23 January 2020

Norges Bank Review

As expected, unchanged rates and little news

This morning, Norges Bank (NB) left the sight deposit rate unchanged at 1.50% in a decision widely expected by both markets and analysts. This was a 'small' meeting that only included a press release, i.e. there was no monetary policy report, revised rate path nor press conference.

Overall, the (new) Monetary Policy Committee gave markets little colour on recent developments and as expected concluded: *'The Committee's current assessment of the outlook and the balance of risks suggests that the policy rate will most likely remain at the present level in the coming period'*. 'In the coming period' should in our view at this instance be interpreted as at least until the next main meeting in March.

In the evaluation of the domestic economy, NB concluded that new information supports the view that capacity utilization is above normal, but that the economy is close to a peak and inflation is close to target. On the external environment, NB stated that the risk of a sharp downturn is reduced, but is not eliminated.

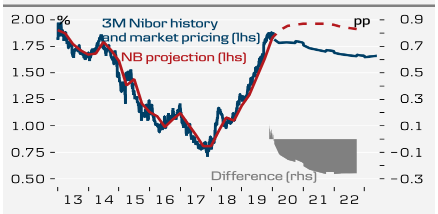
In sum, NB clearly expects the policy rate to remain unchanged at least until the next 'main' meeting in March. This is line with our expectations, but we still pencil in a rate hike in June 2020, even if the probability of this call materialising has fallen considerably in recent weeks and arguably is not much more than 50% at this stage.

Extra: note NB also published a press release stating that the introduction of a Monetary Policy and Financial Stability Committee will not alter communication going forward, but any dissent will now be reported. Detailed minutes of the meeting will still not be published.

Rates/FI. As expected, market reaction has been very limited in the rates space. If NB had presented a new rate path today, it would have indicated a lower than 40% probability of a 2020 hike (what the current rate path implicitly suggests), but likely left a modest tightening bias. Meanwhile, in recent sessions the front-end of the NOK curve has been offered at a considerably tighter spread to EUR (chart 3). Consequently, markets now price in roughly 10bp worth of cuts by year-end with a roughly two-thirds probability of a cut by end 2021. We think this pricing is much too premature. Indeed the recent deceleration in growth has to a large extent been driven by capacity utilisation in the construction sector; e.g. half of the drop in the latest 6M Regional Network Survey was driven by the construction sector and the postponement (not cancellation) of big civil engineering projects due to the lack of qualified labour. Cutting rates does not bring Norway the qualified project managers needed and we think the MPR from December implicitly acknowledged this point. Today's executive briefing also failed to deliver any comments for investors speculating in a rate cut over the coming years.

FX. Price reaction in EUR/NOK has also been very limited with the cross falling a couple of figures upon announcement. The move should probably be seen in the light of some foreign accounts speculating in a dovish tilt today. More generally, NOK has been under heavy pressure over the last few weeks. Generally we think the key element is the return to the investment bias that has characterised markets since 2013: long US tech stocks (and implicitly USD) at the expense of traditional industry and commodity producers. Back in November we argued a case for picking up NOK with a 2-4 month horizon which was looking attractive on a range of metrics. Meanwhile, this case has slowly but surely lost steam and, with the recent string of disappointing data out of Norway alongside renewed downside pressure on oil and gas prices (on corona virus concerns, high supplies, strong USD and warm weather), we reiterate our cautious near-term NOK stance.

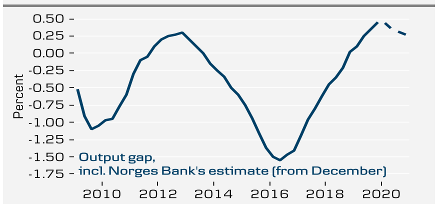
Chart 1: Markets have begun pricing cuts from NB – we think this is premature!



Source: Macrobond Financial, Danske Bank

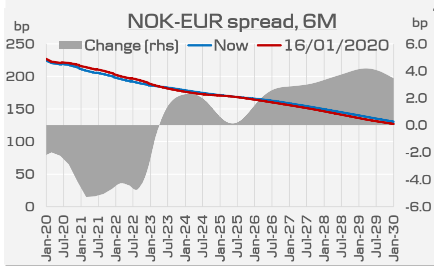
Note: Past performance is not a reliable indicator of current or future results

Chart 2: NB reiterated that capacity utilisation is above normal but that the economy is near a cyclical peak



Source: Macrobond, Danske Bank

Chart 3: NOK-EUR spreads have tightened considerably in short-end



Source: Macrobond, Bloomberg, Danske Bank

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Disclosure

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Expected updates

None.

Date of first publication

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