

Speech

Policy rate will likely be held steady for some time

Introductory statement by Governor Ida Wolden Bache at the press conference following announcement of the policy rate on 21 March 2024.

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Chart: Policy rate kept unchanged at 4.5 percent

Norges Bank's Monetary Policy and Financial Stability Committee announced today its decision to keep the policy rate unchanged at 4.5 percent.

Norges Bank is tasked with keeping inflation low and stable. The operational target is inflation of close to 2 percent over time. We are also mandated to help keep employment as high as possible and to promote economic stability.

Inflation is markedly above the target. High and variable inflation imposes substantial costs on society. Those with the smallest margins are often hardest hit when prices rise rapidly and unexpectedly.

In recent years, the policy rate has been raised significantly in order to tackle high inflation. We now see that the monetary policy tightening is working. Inflation is falling back and the economy is cooling down.

The Committee assesses that the policy rate is now sufficiently high to bring inflation back to the target within a reasonable time horizon. That does not mean that the job is done. We still have a way to go before inflation returns to the 2 percent target. If the policy rate is lowered prematurely, inflation could remain high, among other things, because the krone might then depreciate.

Inflation has been lower than anticipated in December, when we last presented our projections. At the same time, activity in the Norwegian economy has been higher than projected. Therefore, we are now more

confident that we can bring down inflation without a pronounced rise in unemployment.

Let me say a little more about the background for the rate decision and the Committee's assessments.

Chart: Inflation markedly above target

Inflation has moderated over the past months and is now just below 5 percent. While prices are normally raised in the grocery sector in February, this is the first year we registered a fall in food prices since February 2001. Energy prices have also been lower than assumed.

Inflation is still broad based. Over the past half year, goods prices have risen at a slower pace, while the services inflation has remained high.

Chart: Low growth in the Norwegian economy

Growth in the Norwegian economy is low. Norges Bank's Regional Network enterprises overall expect activity to remain steady in the period to summer. Firms supplying goods and services to the petroleum sector are still prospering owing to strong investment growth, while the construction industry expects a further decline. Activity in the retail trade sector is set to edge down a little ahead, but more retail firms now report that prospects have improved.

Given the wide differences across industries, the outlook for the Norwegian economy is uncertain. Among other things, it is uncertain to what extent weak activity in the construction industry will affect other sectors. It is also uncertain how overall wage growth will be affected by the large differences in profitability both within manufacturing and among different sectors.

Over the past few years, the labour market has become less tight. Network enterprises report that recruitment difficulties have eased. At the same time, employment is still high. Over the past year, the number of employed has increased by close to 20 000. Registered unemployment remains low and has been a little lower than expected in December.

Chart: Inflation has come down abroad

International inflation has declined markedly since peaking in 2022, but the decline has stalled a bit in recent months. Goods inflation has fallen most, while services inflation is still high in many countries. Central banks in our main trading partner countries have held policy rates steady in recent months, and the market now expects the interest rate loosening cycle to begin this summer.

The krone strengthened after the monetary policy meeting in December and has been stronger than projected earlier, likely reflecting a larger rise in Norwegian market interest rates than trading partner interest rates.

We do not have a policy target for the krone exchange rate, but we are concerned with the krone exchange rate because it affects the outlook for the Norwegian economy. Over the past year and a half, the krone has lost considerable value. A weaker krone means higher prices for imported goods. The past krone depreciation will continue to contribute to keeping inflation elevated ahead.

Chart: Wage growth is high

It may take time for inflation to return to target also due to other factors. Labour costs have shown a substantial increase in recent years. Combined with higher intermediate goods prices, Norwegian firms are facing high cost inflation. Strong demand has made it possible to pass on higher costs to prices, and we see that the rise in labour costs has increasingly contributed to the rise in prices.

Last year, wage growth reached 5.2 percent, or the highest rate recorded in 15 years. Even so, wage inflation was lower than price inflation. Wage growth is expected to be high this year too, but to slow to 4.9 percent.

Chart: Policy rate will likely be held steady for some time

The Committee assesses that the policy rate needs to be maintained at the current level for some time ahead. A policy rate path broadly consistent with the forecast in the December *Report* provides a reasonable balance between the monetary policy objectives. If the economy evolves as projected in this *Report*, the policy rate will be held steady in the period to autumn before it is gradually lowered.

Chart: Inflation will move down and unemployment edge up

We now expect an improvement in the Norwegian economy ahead compared with the outlook in December. With the current path of the policy rate, inflation is projected to come down faster this year and to approach target in the course of the coming years. Unemployment is expected to increase somewhat, but the number of unemployed is expected to be somewhat lower than projected in December. Wage growth is set to edge lower, but given the decline in price inflation, it is still likely that wages will rise faster than prices in the years ahead.

There is uncertainty about future developments in the Norwegian economy. If the rapid increase in business costs persists or the krone turns out to be weaker than projected, inflation may remain elevated for longer than currently projected. In that case, the Committee is prepared to raise the policy rate again. If there is a more pronounced slowdown in the Norwegian economy or inflation declines more rapidly, the policy rate may be lowered earlier.

We know that the steep series of interest rate increases has a cost. The interest rate rise has come on top of a sharp rise in prices. Many people have less money to spend, and for some of them it has become difficult to make ends meet. It is likely that no further rate increases will be needed. Many people will see an increase in their purchasing power and a lighter debt burden. Even so, we must be prepared for somewhat higher unemployment and for a continued decline in activity in certain industries for a while ahead. But given the current outlook, inflation will return to target without a sharp rise in unemployment.