# Ida Wolden Bache: Inflation is too high

Introductory statement by Ms Ida Wolden Bache, Governor of Norges Bank (Central Bank of Norway), at a press conference following the announcement of the policy rate, Oslo, 15 December 2022.

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Accompanying charts of the speech.

## Introduction

*Chart 1: Policy rate raised from 2.5 to 2.75 percent*

**Norges Bank's Monetary Policy and Financial Stability Committee has unanimously decided to raise the policy rate by 0.25 percentage point to 2.75 percent.**

Norges Bank's task is to keep 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 over time.

*Chart 2: Inflation is too high*

Consumer price inflation is now markedly above the target of 2 percent. In November, the 12-month rise in the consumer price index was 6.5 percent. High energy prices have been a key driver of inflation, but prices are rising rapidly across a range of goods and services, both for domestically produced goods and imported goods. Inflation has been higher than projected and is expected to remain higher in the coming months than projected in September, when we published forecasts the last time.

Price stability is crucial for maintaining a well-functioning economy. Many are now finding it challenging to cope with rapid and unexpected price increases. High inflation erodes purchasing power, and those with low incomes and tight margins are being hardest hit. Our aim is to reduce inflation by raising the policy rate.

*Chart 3: Very high inflation among our trading partners*

Inflation is also high among our trading partners, although it appears that inflation may now have passed the peak in some countries, including the US. At the same time, global freight rates have fallen markedly, and global supply chain constraints appear to have eased. In response to the surge in inflation, many central banks have raised their policy rates to the highest levels seen in more than a decade. Unemployment remains low in many countries, but we believe that high inflation and higher interest rates will lead to weak economic developments among Norway's trading partners ahead.

*Chart 4: Slowdown in the Norwegian economy*

In Norway, the employment rate is high, and the unemployment rate is very low. Economic activity has held up better through 2022 than we had expected.

We are now seeing a slowdown in the economy. A large number of enterprises in our Regional Network expect a decline in activity ahead. Companies are finding it easier to recruit staff. House prices have fallen and are expected to fall further in the period to autumn next year. An easing of pressures in the economy will contribute to curbing inflation further ahead.

Wage growth appears to be higher this year than in 2021, and is expected to increase further next year, in line with the expectations of the social partners. This year, however, inflation is set to be appreciably higher than wage growth. Next year, wages and prices are expected to rise approximately at the same pace.

*Chart 5: The policy rate will most likely be raised further in the first quarter 2023*

We have raised the policy rate considerably over a short period of time. Monetary policy has started to have a tightening effect, and we have not yet seen the full effect of the rate hikes.

When setting the policy rate, we are concerned with balancing the risk of tightening too much against the risk of tightening too little.

Inflation is high and inflation expectations ahead have increased. If we raise the policy rate too little, inflation could remain high for a longer period. This could increase the risk that households and firms become used to high inflation and adjust their price and wage setting behaviour accordingly. It may then be necessary to tighten even further at a later stage in order to bring down inflation.

If we raise the policy rate too much, the economy will contract more than what is necessary to bring down inflation, which is something we want to avoid. We believe that we best balance these considerations by raising the policy rate now.

High inflation is weakening household purchasing power. In the short term, higher interest rates also entail tighter finances for borrowers. I am aware that the situation is now demanding for some people. And I understand that it may be thought that we are adding to the weight of the burden by raising the policy rate in a situation where inflation is already high. But by raising the policy rate, we are pushing down inflation.

The future policy rate path will depend on economic developments. Most likely, the policy rate will be raised further in the first quarter of next year. If the economy evolves as anticipated, the policy rate will be around 3 percent next year. This implies a mortgage rate of between 4 and 4½ percent.

*Chart 6: Inflation falls and unemployment edges up*

Inflation is projected to remain high in the near term but will begin to drift down in the course of next year and approach the inflation target further out. Household consumption is likely to decline next year, and unemployment edges up, albeit from a low level.

The outlook is more uncertain than normal. The economy has been hit by major shocks in recent years, and there may have been changes in economic relationships.

We are uncertain about the extent to which households in Norway will tighten consumption when incomes are not keeping pace with inflation. The effect of high inflation on wage and price setting behaviour is also uncertain.

If pressures in the economy persist, and signs emerge that inflation will remain high for a longer period, a higher policy rate may be needed than currently envisaged. If inflation slows more rapidly or unemployment becomes higher than expected, the interest rate may be lower than projected.

The Committee has also taken its decision on the countercyclical capital buffer. In March, the decision was made to raise the countercyclical capital buffer rate to 2.5 percent, effective from 31 March 2023. Norges Bank's Monetary Policy and Financial Stability Committee has decided to maintain this requirement.

The countercyclical capital buffer requirement strengthens banks' solvency, and thereby their resilience to shocks.