

## Global risk remains key NOK driver despite upbeat Norges Bank

The Norges bank kept its interest rate on hold this morning with a more upbeat view on growth and demand. While modestly positive for NOK, the main driver will remain the general risk environment for the undervalued currency



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### Why so upbeat Norges Bank?

With rates already at zero, it won't come as much of a surprise that the Norges Bank has kept its interest rate on hold at its latest meeting. What's a little more surprising perhaps is its more upbeat stance on the economic outlook.

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The central bank has upgraded its assessment of 2020 GDP and is now expecting an annual decline of 3.5%, compared to -5.2% at its May meeting. Policymakers put this down to some areas being more resilient than expected, including on the outlook for oil investment. That, in turn, has opened the door for a rate hike in 2022, although of course, Governor Olsen reiterated that the policy rate will probably stay where it is for “some time ahead”.

## Not out of the woods yet..

Still, it's worth remembering that neither the Norwegian nor the global economy are out of the woods just yet.

The Norges Bank's own [regional network survey](#) shows activity falling at an annual rate of 5.3% over the past three months, following government lockdown measures. Meanwhile, negotiations on future wage settlements have been postponed to August given circumstances, which could be a source of downside risk. And while the outlook for energy prices looks somewhat better than they did a few weeks back, the relatively low oil prices could have long-lasting effects on oil investment.

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Having said all of that, we don't expect the central bank to add further stimulus, not least because the options are fairly limited. [In a speech last year](#), Olsen noted that neither negative rates nor quantitative easing were really viable options for Norway. On the former, he indicated that the costs of moving rates below zero probably outweigh benefits. For quantitative easing, there are logistical constraints, including that the size of the Norwegian government bond market is pretty small and illiquid.

In short, we don't expect any further easing for the Norges Bank. But like other central banks, we suspect rate hikes won't be on the agenda until 2022 at the earliest.

### **NOK: External drivers to matter more for NOK 2020 outlook**

We have seen a positive knee jerk reaction of NOK to the Norges Bank meeting as the central bank upgraded its growth outlook. Expect the negative output gap to close earlier and the interest rate outlook was revised higher from flat throughout the forecast horizon to a first full hike by 1Q23. While modestly positive for NOK, this on its own should not have a long-lasting effect on currency as the rate hike prospects still remain very remote.

Rather, the prime NOK driver should remain the general risk environment which is to keep the still heavily undervalued NOK on the appreciation path as the global U-shaped recovery unfolds. Indeed, based on our BEER model, NOK is the cheapest G10 currency on a medium-term basis. The gradual upward trend in the oil price (our commodities team targets 50 US\$/bbl in 4Q20) should also contribute to the NOK recovery.

In addition, while other central banks pursue QE, Norway's central bank doesn't and instead

engages in NOK purchases (liquidating the oil fund assets denominated in foreign currencies to fund the rising fiscal deficit). This also underlines a relative NOK attractiveness, particularly vs SEK where Riksbank engages into QE.

We expect EUR/NOK to test 10.00 later this year and look for NOK/SEK to push through the parity.

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