

Norges Bank raises rates, but signals a more cautious stance

While the central bank hiked rates to 0.75%, as expected, an unexpected downward shift in the forecast for future interest rates suggests policy-makers are more concerned about the outlook than before



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The Norwegian central bank raised the policy rate to 0.75%, in line with expectations. But a reassessment of momentum in the domestic economy and concern about the effect of higher rates impacting household spending has prompted the Bank to revise down its forecast.

The new rate path is only marginally lower and still signals two more hikes by the end of 2019. But this shift in the opposite direction of market expectations - for a higher rate path signaling the potential for three hikes in 2019 - suggests the NB has become cautious.

The key reason behind the central bank's caution seems to be concern that raising rates too quickly could have a material

*impact on Norwegian households, which are heavily indebted
and exposed to higher interest rates*

The policy statement indicates the next rate hike will come in 1Q19, which most likely means March, given the NB's preference to move policy rates at meetings where they have a new forecast and a press conference.

Some of the new-found caution appears driven by global risks, in particular, the potential impact of US protectionism. The NB also notes that higher oil prices, while supportive of the Norwegian economy through increased investment in the North Sea, dampens growth elsewhere in the global economy, and that has an off-setting negative effect on Norwegian exports.

But the key reason behind the NB's caution seems to be concern that raising rates too quickly could have a material impact on Norwegian households, which are heavily indebted and exposed to higher interest rates. The NB also refers to the uncertainty surrounding the effect of the first rate hike in seven years.

The key takeaway from today's meeting is that the NB may be uncomfortable with hiking rates at a faster pace than twice per year. Given that this appears driven in large part by the high level of debt among Norwegian households – a factor that isn't going to change anytime soon – it looks like the bar for a faster pace of tightening is fairly high.

The Bank may still be open to a more aggressive stance once the initial uncertainty around the effect of higher rates passes (and if other sources of uncertainty such as the US-China trade war also fade).

If the krone doesn't strengthen as much as the central bank anticipates (EUR/NOK has risen by close to 1% since the policy announcement), that may also support the case for tighter policy. But for now, we think the most likely path for policy rates is two hikes in 2019, starting in March next year.

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