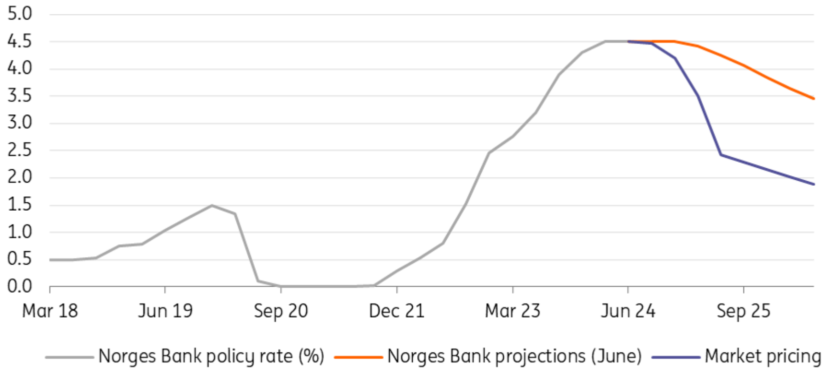
Norges Bank preview: Krone weakness to delay dovish turn

Norway's central bank announces policy this Thursday. Rates are widely expected to be kept on hold, and we think policymakers will retain their hawkish guidance to prevent a new round of krone weakening. Still, one 25bp cut by year-end remains plausible. NOK can continue its recovery in the near term

Fed and disinflation puts pressure on Norges Bank

Norges Bank will publish its monetary policy decision on Thursday 15 August, and there are no expectations of any changes to the policy rate, currently at 5.50%. Since the 20 June meeting, some factors have prompted markets to price in more easing than what had been signalled in the Bank's own rate projections over the next couple of years.

Markets significantly more dovish than Norges Bank



Source: Norges Bank, Refinitiv, ING

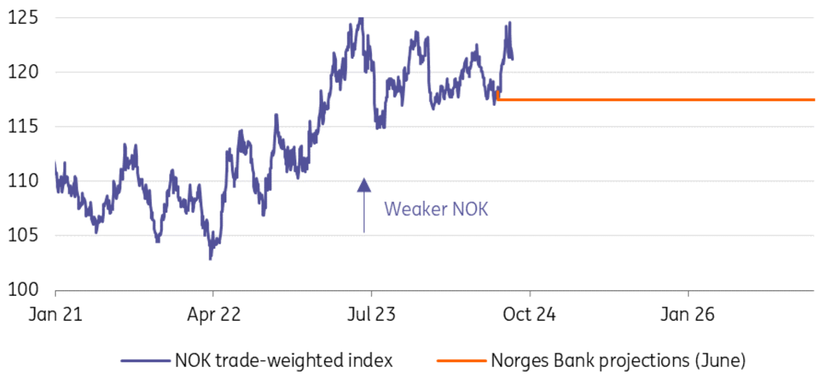
The most important driver of the dovish repricing in the NOK curve has been the sharp rise in easing expectations across the world, and in particular on the Federal Reserve. Norges Bank explicitly takes global rates into account when setting policy, and we believe that members are now facing larger pressure to start easing. As shown in the chart above, Norges Bank had signalled no rate cuts before 1Q25, which is now starting to look like an unrealistically hawkish prospect.

On the domestic side, inflation has eased faster than expected. That has also contributed to growing rate cut bets in Norway, with the swap curve now factoring in 25bp of easing by year-end. Inflation slowed to 2.8% (headline) and 3.1% (underlying) in July, well below Norges Bank's 3.9% and 3.7% respective forecasts for 3Q.

But NOK weakness remains an issue

There are two key counterarguments to turning dovish just yet. First, the Norwegian krone has depreciated significantly since June. As shown below, the NB's trade-weighted NOK index (higher values=weaker NOK) shows a 3.5% depreciation since the June meeting, with peaks of 6.5% earlier in August.

NOK has depreciated of late



Source: ING, Refinitiv

Crucially, NOK is trading more than 3% below Norges Bank's 3Q projections. In the June statement (when NOK was much stronger than now), Governor Ida Wolden Bache reiterated that "if the krone depreciates, wage and price inflation could remain elevated for longer. In that case, there may be a need to raise the policy rate".

The other factor that argues against immediate policy easing is the activity picture in Norway. First quarter Mainland GDP came in at 0.2% quarter-on-quarter and is on track to hit the 0.8% year-on-year Norges Bank forecast for 2024. Manufacturing PMIs rebounded to the highest since April 2022 in July and mortgage demand rose for the first time since 2021 in 1Q, an indication of continued household resilience to high interest rates. In total, the correction in Norwegian house prices in 2023 was a rather modest -1.3%, especially when compared to Sweden's -12% correction. House price growth has turned positive again in 2024 and was +1.5% in June.

No clear incentive to turn dovish for now

We believe Norges Bank will focus on supporting NOK at this juncture. This is an "interim" meeting, and the new economic projections will be published at the 19 September meeting, which is one day after the Fed's announcement (and likely rate cut). So, there is a clear incentive in our view to stick to a hawkish statement at the August meeting and delay a dovish shift in forward guidance until September.

In June, Norges Bank stated that "there is a need to keep the policy rate at today's level for some time and somewhat longer than we had envisaged earlier". In August, they could drop the reference to "somewhat longer than we had envisaged earlier" but we expect them to reiterate that policy will likely be kept restrictive for some time.

NOK can keep recovering

As mentioned above, one of the primary aims of keeping the policy message hawkish is to support the krone. EUR/NOK has entirely erased the August equity selloff-induced gains and is trading back around 11.75-11.80 at the time of writing. However, we estimate the EUR/NOK short-term fair value is at 11.48, meaning the pair remains almost 2.5% overvalued.

A hawkish Norges Bank should prevent further dovish repricing in the NOK curve and smooth the path for a further decline in EUR/NOK. We think a return to 11.40 is possible before the US election risk kicks in and the Fed cuts rates.

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