Fitch Affirms Norway at 'AAA'; Outlook Stable

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Fitch Ratings-London-29 September 2017: 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 'AAA' IDRs and Stable Outlooks reflect the sovereign's strong balance sheet, current account surpluses, large net external creditor position, high performance on human development and governance indicators, and very high income per capita metrics. A robust macroeconomic policy framework and strong buffers afford the authorities considerable room to respond to low oil prices with an expansionary policy stance.

The Norwegian economy is gaining momentum after two years of sluggish growth following the oil price shock. The mainland economy grew at an annualised rate of 2.8% in 1H17, supported by a strong upturn in petroleum investments and robust private consumption spurred by renewed growth in employment. Fitch forecasts mainland GDP growth will pick up to 1.9% y-o-y in 2017 and to around 2% y-o-y in 2018 and 2019, driven by a broad-based recovery in the non-oil sector.

Inflation has moderated since 2H16 due to the fading effect of the krone depreciation and lower wage growth, falling to 1.3% in August 2017 from 3.8% at year-end 2016. Norges Bank kept its policy rate unchanged at 0.5% in September and projects a gradual increase in 2019 as the economy recovers, and capacity utilisation improves.

The current fiscal stance remains expansionary with the fiscal stimulus estimated at 0.5% of mainland GDP in 2017 and the structural non-oil deficit projected at 7.7%, or 2.9% of the balance of the sovereign wealth fund, which is valued at 284% of mainland GDP in September 2017. The general government surplus fell to 4% of GDP in 2016 (2015: 6.0%), and is forecast by Fitch to remain stable at 3.0% of GDP over the forecast horizon.

A prudent fiscal stance remains a key rating strength. The fiscal rule indicates that the structural non-oil fiscal deficits should equal the expected real return on the sovereign wealth fund over time. The return estimate has been adjusted downward by 1pp to 3% in 2017. The government also raised the target equity allocation of the fund from 62.5% to 70%.

A centre-right government led by the Conservative and Progress parties was re-elected in the general election in September. The four centre-right parties, including the Liberal and Christian Democratic parties secured 88 of the 169 seats in parliament. A coalition is to be formed by October and we expect policy continuity to prevail with the main items on the agenda including tax cuts and reforms, enhanced investments in infrastructure and research, and tighter immigration policy.

House price inflation is slowing down, supported by tighter lending standards and house supply coming on stream. After rising rapidly for a prolonged period of time and accelerating in 2016 (+7.0% y-o-y nationwide in 2016 and 21.7% y-o-y in Oslo in 4Q16), price increase is decelerating with growth in residential property price indices (RPPI) at 6.9% y-o-y in 2Q17 after a 10.1% rise y-o-y in the past two quarters. Seasonally adjusted monthly price inflation was close to zero or negative at the beginning of the year.

High and overvalued house prices along with a large stock of household debt, estimated at 236% of disposable income at year-end 2016, and rapid credit growth are latent risks to the sovereign, in our view. The IMF estimates that a 10% decrease in house prices could affect private consumption by 0.9% through a contraction in households' wealth and negative shock to domestic demand.

We expect recently adopted macro-prudential measures will help stabilise the housing market and lead to a gradual price soft landing. The counter-cyclical bank capital buffer is set to increase by 50bps to 2% by end-2017, and a debt-to-income ratio limit and tighter amortisation requirements have been introduced along with a loan-to-value cap for secondary dwellings in Oslo. Tighter supervision for commercial real estate (CRE) lending, higher CRE risk weighting and add-on capital for portfolios highly exposed to CRE will help address current imbalances. Vulnerabilities to financial sectors are also mitigated by banks' strong balance sheets, including solid capitalisation and leverage, low non-performing loans and robust profitability.

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
Fitch assesses Norway's credit profile to be solid, implying that negative rating action in the near term is unlikely. However, the following factors could, individually or collectively, put downward pressure on the ratings:
- Risks to financial stability deriving from a severe macroeconomic shock, which would be amplified by excessive credit growth or household indebtedness.
- A substantial erosion of Norway's sovereign and external balance sheet strengths over the medium term.

KEY ASSUMPTIONS
Fitch assumes that Brent oil prices will average USD52.5p/b this year, USD55.0p/b in 2018 and USD60p/b in 2019.

The full list of rating actions is as follows:

Long-Term Foreign-Currency IDR affirmed at 'AAA'; Outlook Stable

Long-Term Local-Currency IDR affirmed at 'AAA'; Outlook Stable
Short-Term Foreign-Currency IDR affirmed at 'F1+'
Short-Term Local-Currency IDR affirmed at 'F1+'
Country Ceiling affirmed at 'AAA'
Issue ratings on long-term senior-unsecured local-currency bonds affirmed at 'AAA'

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Applicable Criteria
Country Ceilings Criteria (pub. 21 Jul 2017)
Sovereign Rating Criteria (pub. 21 Jul 2017)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy