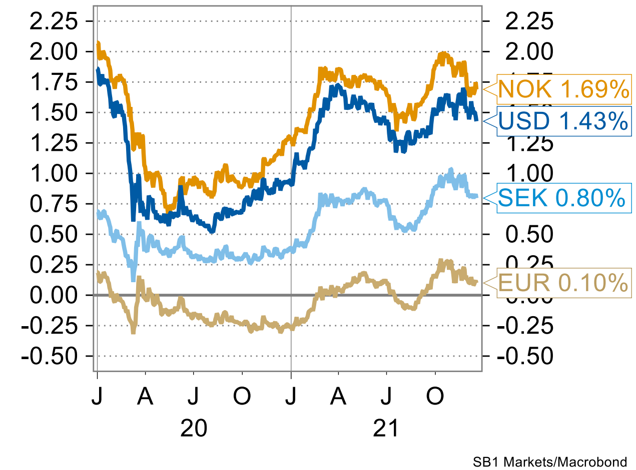


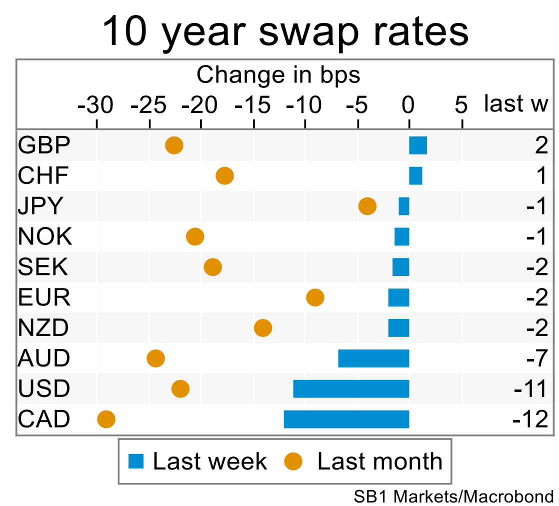




The long end further down, even if central banks are removing stimulus

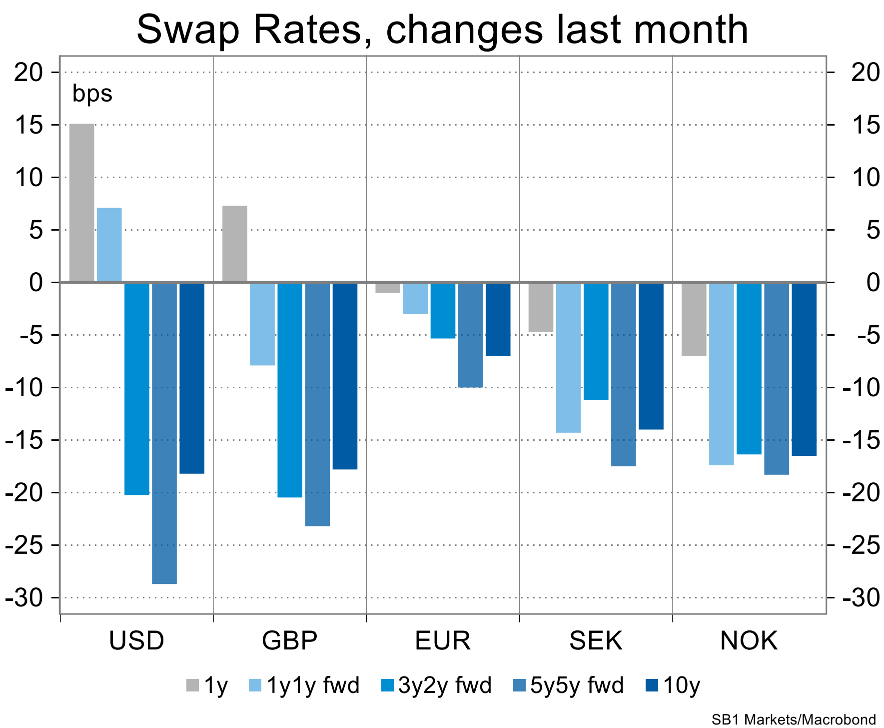


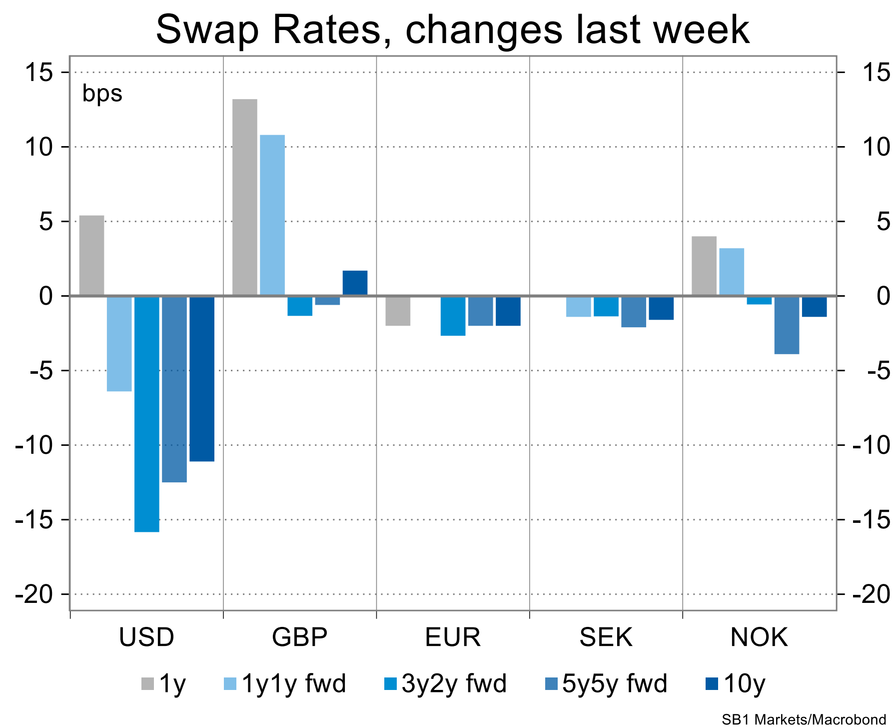




The short end up in USD, GBP and NOK, the most in UK, supported by central b.

The surprise was the largest in UK. The long end down, especially in US. EUR, SEK rates close to unch

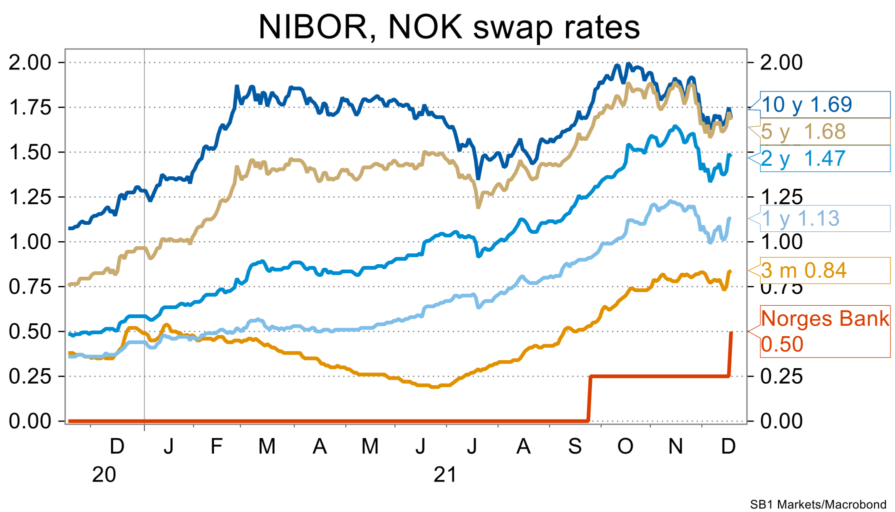


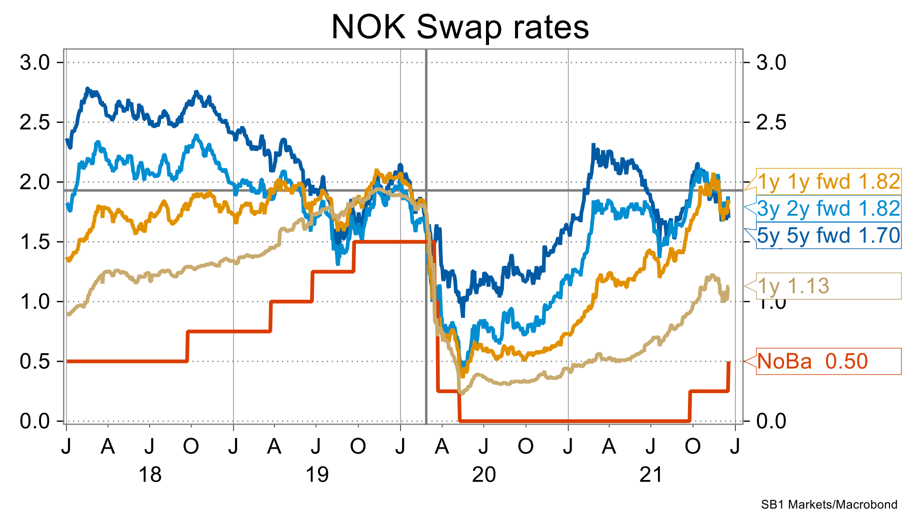


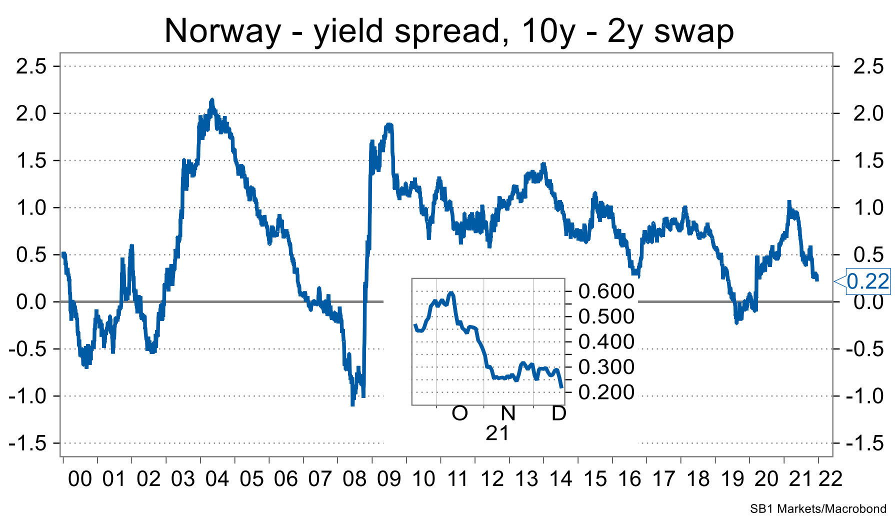
- In the US, just the 1y swap rate rose, while the 2y rate fell – and the 1y 1y fwd declined by 7 bp. And the 3y 2y fwd fell by 16 bps!! The rest of the curve yielded too
  - » Fear of excessive tightening – and a recession. Without any large tightening discounted in the market?

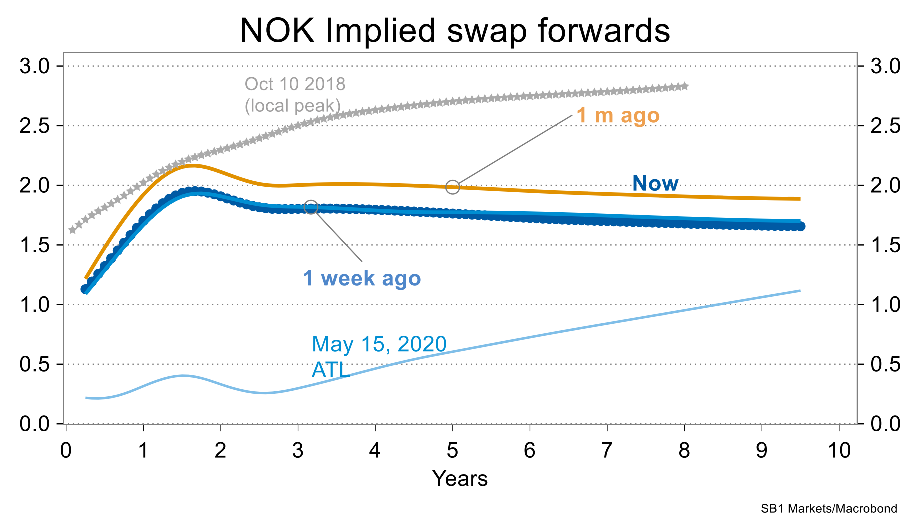
NOK swaps

The short end of the curve up to 10 bps, the long end down



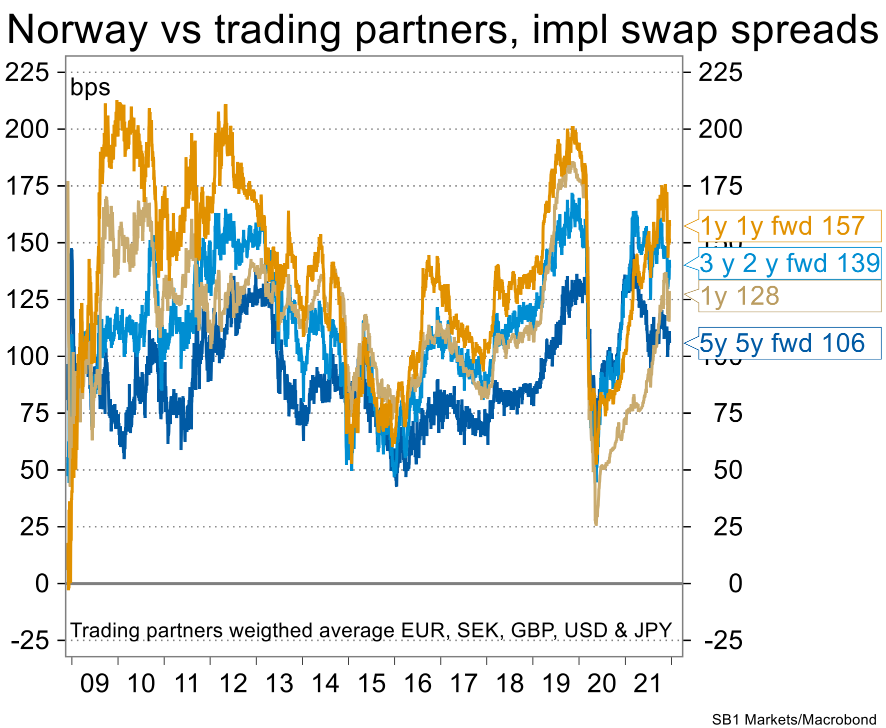


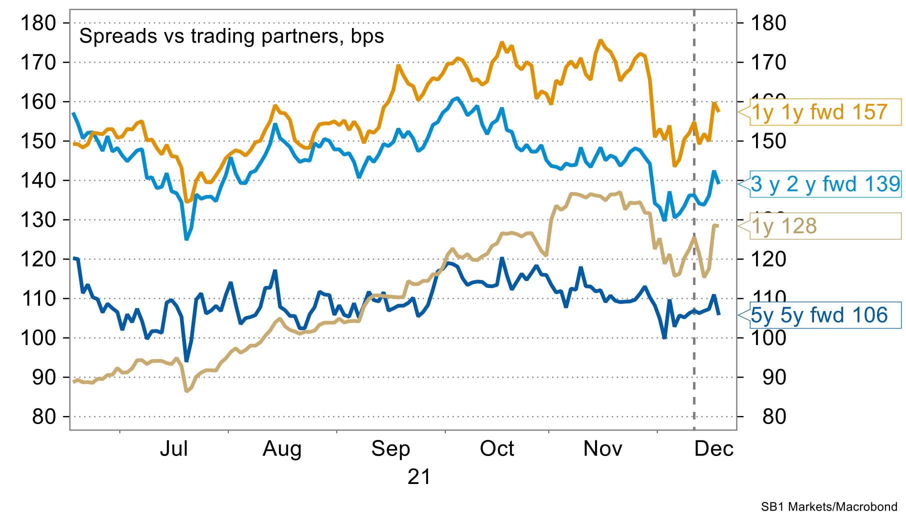


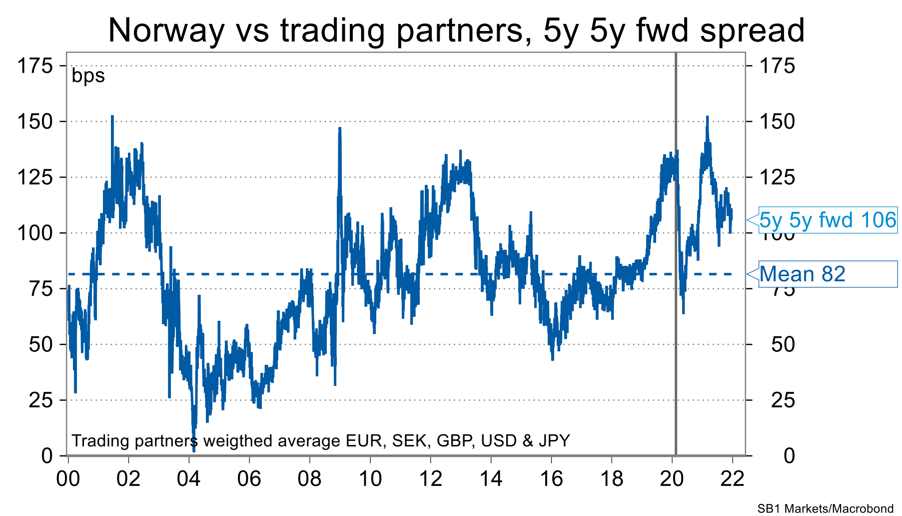


NoBa's hawkish message lifted the spread vs trading partners, at least out to 5y

The 5y 5y spread was unch – at a level well above the historical average



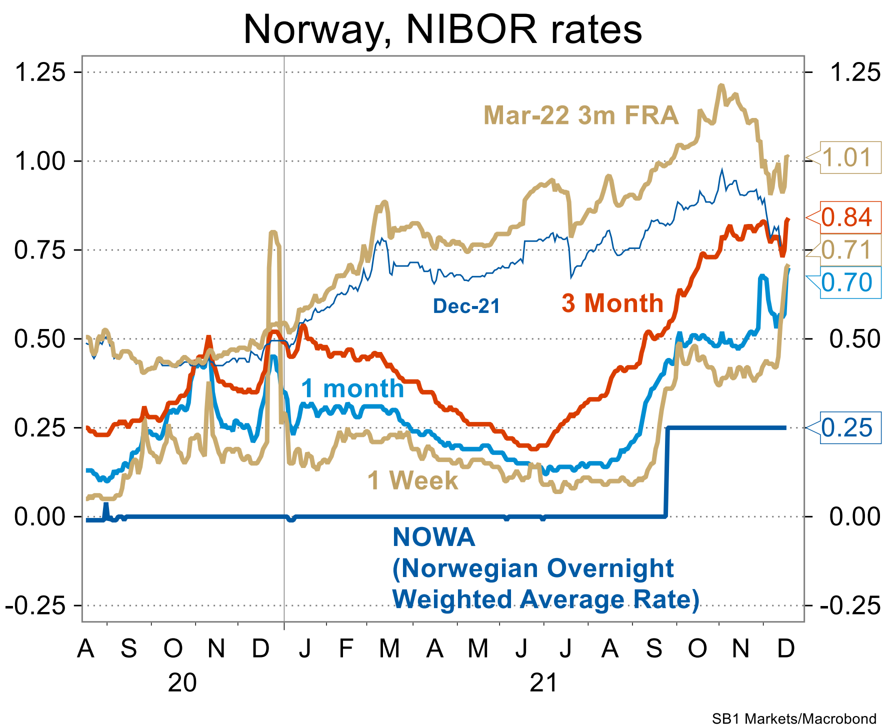


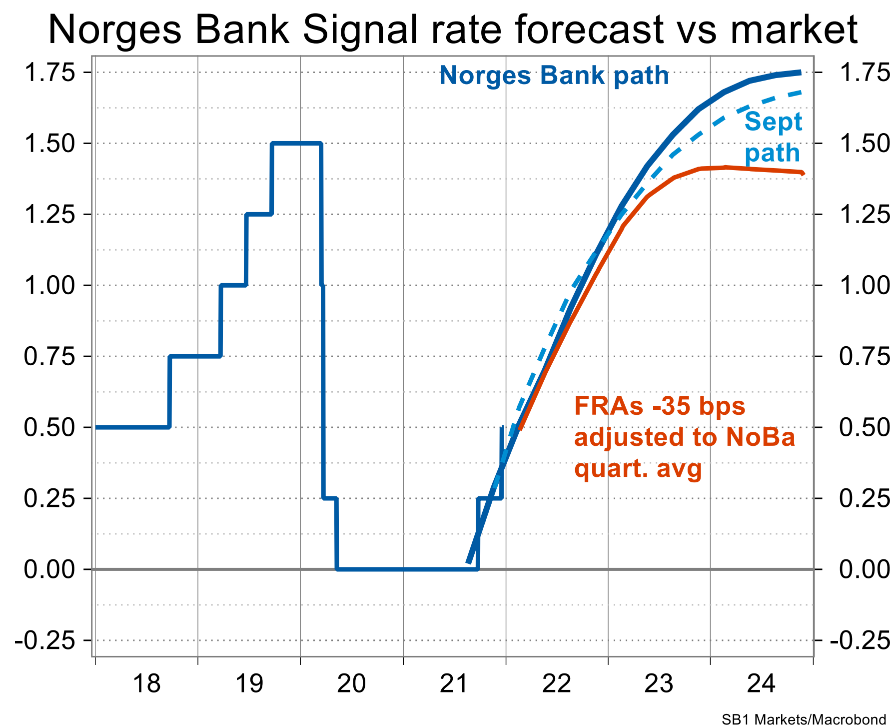


SpareBank 1 MARKETS

Norges Bank surprised us (in the very short end), and the market

Now, the market assumes a 70% probability for a hike in March, the Bank signalled 75%



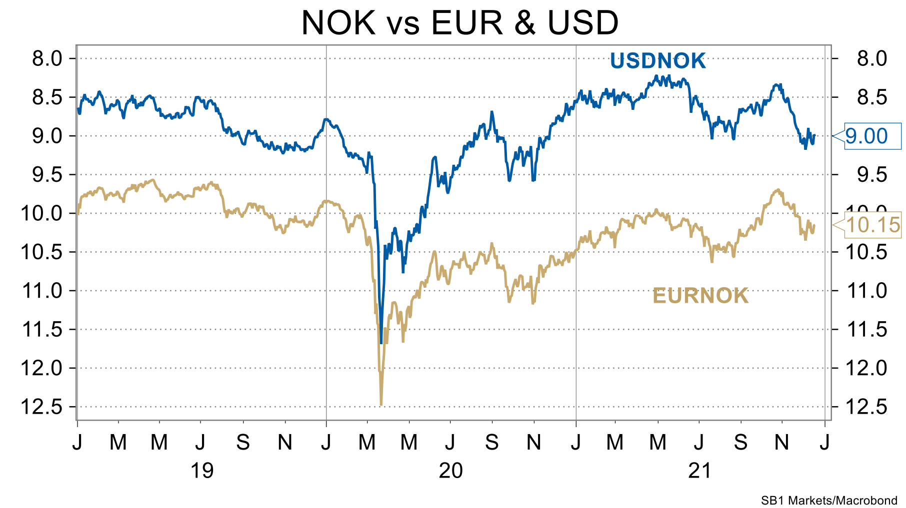


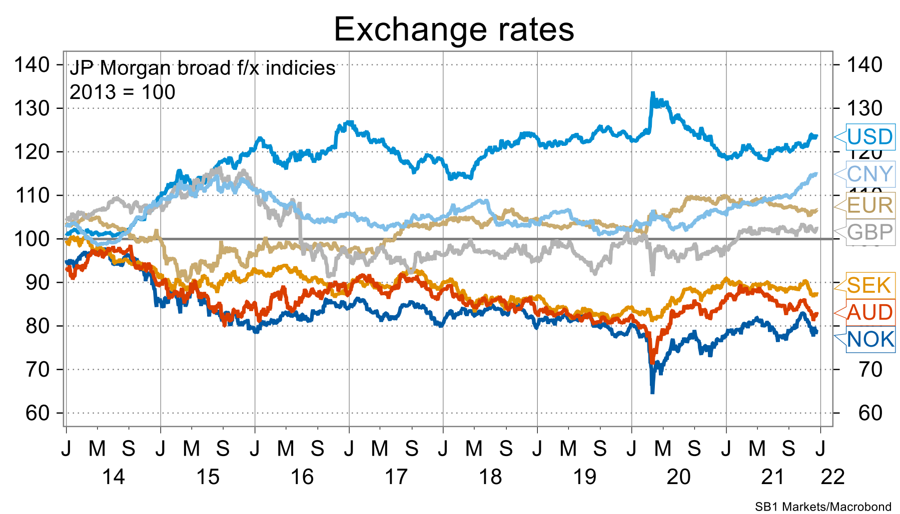
- The **3 m NIBOR** gained 9 bps to 0.83% at Thursday (and another bp at Friday) as Norges Bank decided to lift the signal rate in December, and not wait until January (in order to evaluate the impact of Delta/Omicron). Probably a wise decision
- We assumed the **NIBOR spread** was approx. 40 bps before the probability for a NoBa hike waned a during the two weeks before the meeting
- Now the NIBOR spread is 34 bps (given no NoBa change the coming 3 months, a rather bankers estimate. We round the spread up to 35 bps
- The **March-22 3 m** contract at 1.01% and a 35 bps NIBOR spread implies a 0.66% NoBa policy rate from mid March. If NoBa hikes March 24, the average NoBa rate will be 0.73% in the March FRA period. Thus the markets assumes a 70% probability for a March hike
- NoBa estimate a 0.70% average policy rate in Q2. Given the June meeting 1 week before the end of Q2, we assume NoBa has put a 75% probability for a March hike, close to the market estimate. Further out, the FRAs are slightly below NoBa's path, but no more than 7 bp by the end of 2022

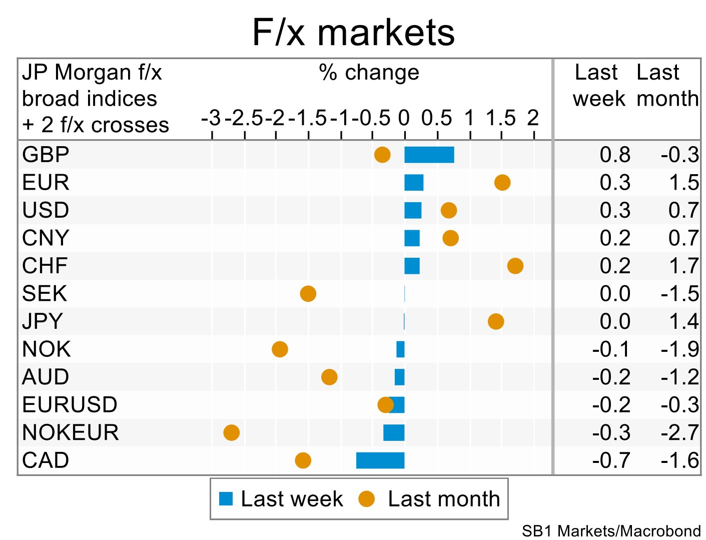
SpareBank 1 MARKETS

BoE's hike supported the GBP somewhat

The CNY continues upwards, to a record strong level. EUR & USD also up last week/month



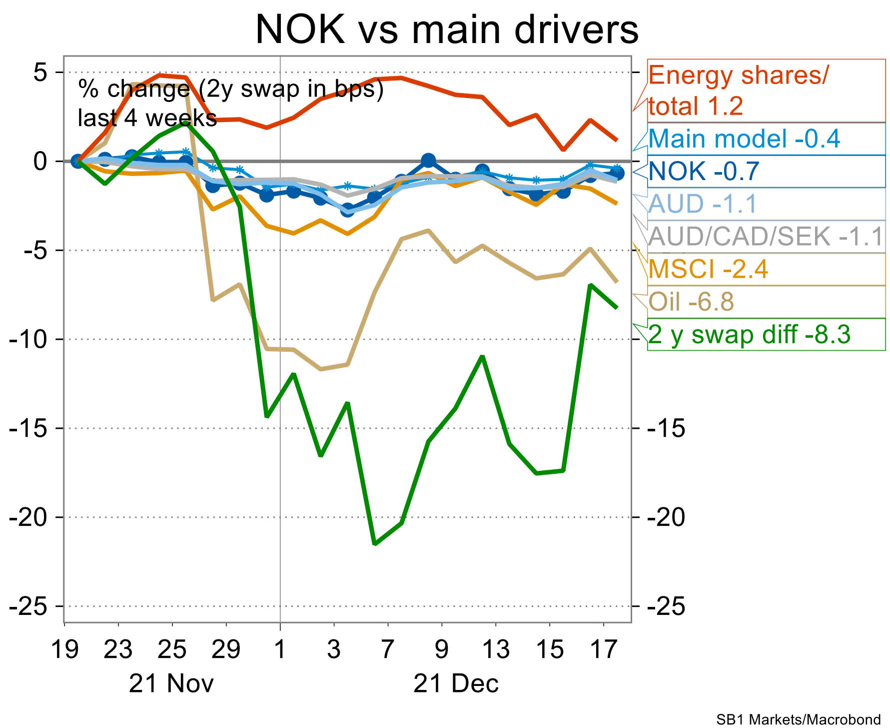


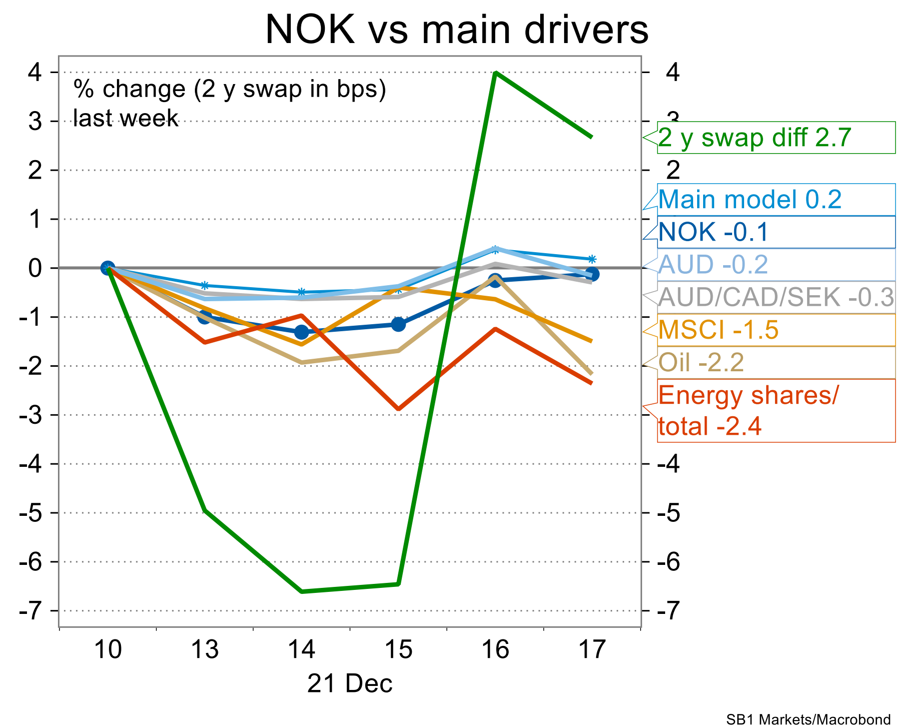


SpareBank 1 MARKETS

NOK unch, perhaps supported by Norges Bank's hike (but AUD unch too)

The oil prices fell slightly. Our model suggested a marginal gain



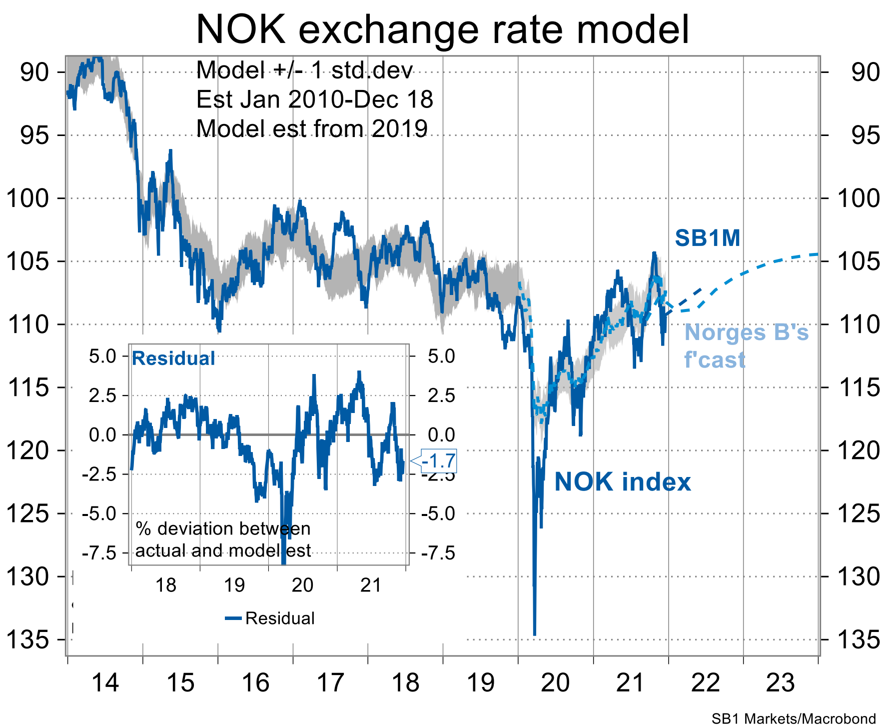


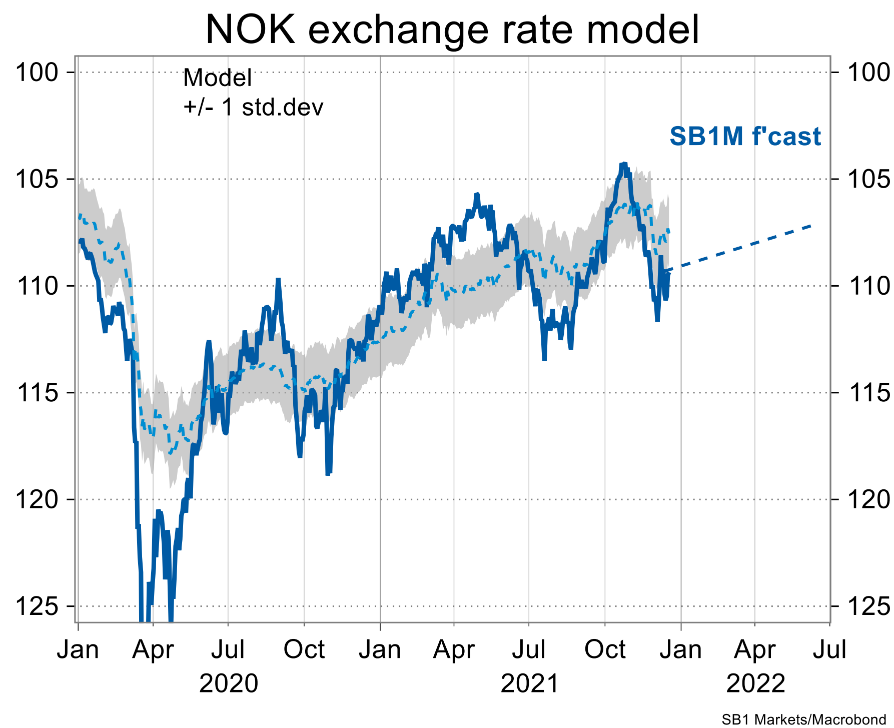
The status vs. the normal drivers:

- ***The NOK depreciated 0.1%, our model estimated (+0.2%). The level less then 2% below the model est (unch)***
- The NOK is 6% <u>weaker</u> than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts (unch)
- NOK is far (9%) <u>stronger</u> than a model which includes global energy companies equity prices (vs the global stock market) (from 8%)

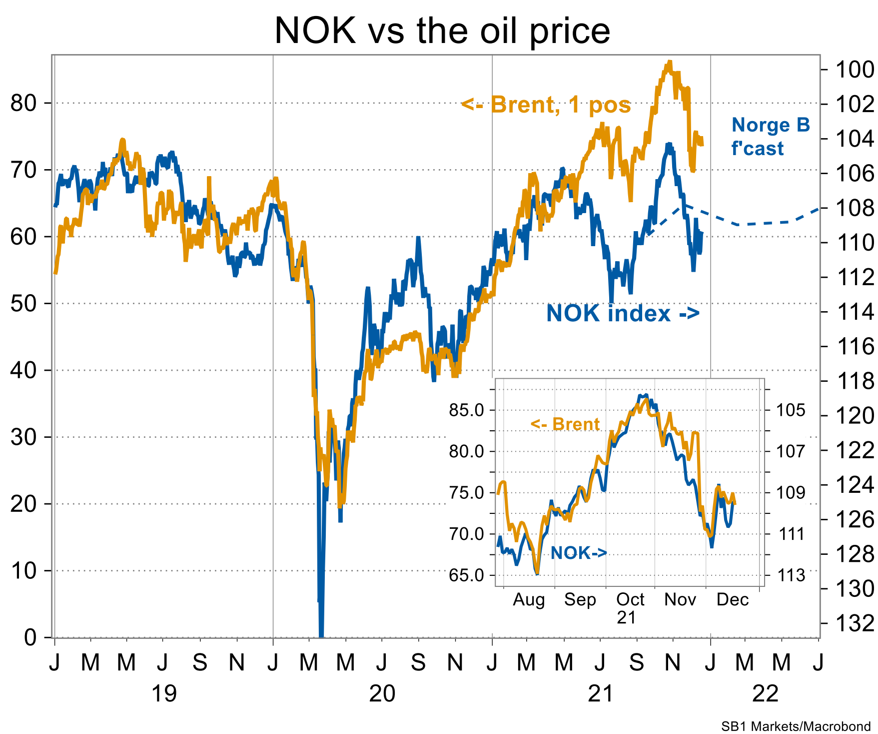
At this and the following pages we have swapped Norges Bank's I44 index for JP Morgan's broad NOK index and rebased it to the current index value for the I44. The I44 has an earlier closing time than the 'official' closing time for f/x crosses. There are no substantial difference between these two indices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

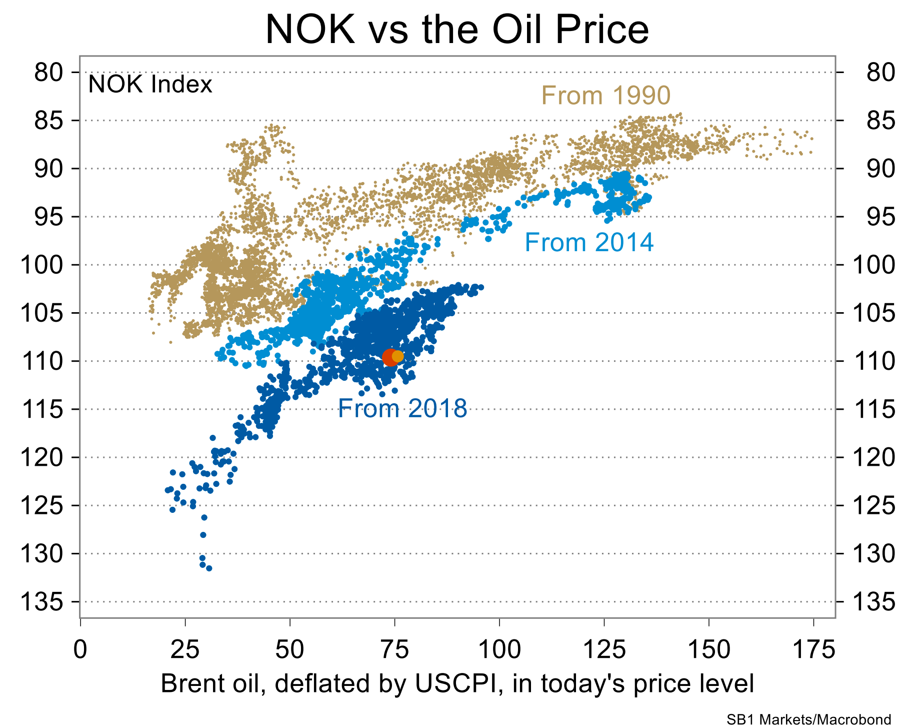
NOK less than 2% below our model estimate





NOK, oil close to unch Friday - Friday

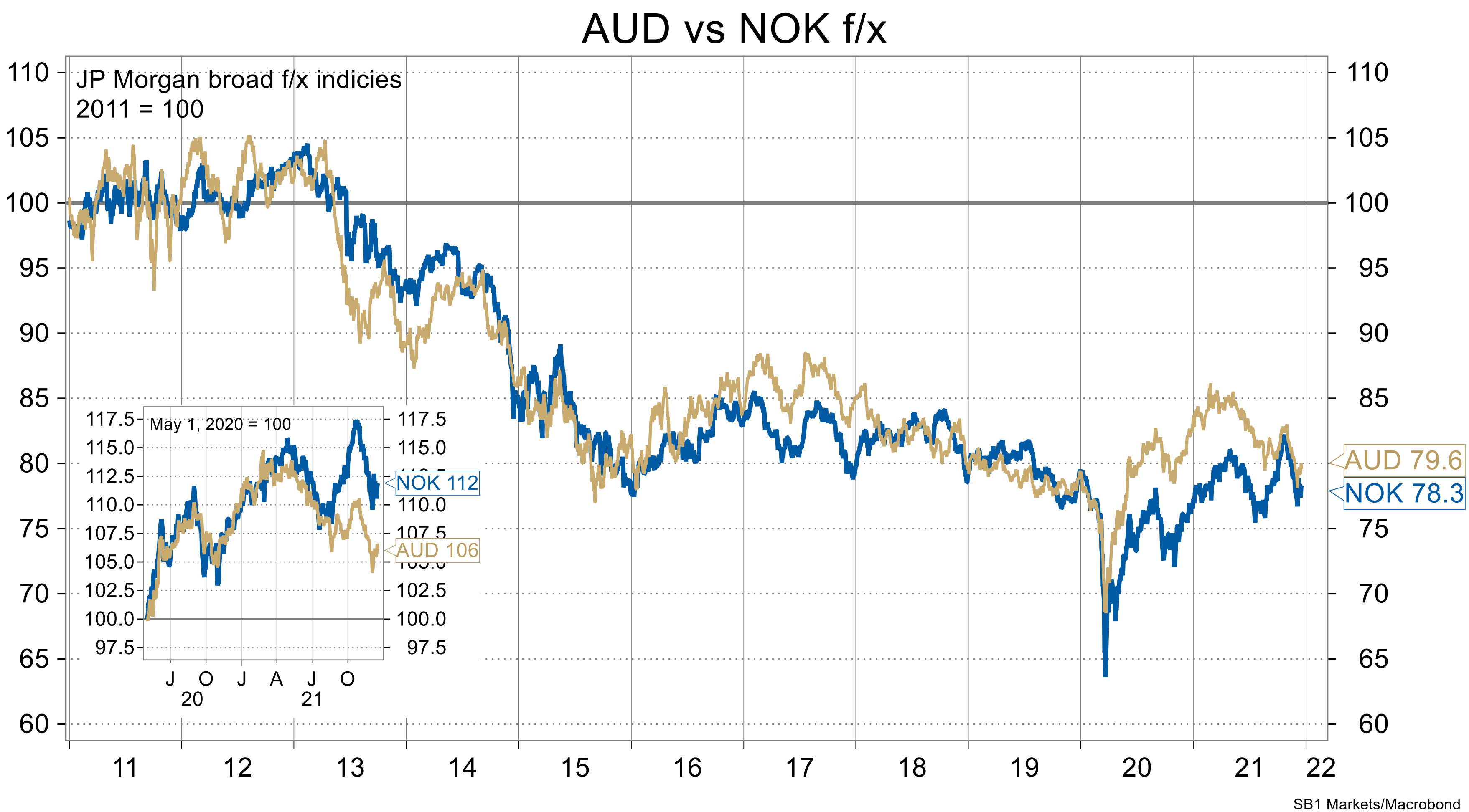




- NOK is still correlating quite closely to the oil price but at a lower level than before 2018 – and now the NOK is weak even vs the past 3 years' relationship
- A USD 10 drop in the oil price weakens the NOK by some 4%, as a partial effect.
  Within a broader model, the impact is smaller

NOK

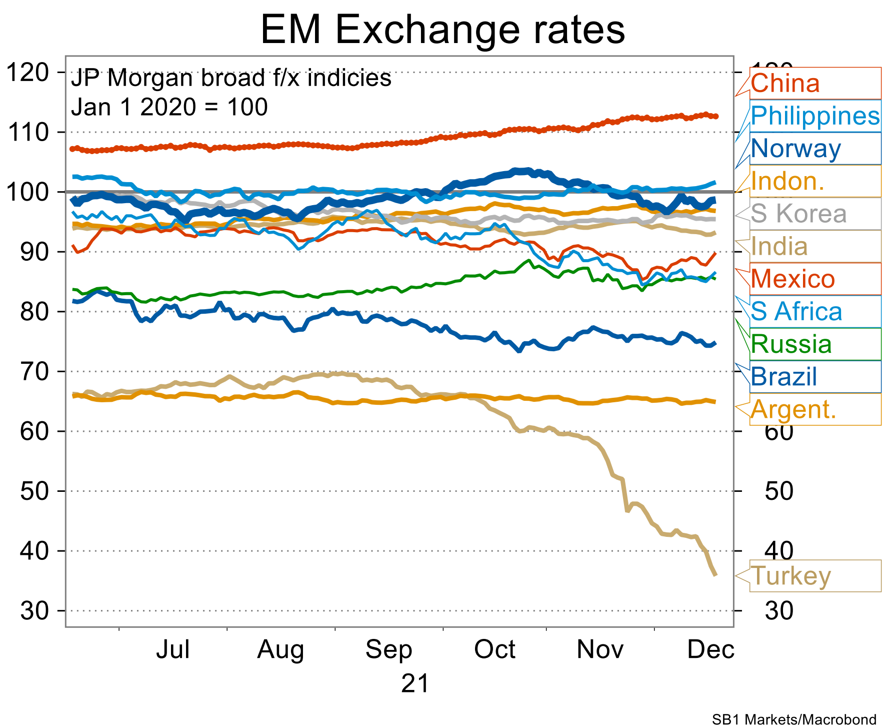
Both NOK and AUD down last week, NOK the most

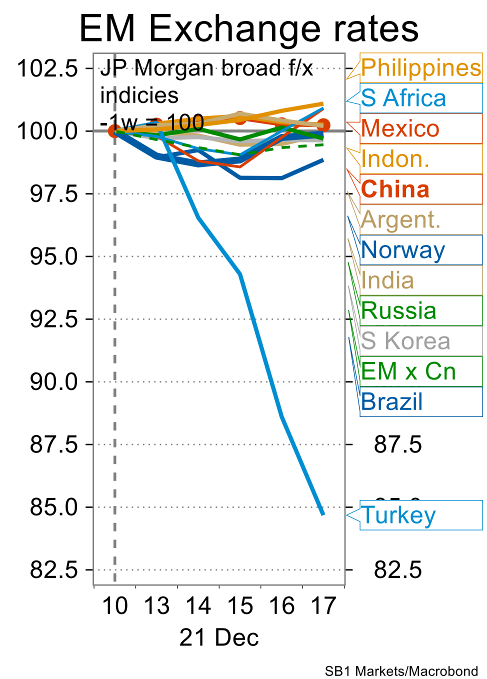


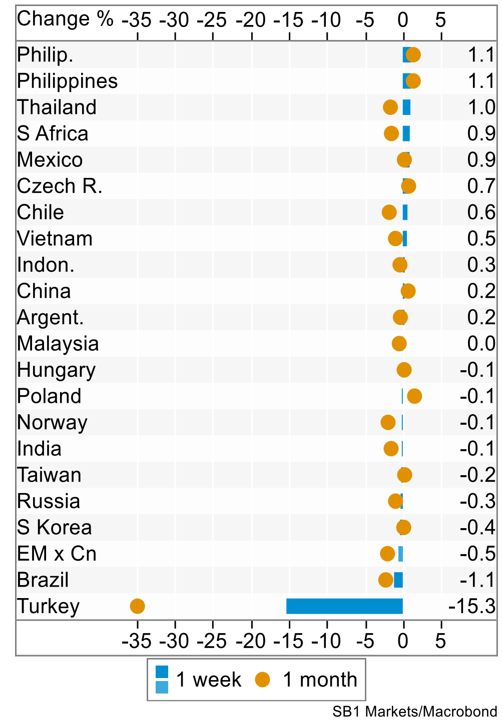
The two f/x indices are back to the 2011 parity (vs each other, from which they never since have deviated much)

Turkey went against the monetary tightening tide. And paid a heavy price

The policy rate was cut, on president Erdogan's command. And the lira fell another 15%!!







- The TRL is down 64% since Jan 1 2020. And by 90% since 2010
- Inflation is at 21.3%, and the central bank cut the signal rate by 1 pp to 14%. Think of it, the central bank cut the real rate to -6.0%! Crazy, isn't it?
  - » Quiz: Which central bank delivers at real rate at -6.3%? Hint: The first letter is F
- The good news: This is a Erdogan/Turkish problem, not a problem for other parts of the Emerging Markets universe

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