EXECUTIVE BOARD'S ASSESSMENT

At its meetings on 8 and 22 June 2016, the Executive Board discussed the monetary policy stance. The starting point for the discussion was the analysis published in the March 2016 *Monetary Policy Report*. The Executive Board decided to reduce the key policy rate by 0.25 percentage point to 0.50% in March. At the same time, the Executive Board's assessment of the outlook suggested that the key policy rate might be reduced further in the course of the year. The analysis in the *Report* implied a decline in the key policy rate to about ¼% at the end of 2016. The key policy rate was projected to increase to close to ¾% towards the end of the projection period. With this path for the key policy rate, there were prospects that inflation would remain close to 3% in the near term before gradually falling to between 1½% and 2% in 2019. Capacity utilisation was projected to decline in the period to autumn 2017, edging up thereafter. At the monetary policy meeting on 11 May, the key policy rate was kept unchanged.

Growth in the world economy is moderate. There are prospects that growth among trading partners will pick up somewhat, at about the same pace as projected in March. Inflation remains low in most advanced countries. Financial markets have recently been marked by the uncertainty surrounding the outcome of the UK referendum on continued EU membership. Expected policy rates among trading partners have declined since the March *Report*.

Oil prices have risen since March and are higher than envisaged in the March *Report*. Futures prices have also increased, but less than spot prices. Futures prices indicate a very gradual upswing in oil prices.

The krone has appreciated and is stronger than anticipated in March. The appreciation partly reflects the upswing in oil prices.

Following the reduction in the key policy rate in March, banks have reduced interest rates on loans to households, but the reduction has been smaller than envisaged. The Norwegian money market premium has remained elevated and has been higher than projected, but is expected to edge down over the coming months. Risk premiums on banks' new wholesale funding have decreased since March.

New national accounts figures show that growth in the Norwegian economy is low, broadly in line with that projected in the March *Report*. According to most of the industries in Norges Bank's regional network, output is expected to increase slightly in the coming period, but the network indicates continued low growth. Low productivity growth in the coming years may restrain economic growth. The Revised National Budget for 2016 implies a more expansionary fiscal policy in 2016 than assumed in the March *Report*.

On the whole, labour market developments have been slightly more favourable than expected. In 2016 Q1, employment was somewhat higher than projected. Unemployment has been stable, and registered unemployment has been somewhat lower than projected. The spring wage settlement indicates that wage growth may be slightly lower in 2016 than envisaged in the March *Report*.

Inflation has moved broadly in line with the projection in the March *Report*. The twelve-month rise in consumer prices adjusted for tax changes and excluding energy products (CPI-ATE) was 3.2% in May. Inflation expectations are well anchored.

House price inflation has moved up and been higher than projected. House prices are rising rapidly in Oslo and the surrounding areas, but have fallen in oil-dependent regions. Household debt has risen at a slightly faster pace than expected.

The Executive Board notes that the analysis in this *Report* implies a decline in the key policy rate to about ¼% at the end of 2016. The key policy rate is projected to rise to ¾% towards the end of the projection period. The key policy rate forecast is little changed, but slightly higher than in the March *Report* through the entire projection period. With this path for the key policy rate, the analyses in this *Report* suggest inflation will move down in the coming years. Inflation is projected at between 1½% and 2% in 2019. Capacity utilisation in the mainland economy is expected to show a small decline in the period to autumn 2017, increasing somewhat thereafter. Monetary policy is expansionary and supportive of structural adjustments in the Norwegian economy. Nevertheless, in an economy marked by restructuring, monetary policy cannot fully counteract the effects on output and employment.

Low interest rates may result in financial system vulnerabilities. As the key policy rate approaches a lower bound, the uncertainty surrounding the effects of monetary policy also increases. This suggests proceeding with greater caution in interest rate setting and reacting somewhat less to news that changes the economic outlook, whether the news pulls in the direction of a lower or higher key policy rate. Should the Norwegian economy be exposed to new major shocks, the Executive Board will not exclude the possibility that the key policy rate may turn negative.

In its discussion of monetary policy in the period ahead, the Executive Board gives weight to the prospect that growth in the Norwegian economy will remain weak, even though the increase in oil prices may reduce uncertainty and push up demand somewhat. Should the rapid rise in house prices persist, household vulnerabilities may increase and heighten the risk of an abrupt fall in demand further out. Inflation has for a period been higher than 2.5%, but lower wage growth and a somewhat stronger krone will weigh down on inflation ahead. An overall assessment of the economic outlook and the balance of risks led the Executive Board to conclude that the key policy rate should be kept unchanged at 0.50% at this meeting. The Executive Board's current assessment of the outlook suggests that the key policy rate may be reduced in the course of the year.

At its meeting on 22 June, the Executive Board decided to keep the key policy rate unchanged at 0.50%.

Øystein Olsen
22 June 2016