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Macro Weekly

Week 38

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Last week, I

- ## The War/European Energy/Commodities
  - » **Ukraine forces** are still pushing the Russian army eastwards but at a slower pace. Some few Russian voices have been allowed criticize the war and even President Putin. Both **China** and **India** both expressed their concerns about the war, which Putin had to acknowledge at the Uzbekistan security summit. Putin's position is no doubt weakened. Which does not have to be good news…
  - » **European gas prices** fell sharply last week, especially the front month contract (UK prices down 25%, continental prices 'just' 10%) but even the coming year was down by 6% - 8% in avg.
    - **The EU Commission** did not propose any energy price caps but rather prefer windfall taxes for energy companies. The extra revenues could be spent by member states to fund mitigating measures for exposed households (and businesses). The tax rate would be 100% for electricity producers, for prices above EUR 180/MWh. In addition, fossil energy producers located within EU should pay an extra tax on extraordinary profits. A 1% of GDP in extra revenues is assumed. However, tax laws are up to member states to decide, and no agreement is so far met
  - » **Other commodity prices** were mixed last week; Metals and oil were close to unchanged, while food prices reversed the decline the previous week
- ## China
  - » **August data** were better than expected both regarding **industrial production** and **retail sales** but production is growing at a slower pace than before the pandemic, and retail sales are far from impressive, even after a substantial upward revision. Sales are some 6% below the pre-pandemic trend
  - » In addition, **housing and other construction starts** are still declining. Both are down more than 50% from the peak in early 2021, the largest setback ever! New home sales rose slightly in August but are down 35 – 40% from the peak. Reduced demand from the construction sector will be felt in other parts of the Chinese economy the coming quarters. Both **new and existing house prices** are still falling, both at close to a -5% pace in Aug. Existing home prices have now fallen 13 months in row, the longest period of decline on record
  - » **Total urban investments** are still robust, despite the downturn in construction starts
- ## USA
  - » **Inflation** has very likely peaked, but prices rose 0.2 – 0.3 pp more than expected in August – and the equity market went into a tailspin. Inflation is still very high. The headline is up 8.3%, and the core 5.9%. Rapid underlying (like 3m/3m) price increases are still unusually broad. **PPI prices** were lower than expected, and prices are heading downwards early in the production process. We are pretty sure inflation will come substantially down the coming months. However, Fed's focus is no doubt more on the labour market and wage inflation – which is determining CPI inflation over time - than the actual price inflation now
  - » **Manufacturing production** has flattened, even if it was slightly better than expected in August. Capacity utilisation was unch., and the level is close to the highest in 20 years
  - » **Core retail sales of goods** was flat in August, 0.5 pp below expectations and July was revised down by 0.4 pp. Sales are trending flat, at best, in volume terms
  - » **Consumer confidence** is recovering according to all surveys (incl Univ. of Michigan's) but most are still well below par. Inflation expectations are declining, broadly. Lower gasoline prices are supportive for both, we assume

Last week, II

- **EMU**
  - **August headline inflation** confirmed at 9.1%, the core at 4.3%. Energy prices directly explains 3.9 pp of the headline of 9.1%. In August energy prices were up 0.9%, but gas prices have since come down somewhat, which should ease overall inflation in September
  - **Underlying labour cost inflation** is far lower than the reported close to 4% y/y growth rate as costs were depressed a year ago (vs. costs before and after). In Q2, labour costs fell at a 1.9% pace (from Q1). We estimate a 2.5% trend growth, and it is not accelerating. However, since productivity growth has slowed during the pandemic, labour cost per produced unit (ULC) has accelerated somewhat - but it is not much above 2%
  - Thus, the ECB does not have a domestic cost problem to address, like the Federal Reserve in the US, where labour costs and ULC has exploded, the latter up to some 5% - which will yield 5% CPI inflation over time. Still, given the tight labour market and a broad increase in inflation, the current 0.75% signal rate is on the low side. In the UK, ULC has accelerated almost up to the US growth rates, and BoE will hike the signal rate to 2.25% on Wednesday. (Norway is luckily far closer to EMU than US/UK regarding growth in ULC)
- **Sweden**
  - **Core inflation**, CPI-F x energy, rose 1% in Aug (seas. adj). The core rate has accelerated sharply recent months, to 6.8% from 1.7% in last December – and again to well above the Riksbank's f'cast. Also, the increase in inflation is broad, but the biggest contributors on the upside in Aug are energy, housing (larger mortgage pmts, included in the headline CPI, not the CPI-F), and clothing, while airline tickets/holiday travel and fuel prices contributed the most on the downside
- **Norway**
  - **Norges Bank's Regional network survey** signals a 0.3% pace of contraction in GDP the next 6 months, we expected +0.5%, down from +1.6% 3 months ago. In June, Norges Bank assumed a +0.3% growth in Q4 and Q1-23. Thus, the network signal 0.5 pp lower growth pace than NoBa assumed. In addition, actual Mainland GDP in July was 1.4% pp below NoBa's f'cast. Just two sectors, oil services and exporters are expecting decent growth, while the construction sector and retailers expect a substantial decline in activity the next months. The reason for the gloomy outlook is that businesses are expecting the high inflation and higher rates to soften demand, and their energy costs are rapidly increasing. At the same time, capacity utilisation is very high, and unusually many respondents report lack of labour (though somewhat fewer than in May). The latter justifies a further tightening but not a series of 50 bps hikes, which the FRA market is still discounting
  - The Homebuilders' **new home sales** were reported marginally up in August, but the trend is down at the level is rather low, at 18' (annual rate). Starts increased by 5' to 23', while **SSB** reported that **building permits** have decreased slightly. However, **non-residential construction starts** soared in August, and both manufacturers and the private service sector is building more than in decades. Even so, the construction sector was in really bad mood in the Network survey
  - The **overall trade surplus** in goods at NOK 215 bn (seas. adj) is the highest ever, equalling some 75% of Mainland GDP! **Oil & natural gas exports** increased by 25% in Aug, after the 26% lift in July, due to higher gas prices. **The Mainland (non energy) trade deficit in goods** increased by 2 bn to NOK 30 bn, equalling 11% of Mainland GDP. Mainland exports have been very strong during and after the pandemic, and the underlying growth rate over the past year is some 20% - though just due to higher prices, in volume terms exports are flattish. Fish, metals & chemicals are reporting strong growth. **Imports** also rose by 1 bn to 75 bn, and at an 11% growth pace

The Calendar: PMIs, Riksbank, Fed, BoE, NoBa, US housing data, NOR (un)employment, wages

Time	Count.	Indicator	Period	Forecast	Prior
Monday September 19					
16:00	US	NAHB Housing Market Index	Sep	48	49
Tuesday September 20					
09:30	**SW**	**Riksbank Policy Rate**	**Sep-20**	**1.50%**	**0.75%**
14:30	US	Building Permits	Aug	1610k	1674k
14:30	US	Housing Starts	Aug	1460k	1446k
Wednesday September 21					
06:00	SW	House prices, HOX			
08:00	SW	Unemployment Rate SA	Aug	7.0%	7.0%
16:00	US	Existing Home Sales	Aug	4.70m	4.81m
20:00	**US**	**FOMC Rate Decision (Upper**	**Sep-21**	**3.25%**	**2.50%**
Thursday September 22					
08:00	NO	Unemployment Rate AKU	Jul	(3.2%)	3.2%
08:00	**NO**	**Payrolls, wages**			
10:00	EC	ECB Economic Bulletin			
10:00	**NO**	**Deposit Rates**	**Sep-22**	**2.25%**	**1.75%**
13:00	**UK**	**Bank of England Bank Rate**	**Sep-22**	**2.25%**	**1.75%**
14:30	US	Current Account Balance	2Q	-$258.4b	-$291.4b
14:30	US	Initial Jobless Claims	Sep-17	220k	213k
16:00	US	Leading Index	Aug	0.0%	-0.4%
16:00	EC	Consumer Confidence	Sep P	-25	-24.9
Friday September 23					
08:00	NO	Credit Indicator Growth YoY	Aug	4.9%	5.2%
09:30	GE	Manufacturing PMI	Sep P	48.2	49.1
09:30	GE	Services PMI	Sep P	47.2	47.7
10:00	**EC**	**Manufacturing PMI**	**Sep P**	**49.0**	**49.6**
10:00	**EC**	**Services PMI**	**Sep P**	**49.0**	**49.8**
10:30	UK	Manufacturing PMI	Sep P	47.4	47.3
10:30	UK	Services PMI	Sep P	49.0	50.9
15:45	**US**	**Manufacturing PMI**	**Sep P**	**51.3**	**51.5**
15:45	**US**	**Services PMI**	**Sep P**	**45.0**	**43.7**
Monday September 26					
02:30	JN	Services PMI	Sep P		49.5
02:30	JN	Manufacturing PMI	Sep P		51.5

- ## Preliminary PMIs
  - » **PMIs** have came in on the softer side in August, in the rich part of the world, that is. The S&P's US PMI was the weakest of all, at 44.6!. However, the ISM surveys did not confirm the sharp decline in activity, in fact ISM services reported strong growth! US services PMI is expected just slightly up in September (risk on the upside?). The EMU PMIs are expected just marginally down, and at 49, the energy crisis is not visible at all, on average – but output in German's manufacturing is falling rapidly. (EMU risk on the downside?)
- ## USA
  - » **Fed's FOMC** will very likely hike the funds rate by 75 bps, for the 3rd time in row. If delivered, the rate will have been hiked by 300 bps in 6 months, the largest 6 m tightening since 1982, of which 275 bps over the past 3 months! That's life, the Federal Reserve totally misread the economy, had some bad luck, and now is re-establishing itself as a true inflation fighter. Which it should, not because inflation is high but because wage inflation has exploded in a labour 'completely out of balance', to quote chair Powell. It will 'cause pain' (Powell) but the cost would become larger if the bank did not act now. Nobody should of course pay much attention to what the FOMC says about the future, especially not regarding the outlook for interest rates (the dot plot), as the bank's guidance has been totally useless. Still, FOMC will probably soon slow down (and will probably say so), of course depending on how much tightening support it receives from worsening 'financial conditions' (long bond rates, credit spreads, stock prices) and how fast the economy slows. The latter should not take that long, as the housing market has turned south, normally the canary in the mine.
  - » **The housing market index, existing home prices, building permits (in that order)** should reveal the status in this sector. The HMI has collapsed recent months, and homebuilders signal a 50% decline in starts. Realtors have reported falling prices for the past two months. Not strange, given the least affordable housing market since 1986, following the 56% surge in the mortgage rate, and a 40% lift in house prices since before the pandemic. Without that much support from higher rents.
  - » The **leading index** has fallen into recession territory but is expected to have stabilised in August
- ## Sweden
  - » **The Riksbank** will likely hike rates by 75 bps on Tuesday, up to 1.5%, still a very low rate. Higher than expected inflation data, a tight labour market, somewhat higher wage inflation, at least among salaried employees. The extremely aggressive stance among most central bankers everywhere these days will also influence the decision! The bank will revise up its interest rate path but probably less than the market has discounted. The downside is of course **housing prises**, which have fallen quite a bit recently – and very likely will be confirmed further down in August (other surveys have told us so).
- ## UK
  - » **Bank of England** was in deep grief last week, as their queen passed away and it postponed the MPC meeting. However, two days after the burial today, the Bank has promised to bring their acts together, we assume to hike the signal rate by another 50 bps, to 2.25%, sort of a neutral rate.
- ## Norway
  - » **Norges Bank** will lift the signal rate by 50 bps (the alternative is 25 bps) to 2.25%, and will signal some further tightening but should not lift the interest rate path peak from the 3.1% signalled in June, just front load the hikes and bring the peak closer in time, to Q1, from Q4. Our arguments, check next page!
  - » **Payrolls, wages & unemployment:** Employment growth is slowing, as the employment rate is very high. Wage inflation may be accelerating somewhat, according to the monthly data in the payrolls report but other wage indicators do not agree. We expect an unchanged 3.2% LFS (AKU) unemployment rate

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

What will Norges Bank do – and say?

Hike the signal rate by 50 bps to 2.25%, and move the 3.1% interest rate peak forward to Q1

Interest rate paths

	NoBA Path 2-22	SB1 NoBA Path 3-22	Change	Fair FRA *) @IMM, NB	FRA** now	FRA-** NoBa
Q3 22	1.39	**1.54**	0.15	2.67	**2.84**	0.17
Q4 22	1.99	**2.46**	0.47	3.22	**3.71**	0.48
Q1 23	2.53	**2.95**	0.42	3.34	**3.82**	0.47
Q2 23	2.87	**3.00**	0.13	3.35	**3.77**	0.42
Q3 23	3.04	**3.00**	-0.04	3.35	**3.72**	0.37
Q4 23	3.10	**3.00**	-0.10	3.35	**3.67**	0.32
Q1 24	3.09	**3.00**	-0.09	3.35	**3.60**	0.25
Q2 24	3.08	**3.00**	-0.08	3.31	**3.55**	0.24
Q3 24	3.04	**2.95**	-0.09	3.26	**3.49**	0.23
Q4 24	2.99	**2.90**	-0.09	3.21	**3.43**	0.22
Q1 25	2.93	**2.85**	-0.08	3.13	**3.38**	0.24
Q2 25	2.85	**2.77**	-0.08	3.05	**3.32**	0.26
Q3 25	2.77	**2.69**	-0.08	2.61		
Q4 25	2.68	**2.60**	-0.08			

*) *Assuming the NIBOR spread at 35 bps*
**) Q4 FRAs adjusted for liquidity prem

Changes in the interest rate path from the June NoBa meeting	Impact bps
Domestic demand (incl oil,gas price), capacity util.	0
Money Market (money market, lending spreads)	0
Prices, wages	4
Foreign factors	0
NOK	-5
Judgement (surveys, fin. stab, global risk etc)	-10
Sum	**-12**
Changes in NOK Jun-23,Dec 24 FRA since after Jun m.	7
Change in the interest path 1 - 2 years from now	

- We expect another – and the last – 50 bps signal rate hike, up to 2.25% (the alternative is 25 bps). In the June MPR, Norges Bank expected to reach this level 3 months later, in December
- We expect Norges Bank to signal further one or most likely two 25 bps hikes before Christmas (in November and December), up to 2.50% or 2.75% by year end
- In the June report, a 3.1% signal rate peak was expected to be reached in Q4-23. <u>We expect the peak level to remain more or less unchanged but to be reached in Q1-23</u>
- The Bank's challenges are obvious:
  - » Inflation is higher, and has broadened since the summer. The bank will revise its forecasts up, even for the core rate and total inflation even more, increasing the risk for higher wage inflation next year. Capacity utilisation remains high, unemployment is at a very low level, and excess demand for labour obvious, witnessing the vacancy rate and business surveys, including last week's NoBa's Network survey. The housing market has not (yet) turned south
  - » At the same time, GDP growth has slowed substantially, earlier than NoBa (and we) have assumed. The Regional Network even signals a moderate decline in GDP. Wage inflation has so far not accelerated (we feared it would, somewhat). On the other hand, cost inflation is somewhat too hight due to a weak productivity performance
  - » The high debt/income ratios among some 1/3 of the households will reduce their disposable income sharply as mortgage rates jumps up. Household credit growth is slowing
  - » Norges Bank will revise its growth forecast somewhat down – but capacity utilisation less. Unemployment will be revised slightly upwards.
- Even if FRA rates have fallen sharply recently (while foreign rate expectations have climbed further), the market still assumes a 3.5% signal rate peak in early 2023. <u>Thus, there is some more downside risk to FRA rates this week</u>

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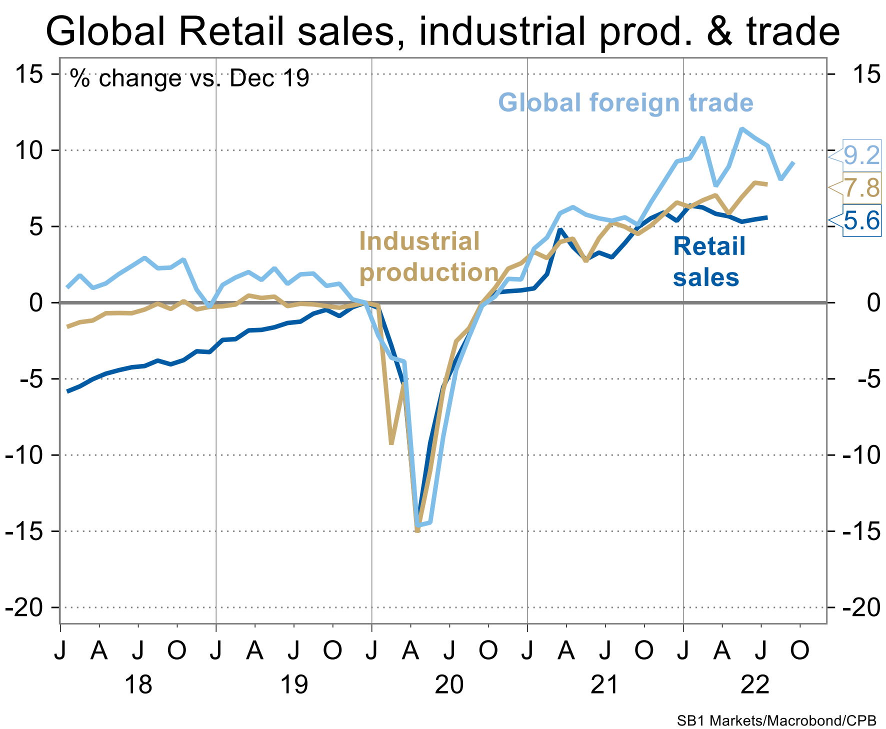
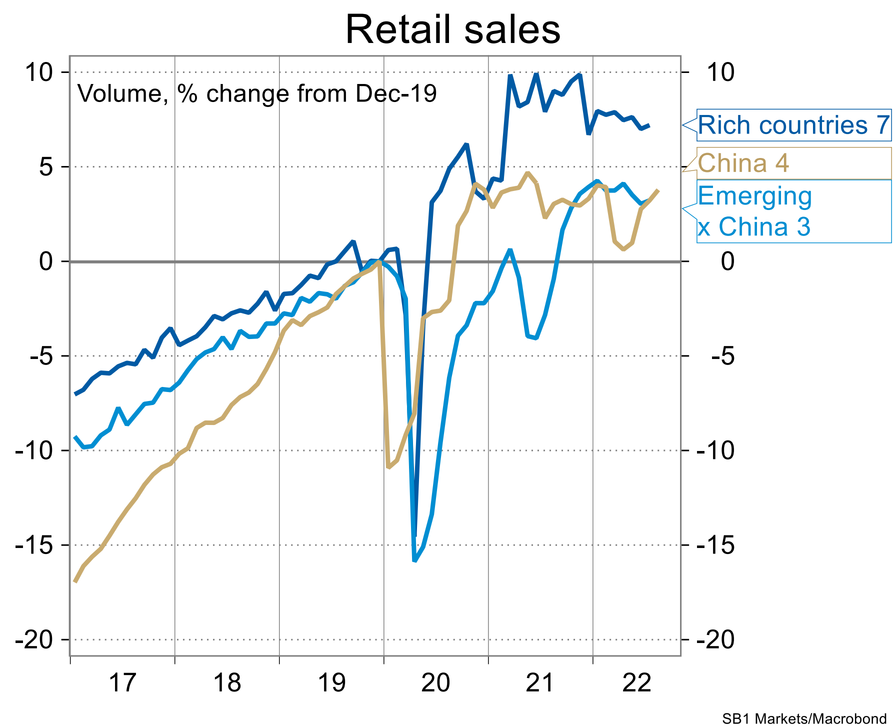
Retail sales are still soft, manufacturing production recovered in May/June/July

Global trade may have flattened. Both manuf. prod. & global trade exposed to lower retail sales

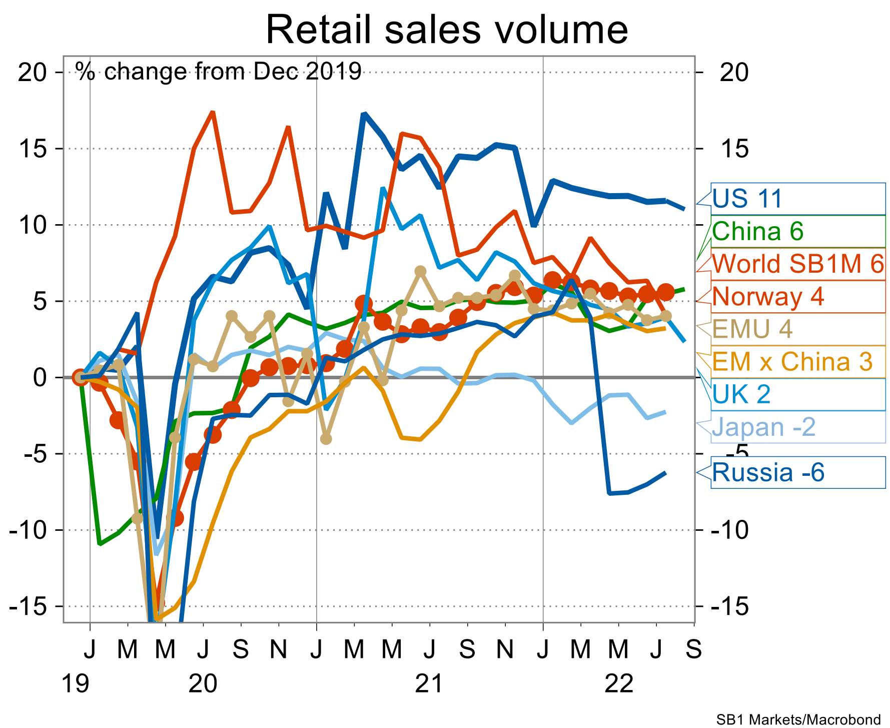


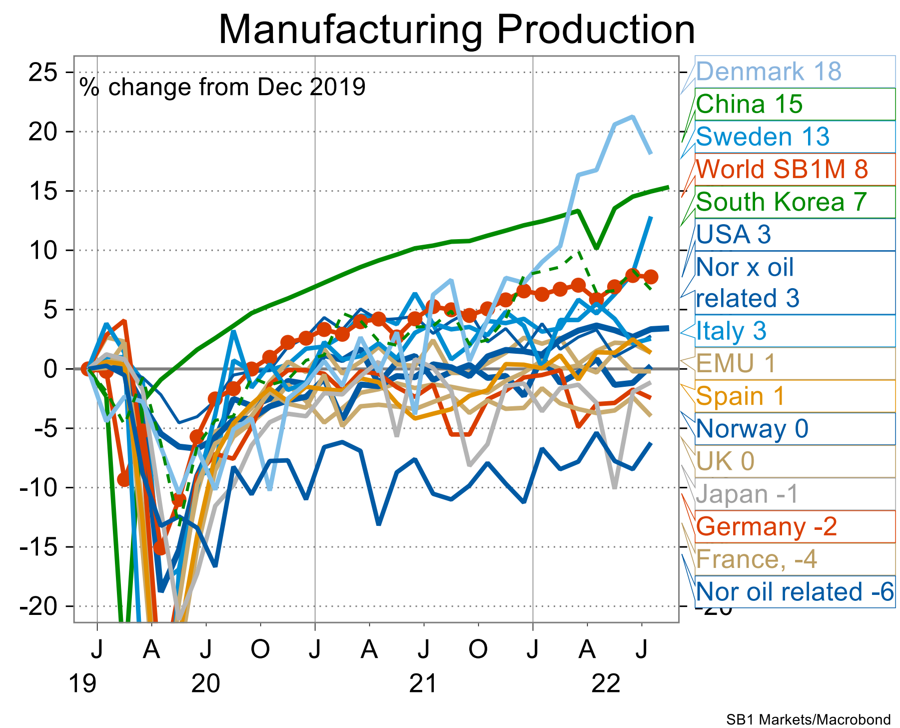


Global trade: The last months are estimates from the Kiel Institute, they are also making a prognoses for the next month based on shipping activity etc.

A broad slowdown of retail sales

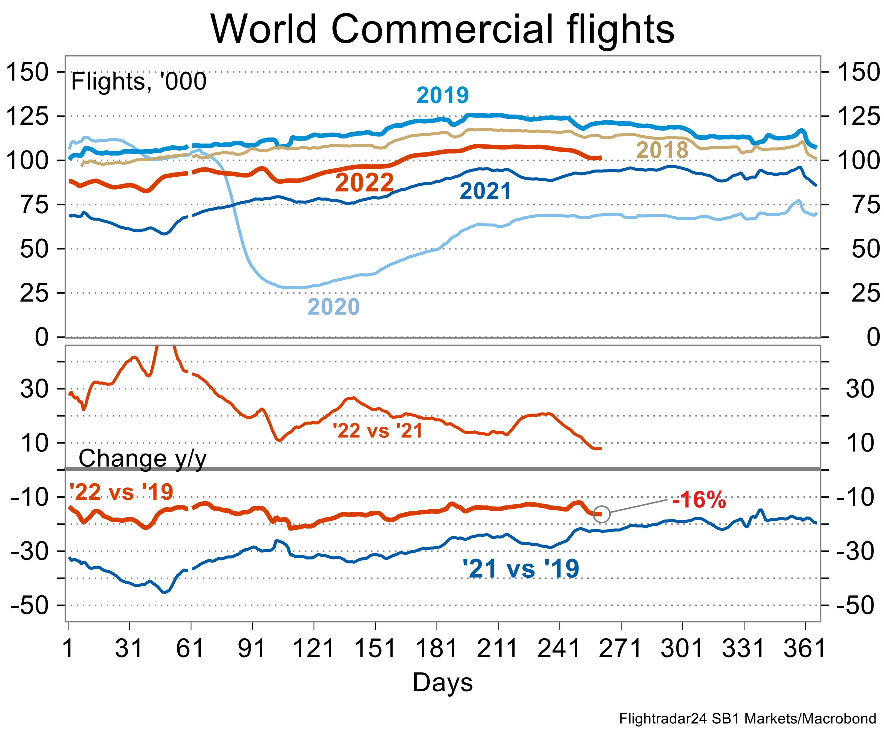
Is manufacturing exposed? Surveys, like the August PMIs send a warning sign too

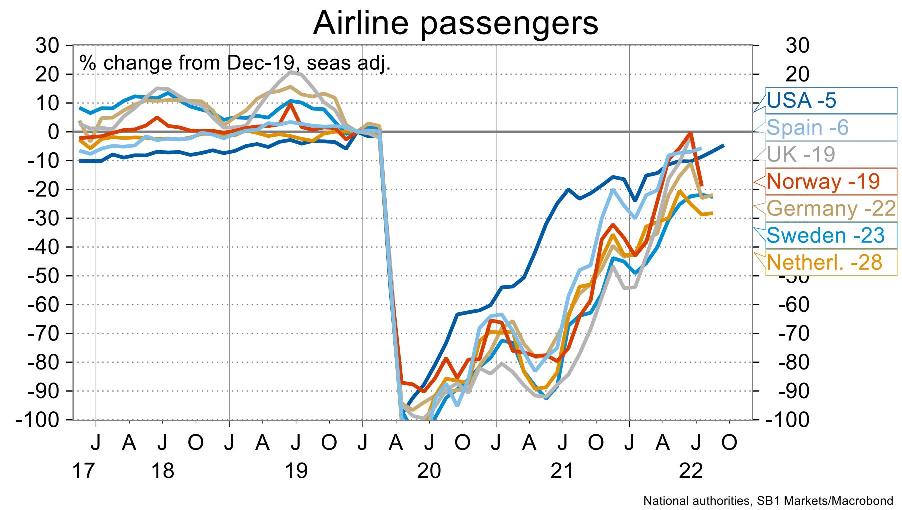


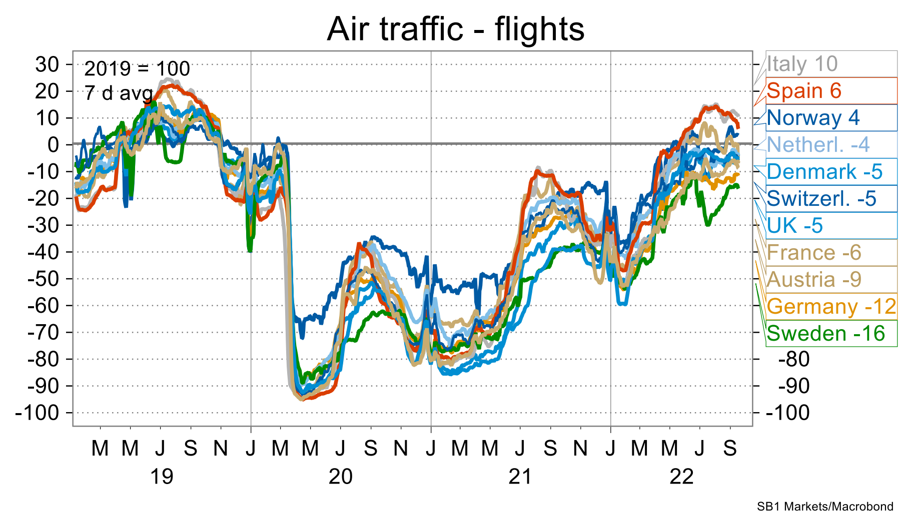


Global airline traffic down last week too, is approaching the 2021 level…

Traffic is down 16% vs. the 2019 level, the largest decline since late June



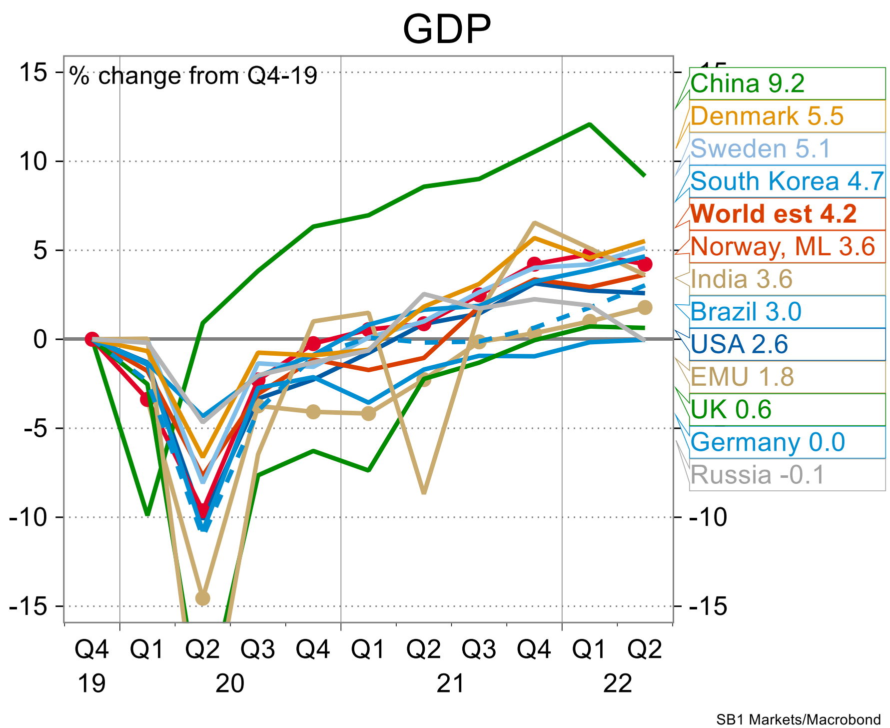


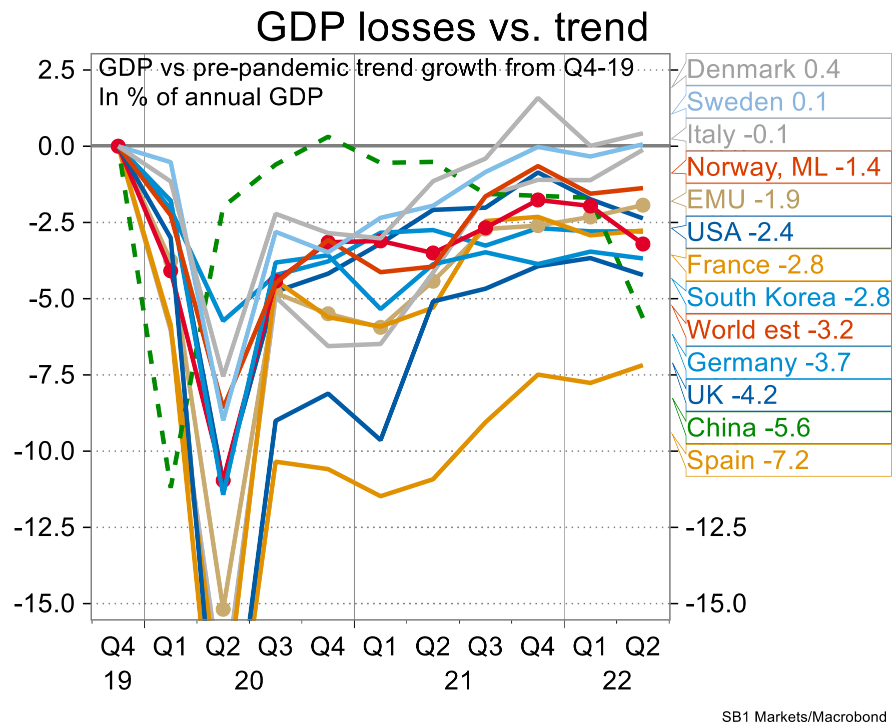


Global trade: The last months are estimates from Kiel Institute

GDP fell in Q2, mostly due to the Chinese lockdowns, and the US 'recession'

Global GDP fell at a 2.8% pace in Q2 (-0.7% not annualised), revised down due to a setback in India

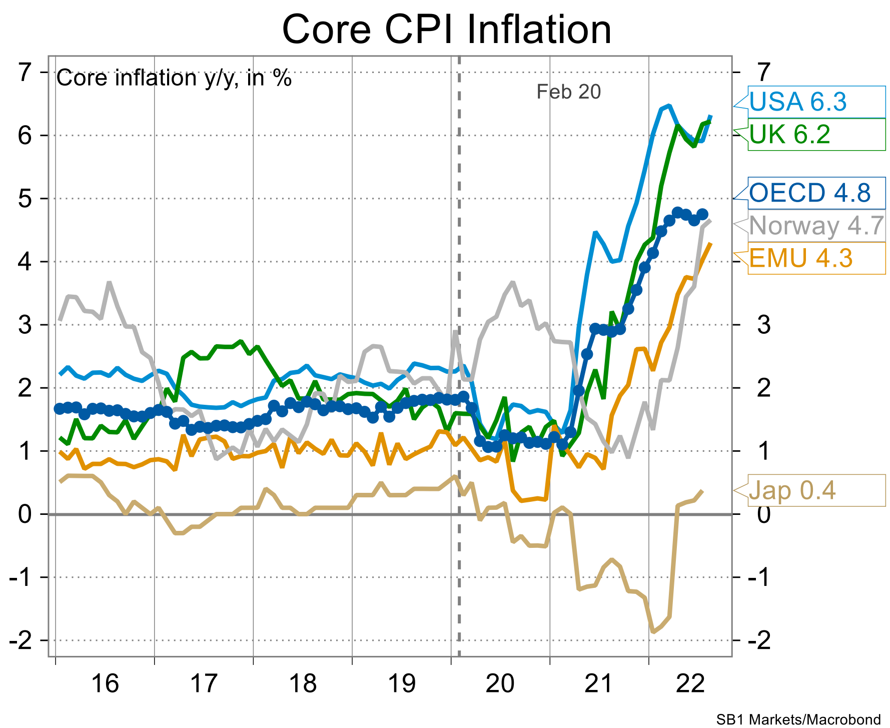


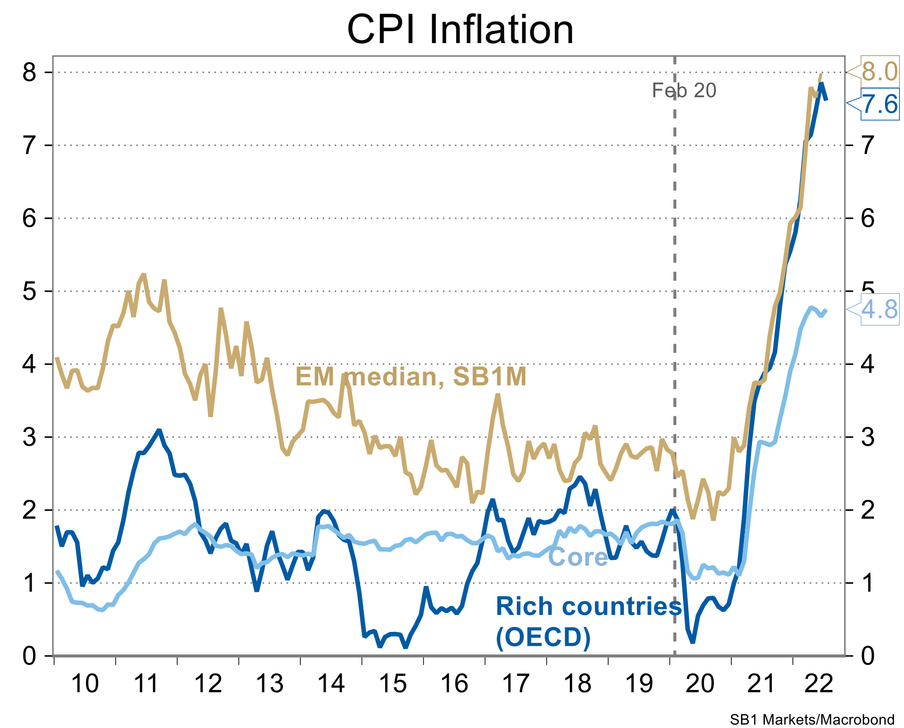


- Global GDP is some 3% below the pre-pandemic growth path

Peak inflation, at least some places – but levels still very high

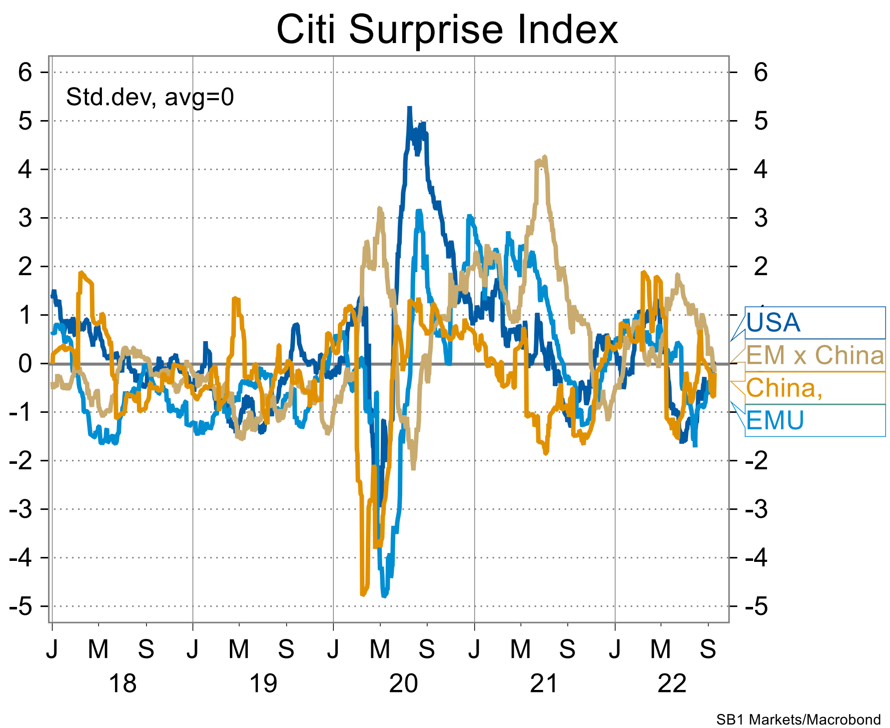
Also for the core rate – even if energy and food has contributed heavily most places

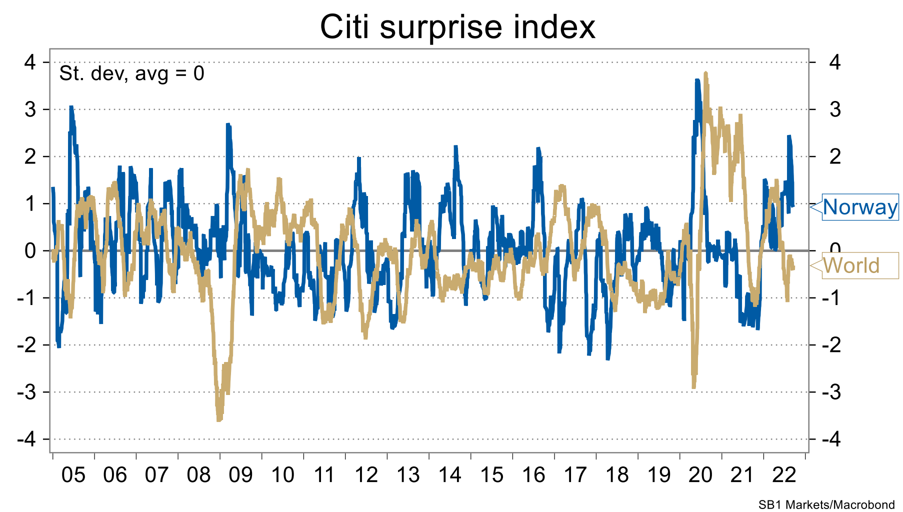


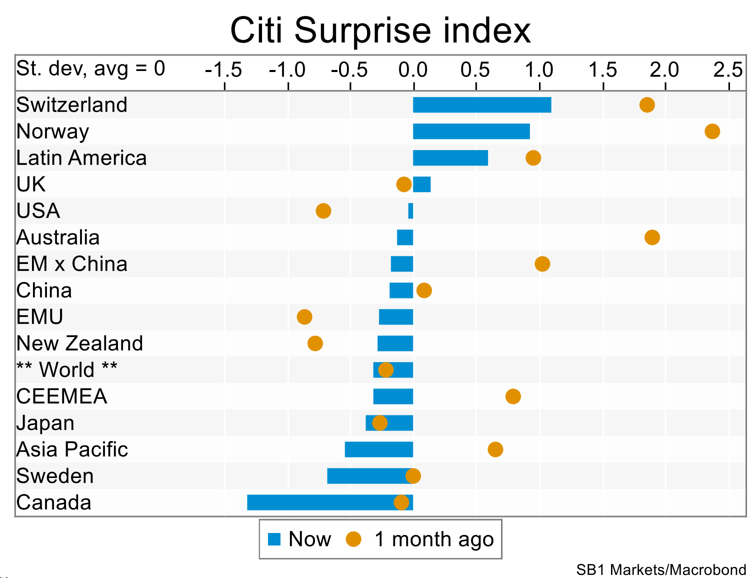


Data still slightly on the downside but most countries/regions close to neutral

US, EMU and China are all below par







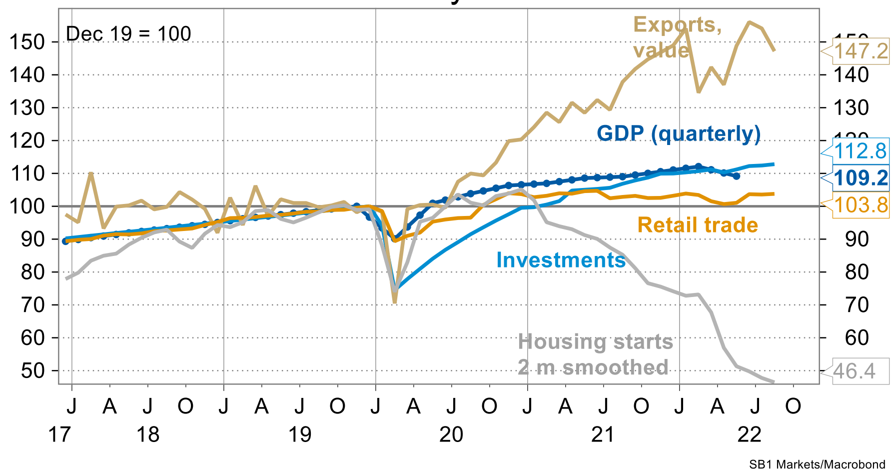
- **Norway** down to no. 2 on the list, even if data have not been that strong?

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

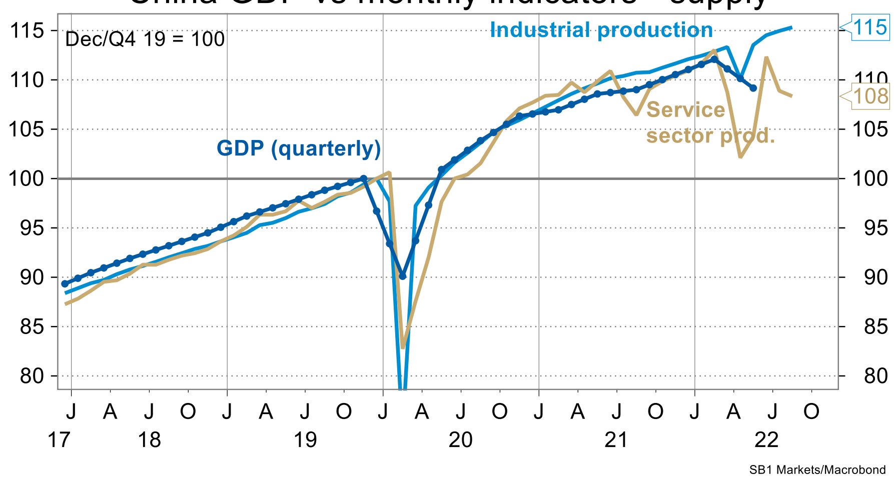
Data on the stronger side in Aug, but construction starts are still very weak

Low inflation gives room for expansive policy measures

China GDP vs monthly indicators - demand



China GDP vs monthly indicators - supply

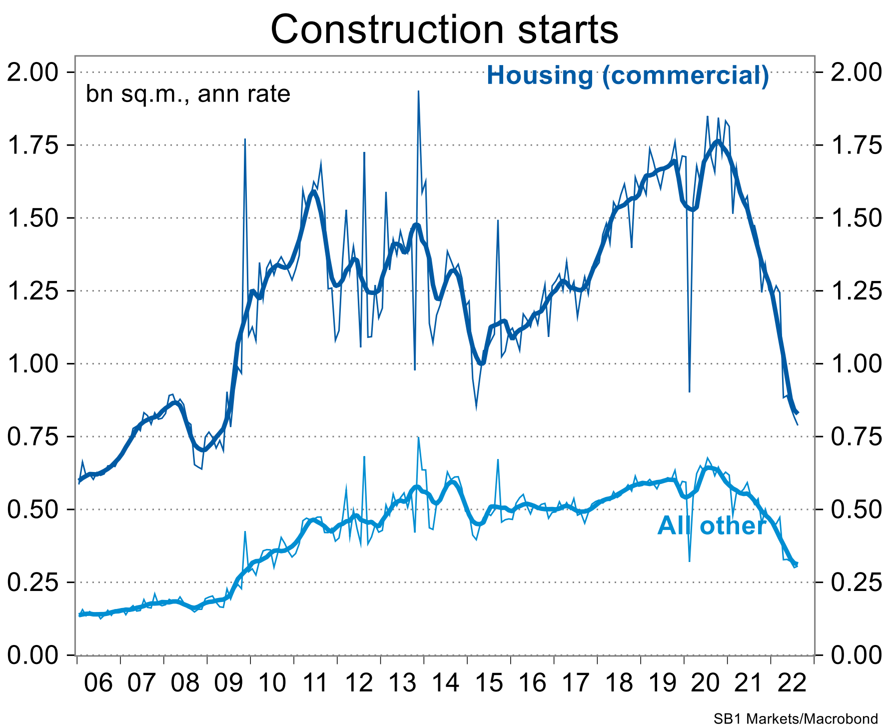


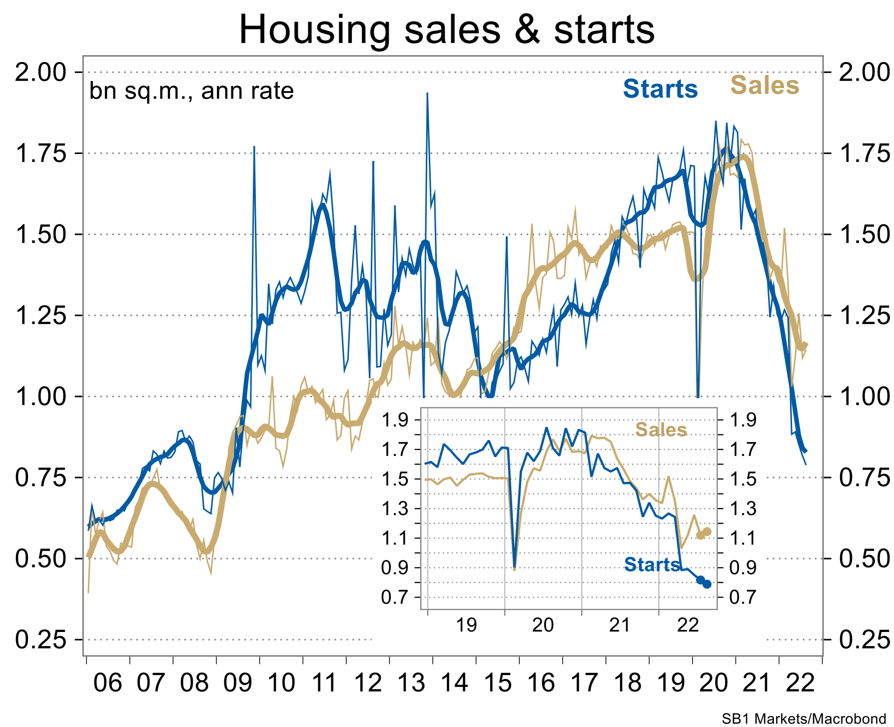
- **Industrial production** rose 0.3% in August and is back to the pre-lockdown trend, and above expectations, up 4.2% y/y, expected 3.8%. Growth is well below the pre-pandemic trend. Steel production was up in Aug (but is trending down), while cement fell further. Autos still in the lead!
- **Service sector production** fell by 0.5% in Aug, following the 3% drop in July and the level is 3%- 4% below the pre-lockdown, and 8% below the pre-Covid trend!
- **Retail sales** were stronger than expected in Aug, and the history for '22 was revised up significantly. However, sales remain weak, the volume is down 6% from the pre-pandemic trend, but auto sales are red hot, suggesting there is no crisis among Chinese consumers. Retail sales rose 5.4% y/y, expected 3.5%!
- **Investments** rose 0.4% in Aug, and is back on track, even if both **residential and commercial construction starts** have fallen by more than 50% from the peak early last year (the largest contraction ever). Starts fell further in Aug. **New home sales,** on the other hand, rose 2.2%, but is down 36% from the peak last year! **House prices** are still falling, -4.9% in Aug
- **Credit growth** increased sharply in Aug, after falling in July, and the growth pace was 10.4%. Credit growth has been accelerating recent months but just due to a very rapid growth in local government debt (lack of revenues from land sales, funding of real estate projects?). The **central authorities** have decided that local governments should increase borrowing further in H2, a massive policy shift, in order to support infrastructure and housing projects – like in the good ol' days
- **CPI inflation** was down 0.2 pp to 2.5%. CPI ex. food & energy was flat at 0.8%. Food inflation is creeping upwards, to 6.1%, but China does not have an inflation problem all in all
- **Exports** were down 5% in Aug, but remain high, of course, up 44% from before the pandemic. **Imports** are still subdued, and the trade surplus is at a record high level. An imbalanced economy?

In sum: August was stronger than expected, and the inflation print underpins that there is room for more old-school policy steps. However, we are not sure that more debt-funded infrastructure spending will solve underlying growth challenges. The 50% drop in housing (and non-residential) starts may have brought construction down to a more sustainable level

New home sales up 2% m/m in August, starts are continuing downwards

Sales are down almost 40% vs. the peak level in early 2021. Starts are down more than 50%!!





- **New home sales** rose 2.2% m/m in Aug following the 11% fall in July. The level is 24% below the pre-pandemic level – and 36% down from the (smoothed) peak early last year – and the lowest since 2015
- **Housing starts** fell 3.5% m/m in Aug, and is thus continuing downwards, following the steep decline in April, during the lock-downs. Starts are down 52% since early 2021, the largest downturn ever! The level is the lowest since 2009!
- **Non-residential construction starts** are also more than cut in half, and the level is the lowest since 2009
- This unprecedented decline in construction starts will lower growth in the Chinese economy substantially – spread over time, as it takes some 3 years from a home is started until it is completed

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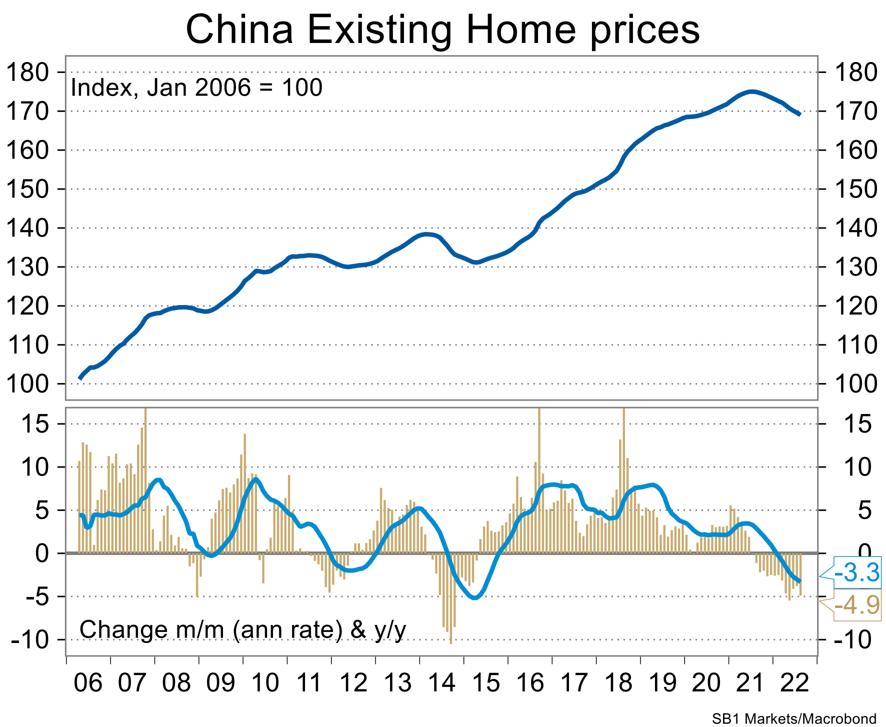
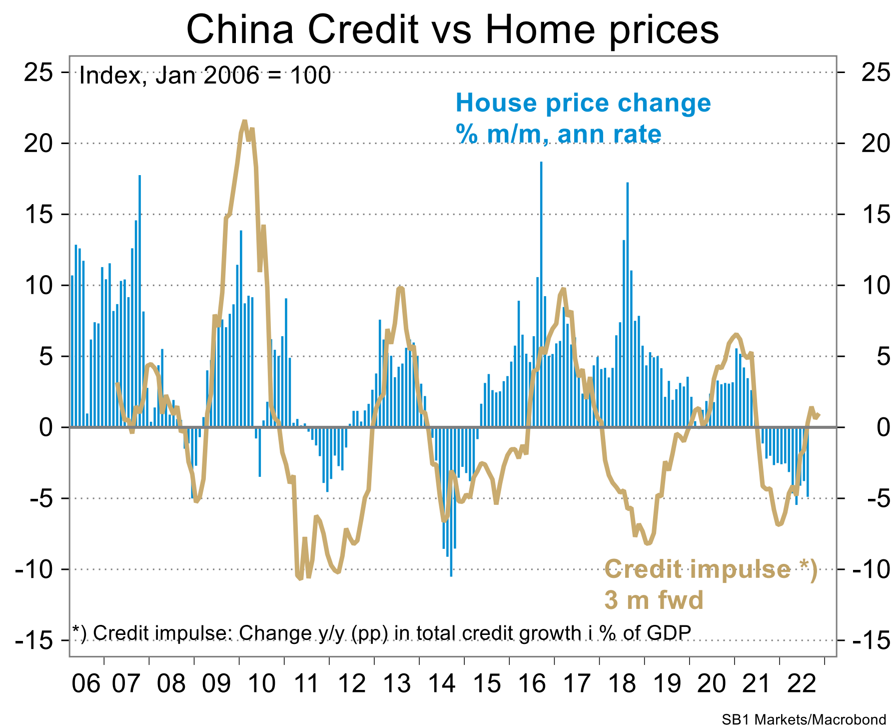
Existing home prices fell further in August – for the 13th month in row

- the longest stretch with falling prices ever. New home prices on the way down too



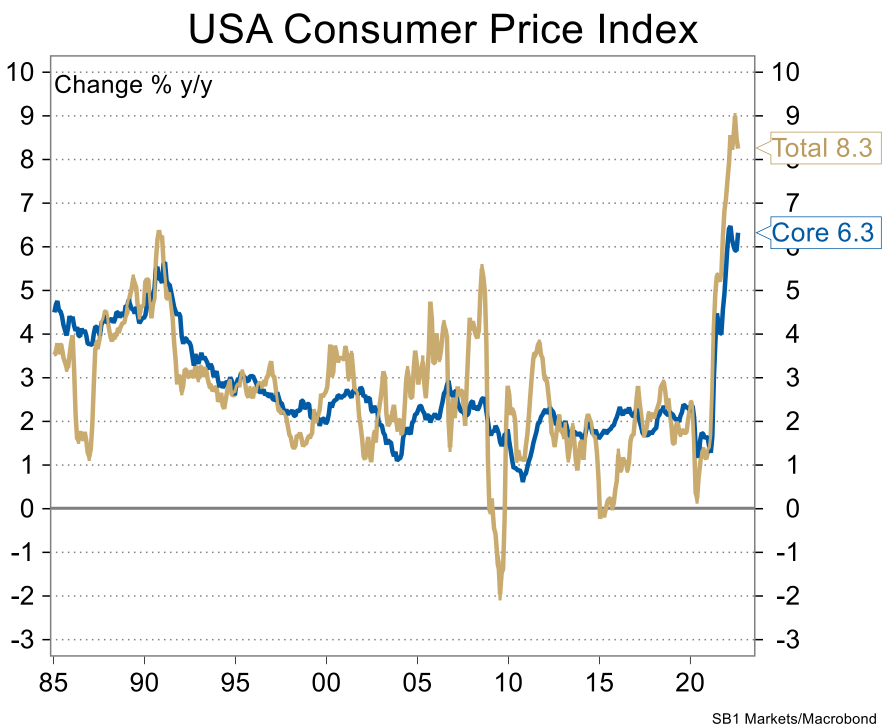


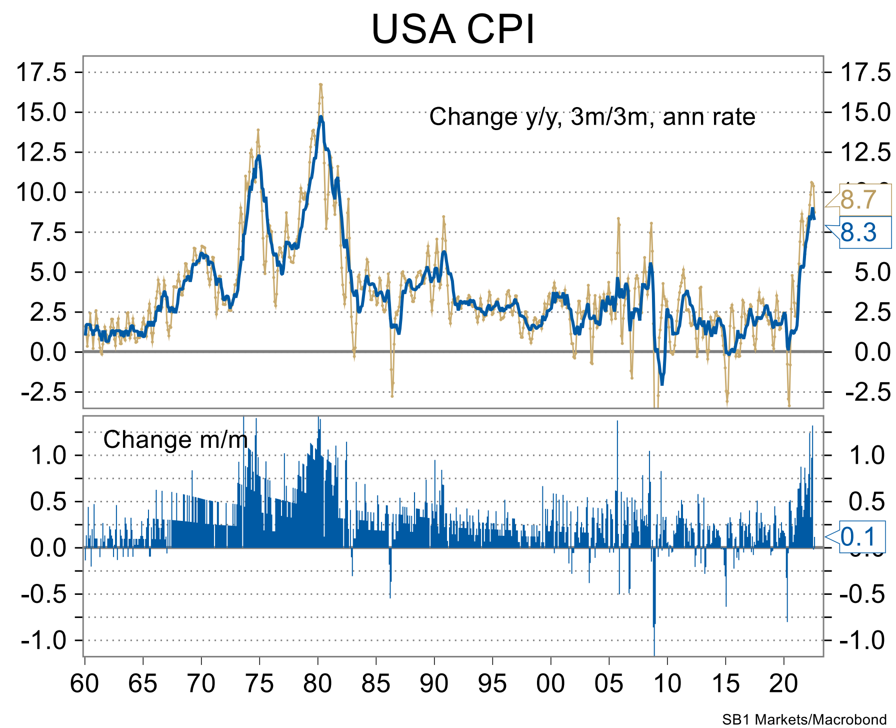
- **Existing home prices** peaked last July, and have been falling at a gradually faster pace, until May. In August, prices fell at 4.9% pace. Prices are down 3.3% y/y, less than the price setback in 2014/15. However, the current setback has now lasted longer than the previous
- **New home prices** also fell last autumn but at a slower pace than existing home prices. In August though, new home price also fell at a 4.9% pace m/m, the fastest so far in this downturn, and they are down 2.2% y/y. Some builders have reported deep price cuts to reduce the inventory and secure financing. The gradual decline in prices since last summer is probably due both some fire sales from construction companies that have run out of other sources of financing, and some hesitance from home buyers
- Prices are still climbing in the four largest Tier 1 cities, but are falling elsewhere – and at the fastest pace in the 'smaller' Tier 3 cities
- **Central authorities** have signalled willingness to expand credit supply again, both to finance infrastructure projects and the construction sector, mostly through local governments that would be allowed to borrow (even) more

SpareBank 1 MARKETS

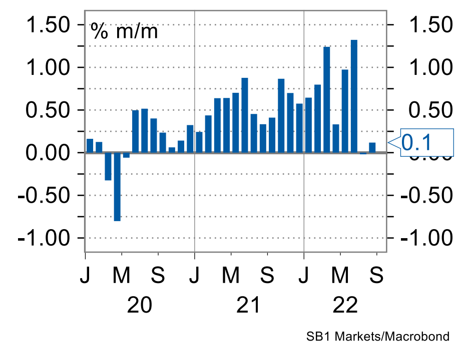
CPI has peaked, but Aug. data still surprised on the upside. Which was bad news…

CPI inflation was 0.2 – 0.3 pp higher than expected. The core up 6.3% y/y, and inflation is broad





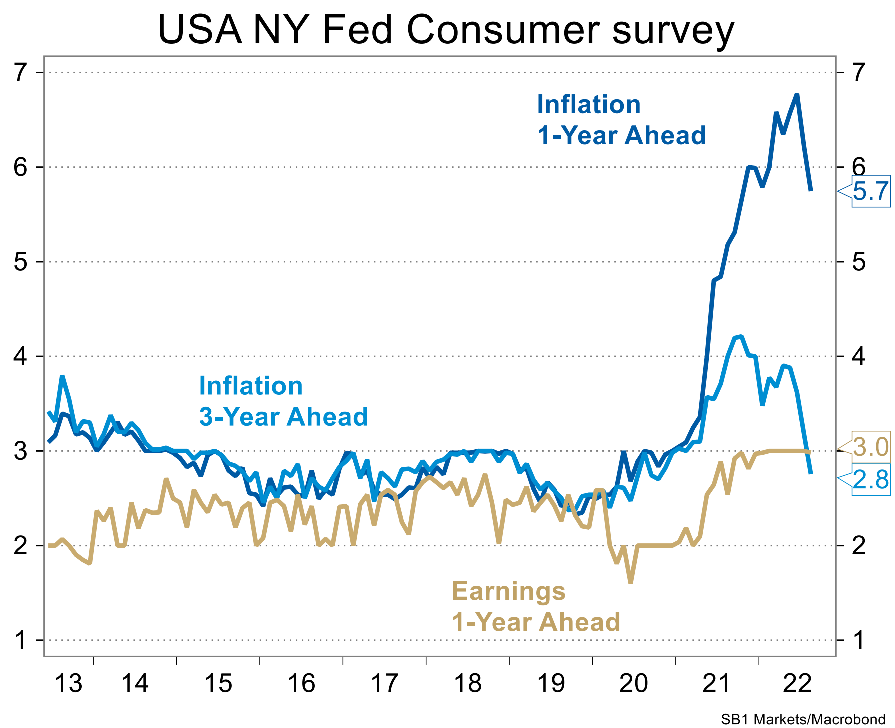
- **Headline CPI** slowed 0.2 pp to 8.3% in August, expected down to 8.1%. Prices rose 0.1% m/m but was expected down
- **Energy prices** fell by 5% (gasoline 10.6%) following similar price cuts in July. Energy is still contributing 1.7 pp to the headline rate
- **Food prices** rose 0.8% m/m and are up 10.9% y/y, lifting the CPI by 1.6 pp. (Food at home is up 13.1%!). Food prices were flat at the producer level in August
- **Surveys** report further price increases the coming months, but at much slower pace the over the prev. months
- Given the CPI surprise, a 75 bps hike next week is a done deal. Powell has finally made up his mind
- We still think **markets** focus too much on actual inflation, especially driven by commodity prices, and to little on wage cost inflation. However, lower margins contraction will also be detected in the CPI report – and they are important for the Fed

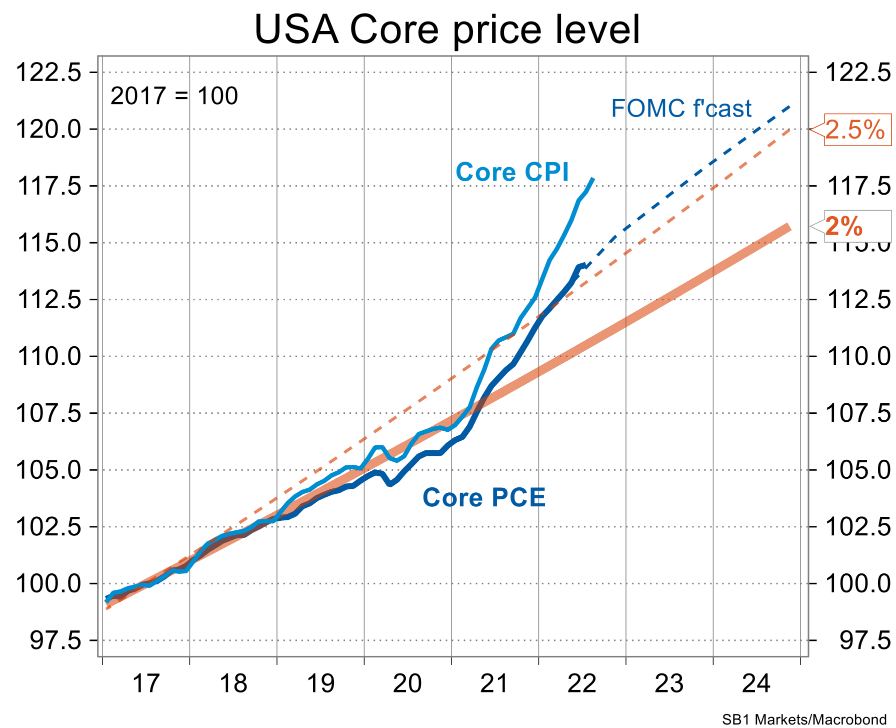


SpareBank 1 MARKETS

NY Fed's survey: Consumers' inflation expectations are falling rapidly

Longer term (3 y) expectations have fallen to 2.8% from above 4%. Are back to a normal level!

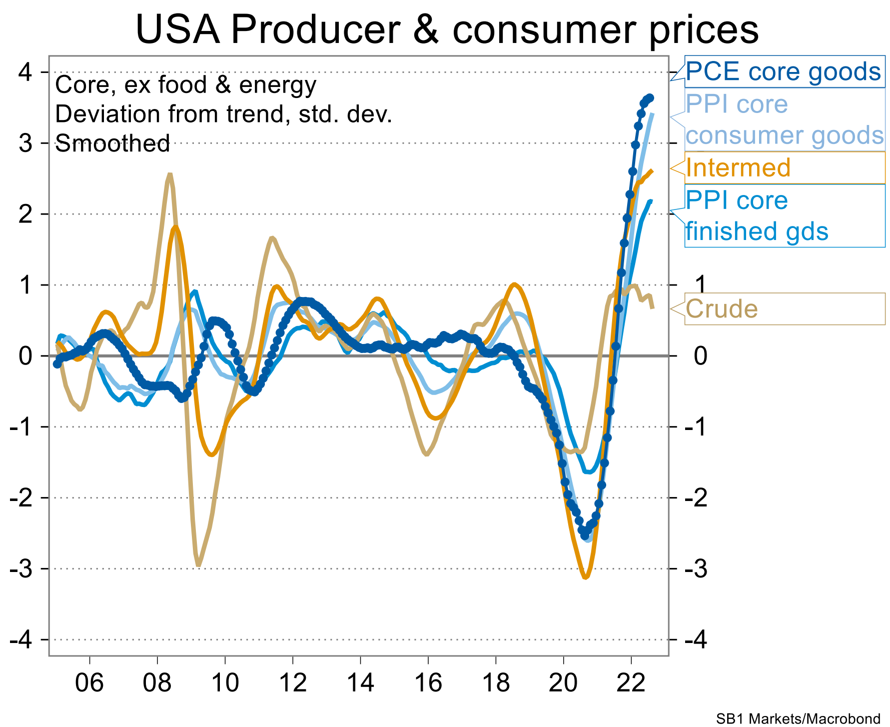


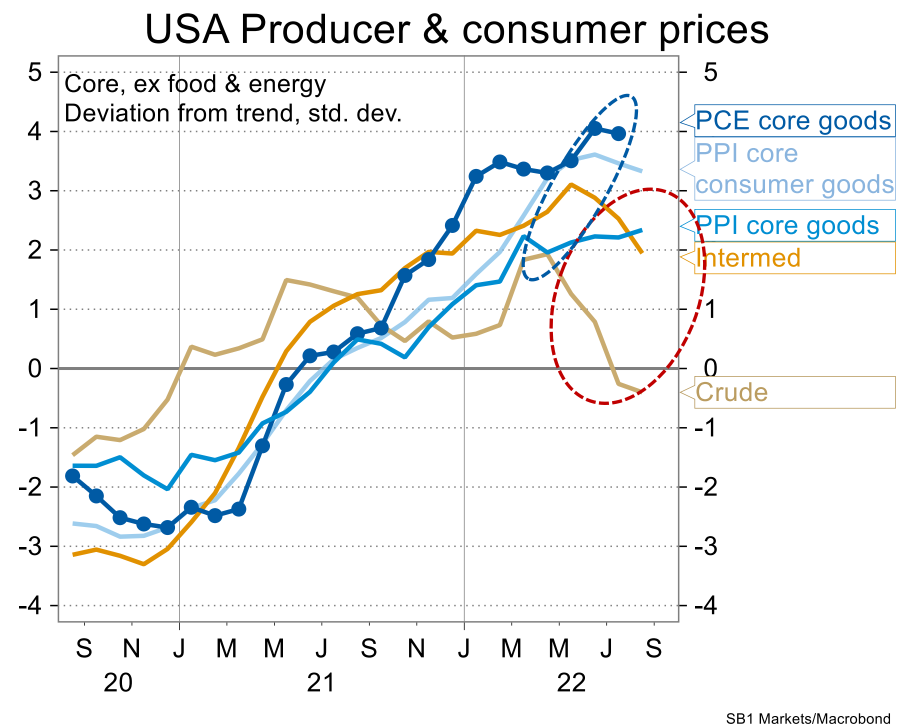


- All surveys tell the same story: Longer term inflation expectations have come down and are not high
- The public has not lost confidence in the Federal Reserve – even if actual inflation is very high, and the price level has departed from the 2% path
  - BTW, do you remember Powell's arguments for an expansionary monetary policy back in 2020, in order to bring the price level up to the 'promised 2% path' by letting inflation run above 2% for a while? *How should he formulate this strategy now??*

Crude core material prices are yielding

Now intermediate goods follow suit – and the core consumer goods PPI grows in line with trend

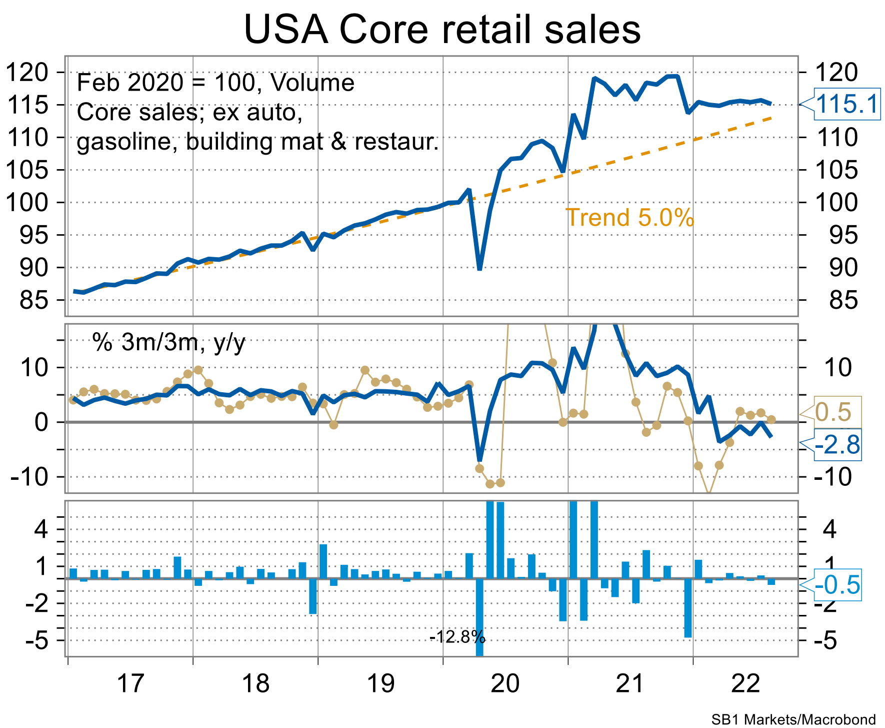


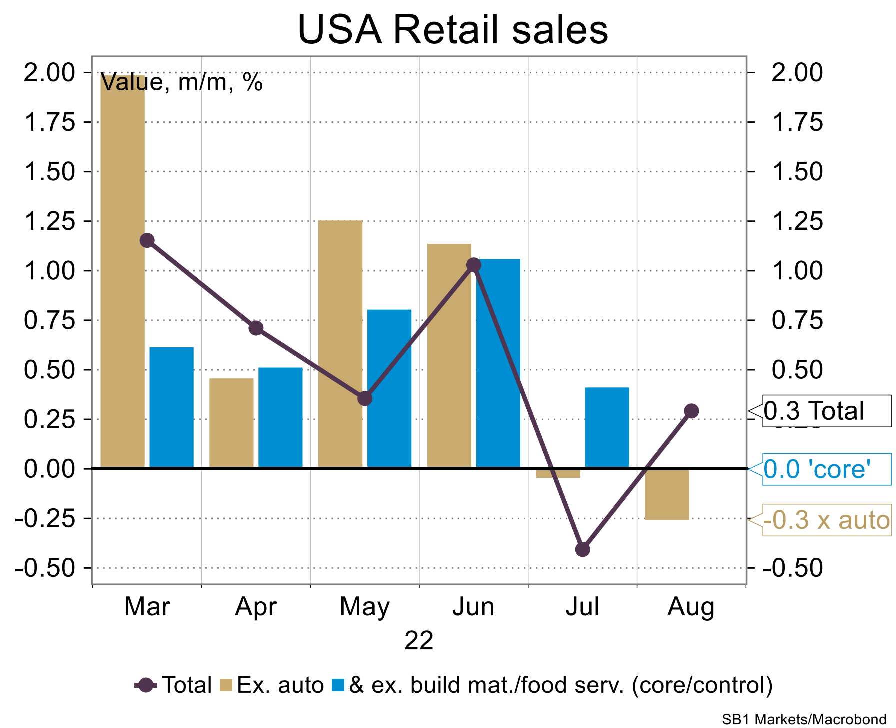


- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months. Following several months with slow growth in these prices to February from last summer, they rose in March and remained at a high level in April – but they are now heading down rapidly (and prices are down y/y, *check next page*). **Intermediate prices** have slowed past two months. We can here see the impact of the broad decline in raw material prices globally – as growth in demand is slowing
- Core consumer goods prices are also yielding at the producer level, rather early vs the normal cycle pattern

Retail sales of goods have flattened (in volume terms), down some 0.5% in Aug

July core sales were revised down by 0.4 pp, and sales in August were 0.5 pp lower than expected

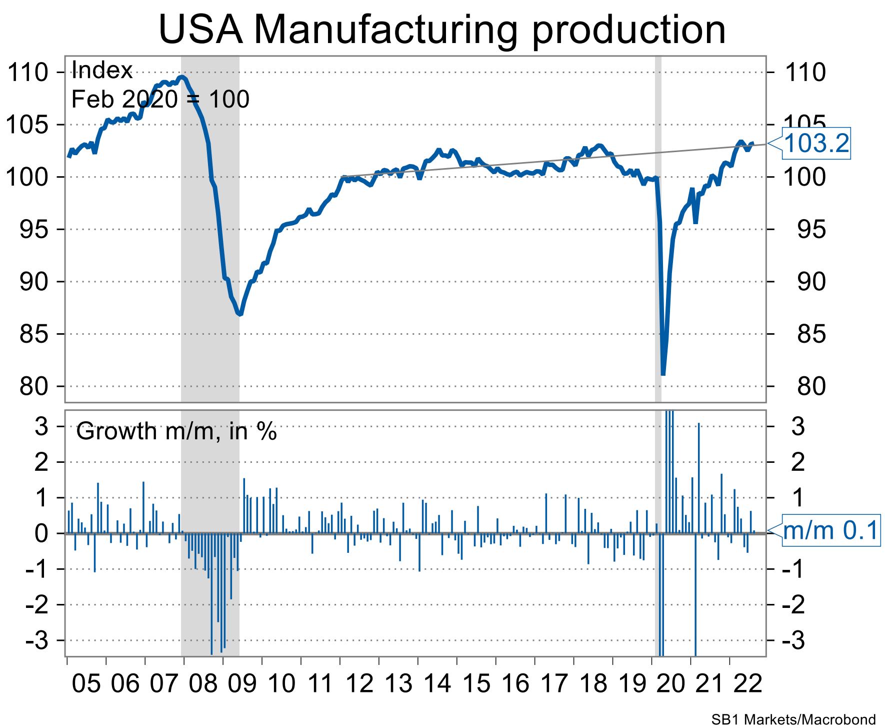


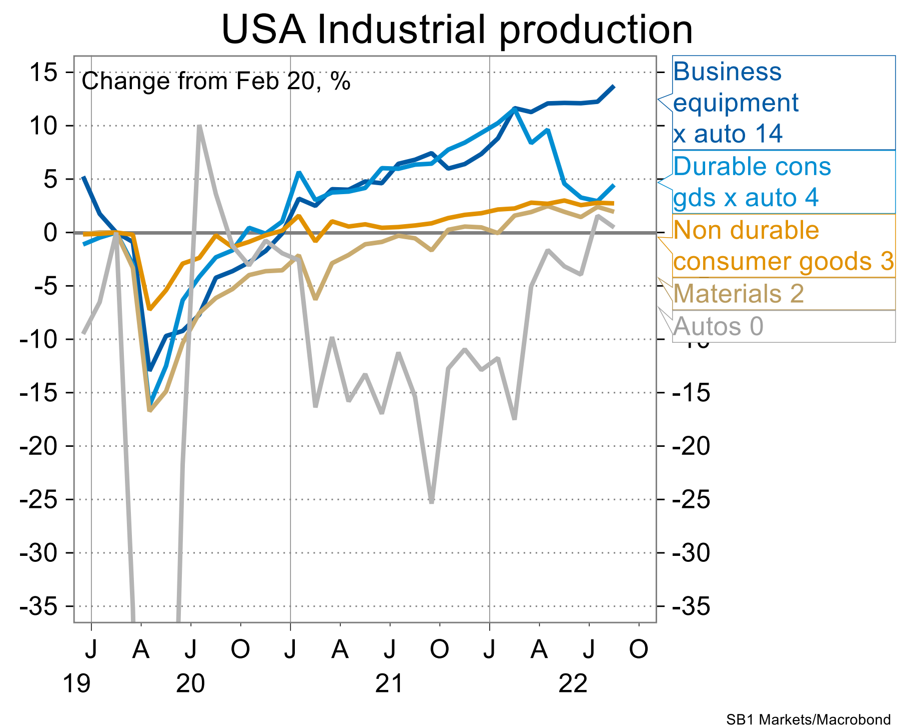


- **Total nominal sales** were up 0.3% in August, 0.1 pp above expectations, but June was revised down by 0.3 pp to 0.7%. Auto sales fell. In addition gasoline sales fell, together with gasoline prices. Total nominal sales are up 30% vs. the Feb 2020 level!
- **Core sales of goods** (=control group, excludes autos, gasoline, building materials & restaurants) was flat in August in value terms, 0.5 pp below expectations (and July data were revised by to 0.4 pp to 0.4%)
- **In volume terms**, core sales are trending slightly downwards: We assume prices rose by 0.5% m/m in August. Thus, in volume terms, sales fell by 0.5% following a 0.2% increase in July (our estimates). 'Real' sales are trending marginally downwards (-2.8% 3m/3m), and are approaching the pre-pandemic trend! Sales are 5% below the level from last November, which was the highest ever

Manufact. prod. up 0.1% in Aug, 0.2 pp better than expected – short trend flat

Auto production slightly down, flat vs. Feb-20, not much worse than some other sectors

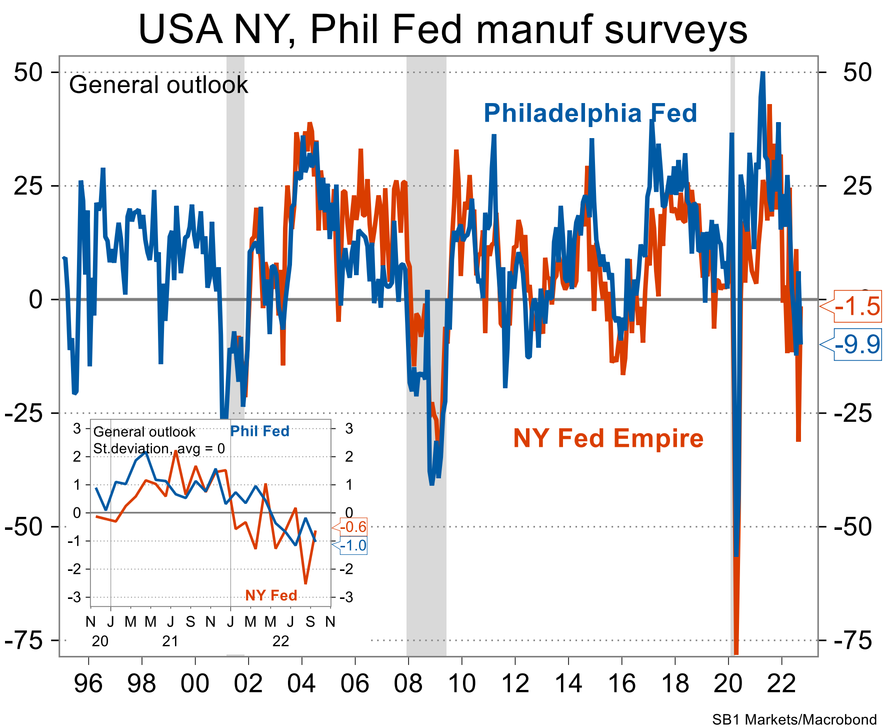


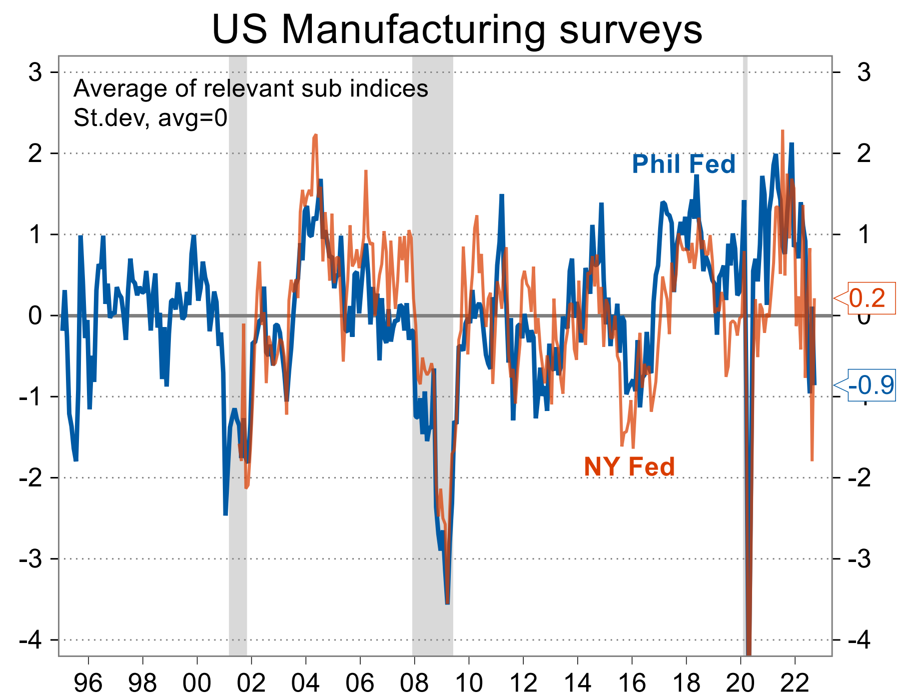


- **Manufacturing production** grew 0.3 pp more than expected. Production is still below the April level, and the 3m/3m rate at -0.9%
  - » Production of business equipment, durable goods x autos up, materials down. Durable goods x auto is down 7% since February
- **Total industrial production**, including utilities, mines/oil production, was flat in August – in line with expectations
- **Capacity utilisation** was unch., and the level is close to the highest in 20 years (the peak was in April)
- **Surveys** have weakened substantially since May. The two first September surveys are mixed but in sum up vs their August prints

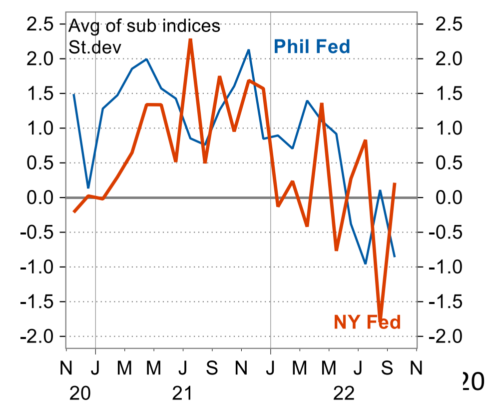
Flip flop: NY Fed's index up, Phil Fed down in September. In sum up

Once again the two surveys differ from month to month. <u>The trend is down for both of them</u>



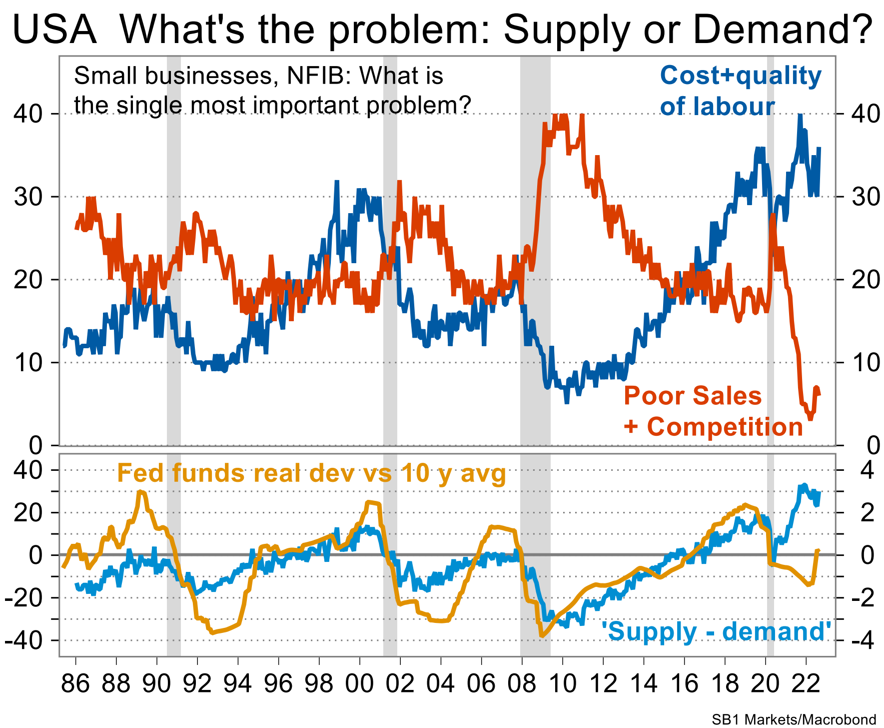


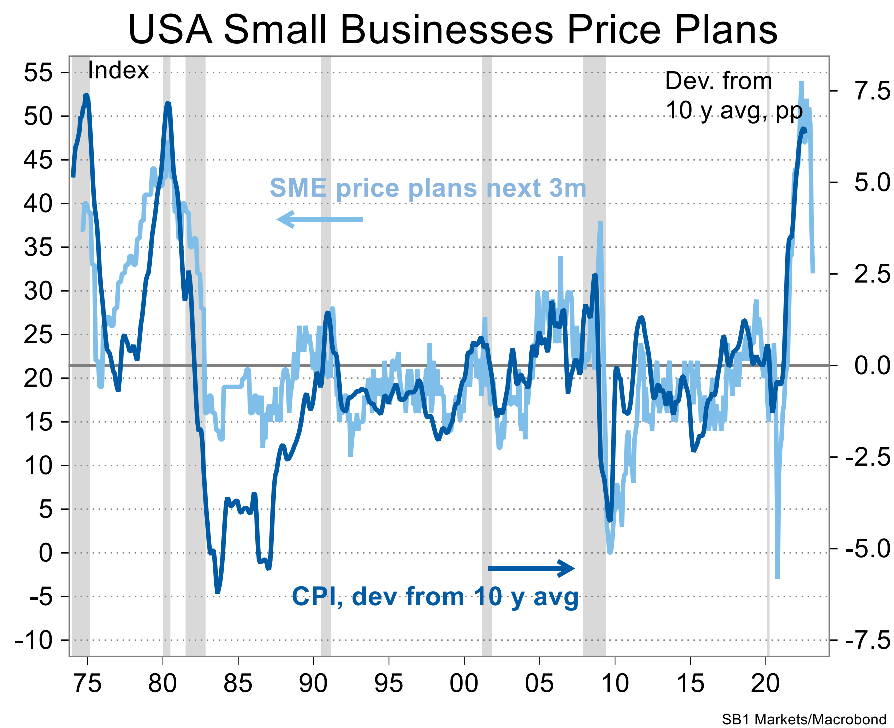
- **NY Fed Empire State manufacturing index** nosedived in August, to -2.5 st.dev below average (one of the worst prints ever) but rose to -0.6 in Sept, 0.7 st.dev better than expected
- **Philadelphia Fed's manufacturing index** surprised on the downside, as it fell to -1 st.dev below average, from -0.2 in Aug, expected up to <u>+0.1</u> st.dev!
  - » The sub-indices told the same story, the two surveys swapped positions in September. Delivery times are falling, and price increases are slowing further – in fact <u>input prices were unchanged in September</u>
- **Taken together:** A small uptick in September and they signal an unchanged manufacturing ISM



Fewer companies report they plan to lift prices (but still far more than normal)

Demand is coming down – but far from a problem yet

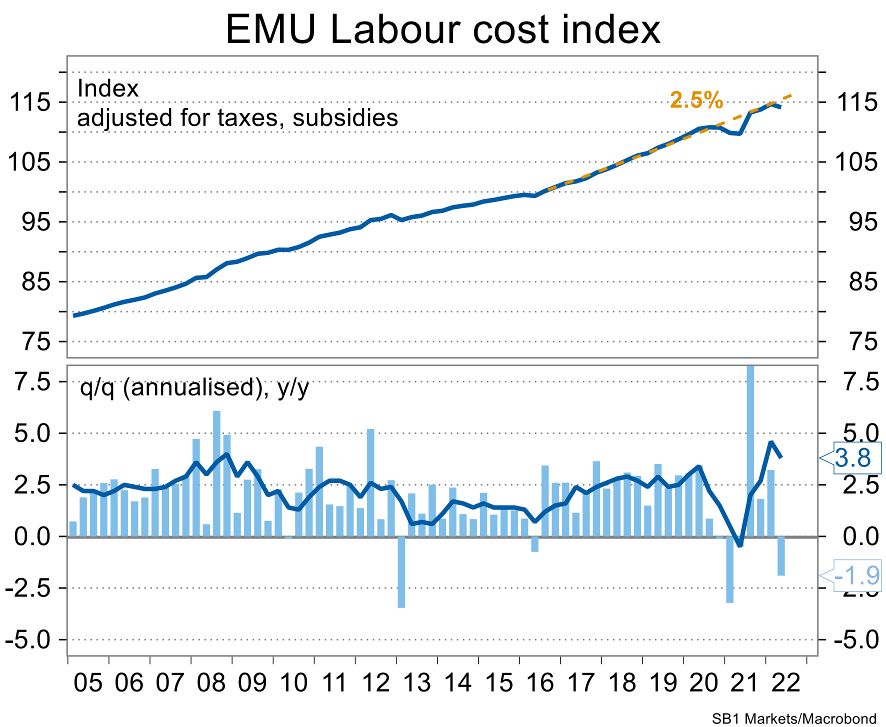


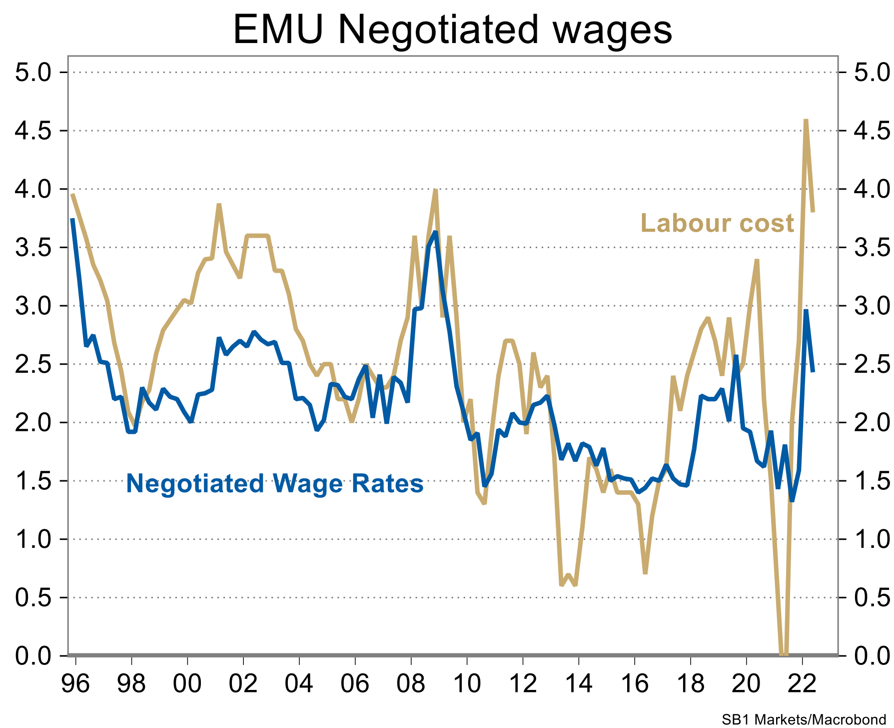


- **The 'gap' between supply and demand concerns** is still very large, but it is now heading down
  - » Very few companies report **poor sales or competition** as a problem. The share is up from March, but fell marginally in August
  - » **Cost & quality of labour** is stated as the most important problem 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
- At the same time, the share of **companies that plan to lift prices**, fell sharply in August, to 32% from 37%. However, the 32% rate is far above an average 21% share, and inflation well above the past 10 y average is still signalled. Even so, a very positive signal
- **We have no doubt:** Over the coming months and quarters, the poor sales/competition (the red line) will climb sharply – and the blue line will come back down to Mother Earth as financial conditions tightens, with or without help from the Federal Reserve. It's normally labelled as a recession, as soon as the red line crosses the 20-line

Europe does not have a wage problem

Yes, labour costs were up 3.8% y/y, but from a (newly found) trough last year, trend at growth at 2.5%

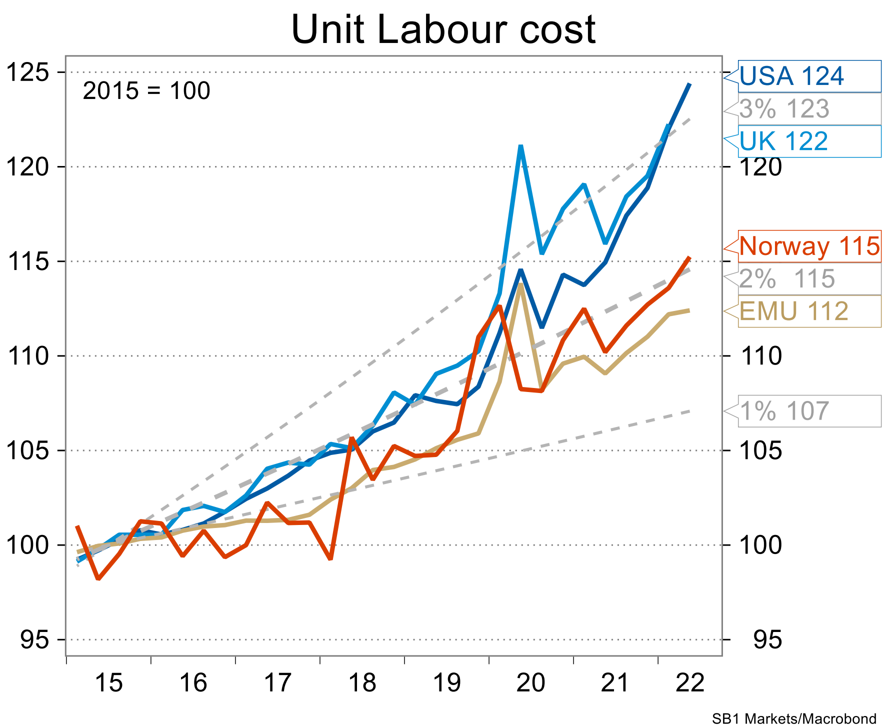


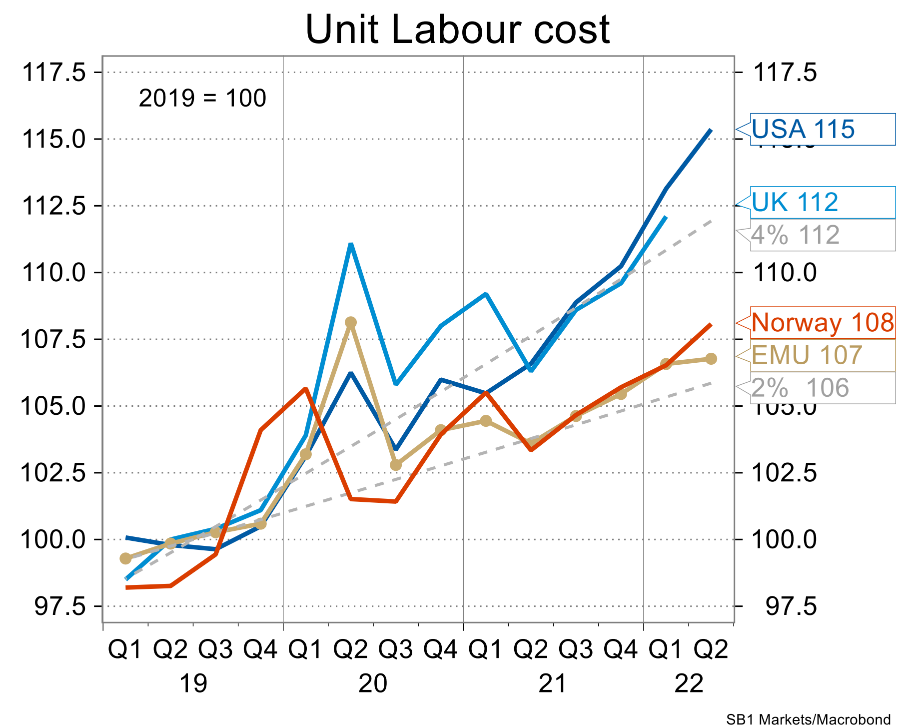


- Labour cost fell 1.9% in Q2 (annualised), following the 3% increase in Q1. The annual growth fell to 3.8% from 4.6% in Q1
  - » History was in sum revised up, from a 2.25% trend to a 2.5% underlying trend path now. The trajectory since early last year was visibly revised, and the annual rate became much higher than we assumed – because labour cost in Q2-20 was sharply revised down. Not reassuring, of course – let's hope the current data is close to reality
  - » The wages and salaries component is up 4.0% (taxes and subsidies not)
- The current 2.5% growth path used to fed into a CPI inflation of around 1.6%, before the pandemic. However, productivity growth has slowed, and Unit Labour cost inflation has accelerated, but not to above 2%, check two pages forward
- Negotiated wages rose 2.4% y/y in Q2, confirming that there is no take off in wage inflation

Unit labour costs not the problem in the EMU, nor in Norway

However, both US and now also UK report a very rapid growth in ULC recent quarters





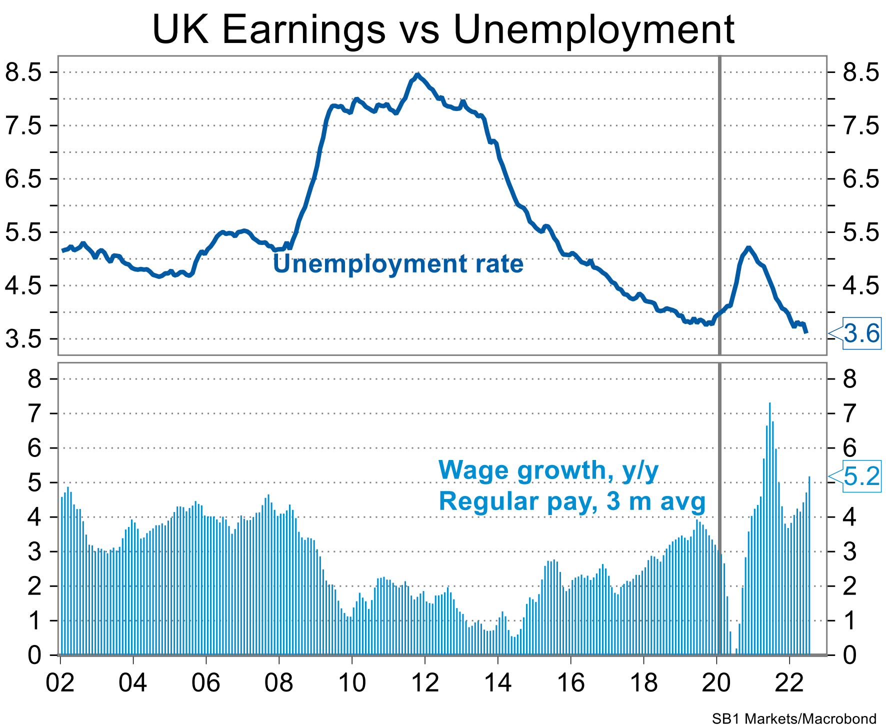
- These differential is wage cost signals different needs for monetary tightening in order to stabilise underlying inflation

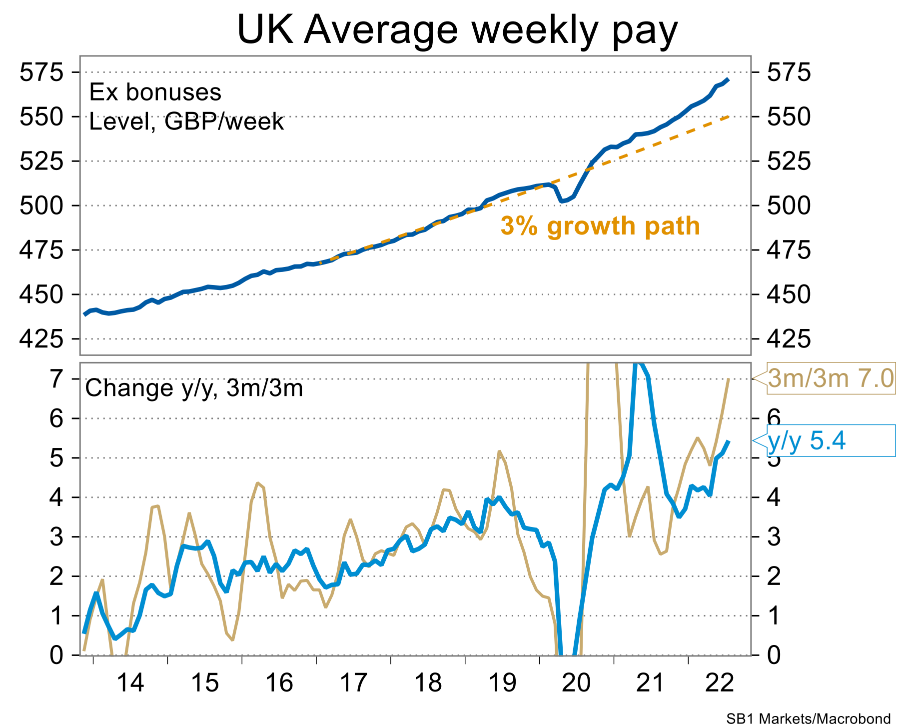
Norway: Mainland Norway, ex government and electricity production. Adjusted for self-employed

SpareBank 1 MARKETS

Lowest unemployment rate since 1974 – and <u>wage inflation is on the way up</u>

… wages ex. bonuses up 7% 3m/3m, up from the pre-pandemic level at 2 – 3½%



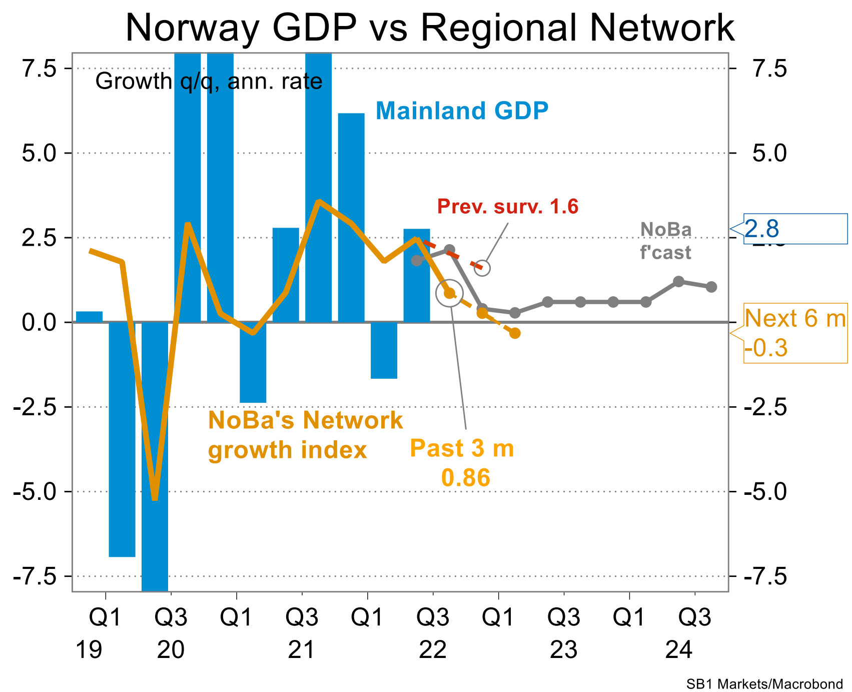


- **Annual wage growth** (regular pay, 3 m avg) <u>accelerated</u> 0.3 pp to 5.4% in July, expected <u>down</u> to 5.0%. Not smoothed, wages were up 5.2%, and the underlying 3m/3m rate accelerated to 7.0%
- **Including bonuses**, total wages are up 5.5% y/y (3 m avg), 0.1 pp higher than expected (*charts next page*)
- Just before the pandemic, wage inflation was approx. 3% (total pay) to 4% (regular pay) – but just between 2% and 3% the preceding years. <u>Thus, the current wage inflation rates are well above the British 'norm', that have yielded 2% CPI inflation</u>
- Some unions in the UK have lifted their ambitions substantially recent months – as inflation is close to 10% - and BoE expect more to come (13%). Wage claims in the same territory have now been aired, not surprisingly, in a very tight labour market. But so far, real wages are nosediving, as wage inflation is far below CPI inflation

SpareBank 1 MARKETS

Norges Bank's Regional Network expects a GDP decline coming months

High inflation, higher rates are expected to stifle demand. Just oil services, exporters expect growth



Implications

- Taken at face value, the network report does not signal much weaker growth than NoBa assumed for the coming quarters. However, the starting point is lower than NoBa assumed (GDP in July), and the Network expects negative growth. At the same time, capacity utilisation is very high, and unusually many respondents report lack of labour
- 25 or 50 bps next week? We still think 50 bps is most likely, but is not a done deal anymore. In addition, the interest rate path's 3.1% peak will probably not be revised up. Check more at page 5

Expectations for the coming months

- The Network expects a -0.3% growth pace the next 6 months (index value at -0.16), we expected +0.5%, down from +1.6% 3 months ago. In June, Norges Bank assumed a +0.3% growth pace in Q4 and Q1-23. Thus, the network signals 0.5 pp weaker growth pace than NoBa assumed. In addition, actual GDP is 1.4% pp below NoBas' f'cast by the start of Q3
  - » Just **manufacturing exporters** expect higher growth, rather surprising. **Oil services** expect continued strong growth. All other sectors expect slower growth – or a substantial decline in activity, like **construction and retail sales**. Construction also reported the sharpest change in expectations
  - » **North, South & South East** report continued decent growth, others not. **Central East** expect a sharp contraction
- **Investment** plans were revised further down, but are not far below average. Profits are expected sharply down (oil companies are not included)
- **Wage inflation** expectations are drifting slowly upwards, and reached 4% in Q3
- Far fewer companies expect to increase their **prices** than 3 – 4 quarters ago

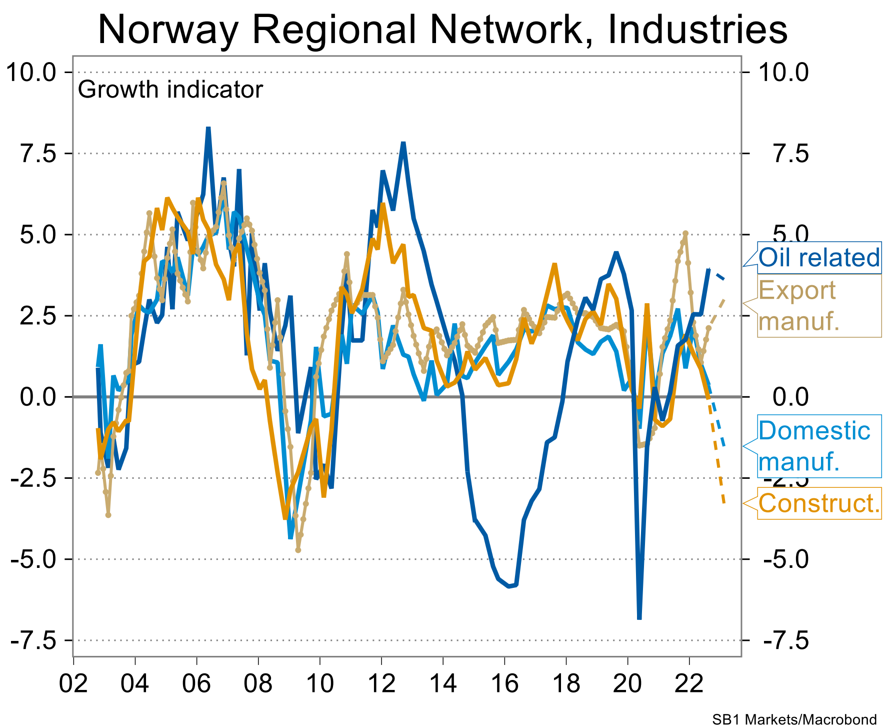
Activity the past 3 months

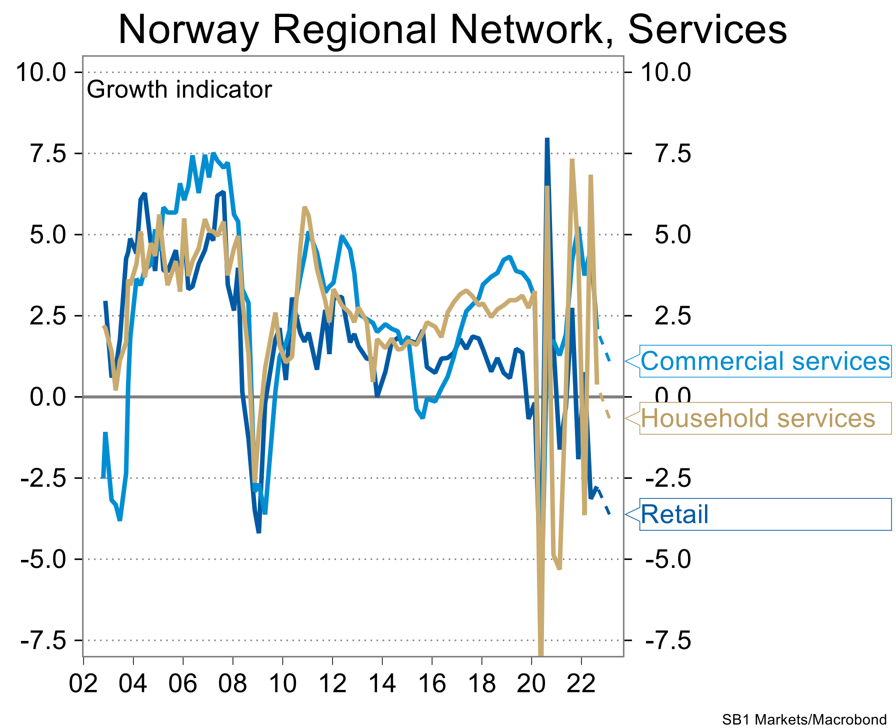
- The Network reports a 0.9% growth pace in May-July period (index value 0.43), we expected 1.0%, down from 2.5% the previous 3 months ago. 3 months ago, growth was expected at 1.6% (for the coming 6 months though). Actual Mainland GDP growth (base value) was at a 1.8% pace over the past 3 months
  - » Retail and construction reported a decline in activity, whereas oil related industries, export industries, and business services reported strong growth
  - » **Capacity utilisation** is still high but has come down over the past year, and **labour shortages** are still an issue, but a little less so than in the last report

SpareBank 1 MARKETS

Oil services, exports OK, others down. Construction expects a really hard landing

Retail trade remains in contraction mode, while commercial services expect less than 1% growth



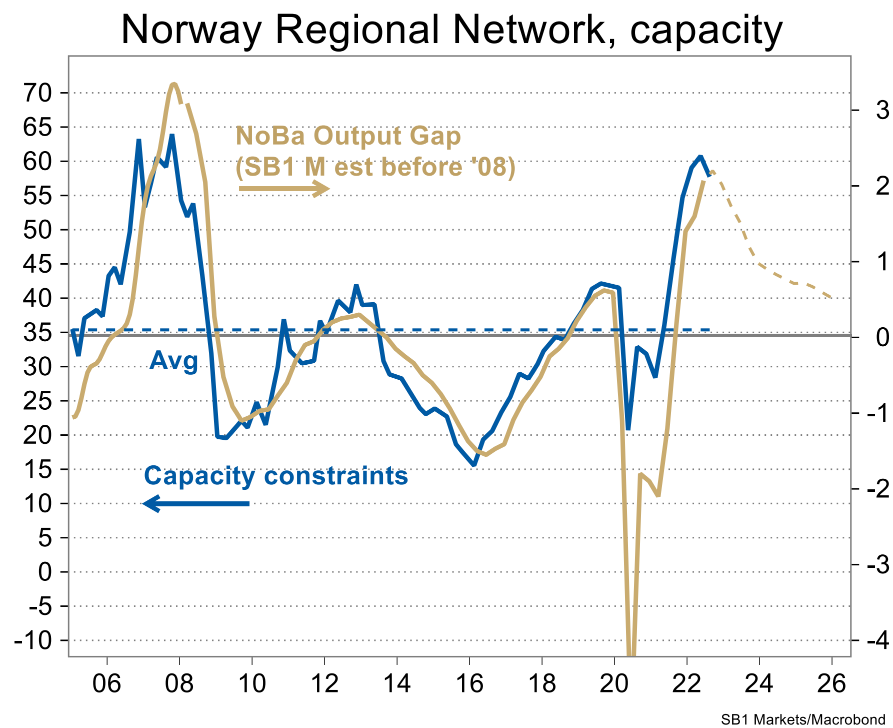


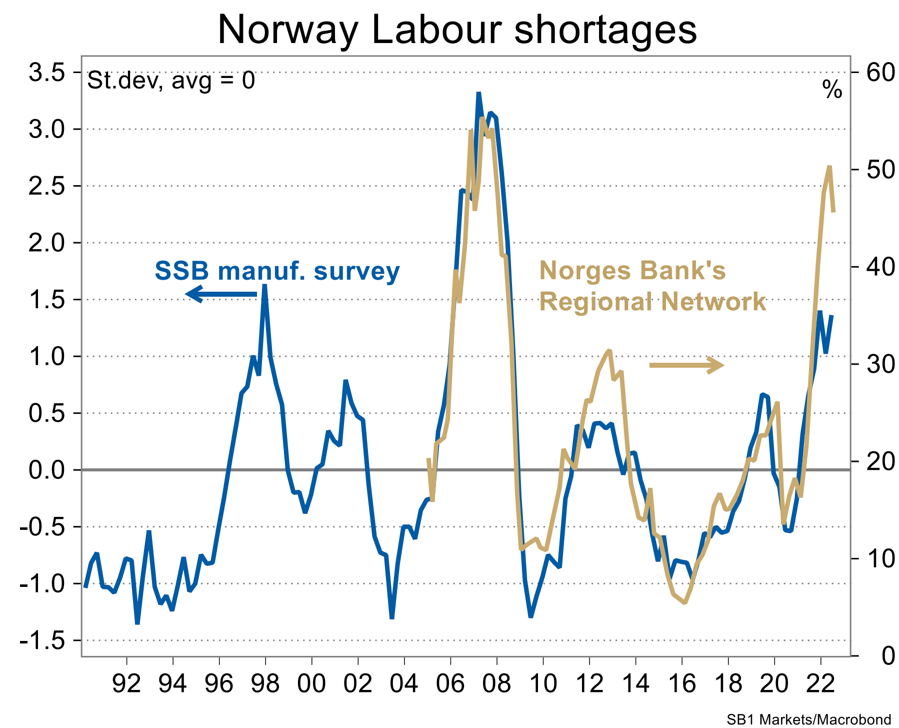
- Oil related industries report stronger growth, not surprising of course: The gas crisis and the tax regime are, needless to say, the reason the oil and gas industry – and its related Mainland related industries that are included in this survey (and not the oil companies) – are doing well

SpareBank 1 MARKETS

Capacity constraints & labour shortages are coming down...

... but both are still sky high

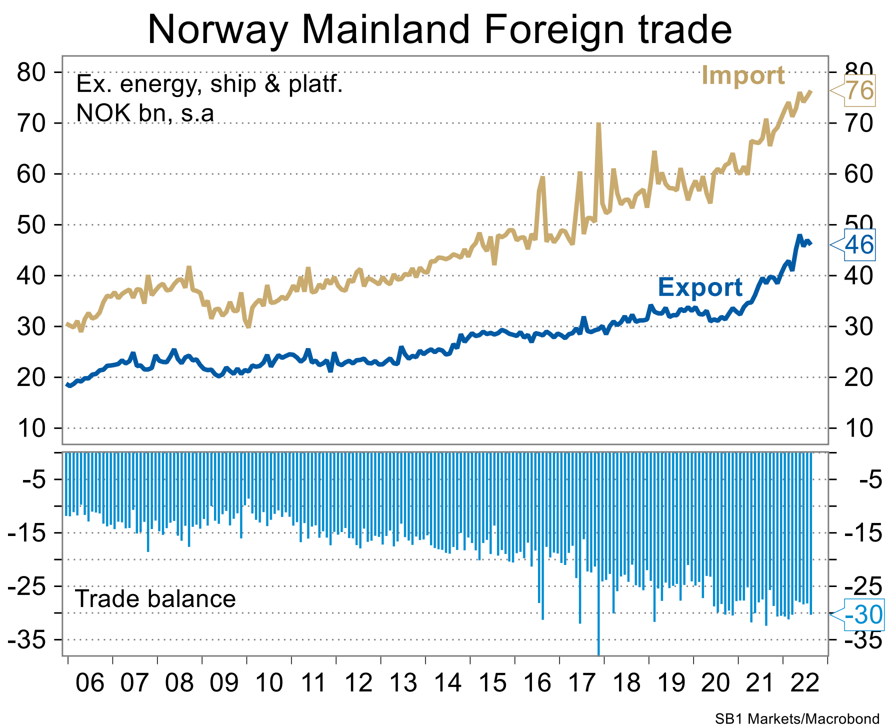


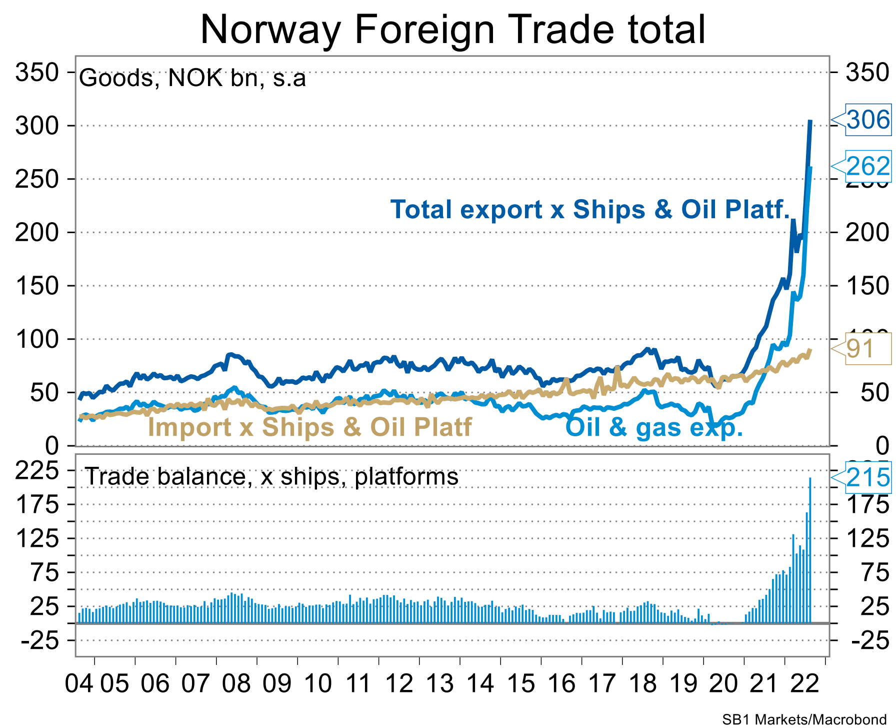


- Fewer companies are reporting **capacity constraints** following the steepest surge ever, but the level is still far above avg. 60% of the companies are reporting that they are operating at full capacity. The correlation to NoBa's assessment of the **output gap** is not 1:1 and the Network report does not suggest than the Bank's estimate will have to be revised up
- **Labour supply** shortages also fell in Q3, but the problem is still way above a normal level, and broad based. Given lower growth expectations the labour market should weaken... eventually
- **Wage expectations** are drifting slowly upwards, check two pages forward – but has not yet crossed the 4%-line

Energy crisis sends trade balance to yet another ATH. Trade surplus at 75% of GDP

Mainland exports still strong – but gas exports through the roof and the main driver

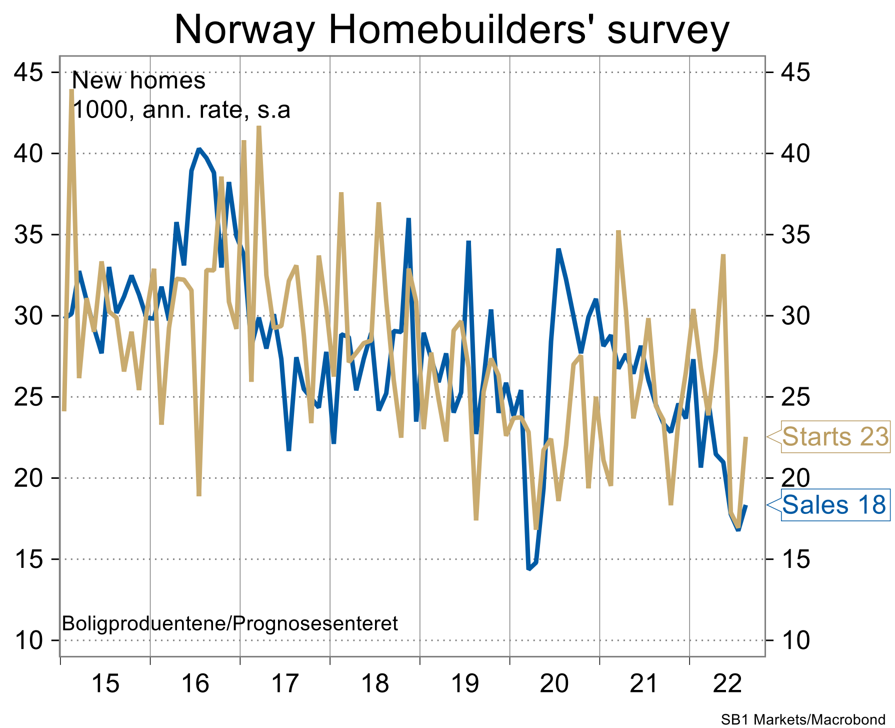


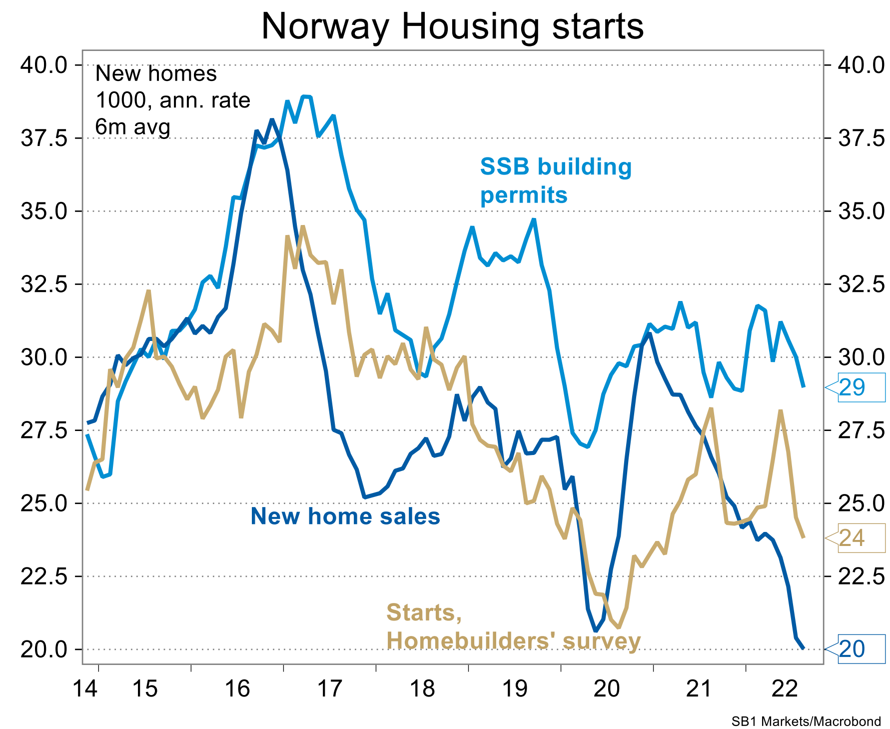


- The seasonally adjusted **overall trade surplus** in goods at NOK 215 bn is the highest ever, equalling some 75% of Mainland GDP!
- **Oil & natural gas exports** increased by 25% in Aug, after a 26% increase in July, due to higher gas prices. From Aug, production of LNG from Melkøya is again running at full capacity, adding to the already high volume produced (but LNG will still amount to less than 5% of total gas exports in '23). In September, gas prices have come down somewhat, but a lift in future prices towards early 2023 signal extreme trade surpluses the coming months too
- **The Mainland (non energy) trade deficit in goods** increased by 2 bn to NOK 30 bn, equalling 11% of Mainland GDP (however, most imports for oil investments are categorised as Mainland imports and sales from the Mainland to the oil sector (both op.ex and cap.ex) are not counted as exports – and the 'real' Mainland trade balance is far, far stronger)
- **Non-energy exports** fell marginally in Aug by some 900 mill, to NOK 46 bn. Mainland exports have been very strong during and after the pandemic, and the underlying growth rate over the past year is some 20%. Exports are up 50% since 2020, mostly due to higher prices but volumes are up as well. Fish, metals & chemicals are reporting strong growth. Measured in volume terms, non-energy exports are flat, though. (Check next page)
- **Imports** also rose by 1 bn to 75 bn, and at an 11% growth pace, in value terms, that is

New home sales marginally up in August, but trending sharply down

… according to the homebuilders. SSB have so far reported far higher building permits





- Boligprodusentene (Home builders) 'always' report that building activity is declining and that it is too low. Now, they are right, August sales were on the weak side, at 18' annualised, just marginally up from the low level in June & July
- Starts increased to 23' in August from 18' – a very volatile data series. The average over the past 6 months is at 24', while SSBs building permits fell to 29' from 30'
- However, the rather steady decline in sales may signal downturn in new starts the coming months. The sharp lift in construction costs and higher mortgage rates may be reasonable explanations

Highlights

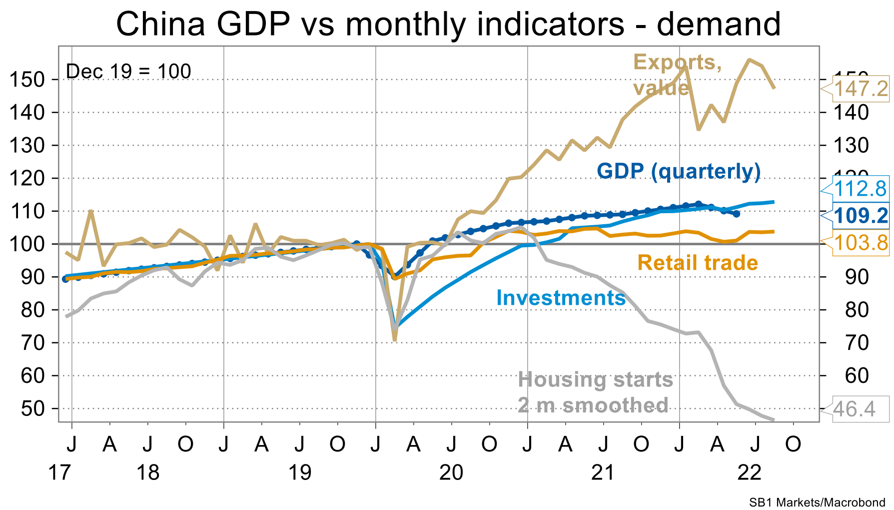
The world around us

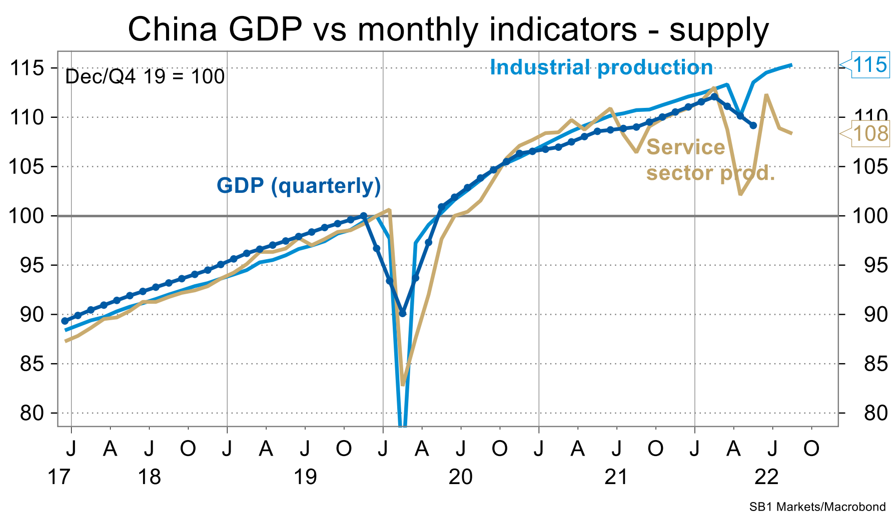
The Norwegian economy

Market charts & comments

Data on the stronger side in Aug, but construction starts are still very weak

Low inflation gives room for expansive policy measures



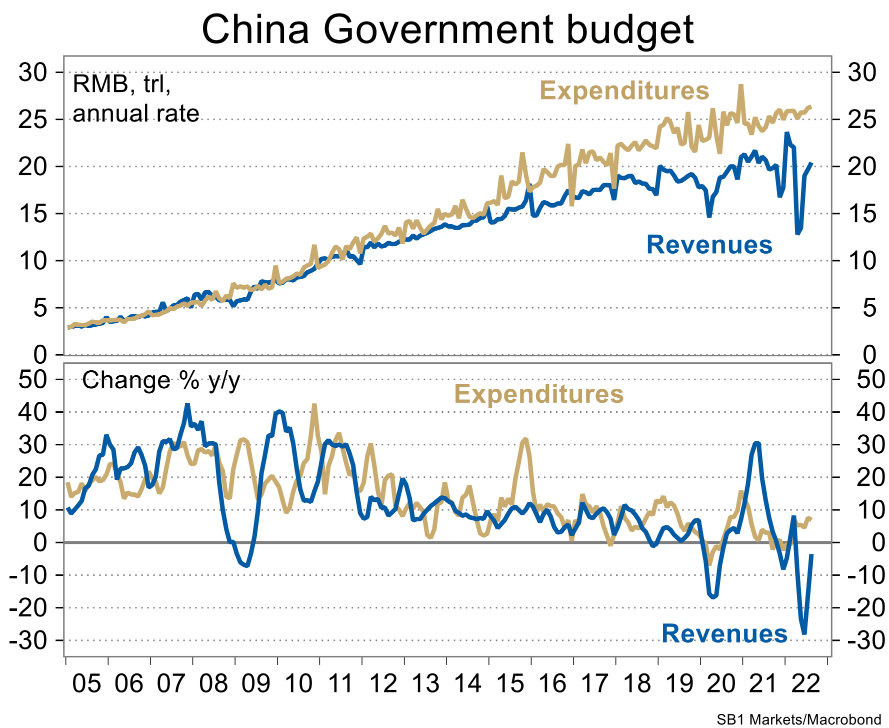


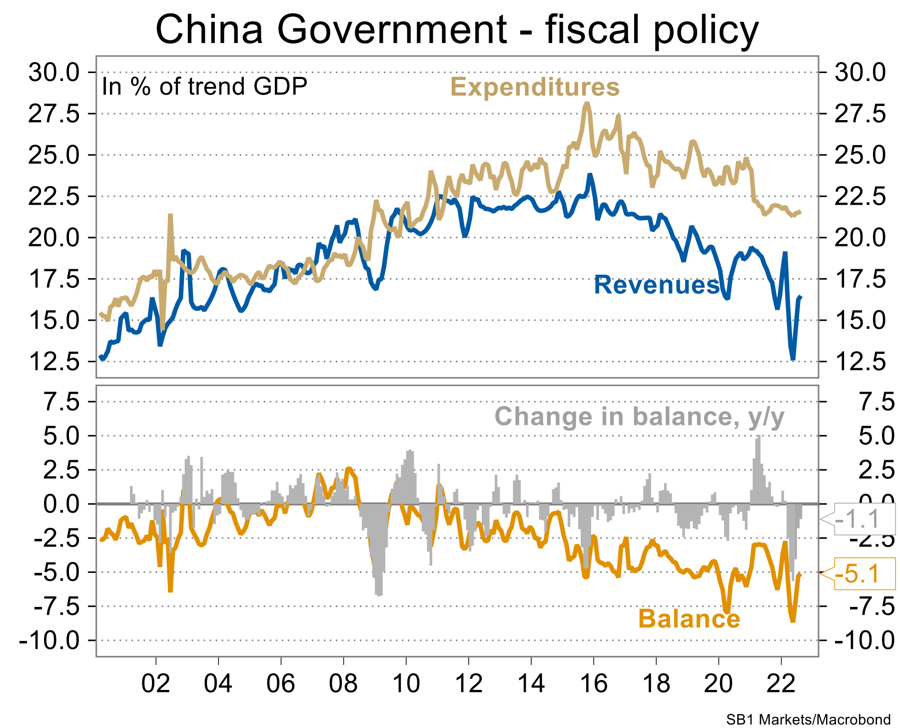
- **Industrial production** rose 0.3% in August and is back to the pre-lockdown trend, and above expectations, up 4.2% y/y, expected 3.8%. Growth is well below the pre-pandemic trend. Steel production was up in Aug (but is trending down), while cement fell further. Autos still in the lead!
- **Service sector production** fell by 0.5% in Aug, following the 3% drop in July and the level is 3%- 4% below the pre-lockdown, and 8% below the pre-Covid trend!
- **Retail sales** were stronger than expected in Aug, and the history for '22 was revised up significantly. However, sales remain weak, the volume is down 6% from the pre-pandemic trend, but auto sales are red hot, suggesting there is no crisis among Chinese consumers. Retail sales rose 5.4% y/y, expected 3.5%!
- **Investments** rose 0.4% in Aug, and is back on track, even if both **residential and commercial construction starts** have fallen by more than 50% from the peak early last year (the largest contraction ever). Starts fell further in Aug. **New home sales,** on the other hand, rose 2.2%, but is down 36% from the peak last year! **House prices** are still falling, -4.9% in Aug
- **Credit growth** increased sharply in Aug, after falling in July, and the growth pace was 10.4%. Credit growth has been accelerating recent months but just due to a very rapid growth in local government debt (lack of revenues from land sales, funding of real estate projects?). The **central authorities** have decided that local governments should increase borrowing further in H2, a massive policy shift, in order to support infrastructure and housing projects – like in the good ol' days
- **CPI inflation** was down 0.2 pp to 2.5%. CPI ex. food & energy was flat at 0.8%. Food inflation is creeping upwards, to 6.1%, but China does not have an inflation problem all in all
- **Exports** were down 5% in Aug, but remain high, of course, up 44% from before the pandemic. **Imports** are still subdued, and the trade surplus is at a record high level. An imbalanced economy?

In sum: August was stronger than expected, and the inflation print underpins that there is room for more old-school policy steps. However, we are not sure that more debt-funded infrastructure spending will solve underlying growth challenges. The 50% drop in housing (and non-residential) starts may have brought construction down to a more sustainable level

Fiscal policy expansionary, due to a rapid decline in revenues

Revenues rose in August but remain down y/y, expenditures are up by 8%

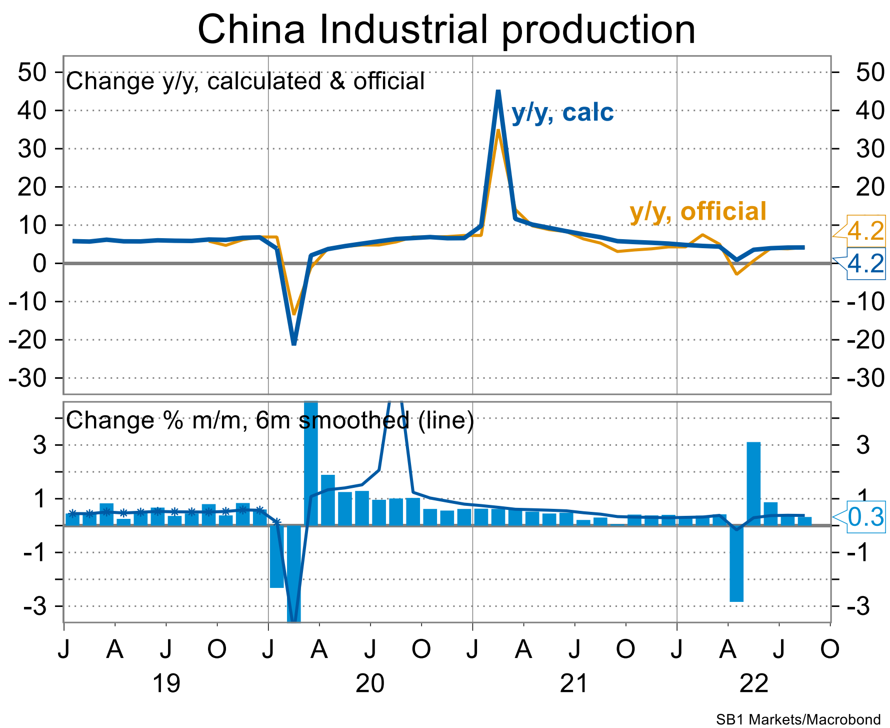


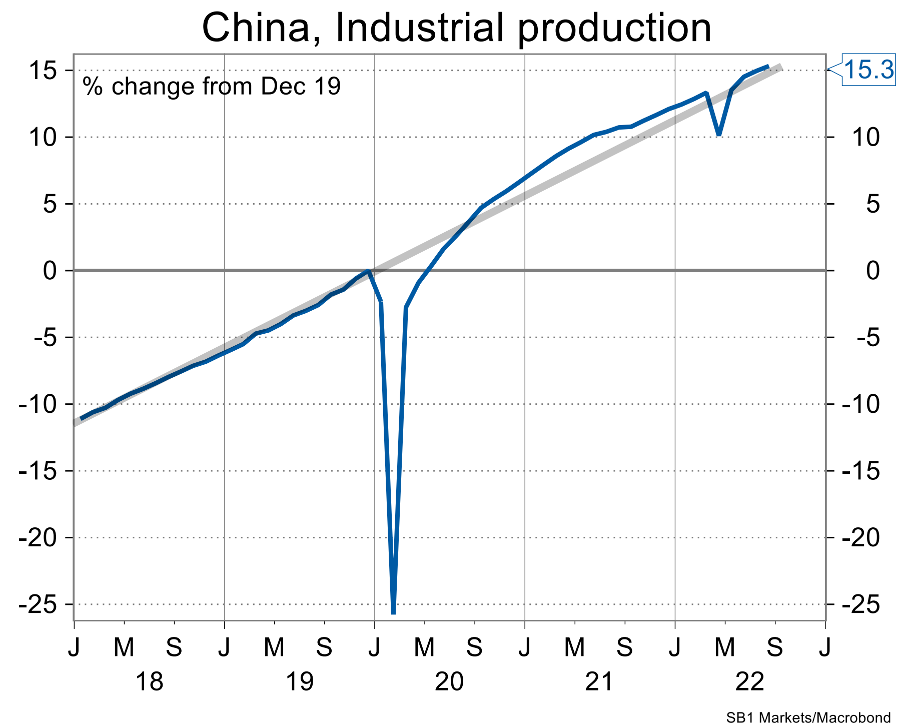


- In % of trend GDP, **public sector revenues** have fallen to below 15% from well above 20% some few years ago. In nominal terms, revenues are flat since early 2020 – after being far below in April and May, during the widespread Covid lockdowns
- **Spending** in % of GDP has also been trending down at close to the same pace
- The **budget deficit** equalled 5.1% of GDP in August, close to the flattish trend since 2019. Fiscal policy is close to neutral
- Recent months, authorities have announced several **infrastructure/housing packages**, however without committing any funding from the central government. Instead, local governments have been allowed to increase their borrowing on bond market

Industrial production surprised on the upside in August (but did not really…)

Production rose by 0.3% m/m, and production is back to the pre-lockdown trend path

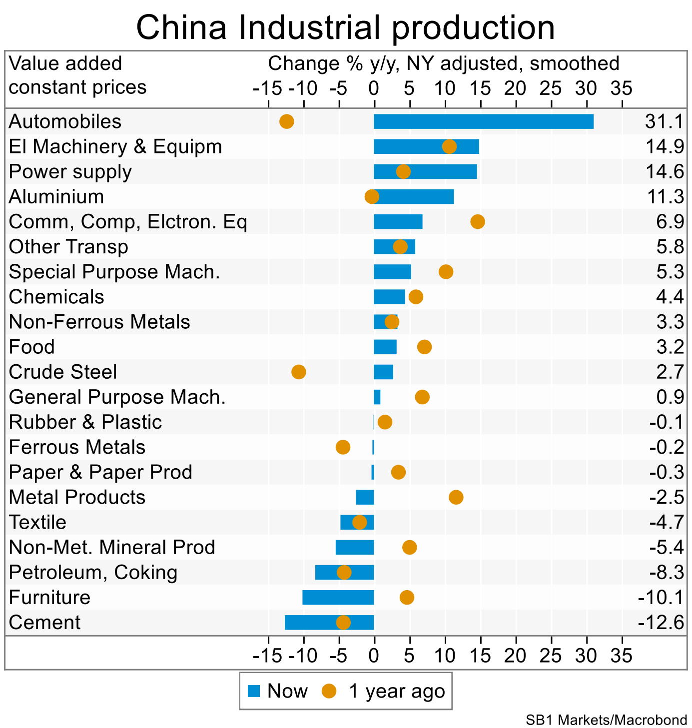




- **The production level** returned to the pre-pandemic trend path in May (grey line at the chart to the right) and was close to the pre-lockdown trend path in August
- **Production grew** 4.2% y/y according to the official data, 0.4 pp above expectations, and up from 3.8% in July
- However, the 0.3% per month growth rate is not that impressive, and growth has slowed since mid-21, to a 3.5% pace, down from 6% before the pandemic

Mixed between sectors: Aluminium and steel up in August; cement down

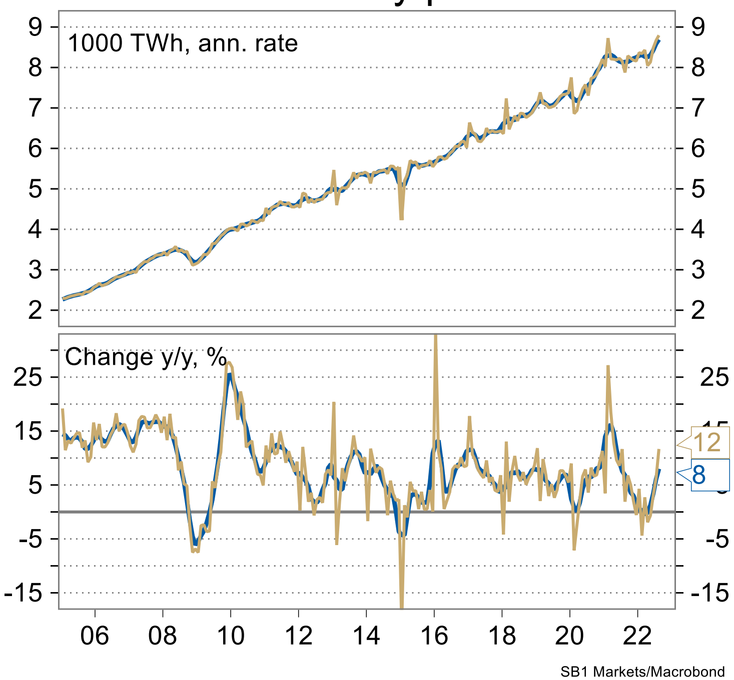
Cement is trending down, so is (very likely) steel. In the lead: Auto production, as sales are soaring

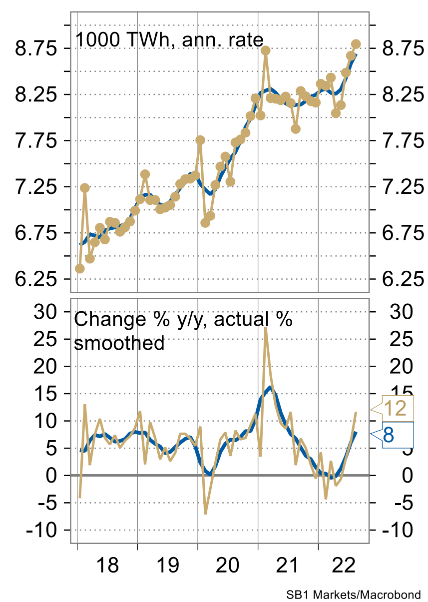


Electricity production further up in August

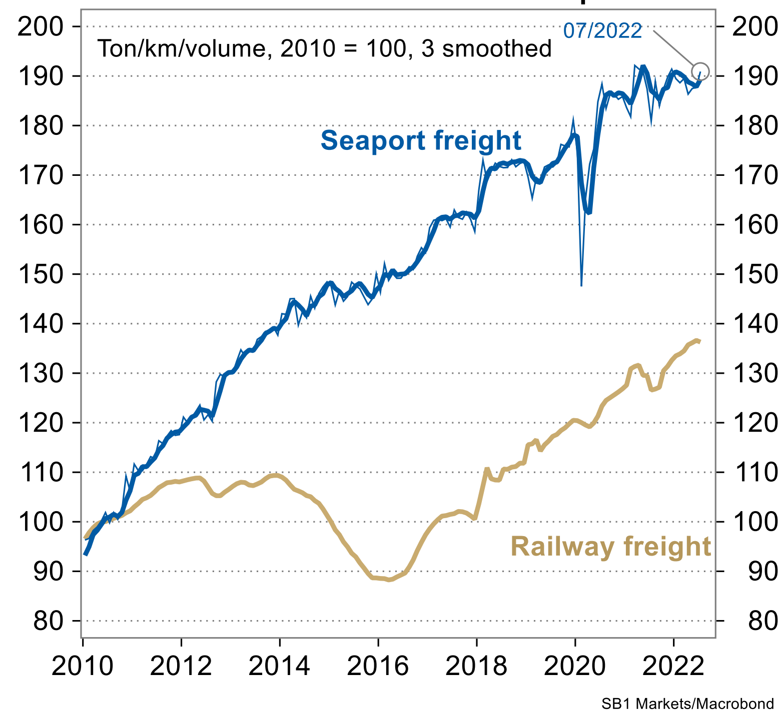
The trend was flat until May, from late 2020

China Electricity production





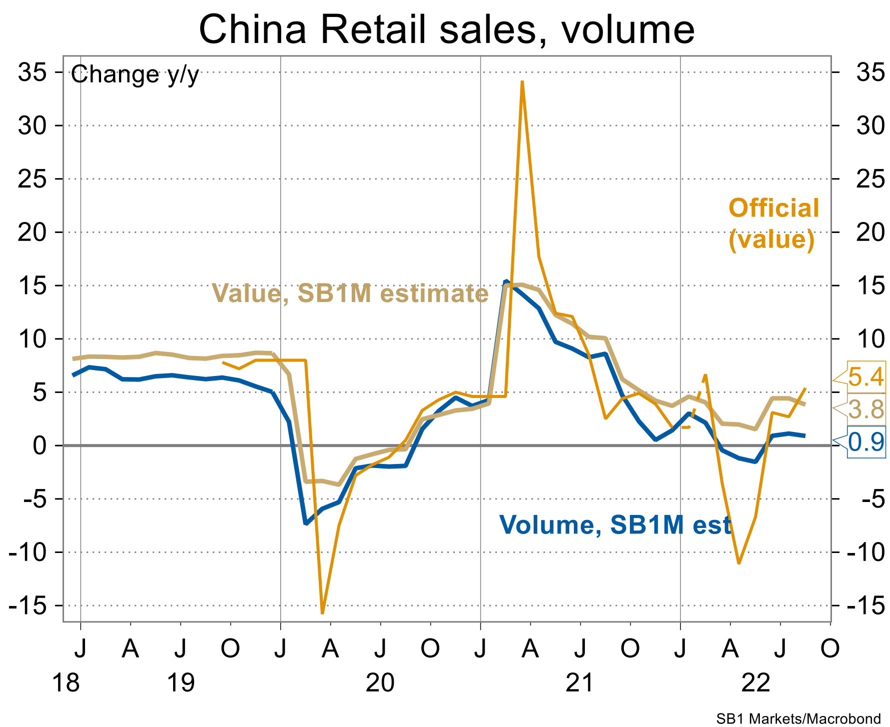
China Trade and transport

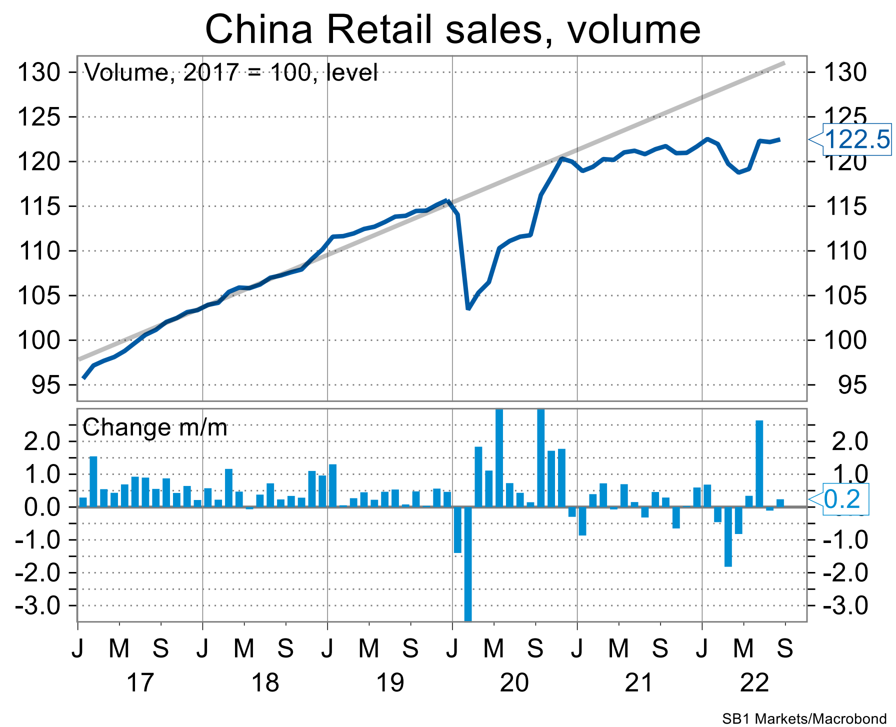


- Seaport traffic has flattened, even if export data are very strong (but imports are not, as domestic demand is weak)
- Even so, domestic railway freight traffic is growing at a normal pace

Retail sales above expectations – 2022 history revised net up quite significantly

Nominal sales up 5.4% y/y, far above expectations at 3.5%, and up from 2.7% in July



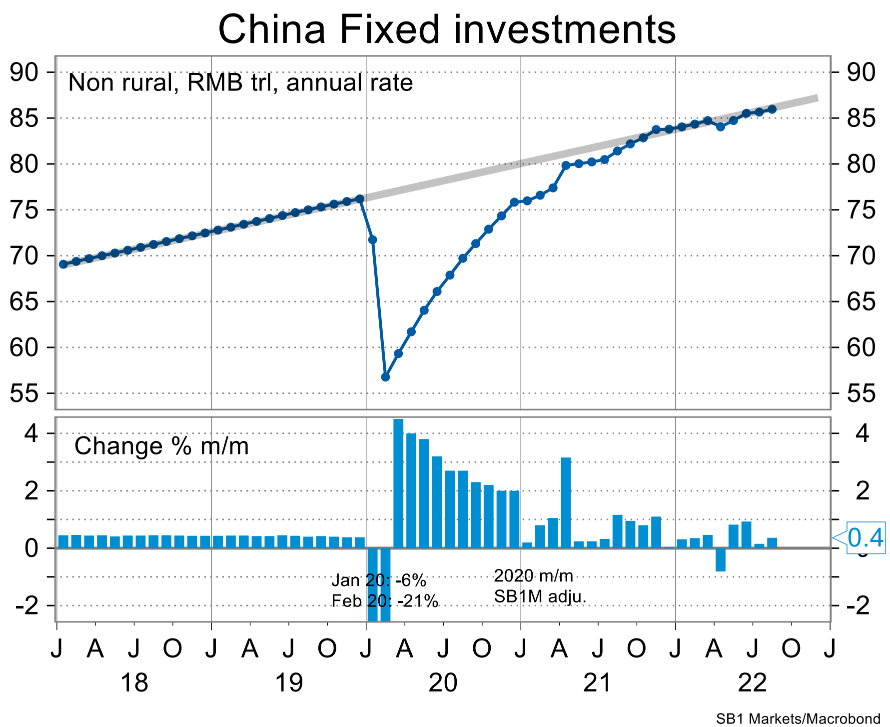


- Sales rose 0.5% m/m in **nominal terms,** and according to our estimate, **volume growth** was 0.2%
  - » Sales in volume terms are up 0.9% from August last year (aggregated monthly changes, the official y/y growth in value terms implies a larger increase in volume terms)
  - » Sales date (monthly s.a changes) since early summer have been revised upwards
- Retail sales volumes are some 6% below the pre-pandemic trend path – and just up 2% vs the late-2020 level!!

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 revisions, the last one this month upwards, has made the analysis even more complicated

Investments grew in August, up 0.4% m/m

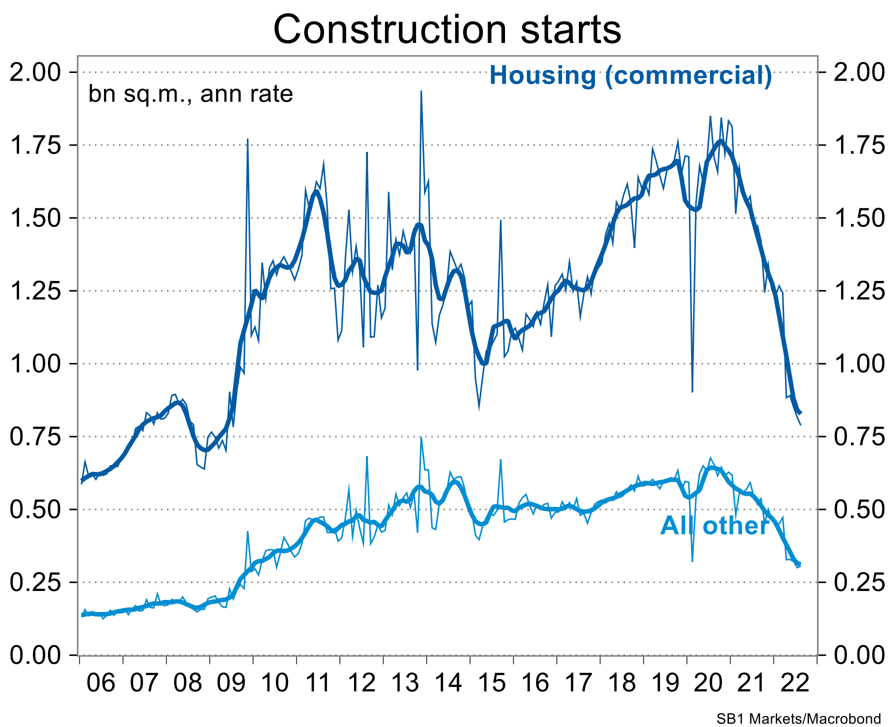
Overall investments are still (strangely) robust, given the downturn in construction starts

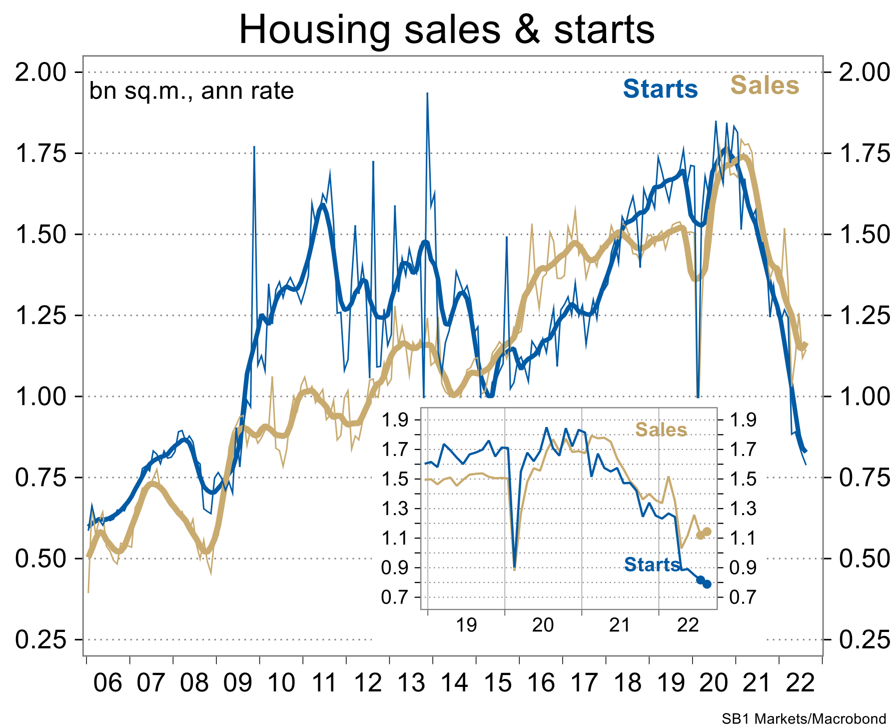


- **Measured y/y** nominal urban investments rose 5.8% in August, stronger than the expected 5.5%%, and up from 5.7% in July However, in volume terms, growth was just some 3%, according to our calculations
- The **investment level** is back to the pre-pandemic growth path
- The decline in construction starts should dampen overall investments the coming quarters

New home sales up 2% m/m in August, starts are continuing downwards

Sales are down almost 40% vs. the peak level in early 2021. <u>Starts are down more than 50%!!</u>

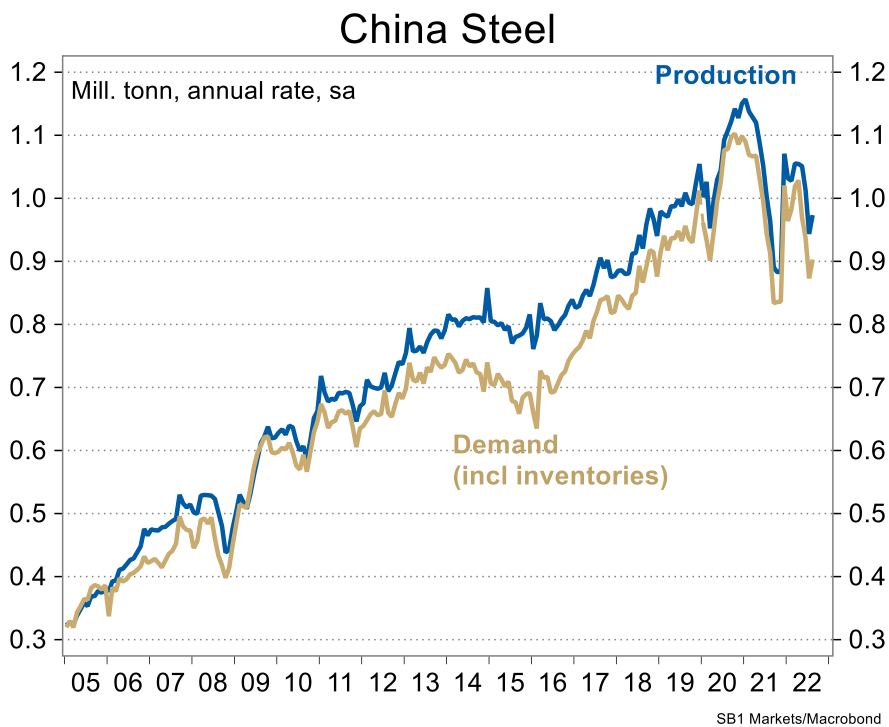




- **New home sales** rose 2.2% m/m in Aug following the 11% fall in July. The level is 24% below the pre-pandemic level – and 36% down from the (smoothed) peak early last year – and the lowest since 2015
- **Housing starts** fell 3.5% m/m in Aug, and <u>is thus continuing downwards,</u> following the steep decline in April, during the lock-downs. Starts are down 52% since early 2021, <u>the largest downturn ever</u>! The level is the lowest since 2009!
- **Non-residential construction starts** are also more than cut in half, and the level is the lowest since 2009
- This unprecedented decline in construction starts will lower growth in the Chinese economy substantially – spread over time, as it takes some 3 years from a home is started until it is completed

Further downside risk for domestic demand for steel?

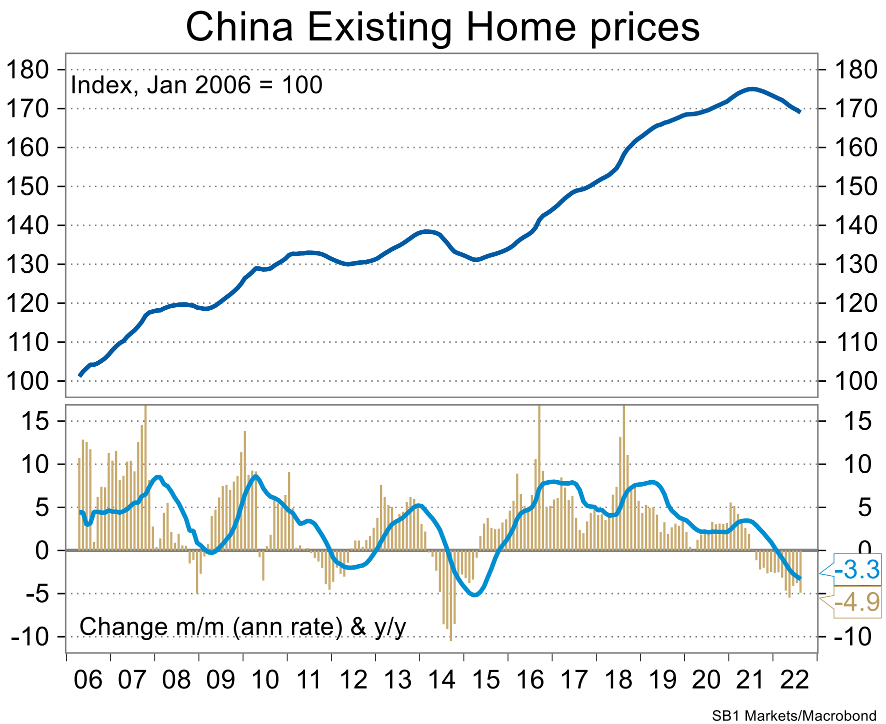
Construction starts are much weaker than current steel production/demand

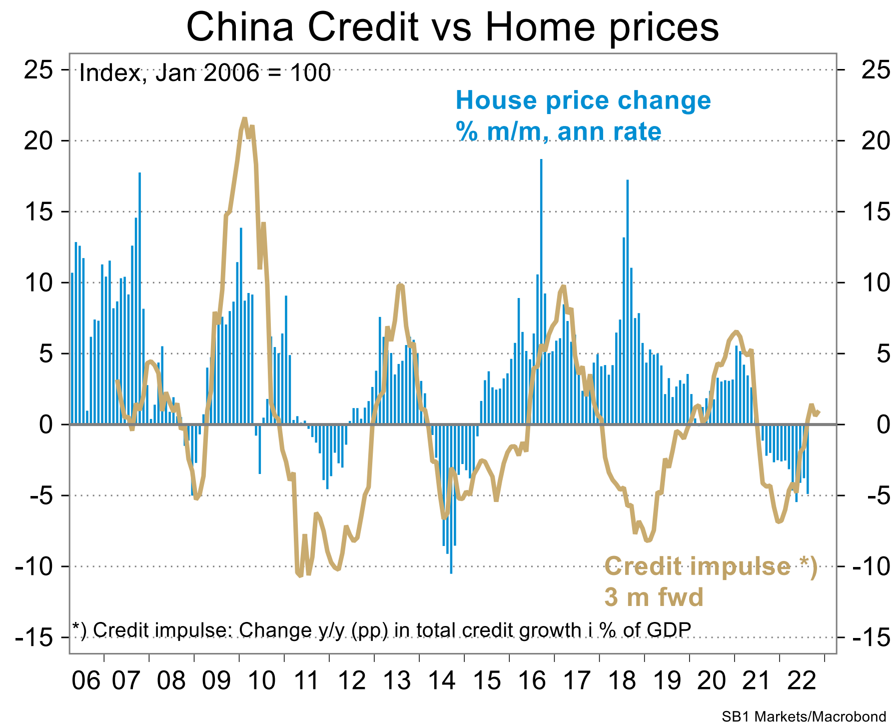


- Construction activity will be under pressure as new starts have fallen sharply. Demand for steel comes early in the building process as well

Existing home prices fell further in August – for the 13th month in row

- the longest stretch with falling prices ever. New home prices on the way down too

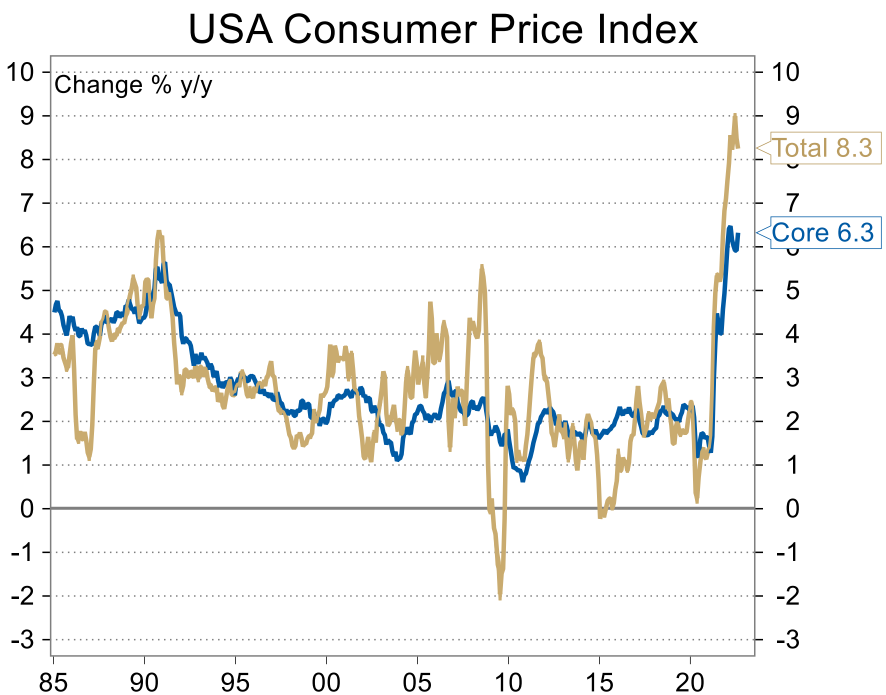




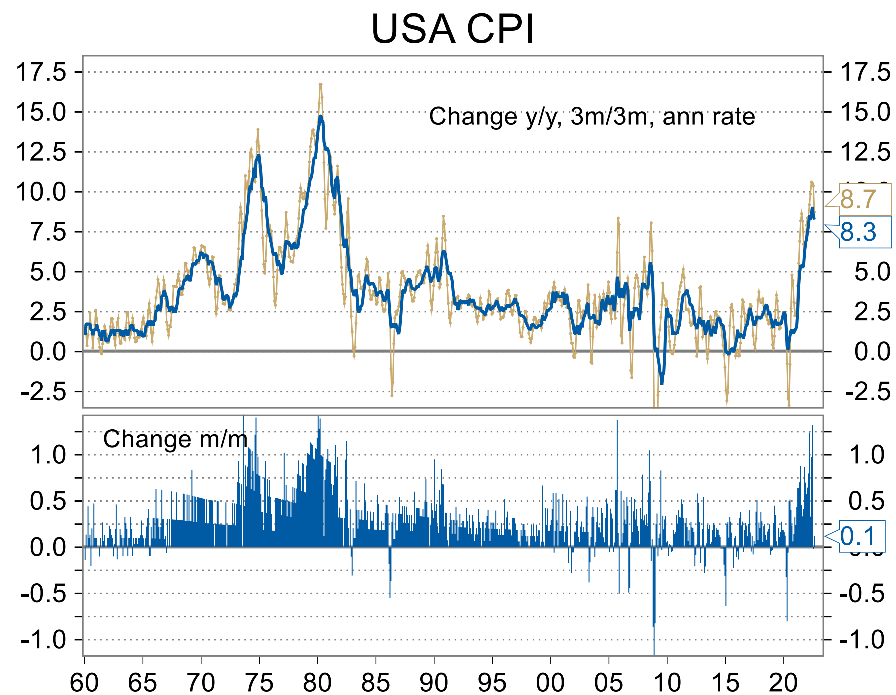
- **Existing home prices** peaked last July, and have been falling at a gradually faster pace, until May. In August, prices fell at 4.9% pace. Prices are down 3.3% y/y, less than the price setback in 2014/15. However, the current setback has now lasted longer than the previous
- **New home prices** also fell last autumn but at a slower pace than existing home prices. In August though, new home price also fell at a 4.9% pace m/m, the fastest so far in this downturn, and they are down 2.2% y/y. Some builders have reported deep price cuts to reduce the inventory and secure financing. The gradual decline in prices since last summer is probably due both some fire sales from construction companies that have run out of other sources of financing, and some hesitance from home buyers
- Prices are still climbing in the four largest Tier 1 cities, but are falling elsewhere – and at the fastest pace in the 'smaller' Tier 3 cities
- **Central authorities** have signalled willingness to expand credit supply again, both to finance infrastructure projects and the construction sector, mostly through local governments that would be allowed to borrow (even) more

CPI has peaked, but Aug. data still surprised on the upside. Which was bad news…

CPI inflation was 0.2 – 0.3 pp higher than expected. The core up 6.3% y/y, and inflation is broad

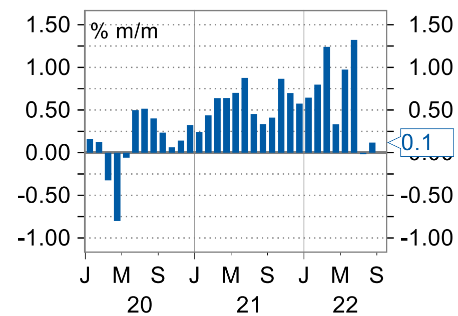


SB1 Markets/Macrobond



SB1 Markets/Macrobond

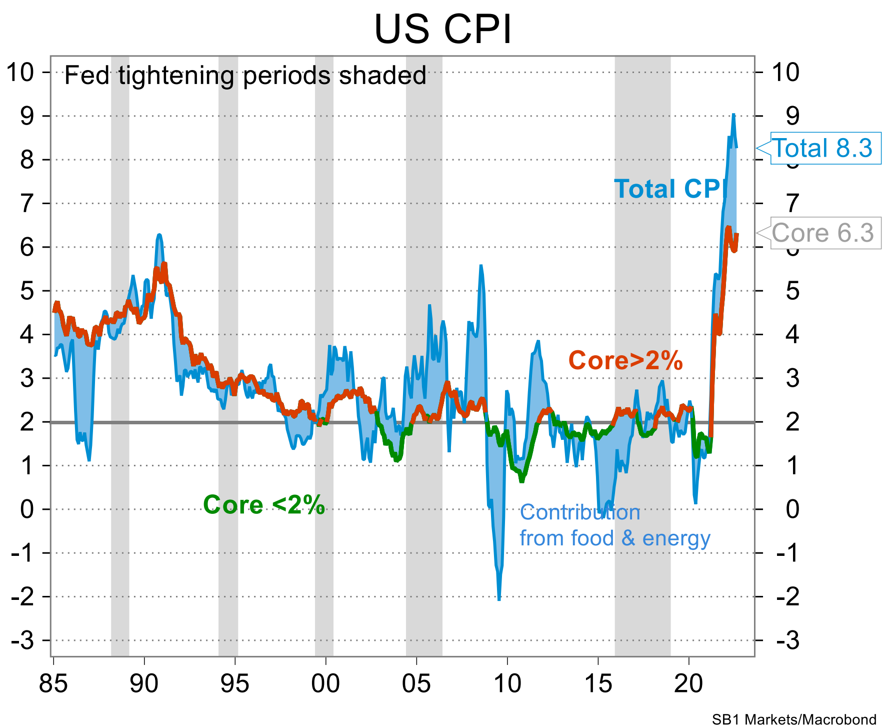
- **Headline CPI** slowed 0.2 pp to 8.3% in August, expected down to 8.1%. Prices rose 0.1% m/m but was expected down
- **Energy prices** fell by 5% (gasoline 10.6%) following similar price cuts in July. Energy is still contributing 1.7 pp to the headline rate
- **Food prices** rose 0.8% m/m and are up 10.9% y/y, lifting the CPI by 1.6 pp. (Food at home is up 13.1%!). Food prices were flat at the producer level in August
- **Surveys** report further price increases the coming months, but at much slower pace the over the prev. months
- Given the CPI surprise, a 75 bps hike next week is a done deal. Powell has finally made up his mind
- We still think **markets** focus too much on actual inflation, especially driven by commodity prices, and to little on wage cost inflation. However, lower margins contraction will also be detected in the CPI report – and they are important for the Fed

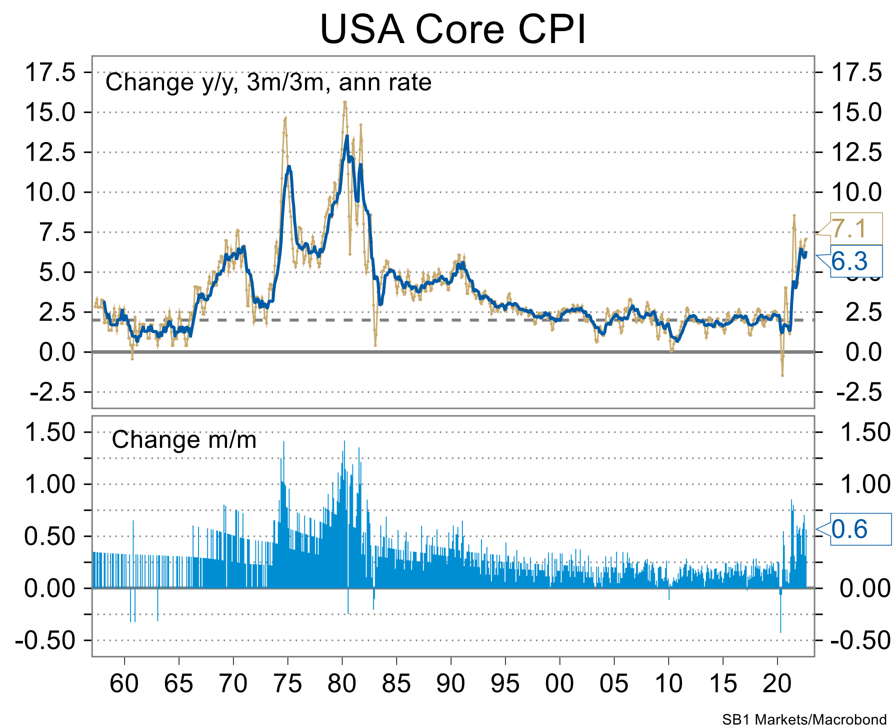


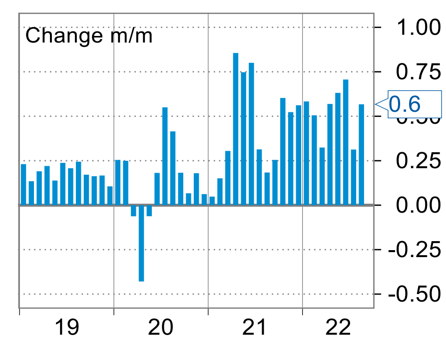
SB1 Markets/Macrobond

Core prices up 0.6%, 0.3 pp more than expected, and up 0.4 pp to 6.3% y/y

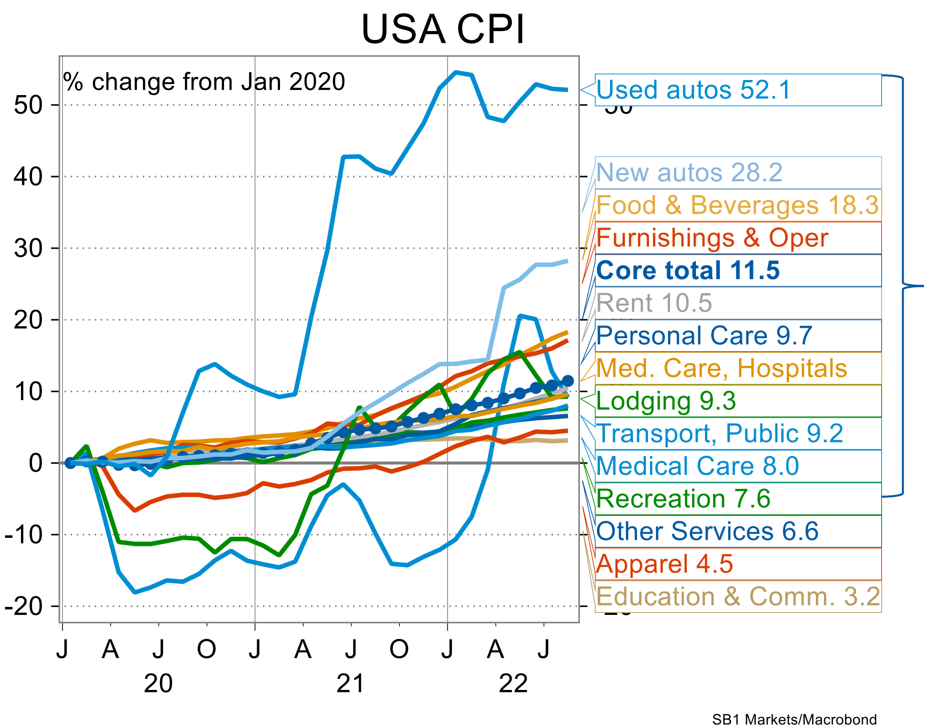
The 3m/3m rate at 7.1% confirms that underlying inflation is still very high

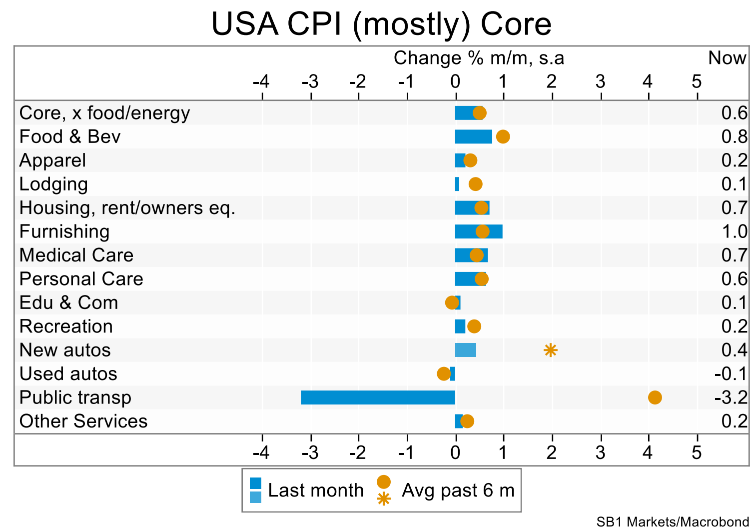


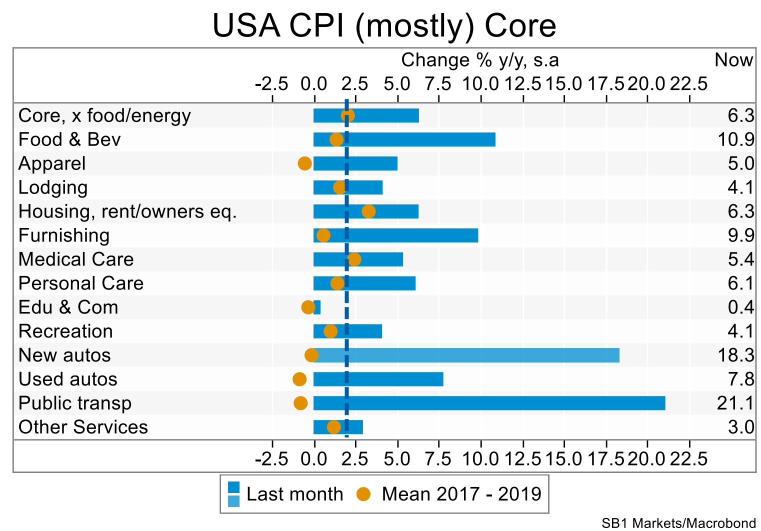




Airfares down, used autos has flattened. But many sectors report rapid price incr.



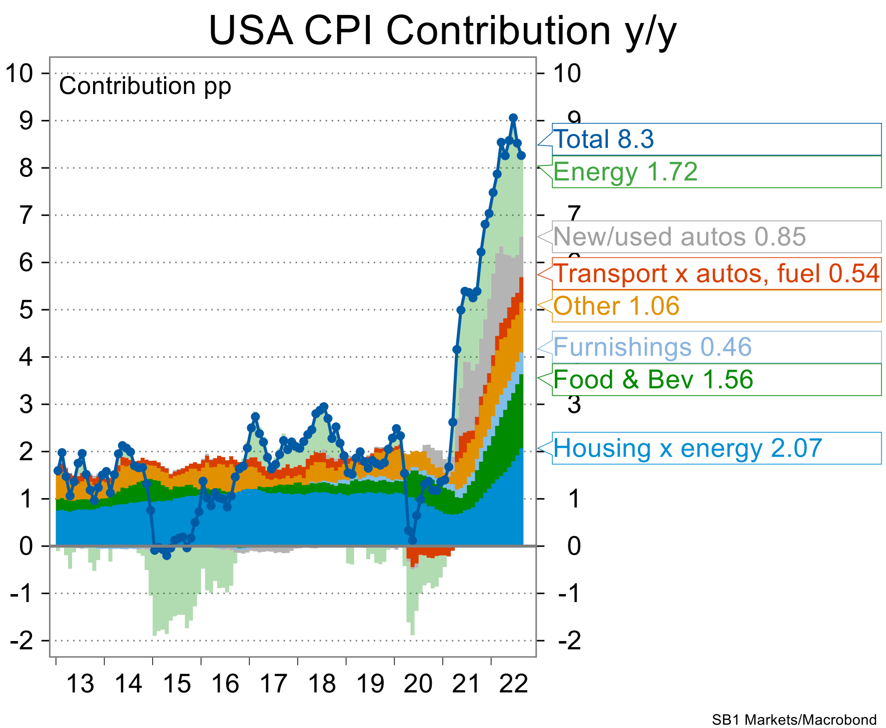


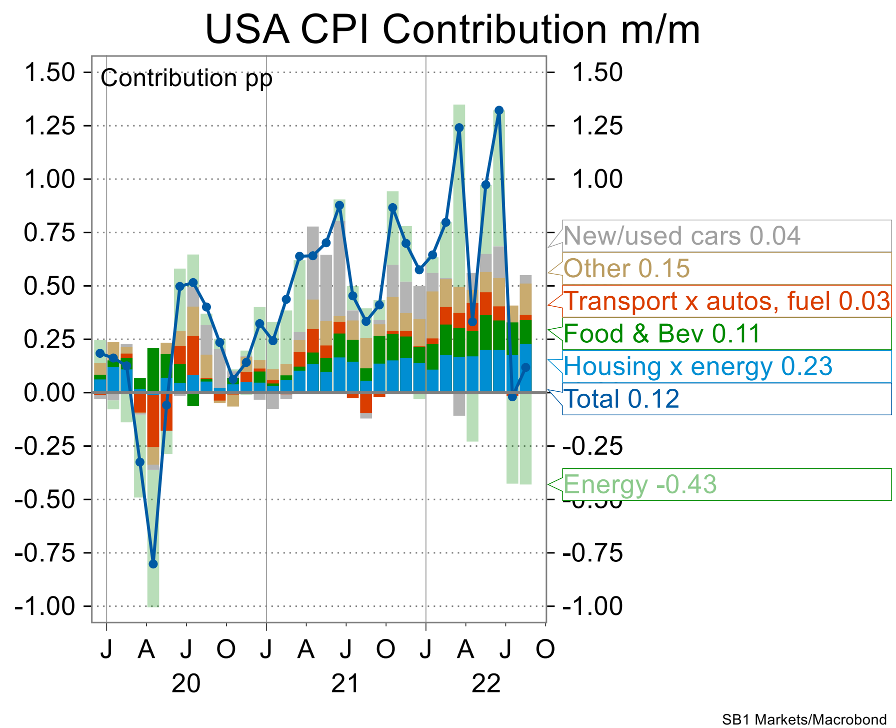


- All but two sectors, apparel and education & communication, are up less than at a 2% pace from before the pandemic
- Just 1 sector is up less than 2% y/y: Education & com.
- Rents are up 6.3% y/y, lifting the CPI by 2.1%, alone!
- One day: A huge downside to used auto prices – and hopefully for some others as well, like food and furnishing prices

Energy & transports (incl autos) explain just 3.1 pp of the 8.3% lift in total CPI

The problem: The rest is up by more than 6% y/y. Housing alone contributes 2.1 pp. Food 1.5 pp





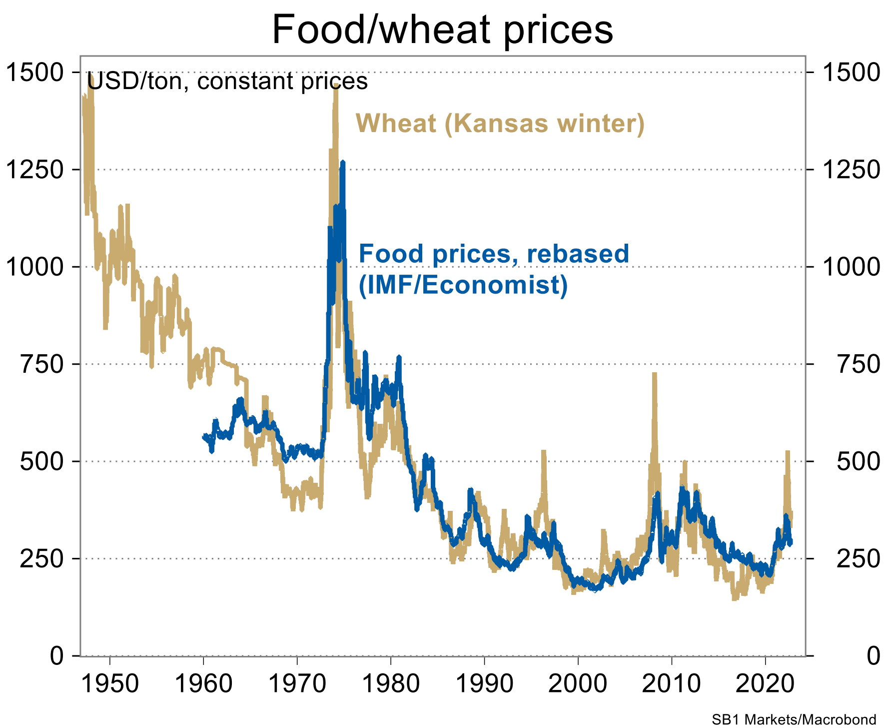
- **Energy** prices fell further in August
- **Excluding** the 3.1 pp contribution to the headline CPI from energy & transport, **"remaining" inflation** has accelerated rapidly
- **Housing x energy** (and x lodging) is contributing by 2.1 pp, though partly due to a low base one year ago. Rents as measured in the CPI are up 6% y/y, but the upside is probably now limited

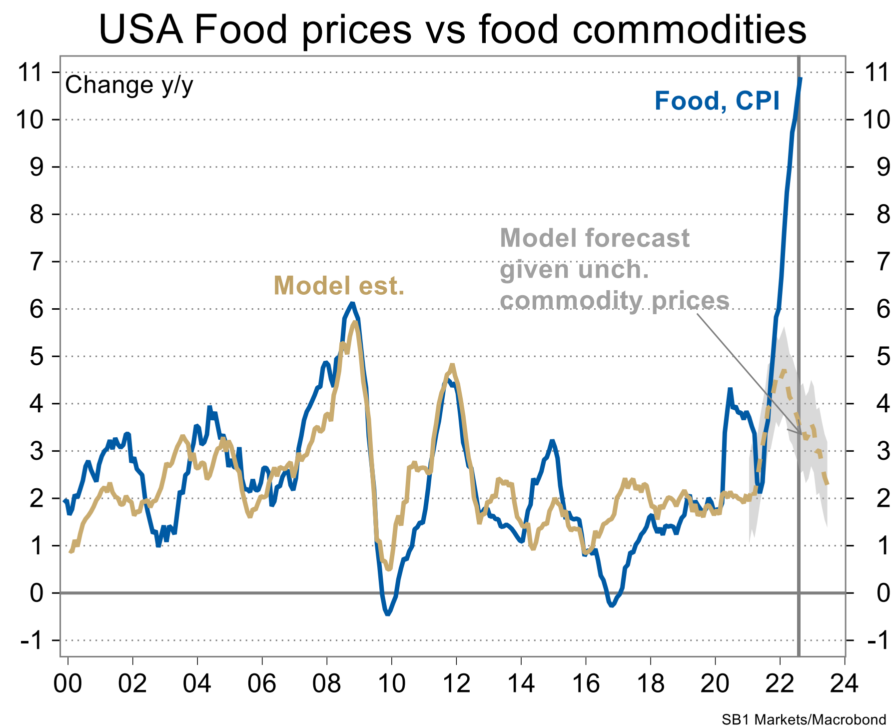
Lodging away from home (incl hotels) is not included in housing at the charts above

SpareBank 1 MARKETS

Food prices through the roof, and now we cannot blame food commodity prices

Food commodity prices did not increase that much, and <u>now they are heading down</u>



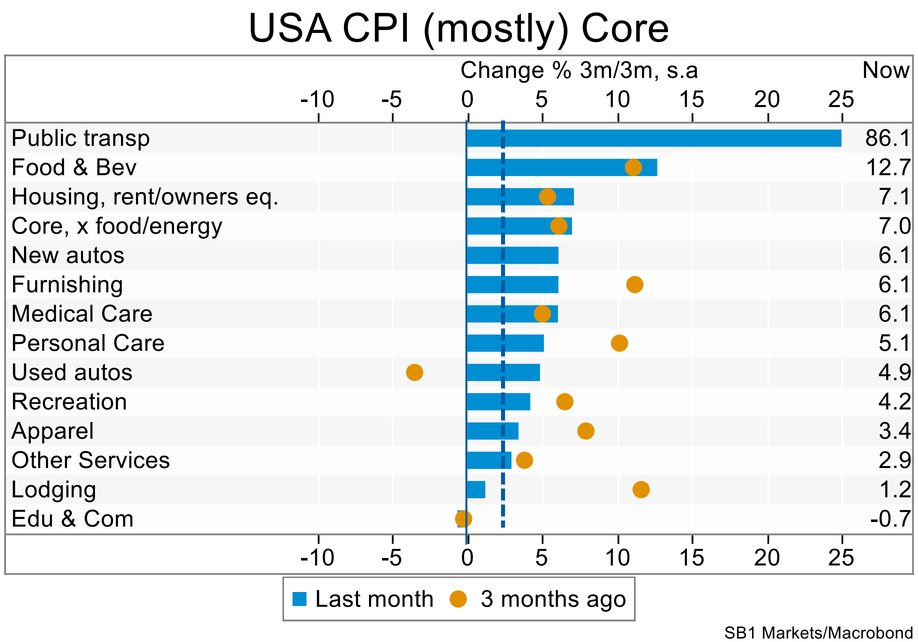


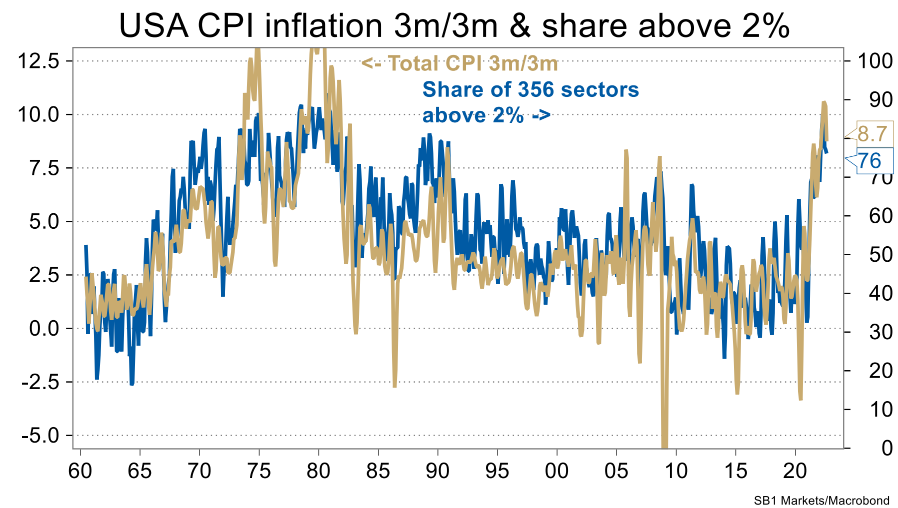
- Why have food prices at the retail level exploded vs. food commodities? The candidates: Freight costs, processing costs, distribution costs, (including energy and wages at each element in the value chain) – and the retail trade sector has increased its profit margins (according to national accounts)
- Very likely, food price inflation in the CPI will fall sharply the coming quarters

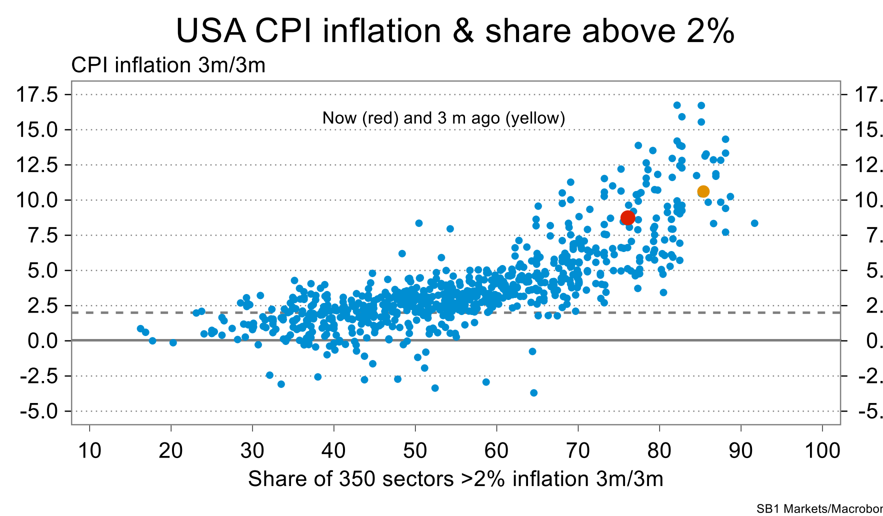
SpareBank 1 MARKETS

Inflation measured 3m/3m: Mixed news – but more slowing than accelerating

However, prices are up 8.7% 3 m/3 m, and 76% of the CPI items are up more than 2% y/y

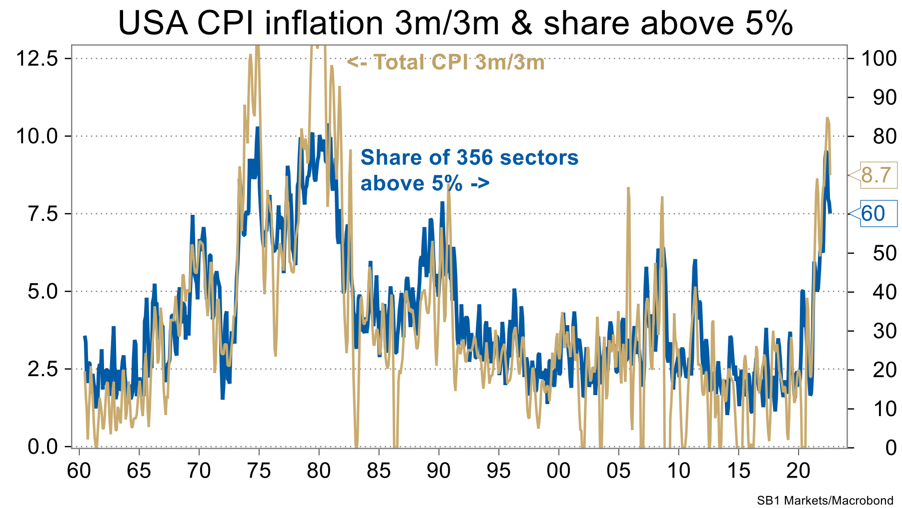


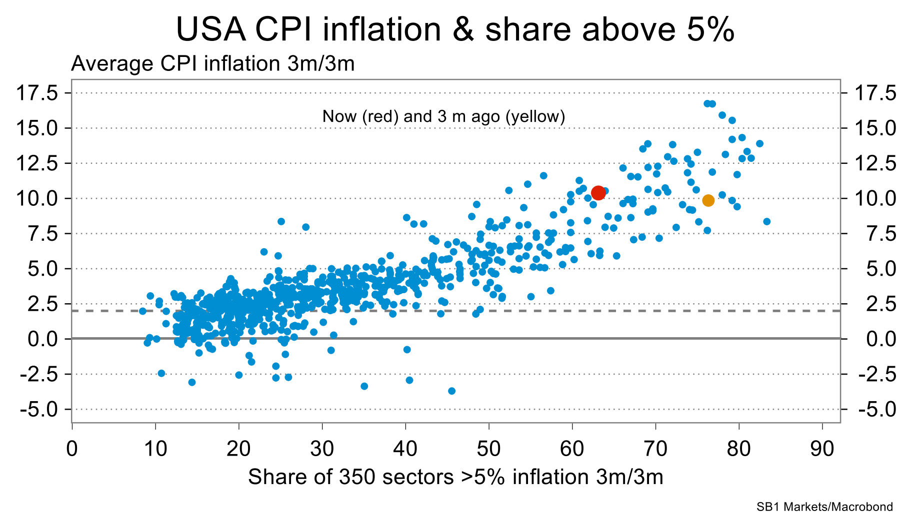




- However, sector sectors are reporting a slowdown in underlying (3m/3m) pace of inflation

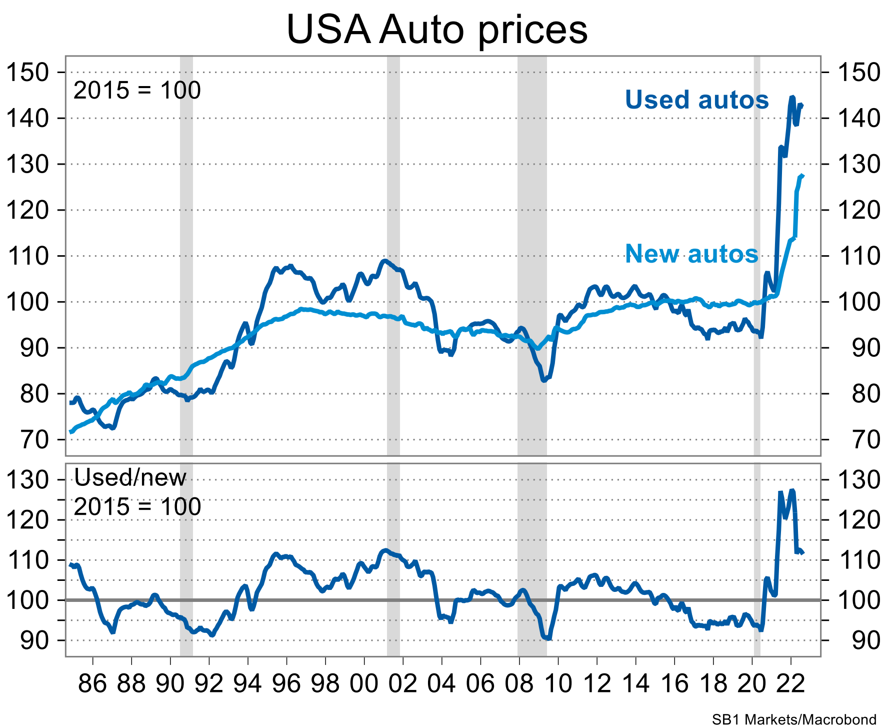
... and 60% of the CPI is up by more than a 5% pace recent months





Used auto prices did not decline as expected – but they 'have' to come down

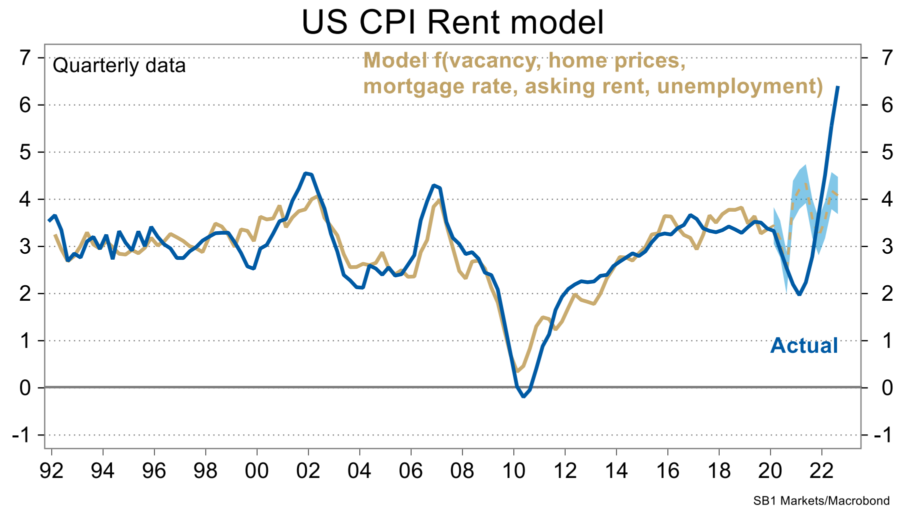
Private surveys had indicated a substantial decline in 2nd hand autos. And new auto prices are soaring



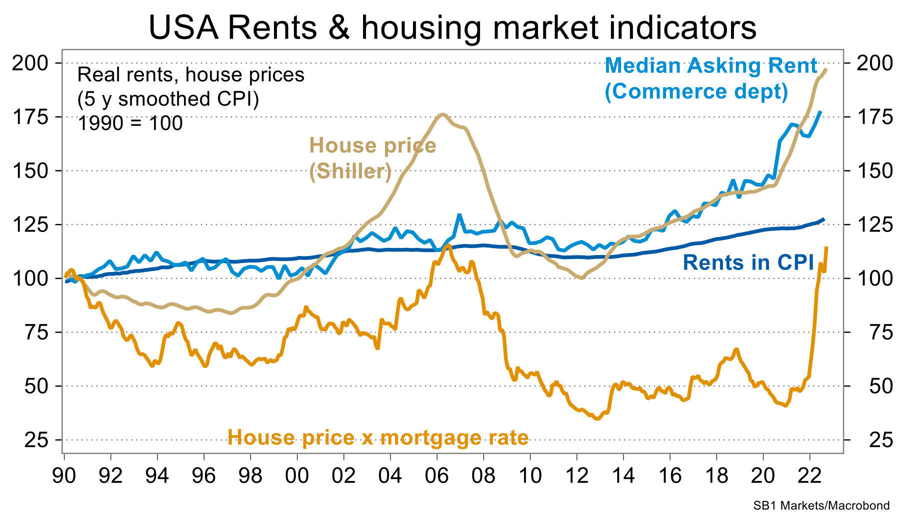
- Production of new cars is most likely still below demand
- At one stage, at least used auto prices will come down to a normal level vs. new car prices
- The new challenge: **New auto prices** have shot up sharply recent months – and these prices will very likely return to a more normal level – production costs are not up 26% through the pandemic!

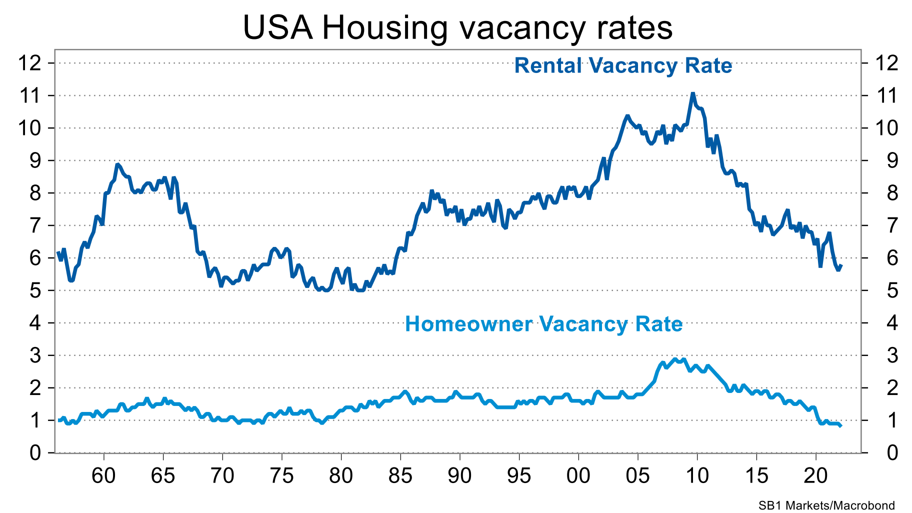
Rents are still accelerating. Will soon peak?

Rents are up 6.3% y/y, while signals from the rental market are mixed



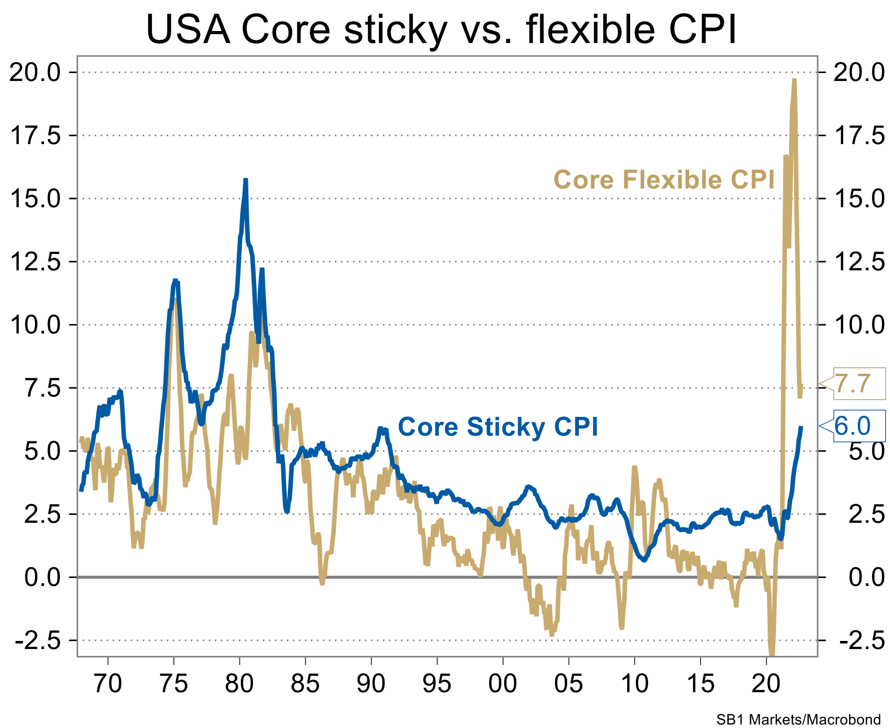
- **The official (Commerce dept) median rental asking price** is on the way up again following a slowdown last autumn. Some other surveys signal slowing rent inflation
- **House prices** are up 19%, and the owner cost (price x mortgage rate) has almost doubled. House prices are now probably falling m/m
- **The rental vacancy rate** has fallen sharply recent quarters, to ATL. The **homeowner vacancy rate** is trending down, and is also at ATL
- **Rent inflation measured in the CPI** has accelerated to 6.3%, though from a base below trend last year but past months rents have been climbing at an 8%-9% pace (m/m), and total housing costs (ex energy) contribute 2.1 pp to headline annual inflation!
- **Our model**, when assuming a substantial slowdown in rental asking price inflation and a rapid decline in existing house price inflation the coming quarters, and a flattening of the 30 y mortgage rate at 6%, signals a decline in rent inflation to below 4%. However, the outlook for the rental market is highly uncertain

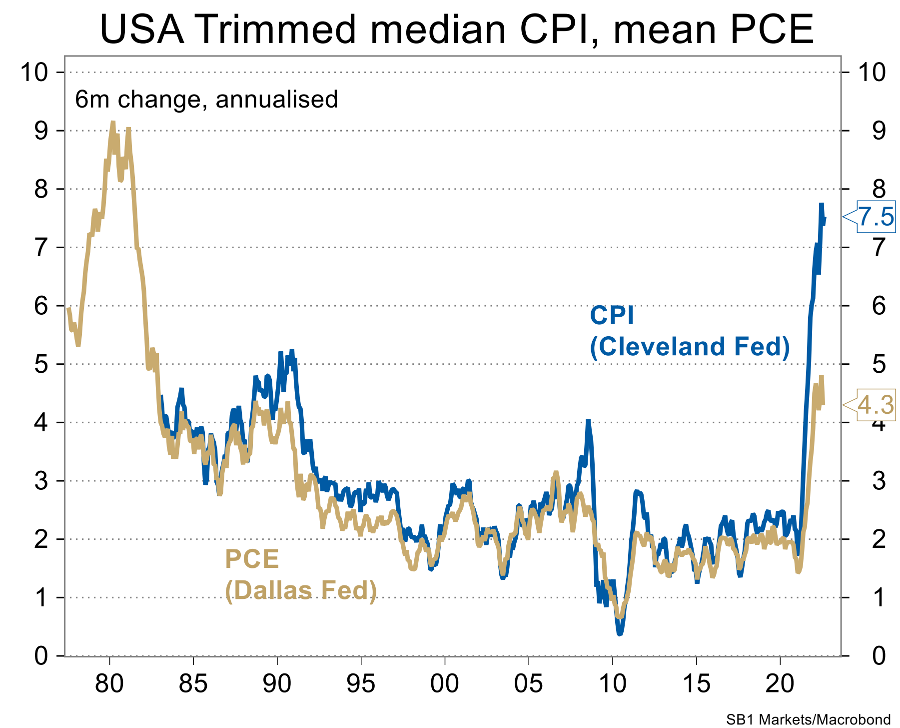




Flexible prices are coming down rapidly, *but sticky prices still on the way up*

Sticky prices are up 6.3% (90% of the CPI). Trimmed price measures have peaked, <u>are still lofty</u>

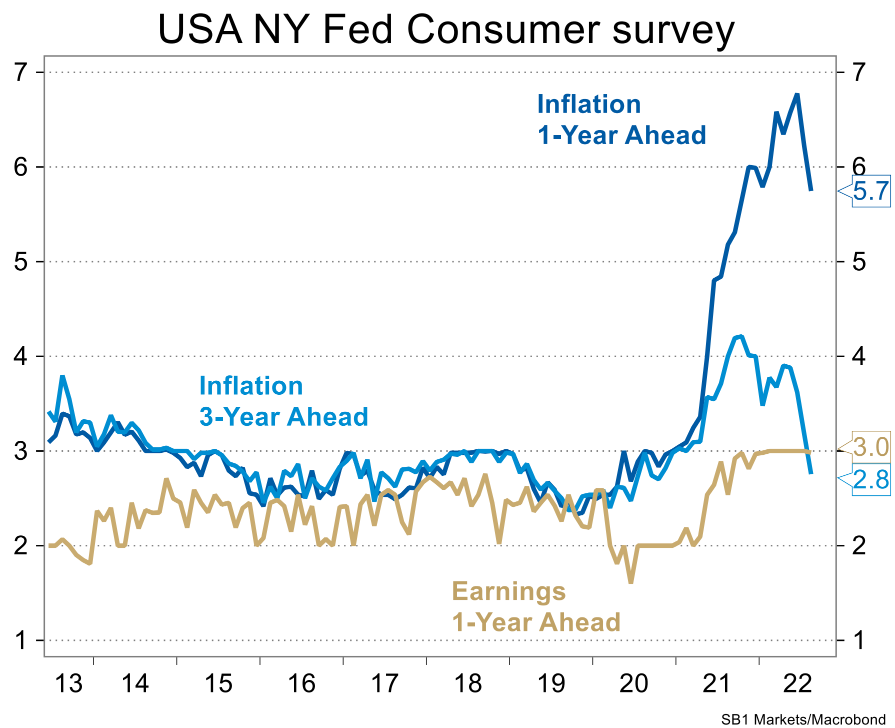


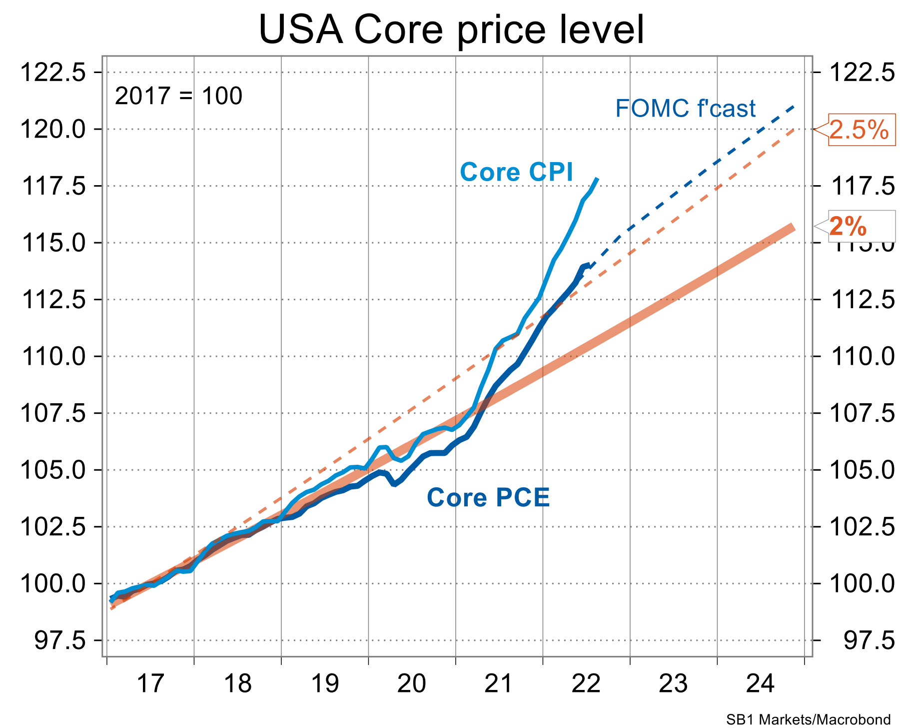


- Almost all of the initial lift in core CPI was due to prices of good & services that often fluctuate, with rapid price increases followed by deep price cuts. These prices are '**flexible'** and represent some 10% of the core CPI. The core flexible CPI is up 7.1% y/y, down from almost 20% at the peak! But still higher than anytime since 1981
- The new challenge: The **sticky components** (90 % of the core CPI) are up 6.0% y/y (up from 5.6% in July). <u>The surge in the sticky index is much more worrisome for the inflation outlook than the ups and downs in the 'flexible' CPI</u>
- The Cleveland Fed **trimmed median CPI** is up at a 7.5% pace over the past six months, down up from 7.4% last month – but still miles above anything seen before (data from 1983). Dallas Fed's **trimmed mean PCE** was up 4.3% in <u>July</u>

NY Fed's survey: Consumers' inflation expectations are falling rapidly

Longer term (3 y) expectations have fallen to 2.8% from above 4%. Are back to a normal level!

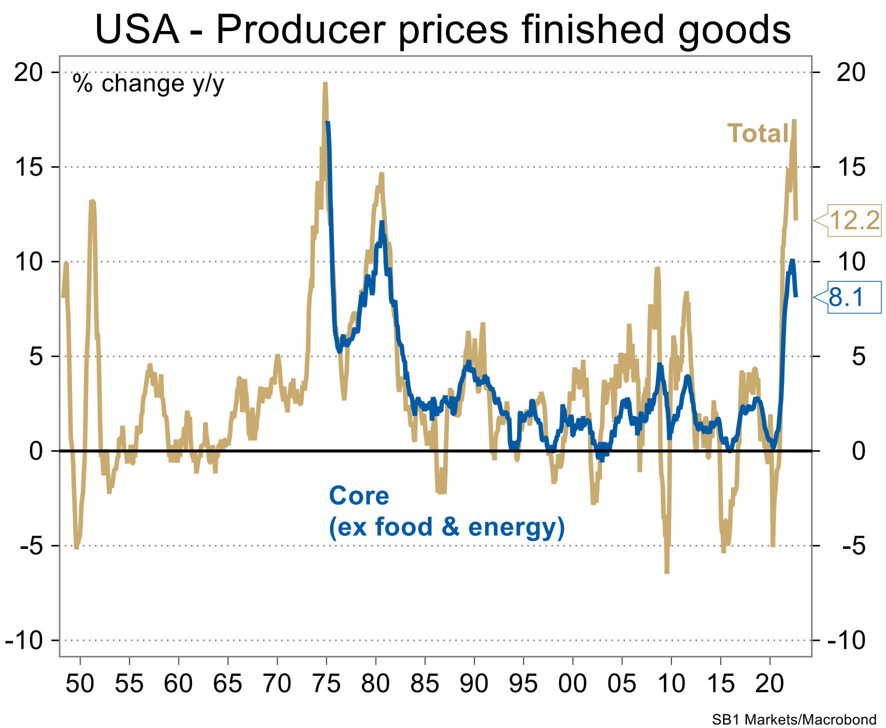


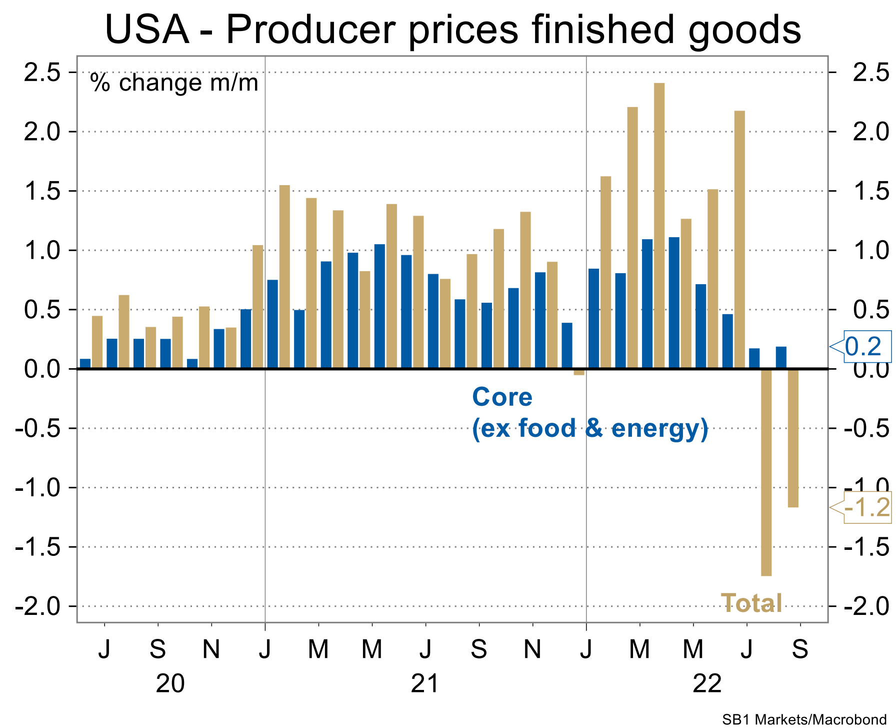


- All surveys tell the same story: Longer term inflation expectations have come down and are not high
- The public has not lost confidence in the Federal Reserve – even if actual inflation is very high, and the price level has departed from the 2% path
  - » BTW, do you remember Powell's arguments for an expansionary monetary policy back in 2020, in order to bring the price level up to the 'promised 2% path' by letting inflation run above 2% for a while? *How should he formulate this strategy now??*

Peak inflation: The finished goods PPI fell 1.2 % m/m as energy prices fell sharply

The core PPI rose just 0.2% in Aug, as in July. In addition: core & intermed. crude material prices slow

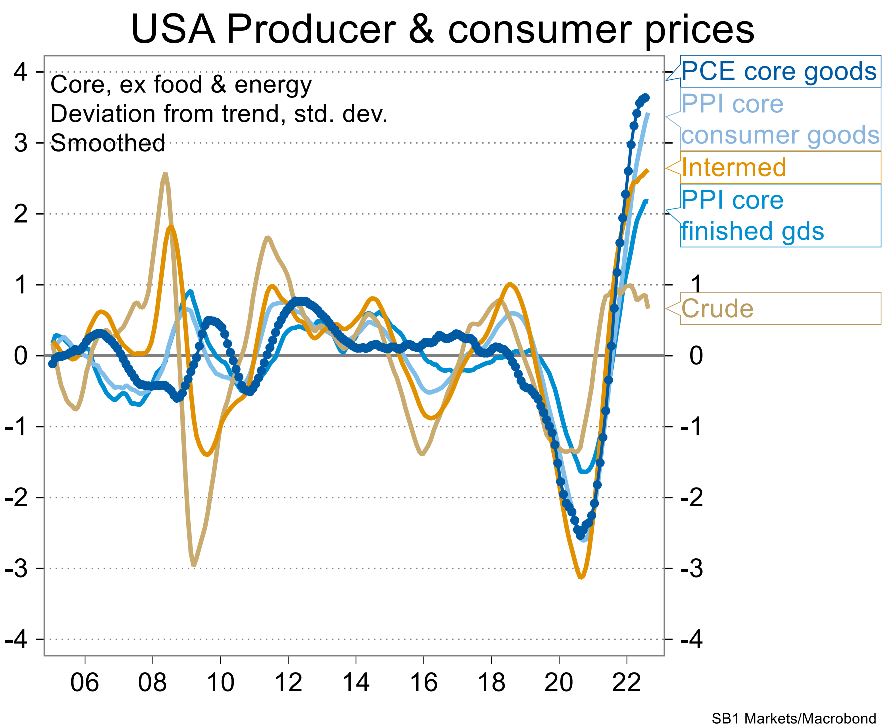


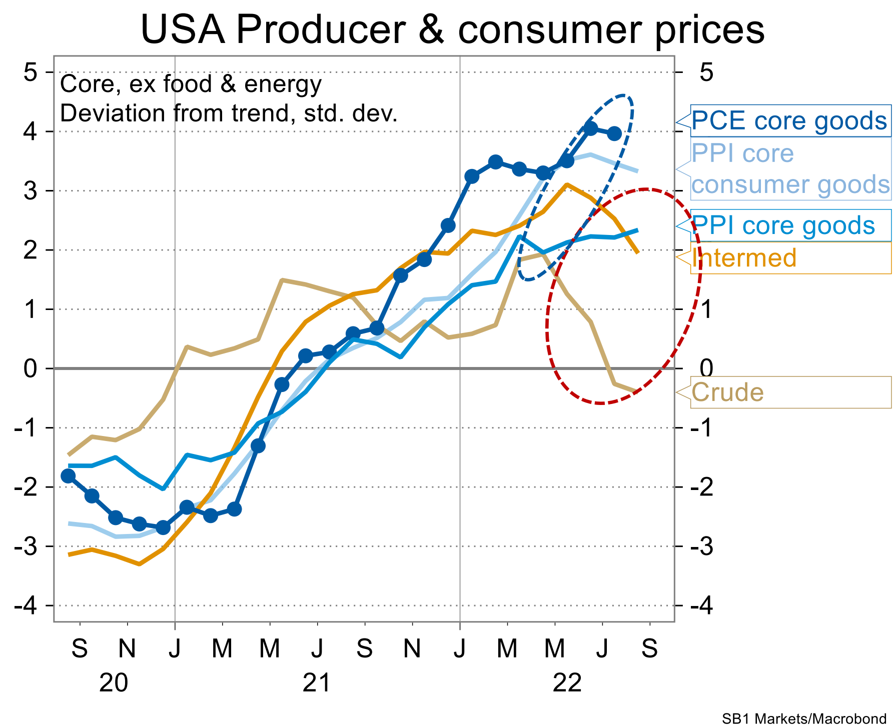


- **The headline finished goods PPI** fell by 1.2% in August, following the 1.7% drop in July. The annual rate slipped 2.5 pp to 12.2%. Energy prices fell 6% while food prices were unch.
- **Core finished goods x food & energy** PPI rose by 0.2%, as in July. The annual growth rate fell by 0.4 pp to 8.1%. The peak was at 10%
- **Crude material prices** are on the retreat – normally the first sign of easing price pressures in the supply chain, and now intermediate material prices are flatting too
- **Core consumer goods prices** (PCE, like in the CPI) have already climbed more than usual vs. PPI prices (partly due to second-hand auto prices, not included in the PPI), limiting the upside risk
- **The 'official' total final demand PPI**, including **services**, fell by 0.5% m/m in July, following the June surge. The annual rate at 9.7% was 0.7 pp lower than expected!

Crude core material prices are yielding

Now intermediate goods follow suit – and the core consumer goods PPI grows in line with trend

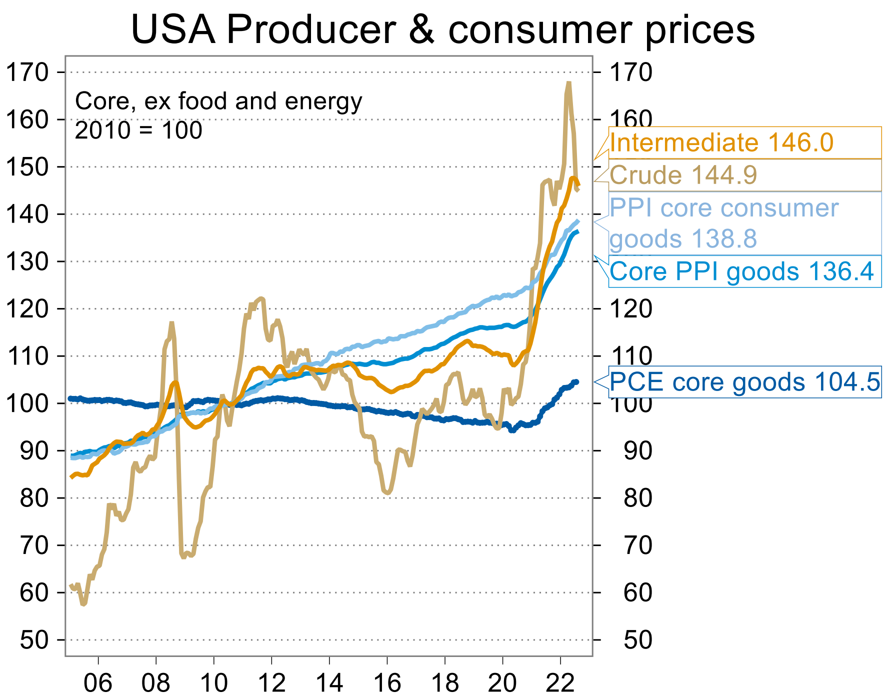




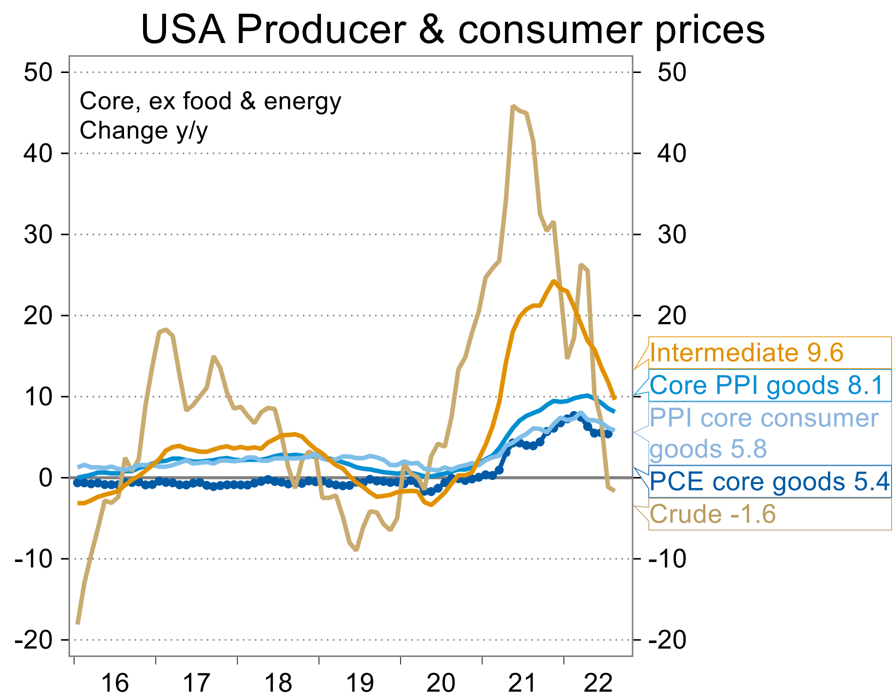
- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months. Following several months with slow growth in these prices to February from last summer, they rose in March and remained at a high level in April – but they are now heading down rapidly (and prices are down y/y, *check next page*). **Intermediate prices** have slowed past two months. We can here see the impact of the broad decline in raw material prices globally – as growth in demand is slowing
- Core consumer goods prices are also yielding at the producer level, rather early vs the normal cycle pattern

Crude core material prices are yielding

(level & growth rates, same series as per the prev. page)



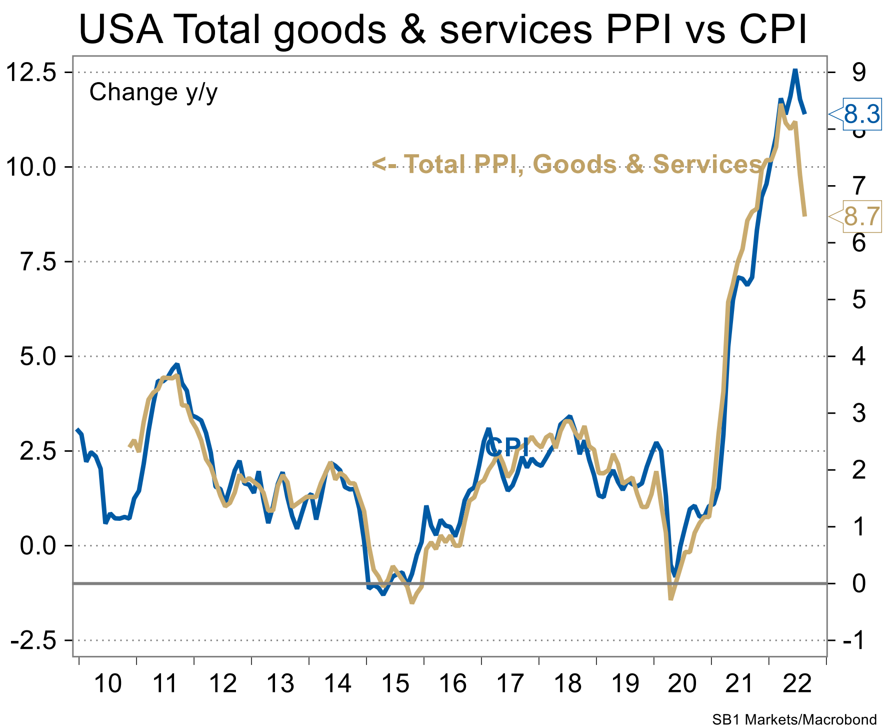
SB1 Markets/Macrobond

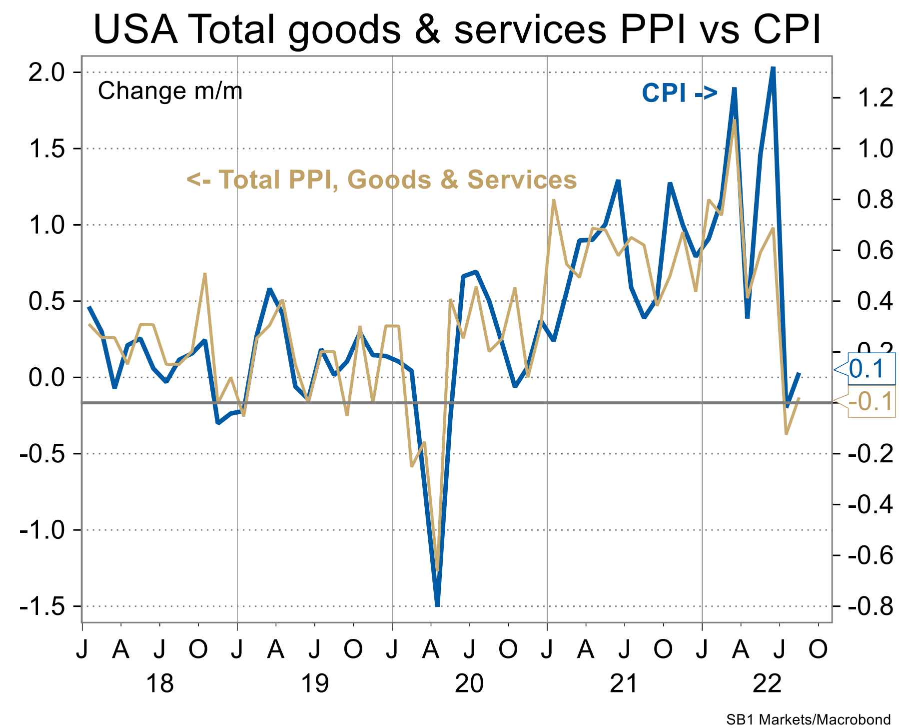


SB1 Markets/Macrobond

Total PPI (services incl.) -0.1 m/m, and the annual rate down 0.9 pp to 8.7%

As expected, another peak inflation message

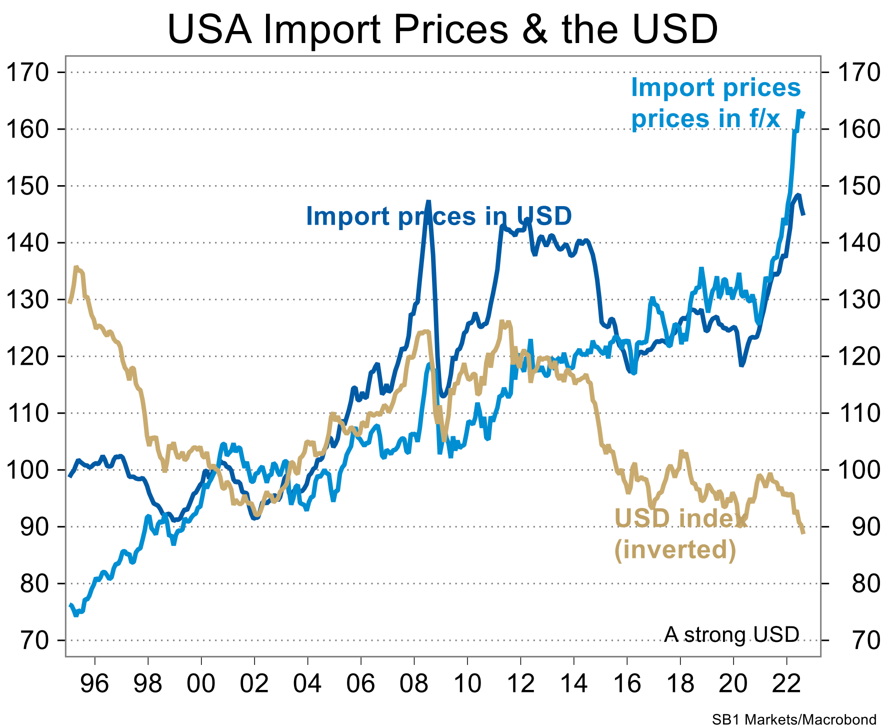


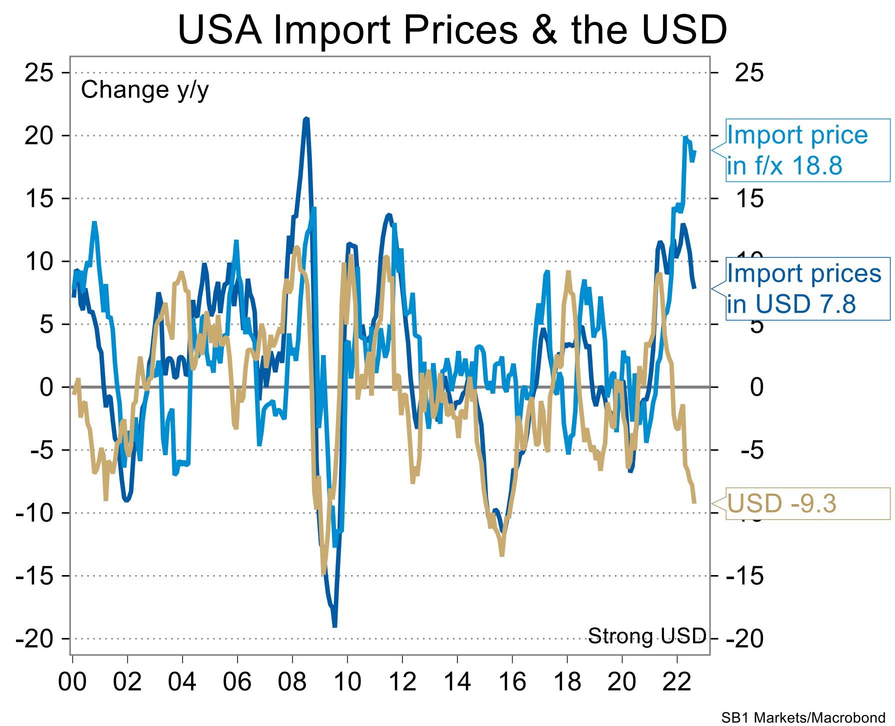


- The correlation between the total PPI, which includes all sorts of services in addition to goods, and the CPI is very close. The current 8.7% annual growth rate, signals a further decline in CPI inflation the coming months

Peak import prices too – but they are not that important

Import prices are up 7.8% y/y, down from the 13% peak in March. A strong USD has cut the bill by 9%

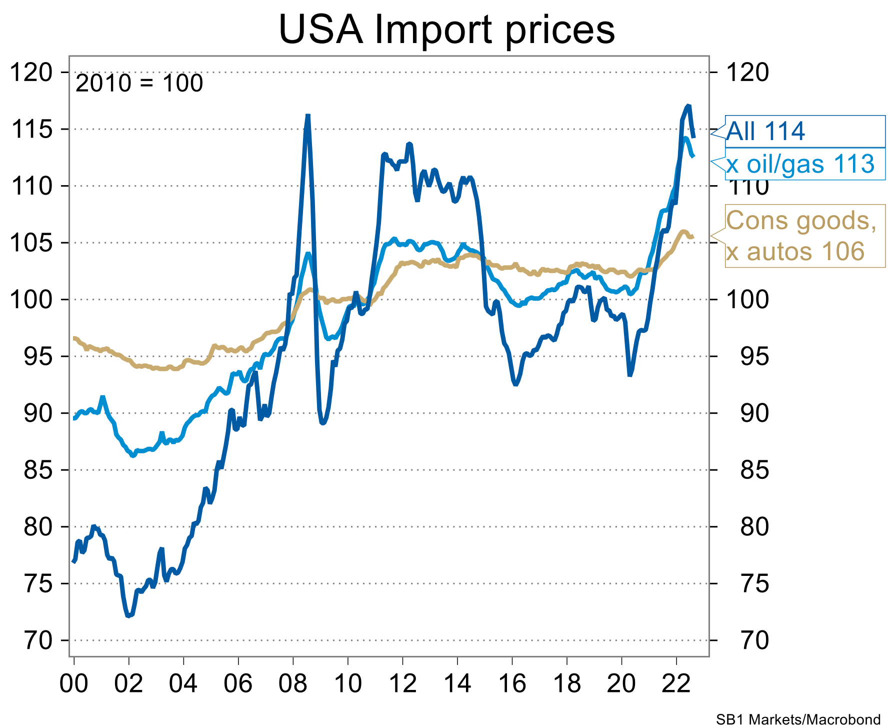


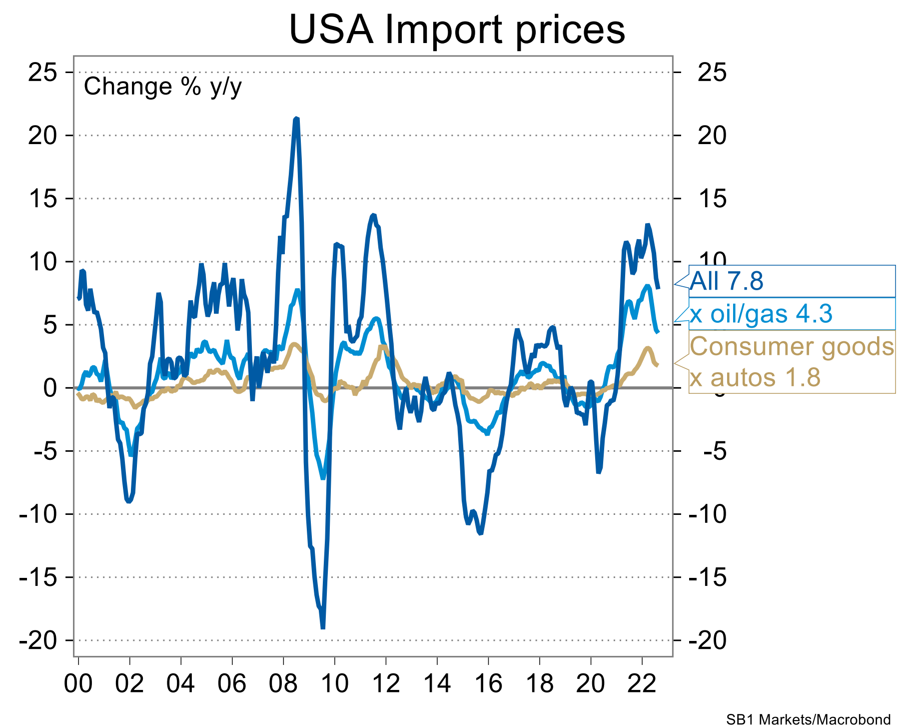


- Import prices, measured in sellers' currencies remains high, at 19% y/y (which should be appreciated by the sellers ☺)

Prices are up 4.3% ex oil/gas, while consumer goods ex auto are up just 1.8%

Total import prices fell 1% m/m, and by 0.2% ex oil & gas. Consumer goods gained 0.1%

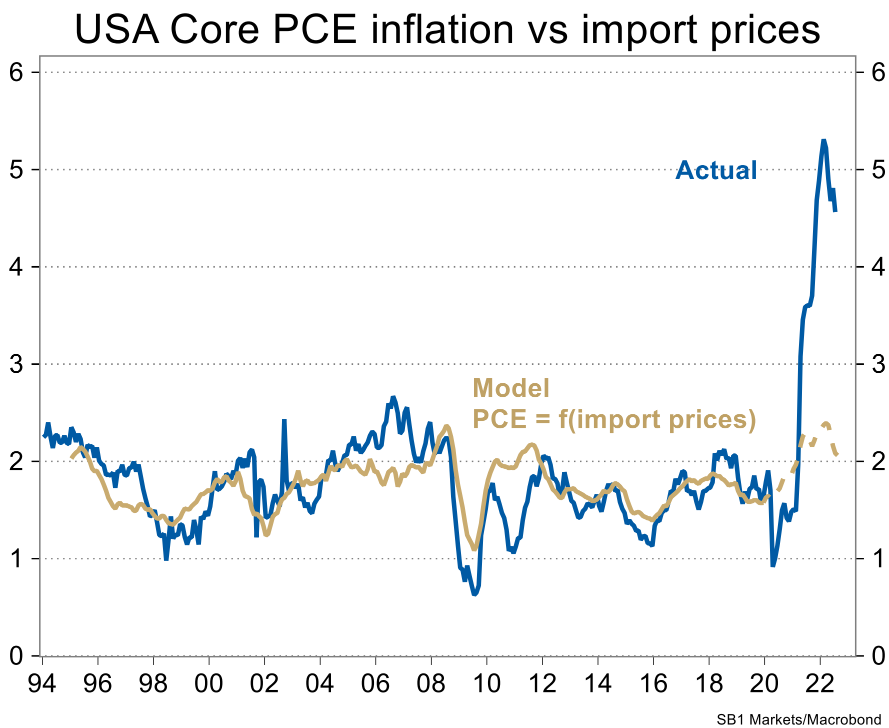




- The total was expeced down 1%

There is some impact to domestic inflation import prices

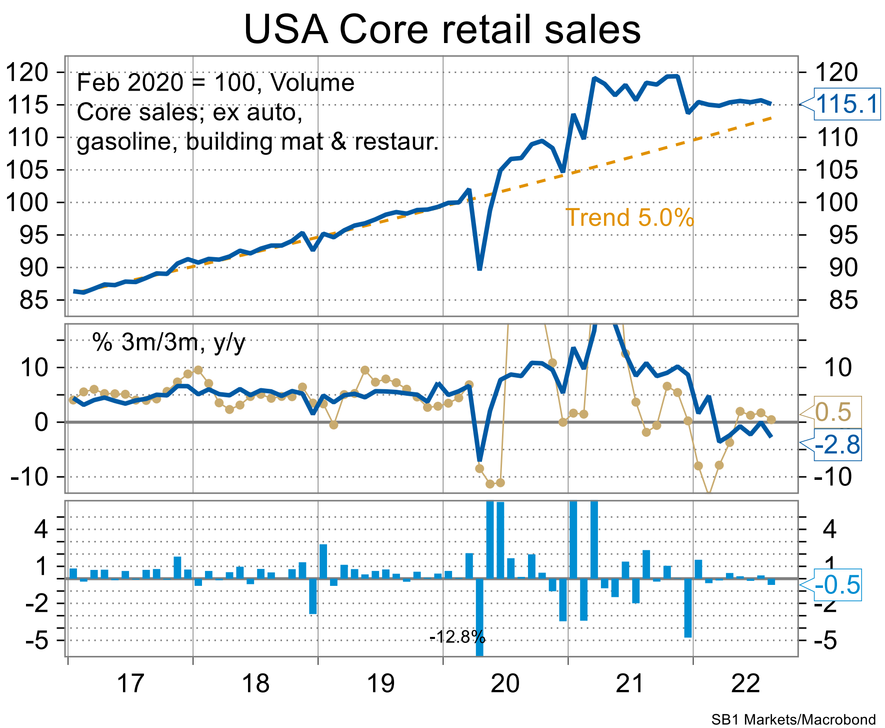
However, import prices cannot in any way explain the recent surge in US inflation

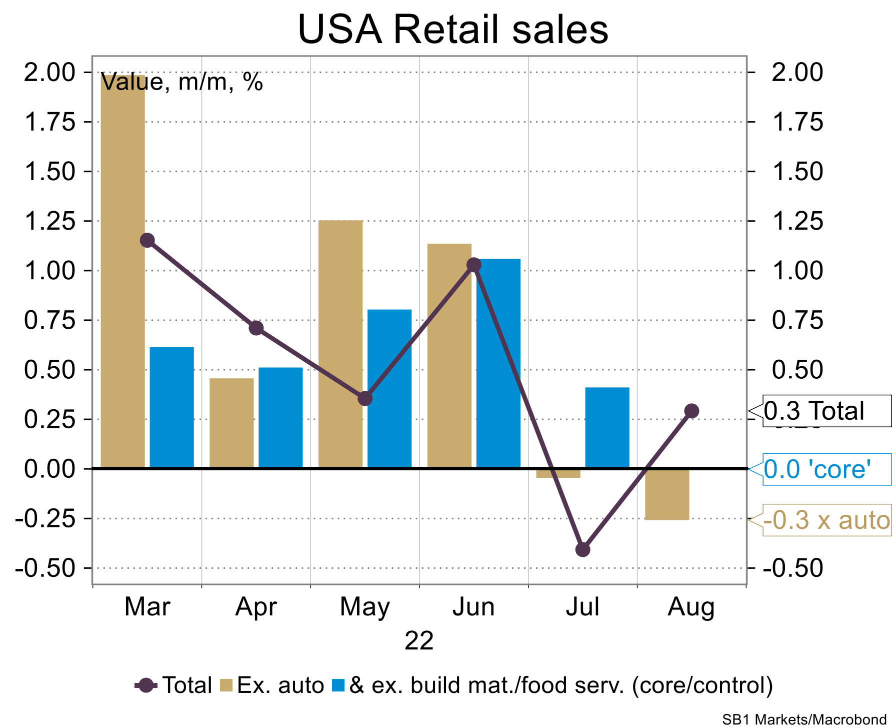


- … and lower import prices should not contribute that much to lower domestic inflation

Retail sales of goods have flattened (in volume terms), down some 0.5% in Aug

July core sales were revised down by 0.4 pp, and sales in August were 0.5 pp lower than expected

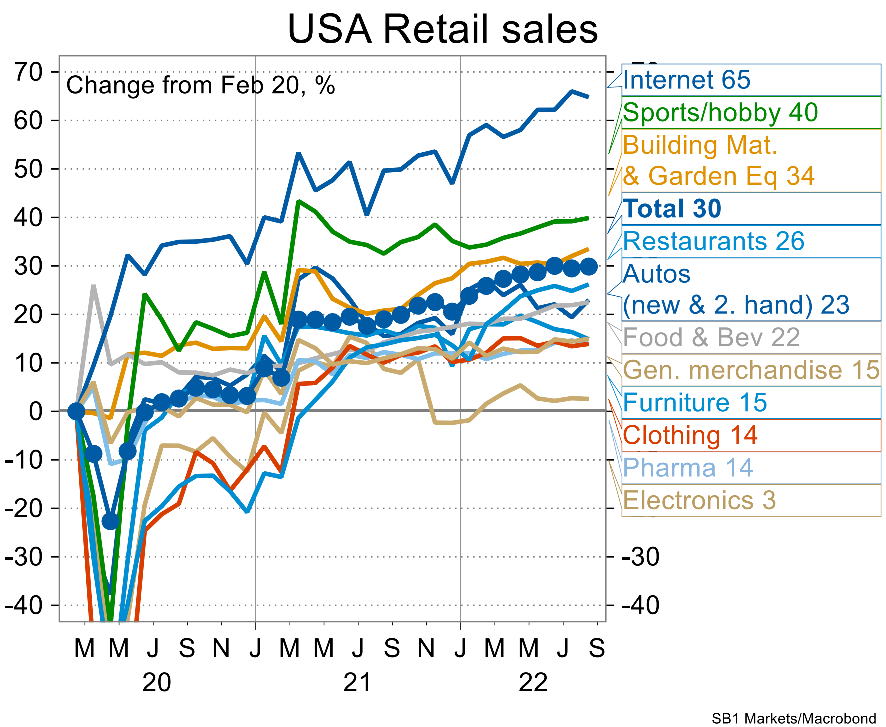




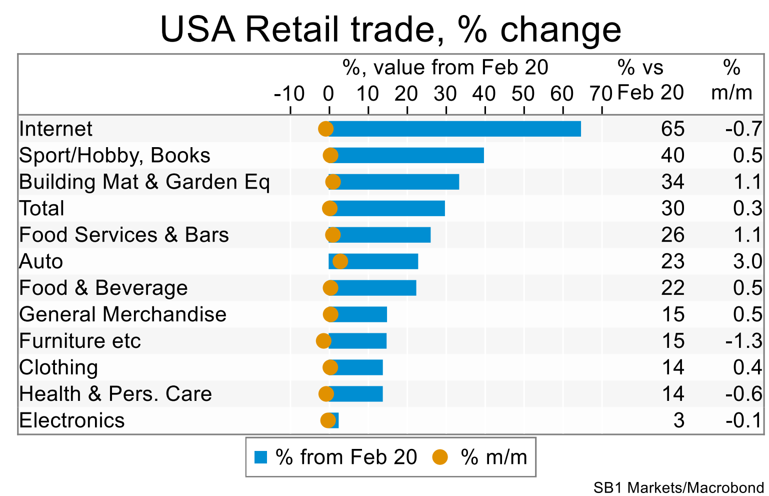
- **Total nominal sales** were up 0.3% in August, 0.1 pp above expectations, but June was revised down by 0.3 pp to 0.7%. Auto sales fell. In addition gasoline sales fell, together with gasoline prices. Total nominal sales are up 30% vs. the Feb 2020 level!
- **Core sales of goods** (=control group, excludes autos, gasoline, building materials & restaurants) was flat in August in value terms, 0.5 pp below expectations (and July data were revised by to 0.4 pp to 0.4%)
- **In volume terms**, core sales are trending slightly downwards: We assume prices rose by 0.5% m/m in August. Thus, in volume terms, sales fell by 0.5% following a 0.2% increase in July (our estimates). 'Real' sales are trending marginally downwards (-2.8% 3m/3m), and are approaching the pre-pandemic trend! Sales are 5% below the level from last November, which was the highest ever

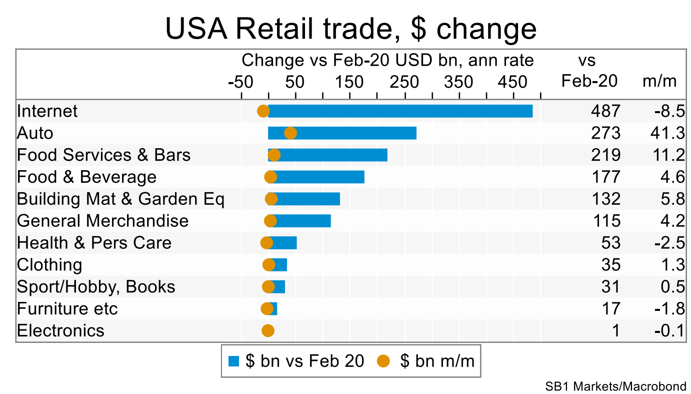
Most sectors reported marginally higher sales in August (in value terms)

Internet sales fell, but are still up 65% since before the pandemic



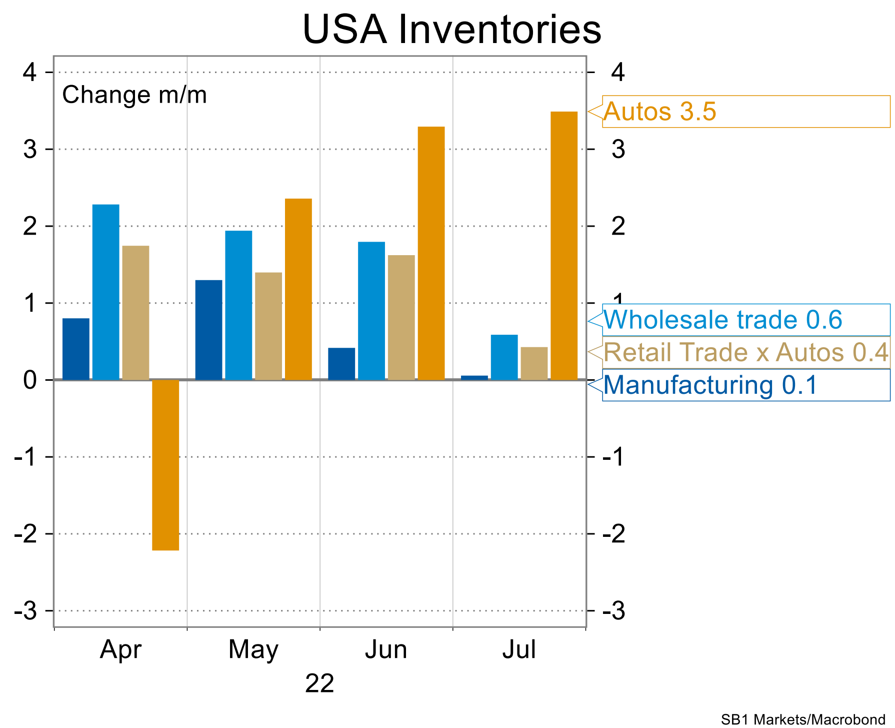
- 4 out of 11 main sectors reported lower sales in Aug, 7 reported higher sales
- Total sales are up 30% in value terms vs Feb. 20
- Restaurants are up 26% vs Feb-20!
- Internet sales are up 65%
- Clothing are up just 14%
- Electronics are up just 3% - in value terms

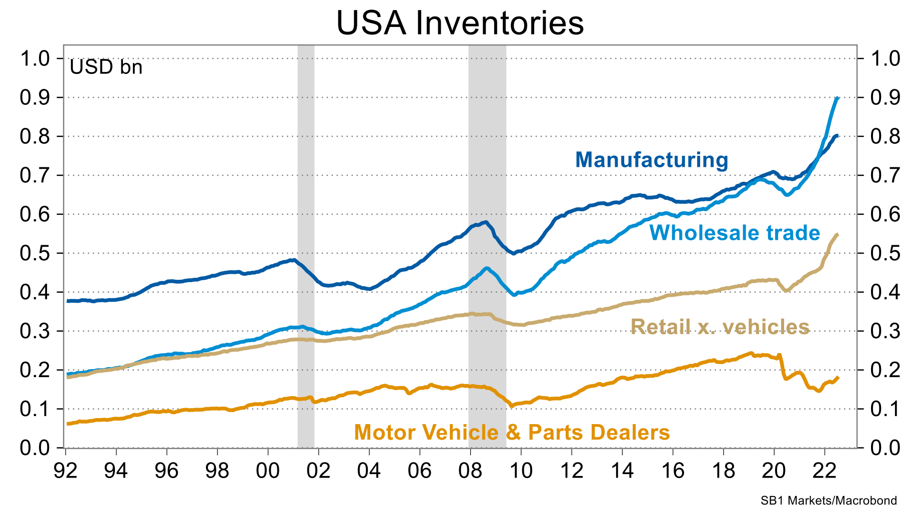


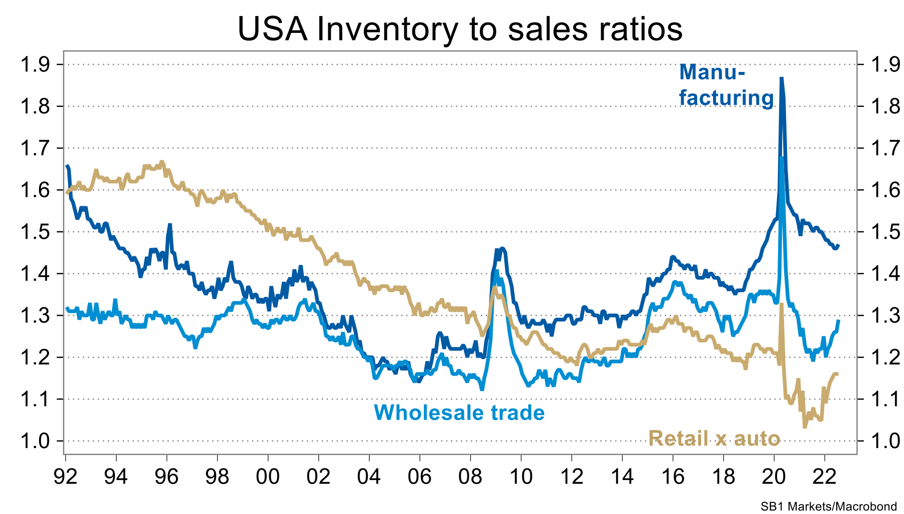


Inventories on the way up, and faster than sales, in wholesale & retail sales

Inventories in trade are not very high vs sales but growth in inventories will very likely slow



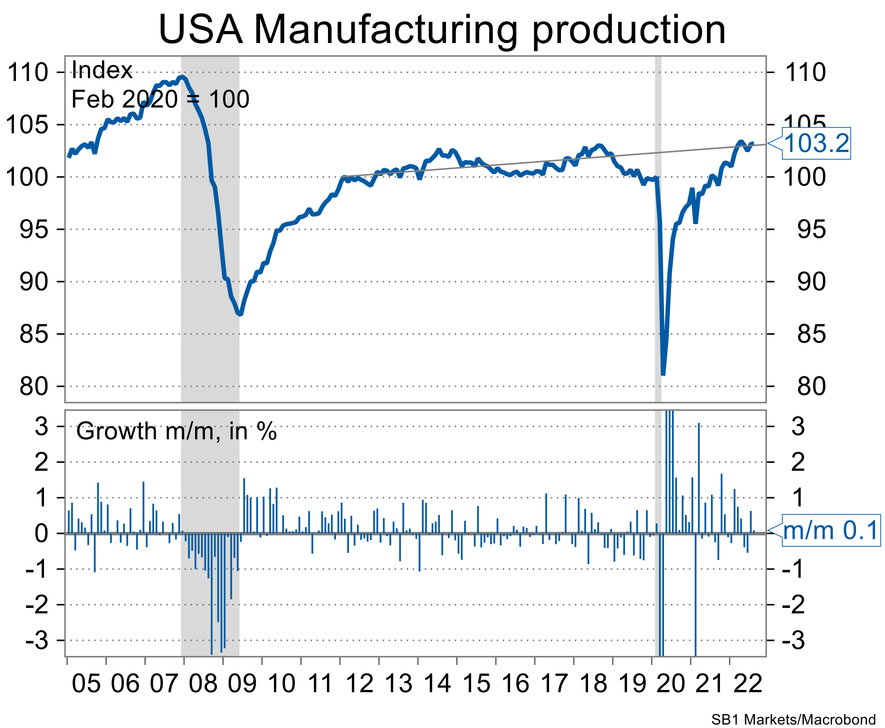


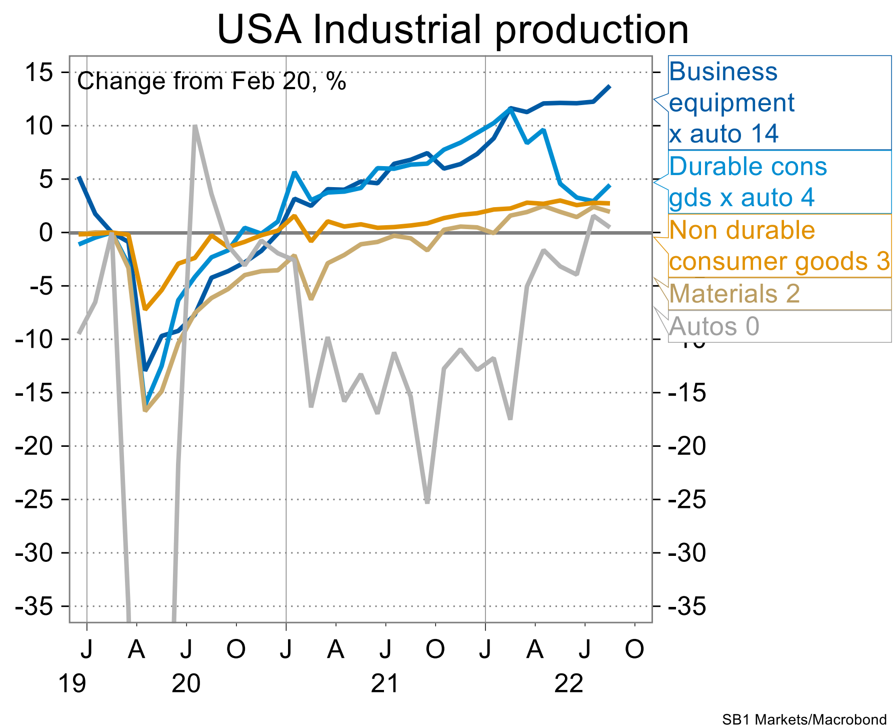


- Inventories in the **manufacturing sector** are falling vs. sales, from a high level – probably a substantial potential for lowering inventories from here

Manufact. prod. up 0.1% in Aug, 0.2 pp better than expected – short trend flat

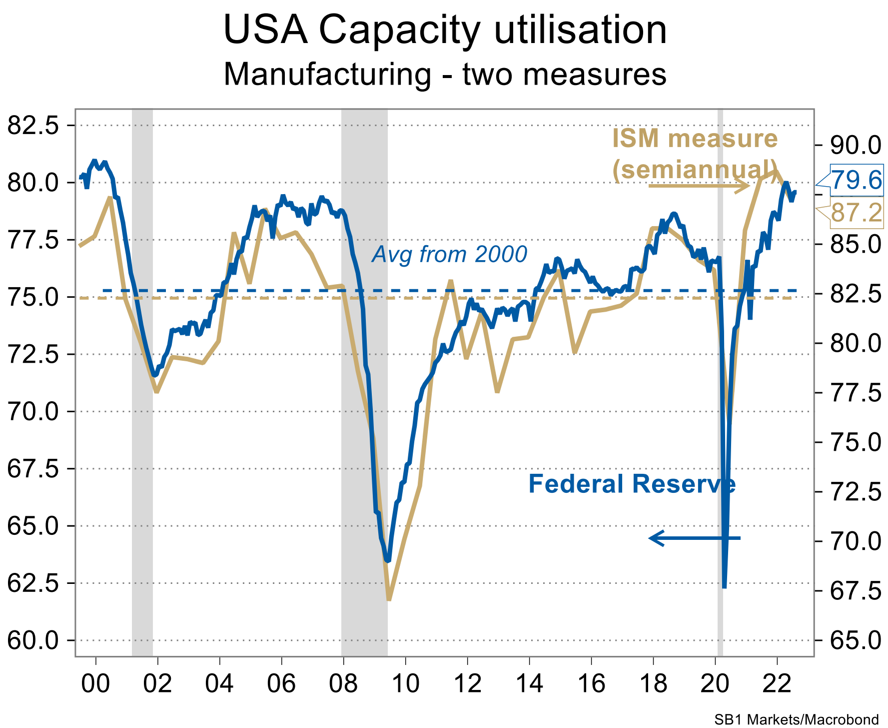
Auto production slightly down, flat vs. Feb-20, not much worse than some other sectors





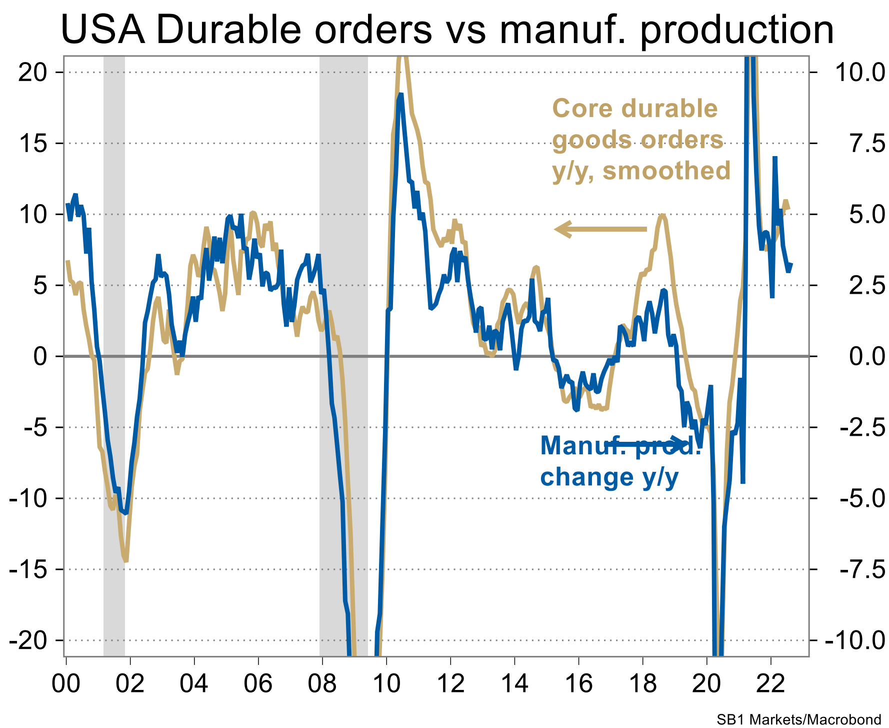
- **Manufacturing production** grew 0.3 pp more than expected. Production is still below the April level, and the 3m/3m rate at -0.9%
  - » Production of business equipment, durable goods x autos up, materials down. Durable goods x auto is down 7% since February
- **Total industrial production**, including utilities, mines/oil production, was flat in August – in line with expectations
- **Capacity utilisation** was unch., and the level is close to the highest in 20 years (the peak was in April)
- **Surveys** have weakened substantially since May. The two first September surveys are mixed but in sum up vs their August prints

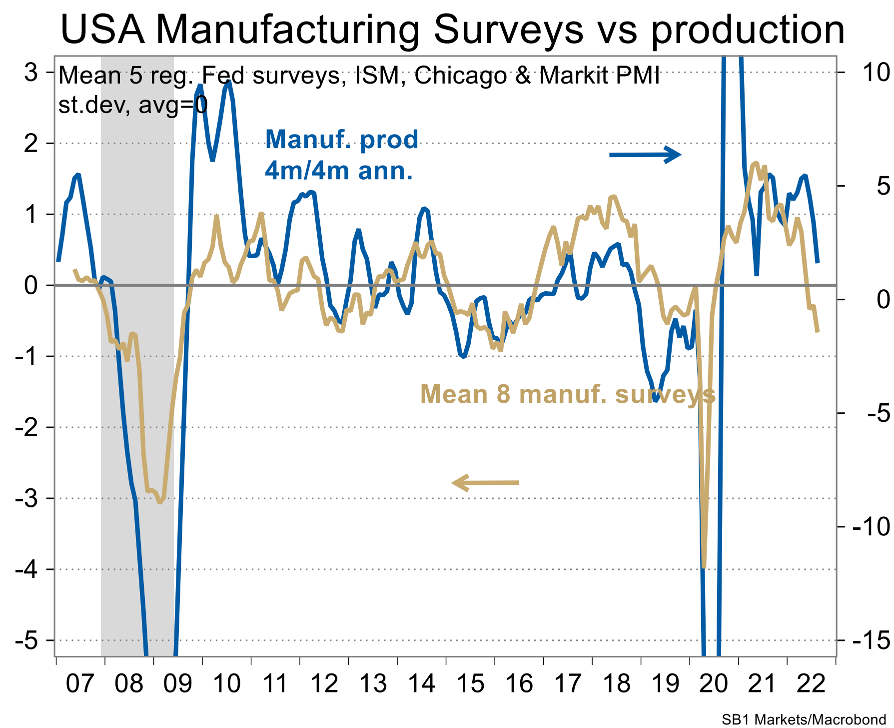
Capacity utilisation remains very high



- **The Federal Reserve** reported a small increase in capacity utilisation in July and the level is just marginally below the highest level in 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

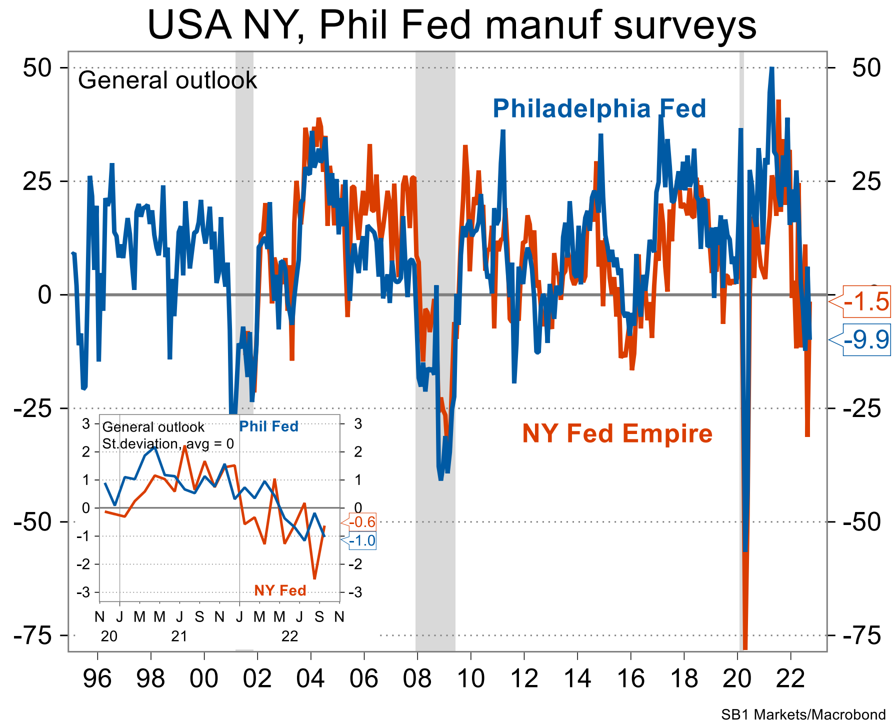
Order inflow signals further growth in production, surveys not

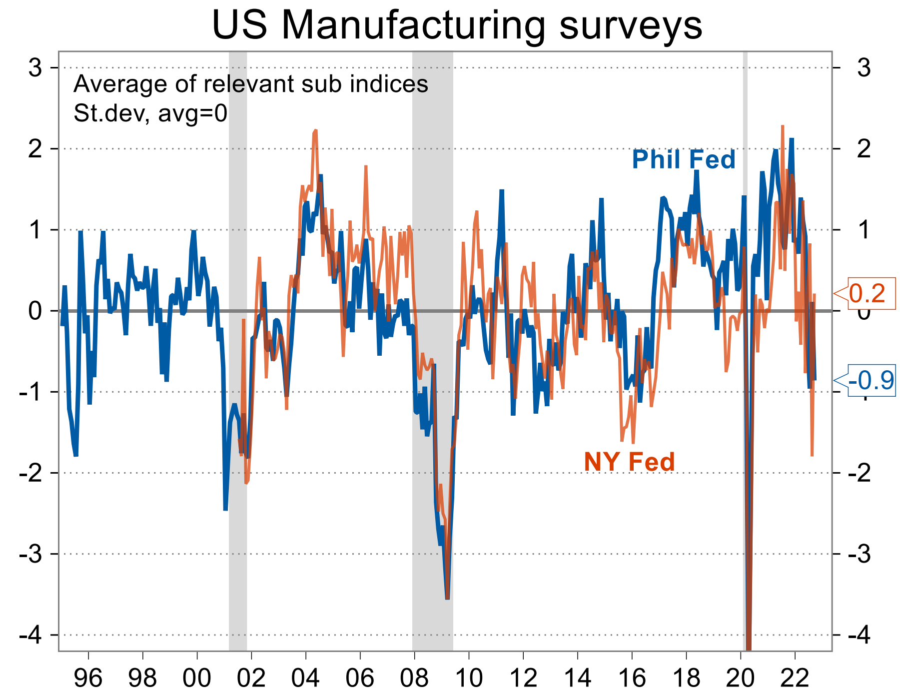




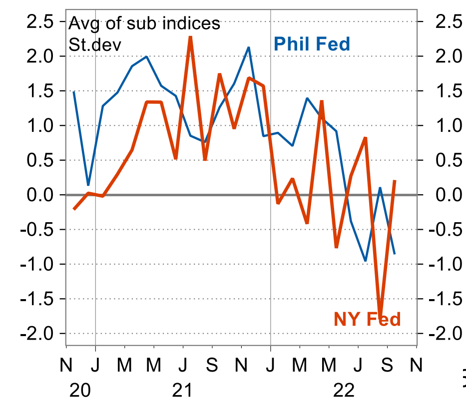
Flip flop: NY Fed's index up, Phil Fed down in September. In sum up

Once again the two surveys differ from month to month. The trend is down for both of them



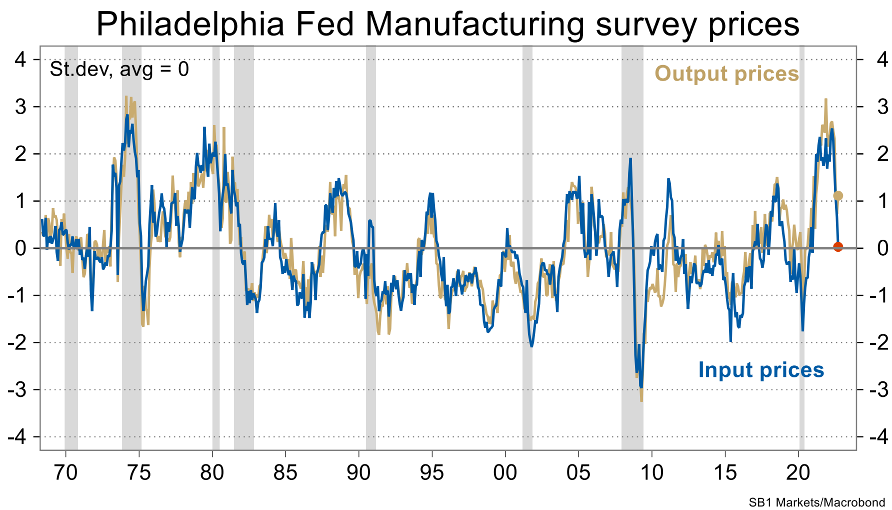


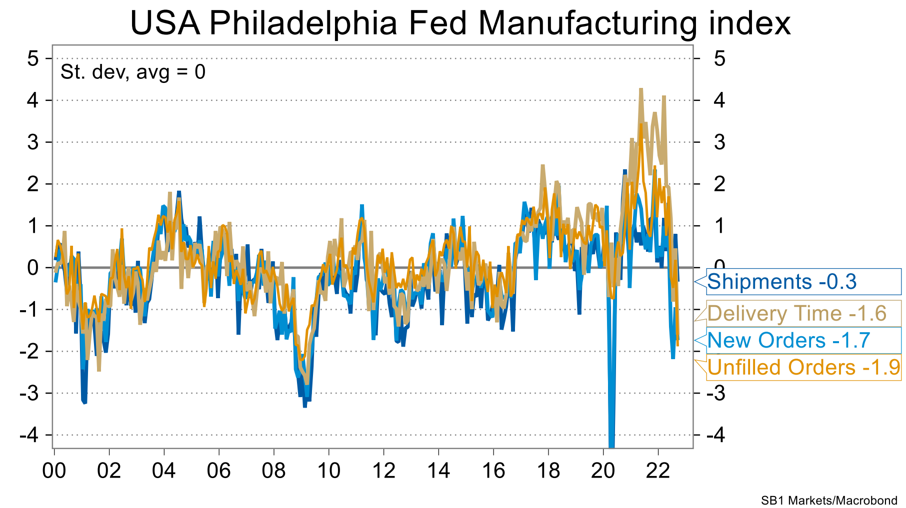
- **NY Fed Empire State manufacturing index** nosedived in August, to -2.5 st.dev below average (one of the worst prints ever) but rose to -0.6 in Sept, 0.7 st.dev better than expected
- **Philadelphia Fed's manufacturing index** surprised on the downside, as it fell to -1 st.dev below average, from -0.2 in Aug, expected up to +0.1 st.dev!
  - » The sub-indices told the same story, the two surveys swapped positions in September. Delivery times are falling, and price increases are slowing further – in fact input prices were unchanged in September
- **Taken together:** A small uptick in September and they signal an unchanged manufacturing ISM

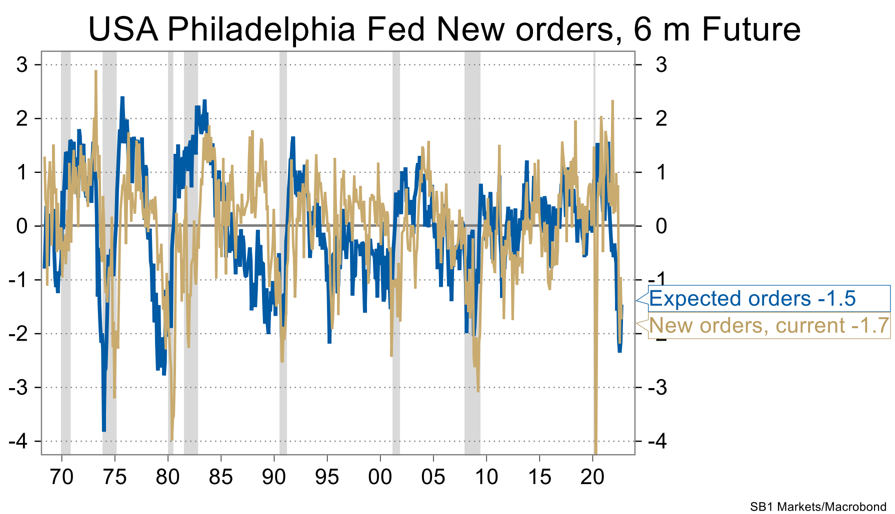


Philly Fed: New orders down, like in recessions. Other activity data weak too

The good news: Input prices index down to an average level, signaling ‘normal’ price increases



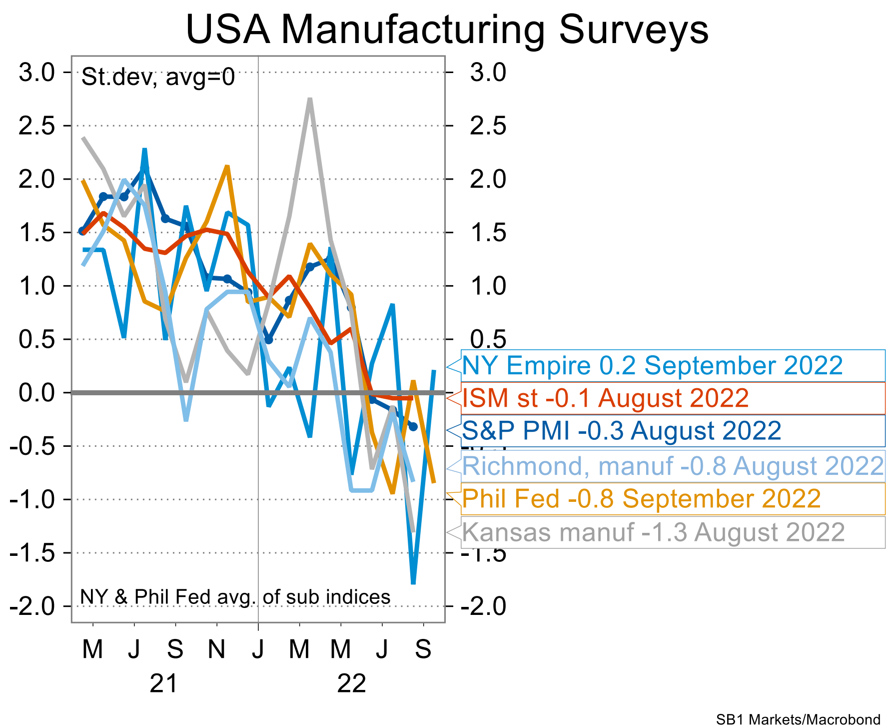


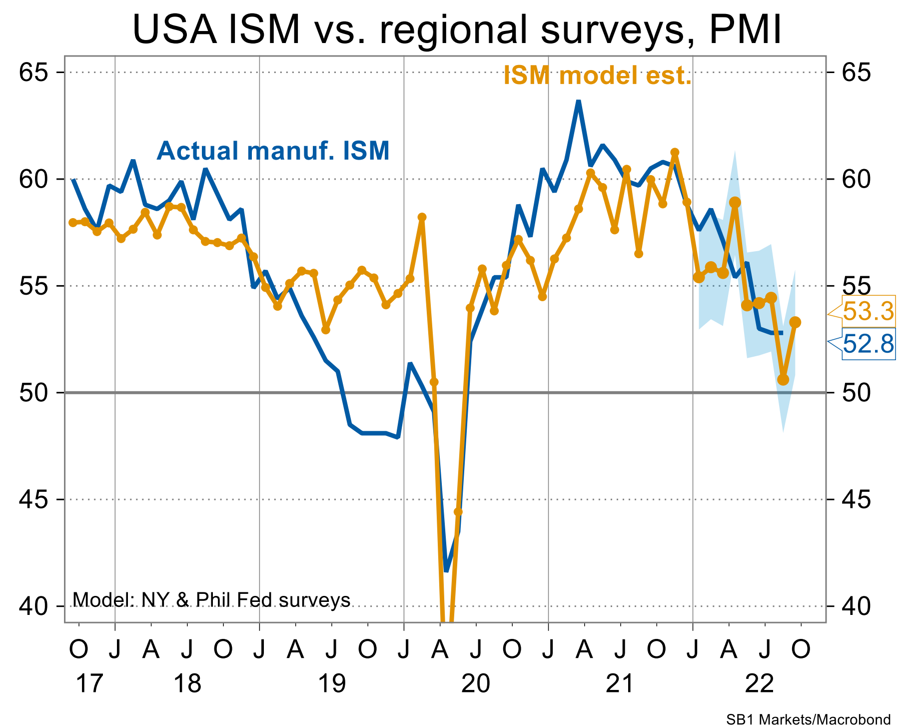


- **Price indices** are still signalling price increases, but not more than normal for input prices (st-dev = 0). Growth in output prices is slowing rapidly too
- **The new orders** index is zig-zagging downwards, -0.7 st.dev to -1.7 in Sept
- **Shipments** slowed, and delivery times fell

NY & Phil Fed in sum up in September, the ISM may stay at close to 53?

More regional surveys will be published this week, as well as PMI from S&P (Markit)

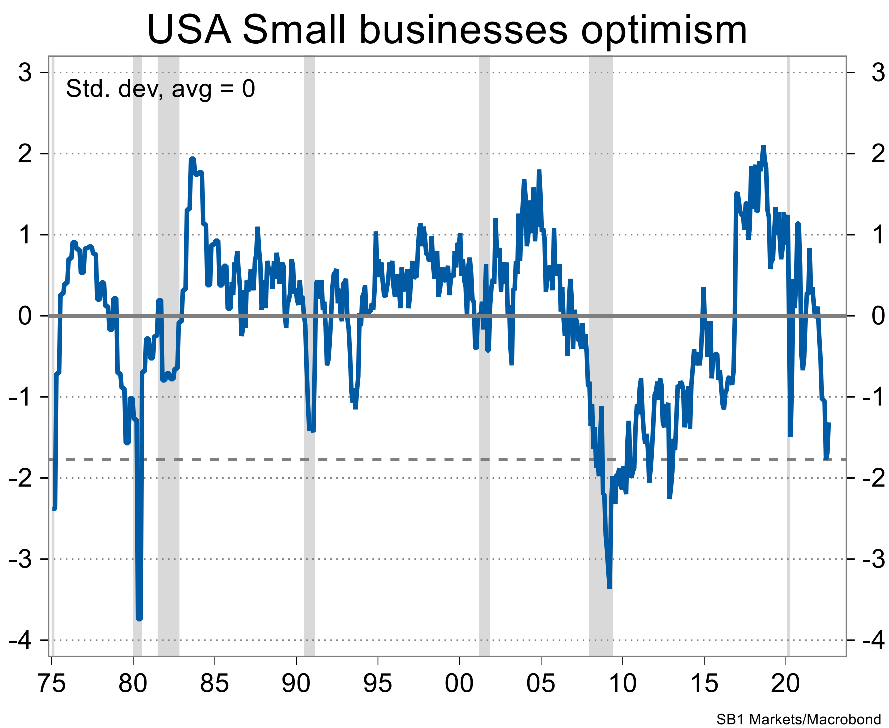


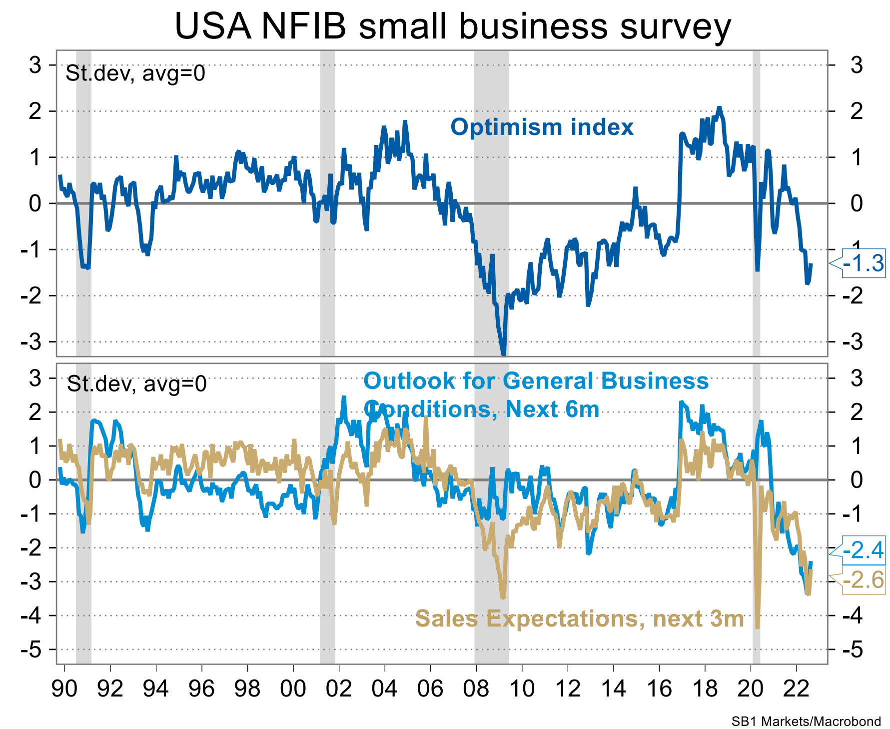


- Big picture: Growth is slowing sharply but manufacturing indices do not signal that the economy has entered a recession (even if order indices are really worrisome)

Small businesses optimism marginally up in August, still 1.3 st.dev below average

… and the outlook is even worse, at 2.4 below. Although, the outlook improved too

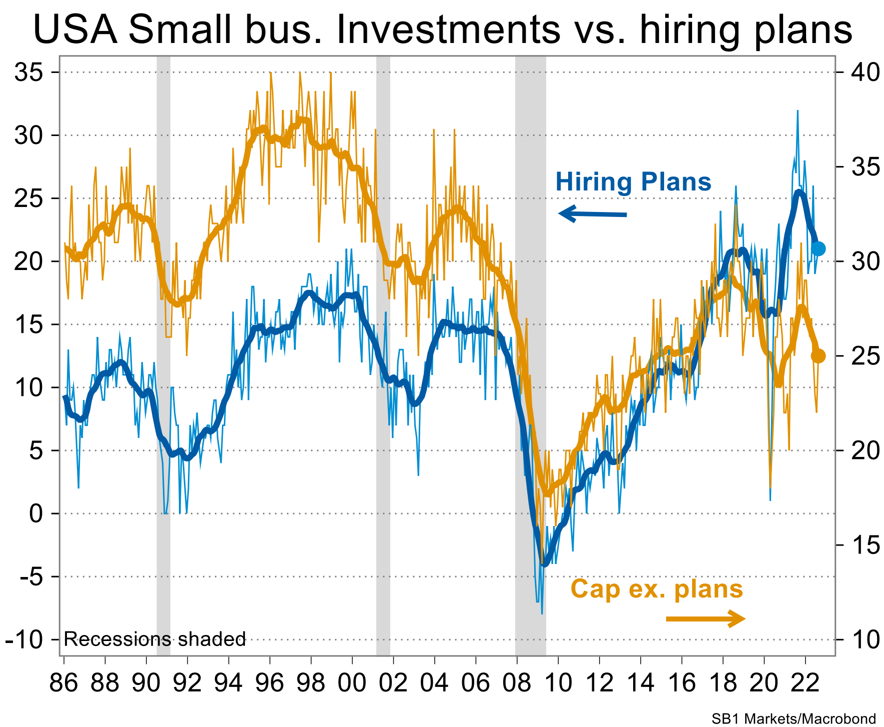


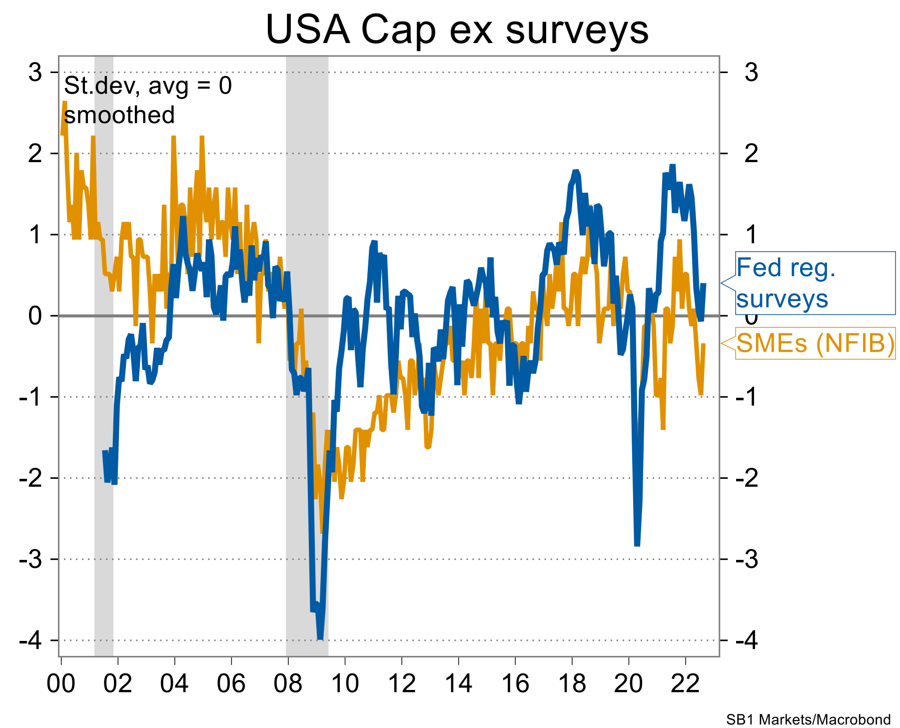


- The **NFIB optimism index** added 1.9 p to 91.8 in August, expected down 0.2 p. The level equals 1.3 st.dev below average. **The outlook for the next 6 months** also rose marginally, but is at a very low level, 2.4 st dev, up from 2.9 in July. **Sales expectations** rose noticeably but are still 2.6 st.dev below avg. (up from 3.4 st.dev below!)
- **Inflation, lack of qualified labour and labour costs** are still the main worries for the SMEs. However, some more companies report that **competition or poor sales** are worries but the share is still very low. Still, that was sufficient to cut the share of companies that **plans to lift prices** by 12 p to 37%. That is not a low share (the average is at 21%), and signals continued inflation far above the past 10 y average
- **Investment plans** fell were revised up somewhat but are still on the low end. **Hiring plans** rose in Aug, and 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

The SMEs increased their investment plans and hiring plans in August

The trend is down for both though

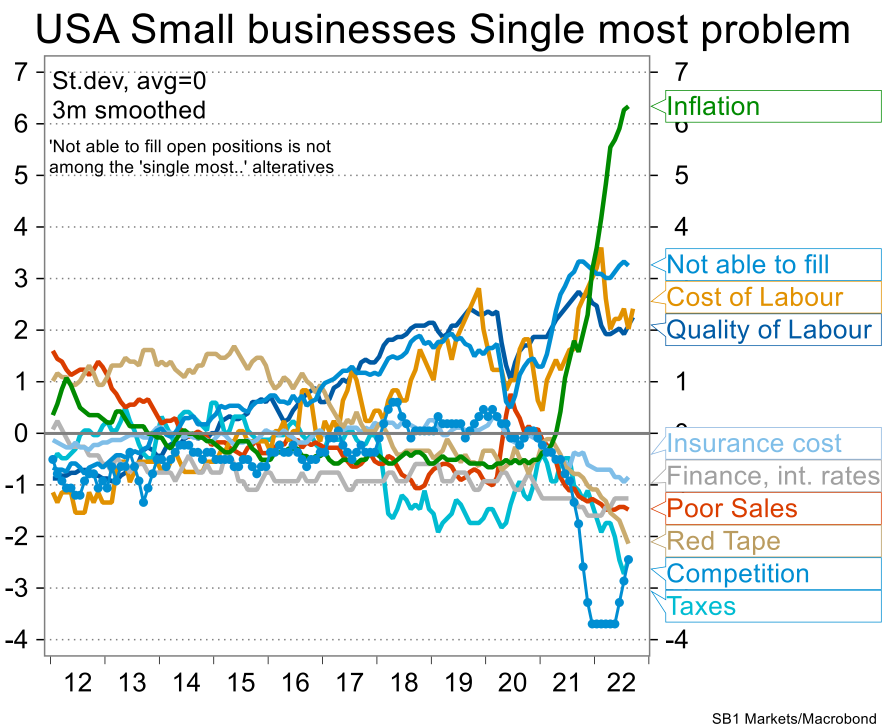


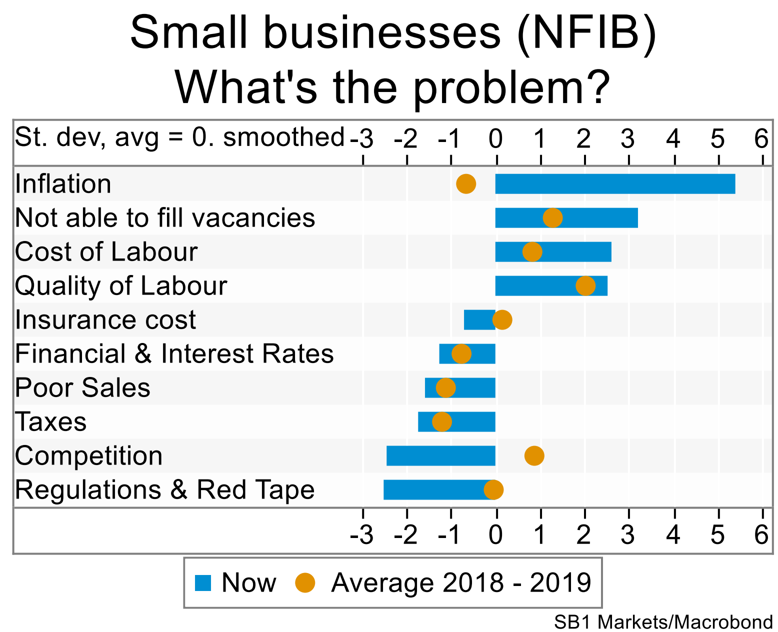


- The NFIB survey report of investment plans far below average
- Other (regional Fed) investment surveys have also come down from the top, but have remained above average, and investments have been revised up in Aug in these surveys as well

Slightly more companies say that competition is their main worry

… but still extremely few. Inflation is the biggest challenge



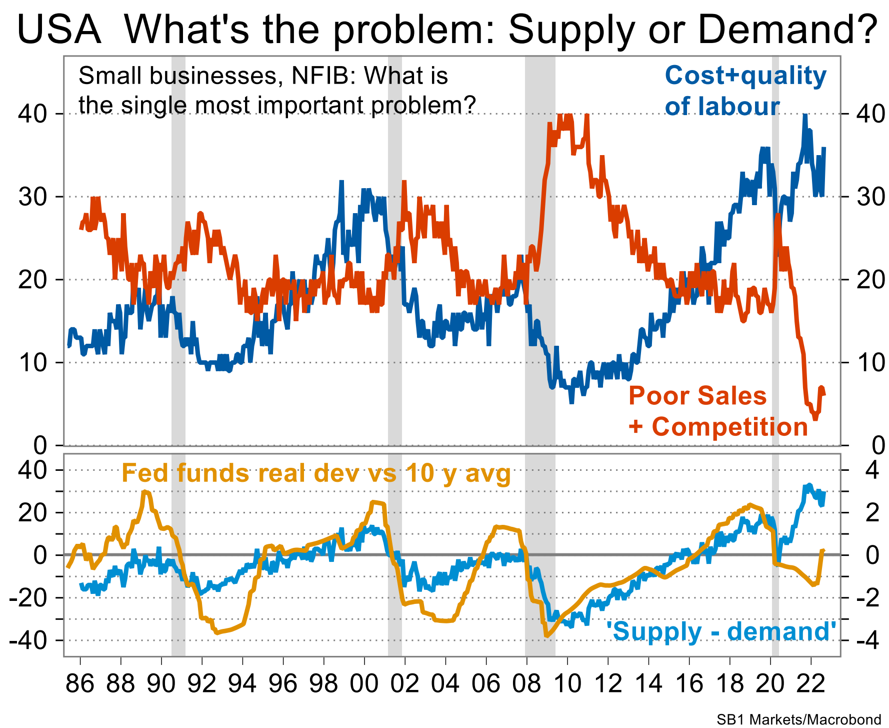


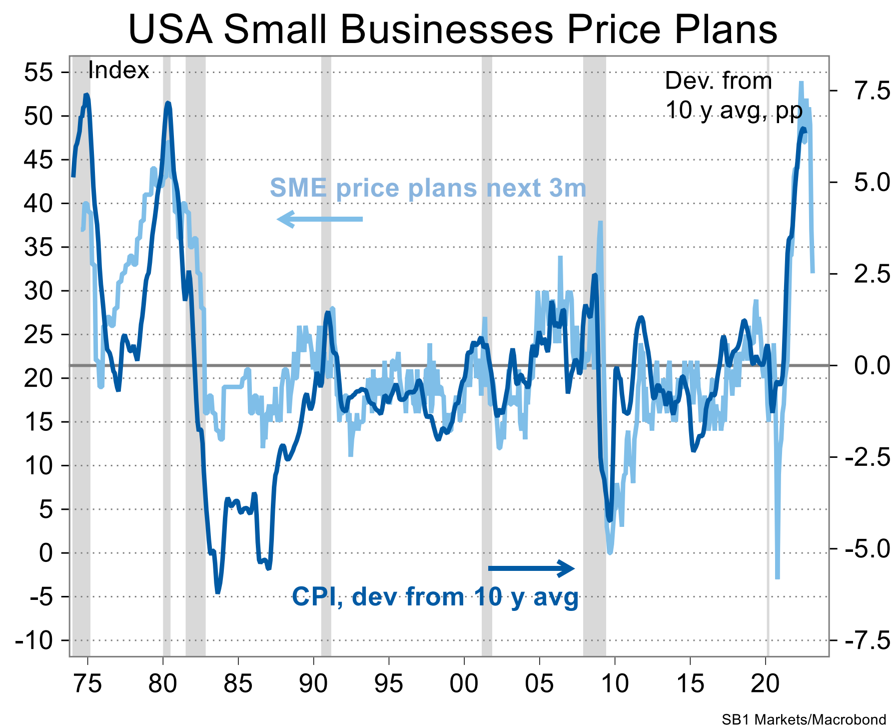
- Companies still report they are constrained from the **supply side**, not from the **demand side**

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

Fewer companies report they plan to lift prices (but still far more than normal)

Demand is coming down – but far from a problem yet

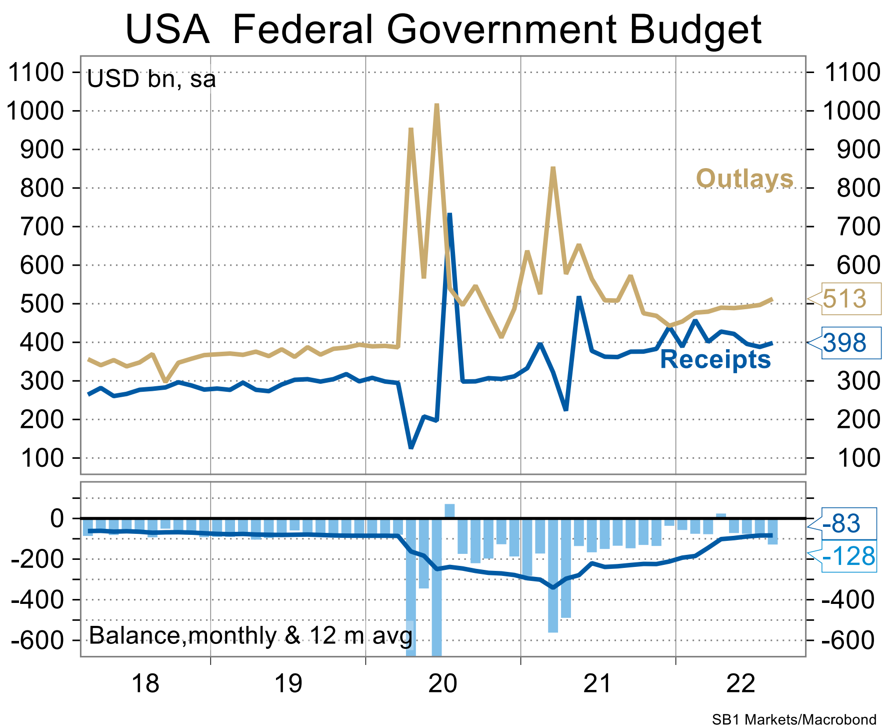


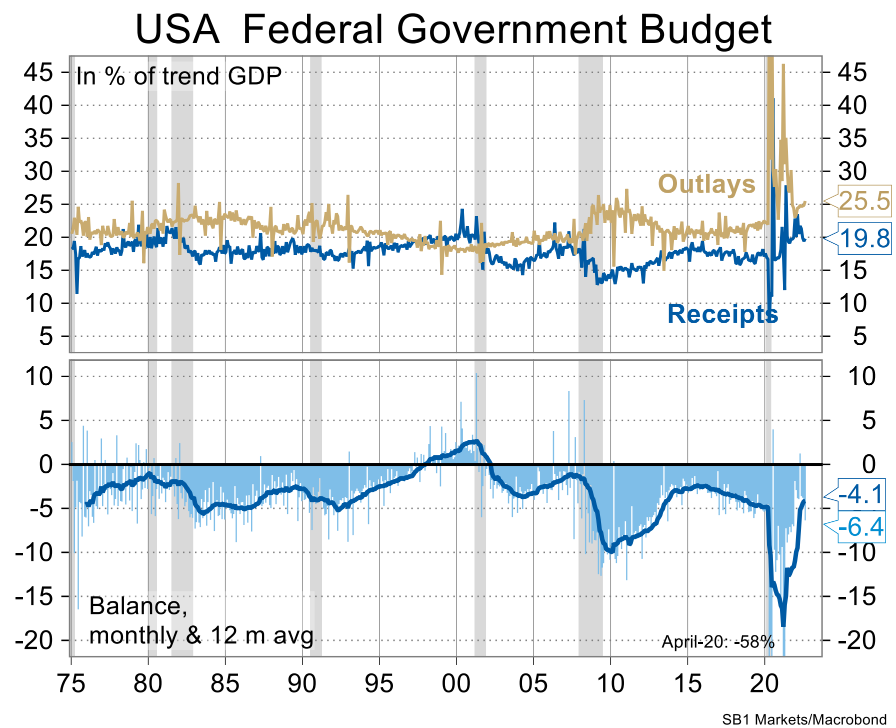


- **The 'gap' between supply and demand concerns** is still very large, but it is now heading down
  - » Very few companies report **poor sales or competition** as a problem. The share is up from March, but fell marginally in August
  - » **Cost & quality of labour** is stated as the most important problem 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
- At the same time, the share of **companies that plan to lift prices**, fell sharply in August, to 32% from 37%. However, the 32% rate is far above an average 21% share, and inflation well above the past 10 y average is still signalled. Even so, a very positive signal
- **We have no doubt:** Over the coming months and quarters, the poor sales/competition (the red line) will climb sharply – and the blue line will come back down to Mother Earth as financial conditions tightens, with or without help from the Federal Reserve. It's normally labelled as a recession, as soon as the red line crosses the 20-line

The budget did not reach balance – and now it is too late?

A slowing economy will not strengthen the budget – and the deficit will widen again

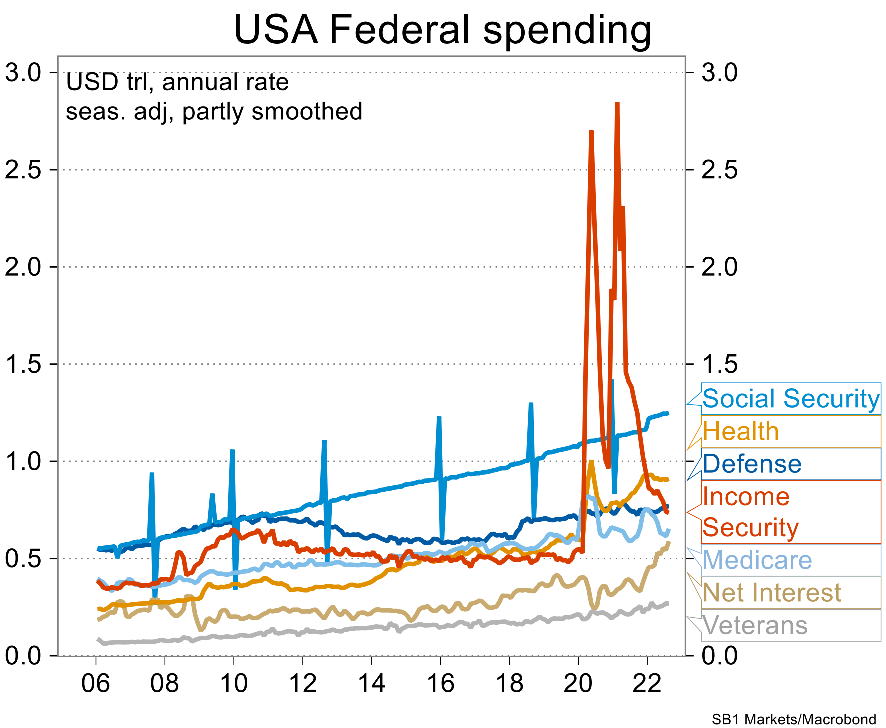


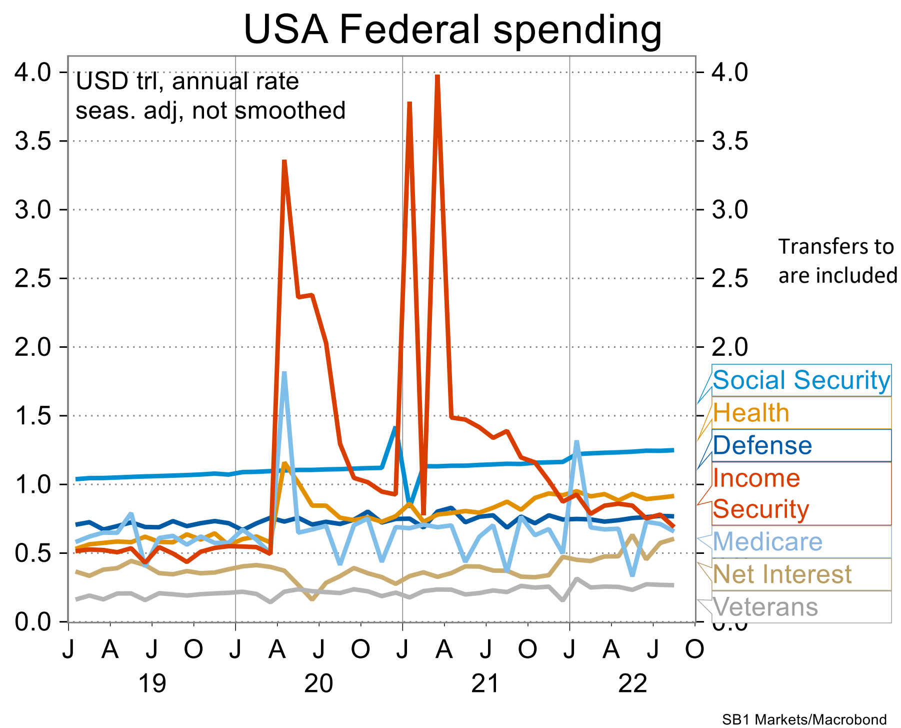


- **Federal expenses** fell throughout last year but are now trending slowly upwards again – and are >20% above the pre-pandemic level. The expenditures equal 25.5% of GDP, up from 21% – 22% before the pandemic
- **Federal receipts** have recovered sharply since last summer, due to robust growth in GDP and employment. Now, revenues are flattening, or declining slightly. Revenues are up 30% vs the late 2019 level. Revenues equal 19.8% of GDP, which is far above the pre-Covid level at some 17%
- The actual **deficit** was just USD 219 bn in August, far less than the expected 296 bn. The seasonally adjusted deficit was USD 128 bn, or 6.4% of GDP. Over the past 12 months the Federal deficit has equalled 4.1% of GDP. Before corona, the federal deficit also was at close to 5%. In a booming economy, the budget should of course have been in surplus, now even more than before the pandemic

Income security & 'other' spending (much to states) on the way down, still high

Net interest rate payment have increased by almost 50%, <u>equalling 1.5% of GDP</u>. And more to come!



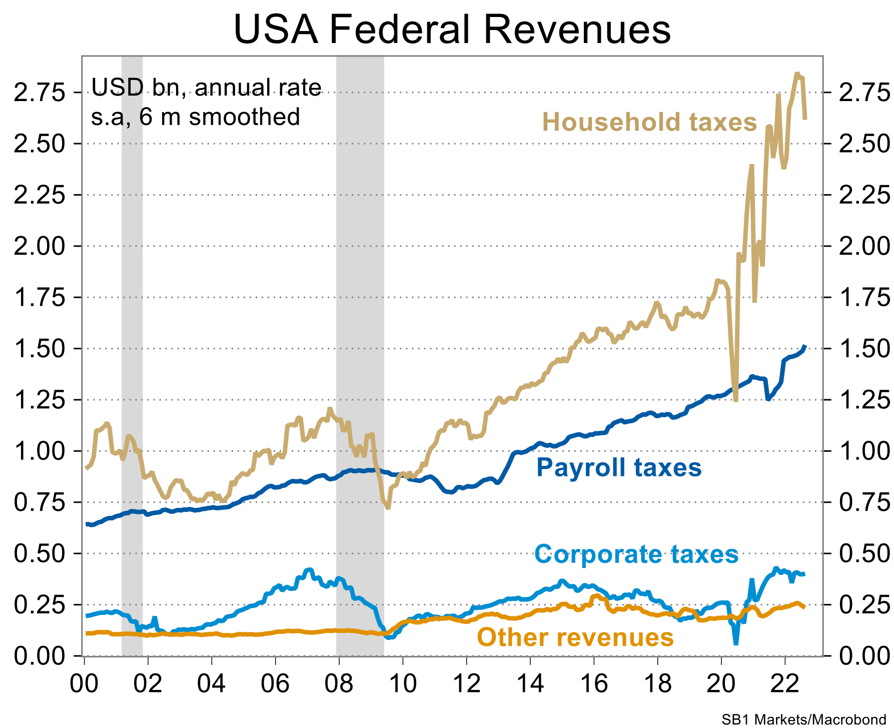


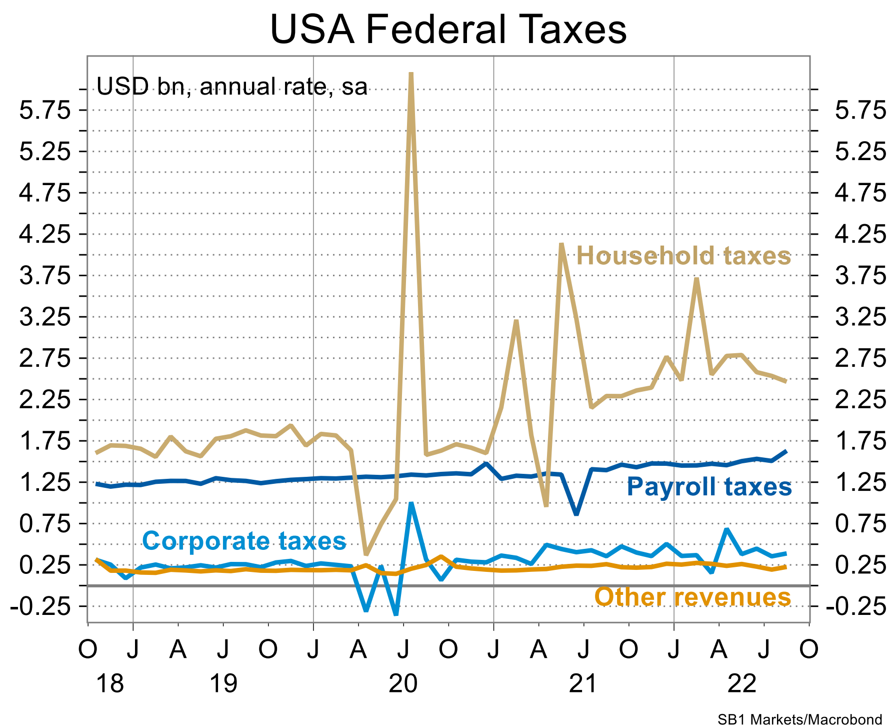
Transfers to local gov. are included in others

- Interest rate payments will increase substantially from the present level, even if bond yields do not climb further form here – since new (and refinanced) debt have to pay current yields, which are higher than average yield on maturing bonds
- Both income security and 'other spending' are well above the pre-pandemic level. Health spending is sharply up too

Tax revenues are remarkably higher than before the pandemic

Especially taxes paid by households (+60%) and corporates (50%+)!

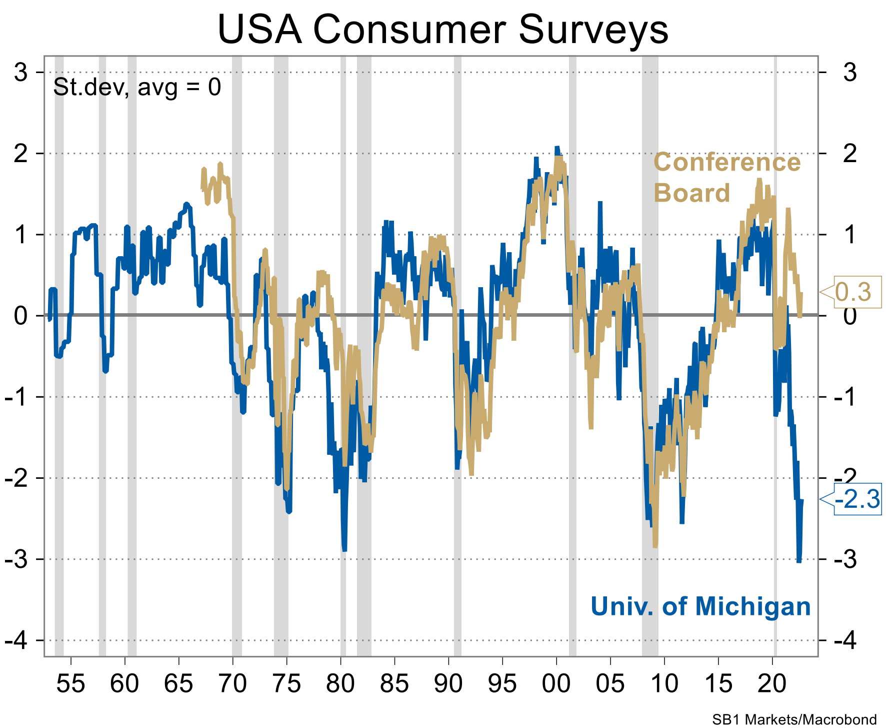




- And taxes have increased more than what could be explained by the surge in nominal GDP (due to the surge in inflation)

Univ. of Mich. sentiment marginally up in Sept, still 2.3 st.dev below average

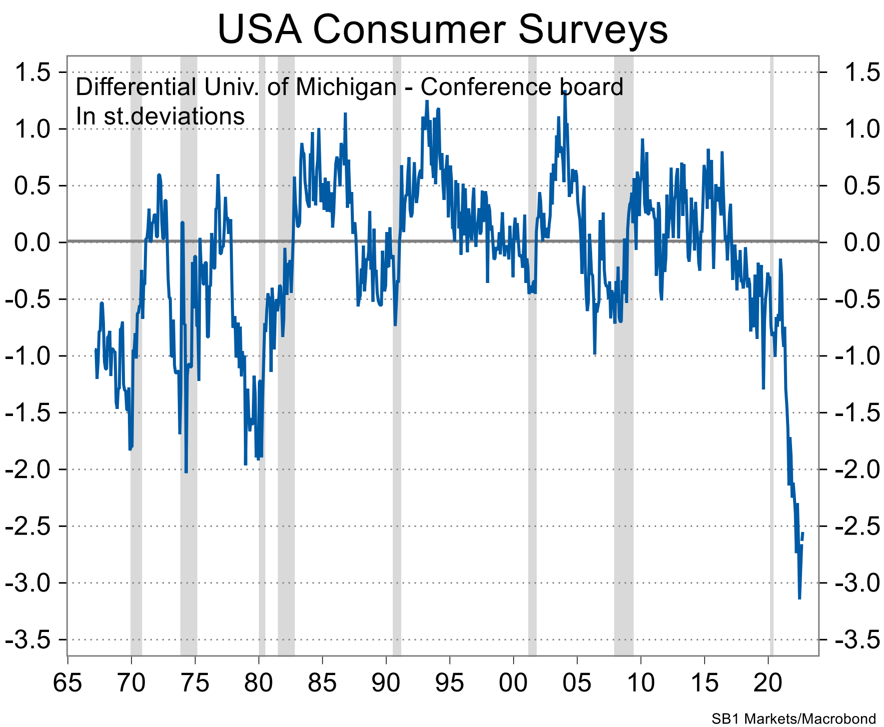
Gasoline prices are falling – as are inflation expectations. All other surveys also up recently

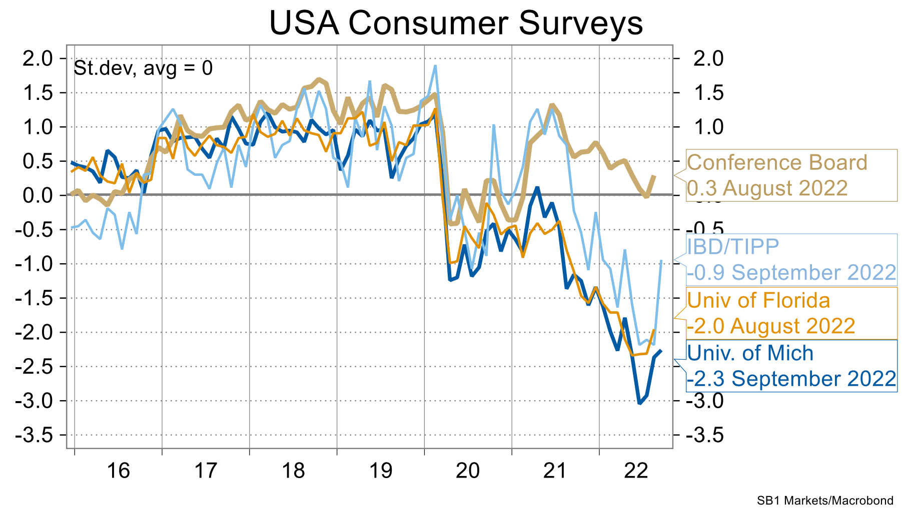


- **University of Michigan's consumer sentiment** fell to ATL at 50.0 in June, equalling 3.1 st.dev below average. Sentiment has since improved, but only marginally. In Sept the index gained 1.3 p to 59.5, which is 2.3 st.dev below average – and slightly below expectations
  - » Both households' assessment of the current situation and expectations improved in Sept, expectations the most
- **The 3 other consumer surveys** we are following have also recovered in July/August/Sept, but only one of them are above par (Conference Board's)
- **Longer-term inflation expectations** inched down 0.1 pp in Sept, to 2.8% (5 y), not a very high level. Short term expectations fell further, by 0.2 pp to 4.6%. The peak was at 5.4%. This decline may explain the lift in general expectations, and is probably due to the decline in gasoline prices (and less due to Fed's hawkish stance, we think)
- **The risk:** The UM survey is still at a very low level, and is often an early bird in cycle

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

The good news: All surveys up over the summer

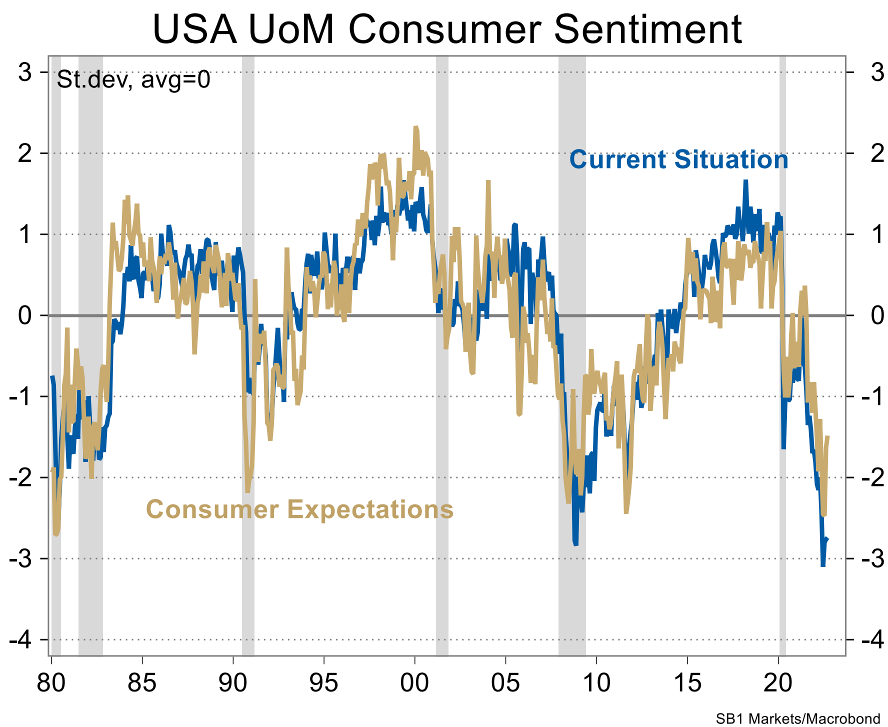


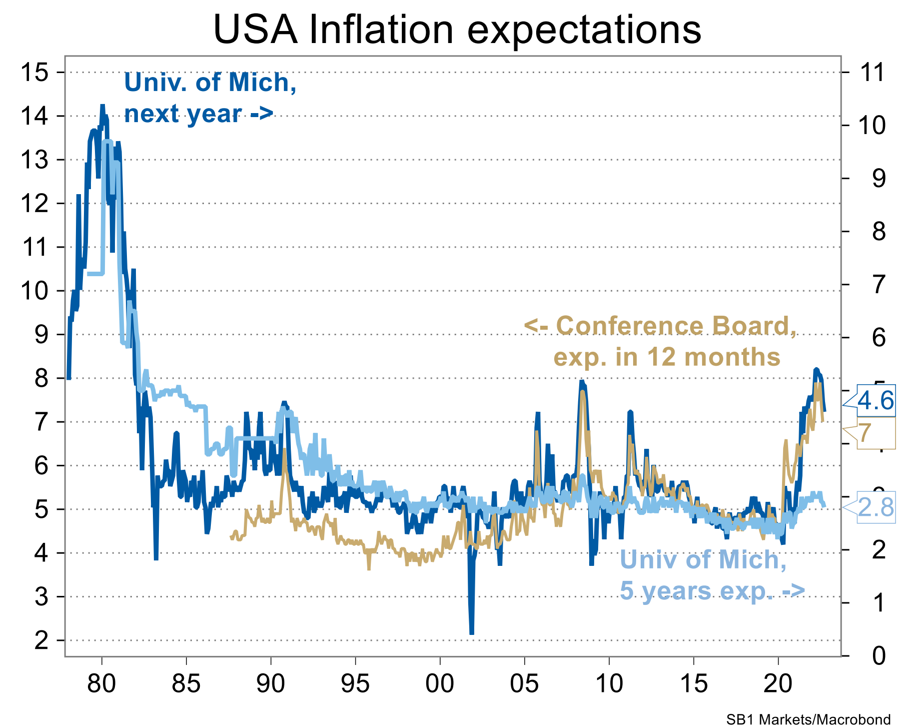


- Quite often, the UM survey has been the canary in the mine vs. recessions, it yields earlier than Conference Board's survey, and the current stance is a VERY bad sign – we have never seen anything like it!
- The IBD/TIPP consumer survey shot up in September, by 1.1 st.dev to -0.9 below average. Univ. of Florida's survey rose in August but remain -2 st.dev below par

Univ of M: Expectations up – but still at a rather low level

Short term inflation expect. fell further, and 4.8% next year is not that high, given the actual 8.5%

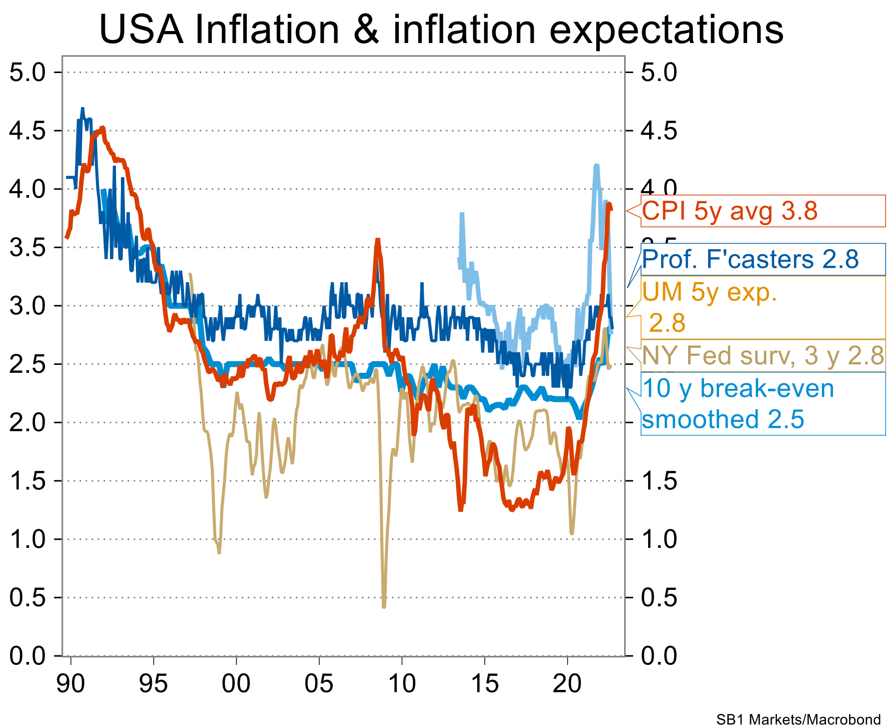


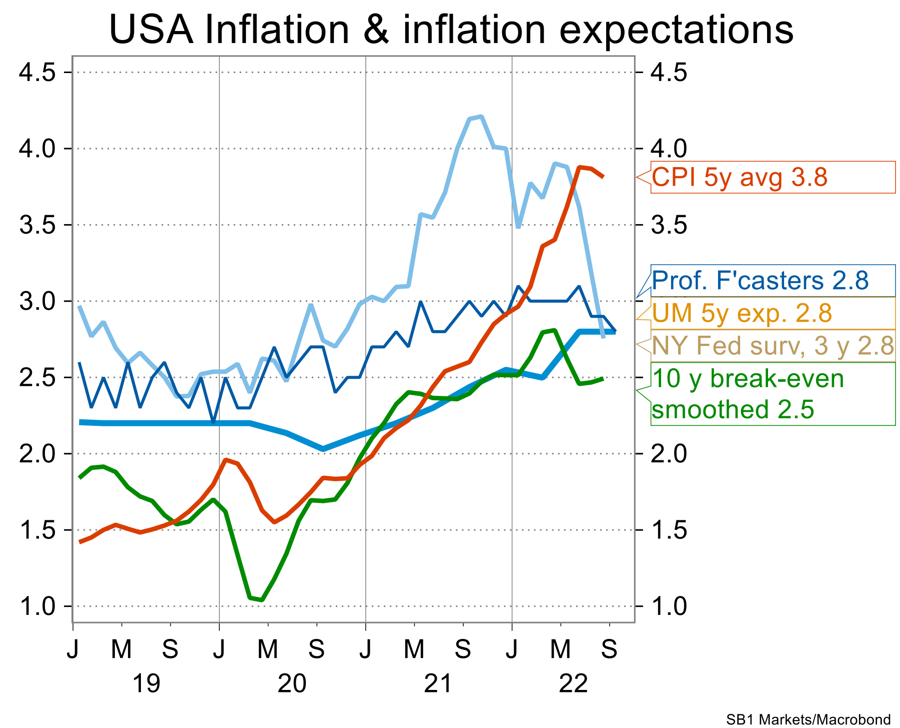


- **The 12 m inflation expectation** fell 0.2 p to 4.6% in September. The peak was at 5.4%, in March. Expectations are well below the current 8.2% y/y CPI print
- **The 5 y inflation expectation** fell one more tick, now to 2.8%
  - » The 2.8% is just 0.2 pp above the average over the past 10 years

Inflation expectations are heading down, even if actual inflation remains high

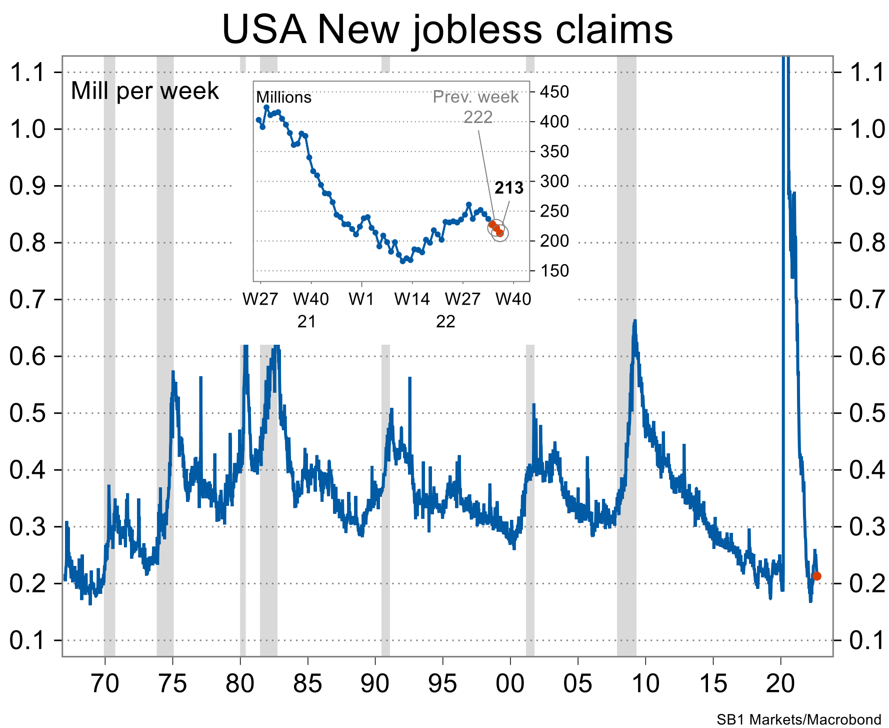
All surveys are signalling low inflation expectations

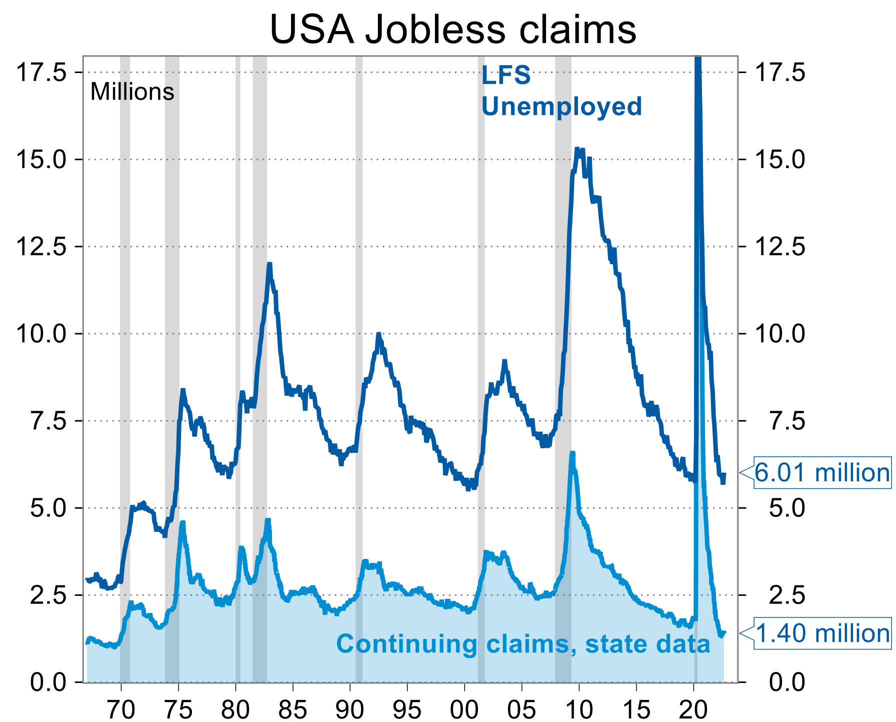




New jobless claims keep declining for the 5th week

Not any recession signal here anymore! And that's the problem (for the Fed, and the market)

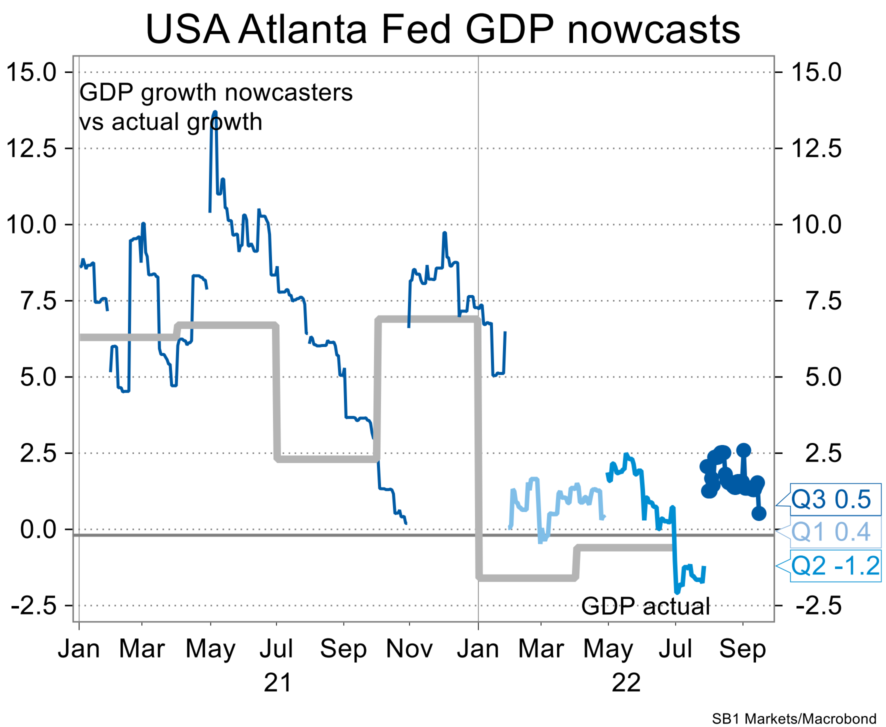


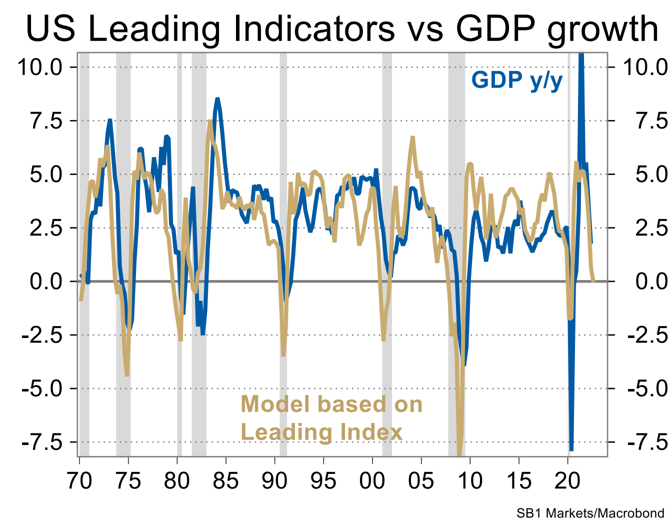


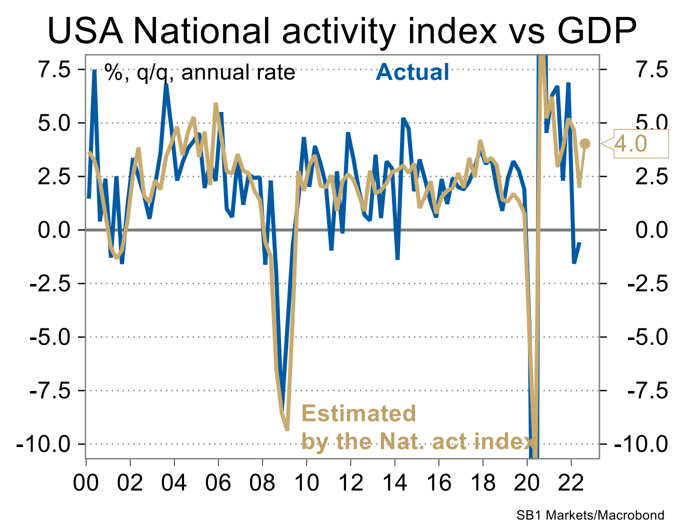
- **New jobless claims** fell by 5'' in week 36 to 213' (from a 4' downward revised level the prev. week!). New claims have fallen by 40' from 6 weeks ago!
- **Continuing claims** rose by just 3' in week 35

Atlanta Fed's nowcaster was right on Q2 GDP. Now it reports 0.5% growth in Q3

Down from 2.6% a two weeks ago, not a positive sign





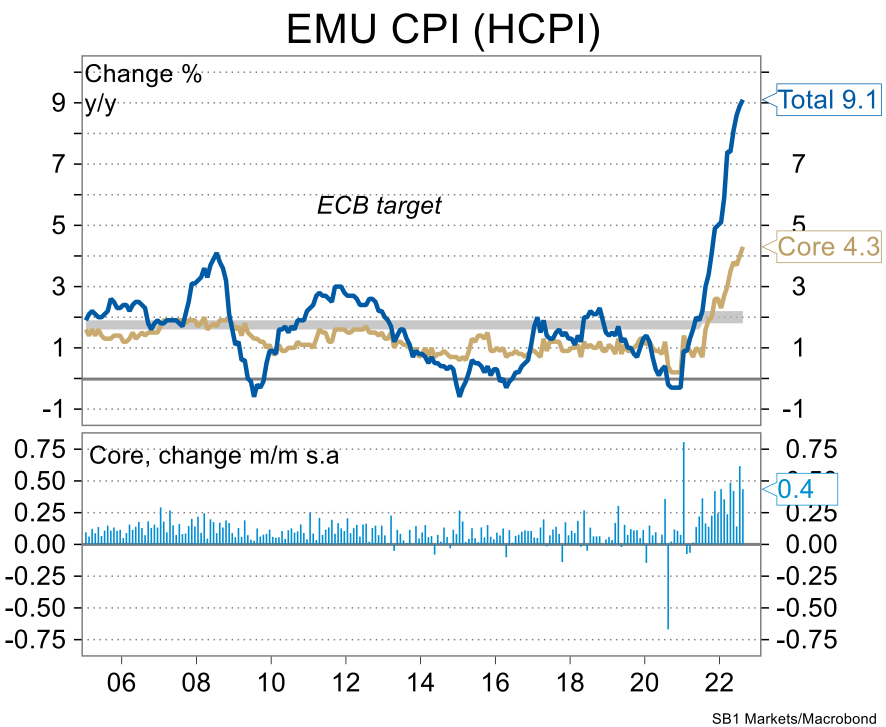


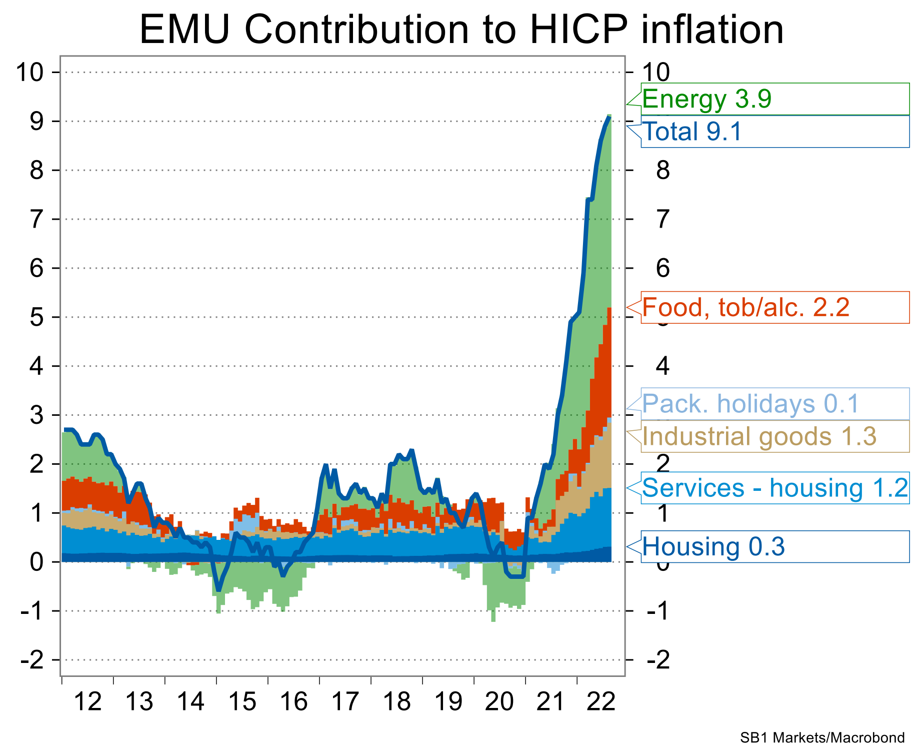
- National Activity index suggests 4% (the July pace). Leading indicators say zero!
- **Q2 GDP** fell 0.6%, revised up from -0.9%

SpareBank 1 MARKETS

Headline inflation confirmed at 9.1%, the core at 4.3%

The headline index up 0.6% m/m, the core 0.4%, the 2nd highest ever





- **Energy prices** directly explains 3.9 pp of the headline of 9.1%. In August energy prices were up 0.9%, and gas prices have since come down somewhat – the Sept print should look rosier

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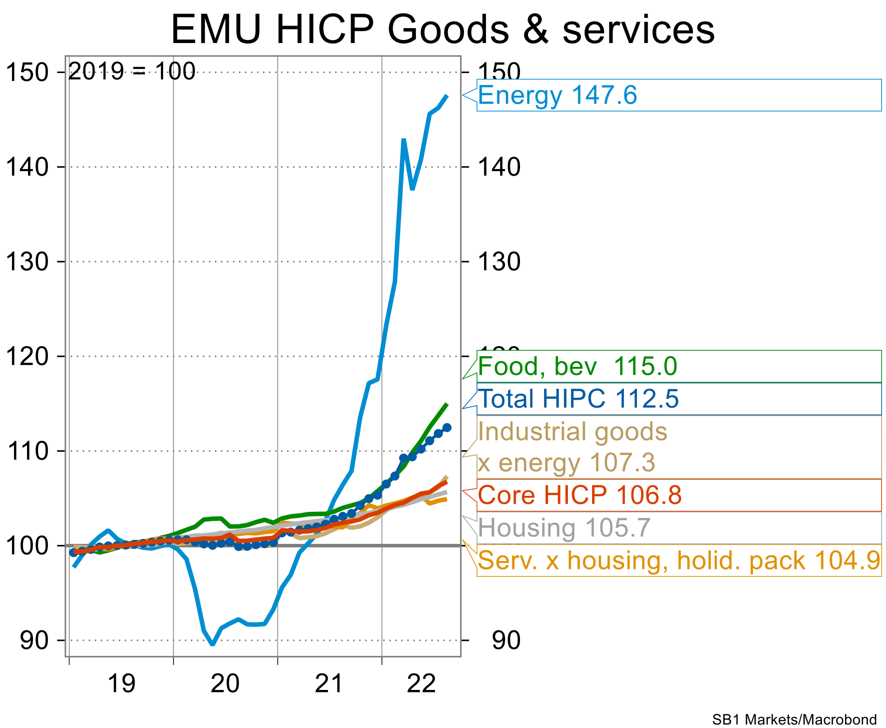
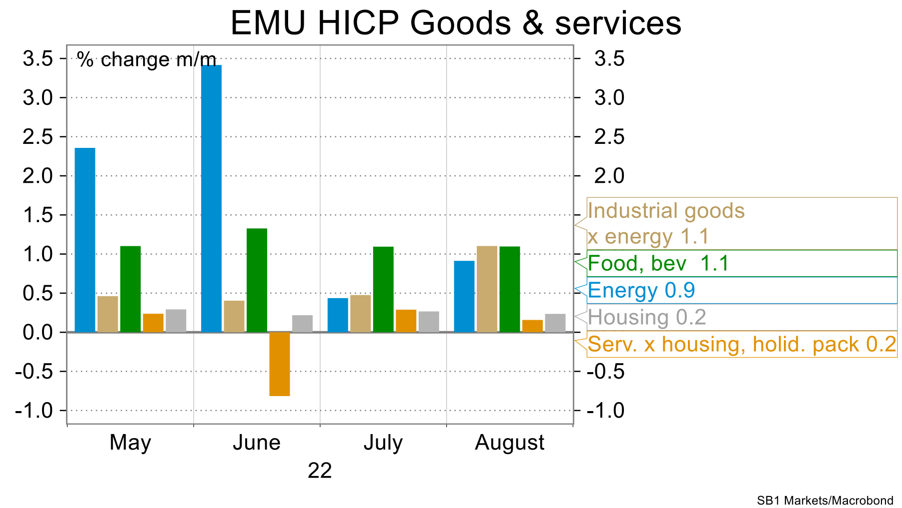
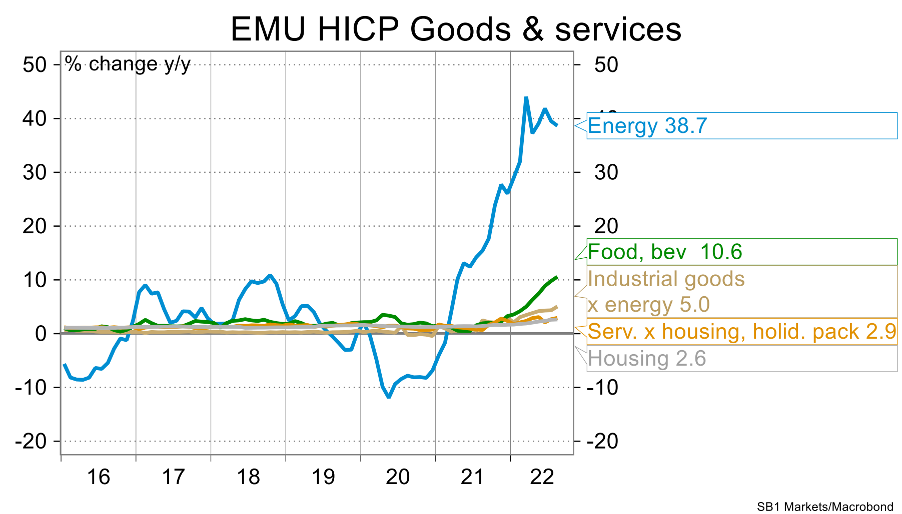
Energy prices have exploded. Food prices are climbing >1% m/m, up 10.6% y/y



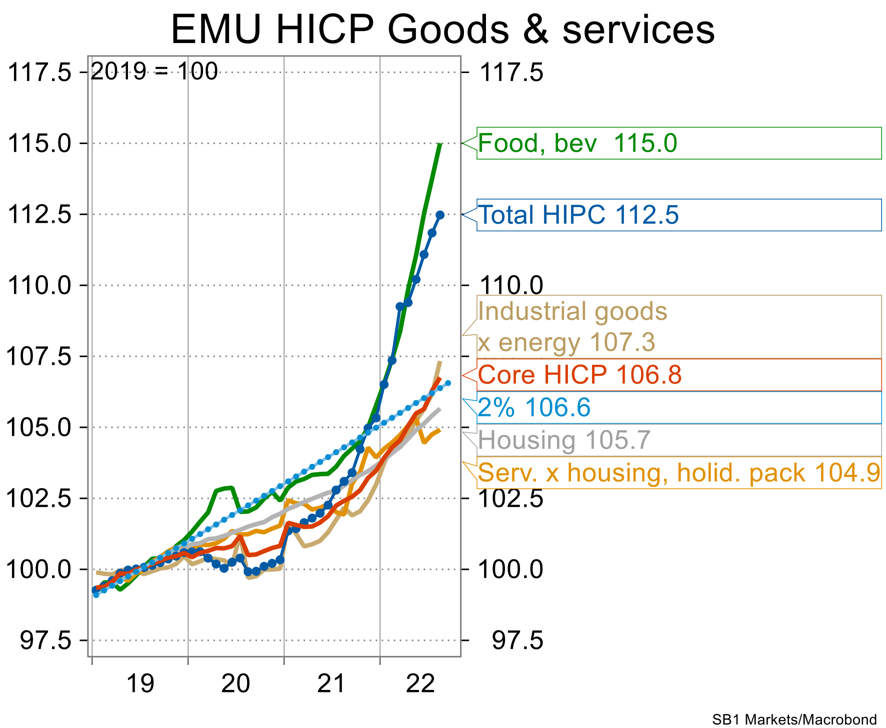


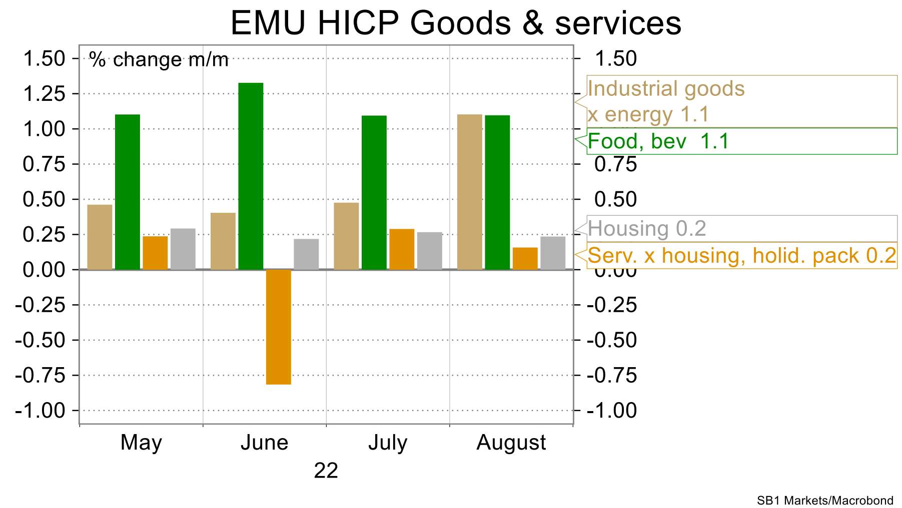


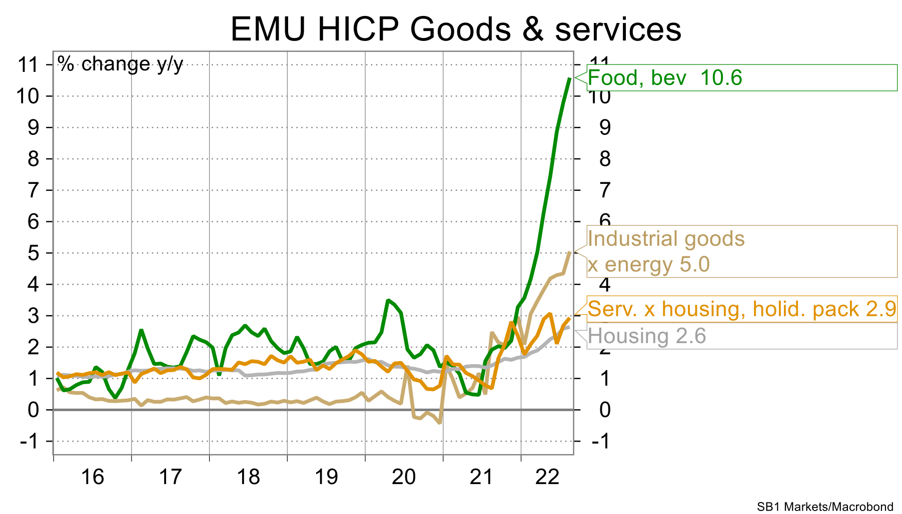
- But the peak is behind us, check two pages forward

And prices ex energy and food are accelerating too

Industrial goods x energy at 5% y/y, and services ex housing 2.9%. Housing is up 2.6%



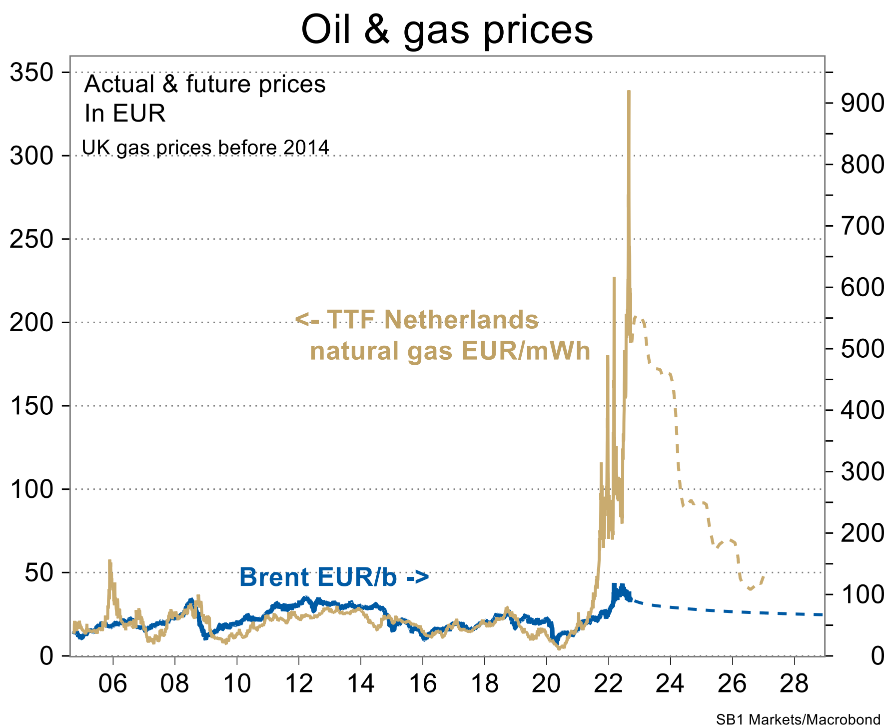


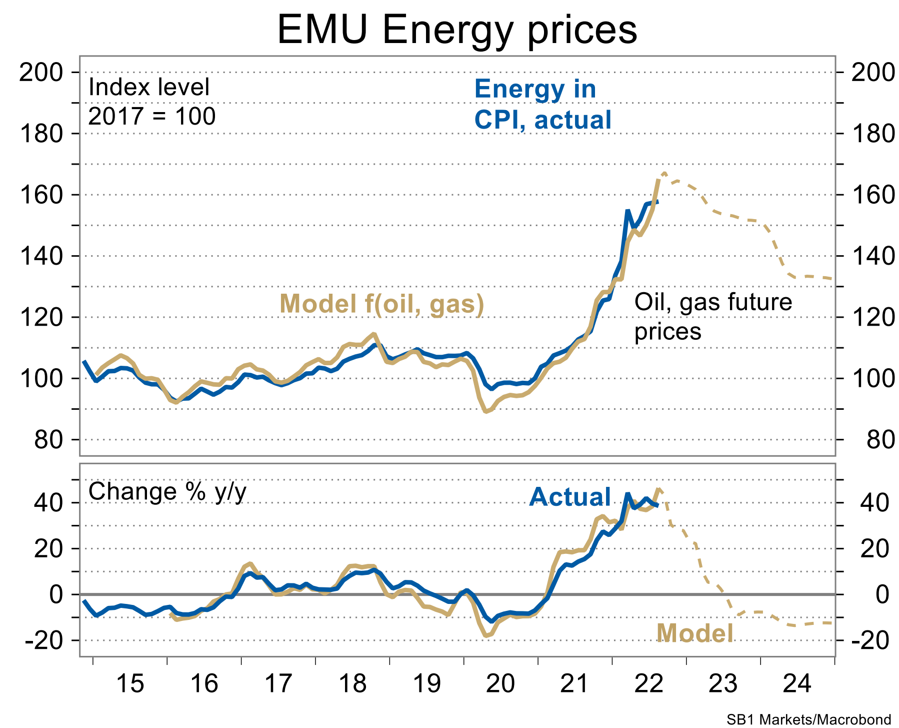


- Industrial goods prices increased by 1.1% in August, and are up 5% y/y. Still, these prices are up 'just' at a 2.3% path since 2019
- Service prices (ex housing, holiday travel) rose 0.2% in Aug, and these prices are below a 2% path vs the 2019 level. Transport and hotels/restaurants have contributed on the upside last year

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

… the peak might be behind us, given the retreat in gas prices recent weeks





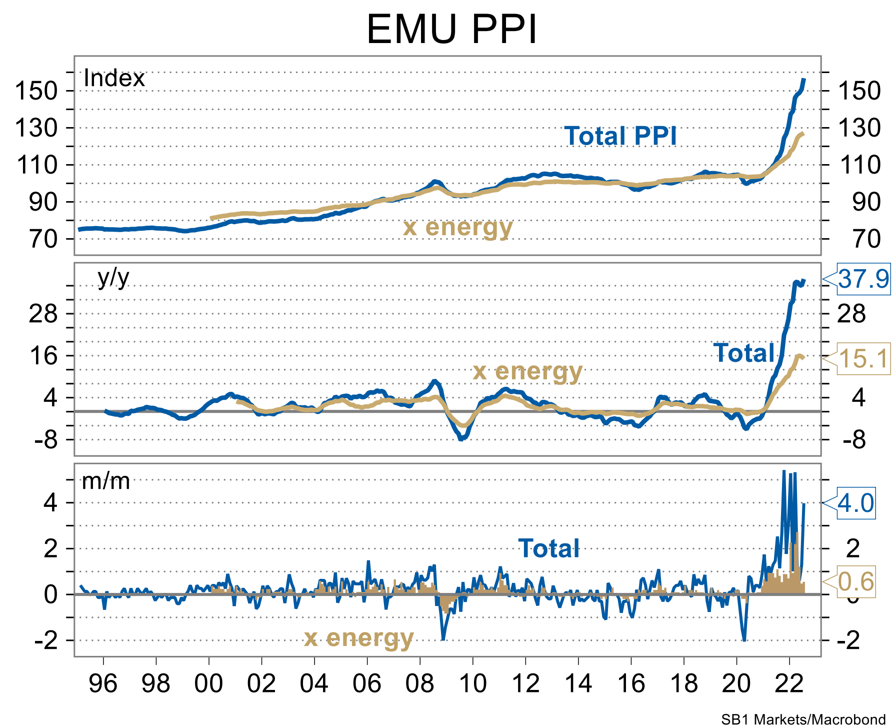
- The short end of the gas price curve has collapsed since the late August peak, and future prices fell substantially as well

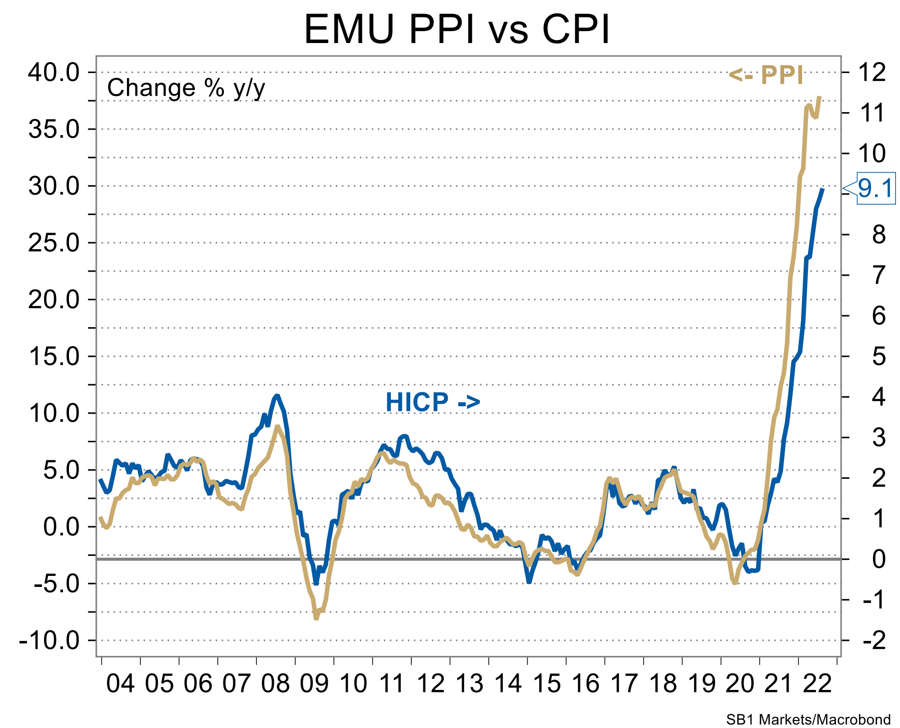
In these models we incorporate all direct impacts from changes in the oil price – as well as the impact from other factors that influence inflation which correlates to the oil price

SpareBank 1 MARKETS

Producer prices keep rising

The total PPI rose 4% m/m in August, the core index added 0.6%

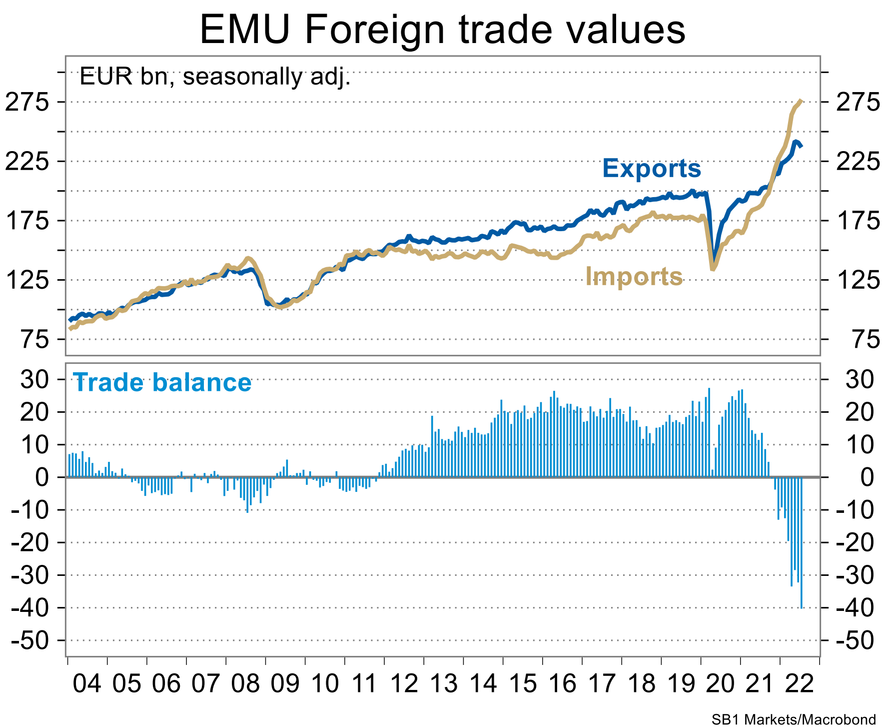


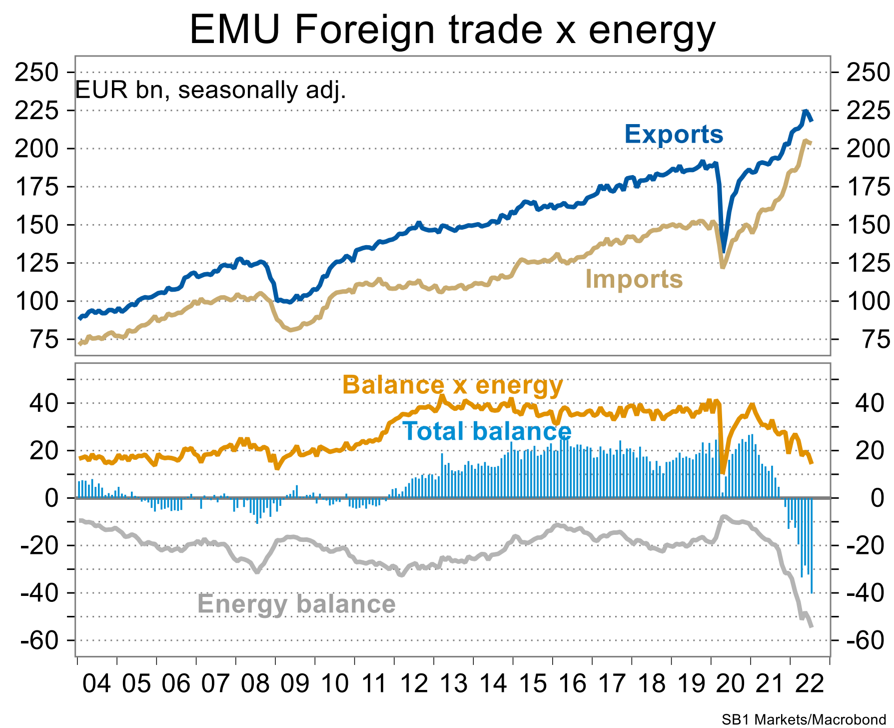


- PPI was up 38% y/y, all included, and 15% x energy
- No signs of lower inflation pressures here

Imports are exploding, and not only due to higher energy prices

The Euro Area is now running a trade deficit at 3.4% of GDP

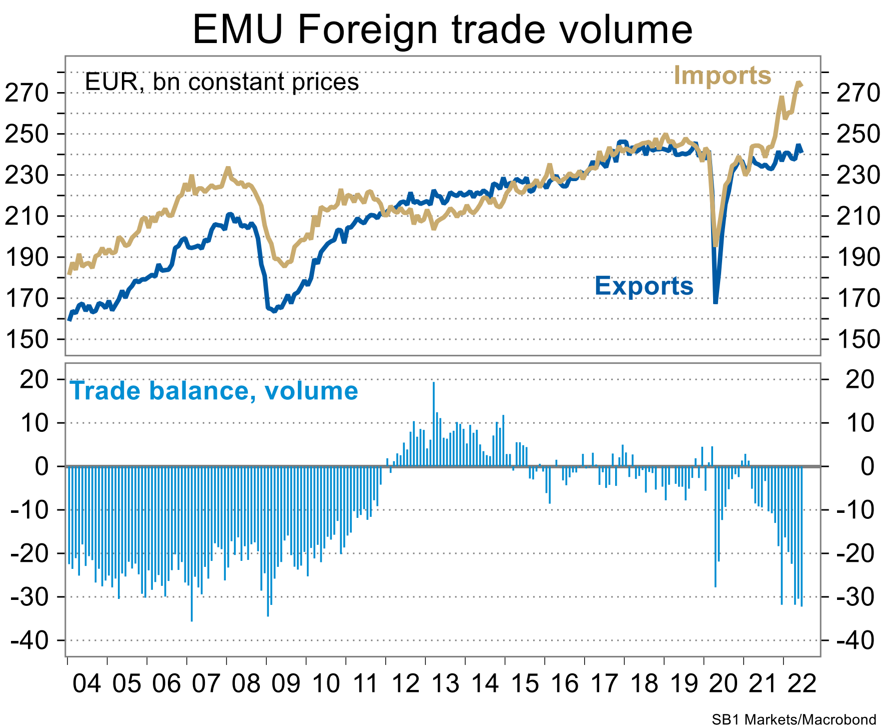




- The trade deficit widened again in July as energy prices soared, to EUR 40 bn (s.a.) from EUR 32 bn in June, a new ATH
- Energy imports are up 152% over the first 6 months in '22 compared to the first 6 months in '21, and imports from Norway are up 151% over the same time period... Makes sense. The net energy balance is EUR -56 bn, or almost 5% of GDP. It used to be some 2%
- Imports are up 43% y/y, while exports are up 'just' 17%. In volume terms, quite another story, check next page

Import volumes up 13% from Feb-20, exports volumes are at the same level

Domestic demand has been strong – and still seems to be



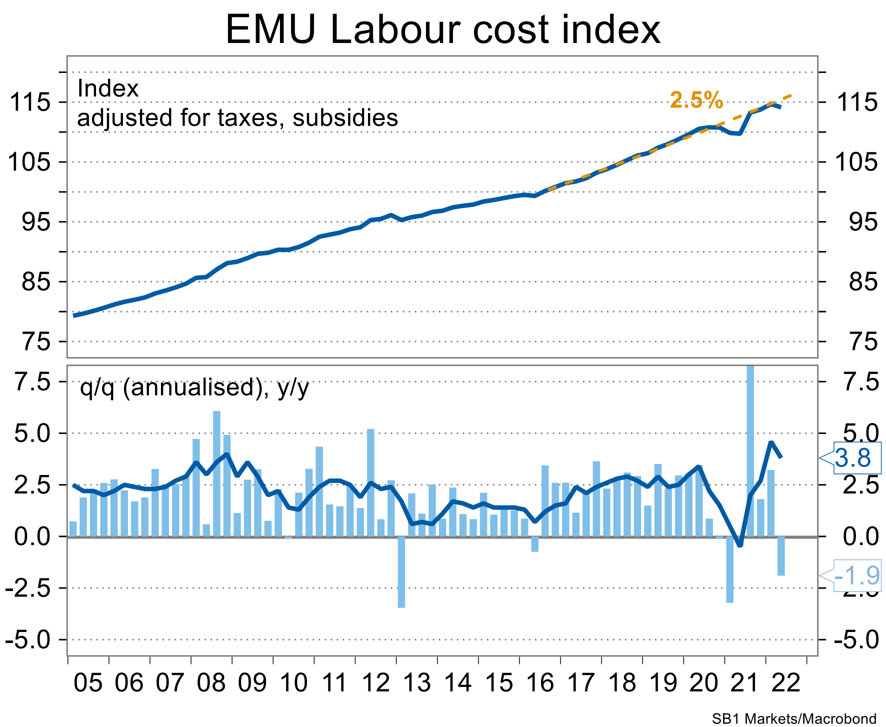
- Import volumes are up 12% y/y
- Export volumes are up 3% y/y

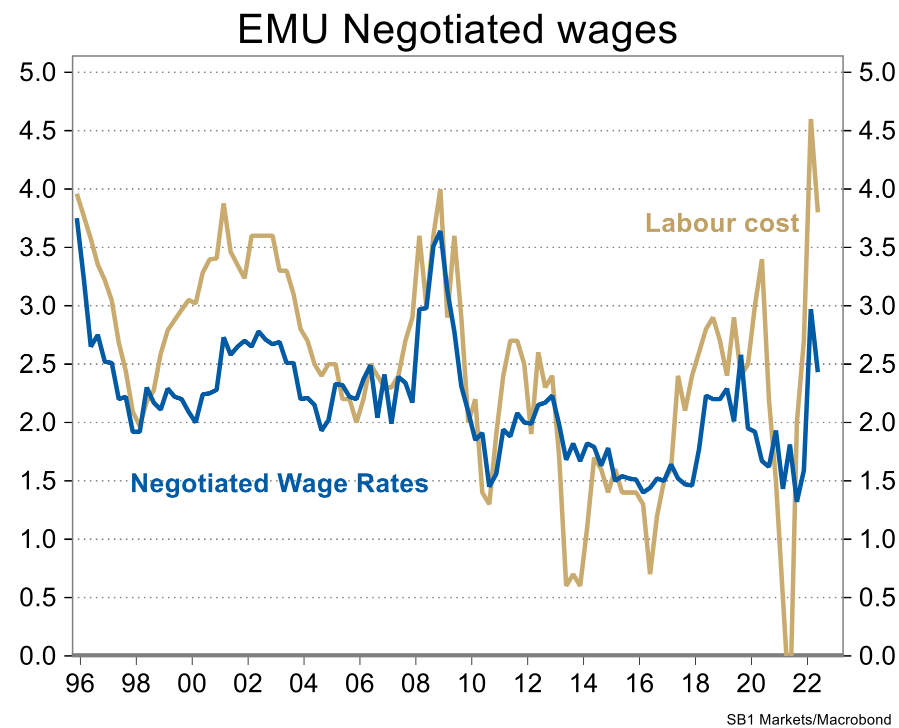
Volume data are lagging value data by one month

SpareBank 1 MARKETS

Europe does not have a wage problem

Yes, labour costs were up 3.8% y/y, but from a (newly found) trough last year, trend at growth at 2.5%

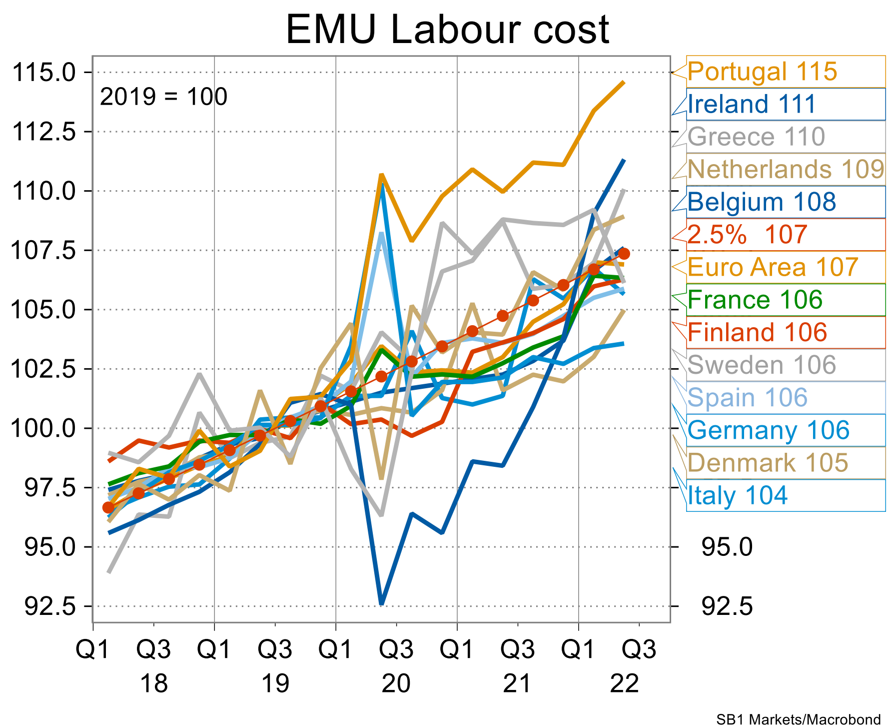




- Labour cost fell 1.9% in Q2 (annualised), following the 3% increase in Q1. The annual growth fell to 3.8% from 4.6% in Q1
  - History was in sum revised up, from a 2.25% trend to a 2.5% underlying trend path now. The trajectory since early last year was visibly revised, and the annual rate became much higher than we assumed – because labour cost in Q2-20 was sharply revised down. Not reassuring, of course – let's hope the current data is close to reality
  - The wages and salaries component is up 4.0% (taxes and subsidies not)
- The current 2.5% growth path used to fed into a CPI inflation of around 1.6%, before the pandemic. However, productivity growth has slowed, and Unit Labour cost inflation has accelerated, but not to above 2%, check two pages forward
- Negotiated wages rose 2.4% y/y in Q2, confirming that there is no take off in wage inflation

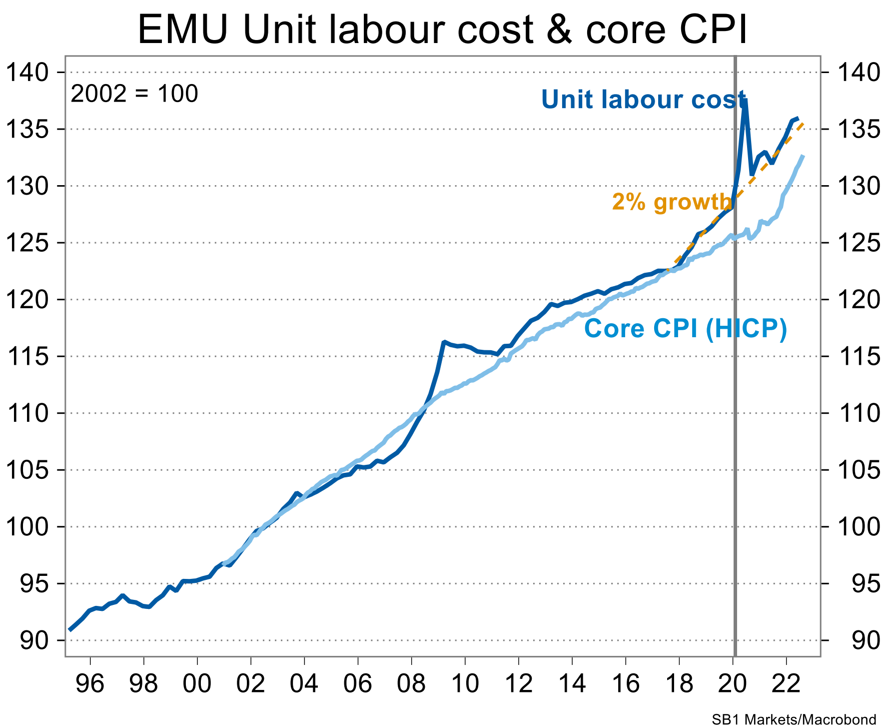
Some EMU countries are reporting higher wage growth

-- but all big 4 are below the 2.5% average path



Unit labour costs have accelerated but are but still close to a 2% trajectory

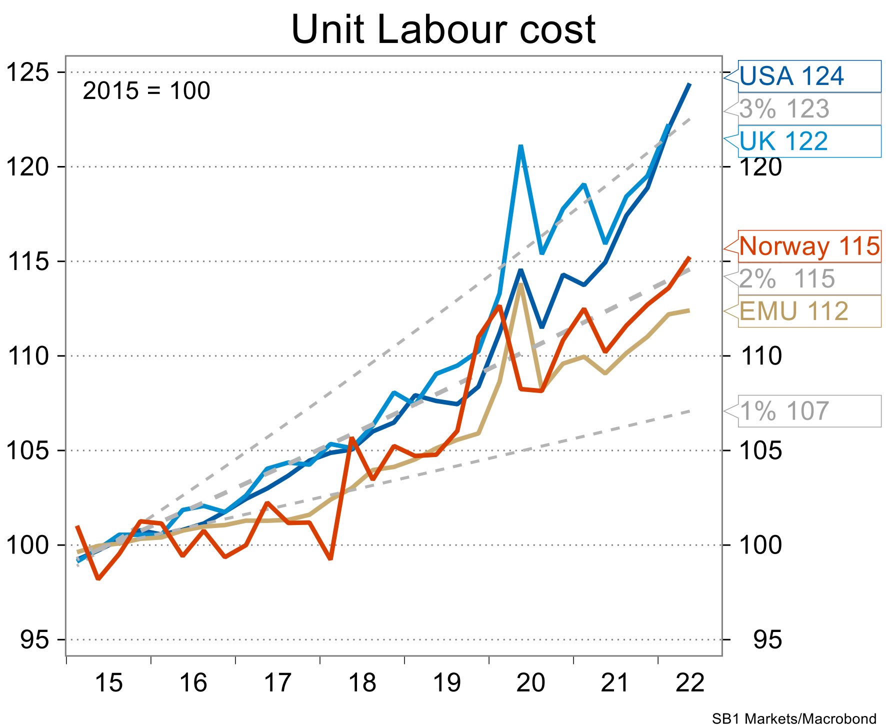
Wage inflation has not accelerated but productivity growth has slowed during/after the pandemic

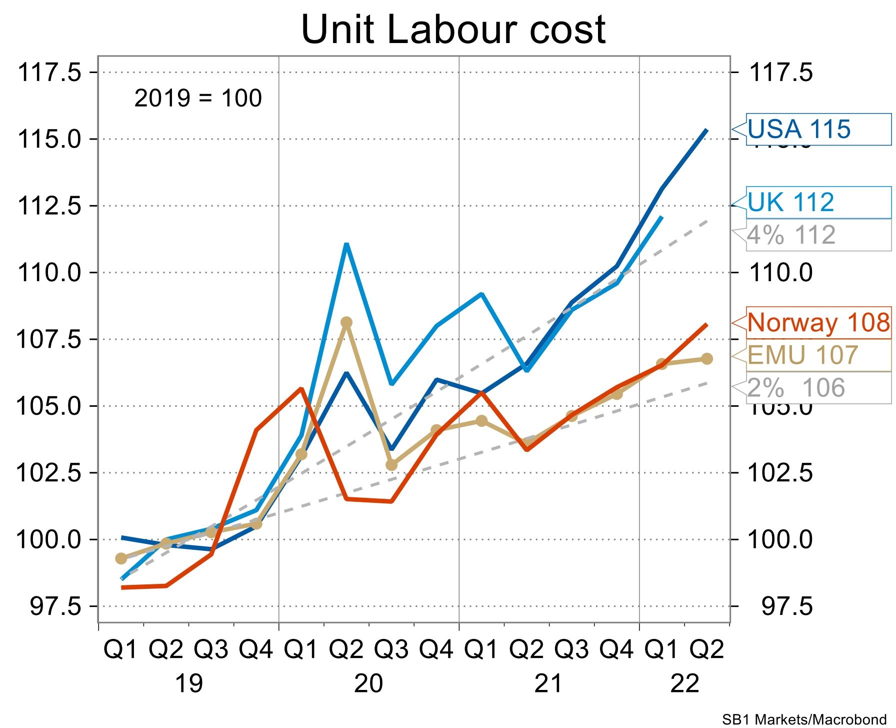


- **Unit labour cost** (labour cost per unit produced = wage cost/production volume, growth in UCL= wage growth – productivity growth) has jumped up during the pandemic as productivity fell because employment was not cut (as in the US)
- On the other hand, in the 3 years before the pandemic – and through the pandemic so far – ULC has accelerated to 2% from 1%. The 1% growth in unit cost corresponded to the long term growth in core rate of inflation at 1% – and a 2% ULC inflation will over time yield a 2% CPI inflation

Unit labour costs not the problem in the EMU, nor in Norway

However, both US and now also UK report a very rapid growth in ULC recent quarters



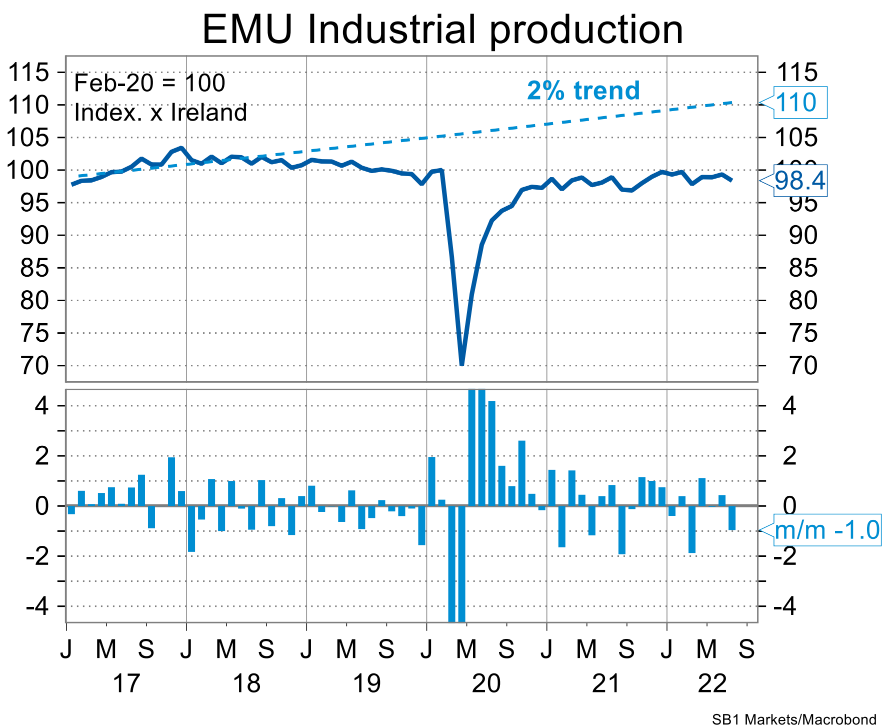


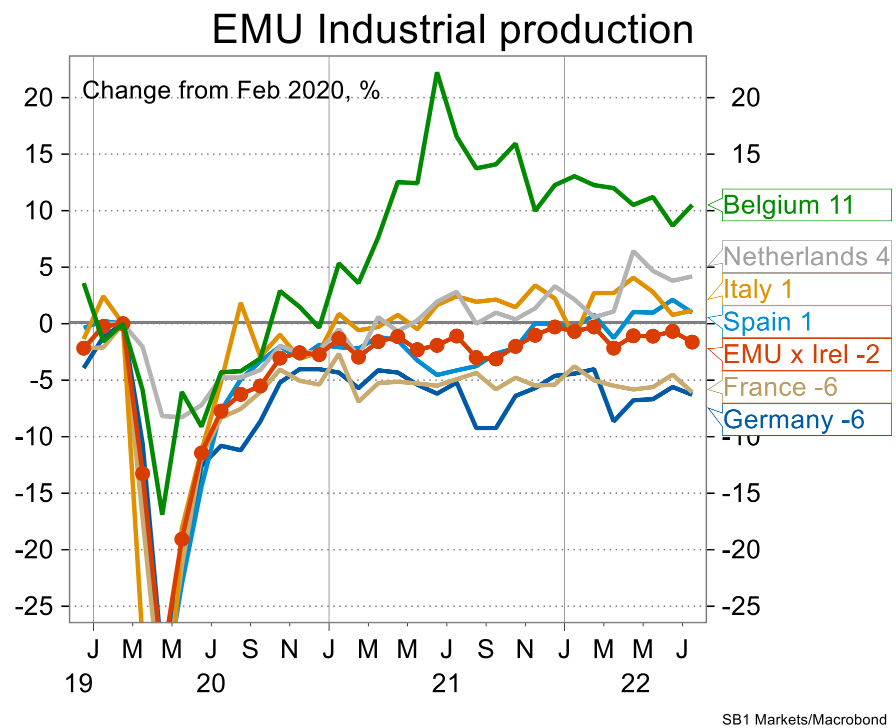
- These differential is wage cost signals different needs for monetary tightening in order to stabilise underlying inflation

Norway: Mainland Norway, ex government and electricity production. Adjusted for self-employed

Industrial production down in July, and the trend is rather down than up

Production was down 1% m/m, slightly more than expected

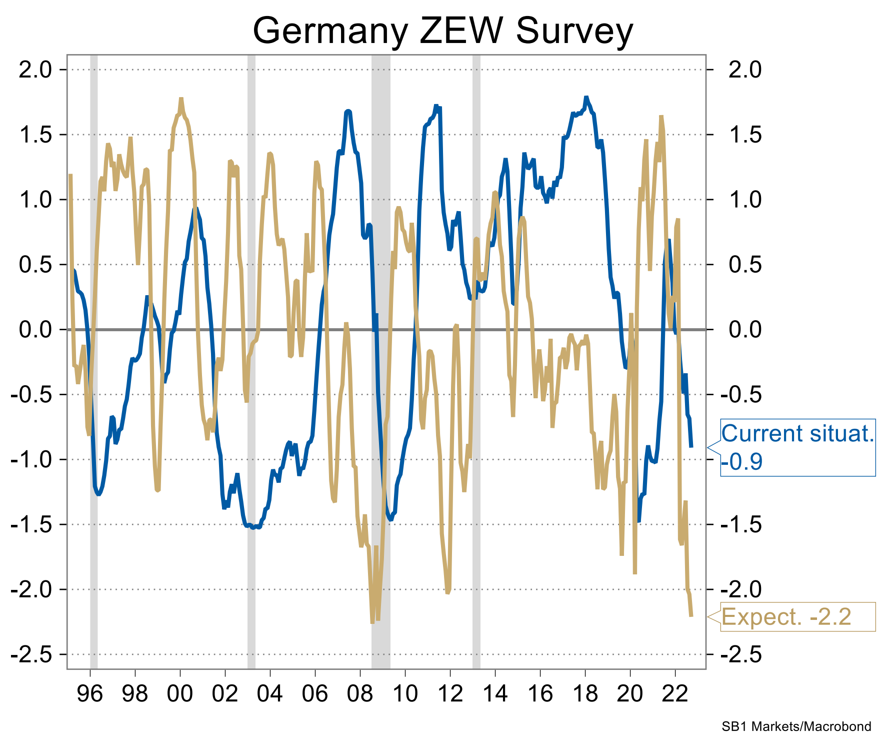


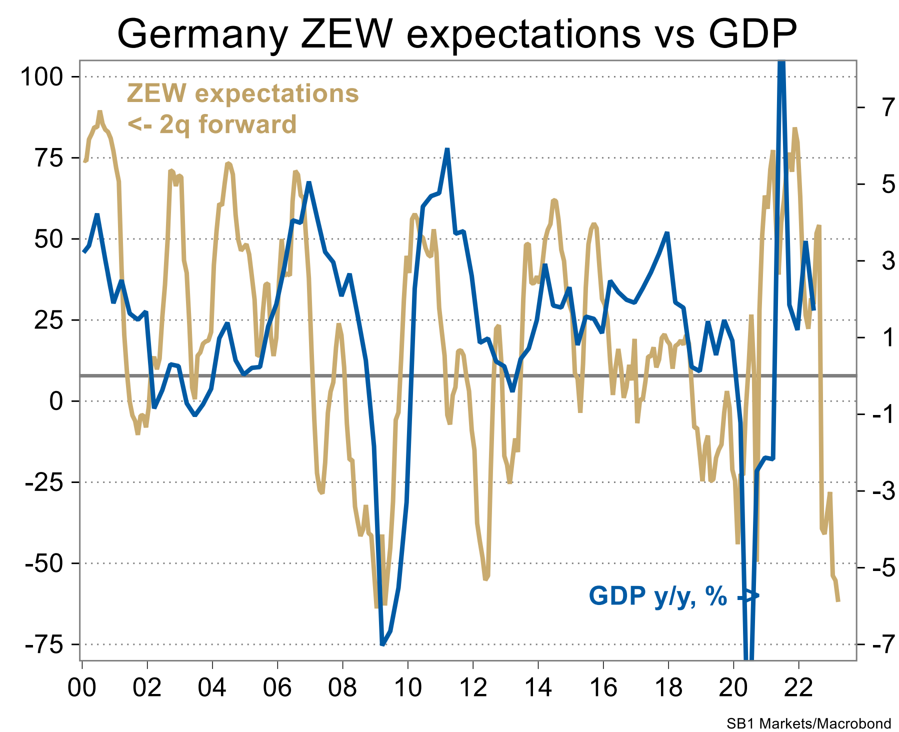


- Production was down in 3 of the big 4 countries in July
  - » At one stage, shutdowns due to gas shortages/high prices should be visible in these stats
- German manufacturing production is down 6% vs the pre-pandemic level, as is France. Italy is up 1%!

ZEW Sept. expectations plummeted to the lowest level since April – '09

German investors/analysts are extremely negative vs. the outlook; The current situation is weakening



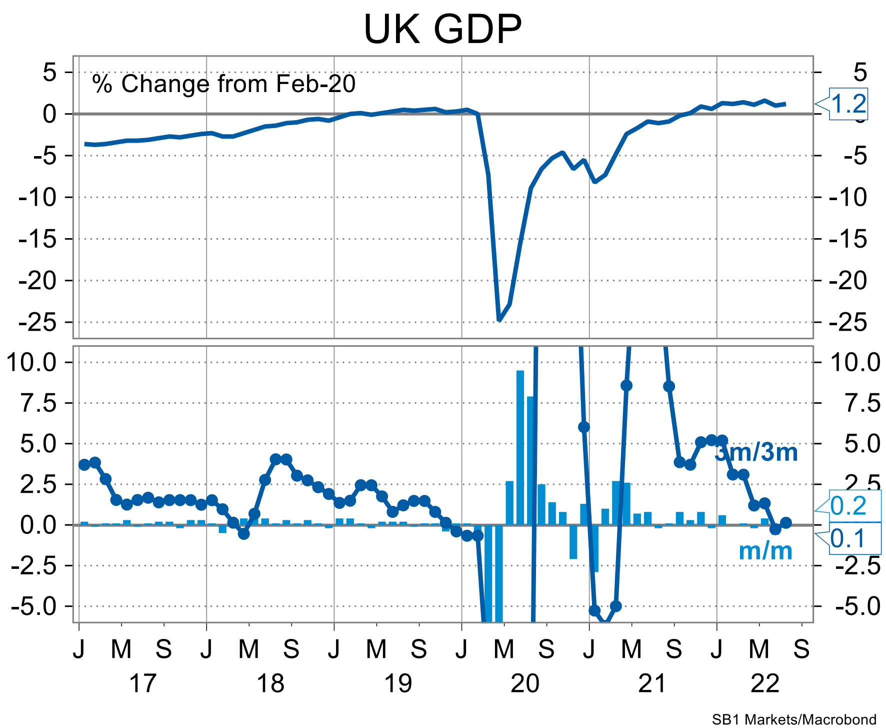


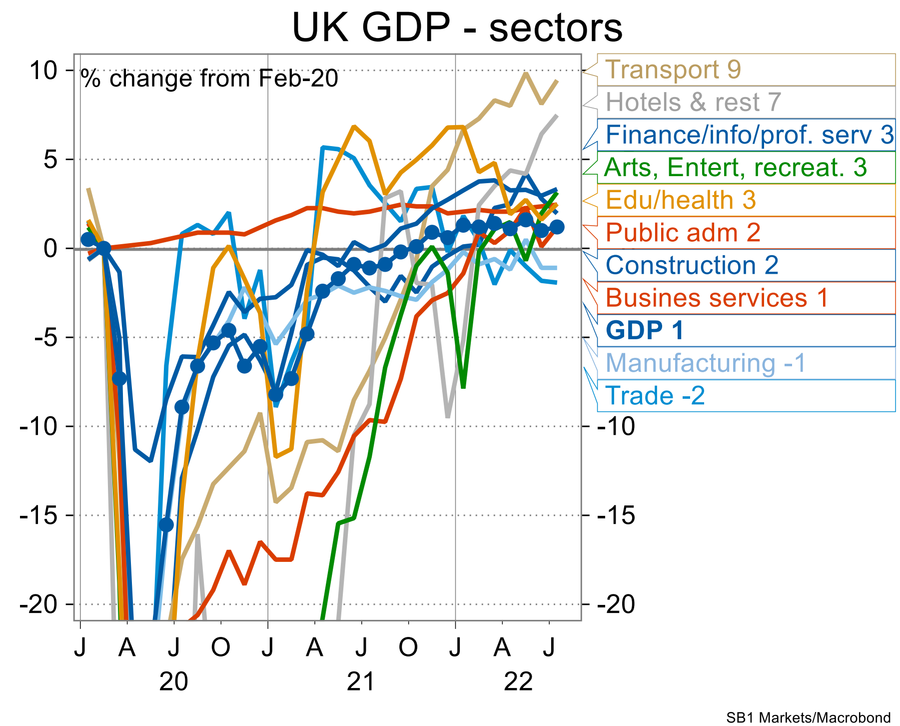
- The **ZEW expectation** fell 6.6 p to -61.9, expected down to -60. The level is 2.2 st.dev below average. It has only been two months, in July and October 2008
- The **current situation** index also fell quite significantly, by 12.9 p to -60.5, to 0.9 st.dev below par
- ZEW of course signals a deep recession in Germany

SpareBank 1 MARKETS

UK GDP has flattened, up 0.2% in July, but just up 0.1% 3m/3m

Hotels, transport still on the way up, other services are mixed and manufacturing, construction down



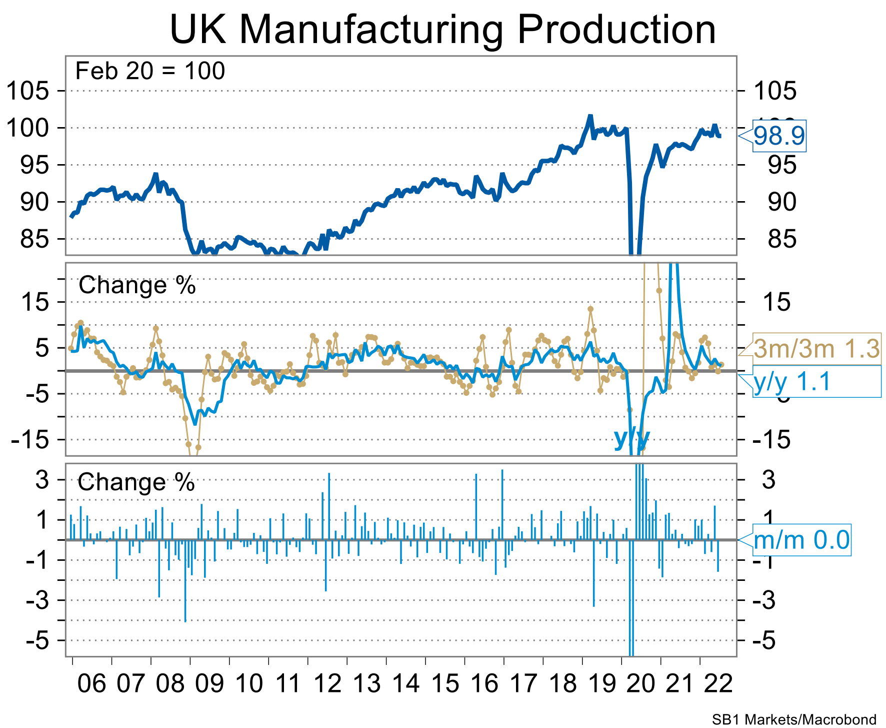


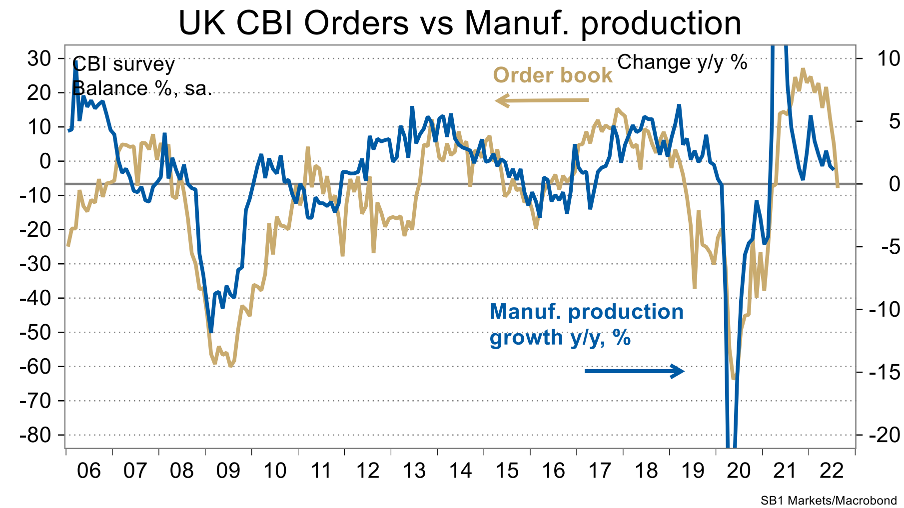
- **Growth in GDP** has been far weaker than expected – and flat – since January, and far weaker than indicated by surveys, following the re-opening of the economy late last year.
  - » GDP is just 1.2% above the pre-pandemic level, more than two years ago
- **Mixed between sectors:** A large contributor to the decline since January is health/education, from a high level – at least partly because covid testing, tracing & treatment have been scaled down. Transport and hotels & restaurants are reporting strong growth and high activity level. Business services, art/entertainment and manufacturing is still on the weak side, which cannot be blamed on the pandemic anymore. Trade is also on the weak side, as retail trade is now heading down
- **Bank of England** expect UK to enter a recession before not too long, due to a steep decline in real incomes, and monetary tightening

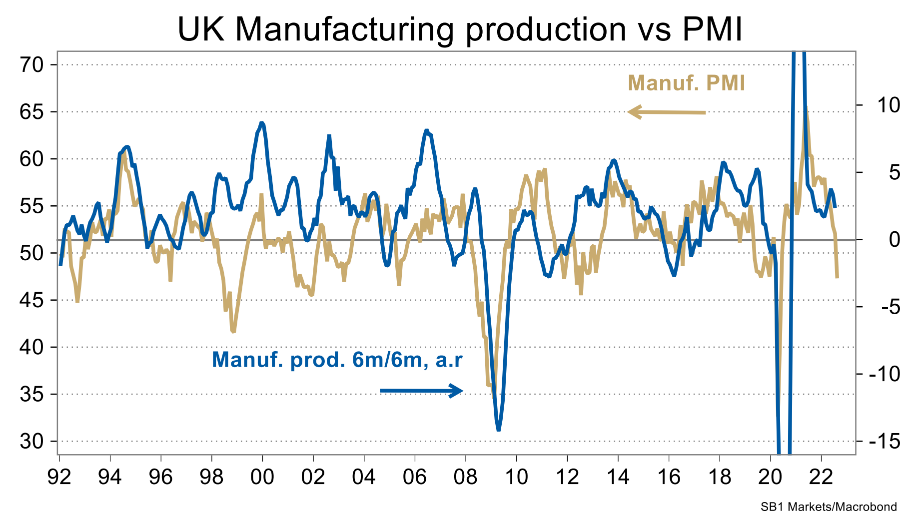
SpareBank 1 MARKETS

Manufacturing production flat in July, and over the recent months

Production was expected up 0.6% in July. The production level is 1.1% below that of Feb-20



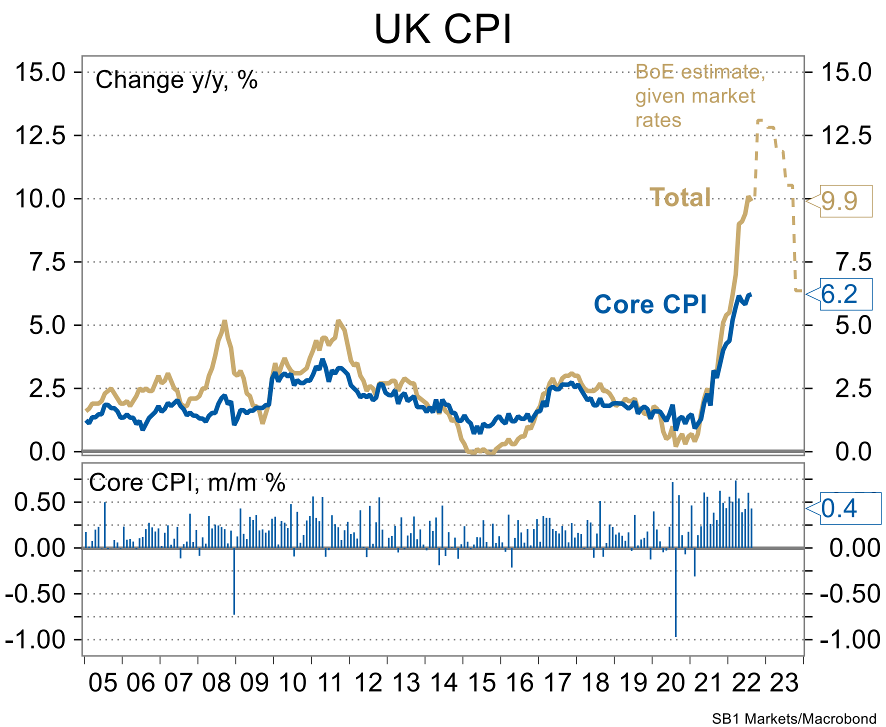


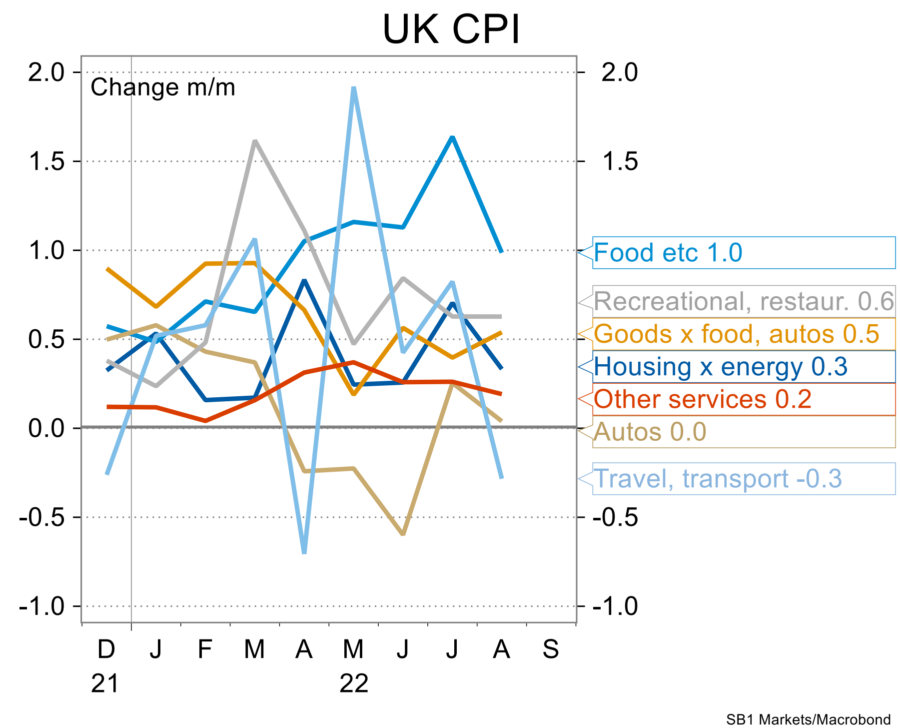


- Production of transport equipment (autos included) rose further in July (+3.9%) but the level is still down 22% vs. Feb-20
- The CBI survey signals a decline in manufacturing orders
- The UK manuf. PMI is signalling that manuf. production will come down quite significantly

UK headline inflation below expectations in August – still at 9.9%

The explanation is lower energy prices. Core up 0.4 m/m, 6.2% y/y

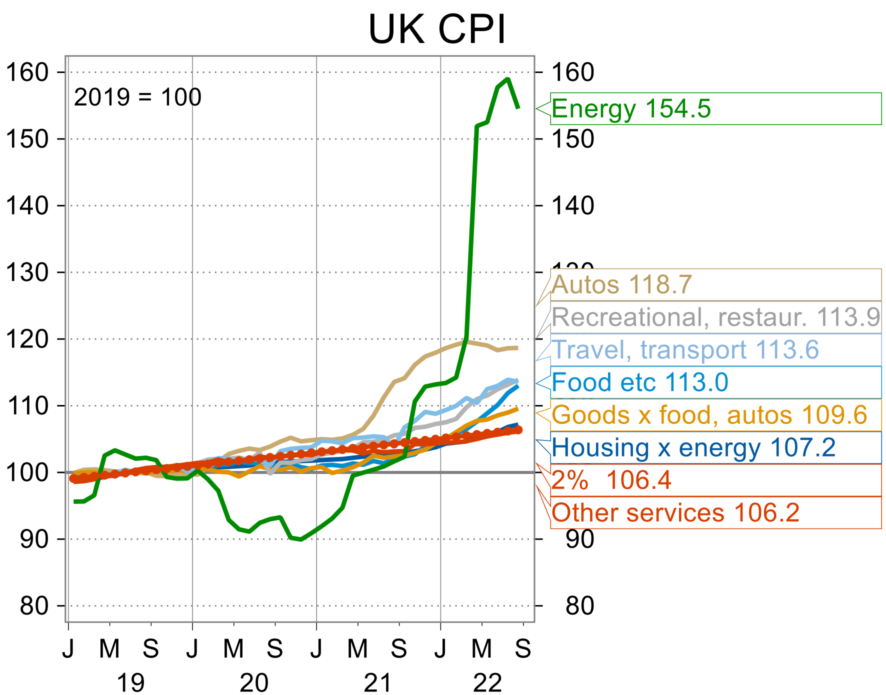




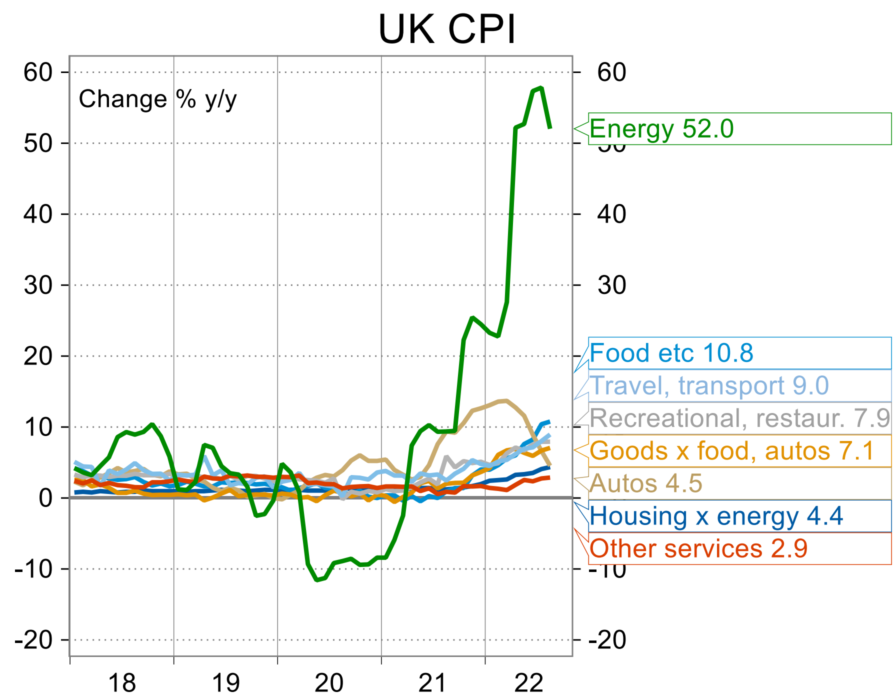
- **The total CPI** rose 0.5% m/m in August. The annual rate fell by 0.2 pp to 9.9%, expected up 0.1 pp to 10.1%
- **Energy prices** were down 2.9% in August but is up by 52% y/y and has lifted the headline y/y rate by 3.4 pp. The regulated price cap for energy was lifted substantially in April (a semi-annual adjustment, the next in October – and then Bank of England expects 13% headline inflation)
- **Food prices** rose 1% m/m, and they are up 10.8% y/y (like in Norway), lifting the headline by 1.8 pp!
- The **core CPI** (ex food and energy) rose 0.4% m/m, below the norm recent months. The core is up 6.2% y/y, unch. from July
- **Auto prices** are now trending down, and price increases for goods x autos & food seem have flattened
- **All major sectors** are reporting growth above 2%, and almost all up by more than a 2% pace since before the pandemic. This is BoE's problem, inflation is broadening, and are also driven by home-made factors. The gas problem cannot be slowed by the bank, of course

Energy is the main culprit

… but most main components are above the 2% growth path



SB1 Markets/Macrobond



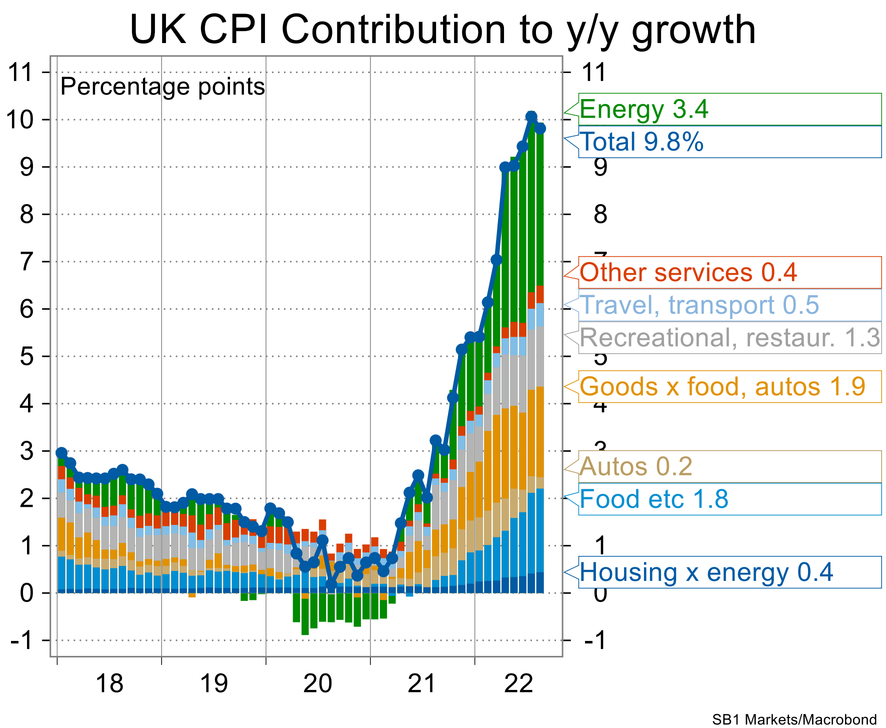
SB1 Markets/Macrobond

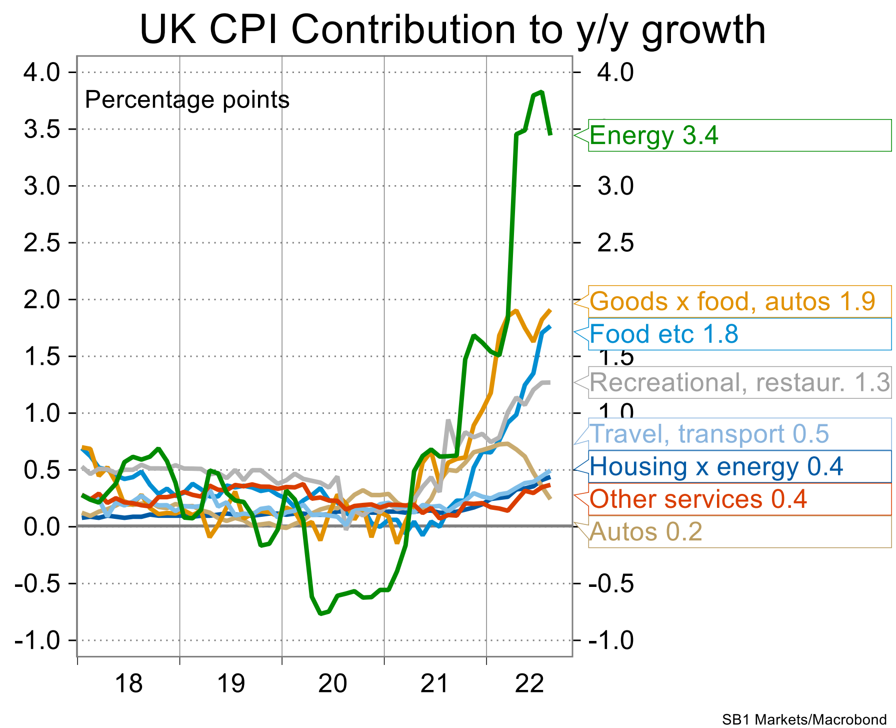
- **Energy prices** are up 52% y/y, much of it due to the 26% m/m surge in April, when semi-annual price cap adjustments were undertaken (the next adjustment is scheduled for October)
- Some positive signs: Auto prices have peaked, and prices for goods x food are not accelerating. Services x housing is up ‘just’ 2.9%

SpareBank 1 MARKETS

Energy is important, but the inflation problem is broad based

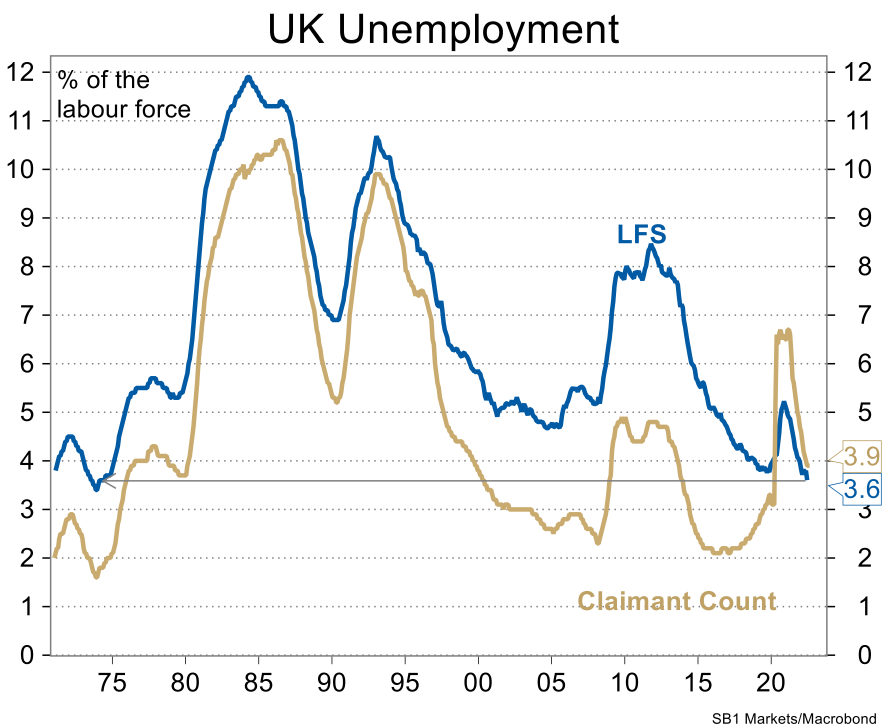
Goods x food & autos prices have shot up, as have recreational services/restaurants, foods

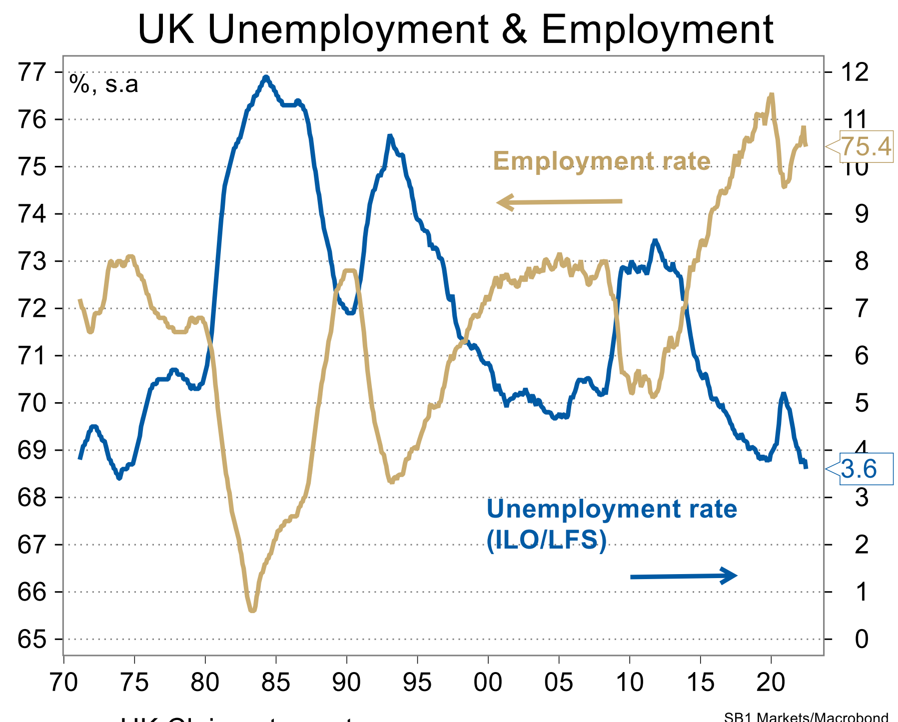


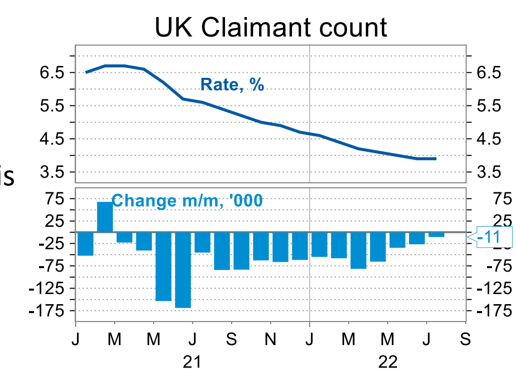


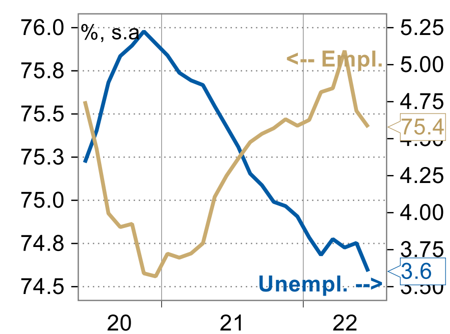
What a crisis: The lowest unemployment rate since 1974!

The unemployment rate unexpectedly fell by 0.2 pp to 3.6%, due to a decline in the employment rate





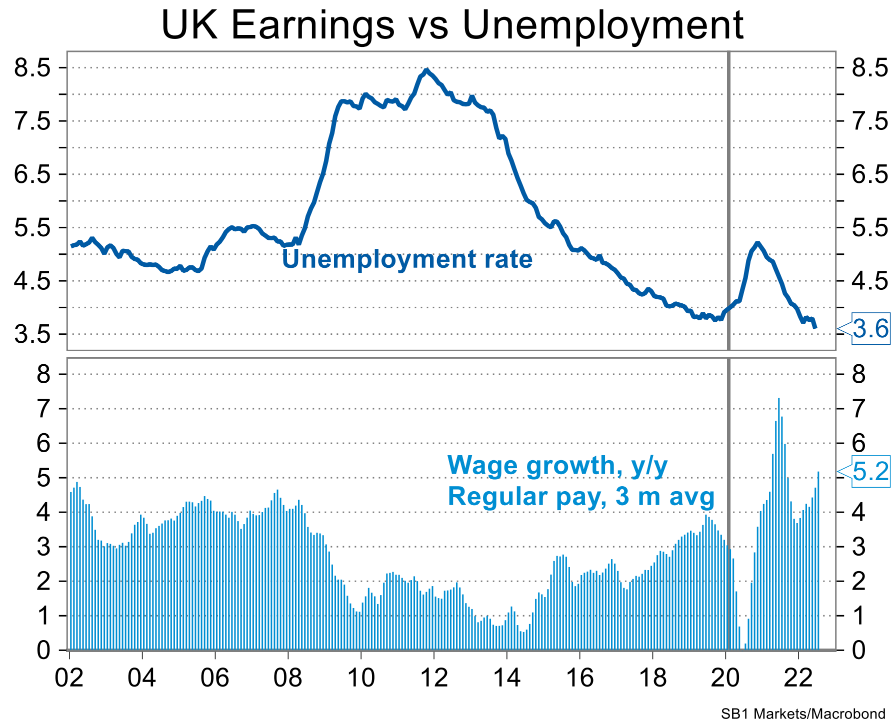


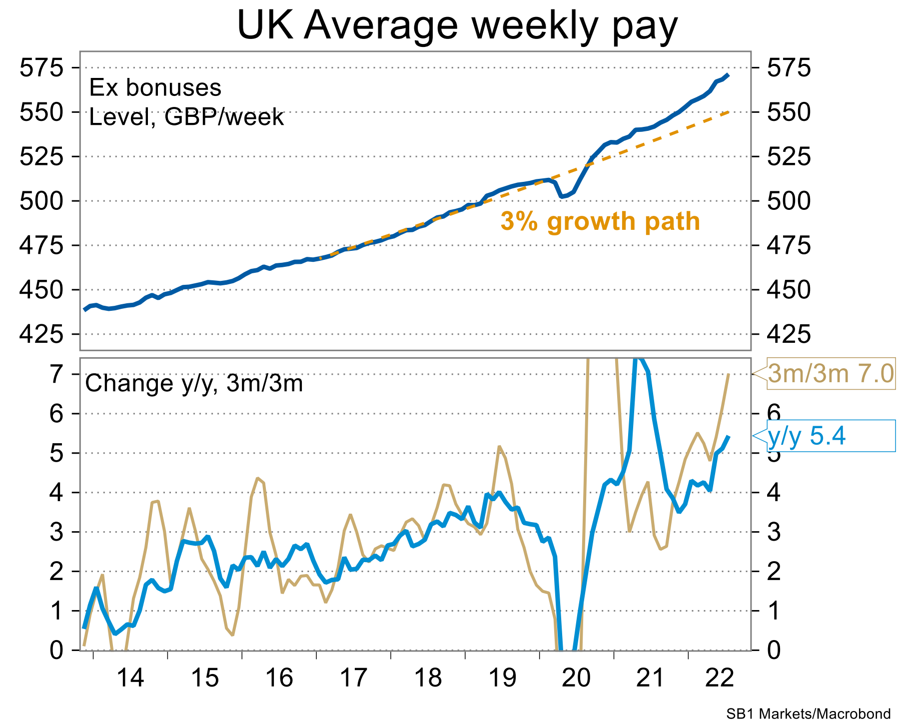


- **ILO/LFS ('AKU') unemployment** is at the lowest level since 1974
- **Claimant counts** ('open unemployment') is still falling, but the 3.9% rate is well above the pre-pandemic level – and the pace of decline is steadily slowing.
- The no. of **unfilled vacancies** fell slightly in July, but remains very high

Lowest unemployment rate since 1974 – and wage inflation is on the way up

… wages ex. bonuses up 7% 3m/3m, up from the pre-pandemic level at 2 – 3½%

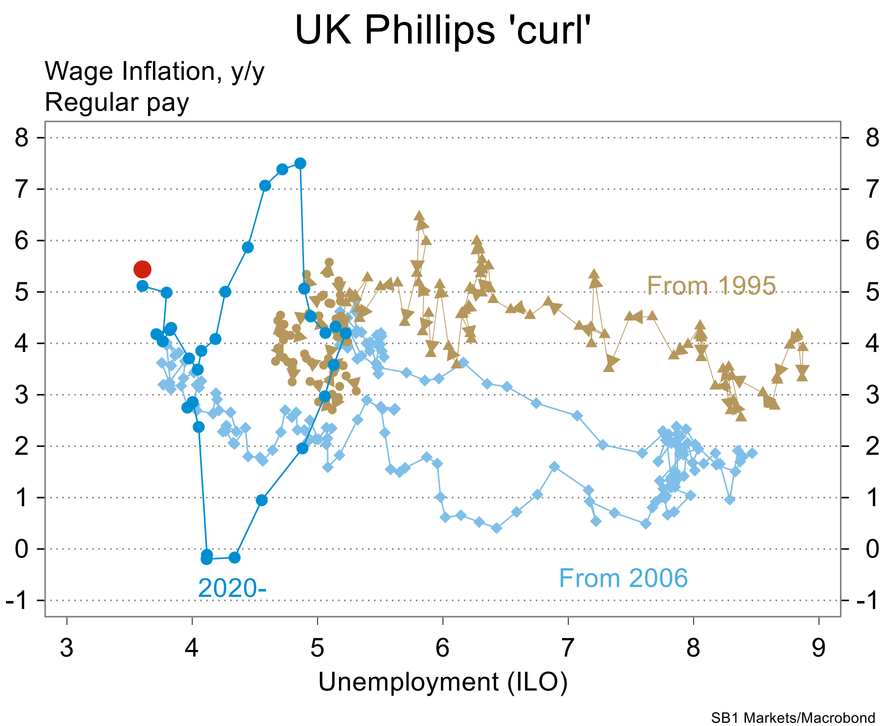


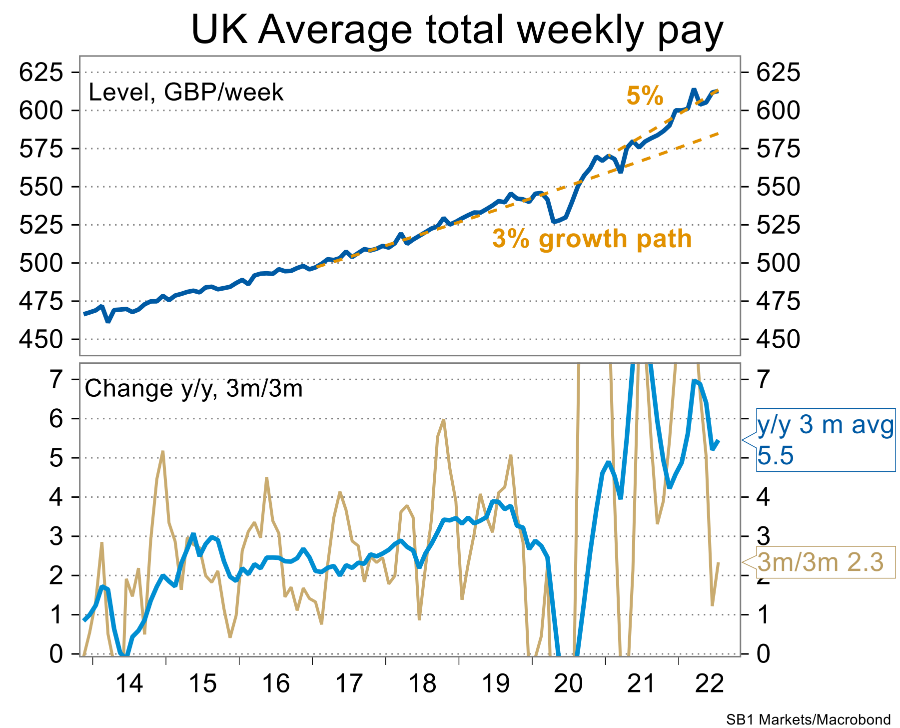


- **Annual wage growth** (regular pay, 3 m avg) accelerated 0.3 pp to 5.4% in July, expected down to 5.0%. Not smoothed, wages were up 5.2%, and the underlying 3m/3m rate accelerated to 7.0%
- **Including bonuses**, total wages are up 5.5% y/y (3 m avg), 0.1 pp higher than expected (*charts next page*)
- Just before the pandemic, wage inflation was approx. 3% (total pay) to 4% (regular pay) – but just between 2% and 3% the preceding years. Thus, the current wage inflation rates are well above the British 'norm', that have yielded 2% CPI inflation
- Some unions in the UK have lifted their ambitions substantially recent months – as inflation is close to 10% - and BoE expect more to come (13%). Wage claims in the same territory have now been aired, not surprisingly, in a very tight labour market. But so far, real wages are nosediving, as wage inflation is far below CPI inflation

Total pay, including bonuses, is accelerating rapidly

The sum up 5.5% y/y, in line with the trend path since early 2021 – well above pre-pandemic trends

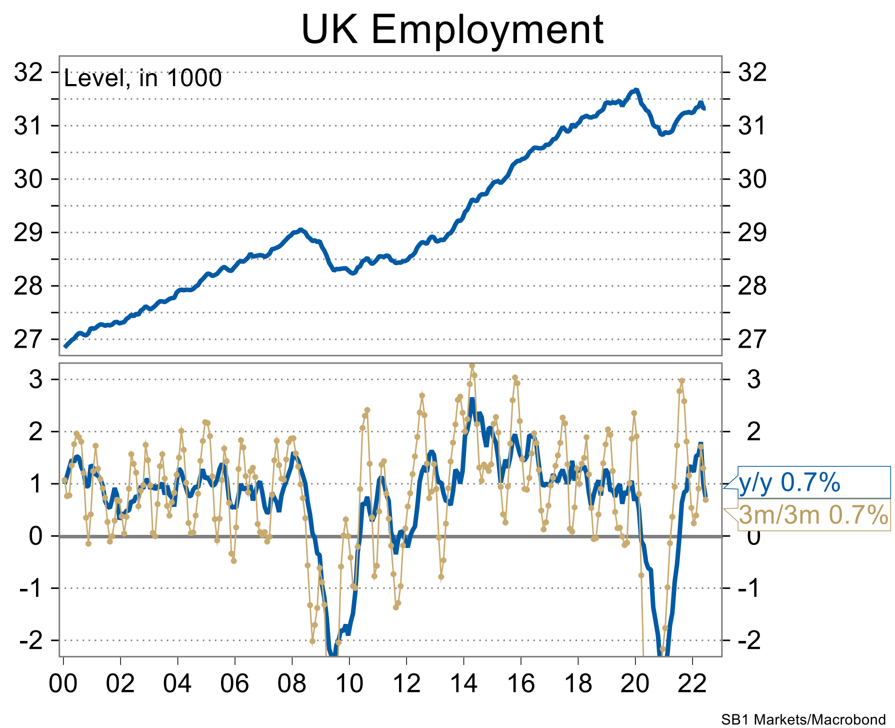


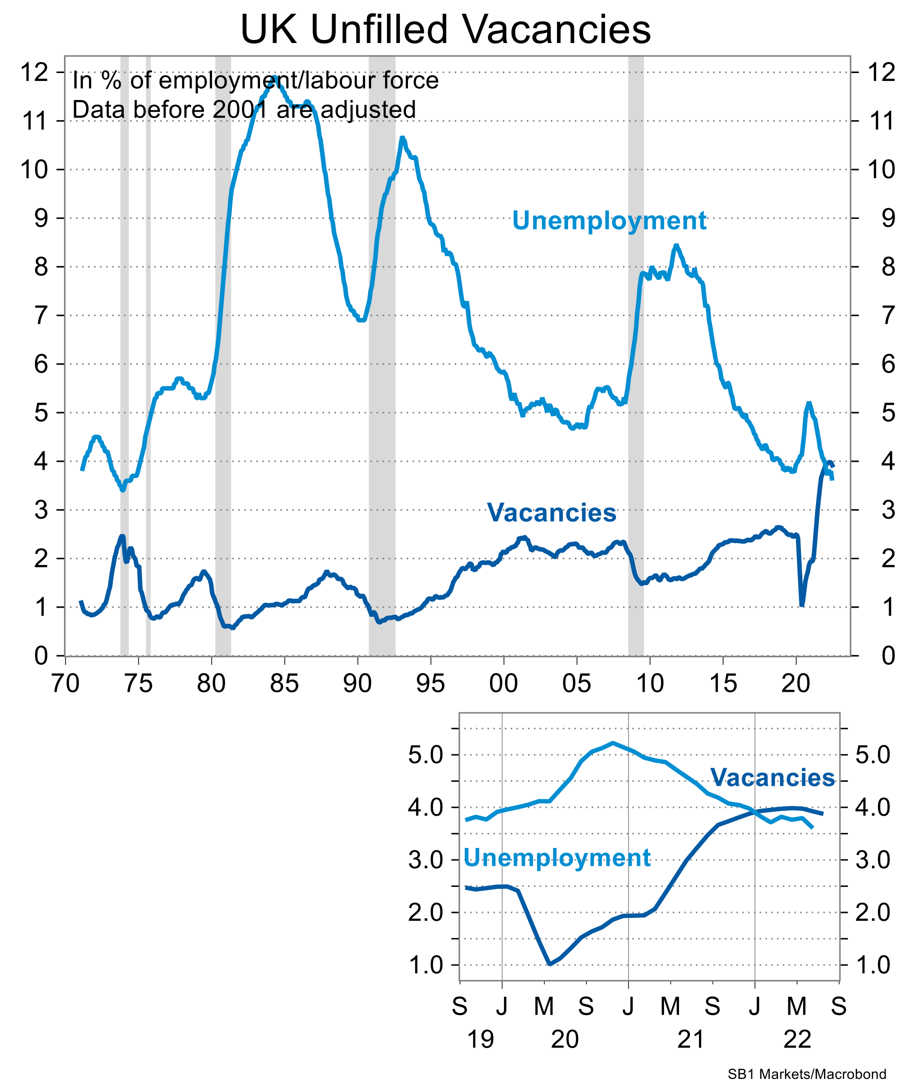


- Wages are on the way up alongside something that looks like a Phillips curve
- It is completely impossible to bring inflation back to 2% over time if wage inflation remains above 5%, probably even above 4%. With a 3% wage inflation rate, inflation was just marginally below the 2% target

A tight labour market – but the peak tightness is behind us?

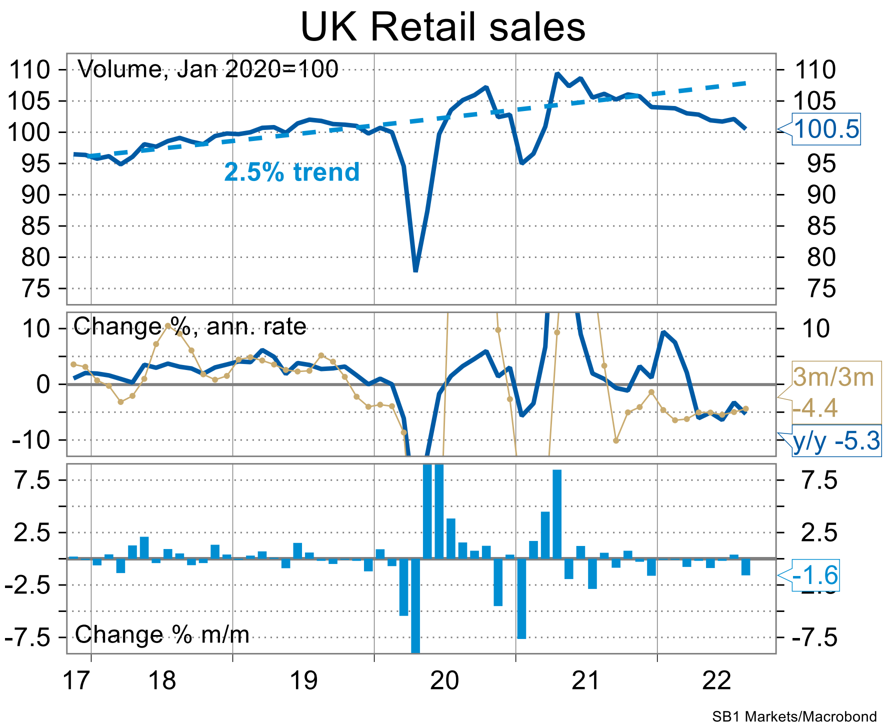
Employment growth is slowing, the vacancy rate fell marginally in June & July

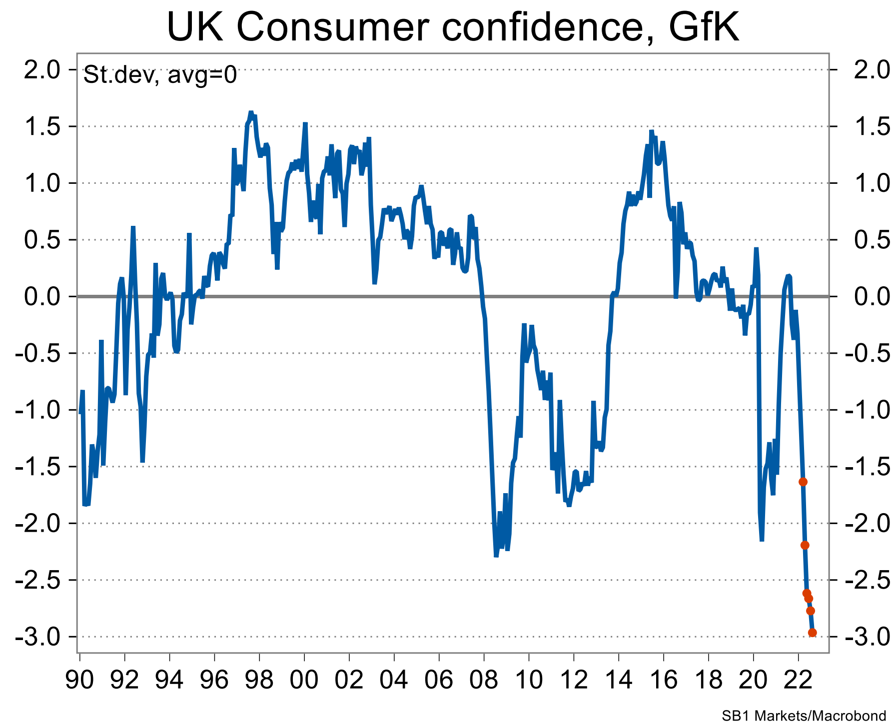




Retail sales very weak in August and are trending downwards

Sales declined by 1.6% m/m, expected down 0.5%. As inflation surges, confidence collapses

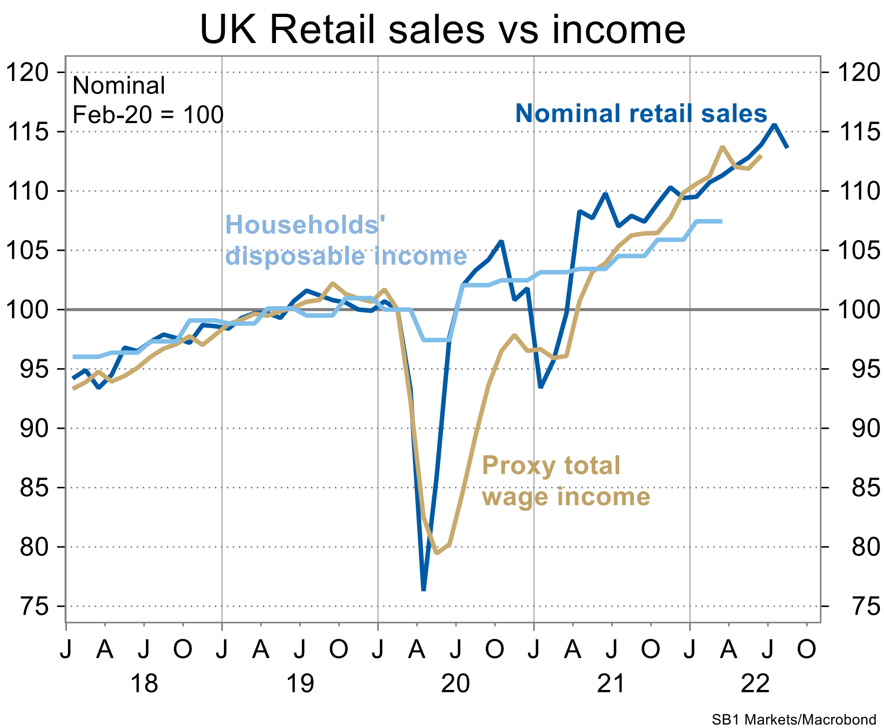


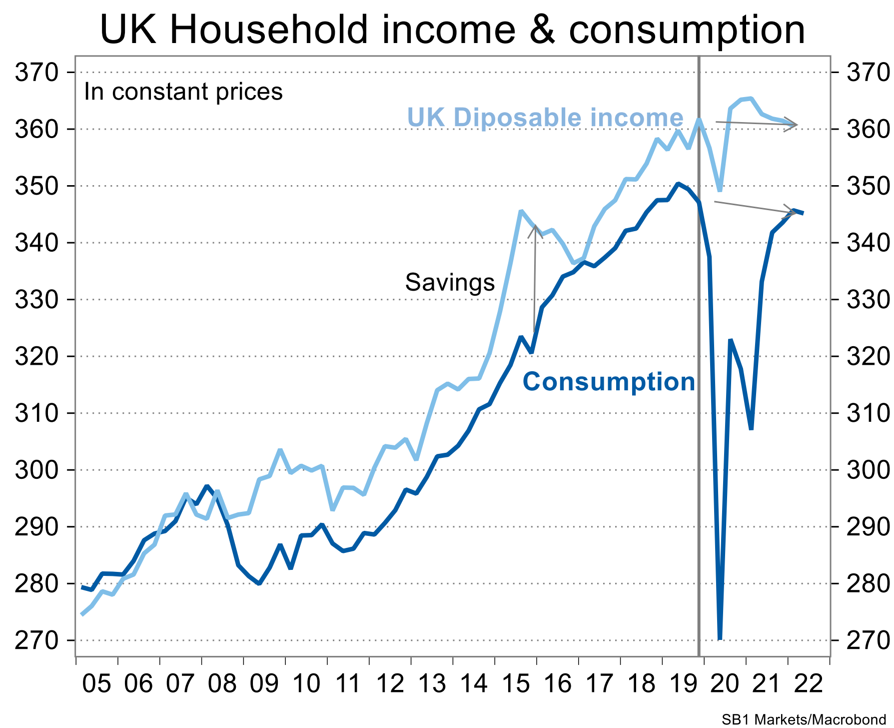


- **Retail sales** peaked Apr-21, and the gradual decline brought sales down to well below the pre-pandemic 2.5% growth path. Sales are down at a 4.4% pace measured 3m/3m, a substantial drag on GDP growth
- **Consumer confidence** fell further in August, to -3 st.dev below average, the lowest ever
  - » High inflation, and an unprecedented decline in real wages and higher interest rates are likely reasons. Beside that, the labour market is strong, the unemployment rate the lowest in 4 decades

Total wage income has kept up with nominal retail sales

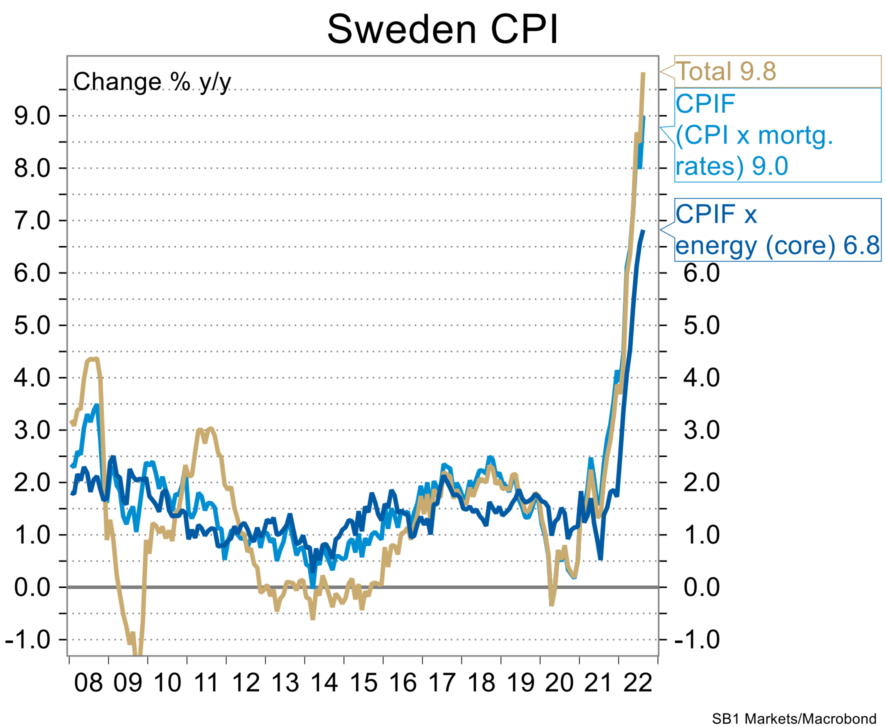
... and total consumption is weaker than normal vs. total disp. income (=savings higher than normal)

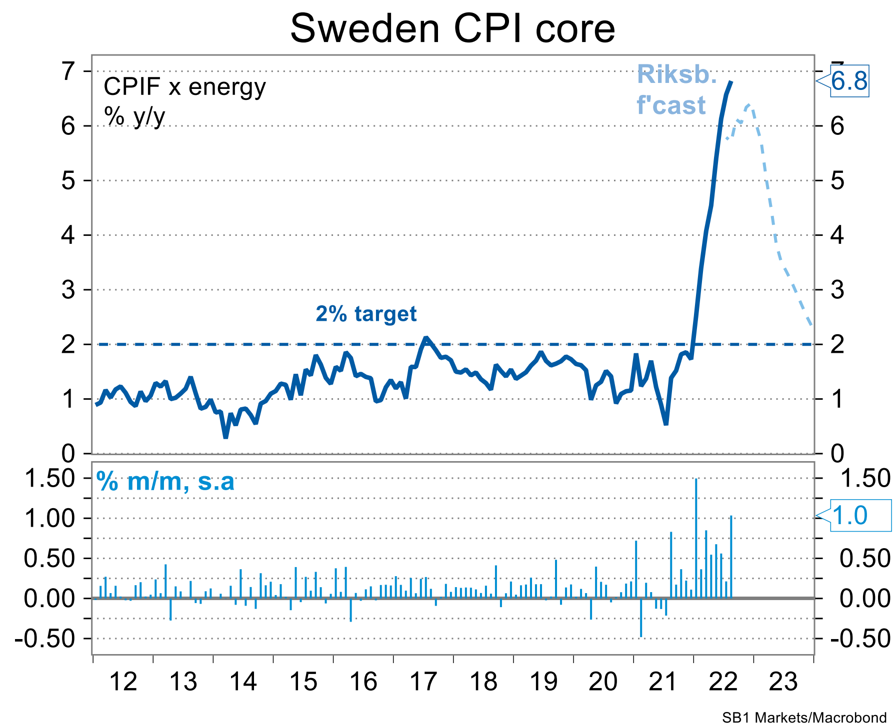




Swedish inflation surged in August

The headline was up 1.3 pp to 9.8%, expected 9.6%. Core CPI also up 1 pp to 6.8%

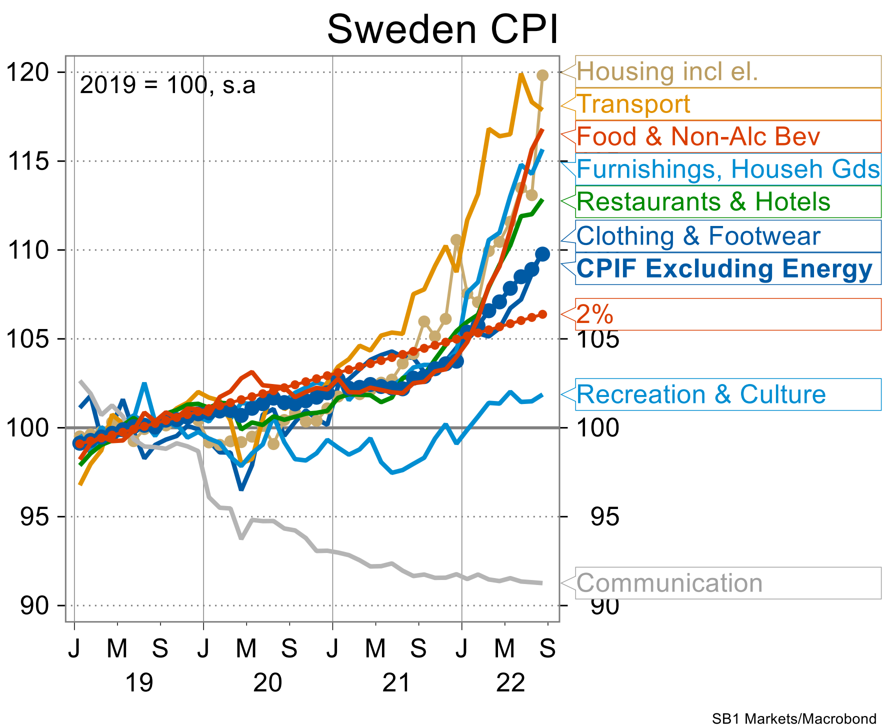


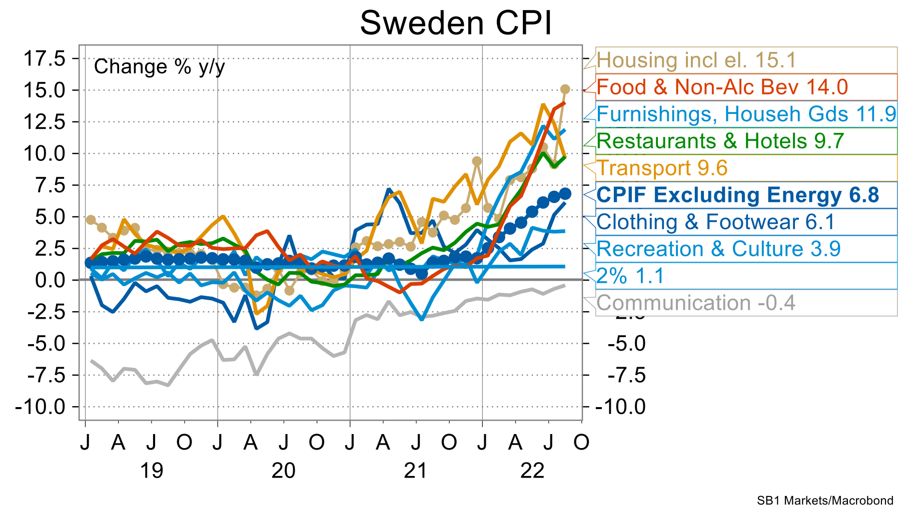


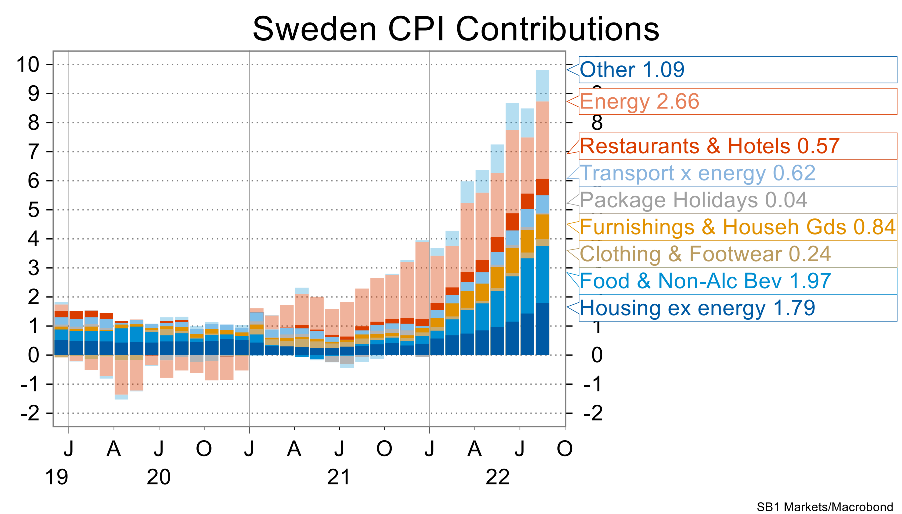
- **CPI-F x energy, the 'real core'**, rose 1% in Aug (seas. adj). The core rate has accelerated sharply recent months, to 6.8% from 1.7% in last December – and again to well above the Riksbank's f'cast
  - » Why is inflation so high? Housing incl. energy prices are up 15% y/y, food prices are up 14%, furnishings 12%, hotels & restaurants 9.7%!
  - » All other measures of underlying inflation are sharply up – and at the highest level in some 30 years
  - » Until Q4, inflation was pretty well explained by higher energy prices, now many more elements are on the move upwards
- **The increase in inflation is broad**, but the biggest contributors on the upside in Aug are energy, housing (larger mortgage pmts), and clothing, while airline tickets/holiday travel and fuel prices contributed the most on the downside
- **The Riskbank** said in its last statement that it would take forceful action to get inflation under control – another 50 bp hike next week has already been communicated by the bank. We believe they will raise by 75 bp and that the rate path will be lifted by min. 50 bps

Inflation in Sweden: a broad acceleration

Just communication is below 2% y/y, and just recreation & culture below a 2% path since 2019

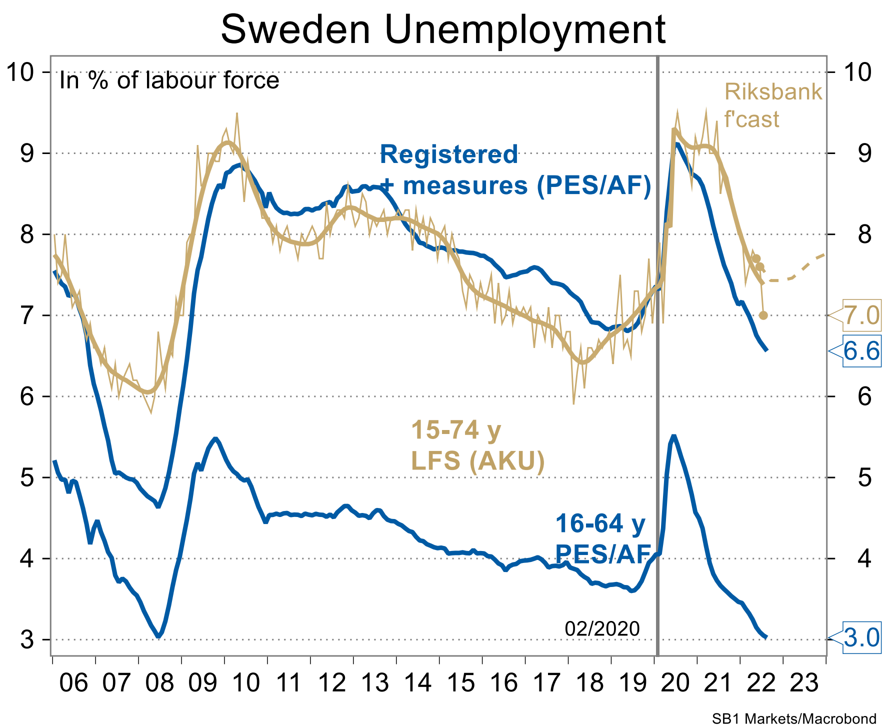


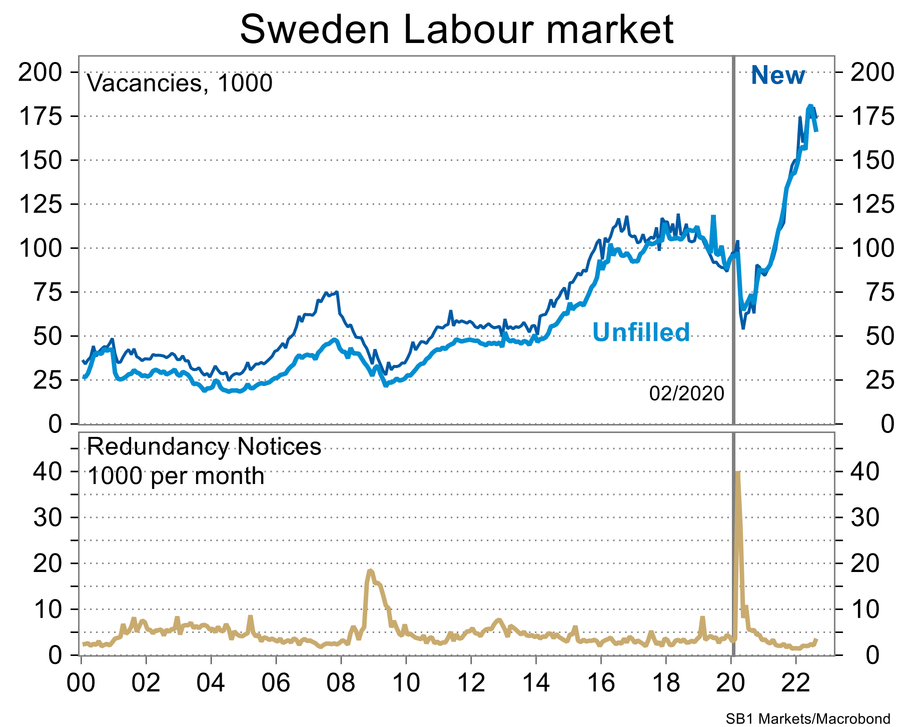




PES unemployment down 0.1 pp to 3.0%, equal to the level before the GFC

Employment is surging, the employment rate is very high. Vacancies remain at extreme levels

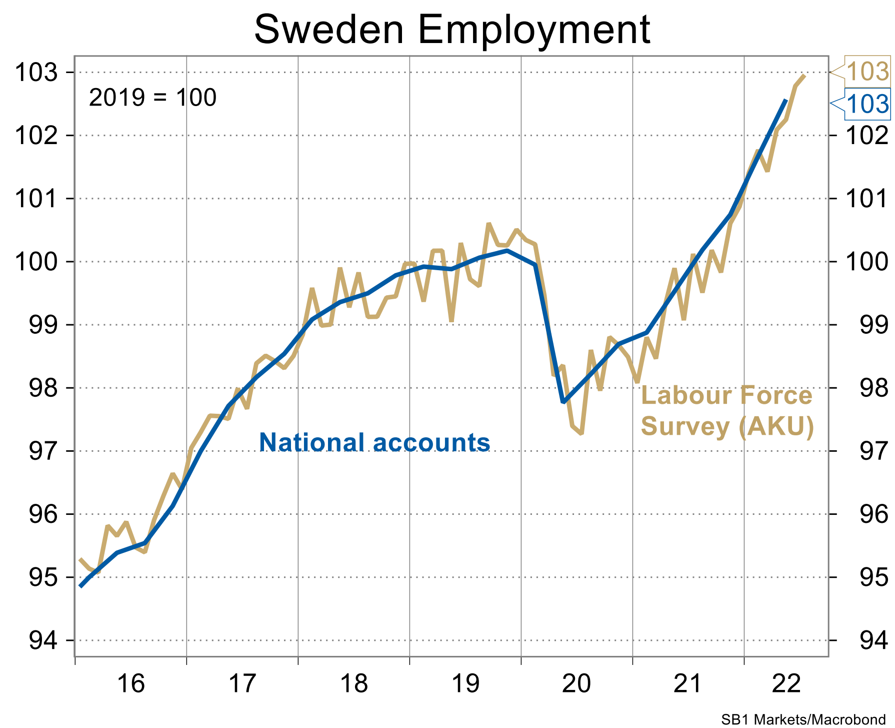


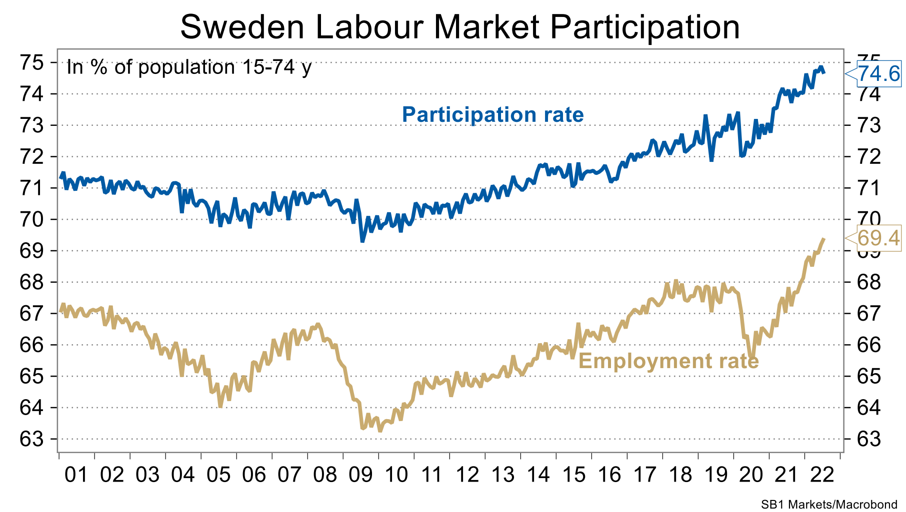


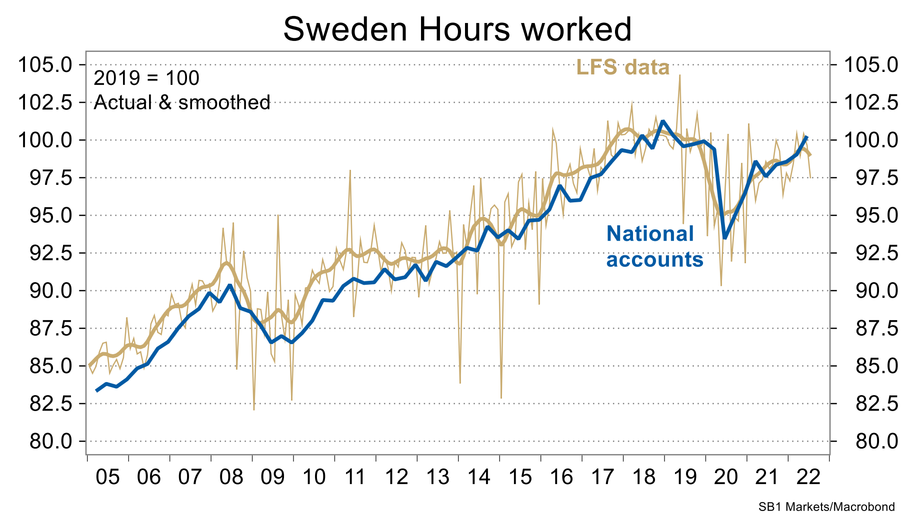
- The **'open' registered unemployment rate** at 3.0% is far below the pre-pandemic level – and very likely soon at the lowest level since 1990, before the housing/banking crisis
  - » **Unemployment including labour market measures** has fallen to 6.6% - which also below the level just before the pandemic hit, but still well above the previous troughs. As the vacancy rate is unprecedented, more mis-match
- The number of new vacancies fell slightly in Aug, from an ATH in July. The no. of unfilled vacancies were also down, for the second month

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

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







- A high vacancy level signal strong demand for labour
  - » Is the decline in hours worked due to the supply side, people do not want to work too long hours?

Highlights

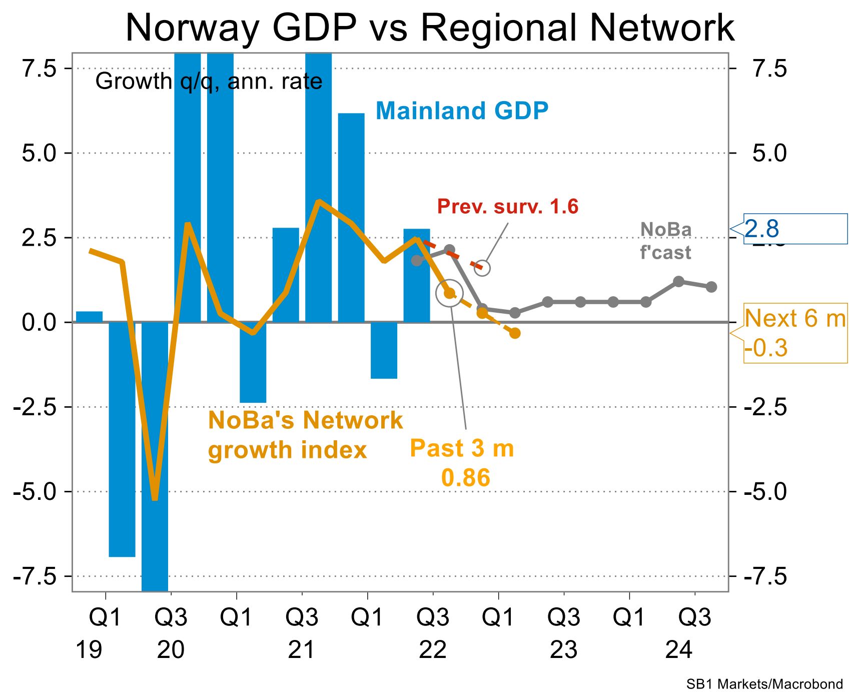
The world around us

The Norwegian economy

Market charts & comments

Norges Bank's Regional Network expects a GDP decline coming months

High inflation, higher rates are expected to stifle demand. Just oil services, exporters expect growth



Implications

- Taken at face value, the network report does not signal much weaker growth than NoBa assumed for the coming quarters. However, the starting point is lower than NoBa assumed (GDP in July), and the Network expects negative growth. At the same time, capacity utilisation is very high, and unusually many respondents report lack of labour
- 25 or 50 bps next week? We still think 50 bps is most likely, but is not a done deal anymore. In addition, the interest rate path's 3.1% peak will probably not be revised up. *Check more at page 5*

Expectations for the coming months

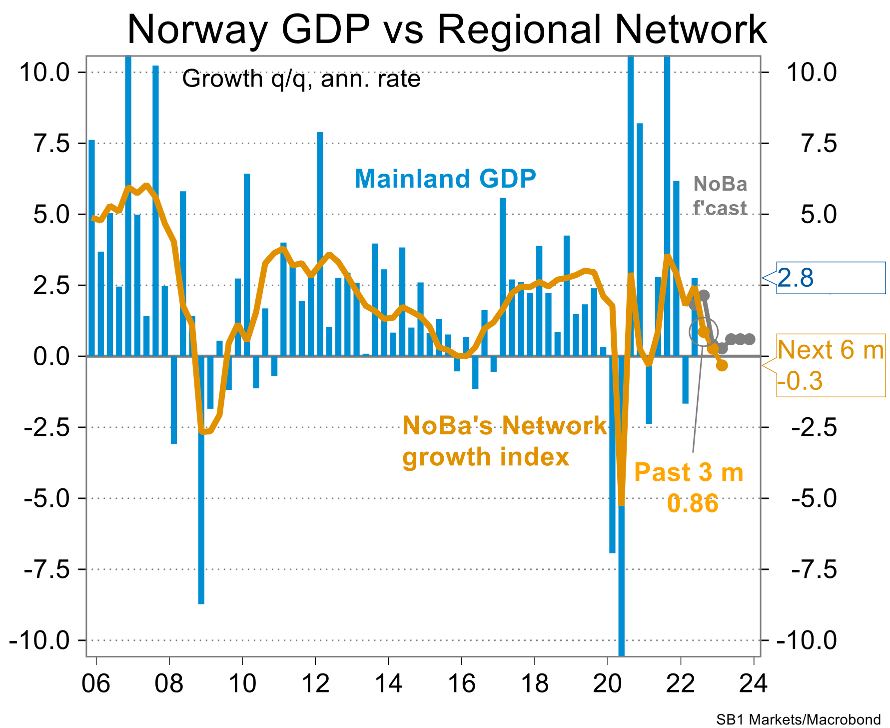
- The Network expects a -0.3% growth pace the next 6 months (index value at -0.16), we expected +0.5%, down from +1.6% 3 months ago. In June, Norges Bank assumed a +0.3% growth pace in Q4 and Q1-23. Thus, the network signals 0.5 pp weaker growth pace than NoBa assumed. In addition, actual GDP is 1.4% pp below NoBas' f'cast by the start of Q3
  - » Just **manufacturing exporters** expect higher growth, rather surprising. **Oil services** expect continued strong growth. All other sectors expect slower growth – or a substantial decline in activity, like **construction and retail sales**. Construction also reported the sharpest change in expectations
  - » **North, South & South East** report continued decent growth, others not. **Central East** expect a sharp contraction
- **Investment** plans were revised further down, but are not far below average. Profits are expected sharply down (oil companies are not included)
- **Wage inflation** expectations are drifting slowly upwards, and reached 4% in Q3
- Far fewer companies expect to increase their **prices** than 3 – 4 quarters ago

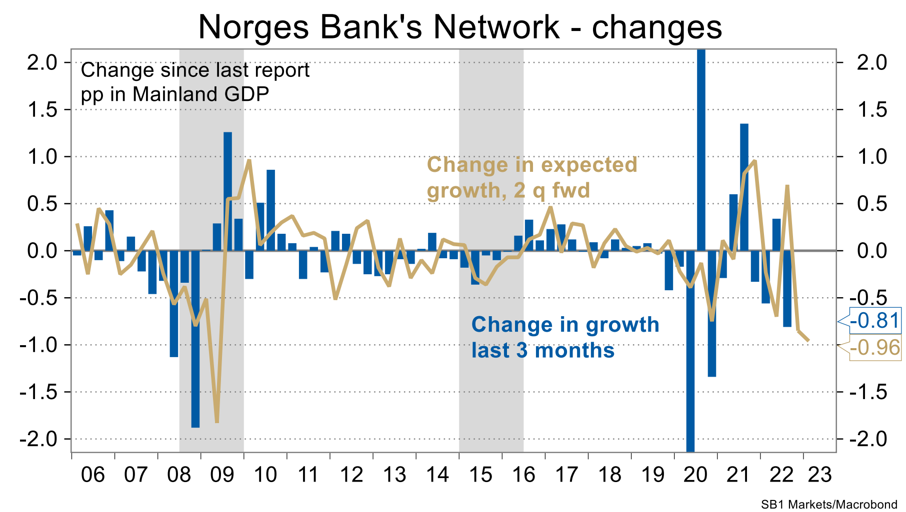
Activity the past 3 months

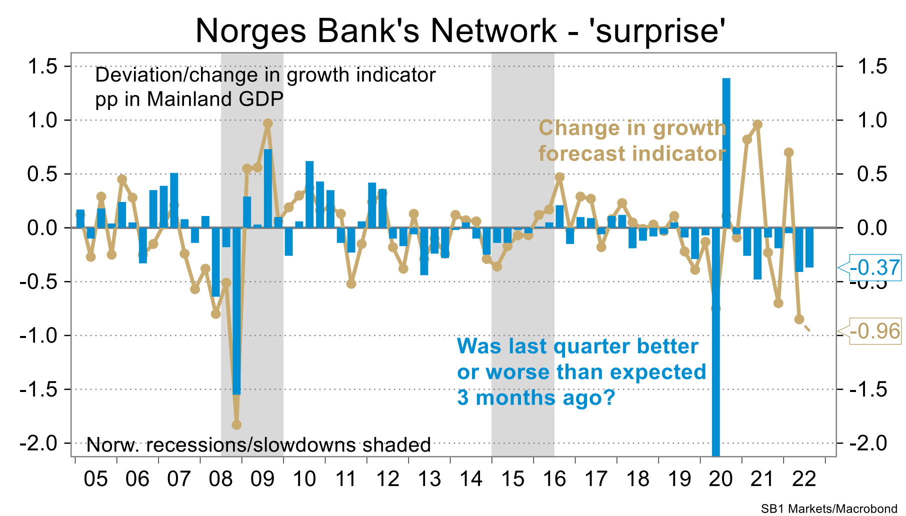
- The Network reports a 0.9% growth pace in May-July period (index value 0.43), we expected 1.0%, down from 2.5% the previous 3 months ago. 3 months ago, growth was expected at 1.6% (for the coming 6 months though). Actual Mainland GDP growth (base value) was at a 1.8% pace over the past 3 months
  - » Retail and construction reported a decline in activity, whereas oil related industries, export industries, and business services reported strong growth
  - » **Capacity utilisation** is still high but has come down over the past year, and **labour shortages** are still an issue, but a little less so than in the last report

The weakest Network report since the financial crisis (x the pandemic)

Growth has slowed unusually fast, the change in the 6 m f'cast the second largest ever!



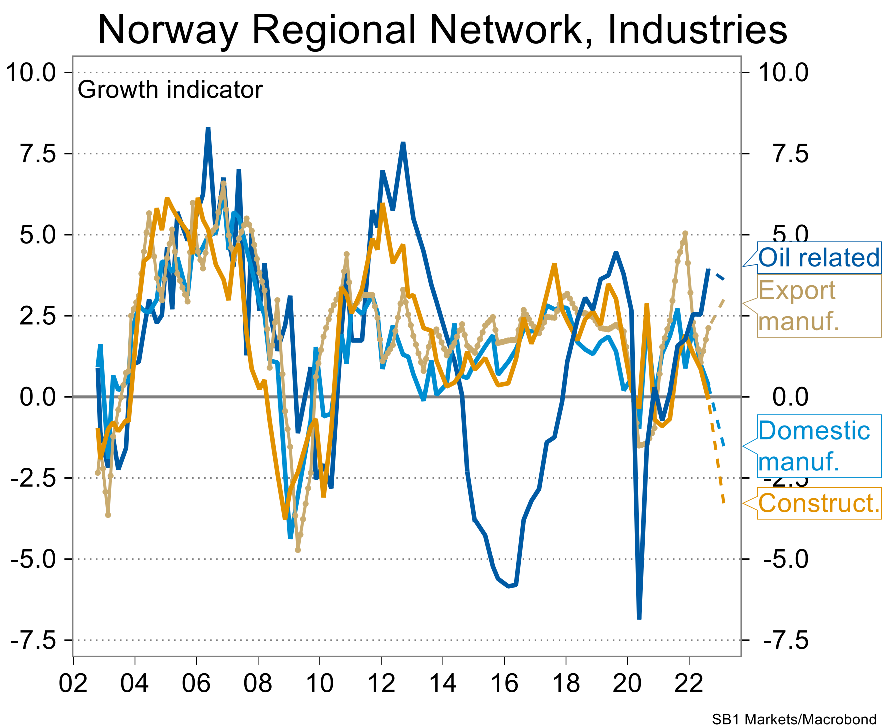


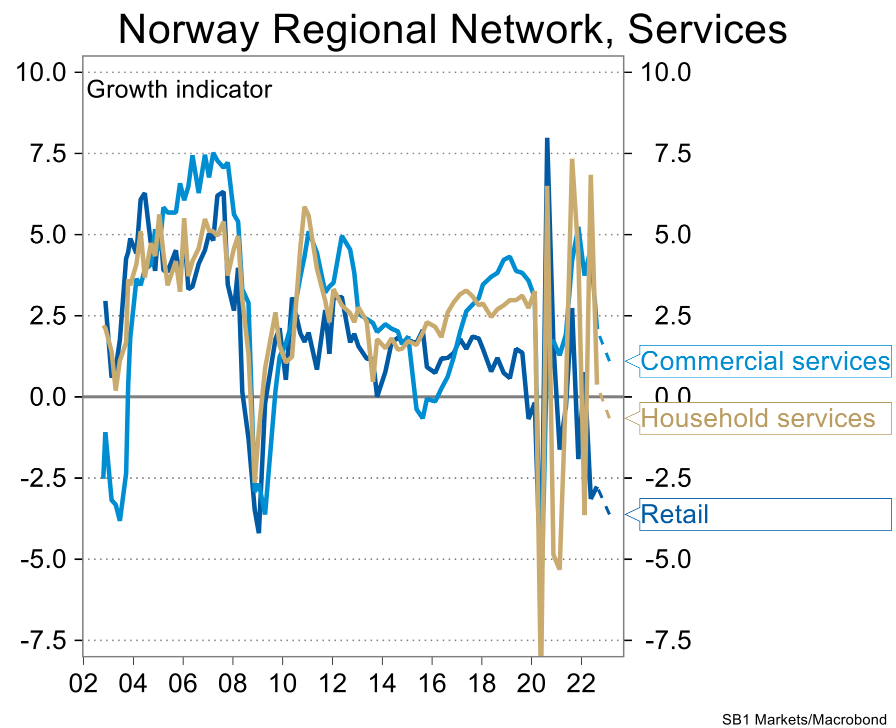


- The past 3 months were once again weaker than expected

Oil services, exports OK, others down. Construction expects a really hard landing

Retail trade remains in contraction mode, while commercial services expect less than 1% growth

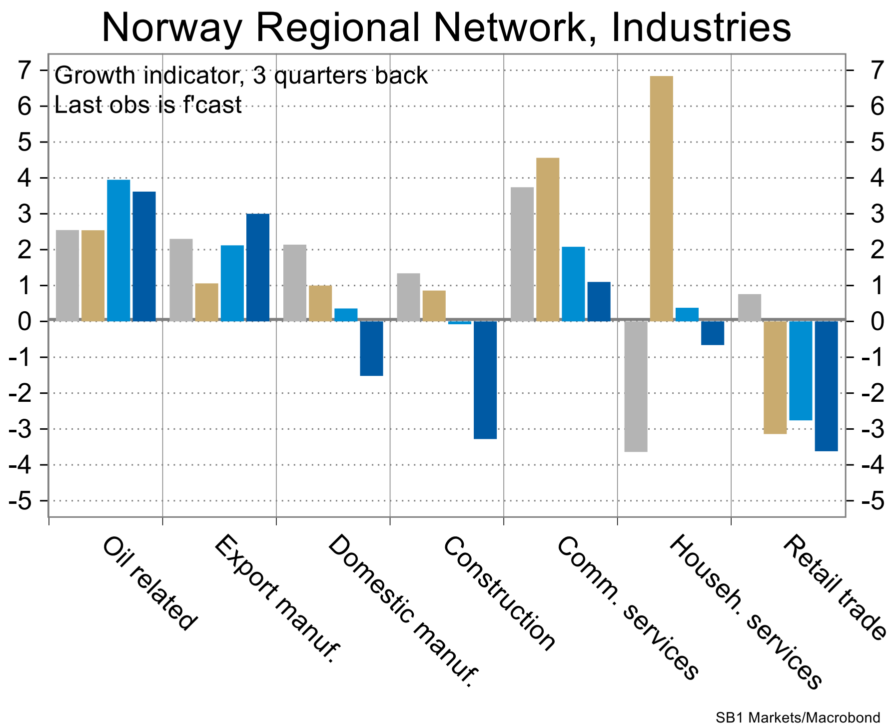




- Oil related industries report stronger growth, not surprising of course: The gas crisis and the tax regime are, needless to say, the reason the oil and gas industry – and its related Mainland related industries that are included in this survey (and not the oil companies) – are doing well

Unusually large sectoral differences: Oil services at the top, retail trade at the bottom

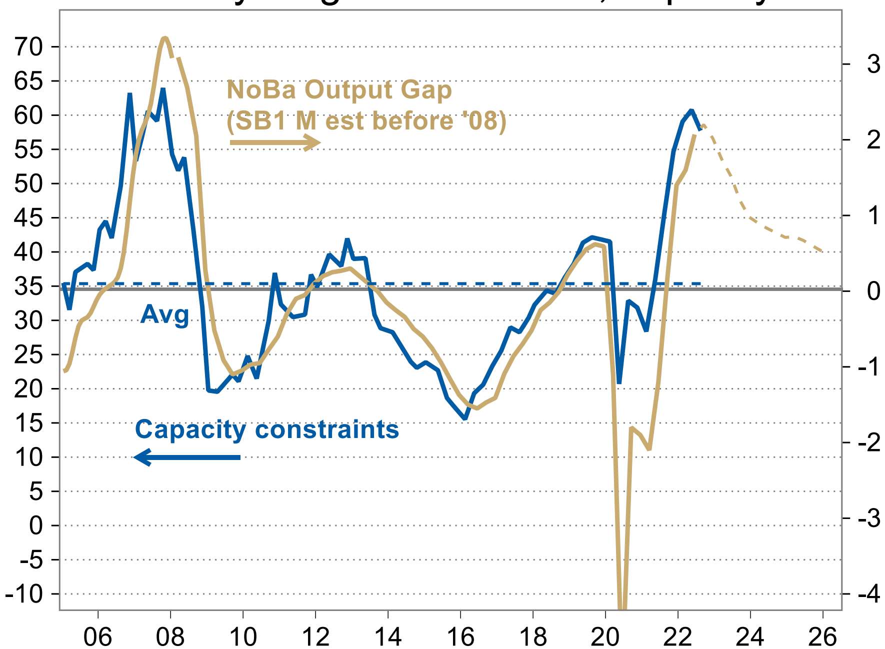
Only export related industries report of higher growth than 3 months ago. Construction fell the most



Capacity constraints & labour shortages are coming down...

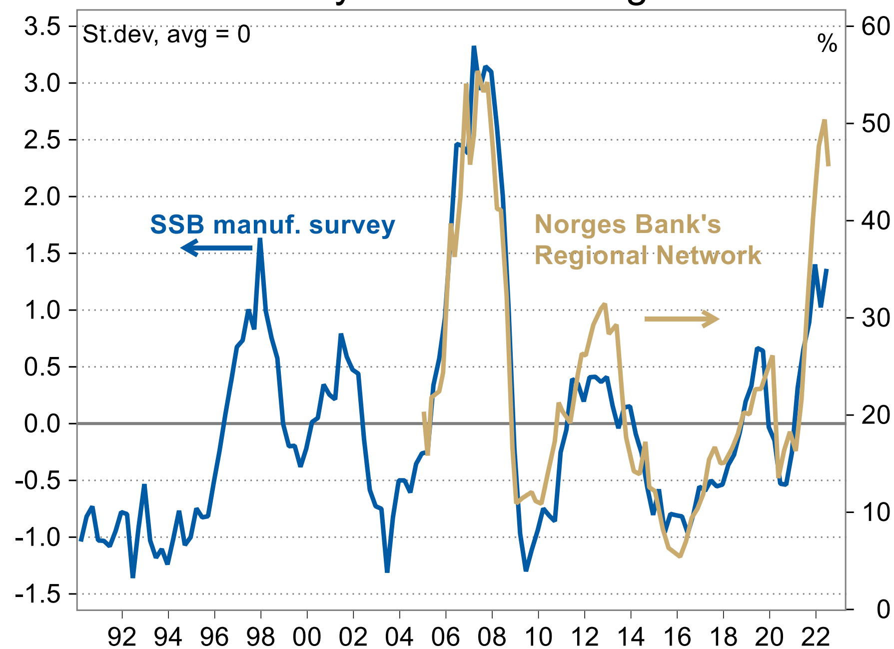
... but both are still sky high

Norway Regional Network, capacity



SB1 Markets/Macrobond

Norway Labour shortages

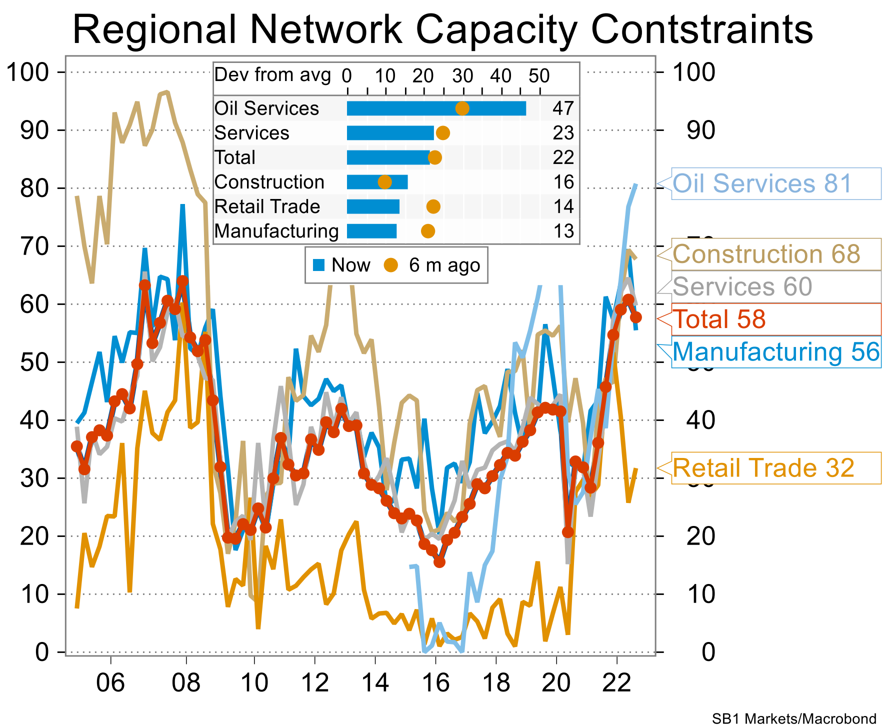


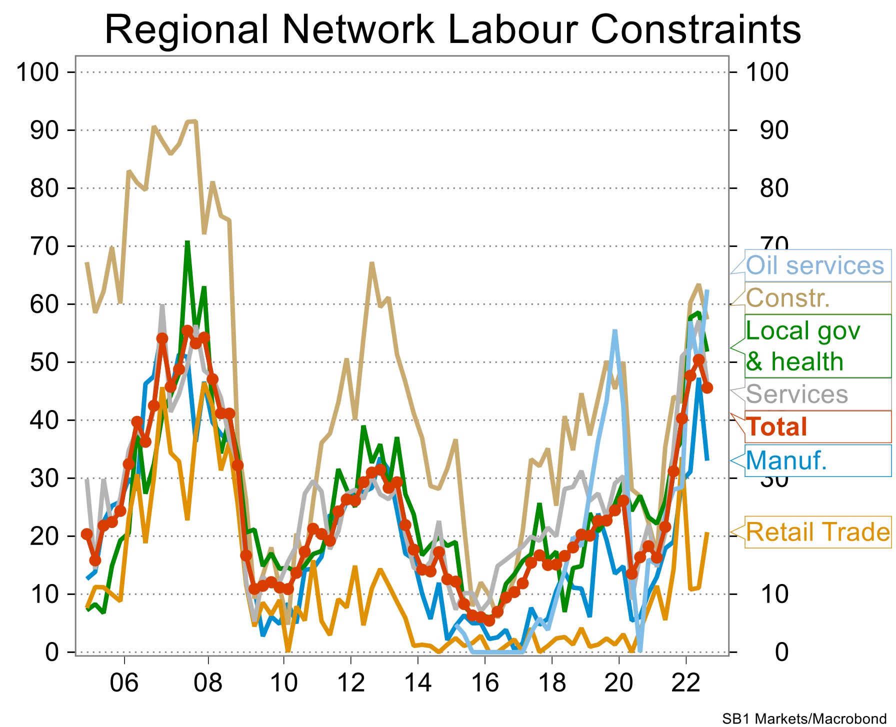
SB1 Markets/Macrobond

- Fewer companies are reporting **capacity constraints** following the steepest surge ever, but the level is still far above avg. 60% of the companies are reporting that they are operating at full capacity. The correlation to NoBa's assessment of the **output gap** is not 1:1 and the Network report does not suggest than the Bank's estimate will have to be revised up
- **Labour supply** shortages also fell in Q3, but the problem is still way above a normal level, and broad based. Given lower growth expectations the labour market should weaken... eventually
- **Wage expectations** are drifting slowly upwards, check two pages forward – but has not yet crossed the 4%-line

Only oil services report of higher capacity utilisation than 6 months ago

Still, all sectors report higher capacity utilisation than normal, even retail trade

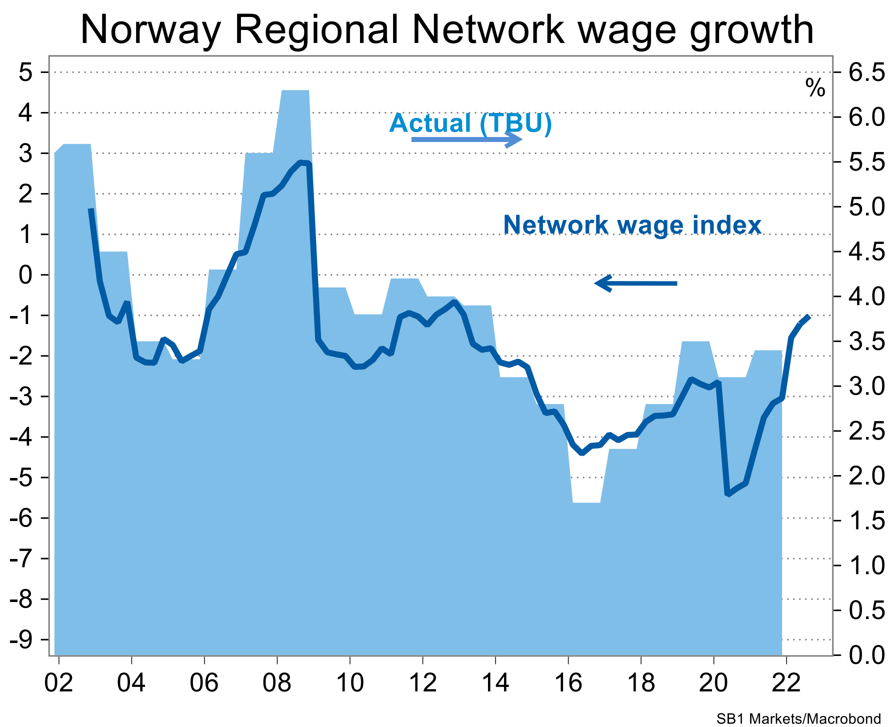


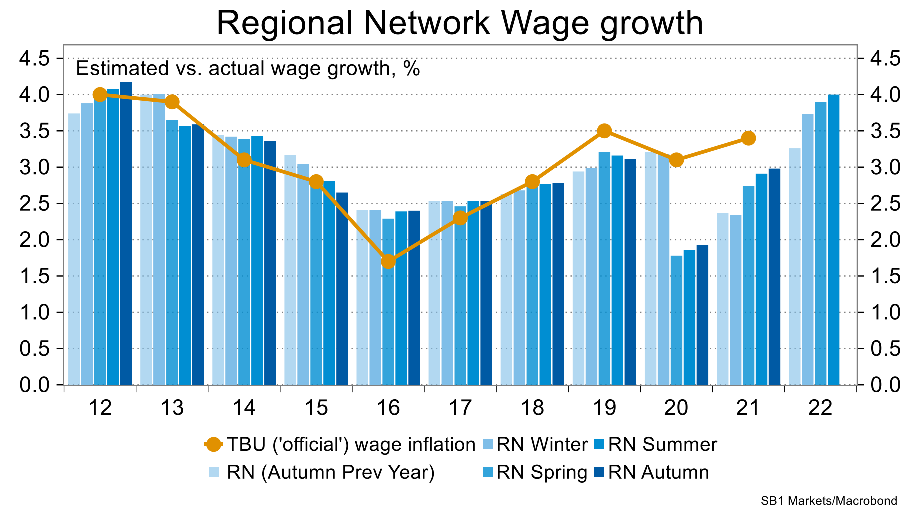


- Most sectors are reporting a decrease in labour shortages – except retail trade and oil services
- Lack of raw materials are still present, while other capacity problems have eased somewhat

The Network assumes 4% wage growth in 2022, up 0.1 pp from June

Wage expectations have been trending up, but not that fast. (No 2023 forecast yet)



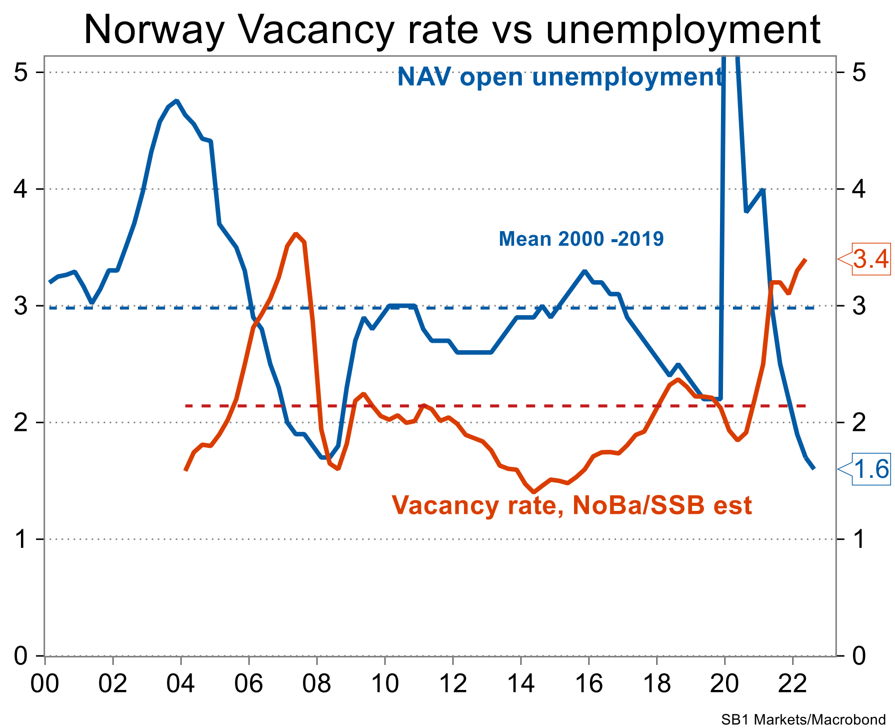


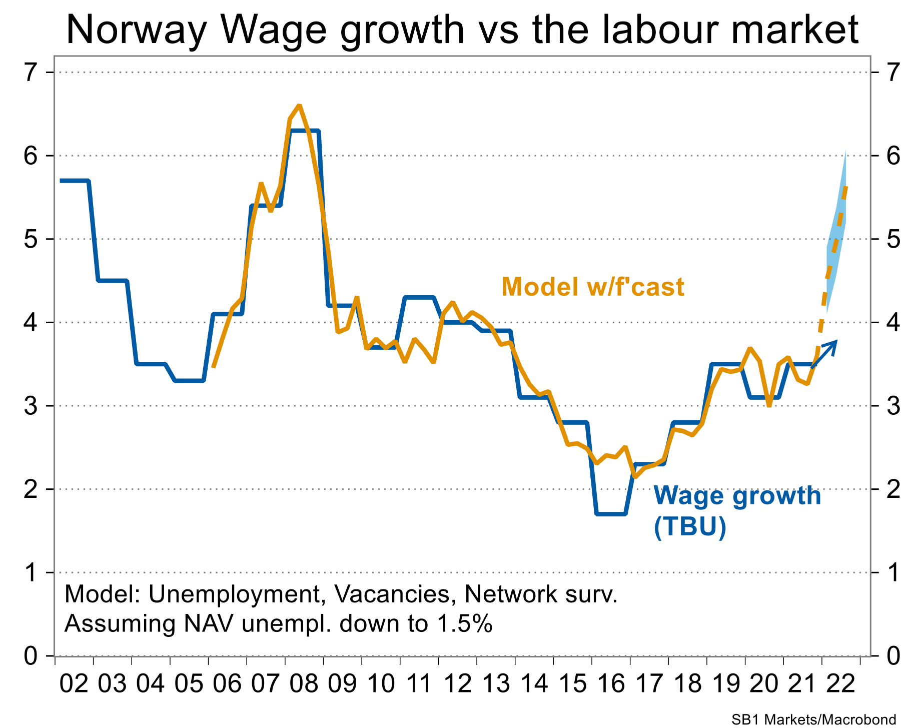
- **Wages growth in 2021** was 3.5% (all employees, and 3.4% in areas covered by wage negotiations) in 2021, well above the Network estimate last December
- **Wage growth in 2022** is expected at 4%, up from 3.9%
- **Norges Bank** assumed 3.9% wage growth in 2022 in its June MPR. NoBa may chose to keep its forecast unchanged – but may lift it 0.1 (SSB estimated 3.8% in its last report)
- **Wage inflation** has been kept better in check than we feared

SpareBank 1 MARKETS

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

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

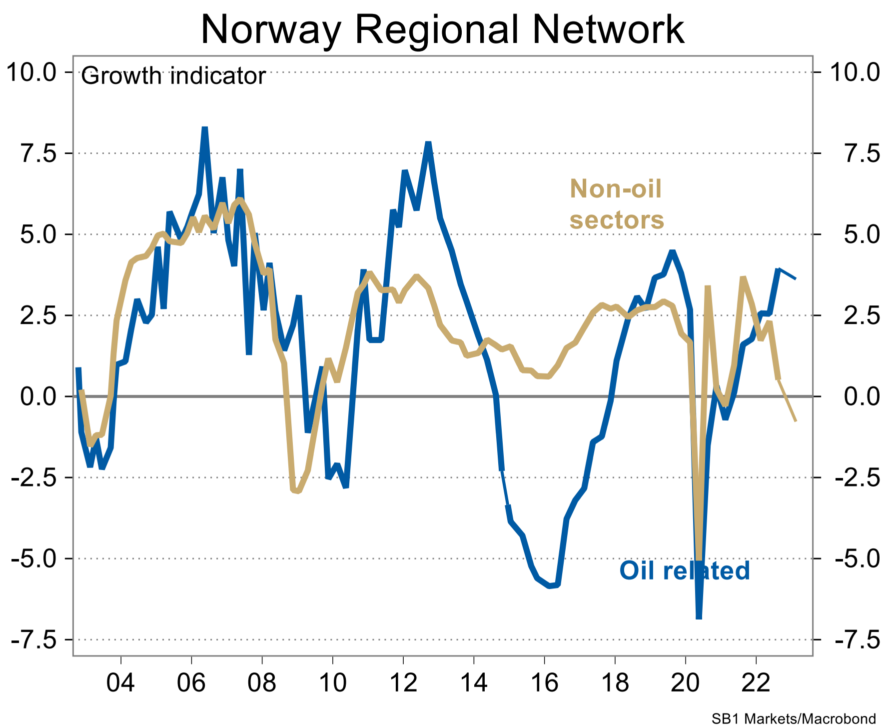


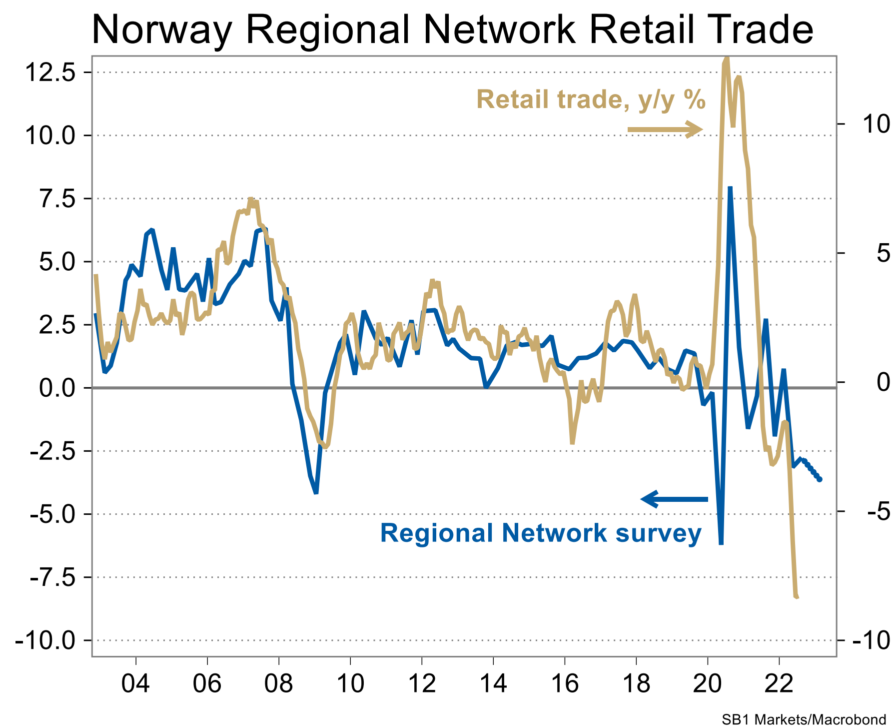


- Actual wage inflation may easily accelerate to 4% through 2022 – if the economy is not hit by a negative demand shock

Oil related businesses still growing rapidly, the others ¾% pace of decline

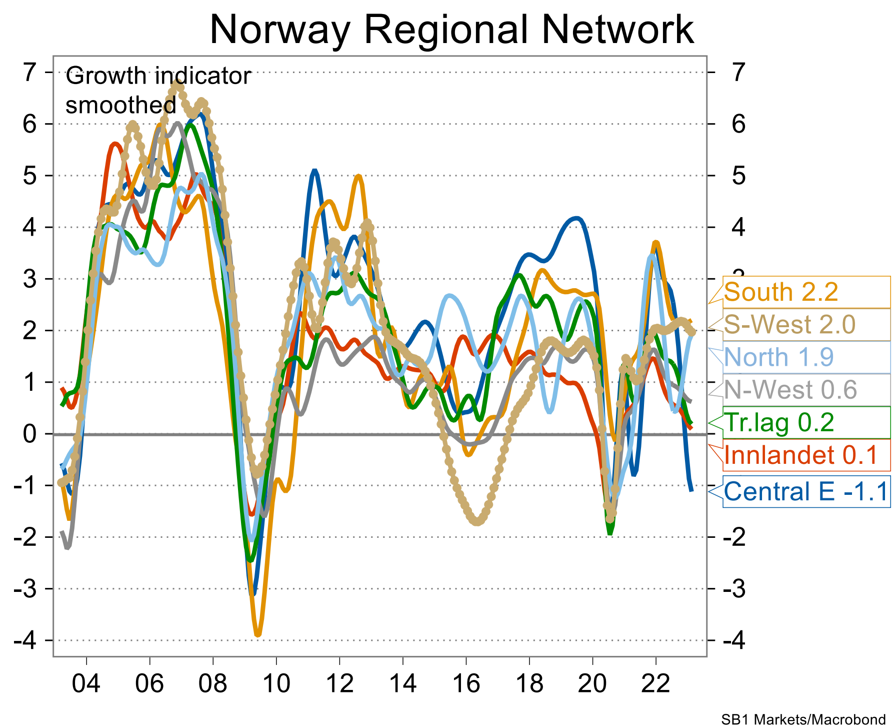
Retailers have for several quarters acknowledged the sales would come back to earth

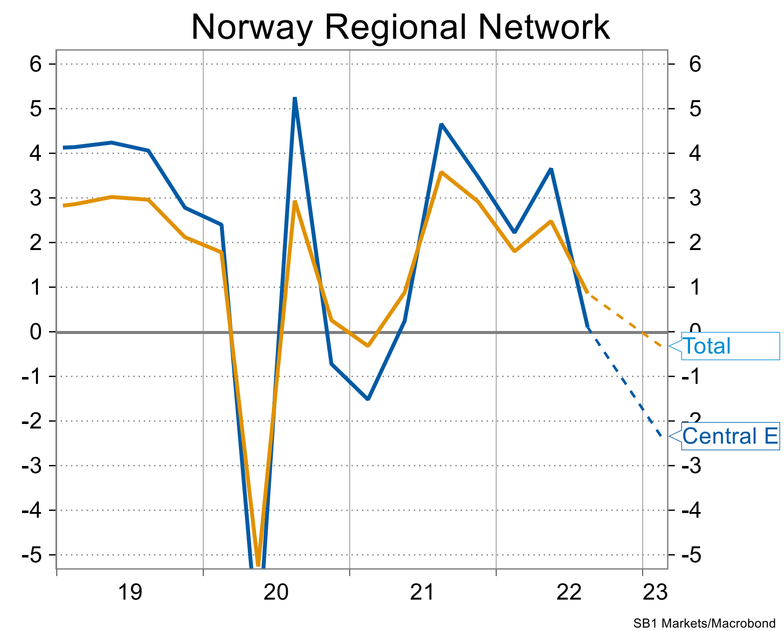


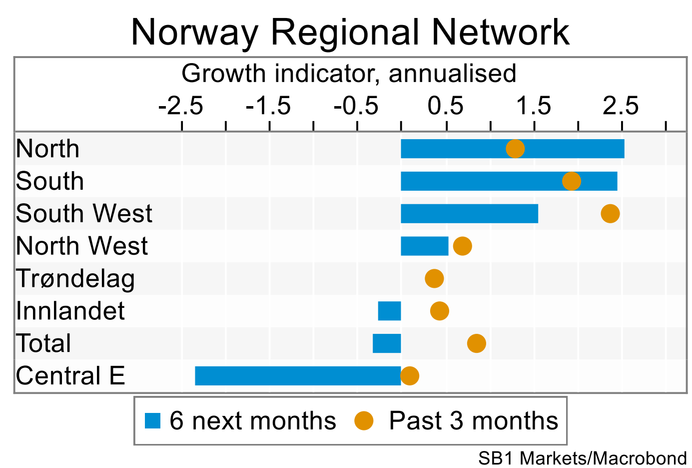


Regions: Central East report a significant downturn, while the Innland stagnates

Oil/gas & natural resources? Higher and strong growth in North and South. South West also OK





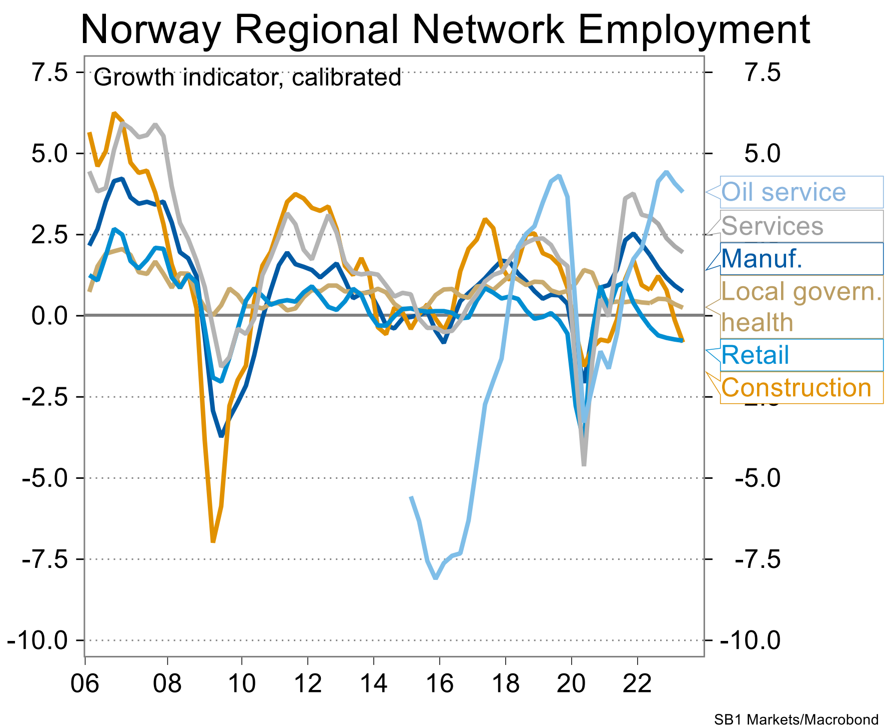


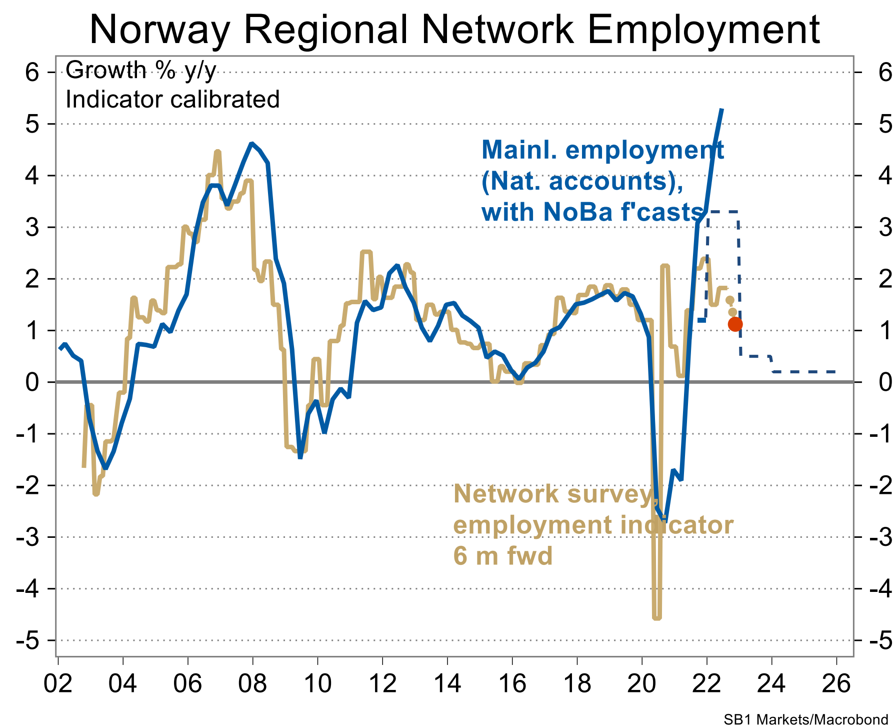
- **Central East** Starts in Oslo/Viken down recent months
- **Oil related industries** in South & South West support these regions now (more than high electricity prices hurt)
- The Northern region is ignited by **natural resource** optimism and (until some days ago), very low electricity prices?

SpareBank 1 MARKETS

The network expects lower, but still 1%, employment growth

Construction, retail trade on the downside. 1% growth is rather ambitious given population growth

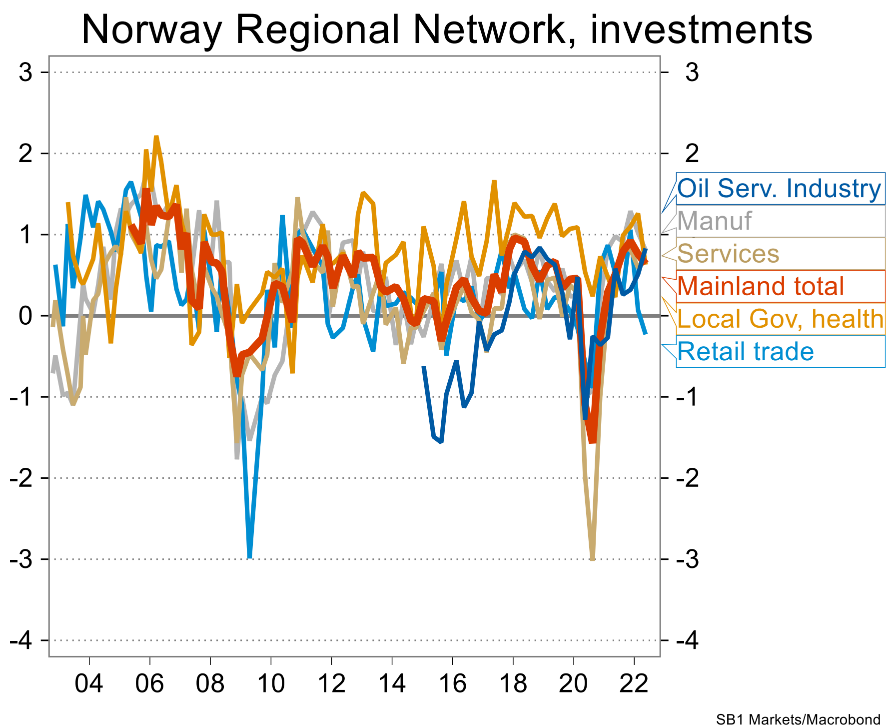


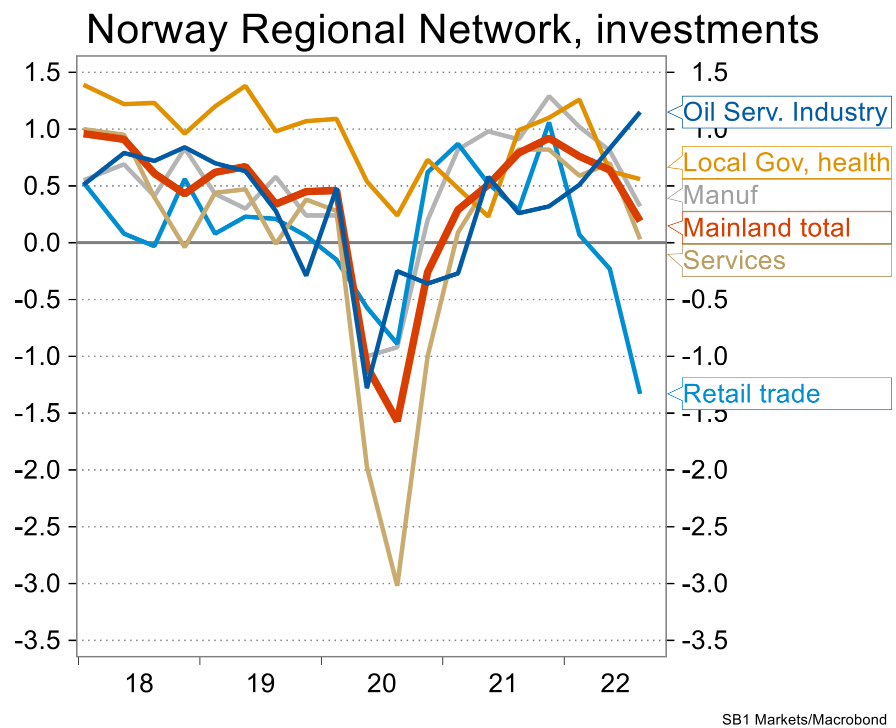


- Oil services are in the lead, as well as ordinary service industries
- The NoBa forecast on the chart to the right represents the bank's annual averages from the June MPR

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

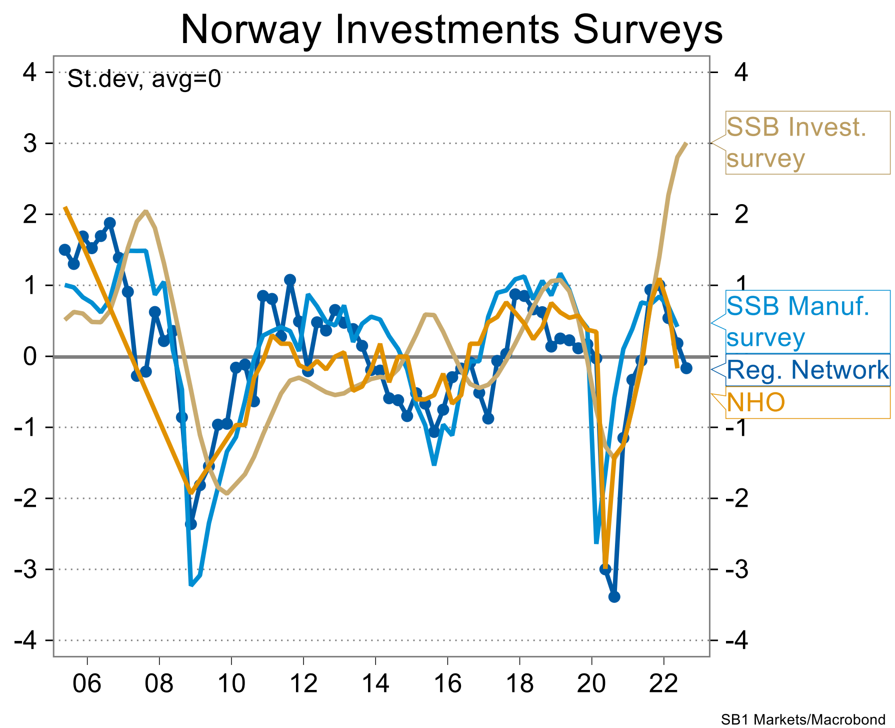
Retail trade will take a break, others not – even if growth ambitions are rather muted now

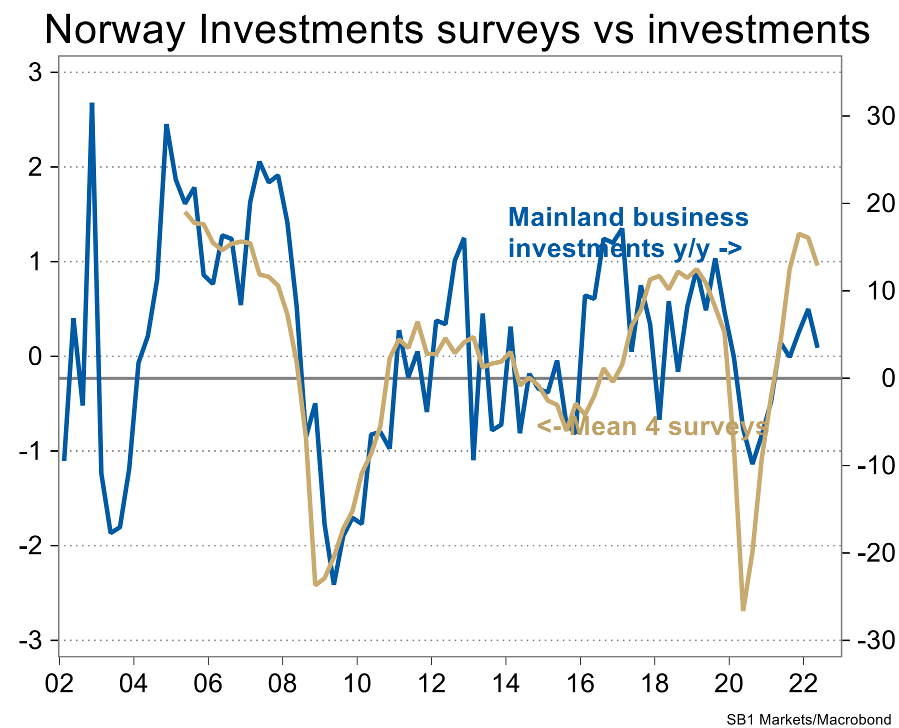




Other (and less updated) investment surveys mixed, in sum weaker

SSB's investment survey is still very upbeat, and normally the most worth listening to

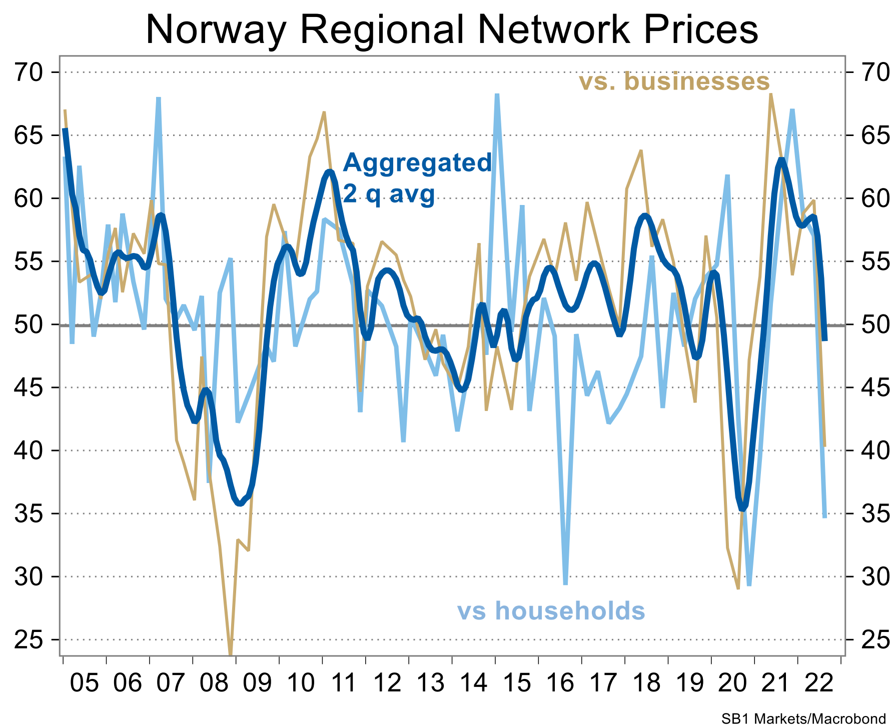


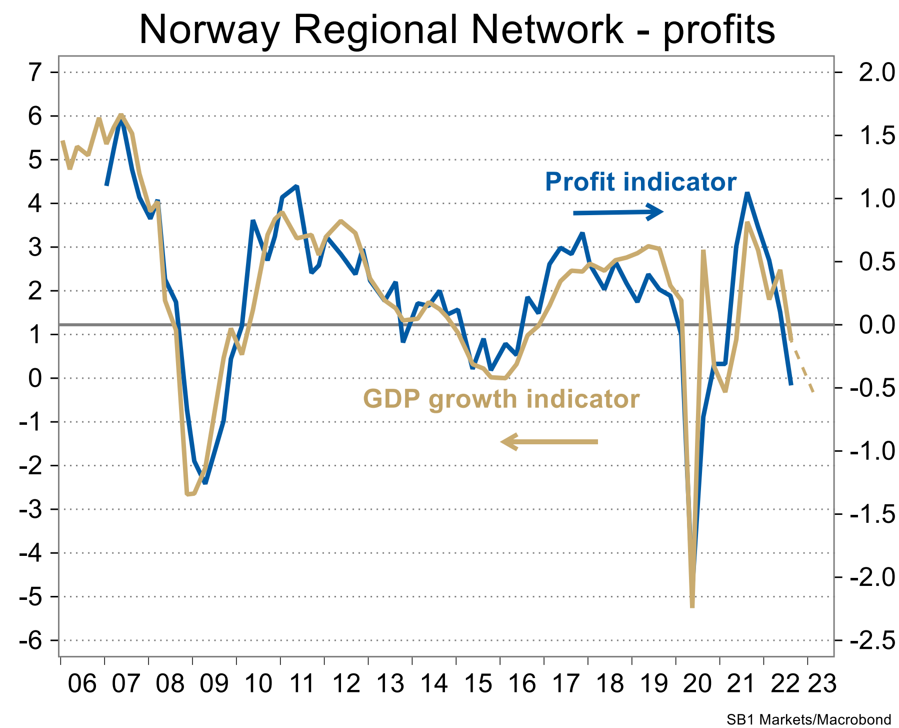


- Two surveys signal growth below average, while SSBs investment survey report very strong growth

The Network: From the most widespread price increases to almost the lowest

The most of the decline during the past two quarters. And as growth turns negative: A profit warning





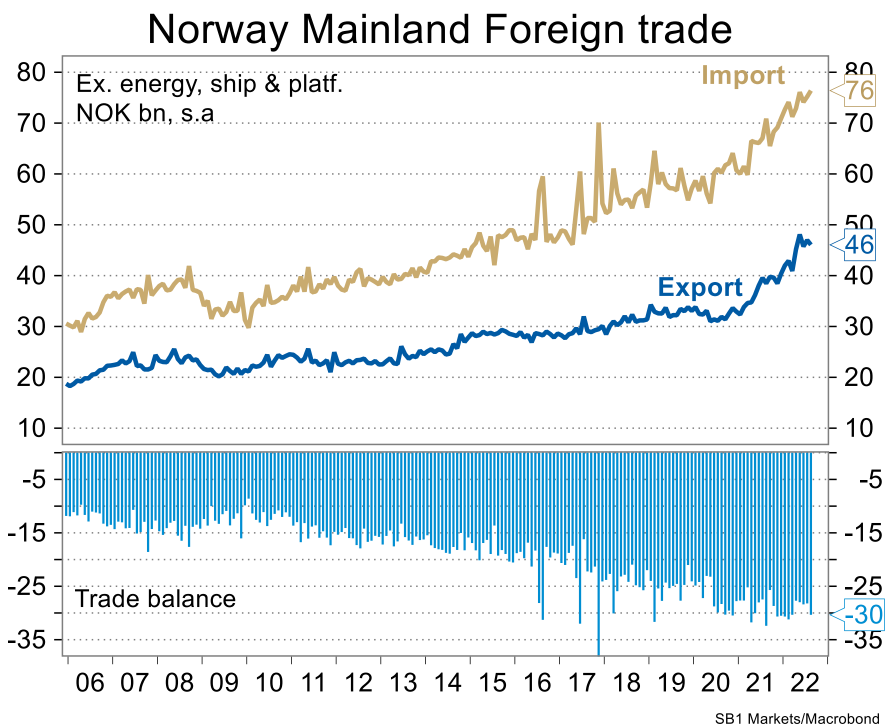
- However, the correlation vs. actual CPI (headline or core) not close to non-existing. Still, a positive signal vs. the inflation outlook

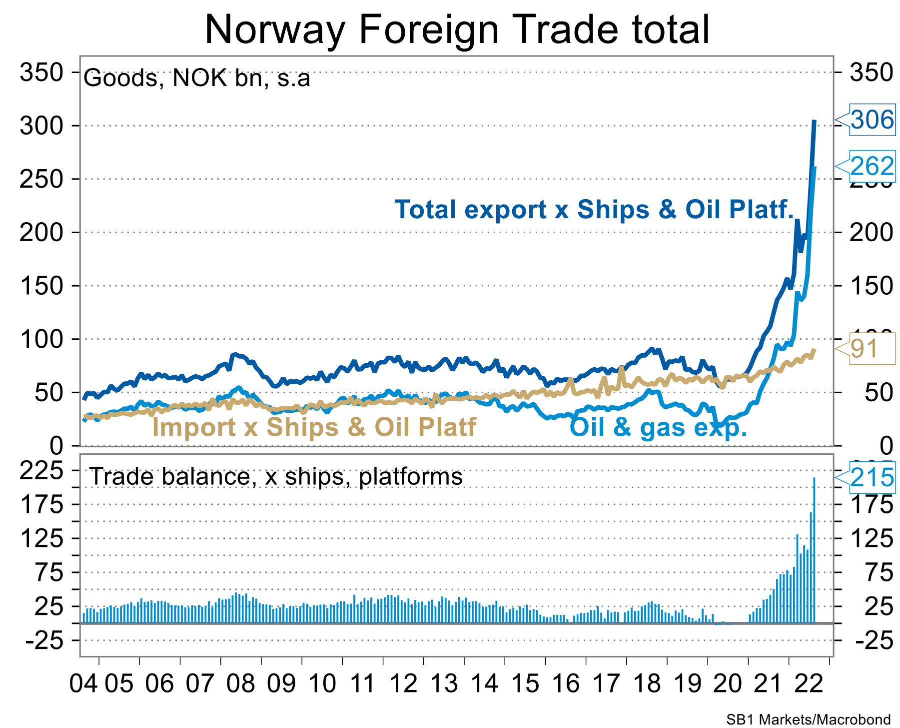
- Respondents expect profits to decline the coming months

SpareBank 1 MARKETS

Energy crisis sends trade balance to yet another ATH. Trade surplus at 75% of GDP

Mainland exports still strong – but gas exports through the roof and the main driver

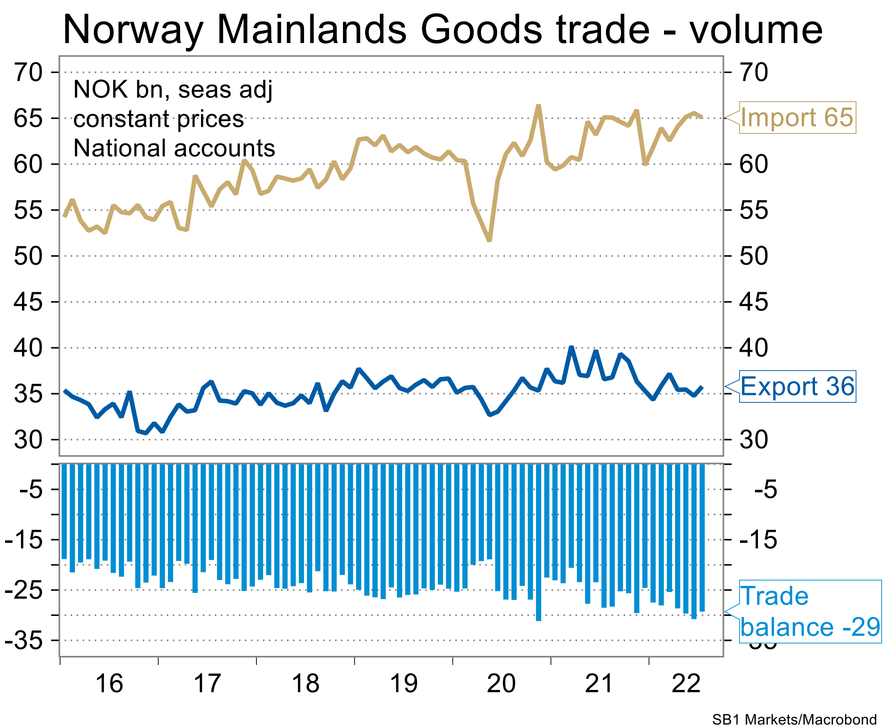




- The seasonally adjusted **overall trade surplus** in goods at NOK 215 bn is the highest ever, equalling some 75% of Mainland GDP!
- **Oil & natural gas exports** increased by 25% in Aug, after a 26% increase in July, due to higher gas prices. From Aug, production of LNG from Melkøya is again running at full capacity, adding to the already high volume produced (but LNG will still amount to less than 5% of total gas exports in '23). In September, gas prices have come down somewhat, but a lift in future prices towards early 2023 signal extreme trade surpluses the coming months too
- **The Mainland (non energy) trade deficit in goods** increased by 2 bn to NOK 30 bn, equalling 11% of Mainland GDP (however, most imports for oil investments are categorised as Mainland imports and sales from the Mainland to the oil sector (both op.ex and cap.ex) are not counted as exports – and the 'real' Mainland trade balance is far, far stronger)
- **Non-energy exports** fell marginally in Aug by some 900 mill, to NOK 46 bn. Mainland exports have been very strong during and after the pandemic, and the underlying growth rate over the past year is some 20%. Exports are up 50% since 2020, mostly due to higher prices but volumes are up as well. Fish, metals & chemicals are reporting strong growth. Measured in volume terms, non-energy exports are flat, though. (Check next page)
- **Imports** also rose by 1 bn to 75 bn, and at an 11% growth pace, in value terms, that is

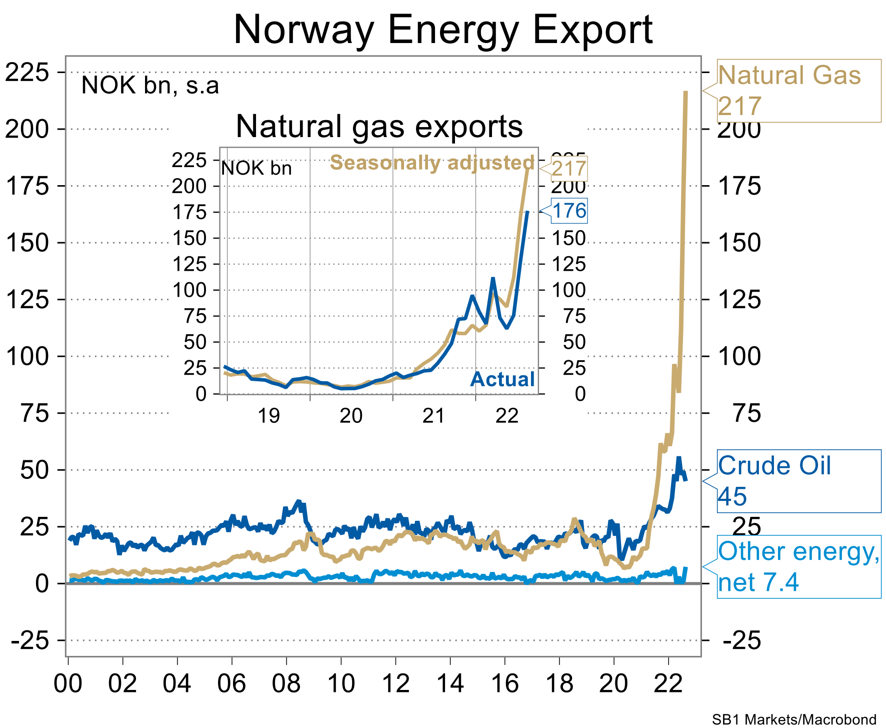
In volume terms, trade Mainland data are not that impressive

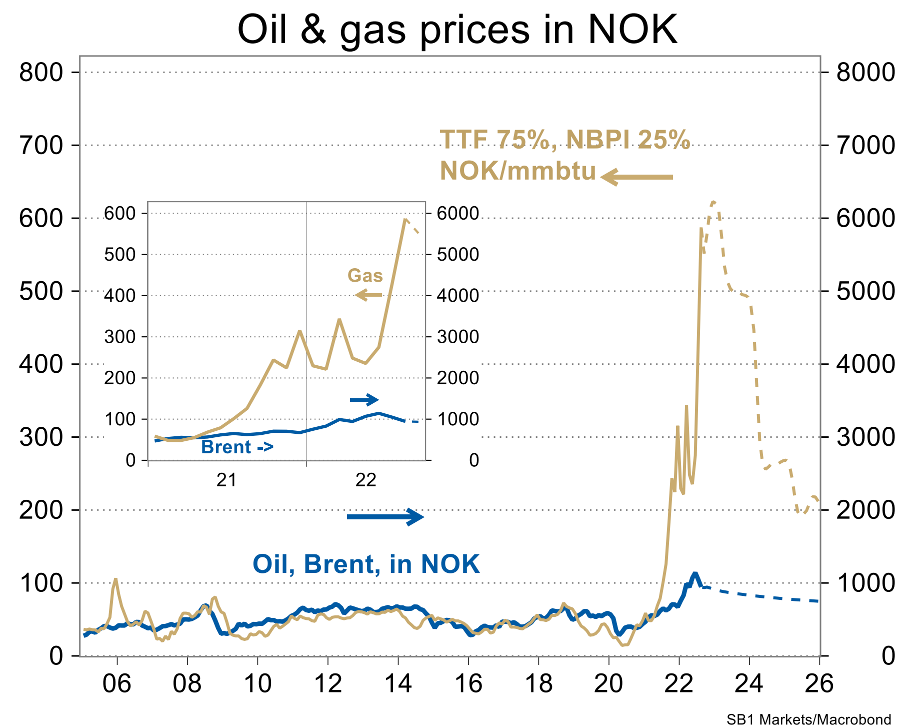
Both export and imports have more or less flattened



Gas exports through the roof due to high prices…

…but prices (and exports) are coming down

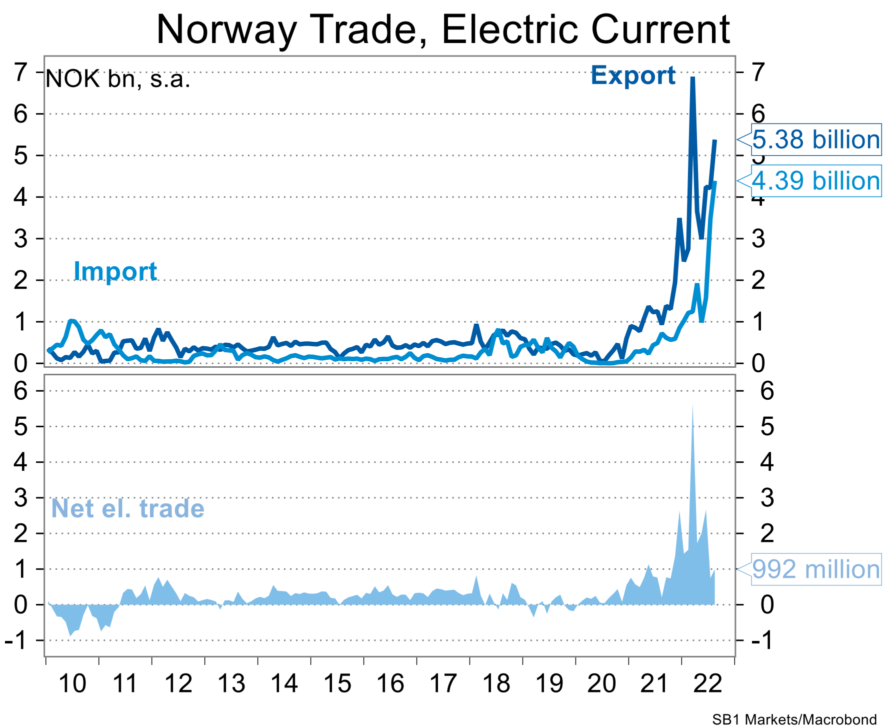




- **Gas prices** (75% TTF Netherland gas prices, 25% NBP UK prices) have shot up as Russian exports to Europe has been cut off. In Aug, prices rose by 37%, to ATH. Actual gas exports rose by 37.5% to NOK 176, after having increased 70% m/m in July. The seasonally adjusted figure was up 27% to NOK 217 (+53% in July). These seas. adj prices are rather uncertain as the seasonal patterns in both volumes and price may be influenced by the current European energy crisis
- **Crude oil exports** fell by 5 bn to NOK 45 bn, due to lower oil prices
- In sum, **petro exports** at 270 bn (seas adj), ATH by far. Most of it, around NOK 240 bn, will end up in the Government's coffers and thereafter transferred directly to the Oil fund – before being returned to the budget via the long term 3% (of the Fund's capital) spending rule
- **Other energy exports** rose in August, due to the surge in prices (imports rose almost just as much)

Norway *does* export a lot of electricity – but quite a bit is imported too

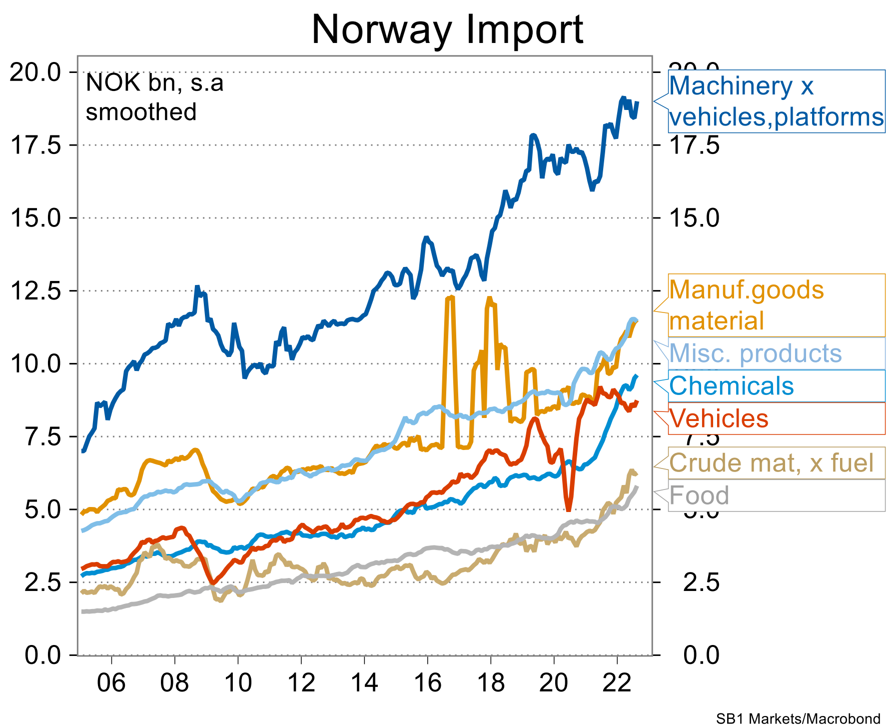
…and most of the increase in value is due to higher el. Prices

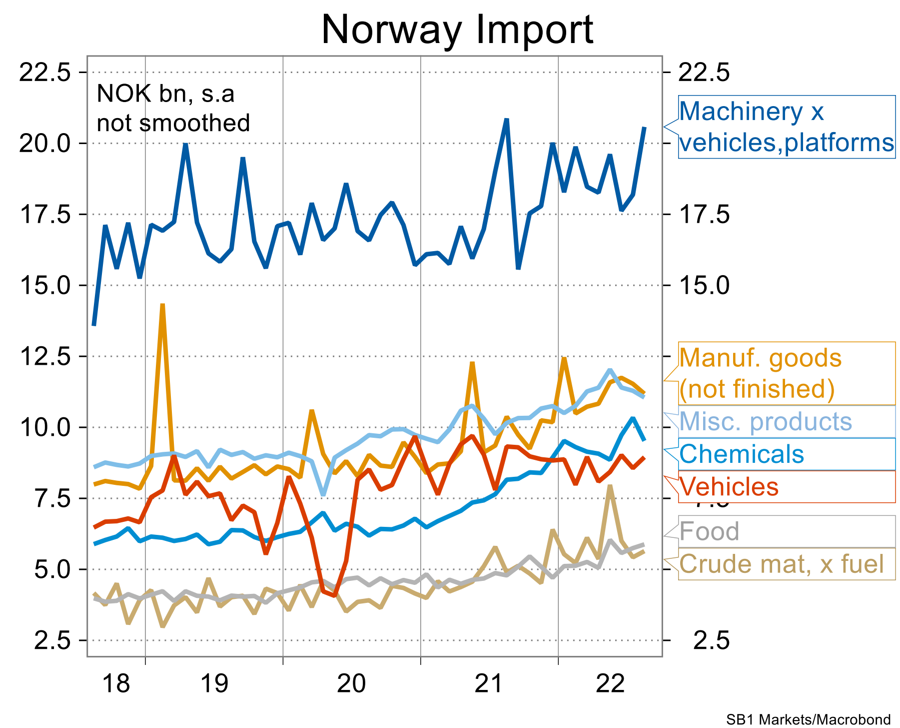


- In Aug, el. exports amounted to NOK 5.4 bn (seas. adj.) up from NOK 0.9 bn in Aug last year
- Imports equalled 4.4 bn, the highest ever

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

However, vehicle imports are finally yielding but probably mostly due to delivery problems

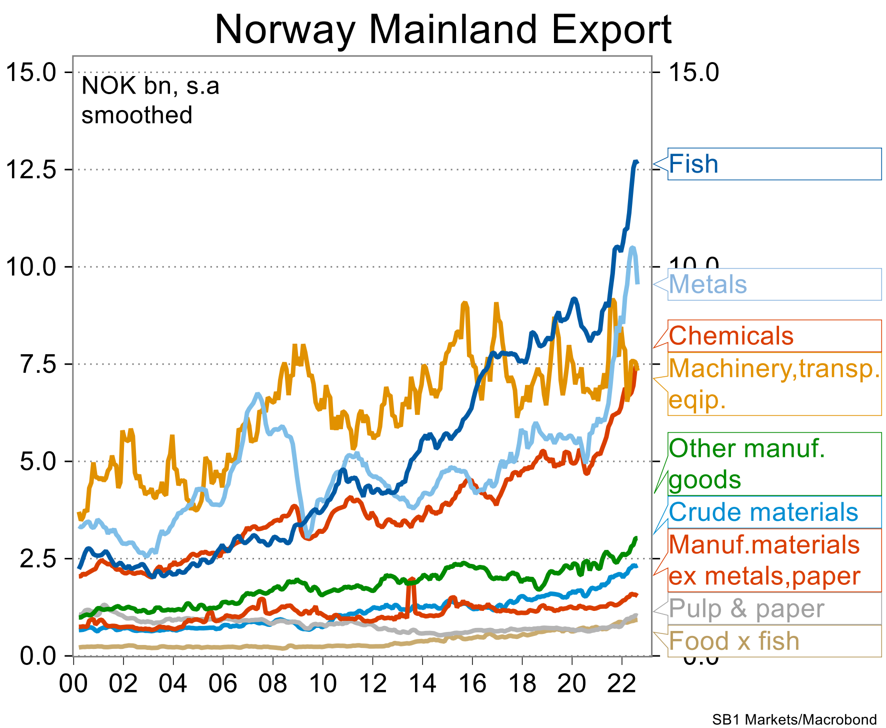


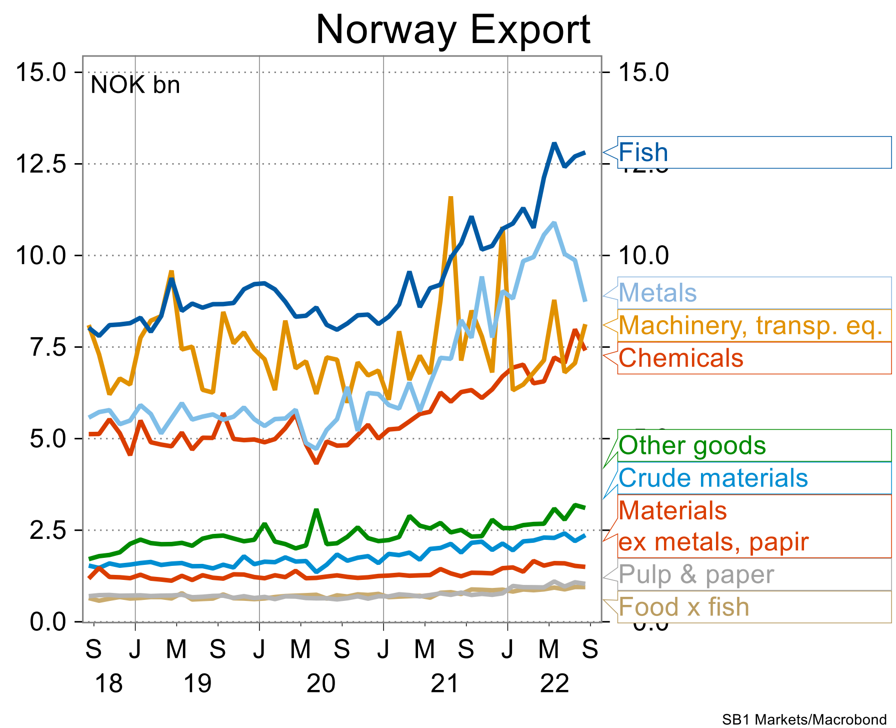


- The spikes in imports of manufactured goods are due to unfinished platforms or ships

Fish exports are surging, and chemicals exports are strong too

Metals exports were down in August, but are up 52% (s. a.) from last year



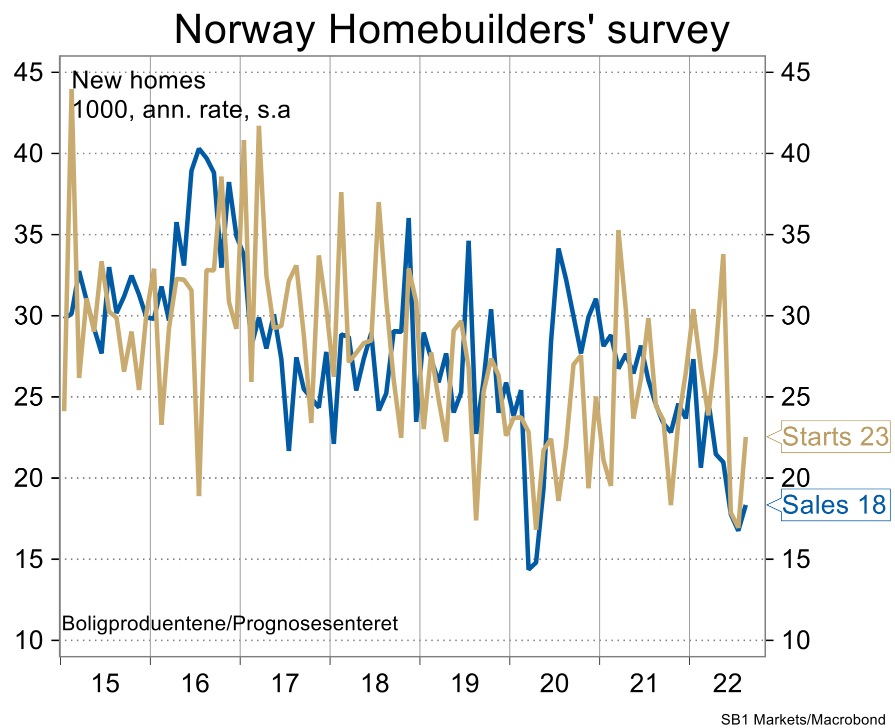


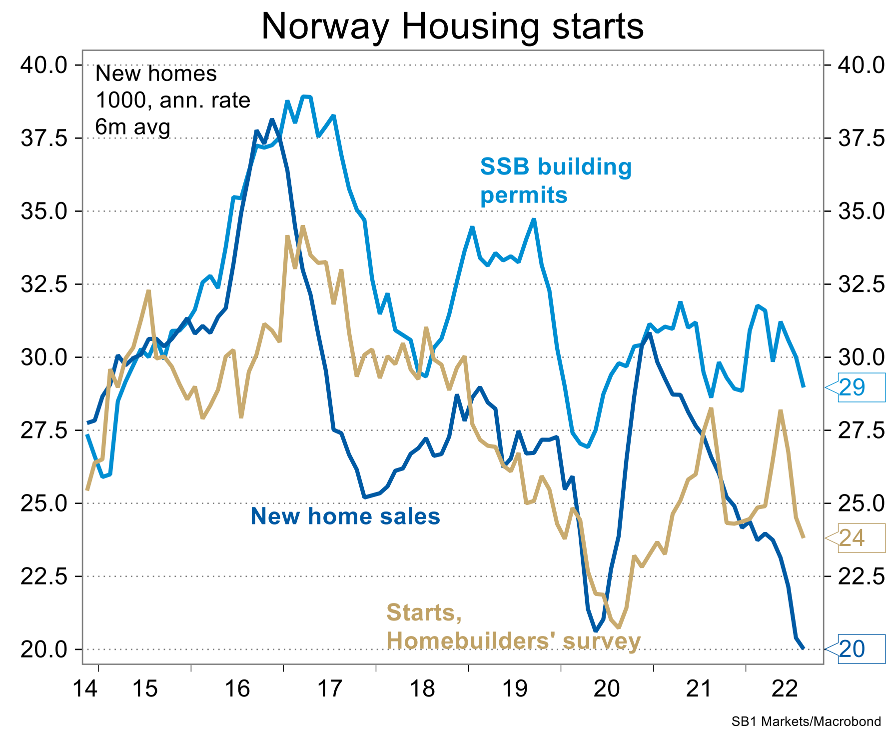
- Raw material prices will very likely come down from the precent high levels (many are on the way down already). At which point the value of commodity exports will come down as well

SpareBank 1 MARKETS

New home sales marginally up in August, but trending sharply down

… according to the homebuilders. SSB have so far reported far higher building permits

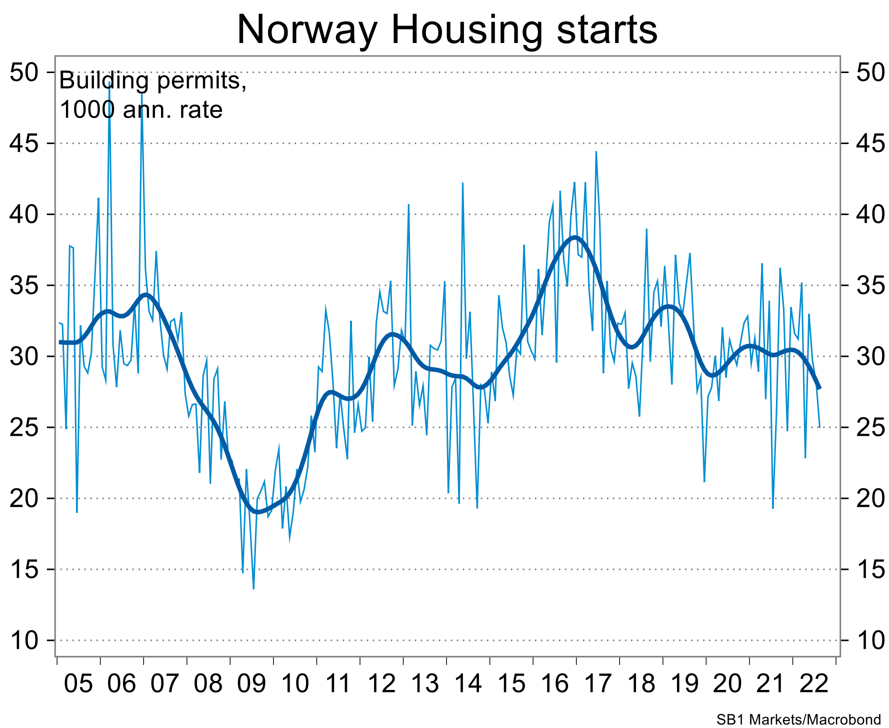




- Boligprodusentene (Home builders) 'always' report that building activity is declining and that it is too low. Now, they are right, August sales were on the weak side, at 18' annualised, just marginally up from the low level in June & July
- Starts increased to 23' in August from 18' – a very volatile data series. The average over the past 6 months is at 24', while SSBs building permits fell to 29' from 30'
- However, the rather steady decline in sales may signal downturn in new starts the coming months. The sharp lift in construction costs and higher mortgage rates may be reasonable explanations

SSB: Housing permits down in August – is the trend turning down?

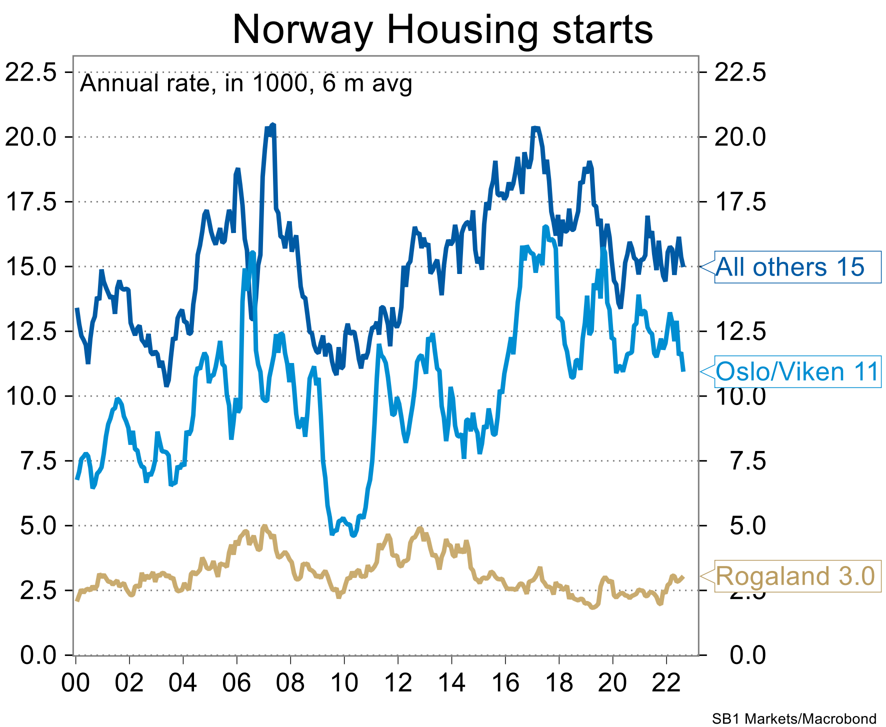
Permits down to 29’ from 31’

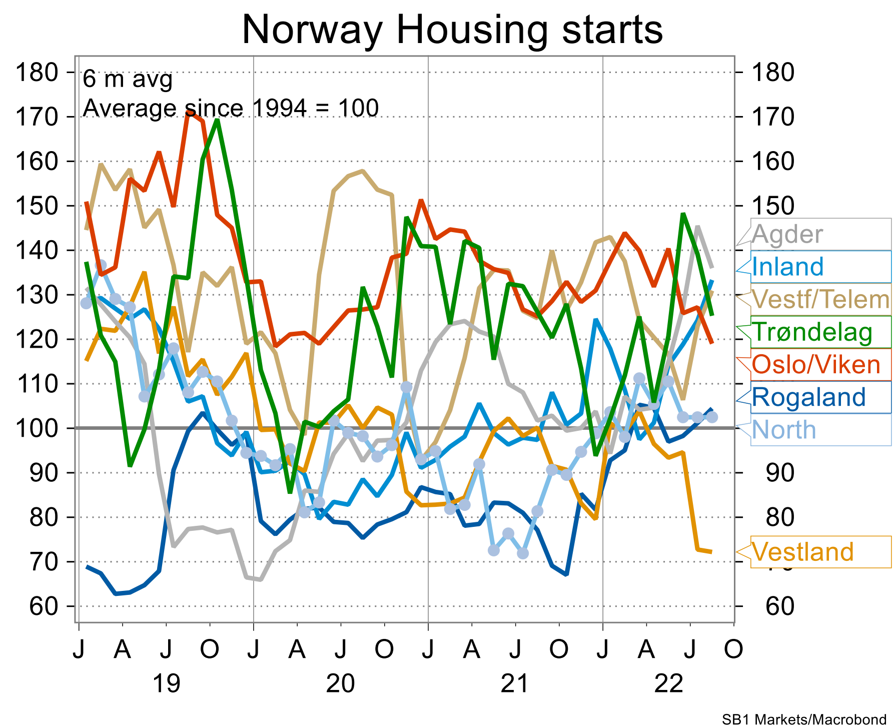


- The average no. of permits the past 6 months is at 29’ (annualised), while Homebuilders (Boligprodusentene) report a 24’ pace
- Student homes, and assisted-living/nursing homes are not included in data from the Homebuilders. Some larger players do not report their activity either

Starts in Oslo/Viken down recent months, the rest of the country close to flat

In sum, that is: Agder and Innlandet at high levels, together with Vestfold & Telemark, Trøndelag



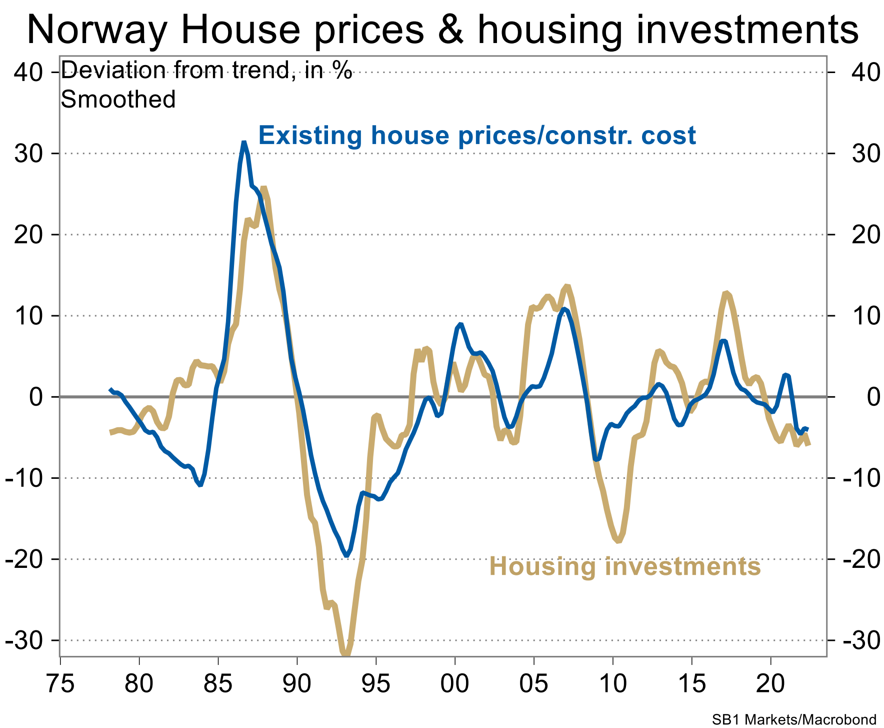


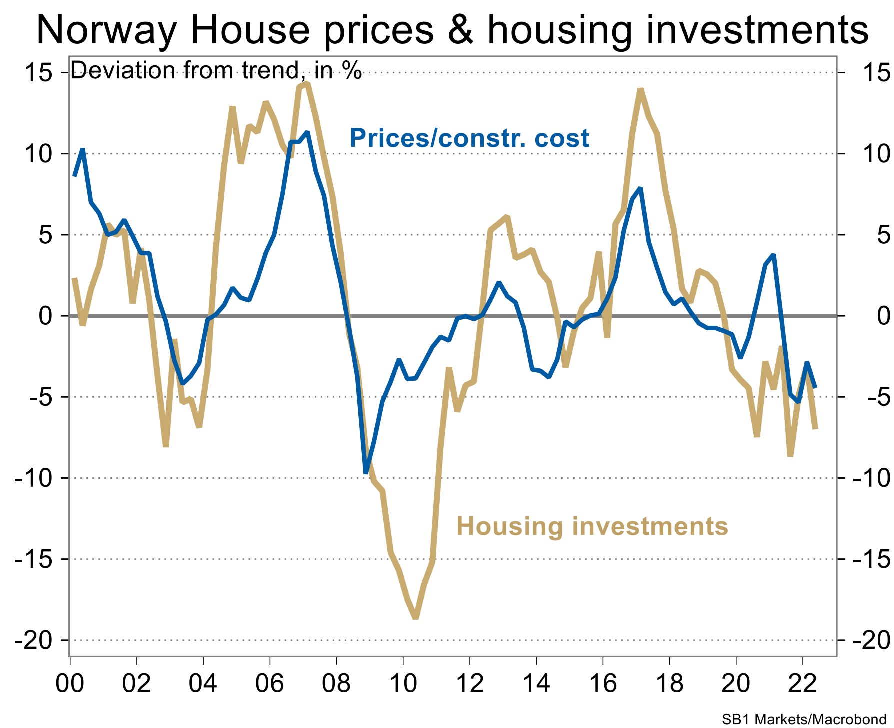
- Almost all regions (barring Vestland) are reporting more starts than past 25 y avg. (measured over the past 6 m average)

SpareBank 1 MARKETS

Housing starts/investments normally in tandem with house prices, no surprise

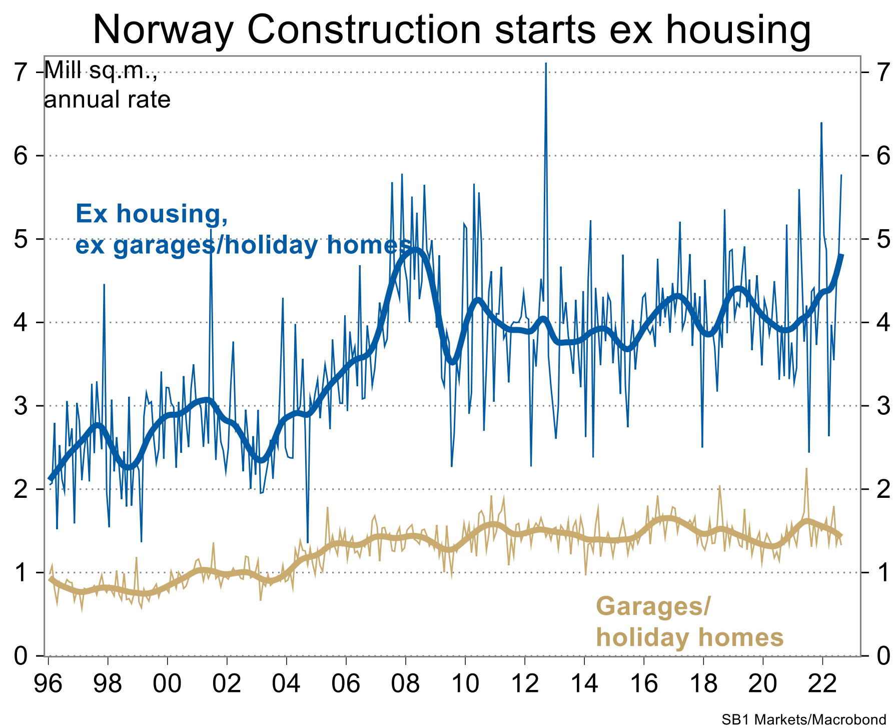
Prices have strengthened recent months – but higher building costs are weighting on starts

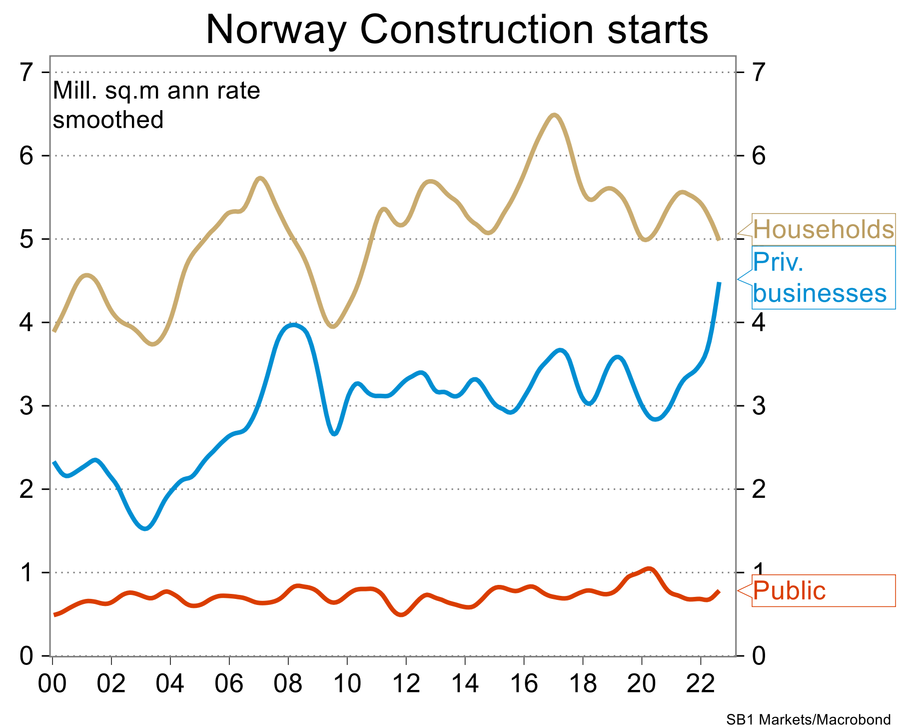




Non-residential construction very strong

Both the private and the public sector are starting up more projects, the private sector level is high

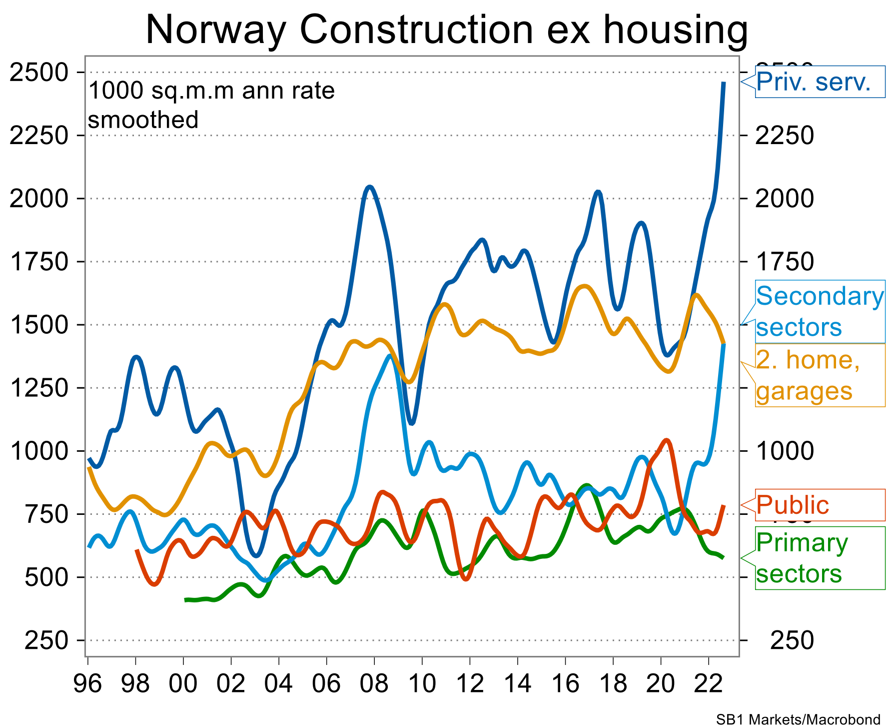


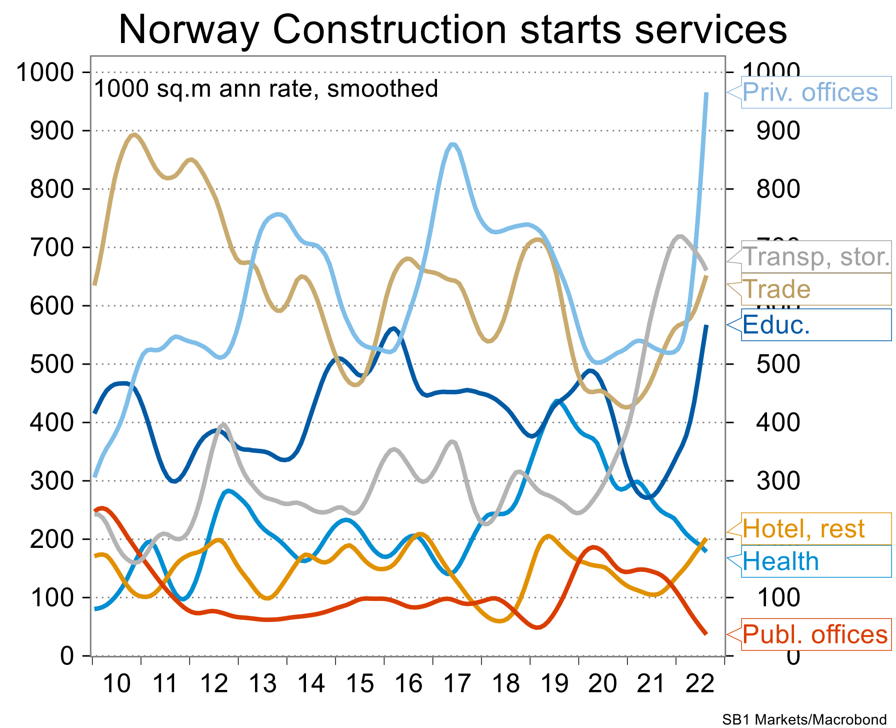


- **Construction starts ex housing & garages/cabins** are very volatile, short term, influenced by single projects
  - » **Private non-residential starts** climbed and are trending upwards, and the level is the highest ever
  - » **Public sector construction starts** have recovered recently, following a decline in 2021
  - » **Construction starts of cabins/garages** climbed 30% – 40% from early 2020 until late 2021– but are now trending slowly down

Both private services and manufacturers are building like crazy

Both well above their pre-financial crisis peak levels



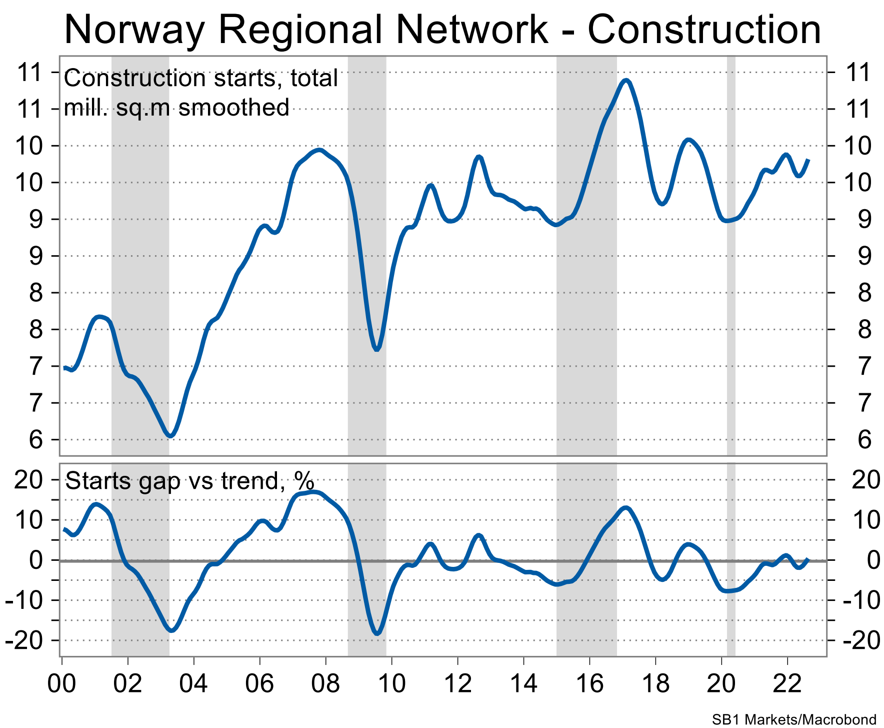


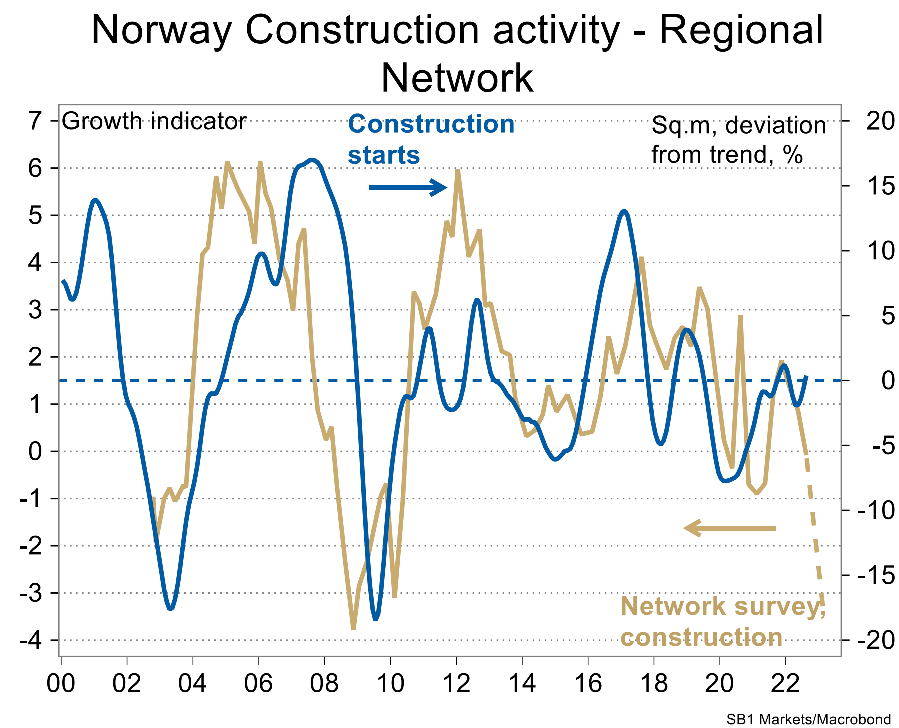
- Secondary sectors (read: manufacturing) sharply up, to the best level ever, at least with data back to 1996
- Starts in private services are very strong led by private offices and transport & storage but also construction starts in trade. Hotels/restaurant are trending up too
- Starts of public offices have fallen sharply but starts the education sector have recovered in 2022

Public on the chart to the left, and at the previous page: Construction starts in public administration, education and health

The Q3 NoBa Regional Network signals a hard landing in the construction sector

… while total construction starts just have flattened, so far.

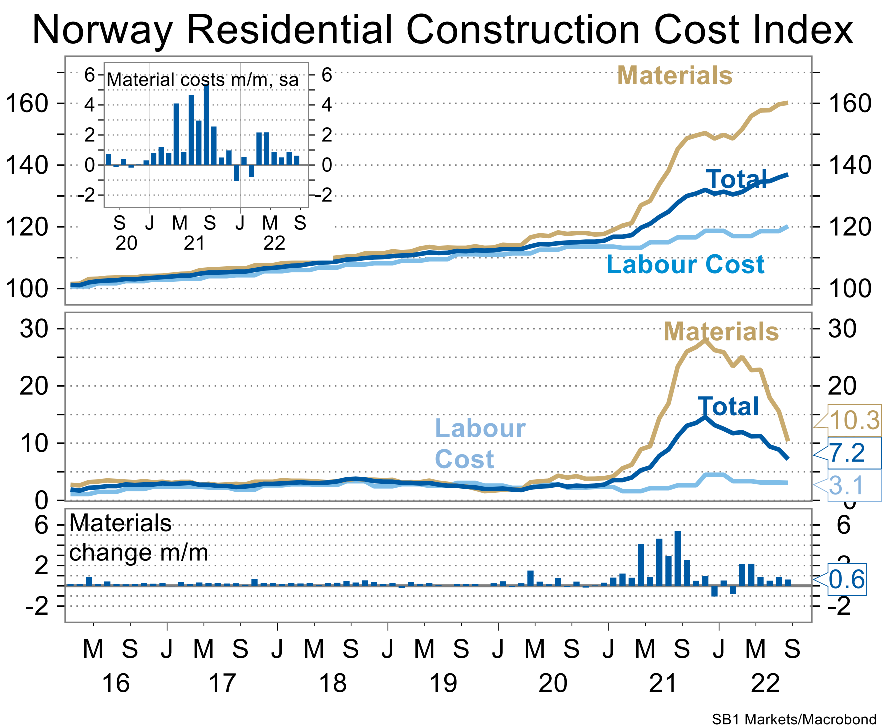


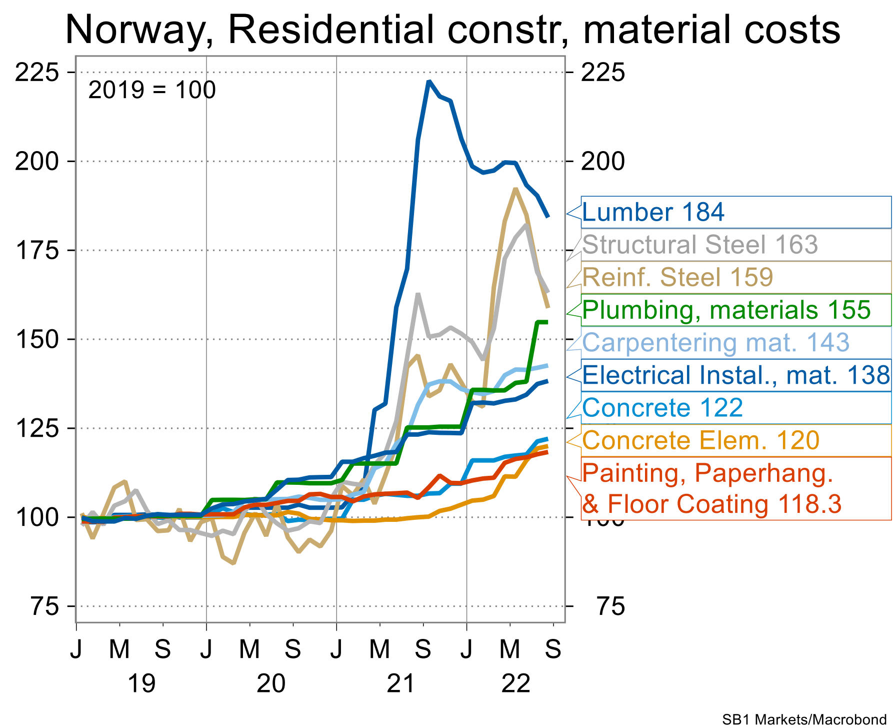


- Companies in the sector now report the sharpest contraction since the Financial Crisis. Back then, starts fell almost 30%
- The ‘long term’ trend in total starts is down since early 2017

Building costs: A further lift in material prices in July too – but lumber, steel down

Other groups were mostly up but y/y growth in material prices are down. Wage inflat. stable at 3.1%

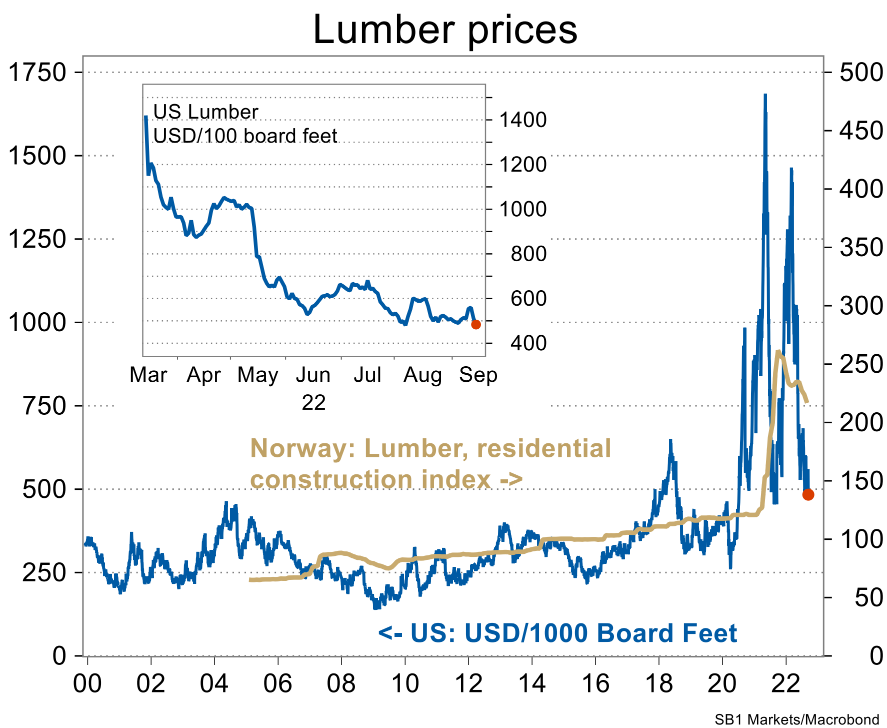




- **Material prices** (houses and apartments) added 0.6% in August, from 0.5% in July. Prices are up 10.9% y/y, down from 28% at the peak last year. Prices are up 34% since before the take-off in early 2021
  - » Lumber prices are trending down, and reports signal further declines the coming months. Steel prices fell in further in July, and given the recent setback in prices on the metal exchanges, end-user prices will very likely be cut further
  - » However, other material prices are still trending up; both concrete (higher energy cost in production?), electrical equipment, painting and others
- **Labour costs** were up just 3.1% y/y in Q3, as in Q2. There are no signs of accelerating wage growth. Given the expected slowdown in the sector, the risk for labour cost inflation now is very limited
- Including labour costs, the **total building** cost index is up by 7.2%, down from the ATH at 14.6% at the peak last Oct. Going forward, we still think lower material costs will bring total construction costs down to more normal levels. At one stage, most material prices will return to start?

US lumber prices (2’’x 4’’) almost back to a normal level

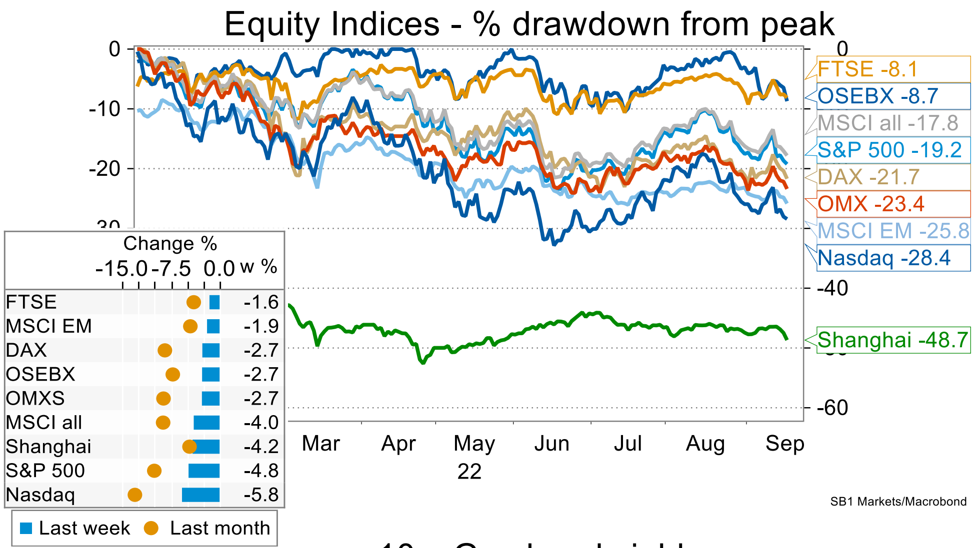
… and steel prices have fallen recent months! More to come in Norway too

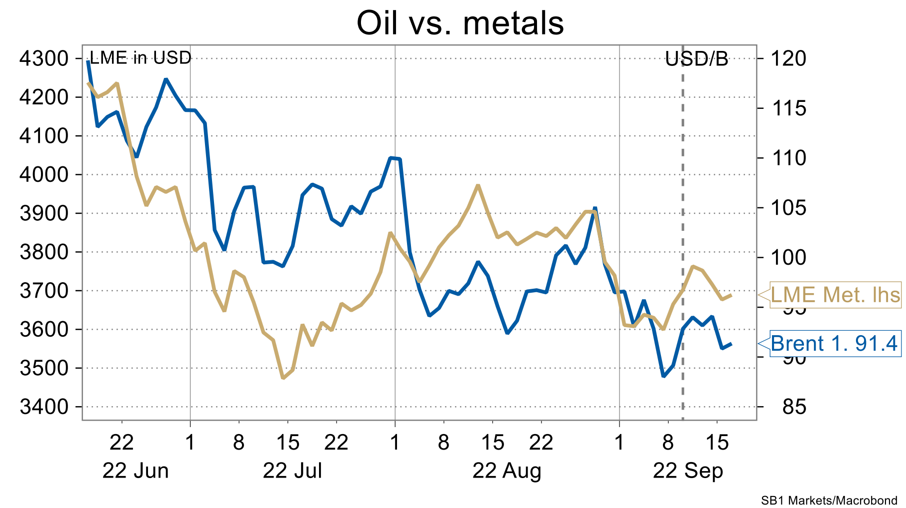


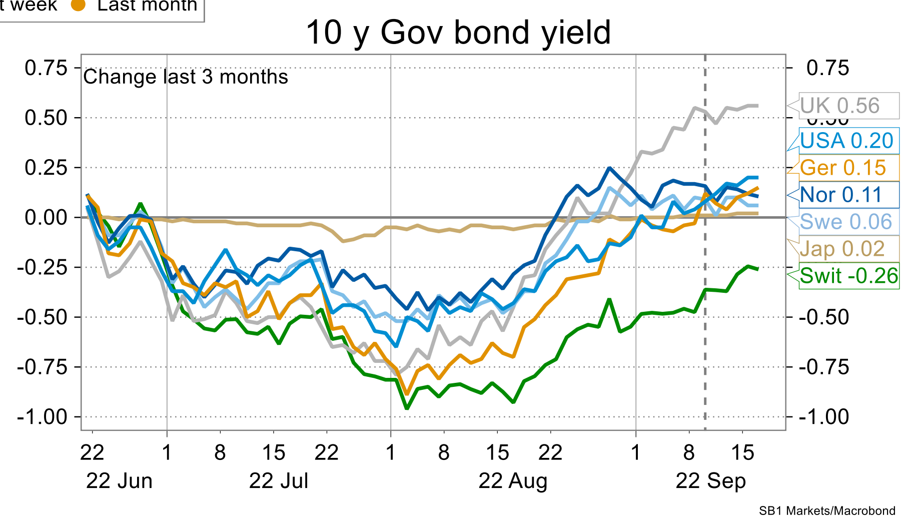
SpareBank 1 MARKETS

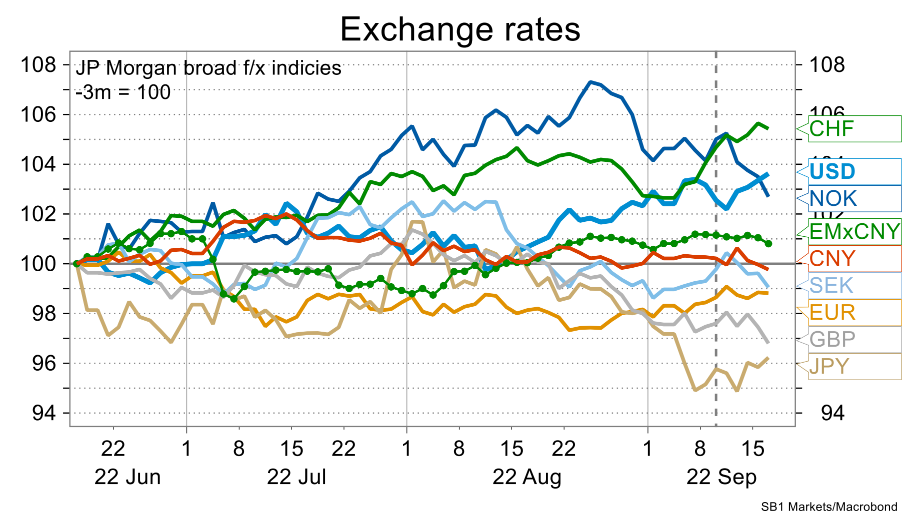
Another CPI shock, equities down, bond yields up. Metals, oil close to flat

The NOK tanked, once more





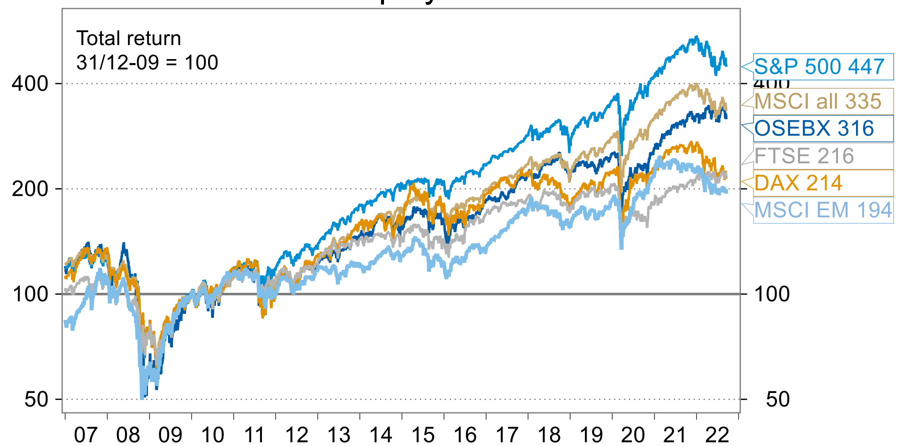




The big picture: Stock markets down, bond yields up

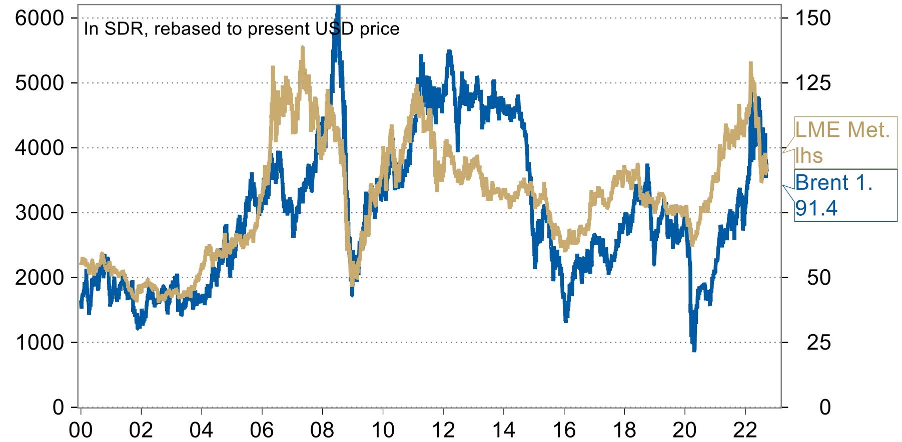
Commodities are on the way down again. The USD is very strong, most other DMs are slipping

Equity Indices



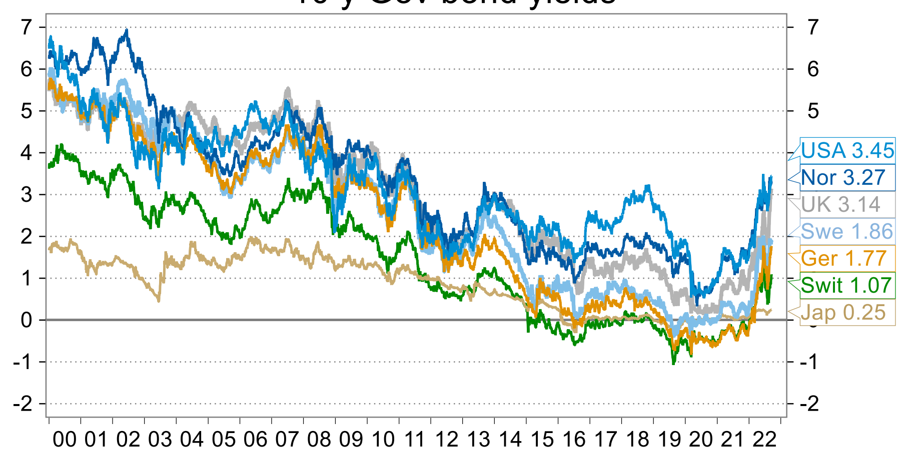
SB1 Markets/Macrobond

Oil vs. metals



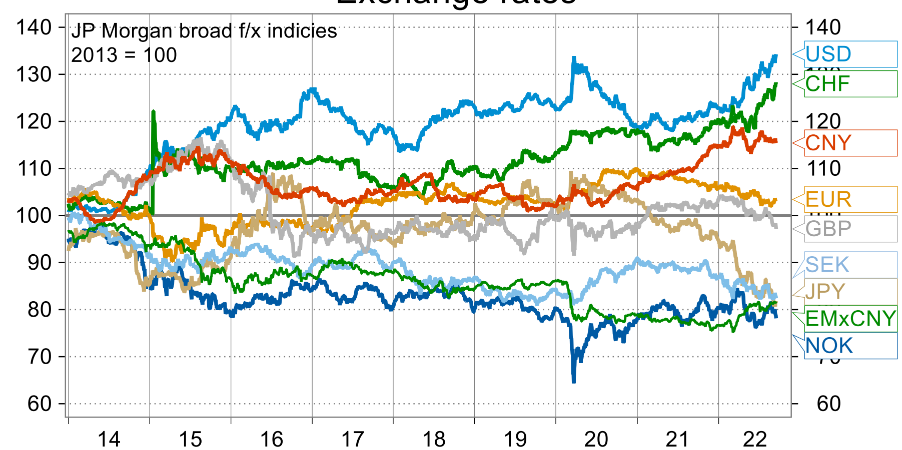
SB1 Markets/Macrobond

10 y Gov bond yields



SB1 Markets/Macrobond

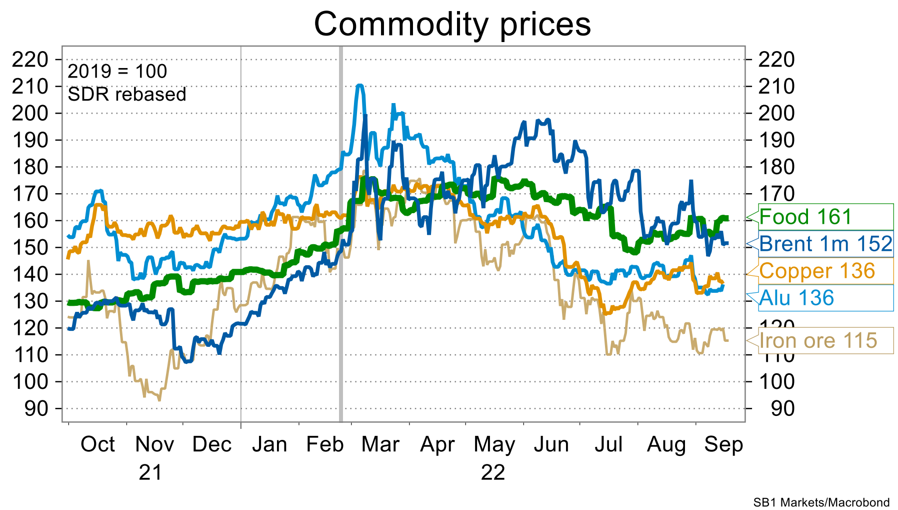
Exchange rates



SB1 Markets/Macrobond

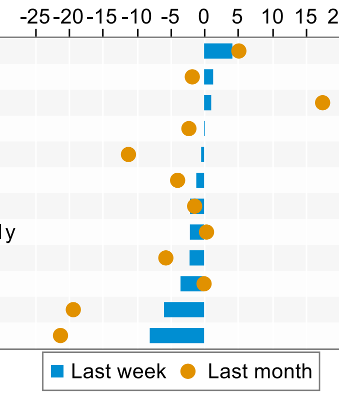
SpareBank 1 MARKETS

Food prices up, metals and oil flat, gas prices sharply down

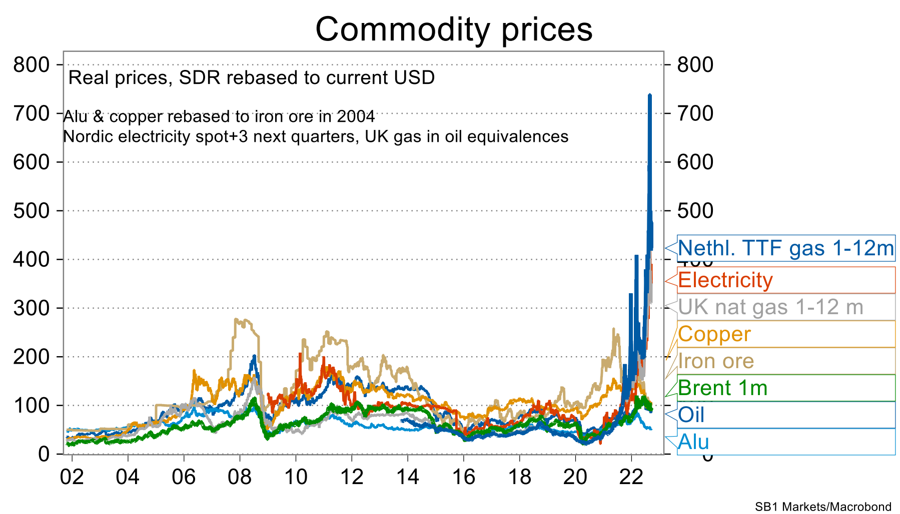


Commodity prices

In SDR % change	last w	last m	Since Feb 23
Food	4	5	3
Aluminum 3 m fwd	1	-2	-24
Wheat	1	18	18
LME Metals	0	-2	-17
US nat gas 1 - 12 m	0	-11	50
Brent 1m	-1	-4	2
Copper,3 m fwd	-2	-1	-15
NOK electricity spot-1y	-2	0	222
Brent 1-12 m	-2	-6	3
Iron Ore	-3	0	-23
Nethl. TTF gas 1-12m	-6	-19	104
UK nat gas 1-12 m	-8	-21	87



SB1 Markets/Macrobond



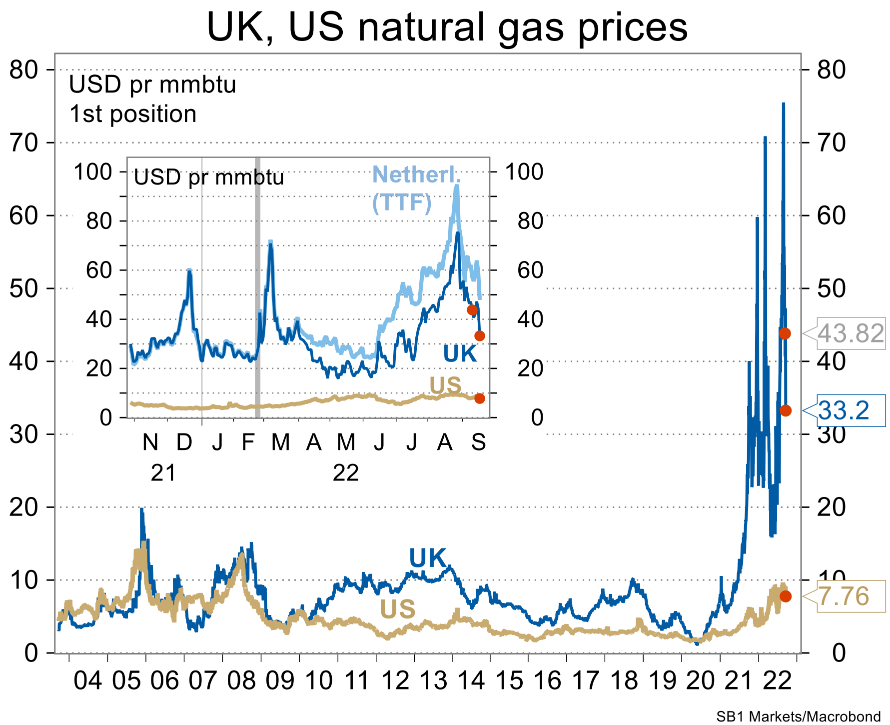
SDR: IMF's Special Drawing Rights – a 'global currency'

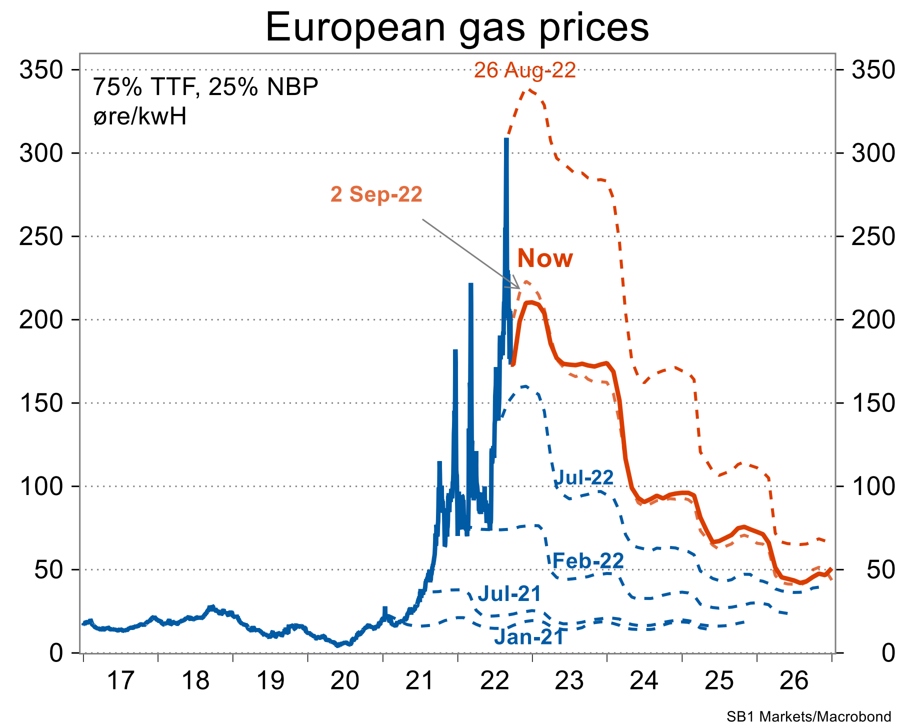
Last week

- **European natural gas** has been extremely volatile recent weeks and fell further last week, especially in the short end of the curve. Prices are down some 40% from the peak, but still just back to the same level as one month ago – a very high price level. EU has seemingly put aside energy price caps, but will impose tax windfall gains, by 30% – 100% in order to fund support programs for household and businesses
- **Oil prices** are trending downwards but not further last weeks
- The Economist's **food commodity rose 4% last week** (in SDRs), reversing the decline the previous week. The very short trend is up
- Most **metal prices** were more or less unchanged last week

Extreme volatility in the European gas market, 1st pos. sharply down last week

Longer dated contracts mixed - and not further down last week





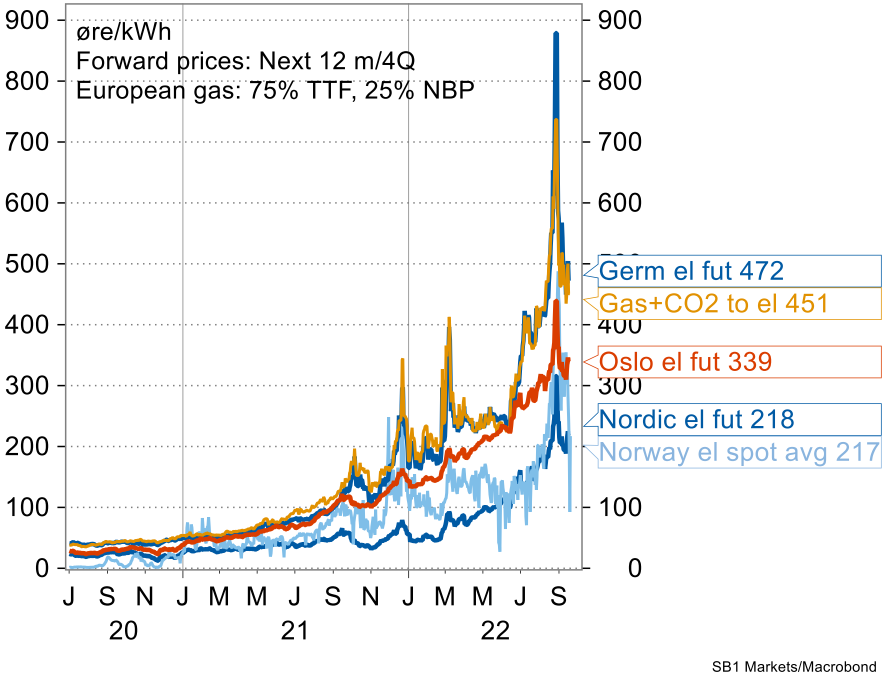
European gas: 75% Dutch TTF, 25% UK NBP, excl. CO2 cost. Red dots: Last and 1 week ago

SpareBank 1 MARKETS

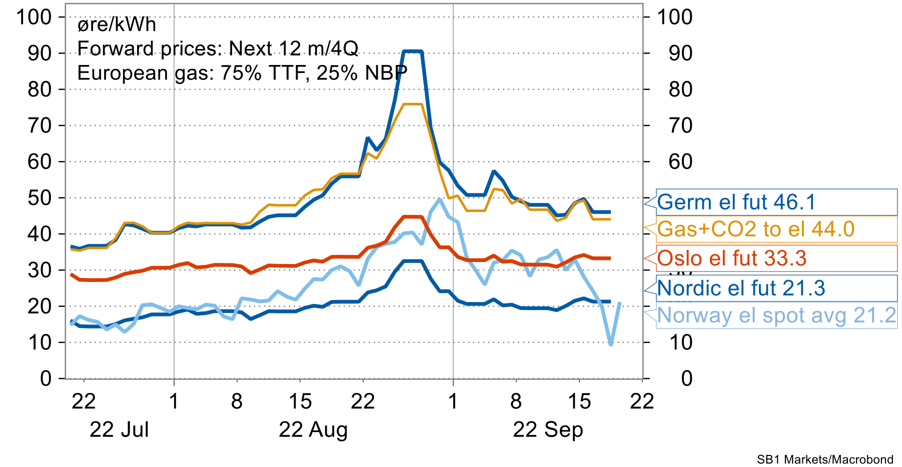
European gas & electricity prices stabilised last week, following the 40% drop

… but the price level remains extremely high

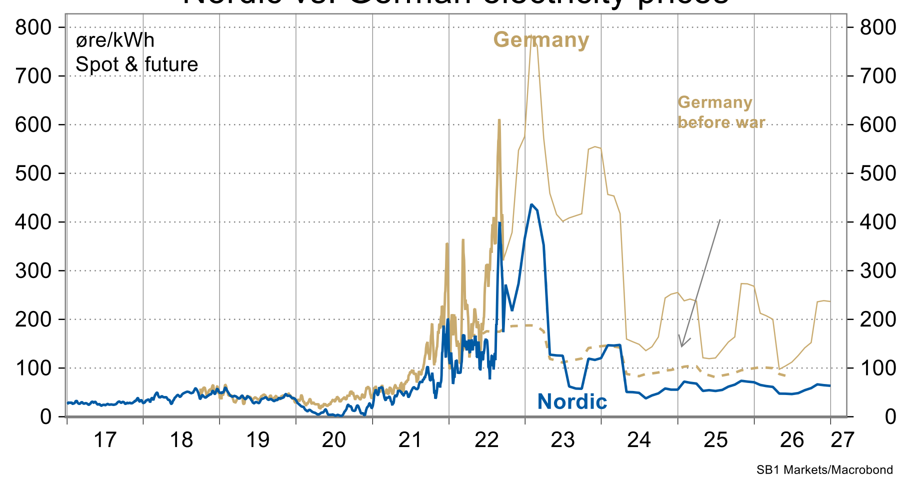
Electricity/gas future prices



Electricity/gas future prices



Nordic vs. German electricity prices

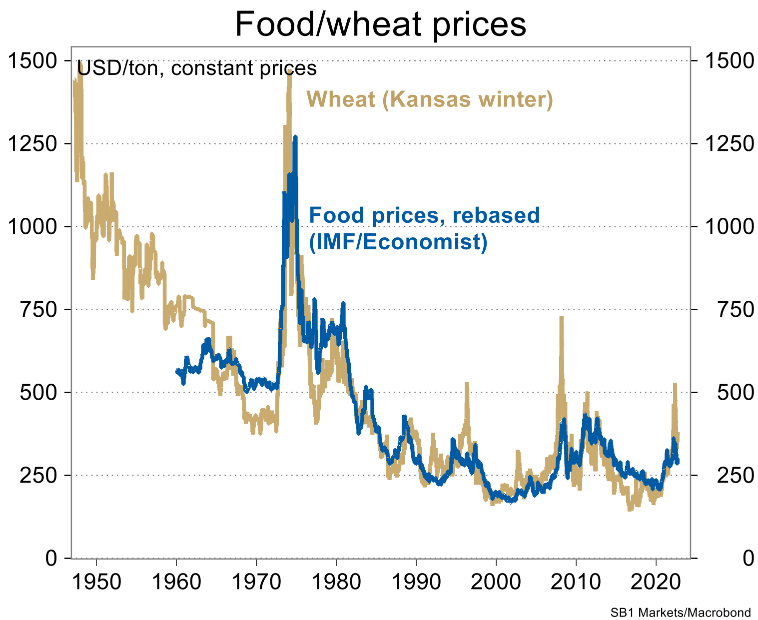


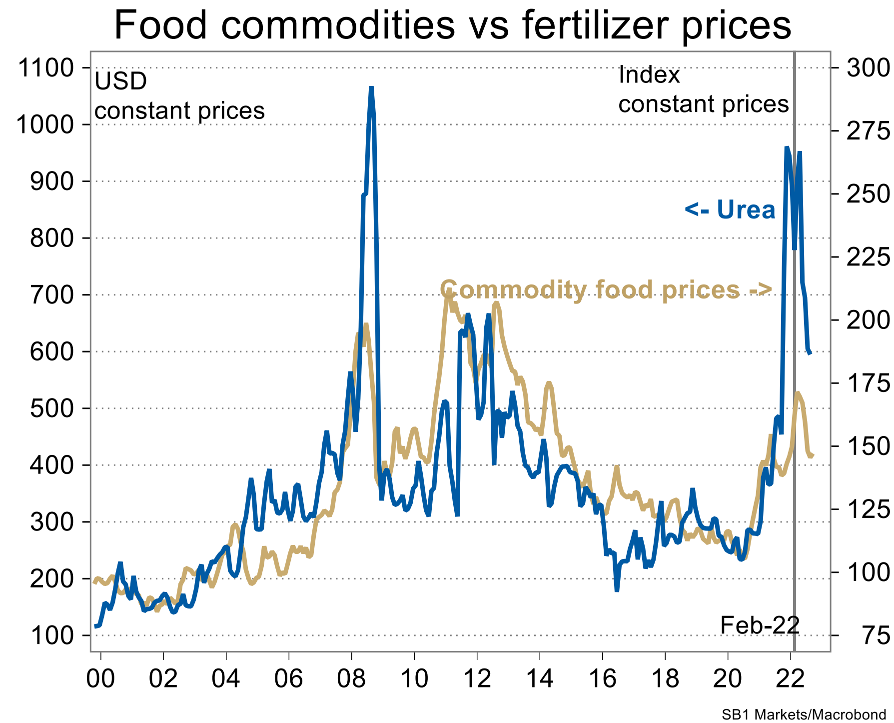
- The EU gas price cap is still a pie in the sky, but may of course be introduced, if so at the expense of Norway (but we are probably able to shoulder the cost…)

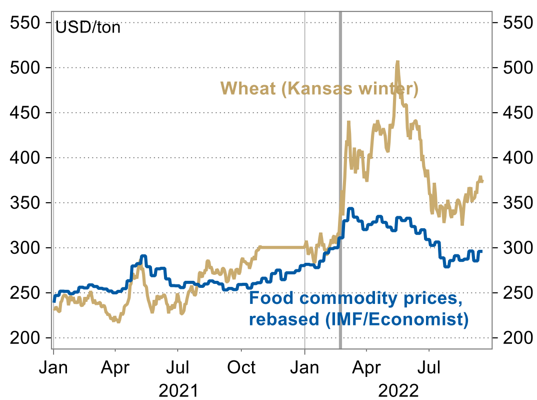
European gas: 75% Dutch TTF, 25% UK NBP, excl. CO2 cost

Food prices up last week, and the very short trend is upwards?

The real price level is anyway not that high, *and close to the 10 y average*. *A global food crisis??*

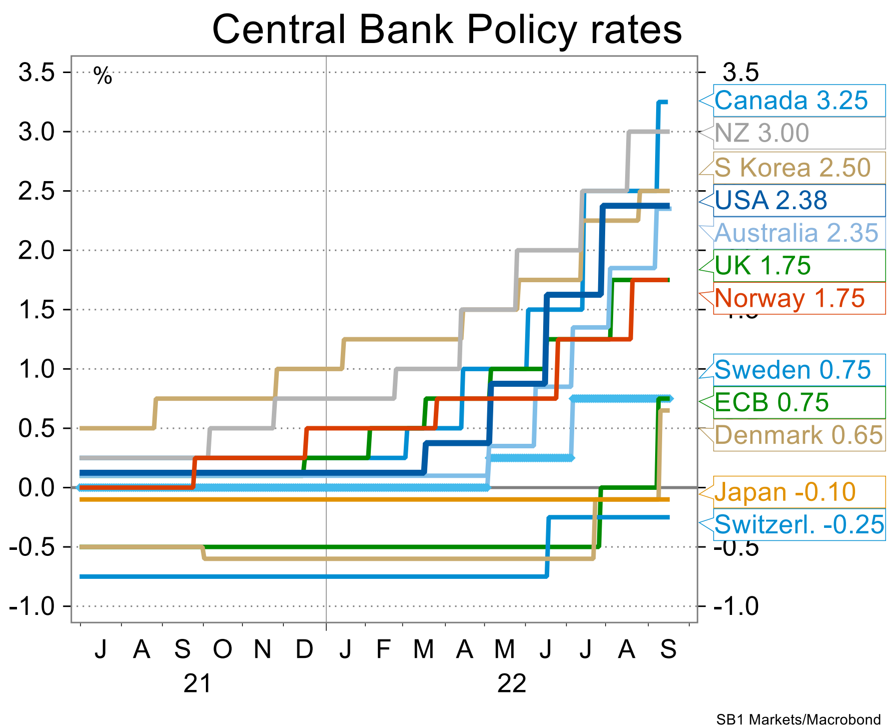


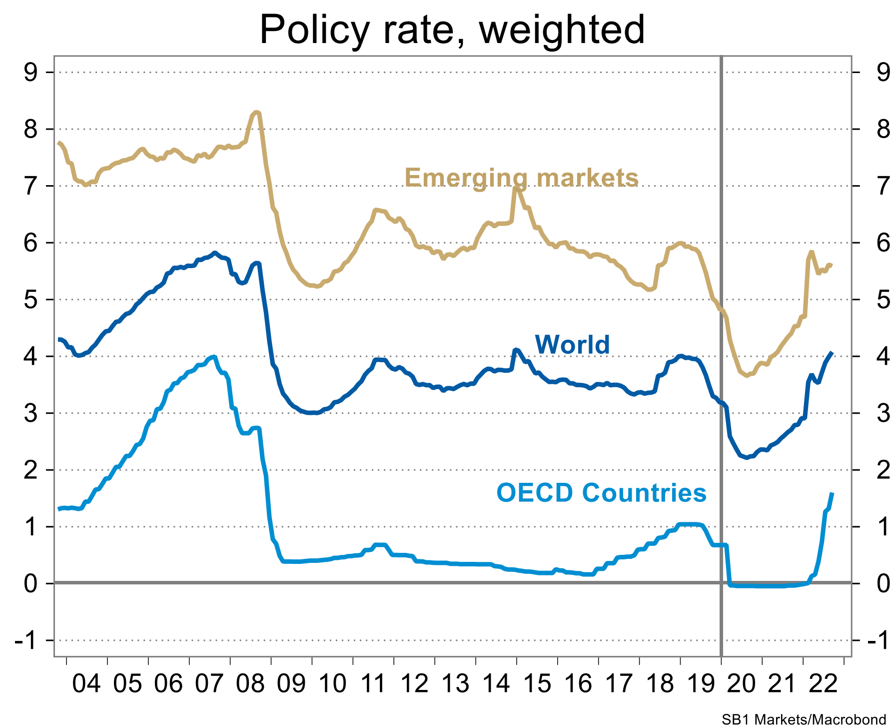




Urea prices are falling rapidly too (but are not low vs. food prices)

Short term rates in the rich part of the world the highest since 2008

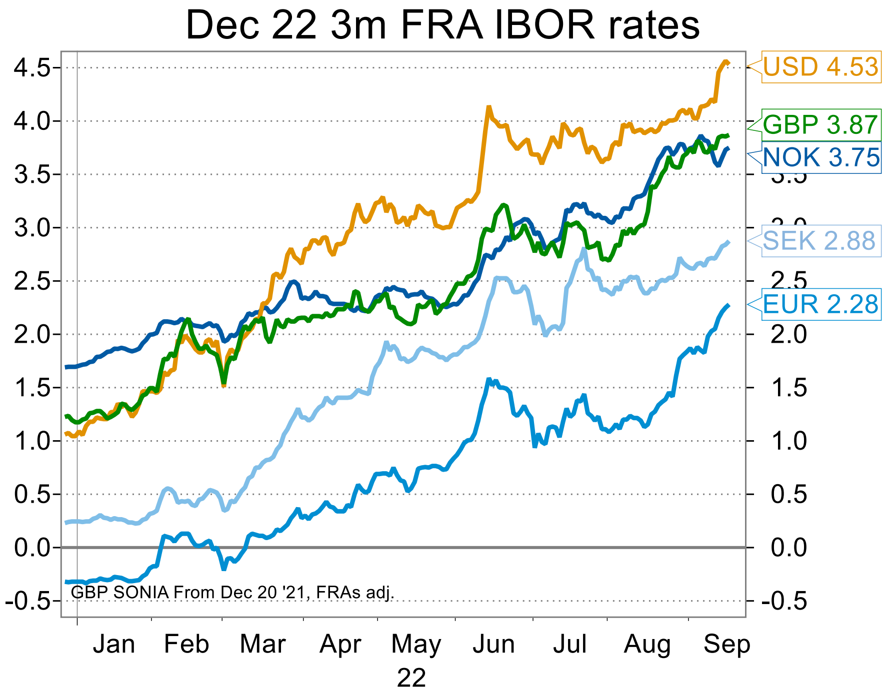


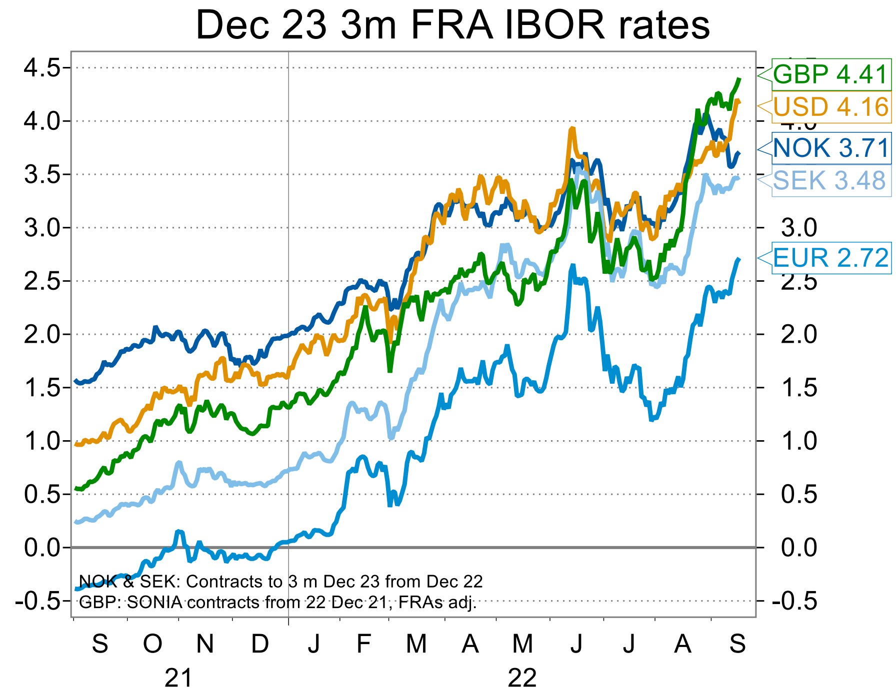


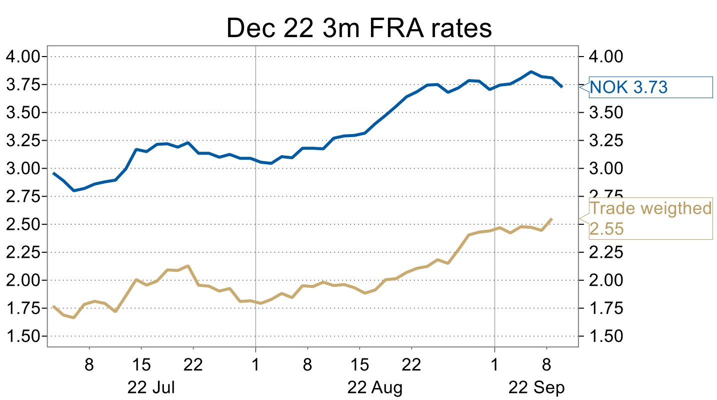
- The EM average policy rate has come down due to the Russian cuts – but the average is on the way up again
- In addition to rate hikes, most central banks have ended their QE buying programs. Some banks will start reducing their holdings, moving into the QT zone. US ramped up its QT program (doubled the pace) from the beginning of September

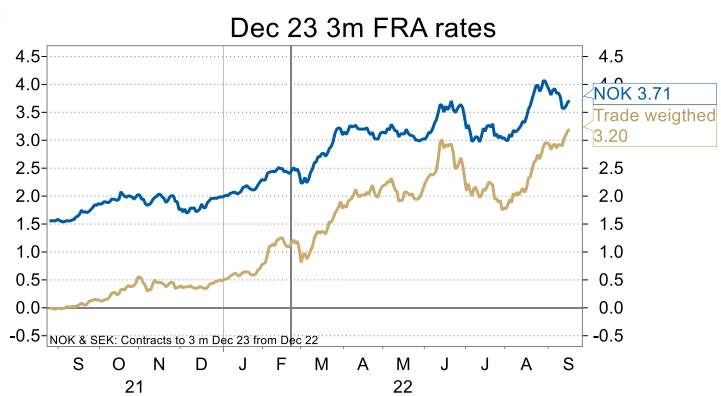
NOK longer dated FRAs down, while rates abroad surged

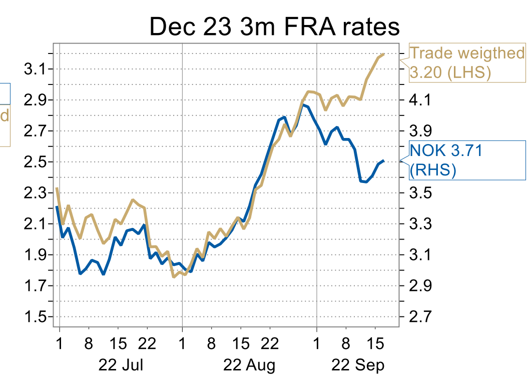
A highly unusual decline in shorter NOK FRA rates vs rates abroad







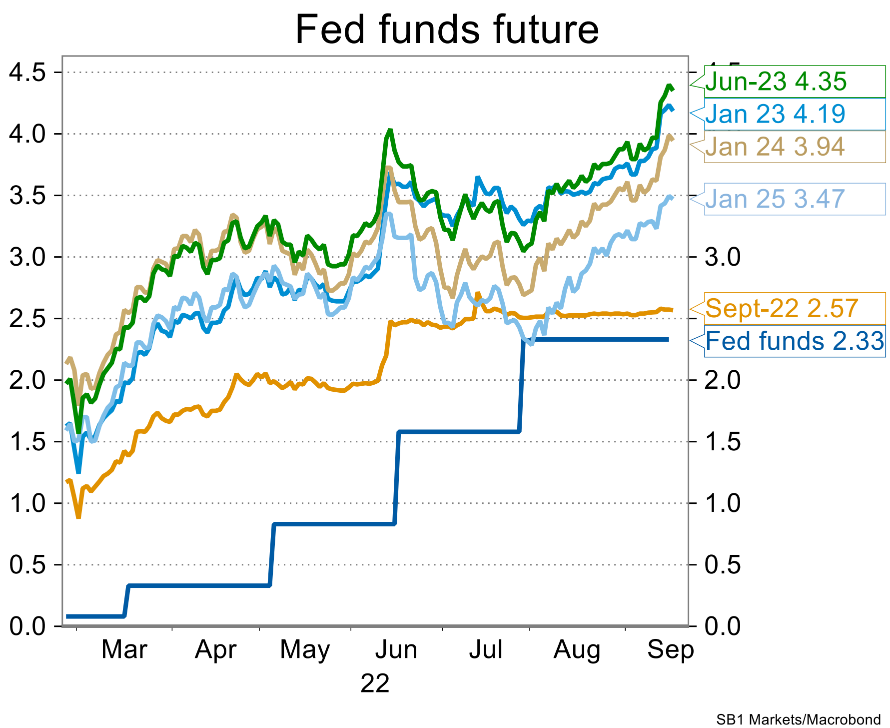


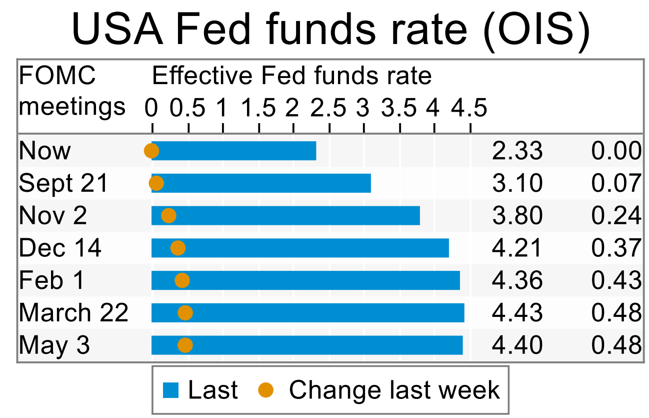


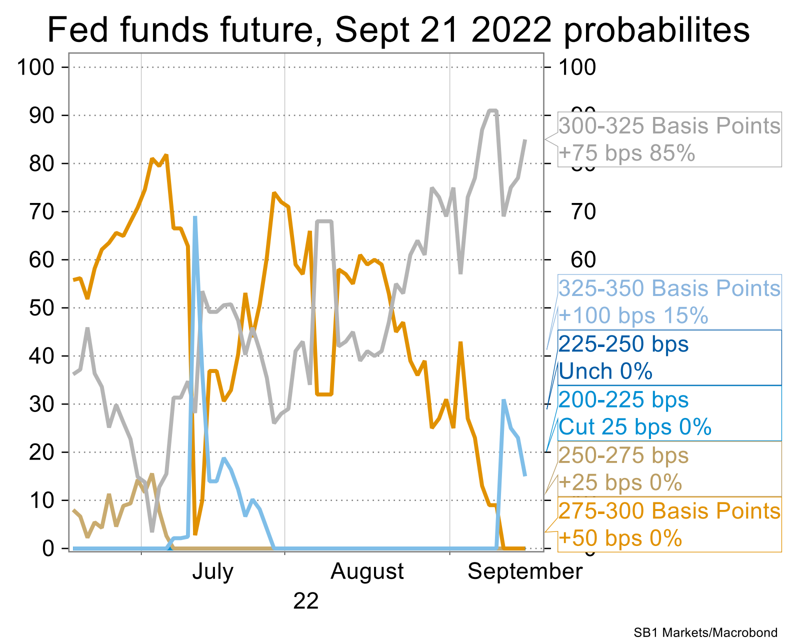
SB1 Markets/Macrobond

Federal Reserve this week: 75 bps hike (85%) or 100 bps (15%)

The peak is still expected to be in March next year, at 4.43%, up 48 bps last week!! A real CPI shock



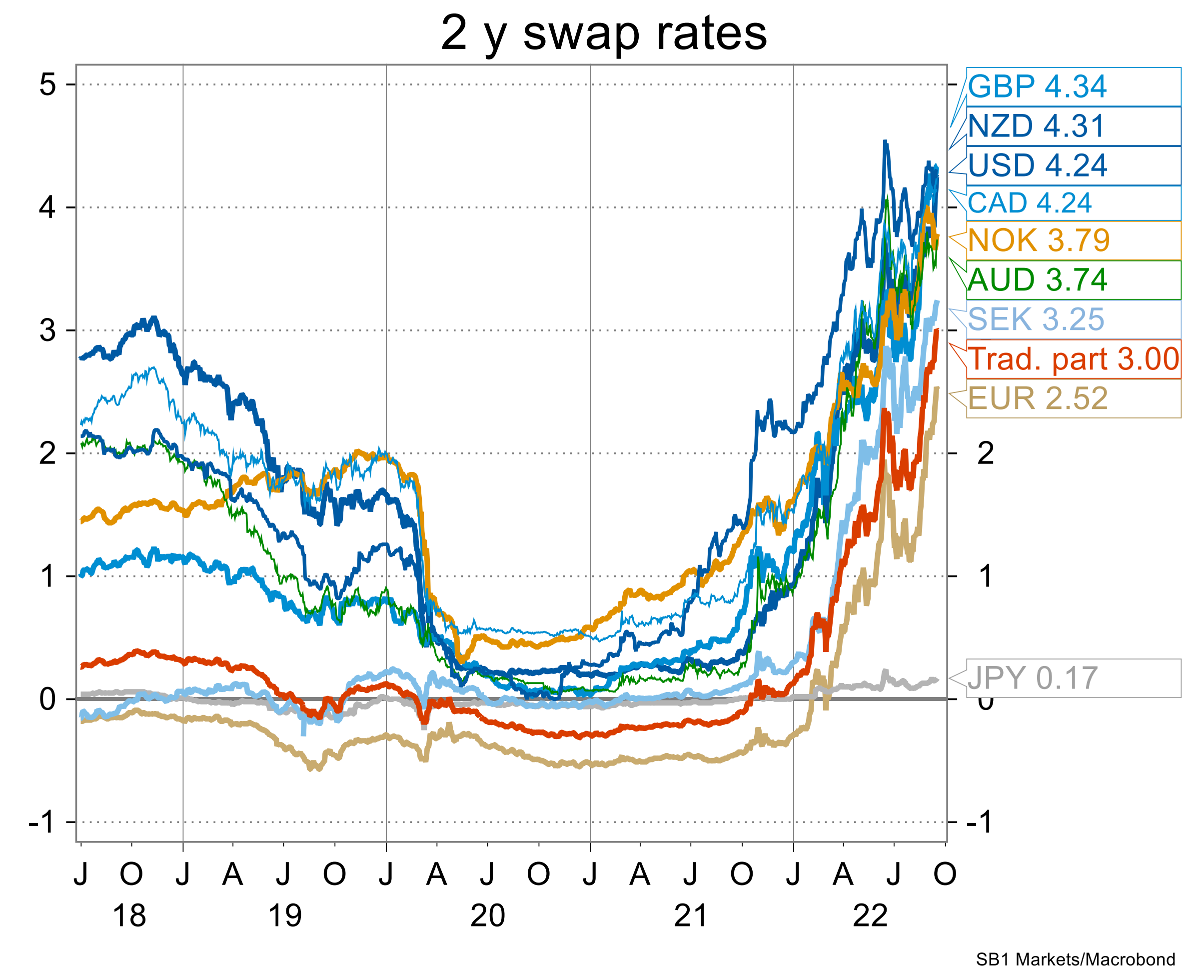


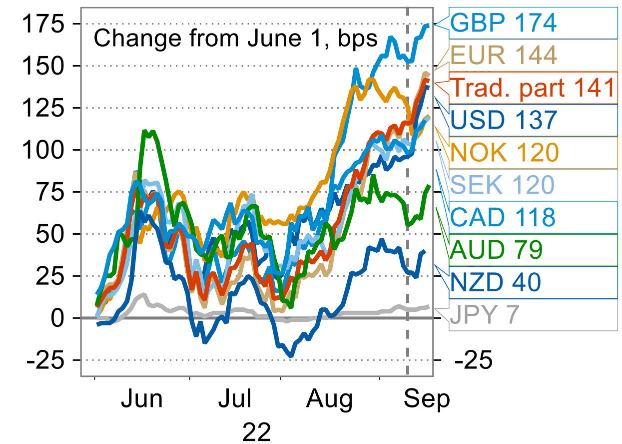


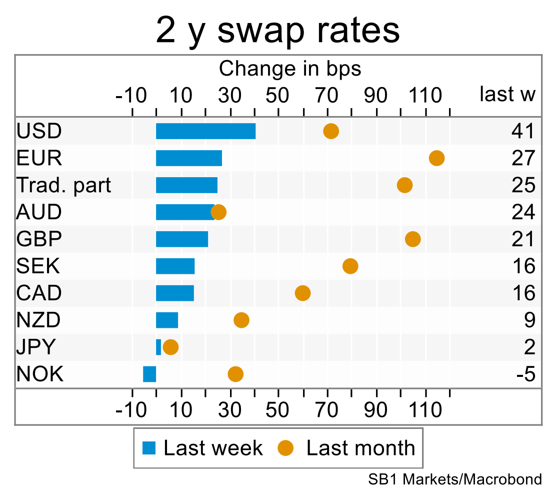
SpareBank 1 MARKETS

NOK 2 y swaps down, all other up, USD +41 bps, EUR +27 bps!

NOK rates have fallen past 3 weeks, foreign rates have climbed. A huge change in the int. rate diff!





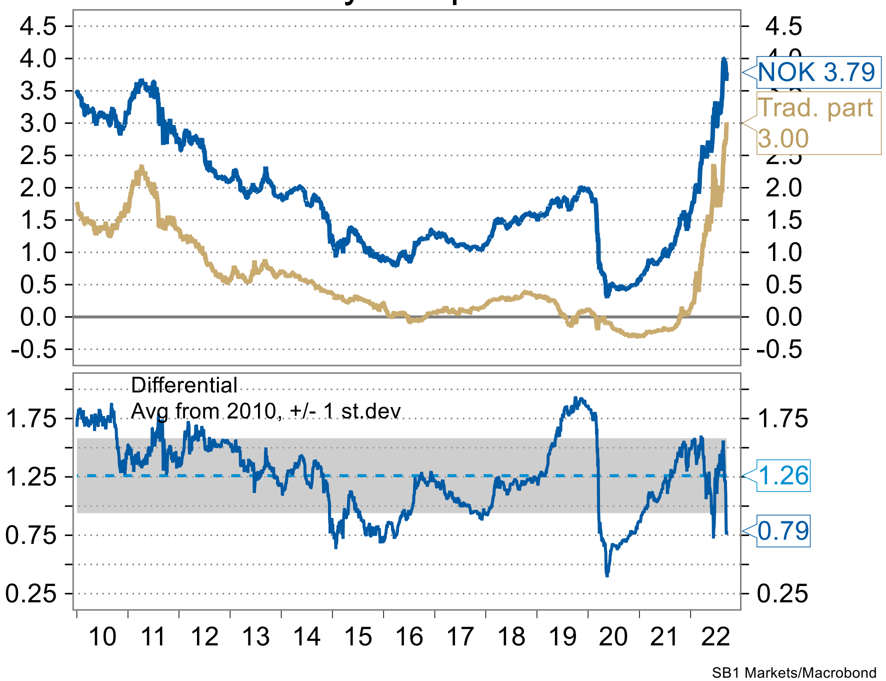


SpareBank 1 MARKETS

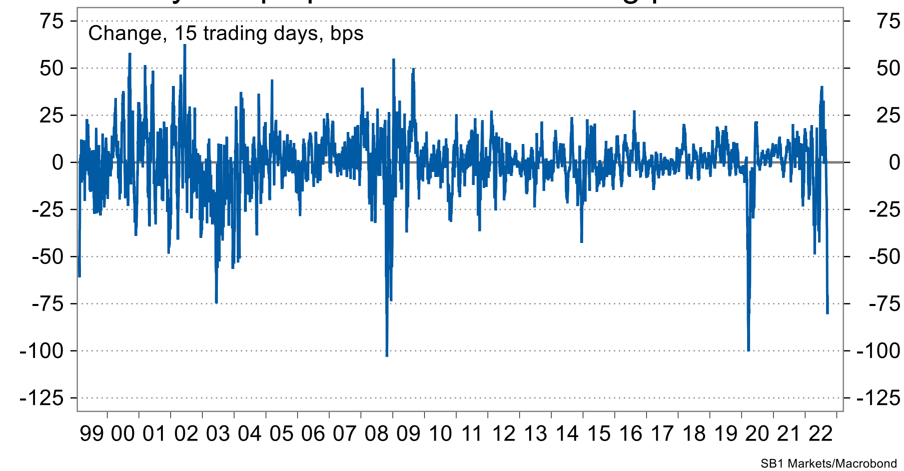
The two year swap spread has fallen by 80 bps since Aug 23, down to 79 bps!

The spread has fallen faster just twice, in Oct. 2008, and in Mar 2020

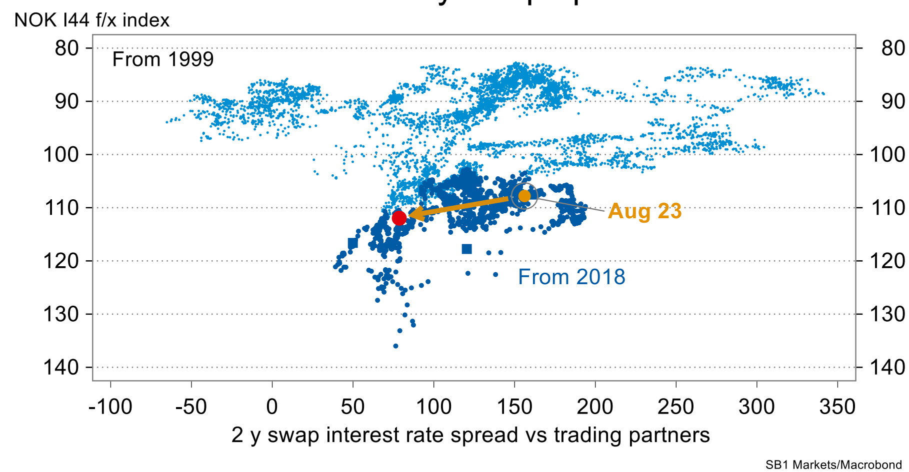
2 y swap rates



2 y swap spread NOK vs trading partners

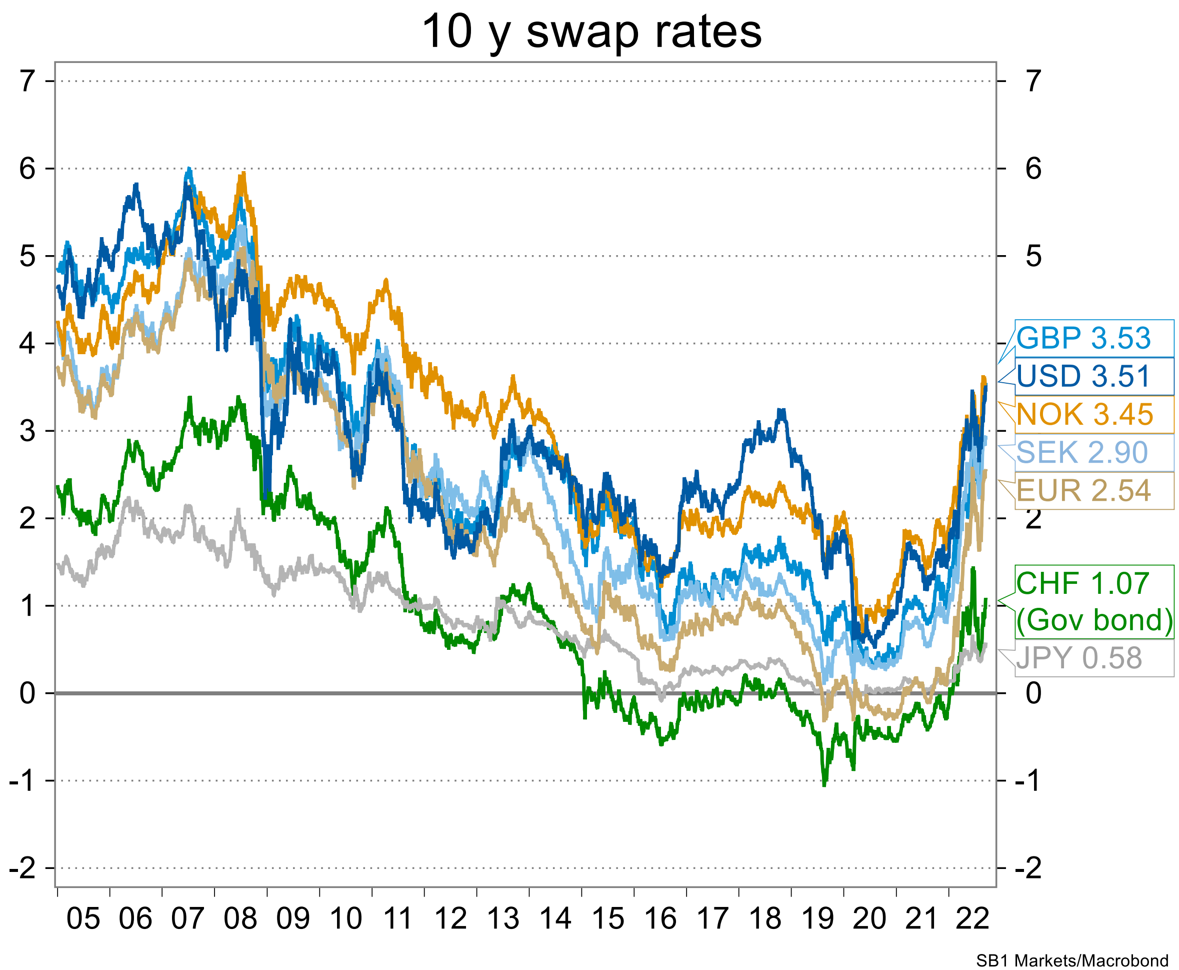


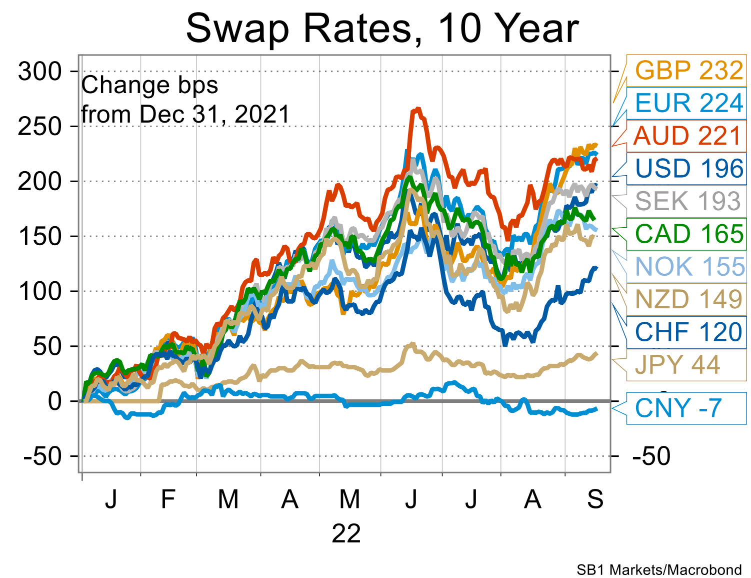
NOK vs. 2 y swap spread

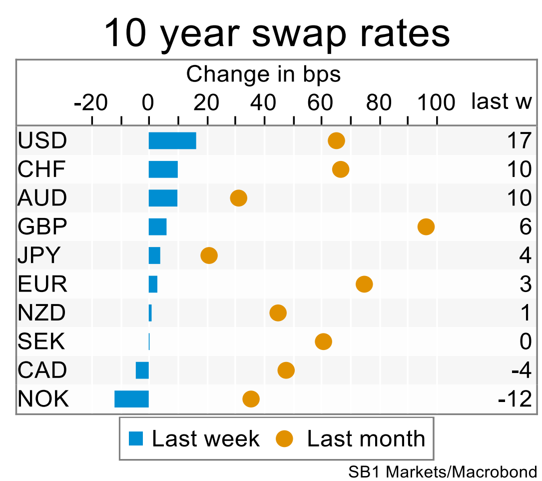


- Rates abroad have surged further, while Norwegian rates have fallen. NOK rates are still higher than among our trading partners
- The NOK has fallen, but not by much (confirming the weak correlation between NOK and the interest rate differential) – and the oil and gas prices have fallen too

NOK (and CAD) 10 y swaps down, SEK flat – all others up. USD up 17 bps!



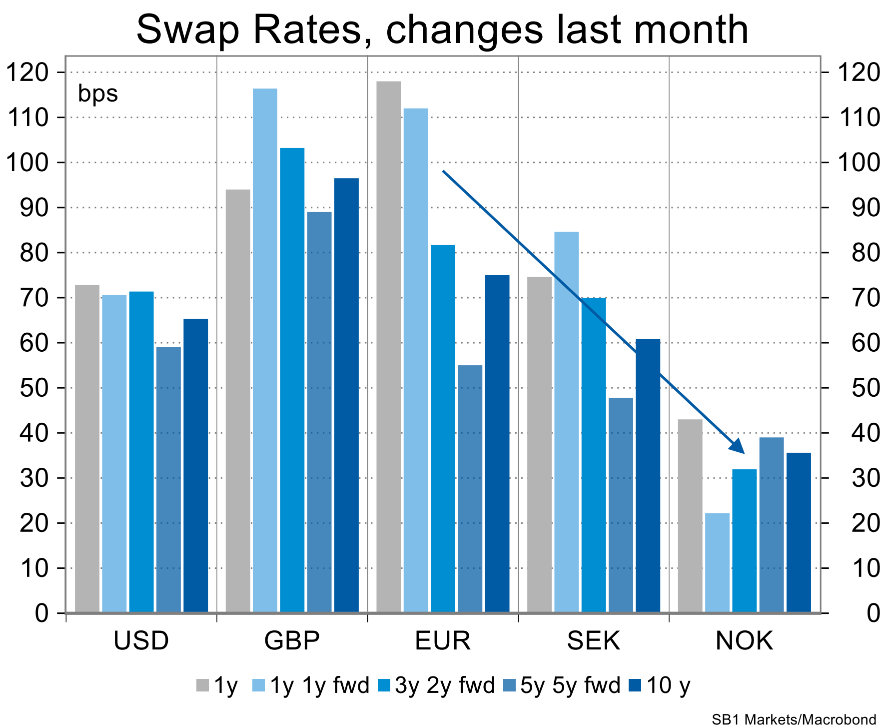


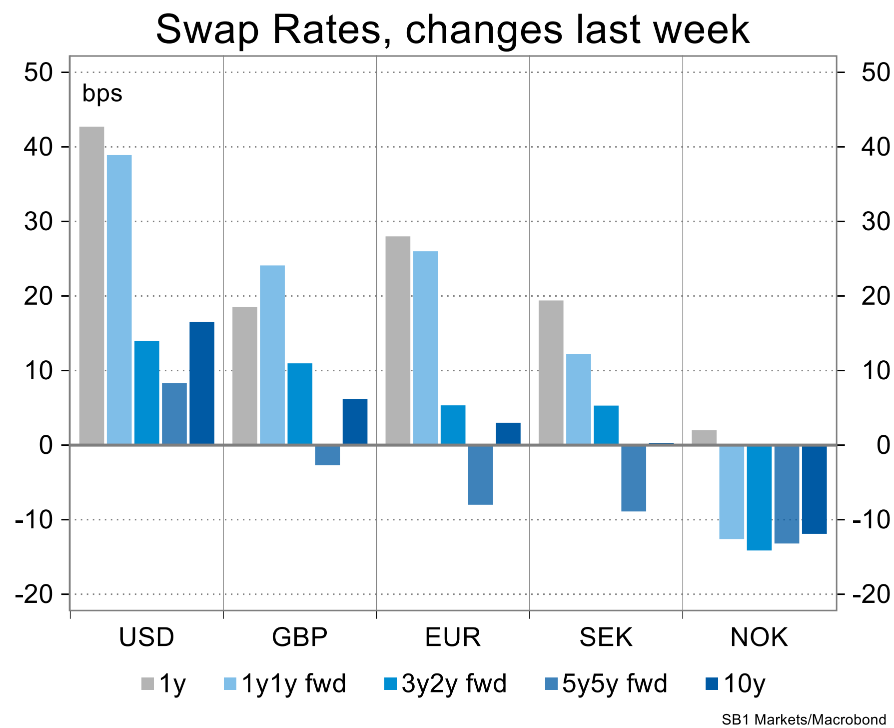


CHF: 10 y government bond yield

Rates up in the short end everywhere, but the least in Norway

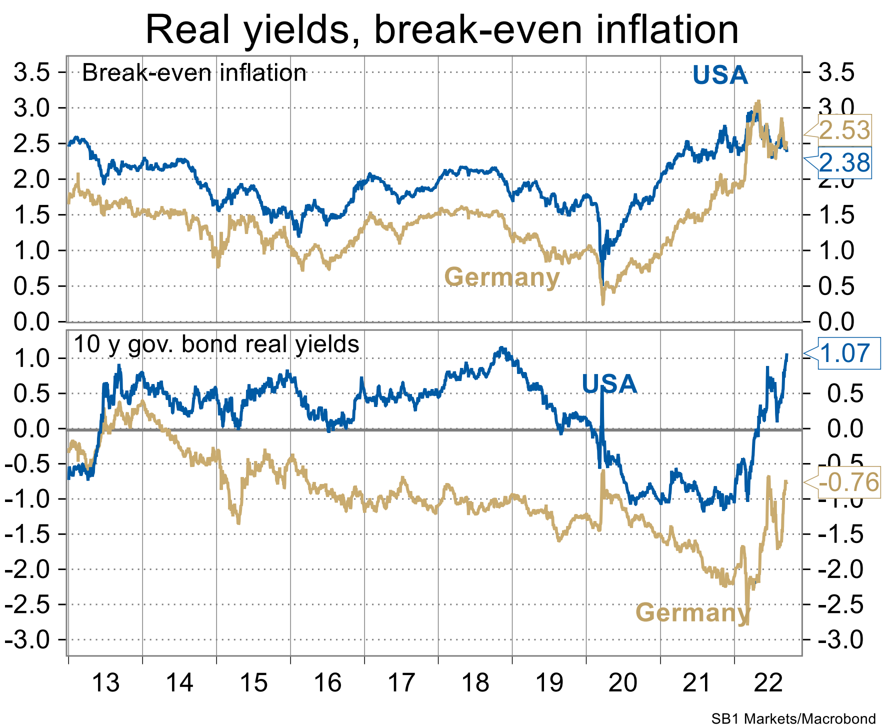
Other rates fell in Norway, but mostly rose abroad. NOK rates far less up than foreign rates past 4 wks

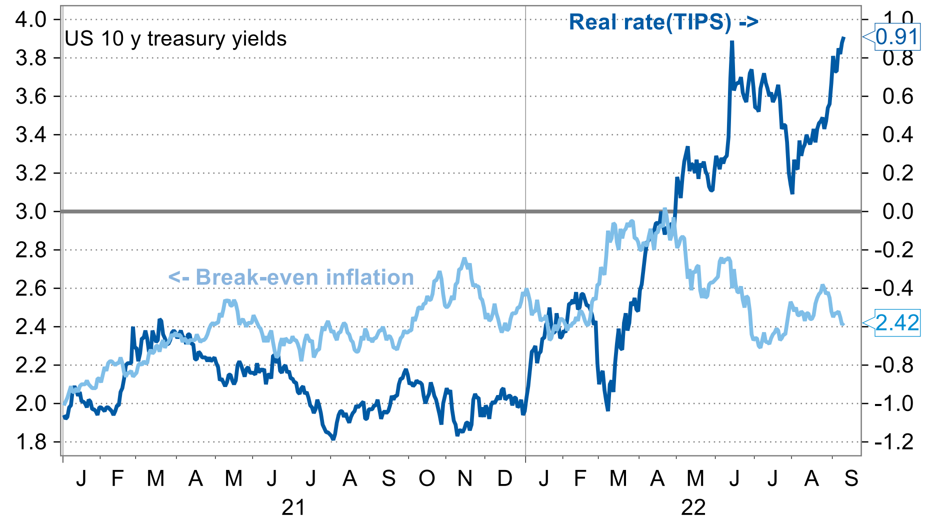




US 10 y real rate up 16 bps to 1.07%

Inflation expectations fell marginally. Small changes in Germany





US & Germany 10 y Gov bond yield

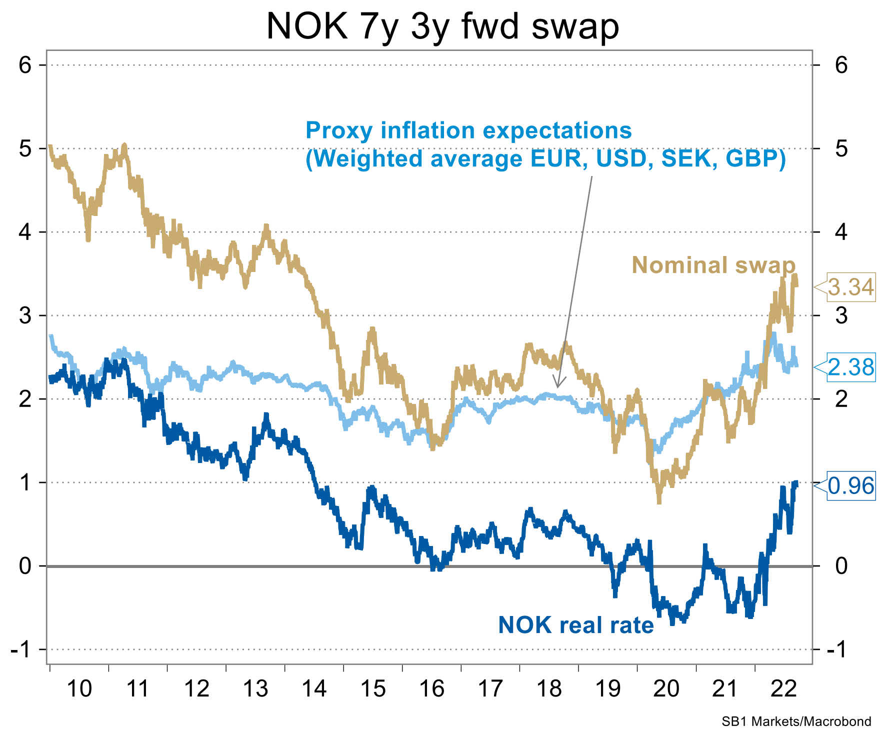
	Yield	Change 1w	Change 1m	Since Feb 18	Min since April-20
USA nominal treasury	3.45	0.12	0.63	1.53	0.52
.. break-even inflation	2.38	-0.04	-0.06	-0.03	1.06
.. TIPS real rate	1.07	0.16	0.69	1.56	-1.19
Germany nominal bund	1.77	0.03	0.85	1.55	-0.65
.. break-even inflation	2.53	0.02	-0.06	0.55	0.40
.. real rate	-0.76	0.01	0.91	1.00	-2.80

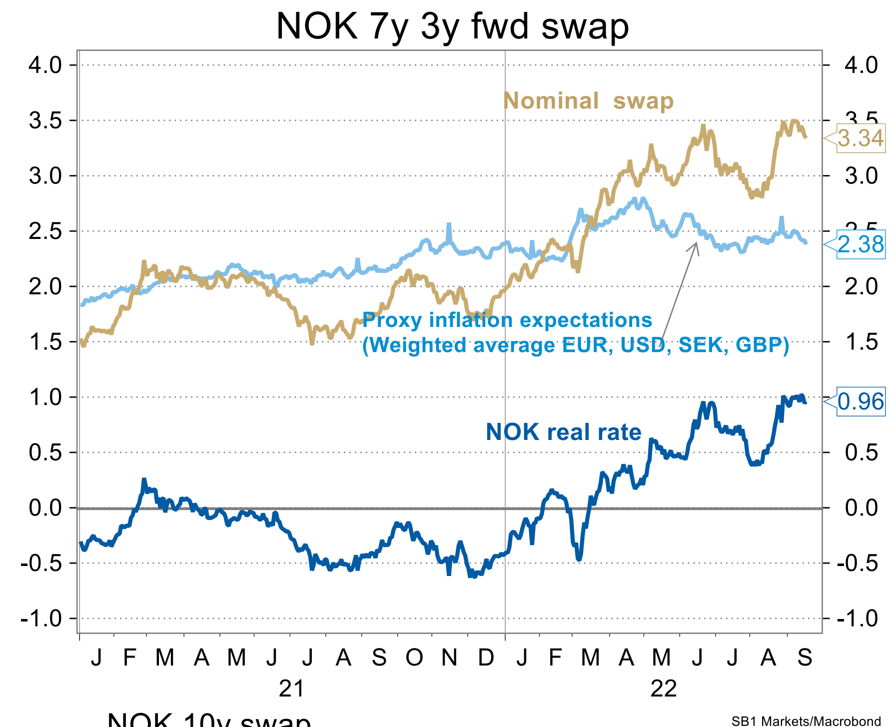
SB1 Markets/Macrobond

- **The 10 y German inflation expectation** at 2.53% is primarily driven by high expected inflation the first year (8%, measured via inflation swaps). Thereafter, inflation is rapidly expected to fall to 2% and below again. Real rates move the opposite direction – they are turning positive

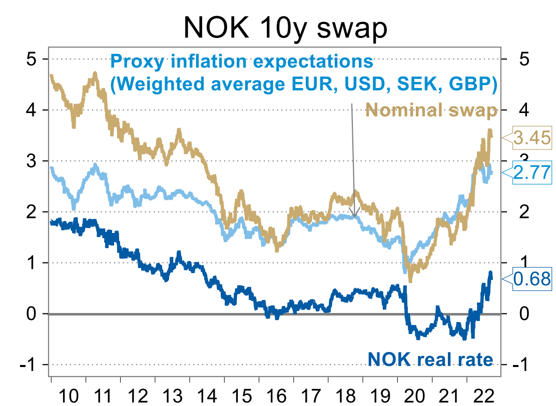
Norway: NOK real rates flattened last week

And inflation expectations are probably falling, here too



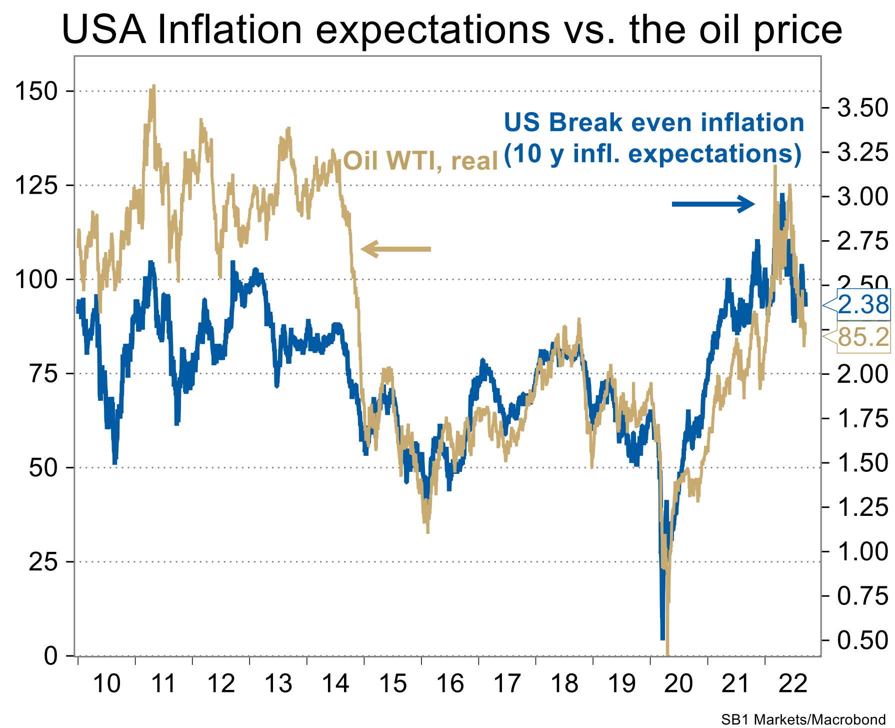


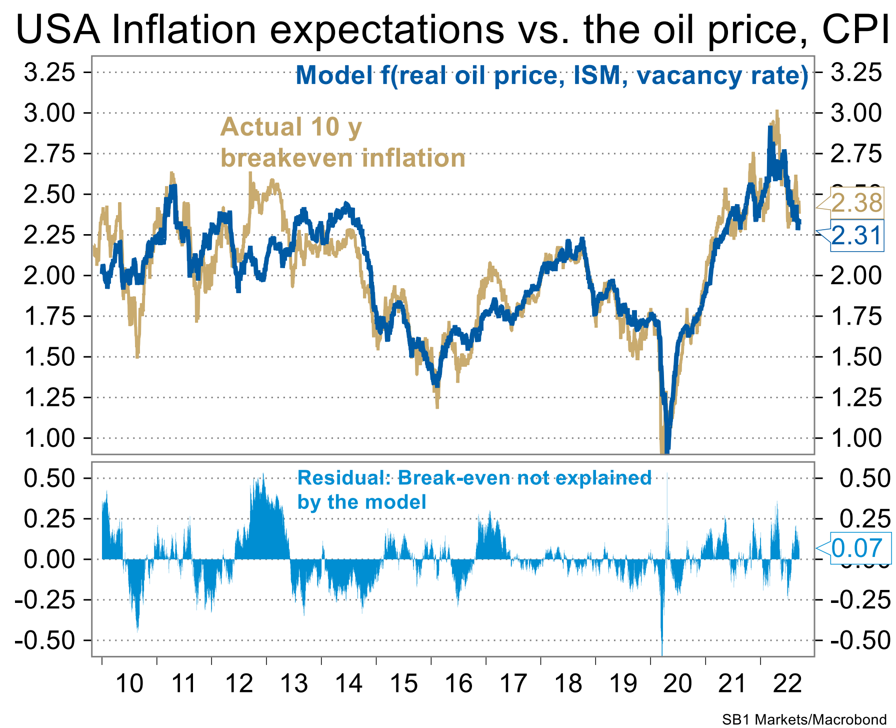
- Thus most of the lift in nominal swap rates recent months is due to higher real rate expectations, not higher inflation expectations
- Our NOK inflation expectation proxy is a weighted average of EUR, SEK, GBP, and USD inflation swaps, cross-checked vs actual inflation differentials and inflation expectations from surveys

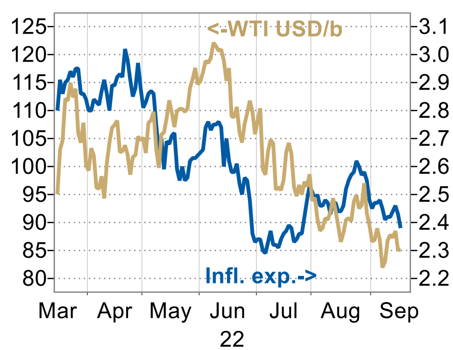


(Longer-term) Inflation expectations marginally down – still somewhat too high?

If the economy slows – and the oil price does not surge – inflation expectations should come down

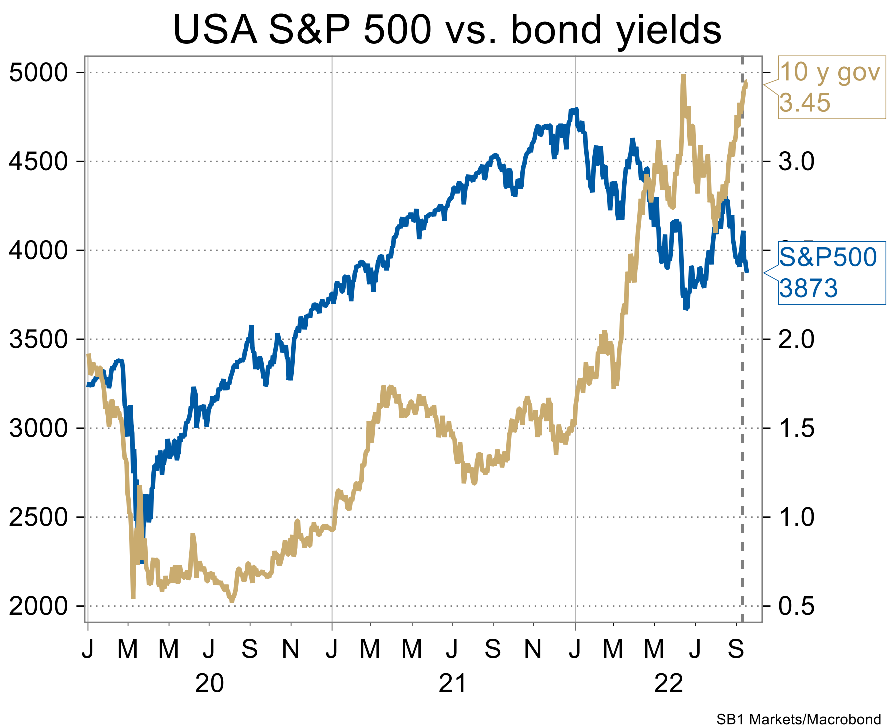


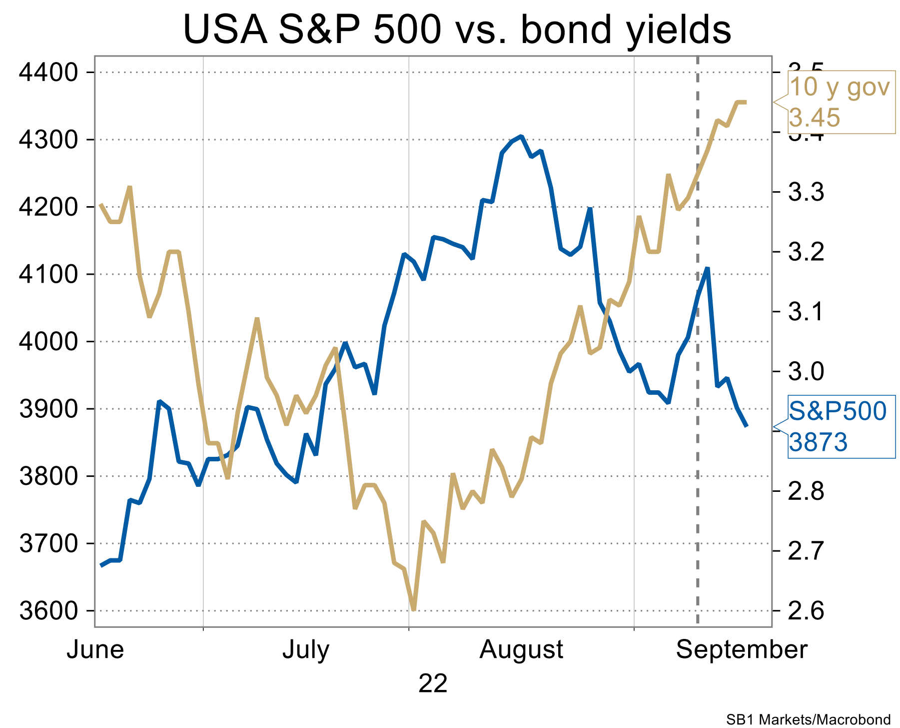




- A simple model including the spot oil price, the current ISM and the current vacancy rate pretty well explains the long-term breakeven inflation expectation in the bond yield curve
- What now? We are uncertain about the oil price, but rather confident that both the ISM, and the vacancy rate will decline. Impact vs the 10 y break-even expected inflation rate
  - » -5 ISM points: -12 bps
  - » -3 vacancy pts, (to 3.6% from 6.6%): -36 bps
  - » - 10 USD/b: -10 bps

Another inflation shock

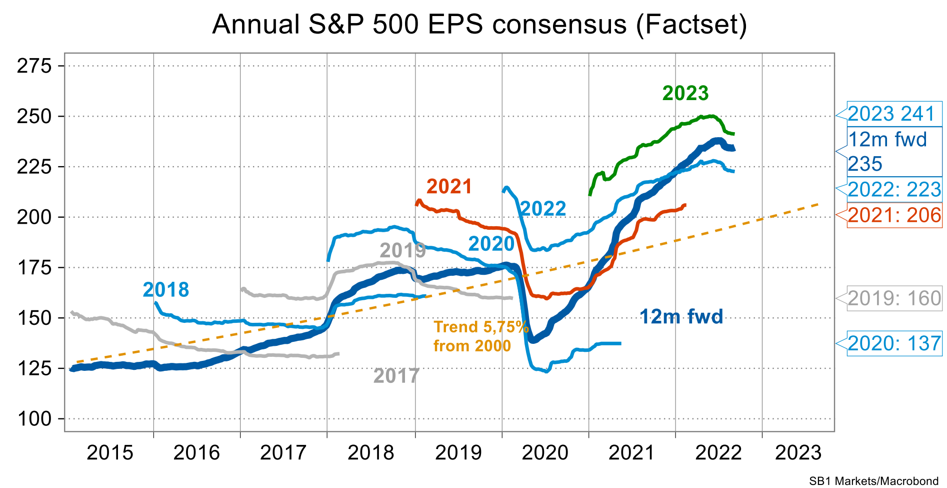


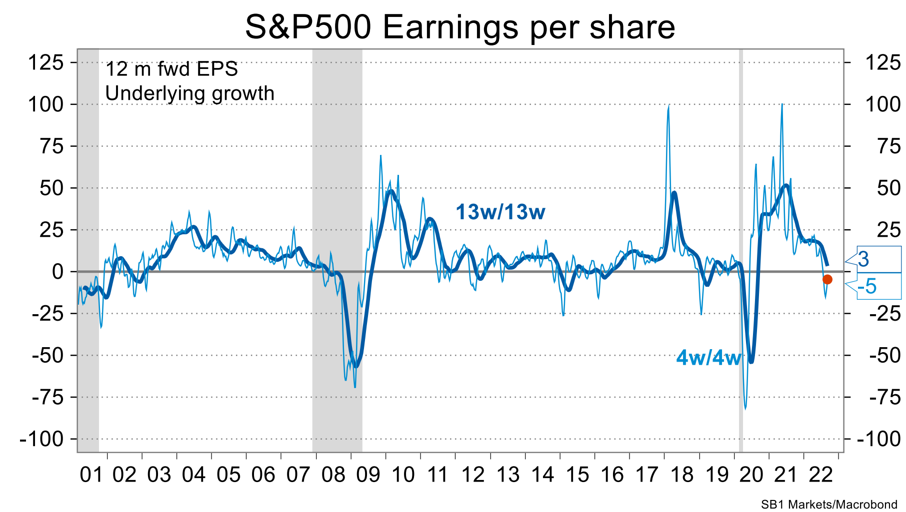


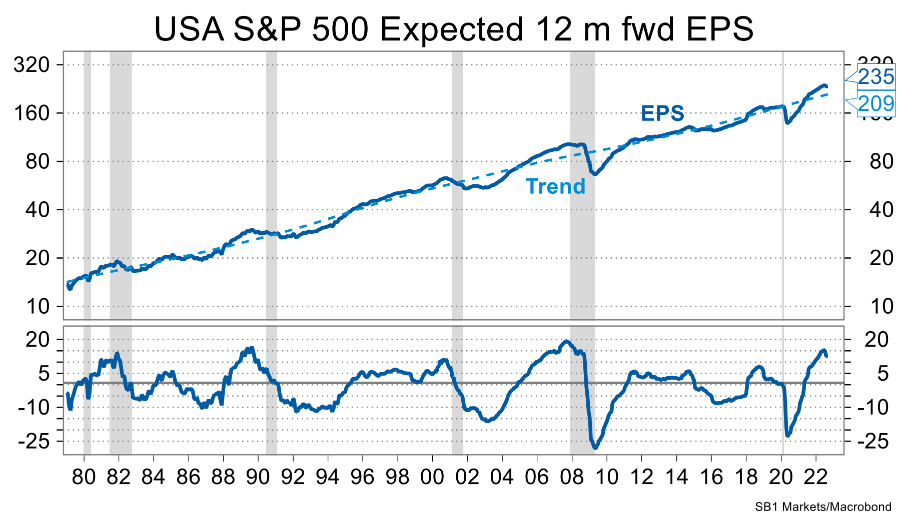
SpareBank 1 MARKETS

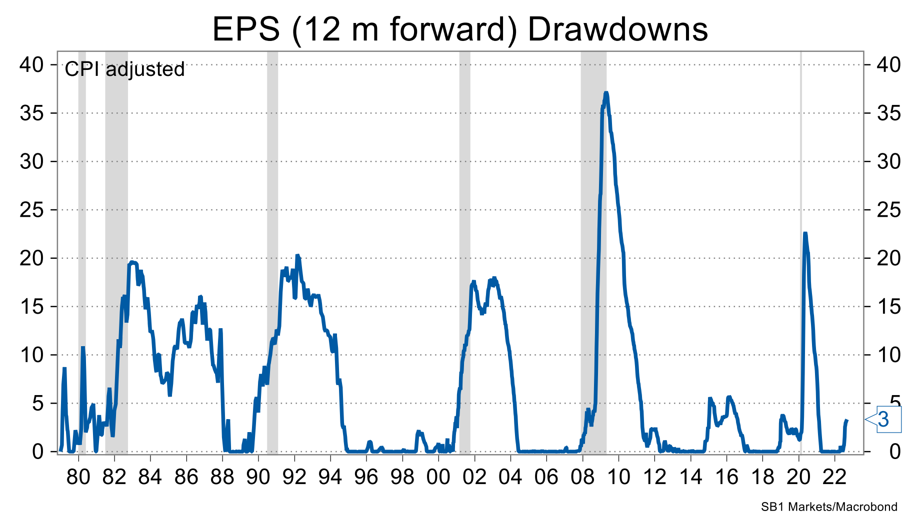
Earnings forecasts finally on the way down – but just slowly recent weeks

S&P 500 expected 12 m fws EPS was some 15% above trend and has just fallen some 3%





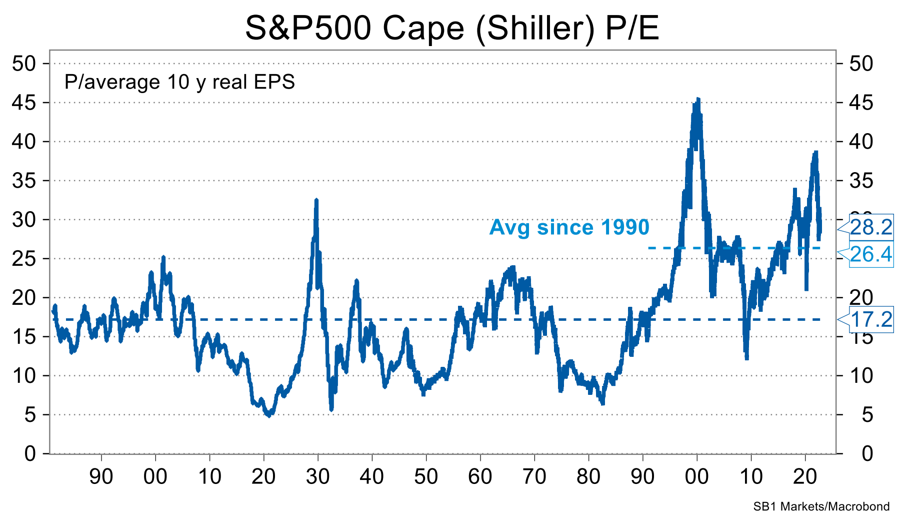


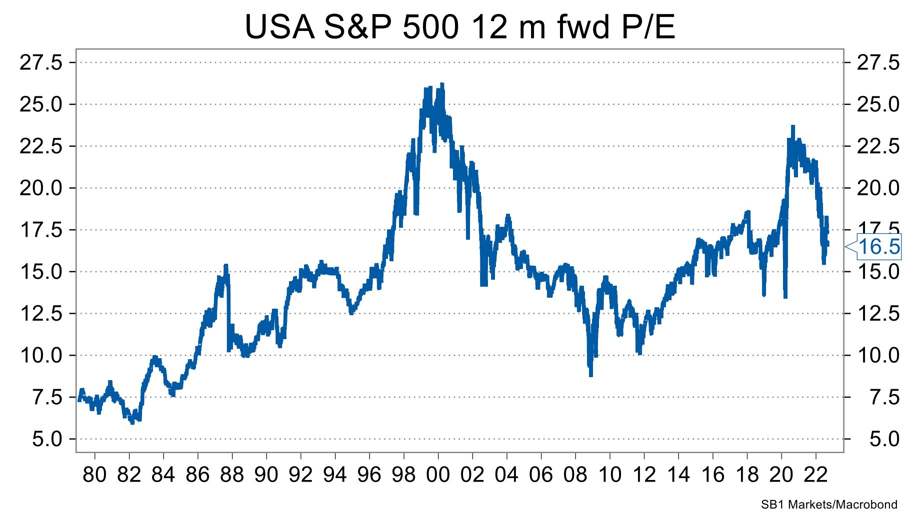


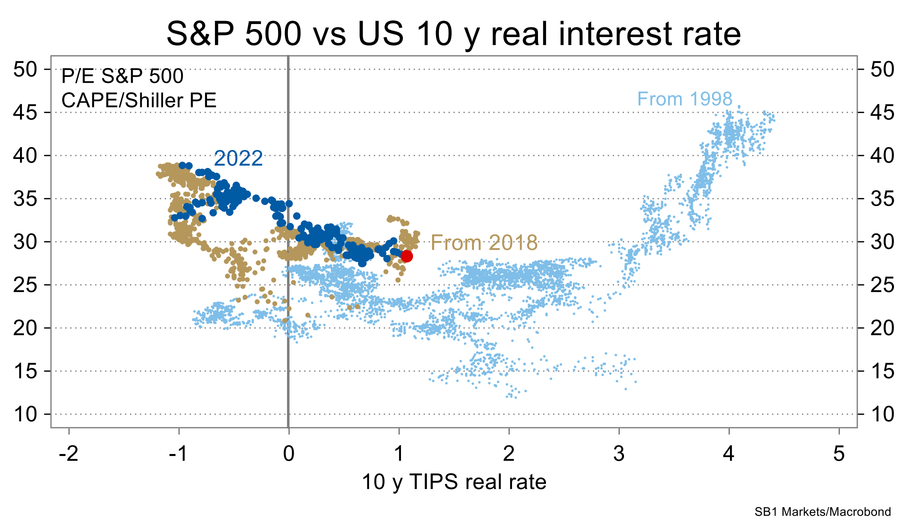
SpareBank 1 MARKETS

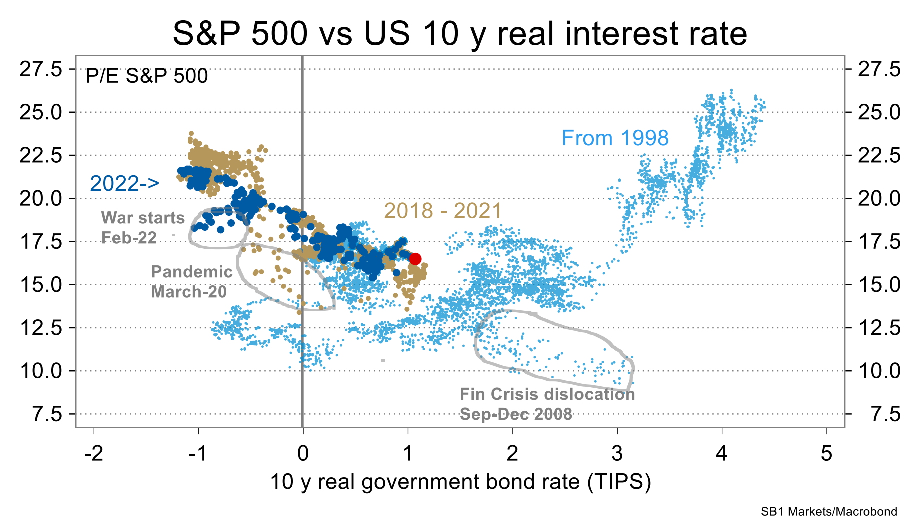
4 valuation charts

The TIPS real rate has been the main driver for the P/E since 2018. And it still probably is



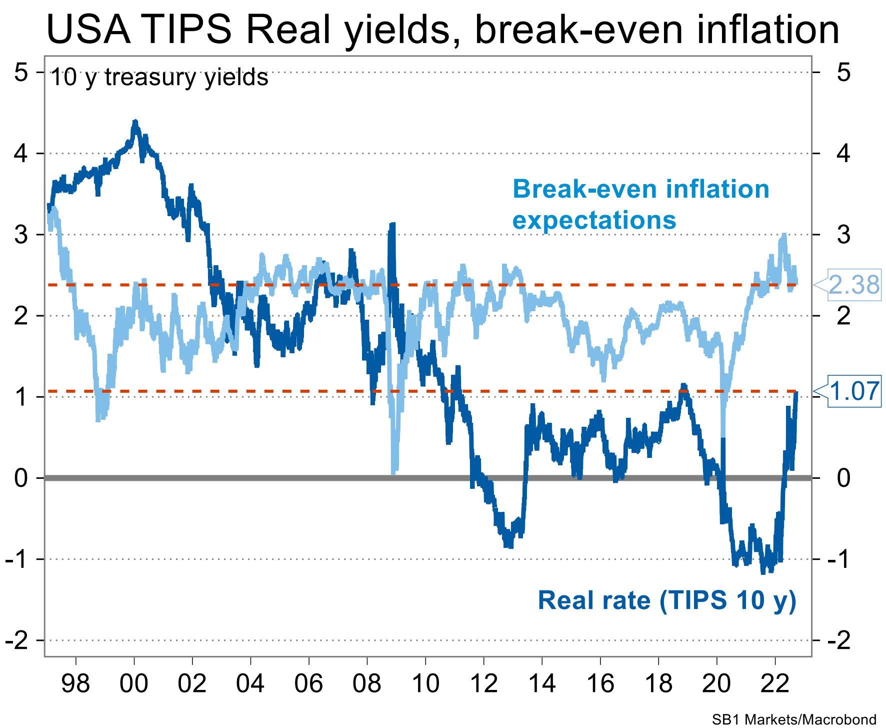


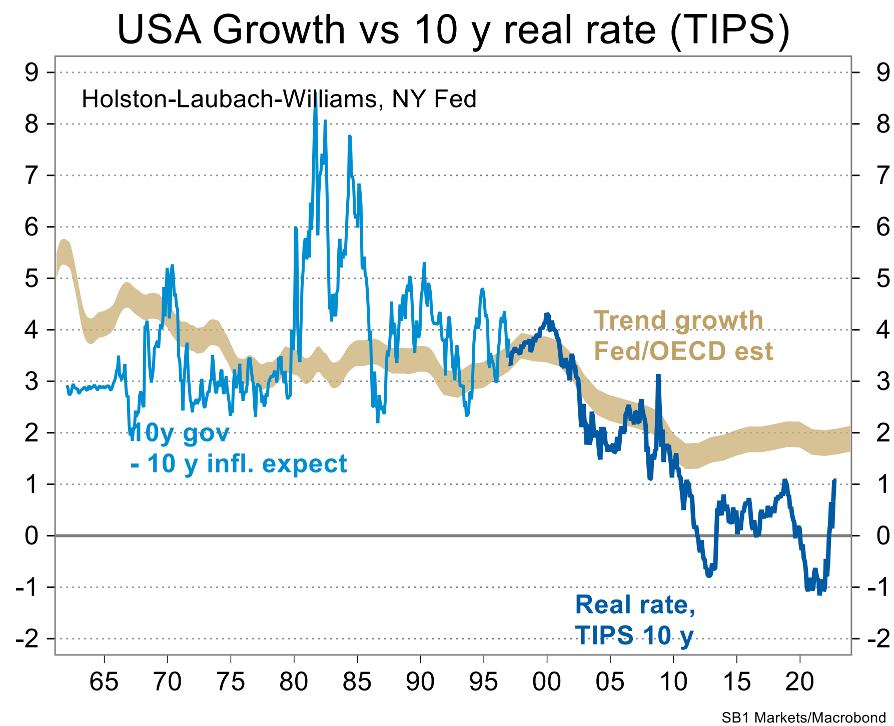




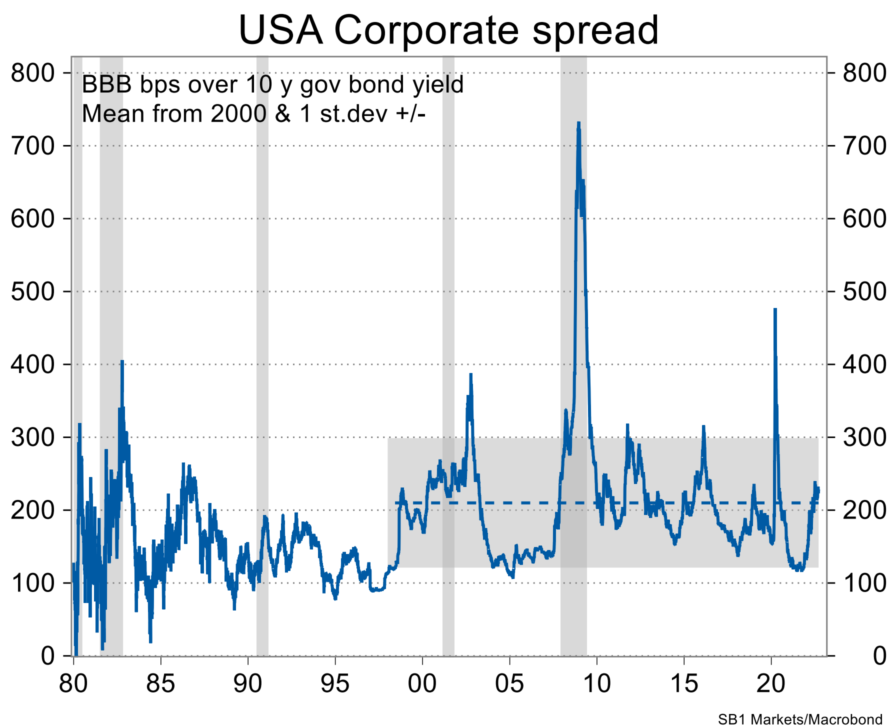
Growth vs real rates: Mind the gap, it's closing, from both sides

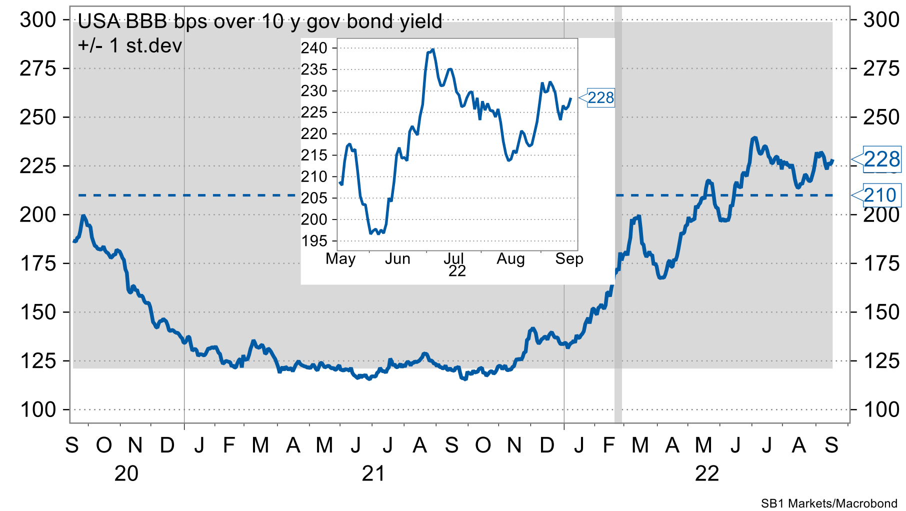
Real rates are up, while short/medium-term growth expectations are declining





Risk on: Credit spreads slightly down – but the longer trend is still up?



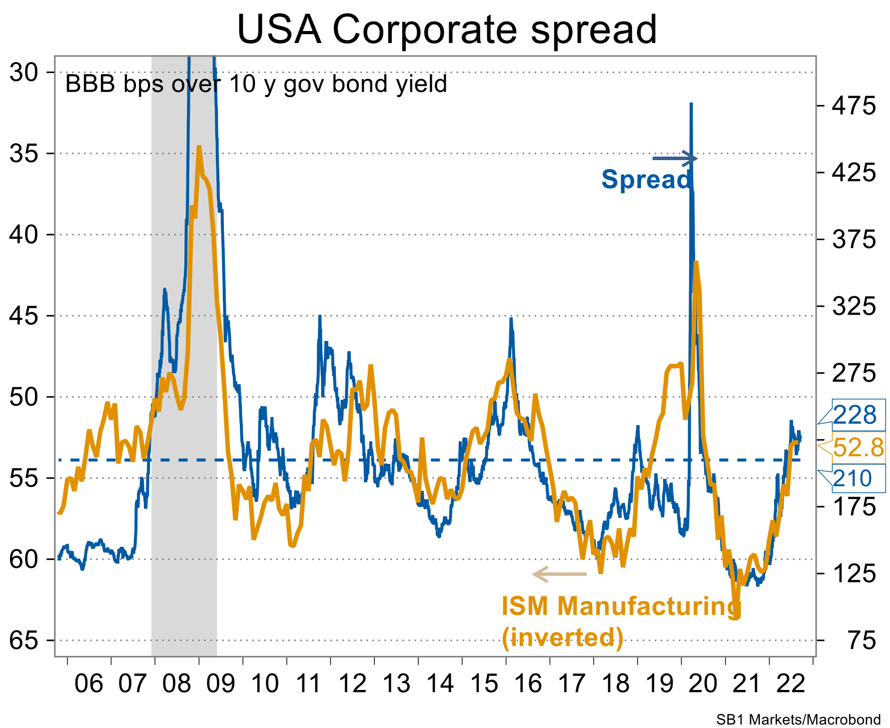


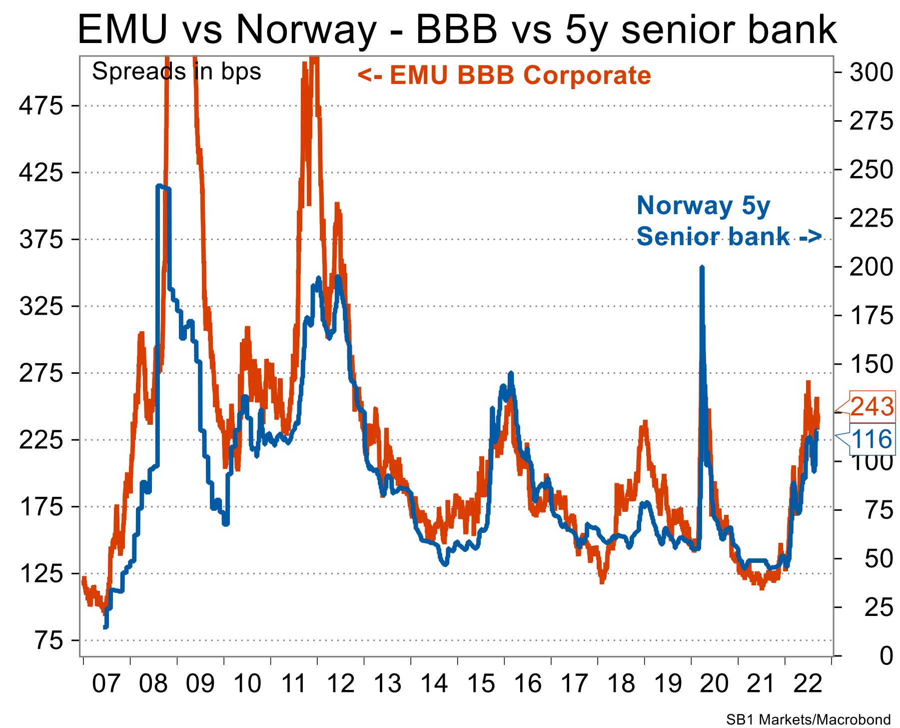
- The US BBB spread is up more than 100 bps from the bottom last autumn, almost a doubling
- In addition, real rates have increased by almost 200 bps since late last year
- Thus, the basis for all valuation metrics has changed dramatically, check the chart two pages forward!

SpareBank 1 MARKETS

Why have credit spreads widened in 2022? Could it be the slowing economy?

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

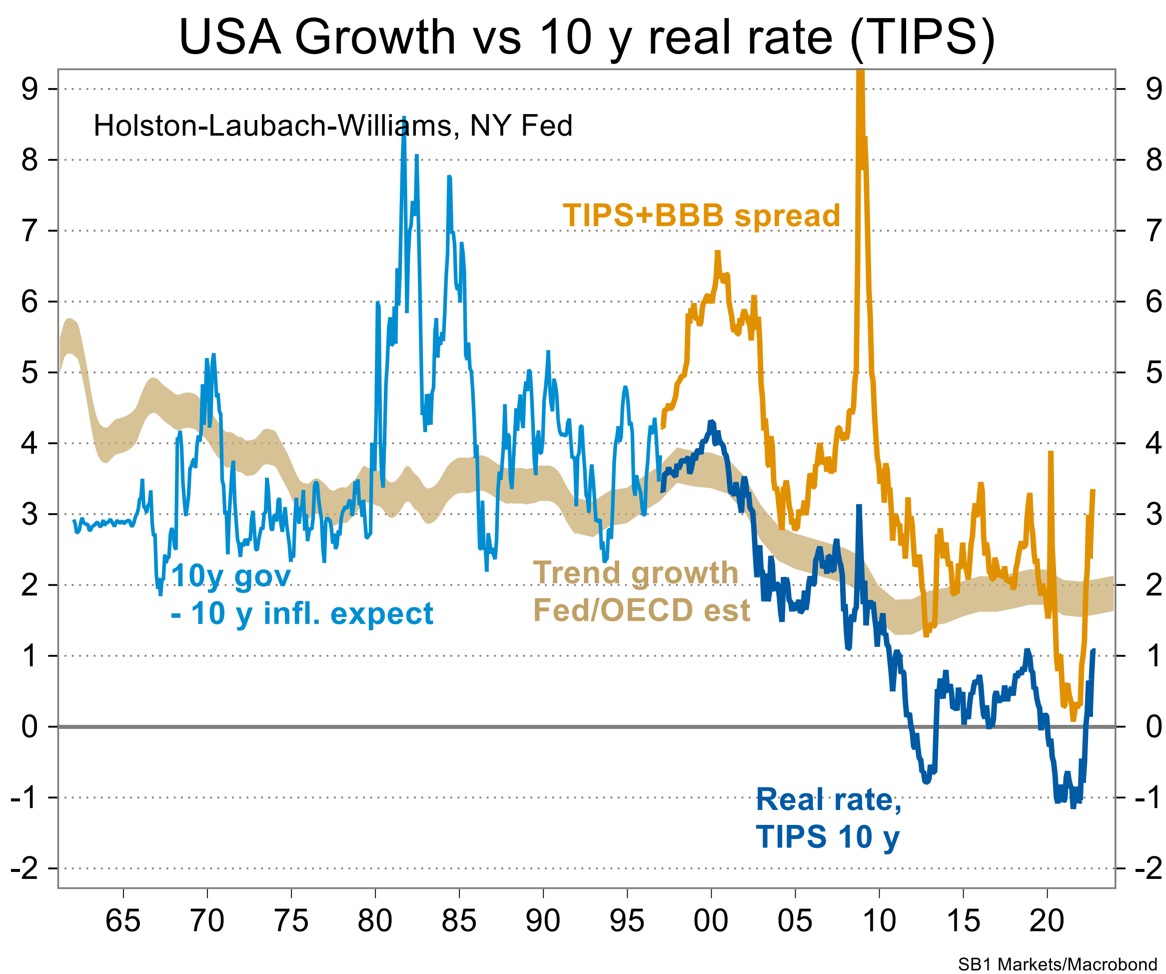




- The answer is not irrelevant for your view on the outlook for spreads, we think
- And do you think Norwegian spreads will be influenced by changes in the global credit market?
- Last week: Norwegian credit spreads rose in sympathy with higher spreads abroad the previous week

The cost of capital is not like it was some few months ago

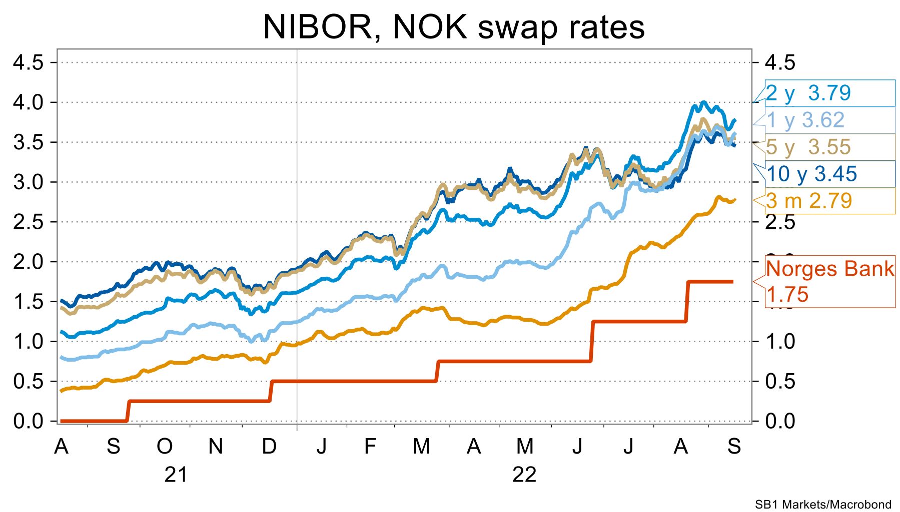
The basis for all valuation metrics has changed dramatically

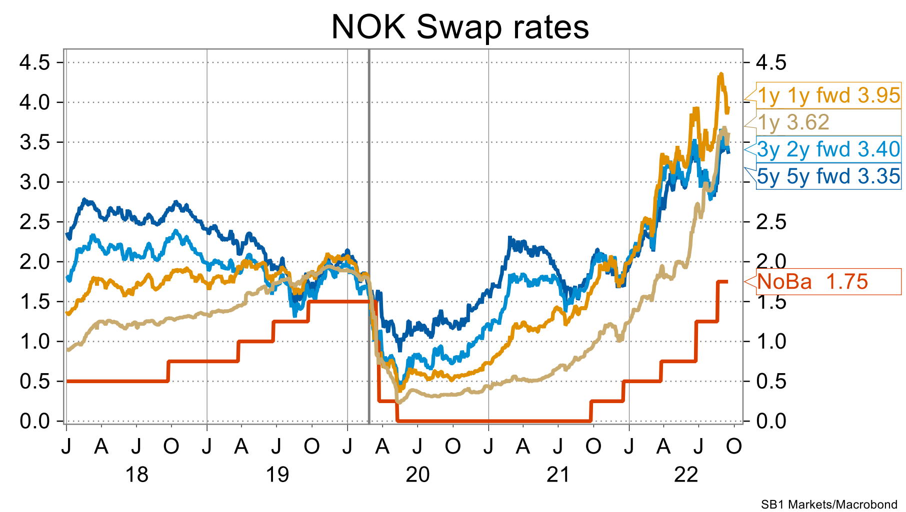


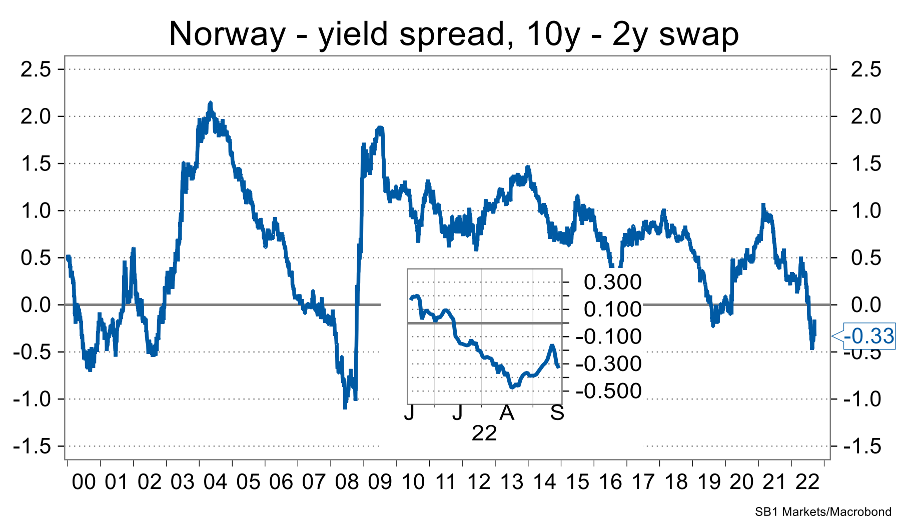
- The total real borrowing cost has increased to 300+ bps from zero by the end of last year:
  - » The TIPS real rate is up from -100 to + 90 bps
  - » The BBB corporate investment grade spread is up from 100+ bps to 225

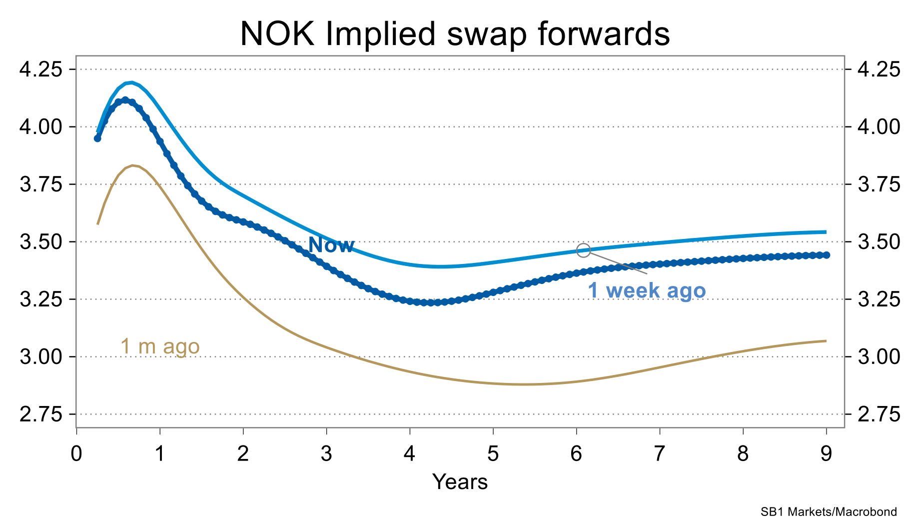
SpareBank 1 MARKETS

Norwegian swap rates fell all over the curve last week





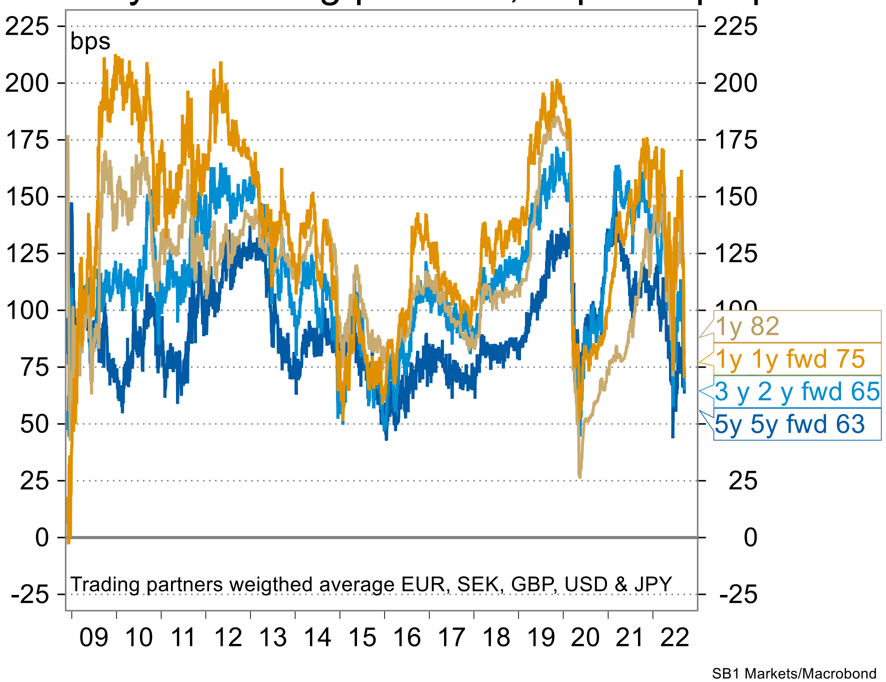


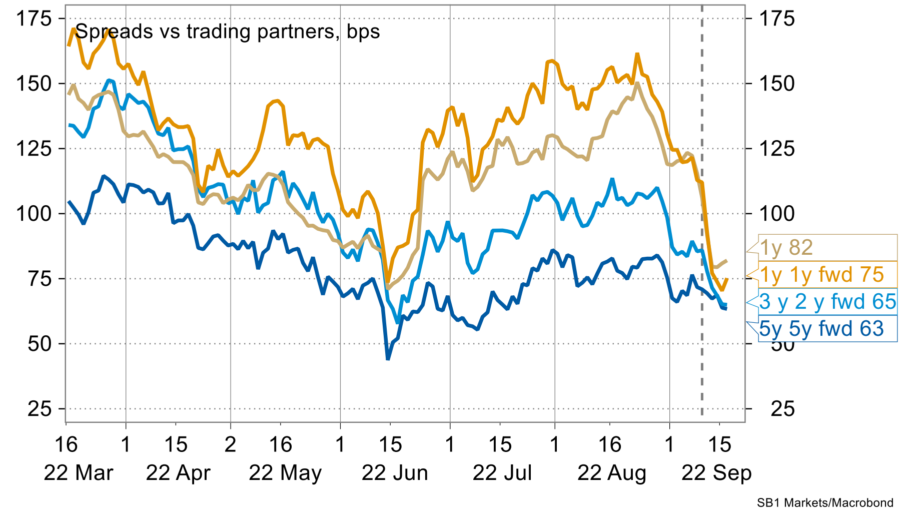


Spreads vs trading partners in the short end have fallen sharply

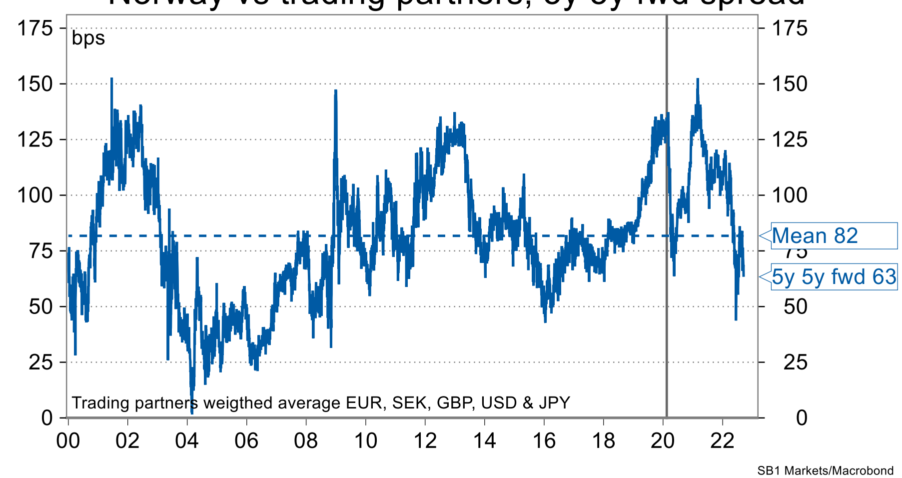
Implied spreads have fallen to levels far below average all over the curve – for good reasons

Norway vs trading partners, impl swap spreads





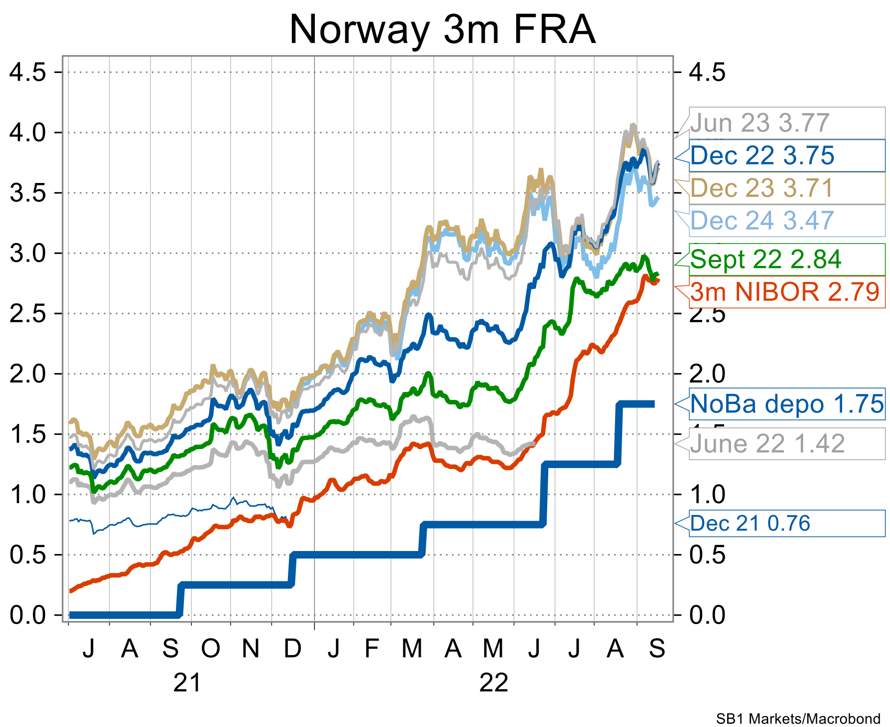
Norway vs trading partners, 5y 5y fwd spread

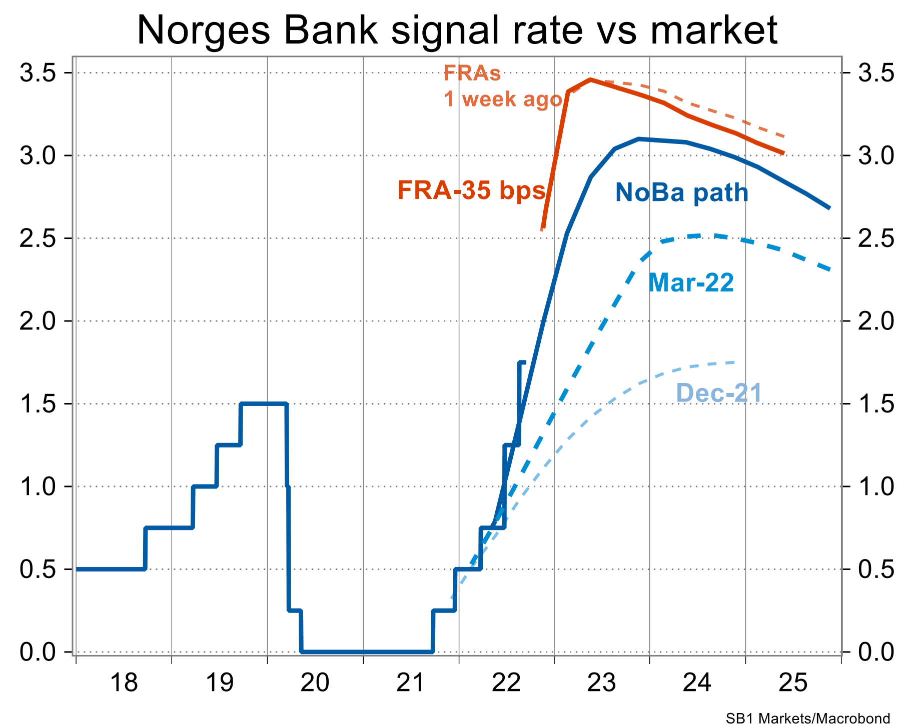


- NOK rates are still well above the average level among our trading partners – and we doubt Norway will need that much higher rates than other countries
  - » Inflation will not deviate much over time
  - » The real rate may of course deviate substantially, depending on structural differences, like growth potential, tax system etc but the current 60 – 80 bps is a substantial differential
- However, the 'structural' low rates in the Euro Area (compared to the Anglo Saxon countries) may take the 'trading partner' average too far down
- Now, there is still some downside potential in the short end, given the still rather aggressive NOK FRA-rate path (check next page)

FRAs mostly down last week, but the market curve still too aggressive

Capacity utilisation is very high but the economy is slowing, wage inflation is not accelerating

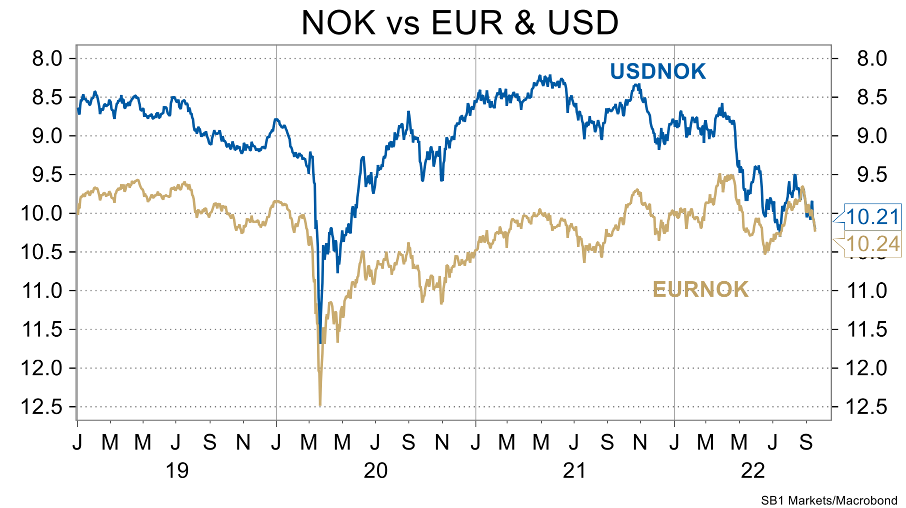


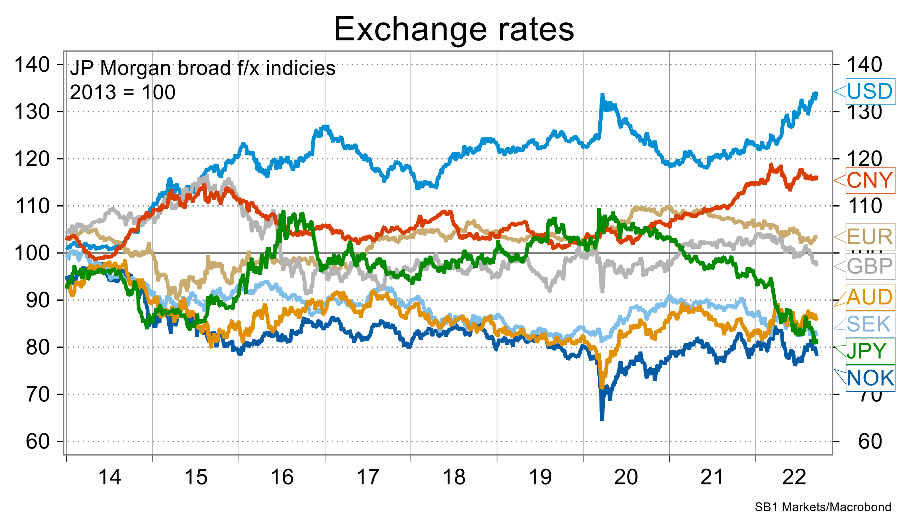


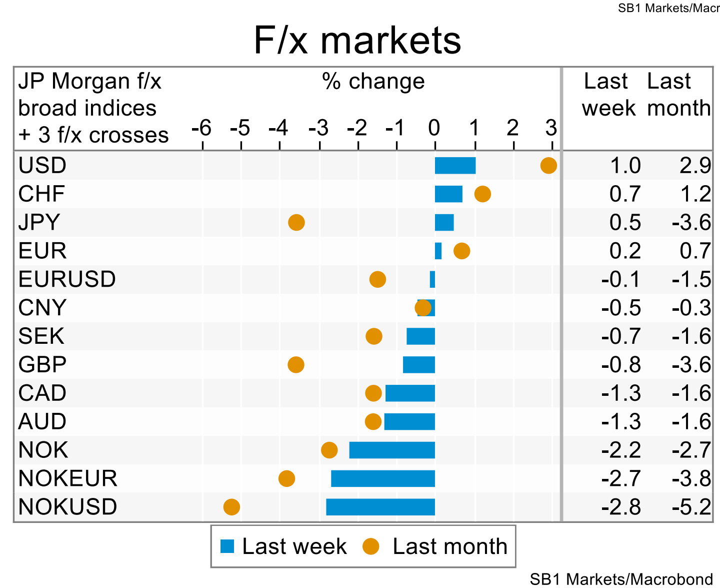
- **The 3 m NIBOR** added 3 bps to 2.79% last week. The market is discounting 50 bps hikes this week, in November and (almost) in December, and then 25 bps in January or March, to 3.5%
- **FRA rates** are down by up to 36 bps from the peak in late August. Still, we assume market expectations are too aggressive. A 3 m NIBOR at 3.77% (June-23 will lift the average mortgage rate to 5%, up from the 1.7% level at the rock bottom (and 2.4% in July, probably 3.4% in late September). Given the average debt level, as well as the proportion of households within the 'fat tail to the right', household demand will hurt too much, and house prices could fall faster and more than is needed to take the inflationary pressure out of the Norwegian economy. Real wages are under pressure as well, and there are few signs of higher wage inflation. GDP-growth has come to a standstill, and the outlook is muted, according to the Regional Network. Growth impulses from abroad will keep growth in check the coming quarters. However, capacity utilisation and excess demand for labour are very high. Thus, a further, some further tightening is warranted
- **Norges Bank** will have to adjust the starting point of the interest rate path on Thursday, but will most likely not lift the 3.1% peak estimate – just bring it forward to Q1 from Q4-23. A signal rate at 2.75% (alternatively 2.5%) by the end of 2020 will be signalled, up from 2.25% in the June path

Once more, NOK the big loser, down 2.2%. The other super-cyclicals down too

The USD strengthens further – and is very strong



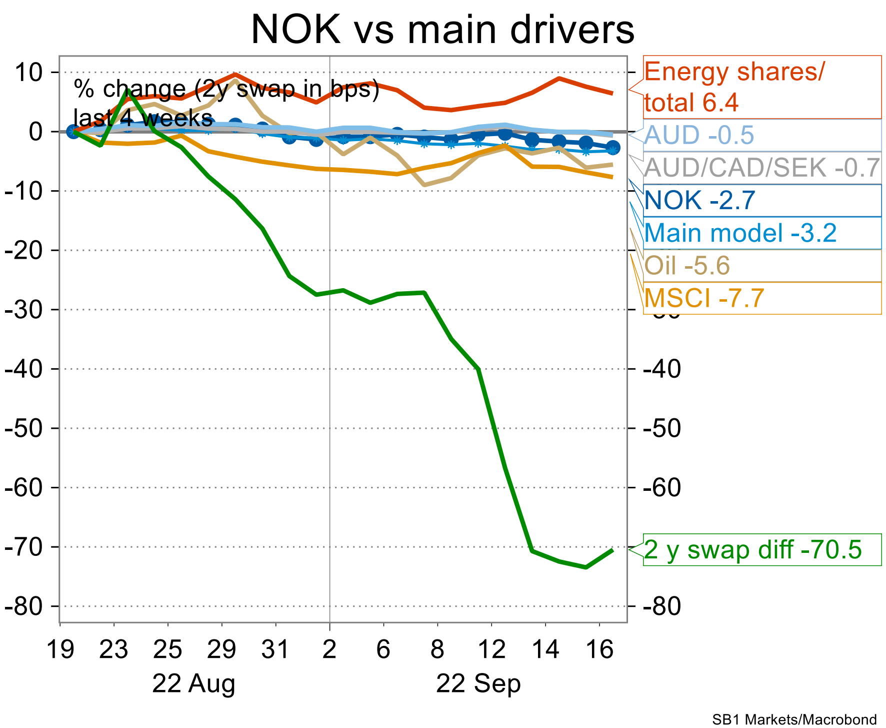


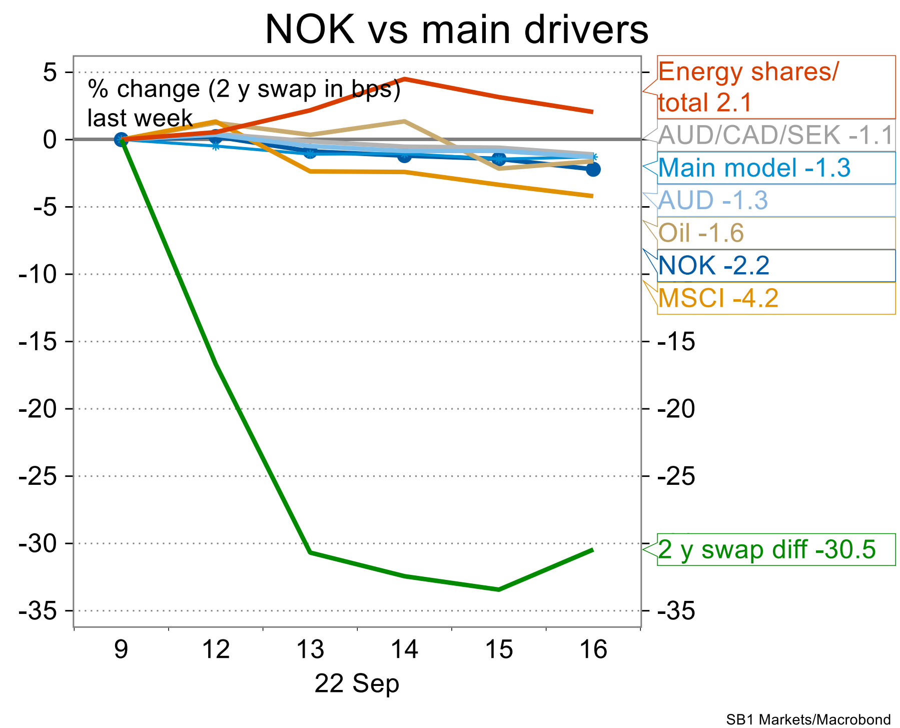


JP Morgan f/x broad indices + 3 f/x crosses	Last week	Last month
USD	1.0	2.9
CHF	0.7	1.2
JPY	0.5	-3.6
EUR	0.2	0.7
EURUSD	-0.1	-1.5
CNY	-0.5	-0.3
SEK	-0.7	-1.6
GBP	-0.8	-3.6
CAD	-1.3	-1.6
AUD	-1.3	-1.6
NOK	-2.2	-2.7
NOKEUR	-2.7	-3.8
NOKUSD	-2.8	-5.2

NOK down 2.2%, our model suggested -1.3%. The gap -1.4%.

A huge decline in the 2 y swap rate differential last week – and recent weeks. A lower oil price too





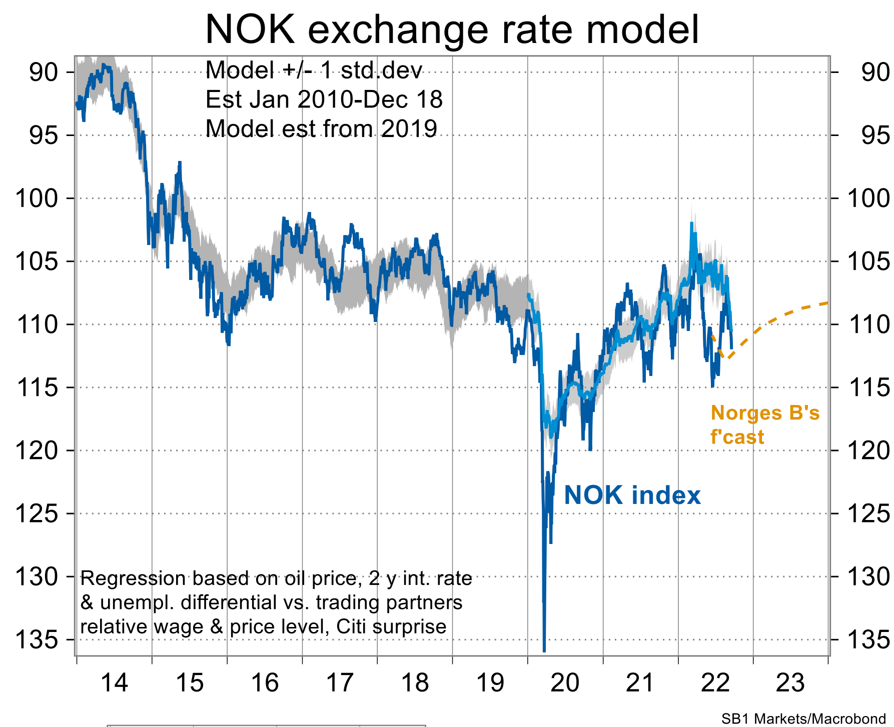
Gaps vs. out model estimates have narrowed – but not last week

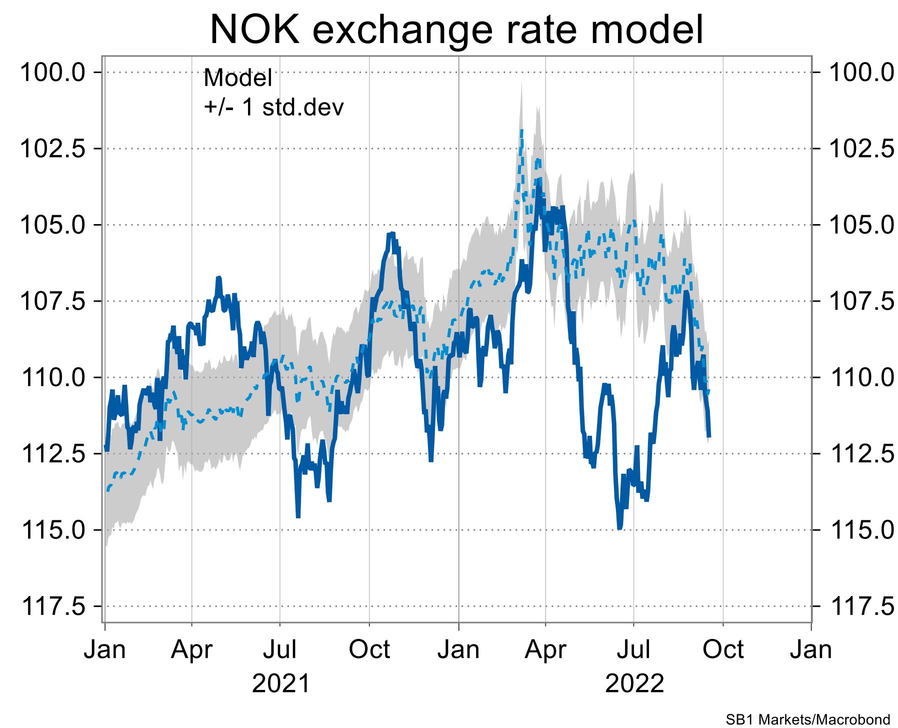
- ***NOK is 1.4% <u>below</u> our main model estimate (from –0.5%)***
- The NOK is 8% <u>weaker</u> than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts, a substantial weakening (from -7%)
- NOK is 2% <u>weaker</u> vs an estimate from a model that includes global energy companies equity prices (vs the global stock market) (from -1%)

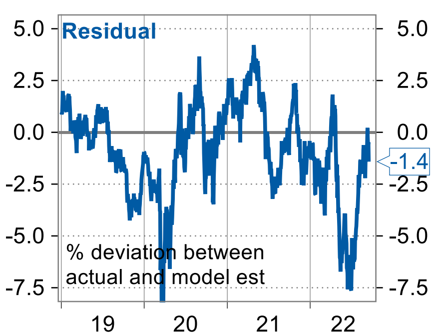
At this and the following pages we have swapped Norges Bank's I44 index for JP Morgan's broad NOK index and rebased it to the current index value for the I44. The I44 has an earlier closing time than the 'official' closing time for f/x crosses. There are no substantial difference between these two indices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

The NOK is 1.4% below our beloved model

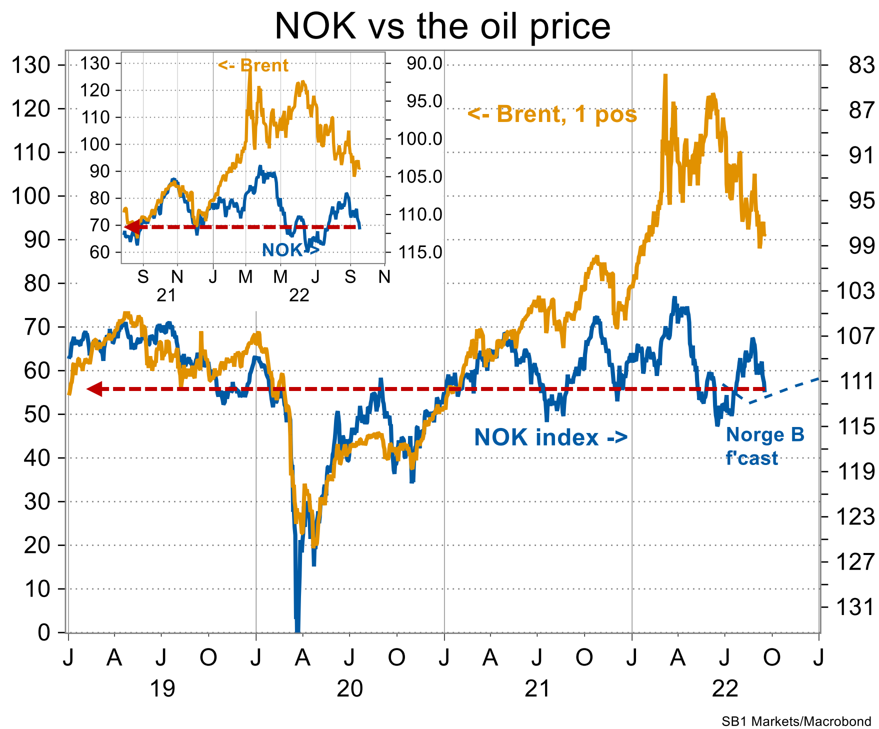
The NOK has recovered recent weeks, even if the oil price is trending down. Gas prices are… volatile

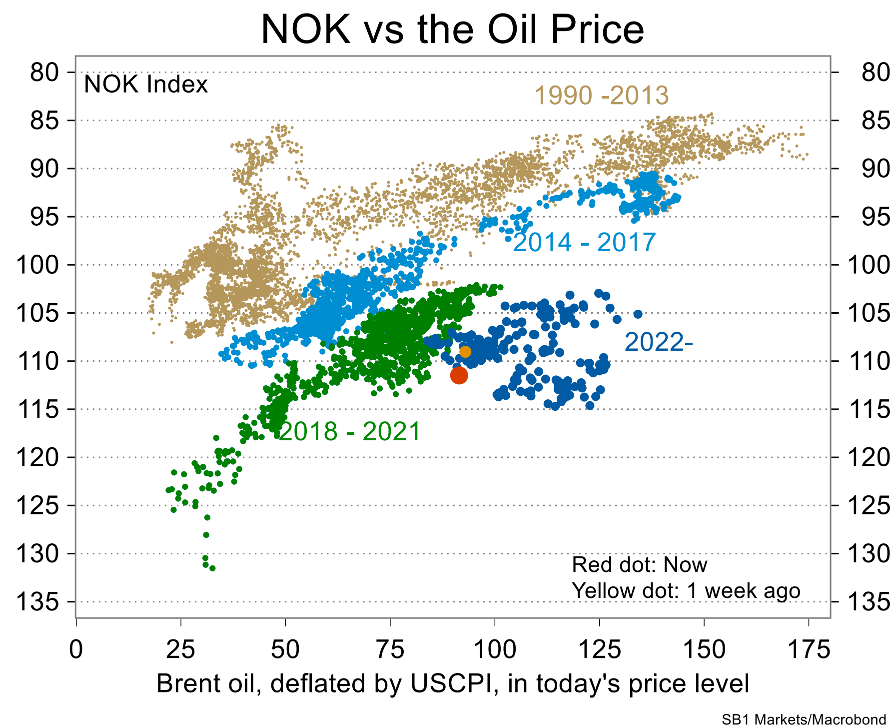






NOK sharply down without a much lower oil price – but the gas price fell sharply

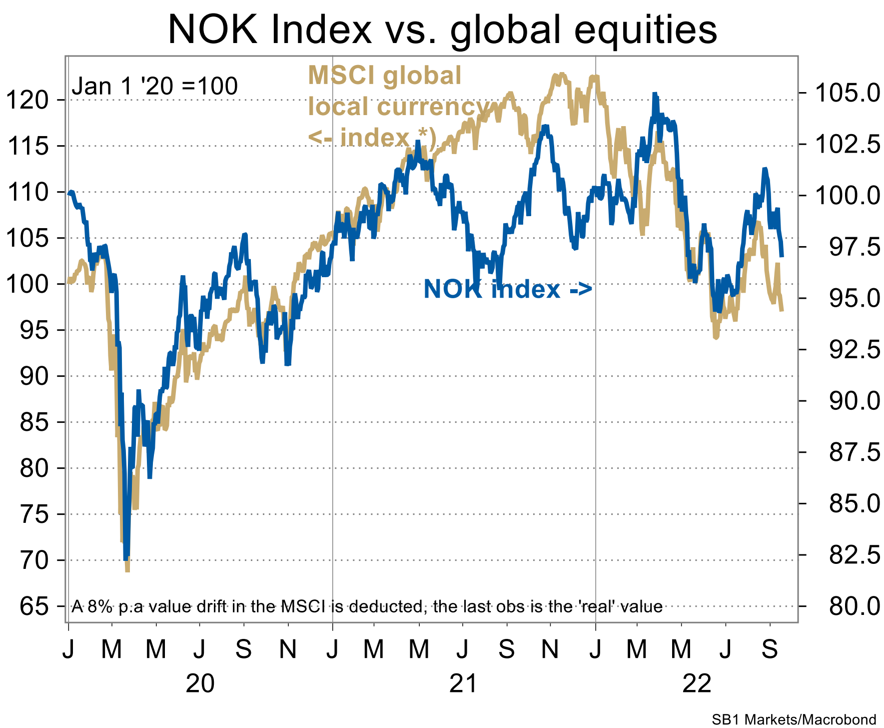


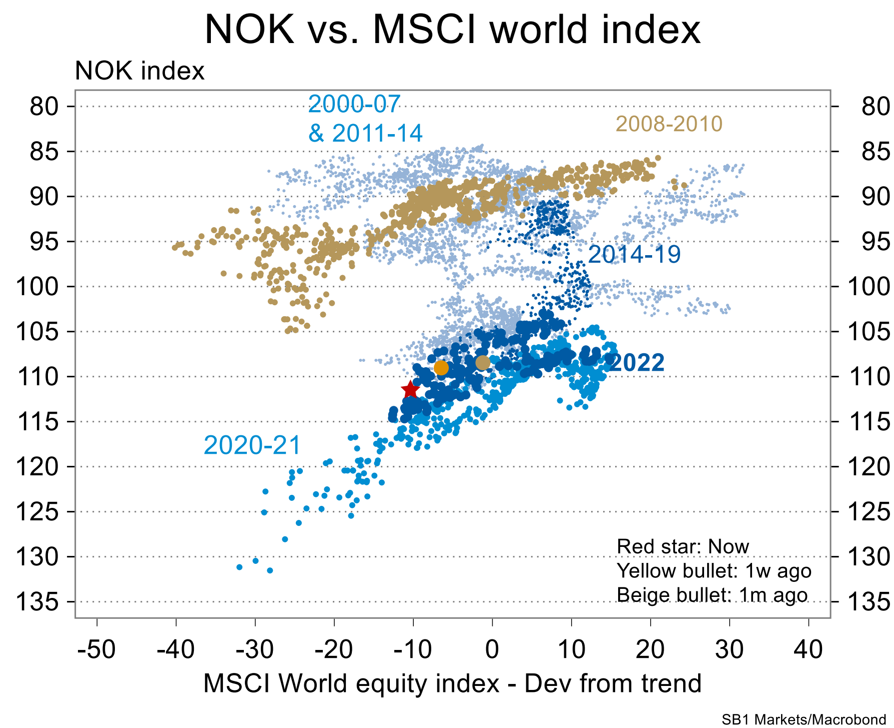


- The x/y chart to the right, the NOK vs the oil price has come closer to the 2018 – 2021 pricing regime
- However, the correlation between the NOK and the oil price has been non-existent since the start of 2022

The NOK joined global stock markets, downwards

The NOK has been more in sync with stock markets than normal since April





- There is no stable correlation over time, and when it is, the oil price is normally the real driver

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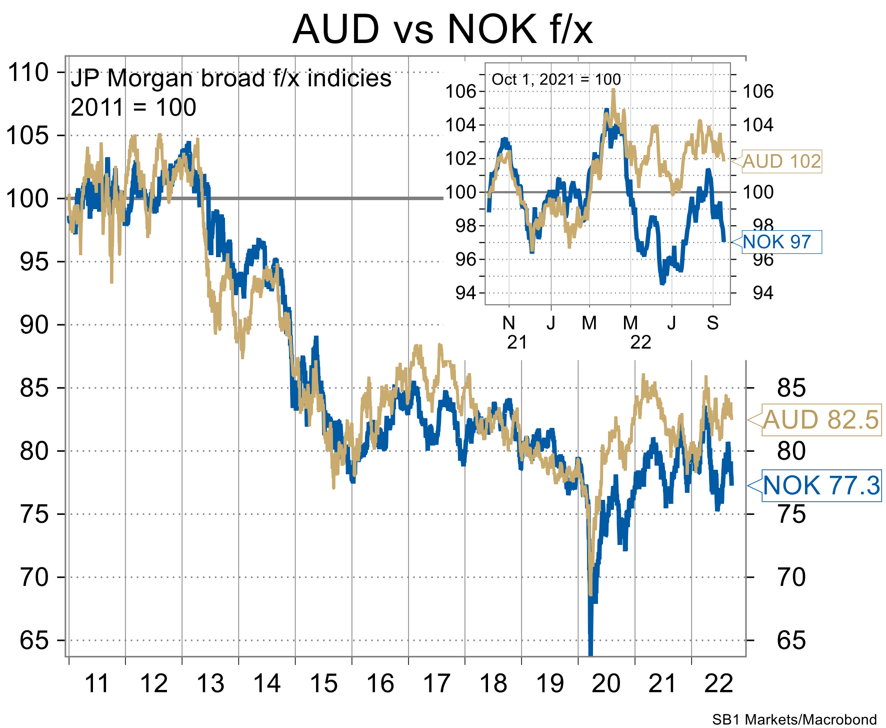
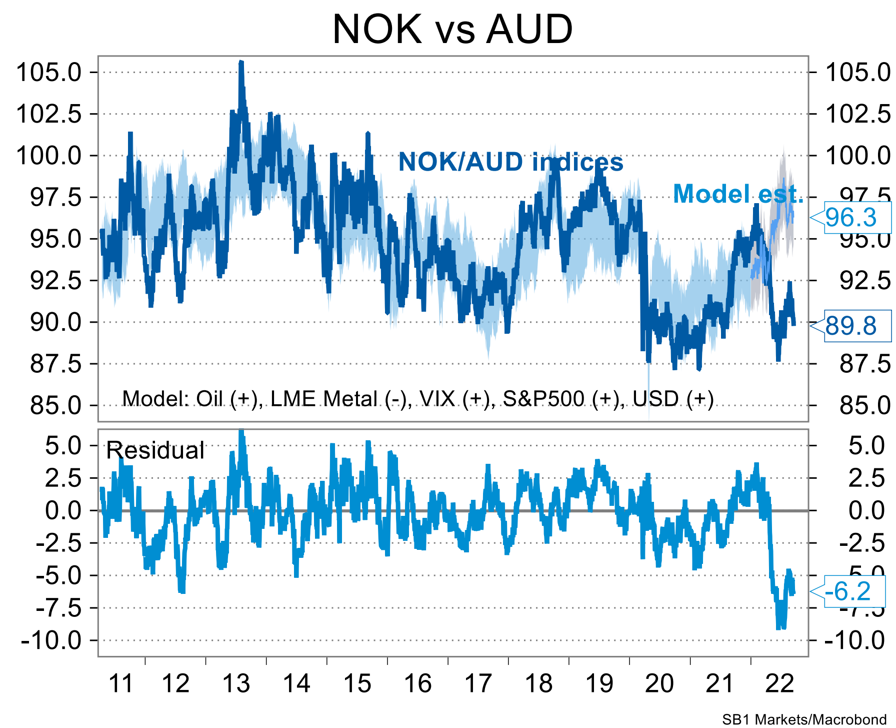
AUD down, NOK even more

NOK is 6% below our model f'cast vs AUD, even if the gas price is not included

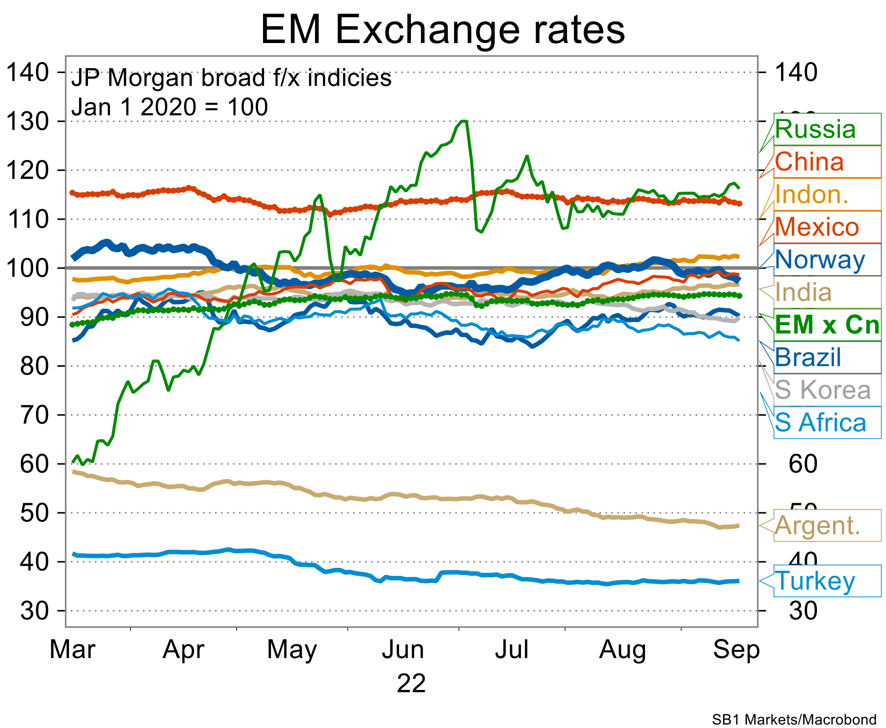


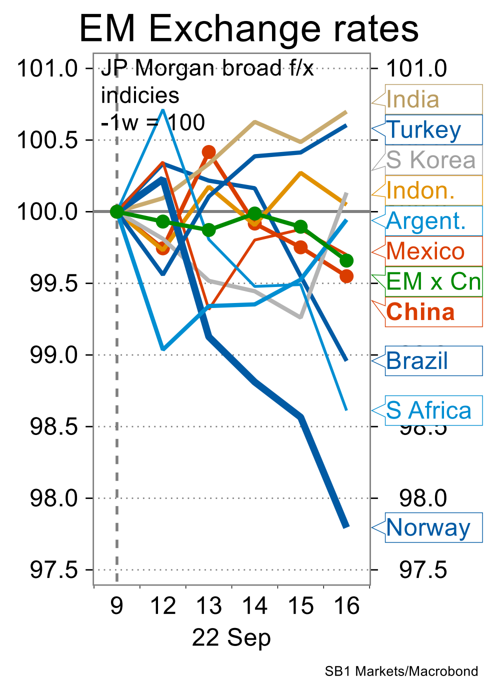


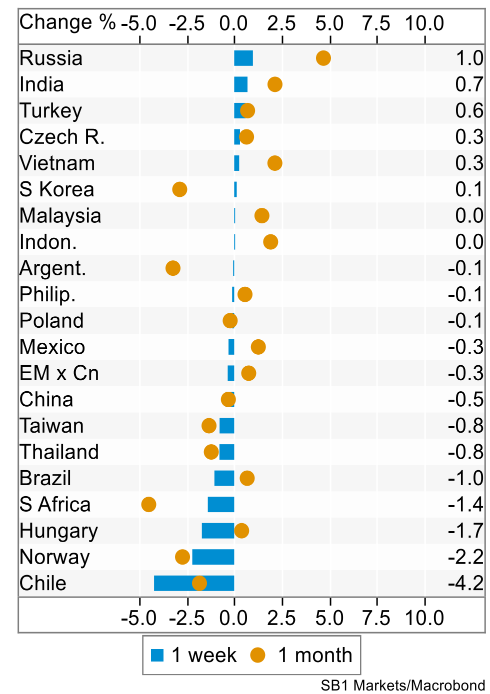
- The discrepancy between the NOK and AUD is highly unusual, given the normal factors that decide the limited gap between the two
- Normally, NOK strengthens vs the AUD when the oil price rises vs. the LME metal index, when VIX, and the S&P500 index increases, and the USD index appreciates. Seem like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

EM f/x: In sum down last week, risk off

The EM f/x markets in aggregate have been stable recent months, is spite of DM rate hikes







- The CNY has been slightly on the weak side recent weeks

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