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Western European Indicators and Insights

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NORWAY: Policy eased significantly?

Pre-emptive move or worried about Krone rally?

Some easing was widely expected, but not to the extent that the Norges Bank reduced its key policy rate by 50 bp to 1.75% after its latest Board meeting, thereby unwinding half of the cumulative hikes seen in the last two years in what was the first cut since mid-2009. It seems that the Board wished to appear very pro-active against the barrage of downside risks it now sees.

At the last (October) meeting, the Bank seemed more equivocal in regard to policy, albeit suggesting that if economic unrest abroad intensified, money market premiums remained high and the outlook for growth and inflation weakened further, the key rate may be reduced.

Seemingly this is what it is exactly reacting to. Indeed, the statement accompanying this rate-cut decision stressed that turbulence in financial markets has intensified (with market funding having also become more expensive and less accessible for Norwegian banks) while external growth is now expected to be clearly weaker, particularly in the Eurozone. Therefore, and in order to dampen the impact on the Norwegian economy, the Board decided to lower the key policy rate.

The statement did acknowledge that activity in the Norwegian economy remains robust, primarily driven by petroleum investment and a high level of housing construction. It also accepted that house prices have risen and household debt is rising at a faster pace than household income, while unemployment has remained stable (and low). However, it referred to a number of indicators to suggest lower growth ahead.

The size of this rate cut is very much a surprise, particularly given the resilience seen in much of the economy and the fact that the continued pick-up in private sector debt growth is hardly indicative of Norwegian banks having faced problems. Certainly there are signs of banking sector stress returning, but only modestly so, especially as the spread of the likes of 3-month Libor over the main official rate having started to fall back in recent weeks. Therefore, the timing and size of this rate cut may have less to do with capping mortgage rates, and more to do with the other obsession of Norges Bank, namely to prevent any clear rise in the Krone.