Norges Bank hikes and signals more tightening in May and beyond

Norway's central bank surprised on the hawkish side today, as its well-telegraphed 25bp rate hike to 3.0% was accompanied by a pledge to hike again in May, as policymakers moved to counter the inflationary effect of a weaker krone. Updated rate projections now signal rates will reach 3.50% this summer

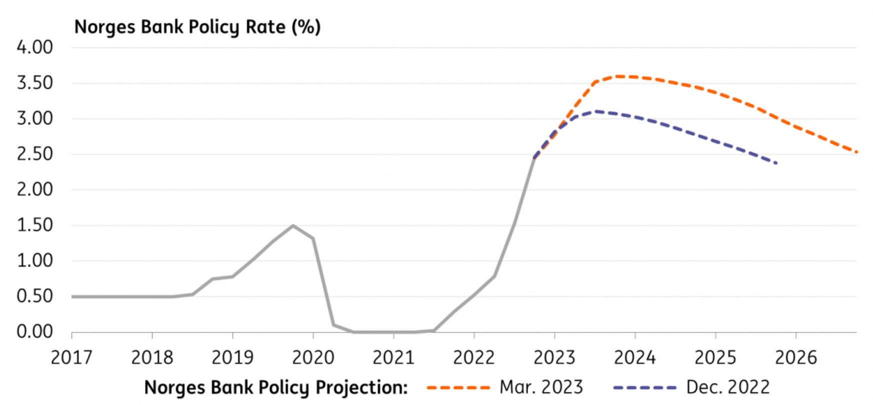
Policymakers are trying to counter the inflationary effect of a weaker krone

A hawkish surprise

Norges Bank today hiked rates by 25bp to 3.0%, in line with what had been previously announced. Despite inflation having been slightly slower than previously expected thanks to lower energy prices, the central bank pointed to wage growth and currency weakness as drivers for further price pressures, and ultimately pledged to raise rates again at the next May meeting.

In the new set of economic forecasts, Norges Bank signalled at least two more rate hikes before the peak, which should be 3.50% reached during the summer. Despite lower energy prices and higher rates, Norges Bank did not bring forward expectations for a return to sub-3.0% inflation, which is still expected at the end of 2024.

New Norges Bank rate projections



Source: ING, Norges Bank

The aim is to support NOK

It appears quite clear – in our view – that the hawkish tilt in the policy message was an attempt to offer support to the krone, whose recent weakness poses (as admitted in the statement) upside risks to inflation. As shown below, the trade-weighted NOK is trading below the late 2020 levels.

Norwegian krone trade-weighted index

Source: ING calculations

This is fully justified by the fact that NOK is the least liquid currency in G10 and was therefore very exposed to the tightening in global financial conditions, market volatility, and lately the turmoil in the banking sector.

A hawkish Norges Bank cannot counter those characteristics of the krone, but should European sentiment continue to stabilise, it can offer a breeding ground for recovery that can ultimately help Norges Bank limit imported inflation. Still, we think EUR/NOK will remain highly volatile, and a sustainable return below 11.00 will require a more substantial return of market confidence in the financial system: something that we may not see in the very near term.

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