

Hawkish Norges Bank to hike rates and signal more to come

We expect the Norwegian central bank to increase interest rates on Thursday and signal another move later in the year. But in light of recent declines in oil prices and overseas interest rate expectations, we could see Norges Bank signal a more cautious path for rates in 2020 and beyond



Source: Shutterstock

Norges Bank is going against the tide of global central bank easing

The Norwegian central bank looks set to go firmly against the global rate cut tide on Thursday, where the stage is set for interest rates to increase by a quarter-point to 1.25%. This would mark the second rate hike so far in 2019.

But given that this move was clearly signposted by policymakers back at the May meeting, the bigger question is whether the bank will signal a third increase later in the year.

Expect the central bank to signal a further move later this year

When Norges Bank last released its interest rate projection back in March, policymakers had pencilled in roughly two further rate hikes in addition to the one expected this week. Back then, the next rate rise was expected to come in the early stages of 2020, but in light of recent developments, we think policymakers may look to bring forward the timing of this to later this year.

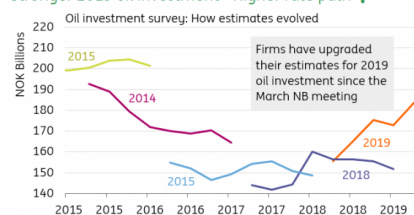
Domestically, the case for tightening continues to look fairly solid. The recovery in energy prices over the past couple of years has helped the economy, particularly given that the break-even cost for new Norwegian projects lies well below current market pricing (break-even is around \$10-35 per barrel, according to the central bank). This has incentivised investment in extraction/pipeline activities, and the latest survey data suggests the total investment in 2019 will be even higher than previously anticipated.

At the same time, the krone has weakened further, defying Norges Bank's forecast for around a 2% average appreciation in the trade-weighted krone across the second quarter.

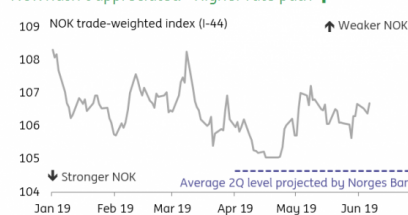
The combination of stronger near-term investment and the weaker krone should have the effect of boosting Norges Bank's rate path in the short-term.

How the latest interest rate projection could change compared to March

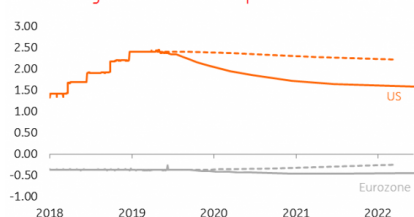
Stronger 2019 oil investment - Higher rate path ↑



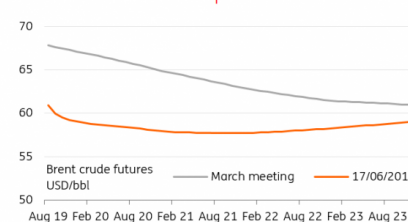
NOK hasn't appreciated - Higher rate path ↑



Lower foreign rates - Lower rate path ↓



Lower oil curve - Lower rate path ↓



Source: Macrobond, ING

The Bank may signal a lower path for interest rates further out

It's not all positive though, and there are question marks over how the projections will look further out. Oil prices have declined across the curve since March, while foreign interest rate expectations have fallen markedly as trade tensions have grown. The mechanical way the Bank formulates its interest rate projections mean both factors could translate into a lower rate path for 2020 and beyond.

We expect a December rate hike from Norges Bank

Wrapping all of this together, it looks pretty likely that the Bank will incorporate a further rate hike later this year into its projections. We think such a move is most likely to happen in December.

All this could support NOK in the short term and even deliver a lower USD/NOK – [please read our article on how the dollar could react to a Fed Dot adjustment](#). However, we doubt Norges Bank policy will be enough to drive NOK persistently stronger against EUR in 3Q19, even if oil prices move higher. Like other high-beta currencies, NOK has been dragged down by concerns about trade wars and weaker global growth.

With a non-negligible risk of the US imposing broader tariffs on China this summer, a hawkish Norges Bank should instead translate into NOK outperformance against SEK (Swedish Krona) as opposed to EUR. Risks to EUR/NOK remain on the upside over coming months unless there are signs of a material improvement in trade tensions.

[Read how the dollar could react to a Fed dot adjustment](#)

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