Norges Bank set to keep rates on hold amid lower energy prices

Lower oil prices and growing anticipation of rate cuts from the global central banks have taken the pressure off Norway's central bank to hike rates one last time in December. We expect an on-hold decision but expect the bank's new rate projection to push back against expectations of imminent rate cuts in 2024. A hawkish hold should partly shield the krone

Norges Bank promised a hike, but no longer needs to deliver

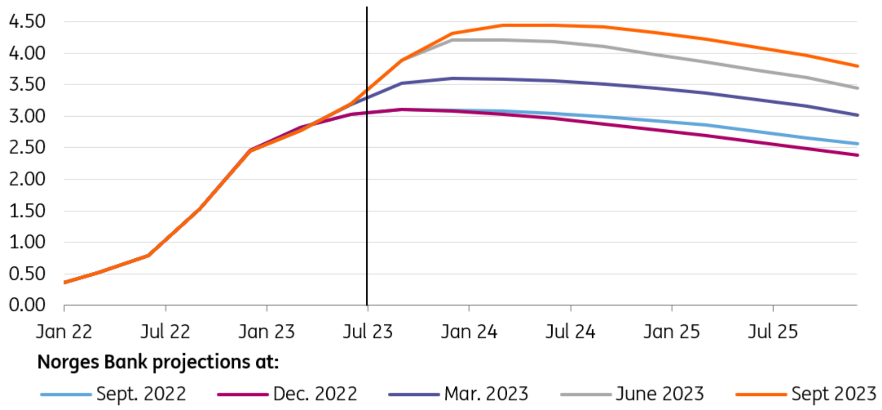
Back in September, Norway's central Bank signalled that a December rate hike was likely. By November, policymakers were watering down those promises and said that further progress on the inflation outlook could lead to a pause. We now think "no hike" is the most likely scenario next week, though it's a close call. Market pricing is leaning this way too.

Since the November meeting and the last forecasts produced in September, we've seen both a pronounced fall in oil prices and a big dovish repricing in global rate expectations. The former is assumed to weigh on oil investment and ultimately growth and the labour market. The latter removes one source of potential weakening pressure on the krone – or at least that's true in theory. Norges Bank's preferred trade-weighted exchange rate index is actually 4% weaker than assumed in the September forecasts.

Still, the net effect of all of that should be a lower interest rate projection for coming months. Previously the projection saw rates peaking around 4.50% and staying there until the latter part of 2024. Assuming we don't get a rate hike from Norges Bank on Thursday, we'd expect a lower peak rate in the projection and there's a chance we also see a slightly earlier rate cut pencilled in. That said, we doubt policymakers will want to endorse the shift away from "higher for longer" among investors over recent weeks.

Ultimately though we do expect rate cuts next year and we think Norges Bank could end up following the Federal Reserve with easing, starting in the second quarter of next year.

Norges Bank interest rate projections over time



Source: Norges Bank

Still reasons to like NOK in the long-end

Markets are pricing in around a 30% implied probability of a rate increase, meaning the risks are skewed to the upside for the Norwegian krone considering how close of a call this is set to be for policymakers. Our baseline is – as discussed – a hold, which should add a bit more pressure on the underperforming NOK, even though Norges Bank may well try to tame dovish speculation by signalling openness to more tightening if necessary. Ultimately, the impact on NOK should not be too material in the event of a hawkish hold, and the krone should quickly revert to being driven by external factors.

Indeed, it's been mostly external factors – namely the dollar recovery, worsening of the European economic outlook, softer oil prices – that have weighed on NOK of late. Domestically, the sustained pace of daily FX purchases in December (NOK 1.4bn) and dovish repricing have had a secondary but non-negligible influence. Expect CPI figures three days before the Norges Bank announcement to move NOK.

Looking beyond the short-term underperformance, and despite a less hawkish Norges Bank, there is still a lot to like about NOK; it is deeply undervalued, has a relatively stable economic outlook, and good carry advantage. We continue to favour the krone against its oil peer the Canadian dollar, in 2024.

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