Norges Bank Review: June 2020

Executive Summary:

- **The Norges Bank kept rates unchanged, alongside expectations, at 0%.**
- **The Bank surprised markets by projecting rate hikes before the end of the forecast horizon, seeing rates reaching 0.5% in 2023.**
- **Policymakers are optimistic over Norway's economic recovery, shifting estimates to show a sharper recovery happening sooner than expected.**

Links:

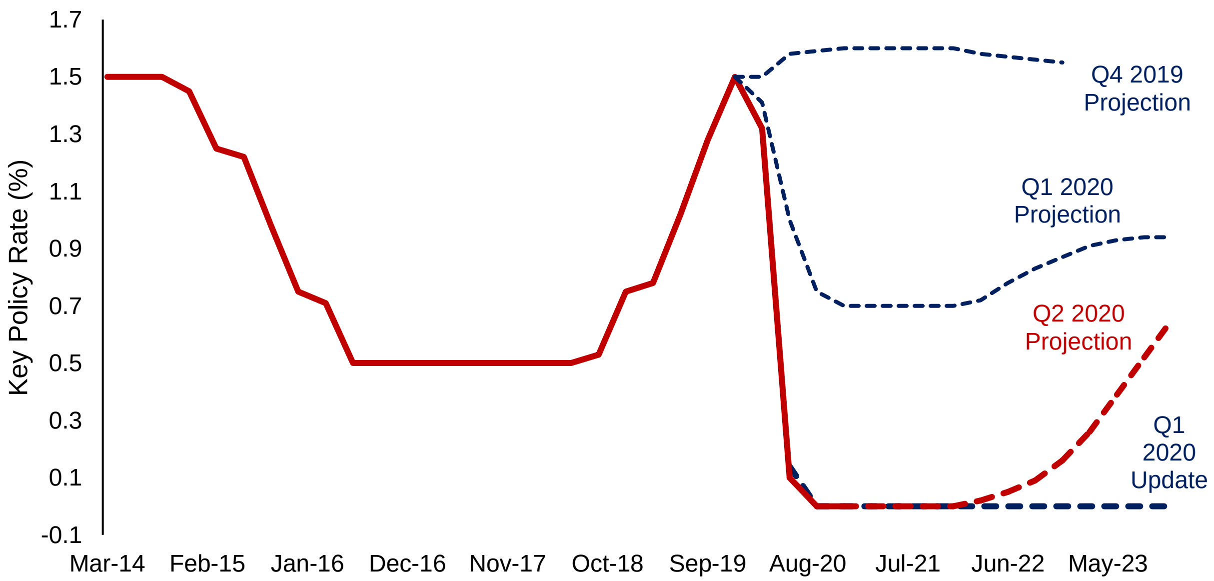
- Monetary Policy Statement: **https://www.norges-bank.no/en/topics/Monetary-policy/Monetary-policy-meetings/2020/june-2020/**
- Monetary Policy Report: **https://static.norges-bank.no/contentassets/ec46da8920184a74acc6cf8ee312f29d/mpr_220.pdf?v=06/18/2020094227&ft=.pdf**

Key Takeaways:

Against the expectations of all analysts surveyed, the Norges Bank surprised markets in June, taking an unexpectedly positive view on the economic prospects for Norway post-COVID crisis. This led to projections showing a shorter downturn, a sharper recovery and a quickly shrinking negative output gap in the years ahead.

Given the optimistic outlook, Governor Olsen raised the likelihood of rate hikes as soon as 2022, with a full 25bps rate hike evident in the projections by the end of that year.

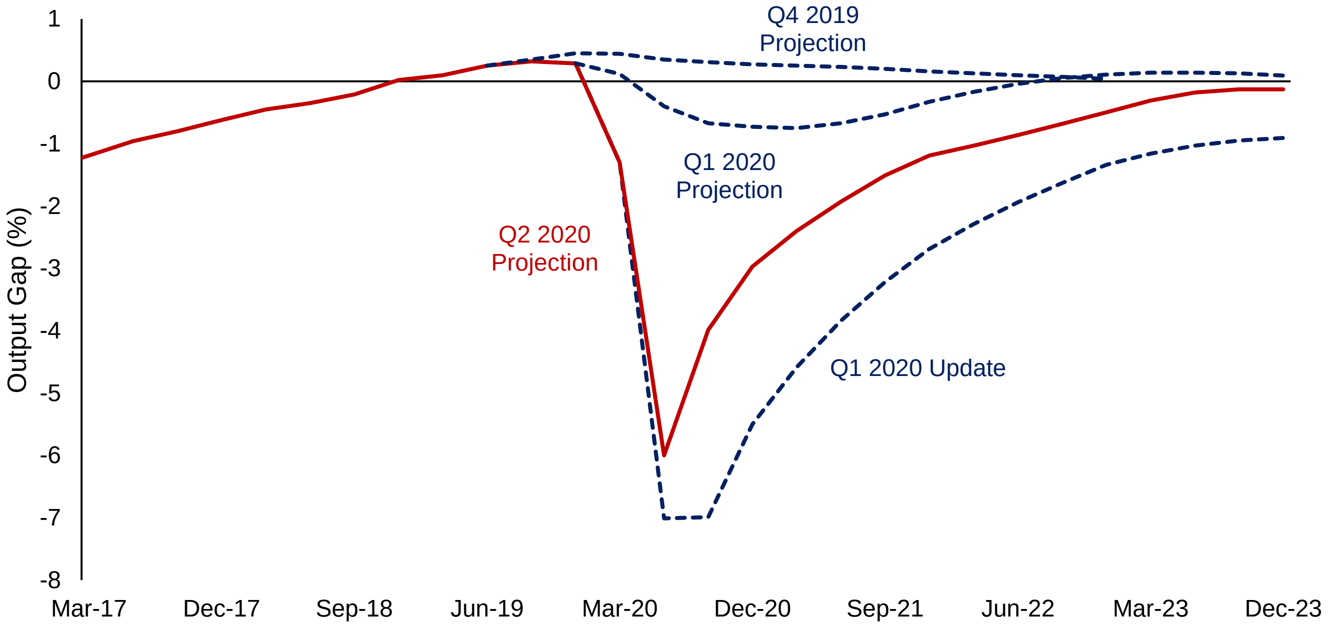
Figure 1: First full rate hike now priced for end-2022



Source: MNI/Norges Bank

On growth, the Bank have now taken the view that Norway will reach pre-crisis output levels by Q3 2021, bringing forward this view by six months from the May economic update. Ahead of this week's decision, board members appear to have increased their focus on realtime economic indicators and gauges for household finances including debit card use (*Ida Wolden Bache: Projections and monetary policy in the time of Covid-19 – May 26th*), house price indices and mortgage rates. These could take more focus in the gaps between the Bank's preferred RNS surveys.

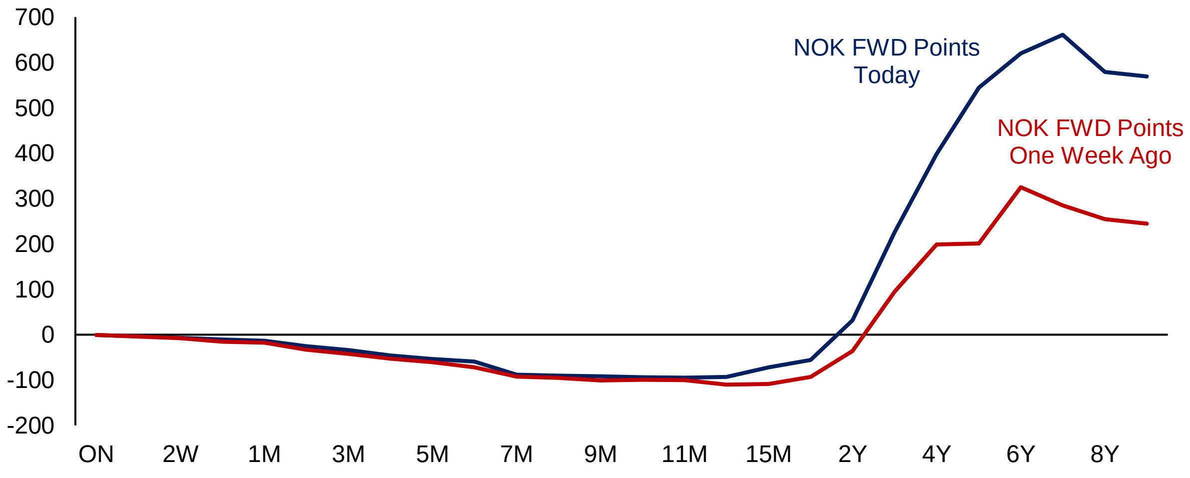
Figure 2: Norges Bank see a near V-shaped recovery



Source: MNI/Norges Bank

Despite the Bank's May projections, money markets had already been pricing a decent chance of a 2023 25bps rate rise before June's policy decision, which may go some way in explaining the relatively muted market response Thursday. The NOK rallied nicely in minutes following the release, but these moves were reversed well ahead of the market close. Forward points are more informative, with tenors capturing the revised projections gaining in sympathy.

Figure 3: Forward points taking heed of new projections



Source: MNI/Bloomberg

Dates to Watch:

July 3rd – June House Price Indices

July 8th – May GDP Release

July 10th – June Inflation Release

August 6th – Q2 Survey of Bank Lending

August 20th – Norges Bank rate decision (no Monetary Policy Report)

Analyst Views (Alphabetic Order)

Danske Bank: The decision was fairly close to their own expectations yet more hawkish than priced in by markets and analyst consensus.

- The omissions of rate path calculations likely reflects the 'technical assumption' of a zero percent rate path that NB presented in May. That is, the rate path should normally have included a probability of negative rates but as NB deems the costs of negative rates higher than the benefits it does not want to signal negative rates.
- They write that it is interesting to note that NB also has made upward adjustments to the oil investment forecast, probably on higher oil prices and a more favourable (temporary) tax regime for oil companies.
- Danske share most of the views presented in the MPR but are a little more optimistic on the global outlook As such, Danske expect the Bank to stay on hold for a long period, but probably start to hike rates at the end of 2021. This will likely mean NB will move forward its expected time for the first hike in September.

ING: Sees the Norges Bank's upbeat economic outlook as somewhat surprising.

- Sees the Bank's decision to boost rate path projections as being due to the outlook for oil investment and other areas being more resilient than expected, opening the door for a rate hike in 2022.
- However, ING warn that neither the Norwegian nor the global economy are out of the woods just yet. While they don't expect any further easing, they suspect rate hikes won't be on the agenda until 2022 at the earliest.

Morgan Stanley: All in all, the meeting was inline with consensus and MS expectations, with the next hike now probable in Q1 2022.

- Growth revisions were mainly due to expectations for higher petroleum revenue spending and a sharper-than-expected bounce in household spending.
- Nevertheless, the output gap will still be at around -1.5% at that time and thus inflation pressures stemming from the labour market and spare production capacity will be subdued.

Nordea: Writes that the upward revision to both the Bank's view of the economy and the rate path was more interesting than the rate decision itself, showing a clear hawkish tilt.

- Nordea see the decision as having sent an important signal: they want to start normalising rates as quick as the economy allows them to.
- The higher oil price and tax changes for the oil sector has contributed to a less pessimistic view on oil investments.

SEB: Finds that the bank's decision to abandon its crisis rate path surprising.

- The decision appears to show that the Norges Bank are concerned that a prolonged period of low interest rates may result in a renewed acceleration in household credit growth, which is probably why the bank did not advise the MoF to lower banks' countercyclical capital buffer further.
- The rate path revision was hawkish relative to their expectations. The 'financial imbalances' element appears to be a new argument that apparently has made the bank to lift its rate path. The surprising rise in

existing home prices in May has clearly made the bank aware of the risk of a renewed acceleration in household credit growth.

Swedbank: Sees new rate path projections as well justified

- With the new rate path, the Norges Bank is the first central bank indicating that raising rates is in the cards in the foreseeable future. Swedbank find the bank's view well justified.
- Swedbank had said it was only a question of time before Norges Bank would change its communication and raise the path. With registered unemployment projected to fall below 3% in 2022, they think it is only natural to project rate normalization to start.

TD Securities: Sees the new rate path as justified by the upgrade to macro forecasts, as well as concerns about financial stability.

- Watches for EURNOK to test recent lows around 10.43 in the wake of the Norges Bank decision. Interestingly, this is first time in a while, the FX market has rewarded a currency where the central bank attempted a more hawkish policy outlook. It is too early to know, however, if this is the start of a broader trend.
- With other central banks in the region still talking about easing, rather forcefully in some cases, this leaves the Norges Bank standing all alone in the hawkish camp.
- TDS will be keeping an eye on Norway's housing market and household debt developments going forward; if they return to prior peaks, we could see the Norges Bank pull forward rate hikes even further still.

MNI Policy

MNI REVIEW: Norges Bank Keeps 0% Rate; Tightening Starts 2022

--Norges Bank Sets Policy Rate At 0%; Forecast Shows Rate at 0.5% By 2023

The Norges Bank left its policy rate unchanged at 0% Thursday, but changed its collective forecast to show tightening starting in 2022 with the benchmark rate reaching 0.5% in 2023.

The Monetary Policy and Financial Stability Committee's unanimous policy decision was expected but the quarterly Monetary Policy Report projections predicted a return towards normality, with tightening introduced at the end of the forecast period whereas none had been shown in its May assumptions.

The policy rate was shown holding at zero percent through 2021 but rising to 0.1% in 2022 and on up to 0.5% in 2023, compared to May's zero rate assumption throughout the forecast period

The committee's view was that while very expansionary monetary policy was required to support the economic recovery there were risks to ushering in a prolonged period of ultra-low rates, that could "increase the risk of a build-up of financial imbalances.

Reduced the policy rate by 1.25 percentage points in March and by 0.25 percentage point in May to take it to zero percent, the Norges Bank has made clear that it has no intentions of dipping into negative territory.

"The Committee does not envisage making further policy rate cuts," it stated, with the policy rate forecast implying a rate at the current level over the next couple of years, followed by a gradual rise as economic conditions normalise," it said.

--'V-SHAPE'

The central bank predicted a near V-shaped recovery, with mainland, non-oil, GDP rising 3.7% in 2021 after falling 3.5% in 2020, growing a further 2.5% in 2022 and 2.0% in 2023. The growth profile was markedly different than May's, although overall growth was similar, with the 2021 GDP forecast up 0.7 percentage point on May's figure but the 2022 one 0.8% percentage point lower and 2023 0.2 point lower. Inflation was shown well above the 2.0% target in 2020, coming in at 3.0% on CPI-ATE measure, and only falling below target in 2022.

There were some chinks of light in the gloomy recent economic data, with Norges Bank seeing unemployment falling more than it had expected and activity picking up faster. The unemployment rate was shown dropping to 3.2% in 2021 from 5.0% in 2020, with this year's forecast down from 6.3% in May.