

NORWAY

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BACK TO GROWTH DESPITE TWO LARGE SHOCKS

Not only was Norway affected by the Covid-19 pandemic, but the country also had to face a big fall in the price of its main export: oil. Nevertheless, these two shocks have been cushioned by the structure of the Norwegian economy and the authorities' fiscal and monetary response. The country's economy is now one of the best positioned to return to its pre-pandemic levels. Indeed, it is already showing signs of improvement.

Since the start of this year, Norway has suffered from two major shocks to its economy. First, the country has been affected by the Covid-19 pandemic, even if the restriction measures put in place by the government have managed to contain the progression of the virus – in fact, Norway has infection and death rates among the lowest in Europe.

In addition, Norway had to deal with a big fall in oil prices. Between 31 December 2019 and 21 April 2020, the price of Brent dropped by more than 70%, dragging the Norwegian krone down. Oil prices have rebounded since and the price of Brent has doubled, but it remains 40% below where it was at the start of the year.

THE CONSEQUENCES FOR THE ECONOMY

Over the first half of 2020, Norway's GDP dropped by nearly 7%, and "mainland" GDP, which excludes the oil sector, declined by more than 8% – which is about the same as the fall in Sweden, where restriction measures have been softer.

Like elsewhere, fiscal and monetary authorities came rapidly to the rescue¹. For the first time since the mid-1960s, the general government balance has recorded a deficit. In the second quarter, the deficit amounted to NOK 64 bn, which is equivalent to about 8% of GDP. Deficits are unusual in Norway because the government can count on revenues from the oil sector, which have been gathered in the Oil Fund (Government Pension Fund-Global, GPF) since 1990. However, the use of the Fund is regulated². Over time, transfers to the central government budget (the structural non-oil deficit) cannot exceed the expected real return on the Fund, which is currently estimated at 3%. Nevertheless, this leaves some flexibility, as excesses can be compensated over the years. What's more, "significant emphasis" is placed on "evening out economic fluctuations to contribute to sound capacity utilisation and low unemployment". This means that, even if the structural deficit exceeds 3% this year, fiscal rules will not be breached.

As far as monetary policy is concerned, the Norwegian central bank (Norges Bank) could count on large room for manoeuvre compared to the Swedish Riksbank or the ECB for instance. The Norges Bank therefore has been able to ease monetary policy substantially by lowering its base rate from 1.5% to 0%, its lowest level ever.

SIGNS OF IMPROVEMENT

Thanks to the lifting of restriction measures and to both fiscal and monetary policy support, the Norwegian economy has bounced back over the past few months. GDP rebounded in May and has kept rising in June and July. Overall, the economy has made up half of lost ground. Furthermore, the country's statistics bureau (SSB) is quite optimistic, forecasting that activity will have returned to its pre-pandemic level before the end of 2021³, which will probably be sooner than most other European countries.

1 <https://www.regjeringen.no/en/topics/the-economy/economic-policy/economic-measures-in-norway-in-response-to-covid-19/id2703484/>
2 <https://www.regjeringen.no/en/topics/the-economy/economic-policy/economic-policy/id418083/>
3 <https://www.ssb.no/en/nasjonalregnskap-og-konjunkturer/artikler-og-publikasjoner/better-times-in-sight-but-situation-remains-serious>
4 <https://www.norges-bank.no/en/news-events/news-publications/Press-releases/2020/2020-06-18-press-release-rate/>

GROWTH AND INFLATION (%)

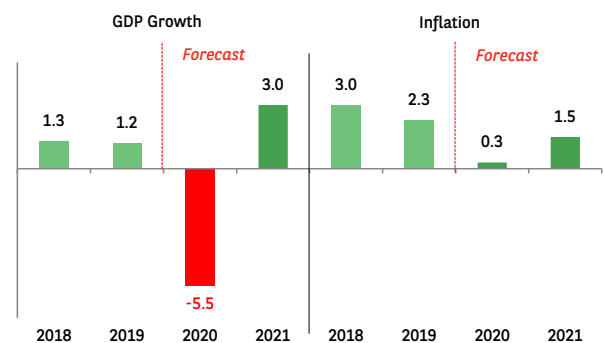


CHART 1

SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

Meanwhile, the Norges Bank has already adopted a more hawkish stance at its last meeting. The weakening of the krone that accompanied the drop in oil prices has raised fears about upward pressures on inflation. While SSB forecasts the CPI inflation rate to stand at 1.5% this year, it estimates that the underlying inflation rate (CPI-ATE) will reach 3.1%. It is certainly with that in mind that the Norges Bank is already anticipating rate hikes in the coming years⁴, which no other major central bank is planning at the moment.

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