

International Commentary — February 11, 2021

## Norges Bank, the Lone Hawk Among the G10

### Summary

- The Norwegian economy showed some resilience towards the end of 2020 and should gather additional momentum as 2021 progresses. Recent data have improved with Norway's January manufacturing PMI staying in expansion territory for the fifth consecutive month, while consumer prices quickened to 2.5% year-over-year.
- The strong inflation print is consistent with recent hawkish commentary from Norges Bank. At its latest monetary policy meeting in January, policymakers opted to hold interest rates steady at current levels. However, the accompanying comments were more hawkish in tone as policymakers were more upbeat on the economic outlook and reiterated they could start raising rates by early next year.
- Given the recent signals from policymakers, in addition to improved data, we now expect two rate hikes from the Norges Bank before the end of 2022. We expect the first policy rate hike to take place in Q1-2022, and the second to occur in Q4-2022.
- Our outlook remains for the Norwegian krone to strengthen over the medium- to longer-term against the euro and greenback. However, given recent developments, the risks around our USD/NOK forecasts are skewed toward faster appreciation than we currently anticipate.

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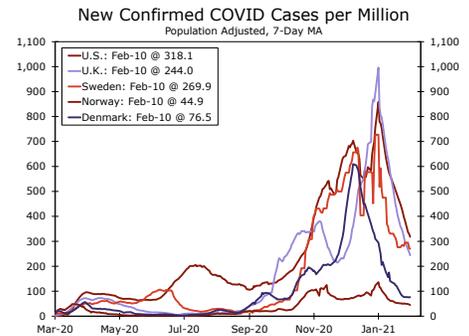
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## Norwegian COVID Cases Rise, but by Far Less Than Other G10 Countries

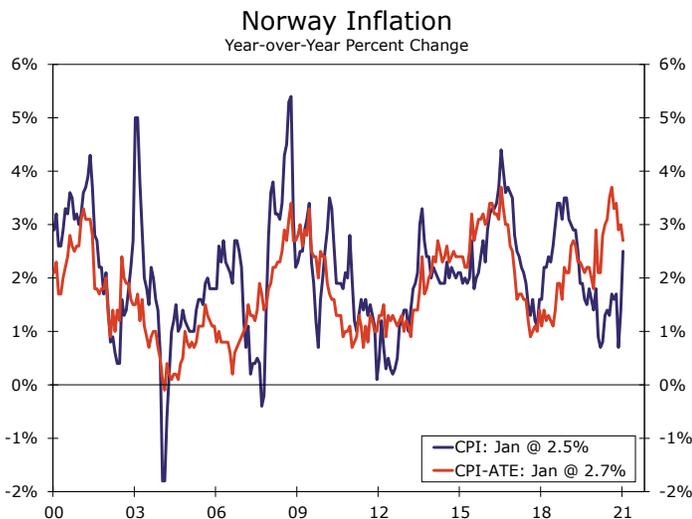
There have been some significant developments in the Norwegian economy over the past month as the economy held up better than expected toward the end of 2020. Even with a third wave of COVID cases and new restrictions, which were put in place in an effort to contain the spread of the virus, Norway is likely to experience a much milder slowdown than most of its European peers. The Norwegian government implemented strict national COVID measures from January 29, which included most events being postponed or canceled, limiting the number of individuals that may attend private gatherings, banning restaurants, bars and cafes from serving alcohol after midnight or without being served food at any time, as well as other social distancing and work from home advisories. Virus case counts accelerated and the new, more contagious, COVID variant was identified in several municipalities including Oslo. But in relation to peers such as the United States (318 cases per million over the last seven days) or Sweden and Denmark (270 and 77 per million, respectively), the rise in cases has been far lower in Norway with about 45 COVID cases per million residents.



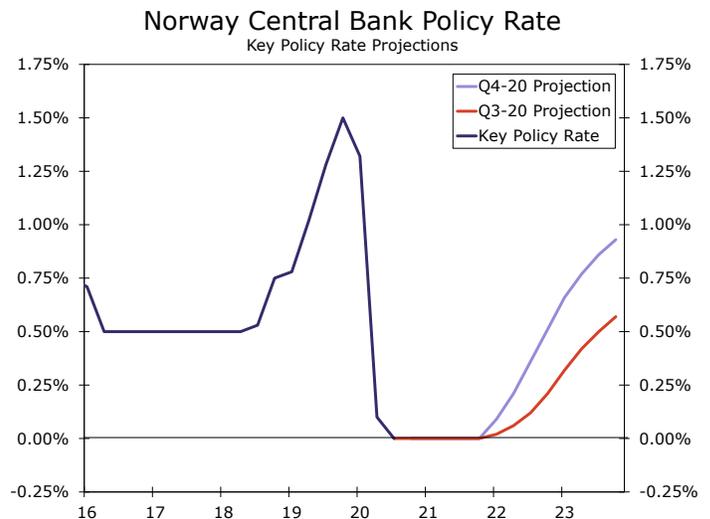
Source: Bloomberg LP and Wells Fargo Securities

## Economic Data Solid Heading Into 2021

Given Norway's progress containing COVID outbreaks, economic growth appears to have only been mildly affected by the third wave of the virus. Economic output in the first two months of the fourth quarter surprised to the upside, with mainland GDP jumping 1.2% month-over-month in October and falling a smaller-than-forecast 0.9% in November. Official data for Q4 will be reported tomorrow, in which we look for the Norwegian economy to grow 0.9% quarter-over-quarter. Looking ahead, we look for economic growth to continue to strengthen, returning real GDP to its pre-COVID level by Q4-2021. Further supporting our expectations, other recent data have also shown signs of resilience. In January, Norway's manufacturing PMI remained in expansion territory for the fifth consecutive month at 51.8, edging slightly lower from 52.0 the prior month. Meanwhile, industrial output increased 3.4% month-over-month in December, while according to the seasonally-adjusted figures, manufacturing output increased 2.3% in the fourth quarter compared to Q3. On the price front, the consumer price index extended its rise in January, as headline inflation jumped 2.5% year-over-year exceeding market expectations, while underlying inflation also beat estimates, rising 2.7%. We do note, however, that the sharp acceleration seen in this week's inflation report could be due in part to the updated weights in the CPI along with other methodological changes. Nevertheless, the January inflation report is consistent with the recent more hawkish rhetoric from Norway's central bank.



Source: Bloomberg LP and Wells Fargo Securities



Source: Norges Bank and Wells Fargo Securities

## The Lone Hawk

Norges Bank kept its policy interest rate at zero percent in its first meeting of 2021; however, the accompanying comments were somewhat hawkish in tone as policymakers reiterated that the central bank could start raising rates early next year. In its policy assessment, the central bank noted that Norwegian forward interest rates were little changed from the December report, and indicate expectations of a policy rate hike toward the end of 2021. Although the January announcement came without an updated forecast, the central bank appeared more upbeat on the economic outlook, and as vaccine availability becomes more widespread, Norges Bank expects economic growth to pick up further out in 2021. Furthermore, in the December Monetary Policy Report, the central bank expected GDP growth to jump 3.7% in 2021 and implied a somewhat faster policy rate increase than projected in its September report. A first rate increase could take place in early 2022, with three additional rate increases after that, reaching an average policy rate of around 0.9% by the end of 2023.

## Norges Bank Likely to be the First Among G10 to Hike Rates

Given recent commentary from policymakers in addition to improved data, we now expect Norges Bank to hike rates twice before the end of 2022. We expect the first policy rate increase to take place in Q1-2022, and the second increase to occur in Q4-2022. Typically, the central bank has moved rates in increments of 25 bps, a pattern we also anticipate going forward. Looking at the last rate hike cycle, Norges Bank first raised rates by 25 bps at its September 2018 policy meeting, then by another 25 bps at its March 2019 meeting as the economy expanded at a solid pace and inflation (roughly around 3%) was a little higher than the target rate of close to 2% overtime. Given similar dynamics today, we believe it is reasonable to see two rates hikes during 2022. If our forecast on the timing of Norges Bank rate increases is correct, it could be the first central bank to implement a rate hike among its G10 peers.

## Norwegian Krone Outlook Remains Constructive

Overall, our outlook remains for the Norwegian economic recovery to gather momentum this year as progress is made on a vaccine front, oil prices remain elevated and the negative effects from COVID dissipate. We look for real GDP to grow 3.6% in 2021, followed by 2.7% growth next year. Although not our base case, we acknowledge that there could be some downside risk to our forecast, characterized by an accelerated spread of the virus weighing on economic output, any issues with the vaccine distribution or a plunge in oil prices, similar to that seen last year.

On the flip side, we could see the pace of Norwegian krone appreciation quicken as rate hikes could be supportive of the krone if other central banks remain on hold, and as vaccinations become more widely available. As we outlined in our January [International Economic Outlook](#), we expect the Norwegian currency to benefit as the global economy also recovers and vaccination availability increases, in addition to broader U.S. dollar softness. Overall, we look for the EUR/NOK exchange rate to reach NOK10.1500 by Q2-2022.

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