



Theme #5: NOK o'Clock

The Norwegian krone has weakened somewhat vs. the EUR since the last FX Blueprint on Jan 10th, reflecting weaker crude primarily but also a Norges Bank that has struggled to make its mind up on what the main focus of monetary policy should be, headline CPI or household debt/house prices.

The latest policy meeting would suggest household debt and house prices now have the upper hand again, although with the caveat this could change if the krone appreciates significantly. However, to be fair to Norges it is a nigh impossible job for any inflation targeting central bank to balance the dilemma of pockets of domestic overheating with external deflation. Add a solid C/A surplus and a triple-A rating and Norges Bank is stuck between a rock and a hard place.

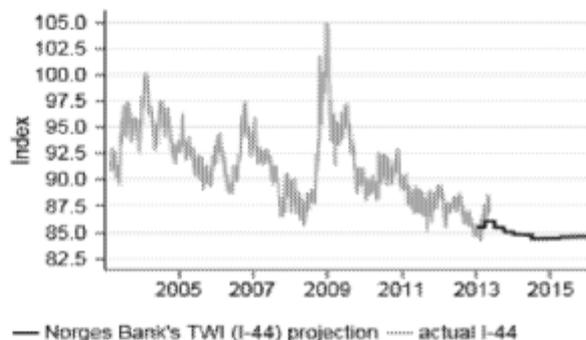
What this means for our outlook for the NOK is that the Norges Bank's NOK TWI projections matter more than ever. Deviations of around 2-3% or more are likely to be crucial over the next couple of rate meetings.

Other factors/variables that will be monitored closely at Norges Bank are: a) total credit as % of GDP; b) house prices as % of disposable income, c) real commercial property prices; d) the share of money market funding in Norwegian financial institutions. These four variables have previously been identified as the key indicators the Bank monitors on an ongoing basis for guidance on longer-term financial stability, and also the main variables that will determine the additional capital requirements for the counter-cyclical capital buffer.

Taken together, the dilemma of balancing the risk of domestic overheating versus excessive currency appreciation and subdued spot inflation is something Norway shares with a number of EM economies and also to a lesser extent with neighboring Sweden. However, Norway's dilemma is further reinforced by the lack of an output gap, Norway's accumulated oil wealth, booming oil & gas investments, extremely low unemployment, and large external surpluses.

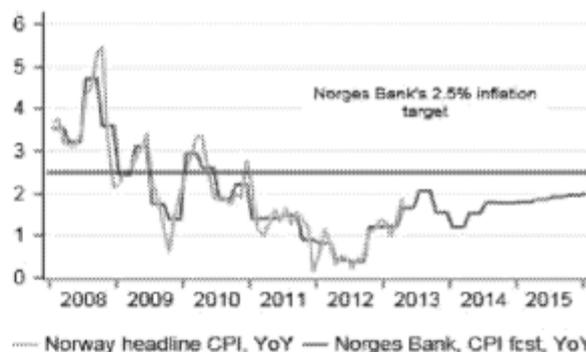
The bottom line, with Norwegian monetary policy likely to continue to be a compromise over the next couple of meetings, the best Norges Bank can hope for currently is that the correction in Brent crude lower will extend and weigh the NOK down. Near-term, and dependent on crude consolidating above/around \$100/barrel, the re-assessment of the Norges policy outlook favour a higher NOK/SEK. Look for a return to the highs from late last year. Target 1.1775, with a stop @ 11.90 (1.1440 at the time of writing).

Figure 1: NOK I-44 slightly weaker than NB's latest projection



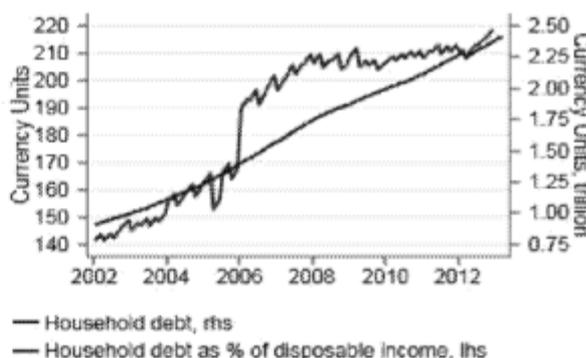
Source: Deutsche Bank

Figure 2: CPI below target, but slightly above NB's projected inflation path



Source: Deutsche Bank

Figure 3: Household debt is increasing again



Source: Deutsche Bank