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Norway to hike rates and signal that there's plenty more to come

We expect another 25bp rate hike from Norges Bank this Thursday and for policymakers to signal rate rises in each of the remaining quarters this year. Markets are not pricing much more tightening than already signalled by the Bank, which leaves room for a hawkish surprise this week, and more NOK strength as a result

Norway is a large energy exporter, which suggests that policymakers will pencil in more tightening than previously expected

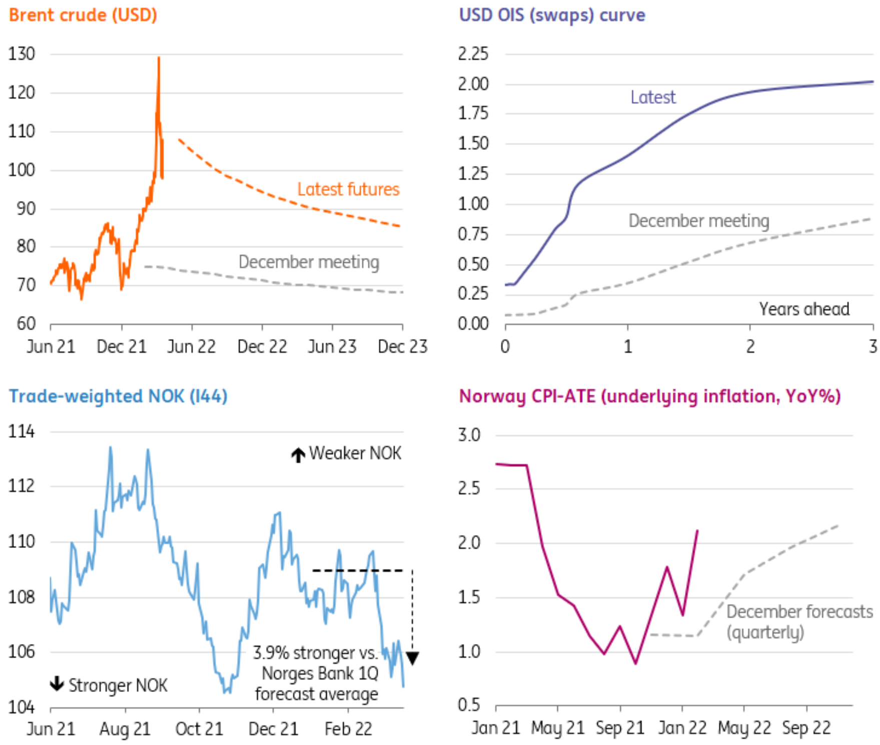
Norges Bank to increase the amount of tightening forecast by the end of 2023

Norway's central bank meets this week and will almost certainly raise rates by another 25 basis points, the third such hike since it began its tightening cycle last September. More importantly, policymakers are likely to noticeably increase the amount of future tightening included in the closely-watched interest rate projection, that will be published alongside the decision.

Norges Bank tends to be fairly model-based in the way this is set out, and the vast majority of the critical inputs point towards a more hawkish response over the coming months. The central bank was already forecasting a total of three rate rises in 2022 and a further two in 2023. Since those projections were made in December, oil and gas futures have moved dramatically higher, as has the amount of tightening being priced for the major central banks.

The Norwegian krone, by contrast, is only modestly stronger compared to what Norges Bank was projecting at the end of last year.

Most economic/market factors point to a more hawkish Norges Bank stance



Source: Macrobond, ING calculations

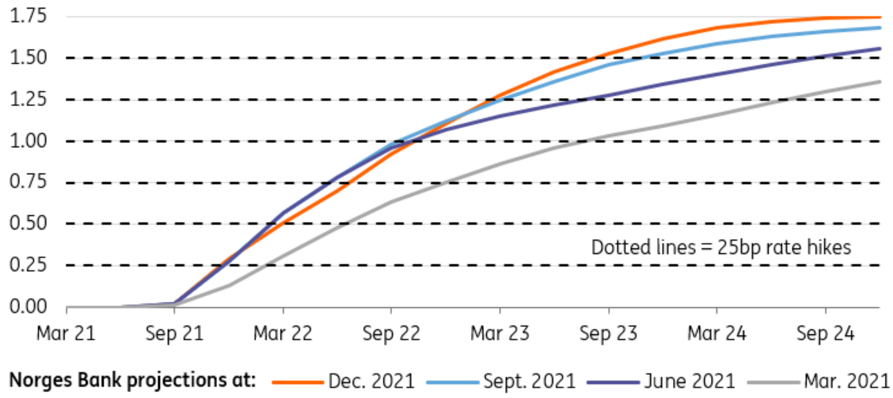
The economic data flow has also generally been supportive of a more aggressive tightening stance. The hit to demand from Omicron has been reasonably modest, while underlying inflation has come in noticeably higher than policymakers were forecasting three months ago.

Of course like every central bank, there's plenty more uncertainty bundled in with all of this as a result of the war in Ukraine. But Norway is ultimately a large energy exporter, and that suggests that on balance policymakers will be pencilling in more tightening than previously expected.

We expect Norges Bank to signal a hike in each of the remaining quarters of 2022, with a chance that they hint at a 50bp move at some point in the near-term (or two consecutive 25bp moves in a single quarter). We'd also expect three or four rate rises to be factored in for

2023. The overall effect is likely to lift the interest rate projection by more than 50 basis points compared to December.

How Norges Bank changed the interest rate projection through 2021



Source: Norges Bank

NOK: Good momentum should linger

The krone is amongst the best-performing currencies since the start of the Ukrainian conflict and is now facing a highly supportive combination of stabilising risk sentiment, relative market optimism about a peaceful resolution, and the well-cemented notion that energy prices will likely remain elevated even after a military de-escalation. EUR/NOK is currently trading at nearly three-year lows.

One lingering question is whether these hawkish inputs will be absorbed by Norges Bank in their forward-looking signals. As discussed above, we think the risks are skewed towards a more hawkish set of rate projections, and we do not exclude that the Bank may signal two hikes in one quarter of 2022 or even a 50bp move. Most importantly, the forecasted terminal rate may be lifted to 2.25% (or even higher), and markets are only pricing in 1.90% (in two years) as a terminal rate, which leaves considerable room for a hawkish repricing of rate expectations.

All in all, we see only a limited risk that this week's Norges Bank announcement will hinder NOK's good momentum, and we see a higher probability that a hawkish surprise (given the market's not so aggressive tightening expectations) will actually add pressure to EUR/NOK. The pair may slip into the 9.50/9.55 area in the coming days.

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