

Norges Bank steps up tightening pace with 50bp rate hike

Norway's central bank has joined the 50bp club and is signalling another 25bp move in August. Hikes at every remaining meeting this year look likely, and that may well include another 50bp hike in September. Despite a more hawkish Norges Bank, the krone should remain vulnerable in the near term due to the unstable risk environment

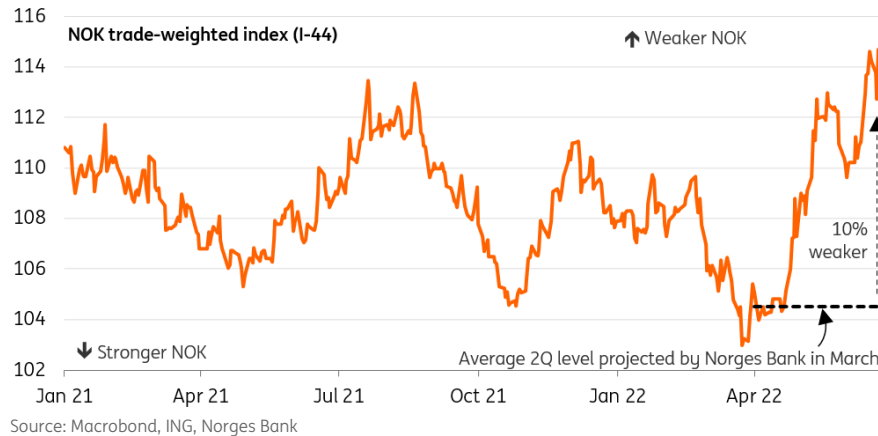


Norges Bank has stepped up the pace of its tightening cycle, hiking rates by 50 basis points for the first time, having previously implemented three 25bp rate rises since last September. That's more than the consensus was expecting, but in reality, it shouldn't come as a huge shock.

Not only had policymakers flagged the possibility of a larger rate hike when they met last month, but most of the indicators Norges Bank looks at have been significantly more hawkish than they were in March when forecasts were last updated. NOK is around 10% weaker than the Bank had expected in March in trade-weighted terms, while the ever-increasing amount of tightening being priced into dollar and euro markets had also pointed to a more aggressive response from Norges Bank. Inflation has come in above expectations, too. The only thing that hasn't budged much from

the March forecasts is the price of oil.

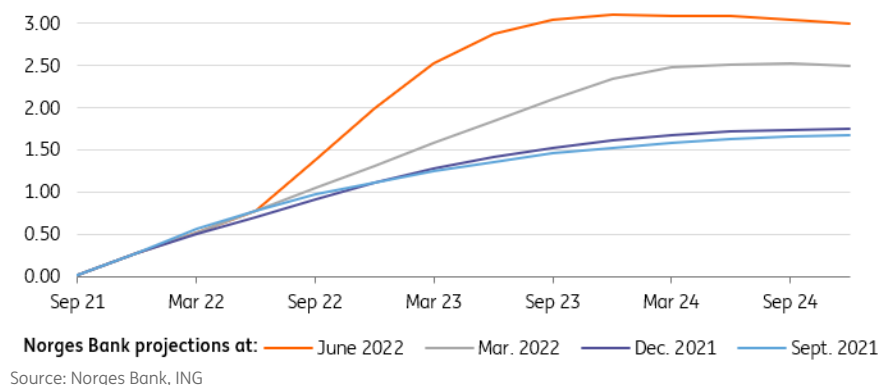
NOK is roughly 10% weaker than NB had expected for the second quarter as a whole



The net result is that policymakers now expect a terminal rate of 3% by next summer, up from their previous estimate of 2.5%. Interestingly, NB is pre-committing to another 25bp hike in August, and the new rate projection appears to factor in roughly 100bp of total additional tightening this year.

There's little reason to doubt this assessment right now. The guidance on a 25bp hike at the August meeting is fairly specific, and means we probably shouldn't expect another surprise 50bp hike at that meeting unless something dramatic changes. But there is a certain advantage to frontloading in this environment, especially for an energy-intensive economy like Norway's. We probably shouldn't rule out another 50bp hike at the September meeting. Failing that, a rate rise at every remaining meeting this year looks increasingly likely.

Norges Bank rate projections compared over time



NOK: Short term remains challenging

EUR/NOK traded lower only quite briefly after Norges Bank's rate hike, despite the swap market indicating that a 50bp was not priced in. Our impression is that markets remain reluctant

to enter long-NOK positions in the current environment, as the low-liquidity character of the krone makes it exceptionally unattractive in periods of unstable risk sentiment. We think NOK will remain vulnerable in the near term on the back of this.

Accordingly, we think that the benefit to the krone from a more hawkish Norges Bank - as well from high energy prices - will become more visible in the second part of the year, when a potentially calmer risk environment may allow the krone to re-connect with its very attractive set of fundamentals. We still target a return to sub 10.00 levels in EUR/NOK by the end of the year.

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