Norges Bank Preview: June 2022

Details:

Monetary policy decision: 0900BST/1000CET/0400ET, Thursday 23rd June 2022.

- Policy Report including new rate path projections due, alongside regular policy statement.

MNI Point of View

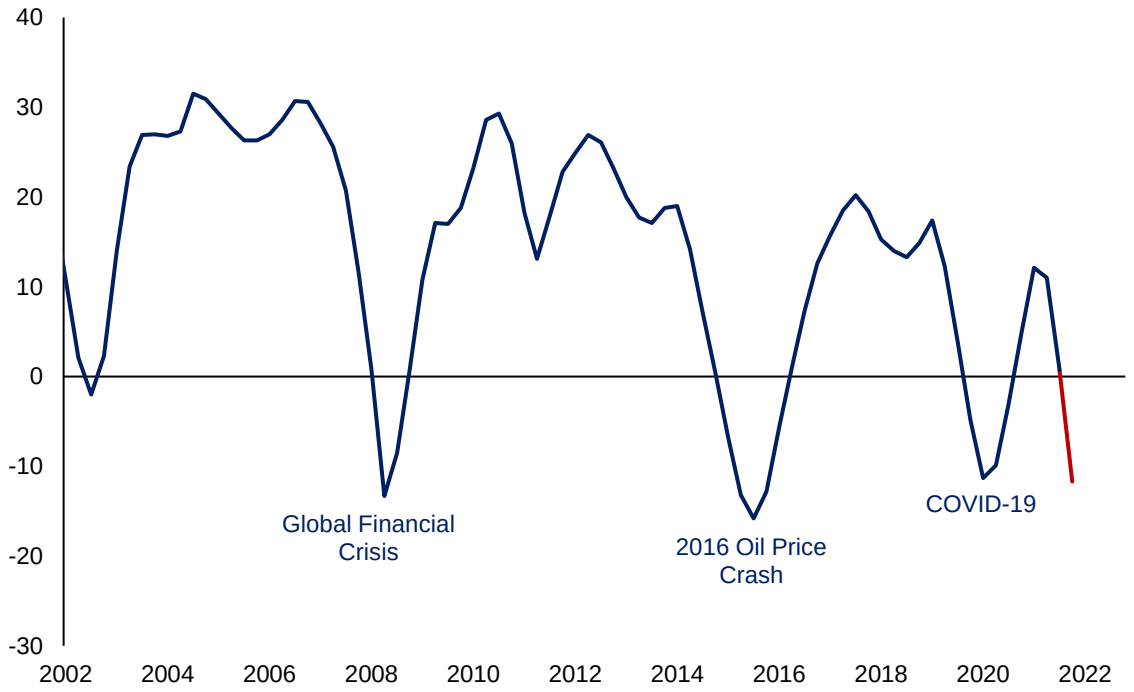
Tighter policy has been well signposted for the June meeting, with the bank signalling a rate hike is "most likely" to be delivered. The size of the hike is less forecastable. Markets have fully priced a 25bps rate rise to 1.00% - and partially a 50bps rise – leaving markets at risk of a 'dovish' disappointment from a mere 25bps hike.

While inflationary pressures, rates among trade partners and firm oil prices argue in favour of a more sizeable 50bps hike this month, the board are likely to stick to their predictable, steady, "gradual" 25bps due to a unique transmission mechanism and a firm preference for credibility-driven policy.

To counter any 'dovish' messages of a 25bps hike this week, the board will likely steepen their path projections further this quarter, introducing – for the first time this cycle – the likelihood of rate hikes at inter-policy report meetings. The bank could reinforce this message by stating that the next rate hike "will likely" follow in August.

Such a policy move would effectively rule out a 50bps rate hike in the near future absent a considerable worsening of the inflation outlook, but could open the door to the "faster" tightening referenced in recent Norges Bank member appearances. A 25bps rate hike at the August and November meetings (i.e. breaking the cycle of quarterly rate rises) would fulfil the bank's criteria of accelerating tightening while maintaining predictability and uniformity of impact on the consumer.

Figure 1: Consumer confidence is now lower than the depths of the COVID crisis



Source: MNI/Bloomberg

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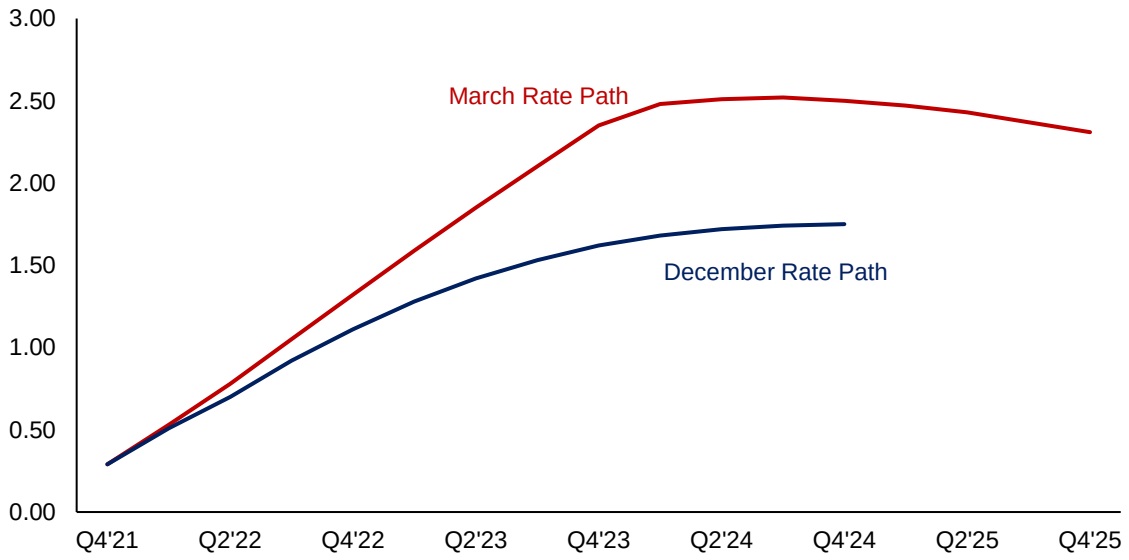
It's the last point that will play particularly on the board's minds this quarter – and will likely be a key facet for the heavy intervention of the judgement factor. Consumer confidence in Norway deteriorated sharply in Q2 and is now lower than the levels seen during COVID-19 lockdowns and is rivalling the fallout from the Global Financial Crisis in 2008. This increases the sensitivity of higher mortgage costs for a Norwegian population that is overwhelmingly likely to be using a floating-rate mortgage product (surveys put floating rate mortgages at circa 95% of the market – a far higher proportion relative to the Eurozone and UK. See the ECB study here). This quickens the monetary transmission mechanism and will allay the pressures to raise rates by 50bps.

There is little precedent for larger rate rises than 25bps in Norway, although the bank conducted a series of back-to-back rate rises in 2009 and – more notably – in 2007. In the lead-up to the Global Financial Crisis, the board were particularly concerned about higher-than-expected growth in wages, inflation indices, house prices and consumer indebtedness. All of these are now familiar themes in a post-COVID economy, and the pattern could repeat itself this year.

In an interview with MNI following the March rate decision, governor Wolden Bache stated explicitly that uncertainty surrounding the economic outlook remains acute. Datapoints and survey releases since then have only clouded the outlook further, suggesting the board will once again lean heavily on the judgement factor to weigh on rate path projections which, on a technical basis, should be significantly steeper.

Figure 2: Norges Bank path projections reach peak of 2.52%, before declining into year-end 2025



Source: MNI/Norges Bank

March's projections put year-end rates at 1.25-1.50%. It's likely previously priced hikes will be front-loaded further at the June report, with the median sell-side analyst seeing deposit rates at 1.75-2.00% for the December meeting. This puts rates north of the bank's judgement of neutral (~1.7%) and should be reflected in the fresh projections. As a result, it's possible the reversal rate will be reached faster – in late 2023, rather than mid-2024.

Most analysts surveyed see the rate path being steepened – but the terminal rate (i.e. the endpoint in 2025) broadly unchanged at 2.25-2.50%.

MNI Norges Bank Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	5.7	3.7	↑	5.1	↑					1.84
Core CPI	% y/y	3.4	2.1	↑	1.3	↑					1.82
PPI	% y/y	64.6	53.2	↑	58.6	↑					0.11
Oil Price (Brent Active)	$bn	114.58	91.15	↑	67.08	↑					1.55
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	54.9	56.0	↓	63.6	↓					-0.30
GDP	% m/m	-0.5	-1.0	↑	0.4	↓					-0.86
Industrial Man Prod	% m/m	1.0	3.3	↓	-1.0	↑					0.44
Regional Network Outlook	Index	0.80	1.65	↓	0.10	↑					-0.33
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
M3 Money Supply	% y/y	7.3	6.7	↑	5.9	↑					-0.31
Credit Indicator	% y/y	4.8	5.1	↓	5.3	↓					-1.65
Non-Fin Corp Credit	% y/y	5.0	5.2	↓	5.2	↓					-0.44
Household Credit	% y/y	4.8	4.9	↓	5.1	↓					-1.53
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	-0.9	0.3	↓	1.4	↓					-0.37
Consumer Confidence (Q)	Index	-11.7	0.7	↓	11.0	↓					-1.11
Unemployment Rate	%	1.6	2.2	↓	2.1	↓					-1.74
Ave Monthly Earnings (Q)	% y/y	3.3	3.9	↓	3.2	↑					0.29
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
OBX	Index	1099	1080	↑	1051	↑					1.61
Norway 10-Year Yield	%	3.34	2.05	↑	1.48	↑					1.22
NW Yield Curve (2s-10s)	bps	47.3	39.5	↑	35.9	↑					0.50
NOK TWI	Index	84.24	88.53	↓	84.82	↓					-0.63

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

Analyst Views (Alphabetical Order) – Rate Path Projections

	Q2'22	Q3'22	Q4'22	Q1'23	Q2'23	Q3'23	Q4'23	[…]	Q4'25
Barclays	1.25%								
Danske Bank	1.00%	1.25%	1.50%	1.75%	2.00%	2.25%	2.50-2.75%	[…]	2.30%
ING	1.25%								
JP Morgan	1.00%								
Natwest Markets	1.00%		2.00%					[…]	3.00%
Nordea	1.00%		2.00%				3.00%		
SEB	1.00%		1.75-2.00%				2.75%	[…]	2.25%
Svenska Handelsbanken	1.25%		2.00%				3.00%	[…]	2.50%
Swedbank	1.00%		1.75%						
Norges Bank	0.78%	1.05%	1.32%	1.59%	1.85%	2.10%	2.35%	[…]	2.31%

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Analyst Views (Alphabetical Order):

Barclays: Looks for 50bps and a higher rate path

- Calls for a 50bp hike at the June meeting with Norges revising up the entire rate path.
- We expect growth forecast to be revised down slightly, with a sizable upward revision in its inflation forecast. Markets are not pricing Norges as aggressively as for other central banks. We think there is room for NOK to recover from its current depressed level, but the currency still faces headwinds from deteriorating global risk sentiment.

Danske: Expects 25bps, signal next rise in September

- We expect the top point of the rate path to fall in the 2.50-2.75% range by end-2023 and that the subsequent inversion will prove steeper than in the March Report leaving a close to unchanged end-point of around 2.3%.
- All is set up for the fourth rate hike in this cycle; the only question is how aggressive Norges Bank will be. If one makes a mechanical calculation of the effect on the rate path from economic factors, you end up with a new rate path that is 50-100bp above the path from the March report, but still 10-50bp below today's market pricing. However, our most important objection to a sharply higher rate path – which is what markets are pricing in - lies in how the NB NEMO-model is designed.
- Our analysis suggests that NB must use a good deal of judgement when updating the rate path. Domestic demand and capacity utilisation have only been marginally higher than last time, which gives no reason to become more aggressive. This suggests that NB will hike rates by 25bp and repeat the signal that rates will most likely rise in September.
- That said, wage growth and in particular price growth have been higher than expected. This clearly speaks in favour of announcing a more aggressive monetary policy than in March. Hence, we expect NB, in addition to hiking, to consider the possibility of raising rates again in August, but without this being referred to as 'most likely'.
- The rate path published in the Monetary Policy Report will probably signal that there is an approximately 50% probability that three additional rate hikes will be delivered after the June meeting and slightly more than four interest rate increases next year, so that the peak in the rate path will fall in the 2.50-2.75% range.
- Ultimately, our call is for NB to hike rates by 25bp in September, December, March and June next year so that the rate peak is reached at 2% next summer. This is based on our expectations of a US recession early next year, the potency of NB monetary policy, and that NB is the most forward-looking of all G10 central banks, in our view.

Goldman Sachs: Faster pace

- We expect Norges Bank to increase the policy rate by 25bp to 1.00%. While both headline and core inflation have surprised Norges Bank's expectations to the upside, we think the Committee will stick to its path projection for a 25bp, rather than 50bp hike.
- Having said that, we see risks skewed towards a larger hike, in particular if the Committee judges wage growth to pick up more strongly.

ING: Sees 50bps hike and, if not, a hint that rate hikes will follow at every meeting

- Norway's central bank has already told us it is going to hike, and it has also hinted that it could step up the pace from its recent string of 25bp moves.
- With oil prices high and global market interest rates rising, we think Norges Bank will follow through with a 50bp hike– or failing that, hint strongly that it could begin hiking at every meeting, as opposed to every alternate one.

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JPMorgan: Expect 25bps, but sees risks of 50bps

- We expect Norges Bank to raise rates by 25bps at next week's meeting taking the policy rate to 1%. There is a risk of a 50bps move as we believe the so-called technical rate path should be screaming for higher rates. However, Norges Bank has numerous times used the "judgment" factor to lower the rate path and only delivered quarterly rate hikes of 25bps as the Committee fears households' response to higher interest rates.
- Inflation and wage expectations have only increased modestly, creating less of an urgency to hike rates by 50bp in June. Also, while hiking more than 25bps appears to have become the new normal among DM central banks, we want to remind that 1) Norges Bank has a very strong, credible forward guidance —in contrast to e.g. the Riksbank—which in May pointed to a 25bps rate hike in June, and 2) Norges Bank is not afraid to stand out among DM central banks and only deliver 25bps.
- We do, however, think it is time for Norges Bank to step out of its comfort zone of raising rates quarterly. Thus, rate hikes of 25bps at the small interim meetings in August in November are now likely and should be reflected in the new rate path.
- We attach 60% probability to our base scenario, while we see 25% risk of a 50bps rate hike coupled with the rate path showing additional moves of 25bps at the two interim meetings in 2H22. Finally, we see 10% risk of the rate path only showing 25bps hikes in September and December, just as the March rate path did.
- On the rate path, we think the technical rate path will be lifted substantially, with the terminal rate raised from 2.5% to over 3%. In isolation, the technical rate path should point to a 50bps rate hike in June, but we think the "judgment" component will lower it to a 25bps rate hike. We believe the final rate path, i.e. the technical rate path plus the "judgment" component, will show a terminal rate of just below 3%

NatWest Markets: Sees 25bps and 4 further hikes in 2022

- We expect Norges Bank to raise rates by another 25bp and quicken its pace of tightening by lifting its rate path at the June policy meeting amid building inflationary pressures and tight labour market.
- We see the updated rate path to signal 4 further rate hikes this year, making use of its 2 interim meetings. The terminal policy rate will likely be brought higher to around 3% from around 2.5% currently. Risks are on the upside and there is a good chance of a 50bp hike considering recent upside surprises in inflation data and NOK weakness. Rates markets are currently pricing about seven more 25bp rate hikes by end of '22. The hurdle for the central bank to be more aggressive than market pricing appears high, and NOK support should be limited if the central bank hikes 25bp as planned.
- We expect the central bank to revise down its growth projections but revise up near term inflation forecasts.
- There seem few signs of wage-prices spiral for now though. The central wage negotiation came in at 3.7% for the coming year, consistent with NB March projections. Local wage negotiations are ongoing, but there seem few signs that there will be a large deviation from the central level. The regional network survey shows that contacts have revised up their estimate for annual wage growth in '22 to 3.9% from 3.7%, which is not dramatically different from central bank forecast.

Nordea: 25bp hike, with rates at 2.00% by year-end

- We expect Norges Bank to hike by 25bp in June and signal that the next rate hike will come at the meeting in August. We see the new rate path signalling overwhelming probability for four more rate hikes after June until the end of 2022.
- We see the new rate path signalling overwhelming probability for four more rate hikes after June until the end of 2022 and a key rate at 3% by the end of 2023. Overall, the new rate path will surely be higher than the March rate path.
- Our calculations show that the technical rate path (without Norges Bank's judgment) could suggest a 50bp rate hike in June given the recent developments. Yet, we don't expect Norges Bank to hike by 50bp in June because of the Committee's judgment, and their desire for managing expectations and gradual rate hikes.
- The Committee has time and time again used the judgment factor to hold down the pace of hikes compared to the modelled technical rate path since Norges Bank strongly prefers to raise interest rates gradually.
- While we don't believe the Norges Bank will slam the door shut on 50bp hikes, the Governor will likely express Norges Bank's intention to move gradually unless there is an imminent risk of inflation getting out of

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hand. We are however sceptical that the market will be very reassured by this as long as global rates move higher. We could thus experience a situation where Norges Bank underdelivers on market expectations for all of 2022.

Rabobank: Sees 50bps as strong option for Norges Bank

- In our view, the outlook for prices suggests that a 50 bps rate hike is still a strong option for Norges Bank rate setters.
- The relatively soft position of the NOK is another reason why the Norges Bank may opt for a larger 50 bps move. Stronger exchange rates are generally more desirable in a high inflationary backdrop.

SEB: Sees year-end rates at 1.75% - below consensus

- We believe a 50bps rate rise is unlikely: Norges Bank is not "behind the curve", domestic inflation is not showing signs of being "persistent" and household interest rate sensitivity is very high. Norges Bank is likely to favor faster rather than larger hikes.
- SEB see the inflation dynamics as supporting their forecast of a further 25bps increase at the following Aug 18 intermediate rate decision.
- We do not believe that Norges Bank believes it is behind the curve, implying there is no immediate urgency to deviate from its guided 25bps increase at the upcoming meeting. Moreover, as a first step Norges Bank is likely to speed up the pace of hikes, rather than the size. The bank has so far sticked to signal rate increases at its MPR meetings, but there are two remaining intermediate decisions this year (Aug 18 and Nov 3) implying that the policy rate could be lifted by 125bps in 25bps steps to 2.00% by year-end, which is above Norges Bank's estimate of a neutral policy rate.
- We expect the front-end of the path to be lifted by 30-35bps, implying four additional rate hikes this year with a possibility for five hikes which would leave the policy rate by year-end between 1.75-2.00%. Further out, we expect Norges Bank to stick to its cautious approach implying one 25bps hike per quarter in 2023 and a year-end policy rate around 2.75% (vs. previously 2.50%). The long end of the path is likely to become more inverted, reflecting a less positive output gap further out.
- We expect the Committee to state that the policy rate will most likely be raised again at the upcoming meeting in August. We do not expect the rate path to signal any 50bps hikes, but if asked during the press conference the Governor is unlikely to rule out a such increase though a faster pace of hikes is likely preferred.
- Regarding domestic inflation and the risk of a price-wage spiral, we do not believe the situation has changed dramatically since the March MPR.
- Surprising by deliver a 50bps instead of the 25bps hike as indicated in the rate path is surely not taking households' interest rate sensitivity into account. Moreover, the sharp fall in the monthly and quarterly consumer confidence indicators with households' pessimism about their own financial situation at par with the lows in the early 90s should rather strengthen the Committee's belief that a gradual approach is necessary. We believe household interest rate sensitivity to remain an important argument for refraining from 50bps hikes.

Svenska Handelsbanken: Sees 50bps rate rise and 2.00% by year-end

- We have leaned towards a 50bps hike, but we stress that uncertainties are high. It will be even more important to see Norges Bank's (upward) revision of the further trajectory of the key policy rate path. For some time, we have expected Norges Bank to deliver one additional rate hike this year (relative to the central bank's projections so far). But as things have turned out, we now believe that Norges Bank will add yet another rate hike this year, with the new rate path showing the key policy rate up to 2.0 percent by the end of this year.
- With capacity pressures running hot, core inflation well above target and with further risks to the upside, Norges Bank will have to move faster into contractionary territory. Against this backdrop, the actual policy rate is currently way too low and Norges Bank not only needs to catch up, but to enter a contractionary mode before end of the year.

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- To be precise, we believe that Norges Bank will hike by 50bps at the upcoming June meeting, and we also expect the new path to show a series of 25bps hikes further ahead: August, September and December (with November as the only pause).
- Further ahead, we believe the key policy rate will continue to rise in measured steps, to closer to 3 percent by year-end 2023. Towards the end of the forecasting horizon (2025), however, we believe that the policy rate will gravitate closer to 2.50 percent; signalling that the policy rate will start the process of moving closer to neutral, conditional on Norges Bank seeing capacity pressures easing, and inflation moving closer to target.

Swedbank: Dilemma between housing market and the NOK

- 50bp clearly remains a viable option, but we stick to our long-held view that Norges Bank will deliver a standard hike of 25bp, but front-load the hikes to include both a hike in August and high probability for a hike also in November – in addition to the more conventional hikes in September and December.
- There are good arguments for hiking by 50bp already now, as the policy rate should by all means have been higher. However, we think there are several reasons for Norges Bank sticking to 25bp this week. Namely: Norges Bank does not like to surprise, neither markets, businesses nor households, the Bank likes to watch data and scrutinize the effects of their hikes and the growth outlook is already ebbing according to the Regional Network.
- As Norway has one the world's most leveraged household sectors, with close to all entertaining floating mortgage rates, it is all but certain how households – and hence the consumption and housing market – will respond to double hikes.
- Our projection entails four more hikes this year, one each quarter, plus at the interim meeting in August to end at 1.75% in December. After that, we believe the economic momentum will be too weak to sustain more hikes.
- Market pricing is for more than six hikes this year and a target rate of 3.2%. We see little reason for Norges Bank to be this aggressive this time around, as it would risk stifle the upswing and short-term outlook is more uncertain.

TD Securities: Looks for 50bps as inflation shows no signs of coming down

- We look for Norges Bank to deliver a 50bps hike despite previously signalling for a 25bps increase, as inflation is showing no signs of coming down, with year-on-year May CPI coming in 1.4ppts above the central bank's latest forecast, and wage growth pressures continue to mount.
- We expect a slight upward revision to the terminal rate in their projected policy path as well.

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MNI STATE OF PLAY: Norges To Choose Between 25-, 50-BP Hike

By David Robinson

Norway's central bank is set to deliver another rate hike at its June meeting as its inflation outlook continues to rise, either upping the tempo of tightening by announcing a 50-basis-point increase on Thursday, or staying at 25 points while releasing a projection indicating rates will rise more quickly than it had foreseen in March.

When hiking from 0.5% to 0.75% on March 23, Norges Bank's Monetary Policy and Financial Stability Committee stated that the next move up would most likely be in June and it projected that the policy rate would rise to around 2.5% by the end of 2023. New Governor Ida Wolden Bache told MNI however that hikes could be in larger increments if needed to control inflation. (See MNI INTERVIEW: Norges Bank Head Says Could Up Tempo Of Hikes)

Other global central banks have since revised inflation forecasts higher, and Norges Bank, which has seen its March inflation forecasts outpaced by reality, is likely to follow suit, though it will also have to factor in the growing risk of recession in Norway's major trading partners. Consumer prices jumped by an annual 5.7% in May, compared to Norges Bank's forecast of 4.3%, and the target CPI-ATE measure rose 3.4% versus the 2.6% projection.

Norges Bank's previous rate path pointed to a couple of hikes in the second half of the year but if the forecasts published in the June Monetary Policy Report were to price in a third, then this would signal a shift to a policy of hiking at interim meetings, which are not accompanied by the detailed analysis contained in the quarterly MPR or by a press conference.

NO SURPRISES

While analysts are split as to whether this week's hike will be by 25 or 50 points, so far Norges Bank has delivered no surprises, with its previous 25-basis-point hikes clearly flagged in advance. Another 25-point increase this time round and a clear statement that the next move is likely in August would continue this approach.

Recent data has highlighted the dilemma facing policymakers. Norges Bank's Regional Network, published this month, found businesses expected growth to decline over the next six months, but also that they thought the tighter monetary policy needed to contain quickening inflation would dampen demand. A growing number reported capacity constraints, while expected wage growth for 2022 was revised up to 3.9% from 3.7%, though even this higher rate is still modest by the standards of Norway's peers.

Money market curves, as elsewhere, are pricing in more aggressive tightening than either analysts are expecting or than the central bank has, so far, signalled. On some readings the curve indicates that the policy rate will rise over 3%, with the equivalent of more than half a dozen 25bps increases this year.

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