Sucden Financial

FX Monthly Report

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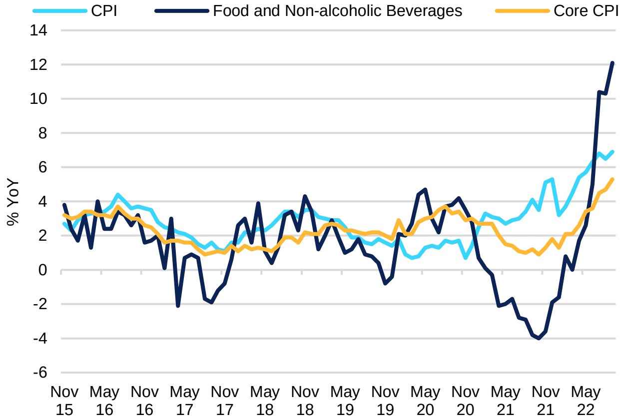
Norway Focus

Norway being part of Europe but not the European Union, continues to drive its own rhetoric regarding the monetary policy outlook it sets. Indeed, Norway was one of the first to start hiking rates in September 2021. With the latest rate hike underway, the markets are pricing in different hiking cycles from Norges Bank and the ECB. The recent move from Norway was in line with the lower end of market expectations, suggesting that the central bank is once again charting its trajectory for a monetary policy shift, as the ECB implemented a jumbo rate hike in October.

However, in line with the rest of Europe, economic pressures are eroding market confidence for households and businesses. Inflationary pressures continue to climb, increasing by 6.9% y/y, vs 6.5% in August. Service, transport and other household-related expenses also rallied significantly, suggesting that inflation is set to remain upwardly sticky for longer than expected. In particular, prices for food and non-alcoholic drinks increased by 12.1% y/y, and transport costs jumped by 11.3%. Likewise, despite having greater access to energy from domestic sources, housing, water, electricity, and gas grew by 5.8%. However, once again, food and energy were the biggest drivers behind growth, but even with the volatile components removed, the core part continues to breach record highs, growing by 5.3% y/y and up by 1.0% m/m. Fixed costs for households are significantly higher than they were a year ago, and we expect to see mortgage rates rise, putting pressure on the housing market. In addition, rents are likely to increase, given landlords re-arranging their mortgages to account for higher interest rates, further compounding household inflation.

Norway CPI vs Food CPI vs Core CPI

Food and non-alcoholic beverage price pressures continue to rally, putting pressure the consumers.

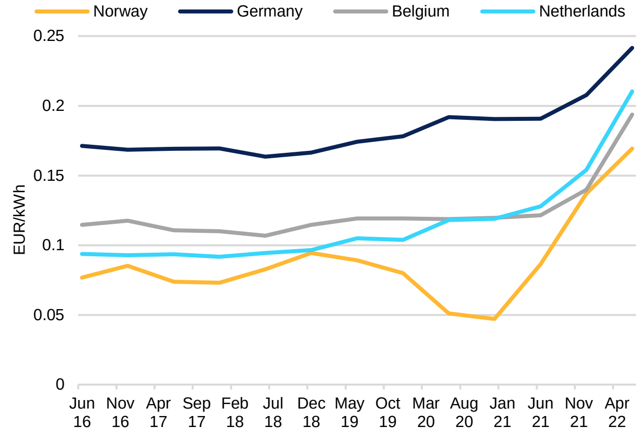


Source: Statistics Norway

Whilst energy price growth has not been of the scale we have seen in Germany and France, Norway's electricity price index increased back to 235 (100=2015); the previous high was 307 seen in December 2021, and we expect this level to be surpassed. Moreover, the most up-to-date data shows that electricity prices for consumption in the manufacturing sector, excluding energy-intensive processes, stood at 125.5Øre/kWh in Q2 2022 and 205.3Øre/kWh for households, including rent and taxes. We expect these levels to have risen since, but September average prices have weakened. Indeed, Norway's average electricity price from 8 am to 8 pm declined sharply in September to EUR238.52/MWh, down from EUR247.07/MWh. Overall, we expect the rise in mortgage rates, rents, food and electricity to keep CPI elevated despite the softer commodity and freight prices, further diminishing consumers' disposable income.

Industrial Electricity Price Consumption 2-20GWh per Region

Norway electricity prices are amongst the lowest in the region, given the country's energy self-sufficiency.

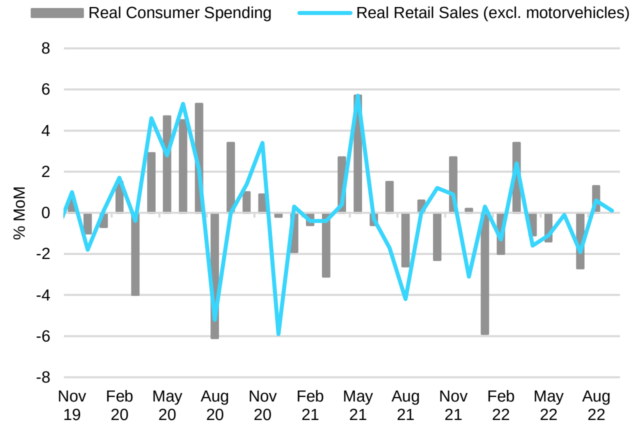


Source: Eurostat

Economic activity shows signs of deceleration as high inflationary data weighs on households and businesses. Real consumer income fell to 127.81 (100=2005) in Q2 2022, and we expect this figure to decline further in Q3 and Q4 2022. Still, consumer spending continues to grow year-on-year, with the August performance at 1.3%. GDP was positive m/m at 0.3%, but the GDP mainland m/m was down 0.3%; both figures are lower than market expectations. Activity in the economy still has a high frequency, but card transaction data fell in August, and the savings ratio has declined, and while household savings are high in absolute figures, this will further eat away at consumers' propensity to consume. As a result, consumer confidence fell to multi-year lows. At the same time, industrial confidence dropped massively, back to -4.4, the lows not seen since the summer of 2020, when the economy was recovering from the first wave of the pandemic. Output for the past three and six months fell compared to the previous reading, at 0.43 and -0.16. This highlights the weakening economy, and we expect headwinds to prevail. Another piece of evidence shows that growth is falling sharply below the trendline in the manufacturing sector, which is likely to soon lead to upward pressure on unemployment and ease the pressure on Norges Bank.

Consumer Spending vs Retail Sales

We expect to see further softness in real consumer spending, following a stall in retail sales in September.

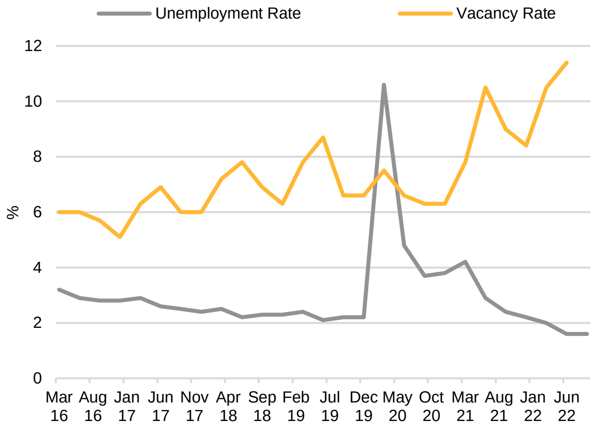


Source: Statistics Norway

The labour market, on the other hand, is showing signs of resilience, as unemployment remains stubbornly low, at 1.6% and has remained at these levels since the summer of 2022. At the same time, vacancies remain historically high, with the Q2 2022 figure of 107,000. This, coupled with low unemployment levels, will further fuel wage gains and add further pressure on the central bank to keep hiking for longer. Still, with a looming threat of recession, we expect the labour tightness to cool at the beginning of next year. If unemployment increases, credit growth will push higher, even with higher household savings.

Unemployment vs Vacancy Rates

Both indicators suggest prevailing tightness in the labour market.

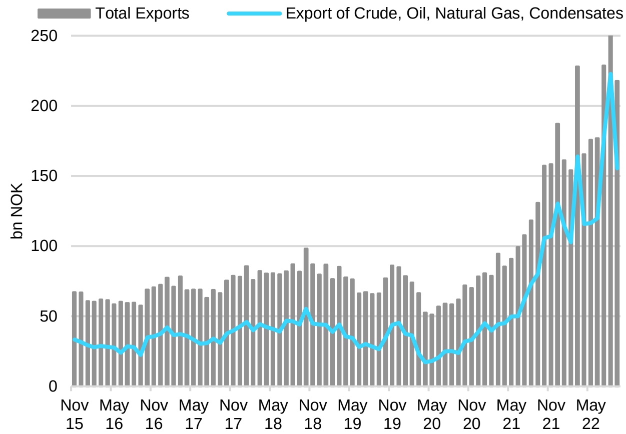


Source: NAV, Eurostat

We expect the oil prices to remain high following the OPEC+ cut, and markets anticipate the futures to remain close to $100/bl until the year-end. At the same time, regional network contacts have lowered their output growth expectation and low forward optimism. Electricity, gas and steam supply production has continued to fall m/m, down by 4.4% in August, up from -6.6%. The looming threat of the energy crisis in Europe is testing trading relations as countries fight to secure enough energy to supply themselves during winter months. The pressure falls on Norway, the largest producer of oil and gas in Europe, following the cut-off from Russia. According to The Norwegian Water Resources and Energy Directorate, the nation's reservoir content is 75.4% full, a high not seen since January 2021. Still, according to Norwegian authorities, gas deliveries for 2022 have been updated to 122bn Sm3, 9bn higher than in 2021. The increased deliveries through the gas pipelines drive the majority of the increase, but companies are also seen operating at near full capacity to benefit from production at higher historical prices.

Total vs Energy Exports from Norway

The softness in exports drove the overall decline in export levels in recent months.

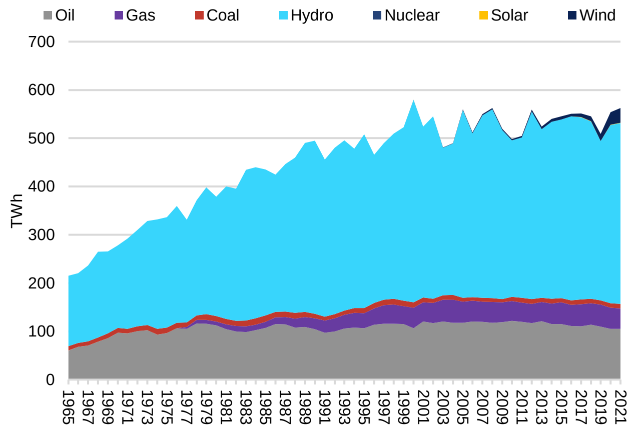


Source: Statistics Norway

In a blow to Europe's access to energy, Norway stated that refilling its hydropower reservoirs would take precedence over foreign sales as utilities in the country's southwest are struggling with severe water shortages. The economy depends on hydropower for more than 90% of its electricity production. They have now postponed this to spring; still, this is creating a higher level of distrust between the European nations, causing many to stockpile energy, even over peak demand. Still, the nation had to combat high electricity prices with subsidies for households to help ease the squeeze the households felt on their purchasing power.

Norway Energy Consumption by Source

Hydro remains key source powering the nation's grid.



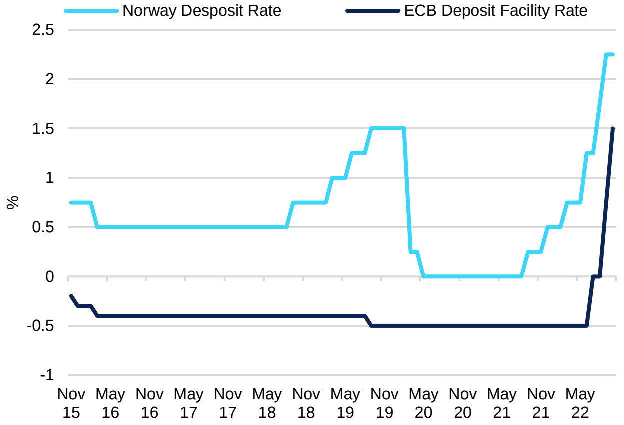
Source: BP

Currency Focus

The Norges Bank increased its key interest rate by 200bps since the start of the year, one of the sharpest increases on record for the economy. With 25bps now underway, the market is currently pricing in a similar rate hike during the next meeting as well as in January. Still, the hike of 25bps is the smallest increase since June and marks the end of the front-loading policy from policymakers, as slower economic indicators offset continued gains in inflationary pressures. The governors have stressed that the unusually uncertain outlook with bigger-than-expected slumps in the housing market and household spending are among the potential risks. With this in mind, this keeps the central bank on track to meet the Q3 assumption of a policy rate reaching 3% in winter, and the average interest on residential mortgages is currently 2.2%, which may increase to 4.3%. Still, historically high inflation is likely to put further pressure on the central bank to raise rates, although at a smaller scale. Still, the Norges Bank expects the level to continue increasing in the coming months and find a peak in H1 2023. As a result, we expect the yield curve to flatten as front-end rates rise, but growth fears could prompt an inversion, but robust trade data boost Norway. While we have seen a rhetoric change from the ECB during its latest meeting, the markets are starting to price in a softer rate hike trajectory as well as the earlier pivot from the Norges Bank, which should add further downside to the krone in the meantime. The strength of this relationship should lessen once the ECB begins to slow down its pace of hiking, which we expect to take place during its next meeting in December. With the ECB still expected to hike by more than 100bps until its peak and Norway already slowing the rate of hikes to 25bps, the EURNOK could rebound by the end of the year. However, NOK remains vulnerable to risk sentiment jitters, and another 25bps worth of tightening by year-end and the softening energy prices still point to a slightly stronger EURNOK.

ECB Deposit Facility vs Norway Deposit Rates

Norway's path of tightening is now converging with the ECB, put the pace is set to slow next year.



Source: ECB, Central Bank of Norway

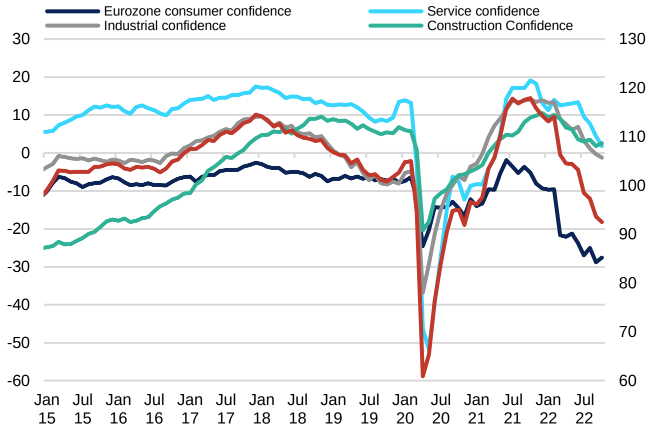
Desk Comments

Euro

The ECB didn't disappoint and continued to front load rate hikes. Hiking by 75bp at the October meet and indicating 50bp in December as they continue to battle against an increase in core inflation. The subsequent statement did little to clarify the ECB's commitment to raising rates at such a pace, so we see the pivot early next year.

European Sentiment

European sentiment has nosedived in the last few months, and remains low. .



Source: European Commission

Despite the volatility around the ECB meeting, EURUSD has been fairly subdued over the month. 1m vols have dropped to 10.8% as a significant risk event passes with EUR trading within the range of the past 2 months. EUR is the best performer among G7 nations last month. Contributing factors are the German economy weathering the economic turmoil far better than expected, the easing of supply constraints in manufacturing and the mild winter around Europe delaying the impact of the energy crisis.

In spite of this we see EUR eventually turning lower and testing last months lows at 0.9630. Lead indicators suggest manufacturing and service activity is slowing down this quarter and the energy crisis will start to grip the EU.

USD

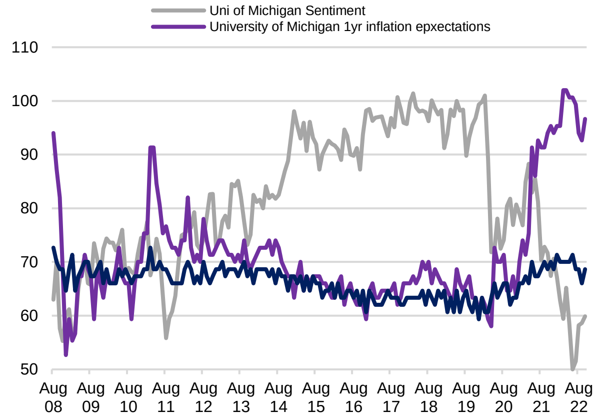
Dollar has been trading relatively sideways and has been on the backfoot recently amid pick up in risk appetite with equities rallying and a milder winter in Europe increasing optimism over gas prices which is lending support to European currencies. Despite the recent vulnerabilities, we still see USD prevailing over the next few months as data remains robust following strong NFP, PMI'S and auto sales. This coupled with Feds message that terminal rates are likely to be higher are all supportive for dollar; the interest differentials will invertedly continue benefitting the dollar as the Fed grapples with inflation.

This week's CPI figure is expected to show a retracement in last month's number with core CPI YoY expected to retrace back to 6.5% and could change short term sentiment. However, in our opinion inflation is still very elevated and if we do not see a retracement by January then terminal rates are likely to be higher still. As it stands, markets are pricing in a 50-basis point hike in December and 25/50 basis points in January with rates peaking in June 2023.

US Midterm elections are also likely to be key focus this week and define where the greenback goes in the short term. The republicans are expected to win both the house and the senate, and if they win by decent margin then this could make it easier for fiscal tightening which could induce a deeper recession in the US and by contingent have global repercussions. In such scenarios long USD vs EM could be a good play.

US Michigan Sentiment Indicators

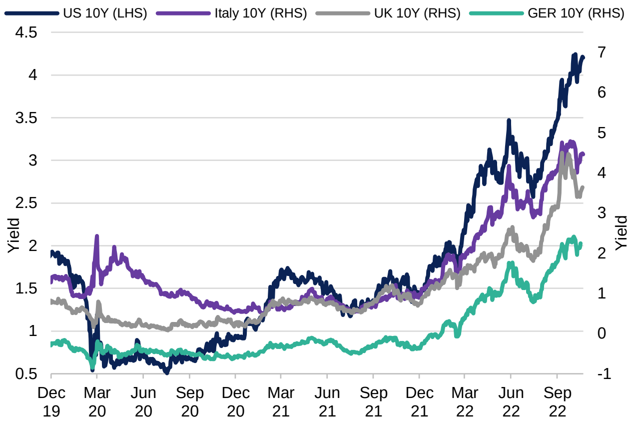
Sentiment is falling to multi-year lows, and inflation expectations are on the rise once again.



Source: University of Michigan

US, UK, Italian, Germany, 10yr Yields

Yields remain elevated as tightening cycle from most developed nations' central banks continue.



Source: Bloomberg

GBP

BOE hikes by 75bp as expected but sends a clear dovish message on the near-term outlook. The pace of hikes is set to slow to 50 bp in December followed by 25 bp throughout Q1 2023. A shift in focus from inflation to recession is on the horizon. The current terminal rate is priced in at 4.7 % and we see this to be the upper end of our projection as the latest macro data suggest a gloomy outlook ahead.

The housing market is already showing signs of slowing down. Prices hit a 5-month low in October and mortgage approvals dropped by 10% last month indicating a greater fall in prices. Since 2009 (base rate dropping close to 0) there have been over 4 million mortgages issued to new homeowners at the lowest rates we've seen in decades. The sharp hike in mortgage rates in addition to rising cost of living will stretch household spending and weigh on GBP in the near term. According to OECD real household income per capita has dropped by 3.5%, which is the largest drop of any G7 nation.

The reversal of Truss fiscal plan has undoubtedly helped GBP. However, we envisage pain ahead as the government battle with the large current deficit and the cost of living crisis meaning rates cannot withstand the current rate hike cycle so we see GBP falling behind the tightening cycle of the FED and eventually testing the lows at 1.1150.

Technical Analysis

GBPUSD

GBPUSD touch higher last month, but still rangebound and holding below green downtrend line. While green downtrend line remains intact then a break of the white trendline could see market trace back to 1.0845 (62% fib). A break below 1.0845 would likely see a test of support @1.0520 and recent lows @ 1.0350. On the upside, a close above the green downtrend could lead to retracement back up to 1.1839 (38.2 % fib line) with a break above paving the way for further gains up to 1.23 (50% fib retracement).

EURUSD

EURUSD has broken downtrend line and could now lead to further retracement back up towards 1.02 resistance level and then blue and green trend line coming in around 1.04/1.05 where expect strong resistance. On the downside, a break below white uptrend could see market test recent lows @ 0.953. A break below would open doors to further decline down to 0.9330 and then 0.90 support level.

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