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Economics Group

Special Commentary

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Global Shocks Weigh on the Norwegian Economy

Executive Summary

- The Norwegian economy has been negatively impacted by two recent shocks—the outbreak of the coronavirus and a plunge in oil prices. Given the substantial uncertainty surrounding the impact of the shocks, the Norges Bank opted to reduce its policy rate 50 bps to 1.00% and lowered the countercyclical buffer to 1.0% from 2.50%, surprising many market participants.

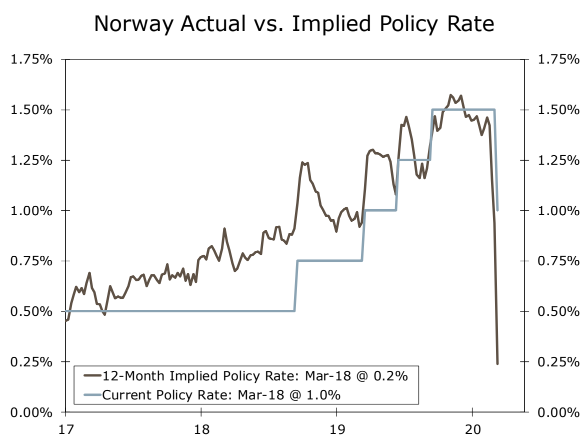
More Easing to Come?

The Norges Bank cut its policy interest rate and lowered the countercyclical capital buffer.

In a surprise move, the Norges Bank slashed its policy interest rate 50 bps to 1.00% and lowered the countercyclical capital buffer from 1.0% to 2.50%, ahead of its regularly scheduled meeting on March 19. The accompanying report noted that economic prospects have weakened substantially, in part on the back of a sharp decline in oil prices.

In our view, the overall statement was relatively dovish as the committee suggested that it will continue to monitor developments and is prepared to make further rate cuts if necessary. Specifically, the latest policy rate projections indicate a little over one additional 25 bps rate cut to bring the policy rate to 0.75% later this year. This signals that the central bank acknowledges that additional stimulus may be necessary to contain any economic damage to the Norwegian economy from the coronavirus outbreak as well as the oil price shock. That said the market is still pricing in roughly 75 bps of cuts, and given the committee's explicit easing bias, we see potential for further monetary easing from the Norges Bank in the coming quarters.

Figure 1



Source: Bloomberg LP and Wells Fargo Securities

Offering further scope for additional easing from the Norges Bank, inflationary pressures have significantly eased in early 2020. In February, headline CPI inflation slowed to 0.9% year-over-year, the lowest since 2012, while underlying inflation slowed to 2.1% year-over-year. We expect consumer prices to slow further given the decline in oil prices, while lower travel demand amid the spread of the coronavirus is also likely to have a negative impact on inflationary pressures. On

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the other hand, a persistently weaker Norwegian currency poses an upside risk to our inflation view, as it could help boost prices.

Economic Prospects Deteriorate

The Norwegian economy is facing a challenging economic environment as it has been hit with two unexpected shocks, the global spread of the coronavirus and a plunge in oil prices. Although the negative economic implications of the coronavirus are uncertain, the pandemic will most certainly weigh on the growth prospects of the Norwegian economy. In addition, the oil price decline is also likely to depress activity in the economy given that oil production is a large part of the Norwegian economy. A few weeks ago, oil prices dropped sharply after Saudi Arabia and other OPEC members failed to reach an agreement on oil production limits. Oil is now selling at just under $30 per barrel, down from more than $68 earlier in the year. If oil production significantly increases and prices stay low for an extended period the Norges Bank may have to implement additional easing measures to avoid (or at least limit the extent of) any recession, given that growth momentum is already subdued. In January mainland GDP growth rose just 0.2% month-over-month following a soft quarter of growth in Q4-2019.

Growth in the mainland economy is now expected to slow to 0.4% for calendar year 2020.

Based on the Norges Bank's new economic projections, growth in the mainland economy is now expected to slow to 0.4% for calendar year 2020, from previously forecast growth of 1.9%, with a modest pickup in growth expected thereafter. Employment growth is also expected to slow as layoff notices have already been issued in some industries, which will likely result in higher unemployment. Meanwhile, wage growth is also projected to weaken to 2.8% in 2020 and slow further into 2021.

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