

Norges Bank has announced that in future the Bank will normally make an extensive evaluation of monetary policy once a month. The Bank has published the dates for the Executive Board's main monetary policy meetings. The Bank will, as far as possible, clarify which factors we consider when decisions are taken. The purpose is to reduce the risk for market participants and avoid unnecessary speculation.

Norges Bank sets the interest rates on banks' loans and deposits in the central bank and thereby influences the level of interest rates in Norway. The objective of monetary policy, as stipulated by the authorities, is stability in the krone exchange rate against European currencies. Since the beginning of the year Norges Bank has interpreted the concept "European currencies" as the euro. However, the Bank does not have instruments to fine-tune the exchange rate. In the orientation of instruments, the Bank emphasises the fundamental conditions for exchange rate stability. Price and cost inflation must, therefore, be brought down to the corresponding aim in the euro area. At the same time, monetary policy is oriented with a view to avoiding deflationary recessions, as this would undermine confidence in the krone.

Norges Bank presents its evaluations of economic developments in the Inflation Report. We use a technical assumption concerning future interest rate developments, which is primarily based on market expectations, as indicated by forward rates. The projections indicate a path for the Norwegian economy given that interest rates move in line with these expectations. If the projections show balanced economic developments, they may support current interest rate expectations.

However, if the projections show an abrupt turnaround in the economy, with low and falling price and cost inflation, market participants may have grounds for revising their interest rate expectations. In such a situation, it would be natural for Norges Bank to reduce interest rates more rapidly than assumed in the projections. Similarly, a reduction in interest rates may be postponed if the projections show relatively high price and cost inflation in the years ahead.

Norges Bank seeks to avoid undue uncertainty concerning interest rate determination by presenting its evaluations and projections in inflation reports and other documents. The Bank's analysis is based on assumptions concerning the exchange rate, fiscal policy, international developments, oil prices and a number of other variables. Any significant deviations from these assumptions will lead to developments that differ from our current projections. The same may apply if it should become clear that the historical relationships underlying the analysis have changed. In its conduct of monetary policy, Norges Bank must take into account the effects of any deviations from the assumptions. This may in turn lead to interest rate developments that are not in line with market expectations.

Market participants' expectations form the basis for their activity in money and foreign exchange markets. However, Norges Bank cannot be bound by market expectations, but must base monetary policy measures on its professional assessment of the outlook for the economy. In its analyses and statements, the Bank will seek to explain the background for its decisions.

Svein Gjedrem

NORGES BANK'S INFLATION REPORT

Pursuant to the Norges Bank Act, the central bank shall be the executive and advisory body for monetary, credit and exchange rate policy. The projections in the Inflation Report provide a basis for the Bank's conduct of monetary policy. The monetary policy conducted by Norges Bank shall be aimed at maintaining a stable krone exchange rate against European currencies. There are two fundamental conditions that must be fulfilled to achieve this. First, price and cost inflation must over time not exceed the corresponding aim for inflation in the euro area. Second, monetary policy must not generate deflation through a recession.

The Inflation Report provides a survey of developments in prices and factors that influence price and cost inflation. It contains an assessment of the outlook for the Norwegian economy and Norges Bank's evaluation of the outlook for price inflation for the next two years. The December Inflation Report includes a longer time horizon and highlights the challenges to the Norwegian economy over a period of 4-5 years. The Governor summarises Norges Bank's assessment in the leader.