EXECUTIVE BOARD'S ASSESSMENT

The analyses in the previous *Monetary Policy Report,* which was published on 22 September 2016, suggested that the key policy rate would remain close to ½% in the coming years. At the same time, the forecast implied a slightly higher probability of a decrease than an increase in the key policy rate in the year ahead. The key policy rate was projected to increase to just below 1% towards the end of the projection period. Inflation was projected to recede to somewhat below 2% in 2019. Capacity utilisation in the mainland economy was assessed to be lower than a normal level, but was expected to increase gradually in the coming years. In September, the Executive Board decided to keep the key policy rate unchanged and indicated that the key policy rate would most likely remain at that level in the period ahead. At the monetary policy meeting on 26 October, the key policy rate was left unchanged.

Growth in the global economy remains moderate, but so far this year growth among Norway's trading partners has been a little stronger than projected in the September *Report*. This primarily reflects robust growth in the UK. The growth projections for Norway's trading partners are little changed, but uncertainty has heightened as a number of US policy issues have yet to be clarified. Inflation is still low among trading partners, but market-based inflation expectations have increased in a number of countries.

The global interest rate level is very low, but policy rate expectations have increased considerably since September. Long-term interest rates have also moved up.

Oil prices have risen in response to the decision by OPEC and several other countries to limit oil production. Prices are now somewhat higher than assumed in the September *Report*. Futures prices have also edged up, but indicate that oil prices will remain close to today's level ahead. The krone has appreciated and is stronger than expected in September.

The premium in the Norwegian money market increased ahead of the entry into force of new US money market regulations in mid-October. The premium was expected to move down following implementation, but has so far shown little change. The premium is expected to decline at a somewhat slower pace than envisaged in September.

A number of banks have increased their mortgage interest rates somewhat in recent months, and interest rates on loans to households are expected to be slightly higher in the coming period than assumed in September. Interest rates on loans to enterprises have also increased somewhat in the past six months.

There are signs that activity in the Norwegian economy is picking up at a somewhat slower pace than projected in September. New national accounts figures show that economic growth is low. Norges Bank's regional network contacts reported in November that output growth had increased slightly, but that it was somewhat weaker than the contacts had envisaged in August. They expect output growth to show a small increase over the next six months. Weaker prospects for petroleum investment in 2017 than anticipated in the September *Report* will contribute to curbing growth next year.

The assumptions in the National Budget for 2017 imply an expansionary fiscal policy also in the years ahead, but indicate that spending of petroleum revenues will be slightly lower than previously assumed.

Unemployment has moved in line with the September projections. Both registered unemployment and unemployment measured by the Labour Force Survey (LFS) are at about the same level as at the time of the September *Report*.

It appears that wage growth will be slightly lower in 2016 than projected in September. Wage growth is likely to pick up somewhat in 2017, but probably to a lesser extent than projected in September, partly reflecting a somewhat slower pick-up in growth in the Norwegian economy. According to Norges Bank's expectations survey, the social partners now expect somewhat lower wage growth in 2017 than they did in autumn.

The twelve-month rise in the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) was 2.6% in November. While the rise in prices for domestically produced goods and services has been broadly in line with projections, prices for imported goods have risen less than projected. Overall, inflation has been lower than projected. The recent appreciation of the krone is expected to push down inflation somewhat faster than envisaged in September.

House price inflation has been high in large parts of the country in recent months, and prices have risen more than projected. Household debt growth has edged up and been higher than expected. Both house prices and household debt are rising faster than disposable income.

The Executive Board notes that the analyses in this *Report* suggest that the key policy rate will remain close to ½% in the coming years. At the same time, the forecast implies a slightly higher probability of a decrease than an increase in the key policy rate in the year ahead. According to the forecast, the key policy rate increases to around 1% at the end of the projection period. The key policy rate forecast is little changed compared with the September *Report*. With this path for the key policy rate, the analyses suggest that inflation will recede in the coming years. Towards the end of the projection period, inflation is projected to lie between 1½% and 2%. The analyses suggest that capacity utilisation will remain close to its current level over the next year, normalising gradually thereafter.

Monetary policy is expansionary and supportive of structural adjustments in the Norwegian economy. In an economy marked by restructuring, monetary policy cannot fully counteract the effects on output and employment. There is room to manoeuvre in interest rate setting, in both directions. Should the Norwegian economy be exposed to new major shocks, the possibility cannot be excluded that the key policy rate may turn negative.

Persistently low interest rates add to vulnerabilities in the financial system. Banking regulation and macroprudential policy measures are the first line of defence against financial instability. In the interest of long-term economic stability, it is nevertheless appropriate to take account of the risk associated with very low interest rates in the conduct of monetary policy. When the key policy rate is close to a lower bound, the uncertainty surrounding the effects of monetary policy is greater than when the interest rate is at a more normal level. This suggests proceeding with greater caution in interest rate setting and reacting somewhat less to news that changes the economic outlook, whether the news pulls in the direction of a lower or higher key policy rate.

In its discussion of monetary policy in the period ahead, the Executive Board gives weight to prospects that inflation will be lower than the inflation target a few years ahead. Moderate wage growth may lead to somewhat lower inflation ahead than projected earlier. At the same time, survey-based inflation expectations a few years ahead appear to be well anchored close to the inflation target. Capacity utilisation is below a normal level and there are prospects that growth in the Norwegian economy will pick up at a slightly slower pace than projected in the September *Report*. Changes in the outlook for inflation and capacity utilisation imply, in isolation, a somewhat lower key policy rate in the coming years. On the other hand, the rapid rise in house prices and household debt has increased the risk of a sharp fall in demand further out. A lower key policy rate increases the risk of a further acceleration in house price inflation and debt accumulation. The risk of a build-up of financial imbalances and the uncertainty surrounding the effects of a lower key policy rate now suggest a cautious approach to interest rate setting.

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 0.50% at this meeting. The Executive Board's current assessment of the outlook suggests that the key policy rate will most likely remain at today's level in the period ahead.

At its meeting on 14 December, the Executive Board decided to keep the key policy rate unchanged at 0.50%.

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