June 20 2022

Macro Weekly

Week 25/2022

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SpareBank 1 MARKETS

Last week, part I

- **The War/Sanctions**
  - Russia is slowly conquering ground in the East, and will probably control Luhansk not before too long. Will the Russian continue? If not, real peace negotiations may start
  - **Most commodity prices** fell last week but European natural gas prices rose sharply due to reduced supplies from Russian and the fire in the US LNG plan, which will substantially reduce US export capacity the coming months
- **USA**
  - **50 or 75? The FOMC** hiked 75 bps, to 1.50 – 1.75%, no surprise after the leakage to WSJ Monday afternoon. The interest rate path (median dot plot) was lifted by up to 150 bps, the largest ever (the previous records were from Dec-21 (70 bps), Marc-22 (120 bps)). The FOMC assumes 7 x 25 hikes at the 4 meetings in H2-22, to 3,25 – 3,50%. Market expectations are slightly above. The FOMC members revised their **growth forecast** sharply downwards, especially for 2022. (A Fed **model exercise** yielded a decline in GDP in both 2022 and 2023, aka known as a recession). **Unemployment** was revised upwards but just by up to 0.5 pp, and it will remain below 4.0% (= assumed long-term equilibrium) until well into 2024. Even so, the **inflation** forecast was revised further up, and will remain above the long-term target for the whole forecast period (until Q4-2024). Still, we deem that the FOMC is now prepared to do 'whatever in takes' to bring price and wage inflation down. Short term pain, long term gain – the cost will be even higher if the Fed moves too slow. The risk for a recession is very high
  - **Both building permits and housing starts** fell more than expected, and Homebuilders reported lower activity – and complained once more about reduced affordability. Not surprising, given the surge in mortgage rates – and house prices
  - **Retail sales** fell in May, and are now trending down, but are still above the pre-pandemic trend. Manufacturing production fell, even if auto production rose further
  - The two first June manufacturing surveys**, Philadelphia & NY Fed**, were both weaker than expected. Details in the Phil Fed survey fell sharply, to well below the average, and the outlook index was weak, with one of the most pessimistic expectations for new orders on record
  - **Real interest rates** shot up last week, by 30 bps to 0.69% (and by 55 bps in Germany), while inflation expectations fell sharply (also in Germany)

Last week, part II

- **China**
  - » **All major activity data** were better than expected in May. **Industrial production** and **investments** climbed almost as much as they declined in April. **Retail sales** were close to unch, still better than expected y/y. **New homes sales and starts** rose somewhat, but are still down 20 – 30% vs February, and -40% y/y – and **home prices** are falling at a faster pace. The previous week, **exports** were reported sharply up, to the highest level ever, and **imports** are not that weak. **Inflation** is muted, at 1 – 2%. **Credit growth** returned to a normal level in May, following the April slump. Even if May was better than expected, the activity level was below par. We assume GDP fell sharply in Q2, and the annual growth was probably close to zero (or below)
- **EMU**
  - » **Labour costs** are accelerating and not just due to less government subsidies, in Q1 at a 4% pace vs. Q4. Not that strange perhaps as unemployment has fallen to the lowest level in 40 years, and vacancies are at ATH. Another argument for the ECB to start hiking rates
  - » **Final inflation data** confirmed the initial estimates, the total at 8.1%, the core at 3.8%
  - » The **ECB board** gathered at an extraordinary meeting just to decide to ask the bureaucrats to come up with something that could keep yield spreads between Germany and other countries in check when the stock of government bonds in the QE program could not be increased further (well, they did not say exactly in that way, but that was the reality)
  - » **In France**, president Macro lost his majority in the National Assembly, and a centre/right will probably have to seek support from the left in most cases. Both the green/hard left and the far-right Rassemblement National (Le Pen) made advances. EMU spreads to widen?
  - » Not in the EMU, but we add that the **Swiss central bank** surprisingly hiked the signal rate by 0.50 bps to -0.25%. More to come.
- **UK**
  - » **Bank of England** hiked by another 25 bps to 1.25%, as expected. The inflation forecast was lifted to above 11% - and the growth outlook has deteriorated further since the early May meeting – where a recession was announced. GDP very likely fell in Q2
  - » The **labour market** is still very tight, even it the LFS unemployment rose a tad in March. Wage inflation has accelerated substantially
- **Sweden**
  - » **CPI inflation** rose more than expected in May, to 7.3% (headline) and 5.4% (core)
- **Norway**
  - » **Norges Bank's Regional Network** expect growth to slow, and more than expected but still in line with NoBa's GDP forecasts. Supply side problems rose further, including lack of labour
  - » **Mainland GDP** surprised at the downside in April, -0.5% due to lower electricity and fish farming production. However household domestic demand as spending abroad increased

The Calendar: The first June PMIs, US housing. An NoBa, we expect a 25 bps hike

Time	Count.	Indicator	Period	Forecast	Prior
Monday June 20					
08:00	NO	Housing starts	May		
11:00	EU	Construction Output MoM	Apr	--	0.0%
Tuesday June 21					
14:30	US	Chicago Fed Nat Activity Index	May	0.47	0.47
16:00	**US**	**Existing Home Sales**	**May**	**5.40m**	**5.61m**
Wednesday June 22					
06:00	SW	Home prices	May		
08:00	UK	CPI YoY	May	9.1%	9.0%
08:00	UK	CPI Core YoY	May	6.0%	6.2%
Thursday June 23					
02:30	JN	Manufacturing PMI	Jun P	--	53.3
02:30	JN	Services PMI	Jun P	--	52.6
08:00	**NO**	**Unemployment Rate AKU**	**Apr**	**--**	**2.9%**
08:00	NO	Employees, wages	May		
09:15	FR	Manufacturing PMI	Jun P	54.0	54.6
09:15	FR	Services PMI	Jun P	57.6	58.3
09:30	GE	Manufacturing PMI	Jun P	54.0	54.8
09:30	GE	Services PMI	Jun P	54.5	55.0
10:00	**EU**	**Manufacturing PMI**	**Jun P**	**53.8**	**54.6**
10:00	**EU**	**Services PMI**	**Jun P**	**55.5**	**56.1**
10:00	**NO**	**Norges Bank, signal rate**	**Jun-23**	**1.00%**	**0.75%**
10:30	**NO**	**Norge Bank, press conference**			
10:30	**UK**	**Manufacturing PMI**	**Jun P**	**53.7**	**54.6**
10:30	**UK**	**Services PMI**	**Jun P**	**53.0**	**53.4**
14:30	US	Current Account Balance	1Q	-$274.5b	-$217.9b
14:30	US	Initial Jobless Claims	Jun-18	225k	229k
15:45	**US**	**Manufacturing PMI**	**Jun P**	**56.0**	**57.0**
15:45	**US**	**Services PMI**	**Jun P**	**53.7**	**53.4**
Friday June 24					
	NO	Consumer Confidence	Jun		
08:00	UK	Retail Sales Inc Auto Fuel MoM	May	-0.7%	1.4%
08:00	NO	Credit Indicator Growth YoY	May		4.8%
10:00	GE	IFO Expectations	Jun	87.4	86.9
16:00	US	U. of Mich. Sentiment	Jun F	50.2	50.2
16:00	**US**	**New Home Sales**	**May**	**592k**	**591k**

- **Preliminary June PMIs**
  - » **Developed markets** report prelim PMIs will be published on Thursday. Just small declines are expected at both side of the pond. We think there are some downside risks to the forecasts, especially in the US
- **USA**
  - » **Both new and existing homes** sales are among the most important data points these days. Existing home sales will very likely decline, as signalled by the pending homes sale stats. New home sales 'collapsed' in April, and are not expected further down in May, even if the Homebuilders are complaining loudly about the rapid deterioration of affordability among their customers
- **EMU**
  - » **Ifo expectations** are at a low level but is expected marginally up in June
- **UK**
  - » **Inflation** is at 9%, and Bank of England assumes above 11% in October, when energy prices will be regulated upwards. No further increase in expected in May, and the core is expected slightly down y/y
- **Norway**
  - » **Norges Bank** is ready for the 4th hike, we still believe the Bank will deliver a 25 bps hike, as 'promised' in March and May, and not a 50 bps hike (and not a 75 bps hike, which have been aired. However, the interest rate path will be revised upwards once more, we assume by at least 50 bps. If data were taken face value, a even larger revision would be appropriate. However, given the highest debt/income rate in the world, and just floating rates, the bank is probably worried that the impact of hikes could be larger normally assumed, given a decline in real wages and a total loss of confidence in Q2. We think it is more likely that FRA rates will decline on NoBa's signals than increase. *See more next page*

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

Norges Bank: A (relative) dove among all the hawks

We think NoBa will hike by just 25 bps, but signal the next hike in August, and then in Sept

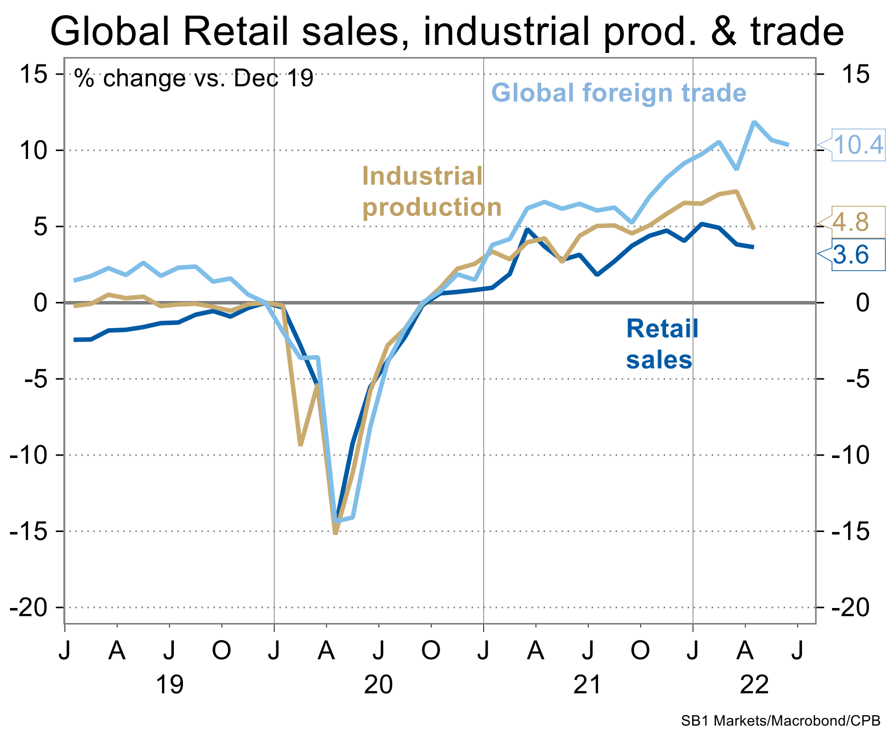
Changes in the interest rate path from the March NoBa meeting	Impact bps
Domestic demand (incl oil price), capacity util.	22
Money Market (money market, lending spreads)	0
Prices, wages	30
Foreign factors	41
NOK	40
Judgement (surveys, fin. stab, global risk etc)	-35
Sum	**98**
Changes in NOK Dec-22/23 FRA since after Dec m.	75
Change in the interest path 1 - 2 years from now	

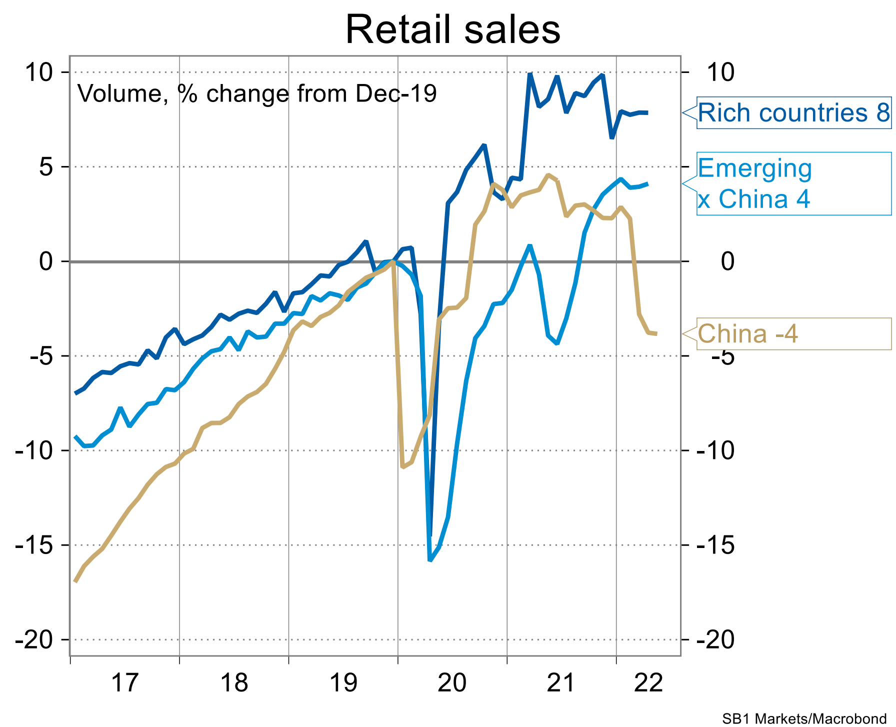
Need for – and consequences of higher rates	USA	Norway
CPI	8.6	5.7
CPI-core	6.0	3.4
Unemployment rate	3,6	2.9
Vacancies	ATH by far	High
Wage inflation	5 - 6%	3.5 – 4%
Credit growth	8% (from 3)	5 (unch)
House prices during the pandemic	+37%	+16%
Debt/income	1 x	2.5 x
Fix or floating debt	Fixed	Floating

- Inflation is higher, unemployment lower, rates abroad has soared, the NOK has fallen sharply, the oil prices is up, signalling another huge lift in the interest rate path
- However, we assume the bank will continue on a cautious pace, and lifting the signal rate by just 25 bp at Thursday, and lift the interest rate path by 50 bps (or up to 75 bps), well below our ‘mechanical’ estimate.
- The peak of the interest rate path will be lifted to 3.00% (or to 3.25%), form 2.50% in the March path. By Dec-22, 1.75 – 2.00% will be signalled, up 25 bps vs. the March forecast

Global activity fell in March/April due to the Chinese lockdowns

Global industrial production fell some 2% due to the 7% setback in China

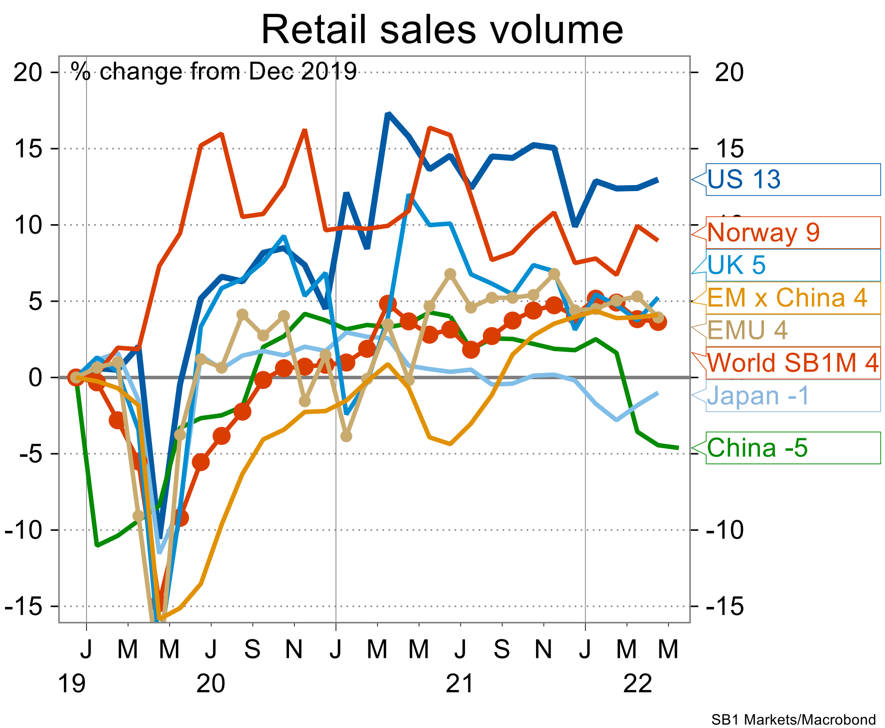


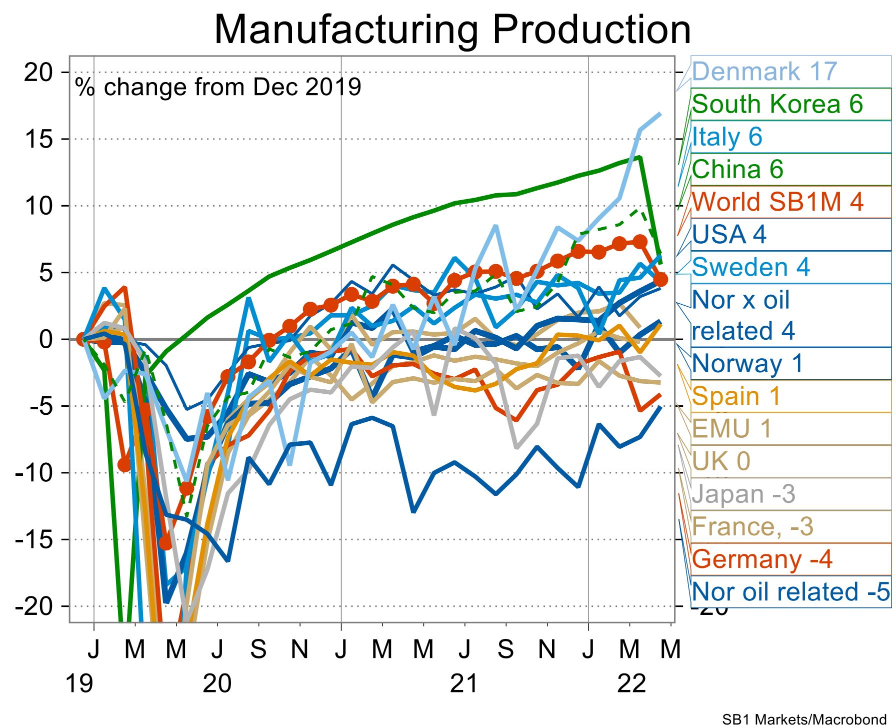


Global trade: The last months are estimates from the Kiel Institute, they are also making a prognoses for the next month based on shipping activity etc.

Retail sales has slowed since January, mostly due to China

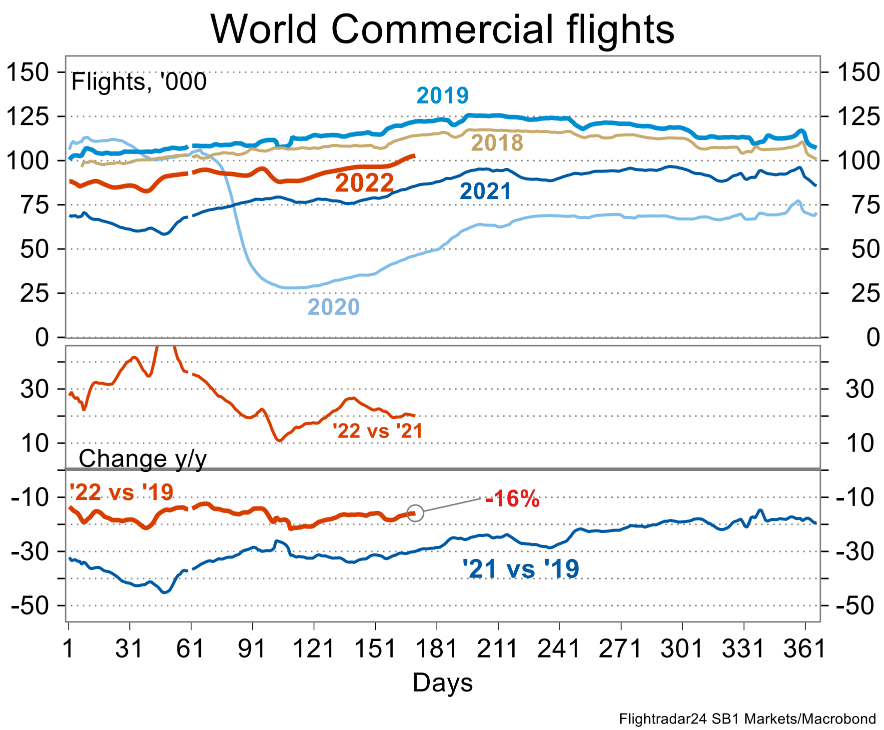
However, both other EMs and most rich countries are reporting slower sales too, it's services now!

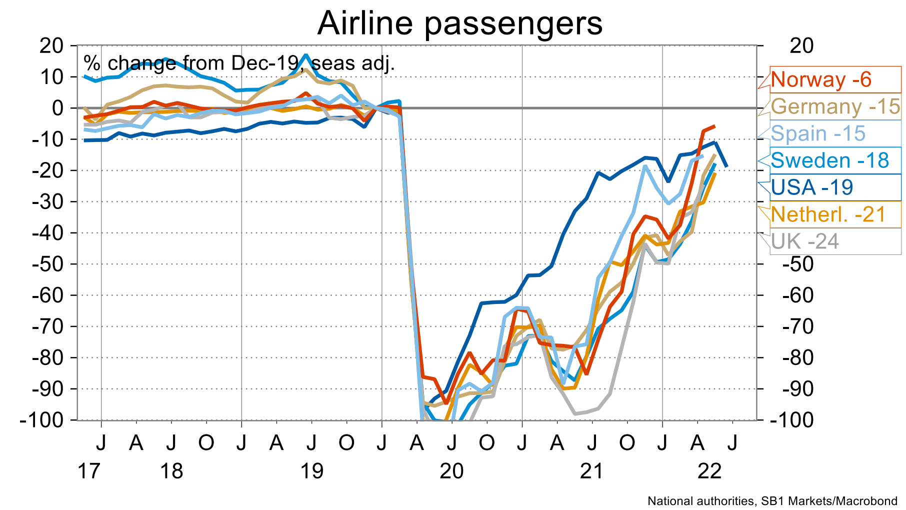


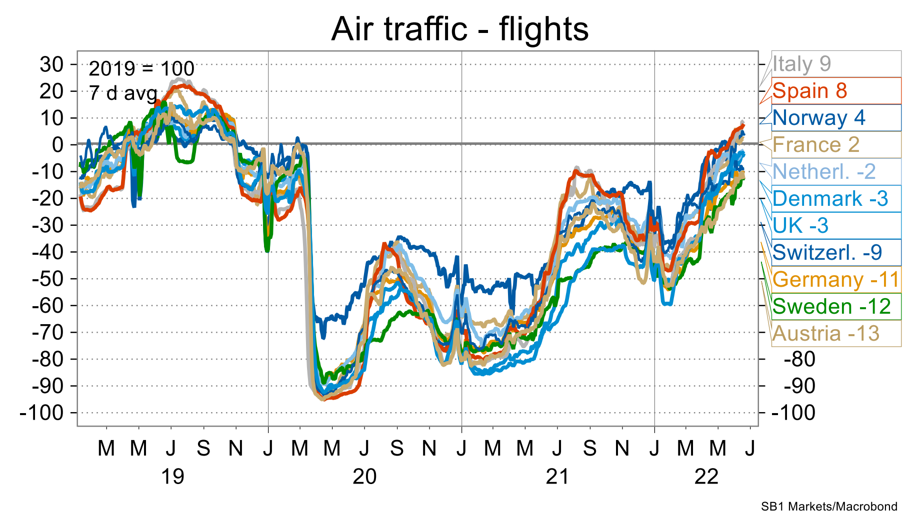


- **Manufacturing production** fell in April due to the steep decline in China
- **Manufacturing production** has been hampered by a deep decline in auto production. The manufacturing PMIs are down from the peak but are still signalling growth but not above trend
  - » China reported a sharp drop in production in April, which will the global aggregate down (but too few others have so far reported)

Global airline traffic on the way up, but not more than the seasonal normal







Global trade: The last months are estimates from Kiel Institute

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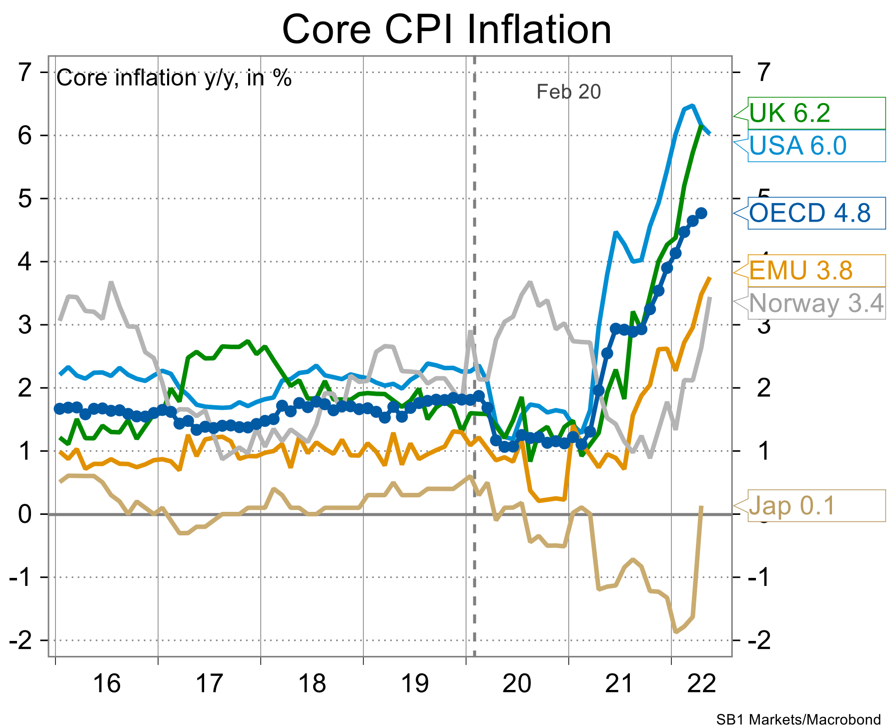
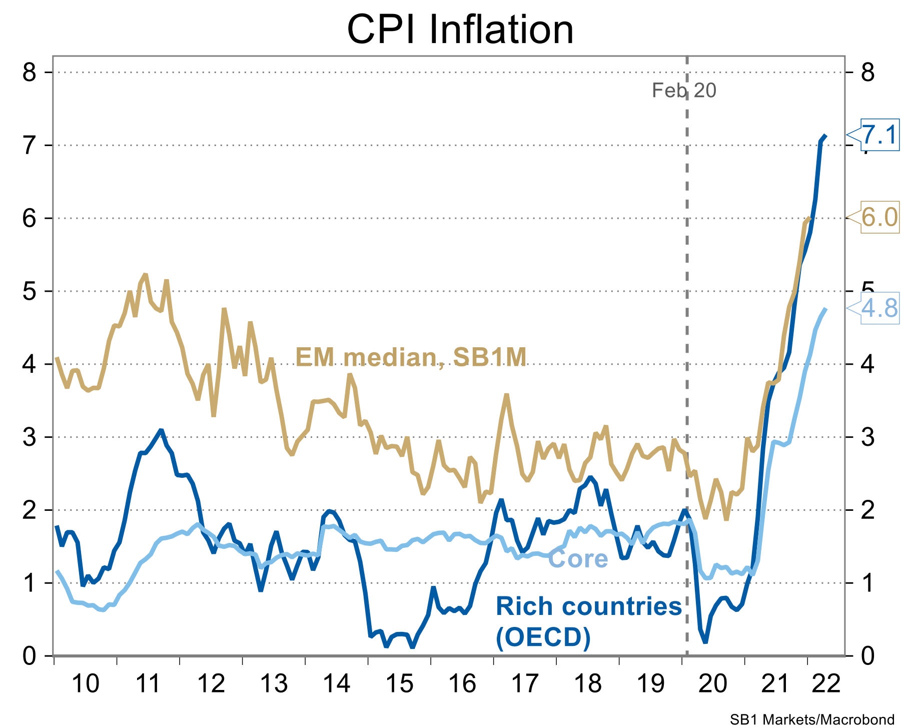
Inflation still the main challenge most places

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

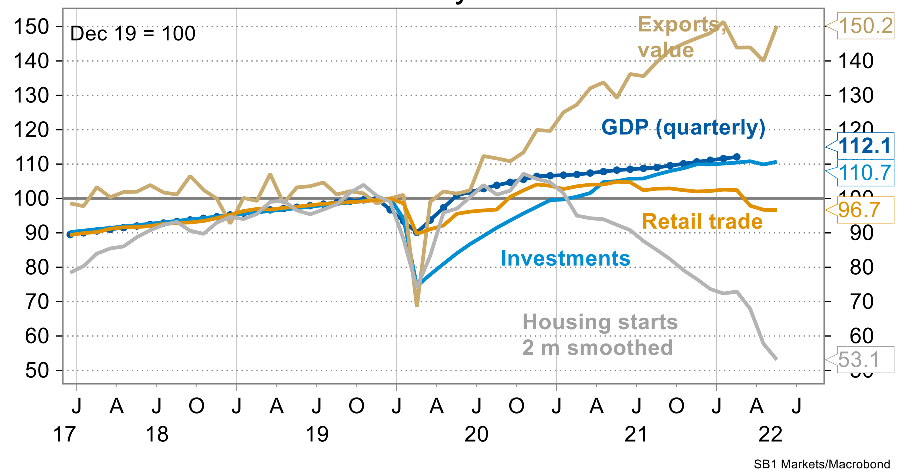




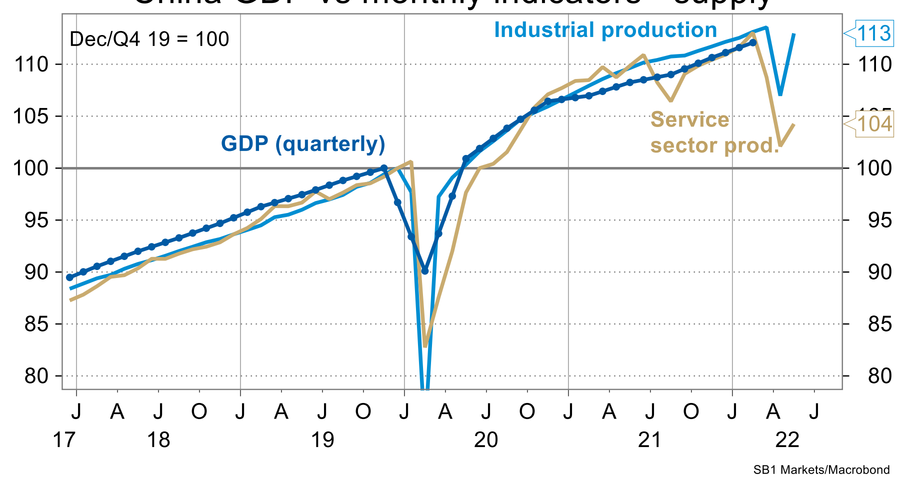
Manufacturing recovered well in May, services not

All date better than expected, but GDP very likely fell sharply in Q2 (from Q1)

China GDP vs monthly indicators - demand



China GDP vs monthly indicators - supply



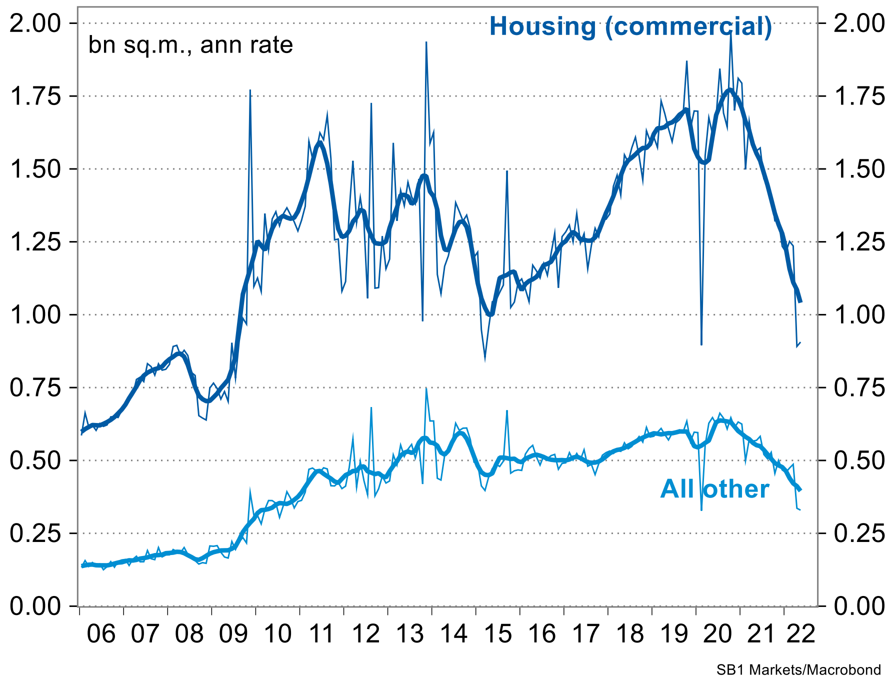
- **Industrial production** rose 5.6% in May following the 5.8% setback in April, well above expectations (+0.7% y/y, vs. expected -0.9%). Production is not far below the March level even if some cites were more or less locked down in May too
- **Service sector production gained 2.1**% in May, following the 6.1% decline in April (and -4% in March. Production is down 5.1% y/y
- Even after assuming a decent further recovery in June, **GDP** will very decline substantially q/q in Q2, and the annual growth rate will approach zero
- **Retail sales** recovered just marginally in May but the annual decline was less than expected, at -6.8%, expected -7.1%. Auto sales rose sharply in May,
- **Investments** rose 0.6% in May following the 0.9% April decline, and the level remains 0.6% below the pre-April trend path. Measured YTD, investments are up 6.2%, 0.2 pp above consensus
- **New homes sales and starts** rose slightly in May, following the 20 – 30% decline since March. Both are down 40 % y/y, as are other construction starts. Incredible data
- **Published the previous week**
  - » **Credit growth** accelerated in May, after the sharp slowdown in April
  - » **CPI inflation** has increased somewhat, but remains lo,. especially ex. food & energy (0.9%)
  - » **Exports** rose to the highest level ever in May, and is not far below even in volume terms. **Imports** rose to, but the level is 'just' close to the pre-pandemic trend

In sum: Better than expected in May, and far better than survey data formally suggested. Still, Q2 was yielded a serious economic setback

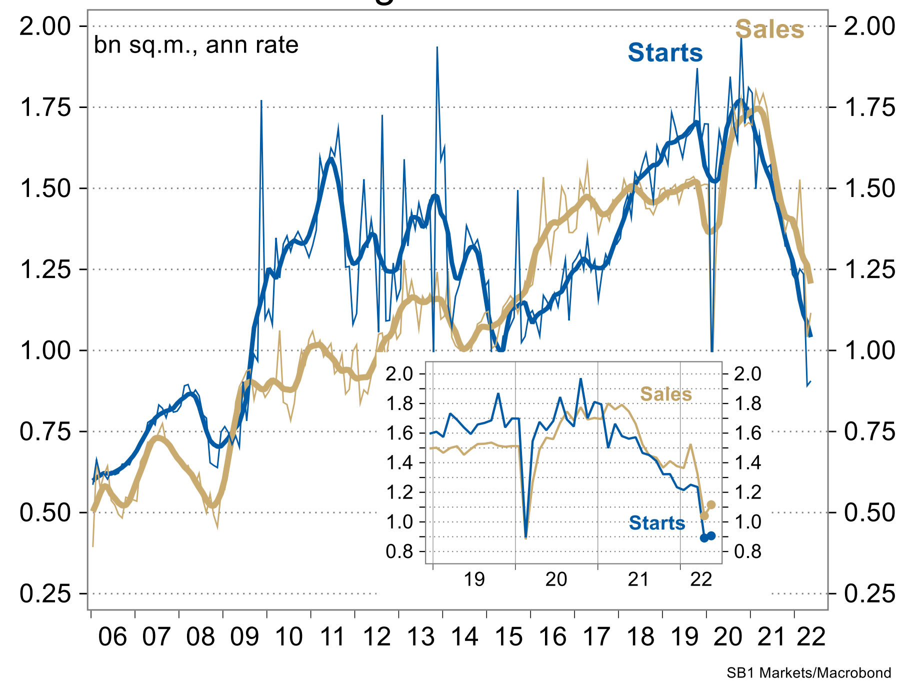
New homes sales, starts stabilised in May following the 20-30% March/Apr. setb.

Let's hope & pray lockdowns are to blame for the drop this spring. The alternative would be worse

Construction starts



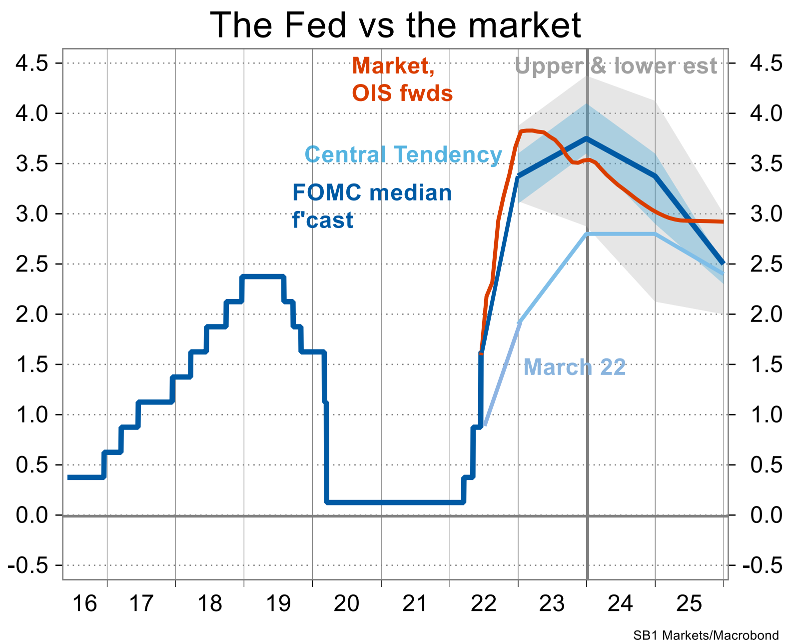
Housing sales & starts



- **New home sales** rose 10% in May, while **starts** were close to unchanged. Both are down 20 – 30% from February, and 40% y/y
- **Big picture, before the lockdowns: Non-residential construction starts** had flattened, following a 25% decline since mid 2020. Both housing & non-residential starts were at the lowest level since 2017. And then came the 2nd leg down in March/April – and starts are at the lowest level since a short drop in 2015 or in 2009/10

The ‘promised’ 75 bps hike was delivered, and the path was lifted by up to 150 bp

The FOMC has taken the gloves off, signal willingness to fight inflation. At any cost?



- **Market reactions**: The far end of the FRA curve fell but up to 20 bps, and long-term yields fell. The stock market rose sharply – before falling much more on Thursday
- **We think this was the last upward revision of the path for a while, the economy is now responding to the total tightening of financial conditions**

- As pre-warned to the WSJ at Monday afternoon, the FOMC hiked the **Fed funds rate by 75 bps to 1.50% – 1.75%**
- **The interest rate path**, the dot plot, was lifted by up to 150 bps, another ATH lift in the path for the 3rd meeting in row (70 bps in Dec, 120 bps in March)
- **The median forecast in the dot plot** for end of 2022 at 3.375% (measured at the mid in the 25-bps signal rate corridor, from 1.625% now), implies 7 x 25 steps during the 4 FOMC meetings in H2. Powell signalled that another 75 bps was not unlikely in July
- The **2022 inflation forecast** was still revised upwards, to 5.2% from 4.3% in 2022 (Q4/Q4), while both 2023 and 2024 remained above the 2% long term target, both the total PCE deflator and the core
- The FOMC members revised their **growth forecasts** significantly downwards, especially for 2022 (to 1.7% from 2.8%, Q4 y/y) but also for 2023. (NY Fed’s model projections are far weaker, a decline in both 2022 and 2023 is forecasted – that is a long recession, check here)
- The **unemployment rate** was revised upwards, already from this year, but it will not climb to more than 4.1% in 2024, vs. the previous 3.6% f’cast, and to marginally above the estimate for the long-term equilibrium at 4.0%
- Finally, the forecast is balanced, in the sense that inflation is too high but unemployment at the same time marginally too high too - but not before 2024. In the meantime, inflation is far above the target while unemployment is below the assume long-term rate. Thus, the FOMC is satisfied with missing both targets at ‘the same side’ through 2022 and 2023 (and probably most of 2024)
- Even so, we think the FOMC now has taken its gloves off and decided to fight hard against price AND WAGE inflation, almost at any cost, signalled by the 150-bps lift of the interest rate path. Because the cost taking the fight at a lager stage will be even larger
- The FOMC members do not say they think a recession is likely. But we are pretty sure they recognise that the risk is substantial. However, most central banks do not predict recessions before they arrive. (The exception now: Bank of England)

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What does the Fed('s model) say? Winter is coming!

The probability for a recession is 90% - and GDP will most likely decline through both '22 and '23!

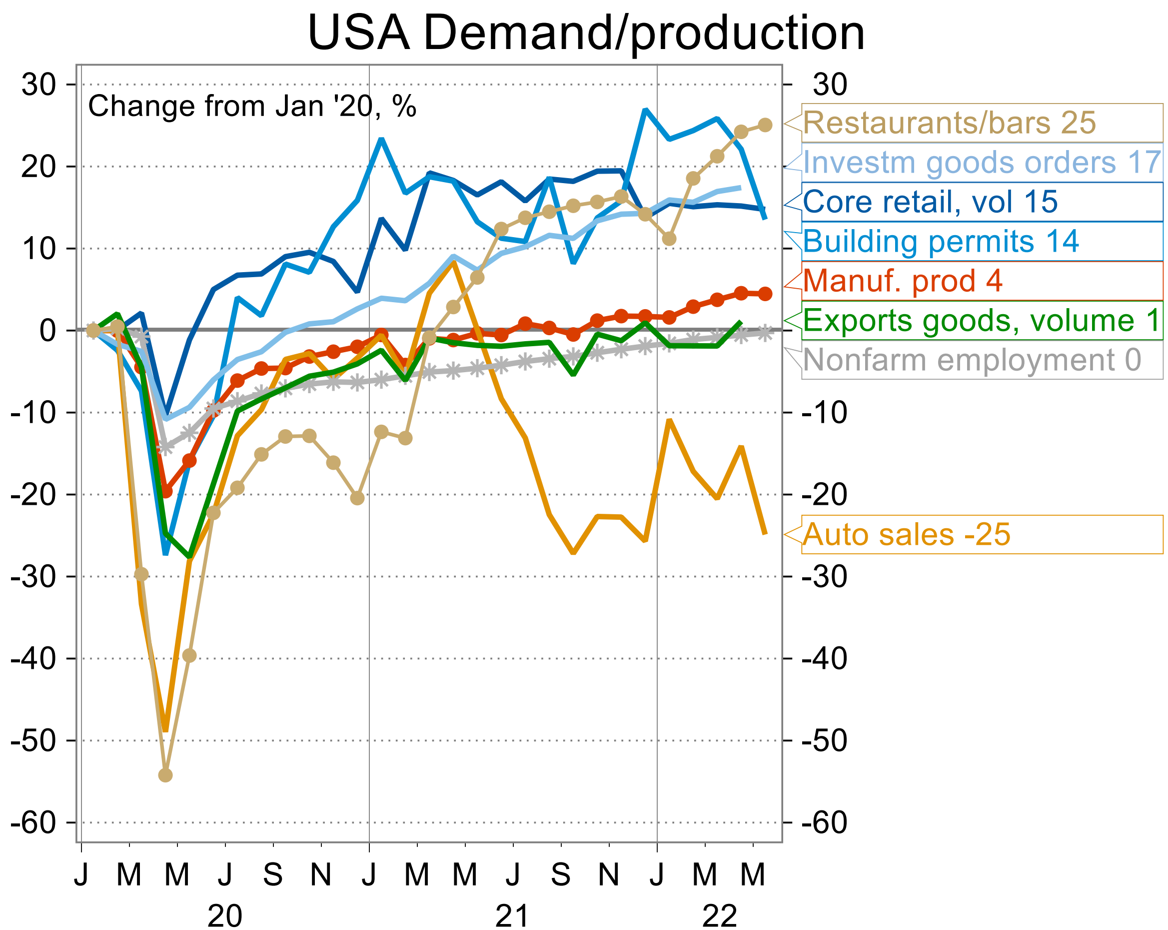
Forecast Comparison

	2022		2023		2024		2025	
	Jun	Mar	Jun	Mar	Jun	Mar	Jun	Mar
GDP growth (Q4/Q4)	-0.6 (-3.6, 2.3)	0.9 (-0.8, 2.6)	-0.5 (-5.0, 4.0)	1.2 (-0.6, 3.1)	0.4 (-4.4, 5.3)	1.5 (-0.3, 3.4)	1.4 (-3.9, 6.5)	1.8 (-0.1, 3.6)
Core PCE inflation (Q4/Q4)	3.8 (3.3, 4.4)	2.8 (2.1, 3.6)	2.5 (1.7, 3.4)	2.2 (1.3, 3.1)	2.1 (1.2, 3.1)	2.0 (1.1, 3.0)	2.0 (1.0, 3.0)	2.0 (1.0, 3.0)
Real natural rate of interest (Q4)	0.9 (-0.4, 2.1)	0.0 (-1.3, 1.4)	0.9 (-0.5, 2.4)	0.4 (-1.1, 1.9)	0.9 (-0.7, 2.4)	0.6 (-1.0, 2.1)	0.8 (-0.9, 2.5)	0.6 (-1.1, 2.3)

- To June from March, the centre forecast for Q4-2022 y/y GDP growth was revised down by 1.5 pp to -0.6%
- .. And the Q4-2023 y/y estimate was cut by 1.7 pp to -0.5%
- Thus, the Q4-2023 GDP level was revised down by 3.2%, and the level will be 1.1% below Q4-2021!
  - » In addition, 2024 and 2025 was revised down by 1.1 pp and 0.4 pp, resp., in sum 1.5 pp. Grand total down 4.7% vs the March f'cast –
- If so, a not very deep, but a rather long-lasting recession – and a slow recovery thereafter
- The model forecast are way below the FOMC members' forecast: by end of 2023, the difference (in GDP level) is 4.5%!!
- The natural real rate of interest was revised up to 0.9% from zero

US: Waiting for demand destruction?

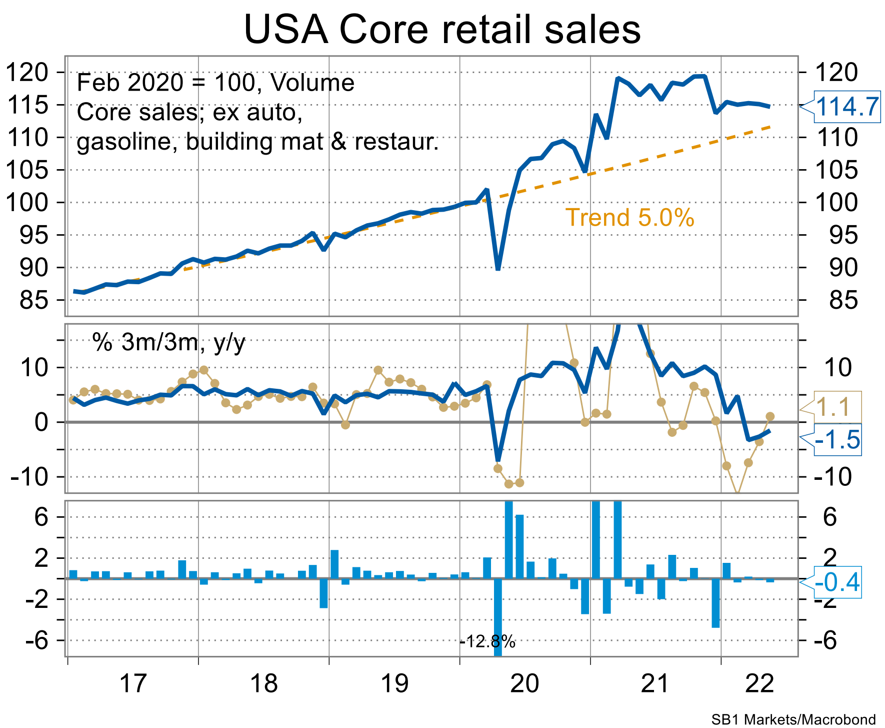
Housing is weakening, and demand for goods ex autos are waning?

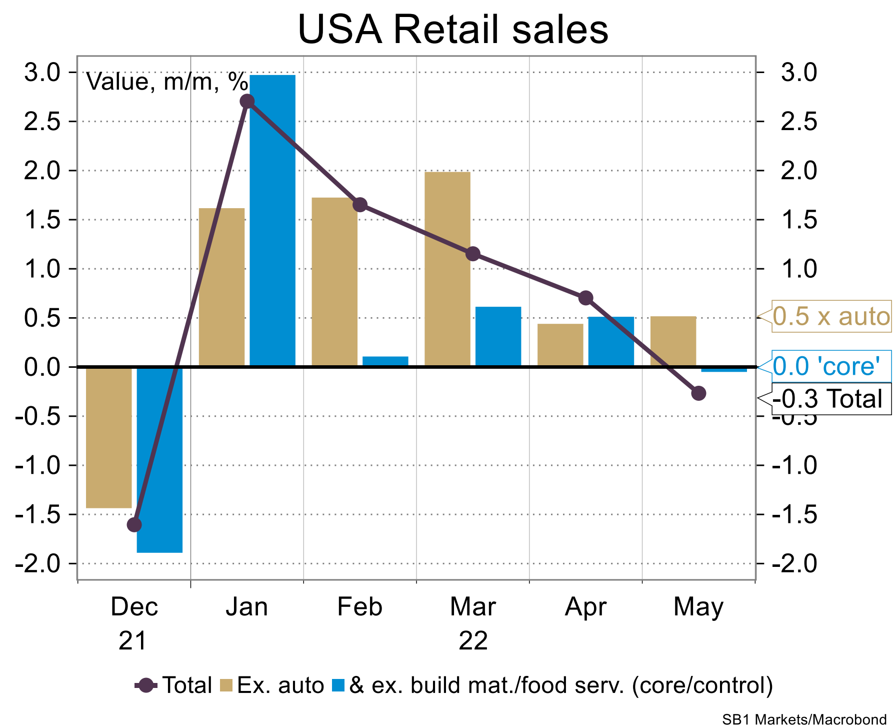


SB1 Markets/Macrobond

Retail sales slows sharply, finally. Services or interest rates to blame?

Real core goods sales are still going strong, and the trend is slightly upwards

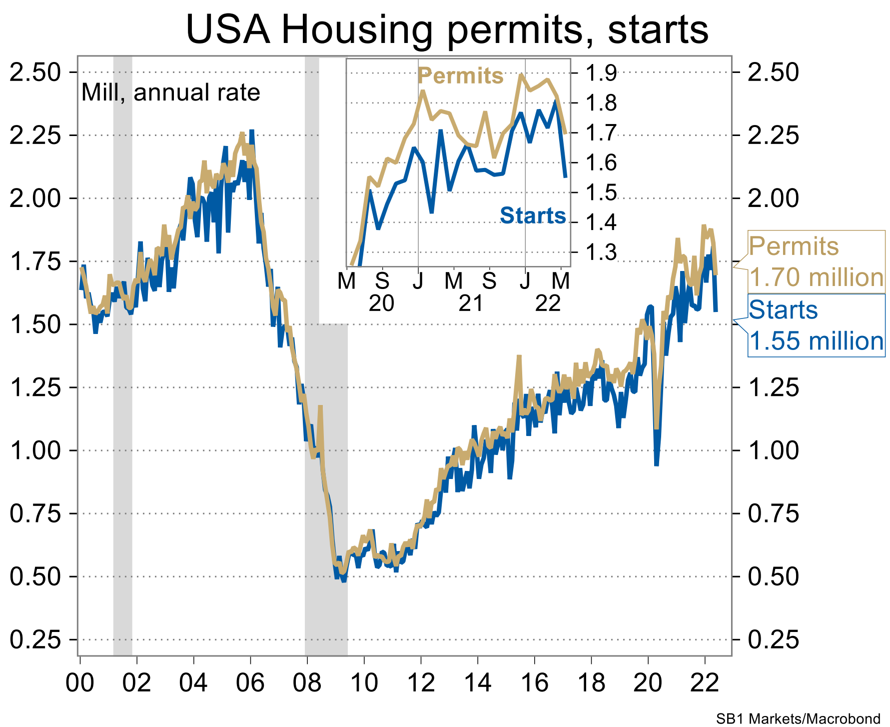


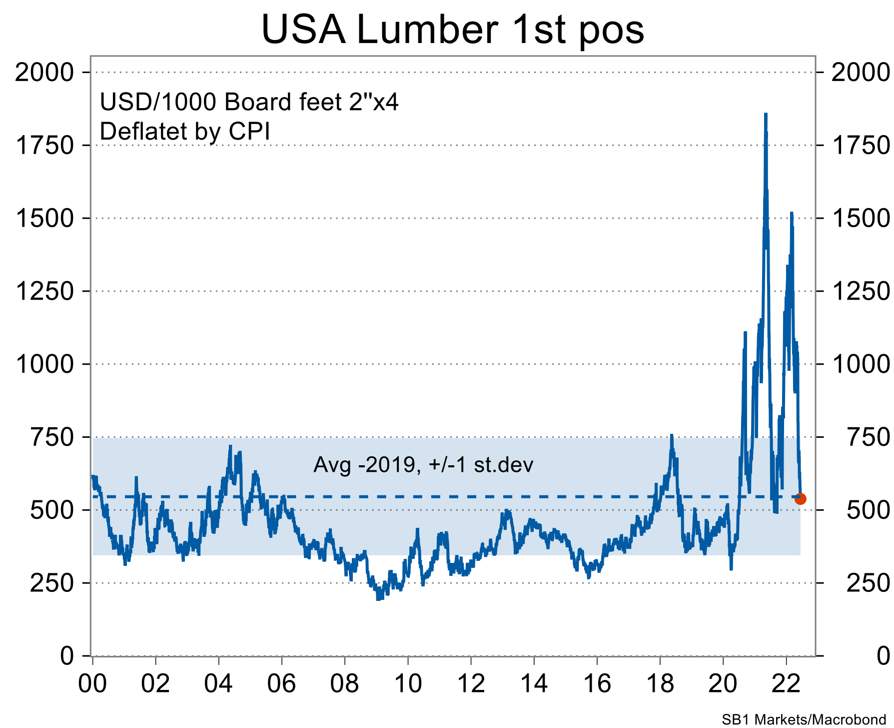


- **Total nominal sales** declined 0.3% in May (expected +0.2%), and April was revised down by 0.2 pp to 0.7%. Total nominal sales are up 29% vs. the Feb 2020 level
- **Core sales of goods** (=control group, excludes autos, gasoline, building materials & restaurants) was flat in May, expected up 0.1%. March was revised down by 0.5 pp to 0.5%. In **volume terms** we estimate a 0.6% decline in May. Revised volume data from December has lowered the path substantially, and sales are not that far above the pre-pandemic trend anymore

Oops, housing starts 'collapsed' in May

Housing starts are still at a rather high level – and the downside is substantial

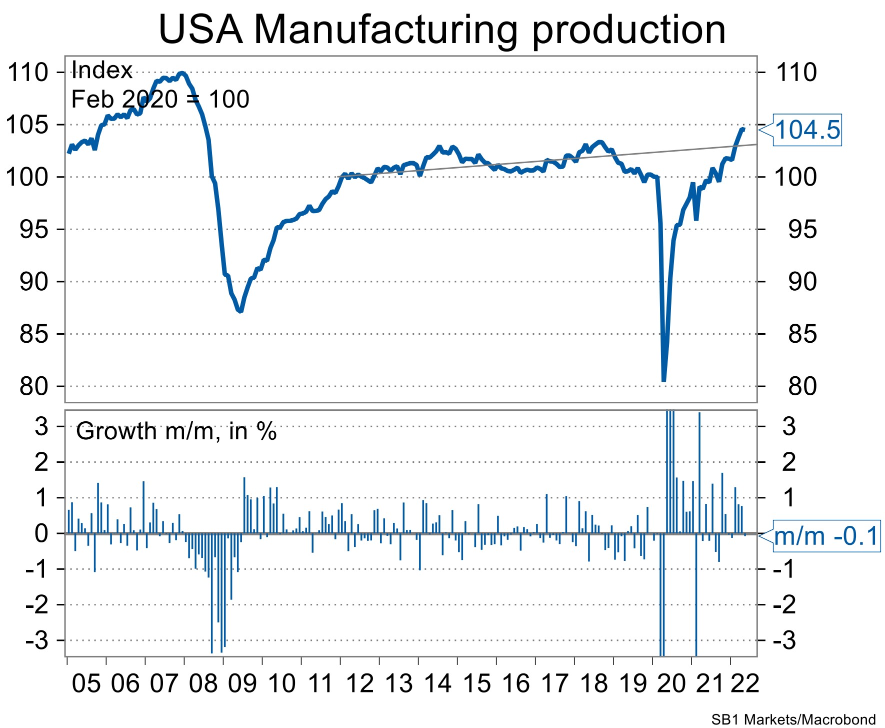


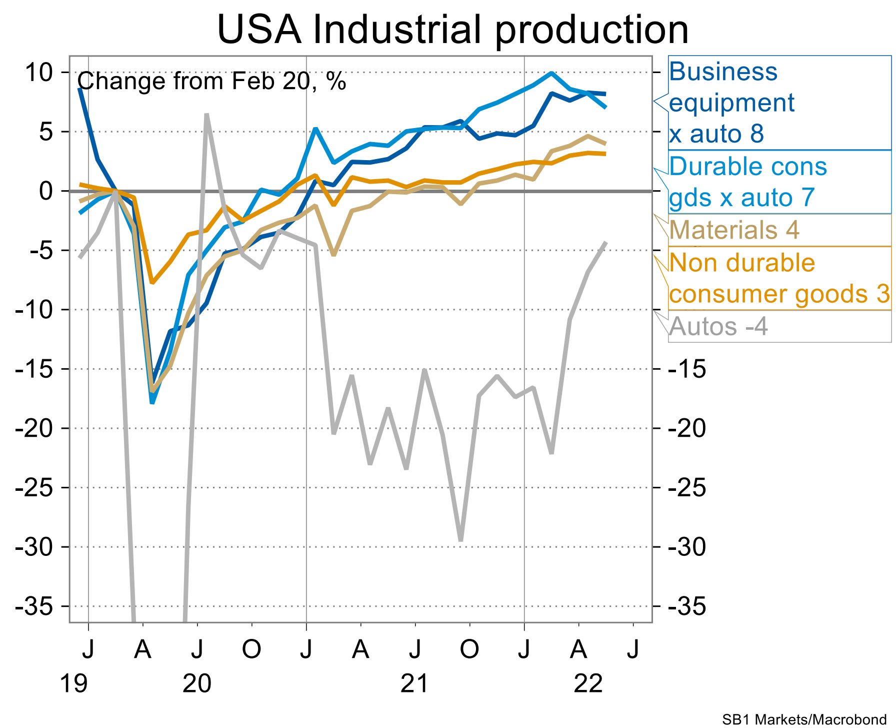


- **Housing starts** fell to 1.55 mill in April, expected 1.69 mill from 1.81 mill in April (upward revised from 1.72 mill). **Building permits** landed at 1.66 mill, expected 1.78 mill, from 1.82 mill in April. Levels are still high but the tide has very likely turned: The Housing market index shows the way, check next page – and the reasons for it on the following pages
- Building **material cost inflation** has come to a sudden halt. **Lumber prices** have 'collapsed' recent weeks and are now back to a normal level, steel prices are falling rapidly too

Manufacturing production down 0.1% in May but the trend is strong

… and the level is well above the pre-pandemic level (& trend)

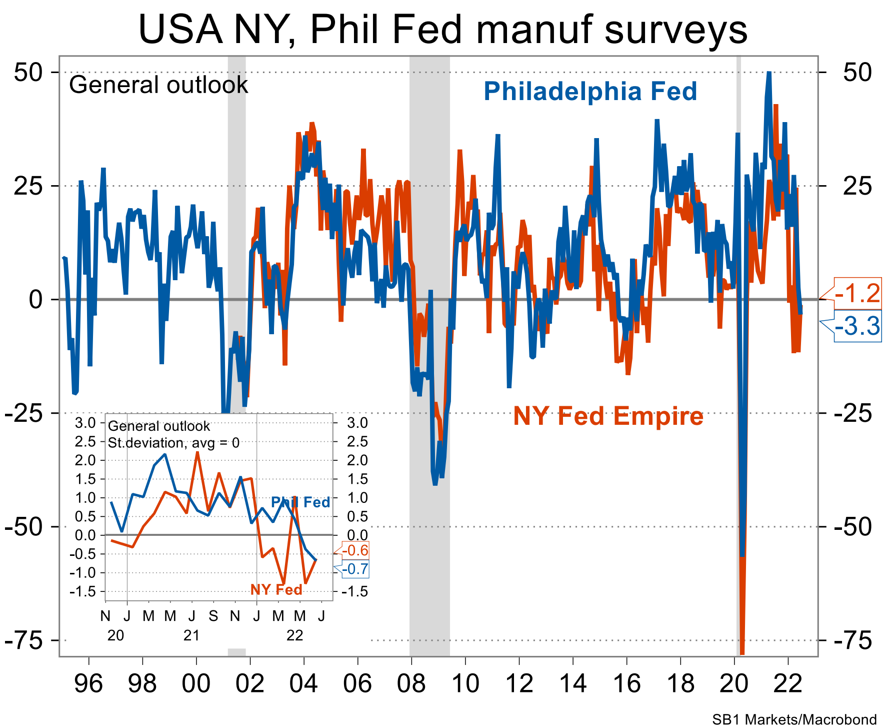


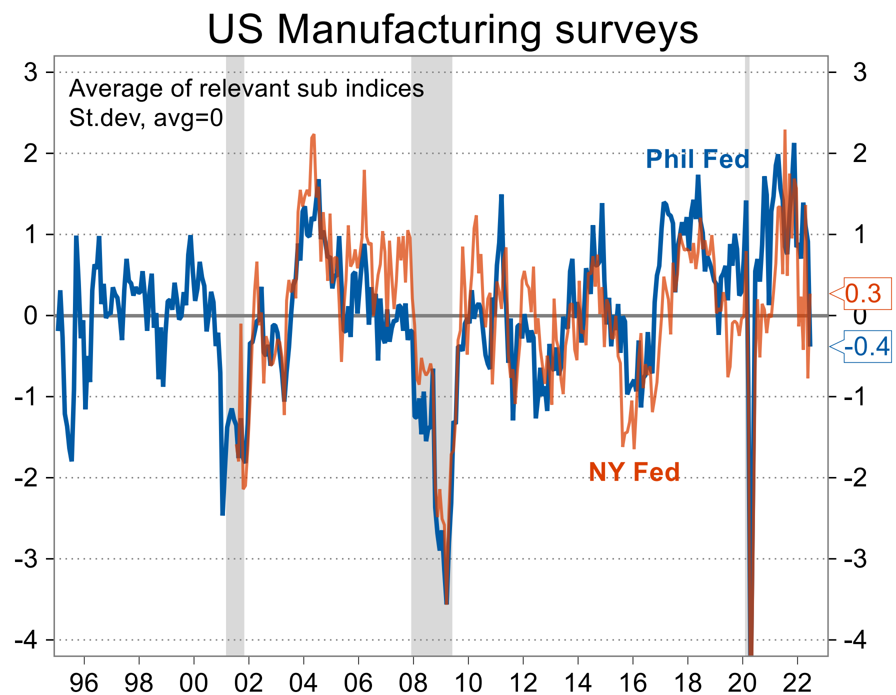


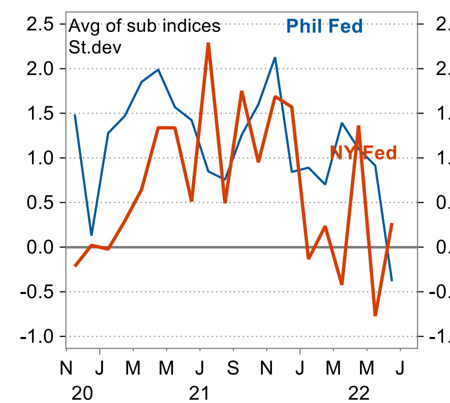
- **Manufacturing production** was expected up 0.3%, following the 0.8% lift in April. Production is still up at an 8.8% 3m/3m pace
  - » Auto production rose further and is just 4% below the Fed-20
  - » Production of all other main components flattened or declined. <u>Durable consumer goods x autos are on the way down. The peak was in February</u>
- **Total industrial production**, including utilities, mines/oil production grew 0.2% in May, down from 1.4% in April (rev from 1.1%)
- **PMI/ISM and all other surveys** signal a continued recovery but at slower pace than until now
- **Capacity utilization** at 79.0%, a very high level

The Philadelphia Fed survey fell sharply in June, NY Fed's recovered

Phil Fed is not signalling a recession - but the outlook index is really weak



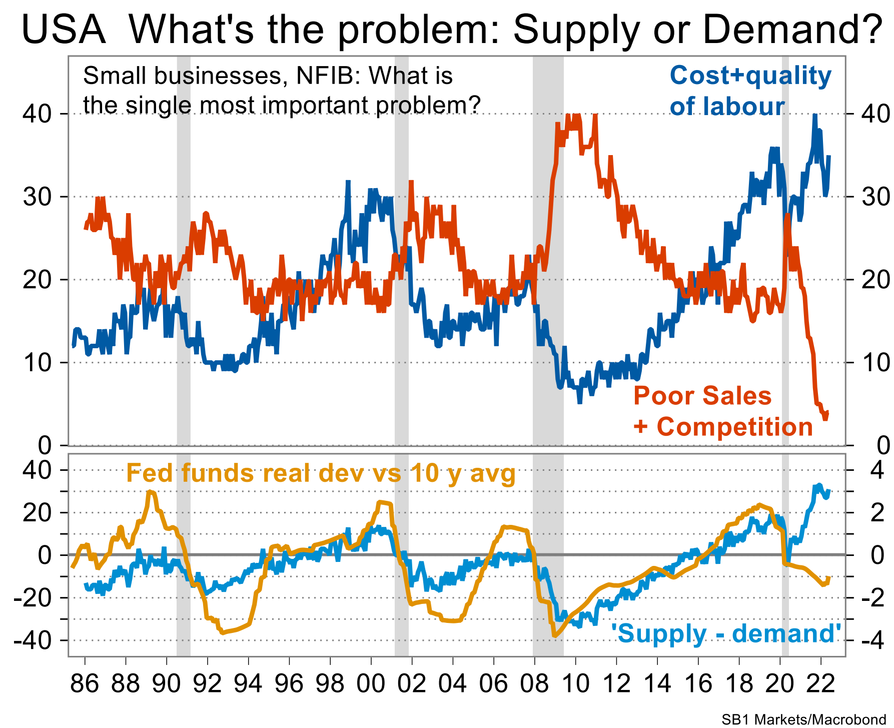


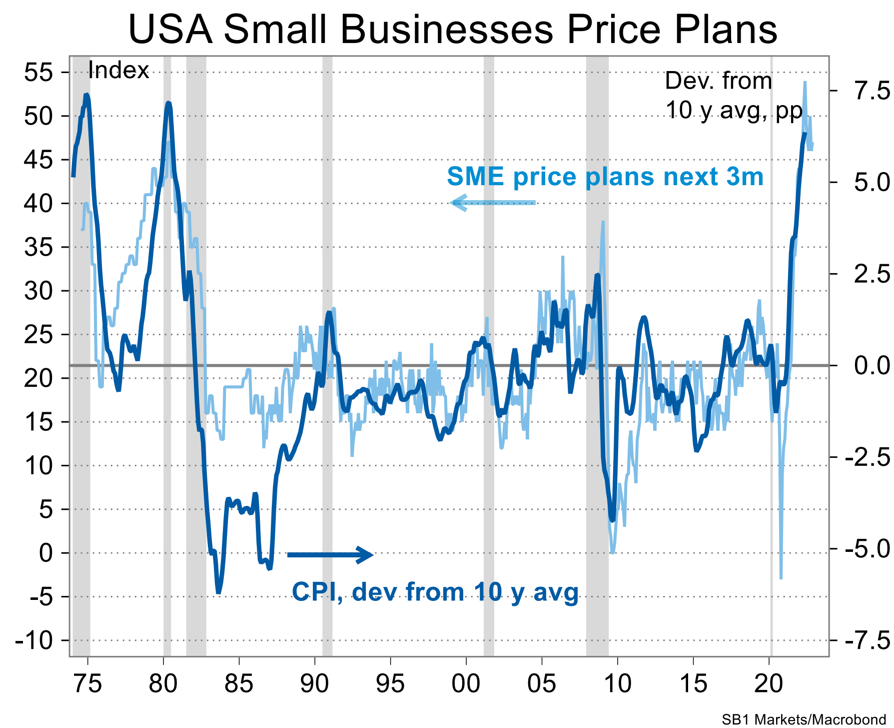


- **Philadelphia Fed's manufacturing index** fell to -3.3 in June from 2.6 in May (and 18 in April), expected up to 5
- from 17.6 in April. The index is well below average at -0.7 st.dev. The relevant sub-indices fell even more, to -0.4 st.dev, from +0.9!
  - » The outlook index (6 m future) fell sharply, and the new orders index collapsed, to far into recessionary level
- **NY Fed Empire State manufacturing index** rose to -1.2 from the -11.6 in May, expected up to 2.3. The index is well below par at -0.6 st.dev, from -1.3 in May. This index has been rather volatile lately, and it was even weaker in March
  - » The **sub-indices** also recovered, up to above average, 0.2 st.dev, from -0.7 in May
- **In sum** not a recession signal but a gradual weakening of the cycle is confirmed

Sales are fantastic, labour supply is still the challenge

A small decline in share of companies that plan to hike prices (but it is still at an extremely high level)

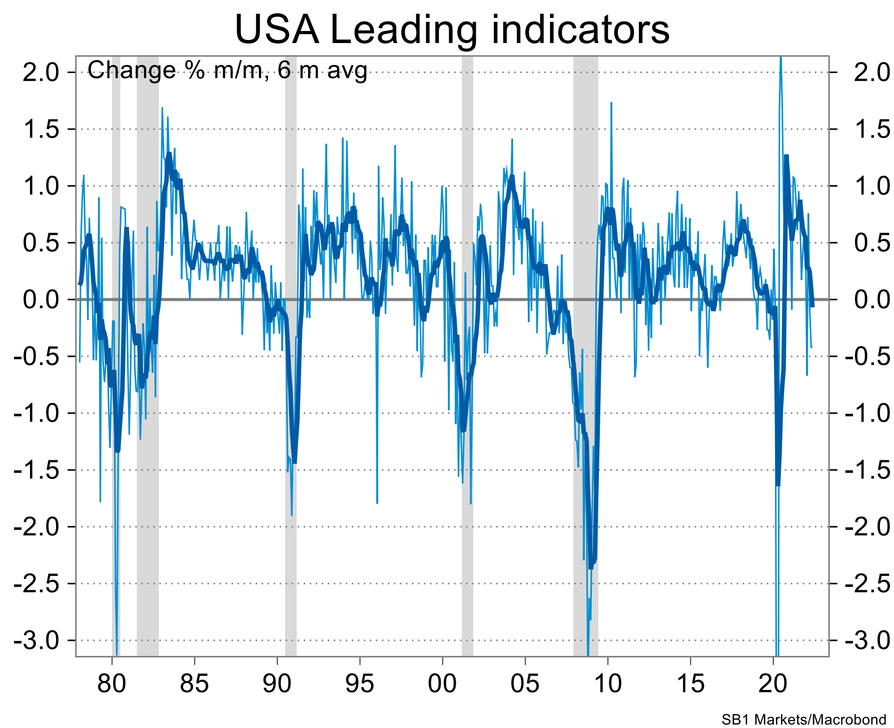


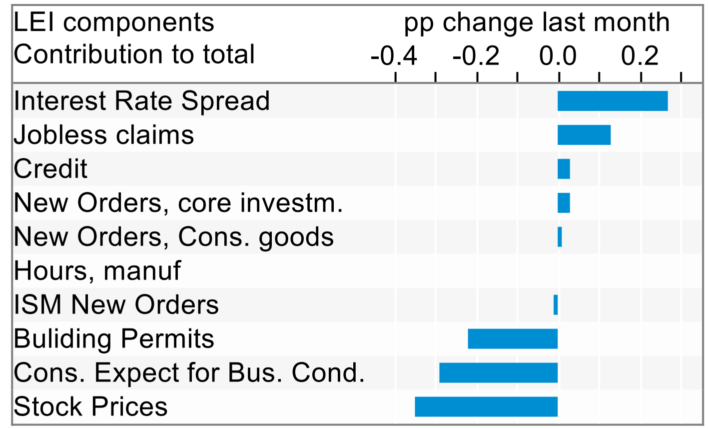


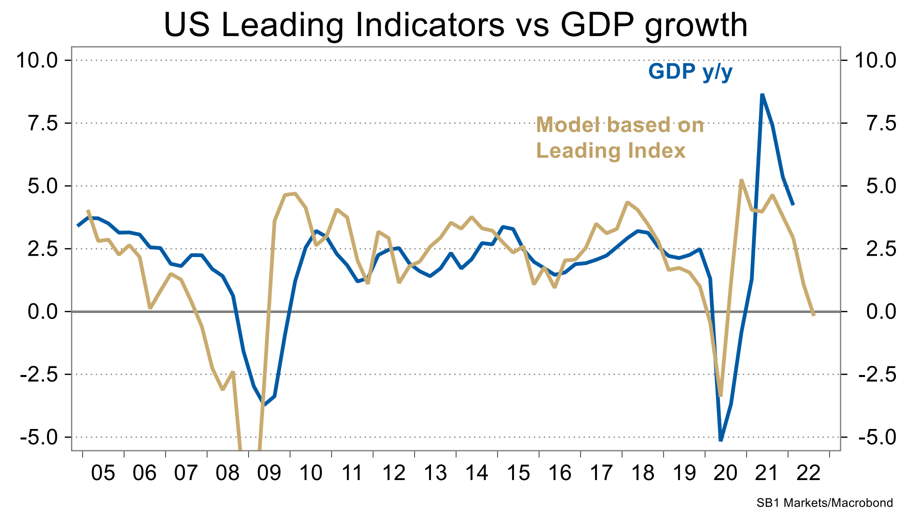
- The share of SMEs that plan to hike their **selling prices** rose 1 pp to 47%, not far below the ATH prints the previous months
- Cost & quality of labour is stated as the most important problem for a much higher share of companies than normal. However, the share has fallen somewhat from the peak, if not further in May
- The **'demand surplus'** has widening from a high level since early 2021 –and the Fed's started their tightening campaign just 3 months ago, far later than normal vs the cycle – '*the bank is far behind the curve*' (we have been saying for some time)

The Leading Economic Ind. down May too, close to a recession warning

The LEI fell by 0.4% for the 2nd month in a row. Recession not a done deal but far from unlikely





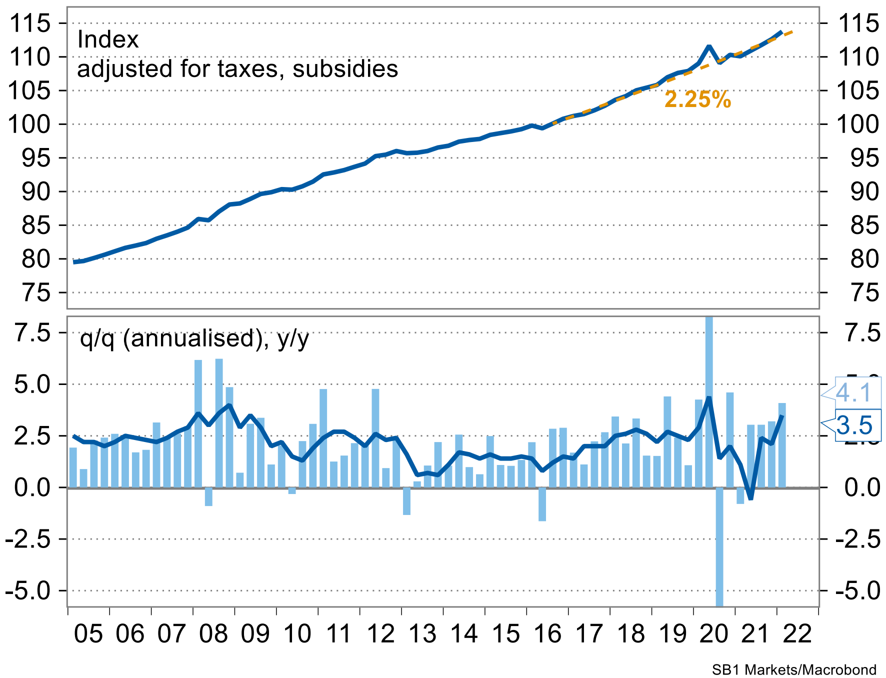


- The LEI fell 0.4% in May, as expected. April was revised down 0.1 pp to -0.4%
- The 6 m average is at -0.1%, not a 'safe' recession bet LEI has been down over 6 months 13 times since 1978 – while 'just' 5 recessions have been recorded
  - » (12 times below zero and 4 recessions if the pandemic is excluded)

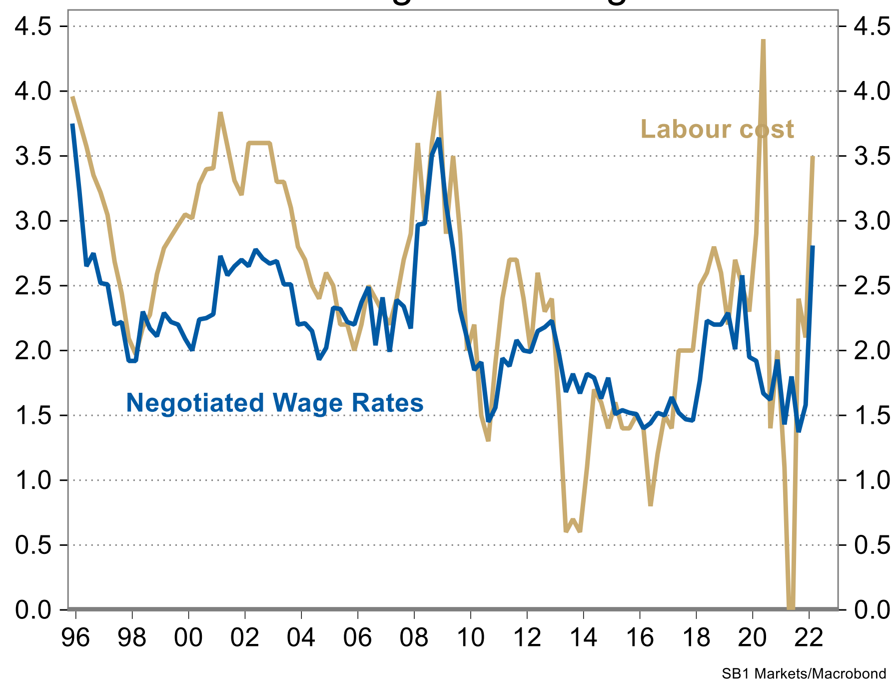
Well, now wage inflation on the way up in the EMU too!

History revised up, and wage inflation was not 2% (or below), but rather 3% – and now up to 4%

EMU Labour cost index



EMU Negotiated wages

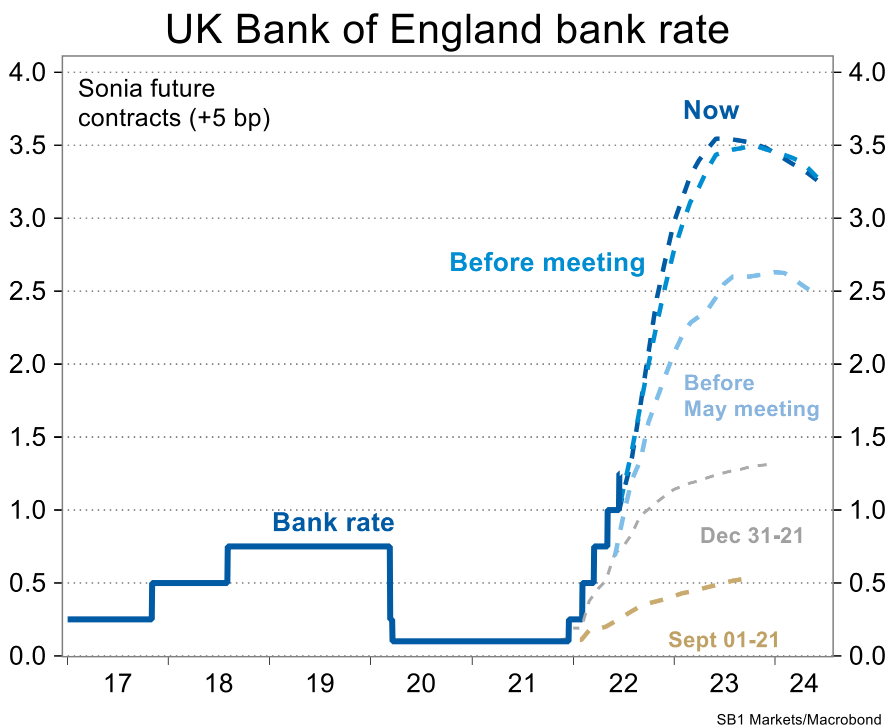


- EMU labour cost data are rather confusing but the story is clear: Wage inflation is probably on the way up
- The labour cost index is up 3.5% (taxes and subsidies included, 3,2% if not included)
- Negotiated wages rose 2.8% y/y in Q1

SpareBank 1 MARKETS

Bank of England: Inflation may reach 11%. And UK is likely in a recession, now?

The Bank hiked for the 5th time, by 25 bps to 1.25%. The outlook is dismal indeed

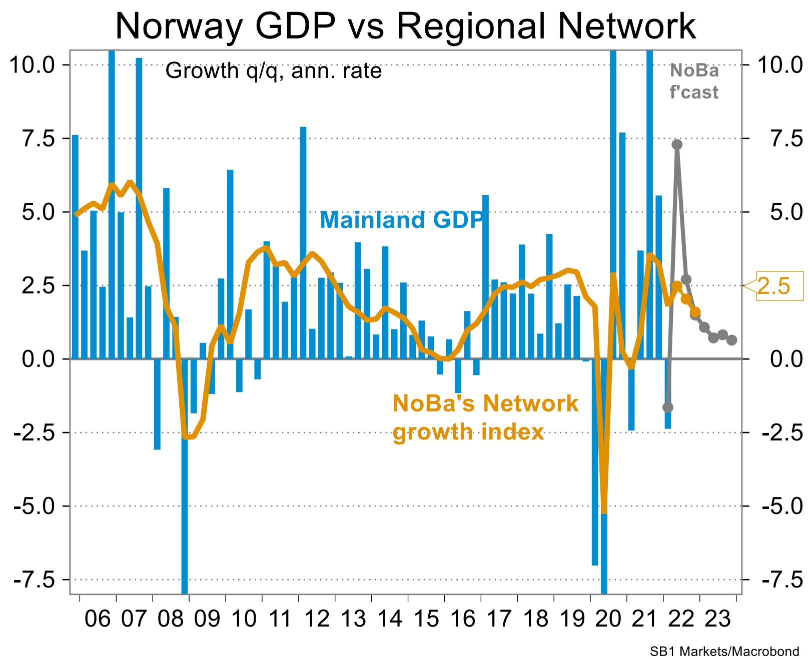


- **The bank rate** was lifted by 25 bps to 1.25%, as widely expected
  - » 3 of 9 member voted for a 50 bps hike, as in May
- **The Bank** is in a terrible squeeze:
  - » It expects inflation to accelerate further, though mostly due to higher energy prices that gradually feeds into the CPI though the semi-annual 'Ofgem' energy price cap adjustments, up to above 11% in late 2022, some 1 pp above the May forecast. Parts of the surge in inflation is caused by domestic factors, like wage inflation in a very tight labour market, and businesses' strong pricing power
  - » However, the surge in inflation will reduce disposable income sharply, and the bank expects 'a very sharp economic slowdown .
  - » GDP is expected to start declining from Q2. Parts of the setback in Q2 is due to special factors like the Queen's Platinum Jubilee (1 extra bank holiday) and less testing and tracing activities. GDP is expected down by -0.3%, vs the +0.1% forecast in May. Even if a huge (GBP15 bn, 0.5% of GDP) *Cost of living support package* was decided in May
  - » A formal forecast for the coming quarters was not published but in the May MPR UK was expected to enter a recession in Q4, and the unemployment start rising from next year, up to 5.5% in 3 years time (from 3.8% now). Now it may be that the recession has already started – however still with a very tight labour market
- **Inflation** is expected to decline rapidly from next year, but the bank does not seem to disagree with the market expectation of a further rise in the signal rate to 3.5% in one year's time
- **QT:** BoE decided as already decided to start building down its holding of assets the bank built up during the QE programs (from August or later)
- The **short end of the UK curve** rose slightly last week (and after the meeting) but the rest of the curve was close to unch.
- The **GBP** fell 0.6% last week

SpareBank 1 MARKETS

Norges Bank's Regional Network expect slower growth, in line with NoBa f'cast

Lack of capacity and high inflation dampens growth expectations



- **Implications**
  - » Taken at face value, the network report did not deviate much from NoBa's outlook. However, higher capacity utilisation, more labour shortages, higher wage inflation and still high price inflation are argument for lifting the interest path – as we assume the Bank will do at Thursday
  - » We expect the interest rate path to be revised up by some 50 bps – leaving the path 50 bps below the FRA market

Activity the past 3 months

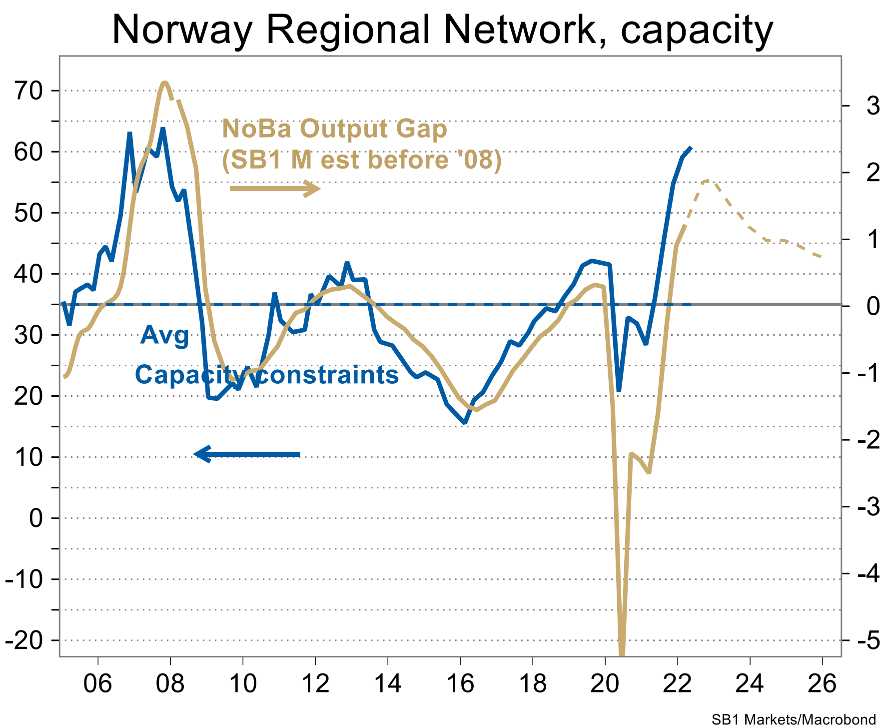
- The Network reports a 2.5% growth pace in Feb-April period (index value 1.24), up from 1.8% the previous 3 months ago. 3 months ago, growth was expected 3.3% (for the coming 6 months though). Actual Mainland GDP growth was 1.6% (annualised) past 3 months.
  - » Household services reported a decline, retail sales rather slow growth
  - » **Capacity utilisation** rose further and are close to ATH, and **labour shortages** became even more widespread, and are not far below ATH

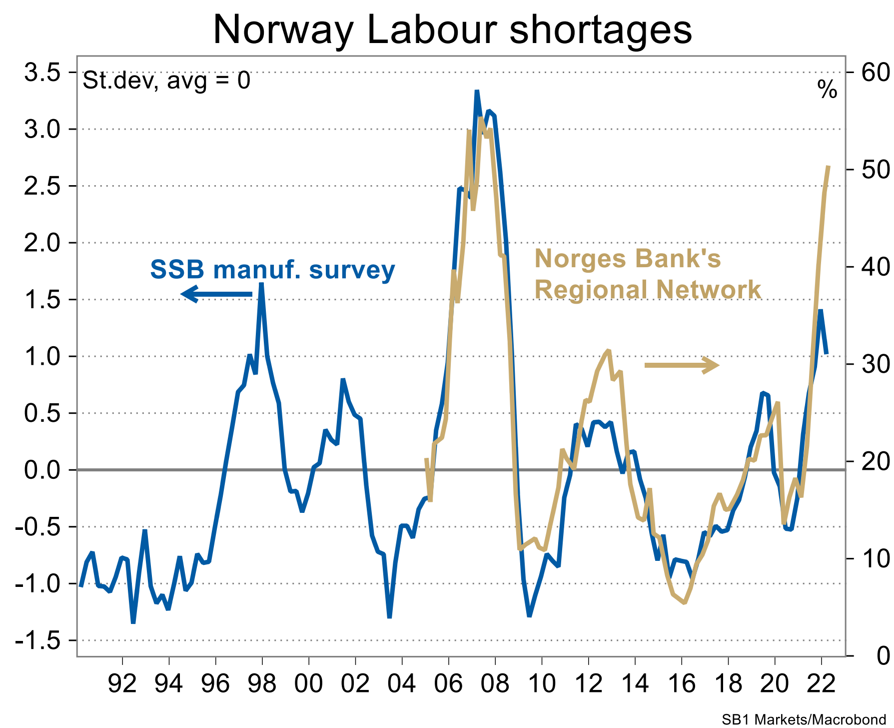
Expectations for the coming months

- The Network expects a 1.6% growth pace the next 6 months (index 0.8), down from 3.3% 3 months ago. Consensus was at 2.8%. In March, Norges Bank assumed a 2% growth pace over the next 6 months (Q2 and Q3)
  - » **Retail trade** expects sales to slow – which is reasonable as consumption of goods have been 'artificially' higher than normal during the pandemic
  - » **Household and commercial services** expect slower growth but still above trend
  - » **Construction** is slowing
  - » **Industries** are reporting stable or higher growth, is sum as we assumed. However oil services did not report higher growth as we assumed (but export industries surprised at the upside
- **Investment** were revised slightly down but growth is still expected (outside retail trade)
- **Wage inflation** expectations were revised up by 0.2 pp to 3.9%
- Companies expect **prices** to increase at an unusual pace but not faster than 3 months ago

Capacity constraints close to ATH, and Labour shortages even more wide spread

Both are not far below the 2007 ATHs



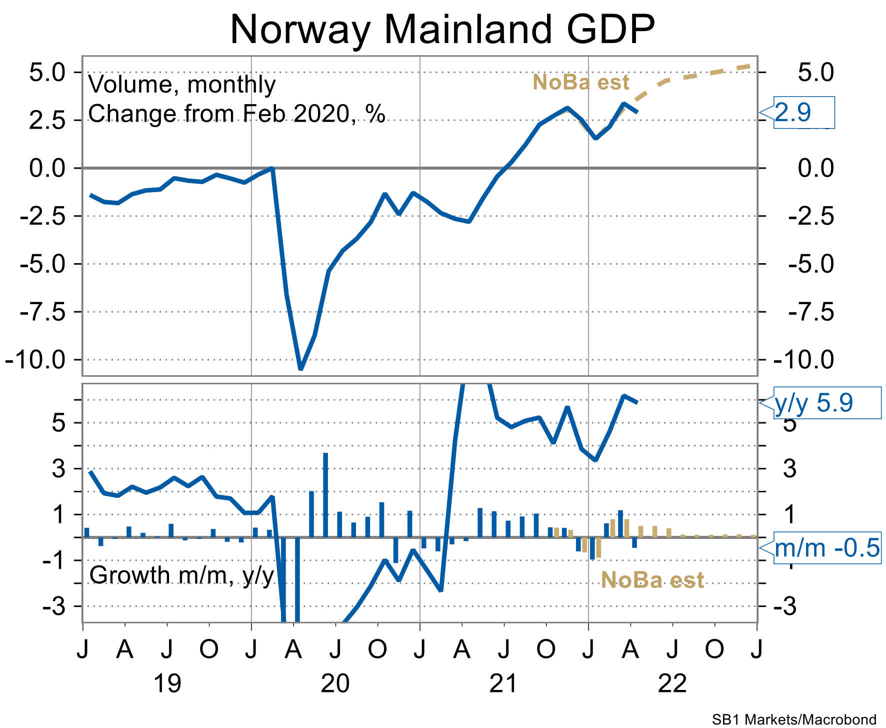


- More companies than since 2007 are reporting **capacity constraints** following the steepest surge ever, over the past 3 quarters. The correlation to NoBa's assessment of the **output gap** is not 1:1 and the Network report does not suggest than the Bank's estimate will have to be revised up. However, the rapid decline in the NAV unemployment rate to 1.7% in May indicate a higher positive output gap
- **Labour supply** shortages are shooting up, but marginally slower in Q2, and the is still below ATH level in 2007 (but not by much). Given growth expectations well above average – and plans to lift employment, the labour market will very likely tighten further the coming months. Where will companies find available workers?
- **Wage expectations** are drifting upwards, check next page

SpareBank 1 MARKETS

Mainland GDP down 0.5% in April, but recovery still very likely intact

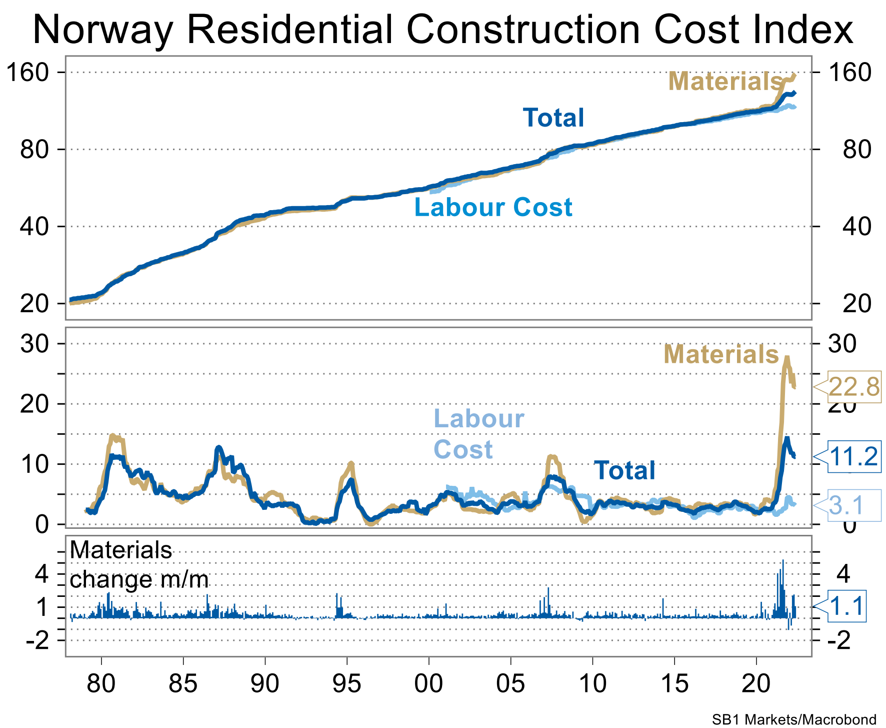
Electricity production, fish farming & trade contributed on the downside, growth elsewhere

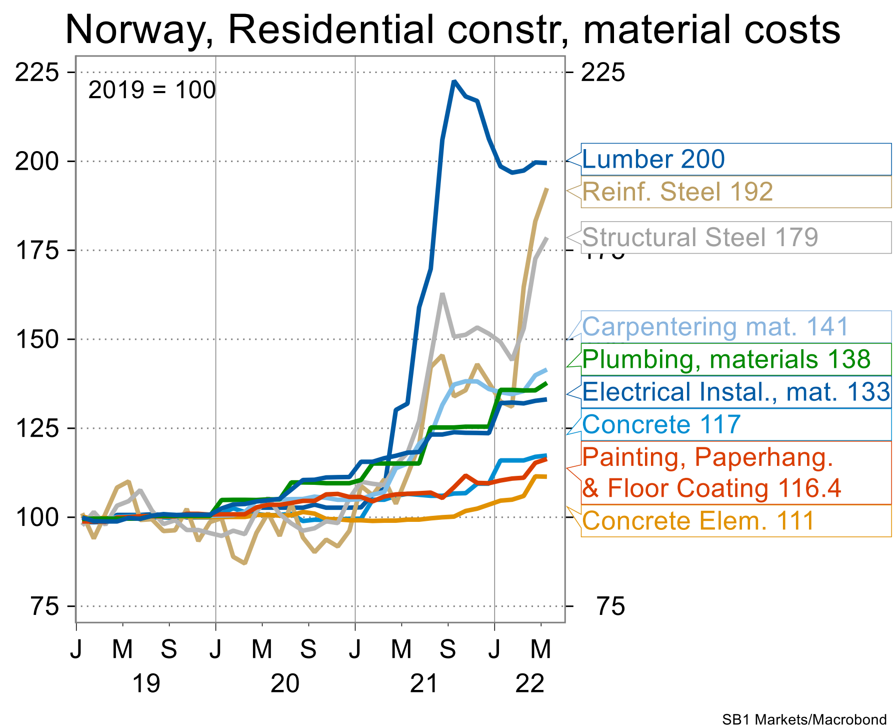


- **Mainland GDP** fell in both December and January due to Covid restrictions and changes in behaviour but recovered in February in March. However, following the surprising decline in April (expected +0.6 to 0.7%), activity is not higher than in November
  - » **Production:** All main sectors except 'other goods' contributed to growth in production in April. Within other goods, electricity production and aquaculture contributed on the downside
  - » **Demand:** Household demand in Norway fell, as spending abroad increased. Housing and Mainland business investments fell too, while oil investments rose further (but they remain below the Feb-20 level)
- **Mainland GDP** is up 2.9% vs the Feb-20 level, which is well below a normal growth path over these two year (4 – 4.5%), indicating an output gap well below the level 2 years ago
  - » However, unemployment is well below the pre-pandemic level, the employment rate (among Norwegian citizens) is far above, and businesses are reporting unusual lack of labour
  - » Businesses are also reporting a much higher capacity utilisation than before the pandemic
  - » Thus, Norges Bank is very likely right when it assumes that the output gap is substantially higher now, than before the pandemic

Building costs: Further up in May but is peaking now?

Lumber has flattened but steel prices rose further. However, commodity prices are on the way down

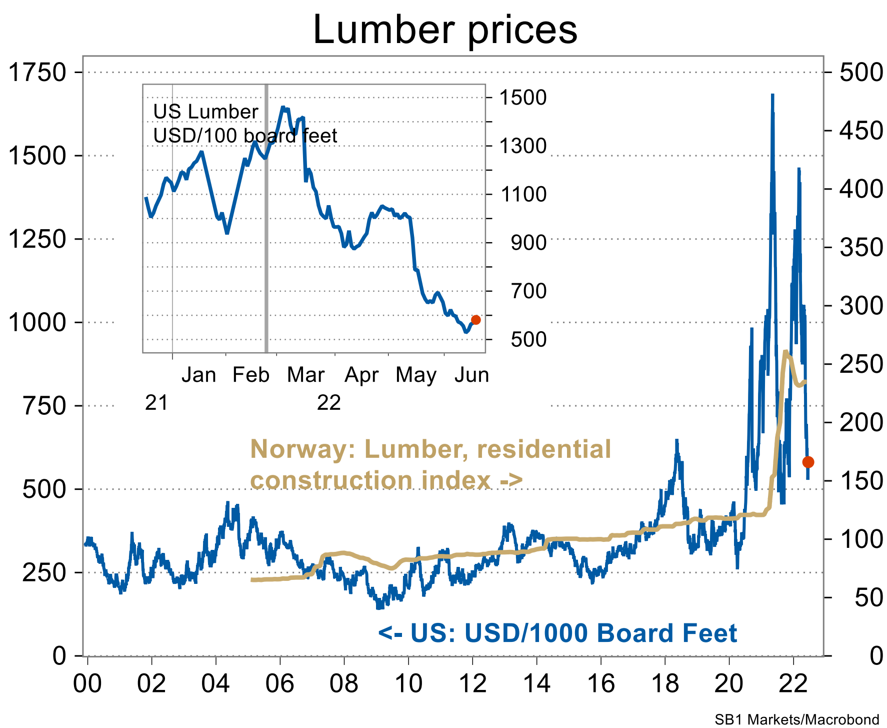




- **Material prices** (houses and apartments) added 1.1% in May, and prices are up 22.8% y/y
  - » Lumber prices has been rather stabile so far in 2022, following a 10% decline since last autumn. Prices are up 100% from the 2019 level. Steel prices are up 80% – 90% - and still increasing
  - » Other material prices are trending up, from 11% (concrete) to plumbing and carpentering material 36% – 40%
- **Labour costs** were just up 3.1% y/y in Q2, down from 4.5% in Q4 (which was the highest growth rate since 2009)
- Including labour costs, the **total building** cost index is up by 11.2%, down from the ATH at 14.6% at the peak last Oct

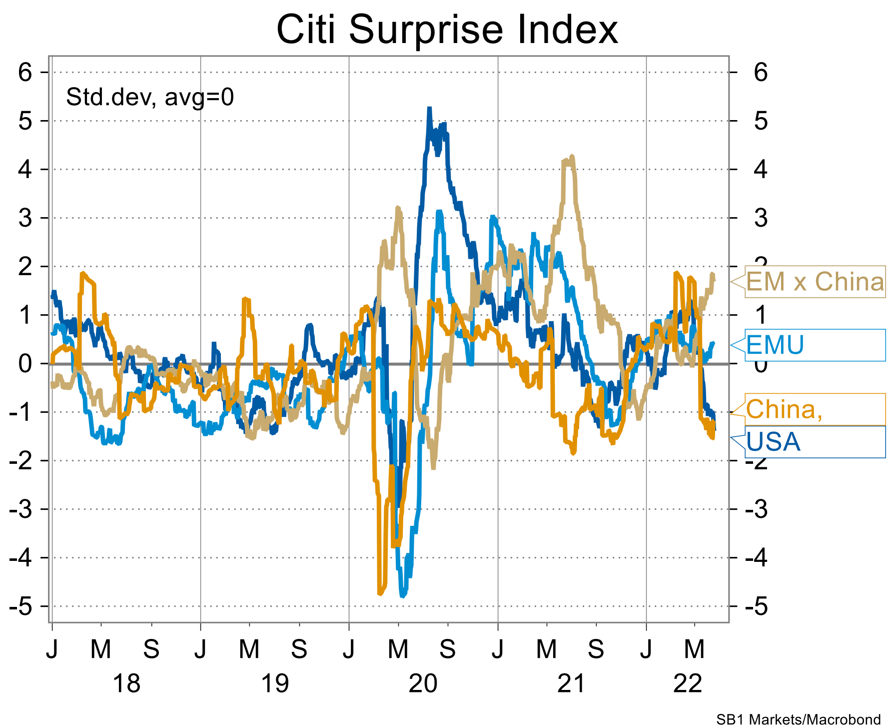
US lumber prices (2''x4) back to a normal level

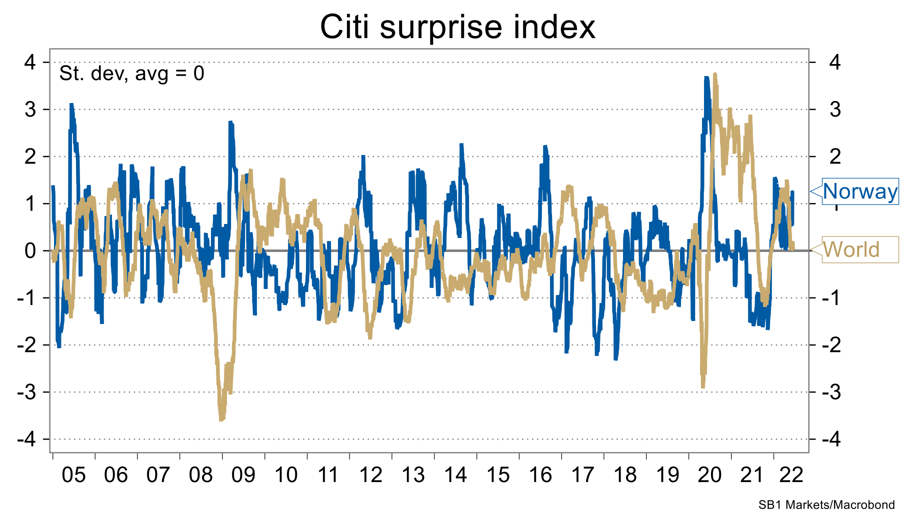
... and global steel prices are in a free fall! Prices will come down in Norway as well

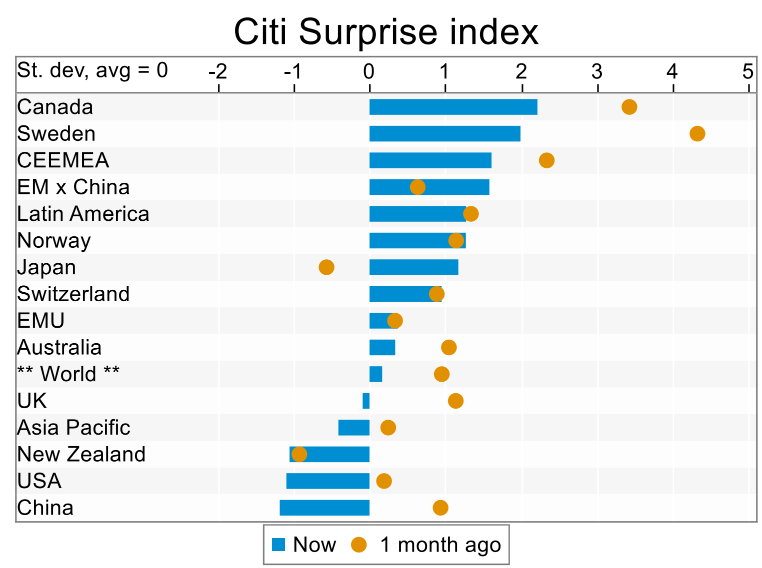


China and the US disappoints most the downside – but China less so last week

The weakening of the US economy is now for real







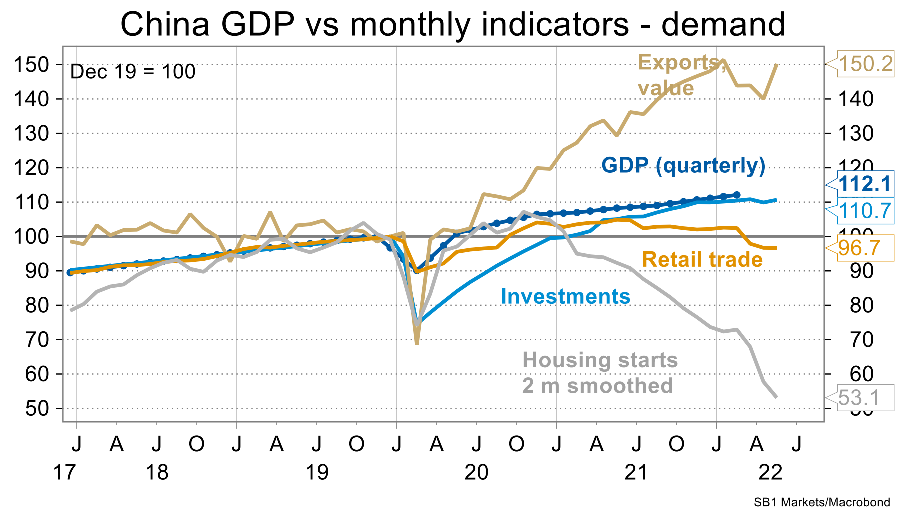
- **Emerging markets** are delivering better results than excepted
- **Norway** is surprising significantly on the upside, according to Citi
- **Canada and Sweden** at the top

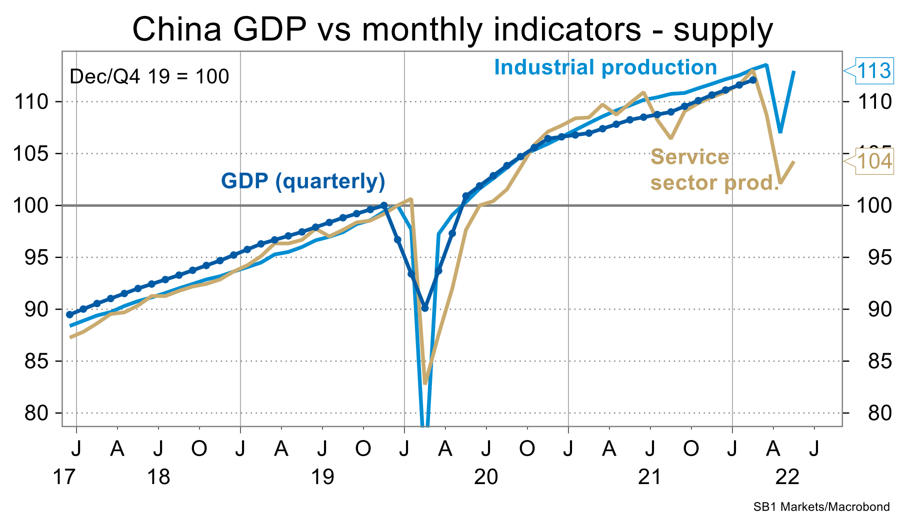
Surprise-indices measure the difference between economists' expectations and the actual outcome over a 3-month rolling window

SpareBank 1 MARKETS

Manufacturing recovered well in May, services not

All date better than expected, but GDP very likely fell sharply in Q2 (from Q1)



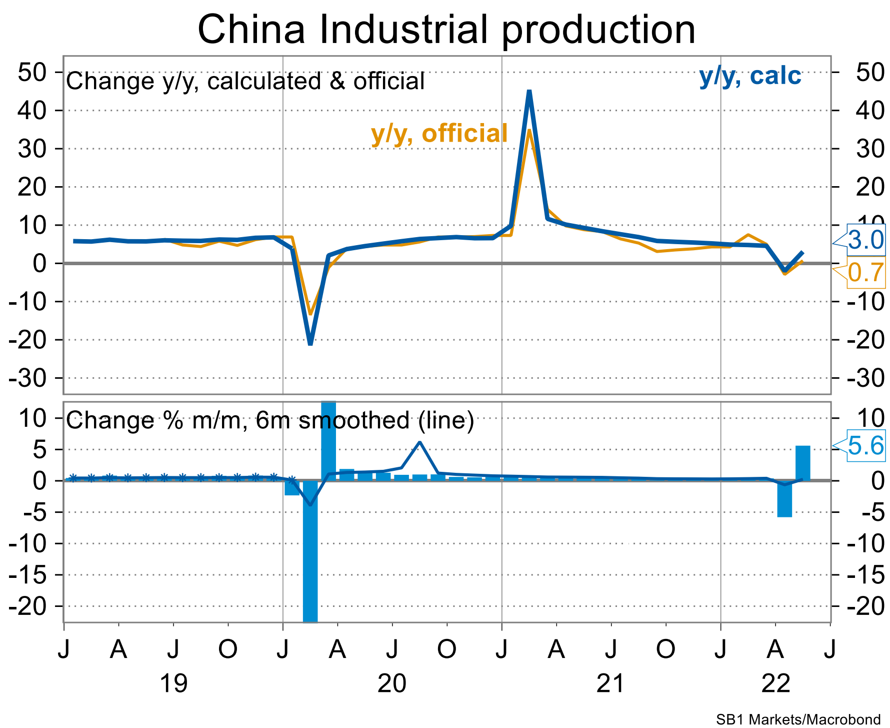


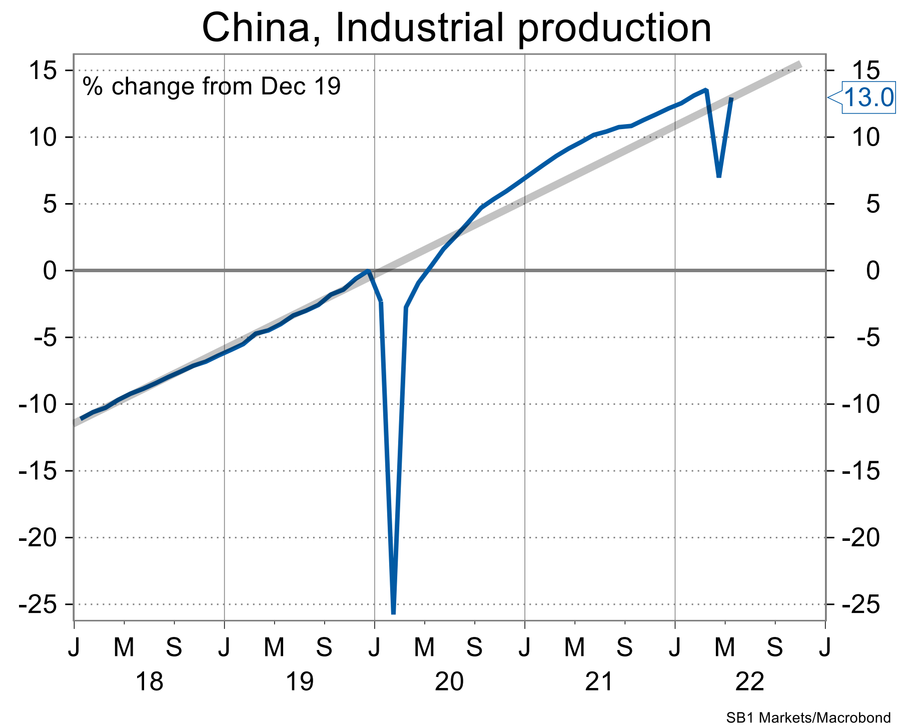
- **Industrial production** rose 5.6% in May following the 5.8% setback in April, well above expectations (+0.7% y/y, vs. expected -0.9%). Production is not far below the March level even if some cites were more or less locked down in May too
- **Service sector production gained 2.1**% in May, following the 6.1% decline in April (and -4% in March. Production is down 5.1% y/y
- Even after assuming a decent further recovery in June, **GDP** will very decline substantially q/q in Q2, and the annual growth rate will approach zero
- **Retail sales** recovered just marginally in May but the annual decline was less than expected, at -6.8%, expected -7.1%. Auto sales rose sharply in May,
- **Investments** rose 0.6% in May following the 0.9% April decline, and the level remains 0.6% below the pre-April trend path. Measured YTD, investments are up 6.2%, 0.2 pp above consensus
- **New homes sales and starts** rose slightly in May, following the 20 – 30% decline since March. Both are down 40 % y/y, as are other construction starts. Incredible data
- **Published the previous week**
  - **Credit growth** accelerated in May, after the sharp slowdown in April
  - **CPI inflation** has increased somewhat, but remains lo,. especially ex. food & energy (0.9%)
  - **Exports** rose to the highest level ever in May, and is not far below even in volume terms. **Imports** rose to, but the level is 'just' close to the pre-pandemic trend

In sum: Better than expected in May, and far better than survey data formally suggested. Still, Q2 was yielded a serious economic setback

Industrial production rose 5.6% in May, following the 5.8% drop in April

Far better than surveys signalled (like the PMIs below 50). Production to recover further in June



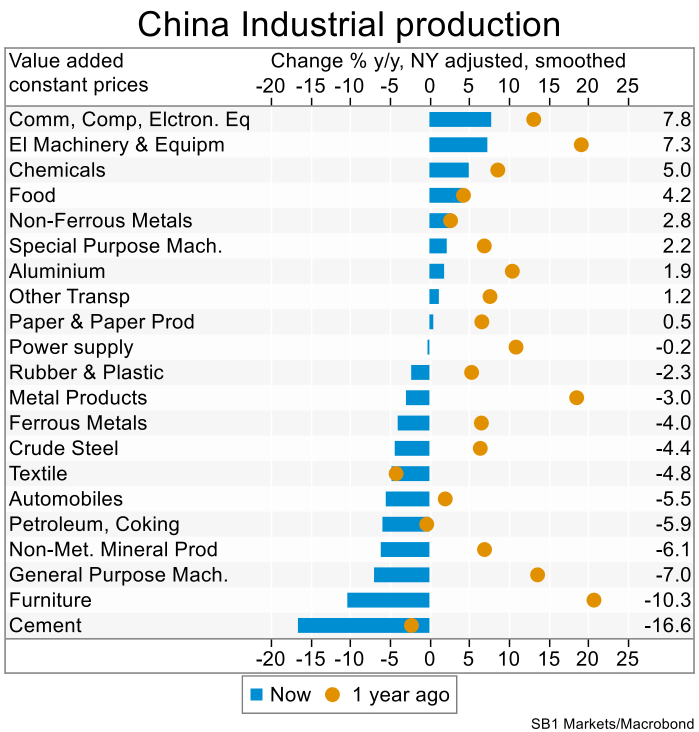


- **The production level** returned to the pre-pandemic trend path in May (grey line at the chart to the right) but still somewhat below the level in March, before the broad lockdowns hit. Production recovered in May, even if restrictions were still in place in some cities, like Shanghai (but workers at some plant were just locked in at the site!)
- **Production grew** 0.7% according to the official y/y data, well above the -0.9% forecast – and up from -2.9% in April

China

Mixed between sectors: Aluminum up, steel flat, cement down

Cement is down 12% recent months and almost 20 since early 2021

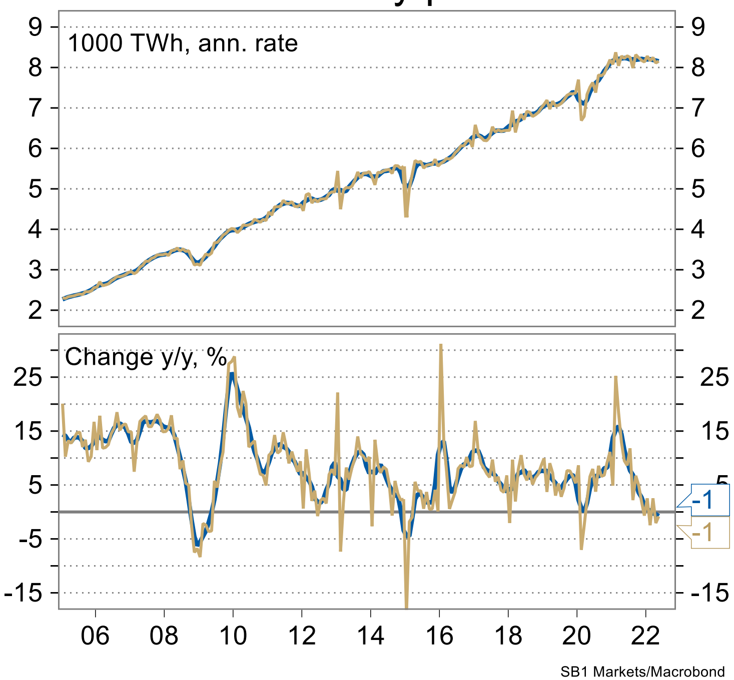


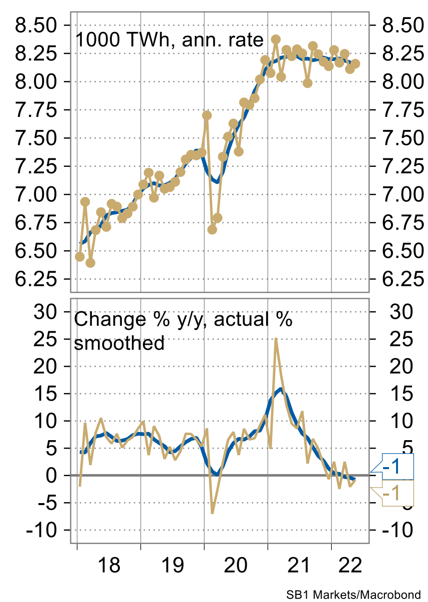
SpareBank 1 MARKETS

Electricity production is trending slowly down

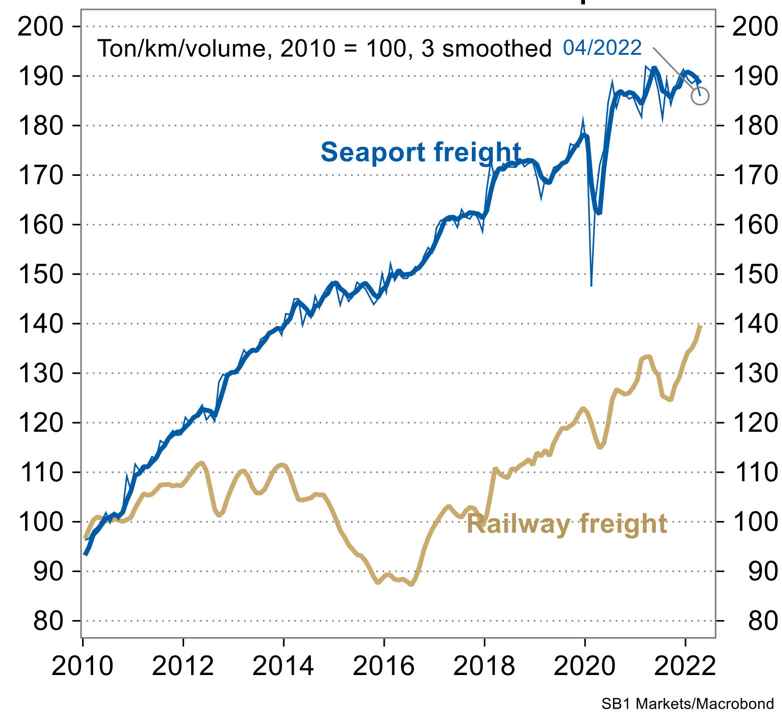
Signals a slow down in heavy industries as well

China Electricity production





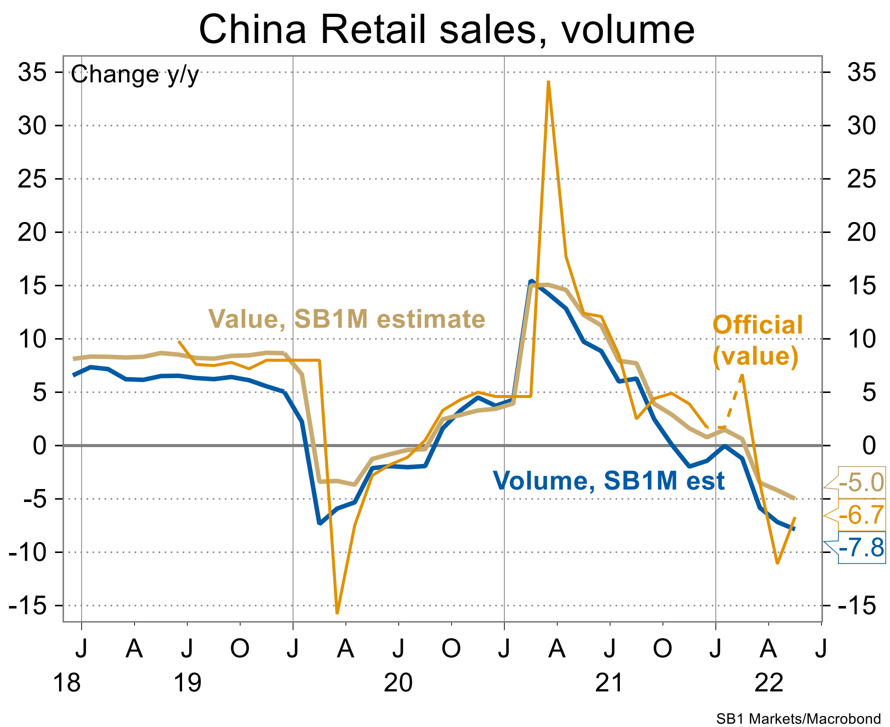
China Trade and transport

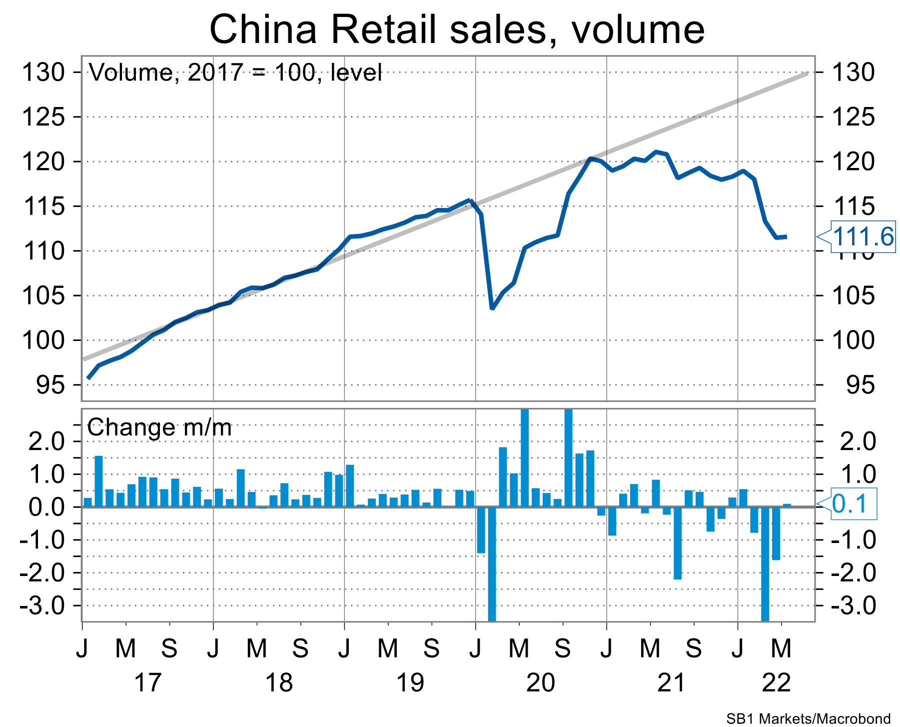


- Seaport traffic is not terrific either (but domestic railway freight is, though)

Retail sales just marginally up in May, following the 6% decline Feb-April

Sales down 6.7% y/y, expected -7.1%. Sales have been weak since late 2000 – og are now very low



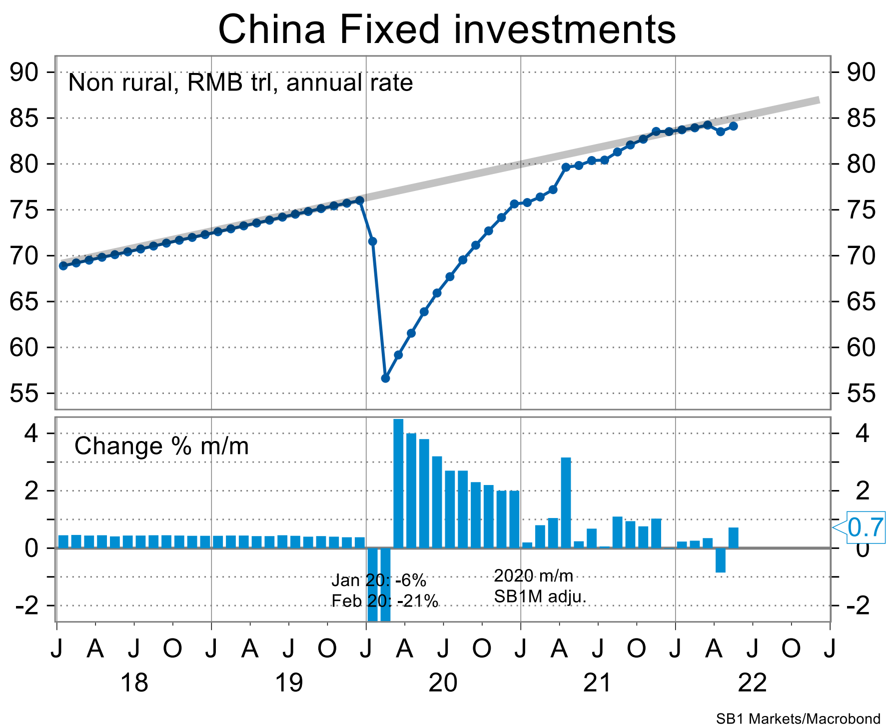


- Sales rose 0.1% m/m in **nominal terms**, we assume the same in **real terms**, following the 1.5% decline in April. We estimate a 8% decline in volume terms measured y/y in May

Memo: Monthly sales data are still somewhat to difficult of decipher, and they are not consistent with annual growth rates - so do not take out interpretation of them too literally

Investments recovered some of the April loss

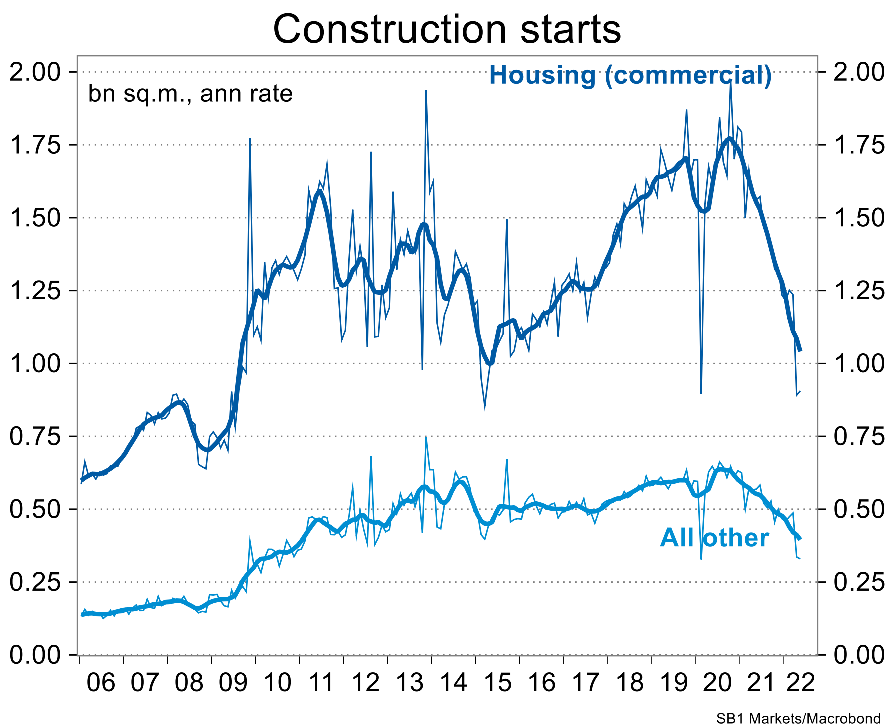
Investments rose 0.7% m/m but still some 0.6% below the pre April trend path

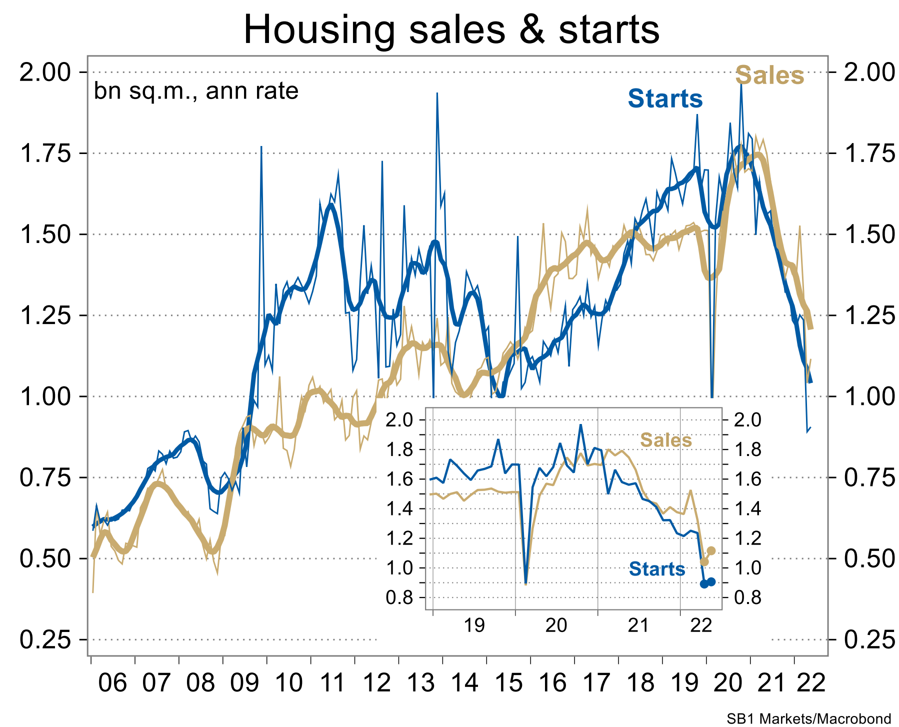


- **Measured YTD**, nominal urban investments rose 6.2%, above the expected 6.0%, down from 6.8% in April (and 9.3% in March). Growth was 5% measured y/y in April
  - » However, in volume terms, growth was probably close to zero
- The **investment level** has been back to the pre-pandemic growth path since last September but fell below in April

New homes sales, starts stabilised in May following the 20-30% March/Apr. setb.

Let's hope & pray lockdowns are to blame for the drop this spring. The alternative would be worse

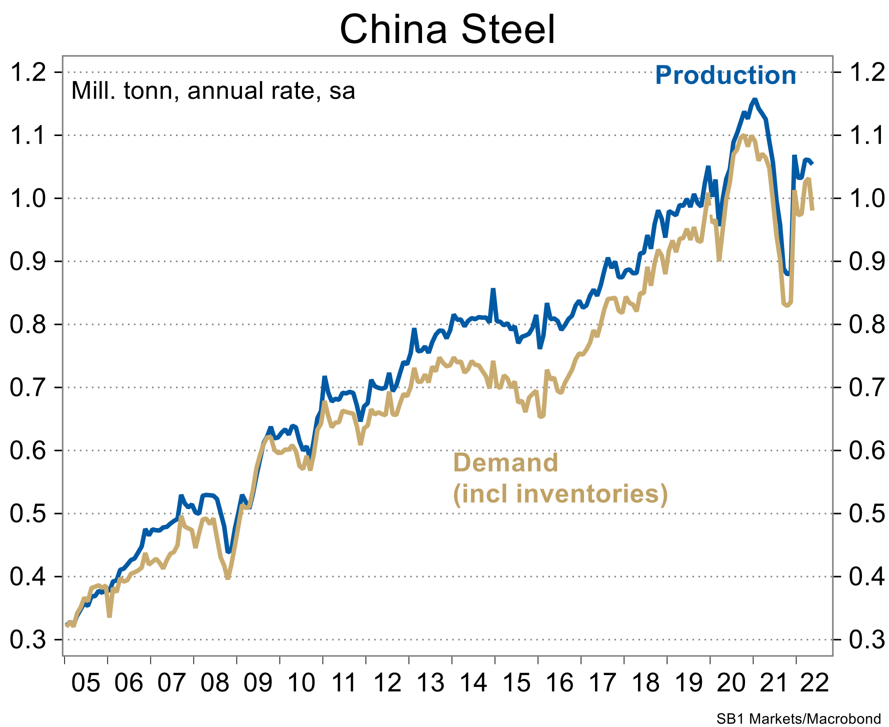




- **New home sales** rose 10% in May, while **starts** were close to unchanged. Both are down 20 – 30% from February, and 40% y/y
- **Big picture, before the lockdowns: Non-residential construction starts** had flattened, following a 25% decline since mid 2020. Both housing & non-residential starts were at the lowest level since 2017. And then came the 2nd leg down in March/April – and starts are at the lowest level since a short drop in 2015 or in 2009/10

Steel production slightly down, domestic demand not.

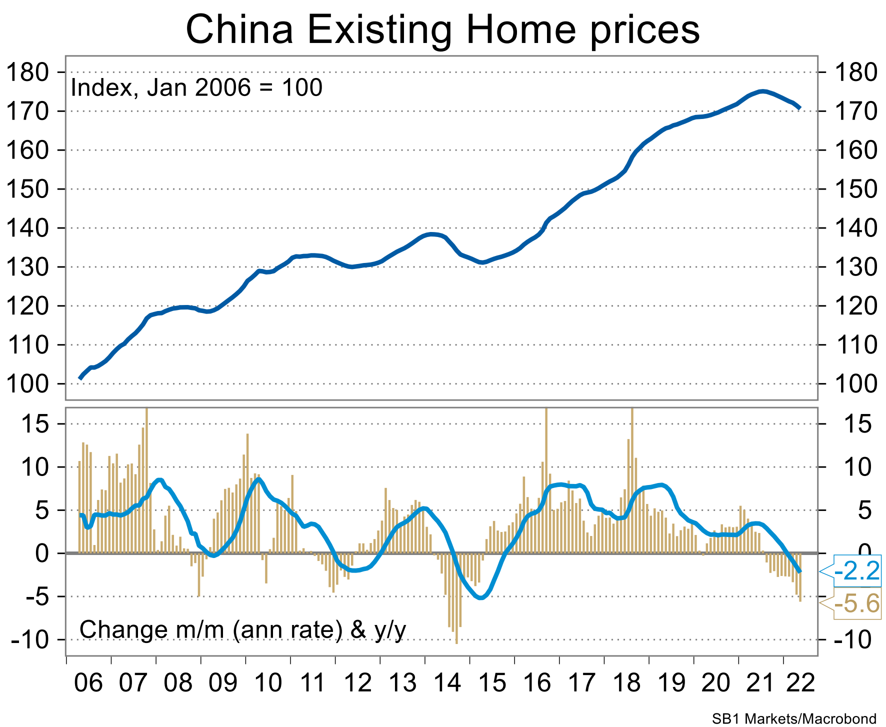
Construction starts are way below steel production/demand

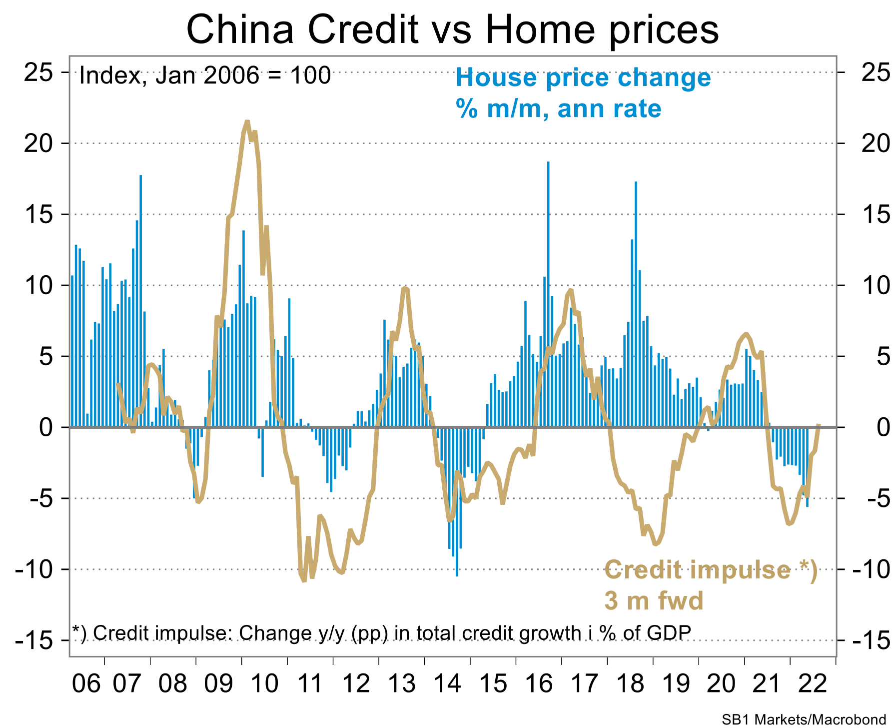


SpareBank 1 MARKETS

Existing home prices fell at an even faster rate in May. Lockdowns, or for 'real'?

Prices fell for the 9th month in row, and are down 2.2% y/y. New home prices fell sharply too

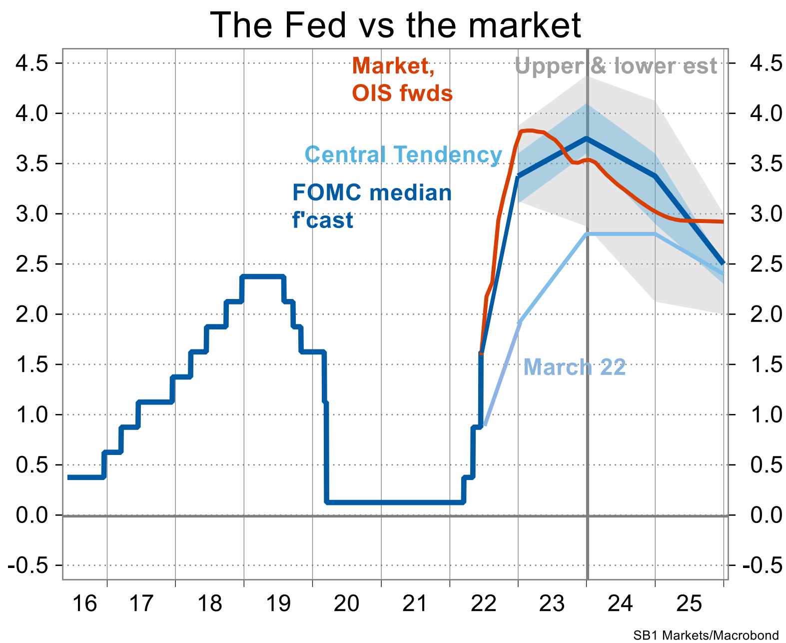




- **Existing home prices** peaked last July, and are falling at an gradually faster pace, in April by 5.6% (m/m annualised), from 4.6% in April. Measured y/y, prices are down 2.2%
- **New home prices** also fell last autumn but slower than existing home prices, and almost stabilised in Q1. However, from February prices have been falling, and in April and May prices fell at a 3.5 – 4% pace, and they are down 0.8% y/y. Some builders have reported deep price cuts to reduce the inventory and secure financing. Analysts have questioned the reliability of the official data, to which we refer here
- The gradual decline in prices since last summer is probably due both some fire sales from construction companies that run out of other sources of financing, and some hesitance from home buyers**.**
- **Credit growth** accelerated marginally during last year and through Q1, however mostly due to increased borrowing from local governments. In April, bank lending collapsed, possibly due to lockdowns (which could impact both supply and demand for credit). In May, credit supply recovered. The **central bank** has cut **signal rates** somewhat, and reserve requirements are cut

The ‘promised’ 75 bps hike was delivered, and the path was lifted by up to 150 bp

The FOMC has taken the gloves off, signal willingness to fight inflation. At any cost?



- **Market reactions**: The far end of the FRA curve fell but up to 20 bps, and long-term yields fell. The stock market rose sharply – before falling much more on Thursday
- **We think this was the last upward revision of the path for a while, the economy is now responding to the total tightening of financial conditions**

- As pre-warned to the WSJ at Monday afternoon, the FOMC hiked the **Fed funds rate by 75 bps to 1.50% – 1.75%**
- **The interest rate path**, the dot plot, was lifted by up to 150 bps, another ATH lift in the path for the 3rd meeting in row (70 bps in Dec, 120 bps in March)
- **The median forecast in the dot plot** for end of 2022 at 3.375% (measured at the mid in the 25-bps signal rate corridor, from 1.625% now), implies 7 x 25 steps during the 4 FOMC meetings in H2. Powell signalled that another 75 bps was not unlikely in July
- The **2022 inflation forecast** was still revised upwards, to 5.2% from 4.3% in 2022 (Q4/Q4), while both 2023 and 2024 remained above the 2% long term target, both the total PCE deflator and the core
- The FOMC members revised their **growth forecasts** significantly downwards, especially for 2022 (to 1.7% from 2.8%, Q4 y/y) but also for 2023. (NY Fed’s model projections are far weaker, a decline in both 2022 and 2023 is forecasted – that is a long recession, check here)
- The **unemployment rate** was revised upwards, already from this year, but it will not climb to more than 4.1% in 2024, vs. the previous 3.6% f’cast, and to marginally above the estimate for the long-term equilibrium at 4.0%
- Finally, the forecast is balanced, in the sense that inflation is too high but unemployment at the same time marginally too high too - but not before 2024. In the meantime, inflation is far above the target while unemployment is below the assume long-term rate. Thus, the FOMC is satisfied with missing both targets at ‘the same side’ through 2022 and 2023 (and probably most of 2024)
- Even so, we think the FOMC now has taken its gloves off and decided to fight hard against price AND WAGE inflation, almost at any cost, signalled by the 150-bps lift of the interest rate path. Because the cost taking the fight at a lager stage will be even larger
- The FOMC members do not say they think a recession is likely. But we are pretty sure they recognise that the risk is substantial. However, most central banks do not predict recessions before they arrive. (The exception now: Bank of England)

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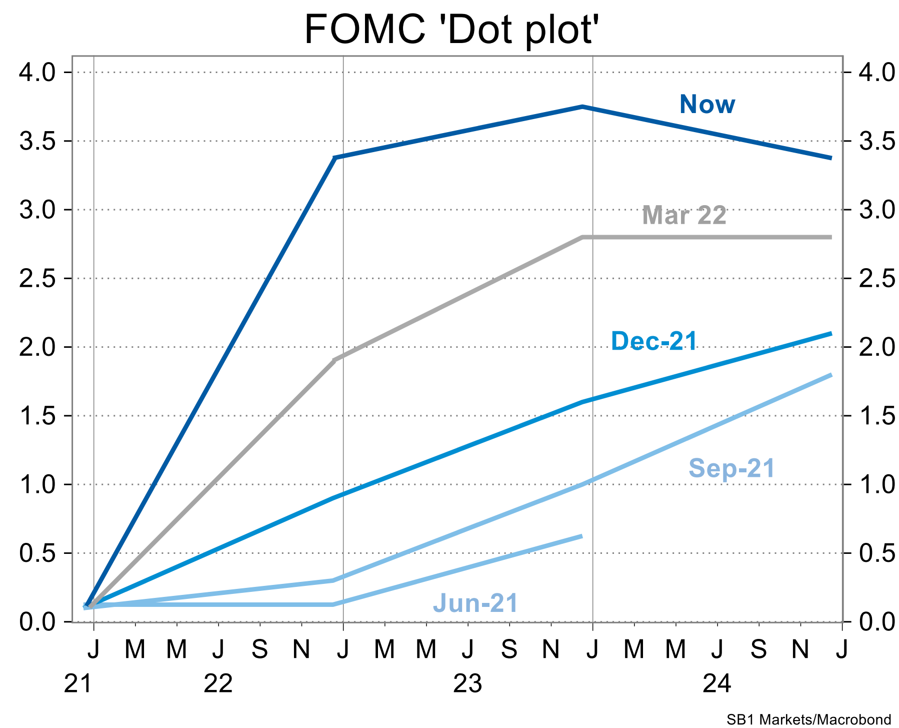
Inflation revised up, growth down, unemployment up. An rates up, big time

The cut in the growth forecast was substantial – not the increase in the unemployment rate

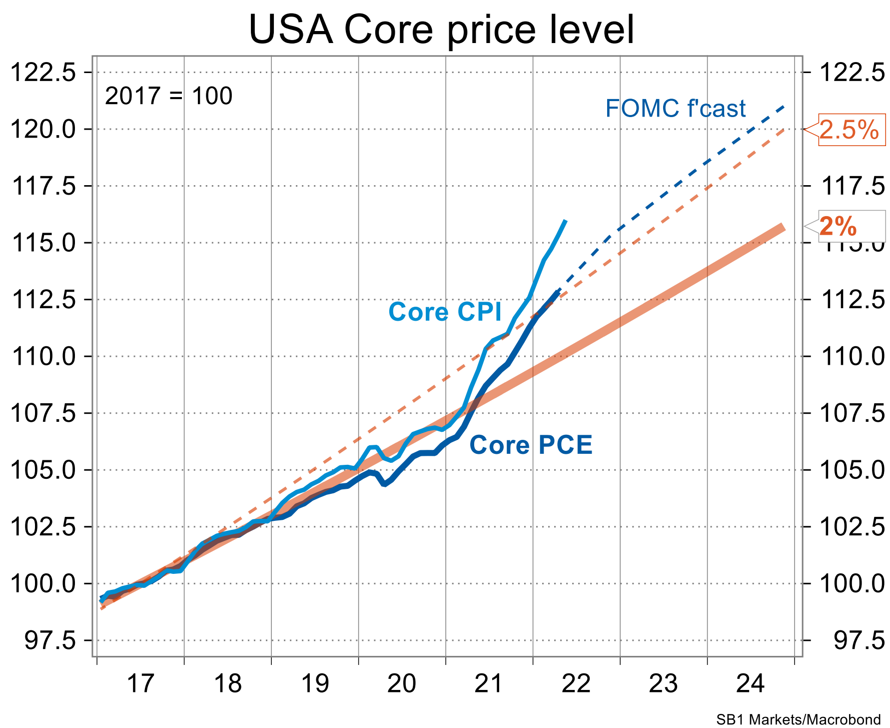
Percent

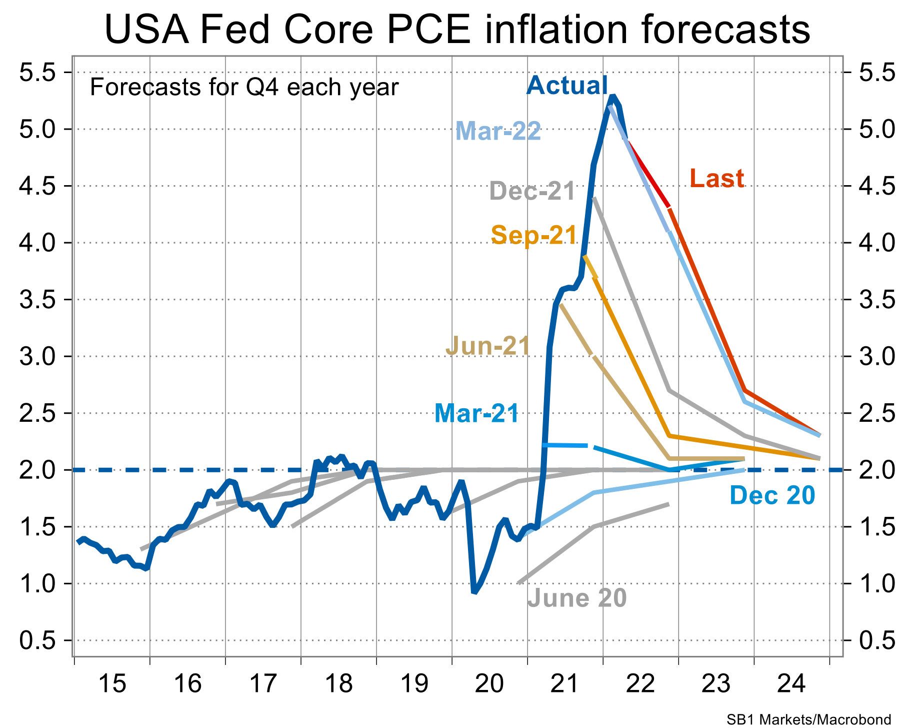
Variable	Median[1] 2022	2023	2024	Longer run
Change in real GDP	1.7	1.7	1.9	1.8
March projection	2.8	2.2	2.0	1.8
Unemployment rate	3.7	3.9	4.1	4.0
March projection	3.5	3.5	3.6	4.0
PCE inflation	5.2	2.6	2.2	2.0
March projection	4.3	2.7	2.3	2.0
Core PCE inflation[4]	4.3	2.7	2.3	
March projection	4.1	2.6	2.3	
Memo: Projected appropriate policy path				
Federal funds rate	3.4	3.8	3.4	2.5
March projection	1.9	2.8	2.8	2.4



- The **'22 GDP f'cast** was revised down by 1.1 pp to 1.7% (it was 4% in December last year). **Unemployment** is revised upwards, by up to 0.5 pp. It will start slowly increasing in 2022, up to 3.7% from the present 3.6%
- **Total PCE inflation** was revised sharply up in 2022 but core not by much. Still, even the core rate of PCE inflation will remain above 2% until 2024 (the last year of f'cast)
- **The median dot plot**, the individual FOMC members interest rate forecasts, was revised up by up to 150 bps, the largest revision ever (dot plots have been published since 2012), following the 120 bps lift in March and the 70 bps upward revision in December. (Dec and March were ATH lifts too). A total turnaround, of course
- **The long term neutral Fed funds rate** is assumed to be 2.5% (median, up 0.1 p), implying a (long term) 0.5% positive real rate. The neutral rate is assume to be reached om early 2023. The quantitative tightening (QT, QE in reverse) by selling bond, which started in early June, will add to the monetary policy tightening

The anchor is lifted? The price level in 2024 will be 4.6% higher than 'promised'

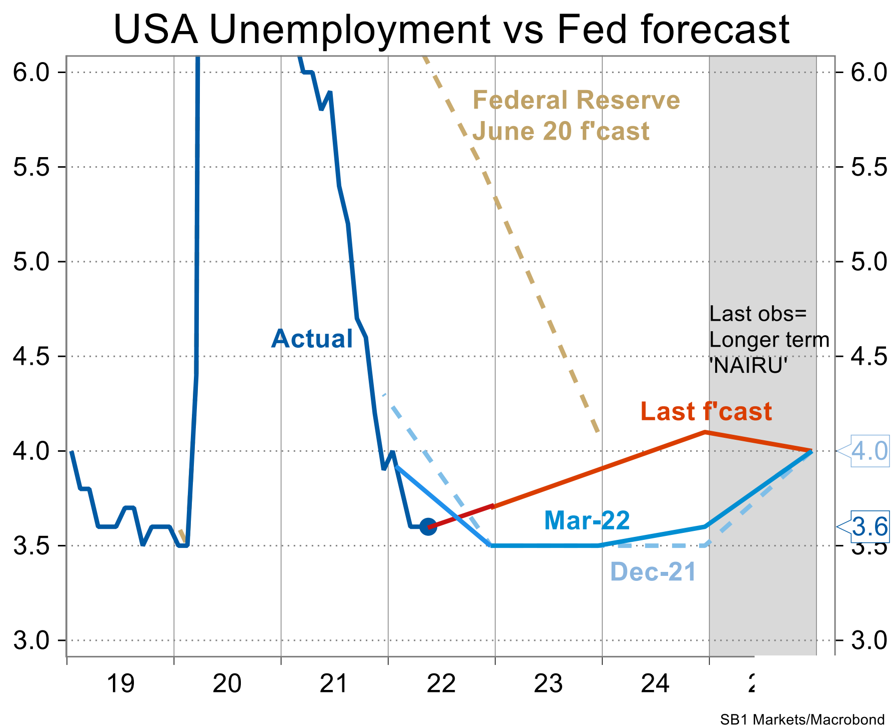




- In August 2020, the FOMC introduced its new **price level target**. The bank aims to reach an average rate of inflation of 2% over time.
- If inflation has been below 2%, annual inflation should be allowed to stay above 2% in order lift the price level up to the long term 2%-path
- And vice versa, at least in principle…

Unemployment expected to stay below the NAIRU the next ~~3~~ 2 years

The long term NAIRU *) rate is still assumed to be 4%. In Q4 2024, 4.1% will be reached

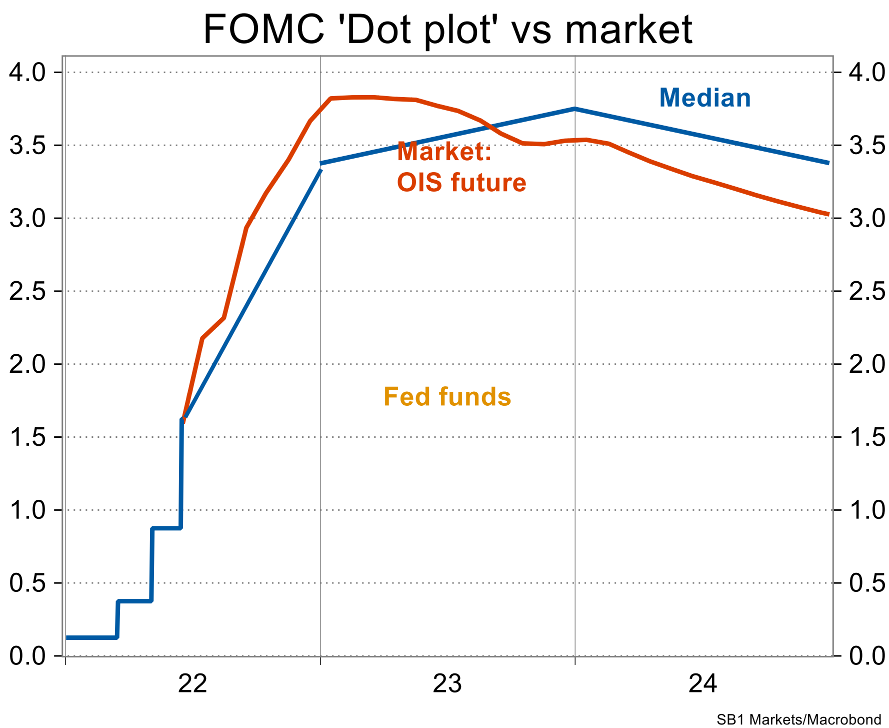


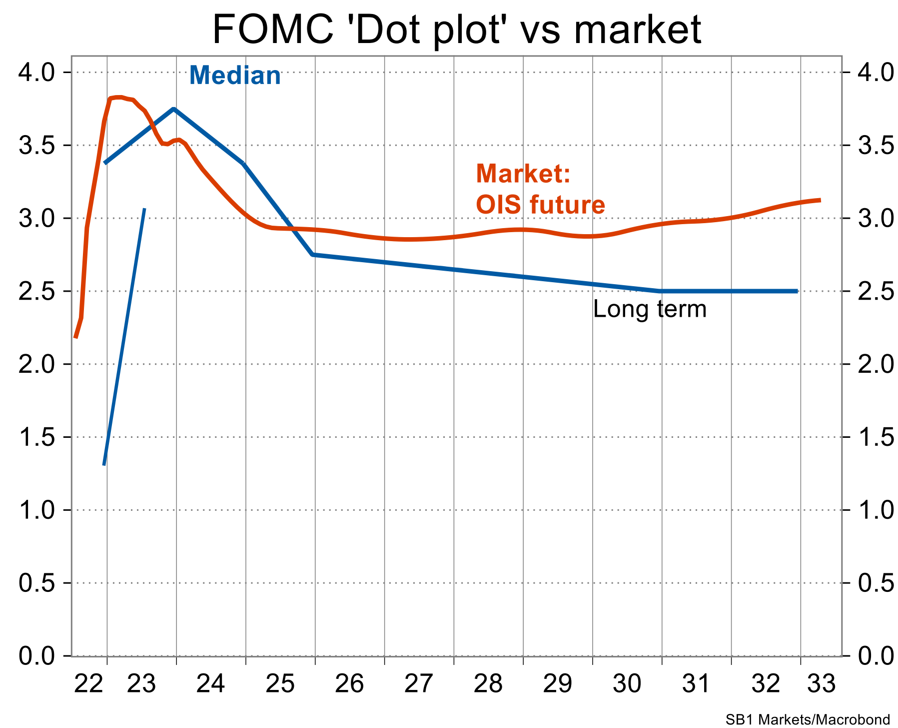
- We think it is rather likely that 4.1% will be reached much earlier. Perhaps even before Q4-2022?

*) 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.

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

Now, the market is above Fed's estimate. 3 months ago, it was far below!





- The market expect the Fed to take 8 x 25 in H2, 1 more than the median FOMC member
- Markets expect the Fed funds rate to turn south from from Q2/Q3 2023
- However, longer term, the rate is expected to stay close to 3%, and above FOMCs estimate of a long-term neutral 2.5% real Fed funds rate

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What does the Fed('s model) say? Winter is coming!

The probability for a recession is 90% - and GDP will most likely decline through both '22 and '23!

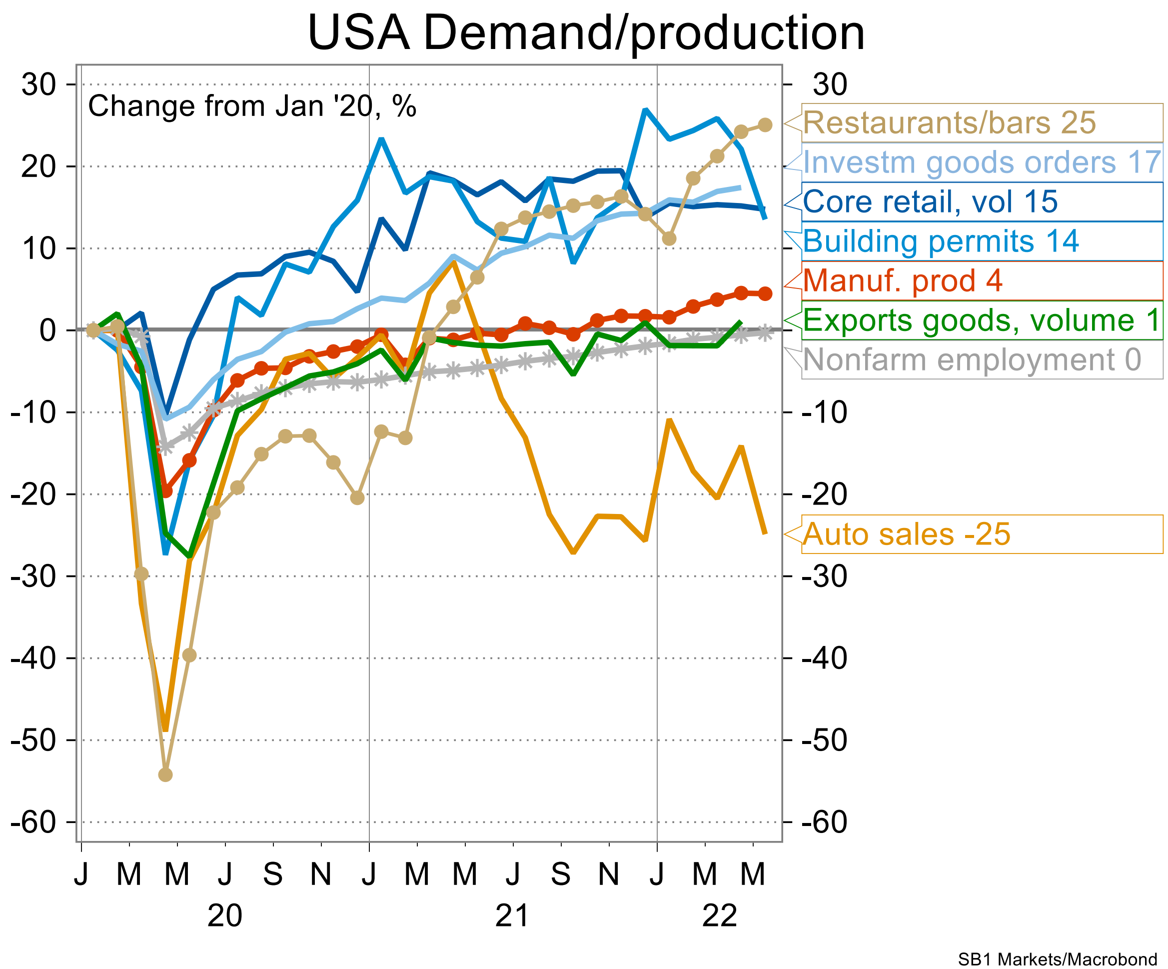
Forecast Comparison

	2022		2023		2024		2025	
	Jun	Mar	Jun	Mar	Jun	Mar	Jun	Mar
GDP growth (Q4/Q4)	-0.6 (-3.6, 2.3)	0.9 (-0.8, 2.6)	-0.5 (-5.0, 4.0)	1.2 (-0.6, 3.1)	0.4 (-4.4, 5.3)	1.5 (-0.3, 3.4)	1.4 (-3.9, 6.5)	1.8 (-0.1, 3.6)
Core PCE inflation (Q4/Q4)	3.8 (3.3, 4.4)	2.8 (2.1, 3.6)	2.5 (1.7, 3.4)	2.2 (1.3, 3.1)	2.1 (1.2, 3.1)	2.0 (1.1, 3.0)	2.0 (1.0, 3.0)	2.0 (1.0, 3.0)
Real natural rate of interest (Q4)	0.9 (-0.4, 2.1)	0.0 (-1.3, 1.4)	0.9 (-0.5, 2.4)	0.4 (-1.1, 1.9)	0.9 (-0.7, 2.4)	0.6 (-1.0, 2.1)	0.8 (-0.9, 2.5)	0.6 (-1.1, 2.3)

- To June from March, the centre forecast for Q4-2022 y/y GDP growth was revised down by 1.5 pp to -0.6%
- .. And the Q4-2023 y/y estimate was cut by 1.7 pp to -0.5%
- Thus, the Q4-2023 GDP level was revised down by 3.2%, and the level will be 1.1% below Q4-2021!
  - In addition, 2024 and 2025 was revised down by 1.1 pp and 0.4 pp, resp., in sum 1.5 pp. Grand total down 4.7% vs the March f'cast –
- If so, a not very deep, but a rather long-lasting recession – and a slow recovery thereafter
- The model forecast are way below the FOMC members' forecast: by end of 2023, the difference (in GDP level) is 4.5%!!
- The natural real rate of interest was revised up to 0.9% from zero

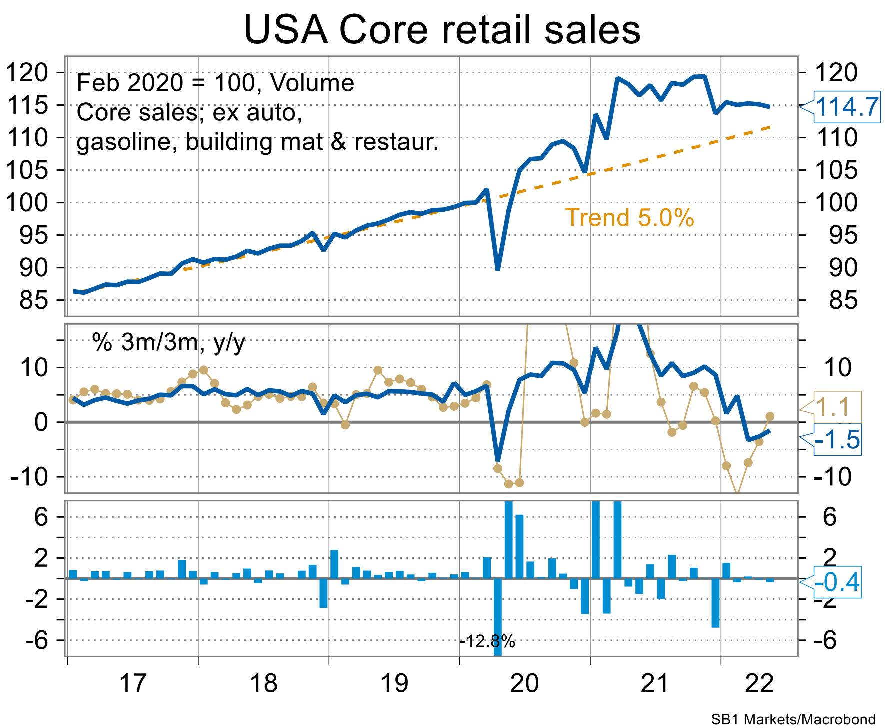
US: Waiting for demand destruction?

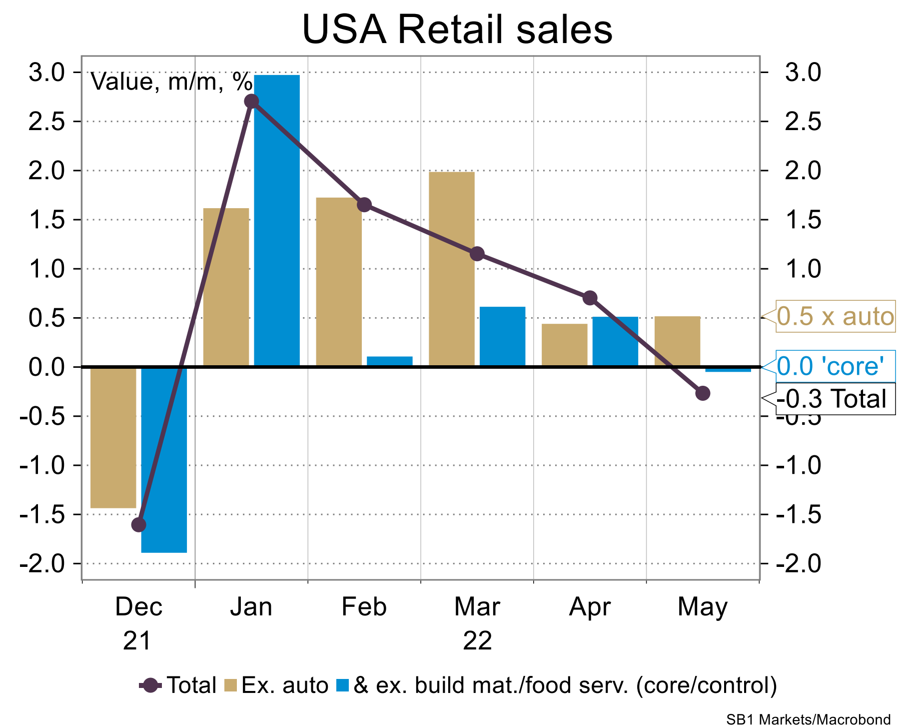
Housing is weakening, and demand for goods ex autos are waning?



Retail sales slows sharply, finally. Services or interest rates to blame?

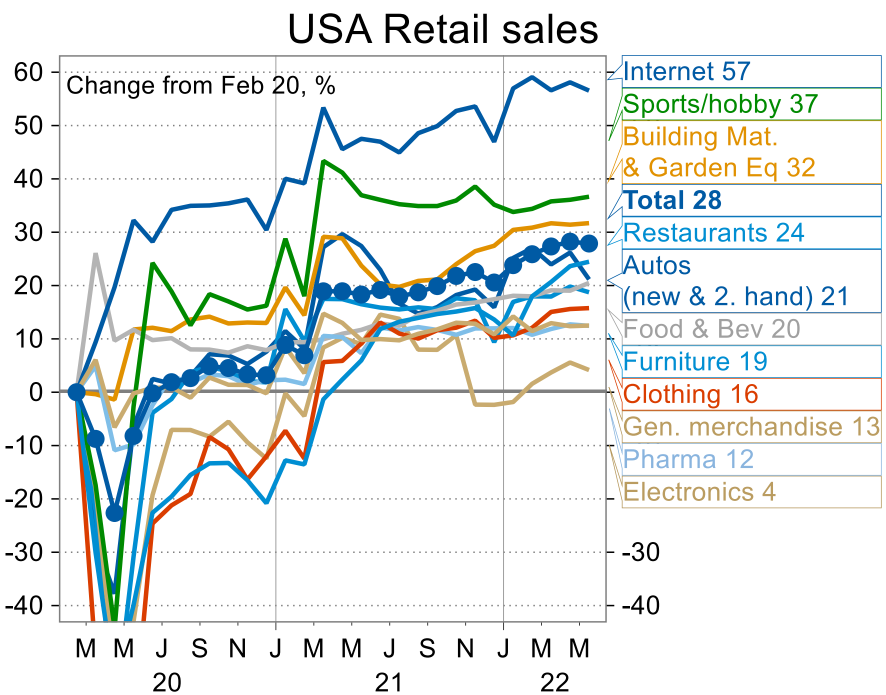
Real core goods sales are still going strong, and the trend is slightly upwards

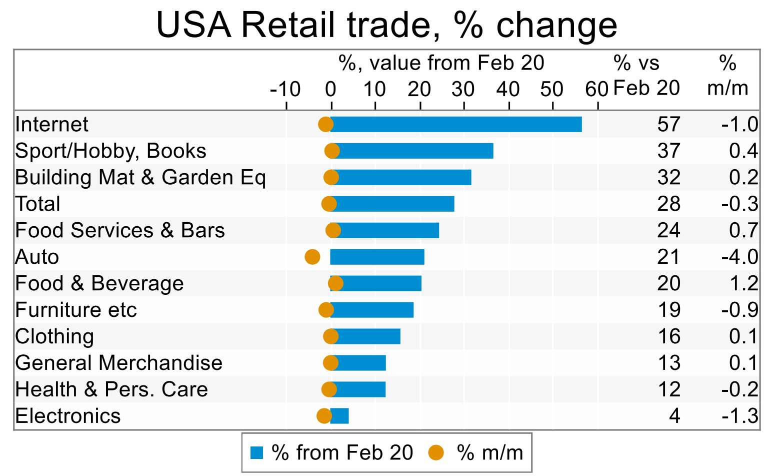


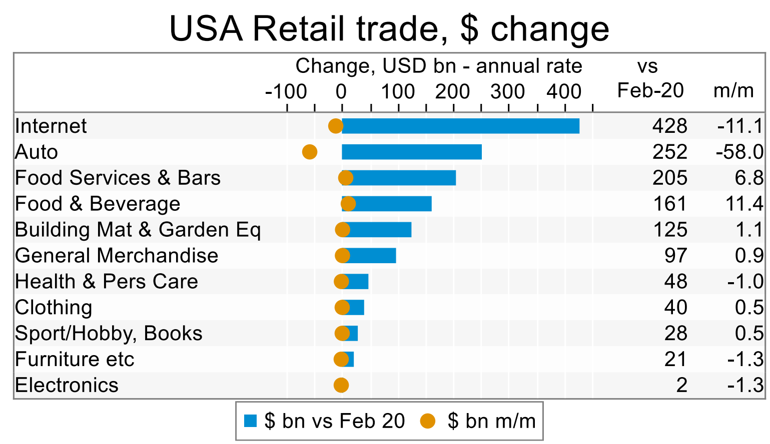


- **Total nominal sales** declined 0.3% in May (expected +0.2%), and April was revised down by 0.2 pp to 0.7%. Total nominal sales are up 29% vs. the Feb 2020 level
- **Core sales of goods** (=control group, excludes autos, gasoline, building materials & restaurants) was flat in May, expected up 0.1%. March was revised down by 0.5 pp to 0.5%. In **volume terms** we estimate a 0.6% decline in May. Revised volume data from December has lowered the path substantially, and sales are not that far above the pre-pandemic trend anymore

Mixed between sectors in May



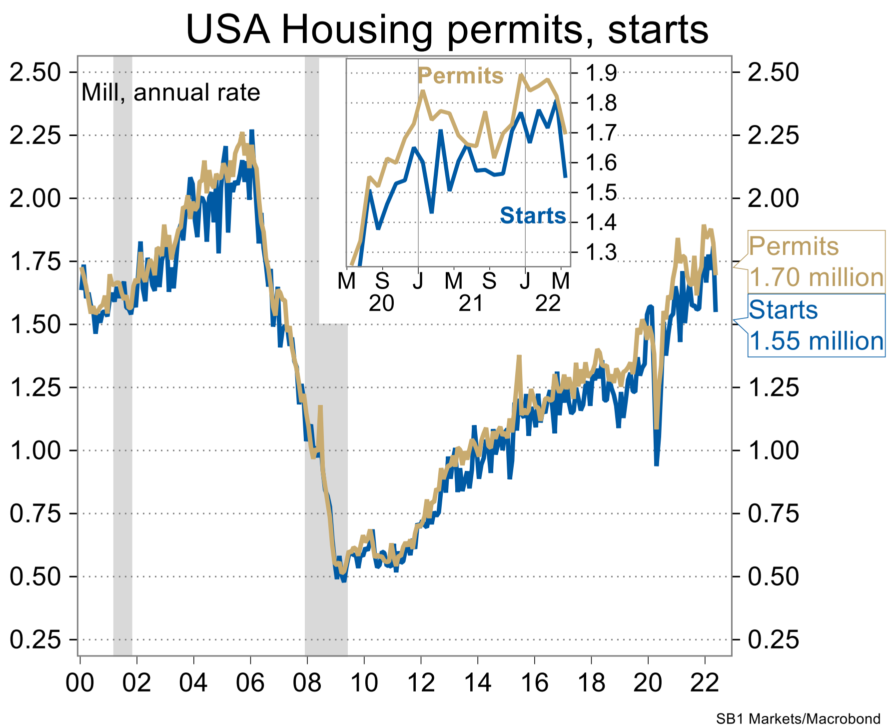


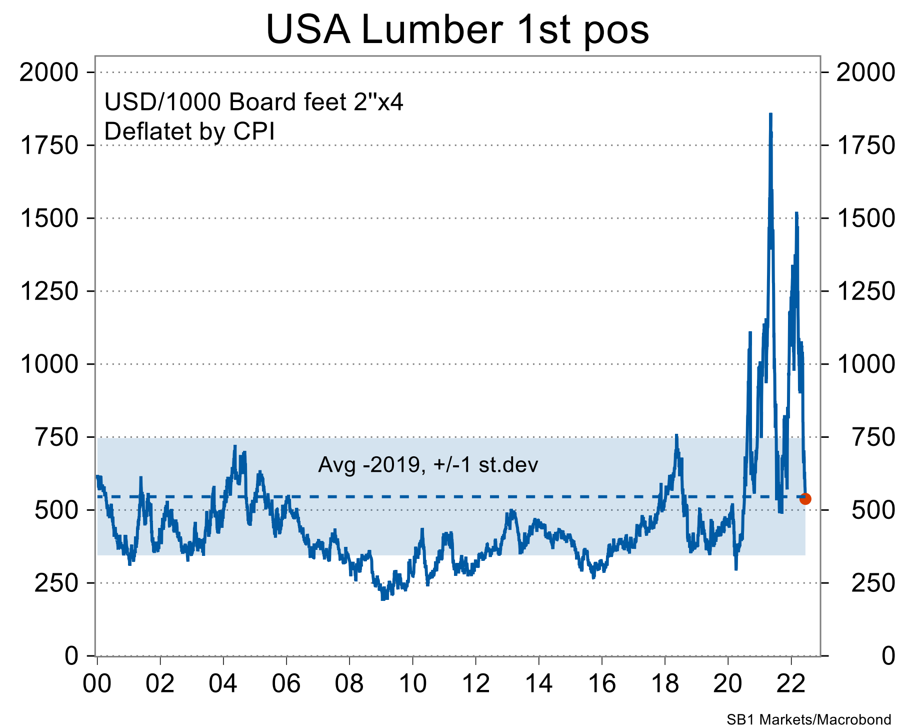


- 5 out of 11 main sectors reported lower sales in May, 6 reported higher sales
- Restaurants are up 24% vs Feb-20!
- Total sales are up 28% in value terms
- Internet sales are up 57%

Oops, housing starts ‘collapsed’ in May

Housing starts are still at a rather high level – and the downside is substantial

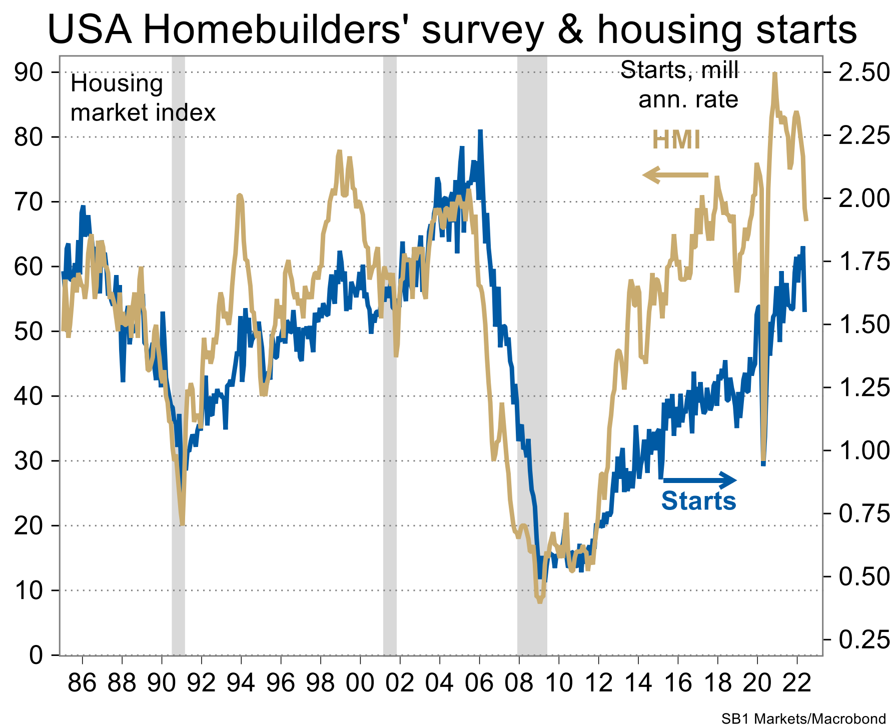


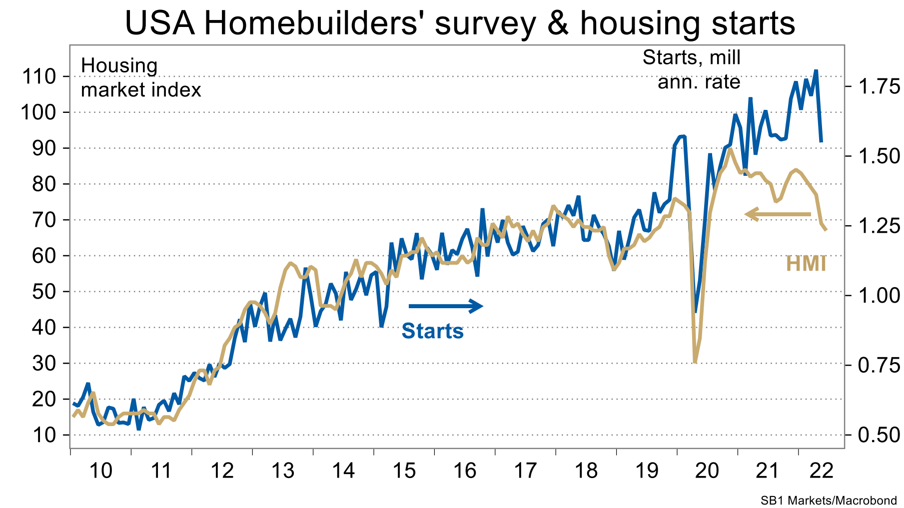


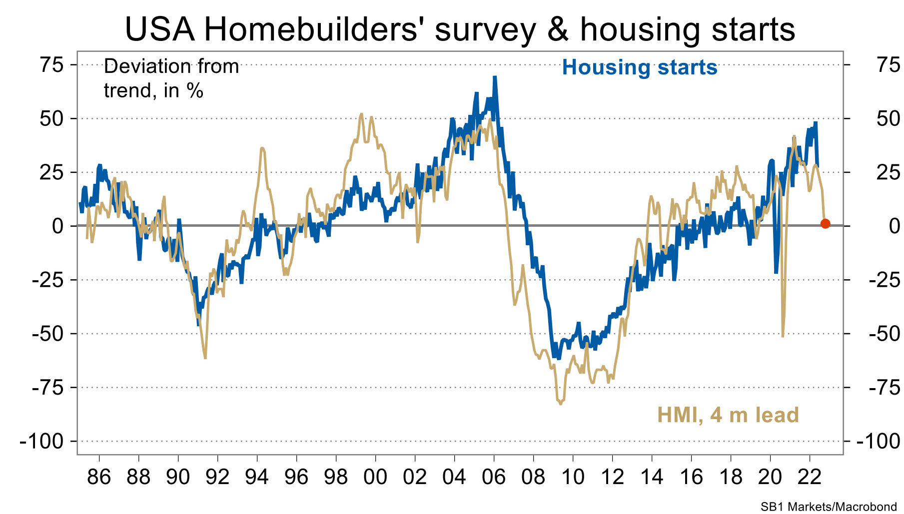
- **Housing starts** fell to 1.55 mill in April, expected 1.69 mill from 1.81 mill in April (upward revised from 1.72 mill). **Building permits** landed at 1.66 mill, expected 1.78 mill, from 1.82 mill in April. Levels are still high but the tide has very likely turned: The Housing market index shows the way, check next page – and the reasons for it on the following pages
- Building **material cost inflation** has come to a sudden halt. **Lumber prices** have ‘collapsed’ recent weeks and are now back to a normal level, steel prices are falling rapidly too

Homebuilders' market index further down in June, but no collapse

Signals a further (20%) decline in housing starts?



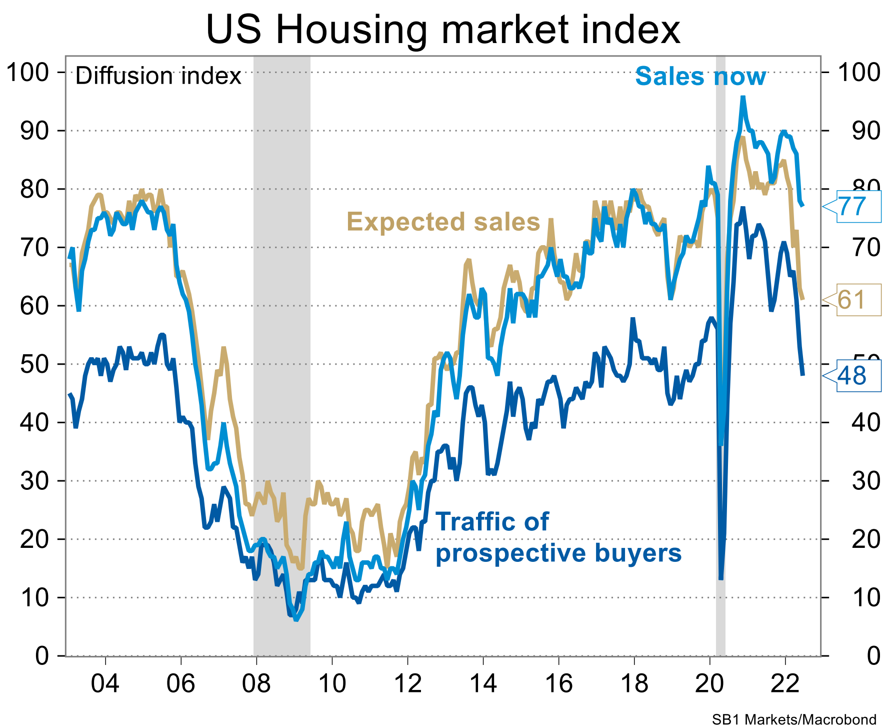


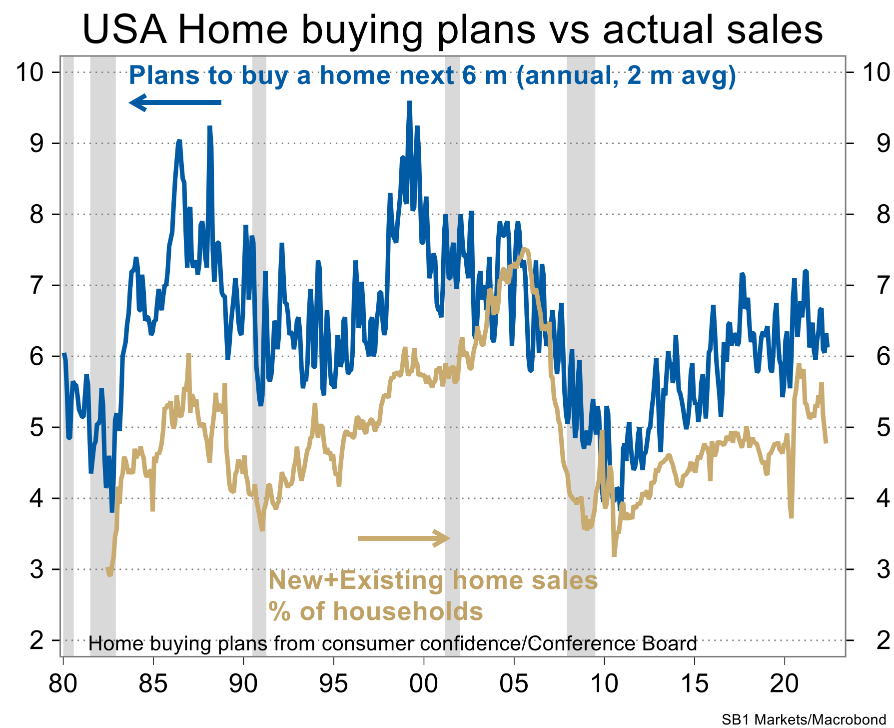


- **The Homebuilders' Housing Market Index (HM)** lost 2 p to 67 in June, expected down 1 p, following the unusual 9 p setback in May
  - Affordability is still the challenge, due to higher mortgage rates, and soaring new home prices (at least until now)
- The decline in the index recent months signal a sharp decline in housing starts, even after the 14% decline in May

All components of the HMI further down in June

Homebuying plans have not fallen by much, according to Conference Board's cons. confidence

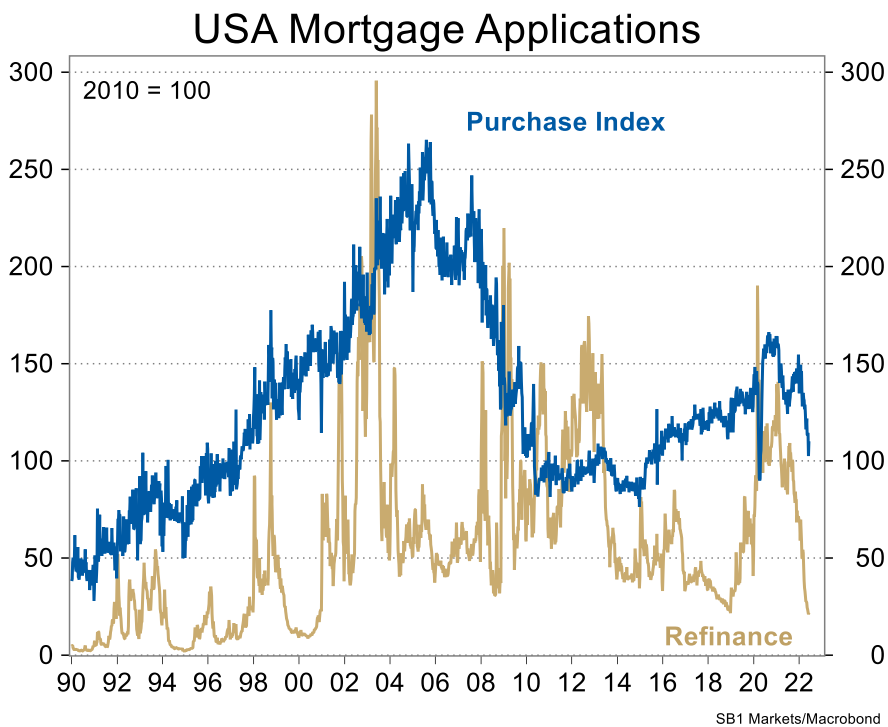


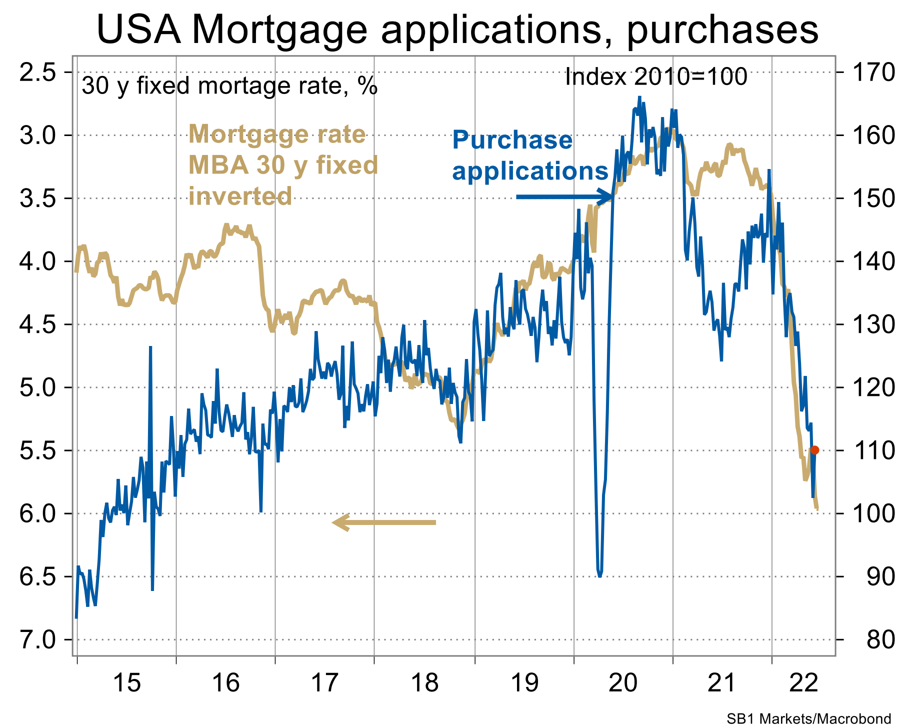


- Conference Board has not reported their June data yet
- Univ. of Michigan has reported that household judge the timing for buying a home to be dismal

Mortgage rates are soaring, and demand for new loans are falling rapidly

However, applications rose last week, reversing the lions' share of the 10% decline the prev. week

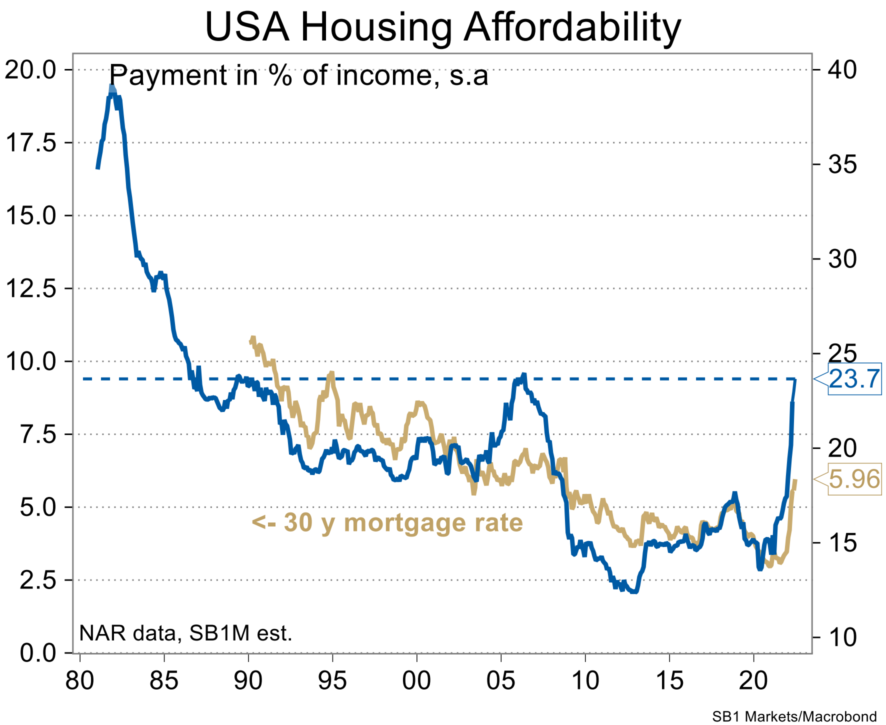


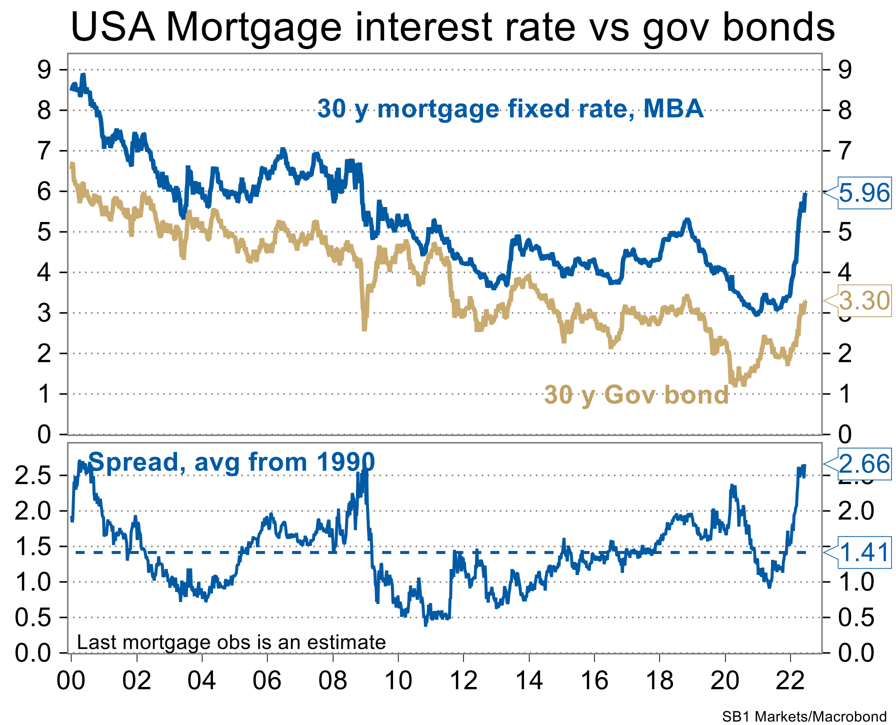


- Applications for new mortgages are down some 25% since the start of the year, and the level is 15% below the pre-pandemic level. We expect a further decline the coming weeks

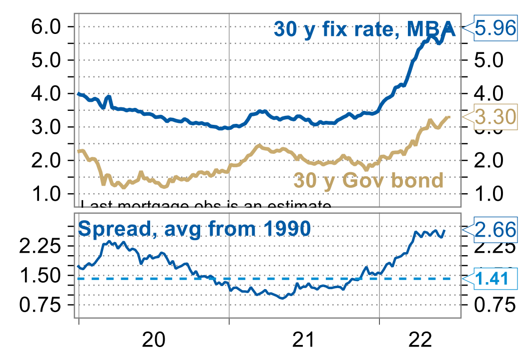
The least affordable housing market since 2008 (almost since 1987)

Prices are up 37% since before the pandemic, the mortgage rate is up 50%. In sum….



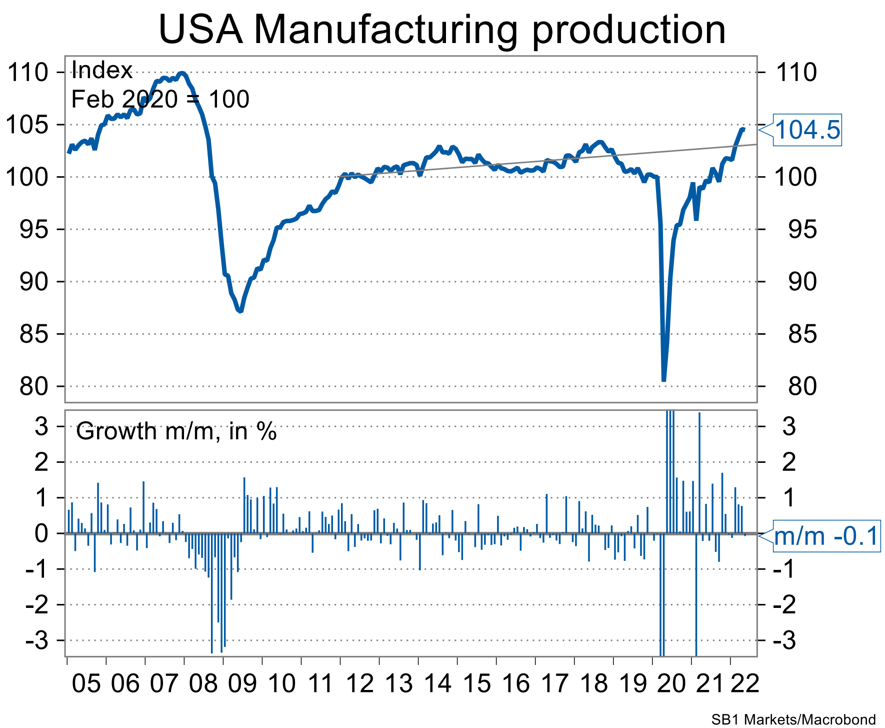


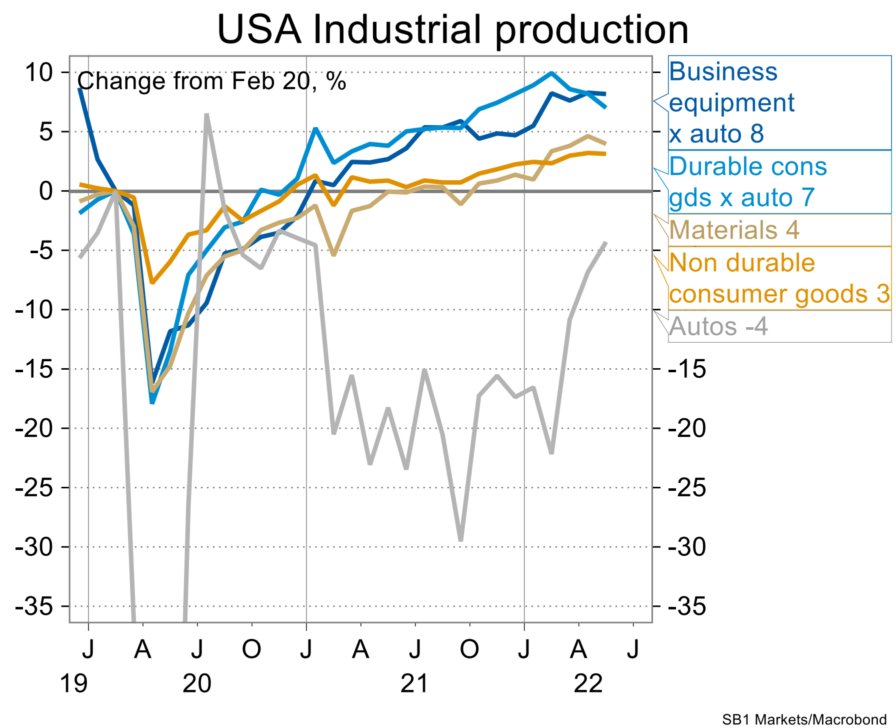
- **The 30 y fixed mortgage rate** has climbed to 5.96% (effective rate) from 3.0% last summer, from 3.5% at the start of 2022. Before the pandemic, the rate was 4.0%
- The **Federal Reserve** concluded its mortgage backed bonds buying campaign in March - and has now start reducing its holdings. No doubt, this shift explains the surge in the spread, to 2.66 pp, way above the average at 1.41 pp



Manufacturing production down 0.1% in May but the trend is strong

… and the level is well above the pre-pandemic level (& trend)





- **Manufacturing production** was expected up 0.3%, following the 0.8% lift in April. Production is still up at an 8.8% 3m/3m pace
  - Auto production rose further and is just 4% below the Fed-20
  - Production of all other main components flattened or declined. Durable consumer goods x autos are on the way down. The peak was in February
- **Total industrial production**, including utilities, mines/oil production grew 0.2% in May, down from 1.4% in April (rev from 1.1%)
- **PMI/ISM and all other surveys** signal a continued recovery but at slower pace than until now
- **Capacity utilization** at 79.0%, a very high level

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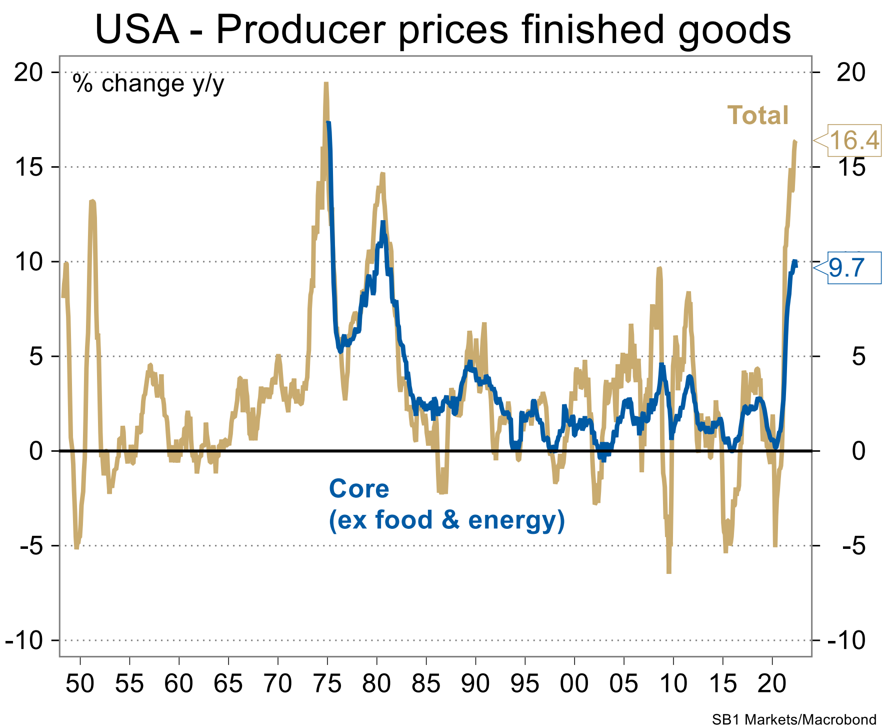
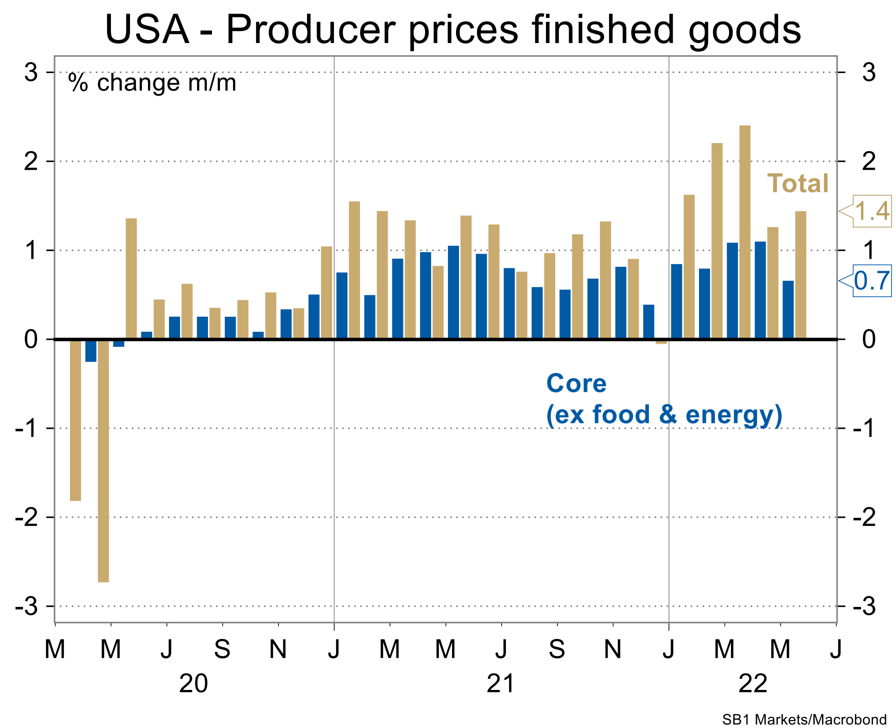
The industrial PPI continues upwards, even the core up 0.7%

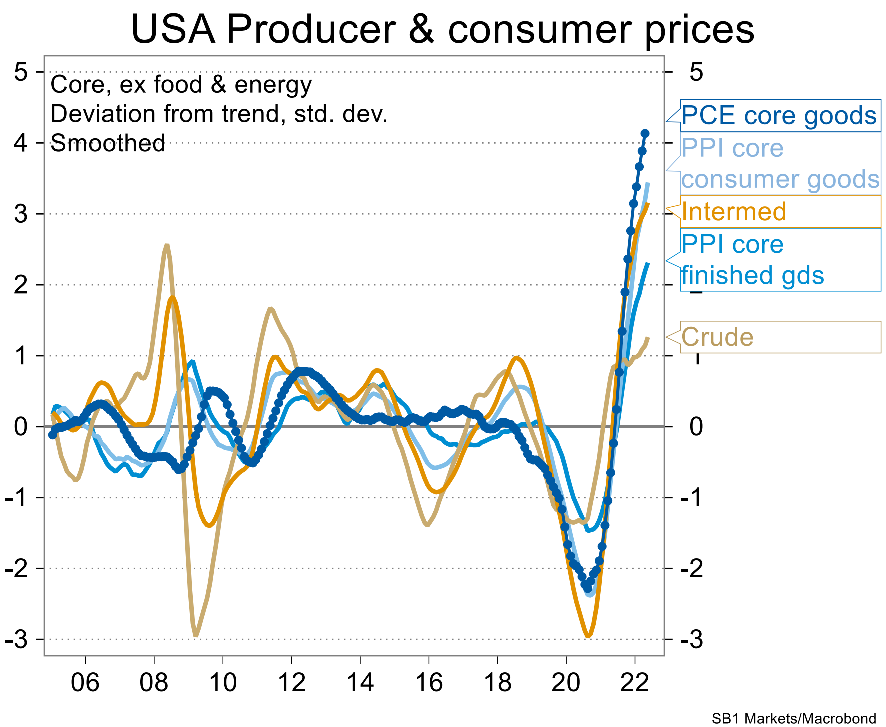
However, crude materials (ex energy) softened again

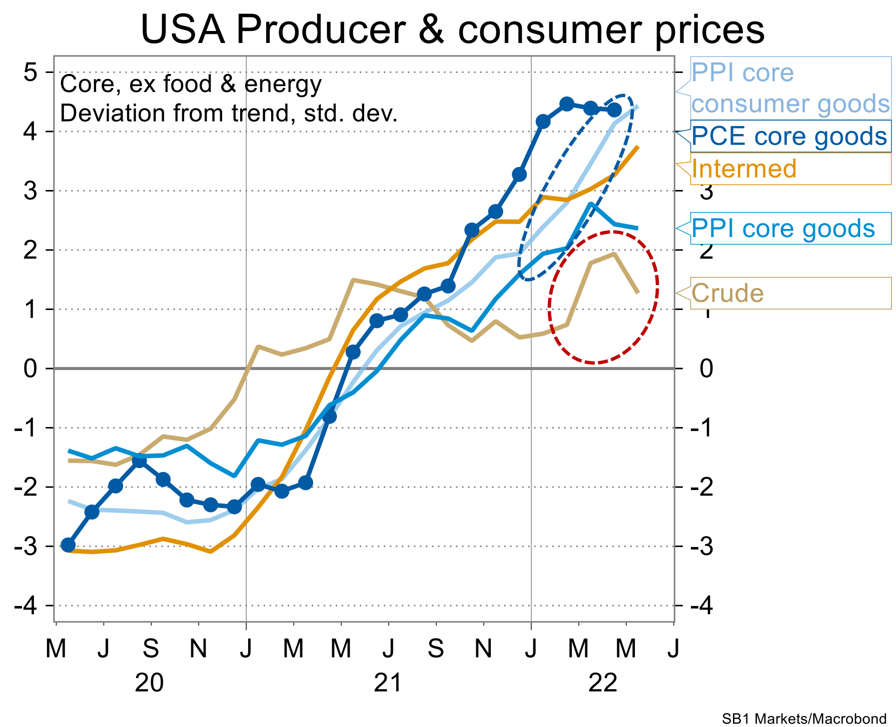




- **The headline finished goods PPI** rose 1.4% in May, down from an upward revised 1.2% in April. The annual rate fell 0.1 pp to 16.3%, the 2nd highest since 1975
- **Core finished goods x food & energy** PPI rose by 0.7%, down from 1.1% in April. The annual growth rate fell 0.3 pp to 9.7%
- **Crude material prices** have been on the retreat since early last summer – normally the first sign of easing price pressures in the supply chain. Following an uptick in March and April, crude goods ex food and energy prices eased again in May
- **Core consumer goods prices** (PCE, like the CPI) have already climbed more than usual vs. PPI prices (partly due to second-hand auto prices, not included in the PPI), limiting the upside risk
- **The 'official' total final demand PPI**, including **services**, rose by 0.8% m/m. The annual rate at 10.7%, was 0.1 pp lower than expected and down from 11.0% in April

Crude core materials on the way up again – but slowed in May





- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months. Following several months with slow growth in these prices, they shot up again in March and remained at a high level in April – but slowed somewhat in May. **Intermediate prices** climbed faster May
- 'Luckly', consumer prices are higher than normal vs. the producer prices, and it is not given that somewhat higher intermediate prices will push consumer prices even higher – especially if final demand slows due to the monetary tightening underway

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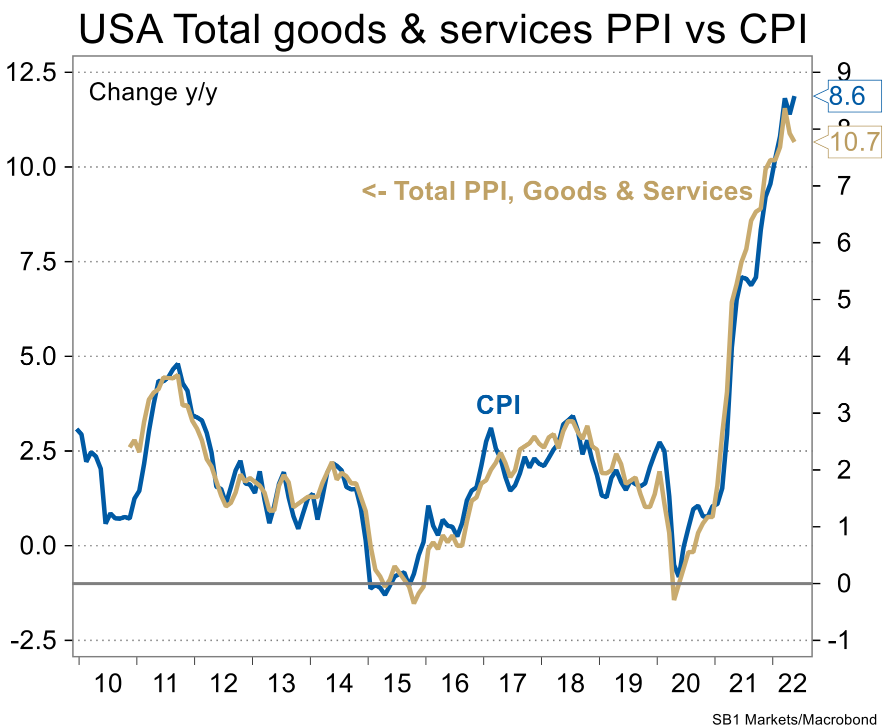
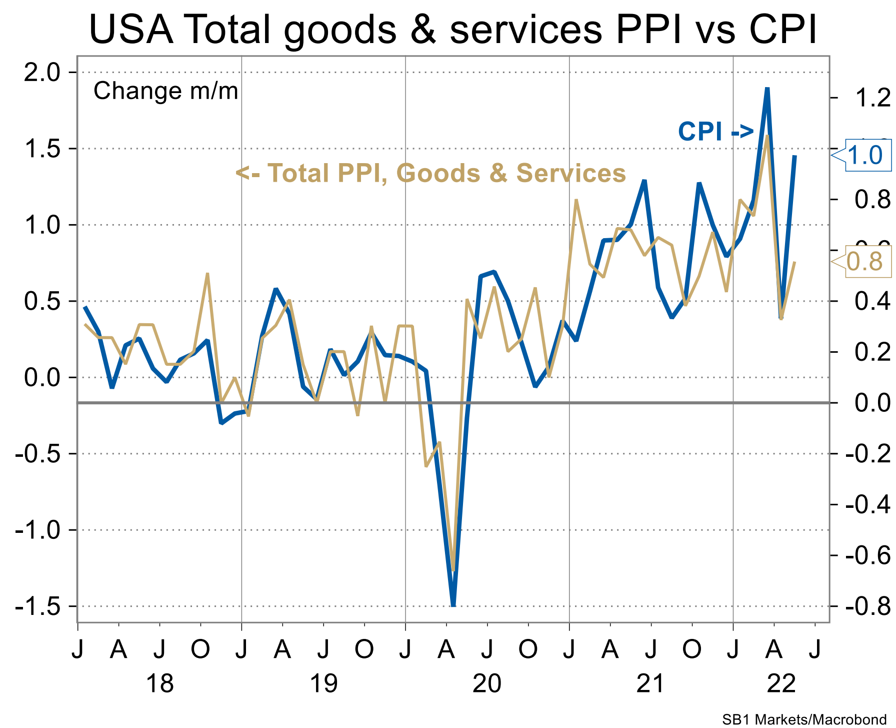
Total PPI (services incl.) down 0.3 pp to 10.7%

The silver lining: Prices increases past two months has slowed – still way too high (0.6 pp on avg)

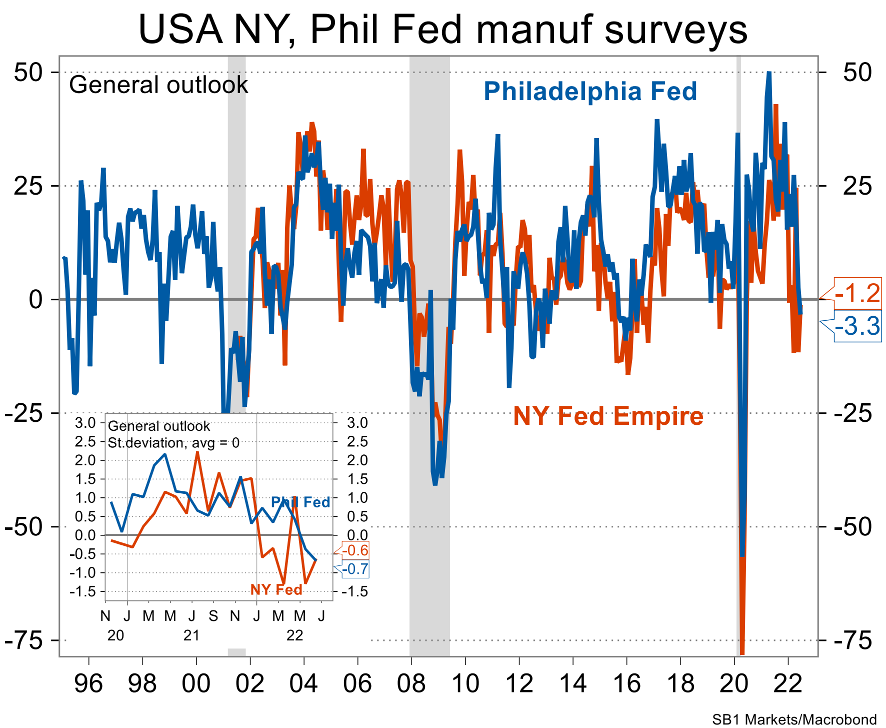


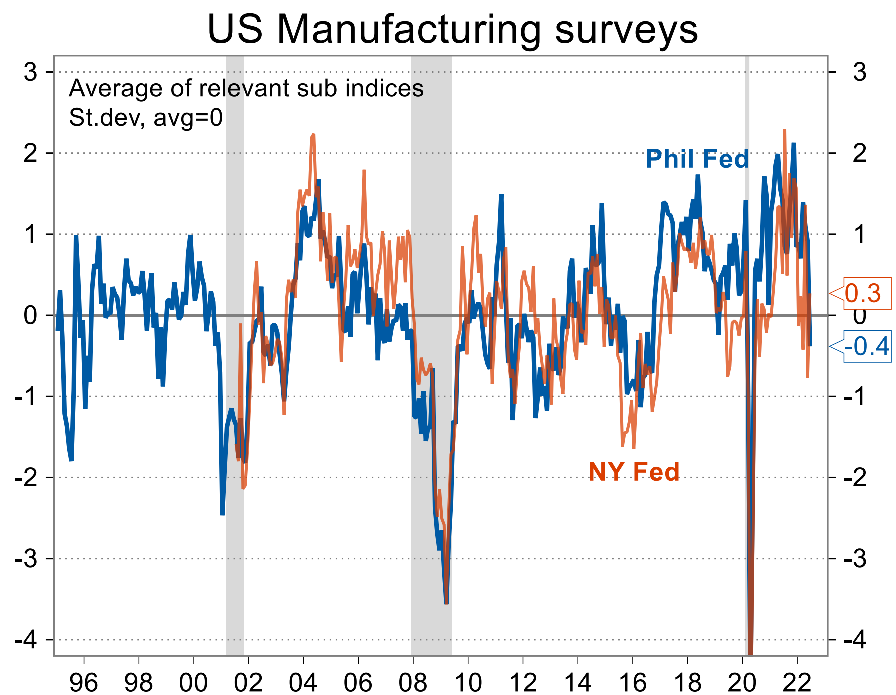


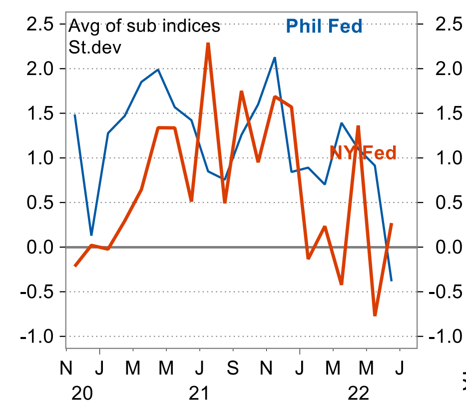
- The correlation between the total PPI, which includes all sorts of services in addition to goods, and the CPI is quite close. The current 10.9% annual growth rate totally out the PPI's 12-year-old history. Still, it seems to be in line with the 8.3% headline CPI inflation

The Philadelphia Fed survey fell sharply in June, NY Fed's recovered

Phil Fed is not signalling a recession - but the outlook index is really weak



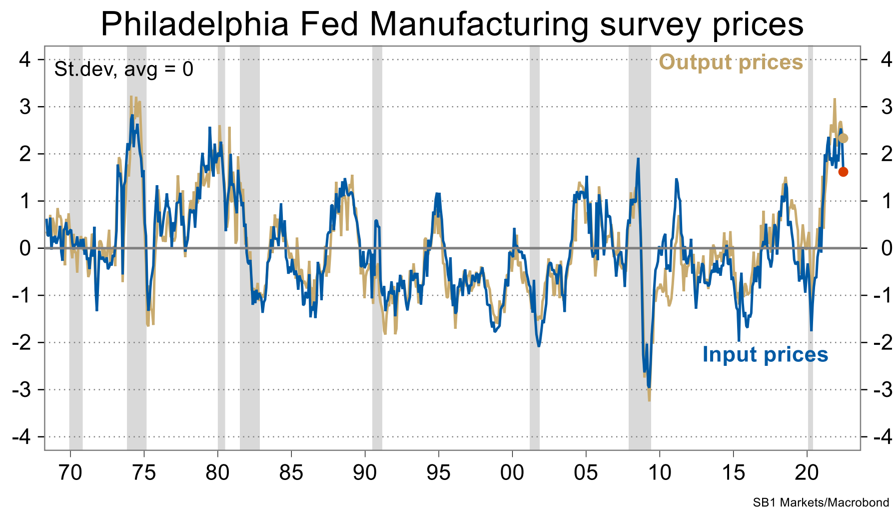


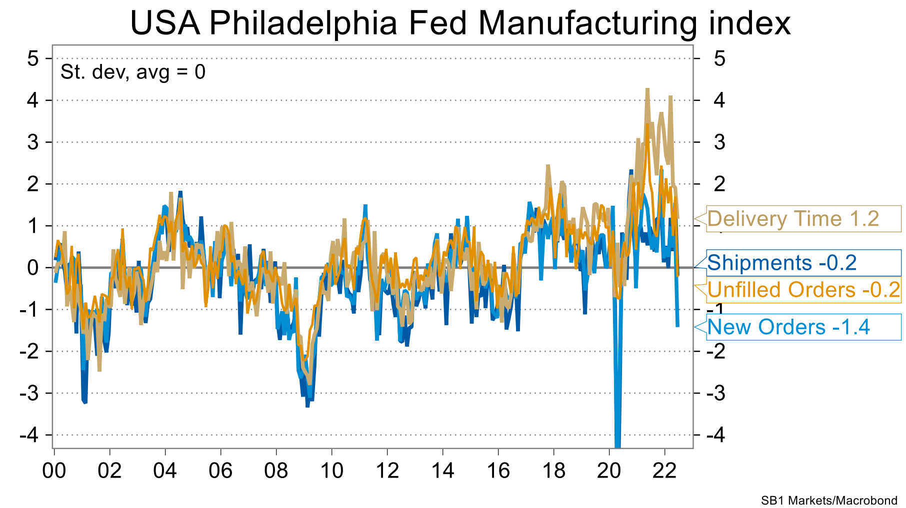


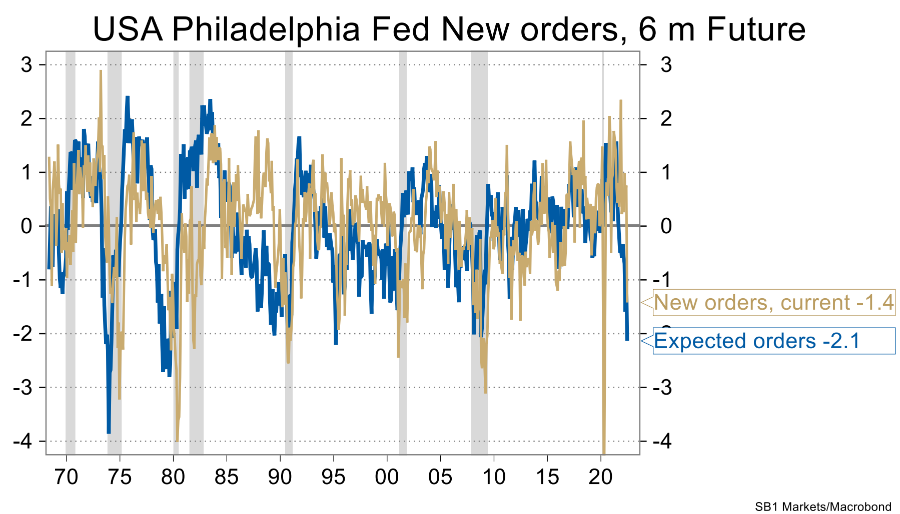
- **Philadelphia Fed's manufacturing index** fell to -3.3 in June from 2.6 in May (and 18 in April), expected up to 5
- from 17.6 in April. The index is well below average at -0.7 st.dev. The relevant sub-indices fell even more, to -0.4 st.dev, from +0.9!
  - » The outlook index (6 m future) fell sharply, and the new orders index collapsed, to far into recessionary level
- **NY Fed Empire State manufacturing index** rose to -1.2 from the -11.6 in May, expected up to 2.3. The index is well below par at -0.6 st.dev, from -1.3 in May. This index has been rather volatile lately, and it was even weaker in March
  - » The **sub-indices** also recovered, up to above average, 0.2 st.dev, from -0.7 in May
- **In sum** not a recession signal but a gradual weakening of the cycle is confirmed

Phil Fed: Expected orders collapsed in June, not a positive omen

Current new orderes fell sharply too, but not into a 'recession like' scenario



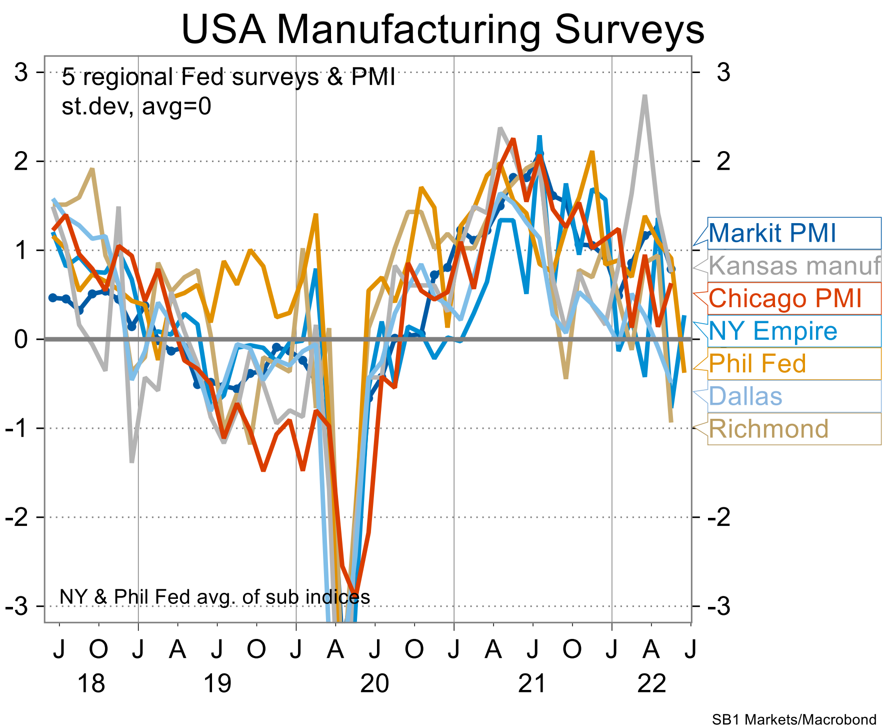


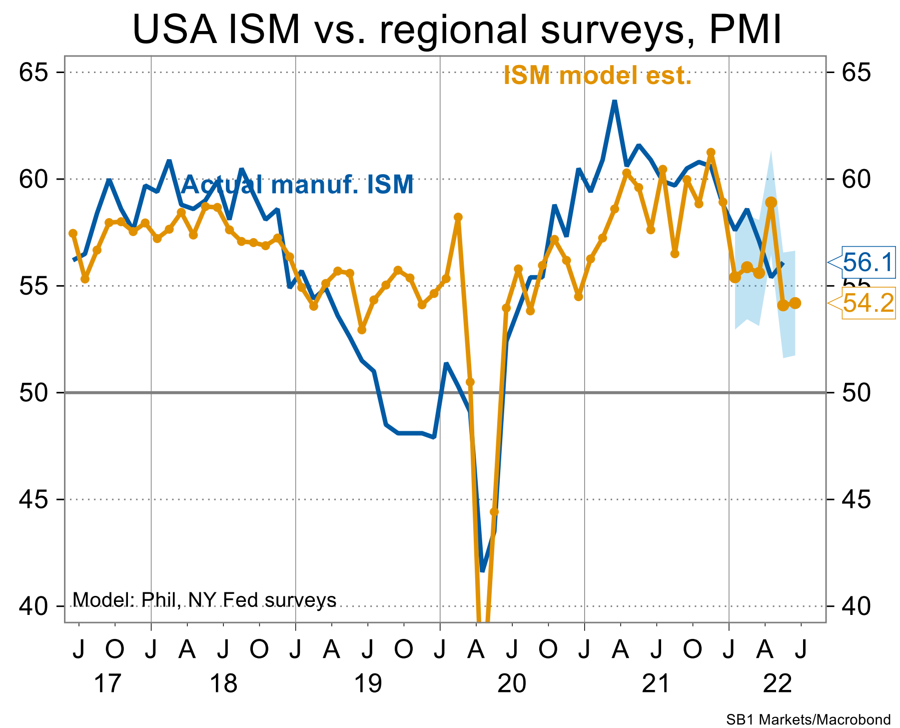


- The **current price** increases are still very high, for both input and output prices – and the delivery times index is still higher than normal – but it is falling rapidly
- New orders were reported sharply down in June, and shipment rose slightly slower than average (that is below trend)
- **The outlook:** The new orders index collapsed in June, to a level normally associated with a recession, the only exception is 1995
  - » Supply chain problems are expected to ease substantially. Price inflation is expected to remain higher than normal

So far: A decline in the ISM in June most likely

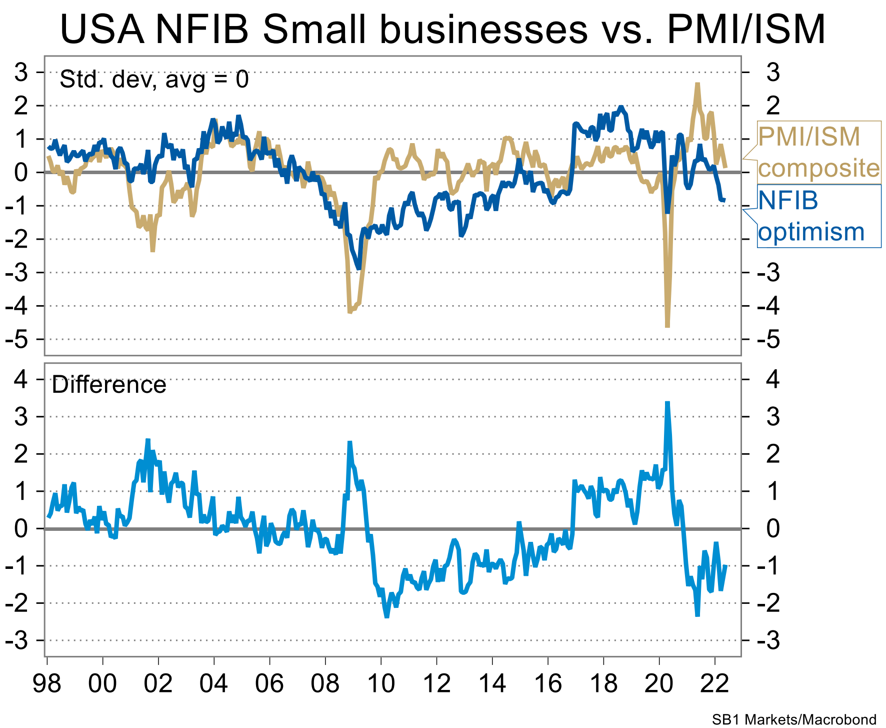
The big picture: Surveys are heading down, manufacturing growth is slowing

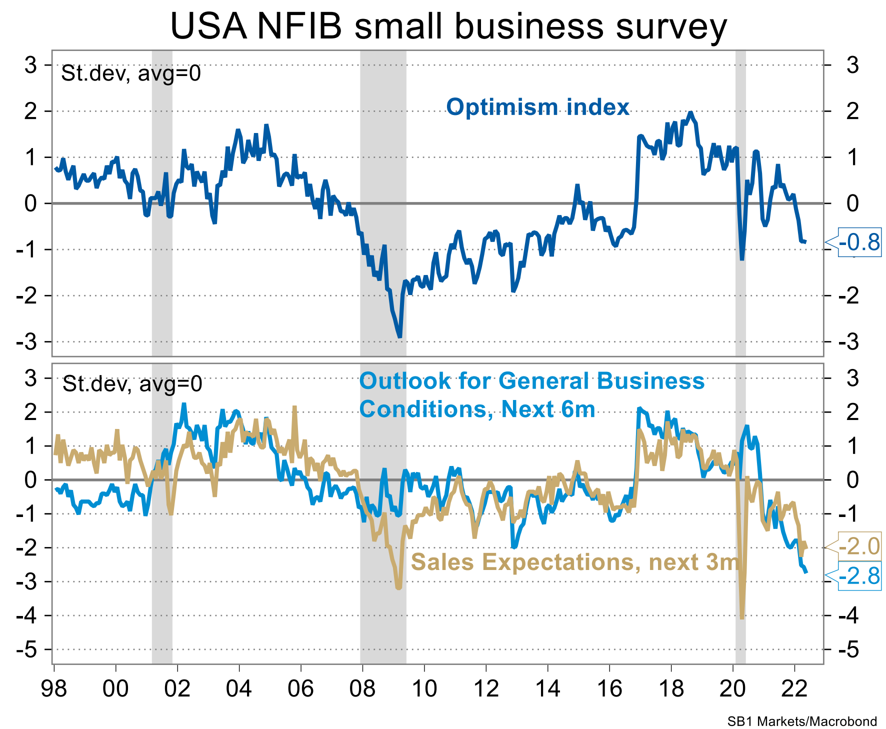




Small businesses optimism flat in June but weak; the outlook the worst ever

The optimism is 0.8 st.dev below par, but the outlook is 2.8 below, the weakest ever!

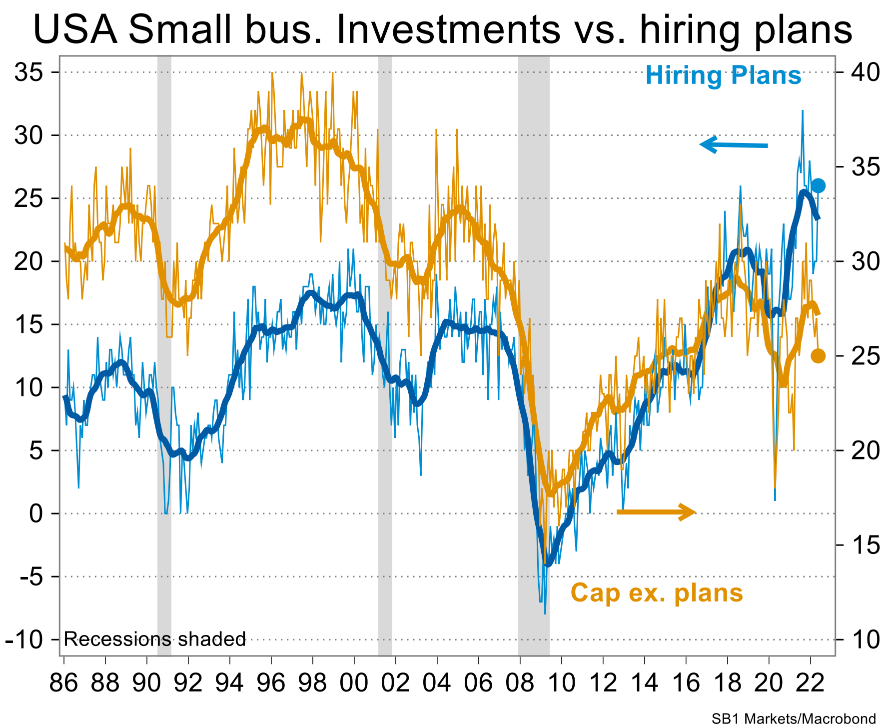


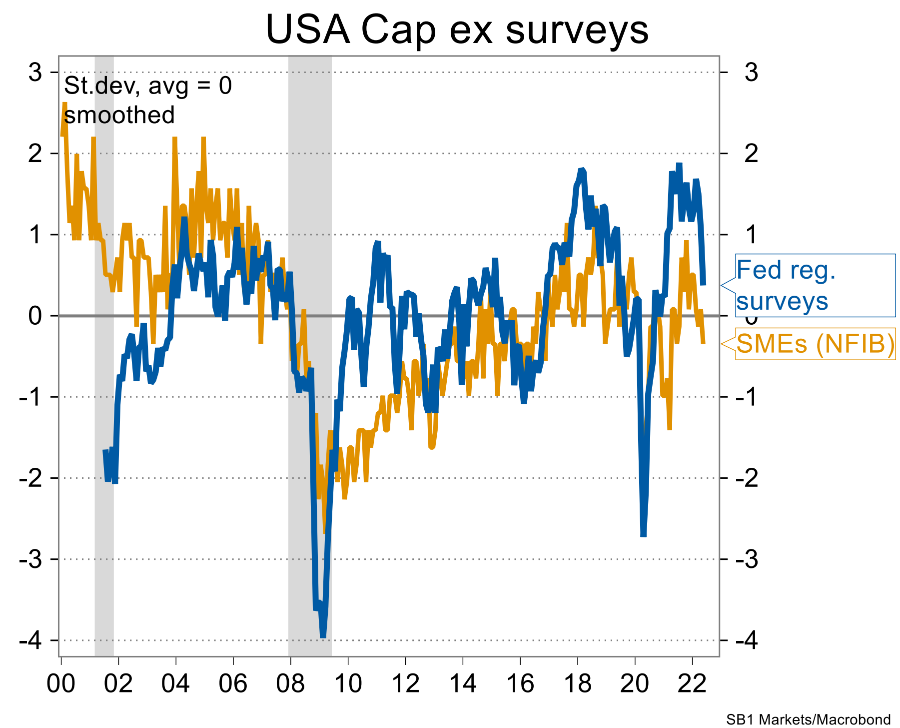


- The **NFIB optimism index** fell 0.1 to 93.1 in June, expected 93.0. The index 0.8 st.dev below average. The distance up to the average of PMI/ ISMs has been reduced, as the latter have fallen faster than NFIB optimism recent months – but the gap is still substantial, the SMEs are rather negative
- **The outlook for the next 6 months** fell to the lowest level ever in June. Lack of qualified labour, labour costs and inflation worry the SMEs.
- 'Nobody' is complaining about current sales, and close to a record share of companies report they plan to lift prices further. **Investment plans** fell to below an average level
- Published the previous week: **Hiring plans** rose in May, to a very high level. The SMEs are still not able to **fill their vacancies**, and many more said so in May. An usual large share of companies still report that they further **compensation increases** (and more said so in May than in April)

The SMEs (and others) are cutting back on their investment plans, not hiring plans

Hiring plans climbed up to a very high level



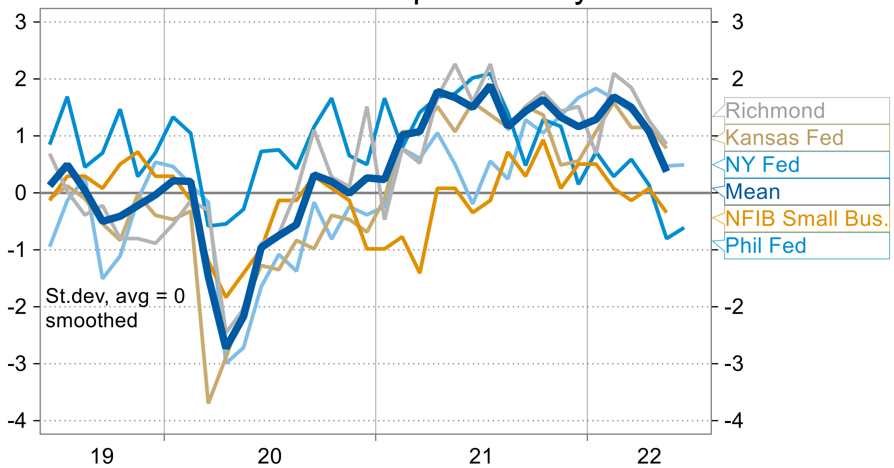


- The NFIB survey now report investment plans below average
- Other (regional Fed) investment surveys are falling rapidly but remain above average

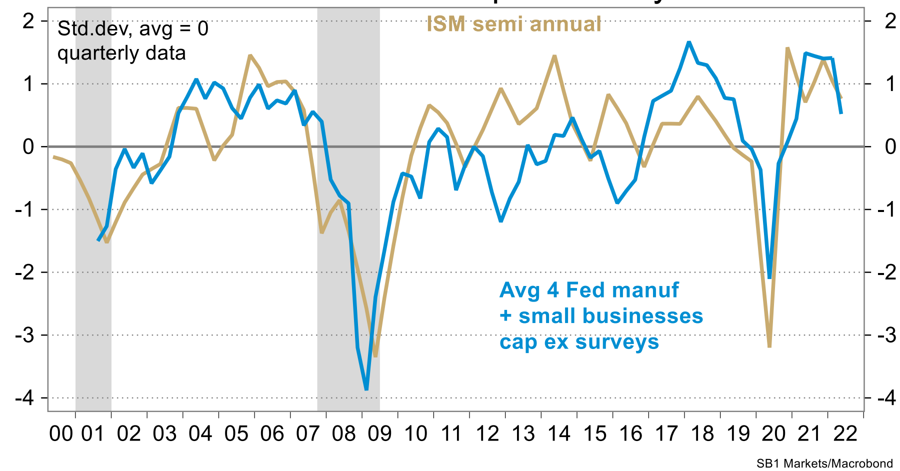
Investment surveys have peaked – but are still not below par, in average

Taken together, aggressive investment plans

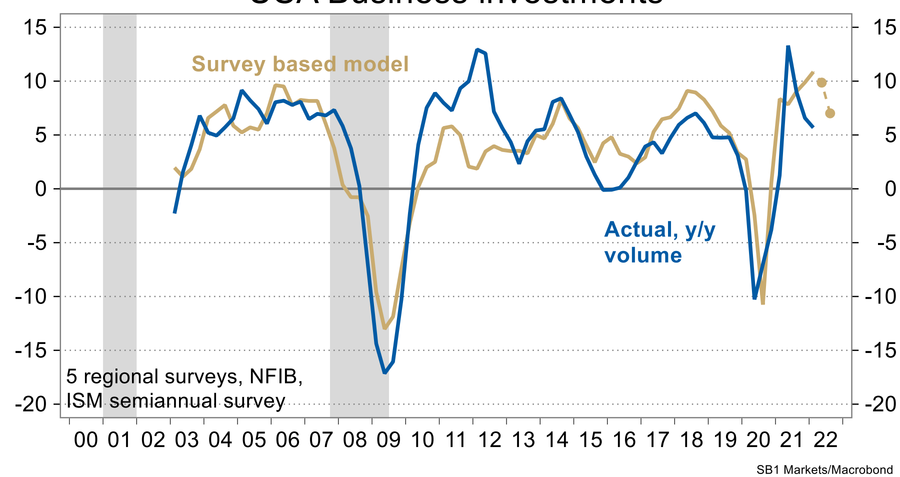
USA Cap ex surveys



USA Business cap ex surveys

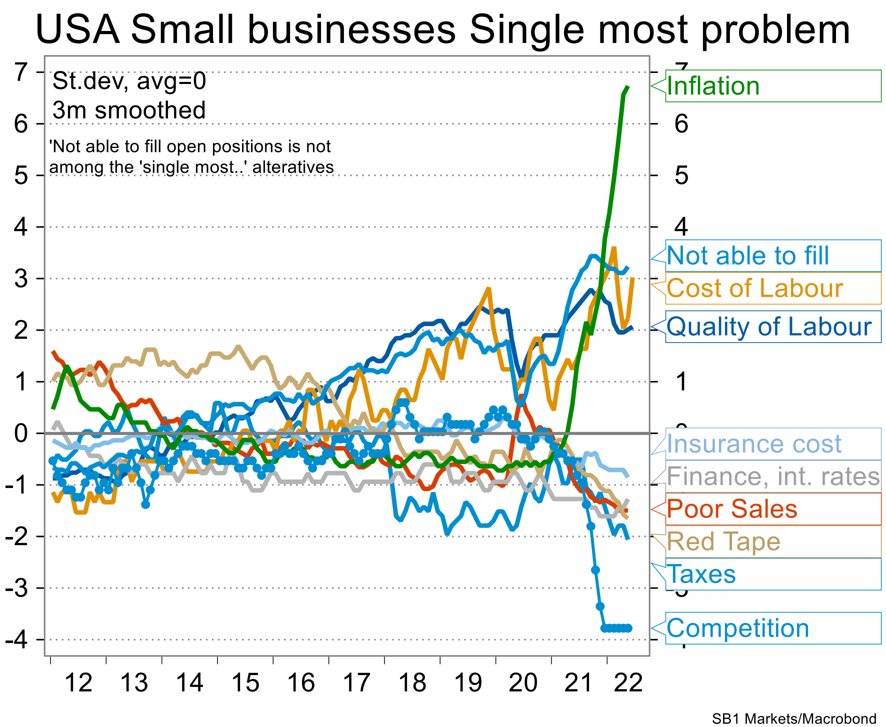


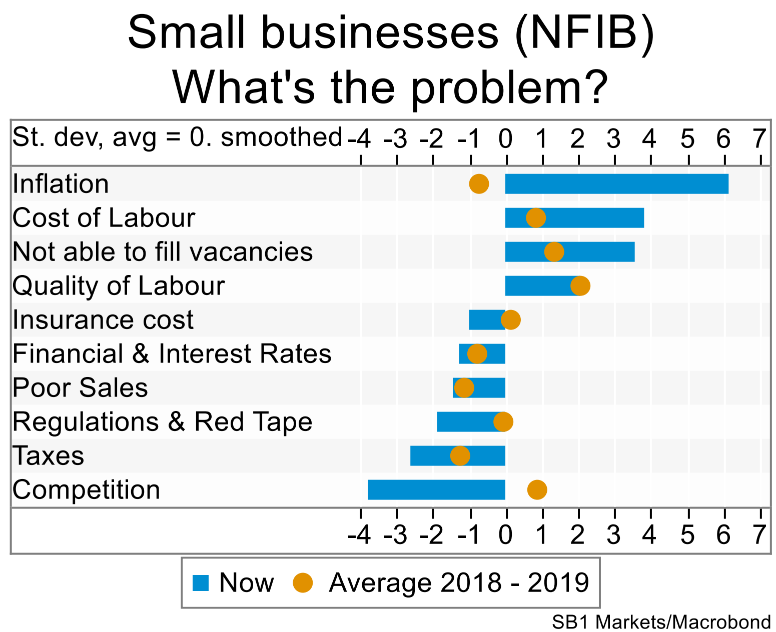
USA Business investments



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

Labour shortages, cost & quality of labour still major problems for the SMEs (and all others)



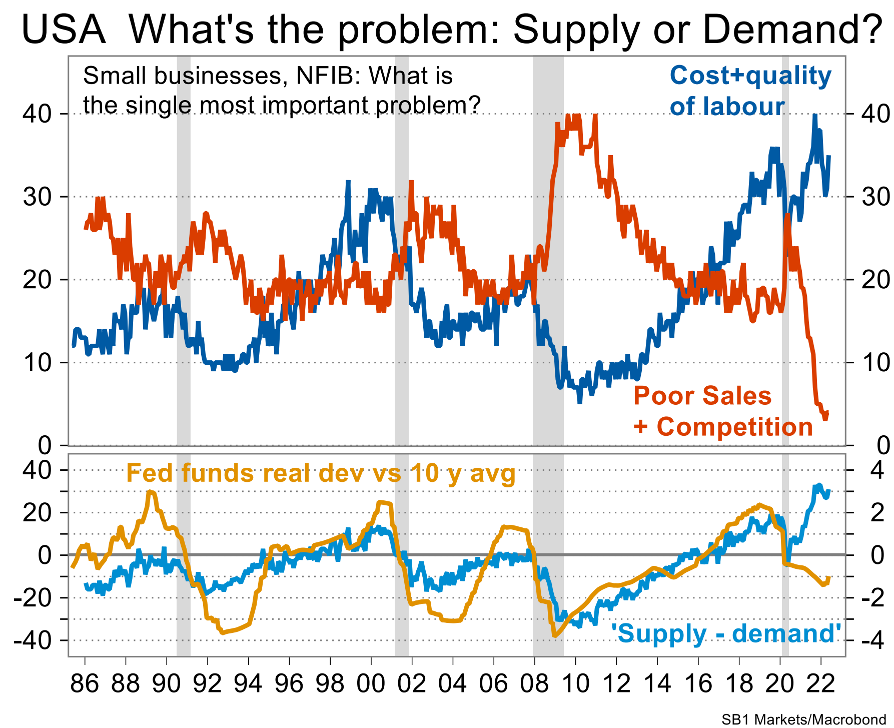


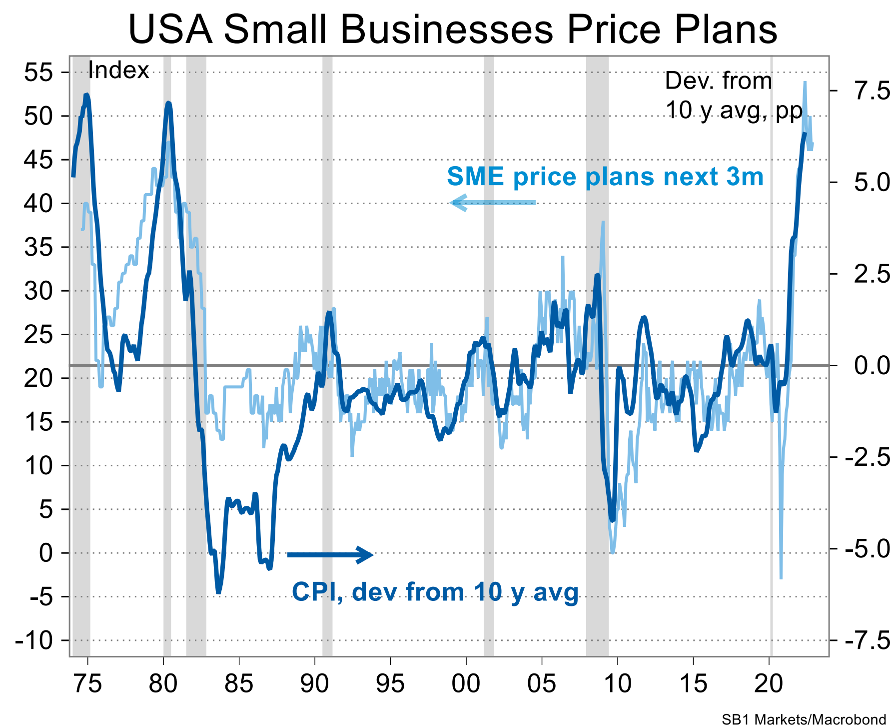
- Companies still report they are constrained from the **supply side**, not from the **demand side**
- In addition, **inflation** is quoted as the most important problem for the SMEs. However, the SMEs themselves are making the problem even larger – they report they plan to hike their selling prices like almost never before

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 in the chart

Sales are fantastic, labour supply is still the challenge

A small decline in share of companies that plan to hike prices (but it is still at an extremely high level)

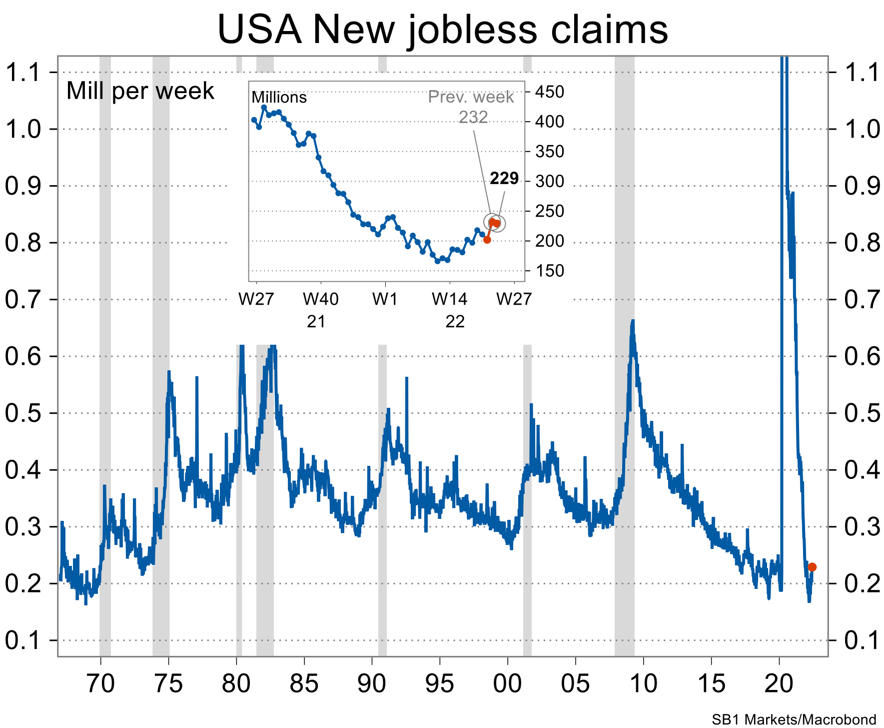


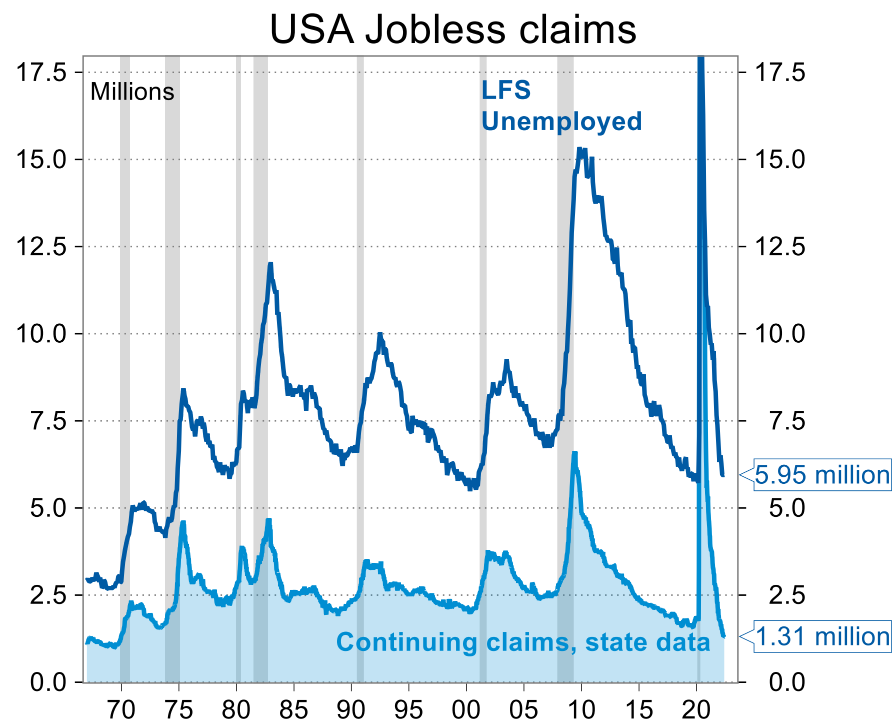


- The share of SMEs that plan to hike their **selling prices** rose 1 pp to 47%, not far below the ATH prints the previous months
- Cost & quality of labour is stated as the most important problem for a much higher share of companies than normal. However, the share has fallen somewhat from the peak, if not further in May
- The **'demand surplus'** has widening from a high level since early 2021 –and the Fed's started their tightening campaign just 3 months ago, far later than normal vs the cycle – '*the bank is far behind the curve*' (we have been saying for some time)

Jobless claims are trending upwards, the bottom was in mid-March

The increase in not yet 'recession-like', but the distance is not that far anymore (check next page)

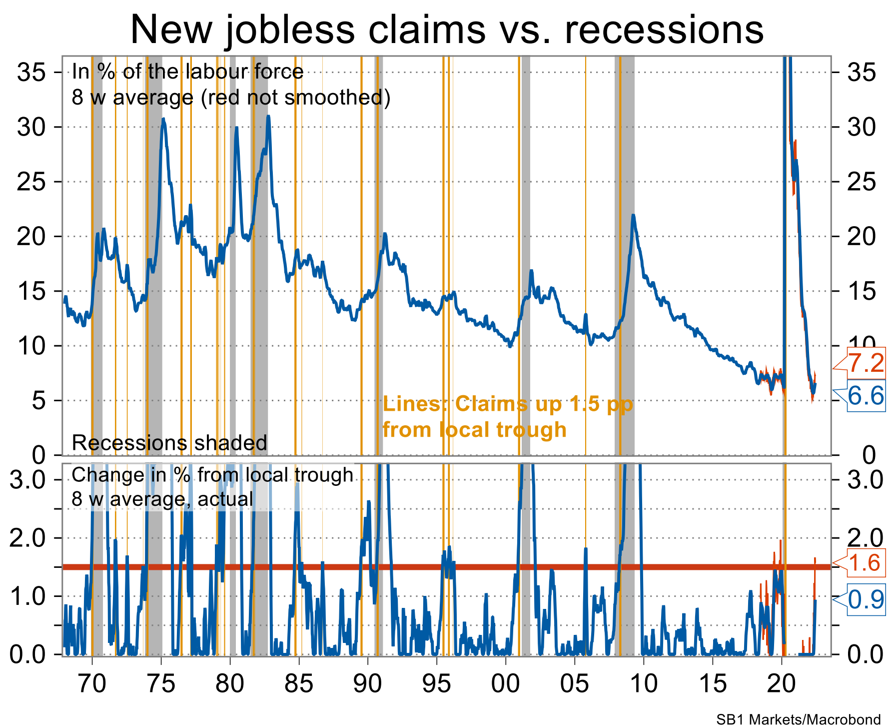




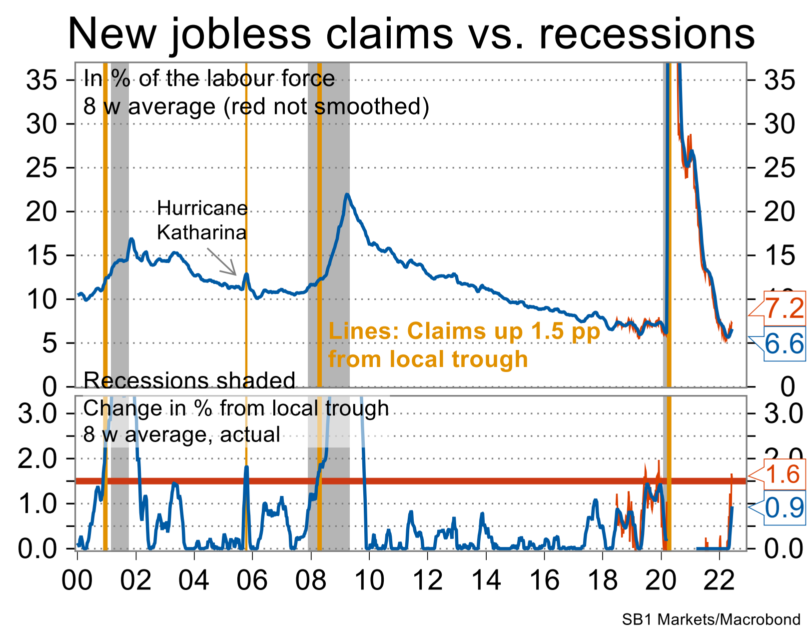
- **New jobless claims** fell by 3' to 229' in week 23. Since the bottom in week 11 in mid-March, the inflow has increased by 63', from 166' – which was the lowest since 1969
- **Ordinary continuing claims** was unch. at 1.31 mill in week 22, at the lowest level since 1969

When a recession hits, jobless claims have been on the way up for a while

The change in the 8-week average is still not large enough to suggest high risk for a recession



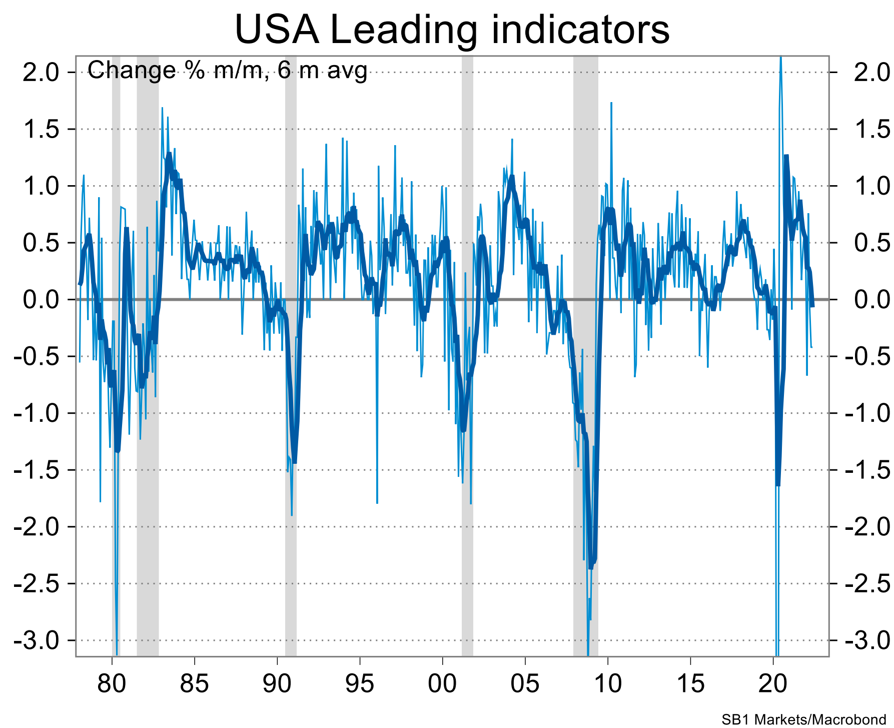
- .... But the margin is shrinking week by week

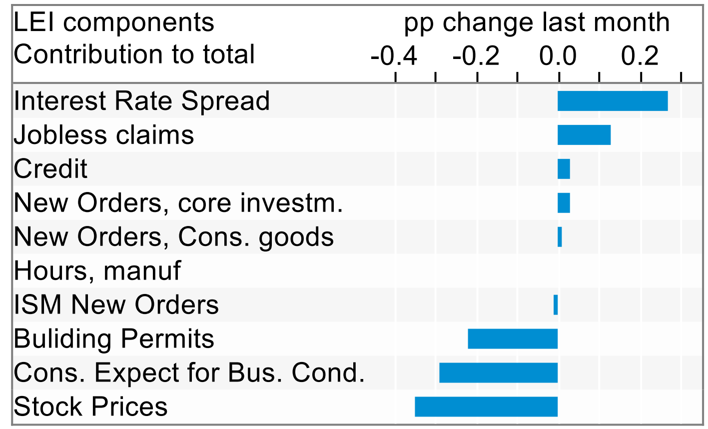


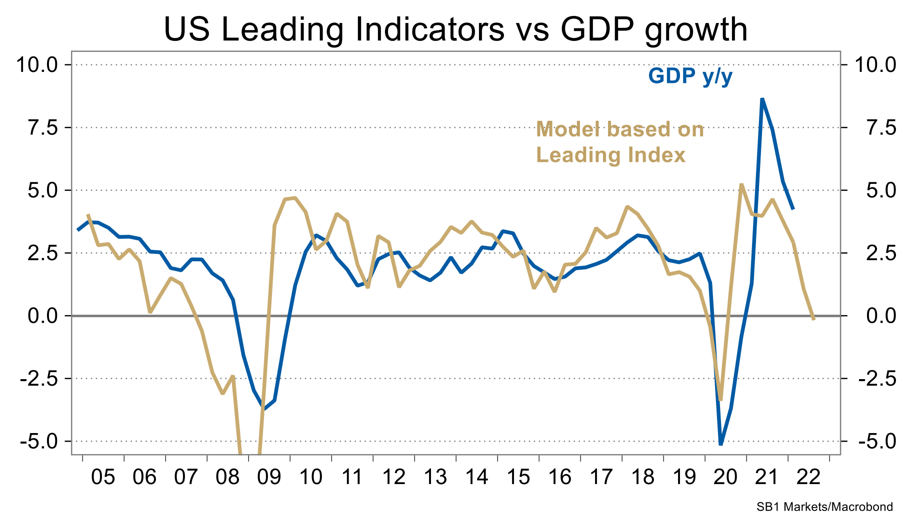
- The yellow lines: New jobless claims (8-week average) up 1.5 pp vs. the labour force
- Now, the average is up 0.9 pp, from 0.6 pp last week

The Leading Economic Ind. down May too, close to a recession warning

The LEI fell by 0.4% for the 2nd month in a row. Recession not a done deal but far from unlikely



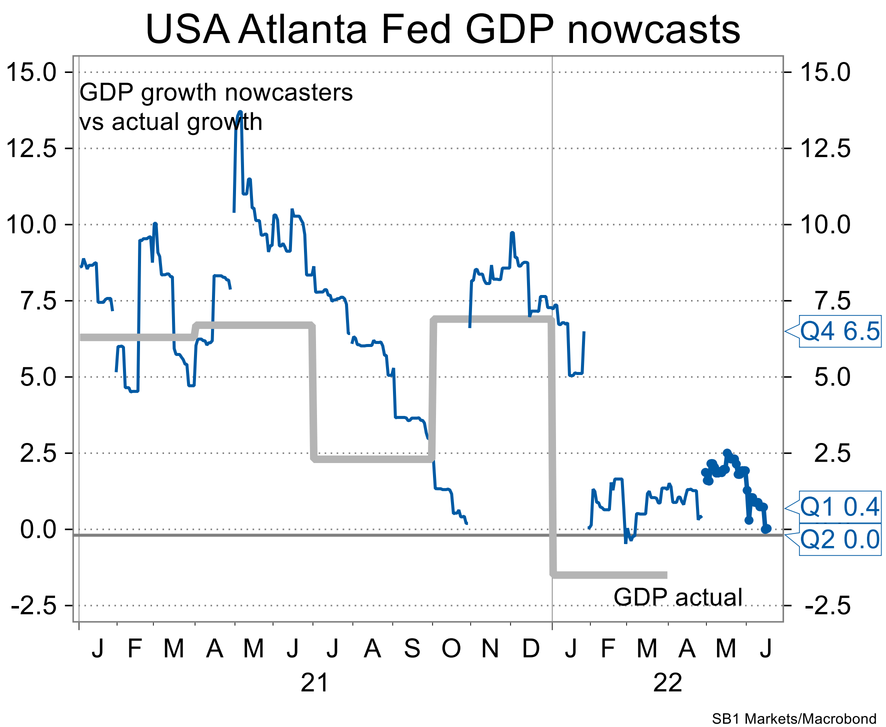


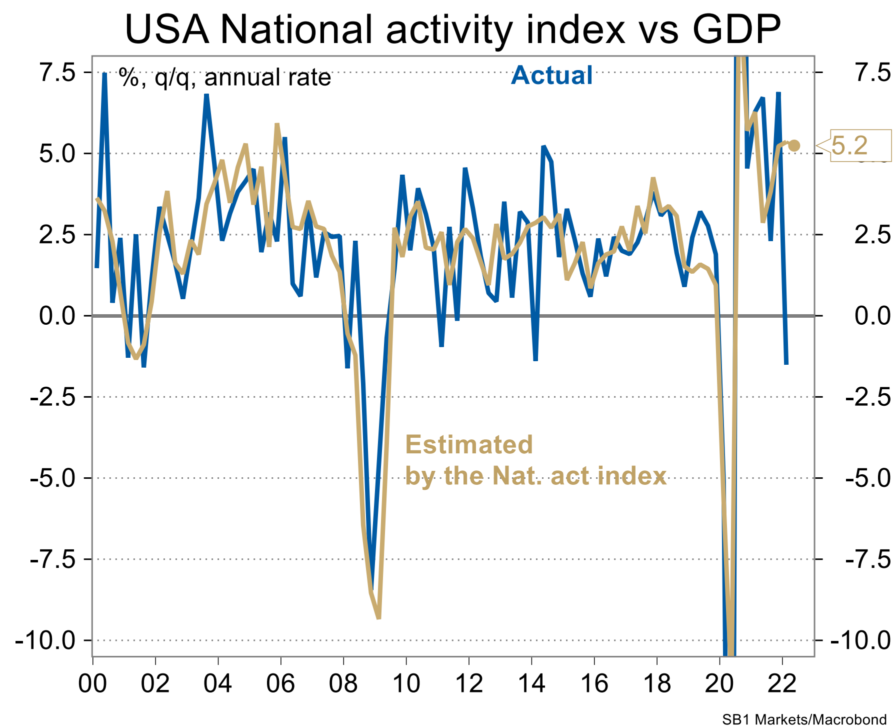


- The LEI fell 0.4% in May, as expected. April was revised down 0.1 pp to -0.4%
- The 6 m average is at -0.1%, not a 'safe' recession bet LEI has been down over 6 months 13 times since 1978 – while 'just' 5 recessions have been recorded
  - » (12 times below zero and 4 recessions if the pandemic is excluded)

Atlanta Fed's nowcaster suggests zero growth in Q2

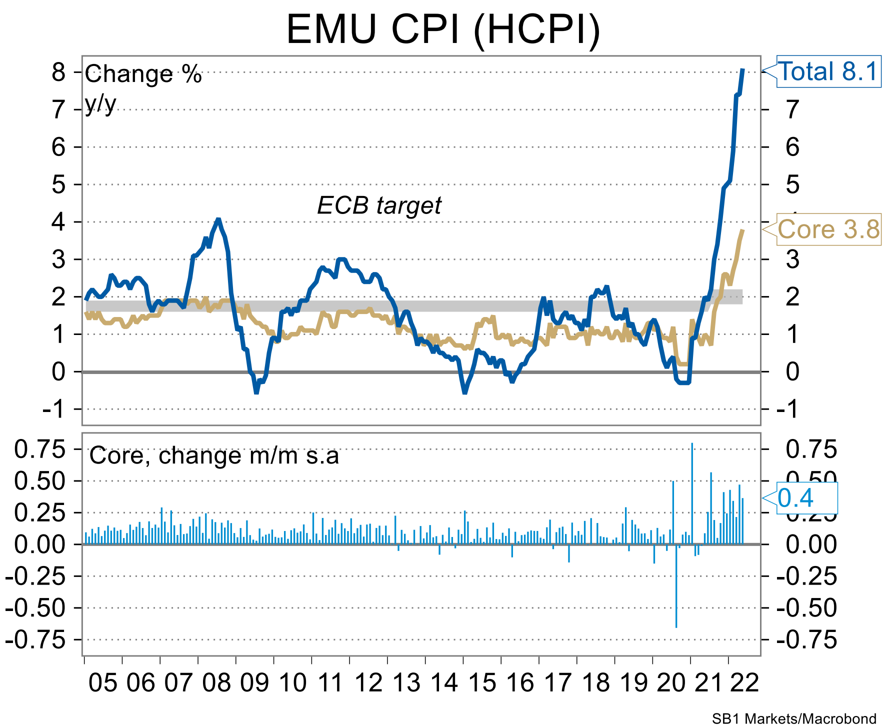
Other nowcasters are not that downbeat

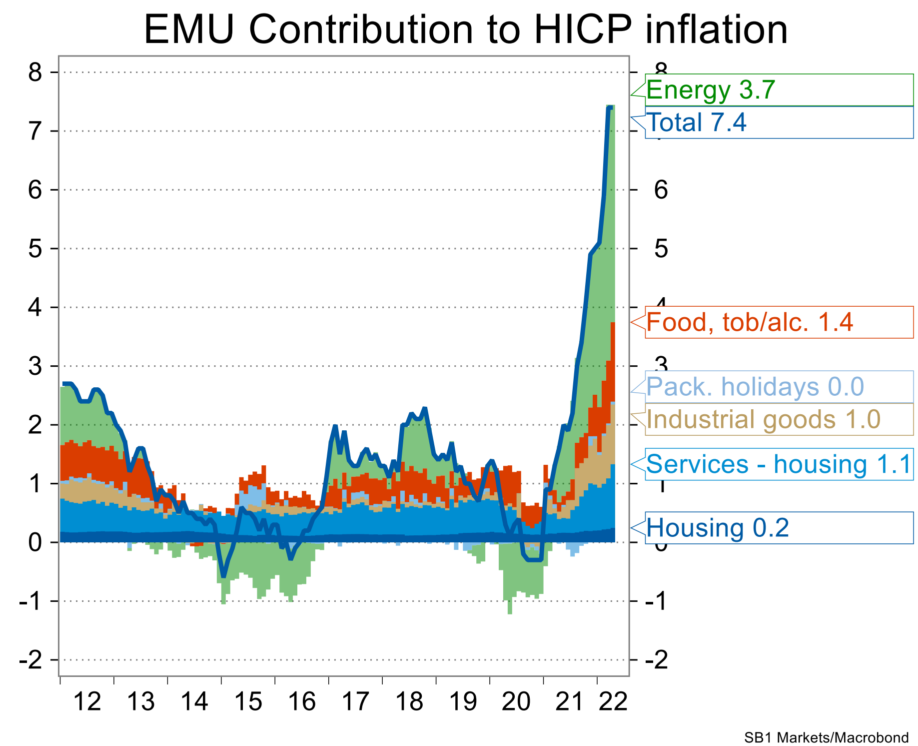




The May inflation 'shock' confirmed

The headline up to 8.1%, the core to 3.8%

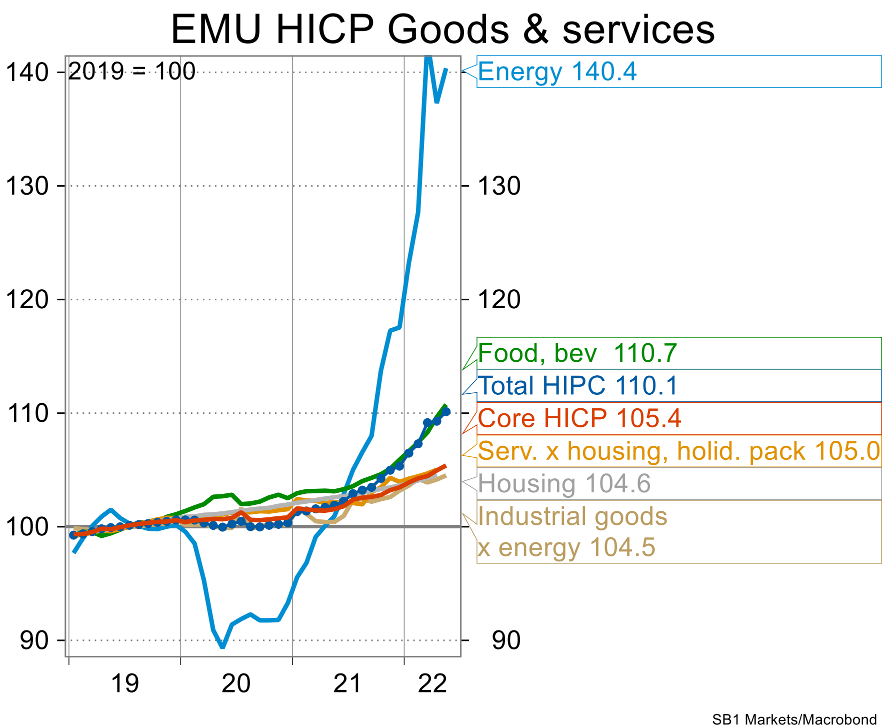


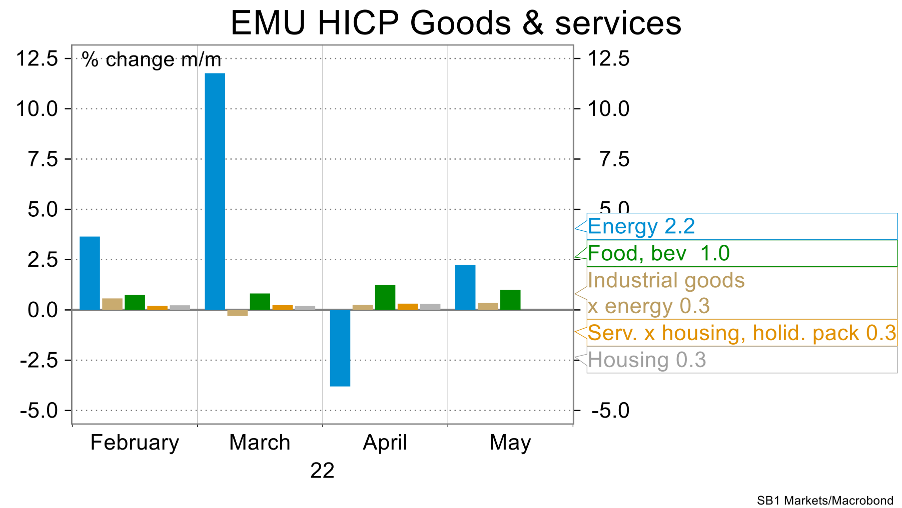


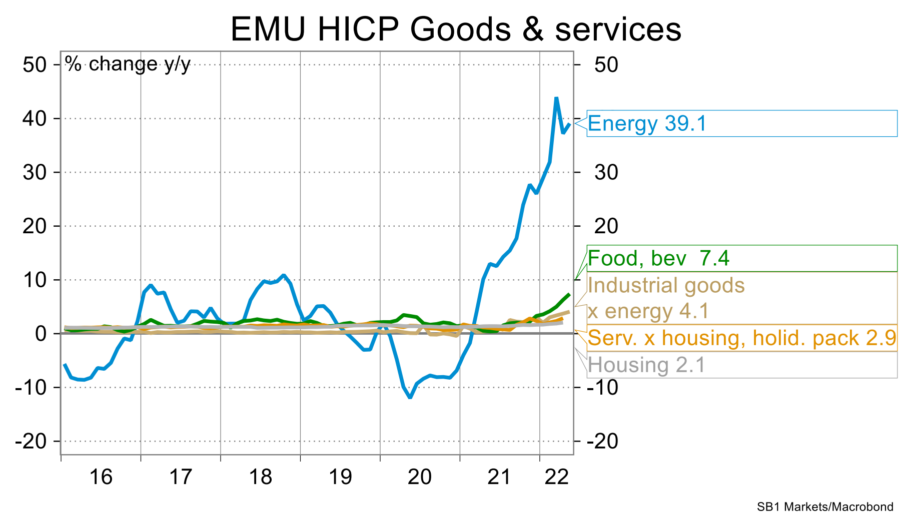
- **The total CPI rose by 0.7% m/m, the core by 0.5%**
- **Energy prices rose more than 2% m/m – and are up 39% y/y. Food prices climbed another 1% and are up 7.4% y/y**
  - » **Energy prices may have peaked now**

Energy prices may have peaked, but food inflation surges, up 1% m/m, 7.4% y/y

But energy is still the BIG story – prices rose 2.2% in May, and are up 39% y/y



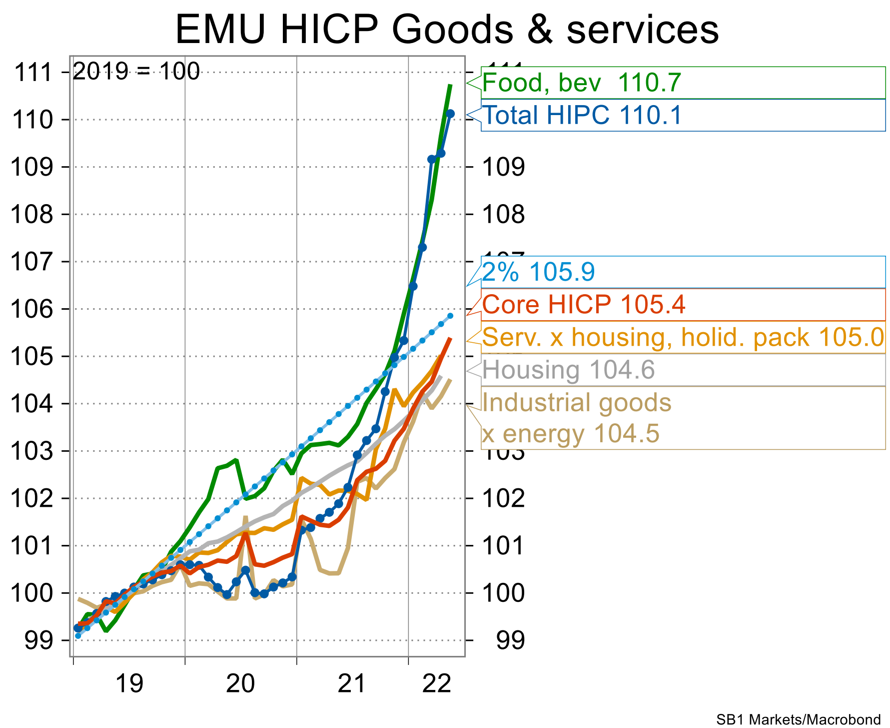


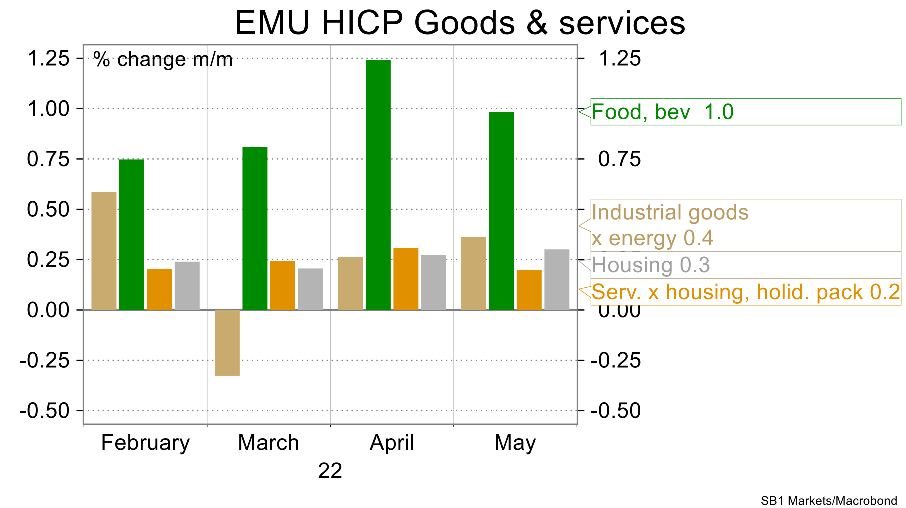


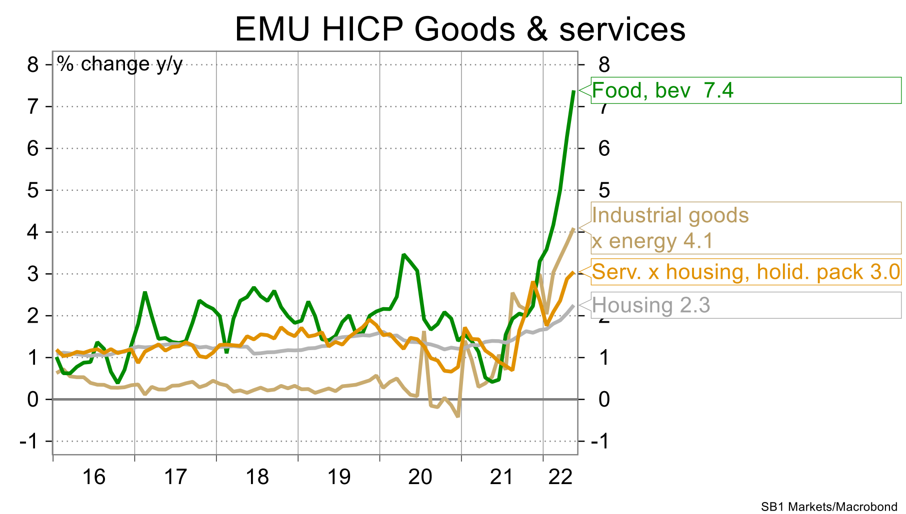
- But the peak is behind us, check two pages forward

And prices ex energy and food are accelerating too

Industrial goods x energy at 4.1%, and services ex housing 2.9%. Housing 2.1%



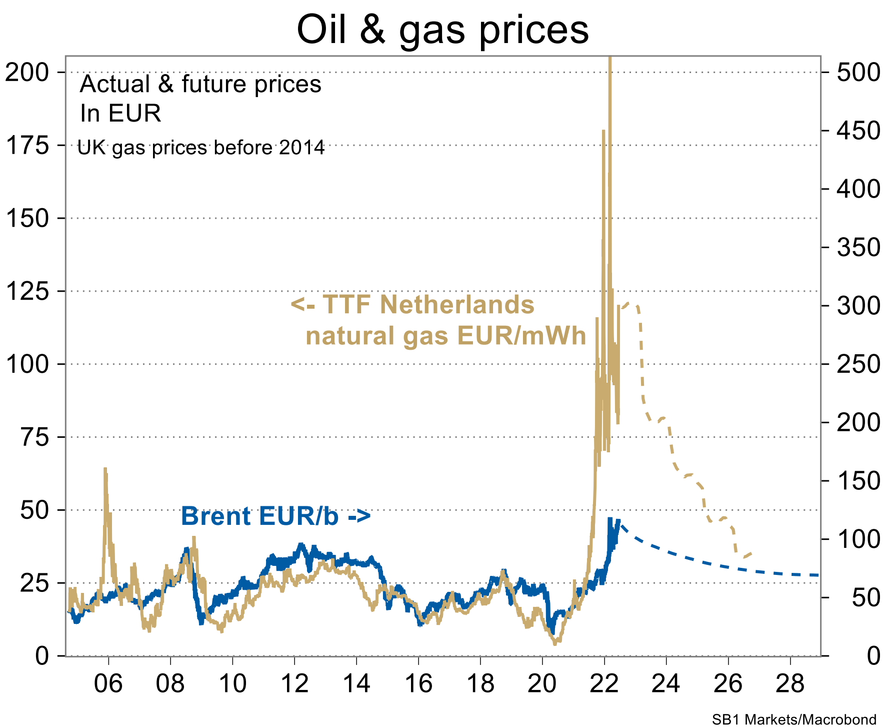


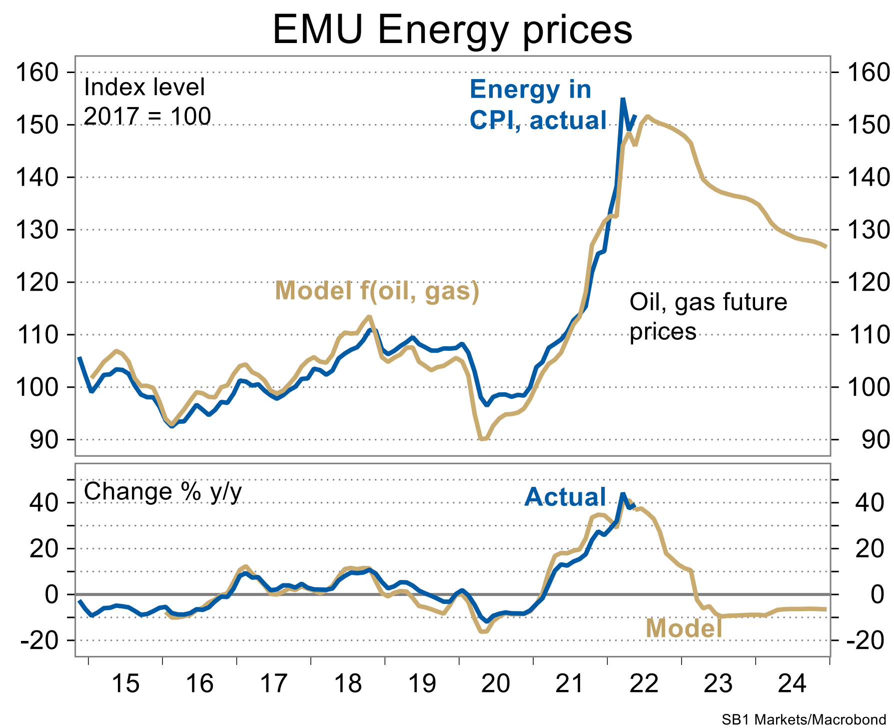


- Industrial goods prices increased 0.3% in May, and are up 4.1% y/y. Still, these prices are well below a 2% path since 2019 – and the annual growth rate should decline substantially during the next months, given the surge in mid 2021
- Services prices (ex housing, holiday travel) rose 0.2% in May, and these prices are also below a 2% path vs the 2019 level. Transport and hotels/restaurants have contributed on the upside last year

Gas, oil prices have lifted 'energy CPI inflation' up to 40% but….

…if futures markets are correct (this time…) , annual energy inflation peaked in March





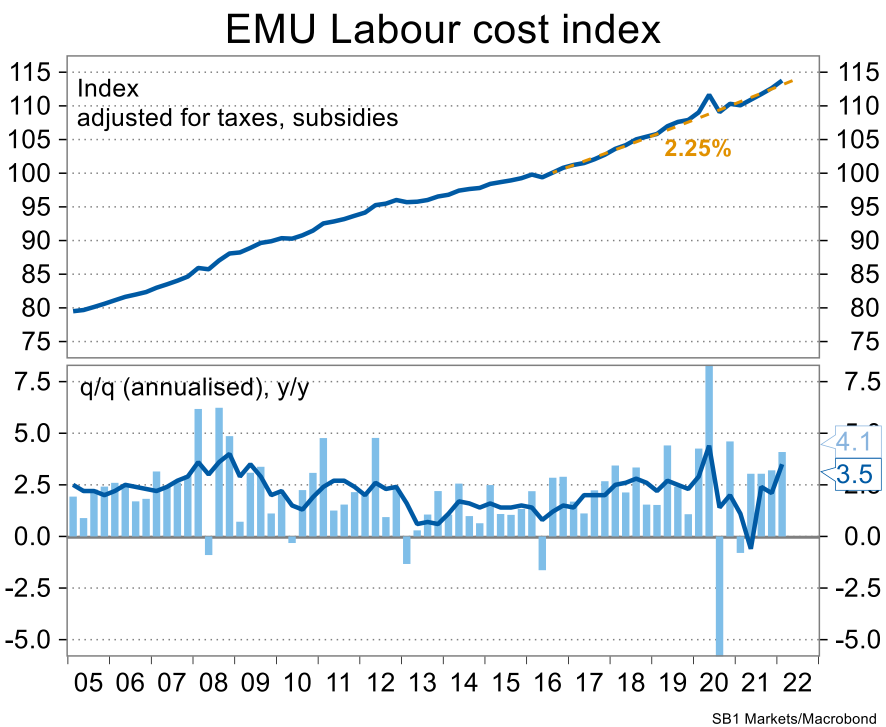
- Futures prices are heading downwards, both for natural gas (TTF) and oil (Brent)
  - » However, gas prices rose sharply last week, both due to cuts in exports from Russia, and the fire in the US LNG plant
- Early next year, energy prices should be down, measured y/y
- Gas and oil have contributed equally to the lift in energy prices measured at the consumer level, according to our models

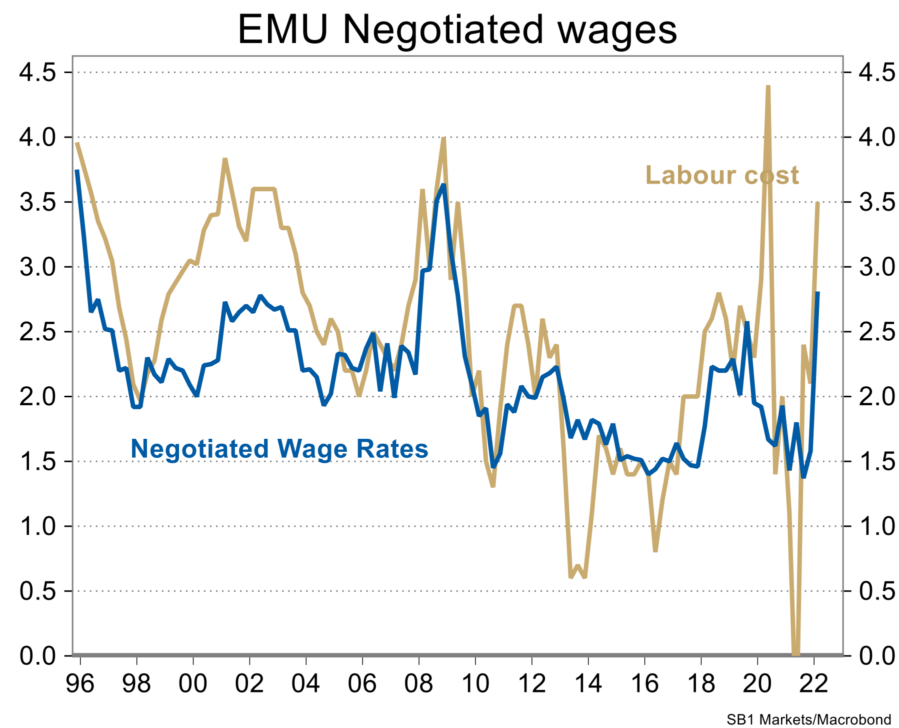
In these models we incorporate all direct impacts from changes in the oil price – as well as the impact from other factors that influence inflation which correlates to the oil price

SpareBank 1 MARKETS

Well, now wage inflation on the way up in the EMU too!

History revised up, and wage inflation was not 2% (or below), but rather 3% – and now up to 4%

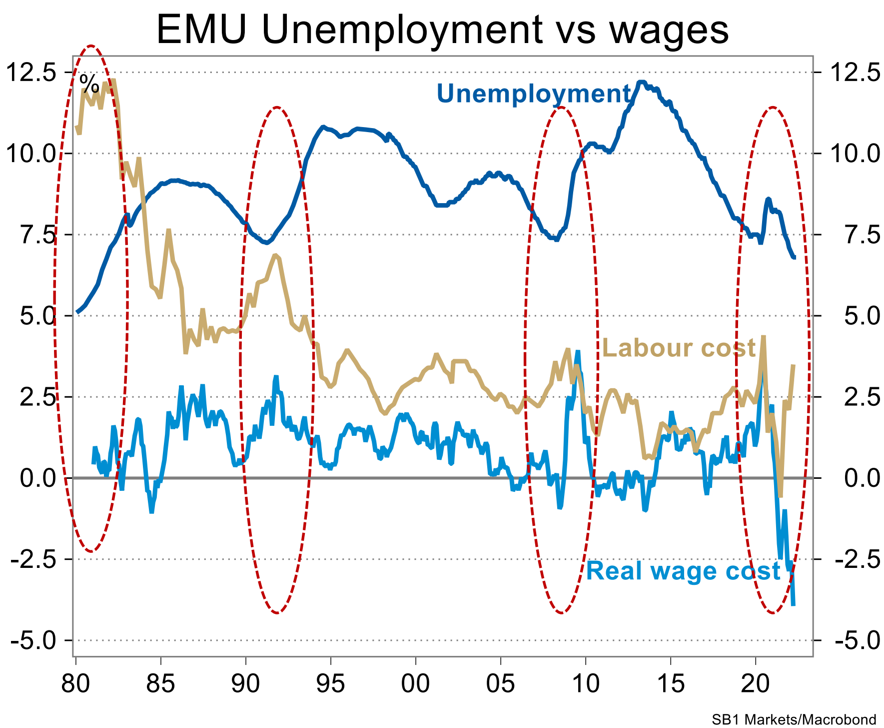


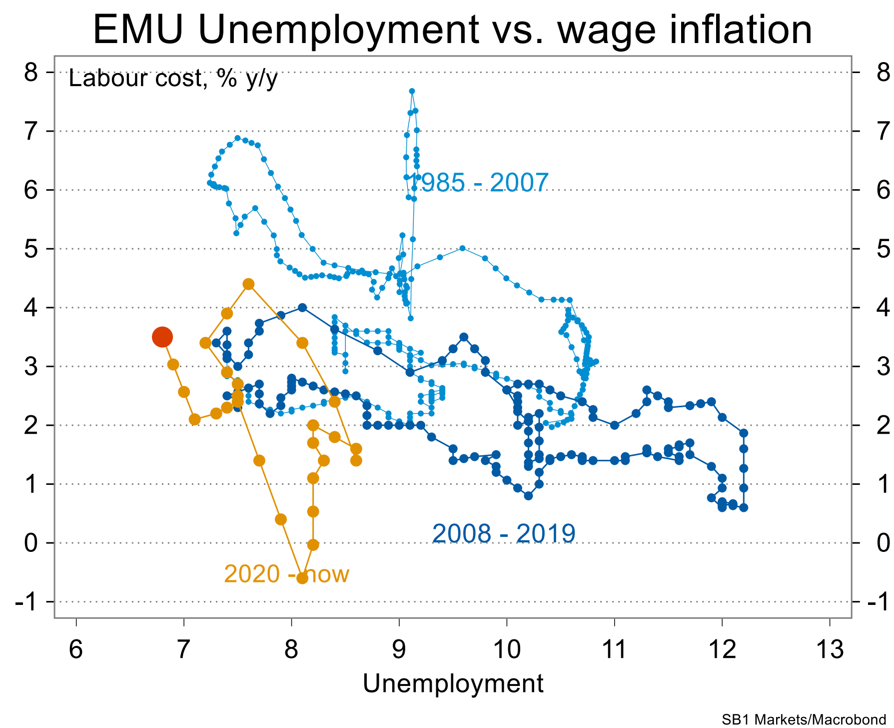


- EMU labour cost data are rather confusing but the story is clear: Wage inflation is probably on the way up
- The labour cost index is up 3.5% (taxes and subsidies included, 3,2% if not included)
- Negotiated wages rose 2.8% y/y in Q1

Unemployment is the lowest since 1981, vacancies are at ATH

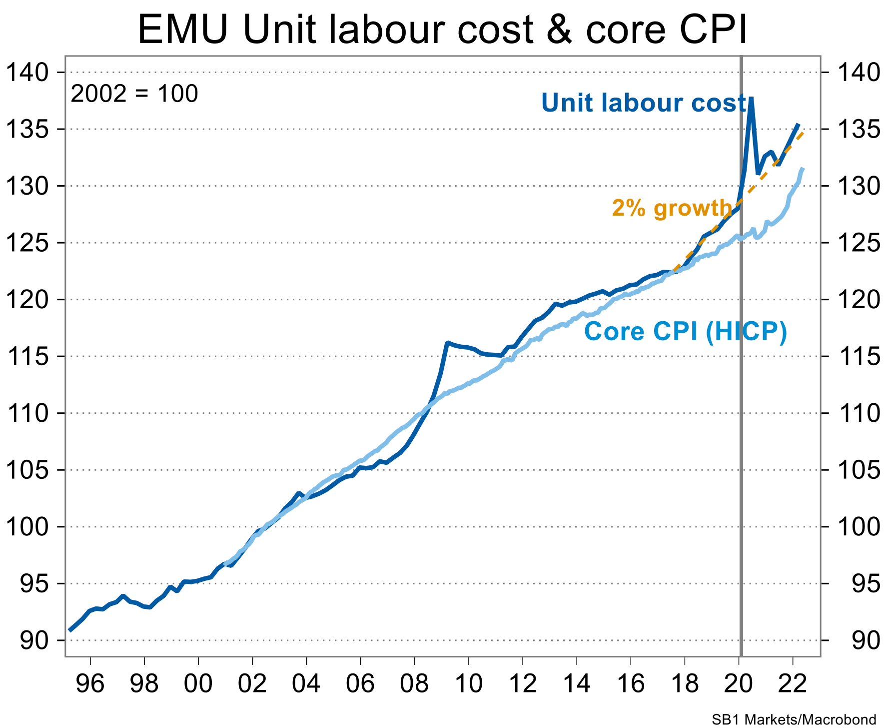
There may be some wage inflation risk in the EMU too? So far, nothing is seen, wage inflation at 2.0%





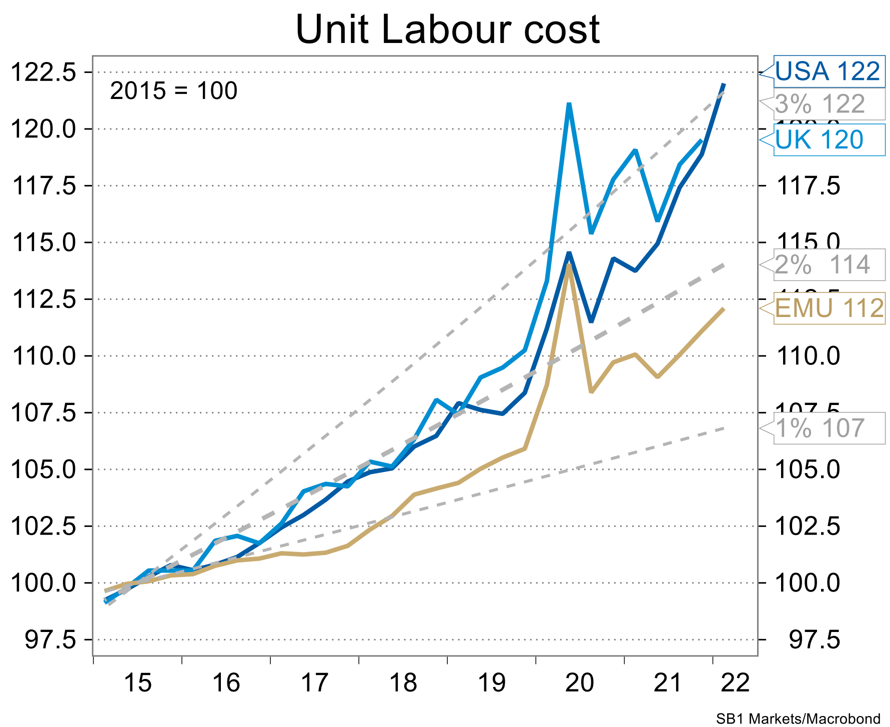
- A problem for the wage earners: Wages are up 2%, while inflation is 7.5% - and real wages are collapsing

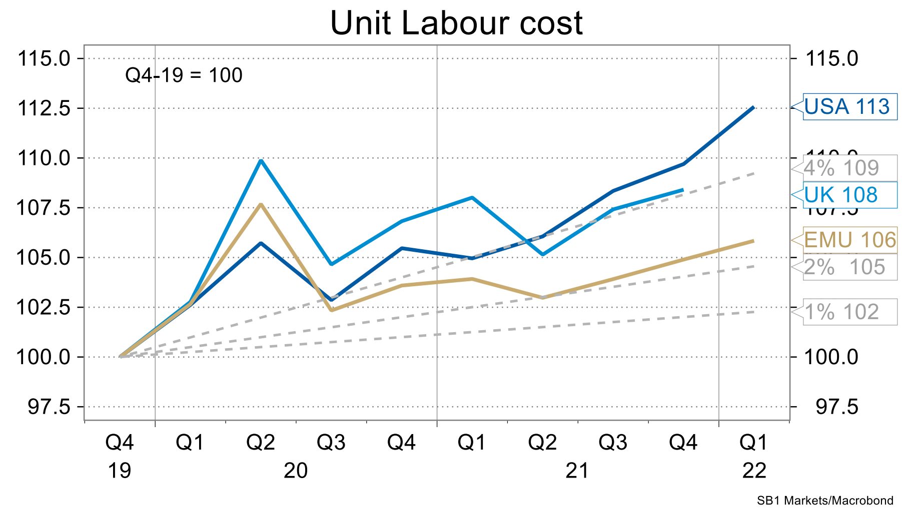
Unit labour costs are accelerating but still on a 2% trajectory



- **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 fell because employment was not cut (as in the US)
- On the other hand, 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 at 1% – and a 2% ULC inflation will over time yield a 2% CPI inflation

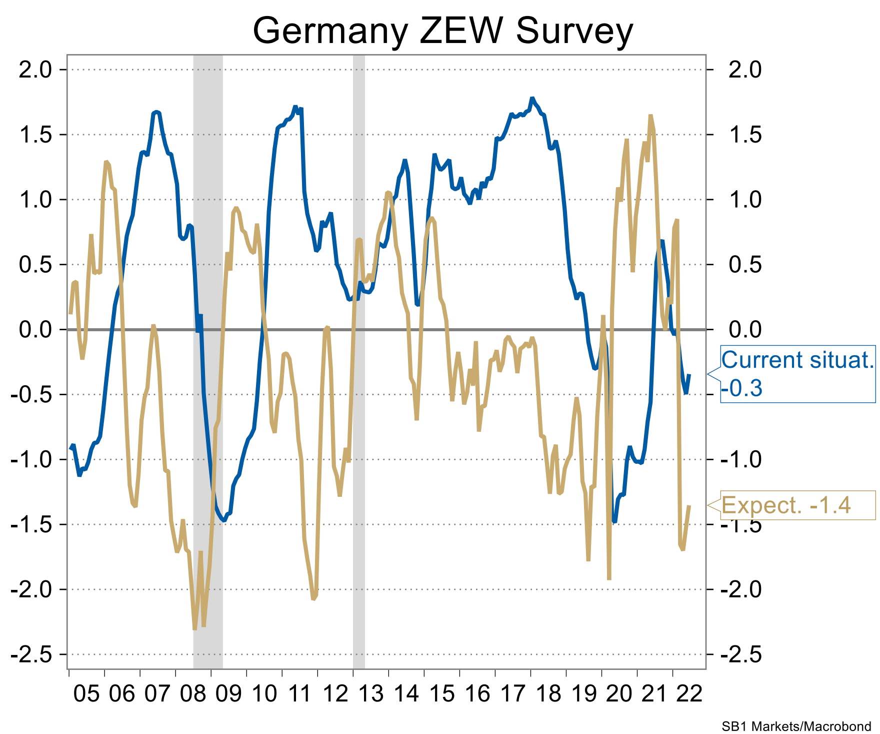
Unit labour costs not the problem in the EMU





ZEW expectations just marginally up in June, level still low

German investors/analysts are still negative vs. the outlook

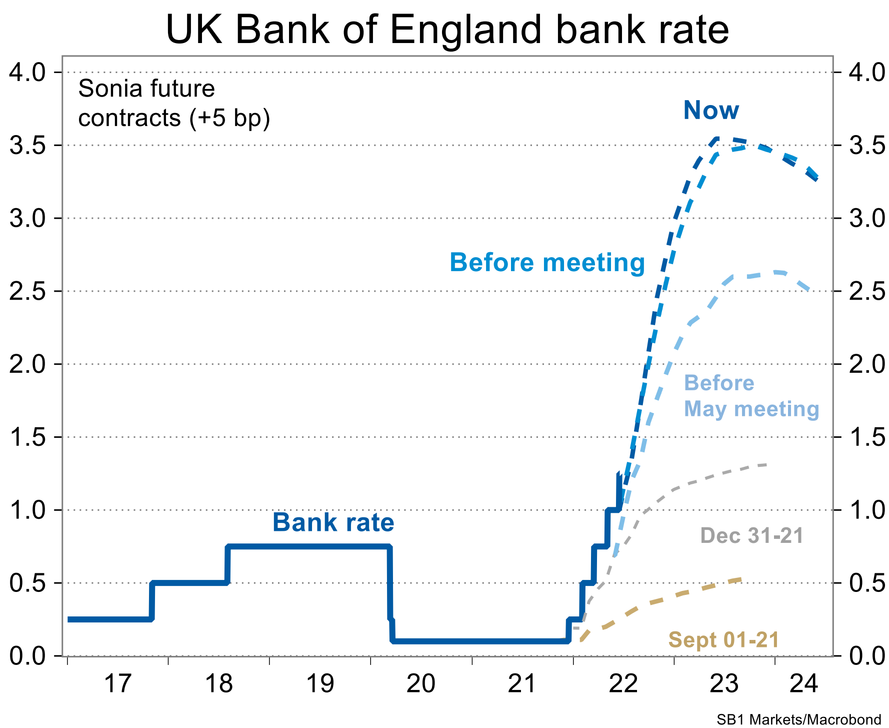


- The **ZEW expectation** rose 6 p to -28, expected up to -24. The level is 1.4 below average. The current situation index rose as well, and it is just 0.3 st.dev below average
- This index signals a substantial contraction in German GDP

SpareBank 1 MARKETS

Bank of England: Inflation may reach 11%. And UK is likely in a recession, now?

The Bank hiked for the 5th time, by 25 bps to 1.25%. The outlook is dismal indeed

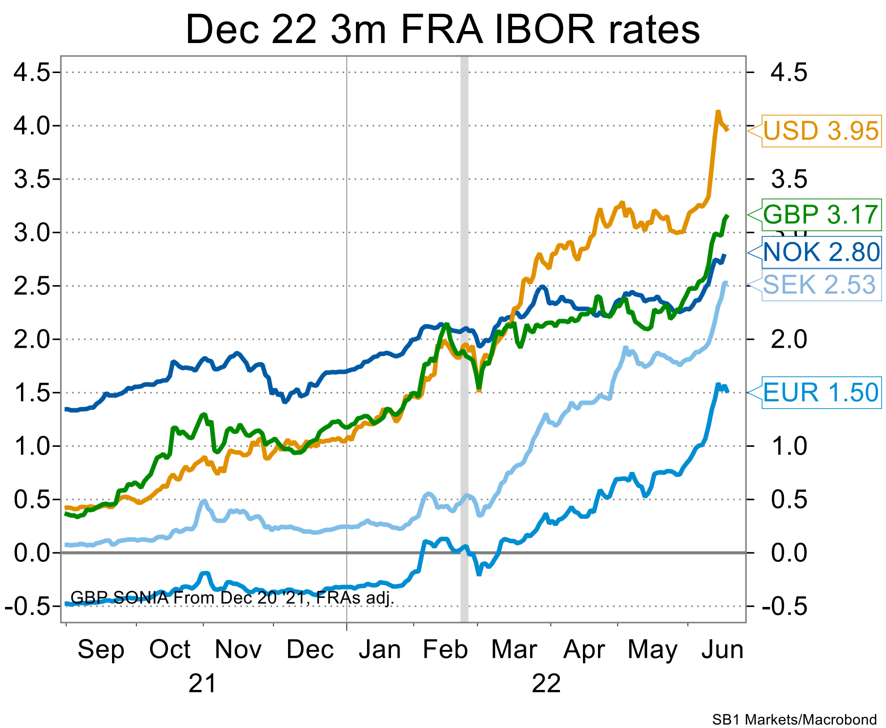


- **The bank rate** was lifted by 25 bps to 1.25%, as widely expected
  - » 3 of 9 member voted for a 50 bps hike, as in May
- **The Bank** is in a terrible squeeze:
  - » It expects inflation to accelerate further, though mostly due to higher energy prices that gradually feeds into the CPI though the semi-annual 'Ofgem' energy price cap adjustments, up to above 11% in late 2022, some 1 pp above the May forecast. Parts of the surge in inflation is caused by domestic factors, like wage inflation in a very tight labour market, and businesses' strong pricing power
  - » However, the surge in inflation will reduce disposable income sharply, and the bank expects 'a very sharp economic slowdown .
  - » GDP is expected to start declining from Q2. Parts of the setback in Q2 is due to special factors like the Queen's Platinum Jubilee (1 extra bank holiday) and less testing and tracing activities. GDP is expected down by -0.3%, vs the +0.1% forecast in May. Even if a huge (GBP15 bn, 0.5% of GDP) *Cost of living support package* was decided in May
  - » A formal forecast for the coming quarters was not published but in the May MPR UK was expected to enter a recession in Q4, and the unemployment start rising from next year, up to 5.5% in 3 years time (from 3.8% now). Now it may be that the recession has already started – however still with a very tight labour market
- **Inflation** is expected to decline rapidly from next year, but the bank does not seem to disagree with the market expectation of a further rise in the signal rate to 3.5% in one year's time
- **QT:** BoE decided as already decided to start building down its holding of assets the bank built up during the QE programs (from August or later)
- The **short end of the UK curve** rose slightly last week (and after the meeting) but the rest of the curve was close to unch.
- The **GBP** fell 0.6% last week

SpareBank 1 MARKETS

GBP FRA rates further up last week, a busy autumn for the Bank of England?

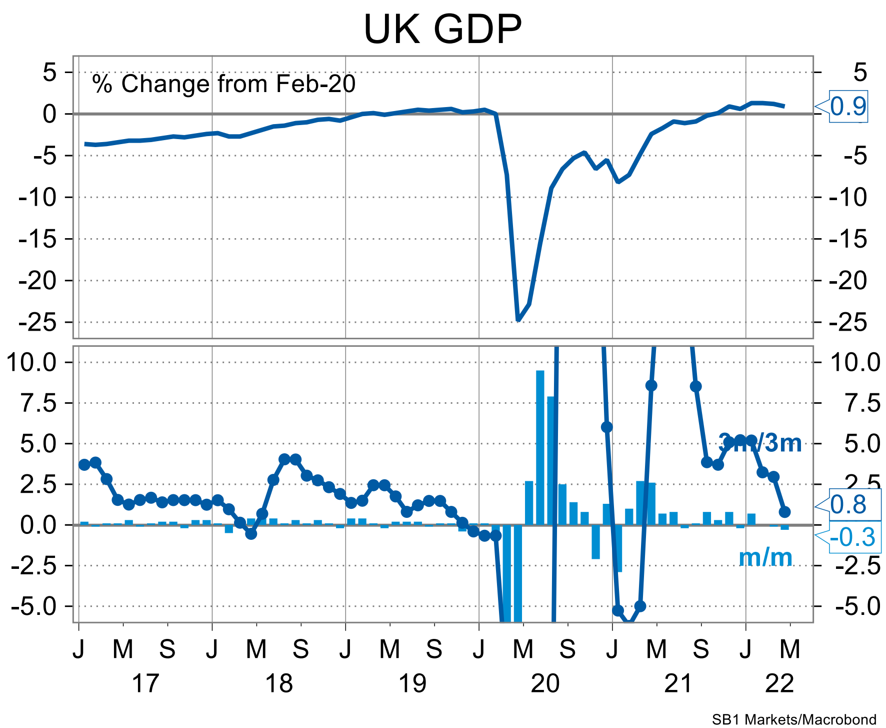
The Bank rate is expected up to almost 3% by December, from the current 1.25%!

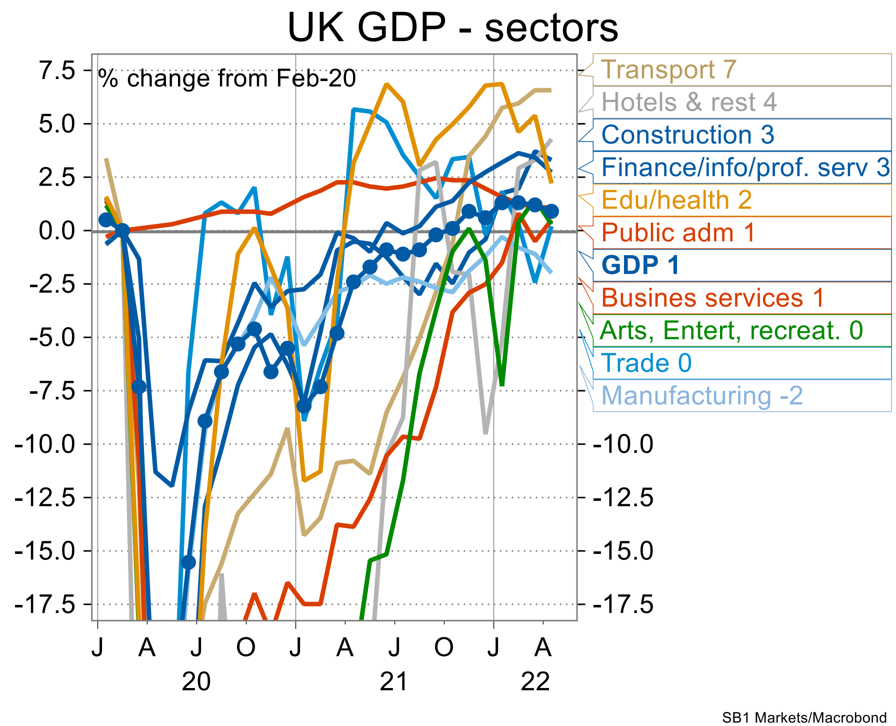


SpareBank 1 MARKETS

GDP is declining; was lower in April than in January! Start of a recession??

GDP fell 0.3% in April, expected up 0.1, following the 0.1 decline in March (and zero in Feb)

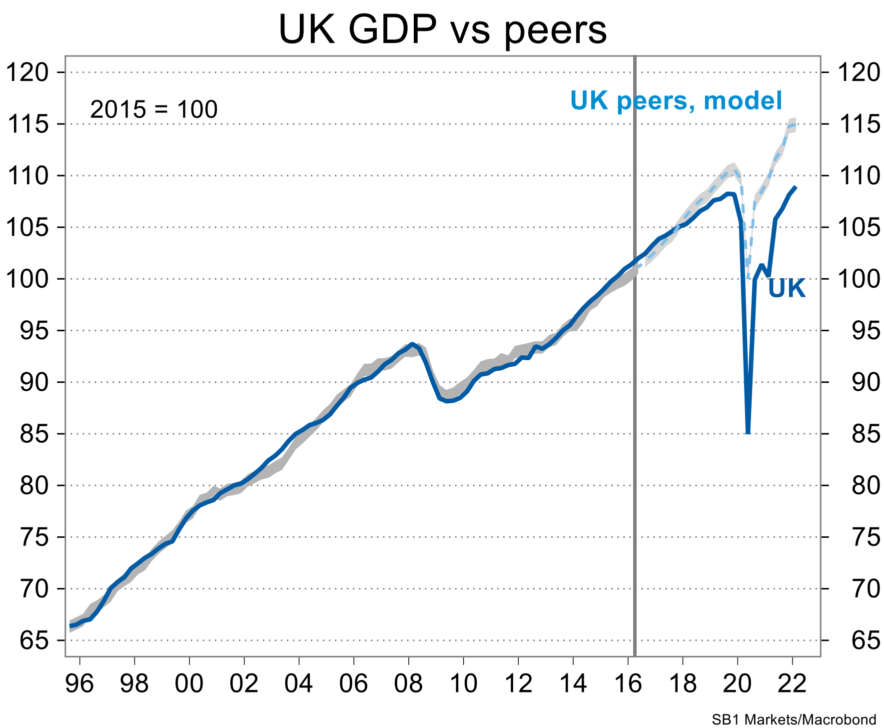




- **Growth in GDP** has been far weaker than expected since January – and far weaker than indicated by surveys, following the re-opening of the economy late last year
  - » GDP is just 0.9% above the pre-pandemic level, more than two years ago
- **Mixed between sectors:** A large contributor to the decline since January is health/education, from a high level – very likely because covid testing, tracing & treatment have been scaled down. Transport and hotels & restaurants are reporting strong growth and high activity level. Business services, art/entertainment and manufacturing is still on the weak side, which cannot be blamed on the pandemic anymore

Whatever happend to Britain?

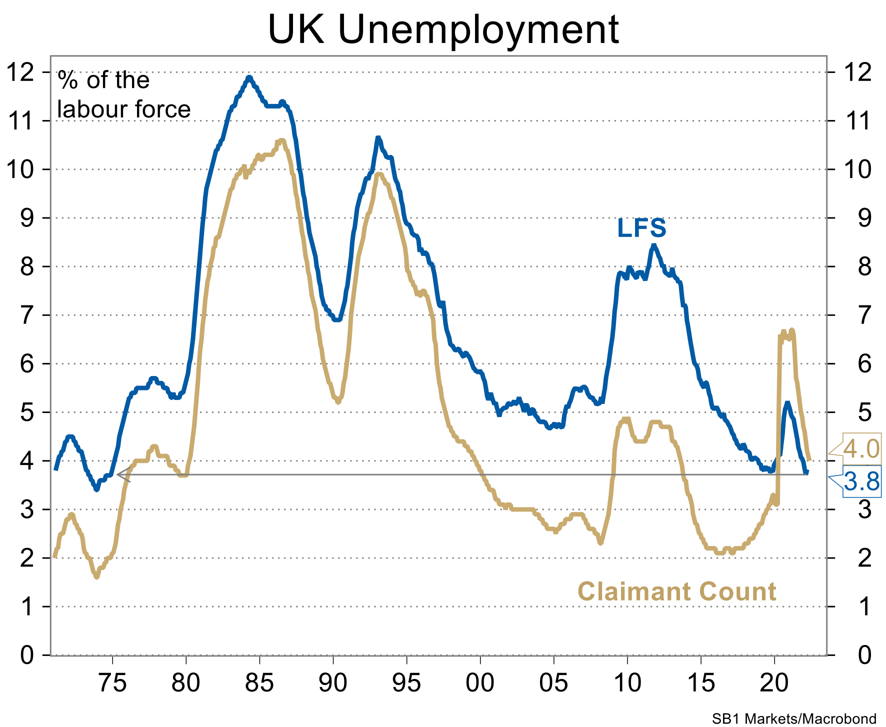
Why has the UK fallen by some 5 % behind its peers since mid 2016?

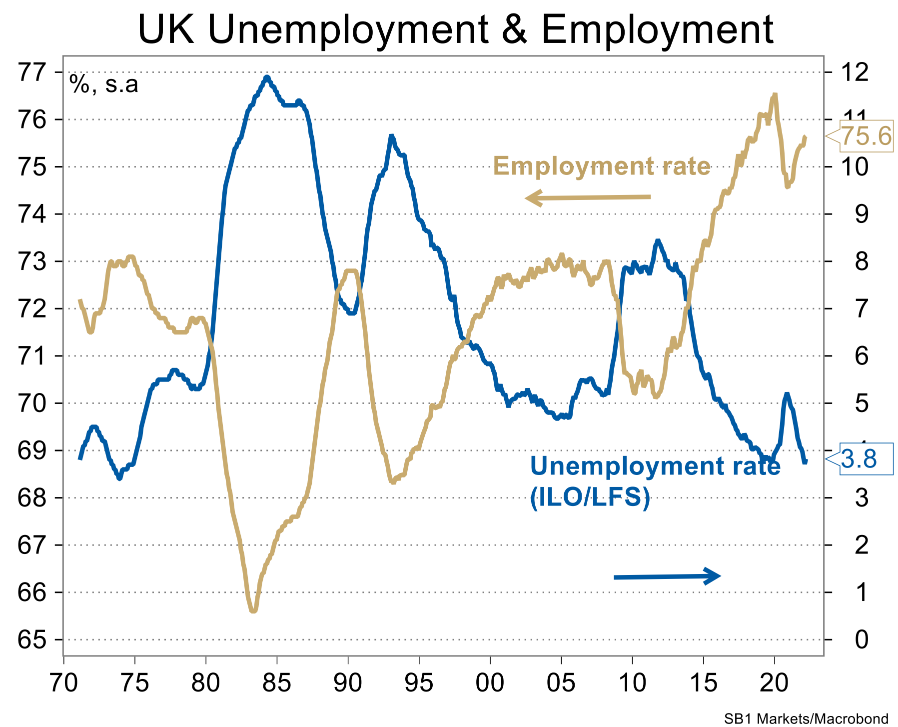


- Half of the damage done happened before the pandemic
- Is this the cost of Brexit? (This model is far too simple but still rather funny)

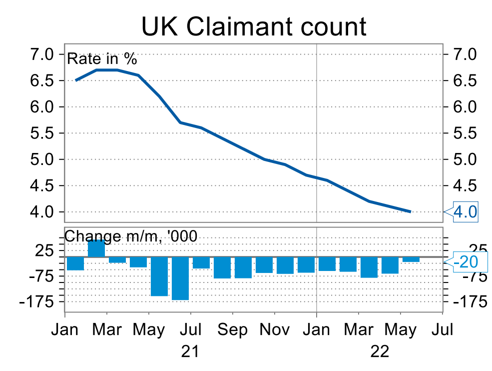
Unemployment up 0.1 pp to 3.8% in March, expected further down

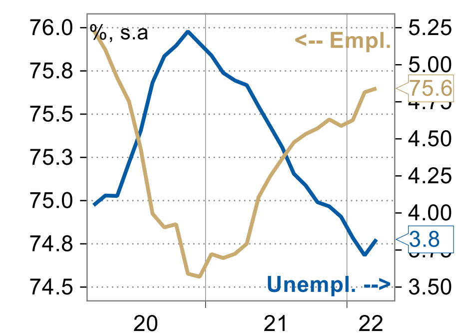
The explanation OK, though: The employment rate rose, but the participation rate gained even more





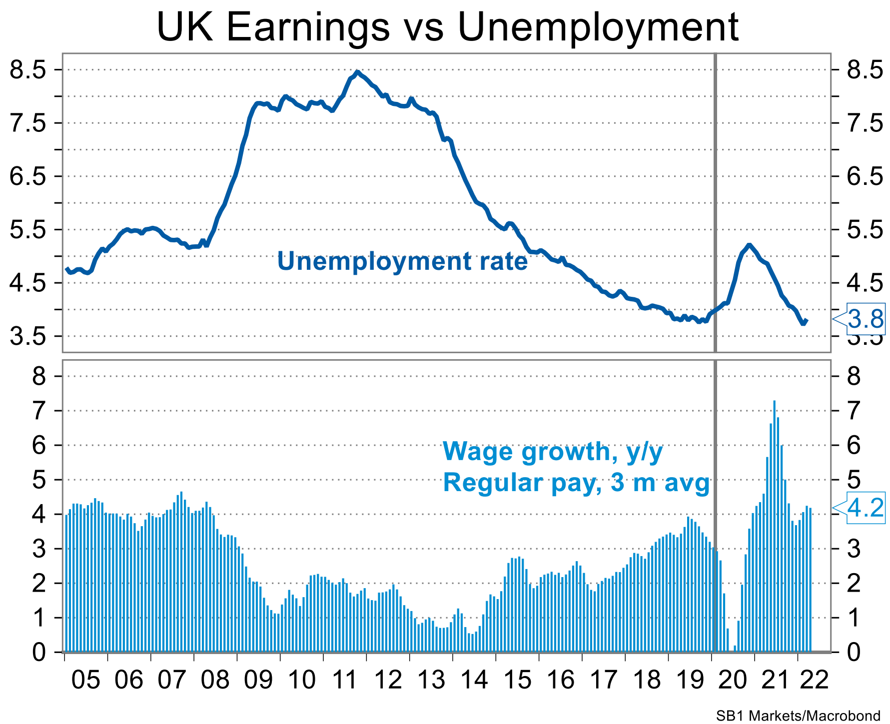
- ILO/LFS ('AKU') unemployment was the lowest since 1975 in February, and the lift in March was small. Still: Is the labour market going into reverse? We doubt
- A re-estimation of population data may have influenced data
- The employment rose further in March (but less than participation)
- The claimant count at labour market offices fell by 20' in May, and less than the normal decline recently. However, the count fell, and the rate declined 0.1 pp to 4.0%. Given the record high level of vacancies, the claimant count 'should' have fallen further. More mismatch in the labour market?
- The no. of unfilled vacancies is record high and still increasing rapidly

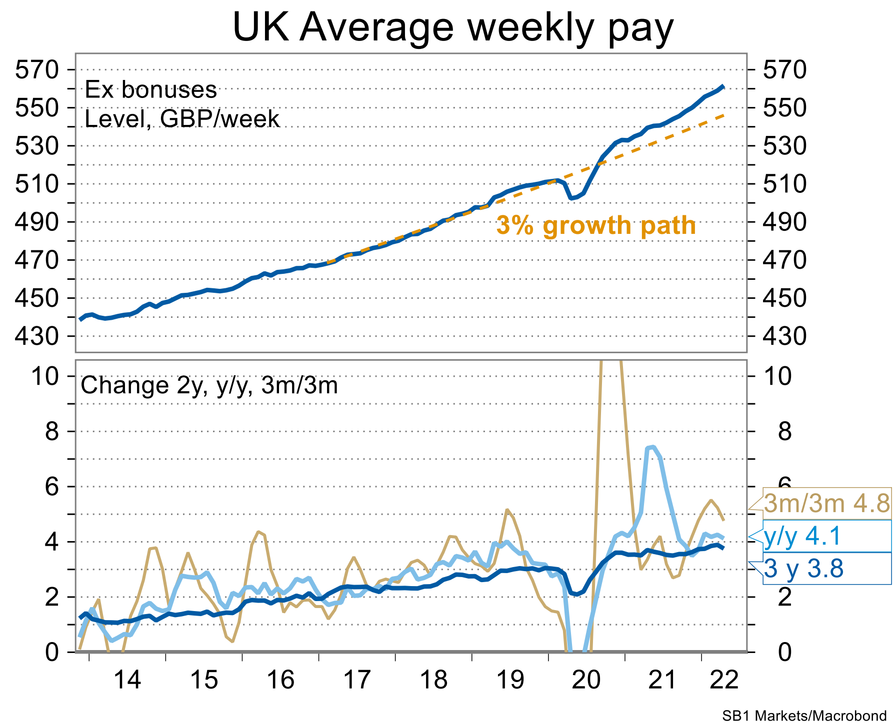




Unemployment has fallen to a low level – and wage inflation on the way up

… wages ex. bonuses up 4.8% 3m/3m

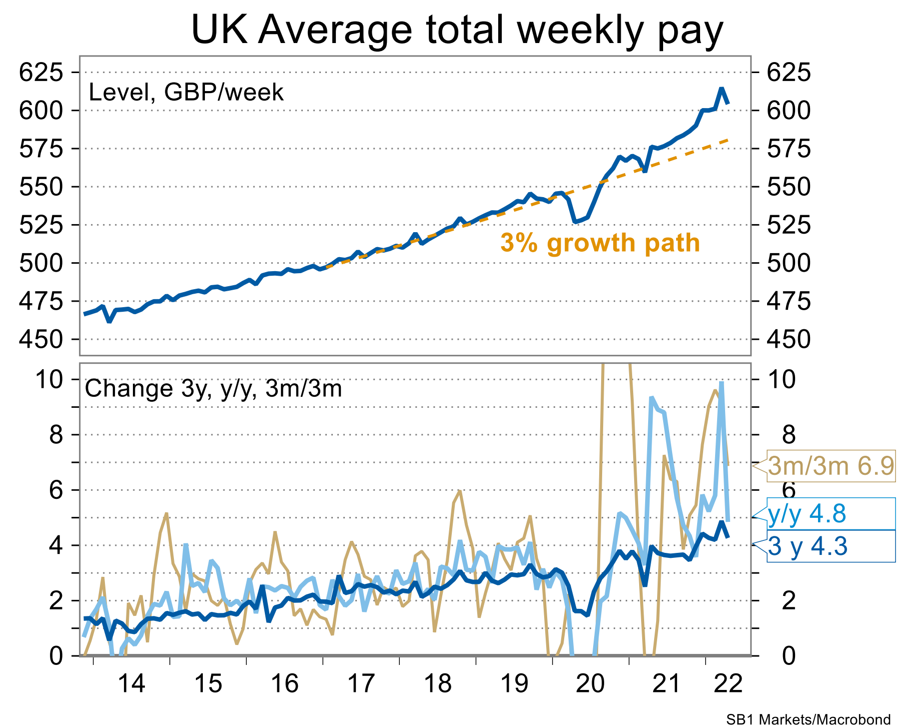




- **Annual wage growth** (regular pay, 3 m avg) was unch. at 4.2% in April, 0.2 pp higher than expected. Not smoothed, wages were up 4.1% (unch). The underlying 3m/3m rate retreated marginally to 4.8%
- **Including bonuses**, total wages are up 4.8%, and underlying 3m/3m growth equals 6.9%
  - Over the 3 past years, total weekly pay is up 4.3% on average
- Just before the pandemic, wage inflation was approx. 3% (total pay) to 4% (regular pay) – but just between 2% and 3% the preceding years. Thus, the current wage inflation rates are well above the British 'norm'
- Some unions in the UK have lifted their ambitions substantially recent months – as inflation is approaching 10% - and BoE expect more to come. Wage claims in the same territory have now been aired, not surprisingly in a very tight labour market

Total pay, including bonuses, is accelerating rapidly

The sum up 6.9% 3m/3m

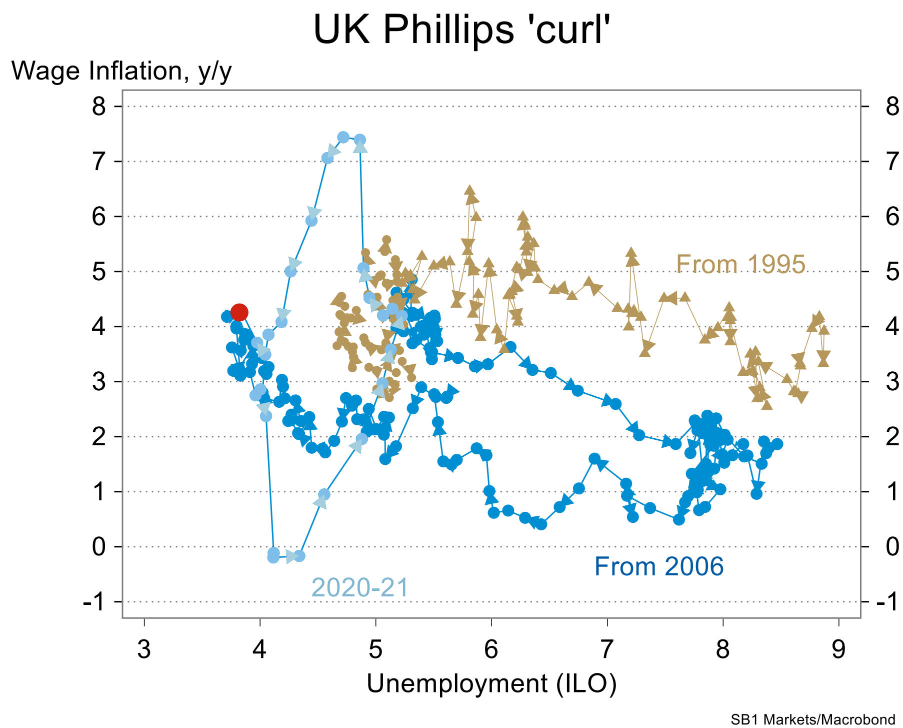


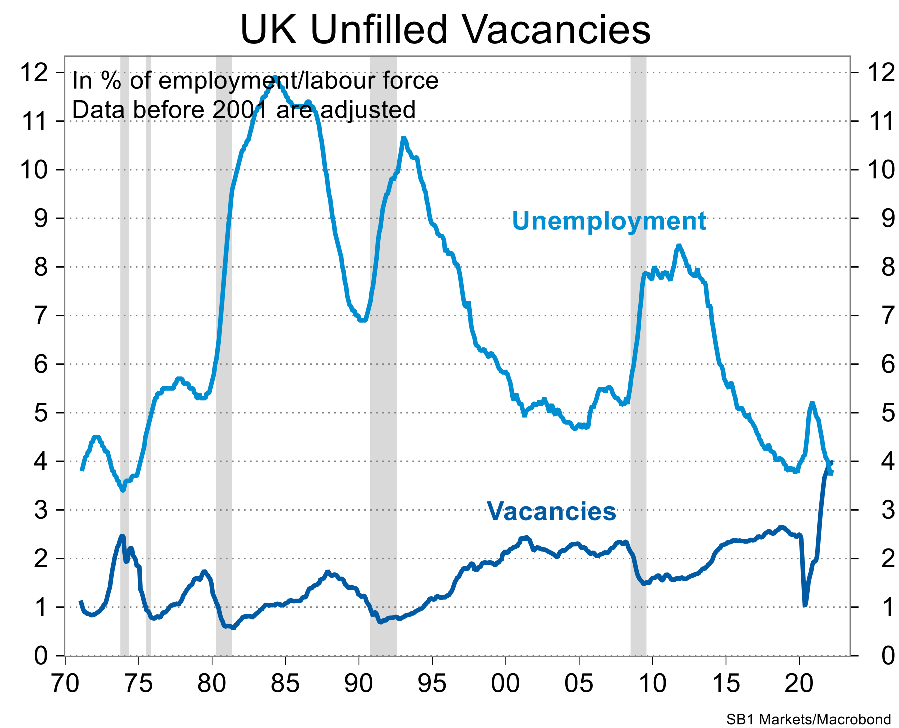
- It is completely impossible to bring inflation back to 2% over time if wage inflation remains above 5%, probably even above 4%. With a 3% wage inflation rate, inflation was just marginally below the 2% target

SpareBank 1 MARKETS

A tight labour market – perhaps the tightest ever due to the vacancy rate

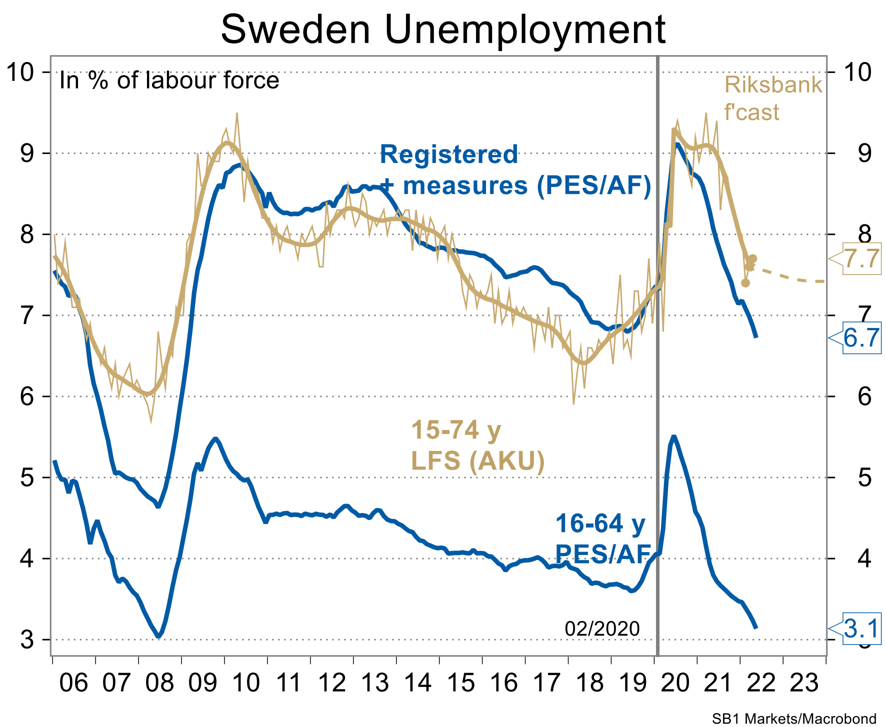
And wages are on the way up alongside something that looks like a Phillips curve

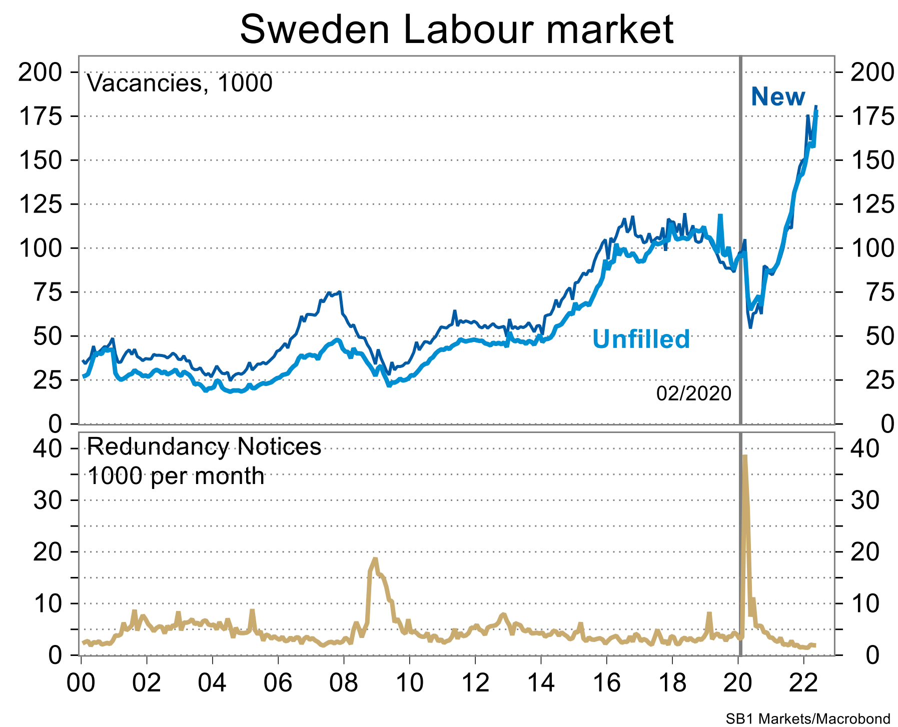




Reg. unemployment sharply down, vacancies up to another ATH

The open unemployment rate continued down by 0.1 pp to 3.1%, the lowest since 2008

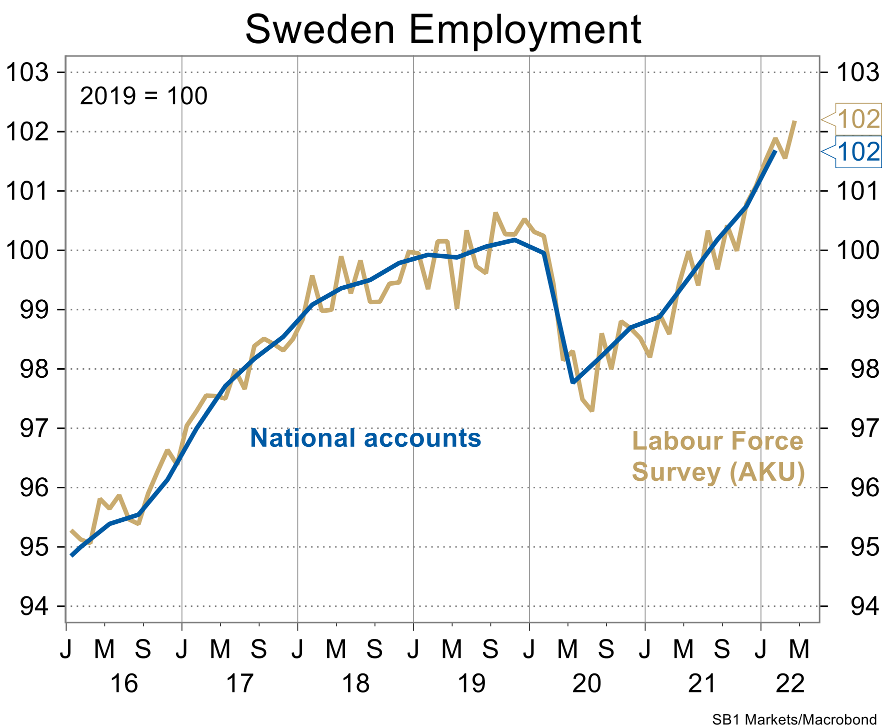




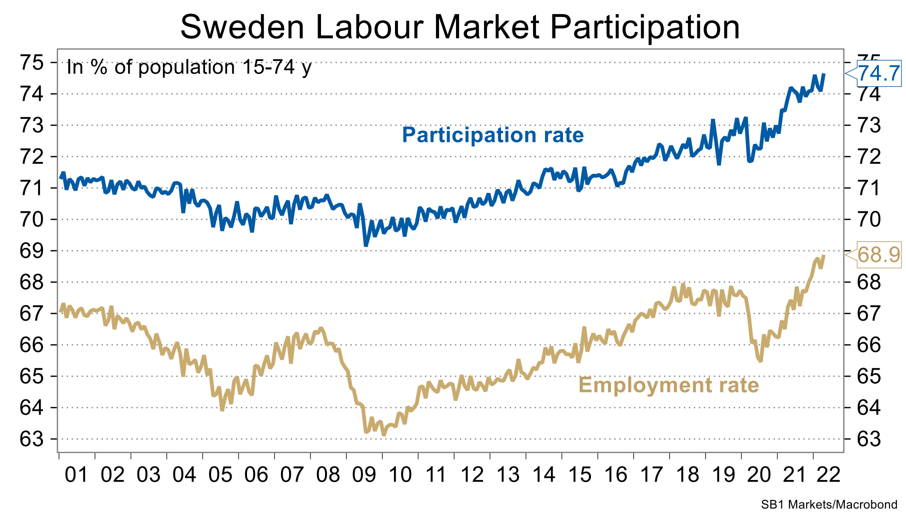
- The **'open' registered unemployment rate** at 3.1% is far below the pre-pandemic level – and a couple of ticks down, at the lowest levels since 1990
  - » **Unemployment including labour market** measures has fallen to 6.7% - which is finally below the level just before the pandemic hit
- Both the number of new vacancies and the number of unfilled vacancies rose sharply in May, to ATH

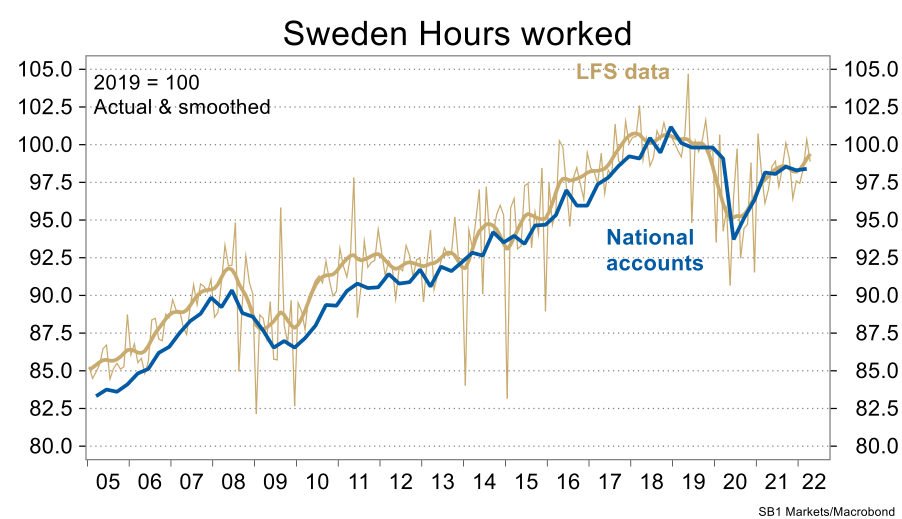
Strong employment growth – and the employment rate is the highest in decades

However, hours worked still below the pre-pandemic level. Strange, as the vacancy rate is very high



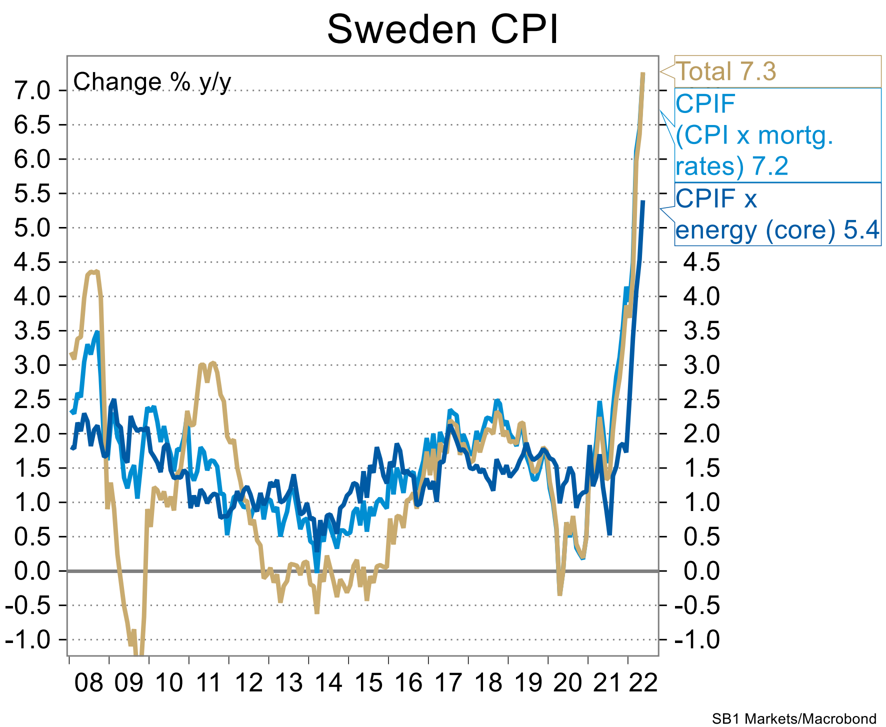
- Is the decline in hours worked due to the supply side, people do not want to work too long hours?

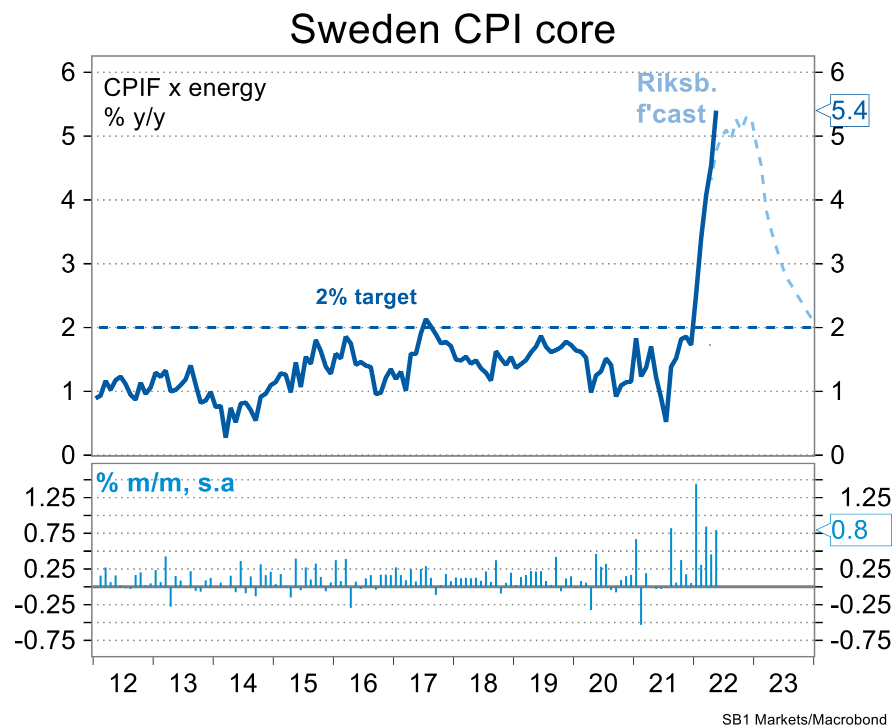




Inflation further up: Headline +0.9 pp to 7.3%, the core +0.9 pp to 5.4%

0.2 – 0.3 pp higher than expected. Now it is far more than energy which contributes, here too

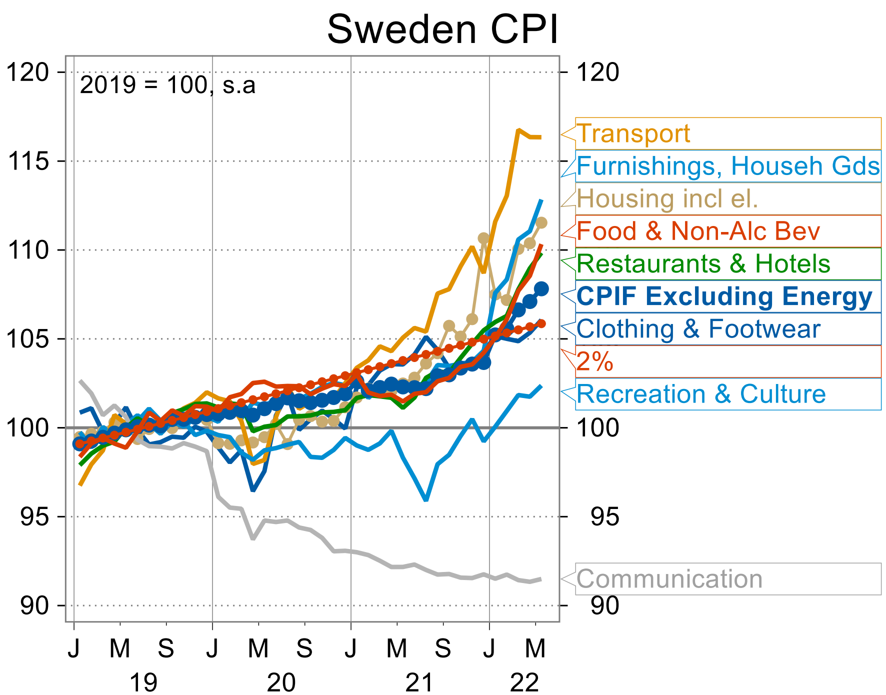




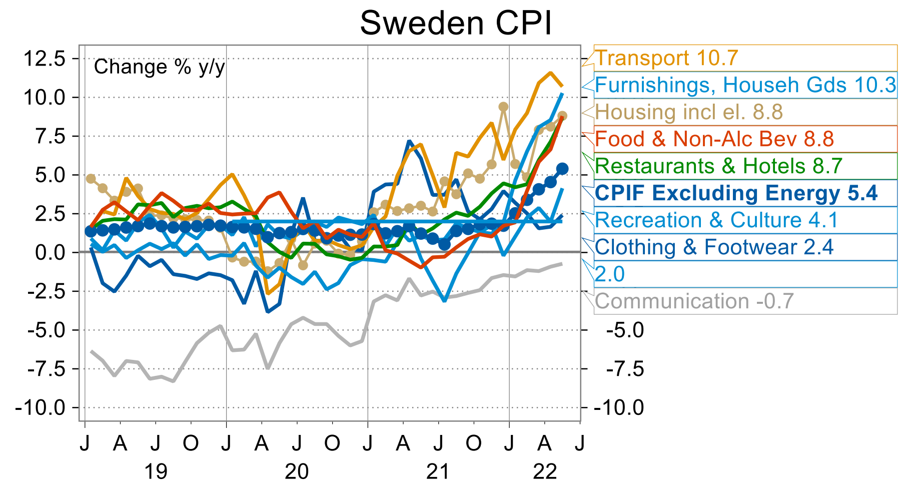
- **CPI-F x energy, the 'real core'**, rose 0.8% in May (seas. adj). The core rate has accelerated sharply recent months, to 5.4% from 1.7% in last December
  - » Why is inflation so high? Food prices are up 8.8% y/y, hotels & restaurants 8.7%, furnishings 10.3%!
  - » All other measures of underlying inflation are sharply up – and at the highest level in some 30 years
  - » Until Q4, inflation was pretty well explained by higher energy prices, now more elements are on the move upwards
- **Headline inflation** also accelerated, and not because energy prices accelerated

Inflation in Sweden: a broad acceleration

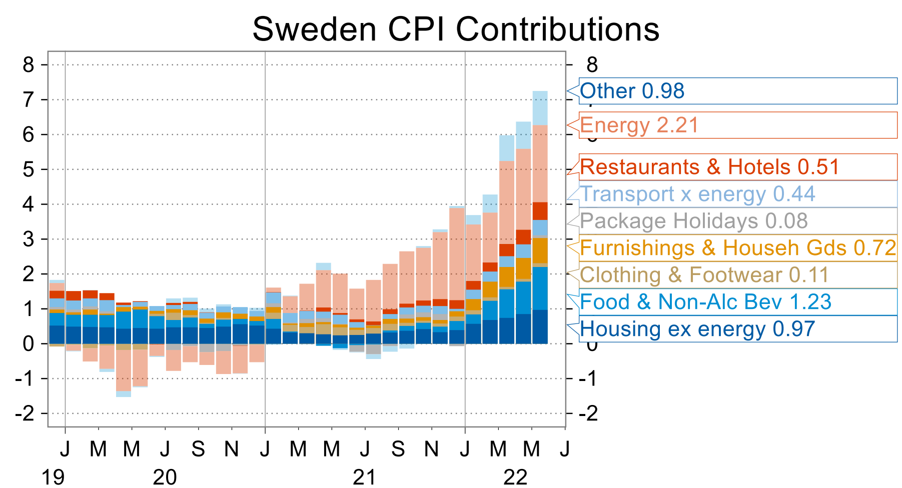
Just communication below 2% y/y



SB1 Markets/Macrobond

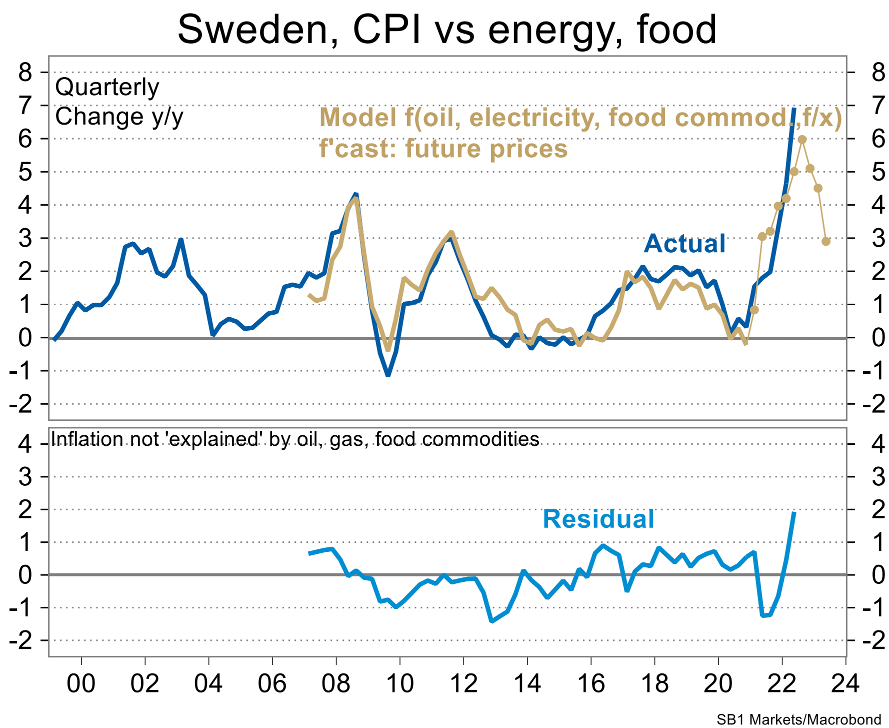


SB1 Markets/Macrobond



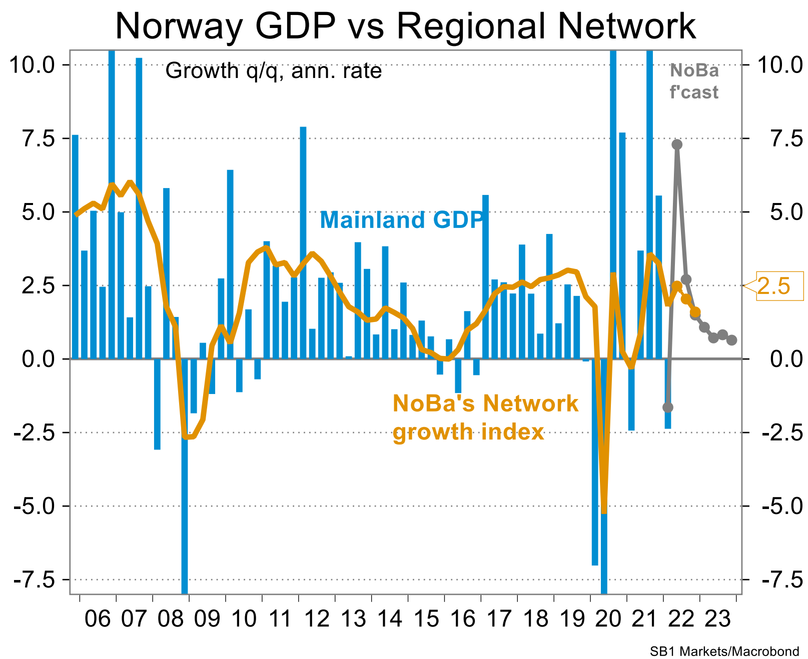
SB1 Markets/Macrobond

Our simple inflation model also tells us it is more than energy prices



Norges Bank's Regional Network expect slower growth, in line with NoBa f'cast

Lack of capacity and high inflation dampens growth expectations



- **Implications**
  - » Taken at face value, the network report did not deviate much from NoBa's outlook. However, higher capacity utilisation, more labour shortages, higher wage inflation and still high price inflation are argument for lifting the interest path – as we assume the Bank will do at Thursday
  - » We expect the interest rate path to be revised up by some 50 bps – leaving the path 50 bps below the FRA market

Activity the past 3 months

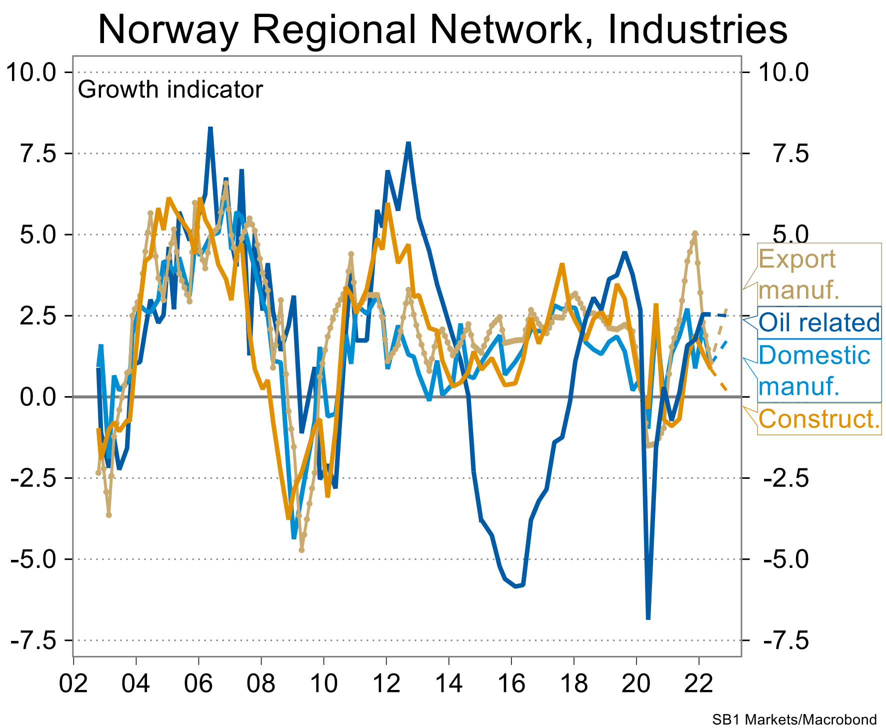
- The Network reports a 2.5% growth pace in Feb-April period (index value 1.24), up from 1.8% the previous 3 months ago. 3 months ago, growth was expected 3.3% (for the coming 6 months though). Actual Mainland GDP growth was 1.6% (annualised) past 3 months.
  - » Household services reported a decline, retail sales rather slow growth
  - » **Capacity utilisation** rose further and are close to ATH, and **labour shortages** became even more widespread, and are not far below ATH

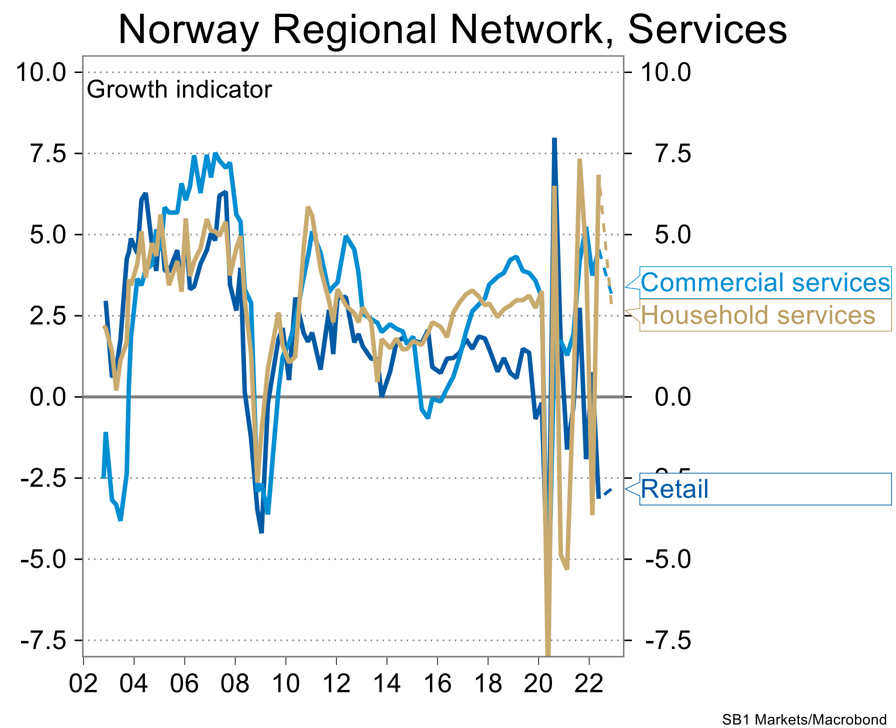
Expectations for the coming months

- The Network expects a 1.6% growth pace the next 6 months (index 0.8), down from 3.3% 3 months ago. Consensus was at 2.8%. In March, Norges Bank assumed a 2% growth pace over the next 6 months (Q2 and Q3)
  - » **Retail trade** expects sales to slow – which is reasonable as consumption of goods have been 'artificially' higher than normal during the pandemic
  - » **Household and commercial services** expect slower growth but still above trend
  - » **Construction** is slowing
  - » **Industries** are reporting stable or higher growth, is sum as we assumed. However oil services did not report higher growth as we assumed (but export industries surprised at the upside
- **Investment** were revised slightly down but growth is still expected (outside retail trade)
- **Wage inflation** expectations were revised up by 0.2 pp to 3.9%
- Companies expect **prices** to increase at an unusual pace but not faster than 3 months ago

Household services report slower growth, still above trend

Retail trade remains in contraction mode, while industries in sum are up

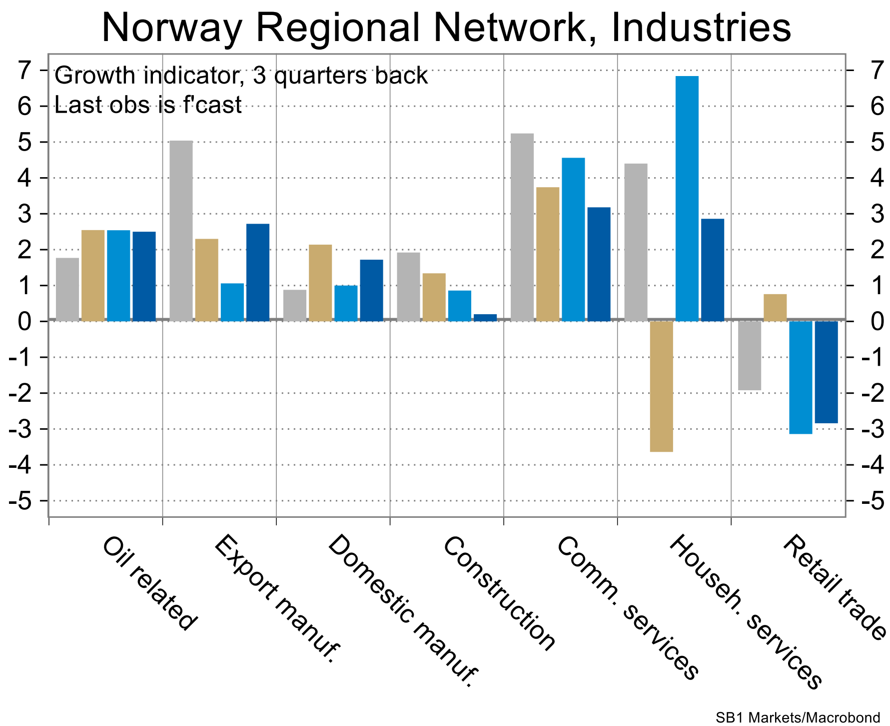




- Oil related surprised on the downside, we expected stronger growth
- Export manufacturing reported higher growth than we expected

Just retail trade expect lower activity, construction a flattening

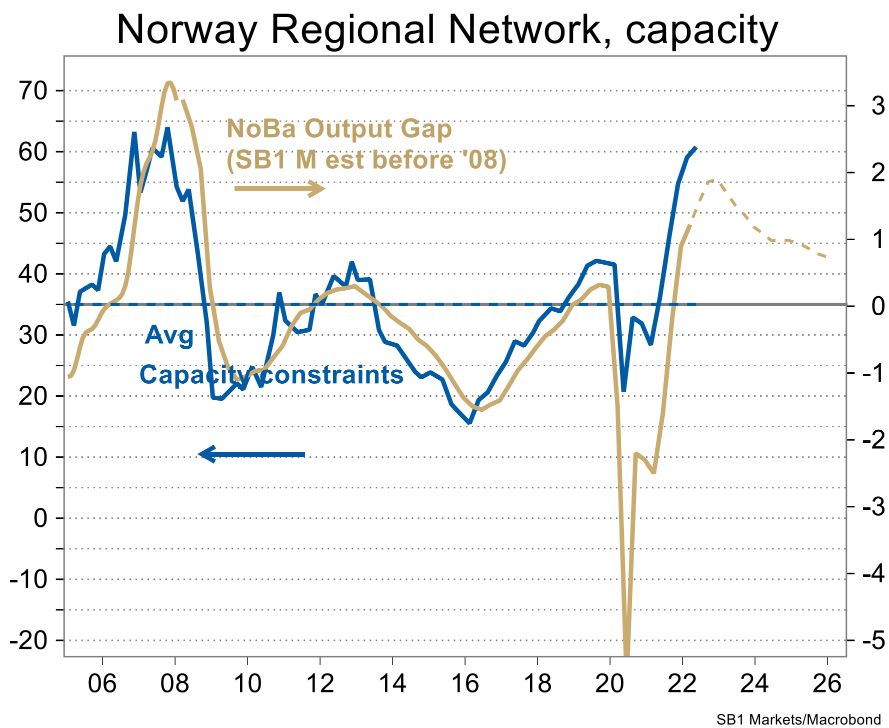
Other sectors report growth, but less brisk in services (post the reopening surge)

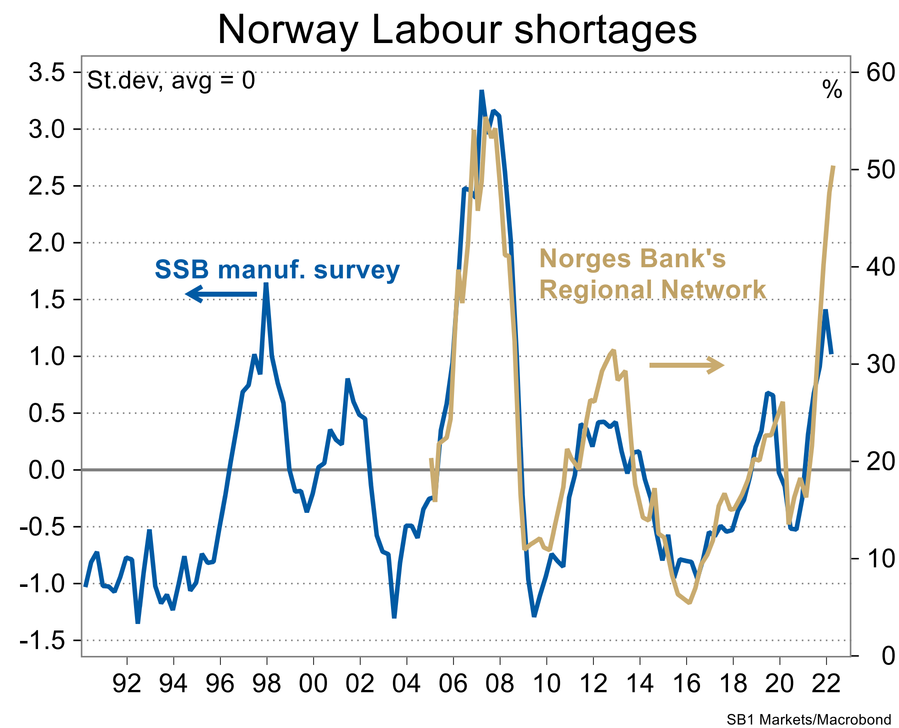


- Oil related surprised on the downside, we expected stronger growth
- Export manufacturing reported higher growth than we expected

Capacity constraints close to ATH, and Labour shortages even more wide spread

Both are not far below the 2007 ATHs

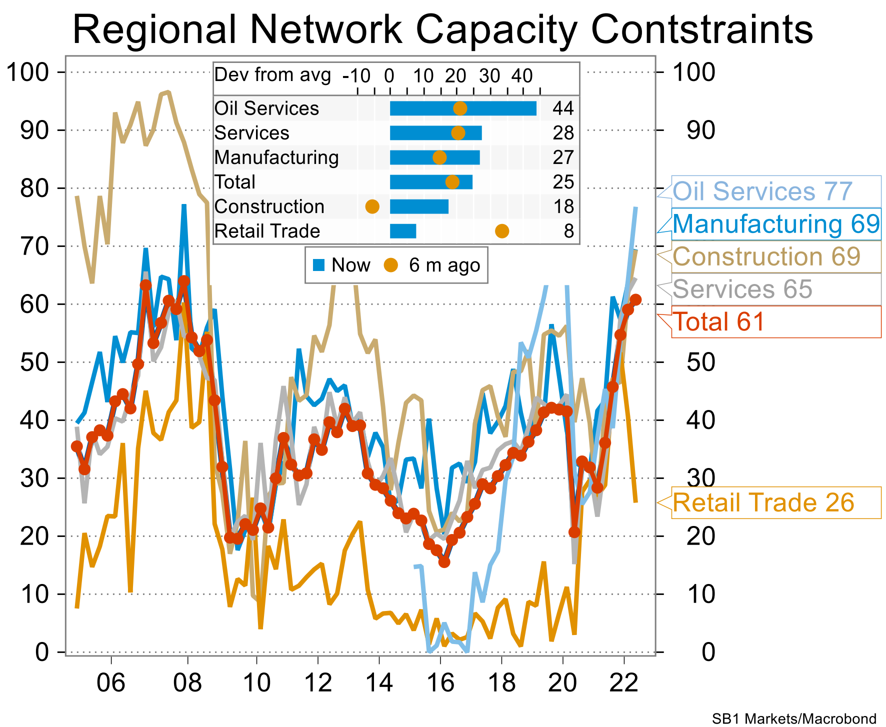


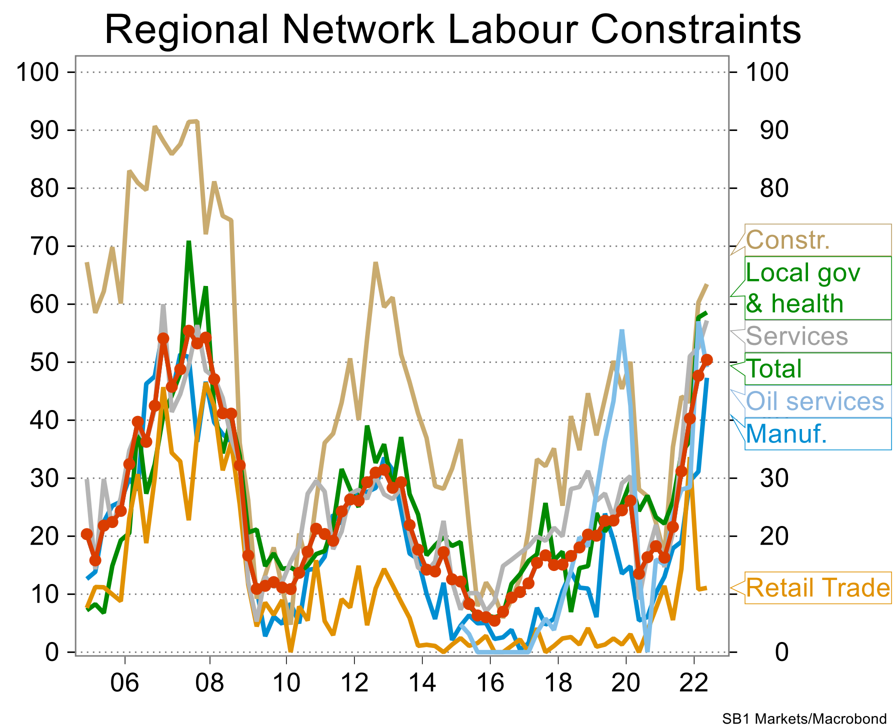


- More companies than since 2007 are reporting **capacity constraints** following the steepest surge ever, over the past 3 quarters. The correlation to NoBa's assessment of the **output gap** is not 1:1 and the Network report does not suggest than the Bank's estimate will have to be revised up. However, the rapid decline in the NAV unemployment rate to 1.7% in May indicate a higher positive output gap
- **Labour supply** shortages are shooting up, but marginally slower in Q2, and the is still below ATH level in 2007 (but not by much). Given growth expectations well above average – and plans to lift employment, the labour market will very likely tighten further the coming months. Where will companies find available workers?
- **Wage expectations** are drifting upwards, check next page

Retail trade reports lower capacity utilisation while others are on the way up

All sectors report higher capacity utilisation than normal

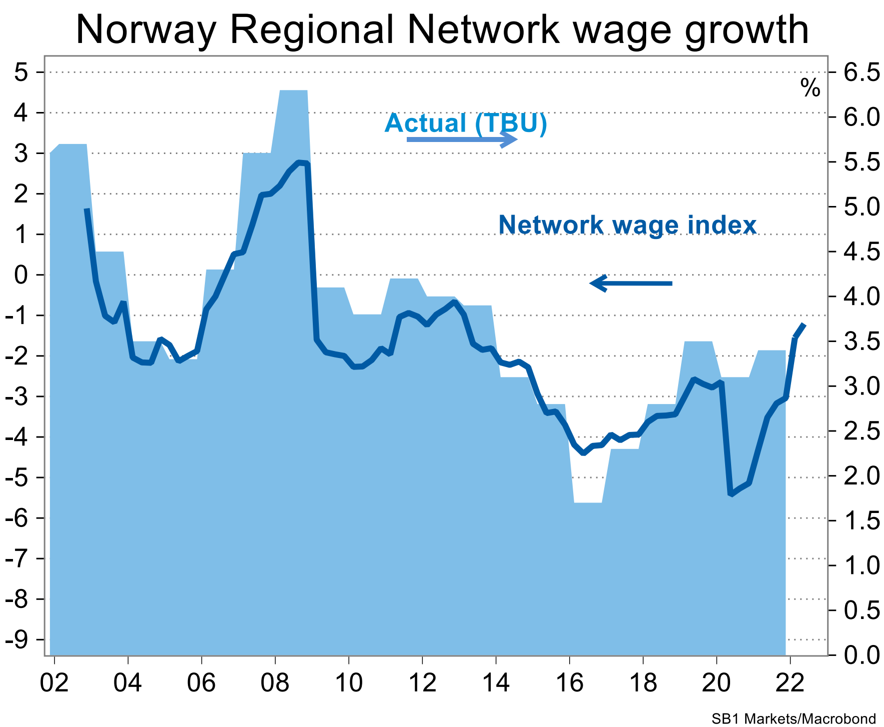




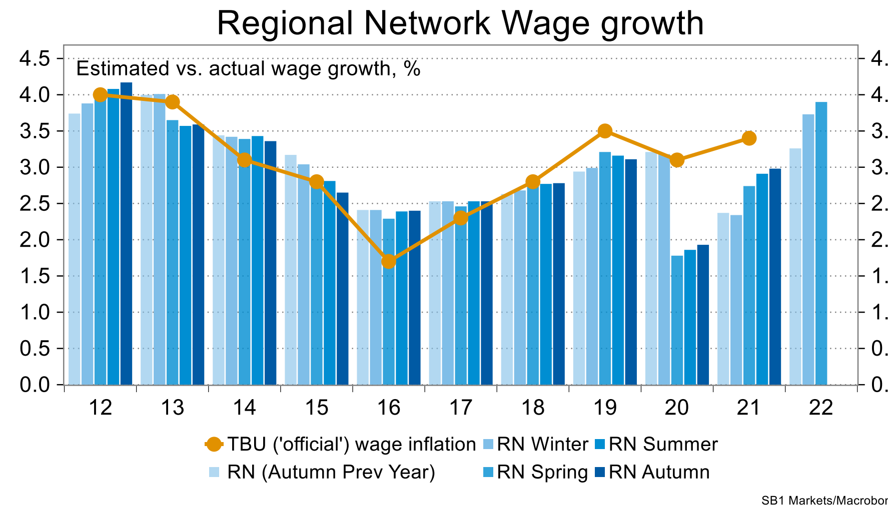
- All sectors are reporting a substantial increase in more labour shortages – except retail sales
- Lack of raw materials and delivery problems have also (of course) increased

Tic toc, tic toc. Wage expectations on the way up, approaching 4%

Still, no major revision in the May network report



- Just once, in 2011, the Network has revised up its wage expectations more in one go than between Feb and May

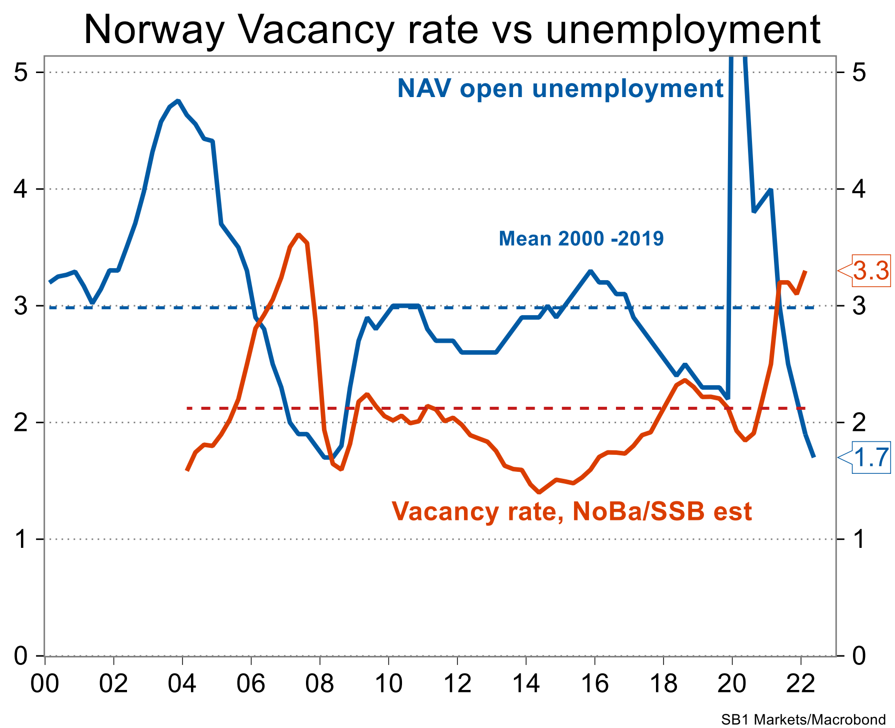


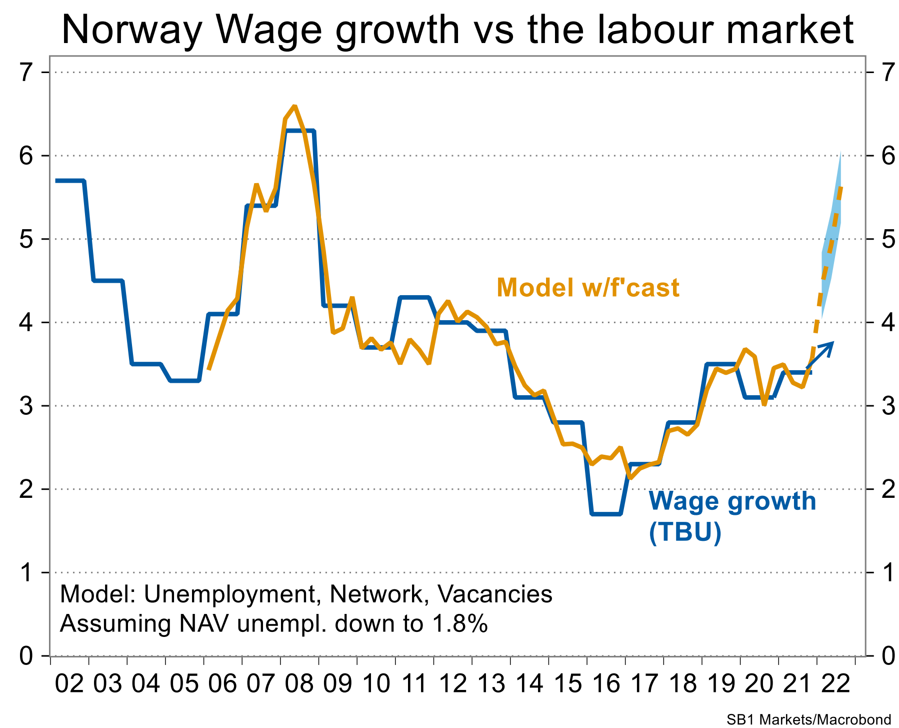
- **Wages growth in 2021** was 3.5% (all employees, and 3.4% in areas covered by wage negotiations) in 2021, well above the Network estimate last December
- **Wage growth in 2022** is expected at 3.9%, up from the 3.7% December forecast.
- **Norges Bank** assumed 3.8% wage growth in 2022 in its March MPR. NoBa may chose to keep its forecast unchanged – but may lift it 0.1 or 0.2 pp (SSB estimated 4.0% in its last report)

SpareBank 1 MARKETS

The labour market is tightening rapidly, and wage expectations are slipping

We not expect this spring's wage negotiations to yield 4% wage growth. However…

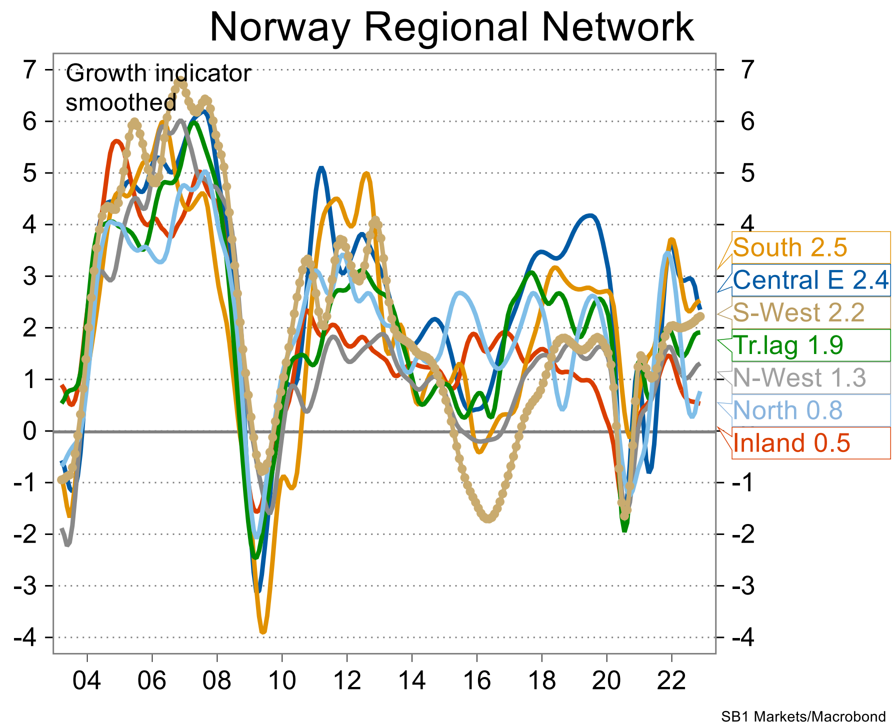


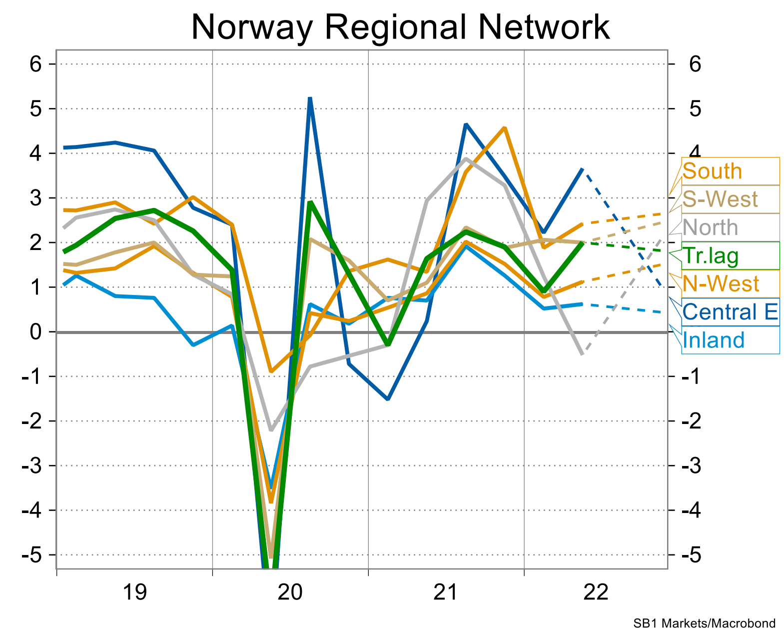


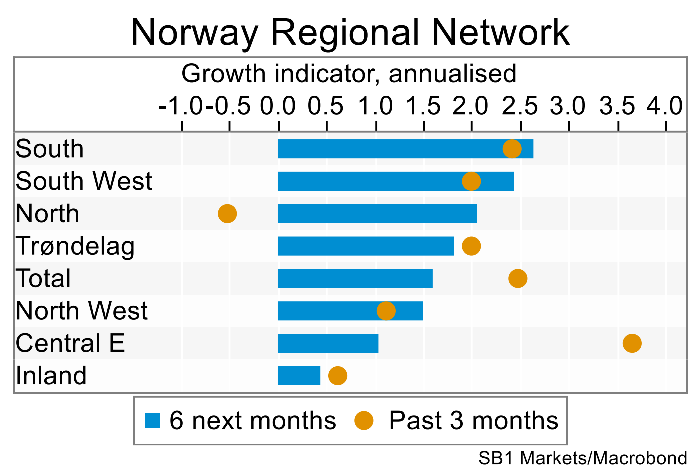
- Actual wage inflation may easily accelerate to 4% through 2022 – if the economy is not hit by a negative demand shock

Regions: Central East report a market slowdown, others flattish or up

Lack of capacity dampens the growth outlook



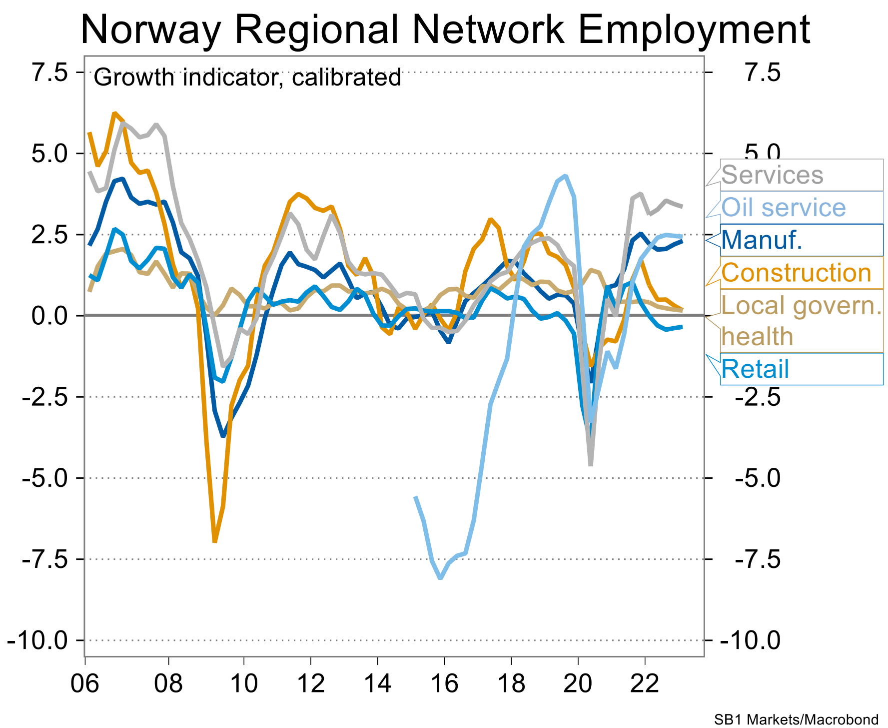


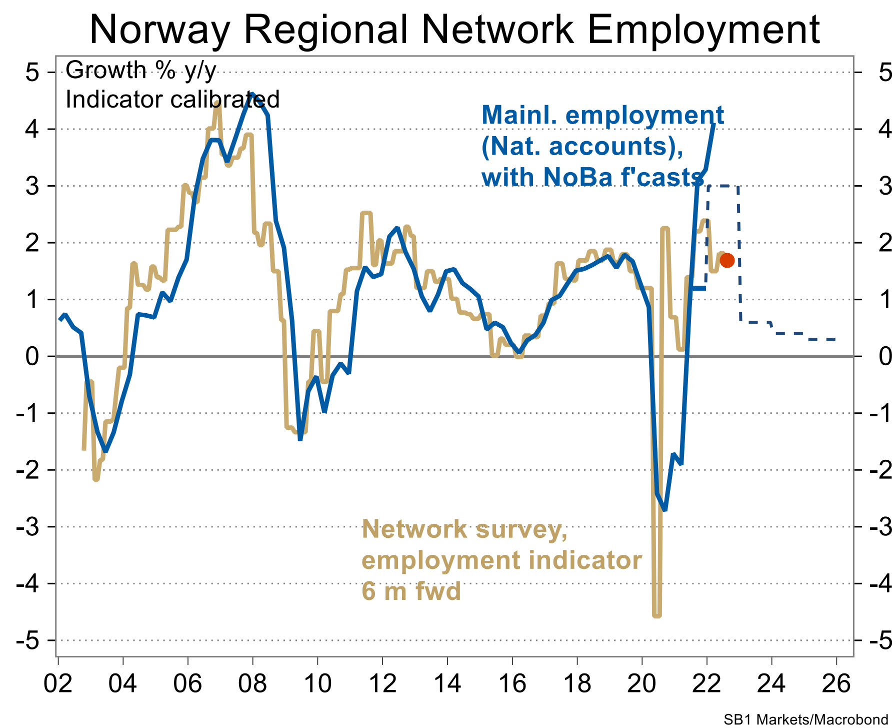


SpareBank 1 MARKETS

The network reports & expects lower, but decent employment growth

… just retail trade on the downside. BTW, where will all those employees come from??



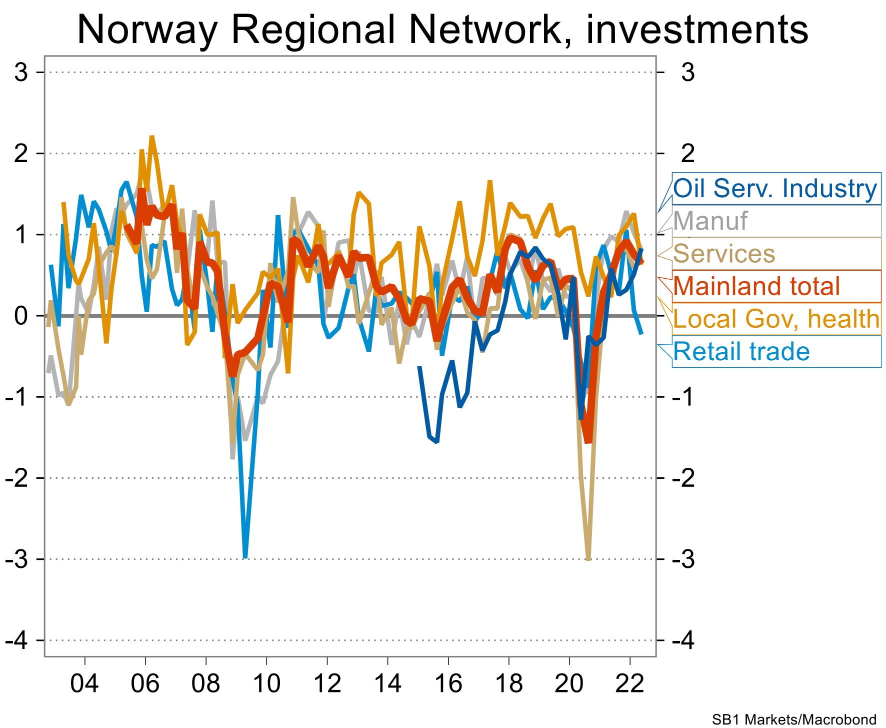


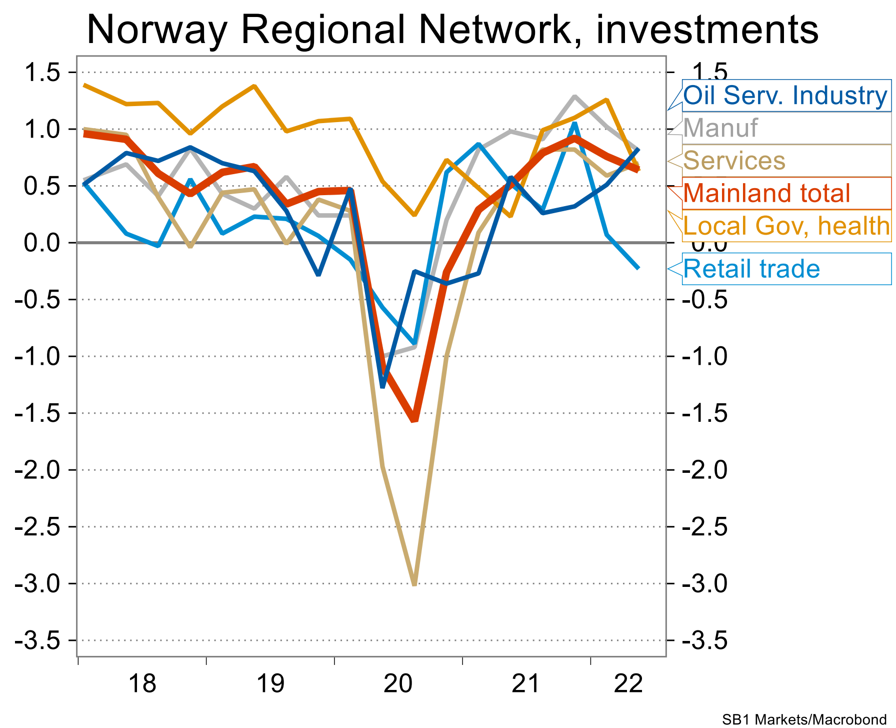
- Services & oil services are in the lead
- The NoBa forecast on the chart to the right represents the bank's annual averages

SpareBank 1 MARKETS

The Network revised investment further down, but oil services are more bullish

Retail trade will take a break, others not – even if growth ambitions were revised slightly down





- Services x trade also reported somewhat higher investment plans

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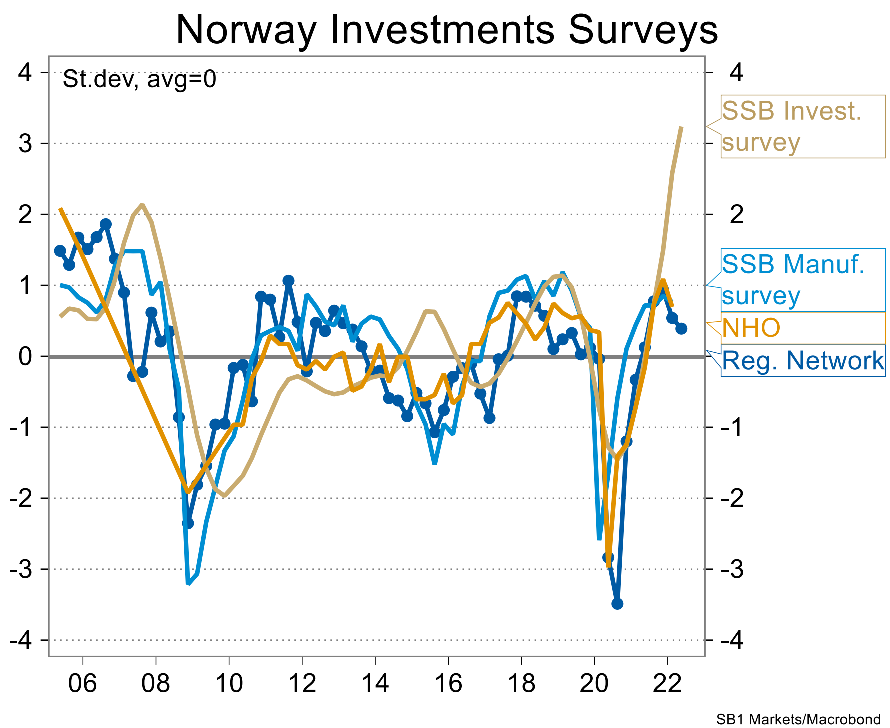
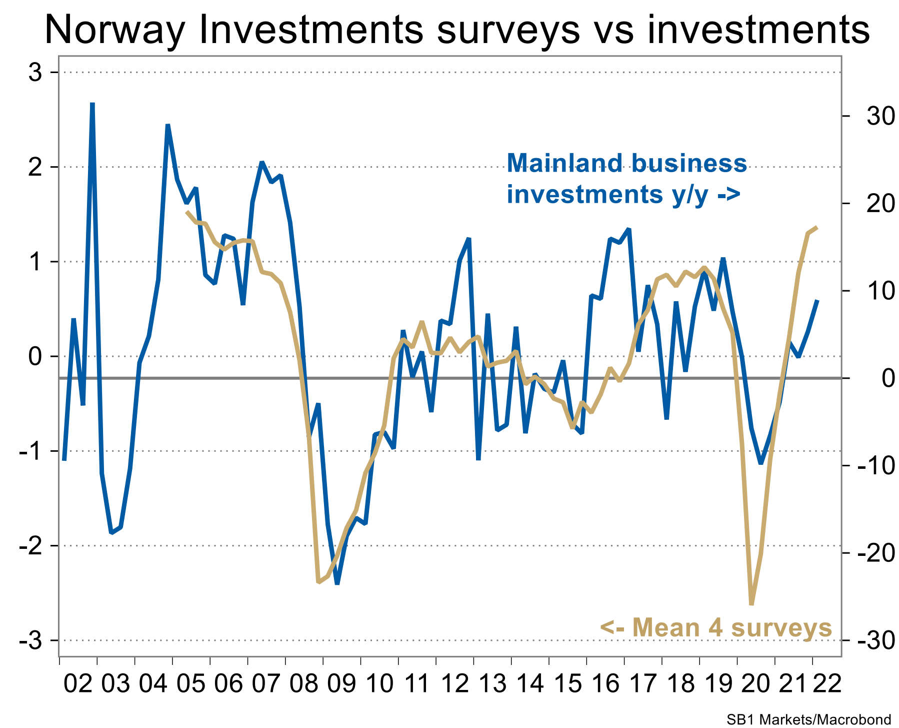
Other (and less updated) investment surveys are more upbeat

SSB's investment survey reported extremely strong investment plans, other surveys not that strong

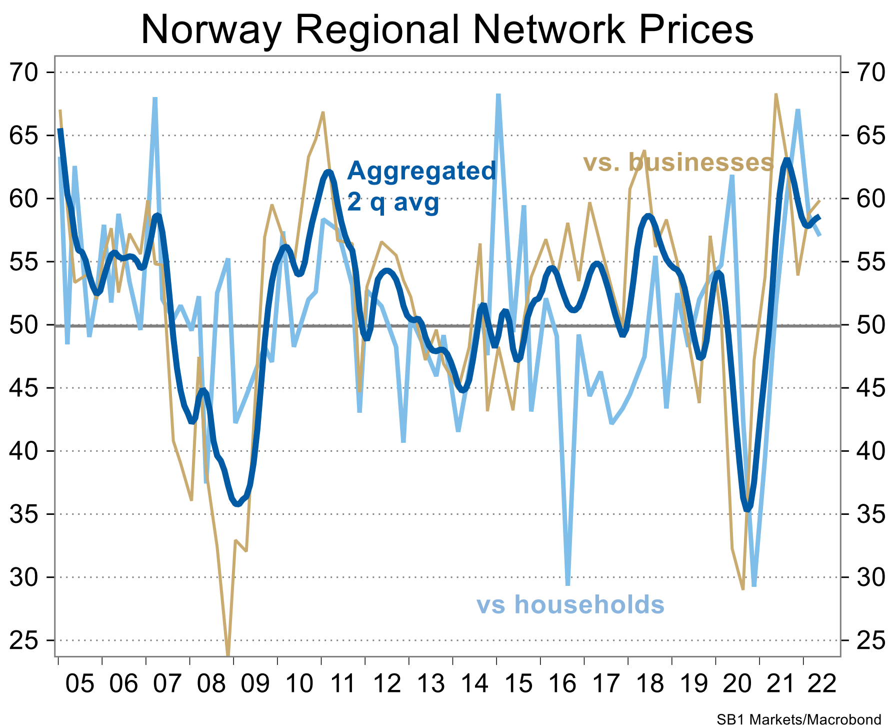




- However, all surveys signal growth in investments above trend – and in sum a substantial lift in Mainland investments

The network signals much higher price inflation than over the past 15 years

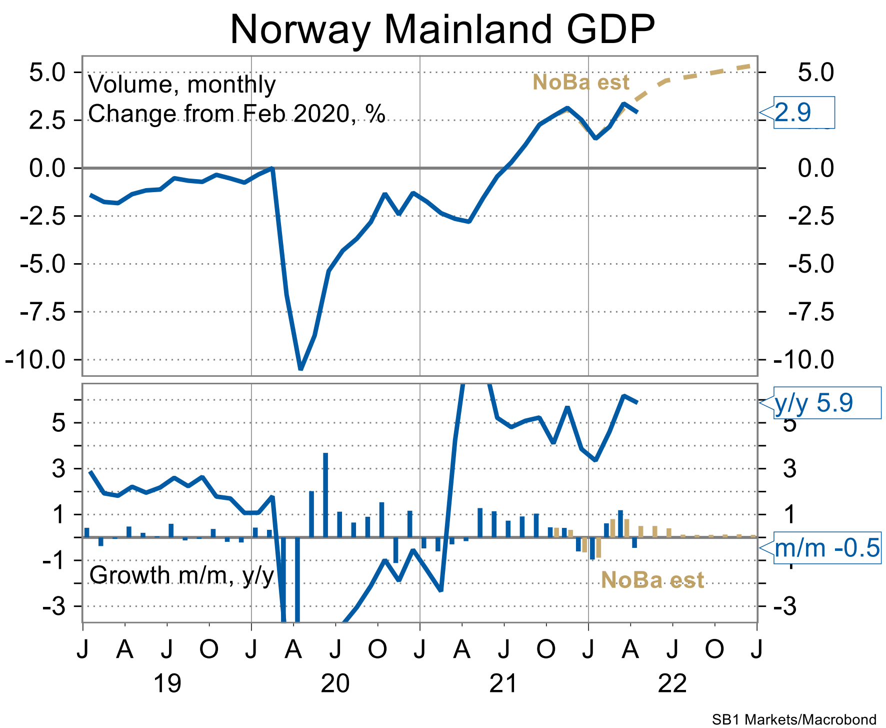
But still not more aggressive than in Q1!



- However, the correlation vs. actual CPI (headline or core) not close to non-existing

Mainland GDP down 0.5% in April, but recovery still very likely intact

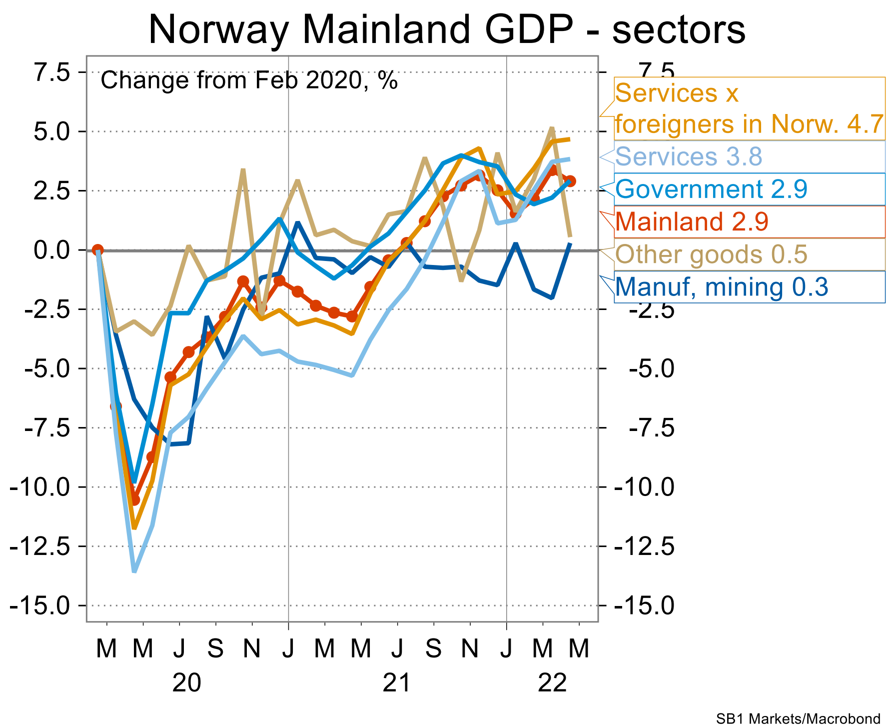
Electricity production, fish farming & trade contributed on the downside, growth elsewhere

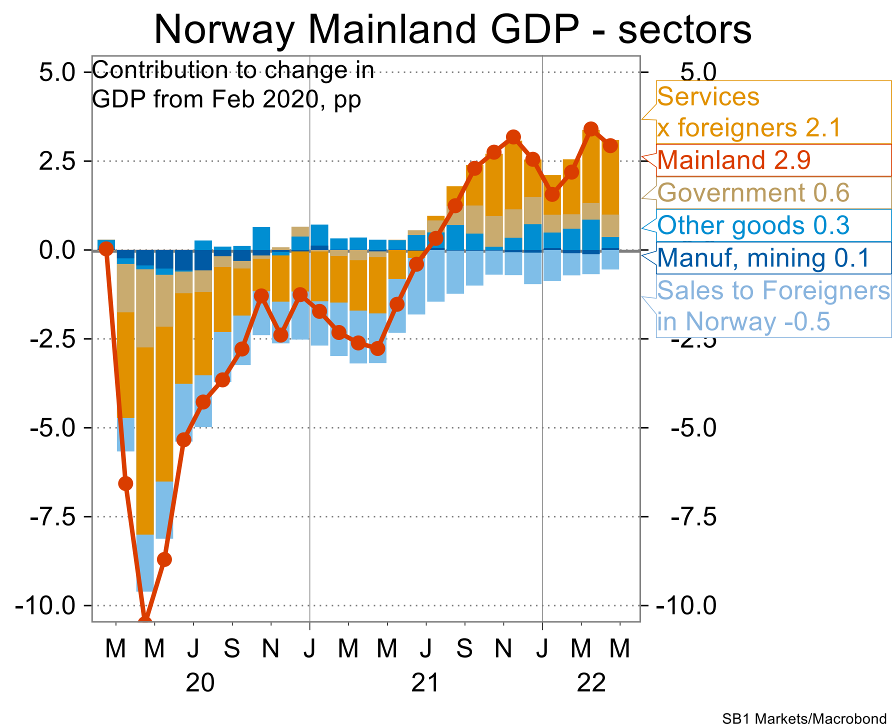


- **Mainland GDP** fell in both December and January due to Covid restrictions and changes in behaviour but recovered in February in March. However, following the surprising decline in April (expected +0.6 to 0.7%), activity is not higher than in November
  - » **Production:** All main sectors except 'other goods' contributed to growth in production in April. Within other goods, electricity production and aquaculture contributed on the downside
  - » **Demand:** Household demand in Norway fell, as spending abroad increased. Housing and Mainland business investments fell too, while oil investments rose further (but they remain below the Feb-20 level)
- **Mainland GDP** is up 2.9% vs the Feb-20 level, which is well below a normal growth path over these two year (4 – 4.5%), indicating an output gap well below the level 2 years ago
  - » However, unemployment is well below the pre-pandemic level, the employment rate (among Norwegian citizens) is far above, and businesses are reporting unusual lack of labour
  - » Businesses are also reporting a much higher capacity utilisation than before the pandemic
  - » Thus, Norges Bank is very likely right when it assumes that the output gap is substantially higher now, than before the pandemic

Production: Services grew further, manufacturing surges – but 'others' fell

Manufacturing is still the weakest sector, up just 0.3% vs the pre-corona level

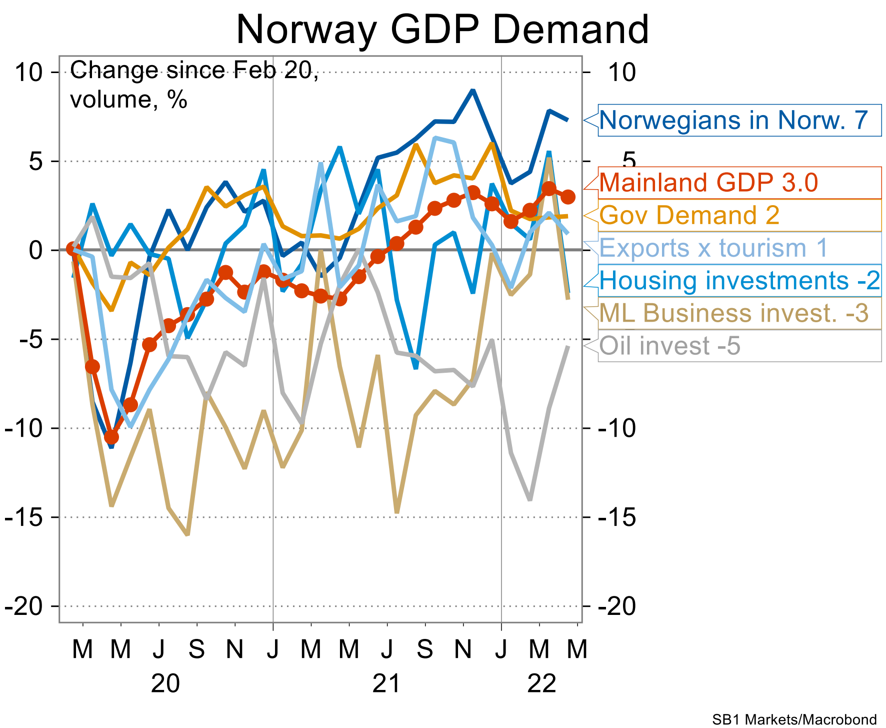


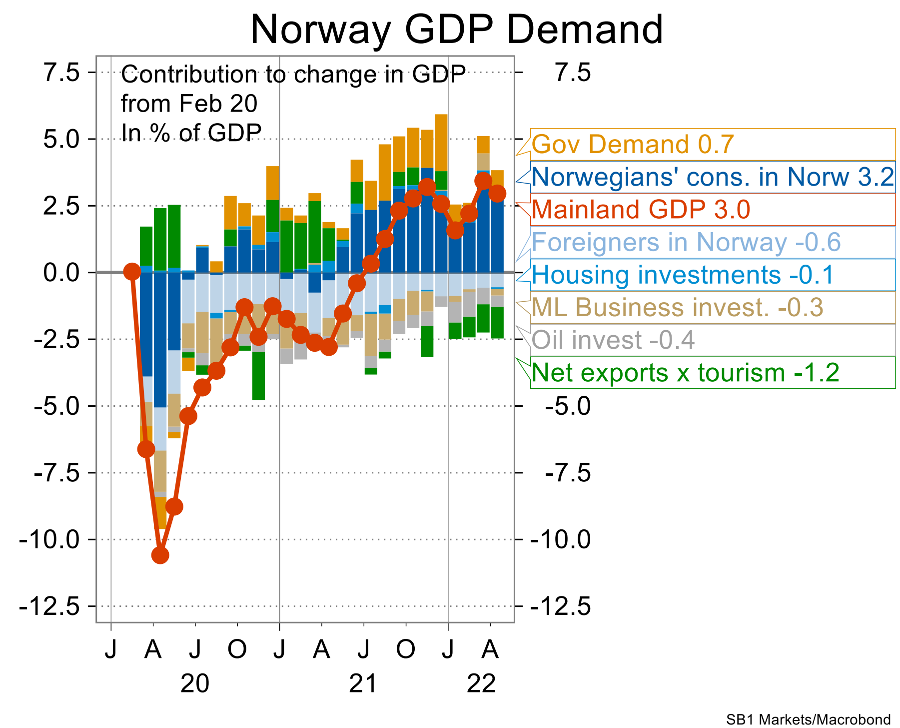


- The 'others' sector includes electricity (which fell 6%), fish-farming, fisheries and construction. In April, el. production, fish-farming in addition to trade (included in services) fell

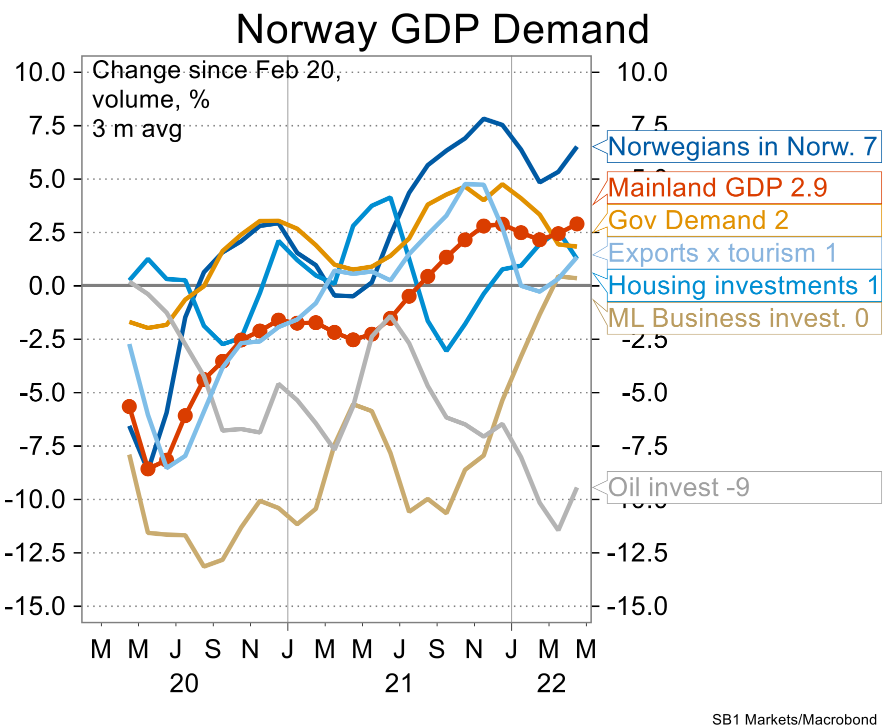
Demand: Consumption in Norway down – we spent more abroad

Oil investments up, Mainland investments down – in April (check the 3 m smoothed chart next page)



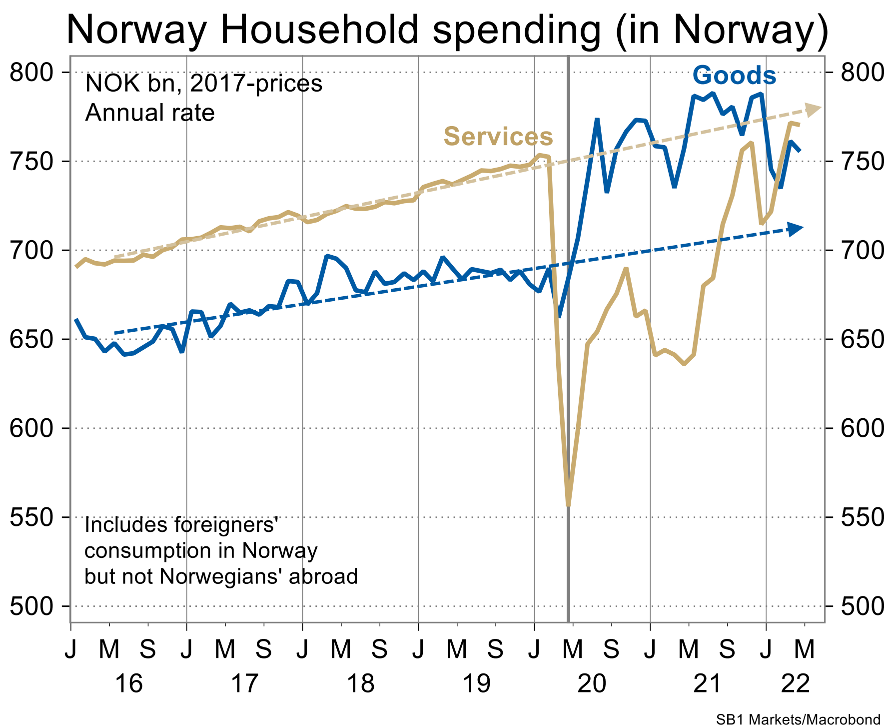


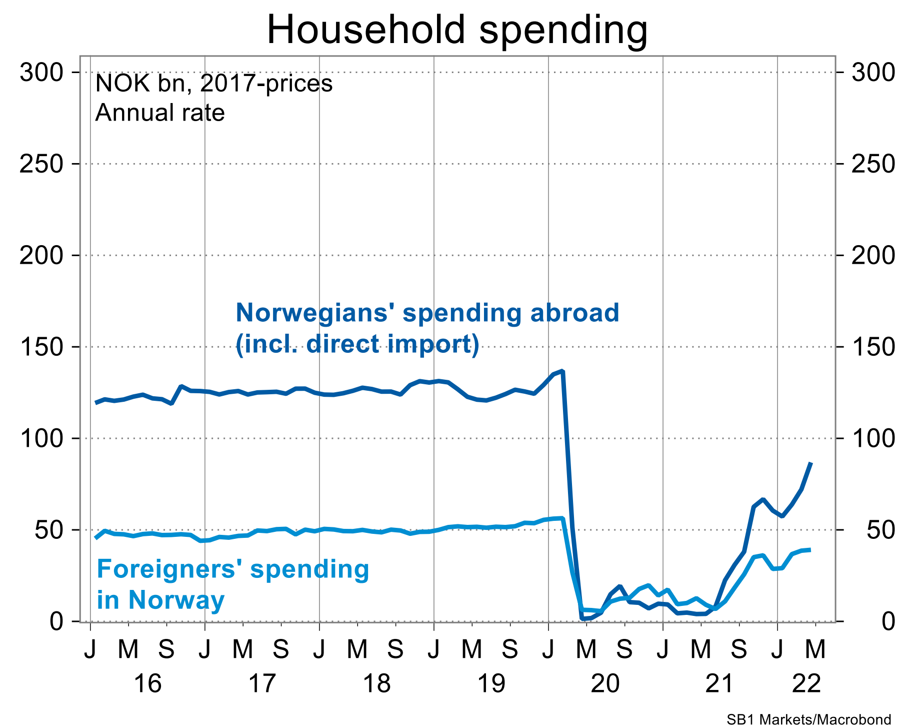
A more smoothed demand view



Spending on services surprisingly fell in April. Still, services are back to trend

Spending on goods is still above a normal level – as spending abroad is still way below normal



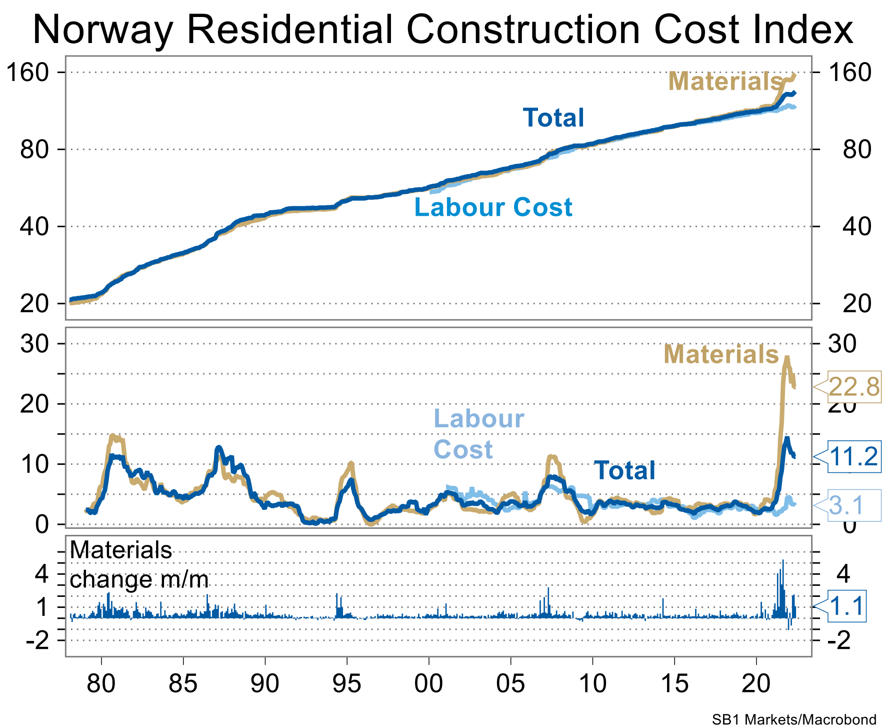


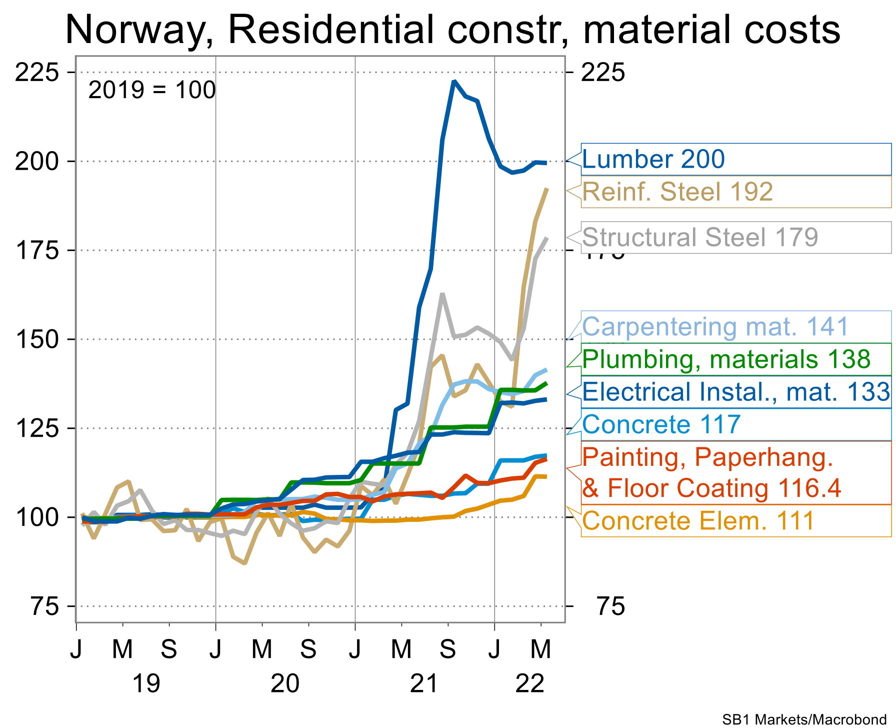
- Foreigners have not yet fully returned to Norway but most of the gap is now closed

SpareBank 1 MARKETS

Building costs: Further up in May but is peaking now?

Lumber has flattened but steel prices rose further. However, commodity prices are on the way down

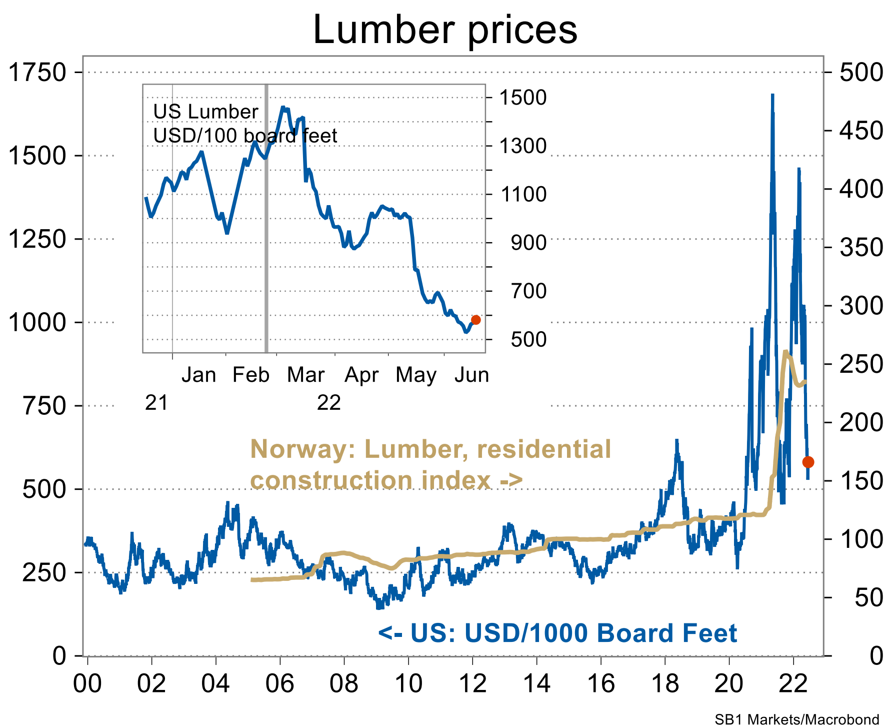




- **Material prices** (houses and apartments) added 1.1% in May, and prices are up 22.8% y/y
  - » Lumber prices has been rather stabile so far in 2022, following a 10% decline since last autumn. Prices are up 100% from the 2019 level. Steel prices are up 80% – 90% - and still increasing
  - » Other material prices are trending up, from 11% (concrete) to plumbing and carpentering material 36% – 40%
- **Labour costs** were just up 3.1% y/y in Q2, down from 4.5% in Q4 (which was the highest growth rate since 2009)
- Including labour costs, the **total building** cost index is up by 11.2%, down from the ATH at 14.6% at the peak last Oct

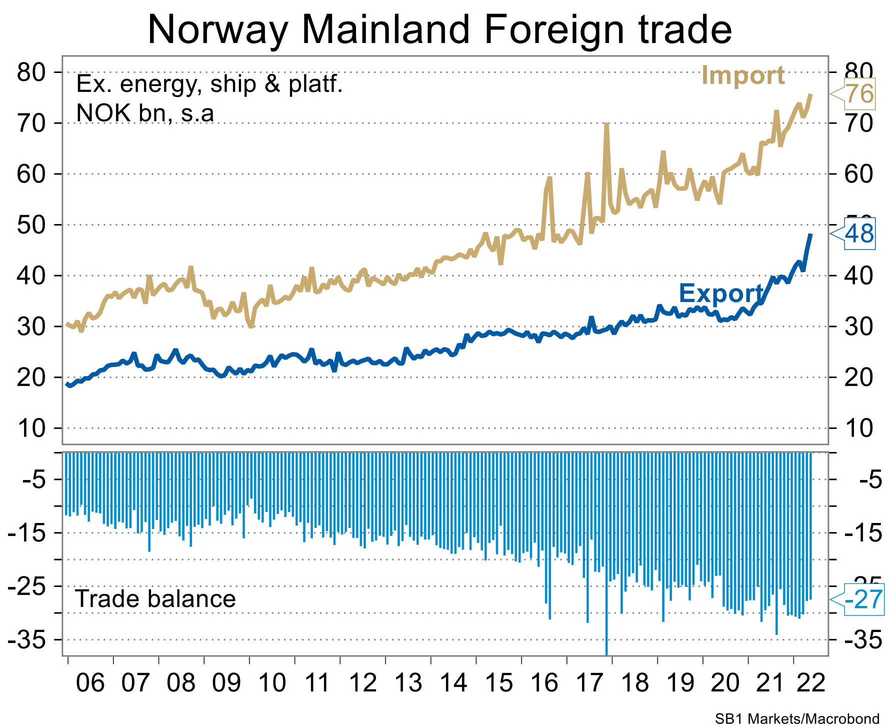
US lumber prices (2''x4) back to a normal level

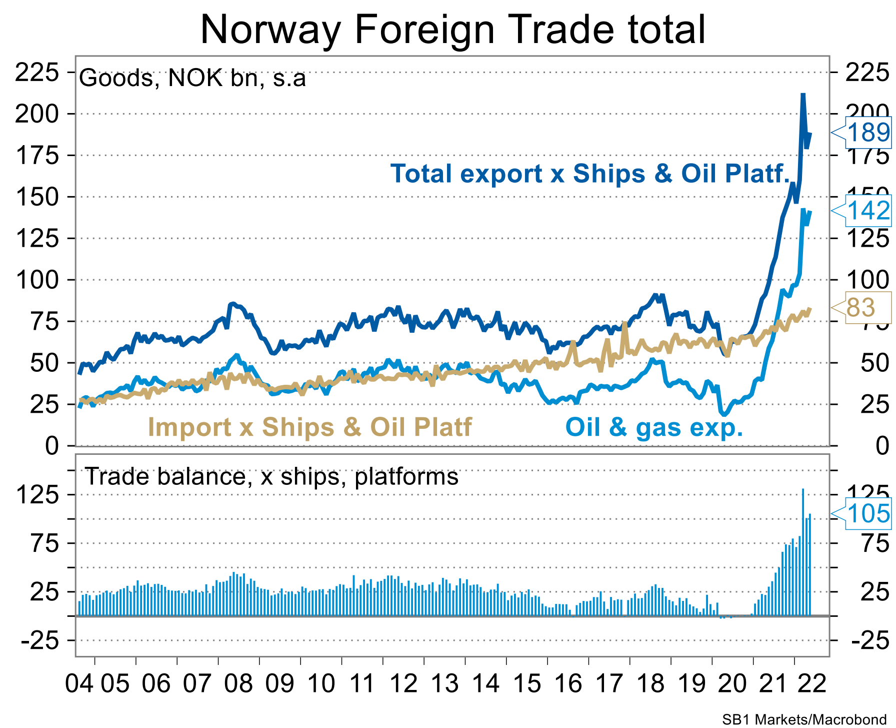
… and global steel prices are in a free fall! Prices will come down in Norway as well



Trade surplus at NOK 105 bn in May, slightly up from April

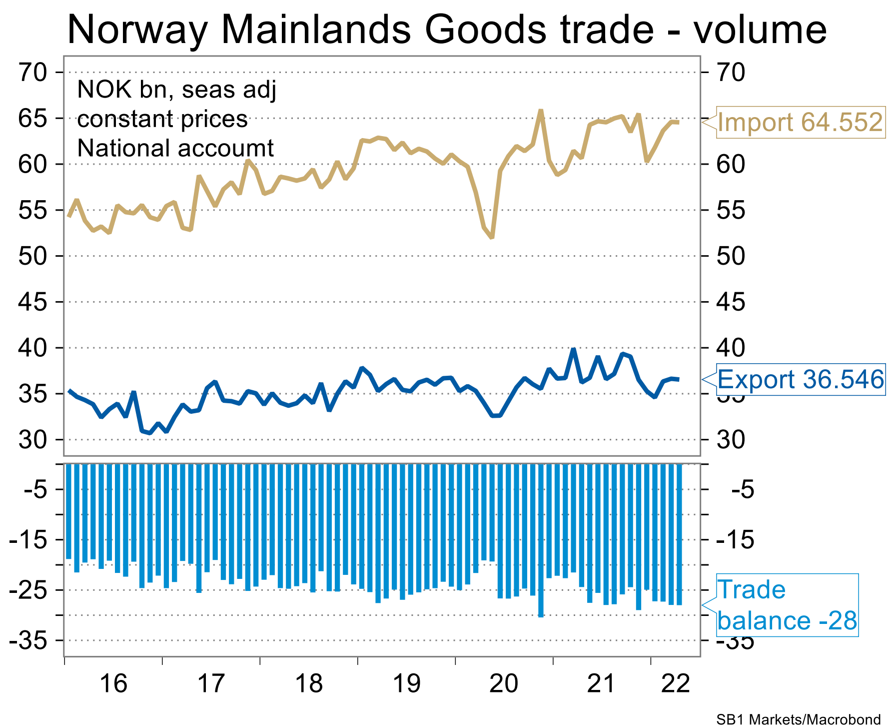
Petro exports at NOK 142 bn, the Mainland ex. energy deficit down, exports even stronger than imp.





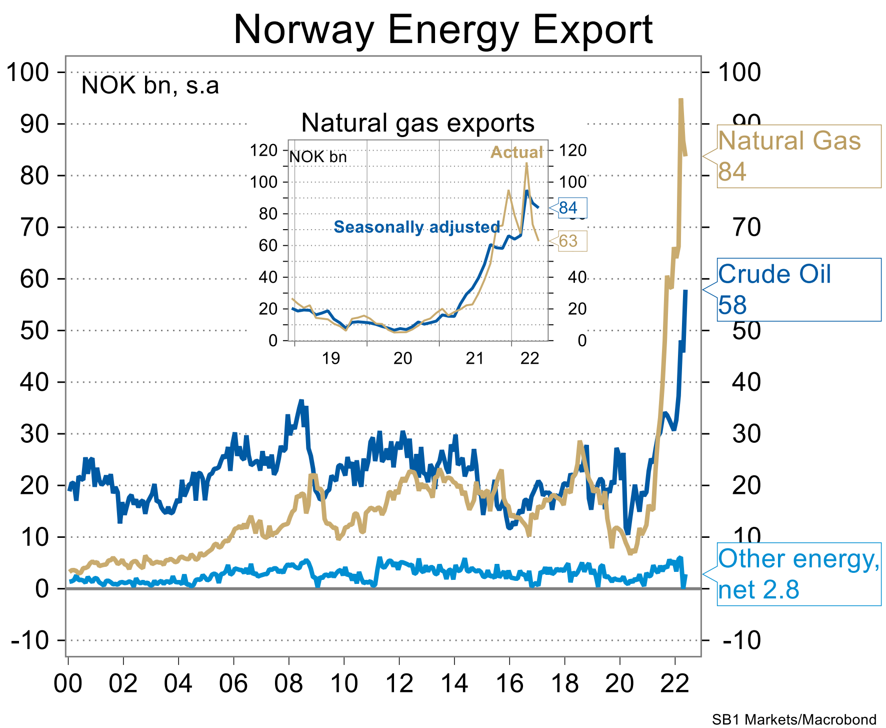
- The seasonally adjusted **overall trade surplus** in goods at NOK 105 bn is the 2nd highest ever, equalling some 30% of GDP!
- **Natural gas exports** fell in May, as the gas price declined further from the ATH level in March. Oil exports were the highest ever, by far
- **The Mainland (non energy) trade deficit in goods** fell by 1 bn to NOK 27 bn, equalling 9% of Mainland GDP (however, most imports for oil investments are categorised as Mainland imports and sales from the Mainland to the oil sector (both op.ex and cap.ex) are not counted as exports – and the 'real' Mainland trade balance is far, far stronger)
- **Non-energy exports** rose sharply in May, NOK 48 bn, the highest level ever. The underlying growth rate over the past year is more than 25%. Exports are up 50% since 2020, mostly due to higher prices but volumes are up as well. Fish, metals & chemicals are reporting strong growth
- **Imports** rose NOK 3 bn to 76 bn, and remain at 15% growth pace

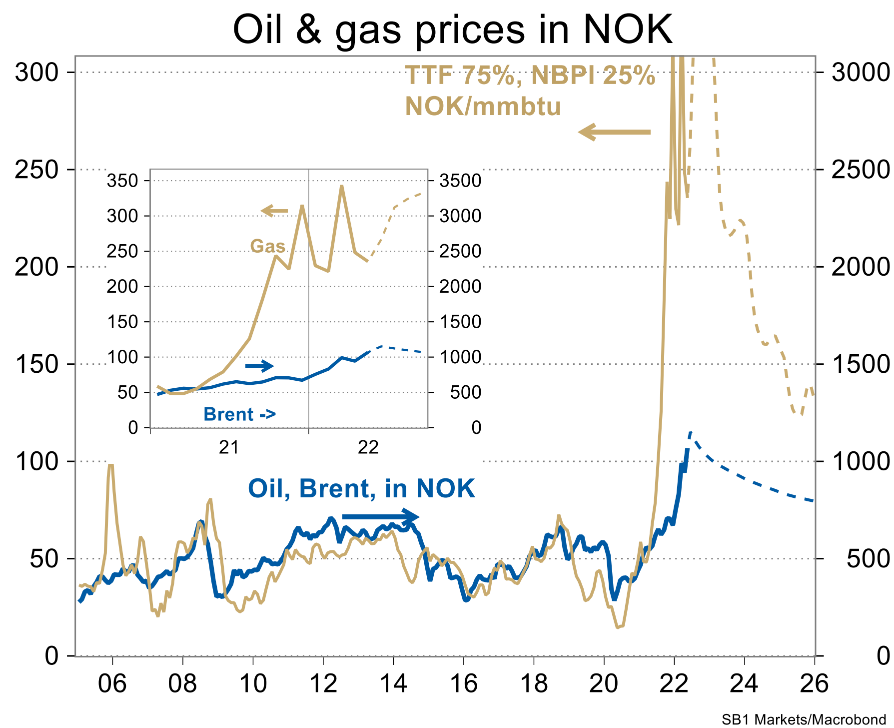
In volume terms, trade data are not that impressive



Gas exports down further down in May as prices fell further

Crude oil exports shot up with the surge in the oil price

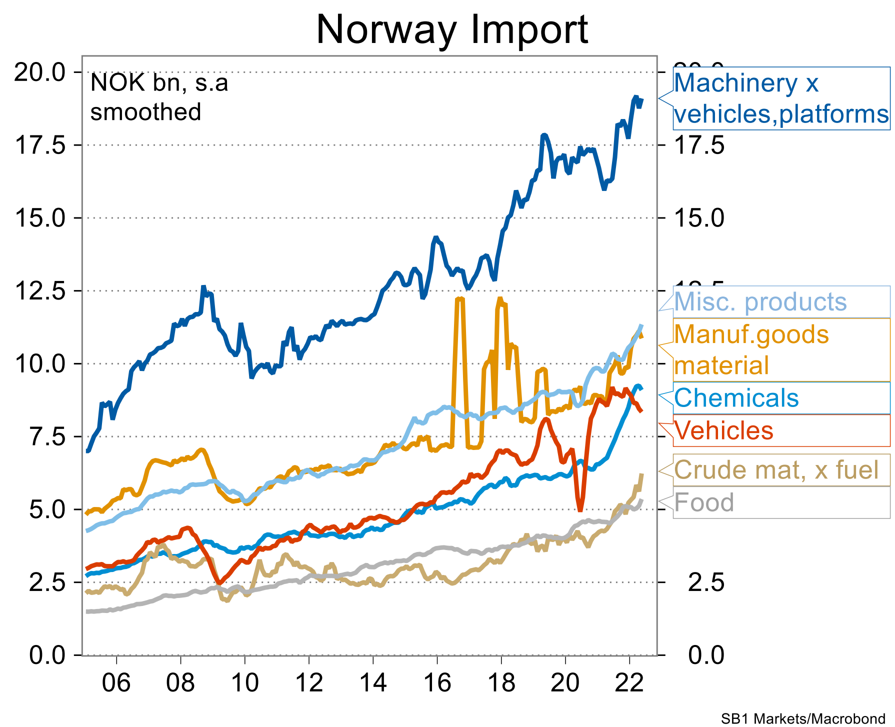


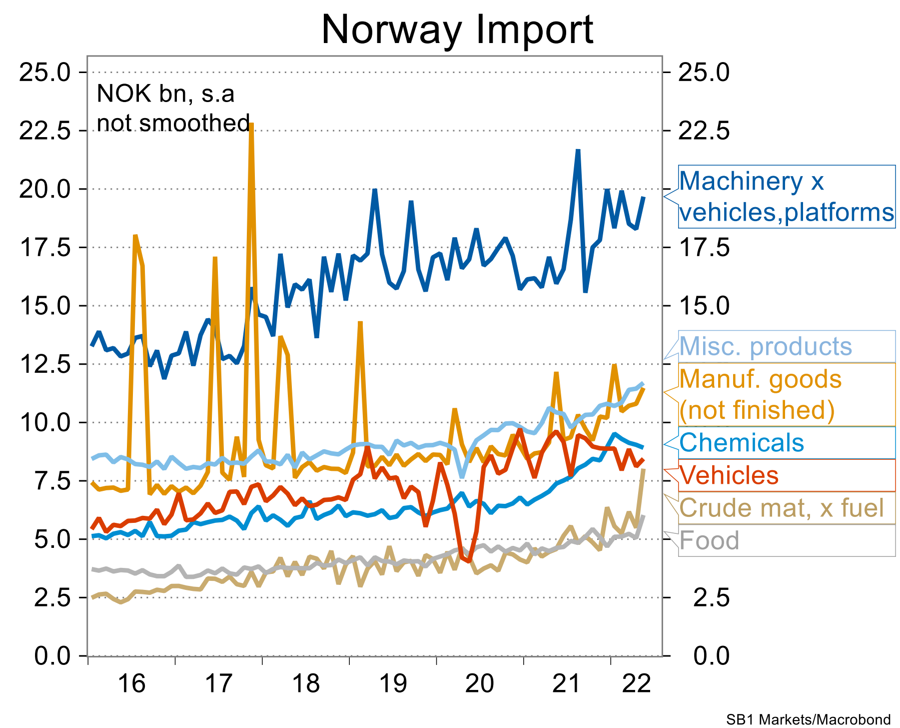


- **Gas prices** (75% TTF Netherland gas prices, 25% NBI UK prices) fell by more than 25% in April from March, and slightly in May too. The value of gas exports fell by NOK 3 bn to 85 bn. Gas prices are expected up again the coming months (future prices rose sharply last week, due to lack of supply from the US and reduced deliveries from Russia
- **Crude oil exports** climbed by NOK 12 bn to bn 58 bn, to an ATH by far
- In sum, **petro exports** at 142 bn, close to ATH. Most of it, more than 120 bn will end up in the Government's coffers
- Other energy exports was low in May, as Norwegian electricity production was kept in check due to a low level of reservoirs in the hydroelectrical system

Most imports are trending rapidly upwards – as domestic demand is strong

Vehicle imports are finally yielding, from a high level

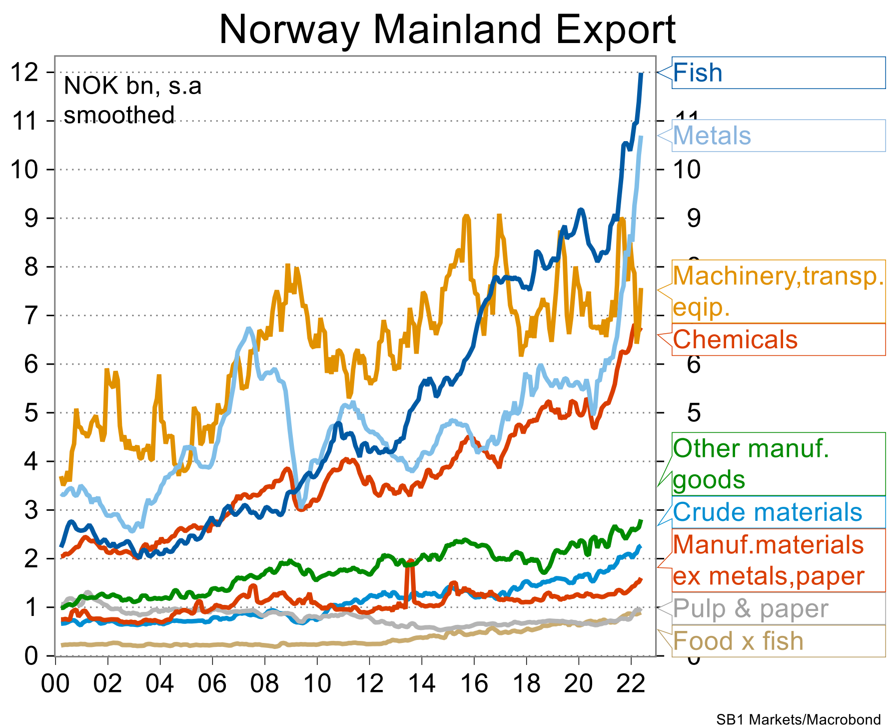


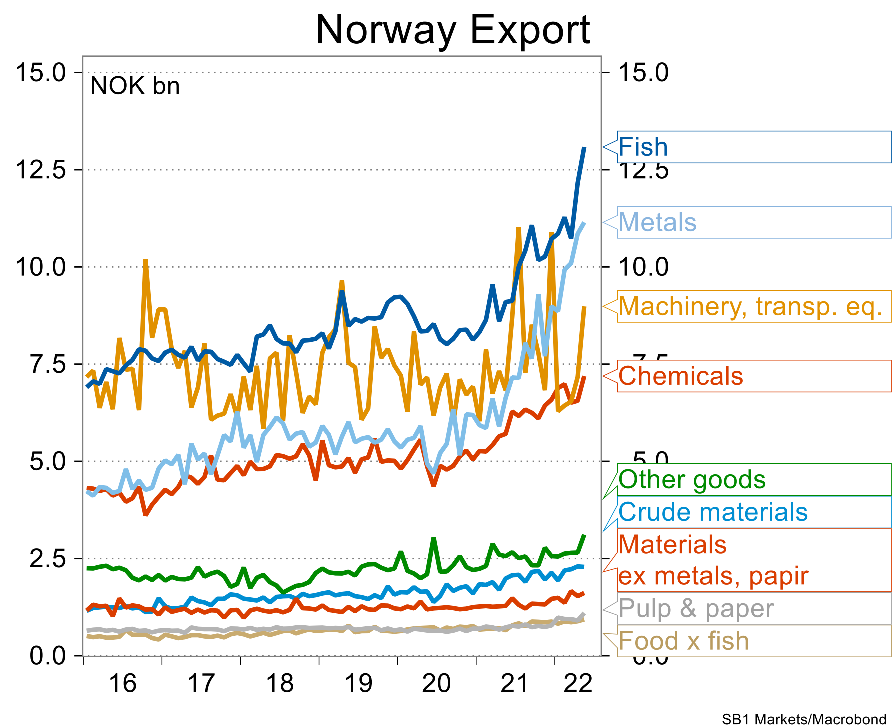


- The spikes in imports of manufactured goods are due to unfinished platforms or ships

Fish exports are surging, metals & chemicals are sprinting upwards too

Exports of machinery & transport eq. sharply down recent months, level unch. from 2014 (and 2007)

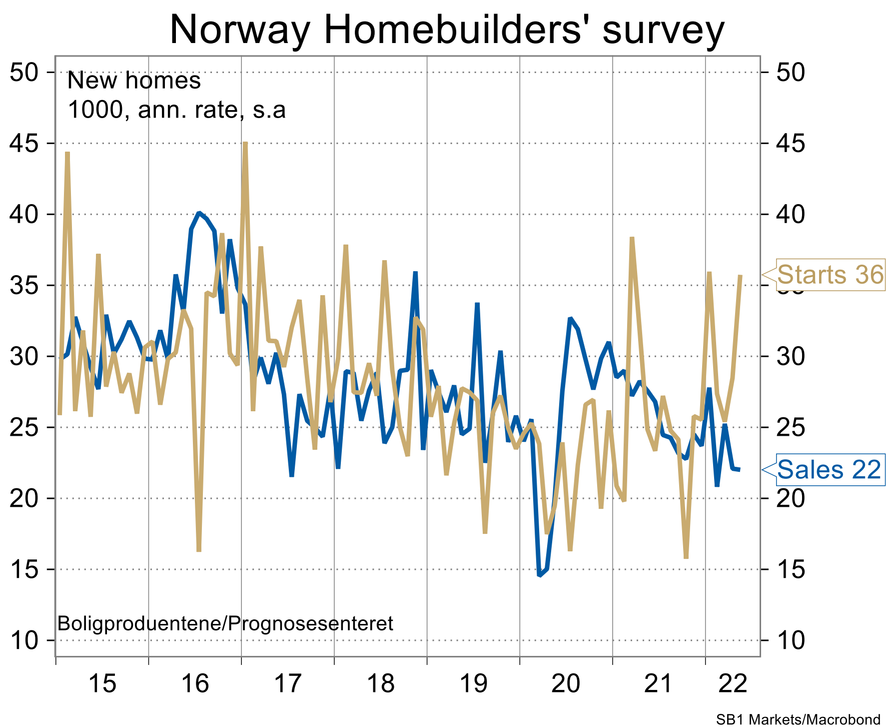


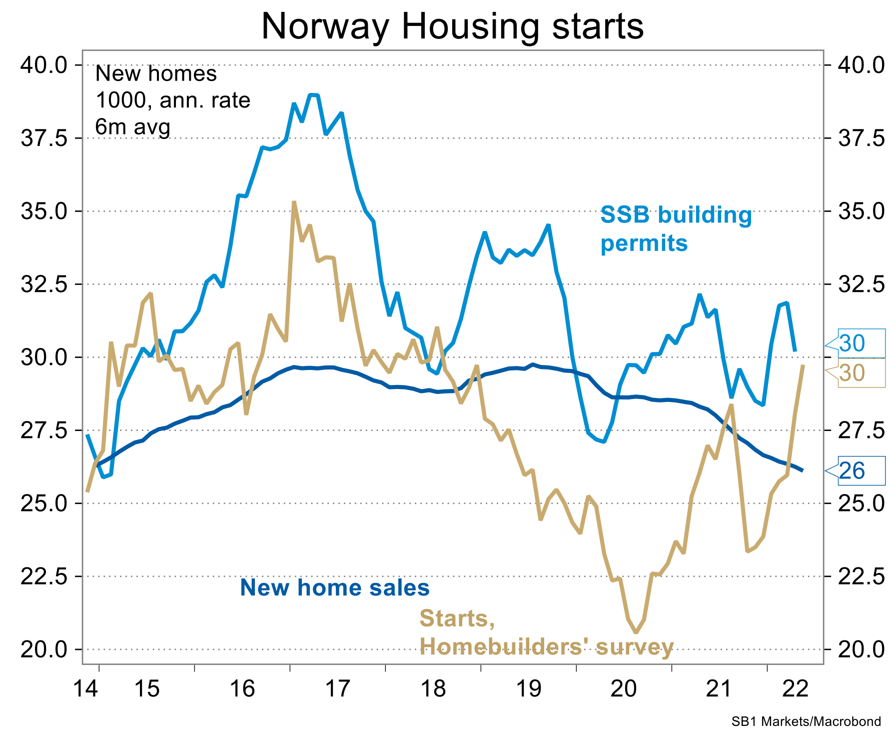


- Raw material prices will very likely come down from the precent high levels (many are on the way down already). Then the value of commodity exports will come down as well

New home sales down are trending down, volatile starts straight up in May

... according to the homebuilders





- Boligprodusentene (Home builders) 'always' report that building activity is declining and that it is too low. Now, sales are trending down, and the level is not high. Sales were unch at 22' in May, somewhat below the average over the past 5 years (26')
- Starts rose to 36' as several apartment projects were started. The May level is very likely too high, given current sales
- SSB report a decent increase in housing starts recent months, and the level is above 30', annualised

SpareBank 1 MARKETS

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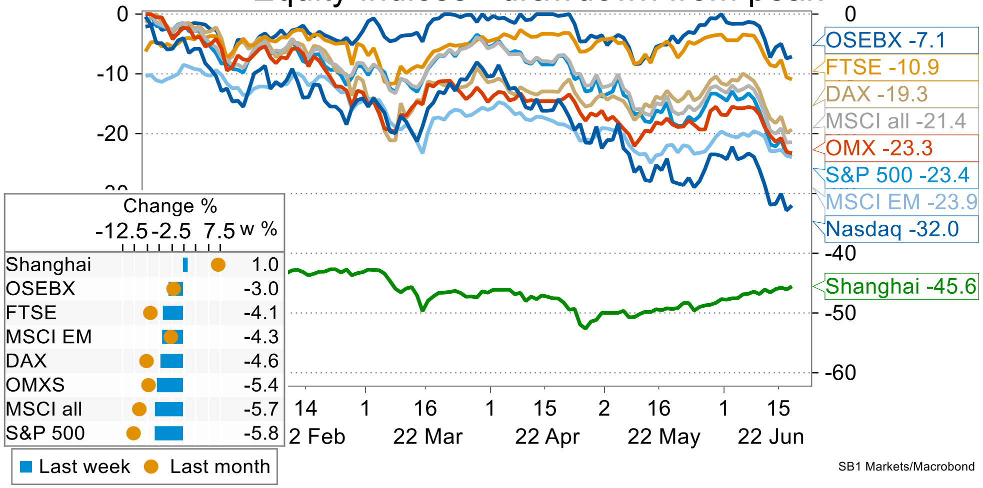
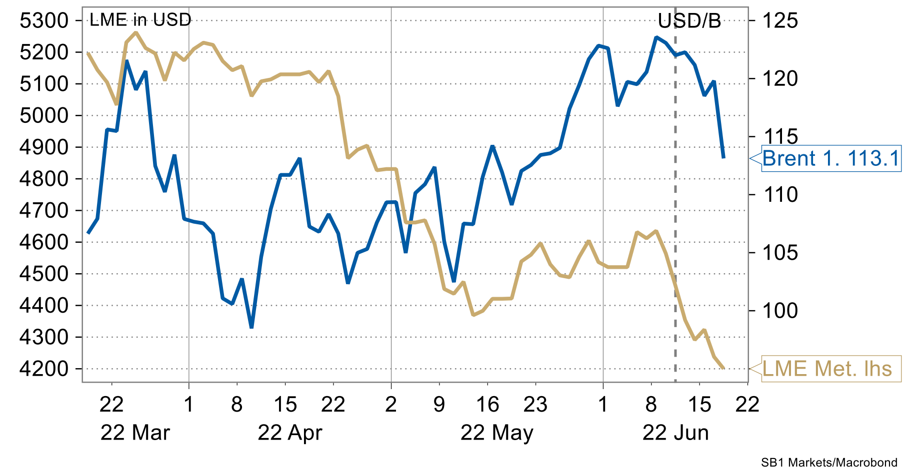
Equities, oil, metals down. Yields up. NOK the big f/x loser

Risk off amid aggressive rate hikes from central banks – and a steep surge in expected real interest rates

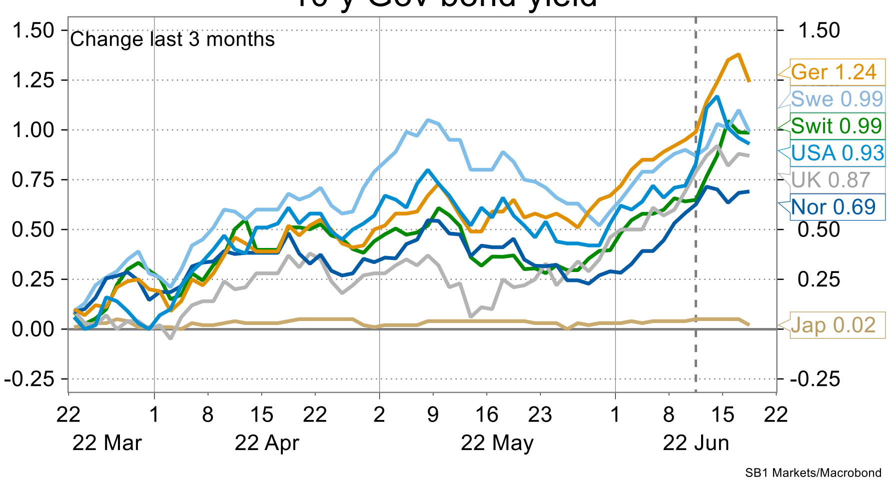
Equity Indices - drawdown from peak



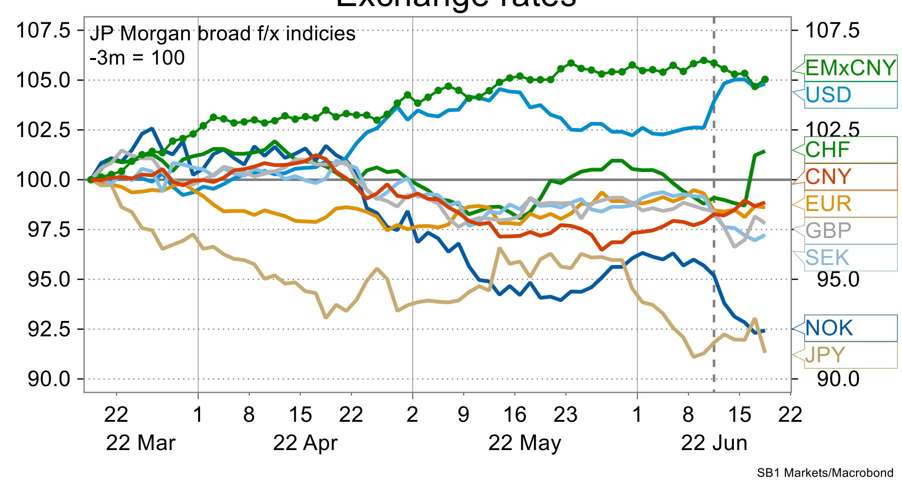
Oil vs. metals



10 y Gov bond yield



Exchange rates



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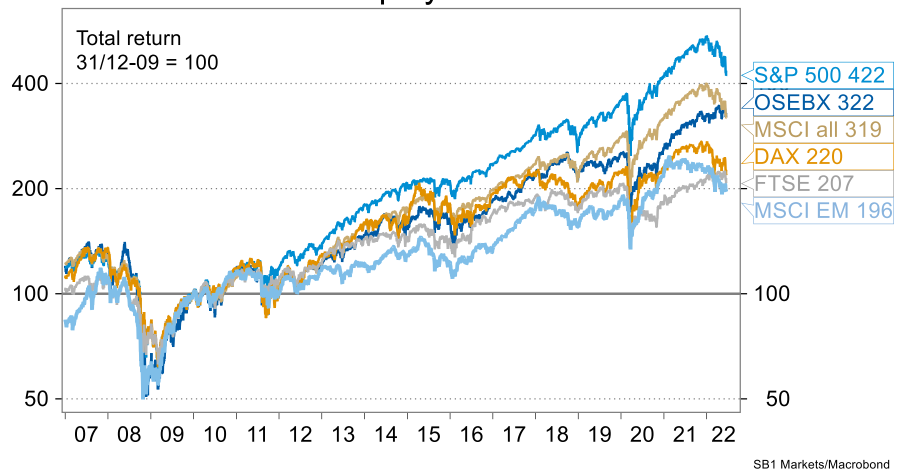
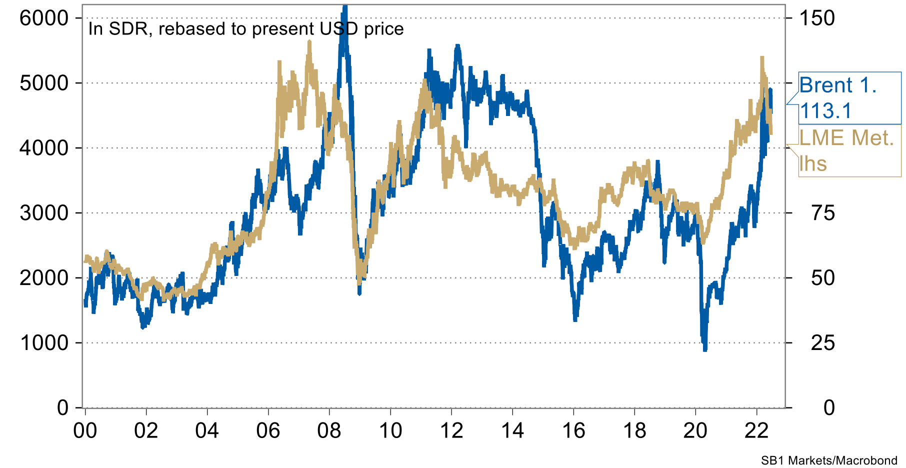
The big picture: Stock markets down (-oil rich OSEBX, FTSE), bond yields up

Commodities have taken a big step upwards – at least until early March, mixed thereafter

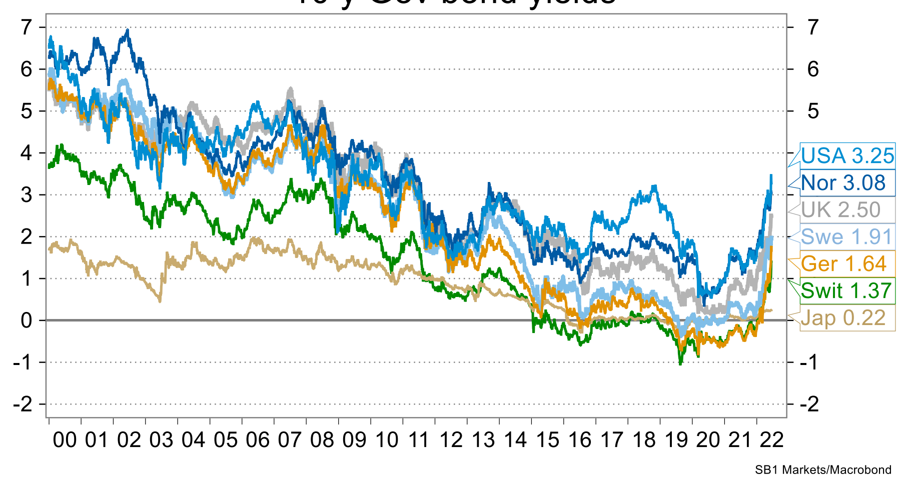
Equity Indices



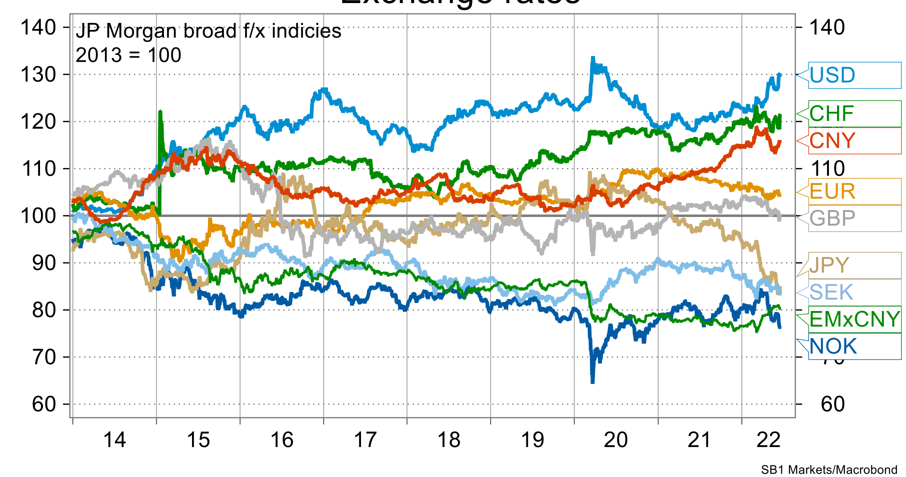
Oil vs. metals



10 y Gov bond yields

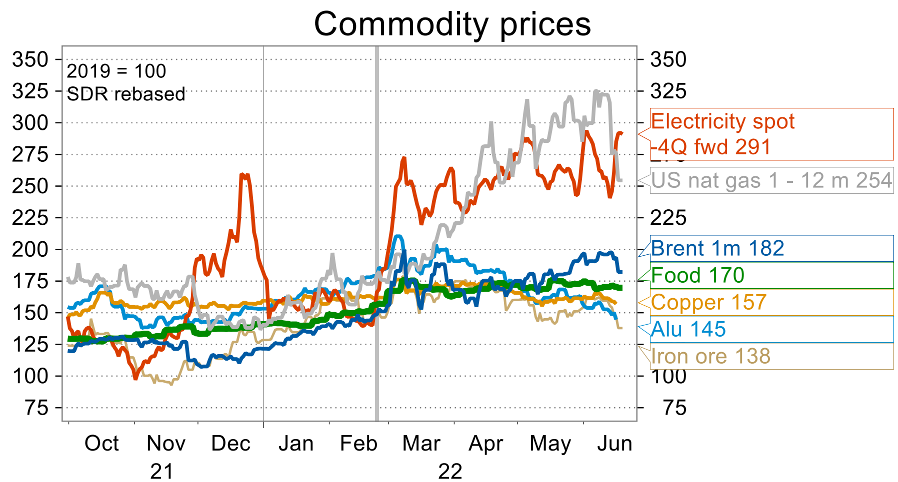


Exchange rates



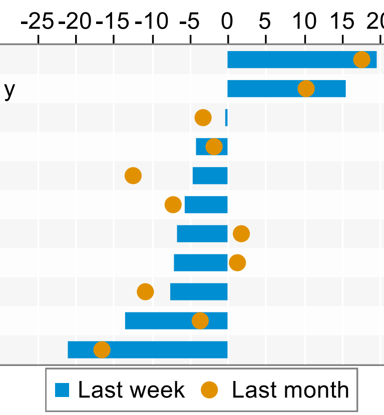
European gas prices sharply up, fire in US LNG plant, less gas from Russia

Metal prices down. Food prices have been stable since just after the war started (in SDRs, down in USD)

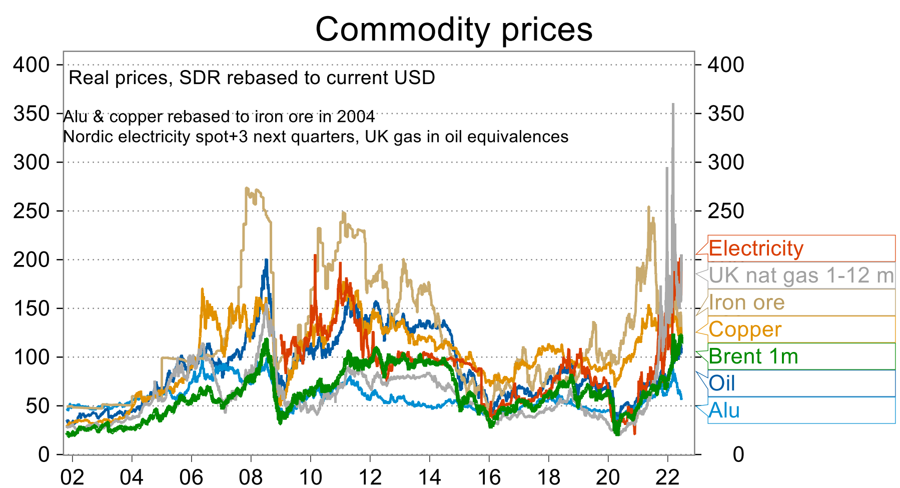


Commodity prices

In SDR % change	last w	last m	Since Feb 23
UK nat gas 1-12 m	20	18	10
NOK electricity spot-1y	16	10	75
Food	0	-3	9
Copper,3 m fwd	-4	-2	-3
Wheat	-5	-12	28
LME Metals	-6	-7	-8
Brent 1-12 m	-7	2	21
Brent 1m	-7	1	23
Aluminum 3 m fwd	-8	-11	-19
Iron Ore	-13	-4	-8
US nat gas 1 - 12 m	-21	-17	41



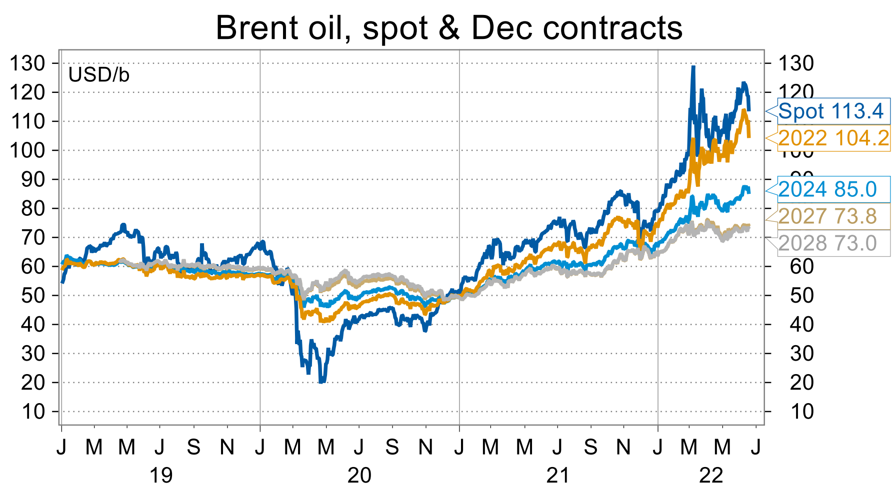
SB1 Markets/Macrobond

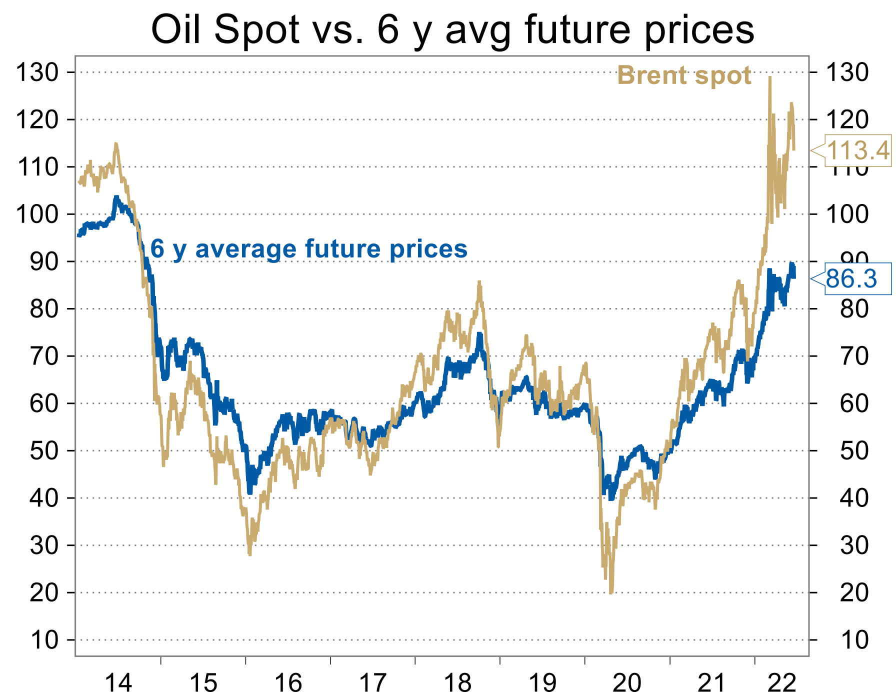


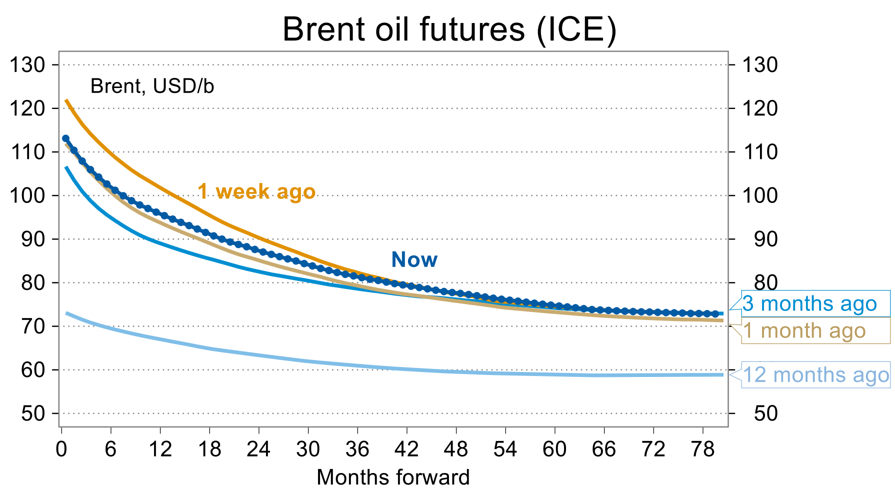
- Oil prices fell sharply last week, on recession fears
- European natural gas prices shot up last week, due to the fire in the US LNG plant, and cuts in gas deliveries from Russia
- US natural gas fell sharply, due to less export capacity due to the fire
- Norwegian electricity prices turned up last week, even if it is still raining – gas prices in Europe are more important
- The Economists food commodity index was flat in SDR terms last week (but fell in USD terms)

SDR: IMF's Special Drawing Rights – a 'global currency'

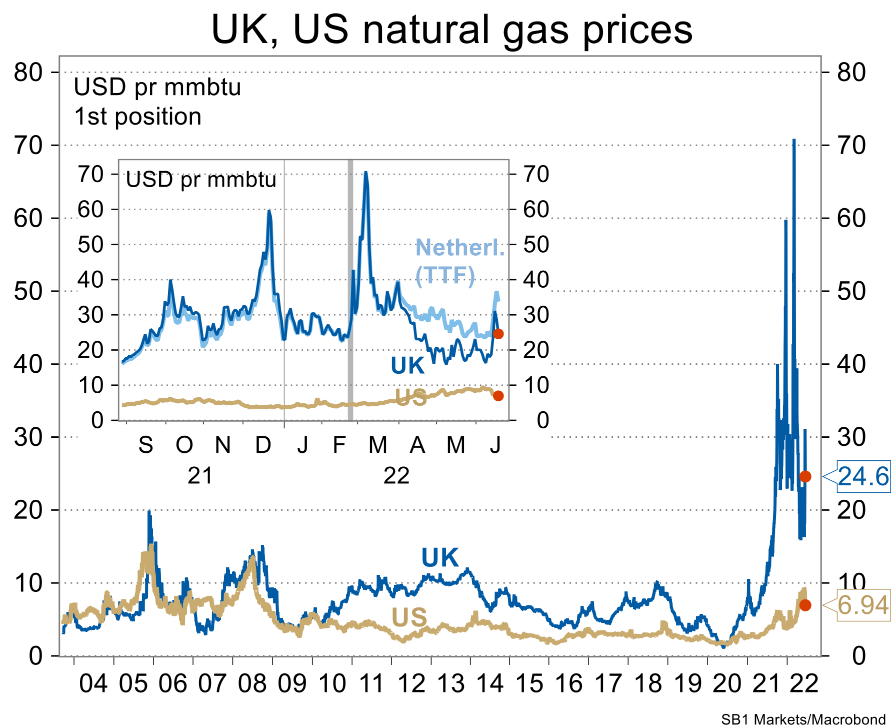
(Just)The short end of the oil curve down last week

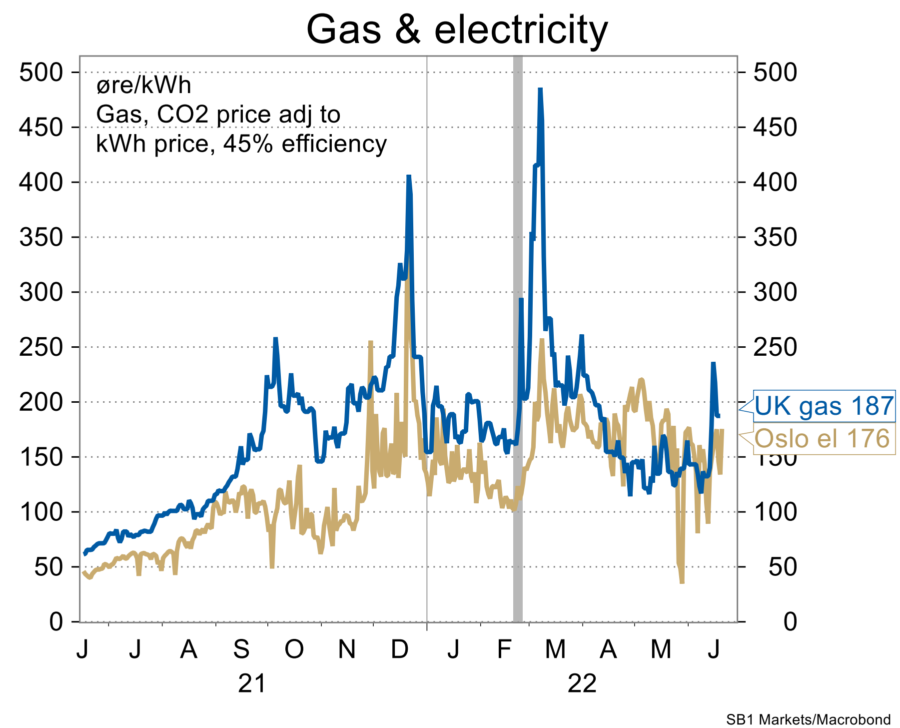




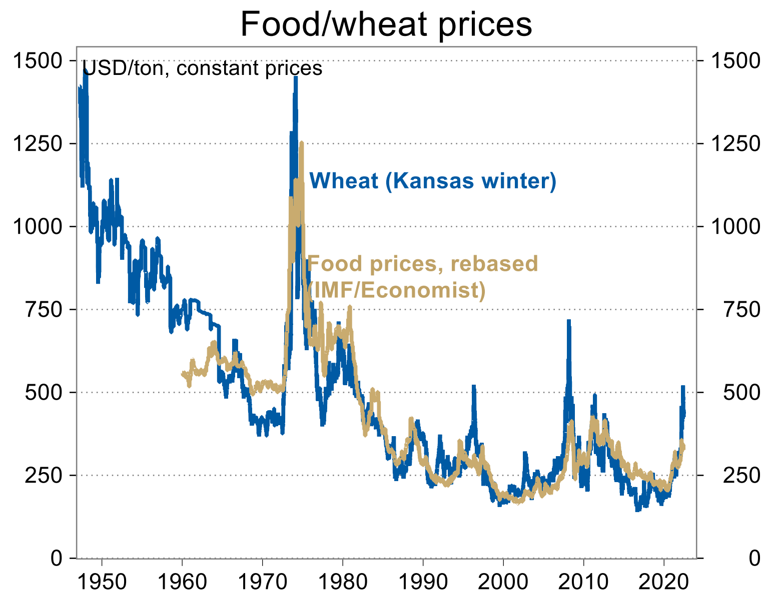


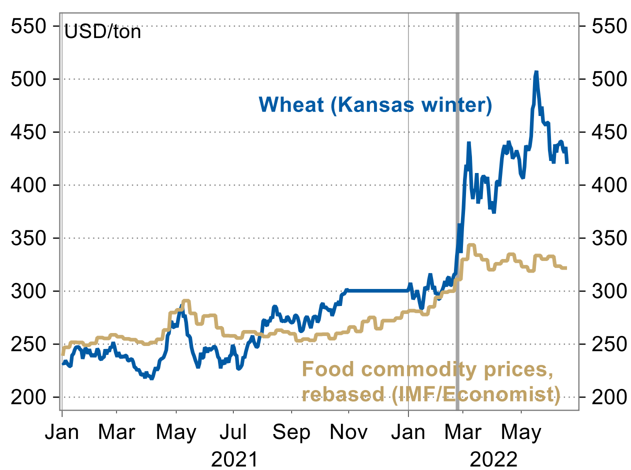
European natural gas prices up due to less supplies from Russia & the US

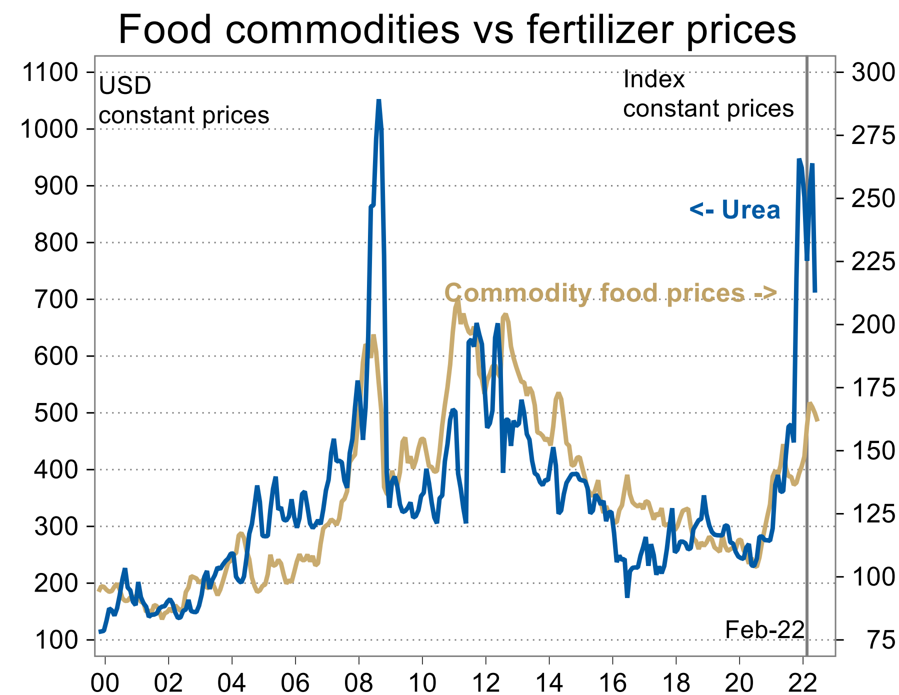




Food prices are trending (very) slowly downwards



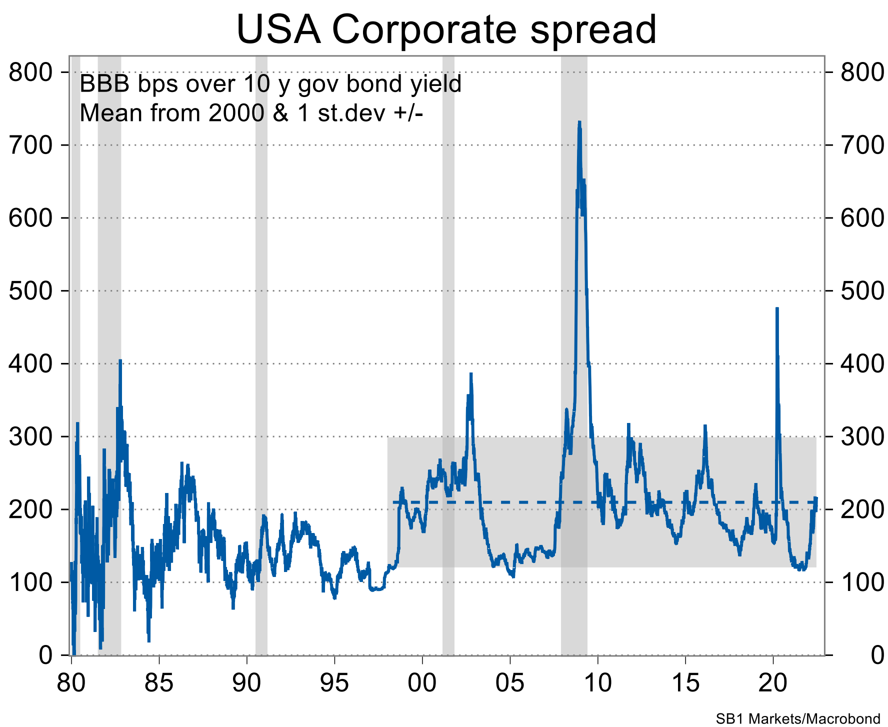


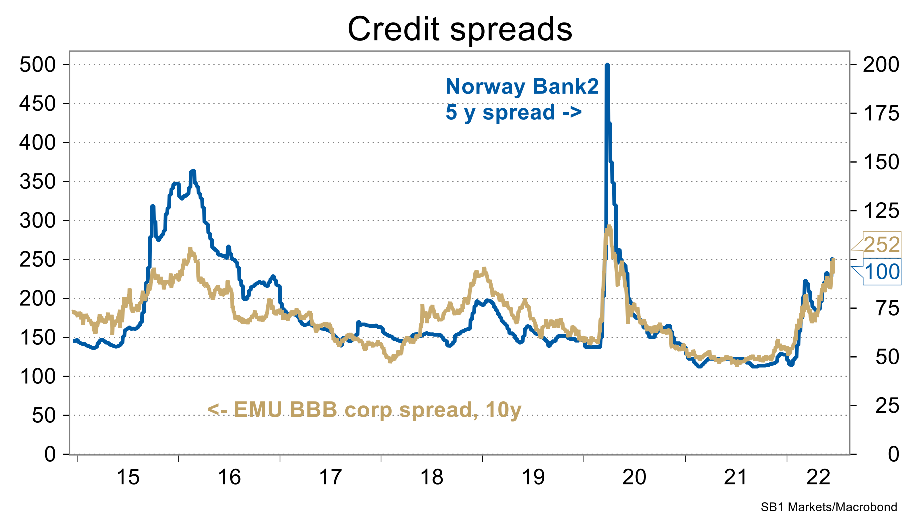


SB1 Markets/Macrobond

Credit spreads further up last week

Still, credit spreads are close to an average level, up from very low levels a few months ago



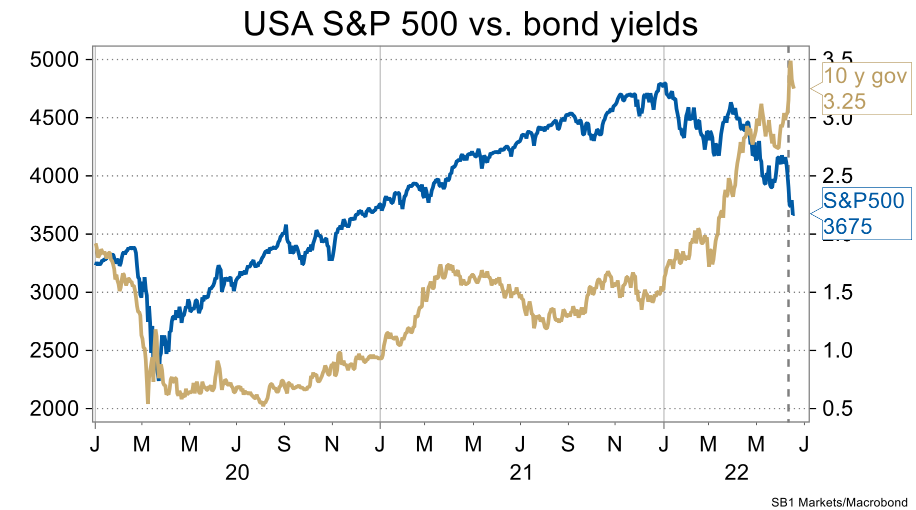


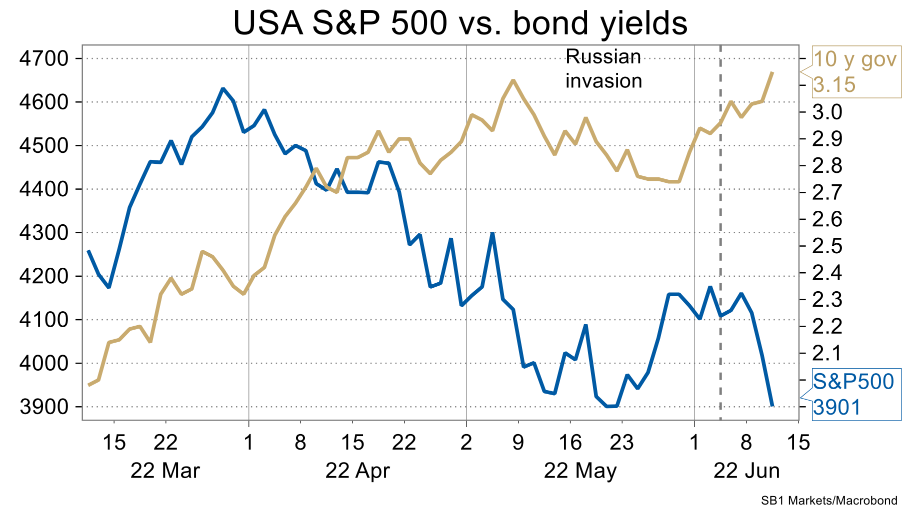
- The total capital cost has increased significantly, as the long term real government bond rate is up almost 200 bps
- European and Norwegian spreads are following suit, as they usually do

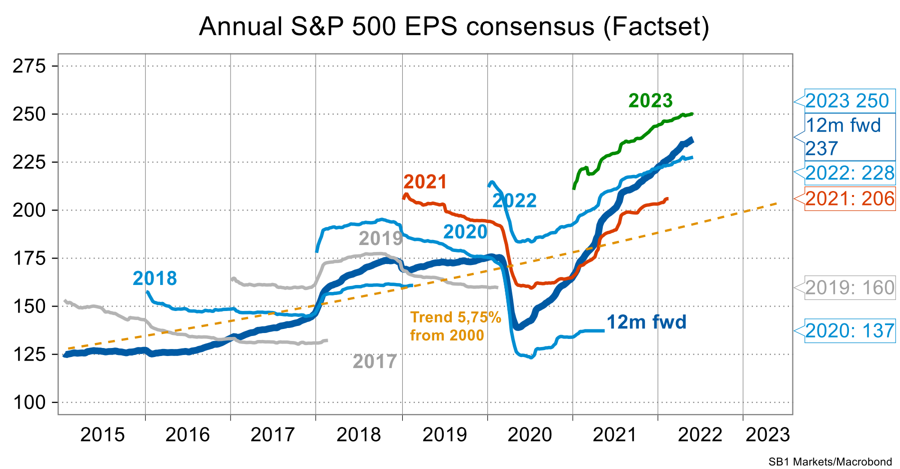
SpareBank 1 MARKETS

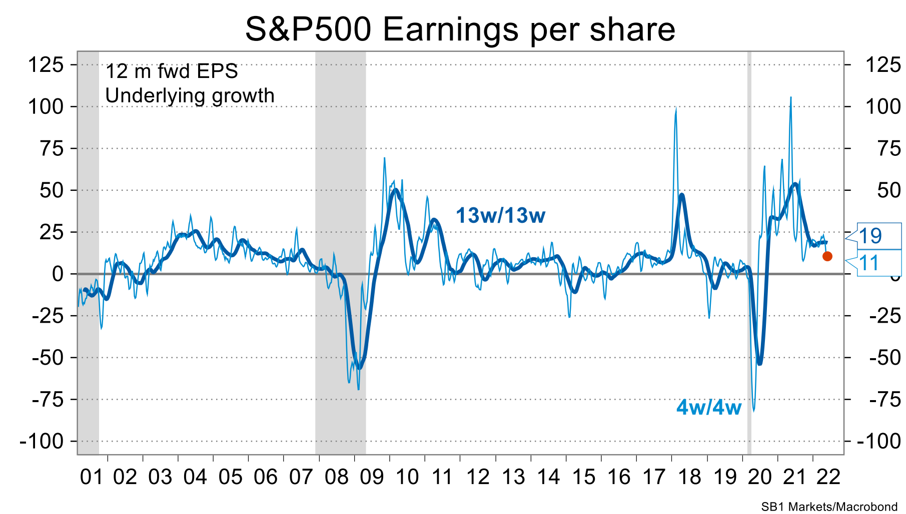
The S&P 500 down 5.8%, bond yields up to cycle high (and down 25 bp from the peak)

Earnings growth is slowing, is approaching single digit. Much more to come





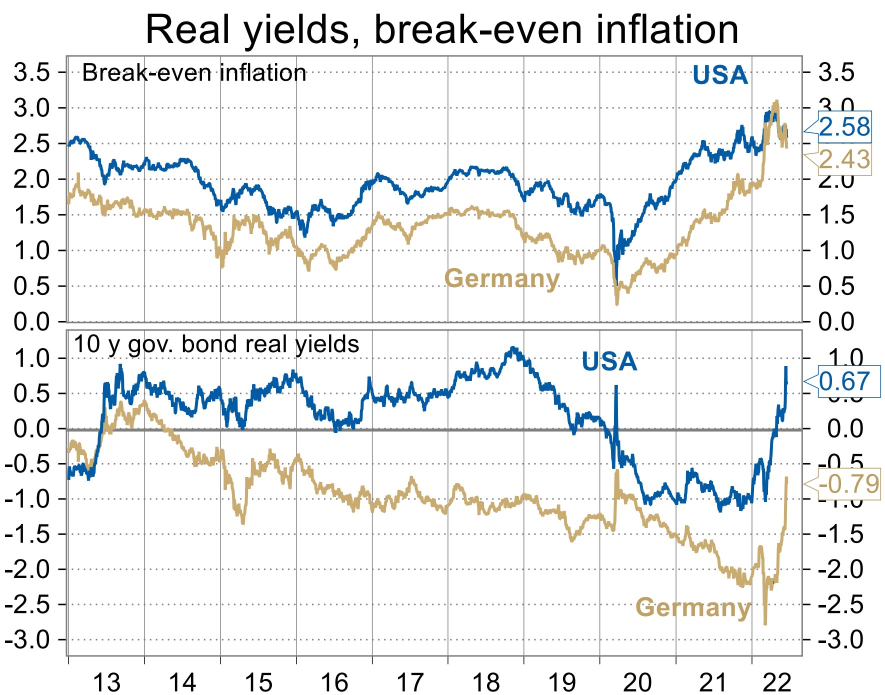


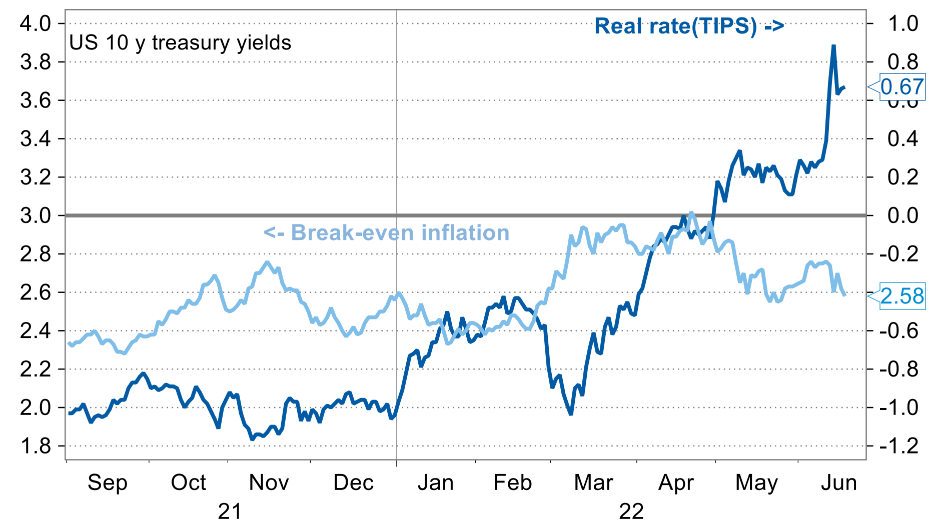


USA real rates shot up almost 30 bps last week, German 55 bps! Infl. expect. down!

Markets are recognising that central banks will have to & are willing to keep inflation in check

… at the cost of higher real rates, of course





US & Germany 10 y Gov bond yield

	Yield	Change 1w	Change 1m	Since Feb 18	Min since April-20
USA nominal treasury	3.25	0.10	0.27	1.33	0.52
.. break-even inflation	2.58	-0.18	-0.13	0.17	1.06
.. TIPS real rate	0.67	0.28	0.40	1.16	-1.19
Germany nominal bund	1.64	0.25	0.65	1.42	-0.65
.. break-even inflation	2.43	-0.30	-0.31	0.45	0.40
.. real rate	-0.79	0.55	0.96	0.97	-2.80

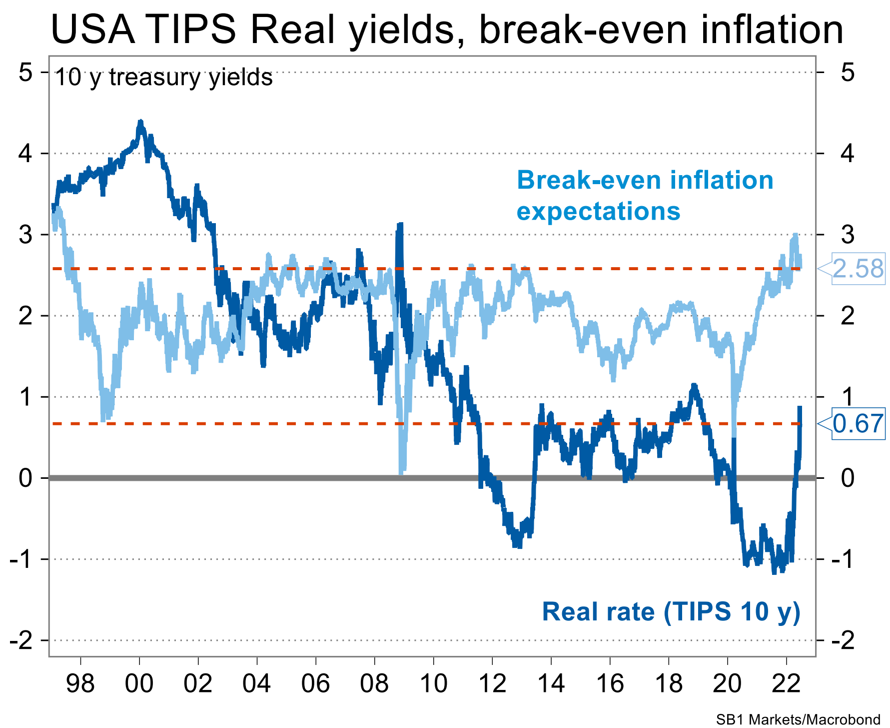
SB1 Markets/Macrobond

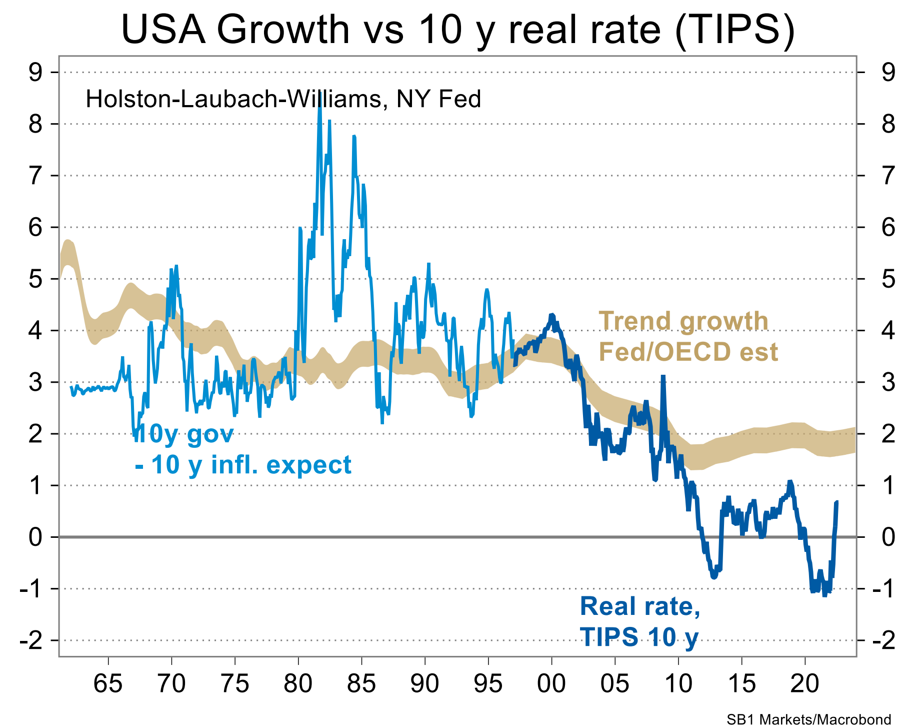
- **The US nominal 10 y bond** yield rose 10 bps last week to 3.25% but was up to almost 3.5% at the peak
  - » **Real rates** gained 28 bps, to 0.67%, a cycle high too(but was up to 0.89%). Inflation expectations fell by 18 bps, to a level first reached in Oct last year
- **The 10 y German bund** added 25 bps to 1.64%
  - » **Real rates** rose 55 bps to -0.79%, also a cycle high, buy wide margi
  - » Inflation expectations fell 30 bps to 2.43% - not that far above the target anymore

SpareBank 1 MARKETS

Mind the gap: It's rapidly closing!

Real rates sharply up – while short/medium-term growth expectations are moving down





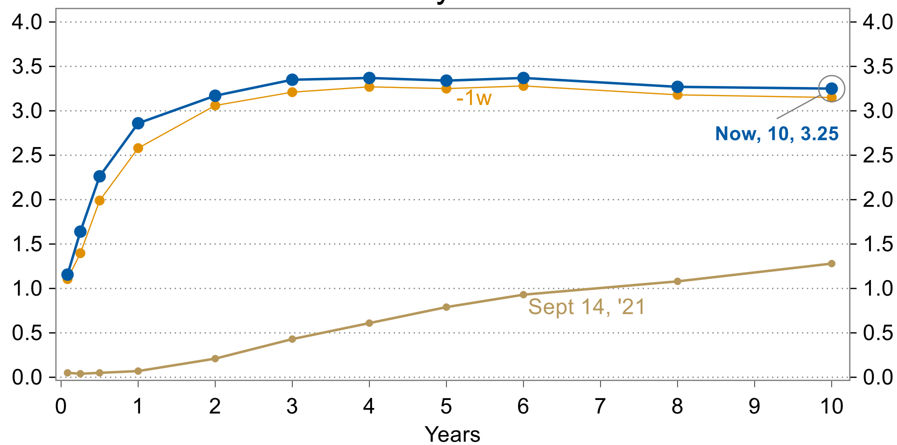
- There is no reason to believe that the current surge in real rates is due to an equivalent increase in growth expectations. It is of course the opposite: At least the short to medium-term outlook is now weakening as central banks finally enter the fight against inflation by at least bringing growth down to below trend growth
  - » Profit margins are VERY exposed
  - » Demand for labour will slow too, and unemployment will increase – in order to get wage inflation down
- The USD 10 trl question: Are all risk markets really discounting this scenario?

SpareBank 1 MARKETS

Another lift in the whole curve last week – most in the short end

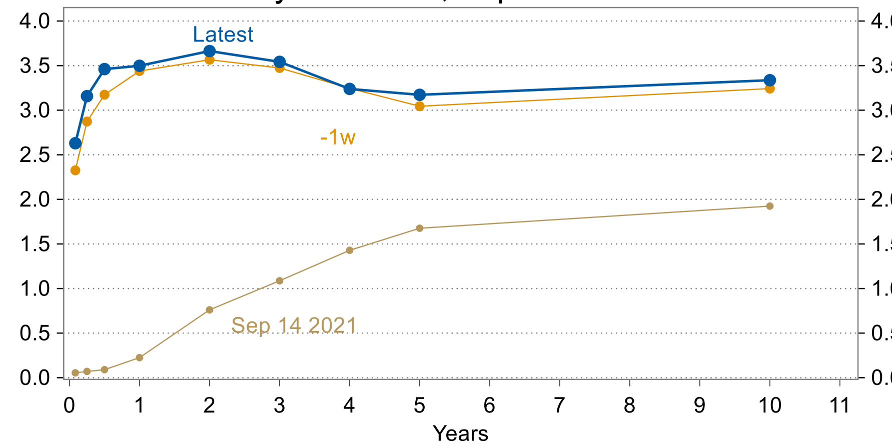
Will the 10y - 2y soon invert?

US Gov yield curve



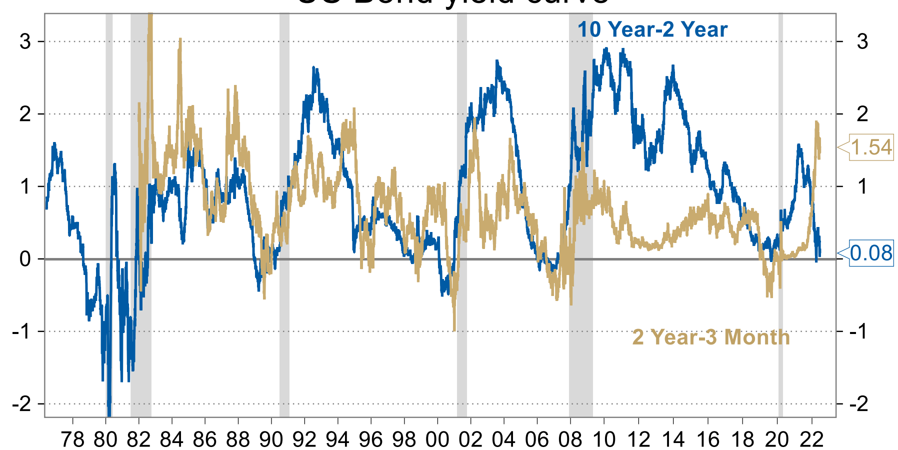
SB1 Markets/Macrobond

US Gov yield curve, implicit forward rates



SB1 Markets/Macrobond

US Bond yield curve



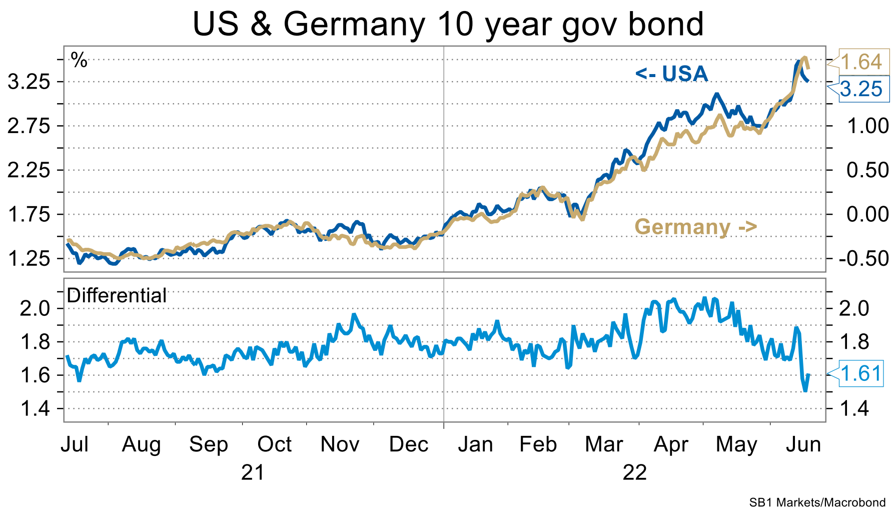
SB1 Markets/Macrobond

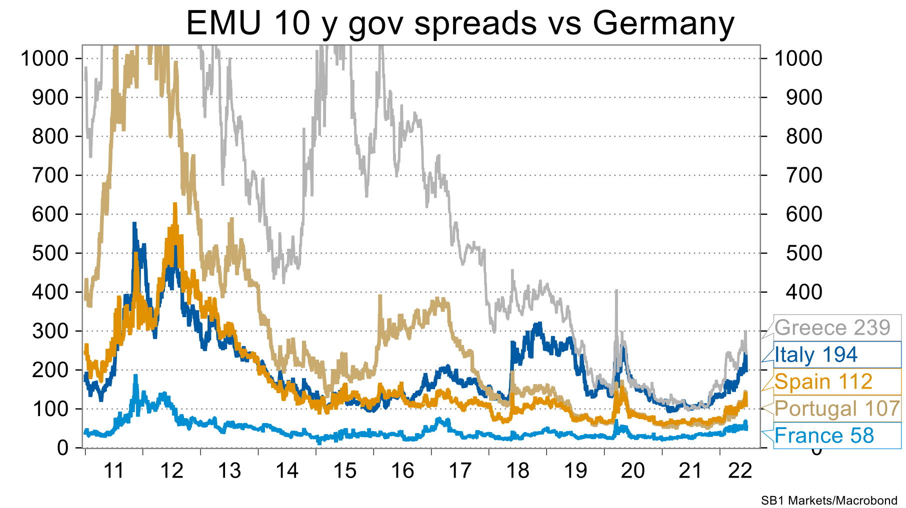
USA Gov yield curve

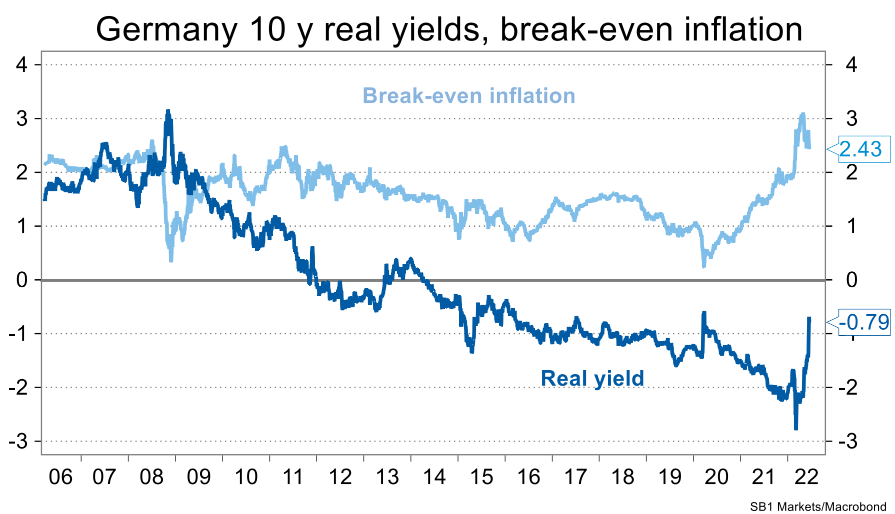
SB1 Markets/Macrobond

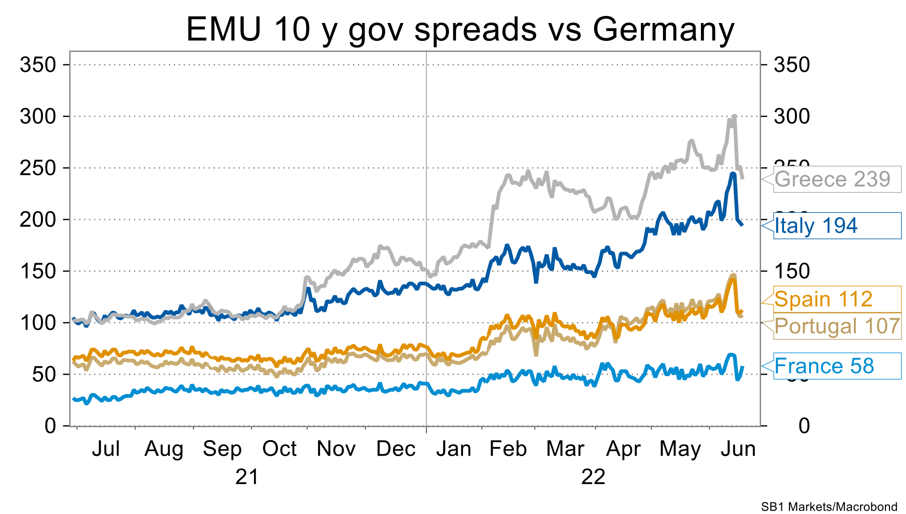
The ECB board did not agree on how to help the periphery…

So they asked the ECB bureaucrats to come up with something. Spreads narrowed sharply



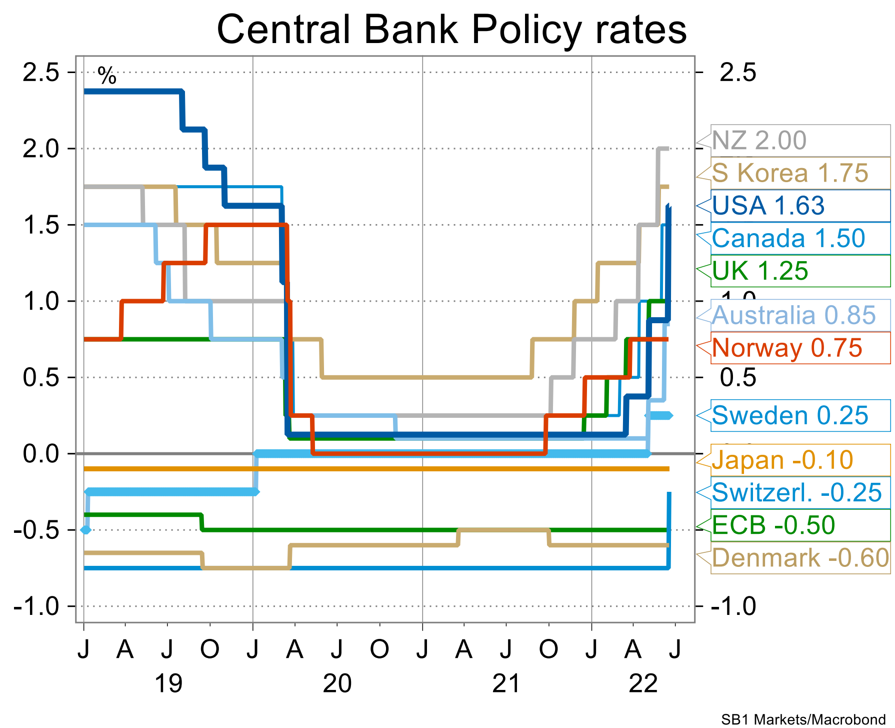


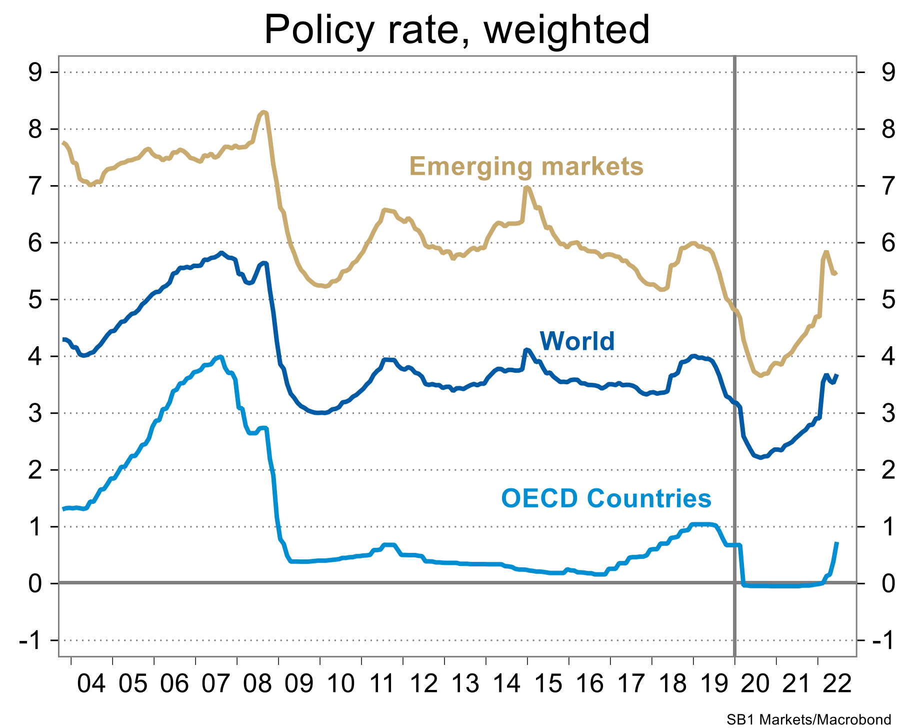




Central banks on the move. US +75 bps, Switzerland + 50 bps

Norway is now no. 7 among rich countries. All the Anglo-Saxon + South Korea ahead



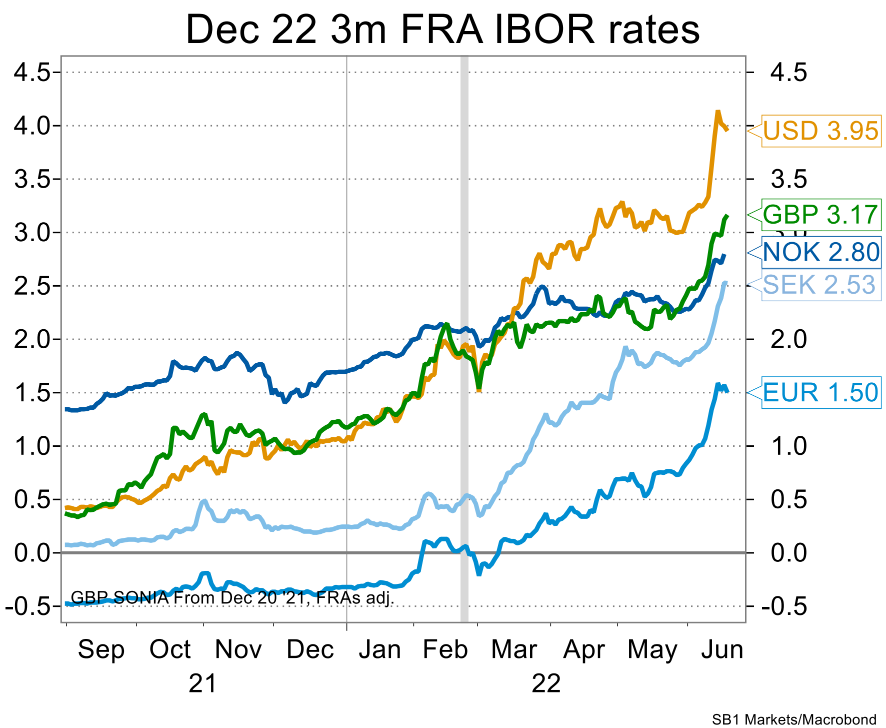


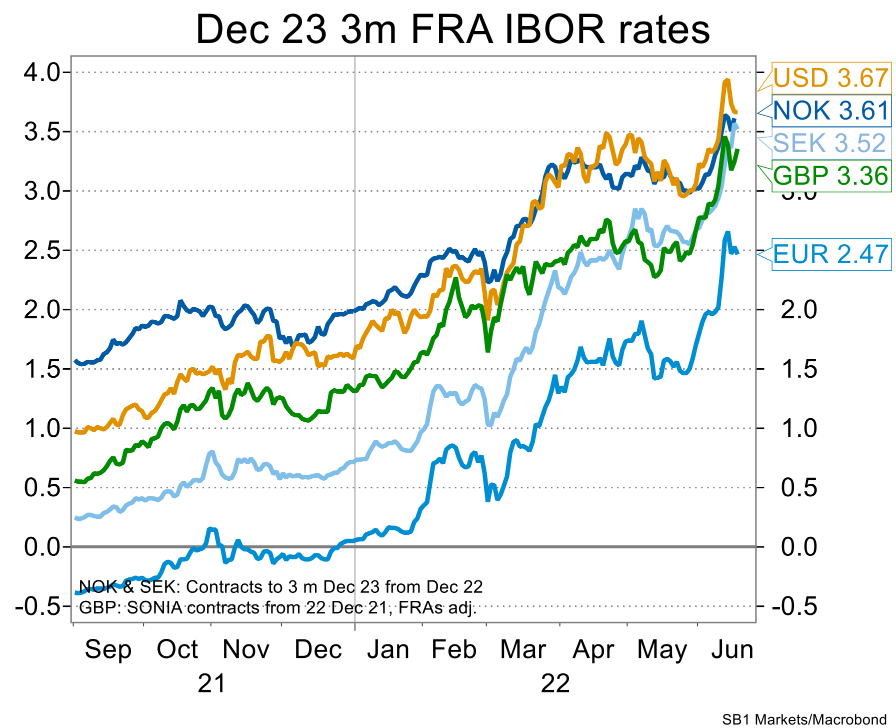
- In addition to rate hikes, central banks (x Japan and the Riksbank) have abolished their QE buying programs
- The EM average policy rate has come down due to the Russian cuts – but the trend is straight up

SpareBank 1 MARKETS

Dec-22 FRAs up everywhere – the USD Dec-23 stalled the other up w/w

SEK Dec-23 contrats almost overtook NOK contracts last week. We had a 125 bps lead January!!





- Is the peak near, for this cycle? Financial conditions are tightening and signs of a slowdown are visible some places

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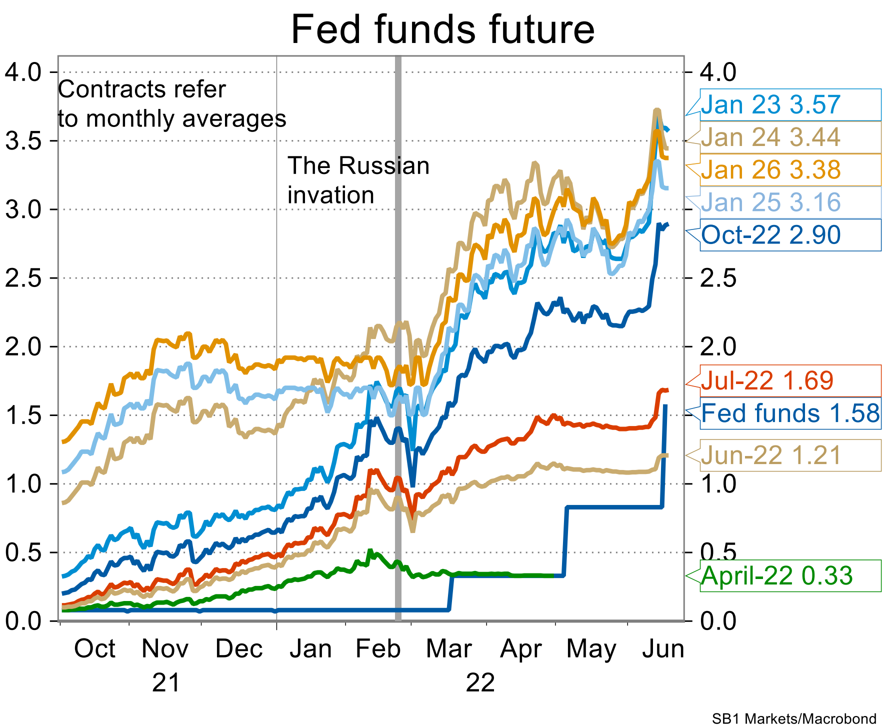
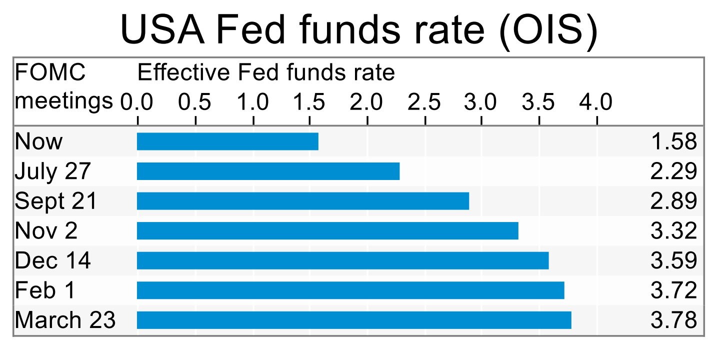
Longer dated Fed f. contracts yielded after Fed's move. Data on the weak side too

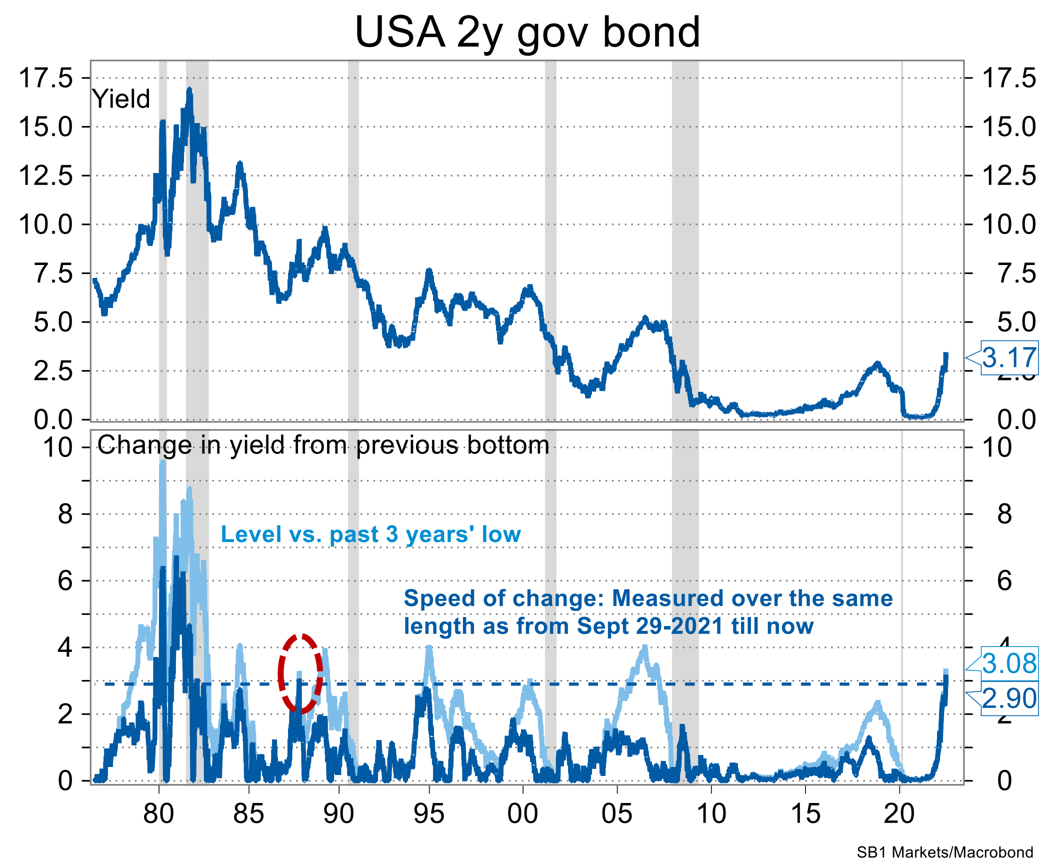
An 85% probability for another 75-bps hike in late July

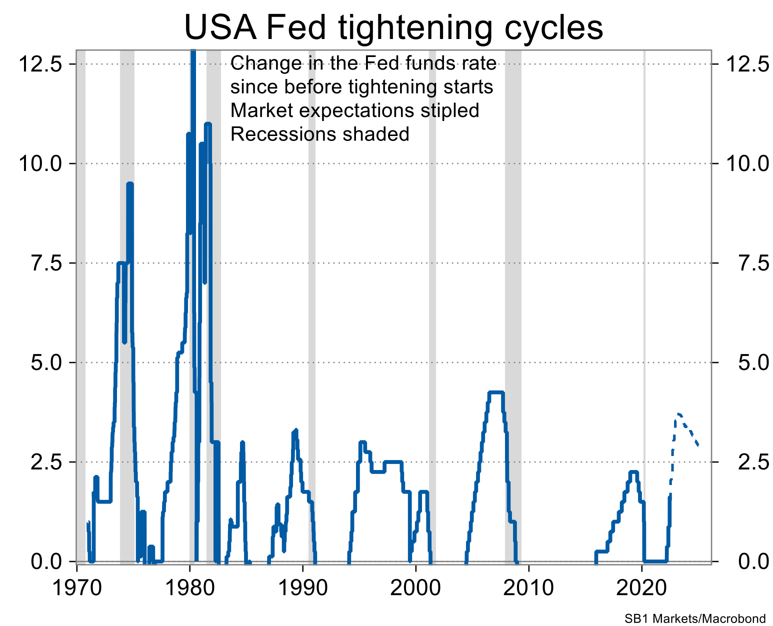




The <u>steepest</u> turnaround in (expected) monetary policy since… 1987☺

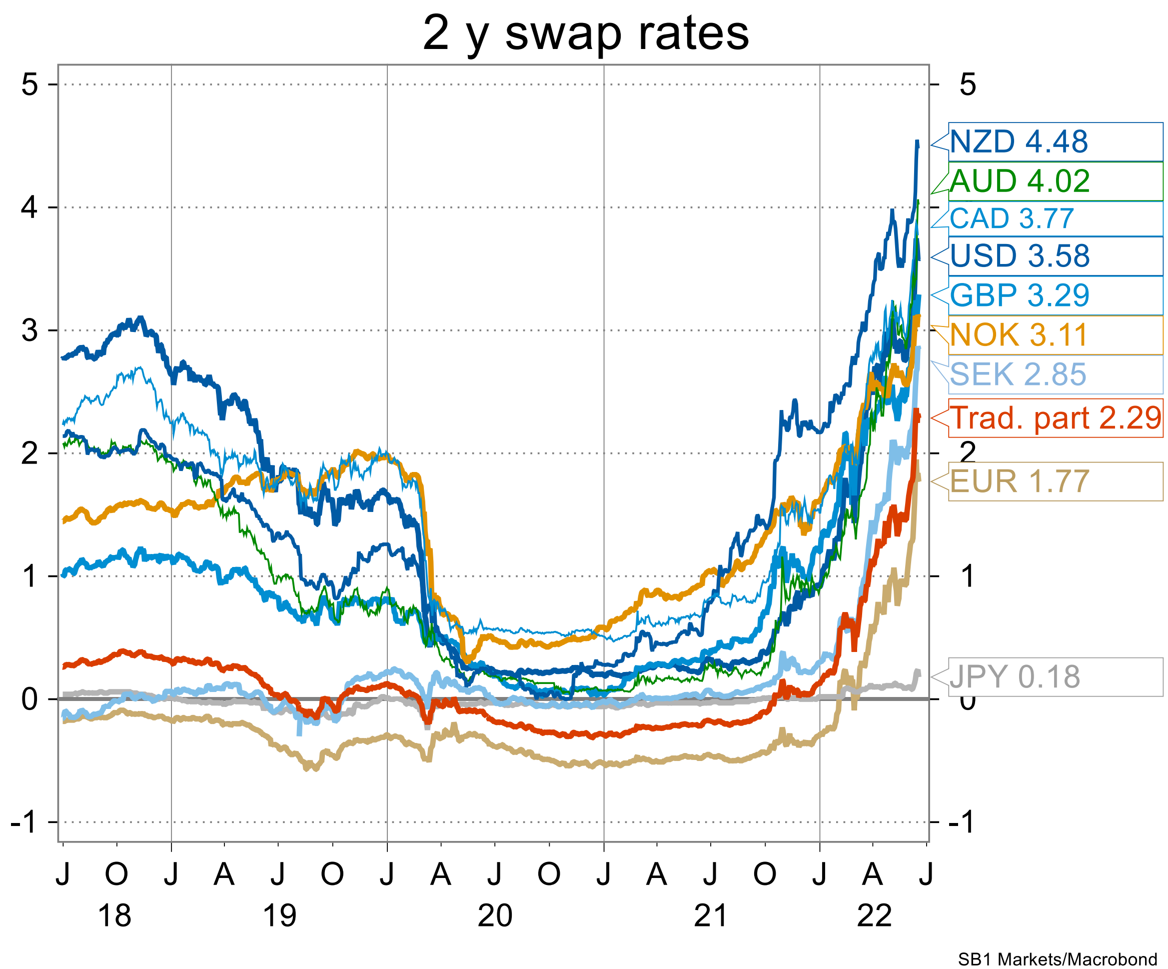
The 2 y gov bond rate is up by 2.90 pp since Sept 29 last year, the quickest lift since 1987

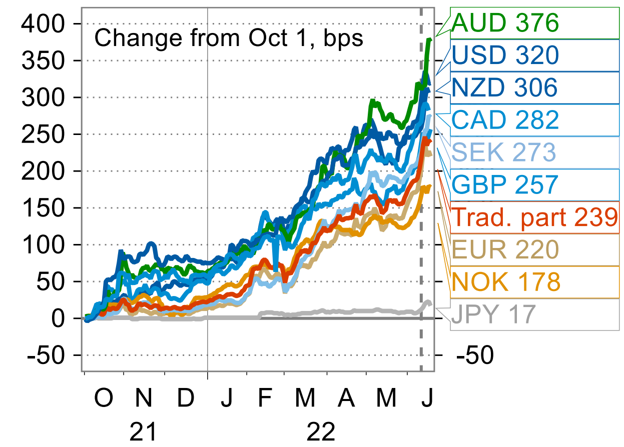


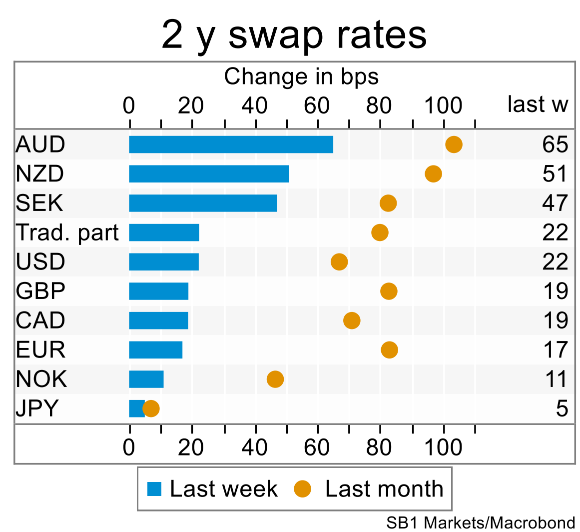


The short end of the curve straight up everywhere

Except Japan, of course

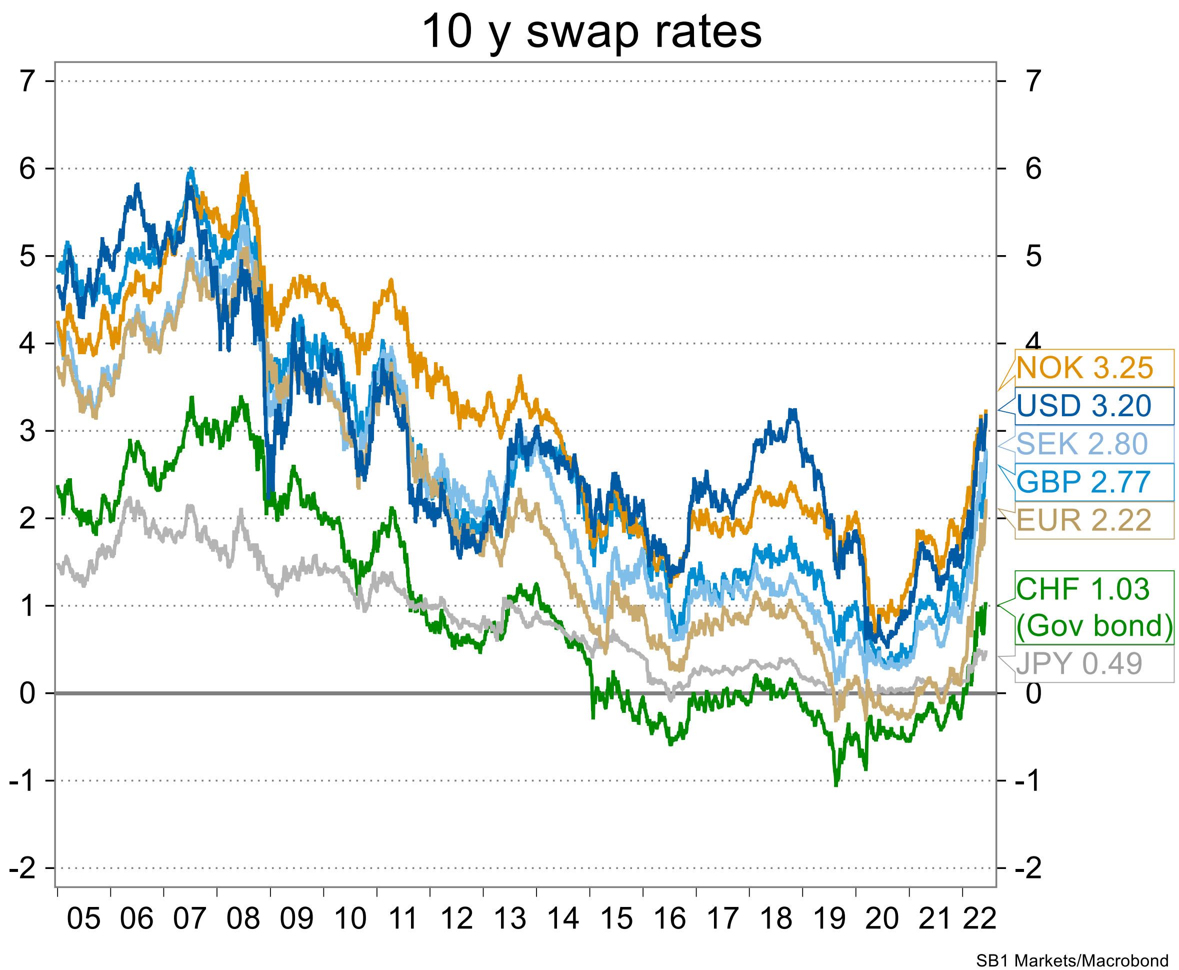


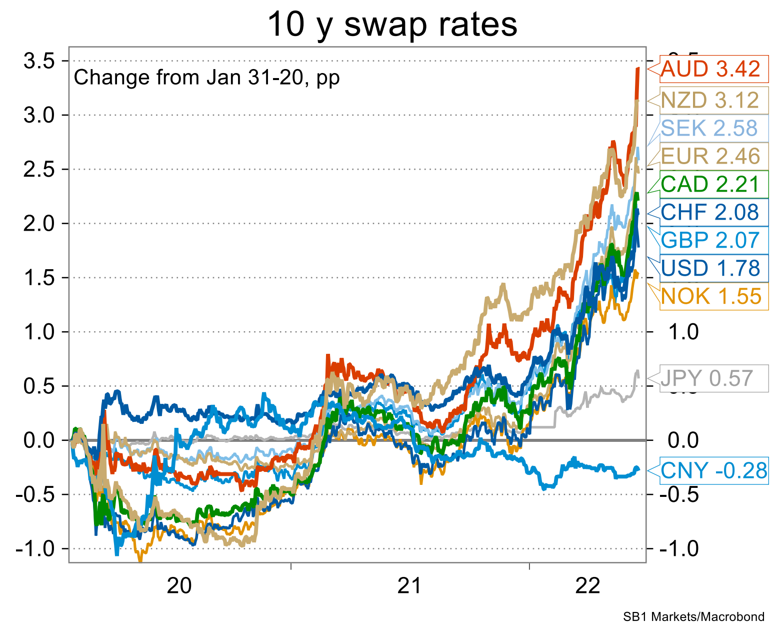


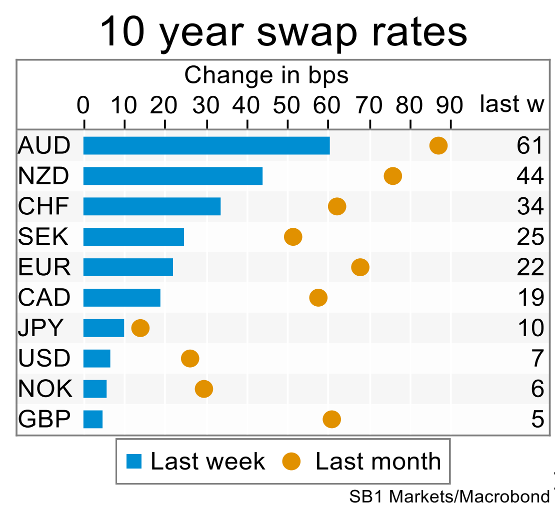


AUD (and NZD) rates exploded last week. CHF, SEK rate sharply up too

Almost all countries recorded new cycle highs, even Japan







CHF: 10 y government bond yield

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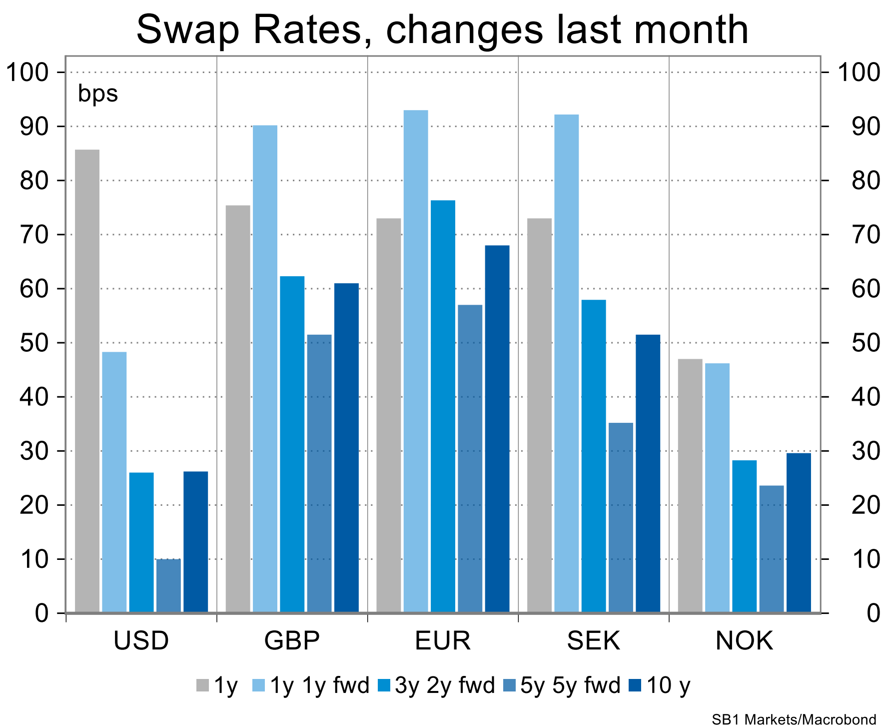
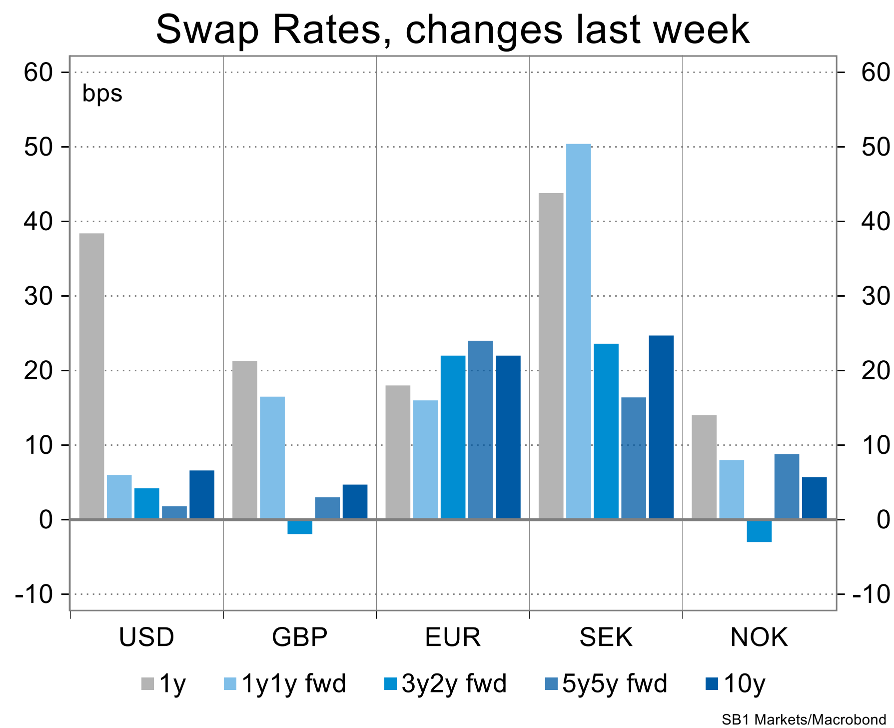
SEK rates sharply up last week – and before a new governor was announced

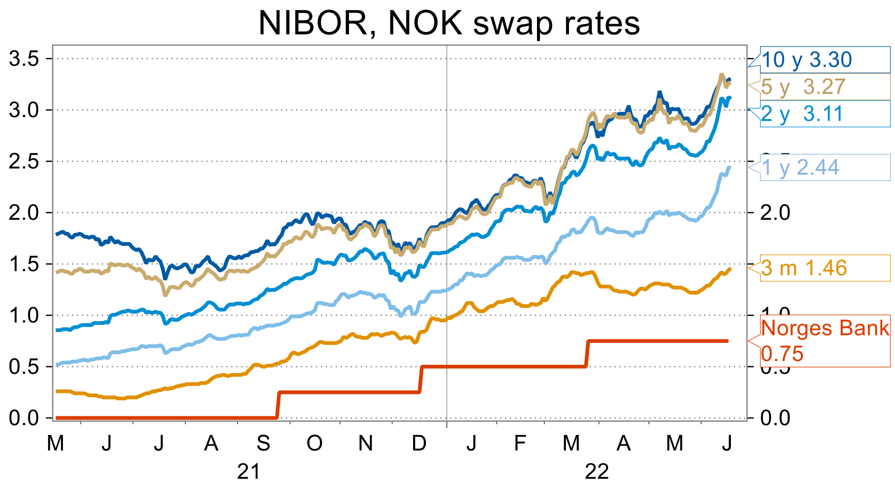
Ingves left, and 'SEC' boss Thedéen, a QE critic, was appointed. EUR rates up as well. NOK rates less

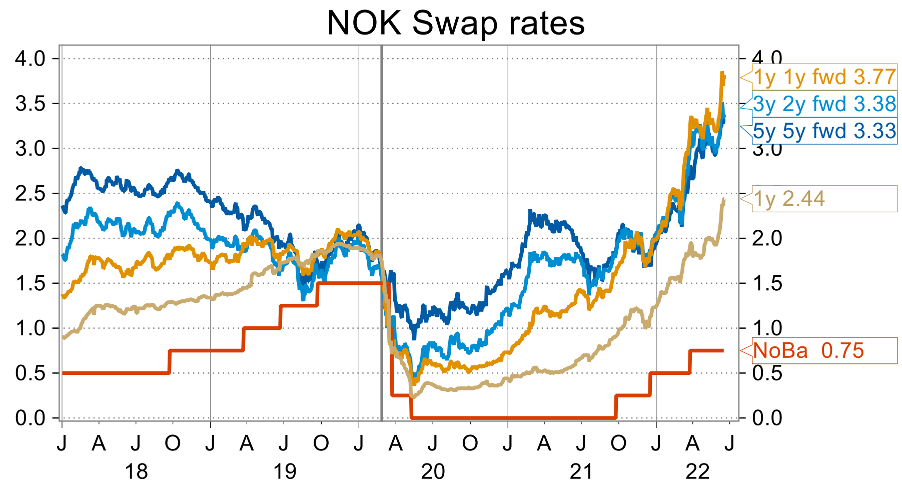


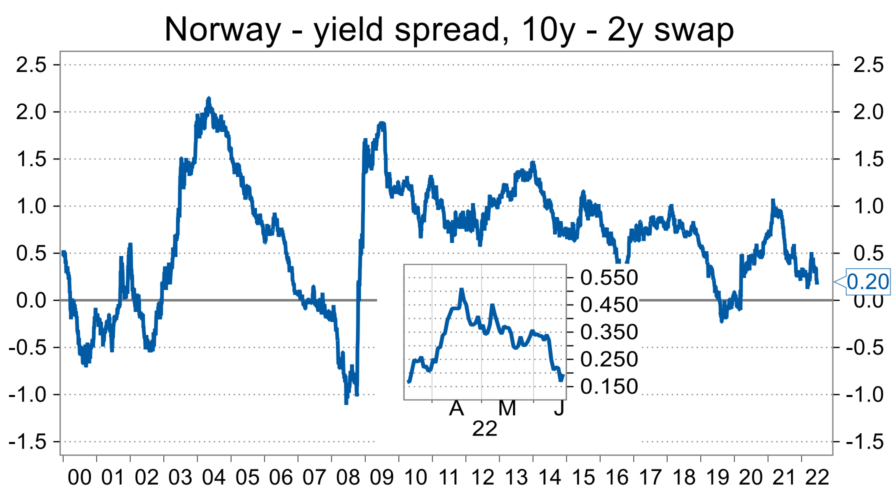


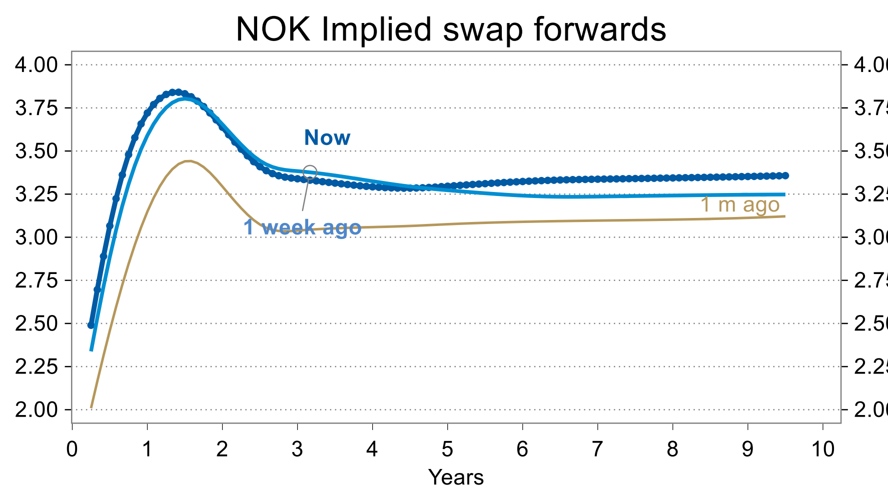
A shift upwards again, over most of the curve – but most in the short end

2 y at 3.11%. 10 y at 3.30%!

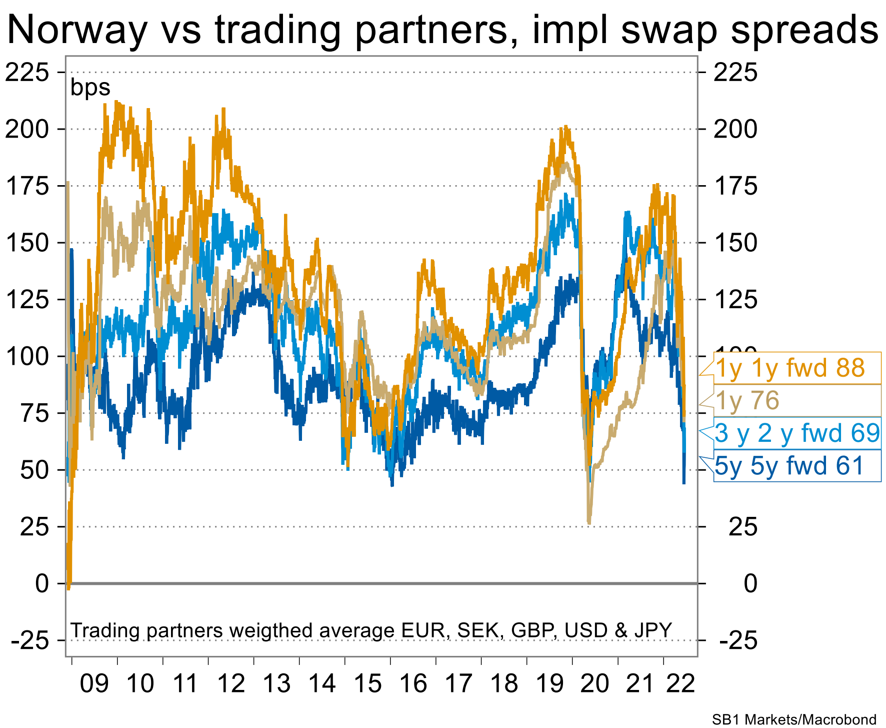


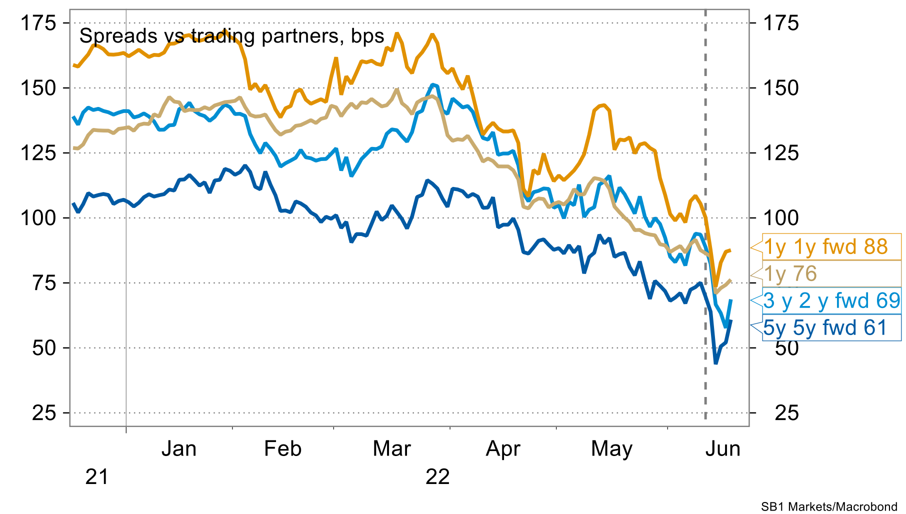


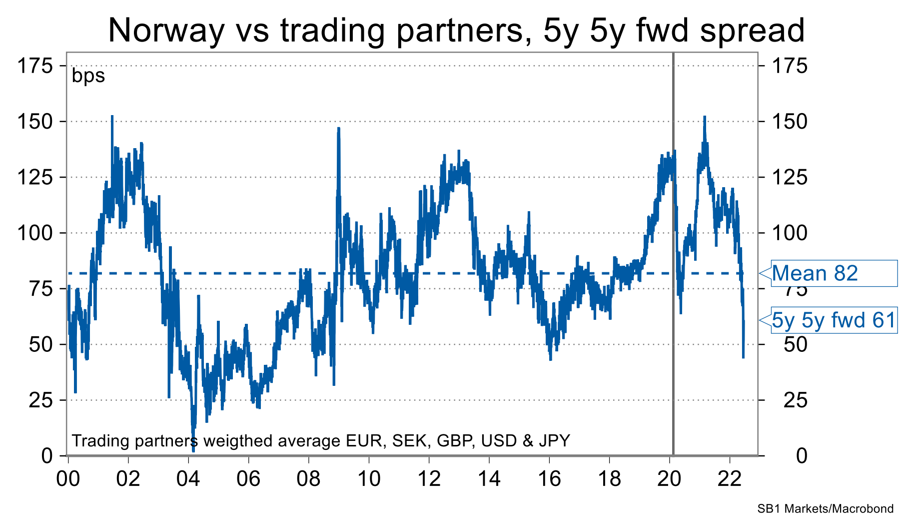




Spreads sharply down last week – and they are now below average







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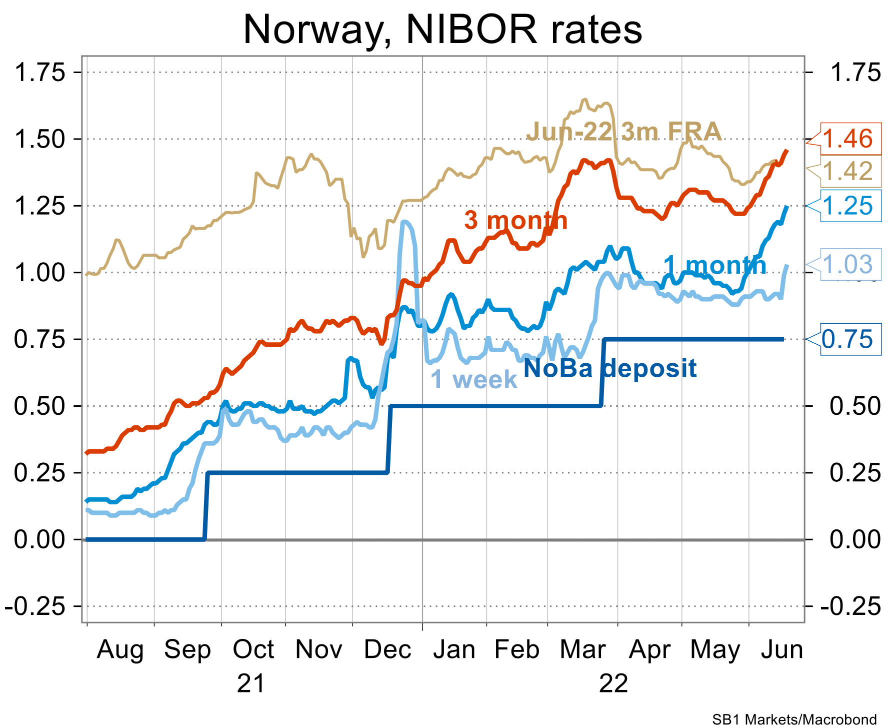
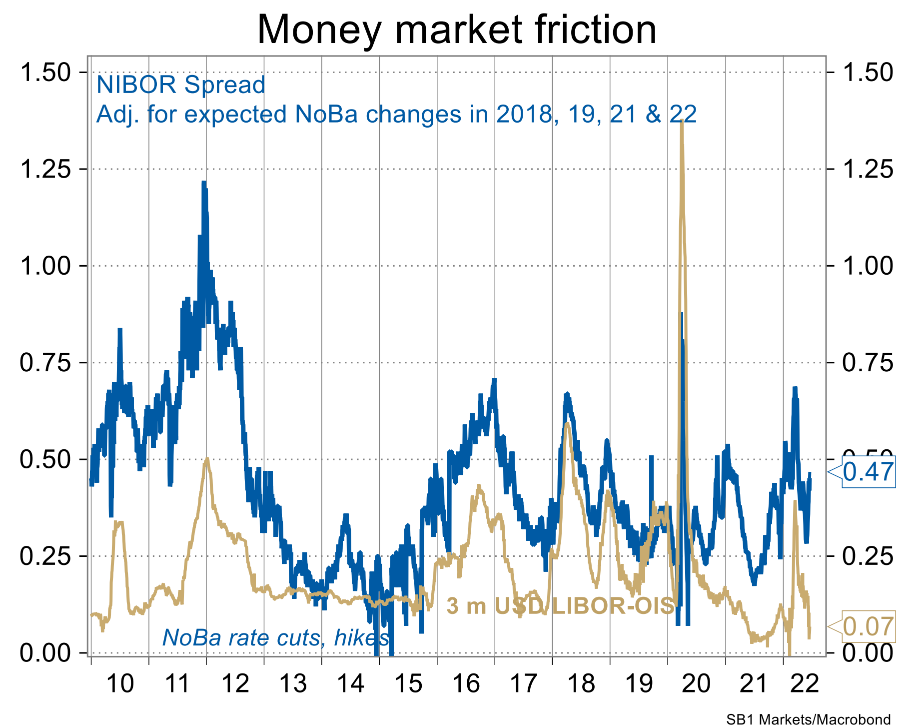
The 3m NIBOR up 7 bps to 1.49%, the NIBOR spread up 5 bps to 47 bps. Or…??

The 47 bps spread is based on a singe hike in June and no hike in August. That's not a done deal now

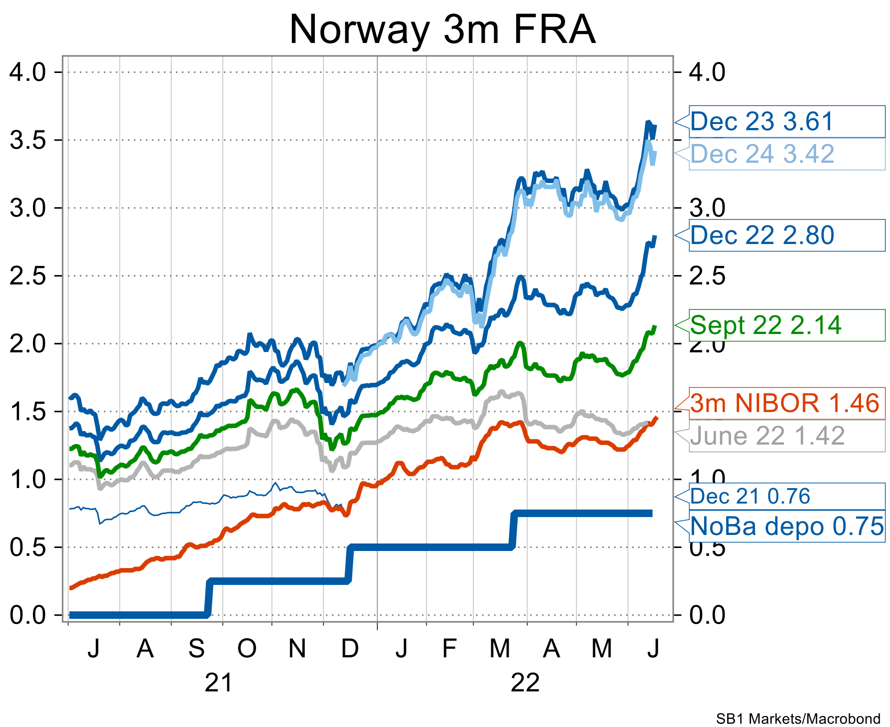


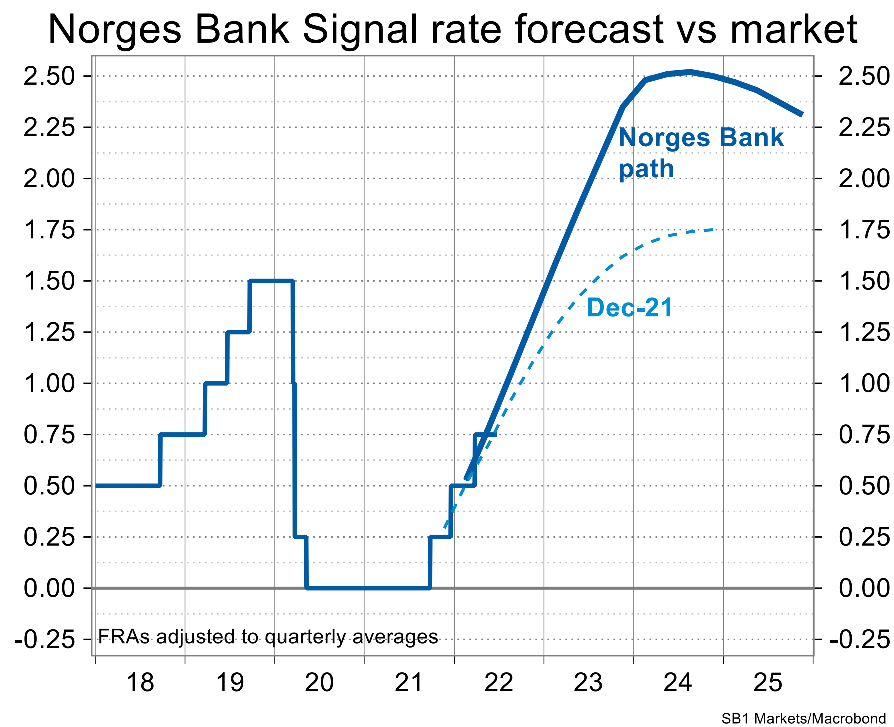


- Money market spread have normalised again. We assume a 35 bps spread going forward
- The USD LIBOR-OIS spread was unch at 7 bps last week – which is a very low level!

Another hike in FRA rates – up to 75 bps above NoBa's March path

Higher inflation the last nail in the coffin, alongside all many others. 50 bps in June can't be excluded



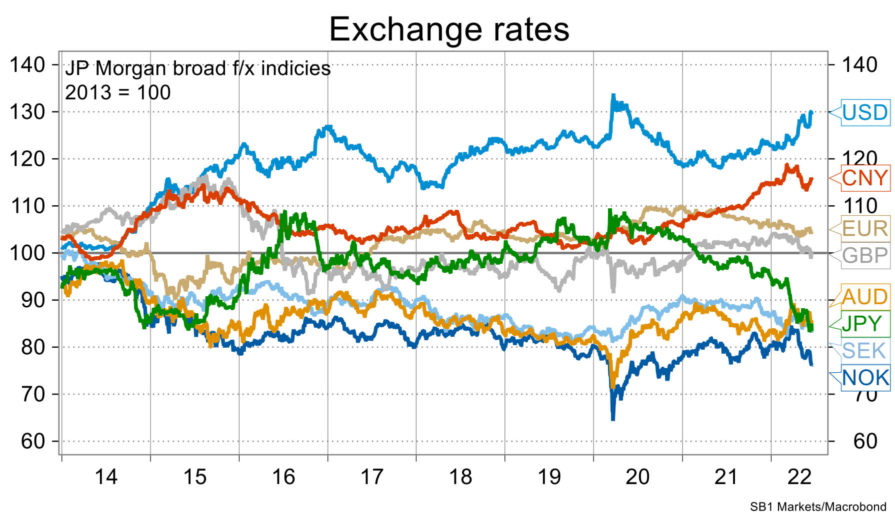


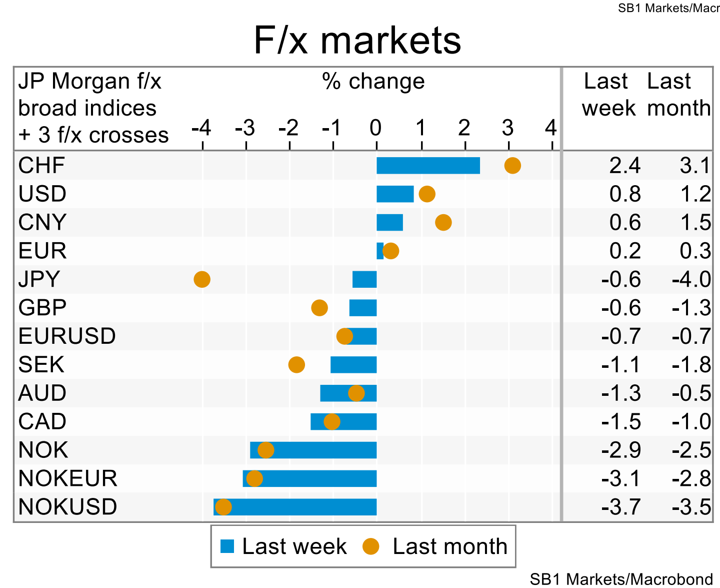
- If NoBa hikes by 25 bps to 1% at the **June 23 meeting** (and no hike in August), the average deposit rate in the duration 3 m NIBOR will be 0.98%. If 25 bps in June, and 25 bps hike in August, 1.10%. If the bank hikes by 50 bps in June, the avg depo rate will be 1.21%
- **Assuming a 35 bps NIBOR spread**: The current June 3m FRA at 1.42% may be reached by combining the 3 'possible' NoBa scenarios
  - » If we exclude the possibility for a 50 bps hike, an August hike is a done deal
  - » If we do not exclude 50 bps in June, the FRA rate may be reached by 40% probability for just a June 25 bps hike, 40% for 25bps in June & August, and 20% for a 50 bps June hike. However, the Sep 3 FRA implies that a just a 25 bp hike in June/Aug is very unlikely (of not a 75 bps hike is assumed in Sept)
- The **Sept 3 m FRA** at 2.04% (+14 bps last week) is 62 bps above the June contract, implying a 1.69% expected NoBa signal rate, implying a 1/3 probability for a 50 bp hike in September, given a 50 bps hike in June/August
- The **Dec 3 m FRA** at 2.65% implies at 2.25% signal rate in average in December - March. In the MPR Norges Bank signalled 1.50 (85%) or possibly 1.75% (15%) in December. An upward revision is in the air…

SpareBank 1 MARKETS

USD, CHF up on more aggressive central banks than expected. NOK the big loser!

The CHF appreciated by 2.4% following the surprising 0.5 pp hike (to -0.25%, more to come)

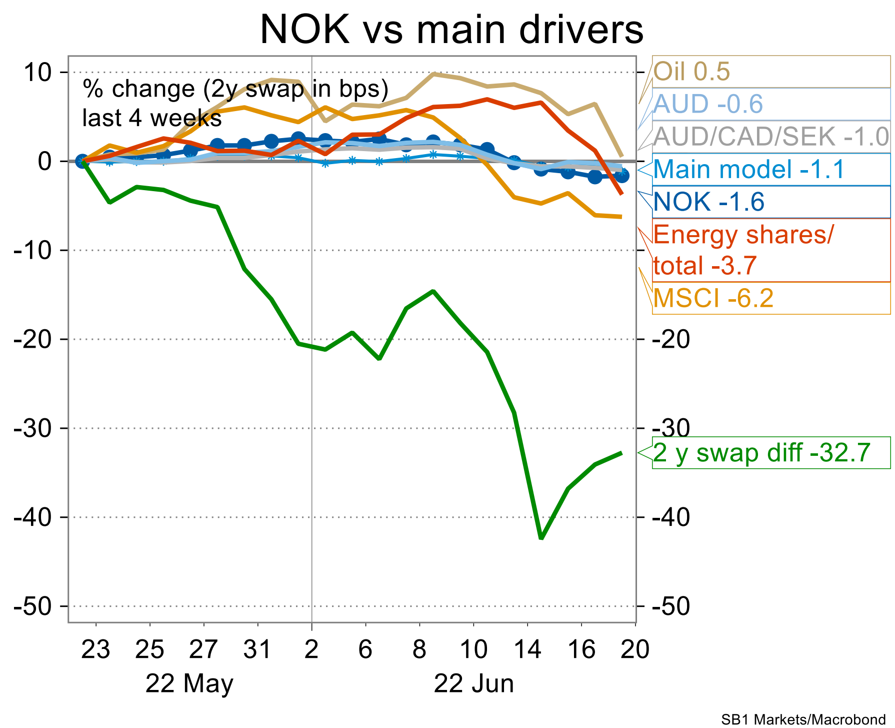


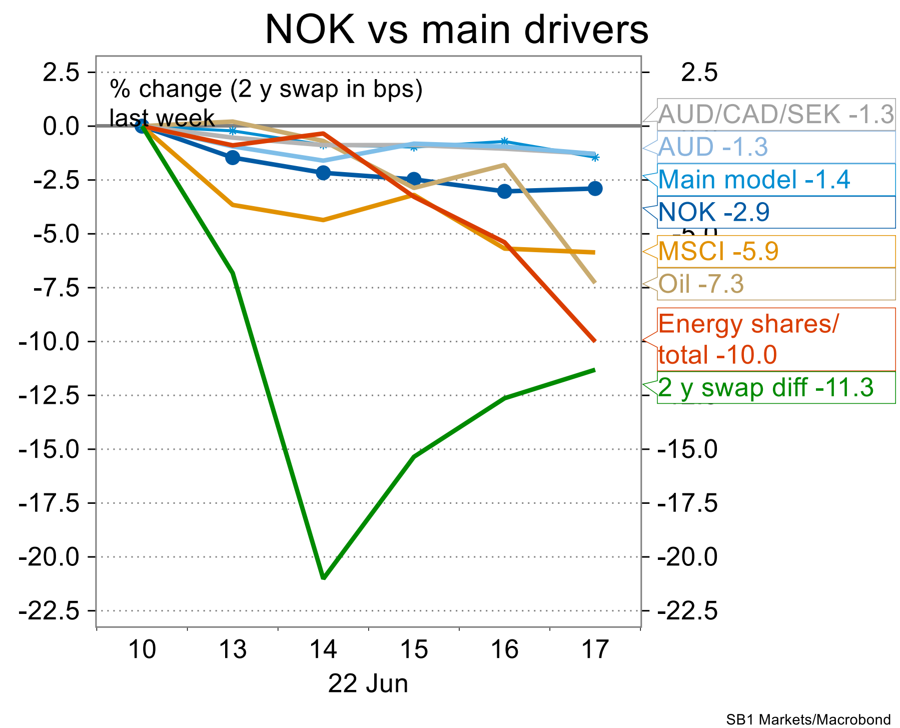


JP Morgan f/x broad indices + 3 f/x crosses	Last week	Last month
CHF	2.4	3.1
USD	0.8	1.2
CNY	0.6	1.5
EUR	0.2	0.3
JPY	-0.6	-4.0
GBP	-0.6	-1.3
EURUSD	-0.7	-0.7
SEK	-1.1	-1.8
AUD	-1.3	-0.5
CAD	-1.5	-1.0
NOK	-2.9	-2.5
NOKEUR	-3.1	-2.8
NOKUSD	-3.7	-3.5

NOK down 2.9%, our model signalled -1.4%, oil price, int. rate spread down

NOK is far below our model estimate, and NOK is weak vs other commodity currencies, energy shares





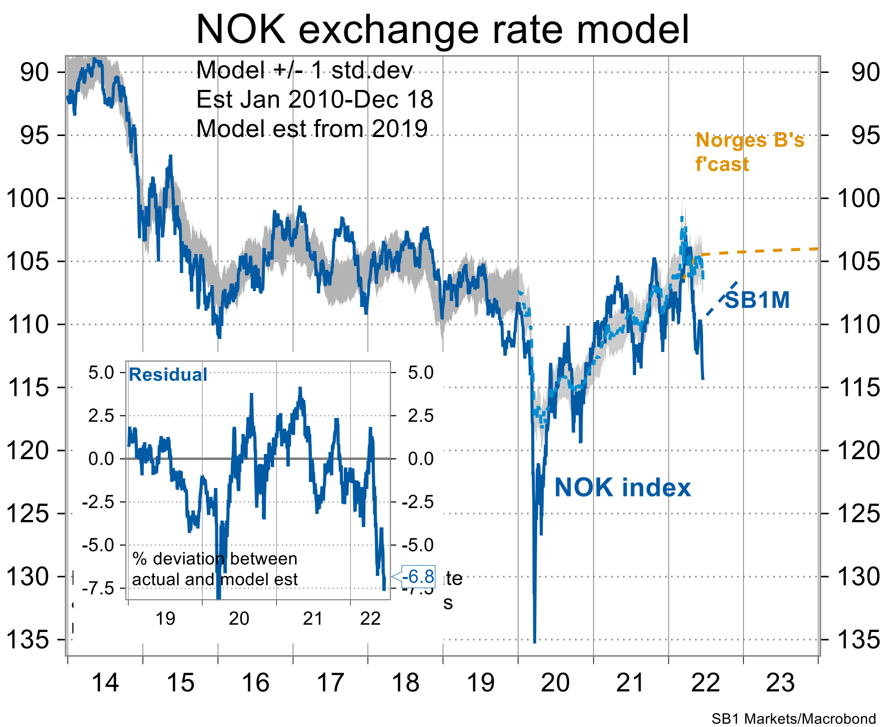
Gaps vs. out model estimates are wide

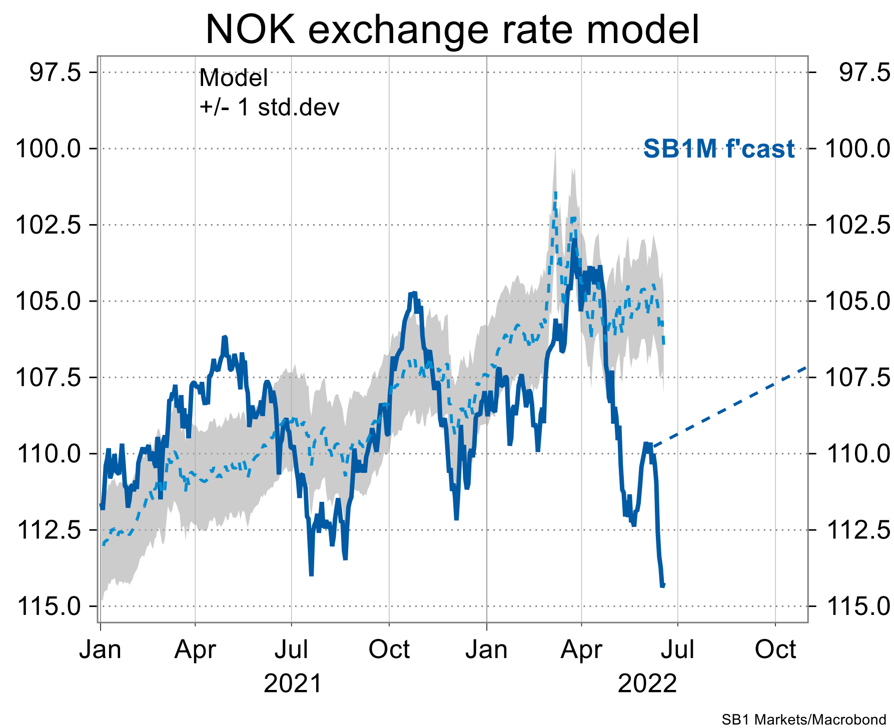
- ***The NOK -2.9% - and it is 6.8% <u>below</u> our main model estimate (from –5.4%)***
- The NOK is 10% <u>weaker</u> than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts (from -8.5%)
- NOK is 4% <u>weaker</u> than a model which includes global energy companies equity prices (vs the global stock market) (unch)

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

The NOK down and 6.8% below our model estimate

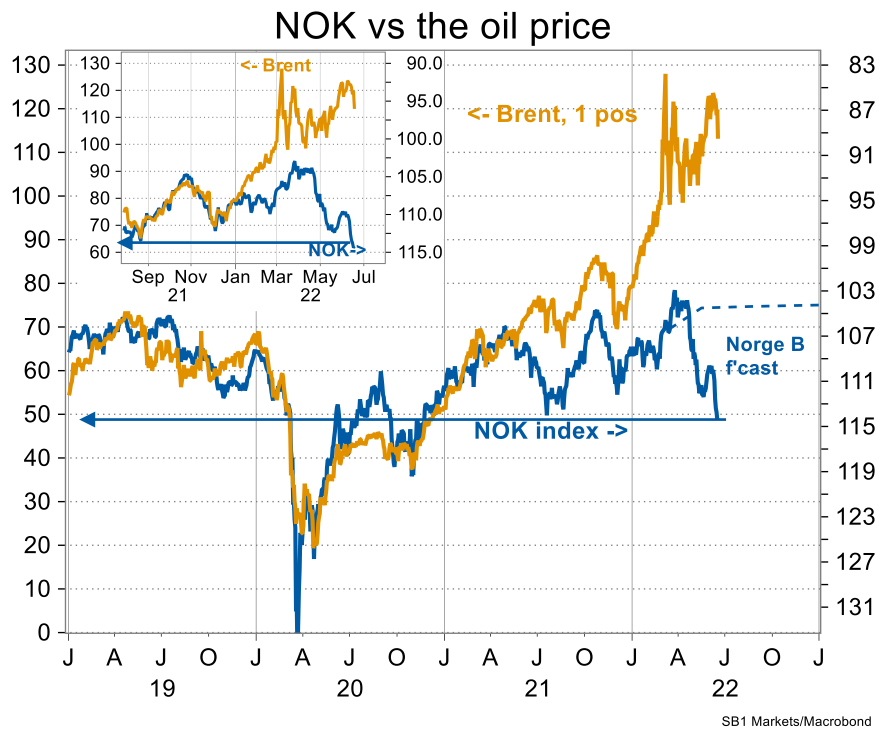
Rather unusual…

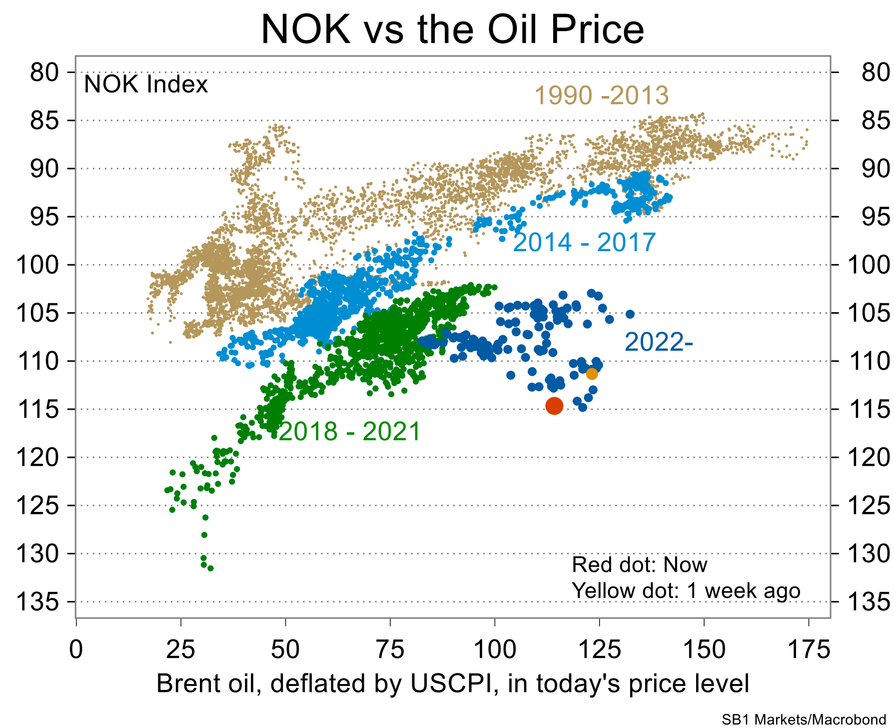




Both the oil price and NOK down last week

NOK is weak, as if the oil price were USD 62/b (rebased to early Jan) or 50 (rebased to May-21)

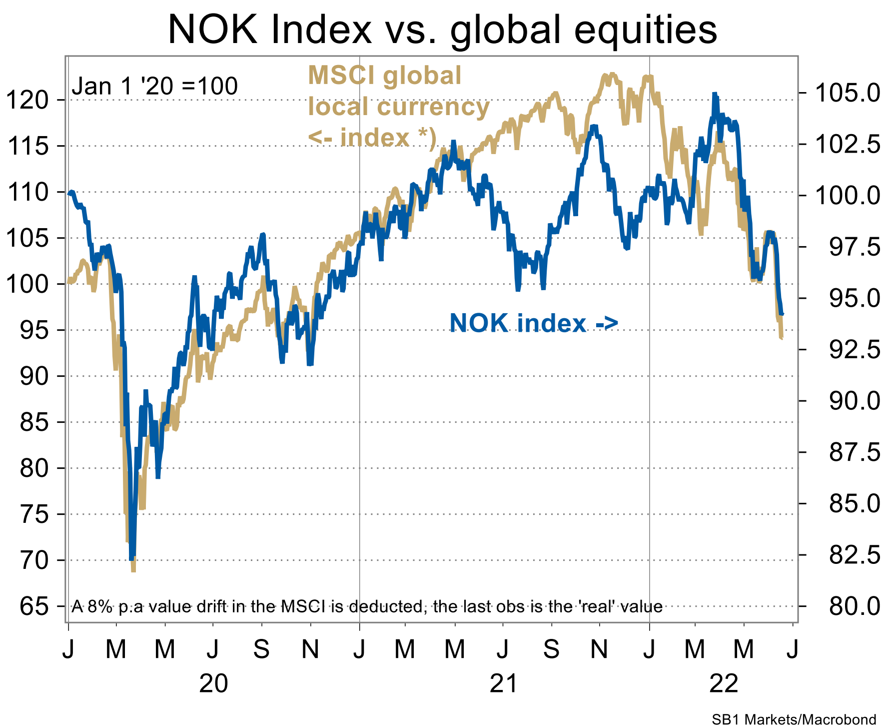


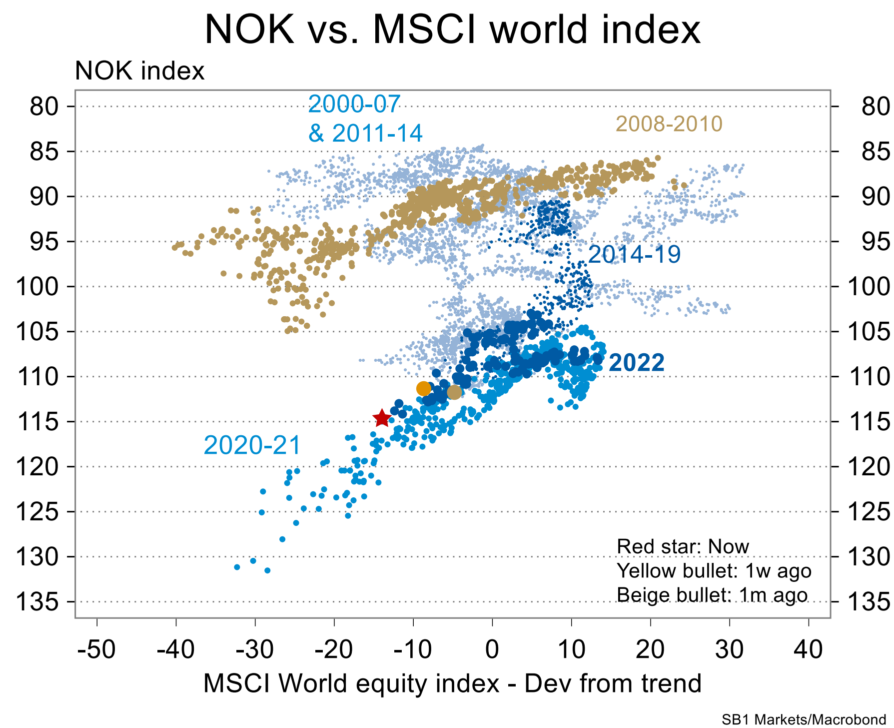


- The NOK has never before been as weak as now, given the oil price

The NOK has fallen alongside the global stock market recently

… but there is no stable correlation over time, and when it is, the oil price is normally the real driver

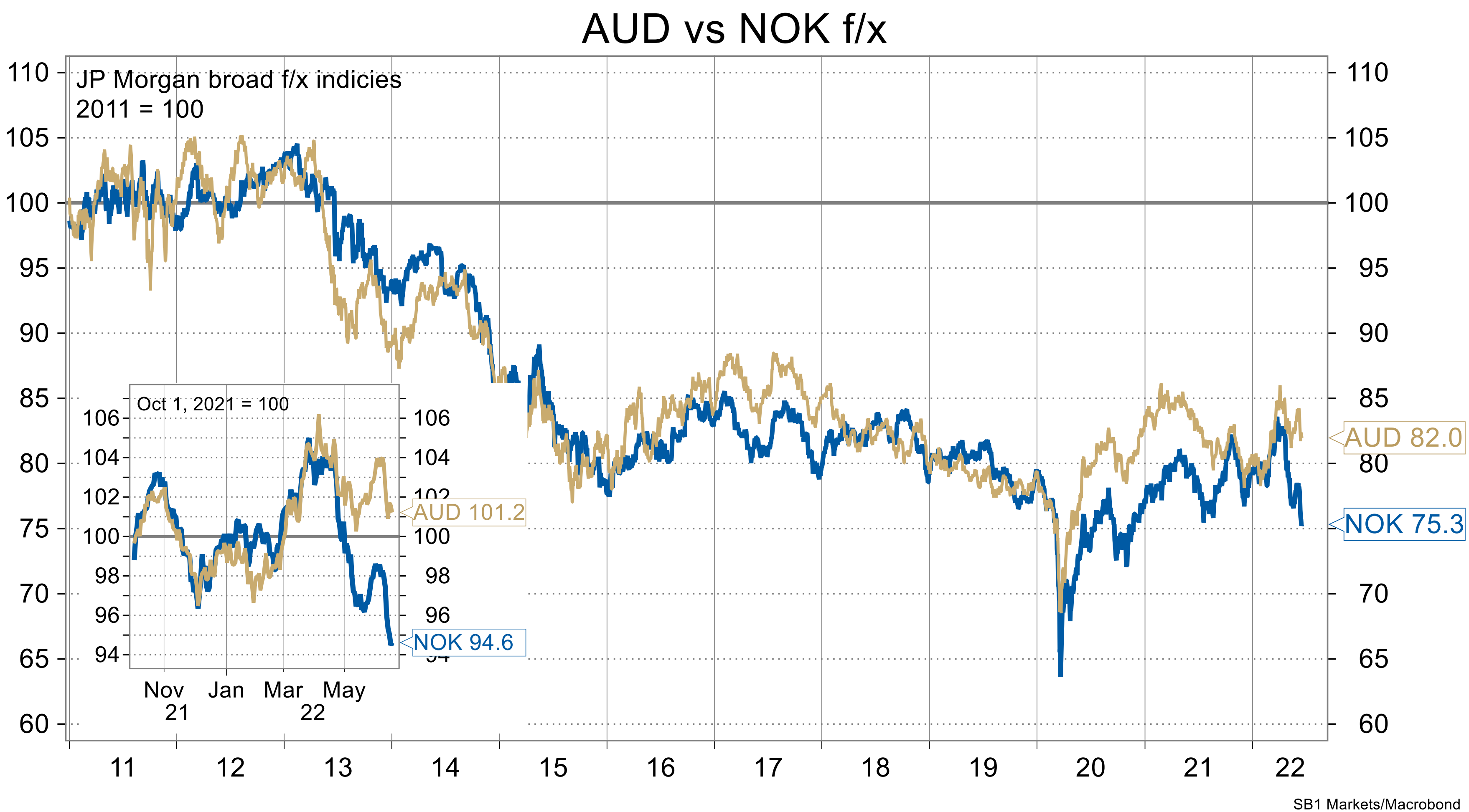




- However, since April oil has not contributed at all vs. the decline in the NOK. So it is RISK OFF again, also vs the NOK?

Both the AUD & NOK down last week, the NOK the most, once more

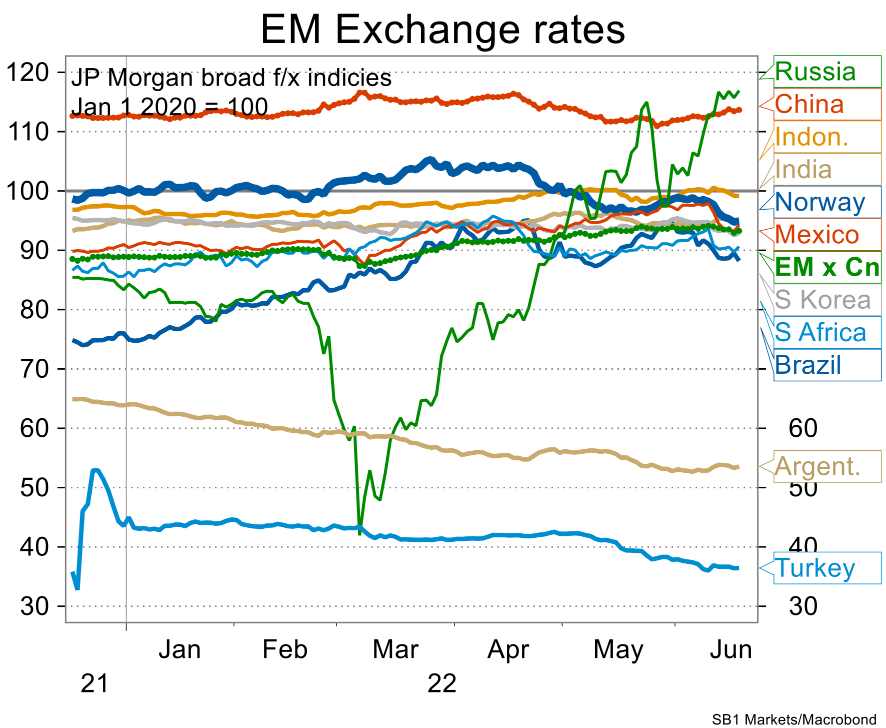
The gap is now among the largest, even in metal prices have been falling for a while, oil & gas not

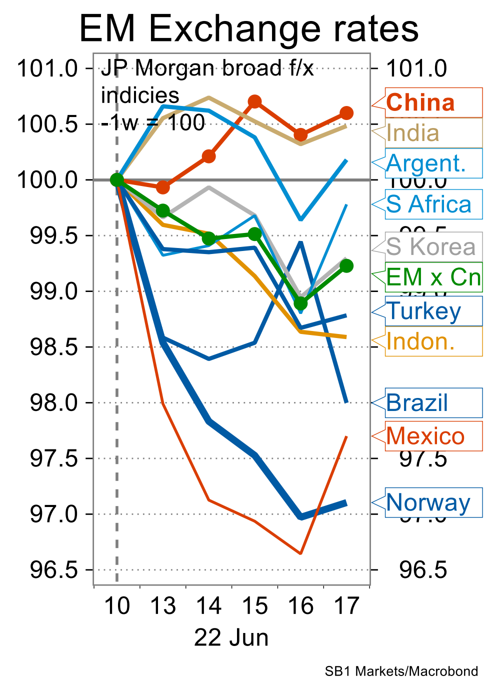


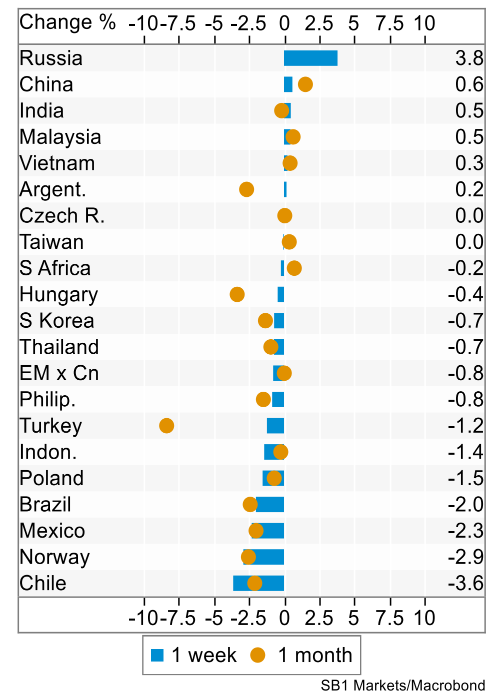
Usually, interest rate differentials <u>have not</u> been important at all for the NOK/AUD relative strength/weakness. NOK has usually <u>strengthened</u> vs. the AUD in times of turbulence in the stock market (VIX, S&P vs. long term trend), and when the oil price has strengthened vs. metal prices

EM f/x mostly down: But CNY and RUB further up

End of lockdowns and a huge Russian trade surplus?







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