October 17, 2022

Macro Weekly

Week 42

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Last week, I

- **The War/European Energy/Commodities**
  - » Putin's Russia is mostly on the back foot both in Ukraine, and abroad and has retaliated the humiliating (but just partly) destruction of the bridge to Crimea, by rocket attacks that mostly hit civilian Ukrainian targets
  - » **European gas and electricity prices** fell further last week. Russia offered to open up Nord Stream 2 on their side, but we doubt the Europeans will open the tap on the other side – even if there are plenty of economic arguments in favour of doing so
  - » Oil prices returned to their downward trajectory, after the lift the previous week following the larger than expected Opec+ cut in quotas
  - » **Metal prices** rose further, inspired by signals about sanctions on Russian aluminium. **Food prices** rose but are trending flattish recent weeks, after the decline since just after the war started
- **Auto sales**
  - » **Global sales** rose further in September and are just 4% below the (low though) average 2019 level. Sales in **China** rose marginally, from the highest level ever, a sign than Chinese households are not scared by the housing market crash. Sales rose in most **other EMs**, and **India** is approaching ATH. If not for **Russia** (still down 70%), EM sales would have been almost back to the 2019-level. Sales climbed in both **US and EU** too but remain 20% and 23% below the 2019-level respectively. Even so, in the US, inventories of unsold cars are low but are increasing slightly. Sales in Norway are up 10%. Global production is trending up
- **China**
  - » The **credit machine** is not working as well as normal. Bank lending is slowly slowing, while local government have pushed up their bond market borrowing, very not because they have more profitable investments to fund, but to bail out the ailing building sector, and compensate for lower revenues from land sales. In September, total credit growth was a tad higher than expected
  - » **Inflation** remain muted, at least vs. global standards these days – and core inflation fell to 0.6%!
  - » At the **CCP conference, President Xi** reiterated most of his flagship slogans. High-quality growth, technological leadership, income distribution, security, including the need to reunite with Taiwan, if needed by military means. The covid policy will be not be changed, according to China's new emperor, who no doubt aims to stay in power until his death

Last week, II

- **USA**
  - » **The Fed minutes** revealed nothing new, but emphasised that the Fed is committed to their restrictive policy stance, even at the cost of economic growth and the labour market. The statement disclosed what has already been communicated, namely that the terminal level of the fed funds rate should remain high until compelling evidence shows that inflation is receding and returning to the target
  - » **US inflation** has peaked, but core inflation is up to cycle peak at 6.6% y/y, up 0.2pp from August and above expectations again, and inflation is still broad. All but one sector are up at more than a 2% pace from before the pandemic. Energy prices fell further, but energy is still up 20% y/y, contributing 1.6 pp to the headline rate. Still, underlying inflation is slowing somewhat, and we expect inflation to come substantially down the coming quarters. Even so, the latest data suggests that the FOMC projection of another 75 bps hike in November (the signal at the last meeting) is close to a done deal. Bond yields ended the week up, and the 10 y gov Friday closed at 4.00%, the highest since April 2010. The equity market fell further, even after a remarkable recovery some few hours after the dismal CPI report, the mood changed for the worse again
  - » **Producer price inflation** has peaked as well, and prices are falling at early stages – confirming that price pressures now are easing
  - » **Retail Sales** probably rose slightly in volume terms in September, and the history was revised upwards – and sales are now flat vs. the highs last year – and sales are trending slowly up now! Univ. of Michigan consumer sentiment rose marginally in Oct, but remains extremely depressed
  - » **Atlanta Fed's median wage** tracker was up 6.5% y/y in September, up from 6.3% in August. However, the 3 m average, which is less volatile and more useful, was down 0.4 pp to 6.3%, and underlying growth may be slowing somewhat. Still, wage inflation remains far above a level that would yield 2% price inflation over time.
  - » The **NFIB small business optimism index** climbed for the 3rd month in a row in September. The level is still weak at 1.2 st.dev below average. The outlook for the next 6 months worsened, and is at a very low level, 2.5 st dev below average. Investment plans fell, like in most other surveys we follow
- **EMU**
  - » **Industrial production** rose more than expected in August, and so far there are few signs of an 'energy crisis meltdown' in energy intensive industries
  - » **The trade deficit** has widened to more than 4% of GDP, the highest ever – due to the soaring energy import bill. However, the ex. energy surplus is more than cut in half, to 1.4% of GDP (energy imports equals 5.5% of GDP). Surely, a drag on the EUR
- **UK**
  - » **Markets** are just partly calmed down, as the chancellor was kicked out after 6 weeks in charge, and the new minister of finance, Jeremy Hunt has scrapped more tax cuts and promises to deliver a tighter budget. Never before have the 'bond vigilantes' killed a political project so thoroughly in just 3 weeks. PM Truss has become a lame duck. Short term rates are coming down, as we expected – but they still remain too high
- **Sweden**
  - » **Headline CPI inflation** rose to 10.8% in September, while core inflation accelerated to 7.4%, but the latest print was in line with the Riksbank f'cast from Sept. Why is inflation so high? Well, Housing incl. energy prices are up 17% y/y, and food prices are up 16%, but other measures of underlying inflation are at the highest level in some 30 years
- **Norway**
  - » Norwegian **inflation data** surprised sharply on the upside in September. **Total inflation accelerated by 0.4 pp**, to 6.9%, the highest since 1988. We expected 5.8%!! If not for electricity subsidies, inflation would have close to 10%. Electricity prices rose 11%, while gasoline prices were up 1.2%, we expected a small decline of 2% for both. **CPI-ATE** (ex. energy and taxes) rose by 0.6 pp to 5.3% - NoBa expected 5.0%. Considering these latest inflation numbers, along with stronger-than-expected GDP data and what some call a less restrictive budget, the chance of a 50 bps hike in November is increasingly more likely. Norges Bank has signalled 2x25 bps in Nov and Dec, while the market is now pricing in 2x50 bps – and a 25 bps hike next year

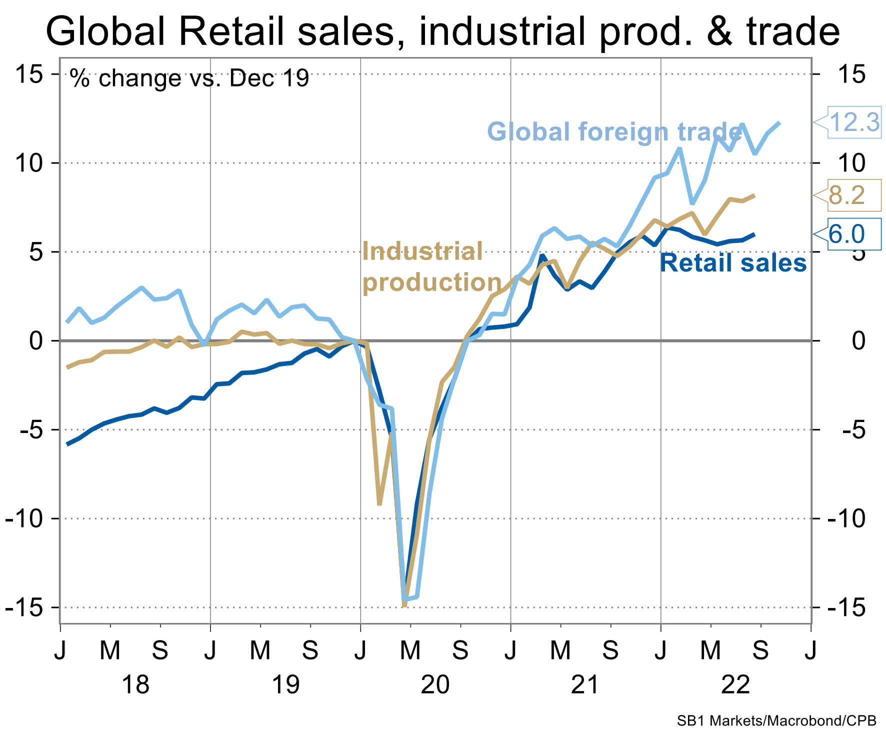
The Calendar: China investments & production, EMU/UK CPI, US housing data

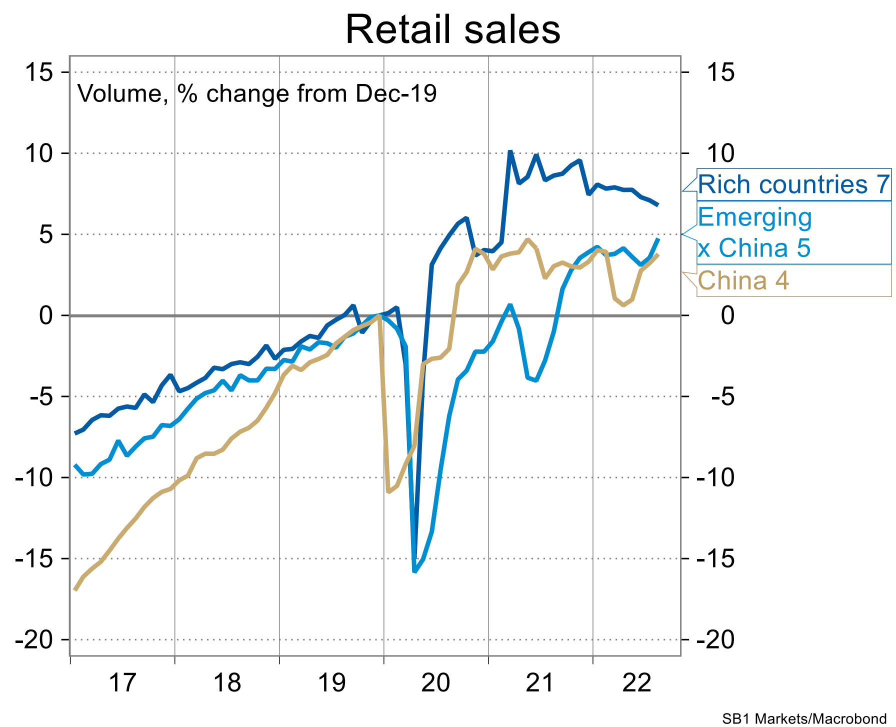
Time	Count.	Indicator	Period	Forecast	Prior
Monday October 17					
08:00	NO	Trade Balance	Sep		197.7b
14:30	US	Empire Manufacturing	Oct	-2.6	-1.5
Tuesday October 18					
04:00	**CN**	**Industrial Production YoY**	**Sep**	**4.9%**	**4.2%**
04:00	**CN**	**GDP SA QoQ**	**3Q**	**3.4%**	**-2.6%**
04:00	CN	Retail Sales YoY	Sep	3.5%	5.4%
04:00	CN	Fixed Assets inv. YoY	Sep	6.0%	5.8%
08:00	NO	Housing starts	Sep		
11:00	GE	ZEW Survey Expectations	Oct	-66.6	-61.9
15:15	**US**	**Manufacturing Production**	**Sep**	**0.1%**	**0.1%**
16:00	**US**	**NAHB Housing Market Index**	**Oct**	**43**	**46**
Wednesday October 19					
03:30	CN	New Home Prices MoM	Sep	--	-0.3%
08:00	UK	CPI YoY	Sep	10.0%	9.9%
08:00	UK	CPI Core YoY	Sep	6.4%	6.3%
11:00	EC	CPI YoY	Sep F	10.0%	9.1%
11:00	EC	CPI Core YoY	Sep F	4.8%	4.8%
13:00	US	MBA Mortgage Applications	Oct-14		-2.0%
14:30	US	Building Permits	Sep	1549k	1517k
14:30	**US**	**Housing Starts**	**Sep**	**1464k**	**1575k**
20:00	US	Fed Beige Book			
Thursday October 20					
01:50	JN	Trade Balance	Sep	-2145.4b	-2817.3b
06:00	SW	House prices, HOX	Sep		
08:00	NO	Industrial Confidence	3Q	(0)	3.2
10:00	NO	Home builders starts and sales	Sep		
10:00	NO	Norges Bank's Lending Survey	Q3		
14:30	US	Philadelphia Fed	Oct	**-5**	**-9.9**
14:30	US	Initial Jobless Claims	Oct-15	**235k**	**228k**
16:00	US	Existing Home Sales, Prices	Sep	**4.69m**	**4.80m**
16:00	**US**	**Leading Indicators**	**Sep**	**-0.3%**	**-0.3%**
Friday October 21					
08:00	UK	Retail Sales Ex Auto Fuel MoM	Sep	-0.4%	-1.6%
08:00	SW	LFS Unemployment Rate SA	Sep	6.9%	6.9%
16:00	EC	Consumer Confidence	Oct P	-30	-28.8
During the week					
	CN	Trade Balance	Sep	$81.20b	$79.39b
	CH	Exports YoY	Sep	4.0%	7.1%
	CH	Imports YoY	Sep	0.4%	0.3%
Monday October 24					
02:30	JN	Services PMI	Oct P		52.2
02:30	JN	Manufacturing PMI	Oct P		50.8

- **China**
  - » **GDP** collapsed in Q2, due to the widespread lockdowns, down 2.6% (-10% annualised). A 3.5% partial recovery is expected in Q3, lifting the annual growth rate to 3.4% from the meagre 0.4% in Q2. 2022 growth will probably be just some 3.5%. Construction activity is falling rapidly, partly compensated by a larger trade surplus. At least partly due to covid restrictions, consumption is not blossoming
  - » **Retail sales** surprised on the upside in August, and the history was revised up significantly. However, the volume is 6% below the pre-pandemic trend
  - » **Investments** rose in August, and is back on the pre-lockdown path. However the underlying growth rate has come down significantly since the before the pandemic. It is still interesting that investments haven't fallen further given that **construction starts** (both residential and commercial) are down more than 50% since early '21, and new home sales are down 36%. Home prices are falling, rather rapidly
  - » **Exports** fell in August, from a very high level (both in nominal and real terms). Lockdowns were probably not to blame but rather weaker demand from abroad, as signalled by manufacturing surveys. **Imports** have been flat since last summer in value terms, and have fallen in volume terms but less than we assumed as new data shows that import prices fell sharply in August
- **USA**
  - » **Manufacturing production** unexpectedly rose in August. The short-term trend is still flat. Surveys are below average and confirm the slowdown, but they do not yet signal a downturn
  - » **The housing market** in the US has hit a rough patch. **Permits** have fallen for the past 5 months, and **starts**, although up last month, are down 13% from the April peak. The home builders index, surveying the sales conditions in the housing market, has fallen faster than anytime before (barring the pandemic) and signals a 50% setback from the local peak). A mortgage rate at above 7% is clearing the market for buyers…
  - » **The leading indicators** 6m average fell to -0.45% last month, a level which has predicted 8 out of the 8 last recessions! A further decline is expected in September, but at a somewhat slower pace
- **EMU**
  - » **The final inflation** data set will remind us that inflation reached 10% in September, and the core accelerated to 4.8%, far above expectations, and although wage inflation is not pressing and a major problem for the ECB, the price increases are broad – and ECB board members continuously tell us they are worried
- **UK**
  - » **Inflation in the UK** is at 10% and it is broad, like elsewhere. All main categories are reporting price growth of (well) above 2%. The data is likely to come in higher than in August, which is also expected by the BoE, which now forecasts that inflation will top out at 13% (before eventual new energy subsidies)!
- **Norway**
  - » **Both housing starts and sales** were up last month, and the sales trend is clearly down. Starts have also come down, especially in Oslo & Viken and in Vestland
  - » We **expect Norges Bank's lending survey** to signal lower loan demand from households, and stricter standards for lending to corporates, especially vs real estate
  - » **SSBs Q3 manufacturing survey** should confirm a slowdown towards zero growth in production

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

Retail sales have stabilised, while manuf. prod. and global trade trend upwards

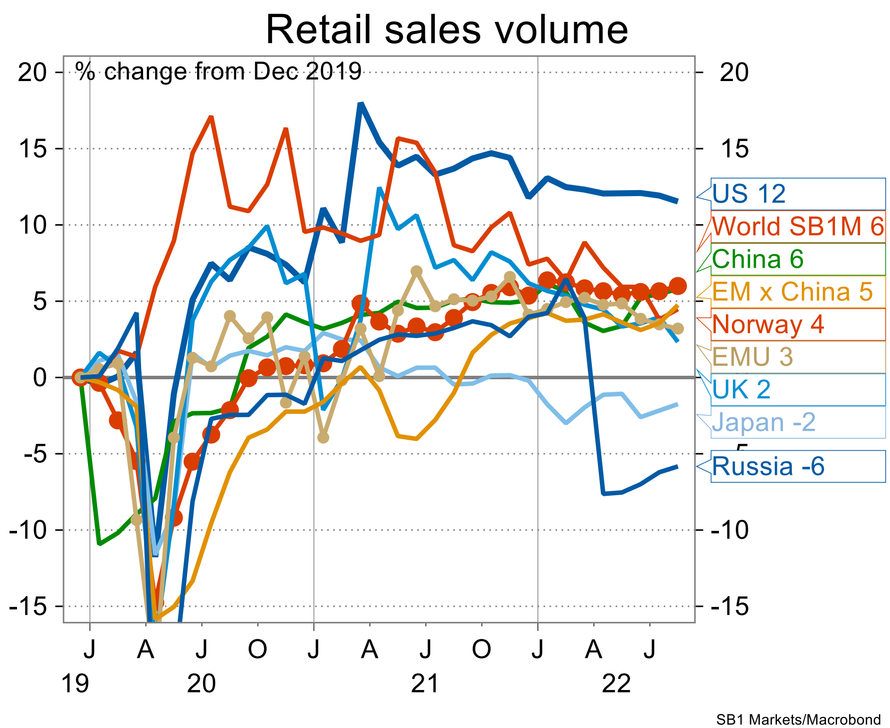


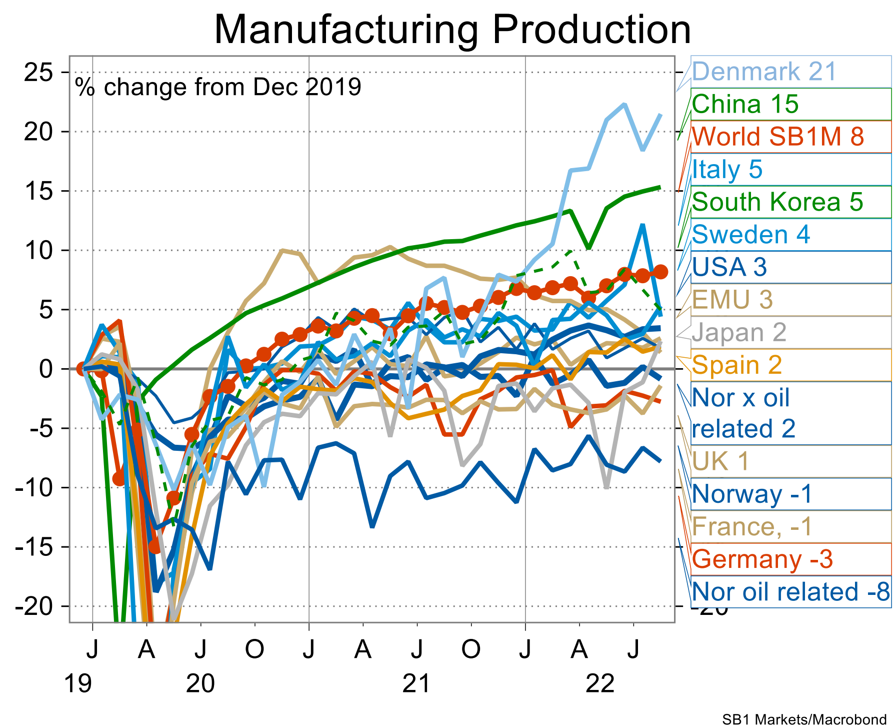


Global foreign trade: The last months are estimates from the Kiel Institute, they are also making a prognoses for the next month based on shipping activity etc.

A broad slowdown of retail sales, at least in the rich part of the world

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





US retail sales: Personal consumption of goods, ex auto & energy

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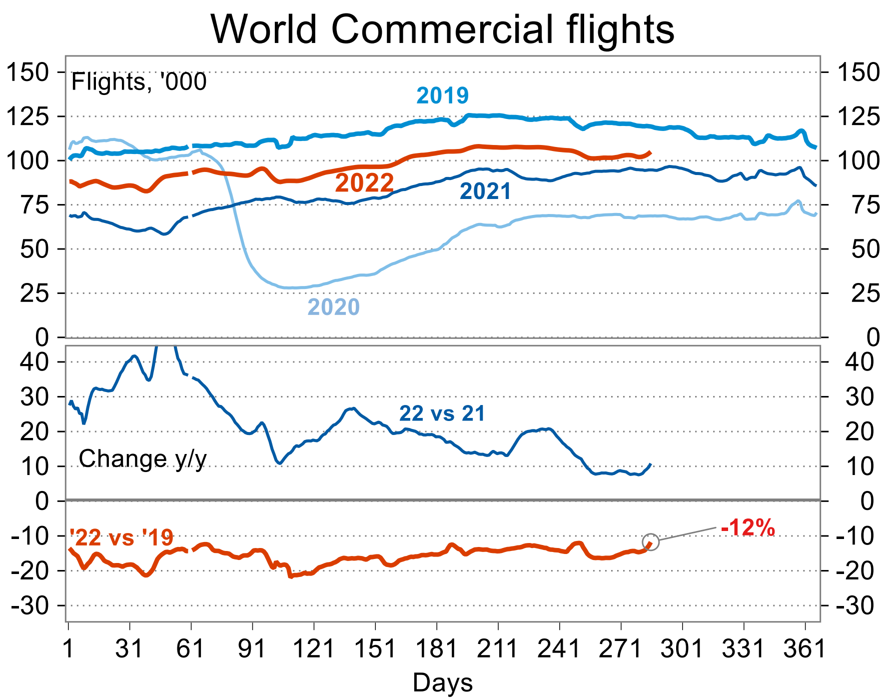
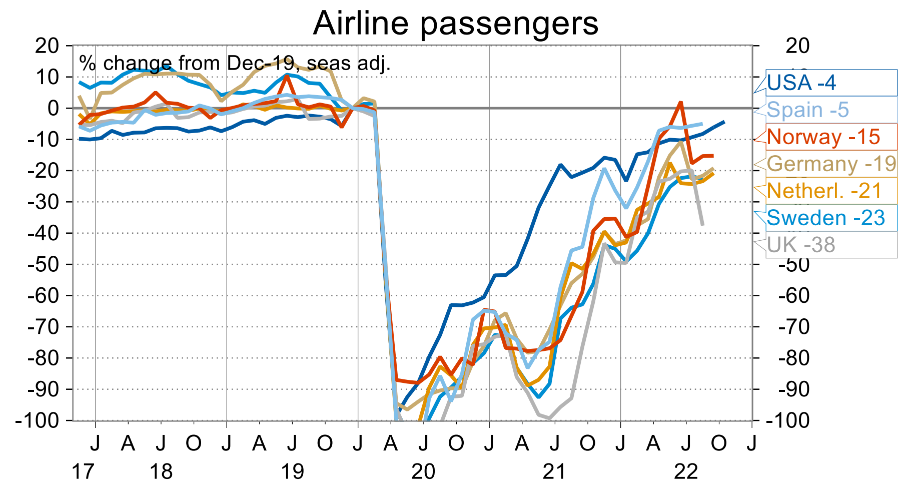
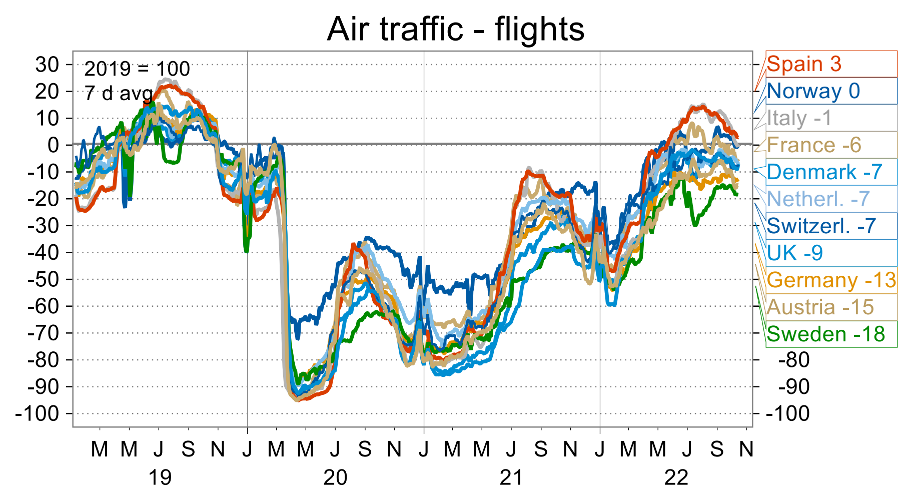
Global airline traffic down slightly up, down 'just' 12% vs. 2019 level



Flightradar24 SB1 Markets/Macrobond



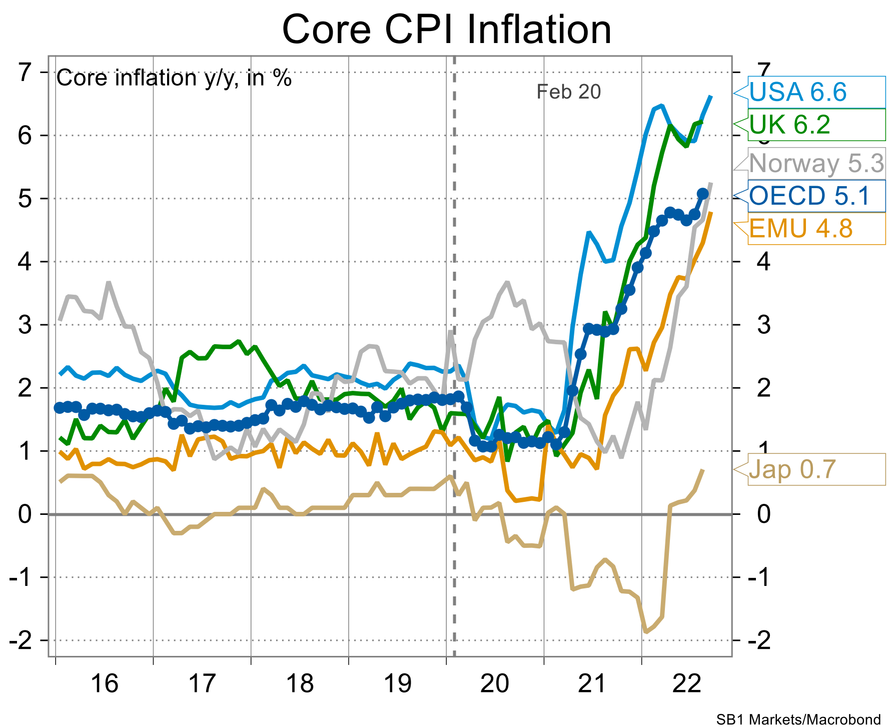
National authorities, SB1 Markets/Macrobond

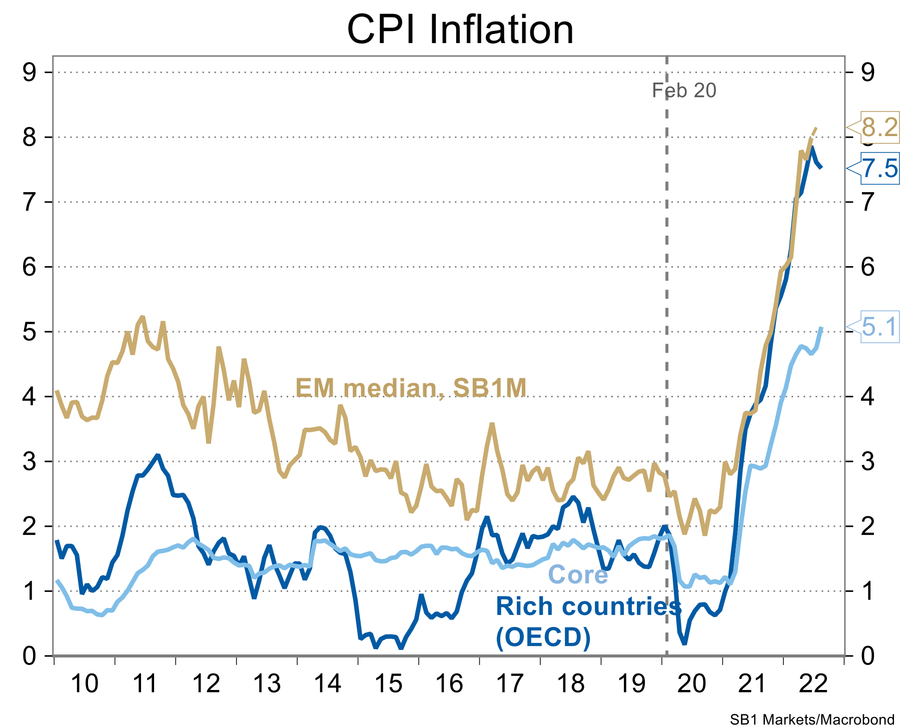


SB1 Markets/Macrobond

Peak inflation? Data are not that obvious anymore

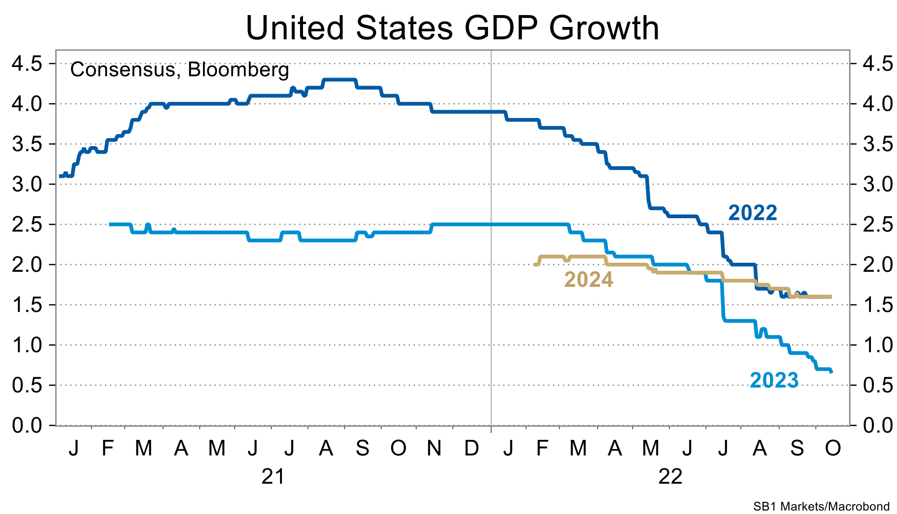
The going rate is 8% headline inflation, and 5% core inflation, and the latter is still on the way up

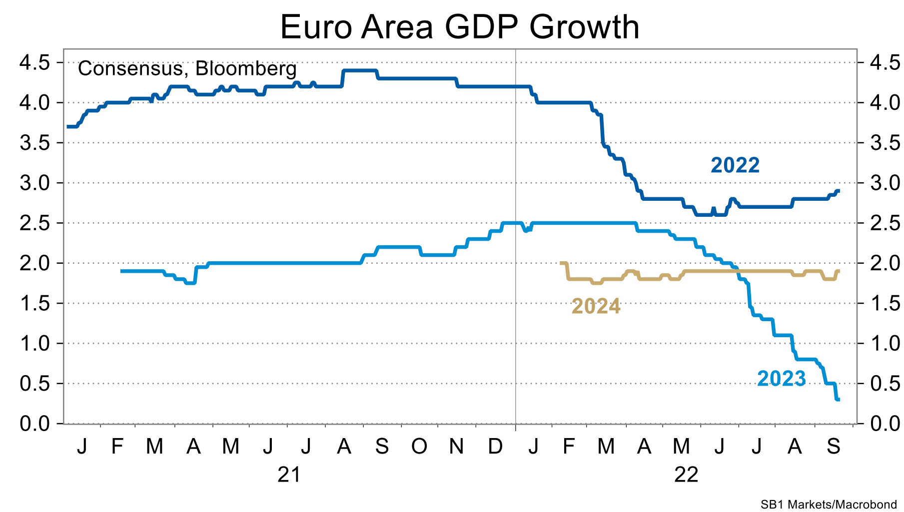


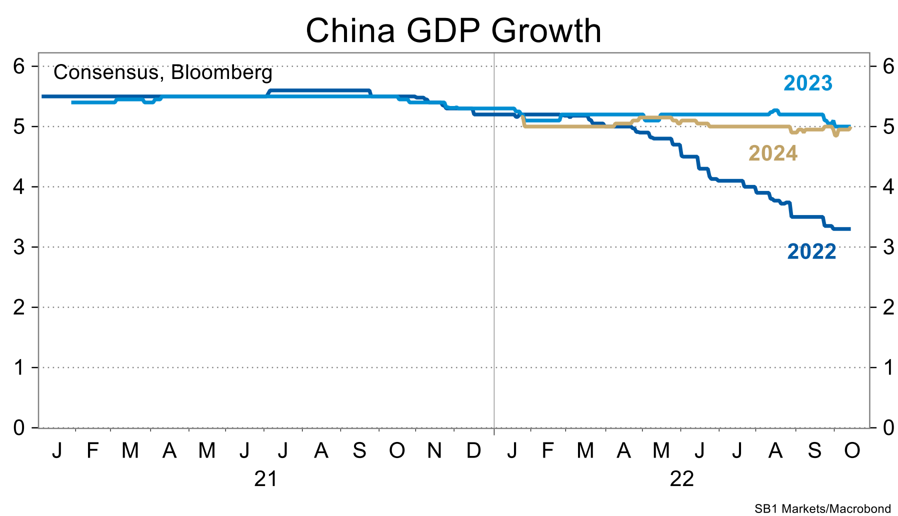


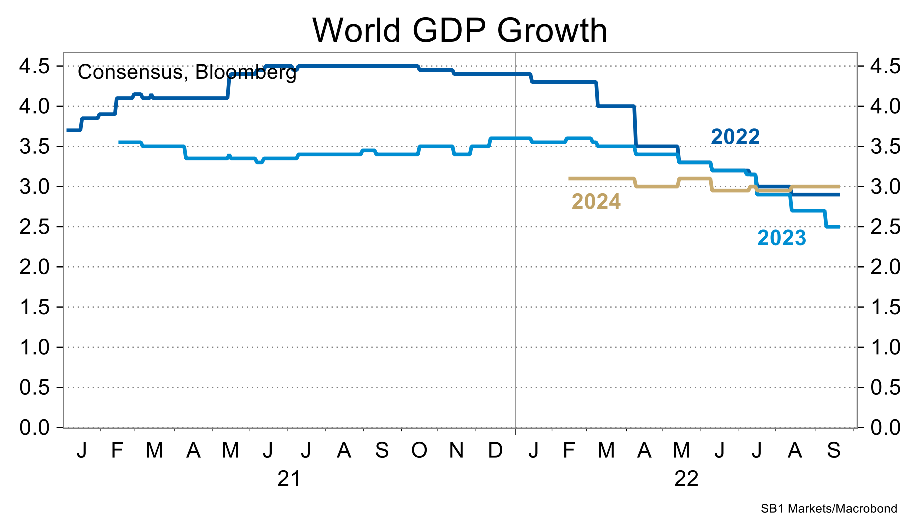
GDP growth expectations: 2023 forecasts are sliding down, and fast in the EMU

In addition, 2022 will be a 'lost' year in China









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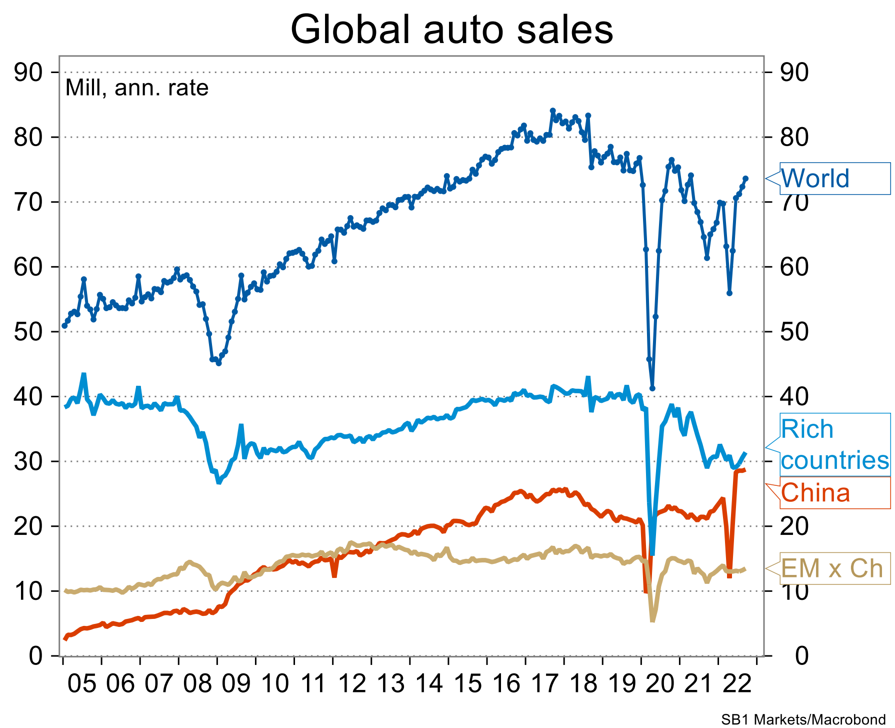
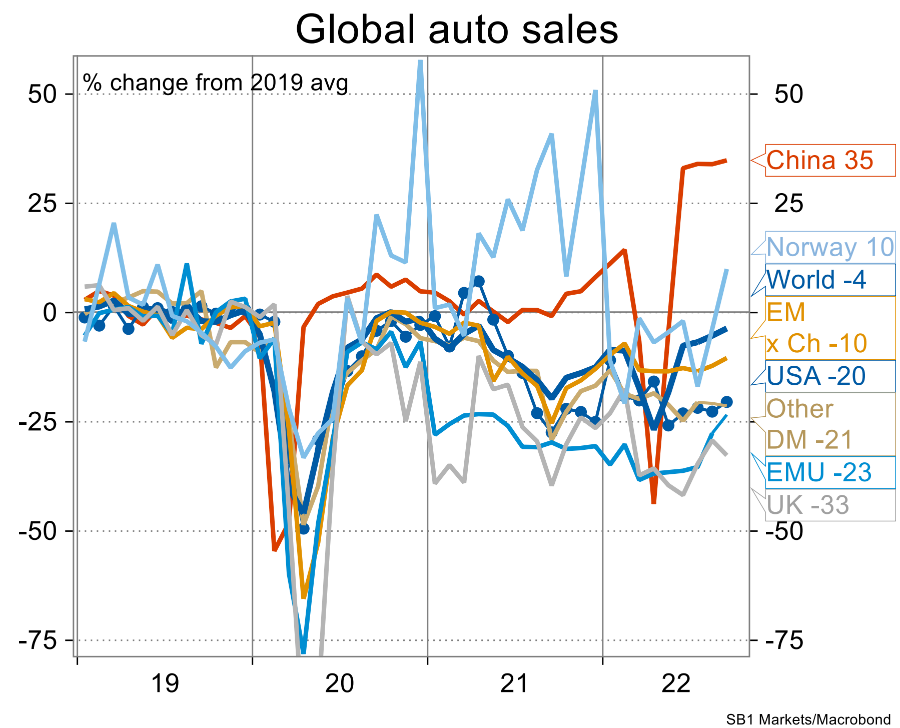
Sales remained strong in China, and sales rose in other parts of the world as well

Global sales further up in Sept, as production is recovering. Sales are still 4% below the 2019 average

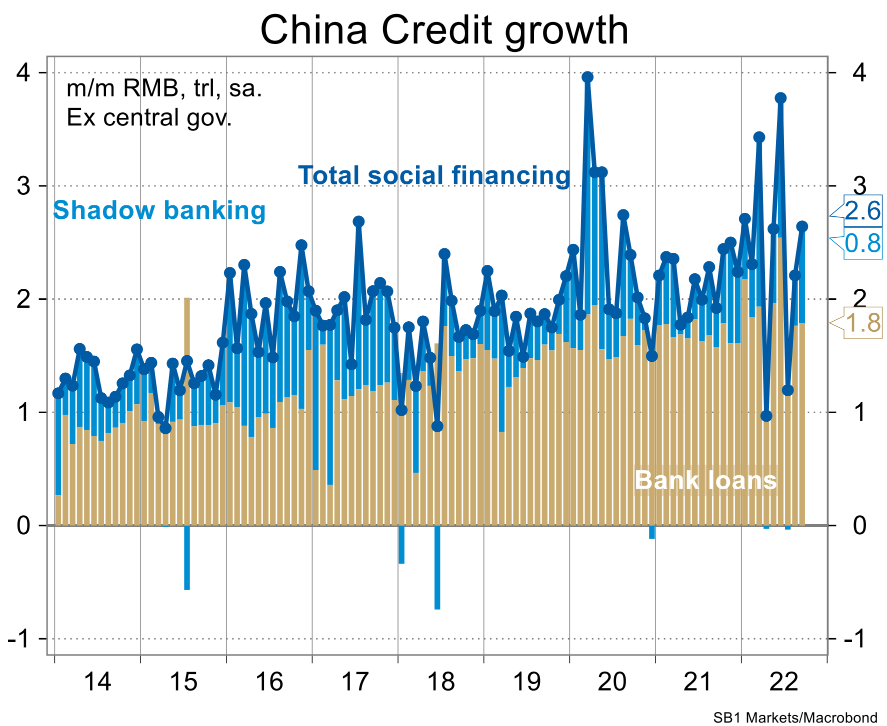


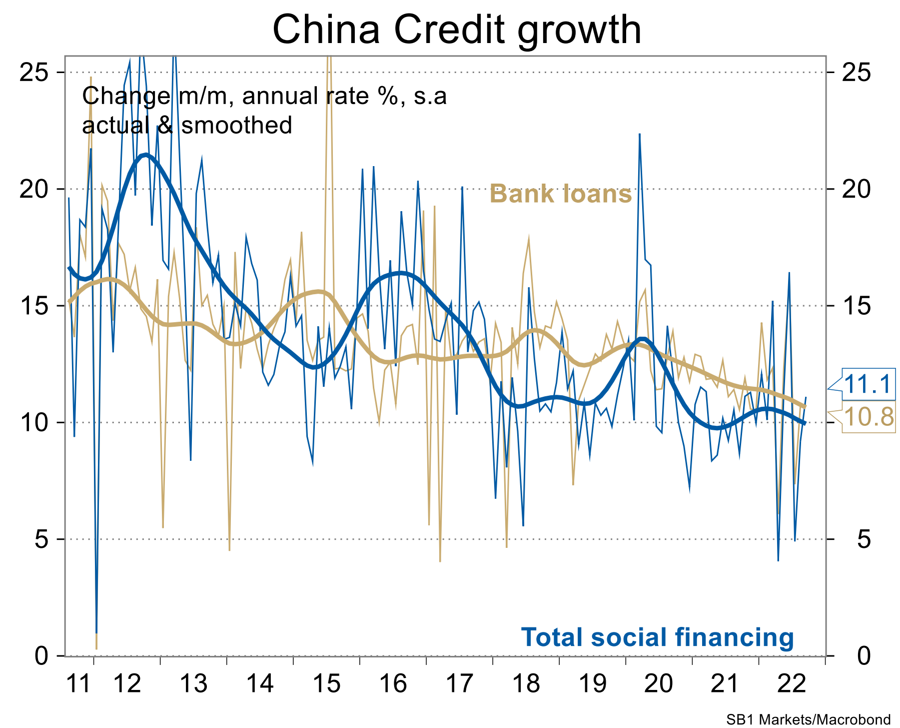


- **Global auto sales** rose 1% in September, following a similar lift in August. Sales are the best since early 2021, and 'just' 4% below the 2019 level
- The regional differences are substantial: Sales kept up at high level in **China** (+35% vs 2019 avg.), and the slump in sales during the lockdowns is more than compensated, signalling that Chinese households are not too worried. Sales in the **US** rose marginally to -20% vs 2019. **EMU** sales rose more but is still 23% below the 2019 level (from -26%). **UK** sales slipped and is down 33%, before the new government messed it up, and rates shot up all over the curve! **Norwegian** sales rose in Sept, 10% above the 2019 level, best among rich countries
- **Indian sales** are close to ATH, while sales are on the way in **many other EMs** as well. **Russian** sales remain depressed, down 70% from a normal level
- **Auto production** is very likely limiting sales most places. However, production is now heading upwards. Chinese production was 32% above the 2019 level in July. South Korea is also above the 2019 level, but auto production is well below a normal level in all western countries and in Japan

Bank credit growth is slowing, some life in the shadows (but it's mostly local)

Total credit growth higher than expected – up to a 11.1% pace from a 5% pace back in July

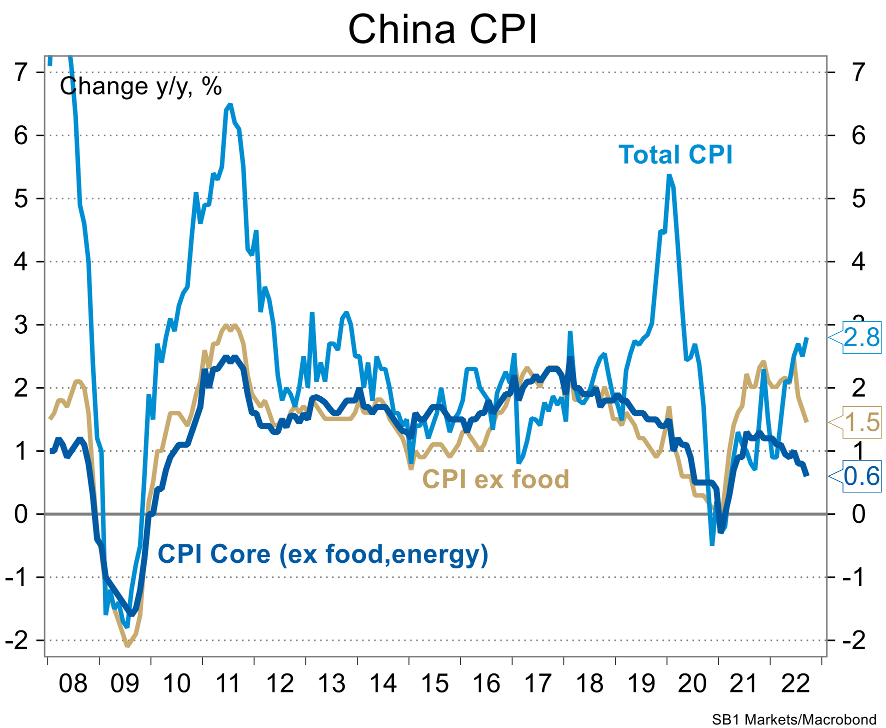


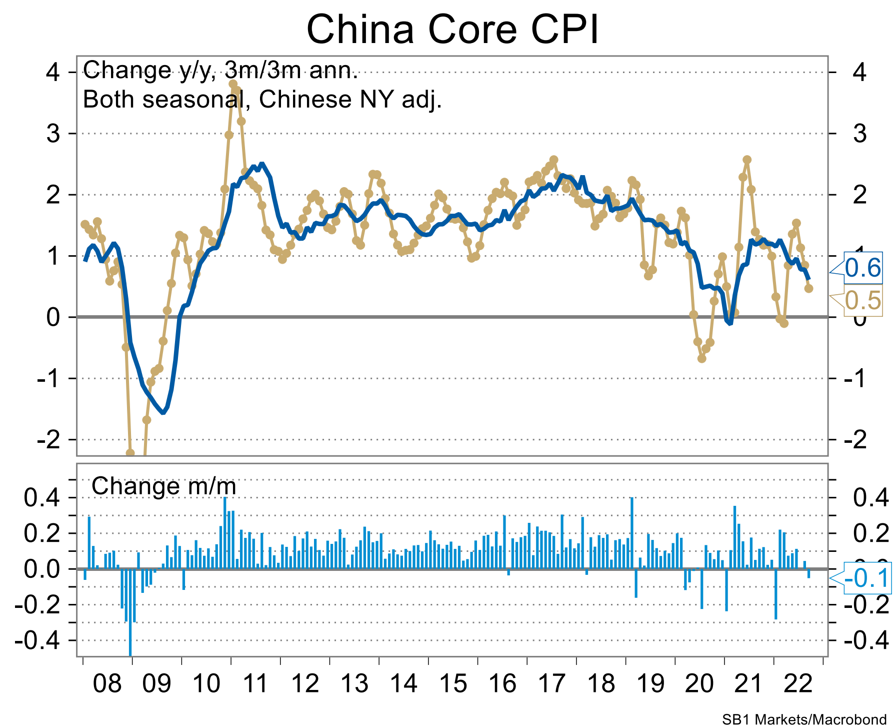


- **Total credit** grew at a 11.1% pace in Sept (m/m, seas. adj. annualised), up from 10.4% in August and 7.3% in July (which have been substantially revised up)
- **Total credit** rose by RMB 3.44 trl, expected 2.7 trl (not seas. adj). The 'core' total social credit (total ex central gov bonds & corporate equites) grew by 2.7 trl (seas adj), up from 2.2 trl in August. The Sept growth rate is close to 'normal'
  - » **Bank loans** rose by RMB 1.8 trl (s.a) or at a 10.8% annualised pace, in line with expectations, and close to the growth rate in August – and close to the underlying growth rate – which trends downwards
  - » **Shadow banking credit** rose by RMB 0.9 trl, and is up 9.0% y/y
  - » **Local governments have been** responsible for most of the increase in credit outside banks over the last year, at least until the past three months. Less revenues from sale of land, and public financing of unfinished building projects requires funding, which is 'dictated' from the central government

No inflation problem in China: Core down 0.1% m/m, down 0.2 pp to 0.6% y/y

Inflation data roughly in line with expectations

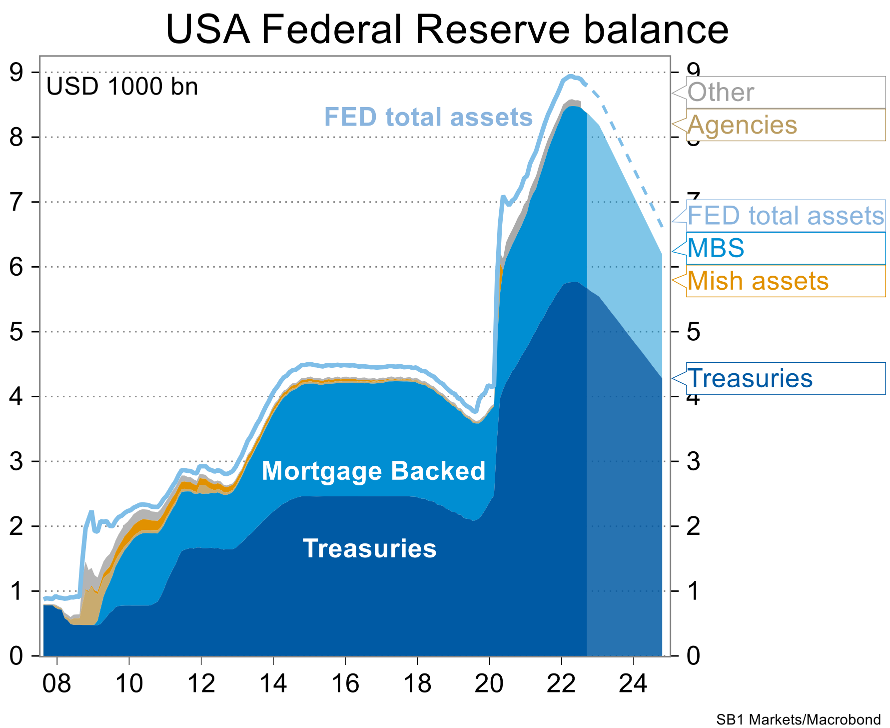




- **Total annual CPI** was up 0.3 pp to 2.8% in Sept, spot on consensus est. Prices rose 0.25% m/m, up from 0% in July
- **The core CPI** (x energy, food) was fell 0.1% m/m, and the annual rate was down 0.2pp to 0.6% y/y. The 3m/3m rate is at 0.5%
- **Food prices** are up 8.8% y/y, with pork prices in the lead again, up 36%
- **Gasoline/fuel prices** are up 19% (down from 20% y/y in Aug)
- **Both core & headline inflation** are still low. **Monetary policy** will not respond to actual inflation data if inflation is not really high or low, the real economy and the credit market is more important. Now authorities are trying to kickstart the economy again after the lockdowns

Fed minutes: No news, but confirming their restrictive stance

Cost of taking too little action outweighs cost of taking too much action



The fed projected another 125 bps increase in the fed funds target rate, atop of the 75 bps in Sept. The minutes, while just reiterating what was already communicated by Jay Powell, was interpreted as slightly hawkish by the equity market which fell on Wednesday post the minutes and higher-than-expected PPI data – bond markets on the other hand saw very small movements in yields

- **The minutes** revealed nothing new, but emphasised that the Fed is committed to their restrictive policy stance
- "Participants reaffirmed their strong commitment to returning inflation to the Committee's 2 percent objective, with many stressing the importance of staying on this course <u>even as the labor market slowed</u>"
- The statement also indicated that once a "sufficient restrictive level" is reached the rate should be kept at that level until compelling evidence shows that inflation is receding and returning to the target
- "A couple of participants remarked that, after the process of balance sheet reduction was well under way, it would be appropriate for the Committee to consider sales of agency MBS…"
- In sum, the minuets, just as the press conference, shows the Fed commitment to bringing inflation down and preventing it from becoming entrenched, even at the cost of the labour market and growth. The committee is also clear that the risk to inflation is on the upside and the risk to their economic projections are to the downside – but bringing down inflation will remain the focus

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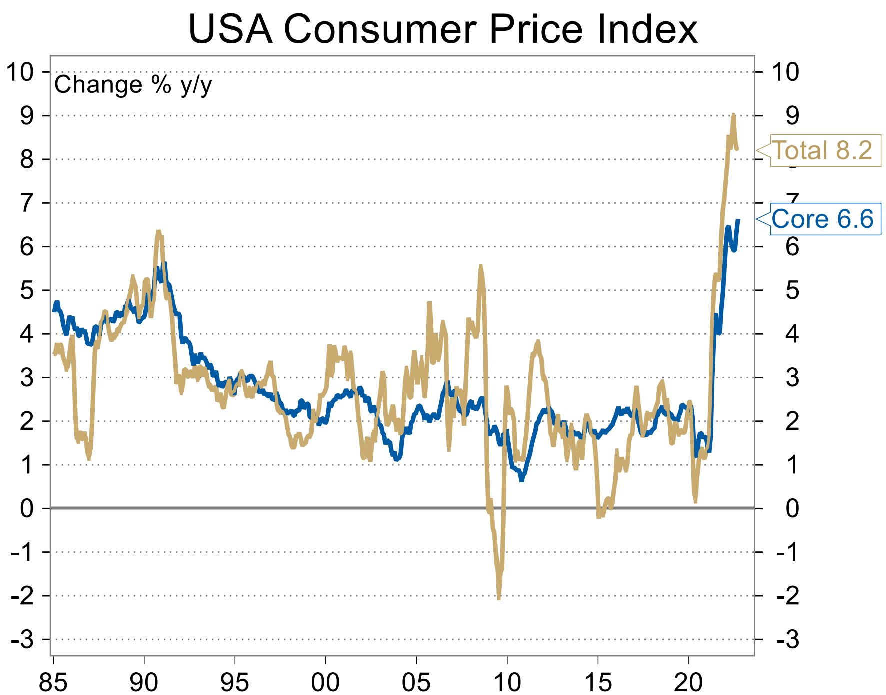
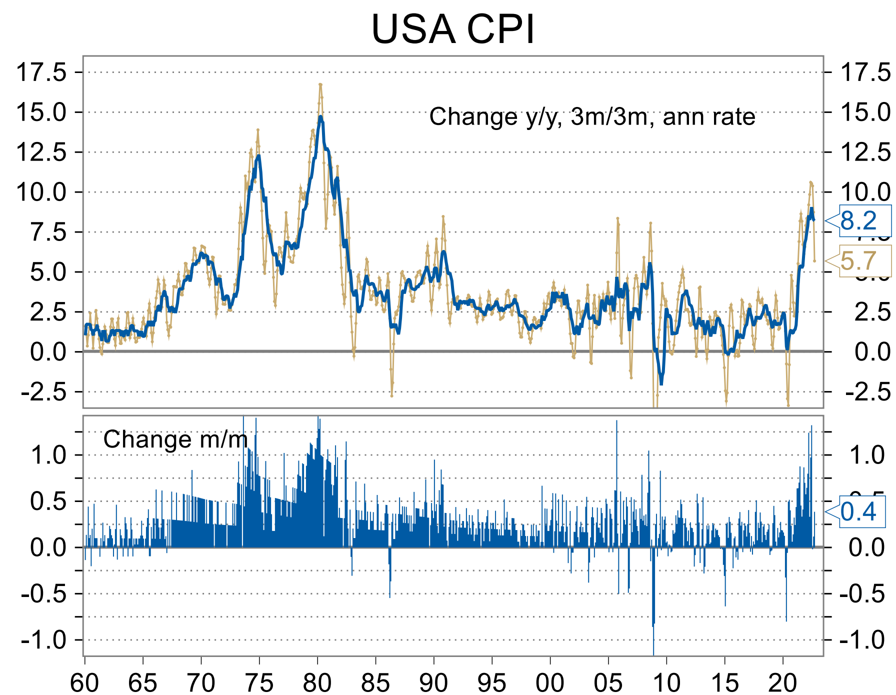
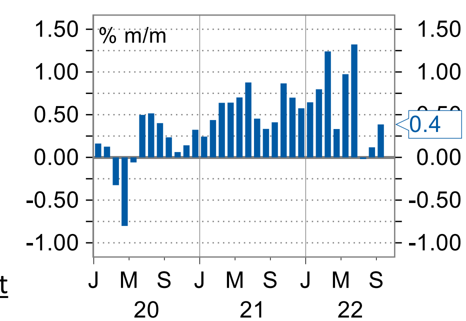
CPI has peaked, but core inflation again well above expectations

CPI inflation was 0.1 – 0.2 pp higher than expected. The core up 6.6% y/y, and inflation is broad

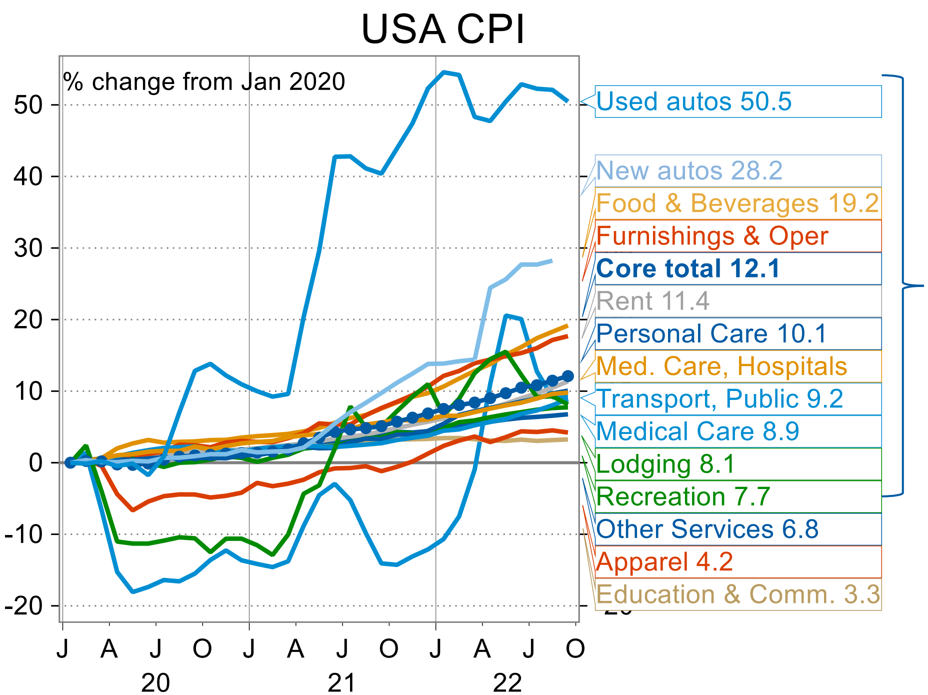


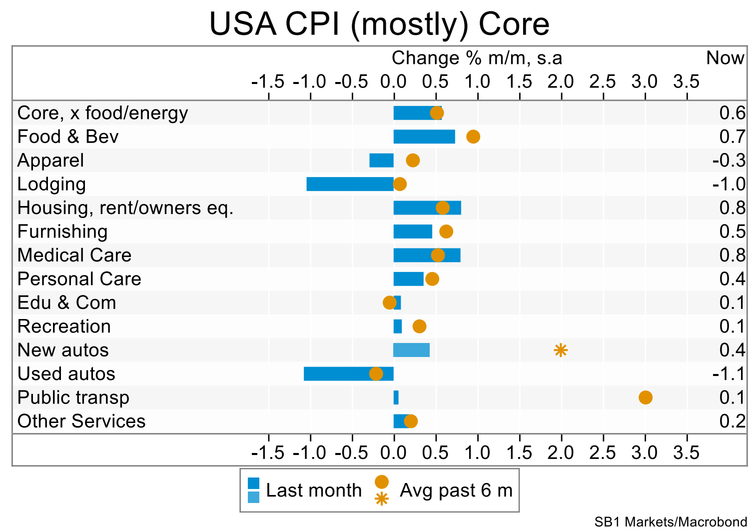


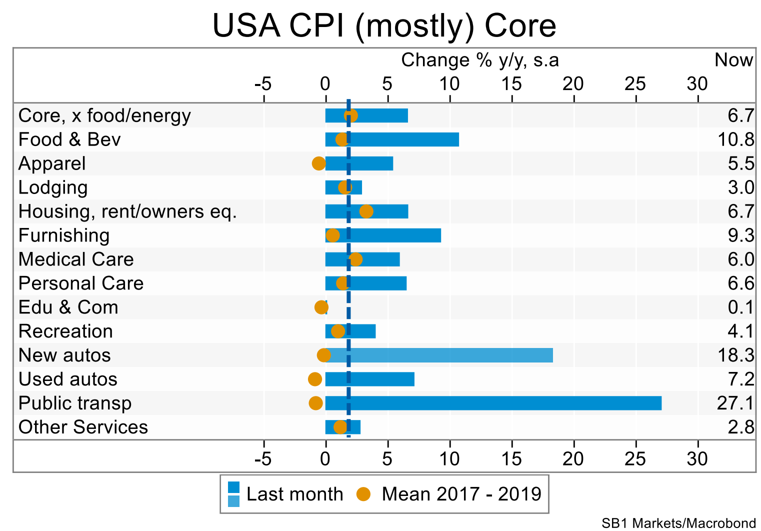
- **Headline CPI** slowed 0.1 pp to 8.2% in September, expected down to 8.1%. Prices rose 0.4% m/m, expected 0.2%
- **Energy prices** fell further, but energy is still contributing 1.6 pp to the headline rate
- **Food prices** rose 0.7% m/m and are up 10.8% y/y, lifting the CPI by 1.6 pp
- **Surveys** report further price increases the coming months, but at much slower pace than over the prev. months
- Given the CPI surprise, a 75 bps hike in November is very likely (which it is according to the Sept. dot plot as well)
- We still think **markets** focus too much on actual inflation, especially driven by commodity prices, and too little on wage cost inflation. However, a contraction in margins will also be detected in the CPI report – and they are important for the Fed



Lodging, used autos & apparel cheaper in September, but most prices were up



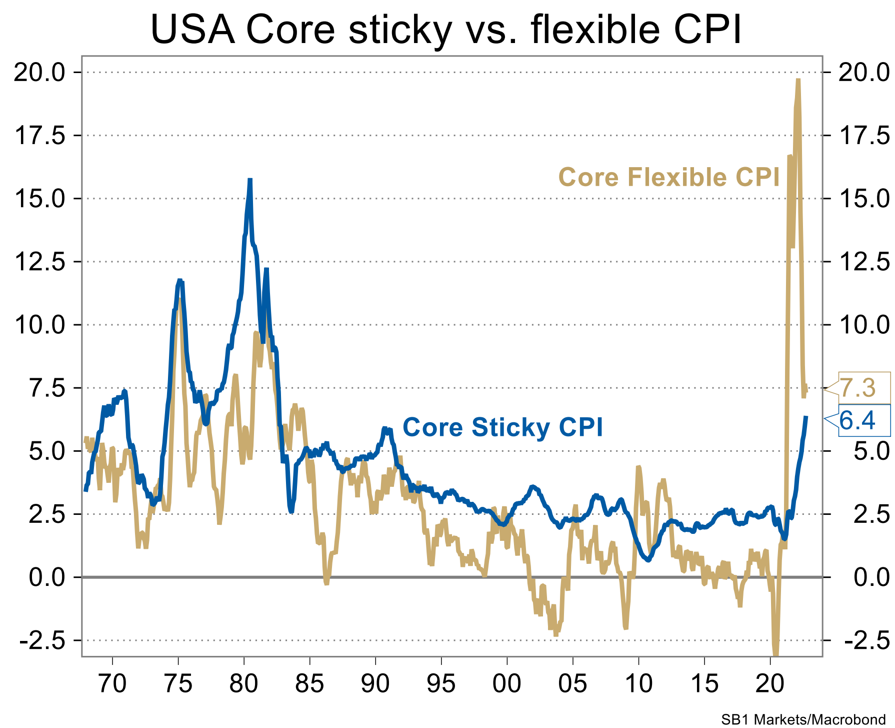


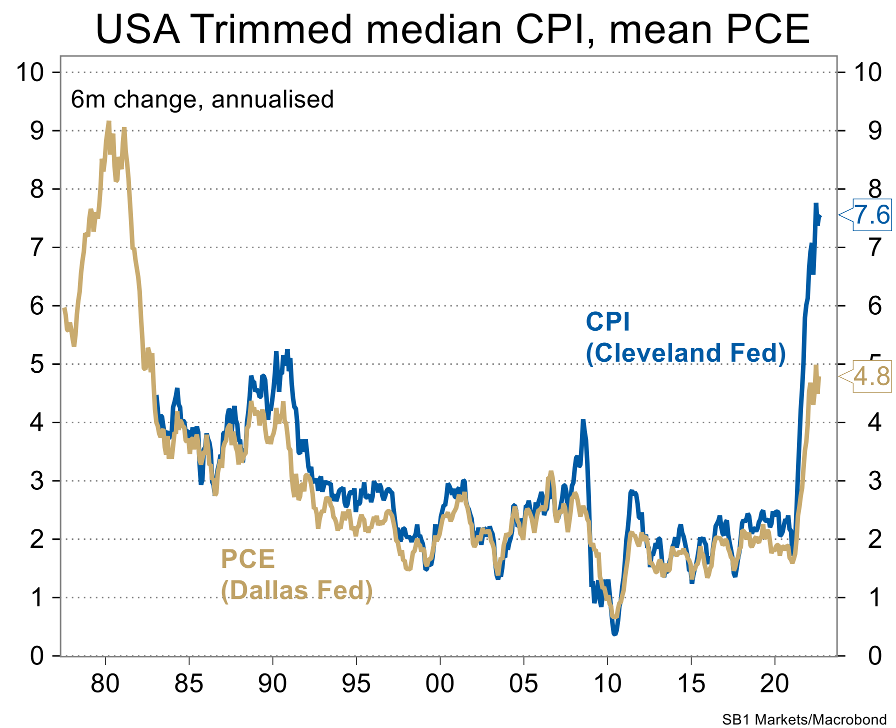


- All but one sectors, education & communication, are up at more than a 2% pace from before the pandemic
- Rents are up 6.3% y/y, lifting the CPI by 2.2%, alone!
- One day: A huge downside to used auto prices – and hopefully for some others as well, like food and furnishing prices

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

Sticky prices are up 6.4% (90% of the CPI). The trimmed median CPI up 7.6%, and close to peak

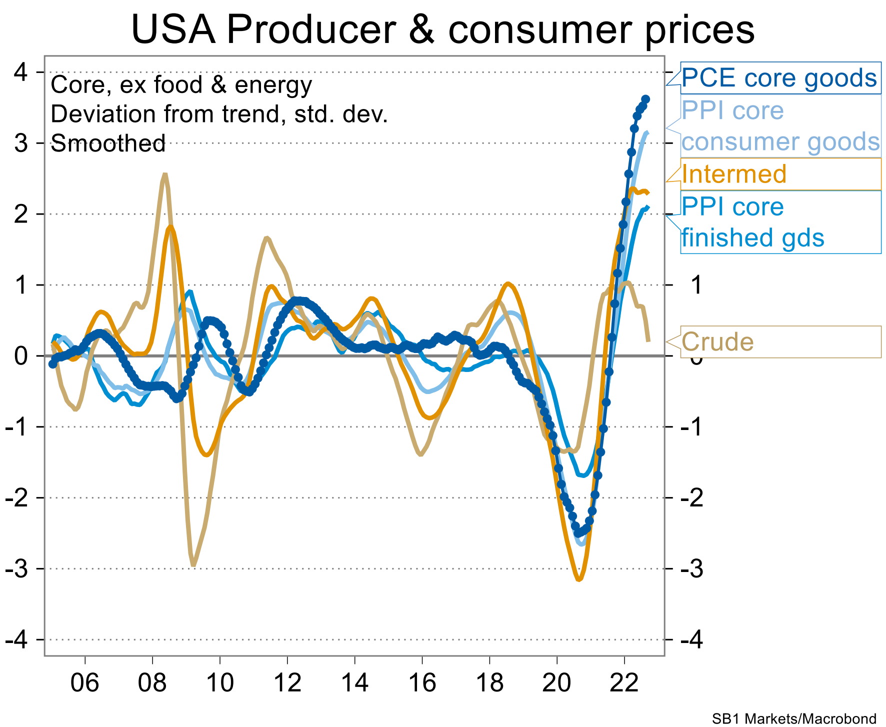


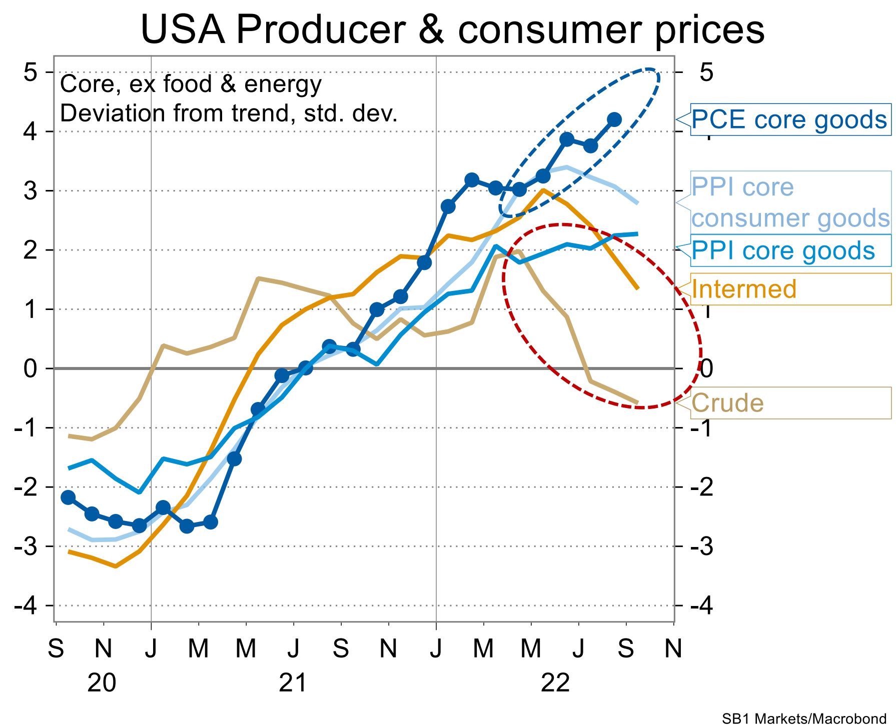


- Almost all of the initial lift in core CPI was due to prices of goods & services that often fluctuate, with rapid price increases followed by deep price cuts. These prices are '**flexible'** and represent some 10% of the core CPI. The core flexible CPI is up 7.3% y/y, down from almost 20% at the peak! But still higher than anytime since 1981
- The new challenge: The **sticky components** (90 % of the core CPI) are up 6.4% y/y. <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 7.6% pace over the past six months, up from 7.5% last month – and miles above anything seen before (data from 1983). Dallas Fed's **trimmed mean PCE** was up 4.8% in <u>August</u>, also close to peak

Crude core material prices are yielding, as are intermediate prices

Core consumer goods PPI have also turned south – and so will probably goods prices in the CPI/PCE

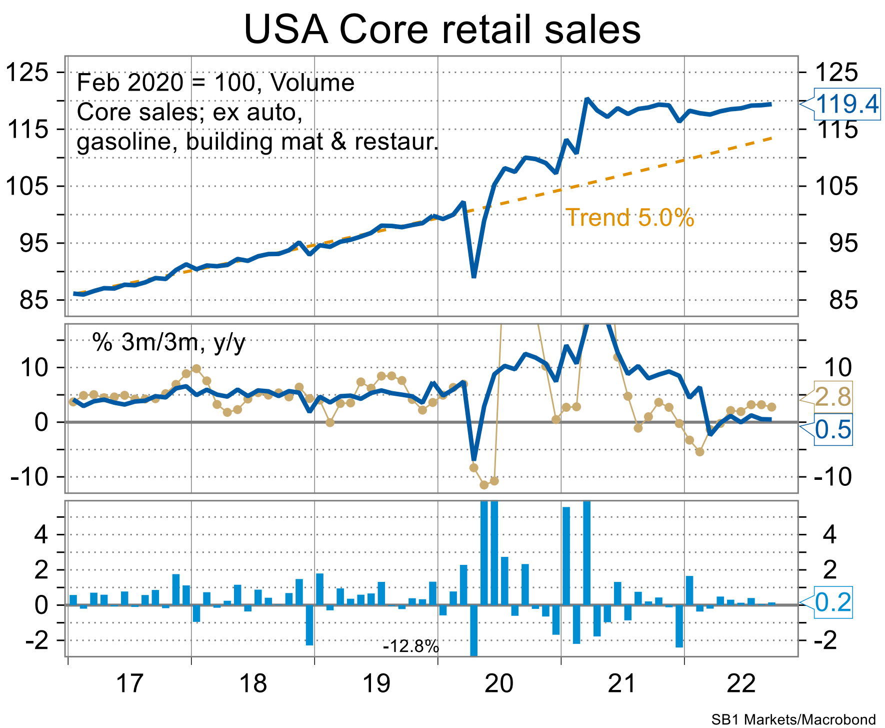


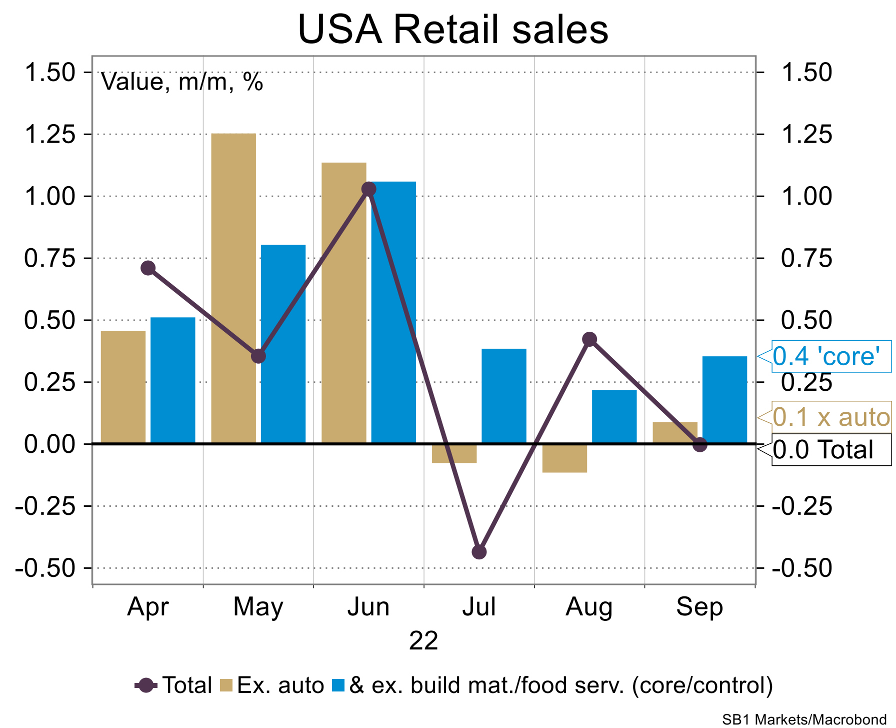


- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months. Following several months with slow growth in these prices to February from last summer, they rose in March and remained at a high level in April – but they are now heading down rapidly (and prices are down y/y, *check next page*). **Intermediate prices** have slowed past three months. We can 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
- The next shoe to start dropping will be goods prices at the consumer level, in the CPI/PPI

Retail sales of goods slowly on the way up again!

Core sales rose 0.4% in September – and probably grew even in volume terms, and Aug revised up

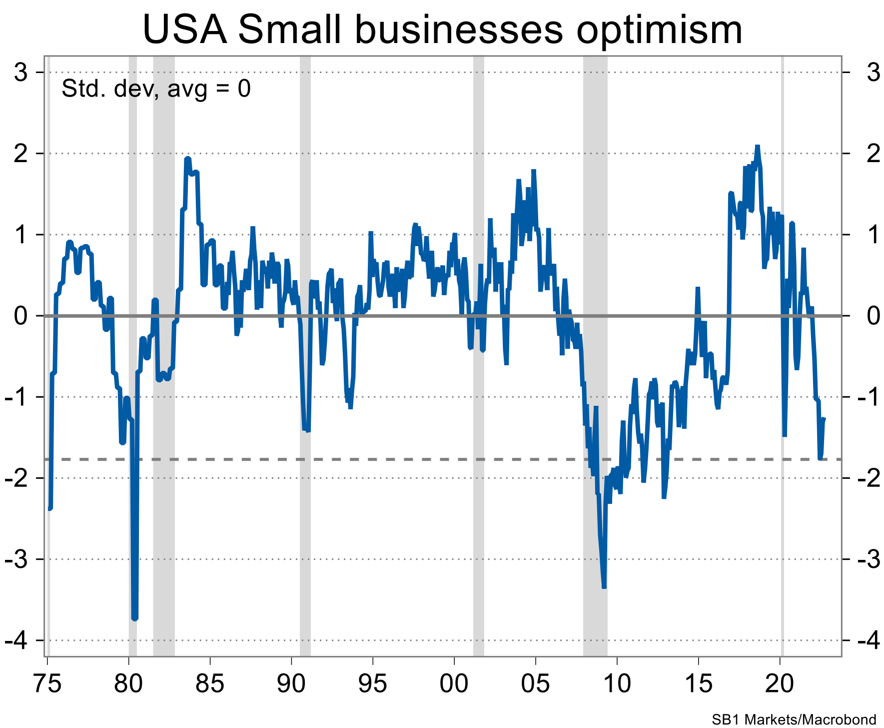


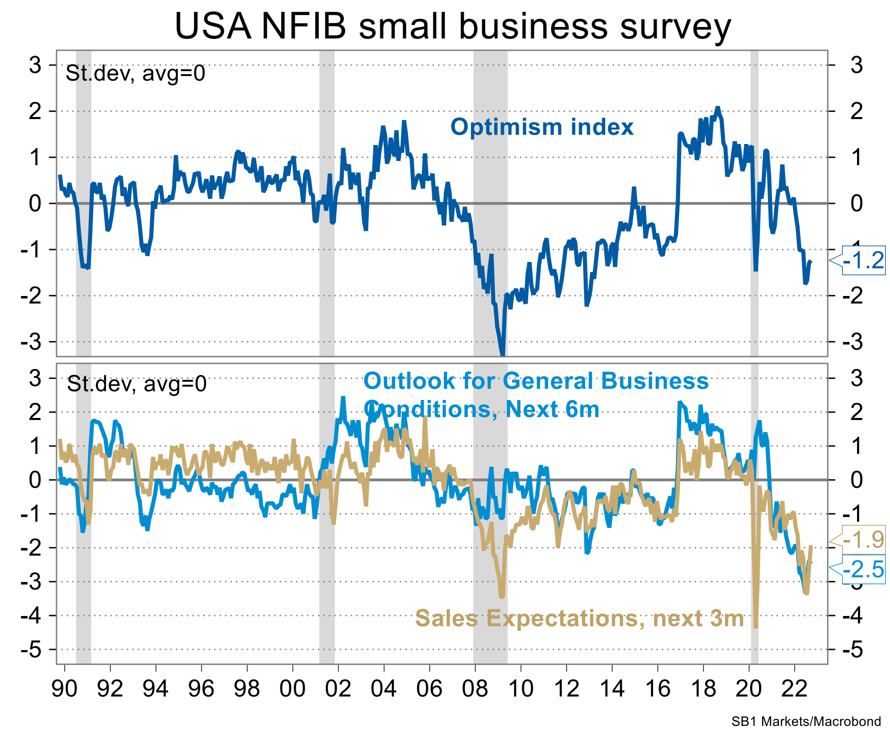


- **Total nominal sales** were flat in September, 0.2 pp below expectations, but August was revised up by 0.1 pp to 0.4%. Auto sales fell, together with building mat., furniture, electronics. Total nominal sales are up 19% vs. the Feb 2020 level!
- **Core sales of goods** (=control group, excludes autos, gasoline, building materials & restaurants) were up 0.4% in value terms, 0.1 pp above expectations (and July data were revised by 0.2 pp to 0.2%)
- **In volume terms**, we assume that core gained 0.2%, as the CPI goods prices (x energy) rose some 0.2%. 'Real' sales are trending marginally upwards (+2.8% 3m/3m), far better than we estimated a couple of months ago! After a substantial revision of Dec-21, sales are just marginally below the peaks last year (we always suspected the Dec-21 data to be wrong, sales volume was reported down by almost 5%, now revised to -2.4%)
- Consumption of goods will support GDP growth in Q3, and September is above the Q3 average

Small businesses optimism marginally up in Sept, still 1.2 st.dev below average

… but the outlook worsened, and is now 2.5 st.dev below average

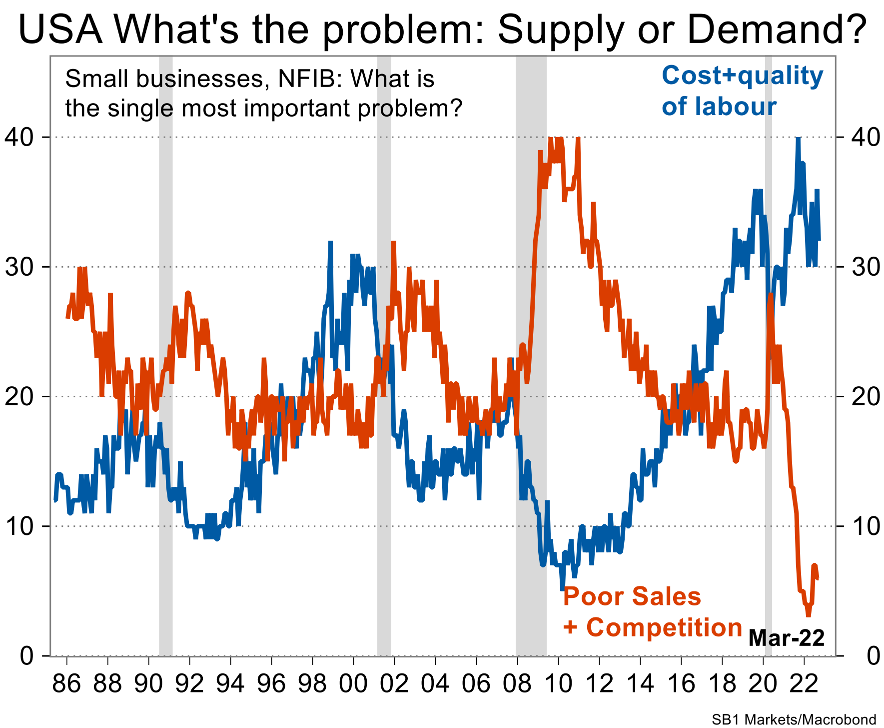


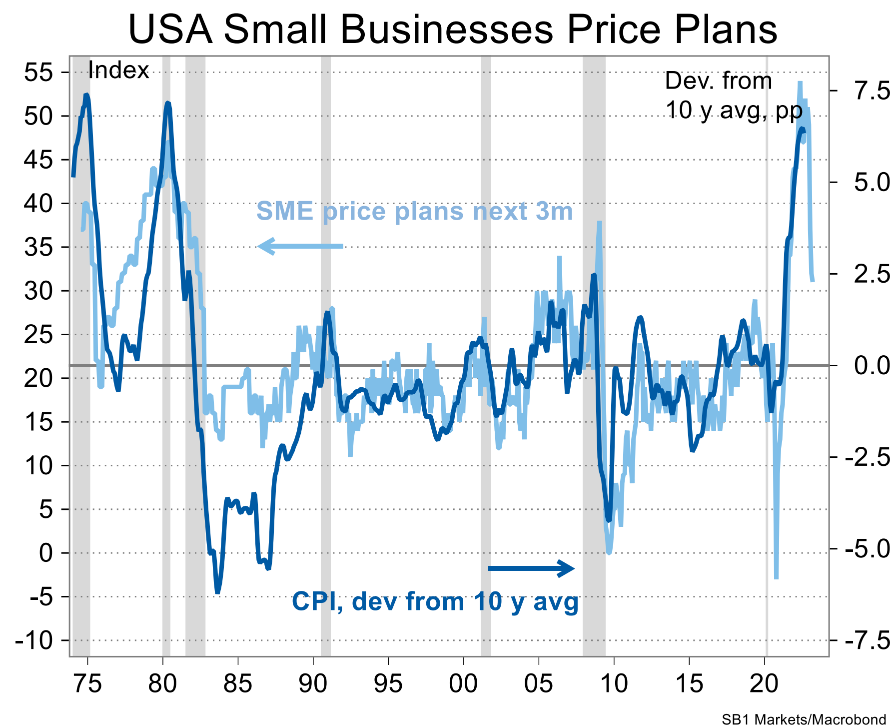


- The **NFIB optimism index** climbed for the 3rd month in a row, up 0.3 p to 92.1 in September, expected down 0.6 p. The level equals 1.2 st.dev below average. **The outlook for the next 6 months** worsened, and is at a very low level, 2.5 st dev, down from 2.4 in August. **Sales expectations** rose noticeably for the 2nd month but are still 1.9 st.dev below avg. (up from 2.6 st.dev below avg. in Aug, and 3.4 st.dev below in July!)
- **Inflation, lack of qualified labour and labour costs** are still the main worries for the SMEs. However, some more companies report that **competition** is a worry but the share is still very low. The share of companies that **plans to lift prices** by fell 5 p to 32%. 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 down, like in most other surveys we follow. **Hiring plans** rose again in Sept, 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

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

Demand is coming down – but far from a problem yet

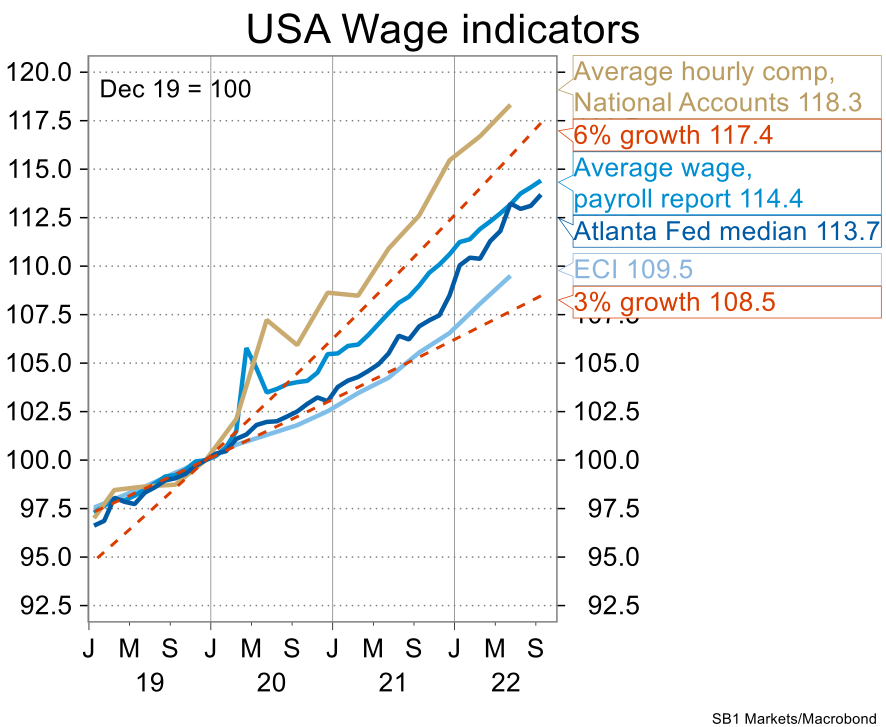


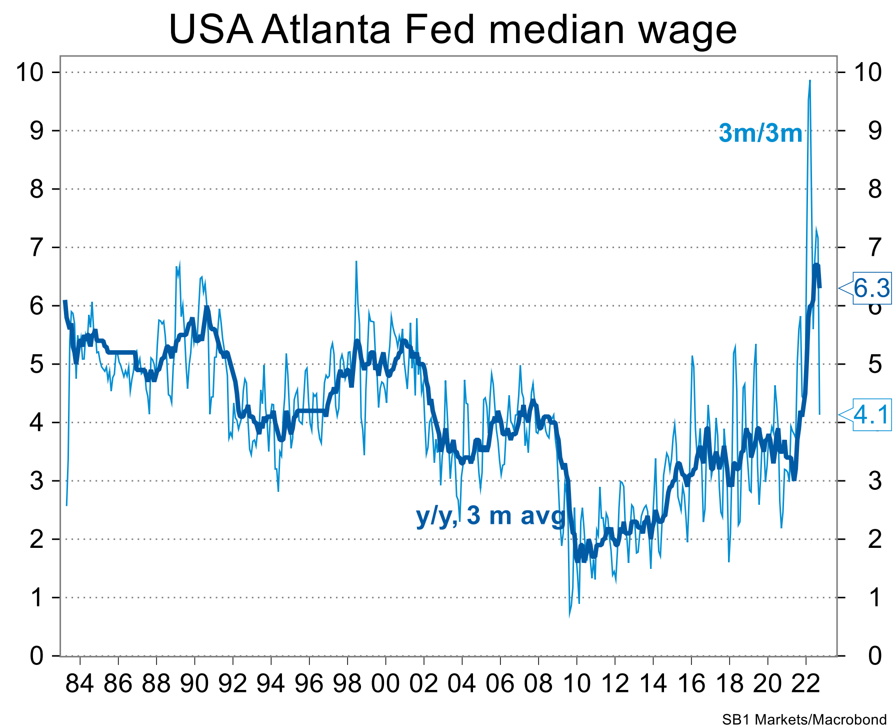


- **The 'gap' between supply and demand concerns** is still very large, but it is now heading down
  - » Very few companies report **poor sales or competition** as a problem. The share is up from March, but fell marginally in August, and was unch in Sept
  - » **Cost & quality of labour** is stated as 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. <u>Even so, a very positive signal</u>
- **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 more help from the Federal Reserve. It's normally labelled as a recession, as soon as the red line crosses the 20-line

Atlanta Fed: Wage inflation is (probably) ~~not~~ slowing somewhat

The median wage +6.5% y/y, 6.3% 3 m avg, down from 6.7% - still 3 pp higher than 'normal' growth

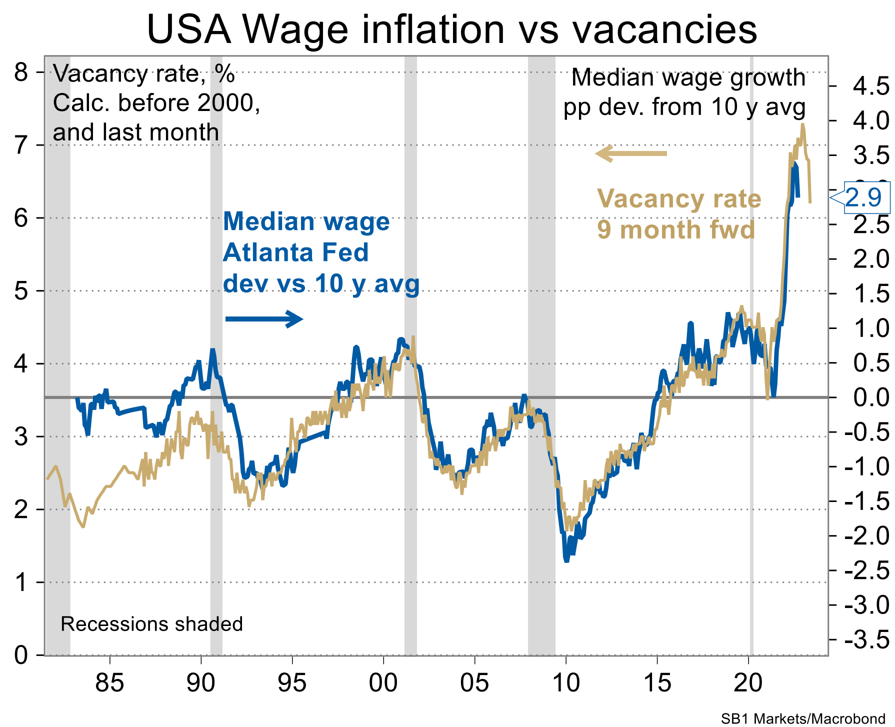


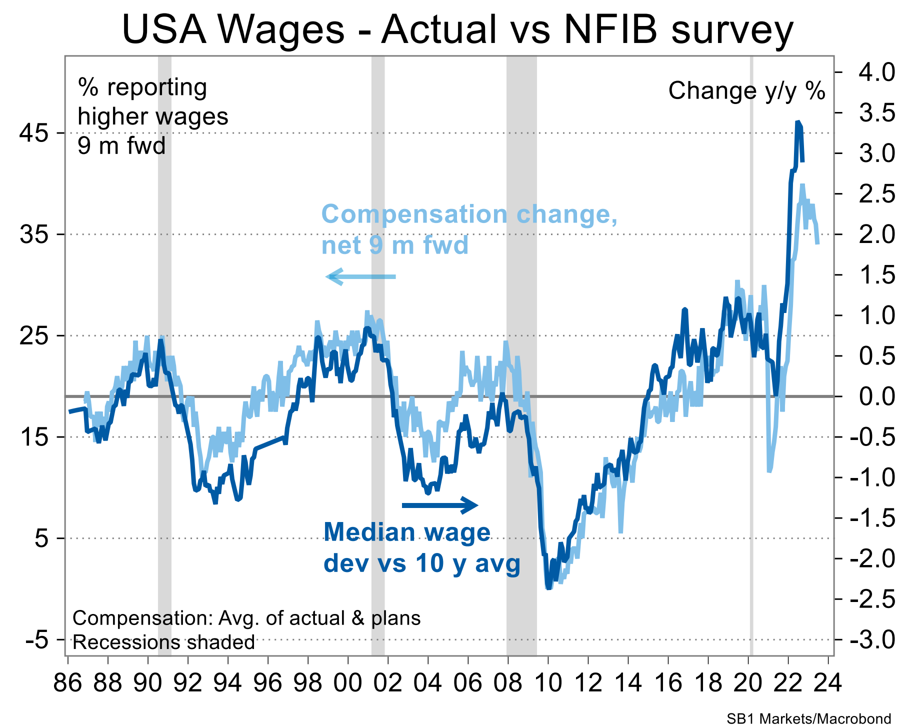


- **Atlanta Fed's median tracker reported** a 6.5% growth in September, up 0.2 pp from Aug. Our calculated m/m was up 0.5%, following two months with slow growth. The 3m/3m rate 'collapsed to 4.1%, but the 'real' underlying growth rate is closer to 6% (a strange June obs. has created some volatility). The **3 m average annual wage** growth fell to 6.3%, from the highest print ever at 6.7% in August. The current wage inflation is 2.9 pp higher than the past 10 average, a wage acceleration we have never seen before
- **All** ages, occupations, industries, job switchers (or not), race, education, urban or rural regions report a sharp acceleration in wage inflation. The only laggards: those who are paid the best, but even this group report higher wage growth recent months
- **All other wage indicators** are reporting fast wage growth, and all are reporting wage growth well above the recent years' average, some are still accelerating, other are slowing marginally but all are growing 2.8% – 4% faster than the past 10 years' average – which will make it impossible to reach the 2% price target over time

Peak wage inflation? Very likely, as demand for labour slows

Still, demand for labour is still strong, and wage inflation is far above a sustainable level



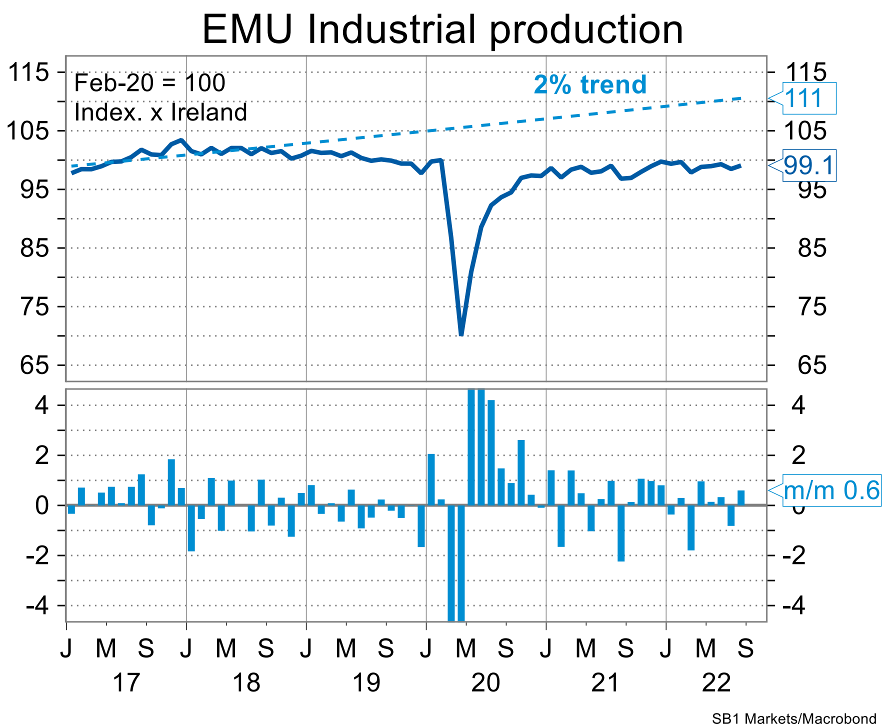


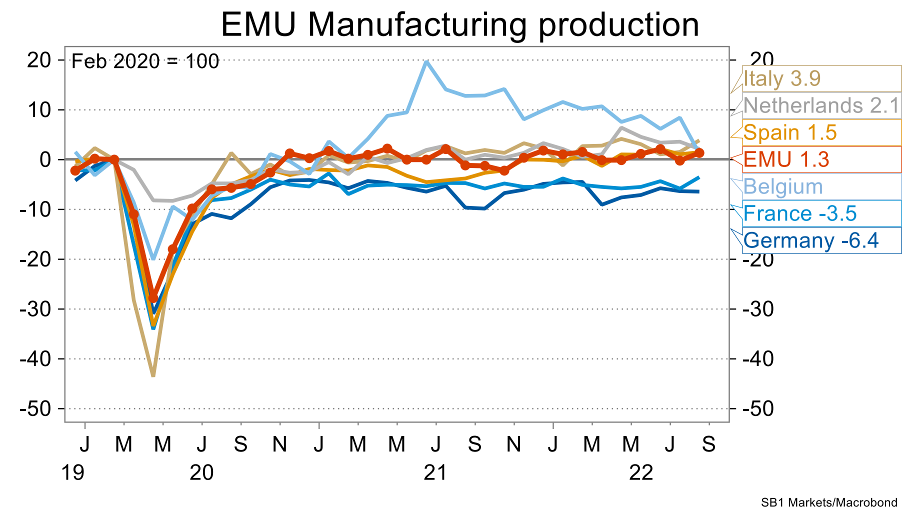
- **Our 'Phillips curve'** based on the vacancy rate signals a further increase in wage inflation the coming quarters even if vacances have peaked. The vacancy rate leads changes in wage inflation quite consistently by 3 quarters. However, we would not be surprised if the current extraordinary high wage inflation turns out to be the peak
  - » Companies (SMEs) compensation plans signal continued high wage inflation but not faster than the present
- **Wage inflation** has already accelerated by almost 3.3 pp vs the 10 y average (Atlanta Fed median) and cannot possibly generate a 2% price inflation rate over time. This is Fed's main headache, not the current high CPI inflation print. And it will become the stock owners' headache too, of course
- **Demand for labour has to be reduced sharply in order to get wage inflation back to a sustainable level! That's the recipe for an unavoidable RECESSION**
  - » Check under which circumstances wage inflation slows on the charts above (hint: find the shaded areas, follow the blue wage line - as well as the vacancy rate or the wage hike plans ☺). Fed will not be able to control inflation if demand for labour is not cut sharply

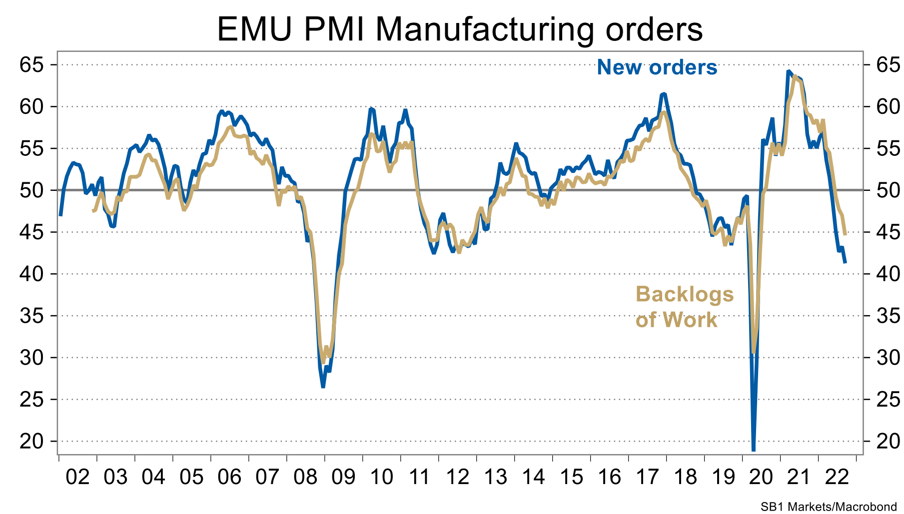
SpareBank 1 MARKETS

EMU industrial production sharply up in August

Total production up 2.5%, expected 1.2% - production ex. Ireland was up 0.6%



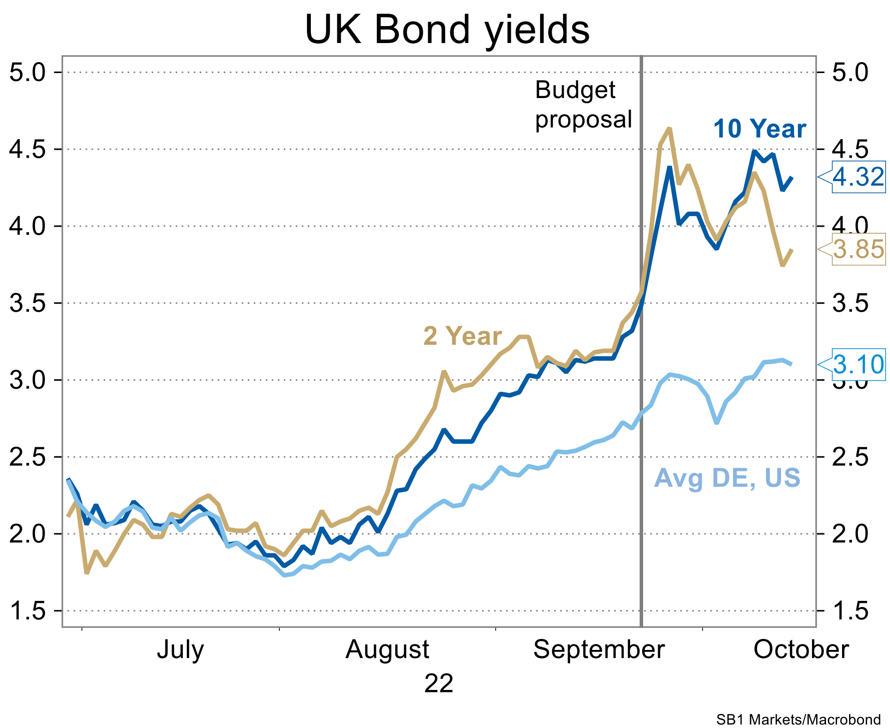




- Production rose 2.5% in August, mostly due to a large increase in production in Ireland, but production rose sharply also in France, somewhat in Spain, while production fell further in Germany, and the Netherlands. Production is still below the pre-pandemic level in France and in Germany (-6.4%)
- The outlook is not that bright though: In September, the manufacturing PMIs dipped below 50 in all of the big 4 countries, signalling a contraction in the sector – The new order sub-index is at the lowest level since 2009!

The gilt sell-off: Pension funds sold gilts to meet margin calls post rate moves

Why did we get big move in gilts and why did the BoE have to step in?

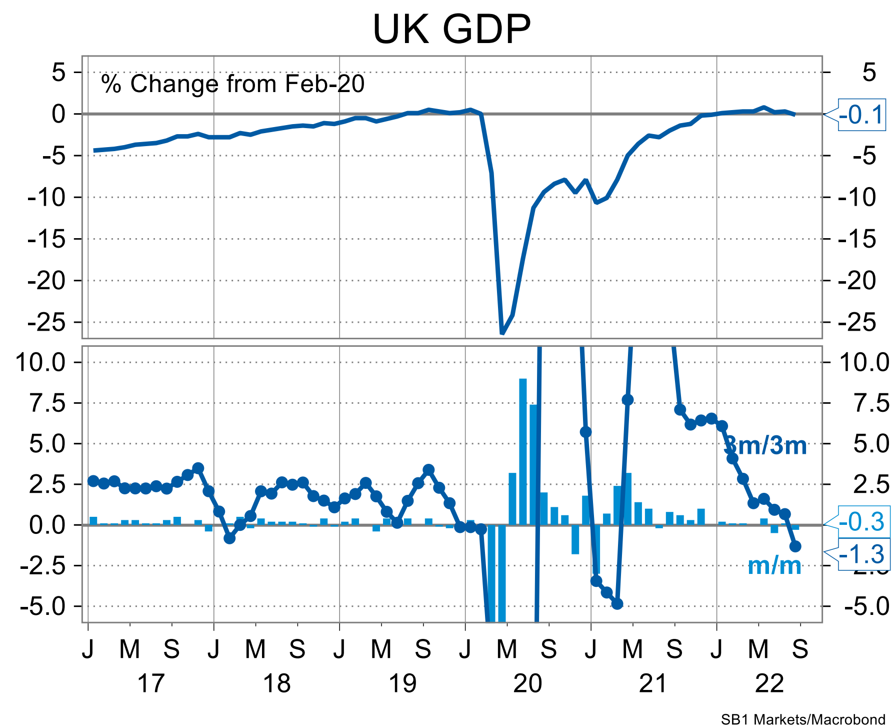


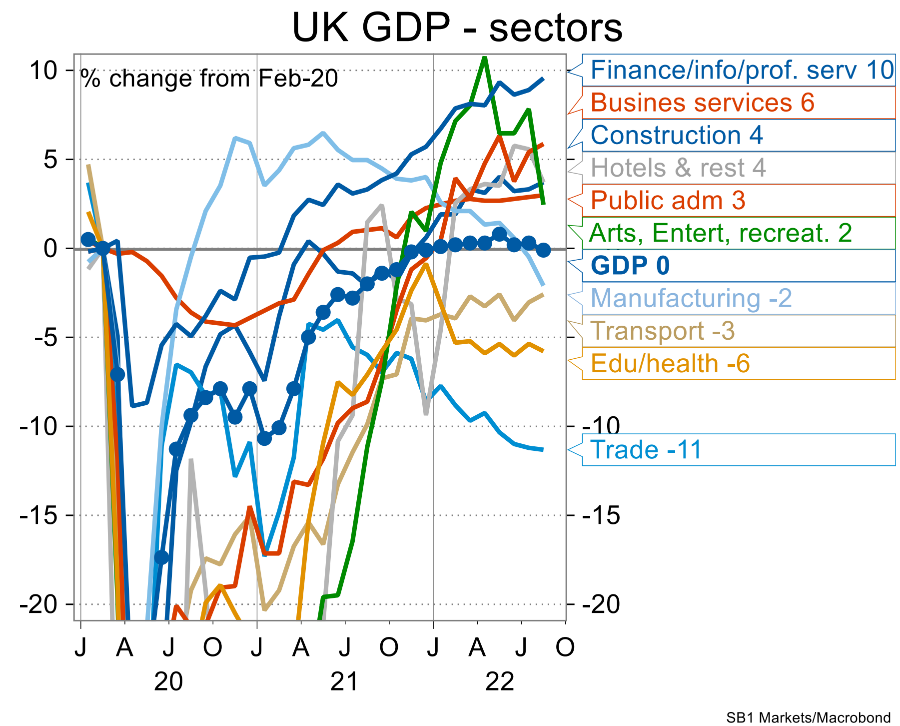
- **The outlook**: Very likely, no more fiscal nonsense
  - » Truss is already a lame duck. Hunt is in charge, and he understands the message from the markets – as well from Tory's parliamentarians
  - » The UK economy is slowing rapidly, and higher short term rate have pushed mortgage rates sharply up recent weeks- which no doubt will send the housing market downwards
  - » UK bond yields have climbed 120 bps more than abroad, and are now too high. Short time rate expectations have also come down – they were too high, and probably still is

- Many pension funds in the UK have used so-called Liability Driven Investment strategies (LDI) to hedge against interest moves using derivatives, like interest rate swaps, to match the (long) duration of their liabilities and their assets
  - » The pension fund will post bonds as collateral (and attain as much as 7x leverage) and pay float and receive on the fixed leg – that way if rates rise the present value of the liabilities will fall and so will the present value of their derivative position…
  - » The reason pension funds do this is because this matches the duration of assets and liabilities, giving them more room to manoeuvre and invest in higher risk assets in order to create more return
- **The problem:** when the new Government proposed huge, unfunded tax cuts on Friday 23 Sep, yields rose sharply on the top of the huge global lift in bond yields, and more than the collateral buffer held by pension funds covered. Thus, the funds' counterparts demanded fresh collateral in a matter of hours, forcing the pension funds to sell liquid assets (gilts) to post more collateral, sending bond yields even higher, forcing them to sell more (and post more collateral)…
- **The (temporary?) solution:** on Wednesday Sept. 28th the BoE stepped in and bought gilts to stop the spiralling rise yields, and signalled willingness to do whatever it takes to stabilize the market. Just limited amounts are so far spent, even if the volatility in the gilt marked has been close to unprecedented. The curve is close to the peak the day before BoE intervened in the gilt market
  - » BoE has offered banks liquidity support and have included a wide range of assets banks can use as collateral for their loans in the central banks (though with serious haircuts, by up to 40% for long duration bonds and high-risk corporate bonds)
- **Now: The BoE** ended its support program on Friday, as pensions funds were ordered to pay up sufficient collateral by the end of the week
  - » At the same time the PM Truss sacked chancellor Kwarteng and both she and her new minister, Jeremy Hunt, stated tax cuts for businesses would be abolished, and public spending would be cut, in order not to increase public borrowing too much. After 6 weeks, Truss had to scrap all of her main promises, to stimulate the economy by deep tax cuts, to focus more on growth than inflation (by limiting BoE's power - the bond vigilantes helped the BoE, big time!), and to limit the power of other oversight institutions

UK GDP is shrinking, down 0.3% in August, and down 1.3% on a 3m/3m basis…

…expected flat m/m. Manufacturing, hotels & restaurants, trade, and entertainment down

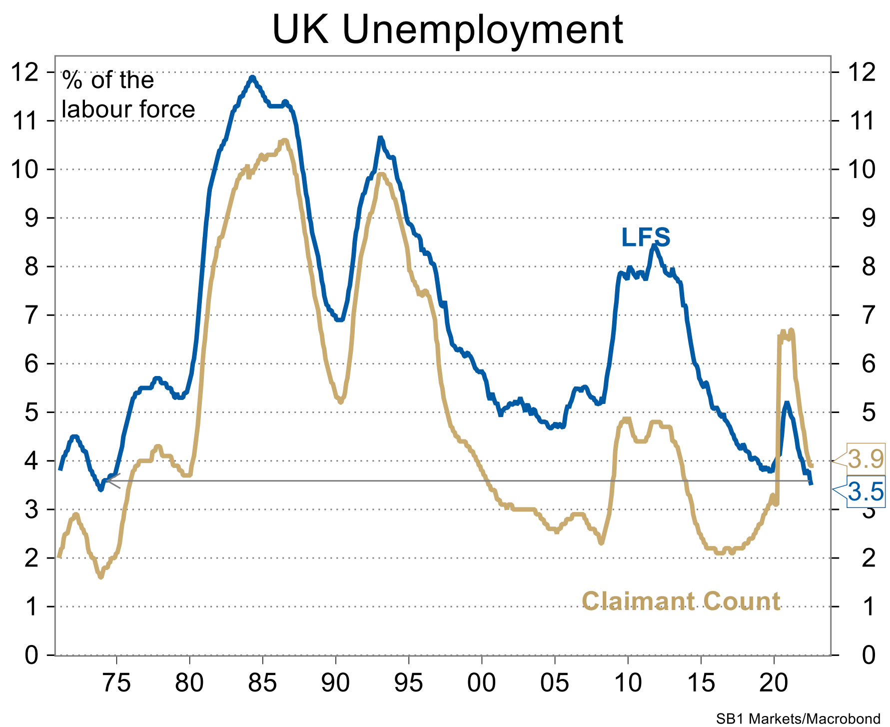


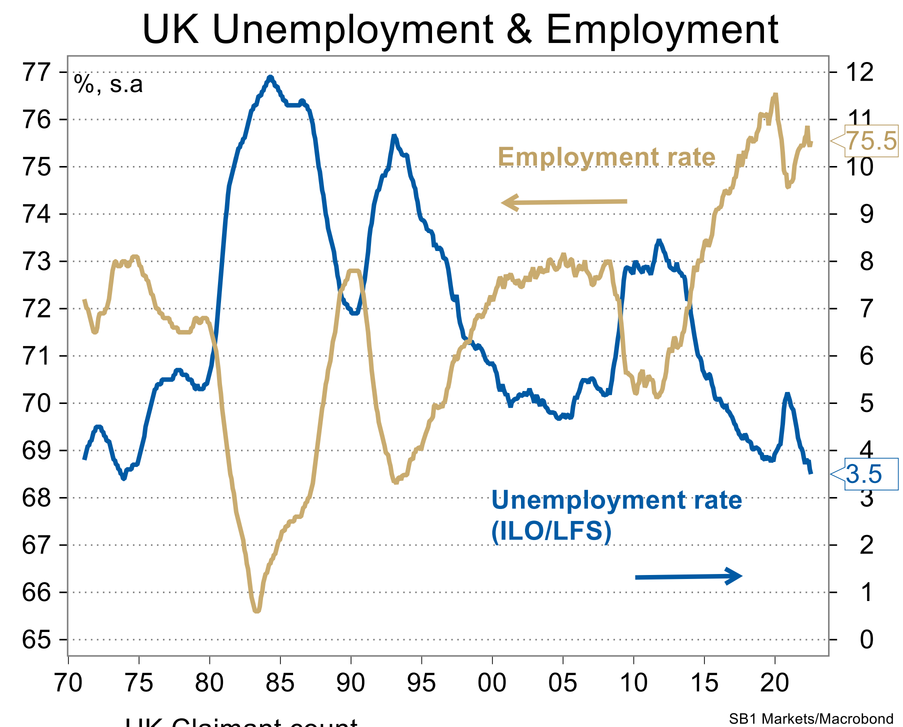


- **Growth in GDP** has been far weaker than expected – and GDP is now 0.1% lower than before the pandemic, 2.5 years ago
- **Mixed between sectors:** The annual revision of GDP data revealed huge changes vs earlier estimates, in a way we have never seen before, in the dimension +10/-10% - which in a sense make mockery of these data. Check next page for the aggregate changes, and if you are able, try to compare the revised sector data at this page with the data that that was published one month ago – we advise you not to spend too much time to figure out what has happened..). Trade has been revised heavily down, and the level is far lower than retail trade data can explain (even if wholesale trade is included). 2 pages forward, the change in the manufacturing value added is shown
  - According to the new data, manufacturing and trade have been the main laggards so far in 2022, together with arts and entertainment (the latter don't sit well vs. the covid story)
- **Bank of England** expect UK to have entered a recession in Q3, due to a steep decline in real incomes, and monetary tightening. And the Queen's death

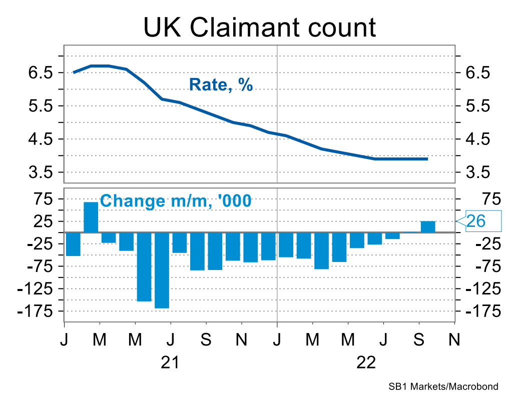
What a crisis: The LFS unemployment rate further down but claimant counts up

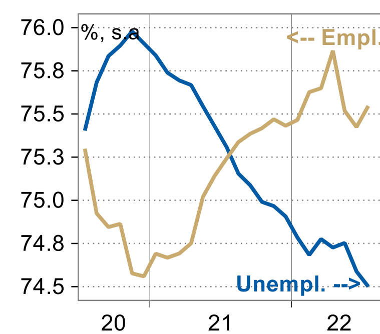
Payrolls still on the way up, and wage growth is still accelerating – from a far too high level





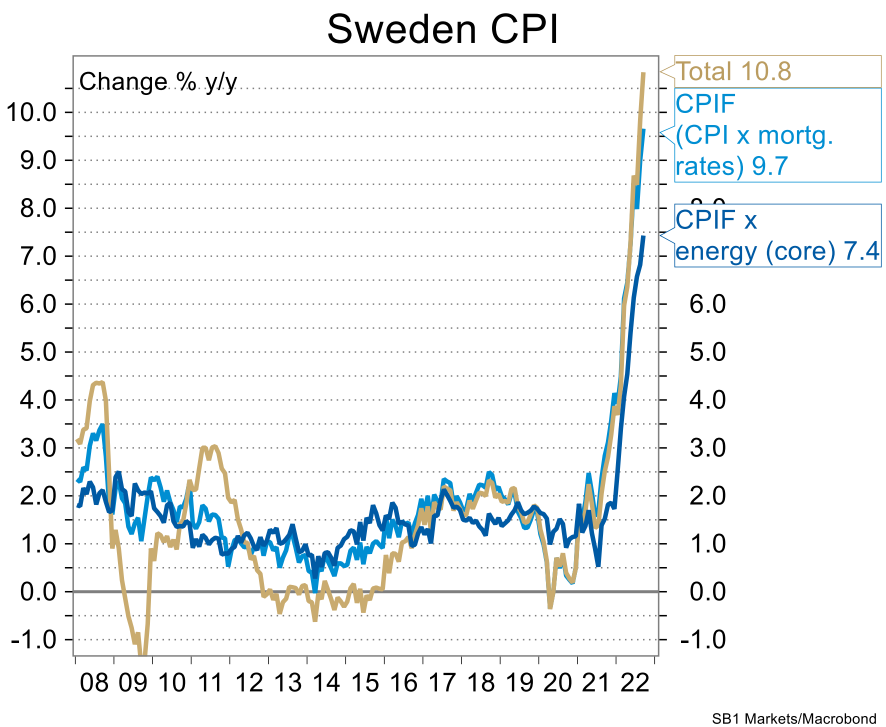
- **ILO/LFS ('AKU') unemployment** fell 0.1 pp to 3.5% the lowest level since 1974, expected unchanged, following the surprising 0.2 pp decline the previous month
- **Claimant counts** ('open unemployment') have flattened at 3.9%, which is not that low, and in September, the <u>number of claimants rose marginally</u>, for the first time since early 2021
- The no. of **unfilled vacancies** is now falling slowly – but remains at a very high level

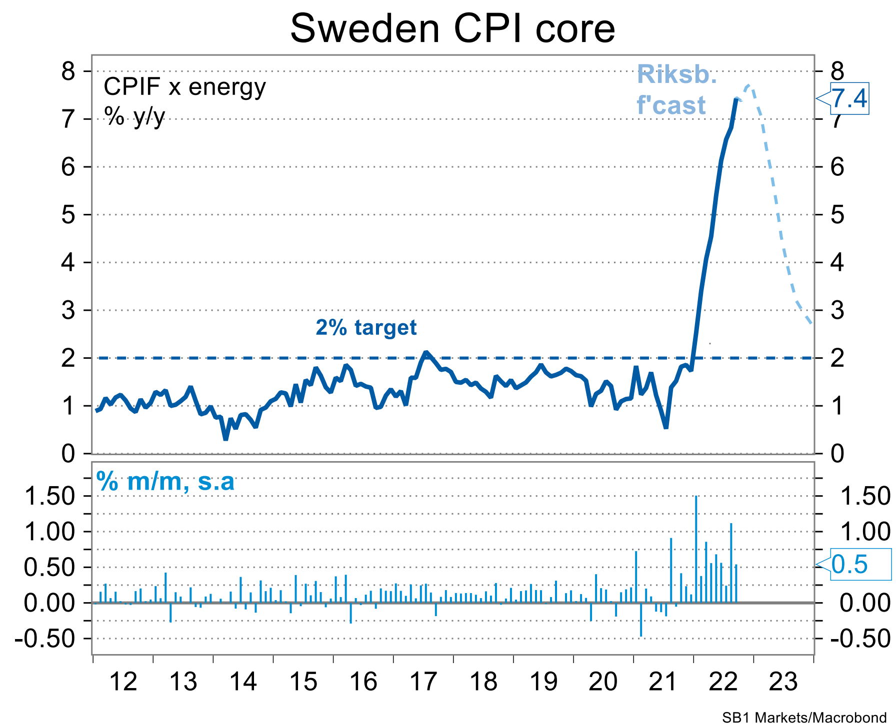




No peak yet for Swedish inflation – core in line with Riksbank f'cast

The headline was up 1 pp to 10.8%, expected 10.5%. Core CPI also up 0.5 pp to 7.4%

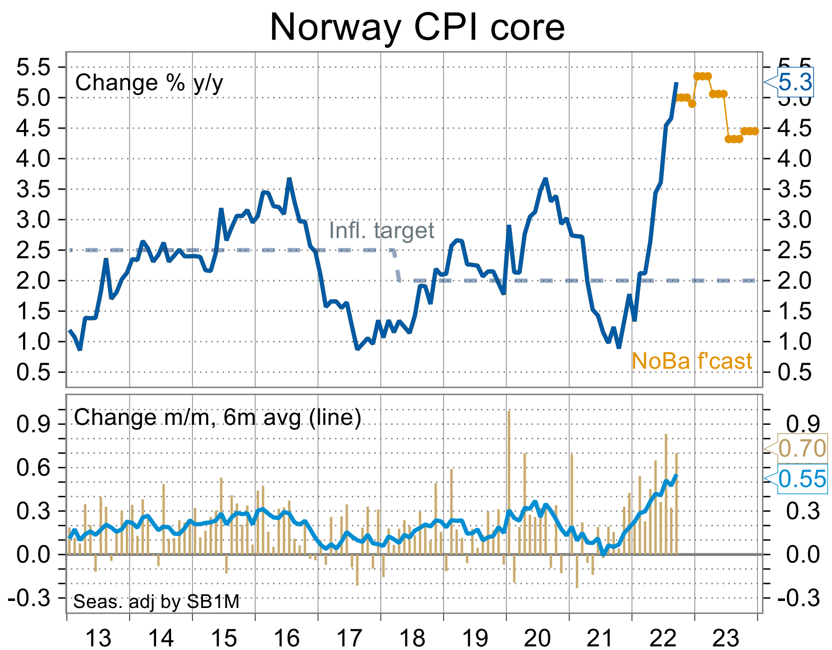


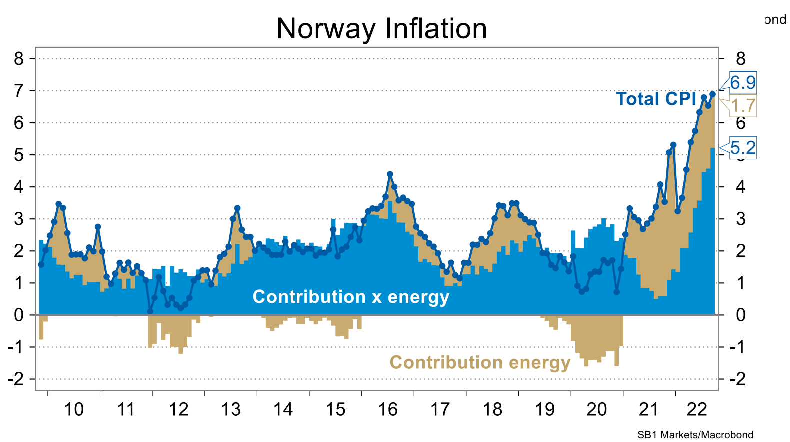


- **CPI-F x energy, the 'real core'**, rose 0.5% in Aug (seas. adj). The core rate has accelerated sharply recent months, to 7.4%, but the latest print was in line with the Riksbank f'cast from Sept. Why is inflation so high? Housing incl. energy prices are up 17% y/y, food prices are up 16%, furnishings 14%, hotels & restaurants 9.8%!
  - All other measures of underlying inflation are sharply up – and at the highest level in some 30 years
  - Until Q4 last year, 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 Sept are energy, housing (larger mortgage pmts), and food, while fuel prices and the category Other vehicle related expenses contributed the most on the downside
- **The Riskbank surprised markets** and hiked by 100 bps at their last meeting, and signalled a 50 bps as the most likely outcome in November. The market, however prices in another 75 – 100 bps

Inflation surprised sharply on the upside – Food for thought for Norges Bank

Headline CPI was up 6.9% y/y, expected 6.2%. The core further up to 5.3% y/y, up 0.7 pp m/m





- **CPI-ATE** (ex. energy and taxes) rose 0.7% m/m (s.a), and the annual rate climbed by 0.6 pp to 5.3% pp, we expected 4.6%. Consensus was at 4.9%, NoBa expected 5.0%
- **Food prices** rose 0.9% in Sept, we expected +0.1%. The annual rate is now at 12.1%. The annual rate will remain lofty the coming year. <u>At one stage, prices will be cut</u>
  - » **Airline ticket prices** fell by 1.4% m/m, as the only main category where prices were down
  - » Prices on **imported goods** rose 0.6% m/m, and are up 5.2% y/y; **domestically produced** goods & services were also up 0.7% m/m and are up 5.3% y/y
  - » **10 sectors** reported growth above 2% y/y, and just 2 are below (and one at 2%). All trimmed/median measures tell the same story: <u>Inflation has broadened</u>
- **Total inflation accelerated by 0.4 pp**, to 6.9%, the highest since 1988. We expected 5.8%!! If not for electricity subsidies, inflation would have close to 10%, a normal rate these days. Electricity prices rose 11% in September, we expected them to fall by 2%. Gasoline prices rose by 1.2%, we expected a small decline of 2%
- **The outlook**
  - » Most of the lift in **electricity prices** are behind us, due to the generous government subsidies
  - » **Gasoline prices** are on the way down and will contribute to a decline in headline CPI
  - » If so, **average 2022 inflation** will be some 5.7%, and above Norges Bank's 5.4% f'cast. The core inflation may average 3.8%, just 0.1 pp above NoBa's f'cast
  - » We expect inflation to slow faster than Norges Bank expects, as the economy slows, and raw material prices declines
- **So what?**
  - » **Inflation** is above NoBa's f'casts, and while imported inflation is high, it explains less than 2% of overall inflation of 6.9%. Take away energy and food too, and domestic inflation is still way above 2%
  - » For **Norges Bank**, as all other central banks, wage inflation is the dominant risk vs inflation over time. So far, wage inflation has not accelerated, as we expected it would. However, as inflation will be high into 2023, there still is a risk that wage inflation will accelerate, even if the economy has slowed somewhat before that. Still, we doubt NoBa's 4.6% 2023 wage inflation forecast is too low, it is rather too high!
  - » Even so, a <u>50 bps hike in November is increasingly more likely</u>. GDP was revised up, and (even if we do not agree), the budget may be deemed less tight than expected. Norges Bank has signalled 2x25 bps in Nov and Dec, while the market is now pricing in something close to 0.5%

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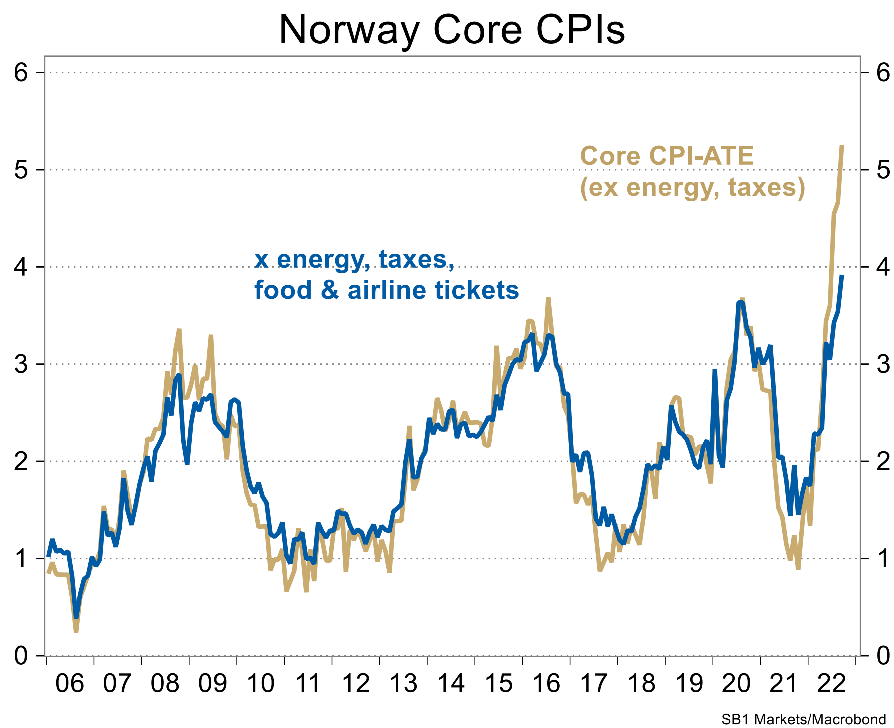
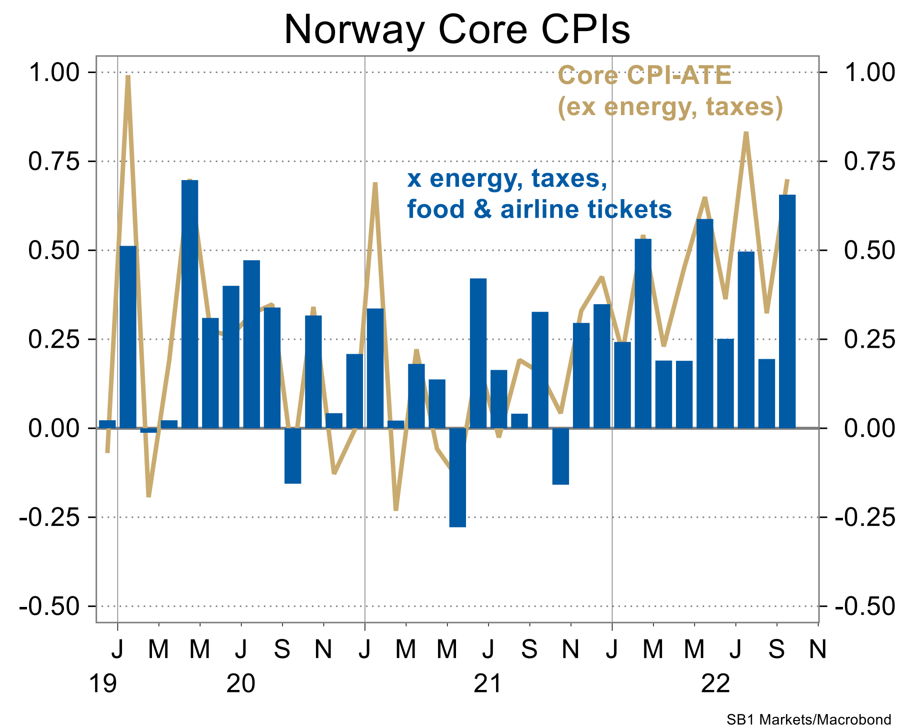
The 'real' core is a problem too: Core ex airfare tickets, food & energy up 3.9% y/y

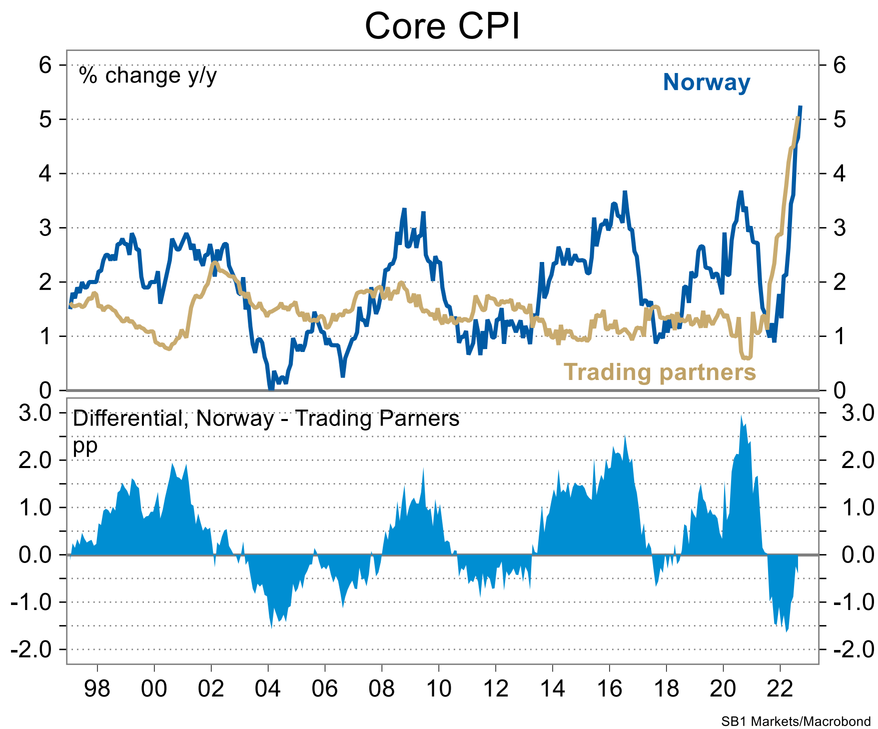
This real core gained 0.7% m/m

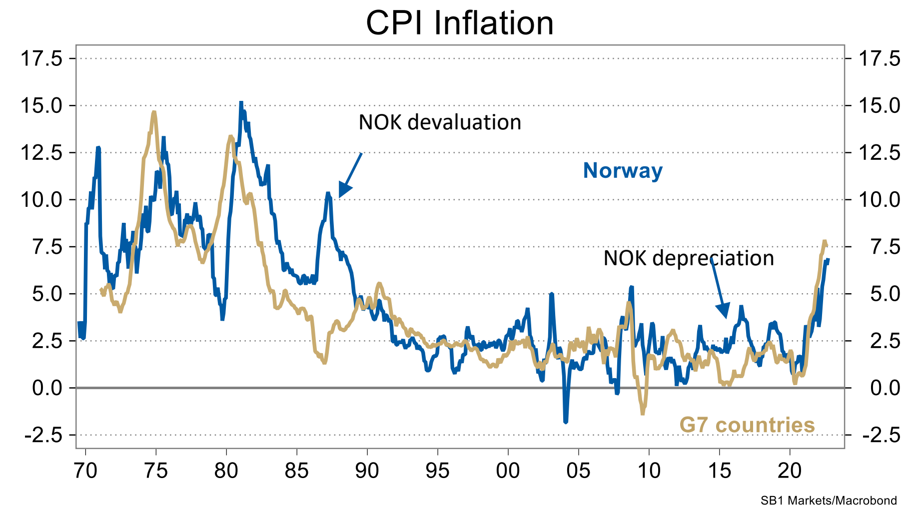


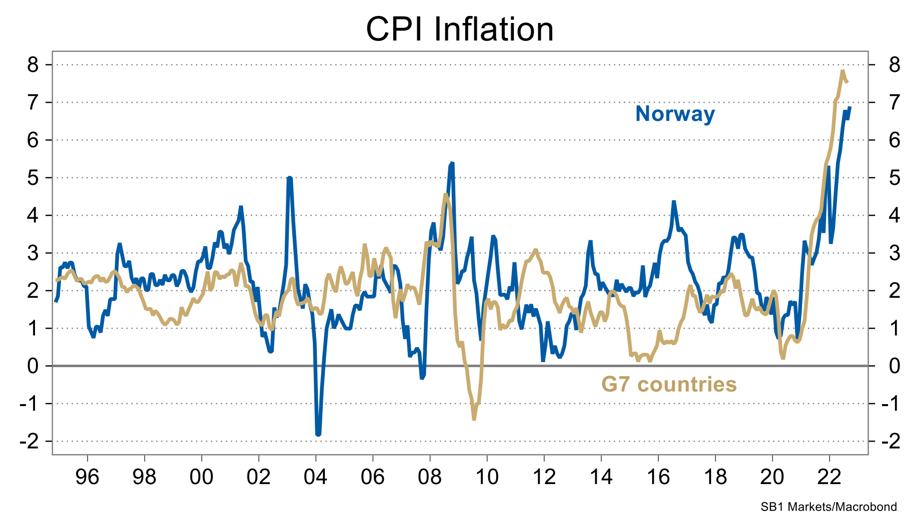


Norway vs ROW: The large, long-term CPI 'regimes' have been correlated

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



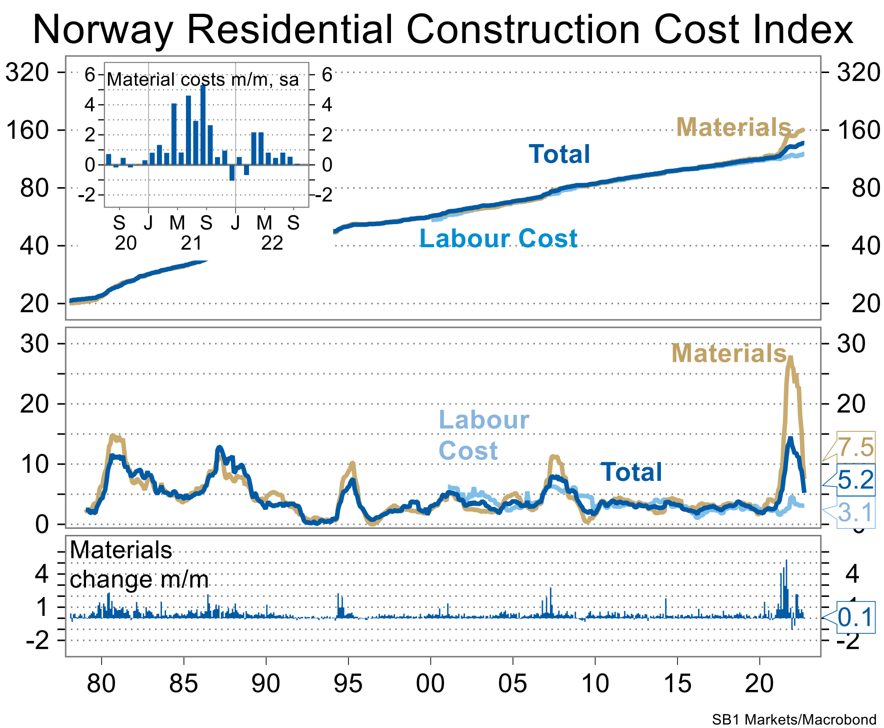


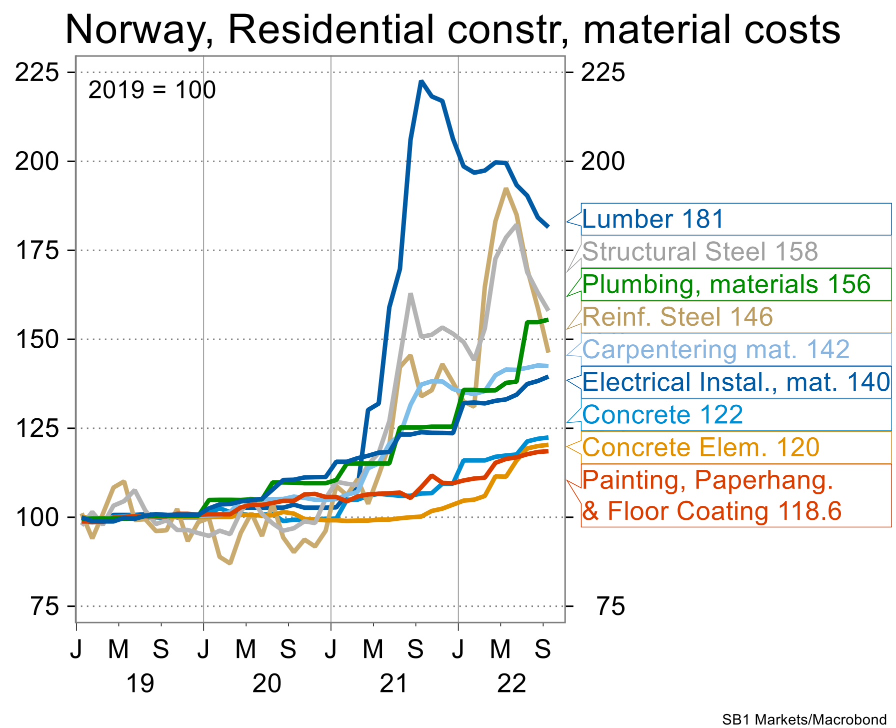


- Norwegian core CPI vs. trading partners' core has been close to uncorrelated past 20 years. The headline CPIs have been somewhat better correlated, due to co-movements in energy prices
- During the last large inflation cycle '70s early '80s Norwegian headline inflation was quite closely correlated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

Building costs inflation is rapidly declining but the cost level is still high

Lumber and steel is down, but other materials are still drifting upwards

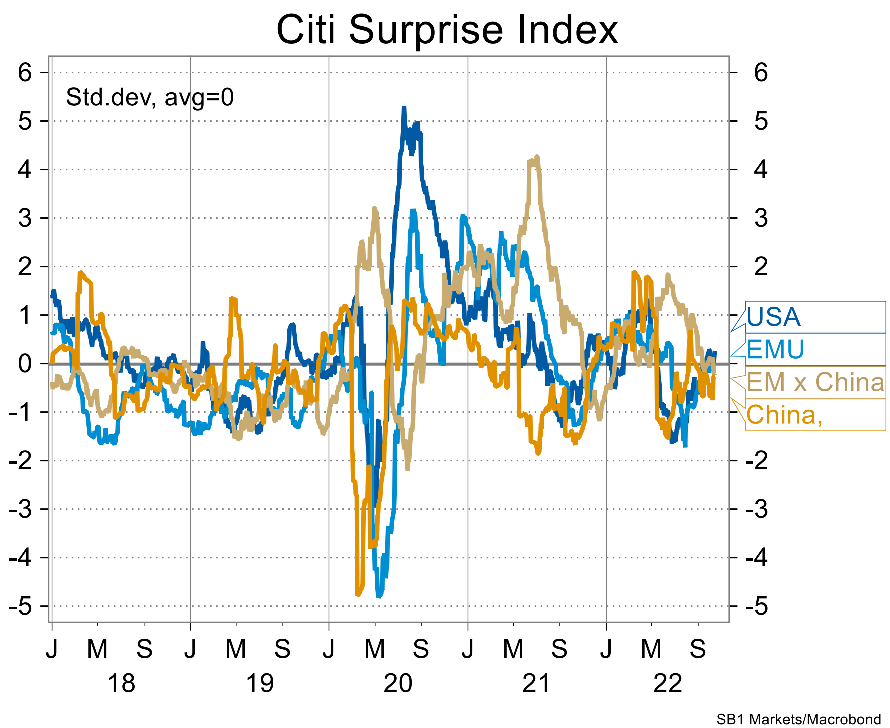


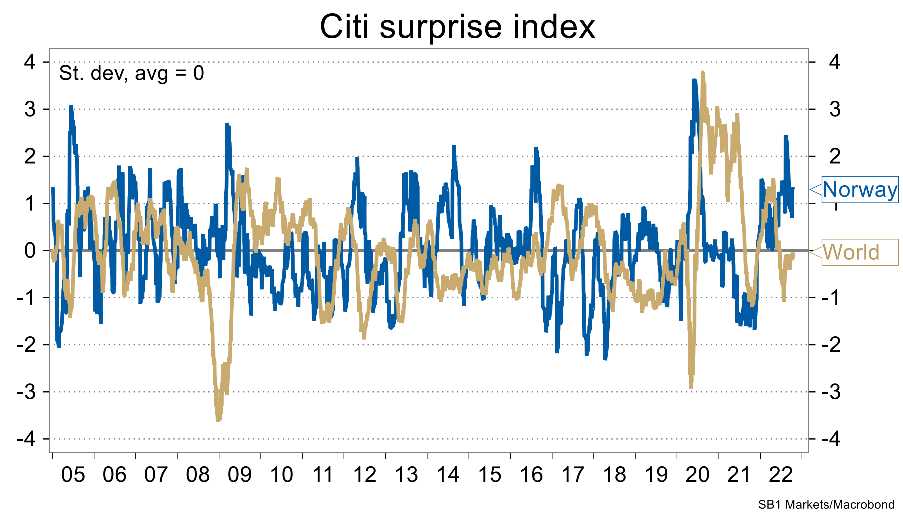


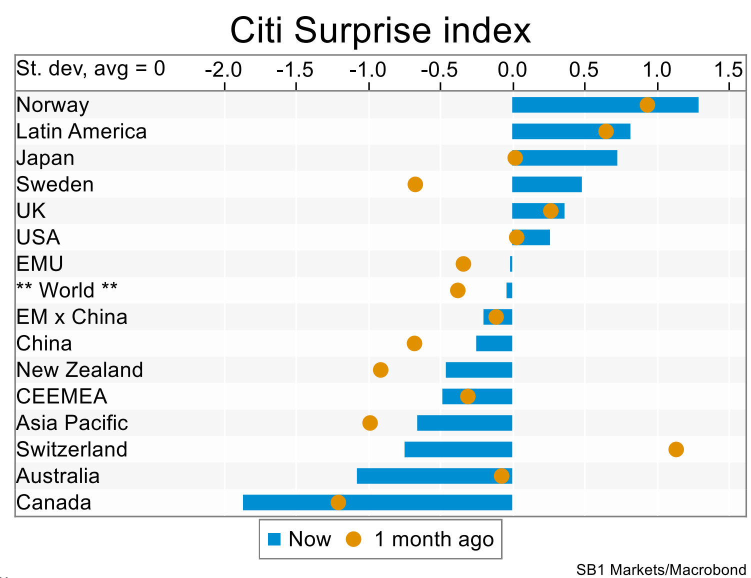
- **Material prices** (houses and apartments) added 0.1% in July, from 0.9% in June. Prices are up 7.5%, down from 10.3% y/y in August (and 28% at the peak). We expected a decline m/m.
  - » Lumber prices are trending down, and reports signal further declines the coming months. Steel prices fell further but the recent flattening/increase in steel prices globally, the potential for a decline from here may have diminished
  - » Other material prices are still trending up; Both plumbing materials, electrical equipment and concreate rose slightly in both August and September
- **Labour costs** were just up 3.1% y/y in Q23, unch from Q2, below the 4.5% gain in Q4 (which was the highest growth rate since 2009)
- Including labour costs, the **total building** cost index is up by 5.3%, down from the ATH at 14.6% at the peak last Oct. The price level is up 12% vs. the pre-pandemic 2.5% growth path. <u>Going forward, we still think lower material costs will bring total construction costs down to more normal levels.</u>

Data close to expectations, according to the Citi surprise index

Norway at the top (but we do not really feel like that is the case…). China, US, EMU close to zero







- **Norway** no. 1 on the list, according to Citi
- … even if our super-cycle friends **Australia, Canada** are at the bottom of the list (and NZ is below par too), while Sweden recovered last week (even if GDP surprised at the downside)

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

Highlights

The world around us

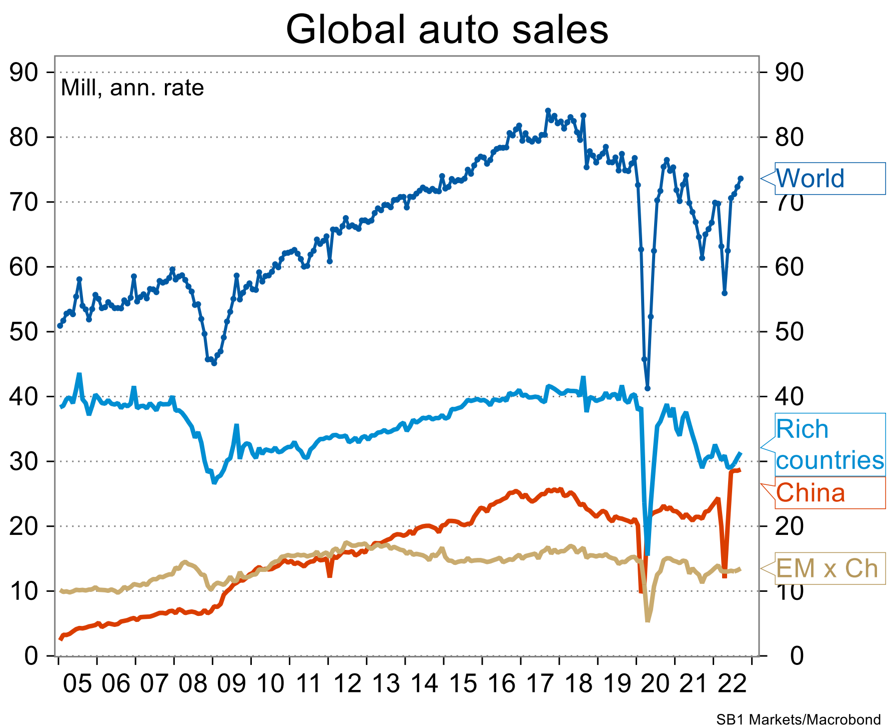
The Norwegian economy

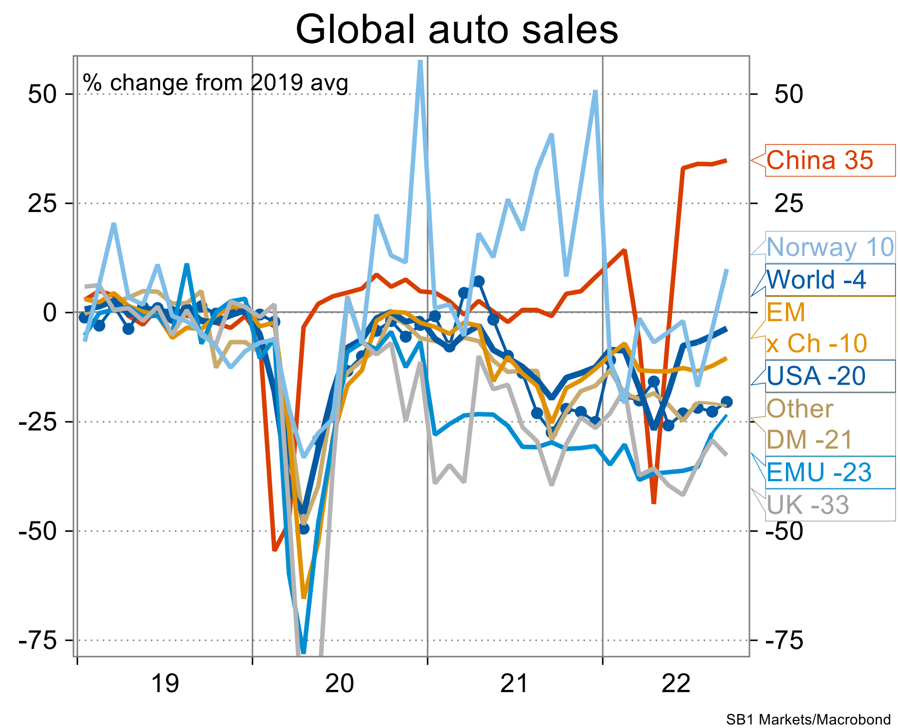
Market charts & comments

SpareBank 1 MARKETS

Sales remained strong in China, and sales rose in other parts of the world as well

Global sales further up in Sept, as production is recovering. Sales are still 4% below the 2019 average

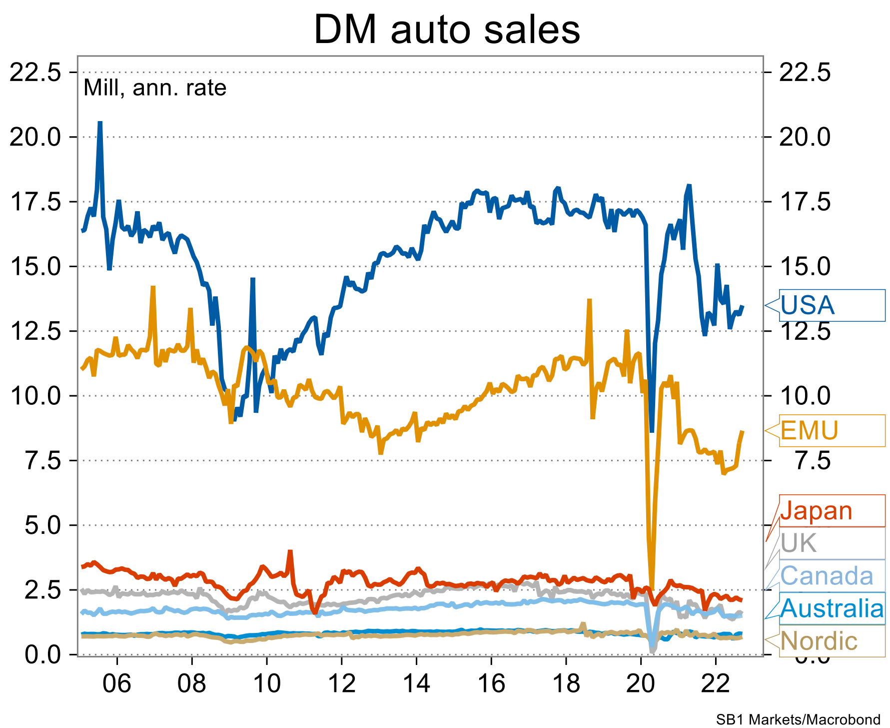


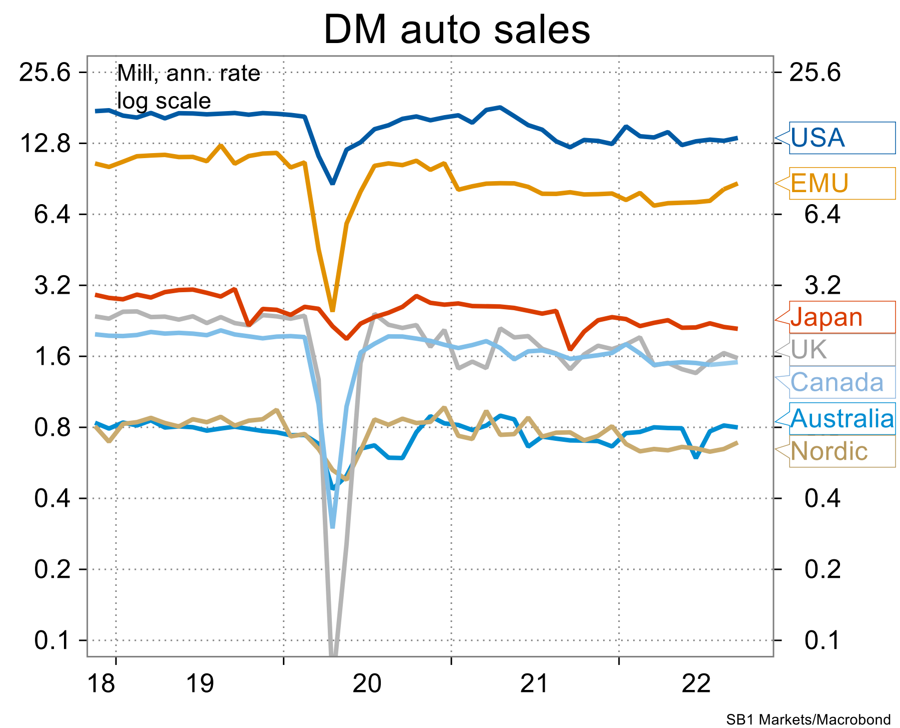


- **Global auto sales** rose 1% in September, following a similar lift in August. Sales are the best since early 2021, and 'just' 4% below the 2019 level
- The regional differences are substantial: Sales kept up at high level in **China** (+35% vs 2019 avg.), and the slump in sales during the lockdowns is more than compensated, signalling that Chinese households are not too worried. Sales in the **US** rose marginally to -20% vs 2019. **EMU** sales rose more but is still 23% below the 2019 level (from -26%). **UK** sales slipped and is down 33%, before the new government messed it up, and rates shot up all over the curve! **Norwegian** sales rose in Sept, 10% above the 2019 level, best among rich countries
- **Indian sales** are close to ATH, while sales are on the way in **many other EMs** as well. **Russian** sales remain depressed, down 70% from a normal level
- **Auto production** is very likely limiting sales most places. However, production is now heading upwards. Chinese production was 32% above the 2019 level in July. South Korea is also above the 2019 level, but auto production is well below a normal level in all western countries and in Japan

DM sales: Most up, even if inflation is high, and interest rates are soaring

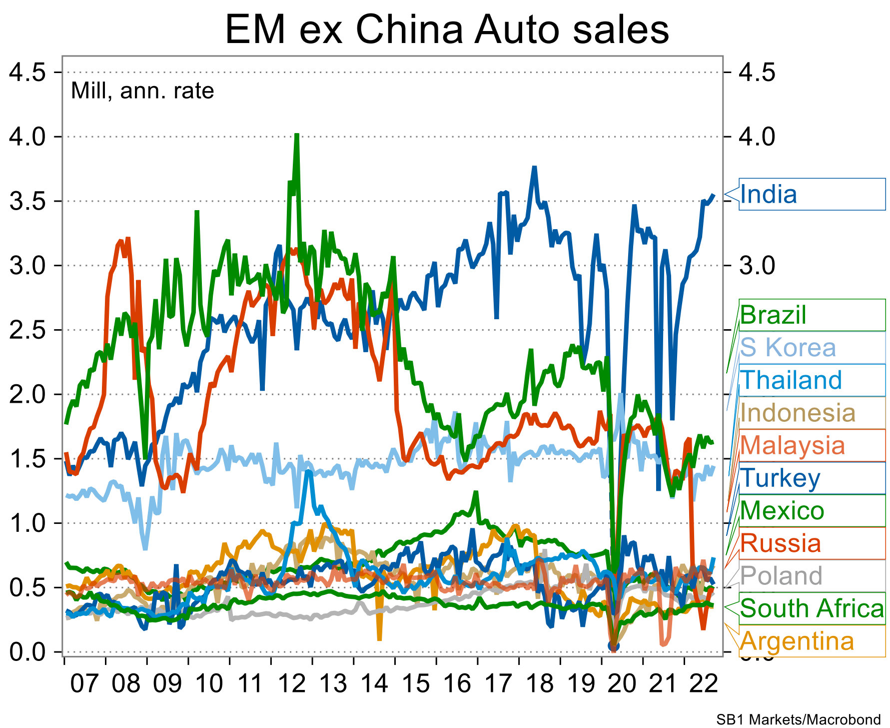
Pent up demand must be considerable as sales have been so low due to lack of supply (semi-cond.)

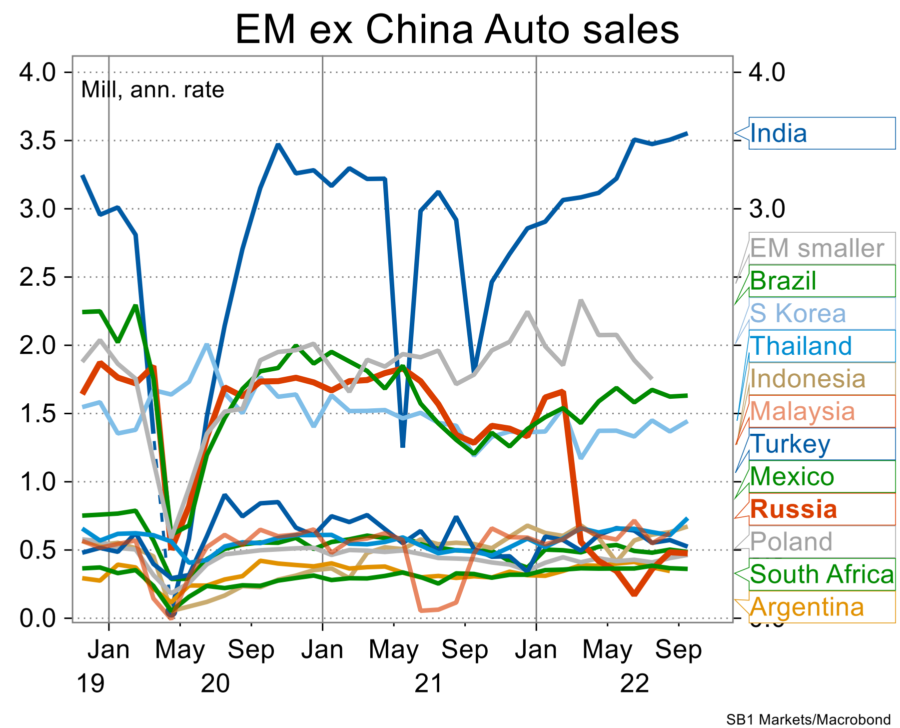




EM: Indian auto sales are approaching ATH. Russian sales remain extremely low

Sales in other EMs are ok. Sales in Brazil, South Korea, Thailand, South Africa are on the way up



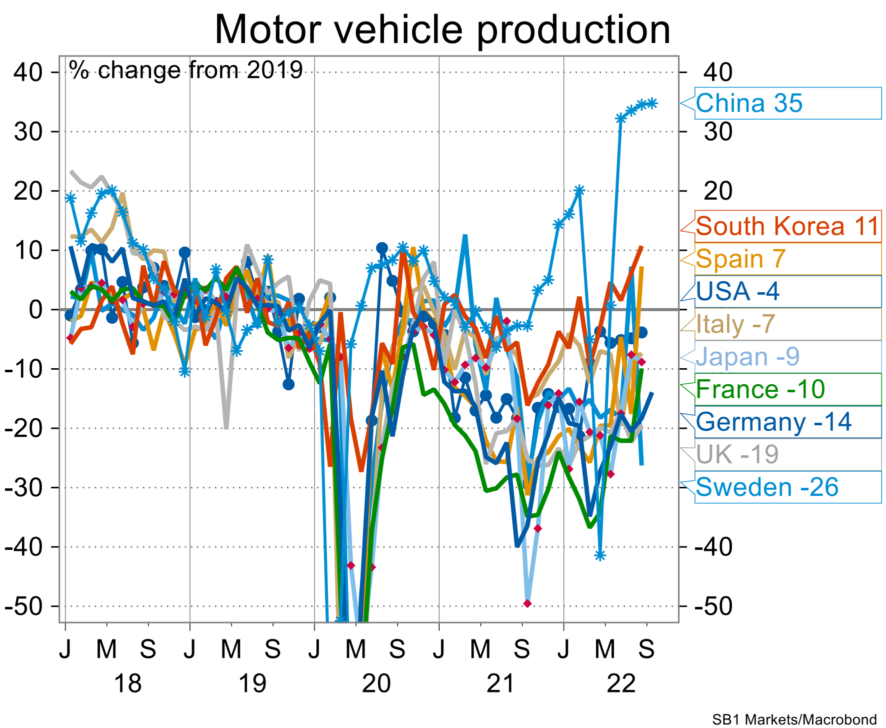


- Sales in EM x China & Russia are just marginally down vs the 2019 level

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

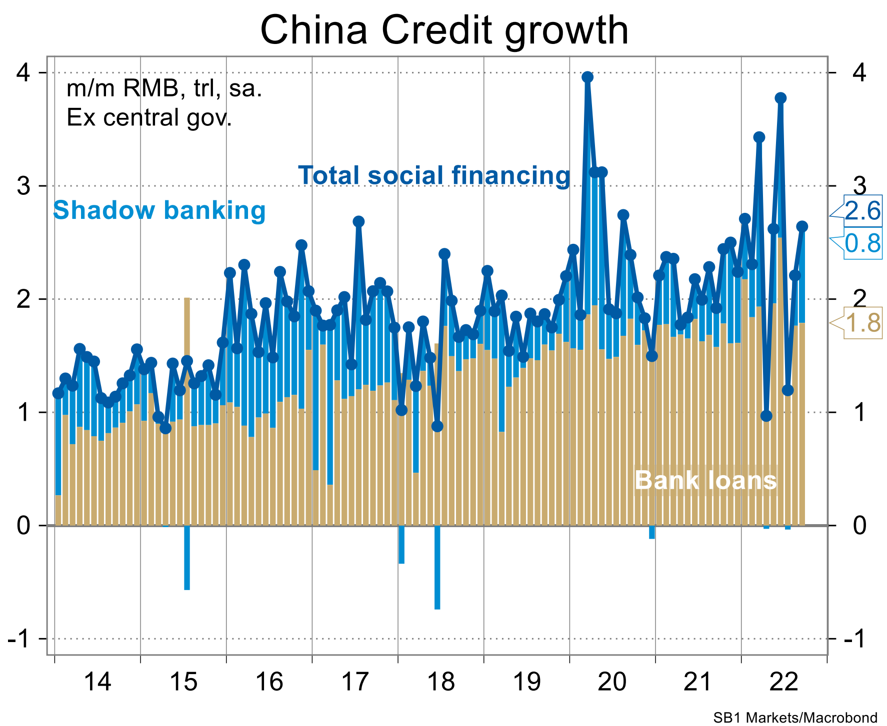
Full speed ahead in China – and other countries are gradually recovering too

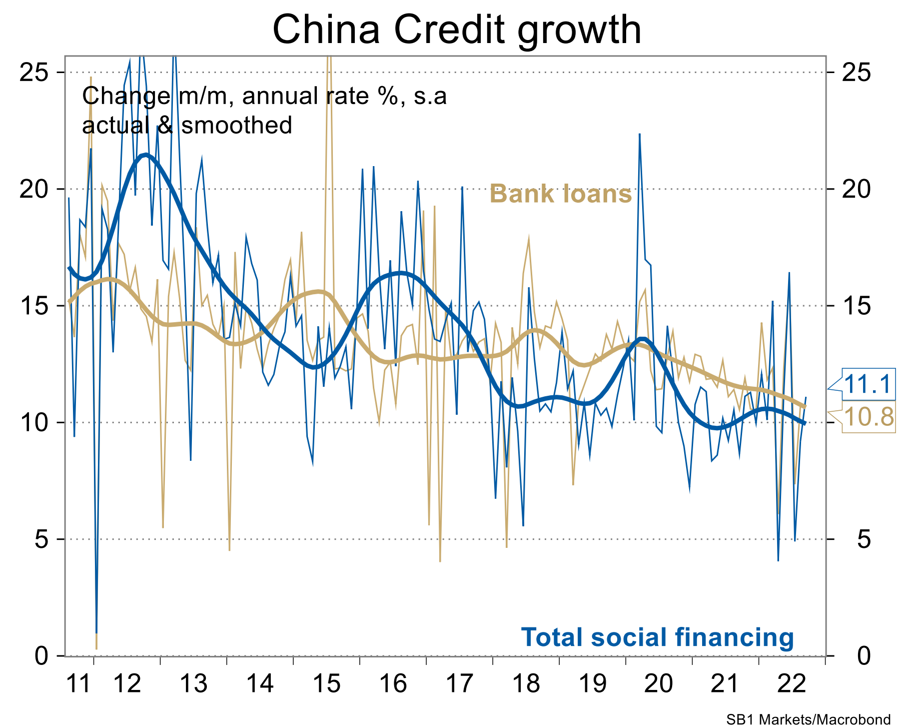
Will pent up demand keep demand and production up even if most economies slow?



Bank credit growth is slowing, some life in the shadows (but it's mostly local)

Total credit growth higher than expected – up to a 11.1% pace from a 5% pace back in July

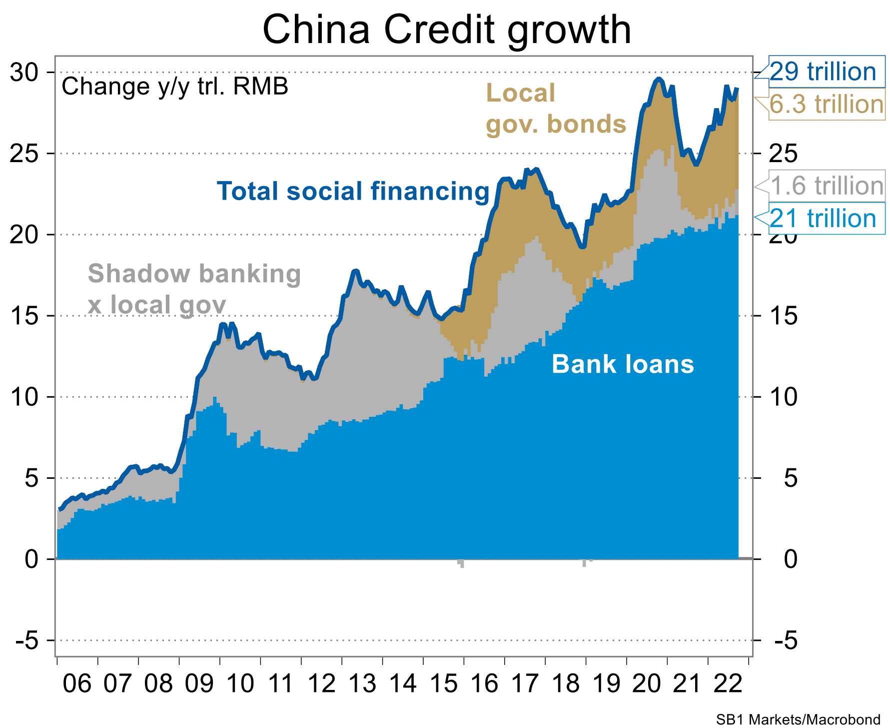


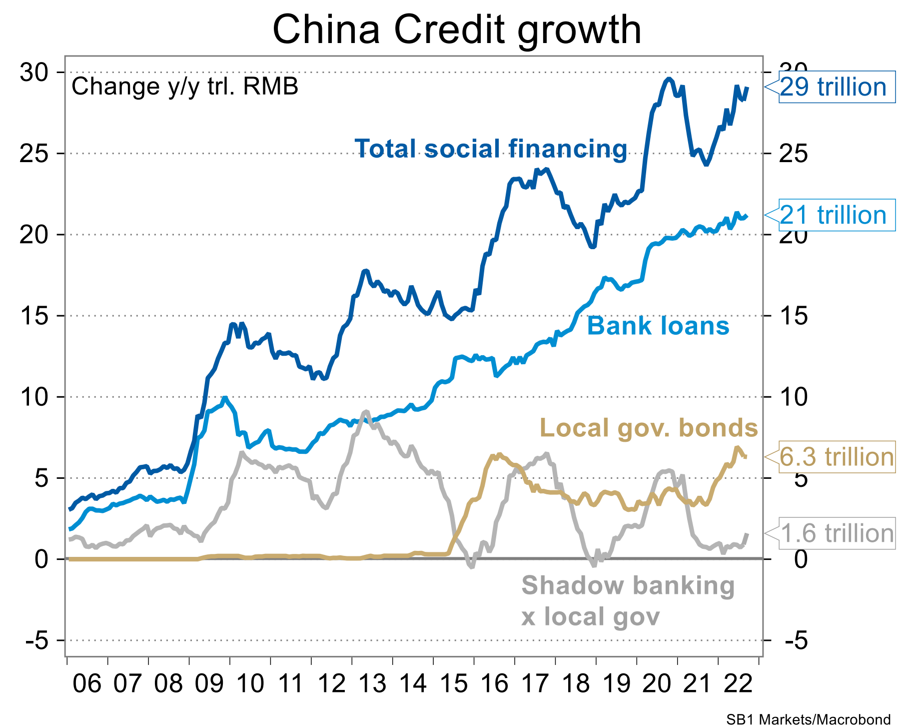


- **Total credit** grew at a 11.1% pace in Sept (m/m, seas. adj. annualised), up from 10.4% in August and 7.3% in July (which have been substantially revised up)
- **Total credit** rose by RMB 3.44 trl, expected 2.7 trl (not seas. adj). The 'core' total social credit (total ex central gov bonds & corporate equites) grew by 2.7 trl (seas adj), up from 2.2 trl in August. The Sept growth rate is close to 'normal'
  - » **Bank loans** rose by RMB 1.8 trl (s.a) or at a 10.8% annualised pace, in line with expectations, and close to the growth rate in August – and close to the underlying growth rate – which trends downwards
  - » **Shadow banking credit** rose by RMB 0.9 trl, and is up 9.0% y/y
  - » **Local governments have been** responsible for most of the increase in credit outside banks over the last year, at least until the past three months. Less revenues from sale of land, and public financing of unfinished building projects requires funding, which is 'dictated' from the central government

Credit growth is accelerating but just due to more local gov't bond issuances

Bank loans are flattening, and there is limited growth in credit outside banks (other than local gov't)

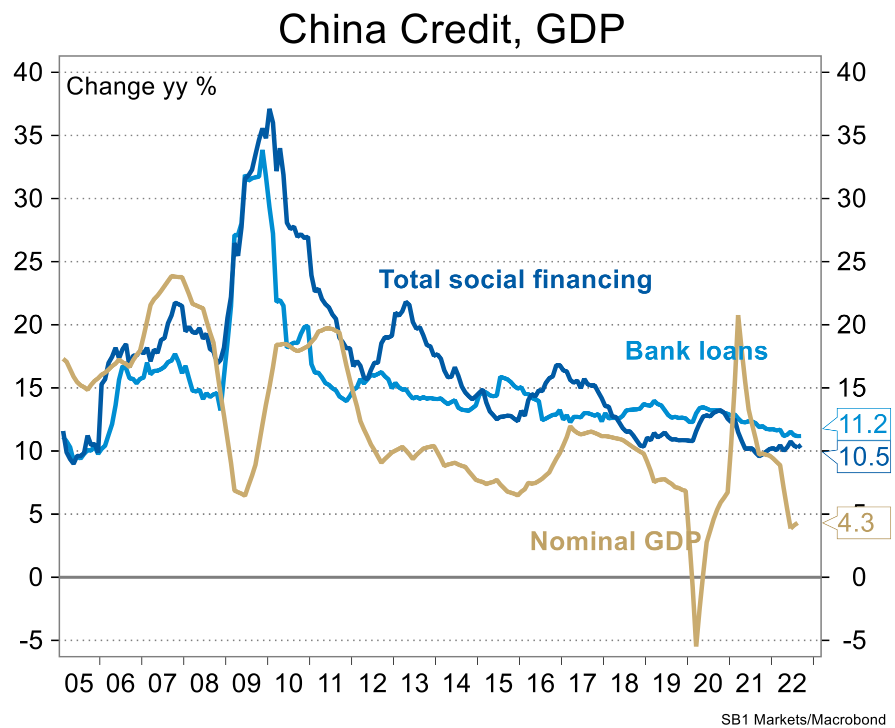


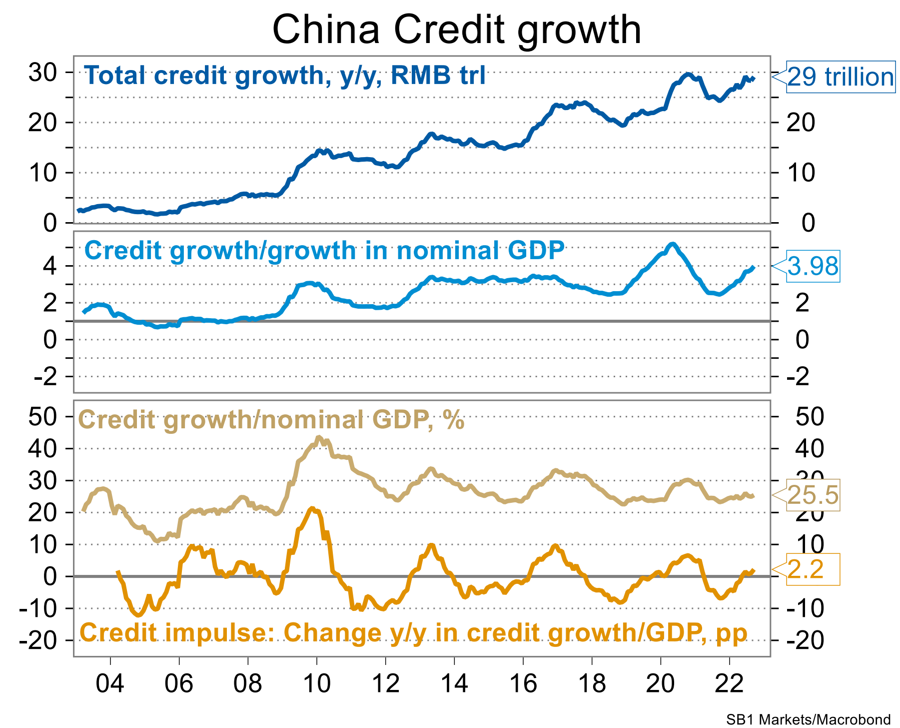


- Over the past year, **total credit** has expanded by RMB 29 trl, equalling more than 25% of annual GDP, up from the 24 trl at the bottom last Sept, (but still down from almost RMB 30 trl at the peak in 2020)
- **Banks** supplied RMB 21 trl of the y/y increase – which implied a gradual decline in the percentage growth rate
- **Local governments** have accelerated their credit growth to 6.3 trl – to above 20% y/y, up from 13% y/y last September!
- Growth in other credit – via the **shadow credit market x local gov bonds** – at 1.5 trl is well below the from 5 trl growth in 2020 (a dramatic slowdown, like many times before…). Growth has increased slightly the past 4 months

Big picture: Credit growth has accelerated, supported by more local gov. debt

… and now central authorities order local governments to borrow even more

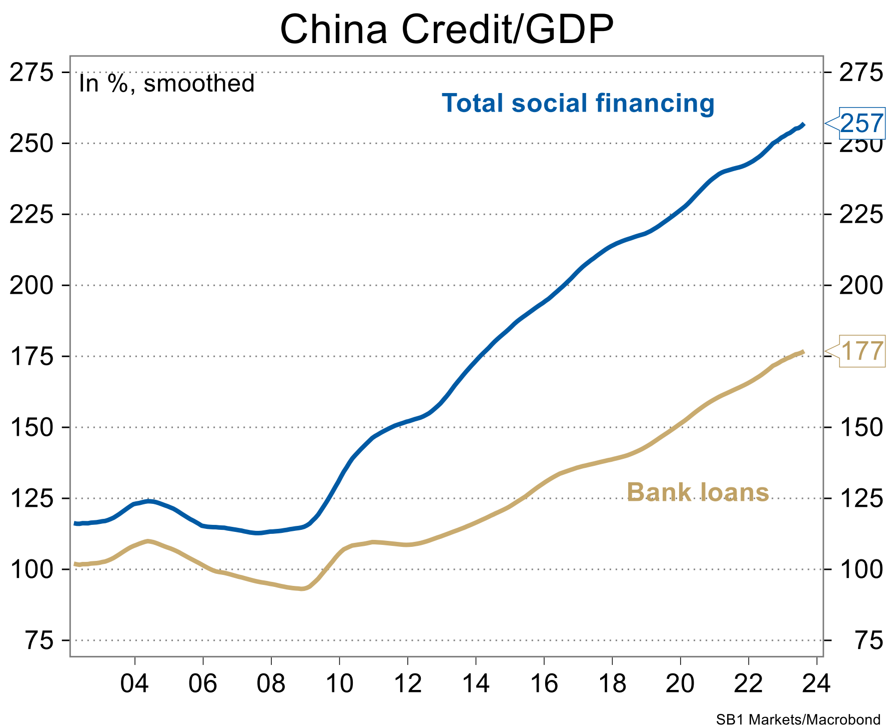


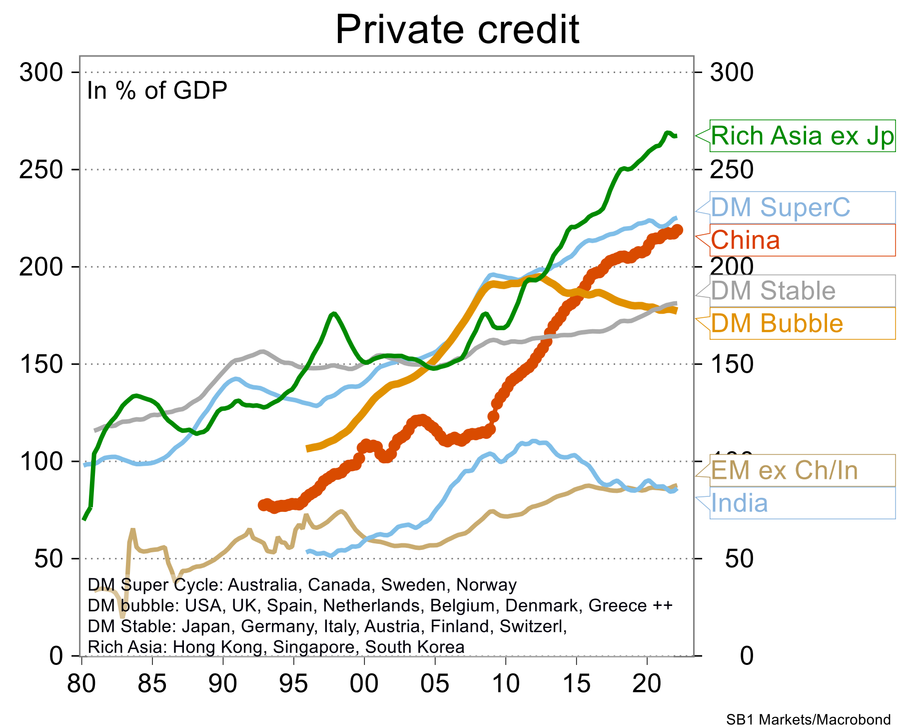


- The credit impulse (change in credit growth vs. nominal GDP) has turned positive, even after the decline in the annual growth rate in July
- **Central authorities** have signalled that **local governments** will be allowed to borrow an additional 1.5 trl by issuing special bonds in H2 in order to fund **infrastructure investments**, lifting overall credit growth by some 0.6 pp (from the present 10.5%).
  - » If executed, local governments may increase their bond debt by an extra 0.25 trl/m, we assume in addition the 'ordinary' RMB 0.5 trl/month
- Growth in bank lending is slowly slowing. The PBoC is likely to take further action, and it has room to do so as China does not have an inflation problem

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

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

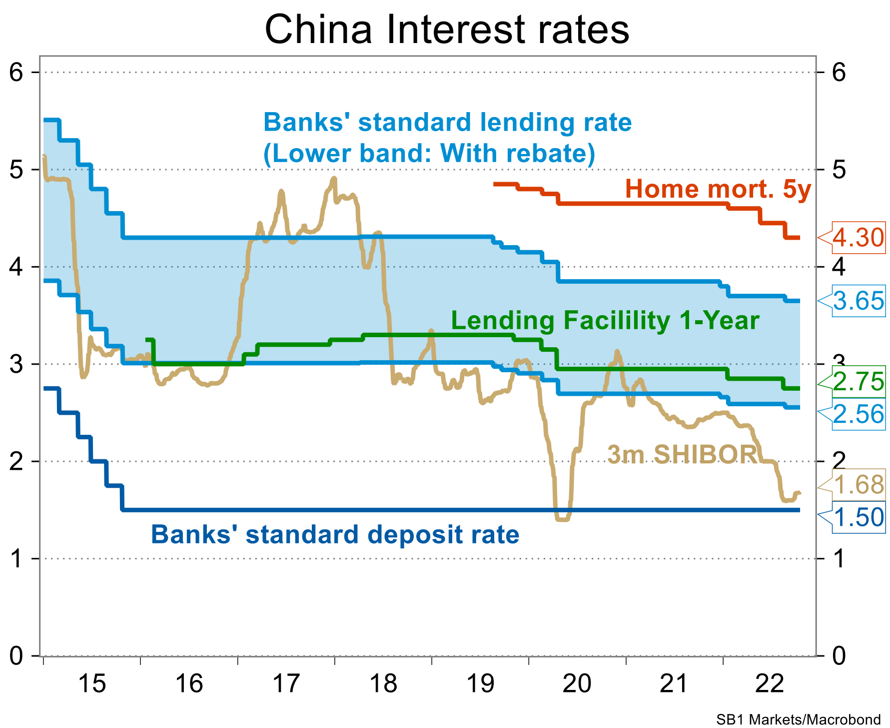


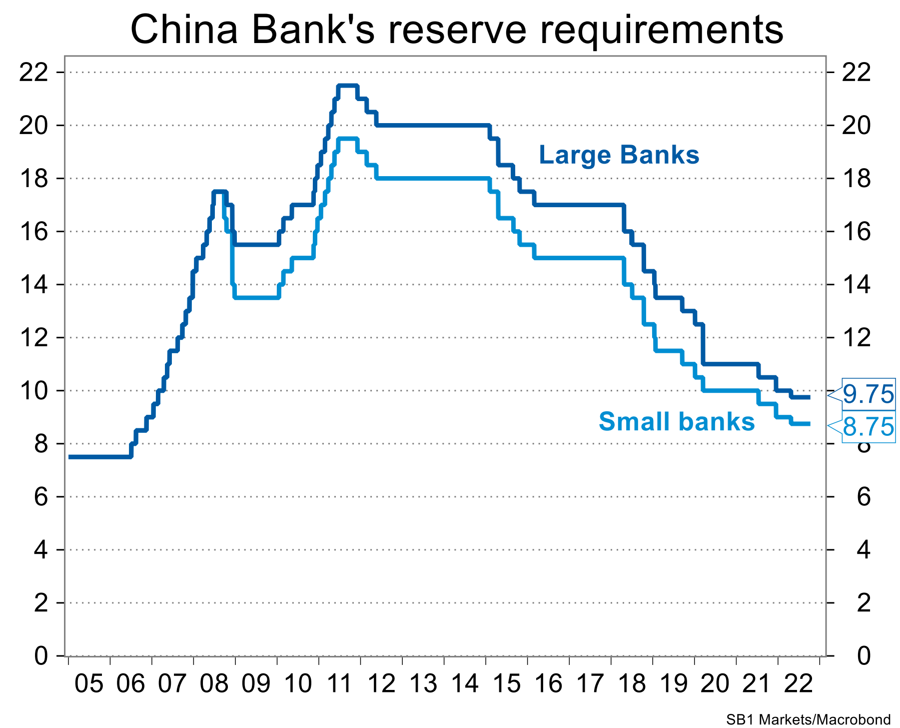


- And there some other outliers as well: DM Supercyclicals (Australia, Canada, Norway, Sweden)

More policy easing in the cards?

Reserve requirements may be cut further, as may signal policy rates

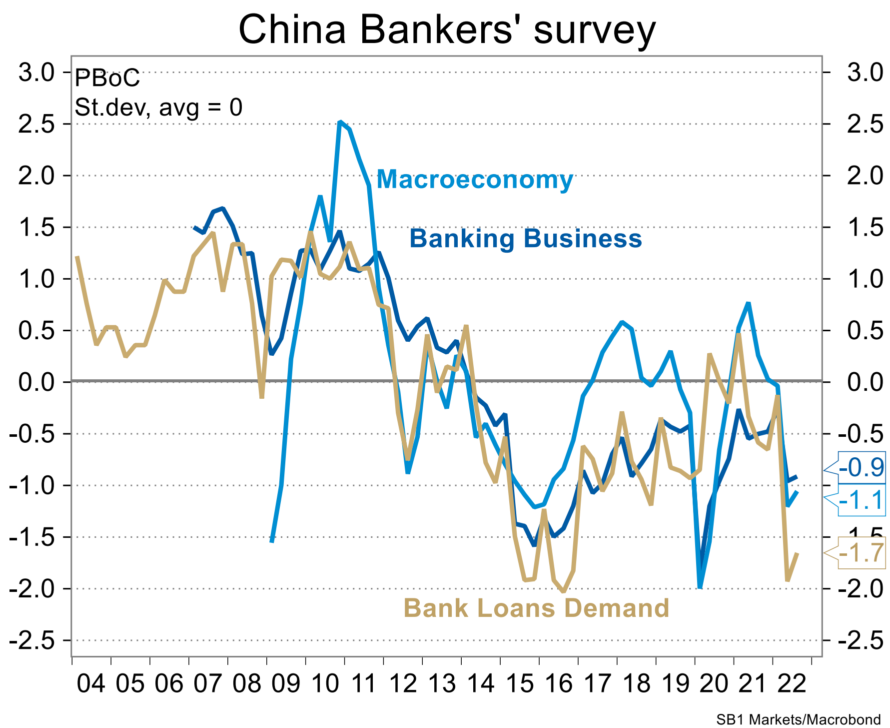


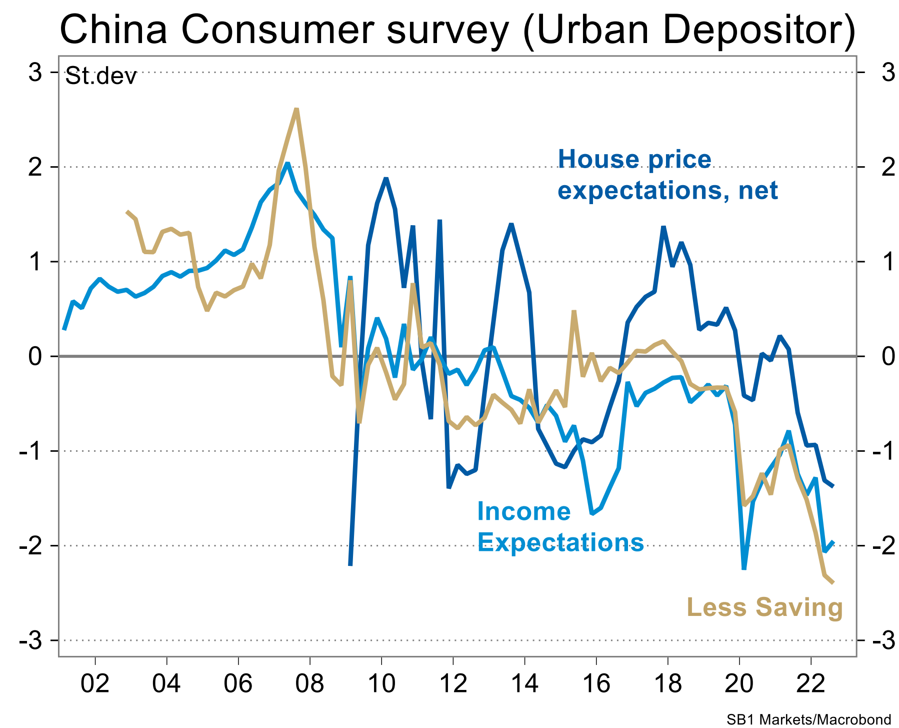


- A series of ambitious schemes for funding of infrastructure projects have been announced recent months, primarily via local government borrowing in the bond market

Sentiment is still weak – but not weaker – in Q3

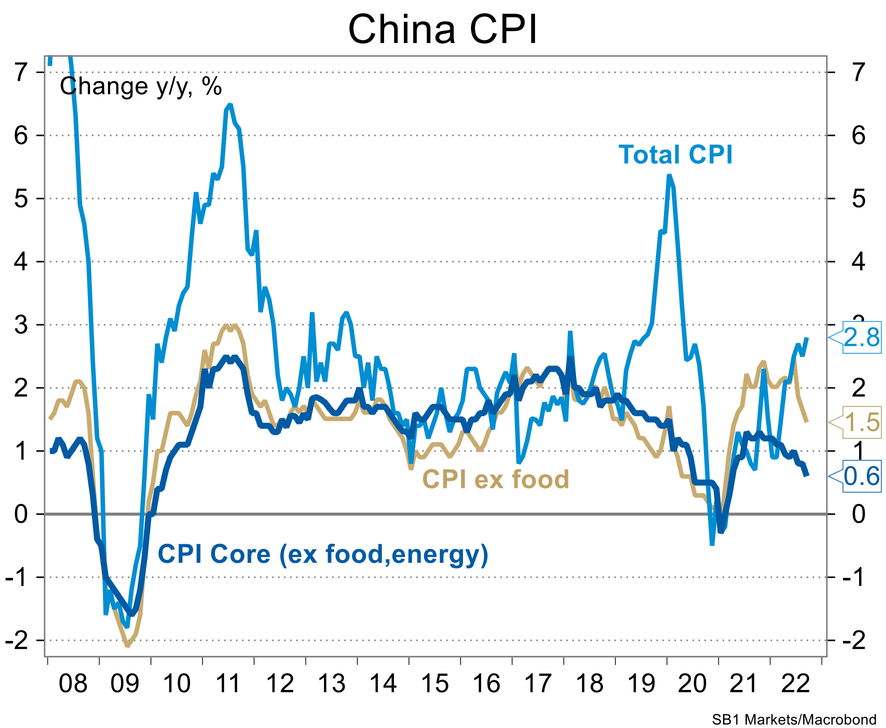
Bankers report very low demand for loans. Households remain in bad mood, and plan to save more

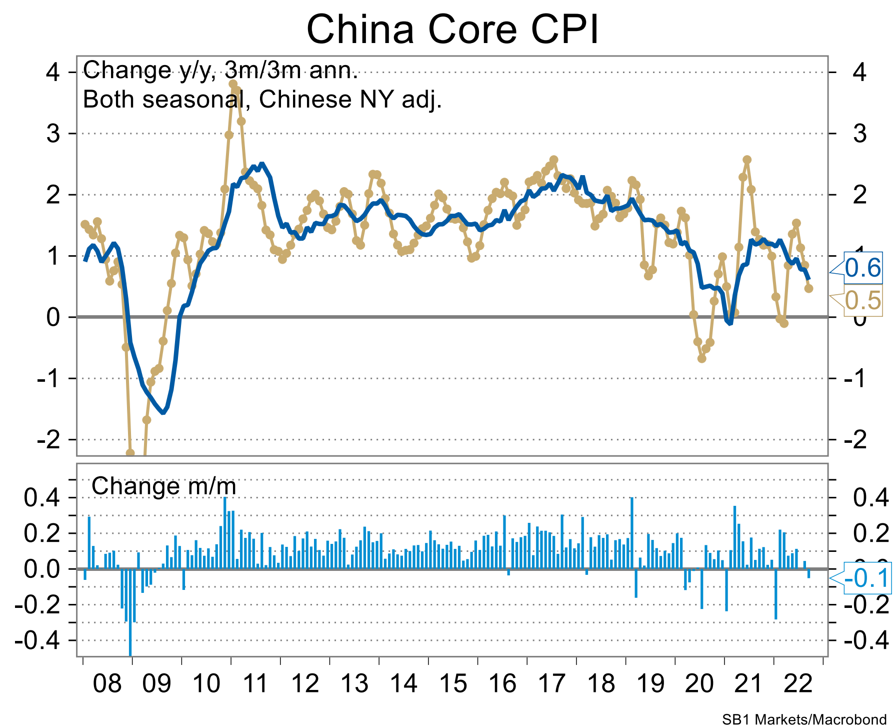




No inflation problem in China: Core down 0.1% m/m, down 0.2 pp to 0.6% y/y

Inflation data roughly in line with expectations

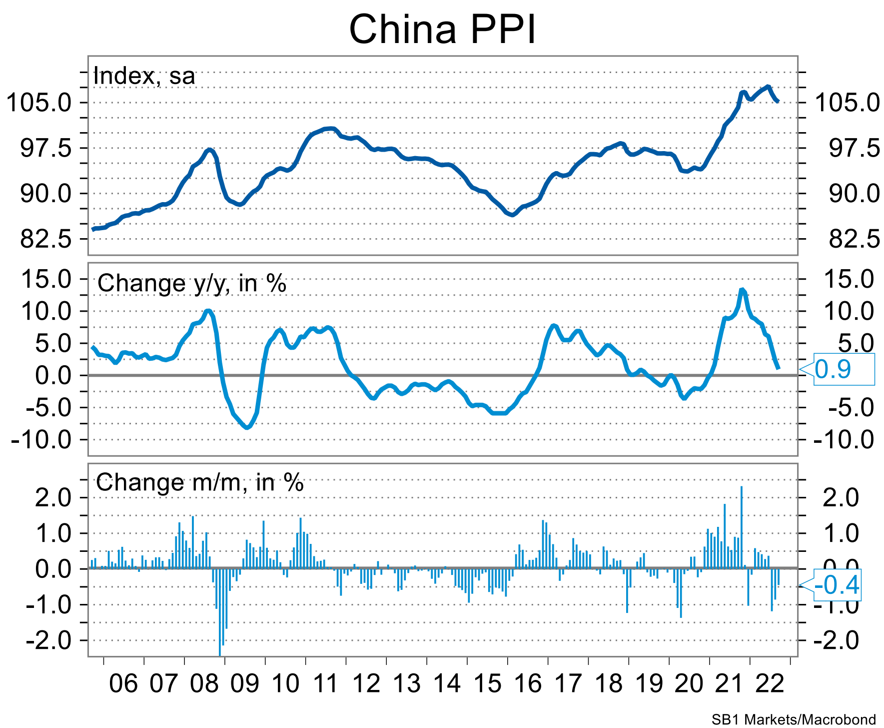


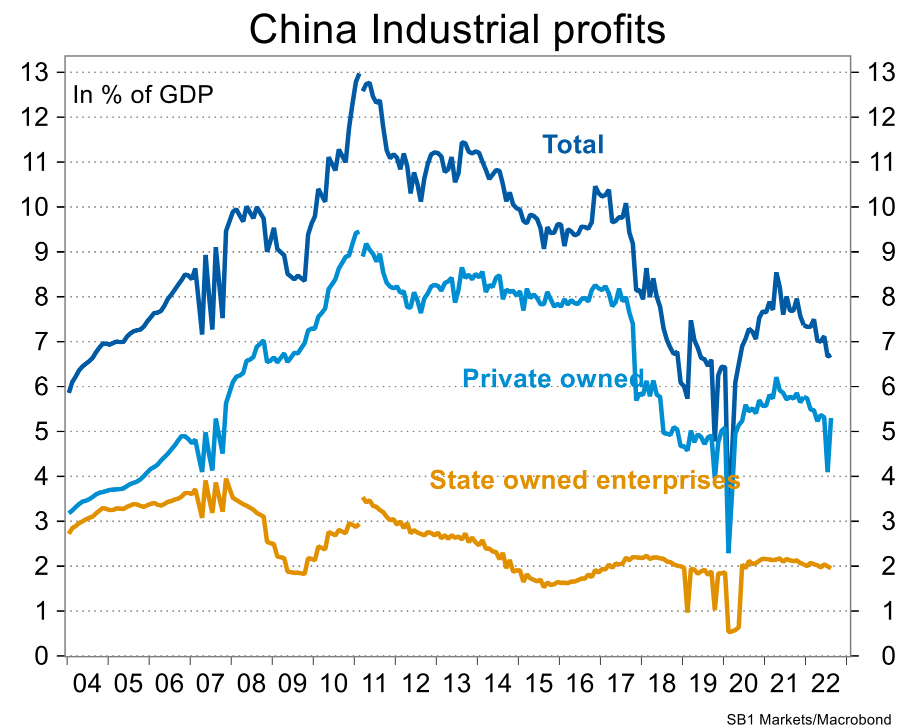


- **Total annual CPI** was up 0.3 pp to 2.8% in Sept, spot on consensus est. Prices rose 0.25% m/m, up from 0% in July
- **The core CPI** (x energy, food) was fell 0.1% m/m, and the annual rate was down 0.2pp to 0.6% y/y. The 3m/3m rate is at 0.5%
- **Food prices** are up 8.8% y/y, with pork prices in the lead again, up 36%
- **Gasoline/fuel prices** are up 19% (down from 20% y/y in Aug)
- <u>**Both core & headline inflation** are still low</u>. **Monetary policy** will not respond to actual inflation data if inflation is not really high or low, <u>the real economy and the credit market is more important. Now authorities are trying to kickstart the economy again after the lockdowns</u>

Producer prices keep falling – the annual rate has fallen to 0.9%

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

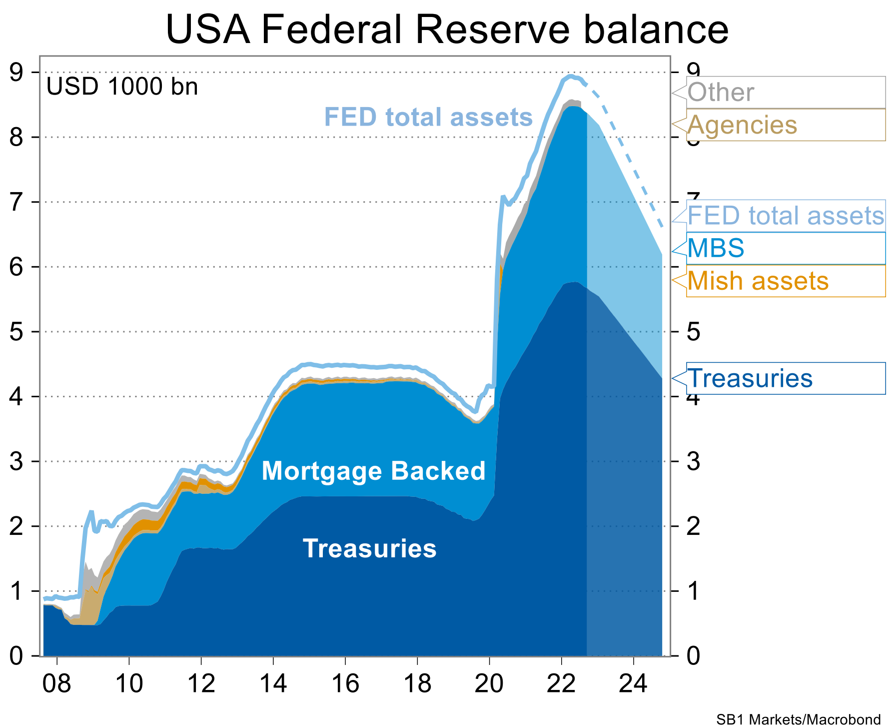




- **At the peak**, the PPI was up 13.5% last October
- **The PPI** fell by 0.4% m/m in Sept, and has fallen over the past 3 months. World demand softening?
- **Consumer goods** are up just 1.8% y/y, durable consumer goods are down 0.6% y/y, while raw materials are up 5.8% - explaining the squeeze on profits
- The correlation between PPI and CPI in China is not impressive (but far better with the US CPI, check here)
- **Profits in privately owned industrial enterprises** are declining in % of GDP. The drop in July must be due to reclassification of some companies

Fed minutes: No news, but confirming their restrictive stance

Cost of taking too little action outweighs cost of taking too much action



The fed projected another 125 bps increase in the fed funds target rate, atop of the 75 bps in Sept. The minutes, while just reiterating what was already communicated by Jay Powell, was interpreted as slightly hawkish by the equity market which fell on Wednesday post the minutes and higher-than-expected PPI data – bond markets on the other hand saw very small movements in yields

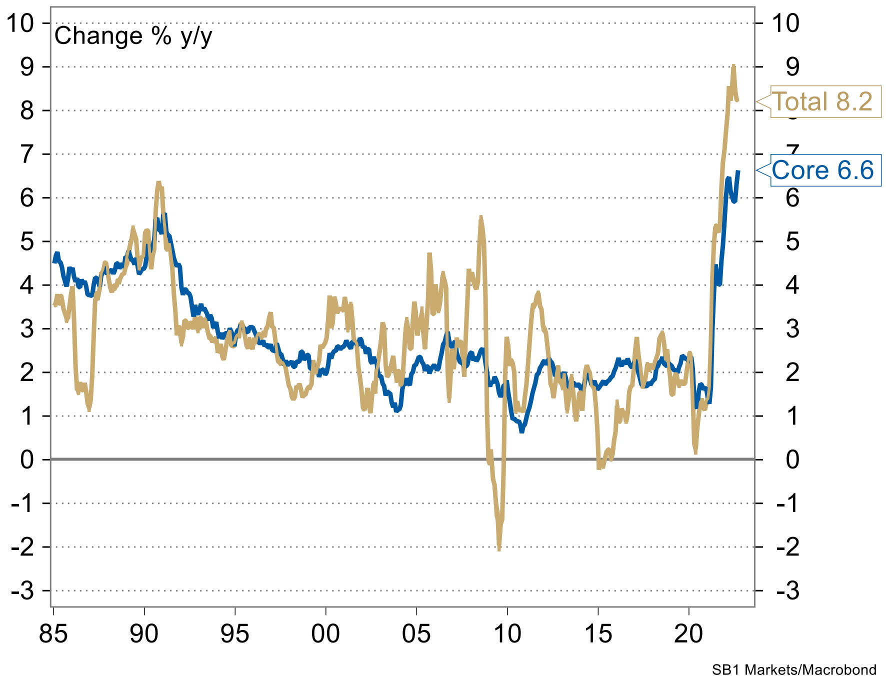
- **The minutes** revealed nothing new, but emphasised that the Fed is committed to their restrictive policy stance
- "Participants reaffirmed their strong commitment to returning inflation to the Committee's 2 percent objective, with many stressing the importance of staying on this course <u>even as the labor market slowed</u>"
- The statement also indicated that once a "sufficient restrictive level" is reached the rate should be kept at that level until compelling evidence shows that inflation is receding and returning to the target
- "A couple of participants remarked that, after the process of balance sheet reduction was well under way, it would be appropriate for the Committee to consider sales of agency MBS…"
- In sum, the minuets, just as the press conference, shows the Fed commitment to bringing inflation down and preventing it from becoming entrenched, even at the cost of the labour market and growth. The committee is also clear that the risk to inflation is on the upside and the risk to their economic projections are to the downside – but bringing down inflation will remain the focus

SpareBank 1 MARKETS

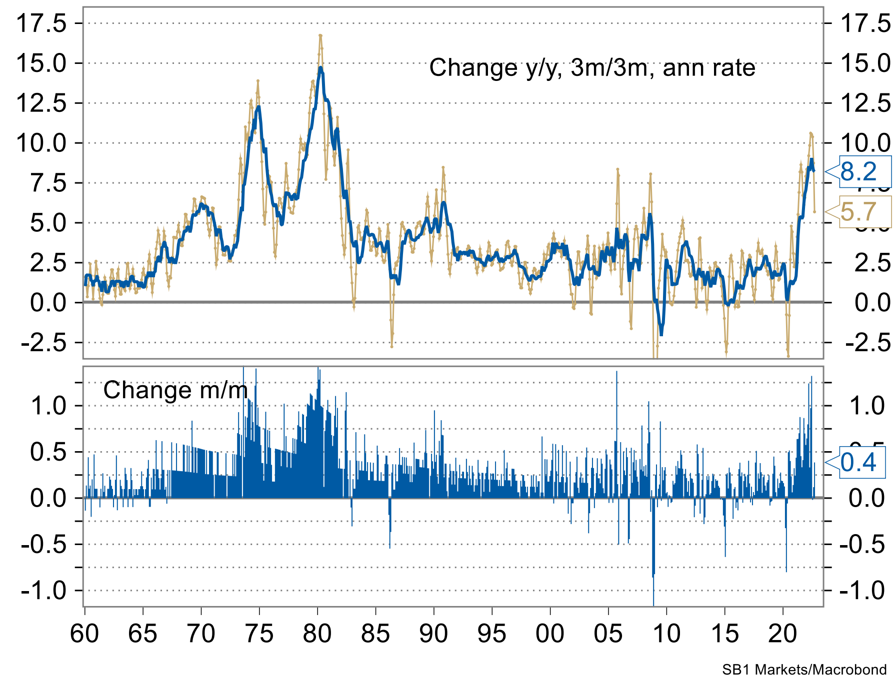
CPI has peaked, but core inflation again well above expectations

CPI inflation was 0.1 – 0.2 pp higher than expected. The core up 6.6% y/y, and inflation is broad

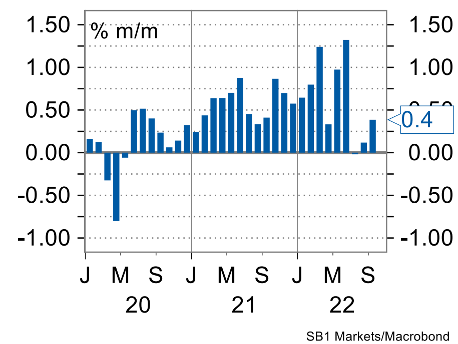
USA Consumer Price Index



USA CPI

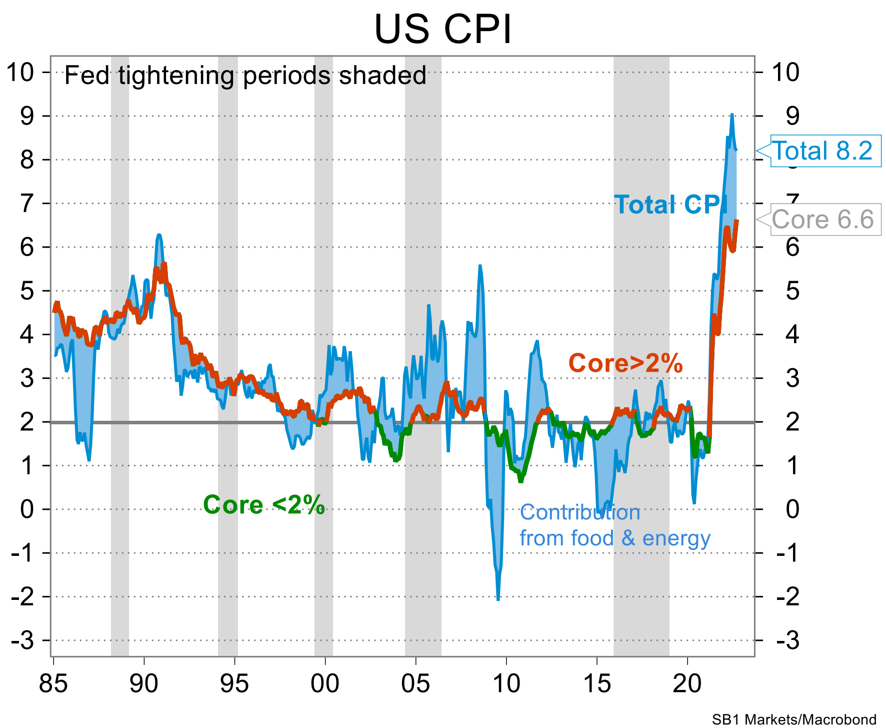


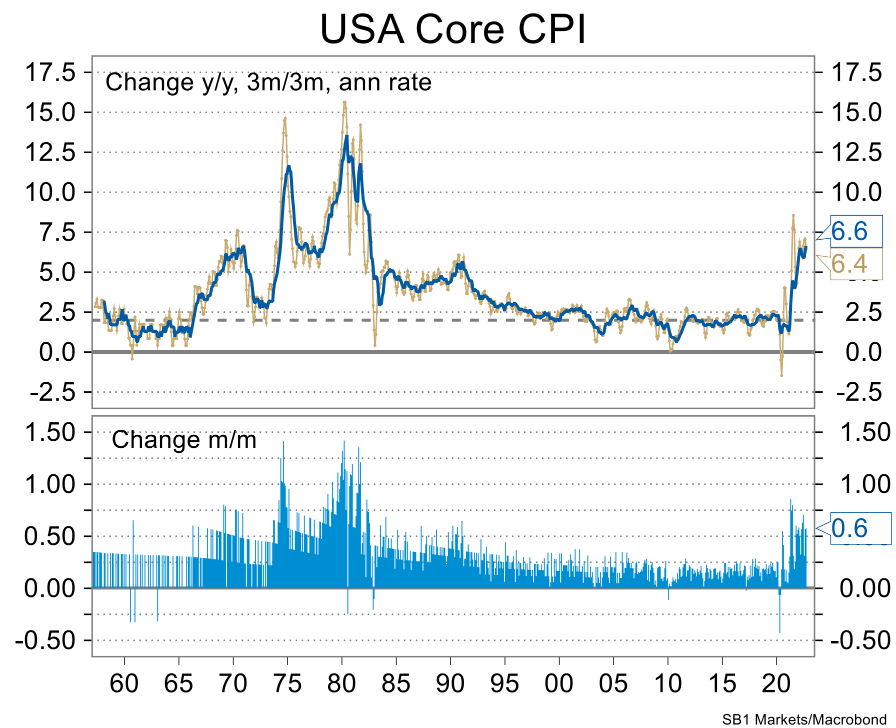
- **Headline CPI** slowed 0.1 pp to 8.2% in September, expected down to 8.1%. Prices rose 0.4% m/m, expected 0.2%
- **Energy prices** fell further, but energy is still contributing 1.6 pp to the headline rate
- **Food prices** rose 0.7% m/m and are up 10.8% y/y, lifting the CPI by 1.6 pp
- **Surveys** report further price increases the coming months, but at much slower pace than over the prev. months
- Given the CPI surprise, a 75 bps hike in November is very likely (which it is according to the Sept. dot plot as well)
- We still think **markets** focus too much on actual inflation, especially driven by commodity prices, and too little on wage cost inflation. However, a contraction in margins will also be detected in the CPI report – and they are important for the Fed

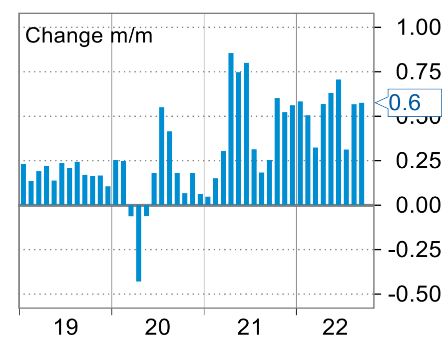


Core prices up 0.6%, 0.1 pp more than expected, and up 0.2 pp to 6.6% y/y

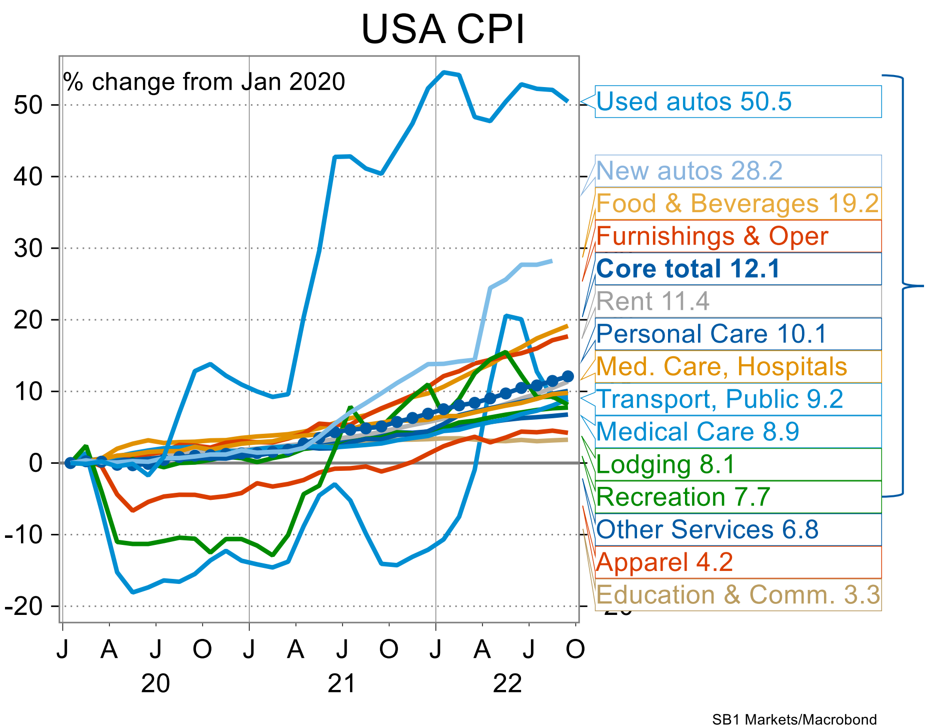
The 3m/3m rate at 6.4% confirms that underlying inflation is still very high

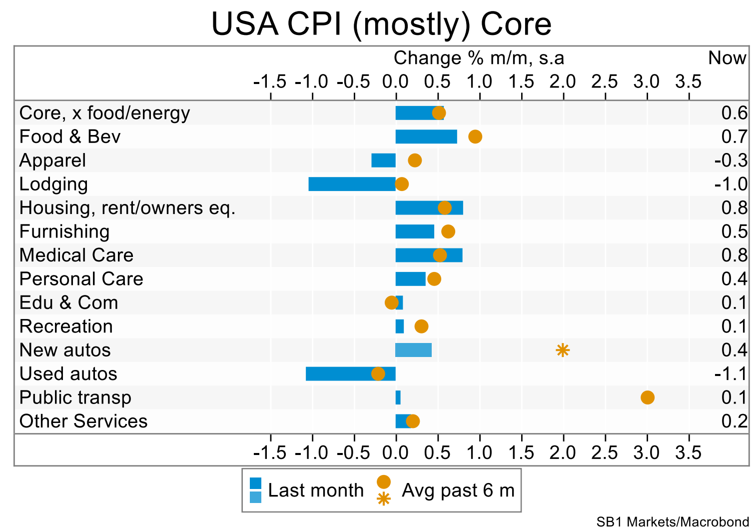


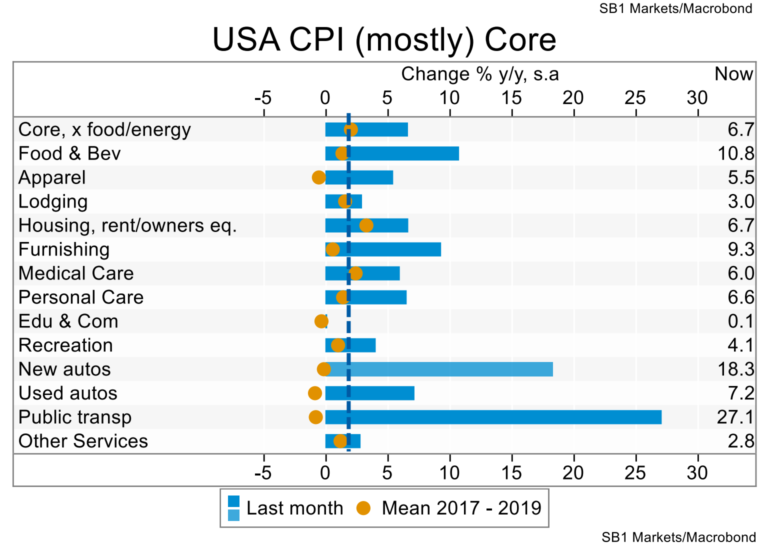




Lodging, used autos & apparel cheaper in September, but most prices were up





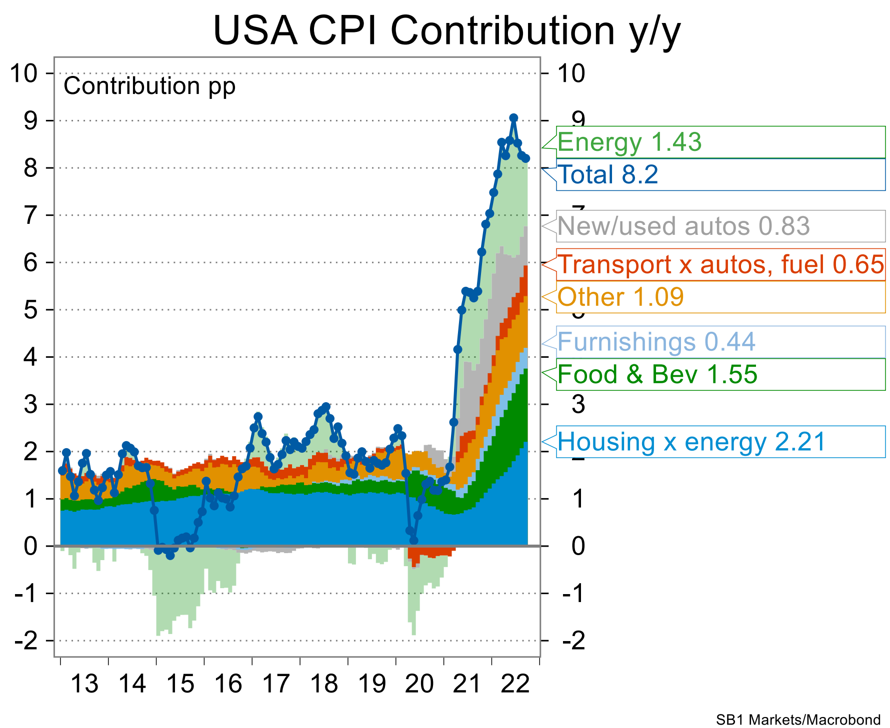


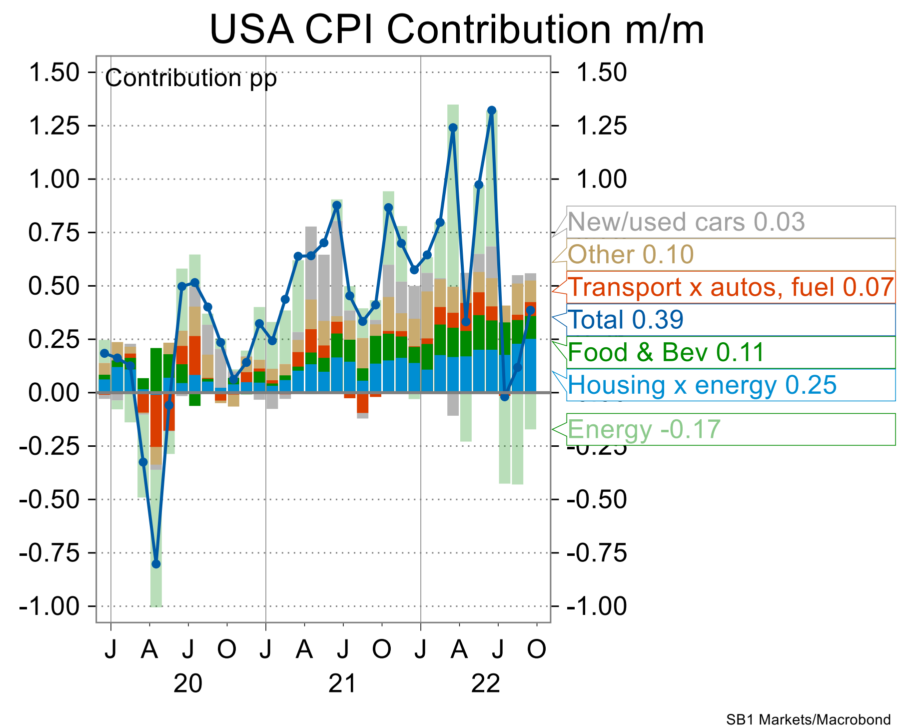
- All but one sectors, education & communication, are up at more than a 2% pace from before the pandemic
- Rents are up 6.3% y/y, lifting the CPI by 2.2%, alone!
- One day: A huge downside to used auto prices – and hopefully for some others as well, like food and furnishing prices

SpareBank 1 MARKETS

Energy & transport (incl autos) explain just 2.9 pp of the 8.2% lift in total CPI

The problem: The rest is up by more than 6% y/y. Housing alone contributes 2.2 pp; food 1.55 pp



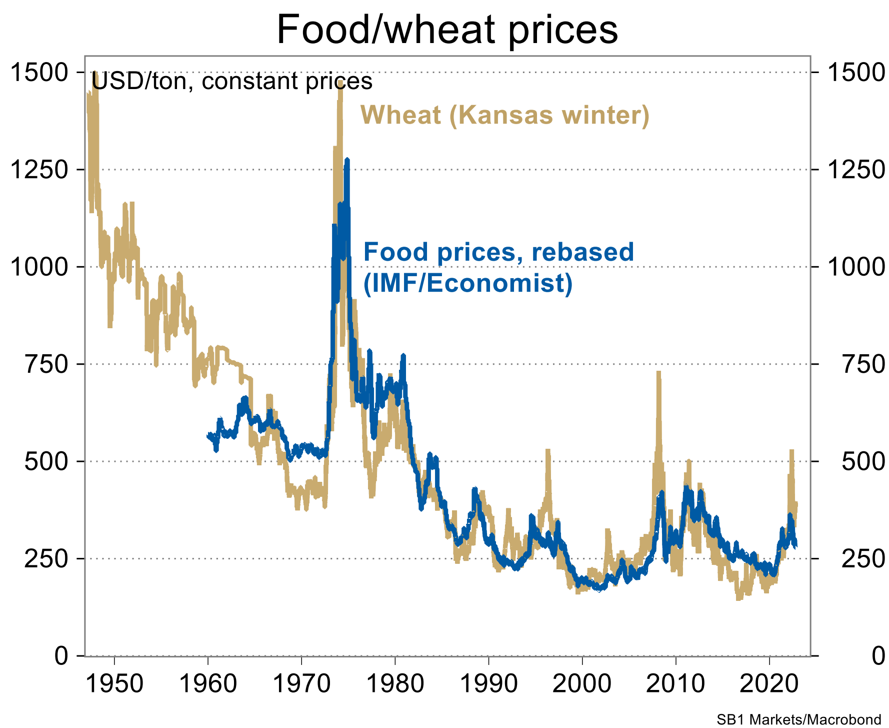


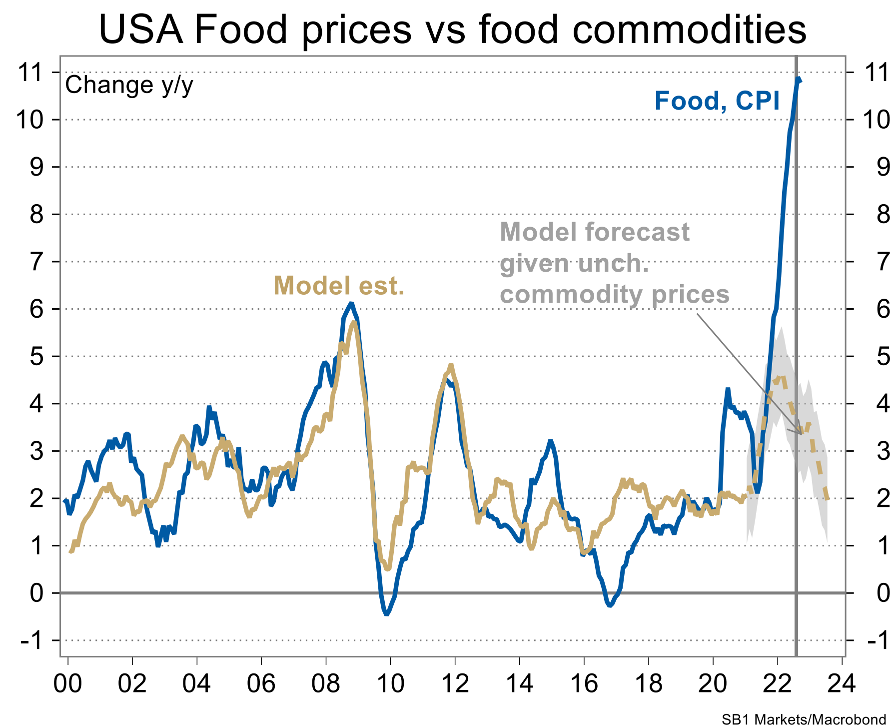
- **Energy** prices fell further in September but are still sharply up y/y
- **Excluding** the 2.9 pp contribution to the headline CPI from energy & transport, **"remaining" inflation** has accelerated rapidly
- **Housing x energy** (and x lodging) is contributing by 2.2 pp, though partly due to a low base one year ago. Rents as measured in the CPI are up 6.8% y/y, but the upside is probably now limited

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

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>



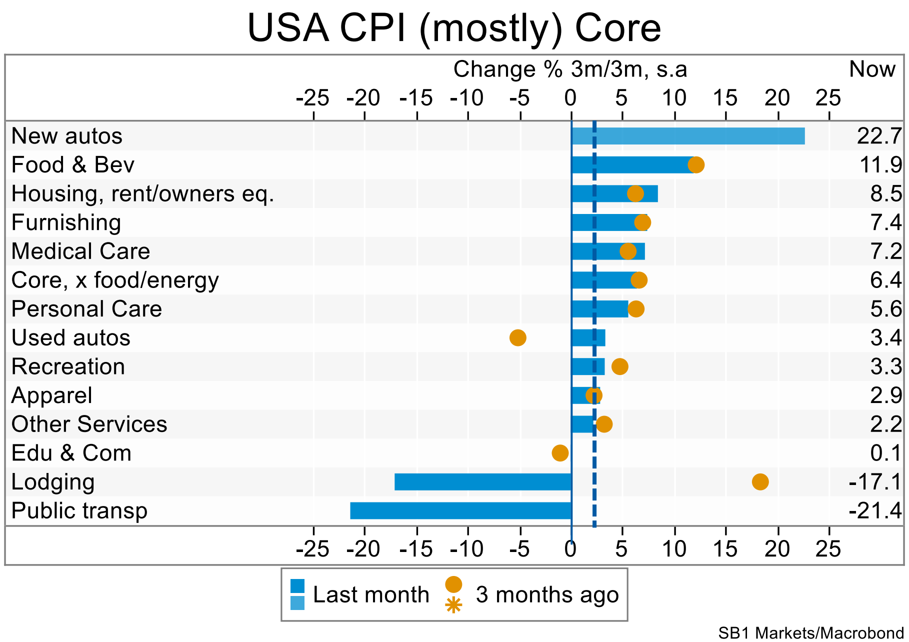


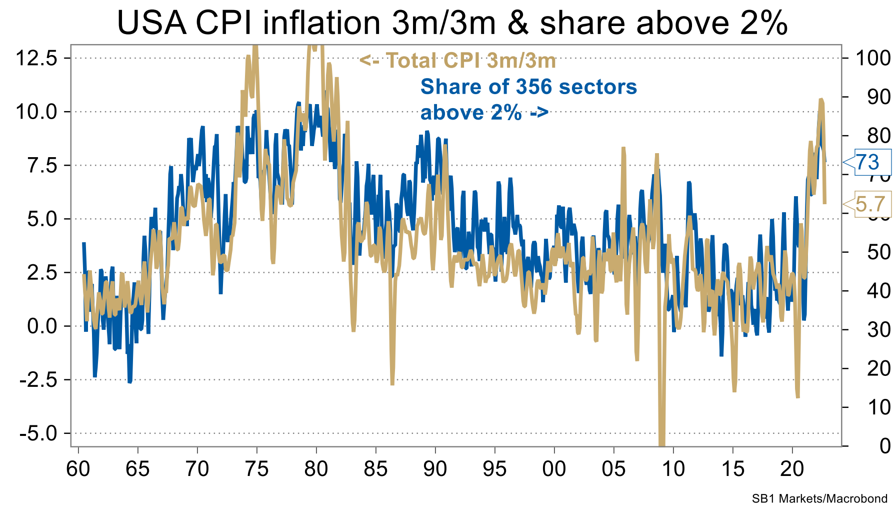
- Why have food prices at the retail level exploded vs. food commodities? The candidates: Freight costs, processing costs, distribution costs, (including energy and wages at each element in the value chain) – and the retail trade sector has increased its profit margins (according to national accounts)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

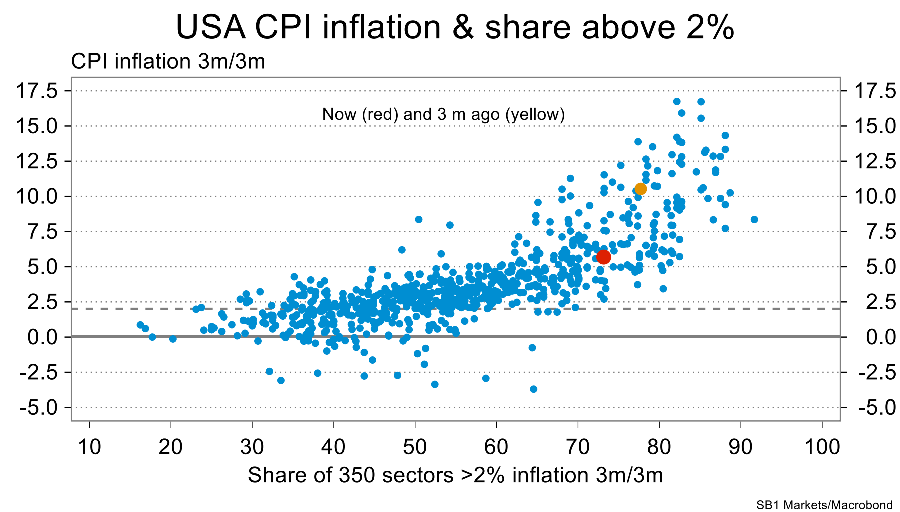
SpareBank 1 MARKETS

Inflation measured 3m/3m: More sub-indices are slowing than accelerating

However, prices are up ‘just’ 5.7% 3 m/3 m, down from above 10% at the peak



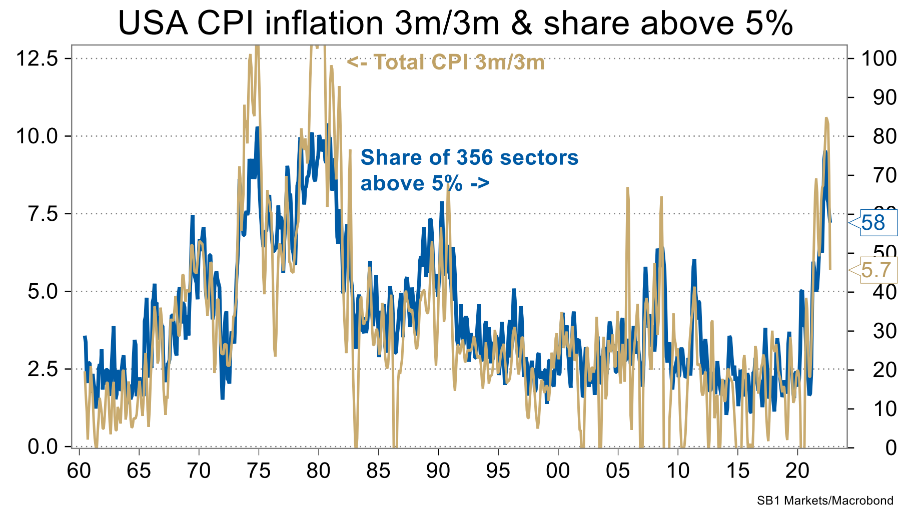


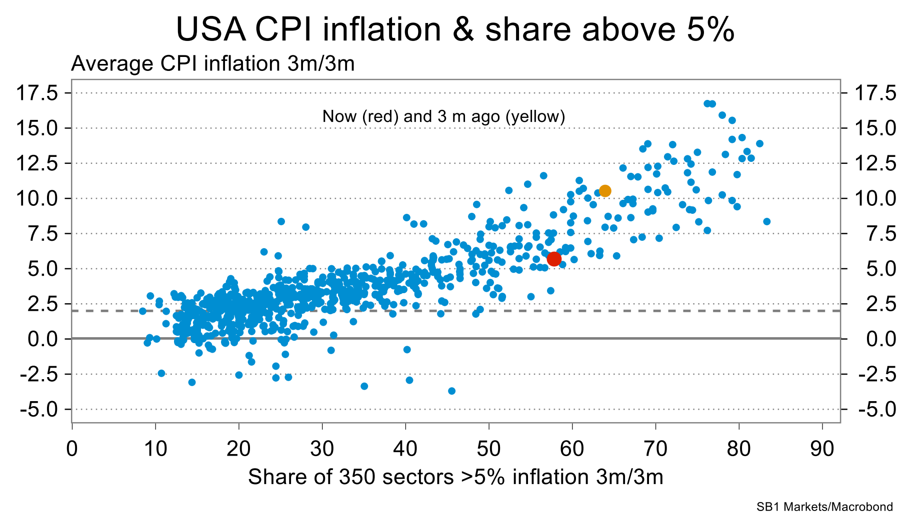


- 73% of the CPI items are up more than 2% y/y
- A substantial negative drag from lodging and public transport recent months

‘Just’ 58% of sub-indices are up more than 5% 3m/3m

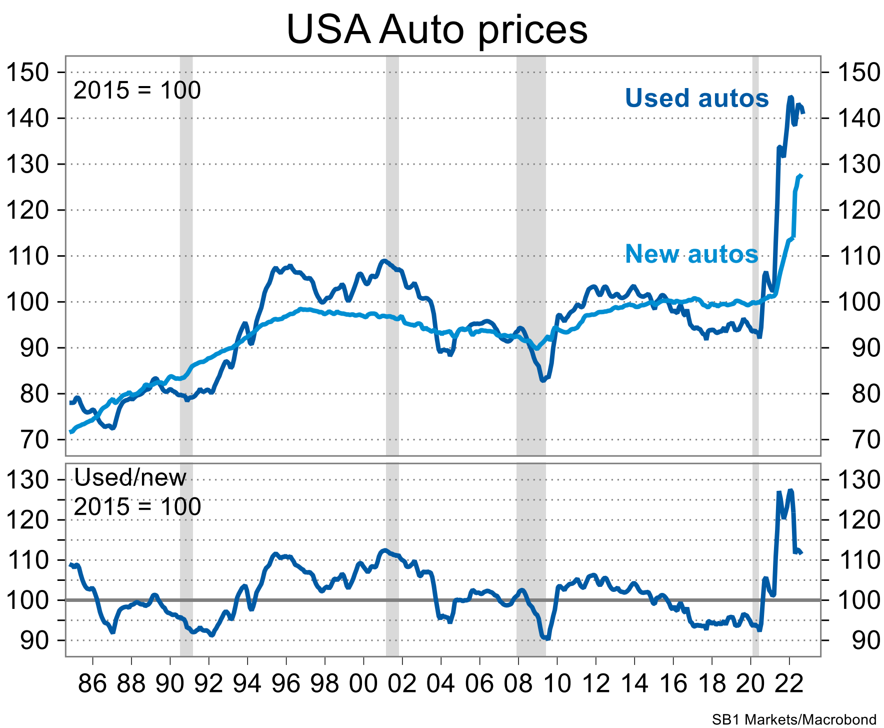
‘Just’ because the share has fallen from almost 80%





Used auto prices did not decline as expected – but they have peaked

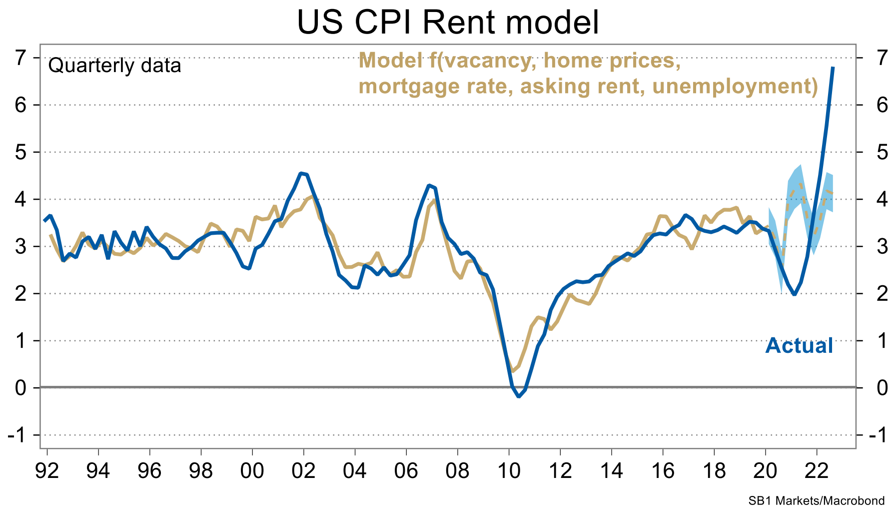
Private surveys had indicated a substantial decline in second-hand autos. New auto prices are soaring



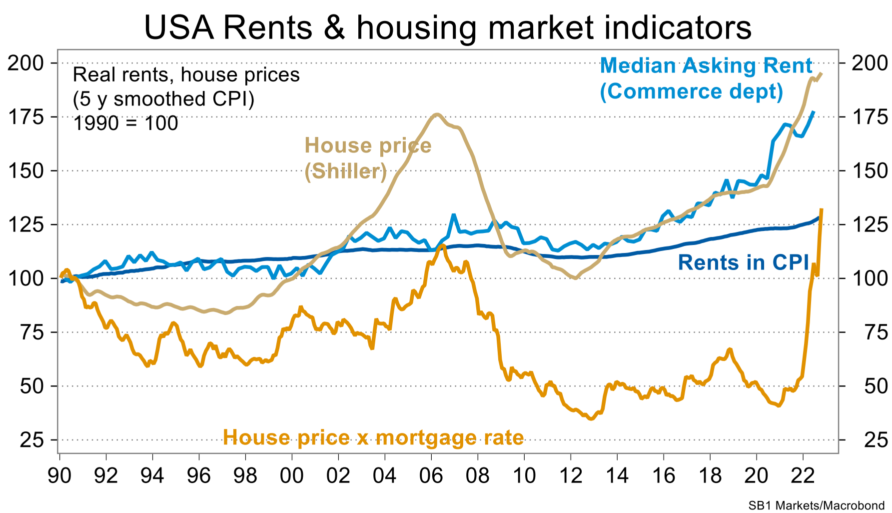
- At one stage, at least **used auto prices** will come down to a normal level vs. new car prices
- **New auto prices** have shot up sharply recent months – and these prices will very likely return to a more normal level – production costs are not up 26% through the pandemic!
  - » We have so far assumed that demand for autos was higher than production capacity but there are reports of higher inventories of new cars

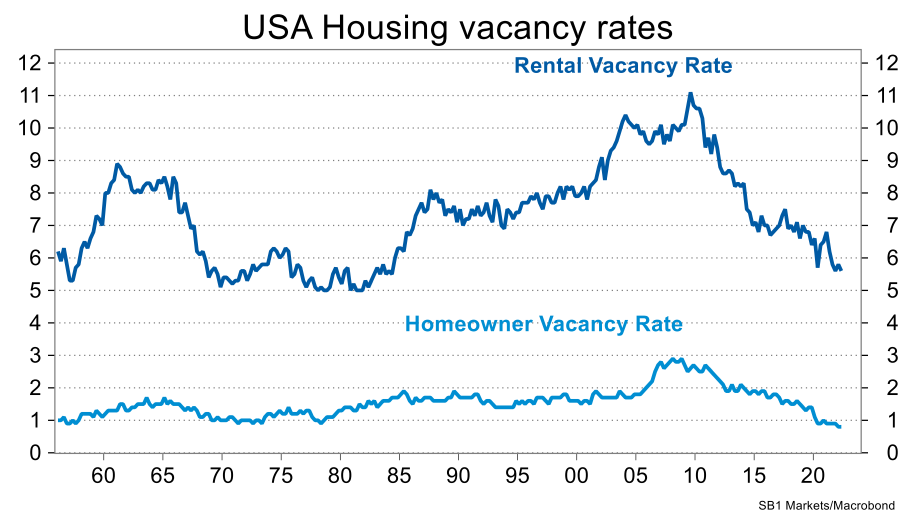
Rents are still accelerating. Will soon peak?

Rents are up 6.8% y/y, while signals from the rental market are mixed



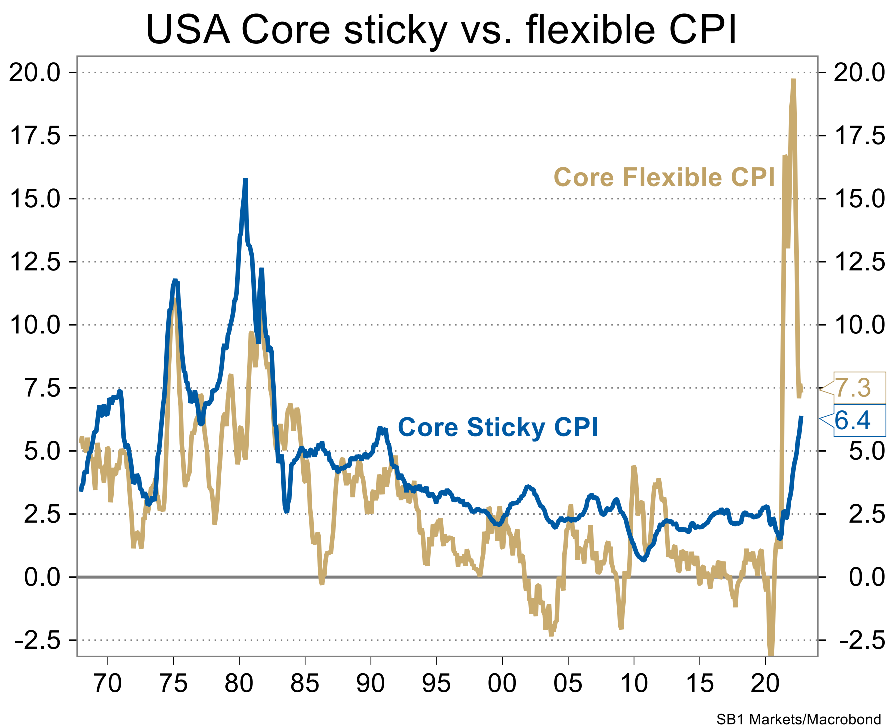
- **The official (Commerce dept) median rental asking price** is on the way up again following a slowdown last autumn. Some other surveys signal slowing rent inflation
- **House prices** are still up double digit y/y, and the owner cost (price x mortgage rate) has almost doubled. House prices are now 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 an ATL
- **Rent inflation measured in the CPI** has accelerated to 6.8%, 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 2.2 pp to annual headline 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

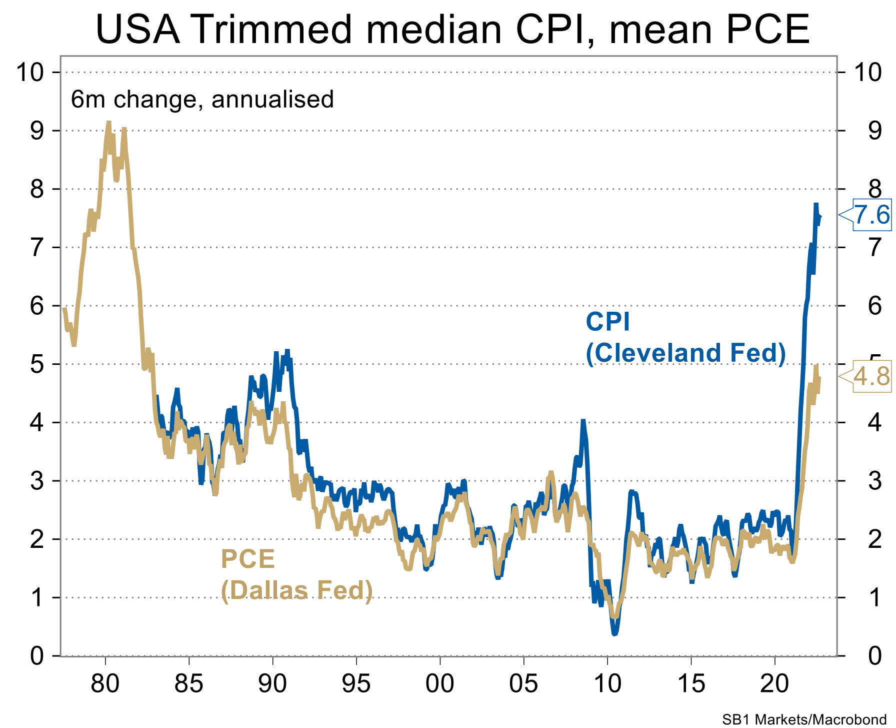




Flexible prices are coming down rapidly, *but sticky prices still on the way up*

Sticky prices are up 6.4% (90% of the CPI). The trimmed median CPI up 7.6%, and close to peak

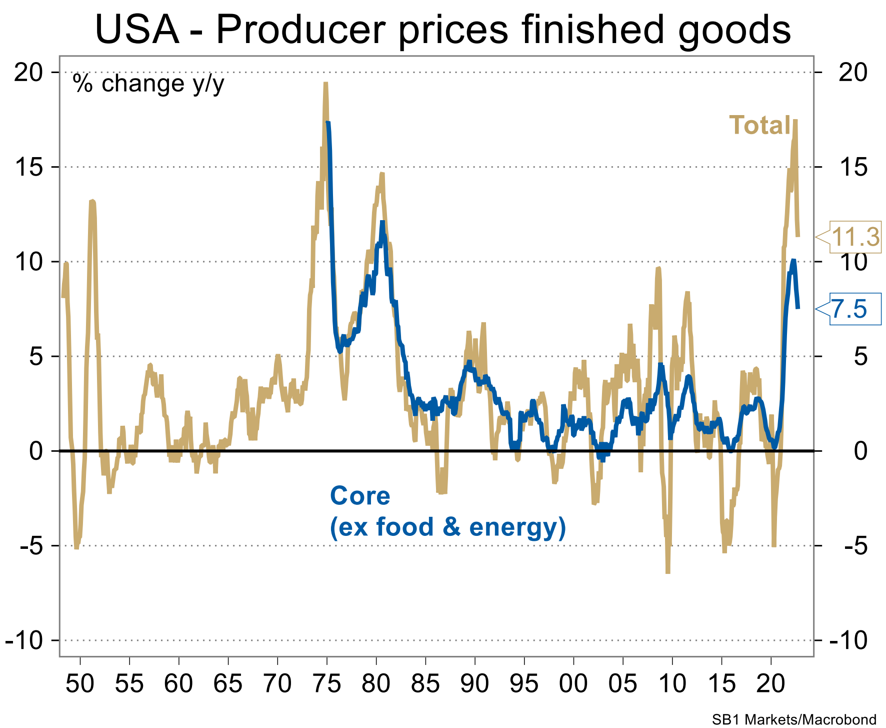


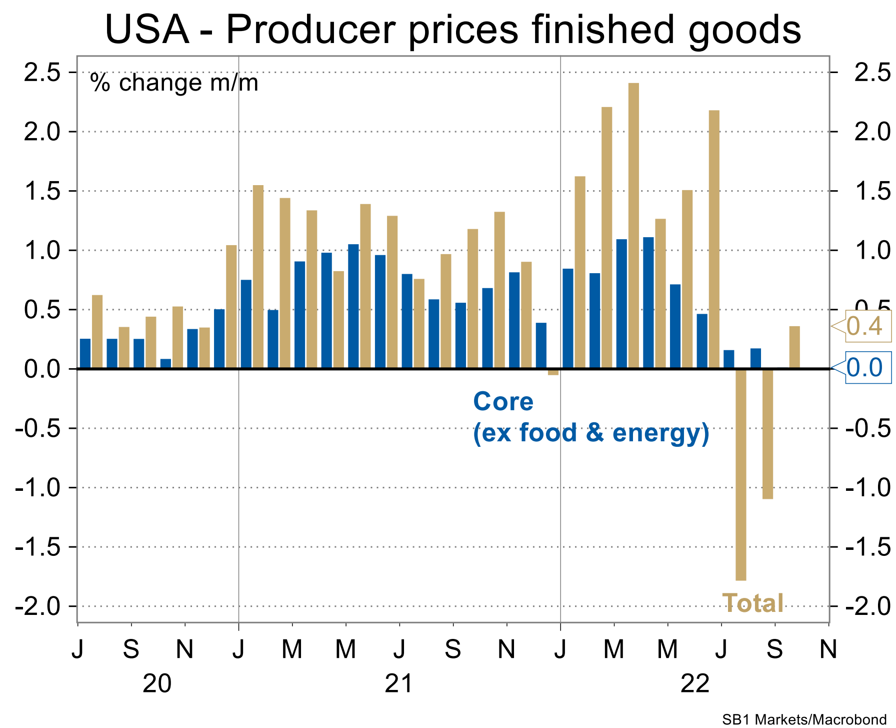


- Almost all of the initial lift in core CPI was due to prices of goods & services that often fluctuate, with rapid price increases followed by deep price cuts. These prices are '**flexible'** and represent some 10% of the core CPI. The core flexible CPI is up 7.3% y/y, down from almost 20% at the peak! But still higher than anytime since 1981
- The new challenge: The **sticky components** (90 % of the core CPI) are up 6.4% y/y. <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 7.6% pace over the past six months, up from 7.5% last month – and miles above anything seen before (data from 1983). Dallas Fed's **trimmed mean PCE** was up 4.8% in <u>August</u>, also close to peak

The goods PPI slightly higher in Sept; but the annual rate fell to 11.3%

PPI has peaked

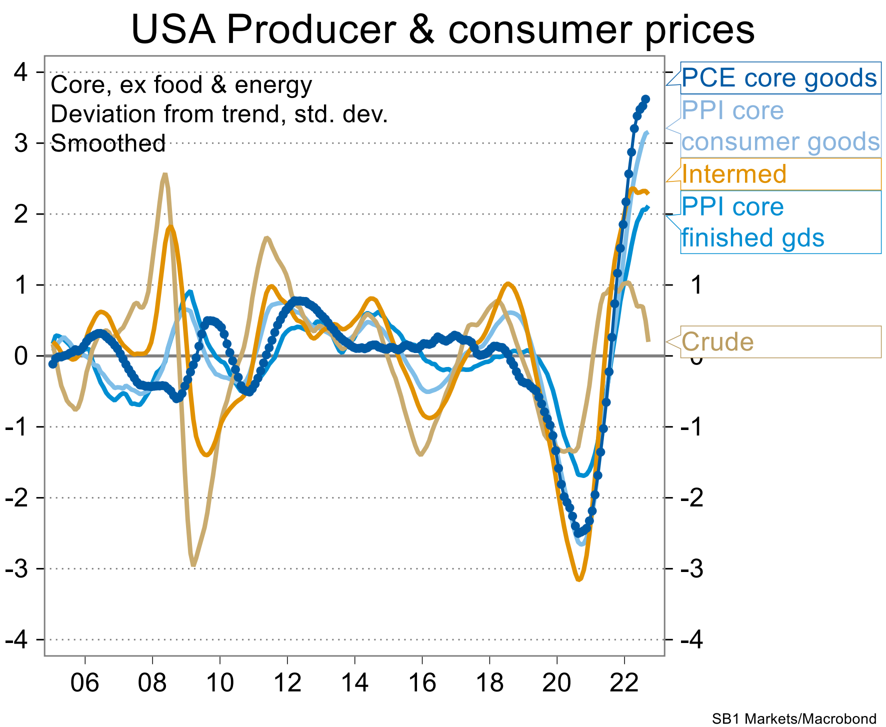


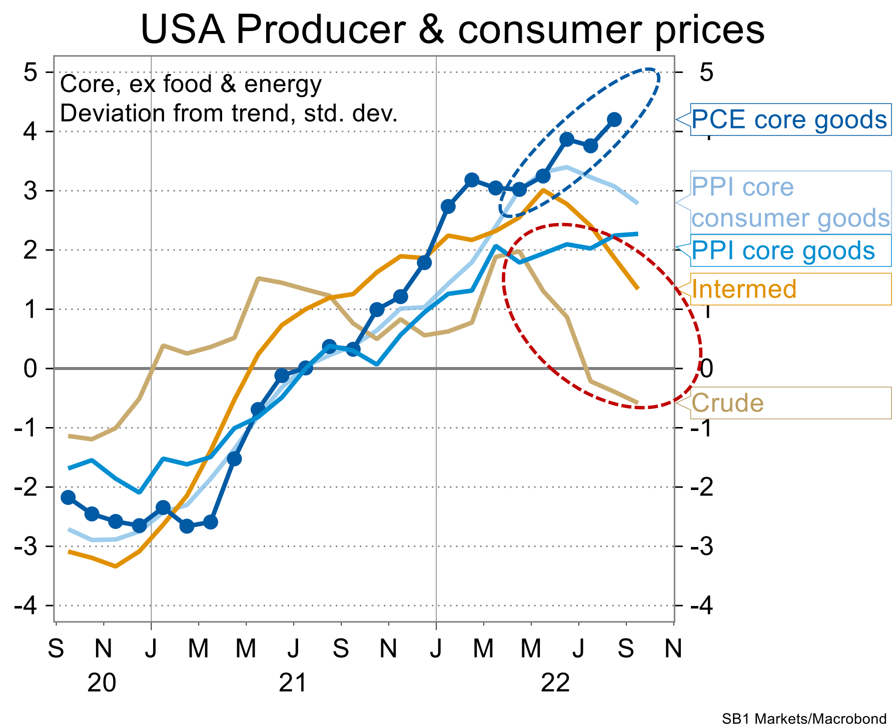


- **The headline finished <u>goods</u> PPI** rose by 0.4% in September, following the 1.2% drop in Aug. The annual rate slipped 0.9 pp to 11.1%. Energy prices fell 6% while food prices were unch.
- **Core finished <u>goods</u> x food & energy** PPI was unchanged in September. The annual growth rate fell by 0.6 pp to 7.5%. 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 **<u>services</u>**, fell by 0.2% m/m in Sept. <u>The annual rate at 8.5% was 0.1 pp higher than expected</u>

Crude core material prices are yielding, as are intermediate prices

Core consumer goods PPI have also turned south – and so will probably goods prices in the CPI/PCE

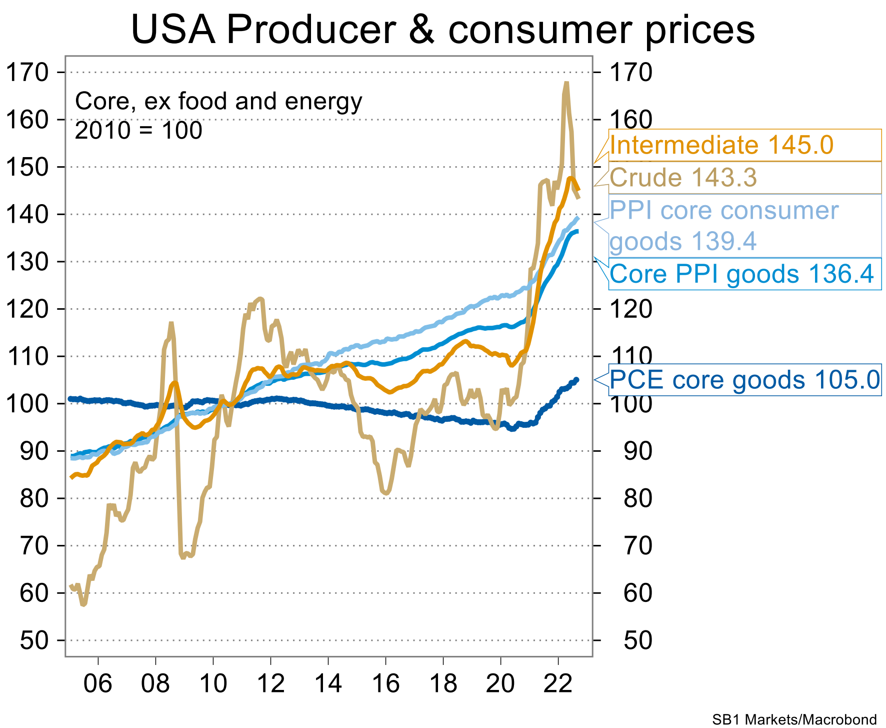


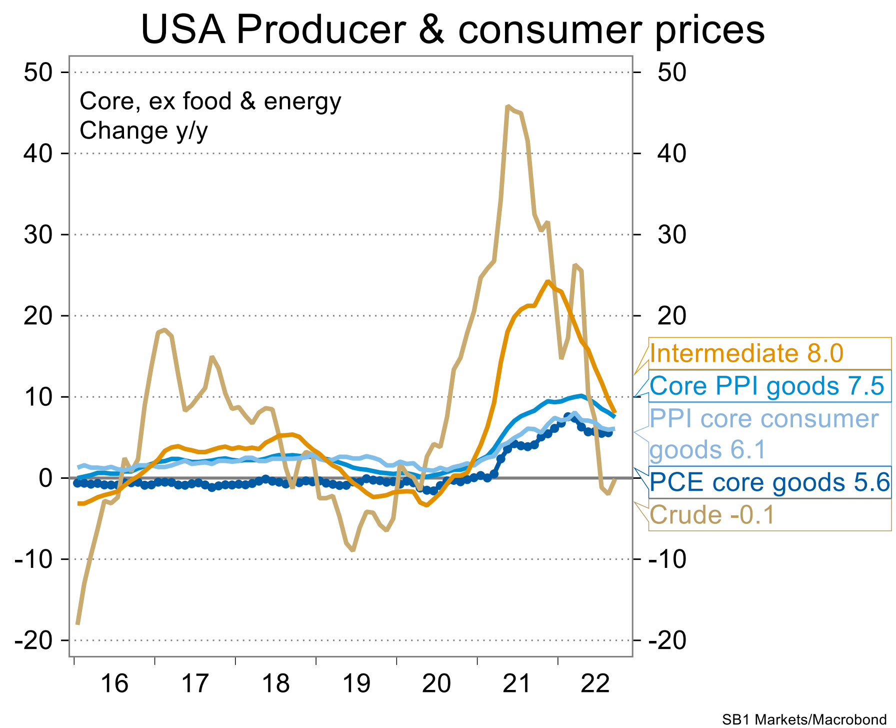


- **Crude goods prices** are leading intermediate goods prices by 4 months, and consumer prices by 12 months. Following several months with slow growth in these prices to February from last summer, they rose in March and remained at a high level in April – but they are now heading down rapidly (and prices are down y/y, *check next page*). **Intermediate prices** have slowed past three months. We can 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
- The next shoe to start dropping will be goods prices at the consumer level, in the CPI/PPI

Crude core material prices are yielding

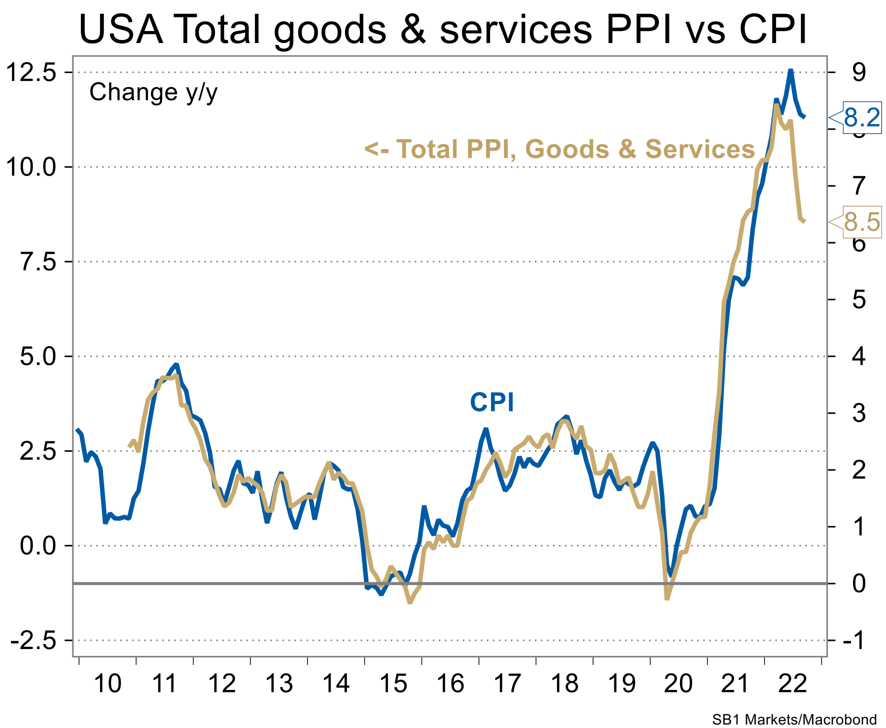
(level & growth rates, same series as per the prev. page)

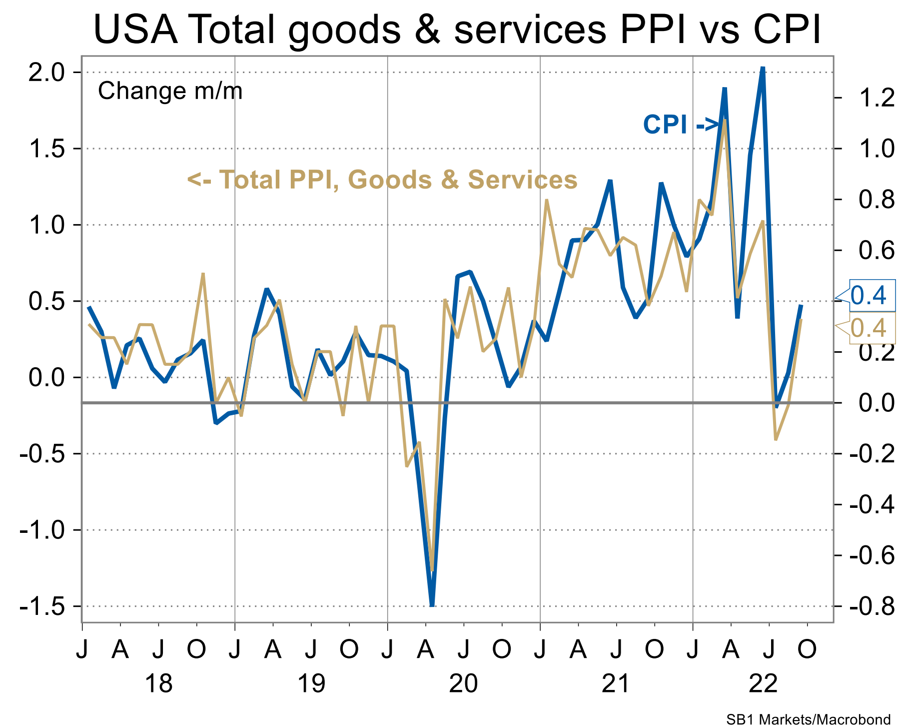




Total PPI (services incl.) +0.4 m/m, and the annual rate still down 0.2 pp to 8.5%

Higher than expected at the top line, but inflation is slowing, at the producer level

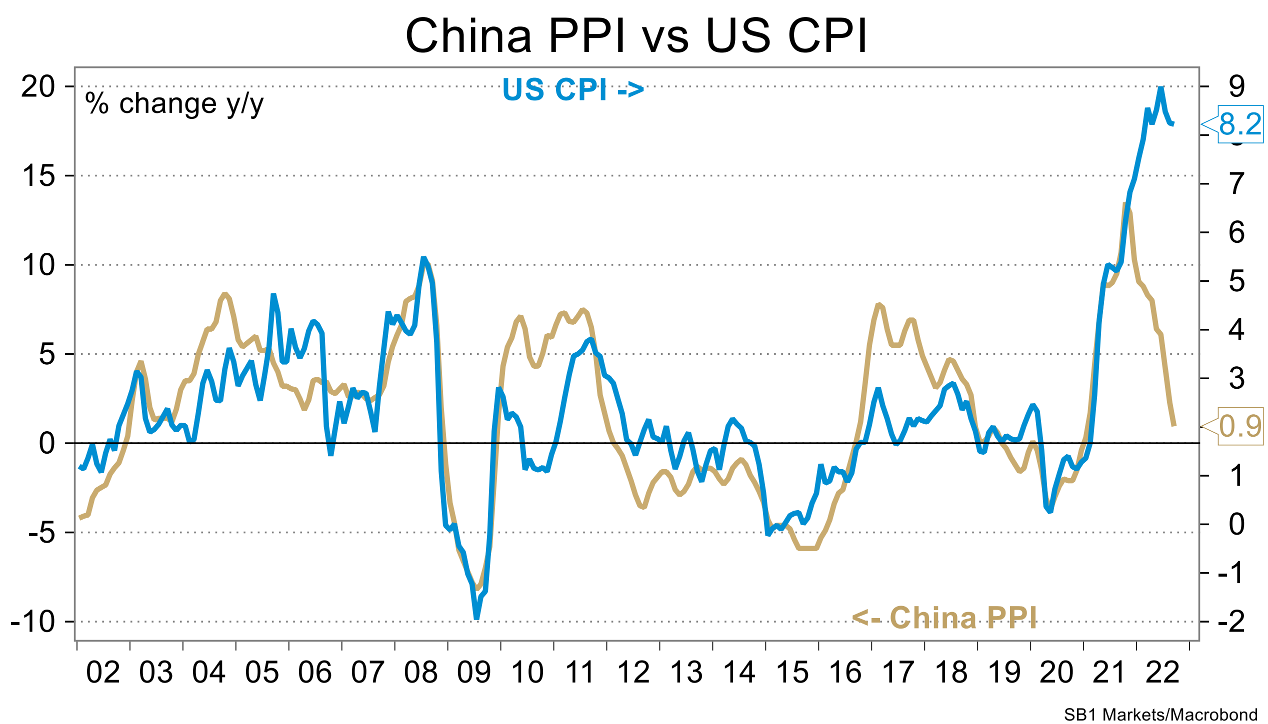




- The correlation between the total PPI, which includes all sorts of services in addition to goods, and the CPI is very close. The current 8.5% annual growth rate, signals a further decline in CPI inflation the coming months

The PPI of another country could be a better predictor of US CPI…

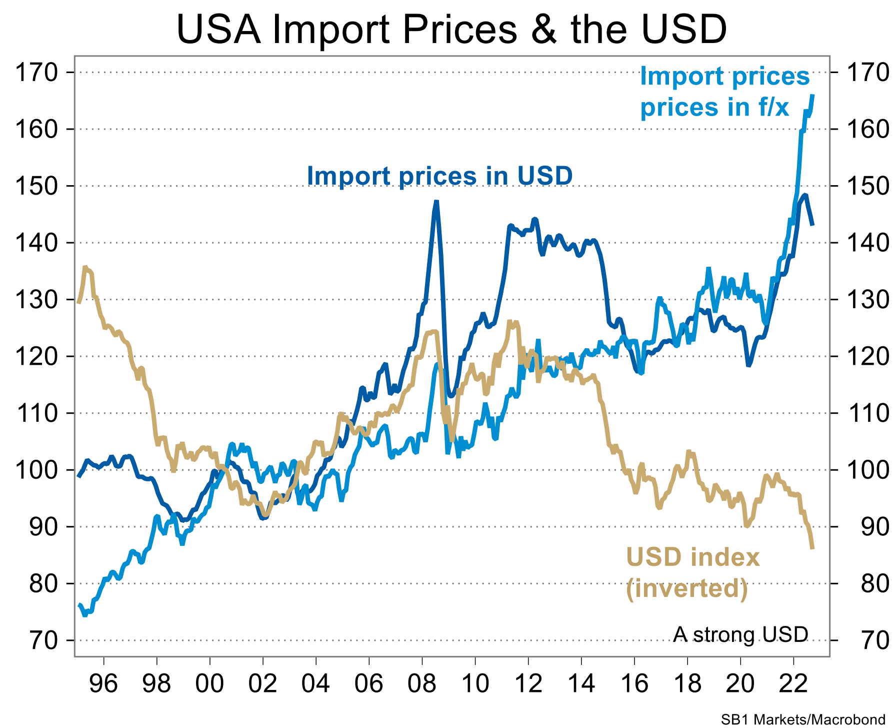
US CPI has moved in sync with the Chinese PPI, and now that PPI has plummeted

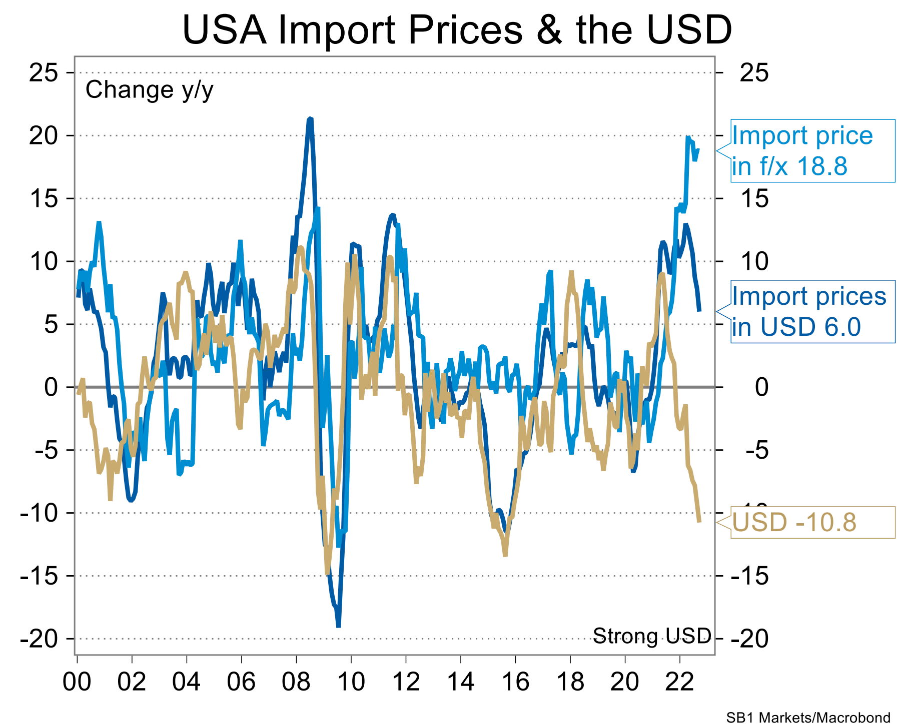


- The Chinese PPI has fallen to 0.9% y/y in September from an annual rate of 13.5% in October last year

Import prices are falling m/m – as the USD appreciates

Import prices are up 6% y/y, down from the 13% peak in March. A strong USD has cut the bill by 11%

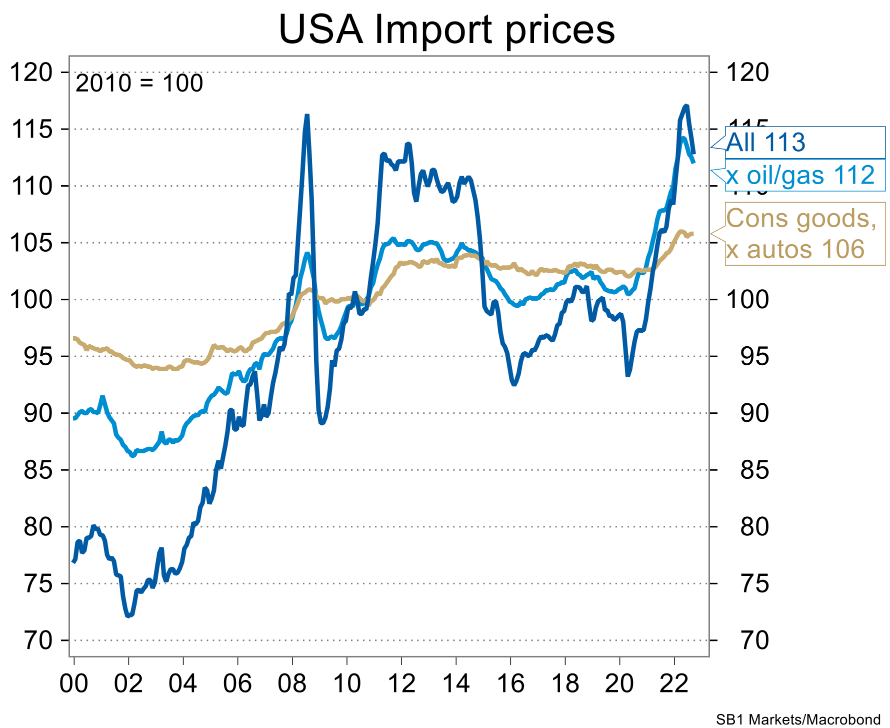


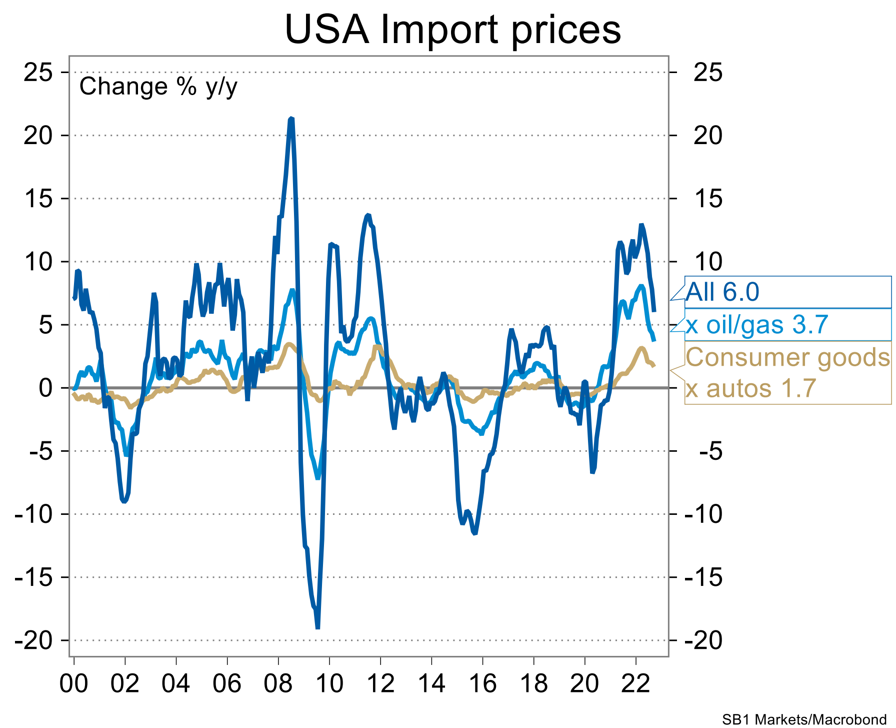


- Import prices, measured in sellers' currencies remains high, at 19% y/y (which should be appreciated by the sellers ☺)

Prices are up 3.7% ex oil/gas, while consumer goods ex auto are up just 1.7%

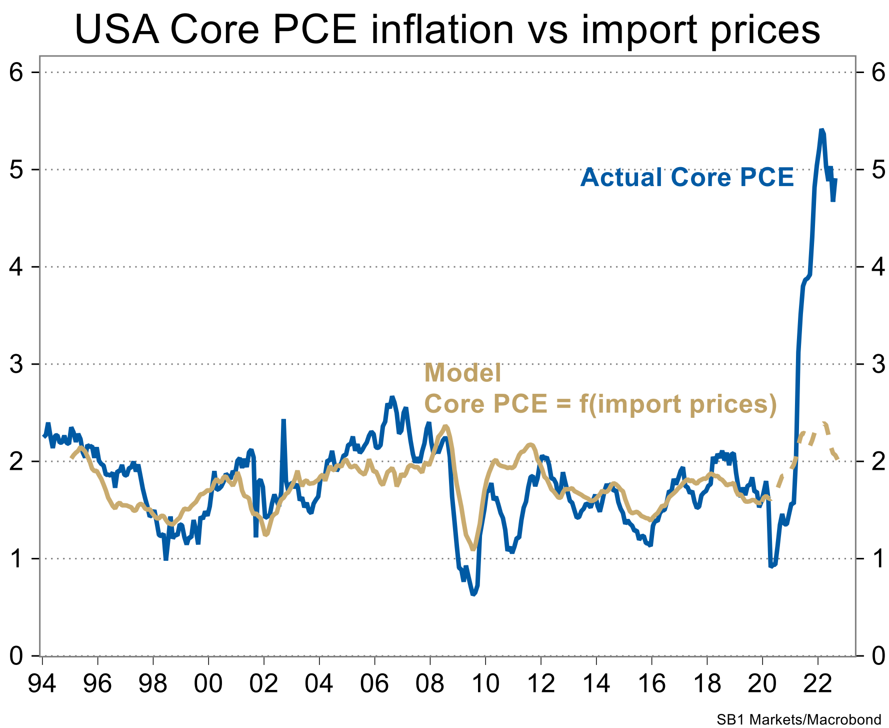
Total import prices fell 1.2% m/m, and by 0.5% ex oil & gas (ex. -0.4%), for the 5th month in row





There is some impact to domestic inflation import prices

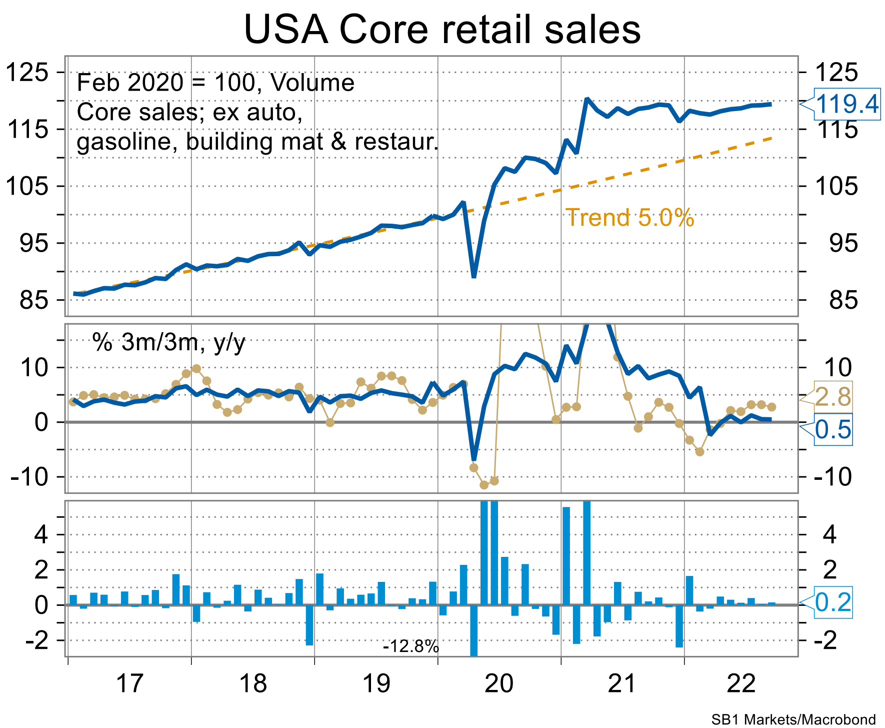
However, import prices cannot in any way explain the recent surge in US inflation

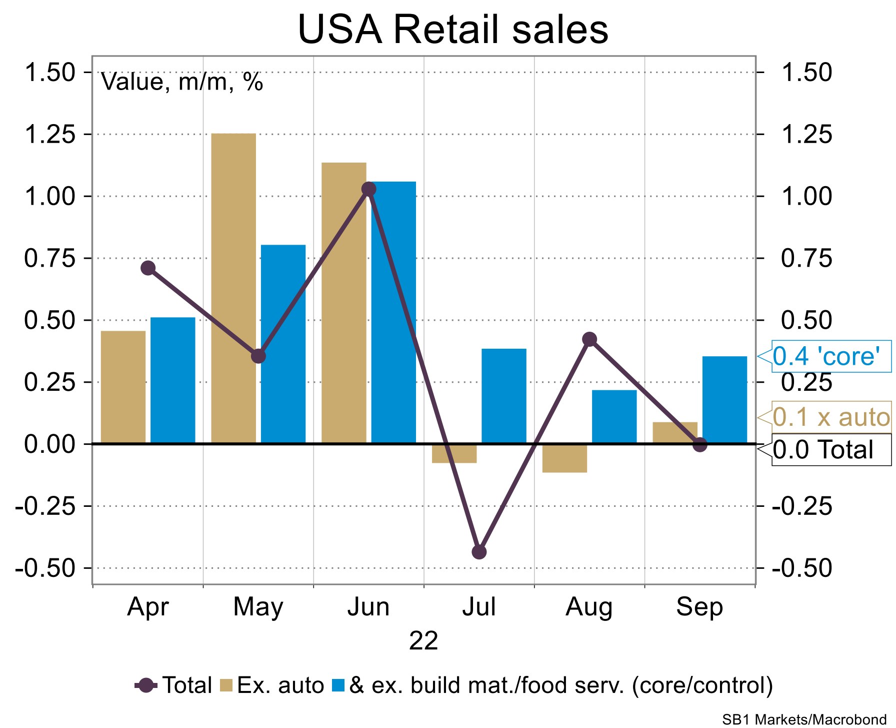


- … and lower import prices should not contribute that much to lower domestic inflation

Retail sales of goods slowly on the way up again!

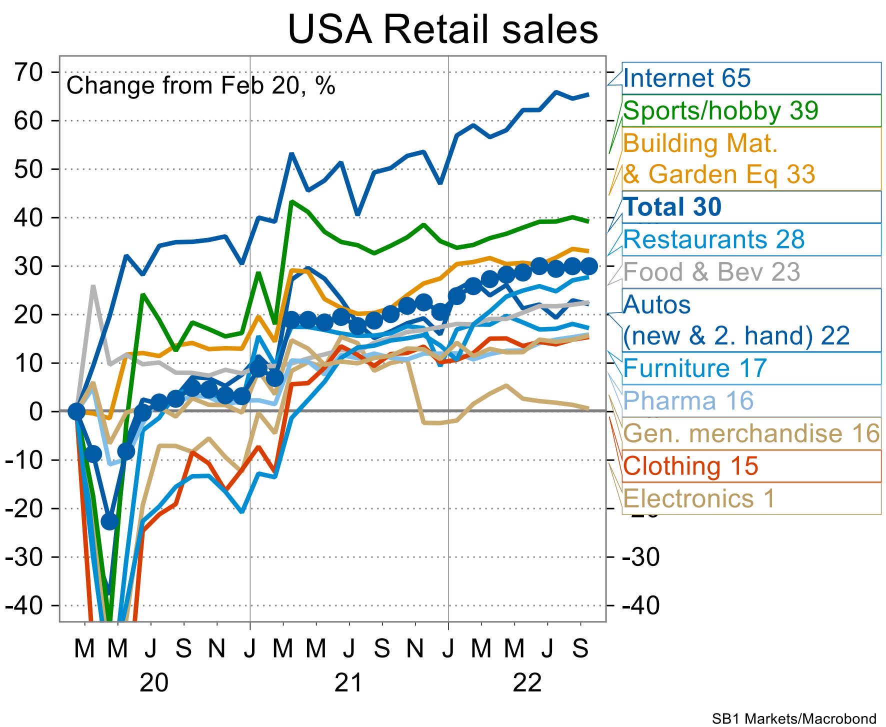
Core sales rose 0.4% in September – and probably grew even in volume terms, and Aug revised up



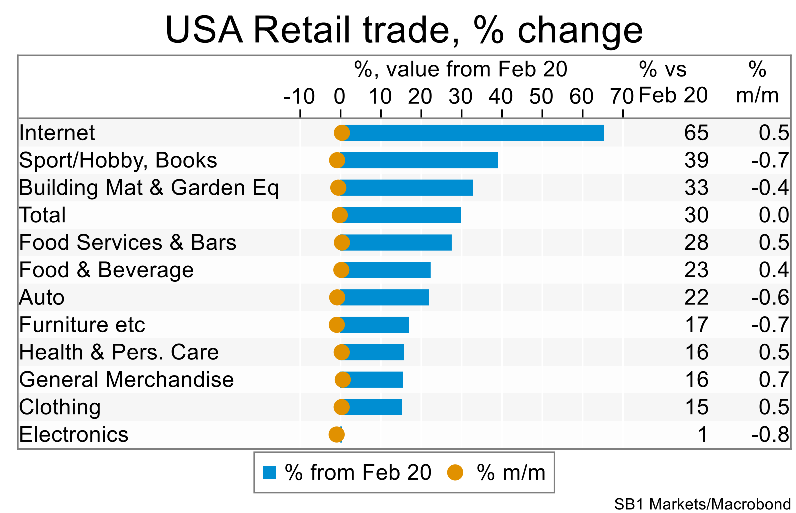


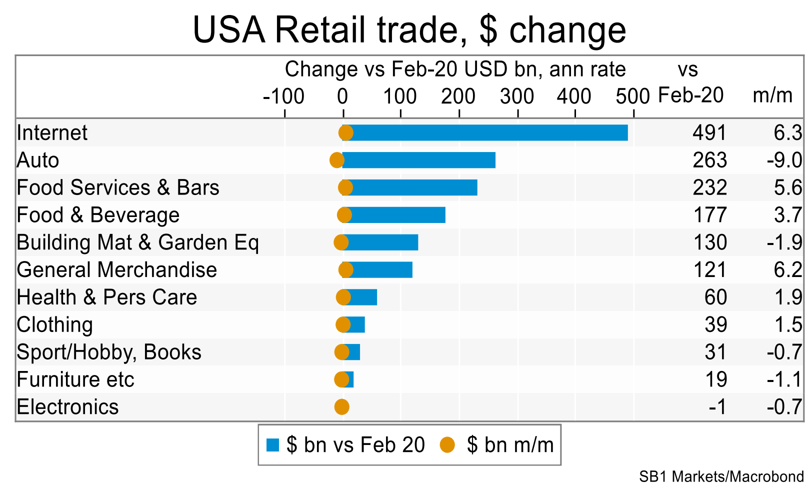
- **Total nominal sales** were flat in September, 0.2 pp below expectations, but August was revised up by 0.1 pp to 0.4%. Auto sales fell, together with building mat., furniture, electronics. Total nominal sales are up 19% vs. the Feb 2020 level!
- **Core sales of goods** (=control group, excludes autos, gasoline, building materials & restaurants) were up 0.4% in value terms, 0.1 pp above expectations (and July data were revised by 0.2 pp to 0.2%)
- **In volume terms**, we assume that core gained 0.2%, as the CPI goods prices (x energy) rose some 0.2%. 'Real' sales are trending marginally upwards (+2.8% 3m/3m), far better than we estimated a couple of months ago! After a substantial revision of Dec-21, sales are just marginally below the peaks last year (we always suspected the Dec-21 data to be wrong, sales volume was reported down by almost 5%, now revised to -2.4%)
- Consumption of goods will support GDP growth in Q3, and September is above the Q3 average

Mixed between sectors, half up, the other half down



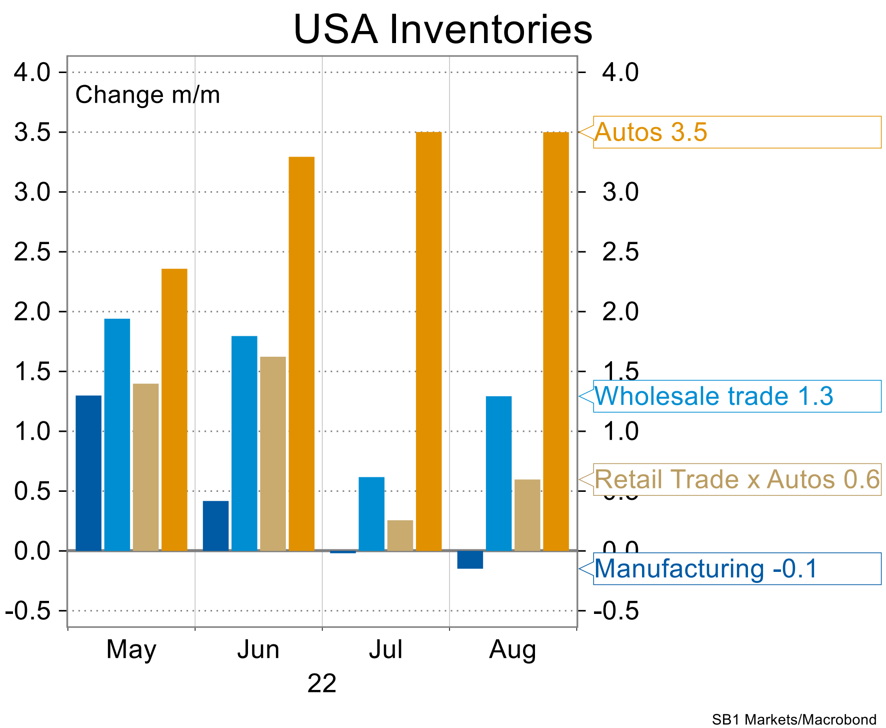
- 5 out of 11 main sectors reported lower sales in Sept, 6 reported higher sales
- Total sales are up 30% in value terms vs Feb. 20
- Restaurants are up 28% vs Feb-20!
- Internet sales are up 65%
- Clothing is up just 15%
- Electronics are up just 1% - in value terms

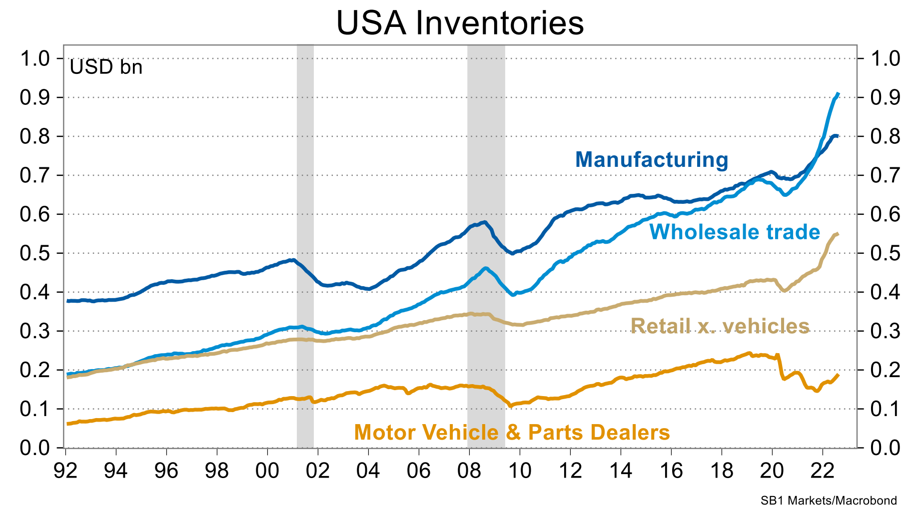


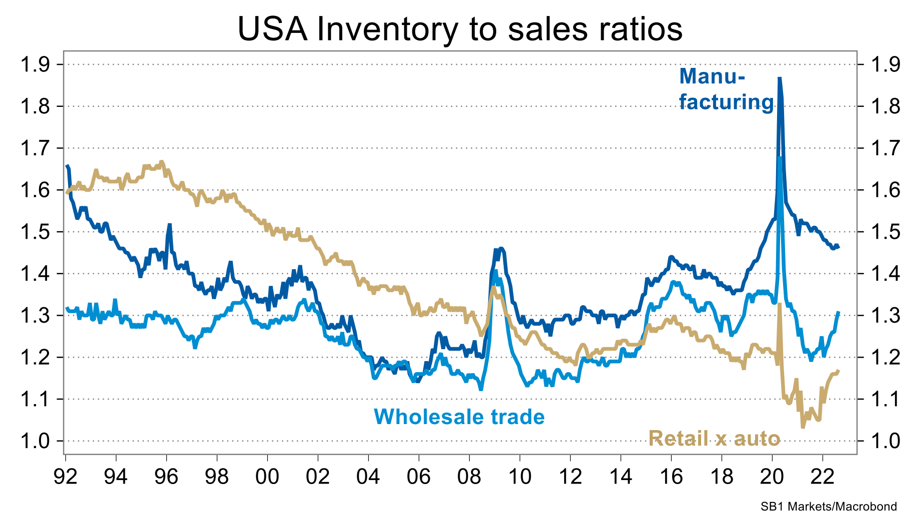


Inventories on the way up, and faster than sales, in wholesale & retail sales

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



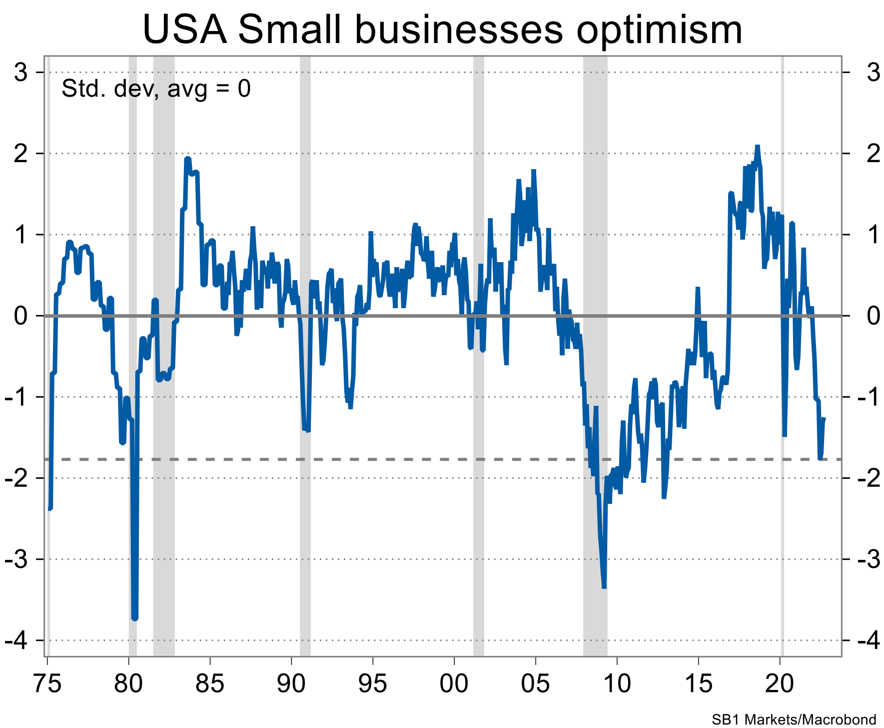


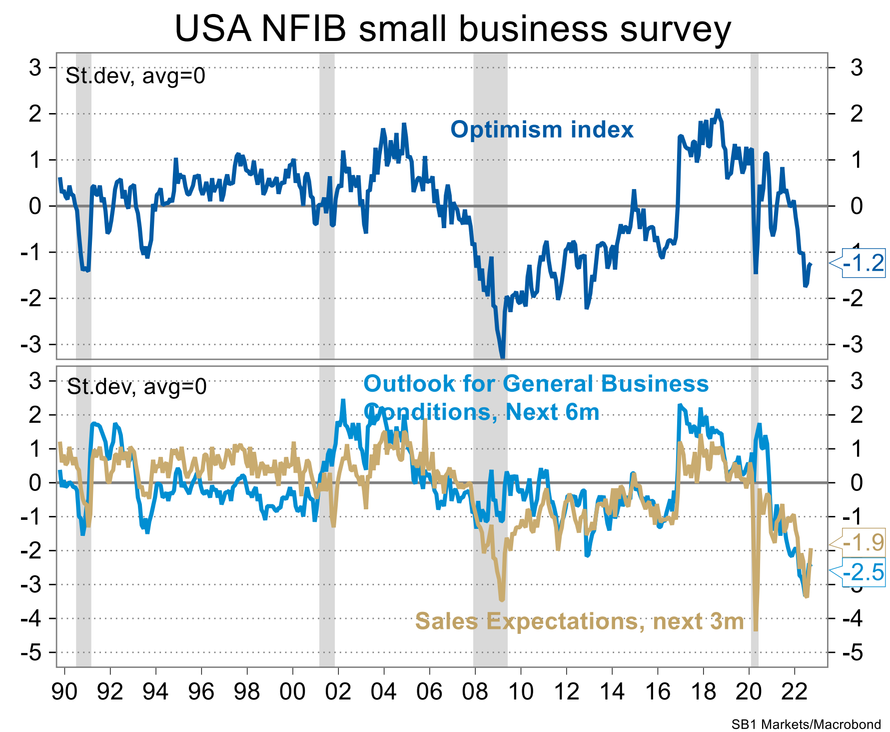


- Total inventories rose 0.8% in August, 0.1 pp less than expected
- Auto inventories are increasing again, signalling some softness in demand (as sales are still far lower than normal)
- Inventories in the **manufacturing sector** are falling vs. sales, from a high level – and there is probably a substantial potential for lowering inventories from here

Small businesses optimism marginally up in Sept, still 1.2 st.dev below average

... but the outlook worsened, and is now 2.5 st.dev below average

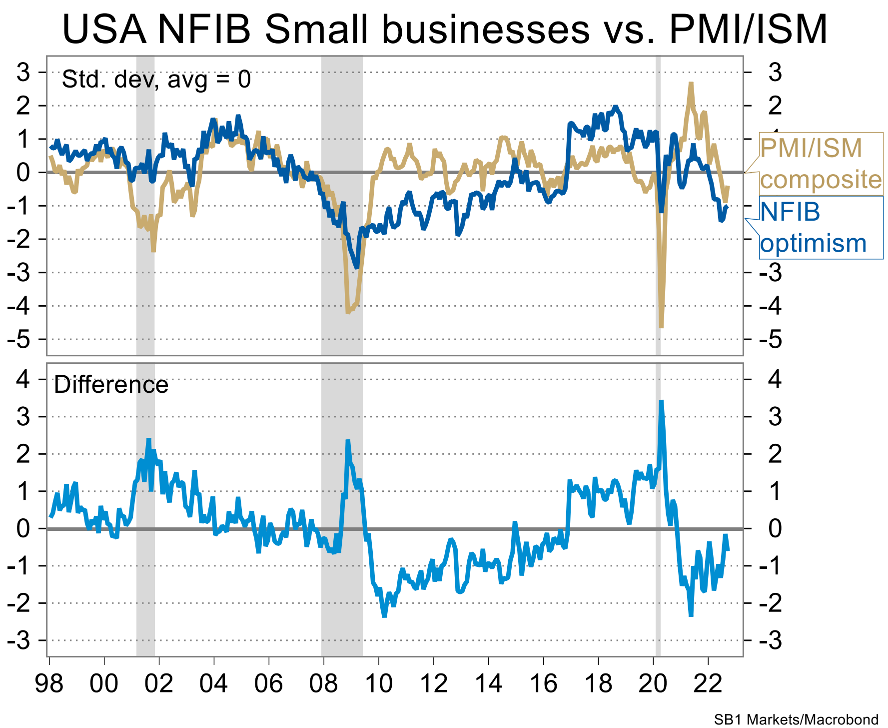




- The **NFIB optimism index** climbed for the 3rd month in a row, up 0.3 p to 92.1 in September, expected down 0.6 p. The level equals 1.2 st.dev below average. **The outlook for the next 6 months** worsened, and is at a very low level, 2.5 st dev, down from 2.4 in August. **Sales expectations** rose noticeably for the 2nd month but are still 1.9 st.dev below avg. (up from 2.6 st.dev below avg. in Aug, and 3.4 st.dev below in July!)
- **Inflation, lack of qualified labour and labour costs** are still the main worries for the SMEs. However, some more companies report that **competition** is a worry but the share is still very low. The share of companies that **plans to lift prices** by fell 5 p to 32%. 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 down, like in most other surveys we follow. **Hiring plans** rose again in Sept, 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**. <u>So it ain't over yet</u>

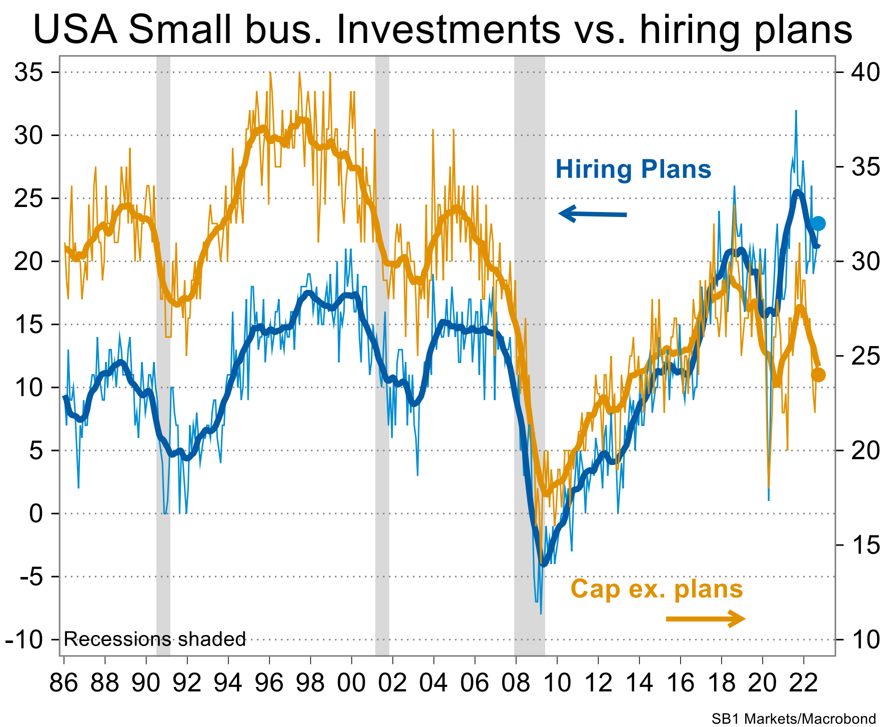
Large and small businesses are more in sync

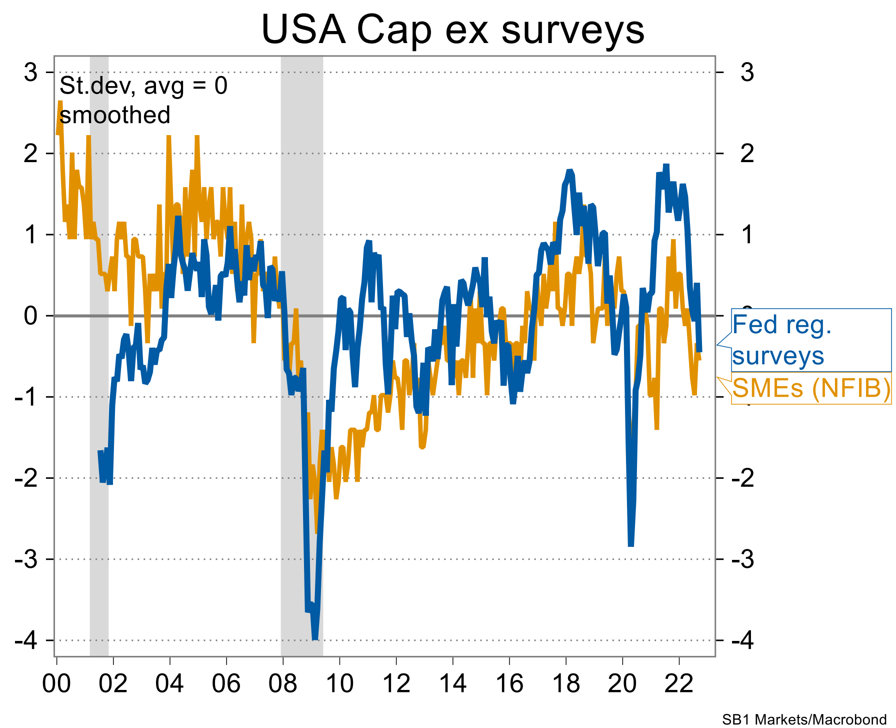
… As it turns out that the SME's were closer to the ball



The party is not yet over: The SMEs lifted their hiring plans in September

While investment plans were cut. The trend for both hiring and investments are down

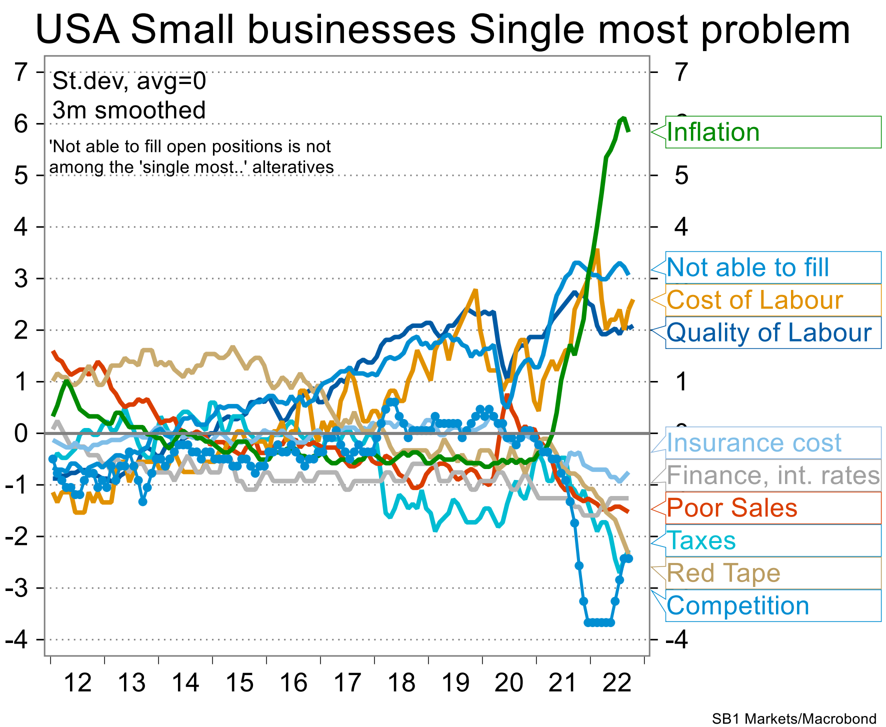


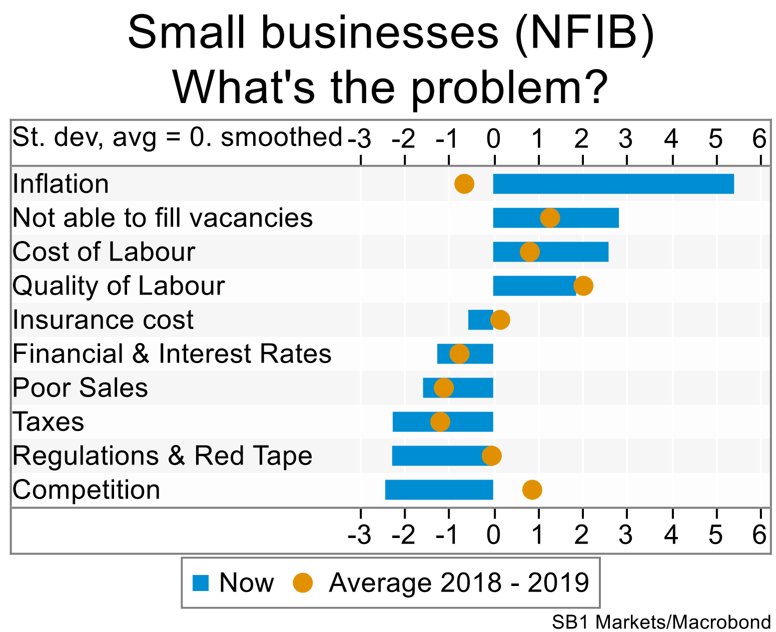


- The NFIB survey report of investment plans far below average
- Other (regional Fed) investment surveys have also come down from the top, to below an average level

Slightly more companies say that competition is their main worry

Inflation is the biggest challenge. Although, fewer worry about inflation than last month



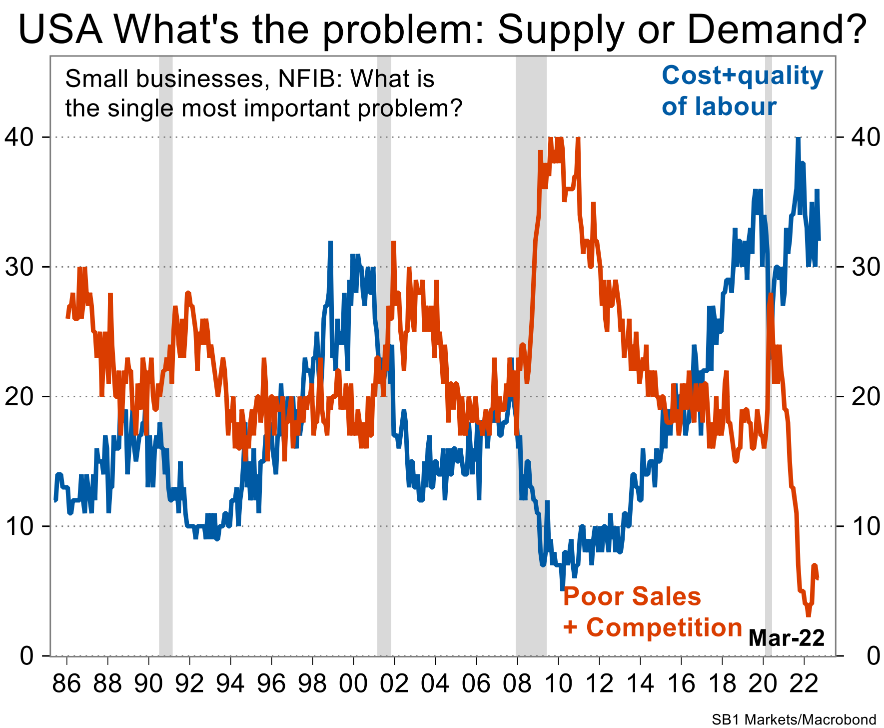


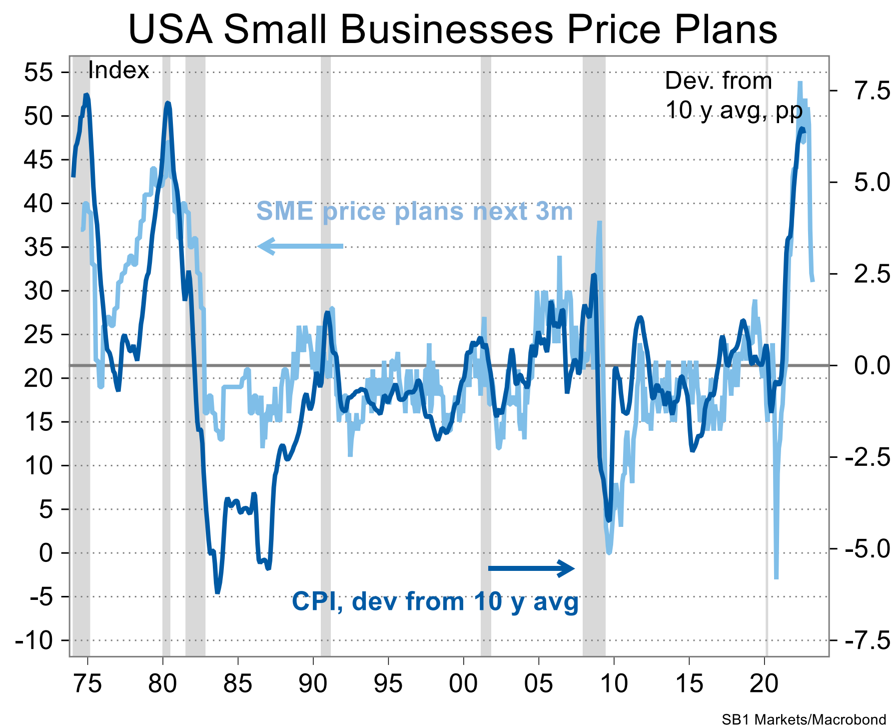
- Companies still report they are constrained from the **supply side**, not from the **demand side**

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

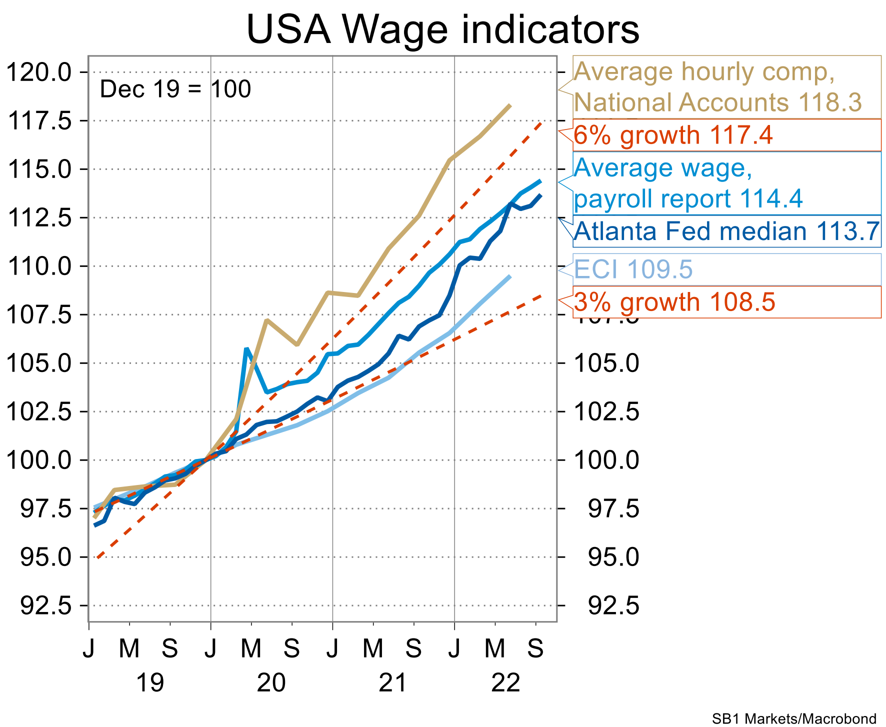


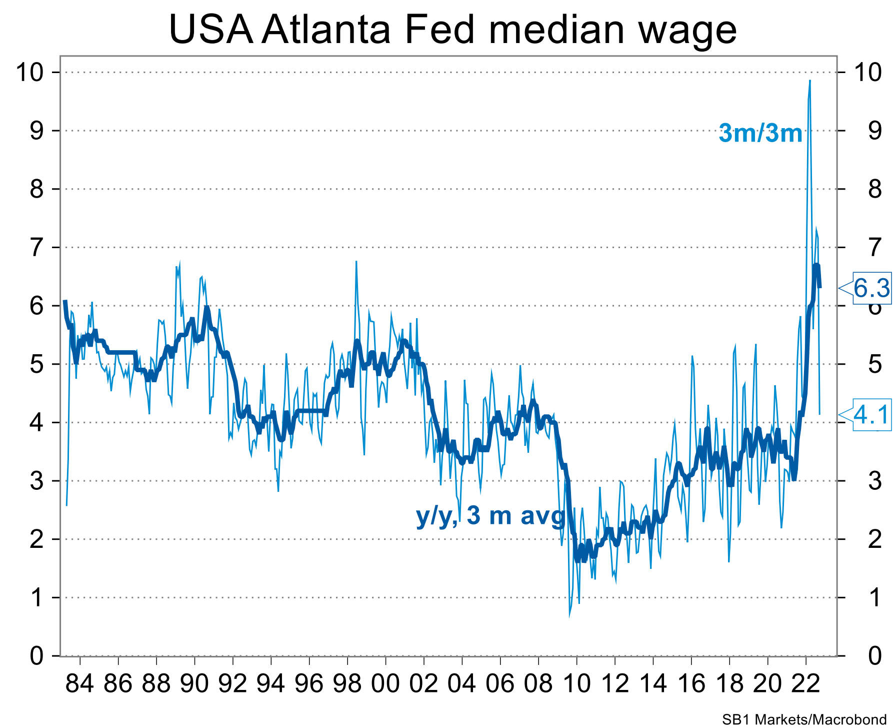


- **The 'gap' between supply and demand concerns** is still very large, but it is now heading down
  - » Very few companies report **poor sales or competition** as a problem. The share is up from March, but fell marginally in August, and was unch in Sept
  - » **Cost & quality of labour** is stated as 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. <u>Even so, a very positive signal</u>
- **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 more help from the Federal Reserve. It's normally labelled as a recession, as soon as the red line crosses the 20-line

Atlanta Fed: Wage inflation is (probably) ~~not~~ slowing somewhat

The median wage +6.5% y/y, 6.3% 3 m avg, down from 6.7% - still 3 pp higher than 'normal' growth

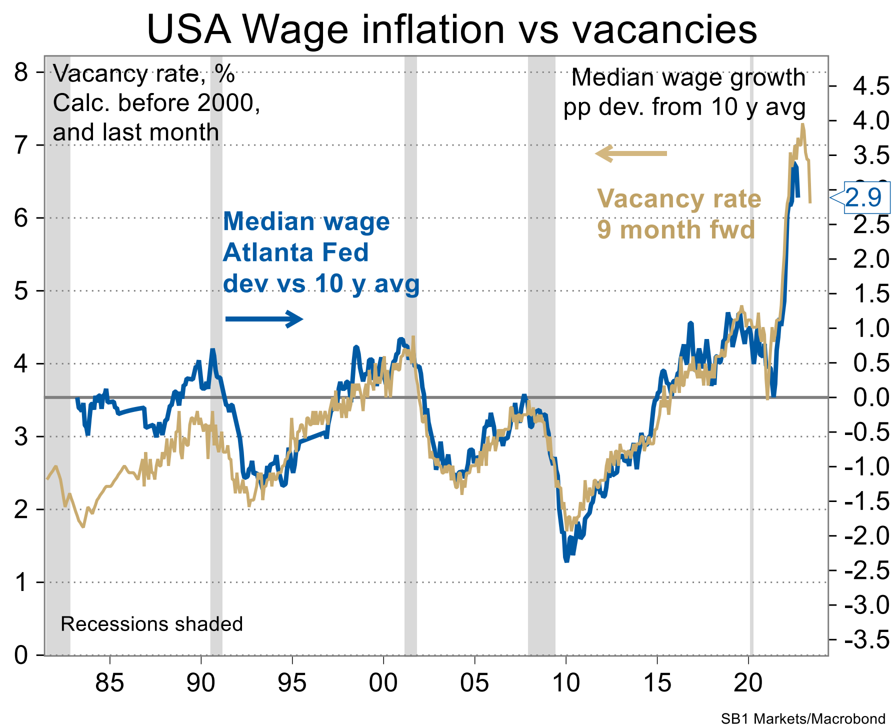


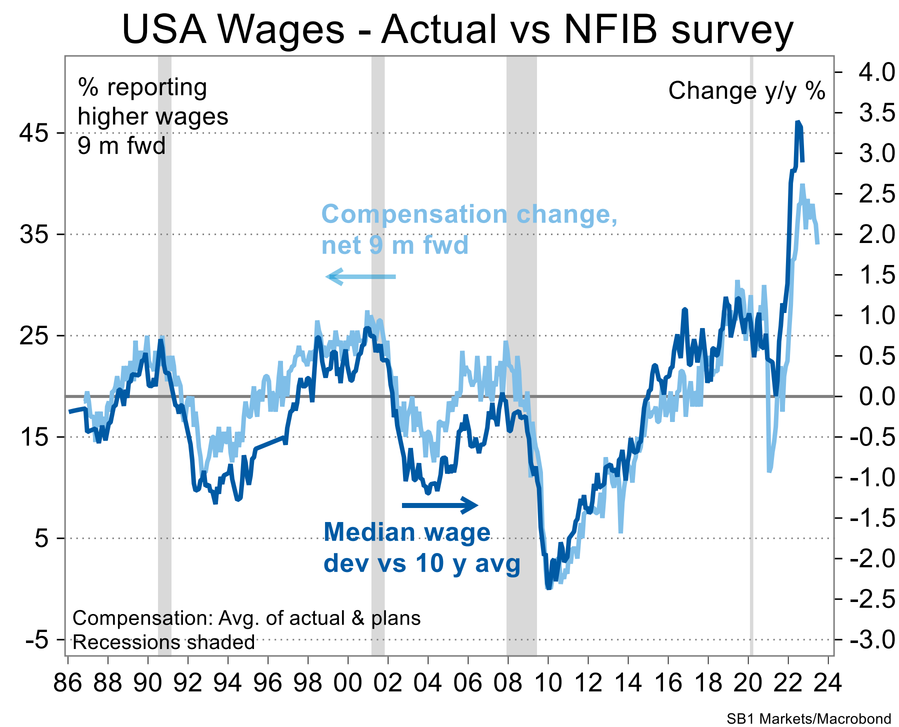


- **Atlanta Fed's median tracker reported** a 6.5% growth in September, up 0.2 pp from Aug. Our calculated m/m was up 0.5%, following two months with slow growth. The 3m/3m rate 'collapsed to 4.1%, but the 'real' underlying growth rate is closer to 6% (a strange June obs. has created some volatility). The **3 m average annual wage** growth fell to 6.3%, from the highest print ever at 6.7% in August. The current wage inflation is 2.9 pp higher than the past 10 average, a wage acceleration we have never seen before
- **All** ages, occupations, industries, job switchers (or not), race, education, urban or rural regions report a sharp acceleration in wage inflation. The only laggards: those who are paid the best, but even this group report higher wage growth recent months
- **All other wage indicators** are reporting fast wage growth, and all are reporting wage growth well above the recent years' average, some are still accelerating, other are slowing marginally but all are growing 2.8% – 4% faster than the past 10 years' average – which will make it impossible to reach the 2% price target over time

Peak wage inflation? Very likely, as demand for labour slows

Still, demand for labour is still strong, and wage inflation is far above a sustainable level

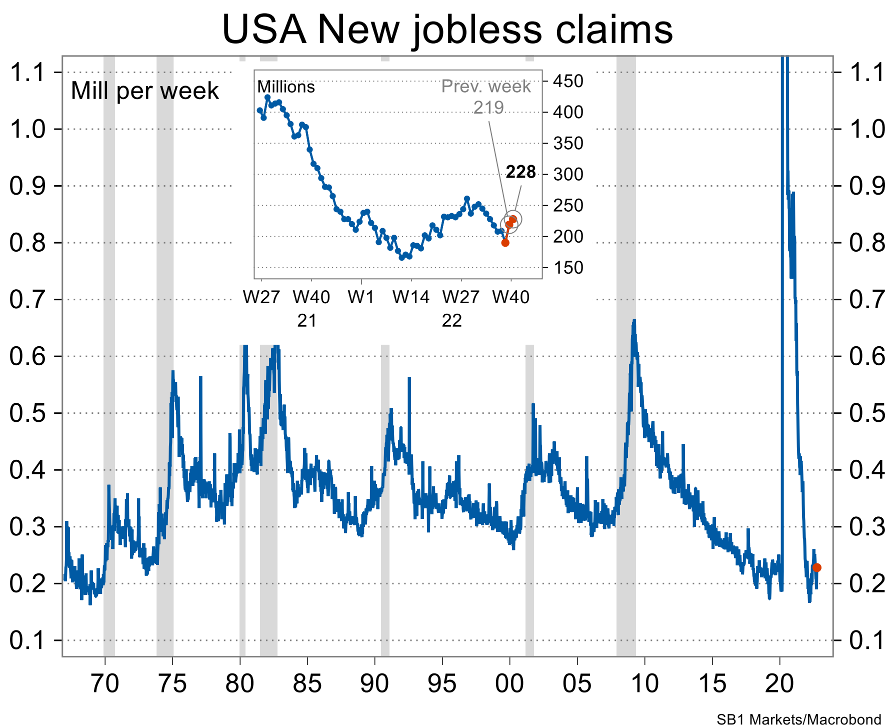


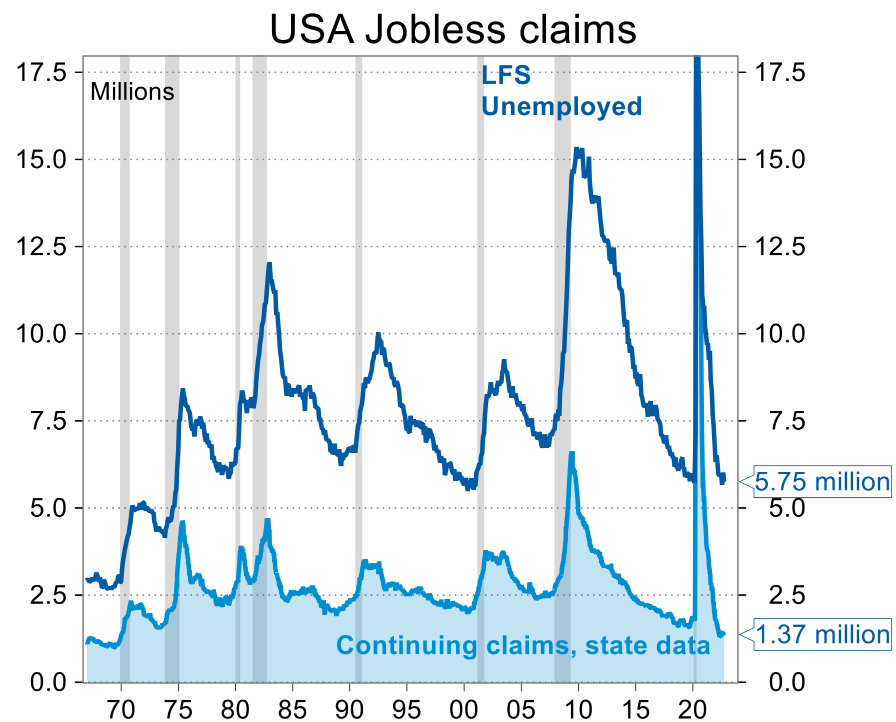


- **Our 'Phillips curve'** based on the vacancy rate signals a further increase in wage inflation the coming quarters even if vacances have peaked. The vacancy rate leads changes in wage inflation quite consistently by 3 quarters. However, we would not be surprised if the current extraordinary high wage inflation turns out to be the peak
  - Companies (SMEs) compensation plans signal continued high wage inflation but not faster than the present
- **Wage inflation** has already accelerated by almost 3.3 pp vs the 10 y average (Atlanta Fed median) and cannot possibly generate a 2% price inflation rate over time. This is Fed's main headache, not the current high CPI inflation print. And it will become the stock owners' headache too, of course
- **Demand for labour has to be reduced sharply in order to get wage inflation back to a sustainable level! That's the recipe for an unavoidable RECESSION**
  - Check under which circumstances wage inflation slows on the charts above (hint: find the shaded areas, follow the blue wage line - as well as the vacancy rate or the wage hike plans ☺). Fed will not be able to control inflation if demand for labour is not cut sharply

New jobless claims are slowly rising, but the labour market is still extremely tight

New jobless claims were up by 9’ to 228’, expected 225’

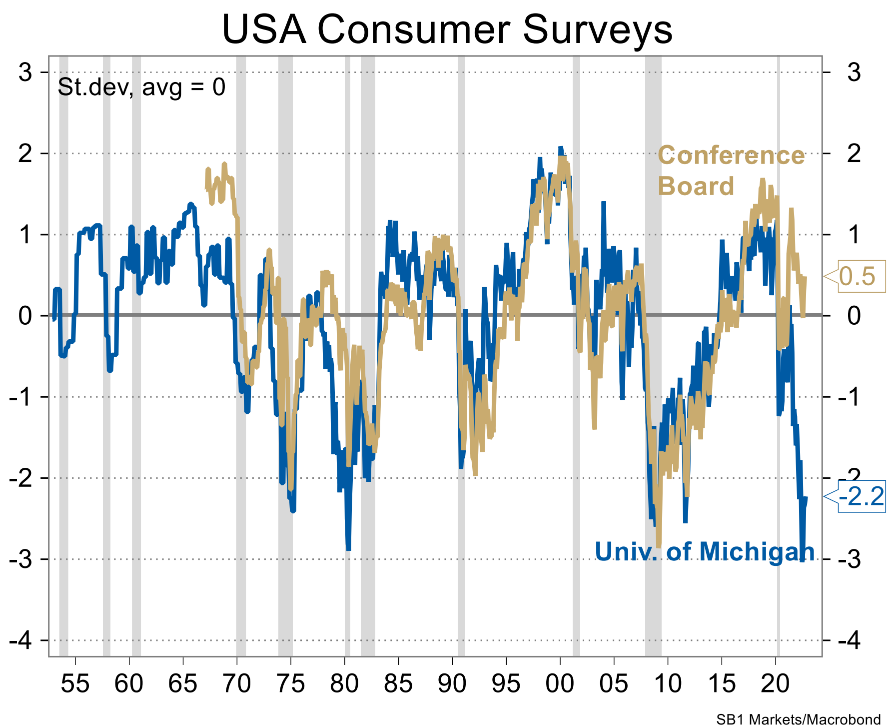




- **New jobless claims** have risen for the past couple of weeks, but the increases are small and far below average. In other words, the data are moving in the ‘right’ direction for the Fed, but it is no clear sign that the jobs market is easing
- **Continuing claims** rose by 3’ in week 39, and the previous week’s data was revised up by 4’

Univ. of Mich. sentiment marginally up in Oct, still 2.2 st.dev below average

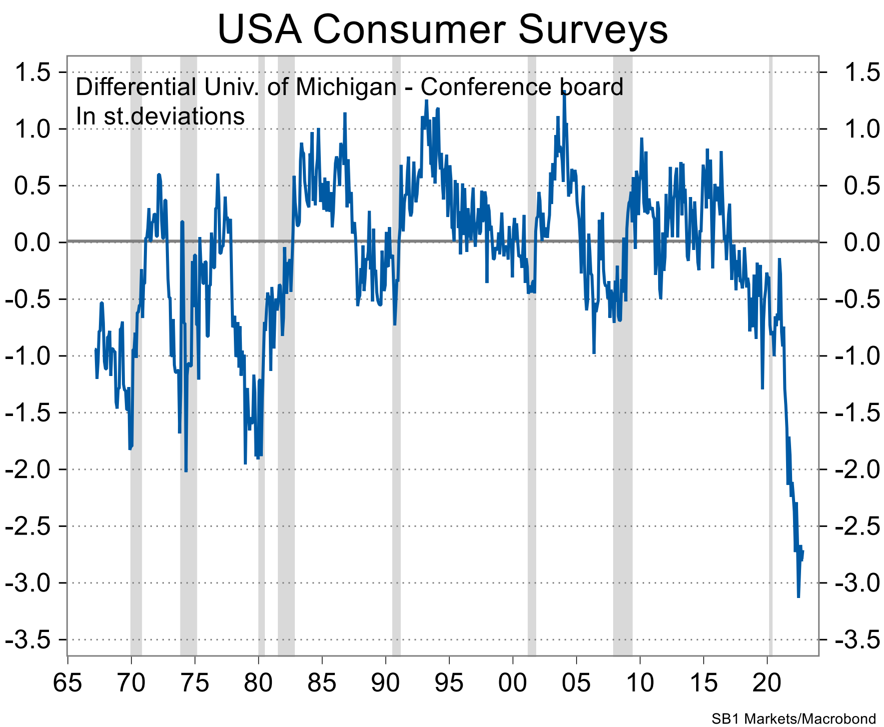
Gasoline prices are falling – as are inflation expectations. All other surveys also up recently

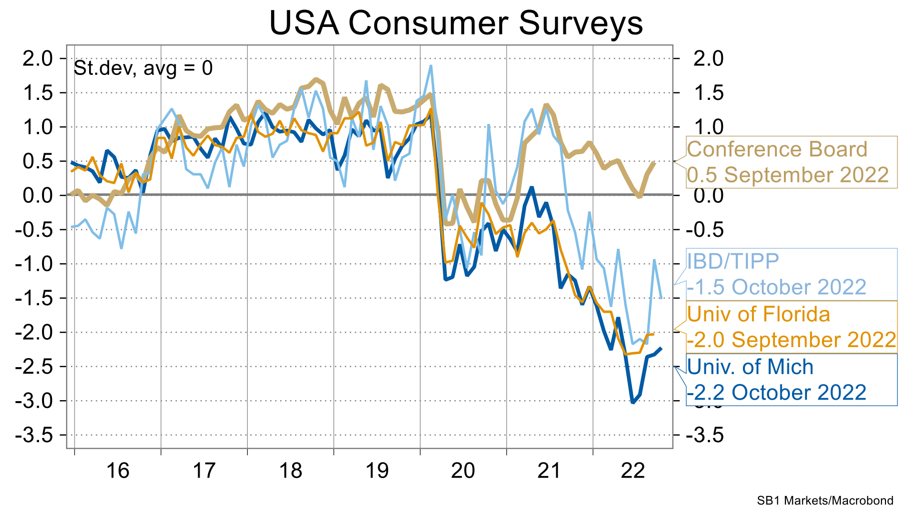


- **University of Michigan's consumer sentiment** fell to ATL at 50.0 in June, equalling 3.1 st.dev below average. Sentiment has since improved, but only marginally. In Sept, the index gained 1.3 p to 59.5, which is 2.3 st.dev below average – and slightly below expectations
  - » Both households' assessment 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 the cycle

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

The good news: All surveys up over the summer

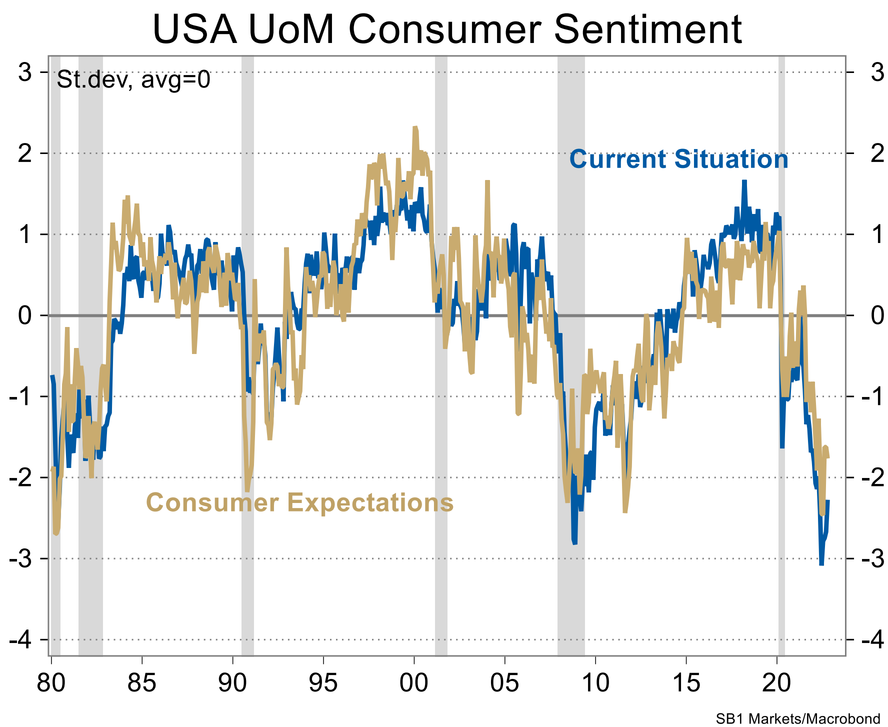


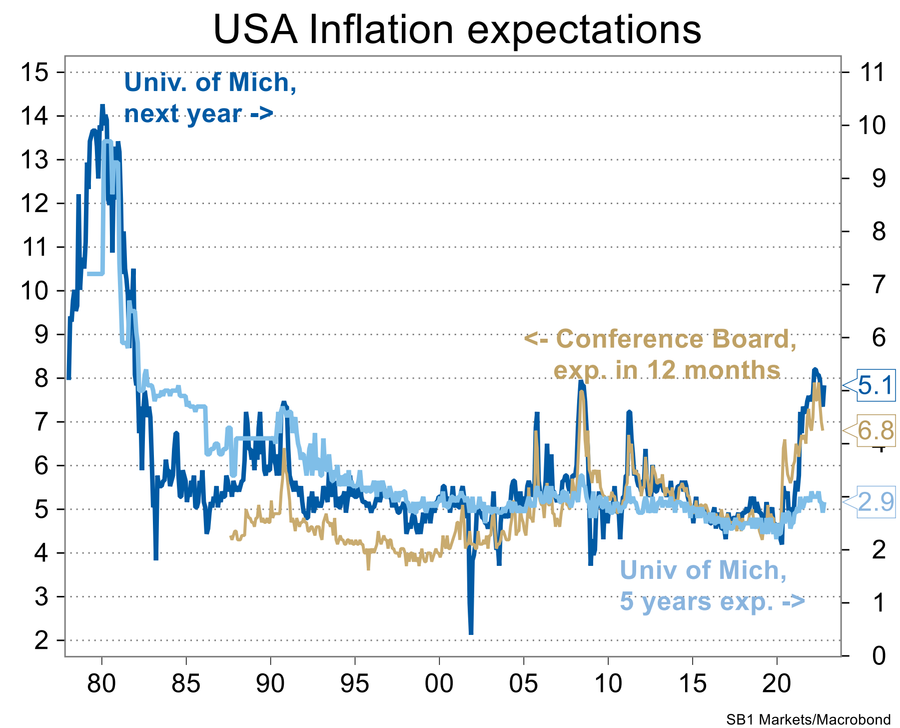


- Quite often, the UM survey has been the canary in the mine vs. recessions, it yields earlier than Conference Board's survey, and the current stance is a VERY bad sign – we have never seen anything like it!
- The IBD/TIPP consumer survey shot up in September, by 1.1 st.dev to -0.9 below average but retreated to -1.5 in Oct. Univ. of Florida's survey rose in both August and but remain -2 st.dev below par

Univ. of Michigan: Expectations down, current situation deemed to be less bad

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

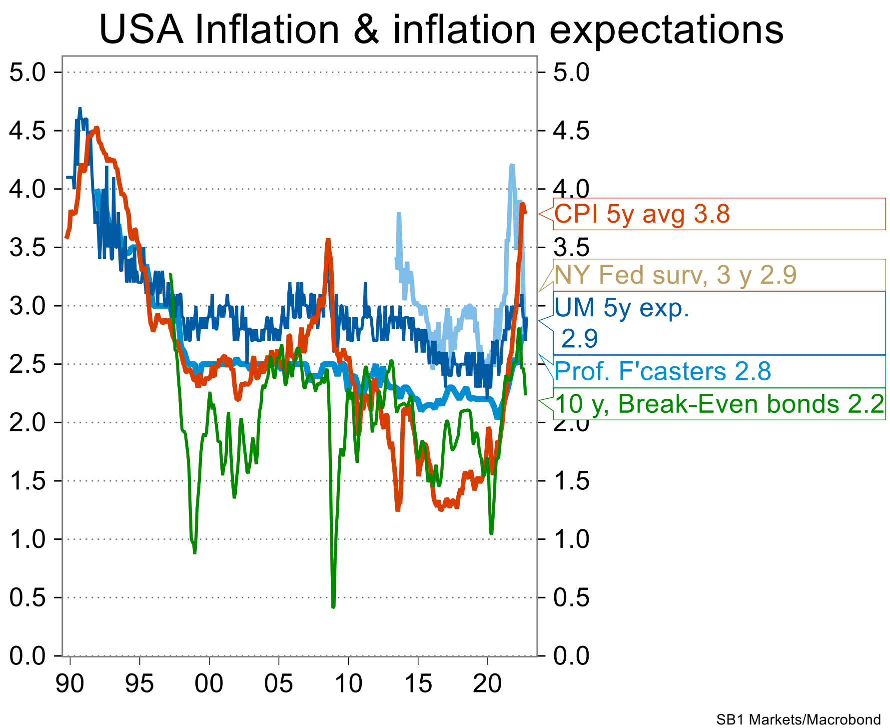


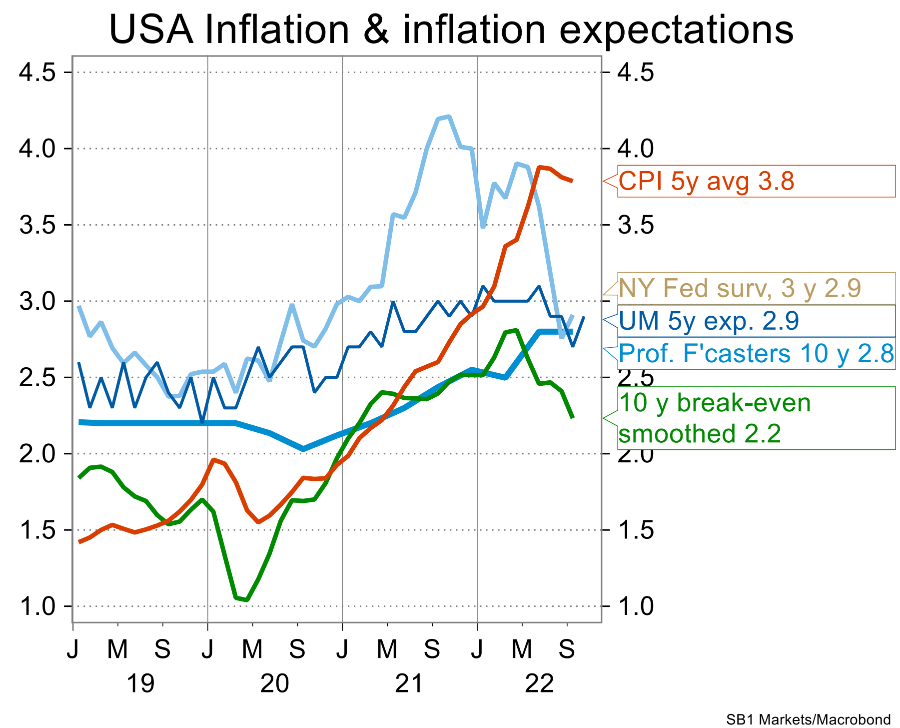


- **The 12 m inflation expectation** rose 0.5 p to 5.1% in October, very likely because the gasoline price turned up again. The peak was at 5.4%, in March. Expectations are well below the current 8.2% y/y CPI print
- **The 5 y inflation expectation** added one tick, to 2.9%
  - » The 2.9% is just 0.3 pp above the average over the past 10 years, not that bad, given the current rate of inflation

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

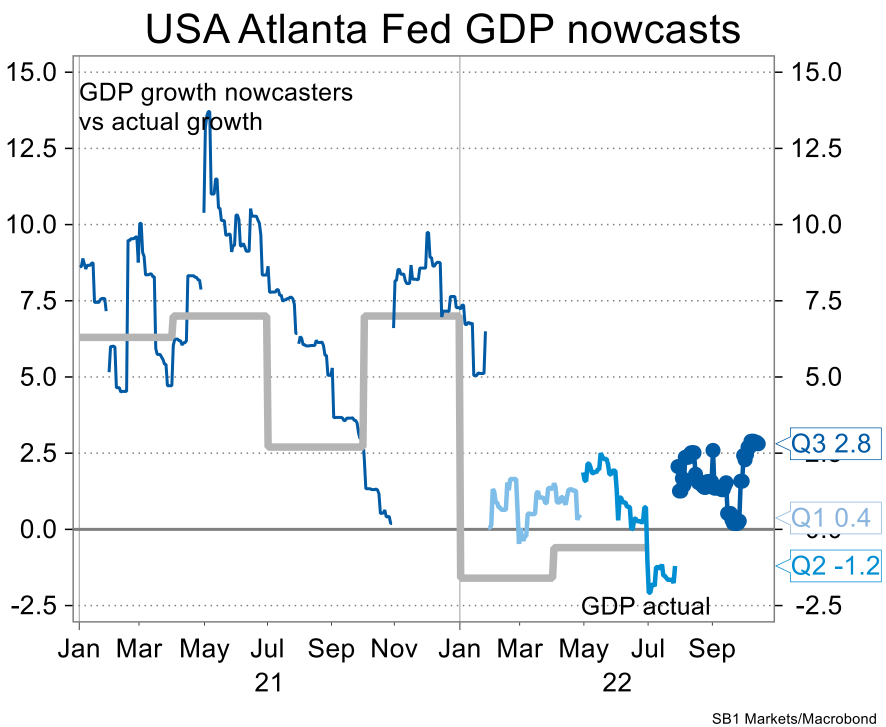
Professional forecasters still expect 2.8% inflation, the market suggests just 2.2%

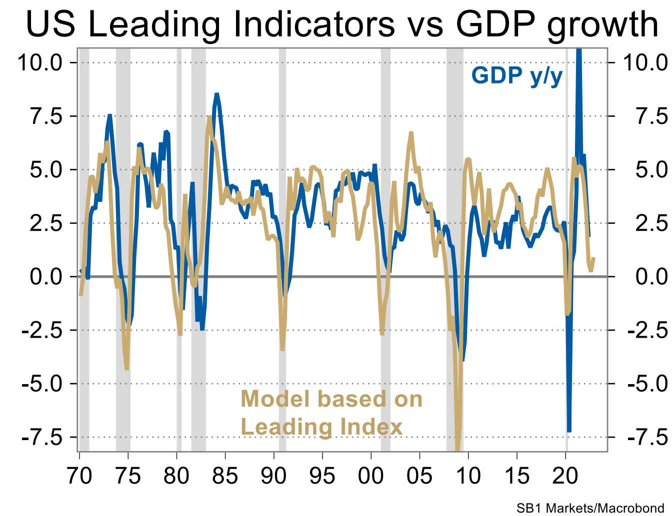


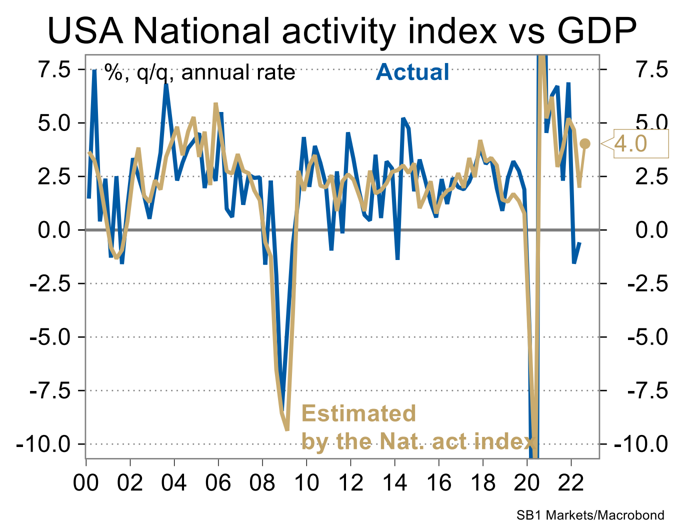


Atlanta Fed's Q3's forecast stable at 2.8%

Net foreign trade will contribute substantially but also private consumption, business investments



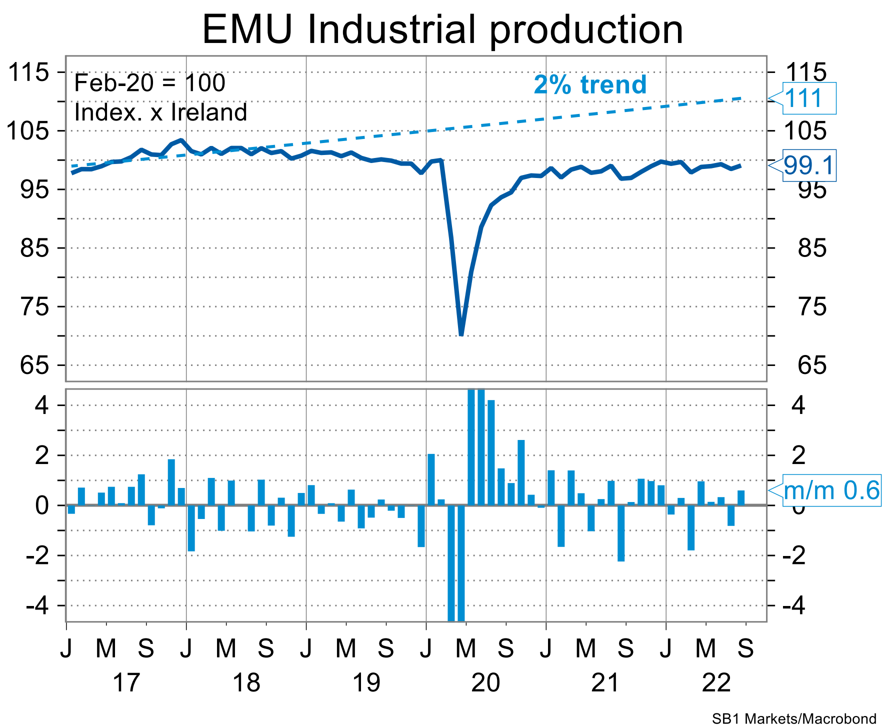


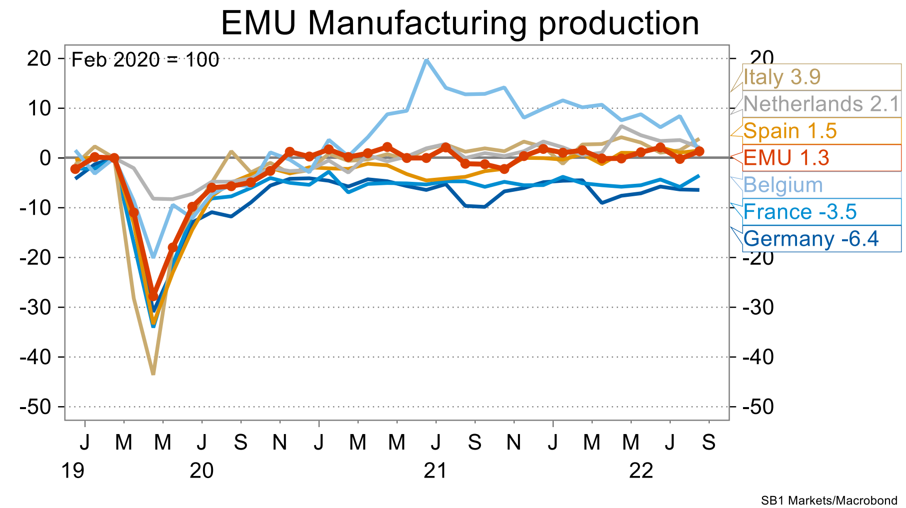


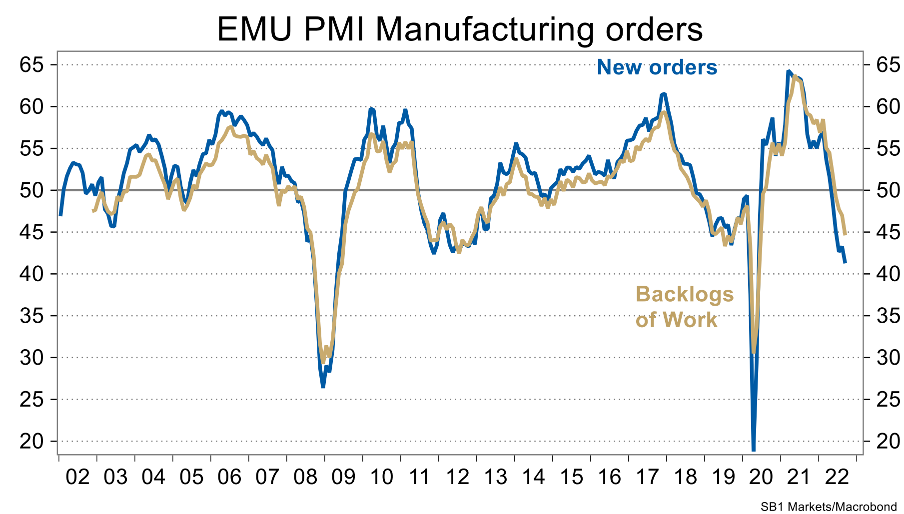
- National Activity index suggests 4% (the July pace). Leading indicators say zero!
- **Q2 GDP** fell 0.6%, revised up from -0.9%

EMU industrial production sharply up in August

Total production up 2.5%, expected 1.2% - production ex. Ireland was up 0.6%

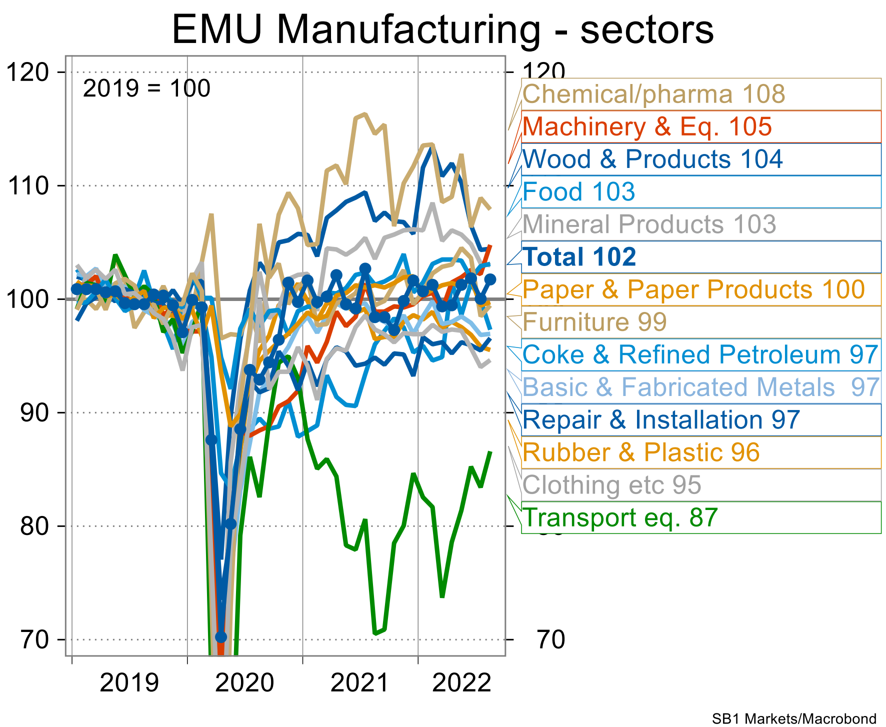


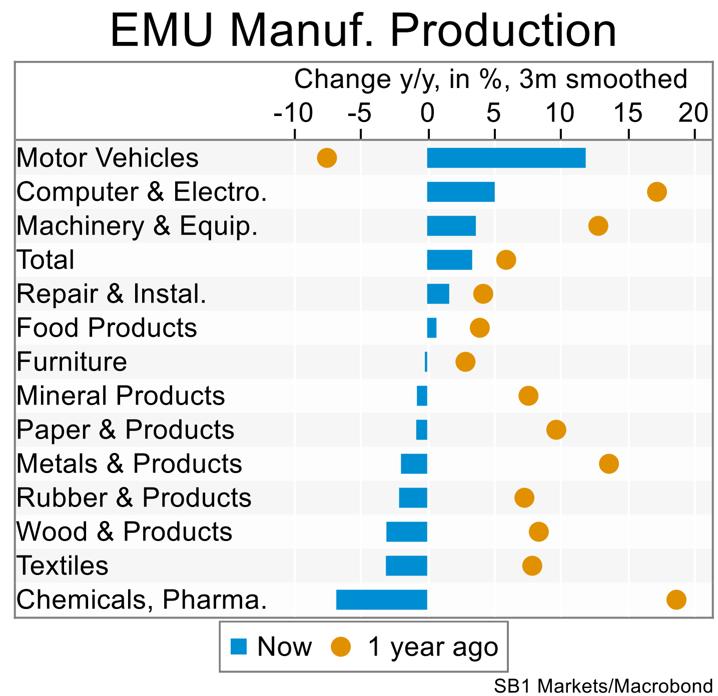




- Production rose 2.5% in August, mostly due to a large increase in production in Ireland, but production rose sharply also in France, somewhat in Spain, while production fell further in Germany, and the Netherlands. Production is still below the pre-pandemic level in France and in Germany (-6.4%)
- The outlook is not that bright though: In September, the manufacturing PMIs dipped below 50 in all of the big 4 countries, signalling a contraction in the sector – The new order sub-index is at the lowest level since 2009!

So far: No big drama in energy intensive industries

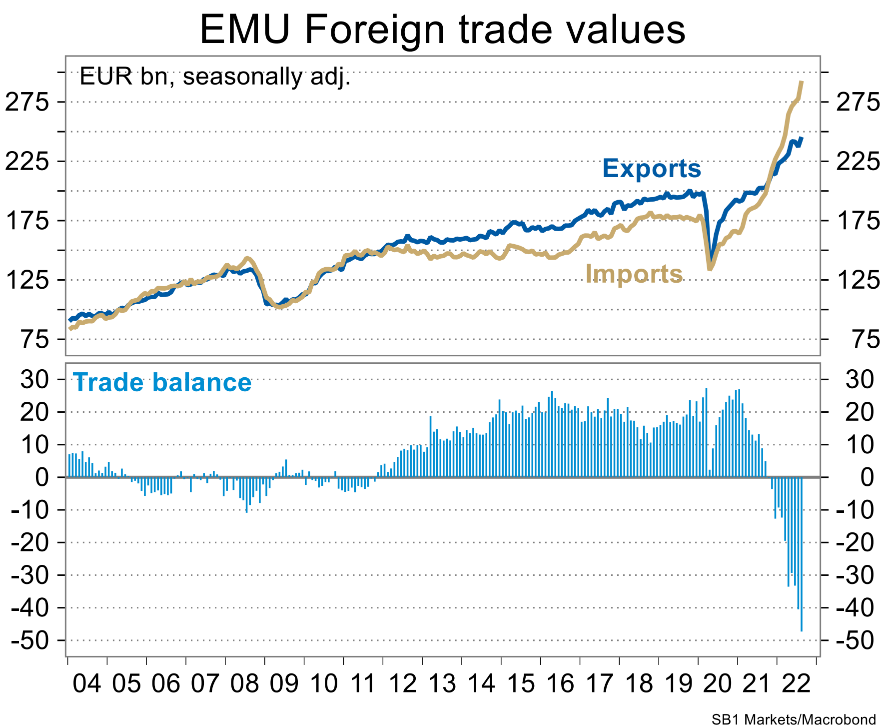


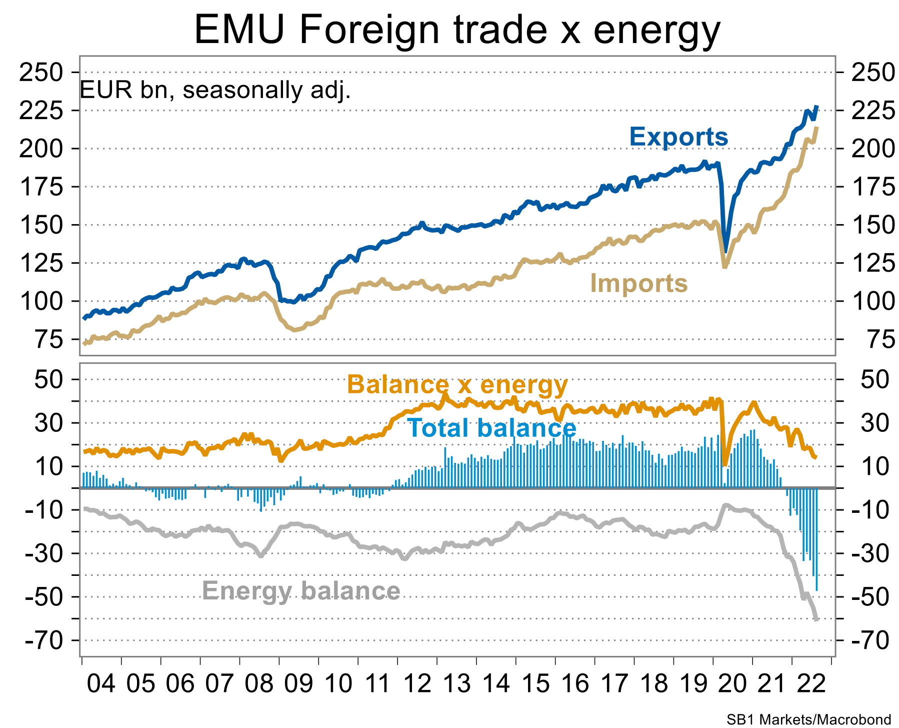


- We have excluded the data & electronics from the chart to the left, because extreme monthly changes in Irish 'production' data makes the time series useless. The volatility in Irish production data are probably mostly tax motivated

Imports are exploding: Energy the main driver

The Euro Area is now running a trade deficit at more than 4% of GDP!

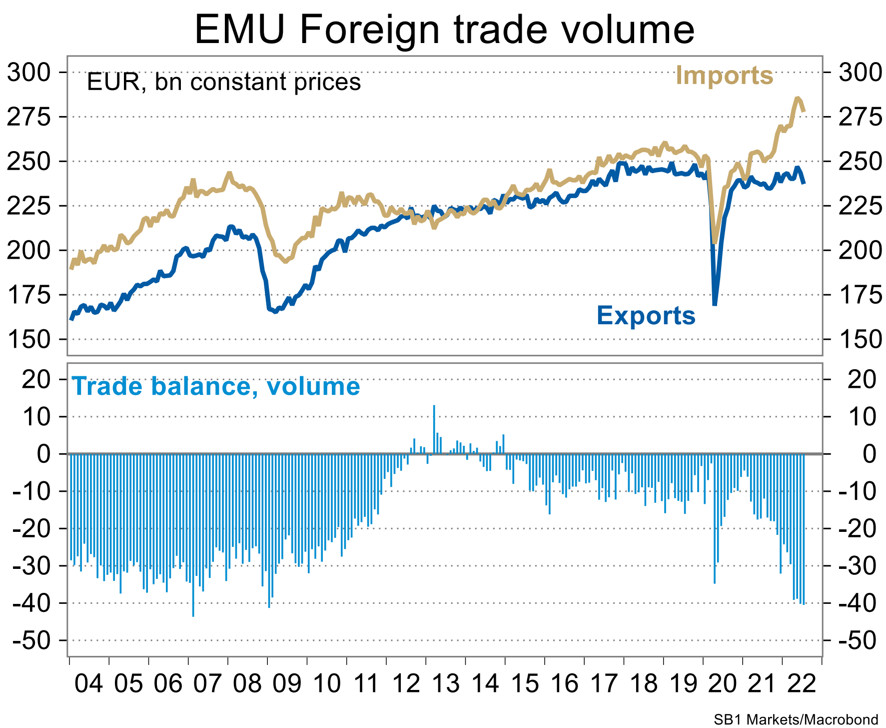




- The trade deficit widened again in August as energy prices soared, to EUR 47 bn (s.a.) from EUR 40 bn in June, a new ATH… again, equaling more than 4% of GDP
- Energy imports are up 152% over the first 6 months in ‘22 compared to the first 6 months in ‘21, and imports from Norway are up 151% over the same time period... Makes sense. The net energy balance in Aug was EUR -61 bn, or 5.5 5% of GDP. It used to be some 2%
- Imports are up 51% y/y, while exports are up ‘just’ 21%. In volume terms, quite another story, check next page

Import volumes up 10% from Feb-20, export volumes are at the same level

Domestic demand has been strong – and still seems to be

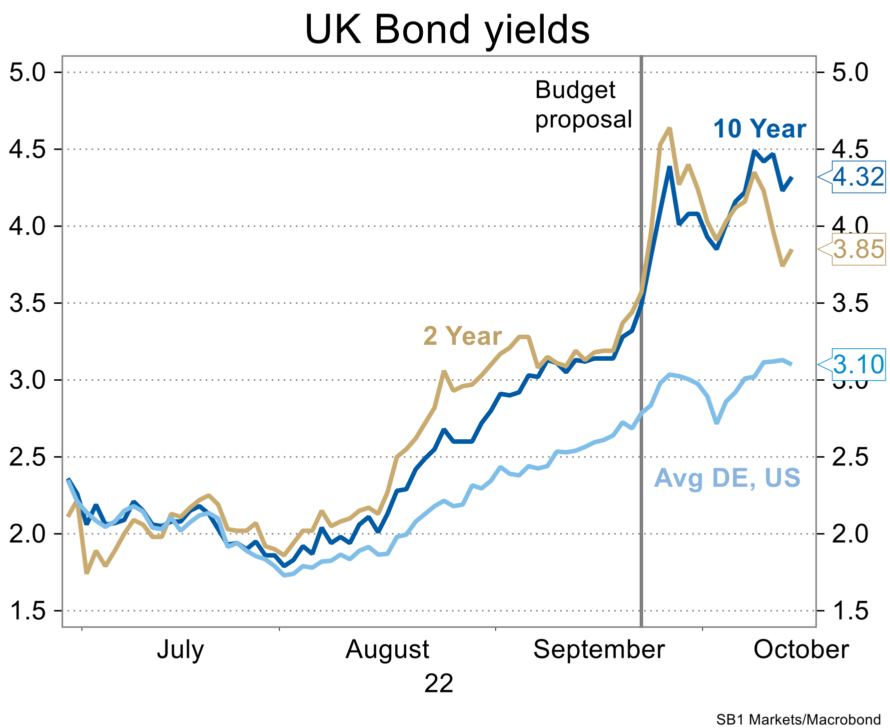


- Import volumes are up 10% y/y
- Export volumes are down 0.2% y/y

Volume data are lagging value data by one month

The gilt sell-off: Pension funds sold gilts to meet margin calls post rate moves

Why did we get big move in gilts and why did the BoE have to step in?

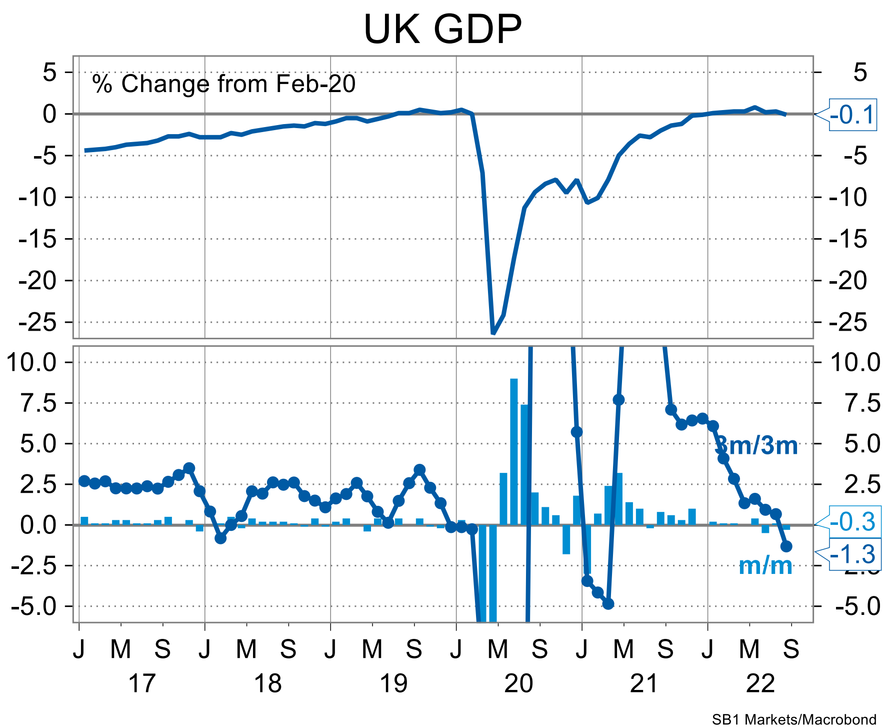


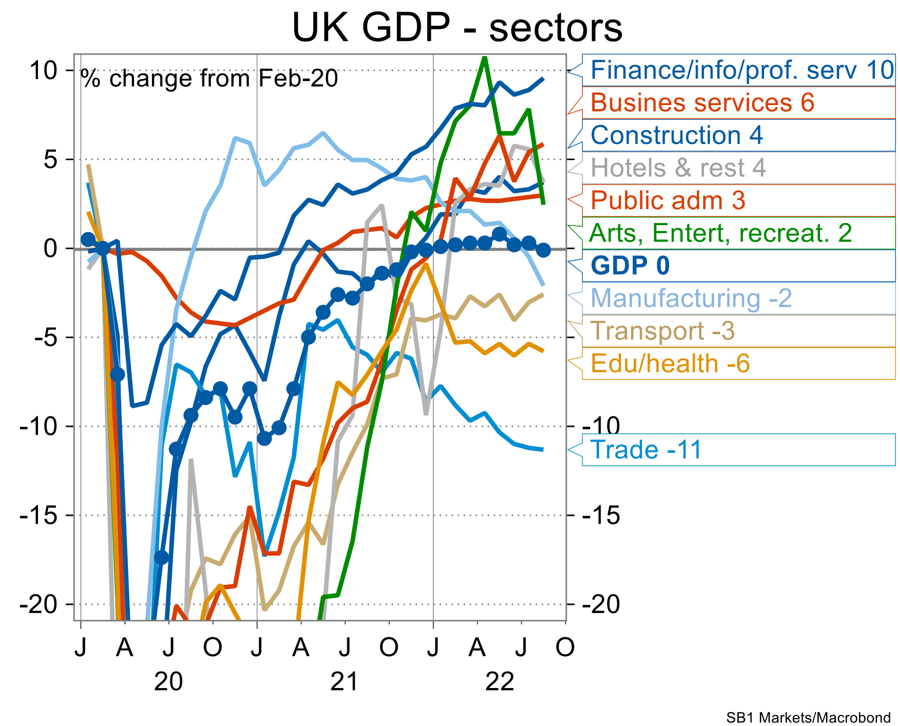
- **The outlook**: Very likely, no more fiscal nonsense
  - » Truss is already a lame duck. Hunt is in charge, and he understands the message from the markets – as well from Tory's parliamentarians
  - » The UK economy is slowing rapidly, and higher short term rate have pushed mortgage rates sharply up recent weeks- which no doubt will send the housing market downwards
  - » UK bond yields have climbed 120 bps more than abroad, and are now too high. Short time rate expectations have also come down – they were too high, and probably still is

- Many pension funds in the UK have used so-called Liability Driven Investment strategies (LDI) to hedge against interest moves using derivatives, like interest rate swaps, to match the (long) duration of their liabilities and their assets
  - » The pension fund will post bonds as collateral (and attain as much as 7x leverage) and pay float and receive on the fixed leg – that way if rates rise the present value of the liabilities will fall and so will the present value of their derivative position…
  - » The reason pension funds do this is because this matches the duration of assets and liabilities, giving them more room to manoeuvre and invest in higher risk assets in order to create more return
- **The problem:** when the new Government proposed huge, unfunded tax cuts on Friday 23 Sep, yields rose sharply on the top of the huge global lift in bond yields, and more than the collateral buffer held by pension funds covered. Thus, the funds' counterparts demanded fresh collateral in a matter of hours, forcing the pension funds to sell liquid assets (gilts) to post more collateral, sending bond yields even higher, forcing them to sell more (and post more collateral)…
- **The (temporary?) solution:** on Wednesday Sept. 28th the BoE stepped in and bought gilts to stop the spiralling rise yields, and signalled willingness to do whatever it takes to stabilize the market. Just limited amounts are so far spent, even if the volatility in the gilt marked has been close to unprecedented. The curve is close to the peak the day before BoE intervened in the gilt market
  - » BoE has offered banks liquidity support and have included a wide range of assets banks can use as collateral for their loans in the central banks (though with serious haircuts, by up to 40% for long duration bonds and high-risk corporate bonds)
- **Now: The BoE** ended its support program on Friday, as pensions funds were ordered to pay up sufficient collateral by the end of the week
  - » At the same time the PM Truss sacked chancellor Kwarteng and both she and her new minister, Jeremy Hunt, stated tax cuts for businesses would be abolished, and public spending would be cut, in order not to increase public borrowing too much. After 6 weeks, Truss had to scrap all of her main promises, to stimulate the economy by deep tax cuts, to focus more on growth than inflation (by limiting BoE's power - the bond vigilantes helped the BoE, big time!), and to limit the power of other oversight institutions

UK GDP is shrinking, down 0.3% in August, and down 1.3% on a 3m/3m basis…

…expected flat m/m. Manufacturing, hotels & restaurants, trade, and entertainment down



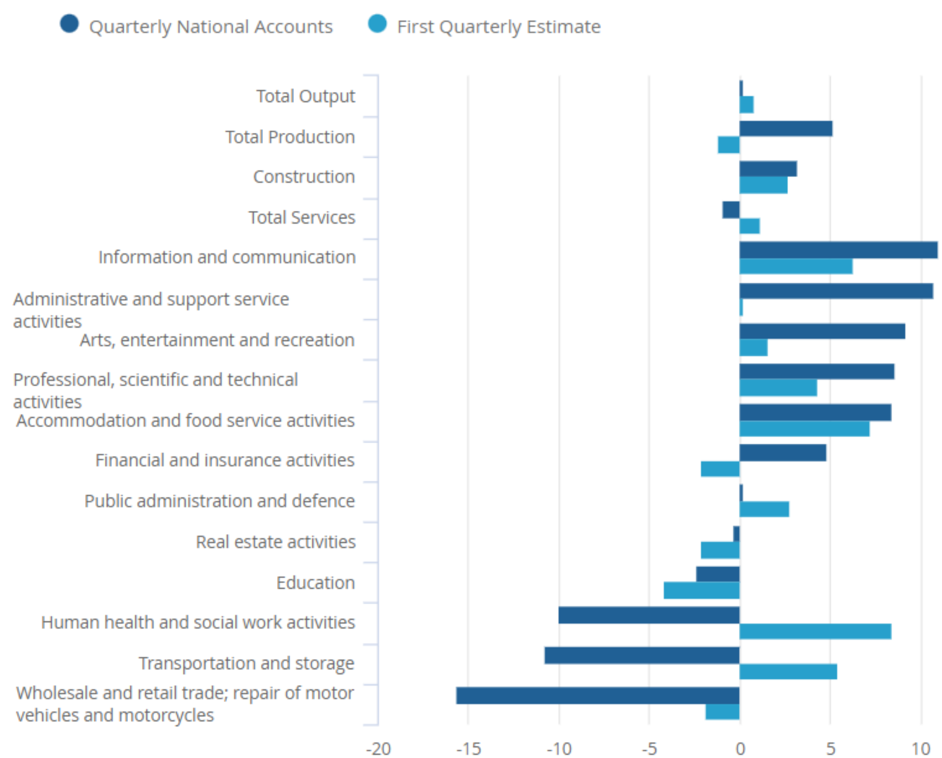


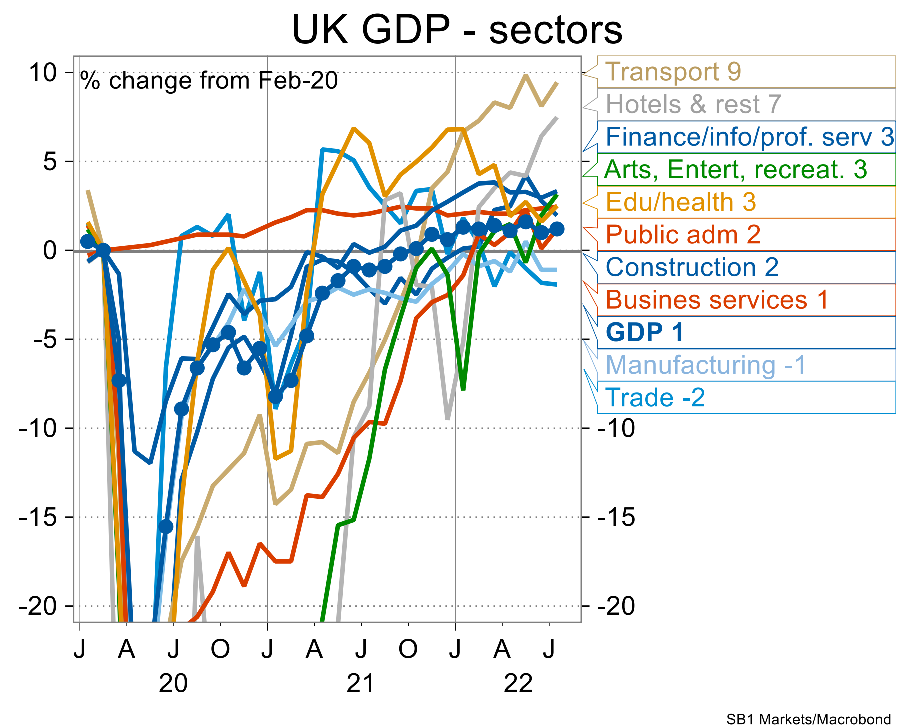
- **Growth in GDP** has been far weaker than expected – and GDP is now 0.1% lower than before the pandemic, 2.5 years ago
- **Mixed between sectors:** The annual revision of GDP data revealed huge changes vs earlier estimates, in a way we have never seen before, in the dimension +10/-10% - which in a sense make mockery of these data. Check next page for the aggregate changes, and if you are able, try to compare the revised sector data at this page with the data that that was published one month ago – we advise you not to spend too much time to figure out what has happened..). Trade has been revised heavily down, and the level is far lower than retail trade data can explain (even if wholesale trade is included). 2 pages forward, the change in the manufacturing value added is shown
  - According to the new data, manufacturing and trade have been the main laggards so far in 2022, together with arts and entertainment (the latter don't sit well vs. the covid story)
- **Bank of England** expect UK to have entered a recession in Q3, due to a steep decline in real incomes, and monetary tightening. And the Queen's death

SpareBank 1 MARKETS

Unprecedented changes in sector-wise value added estimates

UK, percentage change, Quarter 4 (Oct to Dec) 2019 to Quarter 2 (Apr to June) 2022

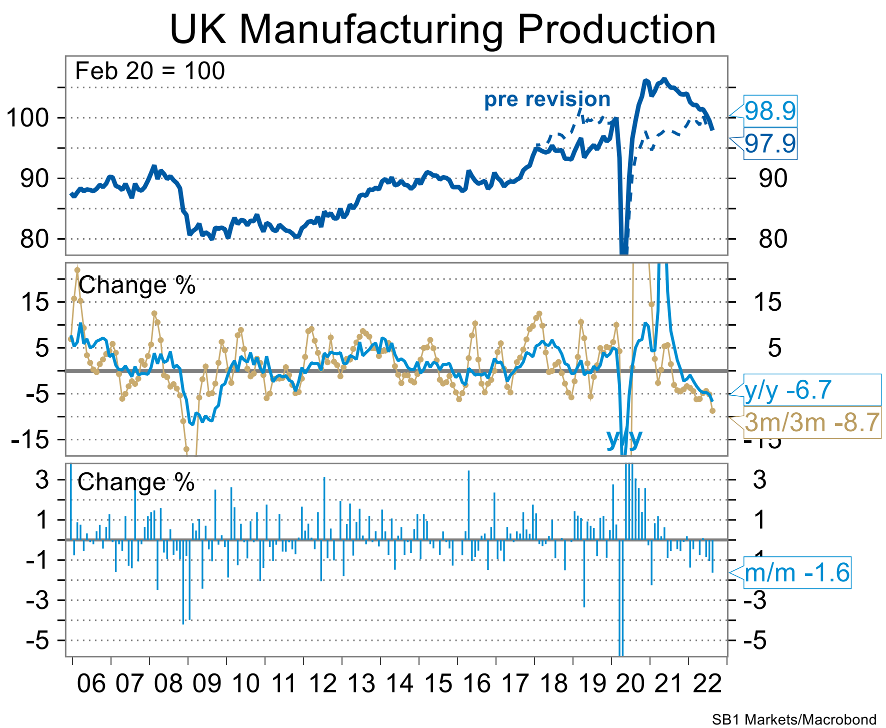


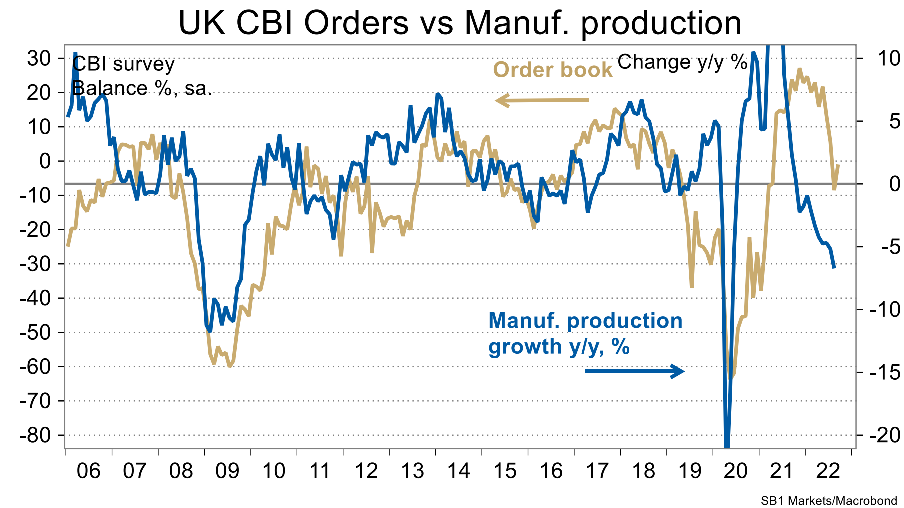


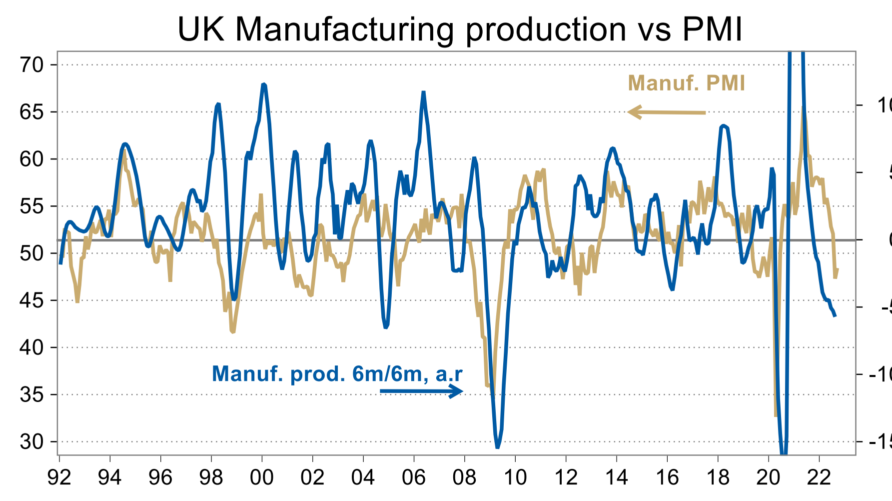
- The revision was published Sept 30th, alongside the revised Q2 GDP data

Manuf. production heavily revised, and surprised on the downside in August

Production was <u>down</u> 1.6% m/m, expected <u>up</u> 0.2%. The level is 2.1% below that of Feb-20



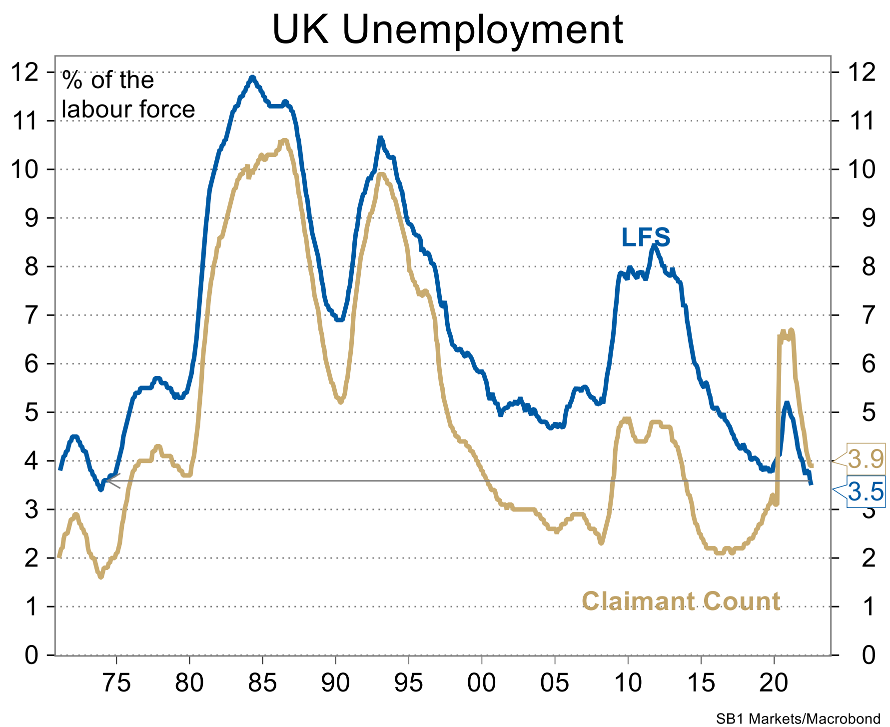


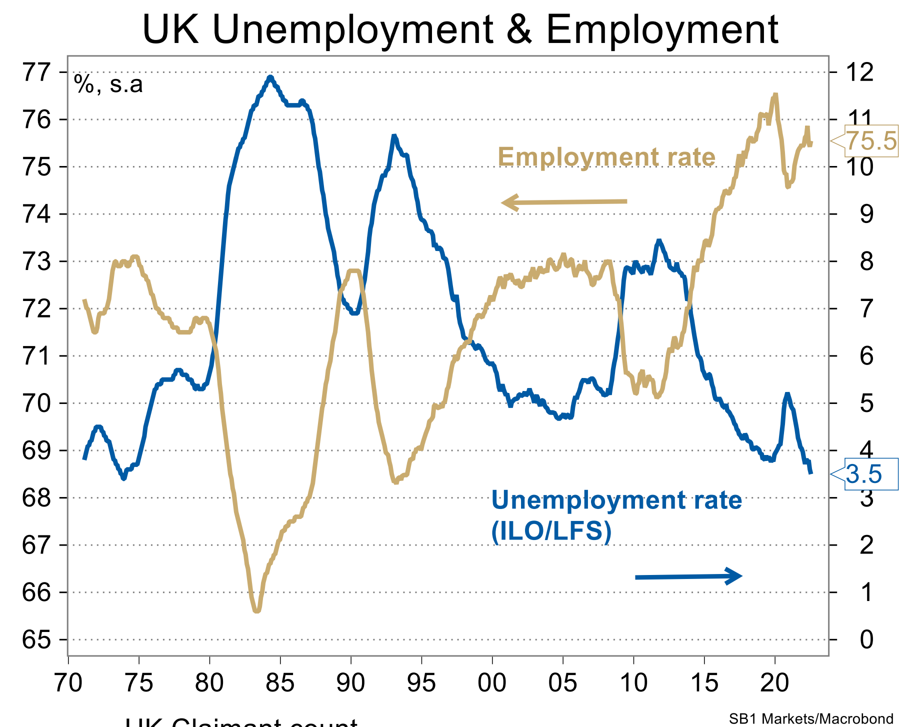


- The new production (=value added, constant prices) data is completely different vs. previous published data, spot the difference during first part of the pandemic (+10%) – and the trajectory since early 2021: down 8%, while the old data said +2!
- According to the current estimates: Production of basic pharmaceuticals fell 6% m/m in Aug. Wood, paper & printing -3.4%, and transport equip. -3.0%. Machinery & equip. was down 1.7%, but the level is still 10% above the pre-pandemic level
- The CBI survey signals a slight increase in manuf. orders, while the manuf. PMI is still weak

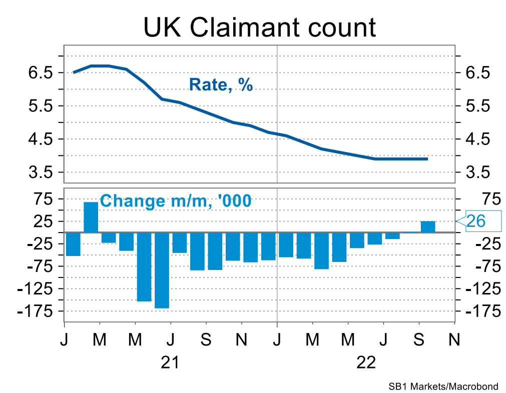
What a crisis: The LFS unemployment rate further down but claimant counts up

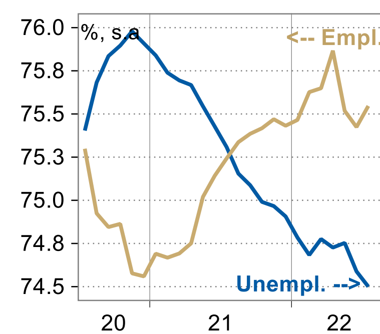
Payrolls still on the way up, and wage growth is still accelerating – from a far too high level





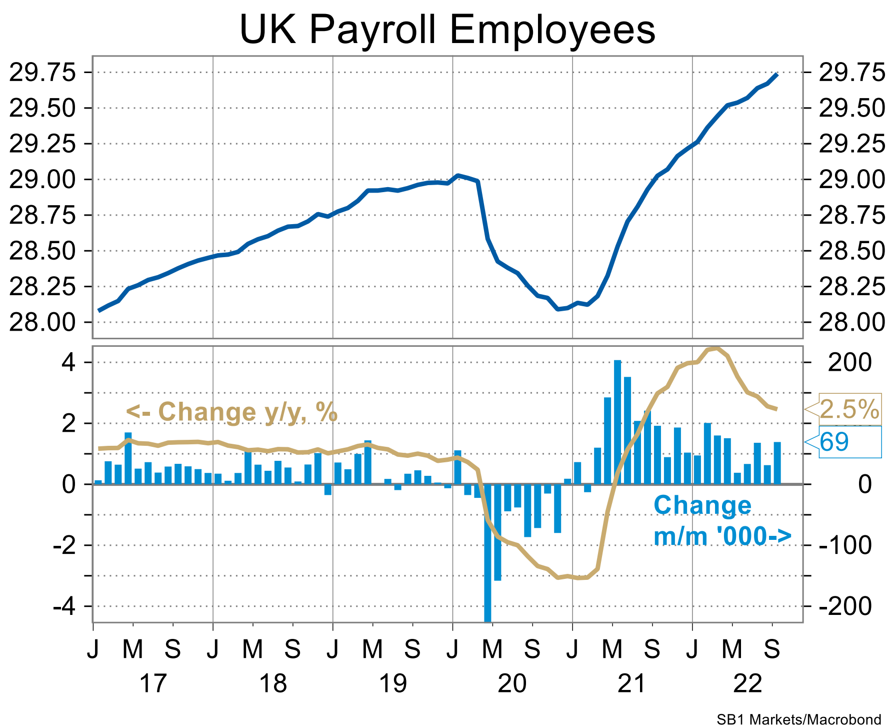
- **ILO/LFS ('AKU') unemployment** fell 0.1 pp to 3.5% the lowest level since 1974, expected unchanged, following the surprising 0.2 pp decline the previous month
- **Claimant counts** ('open unemployment') have flattened at 3.9%, which is not that low, and in September, the number of claimants rose marginally, for the first time since early 2021
- The no. of **unfilled vacancies** is now falling slowly – but remains at a very high level

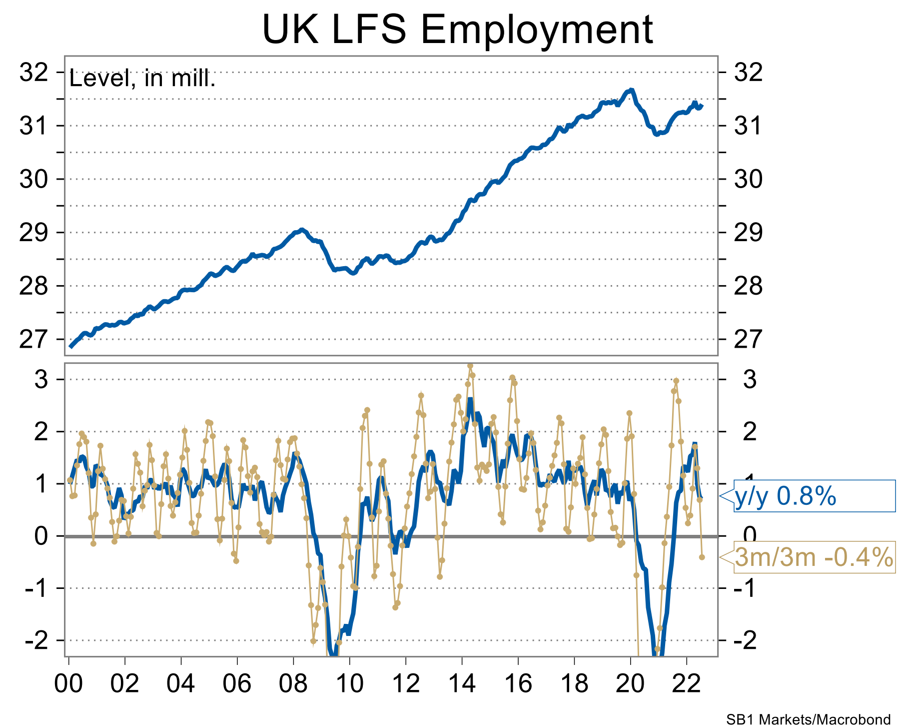




Number of employees is still growing at rapid pace

…and far faster than expected in September, 69’ vs. 35’ (but Aug was revised down by 40’ to 31’)

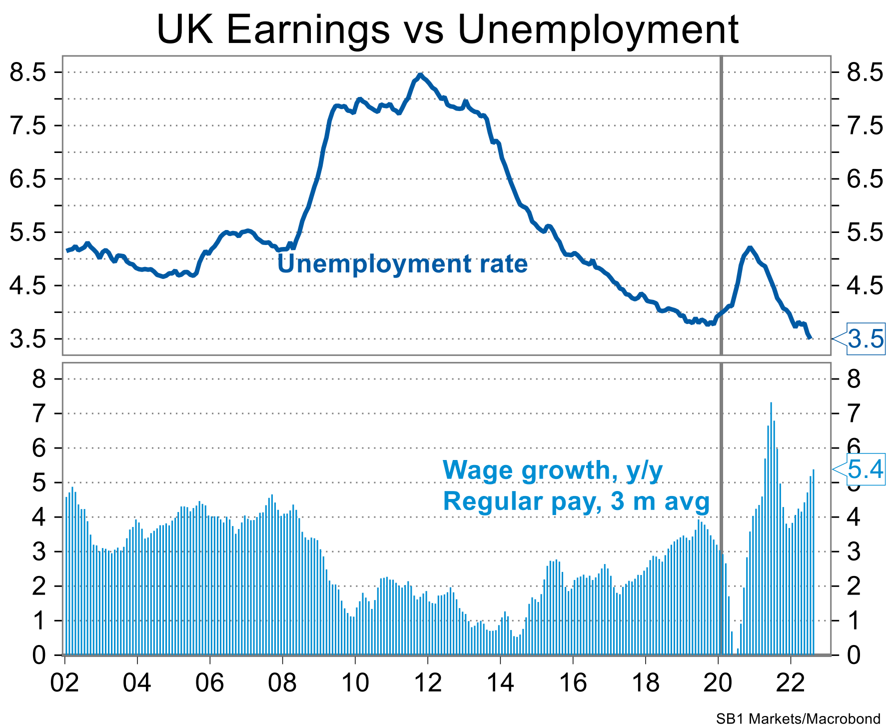


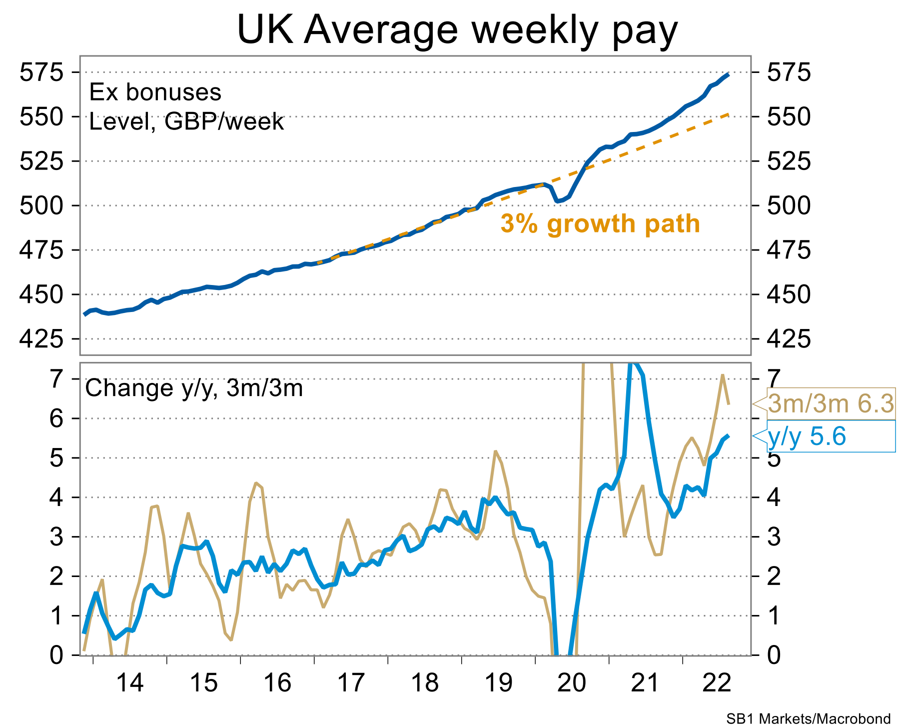


- Total employment measured by the LFS (‘ILO/AKU’) still trending upwards but monthly survey data are rather volatile
- LFS employment is still below the level before the pandemic, while the new payroll stats reports a 2.6% growth. The number of selv-employed have fallen sharply, according to these two data sets

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

… wages ex. bonuses are up 5½%, up from the pre-pandemic level at 2% – 3½%

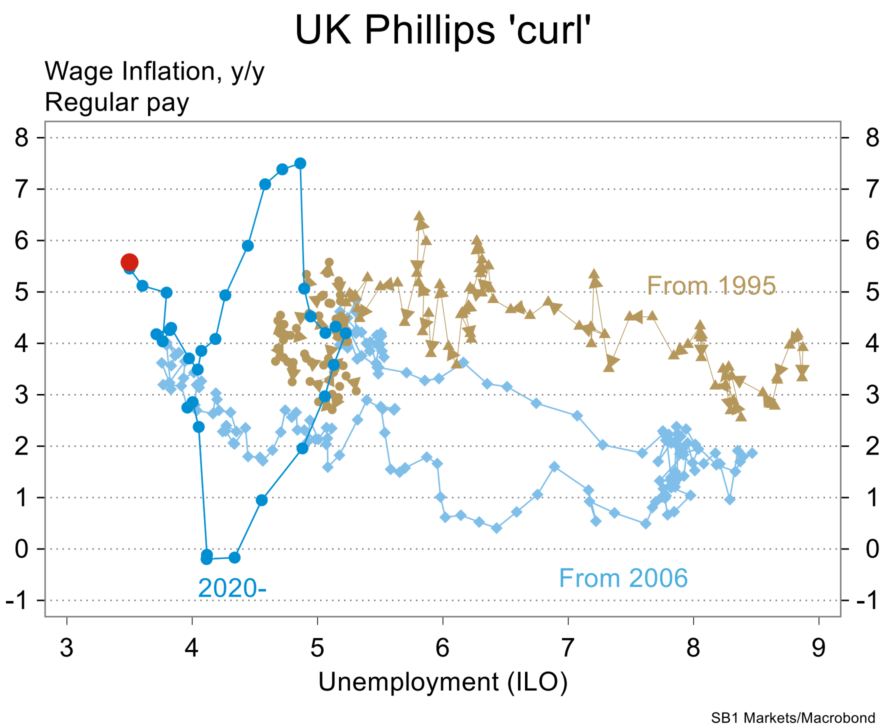


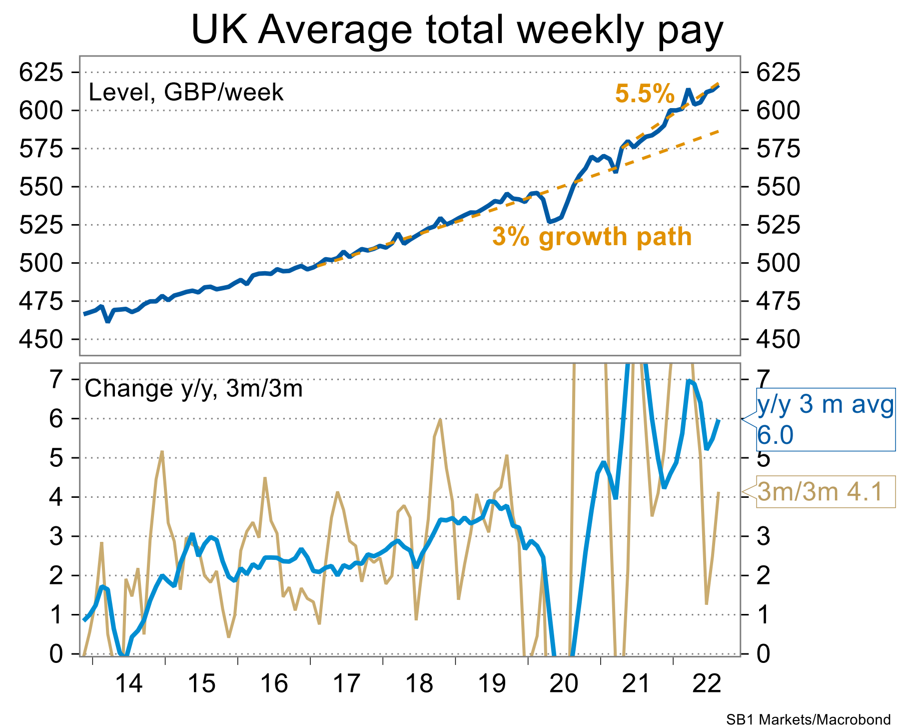


- **Annual wage growth** (regular pay, 3 m avg) accelerated 0.2 pp to 5.4% in August, expected up to 5.3%. Not smoothed, wages were up 5.6%, and the underlying 3m/3m rate is at 6.3%
- **Including bonuses**, total wages are up 6.0% y/y (3 m avg), also 0.1 pp higher than expected (*chart next page*)
- 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. 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 6.0% y/y, the underlying trend is closer to 5.5%, 2.5 pp above the pre-pandemic normal

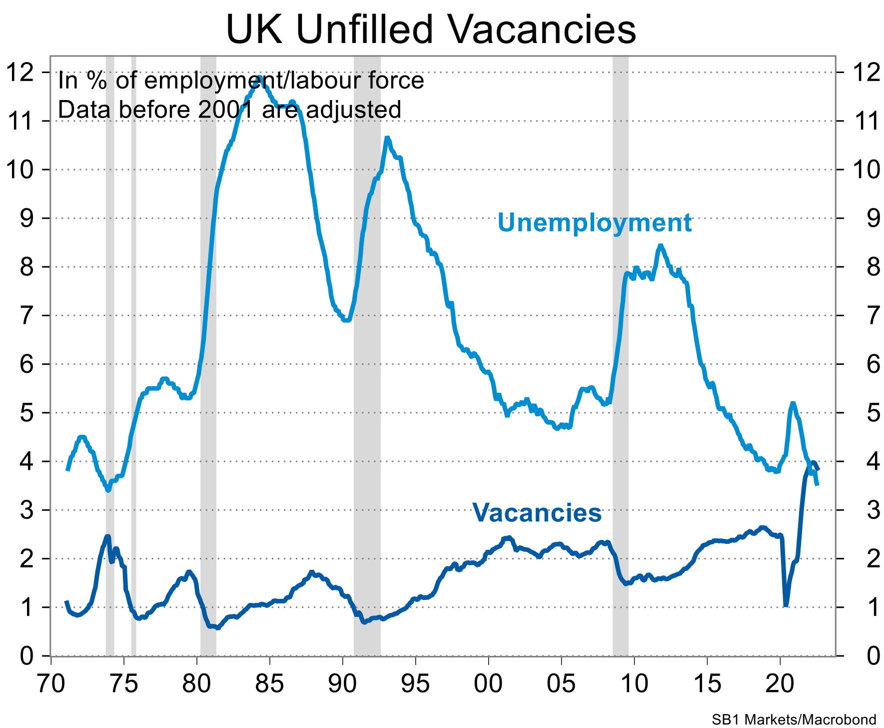


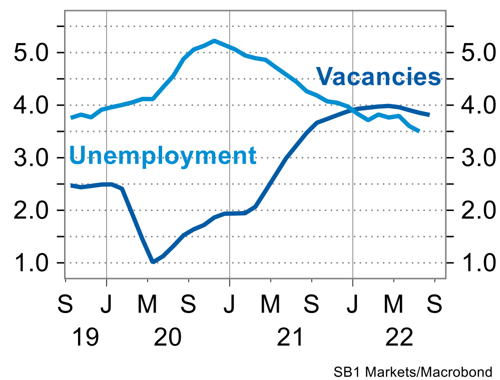


- Wages are on the way up alongside something that looks like a Phillips curve
- It is completely impossible to bring inflation back to 2% over time if wage inflation remains above 5%, probably even above 4%. With a 3% wage inflation rate, inflation was just marginally below the 2% target – and productivity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

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

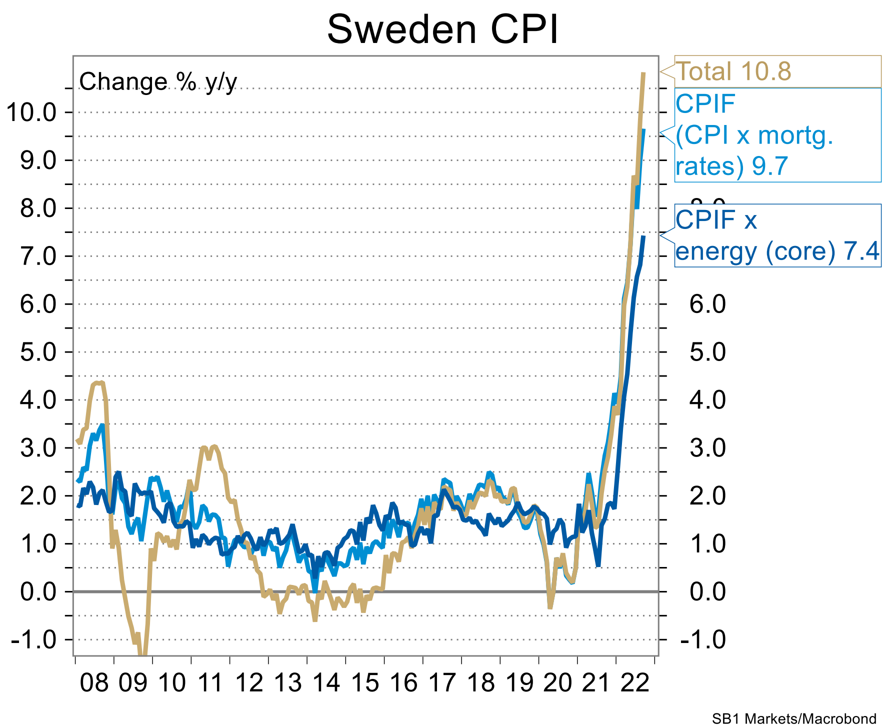
The vacancy rate has fallen marginally the past 3 months but remains extremely high

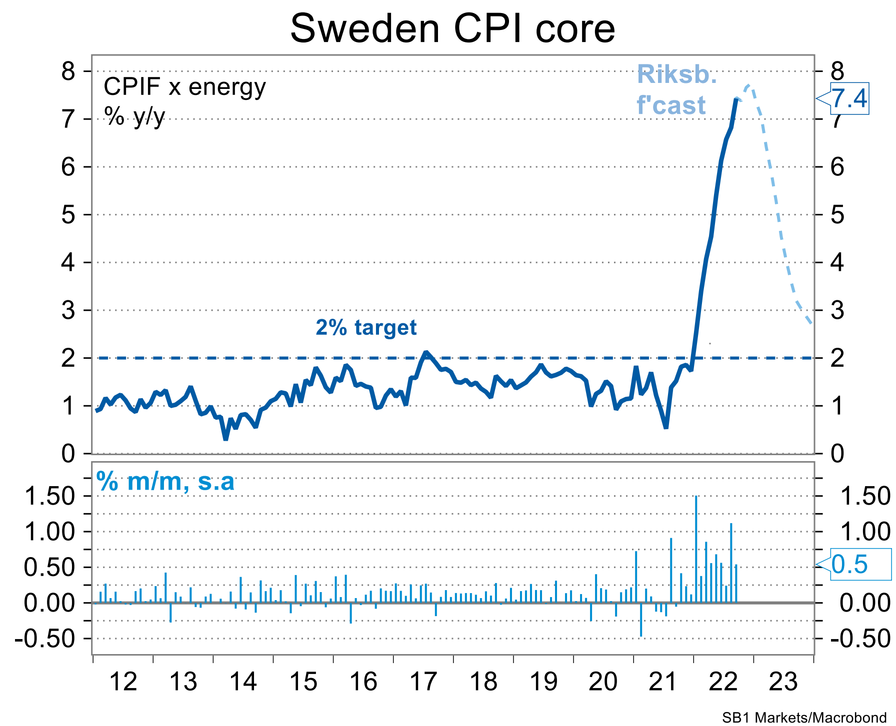




No peak yet for Swedish inflation – core in line with Riksbank f'cast

The headline was up 1 pp to 10.8%, expected 10.5%. Core CPI also up 0.5 pp to 7.4%

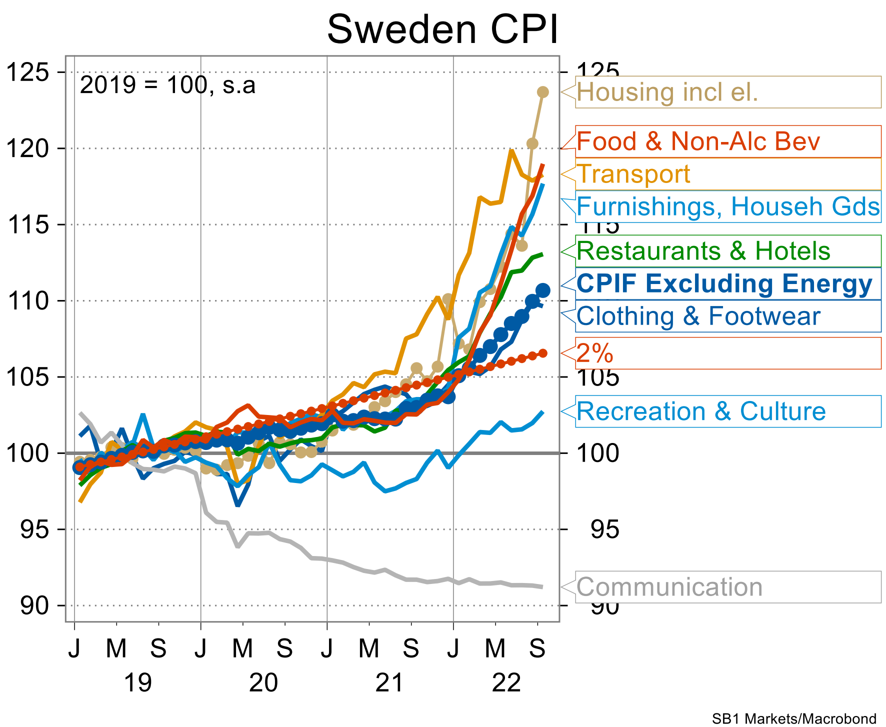


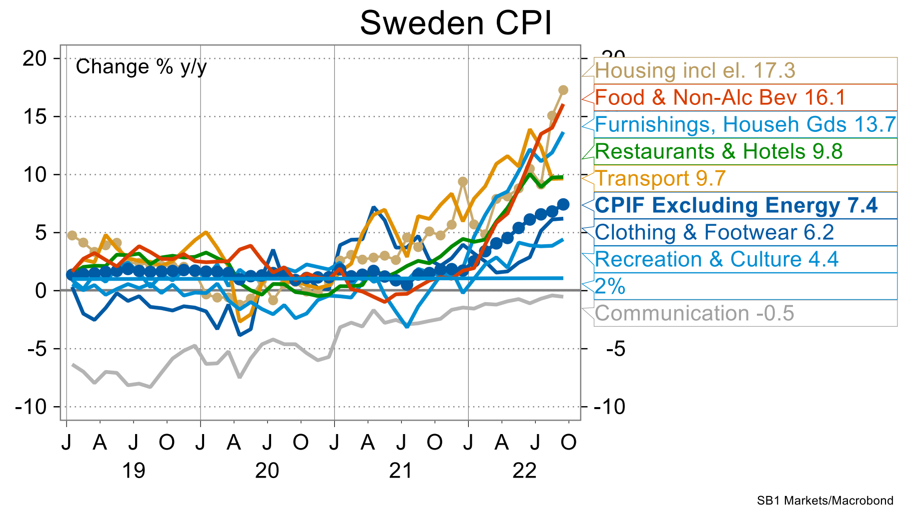


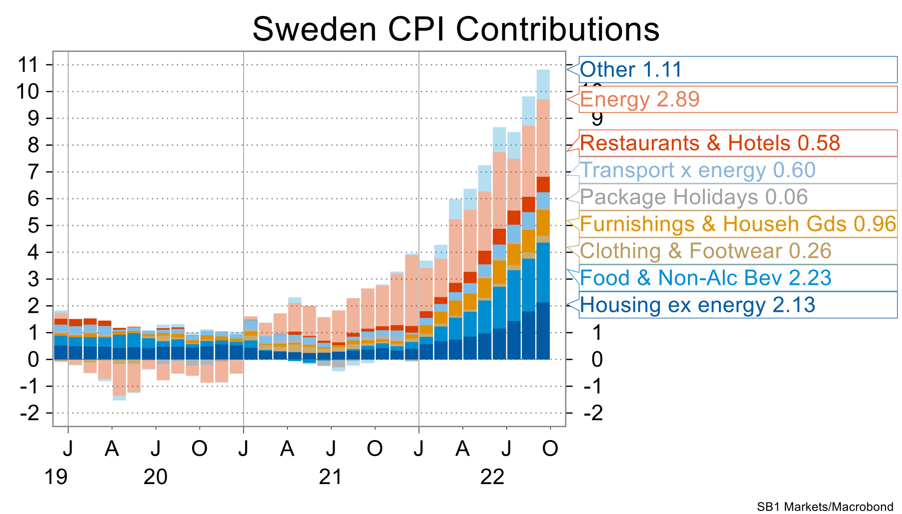
- **CPI-F x energy, the 'real core'**, rose 0.5% in Aug (seas. adj). The core rate has accelerated sharply recent months, to 7.4%, but the latest print was in line with the Riksbank f'cast from Sept. Why is inflation so high? Housing incl. energy prices are up 17% y/y, food prices are up 16%, furnishings 14%, hotels & restaurants 9.8%!
  - » All other measures of underlying inflation are sharply up – and at the highest level in some 30 years
  - » Until Q4 last year, 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 Sept are energy, housing (larger mortgage pmts), and food, while fuel prices and the category Other vehicle related expenses contributed the most on the downside
- **The Riskbank surprised markets** and hiked by 100 bps at their last meeting, and signalled a 50 bps as the most likely outcome in November. The market, however prices in another 75 – 100 bps

Inflation in Sweden: a broad acceleration

Just communication is below 2% y/y, and is together with recr/culture, below a 2% path since 2019

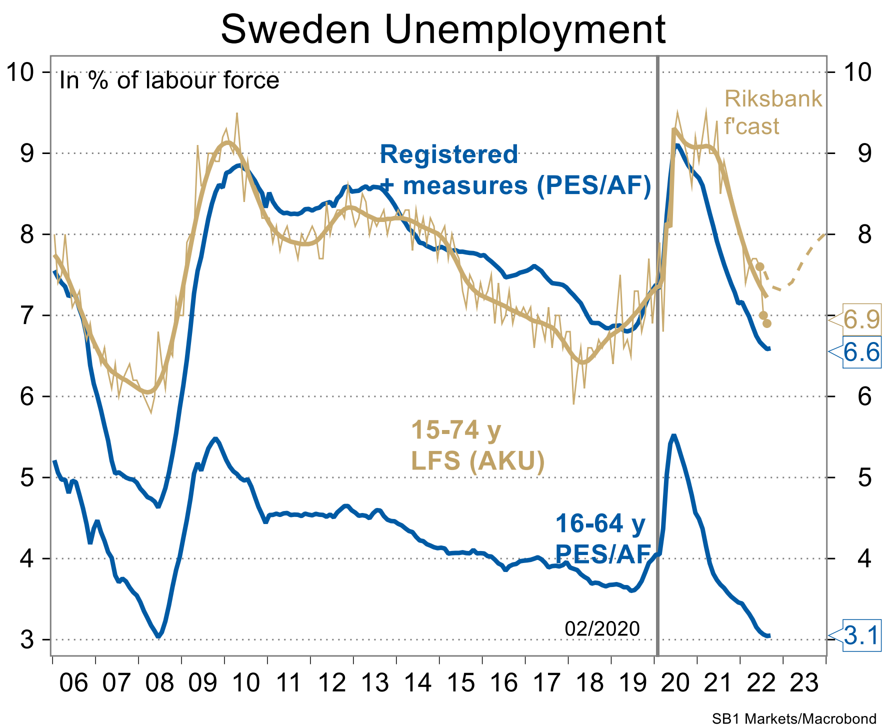


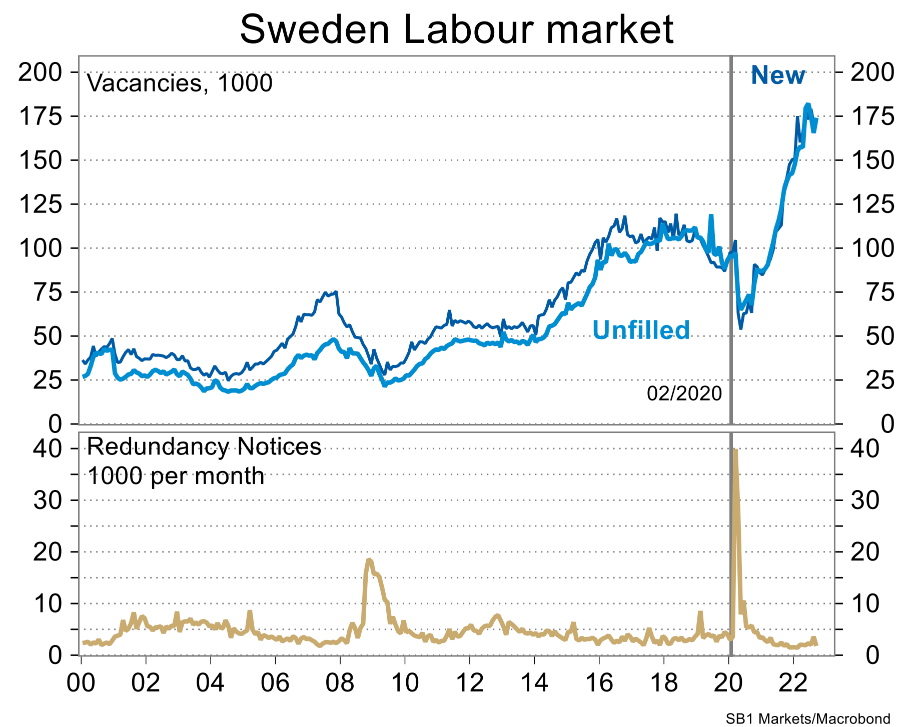




Open unemployment unchanged at 3.1 % in September (6.6% incl. measures)

New and unfilled vacancies have probably peaked but remain at extreme high levels

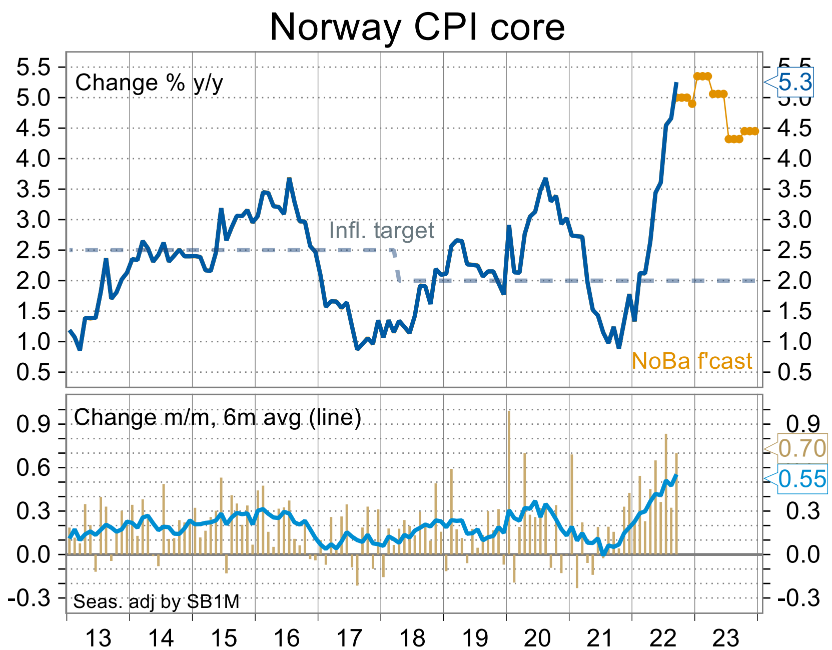


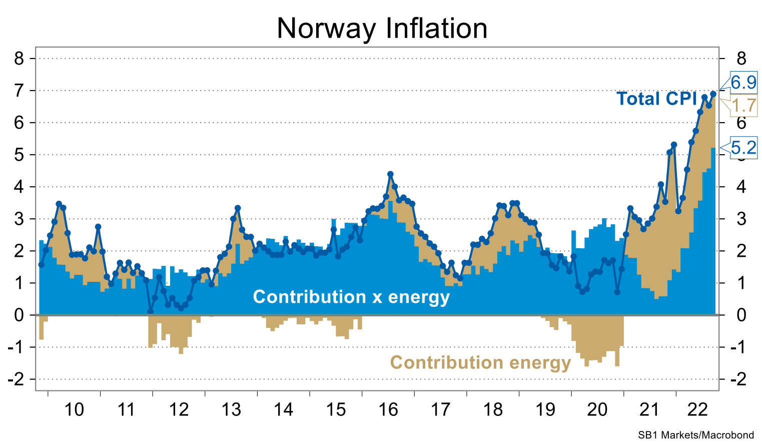


- **Unemployment including labour market** measures has flattened at 6.6% - which is below the level just before the pandemic hit
- The **'open' registered unemployment rate** at 3.1% is far below the pre-pandemic level – and very likely soon at the lowest levels since 1990, before the housing/banking crisis
- Both the number of new vacancies and unfilled are slightly down from the peak. The level is still very high

Inflation surprised sharply on the upside – Food for thought for Norges Bank

Headline CPI was up 6.9% y/y, expected 6.2%. The core further up to 5.3% y/y, up 0.7 pp m/m



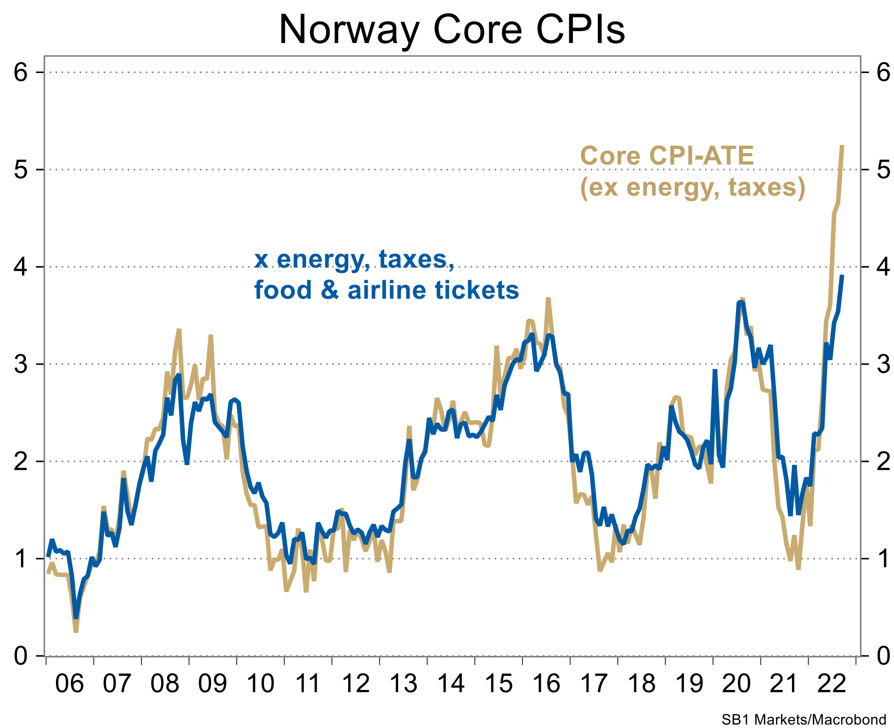


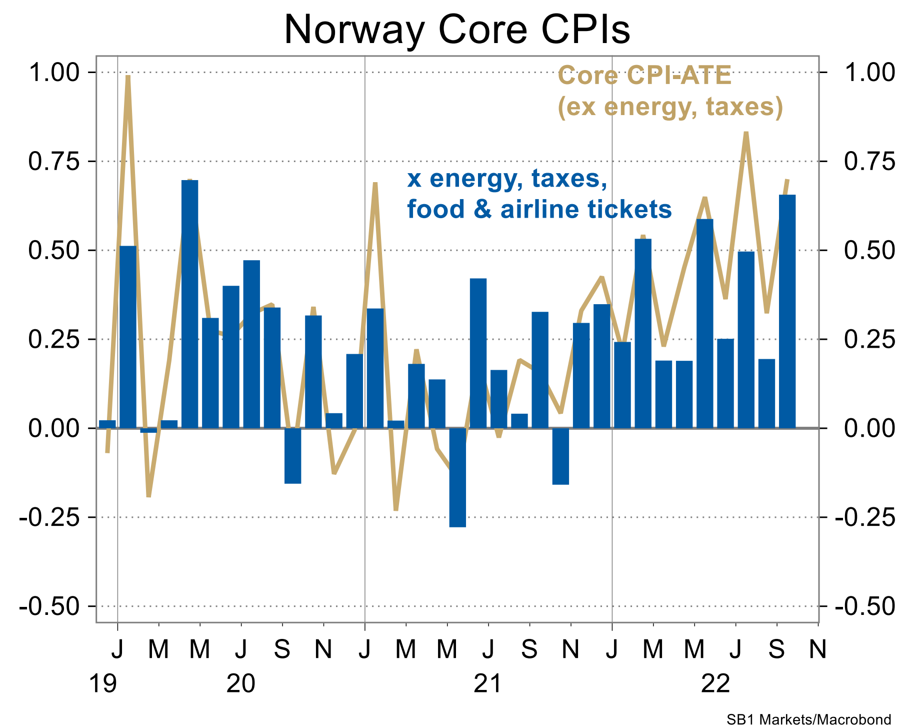
- **CPI-ATE** (ex. energy and taxes) rose 0.7% m/m (s.a), and the annual rate climbed by 0.6 pp to 5.3% pp, we expected 4.6%. Consensus was at 4.9%, NoBa expected 5.0%
- **Food prices** rose 0.9% in Sept, we expected +0.1%. The annual rate is now at 12.1%. The annual rate will remain lofty the coming year. <u>At one stage, prices will be cut</u>
  - » **Airline ticket prices** fell by 1.4% m/m, as the only main category where prices were down
  - » Prices on **imported goods** rose 0.6% m/m, and are up 5.2% y/y; **domestically produced** goods & services were also up 0.7% m/m and are up 5.3% y/y
  - » **10 sectors** reported growth above 2% y/y, and just 2 are below (and one at 2%). All trimmed/median measures tell the same story: <u>Inflation has broadened</u>
- **Total inflation accelerated by 0.4 pp**, to 6.9%, the highest since 1988. We expected 5.8%!! If not for electricity subsidies, inflation would have close to 10%, a normal rate these days. Electricity prices rose 11% in September, we expected them to fall by 2%. Gasoline prices rose by 1.2%, we expected a small decline of 2%
- **The outlook**
  - » Most of the lift in **electricity prices** are behind us, due to the generous government subsidies
  - » **Gasoline prices** are on the way down and will contribute to a decline in headline CPI
  - » If so, **average 2022 inflation** will be some 5.7%, and above Norges Bank's 5.4% f'cast. The core inflation may average 3.8%, just 0.1 pp above NoBa's f'cast
  - » We expect inflation to slow faster than Norges Bank expects, as the economy slows, and raw material prices declines
- **So what?**
  - » **Inflation** is above NoBa's f'casts, and while imported inflation is high, it explains less than 2% of overall inflation of 6.9%. Take away energy and food too, and domestic inflation is still way above 2%
  - » For **Norges Bank**, as all other central banks, wage inflation is the dominant risk vs inflation over time. So far, wage inflation has not accelerated, as we expected it would. However, as inflation will be high into 2023, there still is a risk that wage inflation will accelerate, even if the economy has slowed somewhat before that. Still, we doubt NoBa's 4.6% 2023 wage inflation forecast is too low, it is rather too high!
  - » Even so, a <u>50 bps hike in November is increasingly more likely</u>. GDP was revised up, and (even if we do not agree), the budget may be deemed less tight than expected. Norges Bank has signalled 2x25 bps in Nov and Dec, while the market is now pricing in something close to 0.5%

SpareBank 1 MARKETS

The ‘real’ core is a problem too: Core ex airfare tickets, food & energy up 3.9% y/y

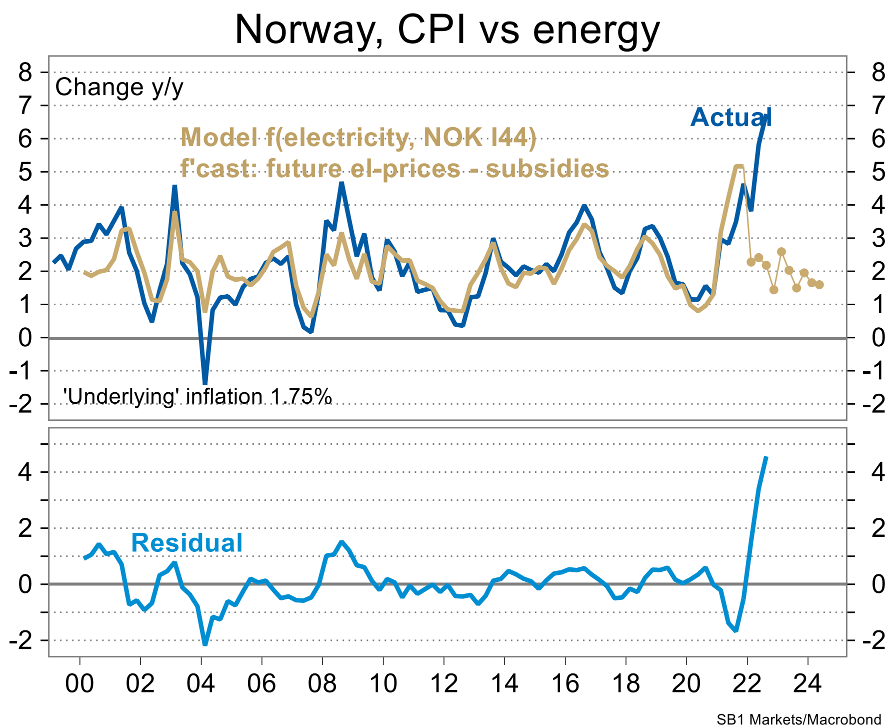
This real core gained 0.7% m/m

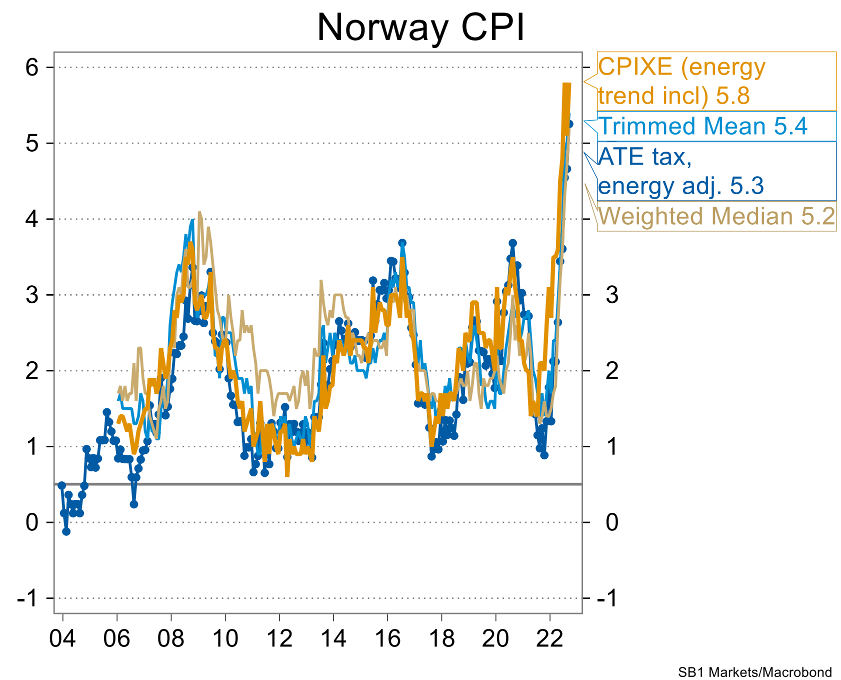




All measures of inflation suggest a broadening, to a 4% – 6% level

… and inflation is far higher than suggested by electricity prices & NOK

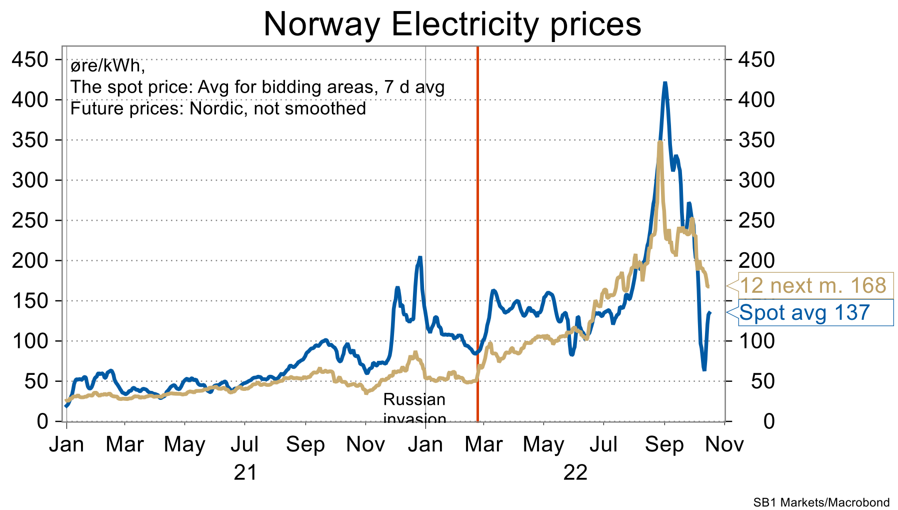


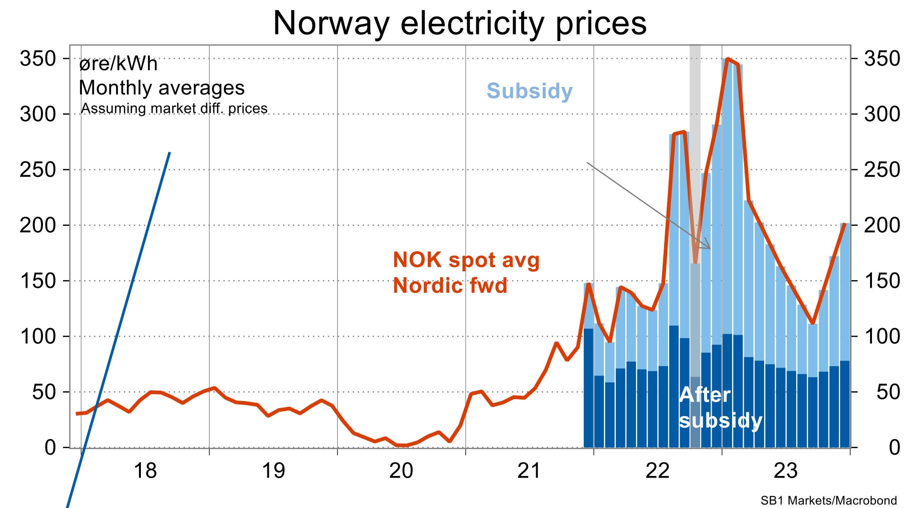


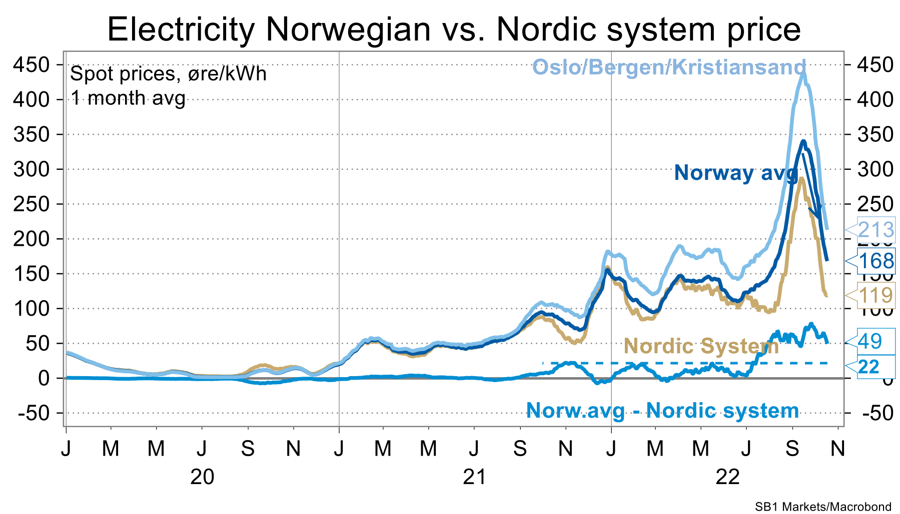
SpareBank 1 MARKETS

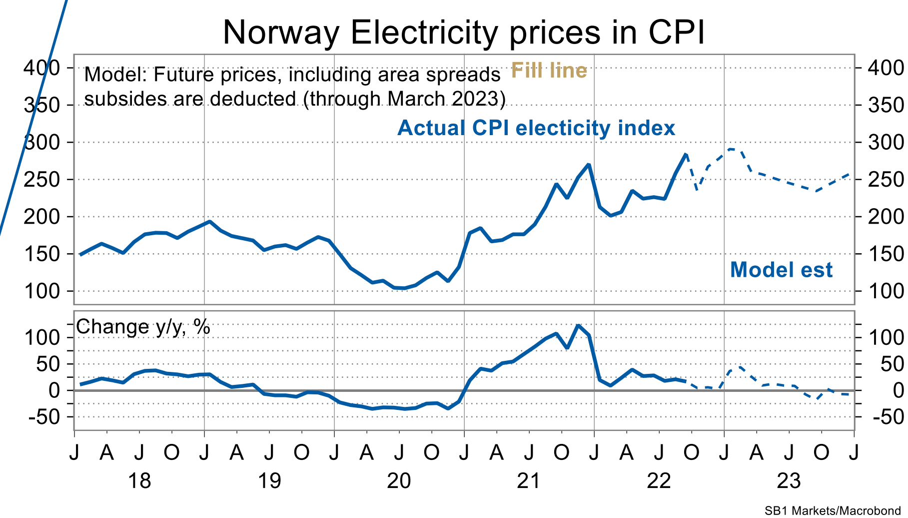
Electricity future prices sharply down but still very high!

The Q4-22 future price still up 5x since before the war started!



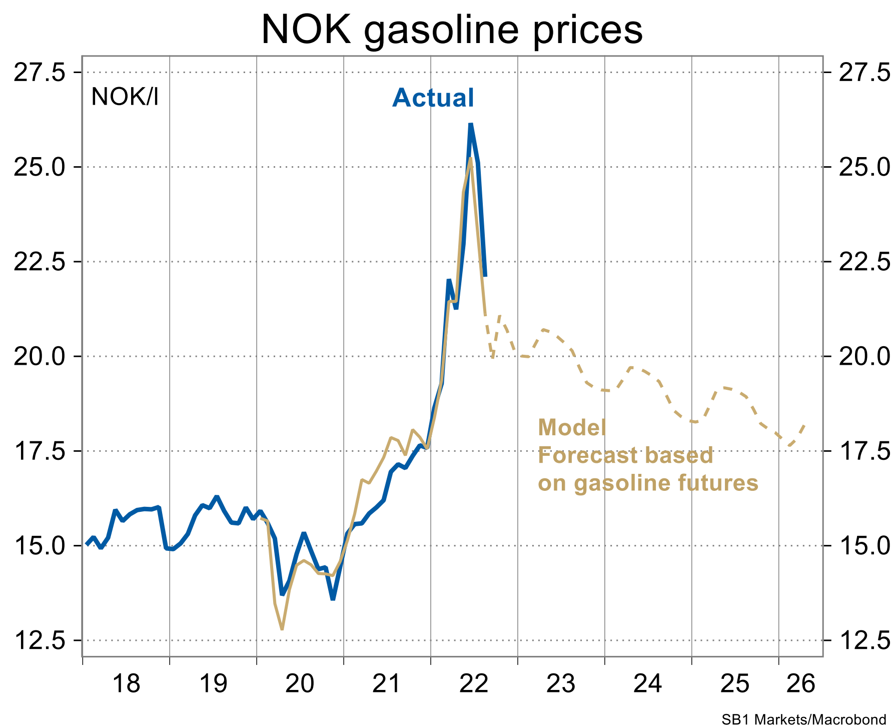


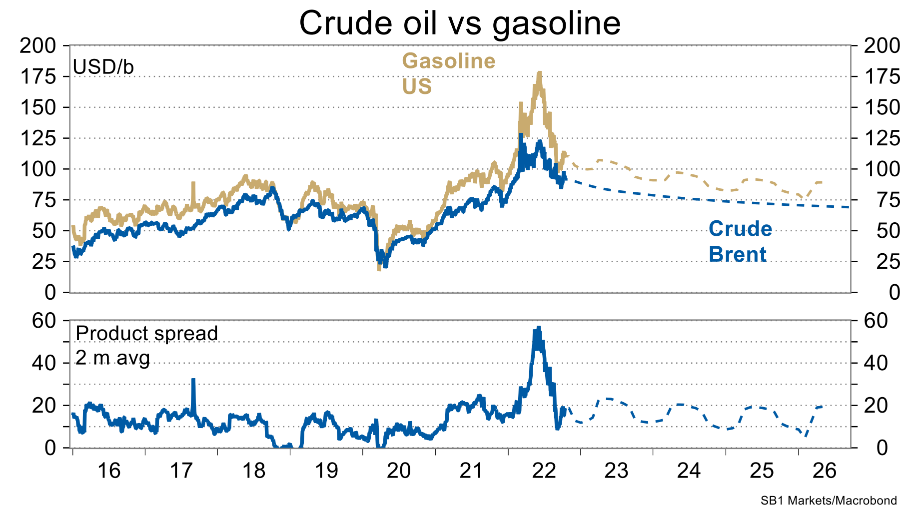


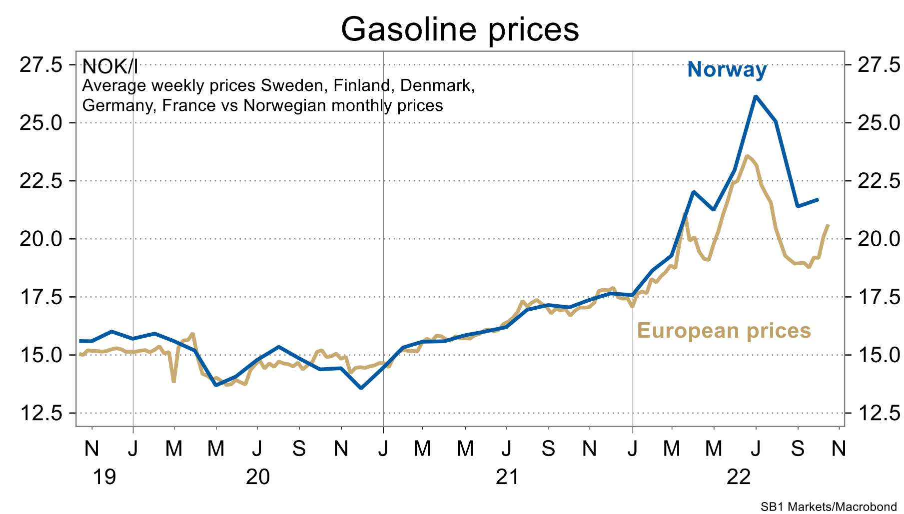


Gasoline prices have come down from the peak, but turned up from mid Sept

The oil price is down from the peak, and gasoline margins have collapsed, to a normal level



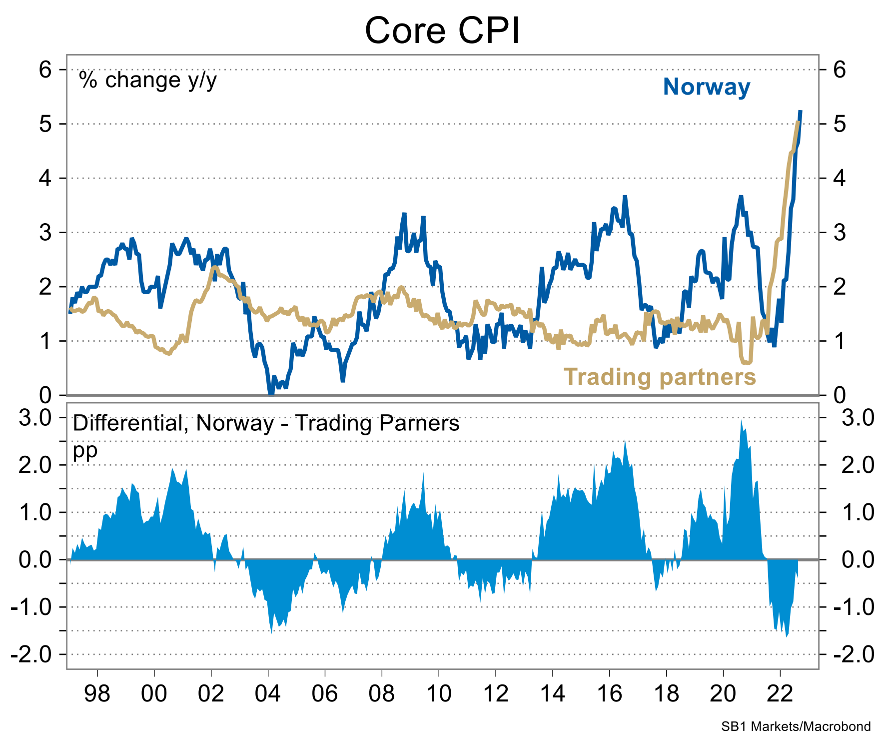


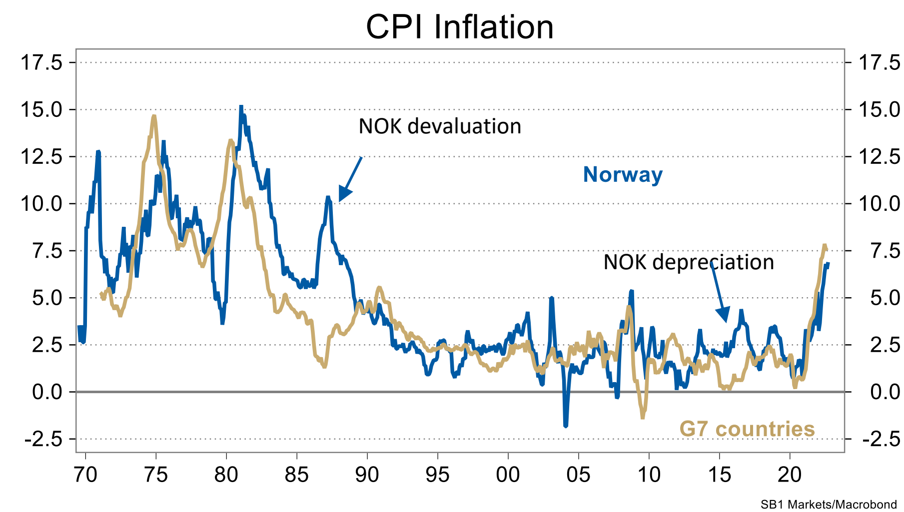


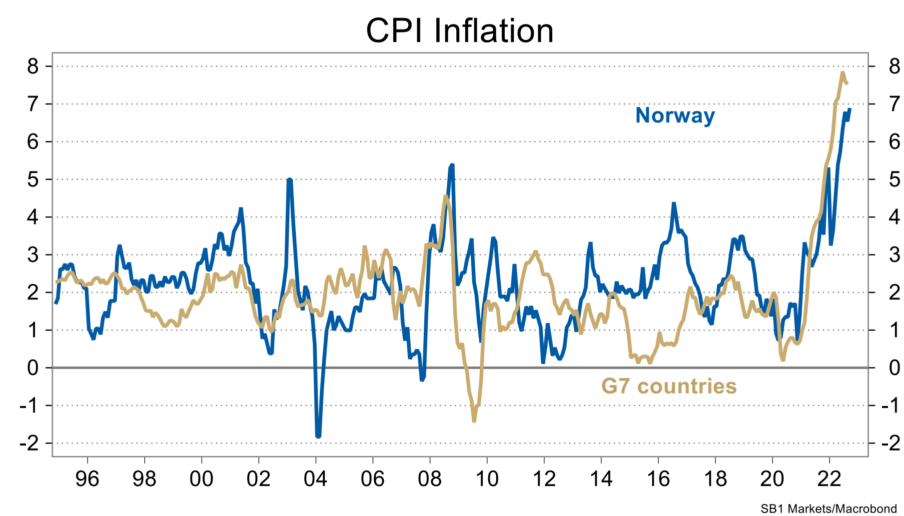
- Refinery/product margins widened sharply in February, but has fallen back to normal level since the peak in early June. In the US as well as in Europe, gasoline prices fell until mid Sept (US and European, as well as Norwegian prices are closely correlated – even in US prices of course is lower than European prices), but have since increased slightly

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

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







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

SpareBank 1 MARKETS

Domestic inflation still very high, and rather broad

Electricity prices rose far more than we expected

		Change m/m, seas. adj			Change y/y			Contribution, pp		
Sep-22	Weight	Out-	SB1M	Dev.	Prev.	Out-	SB1M			Dev. vs
CPI ATE, seas adj.	%	come	f'cast	pp	month	come	f'cast	m/m	y/y	f'cast
Food, non alc bev	12.9	0.9	0.1	0.8	10.3	12.1	10.9	0.12	1.56	0.11
Alcohol, tobacco	4.2	1.3	0.3	1.0	6.0	7.2	5.9	0.05	0.30	0.04
Clothing, footwear	5.1	1.8	0.2	1.6	-1.9	0.6	-1.0	0.09	0.03	0.08
Housing x. energy	20.2	0.3	0.3	0.1	2.2	2.4	2.2	0.07	0.48	0.02
Furnishing	6.9	0.7	0.2	0.5	8.6	7.6	6.7	0.05	0.52	0.04
Health	3.4	0.3	0.2	0.1	2.7	2.8	2.6	0.01	0.09	0.00
Transp. ex. gas, airl. tick	12.2	0.9	0.3	0.6	4.1	4.7	3.8	0.11	0.57	0.07
Airline tickets	0.8	-1.4	-2.0	0.6	28.7	34.8	33.2	-0.01	0.28	0.00
Communication	2.4	0.4	0.2	0.2	0.8	1.1	0.7	0.01	0.03	0.00
Recreation, culture	10.8	1.1	0.2	0.9	3.0	4.3	3.3	0.11	0.46	0.09
Education	0.5	-	-	-	2.0	2.3	3.8		0.01	-0.01
Restaurants, hotels	5.6	0.3	0.4	-0.1	8.6	8.0	8.0	0.01	0.45	-0.01
Other	8.7	0.2	0.3	-0.0	2.4	2.0	2.0	0.02	0.17	-0.00
CPI-ATE, s.a	93.7	**0.7**	**0.2**	0.5	**4.7**	**5.3**	**4.6**			0.44
Norges Bank est.			**0.6**		**4.7**		***5.0***			
Imported	36	0.6	0.2	0.5	4.7	5.2	4.5	0.23	1.89	0.18
Domestic	57	0.7	0.3	0.5	4.7	5.3	4.6	0.42	3.01	0.27
Energy, housing	4.4	10.9	-2.0	12.9	21.0	16.7	3.5	0.48	0.73	0.57
Energy, transport	2.0	1.5	-2.0	3.5	29.6	32.9	28.4	0.03	0.64	0.07
CPI Total	100	**0.7**	**0.1**	0.6	**6.5**	**6.9**	**5.8**	0.73	6.89	0.64
Norges Bank est.			**0.2**		**6.5**		***6.0***			

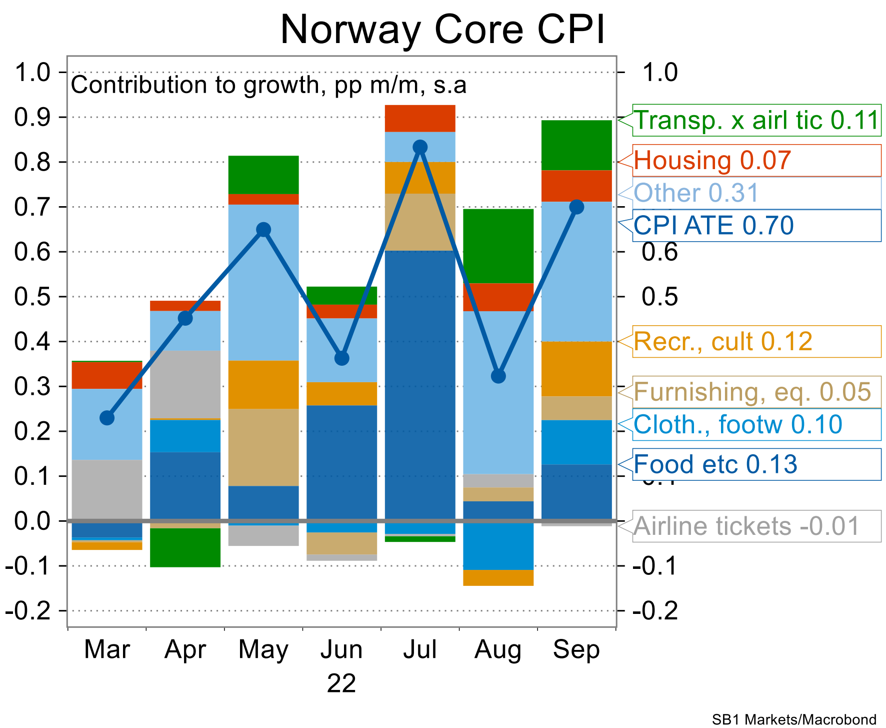
Change m/m, seasonally adjusted (calc by SB1M)
Sum of parts does not necessarily add up to totals

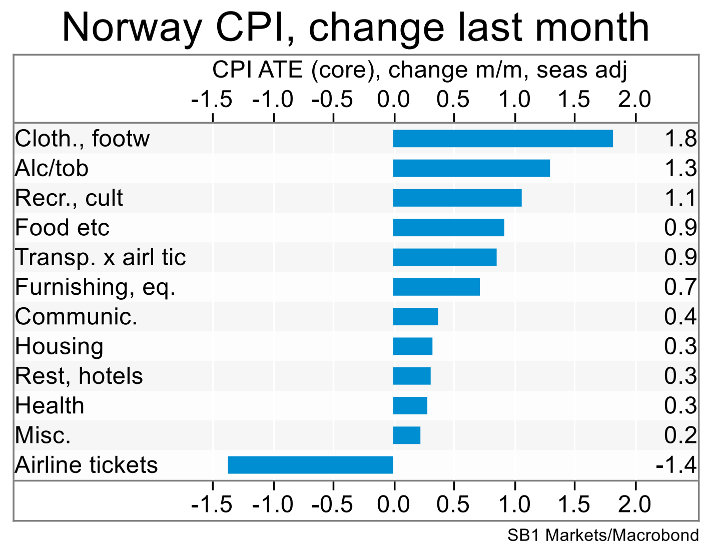
- **Food, non-alc bev.** prices rose 0.9% (ex taxes, seas. adj), we expected a 0.1% increase. The annual growth increased 1.8 pp to 12.1%. The 'real' inflation is far lower
- **Clothing** prices rose 1.8% m/m, after having fallen for more or less since the pandemic. Clothing prices are now up 0.6% y/y. We expected a 0.2% m/m increase and -1% y/y
- **Furniture/hardware/equipm** prices once more surprised on the upside, +0.7% m/m, and 7.6% y/y
- **Transport ex. gas & airfare tickets** rose 0.9%, up 4.7% y/y, surprisingly low given global auto prices
- **Airline tickets** prices were down by 1.4% m/m but are up 35% y/y, from a very low level last year
- **Recreation** prices were up 1.1%, and 4.3 y/y
- **Restaurant/hotel prices** up 0.3% m/m, 8.0% y/y, and way above a 2% path (starting in 2019)
- **CPI-ATE** up 0.7% m/m, 5.3% y/y, 0.7 pp above our forecast and 0.4 pp above consensus, and 0.3 pp above NoBa's 'cast
- Prices on **imported goods** rose 0.6%, and are up 5.2% y/y – a substantial contribution to total (1.9 pp)
- Prices on **domestically produced** goods & services were up 0.7%. The annual rate at 5.3% is remarkably high
- **Electricity (and other heating)** prices increased by 11%. We expected a fall of 2%
- Gasoline/diesel prices rose 1.5% m/m, while we expected a fall of 2%
- … **headline inflation rose to 6.9%, 1.1 pp above our f'cast, and 0.9 pp above Norges Bank's estimate**

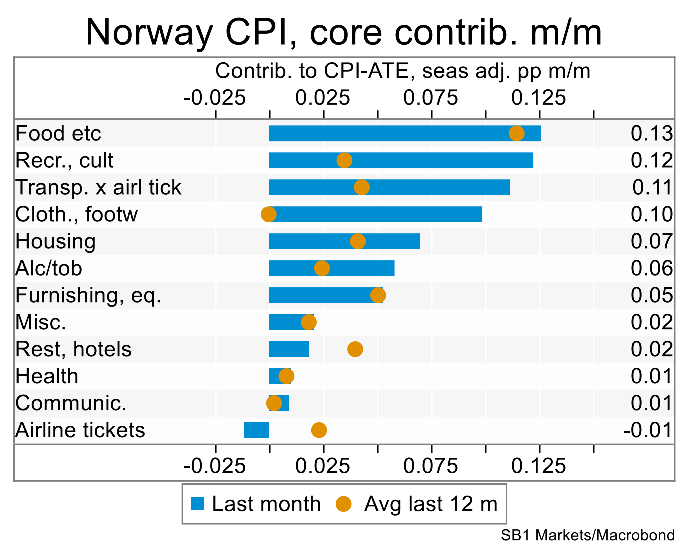
Monthly changes are seasonally adjusted by SB1 Markets. The weighted sum of the components does not necessarily sum exactly up to the total, and deviations m/m and y/y do not necessarily add up. Norges Bank m/m s.a. estimate is implied, calculated by us. Sources: SSB, Norges Bank, SB1 Markets calculations

Everything, barring airline ticket prices, contributed on the upside

Food, recreation, transportation and clothing all contributed 0.1+ pp each to the core

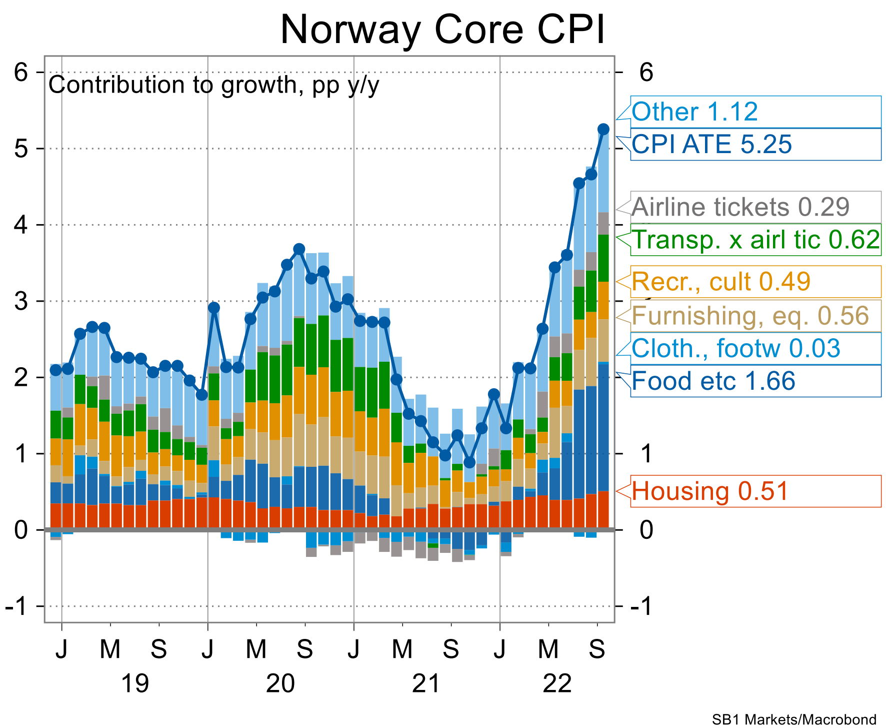


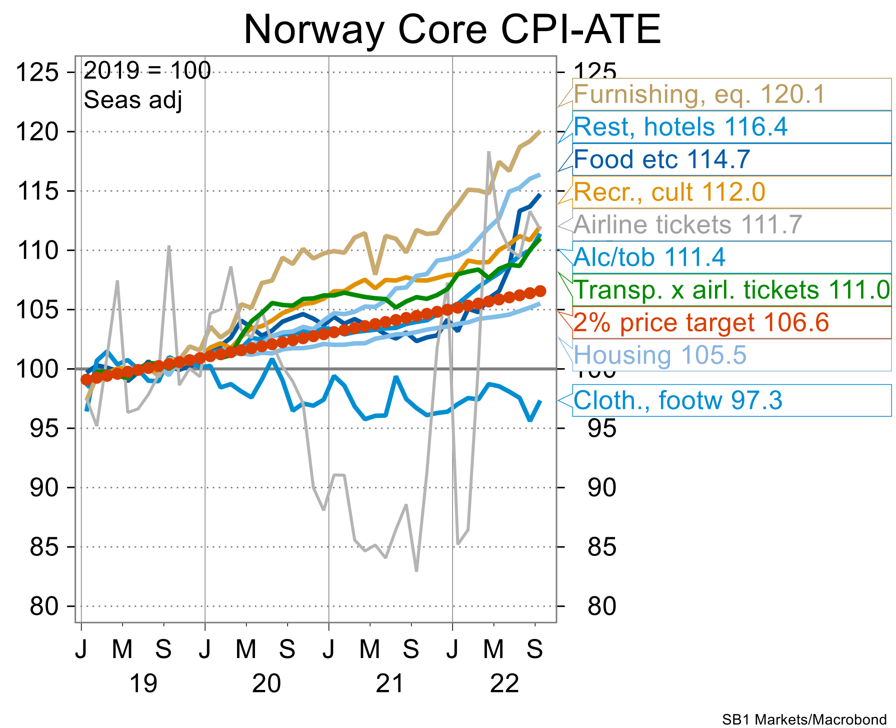




Faster/broader price growth recent months

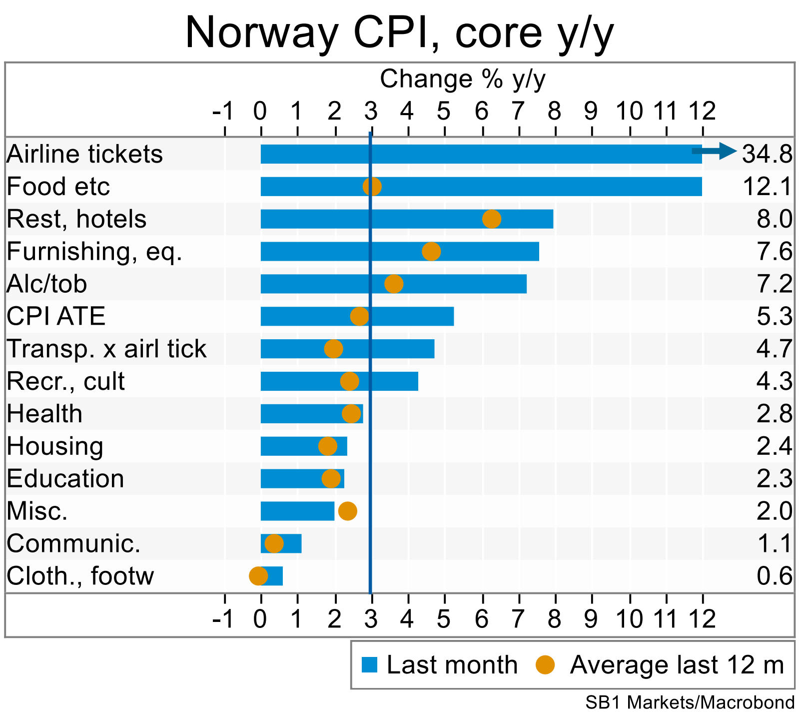
Just clothing/footwear, and housing ex energy below the 2% path since 2019

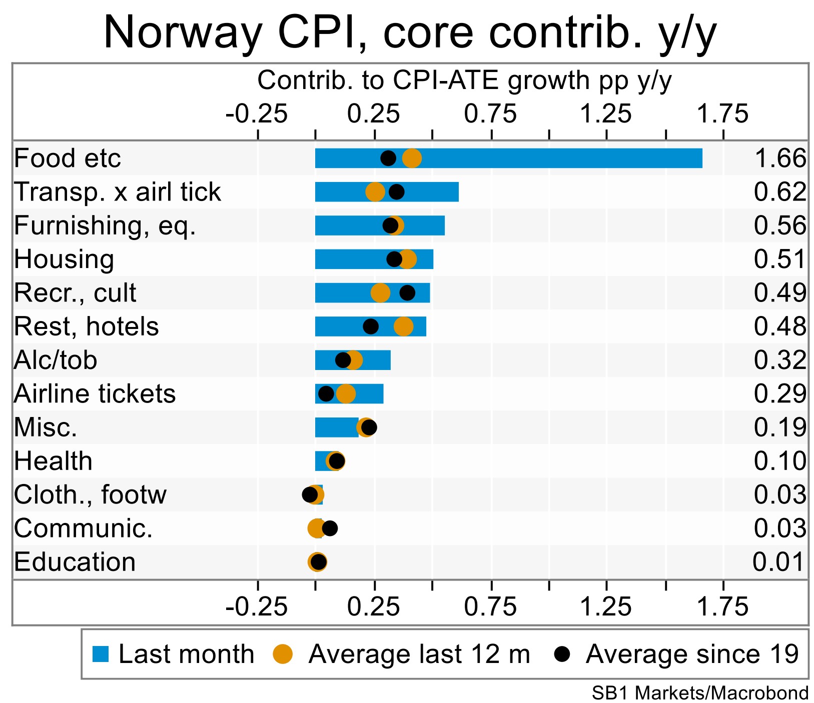




10 sectors report core inflation above 2.0%, just 2 are below

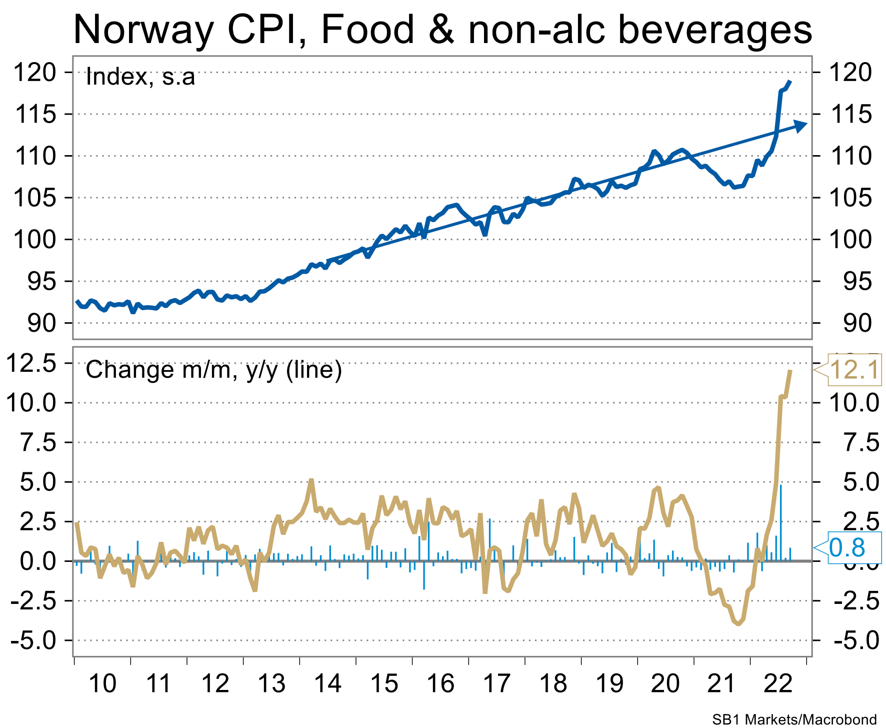
Food, furnishings, housing, and transportation have contributed the most y/y

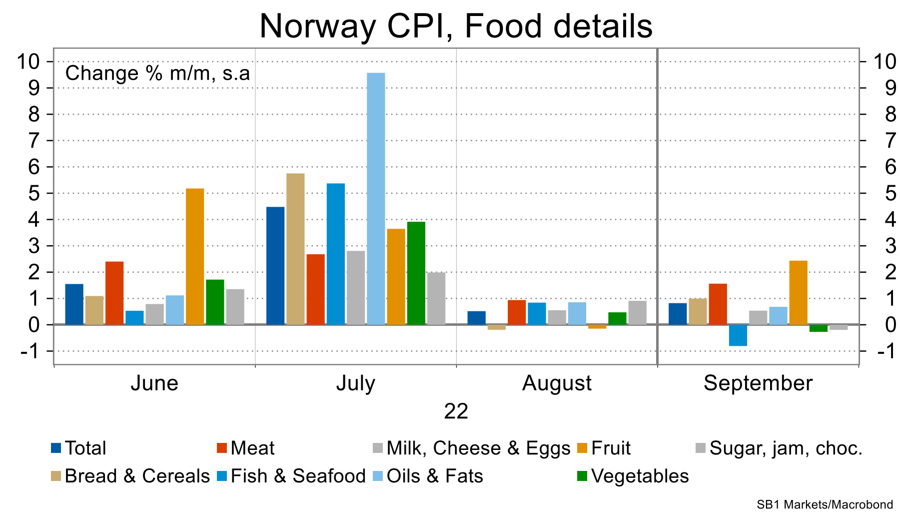




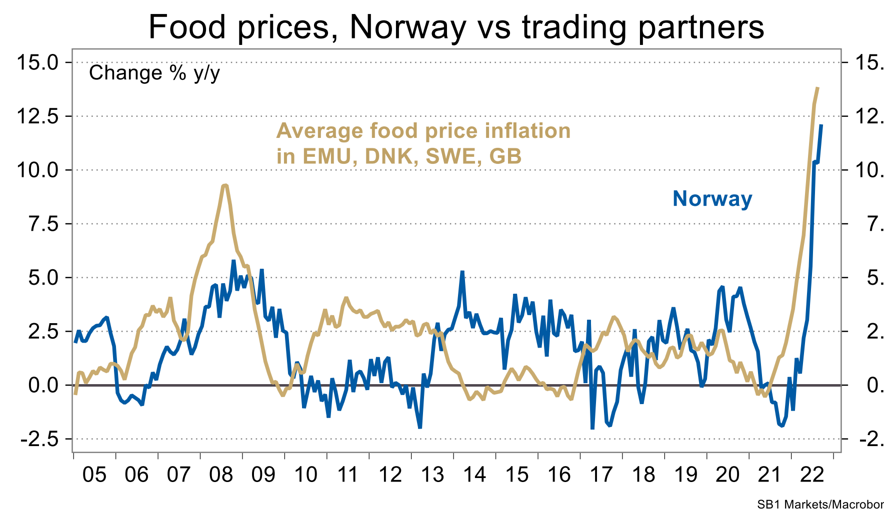
Food prices are up 12% y/y but just some 4% above 'trend'. Prices were low in '22

The 'real' food inflation, from a 'normal' price level last year would have been 'just' 7%



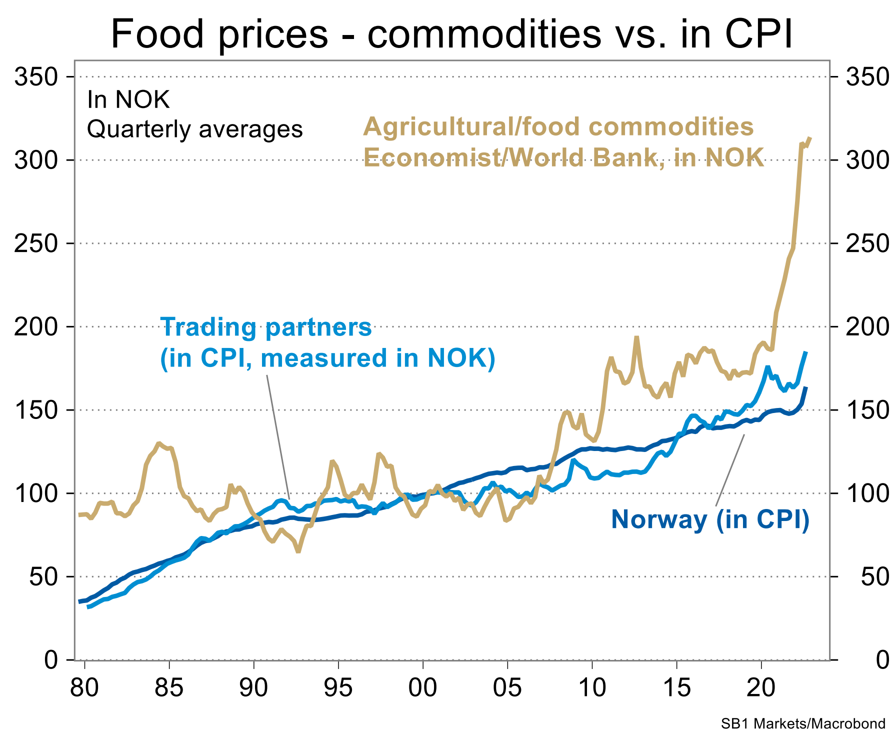


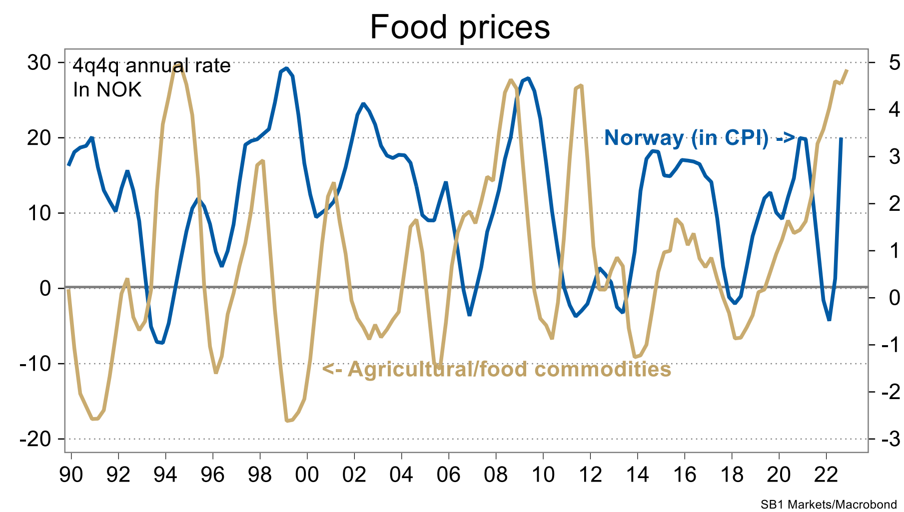
- Prices up 0.9% m/m and 12% y/y. Fruit & meat up the most in Sept, but also bread. Fish prices fell
- Norwegian food prices are now up in line with prices abroad – which is not the norm at all in the highly regulated Norwegian agricultural/food market. The good news now: Food prices (commodities) are trending down globally!

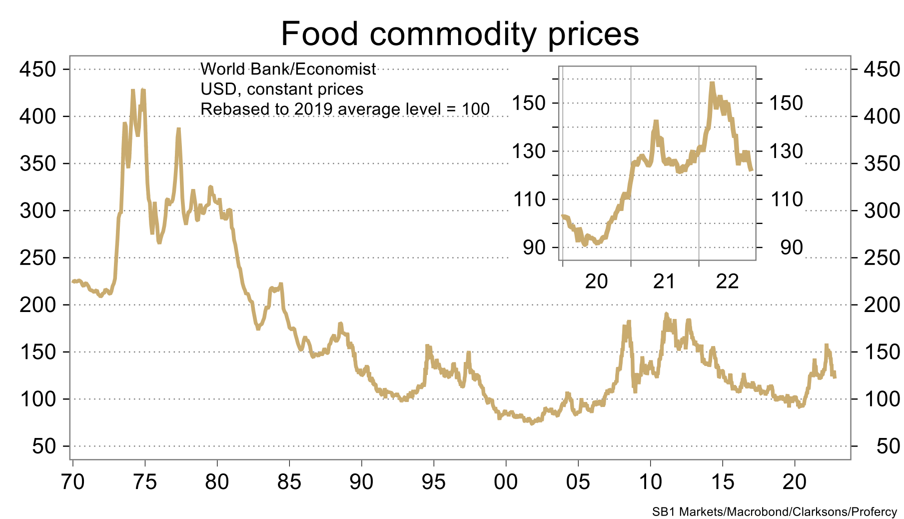


Food commodity prices: Limited correlation to trading partners' food prices

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



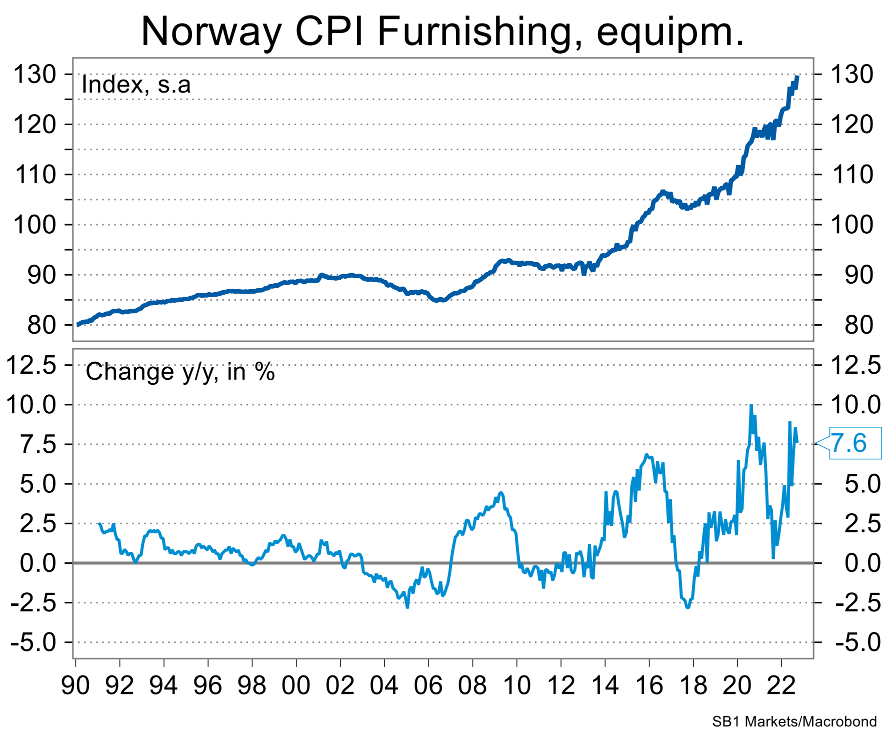


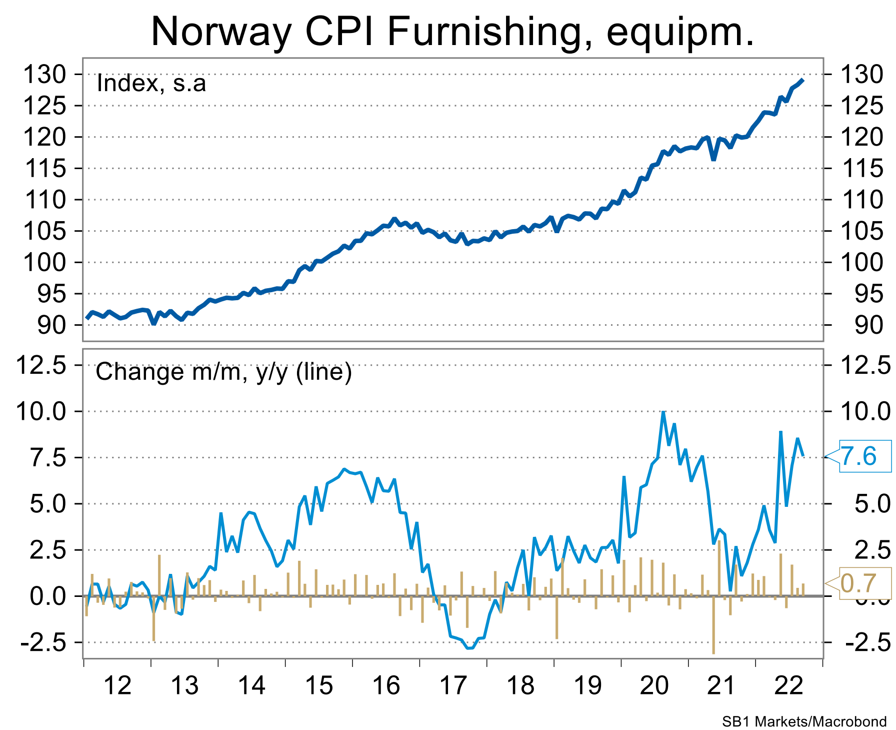


- Agricultural/food commodity prices are sharply up from mid 2020, but have fallen sharply since March, and are now 23% down from the peak. In real terms, prices are far from record high

Furnishing etc. prices up 0.7% in September – and by 7.6% y/y

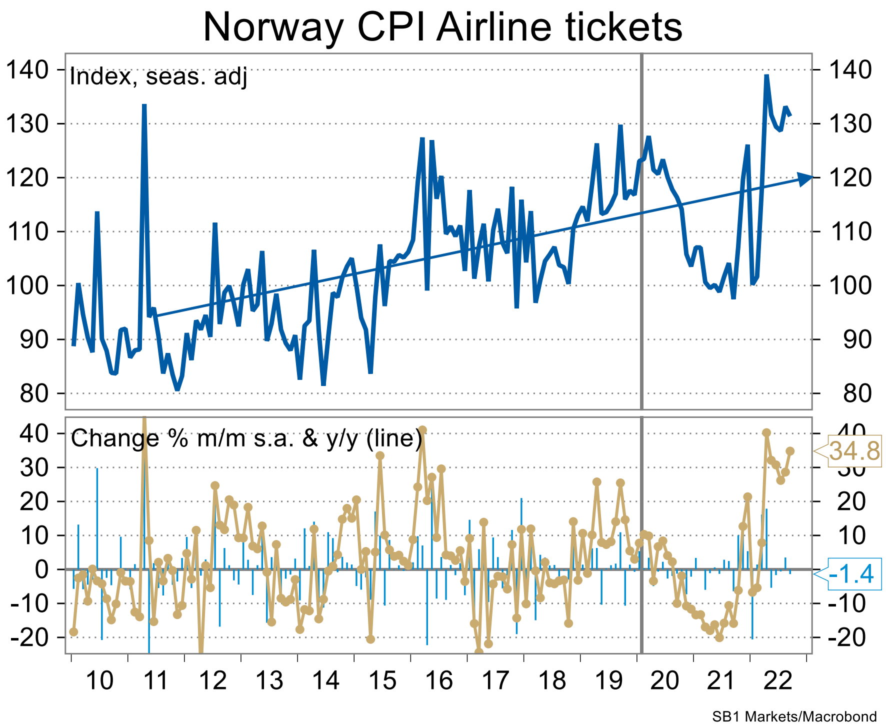
Furniture up 12%, but household appliances just 3%



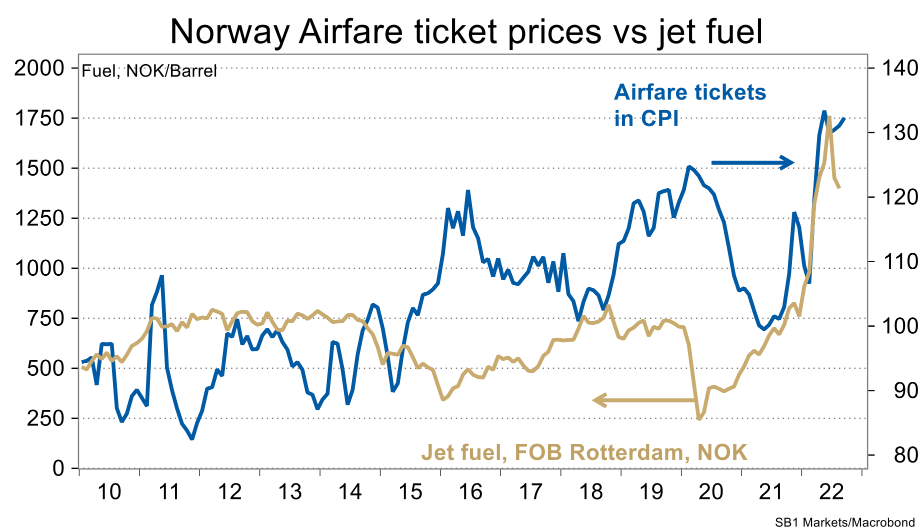


Airfare ticket prices down 1.4% m/m in September

Prices are still clearly above a long term trend (2 ¼ % per year) - and should be given the fuel cost

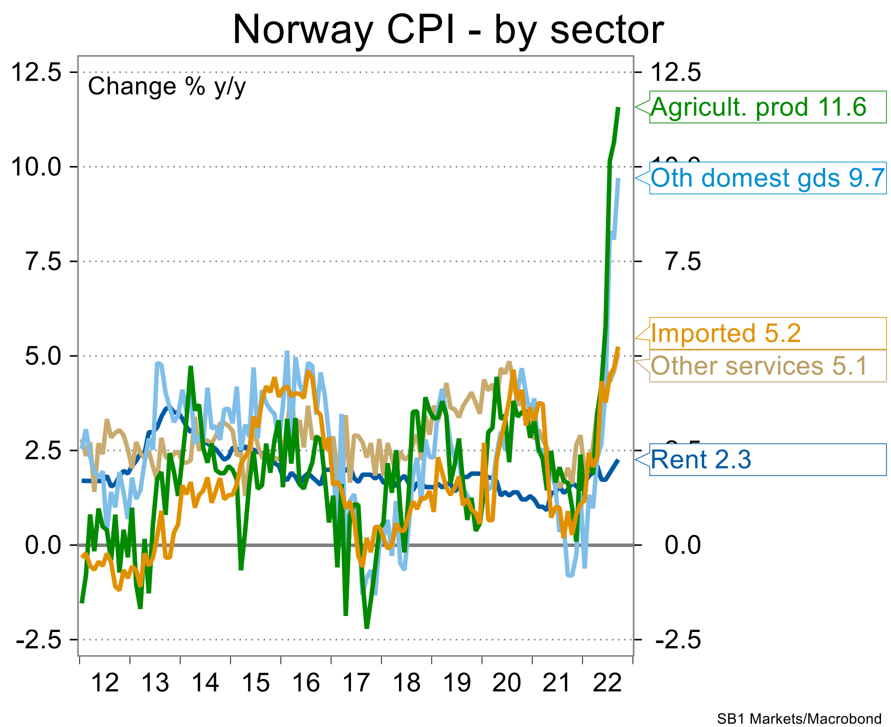


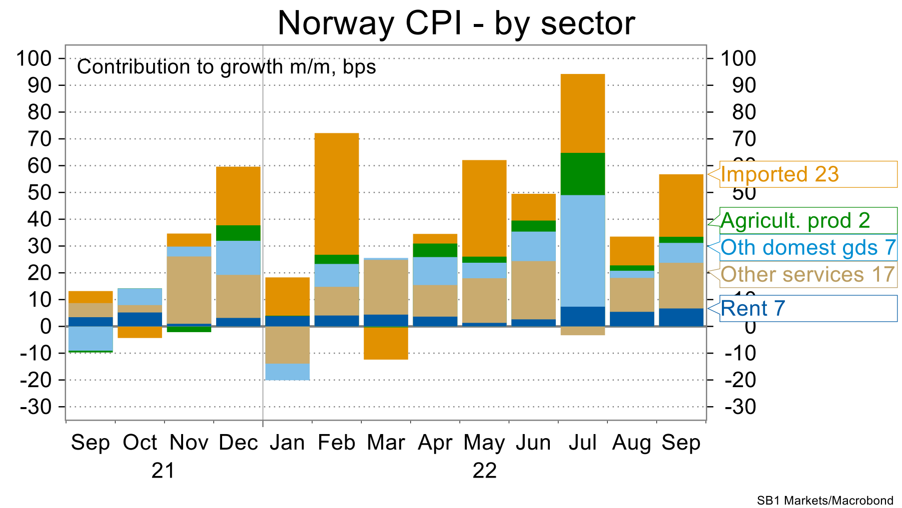
- **Airfare ticket prices** were down 1.4% m/m in September, after rising 3.5% in August. We expected a 2% fall. Prices are up 35% y/y, from a low level last year, during the pandemic – but anyway contributing 0.29 pp to the 5.3% y/y lift in core CPI
- **Prices** are less than 10% above the pre-corona trend path – which could at least partly be explained by the increase in the fuel cost
- However, there is no historical correlation between ticket prices and the **fuel cost**, check the chart below (and fuel prices have fallen 20% since June but may now turn up again)

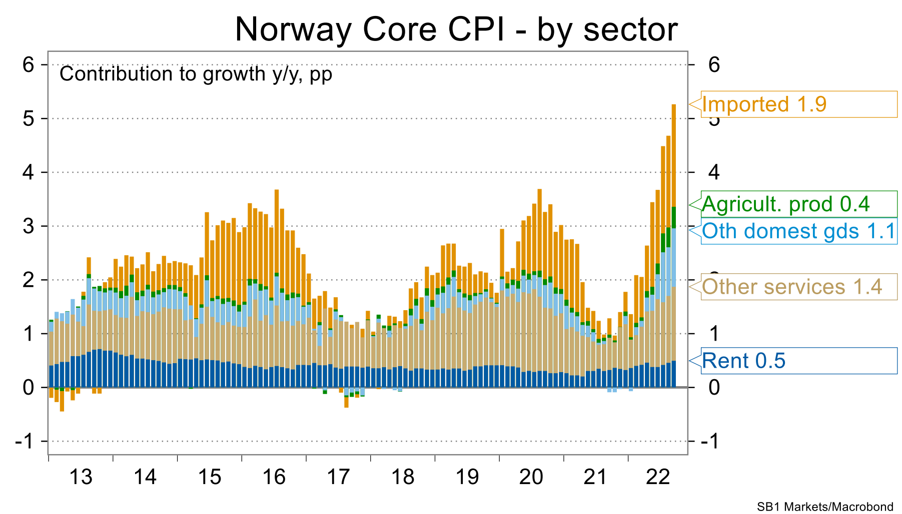


Services and imported goods contributed on the upside in September

Rents have also increased and are now up 2.3% y/y



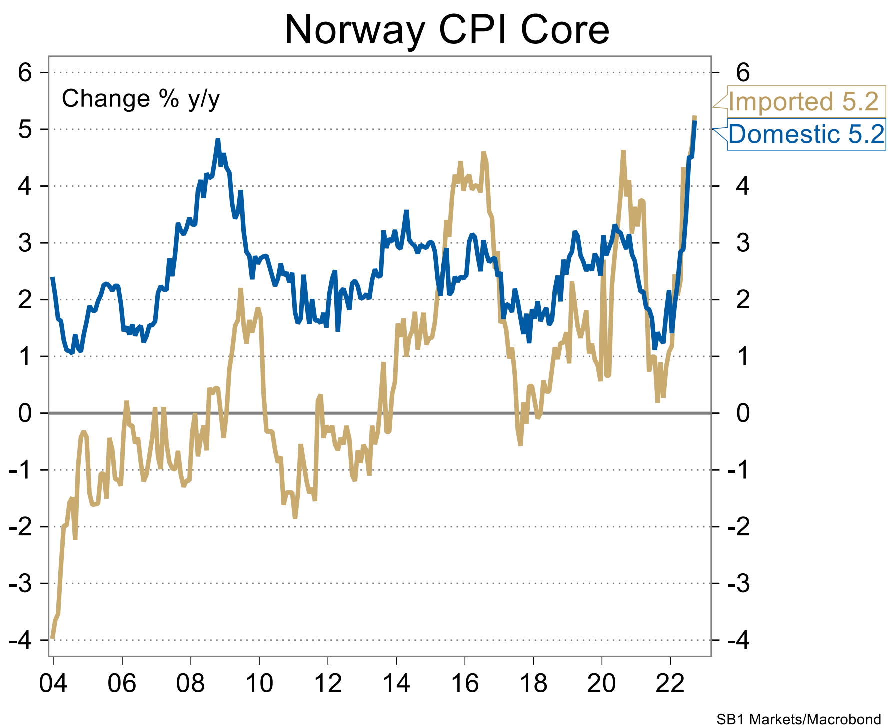


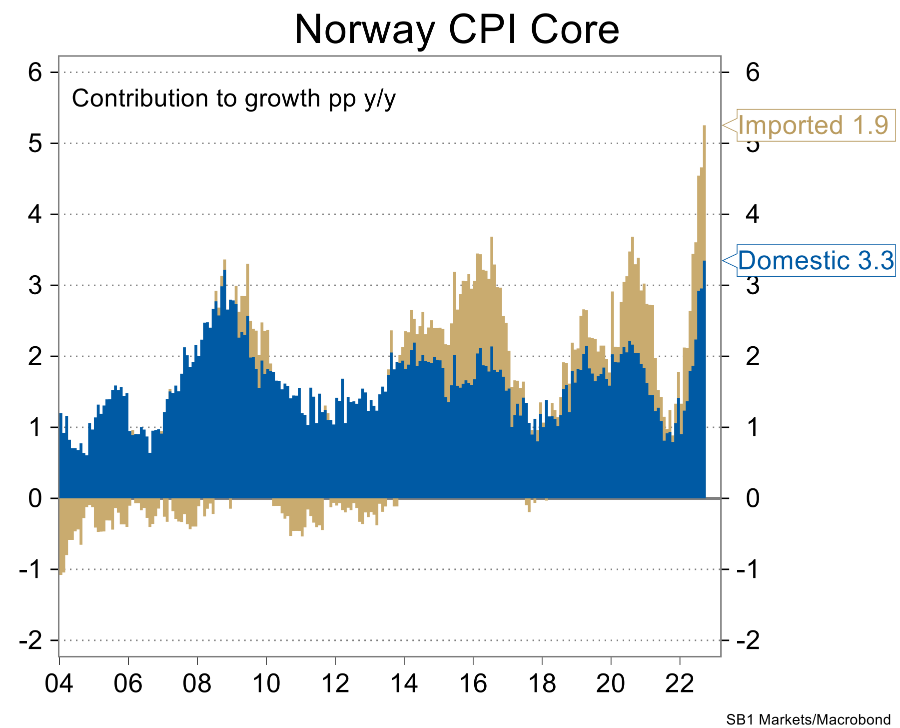


- **Domestic services inflation ex rents** slowed sharply during the corona crisis, and is now climbing faster, up 5.1% y/y, contributing 1.4% to core inflation, with substantial contributions from airline tickets (0.28 pp to total CPI) and hotels/restaurants (0.45 pp) – but also much more
- **Domestically produced agricultural products** are up 11.6% y/y, new ATH, contributing 0.4 pp to the overall core rate
- **Other goods** than agricultural & imported products are up 9.7% y/y, and contributed by a 0.4 pp contribution to the core inflation rate, by far the highest ever
- **Rent inflation** has also increased and is up 2.3% y/y

Both imported goods and domestically produced goods & services up 5.2% y/y

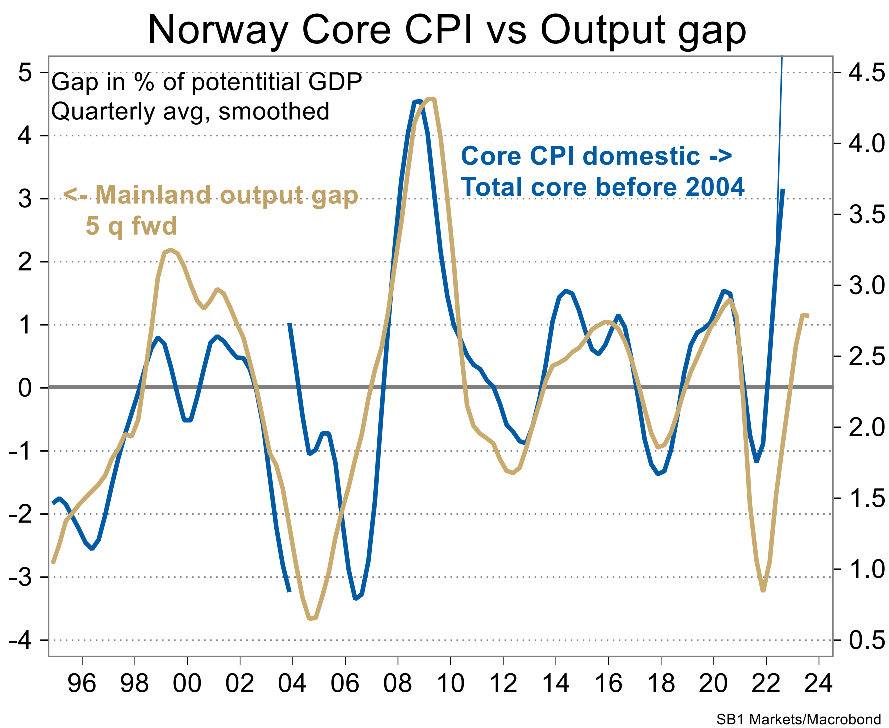
... while the largest contribution to total (core) inflation is from the domestic component

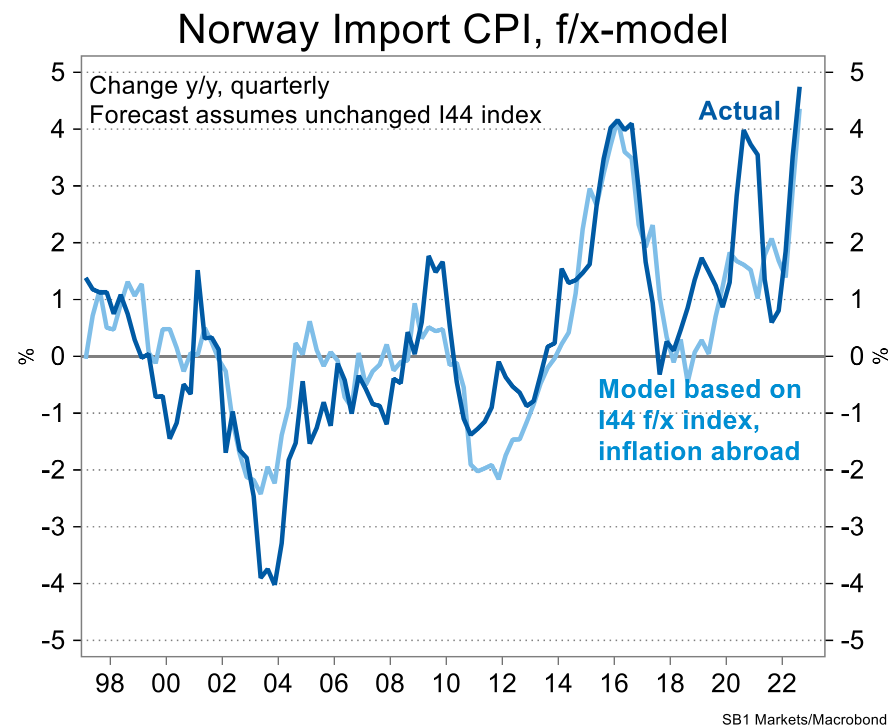




Domestic inflation up due to a strong domestic economy? At least partly

... but the lift has arrived earlier than normal. ‘Imported’ inflation close to the model estimate

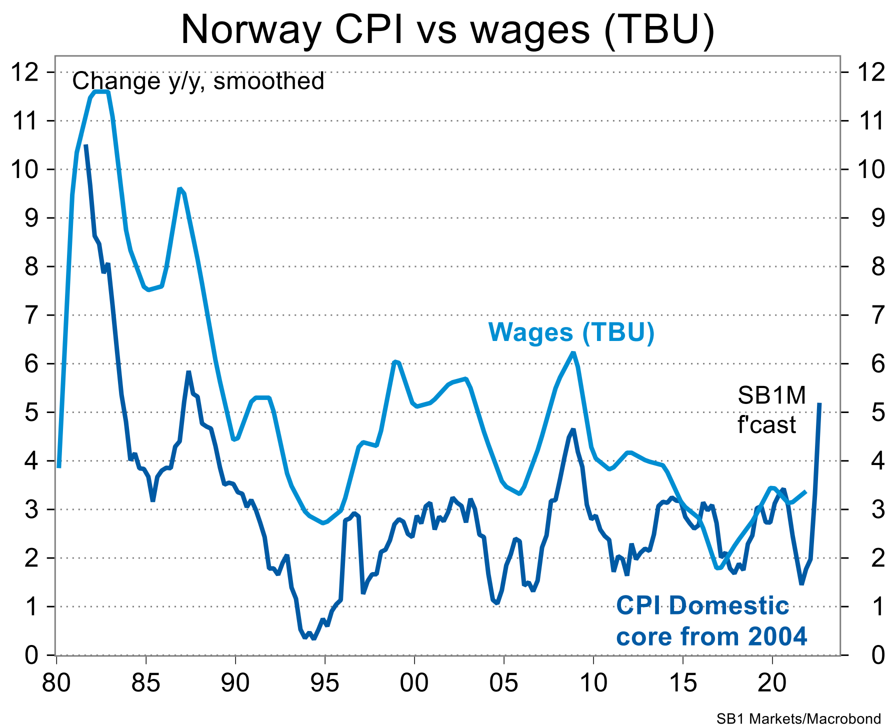


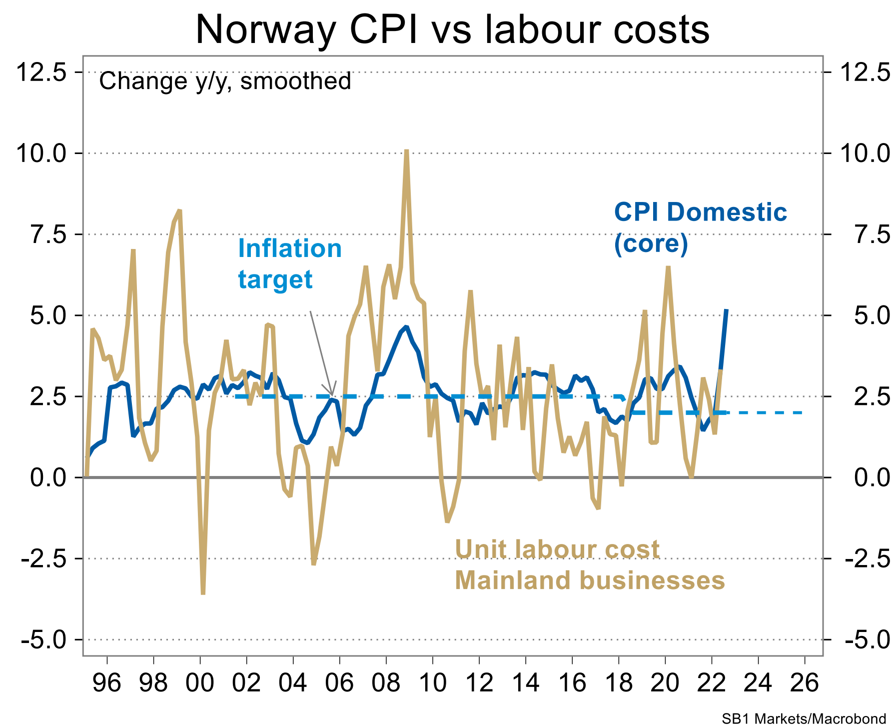


- **Labour market data and surveys** indicate that the output gap is higher than the mechanic calculation on the chart above

Domestic costs: Weak productivity growth is lifting unit labour costs

Wage inflation has not accelerated (we thought it would)

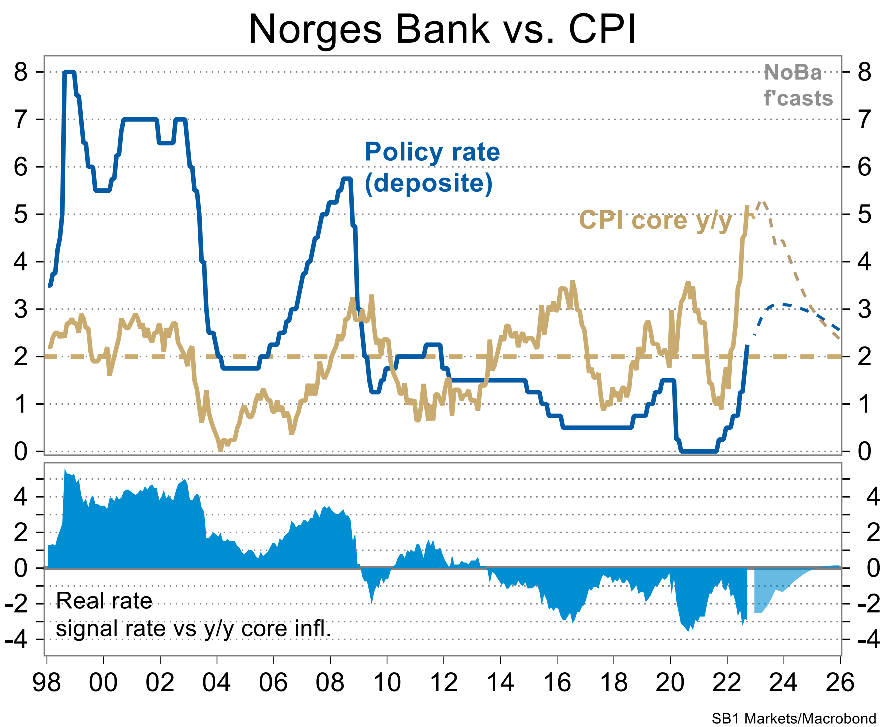


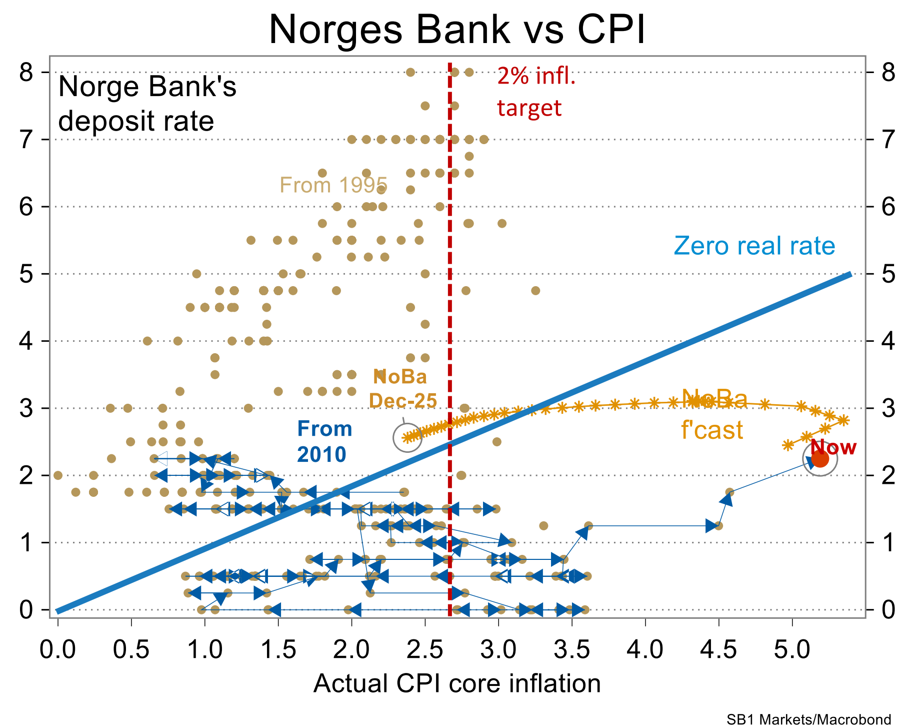


- Unit Labour Cost is us some 3% y/y

Higher inflation is increasing the pressure on Norges Bank

The recent data, combined with higher that assumed growth, adds fuel to the +50 bps hike crowd

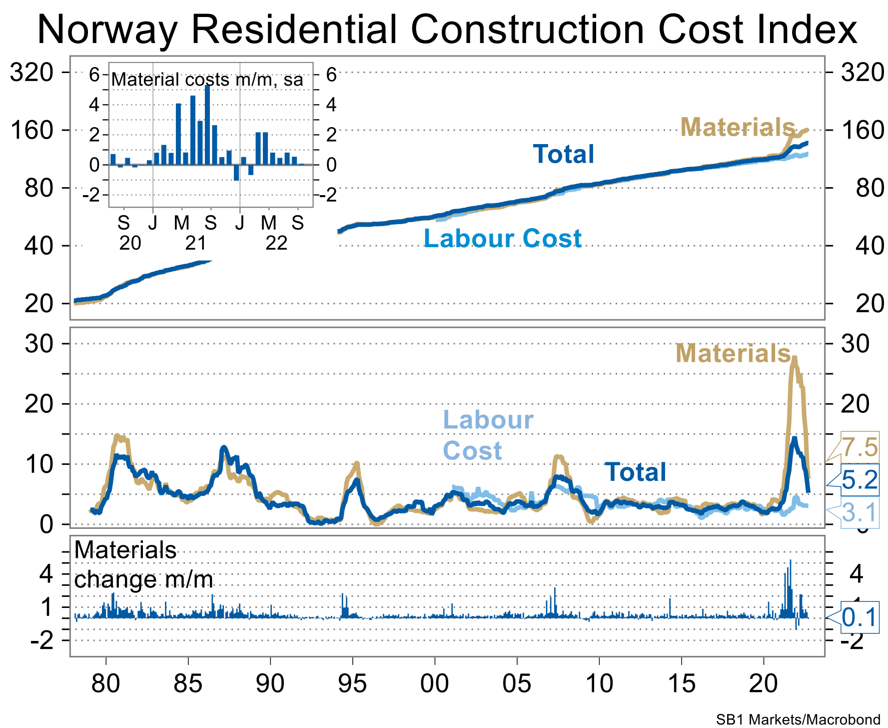


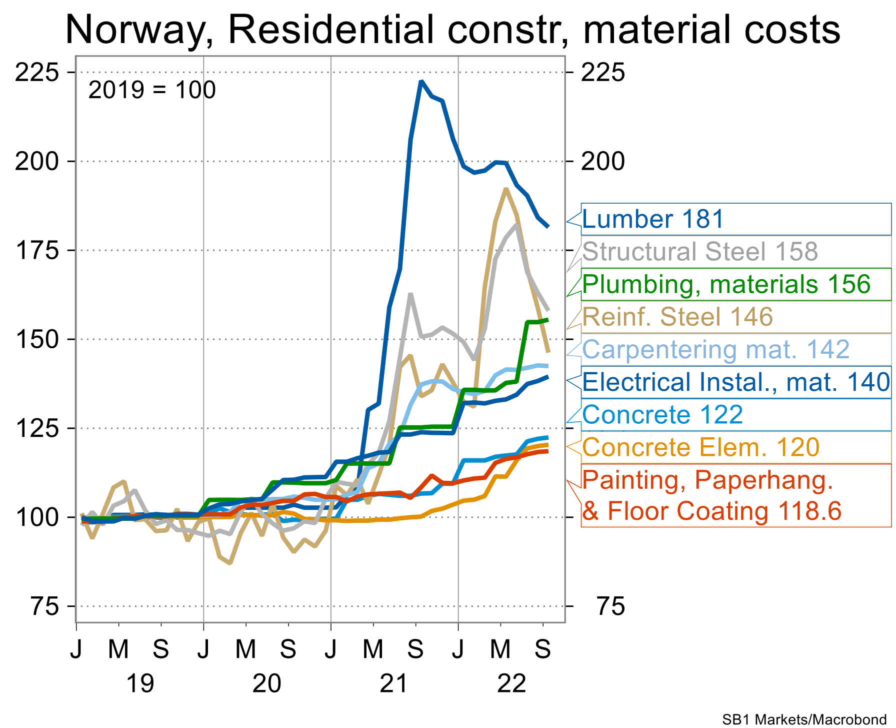


SpareBank 1 MARKETS

Building costs inflation is rapidly declining but the cost level is still high

Lumber and steel is down, but other materials are still drifting upwards



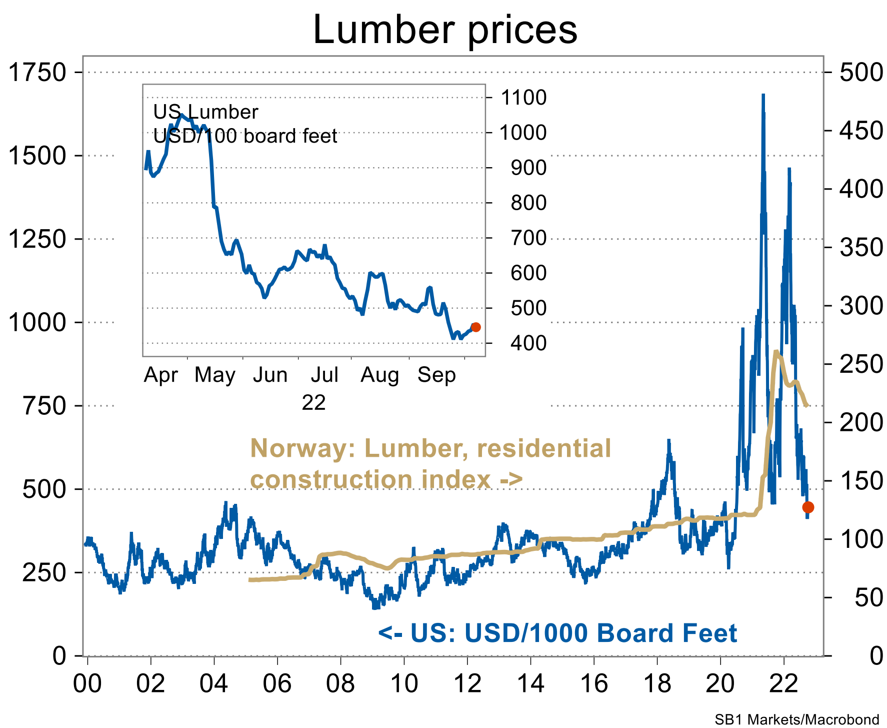


- **Material prices** (houses and apartments) added 0.1% in July, from 0.9% in June. Prices are up 7.5%, down from 10.3% y/y in August (and 28% at the peak). We expected a decline m/m.
  - » Lumber prices are trending down, and reports signal further declines the coming months. Steel prices fell further but the recent flattening/increase in steel prices globally, the potential for a decline from here may have diminished
  - » Other material prices are still trending up; Both plumbing materials, electrical equipment and concreate rose slightly in both August and September
- **Labour costs** were just up 3.1% y/y in Q23, unch from Q2, below the 4.5% gain in Q4 (which was the highest growth rate since 2009)
- Including labour costs, the **total building** cost index is up by 5.3%, down from the ATH at 14.6% at the peak last Oct. The price level is up 12% vs. the pre-pandemic 2.5% growth path. <u>Going forward, we still think lower material costs will bring total construction costs down to more normal levels.</u>

SpareBank 1 MARKETS

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

Steel prices have recovered somewhat recent weeks, perhaps on hopes for a Chinese recovery



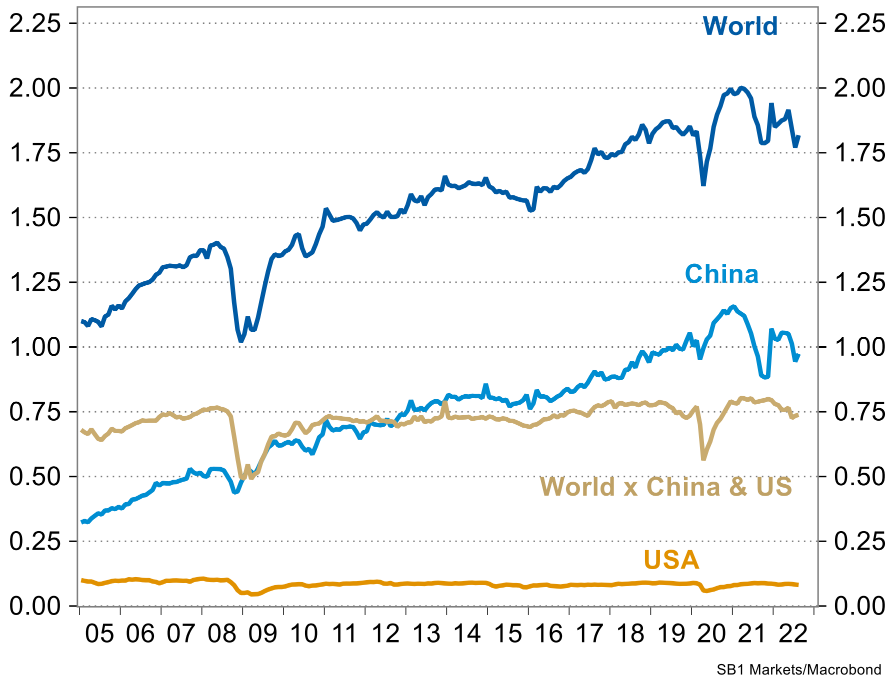
- ...or due to higher energy costs and production cuts in Europe

SpareBank 1 MARKETS

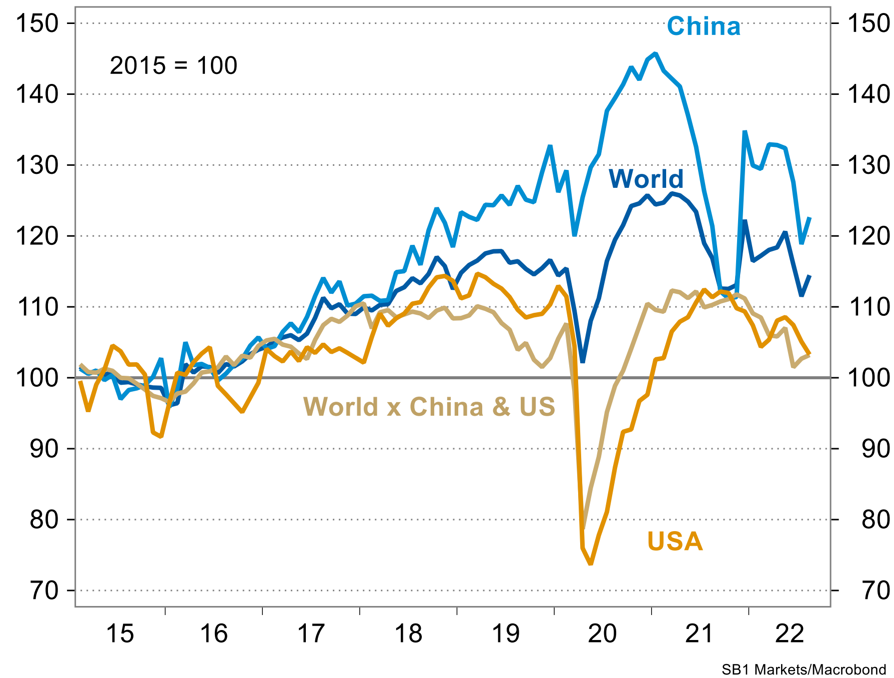
Steel production is heading down everywhere

Normally not a sign of a strong market balance & high prices

World Crude Steel Production

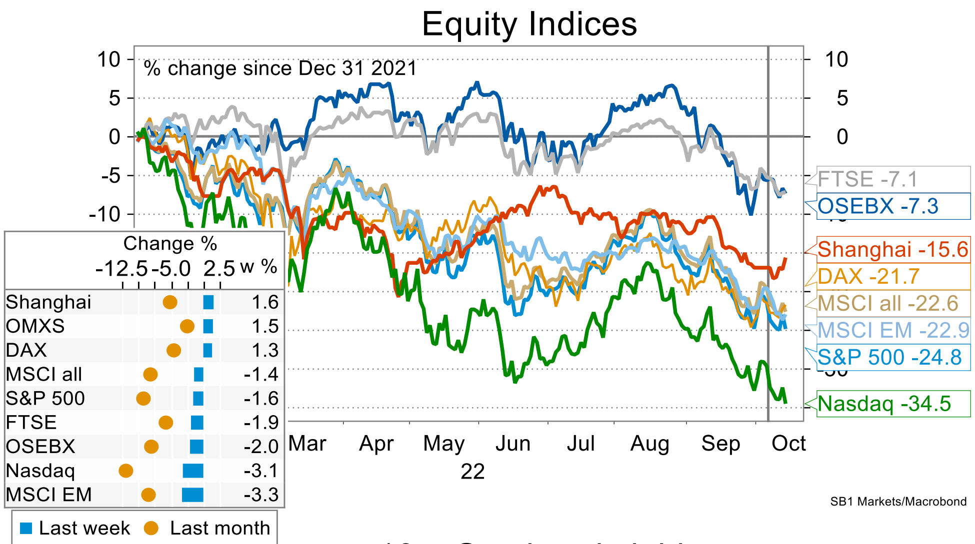


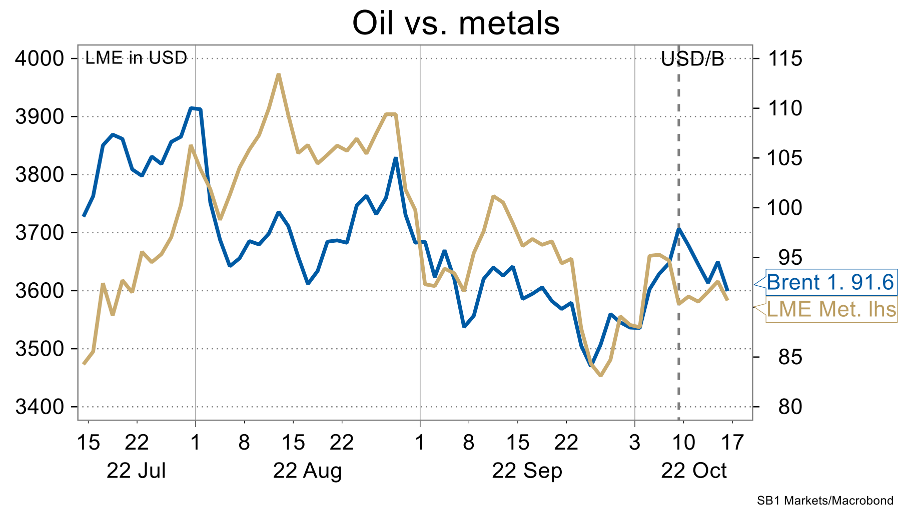
World Crude Steel Production

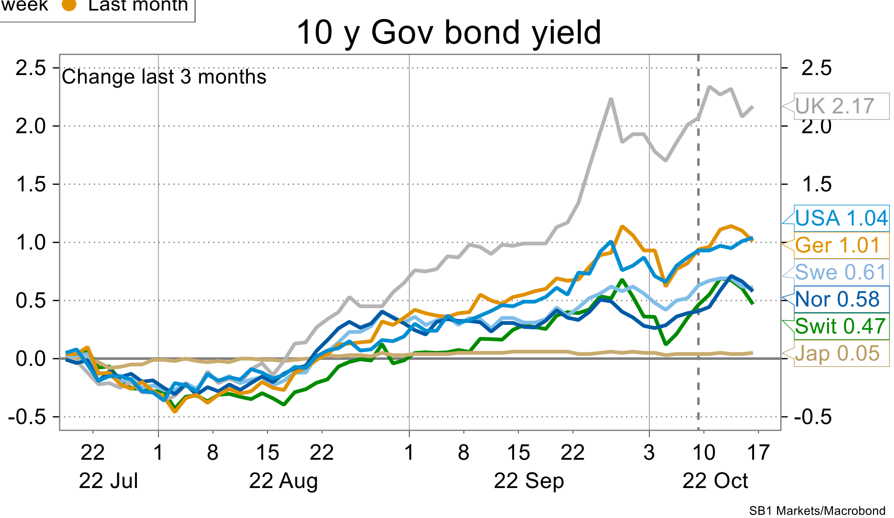


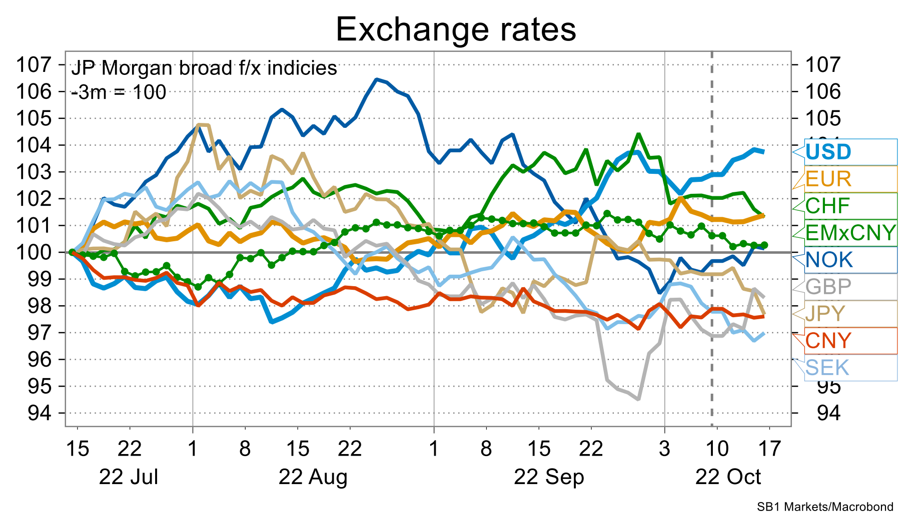
Equity markets are trending downwards, the oil price yielded, again

Bond yields rose further. UK gilts still volatile but not much up last week





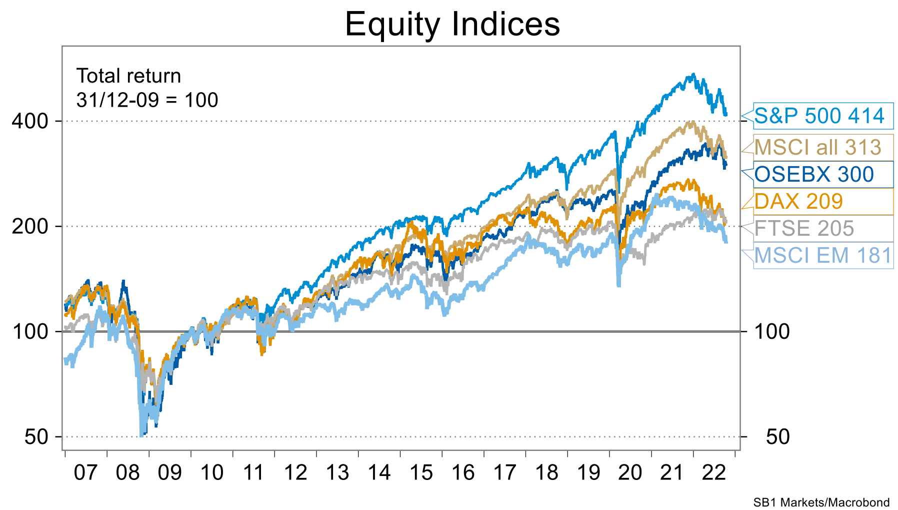


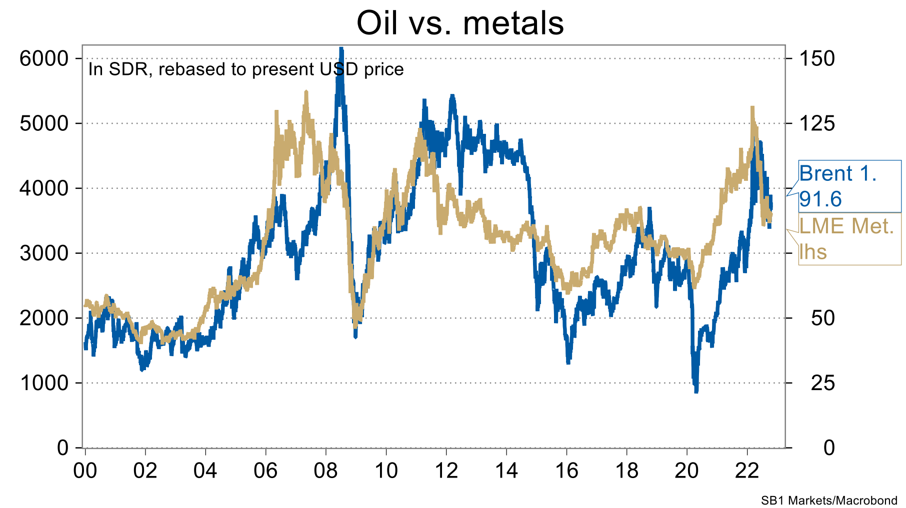


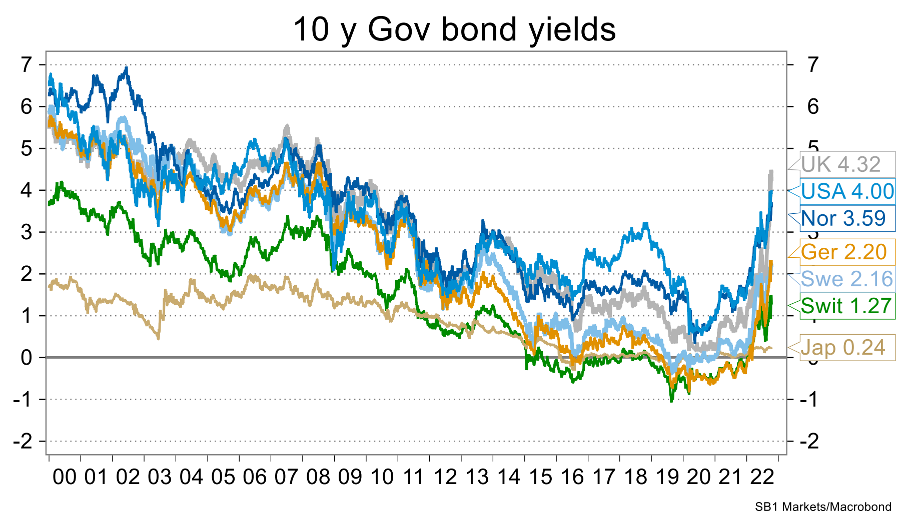
SpareBank 1 MARKETS

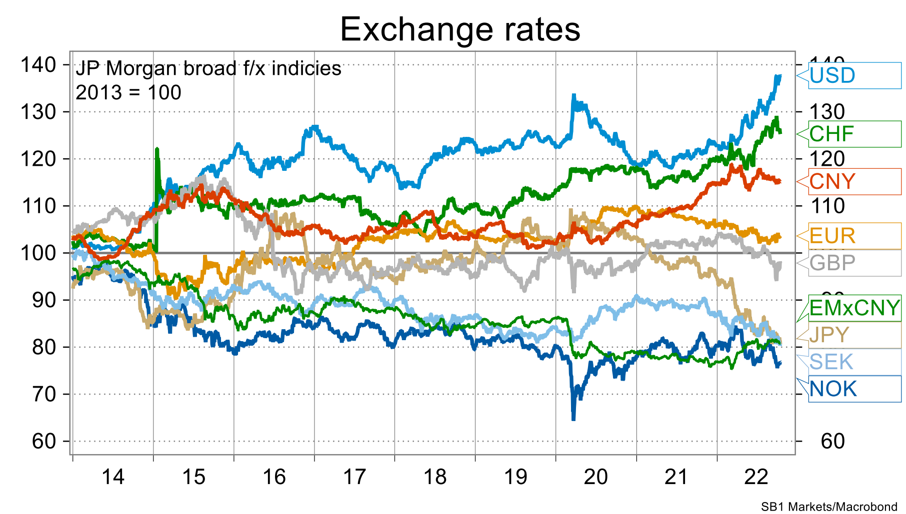
The big picture: Stock markets down, commodities down, bond yields up

The USD is very strong, most other DMs are slipping, NOK including

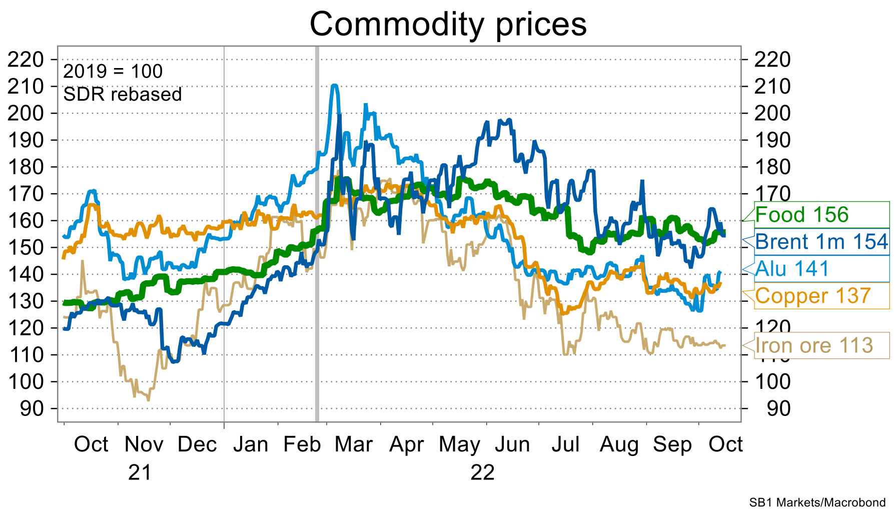


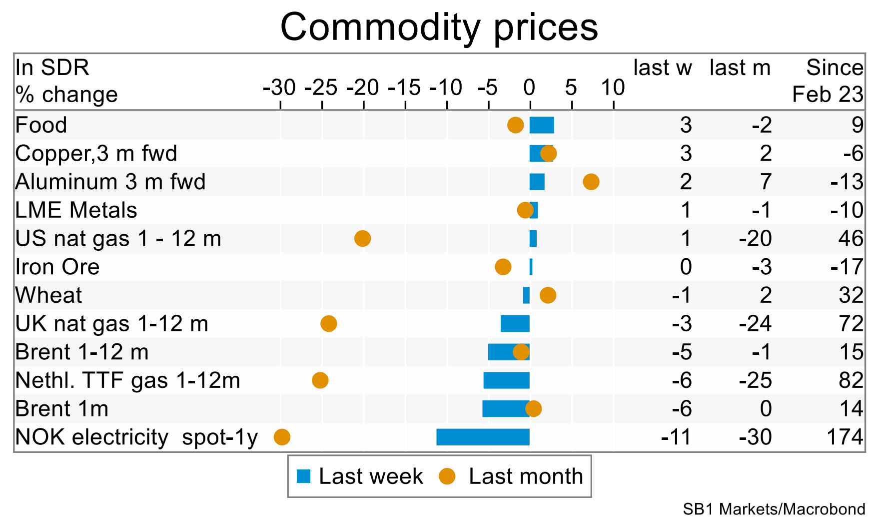


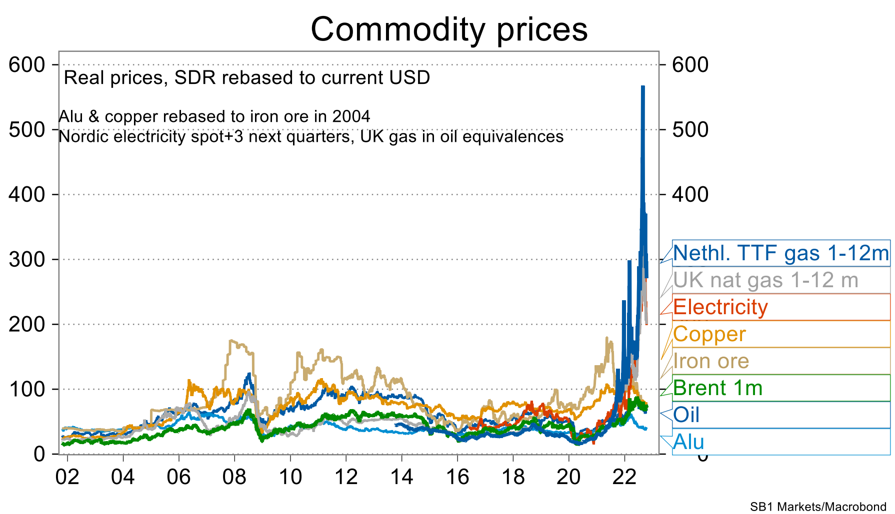




Energy prices down everywhere, metal prices up as Russia may be sanctioned







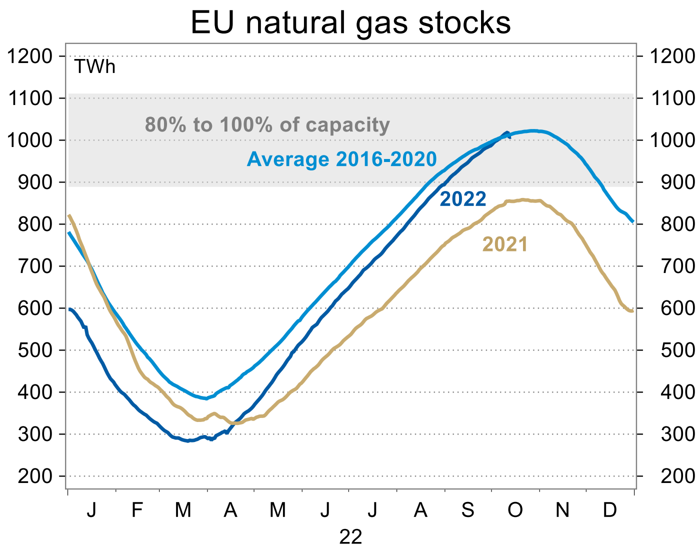
Last week

- **European natural gas** fell further last week, as did the oil price following the surge the previous week, when Opec+ cut production quotas more than expected
- The Economist's **food commodity index rose 3% last week** (in SDRs), and have been trending flat since the summer
- **Metal prices** were mostly up, perhaps mostly due to signals from the US (supported by Alcoa) that Russian aluminium exports could be sanctioned. Iron ore prices are still on the weak side, down 17% since before the war

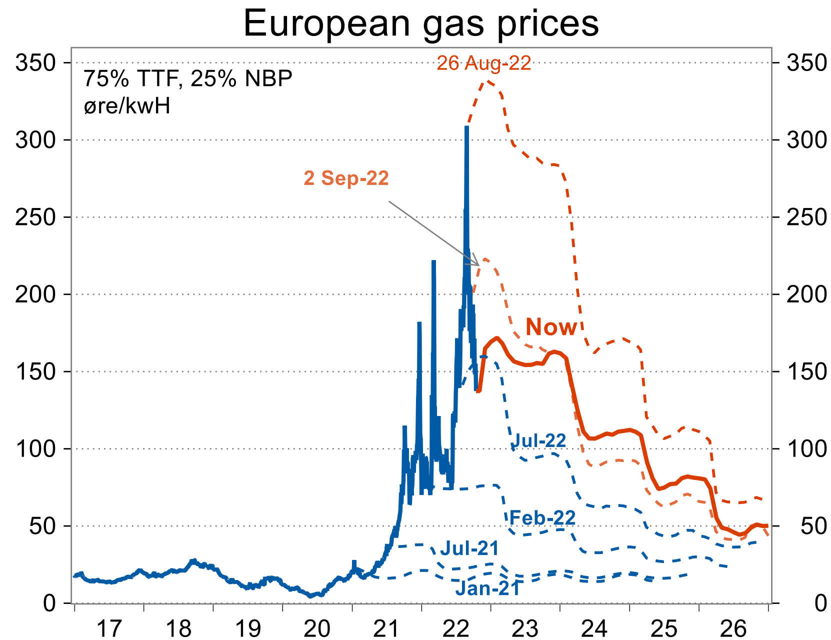
SDR: IMF's Special Drawing Rights – a 'global currency'

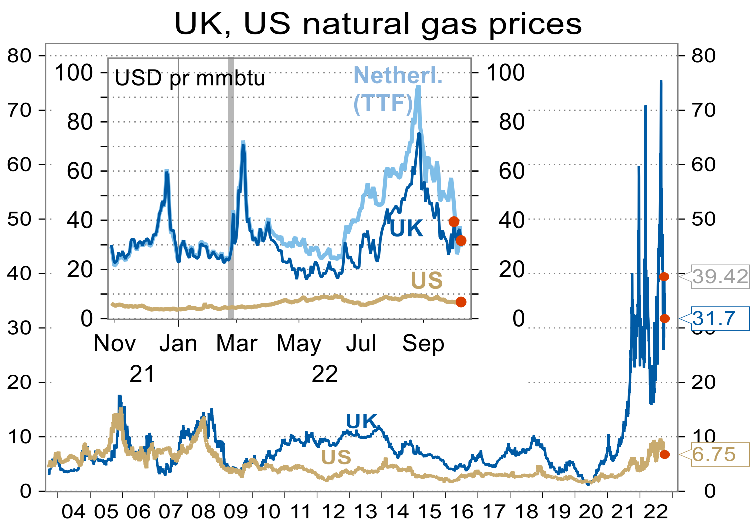
SpareBank 1 MARKETS

European gas/electricity prices are sliding down, as stocks are refilled

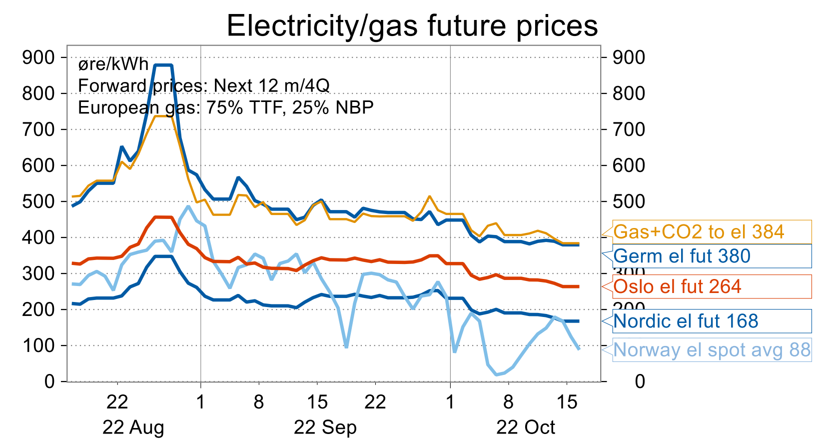


SB1 Markets/Macrobond



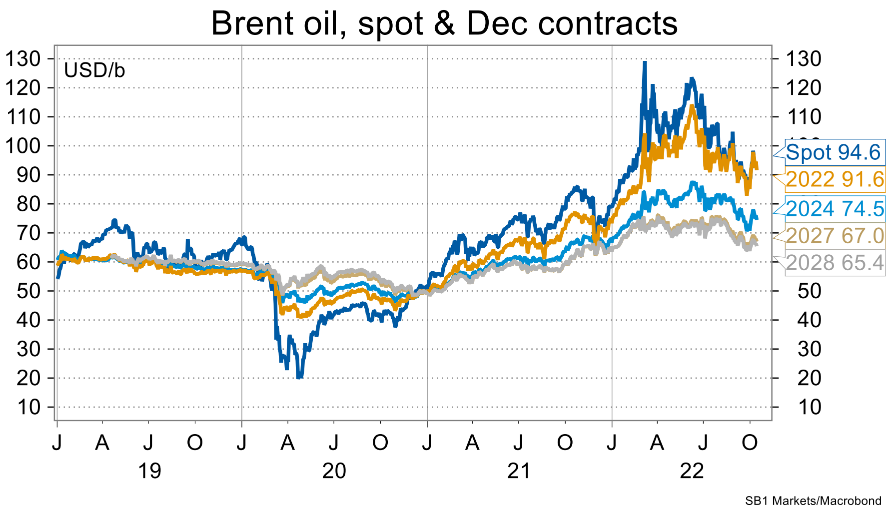


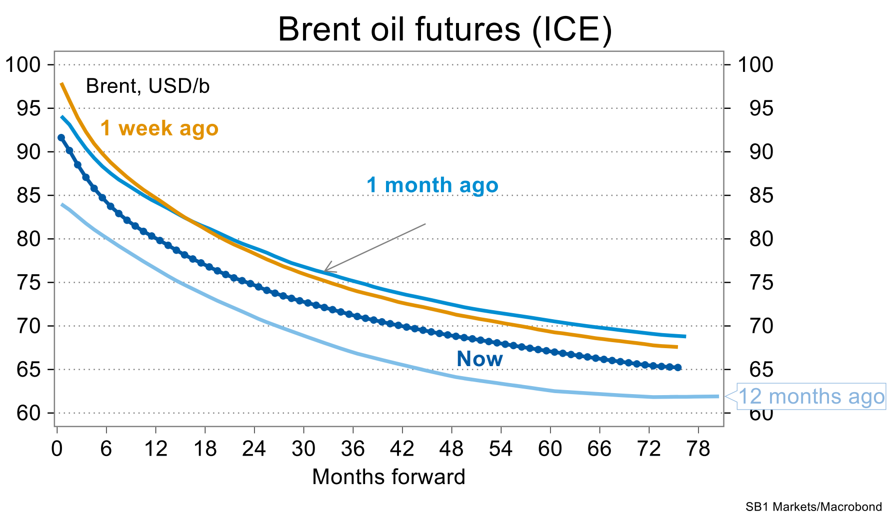
SB1 Markets/Macrobond

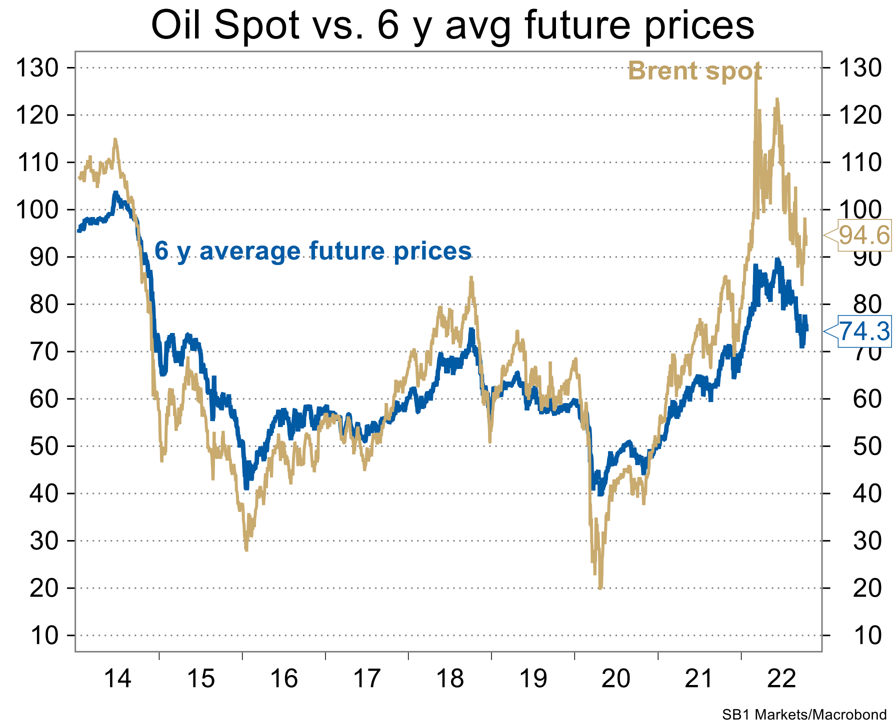


SB1 Markets/Macrobond

The oil price curve shifted down again last week – after the Opec lift

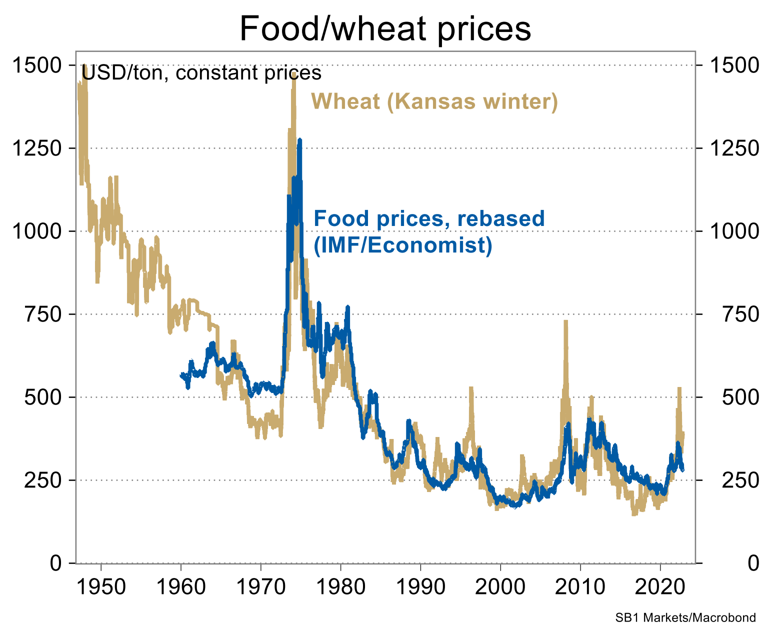


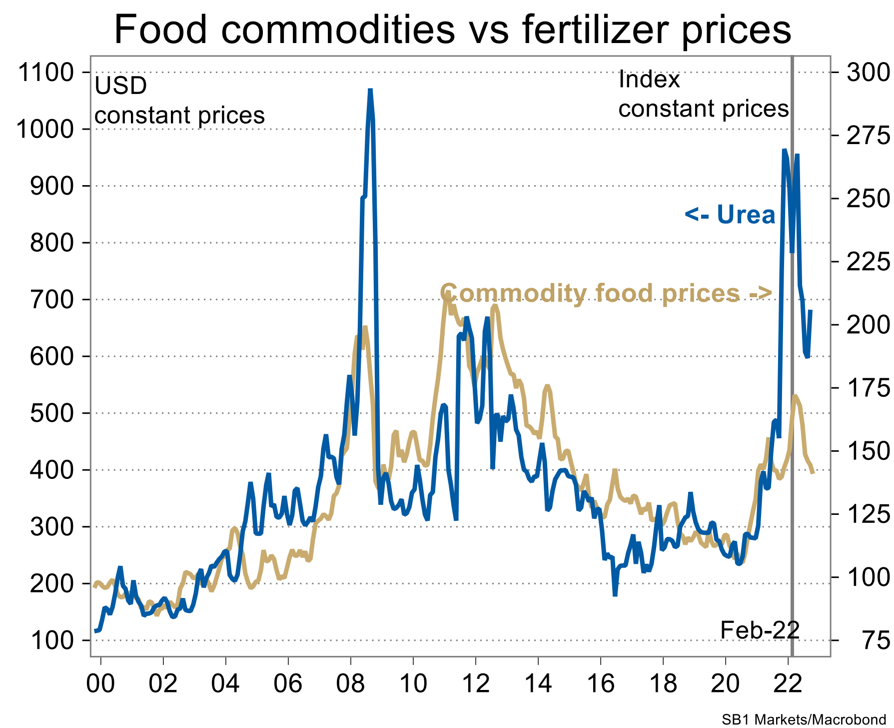


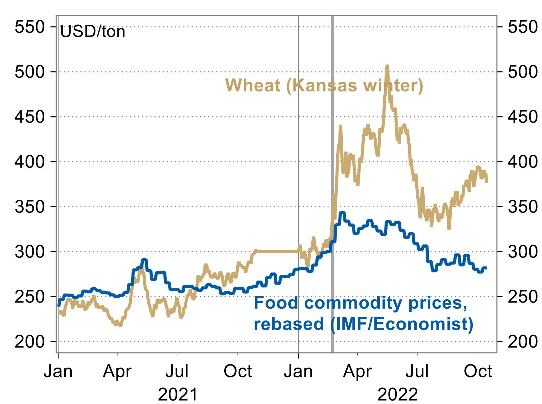


Food prices are trending down, at least measured in a strong USD

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



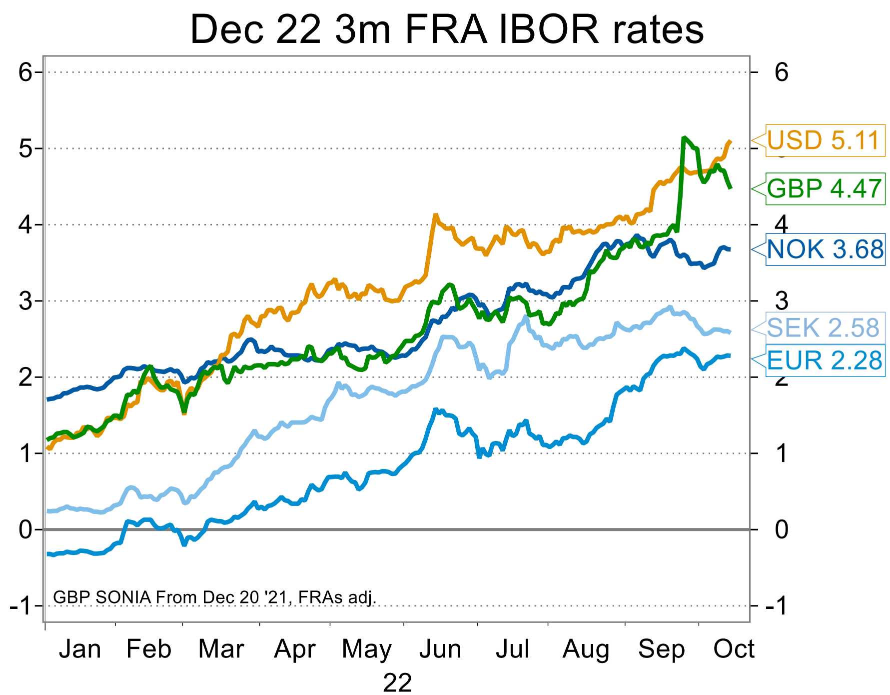


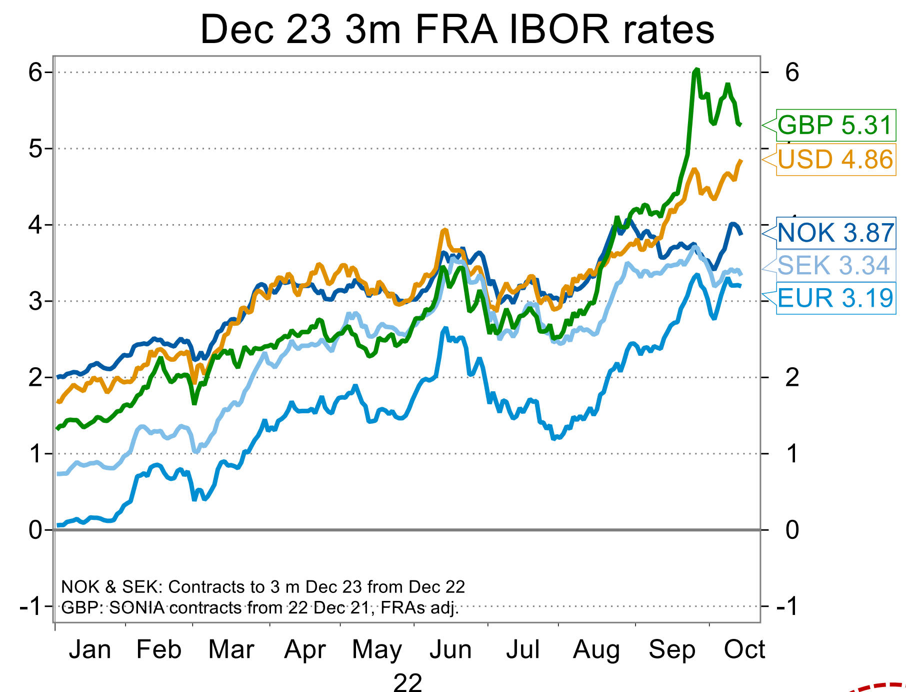


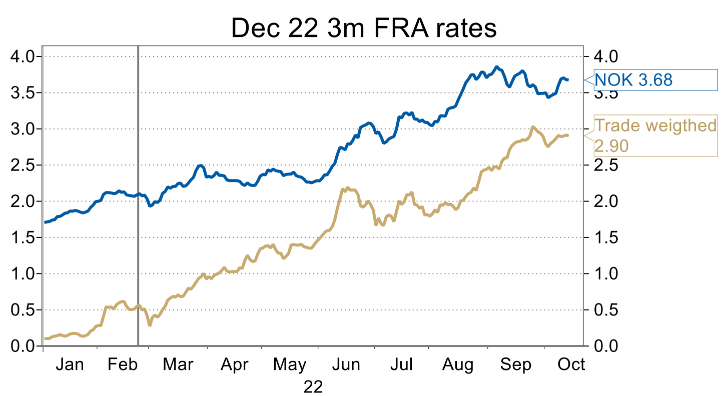
Urea prices have been falling too

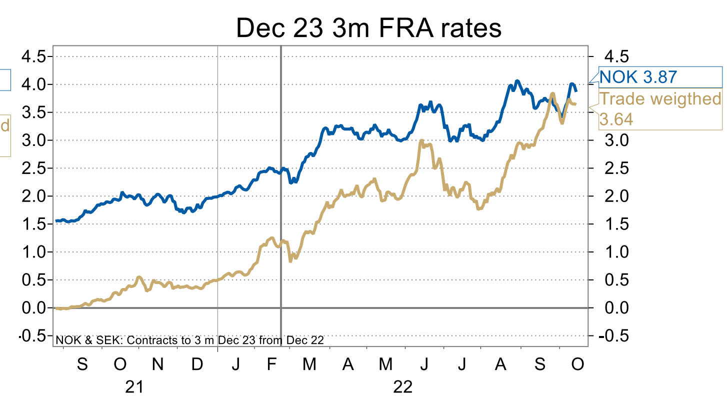
Mixed signals from the FRAs: GBP rate expectations are sliding, as they should

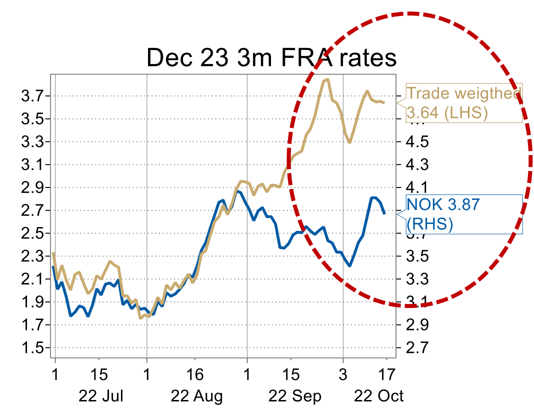
NOK, USD rates sharply up, less so in EUR & SEK







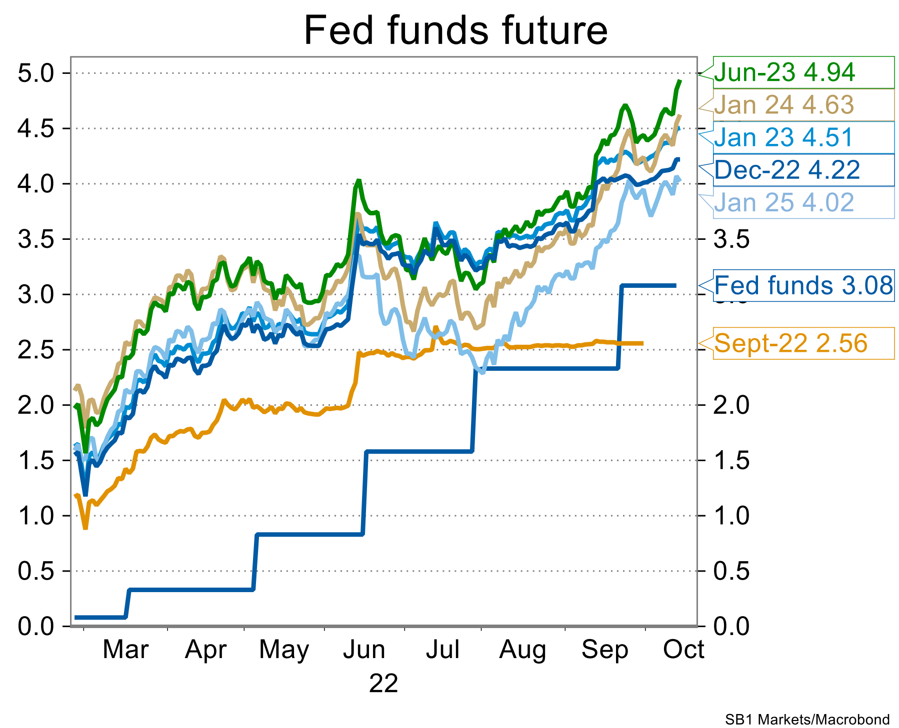


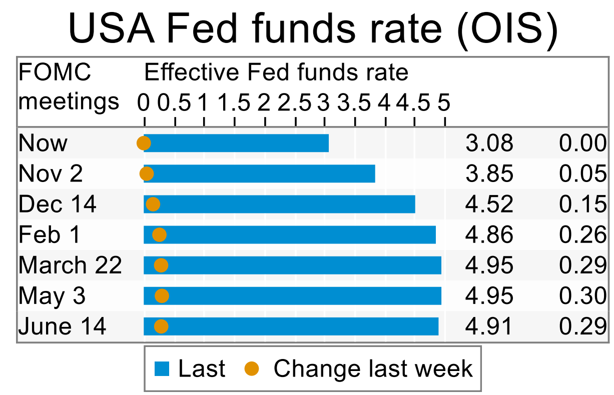


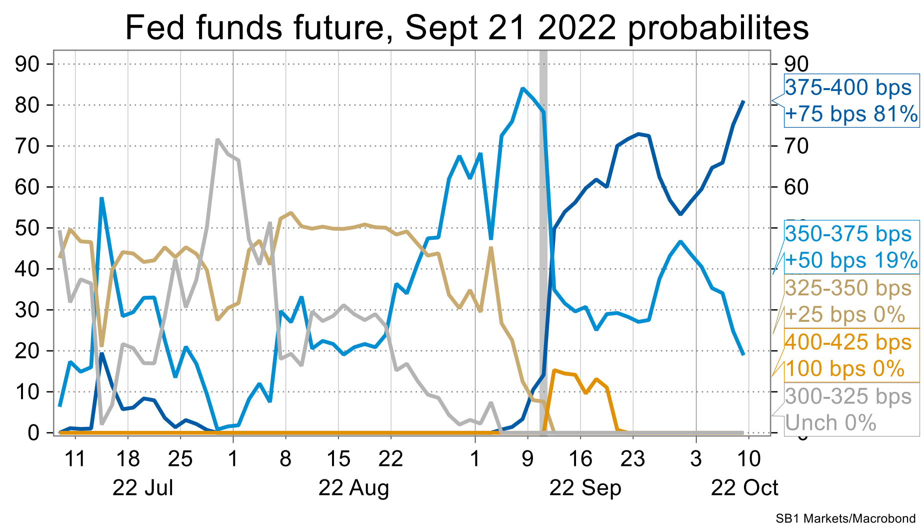
SB1 Markets/Macrobond

Another 'triple' hike in November most likely – as the markets sets view at 5%

... and then 'just' 50 bps in Dec. A peak at 4.95% is expected in March/May, up 30 bps last week!

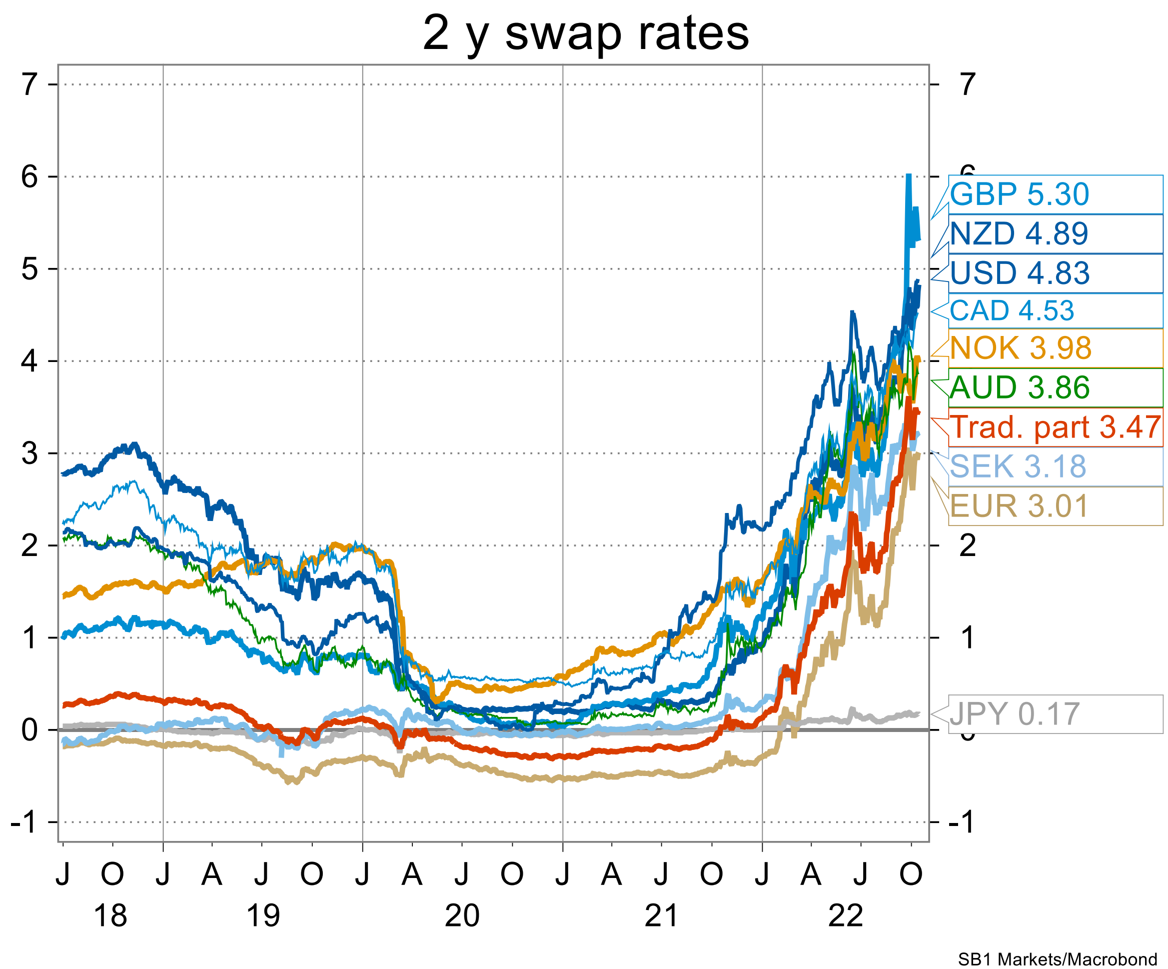


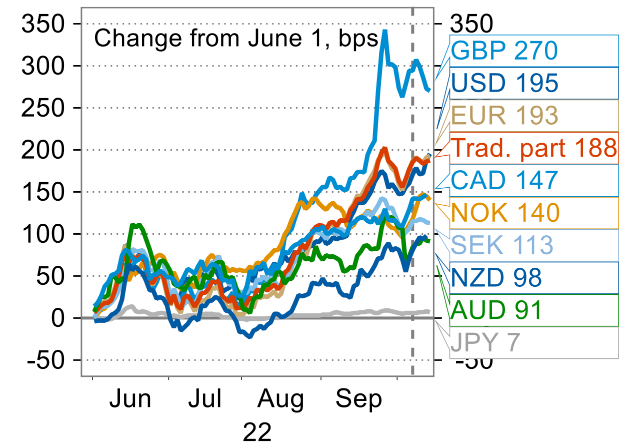


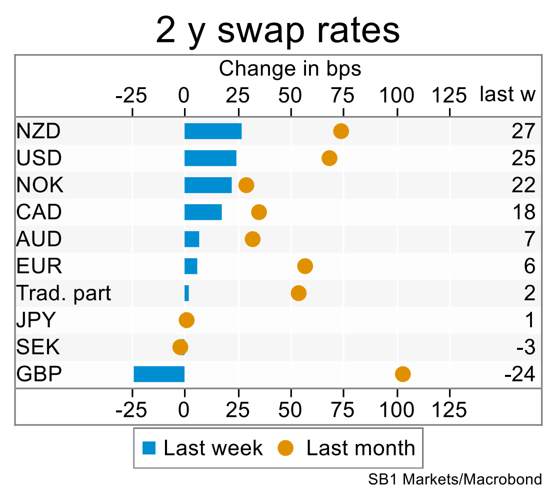


Most 2 y swap rates up, incl. NOK rates which climbed 22 bps last week

GBP rates fell, from high level – and we think there is more downside ahead

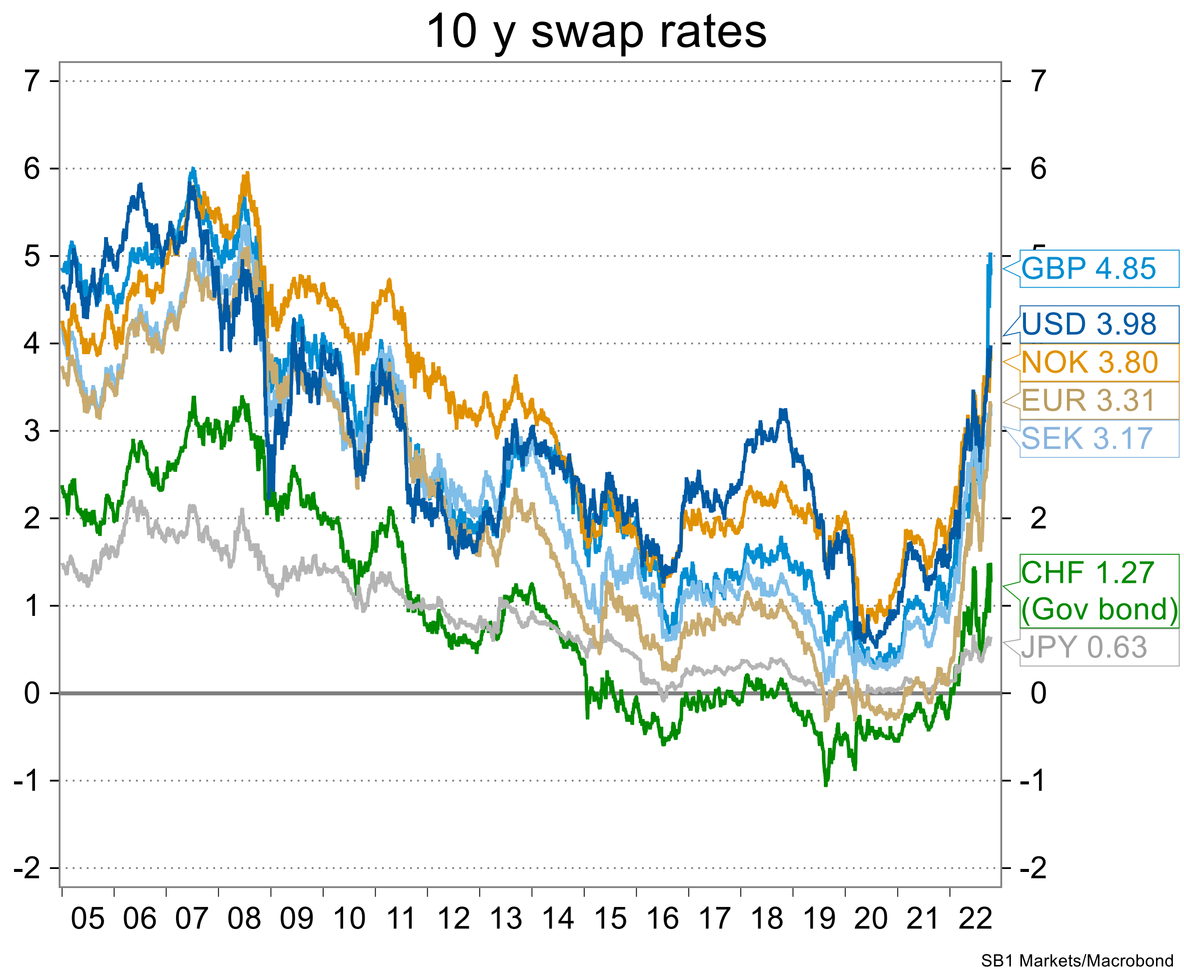


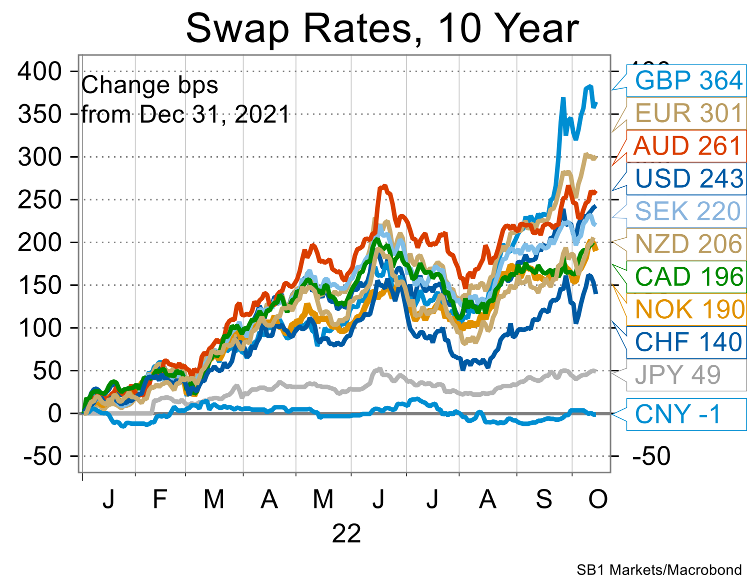


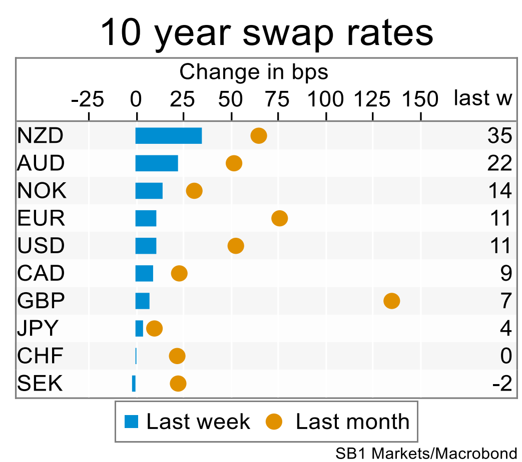


Still trending upwards

GBP swap rates are back up to the same level as before BoE started buying gilts

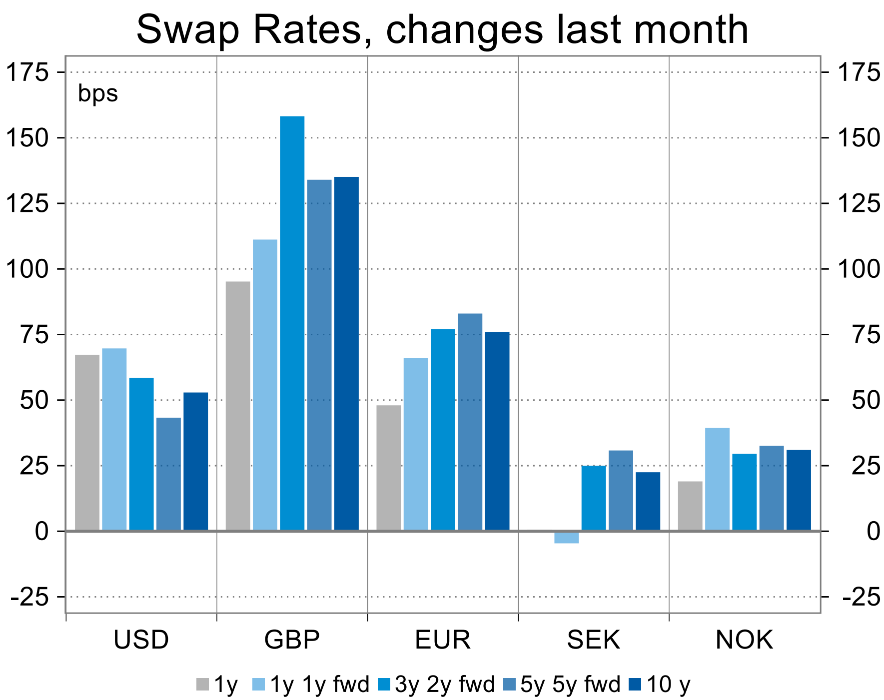




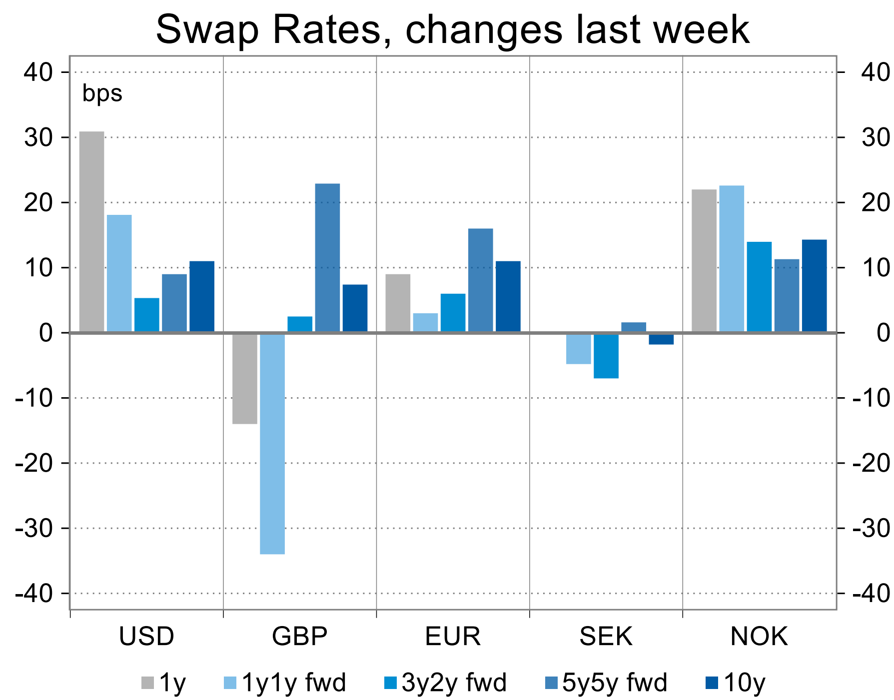


CHF: 10 y government bond yield

NOK rates gained the most last week, as shorter GBP rates fall substantially



SB1 Markets/Macrobond

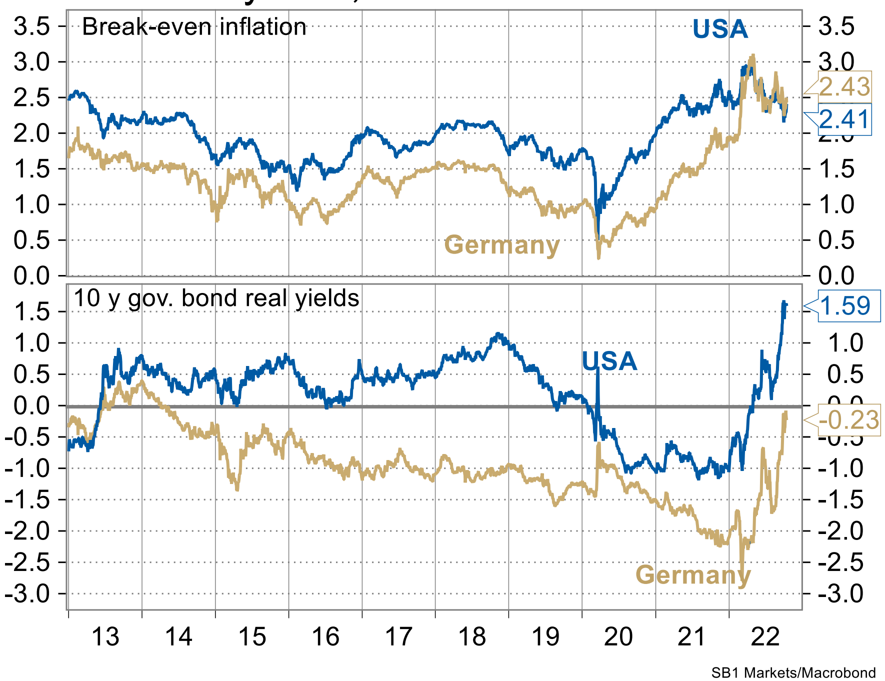


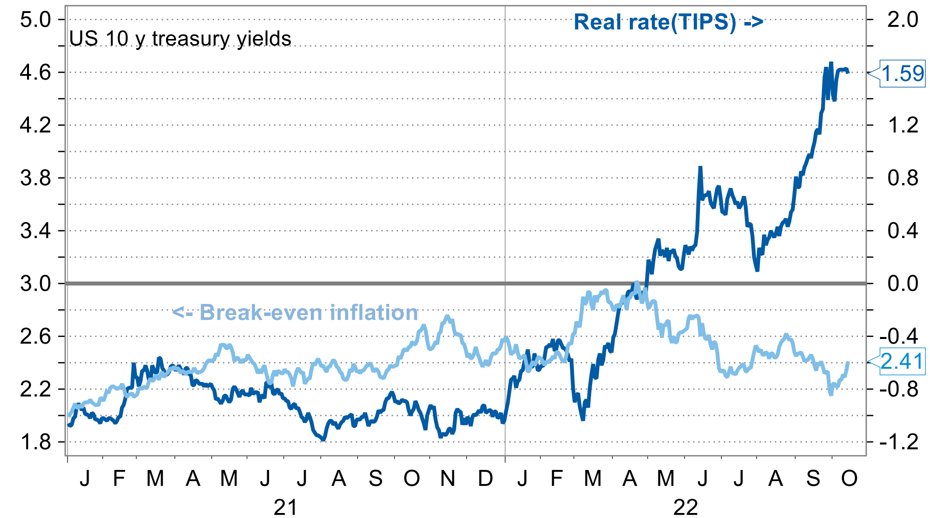
SB1 Markets/Macrobond

A small uptick in inflation expectations, without help from the oil price

10 y real rates marginally down both in the US and in Germany. The 10 y US treasury closed at 4.00%

Real yields, break-even inflation





US & Germany 10 y Gov bond yield

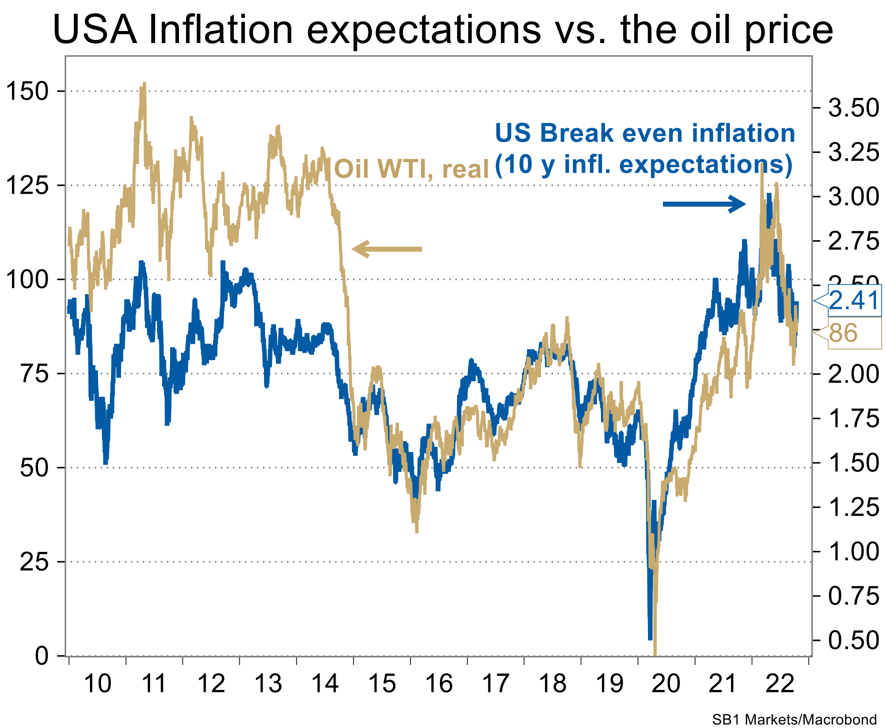
	Yield	Change 1w	Change 1m	YTD	Min since April-20
USA nominal treasury	4.00	0.11	0.59	2.48	0.52
.. break-even inflation	2.41	0.14	-0.05	-0.15	1.06
.. TIPS real rate	1.59	-0.03	0.64	2.63	-1.19
Germany nominal bund	2.20	0.07	0.48	2.41	-0.65
.. break-even inflation	2.43	0.09	-0.06	0.54	0.40
.. real rate	-0.23	-0.02	0.54	1.87	-2.80

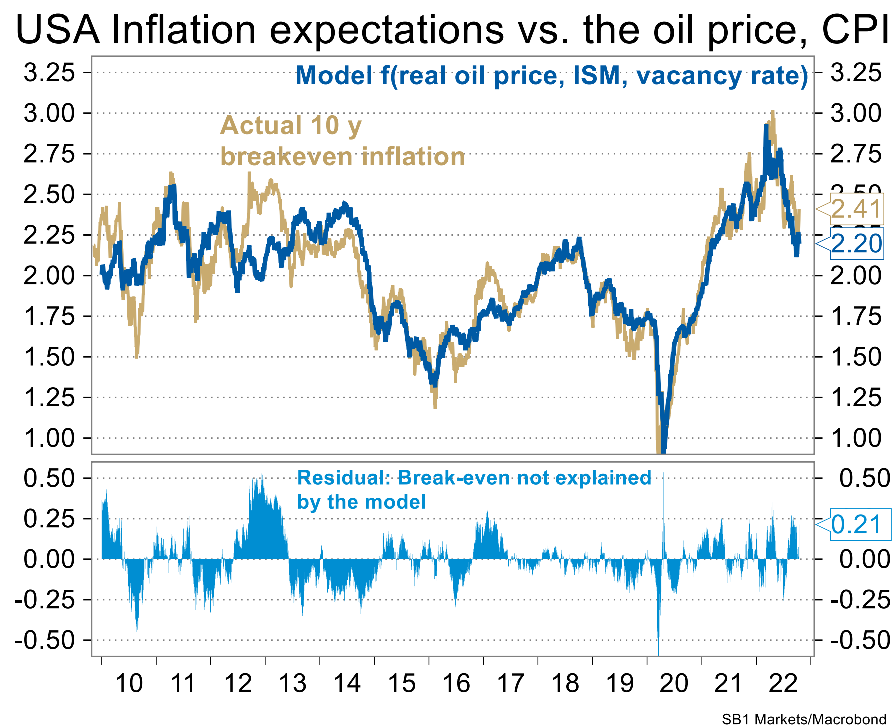
SB1 Markets/Macrobond

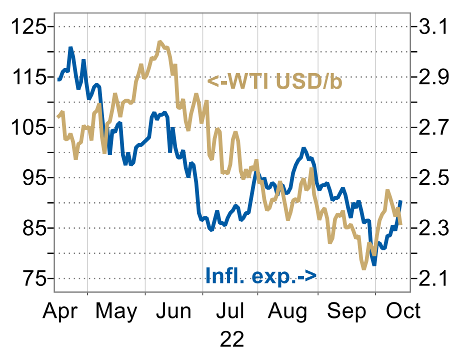
- The lift in real rates so far in 2022 is for the history books!
- No signs of war angst or flight to safety
- No signs of fear of QE measure (a la BoE's gilt stunt) creating more inflation
- In the US, a 10 y CPI expectation at 2.41% is close to Fed's 2% target for the PCE-deflator (which on average is some 0.3 pp below CPI inflation)

(Longer-term) Inflation expectations are trending down, as our model suggests

If the economy slows – and the oil price does not surge – inflation exp. should come further down



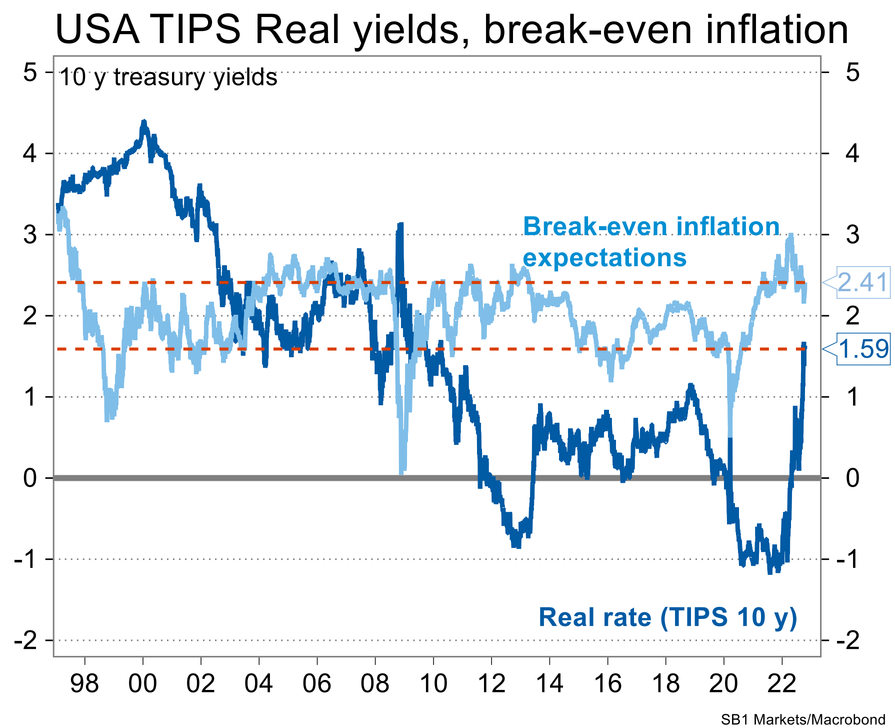


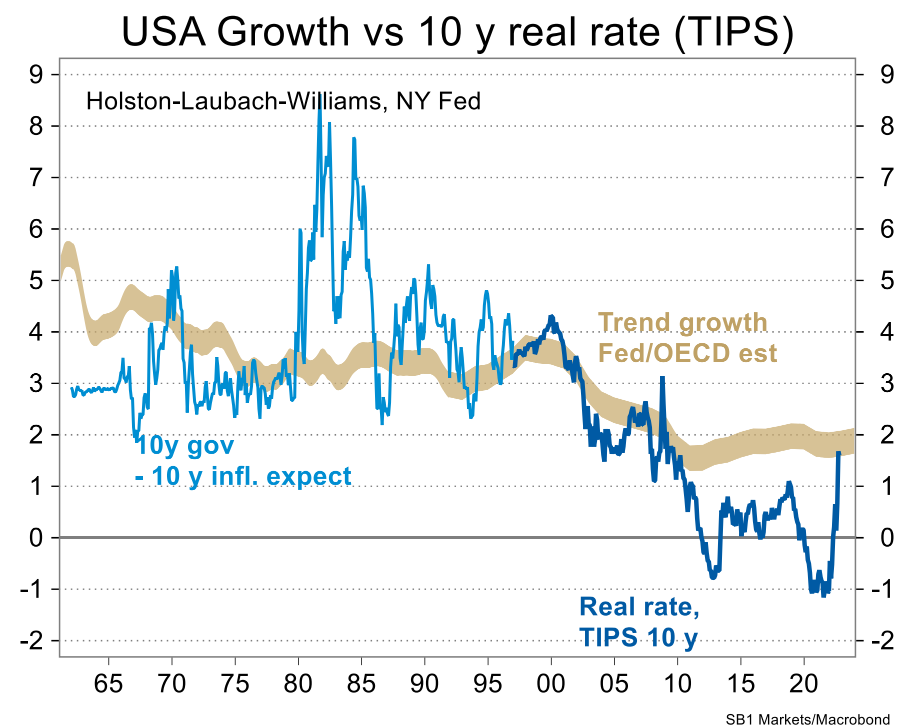


- A simple model including the <u>spot</u> oil price, the <u>current</u> ISM and the <u>current</u> vacancy rate pretty well explains the <u>long-term</u> breakeven inflation expectation in the bond yield curve
- What now? We are uncertain about the oil price, but rather confident that both the ISM, 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 3.2% from 6.2%): -36 bps
  - » - 10 USD/b: -10 bps

Growth vs real rates: Mind the missing gap, it has closed!

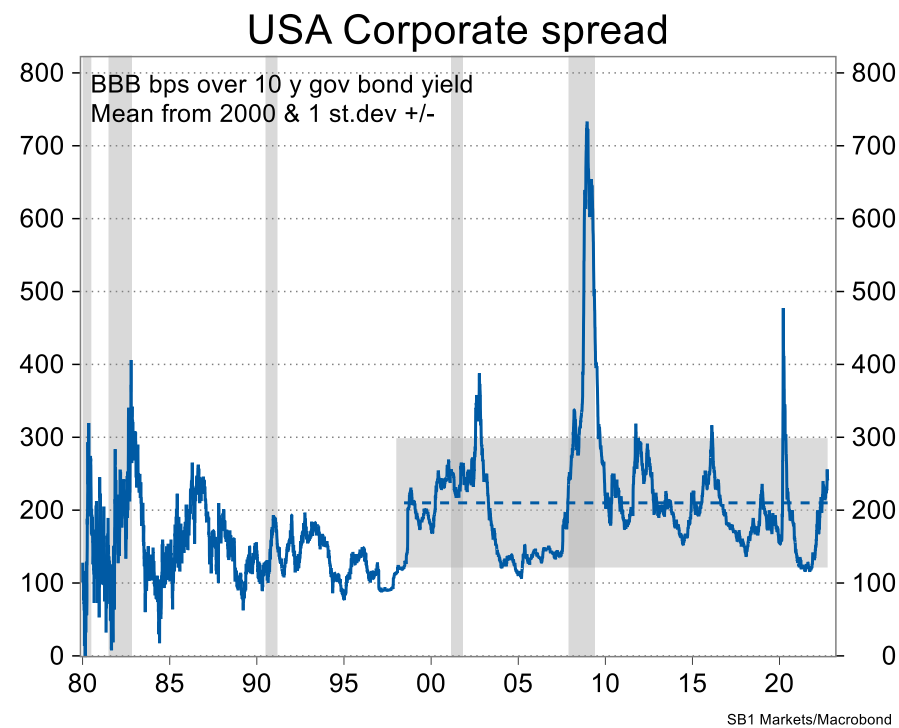
Real rates are up, while short/medium-term growth expectations are declining

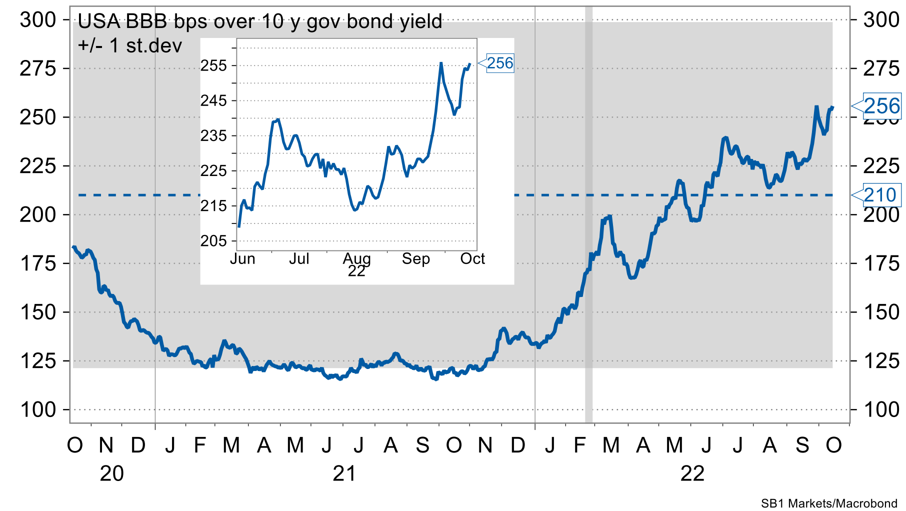




Risk off: Credit spreads widened as equity markets failed to stabilise

The trend is up – and we expect more to come

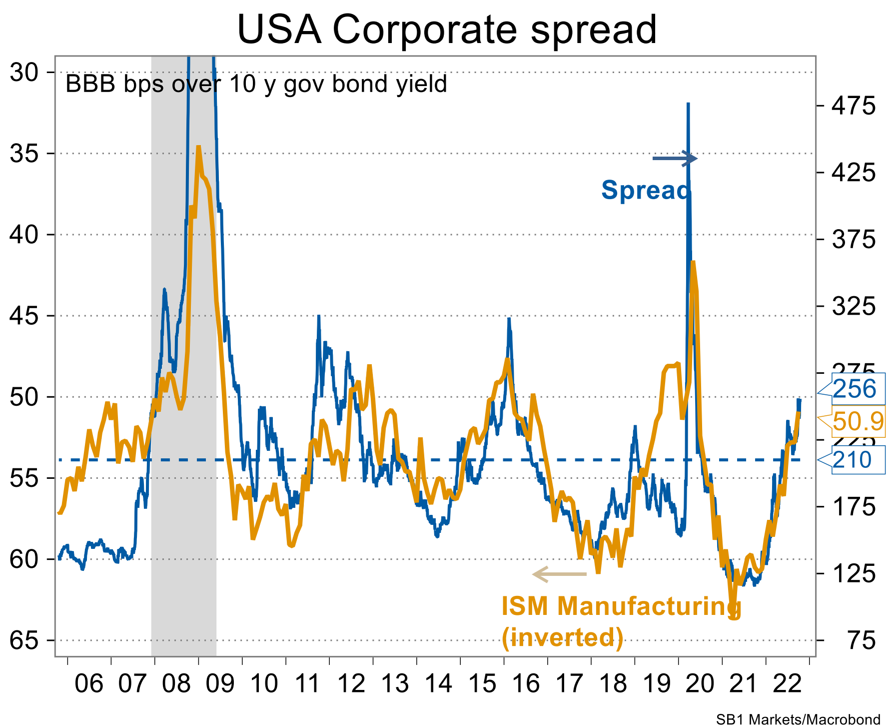


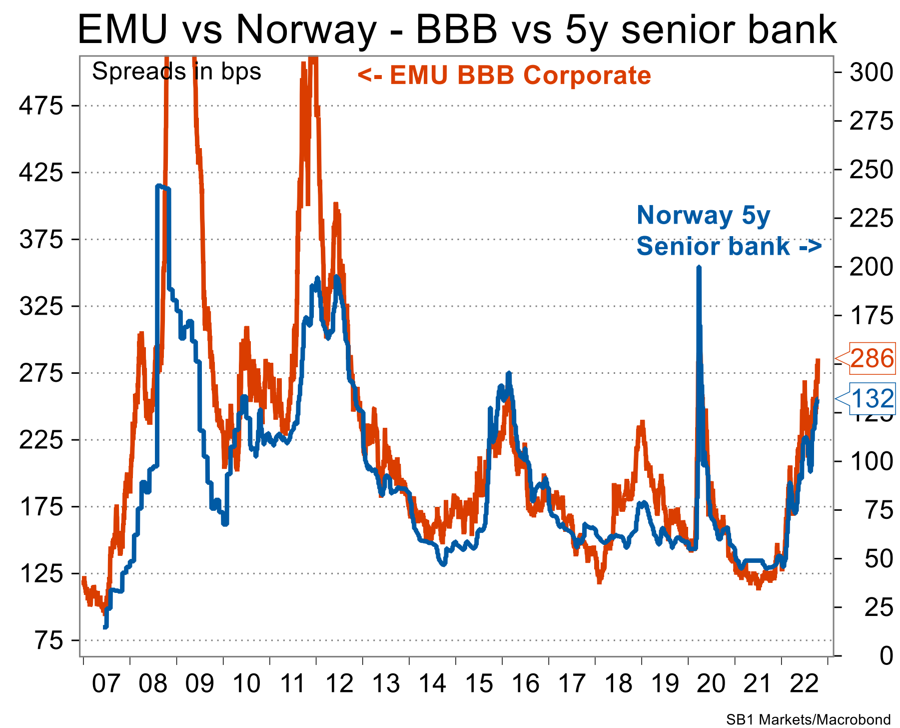


- The US BBB spread is up almost 150 bps from the bottom last autumn, almost a doubling
- In addition, real rates have increased by more than 260 bps since late last year
- Thus, the basis for all valuation metrics has changed dramatically, check the chart two pages forward!

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…

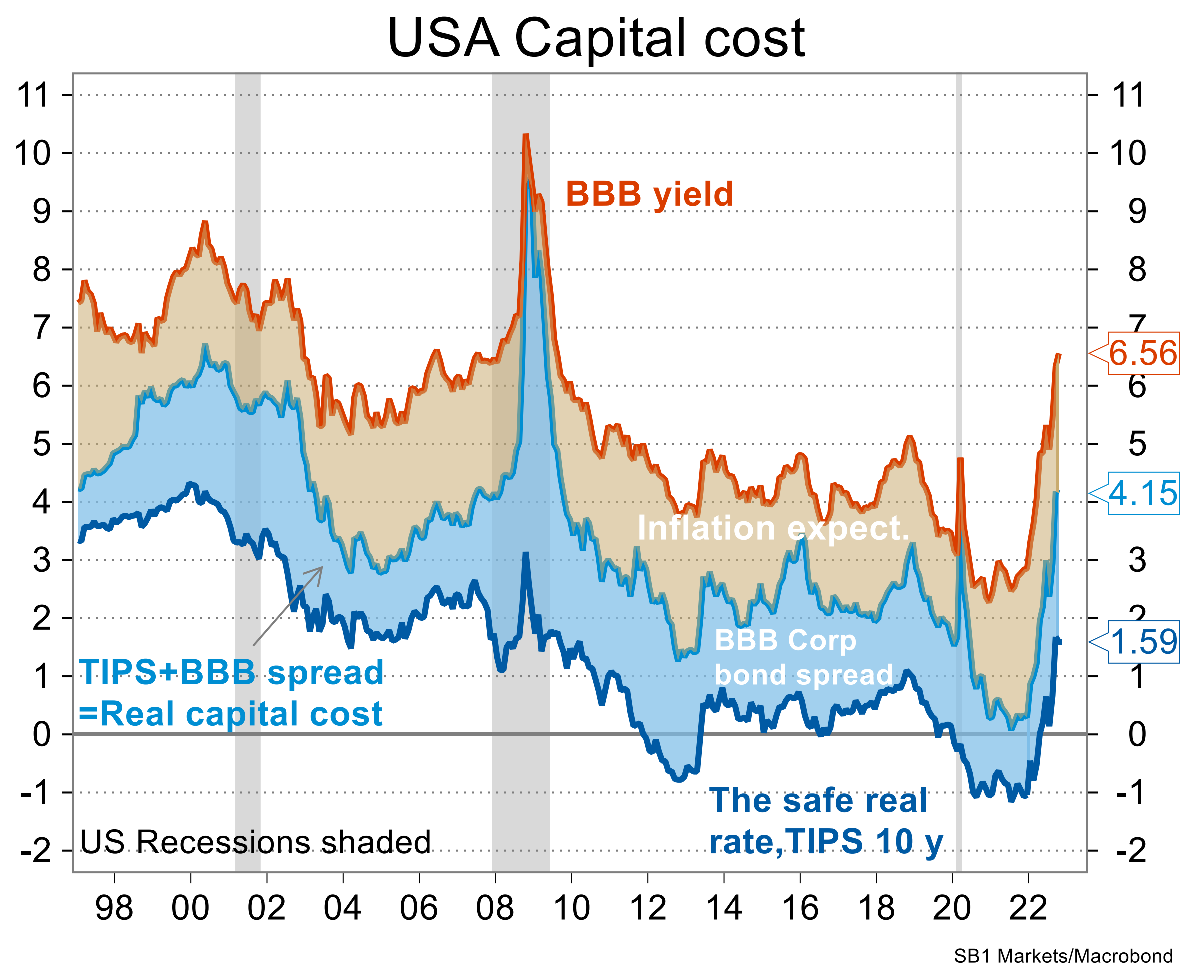




- The answer is not irrelevant for your view on the outlook for spreads, we think
- And do you think Norwegian spreads will be influenced by changes in the global credit market?
- Last week: Norwegian credit spreads rose in sympathy with higher spreads abroad the previous week
- The good news: The recent hike in spreads have made these credit instruments far more attractive, at least from a hold to maturity perspective

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

All valuation metrics have changed dramatically. *As have all calculations of return on capital*



- The total real borrowing cost for a BBB company has increased to 4.2% bps from zero by the end of last year:
  - » The TIPS real rate is up from -100 to + 159 bps
  - » The BBB corporate investment grade spread is up from 120 bps to 256!
- Add on modest inflation expectations, the nominal borrowing cost has increase from well below 3% to above 6.5%

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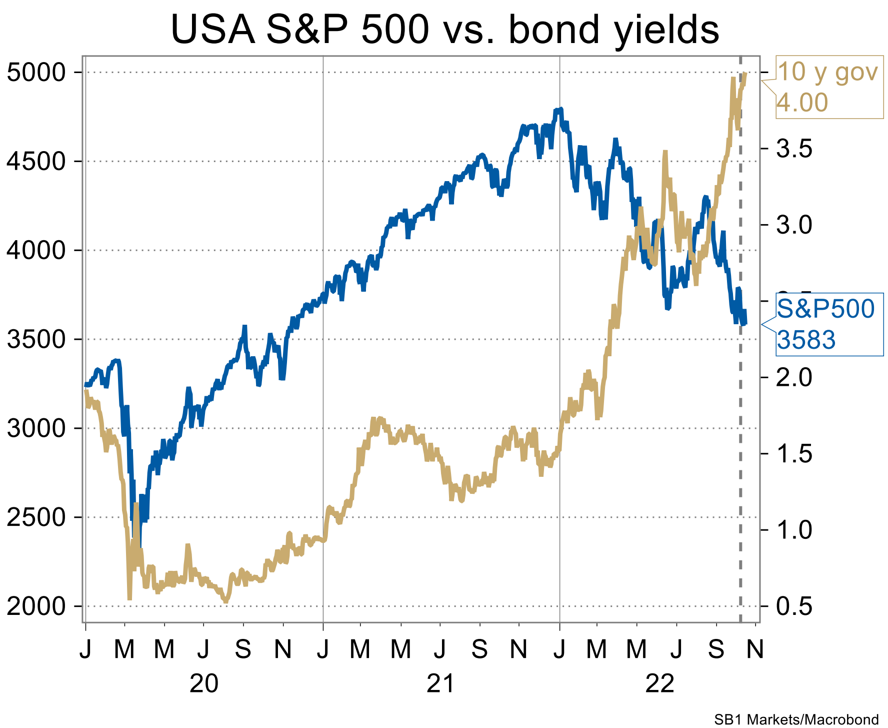
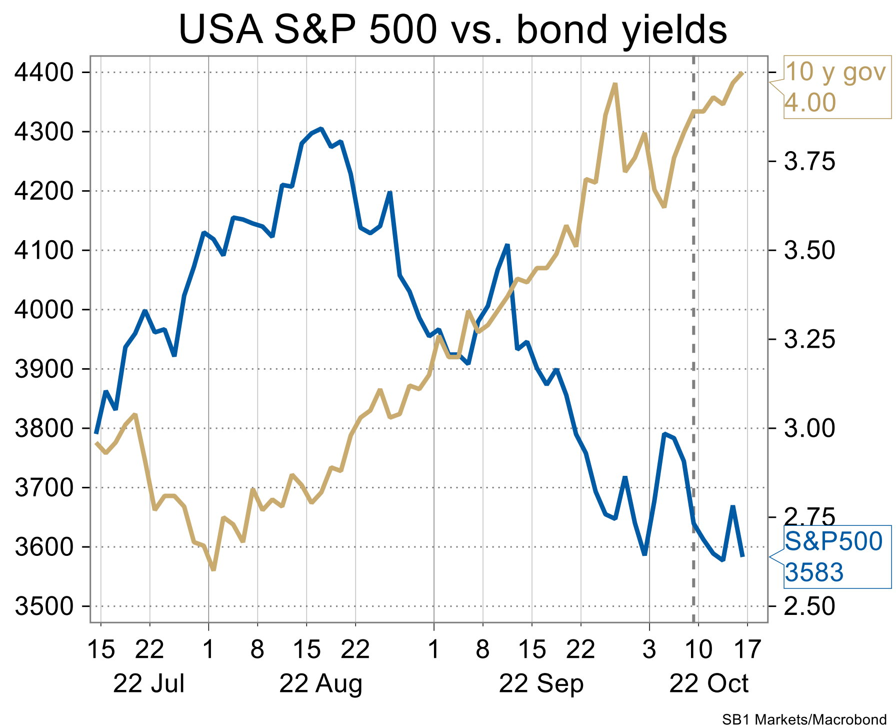
Inflation remains a challenge, bond yields up, stocks down

The 10 y bond yield closed at 4.00% for the first time since April 2010





- Bond volatility has surged recent weeks/months, to levels not seen in 15 years. ‘Something’ is going on

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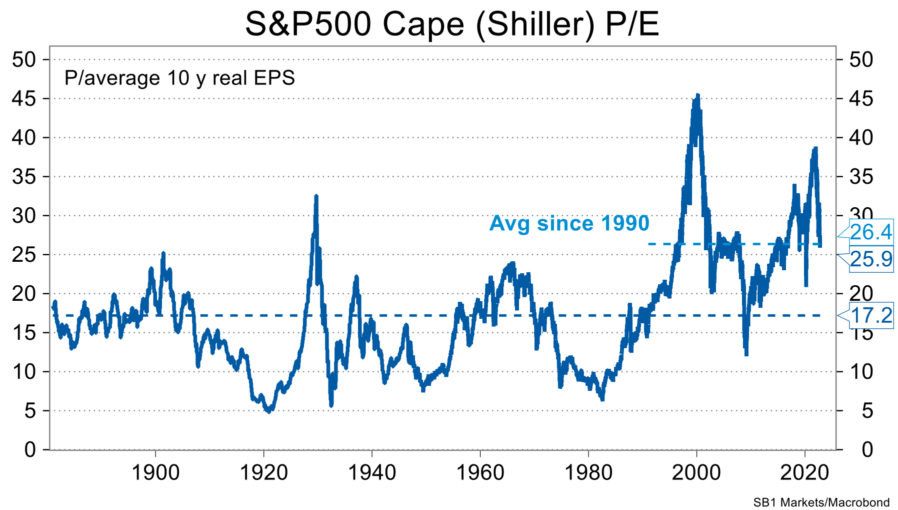
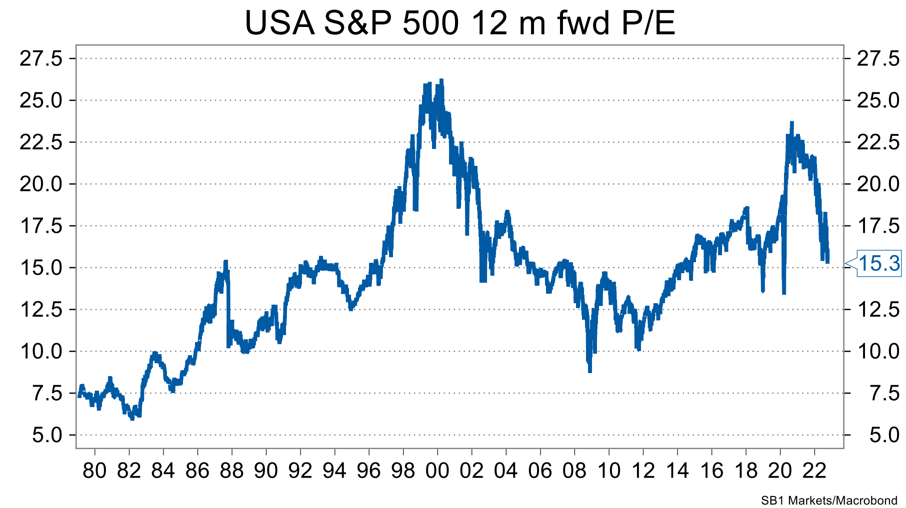
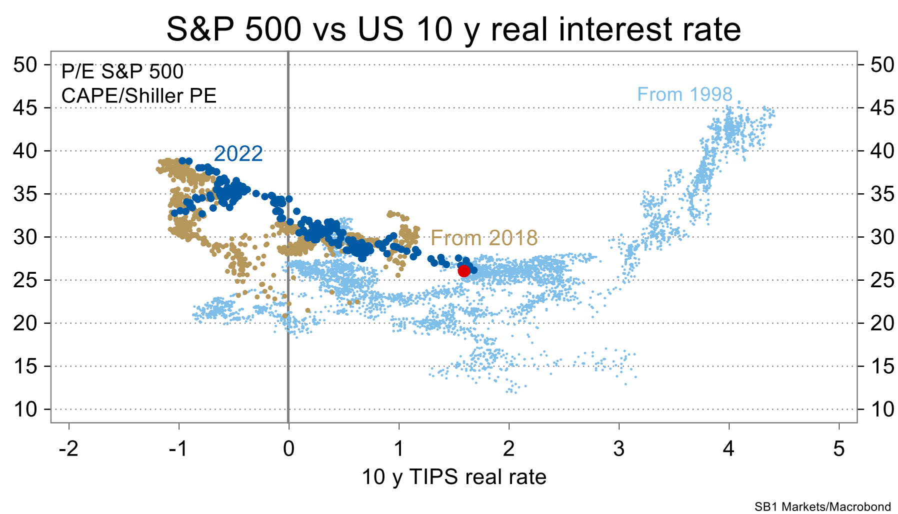
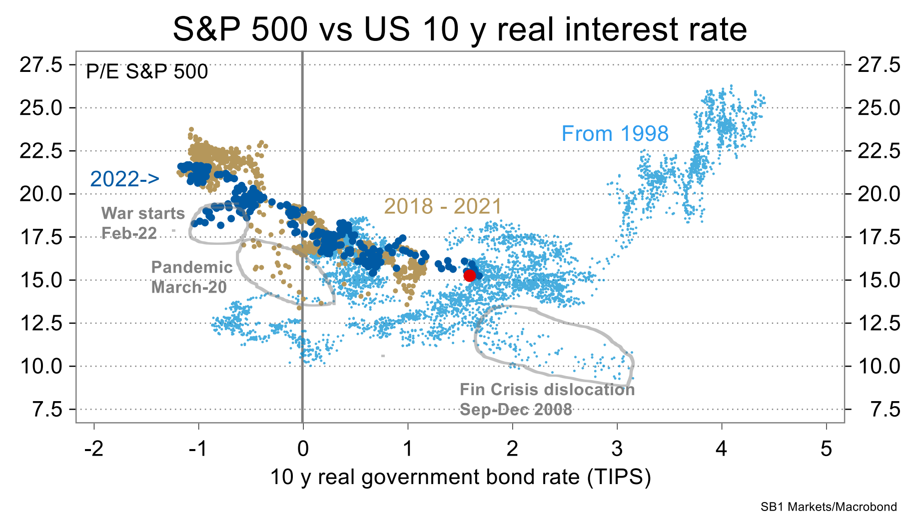
4 valuation charts: Check the extreme tight correlation between real rates, P/E

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





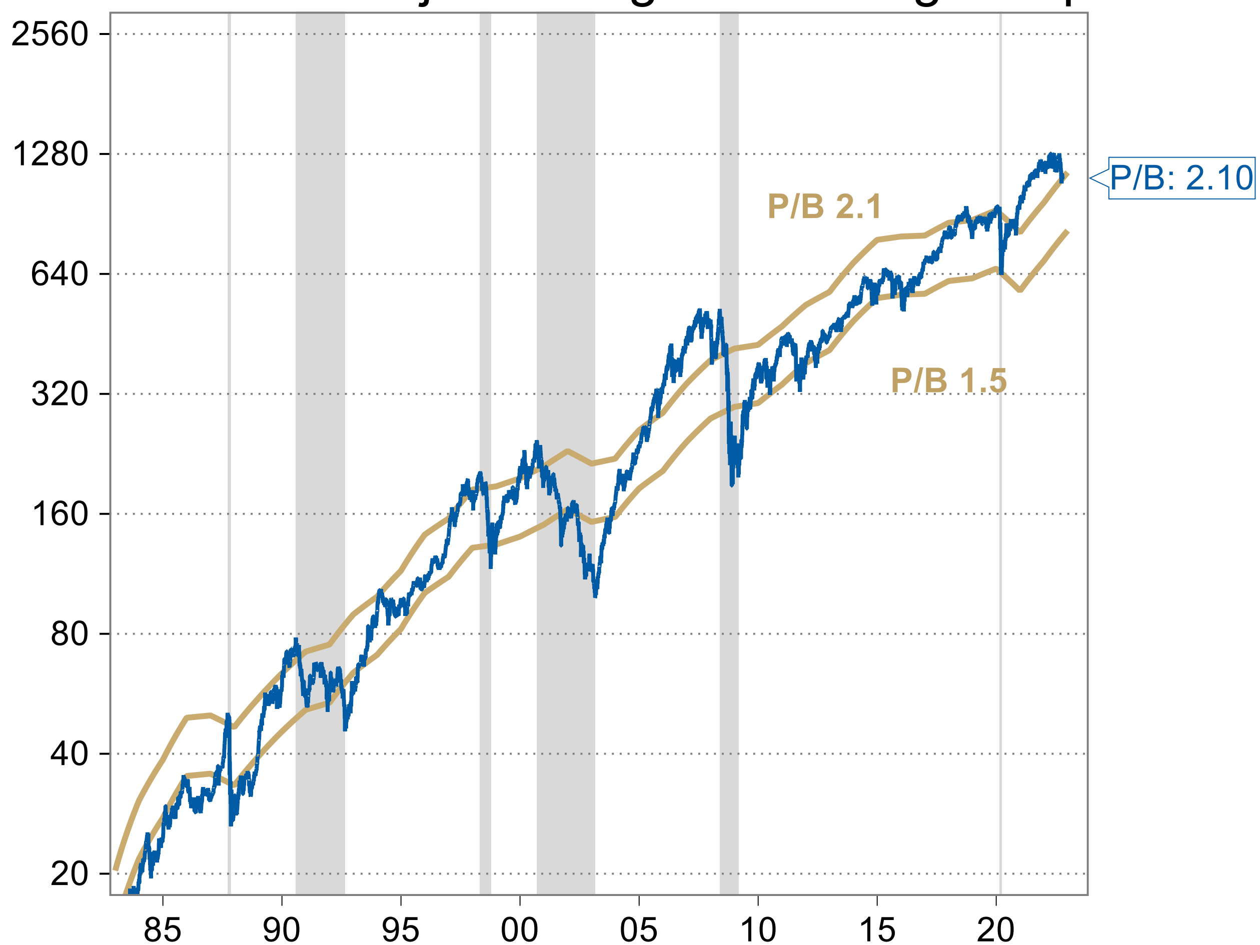




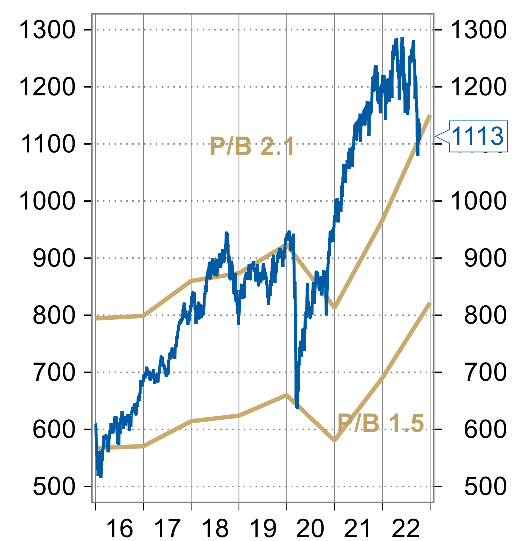
Finally, OSEBX almost hit the upper band of the 1.5/2.1 Price/Book corridor

Thus, it is just 29% down the lower (1.5) band, index level 800! A <u>very</u> safe bottom at 500 (P/B=1)

Oslo Børs - aksjeverdi og verdi av egenkapitalen



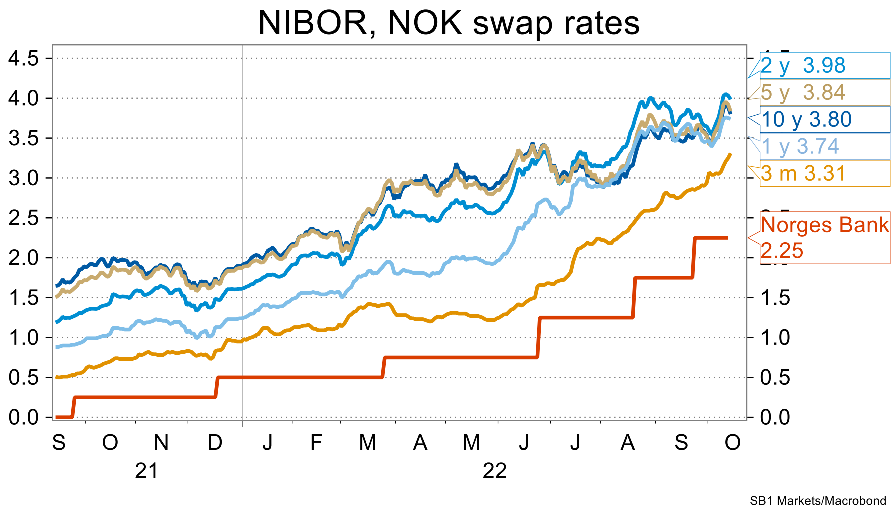
Source: Oslo Børs, Vital, Bloomberg, SB1 Markets, Macrobond.

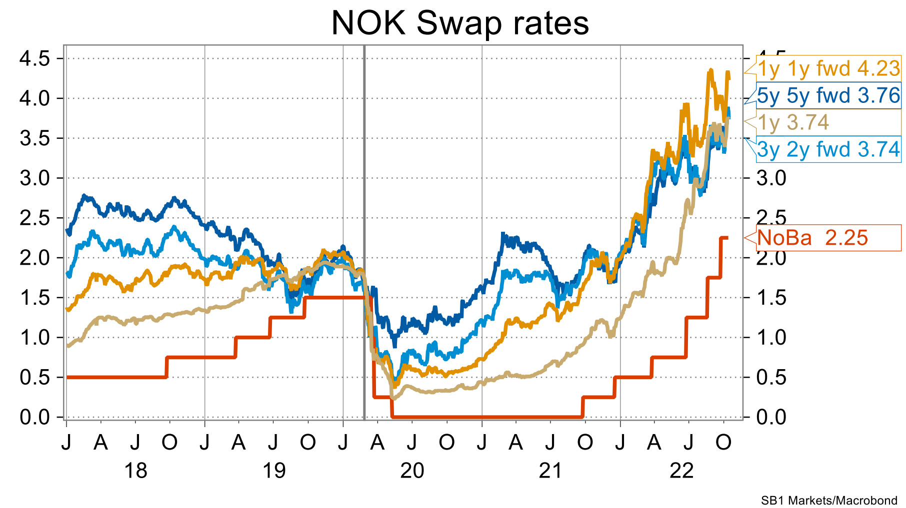


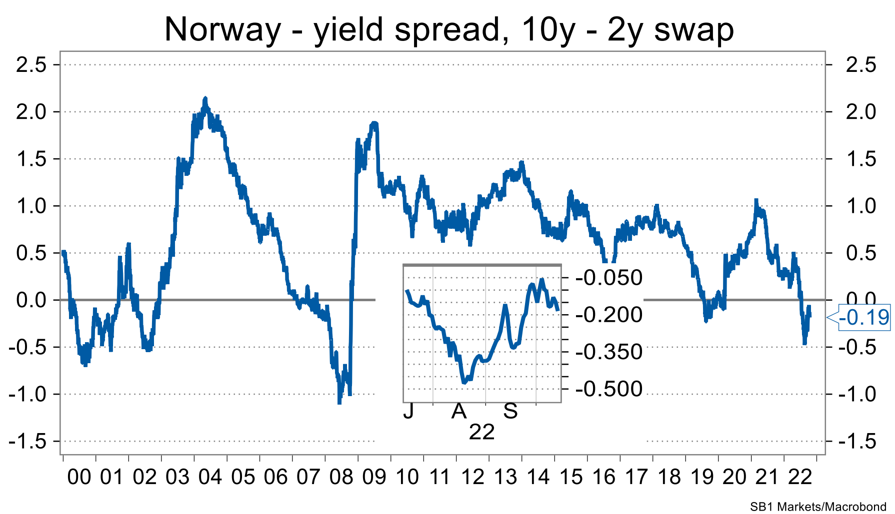
Source: Oslo Børs, Vital, Bloomberg, SB1 Markets, Macrobond.

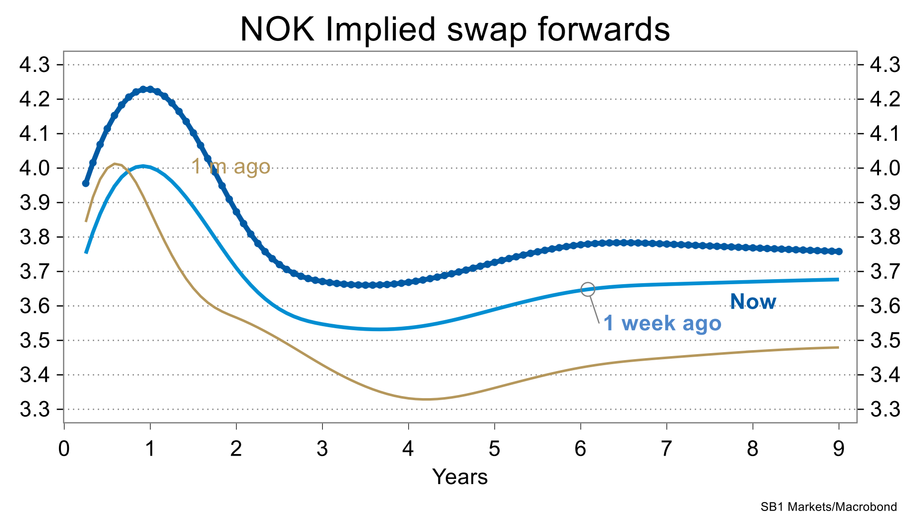
Norwegian swaps up all over the curve

The 3m NIBOR up 19 bp to 3.31%, probably NOT due to a higher NIBOR spread



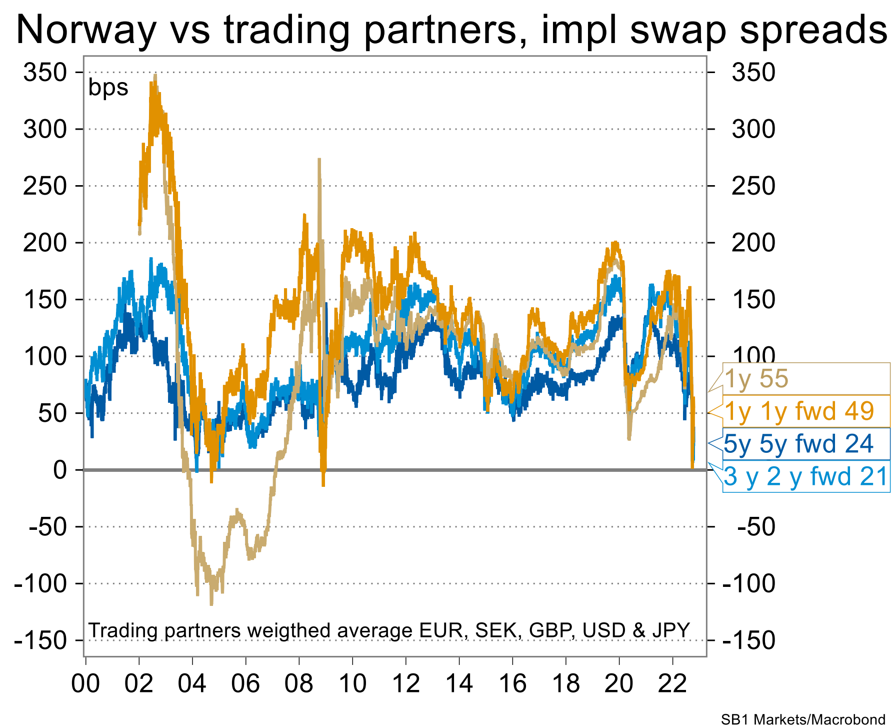


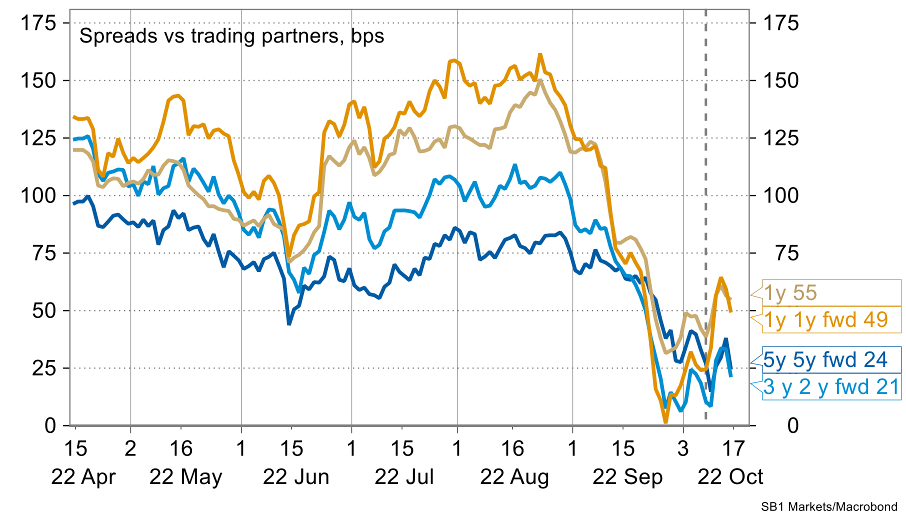


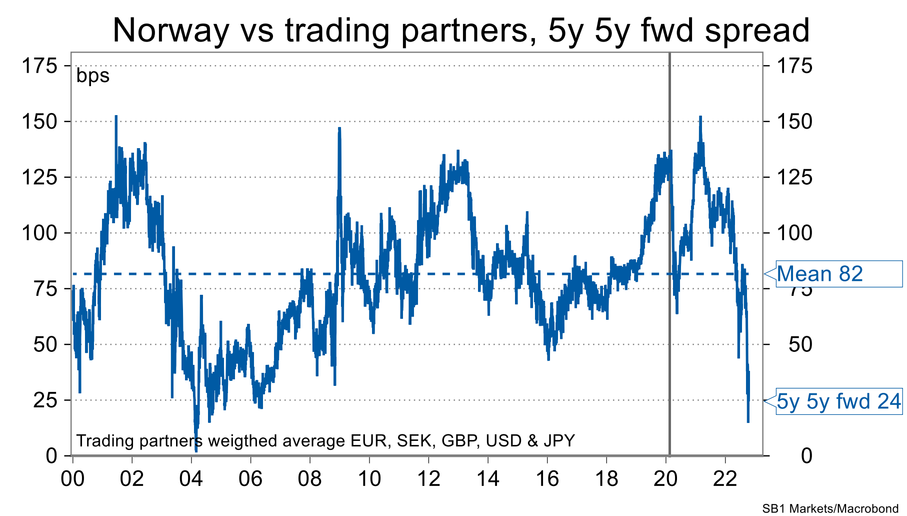


Spreads vs trading partners up from a very low bottom

We do not have a case, the present level is OK







- NOK rates are still above the <u>average</u> level among our trading partners – but the margins have fallen sharply resent weeks
- Now, there may still be some downside potential in the short end, given the still rather aggressive NOK FRA-rate path (check 2 – 3 pages forward)

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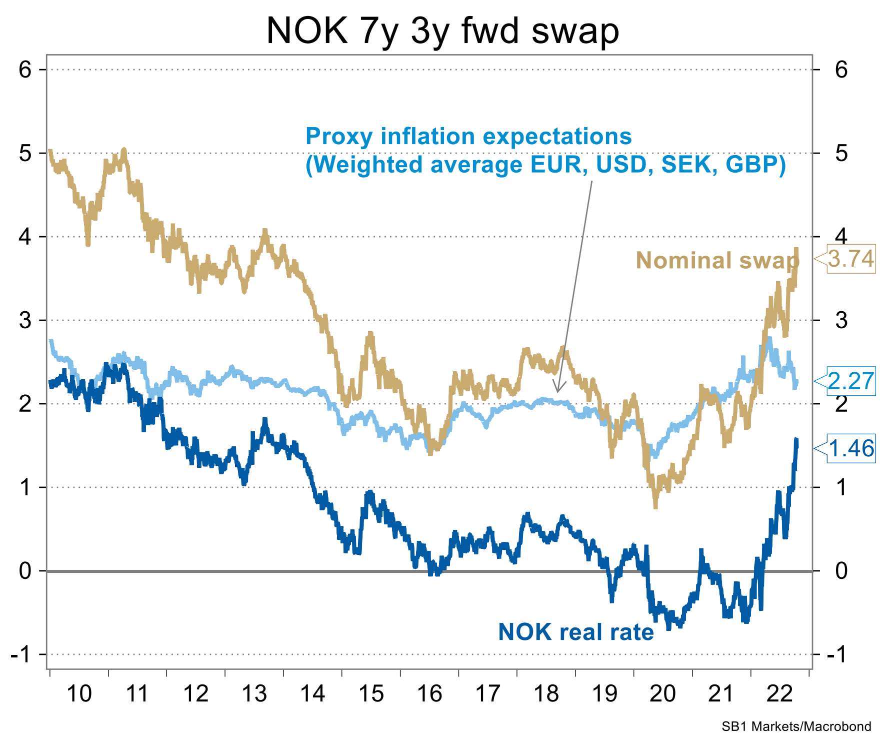
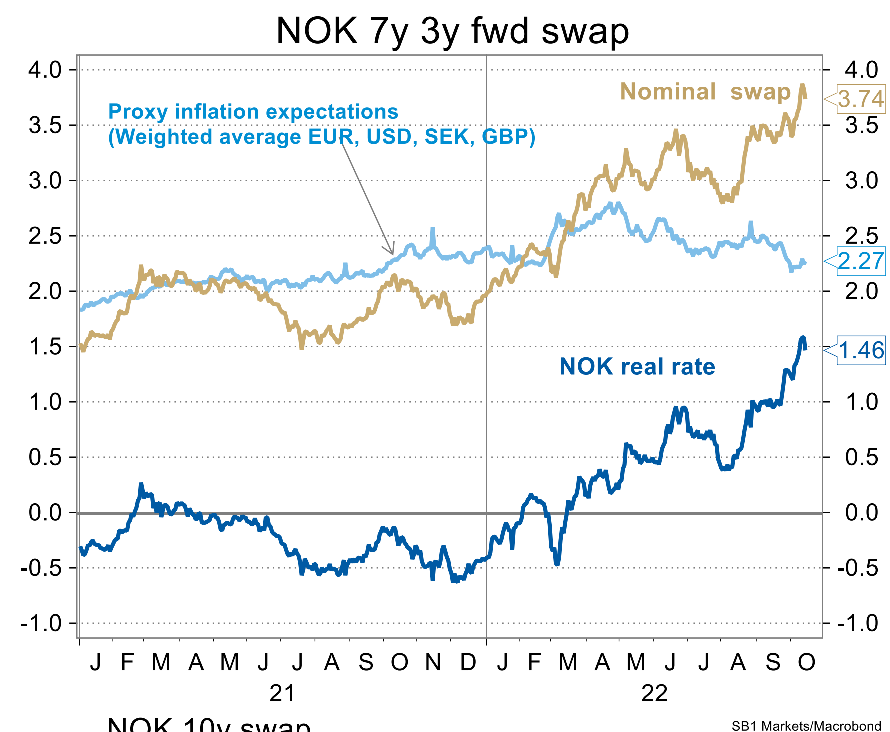
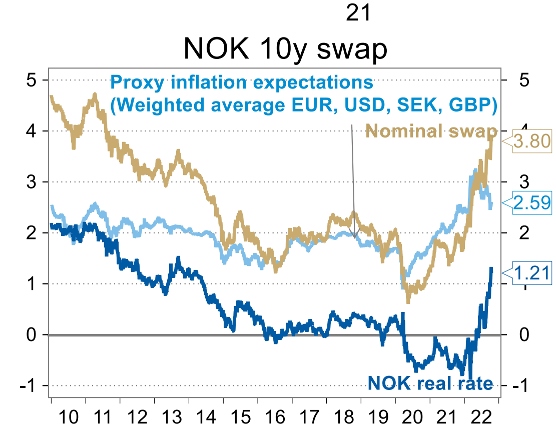
Norway: NOK inflation expectations very likely down, as in the rest of the world

If so, real rates rose sharply in Norway too last week – and the trend is straight upwards





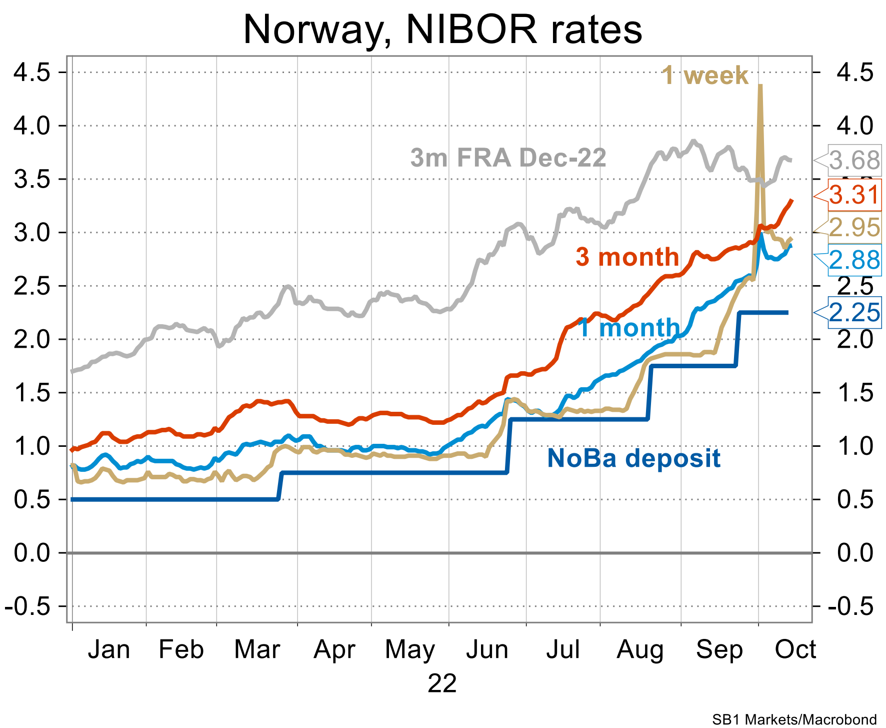
- The lift in nominal swap rates recent months is due to higher real rate expectations, while inflation expectations are trending down

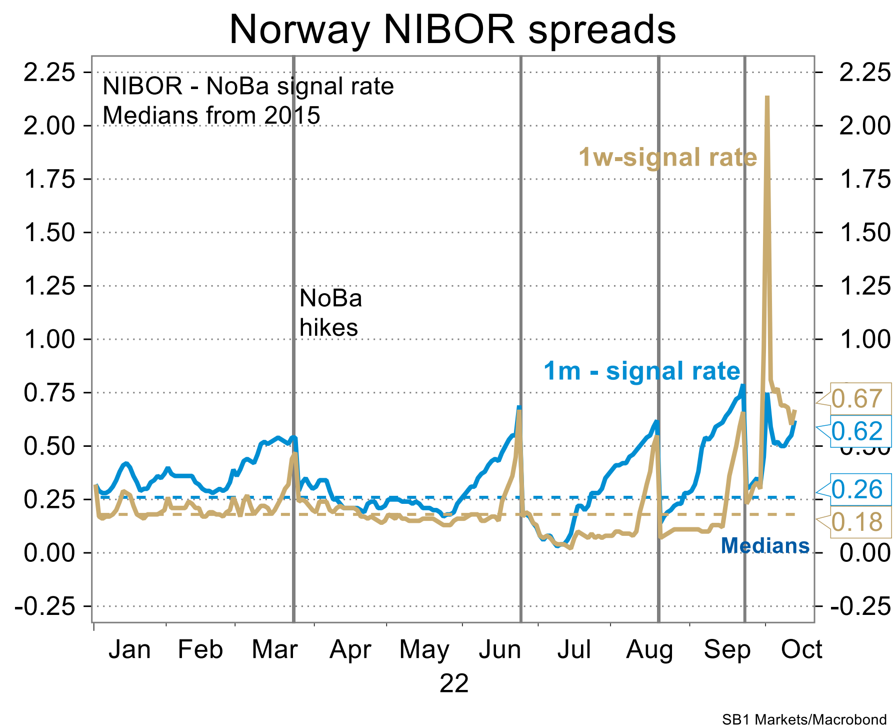


Memo: Our NOK inflation expectation proxy is a weighted average of EUR, SEK, GBP, and USD inflation swaps, cross-checked vs historical inflation differentials and inflation expectations from surveys

Still some stress in the money market, the 1 w NIBOR spread 50 bps 'too high'

.. But the 1 m NIBOR is just 15 bps too high, if a 50 bps Nov 3 NOBA hike is discounted

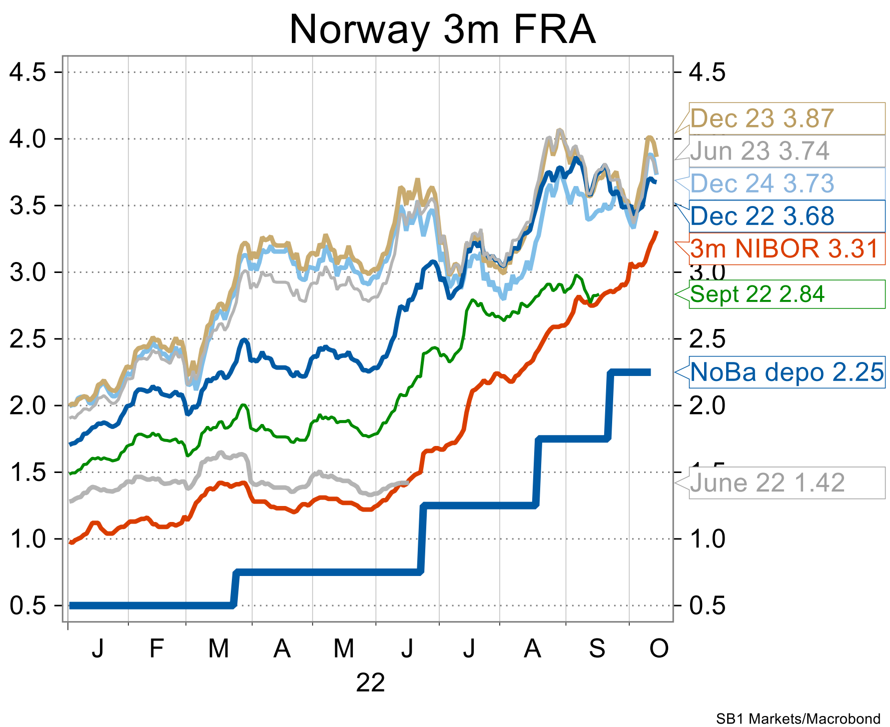


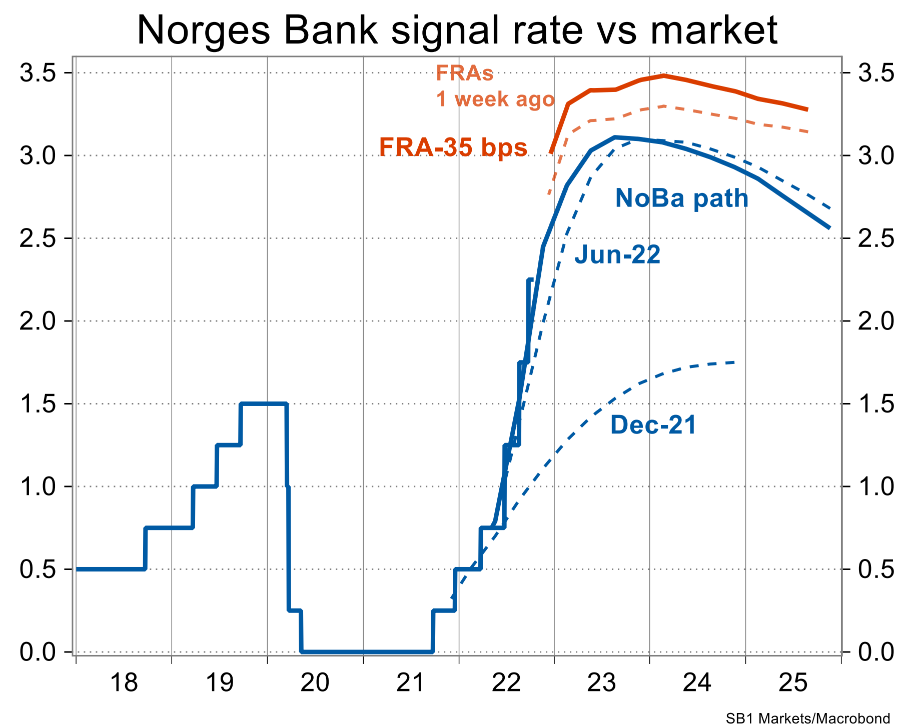


- Which signals that the longer term NIBOR spreads probably not have widened that much, if anything. If so, the FRA-rates adjusted for a 'normal' spread at some 35 bps, reveal the market's expectations for Norges Bank' signal rate

FRAs up 16 – 20 bps last week, the 3 m NIBOR up 26 bps! FRAs signal NoBa at 3.5%

We have no indications that NIBOR spreads have widened (but is higher than normal in the short end)

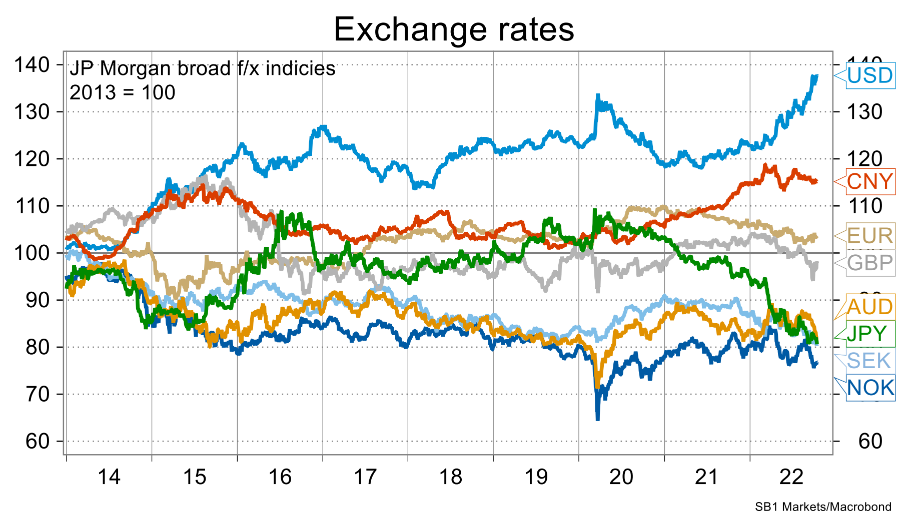


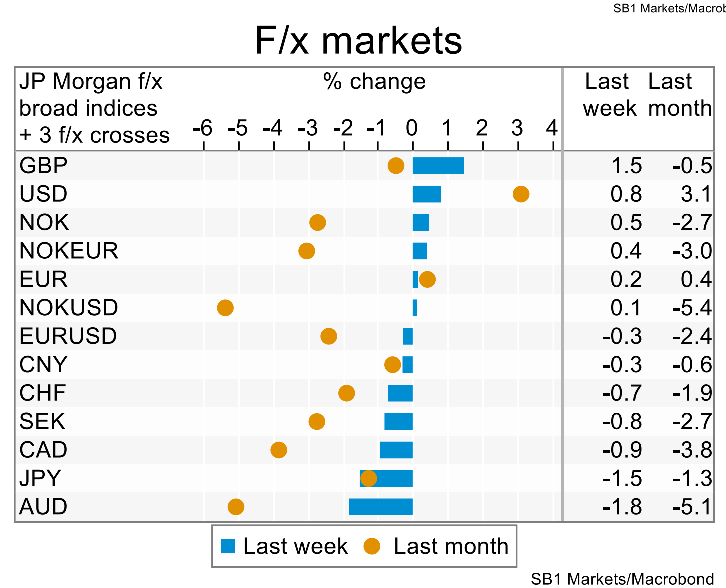


- **The 3m NIBOR** added 26 bps to 3.31% last week. 3m FRA rates rose 16 – 19 bps
- Given the current 3 m NIBOR at 3.31% and the Dec-22 3 m FRA at 3.71% (up 26 bps and 19 bps resp. last week!), the market discounts 50 bps hikes in both Nov and Dec even if the spread is at 55 bps, 20 bps above a normal 35 bps level!
- **Higher inflation** than expected is an argument for a 50 bps hike in November, but we are still not convinced that the bank will take another 'double' as wage inflation has not accelerated by much (if anything)

The GBP climbed, as did the NOK, even the oil price and AUD/CAD/SEK fell

NOK has narrowed the gap vs AUD/CAD/SEK but remains weak





JP Morgan f/x broad indices + 3 f/x crosses	Last week	Last month
GBP	1.5	-0.5
USD	0.8	3.1
NOK	0.5	-2.7
NOKEUR	0.4	-3.0
EUR	0.2	0.4
NOKUSD	0.1	-5.4
EURUSD	-0.3	-2.4
CNY	-0.3	-0.6
CHF	-0.7	-1.9
SEK	-0.8	-2.7
CAD	-0.9	-3.8
JPY	-1.5	-1.3
AUD	-1.8	-5.1

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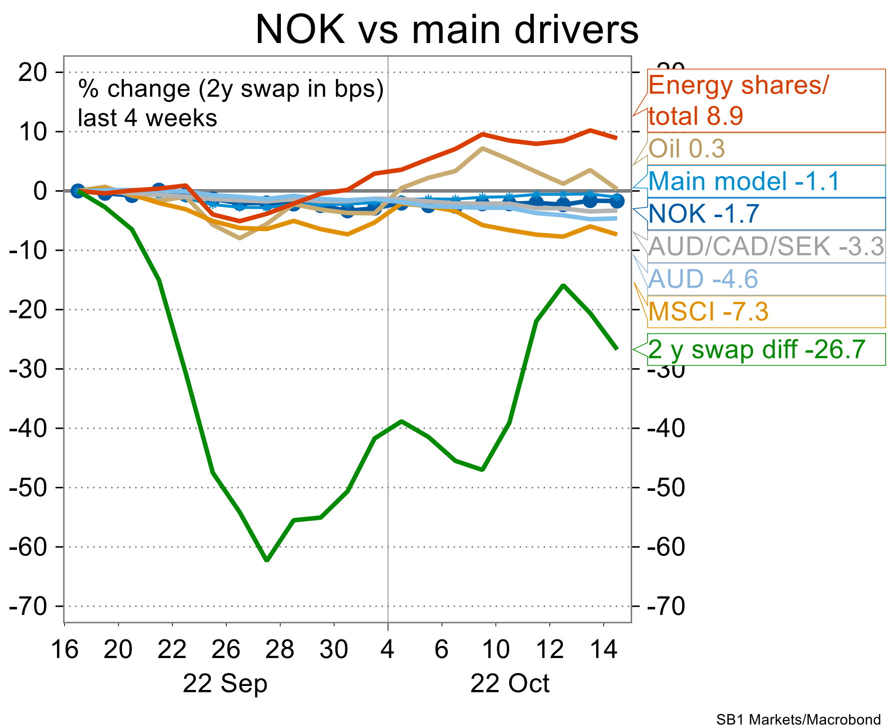
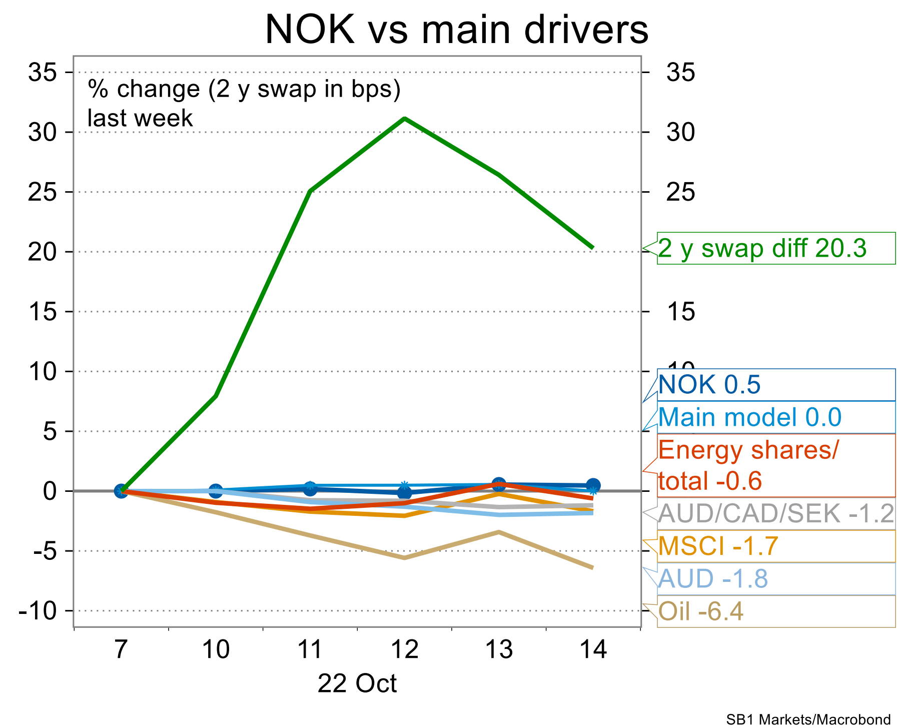
NOK up 0.5%, even if the oil price fell. Some support from higher rates?

Our f/x peers turned down last week, as did the global stock market





Gaps vs. out model estimates mixed last week

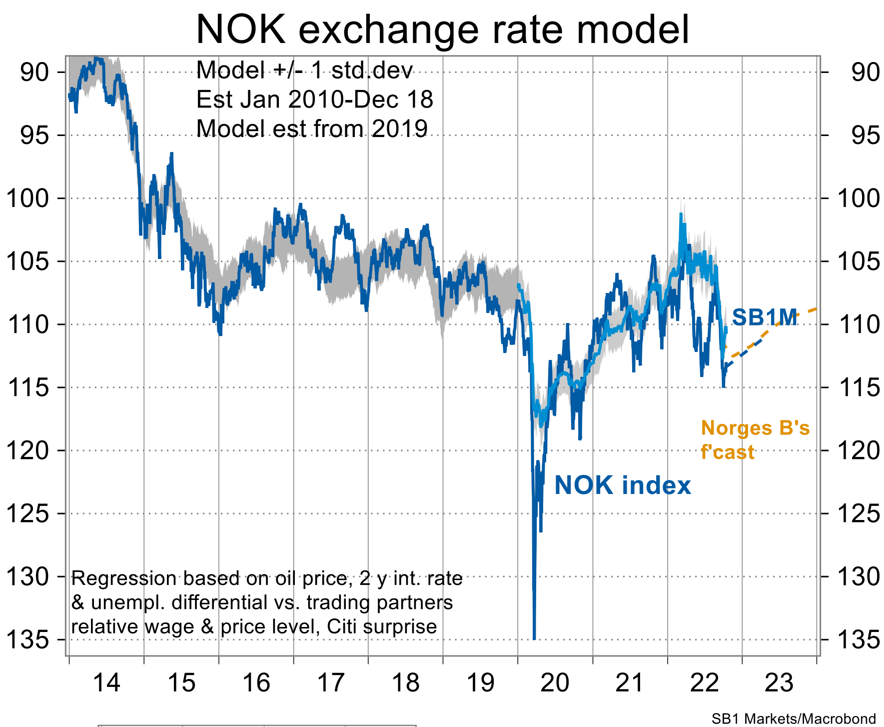
- ***NOK is 2.1% <u>below</u> our main model estimate (from -2.2%)***
- The NOK is 6% <u>weaker</u> than our AUD/CAD/SEK-model, our 'super-cycle peers', predicts, a substantial weakening (from -8%)
- NOK is 4% weaker than an estimate from a model that includes global energy companies equity prices (vs the global stock market) (from -5%)

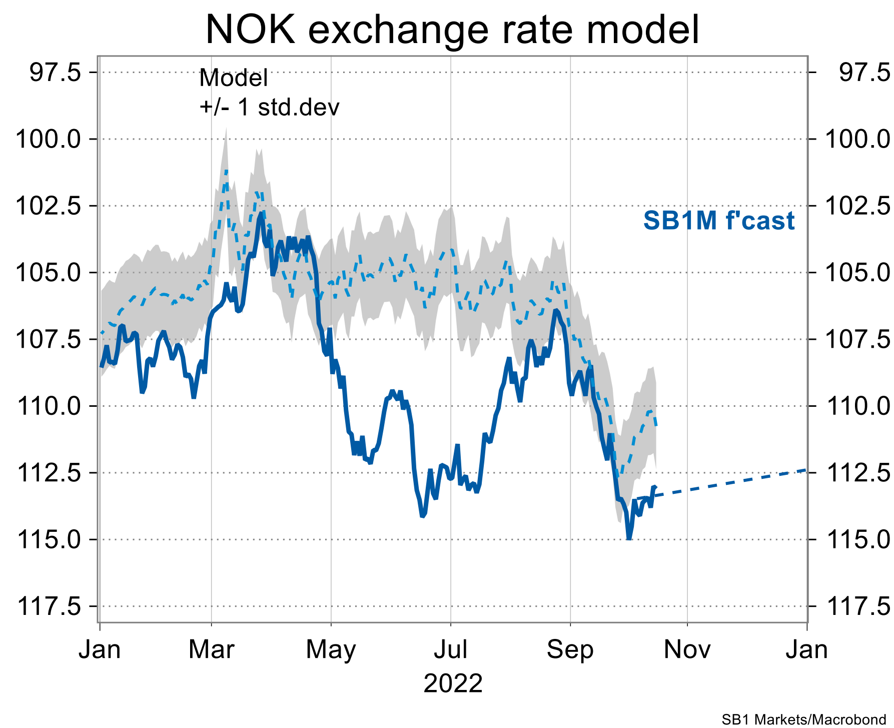
In our monthly report, we forecasted a mild NOK appreciation, from a weak position vs. all of our yard-sticks

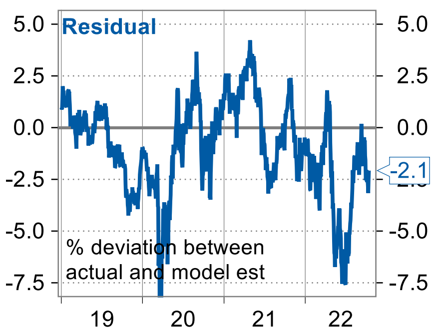
At this and the following pages we have swapped Norges Bank's I44 index for JP Morgan's broad NOK index and rebased it to the current index value for the I44. The I44 has an earlier closing time than the 'official' closing time for f/x crosses. There are no substantial difference between these two indices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

The NOK 2.1% below the model estimate

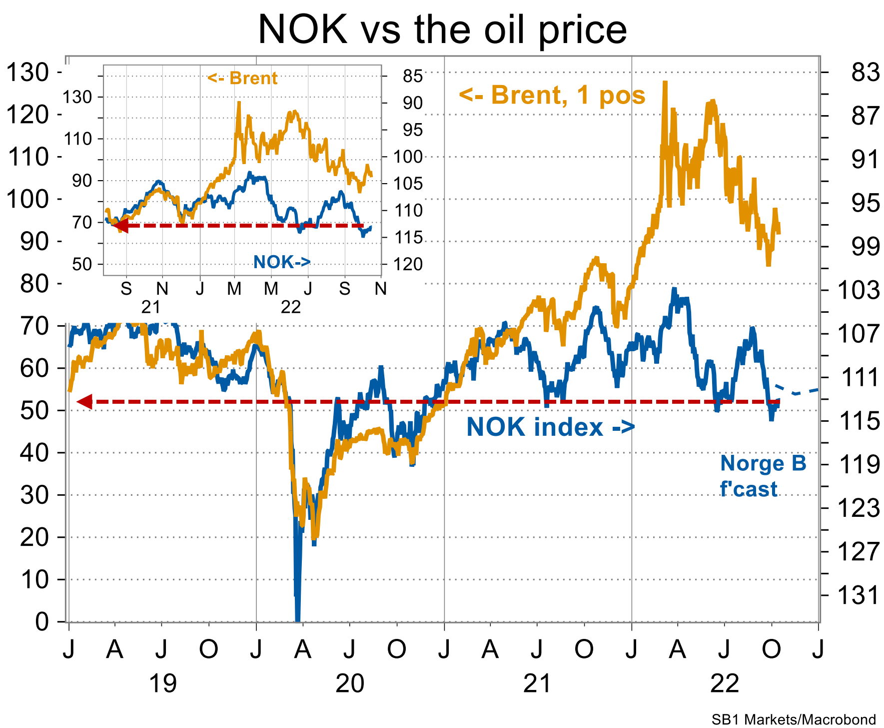
Both are heading down of course

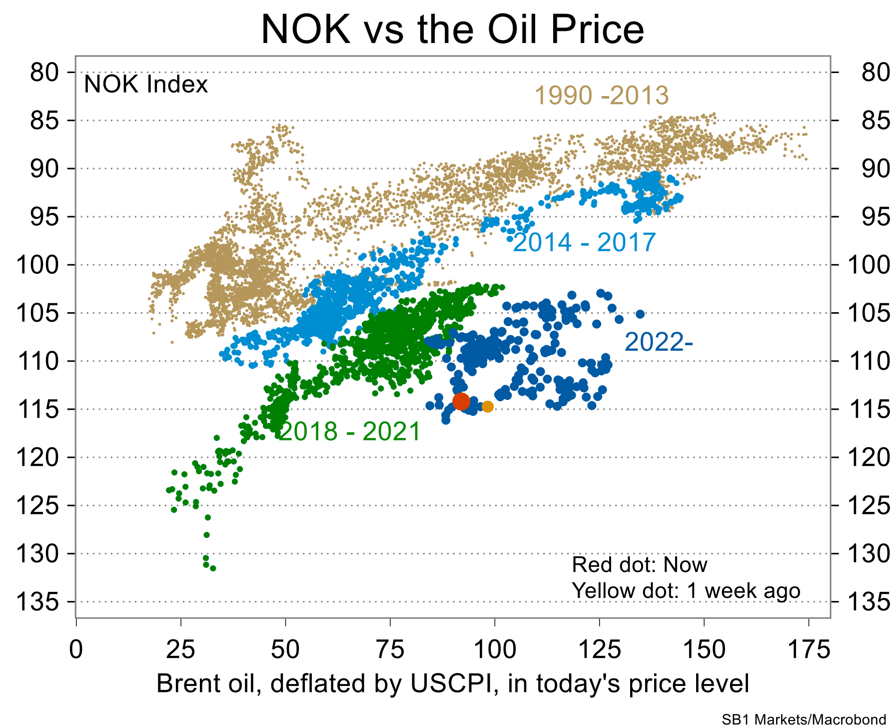






Oil down, NOK slightly up





- The correlation between the NOK and the oil price has been close to non-existent since the start of 2022

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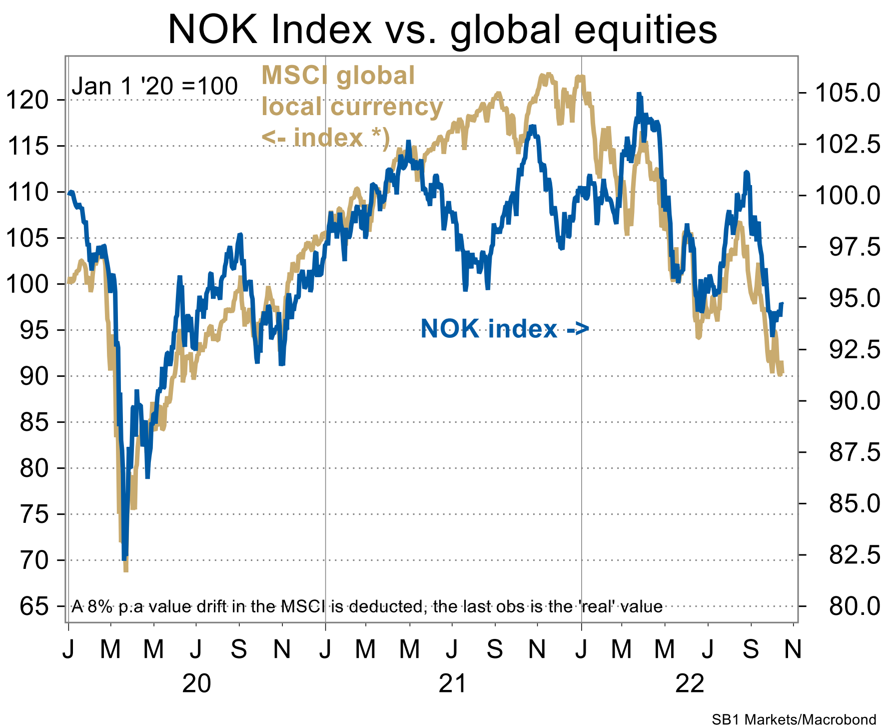
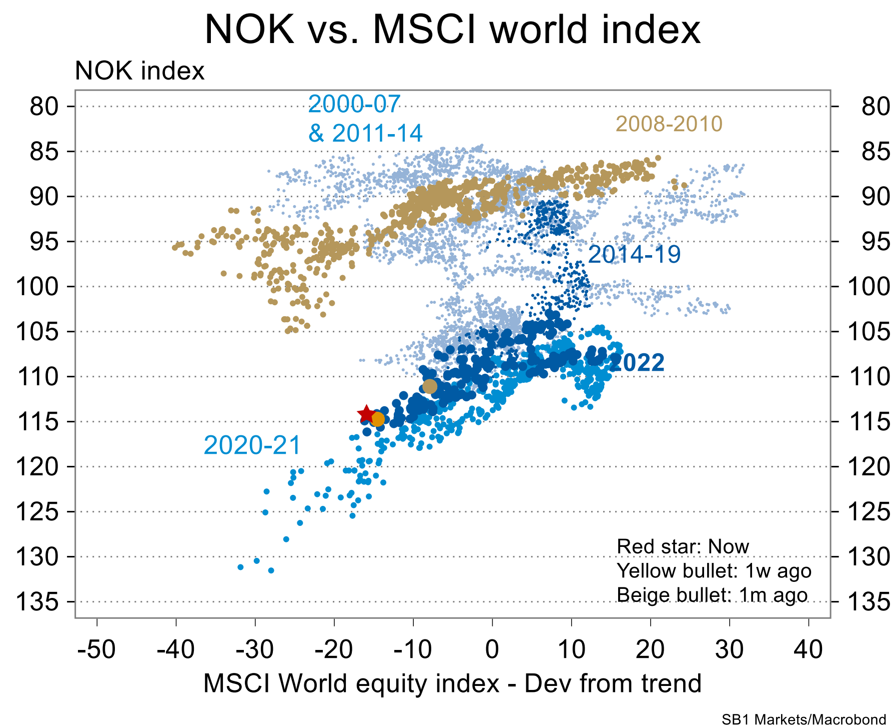
The NOK marginally up, even if the global stock marked was on the weak side

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

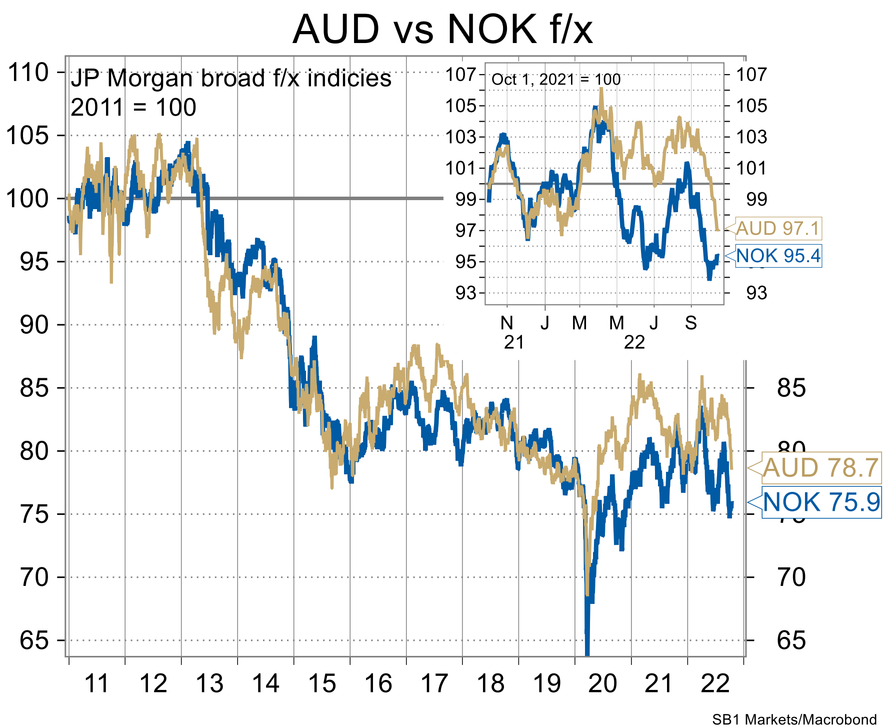


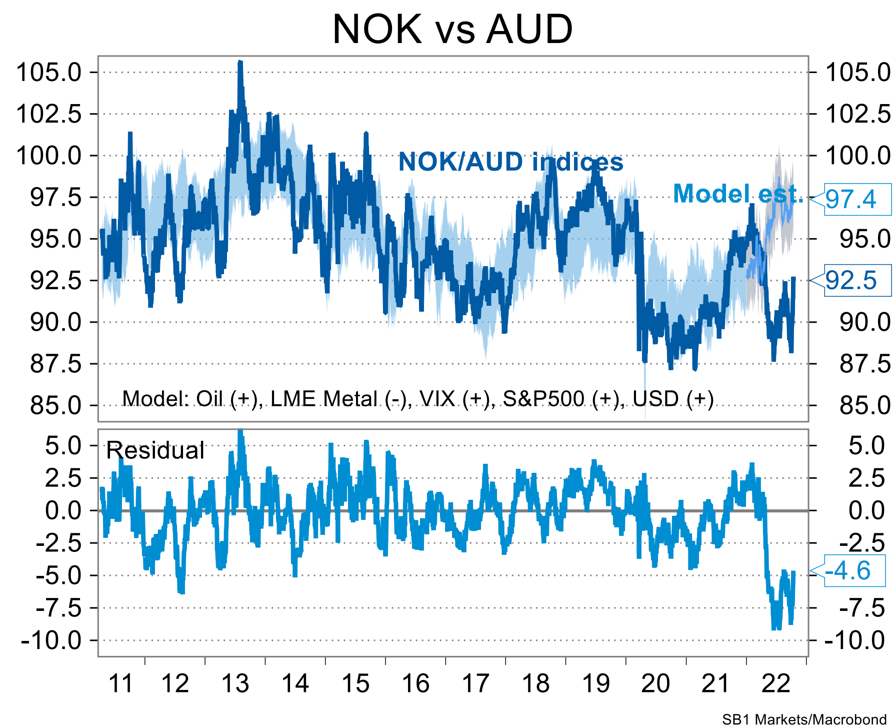


- There is no stable correlation over time, and when it is, the oil price is normally the real driver. Not so much now

We'll Meet Again? The NOK up, the AUD – and the gap narrowed

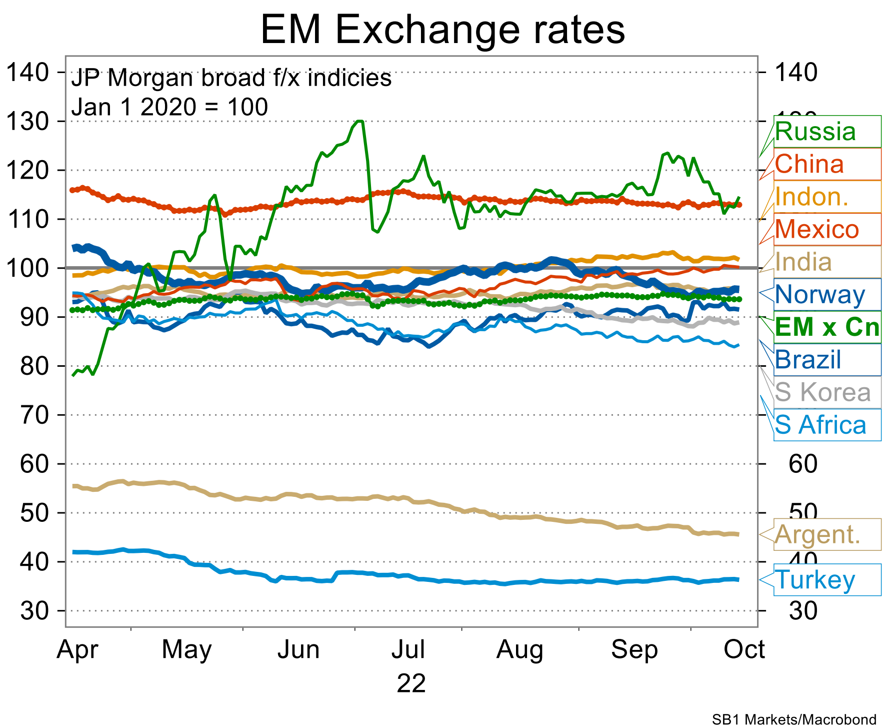
NOK is ~~7%~~ 4.6% below our model f'cast vs AUD

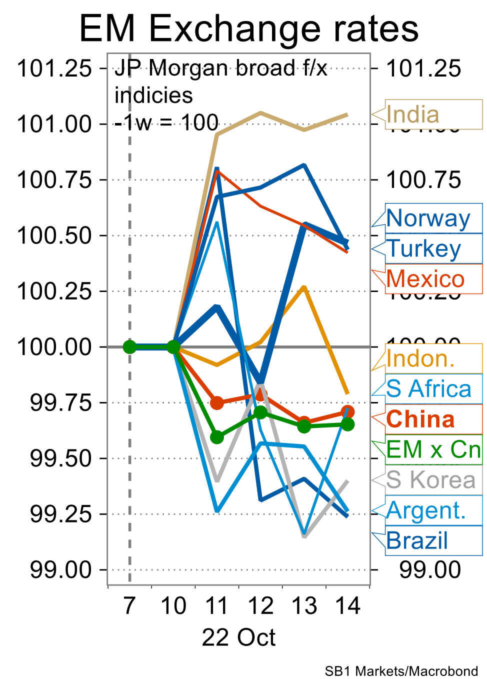


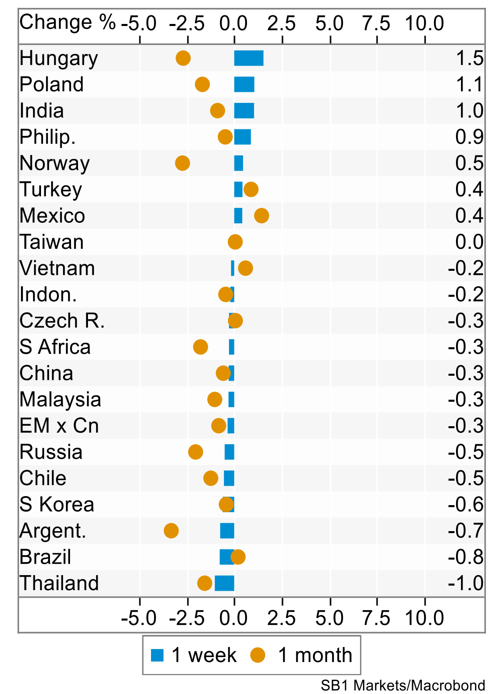


- The discrepancy between the NOK and AUD is unusual, given the normal factors that normally has explained the limited gap between the two
- Normally, NOK strengthens vs the AUD when the oil price rises vs. the LME metal index, when VIX, and the S&P500 index increases, and the USD index appreciates.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

EM f/x (x China) mixed, in sum down last week – but no drama







- The CNY has been slightly on the weak side recent weeks. The weakness vs. the USD is due to a strong USD, not a very weak CNY, trade weighted

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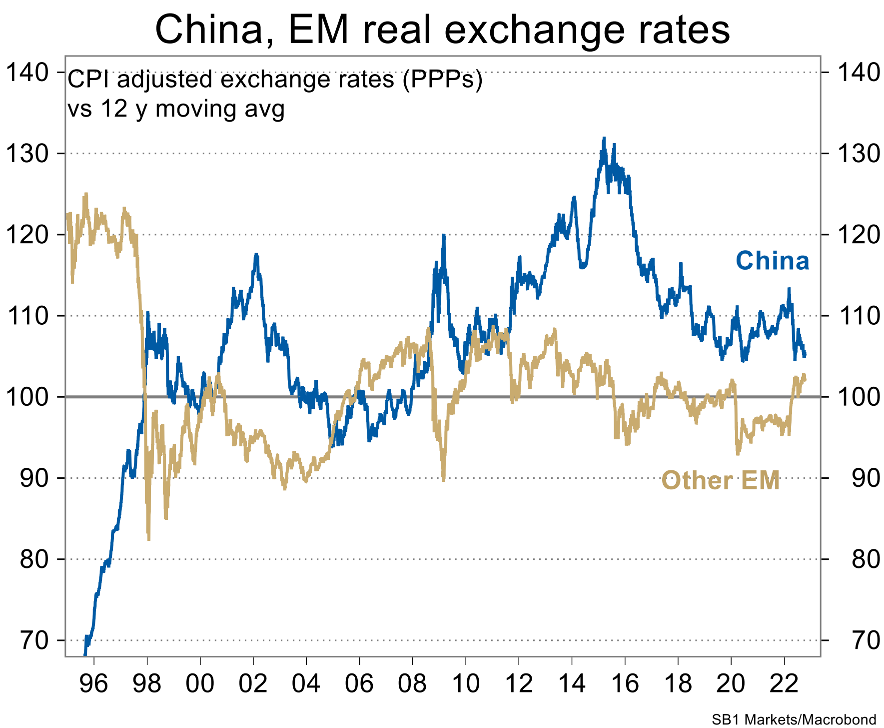
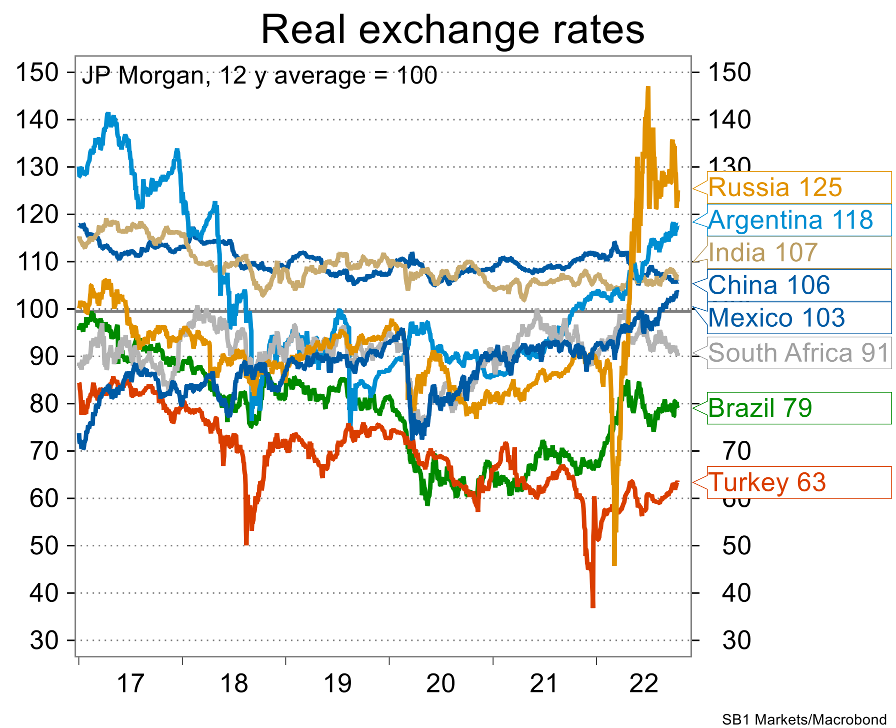
EM f/x, The long view. Higher US interest rates have not crushed EM currencies

Most real exchange rates seem to be at reasonable levels. The Turkish lira is too cheap?





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