Pål Longva: Need to maintain a tight stance for some time

Introductory statement by Mr Pål Longva, Deputy Governor of Norges Bank (Central Bank of Norway), at the press conference following announcement of the policy rate, Oslo, 21 September 2023.

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Accompanying charts to the speech

Today, Norges Bank's Monetary Policy and Financial Stability Committee announced its decision to raise the policy rate by 0.25 percentage point to 4.25 percent. Whether additional tightening will be needed depends on economic developments. Based on the Committee's current assessment of the outlook and balance of risks, there will likely be one additional policy rate hike, most probably in December.

Chart: Inflation is still markedly above target

Inflation is high. High and variable inflation has substantial costs – to people, businesses and society. Rapid and unexpected price increases hit low-income households in particular and those who can least afford it.

It is our job to bring inflation down. The operational target is inflation of close to 2 percent over time. Over the past year, consumer prices have risen by almost 5 percent. Inflation has receded after peaking last autumn but is still markedly above target. Information we have received in recent months indicates that inflation may remain high longer than envisaged before summer. The longer inflation remains high, the more costly it may prove to bring down inflation at a later stage.

Let me say a bit more about economic developments and the Committee's assessments:

Chart: Slower growth in the Norwegian economy

There is brisk activity in the Norwegian economy, and the level of employment is high. But monetary policy tightening is now helping to cool down the Norwegian economy, and activity growth has slowed. Growth in household consumption has softened, and unemployment has edged up a little. House prices have declined.

Overall, the enterprises in Norges Bank's Regional Network expect activity growth to be weak ahead. At the same time, there are wide differences across industries. Oil prices have shown a marked rise, and petroleum investment is set to be higher ahead than expected earlier.

Chart: Rapid rise in prices for many goods and services

Consumer prices have risen rapidly for many goods and services. The jump in inflation was triggered by a surge in some prices, such as energy prices and international freight costs. The rise in prices has gradually spread to a broader range of goods and services.

Last year, we saw a sharp increase in food prices and many other goods, and recently higher rents and services prices have become stronger drivers of inflation. Energy prices are now pushing down on inflation.

International inflation is easing. Global trade flows have normalised, and freight costs have fallen back to pre-pandemic levels. Looking ahead, a slower rise in import prices will dampen inflation in Norway too.

Even though there are forces that are now driving down inflation, we believe it will take time to return inflation to the target. High intermediate goods prices have pushed up business costs, and we believe this will keep inflation high for a while.

Chart: High wage growth

In addition, labour costs are rising fast. This year's pay increases are not large compared with the high rate of inflation, and workers will probably experience a further loss of purchasing power this year. But higher wage growth also means higher business costs.

Next year, wage growth will probably be higher than we expected in June. The social partners have also raised their wage growth expectations for next year. Higher labour costs may lead to higher inflation ahead than envisioned earlier.

Chart: Need to maintain a tight stance for some time

We do not want to raise interest rates more than is necessary to tackle the high level of inflation. We have raised interest rates significantly over a short period of time, and we have not yet seen the full effects of the past rate hikes. We are seeing a slackening of the Norwegian economy. Managing the trade-offs has become more complex.

We believe that we are close to the rate level required to bring inflation down to target. This means that we can take a bit more of a wait-and-see stance.

There will likely be a need to maintain a tight stance for some time ahead. The policy rate forecast has been revised up slightly from June and indicates that the policy rate will lie around 4.5 percent through next year.

Chart: Prospects for lower inflation and somewhat higher unemployment

Higher interest rates and high inflation mean tighter household budgets. For a period ahead, many households will probably have to reduce consumption to make ends meet.

We do not expect a sharp slowdown in the Norwegian economy, but there are prospects that unemployment will edge up. The monetary tightening will drive down inflation ahead, and from next year wages are expected to rise faster than prices again.

There is uncertainty about future economic developments and the extent of the tightening effect of monetary policy. If pressures in the economy persist or the krone weakens, inflation could remain high for longer than envisioned. In that case, the Committee is prepared to raise the policy rate to a further extent than currently envisaged. If there is a more pronounced slowdown in the Norwegian economy or inflation declines more rapidly, the policy rate may be lower.

Either way, the objective remains the same. We will set the policy rate so that inflation stabilises at close to 2 percent. By doing so, we are helping to restore households' purchasing power and promote high employment and economic stability over time.