The Chink in the NOK’s Armor

- Norway’s economy is an out-performer
- But trade headwinds matter to an open economy
- Has Riksbank shown Norges Bank the way?

Norway’s economy belongs to a select group whose performance warranted an upgrade in the IMF’s latest growth forecasts. The IMF foresees mainland GDP growth of 2.5% this year (up from 2.4% previously) and the ‘trickle’-down from the year-to-date rebound in oil, the country’s lifeblood, must take some of the credit.

When we also consider the fact that annual headline inflation is well above the Bank’s 2.0% target at 2.9% (with core running at 2.7%), there is little wonder that Norges Bank is alone among the majority of its peers in advocating further rate hikes in the current cycle.

Yet, not that you would know this from the performance of the NOK: in a week in which expectations for Norwegian monetary policy diverged appreciably with the rest of the world, the NOK had nonetheless ceded 0.4% to the euro by Friday evening as part of a near month-long downtrend that has seen it lose 2.5%.

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doubts over Europe

Simply pinning the NOK’s troubles on a turn in oil’s fortunes this past month and a thinning out in a market crowded with short euro positions would hardly invite controversy; but on the day the NOK began its downtrend, the EUR’s general descent was ongoing and oil prices were days away from their year-to-date highs. Indeed, the more specific thorn in the NOK’s side appeared to be doubts over Europe – recipient of 80% of Norway’s exports.

Although the NOK recovered after the initial shock of the eurozone’s weak April PMIs (published on April 18th), it was subsequently undermined by a succession of negative news reports over the next few days, including unexpectedly weak eurozone consumer confidence and Germany’s downbeat IFO. But then, perhaps most important of all, came a policy about-turn on the part of Riksbank.

Indeed, that Riksbank looked to postpone a further hike in the midst of this downbeat news from the eurozone could hardly be overlooked in Oslo. As one measure of the similarity in Sweden and Norway’s export-gearing to the eurozone, we note that USD/NOK and USD/SEK have been (pegged-regimes aside) the two most correlated European currency pairs since the start of the Millennium (93%).

But given Germany’s own export-gearing, in many respects, all roads lead to China

Riksbank’s Martin Floden said recently that signs of weakening growth in Germany are particularly troubling given its status as the “steam engine of Europe”. But given Germany’s own export-gearing, in many respects, all roads lead to China: the NOK’s largest daily rise this year came on January 4th when it was announced that the US and China would hold vice-ministerial level trade talks.

Whilst a dubious source of support for the NOK amid these doubts over the external environment, the latter might yet see Norges Bank follow Riksbank’s lead on policy.
guidance. Certainly, there are chinks in otherwise impressive Norwegian armour: industrial production fell by 6.5% y/y year in March, today’s Q1 GDP fell short of expectations (see Newswatch) and like Sweden, Norway’s household debt is clearly a source of potential instability.

Accordingly, there is perhaps no wonder that in stressing that talk of further hikes does not constitute any promise to deliver, Norges Bank chief Oystein Olsen has echoed Stefan Ingves’ own stipulation about policy.

On the face of it, the NOK has it all: an energy based currency with producers firmly in the black and underpinned by a lone-hawk central bank. But then, Norway’s sensitivity to the global economic climate through the specific conduit of its European neighbours is ever a double-edged sword for the currency.

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