

Norges Bank Preview: The hawkish outlier

Norway has been a clear outlier in the global shift towards more dovish central bank policy, and in fact, the combination of a weaker-than-expected krone and higher oil prices could see the central bank hint more strongly at a June rate hike this week



The Norges Bank is gearing up for further rate hikes

In stark contrast to both its Scandinavian neighbours and central banks globally, the Norwegian central bank has embarked on a tightening cycle. The Norges Bank raised rates to 1% back in March and the big question ahead of the announcement on Thursday is whether it hints more strongly at a June rate hike.

The case for further tightening certainly looks fairly solid. The domestic economy is in good shape, helped along by the recovery in energy prices over the past couple of years. The central bank estimates that the break-even cost for new Norwegian projects lies between \$10-35 per barrel, well below current market pricing, and this is helping to incentivise energy-related investment. This stronger oil/gas backdrop, combined with general tightness in the jobs market, also means that wage growth looks set to increase further.

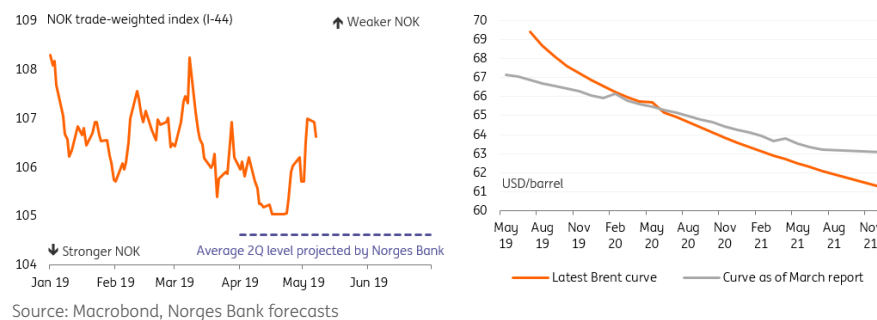
With this in mind, the Norges Bank's March policy rate forecast pointed to further tightening over the next few years. These projections implied that the odds of a June rate hike sit at roughly 50:50

- and that's more or less the view taken by markets, too. But since the last meeting, two things have changed.

- Firstly, the Norwegian krone has weakened further. The Norges Bank had expected the currency to strengthen by almost 2% on a trade-weighted basis on average during the second quarter.
- Secondly, spot oil prices have risen further above the levels factored into the bank's last set of forecasts - although admittedly the pricing of longer-dated contracts has slipped a touch.

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Weaker NOK + higher oil prices = earlier rate hikes?



Putting those two factors together indicates that a June rate hike has become more likely, although as is the case everywhere else, much will hinge on how the outlook for global trade evolves between now and then. While our trade team's base case is that a deal will ultimately be struck between the US and China, this now may not come until the second half of the year. For the time being, this will continue to keep the uncertainty surrounding global growth elevated.

We have been forecasting a rate hike in September, followed by another in March 2020. However it is increasingly possible that this happens in June and December, and we'll be watching closely to see if policymakers drop some additional hawkish hints at this week's meeting.

What this means for NOK

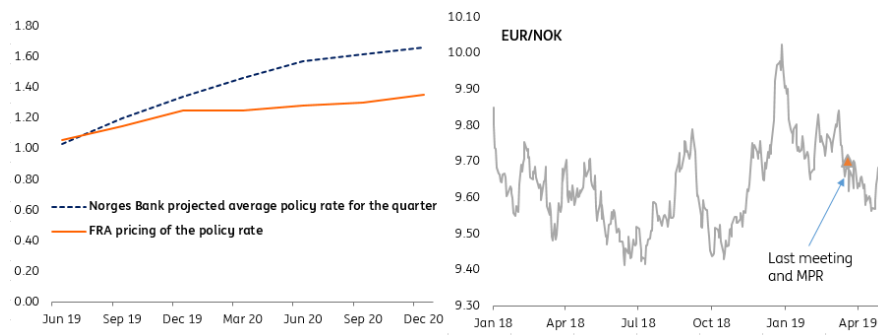
The recent re-assessment of global growth prospects, including Brent reversing off its \$75/bbl high, has seen the NOK underperform over recent weeks. Typically at interim monetary policy meetings, the Norges Bank press release pays heavy lip-service to the prior Monetary Policy Report (MPR).

Should the Norges Bank conclude that the outlook and the balance of risks have not changed substantially since the 21 March report and repeat its view that the policy rate will "most likely be increased further in the course of the next half-year", we would expect NOK interest rates and the currency to get a small lift.

Here the Forward Rate Agreement contracts (priced off the Nibor fixings) show relatively muted expectations for rate rises compared to the path in the Norges Bank's last MPR. A confirmation of that path (certainly a hawkish outlier) could therefore provide some support for the NOK in an otherwise tough environment for activity currencies. This could see EUR/NOK holding below

resistance at 9.85/88 and NOK/SEK making a decisive push above 1.10.

Market pricing of Norges Bank policy path and EUR/NOK



Source: Bloomberg, ING

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