EXECUTIVE BOARD'S ASSESSMENT

At its meetings on 12 March and 26 March 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 4 December 2013, which suggested that the key policy rate should be in the interval 1%–2% in the period to 27 March 2014, unless the Norwegian economy was exposed to new major shocks. The analysis in the *Monetary Policy Report* published on 5 December 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 move up to close to 2½% towards the end of the projection period and that capacity utilisation would remain close to a normal level.

At its meeting on 12 February 2014, the Executive Board discussed topics relevant to the March 2014 *Monetary Policy Report*, including factors that may explain developments in household saving.

In its discussion on 12 March and 26 March, the Executive Board placed emphasis on the following developments:

- Growth among our trading partners remains moderate. On the whole, global growth prospects are broadly in line with earlier projections.
- Policy rates are close to zero in many countries and market expectations concerning policy rates are slightly lower than at the time of the December *Report*. The Swedish central bank lowered its policy rate to 0.75% in December.
- The Norwegian krone depreciated until the beginning of February, but has since appreciated again. On average, the krone has been somewhat weaker than projected in the December *Report*.
- Bank interest rates on housing loans and loans to enterprises remained approximately unchanged in 2013 Q4.
- Growth in the Norwegian economy remains moderate and is in line with the projections in the December *Report*. In February, the enterprises in Norges Bank's regional network reported that output growth was broadly unchanged from October and that they expected that growth might pick up slightly in the period ahead. Growth in petroleum investment is expected to slow markedly as from 2014 and may turn out to be lower than previously assumed. Developments in housing investment may also turn out to be slightly weaker than previously projected. Unemployment has remained approximately unchanged.
- House prices have remained approximately unchanged in recent months and are now somewhat higher than projected in the December *Report*. Growth in household debt has edged down.
- Wage growth in 2013 was 3.9%, somewhat higher than projected in the *December* Report. Consumer price inflation has been marginally higher than projected. Consumer price inflation adjusted for tax changes and excluding energy products (CPI-ATE) was 2.4% in February.

In its discussion of the outlook for developments in the Norwegian and global economy, the Executive Board discussed the pronounced depreciation of the krone through 2013. The depreciation of the krone was considerably more pronounced than the decrease in the interest rate differential against Norway's trading partners would imply. Various factors were discussed that may have been behind these developments. Recently, the krone has appreciated somewhat again. In the discussion it was noted that developments in the krone ahead are uncertain and that foreign-exchange market themes shift rapidly.

Growth in the Norwegian economy slowed over the past year. It was pointed out that the Norwegian economy is now becoming more dependent on growth in sectors other than the petroleum industry. Mainland exports may gradually rise as growth abroad picks up, but the high domestic cost level makes it more challenging for Norwegian firms to fully benefit from the upturn among Norway's trading partners.

Growth in private consumption has been moderate and the saving ratio has risen to a high level. High debt burdens and uncertainty surrounding economic developments, tighter bank credit standards, demographic changes and the pension reform have probably contributed to the increase in household saving. Some of these factors may contribute to a further increase in the saving ratio and low growth in private consumption ahead. At the same time, the saving ratio is now historically high, which may imply that the saving ratio will gradually level off or edge down.

The Executive Board noted that inflation has risen and discussed to what extent the depreciation of the krone through 2013 is affecting consumer prices. At the same time, there is uncertainty surrounding wage growth ahead. Wage growth in 2013 was higher than expected, but a high cost level and an ample supply of labour may contribute to holding down wage growth ahead.

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.

Policy rates for many of our trading partners are close to zero. In Norway, the key policy rate has been 1.5% since March 2012. The interest rates facing households and enterprises are higher. Underlying inflation is now estimated at between 2% and 2½%. Capacity utilisation is likely close to a normal level.

The Executive Board noted that developments since the time of publication of the December *Report* have on the whole been in line with the projections in that *Report* and that the interest rate forecast remains broadly unchanged. The analyses continue to imply a key policy rate at today's level in the period to summer 2015, followed by a gradual rise. With this path for the key policy rate, the analysis in this *Report* implies that inflation will be somewhat below, but close to, 2½% throughout the projection period. Capacity utilisation may edge down in the coming year, but is expected to edge up again towards the end of the projection period to close to a normal level.

In its discussion of monetary policy in the coming period, the Executive Board gave weight to the moderate pace of growth in the Norwegian economy and prospects for somewhat lower capacity utilisation ahead. Inflation is now close to 2.5%, but the driving forces behind inflation further out remain moderate. 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. House price inflation has slowed in the past year, but household debt is still growing faster than income. A lower key policy rate may increase the risk of a renewed acceleration in house prices and debt and a further build-up of financial imbalances. This may increase the risk that financial imbalances further out will trigger or amplify an economic downturn. The Executive Board also gave weight to the uncertainty surrounding economic driving forces and the functioning of the economy, and was of the view that this implies 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.

At its meeting on 26 March, 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 19 June 2014, unless the Norwegian economy is exposed to new major shocks.

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