EXECUTIVE BOARD'S ASSESSMENT

At its meetings on 4 June and 18 June 2014, the Executive Board discussed the monetary policy strategy. The starting point for the discussion was the strategy that the Executive Board adopted at its meeting on 26 March 2014 and the analysis in the March 2014 *Monetary Policy Report*. The strategy suggested that the key policy rate should be in the interval 1%–2% in the period to 19 June 2014, unless the Norwegian economy was exposed to new major shocks. The analysis in the March 2014 *Monetary Policy Report* implied a key policy rate of 1.5% in the period to summer 2015, followed by a gradual rise. With this path for the key policy rate, there were prospects that inflation would lie somewhat below, but close to, 2.5% throughout the projection period. Capacity utilisation was projected to edge down in the coming year, but to edge up again towards the end of the projection period to close to a normal level.

In its discussion at the meeting on 7 May 2014, the Executive Board placed emphasis on the fact that growth among trading partners had been broadly in line with expectations, but that the expected increase in interest rates had again been pushed further out. In Norway, new information indicated that economic developments were broadly in line with projections. House prices had moved up again after falling in autumn 2013. At the same time, bank loan and deposit rates for households and enterprises had been reduced a little. Consumer price inflation was approximately as projected. The Executive Board decided to keep the key policy rate unchanged at 1.5%.

In its discussion on 4 June and 18 June, the Executive Board placed emphasis on the following developments:

- Growth among Norway's trading partners remains moderate. Growth has slackened in emerging economies, while there are signs of a gradual improvement in many advanced economies. Growth for trading partners as a whole is projected to move up from 1¼% in 2013 to 2¼% in 2014, rising further to 2½% in the coming years. The prospects for growth abroad remain broadly unchanged on the March *Report*.

- Policy rates are close to zero in many countries. Market expectations concerning policy rates are lower than expected in March, primarily reflecting lower interest rate expectations for the euro area and Sweden.

- The krone, as measured by the import-weighted (I-44) exchange rate, has been slightly stronger than projected in the March *Report*.

- Banks have lowered lending and deposit rates for households and enterprises, giving rise to the prospect of a lower average lending rate in the next quarters than expected in the March *Report*. Interest rates on loans to households and enterprises are still considerably higher than the key policy rate.

- Growth in the Norwegian economy has been broadly in line with that projected. In May, Norges Bank's regional network reported that output growth remained moderate, but that growth had edged up since February. Household confidence indicators have improved, and growth in private consumption is expected to be higher than projected earlier. On the other hand, there are prospects that growth in business investment and petroleum investment may be lower than expected. Registered unemployment has risen a little. Capacity utilisation in the mainland economy has likely edged down, but is still assessed to be close to a normal level.

- After falling through autumn 2013, house prices have picked up again in recent months and to a somewhat further extent than projected earlier. Household debt has continued to expand.

- Inflation has been slightly higher than projected. Consumer price inflation adjusted for tax changes and excluding energy products (CPI-ATE) was 2.3% in May. Underlying inflation is projected to continue to run between 2% and 2½%. The wage increases negotiated in this year's wage settlements are in line with the projection for annual wage growth of 3½% in the March *Report*.

The point of departure for the Executive Board's assessment of monetary policy is that the key policy rate is set with a view to keeping inflation close to 2.5% over time. The objective of low and stable inflation is weighed against the objective of stable developments in output and employment. Monetary policy should also be robust. There is uncertainty surrounding economic driving forces and the functioning of the economy. This normally suggests a gradual approach in interest rate setting. Monetary policy also takes into account the risk of a build-up of financial imbalances.

Higher capital requirements will strengthen the resilience of banks and can mitigate the risk that imbalances trigger or amplify an economic downturn. If financial imbalances build up, it will be appropriate to assess the level of the countercyclical capital buffer for banks.

The Executive Board noted that the analyses in this *Report* imply a key policy rate at about today's level in the period to end-2015, followed by a gradual rise. The key policy rate forecast is lower than in the March 2014 *Report*. With this path for the key policy rate, the analysis in this *Report* implies that inflation will be somewhat below, but close to, 2.5% throughout the projection period. Capacity utilisation may edge down in the coming year, but is expected to increase somewhat again to close to a normal level towards the end of the projection period.

The Executive Board pointed out that the expected increase in interest rates abroad has been pushed further out and that the krone has appreciated since March. The European Central Bank has lowered its policy rate and market expectations point to further rate cuts by Sveriges Riksbank. Changes in monetary policy expectations abroad may influence the krone and hence the prospects for inflation and activity in Norway.

The Executive Board discussed recent developments in the housing market, noting that it is uncertain whether the rise in house prices through spring represented a catch-up after the decline in autumn 2013 or whether increased household optimism could lead to higher growth in consumption and a continued rise in house prices.

The Executive Board also noted that the latest investment intentions survey for the petroleum industry now indicates a decline in 2015. Experience shows that the projections are shrouded in uncertainty. A sharp fall in petroleum investment may weaken growth prospects for the Norwegian economy. The krone may then also depreciate.

In its assessment of monetary policy in the coming period, the Executive Board gave weight to the fact that global and domestic economic developments have largely been in line with expectations, but growth prospects for the Norwegian economy may be somewhat weaker than previously projected. Both the objective of keeping inflation close to 2.5% and the objective of sustaining capacity utilisation in the years ahead could in isolation imply a somewhat lower key policy rate. A lower key policy rate today may, on the other hand, increase the risk that financial imbalances build up again. Moreover, the Executive Board gave weight to the uncertainty surrounding the current situation and the functioning of the economy. Robustness considerations imply proceeding with caution in interest rate setting. The Executive Board's overall assessment is that the key policy rate should remain at today's level in the coming period. A further weakening of the outlook for the Norwegian economy may warrant a reduction in the key policy rate.

At its meeting on 18 June, the Executive Board decided to keep the key policy rate unchanged at 1.5%. At the same meeting, the Executive Board decided that the key policy rate should be in the interval 1%-2% in the period to the publication of the next *Report* on 18 September 2014, unless the Norwegian economy is exposed to new major shocks.

Øystein Olsen
Oslo 19 June 2014