NORGES BANK

1|20

MARCH

MONETARY POLICY REPORT

Monetary policy assessment

Norges Bank's Monetary Policy and Financial Stability Committee has decided to reduce the policy rate by 0.50 percentage point to 1.00%. There is considerable uncertainty about the duration and the consequences of the coronavirus outbreak, with a risk of a pronounced economic downturn. The Committee is monitoring developments closely and is prepared to make further rate cuts.

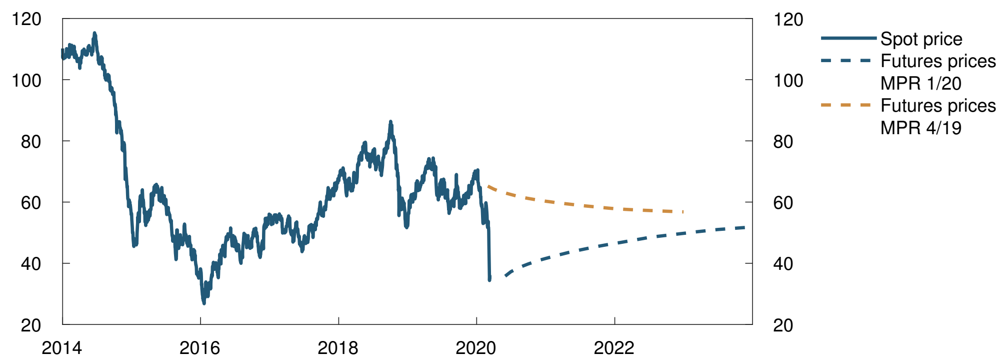
A lower policy rate cannot prevent the coronavirus outbreak from having a substantial impact on the Norwegian economy, but it could dampen the downturn and mitigate the risk of more persistent effects on output and employment.

Weaker global growth and fall in oil prices

The outbreak of coronavirus (Covid-19) has weakened global growth prospects. GDP among Norway's trading partners is expected to be substantially lower in 2020 than projected in the December 2019 Monetary Policy Report. There is considerable uncertainty about the scale and duration of the outbreak and the economic consequences of the measures to limit contagion.

Oil and gas prices have fallen sharply since the December Report, mainly because oil consumption has dropped due to the coronavirus outbreak and because Russia and OPEC did not reach agreement on oil production limits. Futures prices have also declined, but indicate that oil prices will edge up in the coming years.

Chart A Oil prices have fallen
USD/Barrel



Sources: Refinitiv Datastream and Norges Bank

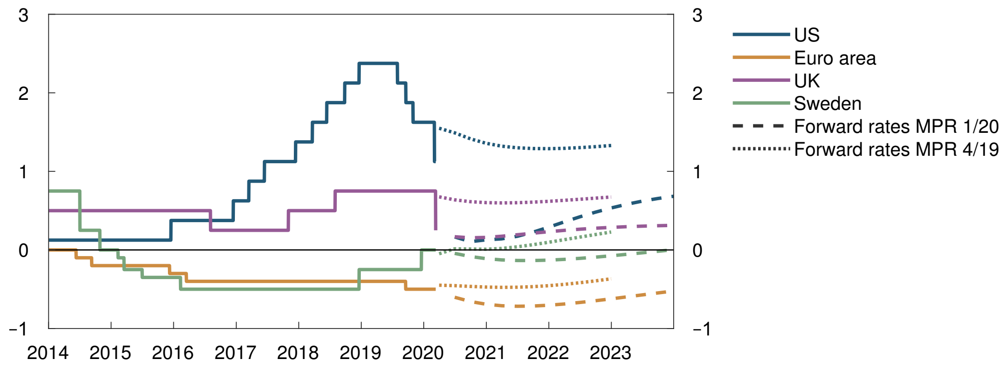
Lower interest rates and weaker krone

There has been substantial financial market volatility lately. A number of central banks have cut policy rates. Forward rates among Norway's trading partners have fallen sharply and indicate a very low interest rate level in the years ahead. Global equity indexes have fallen sharply in recent weeks and are lower than in December.

Norwegian forward rates have also shown a sharp decline. Risk premiums in the Norwegian money market have risen markedly recently. Risk premiums in the Norwegian bond market have also increased.

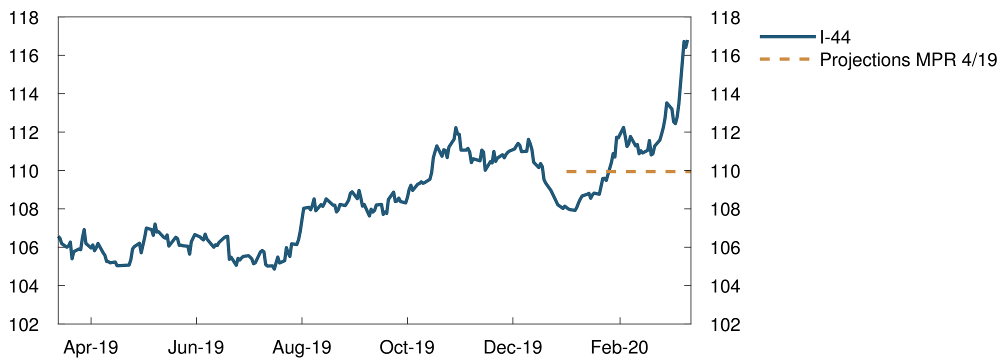
The krone has weakened considerably since the December Report and is weaker than projected, partly reflecting the fall in oil prices and heightened uncertainty surrounding the coronavirus outbreak.

Chart B Lower global interest rates and interest rate expectations
Policy rates and estimated forward rates in selected countries. Percent



Sources: Bloomberg, Refinitiv Datastream and Norges Bank

Chart C Krone exchange rate has weakened
Import-weighted exchange rate index (I-44)



Sources: Refinitiv Datastream and Norges Bank

Coronavirus and oil price decline dampen activity in the Norwegian economy
After several years of solid growth, the Norwegian economy likely reached the peak of the economic cycle towards the end of 2019. Growth in the mainland economy slowed through autumn 2019. At the beginning of the year, capacity utilisation in the Norwegian economy appeared to be somewhat lower than projected earlier, but still slightly above a normal level.

The spread of coronavirus is depressing activity in the Norwegian economy. When the enterprises in Norges Bank's Regional Network were interviewed in February, they expected moderate growth ahead. In a phone survey conducted at the beginning of

March, more than a third of enterprises reported weaker growth prospects owing to the coronavirus outbreak and anti-contagion measures. Many enterprises were already negatively affected. A marked drop in travel demand and cancellations of events are heavily impacting various sectors. Households are cutting back on consumption and businesses are postponing investment out of fear of further contagion. Layoff notices have increased. In recent days, the measures to limit contagion mean that many people can no longer work normally. The Government has recently announced measures to limit the economic consequences of the outbreak.

As a result of the fall in oil and gas prices, growth prospects have weakened. Lower prices reduce the profitability of the petroleum industry in Norway and worldwide, which in turn influences both investment and exports. Already before the price fall, there were prospects that Norwegian petroleum investment would slow in the years ahead. Large investment projects are nearing completion, at the same time as fewer large projects are planned for the coming years.

Krone depreciation pushes up inflation

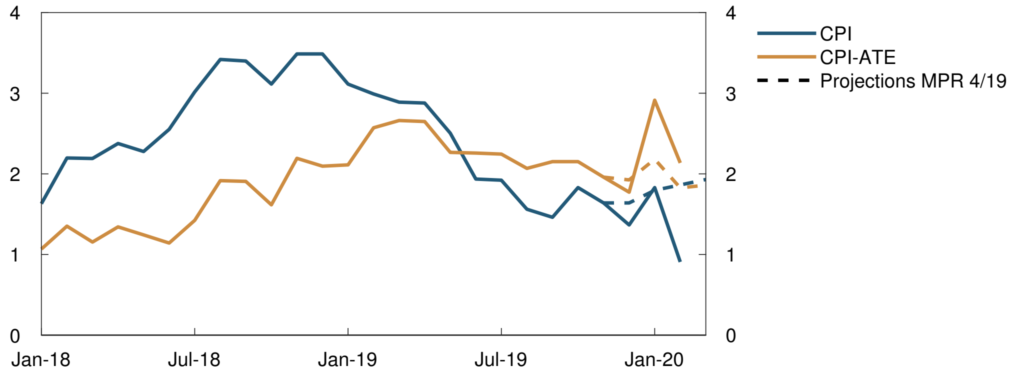
Consumer price inflation moderated through 2019, primarily reflecting a slower rise in electricity prices. In February, the 12-month rise in the consumer price index (CPI) was 0.9%. Adjusted for tax changes and excluding energy products (CPI-ATE), inflation was 2.1%. Underlying inflation has been higher than projected in the December Report.

Labour market tightening in recent years has pushed up wage growth. Combined with a persistently weaker krone, this pushes up inflation. On the other hand, factors such as lower travel demand may push down inflation.

The expectations of the social partners and Norges Bank's Regional Network contacts indicated in February lower wage growth in 2020 than 2019. Weaker growth prospects due to the coronavirus outbreak and the oil price decline are expected to curb wage growth.

Chart D Underlying inflation has been higher than projected

CPI and CPI-ATE. Twelve-month change. Percent



Sources: Statistics Norway and Norges Bank

The policy rate is reduced to 1%

The objective of monetary policy is annual consumer price inflation of close to 2% over time. Inflation targeting shall be forward-looking and flexible, so that it can contribute to high and stable output and employment and to countering the build-up of financial imbalances.

Underlying inflation is moving higher. In light of the krone depreciation, inflation may be higher than the target for a period. Growth in the mainland economy has slowed, and the coronavirus outbreak and the fall in oil and gas prices will dampen activity further. There are prospects of higher unemployment and lower wage growth.

There is substantial uncertainty about the duration and consequences of the coronavirus outbreak. In the Committee's assessment, the outlook for the Norwegian economy and the risk of a pronounced downturn suggest that it is appropriate to reduce the policy rate now.

A lower policy rate cannot prevent the coronavirus outbreak from having a substantial impact on the Norwegian economy, but it could dampen the downturn and mitigate the risk of more persistent effects on output and employment.

The policy rate forecast declines to close to 0.75% in the course of the year, rising somewhat thereafter. The projections are based on information up to and including Wednesday, 11 March. It is assumed that activity in the Norwegian economy will show a sharp decline in the coming quarters due to the coronavirus outbreak. Growth is then projected to pick up somewhat towards the end of 2020 as the measures to limit contagions are scaled back.

The Committee decided unanimously to reduce the policy rate by 0.50 percentage point to 1.00%. The Committee is monitoring developments closely and is prepared to make further rate cuts.

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12 March 2020

At an extraordinary monetary policy meeting on Thursday, 12 March, analyses of the Norwegian and international economy were presented to Norges Bank's Monetary Policy and Financial Stability Committee.

The analyses are based on information up to and including Wednesday, 11 March.

Weaker outlook for the Norwegian economy

The outbreak of coronavirus (Covid-19) and the sharp fall in oil prices are pushing the Norwegian economy into a downturn. There are prospects of higher unemployment and lower wage growth.

There is considerable uncertainty about the scale and duration of the coronavirus outbreak and the economic consequences of the measures to limit contagion. The projections are based on the assumption of a pronounced slowing of growth in the mainland economy over the coming quarters, before rebounding somewhat towards the end of the year.

Based on information up to and including Wednesday, 11 March, we have used our macroeconomic model NEMO for projections of economic developments. The policy rate forecast declines to around 0.75% in the course of 2020, increasing somewhat thereafter. The forecast is markedly lower than in the December *Monetary Policy Report*.

Sharp slowing of global growth in 2020

The coronavirus outbreak has weakened global growth prospects and generated substantial uncertainty about developments ahead. Global equity indexes have declined, credit premiums have risen and financial uncertainty indicators have increased. Several central banks have cut their policy rates and implemented other measures with a view to dampening the economic downturn. Fiscal policy measures have also been introduced in a number of countries. Expected money market rates among trading partners have fallen markedly and are 0.4 percentage point lower at the end of 2022 than in December.

The pandemic is depressing economic activity through several channels. Goods and services production is being hit by lockdowns of businesses and public institutions in many countries. Travel demand has shown a sharp fall. At the same time, consumers are cutting back on spending because of widespread uncertainty, anti-contagion measures and restricted access to goods and services. In light of the outbreak, trading-partner GDP growth in 2020 has been revised down markedly from the December *Report*. The projections for wage and price inflation internationally have also been revised down.

Lower oil prices and weaker krone

The price of oil has hovered around USD 35 per barrel in recent days and is close to half the price prevailing at the time of the December *Report*. The price fall reflects the fact that Russia and OPEC did not reach agreement on production cuts, and substantial production increases are now being planned. In addition, lower oil demand due to the coronavirus outbreak has pushed down oil prices. We assume that oil prices will pick up somewhat further out, in line with futures prices.

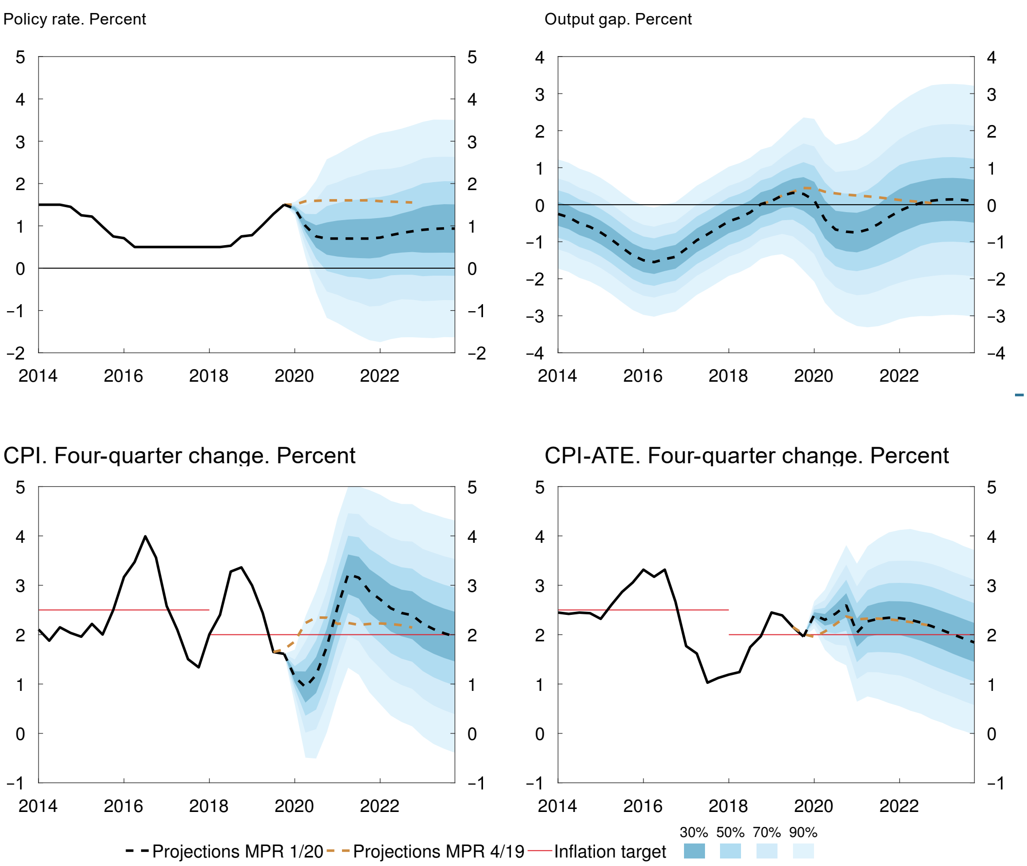
The krone has weakened considerably and is weaker than assumed in the December *Report*. This reflects the fall in oil prices and uncertainty about the economic consequences of coronavirus. The krone is assumed to appreciate somewhat as the uncertainty surrounding the coronavirus fades and oil prices rebound.

Coronavirus outbreak and oil price fall dampen activity in the Norwegian economy
Already in autumn, there was evidence that the Norwegian economy was close to the peak of the economic cycle. Growth in the mainland economy slowed towards the end of 2019 and was somewhat lower than expected in Q4. Growth is expected to slow markedly in the coming quarters as a result of the outbreak (Chart 2).

The fall in oil and gas prices is weighing on investment on the Norwegian shelf. Petroleum investment is expected to hold steady between 2019 and 2020, followed by a decline in the following years. The coronavirus outbreak will most likely depress consumer spending in 2020. As the anti-contagion measures are scaled back, consumer spending is expected to rebound and contribute to lifting growth in the Norwegian economy. Net exports are also expected to increase.

The Government has announced measures to limit the economic consequences of the coronavirus outbreak. The scope of the measures was not known when the projections

Chart 1 Lower policy rate helps meet monetary policy objectives



Sources: Statistics Norway and Norges Bank were made. It is assumed that petroleum revenue spending will increase more than assumed in the December *Report*.

Mainland GDP growth is projected to slow from 2.4% in 2019 to 0.4% in 2020, followed by an improvement in growth thereafter.

Prospects for higher unemployment
After showing a pronounced rise in recent years, employment growth slowed towards the end of 2019. Layoffs are expected in a number of industries in the coming period, resulting in lower employment and higher unemployment. The sharp fall in petroleum prices is also expected to contribute to lower employment ahead. In the projections, the number of employed declines through 2020, before employment picks up a little.

Registered unemployment is projected to increase from the current level of 2.2% to 2.6% towards the end of the year, declining thereafter.

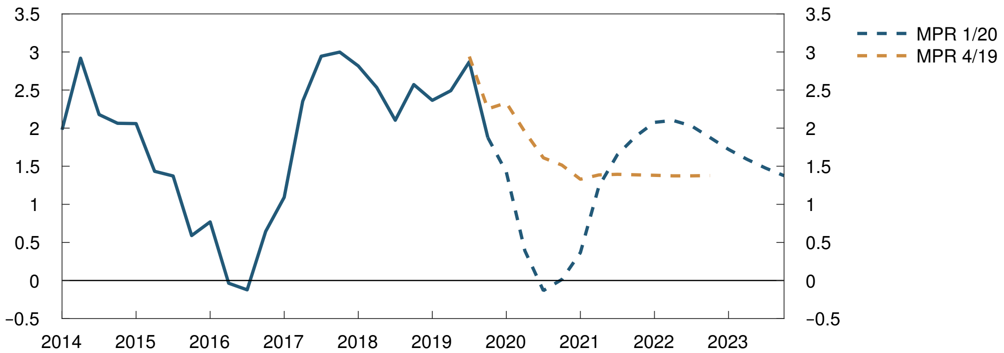
Capacity utilisation is projected to decline ahead and be below a normal level in 2020 and 2021 (Chart 1). As the effects of the coronavirus outbreak start to fade further out and oil prices move higher, there are prospects that capacity utilisation will rebound and stabilise close to a normal level.

The coronavirus outbreak is dampening price and wage inflation
Labour market tightening in recent years has pushed up wage growth. In 2019, annual wage growth was 3.5%, slightly higher than projected. The coronavirus outbreak and the measures to limit contagion are likely to weaken business sector profitability and curb wage growth in 2020. The recent sharp fall in oil prices and prospects for higher unemployment will continue to dampen wage growth in the next few years.

Wage growth is projected to slow to 2.8% in 2020, and decline further in 2021. Towards the end of the projection period, wage growth picks up again, against the background of lower unemployment and higher oil prices.

The decline in electricity prices has restrained the rise in the CPI. In February, the 12-month rise in the CPI was lower than expected, while CPI-ATE inflation rose more than anticipated. The 12-month rise in the CPI-ATE in the coming period is projected to remain

Chart 2 Prospects for sharply lower growth
GDP mainland Norway. Four-quarter change. Percent



Sources: Statistics Norway and Norges Bank between 2% and 2.5%. The fall in oil prices and prospects for continued low electricity prices contribute to curbing overall CPI inflation in 2020.

The effects of anti-contagion measures on inflation are uncertain. Overall, it is assumed that these measures will have a dampening effect on inflation, especially through prices for holidays, hotel services and passenger air travel. Price rises owing to reduced supplies of some goods and services may have the opposite effect. Further out, a weaker krone pushes up inflation, while lower wage growth and capacity utilisation pull in the opposite direction. In the projections, inflation is close to 2% at the end of 2023.

Substantially lower policy rate path

The policy rate is reduced from 1.50% to 1.00%, effective from 16 March. The policy rate path is consistent with a further rate reduction to 0.75% in 2020 Q2. The rate forecast is markedly lower than in the December Report.

The money market premium has increased recently. In the analysis, we assume that the premium remains elevated in the near term, but then rapidly falls to 0.35 percentage point where it is expected to lie until the end of the projection period.

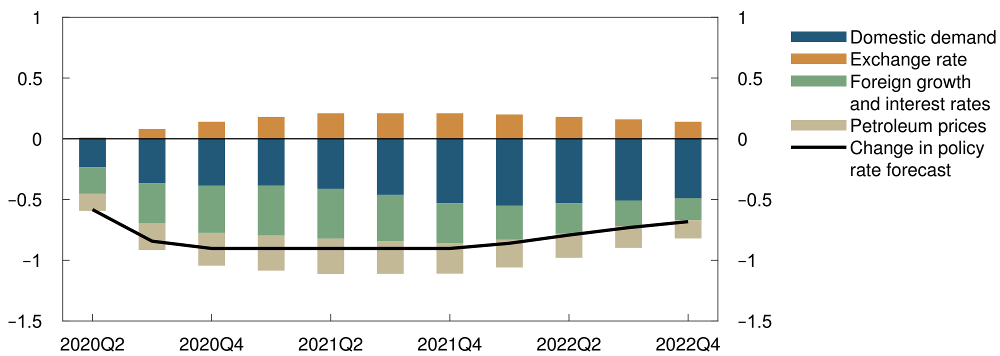
Bank lending rates are expected to follow developments in the policy rate with a lag. The average residential mortgage rate is projected to decrease from about 3% in Q1 to a little more than 2% towards the end of the year. Further out, there are prospects of a gradual rise in mortgage rates.

The coronavirus outbreak and oil prices pull down the policy rate path

The main factors behind the changes in the policy rate forecast are illustrated in Chart 3. The bars show the various factors' contributions. The black line shows the overall change in the policy rate path. The decomposition of the factors behind the changes in the forecast is based on model estimations, but there is no mechanical relationship between news that deviates from the forecasts in the December *Report* and the effect on the new rate path.

Oil and gas prices have fallen sharply since the December *Report*. This implies lower petroleum investment and lower oil service exports. Lower petroleum prices also result in lower profitability in oil-related industries, which in turn suggests lower wage growth. Both conditions imply a lower rate path. The krone depreciation due to lower oil and gas

Chart 3 Oil prices and the coronavirus outbreak pull down the policy rate path
Cumulative contribution. Percentage points



Source: Norges Bank

prices pulls, in isolation, in the opposite direction. Overall, lower oil and gas prices pull down the rate path (beige bars).

Trading partners' import growth and foreign forward rates appear to be lower than projected earlier. This suggests lower demand in the Norwegian economy. Lower interest rates and lower foreign import growth suggest in isolation a lower rate path (green bars).

The projections for private consumption and other *domestic demand* for the coming quarters have been revised down owing to the coronavirus outbreak. A more expansionary fiscal policy will, in isolation, contribute to dampening the decline in demand. Lower demand suggests, in isolation, a lower rate path (dark blue bars).

The *krone* has been weaker than expected. The krone depreciation in recent weeks implies that the exchange rate is now weaker than developments in oil prices and the interest rate differential in isolation would suggest. Some of the recent krone depreciation is therefore interpreted as an increase in the risk premium. A weaker krone improves export firms' profitability and cost-competitiveness and will to some extent counteract the negative effects of lower growth abroad. A weaker krone also pushes up imported goods inflation. Both conditions suggest a higher rate path (orange bars).

Price and wage inflation have been higher than projected. In isolation, this pushed up the rate path. At the same time, it is assumed that the measures to limit contagion of the coronavirus will pull down on inflation in the near term. Overall, price and wage inflation neither pushes up nor pulls down the rate path.

TABLE 1 INTERNATIONAL PROJECTIONS

Change from projections in MPR 4/19 in brackets	Percentage change from previous year				
	2019	2020	2021	2022	2023
GDP					
US	2.3 (0)	1.2 (-0.8)	2 (0.3)	1.9 (0.2)	1.6
Euro area	1.2 (0)	0.2 (-1)	1.7 (0.3)	1.6 (0.3)	1.3
China	6.1 (0)	4.7 (-1.1)	6.1 (0.4)	5.8 (0.2)	5.6
Trading partners [1)]	2 (0.1)	0.9 (-1)	2.2 (0.2)	2.2 (0.2)	2.0
World (PPP) [2)]	3 (0)	2.3 (-1)	3.7 (0.2)	3.8 (0.2)	3.6
Imports [1)]	2.5 (0)	0.3 (-2.3)	3.1 (-0.2)	4.6 (1.2)	3.7
Consumer prices					
Trading partners [1)]	1.8 (0)	1.6 (-0.2)	1.9 (-0.1)	2.1 (0)	2.1
Underlying inflation [3)]	1.4 (0)	1.5 (-0.1)	1.6 (-0.2)	1.8 (0)	1.8
Prices for consumer goods imported to Norway [4)]	1.7 (0)	0.7 (0.1)	0.5 (-0.1)	0.7 (0)	0.7

1) Export weights for GDP and imports. Import weights for consumer prices. 25 main trading partners.
2) GDP weights, three-year moving average. Norway's trading partners account for 73% of total.
3) The aggregate for underlying inflation includes: the euro area, Sweden, UK and US. Import weights.
4) In foreign currency terms. Including compositional effects.

Sources: IMF, Refinitiv Datastream and Norges Bank

TABLE 2A CONSUMER PRICES. TWELVE-MONTH CHANGE. PERCENT

	2019	2020					
	Dec	Jan	Feb	Mar	Apr	May	Jun
Consumer price index (CPI)							
Actual	1.4	1.8	0.9				
Projections in MPR 4/19	1.6	1.8	1.9	1.9			
Projections in PPR 1/20				0.7	0.5	1.0	1.3
CPI-ATE							
Actual	1.8	2.9	2.1				
Projections in MPR 4/19	1.9	2.2	1.8	1.9			
Projections in PPR 1/20				2.2	2.0	2.4	2.5
Imported goods in the CPI-ATE							
Actual	0.6	2.7	0.7				
Projections in MPR 4/19	0.8	1.7	0.7	1.1			
Projections in PPR 1/20				1.2	1.4	1.7	1.7
Domestically produced goods and services in the CPI-ATE							
Actual	2.4	3.1	2.9				
Projections in MPR 4/19	2.4	2.4	2.3	2.2			
Projections in PPR 1/20				2.7	2.4	2.9	3.0

Sources: Statistics Norway and Norges Bank

TABLE 2B GDP FOR MAINLAND NORWAY. QUARTERLY CHANGE. SEASONALLY ADJUSTED. PERCENT.

	2019		2020	
	Q3	Q4	Q1	Q2
Actual	0.6	0.2		
Projections in MPR 4/19		0.4	0.5	
Projections in PPR 1/20			0.0	-0.4

Sources: Statistics Norway and Norges Bank

TABLE 2C REGISTERED UNEMPLOYMENT (RATE). PERCENT OF LABOUR FORCE. SEASONALLY ADJUSTED

	2019	2020					
	Dec	Jan	Feb	Mar	Apr	May	Jun
Actual	2.2	2.2	2.2				
Projections in MPR 4/19	2.2	2.2	2.2	2.2			
Projections in PPR 1/20				2.3	2.3	2.4	2.5

Sources: Norwegian Labour and Welfare Administration (NAV) and Norges Bank

TABLE 3 PROJECTIONS FOR MAIN ECONOMIC AGGREGATES

Change from projections in Monetary Policy Report 4 /19 in brackets	Percentage change from previous year (unless otherwise stated)	Projections			
	2019	2020	2021	2022	2023
Prices and wages					
Consumer price index (CPI)	2.2 (0.0)	1.3 (-0.9)	3.0 (0.8)	2.5 (0.3)	2.1
CPI-ATE	2.2 (-0.1)	2.4 (0.2)	2.2 (-0.1)	2.3 (0.1)	2
Annual wages	3.5 (0.1)	2.8 (-0.4)	2.5 (-0.7)	2.7 (-0.6)	3.2
Real economy					
GDP, mainland Norway	2.4 (-0.1)	0.4 (-1.5)	1.3 (-0.1)	2.0 (0.6)	1.5
Output gap, mainland Norway (level)	0.2 (-0.1)	-0.4 (-0.7)	-0.6 (-0.8)	0.0 (-0.1)	0.1
Employment, persons, QNA	1.7 (0.0)	0.2 (-0.9)	0.0 (-0.4)	1.0 (0.6)	0.9
Registered unemployment rate (level)	2.3 (0.0)	2.5 (0.3)	2.5 (0.2)	2.3 (0.0)	2.2
Demand					
Mainland demand	2.3 (0.0)	0.4 (-1.0)	1.3 (-0.1)	1.8 (0.2)	1.9
-- Household consumption	1.8 (0.2)	0.0 (-1.6)	1.5 (-0.5)	2.2 (0.1)	2.4
-- Business invstment	5.7 (0.2)	-1.5 (-1.6)	-0.2 (-0.2)	1.2 (0.3)	1.5
-- Housing investment	-0.5 (-1.5)	-4.2 (-4.7)	2.7 (1.6)	2.4 (0.6)	2
-- Public demand	2.7 (0.0)	2.3 (0.5)	1.3 (0.1)	1.2 (0.0)	1.1
Petroleum investment	13.1 (-1.4)	0.5 (-4.0)	-12.0 (-7.0)	-4.0 (0.0)	-2
Mainland exports	5.5 (-0.5)	-0.2 (-2.6)	2.8 (-0.2)	4.6 (1.4)	3.4
Imports	5.2 (-1.1)	-2.2 (-4.4)	0.5 (-1.3)	1.9 (-0.2)	2.8
Houseprices and debt					
Houseprices	2.6 (0.0)	3.0 (0.3)	4.1 (0.7)	4.3 (0.9)	3.4
Credit to households (C2)	5.0 (-0.2)	4.5 (-0.7)	4.7 (-0.4)	4.9 (0)	4.6
Interest rate and exchange rate (level)					
Policy rate	1.1 (0.0)	1.0 (-0.6)	0.7 (-0.9)	0.8 (-0.8)	0.9
Import-weighted exchange rate (I-44)	107.6 (-0.1)	115.3 (6.3)	113.4 (5.3)	111.3 (3.3)	110
Money market rates, trading partners	0.5 (0.0)	0.0 (-0.3)	-0.2 (-0.5)	0.0 (-0.4)	0.1
Oil price, Brent Blend. USD per barrel	64.4 (0.1)	42.8 (-19.7)	44.4 (-14.5)	48.4 (-8.8)	51

Sources: Eiendomsverdi, Finn.no, Norwegian Labour and Welfare Administration (NAV), Real Estate Norway, Statistics Norway, Thomson Reuters and Norges Bank

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