Norges Bank hikes rates and signals several more to come

Thursday's rate hike in Norway will likely be followed by more in December and March, and at least one more next year. Given Norges Bank's history of going against the wider G10 central bank trend, there's no reason to doubt this hawkish outlook for now. We expect NOK to emerge as a key outperformer in risk-on periods thanks to its attractive yield profile

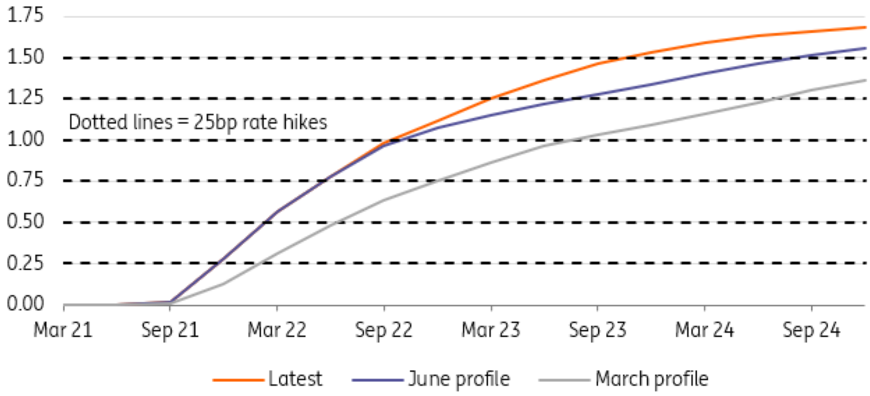
We still think two or three cuts are possible this year in Norway, as inflation could ease back in the coming months

Norges Bank fires the starting gun on a run of hikes

Norway's central bank has fired the starting gun on what is likely to be a fairly rapid set of rate hikes over the coming 18 months. Thursday's hike, taking the deposit rate to 0.25%, was well telegraphed both in the June interest rate projection, and also verbally in the August meeting statement.

But the bigger focus as always is on what comes next, and importantly the latest interest rate projections imply a further three or four rate hikes by the end of 2022. That's fairly similar to what the central bank had predicted in June, though the bigger difference is that policymakers are factoring in around 20bp more tightening during 2023.

Norges Bank interest rate projections compared over time



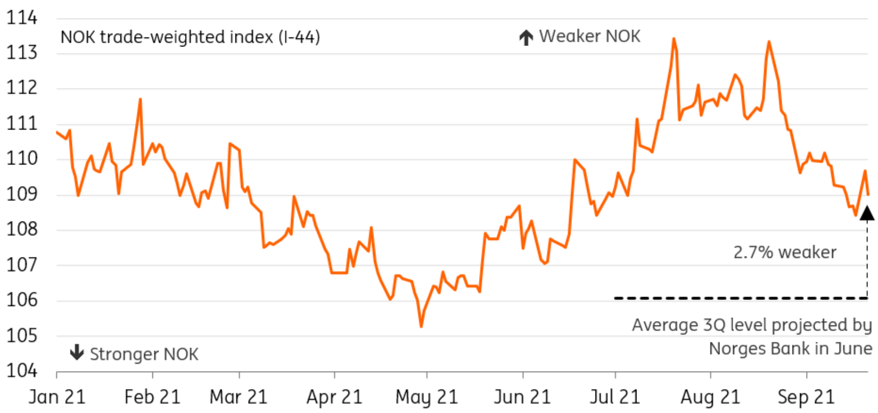
Source: Norges Bank

Again this isn't a huge surprise – NOK is tracking roughly 3% weaker than the central bank had been forecasting for the 3Q on average, while oil prices have bounced back to roughly where they were around the time of the last meeting. All else equal, that requires a higher level of interest rates.

Still, this profile is undoubtedly punchy, and puts Norges Bank in a very different setting to other G10 central banks. But then again it reflects the different structure of Norway's economy – and indeed the more formulaic nature of Norges Bank's policy decisions. So there's little reason to doubt the rough trajectory of the bank's projections at this stage. After all Norway saw several interest rate rises in 2019, at a time where the Fed was cutting.

Barring any further unwelcome surprises on Covid-19, we expect another rate hike in both December and March 2022. The jury's out on whether we see an additional one or two moves in the latter half of next year.

NOK has been trading weaker than Norges Bank had expected



Source: Macrobond, ING

NOK set to benefit from attractive yield profile

The 25bp rate hike today was not at all a surprise to markets, and it was likely the announcement that another hike will likely come in December – and an upgrade in longer-term rate projections -

that generated some lift on NOK, as EUR/NOK broke decisively below 10.1000 after the policy decision release. Incidentally, today's statement is likely reinforcing the degree of trust among investors that Norges Bank will not underdeliver when it comes to following their projected tightening plan.

All this is ultimately cementing expectations that NOK will be tied with NZD as the highest yielding currency in G10 for the foreseeable future. While the current choppy risk environment may keep preventing a sustained revamp in carry trades, the dissipation of some tail risks for global sentiment in the longer run may leave room for those currencies backed by tightening cycles to emerge as outperformers.

We expect to see EUR/NOK back at the 10.00 level by the end of the year, and also expect to see it trade consistently below the 10.00 mark in 2022. We think such a gradual appreciation profile for NOK will not tamper with the Norges Bank monetary tightening plans.

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com