Svein Gjedrem: Hearing before the Standing Committee on Finance and Economic Affairs

Introduction by Mr Svein Gjedrem, Governor of Norges Bank (Central Bank of Norway), at a public hearing before the Storting's Standing Committee on Finance and Economic Affairs, together with Mrs Kristin Halvorsen, Minister of Finance, and Mr Bjørn Skogstad Aamo, Director General of The Financial Supervisory Authority of Norway, Oslo, 13 February 2009.

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Government finance fund and government bond fund

The crisis in the banking sector was initially a problem of liquidity. In October and November, there was considerable turbulence and fear was spreading among banks. Credit premiums were high. The situation has improved.

The improvement is to a considerable extent the result of action taken by the authorities. The swap arrangement whereby banks can exchange covered bonds for government paper has been important. The arrangement is oriented towards larger banks, and a number of banks have made use of this facility, in an amount so far totalling more than NOK 70 billion.

Norges Bank has proposed an extension of the arrangement to provide banks with funding at 5-year maturities. Maturities so far have been up to 3 years. The extension is important to ensure that maturity dates do not all fall within a short period.

The arrangement provides banks with Treasury bills. Banks have used these as collateral for loans, sold them or kept them as liquidity reserves. There has been high demand for Treasury bills. However, the Treasury bills have to be exchanged every six months. Norges Bank has proposed that banks be supplied with government bonds at floating rates and a maturity equivalent to the duration of the swap agreement. This may simplify the arrangement.

Norges Bank has also expanded its use of its ordinary instruments. We have supplied additional liquidity through our loan facilities and made arrrangements for banks to furnish a greater range of securities as collateral for the loans. We have also provided loans with longer-than-usual maturities. 89 banks signed up for a two-year fixed rate F-loan, and two days ago 100 banks signed up for a three-year floating rate F-loan. These F-loans are geared to small banks. As shown in the chart, more than half of the bids have been below NOK 100 million.

Norges Bank has also supplied NOK through currency swaps and offered USD loans to Norwegian banks.

In all, these measures have provided banks with good access to short and long-term funding. However, the interbank market is still not functioning satisfactorily.

We have now moved into a phase where the main challenge may be banks' financial strength. This is partly due to the downturn in the global and Norwegian economies, which over time will result in higher losses, but also because higher capital adequacy is now being required in the markets. The same view has been expressed by the Norwegian supervisory authority.

We see that many banks abroad are raising new capital, with or without assistance from the authorities.

But additional equity capital is now very expensive and perhaps also difficult to procure. The alternative for banks may be to hold back on lending. If they do this on a large scale, it will have considerable negative effects on output and employment. It is understandable that credit growth is now slowing, both because demand for credit is lower and because fewer investments are profitable.

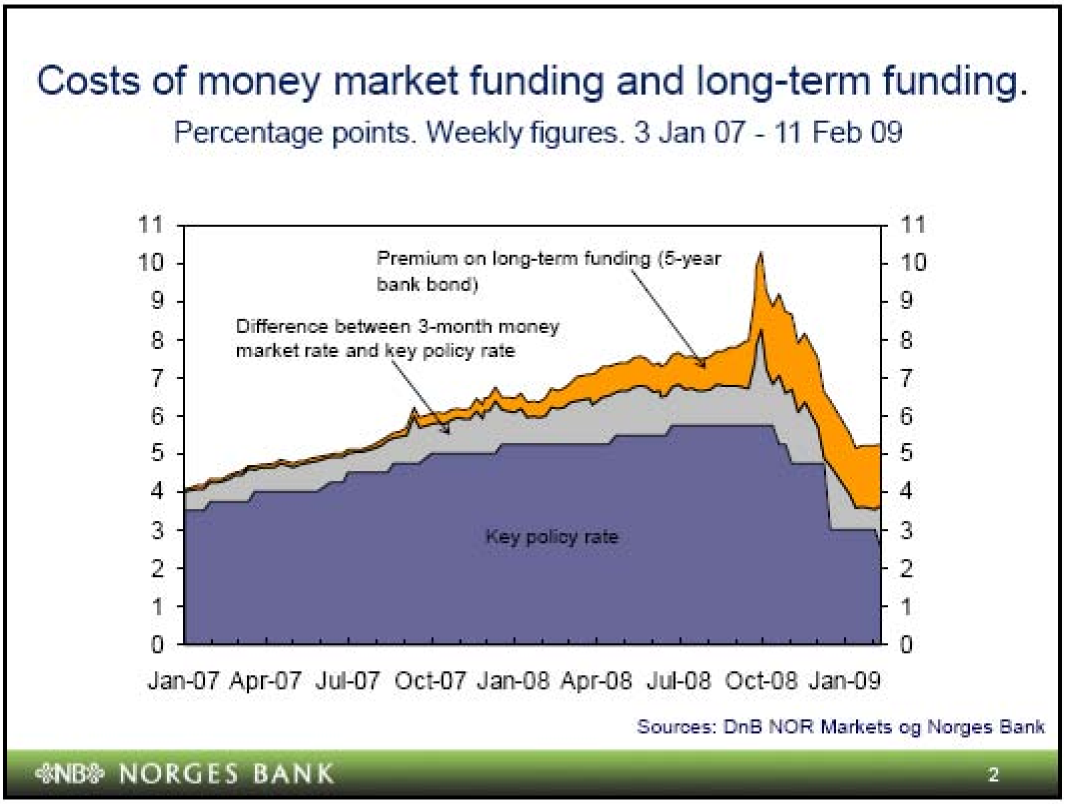
But in addition, it appears that banks are applying stricter criteria in credit assessments and rationing credit. Norges Bank's Survey of Bank Lending shows the banks' own perception of this practice. The chart shows that over the past year banks have reported a tightening of credit standards. It appears that credit flows to households have improved somewhat, but banks are still tightening credit standards for corporate loans.

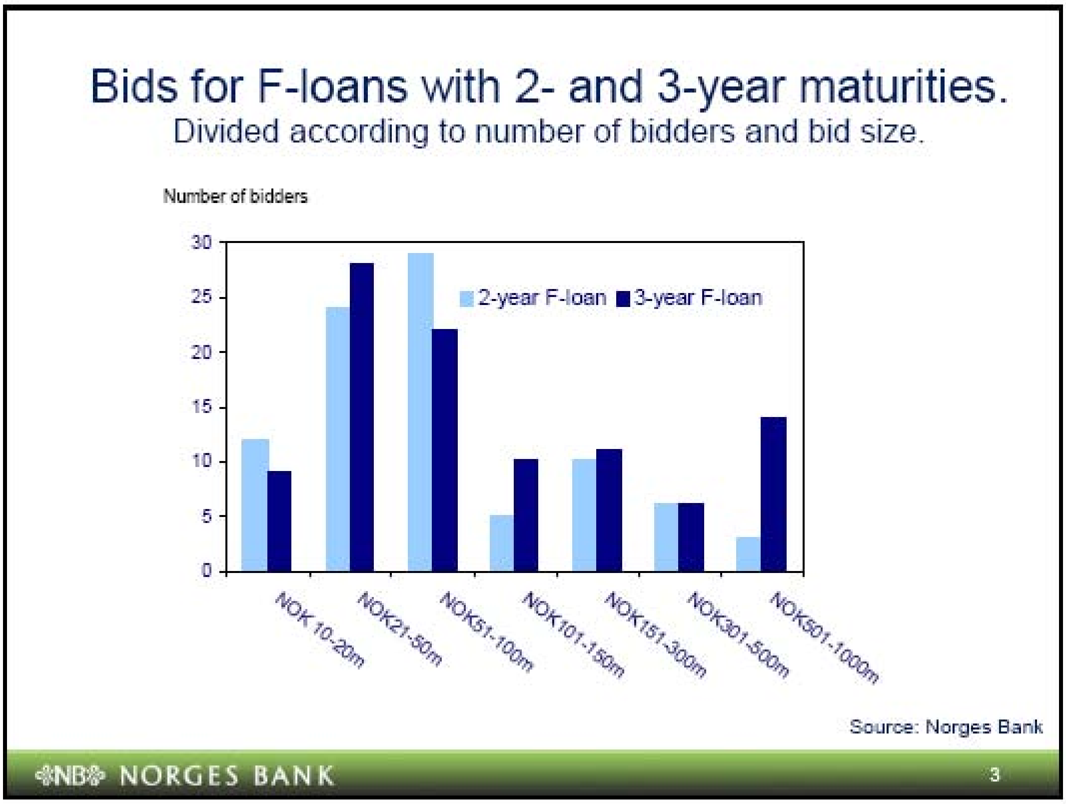
An important lesson to be learned from this economic crisis is that compelling banks to increase their equity capital when the downturn has already started has a considerably negative impact. It is important that banks have sufficient capital to make them resilient even if the downturn should persist over a longer period. For this reason, we have proposed government capital injections in banks.

The government bond fund will buy bank and corporate bonds. In Norges Bank's view, it is particularly important helps to improve demand for corporate bonds. The fund shall primarily buy high quality bonds. The chart shows that it is on the whole borrowers with weaker ratings that are now being excluded.

Norges Bank is nevertheless of the view that higher demand for the best bonds will have a positive effect. This will reduce the pressure on banks, and it may result in a shift in private demand towards bonds with a lower credit rating.

Thank you for your attention.




Bids for F-loans with 2- and 3-year maturities.
Divided according to number of bidders and bid size.
Number of bidders
30
25
20
15
10
5
0
2-year F-loan
3-year F-loan
NOK 10-20m
NOK21-50m
NOK51-100m
NOK101-150m
NOK151-300m
NOK301-500m
NOK501-1000m
Source: Norges Bank
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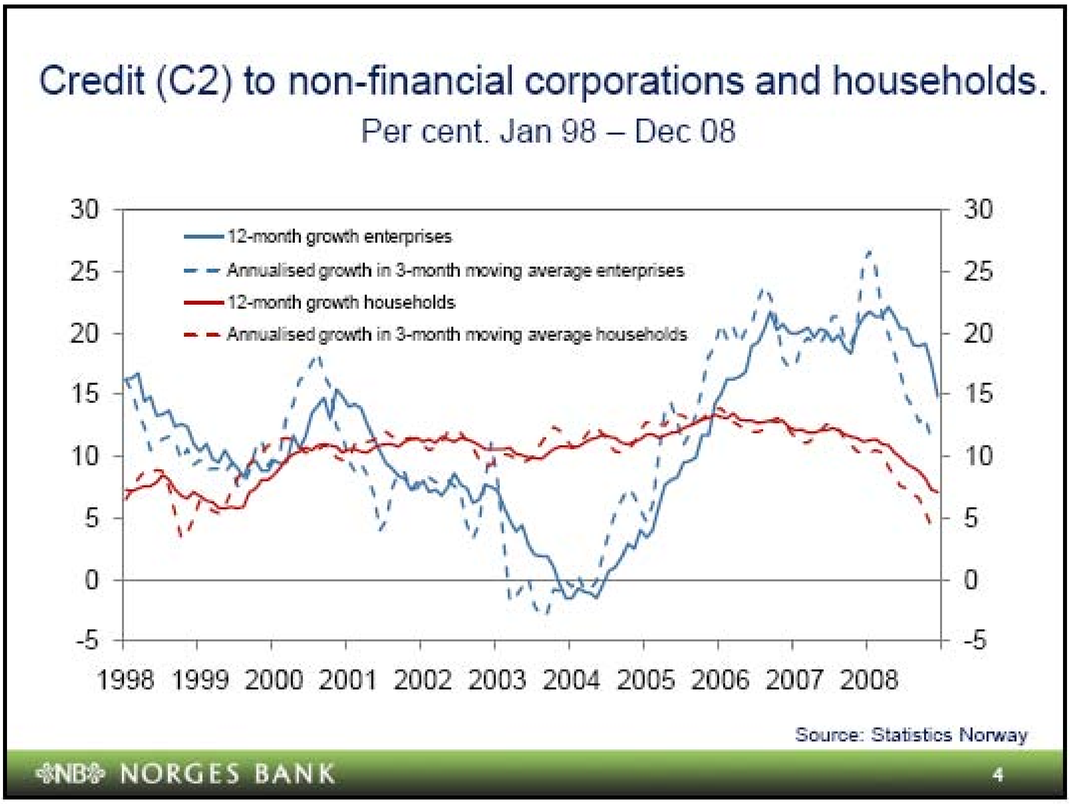
Credit (C2) to non-financial corporations and households.
Per cent. Jan 98 – Dec 08
12-month growth enterprises
Annualised growth in 3-month moving average enterprises
12-month growth households
Annualised growth in 3-month moving average households
30
25
20
15
10
5
0
-5
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
Source: Statistics Norway
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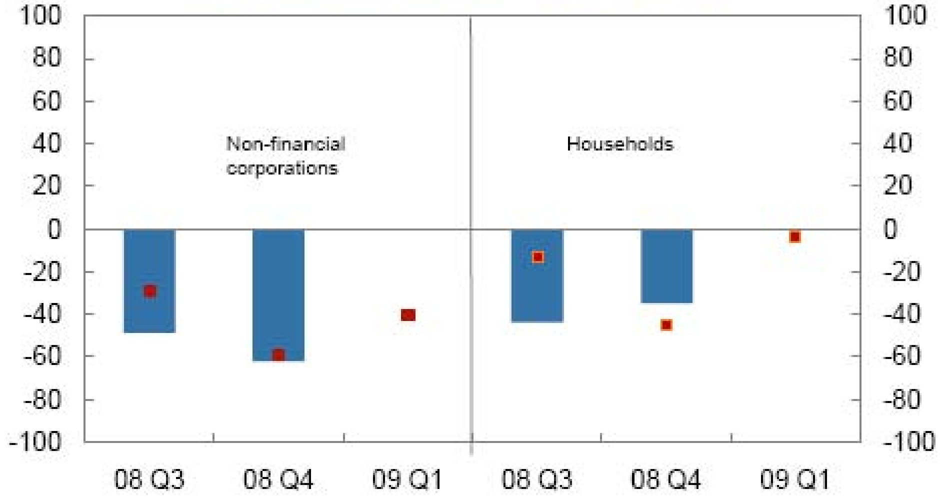
Change in credit standards for approving loans to households and non-financial corporations

Net percentage balances[1]. 08 Q3 – 09 Q1



[1] Net percentage balances are calculated by weighting together the responses to the survey. The blue bars show developments over the last quarter. The red points show expectations over the next quarter. The red points have been moved forward one quarter.

Source: Norges Bank

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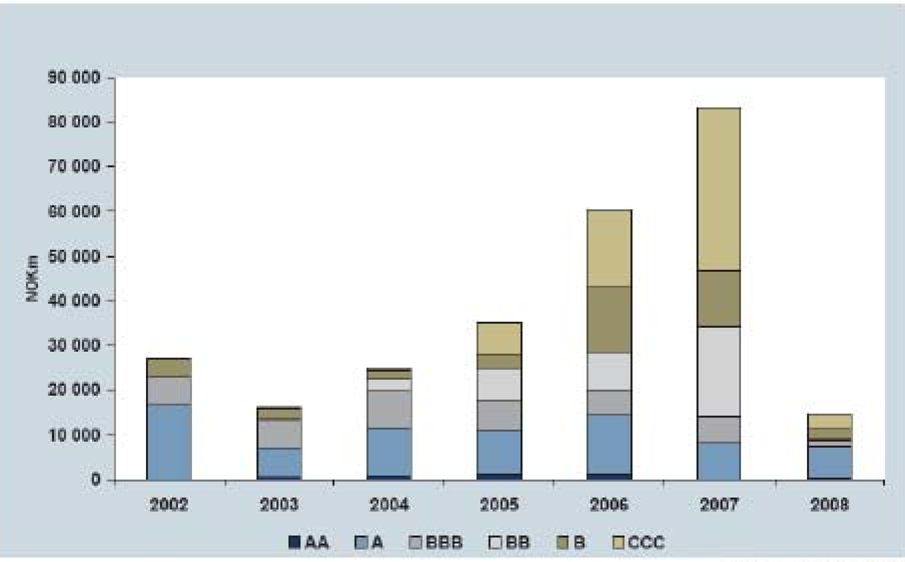
Issued volume of corporate bonds by rating.

Norway. Millions of NOK.



Source: Nordea Markets

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