Executive Board's assessment

Norges Bank's Executive Board has decided to keep the key policy rate unchanged at 0.5%. The Executive Board's current assessment of the outlook suggests that the key policy rate will most likely remain at today's level in the period ahead.

Inflation among Norway's trading partners has been low for a long time, and capacity utilisation has been below a normal level. This has contributed to historically low interest rates abroad. Inflation among trading partners has recently edged up, and there are prospects for a further rise ahead. At the same time, capacity utilisation is on the increase, and economic growth will likely be higher in 2017 than projected in the December 2016 *Monetary Policy Report*. There are prospects that interest rates abroad will rise somewhat faster than envisaged in December.

In the wake of the decline in oil prices since summer 2014, the key policy rate in Norway has been reduced in several steps. Monetary policy is expansionary and supportive of structural adjustments in the Norwegian economy, but it will take time for the effects of the oil price fall to dissipate and for activity to normalise. New information since the monetary policy meeting in December shows that unemployment is lower than projected, and economic growth appears to be gaining some momentum. There are prospects that growth will gradually edge higher and that unemployment will slowly recede in the coming years. After holding relatively steady in recent months, oil prices have fallen somewhat lately. Futures prices have also moved down and indicate that oil prices will remain near today's level in the years ahead. The krone has recently depreciated and is weaker than projected in the December *Report*.

The operational target of monetary policy is annual consumer price inflation of close to 2.5% over time. The substantial depreciation of the krone associated with the oil price fall and the reduction in the key policy rate pushed up inflation. In 2016, the annual rise in the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) was 3%. Inflation is now moving down and has recently been lower than expected. The effects of the past krone depreciation are diminishing, while the effects of the krone appreciation through 2016 are coming into evidence. In addition, wage growth in 2016 turned out to be clearly lower than projected. This must be seen in the light of structural adjustments in the Norwegian economy. Against the background of moderate wage growth, inflation will likely be lower for a period ahead than projected earlier.

Persistently low interest rates may lead to financial system vulnerabilities. The rapid rise in house prices and growing debt burdens indicate that households are becoming more vulnerable. By taking into account the risk associated with very low interest rates, monetary policy can promote long-term economic stability. The uncertainty surrounding the effects of monetary policy when the key policy rate is close to a lower bound suggests a cautious approach to interest rate setting.

The Executive Board judges that there is a continued need for an expansionary monetary policy. Capacity utilisation is below a normal level, and inflation is likely to range between 1% and 2% in the coming years.

In its discussion of monetary policy in the near term, the Executive Board places emphasis on the prospects for lower-than-expected inflation. This implies, in isolation, a lower key policy rate in the period ahead. On the other hand, the upturn in the real economy appears to have taken hold, and unemployment has declined. Inflation expectations appear to be firmly anchored. With a key policy rate close to the current level, there are prospects that inflation will pick up again further out.

Moreover, the Executive Board also gives weight to the risk associated with very low interest rates and the objective of long-term stability in output and inflation. An even lower key policy rate could lead to a further acceleration in house price inflation and debt accumulation and heighten the risk of an abrupt fall in demand further out. The risk of a further build-up of financial imbalances and the uncertainty surrounding the effects of a lower key policy rate weigh against reducing the key policy rate now.

On the basis of an overall assessment of the economic outlook and the balance of risks, the Executive Board decided to keep the key policy rate unchanged at 0.5%. The Executive Board's current assessment of the outlook suggests that the key policy rate will most likely remain at today's level in the period ahead.

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