

Norway: Lower FX purchases suggest appetite for stronger NOK

For the second consecutive month, Norges Bank announced lower-than-expected daily FX purchases (NOK1.9bn) for the month ahead. This may at least partly denote appetite for a stronger domestic currency, which would help fight inflation as Norges Bank's room for tightening may be restrained by Norway's economic woes and vulnerable property market



December FX purchases trimmed to NOK1.9bn

Norges Bank (NB) announced daily FX purchases data for the month of December today, and for the second consecutive month, surprised on the downside. Daily purchases were trimmed from NOK4.3bn to NOK3.7bn in November, and will be further cut to NOK1.9bn next month. December's FX operations will be carried out only until the 16th.

For context, Norges Bank conducts FX operations on behalf of the Ministry of Finance, converting NOK excess petroleum revenues (after financing the budget deficit) into foreign currency holdings, which are then saved in the Government Pension Fund Global (GPF). In practice, NB is selling NOK in the market, primarily against USD and EUR.

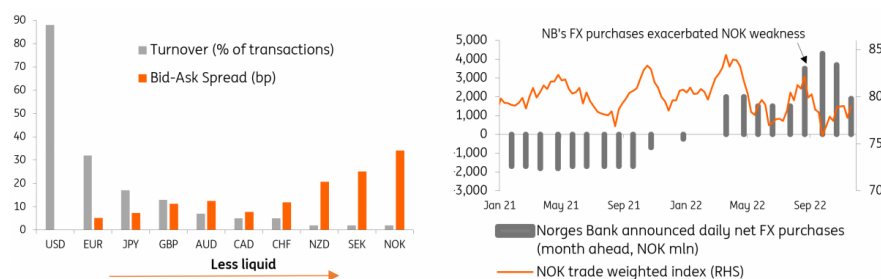
Assessing the FX impact

The lower announced FX purchases are probably related to the recent drop in energy prices. However, the reduction in purchases for December was both unexpected and very sizeable, and followed another surprise decrease in November. We think there may be an ulterior motive behind the Finance Ministry and Norges Bank's move: offering some support to the krone.

NOK is the least liquid currency in G10 (left-hand chart below), which means it is extremely sensitive to global risk dynamics and financial conditions. While the deteriorating liquidity and risk environment in 2022 was the primary driver of NOK weakness, Norges Bank's acceleration in FX purchases in September and October may well have added pressure on the krone.

NOK is the best performing currency in G10 today, trading 1.10% higher against the USD and 0.7% against the euro thanks to Norges Bank's announcement.

NOK driven by liquidity and NB purchases



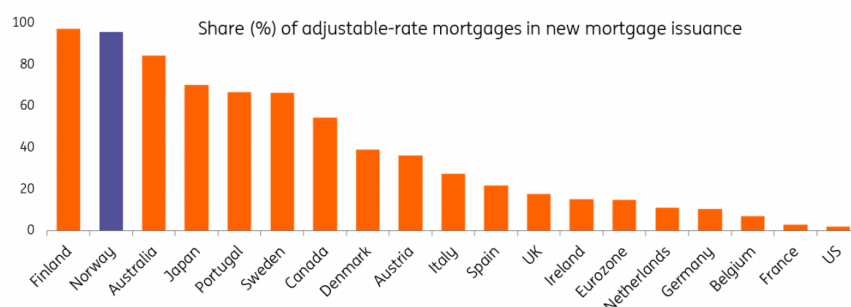
Source: BIS, Norges Bank, ING

Stronger NOK welcome given limited tightening room

In our view, a stronger domestic currency would be welcome in Norway as it would help fight elevated inflation. The most recent CPI reading surprised to the upside once more, revealing an increase in prices to 7.5% in October, significantly higher than the 5.4% average fourth quarter Norges Bank estimates (published in September). As a result of growing economic downside risks, NB has slowed the rate of tightening, raising it only 25bp to 2.50% on November 3rd. Most importantly, its current rate projections only indicate 60bp of additional tightening, which might prove insufficient to bring inflation sustainably lower.

However – along with general concerns about the slowdown in the economy – hawks at the NB may be discouraged by the vulnerability of the Norwegian housing market. As shown below, Norway has the largest share (nearly 96%) of variable rates in G10, which is unquestionably an element of concern given rapidly rising rates. Too much tightening risks causing an undesirably rapid contraction in house prices.

Norway's property market looks vulnerable



Source: OECD, ING

In conclusion, Norges Bank and the Finance Ministry may want to offer some support to NOK via lower FX purchases, with the aim of reducing the need for direct monetary policy action (rate hikes) to fight inflation. We could see Norwegian authorities keep FX purchases lower throughout 2023 for this reason, which would be a positive development for NOK.

However, FX operations are one variable in the NOK equation, and crucially one with a lower weight compared to external factors that are well beyond Norges Bank's control: global risk appetite and financial conditions. As discussed in our [2023 FX Outlook](#), worsening liquidity conditions are likely to pose a challenge to high-beta currencies such as NOK. Our base case is for NOK to appreciate to 9.60 against both EUR and USD by end-2023, but we doubt it will be a smooth ride for the krone.

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