

Norway

Norges Bank with a Dovish Tilt

- As expected, Norges Bank left the key policy rate unchanged at 1.50%, and had not considered a cut. At the same time, the Central Bank lowered its conditional interest rate path in the new Monetary Policy Report (by up to 24bp for 2014 and 38bp for 2015), completely removing any probability of a rate hike next year. The path now indicates initial tightening around summer 2015, a year later than suggested in September. In more details, the December rate path indicates a 28% probability of initial tightening in 1Q 2015, a 52% probability of a first rate hike in 2Q 2015 and 80% probability for a 3Q 2015 hike. The key drivers behind the downgrade were (as expected) weaker-than-expected inflation and wage growth, lower interest rates abroad plus a weaker domestic economic outlook. Meanwhile, a weaker-than-expected NOK exchange rate acted partly as an offset. Today's outcome was slightly on the dovish side compared to our expectations, but when that is said, indications of a mid-2015 rate hike is spot on our call from the December GEOS. We acknowledge, though, that with indications that rates will stay low for longer, the Bank has also moved one step closer to a rate cut should the economic outlook deteriorate further. In other words, risks remain on the downside, and we reckon market pricing will continue to discount a small probability of near-term easing.
- On the economic outlook, the Bank noted that although the moderate upturn in the world economy is continuing, growth prospects among Norway's most important trading partners have weakened somewhat. On the domestic side, the Bank noted that the Norwegian economy is currently growing at a moderate pace, but that growth prospects are weakening. Capacity utilization is assessed to be lower, but close to a normal level. Judging from comments, Norges Bank appears concerned about developments on the housing market, pointing out that pronounced changes in house prices could influence household demand negatively. The Bank now expects home prices to *"weaken to a further extent over the next year than projected in September"* (is seen down by on average 1.6% next year). The Bank underlines that the outlook is uncertain, especially when it comes to developments in inflation, output and employment ahead. In turn, the Bank argues that *"it is thus appropriate to proceed with caution in interest rate setting"*. In other words, Norges Bank stands ready to act, in either direction, should the slowdown become more pronounced or activity regain momentum.
- The revisions to the economic forecasts in the new MPR were broadly as expected, albeit slightly larger in size. On Financial Stability, Norges Bank announced that it has made a recommendation on the size of the countercyclical capital buffer and sent it to the Ministry of Finance, which will then decide on the level on a quarterly basis. The advice will be made public, when the Ministry has made its decision. **For more, see p. 2.**

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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- The revisions to the economic forecasts in the new MPR were broadly as expected, albeit slightly larger in size; domestic growth has slowed somewhat more than expected, and the Bank cuts its 2014-15 mainland GDP forecast (by another 0.25pp to 2.0% Y/Y and 2.5% Y/Y, respectively) and lowered its view on the estimated output gap (by 0.25pp to -0.5% in both years). The inflation path was also lowered, now showing full-year core CPI at 1.5% Y/Y this year and 2.0% Y/Y in 2014 (both cut by 0.25pp). The Bank also now forecasts a weaker import-weighted NOK exchange rate (I-44) ahead compared to its September forecast (91.25 for 2014, i.e. 3.7% weaker than in Sep and 89.75 in 2015, i.e. 2.3% weaker than the previous report).
- On Financial Stability, Norges Bank in mid-March concluded that banks should build an extra capital buffer in the period ahead that they can draw on to absorb higher losses in bad times. According to the new legislation on capital requirements for banks, all banks will be subject to a minimum capital adequacy requirement of 13.5%, at least 10pp of which must consist of Common Equity Tier 1 capital as from summer 2014. An extra requirement of up to 1% in 2015 and up to 2% in 2016 will be imposed on systemically-important banks. On top of this, a countercyclical capital buffer will be introduced. Norges Bank announced today that it has made a recommendation on the size of the buffer and sent it to the Ministry of Finance, which will then decide on the level on a quarterly basis. The advice will be made public, when the Ministry has made its decision, the Bank said.

Appendix A-1

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