International Commentary — May 8, 2024

Mixed Signals From Scandinavian Central Banks

Summary

- Central banks in Norway and Sweden offered mixed signals from their early May monetary policy announcements. Norway's central bank delivered a “hawkish hold”, while Sweden's central bank cut rates with an accompanying statement that was overall dovish in tone.
- Norway's central bank—the Norges Bank—held its policy rate steady at 4.50%, and cited upside risks to inflation, including high wage growth and a weak currency. Of particular note, the Norges Bank also said recent economic data may necessitate monetary policy remaining tight for longer than previously envisaged. Given recent data and the central bank's guidance, **we have pushed back our forecast timing for an initial 25 bps Norges Bank rate cut to September**, from August previously. Beyond September, we expect the Norges Bank to lower interest rates at a 25 bps per quarter pace, which would see the policy rate fall to 3.25% by the second half of next year.
- In contrast, Sweden's central bank—the Riksbank—took a dovish direction at its early May announcement. The Riksbank cut its policy rate 25 bps to 3.75%, while noting inflation that has continued to approach target and weak economic growth. Officials also indicated the policy rate could be lowered two more times in the second half of 2024. **While we agree the Riksbank will proceed cautiously for now with just one 25 bps rate cut in Q3, we forecast two 25 bps rate cuts in Q4** as Swedish inflation converges closer to target, and as the European Central Bank potentially accelerates the pace of its monetary easing as well.

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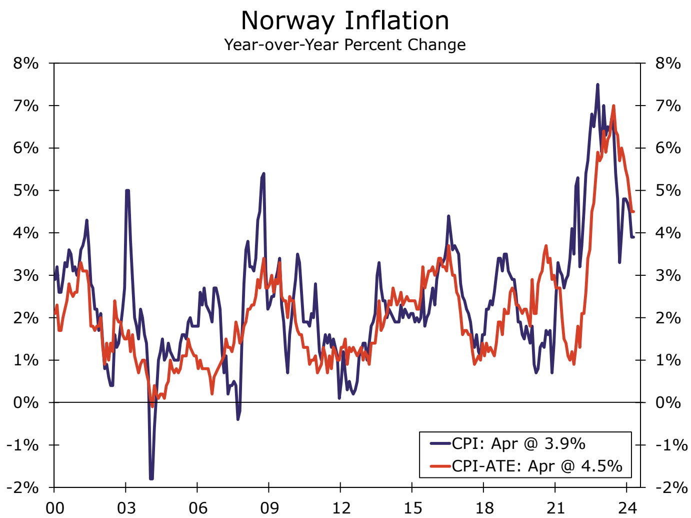
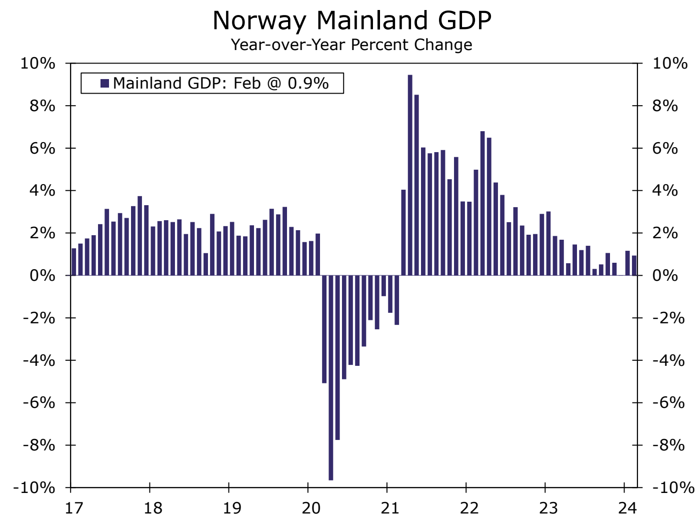
Norges Bank Delivers A Hawkish Hold

At its early May monetary policy announcement, Norway's central bank—the Norges Bank—opted to hold its policy rate steady at 4.50% as widely expected, but offered commentary that leaned on the hawkish side. The accompanying statement detailed recent economic developments and noted that "**the data so far could suggest that a tight monetary policy stance may be needed for somewhat longer than previously envisaged.**" On the inflation front, policymakers noted that while price inflation has slowed, it is still "markedly above target", and that GDP growth has been low, though showed signs of improvement in recent months. Policymakers also cited concerns around high wage growth and the upside risks to inflation posed by a weaker Norwegian krone.



Source: Bloomberg Finance L.P. and Wells Fargo Economics



Source: DataStream and Wells Fargo Economics

In assessing recent data, we agree that recent developments could support Norway's policy interest rate remaining at an elevated level for an extended period. With respect to prices, March headline and underlying CPI inflation slowed more than expected, to 3.9% and 4.5% respectively. That said, inflation still remains above the 2% target. There are also factors that could pose upside risks to inflation in the coming months: higher wage growth and a weaker domestic currency. Policymakers cautioned that wage growth may turn out to be higher than the current forecast—4.9% annual wage growth for 2024—in their announcement last week. In that context, average monthly earnings offered only mild encouragement as they slowed to 6.1% year-over-year, but remained consistent with an elevated pace of wage growth. Policymakers also noted that another upside risk to inflation could take shape in the form of higher costs for imported goods, owing to a weaker Norwegian krone. So far in 2024, the krone has been a laggard among the G10 currencies in terms of its performance against the U.S dollar, with a decline of 6.2% year-to-date versus the greenback.

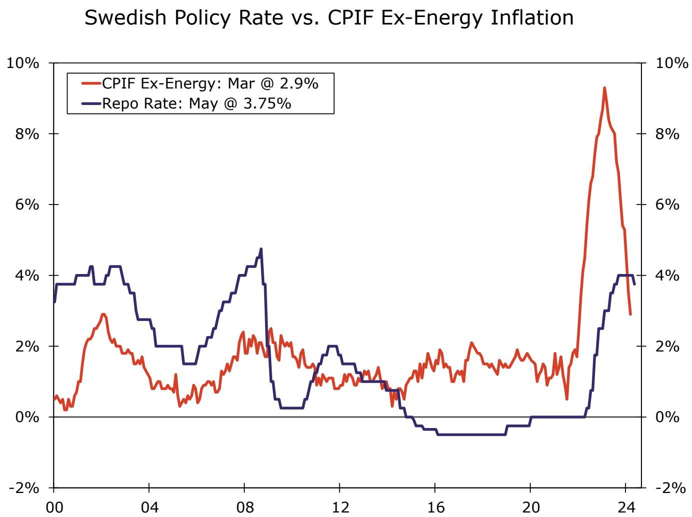
Turning to economic activity, policymakers acknowledged a low growth environment, though they also noted that economic activity has been slightly firmer than expected lately. Recent GDP figures appear consistent with a moderate recovery, albeit one that is uneven. After modest growth through most of 2023, mainland GDP jumped by 0.6% month-over-month in January before slipping back 0.2% February. In our view, the Norwegian economy can recover as 2024 progresses, and we see a gradually strengthening trend through the year.

In our view, lingering inflation risks and a gradually improving economy will likely make policymakers feel comfortable holding rates at their current level for a while longer. Considering both recent data and last week's forward guidance, we have pushed back our forecast timing for an initial Norges Bank rate cut. **We now anticipate an initial 25 bps rate cut in September, compared to our previous forecast for an August move. Beyond September, we expect the Norges Bank to lower interest rates at a 25 bps per quarter rate cut pace, which would see the policy rate fall to 3.25% by the second half of next year.** In addition to our revised outlook, we also see the risks around this new base case as tilted toward later rather than earlier monetary easing.

The Riksbank Begins its Monetary Easing Cycle

In contrast to a more hawkish-leaning Norges Bank, Sweden's central bank—the Riksbank—delivered a 25 bps policy rate cut to 3.75% and offered comments that leaned more neutral-to-dovish in tone. We view the Riksbank monetary policy decision as dovish-leaning for several reasons. First, while the consensus expectation was for a rate cut, there was still a significant minority of economists that expected rates to stay on hold at this week's meeting, and financial markets had not fully priced in the cut. Additionally, there were several dovish elements of the statement that accompanied the monetary policy decision. Bank officials explained their justification for lowering the policy rate by highlighting the combination of slowing inflation and weak economic activity, and also pointed to firmly anchored inflation expectations and a moderation in wage growth. In terms of forward guidance, the Riksbank signaled that if inflation continues to approach and remain close to the 2% target in the longer term, the policy rate "is expected to be cut two more times during the second half of the year." The announcement also touched on risks to the outlook. While inflation risks remain generally balanced, officials did highlight a weaker Swedish krona as one factor that could contribute to upward price pressures. Overall, while Riksbank policymakers appear to be on course for further rate cuts this year, they are attuned to upside risks to the inflation outlook and expressed a desire to proceed with any future rate cuts at a cautious pace.

We believe that Swedish economic data as of late align with further easing from the Riksbank. In terms of price pressures, March CPIF headline inflation was a downside surprise at 2.2% year-over-year, and CPIF ex-energy inflation also surprised to the downside, slowing to 2.9%. Economic growth has also been soft. After contracting for the three quarters through the end of last year, there are early signs that 2024 first quarter growth was also subdued. Sweden's Q1 GDP indicator was weaker than expected, falling 0.1% quarter-over-quarter and 1.1% year-over-year.



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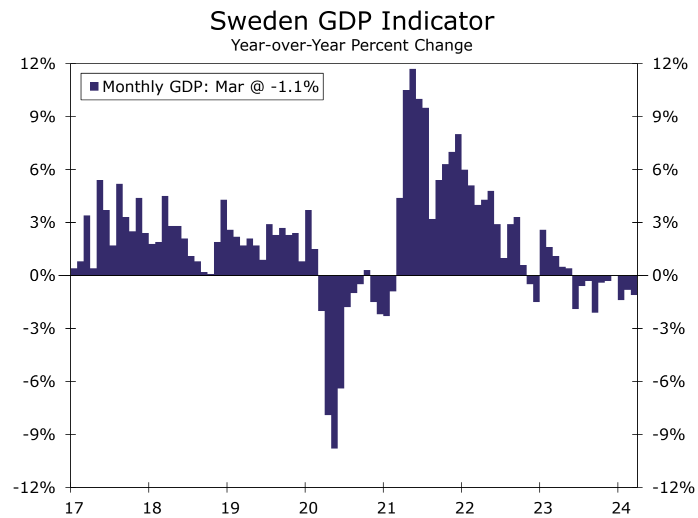

Source: Bloomberg Finance L.P. and Wells Fargo Economics

In terms of our outlook for the Swedish economy and central bank, we believe that,for now, the Riksbank will continue monetary easing at a cautious pace but may accelerate the pace of easing in Q4 of this year. There are a couple of reasons behind our outlook for a slightly more rapid pace of rate cuts. For one, we expect Sweden's economic growth to be quite subdued this year, with our forecast for the economy to expand only 0.1% in 2024. In addition, we expect inflation to have meaningfully converged toward target by the end of this year. Finally, by the last quarter of 2024 we also believe there is potential for the ECB to also accelerate its pace of monetary easing, which we believe will make Riskbank policymakers feel more comfortable taking a similar course. **Considering these factors, we remain comfortable with our outlook for one 25 bps rate cut in Q3 followed by two cuts of the same magnitude in Q4 for a policy rate of 3.00% by year-end 2024.** Given our forecast for somewhat more rapid Swedish monetary policy easing, we also think the Swedish krona could be an underperformer among G10 currencies during 2024.

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