S&P Global
Ratings

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Research Update:

Norway 'AAA/A-1+' Ratings Affirmed; Outlook Remains Stable

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Norway 'AAA/A-1+' Ratings Affirmed; Outlook Remains Stable

Ratings:
Foreign and Local Currency: AAA/Stable/A-1+

For further details see ratings list.

Overview

- The Kingdom of Norway benefits from a prosperous economy, strong fiscal and external positions, and a stable policy environment.
- We are affirming our 'AAA/A-1+' ratings on Norway.
- The stable outlook reflects our expectation that, over our 2017-2020 forecast period, Norway will maintain political stability and monetary flexibility, and that its very strong fiscal and external positions will support economic resilience, enabling the economy to withstand any negative impact from low oil prices.

Rating Action

On Oct. 20, 2017, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term sovereign credit ratings on the Kingdom of Norway. The outlook is stable.

Outlook

The stable outlook reflects our expectation that Norway's credit metrics will remain close to their current very strong levels over our 2017-2020 forecast period, enabling the country to withstand any negative impact from low oil prices.

In light of the strong credit fundamentals, our 'AAA' rating on Norway would come under downward pressure should we observe rapid erosion of the very strong external and fiscal balance sheets, combined with a significant weakening of the strong institutions and governance standards. We currently consider such adverse developments as unlikely, however.

We do not envisage an abrupt house price correction or another negative oil-price shock. However, if either were to materialize, we believe there are adequate buffers on both the government's and the country's external balance sheets to absorb losses.

Rationale

The ratings reflect our view of Norway's stable and predictable policymaking environment, underpinned by high prosperity, as well as very large external and fiscal net asset positions from accumulated petroleum revenues. We estimate Norway's GDP per capita at a very high US$73,500 in 2017, among the highest of all rated sovereigns. Norway has a history of prudent policymaking, reflected in its fiscal rule and the creation and management of Norway's sovereign wealth fund, the

Government Pension Fund Global (GPFG), set up to gradually channel oil revenues into the economy in line with the fund's expected real returns (3%).

Institutional and Economic Profile: Growth momentum picking up as economy shakes off recent petroleum sector cutbacks

- The minority coalition government has a weakened mandate after the 2017 elections, which will test bargaining abilities and could temper reform momentum.
- Economic growth is gaining momentum as mainland economic activity picks up and the petroleum sector looks set to come back on stream following efficiency improvements.
- The housing market is currently cooling down after unhealthy 2016 price hikes, but imbalances are set to remain on the back of high and still increasing household debt.

Following the parliamentary election in September 2017, the incumbent government minority coalition of the Conservative Party and the right-wing Progress Party received a new, albeit weakened mandate, gaining 72 out of 169 seats in Parliament compared with 77 in the previous term of office. Attempts to enlarge the coalition by inviting previous allies the Liberal Party and the Christian Democrats have been dismissed by the Christian Democrats, who have openly refused to sit in government together with the Progress Party. We expect that the weakened mandate, in addition to the Christian Democrats abstaining to extend formal support, will translate into greater need to bargain and to reach cross-parliament consensus in order to navigate key reform initiatives through the budget vote. As such, the current situation implies more uncertainty regarding gaining support for fiscal spending plans and the direction of policy proposals. Therefore, we foresee that the government's reform momentum could slow. That said, despite ideological differences among the various coalition and opposition parties, we believe there is a broad cross-party consensus on key macroeconomic issues.

Currently, there are positive signals from the Norwegian economy, with a bottoming out of petroleum sector cutbacks, as well as a reversal of the negative unemployment trend. We expect that mainland GDP growth will reach about 2% in 2017, while still-tempered production in the petroleum sector will hold back overall headline growth to 1.5%. Mainland GDP growth rests on investments in housing, public investment, and household consumption. Over 2018-2020, we expect a gradual shift in main growth drivers from government spending and housing investments, toward petroleum and business investments, as well as further climbing household consumption and improving exports from the mainland. Notably, in the past two years, housing investments have more or less replaced the petroleum sector's investments. However, we foresee that investments in housing will subside as the housing market now seems to be cooling off, while significant additions to supply are expected over the next two years as large construction projects are completed.

Following important productivity gains in the petroleum sector, and helped by the decline in the Norwegian krone (NOK), we believe the break-even Brent price for oil extraction on the Norwegian Continental Shelf has significantly fallen over the past two years. There are thus increasing signs that petroleum investment cutbacks have turned a corner and will increase in the coming years, from currently low levels, and thus contribute to growth in 2018 and beyond. Looking beyond the petroleum

sector, the depreciation of the krone exchange has led to improvement in cost-competitiveness for Norwegian mainland exports, which could continue to support the rebalancing of the economy toward non-oil related exports, which have been constrained by high unit labor costs and weak productivity. High levels of household debt and historically high house prices remain a concern. The ratio of debt to disposable income continues to increase, reaching 235% of disposable income in 2016, which is one of the highest among countries of the Organisation for Economic Cooperation and Development. Average house prices have increased substantially over the past decade and continued to do so in 2016 when they rose 7.0% in nominal terms. House prices increased at an unhealthy pace in the Oslo region, where the rolling-12-month increase stood at 21.7% in the fourth quarter of 2016, fueled by a notable element of speculation.

As a response to the alarming developments, the government, following a recommendation from the Financial Supervisory Authority of Norway, took macro prudential actions, introducing a debt-to-income ceiling of 5x pre-tax earnings, together with a regional requirement in Oslo of a more strict loan-to-value ratio for the purchase of a secondary dwelling. Following these regulations, together with significant supply coming on the market, house prices have tempered, with notable declines in Oslo where prices are down about 10% in 2017. While we expect household consumption to continue to be a key driver of growth in 2018-2020, we acknowledge uncertainty with regards effects from further house price reduction and its potential drag on household consumption. In our opinion, a potentially rapid and sharp correction in real estate prices constitutes an economic vulnerability that could hamper growth prospects through weakened consumption and investment activity. In addition, we note that the government's 2018 budget bill proposes an increase in VAT to 12% from 10% for a certain group of services, which could hold back consumption of some households. On the other hand, proposals for continued notable reductions in personal income tax rates are set to pull in the opposite direction.

Flexibility and Performance Profile: Vast fiscal and external buffers underpin unparalleled flexibility

- An extremely strong external balance sheet generates sizable income balances, which anchor robust current account surpluses despite a weakened trade position.
- Net transfers from the petroleum fund into the central government budget are becoming the new norm, while implementation of a revised fiscal spending rule implies a neutral fiscal stance for 2018 and beyond.
- Cumulative returns have surpassed cumulative inflows as the GPFG edges past $1 trillion in market value.

The GPFG has grown rapidly since its creation in 1990, and it currently underpins Norway's very strong external and fiscal net asset positions. Increases to the fund are through inflows of petroleum tax revenues, state-owned petroleum activities, and returns on the existing stock of assets. The fund surpassed $1 trillion in September 2017, representing about 240% of Norway's mainland economy. The GPFG's large size and the significant volatility of its value relative to the national budget were key factors in the government's decision to appoint an expert commission to consider how to apply the guidelines for petroleum revenue spending, including the fiscal rule. These led to a 2017 revision of the spending rule to 3% of the fund over time, which is the revised estimated real rate of return, compared with 4% previously. The

structural non-oil deficit in the government's 2017 budget stands at NOK220 billion (about 8% of mainland GDP), reflecting 2.9% of the year-end 2016 GPFG.

Moreover, parliament has taken a decision to increase the equity portion of the fund from its strategic benchmark of 62.5% to 70% over time. Given the high, and increasing, proportion of equities in the GPFG, it is exposed to fluctuations in the global equity markets. While these have been strongly positive in 2017, a sharp drop in equity markets could quickly eat into its market value and limit the possibilities for fiscal spending. In this instance, we acknowledge the flexibility within the fiscal spending framework to deviate from the fiscal spending rule in a given year or years, which will allow government to adjust spending or revenues accordingly. With regards to the fund's asset allocation, we further observe that Norges Bank has advised the Ministry of Finance to gradually alter the fixed income investments (about 25% of the fund) to focus on liquid nominal bonds predominantly in three major currencies.

Similar to 2016, in 2017 we expect the net transfers from the fund to the central government's budget to exceed the inflow to the fund from petroleum revenues by some NOK70 billion. We expect this to become the norm over the longer term, as the net inflow of petroleum revenues is on a structural decline.

For 2018, we observe that the central government budgets a structural non-oil deficit at NOK231 billion (7.7% of mainland GDP) corresponding to 2.9% of the capital of the GPFG at the beginning of the year. The fiscal impulse is estimated at 0.1% suggesting a neutral fiscal stance. Importantly, although revenues from petroleum activities are set to structurally decline, the GPFG's assets will generate a sizable yearly cash flow (dividends and interest). These returns (7.5% of mainland GDP) provide a material revenue source for the consolidated fiscal budget and underpin its surplus position. Over the coming years, these cash flows will constitute the more important revenue source for the government, as opposed to the net inflow of petroleum revenues. Notably, 80% of the fund's returns have materialized over the past five years and in March 2017 the cumulative returns surpassed those of cumulative inflows. We expect the general government surplus to average a robust 4% of GDP over our 2017-2020 forecast period, on the back of the recurring interest and dividend returns on the fund's assets.

The central government's debt issuance is detached from fiscal performance and is carried out to finance capital transactions. We expect central government's debt to remain at around 20% of GDP over 2017-2020, with the debt of local and regional governments adding an additional 15% of GDP to the 35% of GDP total for the general government debt burden. The share of foreign ownership of central government bonds hovers around 60% and could represent a risk should investor sentiment turn sharply against Norway, though this is not our expectation. The government's net asset position remains exceptionally strong at more than 240% of GDP, and the interest burden on general government debt is low, averaging 1.5% of revenues in 2017-2020.

The GPFG's external assets also anchor the country's robust current accounts position. With the growth of the GPFG, Norway is slowly becoming less reliant on merchandise exports for the generation of foreign currency revenue. In 2016, net

income from abroad (dividends and interest earnings), largely reflecting returns on the GPFG's external assets, contributed significantly more to the surplus than the goods and services balance. We observe the 2016 net income balance at around NOK93 billion (3.6% of GDP), which is more than triple that of goods. We expect sound current account surpluses over the forecast horizon of around 5.5% of GDP, with the net income balance continuing to grow, in addition to more tangible support from the goods and services balance through the reemergence of petroleum-related exports. With all the GPFG funds invested abroad, Norway is in an extremely strong net external asset position, at around 480% of CARs for 2017. However, we estimate that Norway's overall external short-term debt by remaining maturity is rather high, exceeding 130% of CARs in 2016, largely as a result of banks' foreign borrowings.

Norges Bank, the central bank, operates an inflation targeting regime and has an established track record of full operational independence and clear policy objectives. It has an array of monetary instruments at its disposal, which, in conjunction with developed capital markets, enables effective policy transmission. We assess the krone as an actively traded, floating currency. According to the Bank for International Settlements' Triennial Central Bank Survey 2016, the krone is bought or sold in 1.7% of global foreign exchange turnover.

The weakening krone has been driving inflation, which peaked at 3.6% in 2016, above Norges Bank's target rate of 2.5%. Real wage growth was notably negative in 2016 because of the elevated inflation level. However, coinciding with a stabilization in oil prices, the krone has strengthened since 2016, hence reducing its pull on inflation. We expect wage growth to pick up in 2018, but to remain overall moderate. We expect these factors to contribute to inflation being well below the central bank's 2.5% target for 2017-2020.

We note that the banking sector turns to the international capital markets to fund credit growth and, including foreign deposits, is in a net external debtor position of about 35% of systemwide loans. With regard to the housing market dynamics and bank funding, the banking system has high regulatory capital standards, and systemically important banks must now comply with Basel III liquidity requirements, which helps mitigate some concerns about the external position. Also, about 40% of banks' external funding comes from the parent banks of Nordea Bank, Danske Bank, and others. Adjusted for this contribution, we estimate that the Norwegian banking sector's share of net external debt financing is closer to 20% of systemwide loans.

One of the region's largest banks, Nordea Bank, has changed its legal structure by turning its subsidiaries in Norway, Finland, and Denmark into branches under the Swedish parent. Cooperation across the Nordic countries will continue in the tradition of the regulatory college set up to supervise Nordea. The regulator considered Nordea as a systemically important institution in Norway prior to the bank redefining its subsidiaries as branches. We note that Nordea Eiendomskredit, Nordea's Norwegian covered bond entity, which includes its assets and liabilities, will remain in Norway despite the recent decision to move the group's headquarters to Finland. Overall, we have not seen any material movements in the Norwegian banking system's external assets and liabilities, nor do we observe any impact on Norway's extremely strong external positions.

Key Statistics

Table 1

Kingdom of Norway Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	2,796	2,968	3,076	3,147	3,118	3,117	3,211	3,334	3,482	3,644
Nominal GDP (bil. $)	499	510	524	499	387	371	387	402	420	439
GDP per capita (000s $)	101.4	102.3	103.6	97.8	74.8	71.2	73.5	75.6	78.2	81.0
Real GDP growth	1.0	2.7	1.0	2.0	2.0	1.1	1.5	1.3	1.5	1.9
Real GDP per capita growth	(0.3)	1.4	(0.3)	0.8	0.8	0.2	0.5	0.3	0.5	0.9
Real investment growth	7.5	7.6	6.3	(0.3)	(4.0)	(0.2)	1.5	1.3	1.7	2.4
Investment/GDP	25.9	26.5	27.9	28.1	27.6	29.3	29.1	28.6	28.3	28.0
Savings/GDP	38.3	39.0	38.2	38.7	35.6	33.2	34.3	34.3	34.0	33.7
Exports/GDP	41.2	40.6	39.1	38.8	37.7	34.1	33.5	33.4	33.6	33.9
Real exports growth	(0.8)	1.6	(1.7)	3.1	4.7	(1.8)	1.1	2.1	2.7	3.5
Unemployment rate	3.3	3.2	3.5	3.5	4.4	4.7	4.4	4.0	3.9	3.7
EXTERNAL INDICATORS (%)										
Current account balance/GDP	12.4	12.5	10.3	10.6	8.0	3.9	5.2	5.7	5.8	5.7
Current account balance/CARs	24.8	25.2	21.5	21.5	16.1	8.3	11.2	12.2	12.3	12.0
CARs/GDP	49.8	49.8	48.0	49.2	49.6	46.6	46.5	46.9	47.1	47.3
Trade balance/GDP	13.4	13.5	11.6	10.0	6.3	3.2	2.6	2.5	2.5	2.5
Net FDI/GDP	(0.5)	0.1	(1.8)	(4.1)	(3.9)	(6.7)	(1.2)	(1.5)	(1.2)	(1.2)
Net portfolio equity inflow/GDP	(9.5)	(7.8)	(0.3)	(3.5)	(1.4)	(3.2)	(3.0)	(2.5)	(2.5)	(2.5)
Gross external financing needs/CARs plus usable reserves	168.9	173.4	158.5	156.8	164.6	171.7	169.7	169.4	169.6	168.7
Narrow net external debt/CARs	(63.2)	(144.5)	(197.8)	(234.2)	(290.6)	(333.7)	(384.8)	(367.9)	(354.2)	(339.8)
Net external liabilities/CARs	(159.1)	(194.7)	(255.2)	(289.2)	(363.8)	(424.1)	(481.9)	(467.6)	(456.1)	(441.4)
Short-term external debt by remaining maturity/CARs	129.6	132.3	112.8	115.6	136.2	137.1	137.9	134.2	132.8	130.7
Usable reserves/CAPs (months)	3.4	3.1	3.2	3.6	4.8	4.3	4.5	4.2	4.1	4.0
Usable reserves (mil. $)	49,397	51,856	58,283	64,801	57,456	60,445	58,480	59,269	61,656	63,651
FISCAL INDICATORS (%, General government)										
Balance/GDP	13.4	13.8	10.8	8.7	6.1	4.0	4.5	4.0	4.0	4.0
Change in debt/GDP	(10.4)	3.0	1.3	(1.4)	4.6	3.5	(0.4)	1.1	1.0	0.9
Primary balance/GDP	14.6	14.7	11.6	9.6	6.9	4.7	5.3	4.9	4.8	4.8
Revenue/GDP	56.5	56.1	54.1	53.8	54.1	54.0	54.0	54.0	54.0	54.0
Expenditures/GDP	43.1	42.3	43.3	45.1	48.0	50.0	49.5	50.0	50.0	50.0

Table 1

Kingdom of Norway Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Interest /revenues	2.0	1.6	1.6	1.5	1.5	1.3	1.4	1.6	1.6	1.5
Debt/GDP	28.8	30.2	30.4	28.3	33.1	36.7	35.2	35.0	34.5	33.9
Debt/Revenue	51.0	53.8	56.3	52.6	61.3	67.9	65.2	64.8	63.9	62.8
Net debt/GDP	(92.7)	(103.4)	(135.9)	(176.9)	(205.4)	(206.5)	(216.9)	(212.9)	(207.8)	(202.6)
Liquid assets/GDP	121.5	133.5	166.4	205.2	238.5	243.1	252.1	247.9	242.4	236.5
MONETARY INDICATORS (%)										
CPI growth	1.3	0.6	2.1	2.1	2.1	3.6	2.0	1.4	1.5	1.7
GDP deflator growth	6.8	3.4	2.5	0.3	(2.8)	(1.1)	1.5	2.5	2.9	2.7
Exchange rate, year-end (LC/$)	5.99	5.57	6.08	7.43	8.81	8.62	7.99	7.99	7.99	7.99
Banks' claims on resident non-gov't sector growth	6.7	5.7	6.7	5.8	5.9	4.5	5.0	5.0	5.0	5.0
Banks' claims on resident non-gov't sector/GDP	126.7	126.2	129.9	134.4	143.6	150.2	153.1	154.8	155.6	156.2
Foreign currency share of claims by banks on residents	5.5	4.6	4.8	5.1	5.4	4.8	4.0	4.0	4.0	4.0
Foreign currency share of residents' bank deposits	27.3	26.6	27.5	28.6	27.4	28.4	27.5	27.5	27.5	27.5
Real effective exchange rate growth	6.5	3.2	0.4	(3.5)	(12.4)	(3.4)	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Kingdom of Norway Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Strength
Economic assessment	Strength
External assessment	Strength
Fiscal assessment: flexibility and performance	Strength
Fiscal assessment: debt burden	Strength
Monetary assessment	Strength

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23,2014
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18,2009
- General Criteria: Use Of CreditWatch And Outlooks - September 14,2009
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07,2017

Related Research

- Sovereign Risk Indicators - Oct. 13, 2017. An interactive version is available at www.spratings.com/sri.
- Sovereign Ratings History - Oct. 11, 2017
- 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions - April 18, 2017
- Global Sovereign Rating Trends: First-Quarter 2017 - April 10, 2017
- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions - April 03, 2017
- Banking Industry Country Risk Assessment: Norway - March 14, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion - February 23, 2017

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient

experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision. After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that all key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

Ratings List

	Rating	
	To	From
Norway (Kingdom of)		
Sovereign Credit Rating		
Foreign and Local Currency	AAA/Stable/A-1+	AAA/Stable/A-1+
Transfer & Convertibility Assessment	AAA	AAA
Senior Unsecured		
Local Currency	AAA	AAA
Short-Term Debt		
Local Currency	A-1+	A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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