

Short EURNOK

Thesis: Inflows from the Eurozone into Norway will continue to rise as EU energy diversifies away from Russia. More hawkish rates policies, stronger activity, and positive carry also support short EURNOK.

Sanctions, escalations provide continuing energy-related inflows

Both currencies have exposure to Ukraine risks, with escalations driving outflows from both currencies. However, in relation to one another, sanctions should direct euro outflows into the krone.

- Norway is a large exporter of oil, gas, and electric power to Europe. Norway is also the closest, cheapest, and relatively climate-friendly alternative supplier to Russian energy. The EU has recently outlined plans that include rapid diversification towards Norwegian energy before year-end. As the EU doubles-down on new sanctions/diversification from Russia, capex, investment, and payment flows into Norway can be expected to intensify. Utilisation figures show that energy output can still rise short-term. Structurally higher prices will increase inflows per unit, while forced diversification away from Russia will increase quantities of units (Appendix B).
- Norway has had an average CA surplus of 6%/GDP over the past several decades. The surplus has rapidly increased over 2021 (Appendix C). Above developments in the Norwegian energy sector will continue to push this higher, increasing demand for the krone - especially from the Eurozone.

Euro relatively weak on multitude of other factors

Besides aforementioned sanctions risks and conflict flows, the euro extends its losses against the krone because of a relatively dovish ECB, a relative economic slowdown, and French election risks.

- The ECB has pivoted recently, indicating that APP will end sometime in June, after which one hike will follow before the end of 2022. The ECB will have to temper future hawkishness despite elevated regional inflation because of peripheral credit yields and direct, supply-side economic slowdowns due to the conflict. I don't expect a major change to this view from the upcoming ECB meeting.
- Meanwhile, Norges Bank (NB) has already begun its hiking cycle amidst a strong domestic economy (Appendix D, E). Even though global and EU slowdowns will weigh on the Norwegian economy, it will continue to post relative strength because of its much closer trade composition to Russia/Ukraine (Appendix F). Overall, the NB has greater room to continue (and likely intensify) its hiking cycle meanwhile relative economic activity will also support the krone over the euro.
- The anti-EU Le Pen's surge in French election polls solidifies her spot in the second round, where she is within the margin of error. She is still seen as the underdog, but risks have driven the euro down. This will likely be the case at least until the final results on April 24th. Analyst estimates on the impact of Le Pen victory in the first (second & legislative) round indicate a 3.7% (7.8%) weaker euro.

SWE, NB FX purchases

Given the elevated exchange rate, NB last week committed to daily NOK 2bn (\$231.9mn) purchases of FX to be invested abroad via the country's sovereign wealth fund. This marks the first shift from intermittent CB krone purchases since 2013. Norges Bank has said that this is not FX intervention but done on behalf of the state for fiscal reasons. Either way, these purchases will weigh on the currency's strength. But I expect that FX movements will still be dominated by the aforementioned bearish factors in the near-term.

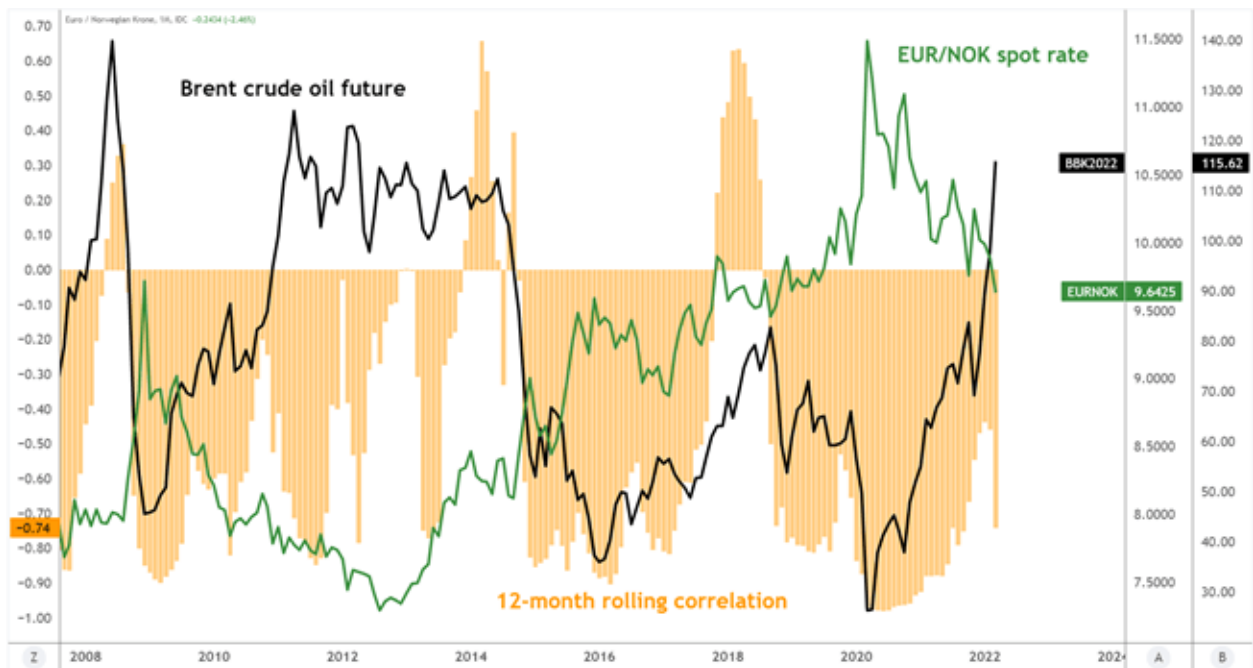
Appendix

A. EURNOK price chart

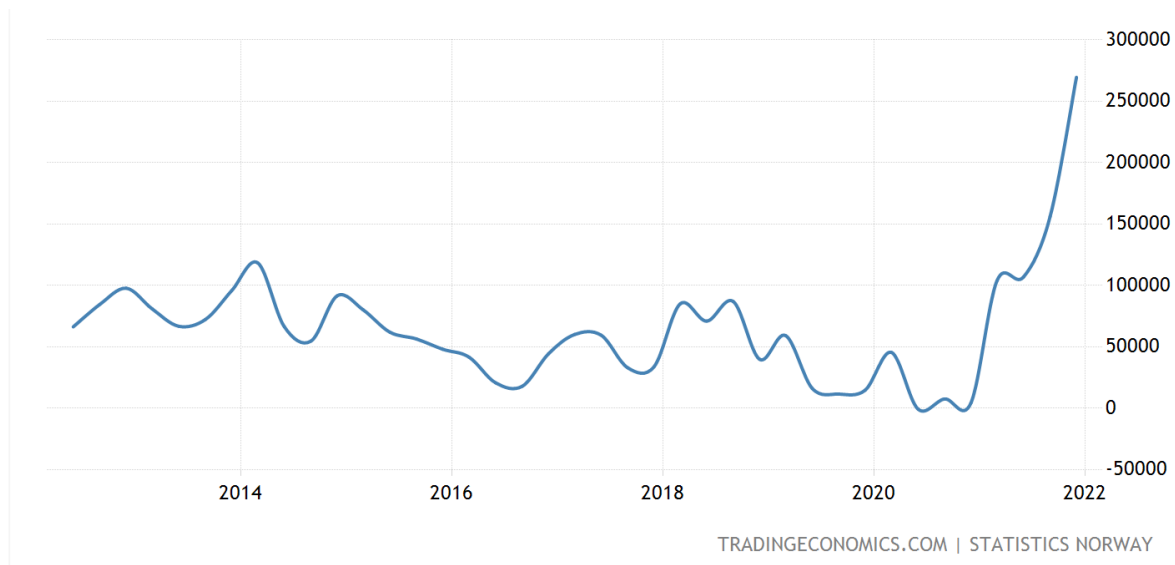


Note: While EURNOK has declined significantly recently, I think that the factors I mentioned provide room for more downside - especially in the near-term until our holding period ends in a couple weeks.

B. Rolling correlation between EURNOK and Brent prices



C. Norwegian current account (latest figure Q4 2021)



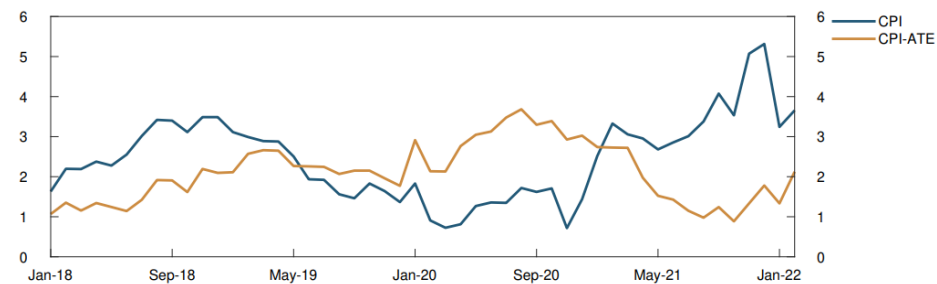
D. Economic & inflation outlooks for EU/Norway

EU	Norway
<p>Eurozone economies have faced significant inflation and headwinds to growth as a result of conflict.</p> <p>GDP growth was cut to 2.9% in 2022. Slower growth was posted on manufacturing PMIs. Consumer sentiment declined on the back of elevated prices owing to the conflict in Ukraine. Sanctions against Russia hit Eurozone growth harder than other regions.</p> <p>Eurozone inflation accelerated to 7.3% in March despite the slowdown in economic activity. Most of this increase was attributable to rising prices for energy, but food prices also contributed to the rise. Eurozone labour markets grew tighter (and more tightness + inflationary pressure can be expected due to the influx of refugees). Wages increases have remained tempered for now, though. Unemployment declined to 6.8% and further declines are expected.</p> <p>Deteriorating growth outlooks paired with mainly supply-side inflation indicates that the ECB may disappoint market expectations of reaching positive rate territory by the end of the year.</p>	<p>After lifting COVID restrictions over the winter, the Norwegian economy began growing faster and additional demand-side inflationary pressures are emerging, encouraging further policy rate hikes.</p> <p>GDP growth, excluding oil and gas production, is expected at 4.1% in 2022, double the long-term trend of ~2%. The unemployment rate fell to 2.1%, the lowest level since 2008, exacerbating existing labour shortages and further contributing to wage increases.</p> <p>Meanwhile, business and real estate activity and investment have remained robust. Housing prices grew faster than 2021 and business investment is expected to grow 5% in 2022, even higher in the energy industry. Inflation figures in chart below.</p> <p>Overall, recent figures surprised to the upside, and the NB hiked rates 25bps further last meeting, after two similar sized hikes at the end of 2021. NB is indicating eight 25bps hikes by 2023-end, with risks to the upside. 50bps hikes were not excluded.</p>

E. Economic figures from Norges Bank

Chart E Rapid rise in underlying inflation

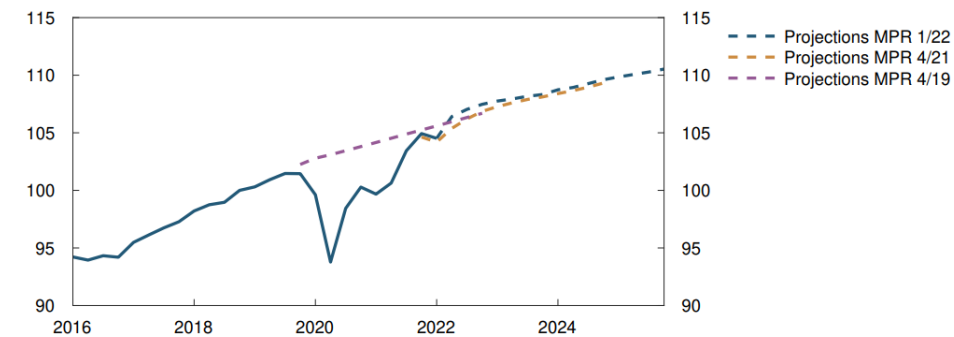
CPI and CPI-ATE. Twelve-month change. Percent



Source: Statistics Norway

Chart 3.3 Marked rise in activity

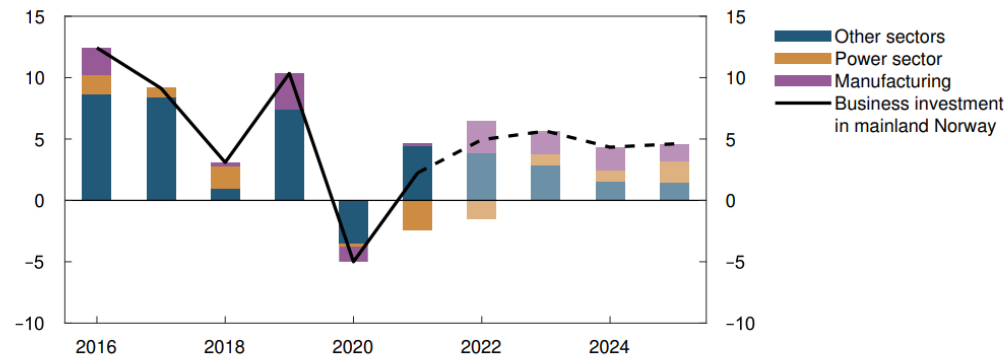
GDP for mainland Norway. Seasonally adjusted. Index. 2018 Q4 = 100



Sources: Statistics Norway and Norges Bank

Chart 3.6 Higher mainland business investment

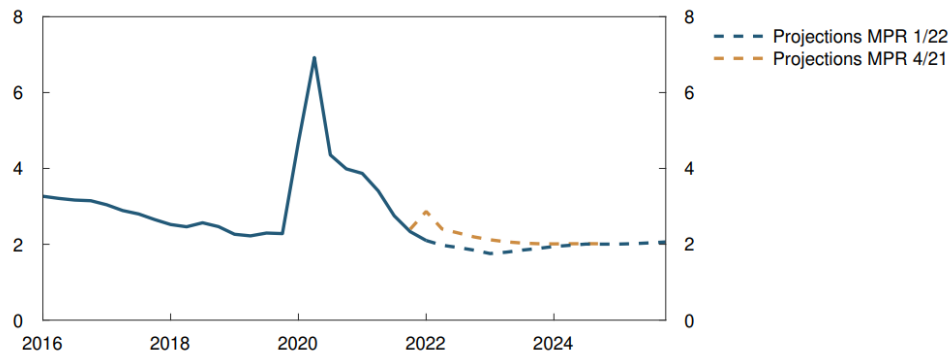
Business investment in mainland Norway. Annual growth. Contribution to annual growth. Percentage points



Sources: Statistics Norway and Norges Bank

Chart 3.12 Unemployment will continue to decline

Registered unemployed as a share of the labour force. Seasonally adjusted. Percent

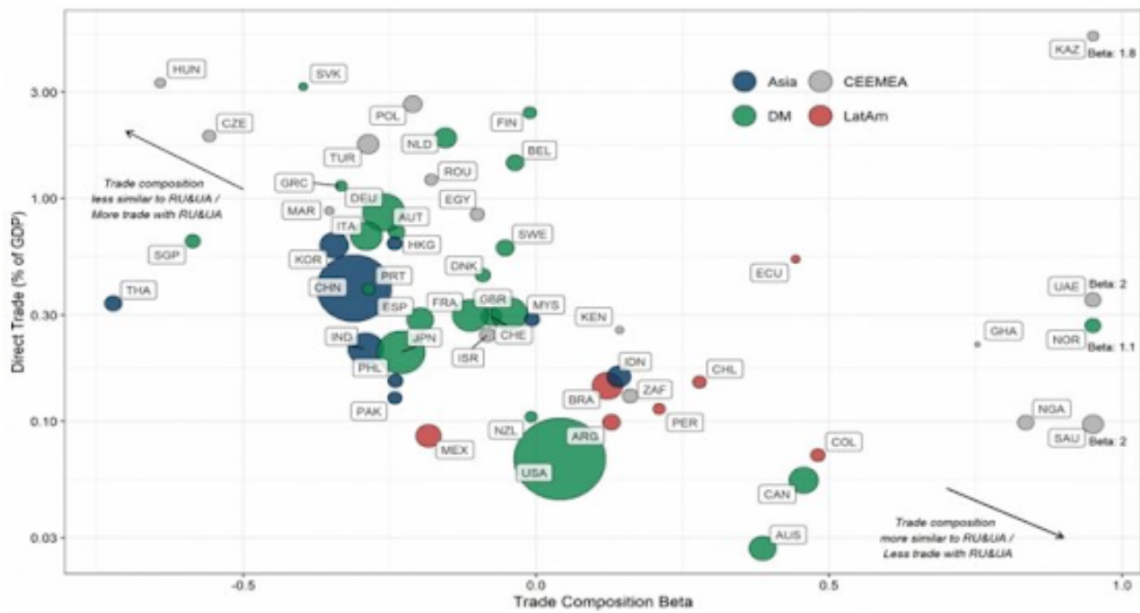


Sources: Norwegian Labour and Welfare Administration (NAV) and Norges Bank

F. Norway, other countries' trade composition comparison to Russia and Ukraine

Exhibit 1: CEE, Turkey and Western European Economies Have Low Trade Composition Betas with Russia and Ukraine, and Have Significant Direct Trade with Russia and Ukraine

Estimated trade composition betas with Russia and Ukraine (x axis); Direct trade with Russia and Ukraine ($(X+M)/(2 \times GDP)$; y log axis)



Source: Haver Analytics, UN Comtrade, Goldman Sachs Global Investment Research

G. Rolling correlation between EURNOK and Brent prices