

Norges Bank Review

On hold, strong tightening bias

As widely expected, Norges Bank (NB) this morning kept policy rates unchanged at 0.75%. Also as expected, the rate path was adjusted moderately downwards on global events and a lower oil price. Still, NB clearly signalled that the next rate hike should be expected in March 2019.

'The Executive Board's current assessment of the outlook and balance of risks suggests that the policy rate will most likely be raised in March 2019.'

The **rate path** published in the Monetary Policy Report (MPR) was adjusted downwards from Q4 19 and throughout 2021. Specifically, the rate path indicates that the next hike will come in March 2019, and the next one most probably in September. Further out the rate path signals slightly less than two hikes in 2021, i.e. roughly five hikes for the next three years.

The factors affecting the rate path were broadly in line with our expectations. Global risks and global forward rates pushed the rate path downwards. Lower oil prices pulled in the same direction. On the other hand, a weaker currency more or less counteracted this effect. Moderately higher inflation and domestic growth also pulled the rate path marginally upwards. Also, according to NB, the uncertainty surrounding the effects of changes in interest rates when rates are close to zero still calls for a more careful approach.

As we expect the global expansion to continue, we still expect NB to hike rates again in March, and deliver another rate hike in H2 19 (likely September).

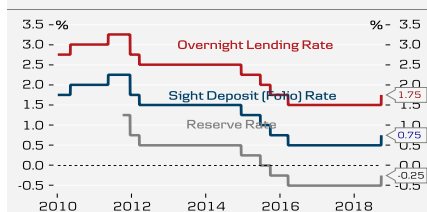
FI/Rates. Market interest rates increased marginally at the short end on the MPR 4/18, despite NB's marginal downward revision of the rate paths. That said, market forward interest rates are still significantly lower than NB's interest rate projection.

Our short-end strategies have in recent months been for higher short-term interest rates both in absolute terms and relative to international peers. The oil led upswing in Norwegian economic activity has been confirmed lately by the regional network report and the recent monthly mainland GDP data. In light of today's MPR 4/18 we reiterate the recommendation for higher market interest rates at the short end. In the 10 December *Reading the Markets Norway* we suggested buying NOK 3M FRA JUN19 outright or vs MAR19 ahead of the NB meeting. At the time the market only discounted a NOK FRA 3m MAR19 at 2.5bp lower than the JUN19 contract. Immediately after the release of MPR 4/18 the spread was 4bp. NB's projection for the 3m Nibor in Q2 is 1.41bp (1bp higher than in the MPR 3/18 report) and in Q3 1.56bp (unchanged), i.e. a curve steepness Q2 – Q3 of 10bp. We expect market interest rates in 2019 to increase according to NB's projections – or more.

We have at present open a few outright strategies for higher interest rates, including paying NOK IRS 2Y/2Y outright. Given the current international economic and political turmoil the outright strategies are risky compared to relative strategies. However, note that the current risk-off environment related to Italy, France and Brexit seems to harm the market's risk appetite for Norwegian fixed income, i.e. affecting the risk related to relative strategies.

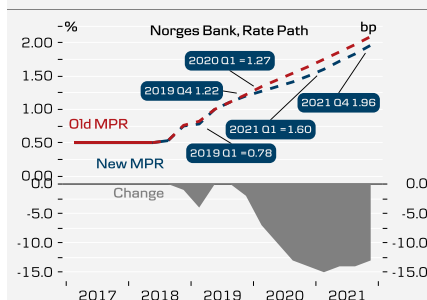
FX. EUR/NOK has fallen three figures at the time of writing. In our view the very near-term potential is limited given the global risk environment and investor focus on year-end seasonality. That said, we think today's decision underpins the NOK attractiveness from a 2019 perspective and supports our case for gradually building NOK longs in the coming weeks. We remain short EUR/NOK (3M seagull) and long NOK/SEK spot outright.

Chart 1: NB left rates unchanged as expected ...



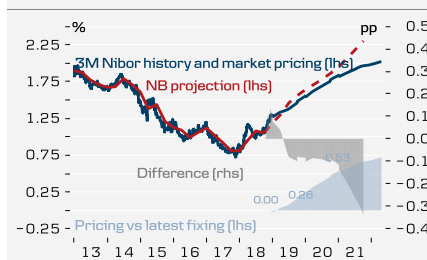
Source: Macrobond Financial, Danske Bank

Chart 2: ... meanwhile the revised rate path still suggests a March hike and two hikes for 2019



Source: NB, Macrobond Financial, Danske Bank

Chart 3: Market pricing still much softer than NB's rate path



Source: NB, Macrobond Financial, Danske Bank

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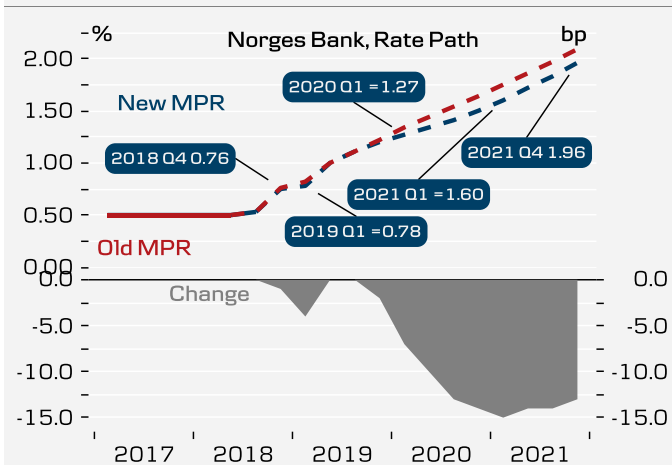
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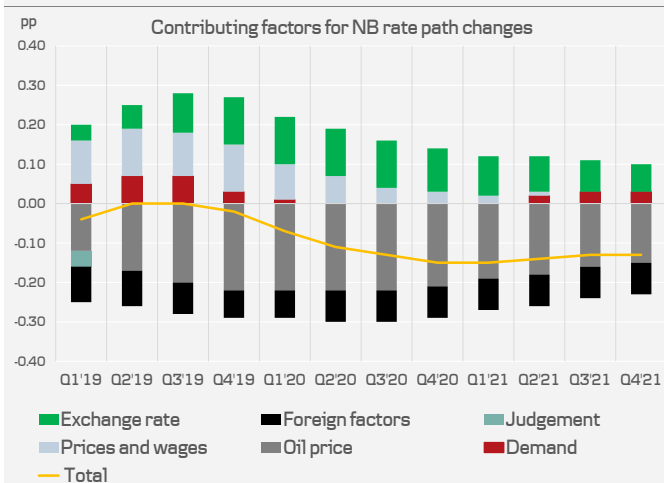
Appendix chart pack

Chart 4: Revised rate path suggests two hikes in 2019, one in 2020 and two in 2021



Source: Norges Bank, Macrobond Financial, Danske Bank

Chart 5: The primary factors behind the lower rate path are external drivers and the oil price



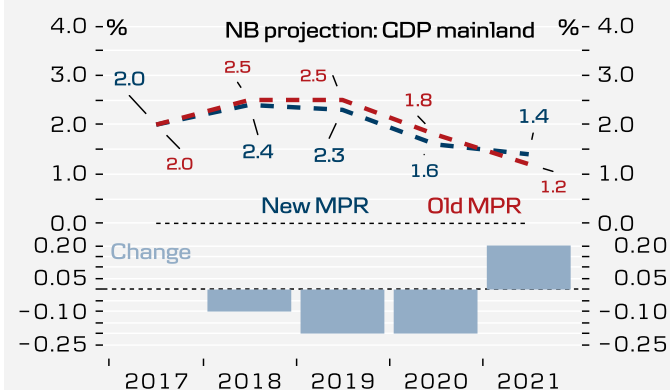
Source: Norges Bank, Macrobond Financial, Danske Bank

Table 1: Contributing factors for changes to the rate path in table format

Contributing factors for rate path changes (pp)							
	Demand	Oil price	Prices and wages	Judgement	Foreign factors	Exchange rate	Total
Q1'19	0.05	-0.12	0.11	-0.04	-0.09	0.04	-0.04
Q2'19	0.07	-0.17	0.12	0.00	-0.09	0.06	0.00
Q3'19	0.07	-0.20	0.11	0.00	-0.08	0.10	0.00
Q4'19	0.03	-0.22	0.12	0.00	-0.07	0.12	-0.02
Q1'20	0.01	-0.22	0.09	0.00	-0.07	0.12	-0.07
Q2'20	0.00	-0.22	0.07	0.00	-0.08	0.12	-0.11
Q3'20	0.00	-0.22	0.04	0.00	-0.08	0.12	-0.13
Q4'20	0.00	-0.21	0.03	0.00	-0.08	0.11	-0.15
Q1'21	0.00	-0.19	0.02	0.00	-0.08	0.10	-0.15
Q2'21	0.02	-0.18	0.01	0.00	-0.08	0.09	-0.14
Q3'21	0.03	-0.16	0.00	0.00	-0.08	0.08	-0.13
Q4'21	0.03	-0.15	0.00	0.00	-0.08	0.07	-0.13

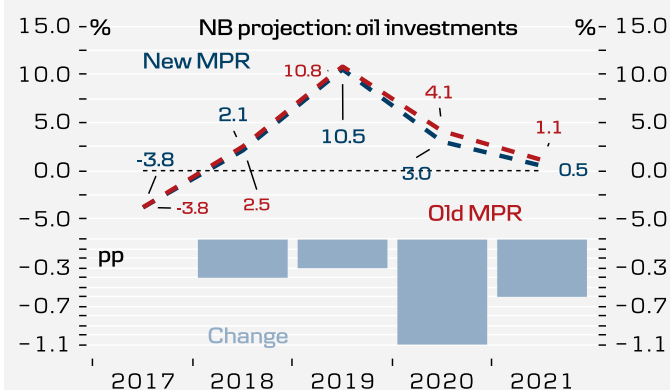
Source: Norges Bank, Danske Bank

Chart 6: Mainland GDP forecasts



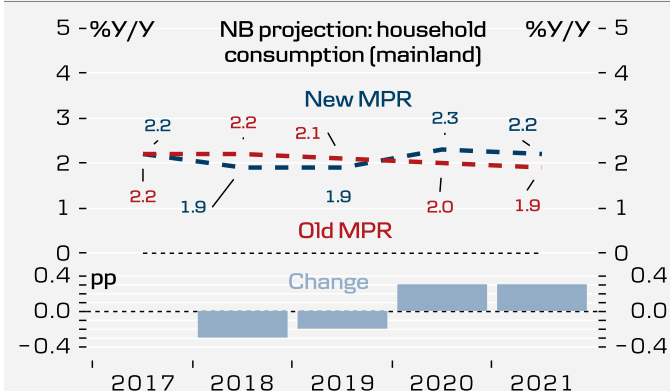
Source: Macrobond Financial, Bloomberg, Danske Bank

Chart 7: Petroleum investments



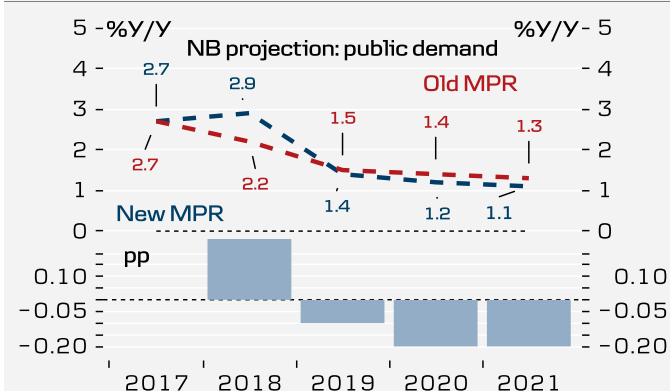
Source: Norges Bank, Macrobond Financial, Danske Bank

Chart 8: Household consumption



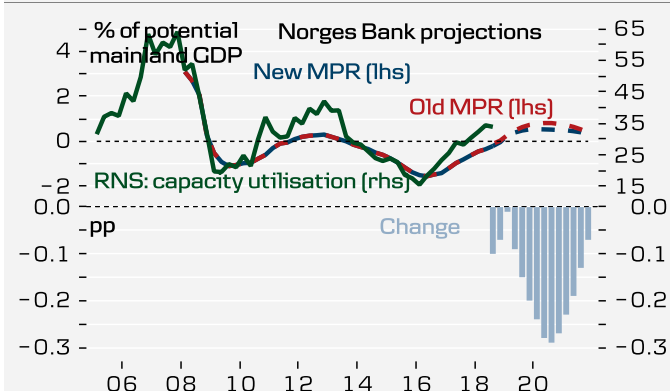
Source: Macrobond Financial, Bloomberg, Danske Bank

Chart 9: Public demand forecasts



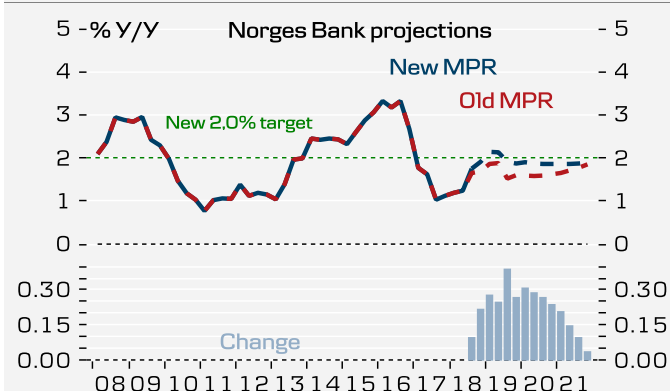
Source: Norges Bank, Macrobond Financial, Danske Bank

Chart 10: Output gap projections



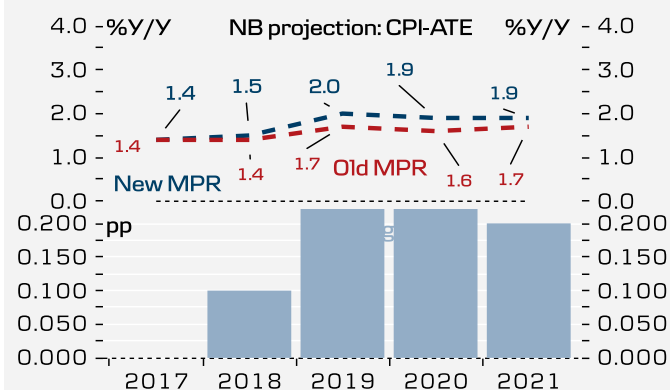
Source: Ministry of Finance, Macrobond Financial, Bloomberg, Danske Bank

Chart 11: Core inflation projections (quarterly)



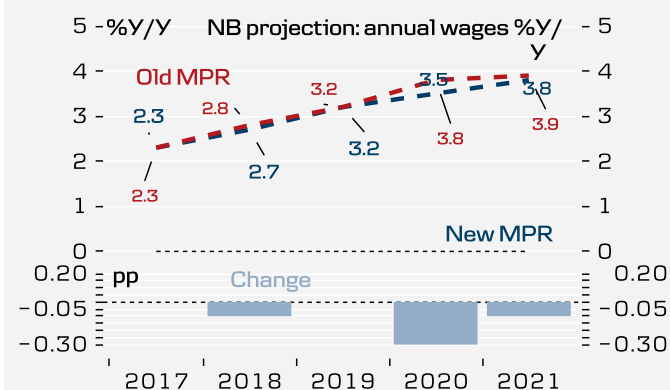
Source: SSB, Macrobond Financial, Bloomberg, Danske Bank

Chart 12: Core inflation (annual)



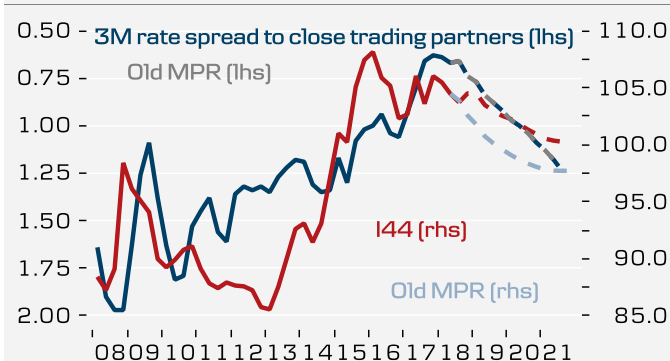
Source: Ministry of Finance, Macrobond Financial, Bloomberg, Danske Bank

Chart 13: Wage growth projections lowered slightly



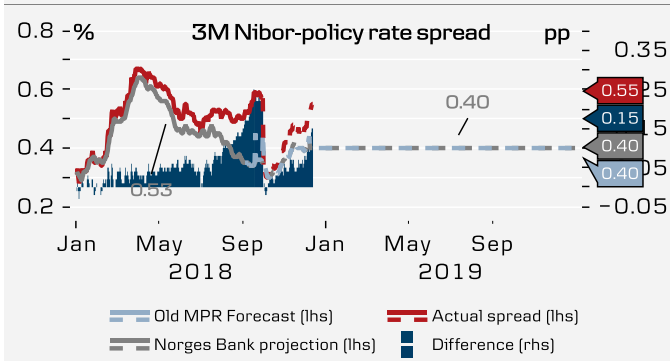
Source: SSB, Macrobond Financial, Bloomberg, Danske Bank

Chart 14: NB still expect a stronger NOK



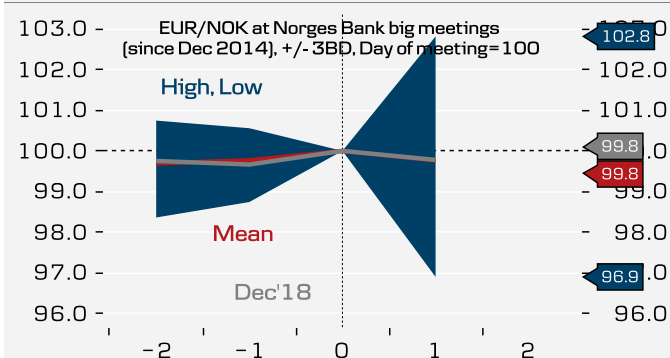
Source: Ministry of Finance, Macrobond Financial, Bloomberg, Danske Bank

Chart 15: NB kept unchanged its Nibor-policy rate spread forecast



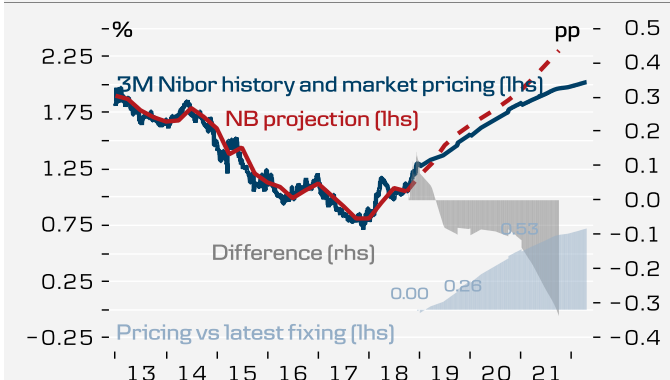
Source: SSB, Macrobond Financial, Bloomberg, Danske Bank

Chart 16: EUR/NOK has fallen three figures - close to historical average



Source: Macrobond Financial, Bloomberg, Danske Bank

Chart 17: We still like to position for higher NOK rates both outright and vs peers



Source: SSB, Macrobond Financial, Bloomberg, Danske Bank

Disclosure

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Frank Jullum, Chief Economist, Jostein Tvedt, Chief Strategist, and Kristoffer Kjær Lomholt, Senior Analyst.

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Expected updates

None.

Date of first publication

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