How Norges Bank might be missing its window to cut rates

We are (reluctantly) aligning with the market and consensus call for a hold at the 19th June meeting. In our view, Norges Bank is missing out on good conditions to cut, as underlying inflation has abated, and currency volatility can return at any moment to thwart easing plans. Based on this, we favour August over September for the next move

A view over Oslo's business district

We had originally called for a June Norwegian rate cut amid a worsening growth picture and signs of easing inflationary pressures. However, inflation and growth figures have led markets and consensus to dismiss the chance of a June move. The question remains open between August and September for the first rate cut; we think markets are underestimating an August move (9bp priced in).

We see dovish risks as new rate and economic projections are released at this meeting. The March update had 3Q25 rates averaging 4.38%, suggesting one 25bp cut at the September meeting, but there might be more openness to a move already in August.

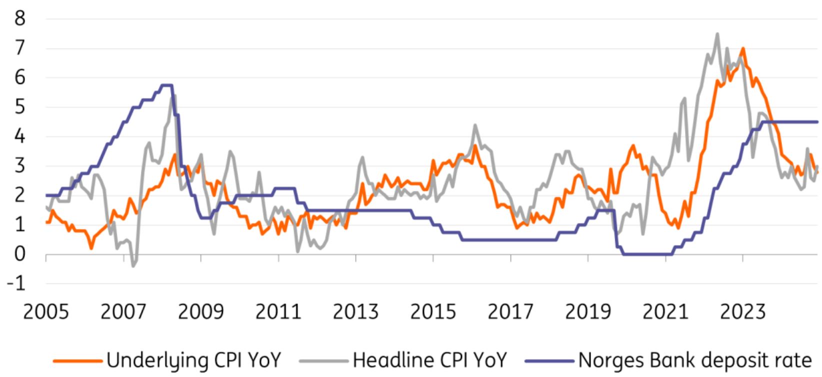
Norges Bank looks too focused on headline inflation

Markets were once again surprised by an out-of-consensus inflation print in Norway this week. May's headline CPI rose 3.0% YoY, reaccelerating from 2.5% and faster than the 2.7% estimate. Norges Bank is likely uncomfortable with inflation at 3.0%, but some of those inflationary factors may not linger. On a MoM basis, services CPI actually fell 0.2% in May, and underlying inflation slowed from 3.0% to 2.8%, undershooting expectations.

When Norges Bank claimed in January it was ready to cut at the next meeting, underlying inflation was close to now, at 2.7%, and projected to stay between 2.7% to 2.8% throughout 2025. We suspect policymakers are overly focused on short-term volatility in the headline CPI at the moment.

Incidentally, the Norwegian krone's trade-weighted index has appreciated an additional 1.4% since the 8 May meeting, which should reduce concerns about imported inflation. When Norges Bank sent its dovish message in January, the NOK TWI was around 4% weaker than it is now and projected to be 3% below current levels for most of the forecast period.

Norwegian policy rate looks too tight



Source: ING, Refinitiv

Growth risks inconsistent with high real rates

On the growth side, mainland Norway GDP was stronger than expected in 1Q25, with a 1.0% QoQ rebound after a 0.4% contraction in 4Q24. However, there are tangible risks of another negative QoQ print in 2Q on the back of the trade impact, and trend unemployment (4.3% in April) is back above the 2018-2019 average.

There are some signs of resilience in manufacturing PMIs and retail sales, but the question is whether that is enough to justify the highest nominal rate in G10 (4.50%), and among the highest real rates – adjusted for latest headline CPI – at 1.45%.

Norges Bank may be missing ideal market conditions to cut

In our view, the conditions to cut rates in June are all there. The main reason we call for a hold is that a central bank that has consistently surprised on the hawkish side is unlikely to deliver a surprise cut when markets and consensus have ruled it out.

However, Norges Bank may be playing a risky gamble with its excessive focus on short-term headline inflation swings. When conditions for cuts arrive, there is no guarantee the krone will be enjoying the current stability.

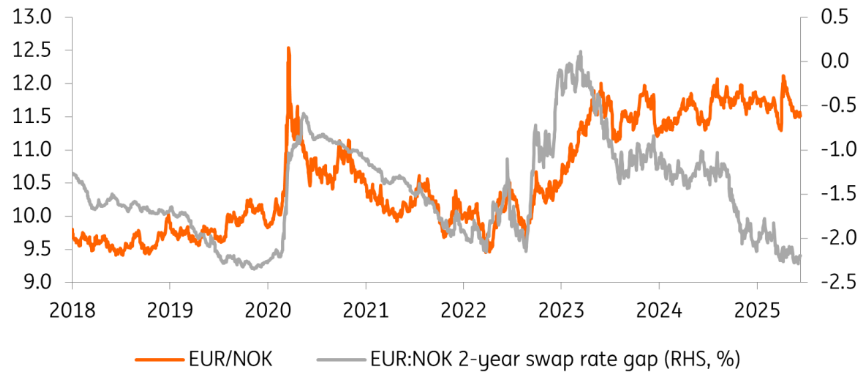
Remember that NOK is the least liquid currency in G10 and the one that generally faces sharper selloffs in times of market instability. So Norges Bank could face a lose-lose scenario: either cutting rates in a NOK sell-off, risking further NOK losses and higher imported inflation, or keeping rates on hold again to stabilise the currency, extending the monetary pain for the economy.

Cuts could be beneficial for NOK in the medium term

We are calling for an August 25bp cut in Norway, followed by at least another one by the end of the year. That is based on the view that Norges Bank will take on a greater sense of urgency with cutting and that NOK does not take a material hit during the summer.

While a dovish repricing in the NOK curve should trigger some NOK softness in the near term, in the longer run it may prove to be a positive, as it would allow Norges Bank to counter NOK selloffs more freely (i.e. without an uncomfortably high real rate) while the domestic growth picture would also improve. After all, EUR/NOK is already expensive relative to short-term rates as well as according to our medium-term BEER model, and a big Norges Bank easing cycle would be needed to justify a structural shift higher in EUR/NOK.

EUR/NOK already expensive relative to short-term rate gap



Source: ING, Refinitiv

> We expect EUR/NOK to trade around 11.20-11.70 for the remainder of the year, and while we retain a generally downward sloping profile for the pair based on valuation considerations, risks of sudden appreciation events due to global risk sentiment instability remain elevated. One could come already in early July, when the approaching deadline for Trump’s tariff pause can trigger market instability and a EUR/NOK rally.

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