

Norway

Low Oil Price to Fuel Additional Norges Bank Rate Cut(s)

- The continued downward trend in oil prices means not only lower growth, but also increased risk of a more pronounced downturn in the Norwegian economy. If oil prices stay at current levels or drift even lower, as we now believe is the case (our commodity team forecasts Brent at \$60/bbl in 1Q and \$55/bbl in 2Q), this would probably prompt Norges Bank (NB) to cut interest rates further. Hence, we change our base case, now expecting NB to cut its key rate, the sight deposit rate, by 25bp to 1.0% at the next monetary policy meeting in March and signal a high probability of additional near-term monetary policy easing. If risks of a severe downturn increase, the sight deposit rate could bottom at 0.75% (likely in May) or lower.
- In the December MPR, NB turned substantially more pessimistic on the outlook for the domestic economy, reflecting negative spillover from the sharp pullback in the petroleum industry and the large drop in the oil price (from about USD 100/barrel to USD 70/barrel at that stage). The Bank not only cut its 2015 mainland GDP growth forecast by 0.75pp to 1.5% Y/Y, it also changed its reaction function; previously, NB argued that amid financial stability considerations (rising house prices and high household debt), the key policy rate was kept above a level otherwise suggested by inflation and economic activity. In December, on the other hand, the Bank argued that the risk of a more serious downturn argued for cutting rates sooner rather than later (see Figure 1): *"A lower key policy rate can counter the risk of a pronounced downturn in the Norwegian economy,"* the statement said. In turn, NB cut the sight deposit rate by 25bp to 1.25% with the conditional interest rate path signaling about a 50/50 probability of another rate cut at the next meeting on 19 March.¹
- Oil prices, both the front end and futures contracts, have already fallen from the level NB based its forecast on in the December MPR (73 USD /barrel for 2015). US crude today trades at USD 52/barrel and Brent at USD 56/barrel. If oil prices remain around these levels until the March NB meeting, as we now believe they will (see Figure 2), NB would most likely lower its mainland GDP and wage growth forecast further. At the same time, the *"risk of a pronounced downturn in the Norwegian economy"* would argue for further monetary policy easing, likely with another 25bp rate cut already at the March meeting and a new conditional interest rate path signalling a high probability of additional near-term easing. If risks of a severe downturn increase, the sight deposit rate could bottom at 0.75% or lower. Market pricing discounts a key policy rate that is around 40bp below today's level.

¹ Heightened uncertainty was a strong argument for Norges Bank behind the December rate cut. This is evidenced by a new factor called *"Acceleration"*, which weighed on the short-end of the conditional interest rate path. Norges Bank explained the new factor in this way: *"There is a risk that developments will be considerable weaker than currently envisaged. An early reduction in the key policy rate could reduce the level of uncertainty, and counteract the risk of a pronounced downturn in the Norwegian economy"*. Without this risk management consideration, the rate path would probably not have suggested a rate cut in December.

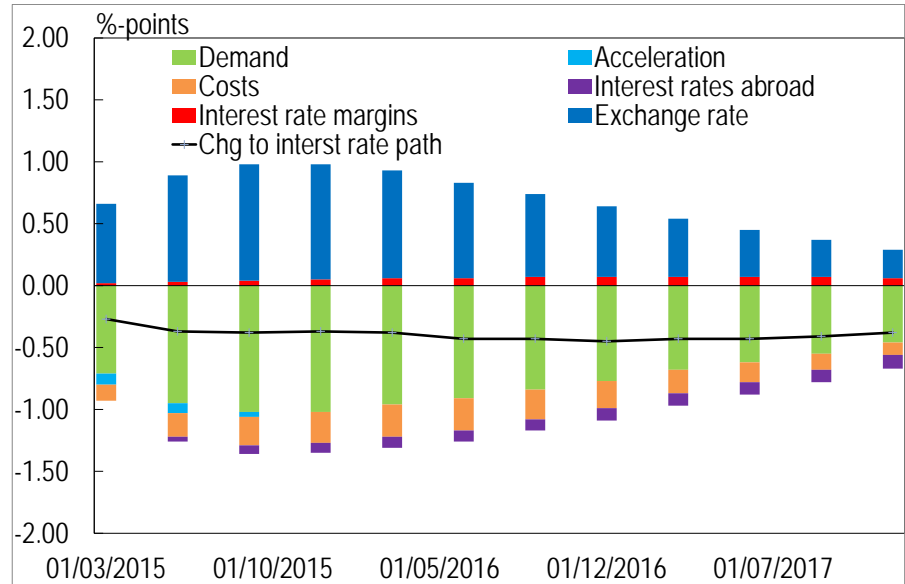
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Lower Oil Price to Fuel Further Rate Cut(s)

Figure 1. Norway – Factors behind Changes in the Conditional Interest Rate Path since MPR 3/14, Cumulative Contribution, %-Points, 1Q 2015 - 4Q 2017



Source: Norges Bank

Figure 2. Citi's Revised Oil Price Outlook

| | | 4Q 14 | 1Q 15 | 2Q 15 | 3Q 15 | 4Q 15 | 1Q 16 | 2Q 16 | 3Q 16 | 4Q 16 | 2014 | 2015 | 2016 |
|-----|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|------|------|
| Old | Brent | 80 | 80 | 75 | 80 | 85 | 85 | 80 | 85 | 90 | 101 | 80 | 85 |
| Old | WTI | 73 | 72 | 67 | 74 | 75 | 76 | 69 | 76 | 79 | 93 | 72 | 75 |
| New | Brent | 78 | 60 | 55 | 65 | 70 | 70 | 67 | 70 | 73 | 100 | 63 | 70 |
| New | WTI | 74 | 52 | 47 | 58 | 61 | 63 | 58 | 63 | 64 | 93 | 55 | 62 |

Source: [Oil and Trouble Ahead in 2015](#), Ed Morse et al, 4 January 2015, Citi Research

Appendix A-1

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