FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Norway at 'AAA'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 28 Aug 2020: Fitch Ratings has affirmed Norway's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Norway's credit profile is supported by very high GDP per capita, extremely strong sovereign and external balance sheets and very strong institutions. The Stable Outlook reflects Fitch's view that large fiscal buffers and a robust macroeconomic policy framework afford the authorities ample room to respond to the coronavirus pandemic. While banks are highly exposed to the real estate sector against the backdrop of elevated house prices and very high household debt, the banking sector has sound credit fundamentals, including strong capital buffers.

Norway's accumulated oil wealth and prudent fiscal policy shield the government's balance sheet from the effects of oil price volatility and will help counter the impact of the pandemic on the economy. Unlike other oil-exporting sovereigns, Norway's budget does not rely on hydrocarbon revenues, but on the profits generated by the sovereign wealth fund (GPFG). Conservative fiscal rules specify that transfers from the GPFG should be no greater than the expected real return of the fund over time (3% of fund's capital), but allow for divergence to smooth economic volatility.

In its revised budget for 2020, the government earmarked a transfer from GPFG of around NOK480 billion, equivalent to 4.6% of the fund's capital or 13.9% of Fitch's GDP forecast. The widening of the non-oil deficit is driven by automatic stabilisers and a sizable fiscal stimulus package, which we expect to add NOK157.5 billion (4.6% of GDP) to government expenditure this year. Measures implemented to support the economy in response to the pandemic mostly consist of various compensation schemes for businesses with large income losses and income protection schemes for individuals. We expect the spending of petroleum revenues to gradually return to 3%.

The resulting deficit of NOK123.8 billion (3.6% of GDP) on the consolidated state and Government Pension Fund budget will be the first negative outturn since 1995. However, despite increased drawdowns on the fund and a negative return (-3.4%) in the first half of the year, the value of the fund increased in the first six months by NOK312 billion (9.0% of GDP) to NOK10.4 trillion (301.3% of GDP) due to krone depreciation. This buffer provides significant room to weather the current crisis and absorb any implicit contingent liabilities that might crystallise from Norway's relatively large SOE sector (government shareholdings are equal to around 25% of GDP). So far, the government has provided direct support to the aviation sector (NOK14.1 billion, or 0.4% of GDP). We expect the crystallisation of contingent liabilities from the government's guarantee programme to be small, due to the low utilisation of the programme.

Given that Norway's non-oil budget deficit is fully financed by the transfers from the GPFG, we expect the government debt level to remain stable, at around 40% of GDP over the forecast horizon. The government issues debt, all in local currency, to finance lending by state banks and other lending facilities (e.g. housing and student loans).

Norway's vast savings in the GPFG invested abroad underpin a net external creditor position (30.4% of GDP expected in 2020; vs the 'AAA' median net creditor position of 20.4% of GDP). The sovereign's net external creditor position is even stronger, forecast at 92.7% of GDP in 2020. Norway runs persistent current account surpluses, driven by significant revenues from oil exports. Despite the pandemic, Fitch projects the current account surplus to increase over the medium term, to 6.1% of GDP in 2022 from 4.1% of GDP in 2019, due to higher oil production and a contraction in imports.

Fitch forecasts Norway's GDP to contract by 2.3% in 2020, followed by a strong recovery, with growth of 3.8% in 2021 and 2.4% in 2022. A sharper decline in mainland GDP, at 4.0% in 2020 with a rebound to 3.7% in 2021, will be cushioned by a strong performance of hydrocarbon GDP. After a decline in 2019, petroleum output is expected to increase by 11.4% this year and 5.6% on average in 2020 - 2022 due to the start of production at Norway's third-largest oil field (Johan Sverdrup) in January 2020. Growth in mainland GDP will be supported by a quick recovery in domestic demand, with high-frequency indicators suggesting private consumption returned to its pre-pandemic levels in July. However, low oil prices are reducing the demand for goods and services exports and will dampen petroleum investment in the medium term.

A pick-up in economic activity and the authorities' focused measures on employment protection should limit the increase in the unemployment rate, which we forecast at 5.2% in 2020 and 4.5% in 2021, up from 3.7% in 2019. However, employment statistics revealed that a large portion of the decline in employment in 2Q was driven by foreign labor, which might exacerbate Norway's long-term challenges stemming from the declining working population due to aging.

Norwegian banks are well positioned to absorb higher loan losses caused by the pandemic. Capital ratios remain sound, with the common equity Tier 1 ratio at 17.4% as of 1Q20 and we expect them to remain above regulatory minimums. Profitability fell considerably in the first quarter owing to increased loan losses but from a relatively high level (return on equity at 6.9% compared with 12.9% in 1Q19). Despite an increase in 1Q, non-performing loans remained very low, at 0.9% of total loans. The banking sector has ample liquidity and access to wholesale funding remains uninterrupted.

Banks have significant exposure to sectors badly affected by the pandemic, especially commercial real estate (CRE) as well as oil and gas (around 18% of total loans excluding financial corporations as of end-2019). The risk of losses on CRE has increased, given inflated prices (a 70% increase over the last decade) and the severe impact of the pandemic on owners of retail property and hotels. However, the banks are mainly exposed to the office segment, which seems more resilient than other types of CRE. CRE companies have strong equity ratios, which should limit the credit losses.

High household indebtedness (230% of disposable income at end-1Q20) in the context of elevated house prices (65% increase over the last decade) and banks' large exposure to mortgage lending (around 50% of the loan book as of end-2019) represents another source of vulnerability. However, households' balance sheets are strong, with net wealth twice as large as gross debt according to Statistics Norway. The bulk of these assets are very liquid, with bank deposits equal to one-third of outstanding household debt. Housing market activity and house prices have recovered since falling steeply in March. Under our baseline scenario, we expect housing demand to be supported by lower interest rates (a cumulative 150bp cut in 2020), despite an increase in unemployment and moderating wage growth.

ESG - Governance: Norway has an ESG Relevance Score (RS) of 5 for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption, as is the case for all sovereigns. Theses scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary

Sovereign Rating Model. Norway has a high WBGI ranking at 96.8 percentile, reflecting its strong institutional capacity, effective rule of law, a low level of corruption and stable political environment.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Norway a score equivalent to a rating of 'AAA' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee did not adjust the output from the SRM to arrive at the final LT FC IDR.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Public Finances: A very large erosion of Norway's sovereign and external balance sheet strength over the medium term.

- Macro: A sharp correction in the Norwegian residential and commercial real-estate market or large losses on trading and lending portfolios that result in a severe macroeconomic shock.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- The ratings are at the highest level on Fitch's scale and cannot be upgraded.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

KEY ASSUMPTIONS

- Fitch expects the global economy to perform in line with Fitch's Global Economic Outlook (29 June 2020), which projects eurozone growth at -8% in 2020, 4.5% in 2021 and 2.8% in 2022. Fitch expects the Brent crude oil price to average USD35p/b in 2020, USD45p/b in 2021 and USD53p/b in 2022.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Norway has an ESG Relevance Score of 5 for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's SRM and is therefore highly relevant to the rating and a key rating driver with a high weight.

Norway has an ESG Relevance Score of 5 for Rule of Law, Institution & Regulatory Quality, Control of Corruption, as World Bank Governance Indicators have the highest weight in Fitch's SRM and is therefore highly relevant to the rating and a key rating driver with a high weight.

Norway has an ESG Relevance Score of 4 for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver.

Norway has an ESG Relevance Score of 4 for Creditor Rights as willingness to service and repay debt is relevant to the rating and a rating driver, as for all sovereigns.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Norway	LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
•	ST IDR	F1+	Affirmed	F1+
•	LC LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
•	LC ST IDR	F1+	Affirmed	F1+
•	Country Ceiling	AAA	Affirmed	AAA

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Sovereign Rating Criteria (pub. 27 Apr 2020) (including rating assumption sensitivity)

Country Ceilings Criteria (pub. 01 Jul 2020)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.1 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.12.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Norway	EU Issued

ADDITIONAL DISCLOSURES FOR UNSOLICITED CREDIT RATINGS

Norway (Unsolicited)

With Rated Entity or Related Third Party Participation	Yes
With Access to Internal Documents	Yes
With Access to Management	Yes

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UNSOLICITED ISSUERS

ENTITY/SECURITY	ISIN/CUSIP/COUPON RATE	RATING TYPE	SOLICITATION STATUS
Norway	-	Local Currency Short Term Issuer Default Rating	Unsolicited
Norway	-	Short Term Issuer Default Rating	Unsolicited
Norway	-	Local Currency Long Term Issuer Default Rating	Unsolicited

ENTITY/SECURITY	ISIN/CUSIP/COUPON RATE	RATING TYPE	SOLICITATION STATUS
Norway	-	Country Ceiling	Unsolicited

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Sovereigns Europe Norway