

EXECUTIVE BOARD'S ASSESSMENT

At its meetings on 14 and 21 September 2016, the Executive Board discussed the monetary policy stance. The starting point for the discussion was the analysis published in the June 2016 *Monetary Policy Report*. The Executive Board decided to keep the key policy rate unchanged at 0.50% in June. At the same time, the Executive Board's assessment suggested that the key policy rate might be reduced in the course of the year. The analysis in the *Report* implied a decline in the key policy rate to about ¼% at the end of 2016. The key policy rate was projected to increase to ¾% towards the end of the projection period. With this path for the key policy rate, there were prospects that inflation would recede in the coming years. Inflation was projected to be between 1½% and 2% in 2019. Capacity utilisation in the mainland economy was expected to show a small decline in the period to autumn 2017, edging up thereafter.

Growth in the world economy is moderate. There are prospects that import growth among trading partners will be somewhat lower in the years ahead than foreseen in June. Heightened uncertainty as a result of the UK's vote to leave the EU is expected to dampen growth in the UK. Inflation remains low in most advanced countries, but is projected to move up gradually in the years ahead. Overall, actual and expected policy rates among trading partners have declined slightly since the June *Report* and are at historically low levels.

Oil prices have recently been broadly in line with that envisaged in the June *Report*. Futures prices have shown little change and indicate a very gradual upswing in oil prices. The krone has appreciated and is somewhat stronger than anticipated in June.

The Norwegian money market premium has increased and been higher than expected. Higher prices for banks' US dollar funding, partly as a result of new US money market regulations, may entail a higher-than-anticipated premium also ahead. Banks' lending margins have edged down.

New national accounts figures show that growth in the Norwegian economy has been slightly higher than projected in the June *Report*. In August, Norges Bank's regional network contacts reported increased growth in output and they expect a further increase ahead. There are signs that growth in the Norwegian economy is picking up at a slightly faster pace than projected in June.

Different labour market indicators show divergent developments, but on the whole capacity utilisation appears to be higher than expected. Registered unemployment has declined and been lower than projected. In August, regional network contacts reported slightly higher capacity utilisation. On the other hand, employment has declined and unemployment measured by the Labour Force Survey (LFS) has been slightly higher than projected.

Inflation has been higher than projected in the June *Report*. The twelve-month rise in consumer prices adjusted for tax changes and excluding energy products (CPI-ATE) was 3.3% in August. The krone depreciation in recent years is underpinning inflation. The pass-through from a weaker krone may have been stronger than foreseen. There are prospects that inflation will be higher in the near term than projected in the June *Report*. Inflation expectations remain well anchored and close to the target.

House price inflation has accelerated and been higher than projected. House prices are rising rapidly particularly in Oslo and surrounding areas. Household debt growth has remained stable. High house price inflation may lead to higher debt accumulation and increased household vulnerabilities.

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. The key policy rate is projected to increase to just below 1% towards the end of the projection period. The key policy rate forecast is somewhat higher than in the June *Report*. With this path for the key policy rate, the analyses suggest that inflation will remain somewhat above 2.5% in the year ahead. Inflation will abate as the effects of the krone depreciation dissipate. Inflation is projected to be somewhat below 2% towards the end of the projection period. Capacity utilisation in the mainland economy is assessed to be higher than assumed in the June *Report*, and is projected to increase gradually in the coming years.

Monetary policy is expansionary and supportive of structural adjustments in the Norwegian economy. Nevertheless, 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.

When the key policy rate is close to a lower bound, the uncertainty surrounding the effects of monetary policy increases. 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 the unexpectedly high rate of inflation in recent months. At the same time, there are signs of somewhat stronger economic growth and higher capacity utilisation than foreseen in June. Low interest rates may contribute to a persistently high rate of increase in house prices and increase the vulnerability of the financial system. On the other hand, growth in the Norwegian economy is moderate, and capacity utilisation is below a normal level. As a result of low cost growth and a somewhat stronger krone, inflation is likely to recede further ahead. 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 21 September, the Executive Board decided to keep the key policy rate unchanged at 0.50%.

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21 September 2016