

# EXECUTIVE BOARD'S ASSESSMENT

At its meetings on 2 December and 16 December 2015, the Executive Board discussed the monetary policy stance. The starting point for the discussion was the analysis published in the September 2015 *Monetary Policy Report*. The Executive Board decided in September to reduce the key policy rate by 0.25 percentage point to 0.75%. The analysis in the *Report* implied a decline in the key policy rate to just above ½% in 2016. The key policy rate was projected to increase to close to 1% towards the end of the projection period. With this path for the key policy rate, there were prospects that inflation would remain close to 3% in the short term before drifting down to around 2% towards the end of the projection period. Capacity utilisation was projected to decline towards the end of 2016, edging up thereafter. The key policy rate was kept unchanged at the monetary policy meeting on 4 November.

Growth in the world economy remains moderate. There are prospects that growth among Norway's trading partners will gain some momentum ahead, broadly in line with the projection in the September *Report*. Inflation in most advanced economies has been lower than in September, restrained by a further decline in energy prices. Core inflation has remained steady.

Policy rates are close to zero in many countries. Since September, the European Central Bank has further reduced the deposit rate and announced that its asset purchase programme will be extended. Sveriges Riksbank has decided to increase its purchases of government bonds. Markets have priced in a high probability of a rise in the policy rate in the US this December and very gradual rate increases thereafter. The first policy rate rise in the UK is expected in autumn 2016. For Norway's trading partners as a whole, expected policy rates have fallen.

Oil prices have fallen since the September *Report* and have recently been slightly below USD 40 per barrel. Futures prices have also declined.

The krone has depreciated since September and is weaker than envisaged in the September *Report*. The depreciation must be viewed in the context of the decline in oil prices and narrower interest rate differentials against other countries.

Norwegian money market premiums have increased and been somewhat higher than foreseen. Risk premiums on bank bonds have also edged up, but average funding costs in the banking sector to date appear to be little changed.

Growth in the Norwegian economy has so far been in line with the September projections. Overall, Norges Bank's regional network contacts report that output growth has slowed somewhat, and there are signs that the effects of the fall in oil prices and the decline in oil investment are spreading to sectors where growth has so far remained steady. Growth prospects in most industries are weaker than anticipated in the September *Report*. Consumer confidence has continued to fall and there are prospects of moderately weaker growth in private consumption. In addition, lower oil prices may contribute to a somewhat larger fall in oil investment in the years ahead than previously anticipated.

Growth in public consumption and investment is supporting overall growth in the economy. The central government budget for 2016 is based on a structural non-oil deficit equivalent to 7.1% of mainland trend GDP. This is an increase of 0.7 percentage point from 2015, more than assumed in the September *Report*. The rise in the number of asylum-seekers will have an impact on the Norwegian economy in the coming years, initially through higher public consumption and investment. The contribution to labour force growth from the asylum-seekers now arriving in Norway will first occur at a later stage.

While registered unemployment has risen in line with the September projections, LFS unemployment has risen somewhat more. Unemployment is still rising primarily in regions closely linked to the oil industry. The restructuring of the Norwegian economy is likely to take time. Unemployment is expected to edge up further.

Consumer price inflation adjusted for tax changes and excluding energy products (CPI-ATE) is around 3%, approximately as projected in September. The krone depreciation since the September *Report* will likely contribute to somewhat higher inflation in the near term than anticipated earlier.

House price inflation has slowed a little through autumn, approximately as envisaged in September. There are still wide regional differences in house price developments, and in areas closely connected to the oil industry house prices have shown little increase or have fallen. Household credit growth has been slightly lower than expected, but household debt is still rising at a faster pace than income. The reduction in the key policy rate in September seems to have passed through fully to bank lending rates. At the same time, the banks in Norges Bank's lending survey report somewhat tighter credit standards.

The Executive Board notes that the analyses in the *Report* indicate somewhat weaker prospects for growth in the Norwegian economy than in September. The analyses in this *Report* imply a reduction in the key policy rate to somewhat below ½% in 2016. The key policy rate is projected to rise to slightly below 1% towards the end of the projection period. With this path for the key policy rate, inflation is projected to remain close to 3% in the near term before drifting down to around 2% towards the end of the projection period. The inflation projections are based on an assumption that the krone exchange rate will gradually appreciate somewhat and that wage growth will pick up over time. Capacity utilisation in the mainland economy is expected to continue to decline in the period to summer 2017, edging up thereafter.

In its discussions of the monetary policy stance in the near term, the Executive Board gave weight to the fact that developments in the Norwegian economy have so far been broadly in line with the September projections. The effects on the Norwegian economy of the fall in oil prices and the decline in oil investment are gradually becoming evident. There are prospects that growth ahead will be somewhat weaker than anticipated, and unemployment is expected to rise slightly more than previously projected. In isolation, this implies a lower key policy rate.

Uncertainty as to the effects of the monetary policy stance suggests a cautious approach to interest rate setting. Monetary policy is expansionary and is supporting the restructuring of the Norwegian economy. The krone has depreciated and inflation has picked up. A lower key policy rate could increase the risk of a more rapid rise in real estate prices and debt. 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 kept unchanged at this meeting.

At its meeting on 16 December, the Executive Board decided to keep the key policy rate unchanged at 0.75%. The Executive Board's current assessment of the outlook for the Norwegian economy suggests that the key policy rate may be lowered in the first half of 2016.

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