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NORWAY: Policy eased again?

Strong currency the clearer cause

Surprising most, the Norges Bank reduced its key policy rate by 25 bp to 1.50% after its latest Board meeting, thereby adding to the equally unexpected but larger 50 bp reduction made last time (ie in December last year). The new rate is the lowest since October 2009 when the last tightening cycle began.

The December cut was largely explained by the need to be very pro-active against the barrage of downside risks the Bank then saw, albeit with it at least implicit that the easing then was more to do with the seeming obsession of Norges Bank, namely to prevent any clear rise in the Krone. At least this time around, the Board is being more open, explicitly pointing to the strong Krone as a justification via its perceived impact on both inflation and real activity.

However, while the accompanying updated Monetary Policy Report (MPR) highlighted that inflation is now expected to remain below target until 2014, it still pointed to clearly strong growth ahead with mainland GDP (ie excluding the rampant petroleum sector) hardly revised lower and therefore still seen likely to enjoy growth of 3% or more this year and in each year out to 2015. The Norges Bank may argue that this is merely trend-type growth, but such a result would leave the economy with no output gap from this year onwards

Such numbers clearly explain why the MPR pointed to no further cuts, as does the continued growth in debt levels in the country. Even so, the sharp drop in exports that undermined GDP growth to some degree last quarter may have been instrumental in turning the more explicit softer Krone rhetoric seen from the Norges Bank so far this year into further action, despite the resilience in growth domestically and the easing in financial market tensions which it duly acknowledged.

The question is will this rate reduction be any more successful than the December move in holding down the currency. Probably not: markets are focusing on the very resilience of the Norwegian economy as one factor for interest in the Krone. In addition, with the Norges Bank advertising that further rates cuts are not being envisaged and even acknowledging the possibility of having to tighten, Norwegian official rates will therefore remain at the top of the range of rates offered by major industrial countries. Regardless, the other question is the extent to which FX markets will see this Norges bank action as a further example of 'currency wars'.