Kingdom of Norway
Rating Report

AAA
STABLE OUTLOOK

Credit strengths

- Wealthy and resilient economy
- Large net public asset position
- Strong fiscal, monetary and financial governance institutions

Credit challenges

- High household debt and imbalances in the real estate sector
- Transition risk from high oil and gas reliance

Rating rationale:

Economic resilience and fiscal surplus: Norway demonstrated significant economic resilience during the Covid-19 pandemic, experiencing only a moderate decline in economic output and maintaining a positive fiscal outlook with an expected rapid return to fiscal surpluses post-crisis.

Large net public asset position: Norway benefits from a significant net public asset position rather than a net public debt position, driven by savings accumulated through its sovereign wealth fund, the Government Pension Fund Global (GPFG) with total assets of USD 1.36trn.

Strong fiscal, monetary and financial governance: The strong fiscal, monetary and financial governance framework support Norway's resilience to crises. The country also benefits from low public debt, issued only to finance capital expenditure, and institutional strengths as a mature economy with one of the world's highest per capita income levels.

Rating challenges include: i) high and rising household debt and imbalances in the residential and commercial property sectors; and ii) the long-run transition to a non-commodity-dependent economy, which exposes Norway to increased stranded asset risks.

Norway's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	aaa		+1/3	AAA
Public Finance Risk		25%	aa+		+3/3	
External Economic Risk		10%	aaa		0	
Financial Stability Risk		10%	aaa		-1/3	
ESG Risk	Environmental Risk	5%	aaa		0	
	Social Risk	5%	aa-		+1/3	
	Governance Risk	10%	aaa		+1/3	
Overall outcome		**aaa**		**0**	**+2**	

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings GmbH

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced over the next 12 to 18 months.

Positive rating-change drivers

- Not applicable

Negative rating-change drivers

- Weakening macroeconomic policy threatens long-run net public and external asset positions
- Financial crisis damages Norway's public sector and financial system balance sheets
- Shortcomings in addressing climate transition risks, resulting in increased stranded asset risks

Ratings and Outlook

Local and foreign currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

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Bloomberg: RESP SCOP

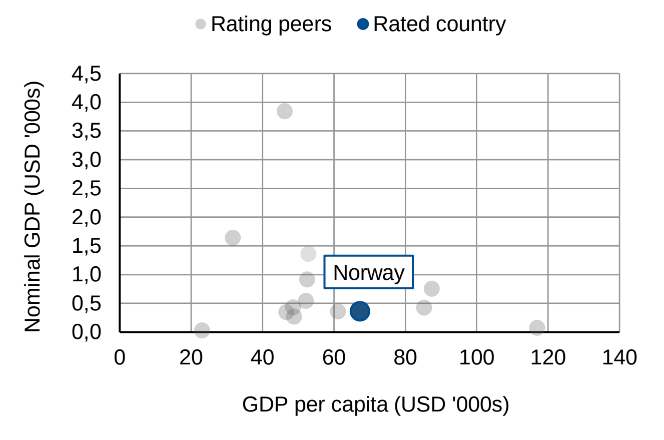
Domestic Economic Risks

- **Growth outlook:** Headline economic output declined by a moderate 0.8% in 2020 compared with an average EU decline of around 6%. The economic lockdown in response to the Covid-19 pandemic caused a sharp contraction during the first half of 2020. Economic activity rebounded quickly as lockdown restrictions were eased over the summer and subsequently fluctuated in line with infection rates. Mainland GDP has now exceeded its pre-pandemic level and sectors that were severely hit during the crisis are expected to be important drivers of the continued recovery. Savings accumulated during the pandemic will also support strong growth in consumption as economic output returns to its pre-pandemic trend. We expect growth to reach 3% in 2021, rising to 3.9% next year before stabilising near its medium-term potential of around 1.5%-2.0% as monetary and fiscal support measures are reduced.
- **Labour market:** Unemployment reached a new high of 5.3% during the summer of 2020 and has since fallen to 4.2% in the three months to July 2021. We believe that the continued recovery in the services sector will result in further declines in the unemployment rate over the coming months and in 2022. While we do not expect any significant long-term economic scarring, one challenge in the near term will be to address the rise in the number of long-term unemployed to avoid skills erosion and ultimately withdrawal from the labour market.
- **Monetary policy:** Norges Bank was the first among the advanced economies' central banks to raise the policy rate since the onset of the pandemic from 0% to 0.25% in September 2021. Given Norway's resilience during the pandemic and as economic activity is starting to normalise, Norges Bank also aims to gradually normalise monetary policy rates. Inflation expectations remain well anchored, although capacity constraints, rising energy prices and labour shortages could lead to some upward pressure on prices and wages in the near term. We expect further increases in the policy rate in December followed by another three hikes in 2022, with the rate reaching 1.25% by the end of next year.

Overview of Scope's qualitative assessments for Norway's *Domestic Economic Risks*

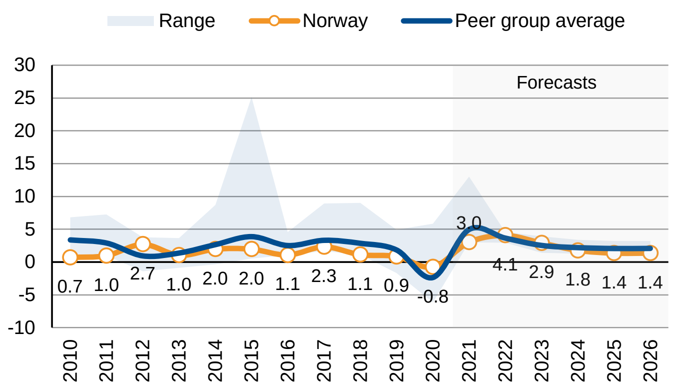
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential
	Monetary policy framework	Strong	+1/3	Credible and effective central bank
	Macro-economic stability and sustainability	Neutral	0	Favourable business environment and highly skilled labour force; weaker economic diversification and exposure to economic volatility due to oil sector

Nominal GDP and GDP per capita, USD thousands



Source: IMF, Scope Ratings GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

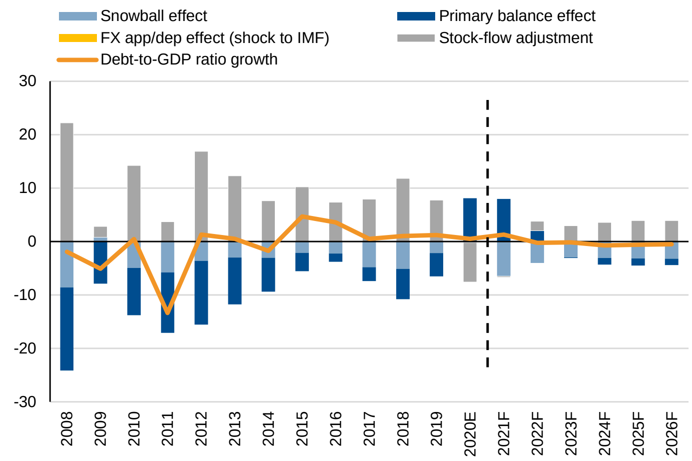
Public Finance Risks

- **Fiscal outlook**: The general government budget stood at a deficit of 6.1% for the first time in 2020 following several decades of consistent government surpluses before the pandemic, supported by revenues from the oil and gas sector. Since the inception of Norway's sovereign wealth fund, transfers to the central government budget from the fund have only exceeded net petroleum revenues on two occasions – in 2016/17 during a slump in oil prices, and in 2020 due to the increased spending needed to respond to the pandemic. Norway's strong fiscal position provided the government with ample capacity to implement the necessary countercyclical measures. Fiscal policy will remain accommodative with support aimed at increasing economic activity and helping the unemployed to return to work. We therefore expect a broadly balanced budget next year before a return to continued surpluses.
- **Debt trajectory:** The GPFG allows Norway to fund any non-oil budget deficits through transfers from its sovereign wealth fund, rather than through debt issuances. The government therefore only borrows in local currency to fund government lending schemes, cover existing debt, ensure that it has sufficient cash reserves and to provide for a well-functioning financial market. As a result, general government debt levels were not significantly impacted by the pandemic, with debt rising from 40.9% in 2019 to 41.4% in 2020. We expect debt to peak at 42.7% of GDP in 2022 before declining towards 40% by 2026.
- **Sovereign wealth fund transfers:** Norway's structural non-oil fiscal deficit amounted to 2.9% of the value of the GPFG in 2019, rising to 3.6% in 2020 and likely to remain at this level in 2021. With the pandemic emergency support being withdrawn, we believe that the structural non-oil fiscal deficit will return below the target of 3% of the sovereign wealth fund's assets in 2022, resulting in a significant reduction of transfers.

Overview of Scope's qualitative assessments for Norway's *Public Finance Risks*

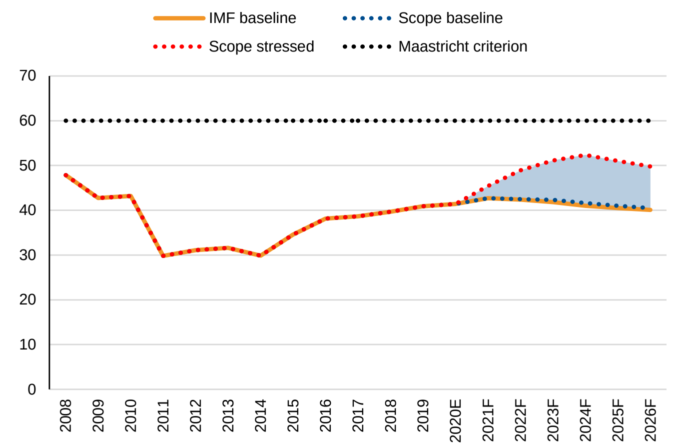
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Fiscal policy framework	Strong	+1/3	Very strong fiscal framework supported by large sovereign wealth fund
	Debt sustainability	Strong	+1/3	Very resilient debt trajectory to severe scenarios
	Debt profile and market access	Strong	+1/3	Sizeable sovereign wealth fund, excellent market access, low government financing costs

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

External Economic Risks

- **Net public asset position**: Norway holds substantial net financial assets amounting to 370% of nominal GDP as of end-2020. The financial assets consist mainly of deposits with Norges Bank, financial investments through the GPFG, equity holdings in domestic enterprises, and lending to or direct investments in state banks and state enterprises. This net asset ratio is by far the highest in a 'aaa' peer analysis.

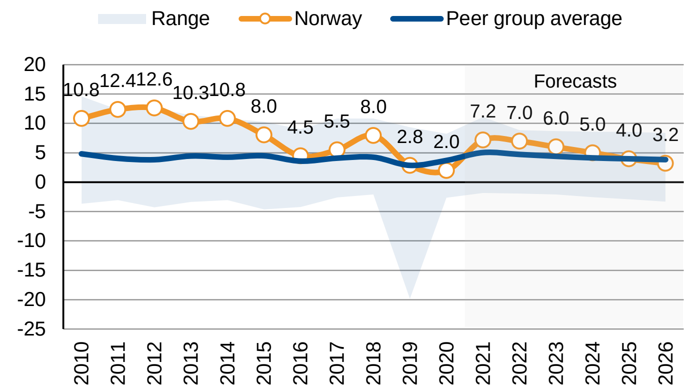
- **Sovereign wealth fund assets**: Since its launch in 1990, the GPFG has grown to its current size of about USD 1.36trn or around 400% of mainland GDP. Fund assets are invested abroad and divestment from oil and gas shares in recent years helps to diversify the country's wealth away from the sector. The prudent investment of Norway's oil wealth, combined with the fiscal rule targeting annual transfers to the budget of 3% of GPFG assets, is a significant credit-positive. Using the fund to delink the current generation and the use of petroleum revenues bolsters fiscal and economic sustainability. It provides a formidable tool for business cycle smoothing, eases the effects of oil price volatility on the mainland economy, decreases the potential for short-term overspending, and provides the foundation for long term investment to benefit future generations.

- **Current account:** Norway's reliance on oil exports exposes the current account to volatility. The country held substantial current account surpluses (of more than 10% of GDP) from 2000 to 2014. This surplus fell below 10% in 2015 owing to lower Brent prices, reaching 2% during in 2020 due to the pandemic. The IMF expects surpluses of 7.1% and 7.0% in 2021 and 2022, and a medium-term current account surplus of about 3.2% of GDP by 2026.

Overview of Scope's qualitative assessments for Norway's *External Economic Risks*

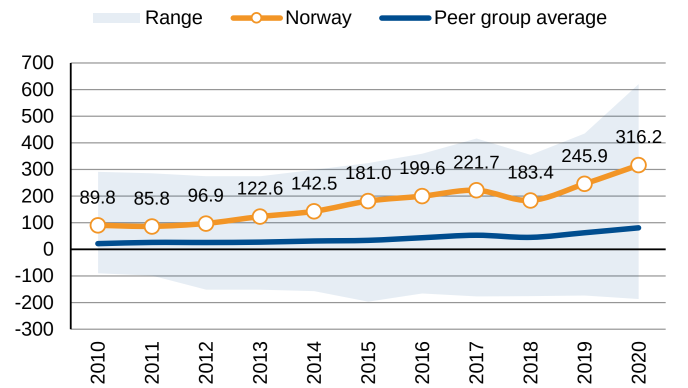
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Weak	-1/3	Reliance on oil exports exposes current account to volatility
	External debt structure	Neutral	0	High external debt, in line with that of peers
	Resilience to short-term shocks	Strong	+1/3	Very robust external-creditor position, anchored by external assets of sovereign fund

Current account balance, % of GDP



Source: IMF, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

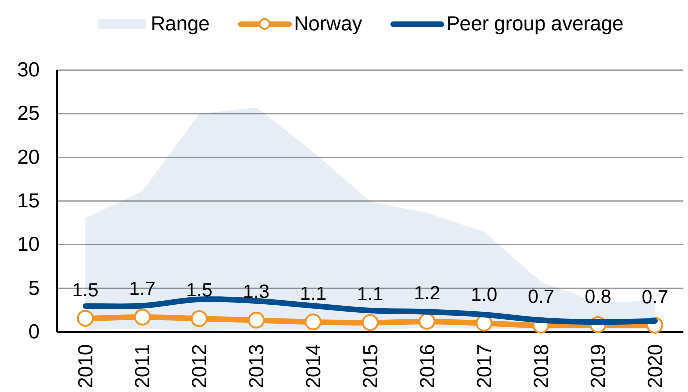
Financial Stability Risks

- **Housing market**: Average house prices have surged to all-time highs, climbing by around 13% since the onset of the pandemic and almost doubling since the 2008 financial crisis. The hike in prices has been fuelled by rising household income, supply constraints and the reduction of the key policy interest rate to 0%. The policy rate increase in September has resulted in a slight rise in demand for fixed-rate mortgages and banks have reported lower margins on their residential mortgage lending. We believe that the expectation of future policy rate increases, in combination with rising housing starts, will moderate house price growth over the next year.
- **Household debt**: Real estate sector risks are intertwined with high and rising levels of household debt, which reached a new peak at 233% of disposable income in Q2 2021 compared with 185% in Q2 2007 before the global financial crisis. While households' debt service ratios have also gradually increased over this period, low interest rates have helped to reduce the average households' interest burden from 6.2% to 4.5% of disposable income. Norway is vulnerable to any significant market corrections, which could adversely impact both the economy and financial stability. As also highlighted by Norway's Financial Supervisory Authority and the IMF, the authorities should consider tightening current macroprudential measures in case of continued strong house price growth and further evidence of market imbalances.
- **Banking sector:** Non-performing loans have remained below 1% throughout the pandemic and regulatory tier 1 capital ratios exceeded pre-pandemic levels in Q2 2021. Norges Bank's 2020 bank stress test indicated that banks will continue to satisfy the capital requirements by an ample margin, have sufficient access to funding, and have the capacity to provide credit to keep supporting the recovery. We believe that banks' losses related to household debt will be moderate as a result of the generous unemployment benefits and sufficient liquid asset buffers held by households.

Overview of Scope's qualitative assessments for Norway's *Financial Stability Risks*

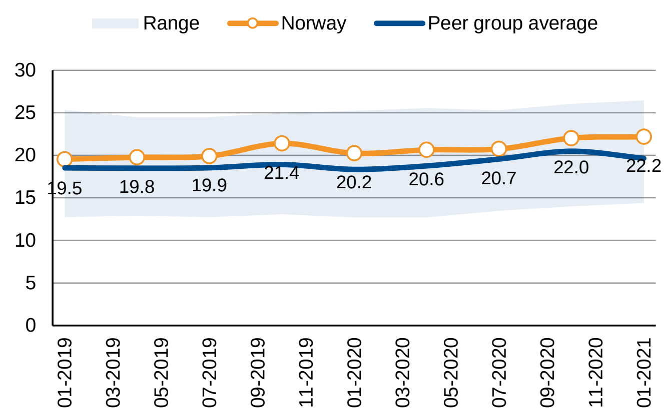
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	High capitalisation & profitability; low non-performing loans
	Banking sector oversight	Neutral	0	Prudent oversight under Norges Bank and the FSA, with the Ministry of Finance responsible for the implementation of macroprudential policy
	Financial imbalances	Weak	-1/3	High household indebtedness, high real estate prices, high interconnectedness in the financial system

NPLs, % of total loans



Source: IMF, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

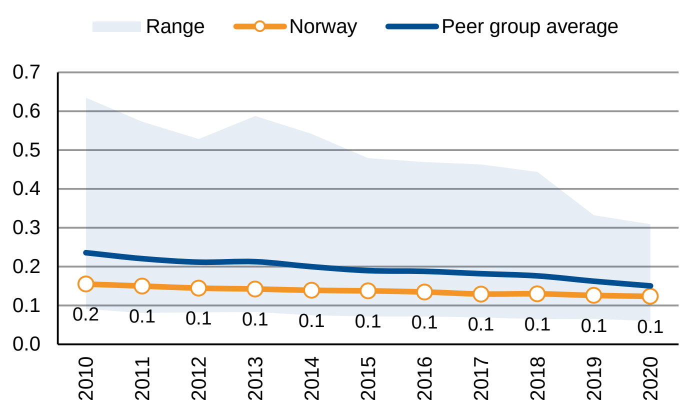
ESG Risks

- **Environment:** Norway remains highly reliant on the oil and gas sector exposing it to long-run transition challenges such as stranded asset risks. The decision to continue oil exploration on the Norwegian shelve had broad political support and the latest licensing round saw continued demand from oil companies with 31 companies filing applications. A faster than expected transition away from fossil fuels in Norway's key export markets increases vulnerability for the sector given the long planning horizons required for exploration activities. However, Norway benefits from low carbon emissions per unit of GDP, low exposure and vulnerability to natural disaster risks, and a low ecological footprint of consumption compared with available biocapacity. The government aims to reach carbon neutrality by 2050. Policies to support this goal include a planned increase of carbon taxes from currently EUR 60 per tonne to EUR 200 by 2030. Several other measures, including subsidies on electric cars and investments in renewable energy, should also support the country's transition.
- **Social:** Norway benefits from low income inequality and high labour force participation. Long-run demographic trends also remain a credit strength, with Norway's old-age dependency ratio forecast to reach 40% by 2050 according to Eurostat, a level similar to that of Sweden and below that of most peers. The country ranked first in the United Nation's 2019 Human Development Index – an indicator predicated on life expectancies, educational achievement and income levels.
- **Governance:** Norway ranks highly on a composite index of six World Bank Worldwide Governance Indicators. Following parliamentary elections in September 2021, the Labour Party candidate Jonas Gahr Støre became the head of a new centre-left coalition minority government, taking over from the previous conservative party-led government which had been in power since 2013. We expect broad policy continuity in Norway's main policy areas, in line with Norway's track record of smooth political transitions.

Overview of Scope's qualitative assessments for Norway's *ESG Risks*

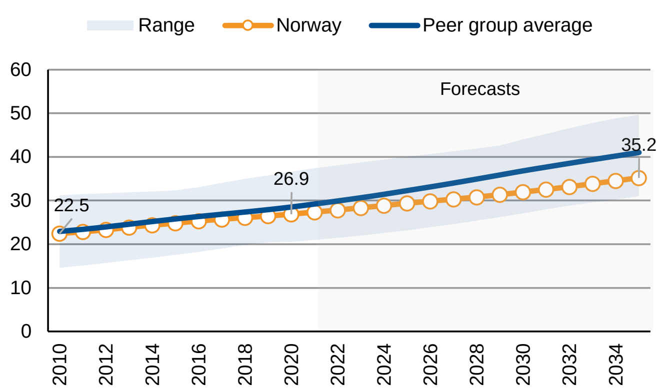
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Environmental risks	Neutral	0	Meaningful but well-managed transition risks to a post-oil economy
	Social risks	Strong	+1/3	Favourable demographics and strong social safety nets, inclusive labour market
	Institutional and political risks	Strong	+1/3	High-quality institutions and stable political environment

CO2 emissions per GDP, mtCO2e



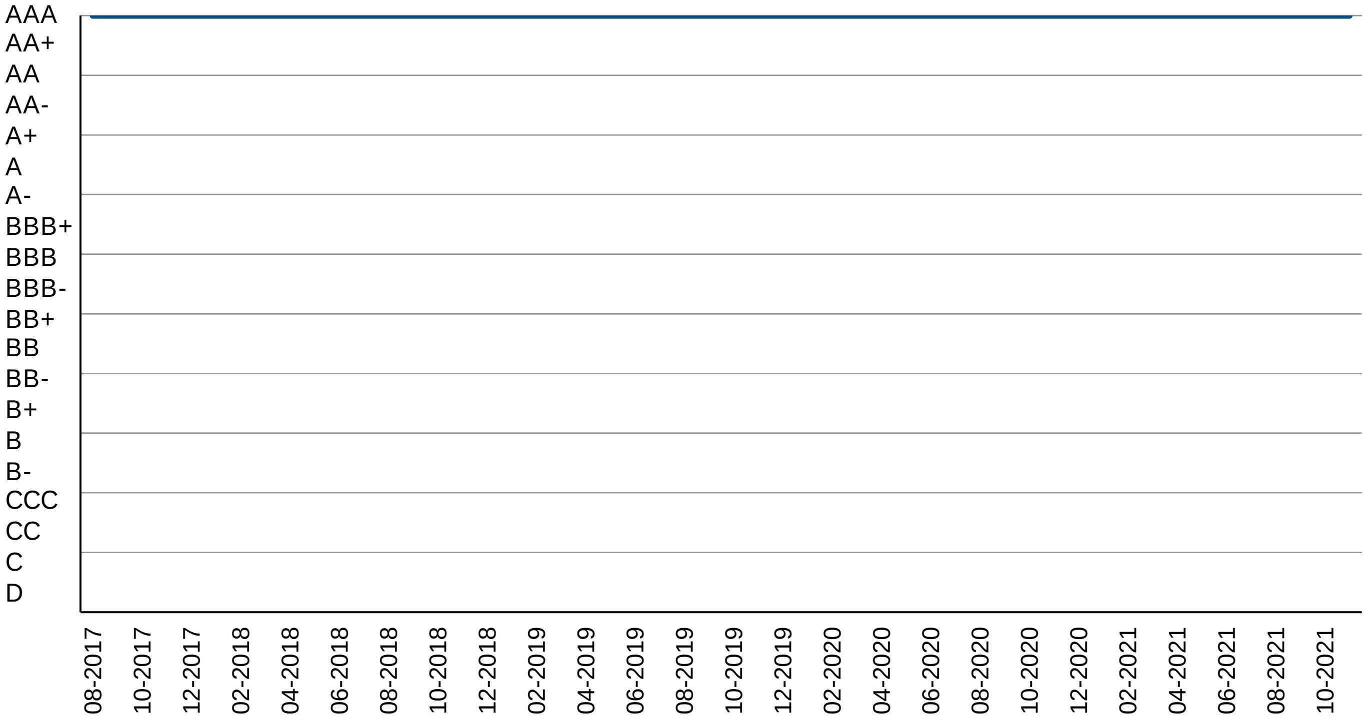
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard.

Peer group
Austria
Denmark
Estonia
Finland
Germany
Ireland
Luxembourg
Netherlands
Norway
Sweden
Switzerland

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021F	2022F
Domestic Economic Risk							
GDP per capita, USD 000s'	70.2	75.3	82.1	75.7	67.3	82.2	84.1
Nominal GDP, USD bn	368.8	398.4	437.0	405.5	362.5	445.5	458.4
Real growth, %[1]	1.1	2.3	1.1	0.9	-0.8	3.0	3.9
CPI inflation, %	3.6	1.9	2.8	2.2	1.3	2.6	2.0
Unemployment rate, %[1]	4.7	4.2	3.9	3.7	4.6	4.2	3.7
Public Finance Risk							
Public debt, % of GDP[1]	38.1	38.6	39.7	40.9	41.4	42.7	42.5
Interest payment, % of government revenue	-4.6	-4.4	-3.8	-3.6	-3.9	-4.6	-4.1
Primary balance, % of GDP[1]	1.5	2.6	5.7	4.3	-8.1	-8.0	-2.0
External Economic Risk							
Current account balance, % of GDP	4.5	5.5	8.0	2.8	2.0	7.2	7.0
Total reserves, months of imports	4.9	5.0	4.4	4.6	6.4	-	-
NIIP, % of GDP	199.6	221.7	183.4	245.9	316.2	-	-
Financial Stability Risk							
NPL ratio, % of total loans	1.2	1.0	0.7	0.8	0.7	-	-
Tier 1 ratio, % of risk weighted assets	19.7	19.4	19.6	21.4	22.0	21.8	-
Credit to private sector, % of GDP	145.8	146.5	143.4	150.6	165.6	-	-
ESG Risk							
CO^2 per EUR 1,000 of GDP, $mtCO^2e$	134.6	129.4	129.9	125.7	123.3	-	-
Income quintile share ratio (S80/S20), x	4.3	4.0	4.1	-	-	-	-
Labour force participation rate, %	78.0	77.2	77.8	78.2	-	-	-
Old age dependency ratio, %	25.3	25.7	26.1	26.4	26.9	27.3	27.8
Composite governance indicator[2]	1.8	1.8	1.8	1.8	1.1	-	-

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: European Commission, IMF, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 12 November 2021	10.1

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