EXECUTIVE BOARD'S ASSESSMENT

At its meetings on 10 March and 16 March 2016, the Executive Board discussed the monetary policy stance. The starting point for the discussion was the analysis published in the December 2015 *Monetary Policy Report*. The Executive Board decided in December to keep the key policy rate unchanged at 0.75%. At the same time, the Executive Board's assessment of the outlook suggested that the key policy rate might be reduced further in the first half of 2016. The analysis in the *Report* implied a decline in the key policy rate to slightly below ½% in 2016. The key policy rate was projected to increase to almost 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 near term before drifting down to around 2% towards the end of the projection period. Capacity utilisation was projected to decline in the period to summer 2017, edging up thereafter.

Growth in the world economy is moderate, with somewhat lower growth prospects for trading partners in the coming years compared with the projections in the December *Report*. Inflation is still very low among Norway's main trading partners.

The beginning of the year was marked by volatility in international financial markets. Stock indices declined in most countries and credit risk premiums increased. At the same time, yields on high-grade government bonds declined. Fears of weaker global growth, particularly in emerging economies, contributed to the volatility. In the past month the volatility has abated and the market impact has partially reversed.

Actual and expected policy rates among trading partners have decreased. The European Central Bank has reduced its deposit rate to -0.4% and the Riksbank in Sweden has cut its policy rate to -0.5%. In the US, the Federal Reserve raised its policy rate in December as expected, but the next increase is now expected to occur later than markets anticipated earlier.

After falling at the start of the year, oil prices are now back at the same level as at the time of the December *Report*, but futures prices have moved down. The krone exchange rate has recently been near the projection in the December *Report*.

Norwegian money market premiums have remained elevated and been higher than assumed. Higher USD funding costs for banks owing to new US money market regulation may contribute to keeping premiums higher than previously expected also in the period ahead. The funding costs facing Norwegian banks have shown little change since December. Banks included in Norges Bank's lending survey reported somewhat tighter credit standards for both households and enterprises in Q4. While lending rates for households seem to have moved in line with that expected in December, new information indicates that banks have increased their margins for enterprises.

New national accounts figures show that growth in the Norwegian economy was lower through 2015 than estimated in the December *Report*. Growth in consumption and private investment was weaker than projected. Overall, the activity level has remained unchanged in recent months according to the contacts in Norges Bank's regional network. Oil service and business service companies report a fall in production, while the other industries report weak growth. Overall, the contacts expect the level of production to remain unchanged the next six months. Consumer confidence has continued to wane and there are slightly weaker prospects for growth in private spending. Oil investment is also expected to show a somewhat more pronounced fall in the years ahead than foreseen earlier.

Unemployment has edged up as expected. The increase in unemployment is largely concentrated in oil regions. Overall employment grew through most of 2015, but there are now signs that employment is levelling off. Unemployment is expected to edge up. There are prospects that wage growth will be lower in 2016 than in 2015.

The rise in consumer prices is a little higher than 3%, which is somewhat higher than projected in the December *Report*. The krone depreciation is underpinning inflation, while weaker price impulses from trading partners and low cost growth in the Norwegian economy are having a dampening impact.

House price inflation has slowed somewhat more than expected in December, with continued wide regional dispersion. Household debt growth has been a little lower than expected. House price inflation and credit growth are both expected to moderate somewhat ahead.

Monetary policy is expansionary and supportive of structural adjustments in the Norwegian economy. The krone has weakened and inflation has moved up. Inflation expectations are well anchored. The Executive Board notes that the analysis in this *Report* implies a decline in the key policy rate to about ¼% at the end of 2016. Towards the end of the projection period, the key policy rate is projected to increase to close to ¾%. With such a path for the key policy rate, the analysis suggests that inflation will stay close to 3% in the near term before gradually falling to between 1½% and 2% in 2019. Capacity utilisation in the mainland economy is expected to decline further in the period to autumn 2017, edging up thereafter. In an economy marked by restructuring, monetary policy cannot fully counteract the effects on output and employment.

The Executive Board discussed the room for manoeuvre in monetary policy. The experience of other countries suggests that the lower bound for the key policy rate is below zero, but it is difficult to provide a precise estimate of the limit. Lower interest rates could increase financial system vulnerabilities. As the key policy rate approaches a lower bound, the uncertainty surrounding the effects of monetary policy increases. This now suggests proceeding with greater caution in interest rate setting. Should the Norwegian economy be exposed to new major shocks, the Executive Board will, however, not exclude the possibility that the key policy rate may turn negative.

In its discussion of monetary policy in the period ahead, the Executive Board gives weight to a somewhat weaker outlook for the Norwegian economy and an expected rise in unemployment. Low wage growth may lead to a slower rise in prices for domestically produced goods and services further ahead. Both the objective of keeping inflation close to target and the consideration relating to capacity utilisation imply a reduction in the key policy rate.

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 by 0.25 percentage point to 0.50%. The Executive Board's current assessment of the outlook suggests that the key policy rate may be reduced further in the course of the year.

At its meeting on 16 March, the Executive Board decided to lower the key policy rate by 0.25 percentage point to 0.50%.

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16 March 2016