

17 December 2008

# New interest rate projections

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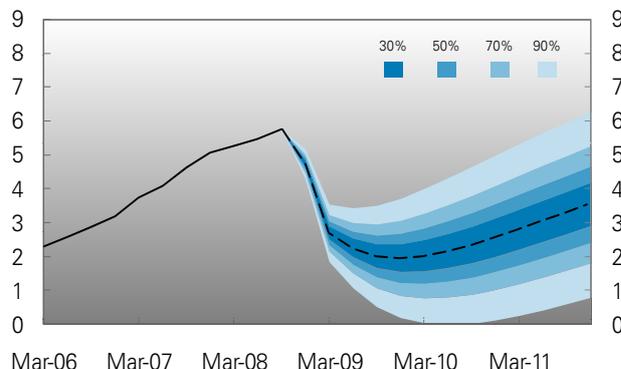
At the monetary policy meeting on 29 October, the Executive Board's strategy was that the key policy rate should be in the interval 4 – 5 per cent in the period to the publication of the next *Monetary Policy Report* on 25 March, unless the Norwegian economy was exposed to new major shocks. The Norwegian economy is now exposed to new major shocks. In the course of November and December, international and domestic growth prospects have weakened considerably. Oil prices and other commodity prices have dropped sharply. An active liquidity policy and the covered bond swap arrangement are dampening the impact, although premiums remain high and liquidity tight in money and credit markets, and it is difficult for the business sector to procure funding. Growing pessimism is weighing down households and firms. Enterprises in Norges Bank's regional network are expecting a fall in production and employment in the next quarters. Inflation is slowing faster than expected, and the risk of inflation becoming too high ahead has been reduced.

Projections for economic growth among our trading partners in 2009 have been revised down by about 1 percentage point compared with the projections in *Monetary Policy Report 3/08*. Interest rate expectations abroad have fallen by an average of about 1 percentage point through the projection period to 2011.

Mainland GDP is now projected to fall in both the fourth quarter of 2008 and the first quarter of 2009. Quarterly growth has been revised down by about ½ percentage point in the fourth quarter of 2008 and by about ¼ percentage point in both the first and second quarters of 2009 compared with the projections in the previous *Report*. Growth projections for petroleum investment have been lowered for both 2009 and 2010. Moreover, it is assumed that fiscal measures will curb the decline in demand.

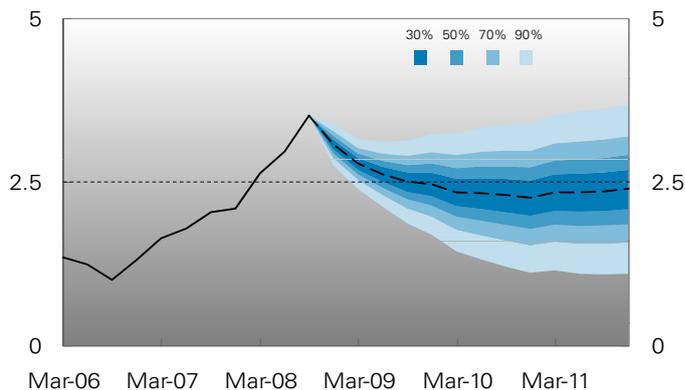
Underlying inflation is now estimated at around 3 per cent, ½ percentage point lower than in September and October. Inflation in the period ahead is expected to remain around ½ percentage point lower than projected in the previous *Report*.

Chart 1 Projected key policy rate as of 17 December 2008 with fan chart. Per cent. 2006 Q1 – 2011 Q4



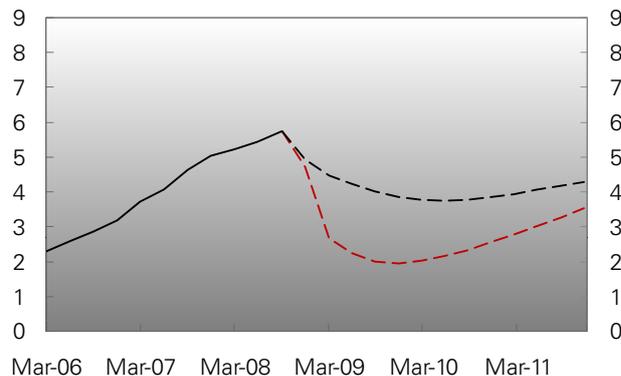
Source: Norges Bank

Chart 2 Projected CPIXE as of 17 December 2008 with fan chart. 4-quarter change. Per cent. 2006 Q1 – 2011 Q4



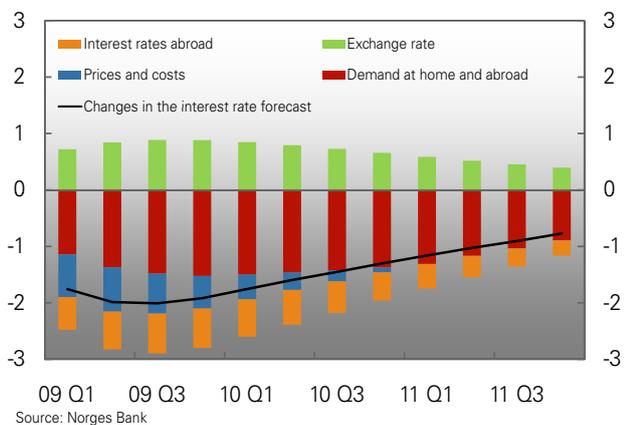
<sup>1)</sup> CPI adjusted for tax changes and excluding temporary changes in energy prices  
Sources: Statistics Norway and Norges Bank

Chart 3 Key policy rate in the baseline scenario in MPR 3/08 (black line) and projected key policy rate as of 17 December 2008 (red line). Per cent. 2006 Q1 – 2011 Q4



Source: Norges Bank

Chart 4 Factors behind changes in the interest rate forecast since MPR 3/08. Accumulated contribution. Percentage points. 2009 Q1 – 2011 Q4



The krone has depreciated further. The import-weighted exchange rate, I-44, is now expected to be 100 in the first quarter of 2009, around 5 per cent weaker than projected in the previous *Report*. The krone is expected to appreciate as financial market conditions improve, but to remain weaker for a longer period than projected in October.

The implications of the new information for interest rate setting have been analysed. The new analysis points towards a considerably lower interest rate than projected in October. New projections for the key rate and CPIXE<sup>1</sup> inflation are shown in Charts 1 and 2. Chart 3 shows the new key rate projections compared with the projections in the previous *Report*. The factors contributing to the change in the interest rate forecast are shown in Chart 4.

1 CPI adjusted for tax changes and excluding temporary changes in energy prices.