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Snap

Norges Bank cuts rates again as oil prices deal further economic blow

Norges Bank has cut rates to the floor, and with negative rates and quantitative easing viewed as unfeasible, that's probably going to be it for the foreseeable future. We doubt that the rate cut will do much damage to the NOK, given its relatively strong fundamentals.

Having already cut interest rates by 125bp in March, the Norges Bank looked like it was pretty much done with its stimulus package.

It's, therefore, a little surprising that policymakers have opted to cut rates by another 25bp to zero this month, although of course, the recent gyrations in the oil market have dealt a further blow to the Norwegian economy. More importantly, Governor Olsen has hinted that this is as far as policymakers are likely to go.

In a speech last year, 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.

As is the case elsewhere, the emphasis now is on fiscal policy to facilitate a faster recovery.

The cut shouldn't do too much damage to the NOK

EUR/NOK briefly rallied over 1% on today's surprise rate cut, though we doubt the move will have lasting consequences for the NOK. After all, Norges Bank is today managing expectations that there will be no further rate cuts and QE isn't really an option.

The NOK, therefore, looks relatively well-placed amongst its G10 commodity peers (CAD) and against its emerging market commodity peers (especially MXN, BRL) – the latter group subject to larger rate cuts and growing concerns about the quality of sovereign balance sheets.

> The FX road to recovery: Which currencies to back on the path out of lockdown?

Oil exposure shouldn't be too much of a hindrance

Late last month we published an FX scorecard identifying some of the themes which should drive currencies through the early stage of the recovery NOK scored quite highly on: i) under-valuation, ii) real rates and iii) correlation with steeper yield curves in recovery phases. The only factor keeping NOK off the top of the podium was its exposure to the oil market.

Given that our commodity team thinks the worst is behind crude prices, oil exposure may not prove so much of a hindrance to the NOK. We, therefore, believe that NOK should perform well during recovery periods. While EUR/NOK may bounce around in the 11.00-11.50 area until clearer signs of a global recovery emerge, we think strong NOK fundamentals should lead EUR/NOK to 10.70 levels later in the year.

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