

Meeting 14 December 2011

## New information since the October Monetary Policy Report (3/11)<sup>1</sup>

### International economy

- The turbulence in financial markets is still ongoing and has spread across more countries and markets. The situation in the euro area has deteriorated. At the same time, weaker export demand and increased financial market uncertainty are now also affecting several emerging market economies in Asia and central and eastern Europe.
- At the EU summit on 8 and 9 December, European leaders agreed to strengthen fiscal policy coordination, including the introduction of stricter rules for correcting excessive fiscal deficits. The rules will be adopted through a new international agreement among euro area countries and the other EU member states wishing to take part in the process. This agreement is to be signed by no later than March 2012.
- According to preliminary figures, GDP growth from the second to the third quarter for Norway's main trading partners was 0.5 per cent. This is somewhat stronger than projected in the October 2011 *Monetary Policy Report*. Growth was particularly strong in Sweden, but GDP growth also picked up in the US and the UK in the third quarter.
- Current economic indicators suggest markedly weaker growth in the euro area in the coming quarters. There are also signs of low growth in most of the other advanced countries. At the end of November, the OECD revised down its growth forecast for the OECD area from 2.8 to 1.6 per cent in 2012.
- The year-on-year rise in consumer prices remains high among many of Norway's trading partners. There are signs that inflation is headed down. For the OECD area as a whole, year-on-year inflation fell from 3.3 per cent in September to 3.2 per cent in October. In the euro area, underlying inflation has remained approximately unchanged in the past months, while it has continued to drift up in the US and the UK. In Sweden, underlying inflation has slowed markedly.
- Long-term inflation expectations have fallen among most of Norway's trading partners. In the UK, short-term inflation expectations have also receded somewhat since the October *Report*.

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<sup>1</sup> All figures are changes since 19 October 2011 unless otherwise specified. All market data are as at 12 December 2011

## Financial markets

### Equities and commodities

- Oil prices have declined somewhat and are now just below USD 110 per barrel.
- *The Economist* weekly commodity-price index has decreased by 3 per cent in XDR<sup>2</sup> terms.
- Gold prices have risen by 3 per cent.
- Equity markets have been volatile, but most international stock market indices are approximately unchanged since the October *Report*.

### Interest rates

- On 30 November, the Federal Reserve, the ECB, the Bank of Japan, the Bank of England, the Swiss National Bank and the Bank of Canada agreed to reduce the interest rate on dollar liquidity swap lines for banks.
- In November, the ECB reduced its key rate by 0.25 percentage point to 1.25 per cent. At the monetary policy meeting in December the key rate was lowered a further 0.25 percentage point to 1 per cent. At the same time, the ECB announced refinancing operations with a maturity of three years. The reserve requirement was reduced from 2 to 1 per cent, and bank collateral eligibility criteria for credit operations were relaxed.
- A lower key rate and more surplus liquidity in the euro area have pushed down the short-term money market rate (EONIA).
- Market participants expect that central bank interest rates will be kept low for a long period ahead. For most of the major currencies, no interest rate increases are expected over the next twelve months. In some countries, a cut in the key rate is expected in the course of 2012.
- With the exception of EONIA rates, most short-term international money market rates have risen. The increase is due to higher risk premiums.
- In Norway, the spread between three-month money market rates and the expected key policy rate (the premium) has risen by approximately 0.2 percentage point since the October *Report*. So far in the fourth quarter, the premium has been considerably higher than assumed in October.
- The interest rate differential against trading partners, as measured by the three-month money market rate, has remained unchanged since October, at around 1.6 percentage points.
- Higher money market premiums and increased risk premiums on bonds have increased the cost of wholesale funding for Norwegian banks, particularly for longer maturities.

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<sup>2</sup> Special drawing rights, IMF. As at 12 December, XDR 1 = NOK 9.00

- According to figures from Norsk Familieøkonomi, the weighted average interest rate on new residential mortgages<sup>3</sup> is 4.0 per cent, an increase of 0.13 percentage point since the October *Report*.
- Long-term US and German government bond yields have shown wide fluctuations. Yields on US ten-year government bonds have fallen somewhat, while they remain approximately unchanged for German government bonds. Norwegian long-term government bond yields have fallen.
- Italian, Spanish and Belgian government bond yields have shown considerable volatility. They rose markedly during most of November, but have recently fallen back. Overall, ten-year government bond yields for these countries have risen since the October *Report*. The spread over German ten-year government bond yields is now 4.5, 3.8 and 2.5 percentage points, respectively. Portuguese and Irish government bond yields have also risen. The spread over German ten-year government bond yields is 11 and 6.7 percentage points, respectively<sup>4</sup>.
- The risk premium for Spanish and Italian covered bonds in particular has increased since the October *Report* by 0.6 and 0.9 percentage point, respectively, to 3.5 and 3.9 percentage points.
- Average CDS prices for European financial institutions, as measured by the iTraxx index<sup>5</sup> have risen by approximately 80 basis points.

### **Exchange rates**

- The effective exchange rate of the US dollar (USD) has appreciated by 2.3 per cent, while the euro (EUR) has depreciated by 2.7 per cent.
- The Japanese yen (JPY) appreciated early in the period following the October *Report*, but depreciated after the Bank of Japan intervened in the foreign exchange market at the end of October. Over the period as a whole, the Japanese yen exchange rate has remained approximately unchanged.
- Commodity currencies, such as the Canadian (CAD) and New Zealand dollar (NZD) have depreciated. The Australian dollar (AUD) has remained approximately unchanged.
- The effective krone exchange rate as measured by the I-44 has depreciated somewhat. Measured by the I-44, the krone exchange rate was on average 87.7 in the fourth quarter. This is slightly stronger than projected in October.

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<sup>3</sup> New variable-rate residential mortgages of NOK 1 million, within 60 per cent of the purchase price

<sup>4</sup> Nine-year government bond yield for Ireland

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

## Norwegian economy

### Prices

- In the year to November 2011, the consumer price index (CPI) rose by 1.2 per cent. This is 0.4 percentage point lower than projected in the *October Report*, primarily reflecting lower-than-expected electricity prices.
- Adjusted for tax changes and excluding temporary changes in energy prices (CPIXE), consumer prices rose by 1.0 per cent in November, down from 1.2 per cent in October. This is 0.1 percentage point lower than projected in the *October Report*. Inflation adjusted for tax changes and excluding energy products (CPI-ATE) was 1.0 per cent in November, 0.1 percentage point lower than projected. Other indicators of underlying inflation were between 1.3 and 1.9 per cent in November.
- In November, the enterprises in Norges Bank's regional network reported moderate price increases over the past 12 months. For the first time since April 2009, enterprises expect a lower rise in prices.

### Output and demand

- According to quarterly national accounts, mainland GDP grew by a seasonally-adjusted 0.8 per cent between the second and the third quarter. This was 0.2 percentage point lower than projected in the *October Report*. Excluding the power sector, mainland GDP increased by 0.6 per cent. Growth in petroleum investment was solid, while private consumption and mainland business investment were relatively weak.
- According to the quarterly national accounts, the volume of traditional exports increased by a seasonally adjusted 0.7 per cent between the second and third quarter of 2011. Total merchandise imports increased by 0.7 per cent in the same period.
- Household spending on goods, adjusted for seasonal variations, fell by 0.2 per cent between September and October, after declining by 0.5 per cent in September. Car purchases showed the largest fall.
- Opinion's Consumer Confidence Index (CCI) fell from -1.9 in October to -2.9 in November after falling considerably the previous month. Between October and November, all subindices except for savings registered a decline in consumer confidence.
- TNS Gallup's trend indicator, which measures households' assessments and expectations concerning their financial situation and the Norwegian economy, fell from a seasonally adjusted 18.6 to 9.7 between the third and fourth quarter of 2011. The trend indicator is now well below its historical average, and is at its lowest level since the second quarter of 2009. The subcomponents for the Norwegian economy the past year and next year fell the most.

- Figures from institutional sector accounts show that household nominal disposable income was 6.0 per cent higher in the last four quarters to the third quarter of this year compared with the same period one year earlier. The household saving ratio, excluding dividend income, was 5.1 per cent in the last four quarters to the third quarter of 2011. In the main revision of the national accounts, the household saving ratio, excluding dividend income, was revised down from 5.3 per cent to 3.6 per cent in 2010.
- According to building statistics, housing starts measured in square metres were 5 per cent lower in the period between August and October than in the period between May and July, adjusted for seasonal variations. Nevertheless, other building starts in the period between August and October were 21 per cent higher than in the same period in 2010. Other building starts were 5 per cent higher in the period between August and October than in the period between May and July.
- Manufacturing output fell by a seasonally adjusted 0.8 per cent between September and October, after rising by 0.9 per cent in the previous month. Working-day adjusted manufacturing output rose by 0.7 per cent in the year to October 2011.
- The Norwegian PMI (Purchasing Managers Index) fell from 50.2 in October to 48.6 in November, adjusted for seasonal variations. This is the lowest index value recorded since December 2009. All subindices fell in November, with the exception of the subindex for output.
- According to Statistics Norway's investment intentions survey, investment in manufacturing, mining and electricity is estimated at NOK 37.4 billion in 2011. This is 9 per cent higher than the corresponding estimate for 2010 and actual investment for the previous year. The estimate for 2012 is 3 per cent higher than the corresponding estimate for 2011.
- According to Statistics Norway's investment intentions survey for the petroleum sector, the value of petroleum investment is estimated at NOK 152.6 billion in 2011. This is 15 per cent higher than the corresponding estimate for 2010 and 22 per cent higher than actual investment for the previous year. The estimate for 2012 is 22 per cent higher than the corresponding estimate for 2011.
- In November, the enterprises in Norges Bank's regional network reported that output growth had edged down since September. Contacts expected even slightly lower growth ahead.

### **Fiscal policy**

- In the Final Budget Bill for 2011, the structural, non-oil deficit is estimated at NOK 99 billion in 2011, i.e. a downward revision of NOK 9.8 billion compared with that projected in the National Budget for 2012. The estimate for the non-oil deficit is reduced by NOK 22 billion to NOK 84.2 billion.

### **Labour market and wages**

- Registered unemployment was a seasonally adjusted 2.6 per cent of the labour force in November, unchanged on October. In November, registered unemployment was in line with the projection in the October *Report*.
- According to Statistics Norway's labour force survey (LFS), unemployment was 3.3 per cent in the period between August and October, up from 3.2 per cent in the period between July and September. Employment increased by 1 000 and the labour force by 4 000 in the same period.
- According to the enterprises in Norges Bank's regional network, employment growth was slightly higher in autumn than through summer. The enterprises in the network expect somewhat lower growth ahead.
- In November, regional network contacts expected annual wage growth of 3¾ per cent in 2012.

### **Domestic credit and house prices**

- Gross domestic debt in the private and municipal sector (C2) rose by 6.8 per cent in the year to October 2011, up from twelve-month growth of 6.7 per cent in September. Debt growth for non-financial corporations was 4.7 per cent in the year to October 2011, up from twelve-month growth of 4.4 per cent in September. Household debt rose by 7.2 per cent in October, unchanged on the twelve-month rate of growth in September and August.
- According to house price statistics from the real estate industry, house prices increased by 8.5 per cent in the year to November 2011, down from a twelve-month rise of 9.1 per cent in October. In November, real house prices, deflated by the CPI, were a seasonally adjusted 7.3 per cent higher than the previous peak in June 2007.