EBD/86/145

May 12, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Norway - Devaluation of the Norwegian Krone

The Managing Director has received the following communication dated May 12, 1986 from the Norges Bank:

> In view of the deterioration in Norway's competitive position and the recent weakening of the external economy, which have led to strong pressure against the Norwegian krone and substantial losses of foreign reserves, the Norwegian Government has decided, with effect from Monday, May 12, to devalue the krone by changing the central value of the Norwegian exchange rate index from 100 to 112 with a margin of 2 1/4 percent on either side of the central value. The change in the central value of the exchange rate index represents a devaluation of the Norwegian krone of about 10.71 percent in effective terms.
>
> Please inform the Board of Executive Directors about this notification.

The attached copy of the press release issued on May 11, 1986 by the Office of the Prime Minister of Norway is circulated at the request of Mr. Fugmann.

Att: (1)

Other Distribution:
Department Heads

ATTACHMENT

Changes in Economic Policy - Devaluation of the Norwegian Krone

In recent months there has been a strong pressure against the Norwegian krone. The foreign exchange reserves have declined by almost 50 billion kroner since November last year. The background to this is that in the course of the past year a too strong pressure has built up in large sectors of the Norwegian economy, the country's competitive position has weakened year by year for several years in a row, and the external economy showed a strong deterioration even before the fall in oil prices. The drop in oil prices has further exacerbated the problems.

A substantial devaluation of the Norwegian krone has therefore become necessary. The timing of this action has been determined by the wish to avoid further speculation and depletion of the foreign exchange reserves in the period ahead.

The devaluation aims at improving the competitive position and contributing to safeguarding economic balance and employment in the long run. This means that it will become more expensive to import goods, and that it will become easier to sell Norwegian goods abroad at better prices. The devaluation will be underpinned and supported by several other measures. It is of decisive importance that the measures will have a lasting effect. The Government's intention is that compensation for the devaluation shall not be granted during the current and coming incomes negotiations. This will form the basis for the work on the fiscal budget for 1987 and for the incomes which are determined by public transfers. The labor market organizations will be contacted with a view to seeking their cooperation toward ensuring that the devaluation will have the intended effects. The Government will present proposals for limiting tax-free gains from speculation. The tightening of demand and the expected decline in offshore activity will contribute to dampening the income growth for many groups in the private sector which have had an especially strong income growth.

A substantial tightening will take place both in fiscal and credit policy in connection with the presentation of the revised national budget for 1986. This will be followed up in connection with the work on the budget for 1987. For the remainder of 1986 the tightening of fiscal policy is estimated at at least 3 billion kroner, equal to 5-6 billion kroner on an annual basis. In addition, credit policy will be tightened. It is especially necessary to slow down the growth in private consumption both by increasing taxes and by limiting public transfers. The Government will formulate the measures in such a way that the greatest burden will fall on those with high income and wealth. The tightening shall have the strongest effect in those sectors of the country where there is pressure on the labor market and the building sector. At the same time, the Government will pursue a policy stimulating growth and innovation in the business sector in order to make the Norwegian economy less dependent on the oil revenues.

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There are several reasons why the Government has found that the time is ripe for carrying out a devaluation of the Norwegian krone:

1. Unless the economic policy is changed, the fall in oil prices may, according to estimates presented by the previous Government, lead to an external current account deficit of 30 billion kroner in 1986 and 45 billion Kroner in 1987. The Government aims at substantially lower deficits than this.

2. The overall trend in prices, incomes and productivity may lead to a worsening of the competitive position in the three-year period 1985, '86 and '87 of a total of 10 percent. It is not possible to restore economic balance and safeguard employment in the long term unless the competitive position improves.

3. Private consumption increased by more than 8 percent in 1985, more than three times what was forecast in the national budget. This has not only led to a strong growth in imports, but has also contributed to clear pressure tendencies in the Norwegian economy. The pressure increased in the first part of 1986. The devaluation will, together with the further measures, contribute to easing the pressure.

4. In recent months and weeks there has been extensive speculation against the Norwegian krone. The announcements which have been issued have not been sufficient to curbing these speculations. A further postponement of a necessary devaluation may lead to substantial losses for the country. Since the turn of the year Norges Bank has had to sell foreign exchange to such an extent that the foreign exchange holdings have declined from about 100 billion kroner to some 75 billion kroner.

The 12 percent devaluation is assumed to lead to an increase in import prices of about 3 percent in 1986 and 5 percent in 1987. The rise in consumer prices may be about 1 percent and 2 percent, respectively.