

Norges Bank preview: Waiting to see how the chips fall

Having raised rates in September, the Norwegian central bank will not be shifting its policy stance at the October meeting. With two rate hikes expected for 2019, we continue to see risks as somewhat skewed to the upside for Norwegian rates but the bar for a more hawkish stance is fairly high



The data argues for a somewhat tighter stance...

At its last meeting the Norges Bank raised rates to 0.75%, the first hike in seven years. But relatively dovish rhetoric and a downward revision to the interest rate forecast meant that despite the hike, the Norwegian central bank actually shifted towards a more cautious stance. With relatively little news since September, it is unlikely the NB will make much of a change to its statement this time around.

On the domestic side, the limited data over the past month has been mixed. September core inflation came in at 1.9%, well ahead of the NB's forecast. While some of that may be down to the effects of the record-hot summer, it does look to us like the NB may have to revise up its inflation forecast again in December.

Set against that, the latest unemployment readings were slightly higher than the NB's projection, which is a marginal negative. The monthly GDP measure for August was also very weak, but that data series is highly volatile and we think the NB puts more weight on its regional network survey for a near-term read on the economy.

At the same time, the trade-weighted currency has appreciated broadly in line with the NB's forecast. But foreign interest rates have increased, largely due to the shift upwards in US rates, and the oil price has risen further (up by more than 3% since the September meeting, despite the recent slide back to \$80 per barrel). Both factors argue for somewhat higher rates, and if these trends persist until December, the NB may have to revise up its interest rate forecast.

But the NB is likely to sit tight for now

But the September decision shows the NB is reluctant to increase rates any faster than the two hikes per year indicated in the current forecast. The key reason behind this caution is the high degree of indebtedness among Norwegian households related to the rapid house price increases over recent years.

This means consumer spending is sensitive to higher rates -- especially as much of Norwegian mortgage debt is floating rate or short-term fixed rate -- and the impact of higher rates is difficult to estimate. The NB's latest bank lending survey showed that demand for fixed-rate mortgages is increasing, as households react to the NB's policy hike, but it will take a long time to shift a meaningful share of mortgages away from floating rates.

In our view, this means that while the tone from the NB could turn more hawkish if the outlook continues to improve (though probably in December rather than now), the bar for actually increasing the pace of tightening is fairly high until there is more certainty on how higher rates are affecting households.

From a market perspective, the NB's October meeting is likely to prove a non-event. The pricing of future interest rates is close to the NB's forecast and unlikely to move much unless the NB signals a change in stance. The Norwegian krone (NOK) has strengthened recently, in large part due to higher oil prices, but the NB is unlikely to provide much support for the currency from current levels, which are in line with its September projections.

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