EXECUTIVE BOARD'S ASSESSMENT

At its meetings on 26 November and 10 December 2014, the Executive Board discussed the monetary policy strategy. The starting point for the discussion was the strategy that the Executive Board adopted at its meeting on 17 September 2014 and the analysis in the September 2014 *Monetary Policy Report*. The analysis in the September 2014 *Report* implied a key policy rate of 1.5% in the period to end-2015, followed by a gradual rise. With this path for the key policy rate, there were prospects that inflation would lie somewhat below, but close to, 2.5% throughout the projection period. Capacity utilisation was projected to edge down in the coming year, but to move up again to close to a normal level thereafter. At the monetary policy meeting on 22 October 2014, the Executive Board decided to leave the key policy rate unchanged at 1.5%. At the same time, the Executive Board pointed out that the uncertainty surrounding the outlook for the Norwegian economy had increased since September.

In its discussions on 26 November and 10 December, the Executive Board placed emphasis on the following developments:

- Growth among Norway's trading partners has been broadly in line with that projected in the September 2014 *Report*. The uncertainty surrounding developments ahead remains elevated, particularly in the euro area.

- Oil prices have fallen sharply. Oil prices have recently hovered around USD 70 per barrel, which is about 35% lower than the average for the first half of 2014.

- Policy rates are close to zero among many of our trading partners. In Sweden, the Riksbank lowered its policy rate by 0.25 percentage point to 0% in October. Market expectations indicate that an interest rate increase abroad has again been pushed further out.

- The krone has depreciated markedly. As measured by the import-weighted krone exchange rate (I-44), the krone has depreciated by more than 7% since the time of the September *Report*.

- Banks' residential mortgage lending rates have been reduced and the lending rate facing households is now slightly lower than envisaged in the September *Report*.

- According to quarterly national accounts figures, the mainland economy grew by a seasonally adjusted 0.4% in Q3. The enterprises in Norges Bank's regional network reported in October that growth in production was fairly moderate and that growth prospects had weakened. The oil supplier industry reported declining activity. Private consumption has been lower than expected and consumer confidence indicators have fallen.

- House prices have risen somewhat more than projected, but the pace of household debt accumulation has been in line with that projected.

- Inflation has been in line with that projected in the September *Report*. Consumer price inflation adjusted for tax changes and excluding energy products (CPI-ATE) was 2.5% in October.

The point of departure for the Executive Board's assessment of monetary policy is that the key policy rate is set with a view to keeping inflation close to 2.5% over time. The objective of low and stable inflation is weighed against the objective of stable developments in output and employment. Monetary policy should be robust. There is uncertainty surrounding economic driving forces and the functioning of the economy. This normally suggests a gradual approach in interest rate setting. In the event of major shocks, it may be appropriate to implement measures to reduce uncertainty and stave off particularly adverse outcomes. It may then be appropriate to pursue a more active monetary policy than normal. A robust monetary policy also takes into account the risk of a build-up of financial imbalances.

Higher capital requirements will strengthen the resilience of banks and can mitigate the risk that imbalances trigger or amplify an economic downturn. If financial imbalances build up, it will be appropriate to assess the level of the countercyclical capital buffer for banks.

The Executive Board noted that the analyses in this *Report* show that the outlook for the Norwegian economy has weakened since September. Oil prices have fallen sharply and activity in the petroleum industry is set to be weaker than projected earlier. Growth in private consumption and business investment are also expected to be lower than projected. At the same time, a weaker krone is contributing to underpinning inflation and to dampening the impact of lower oil prices on the Norwegian economy. The key policy rate forecast is notably lower than projected in September. The analysis in this *Report* suggests that the key policy rate should be lowered and kept at 1¼%, or somewhat lower, in the period towards the end of 2016. With this path for the key policy rate, the analysis suggests that inflation will be somewhat higher than projected earlier and close to 2.5% in the coming years. Mainland capacity utilisation will probably decline to a further extent than projected earlier, but is expected to increase again towards the end of the projection period.

The Executive Board discussed the effects of the sharp drop in oil prices. It was noted that the oil price decline likely reflects increased oil supply, but also lower demand for crude oil owing to slower growth in the world economy. Many oil companies and oil industry suppliers have recently reported staff and cost cutbacks. The sharp fall in oil prices will probably amplify this tendency. It was pointed out that this would engender spillover effects on the mainland economy and that unemployment may edge up ahead. Heightened uncertainty surrounding economic developments may also induce households and businesses to exercise greater caution with regard to consumption and investment decisions. Weaker global oil investment may also curb exports from the oil supplier industry.

Furthermore, it was noted that the Norwegian economy is now becoming more dependent on growth in non-oil sectors to support economic growth in Norway. A weaker krone is helping to improve earnings of Norwegian export companies and Norwegian import-competing industries. As global growth picks up, demand for Norwegian goods and services may also rise.

Economic activity in Norway has remained solid so far and unemployment remains low. Inflation is close to 2.5%. In its assessment of monetary policy in the period ahead, the Executive Board gave weight to the fact that the outlook for the Norwegian economy is notably weaker than envisaged earlier. The depreciation of the krone is likely to underpin inflation. With inflation close to 2.5%, the aim of stable developments in output and employment suggests a lower key policy rate. A lower key policy rate may, in isolation, contribute to keeping the rise in house prices and household debt at a higher rate than household income. On the other hand, oil prices have fallen sharply and the outlook for the Norwegian economy has weakened. The Executive Board attaches importance to countering the risk of a pronounced downturn in the Norwegian economy. An overall assessment of the economic outlook and the balance of risks led the Executive Board to conclude that the key policy rate should be reduced now.

At its meeting on 10 December, the Executive Board decided to reduce the key policy rate by 0.25 percentage point to 1.25%. At the same meeting, the Executive Board decided that the key policy rate should lie in the interval ¾% –1¾% in the period to the publication of the next *Report* on 19 March 2015, unless the Norwegian economy is exposed to new major shocks.

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