Norway to give green light to December rate hike

Surging oil prices mean that Norges Bank will this week reiterate its intention to hike rates in December. We expect that to be followed by a further three rate rises next year. These have already been price in by the market and the krone has already seen the benefits of the hawkish re-pricing, so we think EUR/NOK has limited further downside potential in 4Q

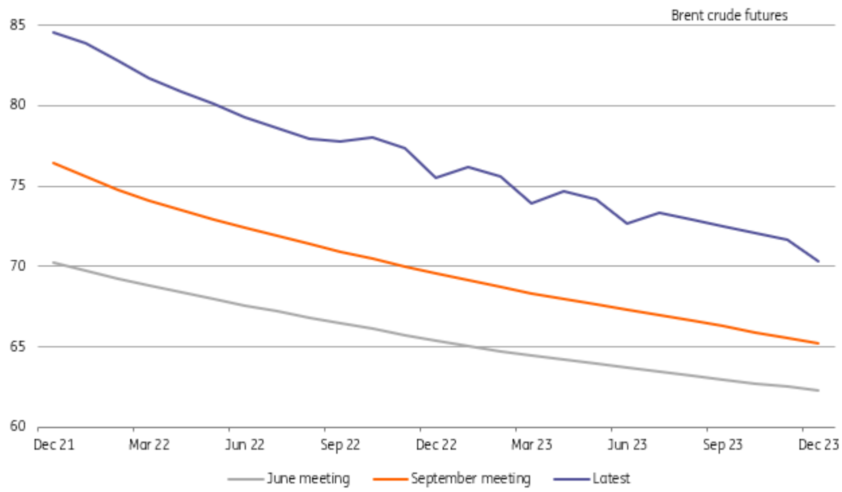
We still think two or three cuts are possible this year in Norway, as inflation could ease back in the coming months

Norges Bank to reiterate plans for a December hike

G10 central banks have recently adopted a more hawkish tone, from Canada suddenly terminating QE asset purchases, to the UK considering an early rate hike. True to past form, Norges Bank was already ahead of the game, having hiked rates back in September. This week's meeting only entails a brief statement, but it will almost certainly confirm that a second hike in December is on the way.

The bigger question is whether policymakers will look to hike more aggressively in 2022. Norges Bank already has three moves pencilled in next year according to its September forecasts.

Booming oil prices could trigger greater investment



Source: Refinitiv, ING

Bearing in mind that Norway tends to approach monetary policy in a fairly formulaic way, there have been some fairly big changes in the markets since those forecasts a few weeks ago. The recent surge in oil prices is clearly a decent boost to demand for Norway's energy-dependent growth mix. Oil and gas make up around 18% of GDP. All else equal, the recent upward shift across the brent crude futures curve should see policymakers pencil in higher numbers for oil investment over the next year or so.

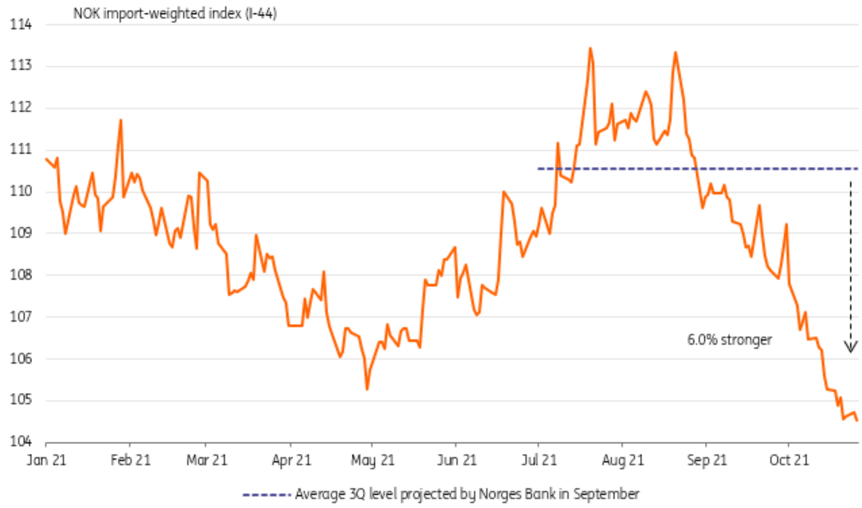
The recent increase in interest rate expectations for foreign central banks is also usually taken as a net-hawkish factor when it comes to Norges Bank's own rate projections.

The flip side of higher energy prices has been a noticeable outperformance in the currency over recent weeks. The trade-weighted NOK is tracking some 6% stronger than Norges Bank's forecast 3Q average.

Putting all that together, if policymakers were to make any public forecast changes – which they won't do until December – then the stronger NOK would probably largely offset the rise in oil prices, and there would likely be only minimal changes to the central bank's interest rate projection.

In short, we expect a December rate hike and most likely three further increases through 2022.

NOK has outperformed expectations



Source: Macrobond, ING

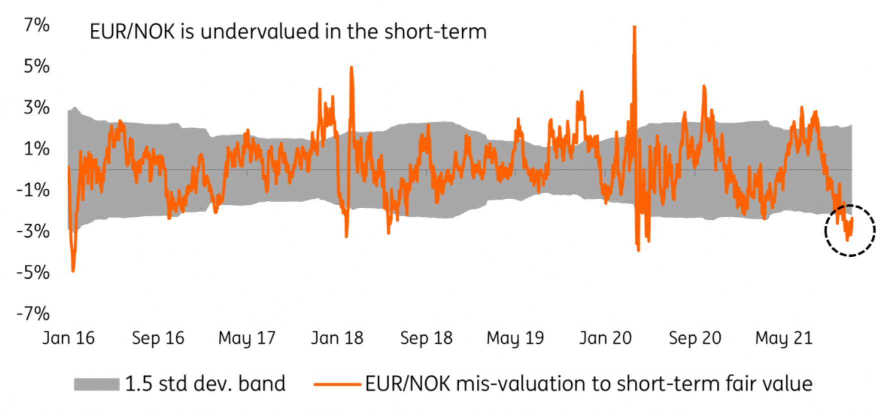
FX: NOK already embedding hawkish expectations

We expect this week's Norges Bank meeting to generate a quite contained market impact, as we should merely see a confirmation that interest rates will be raised again in December, a prospect that is already very much priced in by markets.

We have recently seen in Australia a case of dislocation between FX and rates dynamics, where AUD only saw some limited benefits from the sharp rise in short-term yields while over-discounting the post-RBA moderate bond rebound. NOK appears to be on the other side of the spectrum, having fully benefited from the hawkish re-pricing in domestic rate expectations. As markets are already pricing in around 95bp of tightening by Norges Bank in the next 12 months, there also appears to be limited room for more hawkish re-pricing.

Accordingly, and considering that EUR/NOK has recently been scoring as undervalued (around 2%, chart below) according to our short-term fair value model, we think that more benefits for NOK stemming from the Norges Bank's tightening cycle should come through a carry advantage (which should play out in the longer run) rather than from the central bank surprising on the hawkish side. We see only limited downside room for EUR/NOK in 4Q, and we expect 9.70 as a year-end value.

EUR/NOK short-term fair value model



Source: ING, Refinitiv

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