
July 19, 2022

# Macro Weekly – Summer edition I

**July 2022**


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

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

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

Highlights

The world around us

The Norwegian economy

Market charts & comments

# Past two weeks, part I

- **The War/Sanctions**
  - » Russia is slowly conquering ground in the East Ukraine. Will the Russian continue? If not, real peace negotiations may start. Discussions on wheat exports from the Ukraine continues – and wheat prices have fallen sharply
  - » **Most other commodity prices** fell further last week –and they have been on the retreat since March/April. A bleaker growth outlook and probably less hoarding may explain the decline in prices. However, while European natural gas prices fell last week, they are still elevated. Yesterday's force majeure message from Gazprom vs. gas deliveries via Nord Stream 1 may signal that Russian gas will not start flowing as normal after the planned maintenance pause (should be finished by Thursday this week). If so, a further increases in European gas and electricity prices are likely
- **Services & composite PMI**
  - » The steep lift in the **Chinese** PMIs after the lockdowns lifted the global PMI in June – but other **Emerging Markets** also contributed. The decline in the **rich part of the world** was smaller than initially reported. In sum, the **global PMI** rose, but the underlying trend is down, at least in the rich part of the world
- **Global auto sales**
  - » **Sales** rose sharply in June, thanks to a big lift in sales in **China**, to 34% <u>above</u> the 2019 level (and sales were the highest in any country in a single month, by far). Sales rose in both **US** and the **EMU** too, but sale here are still low, 23% and -36% <u>below</u> the 2019 level resp. Sales in **Emerging Markets X China** are recovering, even if sales in **Russia** are down 92% since before the war started. **Global sales** are 7% below the 2019 level (which was not that impressive). Production is still below a normal level, except for China and South Korea – and lack of supply is no doubt hampering sales most places
- **China**
  - » **GDP** fell by 10% in Q2 (-2.6% not annualised), and was down 0.4% y/y, the latter 0.8 pp weaker than expected. The lockdowns were an economic disaster
  - » **June data were mixed**: Retail sales, housing has not recovered after the lockdowns. More policy stimulus under way
    - ▪ **Exports** are very strong, up to ATH, also in volume terms, well above expectations. **Imports** are still on the weak side
    - ▪ **Industrial production** is back on track, but slightly lower than expected. **Service sector production** rose sharply in June but is still below par
    - ▪ **Retail sales** remain weak, no recovery after the lockdowns – but annual growth was higher than expected (due to a data revision)
    - ▪ **Investments in total** are also back on track, but **housing starts** are still falling – and they are down 50% since early 2021, the largest decline, ever. **House prices** are falling too, both for new and existing homes
    - ▪ **Credit growth** remained at a normal level in June, and growth has accelerated somewhat recently – however just due to a strong growth in local government borrowing, probably not a sign of real economic strength
    - ▪ The central authorities have announced ambitious plans for a surge in **infrastructure investments** (6% of GDP is mentioned), funded by debt, including by local governments which will be allowed to borrow even more in H2 (the ol' trick, when growth slows).
    - ▪ **Fiscal policy** is already highly expansionary, due to a sharp decline in revenues (and not due to more spending)
    - ▪ **Inflation** remains muted, the headline at 2.5%, the core at 1.0%

# Past two weeks, part II

- **USA**
  - » Another disastrous **CPI** print, and market briefly discounted a 100 bps hike at the July 27 meeting. Expectations have moderated, and down they are back to a 75 bps hike in late July – with another (and the 3rd) 75 bps hike in September as the most likely outcome. Headline inflation at 9.1% (1.3% m/m) and core at 5.9% (0.7% m/m) were not good news. Some prices are moderating but the big picture is still a broad surge in inflation with a price increases for large majority of goods and services above 5% - even if energy and food prices are important too
  - » The **PPI** also reported higher inflation than expected, but core crude good prices are easing. So are energy and (commodity) food prices, and peak inflation is probably at hand now, at least in the US
  - » However, we still think **wage inflation** is far more important than energy/food/commodity prices – they will come down. **Atlanta Fed median wage tracker** was a disaster in June, up 7.4 y/y – and even the 3 m avg at 6.7% is well above anything seen before. The no. of unfilled vacancies have peaked, but remains at an extremely high level. In the **non-farm payrolls** report, wage inflation has moderated somewhat
    - ▪ We do not think it is likely that wage inflation will decline substantially without large decline in demand for labour. Employment is still on the way up and unemployment has not inched upwards (but weekly new jobless claims have increased visibly, and a recession warning is sent). There are other signs of weakness in the economy too:
  - » **Retail sales** of goods (volumes) are heading downwards, and are not far above the pre-pandemic trend, and manufacturing production has fallen the past two months (as surveys have weakened, at least until an upbeat NY Fed July survey
  - » **Manufacturing production** has been accelerating recent months, at least until last months. Surveys, like the ISM, are signalling a slowdown, not yet a downturn (except for the steep decline in the new order indices in June). The first July manufacturing survey, from the NY Fed, surprised at the upside
  - » **Homebuilders** reported an almost unprecedented decline in the Housing Market Index in July, just April-20 was even worse. A deep decline in housing starts is signalled (down 50% from the local peak in early 2022). That's of course a very recession-like figure
  - » **Small businesses** in general are extremely pessimistic, and now some more companies are reporting poor sales/competition as problem. Even so, they the share of companies that complain about demand is very low, companies are not able to fill job openings, and they plan to lift wages and prices in an unusually aggressive way
  - » **Fed's beige book** (regional network) was on the soft side, and confirmed somewhat weaker demand, an even somewhat easing of wage an price pressures
  - » **Atlanta Fed's GDP** nowcaster signals a 1.5% decline in GDP in Q2, following the 1.6% setback in Q1. Economist bet on a positive 0.8% growth rate

# Past two weeks, part III

- **Norway**
  - CPI inflation in June was higher than expected, at least the headline at 6.3% but the core at 3.6% was higher than Norges Bank assumed in the June MPR. Domestic inflation is picking up steam, and it is broadening. Electricity prices are still on the way up (but subsidies covers most of the costs for households), but gasoline prices have probably already peaked, as abroad
  - **House prices** rose further in June, and more than Norges Bank (and we) expected. The inventory of unsold homes is emptied. But higher mortgage rates will soon bite (or more precise: they will be hiked until they bite)
  - **Building costs** rose further in June, but growth is rapidly slowing. Both lumber and steel prices fell – and substantial price cuts in material prices are now underway and demand is slowing and supply is strengthening
  - **Mainland GDP** fell by 0.2% in May, due to a steep decline in manufacturing production (chemicals, refined products the main laggards). Underlying GDP growth is slowing both due to demand and supply side factors but the post-pandemic recovery is still intact
  - **Interest rate expectations** have shot up, and the 3 m NIBOR was fixed at 2.11% yesterday, up from below 1.7% in early July! The market is discounting 50 bps hikes in NoBa's signal rate in both August and September and further 'single' hikes in November and December. We think that's a bit too aggressive (But the Canadian central bank hiked the signal rate by 100 bps two weeks ago)

# The Calendar, week 29: Prelim. July PMIs, US housing. And the first ECB hike

| Time | Count. | Indicator | Period | Forecast | Prior |
|---|---|---|---|---|---|
| **Tuesday July 19** | | | | | |
| 08:00 | NO | Housing Starts | May | 6.7% | 6.8% |
| 08:00 | UK | Average Weekly Earnings | May | 6.7% | 6.8% |
| 11:00 | EC | CPI YoY | Jun F | 8.6% | 8.1% |
| 11:00 | EC | CPI Core YoY | Jun F | 3.7% | 3.7% |
| **14:30** | **US** | **Housing Starts** | **Jun** | **1595k** | **1549k** |
| **14:30** | **US** | **Building Permits** | **Jun** | **1680k** | **1695k** |
| **Wednesday July 20** | | | | | |
| 06:00 | SW | House prices | Jun | | |
| 08:00 | UK | CPI YoY | Jun | 9.3% | 9.1% |
| 08:00 | UK | CPI Core YoY | Jun | 5.8% | 5.9% |
| 16:00 | US | Existing Home Sales | Jun | 5.40m | 5.41m |
| 16:00 | EC | Consumer Confidence | Jul P | -24.5 | -23.6 |
| **Thursday July 21** | | | | | |
| 08:00 | NO | Industrial Confidence | 2Q | (4) | 8.8 |
| **14:15** | **EC** | **ECB Deposit Facility Rate** | **Jul-21** | **-0.3%** | **-0.5%** |
| 14:30 | US | Philadelphia Fed Business | Jul | -0.5 | -3.3 |
| 14:30 | US | Initial Jobless Claims | Jul-16 | 240k | 244k |
| 16:00 | US | Leading Index | Jun | -0.50% | -0.40% |
| **Friday July 22** | | | | | |
| 02:30 | JN | Manufacturing PMI | Jul P | -- | 52.7 |
| 08:00 | UK | Retail Sales Inc Auto Fuel MoM | Jun | -0.2% | -0.5% |
| 09:15 | FR | Manufacturing PMI | Jul P | 51.0 | 51.4 |
| 09:15 | FR | Services PMI | Jul P | 52.9 | 53.9 |
| 09:30 | GE | Manufacturing PMI | Jul P | 51.0 | 52.0 |
| 09:30 | GE | Services PMI | Jul P | 51.4 | 52.4 |
| **10:00** | **EC** | **Manufacturing PMI** | **Jul P** | **51.0** | **52.1** |
| **10:00** | **EC** | **Services PMI** | **Jul P** | **52.0** | **53.0** |
| **10:00** | **EC** | **Composite PMI** | **Jul P** | **51.0** | **52.0** |
| 10:30 | UK | Manufacturing PMI | Jul P | 52.0 | 52.8 |
| 10:30 | UK | Services PMI | Jul P | 53.4 | 54.3 |
| **15:45** | **US** | **Manufacturing PMI** | **Jul P** | **51.5** | **52.7** |

- **Preliminary PMIs**
  - » **Both manufacturing & services** are expected down some 1 p to the 51-52 level in both EMU, UK and in the US. The direction has been down recent months, and the margins to less favourable times are not wide anywhere in the rich part of the world
- **USA**
  - » **Housing** is on the way down, normally one of the best indicators of a recession around the corner. Yesterday, homebuilders reported an almost unprecedented collapse in their Housing Market Index (just Apr-20 was even worse). Housing starts and existing home sales out this week
- **EMU**
  - » **The first** hike from the ECB is a done deal. Consensus is for a 25 bp hike, which also has been signalled from the ECB leadership
- **Sweden**
  - » Check out **Swedish house prices**, they will probably continue downwards
- **Norway**
  - » Just **SSB's quarterly manufacturing survey** (which though says a lot about GDP growth, corporate earnings etc

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

# The Calendar, week 30: Another 75 bps Fed hike. US & EMU GDP. EMU CPI. Norw. unempl.

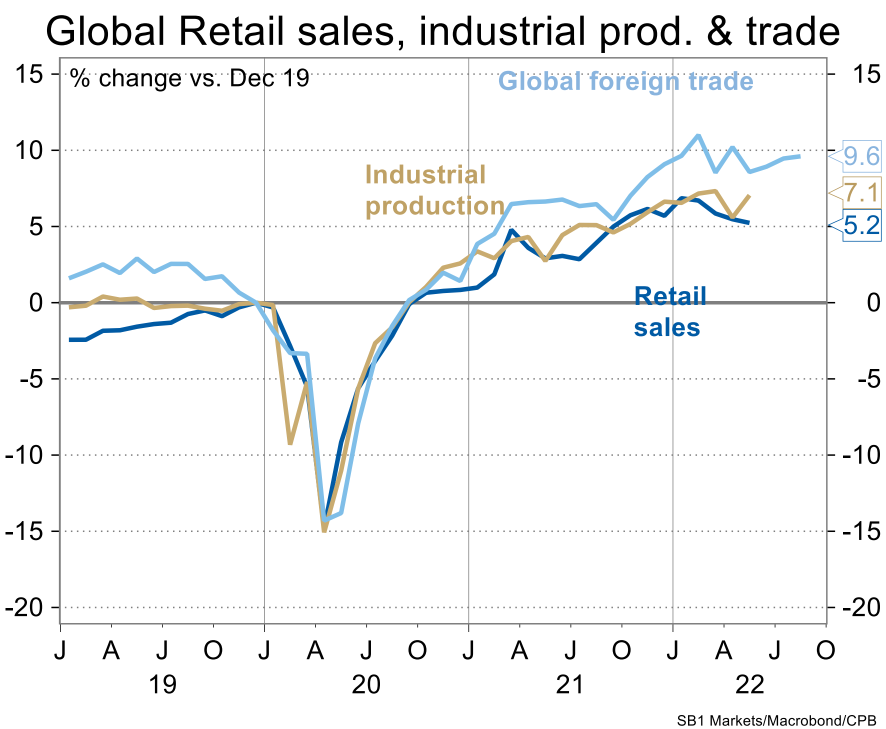
| Time | Count. | Indicator | Period | Forecast | Prior |
|---|---|---|---|---|---|
| **Monday July 25** | | | | | |
| 10:00 | GE | IFO Business Climate | Jul | | 92.3 |
| 12:00 | UK | CBI Business Optimism | Jul | | -34 |
| 14:30 | US | Chicago Fed Nat Activity Index | Jun | | 0.01 |
| 15:00 | US | S&P CoreLogic CS 20-City YoY | May | | 21.2% |
| 16:00 | US | Conf. Board Consumer | Jul | 99 | 98.7 |
| **16:00** | **US** | **New Home Sales** | **Jun** | **675k** | **696k** |
| **Wednesday July 27** | | | | | |
| 10:00 | EU | M3 Money Supply YoY | Jun | | 5.60% |
| 14:30 | US | Advance Goods Trade Balance | Jun | -$103.2b | -$104.3b |
| 14:30 | US | Durable Goods Orders | Jun P | 0.5% | 0.8% |
| 14:30 | US | Cap Goods Orders Nondef Ex Air | Jun P | | 0.6% |
| **16:00** | **US** | **Pending Home Sales MoM** | **Jun** | | **0.7%** |
| **20:00** | **US** | **FOMC Rate Decision (Upper** | **Jul-27** | **2.50%** | **1.75%** |
| **Thursday July 28** | | | | | |
| | GE | Retail Sales MoM | Jun | | 0.6% |
| **08:00** | **NO** | **Unemployment Rate AKU** | **May** | **(3.1%)** | **3.2%** |
| 08:00 | NO | No. of Employees | Jun | | |
| 08:00 | SW | GDP Indicator SA MoM | Jun | | 0.7% |
| 08:00 | SW | GDP Indicator SA QoQ | 2Q | | -0.4% |
| 08:00 | SW | Retail Sales MoM | Jun | | -0.6% |
| 09:00 | SW | Economic Tendency Survey | Jul | | 105.9 |
| 11:00 | EU | Economic Confidence | Jul | | 104 |
| 14:00 | GE | CPI YoY | Jul P | | 7.6% |
| **14:30** | **US** | **GDP Annualized QoQ** | **2Q A** | **0.8%** | **-1.6%** |
| 14:30 | US | Initial Jobless Claims | Jul-23 | | |
| **Friday July 29** | | | | | |
| 01:50 | JN | Retail Sales MoM | Jun | | 0.6% |
| 01:50 | JN | Industrial Production MoM | Jun P | | -7.5% |
| 07:30 | FR | GDP QoQ | 2Q P | | -0.2% |
| 10:00 | GE | GDP SA QoQ | 2Q P | | 0.2% |
| **11:00** | **EU** | **GDP SA QoQ** | **2Q A** | | **0.6%** |
| **11:00** | **EU** | **CPI Estimate YoY** | **Jul** | | **8.6%** |
| **14:30** | **US** | **Employment Cost Index** | **2Q** | **1.1%** | **1.4%** |
| 14:30 | US | Personal Spending | Jun | 0.7% | 0.2% |
| 14:30 | US | Real Personal Spending | Jun | | -0.4% |
| 14:30 | US | PCE Core Deflator MoM | Jun | 0.5% | 0.3% |

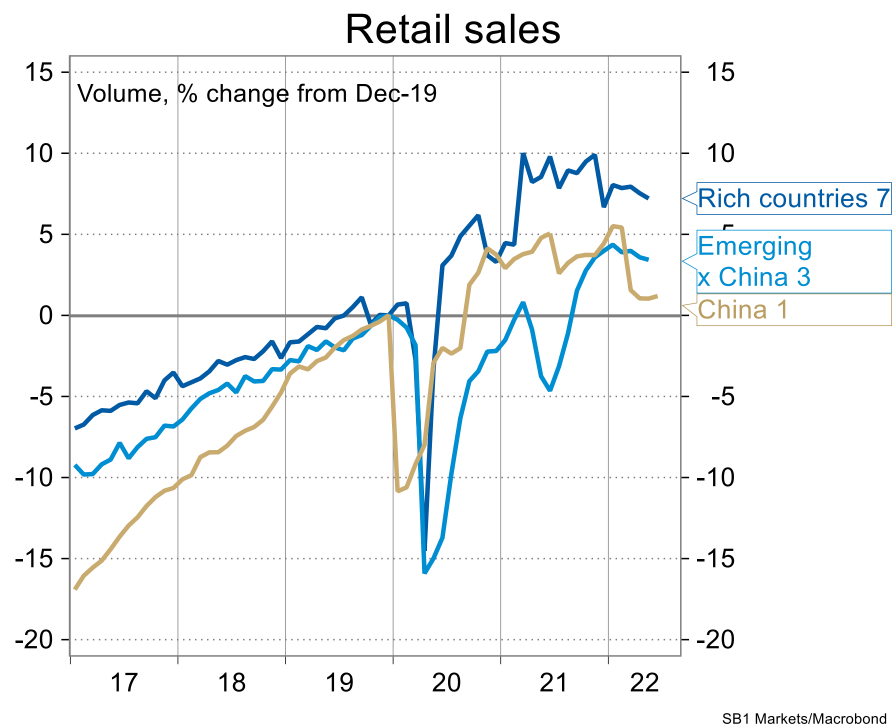
- **USA**
  - **The Fed Reserve** will lift the signal rate by another 75 bps, barring a stock market crash before the meeting
  - **GDP** is expected up by 0.8% in Q2. Nowcasters are all over the place. Atlanta Fed's gauge suggests a 1.5% decline, which seems rather pessimistic
  - **More housing data**: New home sales and house prices. Sales have fallen substantially already but prices are still on the way up (but these stats are lagging)
  - Perhaps the most important data point: **The Employment cost index**. A slowdown is expected in Q2
- **EMU**
  - **GDP** probably grew in Q2 but less than in Q1, 2.4% (0.6% not annualised)
  - HICP (CPI) inflation will remain at very high levels. Electricity prices rose further and core inflation is way above the price target (albeit far lower than in the US)
- **Norway**
  - **LFS unemployment** was revised up in April but the trend is down – and we expect a further reduction in May as demand for labour remains brisk

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

# Global manufacturing production up in May, thanks to China

… which lowered production sharply in April. Retail trade is trending down. China at the bottom



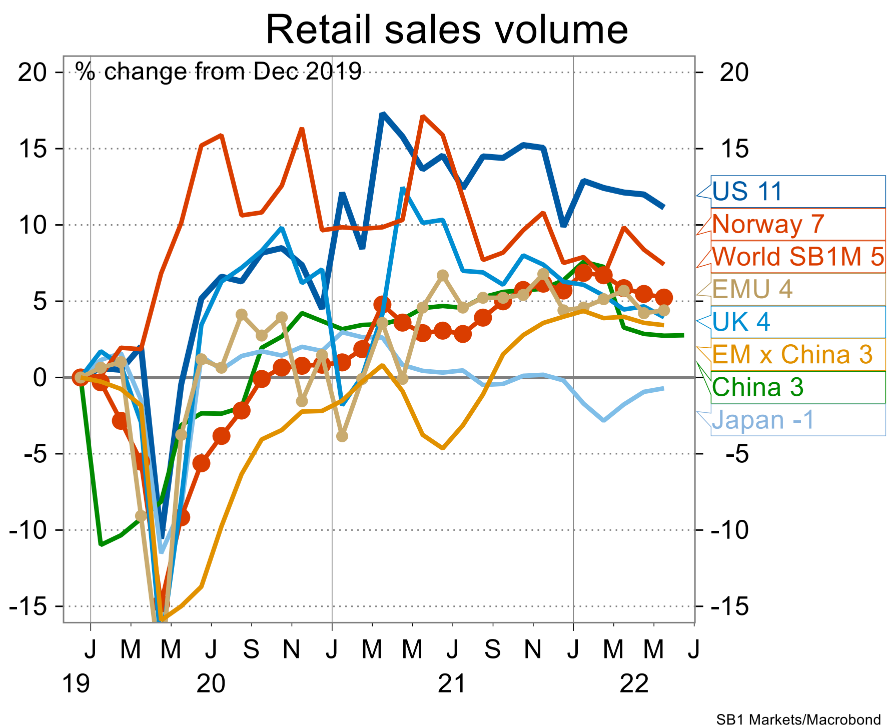



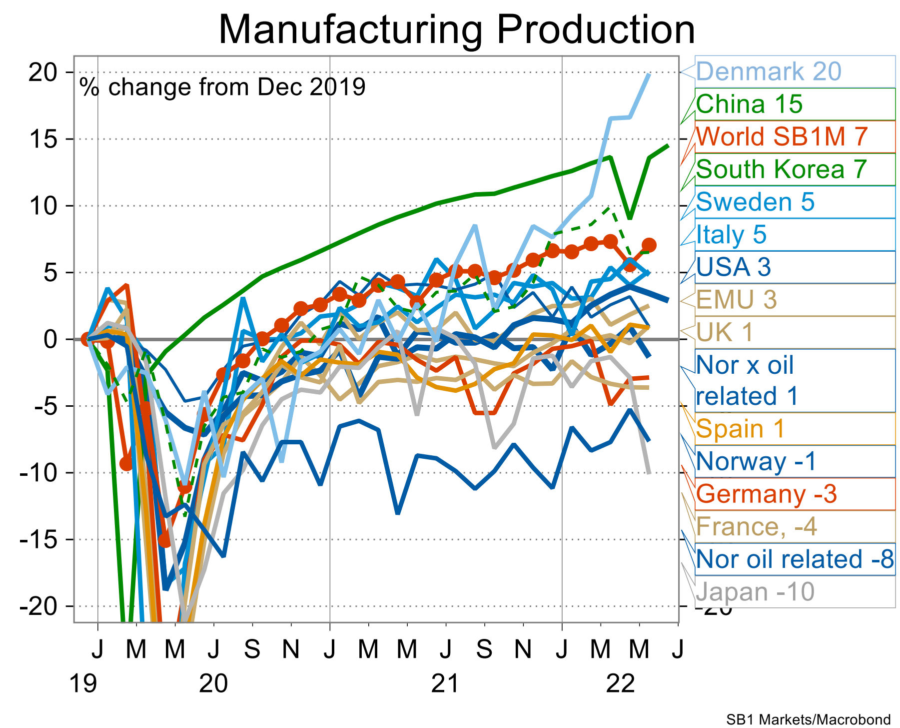

- Global foreign trade has flattened at high level since early 2022

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.

# The decline in retail sales is broad based.

## Manufacturing production is trending upwards – and is exposed?

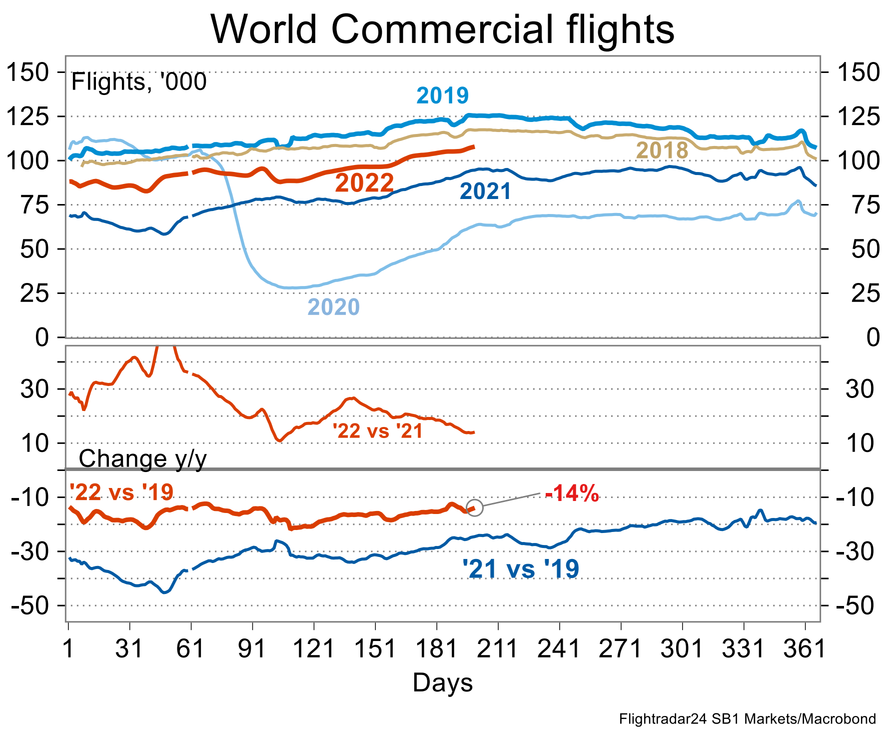


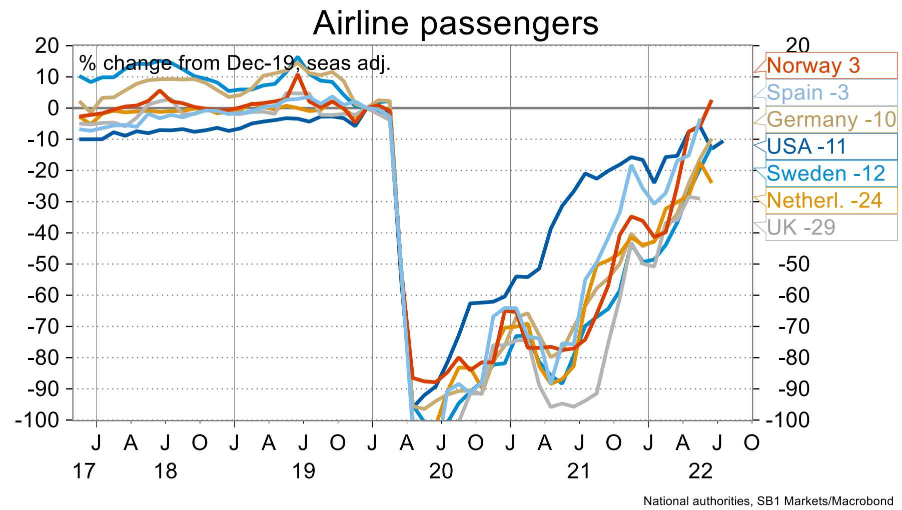



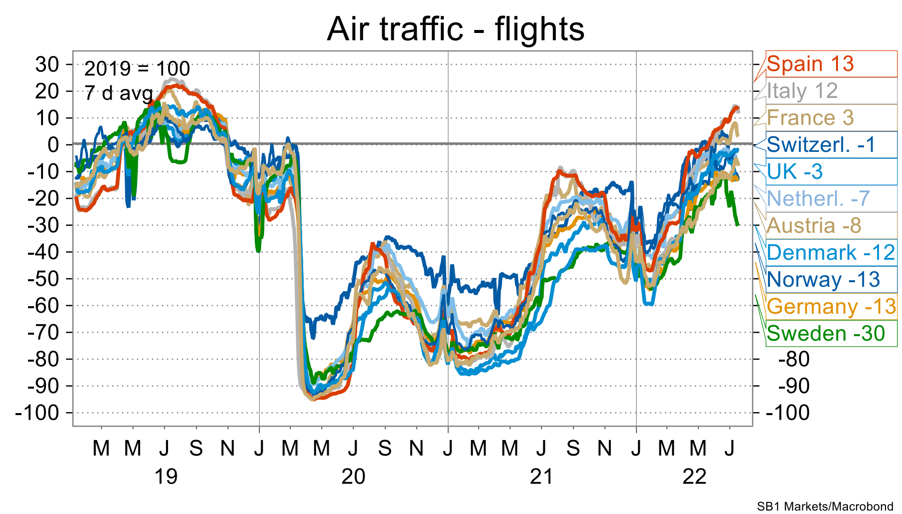
SpareBank 1 MARKETS

# Global airline traffic on the way up

and finally marginally more than the seasonal normal



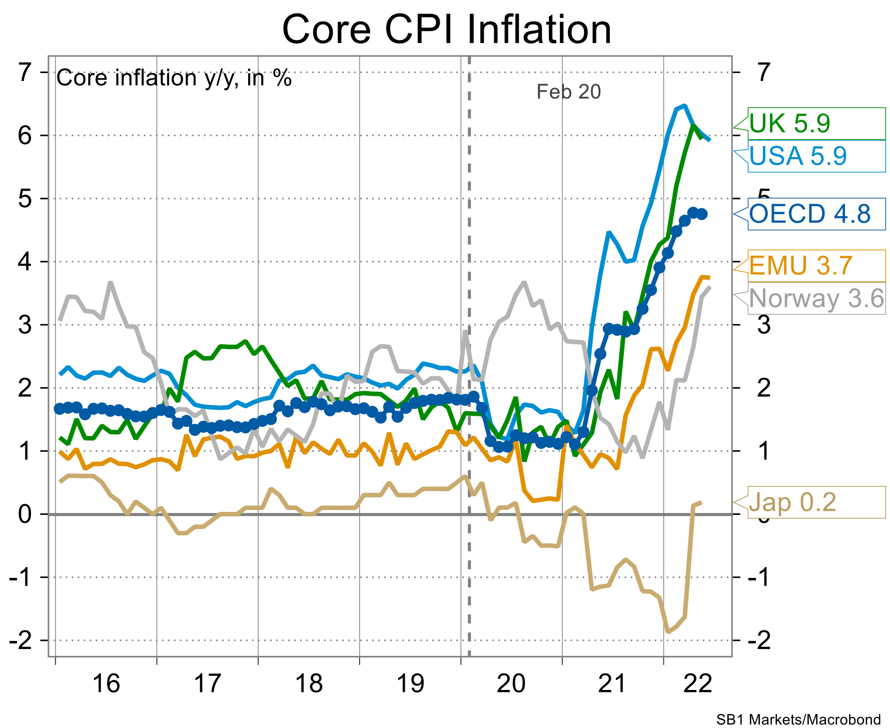



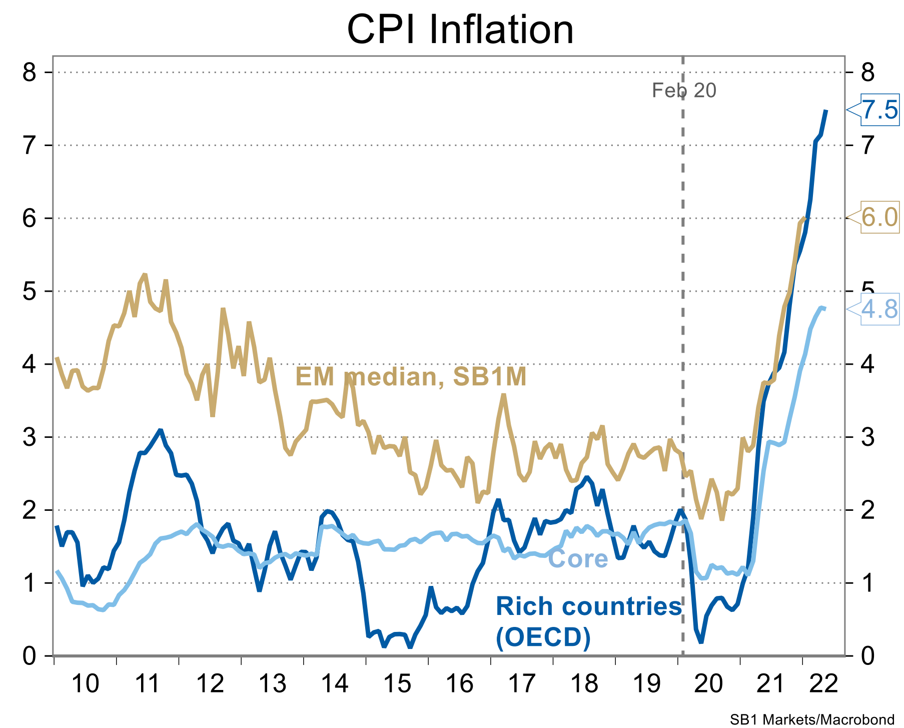




Global trade: The last months are estimates from Kiel Institute

# Inflation still the main challenge most places

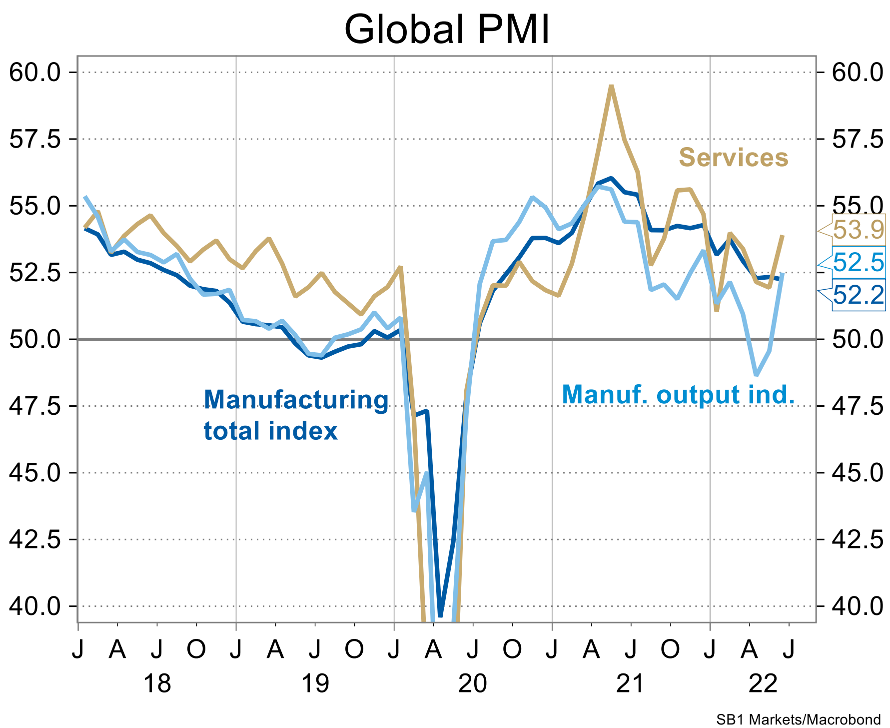
Energy prices the main culprit, but core inflation has turned up almost everywhere

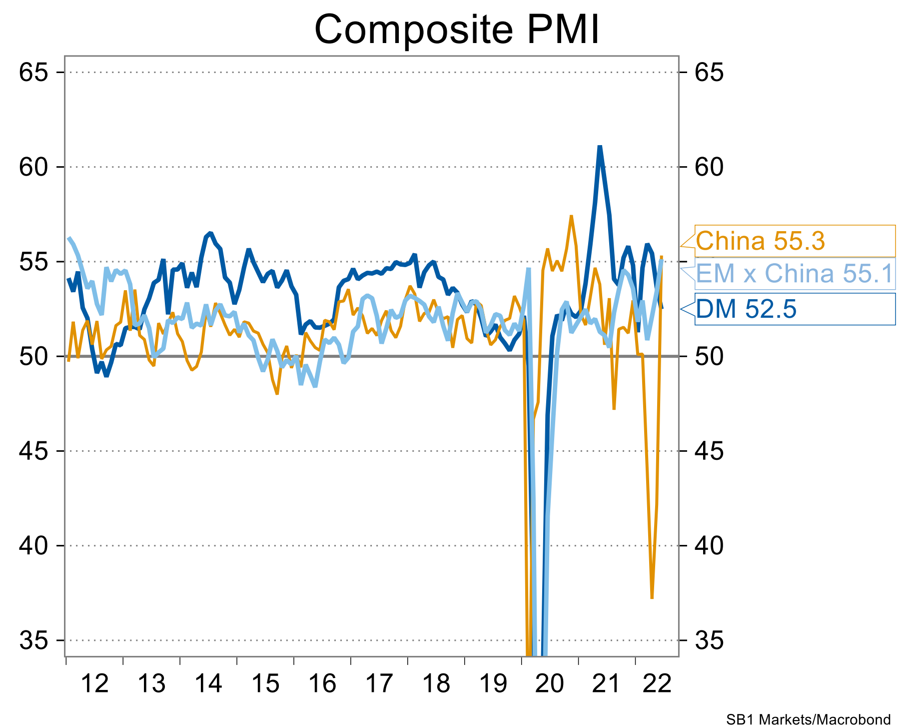


# China lifted both the manufacturing and the services PMIs, as did EM x China!

And the downturn in DM was smaller than the flash estimates indicated

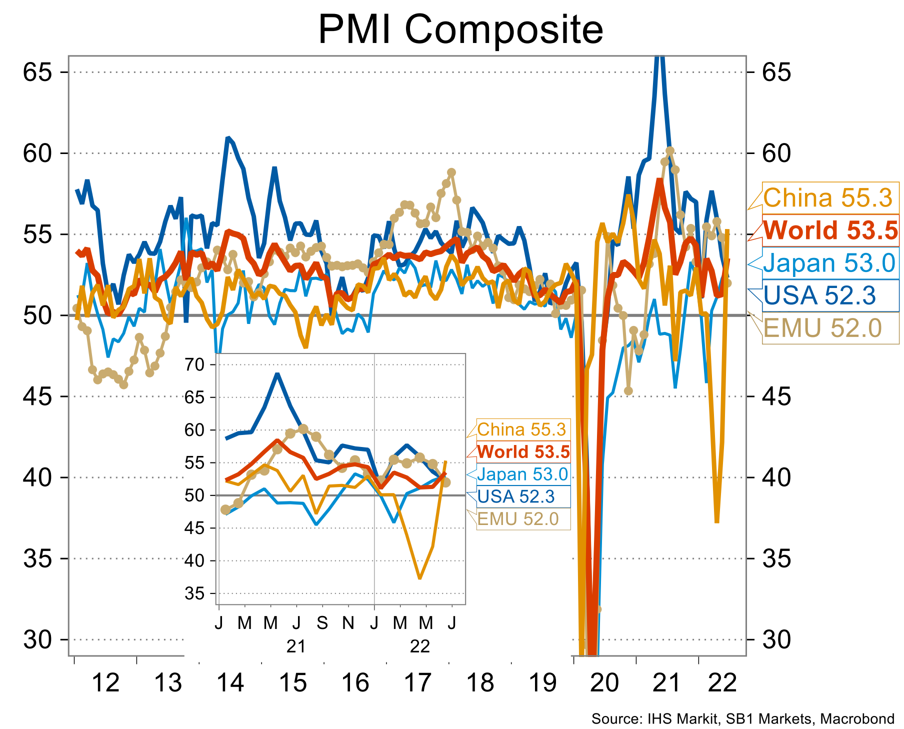


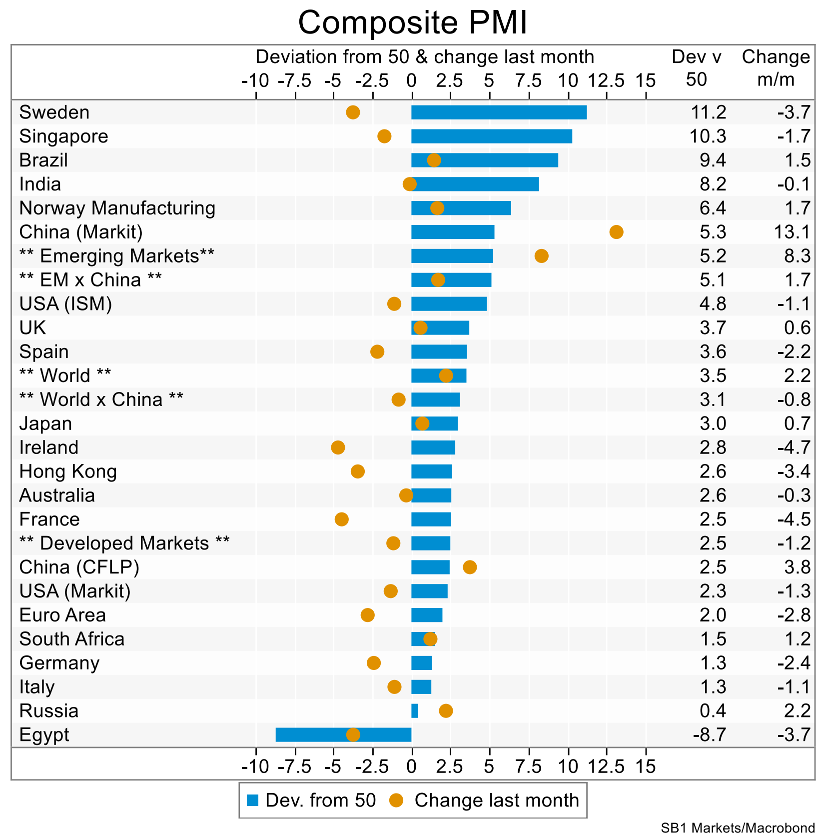




- Both manufacturing & services contributed to the uptick in the composite PMI

# The global PMI sharply up, even if the rich part of the world retreated

## The uptick in China is mostly 'technical' after the lockdown downturn

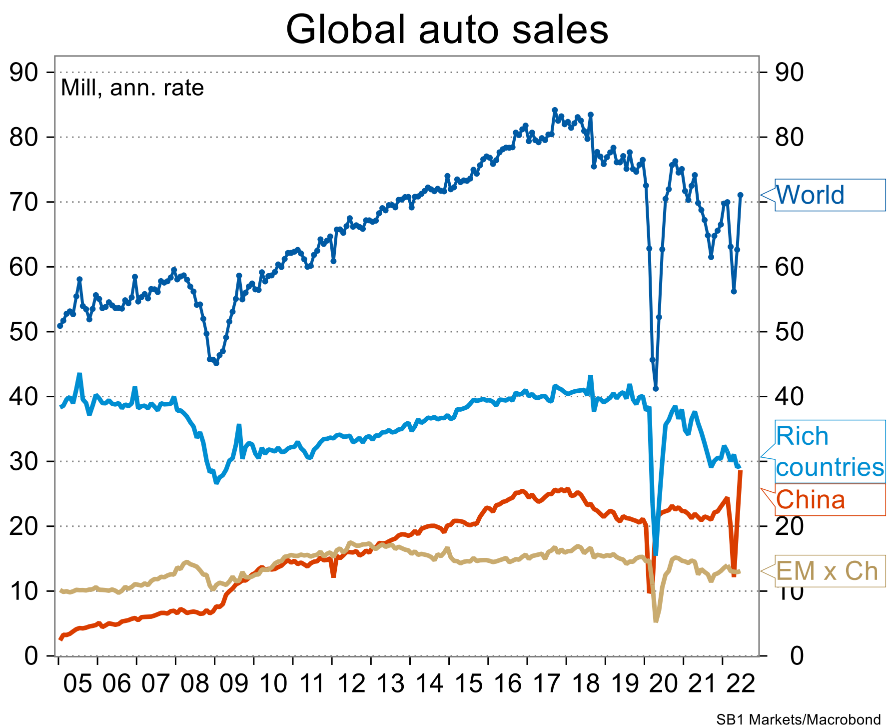


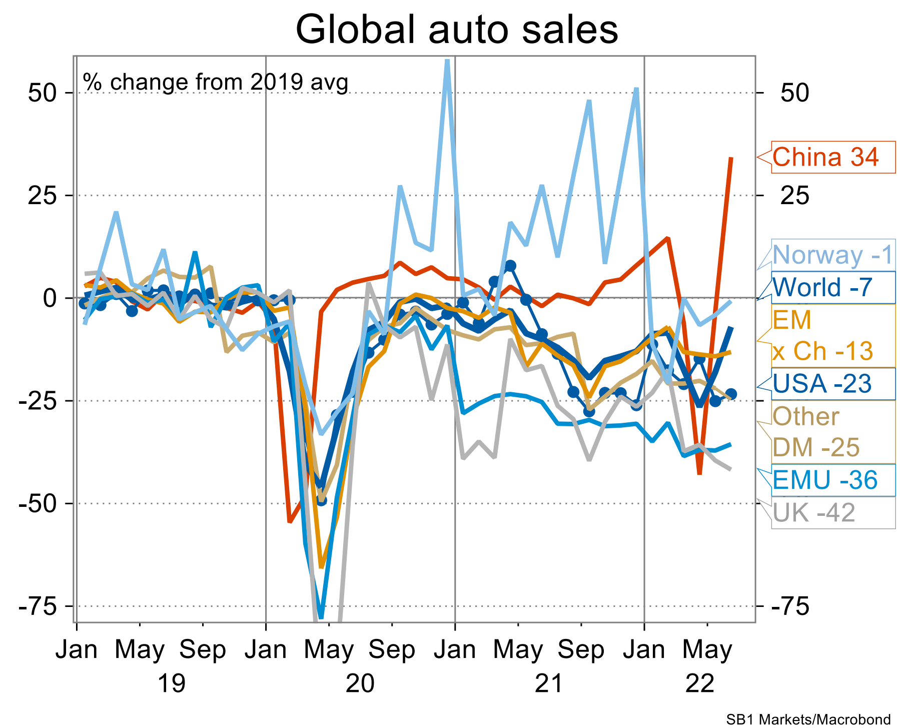




- 16 countries/regions down in May (from 14), and 11 up
- **Both China and Russia** contributed on the upside in June, as did Brazil
- **The rich countries (Developed Markets, DM) PMI** declined 1.2 p due to a decline in both EMU, UK and US
- **Sweden** still has the pole position, ahead of Singapore, and Brazil & India
- (**Norway** does not compete here, we just have a manufacturing PMI. The level would have yielded a 5th place in the composite race (from no. 10 in May)

# Chinese June auto sales the highest in any country, ever

## Sales were stable in the rich part of the world, and inched upwards in Emerging Markets x China



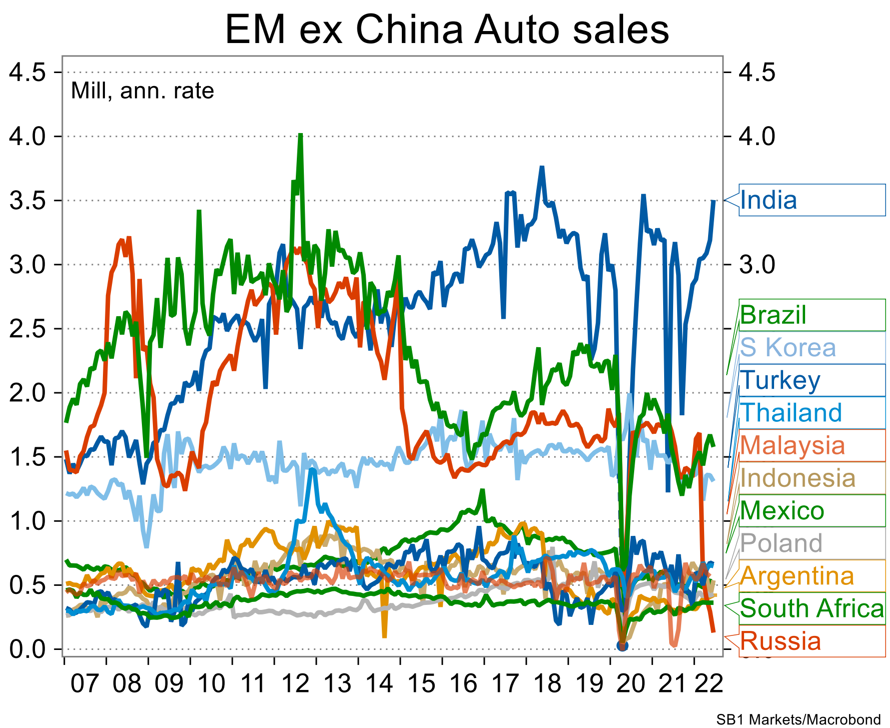



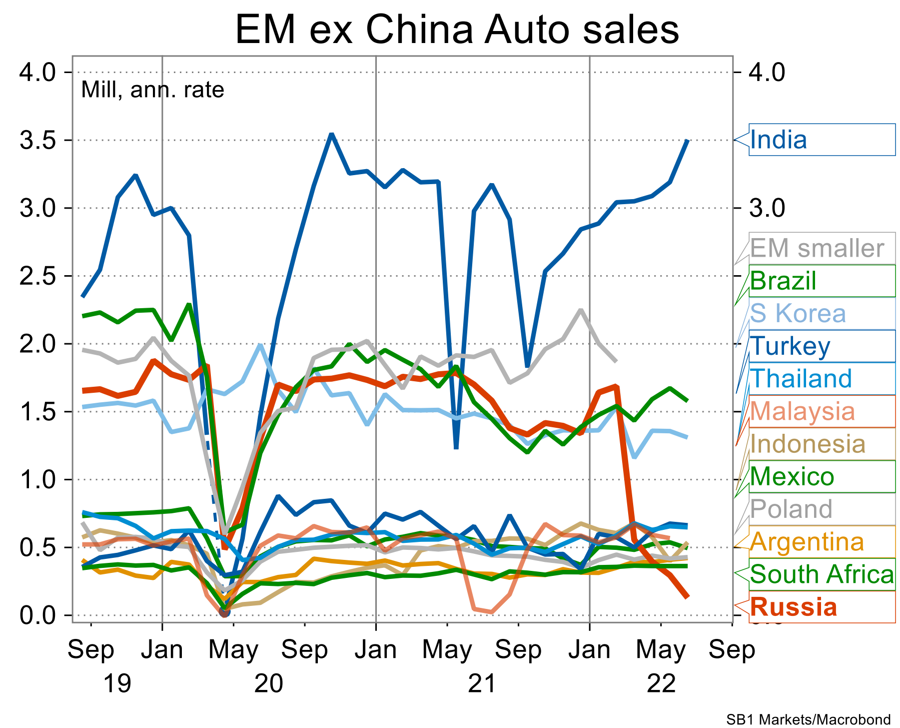

- **Global auto sales** rose 14% in June, thanks to a further recovery in sales in China, to 29 mill units (annual rate) from 21 mill in May. Global sales are still far below (-7%) the 2019 level – but even so the best since last May
- Sales in the **US** rose marginally to -23% vs 2019. **EMU** sales also rose marginally but remain 36% below the 2019 level. **UK** sales are down 42%! **Norwegian sales** are just 1% below the 2019 level
- **Russian sales** are down 92% since before the war, probably both due to lack of supply (imported cars at least) and reduced demand from households
- Still, **EM x China total** is down 'just' 13% vs. the 2019 level (the decline in Russia equals more than a 10 pp drag – and the rest is almost back!)
- **Auto production** is very likely limiting sales most places. However, Chinese production was 32% above the 2019 level in June. South Korea is also above the 2019 level, but auto production is well below a normal level in all western countries and in Japan

SpareBank 1 MARKETS

# EM: Russian sales further down, -92% vs the pre war level. India going strong

… at least according to prelim. Indian data. Other EM countries on the way up



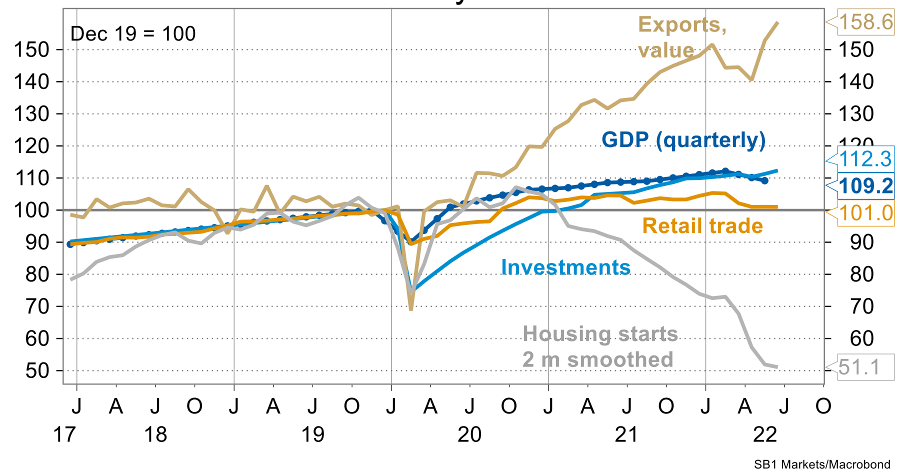




Not all countries have reported yet, and for some countries we have just plugged in figures from media reports that are not always correct

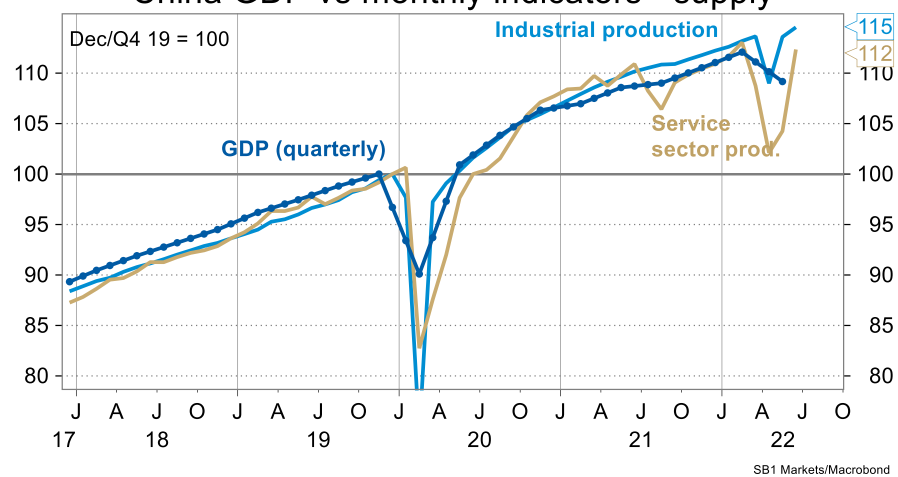
# GDP down 10% in Q2 (-2.6% not annualised). More infrastructure spending ahead

## June data mixed: Housing, retail still weak. Other investments, ind. prod, exports, credit OK

China GDP vs monthly indicators - demand




China GDP vs monthly indicators - supply

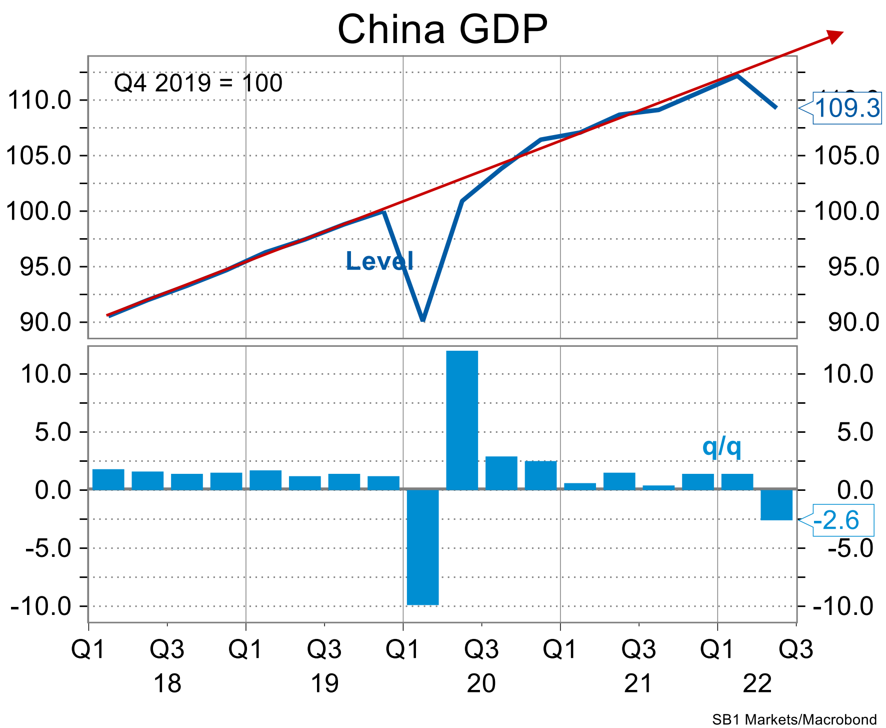


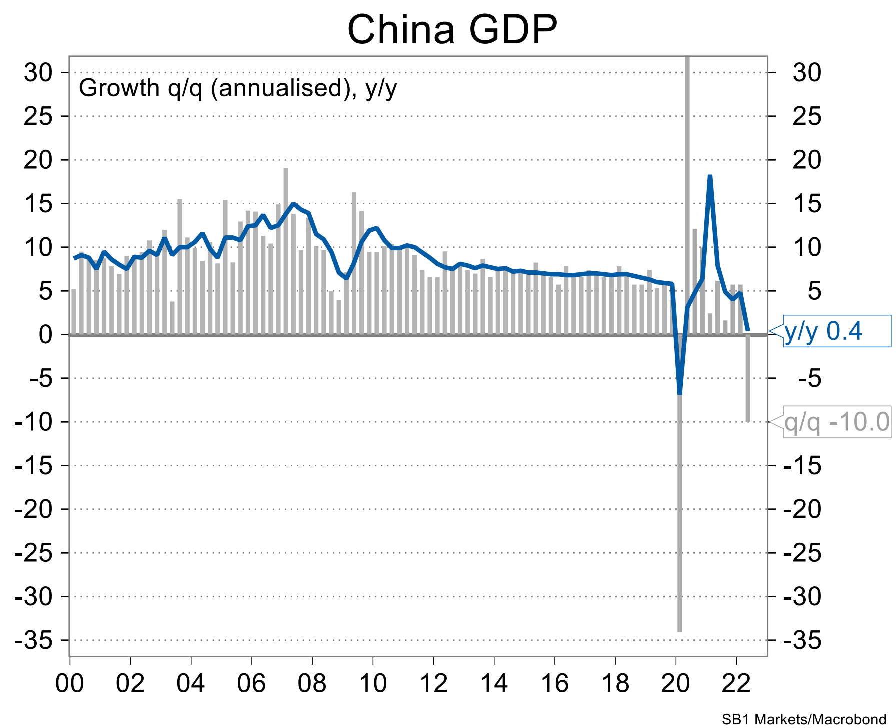

- **GDP** fell 10% in Q2, more than expected (8%, 2.6% vs 2% not annualised), and is up just 0.4% y/y, expected 1.2% - the second worst quarter ever
- **Industrial production** rose 0.8% in June (after 4.2% in May) and is back to the pre-lockdown trend, still marginally lower than expected, 3.9% vs. 4.0% y/y
- **Service sector production** gained 7.8% m/m in June but is still clearly below the pre-lockdown trend, and activity is up just 1.3% y/y – and Q2 was in sum really weak
- **Retail sales** remained close to unch m/m in volume terms in June, at a very low level. Sales were up 3.1% y/y nominally, below retail price inflation (and sales are down y/y in volume terms. Still, expectations were much lower, at just 0.3% y/y
- **Investments** rose 1% in June, and is back on track, even both residential and commercial construction starts has fallen by 50% from the peak early last year (the largest contraction ever), without sigs of any recovery - not even from the 25% drop in starts during the lockdown. However, new home sales have partially recovered after the lockdown, and are down 'just' 30% from the peak last year
- **Credit growth** remained at a normal level in June, but just due to a continued increase in local government borrowing
- **Central authorities** have decided that local governments can increase borrowing in H2 in order to fund infrastructure projects. A massive policy shift, in order to support growth like in the good ol' days. However most of the 7 trl infrastructure program (Bloomberg est, 6% of GDP!) must be funded from other sources than the 1.5 trl local gov. extra borrowing
- **CPI inflation** has increased somewhat, but remains low (2.5%),. especially ex. food & energy (1.0%)
- **Exports** rose to the highest level ever in June, even in volume terms, and to far above any recent trend paths. (No supply chain disruption?).
  **Imports** fell slightly, and remains somewhat below the pre-pandemic trend
- **Fiscal policy** is very expansionary (a 5% of GDP increase in the budget deficit), not due to higher spending, but a dramatic reduction in revenues

**In sum:** Q2 was an economic disaster, hopefully short-lived. However, June data are not impressive, just industrial production and total investments were back on track in June. The announced boost in infrastructure investments may strengthen domestic demand short term, but will probably not support growth long term due to lack of profitable projects and an ever higher debt level

# GDP down 10% in Q2 (2.6% not annualized), up just 0.4% y/y

## GDP fell

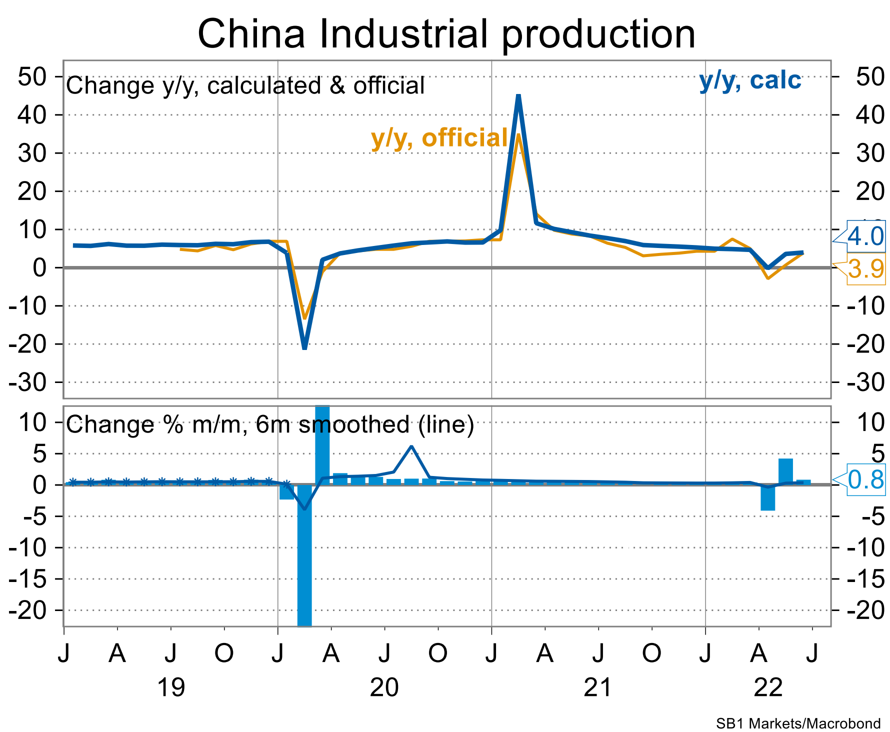


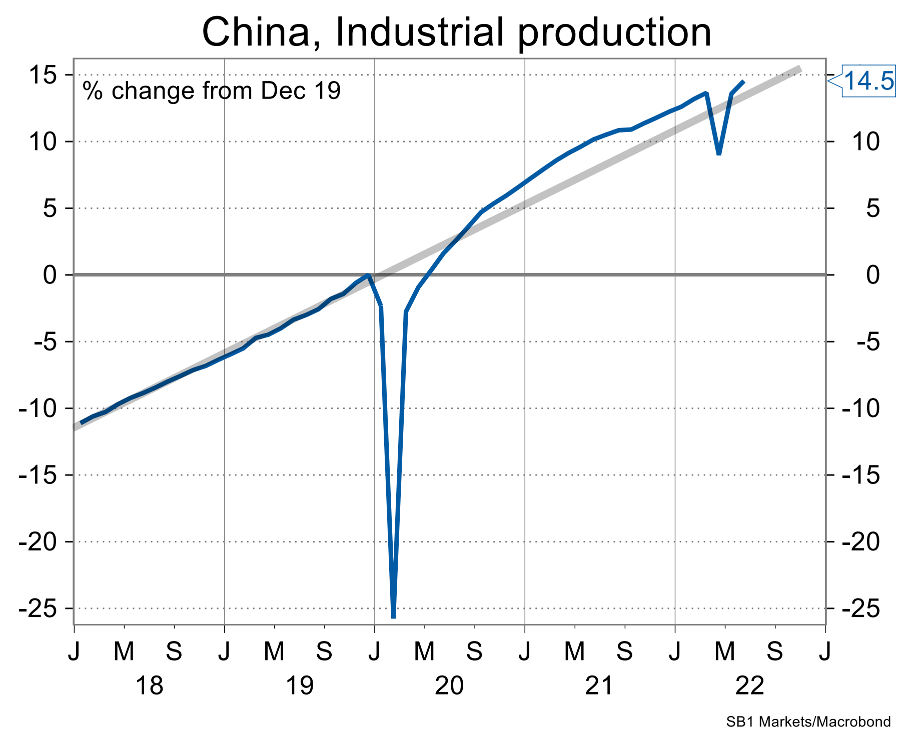




- GDP was 0.6 – 0.8% weaker than expected – but still just ¼ of the decline in Q1-20
- Consumption fell sharply in Q2, while net exports rose. Investments were close to unch

# Industrial production back on track after the lockdowns

Production rose by 0.8% m/m in June, following the 4.2% lift in May (after the 4.1% drop in April)

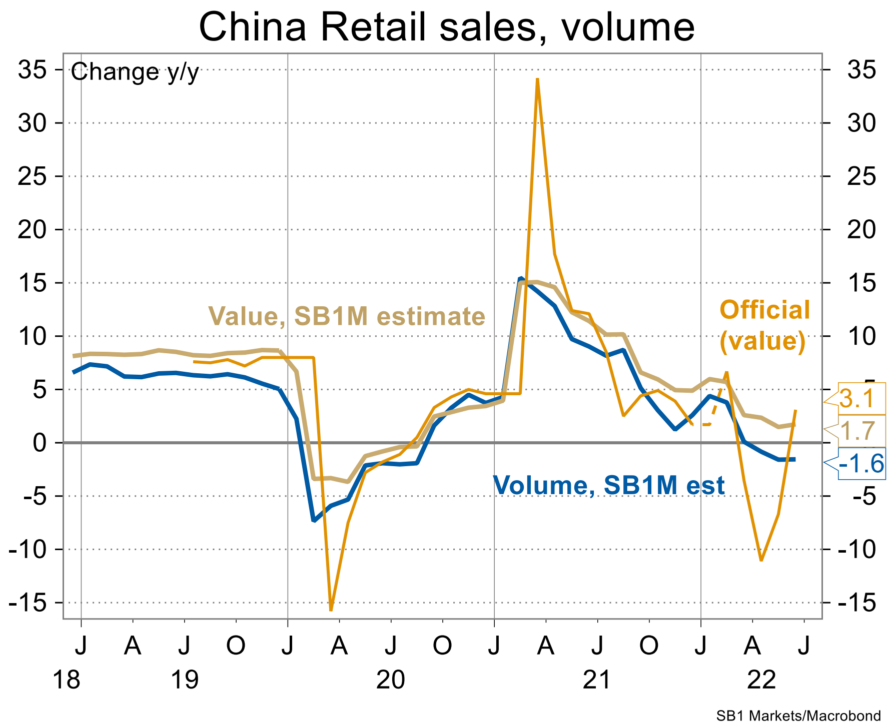



- **The production level** returned to the pre-pandemic trend path in May (grey line at the chart to the right) and was almost back to the pre-lockdown trend path as well in June
- **Production grew** 3.9% according to the official y/y data, 0.1 pp below expectations – and up from 0.7% in May

# Retail sales still very weak in June, no post-lockdown surge

## Nominal sales up 3.1% y/y, far better than expected (0.3%) but monthly data shows no recovery



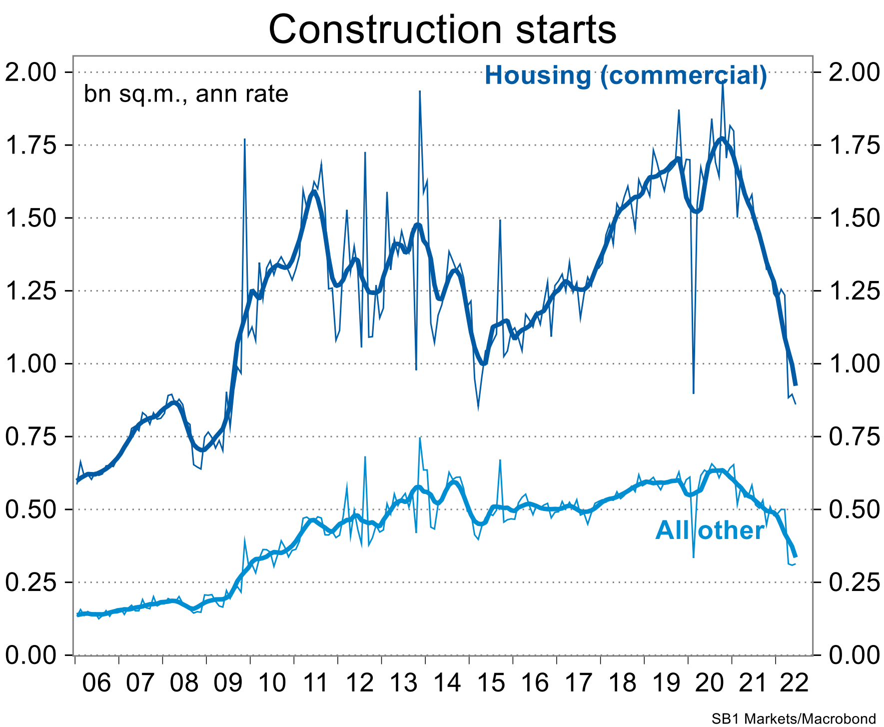


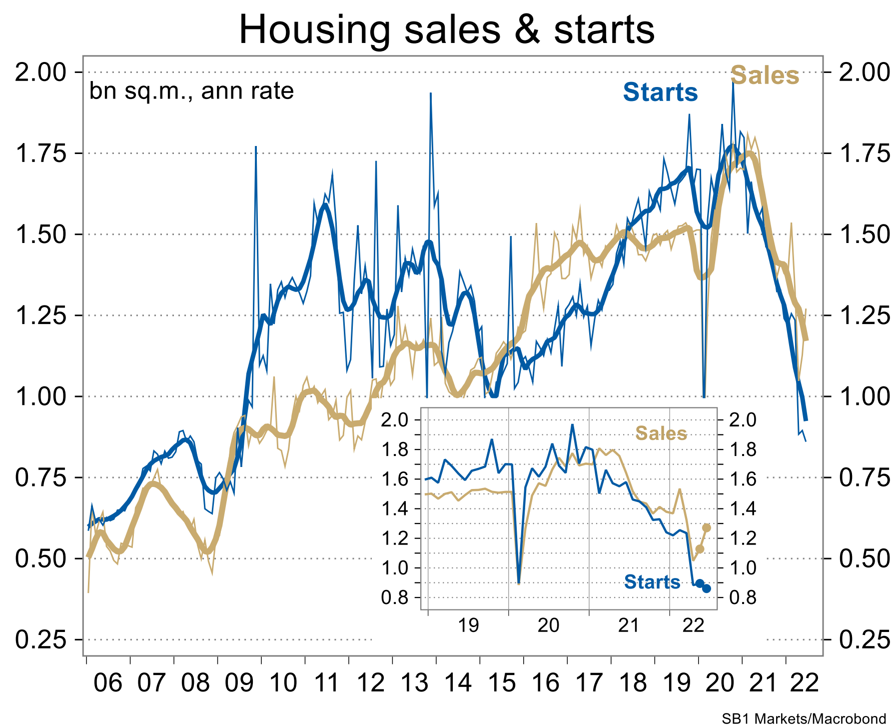
- Sales rose 0.6% m/m in **nominal terms** but retail prices also rose in June, and the **volume growth** was limited

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. Several revision, the last one this month upwards, has made the analysis even more complicated

# New home sales up 12% in June, still -10% vs pre-lockdowns. Starts further down

Sales are down 30% vs. the level in peak in early 2021. Starts are still falling, and are down 50%!!

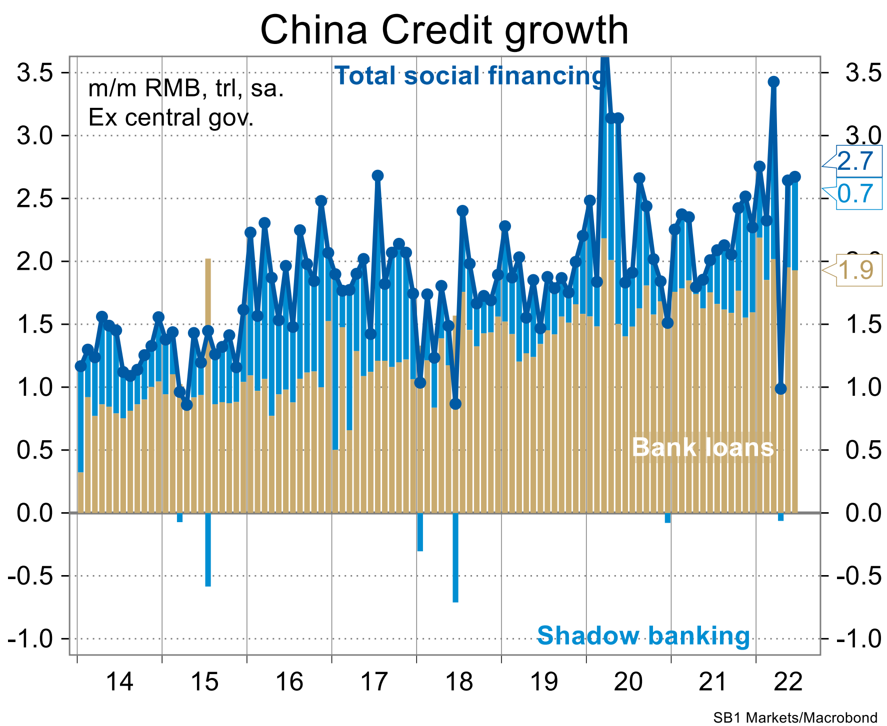


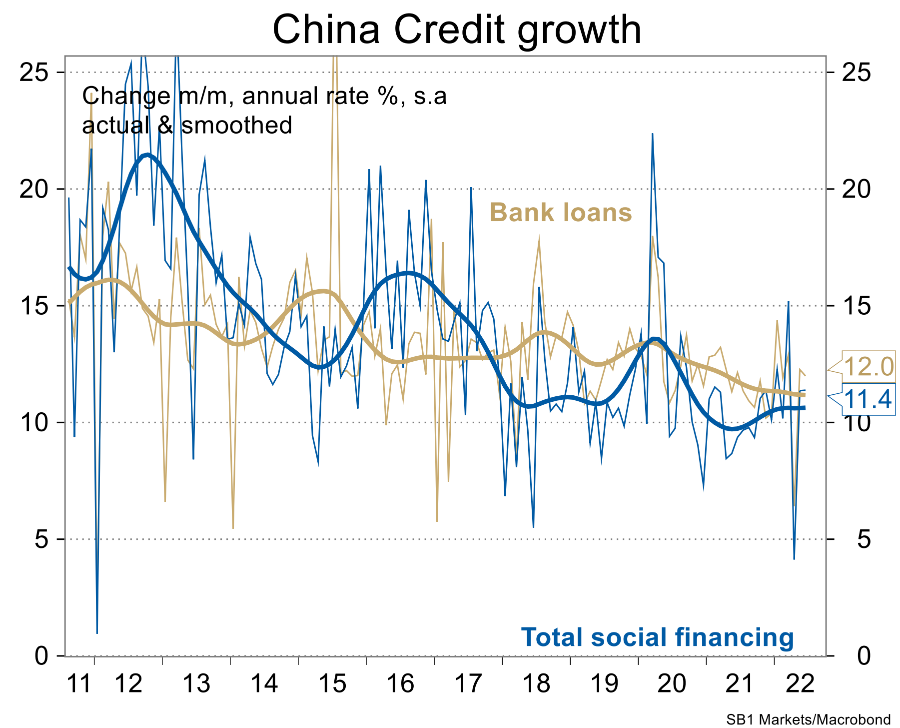




- **New home sales** rose 12% in June following the 10% lift in May (after the 30% collapse in April), but the level is still well below the pre-lockdown level – and 30% down from the peak early last year – and the lowest since 2015
- **Housing starts** fell marginally in June, and have not recovered at all since the lockdowns ended. Starts are cut in half since early 2021, the largest downturn ever! The level is the lowest since 2009!
- **Non-residential construction starts** are also cut in half – and has not recovered after the lockdowns – and the level is the lowest since 2009

# Credit growth on track in June too

Plans for a debt funded infrastructure investment boom may lift overall credit growth coming months

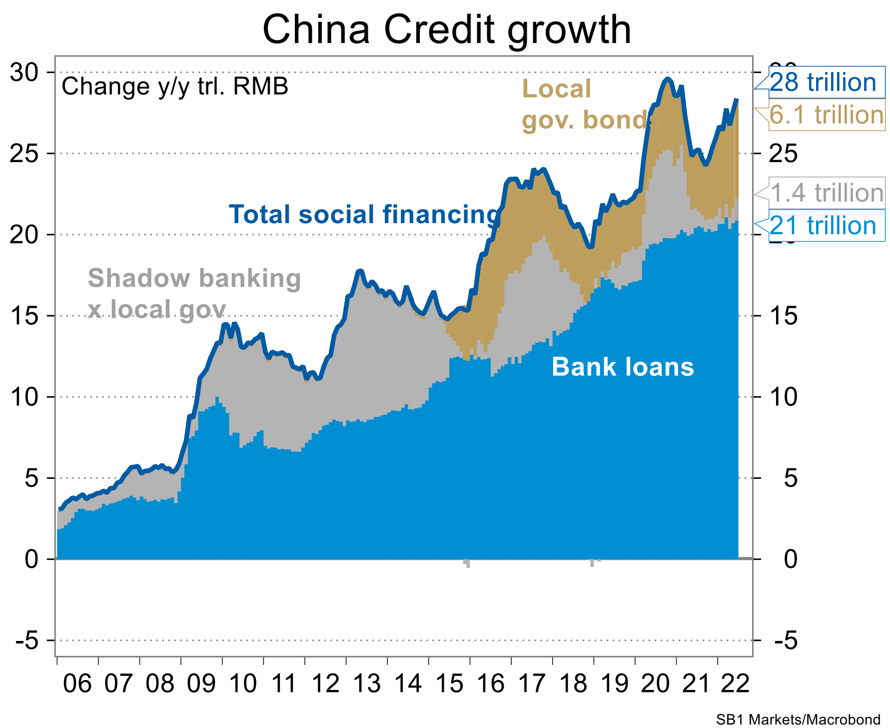


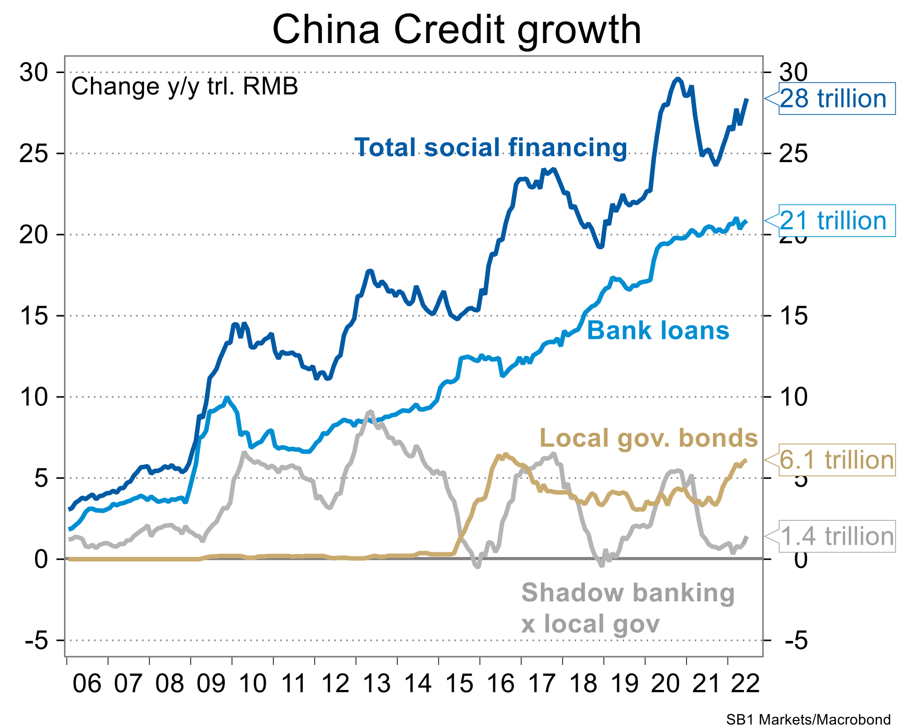




- **Total credit** grew at a 11.4% pace in June (m/m, seas. adj. annualised), unch from May. The annual rate gained 0.3 pp to 10.4%
- **Total credit** rose by RMB 5.1 trl, expected 4.1 trl (not seas. adj, a very low f'cast). The 'core' total social credit (total ex central gov bonds & corporate equites) grew by 4.0 trl (seas adj). The core was up 2.7 trl, seas. adj
  - » **Bank loans** rose by RMB 1.9 trl (or 1.9 trl s.a) or at a 12% annualised pace, marginally above expectations. Still, growth has been slowing since mid 2020
  - » **Shadow banking credit** rose by RMB 0.7 trl, and is up 8.7% y/y. **Local governments have been** responsible for most of the increase in credit outside banks recent months. Less revenues from sale of land, and public financing of unfinished building projects may explain the steep increase in debt (22% y/y, see more next page)

# Credit growth is accelerating but just due to more local goverm. bond issuances

Bank loans are flattening, and there is limited growth in credit outside banks (other than local gov)

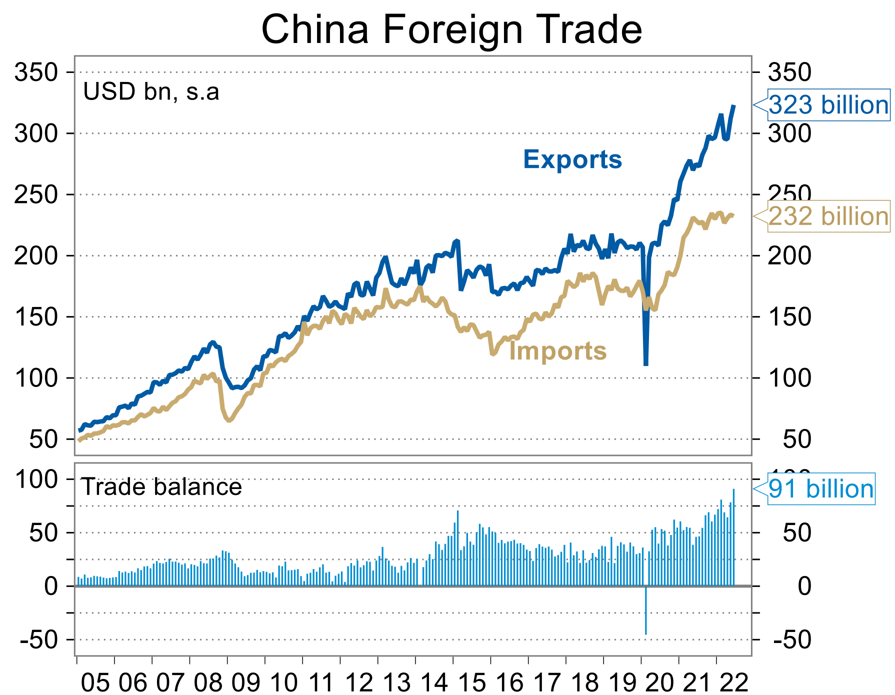


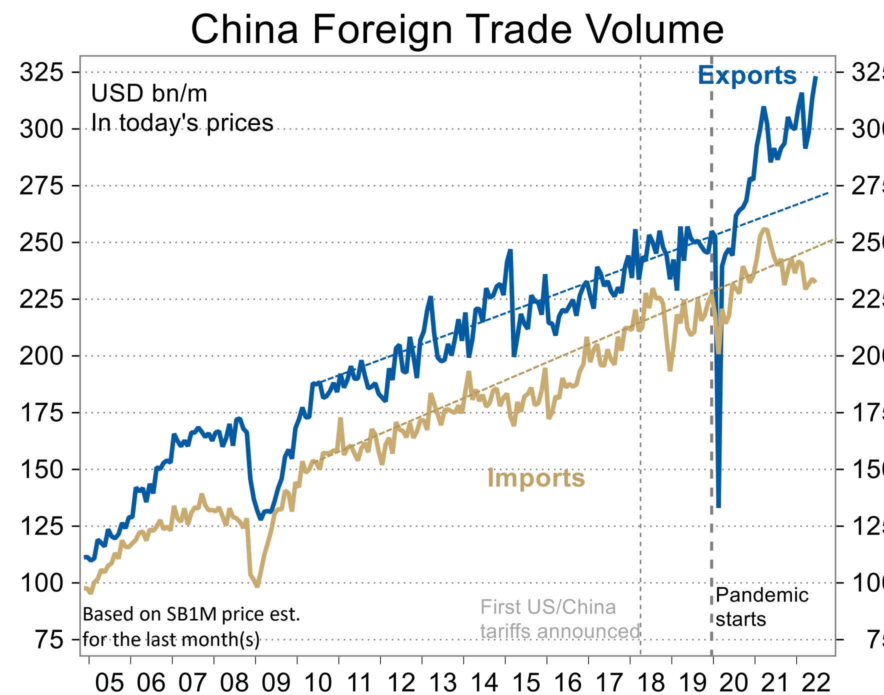




- Over the past year, **total credit** has expanded by RMB 28 trl, equalling more than 25% of annual GDP, up from the 24 trl at the bottom last Sept, (but still down from almost RMB 30 trl at the peak in 2020)
- **Banks** supplied RMB 21 trl of the y/y increase – and the rate has been almost flat since early last year, implying a gradual decline in the y/y growth
- **Local governments** have accelerated their credit growth, now up 6 trl – to 22% y/y from 13% y/y back in last September!
- Growth in other credit – via the **shadow credit market x local gov bonds** – has lowed to RMB 1 trl from 5 trl in 2020 (a dramatic slowdown, like many times before…). Growth has increased slightly the past two months

# A further lift in exports in June, even volumes up to ATH. Imports are sagging

## Exports gained 6% m/m, are 25% above the pre-pandemic level in volume terms

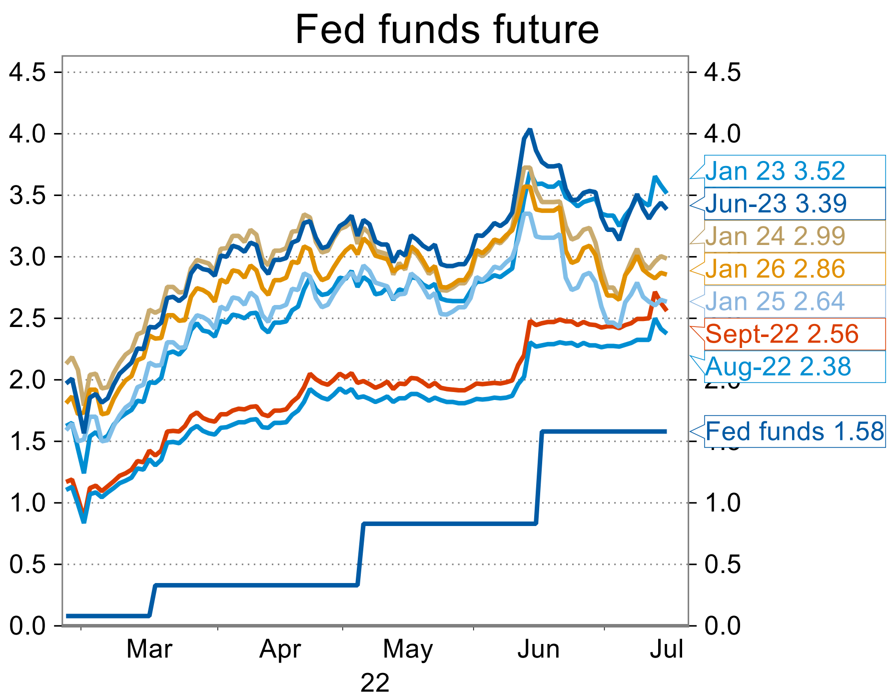



- **Export values** grew by 4% in (a strong) USD terms in June (our seas adj), and are up 18% y/y, from 17% in y/y in May, 6 pp better than expected. Exports are record high, both measured in value and volume terms! Export values are up more than 50% from before the pandemic**. Export volumes** are up 30%! Export volumes have survived the lockdowns. Is lack of supply the main reason for the surge in inflation (x food & energy)? *Dream on!*
- **Import** values fell 1% m/m in June, and are up 2% y/y, 2 pp below expectations. Import values are down 3% from the peak. In **volume terms** the decline in imports is far larger, by 10% - and by 6% since January, and the recovery since the lockdowns has been marginal. Imports volumes are below the pre-pandemic trend but not much vs. previous deviations from this trend
- The **trade surplus** at USD 97 bn, 22 bp larger than expected, and the highest ever. In seasonally adjusted terms, at USD 91 bn, or some 6% of GDP, the highest since 2008! Growth has become export led, again? At least partially as a higher trade surplus in goods have lifted GDP by some 2% since before the pandemic

SpareBank 1 MARKETS

# Fed's Beige book report somewhat slower growth, less price/wage pressures




SB1 Markets/Macrobond

USA Fed funds rate (OIS)

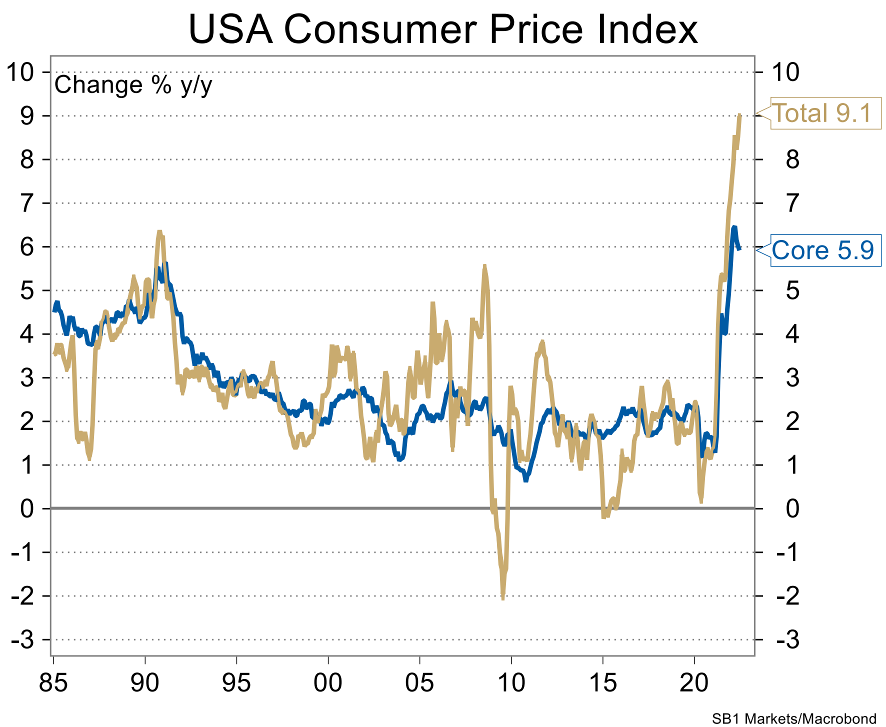
| FOMC meetings | Effective Fed funds rate (-0.5 0.5 1.5 2.5 3.5) | Last | Change last week |
|---|---|---|---|
| Now | | 1.58 | 0.00 |
| July 27 | | 2.36 | 0.05 |
| Sept 21 | | 3.00 | 0.13 |
| Nov 2 | | 3.36 | 0.09 |
| Dec 14 | | 3.52 | 0.05 |
| Feb 1 | | 3.55 | -0.01 |
| March 23 | | 3.52 | -0.06 |

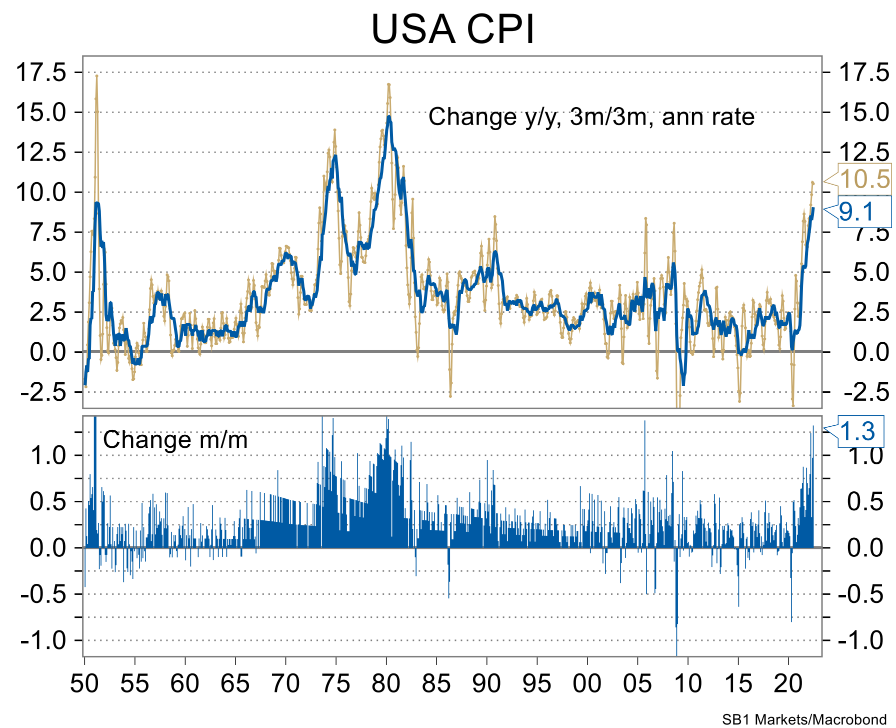
■ Last ● Change last week

- Main messages from the regional survey
  - » Growth everywhere, but several districts reported signs of slowdown in demand and a further slowdown was expected for the next 6 – 12 months. Some had been talking about the risk for a recession
  - » High inflation had made a dent in household demand
  - » Mixed activity in the manufacturing sector
  - » Demand for housing weakened noticeably
  - » The labour market was still very tight but nearly all districts noted modest improvements in labour availability (which not has been signalled by surveys) – and wage pressures were easing some places
  - » Inflation remained high but construction costs were coming down, and inflation were slowing for many other goods. However some sectors reported strong pricing power
- Taken face value, the Beige book confirms than growth is slowing, but not that the economy is a recession now
- The interest rate market has been volatile, and at one stage, after the June CPI report, a 100 bps lift in the signal rate at the July 27 FOMC meeting was discounted. Now 75 bps will be sufficient – but the likelihood for a 3rd 75 bps hike in September is still very high
- We think the Fed next week will reiterate both the need for bringing inflation down but at the same time recognising that the need for future hikes will be decided by incoming data. A 75 bps hike is a done deal (if the stock market does not crash)

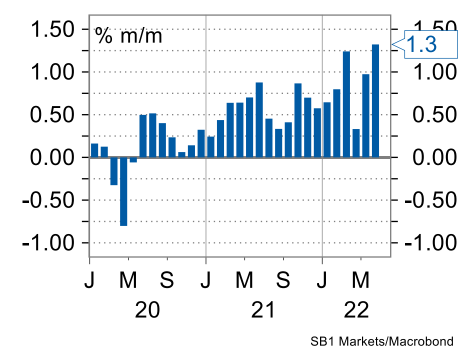
# Another inflation surprise: CPI up 1.3% m/m, core +0.7%. A 100 bps July hike?

## Inflation is broadening further. Fed has no choice but to lift the signal rate rapidly coming months



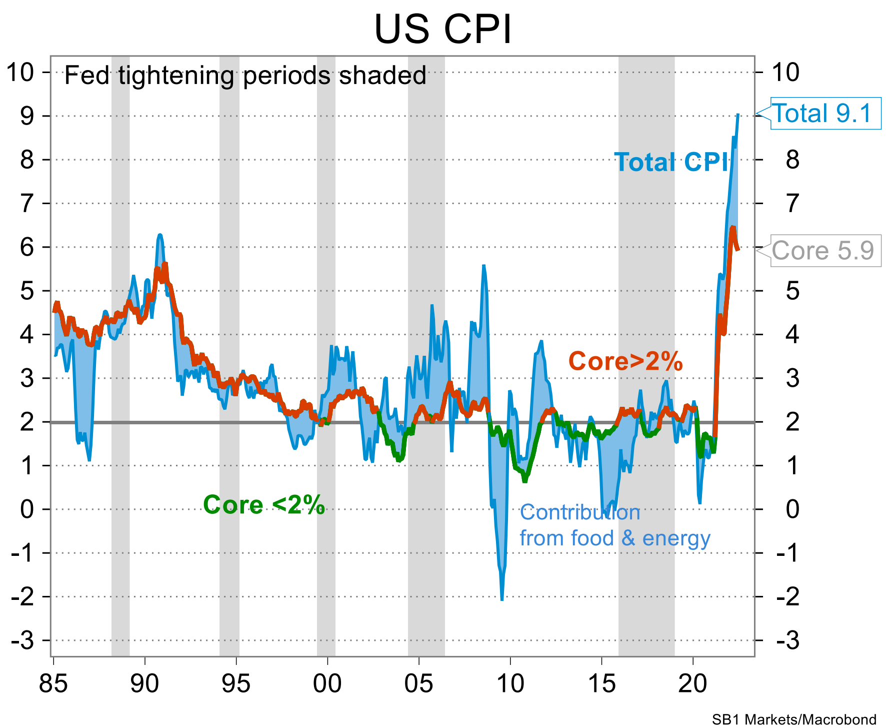



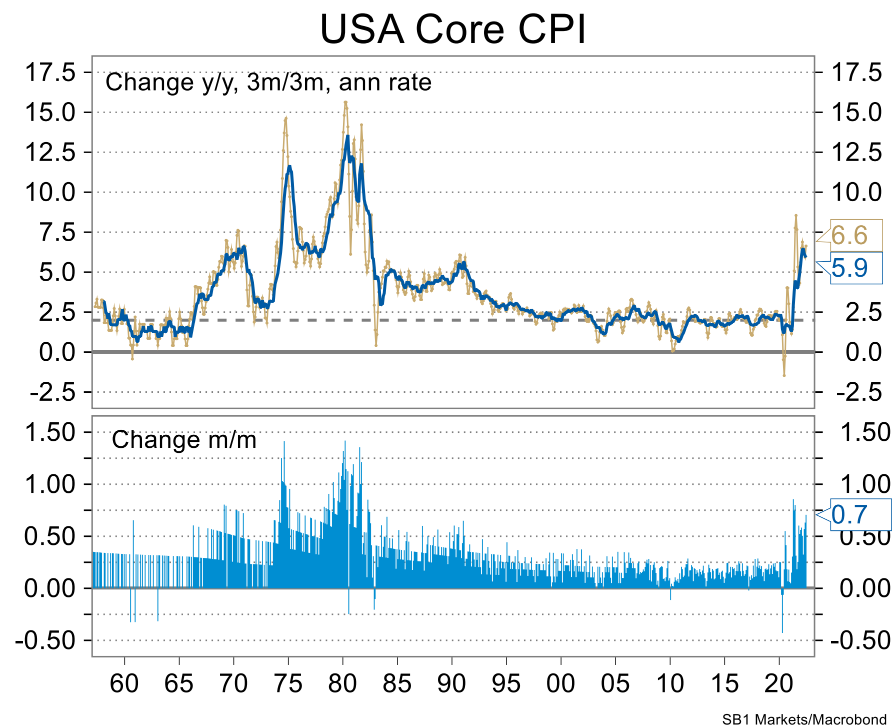

- **Headline CPI** accelerated to 9.1% in June, once again the highest since 1981, up from 8.6%, expected 8.8%. Prices rose 1.3% m/m, expected 1.1%, and up from 1.0% in May. The 3m/3m rate was close to unch at 10.5%, also the highest since 1980. So inflation is not yet slowing
- **Energy prices** rose 7.5% m/m and are up 42% y/y, contributing 3 pp to the headline. Gasoline prices are up almost 60%. In July, energy prices have so far been falling rapidly, and the headline inflation rate will very likely decline
- **Food prices** rose 1.0% m/m and are up 10.1% y/y. (Food at home is up 12.2%!)
- **Surveys** report further price increases the coming months
- The lift in the CPI report lifted interest rate expectations sharply – and a 100 bps hike at the July 27 FOMC meeting all of sudden become a likely outcome – but markets have calmed somewhat down



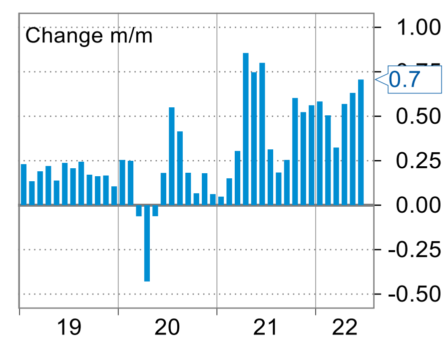
# Core inflation higher than expected too, up 0.7% m/m

… 0.2 pp more than expected. The annual rate still down 0.1 pp to 5.9%



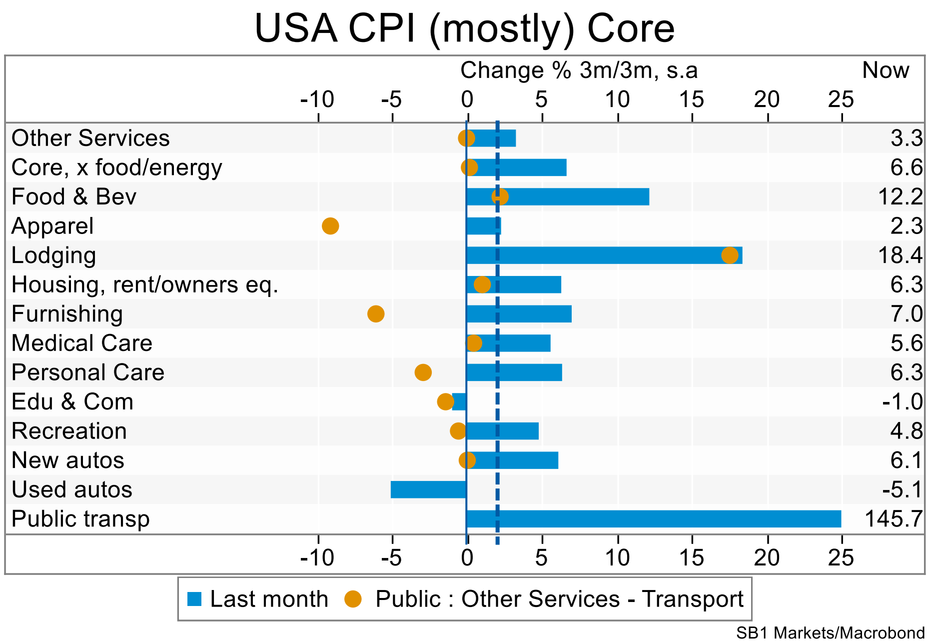

- The 3m/3m rate was unchanged accelerated 0.5 pp to 6.6%
- **Peak inflation?** Last summer prices slowed somewhat, and the annual rate may now climb further

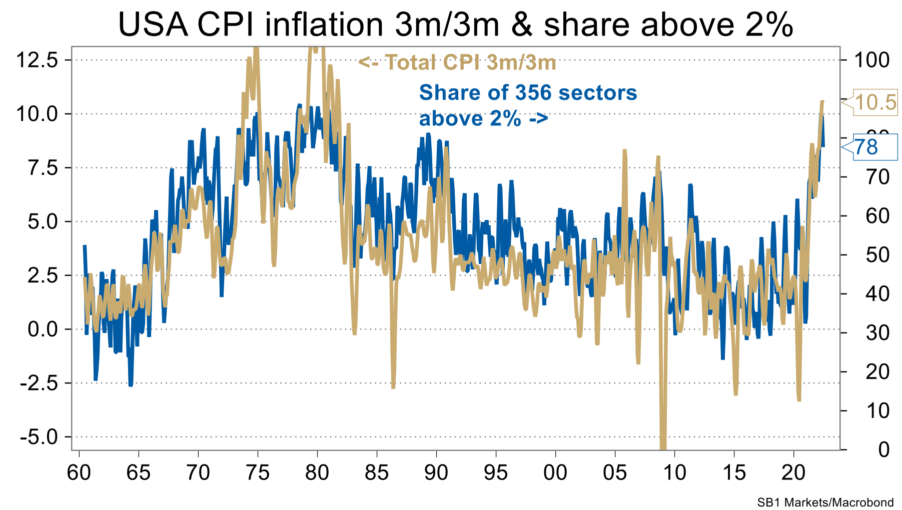


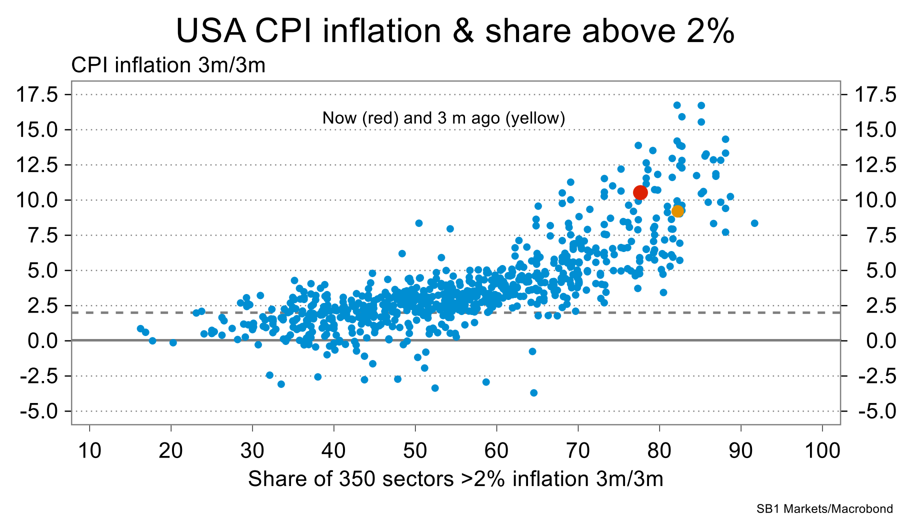
SpareBank 1 MARKETS

# Inflation measured 3m/3m: No good news

## Prices are up at a 10.5% pace, and a large majority of sectors are reporting high underlying inflation

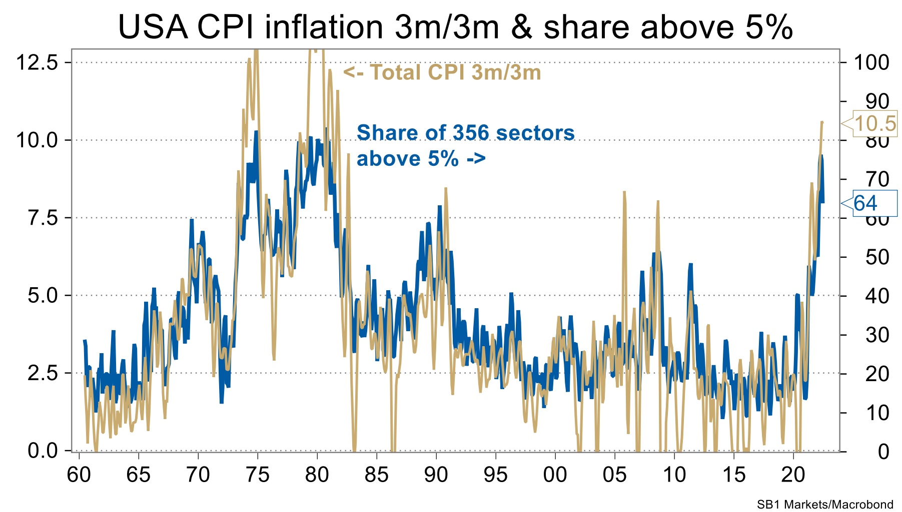


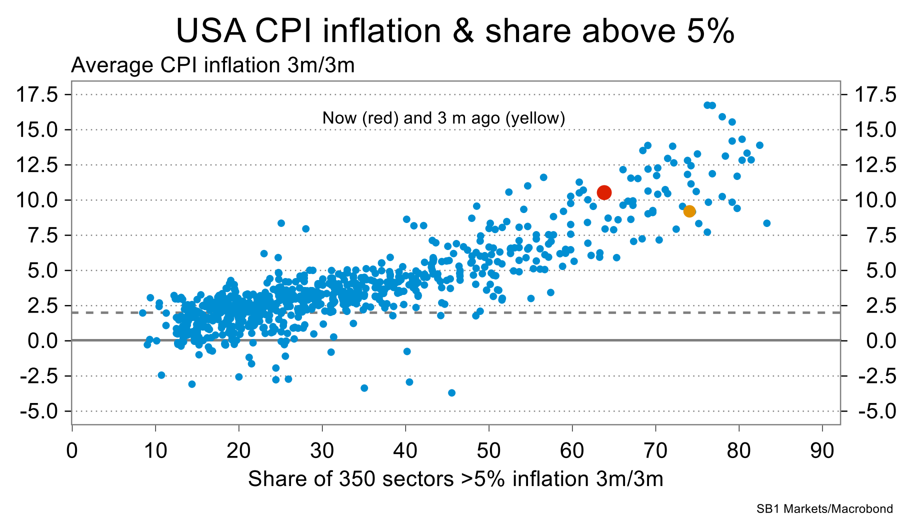




- Measured over the past 3m/3m inflation is accelerating in almost all sectors (barring used autos)
- Of 350 sub-sectors, 85% are up more than 2% over the 3m/3m, normally signalling an underlying inflation rate at 10% - where we now are

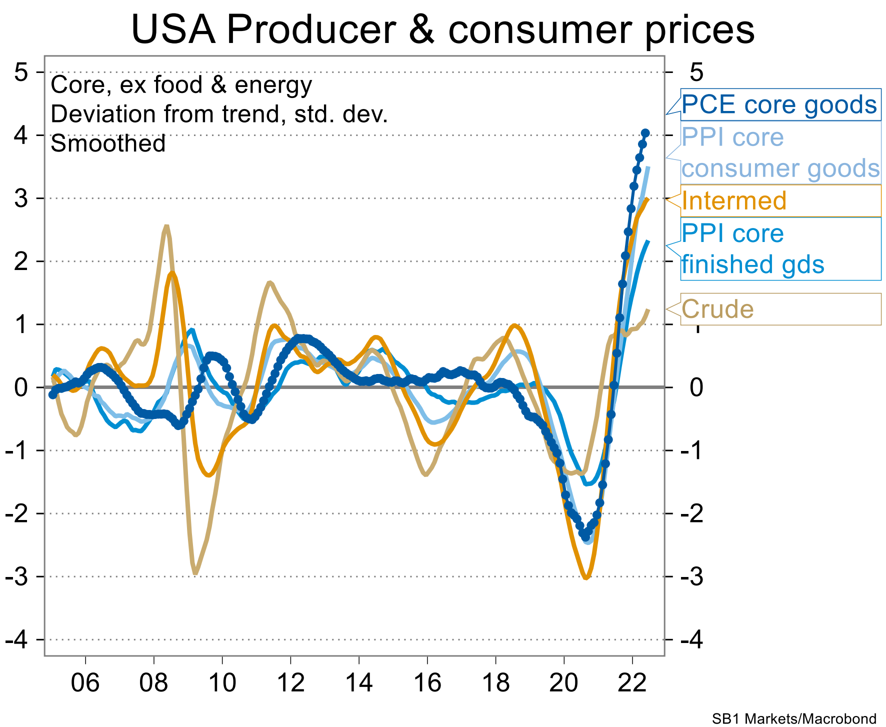
# ... and 2/3 of the CPI is up by more than a 5% pace recent months

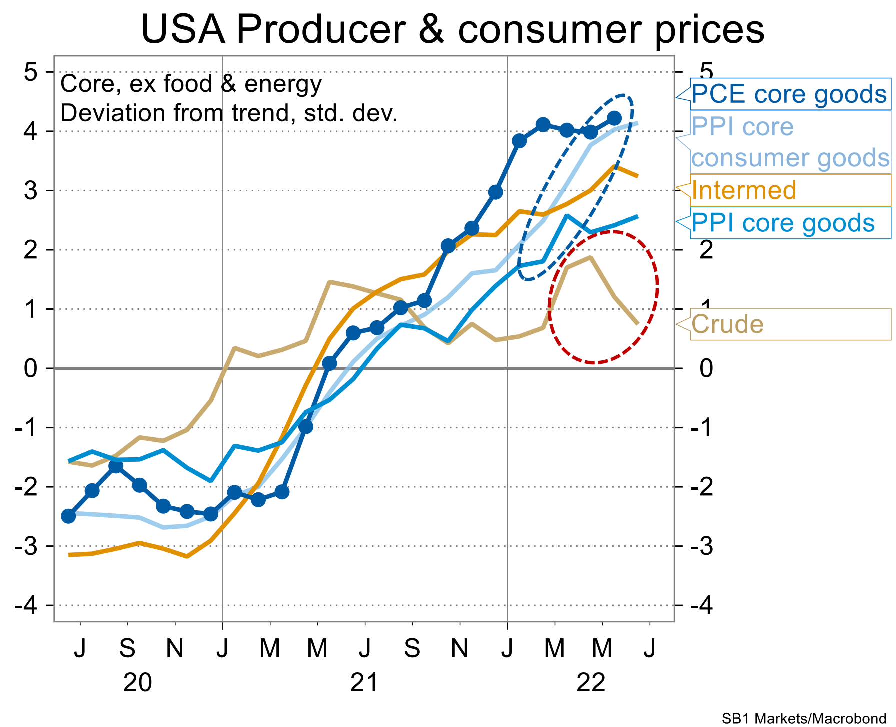


SpareBank 1 MARKETS

# Crude core material prices are yielding

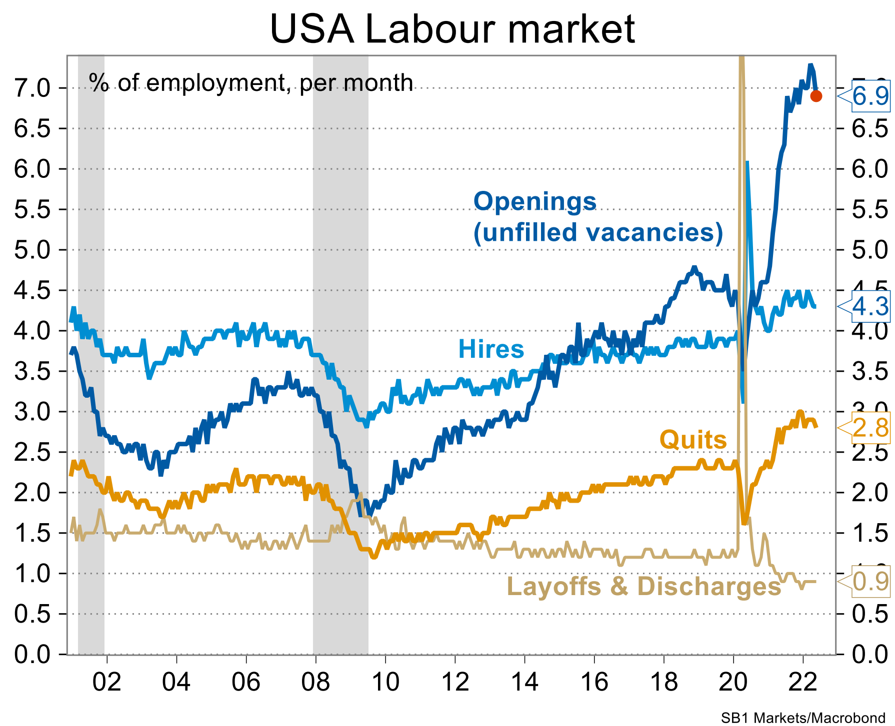



- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months. Following several months with slow growth in these prices, they shot up again in March and remained at a high level in April – but slowed somewhat in May. **Intermediate prices** climbed faster May
- 'Luckily', consumer prices have been 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

# The vacancy rate further down in May, still very high

## Voluntary quits down but also still at very high level, still record low level of layoffs

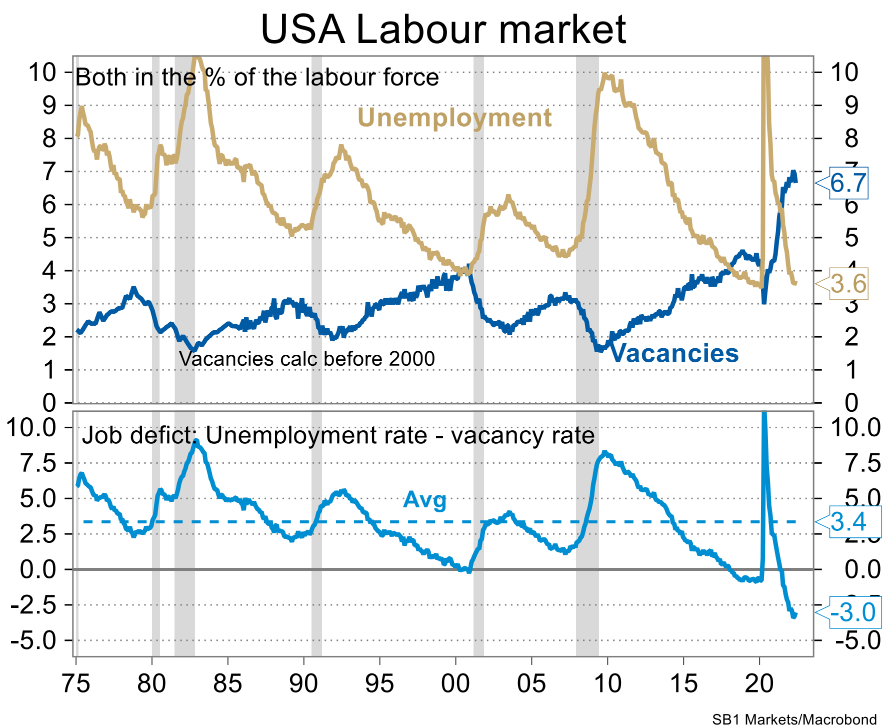


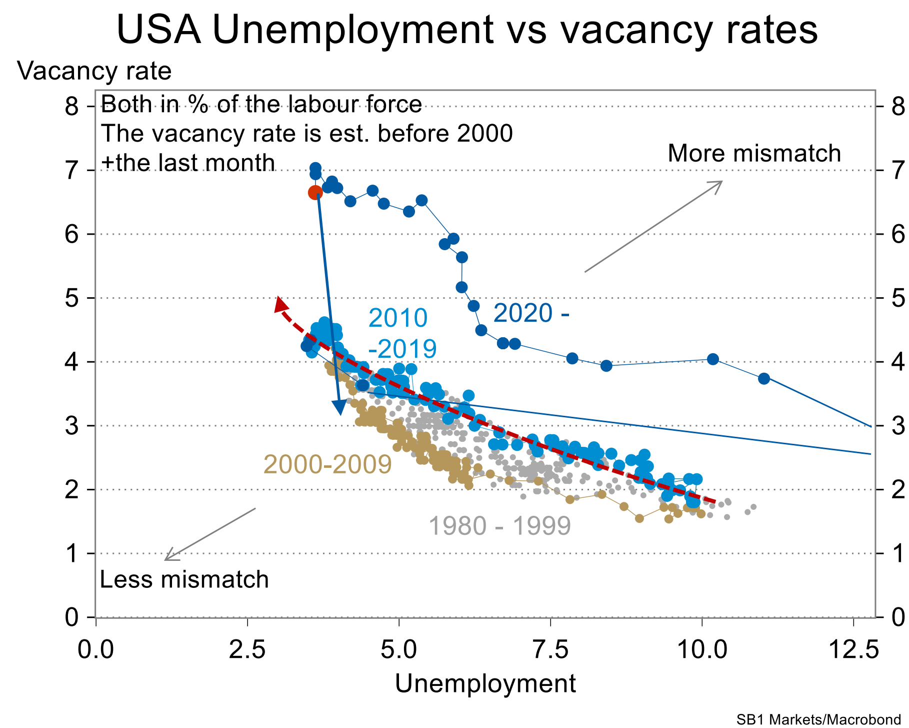

- The number of **unfilled vacancies** declined 0.4 mill to 11.3 mill in May from 11.7 mill in April, expected down to 11.0 mill from previously reported 11.4 mill. The rate (vs no. of employed) fell by 0.3 pp to 6.9%, from previously reported 7.0% in April
  - » For several months, the no. of unfilled vacances have been revised upwards, and the last observation overstates the real decline in job openings
  - » The highest print ever before the pandemic was 4.7%, and the rate was 4.5% just before the pandemic hit
- **The SMBs (NFIB survey)** reported an unchanged, and close to record high share of companies that were not able to fill positions in June. These two series are very closely correlated – and both have been at extreme levels
- **New hires** was unchanged at 6.5 mill in May, equalling 4.3% of the employment level (marginally revised down). The trend has been completely flat since early 20021
- The number of **voluntary quits** was unch. at 4.3 mill, equalling 2.8% (marginally revised down), not far below ATH from last November. As with unfilled vacancies, quits are closely correlated to wage inflation – for obvious reasons
- **Layoffs** equalled 0.9% of employment in May, at the same level as during the previous months, 0.1 p above the ATL last Dec
- **In sum:** The report confirms continued very tight labour market, far tighter than we have seen anytime in modern history – but it is not getting even tighter

SpareBank 1 MARKETS

# Will it be possible to bring vacancies down, without creating a recession?

Based on history, it seems to be impossible, the two indicators are quite closely correlated

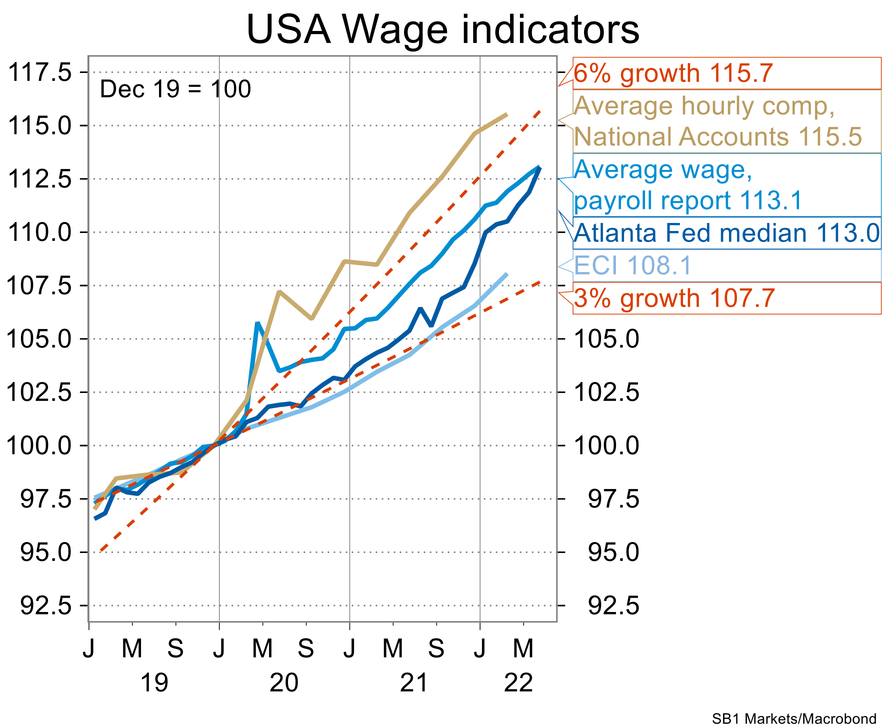


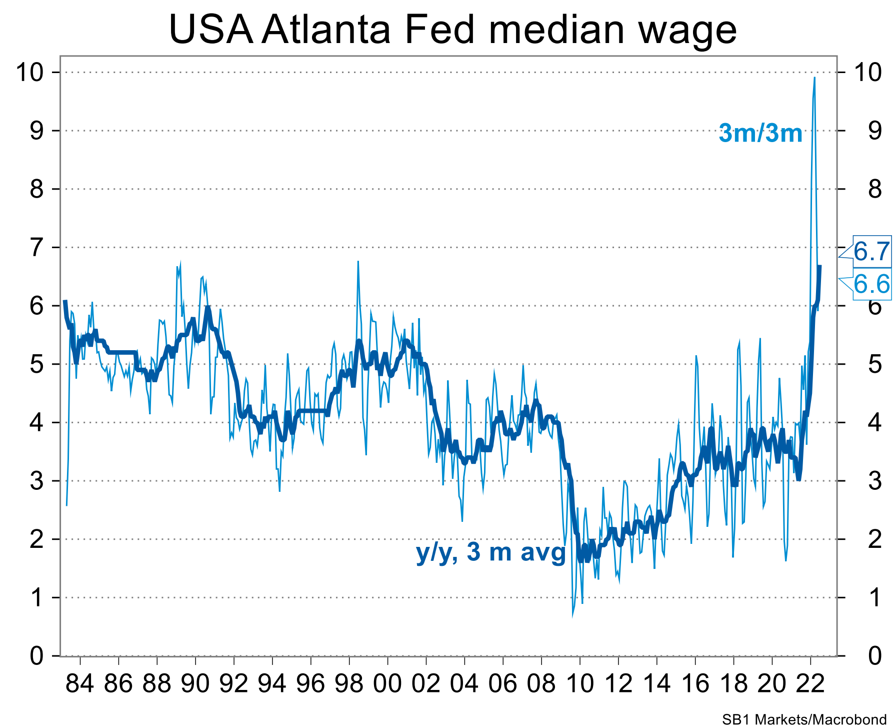




- **The Unemployment - Vacancy-curve** (UV, Beveridge curve) far up in the north-west quadrant, signalling both a tight labour market but also a higher vacancy rate than normal vs. the unemployment rate
- In principle vacancies may be reduced without pushing the unemployment rate up (aka recession), as the vacancy rates is so much higher than normal. But it seems very unlikely, as policies that reduce overall demand for goods and service and thus demand for labour – which is needed in order to bring wage inflation down (check two pages forward) – will hit both companies that have vacancies, and those which do not have. The labour market is very not so flexible that redundant labour will seamlessly be transferred to fill still vacant positions in other companies/sectors/regions. <u>If such transfer had been easy, it would have happened already, and the unemployment rate would have been lower</u>

# Wage inflation is soaring, says the Atlanta Fed median wage tracker

The median wage is up 7.4% y/y, 6.7% 3 m smoothed. Take off ‘for everybody’ (x the very best paid)

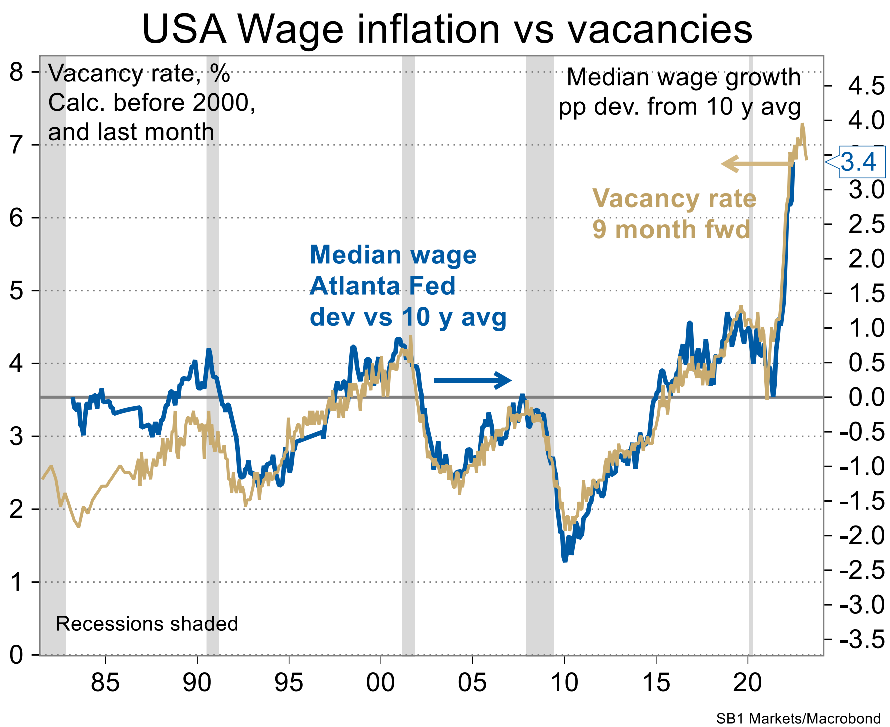


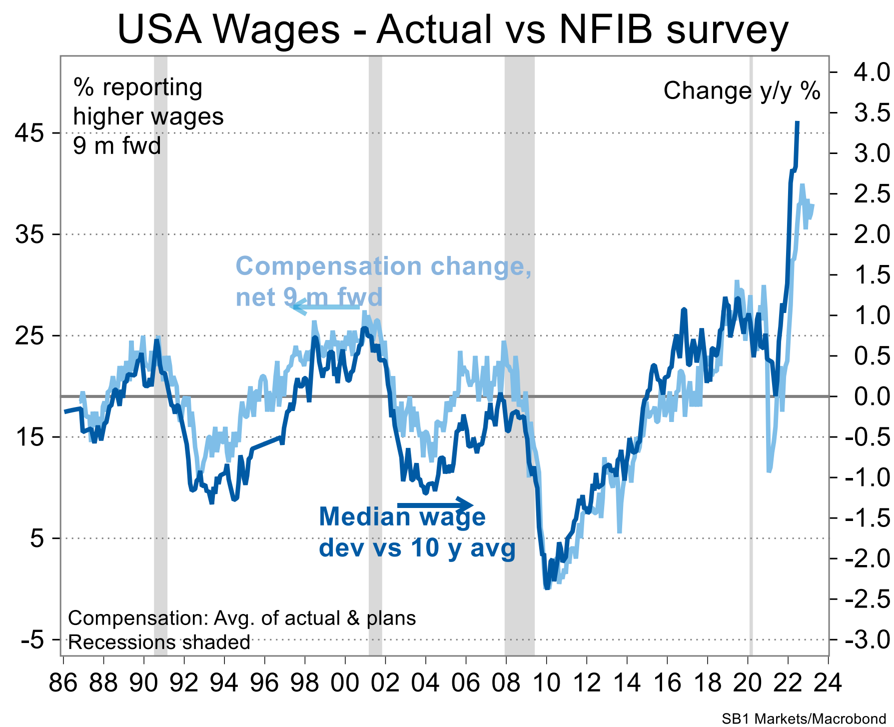




- **Atlanta Fed’s median tracker reports** a 7.4% growth in June (ATH, by far), up from 6.5% in May, as wages rose by 1.1% m/m in May. The 3 m annual wage growth is 6.7% (ATH, by far), and the current wage inflation is 3.4 pp higher than the past 10 average, a wage acceleration we have never seen before (all data from 1983).
- **All** ages, occupation, industry, job switcher (or not), race, education, urban or rural, region all raport a sharp acceleration. The only laggards: the who that are paid the best but even this group report higher wage growth recent months
- **All other wage indicators** are reporting fast wage growth, and all are reporting wage growth well above the recent years’ average. However, in the payrolls report, wage inflation has slowed slightly recent months

# So why are wage inflation soaring like never before?

## Because vacancies are higher than anytime before, it seems like. How to bring wage inflation down?

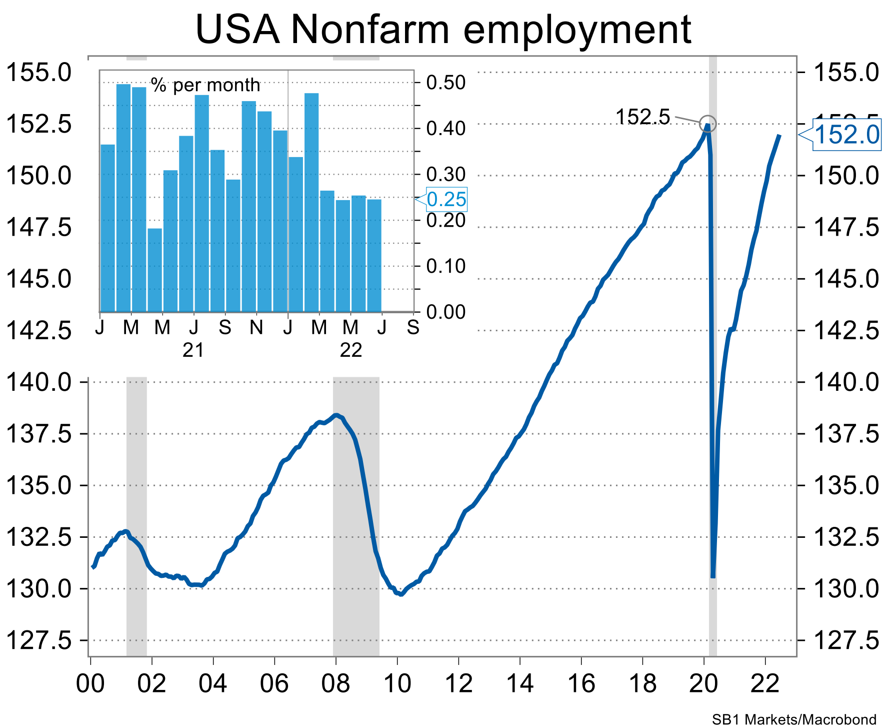


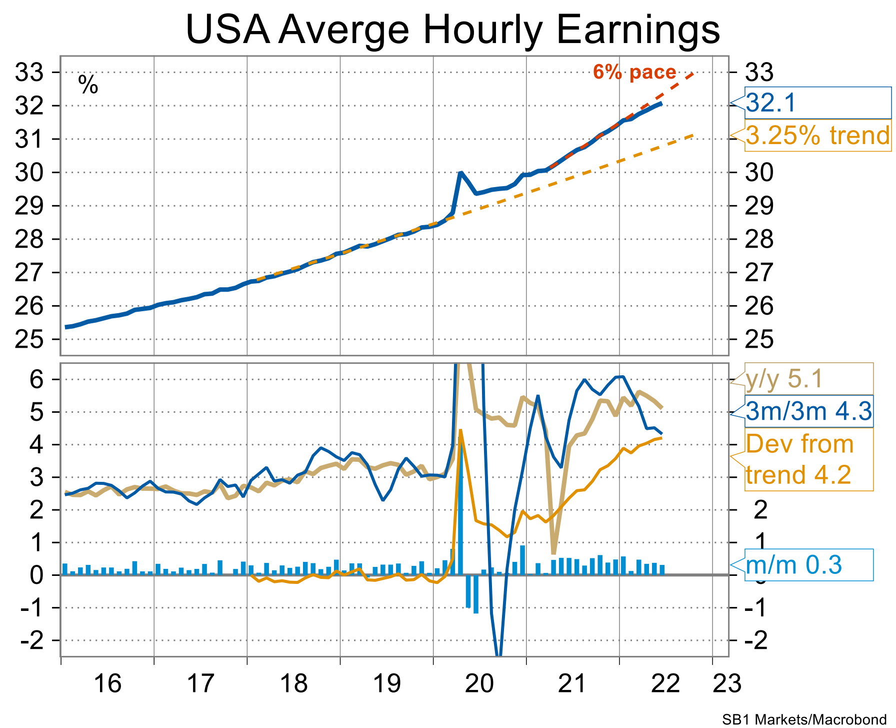




- **Our 'Phillips curve'** based on the vacancy rate signals a further increase in wage inflation the coming quarters even if vacances may have peaked, as the vacancy rate leads changes in wage inflation quite consistently by 3 quarters. However, we would not be surprised if the current extraordinary high wage inflation turns out to be the peak
  - Companies (SMEs) compensation plans signal continued high wage inflation but not faster than the present
- **Wage inflation** has already accelerated by almost 3.5 pp vs the 10 y average (Atlanta Fed median) and cannot possibly generate a 2% price inflation rate over time. This is Fed's main headache, not the current high CPI inflation print. And it will become the stock owners' headache too, of course
- **Demand for labour has to be reduced sharply in order to get wage inflation beck to a sustainable level! That's the recipe for an unavoidable RECESSION**
  - Check under which circumstances wage inflation slows on the charts above (hint: find the shaded areas, follow the wage line - as well as the vacancy rate or the wage hike plans ☺). Fed will not be able to control inflation if demand for labour is not cut sharply

# Steady growth in employment, wage inflation is slowing somewhat!

## Labour force, employment rates have flattened, even if demand for labour is strong. Maximum empl.?

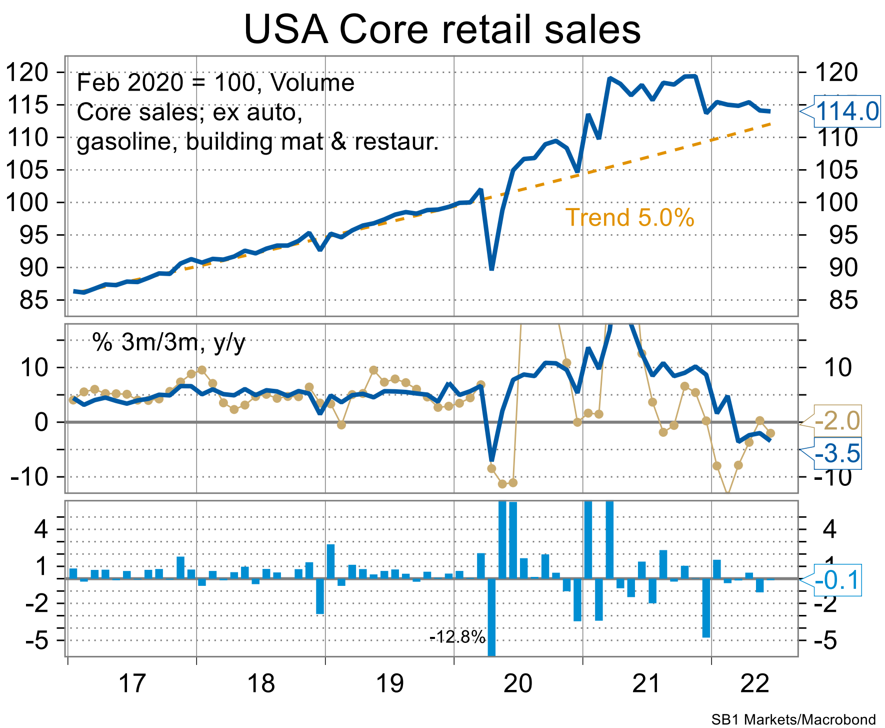


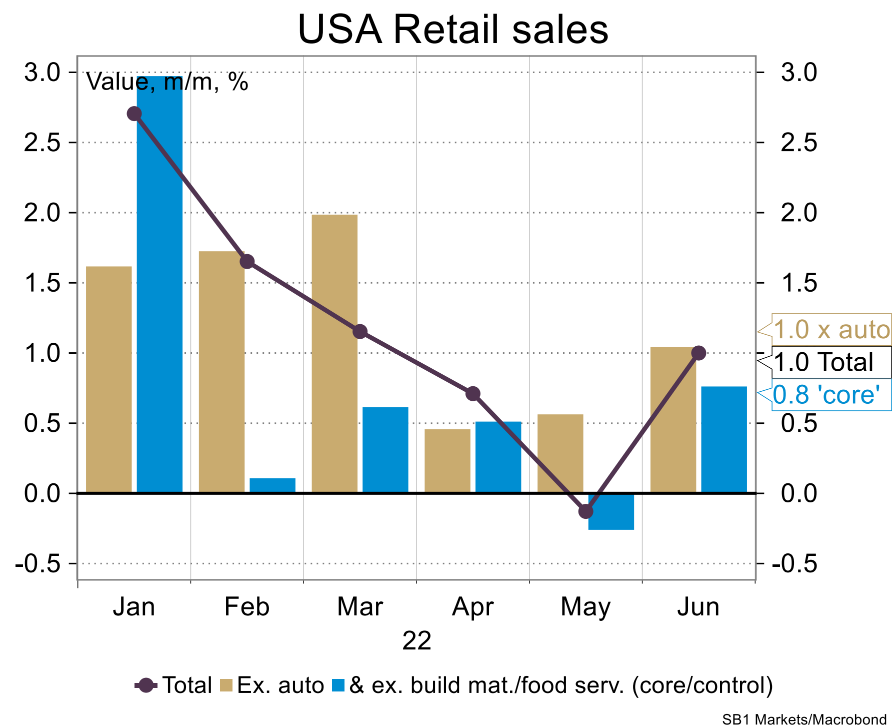




- **Nonfarm payrolls** rose by 373' in June, much more than expected (250'), and in line with growth the previous 3 months. Payrolls are still down 0.5 mill vs. Feb-20 or by 0.3%. The LFS employment fell by 315', and the **employment rate** fell 0.1 pp to 59.9. This rate has been at this levels since February
- **The participation rate** lost 0.1 pp to 62.2%, a rate reached last November. Very few now states Covid as a reason for not working/searching work (0.2%)
- **The unemployment rate** was stable at 3.6%, as expected. The FOMC lifted it's Q4-22 f'cast by 0.2 pp to 3.7% (and to 4.1%, 0.1 pp above the assumed NAIRU, by the end of 2024.
- **Wage inflation is slowing: The average wage** rose 0.3%, as in May, and as expected. The 3m/3m rate has fallen to 4.3% from 6% in January. The annual rate fell 0.2 pp to 5.1%. Annual rate was 0.1 pp above expectations as May was revised up by 0.1 pp to 5.3%. Before the pandemic, average wages rose by 3¼%, and wages are now 4.2% above this trend
- **Maximum employment:** Both the participation and the employment rates have flattened recent months, as the same time as the demand for labour is very strong, witnessing the extreme level of unfilled vacancies. The supply side is obviously the bottleneck at the labour market. For the time being, maximum employment is reached – and wage inflation is well above a sustainable level

# Retail sales sharply up in June, at least in nominal terms, after the May setback

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

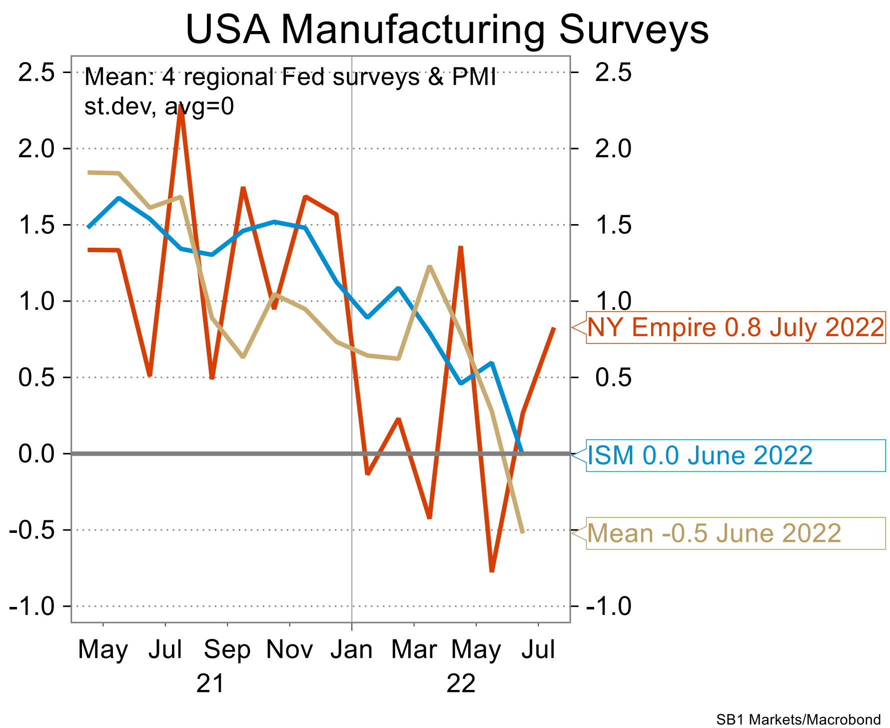



- **Total nominal sales** gained 1.0% in June (expected +0.9%), and May was revised up by 0.2 pp to -0.1%. Total nominal sales are up 29% vs. the Feb 2020 level
- **Core sales of goods** (=control group, excludes autos, gasoline, building materials & restaurants) climbed 0.8 in June in value terms, expected up 0.3%. May was revised down 0.3 pp to -0.3%
- **In volume terms**, core sales are far less flattering: We assume prices increases at 0.9% in both May and June. Thus, in volume terms, sales fell by more than 1% in May and by 0.1% in June – and 'real' sales are trending down and are approaching the pre-pandemic trend! Sales are 5% below the November level

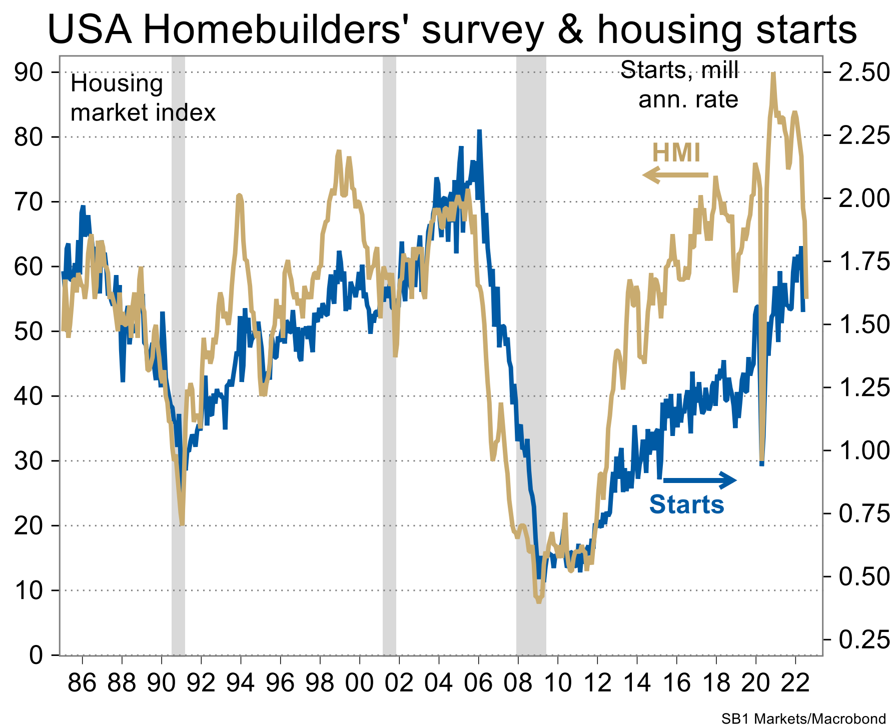
# Not everything is pointing down: the NY Fed manufacturing survey up in July

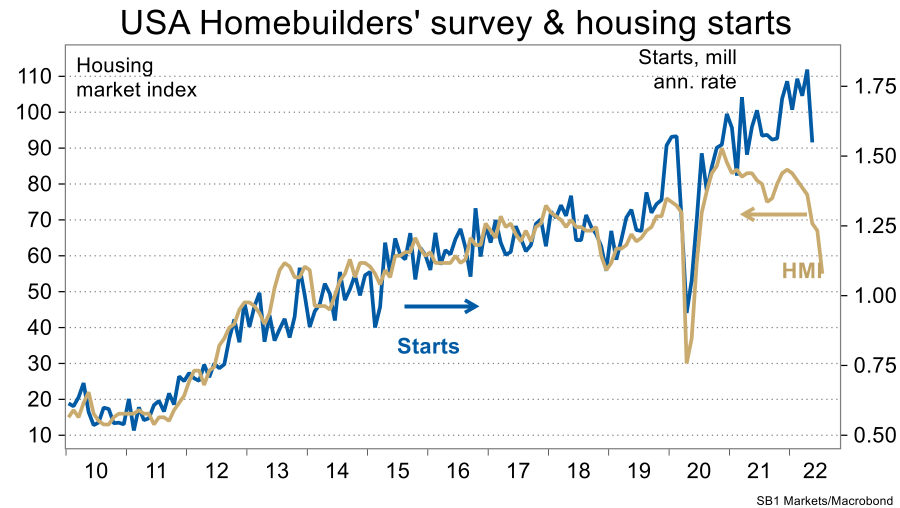
Expected down but gained  0.5 st.dev to +0.8 above avg. However, this survey is rather volatile

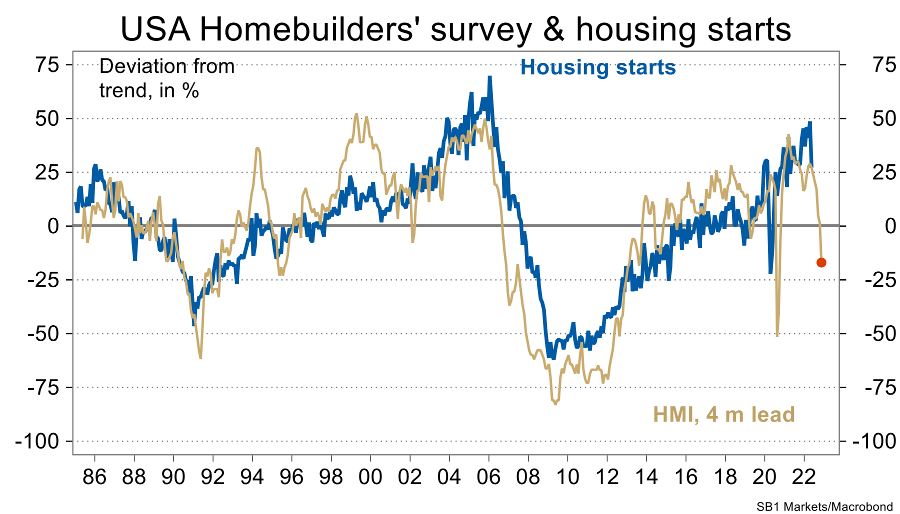


# Homebuilders’ index straight down in July: a further, steep decline in starts ahead

## The HMI down 12 p to 55, the 2nd largest decline ever (after April-20). Starts down



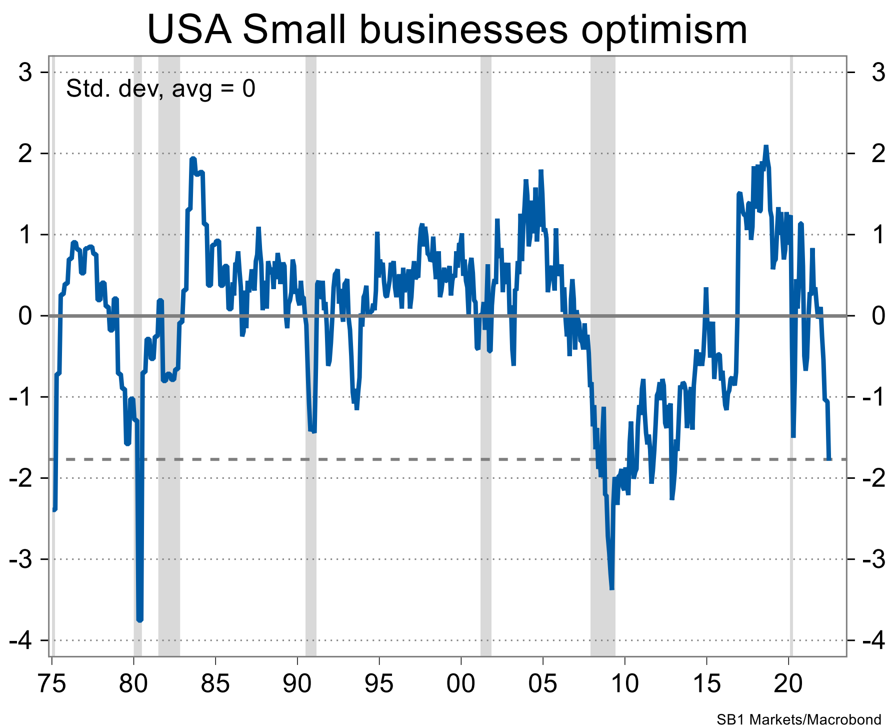



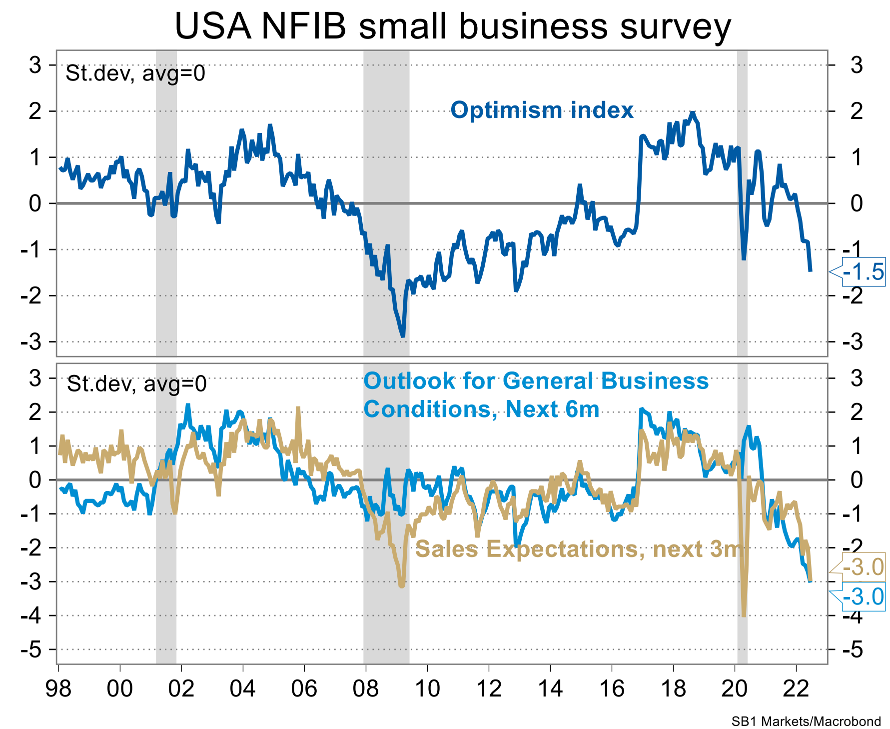




- **The Homebuilders’ Housing Market Index (HM)** lost 12 p to 55 in July, expected down just 1 p! The monthly setback is unprecedented, ex. April-20 (as is the decline over the past 3, 6 or 8 months)
  - » Affordability is still the challenge, due to higher mortgage rates, and soaring new home prices (at least until now)
- <u>The decline in the index recent months signal more than a 1/3 decline in housing starts – which already has fallen by 14% - in sum a 50% setback</u>

# Small businesses optimism down in June, to deep into recessionary territory

The optimism is 1.8 st.dev below par, and the outlook is even worse, at 3 below, the weakest ever!



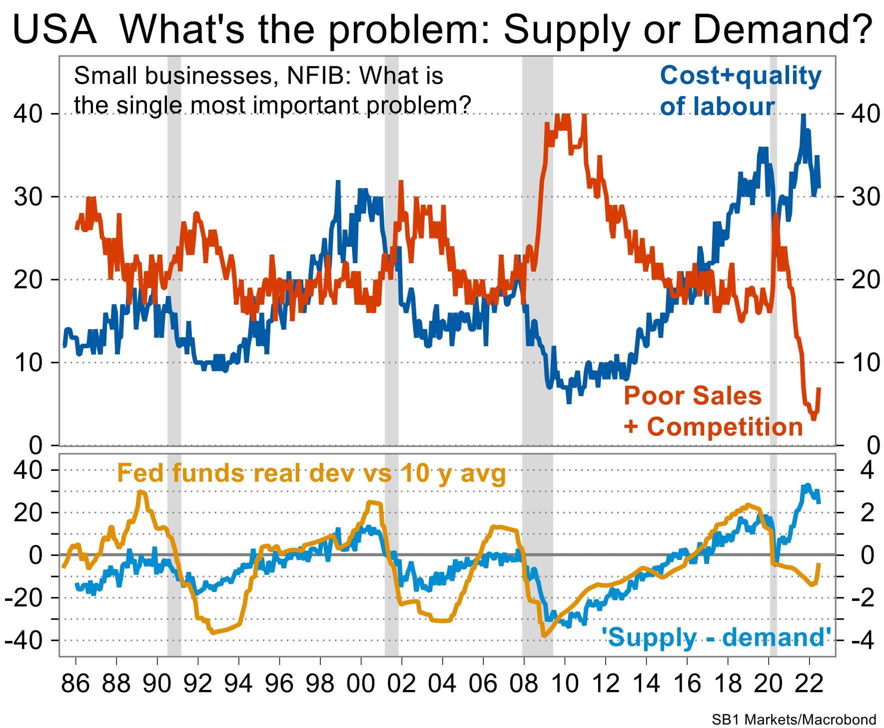



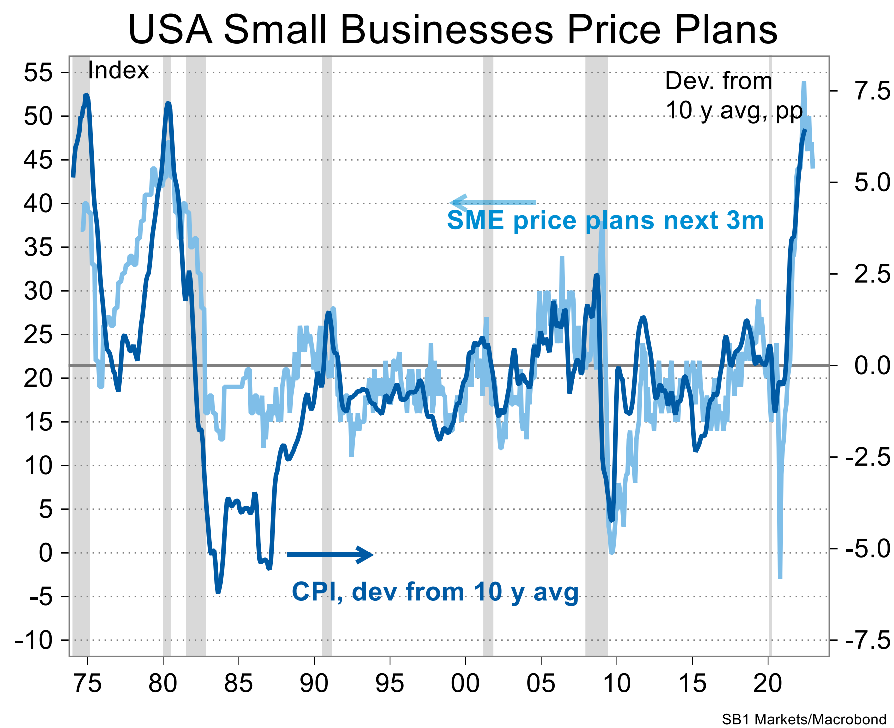

- The **NFIB optimism index** fell 3.6 p to 89.5 in June, expected down 0.6 p – or down by 0.7 st.dev to -1.8 st.dev below average, a rather unusual level, especially since actual sales still are terrific. **The outlook for the next 6 months** fell to the lowest level ever in June. Inflation, lack of qualified labour and labour costs are still the main worries for the SMEs.
- However the share of companies that report **competition or poor sales** as a worry rose slightly, and some fewer companies report they plan to **lift prices** further. Even if very few complains about sales, and the share of companies that plan to lift prices still is very high, the tide may have turned
- **Investment plans** fell sharply to well below an average level. Hiring plans fell to, but remain aggressive – and companies still report they are not able to **fill their vacancies**, and a close to a record share of SMEs report they plan to **lift compensation further**. So it ain't over yet

SpareBank 1 MARKETS

# Has the tide turned? More companies report demand weakness (but still very few)

Fewer companies report they plan to lift prices (but still extremely many). It's a long way back 'home'

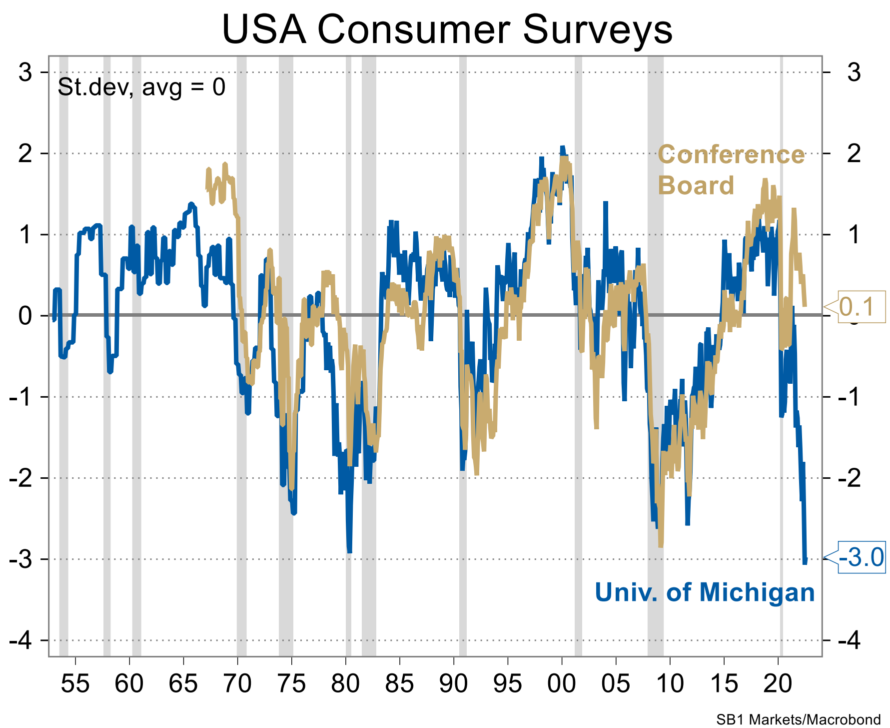



- **The 'gap' between supply and demand concerns** is still close to unprecedented, which signals that demand is still far too high to 'balance' the economy – an the result is still extraordinary aggressive plans for hiking prices
  - » The share of SMEs that plan to hike their **selling prices** fell 3 pp to 44% - which is still a very high level
- **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 – and compensation plans are marginally revised down
- **We have no doubt:** Over the coming months and quarters, the red line will climb sharply – and the blue line will come back down to Mother Earth as financial conditions tightened, with or without help from the Federal Reserve. It's normally labelled as a recession

# Univ. of Mich. sentiment stabilised in July. At an ALT

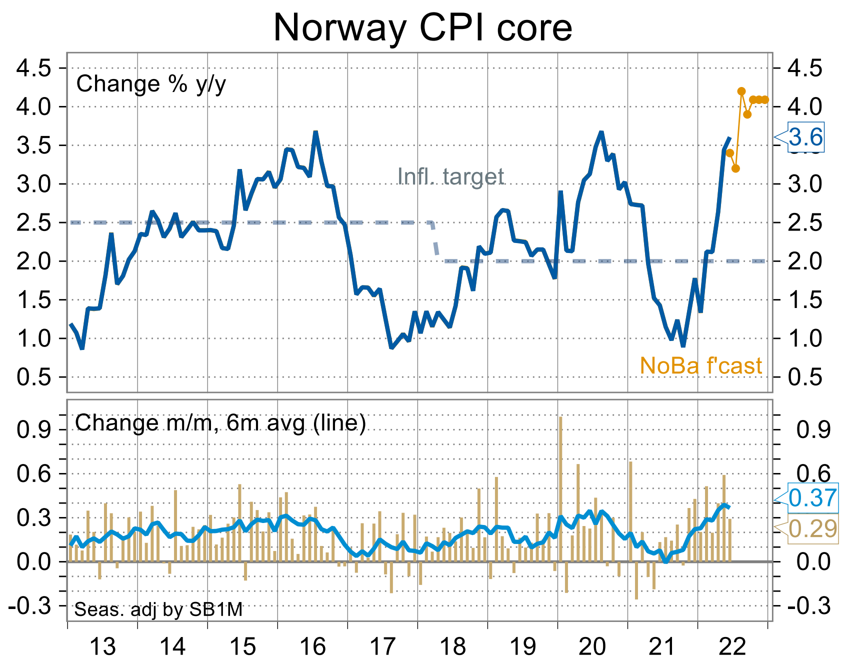
## Inflation expectations fell

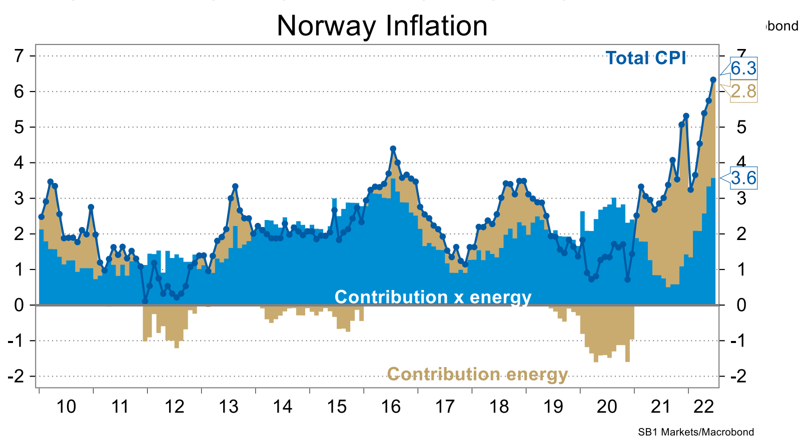



- **University of Michigan's consumer sentiment** fell to ATL at 50.0 in June, equalling -3.1 st.dev below average. In July, a marginal recovery, to 51.1 (3.0 st.dev)
  - » Households' assessment of the current situation rose marginally but remains at a level never seen before. Expectations were close to unch, but at very low level
- **2 of the other 3 consumer surveys** we are following also reported an uptick in June/July, but both are deep in negative territory, at below -2 st.dev
  - » Just the **Conference Board's** measure is still above average (at +0.1 st.dev) in June. The discrepancy between the two 'main' surveys have never been larger
- **Inflation expectations** fell slightly in July, and longer-terms forecasts are not at that high (5 years at 2.8%)
- **The risk:** The UM survey often has been an early bird in the cycle, and the survey may be 'right'
  - » In the Conference Board survey, expectations have fallen sharply, and the discrepancy to households' of

# Inflation further up in June, now the focus turns to core, domestic inflation

## Headline inflation up 0.6 pp to 6.3%. The core up 0.2 pp to 3.6% (we exp. 3.7%), food up 1.8%!



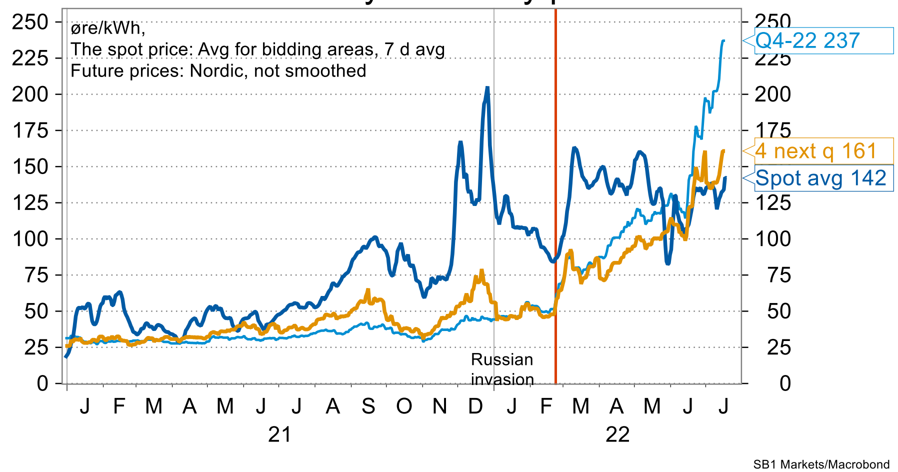




- **CPI-ATE** (ex. energy and taxes) rose 0.3% m/m, and the annual rate climbed by 0.2 pp to 3.6%, we expected 3.6%. NoBa assumed 3.4% in the June MPR
  - » **Food prices** surprised at the upside, +1.7% (seas adj), and 5.0% y/y (both with non-alc beverages included), lifting the core CPI by 0.8 pp (but food prices are just marginally above the late 2020 level). Most sub-components contributed m/m in June, fruit and meat the most. Next month, the semi-annual July price adjustment will likely will be far larger than normal. Hotel & restaurant prices rose 2% m/m, and 9.2% y/y
  - » **Airline ticket** prices fell but are still up 31% y/y (0.25 pp contrib)
  - » Prices on **imported goods** rose 0.2% m/m and are up 3.7% y/y, while **domestically produced** goods & services were up 0.3% m/m and are also up 3.7% y/y – and accelerating
  - » Most sectors report growth above 2% y/y, and most are up by more than 2% on average since 2019
- **Total inflation also accelerated, by 0.6 pp**, to 6.3%, the highest since 1988. If not for electricity subsidies, inflation would have been above 8%. Electricity prices rose marginally (seas adj). Auto fuel prices climbed 12% - both somewhat above our forecasts. Energy is contributing 2.8 pp to the 6.3% y/y headline CPI rate
- **The outlook**
  - » **The electricity price** may increase marginally in July – and then rapidly during the autumn, according to the future market – following steep prices increases recent weeks. However, households will be sheltered from the most of these price hikes, due to the subsidies
  - » **Gasoline prices** probably peaked in June, and are now heading down, in Norway as abroad, both due to the decline in crude prices, as well as refinery margins
  - » However, higher **food prices** may lift the **core inflation** further in July, and price increases are still rather broad for other goods and services
  - » If so, **average 2022 inflation** will some 5%, above Norges Bank's 4.6% forecast.
- **So what?**
  - » **Real disposable** income is substantially reduced, even if **wage inflation** may in the end surprise on the upside in a tight labour market. Lower savings will partly compensate, but household demand is exposes too
  - » For **Norges Bank** wage inflation is the dominant risk but actual inflation will influence wage inflation, and even more as the labour market is still very tight

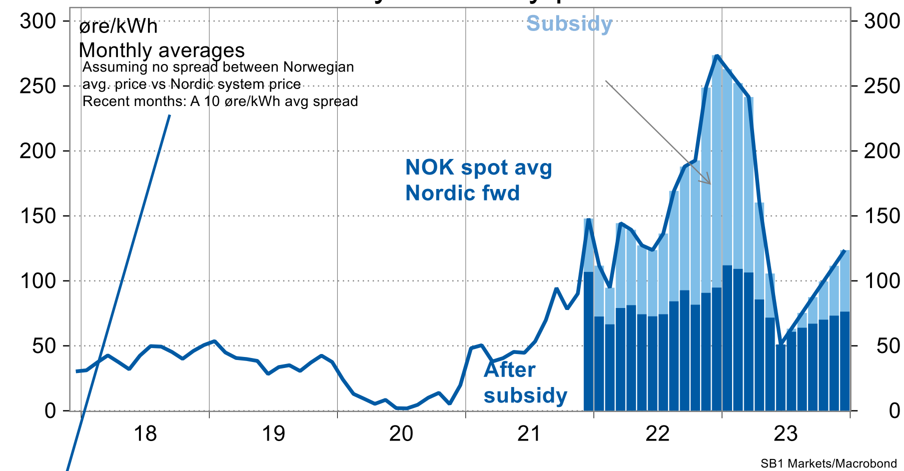
# Future prices sharply up recent weeks – due to the tight European gas market

## The Q4 future price up 70% vs. 2021 – but subsides will cover the most of the costs, for households

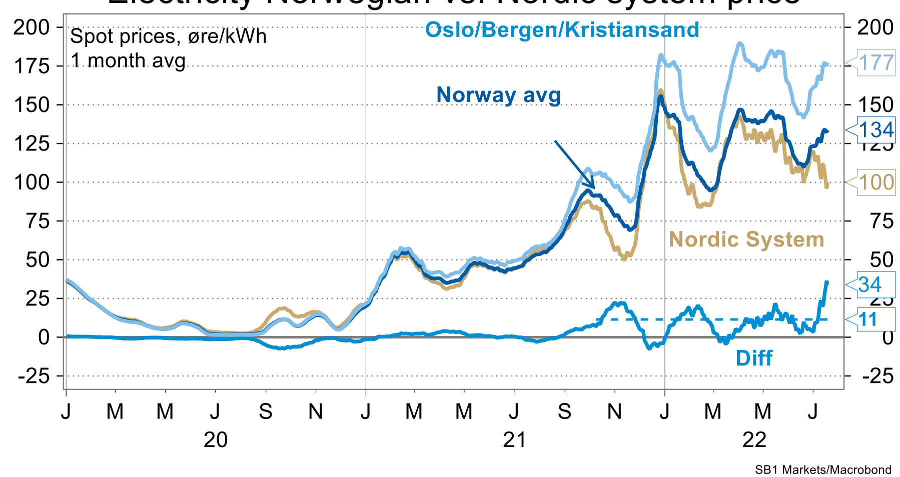
Norway Electricity prices



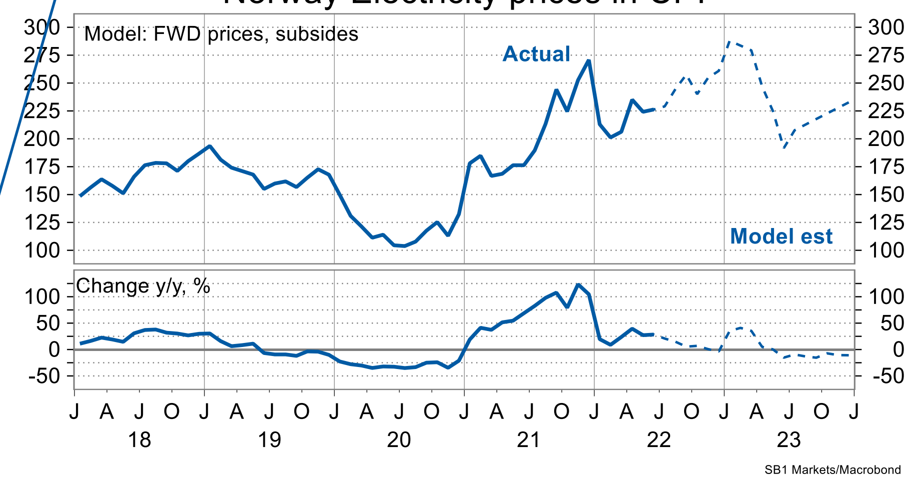

Norway electricity prices




Electricity Norwegian vs. Nordic system price

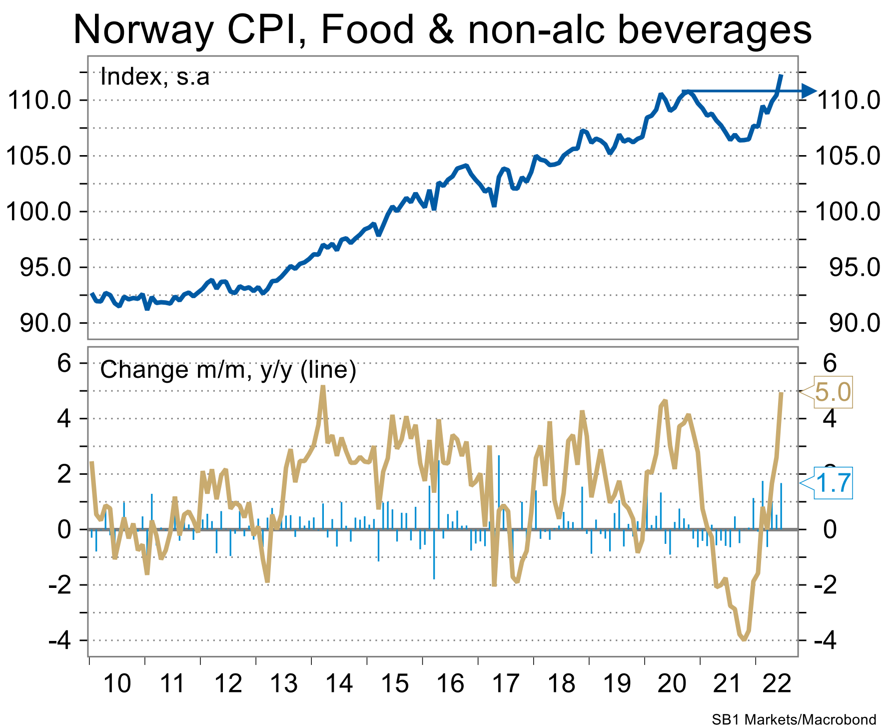


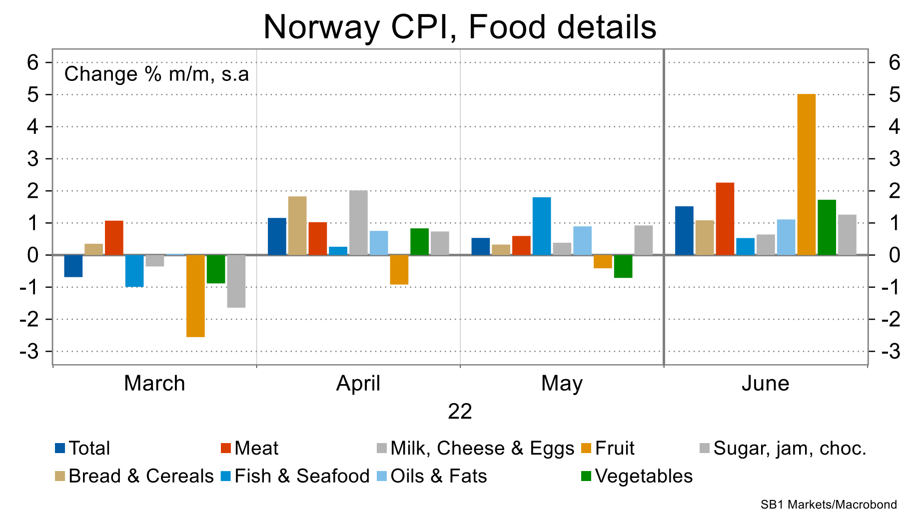

Norway Electricity prices in CPI

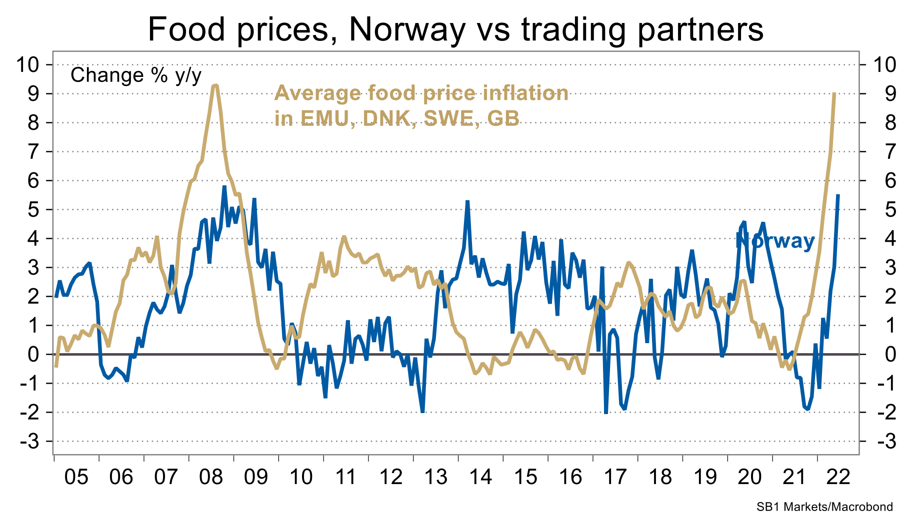


# Food prices finally higher than in late 2020 – but June hike was steep

## Food & non-alc beverage prices rose by 1.6% in June (s.a, actual 1.7%% ), and are up 5.1% y/y



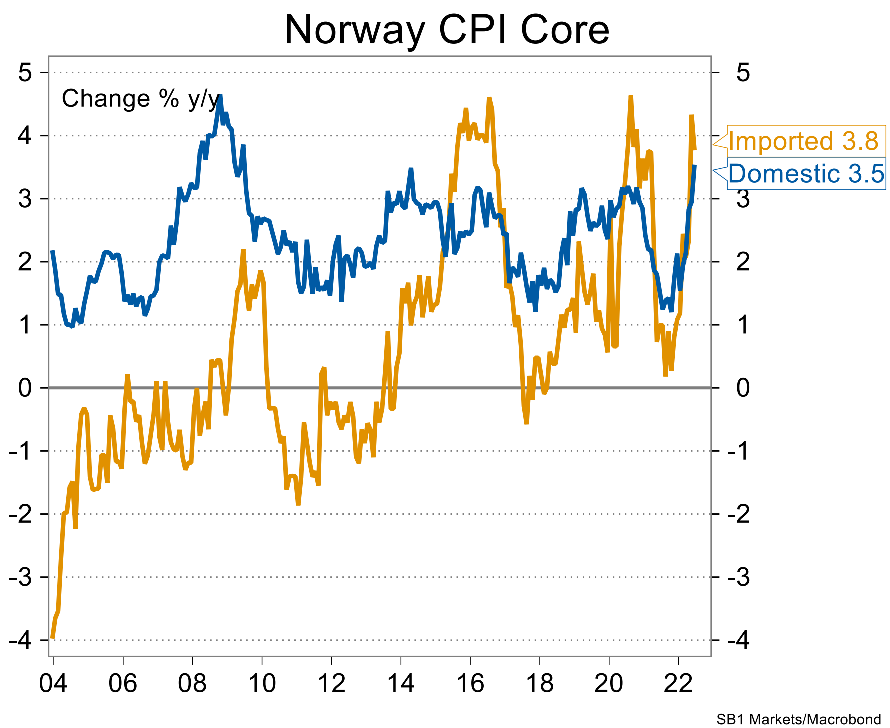



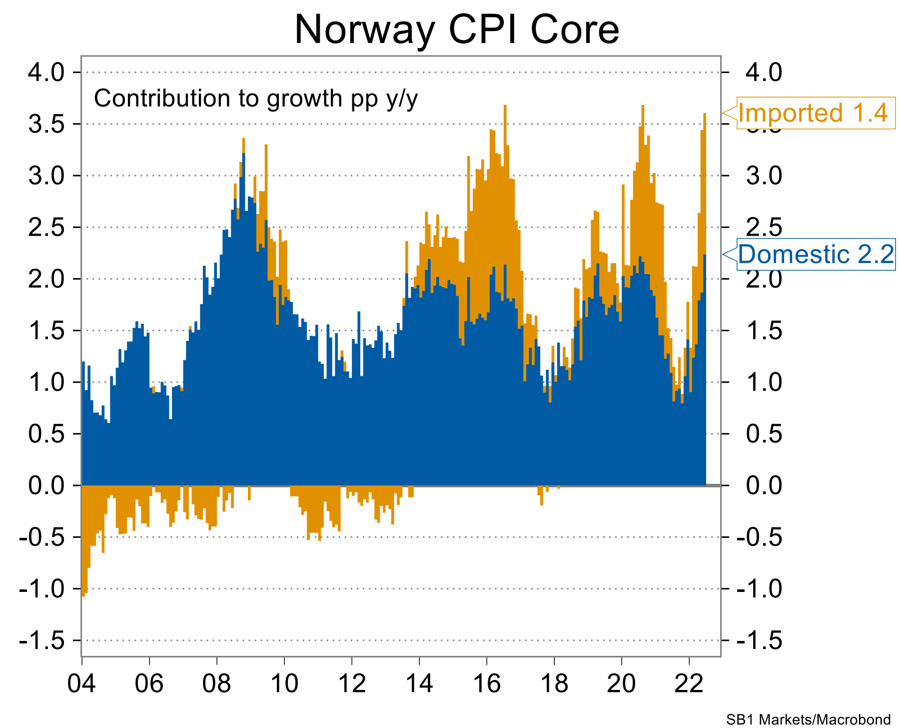

- **Food price inflation is accelerating abroad, but Norwegian CPI food prices** are not closely correlated with food prices among our European neighbours. <u>The NOK exchange rate is normally explaining more</u>
- The price lifts in June was broad, but unusually strong for fruits (5%) but also for meat (2.2%) and vegetables (1.7%)
- In July, prices increases are normally rather high, both due to the semi-annual adjustment of prices following negotiations between producers/wholesalers and retails and high prices for Norwegian seasonal produce. This year, the negotiated prices were very likely lifted much more than normal, and another substantial increase m/m and in the annual growth rate is expected. <u>Then</u> we can start talking about high food prices – so far they have been low!

SpareBank 1 MARKETS

# Prices on imported goods in the lead – without a much weaker NOK

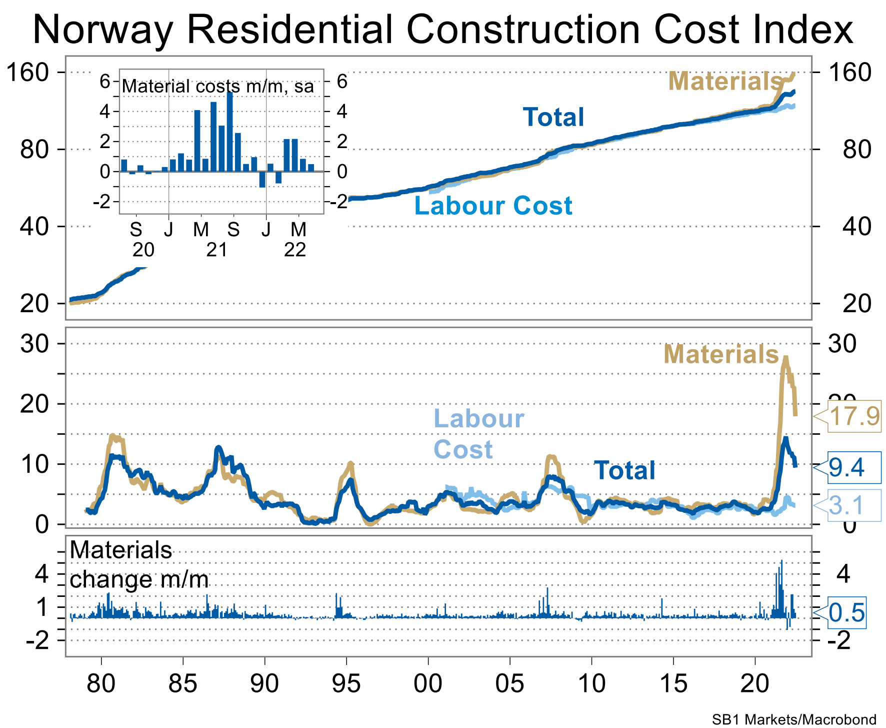
However, 'domestic' inflation is also far above the 2% inflation target, and is contributing more

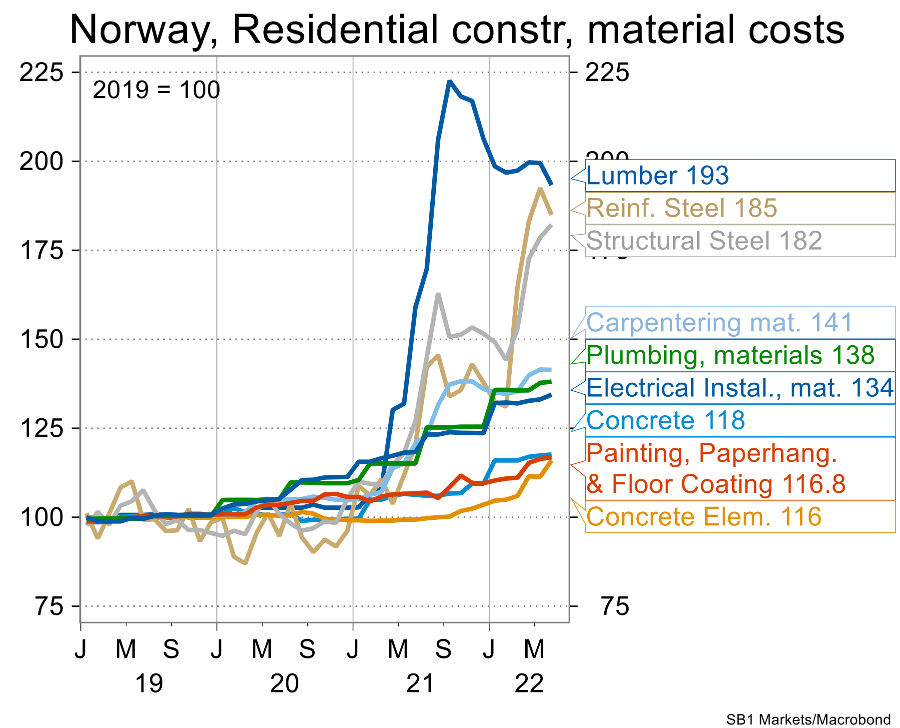


# Building costs: Just marginally up in June – and are probably close to peak

## Lumber & some steel prices fell in June – and much more to go. Other materials flat or just marg. up

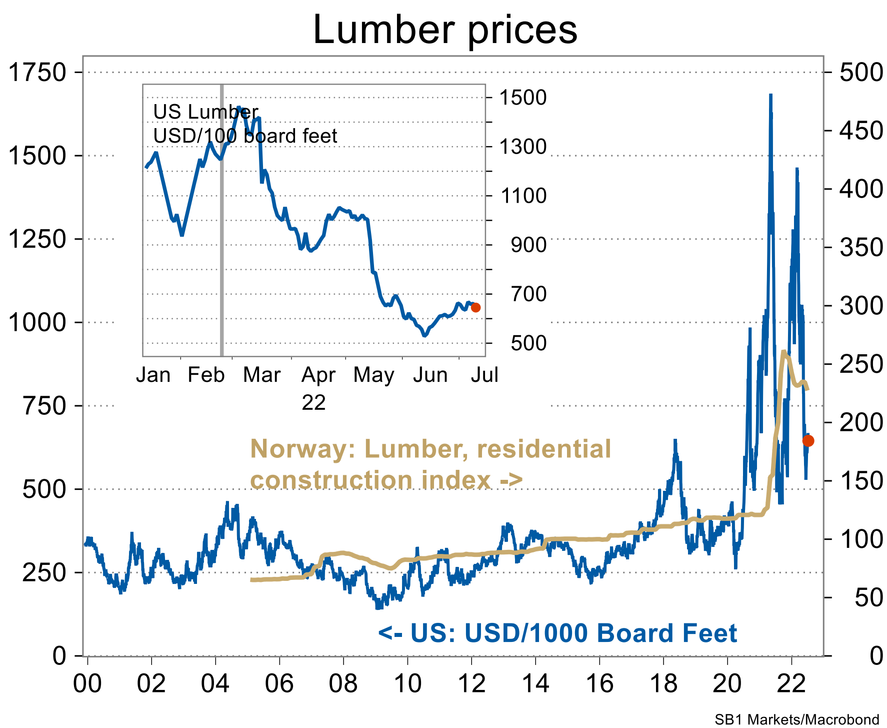



- **Material prices** (houses and apartments) added 0.5% in May, and prices are up 17.9% y/y, down from 22.8% y/y in May
  - » Lumber prices are trending down, and reports signal that prices will decline further the coming months. Steel prices have fallen substantially at metal exchanges, and now end user prices will come sharply down
  - » Other material prices are still trending up, from 11% (concrete) to plumbing and carpentering material 36% – 40% - but most prices are close to flattening
- **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 9.4%, down from the ATH at 14.6% at the peak last Oct. <u>Going forward, low material costs will bring total construction costs down to more normal levels</u>

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

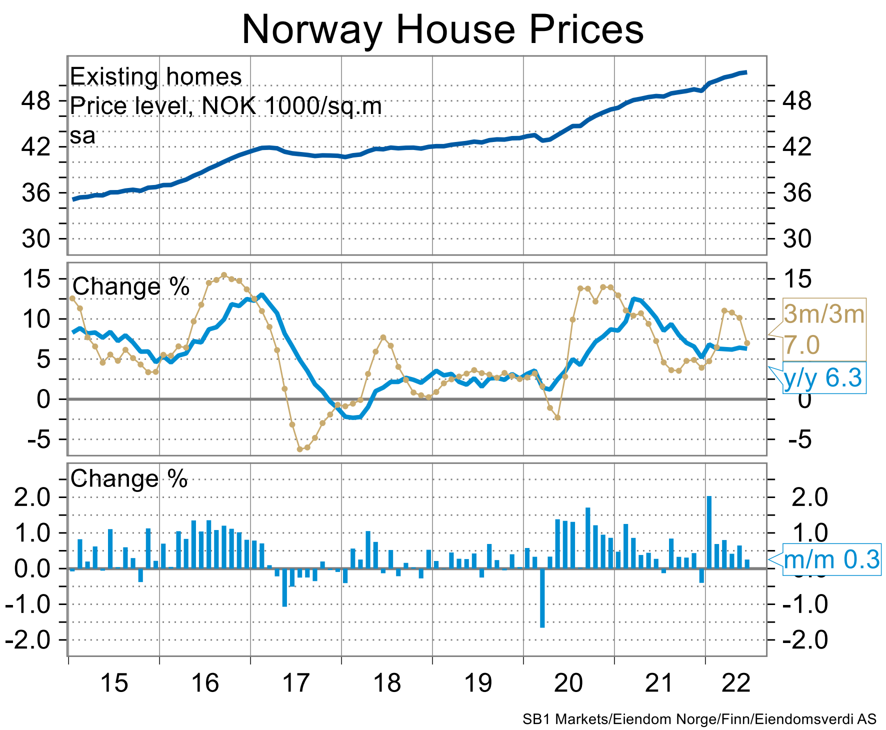
... and steel prices have been in a free fall recent weeks! Prices will come down in Norway as well

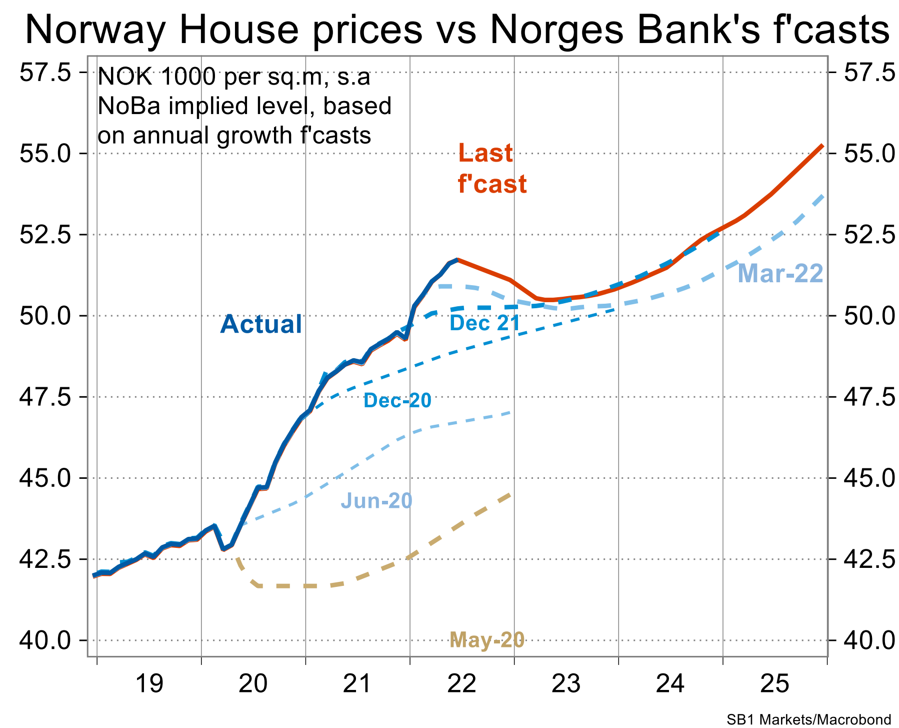



SpareBank 1 MARKETS

# House prices further up in June, as the inventory of unsold home is ‘emptied’

Prices up 0.3%, 0.1 pp above NoBa’s, our f’casts. Will prices start declining in July, as NoBa assumes?

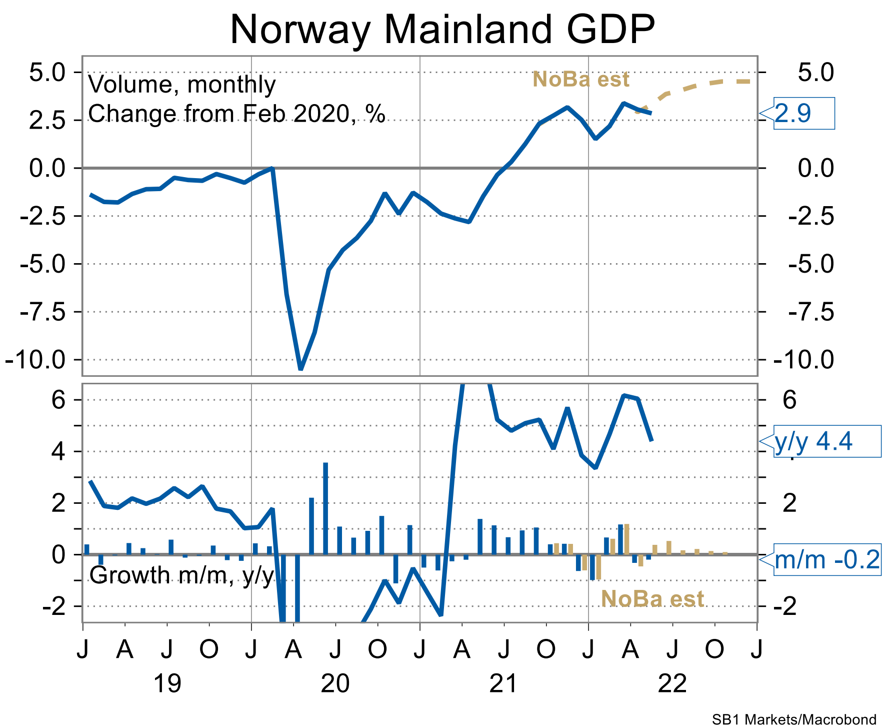



- **House prices** are still on the way up, but the 0.3% lift in June was the lower than over the previous months. The number of transactions fell marginally, and the inventory fell, to another record low level. New documentation requirements may have supressed supply in early 2022 but that excuse is now becoming less likely
- In the June MPR, **Norges Bank** expected that prices start declining in July, and continued downwards until Q2 next year, in sum by approx. 2¼%. The well announced interest rate ‘shock’ should lead to some weakening. If the current plan is not sufficient, rates will probably continue upwards until they bite. The reason: The main transmission mechanisms between interest rates and the real economy is through the housing market, and the impact on household disposable income. The currency link has not been working for a long while

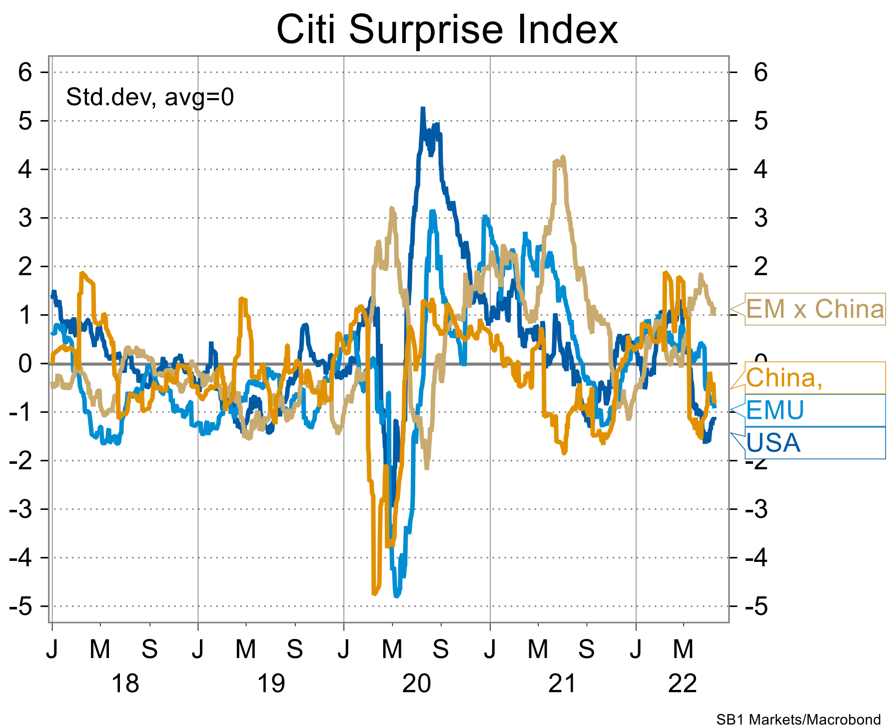
# Mainland GDP down 0.2% in May, following the 0.3% drop in April

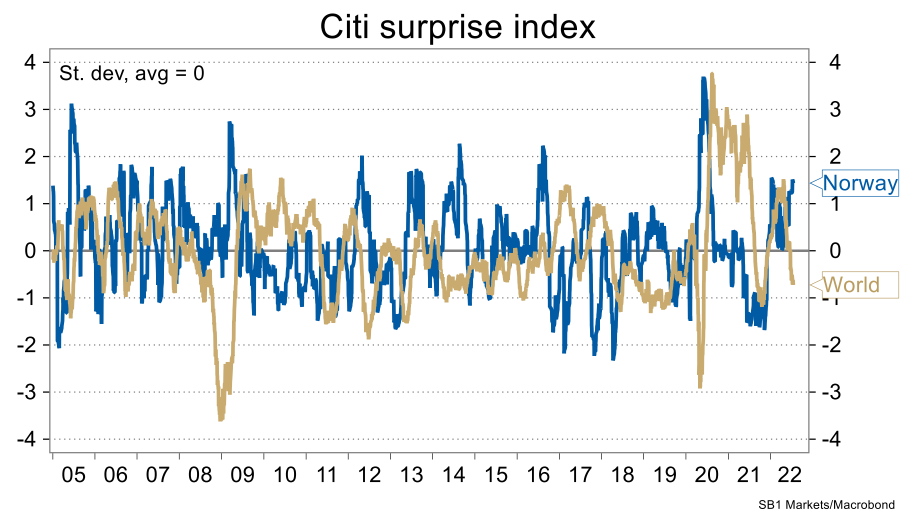
## The post-pandemic normalisation is mostly over. Manufacturing production the weak link in May

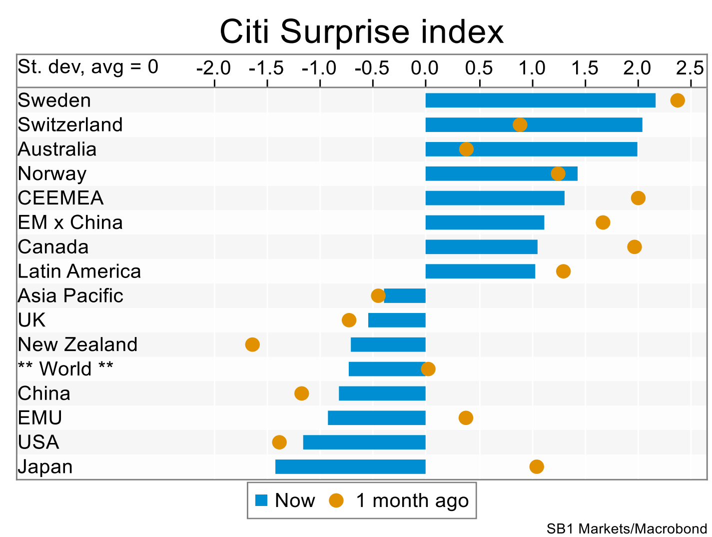



- **Mainland GDP** has fallen the two past months, both have been weaker than expected. April was revised slightly up, but production still fell 0.3%. The trend is still upwards but both supply and demand factors may dampen growth going forward
  - » **Production:** Manufacturing production fell 3.4% in May, a rather surprising decline. The other main sectors reported growth in May
  - » **Demand:** Household demand in Norway fell slightly in April and May, and in May without an increase in spending abroad. Both housing, Mainland business and oil sector investments rose in May. Net exports fell
- **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, and close to record low levels, 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

# US, EMU & China (and thus the World) surprises at the downside




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

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

Highlights

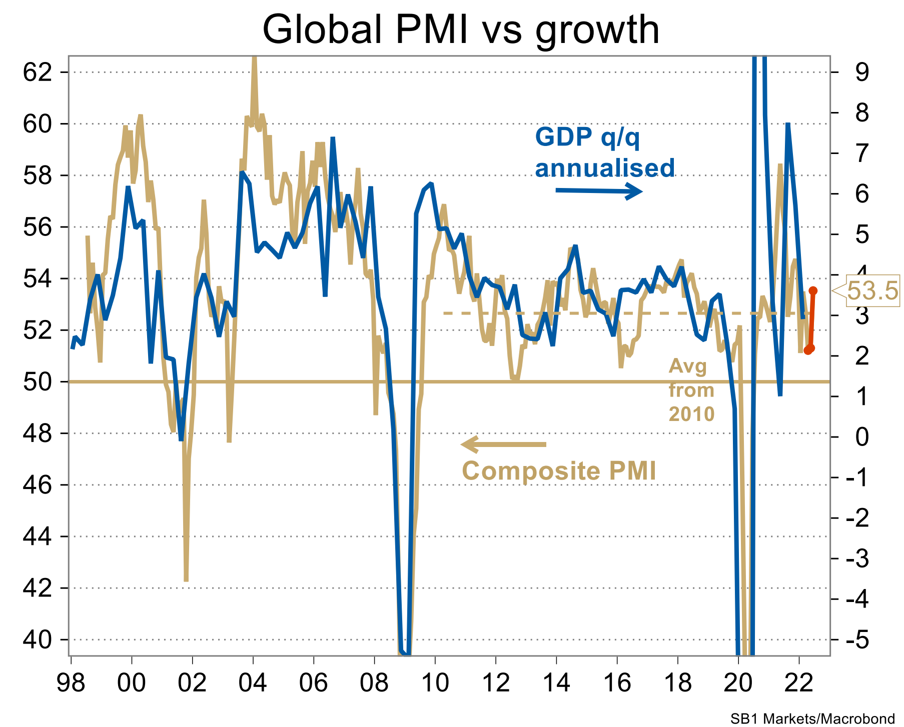
The world around us

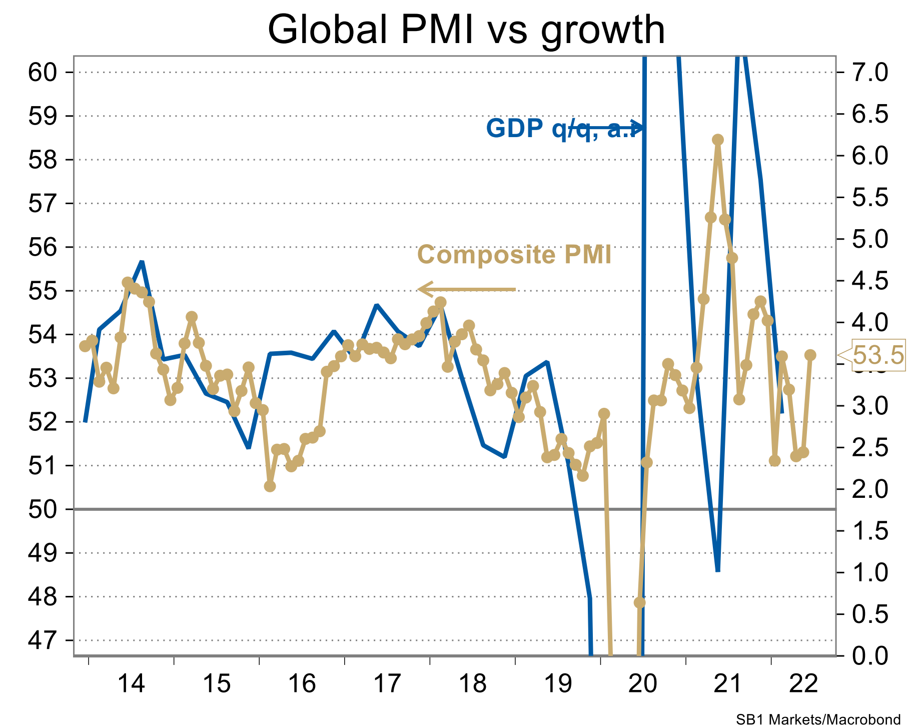
The Norwegian economy

Market charts & comments

# The global PMI sharply up in June, thanks to China – and other EMs too!

The global index gained 2.2 p to 53.5, signalling above trend growth, at some 3.5%. However…

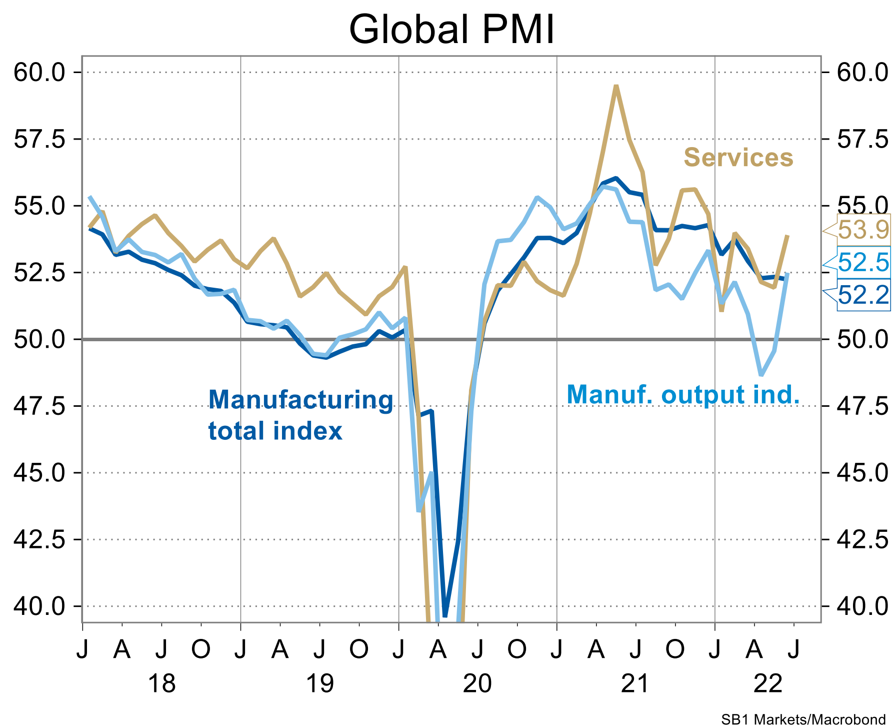


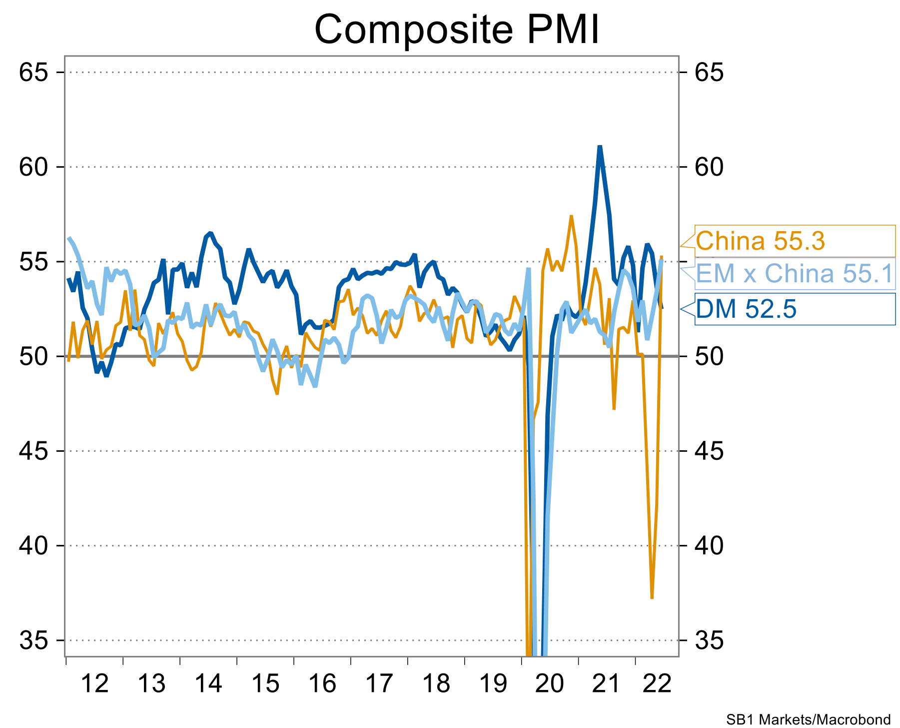




- The **Chinese Caixin composite PMI** climbed 13.4 p, to 53.3 in June, lifting the global index by almost 2 p
- **In DM, the composite index** lost 1.2 p to 52.5, though substantially less than the preliminary PMIs signalled, as the US PMIs fell less than expected

# China lifted both the manufacturing and the services PMIs, as did EM x China!

And the downturn in DM was smaller than the flash estimates indicated



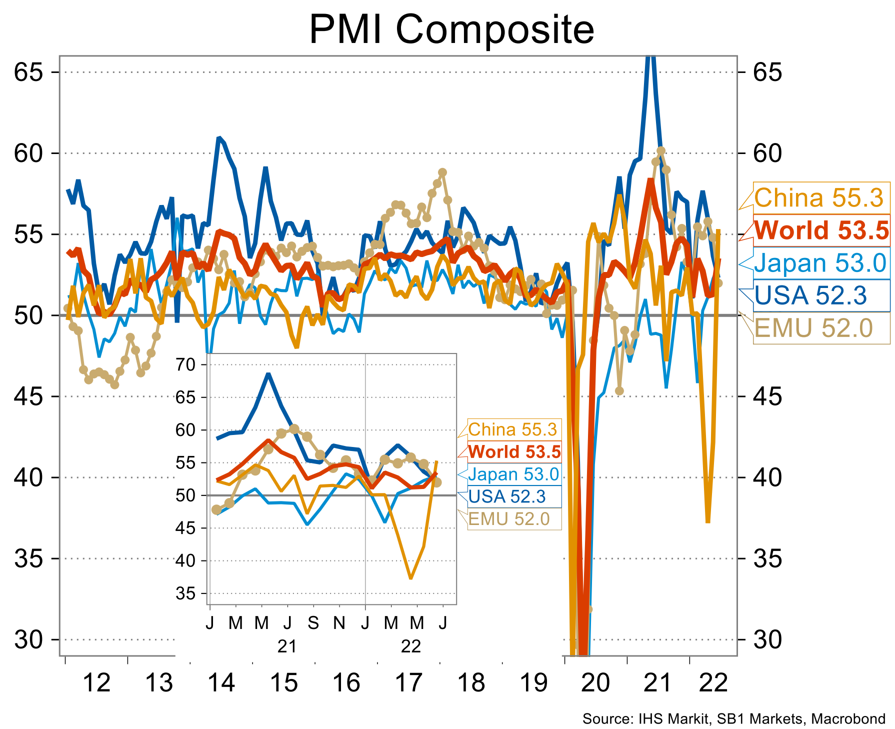



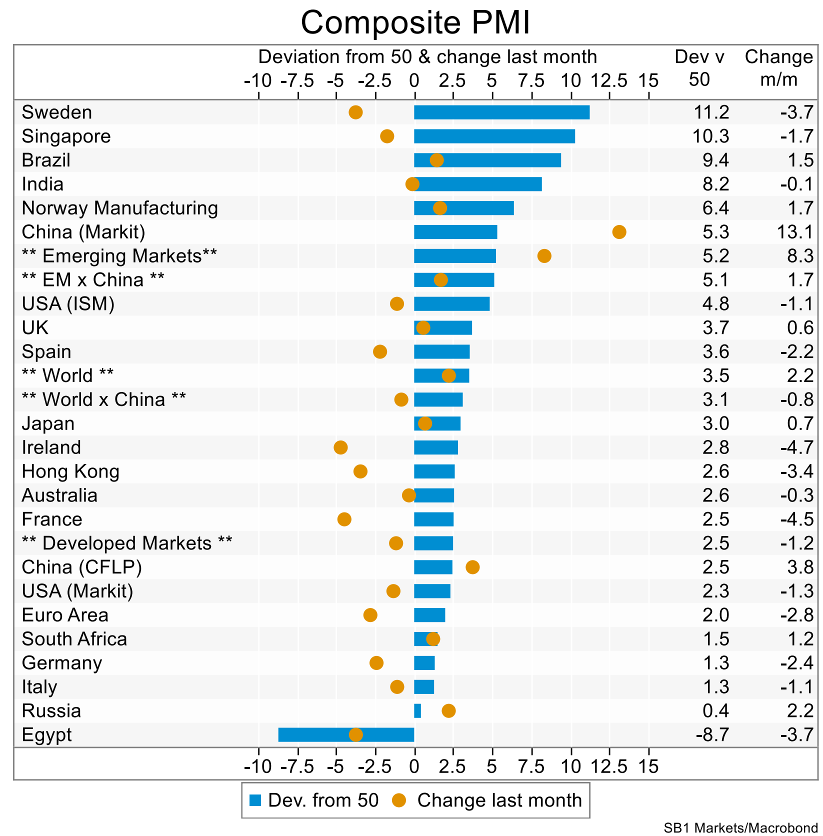

- Both manufacturing & services contributed to the uptick in the composite PMI

SpareBank 1 MARKETS

# The global PMI sharply up, even if the rich part of the world retreated

## The uptick in China is mostly 'technical' after the lockdown downturn



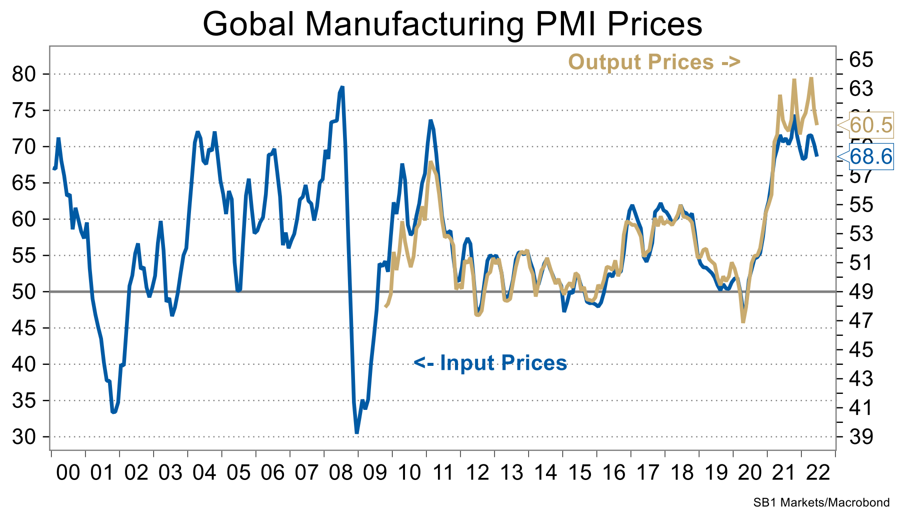



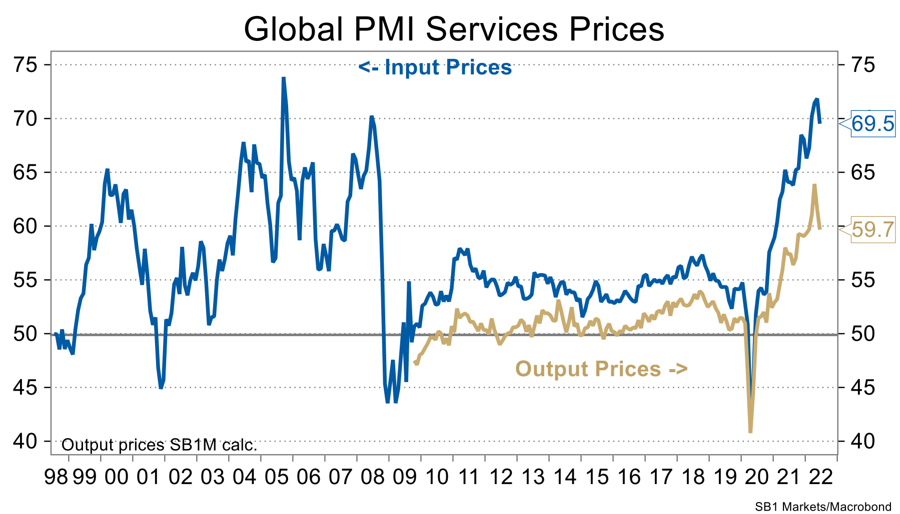

- 16 countries/regions down in May (from 14), and 11 up
- **Both China and Russia** contributed on the upside in June, as did Brazil
- **The rich countries (Developed Markets, DM) PMI** declined 1.2 p due to a decline in both EMU, UK and US
- **Sweden** still has the pole position, ahead of Singapore, and Brazil & India
- (**Norway** does not compete here, we just have a manufacturing PMI. The level would have yielded a 5th place in the composite race (from no. 10 in May)

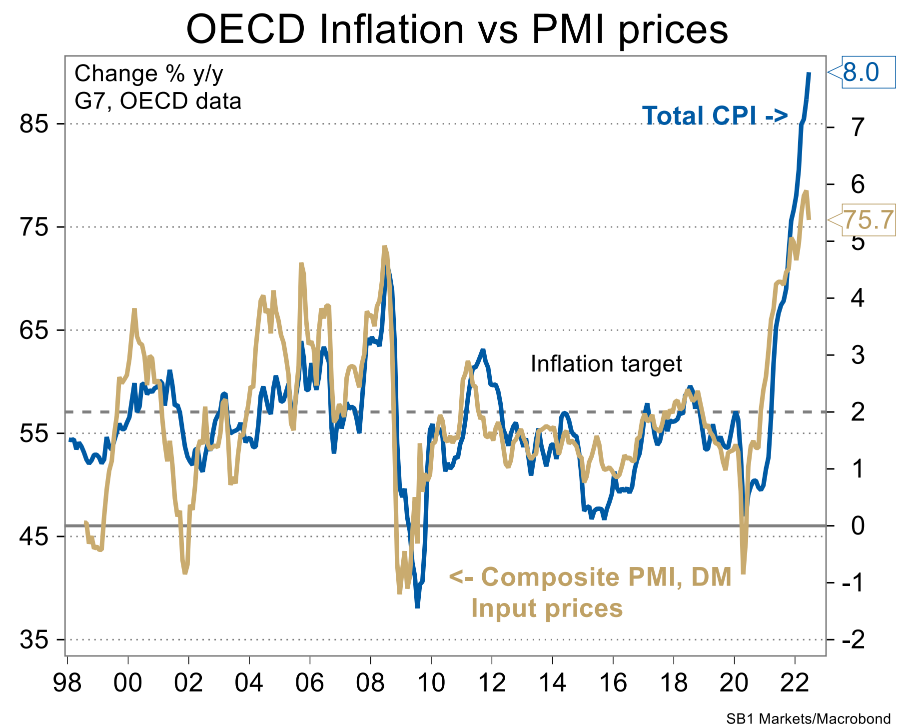
SpareBank 1 MARKETS

# Price increase are slowing, say the PMIs

## All price indices remain at very high levels, though

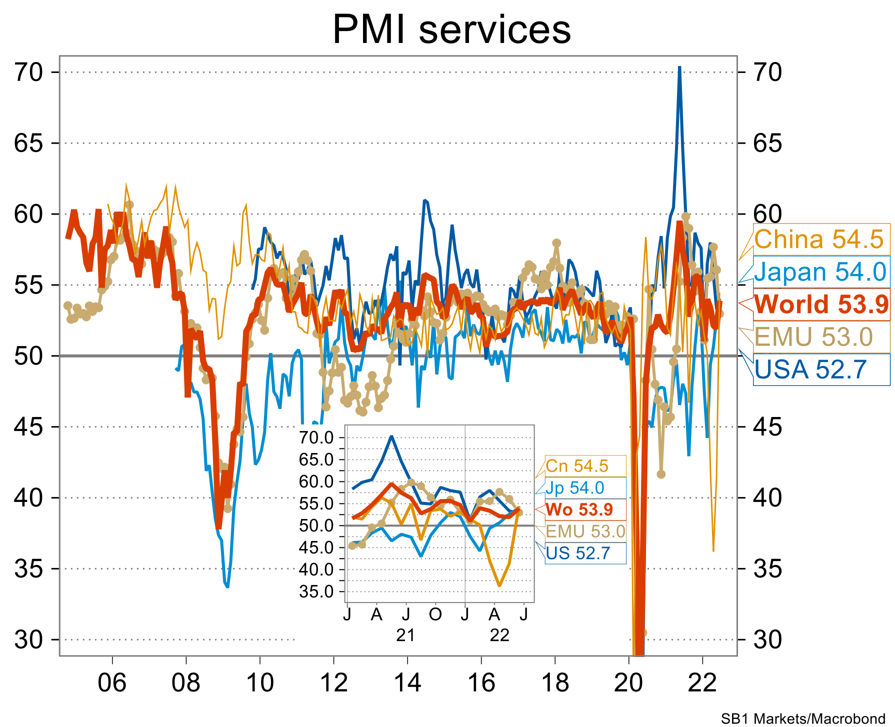


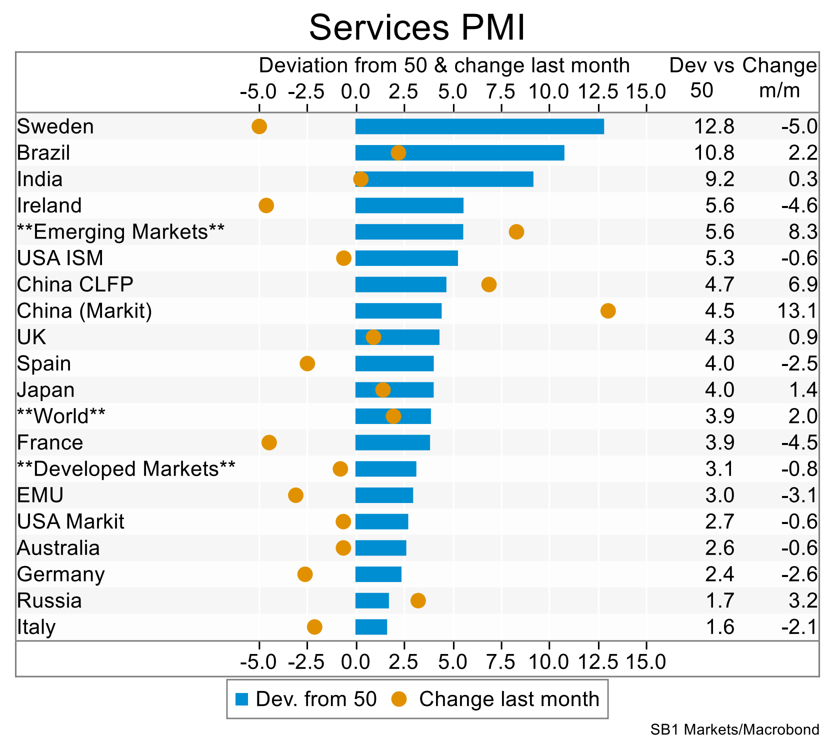



# Services slowed almost everywhere in May, except for China and Russia

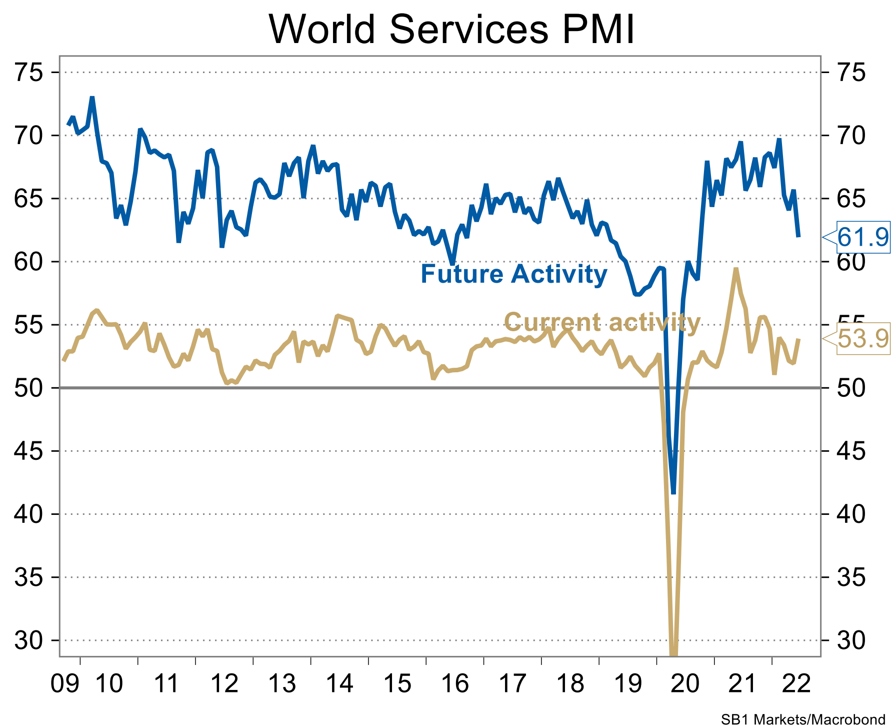
… where the activity level fell but at slower pace in May. China and Russia the only ones below 50!

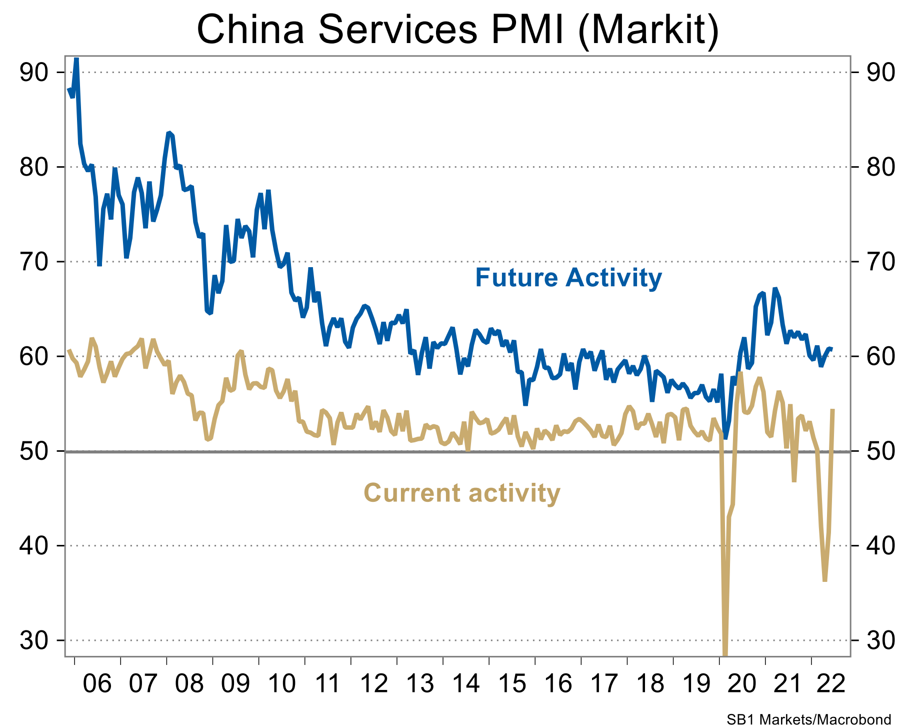



- **The global service sector PMI** gained marginally in May, by 0.1 p to 52.2. Outside China and Russia, just 2 countries reported higher growth in May – the others were down, the UK the most

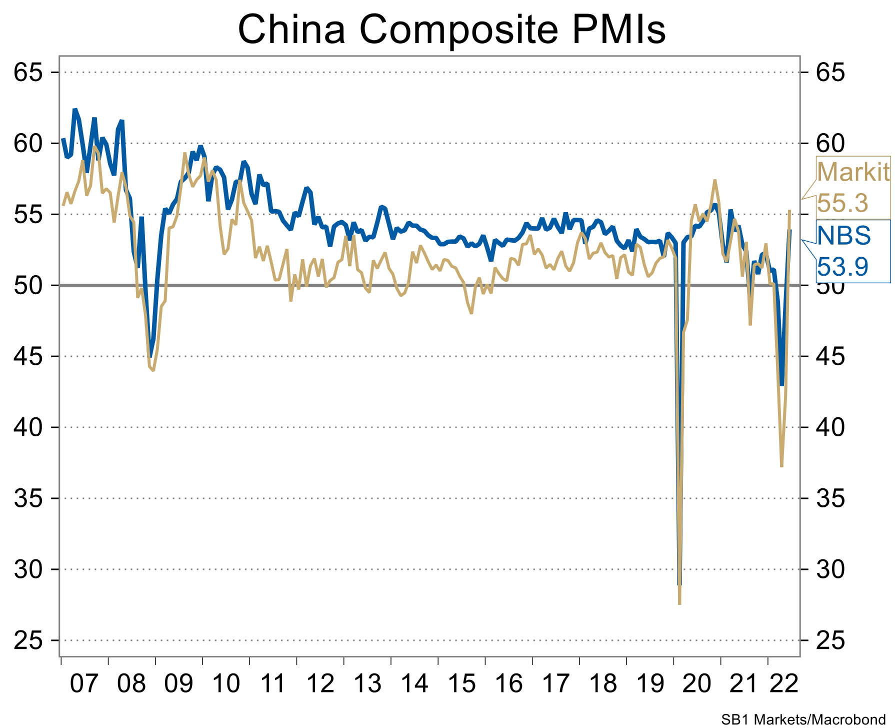
# The service sector report that the future is not that bright anymore

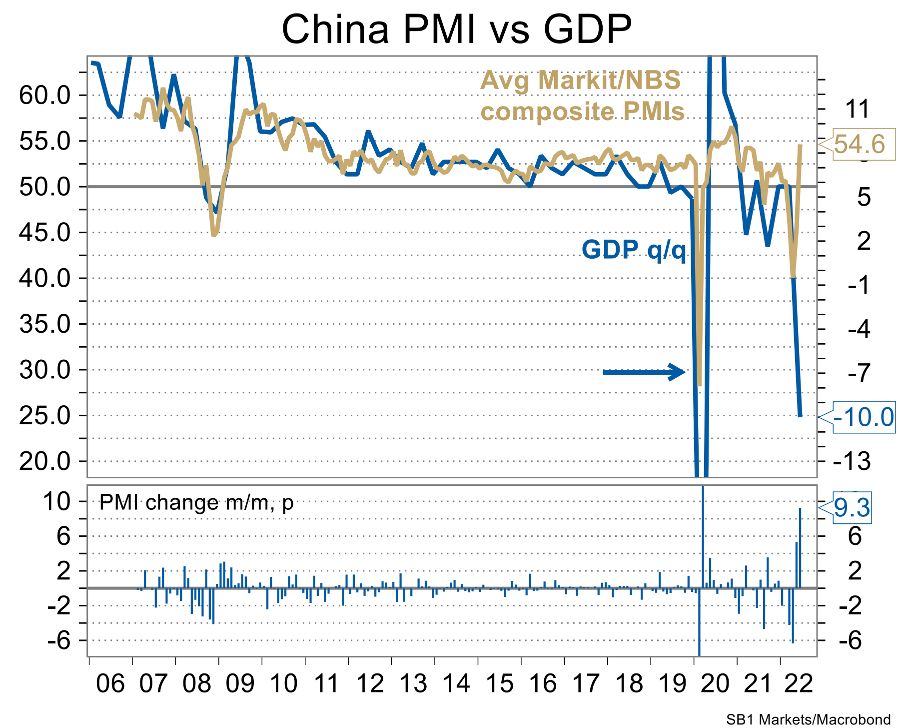


# A 9 p lift in the composite PMI average in June, the 2nd best ever

... following the downturn during the lockdowns. Which is needed, after the 10% drop in GDP in Q2

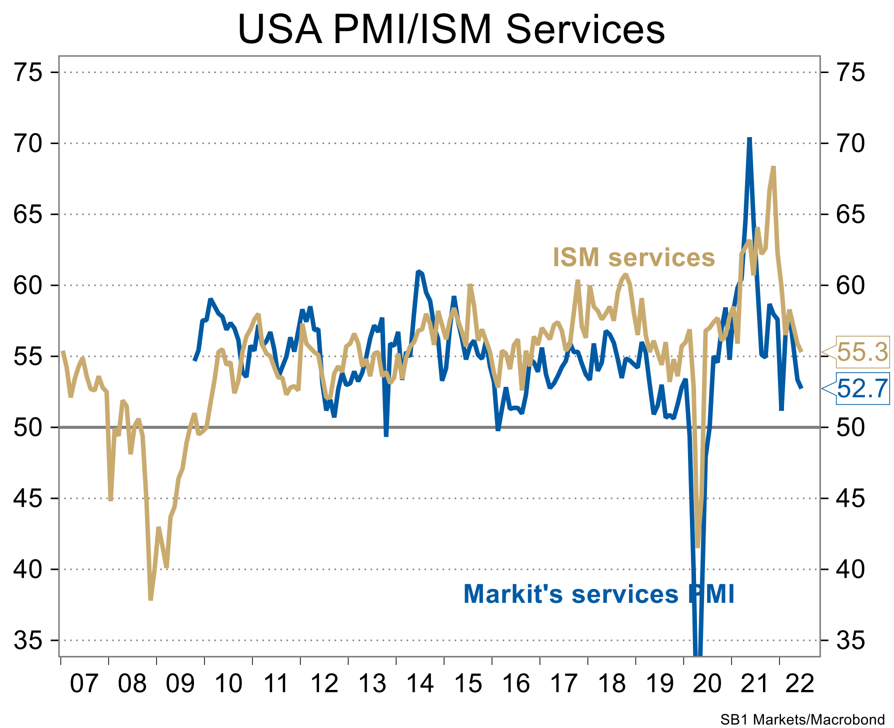


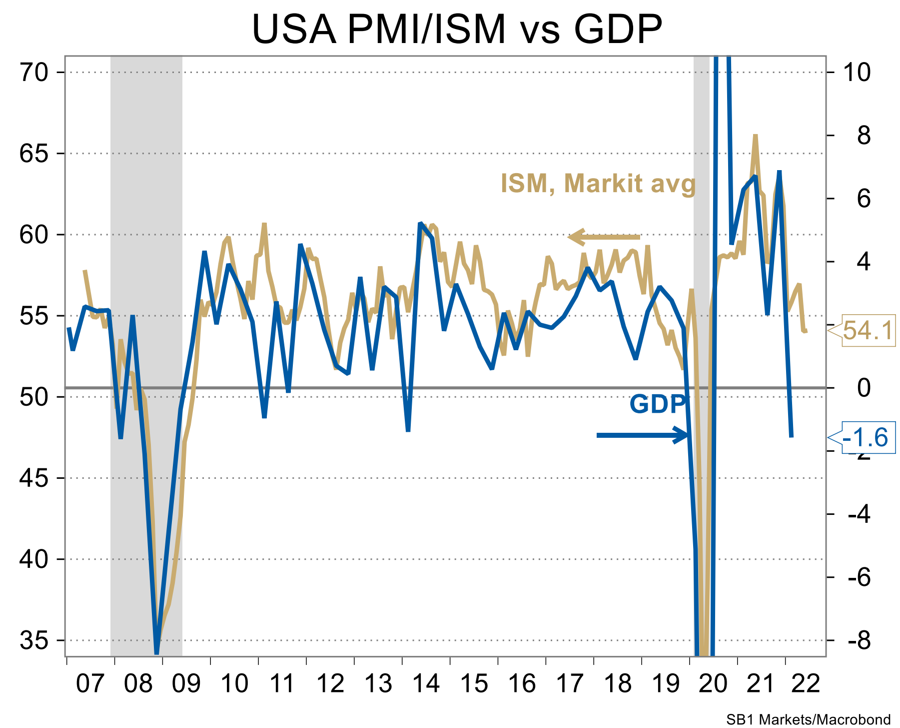




- ... the decline in GDP was 2.6% q/q, not annualised

# Services ISM further down but still somewhat above average at 55.3

Markit's services PMI confirmed down too. <u>The grand PMI/ISM total at 54.1, signals 2 % GDP growth</u>

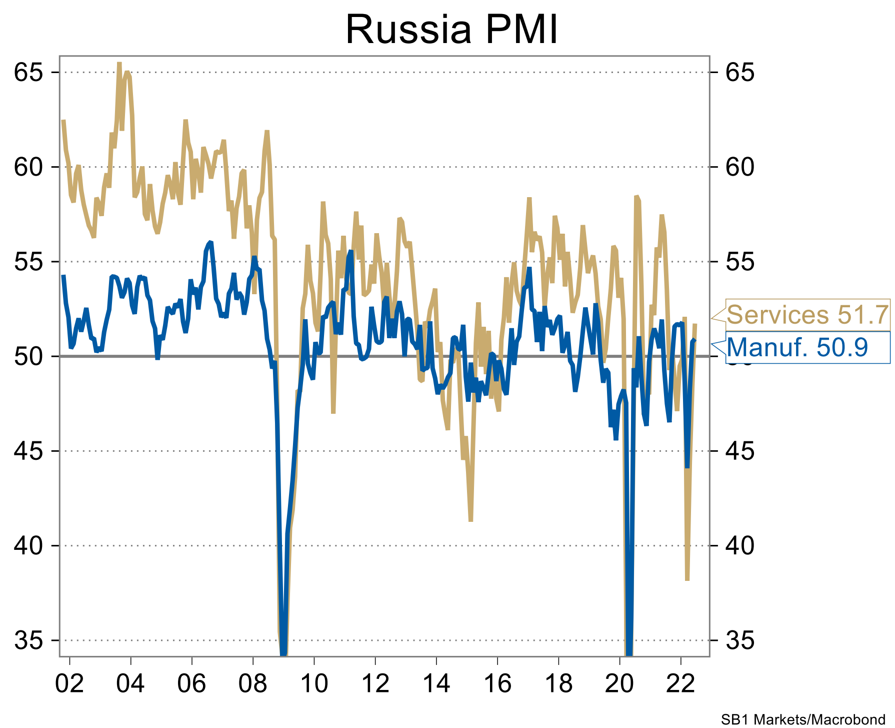


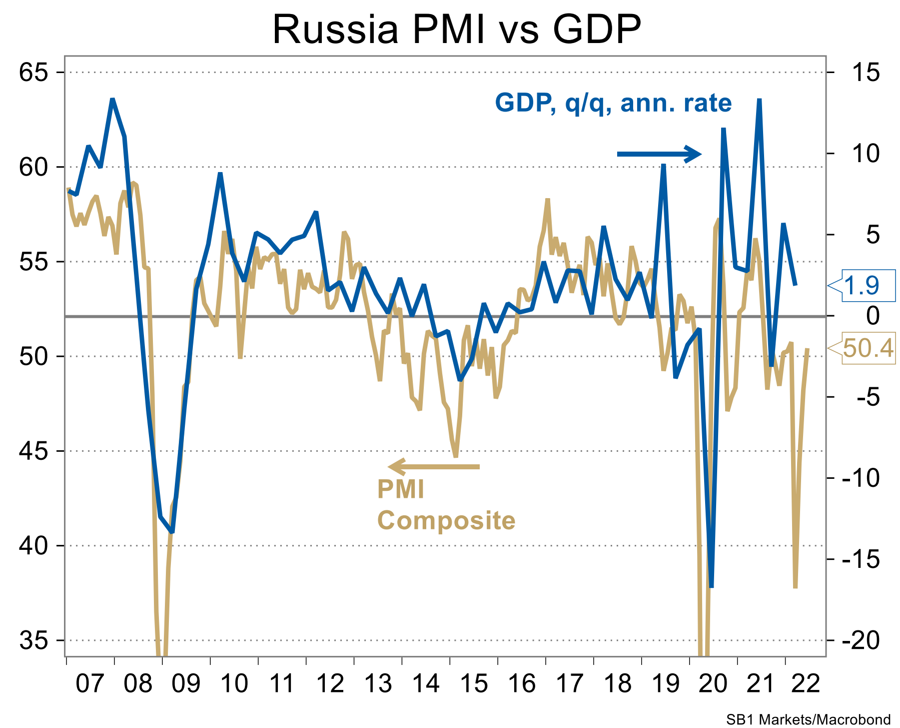




- The decline in Markit's survey was smaller than the initial estimate
- However, all business surveys are trending downwards

# Growth in Russia in June, following the downturn during the spring

The composite PMI rose further by 3.8 p to 48.2, signalling a continuing but moderate decline in GDP

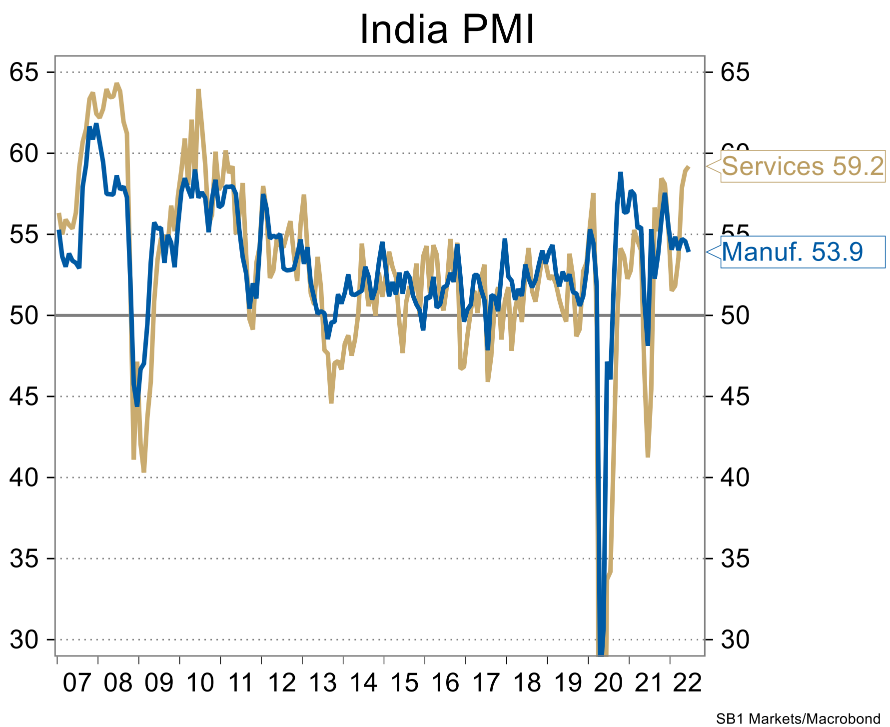


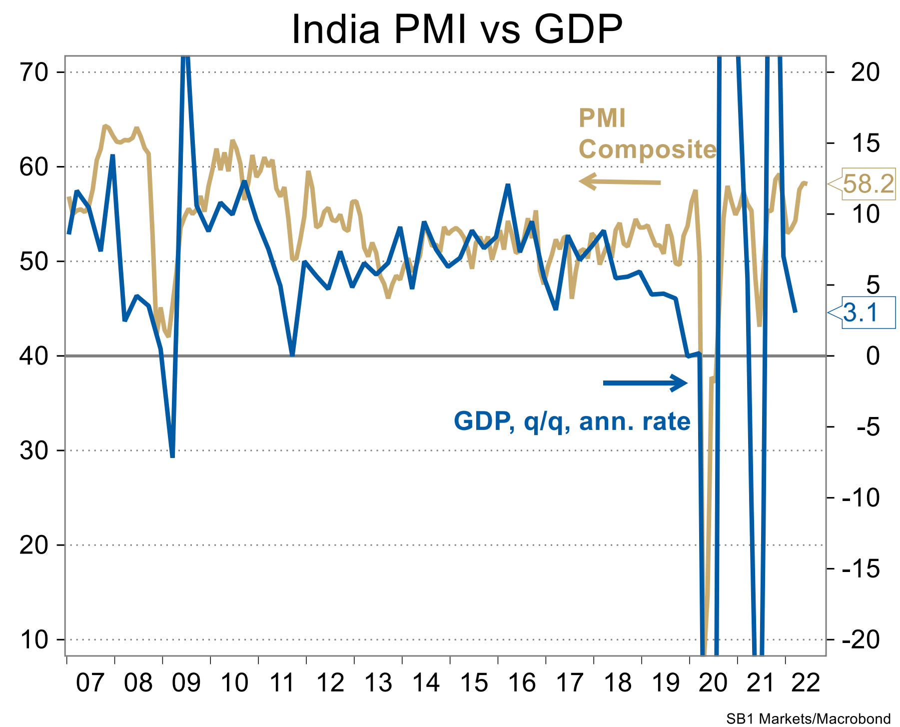




- **Both the manufacturing sector and services** – and the composite PMI crossed the 50 line
- **The composite PMI** at 50.4 is still well below an average level, which usually corresponds to a decline in GDP. The correlation is not very impressive though
- **A reminder:** The PMIs are not sentiment surveys – respondents are asked about in changes in actual activity (new orders, output, employment, inventories) from the previous month

# The PMIs close to unch in June – services & the compostite at very high levels

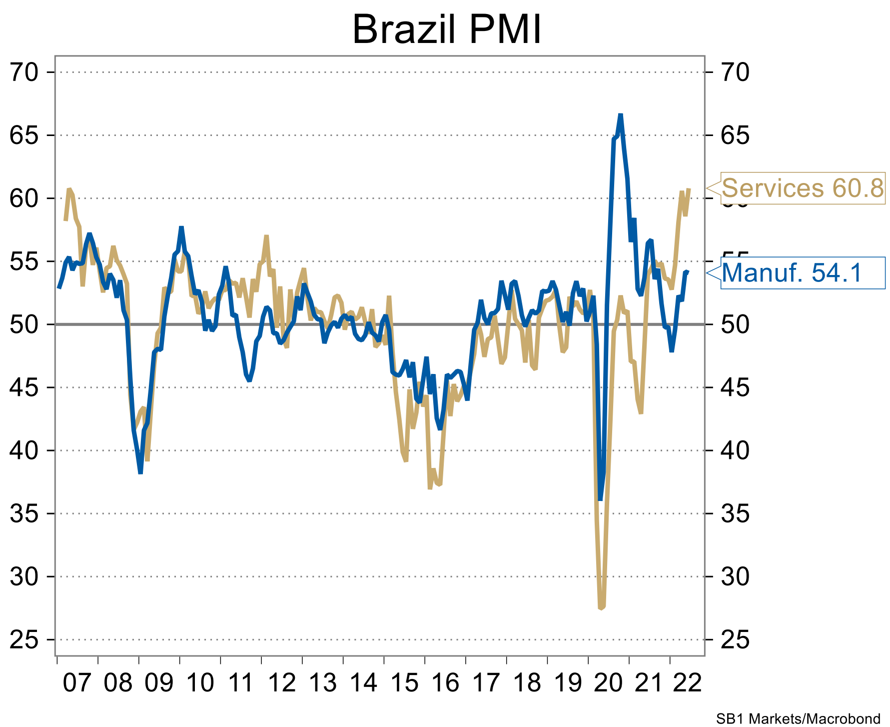
## The composite PMI fell 0.1 p to 58.3

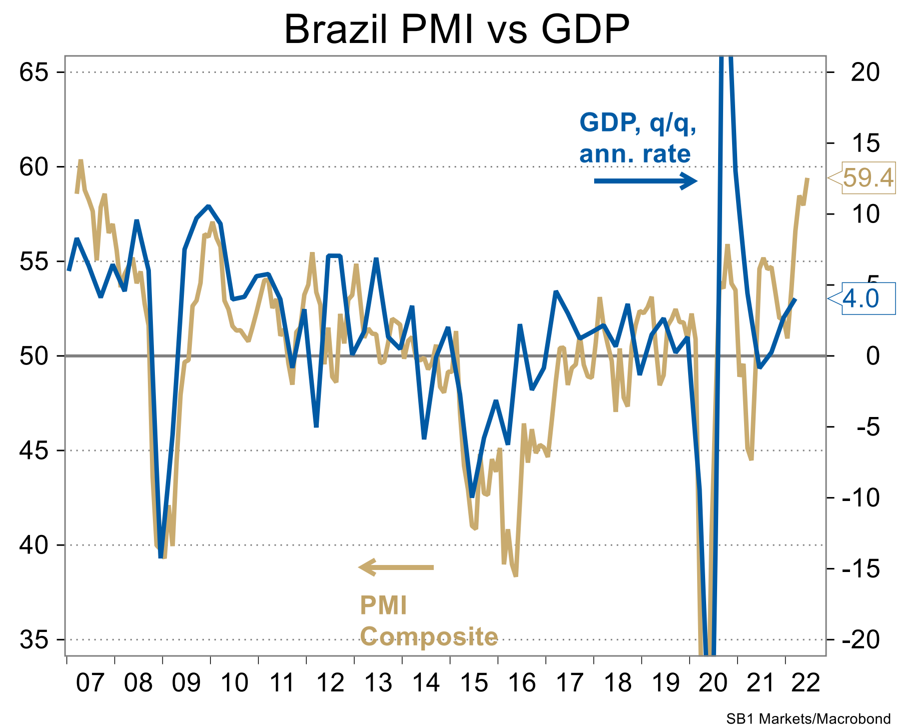



- The **service sector** report the highest growth since 2011
- In Q1, **Indian GDP growth** slowed to a 3.1% pace, down from 7% in Q4. The PMI signals higher growth in Q2
  - » However, the correlation between the PMIs and GDP is rather weak – and due to the pandemic, growth rates have been all over the place the past 2 years

# The composite PMI at the best level since 2007, at 59.4

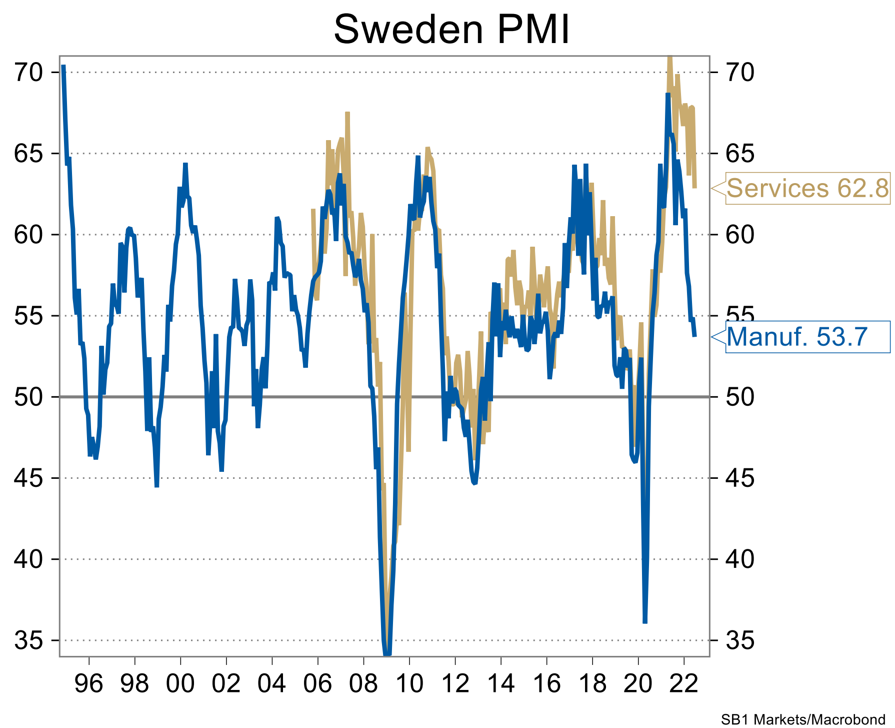


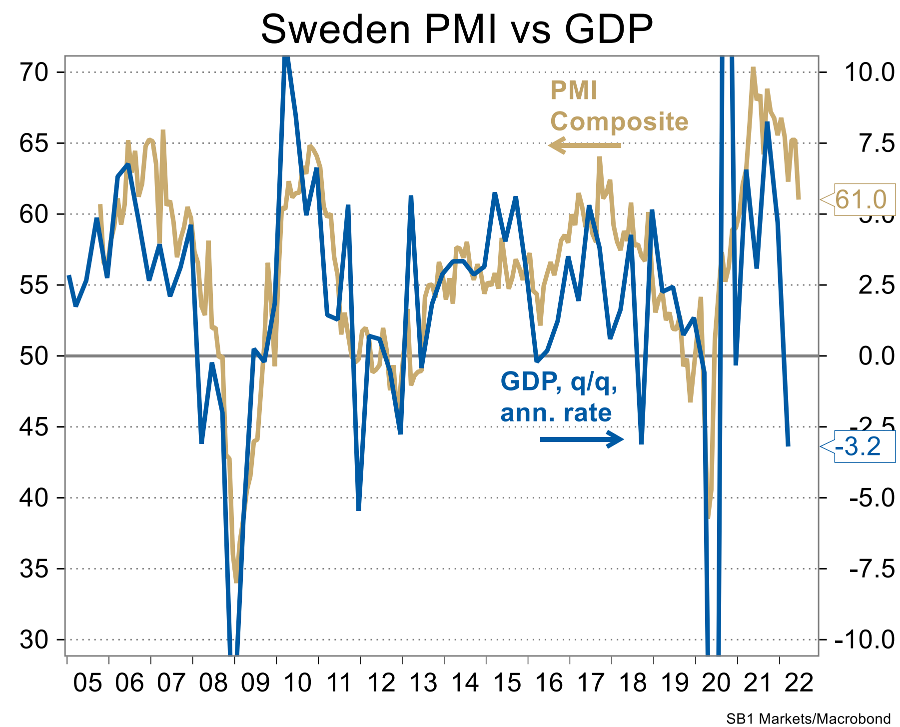




- GDP growth has picked up some steam the past 2 quarters

# The PMIs have peaked – as has growth

## The composite index at 61 still signals 5% GDP growth

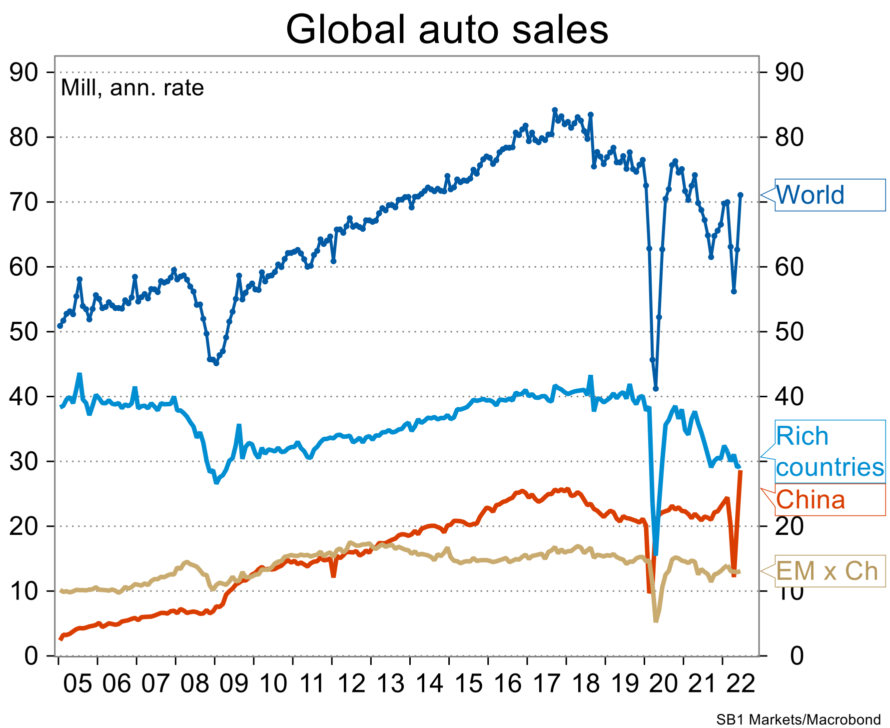


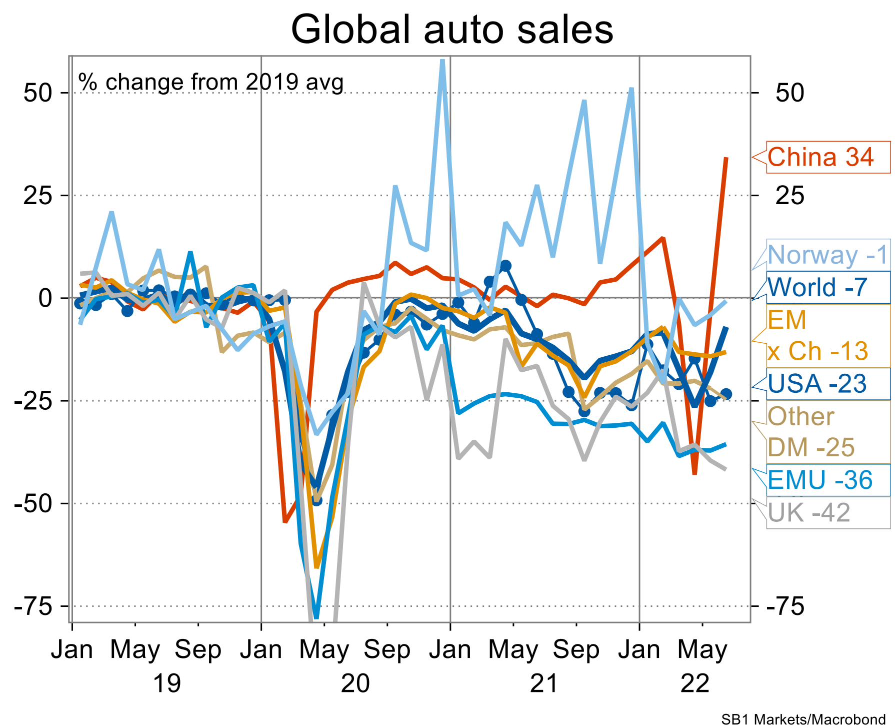




- In Q1, **GDP** fell at a 3.2% pace, due to the Omicron slowdown in some services (which BTW was not captured by the service sector PMI)

# Chinese June auto sales the highest in any country, ever

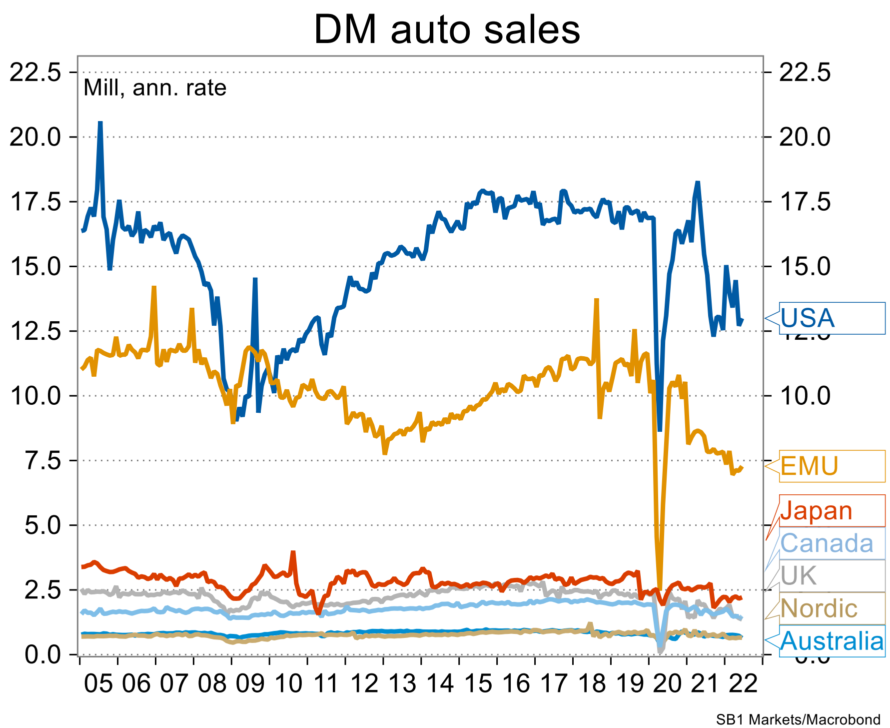
## Sales were stable in the rich part of the world, and inched upwards in Emerging Markets x China

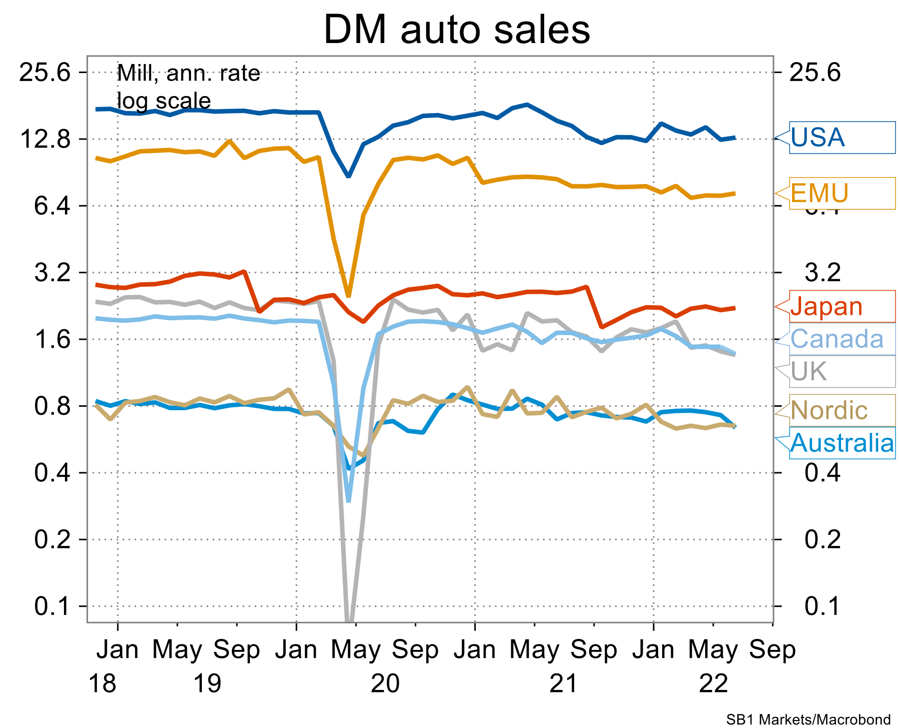



- **Global auto sales** rose 14% in June, thanks to a further recovery in sales in China, to 29 mill units (annual rate) from 21 mill in May. Global sales are still far below (-7%) the 2019 level – but even so the best since last May
- Sales in the **US** rose marginally to -23% vs 2019. **EMU** sales also rose marginally but remain 36% below the 2019 level. **UK** sales are down 42%! **Norwegian sales** are just 1% below the 2019 level
- **Russian sales** are down 92% since before the war, probably both due to lack of supply (imported cars at least) and reduced demand from households
- Still, **EM x China total** is down 'just' 13% vs. the 2019 level (the decline in Russia equals more than a 10 pp drag – and the rest is almost back!)
- **Auto production** is very likely limiting sales most places. However, Chinese production was 32% above the 2019 level in June. South Korea is also above the 2019 level, but auto production is well below a normal level in all western countries and in Japan

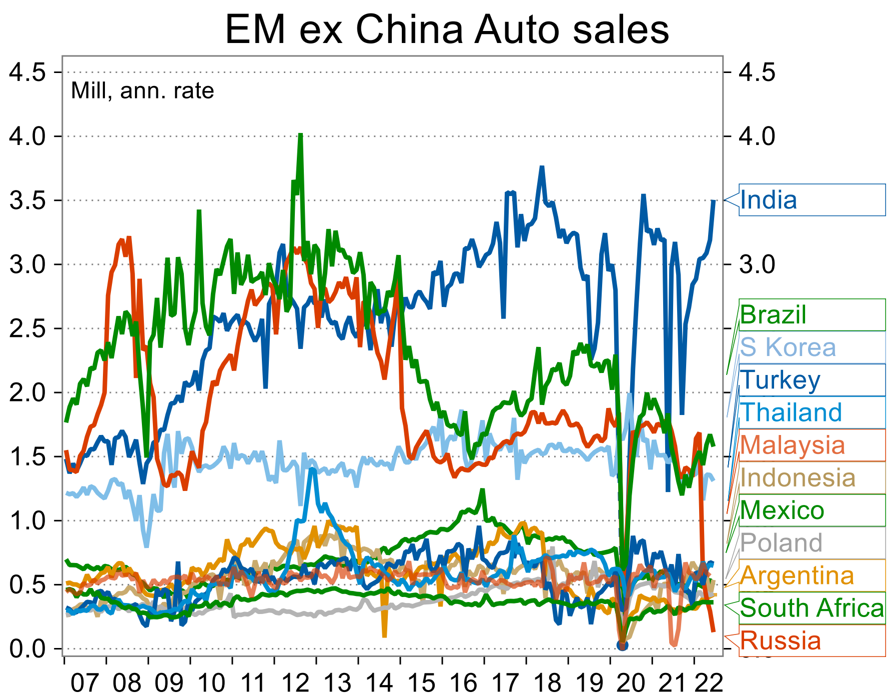
# DM sales: Sales in Europe & Japan are still very low. US sales are trending up!

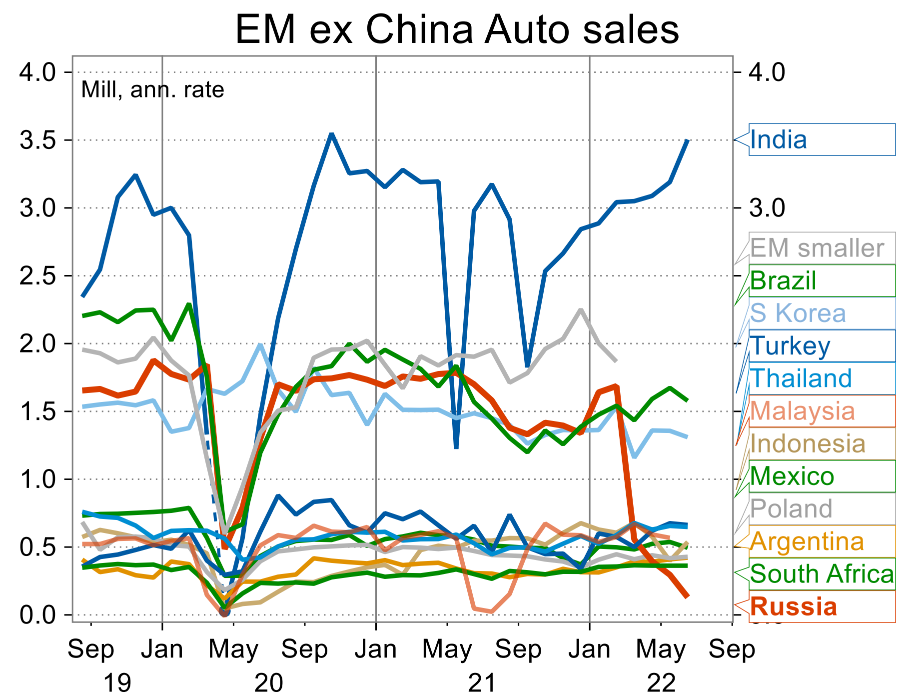


# EM: Russian sales further down, -92% vs the pre war level. India going strong

… at least according to prelim. Indian data. Other EM countries on the way up

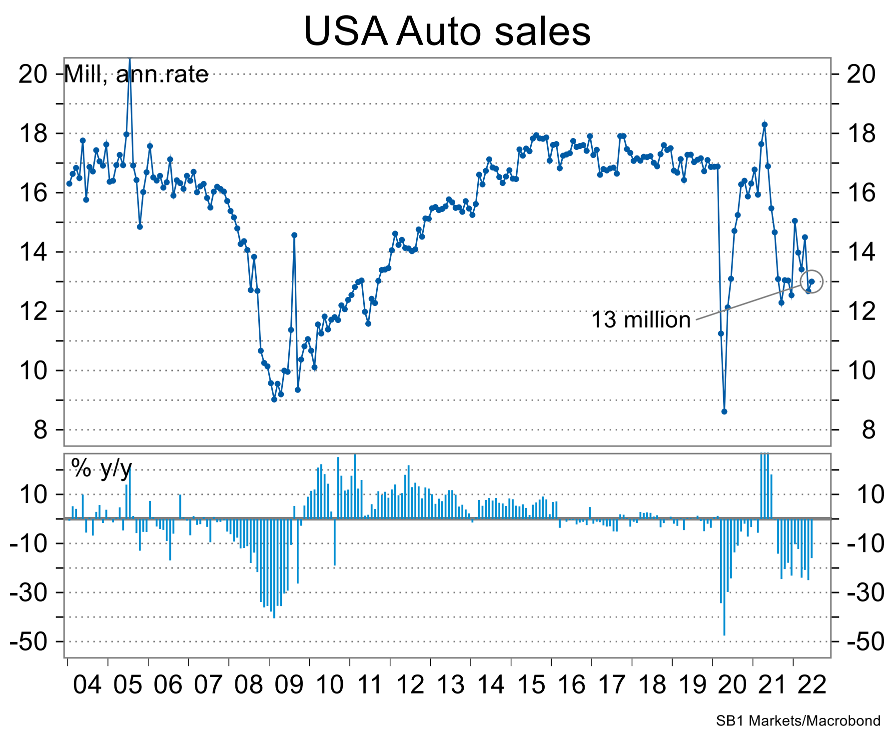


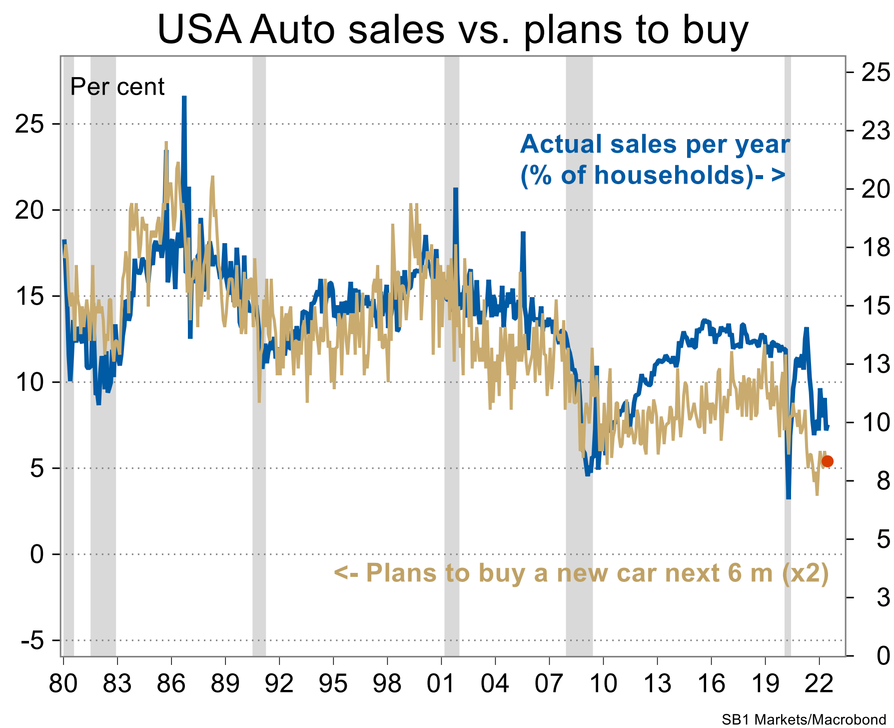




Not all countries have reported yet, and for some countries we have just plugged in figures from media reports that are not always correct

# US auto sales marginally up in June, to 13 mill, from 12.7

## Sales fell short of expectations, 13.5 mill. Lack of supply very likely to blame

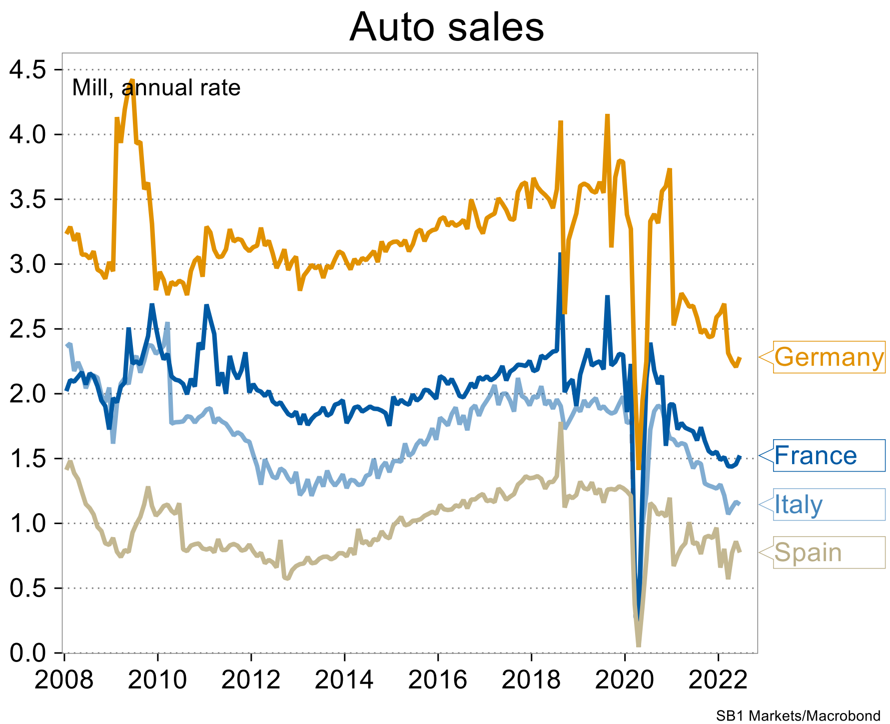


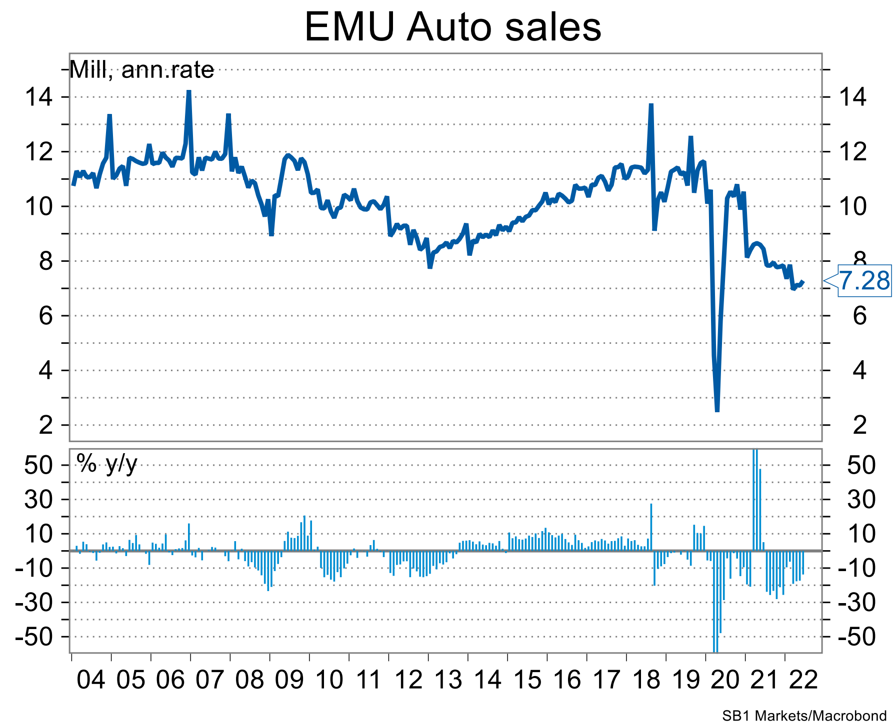




- Sales are down almost 25% vs. the 2019 level
- Plans for buying a new car has been stable at a record low level over the past year

# Auto sales slightly up up in June, still down 36% vs. the 2019 level

Sales rose in both Germany and France. Total sales up 0.2 mill to 7.3 mill



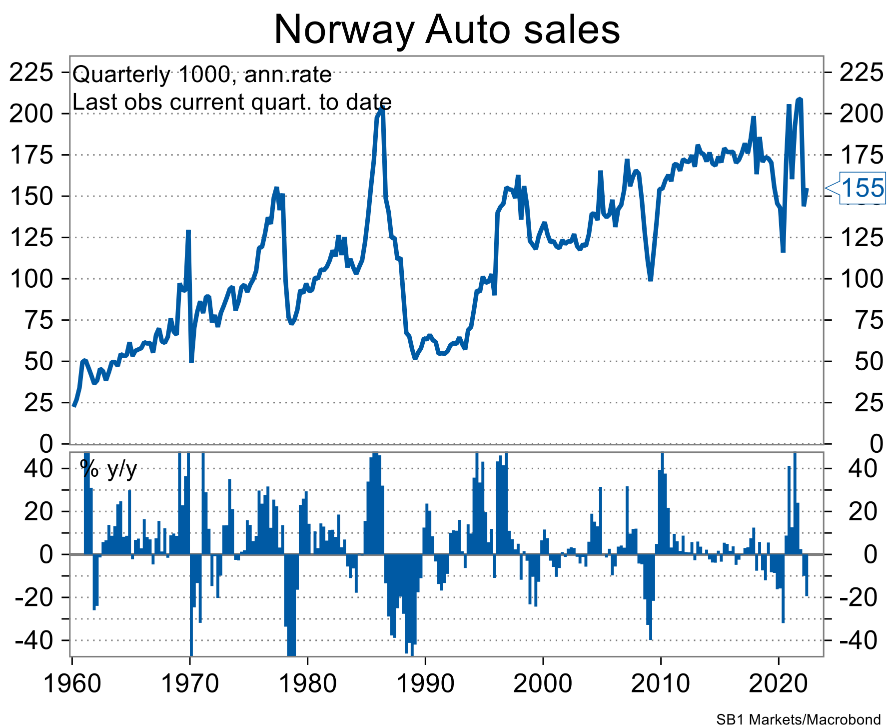



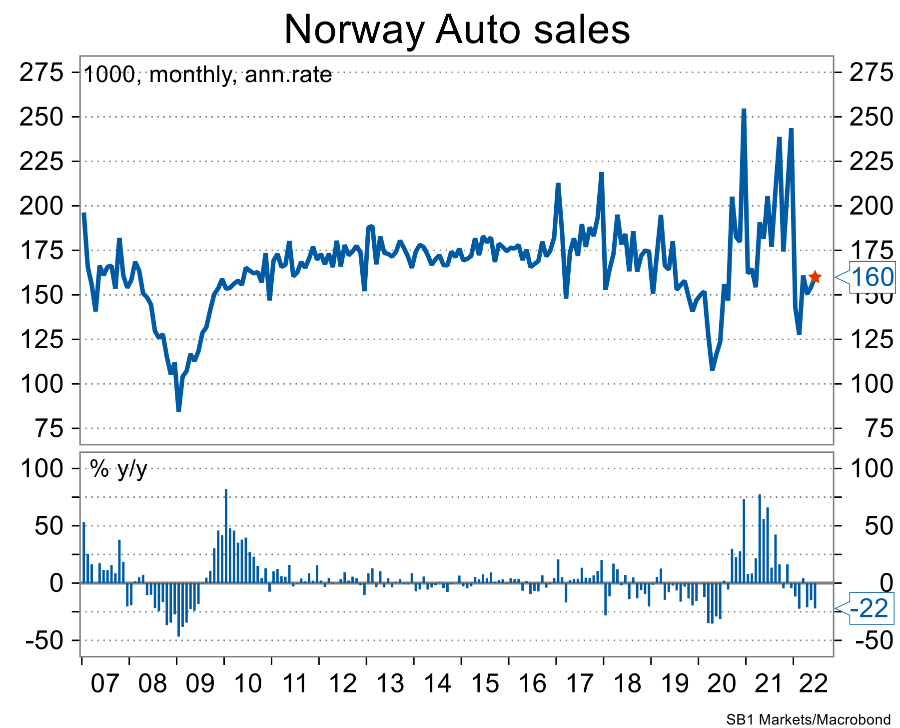

- All markets have reported substantial decline in auto sales since early 2021 – delivery problems is the main culprit, but some demand weakness as well?

SpareBank 1 MARKETS

# Norway: Stable 'low' auto sales, as delivery times are getting longer

Media reports indicate that demand is no problem, but deliveries are the real challenge



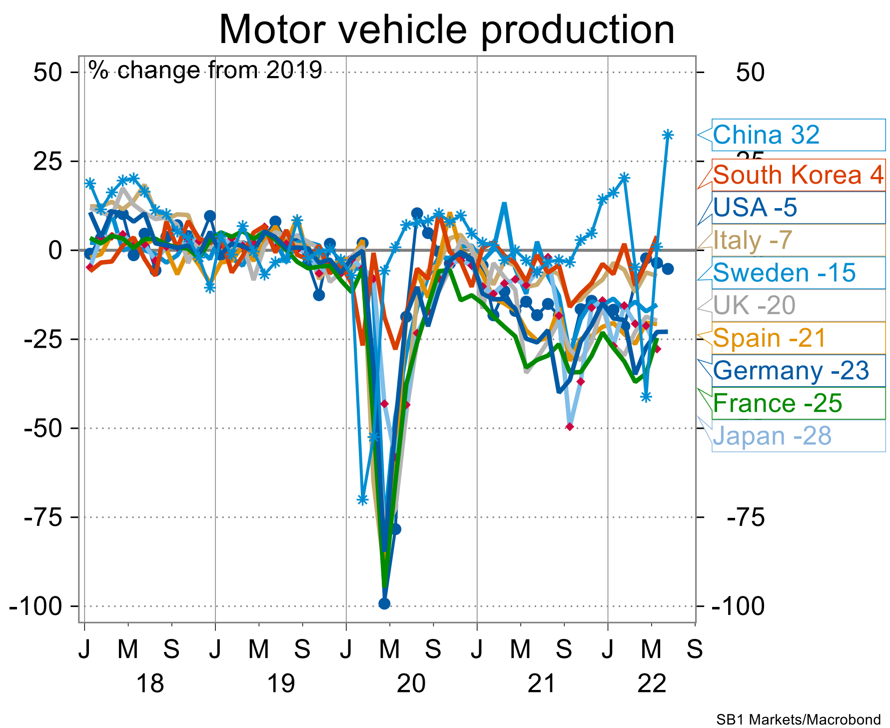




- New registrations rose slightly to a 160' pace in June, from 150' in May
- New registrations in Q2 were marginally higher than in Q1, still 25% down from the ATH in Q4 last year

SpareBank 1 MARKETS

# Full speed ahead in China, Korea OK too. US just 4% below the 2019 level

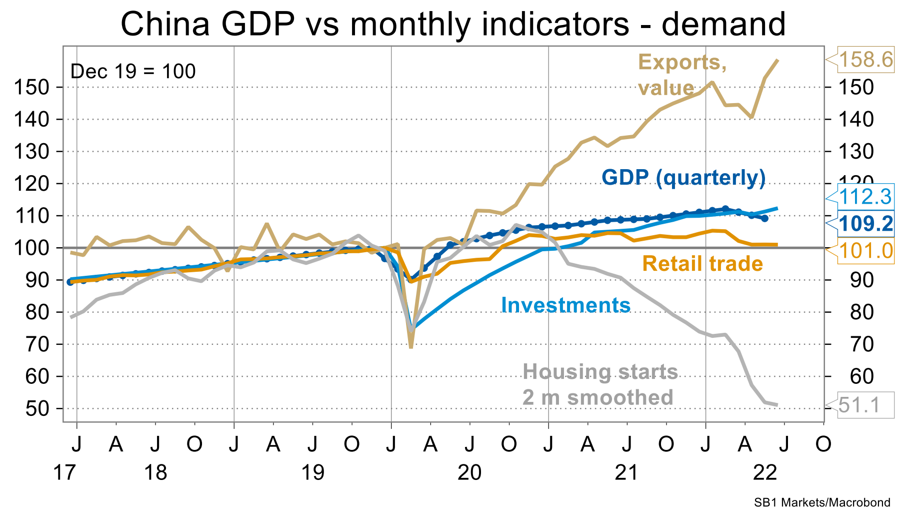
Auto production in most of Europe and Japan still down 20 – 30%

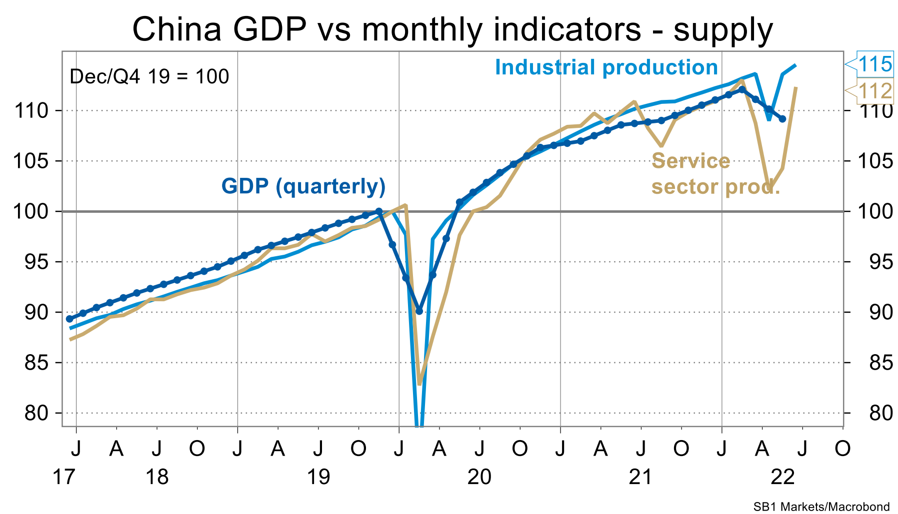


SpareBank 1 MARKETS

# GDP down 10% in Q2 (-2.6% not annualised). More infrastructure spending ahead

## June data mixed: Housing, retail still weak. Other investments, ind. prod, exports, credit OK



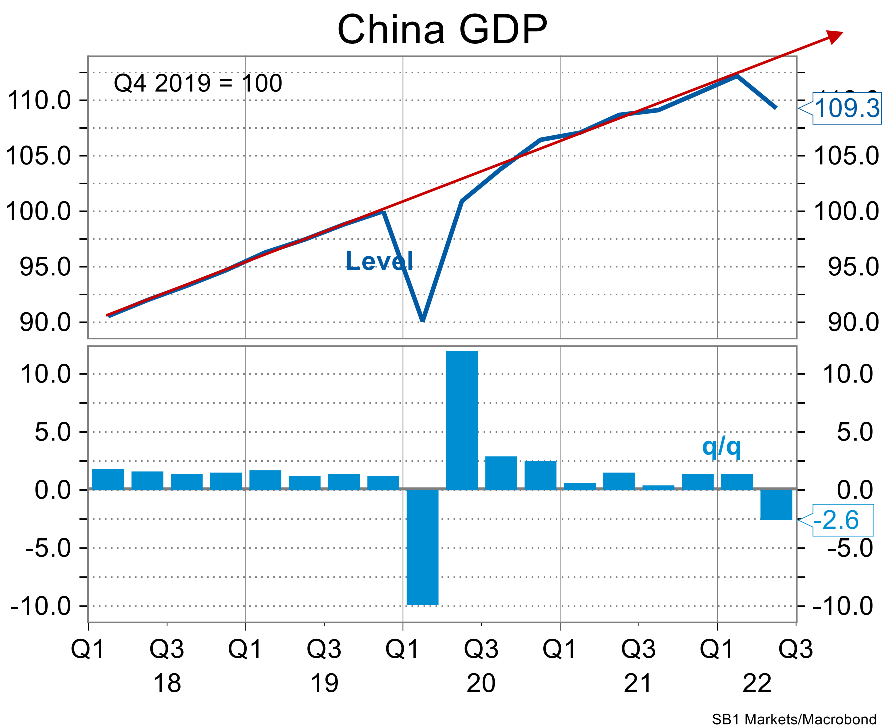



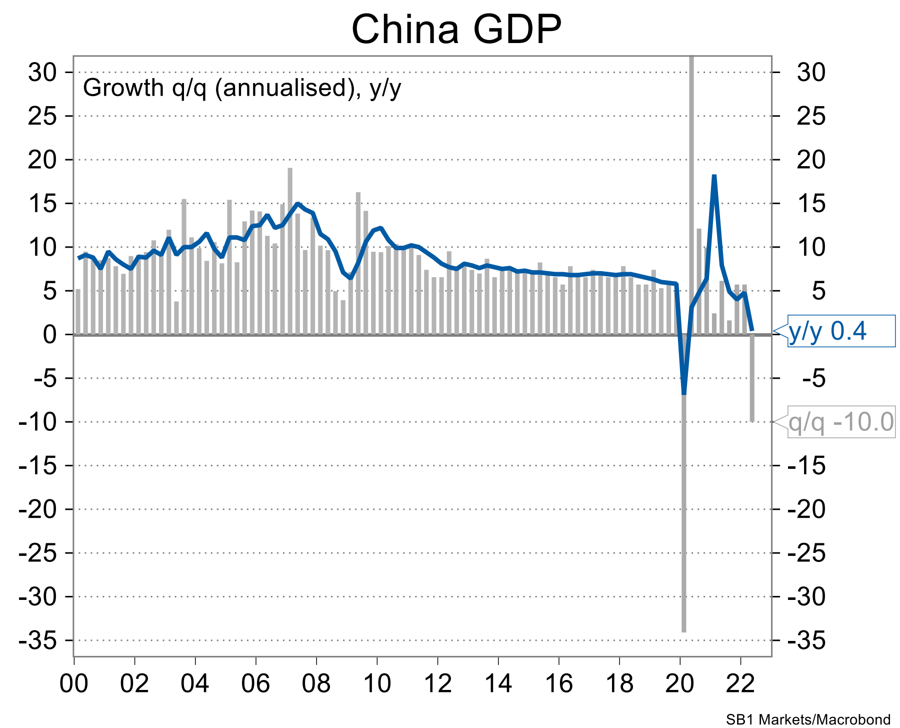

- **GDP** fell 10% in Q2, more than expected (8%, 2.6% vs 2% not annualised), and is up just 0.4% y/y, expected 1.2% - the second worst quarter ever
- **Industrial production** rose 0.8% in June (after 4.2% in May) and is back to the pre-lockdown trend, still marginally lower than expected, 3.9% vs. 4.0% y/y
- **Service sector production** gained 7.8% m/m in June but is still clearly below the pre-lockdown trend, and activity is up just 1.3% y/y – and Q2 was in sum really weak
- **Retail sales** remained close to unch m/m in volume terms in June, at a very low level. Sales were up 3.1% y/y nominally, below retail price inflation (and sales are down y/y in volume terms. Still, expectations were much lower, at just 0.3% y/y
- **Investments** rose 1% in June, and is back on track, even both residential and commercial construction starts has fallen by 50% from the peak early last year (the largest contraction ever), without sigs of any recovery - not even from the 25% drop in starts during the lockdown. However, new home sales have partially recovered after the lockdown, and are down 'just' 30% from the peak last year
- **Credit growth** remained at a normal level in June, but just due to a continued increase in local government borrowing
- **Central authorities** have decided that local governments can increase borrowing in H2 in order to fund infrastructure projects. A massive policy shift, in order to support growth like in the good ol' days. However most of the 7 trl infrastructure program (Bloomberg est, 6% of GDP!) must be funded from other sources than the 1.5 trl local gov. extra borrowing
- **CPI inflation** has increased somewhat, but remains low (2.5%),. especially ex. food & energy (1.0%)
- **Exports** rose to the highest level ever in June, even in volume terms, and to far above any recent trend paths. (No supply chain disruption?).
  **Imports** fell slightly, and remains somewhat below the pre-pandemic trend
- **Fiscal policy** is very expansionary (a 5% of GDP increase in the budget deficit), not due to higher spending, but a dramatic reduction in revenues

**In sum:** Q2 was an economic disaster, hopefully short-lived. However, June data are not impressive, just industrial production and total investments were back on track in June. The announced boost in infrastructure investments may strengthen domestic demand short term, but will probably not support growth long term due to lack of profitable projects and an ever higher debt level

# GDP down 10% in Q2 (2.6% not annualized), up just 0.4% y/y

## GDP fell




- GDP was 0.6 – 0.8% weaker than expected – but still just ¼ of the decline in Q1-20
- Consumption fell sharply in Q2, while net exports rose. Investments were close to unch

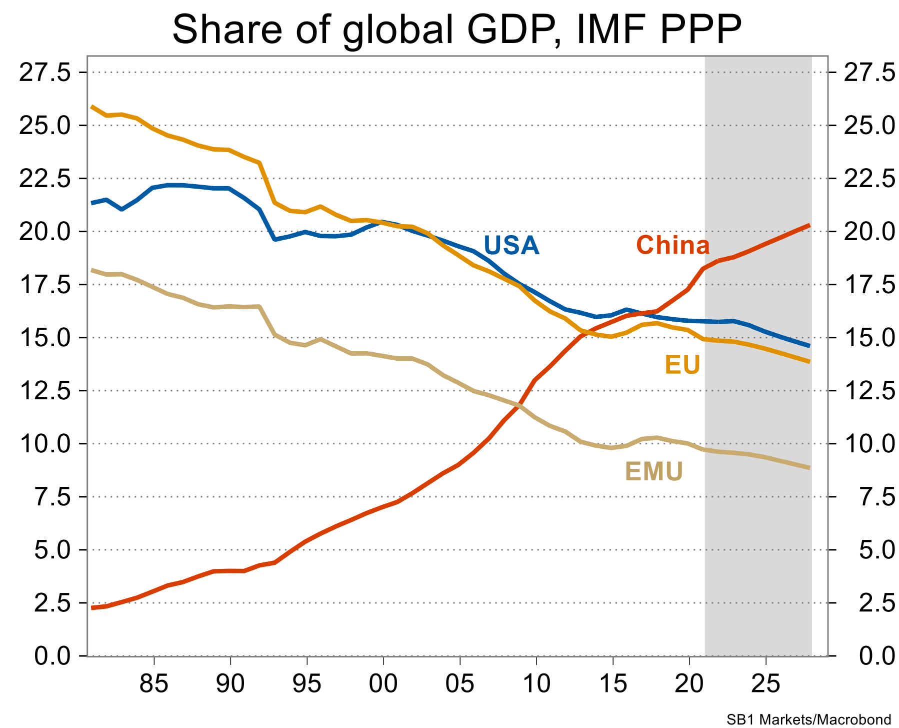
# A sharp contraction in consumption the only drag on growth

Net exports contributed positively in y/y (and q/q) in Q2

SpareBank 1 MARKETS

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

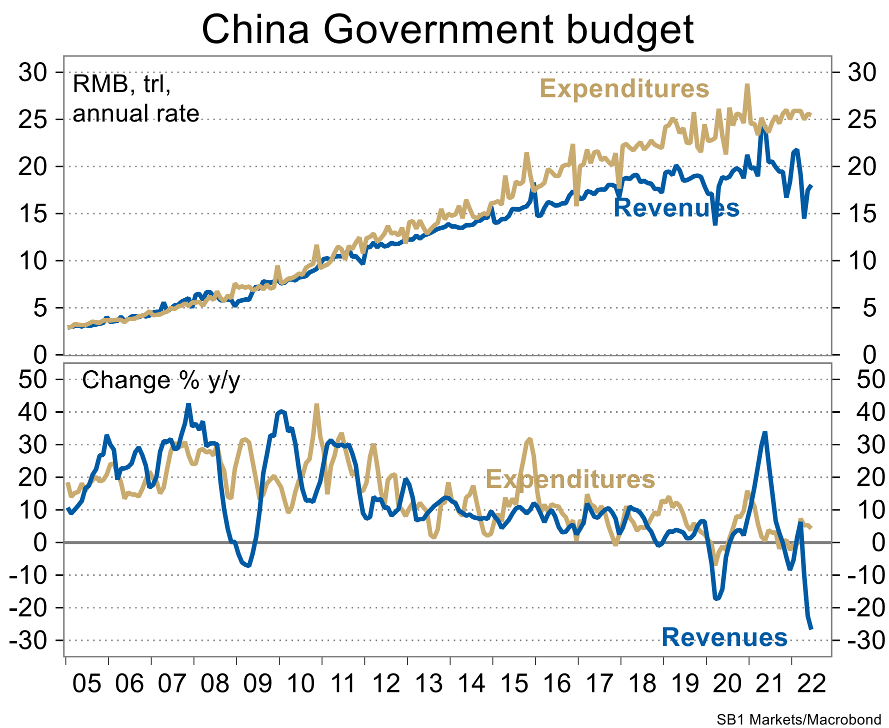
## In Q2, world GDP slowed substantially due to China, and very likely the US as well

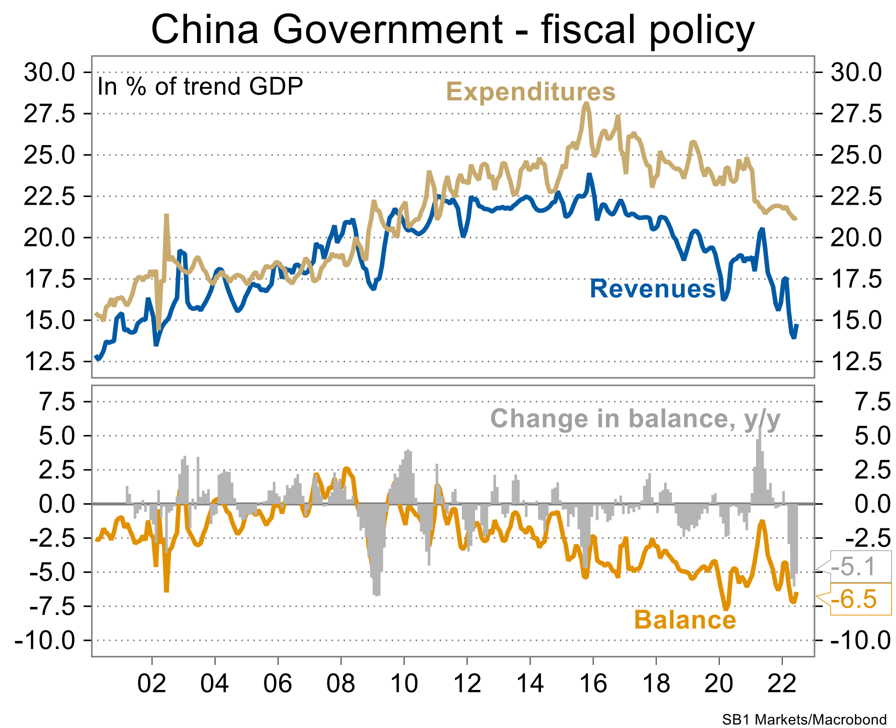




- Until now, there has not been any downturn in the world economy for which we can really blame the Chinese
- Just China has so far reported Q2 data
- Measured in purchasing parity adjusted prices, the Chinese GDP has been larger than the US GDP since 2017 – and the underlying growth rate is very likely still higher

# Fiscal policy very expansionary, so far just due to declining revenues

Revenues are sharply down, and at a low level even in June. Growth in expenditures has slowed

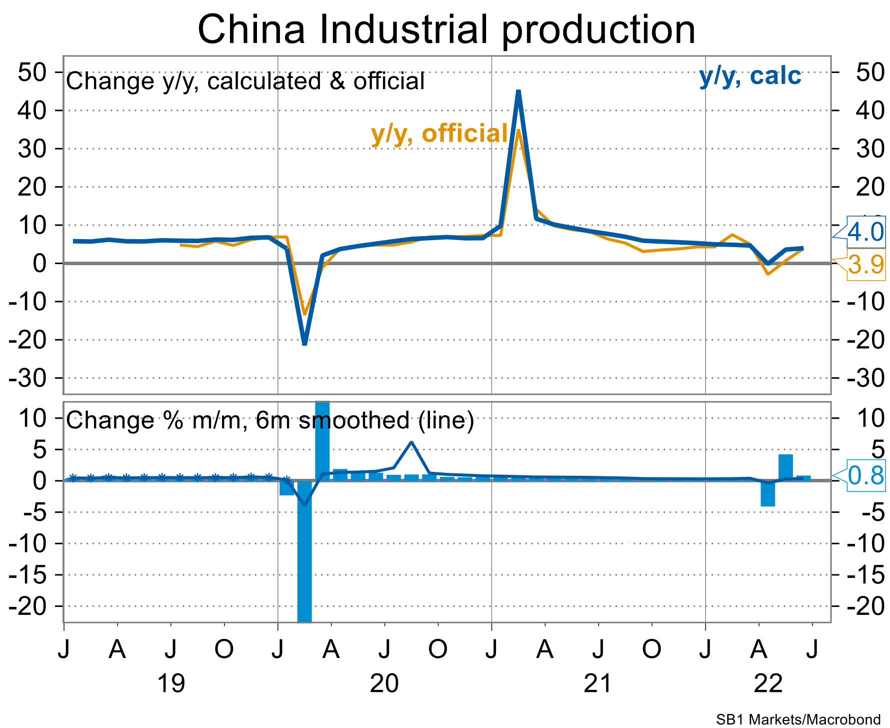


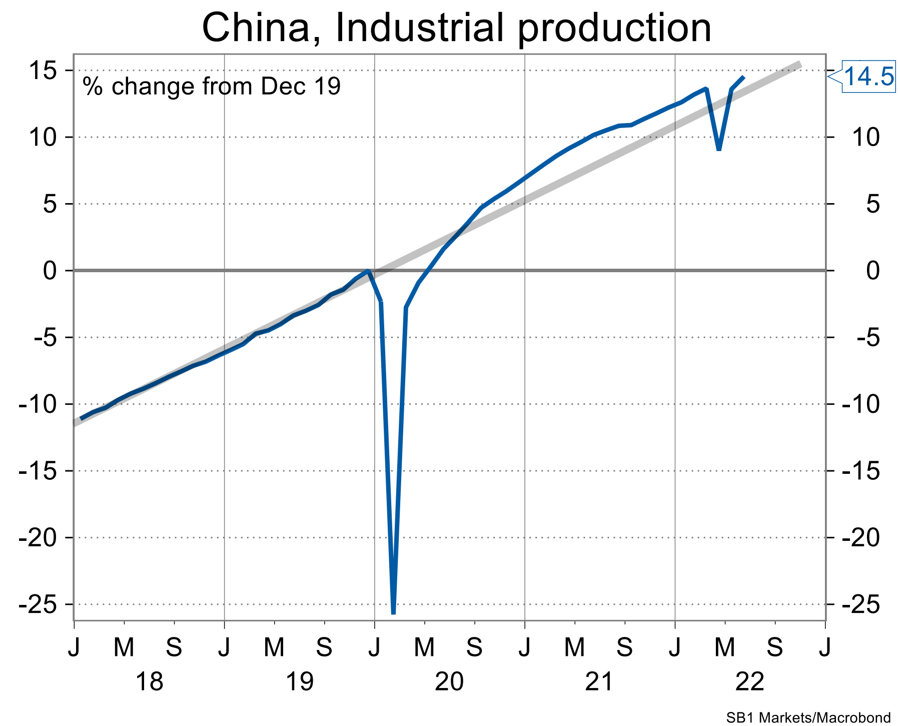




- In % of GDP, **public sector revenues** have fallen to 15% from well above 20% some few years ago. In nominal terms, revenues are down 25% y/y, as activity in the private sector slowed sharply during the lockdown. These revenue data may signal that the downturn has been even harder than other data has revealed
- **Spending** in % of GDP has also been trending down but as spending has not been cut during the lockdowns, it has not fallen much further in % of GDP
- The **budget deficit** equalled 6.5% of GDP in June, close to record high (7.5% during the start of the pandemic), and it has increased by 5 pp over the past year- an unusual fiscal stimulus
- Now, authorities are arguing for a large increase in **infrastructure spending**, partly funded by more local government borrowing, and some by the central government, probably funded by more borrowing

# Industrial production back on track after the lockdowns

## Production rose by 0.8% m/m in June, following the 4.2% lift in May (after the 4.1% drop in April)

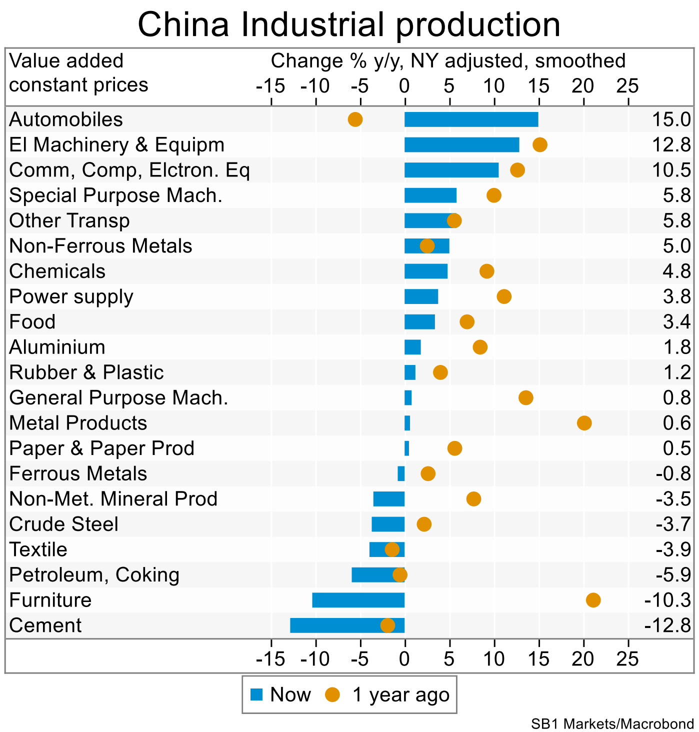



- **The production level** returned to the pre-pandemic trend path in May (grey line at the chart to the right) and was almost back to the pre-lockdown trend path as well in June
- **Production grew** 3.9% according to the official y/y data, 0.1 pp below expectations – and up from 0.7% in May

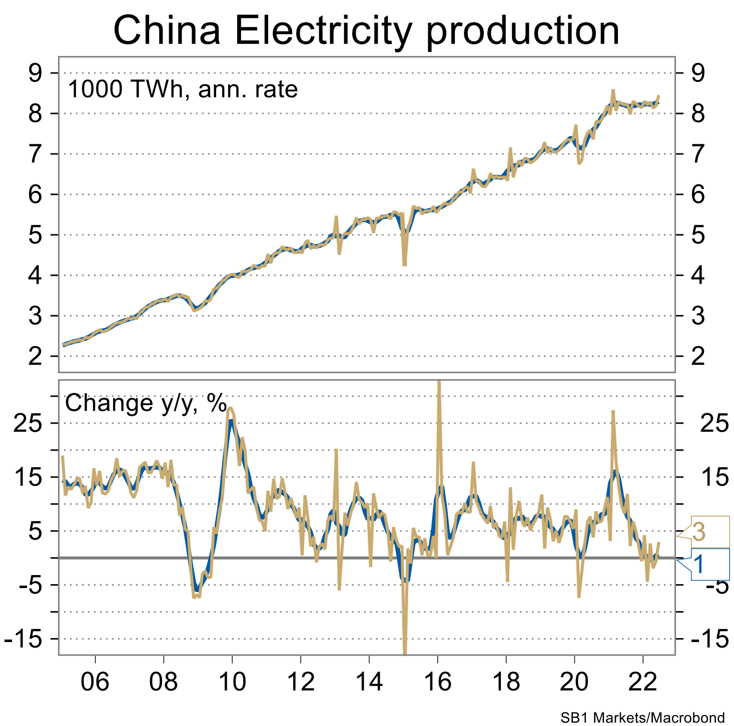
# Mixed between sectors: Aluminum up, steel flattish, cement down

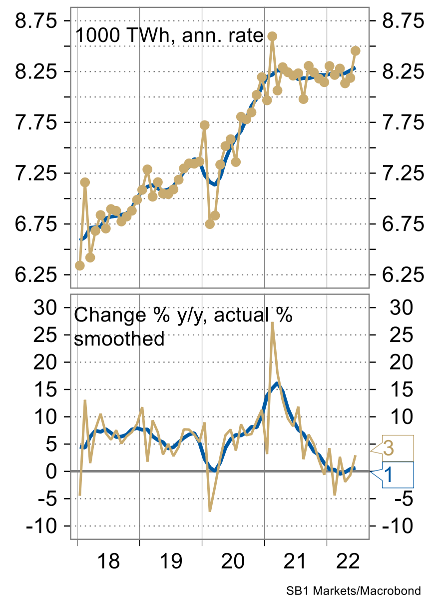
Cement is down 12% recent months and by 20% since the peak last year




# Electricity production up in June but trend close to flat

Signals a slowdown in heavy industries as well



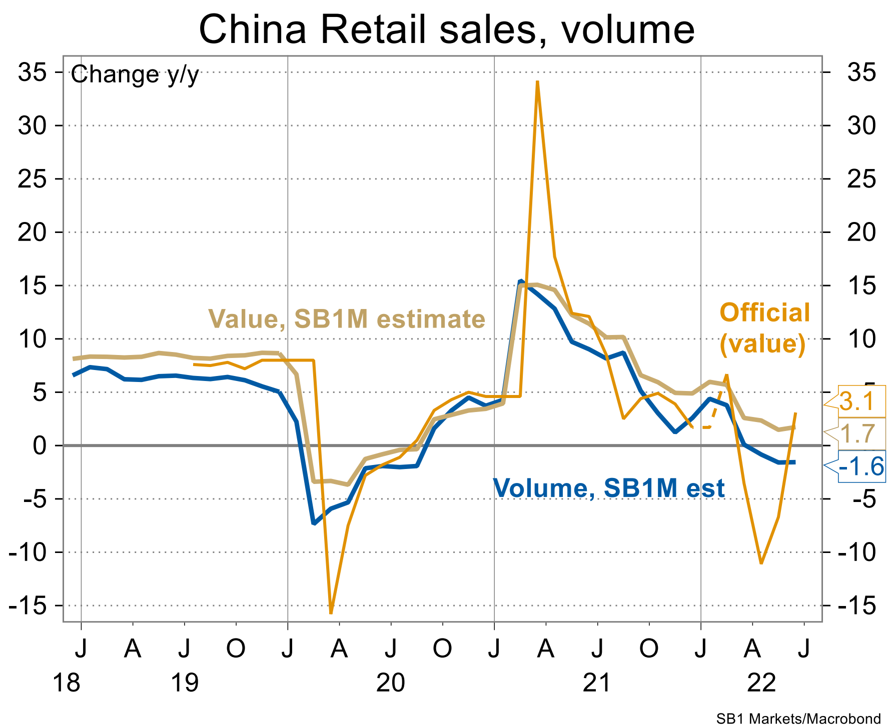



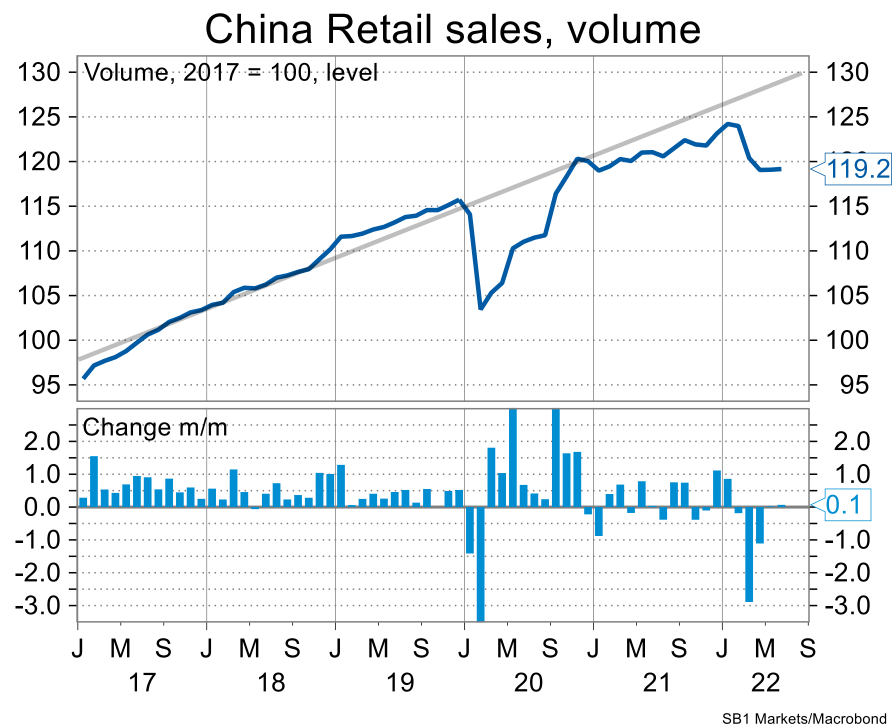


- Seaport traffic is not terrific either, even if exports are straight up
- Domestic railway freight traffic has not been hurt by lockdowns at all

# Retail sales still very weak in June, no post-lockdown surge

## Nominal sales up 3.1% y/y, far better than expected (0.3%) but monthly data shows no recovery



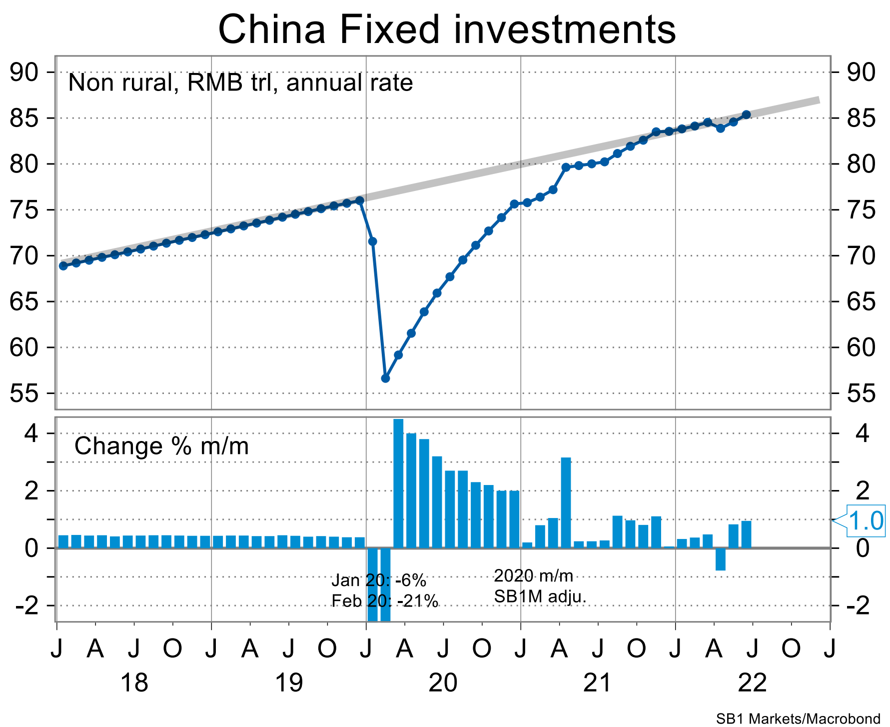




- Sales rose 0.6% m/m in **nominal terms** but retail prices also rose in June, and the **volume growth** was limited

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. Several revision, the last one this month upwards, has made the analysis even more complicated

# Investments back to the pre-lockdown (and pre-pandemic) trend path!

## Investments rose 1% m/m, rather remarkable given the downturn in construction starts past 3 m

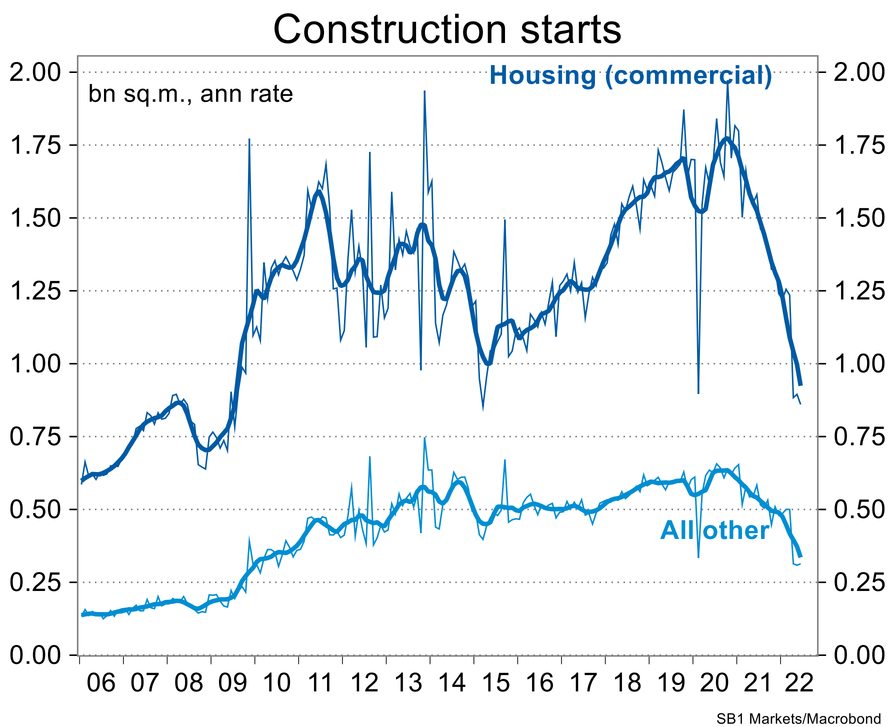


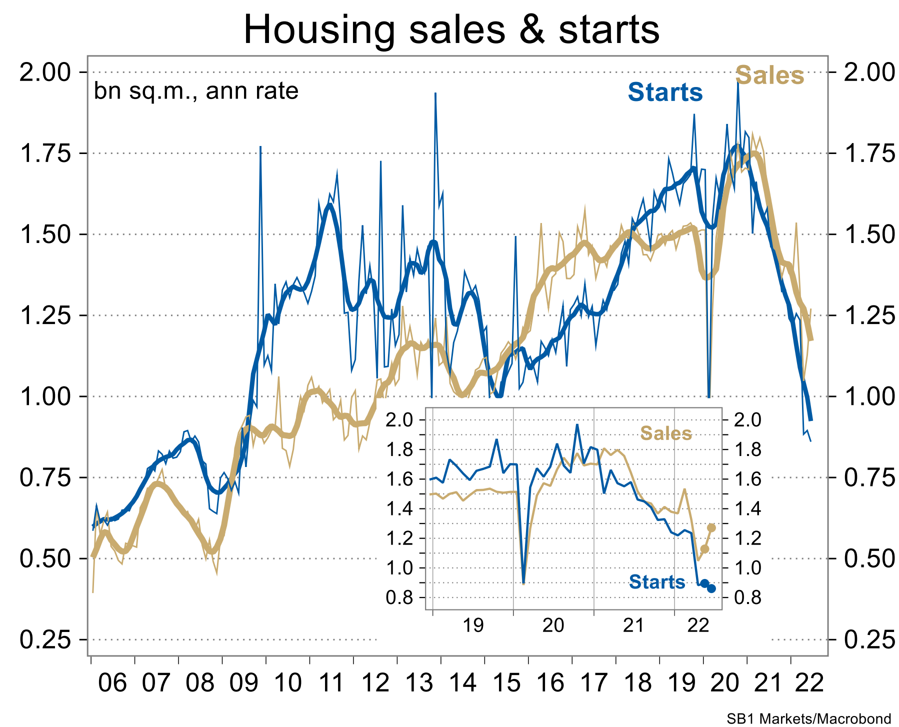


- **Measured YTD**, nominal urban investments rose 6.1% in June, above the expected 6.0%, down from 6.2% in May. Growth was 7% measured y/y in June
  - » However, in volume terms, growth was just some 2%
- The **investment level** is back to the pre-pandemic growth

# New home sales up 12% in June, still -10% vs pre-lockdowns. Starts further down

Sales are down 30% vs. the level in peak in early 2021. Starts are still falling, and are down 50%!!



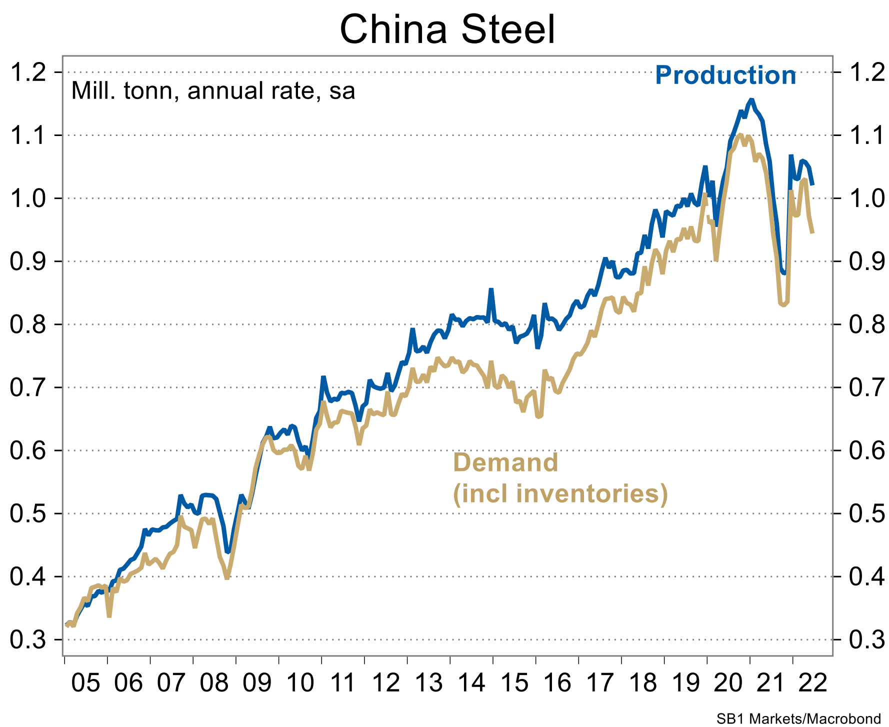




- **New home sales** rose 12% in June following the 10% lift in May (after the 30% collapse in April), but the level is still well below the pre-lockdown level – and 30% down from the peak early last year – and the lowest since 2015
- **Housing starts** fell marginally in June, and have not recovered at all since the lockdowns ended. Starts are cut in half since early 2021, the largest downturn ever! The level is the lowest since 2009!
- **Non-residential construction starts** are also cut in half – and has not recovered after the lockdowns – and the level is the lowest since 2009

SpareBank 1 MARKETS

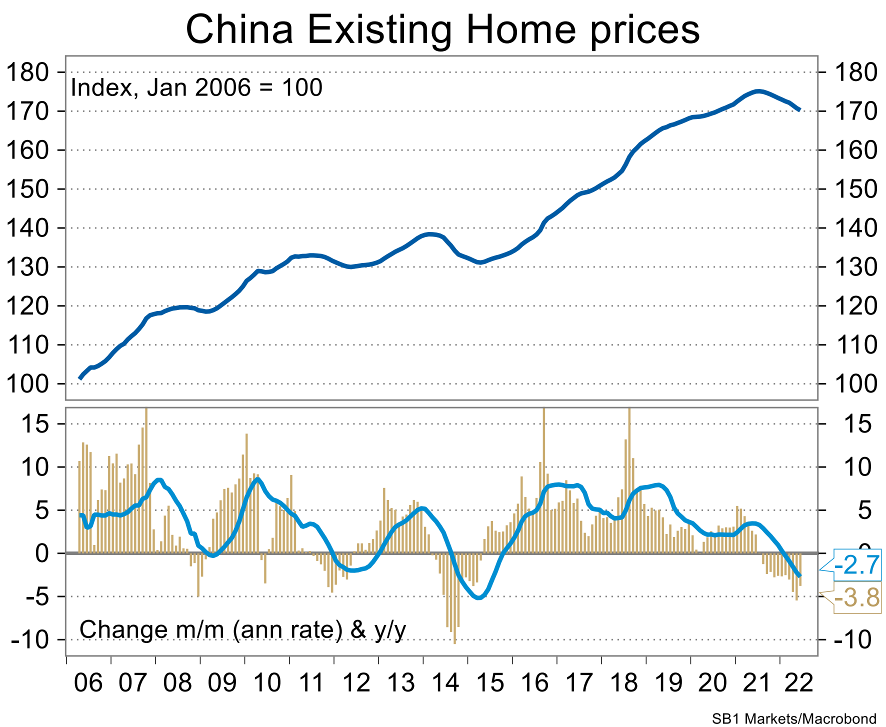
# Downside risk for domestic demand for steel?

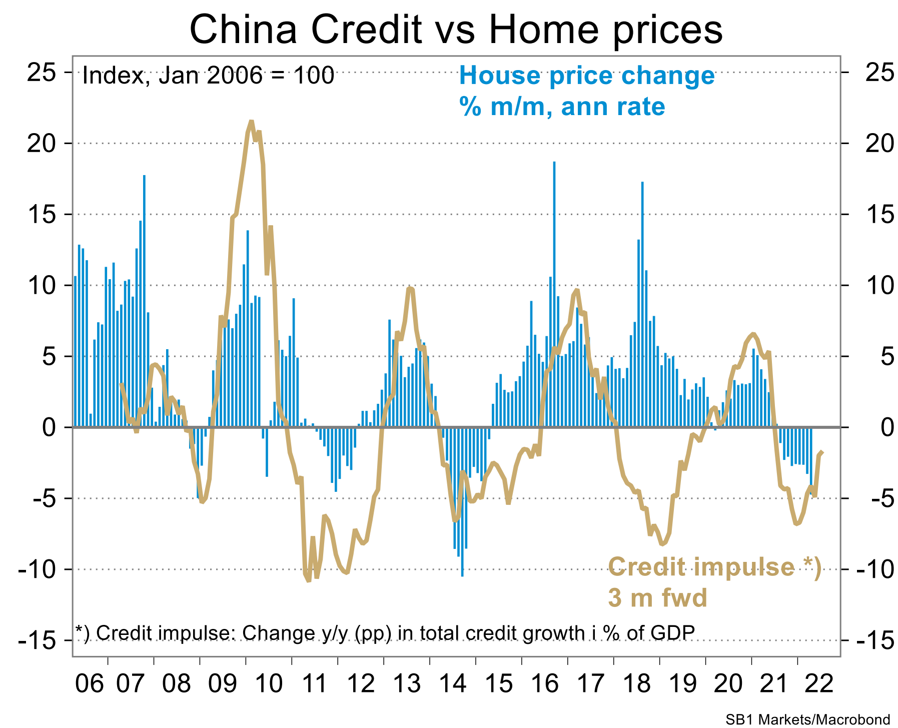
Construction starts are way below steel production/demand




# Existing home prices fell further in June but at a slower pace than in May

Prices fell for the 9th month in row, and are down 3.8% y/y.New home prices are on the way down too

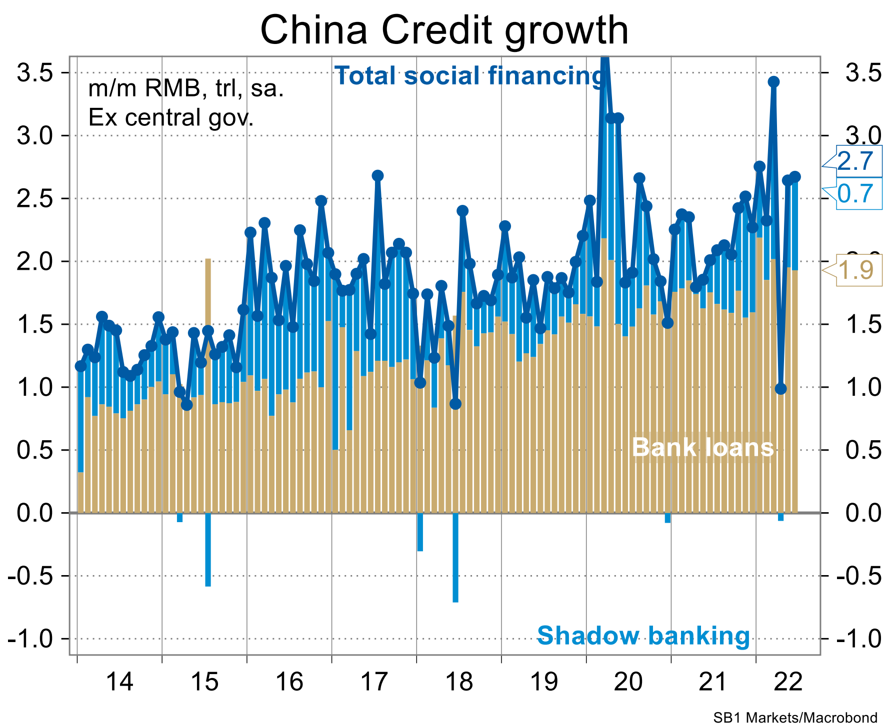


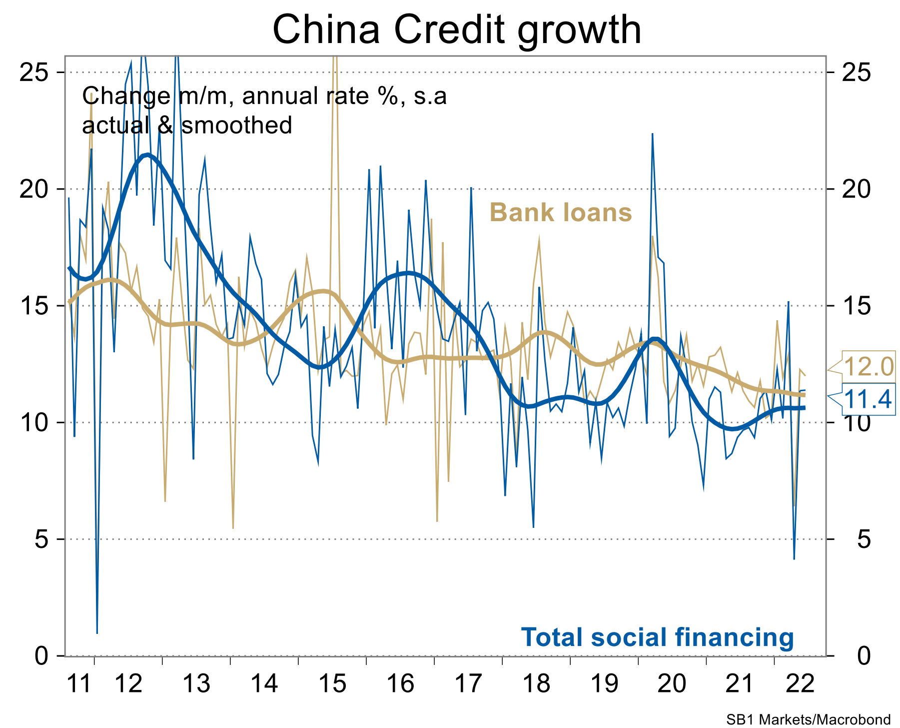




- **Existing home prices** peaked last July, and have been falling at an gradually faster pace, in June by 3.8% (m/m annualised), which though was down from the 5.5% pace in May. Measured y/y, prices are down 2.7%
- **New home prices** also fell last autumn but at a slower pace than existing home prices. In June, price fell at a 3.2% pace m/m, and they are down 3.2% 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. There are numerous reports on dissatisfied new home buyers that are forced to fulfil their obligations
- 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**.** In March/April **new home sales** collapsed 25% due to the lockdowns and is now just slowly recovering
- **Authorities** have signalled willingness to expand credit supply again, also to the construction sector

# Credit growth on track in June too

## Plans for a debt funded infrastructure investment boom may lift overall credit growth coming months

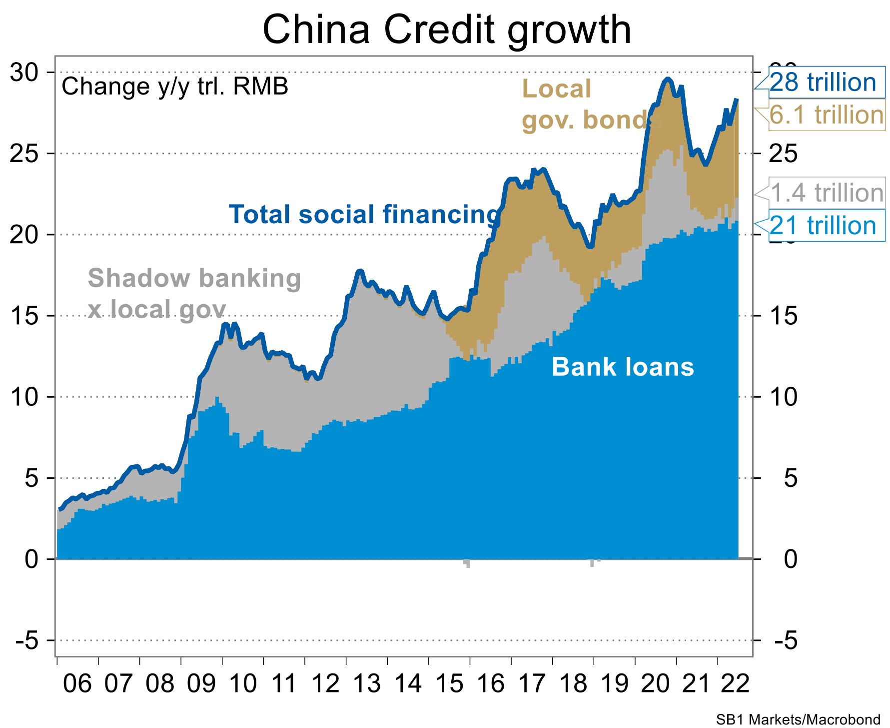


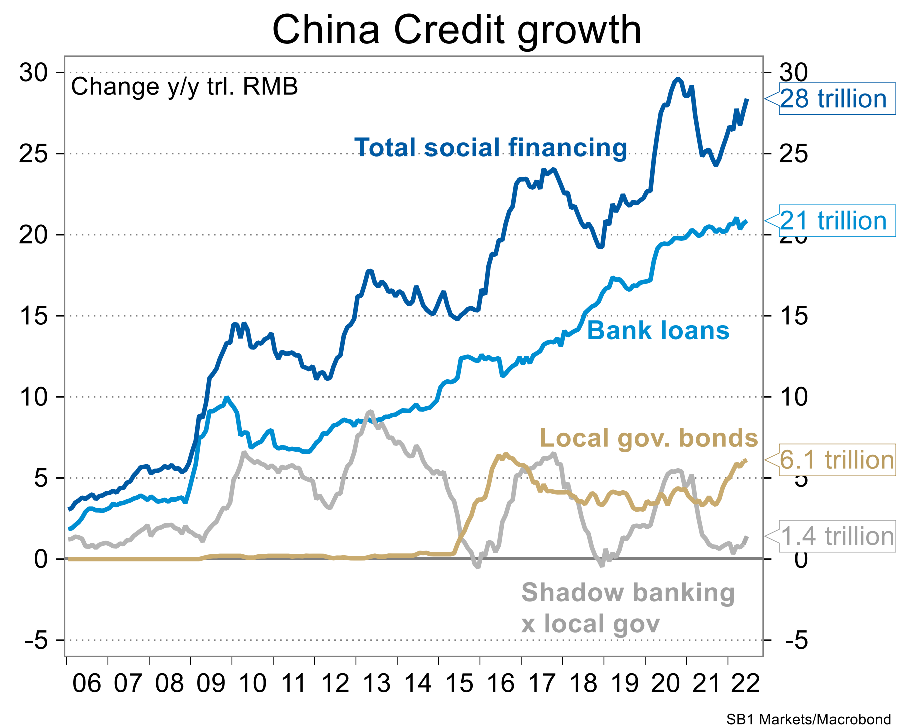




- **Total credit** grew at a 11.4% pace in June (m/m, seas. adj. annualised), unch from May. The annual rate gained 0.3 pp to 10.4%
- **Total credit** rose by RMB 5.1 trl, expected 4.1 trl (not seas. adj, a very low f'cast). The 'core' total social credit (total ex central gov bonds & corporate equites) grew by 4.0 trl (seas adj). The core was up 2.7 trl, seas. adj
  - » **Bank loans** rose by RMB 1.9 trl (or 1.9 trl s.a) or at a 12% annualised pace, marginally above expectations. Still, growth has been slowing since mid 2020
  - » **Shadow banking credit** rose by RMB 0.7 trl, and is up 8.7% y/y. **Local governments have been** responsible for most of the increase in credit outside banks recent months. Less revenues from sale of land, and public financing of unfinished building projects may explain the steep increase in debt (22% y/y, see more next page)

# Credit growth is accelerating but just due to more local goverm. bond issuances

Bank loans are flattening, and there is limited growth in credit outside banks (other than local gov)

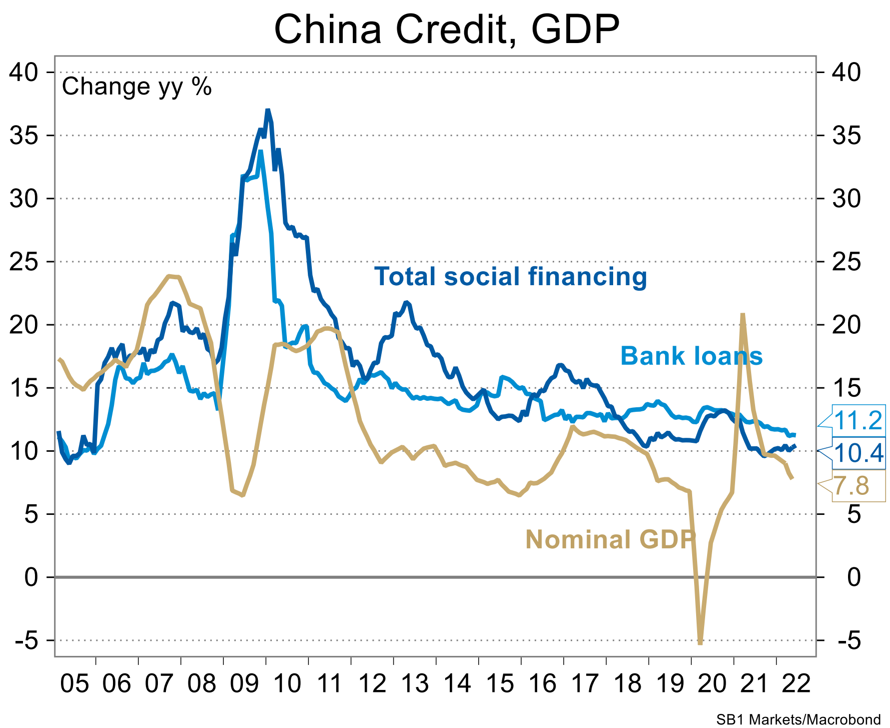


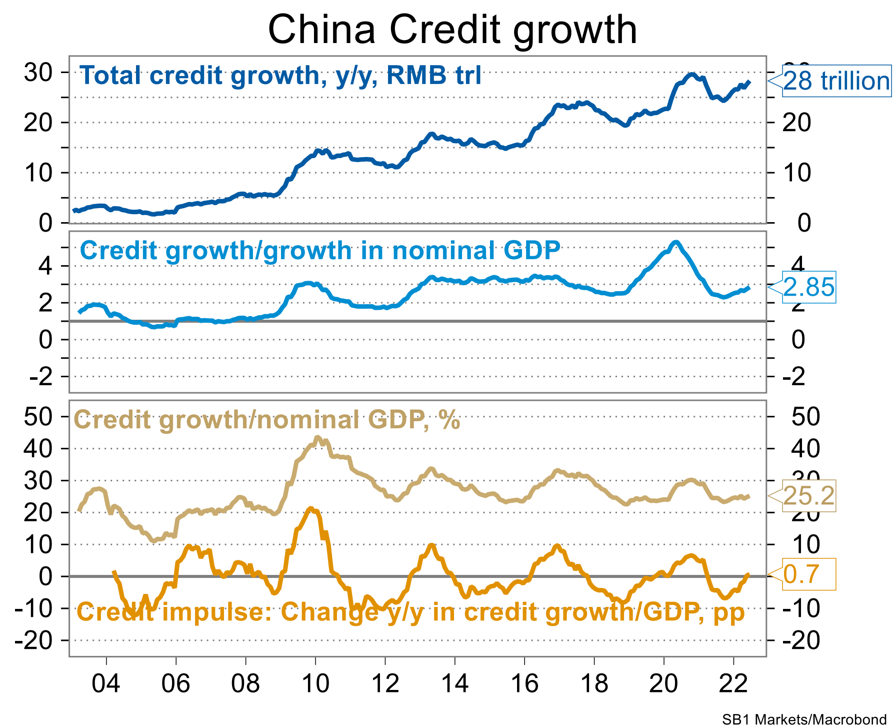




- Over the past year, **total credit** has expanded by RMB 28 trl, equalling more than 25% of annual GDP, up from the 24 trl at the bottom last Sept, (but still down from almost RMB 30 trl at the peak in 2020)
- **Banks** supplied RMB 21 trl of the y/y increase – and the rate has been almost flat since early last year, implying a gradual decline in the y/y growth
- **Local governments** have accelerated their credit growth, now up 6 trl – to 22% y/y from 13% y/y back in last September!
- Growth in other credit – via the **shadow credit market x local gov bonds** – has lowed to RMB 1 trl from 5 trl in 2020 (a dramatic slowdown, like many times before…). Growth has increased slightly the past two months

# Credit growth is slightly accelerating

## … and now central authorities orders local governments to borrow even more

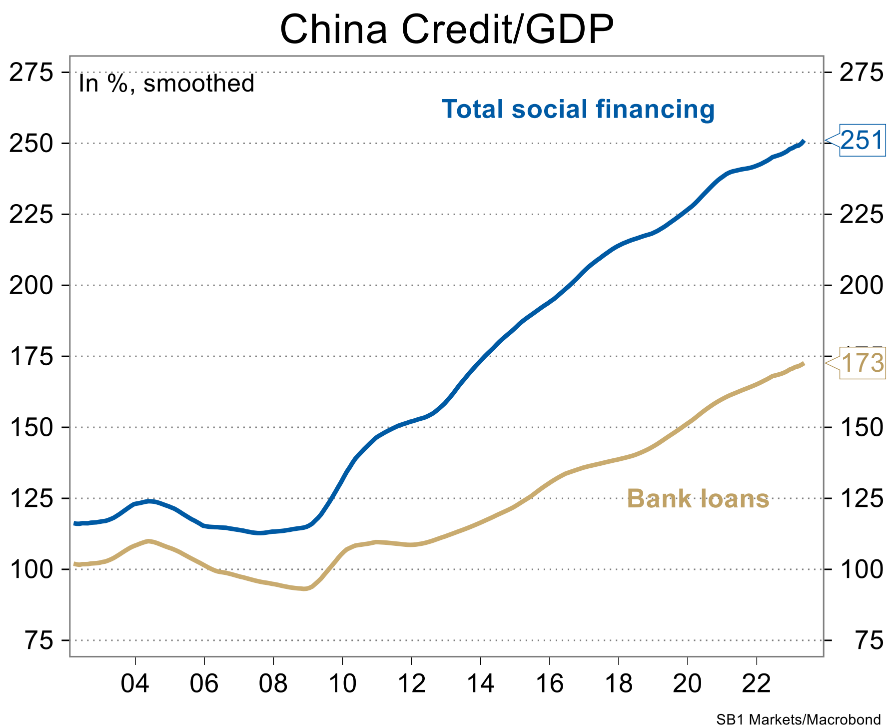


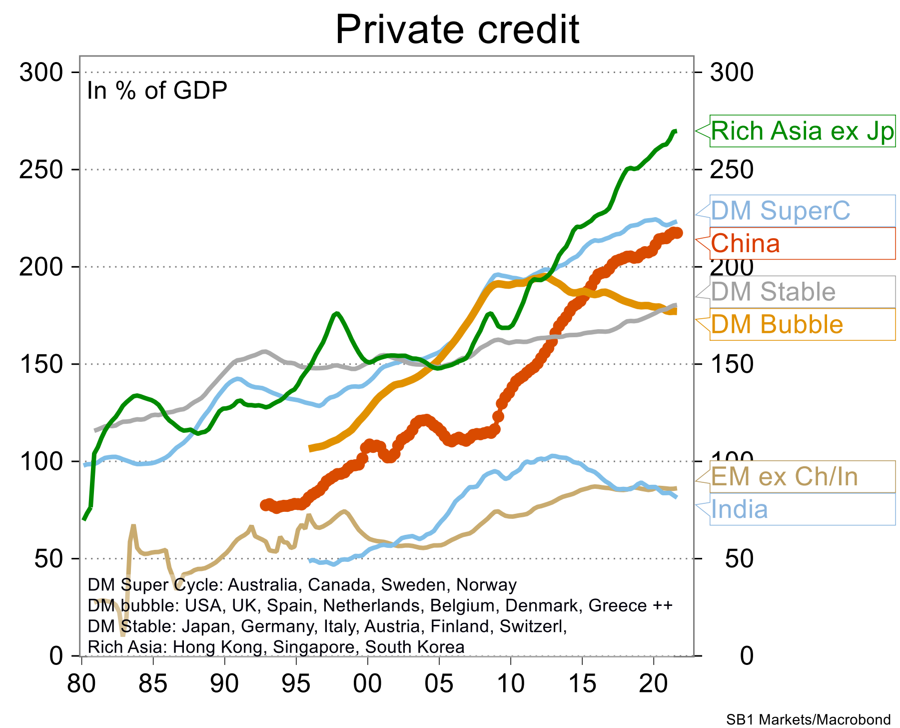




- The credit impulse (change in credit growth vs. nominal GDP) has turned positive
- **Central authorities** have signalled that **local governments** will be allowed to borrow an additional 1.5 trl by issuing special bonds in H2 in order to fund **infrastructure investments**, lifting overall credit growth by some 0.6 pp (from the present 10.4%).
  - » If executed, local governments may increase their bond debt by an extra 0.25 trl/m, we assume in addition the 'ordinary' RMB 0.6 trl/month
- **The total infrastructure plans** may equal RMB 7 trl (or as much as 6% of GDP), according to a Bloomberg analysis. If this policy shift materialises, an old trick in order to stimulate growth will be drawn once more : Invest more in infrastructure, funded by debt – even if the analysis recent years until now has been that the return on these investments has been dismal

# Private sector credit: China is an outlier, together with other rich Asian countries

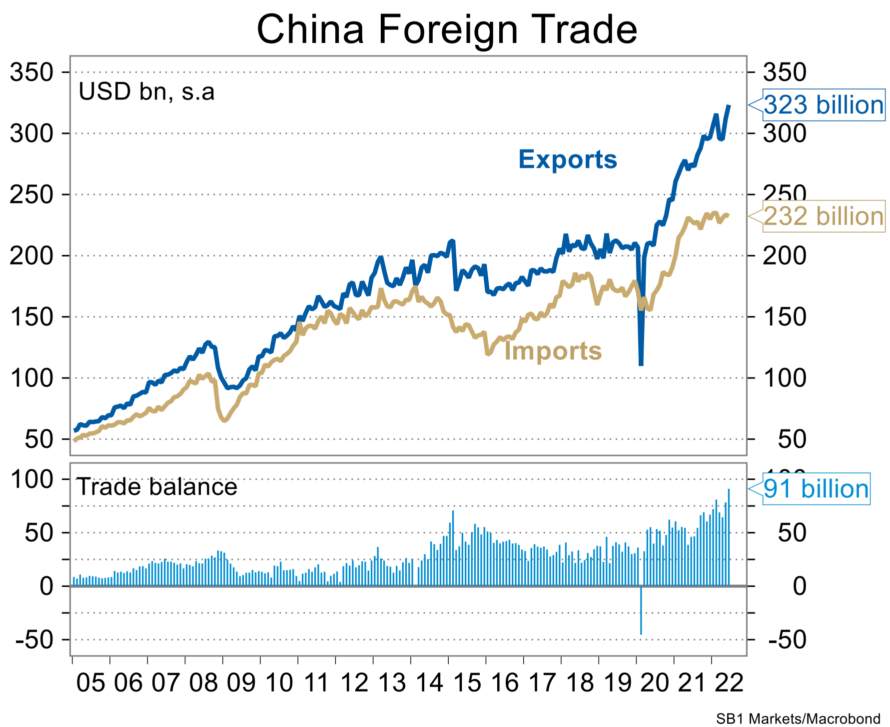
The 'global' private sector debt bubble is reality a Chinese bubble (with support South K, Singap., HK)



# A further lift in exports in June, even volumes up to ATH. Imports are sagging

## Exports gained 6% m/m, are 25% above the pre-pandemic level in volume terms

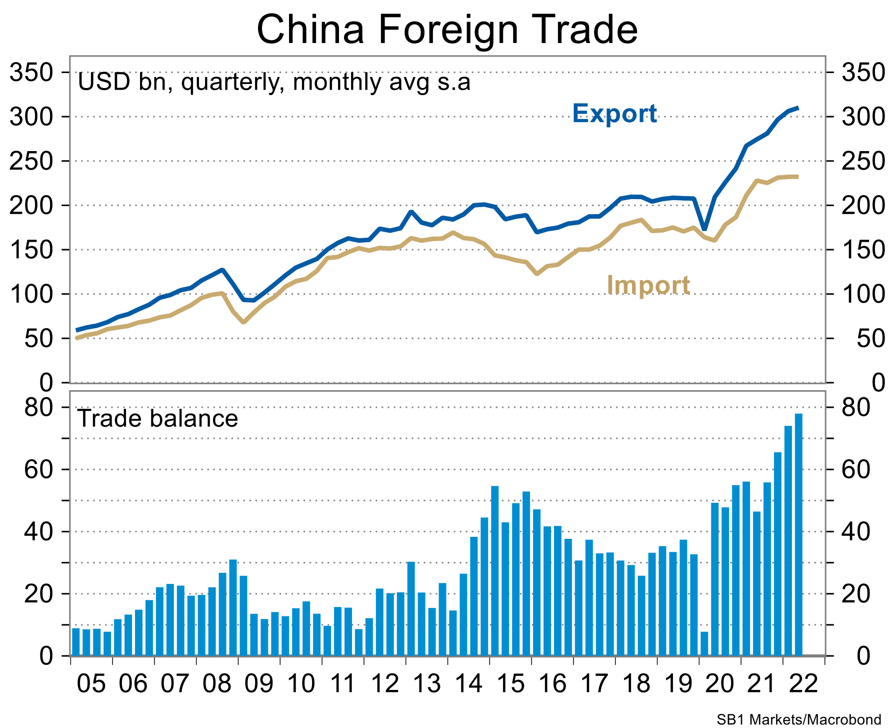




- **Export values** grew by 4% in (a strong) USD terms in June (our seas adj), and are up 18% y/y, from 17% in y/y in May, 6 pp better than expected. Exports are record high, both measured in value and volume terms! Export values are up more than 50% from before the pandemic**. Export volumes** are up 30%! Export volumes have survived the lockdowns. Is lack of supply the main reason for the surge in inflation (x food & energy)? *Dream on!*
- **Import** values fell 1% m/m in June, and are up 2% y/y, 2 pp below expectations. Import values are down 3% from the peak. In **volume terms** the decline in imports is far larger, by 10% - and by 6% since January, and the recovery since the lockdowns has been marginal. Imports volumes are below the pre-pandemic trend but not much vs. previous deviations from this trend
- The **trade surplus** at USD 97 bn, 22 bp larger than expected, and the highest ever. In seasonally adjusted terms, at USD 91 bn, or some 6% of GDP, the highest since 2008! Growth has become export led, again? At least partially as a higher trade surplus in goods have lifted GDP by some 2% since before the pandemic

# Q2: Export volumes up, import volumes down. Exports are far above the p-p trend

So supply chain problems and lack of supplies are the reason for high inflation in the West??

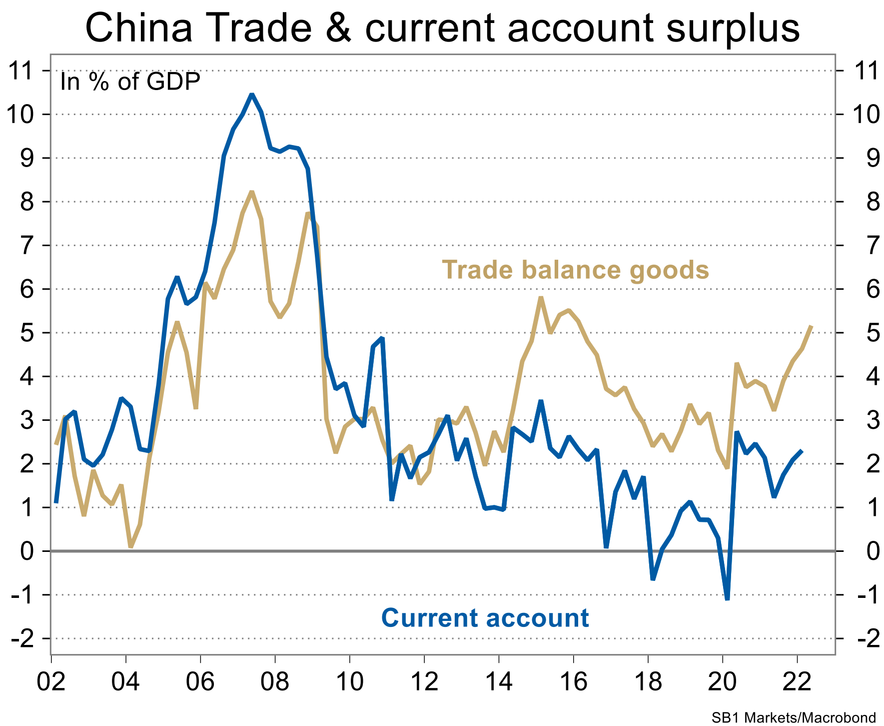


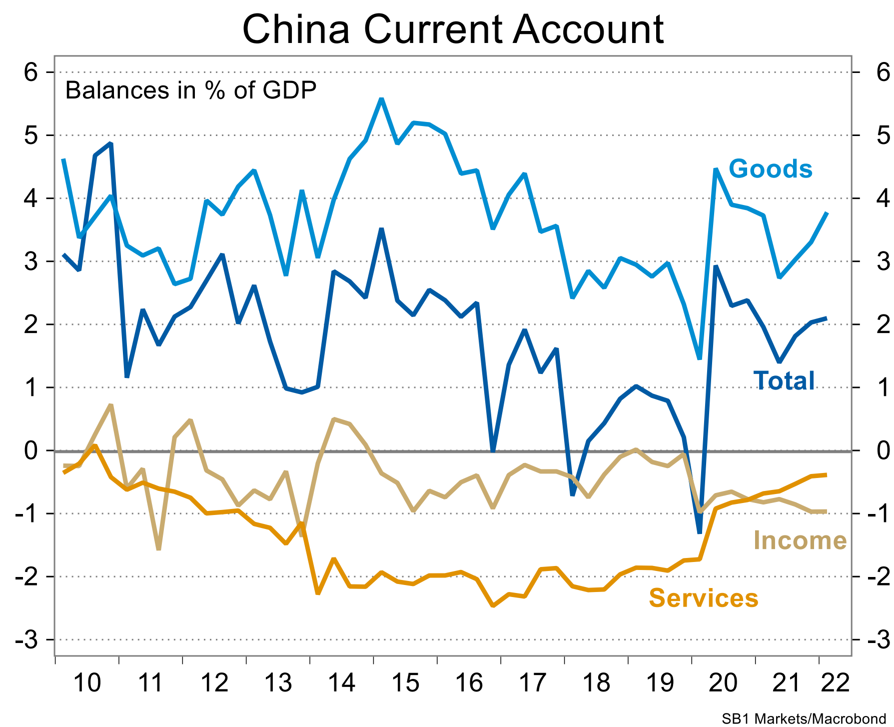


- The lockdowns are not visible in Q2 export stats!
- Import volumes peaked in Q2-21 but are not far (and not significantly) below the pre-pandemic growth path in Q2

# The trade surplus is trending upwards again, even in % of GDP

## The current account is solid in plus too, as the Chinese are not travelling abroad anymore

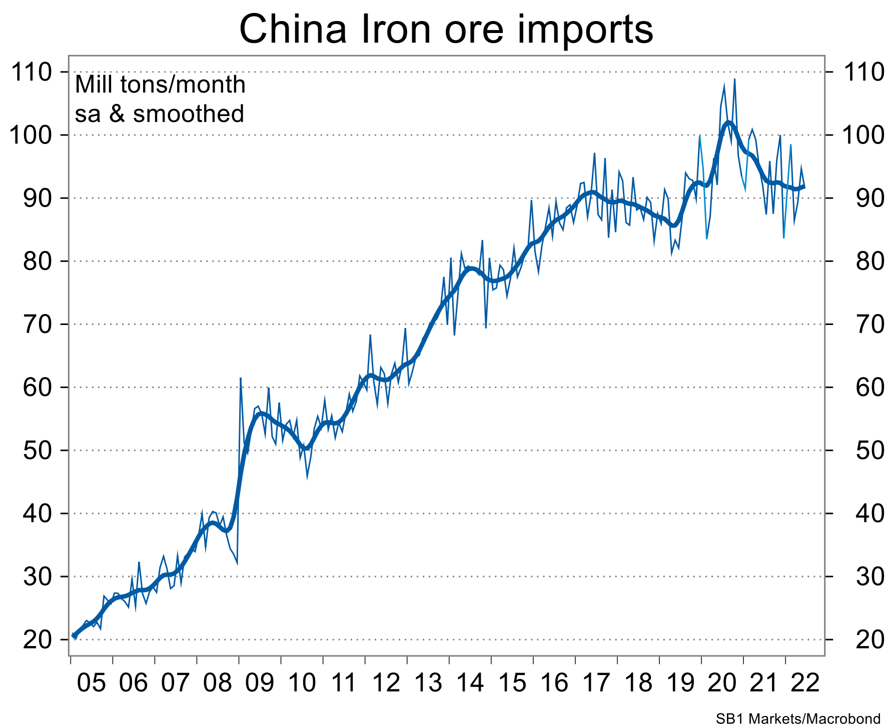


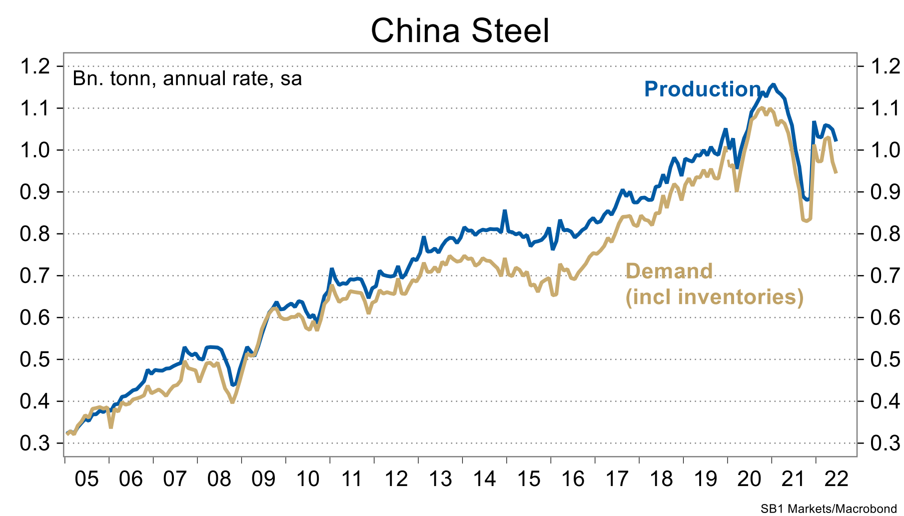

- China runs a deficit in net (mostly capital) income from abroad, even if the country has a huge net positive financial position
  - » China has invested much in low yielding US government bonds (and other low yielding investments); foreigners have been investing in profitable production capacity in China

# Iron ore imports are flattening, 10% down from the peak in 2020

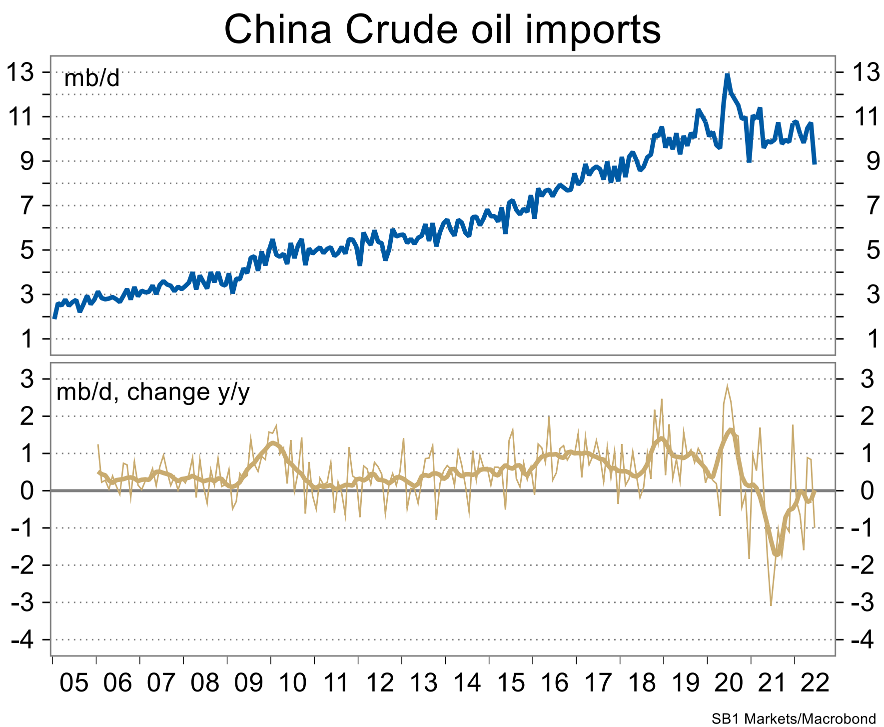
## Steel production has stabilised too, although almost 10% below the peak in early 2021

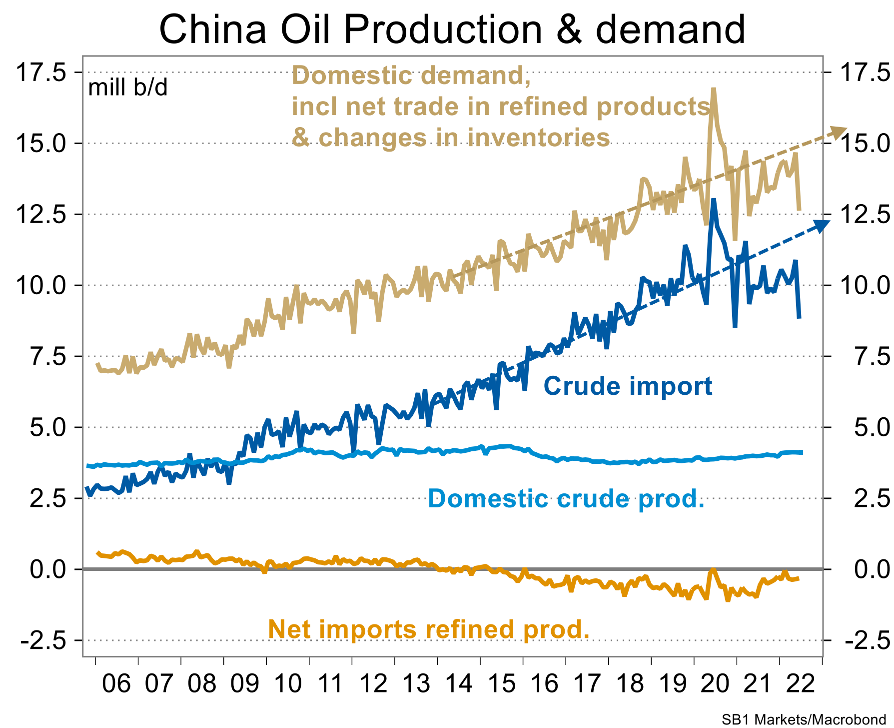



- **Production and domestic demand** (incl. inventories) fell sharply in Q2-Q3 last year – by 25% – due to public regulations and probably the setback in the construction sector
- Activity recovered sharply in December – and was stable through Q1
- **Domestic demand** has slowed past 3 months, probably due to the sharp contraction in construction starts

# Crude oil imports suddenly sharply down in June, probably an outlier

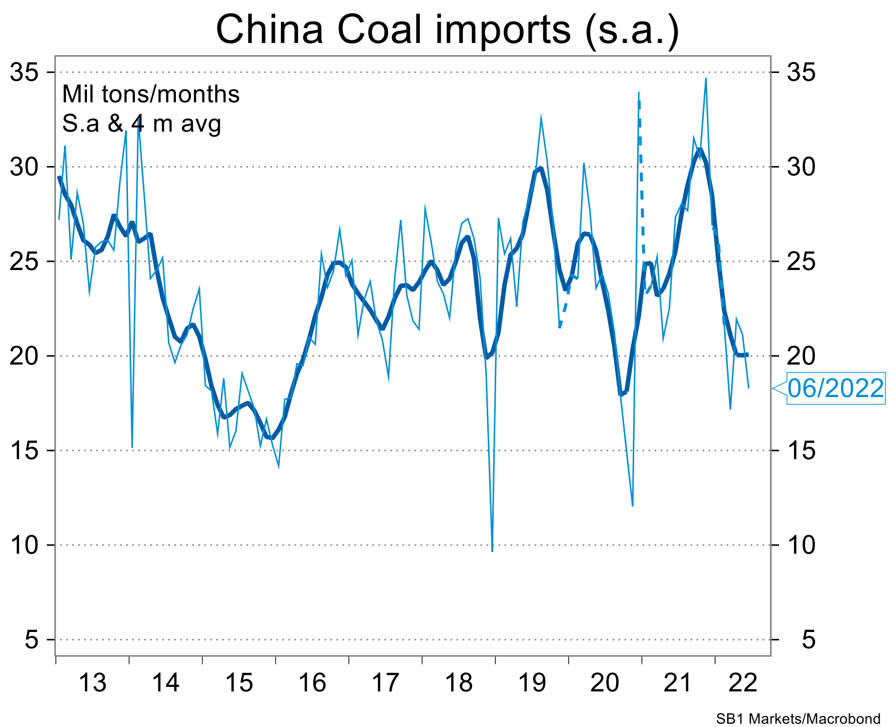


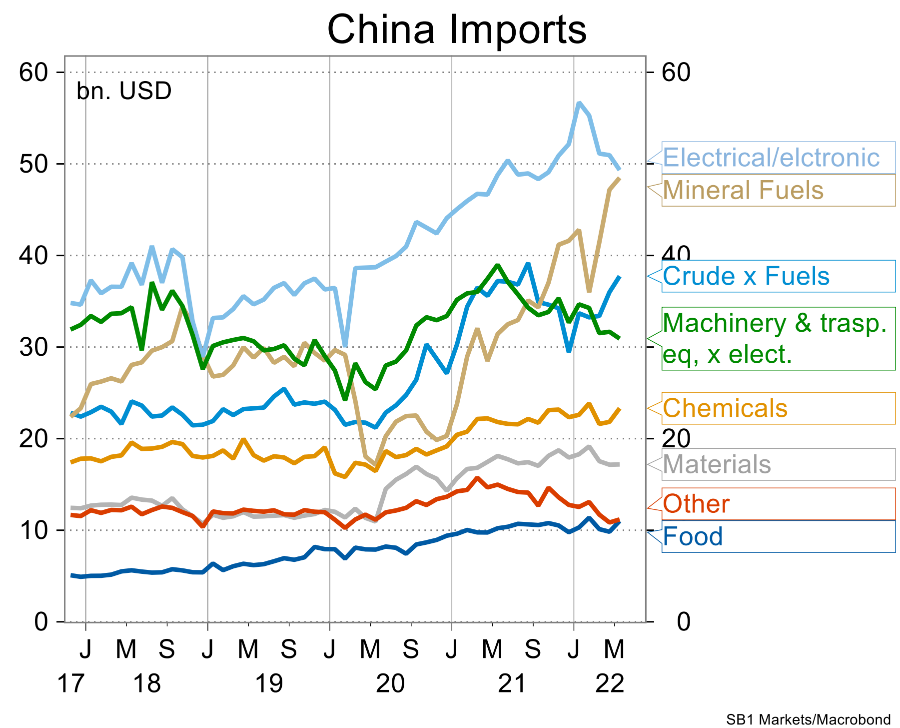




- 4 years without growth in **crude oil** import or domestic demand is rather surprising?
- However, higher net imports of **refined products** since early 2020 (almost 1 mb/d) and a small increase in domestic crude production have partly compensated for the flattening in crude imports - implying that domestic demand for oil/oil products is still increasing – but still at a slower pace
- Some **inventory/reserve building/drawdowns** may explain short term deviations but probably not the whole slowdown in apparent domestic demand

# Coal imports still well below a 'normal' level in June

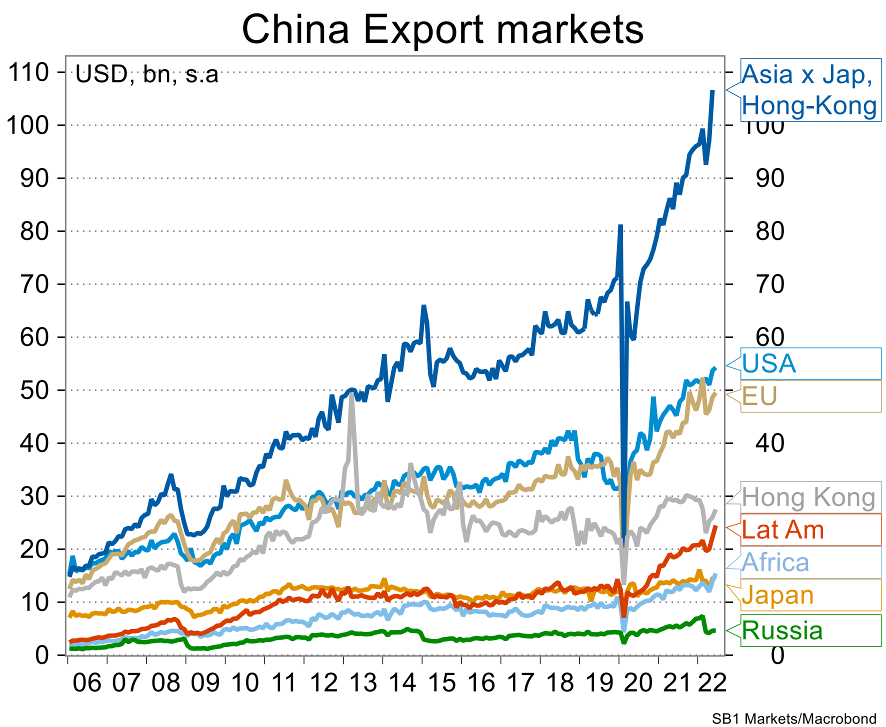
## Imports of most goods x mineral fuels fell m/m in May



# Chinese exports to Russia remained at very low level in June

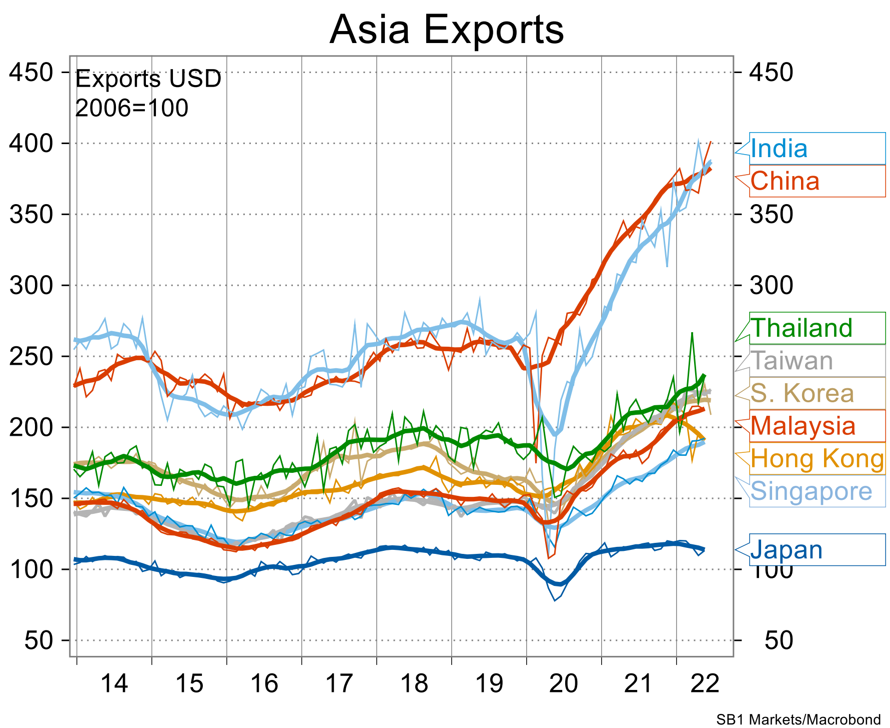
While exports to most other markets climbed to ATHs

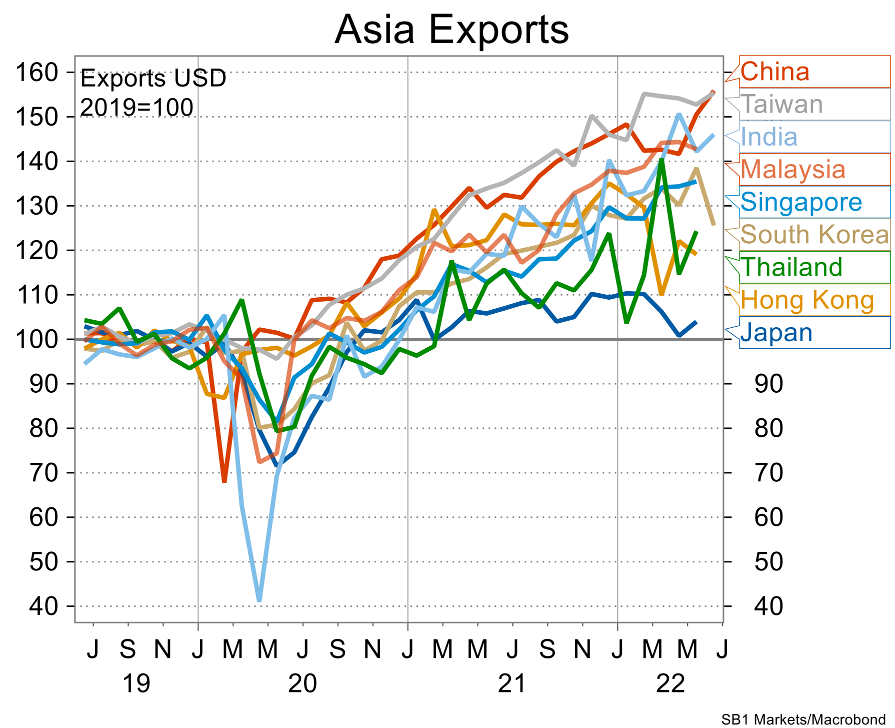


SpareBank 1 MARKETS

# Exports from other Asian counties are mostly trending up (ex Japan, Hong Kong)

South Korean exports were weak in June too but has been trending up

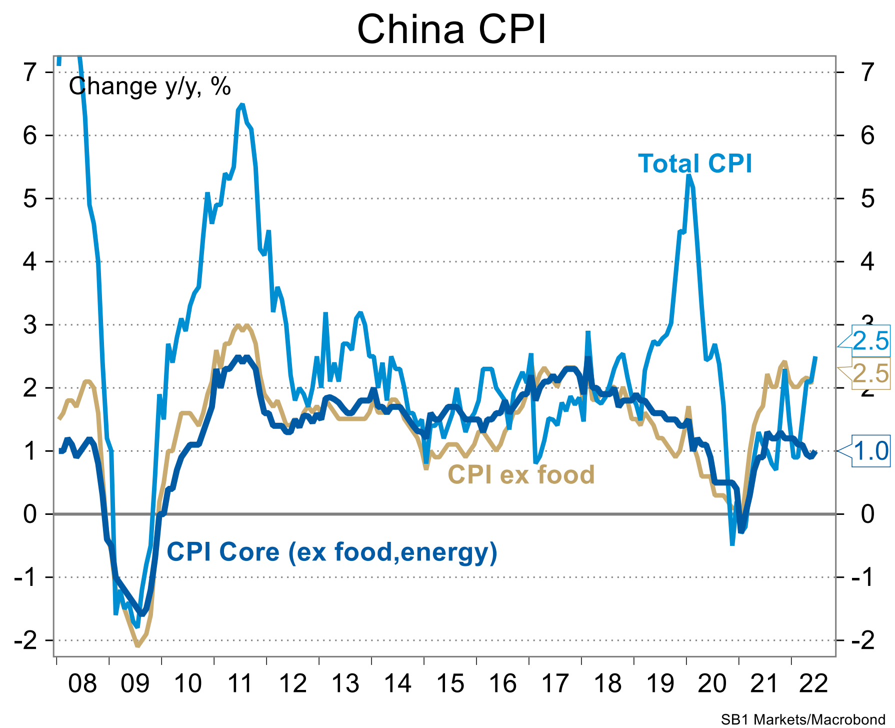


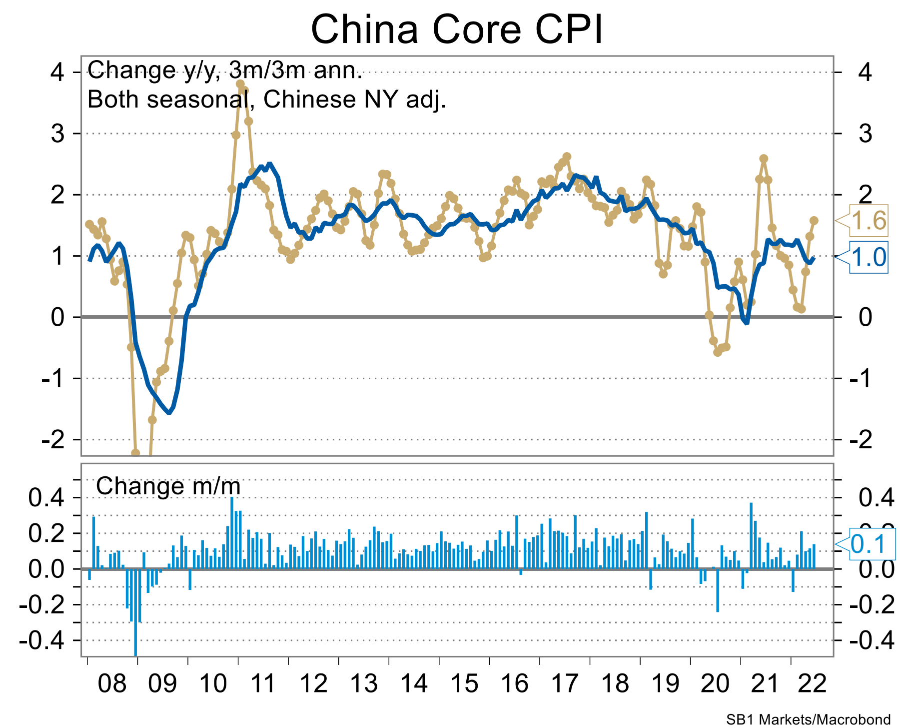



SpareBank 1 MARKETS

# Headline inflation up 0.4 pp to 2.5%, core still just at 1%

Inflation is not China's predominant challenge these days, to put it mildly

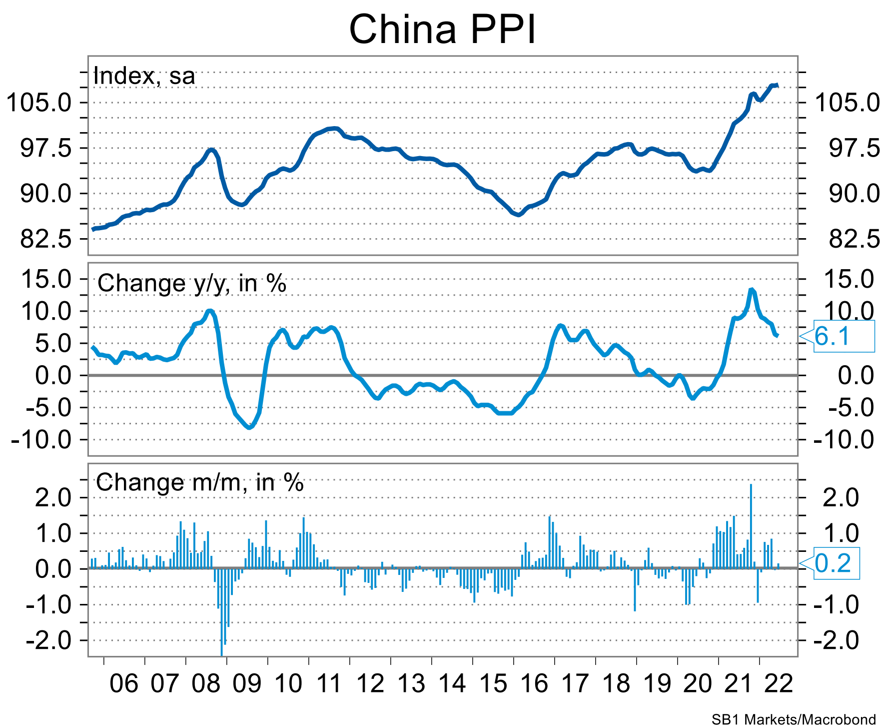


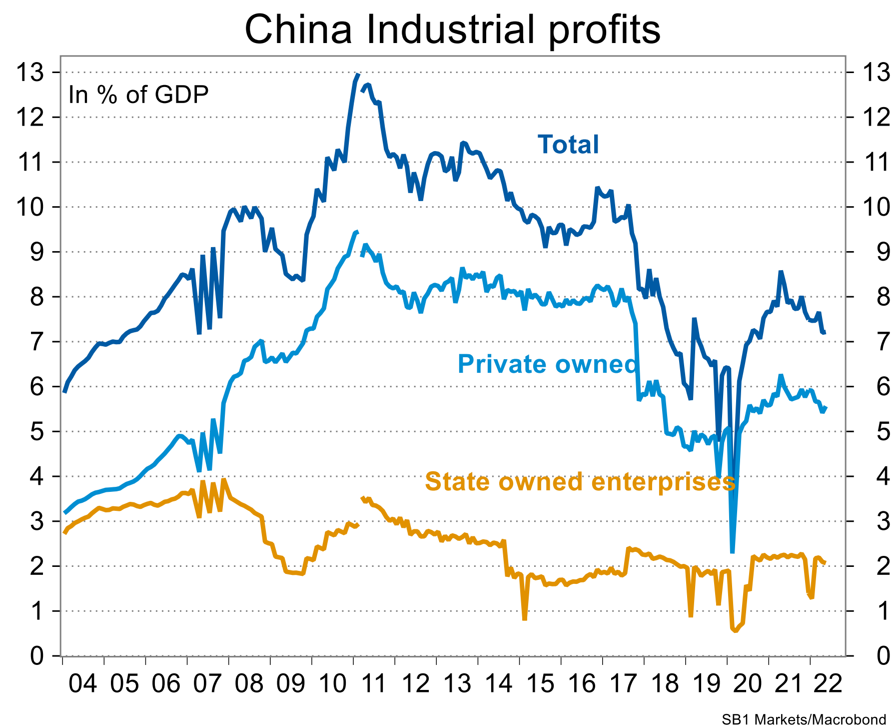




- **Total annual CPI** was accelerated to 2.5% in June, as expected. Prices rose 0.4% m/m, up from 0.2% in May
- **The core CPI (x energy, food)** gained 0.1 pp to 1.0% y/y. Prices rose 0.1 pp m/m. The 3m/3m rate is at 1.6%
- **Food prices** are up 2.9% y/y even if pork prices are down 6% - and other prices are up some 4.5%, less than in the West (but fruits are up 20%)
- **Gasoline/fuel prices** are up 33%
- **Both core & headline inflation** is still low. **Monetary policy** will not respond to actual inflation data if inflation is not really high or low, the real economy and the credit market is more important. Now authorities try to kickstart the economy again after the lockdowns

# Producer prices up 0.2% m/m in June – and 6.1% y/y (from 13.5% at the peak)

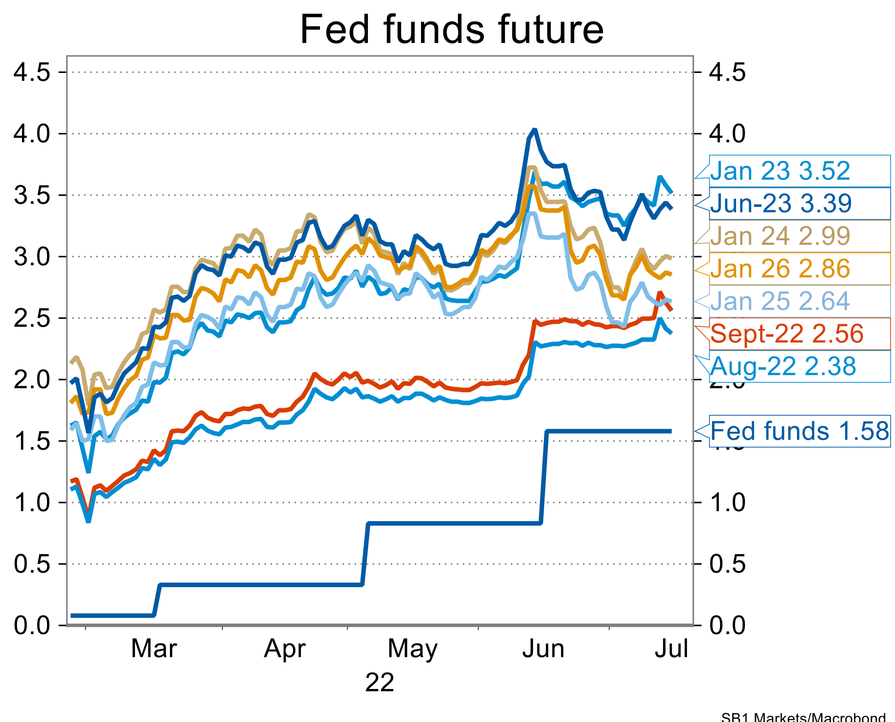
A sign of slowdown in goods inflation globally? Corporate profits are heading south




- **The PPI** fell in May and rose just marginally in June
  - » Consumer goods are up just 1.7% anyway, durable consumer goods are down 0.2% y/y, while raw materials are still up 15% - explaining the squeeze on profits
- The correlation between PPI and CPI in China is not impressive
- **Profits in privately owned industrial enterprises** are declining in % of GDP

# Fed’s Beige book report somewhat slower growth, less price/wage pressures




USA Fed funds rate (OIS)

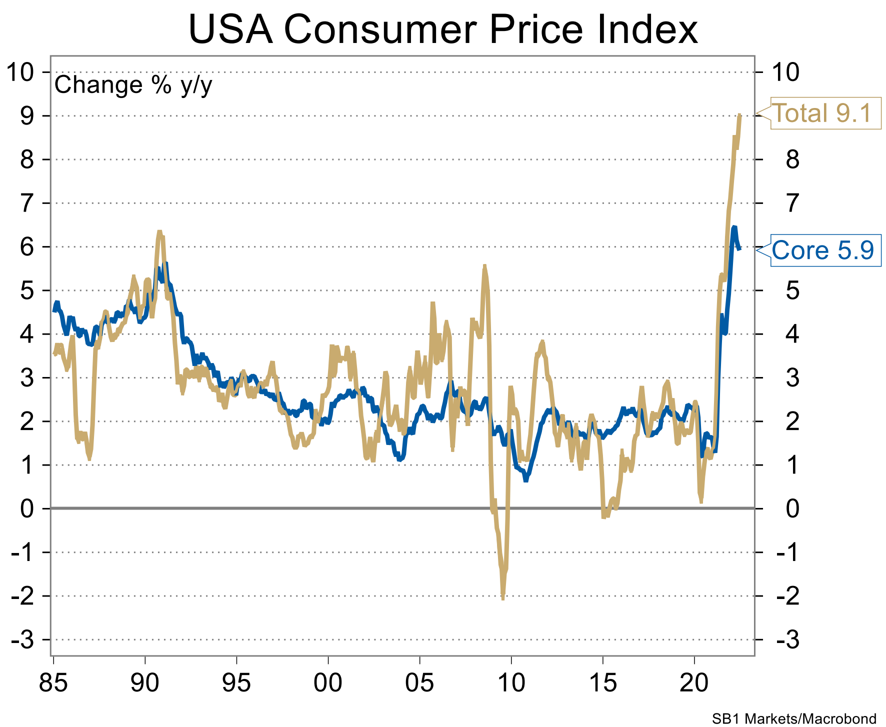
| FOMC meetings | Effective Fed funds rate: Last | Change last week |
|---|---|---|
| Now | 1.58 | 0.00 |
| July 27 | 2.36 | 0.05 |
| Sept 21 | 3.00 | 0.13 |
| Nov 2 | 3.36 | 0.09 |
| Dec 14 | 3.52 | 0.05 |
| Feb 1 | 3.55 | -0.01 |
| March 23 | 3.52 | -0.06 |

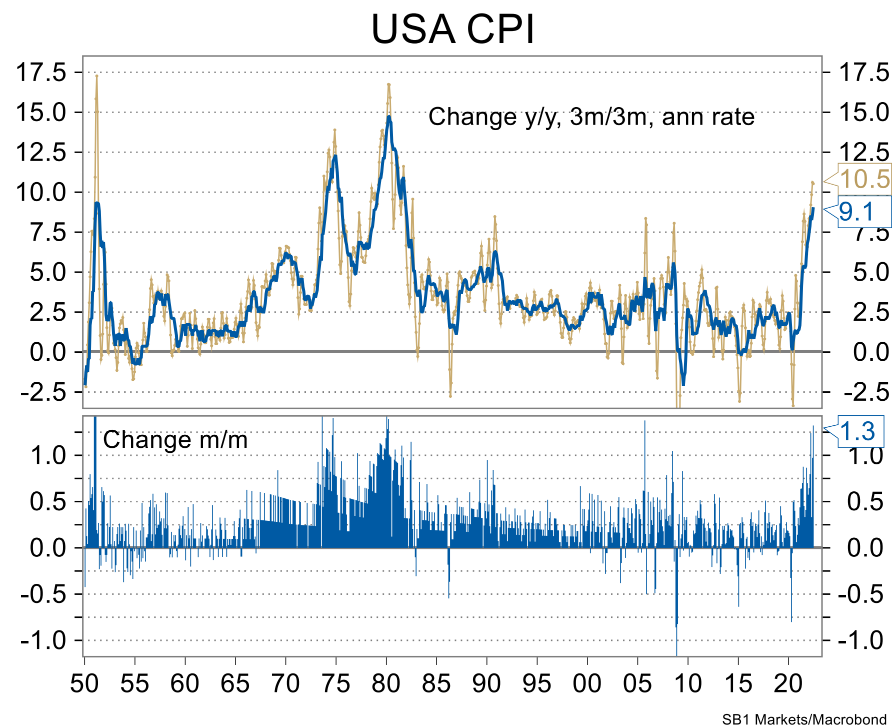
- Main messages from the regional survey
  - Growth everywhere, but several districts reported signs of slowdown in demand and a further slowdown was expected for the next 6 – 12 months. Some had been talking about the risk for a recession
  - High inflation had made a dent in household demand
  - Mixed activity in the manufacturing sector
  - Demand for housing weakened noticeably
  - The labour market was still very tight but nearly all districts noted modest improvements in labour availability (which not has been signalled by surveys) – and wage pressures were easing some places
  - Inflation remained high but construction costs were coming down, and inflation were slowing for many other goods. However some sectors reported strong pricing power
- Taken face value, the Beige book confirms than growth is slowing, but not that the economy is a recession now
- The interest rate market has been volatile, and at one stage, after the June CPI report, a 100 bps lift in the signal rate at the July 27 FOMC meeting was discounted. Now 75 bps will be sufficient – but the likelihood for a 3rd 75 bps hike in September is still very high
- We think the Fed next week will reiterate both the need for bringing inflation down but at the same time recognising that the need for future hikes will be decided by incoming data. A 75 bps hike is a done deal (if the stock market does not crash)

SpareBank 1 MARKETS

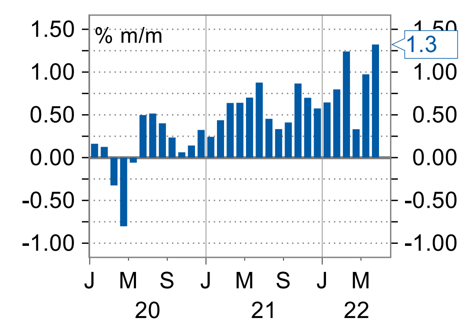
# Another inflation surprise: CPI up 1.3% m/m, core +0.7%. A 100 bps July hike?

## Inflation is broadening further. Fed has no choice but to lift the signal rate rapidly coming months



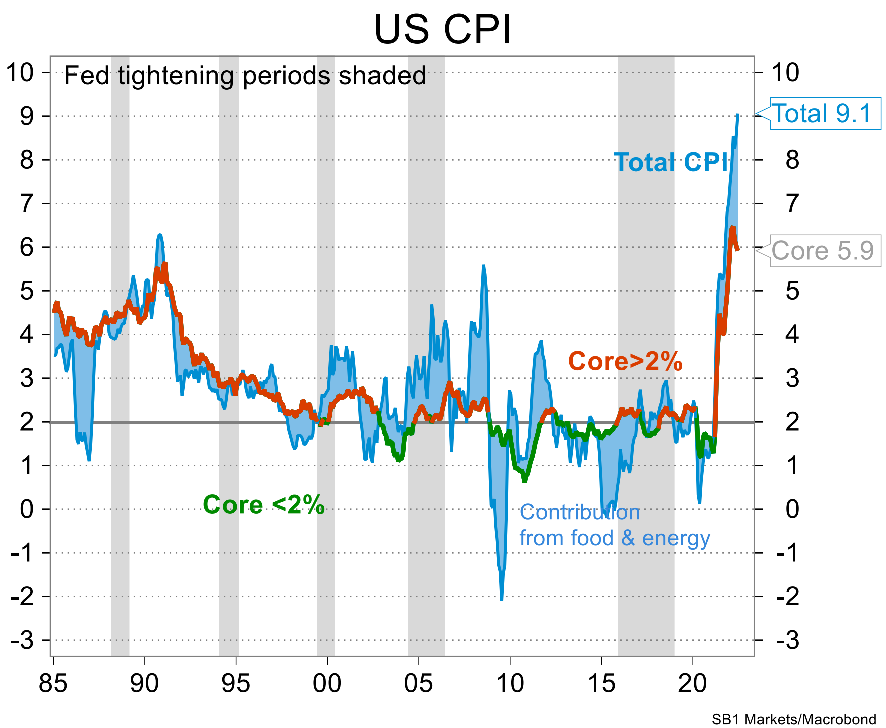

- **Headline CPI** accelerated to 9.1% in June, once again the highest since 1981, up from 8.6%, expected 8.8%. Prices rose 1.3% m/m, expected 1.1%, and up from 1.0% in May. The 3m/3m rate was close to unch at 10.5%, also the highest since 1980. So inflation is not yet slowing
- **Energy prices** rose 7.5% m/m and are up 42% y/y, contributing 3 pp to the headline. Gasoline prices are up almost 60%. In July, energy prices have so far been falling rapidly, and the headline inflation rate will very likely decline
- **Food prices** rose 1.0% m/m and are up 10.1% y/y. (Food at home is up 12.2%!)
- **Surveys** report further price increases the coming months
- The lift in the CPI report lifted interest rate expectations sharply – and a 100 bps hike at the July 27 FOMC meeting all of sudden become a likely outcome – but markets have calmed somewhat down

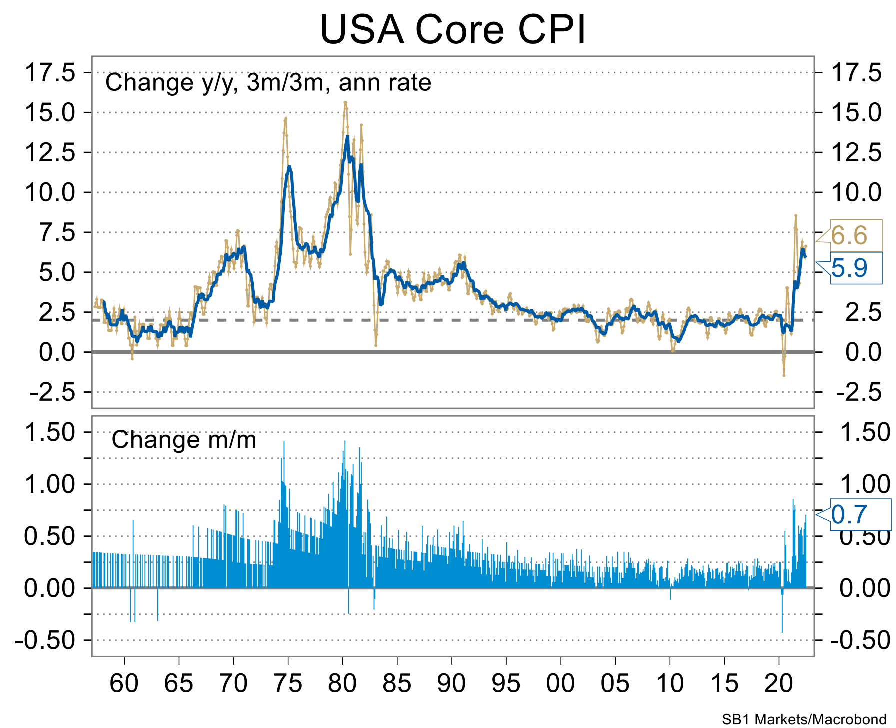


SpareBank 1 MARKETS

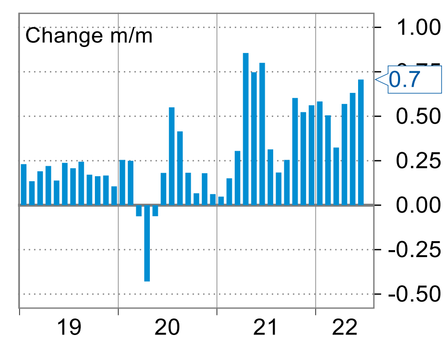
# Core inflation higher than expected too, up 0.7% m/m

... 0.2 pp more than expected. The annual rate still down 0.1 pp to 5.9%



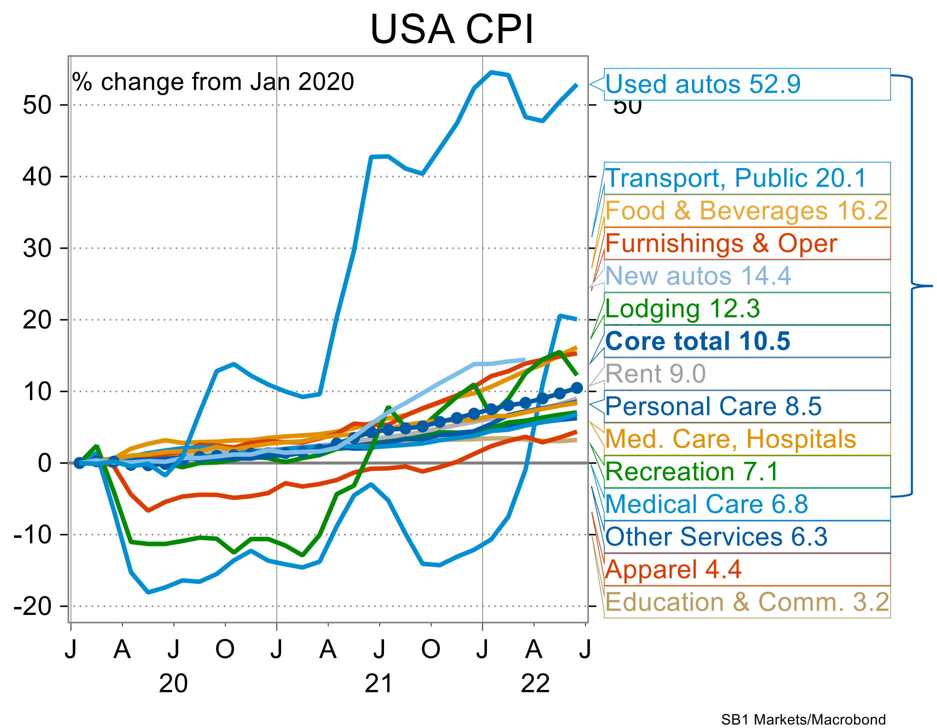

- The 3m/3m rate was unchanged accelerated 0.5 pp to 6.6%
- **Peak inflation?** Last summer prices slowed somewhat, and the annual rate may now climb further

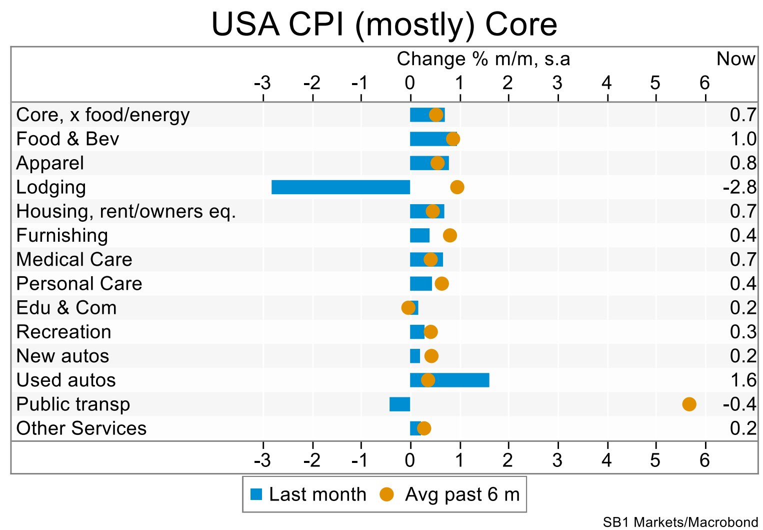


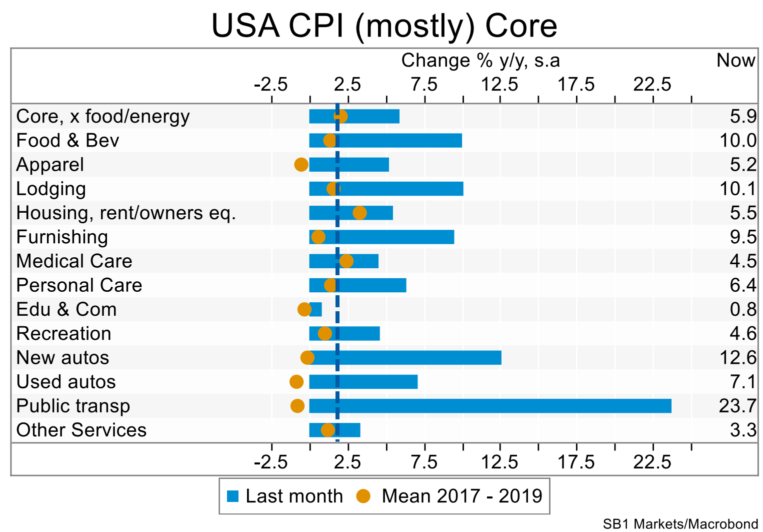
SpareBank 1 MARKETS

# Besides energy, public transport (airline fares), lodging & autos in the lead

## Food (at home) prices are up 12.2%. (And gasoline prices are up 59.9%!)



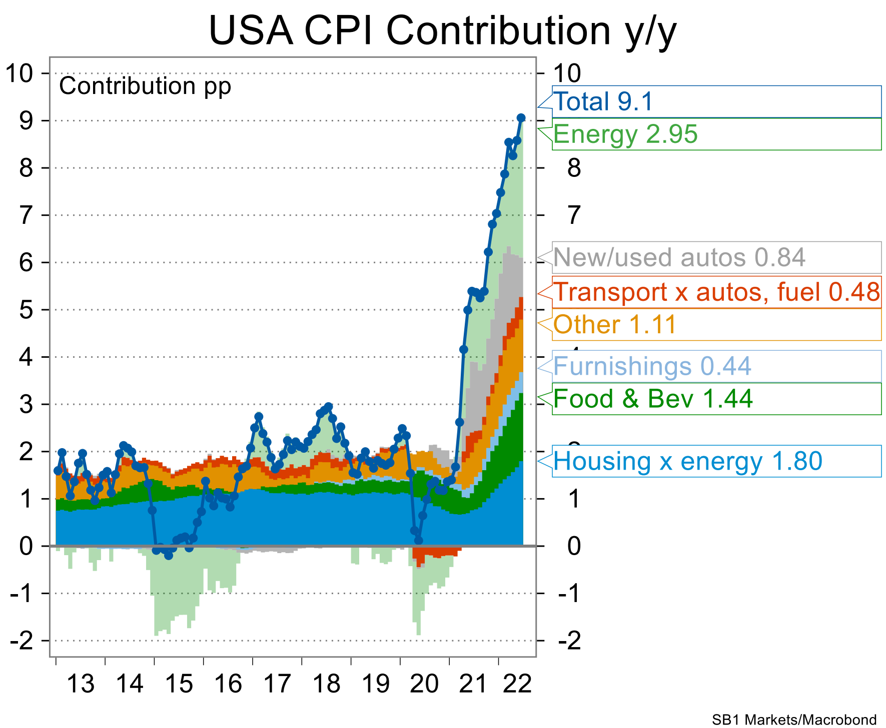



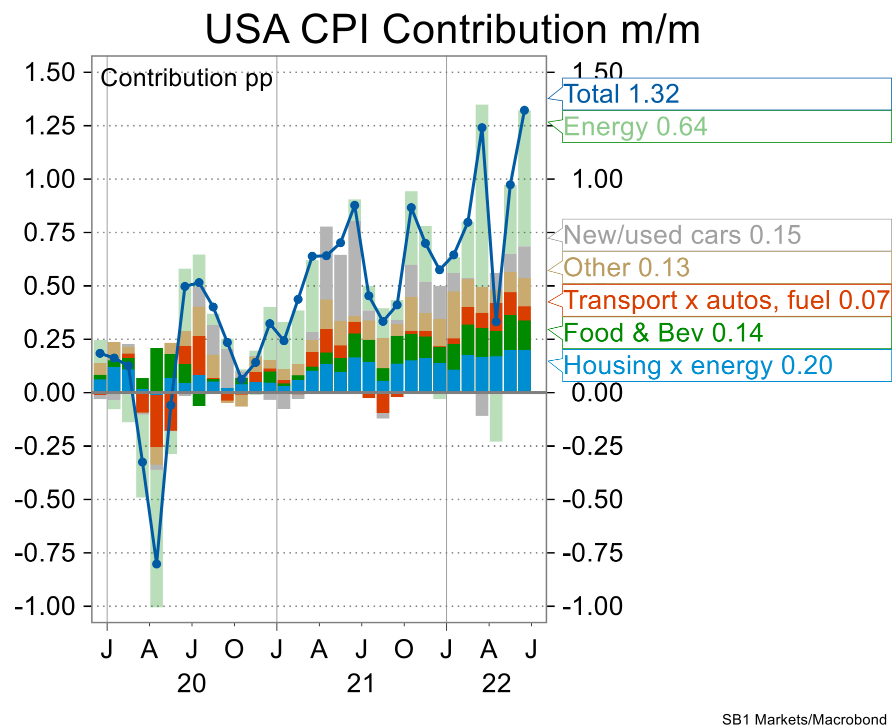




- Most sectors report inflation above 2% from before the pandemic, just apparel education & communication below
- All but two sectors, apparel and edu. & com, are up at more than a 2% pace from before the pandemic
- One day: A huge downside to used auto prices – and hopefully for some others as well (like publish transport and several other sectors)

# Transport (incl. used cars) & energy explain 4.3 pp of the 9.1% lift in total CPI

## The problem: The rest is up by some 5% y/y. Housing alone contributes 1.8 pp. Food 1.5%



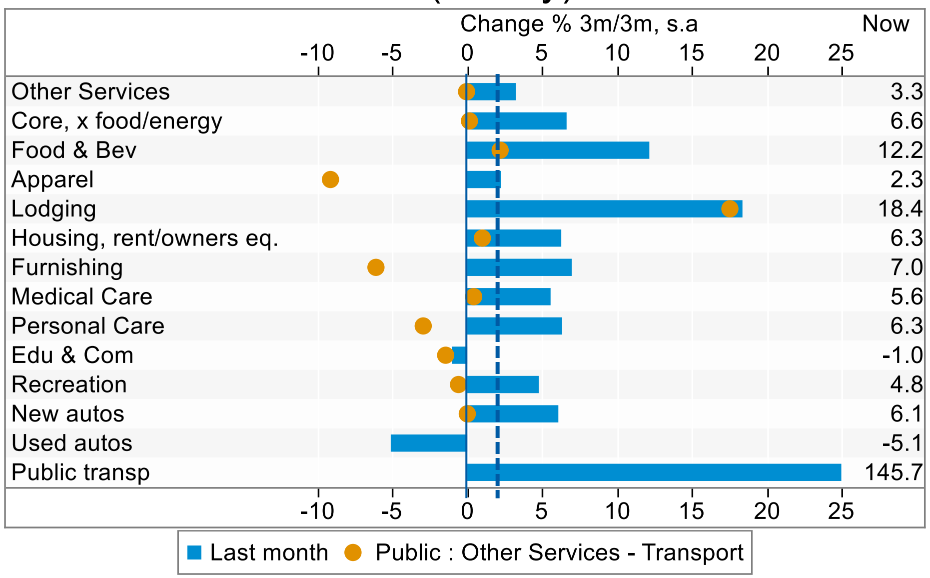

- **Energy** prices gained 3.9% m/m in May, as both natural gas and gasoline prices rose – and prices are up by 34.6% y/y
- **Excluding** the 4% pp contribution to the headline CPI from energy & transport, **"remaining" inflation** has accelerating rapidly
- **Housing x energy** (and x lodging) is contributing by 1.7 pp, though partly due to a low base one year ago. Rents as measured in the CPI are up almost 5% y/y, but the upside is probably now limited

Lodging away from home (incl hotels) is not included in housing at the charts above

# Inflation measured 3m/3m: No good news

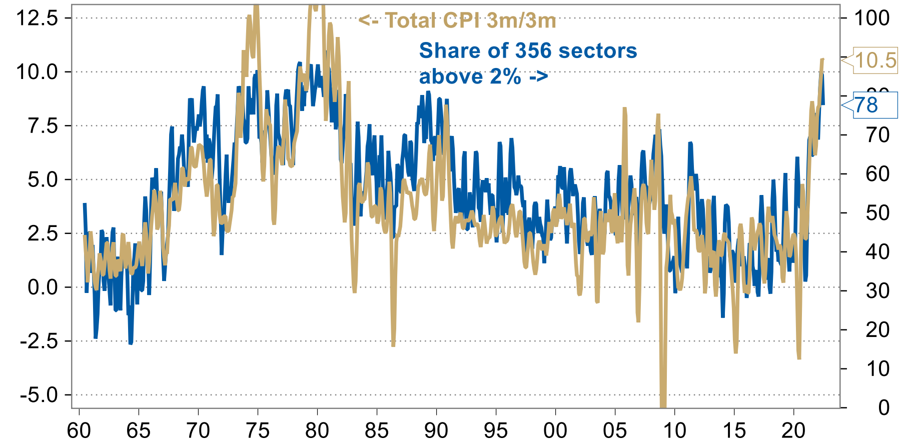
Prices are up at a 10.5% pace, and a large majority of sectors are reporting high underlying inflation

USA CPI (mostly) Core



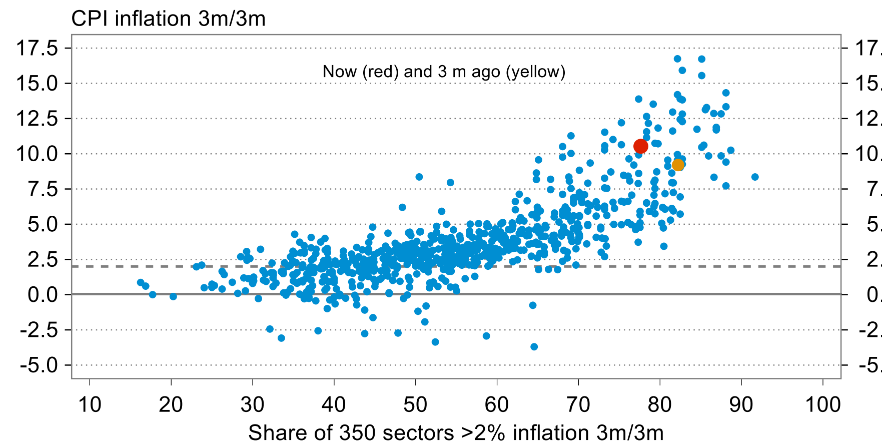

SB1 Markets/Macrobond

USA CPI inflation 3m/3m & share above 2%




SB1 Markets/Macrobond

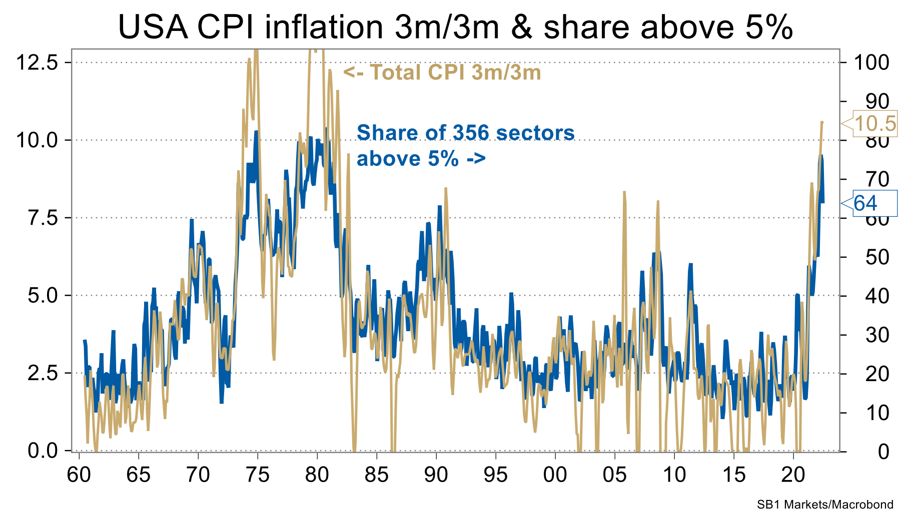
USA CPI inflation & share above 2%

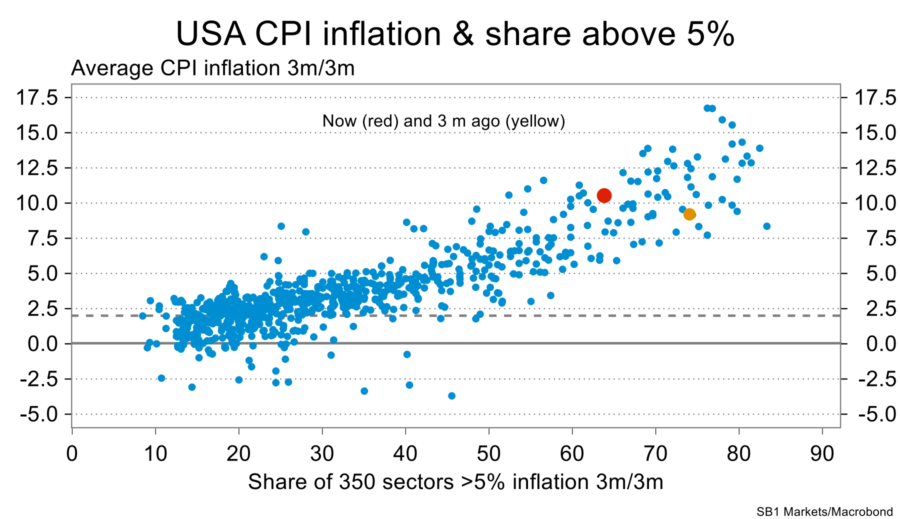



SB1 Markets/Macrobond

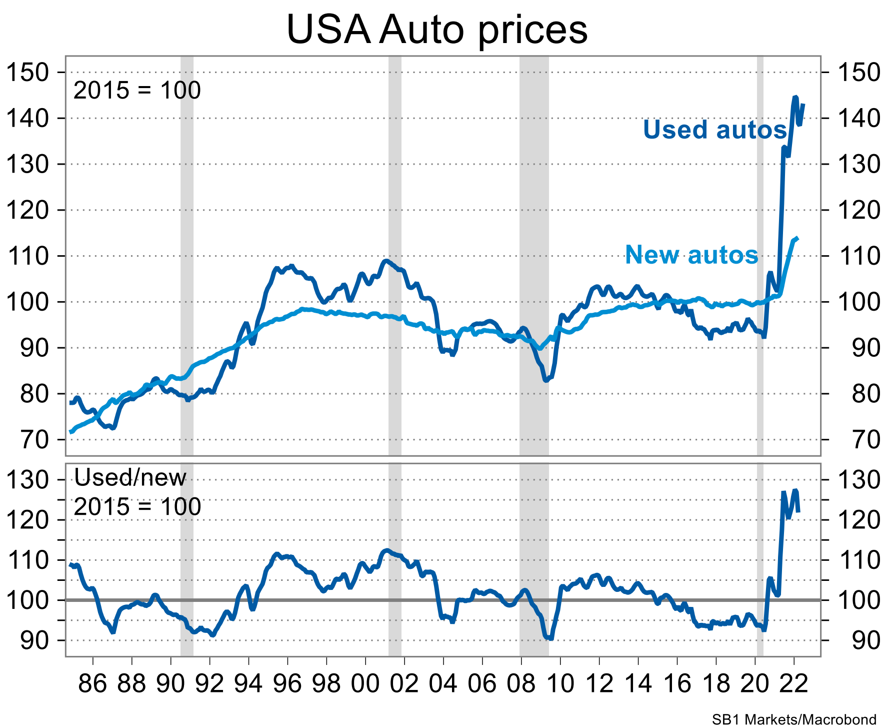
- Measured over the past 3m/3m inflation is accelerating in almost all sectors (barring used autos)
- Of 350 sub-sectors, 85% are up more than 2% over the 3m/3m, normally signalling an underlying inflation rate at 10% - where we now are

# ... and 2/3 of the CPI is up by more than a 5% pace recent months



# Second-hand car prices slightly up in June – but the downside is huge

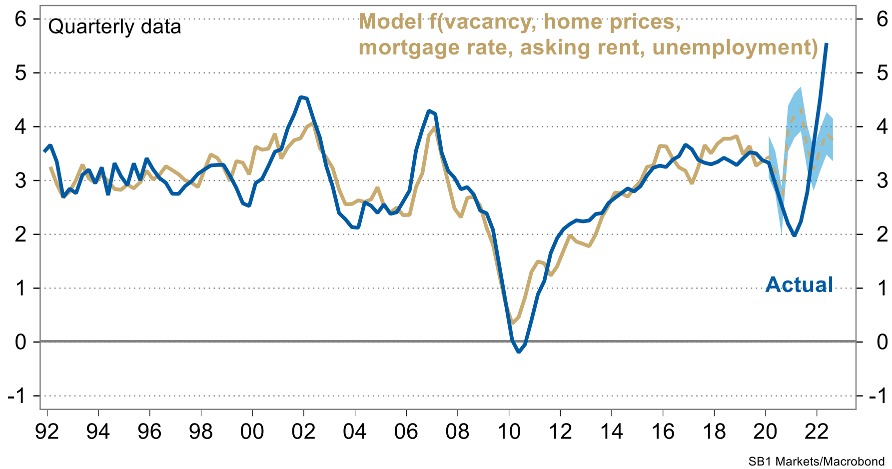



- Production of new cars is still way below demand – but prices are more up in the US than elsewhere
- At one stage, at least used auto prices will 'collapse', down to a normal level vs. new car prices – and there is a substantial downside for new cars as well

# Rents are accelerating, though from a low level last year. Will soon peak?

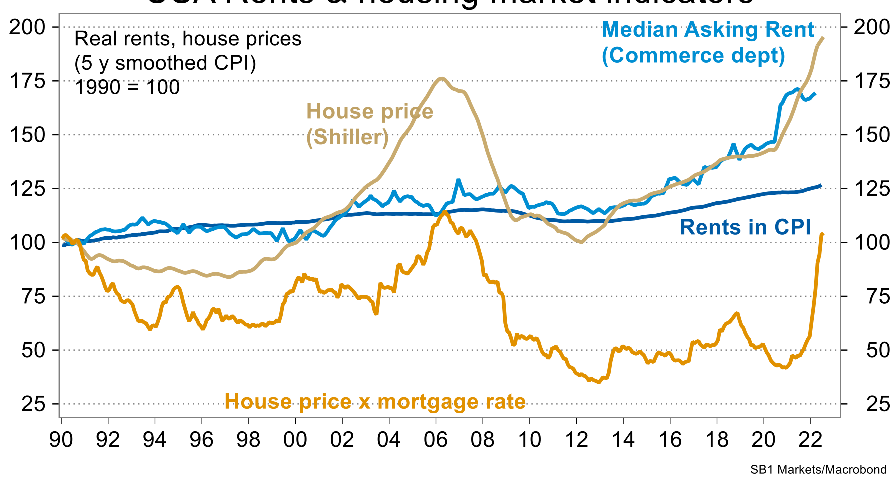
## Rents are up 5.6% y/y, while signals from the rental market are mixed

US CPI Rent model

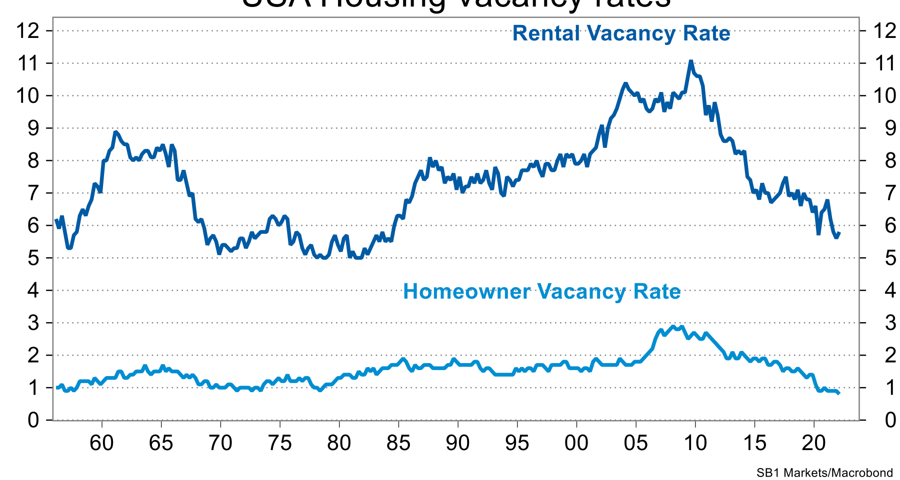



- **The official (Commerce dept) rental asking price** has been reported down since last autumn. Other rental surveys are still reporting higher rents but from a lower level
- **House prices** are up 20%, and the owner cost (price x mortgage rate) has almost doubled
- **The rental vacancy rate** has fallen sharply recent quarters, to ATL. The **homeowner vacancy rate** is trending down, and is at a record low level
- **Rent inflation measured in the CPI** has accelerated to 5.6%, though from a base below trend last year. Now, rents are climbing at a 5.5% pace (m/m), and total housing costs (ex energy) contributes 2% to headline inflation!
- **Our model**, when assuming a market slowdown in rental asking price inflation and a gradual decline in existing house price inflation the coming quarters, and a flattening of the 30 y mortgage rate at 5.5%, signals a decline in rent inflation to below 4%. However, the outlook for the rental market is highly uncertain

USA Rents & housing market indicators

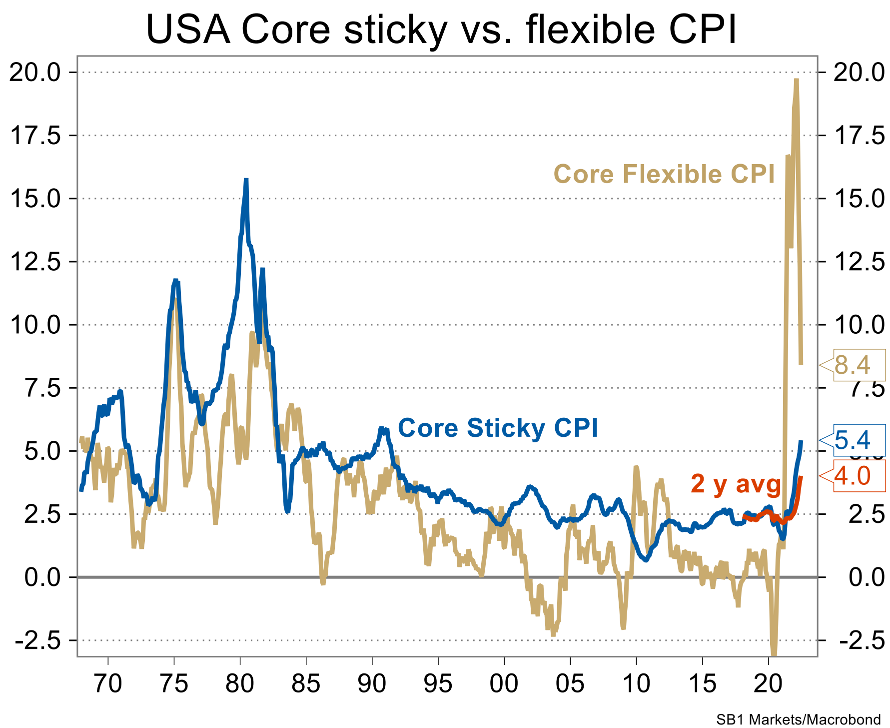


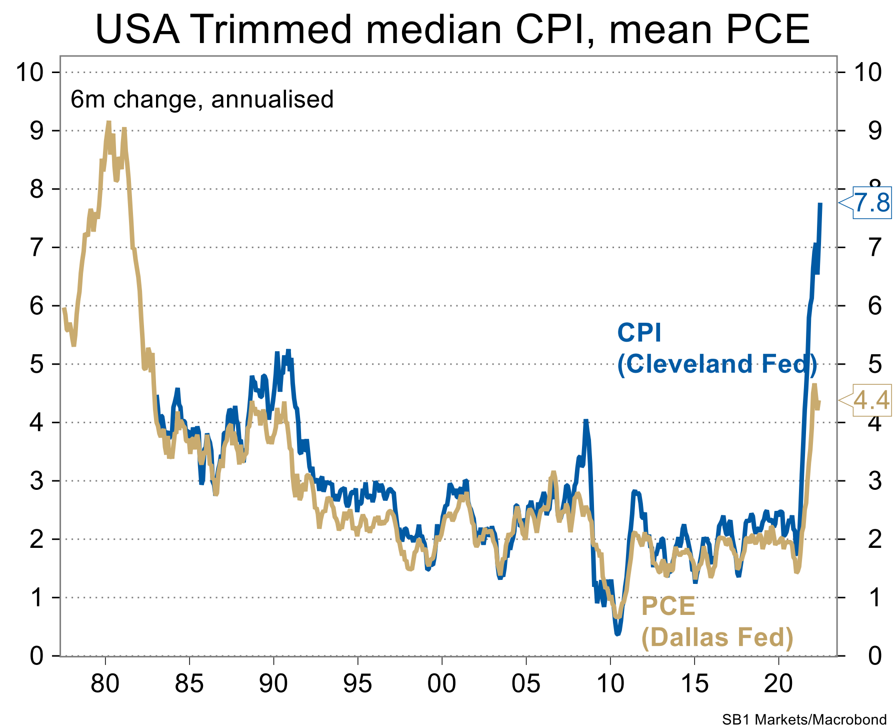

USA Housing vacancy rates



# Flexible prices have clearly peaked buy sticky prices still on the way up

## … even measured over the past two years. Trimmed price measures are still (very) elevated

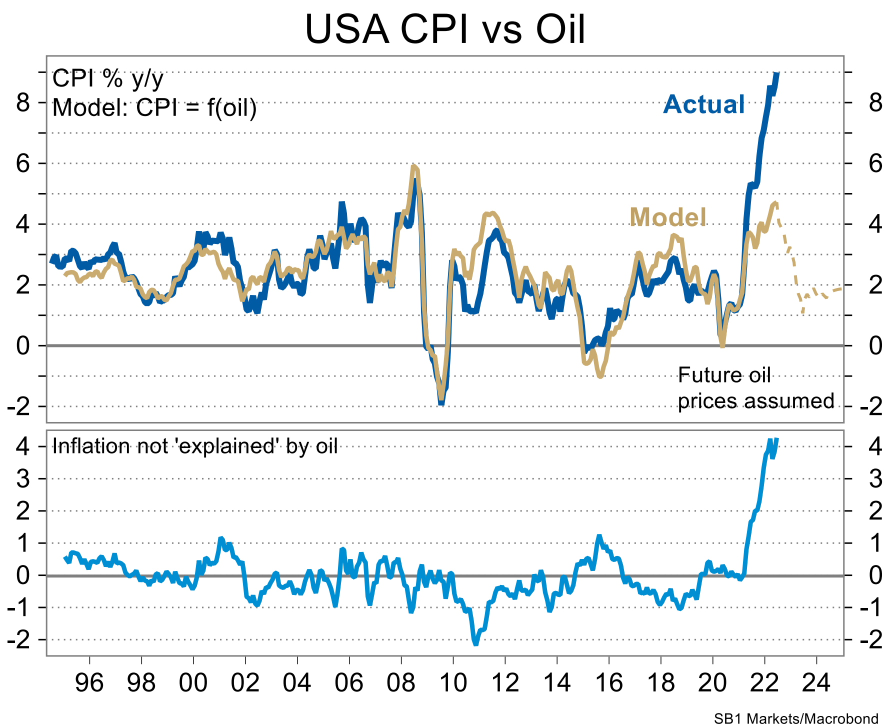


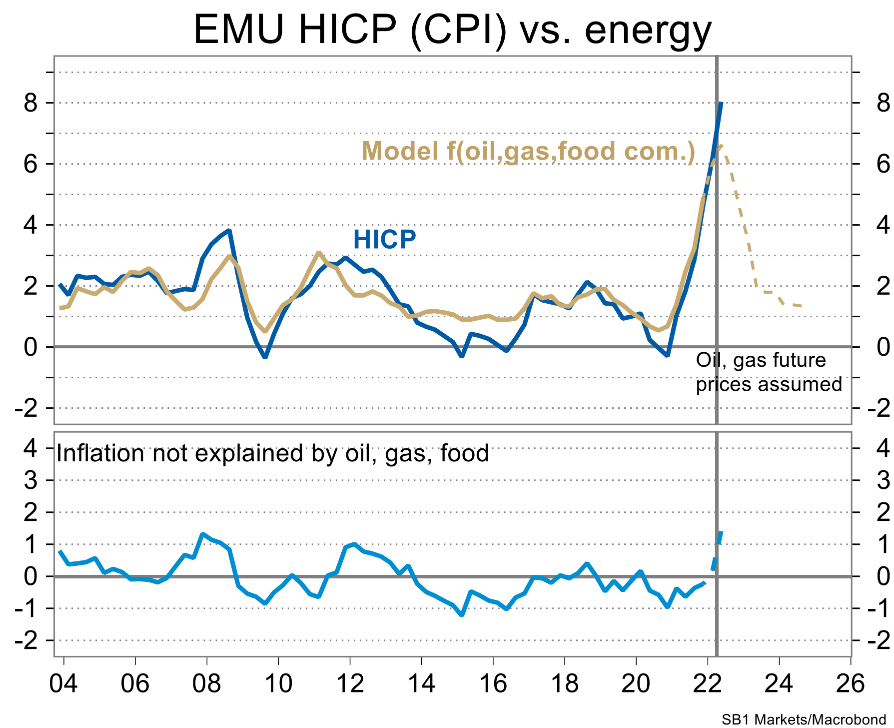




- The Cleveland Fed **trimmed median CPI** is up at a 7.8% pace over the past six months, up from 7.1% in May – and miles above anything seen before (data from 1983). Dallas Fed's **trimmed mean PCE** was up 4.4% in May, down 0.3 pp from ATH in February – but still extremely high
- Almost all of the initial lift in core CPI was due to prices of good & services that often fluctuate, with rapid price increases followed by deep price cuts. These prices are **'flexible' and** represent some 10% of the core CPI. The core flexible CPI is up 8.4% y/y, down from almost 20% at the peak! But still higher than anytime since 1981
- The new challenge: The **sticky components** (90 % of the core CPI) are up 5.4% y/y (up from 5.0% in May), the highest level since 1992 – and even the 2 y avg. is at 4.0%. The surge in the sticky index is much more worrisome for the inflation outlook than the ups and downs in the 'flexible' CPI

# If it just was energy, CPI would have been up 4.5%. Not 8.6%

CPI is up 4 pp more than explained by the oil price, unprecedented. In EMU, 1pp more?

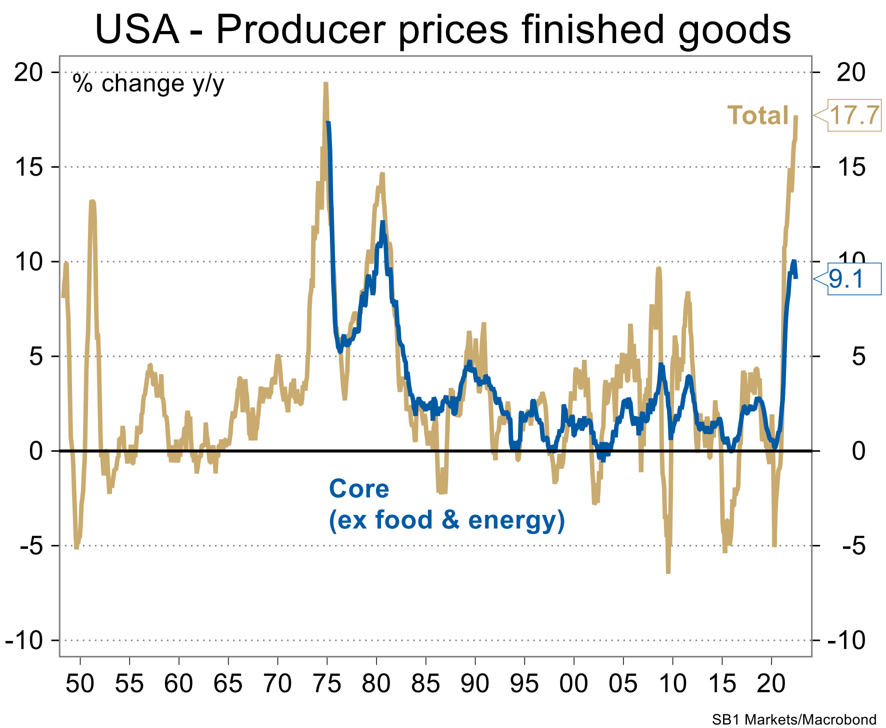


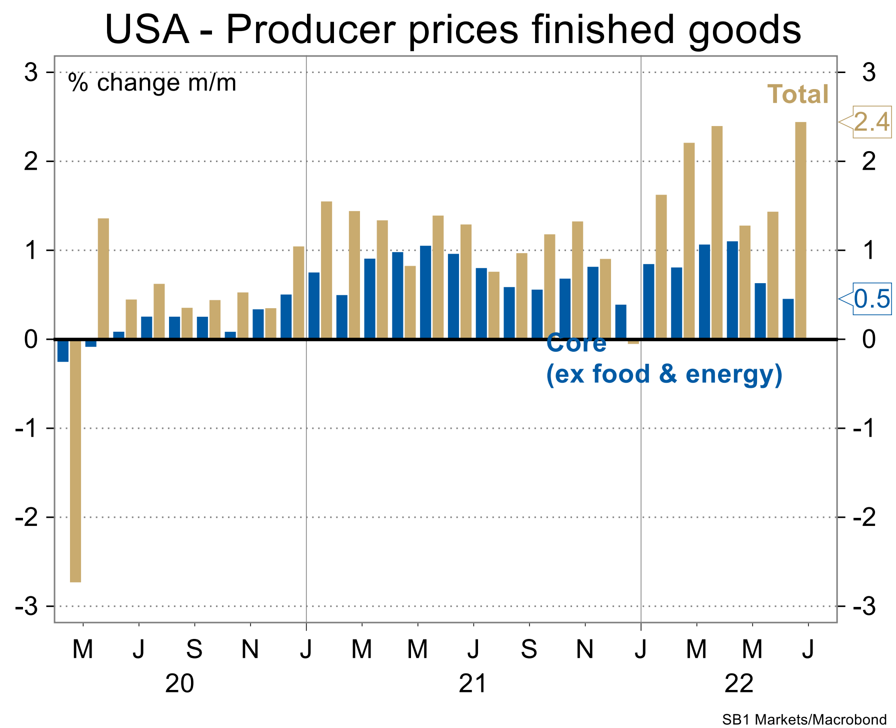




- **Oil price cycles** have explained some 80% of the changes in the US CPI growth the past 30 years, which for all practical purposes, is "everything"
  - » In our model we incorporate all direct impacts from changes in the oil price – as well as all the indirect impacts. The current model residual, at almost 4 pp is totally unprecedented
  - » The oil price impact should peak now – and the contribution should decline rapidly, if the oil price declines as signalled by future prices
- **In EMU**, the almost all of the CPI acceleration recent months can be explained by the increase in energy prices – and if oil/natural gas prices follows the future prices, inflation is now close to the peak, and the annual growth rate will return to below 2% in early 2022

# The industrial PPI up 2.4% in June. The core 'just' 0.5% - and it is slowing

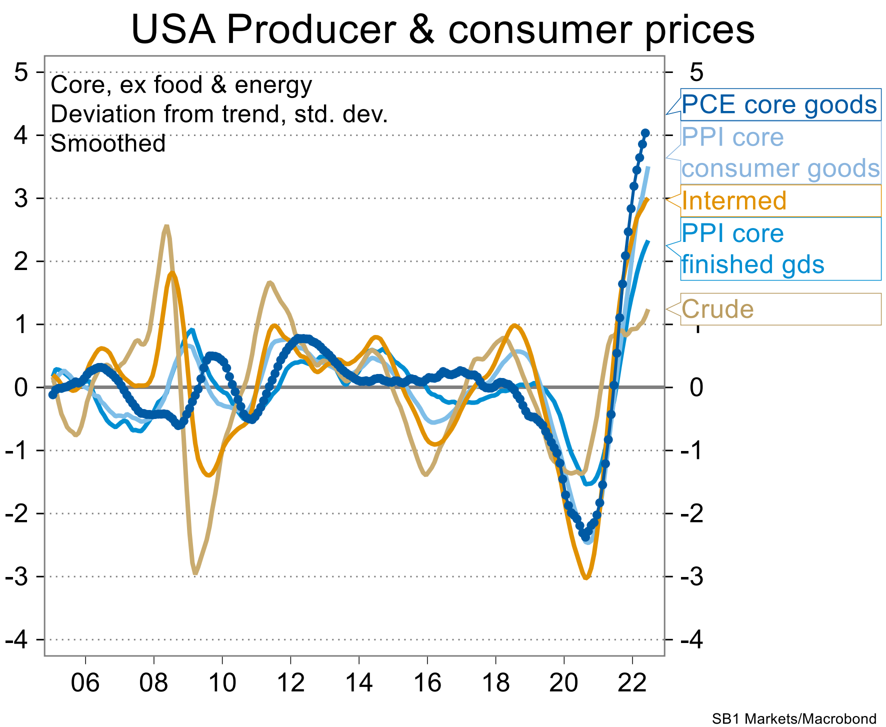
## In addition: crude materials (ex energy) are softening again

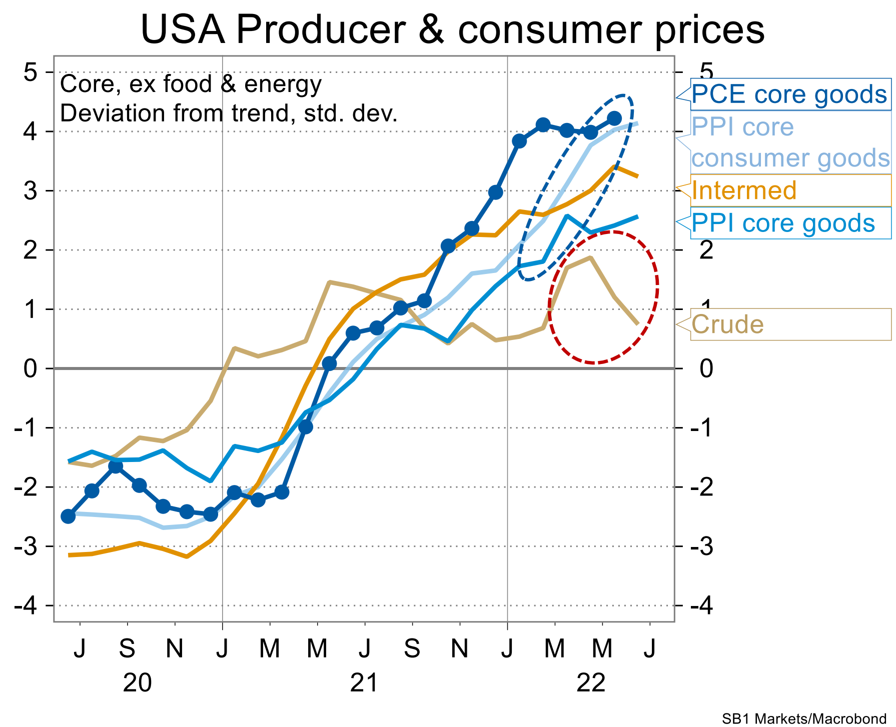



- **The headline finished <u>goods</u> PPI** rose 2.4% in June, up from 1.4% in May. The annual rate gained 1.4 pp to 17.7, the 2nd highest print ever, data from the 1940'ies. Energy and food prices are to blame, and both have so far fallen in July
- **Core finished <u>goods</u> x food & energy** PPI rose by 0.5%, down from 0.7% in May. The annual growth rate fell 0.6 pp to 9.1%
- **Crude material prices** are on the retreat – normally the first sign of easing price pressures in the supply chain
- **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 **<u>services</u>**, rose by 1.3% m/m, a new record. The annual rate at 11.2% close to ATH

# Crude core material prices are yielding

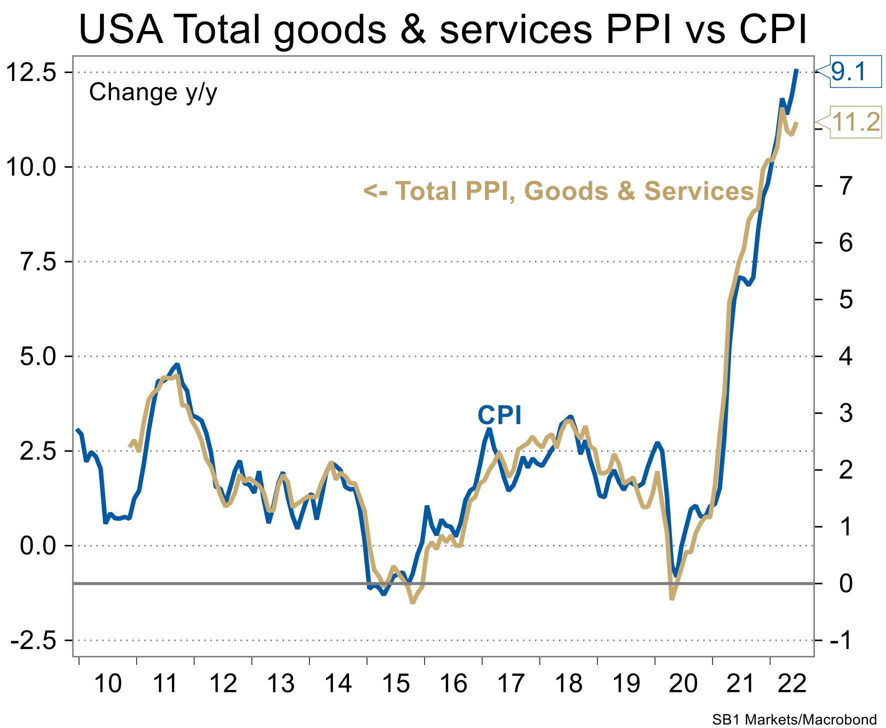


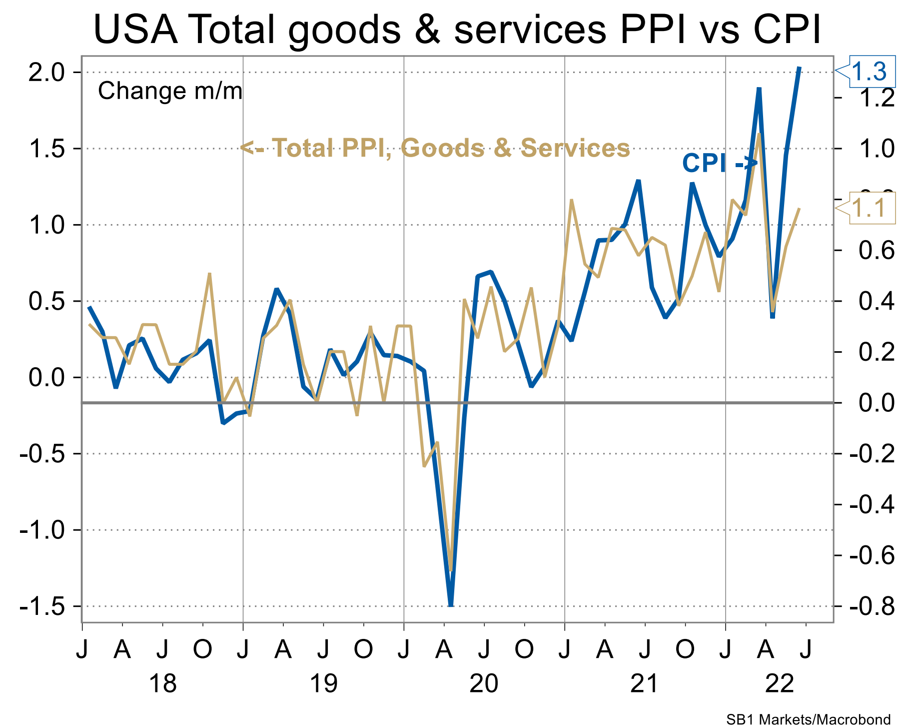




- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months. Following several months with slow growth in these prices, they shot up again in March and remained at a high level in April – but slowed somewhat in May. **Intermediate prices** climbed faster May
- 'Luckily', consumer prices have been 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

# Total PPI (services incl.) up 1.3% m/m, the core up 1.1%

## Not at peak inflation signal

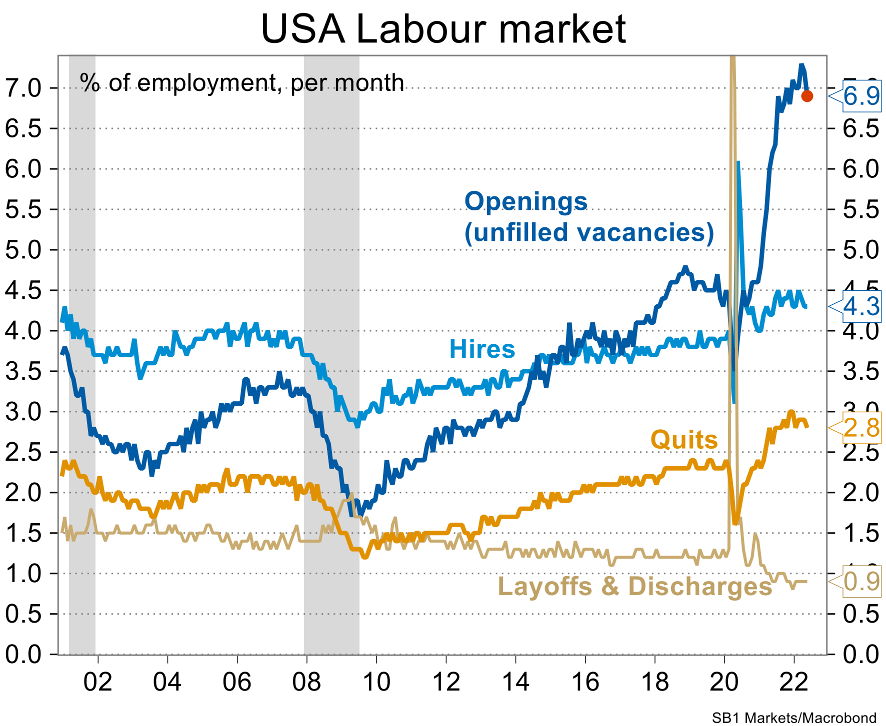



- The correlation between the total PPI, which includes all sorts of services in addition to goods, and the CPI is very close. The current 11.2% annual growth rate is not far below the ATH (In this series 12-year-old history) – and signals elevated CPI inflation

# The vacancy rate further down in May, still very high

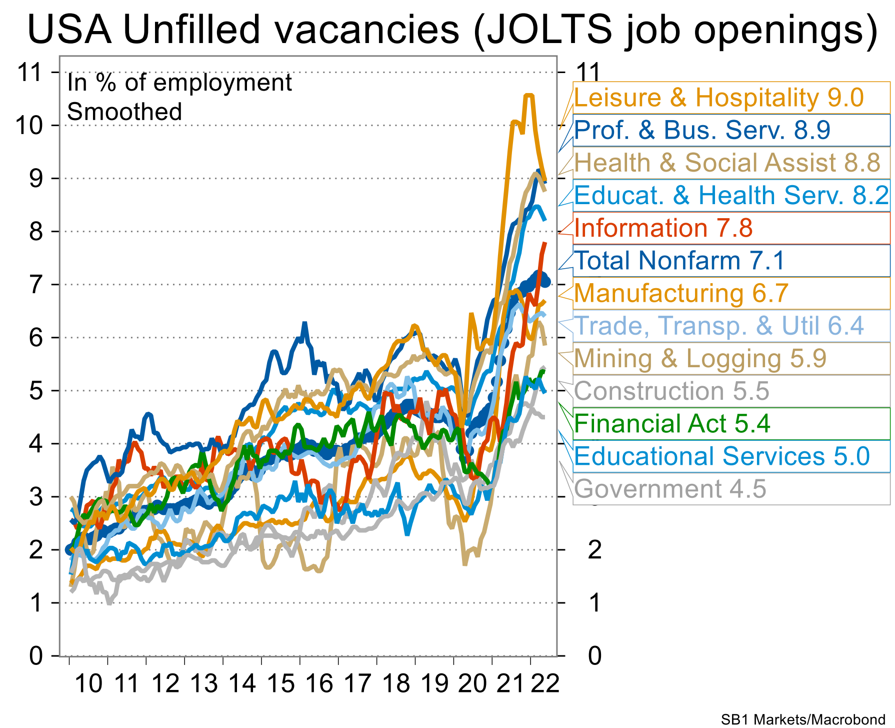
## Voluntary quits down but also still at very high level, still record low level of layoffs

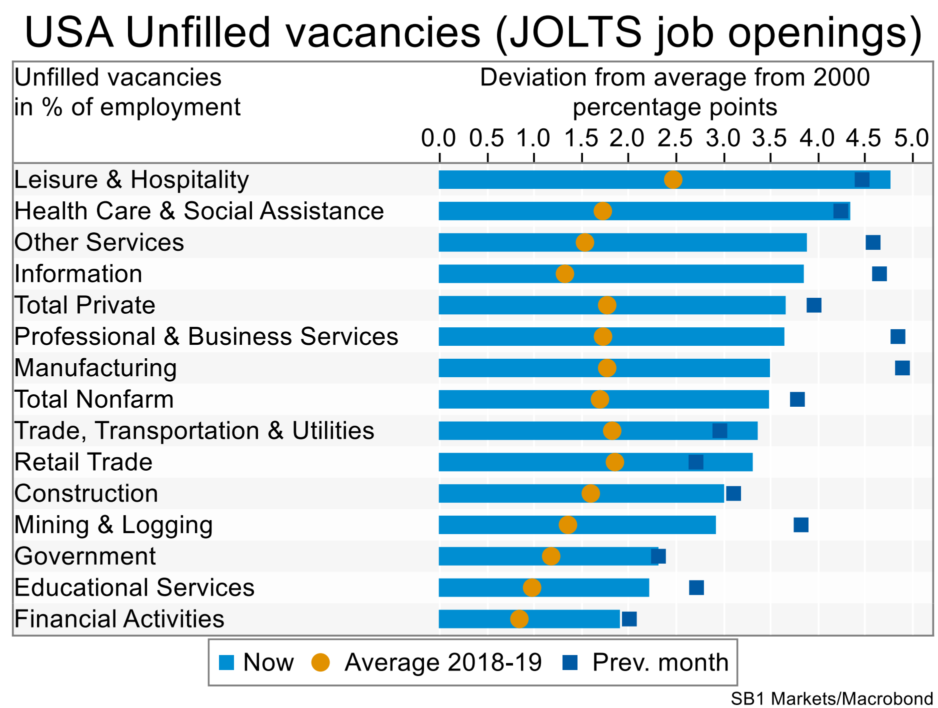



- The number of **unfilled vacancies** declined 0.4 mill to 11.3 mill in May from 11.7 mill in April, expected down to 11.0 mill from previously reported 11.4 mill. The rate (vs no. of employed) fell by 0.3 pp to 6.9%, from previously reported 7.0% in April
  - » For several months, the no. of unfilled vacances have been revised upwards, and the last observation overstates the real decline in job openings
  - » The highest print ever before the pandemic was 4.7%, and the rate was 4.5% just before the pandemic hit
- **The SMBs (NFIB survey)** reported an unchanged, and close to record high share of companies that were not able to fill positions in June. These two series are very closely correlated – and both have been at extreme levels
- **New hires** was unchanged at 6.5 mill in May, equalling 4.3% of the employment level (marginally revised down). The trend has been completely flat since early 20021
- The number of **voluntary quits** was unch. at 4.3 mill, equalling 2.8% (marginally revised down), not far below ATH from last November. As with unfilled vacancies, quits are closely correlated to wage inflation – for obvious reasons
- **Layoffs** equalled 0.9% of employment in May, at the same level as during the previous months, 0.1 p above the ATL last Dec
- **In sum:** The report confirms continued very tight labour market, far tighter than we have seen anytime in modern history – but it is not getting even tighter

# All sectors are reporting far more vacancies than before the pandemic

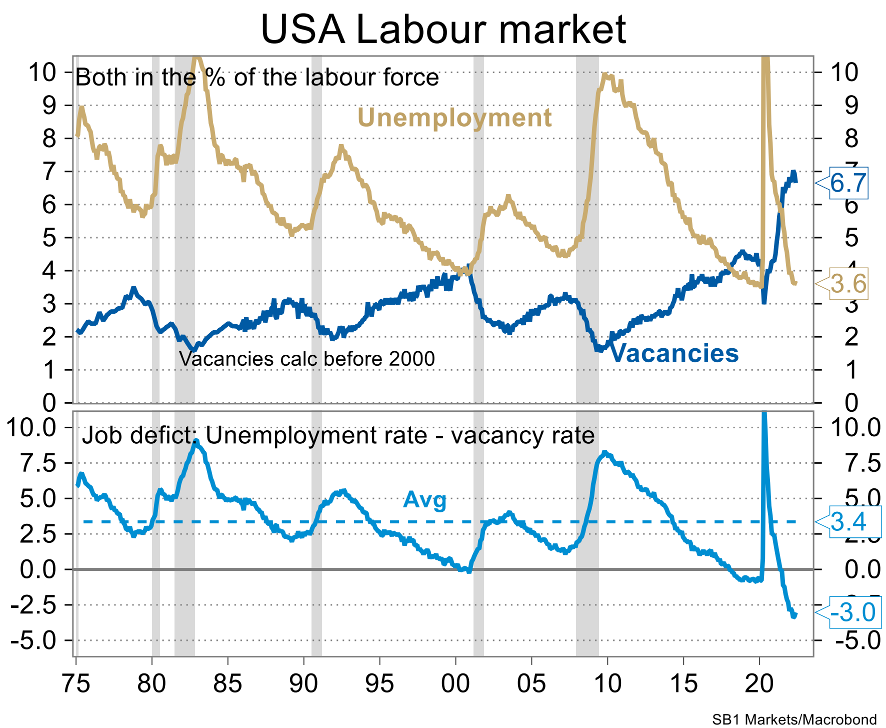
Most sectors are still trending upwards. The leisure & hospitality sector has peaked, still at 9%

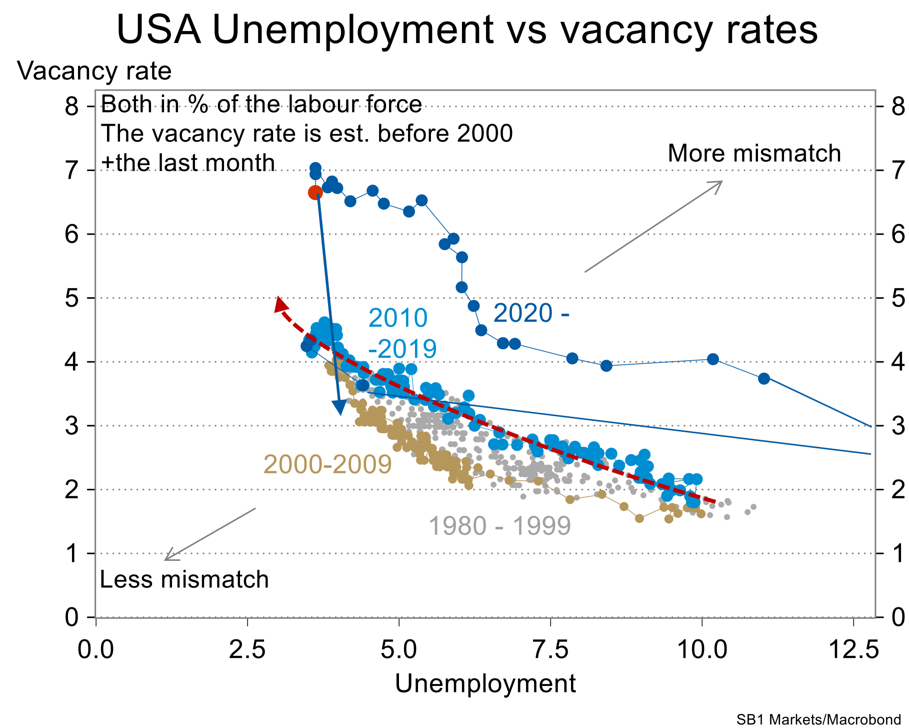


# Will it be possible to bring vacancies down, without creating a recession?

Based on history, it seems to be impossible, the two indicators are quite closely correlated

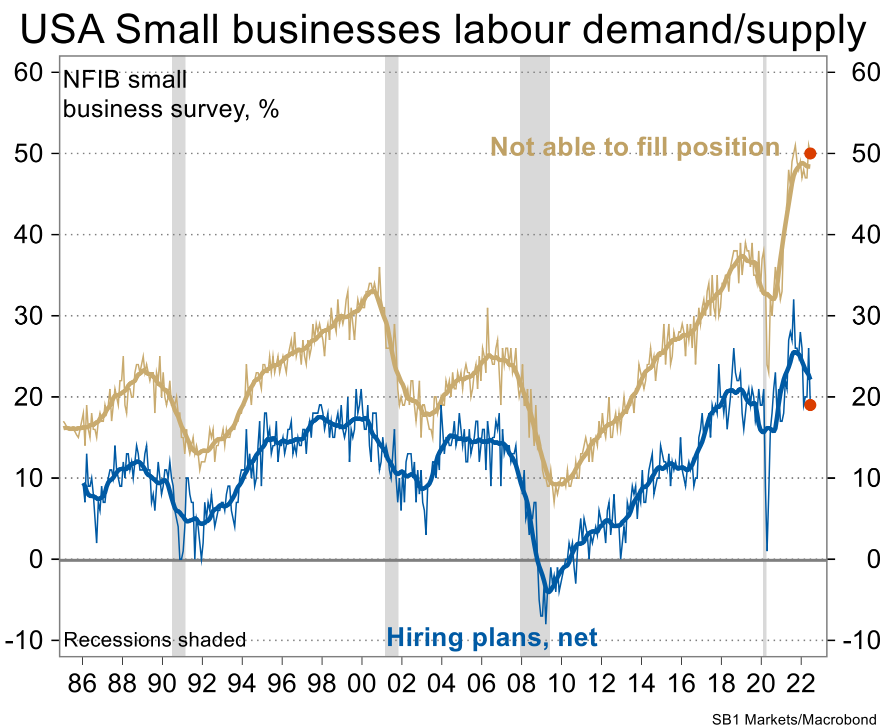


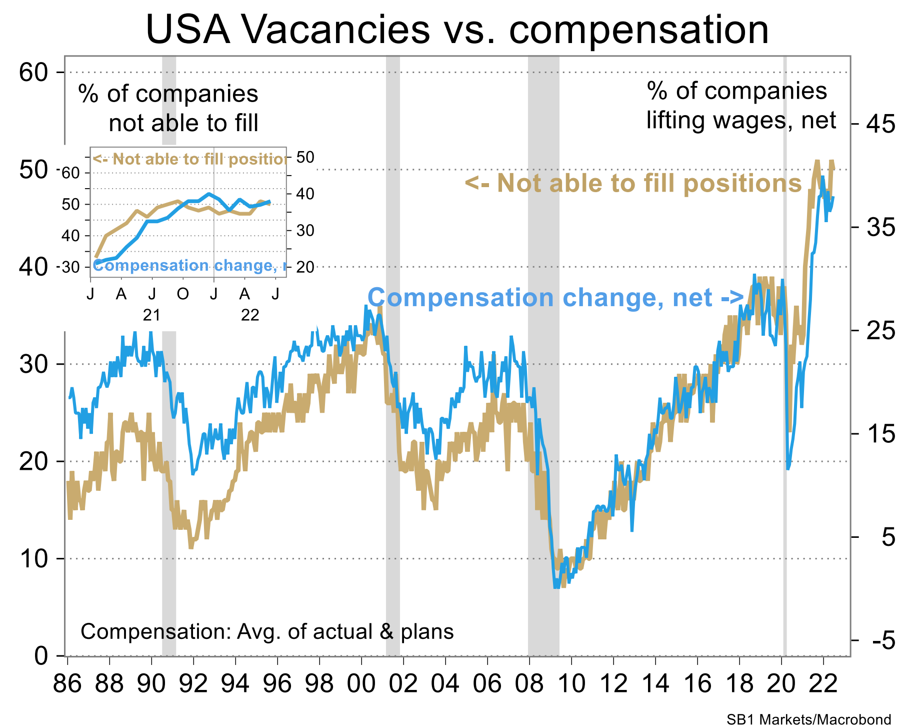




- **The Unemployment - Vacancy-curve** (UV, Beveridge curve) far up in the north-west quadrant, signalling both a tight labour market but also a higher vacancy rate than normal vs. the unemployment rate
- In principle vacancies may be reduced without pushing the unemployment rate up (aka recession), as the vacancy rates is so much higher than normal. But it seems very unlikely, as policies that reduce overall demand for goods and service and thus demand for labour – which is needed in order to bring wage inflation down (check two pages forward) – will hit both companies that have vacancies, and those which do not have. The labour market is very not so flexible that redundant labour will seamlessly be transferred to fill still vacant positions in other companies/sectors/regions. <u>If such transfer had been easy, it would have happened already, and the unemployment rate would have been lower</u>

# SMEs still unable to fill vacant positions, wage plans slightly more aggressive

## However, somewhat fewer companies plan to hire – still an unusual high proportion

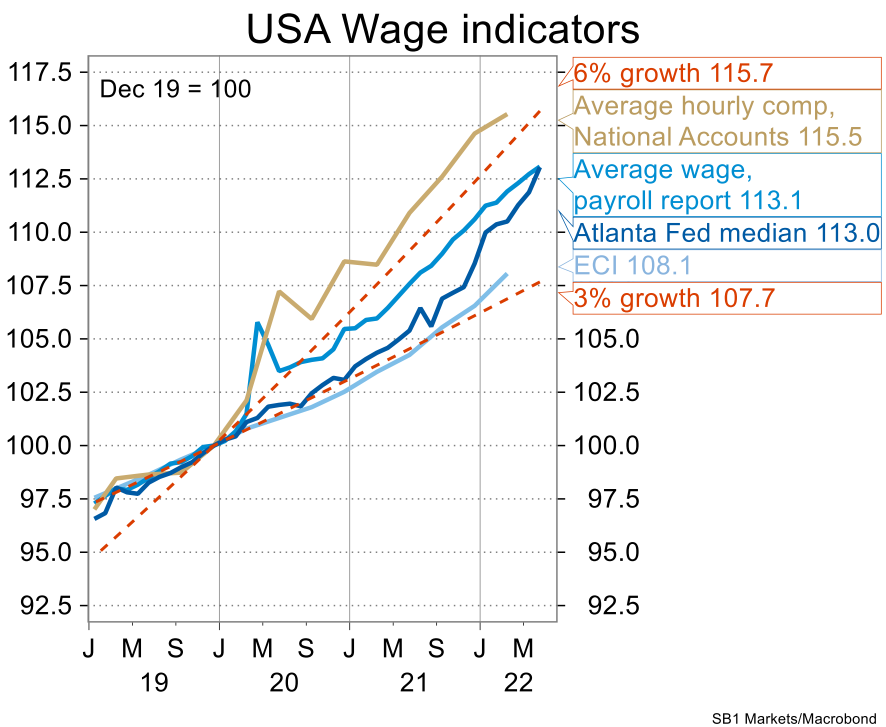


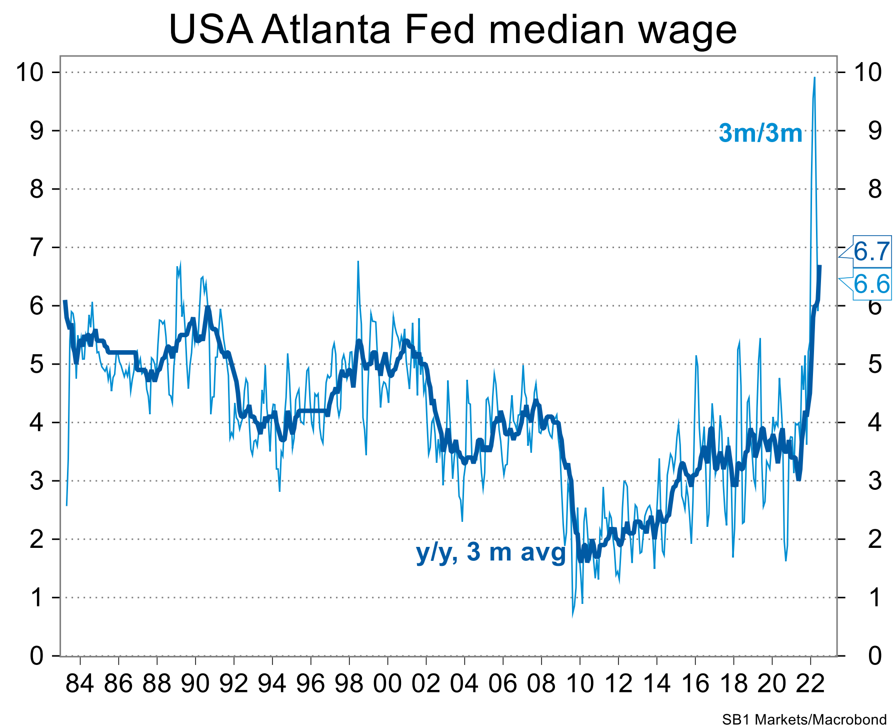




- 38% of companies report that they **plan to lift compensation** in the coming months, up from 37% in May. The peak was at 40% in last December. Before that, the ATH was at 27%, while the average – signalling no acceleration in wage growth, is at some 20%

# Wage inflation is soaring, says the Atlanta Fed median wage tracker

The median wage is up 7.4% y/y, 6.7% 3 m smoothed. Take off 'for everybody' (x the very best paid)

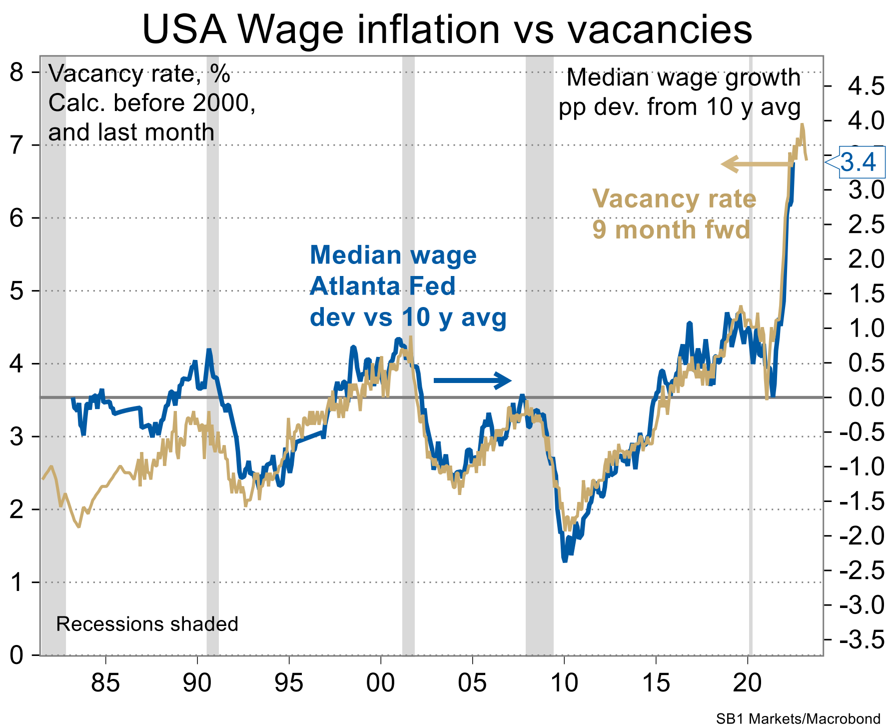


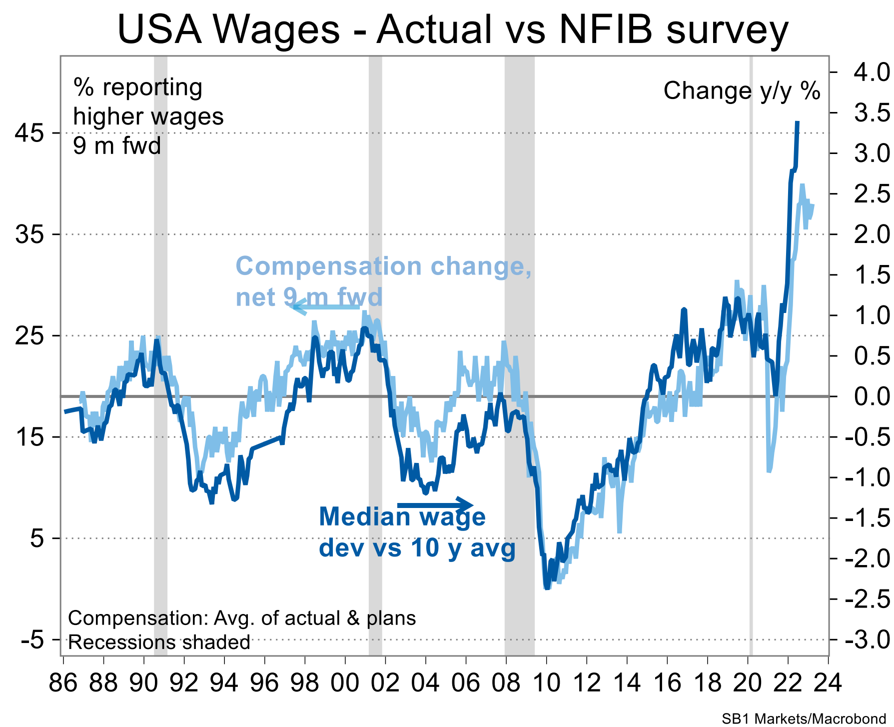




- **Atlanta Fed's median tracker reports** a 7.4% growth in June (ATH, by far), up from 6.5% in May, as wages rose by 1.1% m/m in May. The 3 m annual wage growth is 6.7% (ATH, by far), and the current wage inflation is 3.4 pp higher than the past 10 average, a wage acceleration we have never seen before (all data from 1983).
- **All** ages, occupation, industry, job switcher (or not), race, education, urban or rural, region all raport a sharp acceleration. The only laggards: the who that are paid the best but even this group report higher wage growth recent months
- **All other wage indicators** are reporting fast wage growth, and all are reporting wage growth well above the recent years' average. However, i<u>n the payrolls report, wage inflation has slowed slightly recent months</u>

# So why are wage inflation soaring like never before?

Because vacancies are higher than anytime before, it seems like. How to bring wage inflation down?

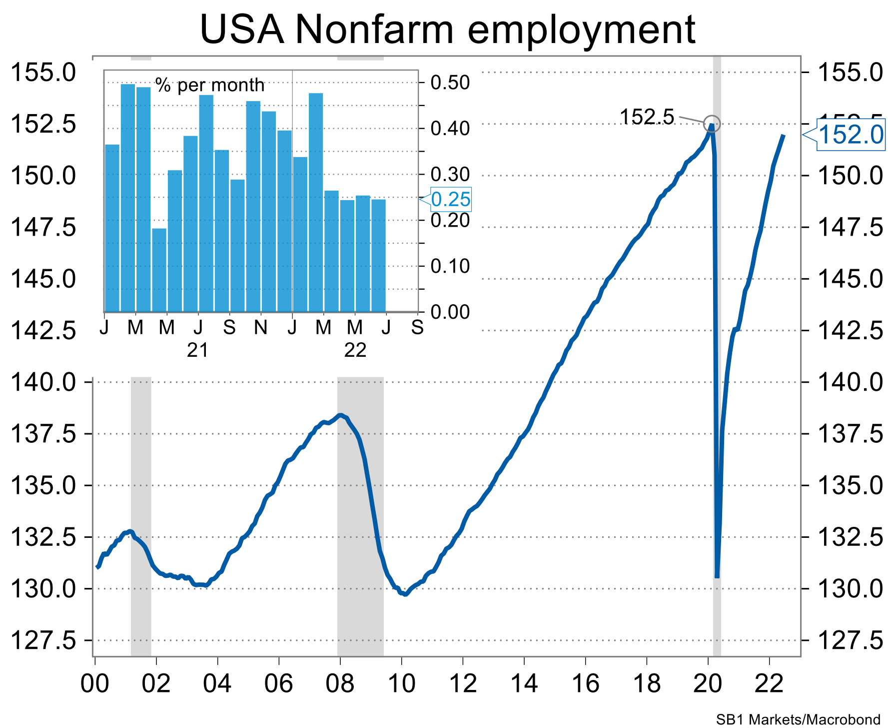


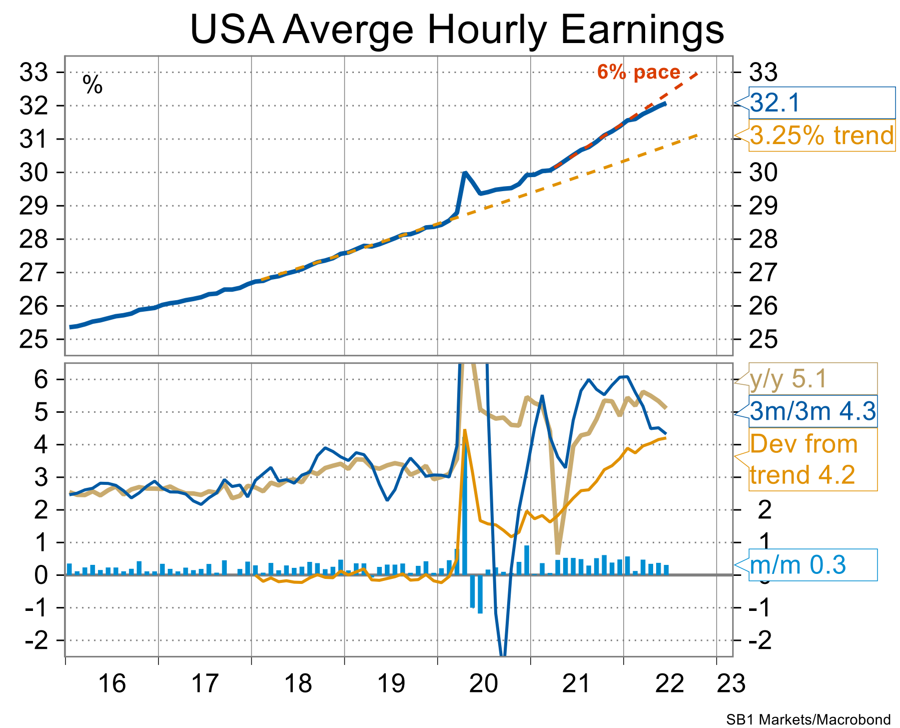




- **Our 'Phillips curve'** based on the vacancy rate signals a further increase in wage inflation the coming quarters even if vacances may have peaked, as the vacancy rate leads changes in wage inflation quite consistently by 3 quarters. However, we would not be surprised if the current extraordinary high wage inflation turns out to be the peak
  - Companies (SMEs) compensation plans signal continued high wage inflation but not faster than the present
- **Wage inflation** has already accelerated by almost 3.5 pp vs the 10 y average (Atlanta Fed median) and cannot possibly generate a 2% price inflation rate over time. This is Fed's main headache, not the current high CPI inflation print. And it will become the stock owners' headache too, of course
- **Demand for labour has to be reduced sharply in order to get wage inflation beck to a sustainable level! That's the recipe for an unavoidable RECESSION**
  - Check under which circumstances wage inflation slows on the charts above (hint: find the shaded areas, follow the wage line - as well as the vacancy rate or the wage hike plans ☺). Fed will not be able to control inflation if demand for labour is not cut sharply

# Steady growth in employment, wage inflation is slowing somewhat!

## Labour force, employment rates have flattened, even if demand for labour is strong. Maximum empl.?

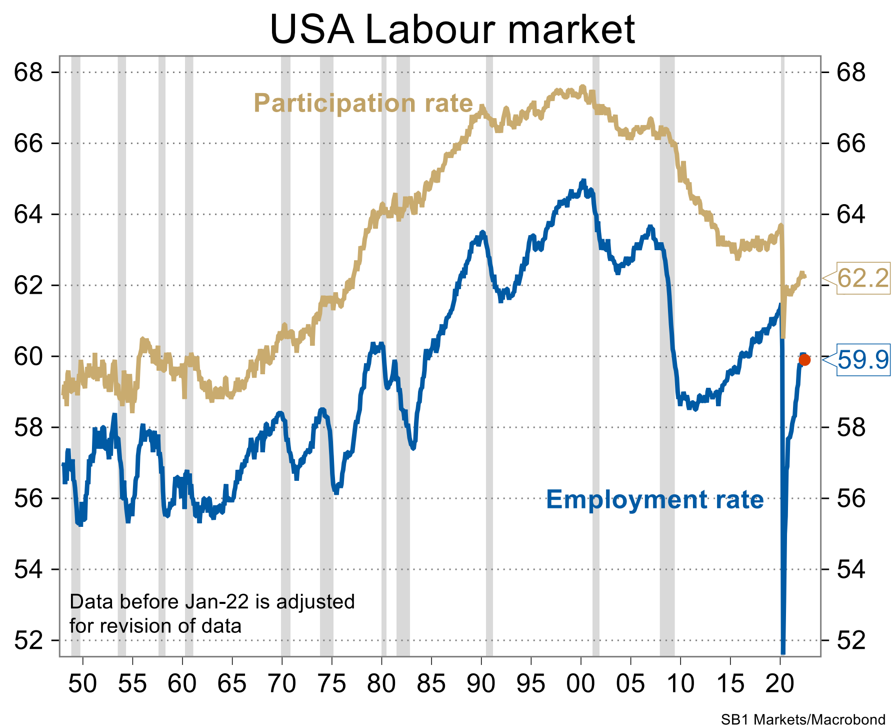


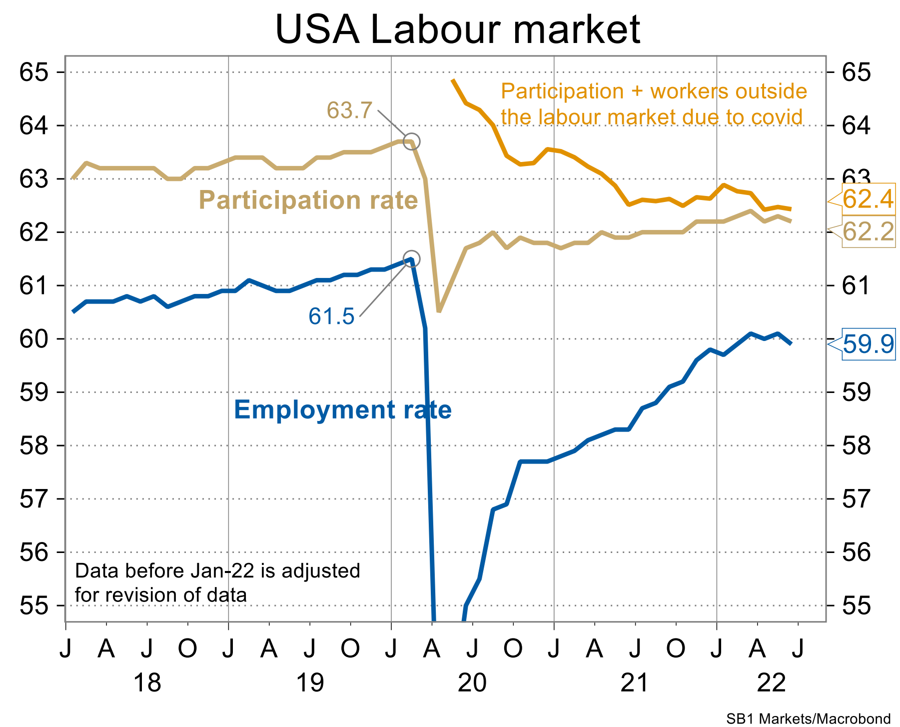




- **Nonfarm payrolls** rose by 373' in June, much more than expected (250'), and in line with growth the previous 3 months. Payrolls are still down 0.5 mill vs. Feb-20 or by 0.3%. The LFS employment fell by 315', and the **employment rate** fell 0.1 pp to 59.9. This rate has been at this levels since February
- **The participation rate** lost 0.1 pp to 62.2%, a rate reached last November. Very few now states Covid as a reason for not working/searching work (0.2%)
- **The unemployment rate** was stable at 3.6%, as expected. The FOMC lifted it's Q4-22 f'cast by 0.2 pp to 3.7% (and to 4.1%, 0.1 pp above the assumed NAIRU, by the end of 2024.
- **Wage inflation is slowing: The average wage** rose 0.3%, as in May, and as expected. The 3m/3m rate has fallen to 4.3% from 6% in January. The annual rate fell 0.2 pp to 5.1%. Annual rate was 0.1 pp above expectations as May was revised up by 0.1 pp to 5.3%. Before the pandemic, average wages rose by 3¼%, and wages are now 4.2% above this trend
- **Maximum employment:** Both the participation and the employment rates have flattened recent months, as the same time as the demand for labour is very strong, witnessing the extreme level of unfilled vacancies. The supply side is obviously the bottleneck at the labour market. For the time being, maximum employment is reached – and wage inflation is well above a sustainable level

# Weak labour force survey data in June, both participation, employment down

Both are now trending flat – while *vacancies run extremely high*. Signals an emptied labour market?

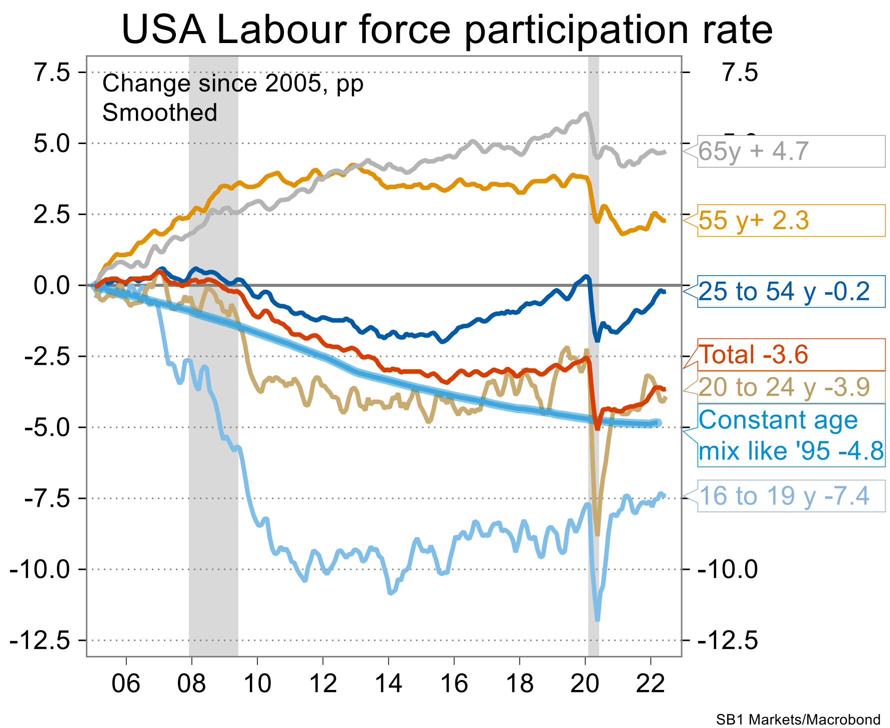


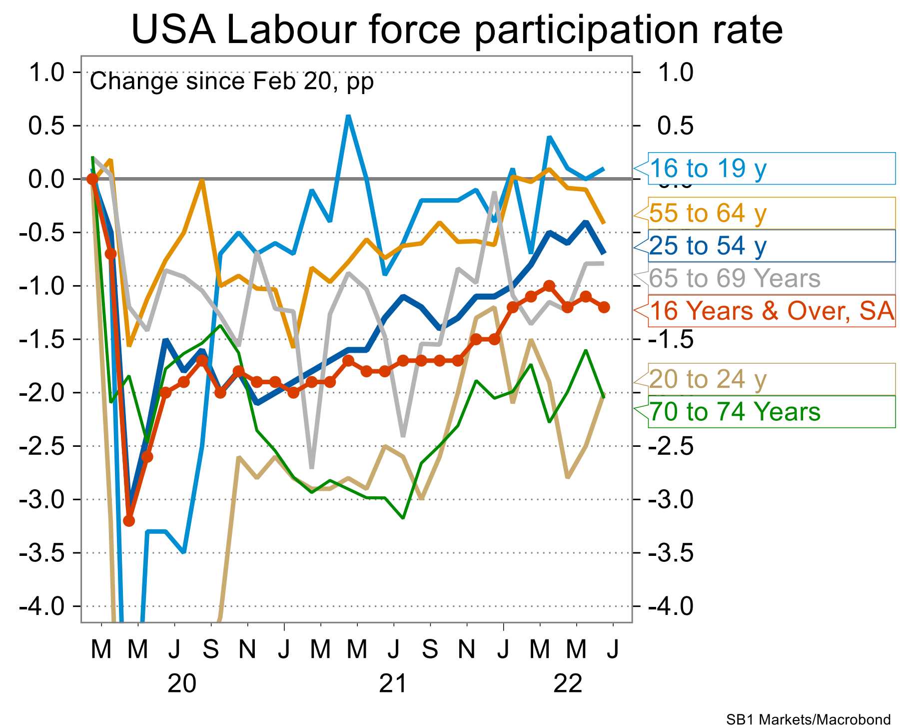




- In June, **the labour force participation rate** fell back again, by 0.1 pp to 62.2%, a level first reached (in this recovery) in Dec 2021. This rate is still 1.5 pp (2.4%) below the pre-pandemic local peak. Just some few are not able to work due to Covid (0.2% of the labour force)
- **The employment rate** fell 0.2 pp to 59.9% (even if the payrolls rose by 0.25%). This rate has flattened since February. This rate is 1.6 pp (2.6%) below the pre-pandemic local peak
- Why has both the participation and employment rates flattened, at the same time as demand for labour still very likely is very strong, witnessing the still high (JOLTS) vacancy rate, and the close to ATH share of SMEs reporting they are not able to fill open positions. The only reasonable explanation is that all persons that want to have a job and are able to work - at least for the time being – have now entered the labour market

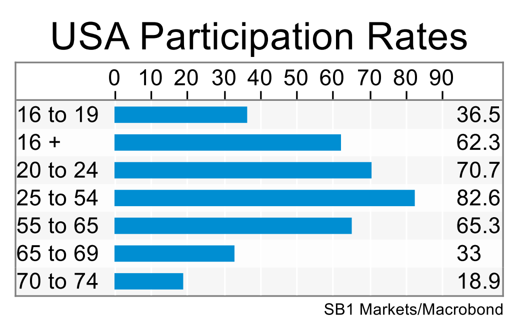
# Participation rates: Core age groups almost back to pre-Covid & pre-GFC levels

Thus, the core reserve may be limited. The 65+ segment seems hard to get back



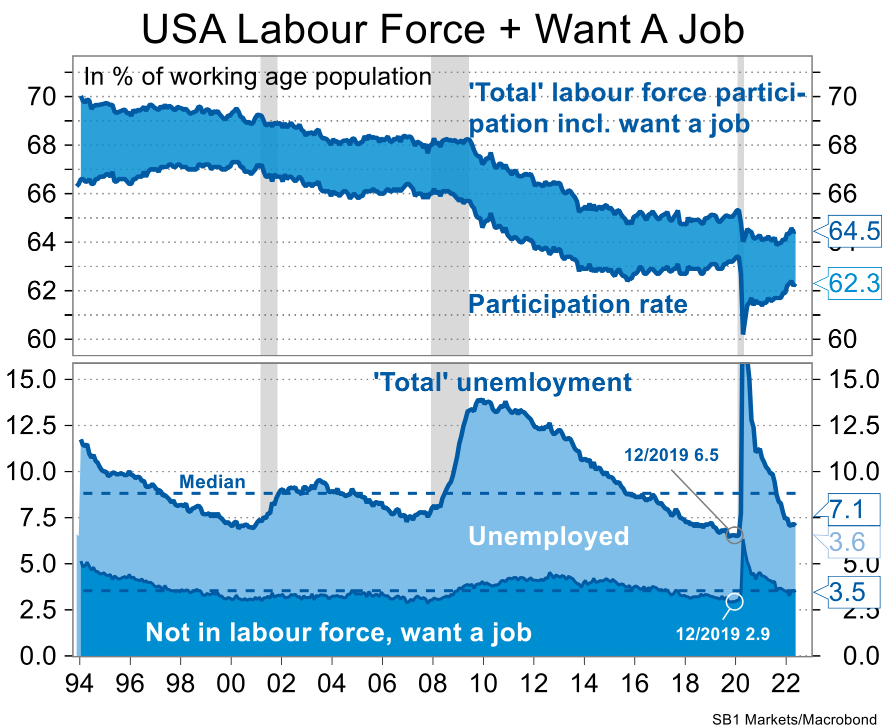



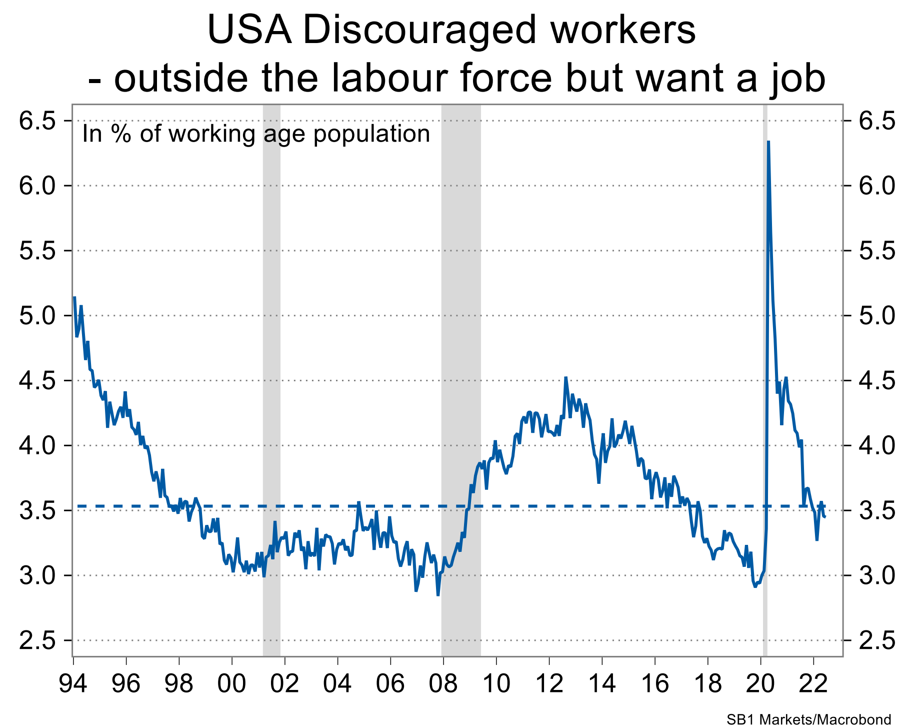

- The participation rate among the 25 – 64 y group is now almost back to the level from before the pandemic. The 20 – 24 y group remains well below. The 65+ group is still below the early 2020 level
- As the US population is aging, and a decline in the average participation rate <u>over time</u> is no surprise. The chart above illustrates the impact. The thick light blue line illustrates the participation rate if each group kept their participation rate at the 2005 level. The decline is due to the larger old cohorts



# Not that many outside the labour force say they want a job

## These outsiders equal 3.5% of the labour force, which is at the historical average

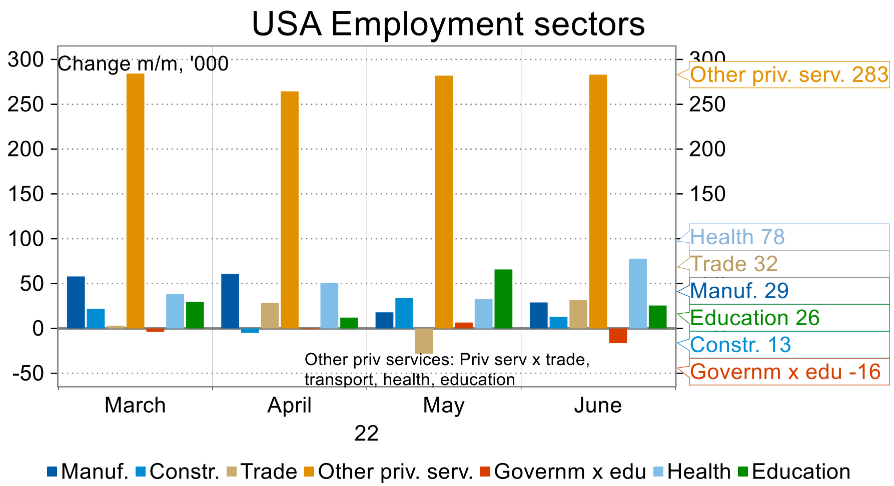


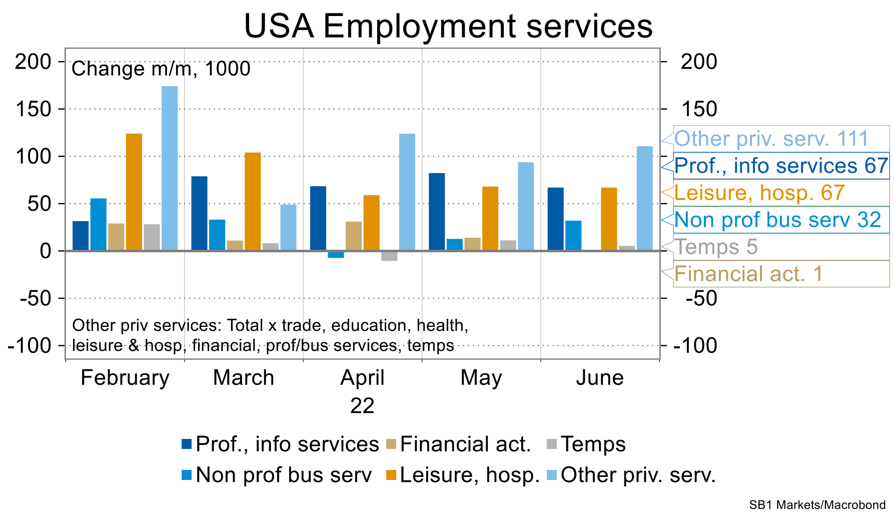




- Normally, the ‘discouraged workers’ rate is lower than average in booming times – and it ‘should’ have been below average by now. Those who sat they cannot work due covid now constitutes just a small fraction of the 3.5% rate
- Given the present high vacancy rate it seems to be rather challenging to squeeze this part of the population into the labour market

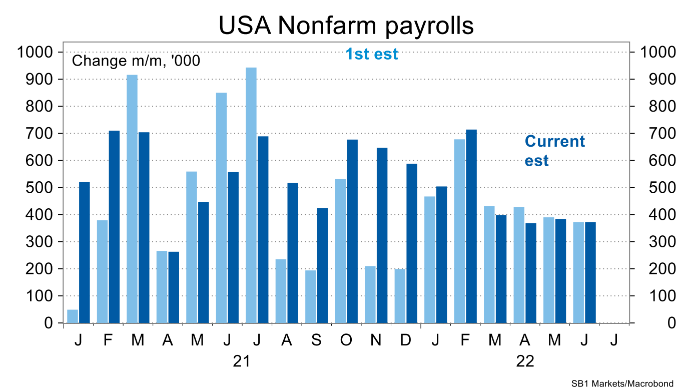
# In June: Steady growth in most sectors

## Private services in the lead, as normal



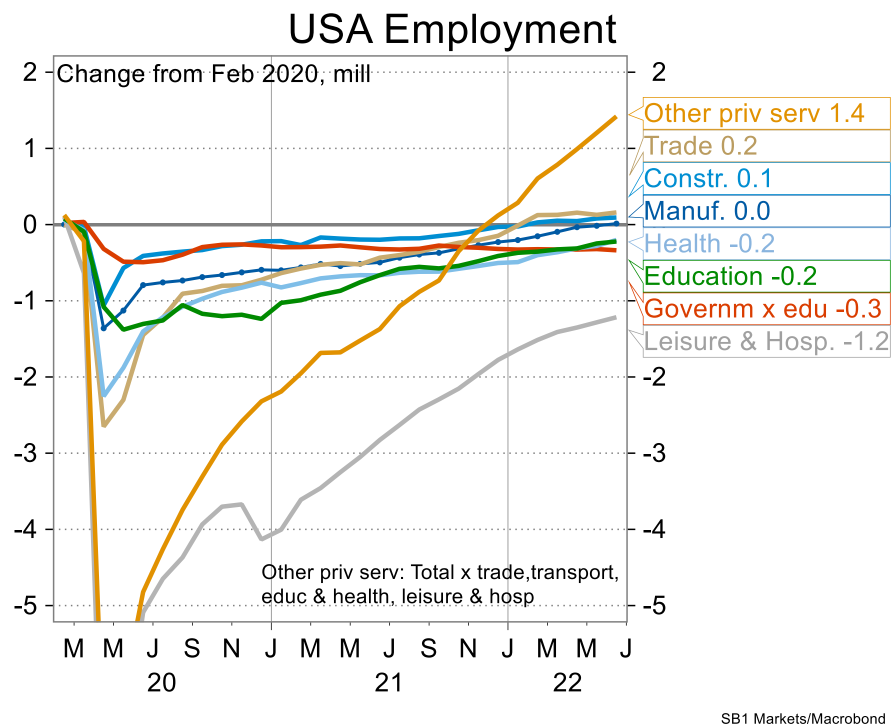



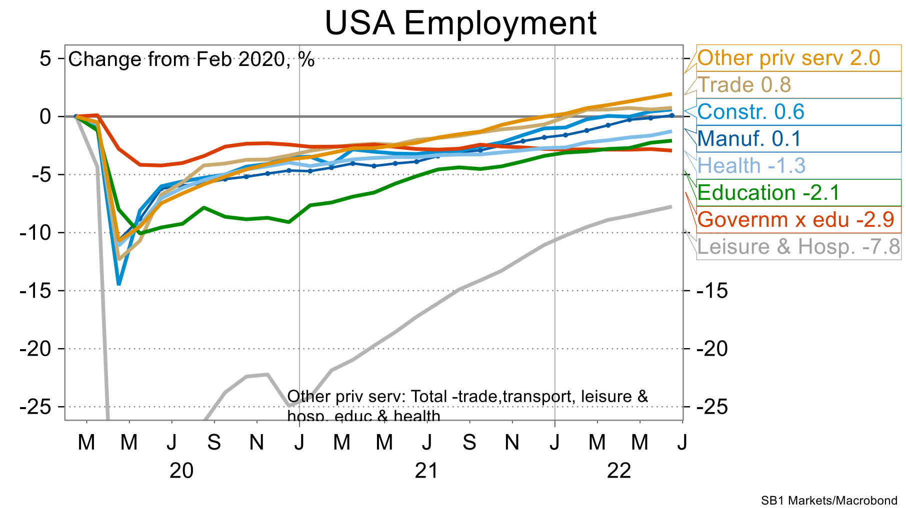

- **Last month:**
  - **Leisure & hospitality** (restaurants ¾ of the total, hotels, parks, gambling, arts++) added 67' jobs. Growth is now slowing, even if the no. of employed is still 8% below the pre-Covid level. A permanent change in demand vs. this sector??
  - **Trade added 32**' jobs but growth in slowing, alongside flattening sales
  - A broad increase in payrolls in other **private services**
  - **Manufacturing** added 18', a 'normal' growth figure
  - **Construction** sector employment up by 26, more than normal, even if new home sales & starts are slowing
  - **Education** (private & public) up by 26', more than normal, from a level that is well below normal
  - Employment in **government** (ex education) down by 16'
  - No major revisions

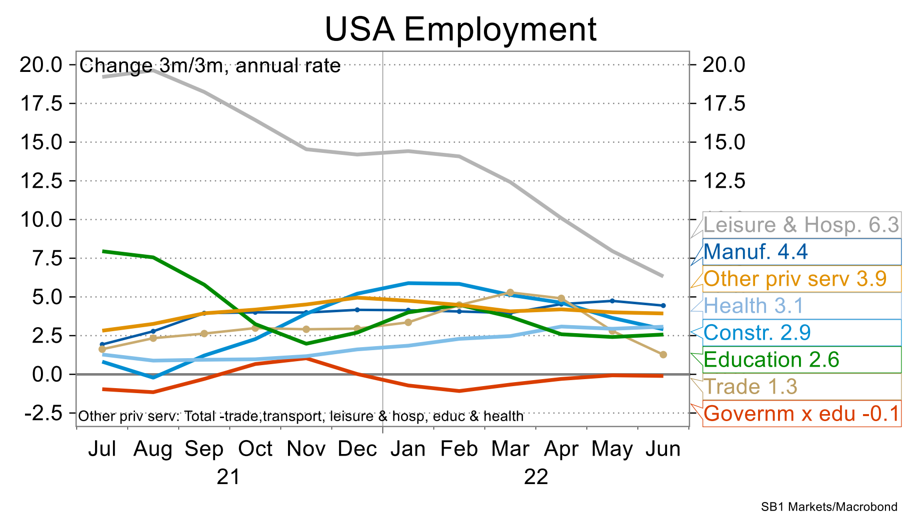


# Vs. Feb-20: Several private services are up, but leisure/hospitality still down 8%

Manufacturing and construction are back to their pre-pandemic levels

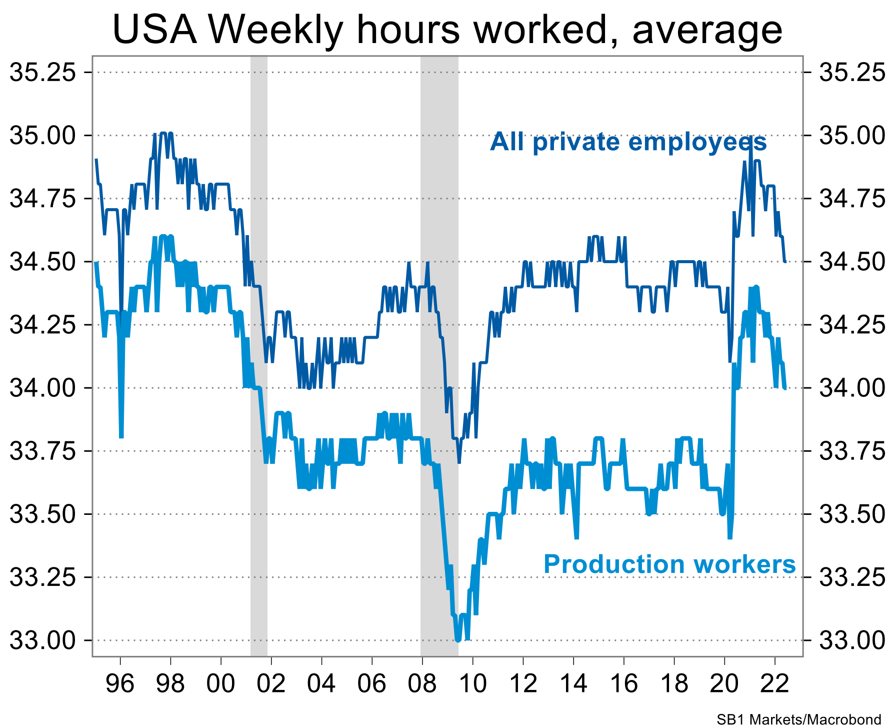


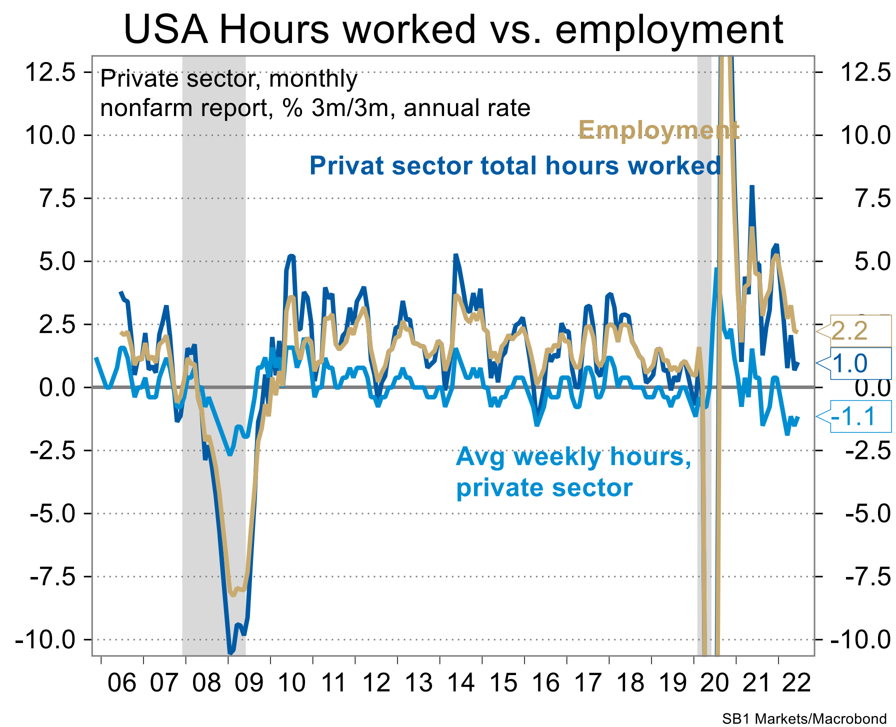



# Average weekly hours down but not yet in a recession-like style

A bit strange, given lack of labour. Are part-time workers returning to work?



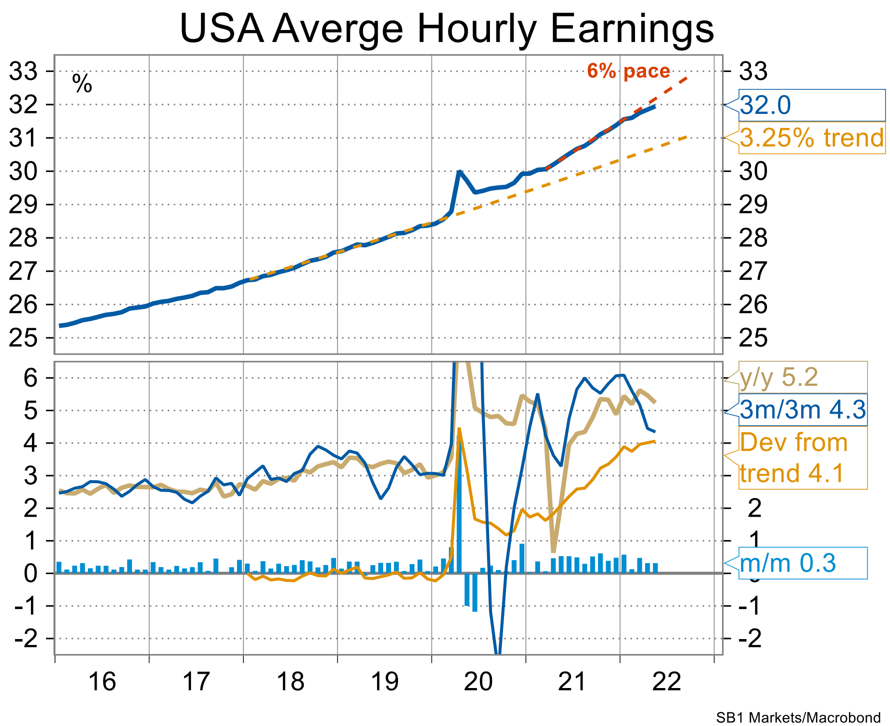




- Underlying growth in total hours worked in the private sector has fallen to 1% (3m/3m, now Q2/Q1)

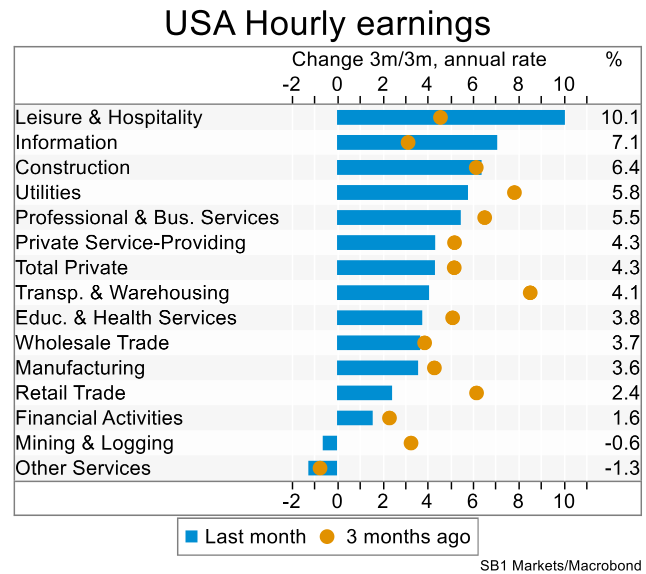
SpareBank 1 MARKETS

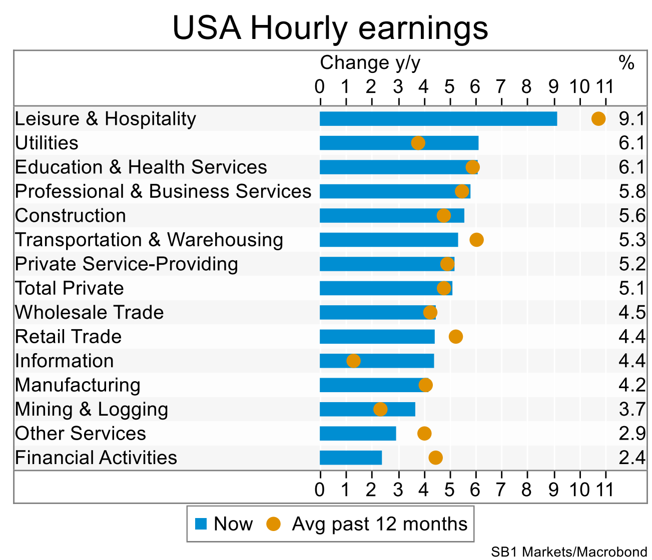
# The REALLY good news: Wage growth ~~may be~~ is slowing somewhat

## The decline in wage inflation is broad based, and the 3m/3m rate has fallen to 4.3% from 6% in January



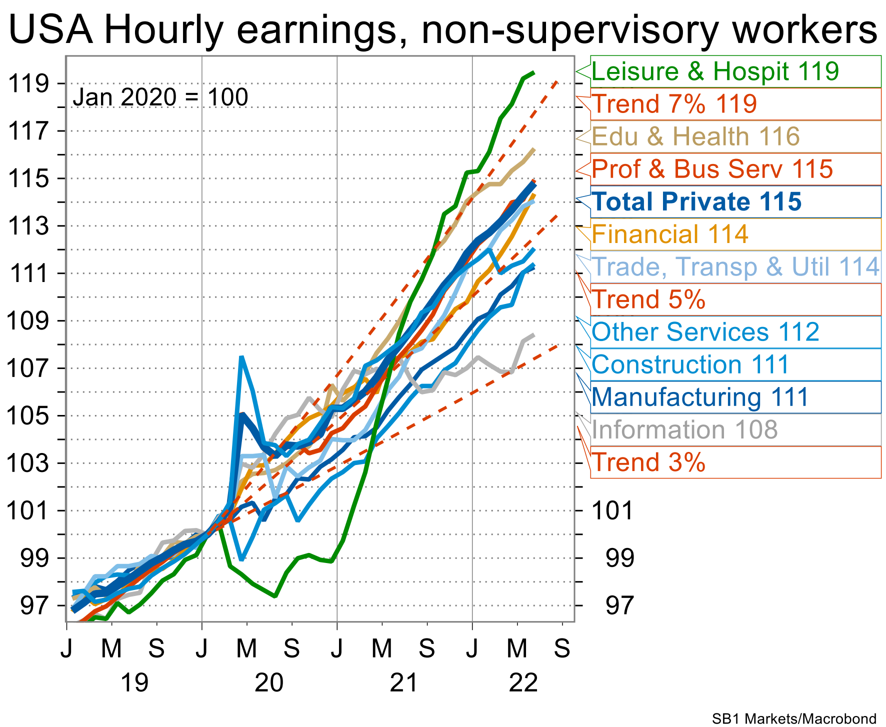

- The **average wage** rose by 0.3% in June, as expected. **The annual rate** slowed by 0.1 pp to 5.2%, expected 5.1% (from an upward revised 5.3% level in May)
  - » Underlying (3m/3m) growth has slowed to 4.3% from 6% in January
  - » Before the pandemic, wage inflation was at approx. 3¼%
- In manufacturing wages are up by just 3.6%, measured 3m/3m – but still above 10% in leisure and hospitality. Finance at the bottom, just 2.4% 3m/3m (and 1.6% y/y!)
- These monthly wage data are not adjusted for the change in employment mix between sectors or within sectors



# Wages are climbing at 4% – 7% growth pace, the average at 5.5% since Jan-20

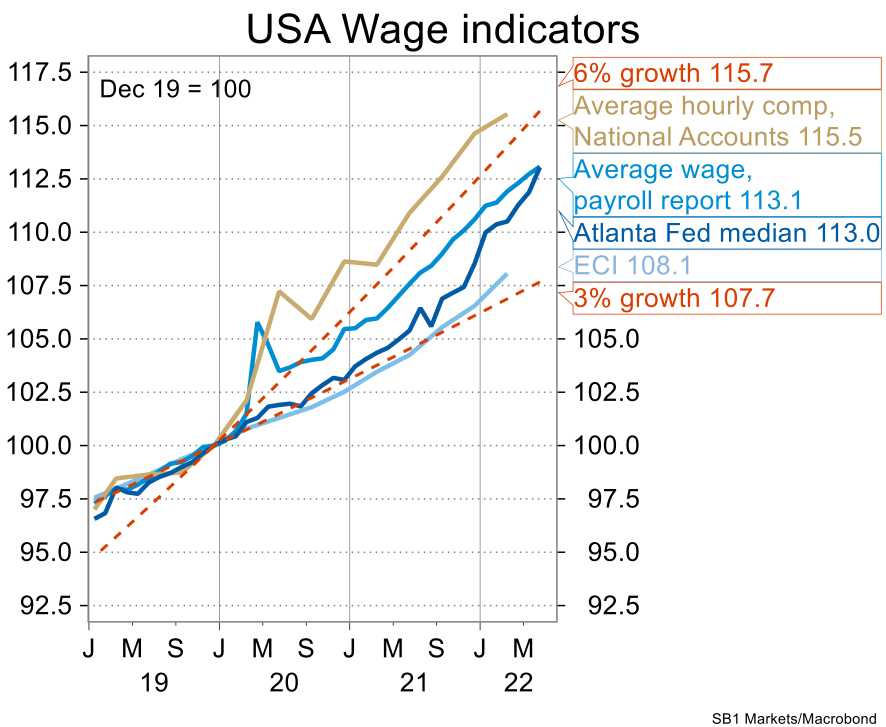
… And well above the pre-pandemic growth paths in all sectors (barring information)

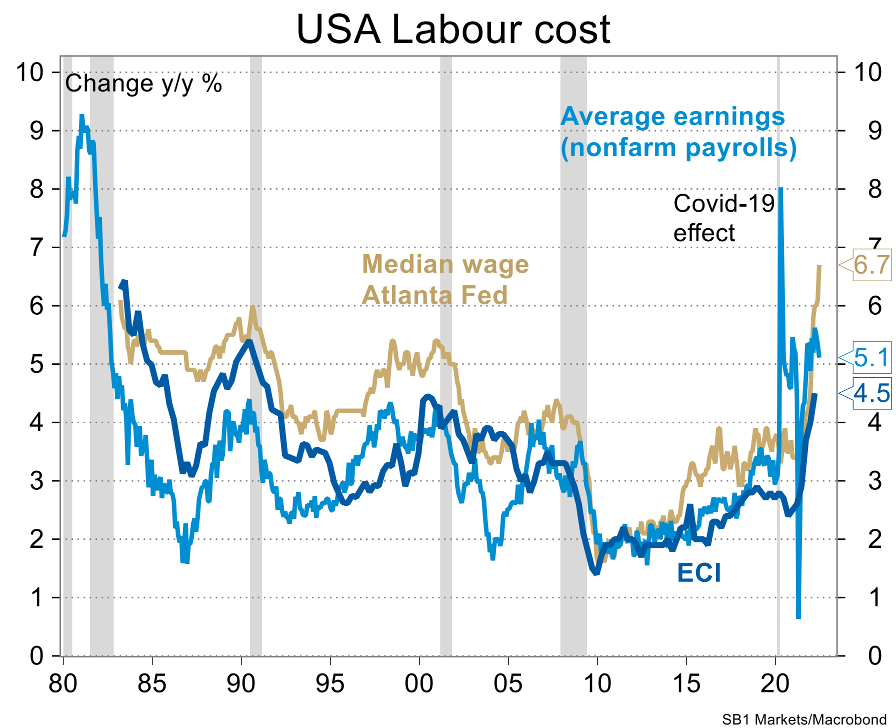



Memo: On the chart above, wages for non-supervisory workers are shown. When all employees are included, growth is slightly lower in most sectors

# No clear signal of any slowdown in wage inflation (barring in the payrolls report)

… and all are reporting much higher wage inflation than before the pandemic

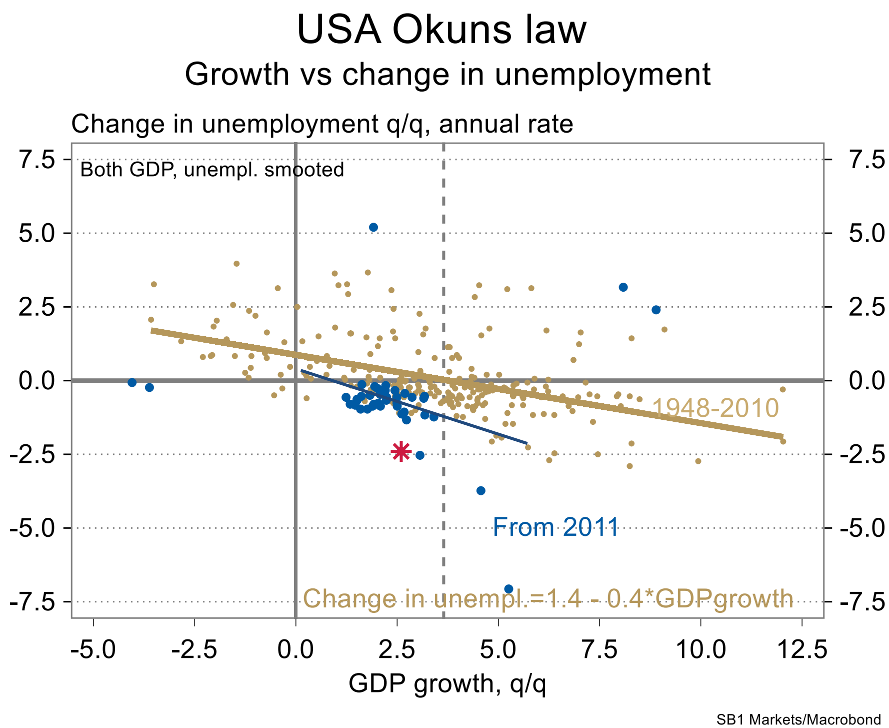


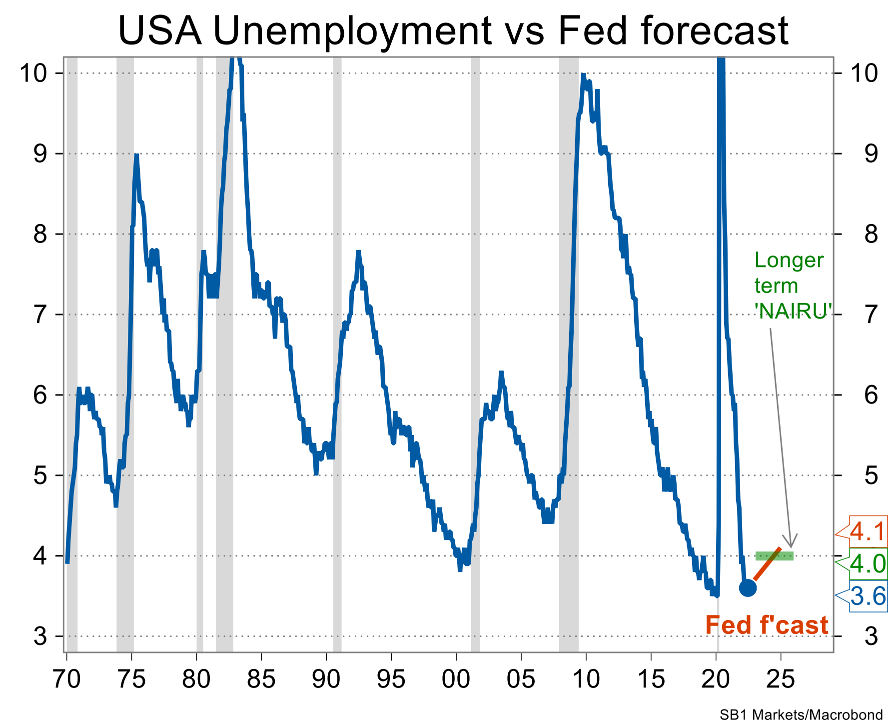




- **All wage indicators** are reporting faster wage growth, and all reporting wage growth well above the average recent years
- Growth in wage/earnings/compensation indicators are up 1.5 – 3.5 pp vs the their respective 10 y averages
- Over the past 10 years, inflation has been close to 2%, and well above 2% if calculated over a shorter period
- It will be a 'challenge' to keep inflation at 2% if wage inflation remains at 5% - 6 %. Productivity growth has not accelerated. Profit margins may take a beating – and they no doubt will – but not sufficient to bring inflation down to acceptable levels on their own. Wage inflation will probably not slow by much before demand for labour weakens – and unemployment increases

# Unemployment has stopped falling because growth has slowed

## In the good ol' days, some 2.5% – 3% growth was sufficient to stabilise unemployment



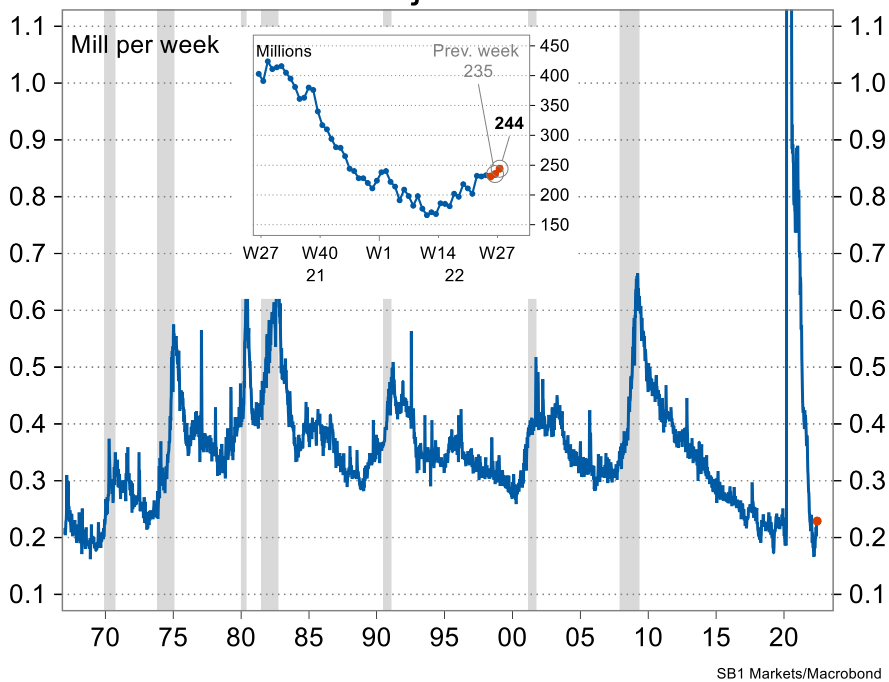




- Now, growth will probably have to slow more in order to prevent unemployment for falling further
  - » But we have not seen normal cycles recent years, from 2010 to 2019 a just a continuous decline in the unemployment rate
- **GDP** fell in Q1, and growth was at best modest in Q2 (some forecasts are for a further decline) – and unemployment may have bottomed
- **Fed's forecast**: The softest of all landings, almost not a landing at all (unemployment will stay below a 4% NAIRU estimate until mid 2024, for 2 more years). If this forecast becomes reality, it will be for the first time ever the unemployment stay close to its cycle through for so long

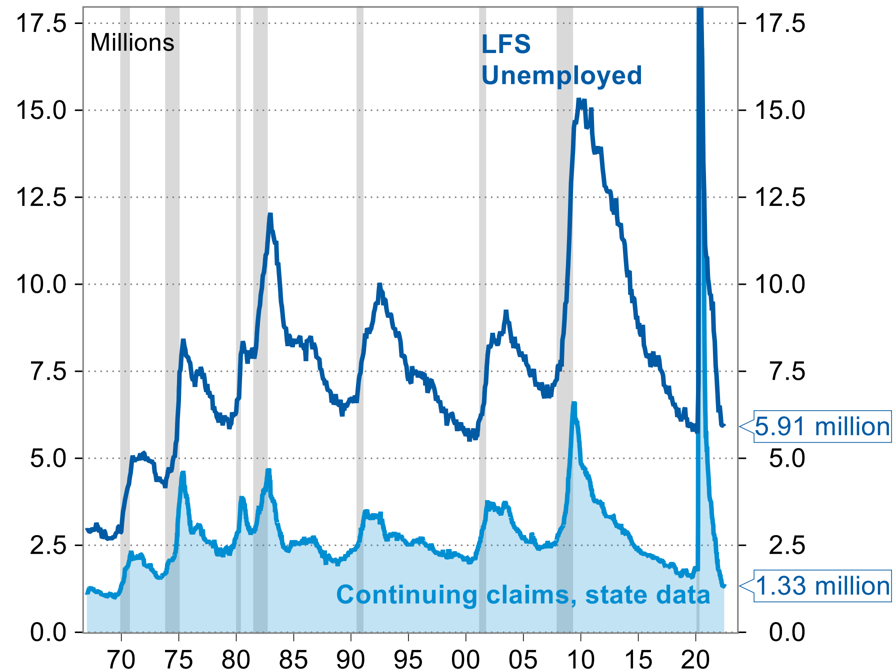
# New jobless claims are trending upwards but very slowly. Still…

## The increase from the bottom is sending a warning sign (check next page)

USA New jobless claims



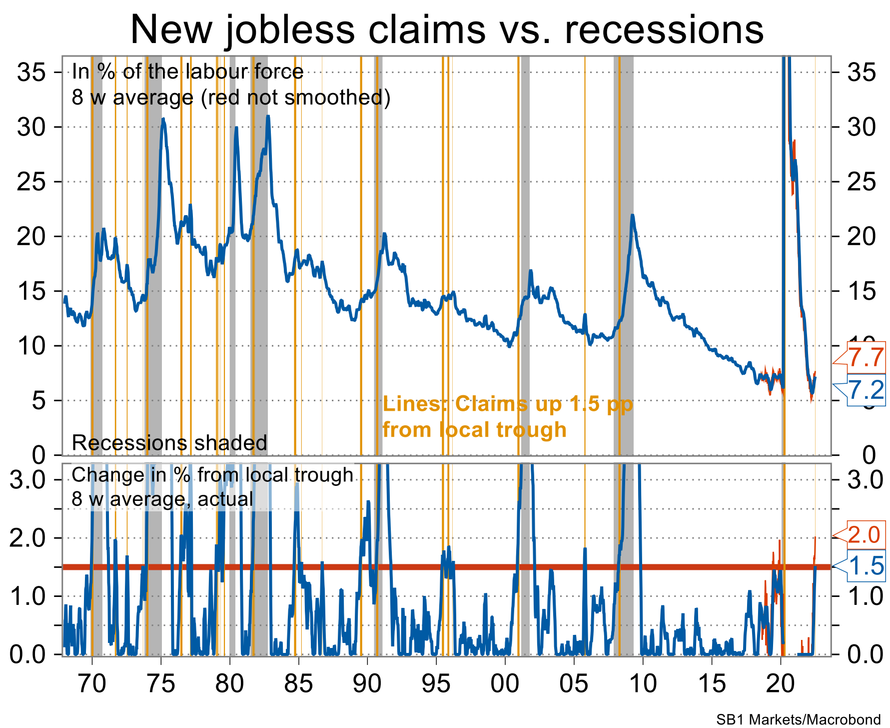

USA Jobless claims

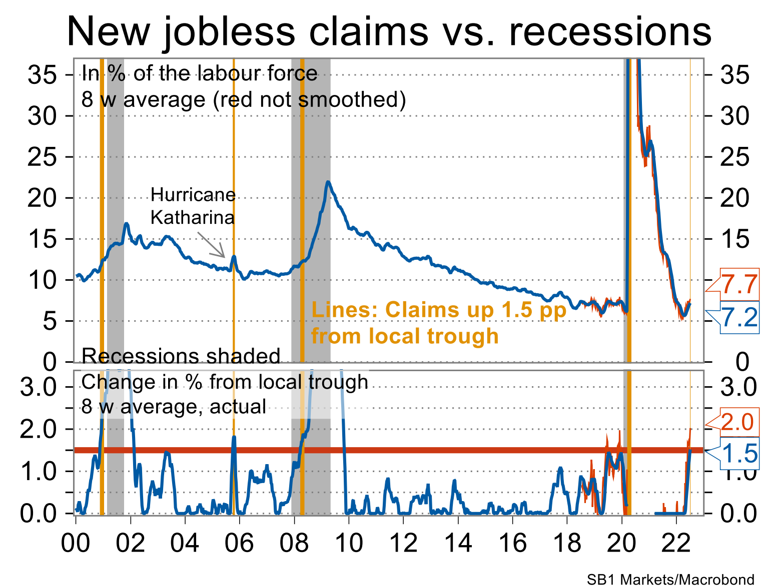



- **New jobless claims** fell by 9' to 244' in week 27. Since the bottom in week 11 in mid-March, the inflow has increased by 78', from 166' – which was the lowest since 1969. Retooling in the auto industry, which may hard to adjust for by the standard seasonal adjustment methods, may explain the lift the previous week
- **Ordinary continuing claims** fell 41' to 1.33 mill in week 26, a very low level – but have probably also bottomed

# A yellow warning line was drawn last week, the new claims rate up 1.5pp

## The lift in the 8-week average has reached an important treshold

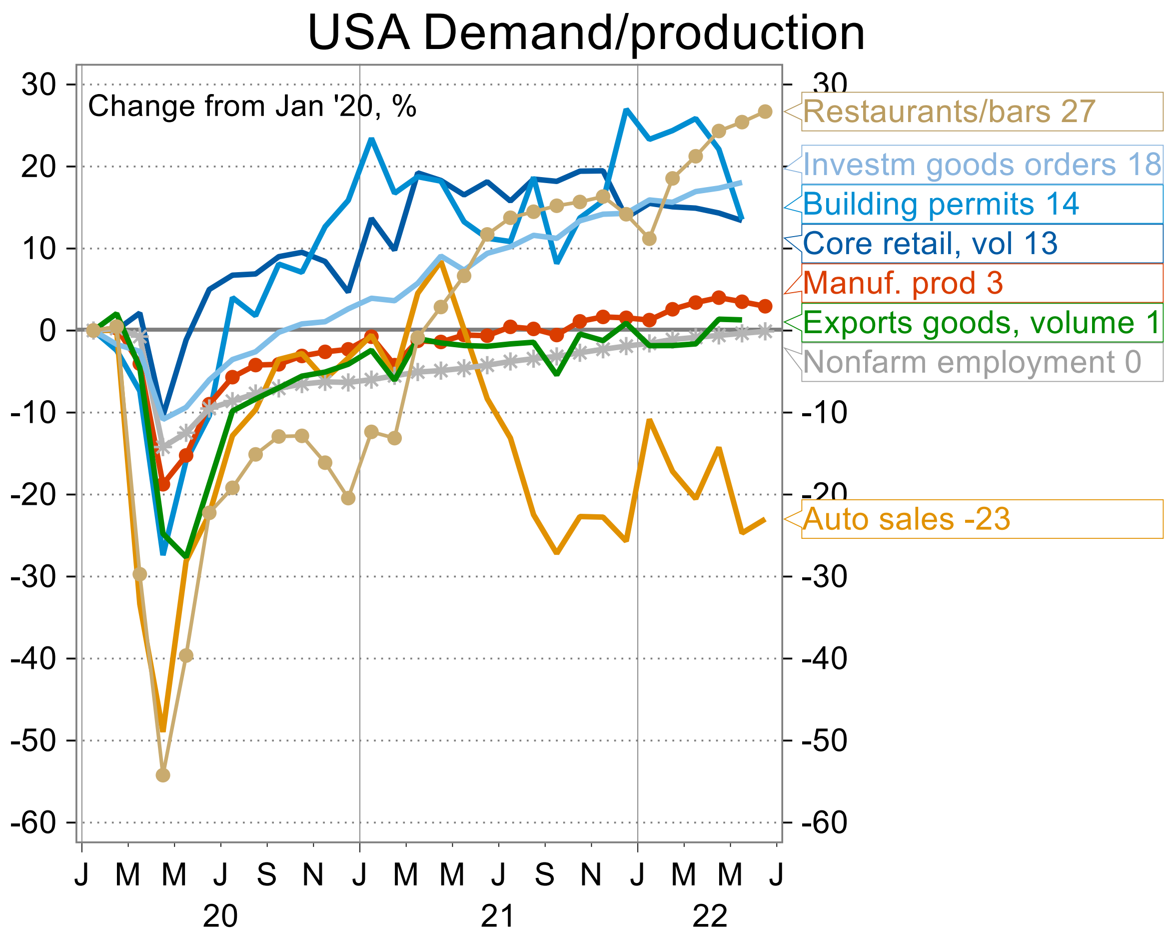



- The yellow lines: New jobless claims (8-week average) up 1.5 pp vs. the labour force
- Now, the average is up 1.5 pp, from 1.4 pp the previous week. Thus, a yellow line was drawn at the charts above, for the first time since 2005 (Hurricane Katharina), without a recession around the corner (line in 2008, 2020), and before that in 1996
- Our recession signal model based on new jobless claims has sent several false signals, and the signals often comes too late. Even so, the inflow of new unemployed persons is tightly correlated to the economic cycle – and the cycle is now weakening

# US: Waiting for demand destruction?

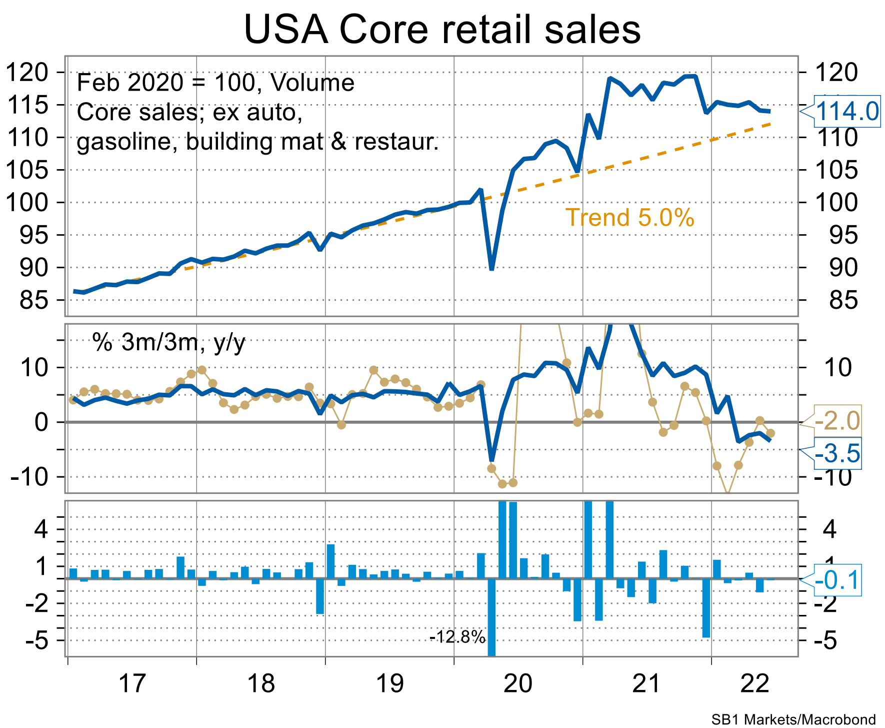
Housing is weakening, and demand for goods ex autos are waning?

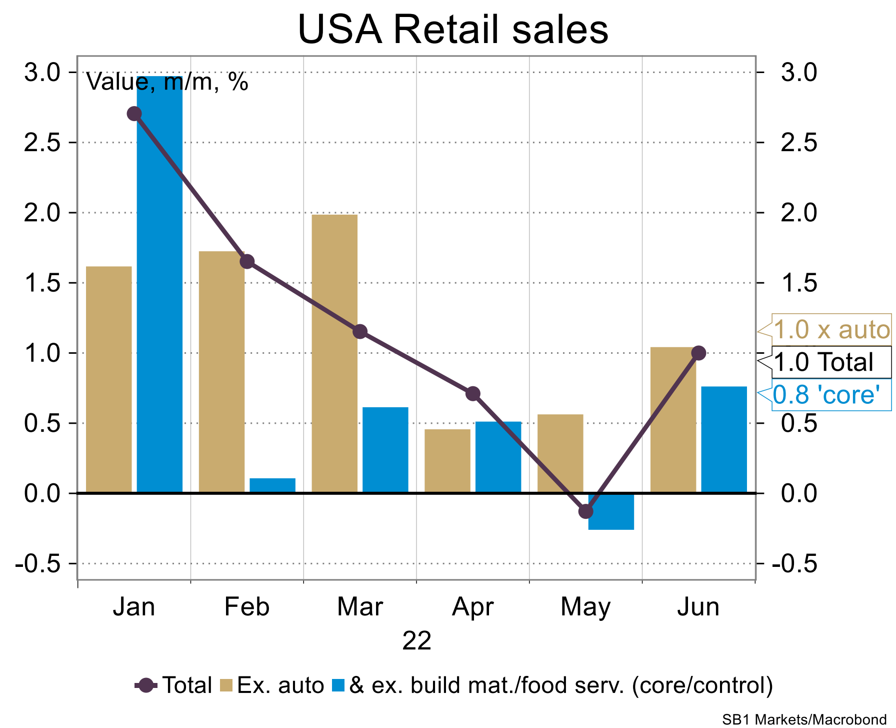



SB1 Markets/Macrobond

# Retail sales sharply up in June, at least in nominal terms, after the May setback

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

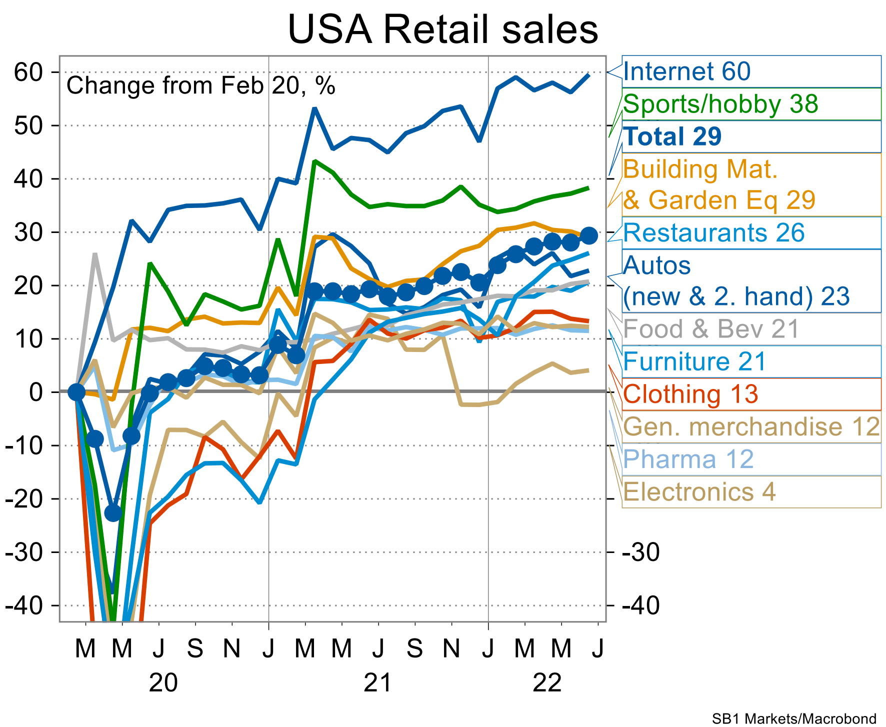


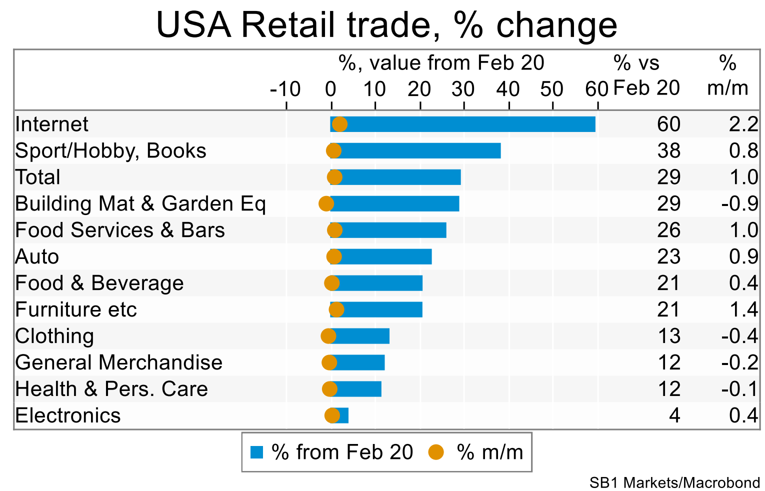

- **Total nominal sales** gained 1.0% in June (expected +0.9%), and May was revised up by 0.2 pp to -0.1%. Total nominal sales are up 29% vs. the Feb 2020 level
- **Core sales of goods** (=control group, excludes autos, gasoline, building materials & restaurants) climbed 0.8 in June in value terms, expected up 0.3%. May was revised down 0.3 pp to -0.3%
- **In volume terms**, core sales are far less flattering: We assume prices increases at 0.9% in both May and June. Thus, in volume terms, sales fell by more than 1% in May and by 0.1% in June – and 'real' sales are trending down and are approaching the pre-pandemic trend! Sales are 5% below the November level

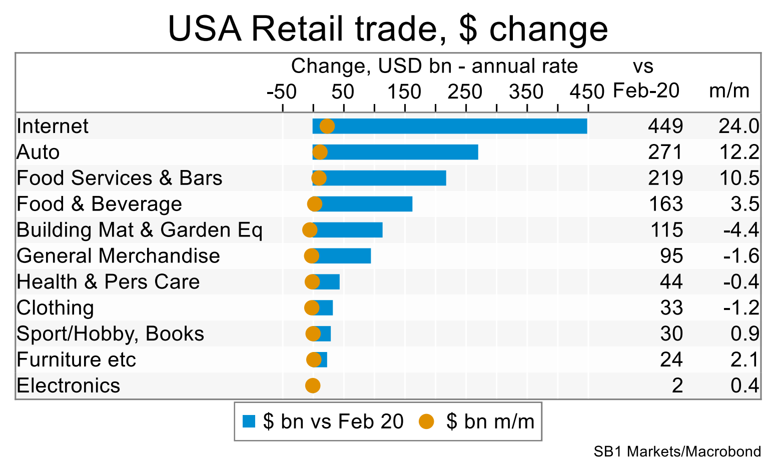
SpareBank 1 MARKETS

# Mixed between sectors in June



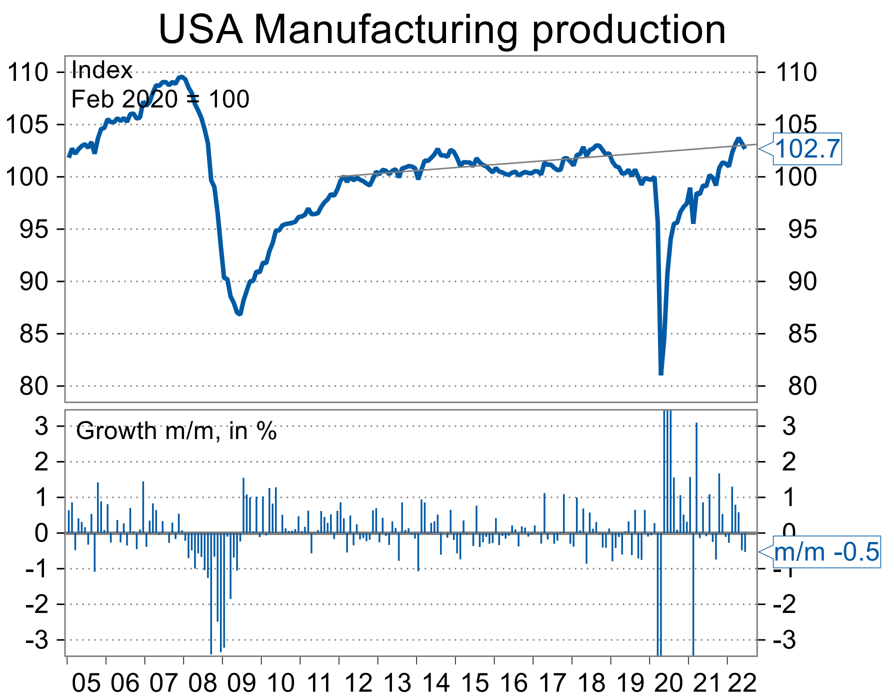

- 4 out of 11 main sectors reported lower sales in June, 7 reported higher sales
- Restaurants are up 26% vs Feb-20!
- Total sales are up 29% in value terms
- Internet sales are up 60%
- Electronics are up just 4% - in value terms



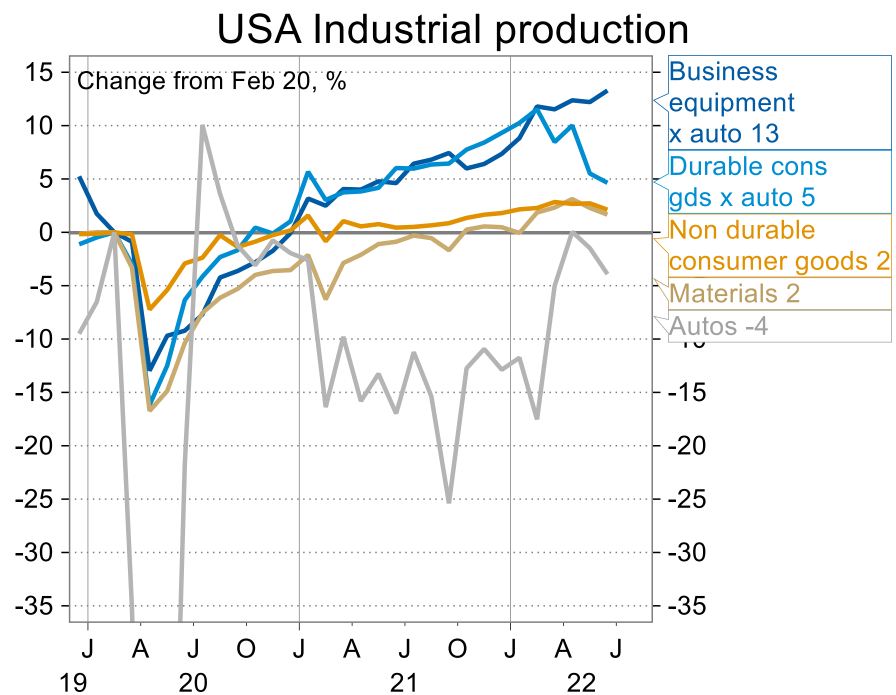



# Manufacturing production down 0.5% in June, as in May (after a -0.4 pp revision)

Durable consumer goods x autos has been the major drag recent months, but just business eq.m. up



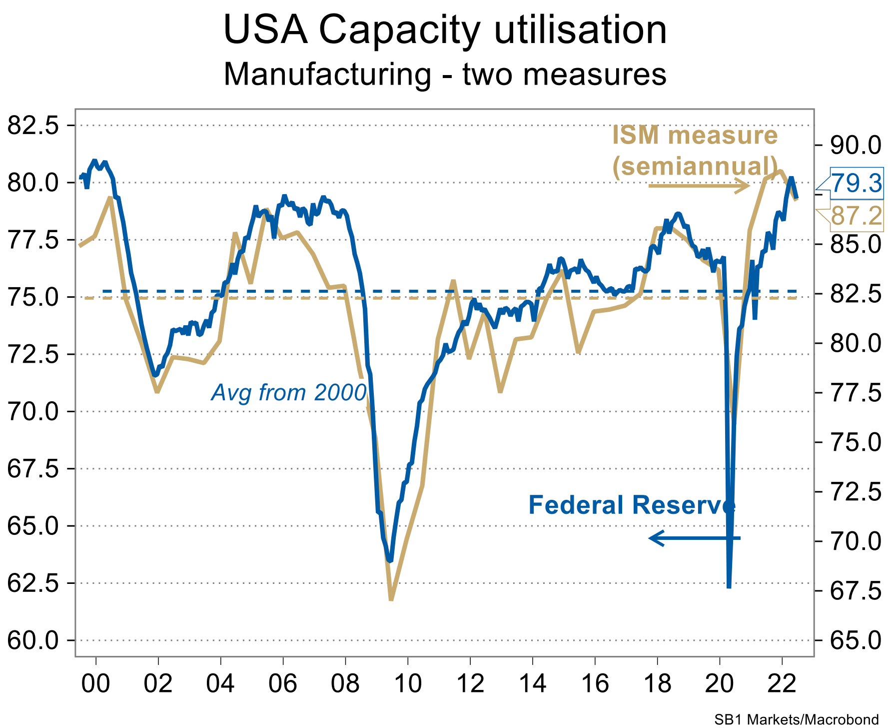

SB1 Markets/Macrobond




SB1 Markets/Macrobond

- **Manufacturing production** was expected down 0.1% in June, following the 0.1% decline in May. The outcome was 0.8% weaker, down 0.5% both months. The decline was rather broad, just production of business equipment increased in May/June. The downturn in May/June is limited vs. the increase over the previous months/quarters
  - » Auto production was up to a 'normal level in April, but is now down 4% vs the Feb-20 level
  - » Production of consumer durable goods (x autos) have fallen 7% since February, but is still 5% above the level before the pandemic
- **Total industrial production**, including utilities, mines/oil production fell 0.2% in June, from unch in May (revised 0.2 pp down)
- **Surveys** have weakened substantially in May and June, signalling close to a stagnating manufacturing sector. However, in July, NY Fed's Empire State survey rose again!
- **Capacity utilization** has been revised up at, and even after a small decline recent months, it is at 79.3%, one of the best prints past 20 years

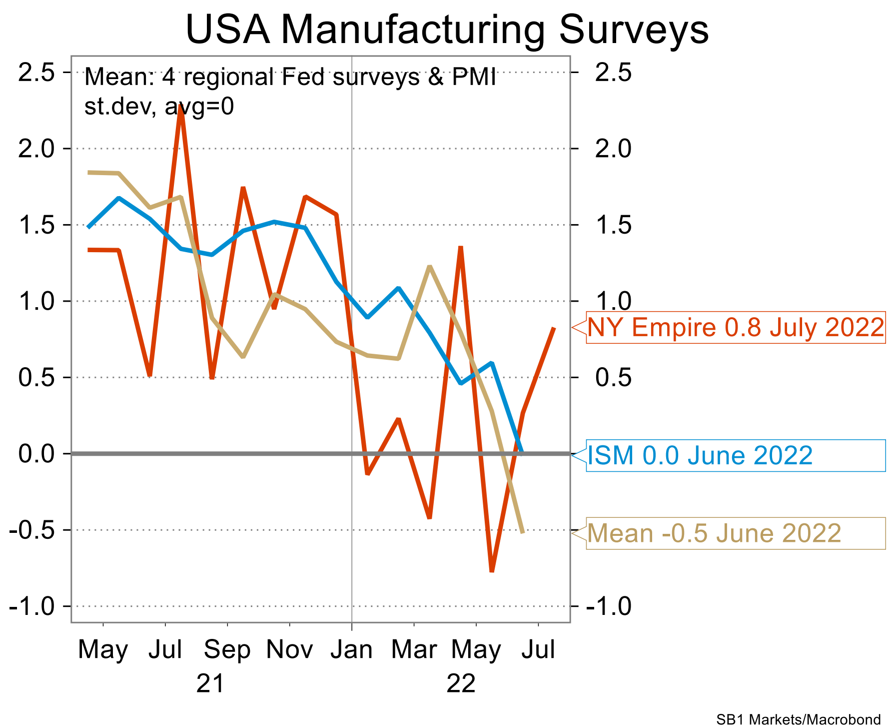
# Capacity utilisation remains very high




- **The Federal Reserve** reports a 1 pp decline in capacity utilisation in the manufacturing production past two months, down to 79.3, still one of the best prints the past 20 years
- **ISM's semi-annual** survey reported a decline in the cap. utilisation to 87.2% in H1/May
  - » These two measures have not been 100% correlated but they now agree that assessing the growth outlook
- The Fed's estimate is model based, while the ISM survey is based on companies assessment of their own capacity utilisation

# Not everything is pointing down: the NY Fed manufacturing survey up in July

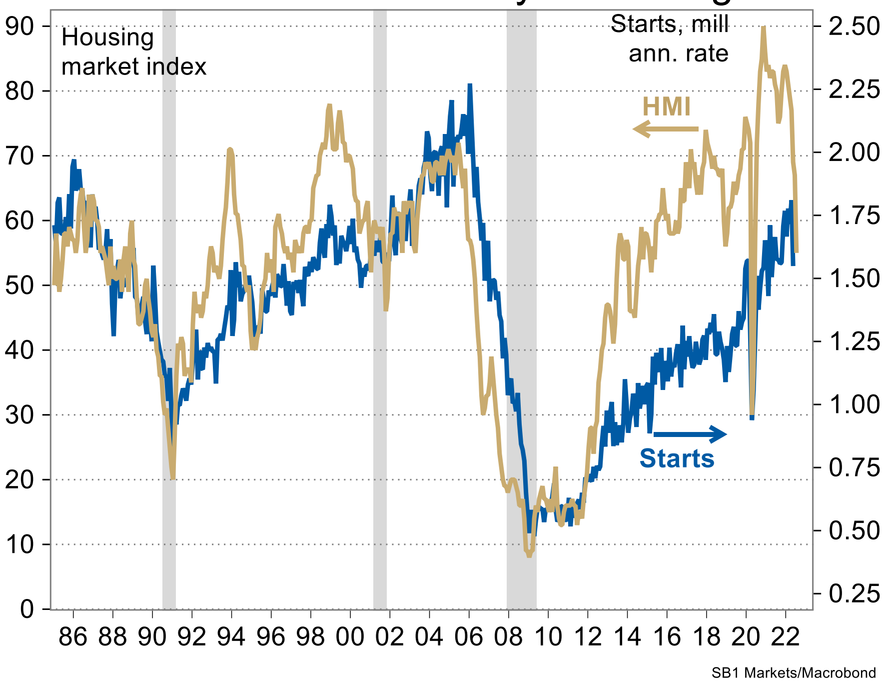
Expected down but gained 0.5 st.dev to +0.8 above avg. However, this survey is rather volatile



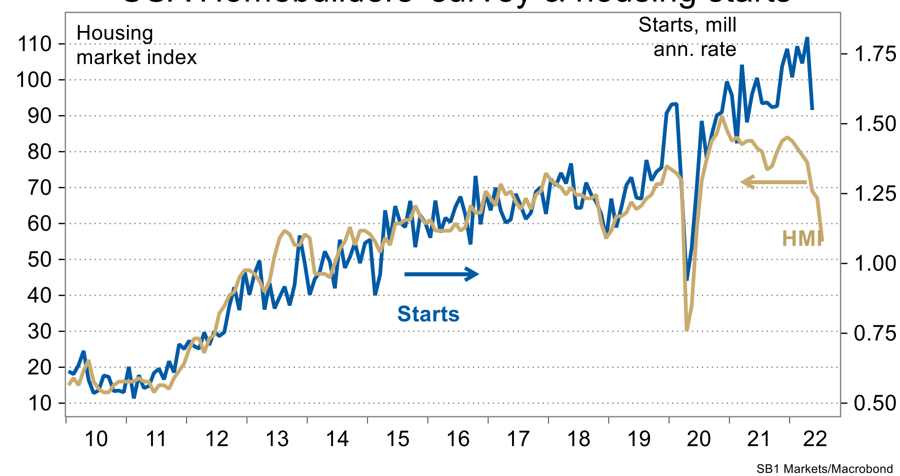
# Homebuilders' index straight down in July: a further, steep decline in starts ahead

## The HMI down 12 p to 55, the 2nd largest decline ever (after April-20). Starts down

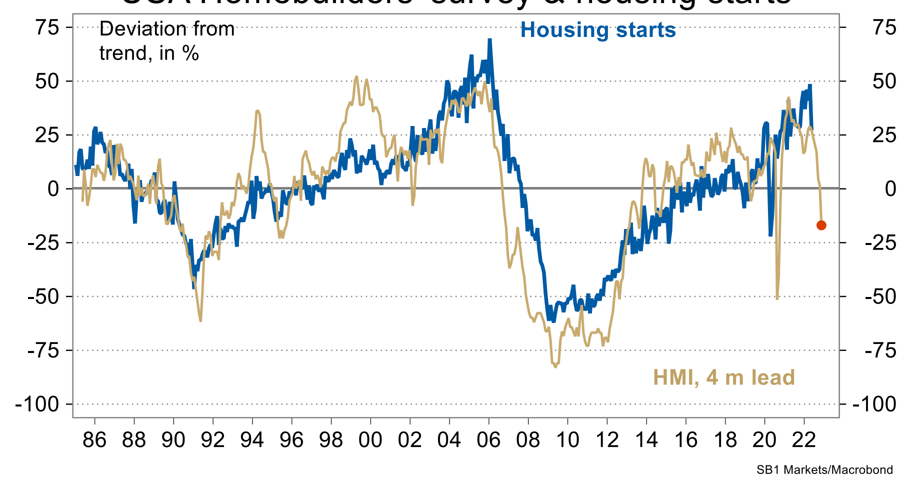
USA Homebuilders' survey & housing starts




USA Homebuilders' survey & housing starts



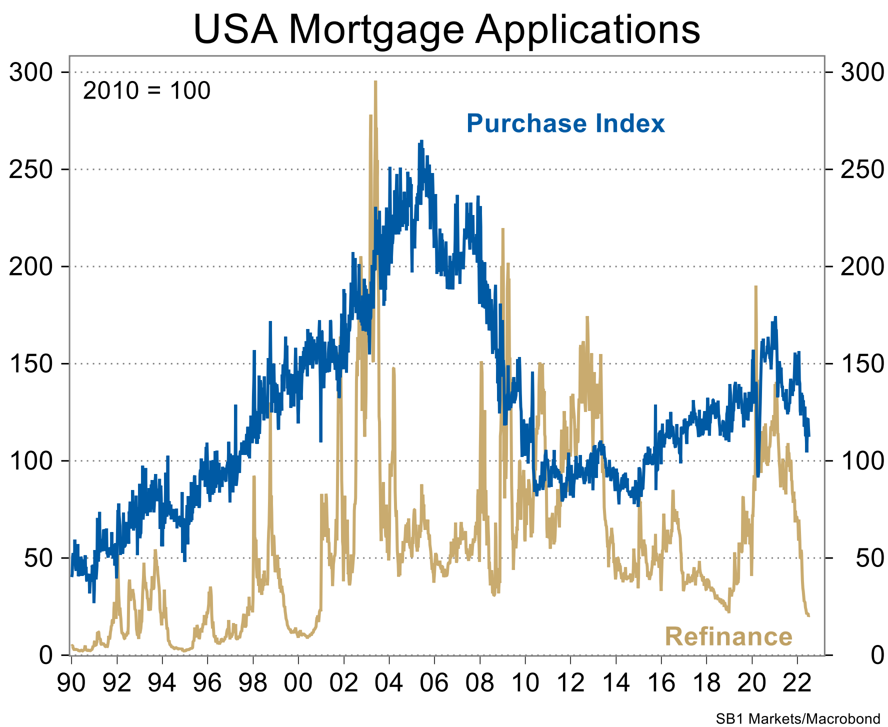

USA Homebuilders' survey & housing starts

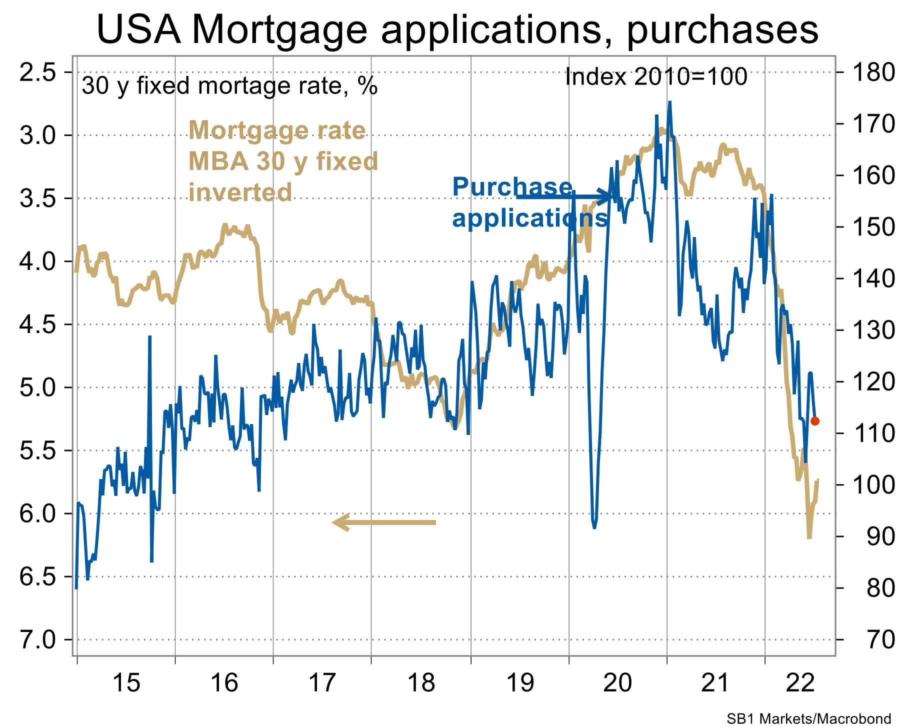



- **The Homebuilders' Housing Market Index (HM)** lost 12 p to 55 in July, expected down just 1 p! The monthly setback is unprecedented, ex. April-20 (as is the decline over the past 3, 6 or 8 months)
  - » Affordability is still the challenge, due to higher mortgage rates, and soaring new home prices (at least until now)
- The decline in the index recent months signal more than a 1/3 decline in housing starts – which already has fallen by 14% - in sum a 50% setback

# Demand for new mortgages has fallen 25 – 30%

But not further recent weeks, perhaps due to a decline in the 30 y mortgage rate

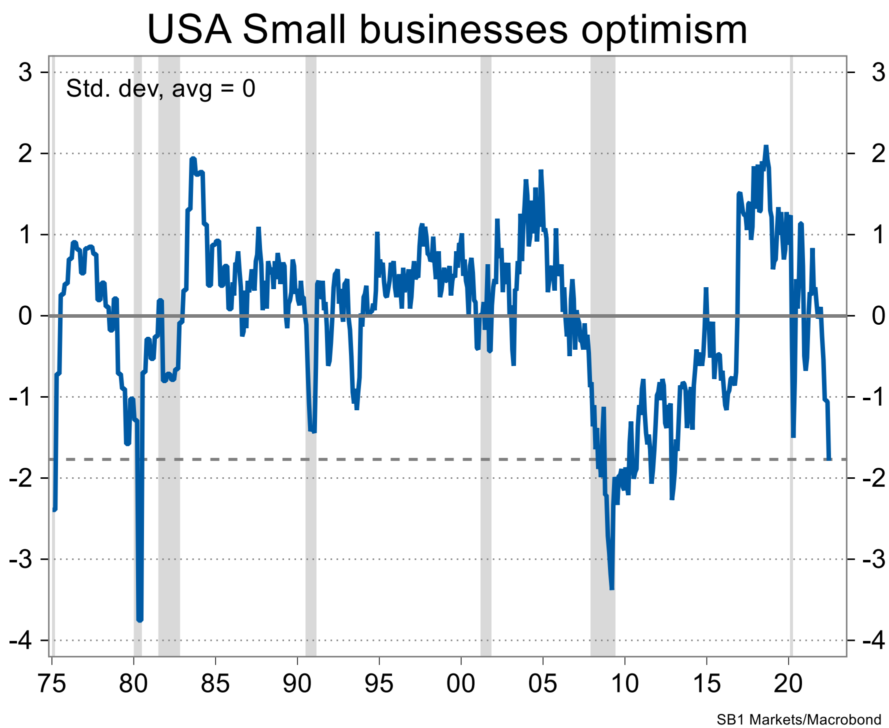


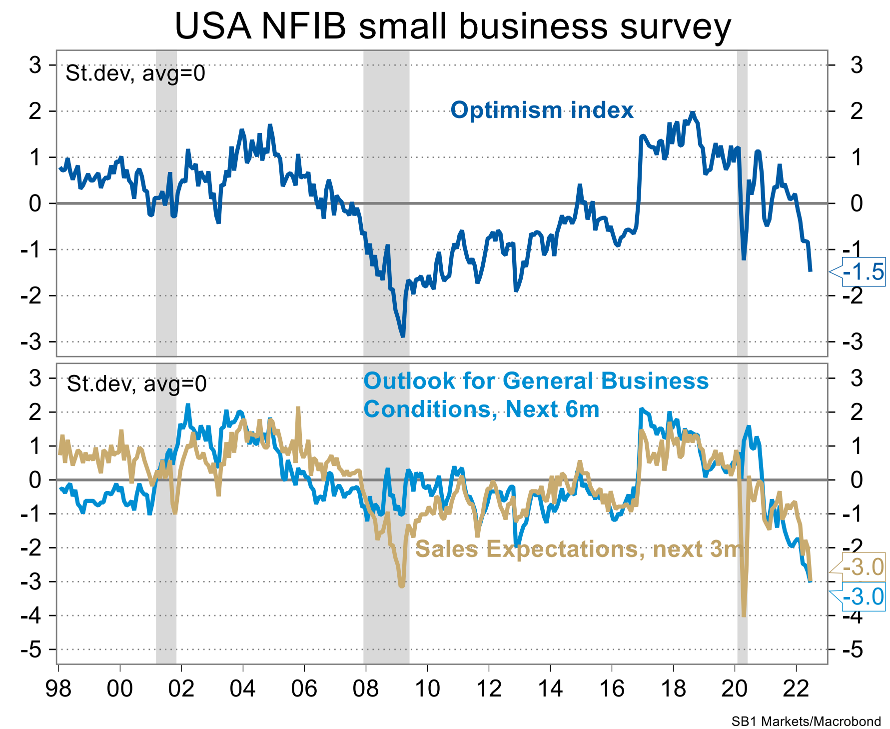




- Applications for new mortgages are down some 25% since the start of the year, and the level is 15% below the pre-pandemic level. We expect a further decline the coming weeks

# Small businesses optimism down in June, to deep into recessionary territory

## The optimism is 1.8 st.dev below par, and the outlook is even worse, at 3 below, the weakest ever!



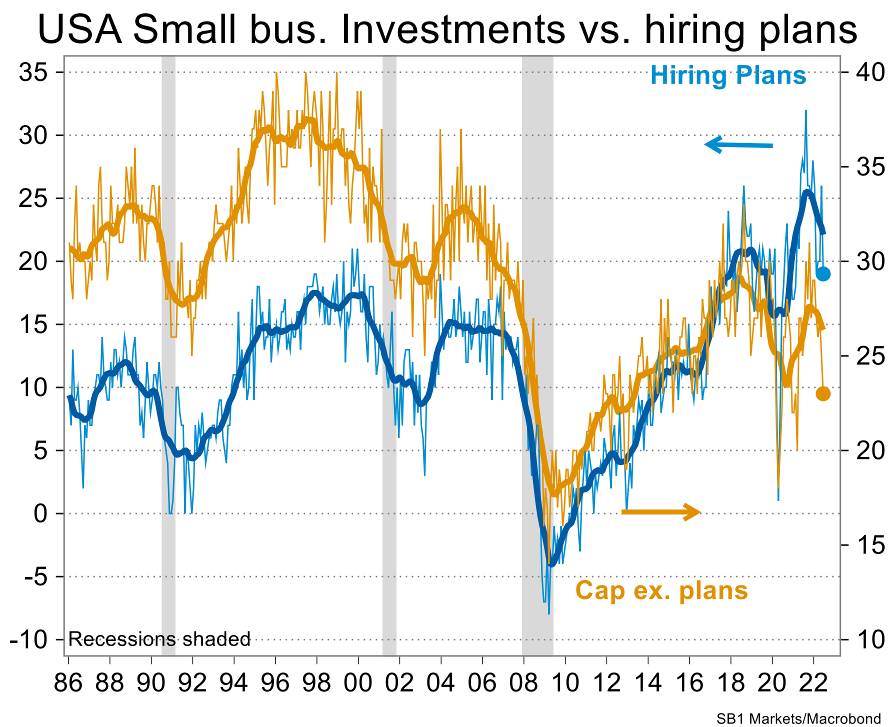



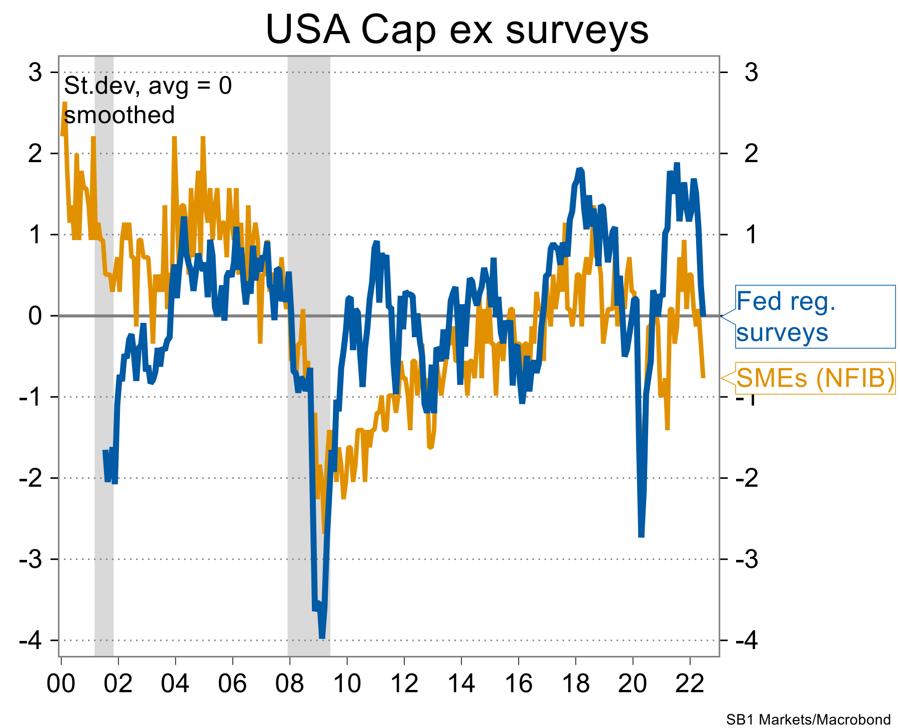

- The **NFIB optimism index** fell 3.6 p to 89.5 in June, expected down 0.6 p – or down by 0.7 st.dev to -1.8 st.dev below average, a rather unusual level, especially since actual sales still are terrific. **The outlook for the next 6 months** fell to the lowest level ever in June. Inflation, lack of qualified labour and labour costs are still the main worries for the SMEs.
- However the share of companies that report **competition or poor sales** as a worry rose slightly, and some fewer companies report they plan to **lift prices** further. Even if very few complains about sales, and the share of companies that plan to lift prices still is very high, the tide may have turned
- **Investment plans** fell sharply to well below an average level. Hiring plans fell to, but remain aggressive – and companies still report they are not able to **fill their vacancies**, and a close to a record share of SMEs report they plan to **lift compensation further**. So it ain't over yet

SpareBank 1 MARKETS

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

## Hiring plans climbed up to a very high level

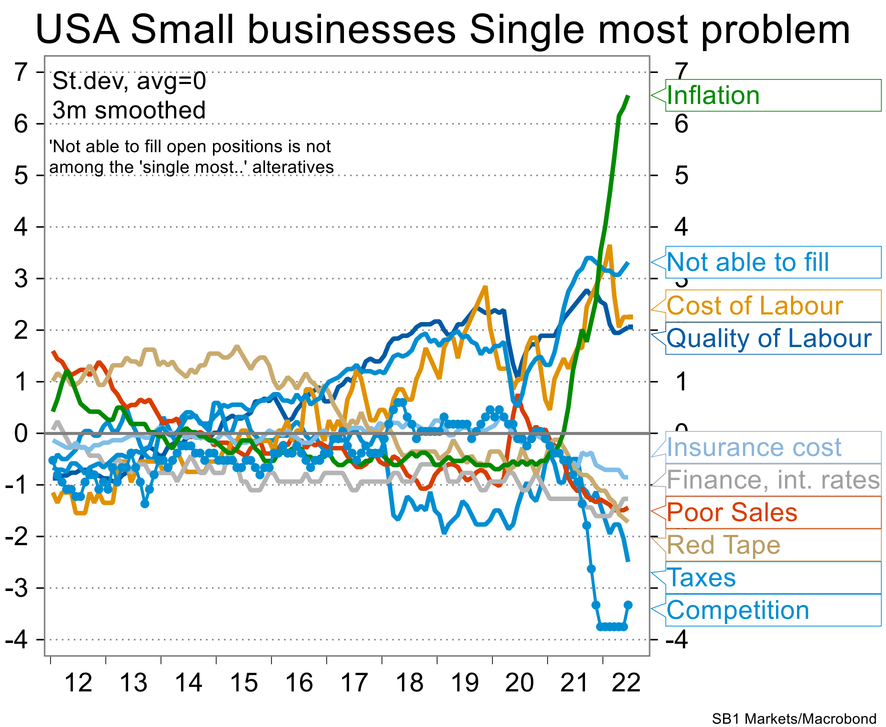


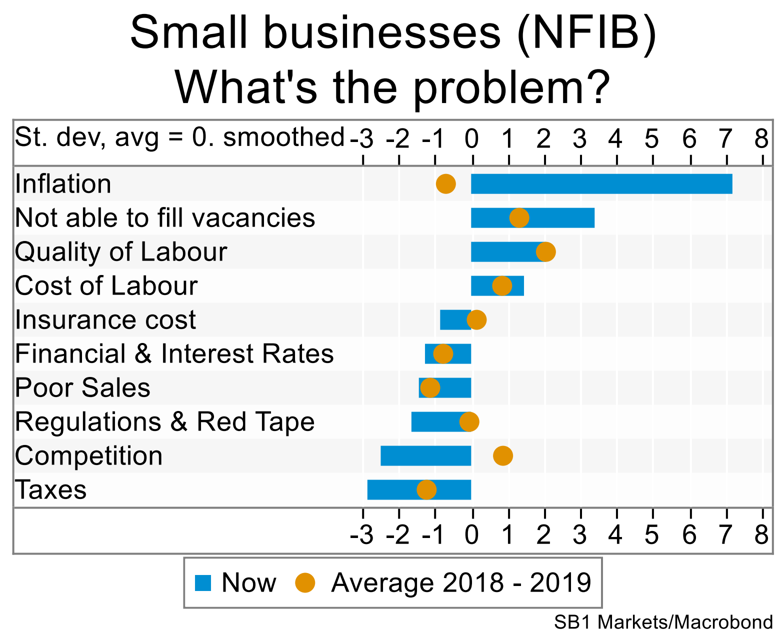




- The NFIB survey now report investment plans below average
- Other (regional Fed) investment surveys are falling rapidly but remain above average

# Slightly more companies say that poor sales & competition is their main worry

... but still extremely few



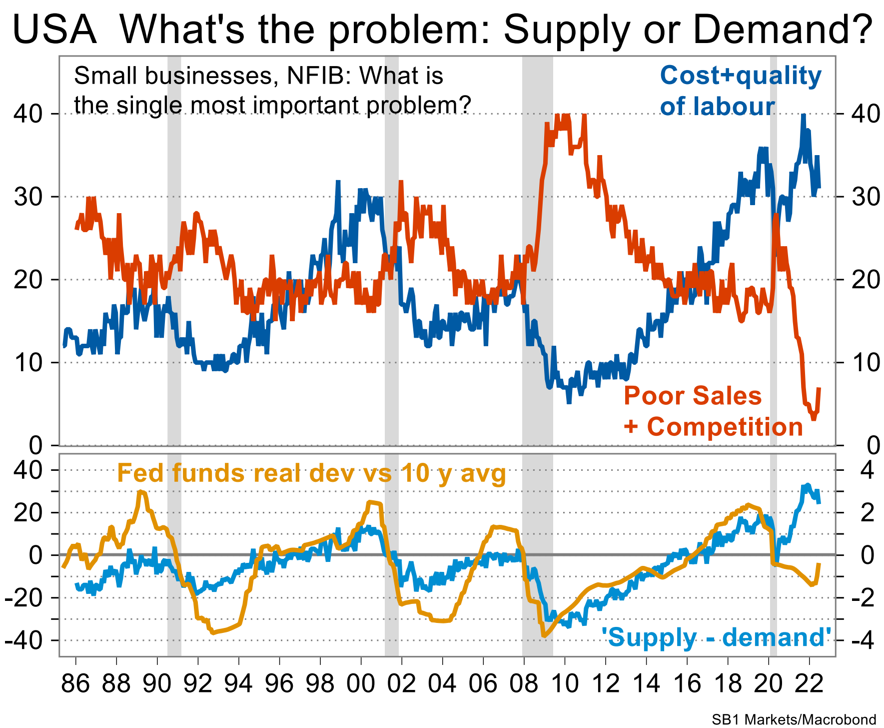



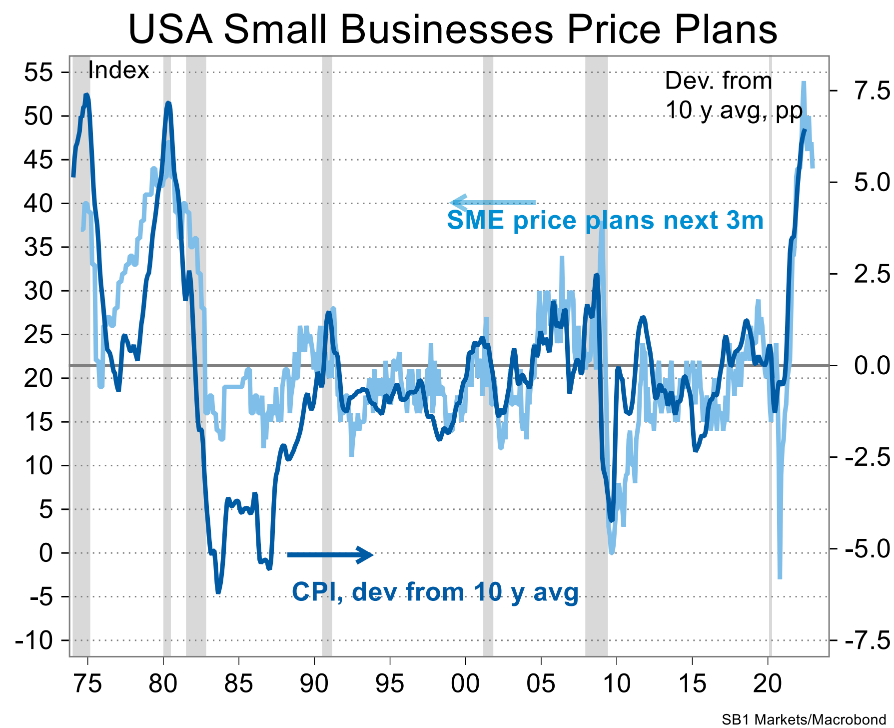

- Companies still report they are constrained from the **supply side**, not from the **demand side**
- In addition, **inflation** is quoted as the most important problem for the SMEs. However, the SMEs themselves are making the problem even larger – they report they plan to hike their selling prices 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

# Has the tide turned? More companies report demand weakness (but still very few)

Fewer companies report they plan to lift prices (but still extremely many). It's a long way back 'home'

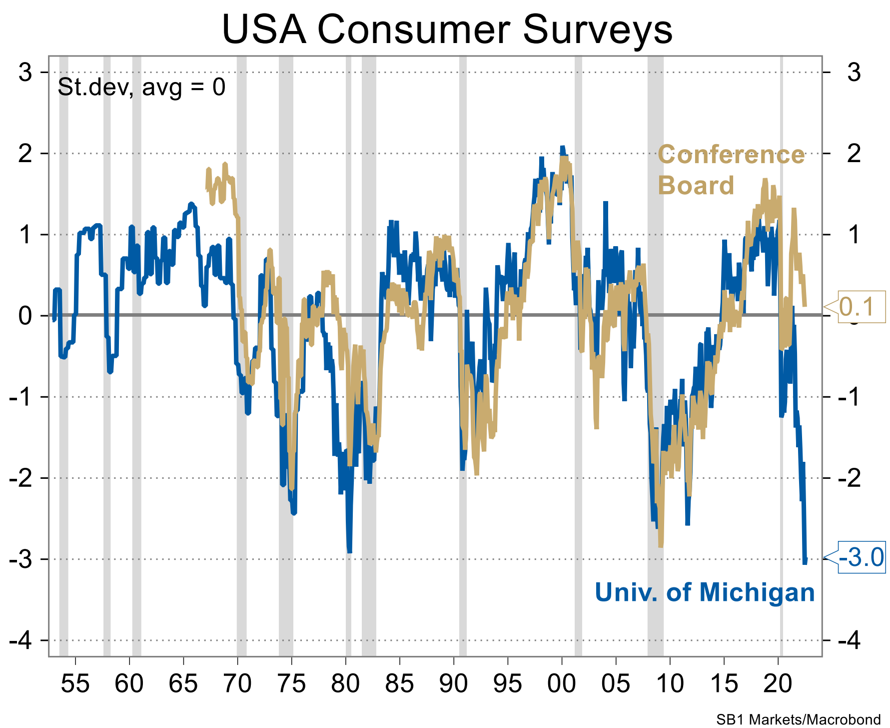



- **The 'gap' between supply and demand concerns** is still close to unprecedented, which signals that demand is still far too high to 'balance' the economy – an the result is still extraordinary aggressive plans for hiking prices
  - » The share of SMEs that plan to hike their **selling prices** fell 3 pp to 44% - which is still a very high level
- **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 – and compensation plans are marginally revised down
- **We have no doubt:** Over the coming months and quarters, the red line will climb sharply – and the blue line will come back down to Mother Earth as financial conditions tightened, with or without help from the Federal Reserve. It's normally labelled as a recession

# Univ. of Mich. sentiment stabilised in July. At an ALT

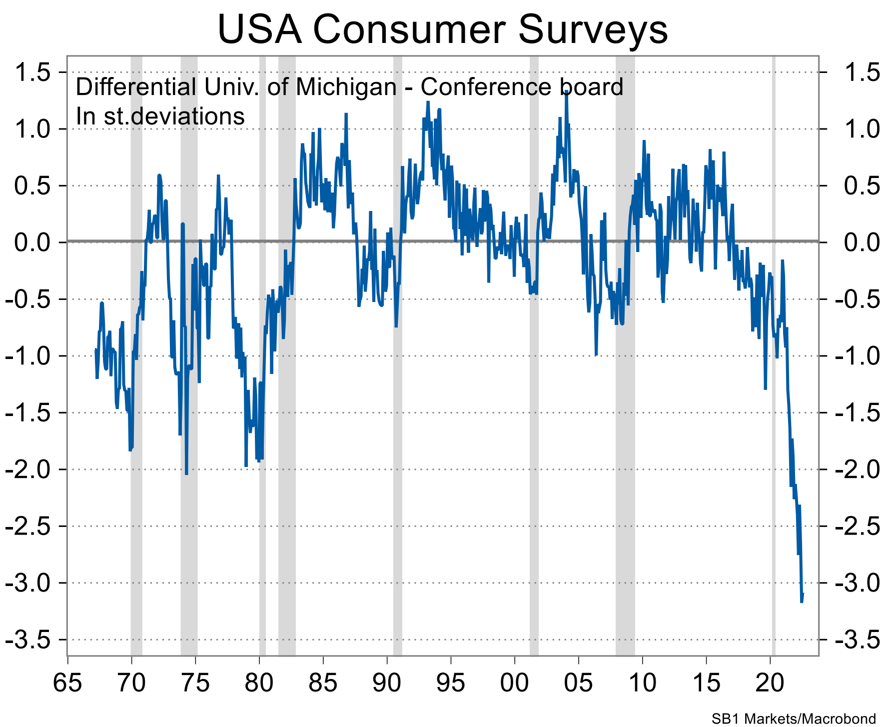
## Inflation expectations fell

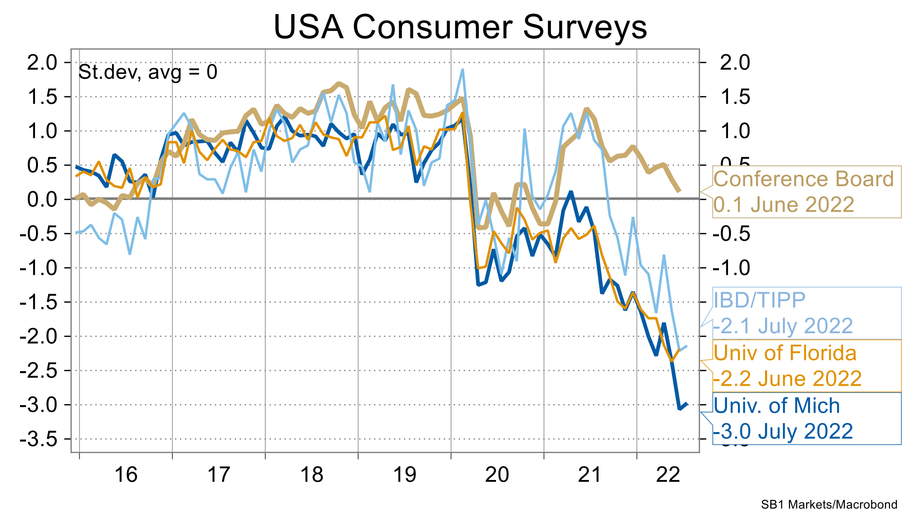



- **University of Michigan's consumer sentiment** fell to ATL at 50.0 in June, equalling -3.1 st.dev below average. In July, a marginal recovery, to 51.1 (3.0 st.dev)
  - » Households' assessment of the current situation rose marginally but remains at a level never seen before. Expectations were close to unch, but at very low level
- **2 of the other 3 consumer surveys** we are following also reported an uptick in June/July, but both are deep in negative territory, at below -2 st.dev
  - » Just the **Conference Board's** measure is still above average (at +0.1 st.dev) in June. The discrepancy between the two 'main' surveys have never been larger
- **Inflation expectations** fell slightly in July, and longer-terms forecasts are not at that high (5 years at 2.8%)
- **The risk:** The UM survey often has been an early bird in the cycle, and the survey may be 'right'
  - » In the Conference Board survey, expectations have fallen sharply, and the discrepancy to households' of

# The gap between Conf. Board & Univ. of Mich is larger than ever before

## Other surveys confirm a gloomy mood among US households

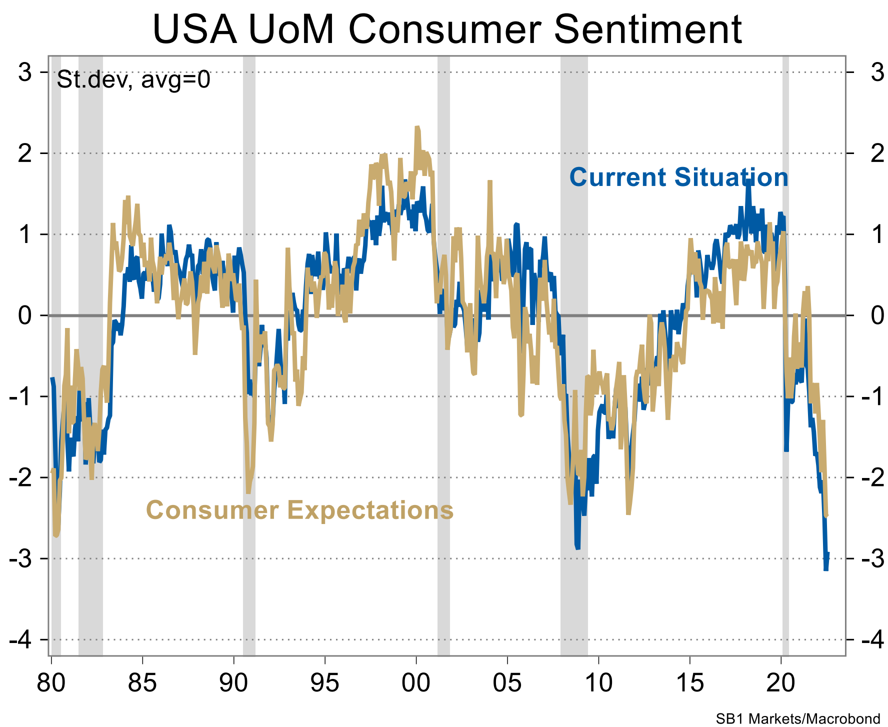



- Quite often, the UM survey has been the canary in the mine vs. recessions, it yields earlier than Conference Board's survey, and the current stance is a VERY bad sign – we have never seen anything like it!
- The IBD/TIPP the Univ. of Florida surveys both stabilised in June/July

# Univ of M: Both the current situation and the outlook is really bad

Inflation expectations fell in July – and long term expectations are not that high



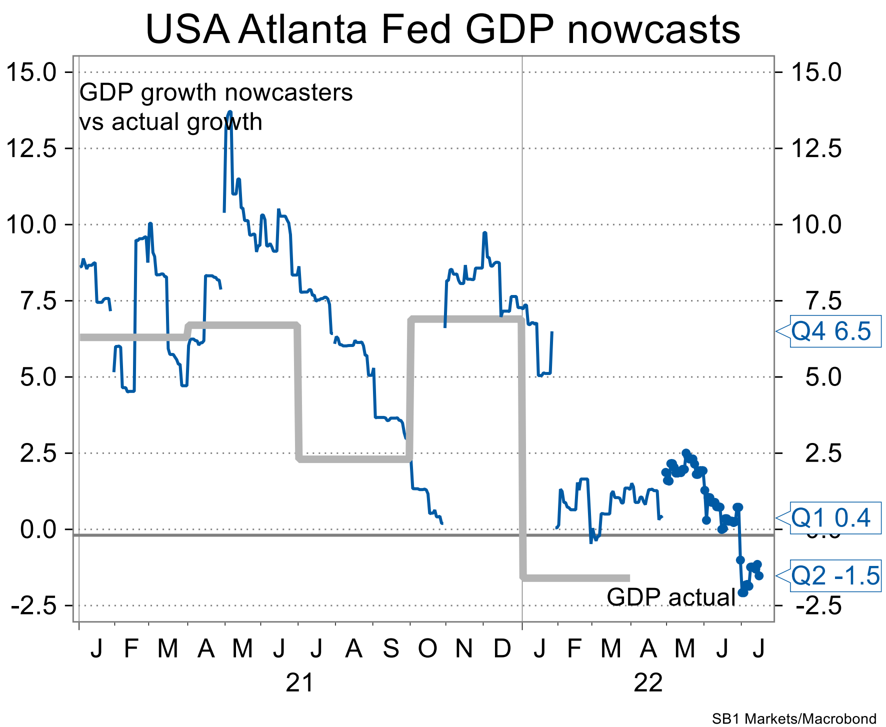


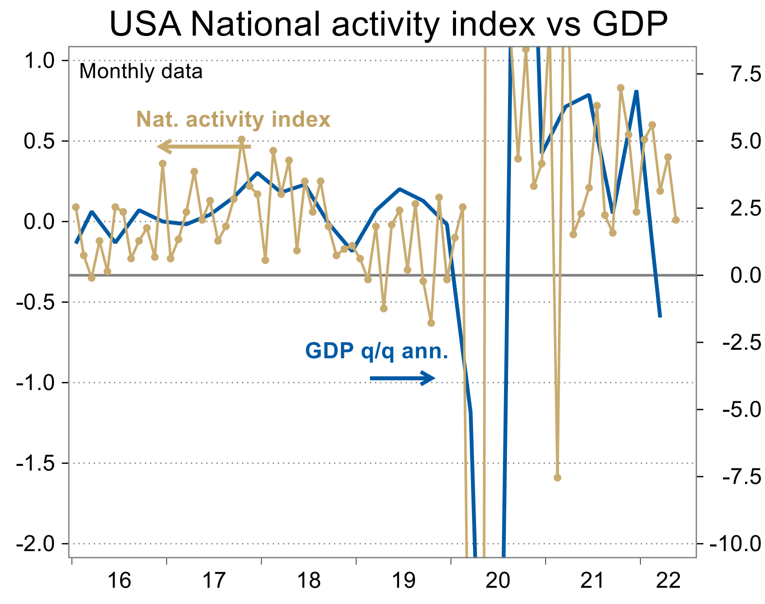
- The 12 m inflation f'cast fell by 0.2 pp to 5.2%, from the highest level since 1983
- The 5 y inflation expectation fell 0.2 pp to 2.9%, still above a 10 y avg – but lower than seen many times past 3 decades

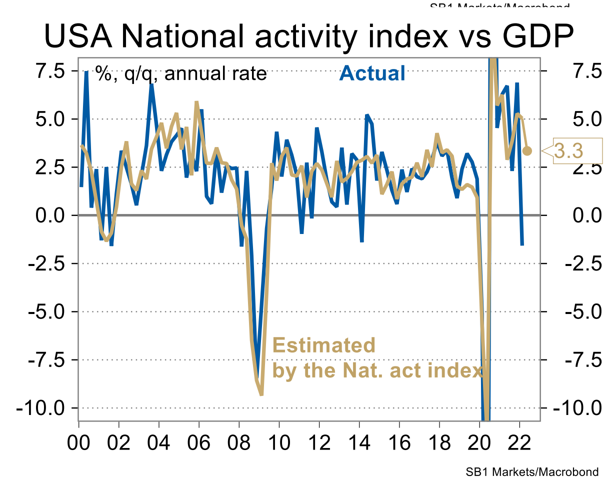
SpareBank 1 MARKETS

# Atlanta Fed’s nowcaster suggests a 1.5% decline in Q2 GDP

… while the National Activity index just signals slowdown to some 2% GDP growth in May




- **In a quarterly model**, the Activity index suggests a 3.3% growth pace, way above Atlanta Fed’s nowcaster
- **The consensus** Q2 GDP growth forecasts among economist has fallen to 0.8% - from almost 3% some few weeks ago
- **In Q1 GDP** fell 1.6%

Highlights

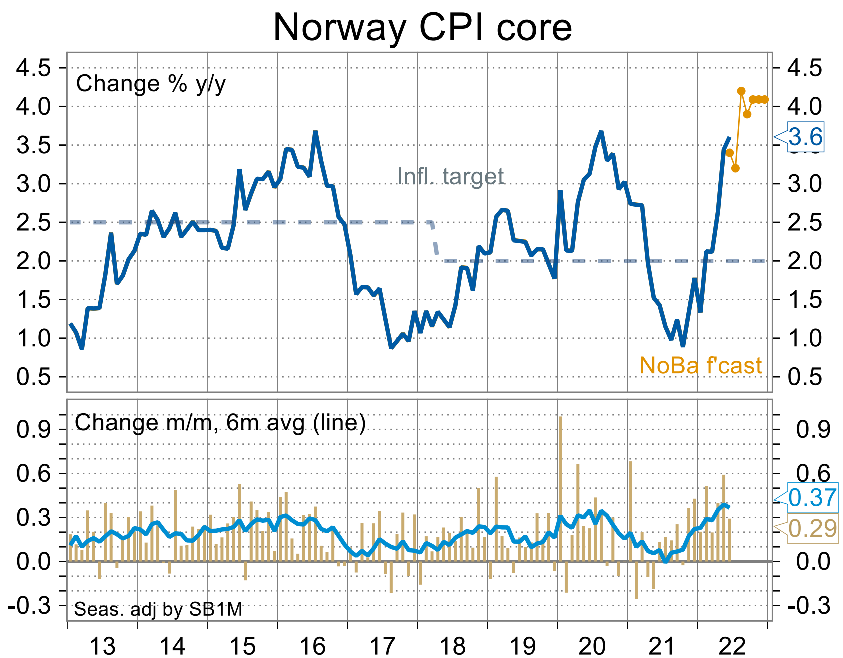
The world around us

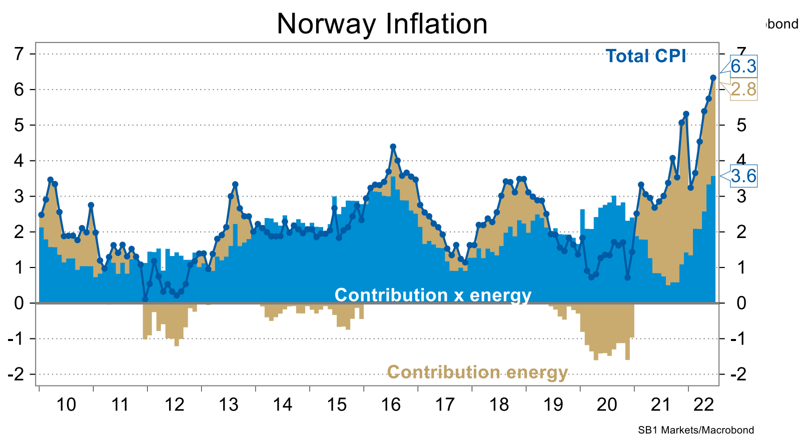
The Norwegian economy

Market charts & comments

# Inflation further up in June, now the focus turns to core, domestic inflation

## Headline inflation up 0.6 pp to 6.3%. The core up 0.2 pp to 3.6% (we exp. 3.7%), food up 1.8%!



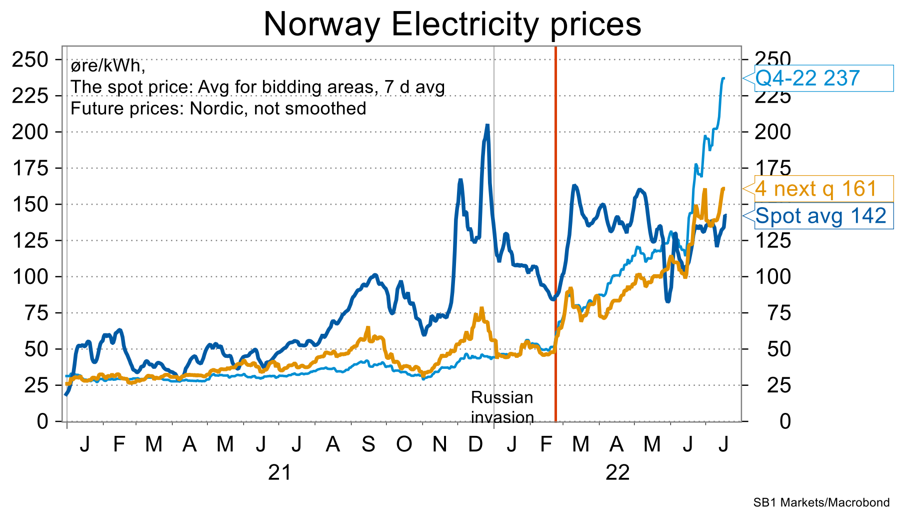



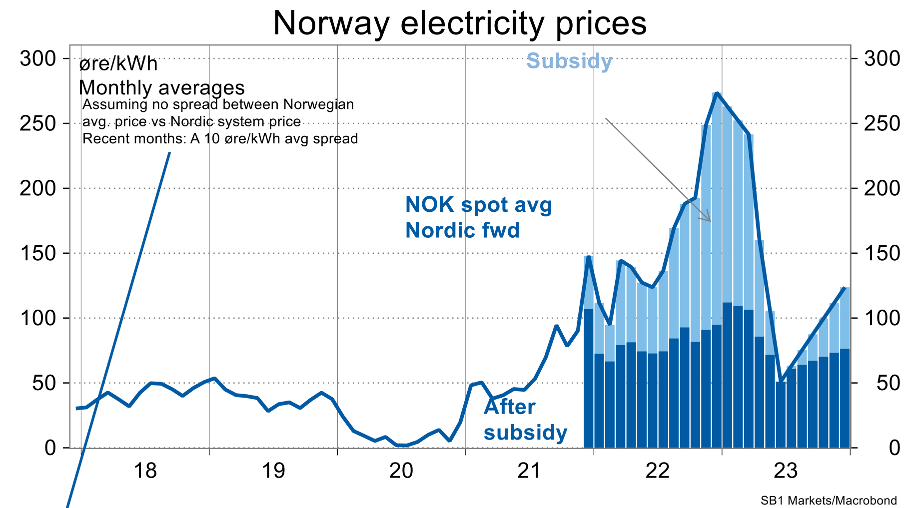

- **CPI-ATE** (ex. energy and taxes) rose 0.3% m/m, and the annual rate climbed by 0.2 pp to 3.6%, we expected 3.6%. NoBa assumed 3.4% in the June MPR
  - **Food prices** surprised at the upside, +1.7% (seas adj), and 5.0% y/y (both with non-alc beverages included), lifting the core CPI by 0.8 pp (but food prices are just marginally above the late 2020 level). Most sub-components contributed m/m in June, fruit and meat the most. Next month, the semi-annual July price adjustment will likely will be far larger than normal. Hotel & restaurant prices rose 2% m/m, and 9.2% y/y
  - **Airline ticket** prices fell but are still up 31% y/y (0.25 pp contrib)
  - Prices on **imported goods** rose 0.2% m/m and are up 3.7% y/y, while **domestically produced** goods & services were up 0.3% m/m and are also up 3.7% y/y – and accelerating
  - Most sectors report growth above 2% y/y, and most are up by more than 2% on average since 2019
- **Total inflation also accelerated, by 0.6 pp**, to 6.3%, the highest since 1988. If not for electricity subsidies, inflation would have been above 8%. Electricity prices rose marginally (seas adj). Auto fuel prices climbed 12% - both somewhat above our forecasts. Energy is contributing 2.8 pp to the 6.3% y/y headline CPI rate
- **The outlook**
  - **The electricity price** may increase marginally in July – and then rapidly during the autumn, according to the future market – following steep prices increases recent weeks. However, households will be sheltered from the most of these price hikes, due to the subsidies
  - **Gasoline prices** probably peaked in June, and are now heading down, in Norway as abroad, both due to the decline in crude prices, as well as refinery margins
  - However, higher **food prices** may lift the **core inflation** further in July, and price increases are still rather broad for other goods and services
  - If so, **average 2022 inflation** will some 5%, above Norges Bank's 4.6% forecast.
- **So what?**
  - **Real disposable** income is substantially reduced, even if **wage inflation** may in the end surprise on the upside in a tight labour market. Lower savings will partly compensate, but household demand is exposes too
  - For **Norges Bank** wage inflation is the dominant risk but actual inflation will influence wage inflation, and even more as the labour market is still very tight

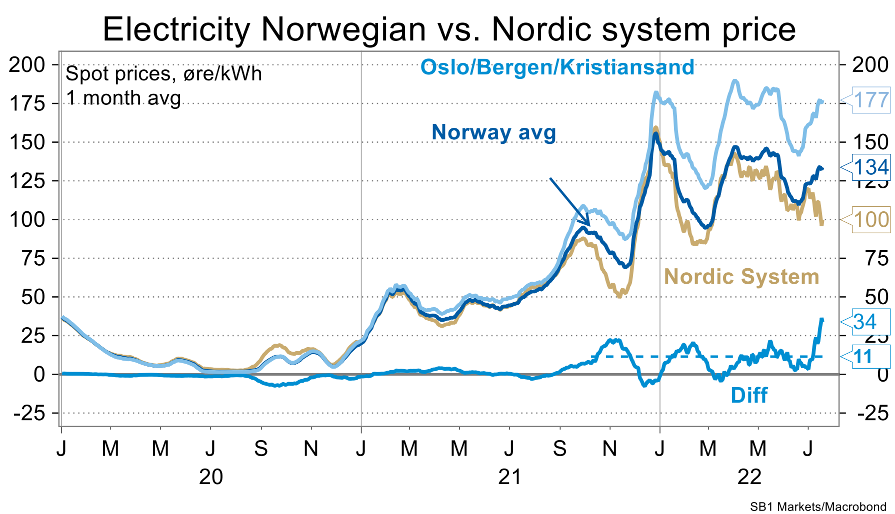
SpareBank 1 MARKETS

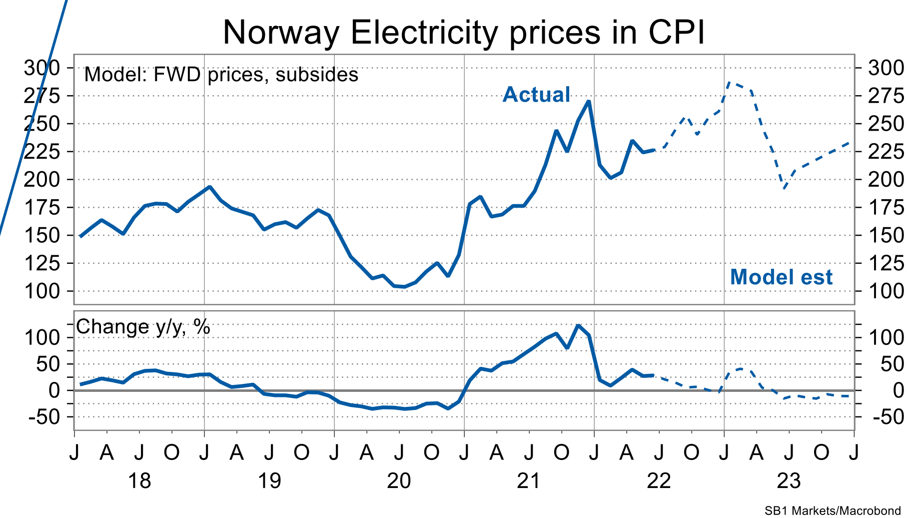
# Future prices sharply up recent weeks – due to the tight European gas market

The Q4 future price up 70% vs. 2021 – but subsides will cover the most of the costs, for households



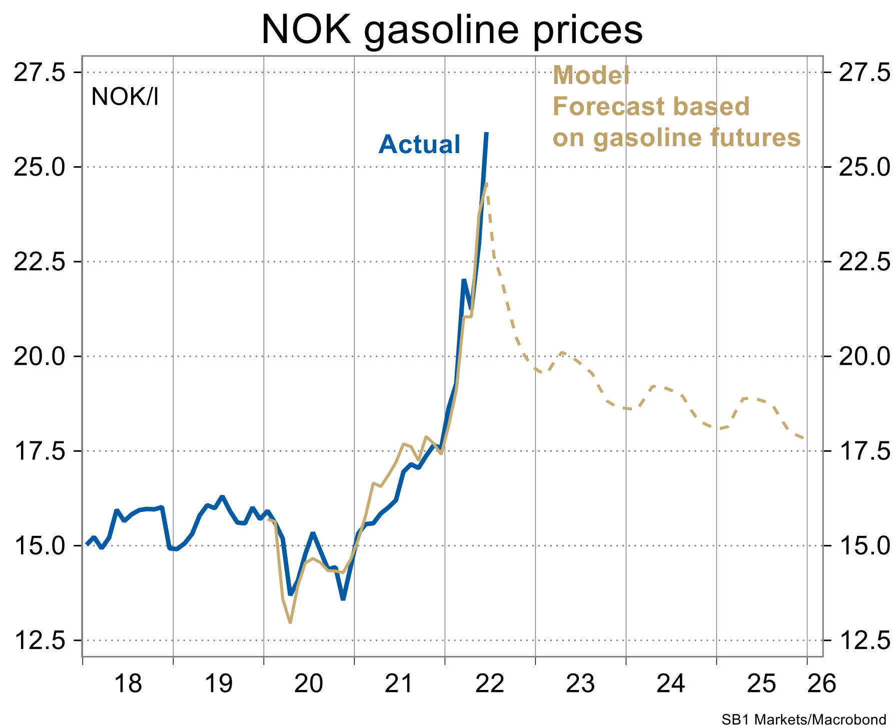



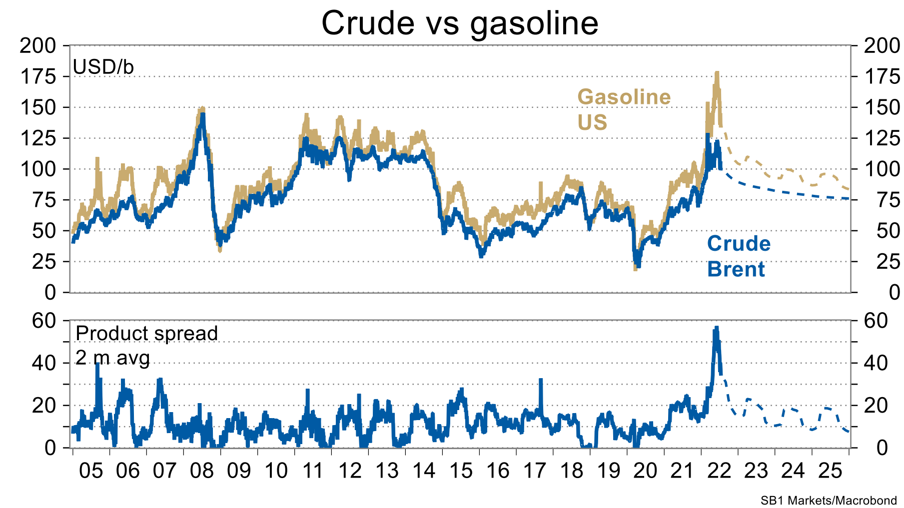



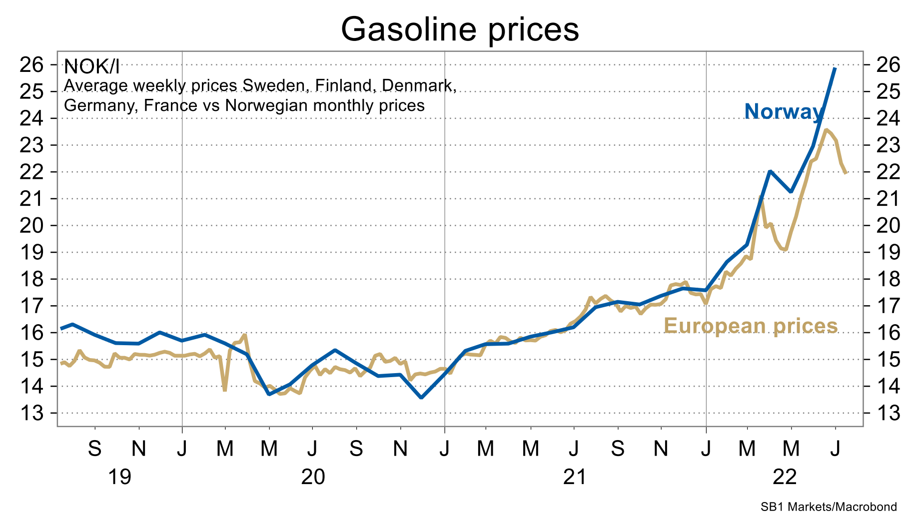



# Gasoline prices are peaking? (In addition, prices are above our model f'cast)

## The oil price is down from the peak, and gasoline margins are narrowing (but are still rich)



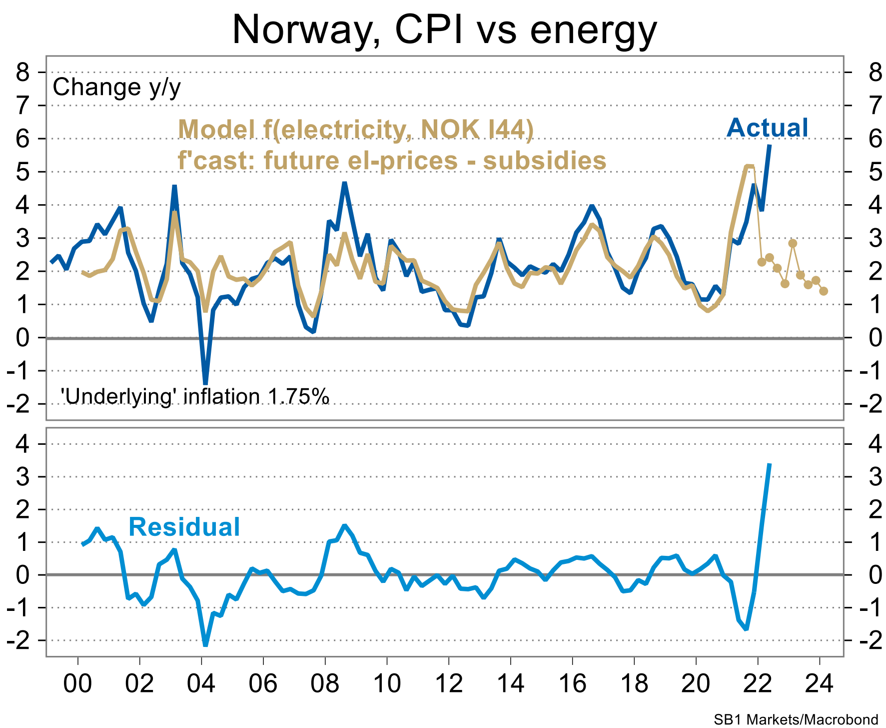




- Refinery/product margins have widened sharply since February. However, recently the margin has fallen somewhat, and futures markets expect a narrowing the coming months/quarters. In the US as well as in Europe, gasoline prices have fallen recently (US and European, as well as Norwegian prices are closely correlated – even in US prices of course is lower than European prices
- So, we are very confident that Norwegian gasoline price have peaked too – and it is quite likely the July average will be lower than the Jun avg. They will still be up y/y until late Q1-23, given current future prices

# Inflation suddenly substantially higher than suggested by electricity prices & NOK

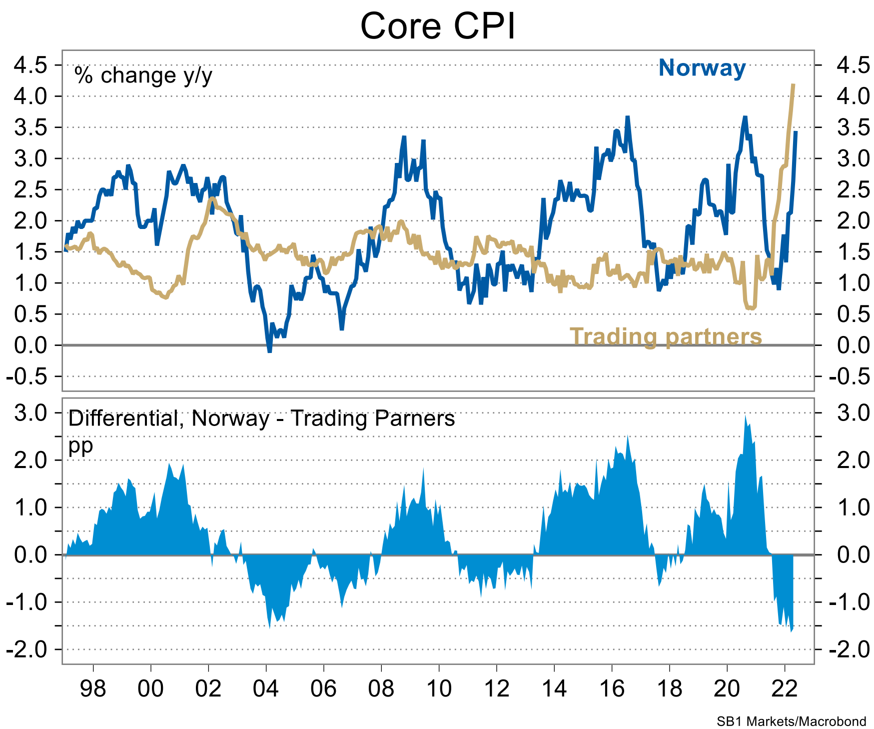
Our simple model confirms that inflation has broadened in H1-22

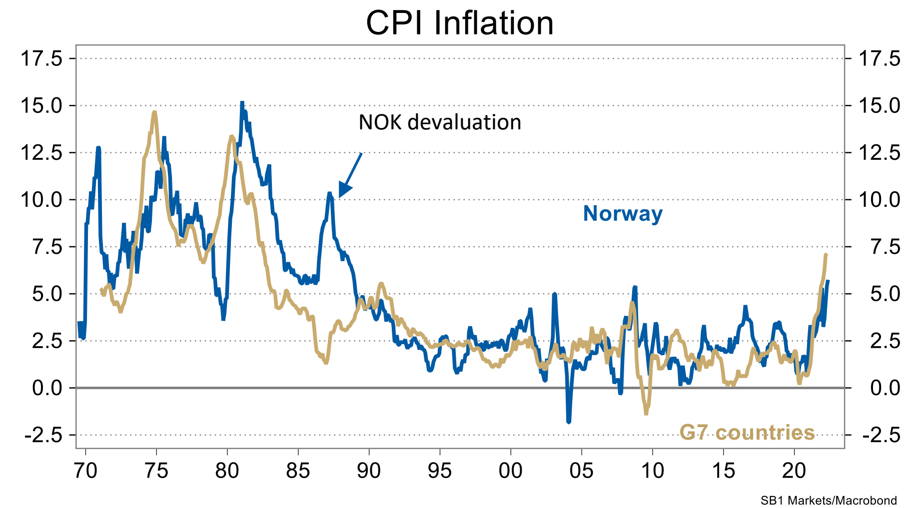


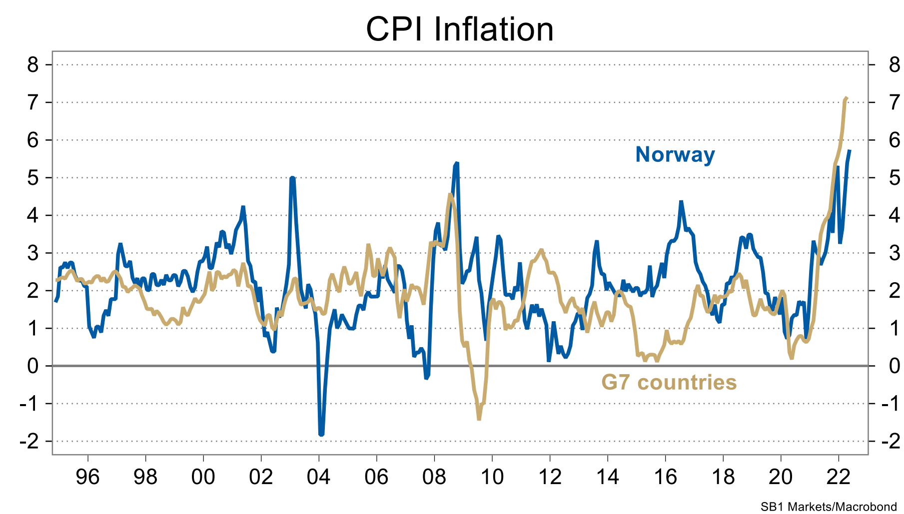

- On the other hand, actual inflation was well <u>below</u> the model forecast through 2021

# Norway vs ROW: The large, long-term CPI ‘regimes’ have been correlated

But limited short-term correlation, at least in the ‘low-inflation regime’. In which we are not anymore




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

# Food prices surprised at the upside, they are finally higher than in late 2020

## Airfare tickets cheaper than we expected, several other components too.

| | | Change m/m, seas. adj | | | Change y/y | | | Contribution, pp | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *Jun-22* | Weight | Out- | SB1M | Dev. | Prev. | Out- | SB1M | | | Dev. vs |
| CPI ATE, seas adj. | % | come | f'cast | pp | month | come | f'cast | m/m | y/y | f'cast |
| Food, non alc bev | 12.9 | 1.8 | 0.7 | 1.1 | 3.0 | 5.5 | 4.3 | 0.24 | 0.71 | 0.15 |
| Alcohol, tobacco | 4.2 | 0.7 | 0.4 | 0.3 | 4.6 | 5.2 | 4.9 | 0.03 | 0.22 | 0.01 |
| Clothing, footwear | 5.1 | -0.4 | 0.2 | -0.6 | 2.5 | 2.1 | 2.6 | -0.02 | 0.11 | -0.03 |
| Housing x. energy | 20.2 | 0.2 | 0.2 | -0.0 | 1.8 | 1.8 | 1.8 | 0.03 | 0.37 | -0.00 |
| Furnishing | 6.9 | -0.7 | 0.0 | -0.7 | 8.9 | 4.8 | 5.7 | -0.05 | 0.33 | -0.05 |
| Health | 3.4 | 0.3 | 0.2 | 0.1 | 1.9 | 2.2 | 2.1 | 0.01 | 0.07 | 0.00 |
| Transp. ex. gas, airl. tick | 12.2 | 0.3 | 0.4 | -0.1 | 2.3 | 2.8 | 2.8 | 0.03 | 0.34 | -0.02 |
| Airline tickets | 0.8 | -1.6 | 10.0 | -11.6 | 32.1 | 30.8 | 47.2 | -0.01 | 0.24 | -0.09 |
| Communication | 2.4 | -0.1 | 0.1 | -0.2 | -0.5 | -0.9 | -0.7 | -0.00 | -0.02 | -0.00 |
| Recreation, culture | 10.8 | 0.4 | 0.2 | 0.2 | 3.1 | 2.9 | 2.6 | 0.05 | 0.31 | 0.02 |
| Education | 0.5 | - | - | - | 2.0 | 2.0 | 2.0 | | 0.01 | 0.00 |
| Restaurants, hotels | 5.6 | 2.1 | 0.6 | 1.5 | 7.2 | 8.7 | 7.2 | 0.12 | 0.49 | 0.08 |
| Other | 8.7 | 0.5 | 0.2 | 0.3 | 2.4 | 3.0 | 2.7 | 0.05 | 0.26 | 0.03 |
| **CPI-ATE, s.a** | 93.7 | **0.3** | **0.4** | -0.1 | **3.4** | **3.6** | **3.7** | | | -0.08 |
| ***Norges Bank est.*** | | | ***0.1*** | | ***3.4*** | | ***3.4*** | | | |
| Imported | 36 | 0.2 | 0.1 | 0.1 | 4.3 | 3.7 | 3.7 | 0.08 | 1.36 | 0.03 |
| Domestic | 57 | 0.3 | 0.5 | -0.2 | 2.9 | 3.5 | 3.7 | 0.19 | 2.02 | -0.12 |
| Energy, housing | 4.4 | 3.9 | -2.0 | 5.9 | 27.8 | 28.3 | 20.7 | 0.17 | 1.24 | 0.26 |
| Energy, transport | 2.0 | 12.1 | 8.0 | 4.1 | 40.3 | 54.6 | 48.9 | 0.24 | 1.06 | 0.08 |
| **CPI Total, s.a** | 100 | **0.6** | **0.4** | 0.2 | **5.7** | **6.3** | **6.2** | 0.58 | 6.33 | 0.15 |
| ***Norges Bank est.*** | | | ***-0.1*** | | ***5.7*** | | ***5.6*** | | | |

*Change m/m, seasonally adjusted* (calc by SB1M)

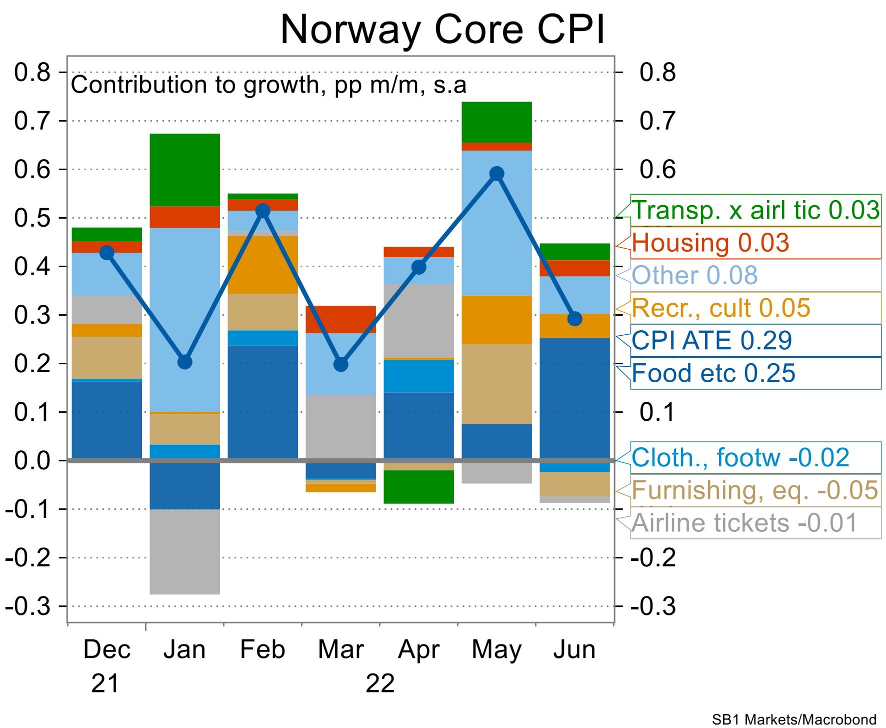
*Sum of parts does not necessarily add up to totals*

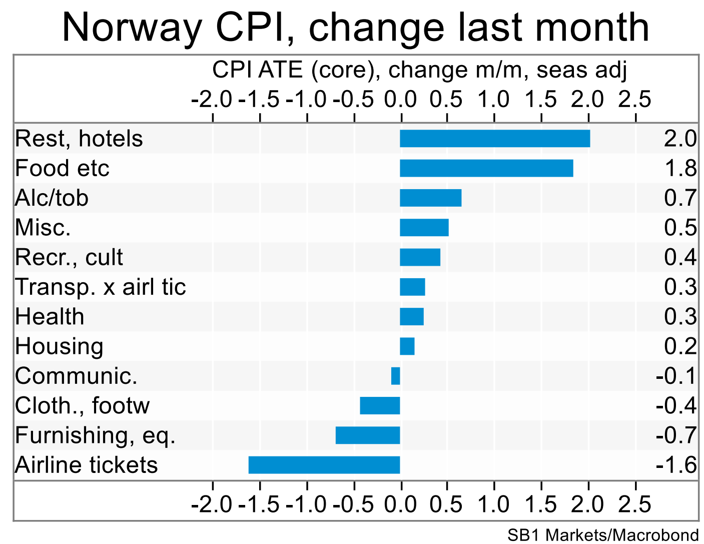
- **Food, non-alc bev.** prices rose 1.8% (ex taxes, seas. adj), 1.1 pp more than we exp! The annual growth is 5.5%
- **Clothing** prices fell 0.4%, and are up 2.1% y/y
- **Furniture/hardware/equipm** prices fell slightly following the steep rise in May
- **Transport ex. gas & airfare tickets** rose 0.4%, up 2.8% y/y, surprisingly low given global auto prices
- **Airline tickets** prices fell 1.6% m/m but are up 31% y/y, from a very low level last year
- **Recreation** prices added 0.4%, up 2.9 y/y
- **Restaurant/hotel prices** up 2.1% m/m 8.7% y/y, and way above a 2% path (starting in 2019)
- **CPI-ATE** up 0.3% m/m, 3.6% y/y, below our f'cast
- Prices on **imported goods** rose 0.2%, and are up 3.7% y/y – a substantial contribution to total (1.4pp)
- Prices on **domestically produced** goods & services rose 0.3%. The annual rate at 3.5% is well above 2%
- **Electricity (and other heating)** prices rose 4%, we expected -2%, and prices are still up 28% y/y
- Gasoline/diesel prices rose 12%, 4 more than we expected. Prices are up 54.6% y/y – but have peaked?
- … **headline inflation climbed to 6.3%!**

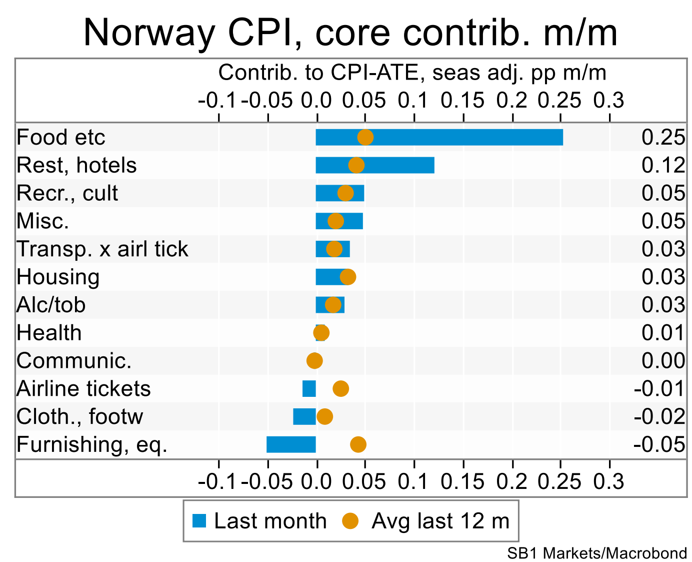
<u>Monthly changes are seasonally adjusted by SB1 Markets</u>. The weighted sum of the components does not necessarily sum exactly up to the total, and deviations m/m and y/y do not necessarily add up. Norges Bank m/m s.a. estimate is implied, calculated by us. Sources: SSB, Norges Bank, SB1 Markets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

# Food prices made the heavy lifting in June. More to come in July

Hotels also contributed substantially on the upside in June. Airline ticket prices surprisingly fell



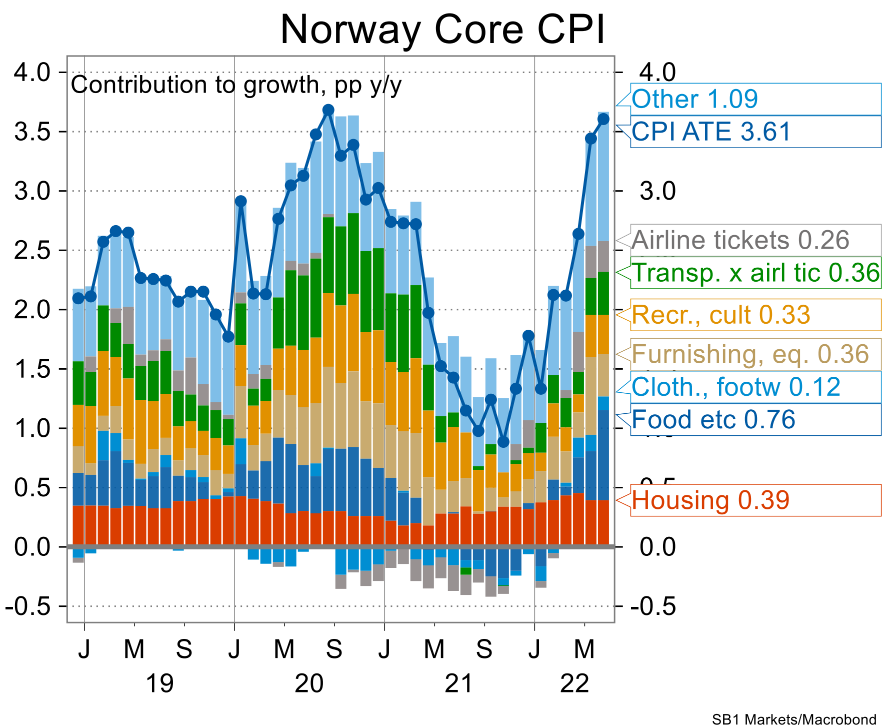



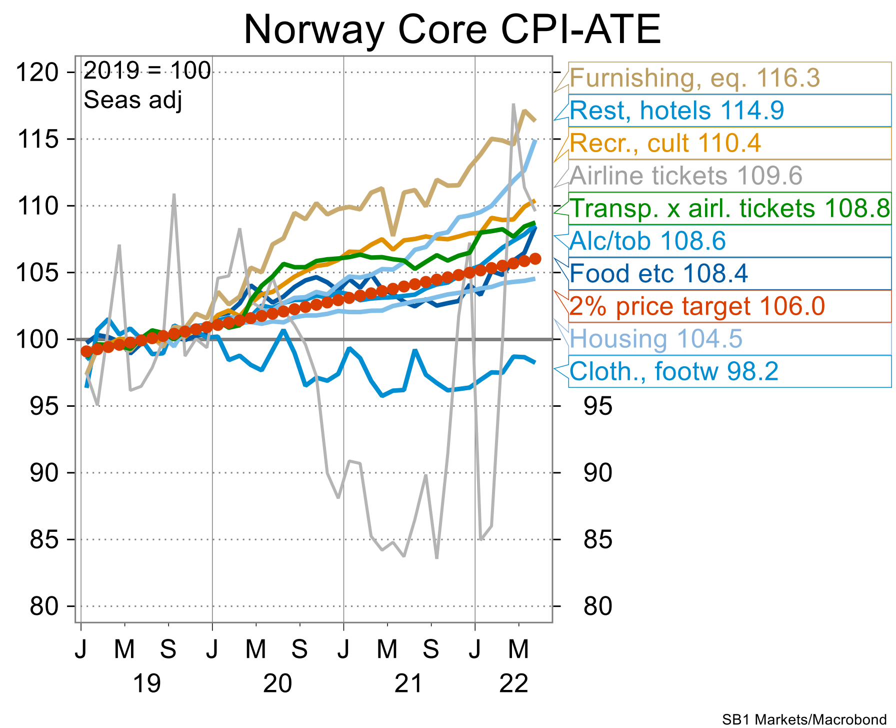



SpareBank 1 MARKETS

# Faster/broader price growth recent months

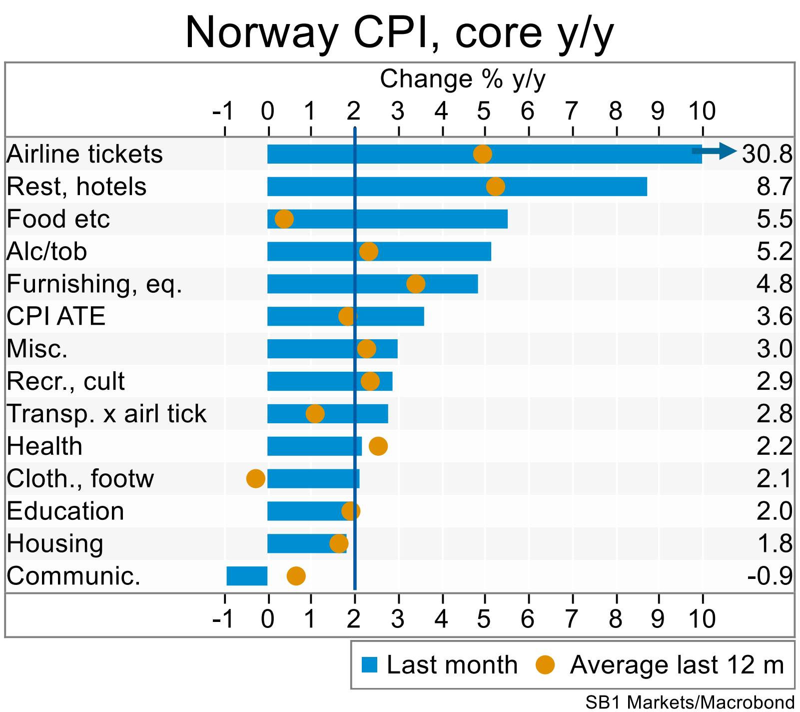
## Just clothing/footwear, and housing ex energy below the 2% path since 2019

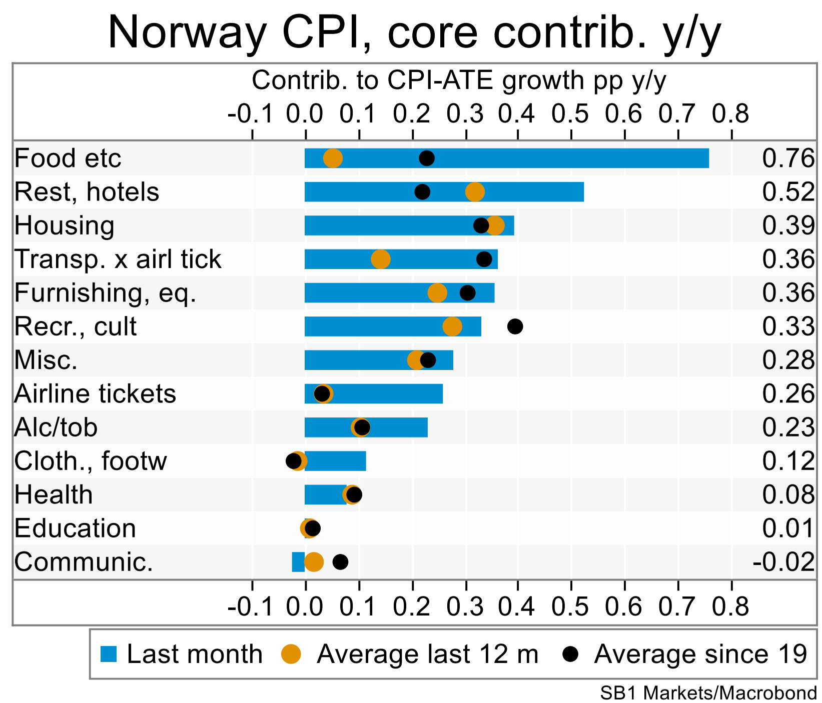


# 11 sectors report core inflation above 2.0%, just 3 are at 2% or below!

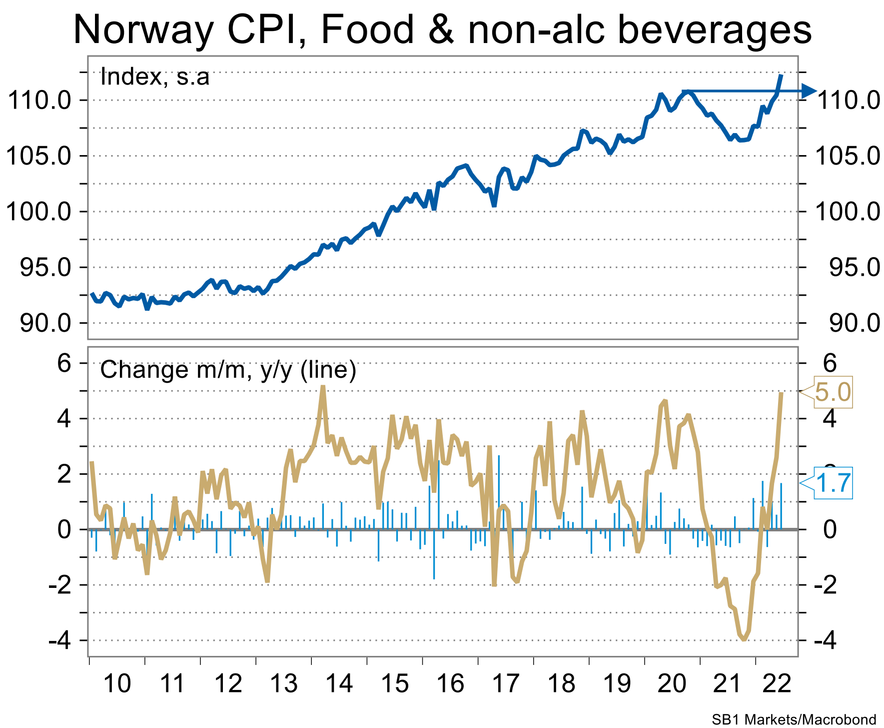
Food, restaurants/hotels & housing have contributed the most y/y

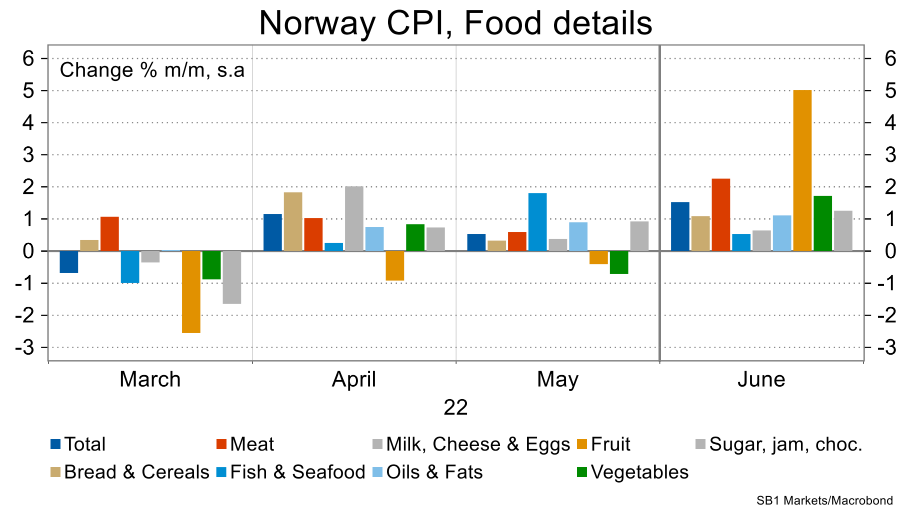


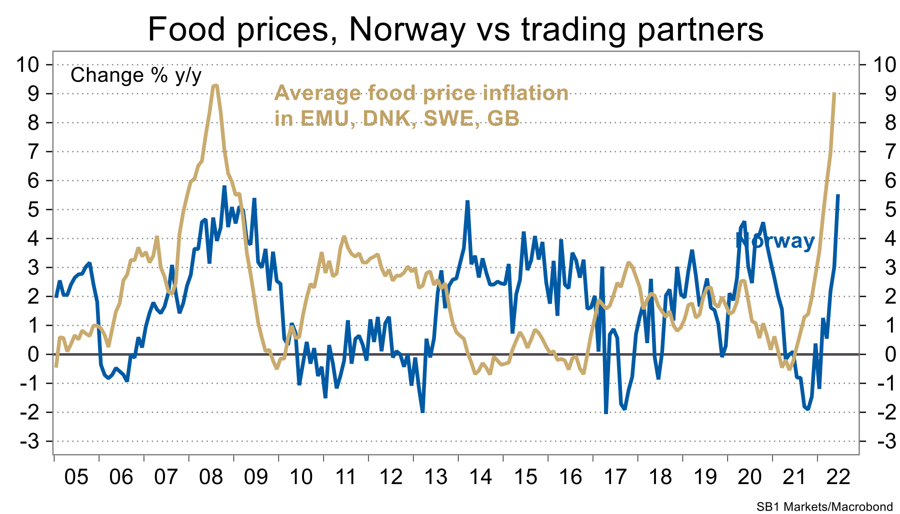



# Food prices finally higher than in late 2020 – but June hike was steep

Food & non-alc beverage prices rose by 1.6% in June (s.a, actual 1.7%% ), and are up 5.1% y/y



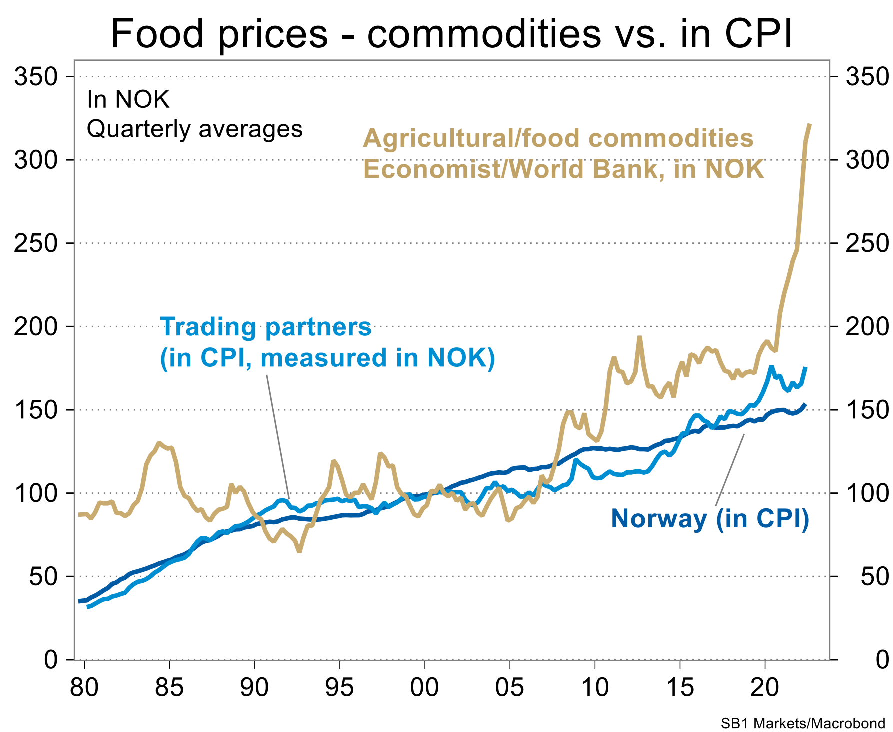



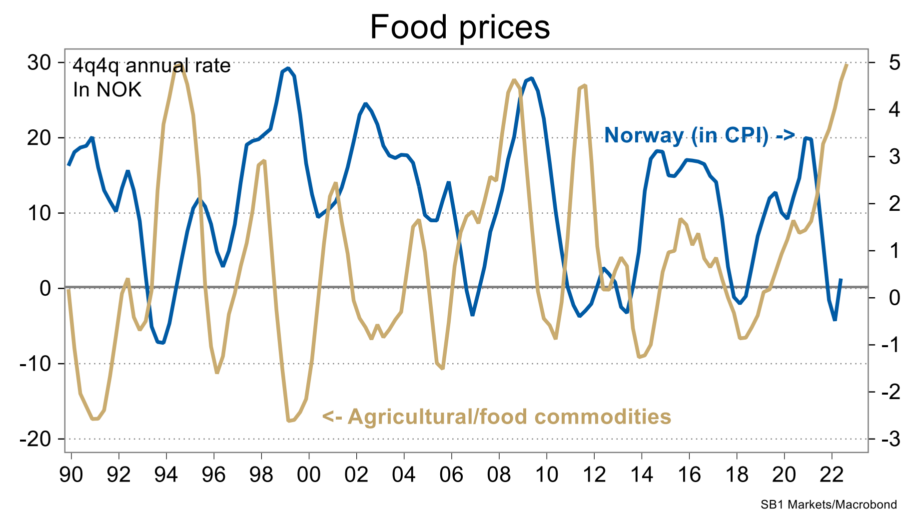



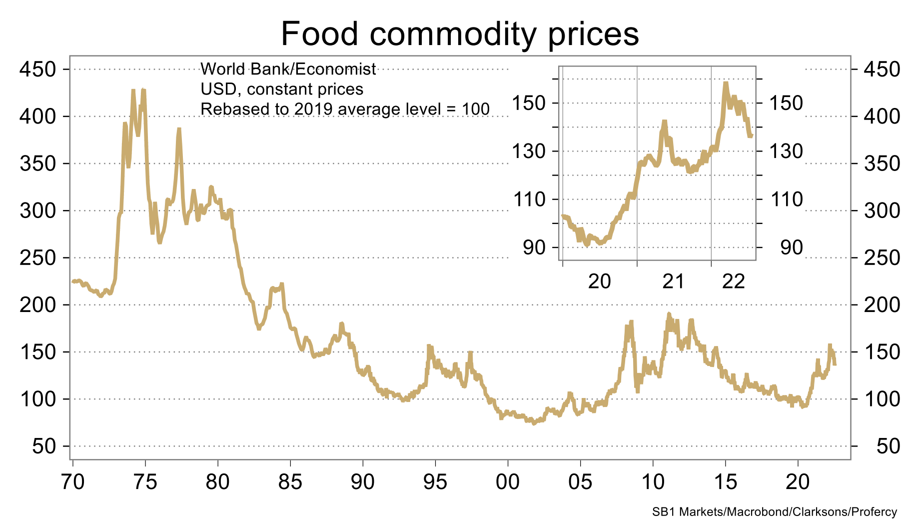

- **Food price inflation is accelerating abroad, but Norwegian CPI food prices** are not closely correlated with food prices among our European neighbours. The NOK exchange rate is normally explaining more
- The price lifts in June was broad, but unusually strong for fruits (5%) but also for meat (2.2%) and vegetables (1.7%)
- In July, prices increases are normally rather high, both due to the semi-annual adjustment of prices following negotiations between producers/wholesalers and retails and high prices for Norwegian seasonal produce. This year, the negotiated prices were very likely lifted much more than normal, and another substantial increase m/m and in the annual growth rate is expected. Then we can start talking about high food prices – so far they have been low!

# Food commodity prices: Limited correlation to trading partners' food prices

… And no stable correlation to Norwegian food prices (in the CPI). Now, food com. prices are falling



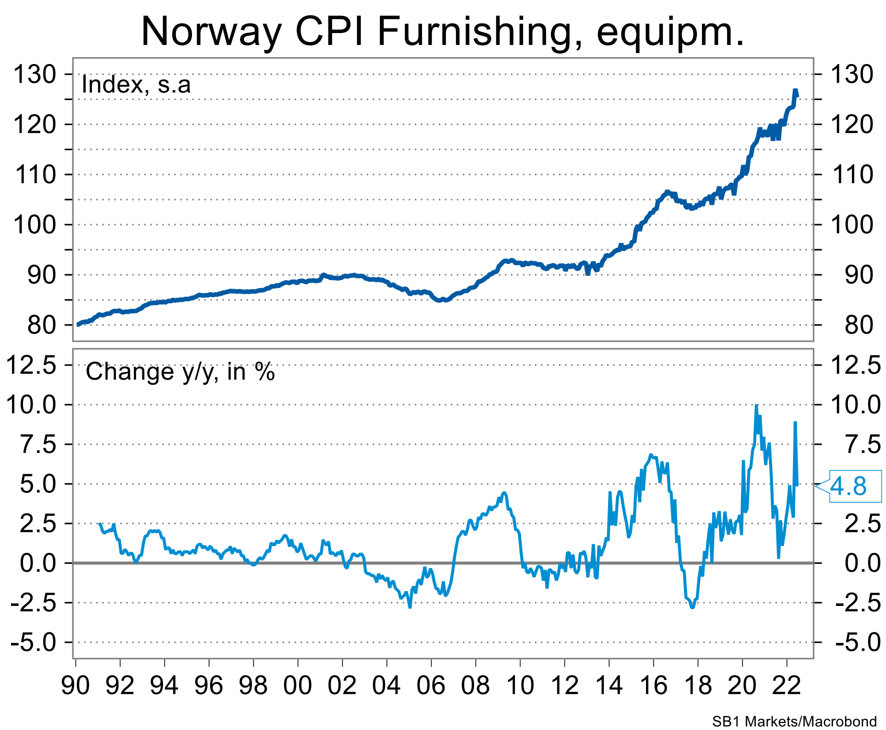



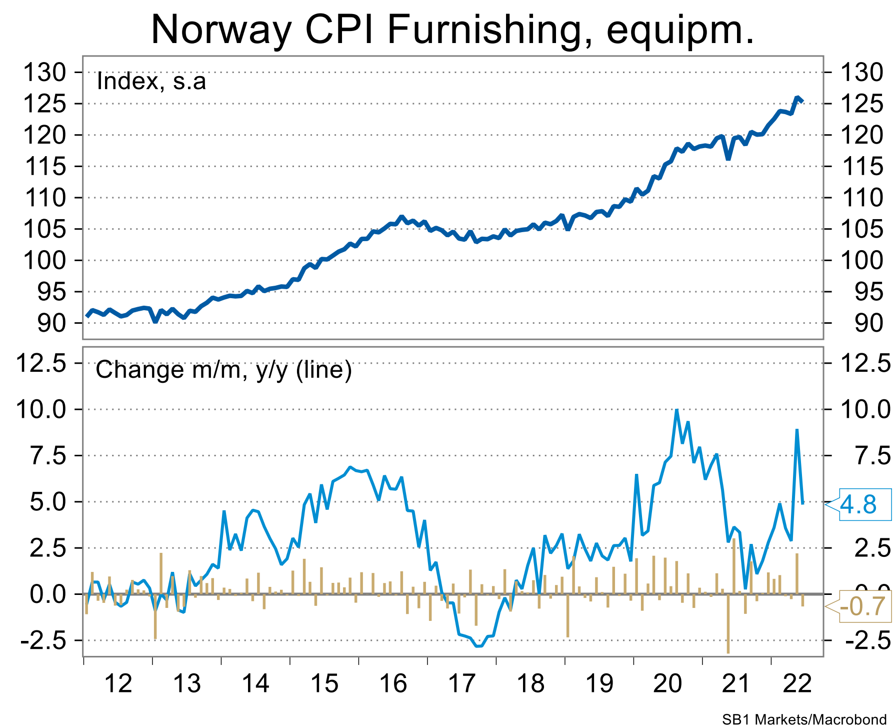




- Agricultural/food commodity prices are sharply up from mid 2020, but have fallen since March, and are now well below 10% higher than in early 2021. In real terms, prices are far from record high (check here)

# Furnishing etc. prices reversed parts of the May hike, up 'just' 4,8% y/y

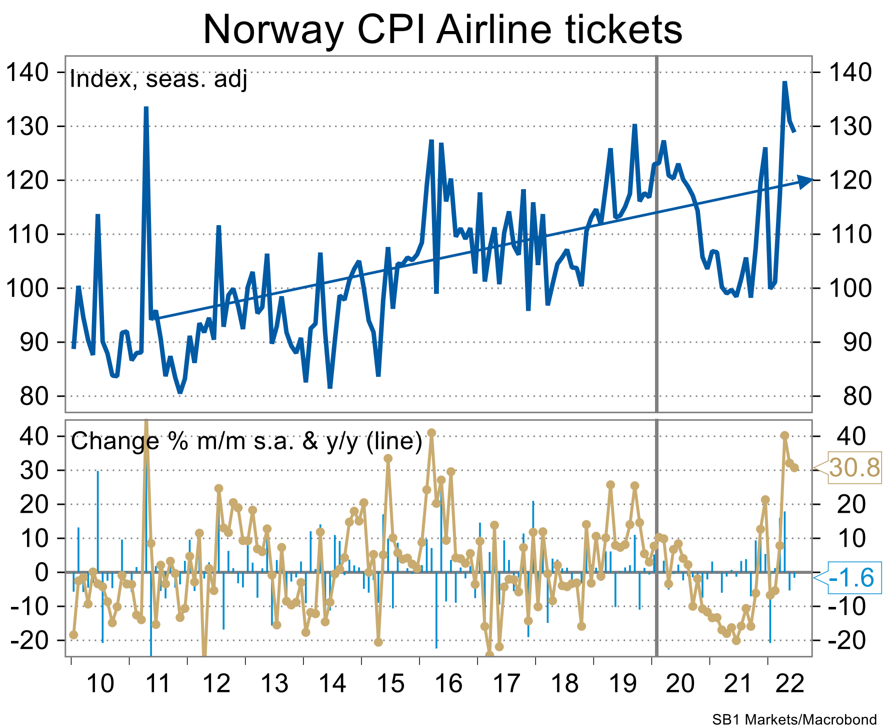
Furniture up 10% but household applications 'just' 3%%



# Airfare ticket prices: Slightly down in June – but will climb in July?

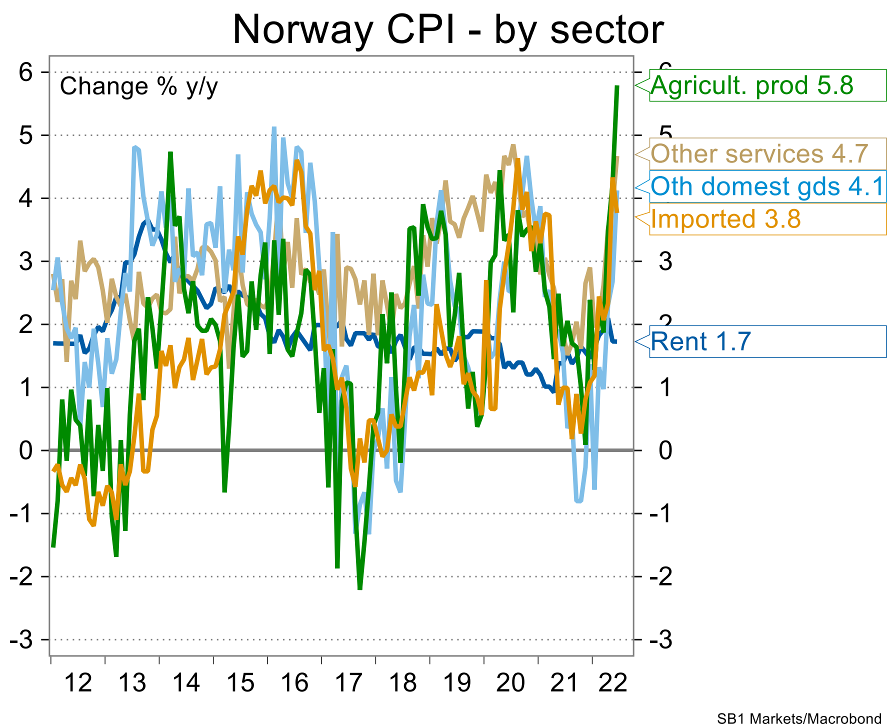
(at least as long as SAS is hit by the pilot’s strike)

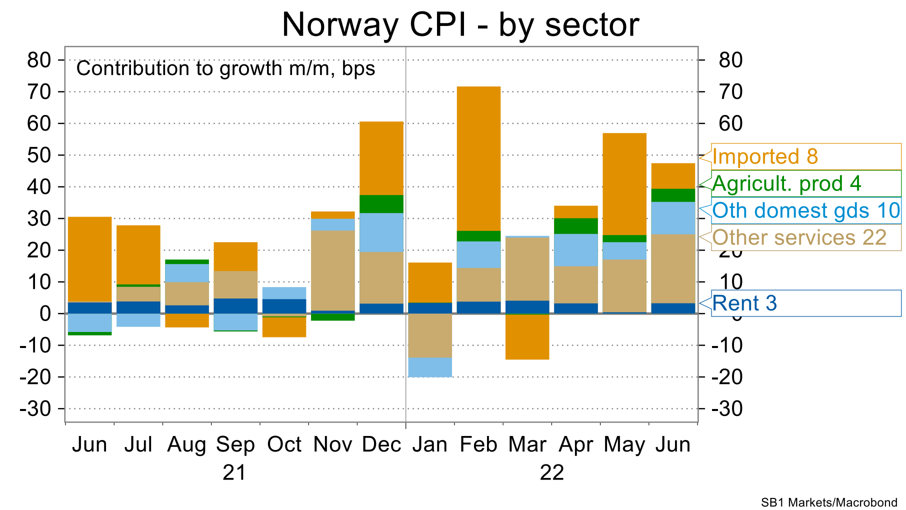


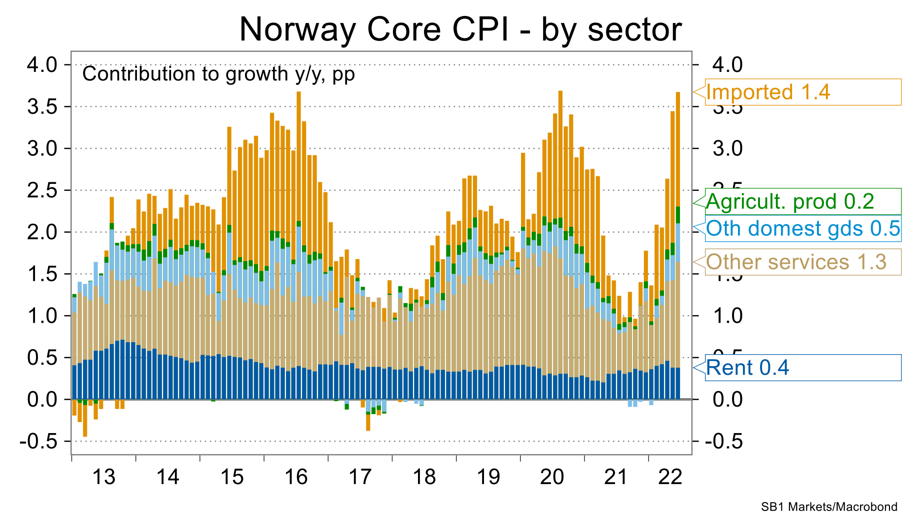

- **Airfare ticket prices** fell 1.6% m/m in June (after a shaky seasonal adjustment procedure), we expected at 10% lift. Prices are still up 31% y/y, from a low level last year, during the pandemic – contributing by 0.25 pp to the 3.4% y/y lift in core CPI
- **Prices** are less than 10% above the pre-corona trend path – which could at least partly be explained by the increase in the fuel cost
- The upside risk is probably limited – if the supply side is not hurt

# Domestic agricultural products up 1.2% but just a limited contribution to the total

## Domestic goods & services and imported goods the main contributors to core inflation



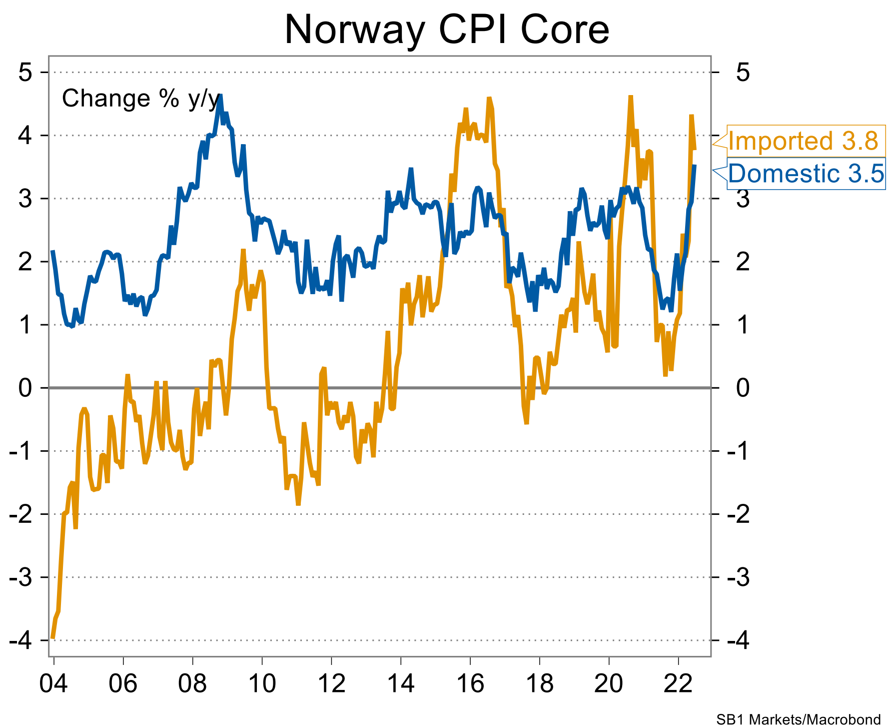



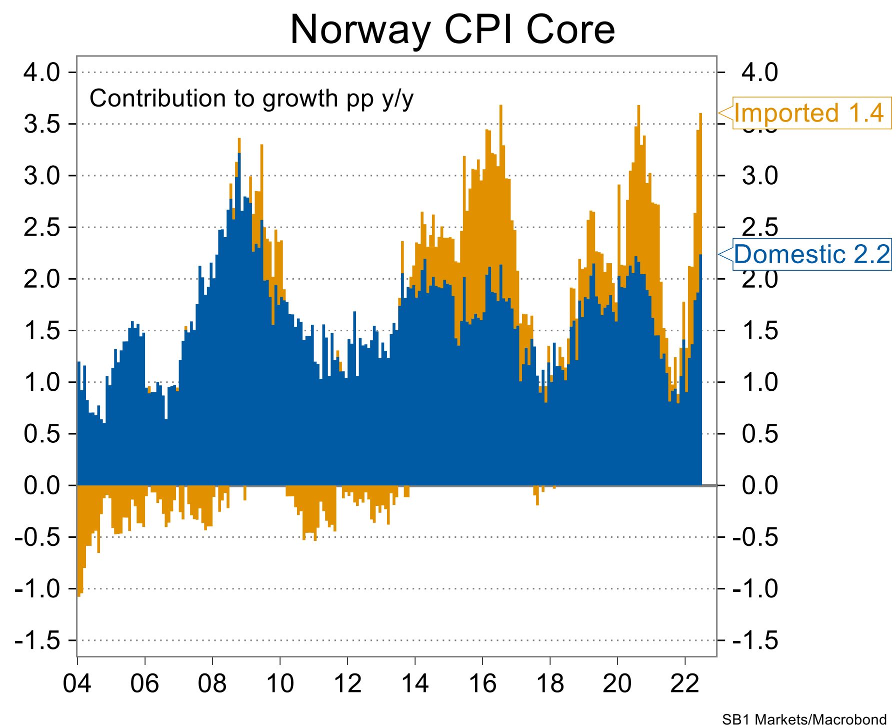




- **Domestic services inflation ex rents** slowed sharply during the corona crisis, and is now climbing faster, with a substantial contribution from airfare tickets (0.25 pp out of 1.3%) and hotels & restaurants (0.50 pp)
- **Rent inflation** has slowed to 1.7% but still ‘explains’ 0.4 pp of the core inflation rate
- **Other goods** than agricultural & imported products are up 4.1% y/y, and contributed by a 0.5 pp contribution to the core inflation rate

# Prices on imported goods in the lead – without a much weaker NOK

However, 'domestic' inflation is also far above the 2% inflation target, and is contributing more

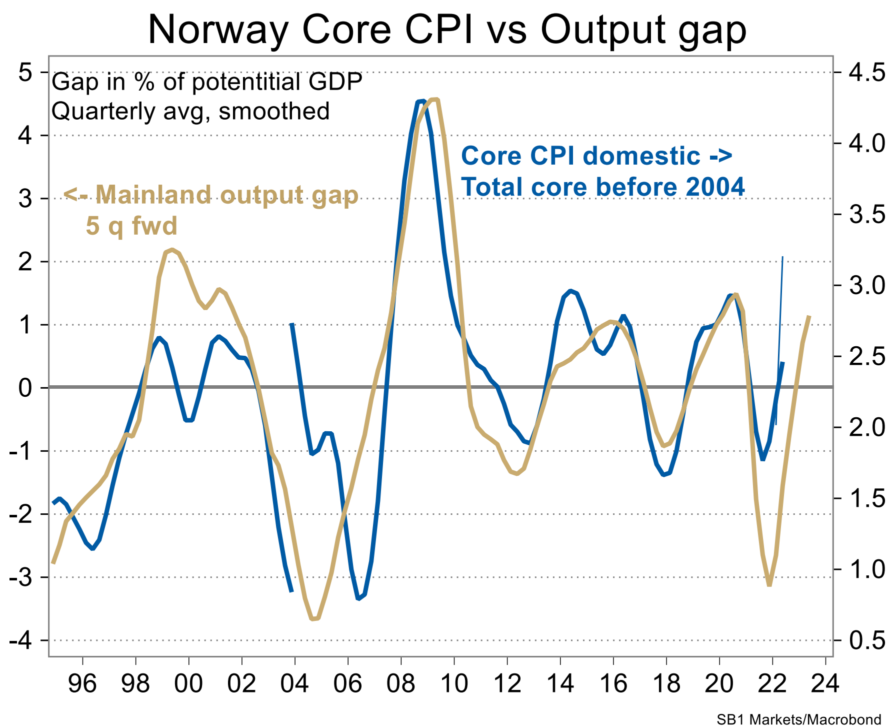


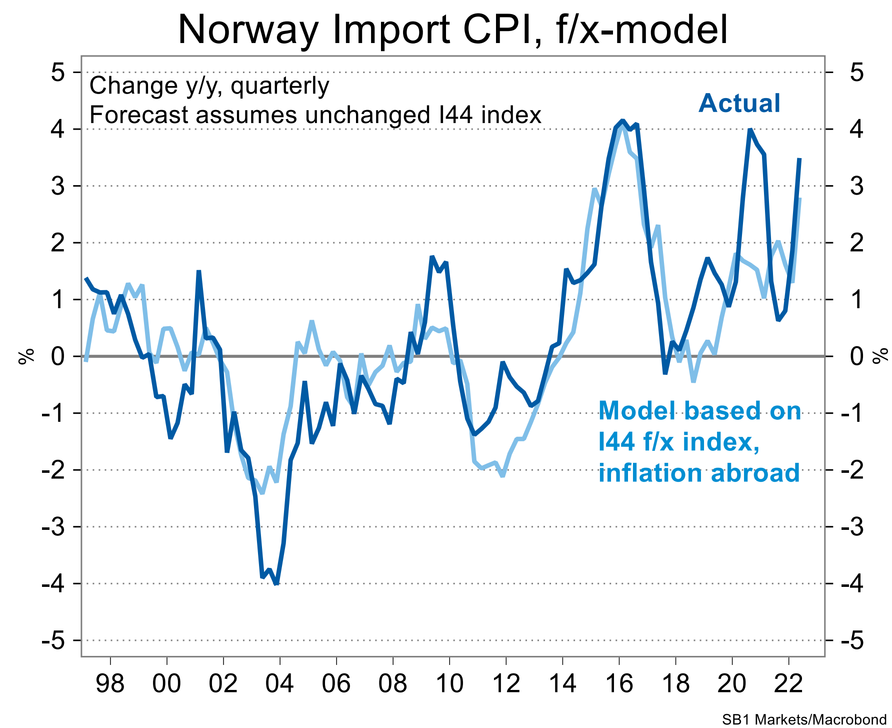



SpareBank 1 MARKETS

# Domestic inflation up due to a strong domestic economy? Seems so

... but the lift has arrived earlier than normal. 'Imported' inflation marginally above model estimate

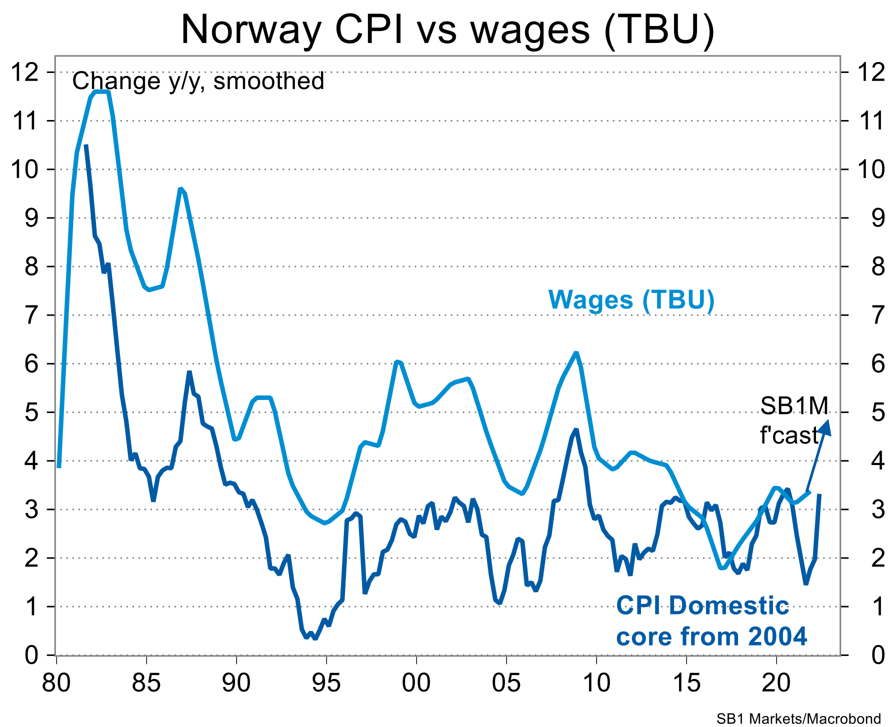


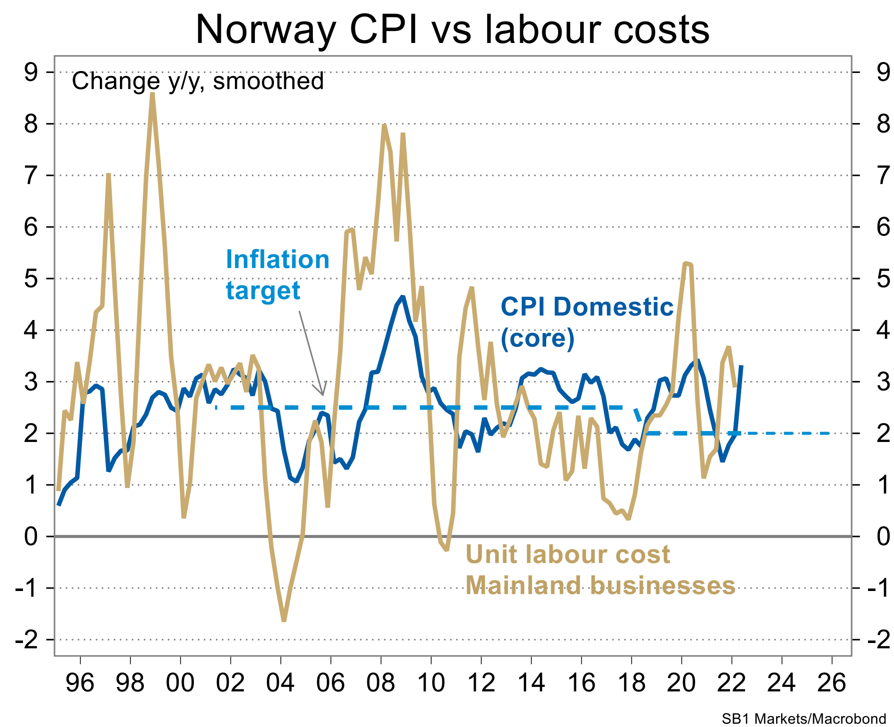



SpareBank 1 MARKETS

# Domestic costs: Wage inflation is increasing, cost inflation above infl. target

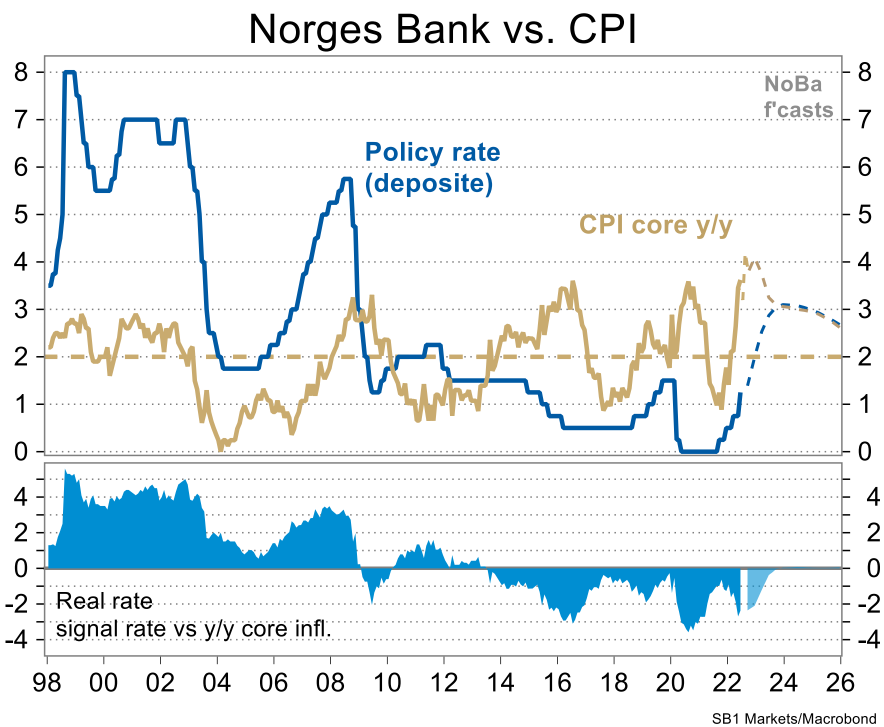
Wage inflation has turned up. Unit labour cost up 3% y/y in Q1

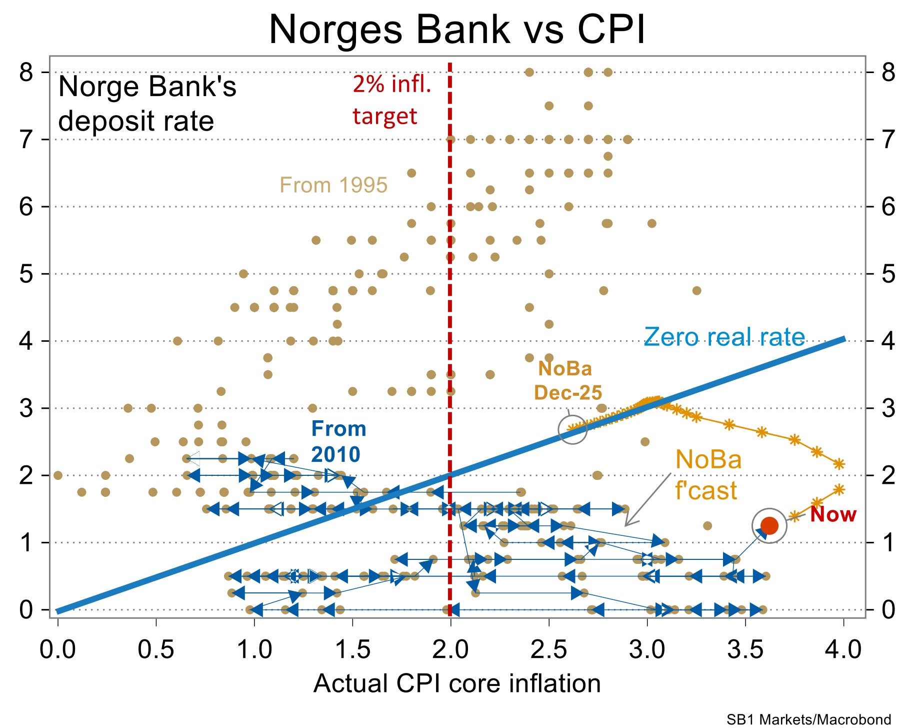


# Will higher inflation increase the pressure on Norges Bank?

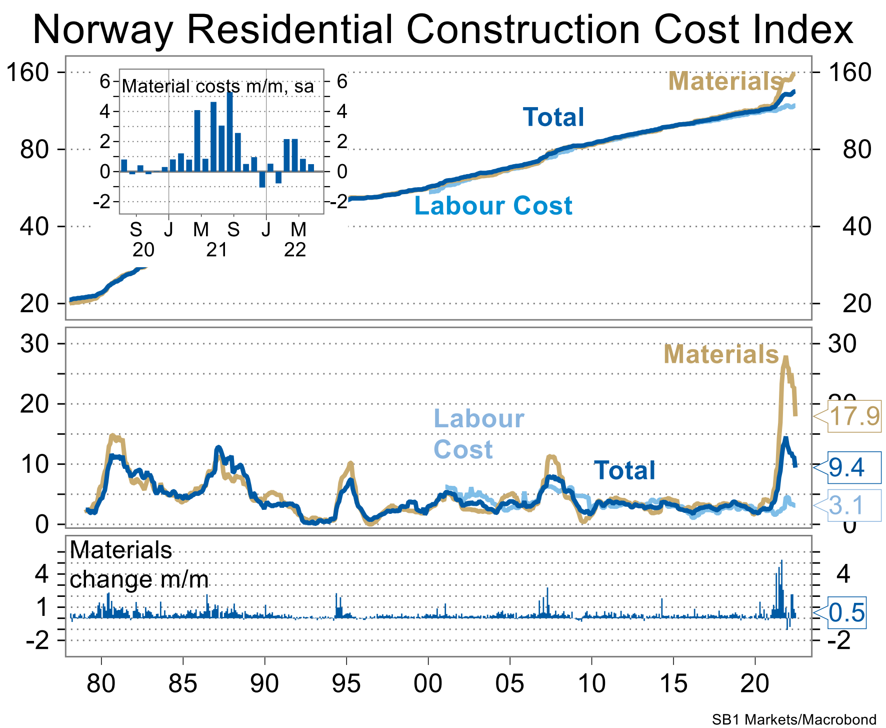
Somewhat

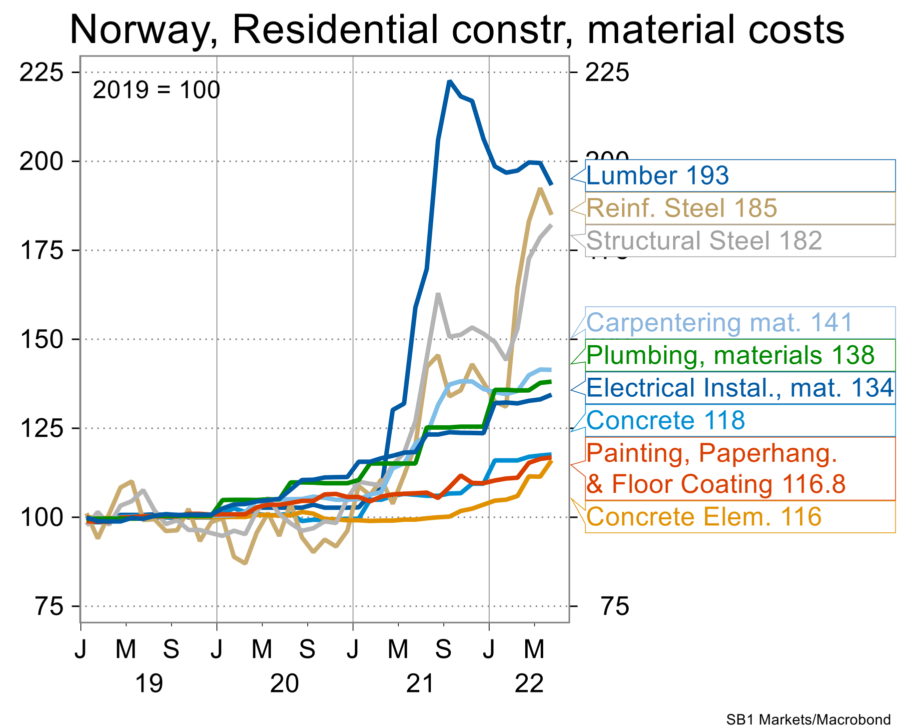


# Building costs: Just marginally up in June – and are probably close to peak

Lumber & some steel prices fell in June – and much more to go. Other materials flat or just marg. up



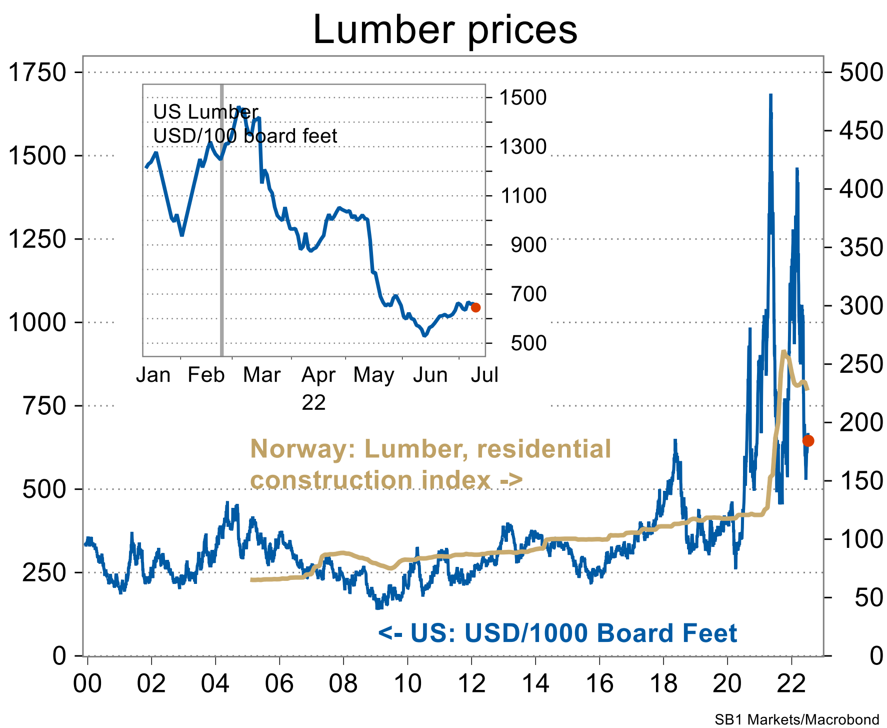




- **Material prices** (houses and apartments) added 0.5% in May, and prices are up 17.9% y/y, down from 22.8% y/y in May
  - » Lumber prices are trending down, and reports signal that prices will decline further the coming months. Steel prices have fallen substantially at metal exchanges, and now end user prices will come sharply down
  - » Other material prices are still trending up, from 11% (concrete) to plumbing and carpentering material 36% – 40% - but most prices are close to flattening
- **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 9.4%, down from the ATH at 14.6% at the peak last Oct. <u>Going forward, low material costs will bring total construction costs down to more normal levels</u>

SpareBank 1 MARKETS

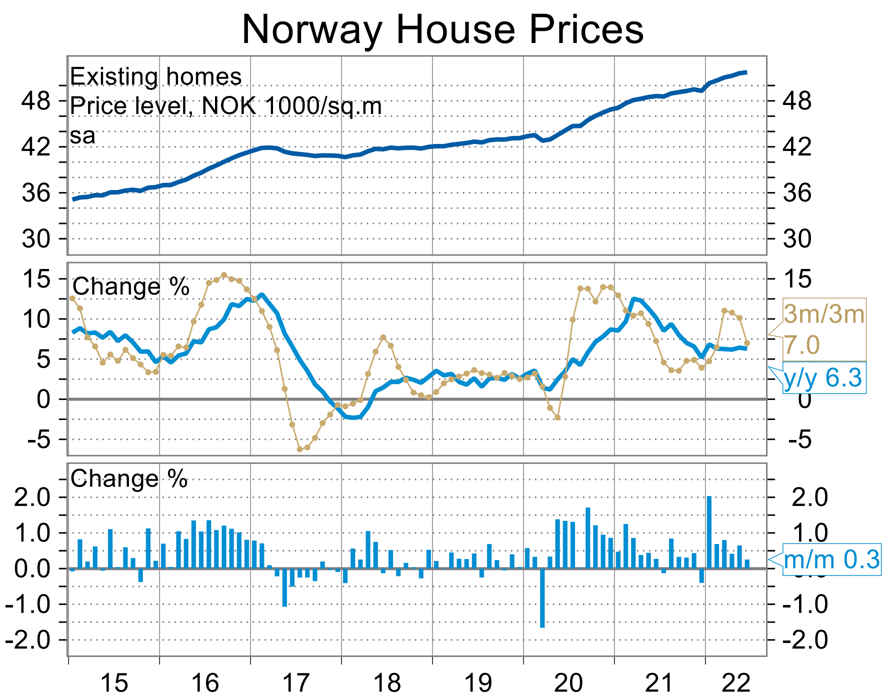
# US lumber prices (2''x4) almost back to a normal level

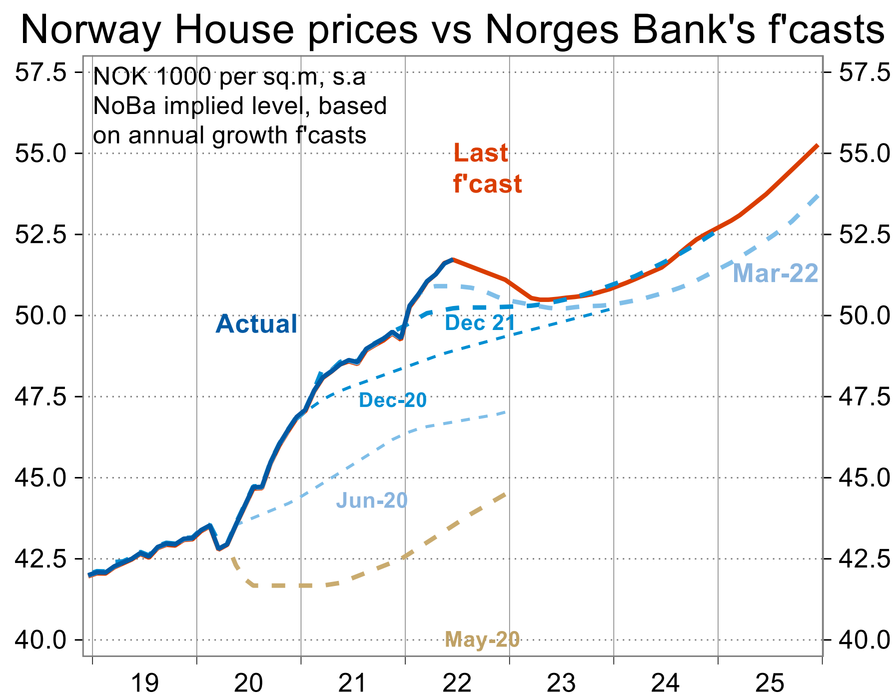
... and steel prices have been in a free fall recent weeks! Prices will come down in Norway as well




# House prices further up in June, as the inventory of unsold home is 'emptied'

Prices up 0.3%, 0.1 pp above NoBa's, our f'casts. Will prices start declining in July, as NoBa assumes?

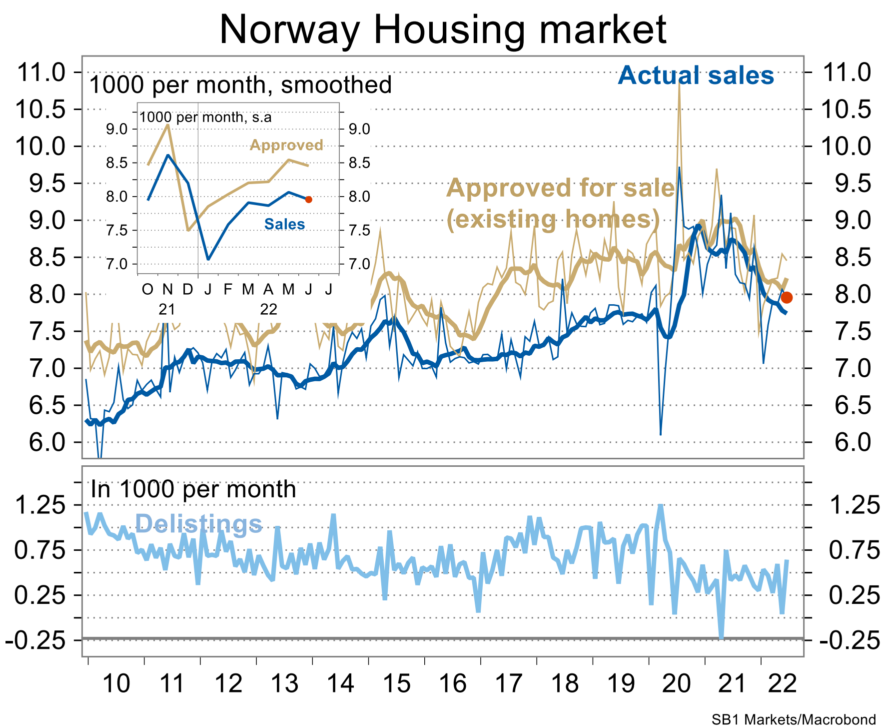


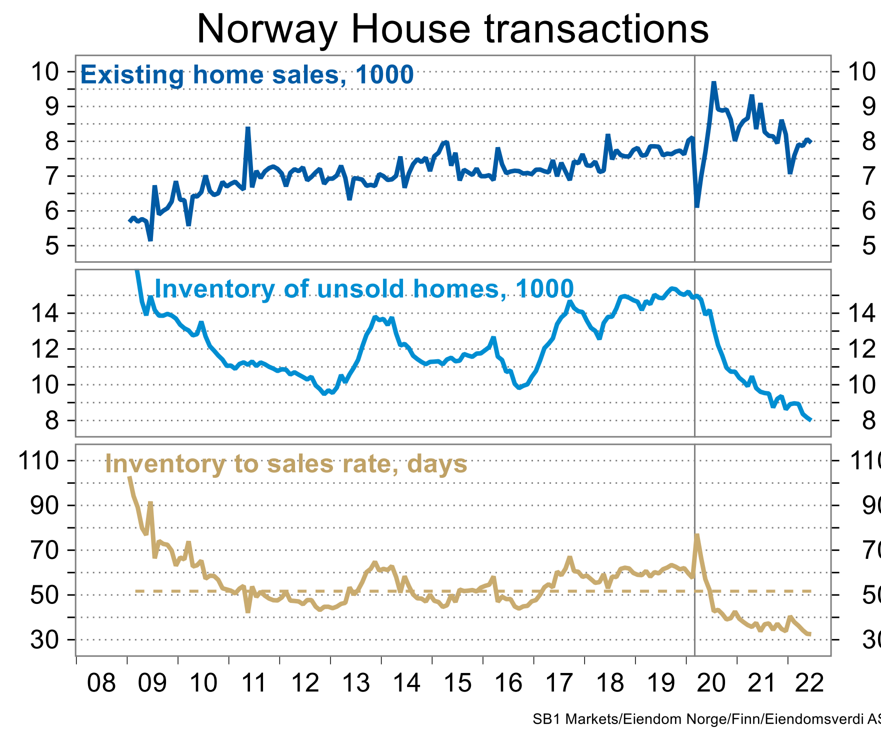




- **House prices** are still on the way up, but the 0.3% lift in June was the lower than over the previous months. The number of transactions fell marginally, and the inventory fell, to another record low level. New documentation requirements may have supressed supply in early 2022 but that excuse is now becoming less likely
- In the June MPR, **Norges Bank** expected that prices start declining in July, and continued downwards until Q2 next year, in sum by approx. 2¼%. The well announced interest rate 'shock' should lead to some weakening. If the current plan is not sufficient, rates will probably continue upwards until they bite. The reason: The main transmission mechanisms between interest rates and the real economy is through the housing market, and the impact on household disposable income. The currency link has not been working for a long while

# The number of transactions up in May, and the level is not low

Still, the inventory of listed homes fell further, to ATL

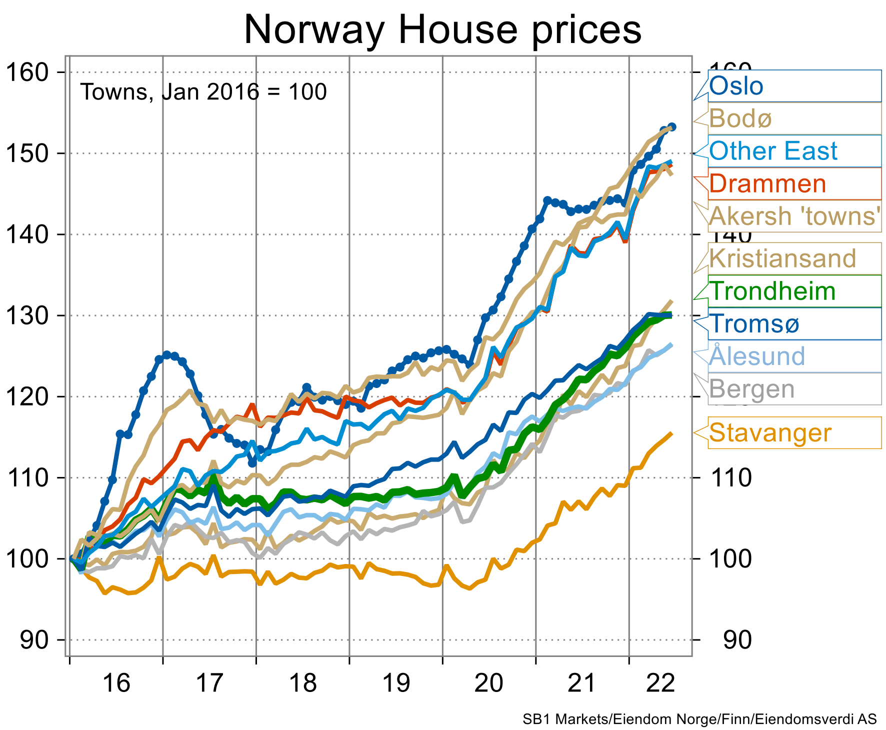


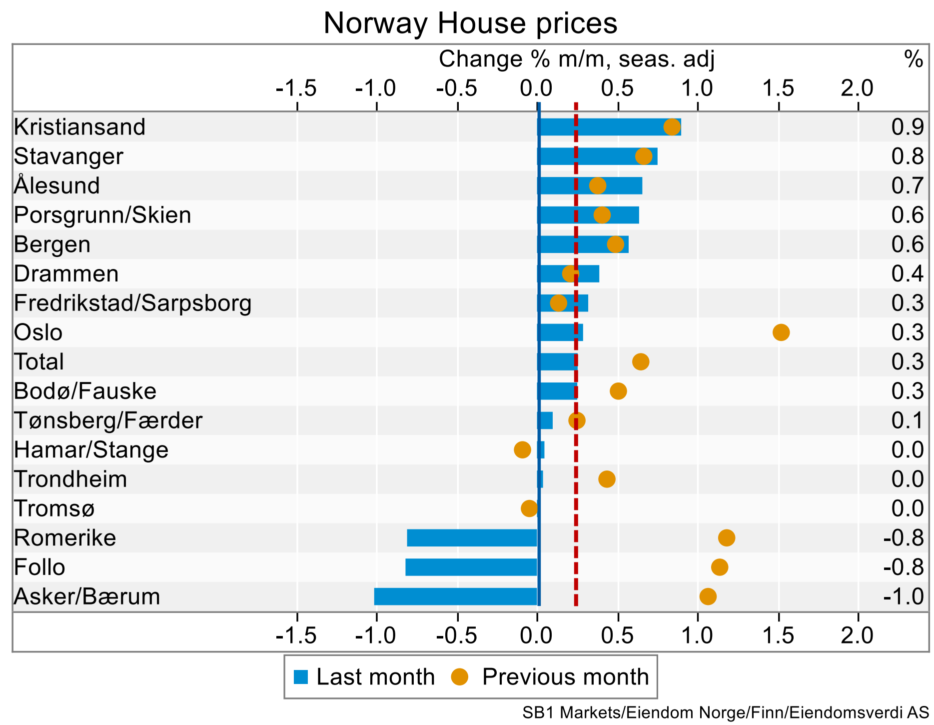




- **The number of transactions** has partially recovered following the large decline in January (new documentation requirements) but the level is lower than during the pandemic (but higher than before the pandemic!)
- The **supply of new existing homes for sale (approvals)** bottomed in December, and rose further in May
- The **inventory of unsold homes** declined in May, to the lowest level ever (since 2009, measured by this stats)
- The **inventory/sales ratio** declined 1 day to 33 days, vs an average at 52 days
- The **actual time on market** for those homes fell 1 day too, to 31 days, the fastest pace in almost 10 years (average 42 days)

# All cites but Hamar reported higher prices in May

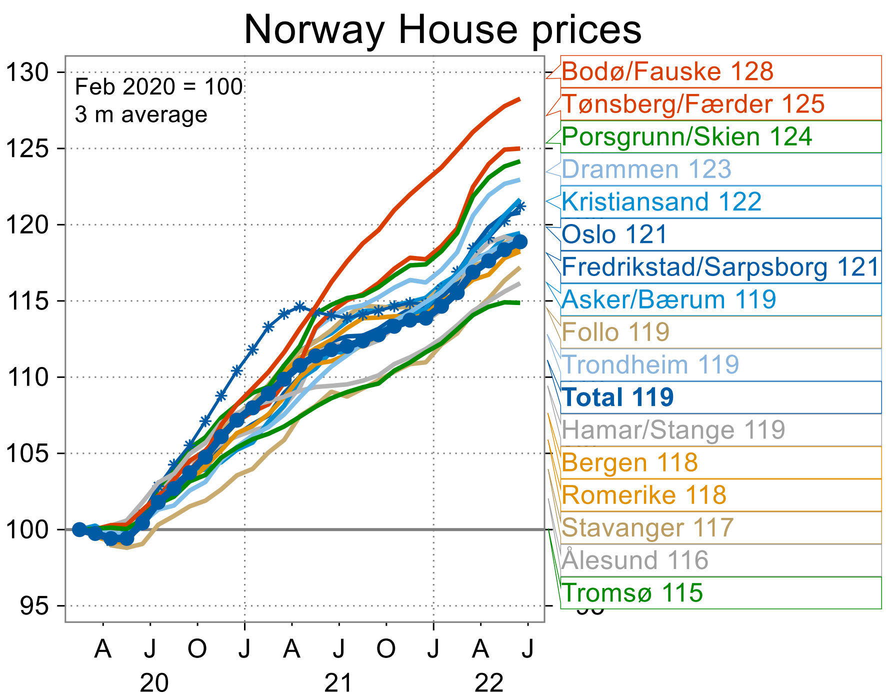
Oslo prices up 1.6%

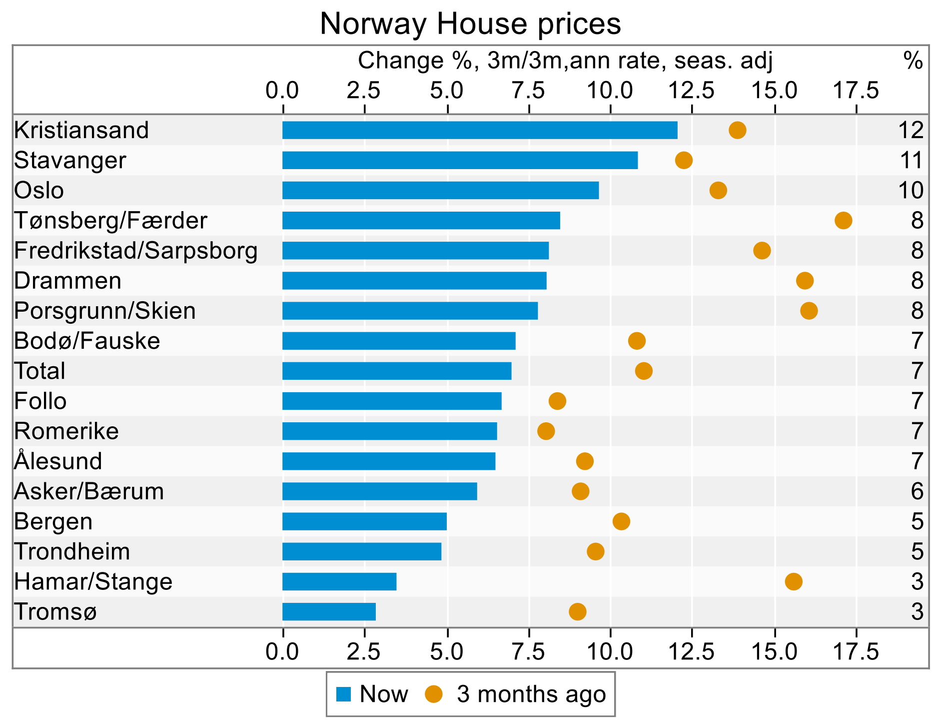


# The big picture: Now prices are climbing the fastest in the Outer East

## Bodø has lost some momentum



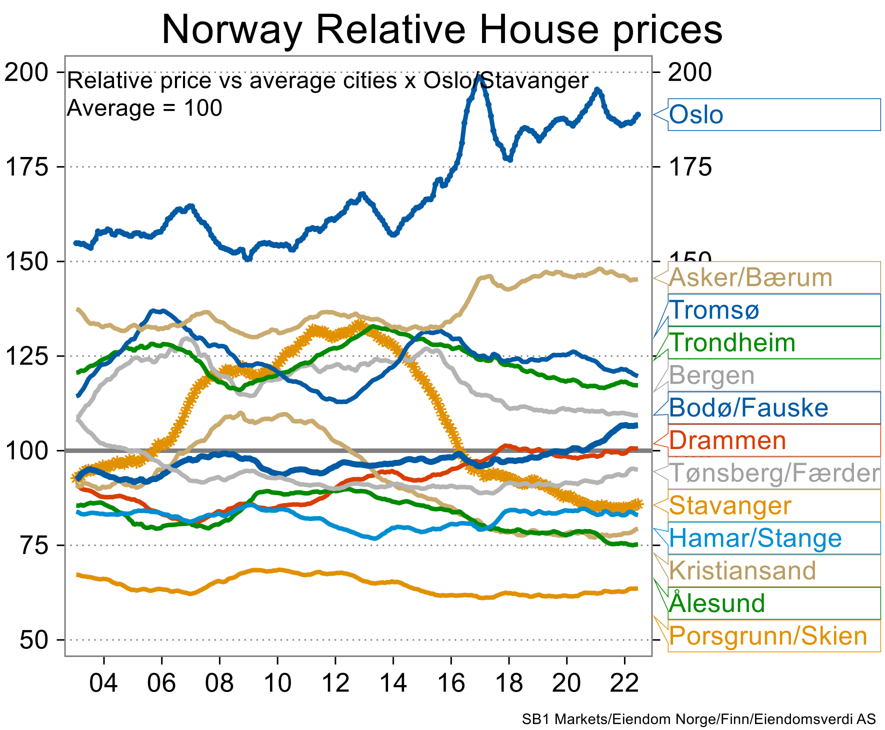



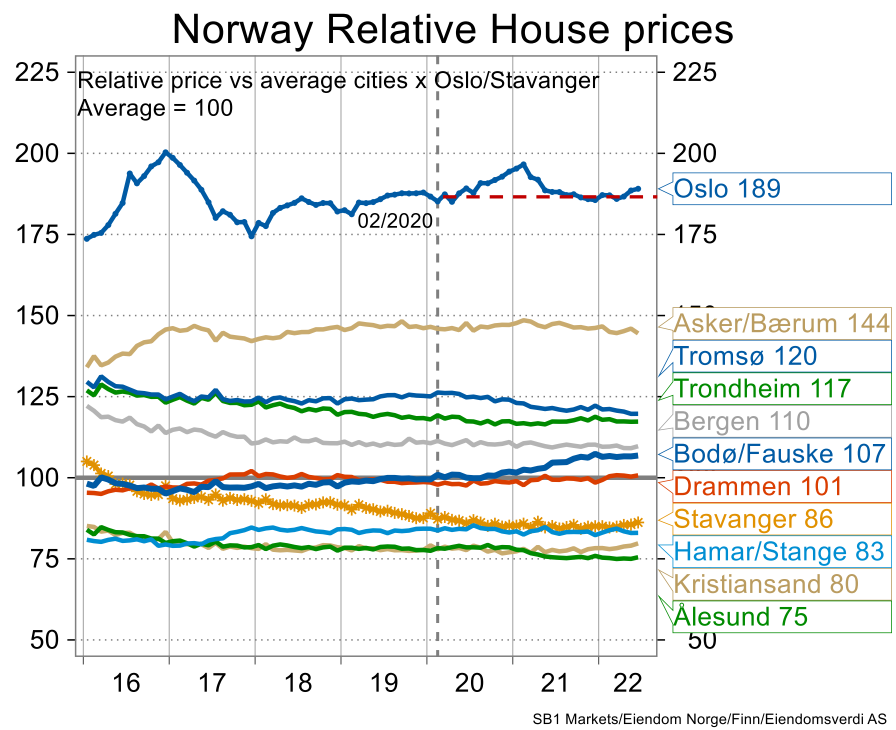

- Bodø the winner through the pandemic (but Oslo since 2016, check the previous page)
- After Bodø, eastern towns have been the winners since the start of the pandemic, Tønsberg, Porsgunn/Skien, Drammen and Fredrikstad/Sarpsborg, and prices are still climbing the fastest here
- Bergen, Stavanger, Ålesund and Tromsø at the bottom of the list (vs. early 2000)

SpareBank 1 MARKETS

# Oslo relative prices above the pre-pandemic level again

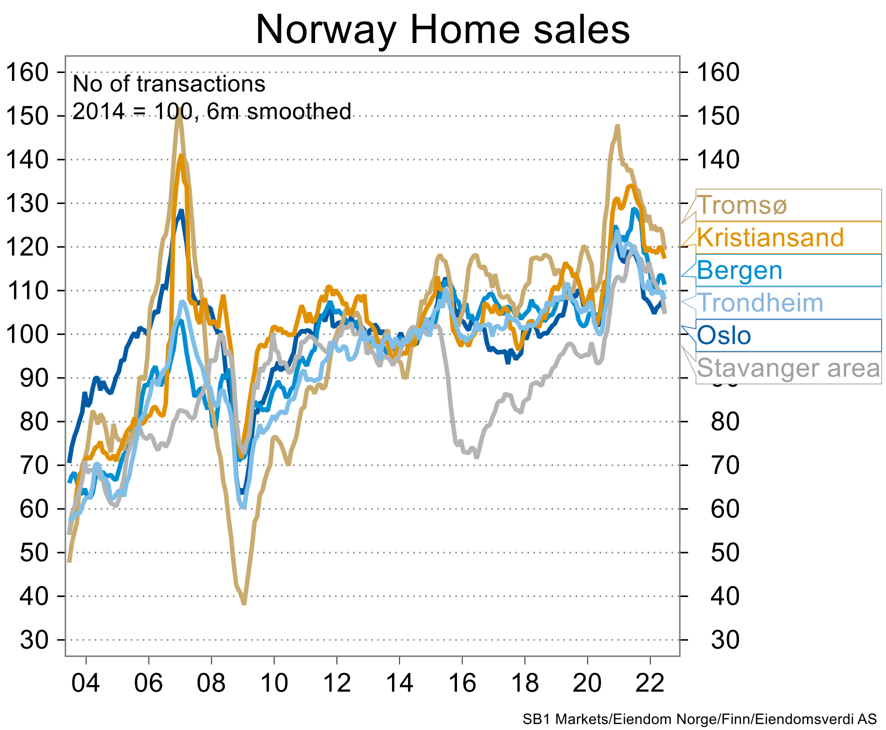
Stavanger is slowly climbing again, relatively

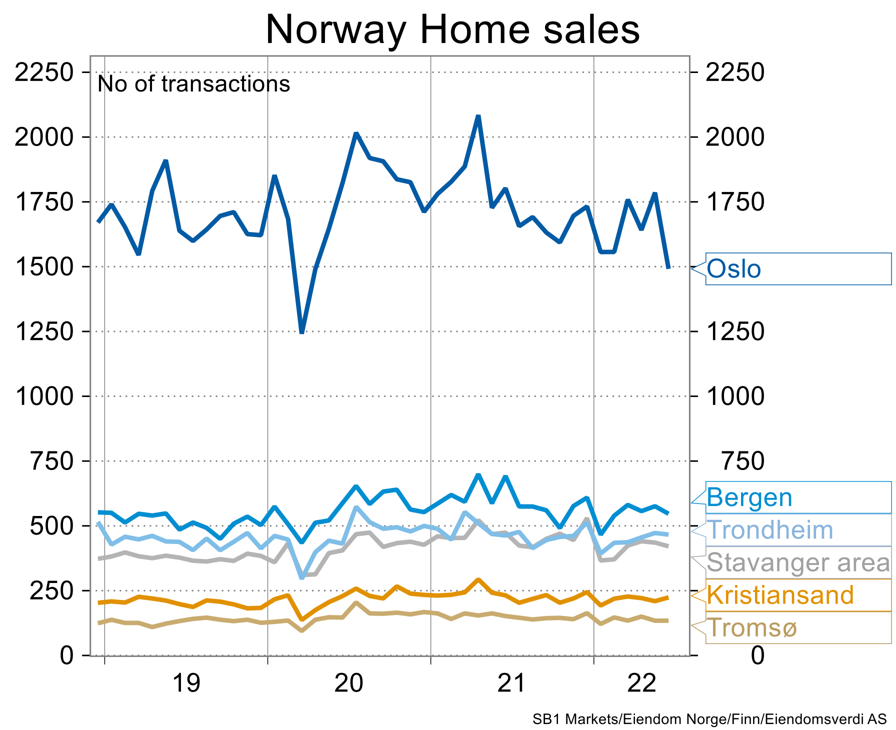



- Housing starts in Stavanger/Rogaland are still not lower than normal. It is still profitable to build, even at 'Hamar/Stange' prices! And why shouldn't it??

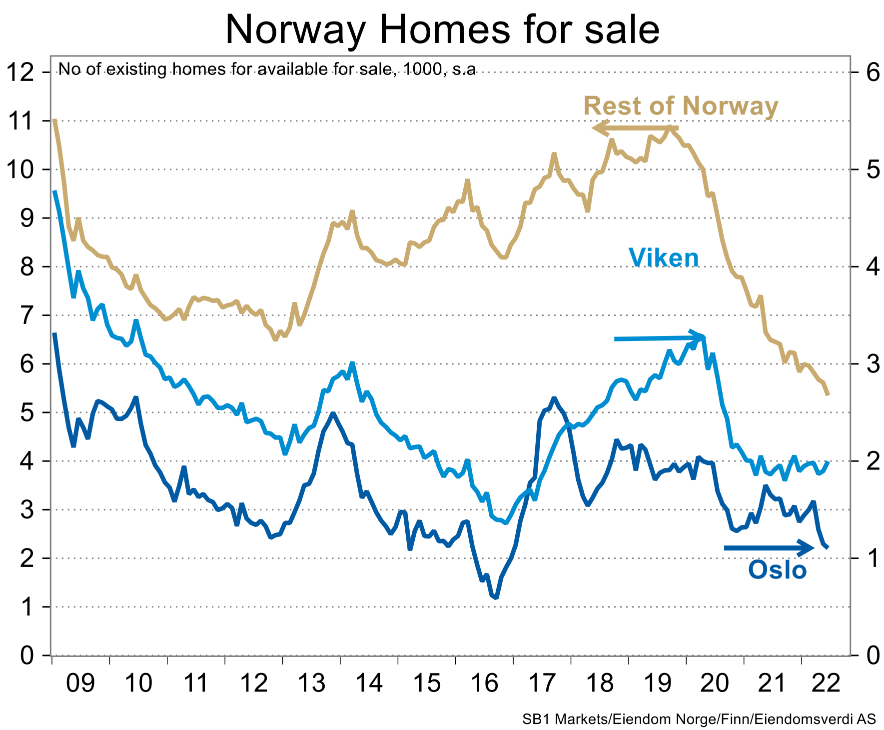
# Number of transactions down past months but just Oslo in June

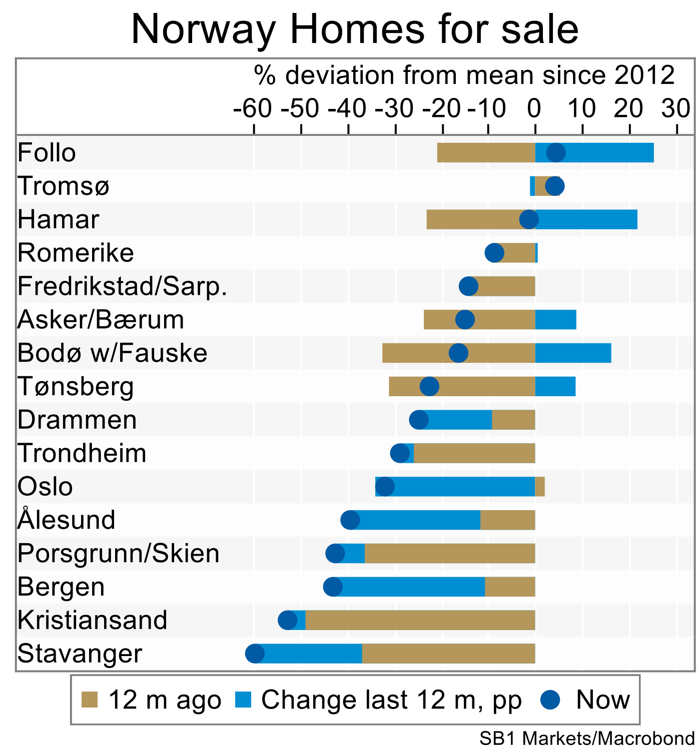


# The inventory is lower than normal everywhere (except in Follo and Tromsø)

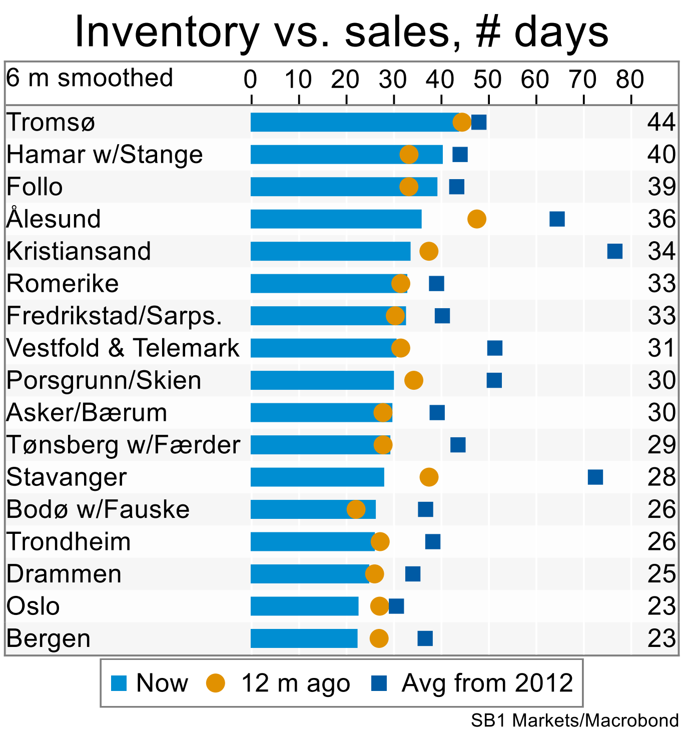
...and the inventory is falling 8 in cities, increasing in 5, and is flat in 3. Oslo reports the largest decline



# The inventory is turned around faster than normal everywhere

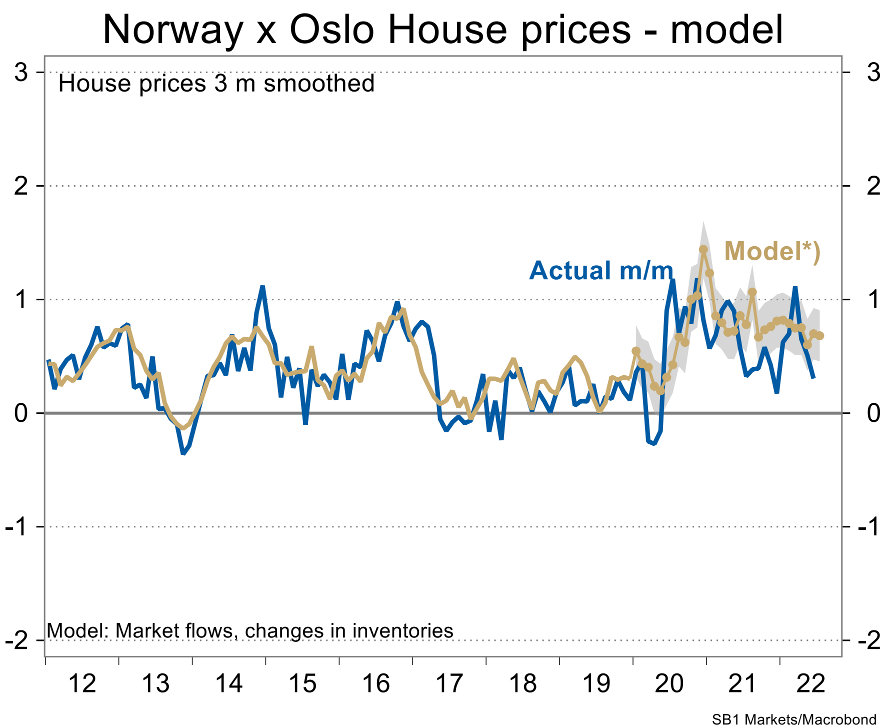
## Though with substantial regional differences – and some cities are reporting a slower turnaround

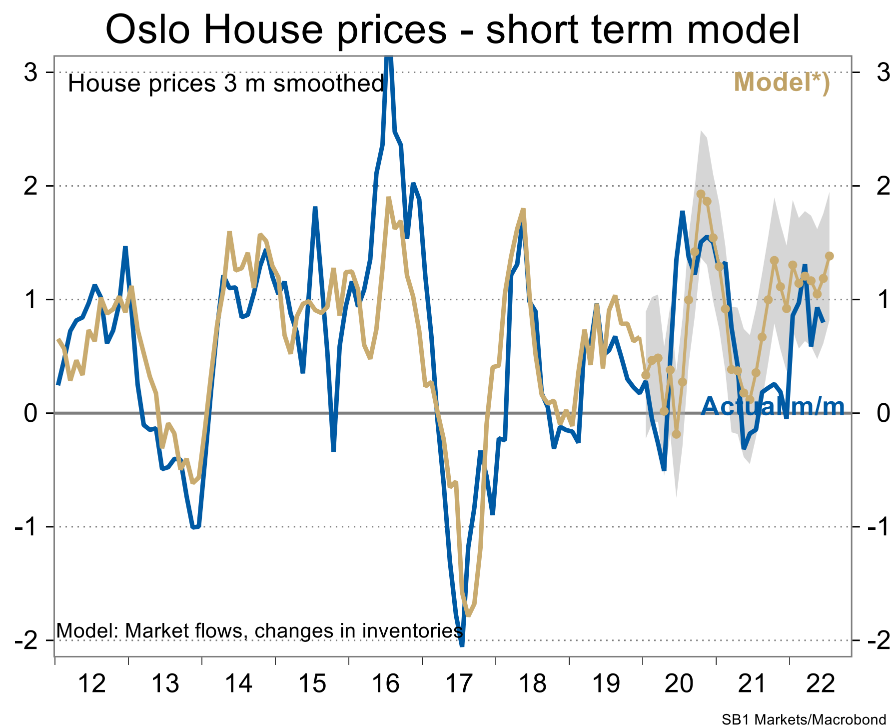



- On average, the i/s ratio has fallen the past 12 months – the most in Stavanger and Ålesund

SpareBank 1 MARKETS

# Short term market flows suggest decent price growth

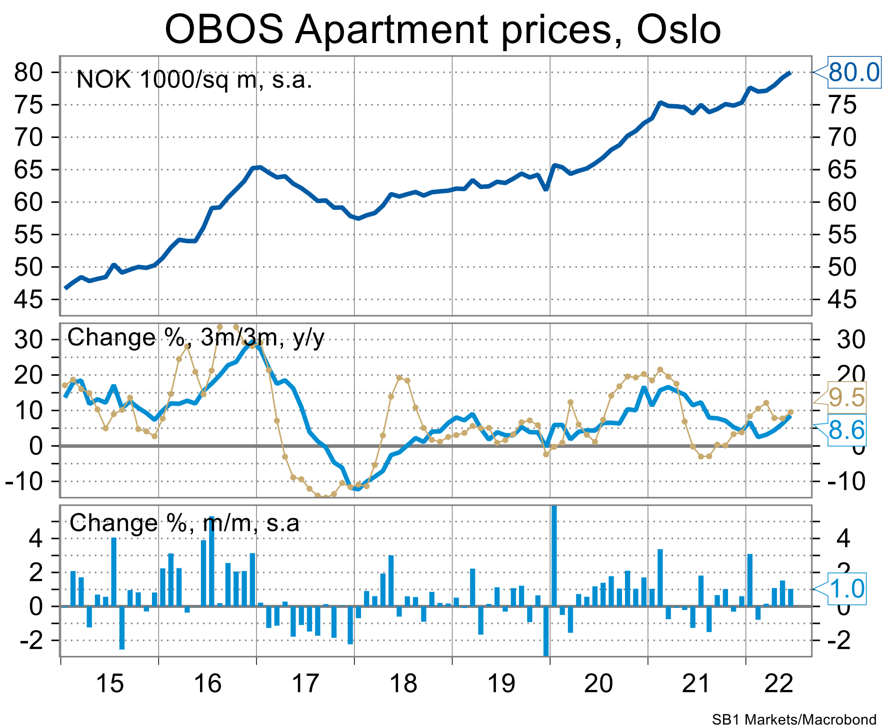


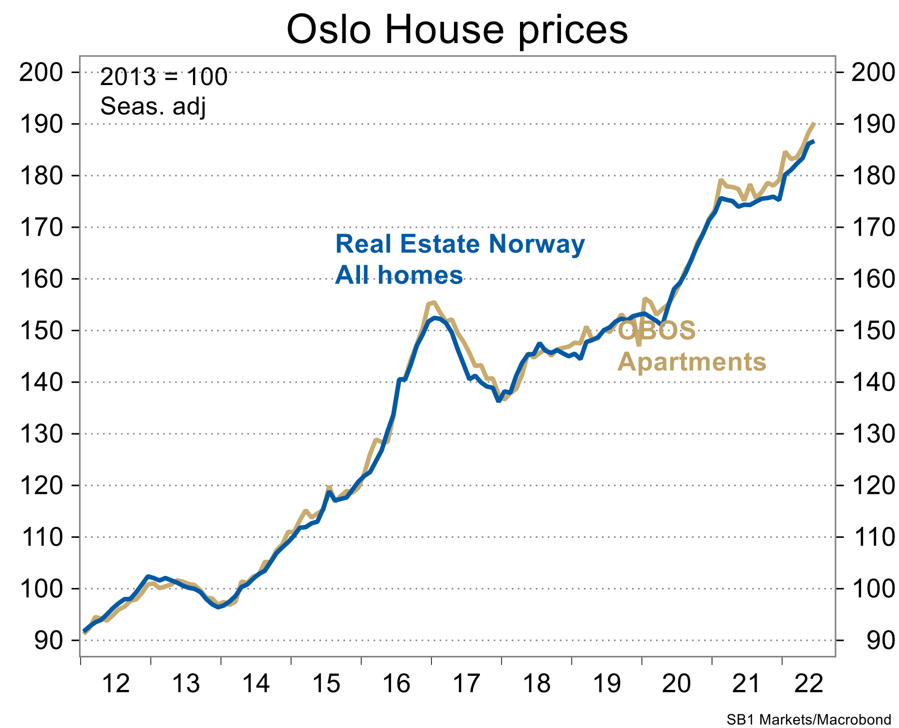




- Our **national x Oslo model** based on flows and the inventory signals a 0.7% growth in house prices per month, marginally above the 0.3% rate past 3 months
- Our **Oslo model** signals well above 1% growth, above the 0.8% lift per month the past 3 months
- **Mortgage rates** are not included in these short-term market models, because they have not consistently added to the models' performance. Still, over time, mortgage rates and credit growth are important driver for house prices, and now rates are on the way up
- *These models are not long-term price models, just short-term models based on flows of (existing) houses approved for sale, actual sales and changes in inventories – which are normally correlated to prices*

SpareBank 1 MARKETS

# OBOS apartment prices up 1.0% in June, up 8.6 y/y!

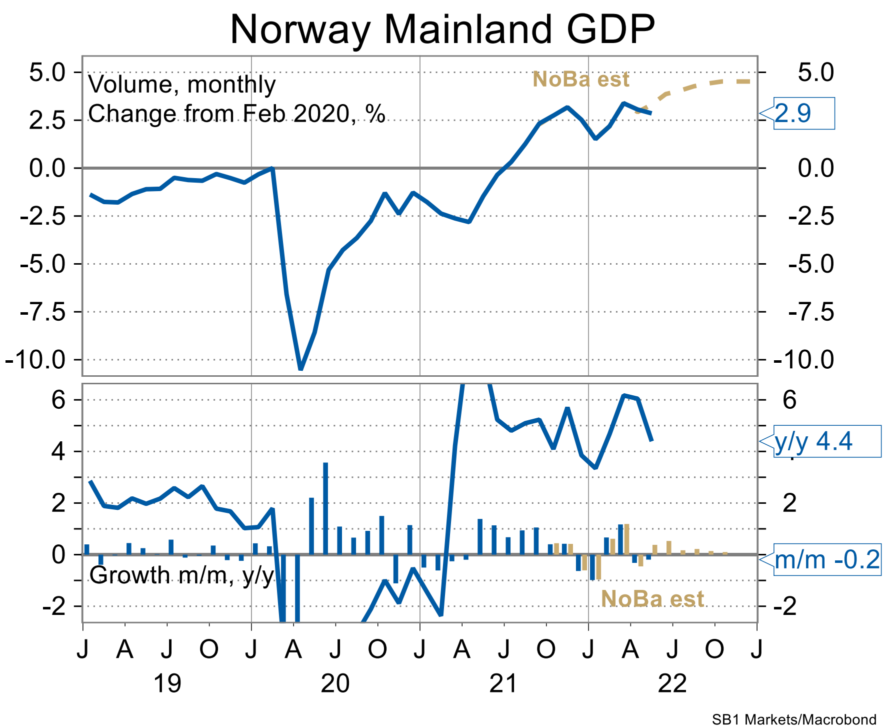



Co-op apartment prices follow the overall Oslo market quite closely, the average price level is somewhat lower than total Oslo market

# Mainland GDP down 0.2% in May, following the 0.3% drop in April

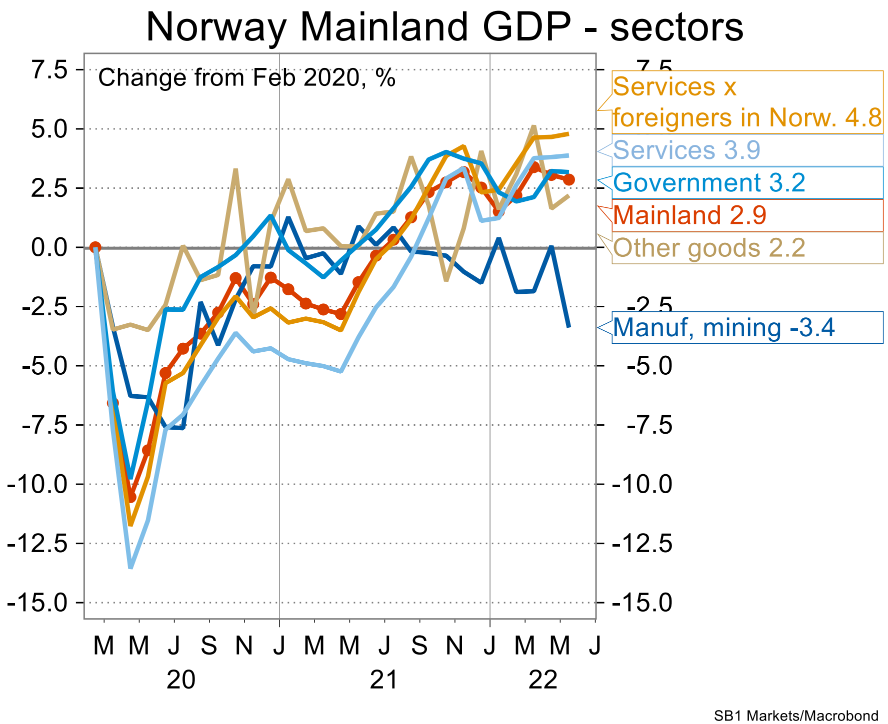
## The post-pandemic normalisation is mostly over. Manufacturing production the weak link in May

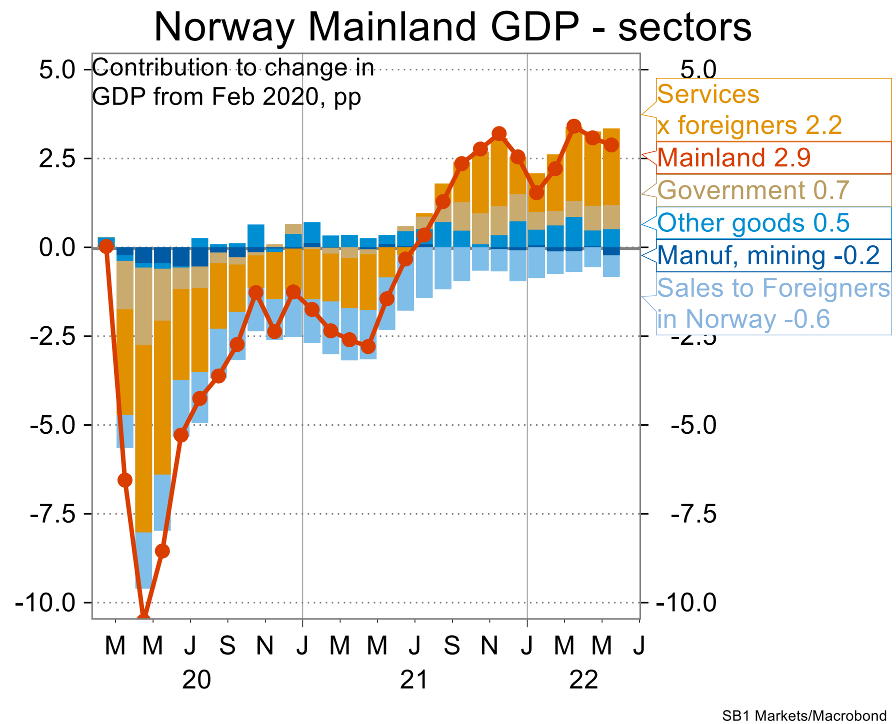



- **Mainland GDP** has fallen the two past months, both have been weaker than expected. April was revised slightly up, but production still fell 0.3%. The trend is still upwards but both supply and demand factors may dampen growth going forward
  - » **Production:** Manufacturing production fell 3.4% in May, a rather surprising decline. The other main sectors reported growth in May
  - » **Demand:** Household demand in Norway fell slightly in April and May, and in May without an increase in spending abroad. Both housing, Mainland business and oil sector investments rose in May. Net exports fell
- **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, and close to record low levels, 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

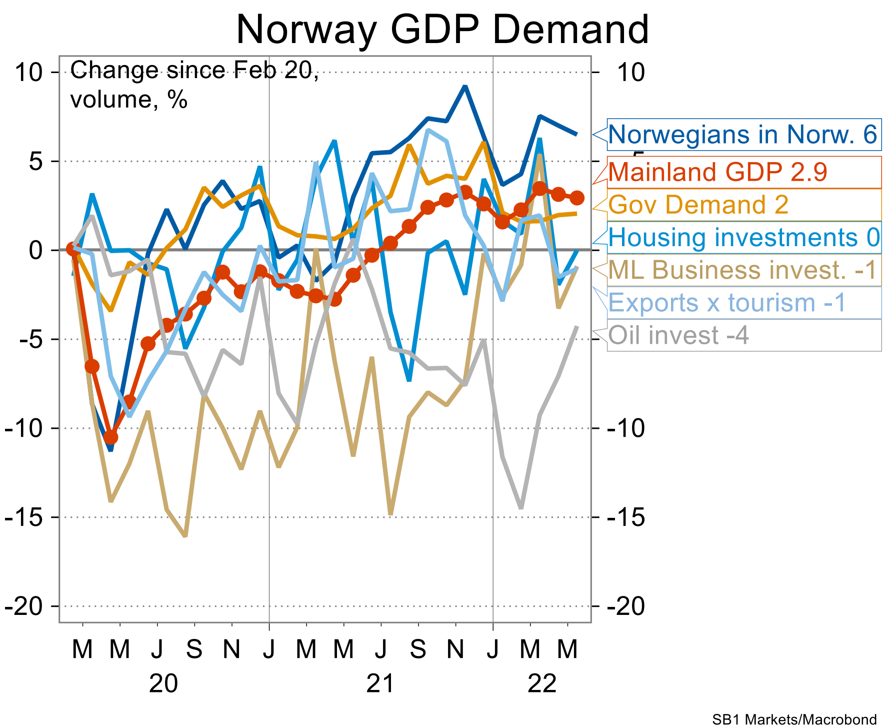


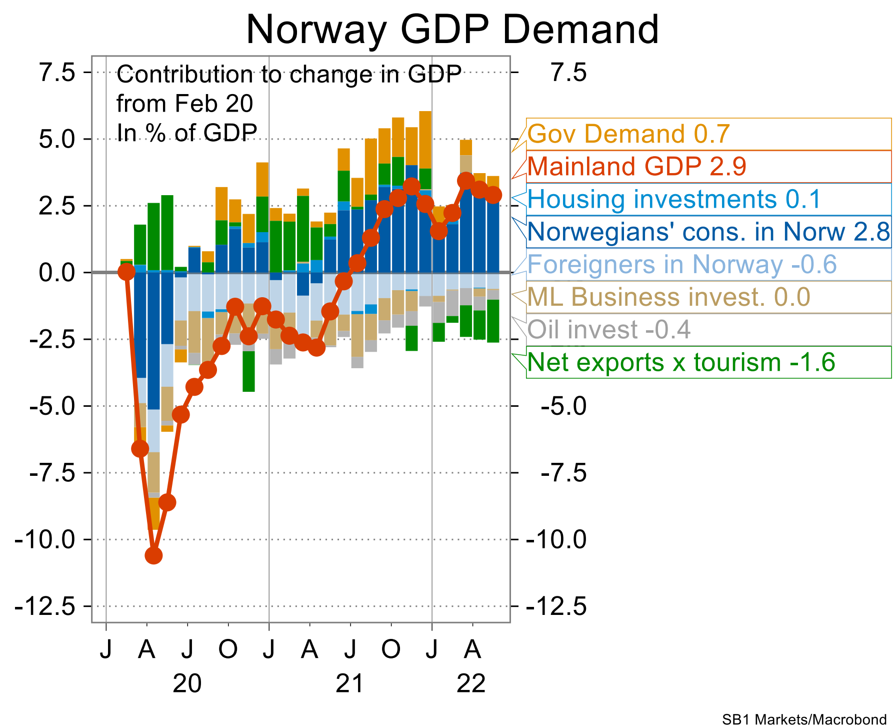




- The ‘others’ sector includes electricity (which fell 6%), fish-farming, fisheries and construction. In April, el. production, fish-farming in addition to trade (included in services) fell

# Demand: Consumption in Norway down in April/May – investments up in May

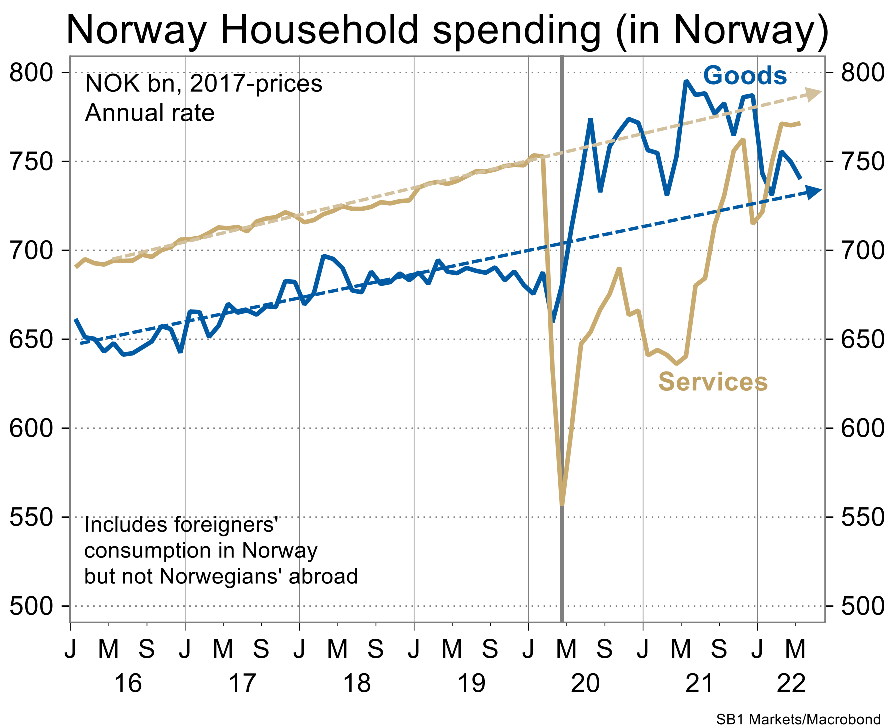
Net imports also contributed on the downside in May

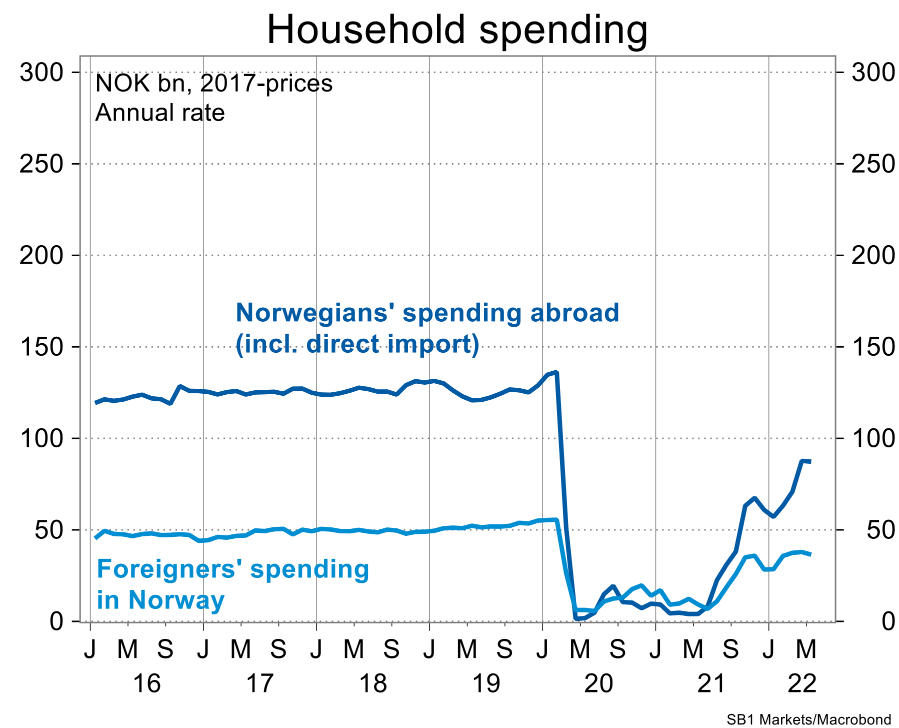


# Spending on goods back down to the (pre)pre-pandemic trend

## Services has almost recovered but remains somewhat below the old trend

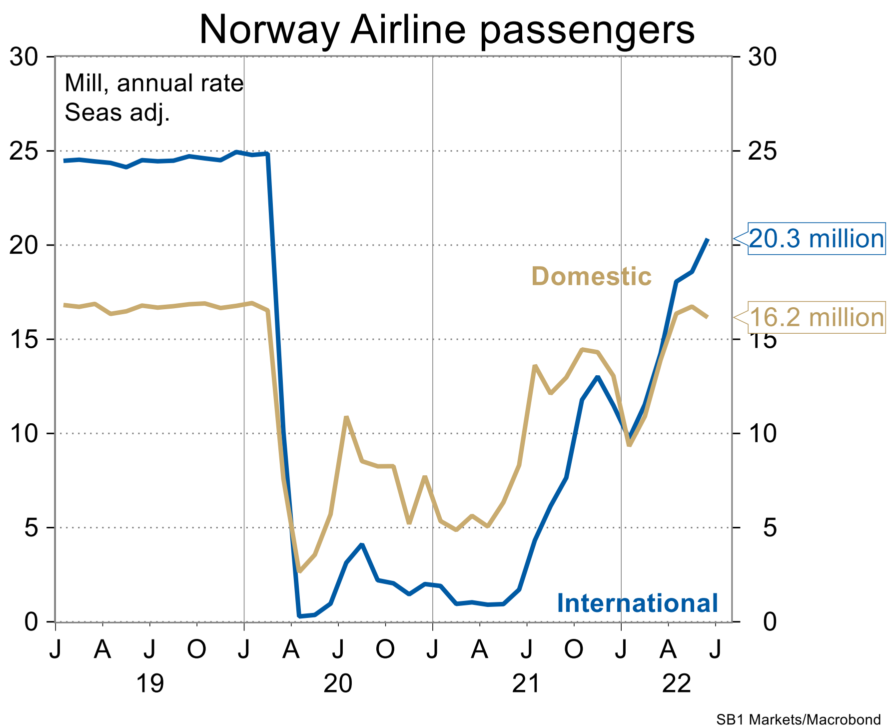


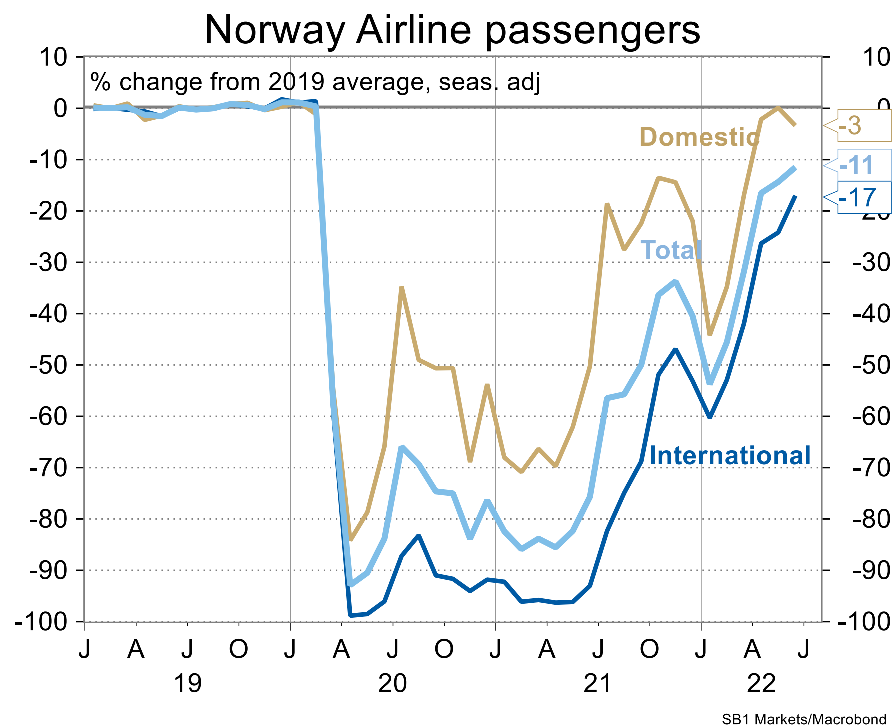




- Spending abroad still almost 30% a normal level – and will probably recover further the coming months/quarters
- Foreigners’ spending in Norway is also down 30% vs the pre-pandemic level

# International airline traffic further up in June, still 17% down vs. the 2019 level

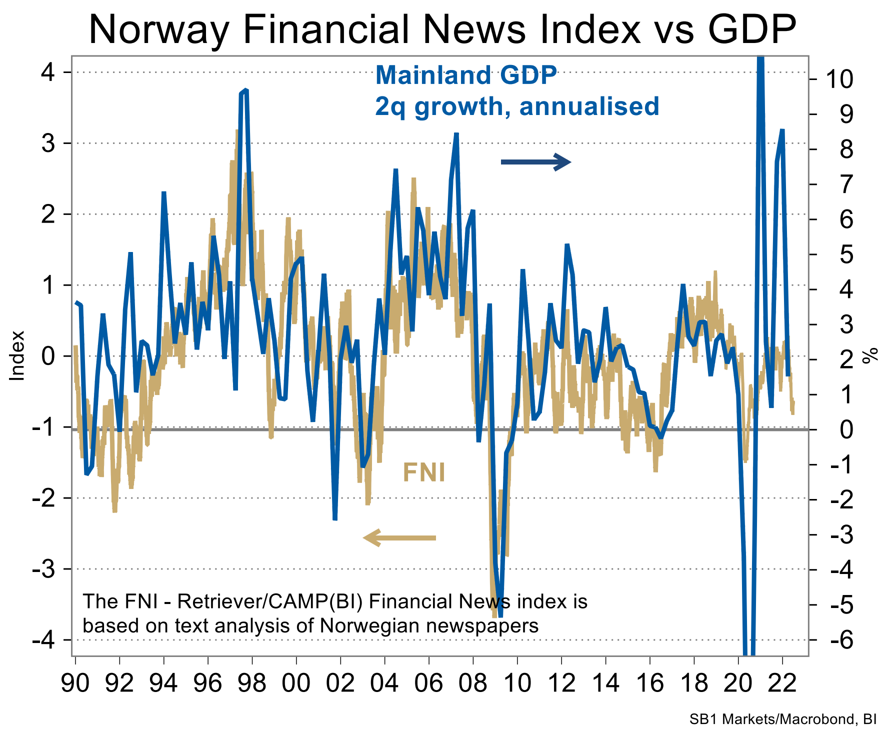
## Domestic traffic is back to a normal level – and fell slightly in June

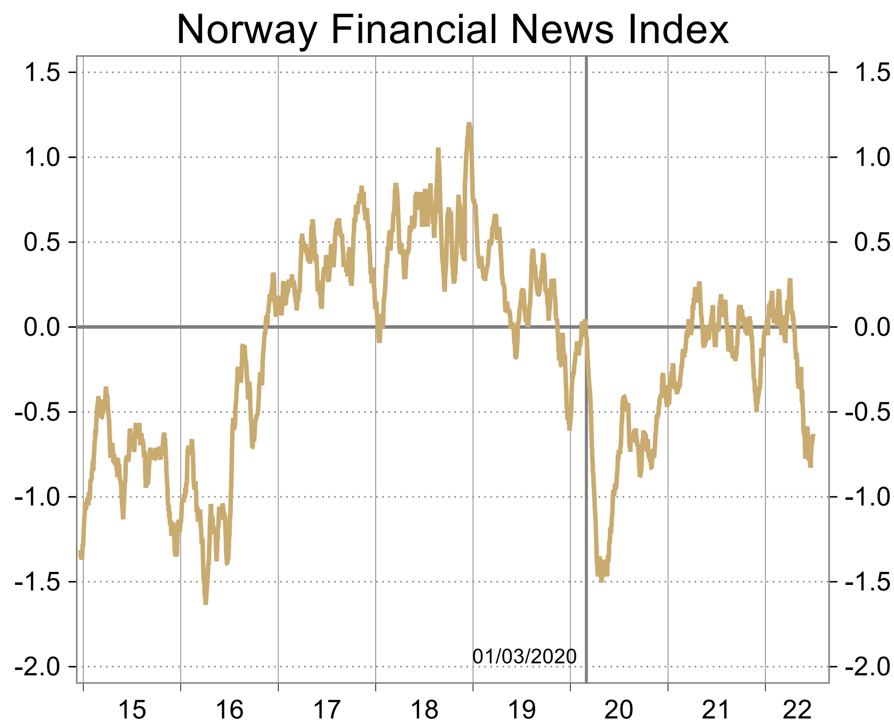


# The Financial News Index confirms a growth slowdown

## The FNI has fallen since the war started and recession risk debates have blossomed everywhere




- In June, the index stabilised following a decline equalling a 2 pp GDP growth slowdown – down to a 0.5 pp growth pace
- The FNI has not tracked the post-pandemic recovery well – but growth data has been much more volatile than normal

Financial News Index is based on an analysis of text in Norwegian newspapers covering the economy, tracking 'economic' words and assessments. The index follows the cycle well but is rather volatile, short term. The FNI is published by Retriever/CAMP(BI)

Highlights

The world around us

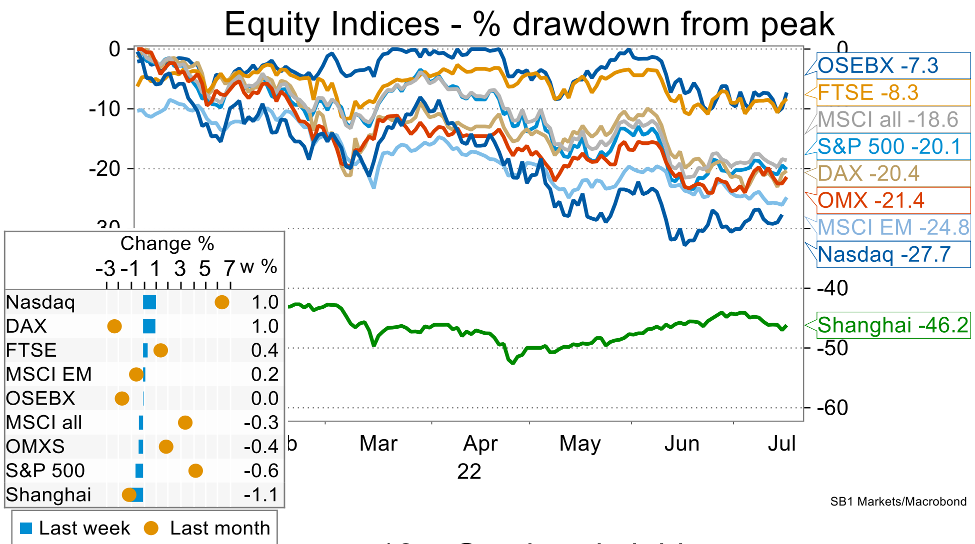
The Norwegian economy

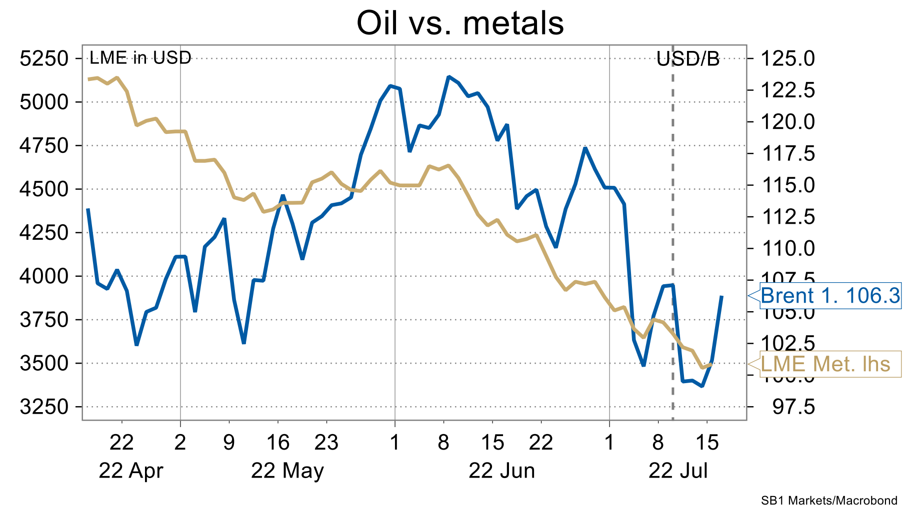
Market charts & comments

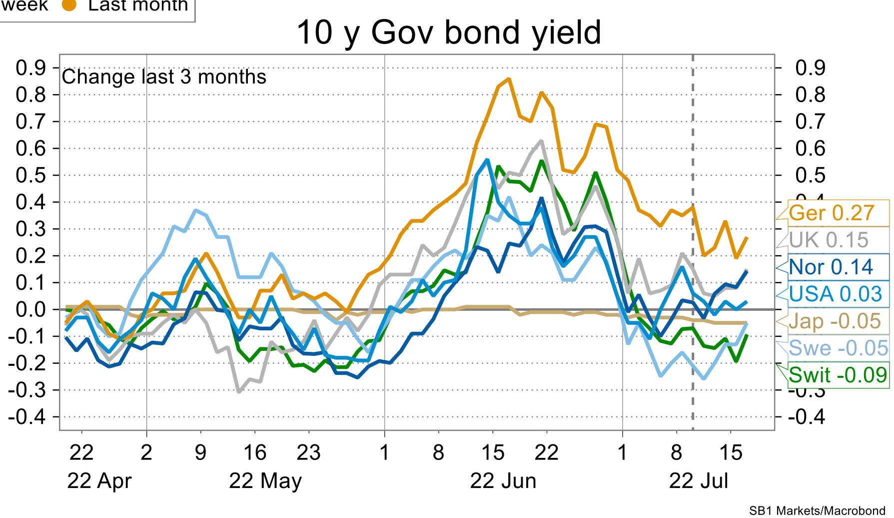
SpareBank 1 MARKETS

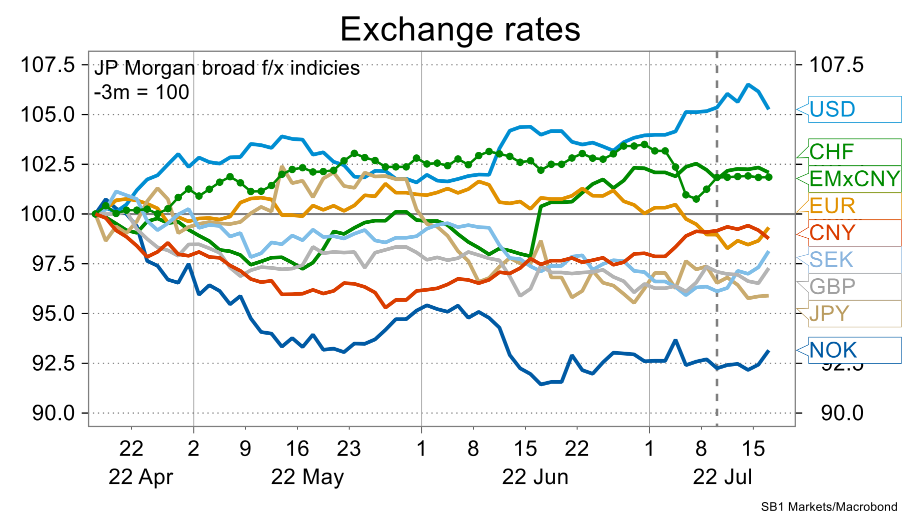
# Equity markets still volatile, mix last week. Oil, metals are trending down

… signalling a weaker growth outlook. Bond yields mixed last week, are mostly down so far in July



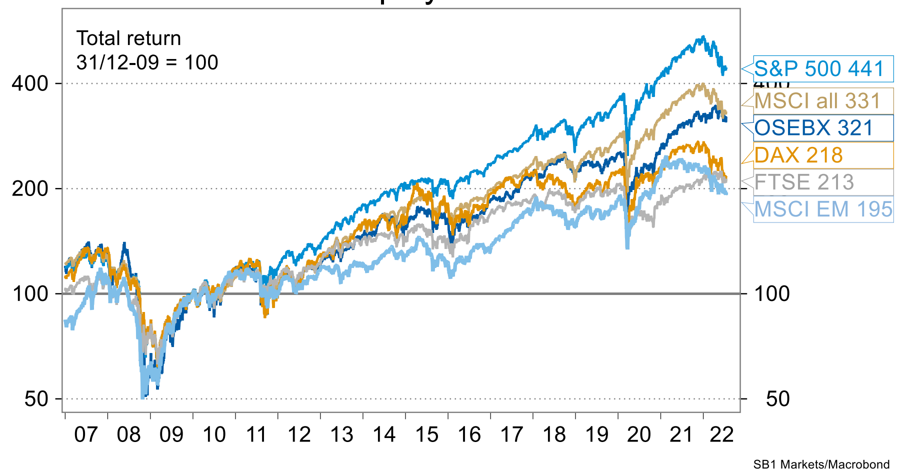



SpareBank 1 MARKETS

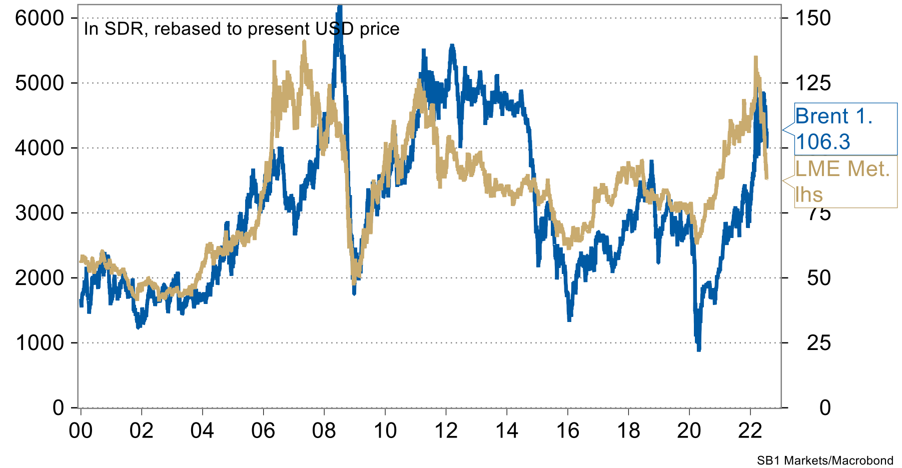
# The big picture: Stock markets down, bond yields up.

## Commodities on the way up until early March: and mostly down thereafter

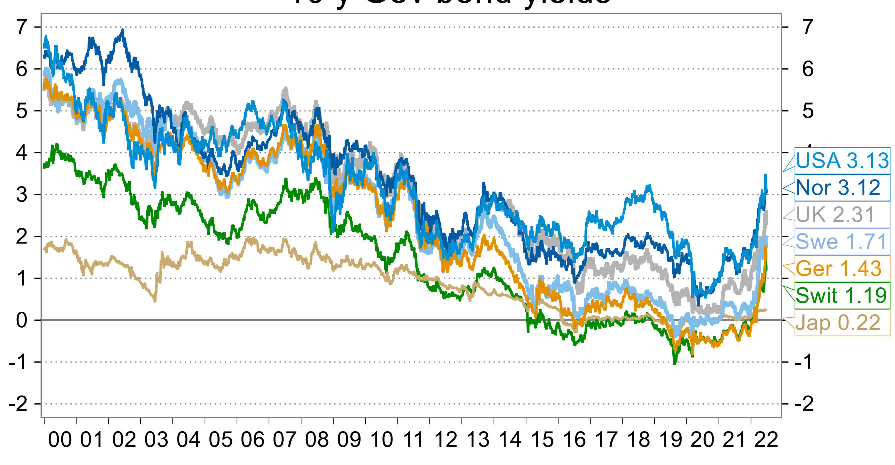
Equity Indices



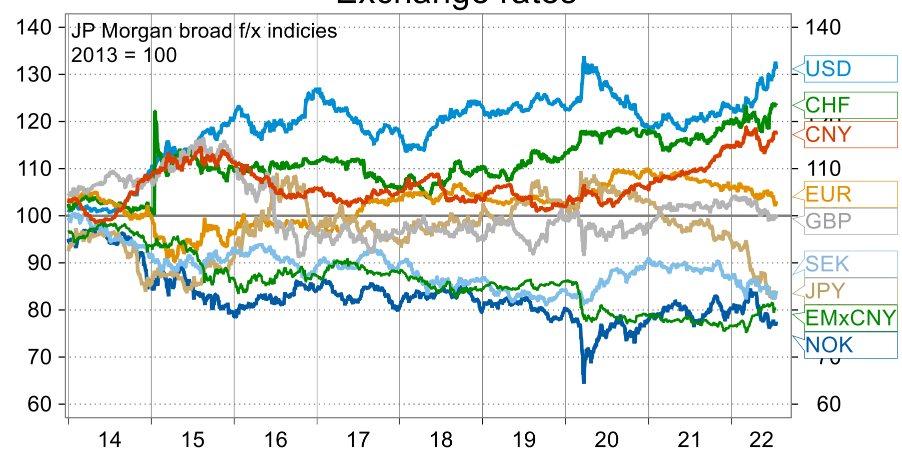

Oil vs. metals




10 y Gov bond yields

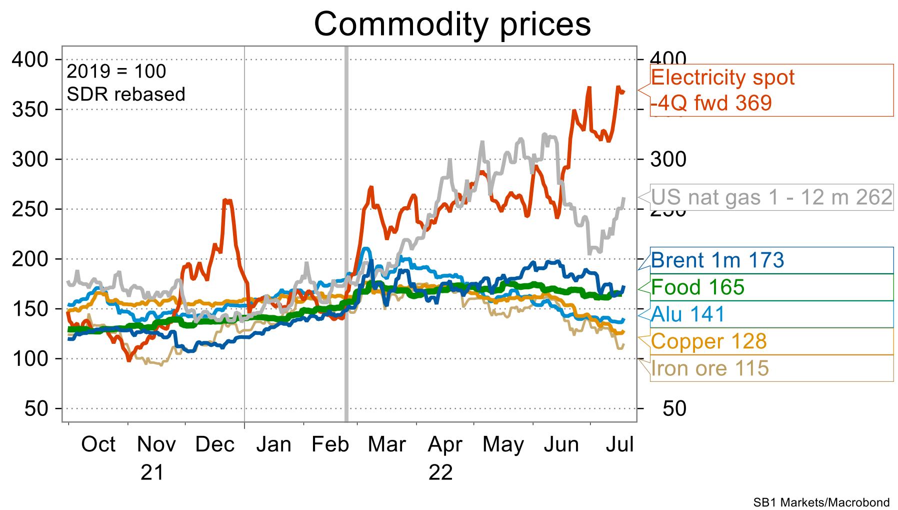


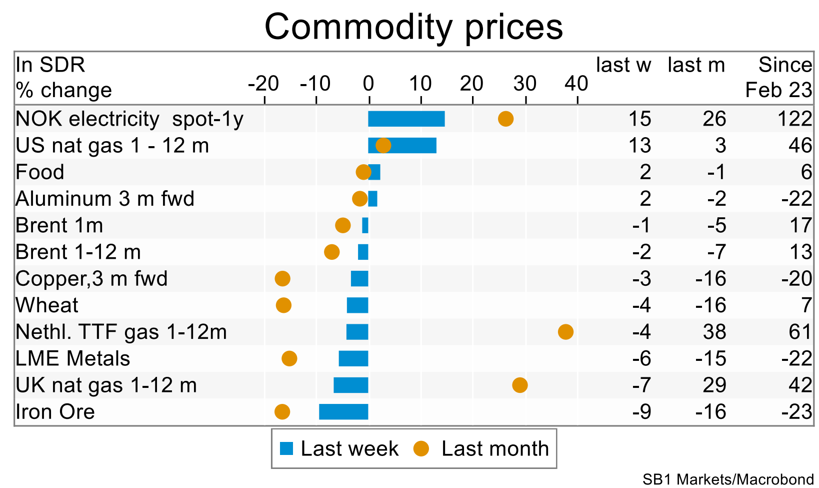

Exchange rates

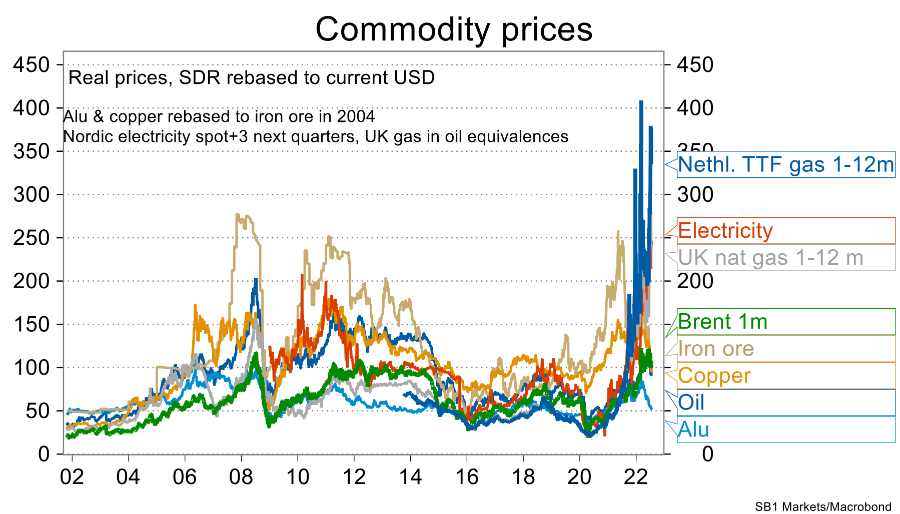


SpareBank 1 MARKETS

# Most commodity prices are on the way down, except European gas/el prices



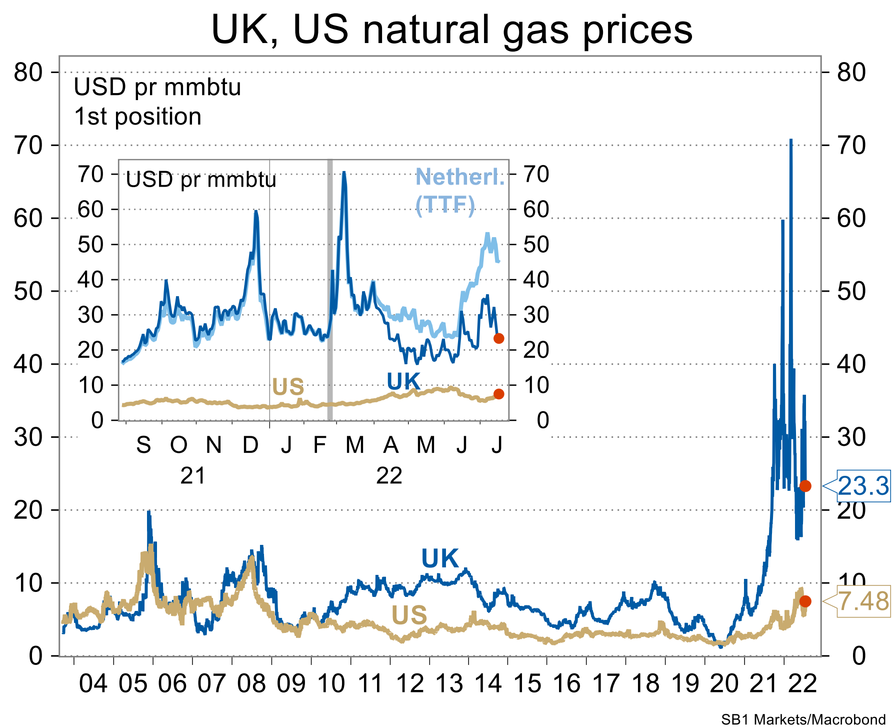



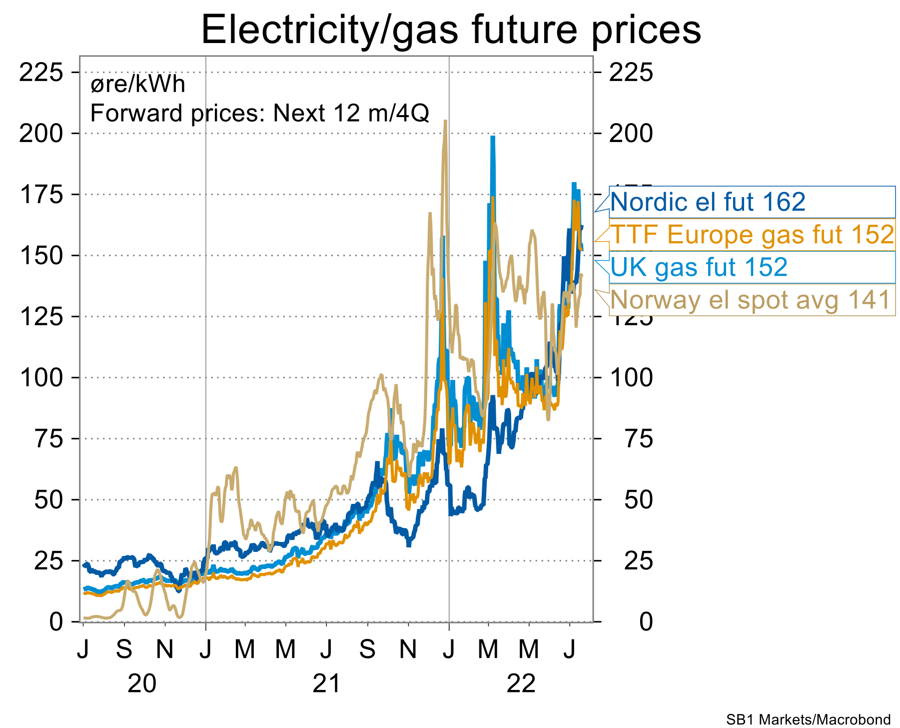

- Oil prices stabilised in the short end, prices fell further out of the curve
- European natural gas prices rose further last week – lack of Russian gas – and less US LNG the coming months due to the fire in a LNG plant
- US natural gas fell further, due to less export capacity
- The Economists food commodity index is trending slowly down, even measured in SDRs
- Metal prices are falling sharply

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

# European natural gas prices rose further, while prices are falling in US

## Lack of piped gas from Russia and less LNG from US the coming months

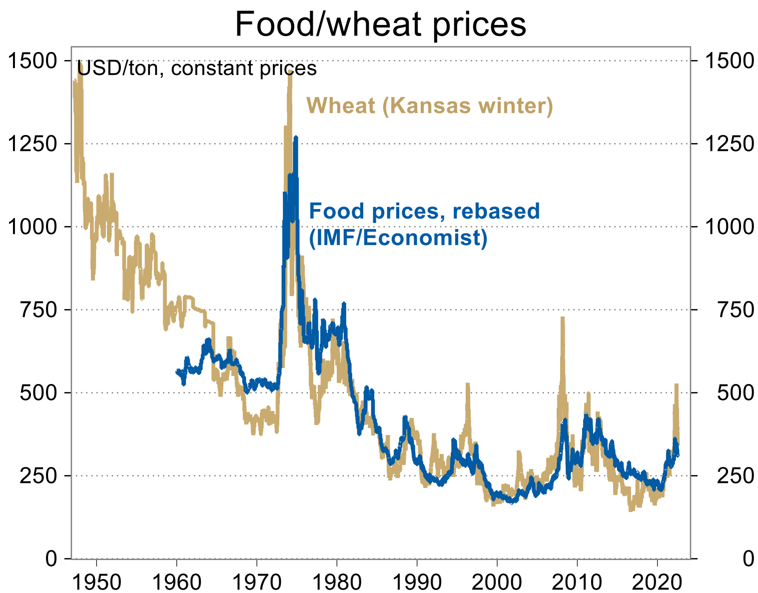


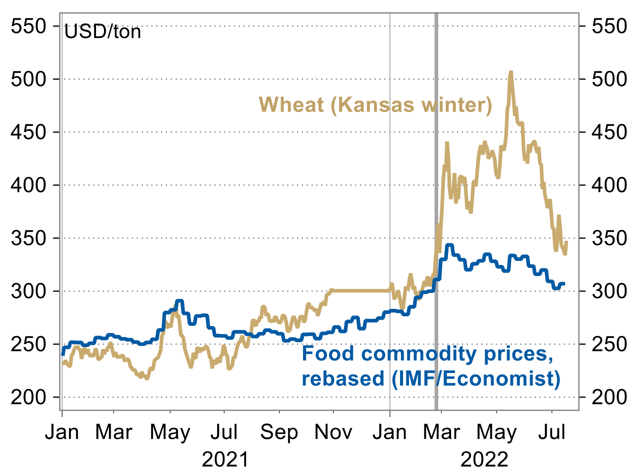



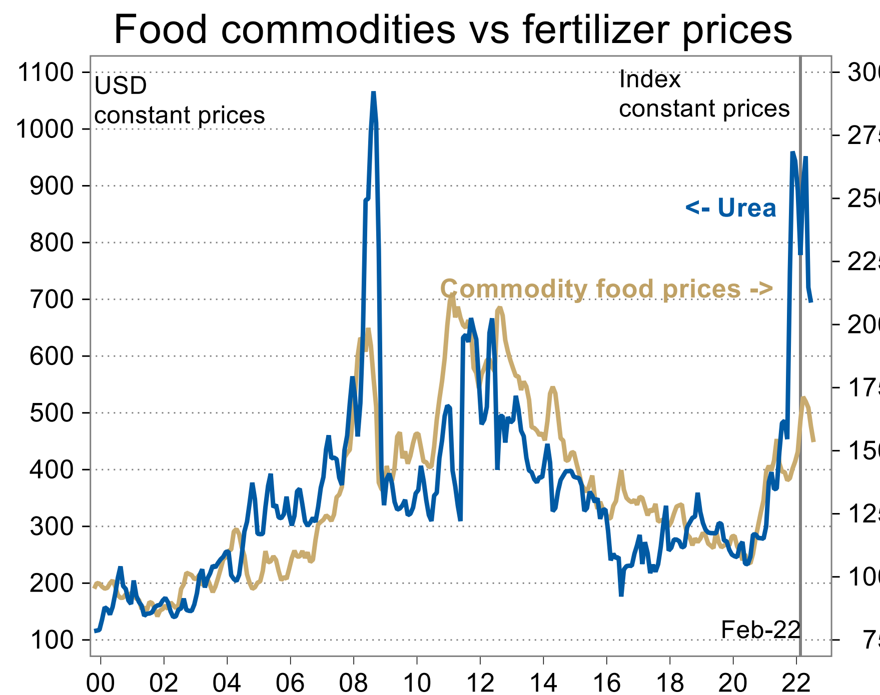

- Continental gas prices are twice as high as UK gas prices in the short end of the price curve, due to lack of transfer capacity, and risk for restrictions on UK gas exports to Europe
- However, for the coming 4 quarters, future prices are similar – and close to Nordic electricity prices

# Food prices are trending downwards

Wheat prices are falling rather rapidly and are up just 13% from before the war, from +60% at the top

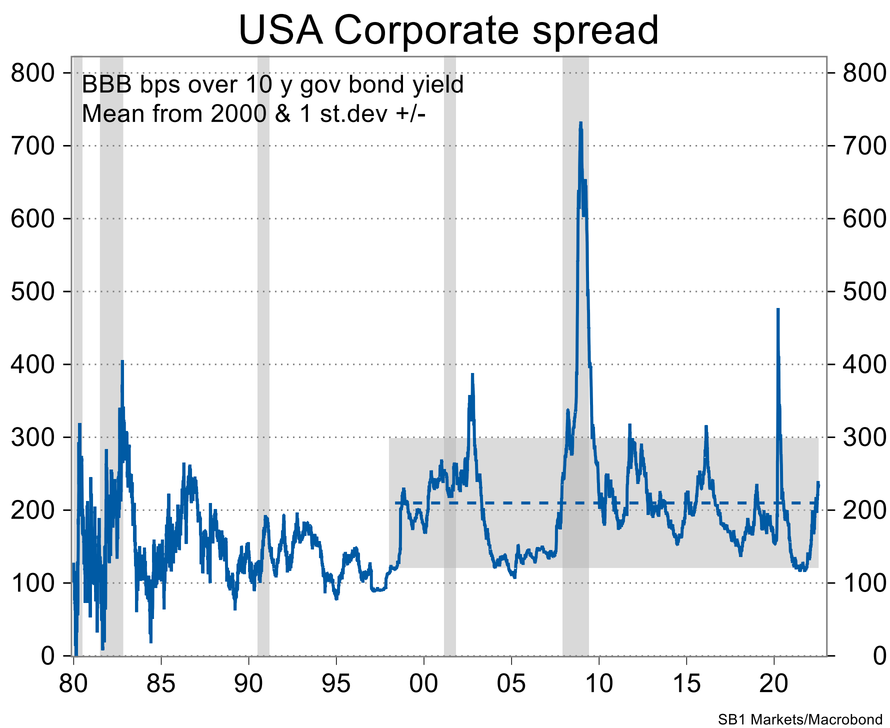


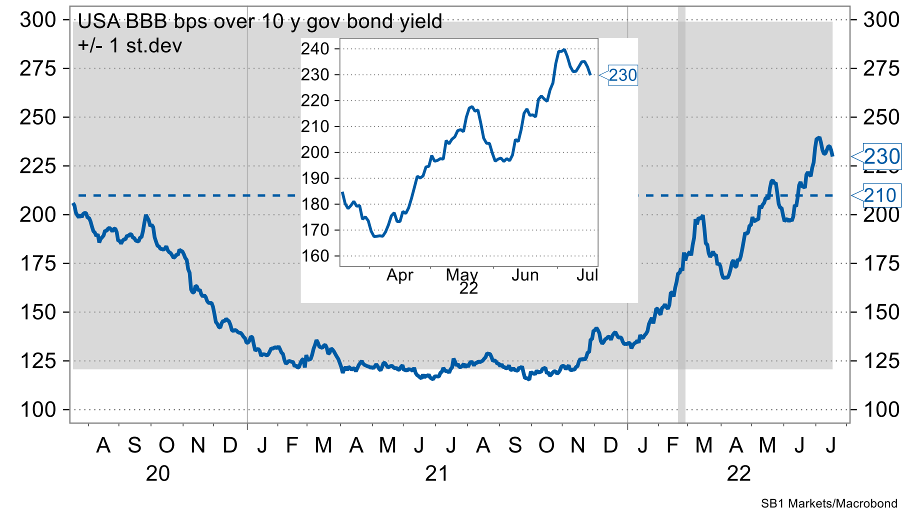




SB1 Markets/Macrobond

# Credit spreads have climbed to above average but fell marginally last week

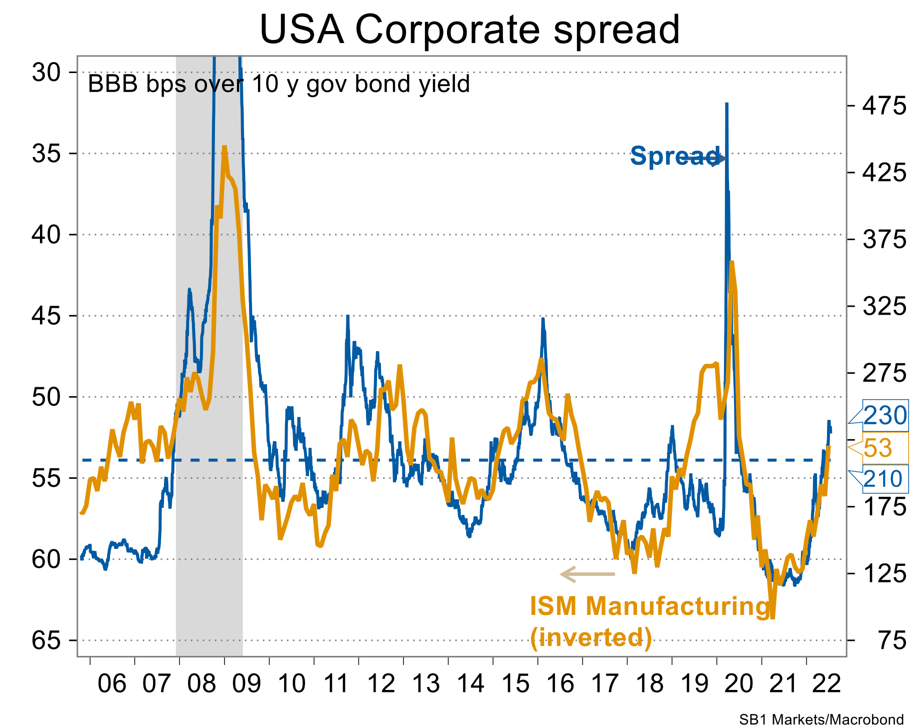


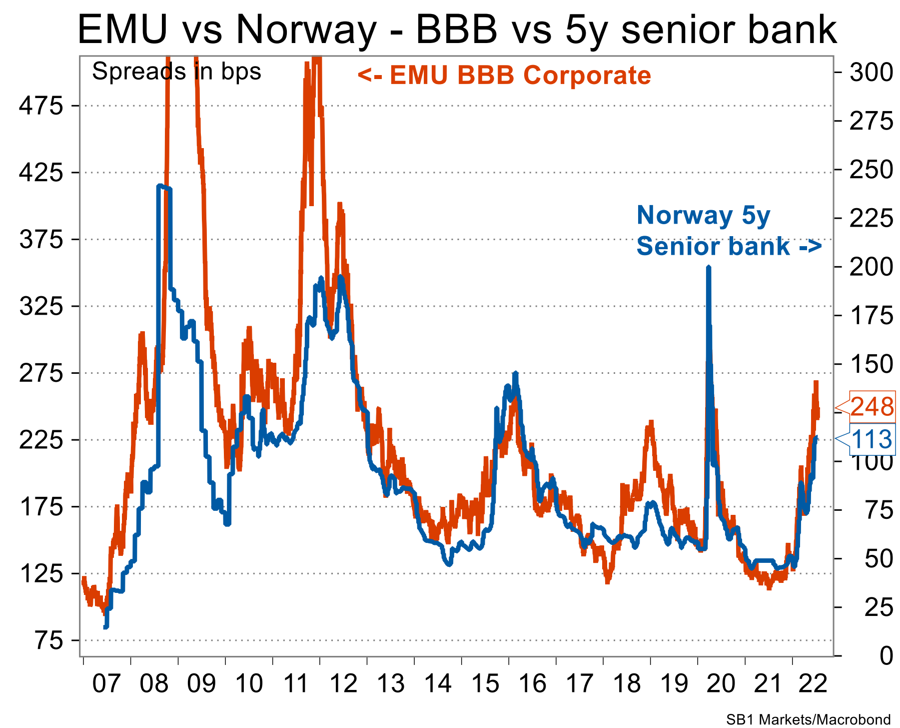




- The US BBB spread is up 110 bps from the bottom last autumn, more than a doubling

# Why are credit spreads widening? Could it be the slowing economy?

What do you think is more likely: An ISM at ~~50~~ 45 or 60 in some few months time? We are quite sure..

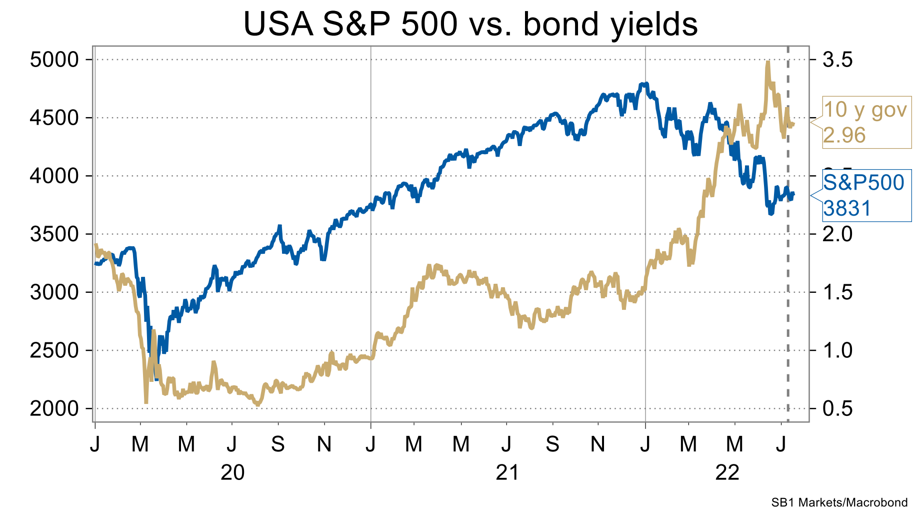


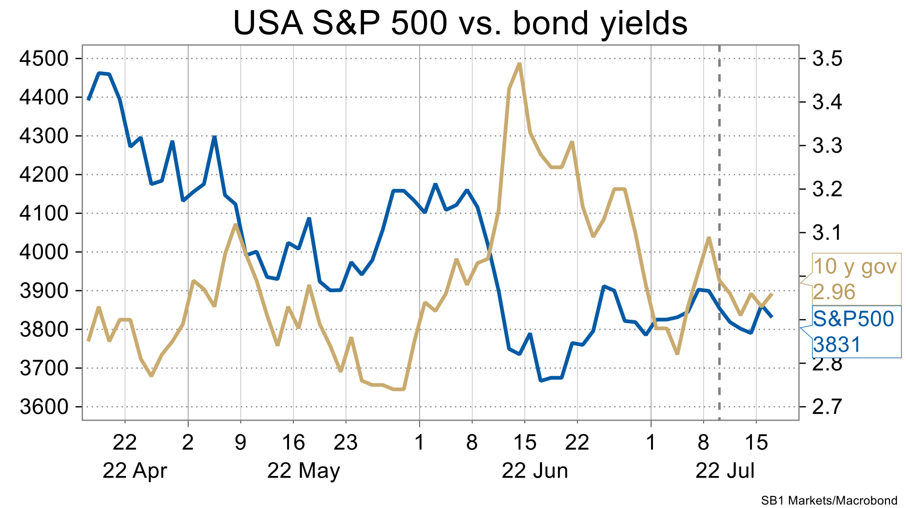



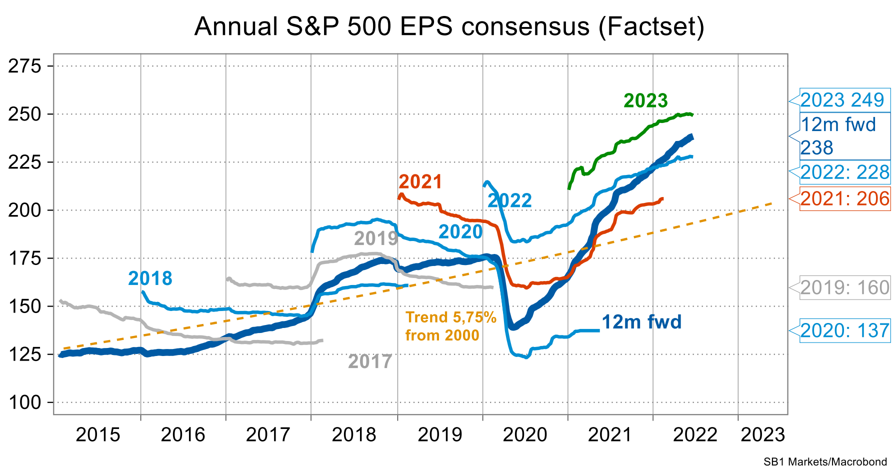

- The answer is not irrelevant for your view on the outlook for spreads, we think
- And do you think Norwegian spreads will be influenced by changes in the global credit market?

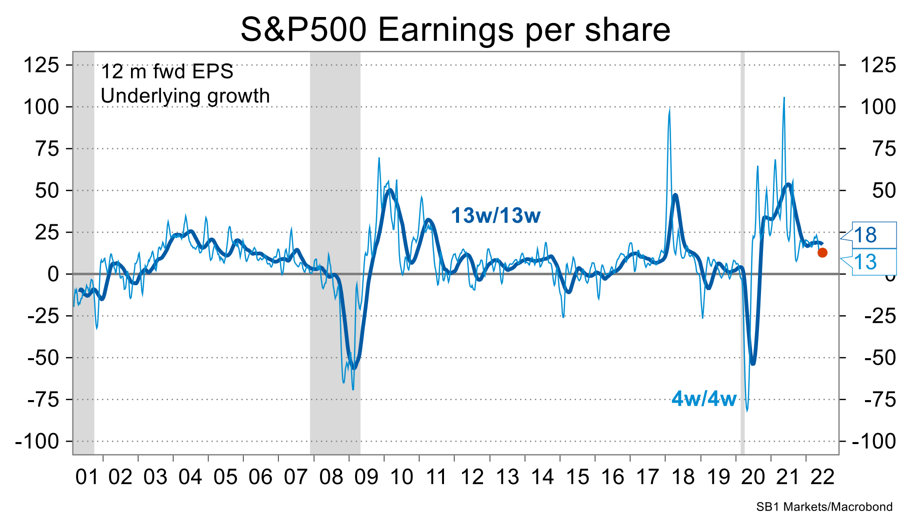
# The S&P 500 has been trending slowly upwards since mid June

… but the longer-term trend is still down. No trend in long bond yields. The next shoe to drop: EPS!



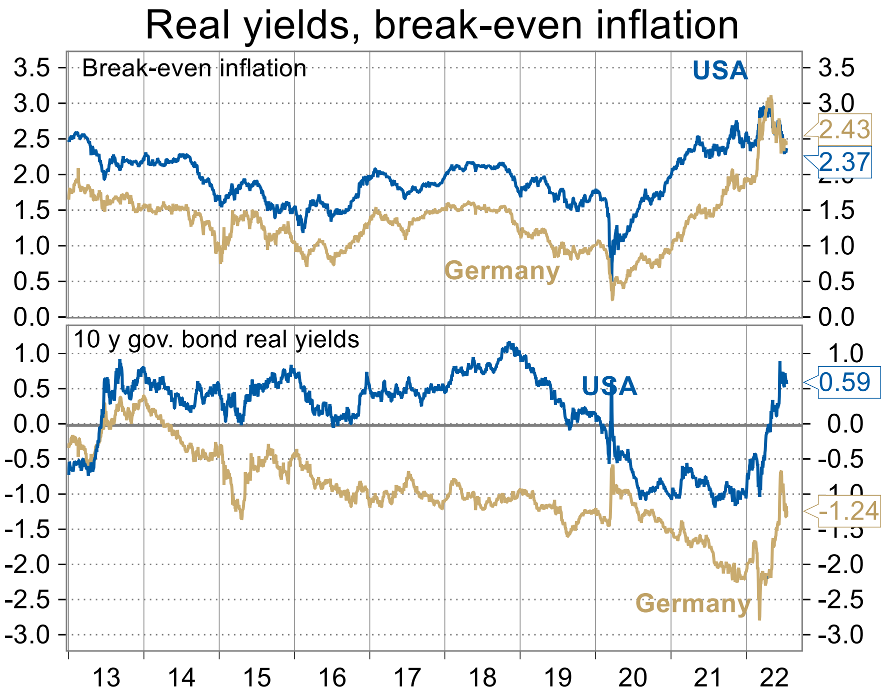



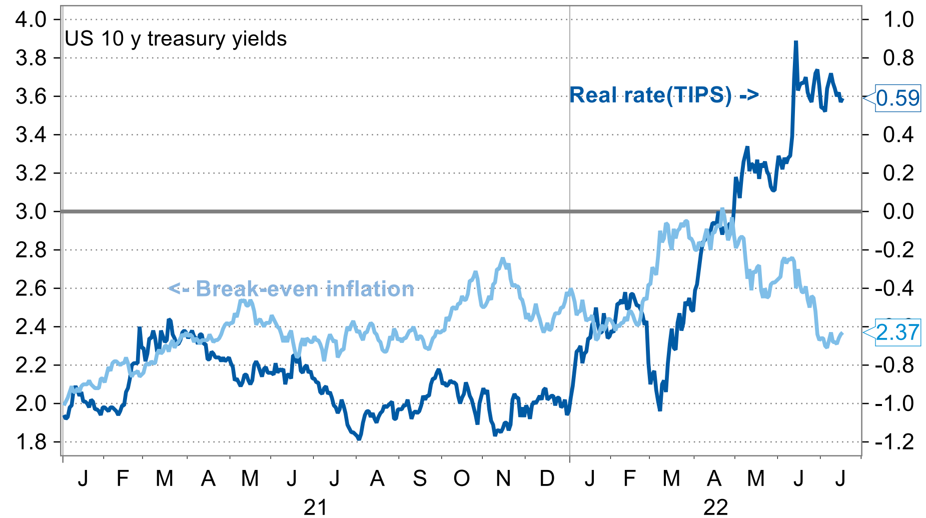



# Inflation expectations are falling both in the US & Europe

In Europe, real rate expectations are falling too, while they have stabilised in the US, at a ‘normal’ level



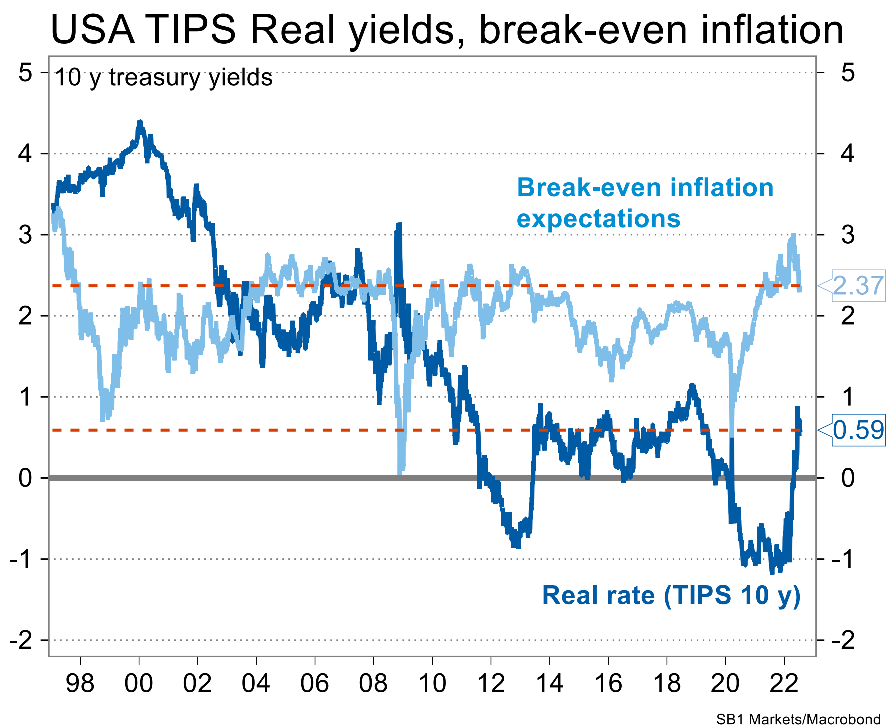

US & Germany 10 y Gov bond yield

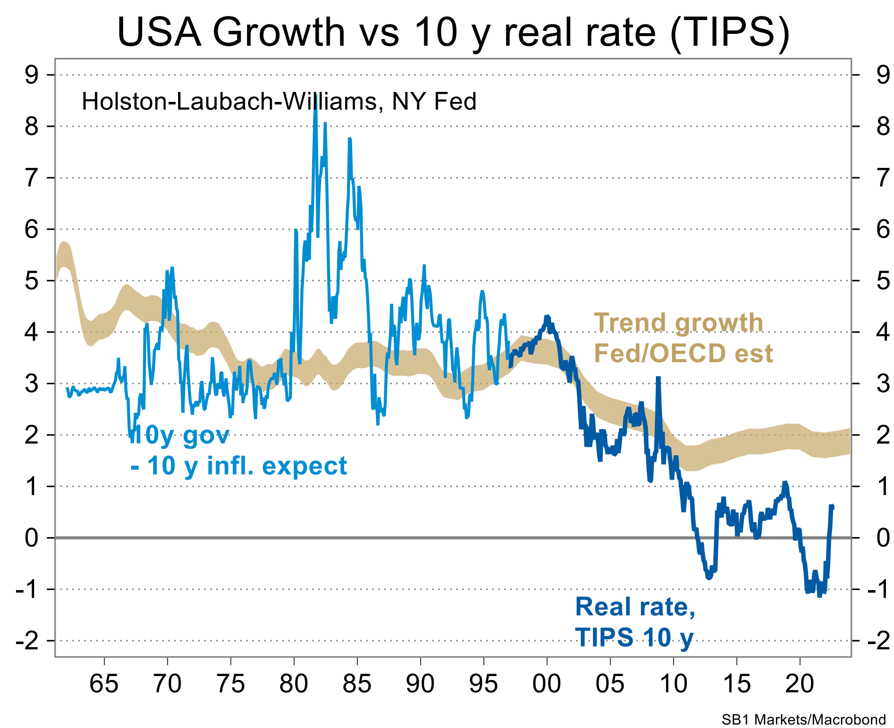
| | Yield | Change 1w | Change 1m | Since Feb 18 | Min since April-20 |
|---|---|---|---|---|---|
| **USA nominal treasury** | 2.96 | -0.03 | -0.29 | 1.04 | 0.52 |
| .. break-even inflation | 2.37 | 0.05 | -0.21 | -0.04 | 1.06 |
| .. TIPS real rate | 0.59 | -0.08 | -0.08 | 1.08 | -1.19 |
| | | | | | |
| **Germany nominal bund** | 1.19 | -0.11 | -0.45 | 0.97 | -0.65 |
| .. break-even inflation | 2.43 | -0.01 | 0.00 | 0.45 | 0.40 |
| .. real rate | -1.24 | -0.10 | -0.45 | 0.52 | -2.80 |

SB1 Markets/Macrobond

# Mind the gap: It's rapidly closing!

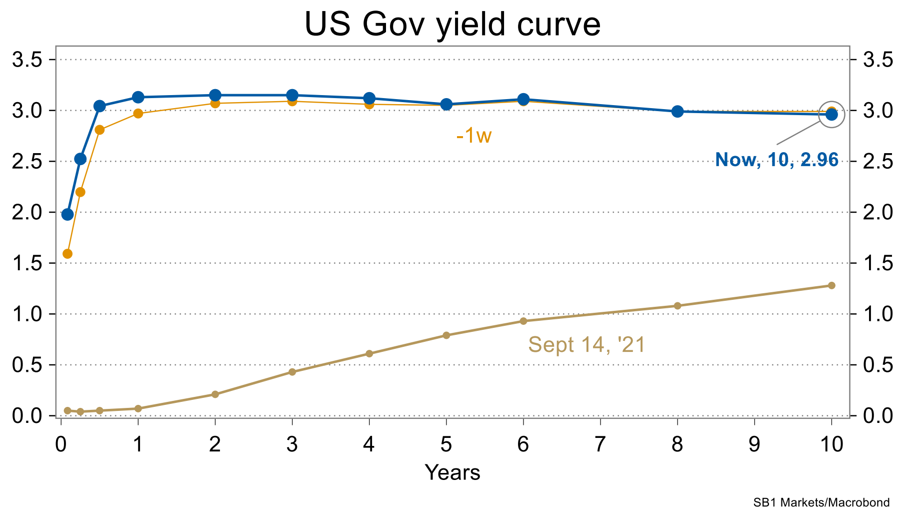
Real rates have returned to a more normal level – while short term growth expectations are falling

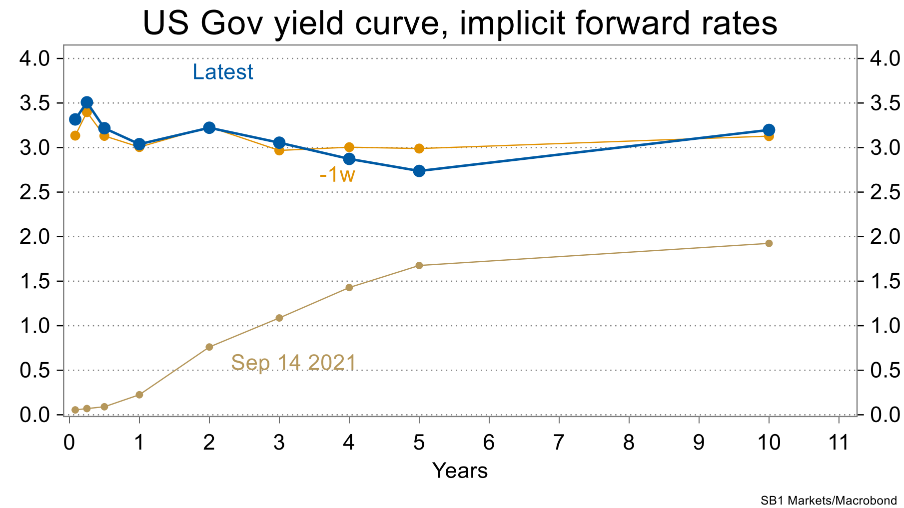


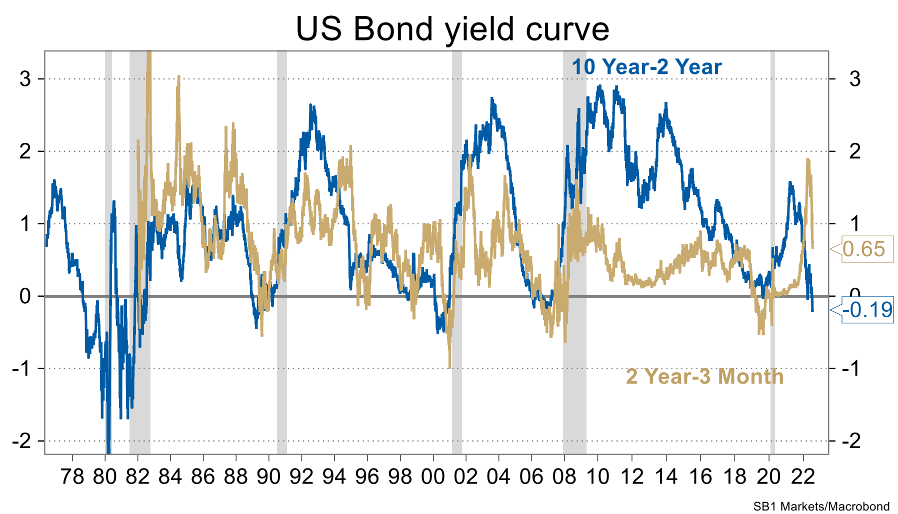



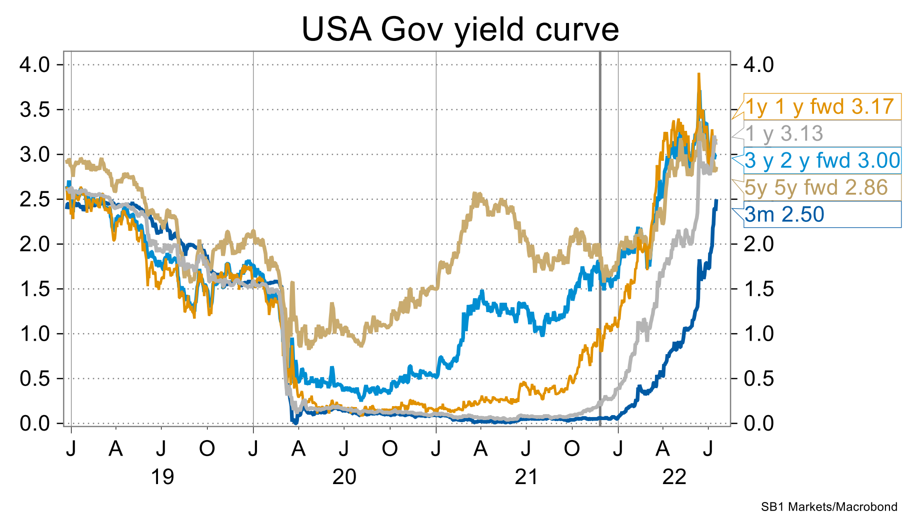

- There is no reason to believe that the current surge in real rates is due to an equivalent increase in growth expectations. It is of course the opposite: At least the short to medium-term outlook is now weakening as central banks finally enter the fight against inflation by at least bringing growth 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?

# An inverted curve from 2 years onward



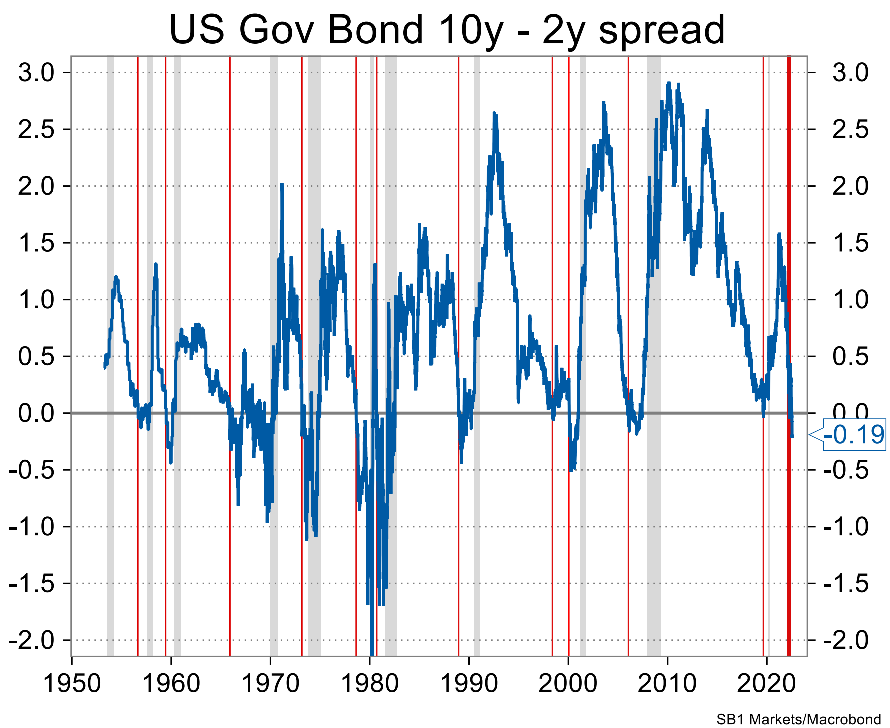



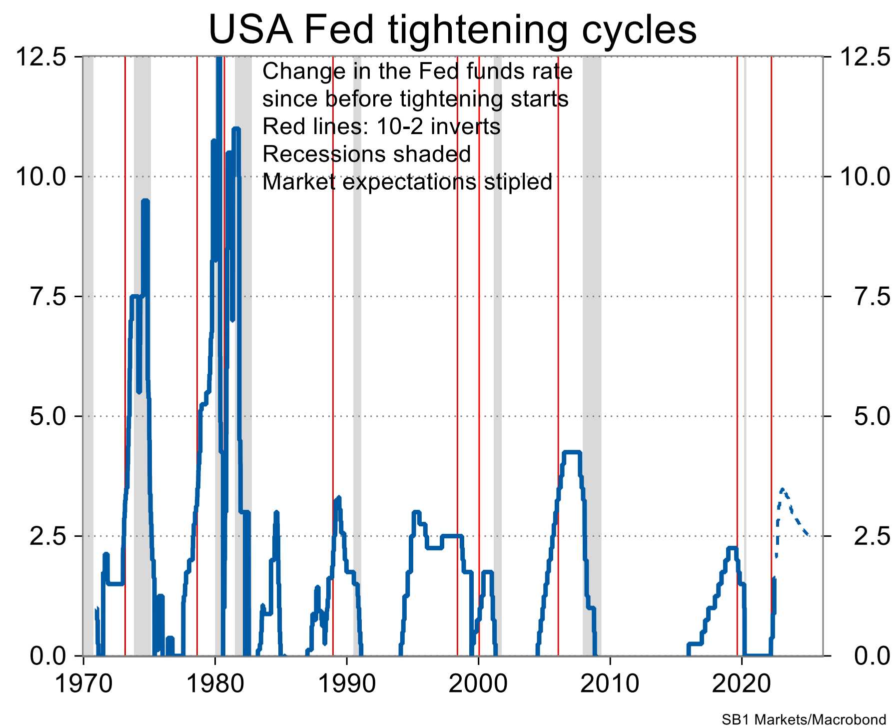



# The side show: The curve flattens/inverts when the Fed tightens

– when growth has been too strong for too long. And not primarily because long term rates declines

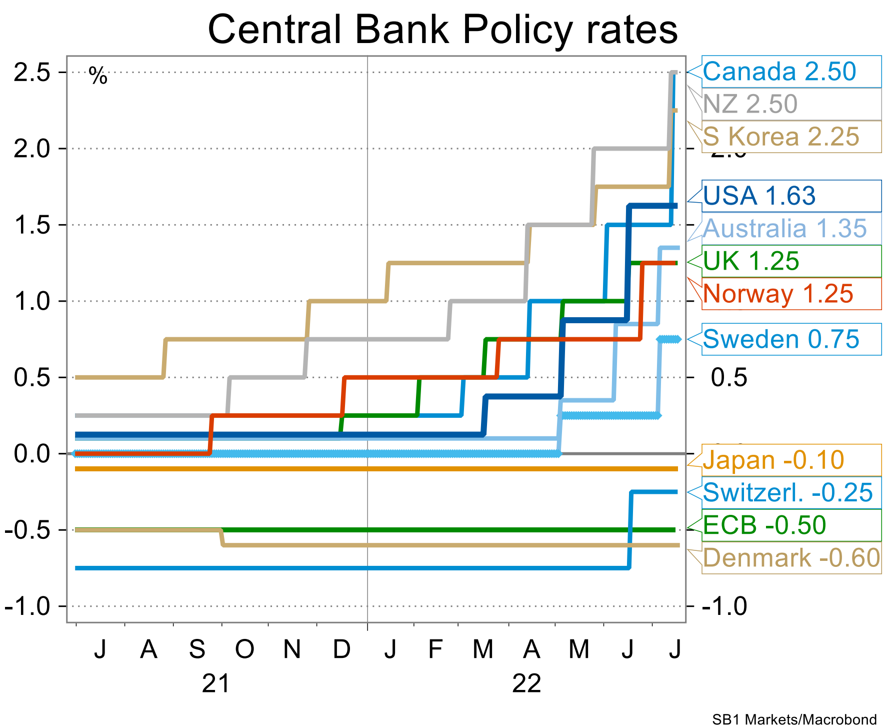


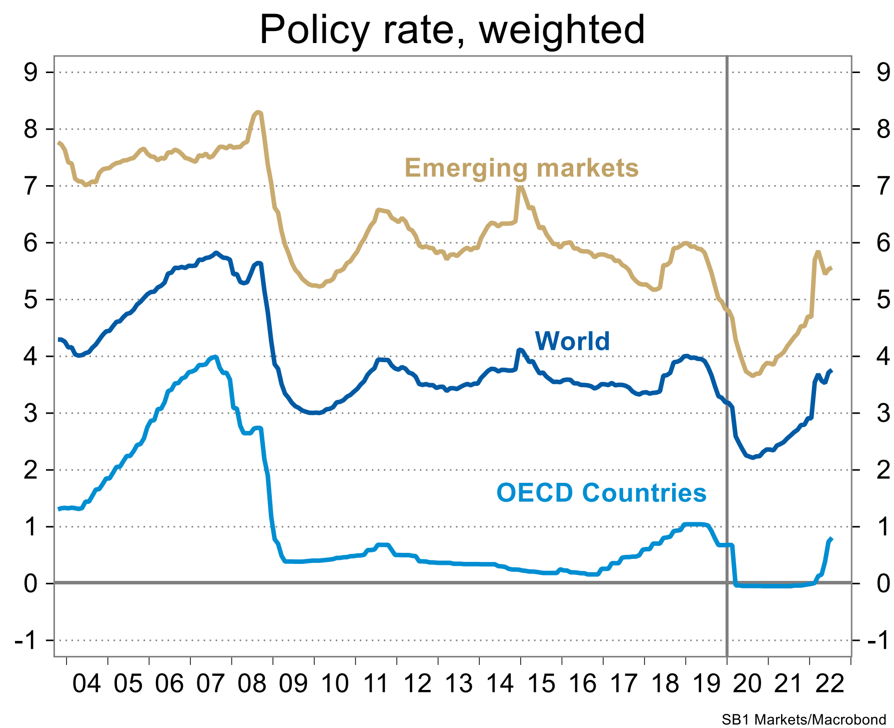




- Thereafter, normally a recession. Not because the curve had flattened but because growth had been too high for too long – and the Fed tried to calm the economy down – and succeeded somewhat too much
- Fed tightened in 1971, 1983 and in 1994 without 'creating' a recession but a recession was the outcome of the 6 other tightening campaigns (but we would not blame the Fed for the 2 months' 2020 'pandemic recession', it was not an 'economic' recession)
- The 10 y -2 y curve has inverted ahead of all recessions, from some few months before up to 2 years before. In 1966 and 1998 the curve inverted without any recession around the corner
- Last week, the 10 y – 2y spread fell to -0.19%. So more recession risk? Sure, but not <u>because</u> the curve has inverted

# Central banks on the move, Canada hiked 100 bps in one go

Norway is now at split 6th position among rich countries. This week: ECB will start hiking!

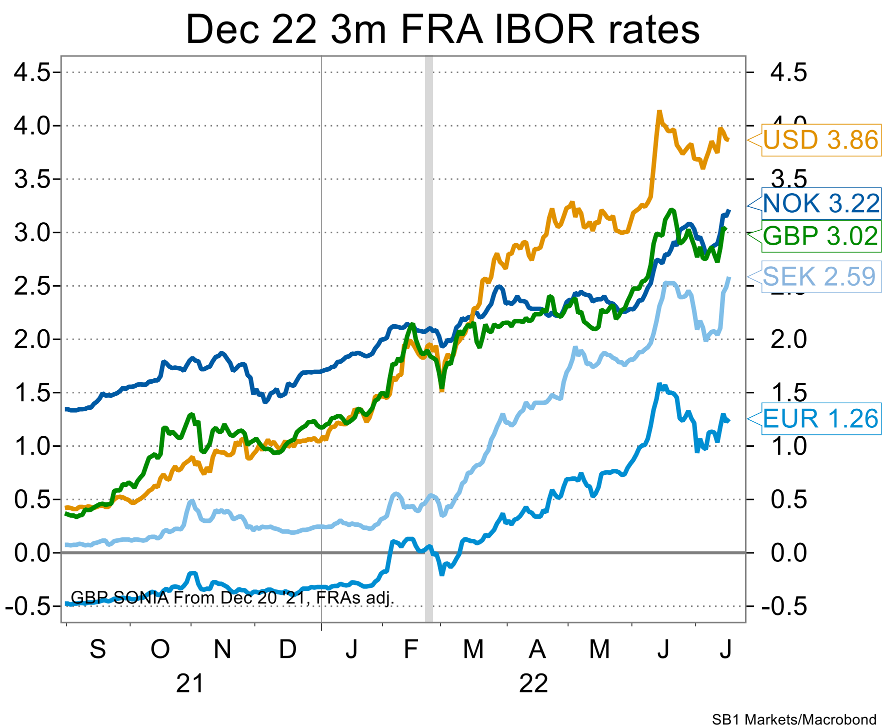


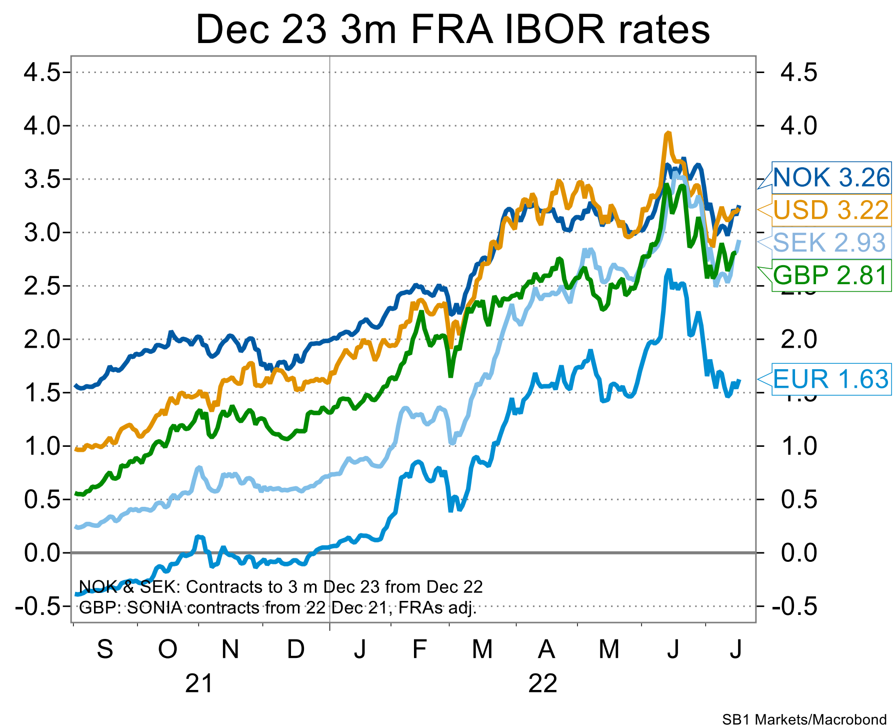




- In addition to rate hikes, central banks (x Japan and the Riksbank) have abolished their QE buying programs
- The EM average policy rate has come down due to the Russian cuts – but the trend is straight up

SpareBank 1 MARKETS

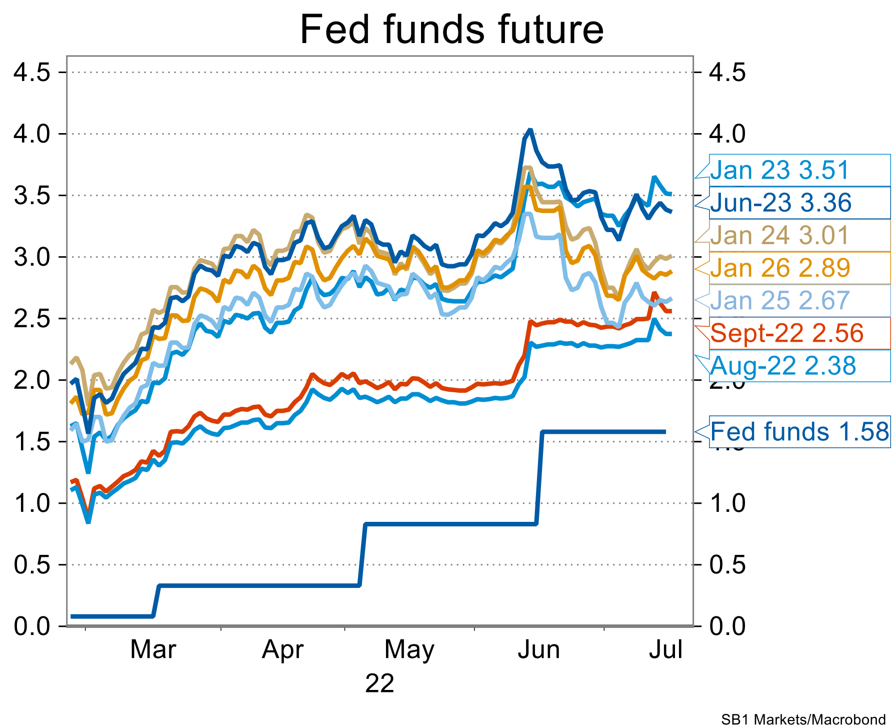
# More frontloading is expected – but longer dated FRAs are falling sharply

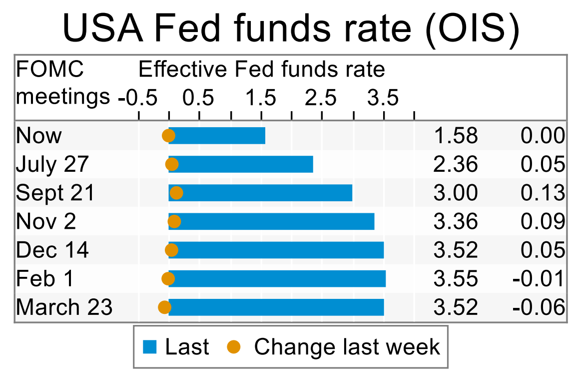


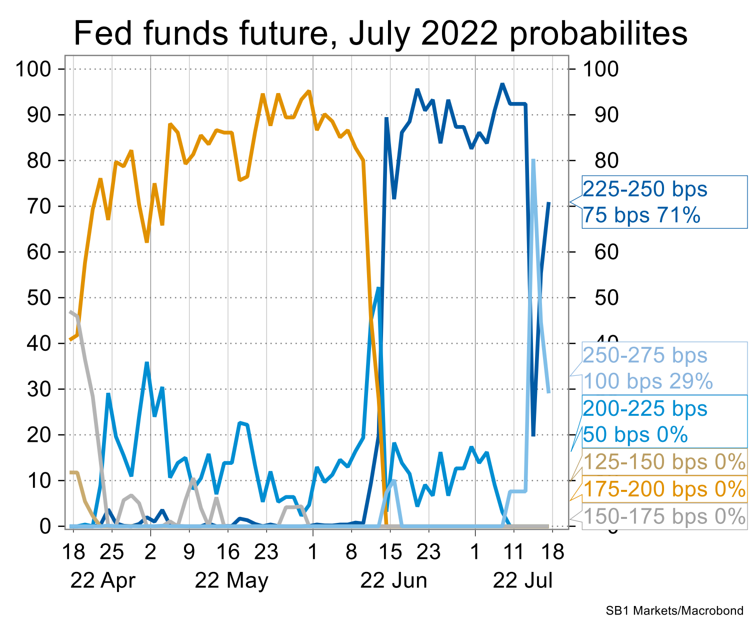



# 100 bps in July was put on the table – and then taken off. 75 bps is enough?

But if so, 75 bps in September is more likely than 'just' 50 bps

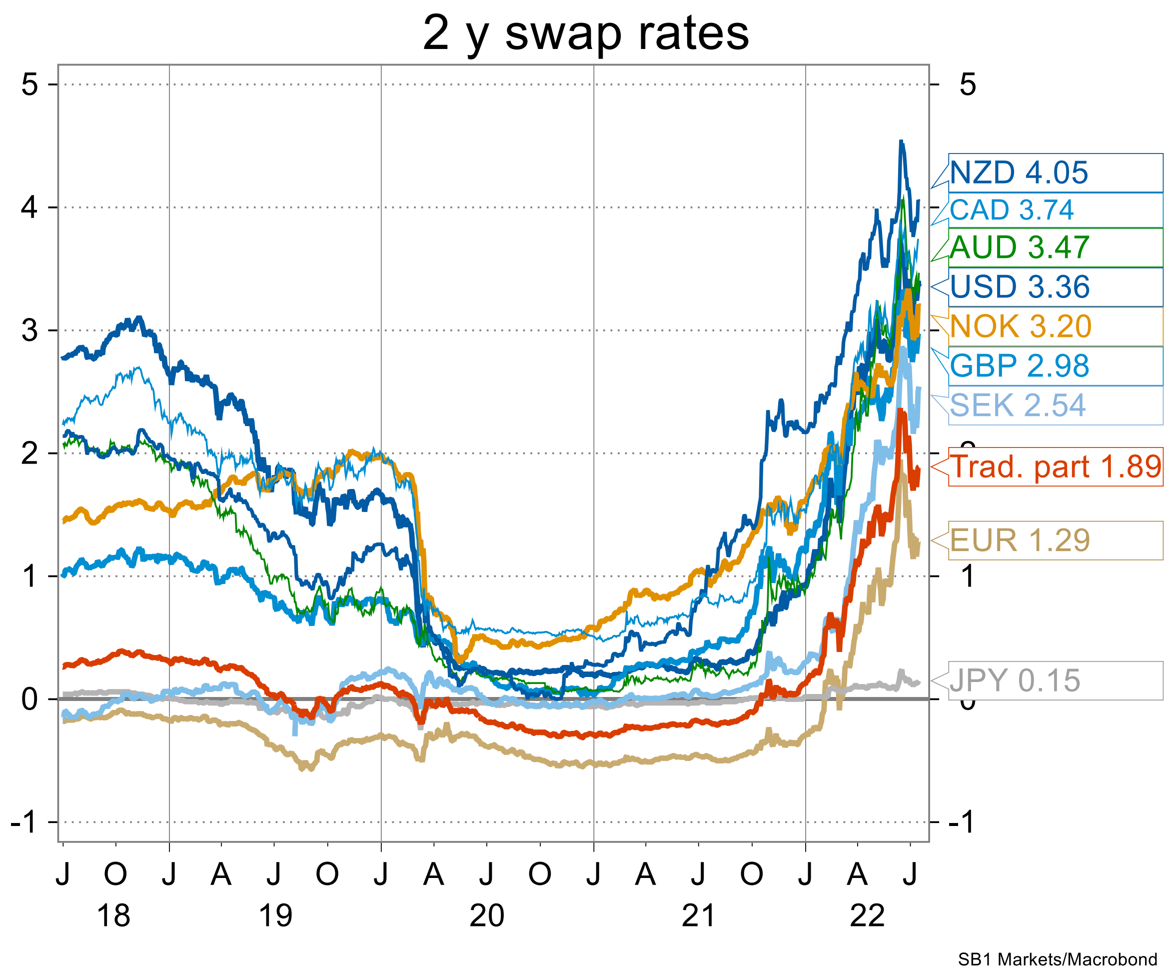


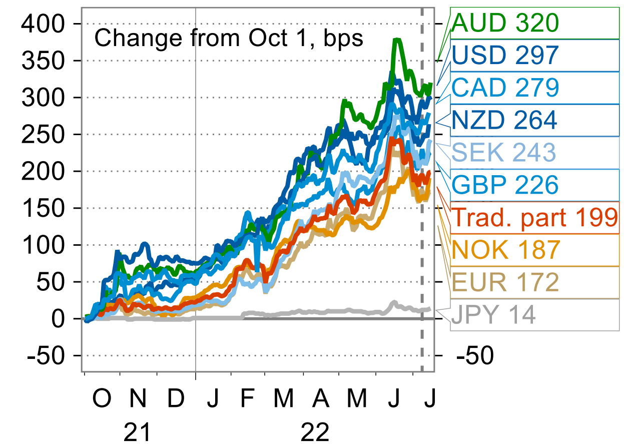



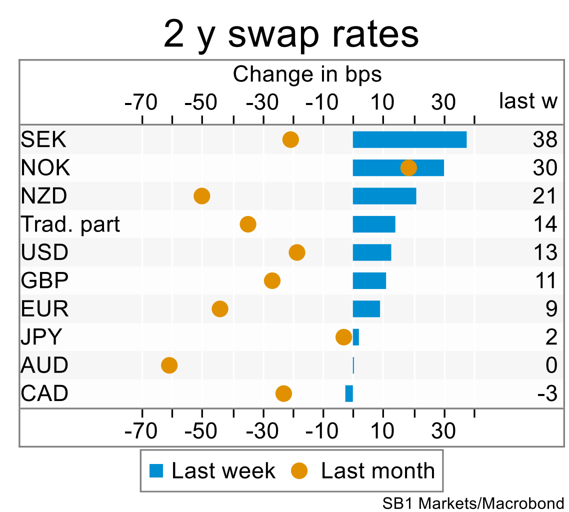




- Shorter dated contracts up, longer dated down
- The Fed Fund future curve is peaking in Feb-23

# 2 y swaps mostly up last week – mostly down last month

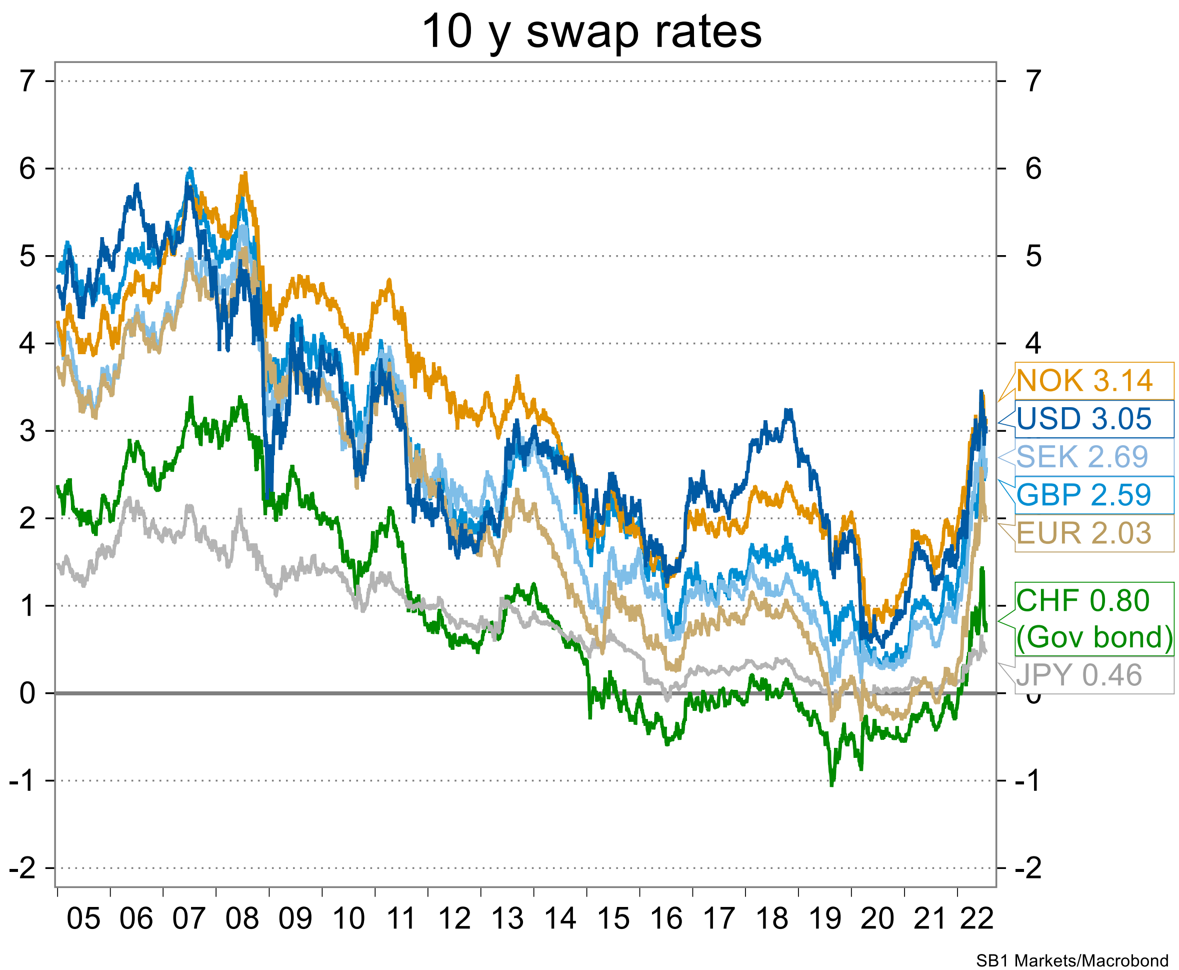


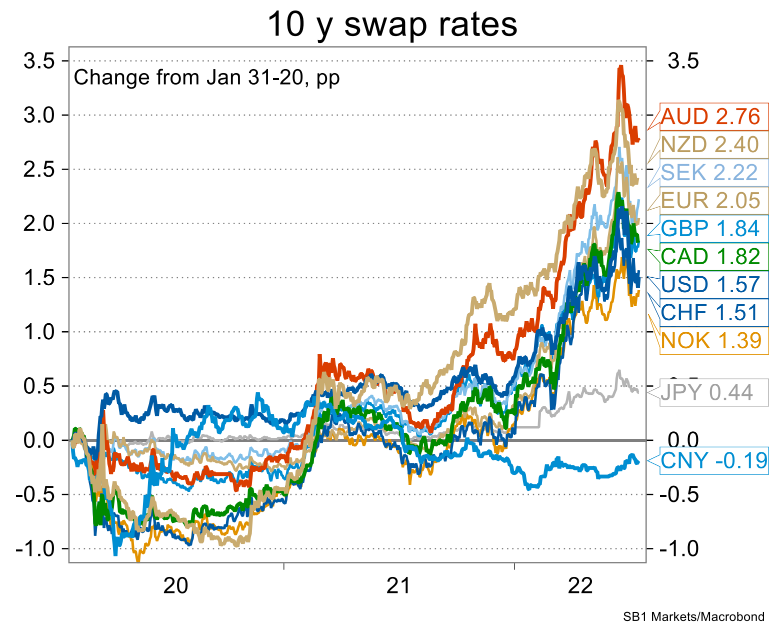



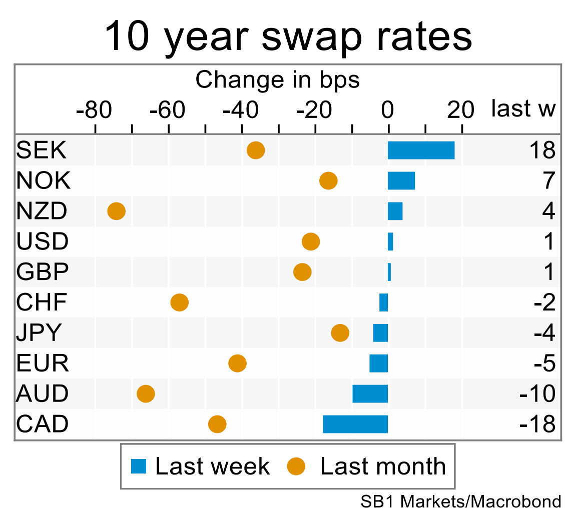



# 10 y swaps mostly down last week (and everywhere last month)

The recession is coming



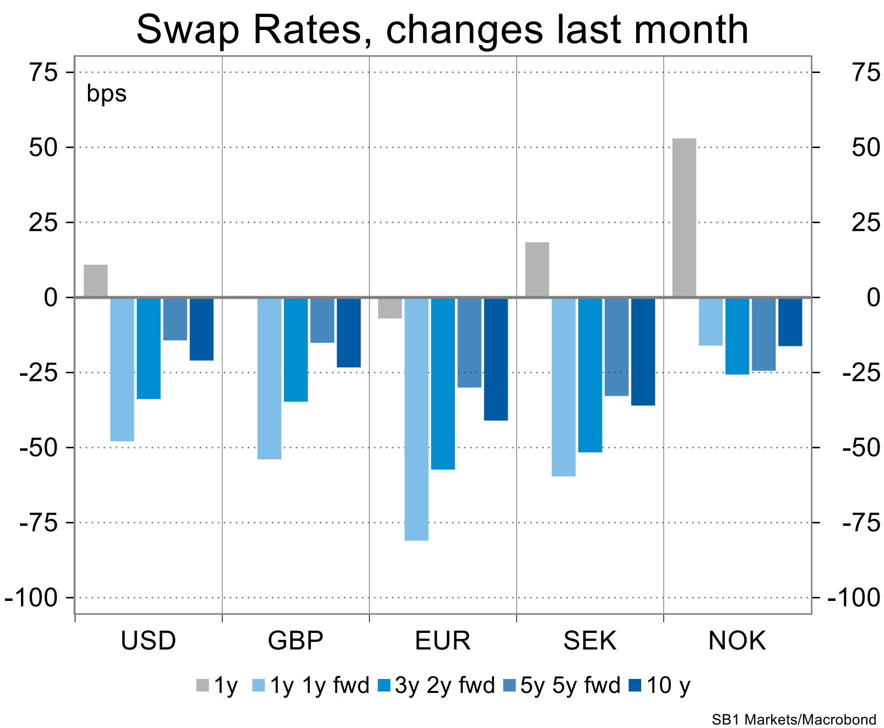



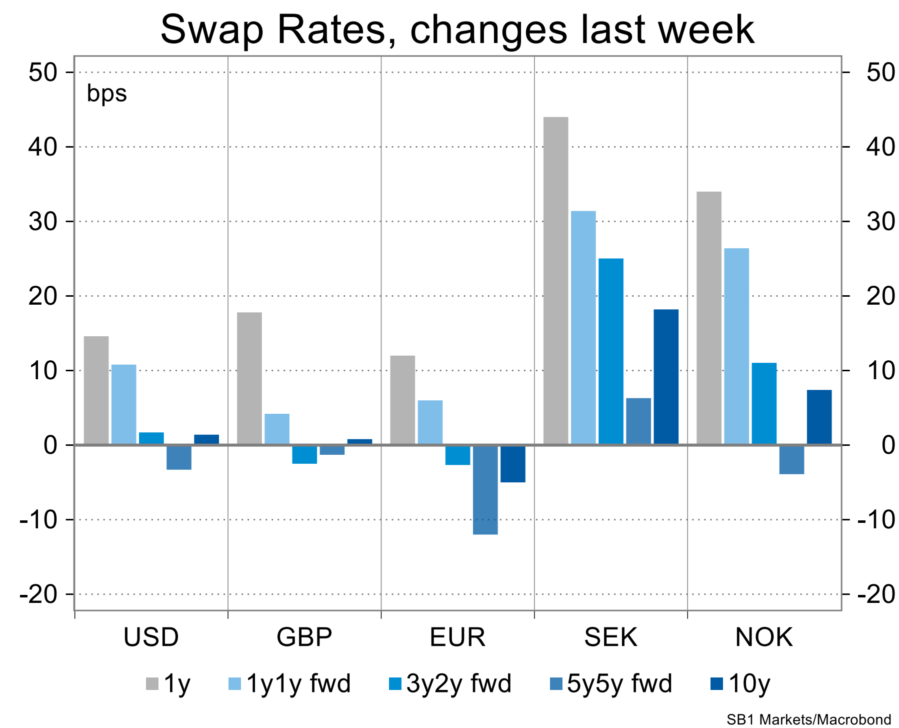




CHF: 10 y government bond yield

# Almost all rates down last 4 weeks, except the short end some places

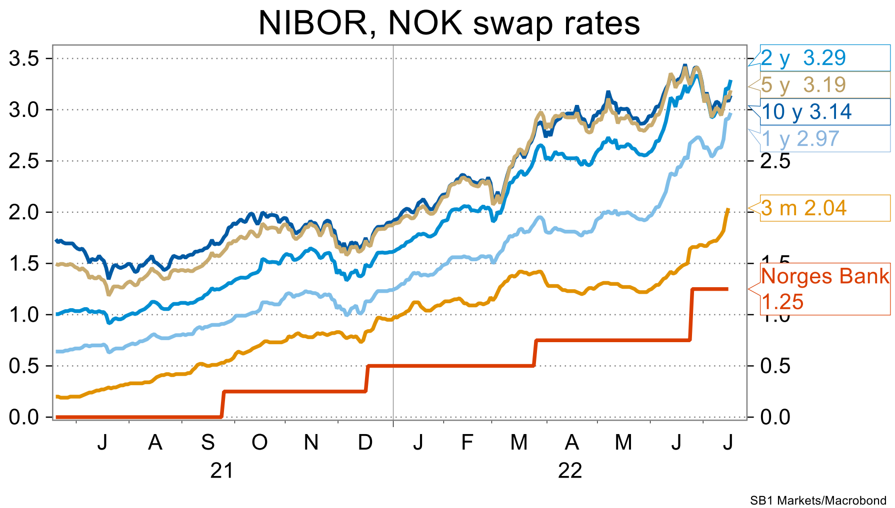
## Mixed last week – rates in SEK & NOK sharply up

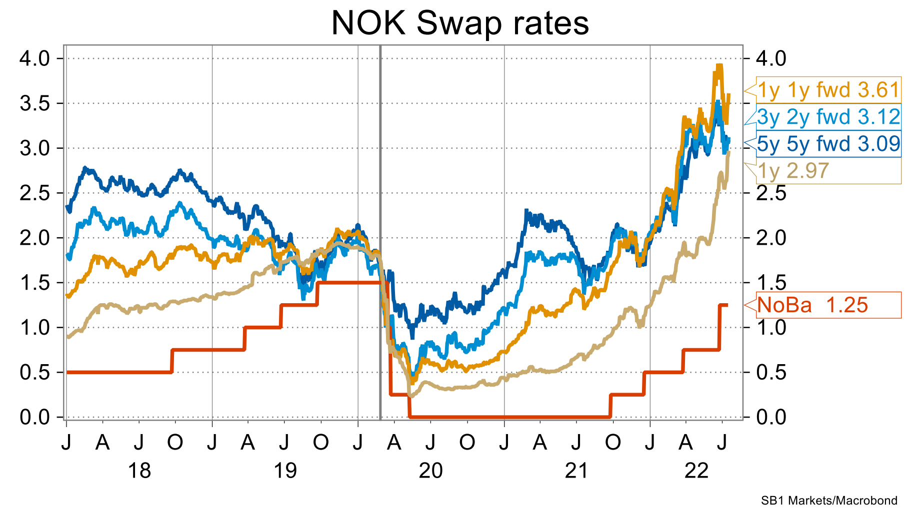


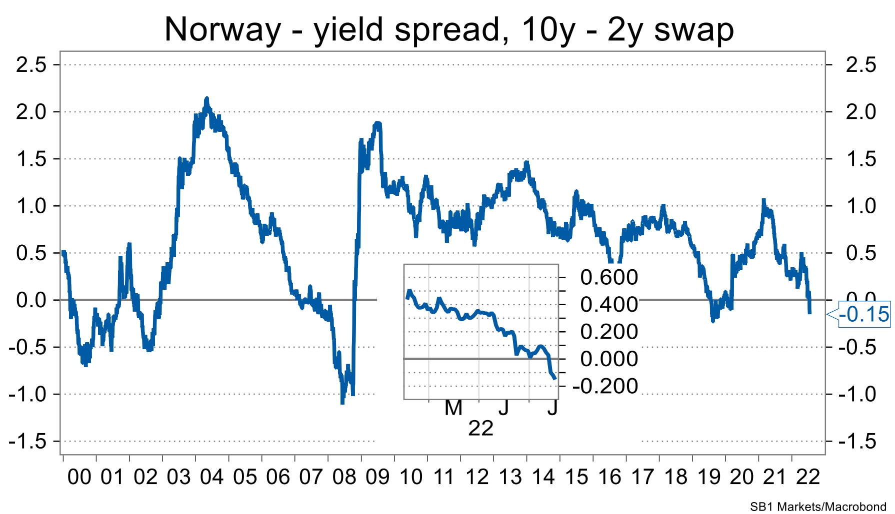



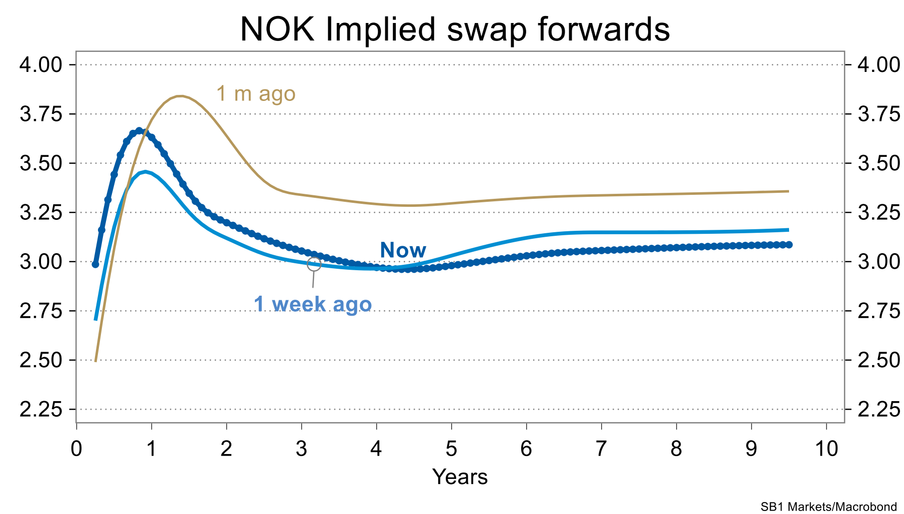
# A steeper curve in the short end, but a lower peak

## The 10 - 2y is finally inverted. Implied rates down from 1 year onward the last month

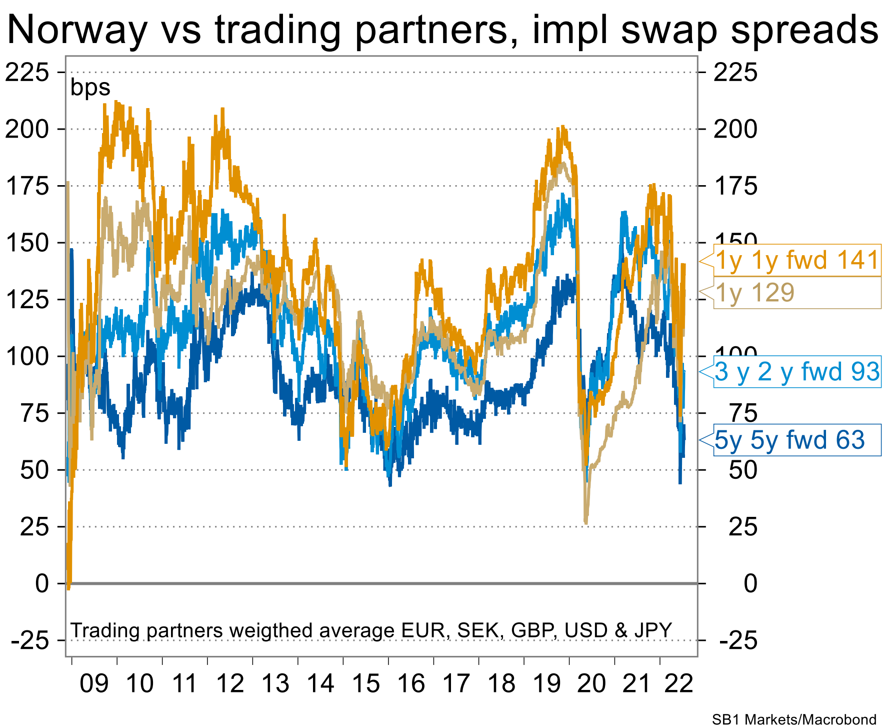


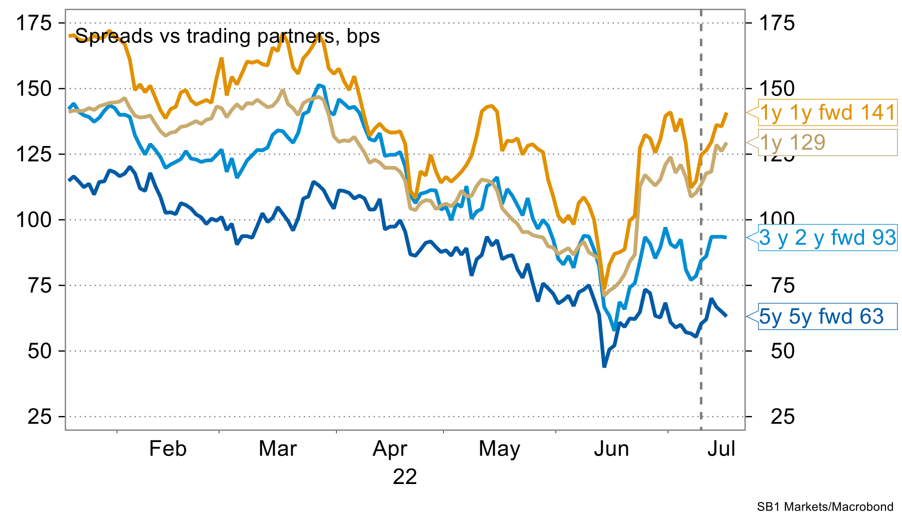



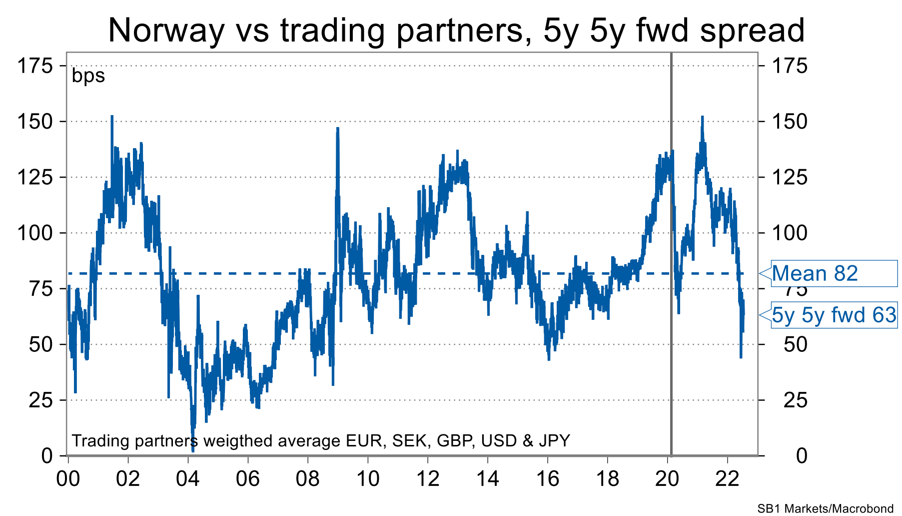



# Spreads out all over the curve, by most in the short end

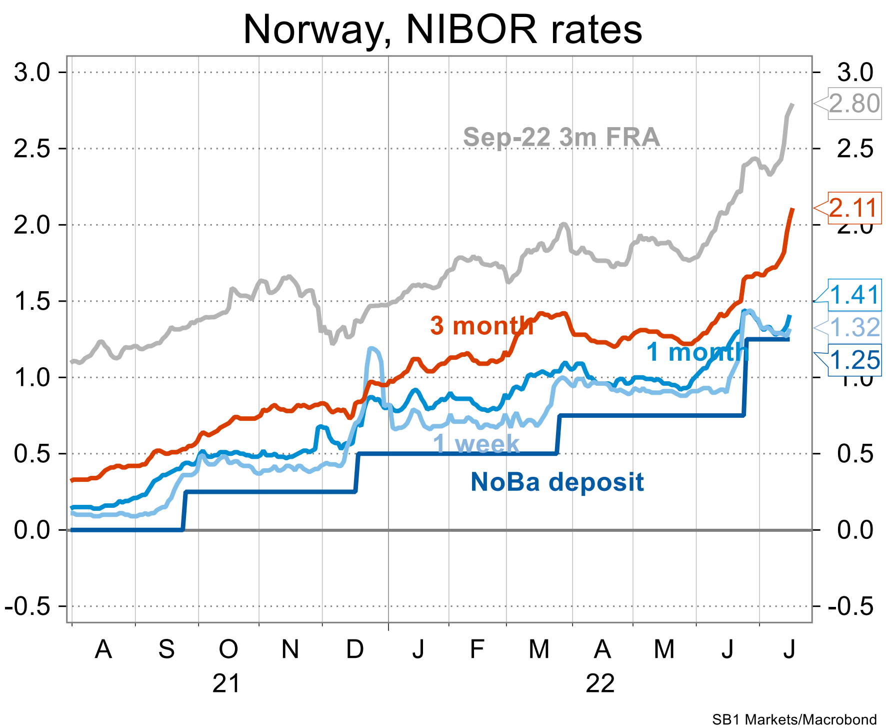


SpareBank 1 MARKETS

# The 3m NIBOR up to 2.11% as 50 bps NoBa hikes in both Aug and Sept is discount.

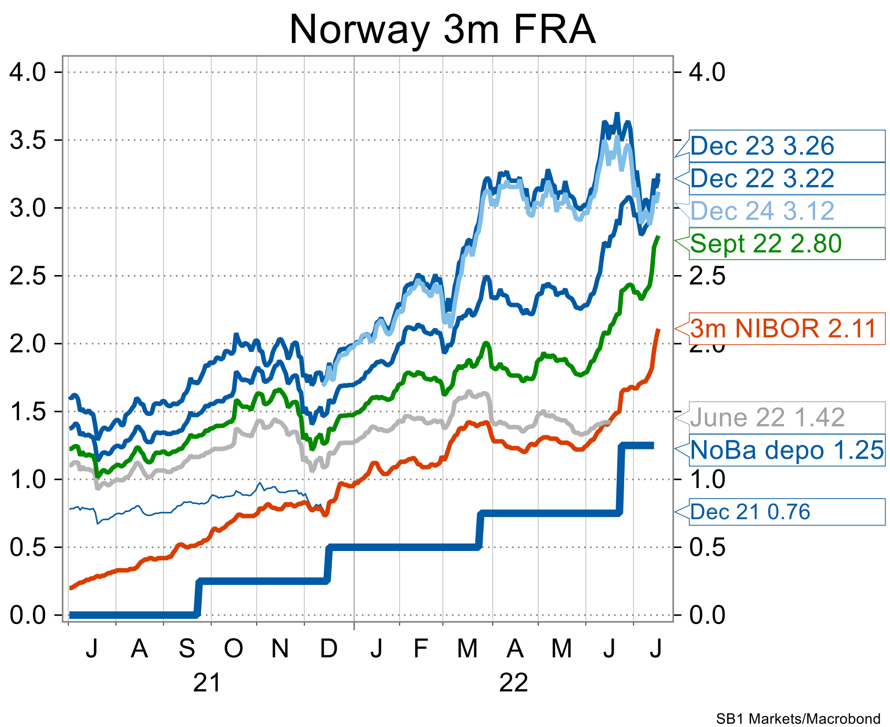


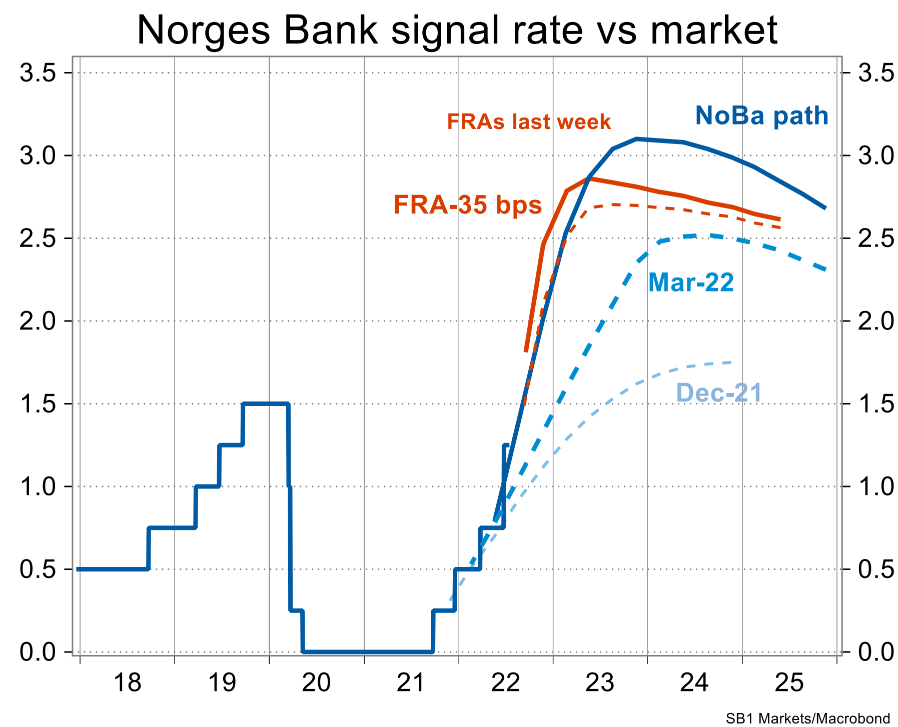

- The USD LIBOR-OIS spread fell 3 bps to 10 bps last week – which is a low level!

SpareBank 1 MARKETS

# A huge lift in the short end of Norwegian (NIBOR) curve

## The short term FRAs up 30 – 40 bps since early July, 50 bps hikes are discounted in both Aug & Sept



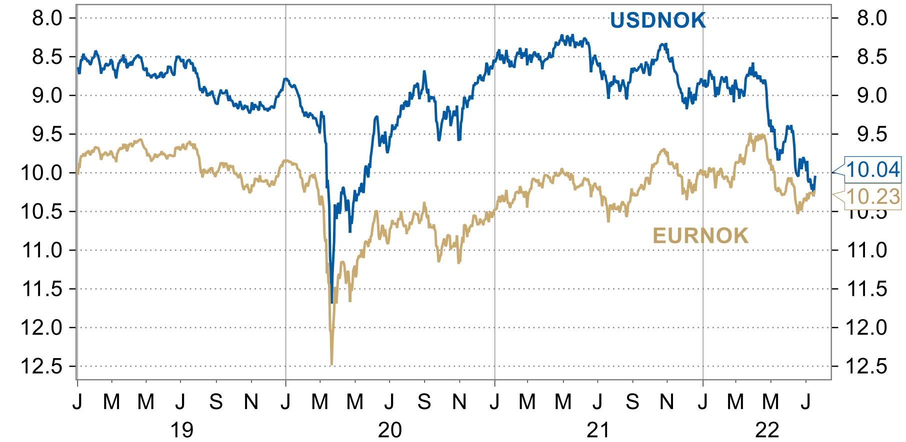

- **If NoBa hikes by 25 bps** in August and September, which was clearly signalled in the June MPR, the average signal rate will be 1.49% the coming 3 months. The current 3m NIBOR is at 2.11%, and with a Sept 3 m FRA at 2.8%, 50 bps hikes in both August and September is discounted – and further 25 bps hikes in November, December and almost one in March – in sum some somewhat below 3% - and below NoBa's assumed peak at 3.1%
- Thus, the market now expects a frontloaded but shorter hiking process, with a lower peak level than NoBa assumed in June. This change is parallel to the change in the US
- **We think the 50 + 50 bps hikes in August and September are more aggressive than Norges Bank will deliver**

# USD = EUR, almost. NOK up last week but is still very weak

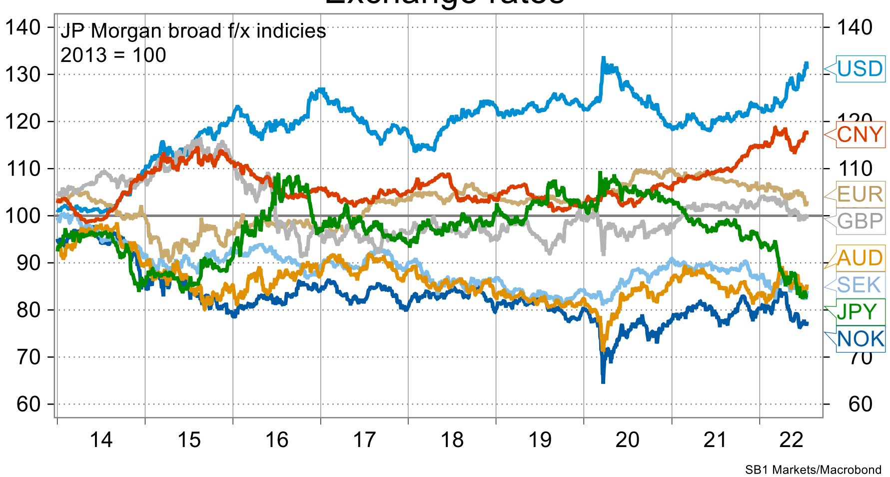
## USD is once more a safe haven, even if there are challenges over there too

### EURUSD

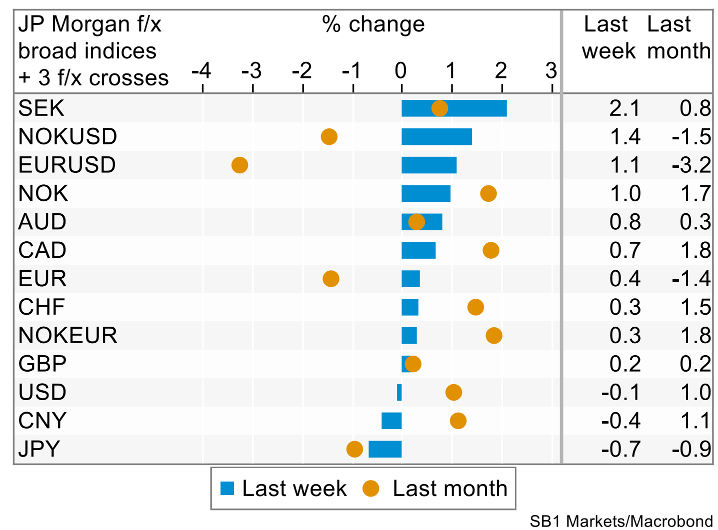

### NOK vs EUR & USD




### Exchange rates



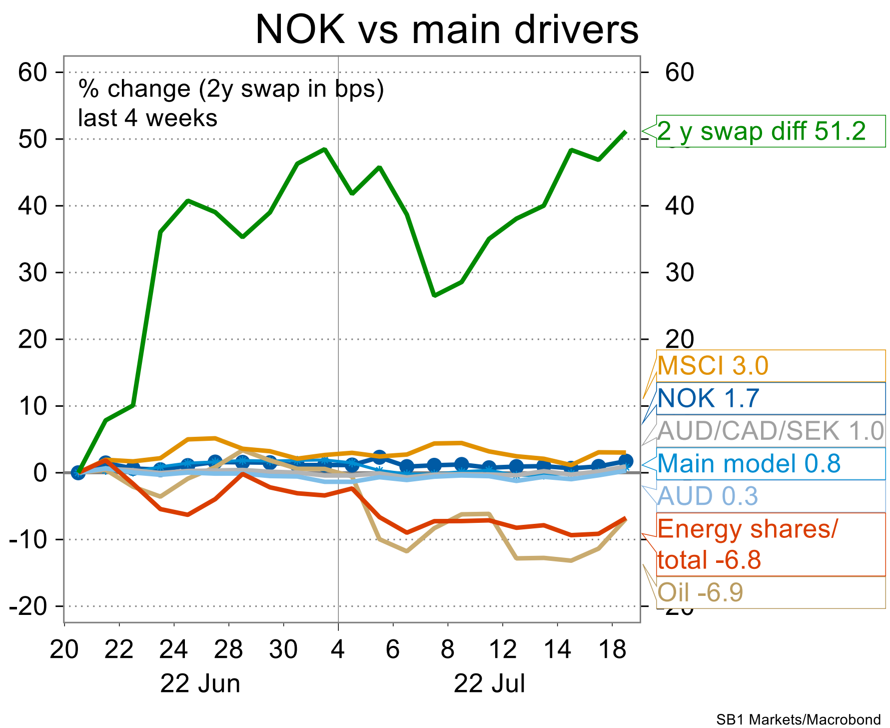

### F/x markets

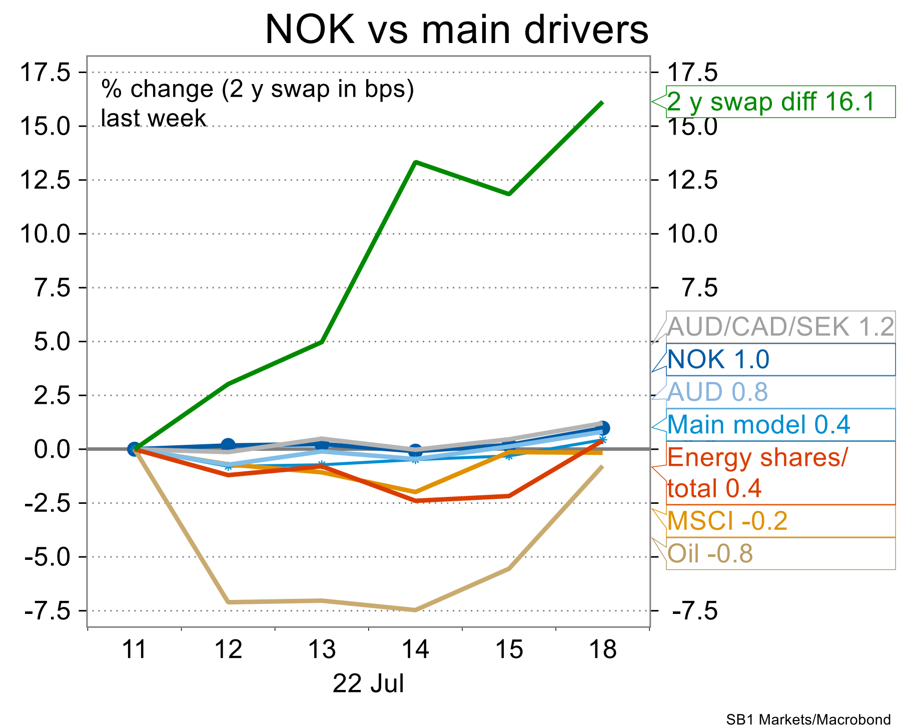



| JP Morgan f/x broad indices + 3 f/x crosses | Last week | Last month |
|---|---|---|
| SEK | 2.1 | 0.8 |
| NOKUSD | 1.4 | -1.5 |
| EURUSD | 1.1 | -3.2 |
| NOK | 1.0 | 1.7 |
| AUD | 0.8 | 0.3 |
| CAD | 0.7 | 1.8 |
| EUR | 0.4 | -1.4 |
| CHF | 0.3 | 1.5 |
| NOKEUR | 0.3 | 1.8 |
| GBP | 0.2 | 0.2 |
| USD | -0.1 | 1.0 |
| CNY | -0.4 | 1.1 |
| JPY | -0.7 | -0.9 |

# NOK up 1%, our model said 0.4%. Oil was flat vs. last week, NOK int. rates up

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




Gaps vs. out model estimates are extremely wide

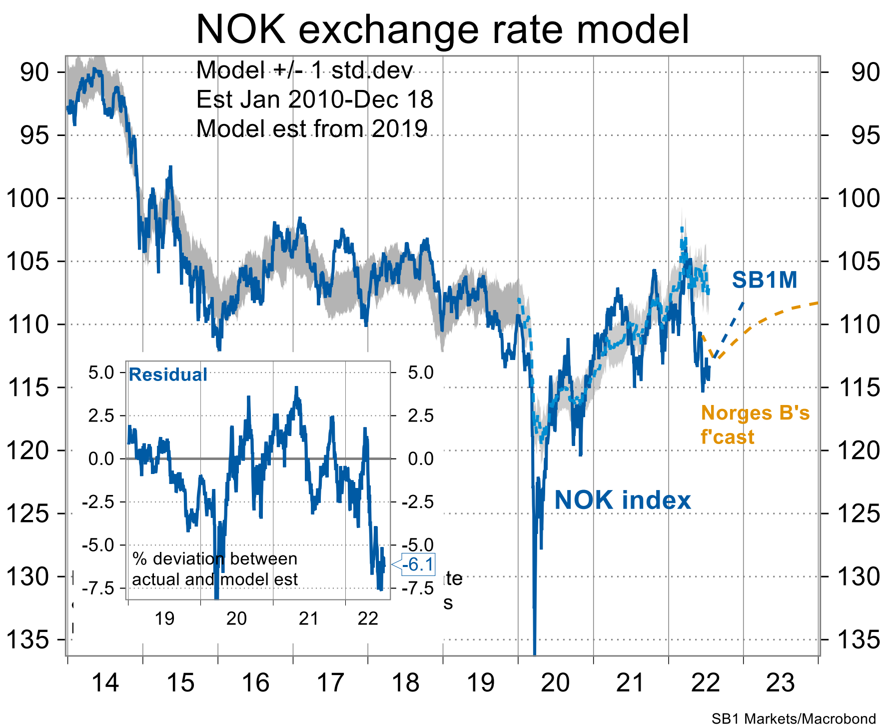
- ***The NOK +1%, our main model said +0.4%  - and NOK  is 6.1% <u>below</u> our main model estimate (from –6.7%)***
- The NOK is 10% <u>weaker</u> than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts (from 9)
- NOK is 4% <u>weaker</u> than a model which includes global energy companies equity prices (vs the global  stock market) (from 3)

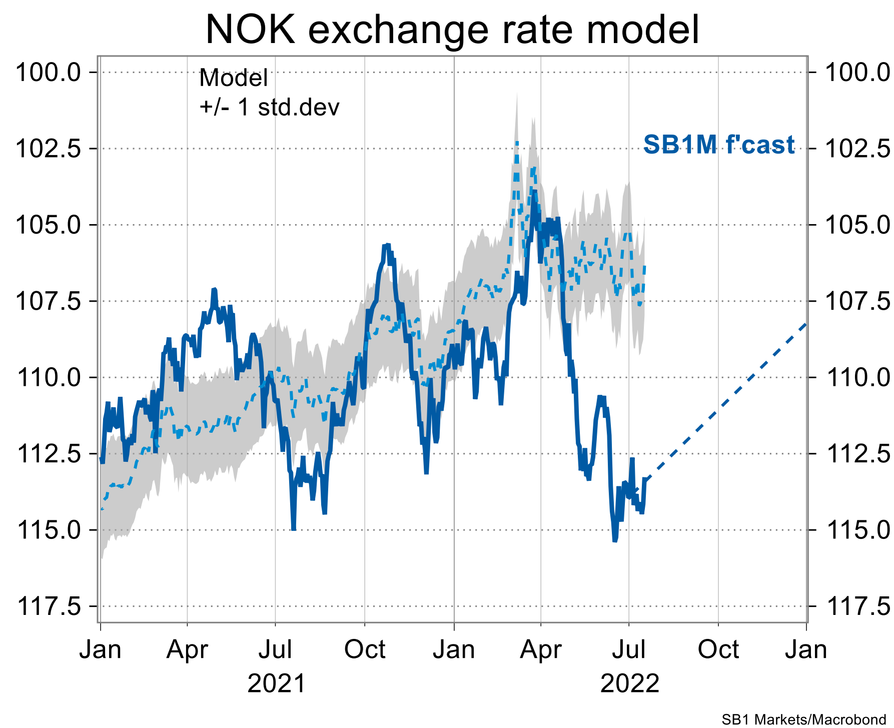
At this and the following pages we have swapped Norges Bank's I44 index for JP Morgan's broad NOK index and rebased it to the current index value for the I44. The I44 has an earlier closing time than the 'official' closing time for f/x crosses. There are no substantial difference between these two indices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

SpareBank 1 MARKETS

# The NOK is 6.1% below our model estimate

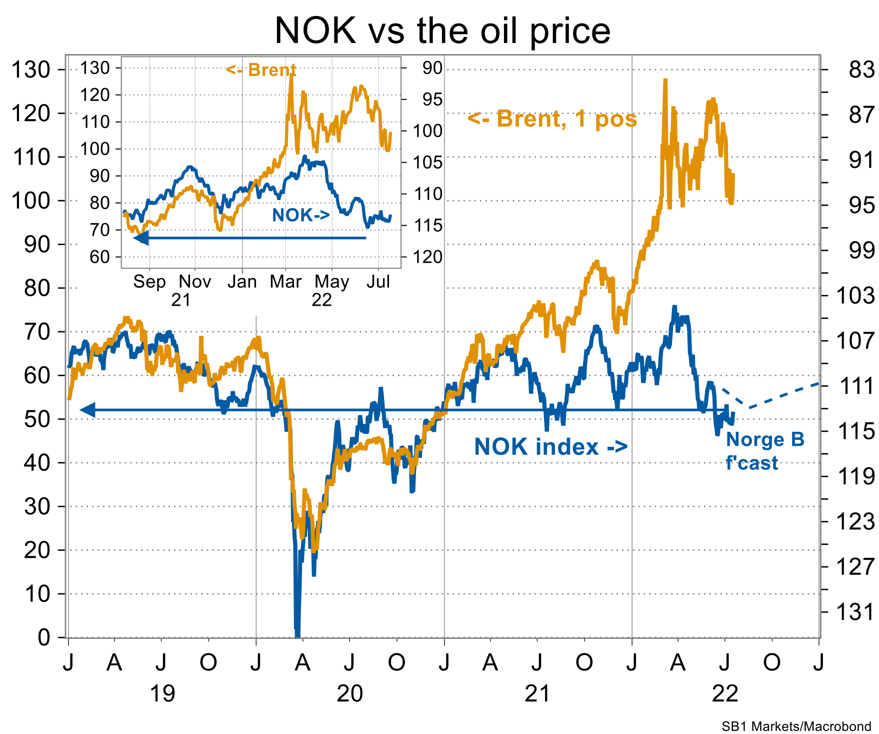
Up vs the bottom in late June, but still rather unusual

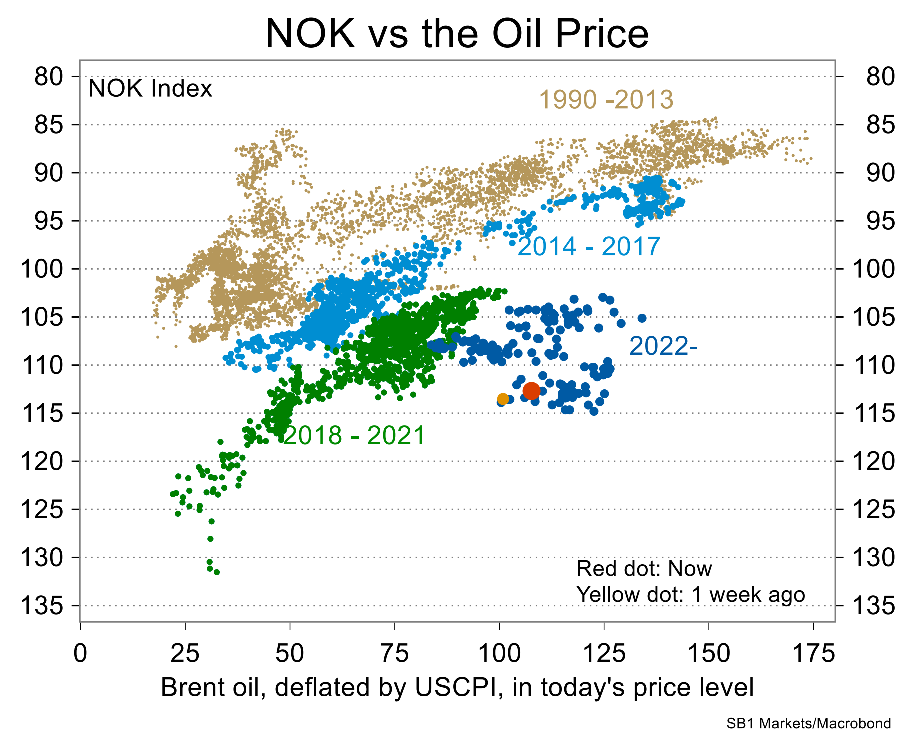


# Oil unch last week, NOK 1% up

NOK is weak, as if the oil price was USD 70/b (rebased to early Jan) or USD 50/b (rebased to May-21)



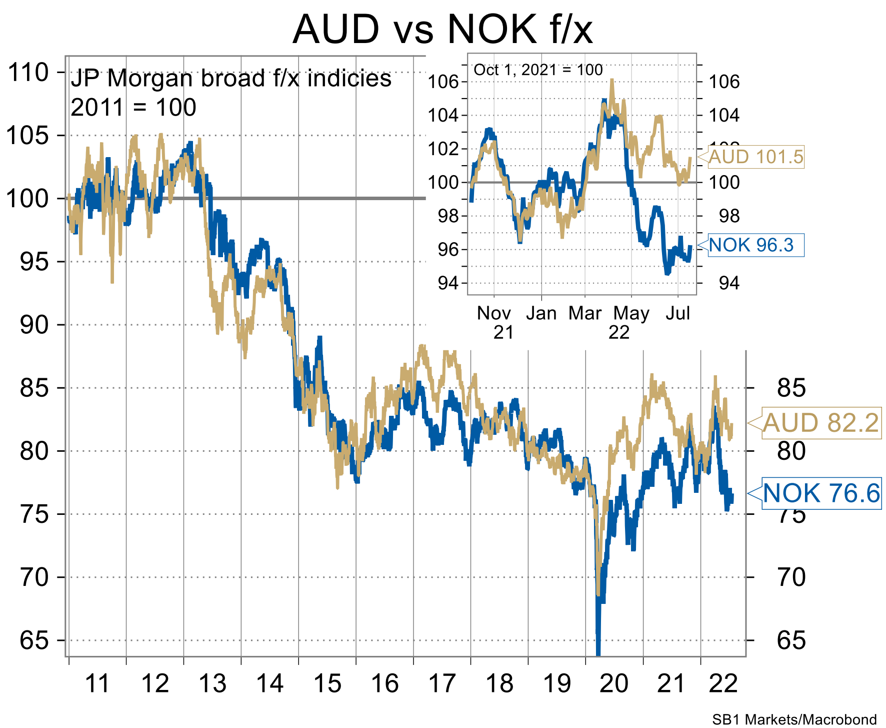



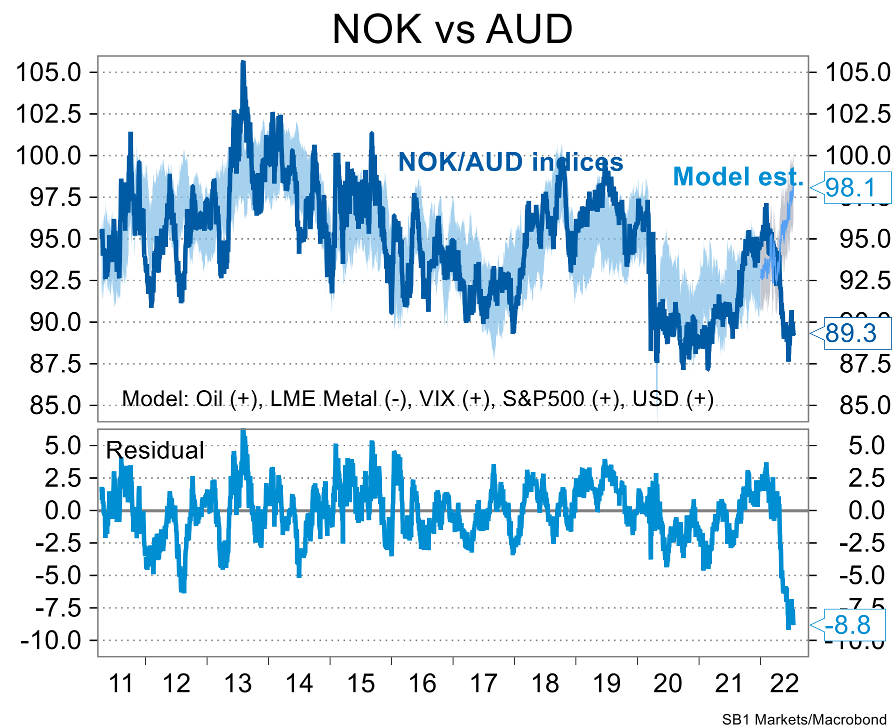

- The NOK has never before been as weak as the recent weeks, given the oil price

SpareBank 1 MARKETS

# AUD and NOK up last week – but NOK is too weak vs. the AUD?

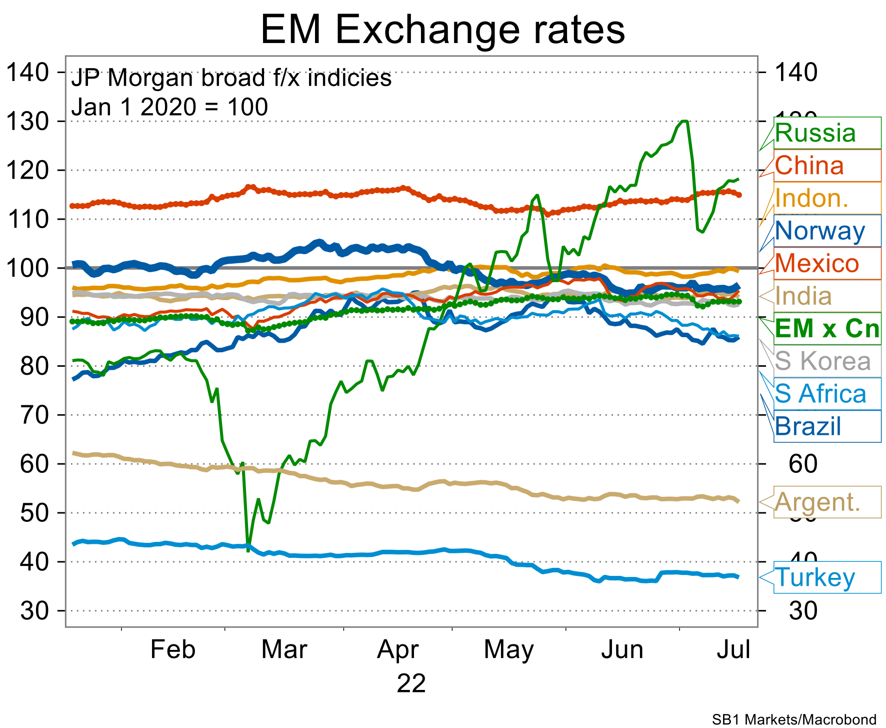
The gap is now among the largest, even if metal prices have been falling for a while, oil & gas not

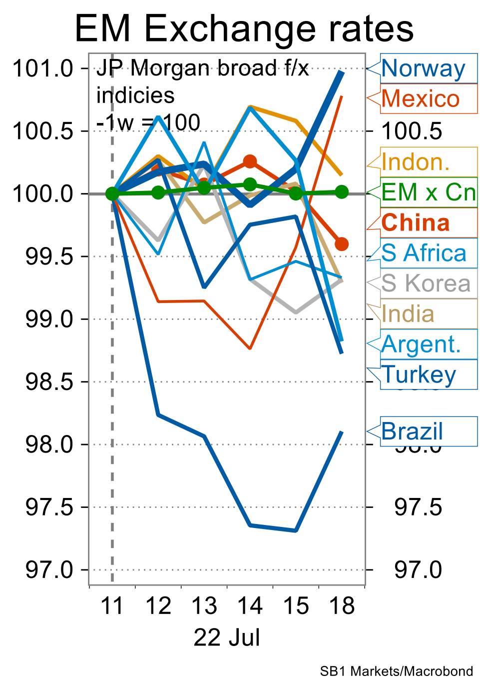


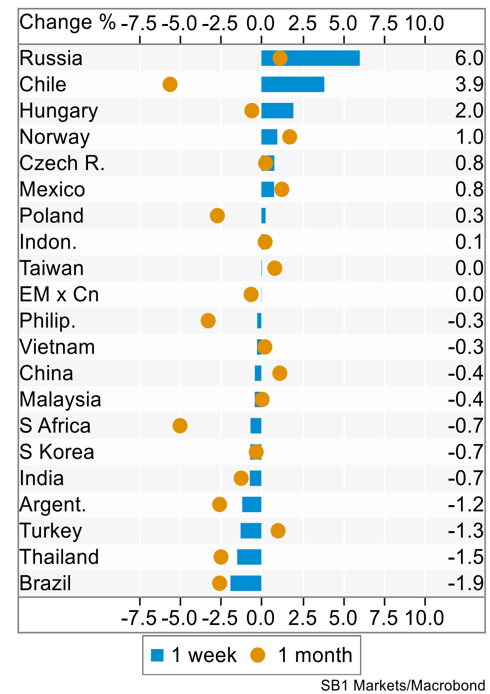




- The discrepancy between the NOK and AUD is highly unusual, given the normal factors that decide the gap
- Normally, NOK strengthens vs the AUD when the oil prices rises vs. the LME metal index, when VIX, and the S&P500 index increases, and the USD index appreciates. Seem like we need a new model. Until we find it, buy the NOK index (and short the AUD index)

# EM f/x mixed: in sum flat



# DISCLAIMER

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

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

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

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

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

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

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

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

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