Norges Bank the last hawk standing

- **Fundamental support for further NOK appreciation strengthened,…**
- **…as Norges Bank affirms their hawkish stance…**
- **…but global uncertainties will keep the NOK at bay**

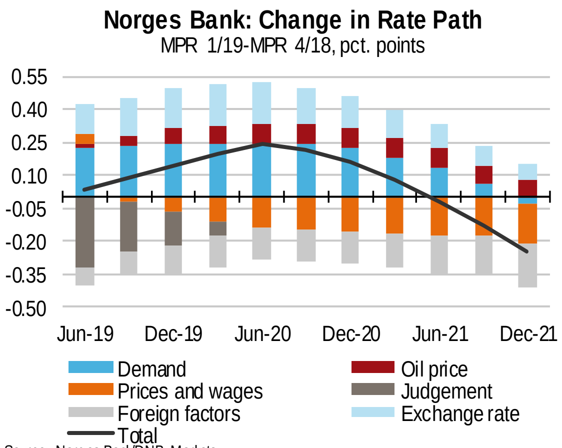
Norges Bank making a hawkish turn. Not only did the central bank hike the key interest rate by 25bp and lift the interest rate path this year, but Norges Bank cemented their clear intent of hiking further; interest rates "*will most likely be increased further in the course of the next half-year*." Moreso, the interest rate path indicates close to 70% probability of a third hike this year.

Capacity utilization is rising, but weaker price signals further out. We expected upward revisions to the interest rate path from recent inflation surprises, higher oil prices, higher capacity utilisation and a weaker than expected exchange rate to outweigh the downward pull from a weaker foreign growth outlook and interest rates abroad. We were however not positive enough on the domestic picture. Norges Bank paints a very solid picture of the economy, lifting forecast for mainland GDP by 0.4%-points to 2.7% this year and by 0.2% points to 1.8% next year. In light of this upward revision, the negative effect on the interest rate path from judgement is no surprise. Norges Bank has time and time again been vocal of their desire to tread cautiously, as the effects of tighter monetary policy after years of low interest rates are uncertain. Slightly surprising is the downward revision of prices and cost on the back of weaker margins within some sectors. Granted, the labor cost share within oil service has increased over recent year, which could mean less spill-over to other sectors. However, these data are prone to revisions, and probably not taken face value by labour market parties in wage settlements. Thus, we may see this effect having the opposite sign at a later stage.

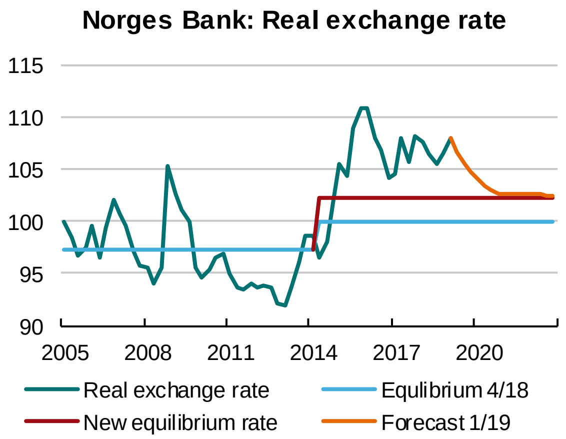
Fundamental support for NOK is gathering, but global uncertainties still a drag. Fundamentals have for some time pointed to a stronger NOK, and these factors now seem even stronger. The macroeconomic backdrop remains solid. In particular, interest rate differentials have widened and Norges Bank expects the interest rate differential against the main trading partners to widen another 70bp towards the end of 2020, almost 40bp more than expected back in December. Oil prices have risen, trading close to our Q2 target of $68/b, with Iran and Venezuela clouding the outlook. While fundamentals remain supportive, the external backdrop remains uncertain. Risk sentiment is still weighed down by quantitative tightening, Brexit, US/China trade talks, slowing Chinese growth, slowing European growth, US recession concerns, Italian politics and empty central bank toolboxes. Thus, NOK attractiveness should be limited.

Norges Bank still sees the NOK as undervalued, but less than previously assumed. Estimates of the equilibrium exchange rate have been revised weaker in the aftermath of the oil price shock in 2014/15, as estimates of long term oil prices have been lowered. Such a drop in oil prices reduces Norway's petroleum revenues and wealth, necessitating an improvement of competitiveness either through a weaker nominal exchange rate or lower price or wage inflation than among trading partners. Given the prolonged period of a weak nominal exchange rate and low wage growth, Norges Bank now assume that the real exchange rate is some ~6% weaker than the equilibrium rate. Previous estimates meant the NOK was undervalued by ~8%.

Magne Østnor, DNB Markets



Source: Norges Bank/DNB Markets



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NOK Comment

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