Press Release

Date of Release: April 27, 2018

DBRS Confirms Norway at AAA, Stable Trend

Industry: Public Finance--Sovereigns

DBRS Ratings Limited (DBRS) confirmed the Kingdom of Norway's Long-Term Foreign and Local Currency – Issuer Ratings at AAA and Short-Term Foreign and Local Currency – Issuer Ratings at R-1 (high). The trend on all ratings remains Stable.

KEY RATING CONSIDERATIONS

Norway's AAA ratings are underpinned by its high public-sector wealth, prudent management of its oil-related windfalls, strong external position and sound institutional framework. Norway faces some challenges, such as dealing with the accumulation of household debt, its reliance on the petroleum sector, and an aging population. Nonetheless, the country is well equipped to deal with these challenges and shocks could be absorbed by substantial buffers. The size of the Government Pension Fund Global (GPFG or the Fund), whose market value was equivalent to 303% of mainland GDP at the end of last year, is a significant backstop, along with a flexible exchange rate.

The Stable trend reflects DBRS's view that downward risks to the ratings are limited. Since 2017 economic activity has been buoyant following years of subdued performance, with real GDP growth expected to slightly accelerate to 2.1% in 2018 compared with 1.8% recorded last year, also on the back of higher oil prices. The moderate fall in house prices which started in Spring 2017 and reached an annual rate of -2.3% last month, is showing some signs of stabilization. This cooling down of housing price inflation to some extent reduces the risk of a sharp correction that could weigh on economic growth.

RATING DRIVERS

Norway is well-placed in the AAA rating category. Potential downward rating drivers include one or a combination of the following: (1) a worsening of financial conditions and medium-term growth prospects that is severe enough to materially affect Norway's financial stability and fiscal position; and (2) a significant loosening of the government's commitment to prudent fiscal policy.

RATING RATIONALE

Prudent Fiscal Management of Oil-Related Proceeds and a Strong Government Balance Sheet

Public finances benefit from conservative management of revenues coming from the oil sector. Following the introduction of a fiscal rule in 2001, the government is responsible for transferring the State's net cash flow from the petroleum industry to the GPFG, and over time only the expected real return of the Fund can be allocated to finance the non-oil deficit. This aims to preserve the real value of the Fund for the benefit of future generations and to isolate the government's budget from volatility in petroleum revenues. However, given the size of the Fund, fluctuation in its value may become a larger source of volatility. Last year, the government revised the expected annual real rate of return of the Fund to 3% from 4%, driven by expected lower international interest rates. This will translate into a more conservative fiscal stance going forward. In 2018, the fiscal impulse, measured by the increase in the structural non-oil deficit, will be limited to 0.1% as a share of the trend mainland GDP, well below the average of 0.6% registered in the 2014-2017 period.

Despite current sizeable government balance surpluses (4.6% of GDP on average over the last four years), in the medium- to long-term, an aging population will increasingly put pressure on public finances. A sharp rise in age-related spending is anticipated to begin in ten to 15 years, at the same time as the returns from the Fund measured as a share of mainland GDP are expected to drop. The government expects a funding requirement to arise (1.7% of mainland GDP per decade between 2030 and 2060) if no reforms are implemented in the meantime. However, the government is already assessing potential measures that could be implemented to address this funding gap.

The government's robust balance sheet is a key strength for DBRS's ratings. The government's net asset position reached 288.4% of gross domestic product (GDP) in 2016, which is very strong compared with other AAA-rated sovereigns and it is largely explained by the sovereign wealth fund. DBRS expects the gross general government debt ratio to hover around 37% of GDP in coming years. In the event of a negative shock, net rather than gross government debt is most likely to be affected. This means that fiscal stimulus, taking the form of a higher non-oil fiscal budget deficit, could be financed by higher transfers from the GPFG, as debt issuance is destined to finance capital transactions. Thereby, given the fiscal guidelines and the government's asset position, gross government debt is generally insulated from negative shocks.

Economic Recovery Gains Momentum but Household Debt Makes the Country Vulnerable to Shocks

This year, economic growth for the mainland is projected to accelerate to around 2.4% compared with 1.8% in 2017. The main driver will be consumption which should more than compensate for the negative contribution of housing investment. While the former is supported by an improvement in the labour market, the latter is correcting following previous record growth levels, in combination with a high supply of new dwellings and a slowdown in population growth because of lower immigration. At the same time, petroleum investments, which have been a significant drag on mainland growth between 2014 and 2017, will contribute to growth starting from 2018. This is because of the recovery in oil prices from 2016 lows and significant cost-cutting efforts.

Despite a brighter outlook for economic growth, which is projected to remain at solid at around 2.3% for the mainland in the period 2019-2020, a more severe than expected contraction in the housing market could have a negative impact on the economy. Moreover, intensifying geopolitical risks and inward trade policies might result in a slowdown of global growth, containing Norway's economic performance.

Financial imbalances have built up in the context of increasing household debt and overvalued house prices. This is among other factors related to an accommodative monetary policy, which has fuelled credit growth and kept the household interest burden contained since 2009. After roughly doubling since 2000, house prices have started to cool down since spring 2017 because of tighter regulation on new residential mortgage loans and strong housing investment in the past. Nevertheless, recently the decline in house price inflation has started to show signs of stabilization reducing the risk of a significant impact on consumption via a lower wealth perception of households.

However, the debt-to-disposable income ratio continues to grow and at 238.5% at end-2017 makes the country vulnerable to shocks. Given that a significant portion of mortgage loans have variable interest rates, households are particularly exposed to rising rates. While the interest rate burden is low in historical terms, the total debt burden has increased because of the higher level of indebtedness. In response to a negative shock, households may materially reduce spending that could amplify any potential economic downturn. With the new 2% inflation target and capacity utilisation normalising, Norges Bank (the Norwegian central bank) is expected to hike interest rates before the end of this year, with a stepped increase taking rates from 0.5% close to 2% towards the end of 2021. Financial vigilance has resulted in banking regulation measures and macro-prudential policies to contain risks, although more measures may be needed in the future.

However, banks' low loan losses and strong capital buffers mitigate the risks to financial stability. Asset quality remains very strong, with non-performing loans (NPL) as a share of total gross loans at 1.3% in Q2 2017, one of the lowest in Europe, while the average Common Equity Tier 1 (CET1) capital ratio at around 15.4% at end-2017 among large Norwegian banks is double the rate it was during the financial crisis.

Strong External Position Provides a Significant Buffer to absorb external shocks

Norway's strong external position provides significant buffers to weather external shocks. The country's net international investment position stood at 222.6% of GDP at end-2017. The public sector, through the GPFG, is the main contributor to Norway's net creditor position. On the other hand, the private sector is a net debtor to the rest of the world. The banking sector's external debt reached 95.4% of GDP at end-2017, stemming from its reliance on foreign funding. Nonetheless, the overall economy has ample room to manoeuvre in the case of a temporary disruption in liquidity conditions. Moreover, Norway continues to record robust current account surpluses averaging 7.5% of GDP a year over the last five years.

A Consensus Approach Bodes Well for a Predictable Policy Framework

Norway benefits from strong political institutions with a well-established track record of a consensus-based approach to macroeconomic policy. This is conducive to a stable and predictable policy framework. DBRS expects a continuation of policy making despite the centre-right emerging with a weaker mandate from the September 2017 election. This has been followed by decision of the Christian Democrats to withdraw from the negotiations with the Conservatives, the Progress Party and the Liberals, which instead formed a minority government that is short of five seats in the parliament. In this context, DBRS considers political tensions among parties more likely, particularly as a result of the government's reliance on the external support of the Christian Democrats, which to some extent could delay implementation of the reforms. However, DBRS does not project a significant shift in the fiscal stance as a result of this situation.

RATING COMMITTEE SUMMARY

The DBRS Sovereign Scorecard generates a result in the AAA – AA (high) range. The main points discussed during the Rating Committee include: the housing market, macro prudential policies, debt management, fiscal space, and the Government Pension Fund Global.

KEY INDICATORS

Fiscal Balance (% GDP): 4.9 (2017); 3.7 (2018F); 3.8 (2019F)
Gross Debt (% GDP): 36.7 (2017); 36.7 (2018F); 36.7 (2019F)
Nominal GDP (USD billions): 389.0 (2017); 398.6 (2018F); 408.6 (2019F)
GDP per Capita (USD): 73,635 (2017); 74,706 (2018F); 75,829 (2019F)
Real GDP growth (%): 1.8 (2017); 2.1 (2018F); 2.1 (2019F)

Consumer Price Inflation (%): 1.8 (2017); 2.0 (2018F); 1.6 (2019F)
Domestic Credit (% GDP): 106.9 (2016); 106.4 (2017)
Current Account (% GDP): 5.1 (2017); 6.6 (2018F); 6.3 (2019F)
International Investment Position (% GDP): 203.4 (2016); 222.6 (2017)
Gross External Debt (% GDP): 169.6 (2016); 162.2 (2017)
Governance Indicator (percentile rank): 98.6 (2016)
Human Development Index: 0.95 (2015)

Notes:

All figures are in Norwegian krone (NOK) unless otherwise noted. Public finance statistics reported on a general government basis unless specified. Governance indicator represents an average percentile rank (0-100) from Rule of Law, Voice and Accountability and Government Effectiveness indicators (all World Bank). Human Development Index (UNDP) ranges from 0-1, with 1 representing a very high level of human development.

The principal applicable methodology is Rating Sovereign Governments, which can be found on the DBRS website www.dbrs.com at http://www.dbrs.com/about/methodologies. The principal applicable rating policies are Commercial Paper and Short-Term Debt, and Short-Term and Long-Term Rating Relationships, which can be found on our website at http://www.dbrs.com/ratingPolicies/list/name/rating+scales.

The sources of information used for this rating include the Ministry of Finance of Norway, Norges Bank, Statistics Norway, the Financial Supervisory Authority of Norway, Norges Bank Investment Management, Bank for International Settlements, IMF, World Bank, UNDP, Haver Analytics. DBRS considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

This is an unsolicited rating. This credit rating was not initiated at the request of the issuer.

This rating included participation by the rated entity or any related third party. DBRS had no access to relevant internal documents for the rated entity or a related third party.

DBRS does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

Generally, the conditions that lead to the assignment of a Negative or Positive Trend are resolved within a twelve month period. DBRS's outlooks and ratings are under regular surveillance.

For further information on DBRS historical default rates published by the European Securities and Markets Authority ("ESMA") in a central repository, see:
http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

Ratings assigned by DBRS Ratings Limited are subject to EU and US regulations only.

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Last Rating Date: 3 November 2017

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Information regarding DBRS ratings, including definitions, policies and methodologies, is available on www.dbrs.com.

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Norway, Kingdom of	Short-Term Foreign Currency Debt - Issuer Rating	Confirmed	R-1 (high)	Stb	Apr 27, 2018
Norway, Kingdom of	Short-Term Local Currency Debt - Issuer Rating	Confirmed	R-1 (high)	Stb	Apr 27, 2018
Norway, Kingdom of	Long-Term Foreign Currency - Issuer Rating	Confirmed	AAA	Stb	Apr 27, 2018
Norway, Kingdom of	Long-Term Local Currency - Issuer Rating	Confirmed	AAA	Stb	Apr 27, 2018

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