DNB

Preview
08.06.2018

21 June: September rate hike still likely

- **We expect Norges Bank to leave policy rates where they are at the June meeting**
- **The interest rate path is likely to be lowered …**
- **… but we expect Norges Bank to keep the signal of a September hike**

Our expectation: We expect Norges Bank to leave interest rates where they are at this meeting, in line with the previous guidance. News since the March meeting supports a modest downward shift in the rate path, broadly explained by a decline in forward rates abroad. For 2018 we expect Norges Bank will keep a September hike on the table. A further decline in unemployment, higher oil prices, a weak NOK and renewed strong price growth in the housing market support this view, while lower-than-expected core inflation is an argument for Norges Bank to be cautious. May inflation data due on Monday and Norges Bank's Regional network survey due on Tuesday are important figures that could affect the rate path. We expect core inflation was unchanged from April to May, and that the Regional network will still signal solid growth in economic activity.

Thursday 21 June at 10:00 CEST: Announcement of the executive board's interest rate decision and publication of Monetary Policy Report 2/18. A press conference following the announcement will be held at 10.30 am, to be streamed on Norges Bank's website (in Norwegian).

The March meeting: Norges Bank left the key policy rate unchanged at 0.50% as was widely expected. The new rate path was raised from Q3 2018. Norges Bank governor Olsen stated that "…current assessment of the outlook and the balance of risks suggest that the key policy rate will most likely be raised after summer 2018". The rate path indicated a full 25bp rate hike in September and another in March 2019. **The May meeting** did not bring any new information to the table.

Developments since the previous meeting:

<u>Growth outlook abroad:</u> GDP growth forecasts from Consensus Economics indicate marginally lower expectations for the US and European economies, most likely affected by low growth numbers for Q1. We believe Norges Bank is also likely to lower its forecasts. This may contribute to a slightly lower rate path. Inflation forecasts abroad seem to be in line with current expectations.

<u>Interest rate expectations abroad:</u> 3m forward interest rates abroad have declined. From the week before Norges Bank's March meeting, foreign FRAs are roughly unchanged for 2018, but down 5bp for 2019, 17bp for 2020 and 22bp for 2021. Major trading partner currencies are the EUR, USD, SEK and GBP, and the drop in the EUR, SEK and GBP rates has more than counteracted the rise in the USD rates. The decline will contribute to a lower rate path in our view.

<u>Exchange rate</u>: So far in Q2, the import-weighted foreign exchange rate, I-44, has been 0.8% above Norges Bank's forecast, while the current level is closer to Norges Bank's quarterly forecast. A lower interest rate differential between the NOK and major trading partner currencies explains some of the weakness, while a USD10 rise in the spot oil price and USD5 rise in the 2023 forward oil price are arguments for a stronger NOK than expected. Hence, the NOK should – in Norges Bank's view – have been stronger, but a slightly weaker NOK was observed. Thus, FX movements will contribute to a higher rate path.

<u>3m Nibor has been high</u>: So far in Q2, 3m Nibor has averaged 1.10%, versus Norges Bank's forecast of 1.00% for the quarter, due to higher money market premiums, but has fallen in recent weeks, and is currently close to expectations. A lower expected spread between 3m Libor and 3m OIS for USD over the next half year, which feeds into 3m Nibor, supports Norges Bank's forecast for the money market premiums. Despite the movements in 3m Nibor, new mortgage rates have been fairly stable. Housing market regulation was a factor in tightening credit standards in 2017, but banks do not expect a further tightening going forward. We do not expect changes in money market premiums and bank's credit standards to affect the rate path this time.

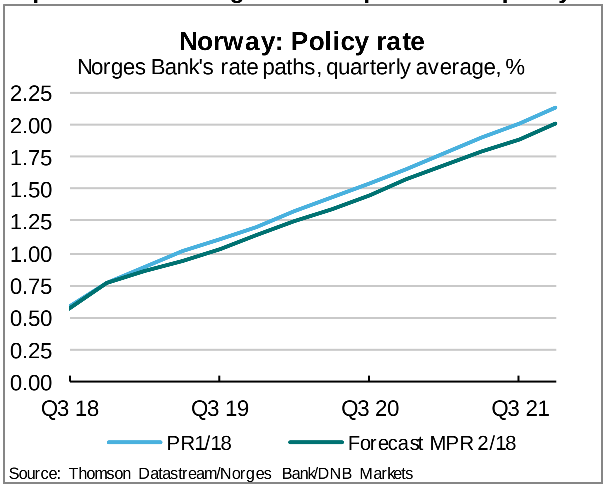
<u>Higher capacity utilisation</u>: Mainland GDP growth was 0.6% QOQ in Q1, a tad below Norges Bank's forecast of 0.7%. However, the GDP figures were far weaker than the headline growth suggested, which was helped by a sharp drop in imports of financial business-related services in Q1. Domestic demand rose by only 0.1% QOQ, and mainland companies excluding the electricity sector had a drop in output growth from 1.0% QOQ in Q4 to 0.5% QOQ in Q1. However, we interpret the weak quarter as temporary and affected by an incidental weak spot in private consumption, and believe Norges Bank interprets the figures correspondingly. Furthermore, unemployment seems to have fallen more than Norges Bank forecast in March, and employment growth has been solid. The petroleum investments survey combined with the Q1 national accounts suggest a downward revision for oil investments in 2018, but an upward revision for 2019. House prices started to pick up again in 2018 after falling during 2017, and the outlook for house prices has improved relative to Norges Bank's forecast from March. This turnaround indicates improving consumer confidence, increasing the likelihood of a pick-up in credit growth and raising the risk of financial instability. Together, we believe some basis points to the rate path.

<u>Inflation below expectations</u>: Core inflation was 1.3% YOY in April, 0.3%-points below Norges Bank's forecast. May data is due on Monday morning. Lower-than-expected inflation may affect 2018 and to an extent 2019 inflation forecasts, and contribute to a lower rate path.

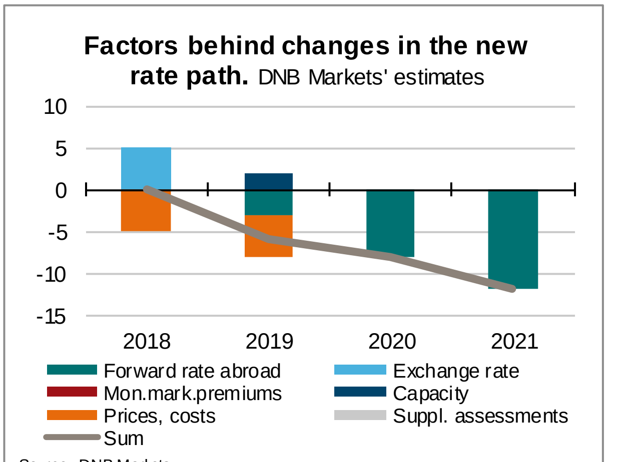
Overall, we believe Norges Bank still wants to raise policy rates after summer. Trends in the housing market are probably important. For the remainder of 2018, lower inflation than expected contributes to a lower rate path. This will however be offset by a weaker NOK than assumed and we end up with unchanged rate path for Q4. For 2019–2021 the drop in foreign forward rates dominates, and could well pull down the rate path.

Kyrre Aamdal, DNB Markets

Expectations to Norges Bank's path for the policy rate

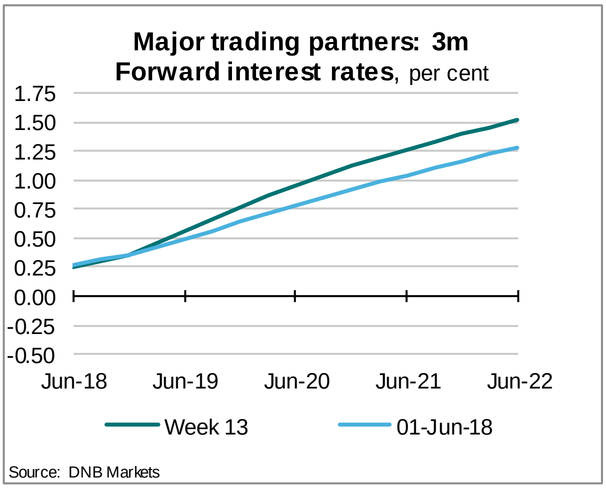


Source: Thomson Datastream/Norges Bank/DNB Markets

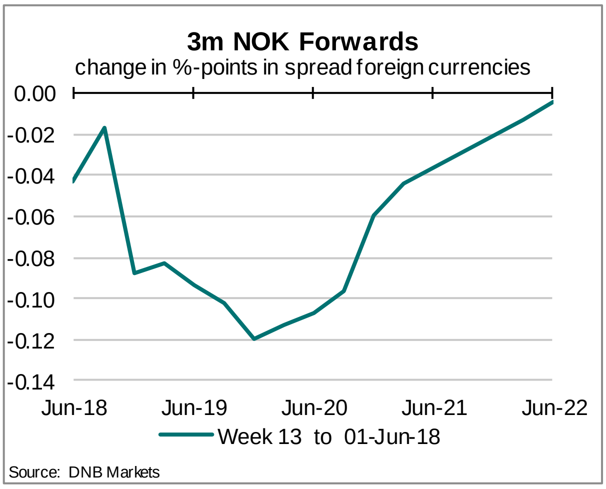


Source: DNB Markets

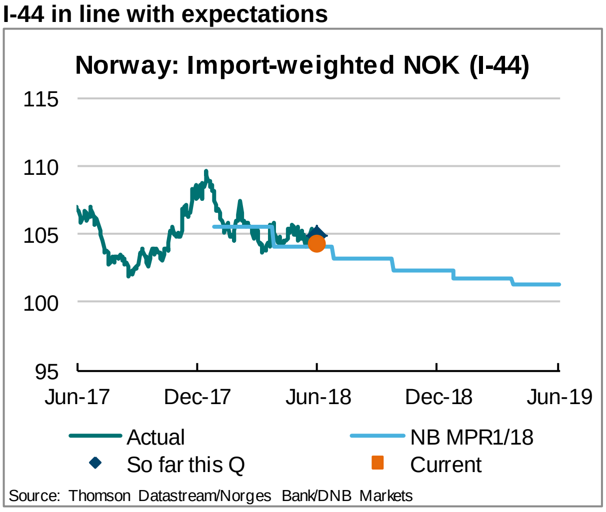
Lower rates abroad…



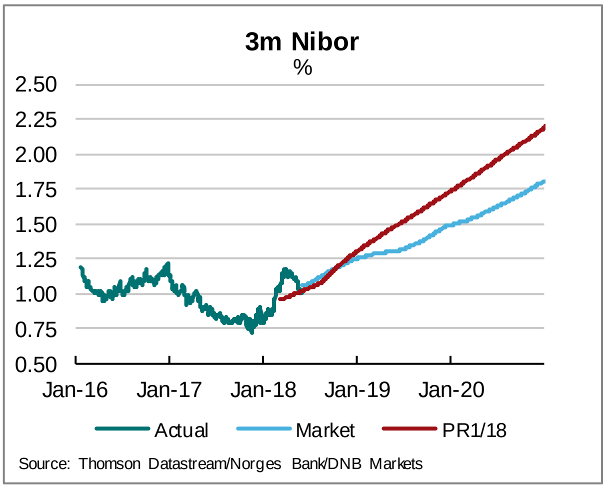
… but NOK rates have declined even more



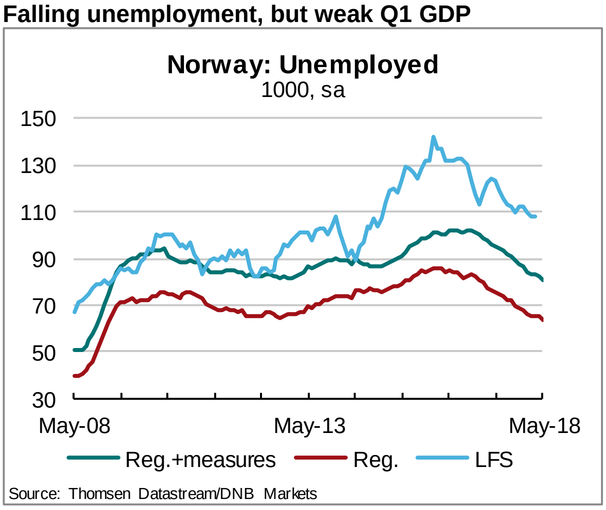
I-44 in line with expectations



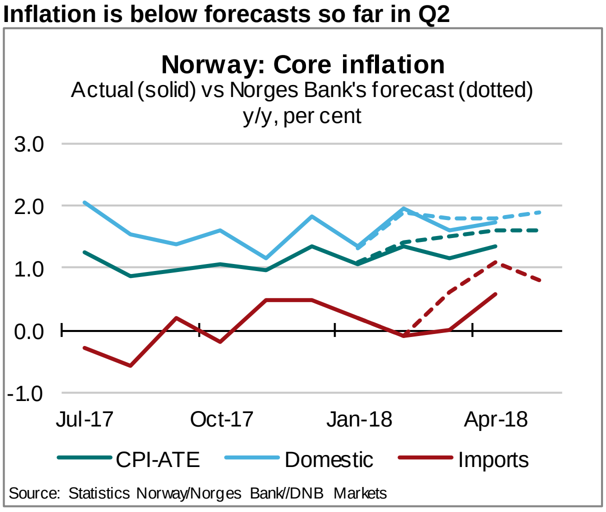
3m Nibor returned and is now close to NB's forecast



Falling unemployment, but weak Q1 GDP



Inflation is below forecasts so far in Q2



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