Ida Wolden Bache: The conduct of monetary policy

Introductory statement by Ms Ida Wolden Bache, Governor of Norges Bank (Central Bank of Norway), at the hearing of the Standing Committee on Finance and Economic Affairs of the Storting (Norwegian parliament) in connection with the Storting's deliberations on the Financial Market Report, Oslo, 9 May 2025.

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Charts accompanying the speech

Thank you for this opportunity to report on the conduct of monetary policy.

We live in a turbulent time. The security policy landscape has changed, and there is uncertainty about global trade policy. In recent weeks, we have seen large movements in financial markets, and global growth prospects appear to have weakened. I will come back to the potential implications of a global trade conflict for monetary policy in our country. Let me first say a few words about the year behind us and the assessments we have made.

The assessments have been made in line with the mandate assigned to the central bank. The operational target is consumer price inflation of close to 2 per cent over time. At the same time, we are mandated to help keep employment as high as possible and to promote economic stability.

When I was here last year, inflation was on the way down, but still markedly above target. Unemployment had risen somewhat from a very low level. The policy rate was 4.5 percent, after we had raised it significantly in the preceding years.

Chart: Economic growth is low

Monetary policy has contributed to cooling down the Norwegian economy, and growth in the Norwegian economy was low last year. Growth in household consumption and business investment slowed, and housing construction continued to fall. Developments in other parts of the economy nevertheless contributed to sustaining overall activity. The oil tax package put in place during the pandemic boosted investment on the Norwegian shelf. In addition, there was strong growth in public sector demand.

Employment increased through last year, and the employment rate is now higher than before the pandemic. Unemployment increased a little further last year, but less than we had envisaged. Unemployment is overall close to the level in the period before the pandemic.

Chart: Inflation slowed through last year

Inflation among our trading partners slowed through last year, and central banks in a host of countries began to lower their policy rates.

Inflation in Norway also slowed rapidly and faster than we had expected. Inflation nevertheless remained above the target. And there were prospects that inflation would not slow as quickly ahead.

Chart: Wage growth is high

Wage growth has gradually increased in recent years, with overall annual wage growth reaching 5.6 percent last year. That was, by a good margin, the highest wage growth recorded in 16 years. Wages also rose considerably faster than prices, leaving most households better off. After several years of high inflation and higher interest rates, purchasing power per capita was nevertheless lower at the end of last year than at the end of 2019.

With weak productivity growth, wage growth contributed to raising business costs. The krone exchange rate weakened a little over last year.

Chart: Domestic goods and services inflation remains elevated

Imported goods inflation has slowed markedly. Inflation is now being driven by the rise in prices for domestically produced goods and services.

When setting the policy rate through last year, we sought to strike an appropriate balance between the objectives of monetary policy. If we had eased monetary policy prematurely, inflation could remain above target for too long. On the other hand, an overly tight monetary policy could restrict the economy more than needed. We wanted to avoid that.

Towards the end of last year, we assessed that we were approaching the time to begin easing monetary policy somewhat. We signalled that if the economy evolved as projected at that time, the policy rate would be lowered in March this year.

But it turned out that the economy did not evolve as we had envisaged. Inflation rose and turned out to be higher than we had projected. Wage growth also proved to be considerably higher than projected. That raised prospects that inflation would be higher ahead. As we drew closer to the monetary policy meeting in March, it became clear to us that we had to maintain the current stance for somewhat longer in order to bring inflation back to the target within a reasonable time horizon.

The Monetary Policy and Financial Stability Committee held a new monetary policy meeting this week. The Committee decided to keep the policy rate unchanged. There is uncertainty about future economic developments, but if the economy evolves as we now envisage, the policy rate will most likely be reduced in the course of this year.

But even if the policy rate is lowered further out, we must not expect it to come down to the levels we have been accustomed to over the past decade. Inflation has fallen significantly from the peak. That does not mean the job is done. To maintain confidence in the inflation target, it is important to go the last mile of disinflation and to bring inflation all the way back to target.

Chart: Sharp tariff increases

Uncertainty about the economic outlook is greater than normal. International trade barriers have increased since the new US administration took office, and there is uncertainty about future trade policies.

At the beginning of April, the US announced a sharp increase in tariffs. China responded by raising tariffs on goods from the US, and in the days that followed, tariffs between the two countries were raised further. Other countries have also announced higher tariffs on imports of US goods. The US has since postponed some tariff increases for many countries.

Historical experience and economic research suggest that increased trade barriers may dampen global economic activity. The uncertainty surrounding future tariffs may alone induce firms to postpone investment and households to reduce consumption. Over time, lower trade can lead to less efficient supply chains, weaker diffusion of technology and productivity losses. Many analysts, including the IMF, have lowered their forecasts for global economic activity as a result of the trade conflict, particularly for the US.

The impact on inflation is more uncertain. On the one hand, lower activity could curb inflation. On the other hand, higher tariffs may result in higher prices in the countries that introduce tariffs. Higher tariffs on intermediate goods in one country can spill over to prices in other countries through global supply chains. The impact on inflation in Norway will also depend on the impact on the krone exchange rate.

Higher tariffs and greater uncertainty have led to large movements in financial markets. Major equity indices dropped markedly at the beginning of April, and financial market uncertainty indicators rose. These movements have since largely been reversed.

The US dollar has depreciated against a range of currencies. Policy rate expectations have fallen, and oil prices and other commodity prices have also fallen, which may among other things reflect a weaker global economic outlook.

We must be prepared for swings in financial markets ahead too. Norges Bank has, as always, contingency arrangements in place and closely monitors market developments.

Over the past years, we have experienced large changes in individual prices and high imported price inflation, which triggered a debate about how monetary policy should react to a rise in inflation that is caused by conditions that Norges Bank cannot influence. For the time being, we do not know how higher trade restrictions will impact inflation in Norway. The trade conflict has nevertheless brought this discussion to the fore again. Let me say a few words about this.

Chart: Inflation is still too high

We are mandated to stabilise aggregate consumer price inflation around the inflation target. It is measured by the consumer price index, the CPI. The CPI is a measure of developments in living costs. But the CPI can fluctuate widely from month to month owing to changes in individual prices. We largely look through short-term swings and will only use the policy rate if we expect changes in individual prices to spill over to other prices and wages, and lead to a broad-based change in consumer price inflation. For example, when cocoa prices rose sharply earlier this year, there was little reason to worry about a persistent rise in inflation. Cocoa is not used in the production of many other goods or services, with little risk that higher cocoa prices would be passed on to other prices.

If inflation rises, we must make an assessment of whether the rise is temporary or whether there is a risk of a more persistent rise. To aid our assessment, we look at different measures of inflation that exclude highly volatile prices. Energy prices fluctuate widely, and an important indicator of underlying inflation is the CPI adjusted for tax changes and excluding energy products, CPI-ATE, which is published by Statistics Norway at the same time as the CPI. We also look at other measures, which indicate that underlying inflation has recently ranged between 3 and 4 percent.

There are many prices we cannot influence. That does not mean we can disregard them when setting the policy rate. For example, we cannot influence international prices, and we cannot influence tariff rates. But we can influence the spillover effects on domestic prices, and thereby reduce inflation persistence. By dampening the level of economic activity, we can counteract spillovers effects from changes in prices for individual goods to other prices and wages. And we can influence the krone exchange rate. The exchange rate is influenced by a host of factors that we cannot control, but also by the interest rate.

If prospects suggest that inflation will rise markedly above the target, we must react. If we do not react, we risk a loss of confidence in the inflation target. The cost of bringing inflation back to target may then become high, among other things because the krone could depreciate markedly.

If a rise in inflation is due to supply-side conditions, monetary policy will normally react less than if the rise is due to high demand. We cannot rule out a situation where an intensified global trade conflict could raise prospects of higher inflation and lower economic activity in Norway. We must then weigh the aim of bringing inflation back to 2 percent against the aim of keeping employment as high as possible.

We interpret our mandate to mean that we must give considerable weight to employment – also in situations when inflation deviates significantly from the target. The aim of keeping employment as high as possible will also be important in the face of increased uncertainty and a more extensive global trade conflict.

Chart: There is uncertainty surrounding the interest rate outlook

In March, we presented a forecast indicating that the policy rate would decline to 4 percent by the end of the year and gradually fall further over the next years. In June, we will provide an updated forecast. The forecasts show the most likely policy rate path.

In recent years, we have had to make large adjustments to the policy rate forecasts – because economic developments turned out to be different from what we had envisaged. An argument against publishing a policy rate forecast is that it can be perceived as a promise. In today's world of great uncertainty, some people may ask whether it is meaningful to publish a policy rate forecast.

We believe so. Transparency about what we assess to be the most likely policy rate path ahead has an inherent value. Moreover, it is also a clear advantage that the forecasts we publish for other variables - such as inflation and unemployment - are based on the policy rate path that we assess to be the most likely path. It makes it easier for the outside world to evaluate us.

We attach great importance to communicating that there is uncertainty surrounding the policy rate forecast, and our experience is that the uncertainty is well understood by the analysts and markets. We never make any promises about the policy rate. The promise we make is that we will set the policy rate in line with the mandate we have been assigned.

The Monetary Policy Regulation was last updated in 2018. The regulation has since remained unchanged. That does not mean that monetary policy has not been evaluated. The conduct of monetary policy has been evaluated annually, including by the expert group Norges Bank Watch. Norges Bank regularly updates its monetary policy strategy and takes on board new knowledge.

Throughout the past period, it has been important that the Storting and the Government have stood by the mandate for monetary policy. If doubt had arisen about our objective, the cost of bringing down inflation could have been greater.

It is nevertheless sensible that the mandate is also reviewed on a regular basis, and in the *Financial Markets Report*, the Ministry of Finance announced that a review of the Monetary Policy Regulation will be conducted every eighth year. In other countries, too, the mandate for monetary policy is reviewed regularly. It is important that such reviews are conducted at specified intervals, as the Ministry is now proposing, and not as a result of the prevailing state of the economy.

A review provides an opportunity to benefit from new insights. It could also strengthen the democratic anchoring of the mandate for monetary policy – even if changes are not substantial.

A review could naturally include a discussion of the tasks for monetary policy, and the weight given to various objectives. An important consideration should be that there is consistency between objectives and the tools available to the central bank.

Norges Bank has monetary policy instruments to keep inflation low and stable over time. Monetary policy also influences output and employment, but in the long term they are primarily affected by other factors. Low and stable inflation is important for a well-functioning economy and provides the best possible basis for high employment over time.

As part of the review, Norges Bank has been asked to present an assessment of its experience of the current monetary policy regulation and of international experiences and research on monetary policy. We look forward to carrying out the assignment given to us by the Ministry of Finance and will start the work immediately.

Let me finish.

The very high level of inflation has come down significantly without a large increase in unemployment. The financial system in Norway is robust. We have solid government finances, responsible social partners and a clear mandate for monetary policy. We must be prepared to face future turbulence, but we have a good basis for dealing with it.

Now, I look forward to answering your questions.