

## Norges Bank preview: Sticking to the September rate hike

Norway's central bank is set to deliver a largely unchanged policy stance. That means a first rate hike in September is getting closer and more certain



When Norges Bank raised (NB) its interest rate forecast back in March, shifting the first expected rate hike from December to September, it was the fifth time in a row that the Norwegian central bank indicated a more hawkish policy stance. That streak is set to be broken at the June meeting, as the NB looks likely to leave its interest rate forecast largely unchanged, and if anything is likely to shift it slightly downwards.

Since March, the picture has become a bit more muddled for the NB. The domestic data has been mixed, with core inflation in particular disappointing. And the global outlook looks less benign, with growth momentum softening in Europe and the US's increasingly aggressive stance on trade policy presenting a major risk. But underlying momentum in the Norwegian economy looks solid and this should keep the NB's relatively hawkish stance intact. We expect the NB to reiterate its commitment to raising rates "after the summer".

## Domestic economy sound despite soft core inflation

On the domestic front, the main bad news has come from core inflation, which has been well below the NB's projection at 1.3% on average in April and May vs the NB's 2Q forecast of 1.5%. A small downward revision to the core inflation forecast is likely.

Headline inflation has been higher than anticipated (2.3% vs 2.2%), but that is largely down to higher energy prices. The NB will put relatively less weight on this transitory effect, though its forecast will have likely shift up a little. On the other hand, an argument can be made that some of the weakness in core inflation is also down to temporary factors.

1Q growth at 0.6% was in line with the NB's projection. Employment grew slightly faster than anticipated, and house prices also surprised to the upside. May's increase in house prices compares favourably to the NB's projection, which expected 1.5% fall. The downside risk from the housing market downturn that worried investors so much back in 4Q looks to be fading.

The latest regional network survey, a key input for the NB's forecasting models, indicates near-term growth roughly in line with the March forecast (a little slower in 2Q, but better in the second half of 2018). The survey also indicated employment and wages will pick up further, suggesting a slight positive revision for the NB's projections.

## Oil a big positive

Though the external environment has arguably deteriorated since March, in the sense that the global growth looks a bit less buoyant (at least in Norway's key trading partners in Europe), the key external factors that the NB monitors actually point towards a somewhat tighter policy stance.

Most importantly, oil prices have risen materially since March, and are about 15% above the NB's previous projection. The exchange rate has strengthened slightly, but by less than the NB expected. Growth in trading partners looks a touch weaker and foreign interest rates somewhat lower than the NB's expectations in March. Taken together, the material increase in oil prices outweigh the small negatives from other factors.

Two big downside risks will also be on policymakers' minds. The Trump administration's increasingly aggressive trade stance and the turmoil around Italy's new government pose significant risks to the global outlook. This probably won't affect the NB's policy stance directly at this point. But it means the risks to the interest rate forecast are arguably skewed to the downside, and this may be reflected in the policy statement.

## Still on track for a September hike

On balance, the NB's interest rate projection is likely to look similar to March. The possibility of an August hike, always a stretch, has probably gone. But September looks increasingly likely, though the rate path may be adjusted downwards slightly to indicate some uncertainty. But at this point we think it would take a significant downturn in the outlook over the summer to shift the NB away from delivering on the September hike.

Further out, the rate path will remain gradually upwards sloping but could be adjusted down a touch. The current path indicates slightly less than two hikes each year in 2019-21, which is likely to remain the case.

To the extent that a September hike is not fully priced into the Norwegian interest rate curve, a confirmation from the NB that it is still set on delivering a hike "after summer" would likely see some upside for the krone. Compared to other central banks in Western Europe, the NB looks relatively hawkish. So long as oil prices hold up, we expect that pattern to continue.

## Norges Bank interest rate projections

