

## It's all about liquidity for NOK, despite Norges Bank rate cut

Having cut interest rates by 125bp over the past week, the Norwegian central bank is now close to the limits of what it can feasibly do on monetary policy. But in a market driven by dollar funding needs, characterised by the squeeze in low liquidity currencies, these rate cuts seem irrelevant for the Norwegian Krone (NOK)



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The Norges Bank has become the latest central bank to effectively go 'all-in' to tackle the impact of the virus on the economy. The Norwegian central bank has cut rates from 1% to 0.25%, having already cut from 1.5% only last week.

Policy makers have indicated they could cut rates again, although in reality once rates are at (or close to) zero, that's probably about it now on the monetary policy side.

In a speech last year, Governor Olsen noted that neither negative rates nor quantitative easing were really viable options for Norway. On the former, he indicated that the costs of moving rates below zero probably outweigh benefits. In the case of quantitative easing, there are more logistical constraints - the size of the Norwegian government bond market is pretty small and illiquid. Olsen also noted that given holders are typically overseas investors, the substitutability into other Norwegian assets that QE is partly designed to achieve probably wouldn't occur.

That said, like other central banks there is probably scope to introduce further targeted measures to support banks and to encourage financing. But ultimately like elsewhere, the emphasis is now on fiscal policy to help cushion the blow.

## NOK: The Norges Bank policy set up does not matter for NOK at this point

In a market-driven by dollar funding needs, characterised by the squeeze in low liquidity currencies, the Norges Bank (NB) rate cuts currently seem irrelevant for the NOK, which is the currency with lowest liquidity in the G10 FX space.

In the same way the NB rate hikes have not helped NOK much in previous years, the cuts don't matter much now. So despite the NB slashing interest rates to 0.25%, the effect on NOK hasn't been negative and the krone is actual up vs EUR today, primarily driven by the rebound in global risk appetite (its key driver over the past week).

Following the sharp rise in NOK volatility and the currency's meltdown in prior days, the issue of the (lack of) dollar liquidity and its eventual resolution will be in our view the key driver of NOK. Both EUR/NOK and USD/NOK screen as heavily overvalued based on our BEER model (NOK being the cheapest G10 currency at this point, 30% undervalued vs USD), but the krone may only rebound on a more sustainable basis from the current extreme levels once the market functioning returns to normal.

As for the NB rate cut, even after today's reduction in the policy rate, the NOK implied yield does not stand out negatively vs its G10 peers, with NOK still offering one of the highest implied yields

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