

Hawkish surprise from Norge's Bank

The central bank delivered a hawkish surprise this morning. Although it left rates unchanged, it was more upbeat on prospects of the economy and shifted the interest rate forecast forward significantly



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Upbeat forecast means tighter policy ahead

As expected, Norge's Bank kept interest rates unchanged at 0.5% but shifted its forecast for interest rates forward more than anticipated. The forecast now shows the expected interest rate at and 0.62% in 4Q18 and 0.74% in 1Q19, implying a 50-50 chance of a rate hike by the end of next year. The previous forecast didn't anticipate the first hike until 3Q17. The press release also stated that rates would 'remain at 0.5 percent in the period to autumn 2018, followed by a gradual increase', materially more hawkish than the previous language.

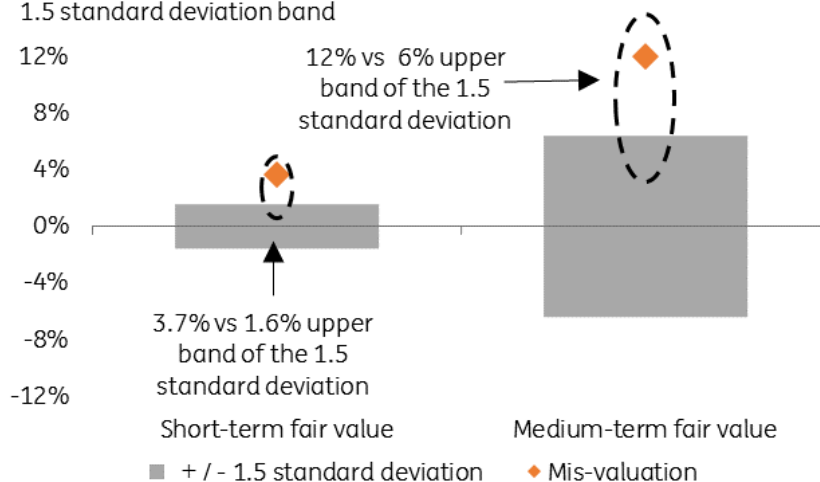
Projections for inflation were revised up materially on the back of higher oil prices and a weaker Norwegian Krone (NOK). More importantly, the central bank also revised its forecast upwards for the output gap due to a tighter labour market. Norges Bank now sees the output gap closing in 1Q19 vs 3Q19 in the September forecast. And the assessment of the housing market continues to be very sanguine, with the NB expecting a soft landing, whereas the market seems to have priced in significant downside risk to the housing market.

NOK's trough likely behind us

With NOK being ultra-cheap, its disconnect from the oil price over the past months underlines it, and undervalued by 3.7% and 12% on short-term and medium-term basis respectively, plenty of bad news is already priced into the currency. The non-negligible shift in the Norges Bank forward rate guidance should stabilise NOK and lead to further near-term NOK gains. We target EUR/NOK 9.65 in coming days. This is in line with our [2018 FX Outlook: Happy Hour!](#), where we expressed the view of overdone NOK weakness, targeting EUR/NOK 9.40 levels by the end 2018.

NOK is very cheap against EUR

EUR/NOK misvaluation vs short-term financial fair value model and medium term BEER model. In both instances the mis-valuation exceeds 1.5 standard deviation band



With SEK feeling the positive spill-over

Today's NB decision is also very good news for SEK, with EUR/SEK feeling the positive spill-over effect from higher NOK. With the Stibor interbank rates expected to normalise in very early 2018 (once the year-end resolution fund induced dislocations to disappear), EUR/SEK should move closer to 9.60 in 1Q18.