

Monetary Policy Meeting, 10 May 2012

## New information since the March *Monetary Policy Report* (1/12)<sup>1</sup>

### International economy

- Overall, economic developments among trading partners have been broadly as projected in the March *Monetary Policy Report* (1/12). Higher activity in several emerging market economies has contributed to improving global developments since the beginning of 2012. On the other hand, in many European countries, growth is low or slowing, and the persistent euro area sovereign debt crisis has again fuelled uncertainty. The situation in Spain and developments in Greece following the parliamentary election are of particular concern.
- In *World Economic Outlook*, which was published in April, the IMF forecasts that global economic growth will be 3.5 percent in 2012. This is an upward revision of 0.2 percentage point from the January forecast. The IMF assesses global growth prospects as somewhat brighter, but warned in particular against the overall impact of many countries carrying out extensive fiscal austerity at the same time.
- The twelve-month rise in consumer prices among Norway's main trading partners has edged down since peaking in September 2011. In recent months, underlying inflation has remained approximately unchanged among trading partners as a whole.
- Among most of Norway's trading partners, long-term and short-term inflation expectations are somewhat lower than at the time of publication of the March 2012 *Report*, while short-term inflation expectations in the UK are approximately unchanged.

### Financial markets

#### Equities and commodities

- Equity markets have declined since the *March Report*. In Europe, the Stoxx 600 index has fallen by around 7 percent. The equity index for European financial institutions has fallen by about 15 percent.
- Oil prices<sup>2</sup> have declined by 10 percent and are now USD 115 per barrel.

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<sup>1</sup> All figures are changes since 14 March 2012, unless otherwise specified. All market data are as at 8 May 2012

- *The Economist* weekly commodity-price index measured in XDR<sup>3</sup> is approximately unchanged.

## Interest rates

- The yield on 10-year Spanish government bonds has risen by nearly 70 basis points, while the corresponding Italian government bond yield has increased by nearly 60 basis points. The yield on 10-year Greek government bonds has risen by close to 500 basis points, while the yield on 10-year Portuguese government bonds has fallen by close to 250 basis points.
- Long-term US and German government bond yields remain very low, having fallen further since the *March Report*. Norwegian long-term government bond yields have also moved down.
- International money market rates have edged down since the *March Report*. Short-term key rate expectations are broadly unchanged. This means that international money market risk premiums have declined somewhat.
- In Norway, both money market rates and short-term key rate expectations have fallen since the *March Report*. So far in the second quarter, the risk premium in three-month NIBOR has shown little change and has been approximately as projected.
- The interest rate differential between Norway and trading partners narrowed at the time the *March Report* was published. The differential has since widened a little again and is now around 1.3 percentage points, as measured by the three-month money market rate. The expected interest rate differential ahead has also widened slightly again since mid-March.
- Market participants expect that central bank interest rates will be kept low for a long period ahead. For most of the major currencies, interest rates are expected to remain unchanged over the next twelve months. In some countries, a cut in the key rate is expected in the course of 2013.
- According to figures from Norsk Familieøkonomi, the weighted average interest rate on new residential mortgages<sup>4</sup> is 3.86 percent, a decrease of 0.16 percentage point since the *March Report*.
- Risk premiums for Italian covered bonds are unchanged since the *March Report*, while risk premiums for Spanish covered bonds have increased by 0.5 percentage point.
- Average CDS prices for European financial institutions, as measured by the iTraxx index<sup>5</sup>, have risen by 55 basis points. The European sovereign CDS index<sup>6</sup> is approximately unchanged.

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<sup>2</sup> Average for the past five trading days

<sup>3</sup> Special drawing rights, IMF. As at 8 May, XDR 1 = NOK 8.95

<sup>4</sup> New variable-rate residential mortgages of NOK 1 million, within 60 percent of the purchase price

## Exchange rates

- The effective exchange rates of the US dollar (USD) and euro (EUR) have depreciated by 1.5 and 1.8 percent, respectively. Pound sterling (GBP) has appreciated by 3.3 percent to its strongest level since August 2009. The Japanese yen (JPY) has appreciated by 5 percent.
- The Australian dollar (AUD) has depreciated by 4.7 percent. The Reserve Bank of Australia lowered the cash rate by 50 basis points at its monetary policy meeting on 1 May, which led to a weaker exchange rate. The New Zealand dollar (NZD) has depreciated by 3.8 percent, while the Canadian dollar (CAD) has depreciated by 1.2 percent. Speculation that Canada will be the first among the G7 countries to begin reversing a very expansionary monetary policy has curbed the CAD depreciation.
- The effective krone exchange rate measured by the I-44 has remained relatively stable in recent weeks, averaging 87.3 so far in the second quarter. This is somewhat weaker than projected in the *March Report*.

## Norwegian economy

### Prices

- In the year to April 2012, the consumer price index (CPI) rose by 0.3 percent.
- Adjusted for tax changes and excluding temporary changes in energy prices (CPIXE), consumer prices rose by 0.6 percent in April, down from 1.3 percent in March. Inflation adjusted for tax changes and excluding energy products (CPI-ATE) was 0.7 percent in April. Other indicators of underlying inflation were between 1.1 and 1.7 percent. Inflation in April was approximately as projected in the *March 2012 Report*.

### Output and demand

- Seasonally adjusted household spending on goods rose by 1.6 percent from February to March, after rising by 0.7 percent the previous month.
- Opinion's Consumer Confidence Index (CCI) showed an increase in April for the fourth consecutive month. The index rose from 8.3 in March to 9.4 in April. The level in April was above the average for the index since May 2007.
- According to building statistics, housing starts measured in square metres were 6.5 percent lower in the period between January and March than in the previous three-month period, adjusted for seasonal variations. At the end of

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<sup>5</sup> The iTraxx financial index contains the CDS spreads of 25 major European financial institutions.

<sup>6</sup> The European sovereign CDS index has been reconfigured since the *March Report*. Cyprus has replaced Greece, which was removed from the index. This readjustment took place around the time of the previous monetary policy meeting. The change has therefore been measured as from 20 March 2012.

March, 40 632 dwellings were under construction. In the period between January and March, 5 234 dwellings were completed, while in the same period in 2011, 5 153 dwellings were completed.

- Seasonally adjusted manufacturing output increased by 0.4 per cent in the first quarter, compared with the fourth quarter of 2011. Working-day adjusted manufacturing output fell by 0.8 percent in the year to March 2012.
- Adjusted for seasonal patterns, the Norwegian PMI (Purchasing Managers Index) rose from February to March, but fell from 59.3 in March to 53.7 in April. The indices for employment and new orders contributed the most to the decline in April.
- The enterprises included in Statistics Norway's business tendency survey for manufacturing and mining reported higher output and employment in the first quarter. Orders in the domestic market rose, while export orders were broadly unchanged. The composite economic indicator for manufacturing rose from 6 in the fourth quarter of 2011 to 9 in the first quarter of 2012. Enterprises expect an increase in output, employment and order intake in the current quarter.
- Information obtained from a limited sample of Norges Bank's regional network contracts indicates somewhat stronger output growth than enterprises envisaged in January. The overall market outlook also appears to have improved slightly since January.
- In the government accounts for 2011, the structural non-oil deficit is estimated at NOK 94 billion, NOK 5 billion lower than in the final budget. The deficit is estimated at 3.1 percent of the Government Pension Fund Global.

### **Labour market and wages**

- Registered unemployment stood at a seasonally adjusted 2.5 percent of the labour force in April, up from 2.4 percent in March.
- According to Statistics Norway's Labour Force Survey (LFS), seasonally adjusted unemployment was 3.2 percent of the labour force in February. Employment increased by 6 000 and the labour force by 3 000 from January to February.
- Wage settlements for 2012 have begun, with the Norwegian United Federation of Trade Unions and the Federation of Norwegian Industries reaching an agreement following mediation. The Technical Reporting Committee on Income Settlements has estimated the carryover for this group at 1.3 percent, and the centralised wage negotiations resulted in an overall pay increase of approximately 0.85 percent.

## **Domestic credit and house prices**

- Gross domestic debt in the private and municipal sector (C2) rose by 7.0 percent in the year to February 2012, up from a year-on-year rise of 6.9 percent in January. Household debt increased by 7.3 percent in February, up from 7.2 percent in January. Debt growth for non-financial corporations was 6.4 percent in February, up from 5.8 percent in January.
- According to house price statistics from the real estate industry, house prices increased by 8.5 percent in the year to April 2012. The twelve-month rise was 6.9 percent in March. Seasonally adjusted, house prices rose by 0.9 percent between March and April, after rising by 0.6 percent the previous month.