Norge's Bank Preview: Still on hold

Norway's Central Bank will keep its key policy rate at 0.5% this week, but may shift the path of its interest rate forecast forward

The big picture for the NB is largely unchanged from recent months: the domestic recovery remains on track and the external environment looks benign. Given the output gap remains negative and inflation is projected to stay below target, the NB will not feel pressured to hike rates anytime soon. But a higher oil price and lower NOK suggest the interest rate forecast could move forward into the first half of 2019.

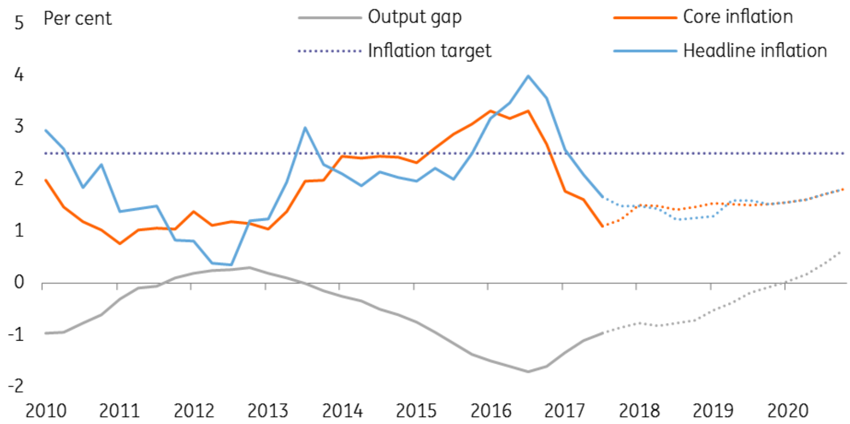
Limited news on the domestic front

Domestic data over the past couple of months have been broadly in line with the NB's projections from September. Q3 GDP growth of 0.6% QoQ (and a downward revision to Q2) was in line with expectation. Forward-looking indicators and the NB's regional network survey suggest growth is set to continue at a similar pace over the coming quarters.

Inflation has disappointed this autumn, with the November print out today particularly weak. While this is partly explained by temporary factors, such as a big drop in air travel prices in November, underlying price pressure looks somewhat weaker than the NB's latest near-term projections.

Recently, uncertainty on the housing market has been in focus in Norway. Norwegian house prices have fallen by around 5% since April. The pace of declines has been gradual, though Oslo has seen more rapid falls. The latest data show prices falling more slowly in November, supporting the NB's assessment that the housing market will see a soft landing.

NB's forecast of inflation and the output gap



Source: Norge's Bank

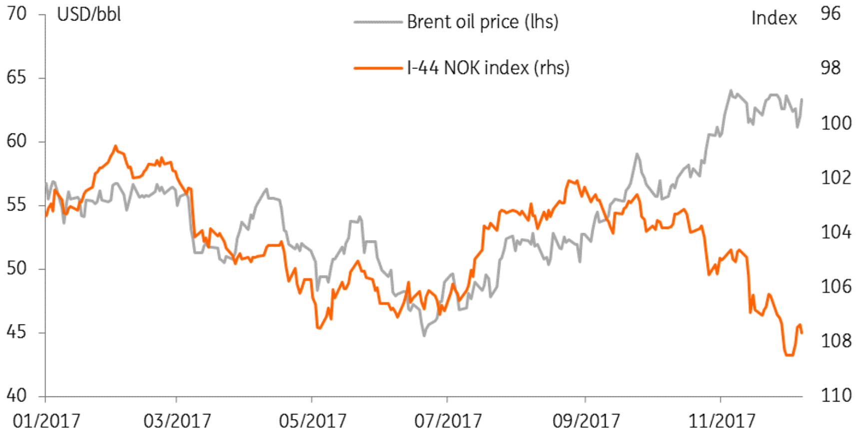
Significant moves in oil and NOK

In contrast, external factors have changed materially. Oil prices have risen by around 8% and the trade-weighted NOK index has depreciated by 4% since the NB's last meeting at the end of October. These are fairly chunky moves and will push up on the NB's inflation forecast in the near term as prices for fuel and imported goods increase.

Given the relatively mechanical framework the NB uses to set its interest forecast, a higher inflation forecast should translate into a somewhat more aggressive predicted path for the key policy rate. But we think the NB is likely to remain cautious because the divergence between oil prices and NOK, which normally tend to move in the same direction, is likely to reverse at some point. In the medium term, the NOK is still likely to appreciate given it looks materially undervalued on a fundamental basis.

Petro-currencies lose their mojo

Oil and NOK in 2017



Source: Macrobond

But the NB will remain dovish

On current trends, solid but not spectacular growth will slowly erode the negative output gap towards mid-2019. This should slowly push inflation up towards the target. The key domestic uncertainty remains the housing market, but we think the improving data will make the NB increasingly comfortable with its soft-landing projection.

The moves in oil and currency markets are likely to push the NB's forecast interest rate path forward such that the first rate hike comes in the first half of 2019 (compared to 2019Q3 in the NB's September forecast), which is roughly where the market is currently pricing the first hike.