Nordea

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Norges Bank Preview: Guiding for a September cut

Marketing communication

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Norges Banks rate path will be lowered next Thursday and the central bank will guide towards a first cut in September

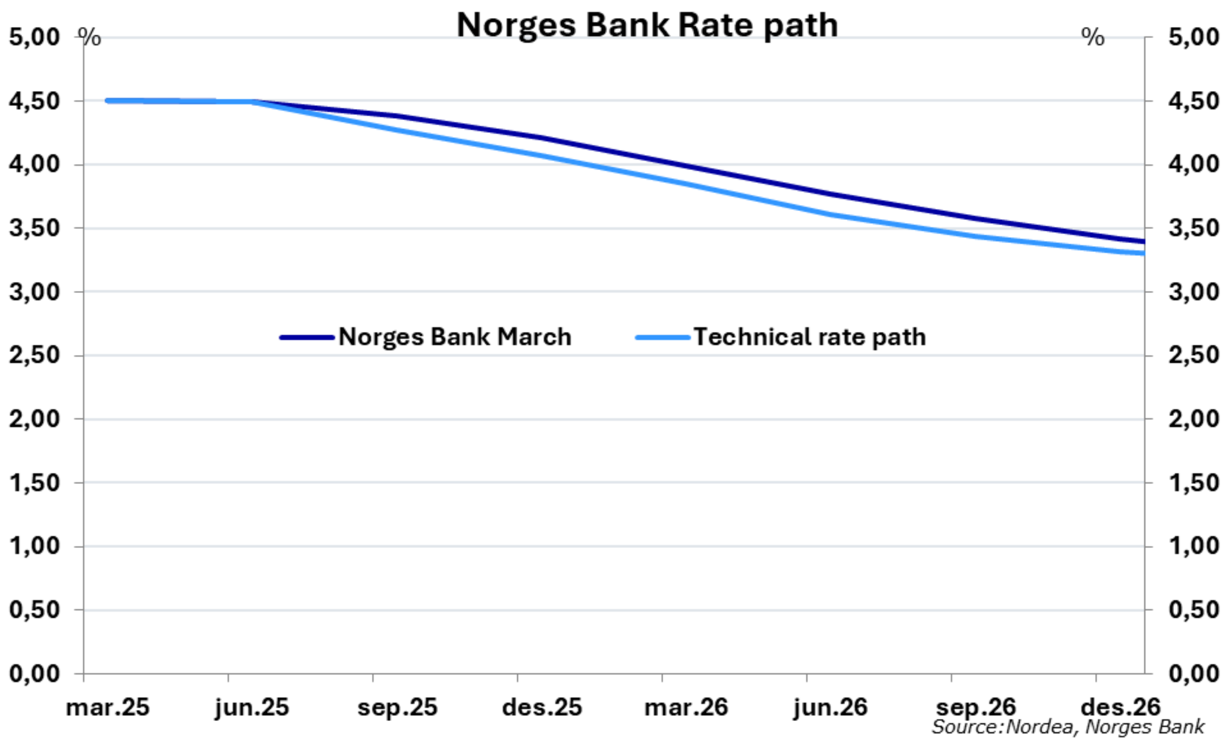
Somewhat lower inflation than expected, lower rates abroad and a Regional network broadly in line expectations mean that Norges Banks rate path will be lowered next Thursday. The new path will indicate two cuts before year end and a decent probability of a cut already in August. Norges Bank will guide towards a first cut in September, however.

At face value, the new information since March could actually have led to a rate cut from Norges Bank already next week. We rule this possibility out. Norges Bank will not think they are in any hurry to lower rates. Yes, inflation is somewhat lower than expected (0.2-0.3pp) but it is still too high. Moreover, core inflation will pick up again this autumn due to base effects and will hover around or slightly above 3% for the rest of the year. At the same time, unemployment is low and growth has picked up to a level close to or even slightly above potential growth. The driver behind this growth-pickup is higher private consumption. Purchasing power increased a lot last year and will increase substantially also this year as wage growth (at around 4.5%) will outpace inflation with a good margin.

From a risk management point of view, Norges Bank will opt to wait. They have highlighted the following trade-offs: *"If the policy rate is lowered prematurely, prices may continue to rise rapidly. On the other hand, an overly tight monetary policy could restrict the economy more than needed to bring inflation down to target".* Based on the incoming information about developments in the Norwegian economy, it is hard to argue that monetary policy is currently overly tight. They also know that lower rates will boost growth further, running the risk that further disinflation could stall.

While somewhat lower inflation than expected and lower rates abroad pulls the rate path down, we think they will have a small positive contribution to the rate path from domestic demand. Growth in Q1 was clearly higher than Norges Bank expected (1.0% vs 0.6% q/q). In particular, private consumption was higher and was growing at a rate between 3-4% the first three months of the year. In April retail trade continued strongly up, with 3m/3m annualised growth at 6%. Housing investments also turned slightly up in Q1 while Norges Bank had assumed it would continue to fall the first half of this year and only turn positive from autumn onwards. Furthermore, while the Regional network was broadly in line with expectations, growth in Q3 is expected to be slightly higher (0.1pp) than Norges Bank had in their forecast in March.

In sum, the rate path could be lowered by some 10-15 bp compared to the March path based on the factors above. In that case it would indicate 5 rate cuts by end of next year. However, we do suspect that Norges Bank could revisit their assumption for the neutral rate. This is the dark horse. Over the last two years, they have adjusted up their view twice. In 2023, they said that the neutral real money market rate probably was in the upper part of the range of -0,5/+0,5%. Last year they revised the interval to 0%-1%. Based on developments in the Norwegian economy lately, with growth picking up on the back of stronger growth in the interest rate sensitive sectors, it would make sense to adjust the neutral level. Furthermore, Norges Bank normally pay attention to market pricing when judging what a neutral rate could be. 5y5Y forward rates have been hovering close to 4% for quite some time now, indication a real rate close to 2% and clearly higher than the assumption of Norges Bank. If they do adjust the level for the neutral real money market rate to say 0.5%-1.5%, this would pull the rate path up and lift the end-point. If Norges Bank do not revise their assumption now, we do think they will at some point over the next year. Therefore we do not necessarily believe Norges Bank will deliver very many rate cuts, even if we have to admit that a cut in September now seems much more probable than it did in March.



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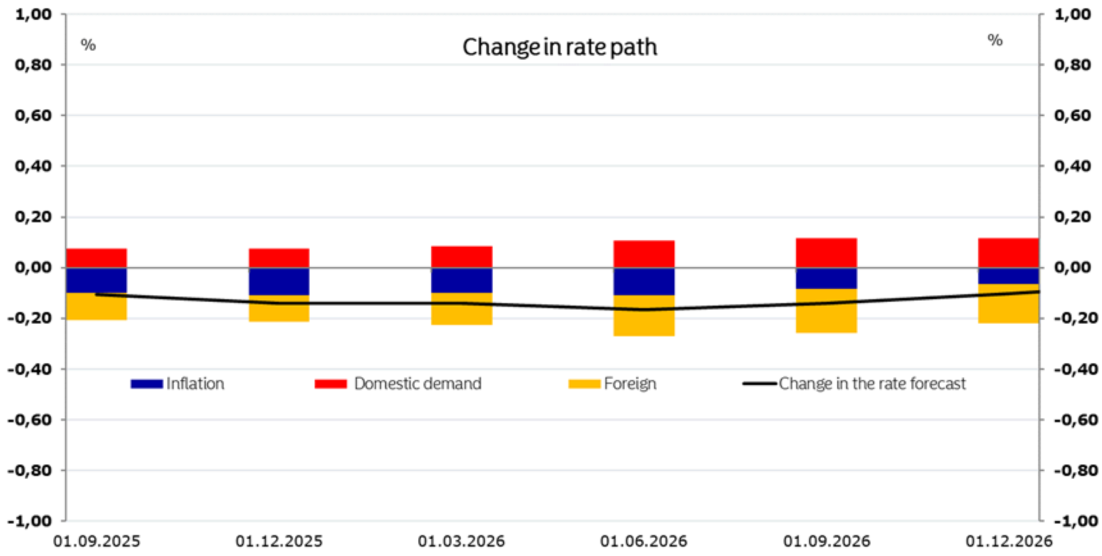
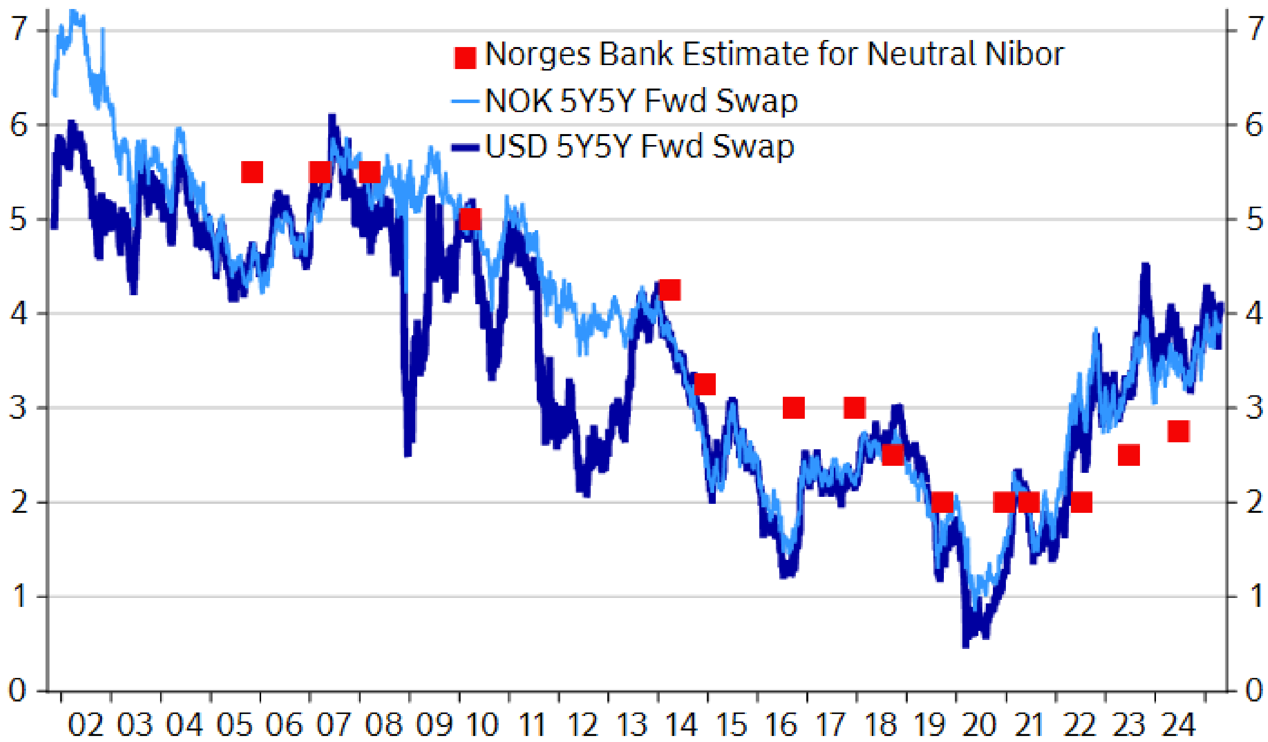


Source: Norges Bank, Nordea



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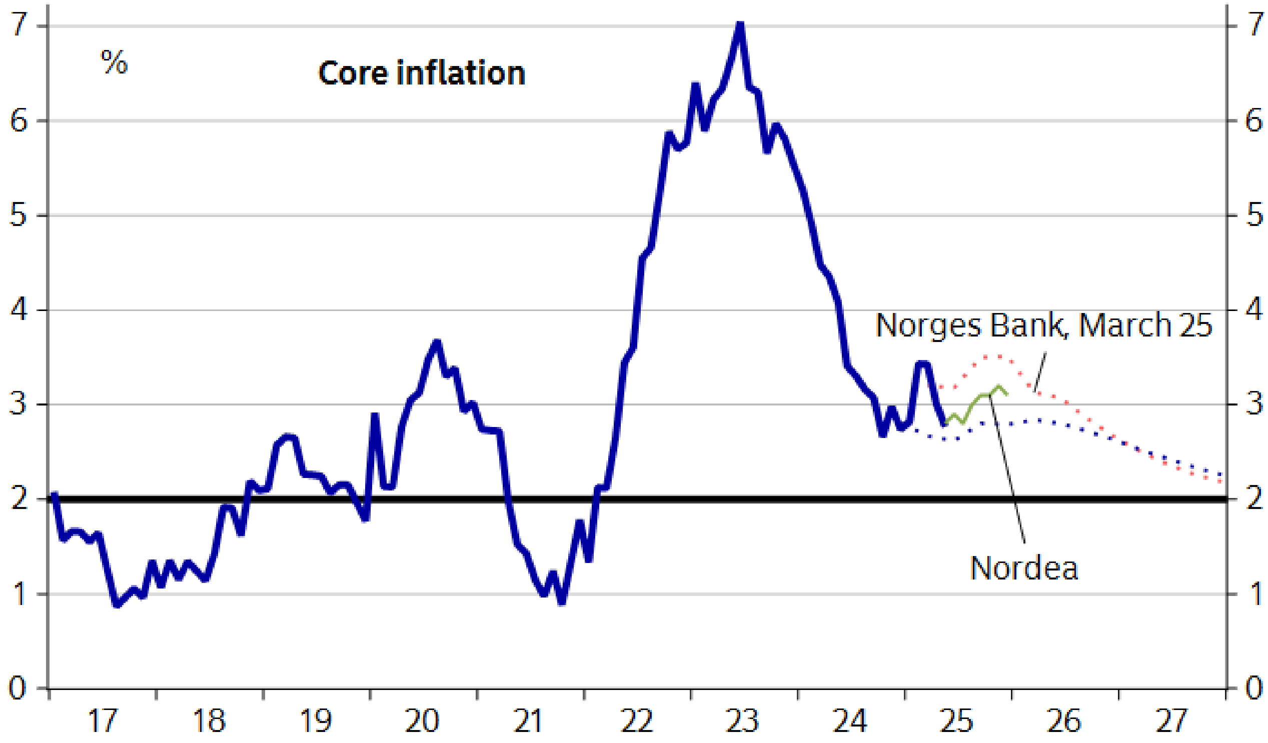

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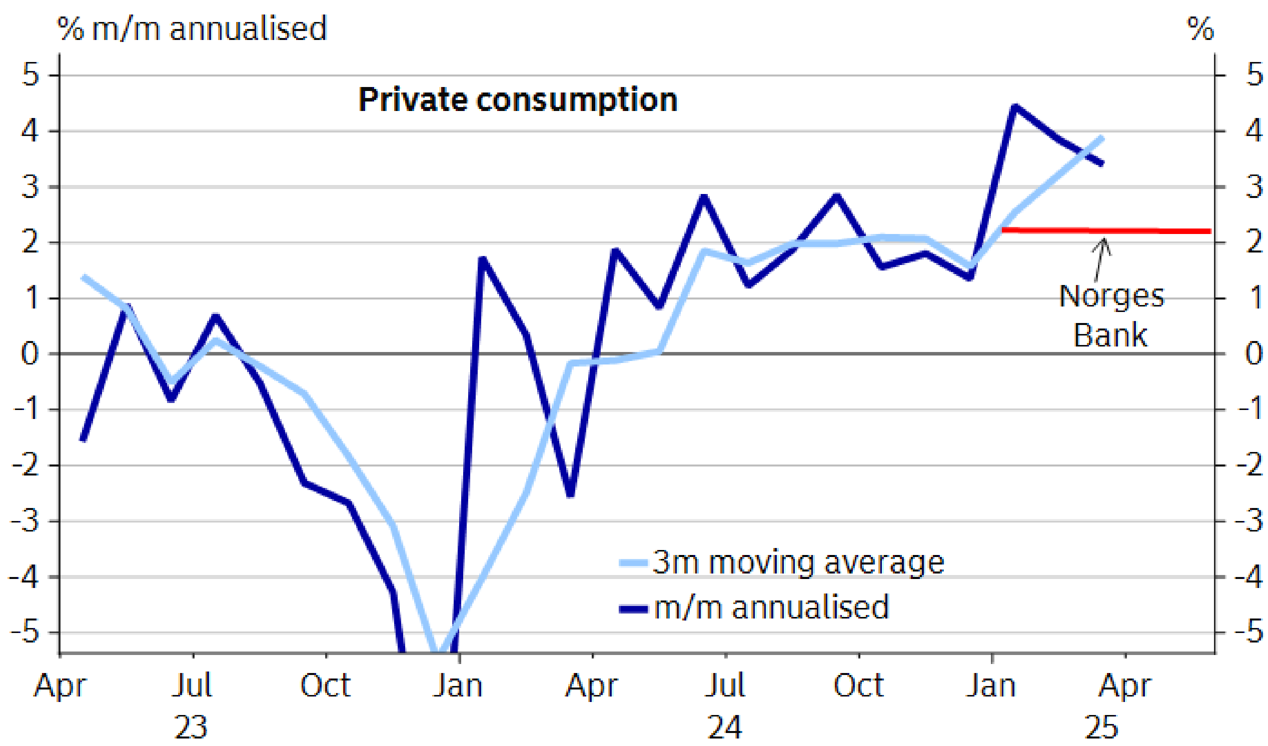

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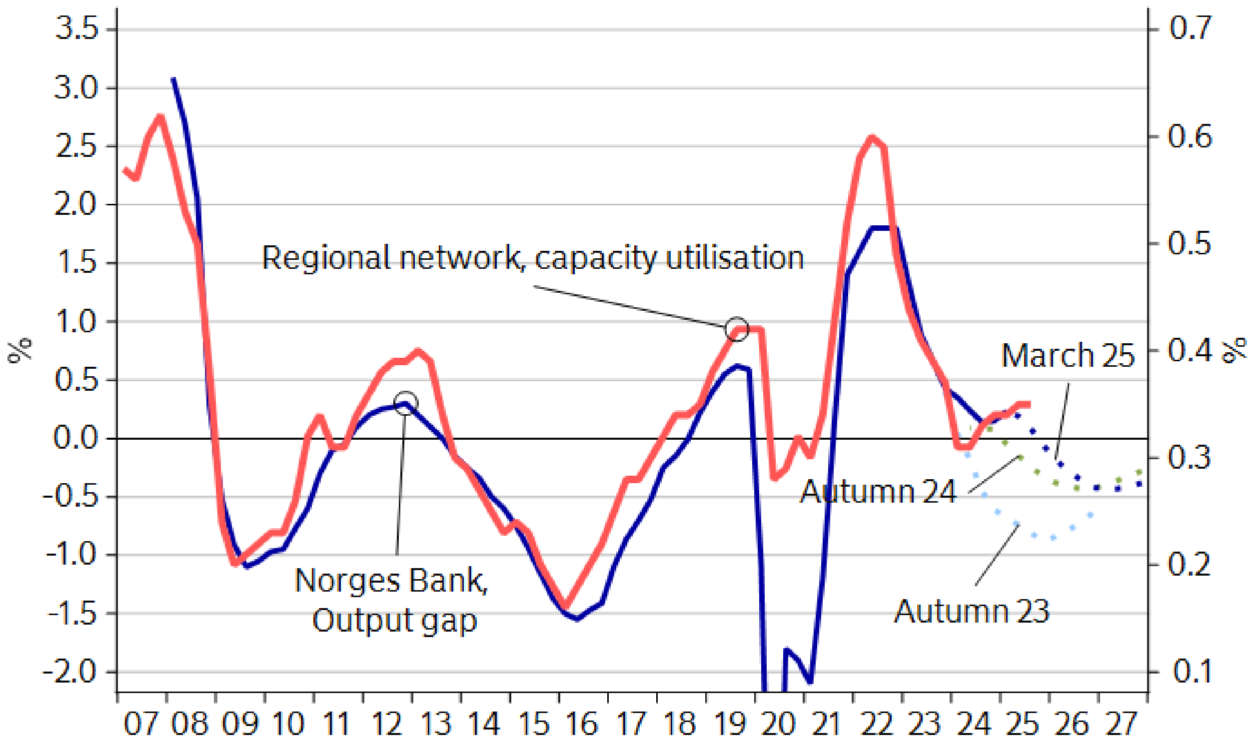

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