EXECUTIVE BOARD'S ASSESSMENT

At its meetings on 4 March and 18 March 2015, 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 10 December 2014 and the analysis in the December 2014 *Monetary Policy Report*. The Executive Board decided to reduce the key policy rate by 0.25 percentage point to 1.25% in December. The analysis in the December *Report* implied a key policy rate of 1¼% or somewhat lower in the period to end-2016. With this path for the key policy rate, there were prospects that inflation would lie close to 2.5% in the coming years. Capacity utilisation in the mainland economy was projected to decline in the coming year, but to edge up again thereafter.

In its discussions on 4 March and 18 March, the Executive Board placed emphasis on the following developments:

- Growth among Norway's trading partners remains moderate and has been broadly in line with that projected. Growth in emerging economies has slowed, but there are signs of a gradual improvement in a number of advanced economies.

- Consumer price inflation is low among most of Norway's trading partners and is close to zero in many countries.

- Market expectations concerning foreign policy rates are lower than in the December *Report*. Long-term interest rates have continued to decline. Several foreign central banks have further eased monetary policy. In Sweden, the Riksbank lowered its policy rate to -0.1% and at the same time announced purchases of government bonds. The European Central Bank (ECB) has expanded its asset purchase programme to include government bonds. In Denmark, the Nationalbank reduced the interest rate on certificates of deposit to -0.75%.

- In January, oil prices fell to their lowest level since 2008, but have since edged up. Recently, oil prices have hovered around USD 55 per barrel, which is some USD 15 below that anticipated in December. Futures prices have also declined.

- The krone has depreciated since the December *Report*. So far in Q1, the krone exchange rate has on average been approximately 3% weaker than that projected in December.

- Growth in the Norwegian economy was somewhat stronger in 2014 Q4 than projected in December, while growth in the preceding quarters was revised down. In January, the contacts in Norges Bank's regional network reported that output growth was slowing. Activity in the oil service industry has declined further, but the other sectors report continued growth. In the period ahead, network contacts expect growth to slacken further. Registered unemployment has so far remained stable and is slightly lower than expected.

- Banks have lowered their residential mortgage rates by a little more than ¼ percentage point. House prices are still rising at a fast pace and are somewhat higher than projected in December. The rate of household debt accumulation has been slightly lower than that projected, but debt continues to rise faster than household income.

- Wage growth was 3.1% in 2014, which is lower than that projected in the December *Report*.

- Consumer price inflation adjusted for tax changes and excluding energy products (CPI-ATE) was 2.4% in February, slightly lower than that projected in the December *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. 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 seeks to be robust. In the event of major shocks, this may imply a more active monetary policy than normal. A robust monetary policy also takes into account the risk of a build-up of financial imbalances.

The Executive Board noted that the analyses in this *Report* show a weaker outlook for the Norwegian economy than in December. Oil prices have continued to fall, and activity in the petroleum industry appears to be declining to a further extent than previously assumed. Wage growth in 2014 proved to be lower than projected and there are expectations that wages will also increase somewhat less than previously projected. This will eventually result in a weaker rise in prices for domestically produced goods and services. Lower interest rates abroad also pull in the direction of lower interest rates in Norway. The analysis suggests a key policy rate of approximately 1% in the coming years, followed by a gradual increase. The path for the key policy rate is lower throughout the projection period than the path projected in the December *Report*. With this path for the key policy rate, the analysis in this *Report* suggests that inflation will increase somewhat in the coming quarters before edging down and lie slightly above 2% later in the projection period. Capacity utilisation in the mainland economy is assessed as being lower than what may be regarded as a normal level and is projected to decline further. Towards the end of the projection period, capacity utilisation is expected to rise to a more normal level.

The Executive Board discussed the effects of lower oil prices on the Norwegian economy. Lower oil prices will result in weaker developments in the mainland economy, but it will likely take time before the full impact becomes evident. A flexible labour market appears to be limiting the rise in unemployment and unemployment has so far only shown a slight increase. The krone exchange rate has been affected by changes in the oil price. The depreciation of the krone will contribute to underpinning inflation in the coming period and dampen the impact of lower oil prices on the Norwegian economy.

The Executive Board also discussed the consequences of low foreign interest rates for the Norwegian economy. Low foreign interest rates influence developments in the krone and hence inflation prospects and are also contributing to keeping interest rates low in Norway. Low interest rates may increase the pressure in the housing market. High house price inflation in turn pushes up debt growth.

In its discussion of monetary policy in the period ahead, the Executive Board gave weight to the fact that developments in the Norwegian economy so far have been broadly as expected, even though the outlook is slightly weaker than in December. The krone depreciation lifts inflation in the short term. The forces driving inflation further ahead are weaker. Both the objective of keeping inflation close to target and the objective of sustaining capacity utilisation in the years ahead imply a lower key policy rate. The key policy rate was reduced in December to counter the risk of a pronounced downturn in the Norwegian economy on account of lower oil prices. However, the effects of the fall in oil prices on the real economy have so far been relatively small. At the same time, house prices are still rising rapidly. This may increase household vulnerability and may trigger or amplify an economic downturn further ahead. An overall assessment led the Executive Board to conclude that the key policy rate now should be kept unchanged. If developments in the economy ahead prove to be broadly as projected, there are prospects that the key policy rate will be lowered.

At its meeting on 18 March, the Executive Board decided to keep the key policy rate unchanged at 1.25%. At the same meeting, the Executive Board decided that the key policy rate should lie in the interval ½%–1½% in the period to the publication of the next *Report* on 18 June, unless the Norwegian economy is exposed to new major shocks.

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18 March 2015