Liquid Insight

Norges & Riksbank previews: Norges has more work left, but may take its time

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Rates and Currencies Research
Global

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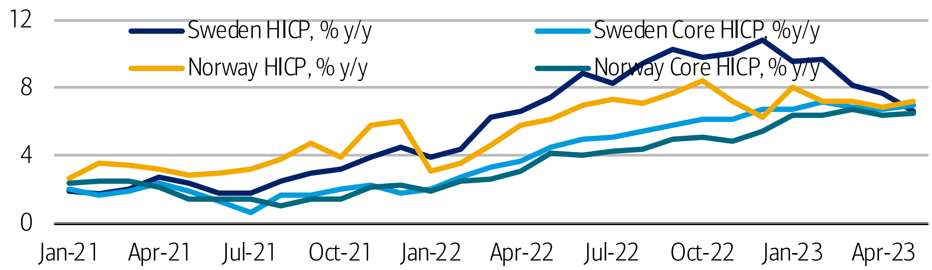
Key takeaways

- Norges: We expect 25bp this week, with risks of 50bp. Terminal at 4%, with risks for more and a flatter path.
- Riksbank: We expect 25bp next week. Faster QT likely. We see no more hikes later, but Bank will likely leave the door open.
- FX: The upcoming meetings pose modest downside risks to our bullish NOKSEK view. But central bank outlook still in support.

By Rob Wood and Michalis Rousakis

Chart of the day: Sweden vs Norway HICP inflation
Core inflation similar, but going forward we expect more persistence in Norway



Source: Statistics Norway, Statistics Sweden, Eurostat
Note: Norway's headline inflation affected by support scheme for electricity costs

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Norges & Riksbank: 25bp, but Norges has more work left

We continue to see Norges hiking rate by 25bp this week. Hawkish data has raised the risk of a bigger, 50bp move, but we don't feel the arguments are convincing enough. We expect the central bank to raise its terminal to 4%, with risks of a higher terminal, and perhaps go "higher for longer".

We continue to expect Riksbank to slow down its hiking pace to 25bp next week. Riksbank could also speed up bond sales. Riksbank may indicate a chance of one more hike in September, but we are not sure if it will be delivered. We keep our terminal rate forecast at 3.75%, with risks still to the upside but more balanced than before.

We expect NOKSEK to recover further in the coming months and forecast 1.04 by year-end. While our relative monetary policy outlook for this year and next is the reason for our bullish NOKSEK view, our base case for the upcoming meetings given market pricing suggests modest downside risks to our long NOKSEK trade recommendation (entry April 28 at 0.9638, stop/loss 0.9280, current spot 1.0065, see Buy NOK/SEK 28 April 23).

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Norges: 25bp, 4% terminal, likely flatter path, upside risks

We continue to expect Norges to hike rate by 25bp this week. Hawkish data has raised the risk of a bigger, 50bp move, but we don't feel the arguments are convincing enough.

Hawkish inflation, hawkish Regional Network Survey

On the one hand, inflation, both imported and domestically-generated, surprised clearly hawkishly (Exhibit 1), unemployment remains low, housing prices have retraced their last year's losses, and NOK is very weak, and weaker than Norges expected. Meanwhile, Norges Bank's widely watched Regional Network Survey showed higher wage growth expectations and improving growth (Exhibit 2).

Weak activity data, easing capacity constraints, some hawkish news expected

On the other hand, growth was surprisingly weak in the latest monthly data, with March also revised lower, with the overall outcome below Norges' expectations (Exhibit 3). Unemployment is indeed low but in line with Norges. Wage expectations in the Regional Network Survey were also broadly in line with Norges (+30bp vs Norges' forecast for this year, which we do not find that surprising after the wage agreement, but fully in line for next year). Capacity and labour supply constraints continued easing and are almost back to their average levels—in fact, capacity constraints are below the levels seen during the pandemic (Exhibit 4).

Hawkish newsflow meets Norges' gradualist approach

To be sure, we agree that a higher terminal rate is needed, but we think Norges will continue favoring a more gradualist approach, as outlined by Norges Bank Governor in May:

"Inflation is now markedly above the target. We could have raised the policy rate higher and faster than we have so far. Inflation might then have come down faster.

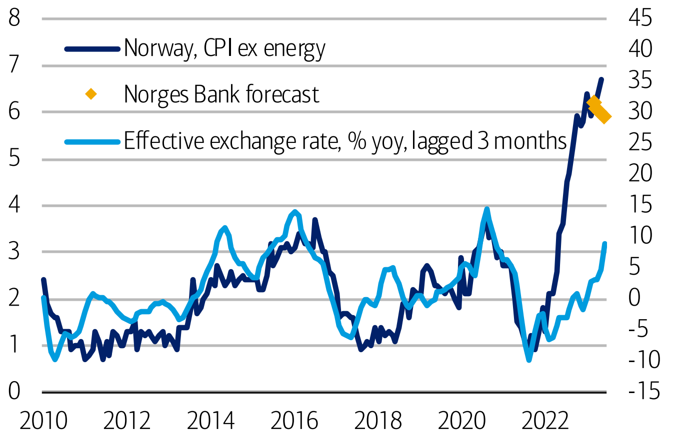
The reason we are taking a while to bring down inflation is that our job is also to contribute to high and stable employment. We do not want to restrain the economy more than that required to tame inflation." (Norges Bank Governor, "The conduct of monetary policy", 9 May 2023).

Bottom line - we expect Norges to react to the overall hawkish newsflow, not via a faster hiking pace, but via a higher and likely flatter interest-rate path. The central bank previously saw rates peaking at 3.60% in December with 2-3 rate cuts in the following 2 years. We expect it to raise its terminal-rate forecast to 4%, and to potentially move towards Riksbank's profile of holding at that level for a longer period. We see risks skewed to a higher terminal.

Risk – frequency of price adjustments and FX passthrough

A risk to the hiking pace is whether Norges' reaction function has changed. A detail perhaps overlooked in the Regional Network Survey is that contacts reported that they adjust selling prices more frequently than before the pandemic and react faster to the exchange rate. Also to the extent the monetary policy may affect the passthrough to prices, we judge that these findings could tilt Norges' reaction function to a hawkish direction.

Exhibit 1: Norway inflation and Norges' forecast (percent)
Currency likely explains a small part of inflation rise



Source: BofA Global Research, Statistics Norway, Norges Bank. Note: We use Norges Bank projections for both CPI ex energy and the effective exchange rate

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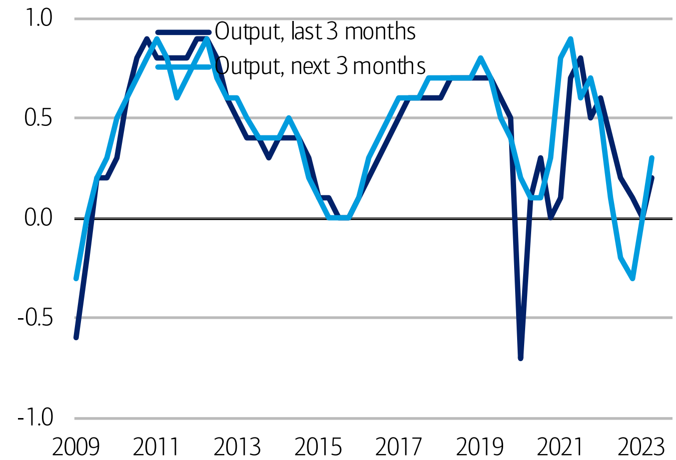
Exhibit 2: Regional Network Survey, aggregate activity data
2Q Regional Network Survey showed resilience and an improved outlook



Source: Norges Bank Regional Network Survey 2/2023

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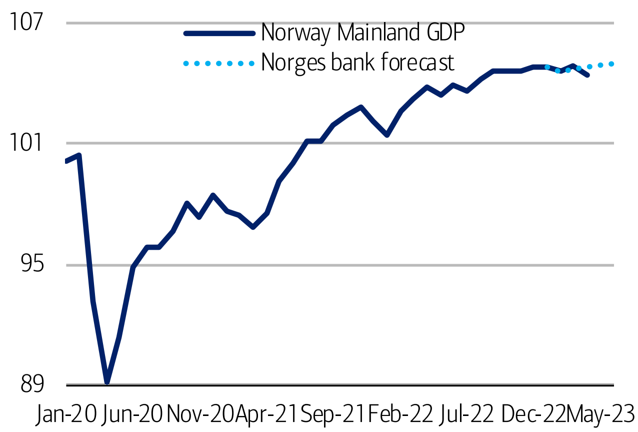
Exhibit 3: Norway monthly GDP and Norges' forecast
GDP weaker than Norges expected



Source: BofA Global Research, Statistics Norway, Norges Bank

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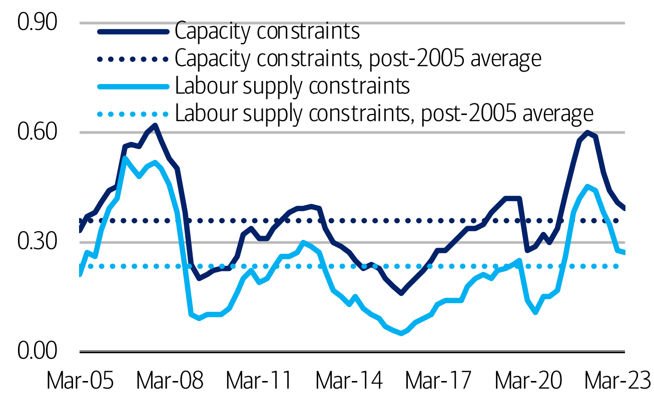
Exhibit 4: Regional network survey, capacity utilization and labour supply constraints
Capacity and labour supply constraints continued easing



Source: Norges Bank, Regional Network Survey 2/2023

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Riksbank: 25bp next week and likely done

We continue to expect Riksbank to slow down its hiking pace to 25bp next week. It could also speed up bond sales.

We think the resilient activity & labour market data (Exhibit 5), the high ex-energy CPIF inflation (although just 10bp above Riksbank's forecasts, Exhibit 6), and SEK weakness will likely prompt the Riksbank to indicate a chance of another hike in September.

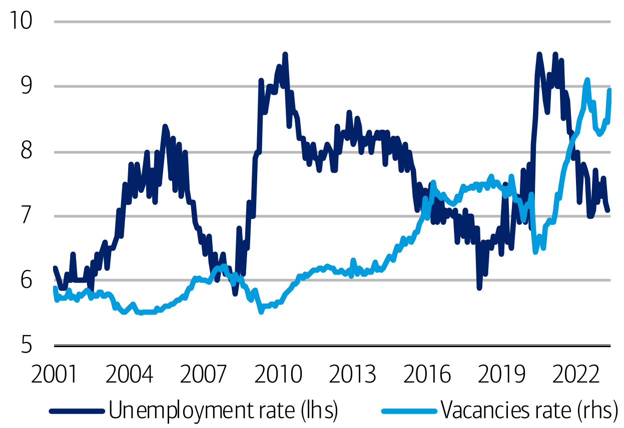
But we are not sure that Riksbank will actually deliver it, given Sweden's high rate sensitivity (already seen in household consumption and housing investment), which will likely help inflation pressures to continue moderating in the next months. Hence, we keep our terminal rate forecast at 3.75%.

We now find risks more balanced than before (headline CPIF below Riksbank's forecast—see Exhibit 6—and May manufacturing PMI extremely weak—see Exhibit 7), we still think they are tilted to the upside because of SEK and, to this extent, the ECB.

With that said, our recent Stockholm fieldtrip suggested that Sweden's high rate sensitivity (Exhibit 8), tight fiscal policy, modest wage growth, and stable inflation expectations suggest that Riksbank may not need to match the ECB hikes one-for-one ([Stockholm investor fieldtrip notes: hope is inflation falls fast 14 June 2023]).

Exhibit 5: Sweden unemployment rate and vacancies

Vacancies rose in May. Labour market remains surprisingly tight



Source: BofA Global Research, Statistics Sweden. To estimate the May vacancy rate we use the April data for the size of the labour force.

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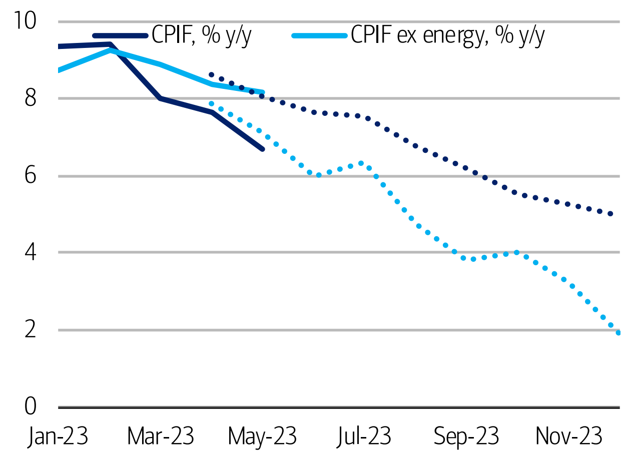
Exhibit 6: Swedish CPIF inflation

Headline below Riksbank forecasts but ex energy slightly above



Source: Statistics Sweden, Riksbank. Dotted lines show Riksbank April forecasts.

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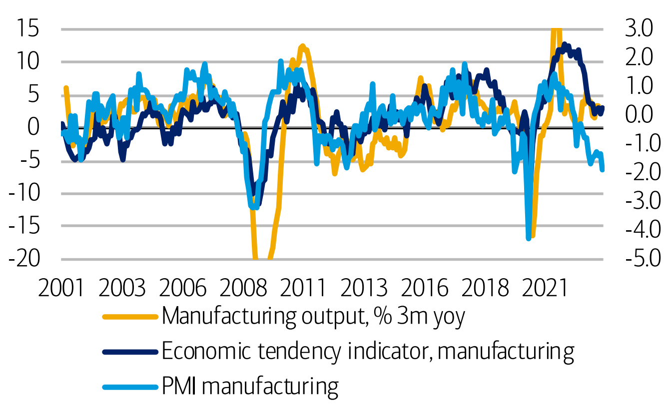
Exhibit 7: Surveys vs. manufacturing growth

Sharp fall in PMI provides worrying signal, but PMI diverged from hard data, so hard to put much weight on it. Economic Tendency indicator remains stronger (although also not a great guide recently)



Source: BofA Global Research, Swedbank, National Institute of Economic Research

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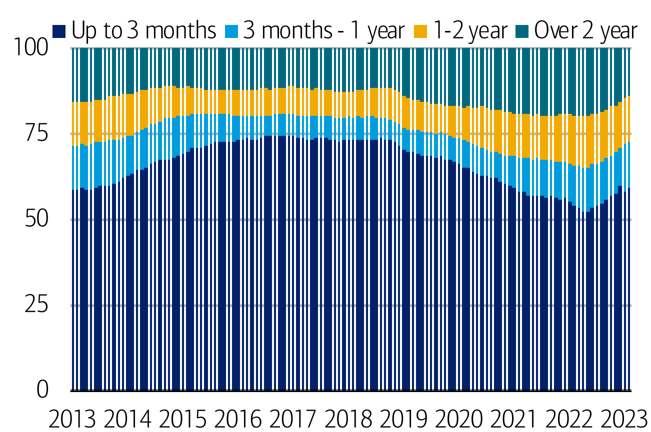
Exhibit 8: Households' remaining fixed-interest periods, %

In Feb c27% of loans with 1Y+ remaining fixed-interest period and c14% 2Y+



Source: Statistics Sweden via Riksbank (Monetary policy Report, April 2023)

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FX: NOKSEK higher, but meetings pose downside risks

We expect NOKSEK to recover further in the next months and forecast 1.04 by year-end. While our relative monetary policy outlook for this year and the next is the reason for our bullish NOKSEK view, our base case for the upcoming central bank meetings given current market pricing suggests modest downside risks to our long NOKSEK trade recommendation (entry April 28 at 0.9638, stop/loss 0.9280, current spot: 1.0065, see [Buy NOK/SEK 28 April 23]).

NOK – counting on oil and Norges

We remain constructive on NOK, expecting:

(1) Higher oil prices, with our commodities team expecting Brent at US$82/bbl in 4Q and US$90/bbl in 2024 (The battle royale between oil and money 5 June 23). We expect China's outbound airline seats to approach 50% of their 2019 levels by 3Q (ASEAN tourism: into the final third 5 May 23).

(2) A clearly more hawkish stance by Norges, following the hawkish inflation data and the Regional Network Survey. We see them raising their terminal to 4%, with risks for more (markets currently price the Norges terminal at c. 4.10%). We reiterate our view that Norges' gradual stance does not necessarily mean lower rates, and even if it does, it could mean fewer rate cuts later.

(3) More favorable oil-related NOK flows in 2H by Norges and petroleum companies *combined*, given Norway's increased fiscal needs.

We expect EURNOK at 10.60 (USDNOK at 10.10) by year-end. But our bearish view on risk sentiment suggests (likely near-term) downside risks for NOK, esp. vs. G4 and CHF.

SEK – cautious at least through 3Q

Meanwhile, we remain cautious on SEK *at least* through 3Q, although we find it undervalued from a long-term perspective. In our base case, EURSEK is at 11.50 (USDSEK 10.95) in 3Q before it starts to fall in 4Q.

But SEK has already proven weaker vs. our bearish expectations. Still, we continue seeing risks for more and/or prolonged SEK weakness because:

(1) We are concerned about the highly rate-sensitive Swedish households.

(2) We see risks around the Swedish property markets, particularly commercial real estate.

And we are bearish on the global risk sentiment.

We think Riksbank is between a rock and a hard place until inflation starts falling meaningfully. Our more constructive view on SEK towards year-end partly reflects our economists' base case of inflation falling fast enough in the coming months. To this end, we are somewhat encouraged by the recent two-year wage agreement, the stable inflation expectations and, to some extent, the inflation data (more for headline, less for ex energy). But we are also mindful of the lags with which higher rates affect borrowers, as loan terms reset and maturities hit markets.

We think a lower Riksbank terminal relative to that of other central banks would initially be negative for SEK but, assuming this reflects lower inflation and not a "blinking" Riksbank, this could suggest upside risks for SEK later—by lowering "hard-landing" risks. To this end, until inflation, particularly core, starts falling meaningfully, the market will likely continue pricing "hard-landing" risks. And, if inflation proves overly sticky on its way down, Riksbank will not be in an enviable position at all.

Notable Rates and FX Research

- **Global Rates, FX & EM Year Ahead 2023 –** Year Ahead 2023: Pivot ≠ Peak, 20 Nov 2022
- **The second half of the year, Global FX Weekly**, 16 June 2023
- **No decisive drop, Global Rates Weekly**, 16 June 2023
- On a wait & see mode…, **Liquid Cross Border Flows**, 12 June 2023

Rates, FX & EM trades for 2023

For a complete list of our open trade recommendations, as well as our trade recommendations closed over the past 12 months, see the reports below:

Global FX Weekly: The second half of the year 16 June 2023

Global Rates Weekly: No decisive drop 16 June 2023

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