The Monetary Policy Report process in Norges Bank

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The views expressed in this report are those of the author.

Foreword

In January 2010, Ingimundur Fridriksson was asked to assess the interest rate decision process in Norges Bank. Fridriksson served at the Central Bank of Iceland from 1975 and as a member of the Board of Governors from 2002 to 2003 and from 2006 to 2009. He has also served as Executive Director for the Nordic-Baltic Constituency in the International Monetary Fund. His long-standing experience with central banking and monetary policy provides an excellent background to evaluate the internal process.

His report was presented to the Board in October 2010. It gives an overview of the discussions and deliberations leading up to the publication of Monetary Policy Report 1/10 and the interest rate decision in March 2010.

The following questions were posed when the task was assigned:

- Is the advice of the Monetary Policy Wing (PPO) on the interest rate and the rate path to the Bank management clear and well reasoned?
    - Do the internal processes in the PPO ensure an independent and well reasoned advice on the interest rate and the rate path. Is all relevant information presented?
    - Is the quality of the analysis of economic developments and of the projections satisfactory?
    - Is the format of the advice on the interest rate and the rate path – both internally in the PPO and to the Bank management – appropriate?
- Do the processes ensure that Bank management and the Executive Board are given a good basis for their decision on the interest rate and the interest rate interval?
    - Is all relevant information made available to the decision makers?
    - Is the quality of the oral presentations and the written background material presented to the Bank management and the Executive Board satisfactory?
- Is the quality good and the form of the external communication appropriate?
    - Monetary Policy Report.
    - Background note to the interest rate decision.
    - Press conference.

External evaluations serve as a useful cross-check on the methods and mind-set of the central bank. Fridriksson's conclusions and suggestions will be studied carefully with the aim to improve the decision making processes further. In line with Norges Bank's policy on transparency, the main thrust of his report is hereby made public.

December 2010,

Jon Nicolaisen

Executive Director
Norges Bank Monetary Policy

The PPR process in Norges Bank[1]

This note does not reflect a study of the Norwegian monetary policy framework, but rather reflects some personal observations on the process leading to the interest rate decision and the adoption of the monetary policy strategy on March 24, 2010, and the publication of the Monetary Policy Report on the same date.

Before turning to the process itself, it will be useful to very briefly review the framework within which Norwegian monetary policy is set and conducted. In March 2001, an inflation targeting framework was adopted for monetary policy. The record in the nine years since 2001 speaks for itself. Norges Bank has very successfully implemented its policy within this framework as best reflected in a stable rate of inflation near the target for the whole period.

Guidelines were set in a Regulation by the Ministry of Finance on Monetary Policy dated March 29, 2001[2]. It includes the following:

> **§ 1.**
> Monetary policy shall be aimed at stability in the Norwegian krone's national and international value, contributing to stable expectations concerning exchange rate developments. At the same time, monetary policy shall underpin fiscal policy by contributing to stable developments in output and employment.
>
> Norges Bank is responsible for the implementation of monetary policy.
>
> Norges Bank's implementation of monetary policy shall, in accordance with the first paragraph, be oriented towards low and stable inflation. The operational target of monetary policy shall be annual consumer price inflation of approximately 2.5 per cent over time.
>
> In general, the direct effects on consumer prices resulting from changes in interest rates, taxes, excise duties and extraordinary temporary disturbances shall not be taken into account.
>
> **§ 2.**
> Norges Bank shall regularly publish the assessments that form the basis for the implementation of monetary policy.

The Monetary Policy Bulletin includes the following statement on monetary policy in Norway[3]:

> ***Objective:***
> *The operational target of monetary policy is low and stable inflation, with annual consumer price inflation of approximately 2.5% over time.*

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[1] This is an abbreviated version of an internal Norges Bank report. PPR = Pengepolitisk rapport, i.e. *The Monetary Policy Report*

[2] Established by Royal Decree of 29 March 2001 pursuant to Section 2, third paragraph, and Section 4, second paragraph, of the Act of 24 May 1985 no. 28 on Norges Bank and the Monetary System.

[3] Monetary Policy Report 2010/1; March 24, 2010, p. 6. See also Ingvild Svendsen, Øistein Røisland and Kjetil Olsen: *Trade-offs in monetary policy*; Norges Bank Economic Bulletin 2/2004.

Implementation
Norges Bank operates a flexible inflation targeting regime, so that weight is given to both variability in inflation and variability in output and employment. In general, the direct effects on consumer prices resulting from changes in interest rates, taxes, excise duties and extraordinary temporary disturbances are not taken into account. Monetary policy influences the economy with a lag. Norges Bank sets the interest rate with a view to stabilizing inflation close to the target in the medium term. The horizon will depend on disturbances to which the economy is exposed and the effects on prospects for the path for inflation and the real economy.

The decision-making process
The main features of the analysis in the Monetary Policy Report are presented to the Executive Board for discussion at a meeting about two weeks before the Report is published. Themes of relevance to the Report have been discussed at a previous meeting. On the basis of the analysis and discussion, the Executive Board assesses the consequences for future interest rate developments, including alternative strategies. The final decision to adopt a monetary policy strategy is made on the same day as the Report is published. The strategy applies for the period up to the next Report and is presented at the end of Section 1 in the Report.
The key policy rate is set by Norges Bank's Executive Board. Decisions concerning the interest rate are normally taken at the Executive Board's monetary policy meeting every sixth week. The analyses and the monetary policy strategy, together with assessments of price and cost developments and conditions in the money and foreign exchange markets, form a basis for interest rate decisions.

Communication of the interest rate decision
The monetary policy decision is announced at 2 pm on the day of the meeting. At the same time, the Executive Board's monetary policy statement is published. The statement provides an account of the main aspects of economic developments that have had a bearing on the interest rate decision and the Executive Board's assessments. The Bank holds a press conference at 2:45 pm on the same day. The press release, the Executive Board's monetary policy statement and the press conference are available on www.norges-bank.no.

Reporting
Norges Bank reports on the conduct of monetary policy in the Monetary Policy Report and the Annual Report. The Bank's reporting obligation is set out in Section 75c of the Constitution, which stipulates that the Storting shall supervise Norway's monetary system, and in Section 3 of the Norges Bank Act. The Annual Report is submitted to the Ministry of Finance and communicated to the King in Council and to the Storting in the Government's Kredittmeldingen (Credit Report). The Governor of Norges Bank provides an assessment of monetary policy in an open hearing before the Standing Committee on Finance and Economic Affairs in connection with the Storting deliberations on the Credit Report.

Composition of the Executive Board

The Executive Board consists of seven members. The Governor and the Deputy Governor serve as chairman and deputy chairman, respectively. The other members come from outside the Bank. "The conduct of monetary policy is one of the Executive Board's most important tasks".[4] As of 2010, the two alternate members of the Board normally attend its seminars and meetings.

Monetary Policy Report

Three times a year, the Monetary Policy Report (hereafter referred to as the PPR) is published simultaneously with the announcement of the interest rate decision. Thus there are full-scale policy reviews three times a year which are concluded with the publication of the PPR. Incremental policy reviews take place between publication dates.

The decision making process

The monetary policy decision making process starts with preparatory work at the department level in the Monetary Policy Wing of the Bank, hereafter referred to as the PPO. These are the economics department (ØKA), the monetary policy department (PA), the market operations department (MOA) and the international department (INT), based on their respective responsibilities. As mentioned at the outset, this note relates primarily to the phase leading to the interest rate decision on March 24, 2010. In that process, I did not observe first hand the internal preparations in each individual department of the PPO, but I discussed some aspects of the processes with the directors of PA and ØKA. I also had a meeting with the Executive Director of the Financial Stability Wing (FST).

Efforts are made to engage the staff in the process ("inclusiveness"); by actively participating in the early preparatory work as appropriate, by having a chance in department meetings to express an opinion about what the advice to the Executive Board should be, and through detailed reporting back to their staff by the respective directors after seminars and decision making meetings of the Executive Board. All of this is expected to increase the staff's sense of shared responsibility and its motivation.

The preparatory work in each department was reflected in the various meetings at the PPO level which I attended. These were chaired by the Executive Director of PPO. The views of the PPO were shaped and sharpened in these meetings. The Executive Director of PPO asked probing questions and made clear requests for further work or amendments. Subsequently, the analyses and recommendations of the PPO were refined and presented to the Governor and Deputy Governor in meetings with them and made up the essence of the analysis and recommendations eventually presented to the Executive Board in a seminar and finally in the formal interest rate decision meeting.

In observing the PPR process I had the opportunity to attend the following meetings all of which entailed participation from ØKA, PA, INT and MOA, directors and staff as appropriate depending on the topic and type of meeting[5]:

- February 9: PPO meeting - Exogenous projections – The current situation
- February 16: PPO meeting - Themes in the PPR
- February 16: PPO meeting - Medium and longer term outlook

[4] Norges Bank's website: The Executive Board.
[5] A brief description of each individual meeting or seminar is annexed to this note.

- February 17: Seminar with the Governor and Deputy Governor on PPR 1/10 – the international economy and market developments
- February 17: PPO meeting - Interest rate projections
- February 19: PPO meeting - The monetary policy advice, the current situation, interest rate path and interest rate discussion on March 24, and projections
- February 23: Seminar with the Governor and Deputy Governor: The current situation
- February 23: Seminar with the Governor and Deputy Governor on the PPR 1/10, the longer term outlook
- March 1: Meeting with the Governor and the Deputy Governor on the PPO recommendation on the monetary policy strategy
- March 1: PPO "debriefing" immediately after the meeting above
- March 2: Meeting with the Governor and Deputy Governor on the first draft of PPR 1/10, preceded by continuation of the discussion from the day before
- March 3: Meeting with the Governor on preparations for the Executive Board seminar scheduled for March 10
- March 10: Executive Board seminar
- March 11: Executive Board seminar - continued
- March 11: Formal Executive Board meeting – Monetary policy assessment and strategy – direct continuation from the preceding seminar.
- March 15: "Debriefing" with the Governor
- March 24: The policy rate decision meeting of the Executive Board

Each of the meetings was important in its own right and a fundamental part of the overall process. The key meetings, if they are to be specifically identified, were in my view the PPO meeting on February 19, the meetings with the Governor and the Deputy Governor on March 1 and 2, and the Executive Board seminars on March 10 and 11. Annexed to this note is a brief description of individual meetings and seminars.

Earlier reviews

The interest rate decision making process in Norges Bank has been reviewed in the past, including some years ago by David Archer and Per Jansson[6]. Among their conclusions was that they saw clear strengths in the current arrangement, i.e. three full-scale reviews a year and opportunities for interest rate resets at more frequent intervals.

In their report, Archer and Jansson applauded the process in which different voices can be heard "with the hope that diversity of perspective both enriches understanding and guards against the dangers of group-think." Nevertheless, they identified three things which struck them, i.e. the similarity of advice ("there is no reasonable alternative"), alleged homogeneity of the management group, and the dominance of one person in process design and policy advice (the PPO Executive Director at the time). This, they offered, could be solved by the Governor and other senior staff, in some combination, taking on greater responsibility for process design.

Among their observations was that they found what they called the incremental policy review process (in between PPR publication dates) "to be curiously lacking in references back to the

[6] David Archer and Per Jansson (2005): "The Norges Bank interest rate setting process – A review"; unpublished internal report.

economic issues that were of greatest significance at the last strategic review." If this observation was correct at the time, it does not appear to be valid now.

Archer and Jansson also observed that "…the reasoning linking the financial stability wing's observation of financial stability indicators and its advice was not very obvious to us".

David Longworth and Asbjørn Rødseth evaluated the decision-making process of Norges Bank in 2003, only two years after the adoption of the inflation targeting framework[7]. They reviewed the strategy document and other material put forward to the Executive Board. Among other things they suggested research and development relating to forecasts and assessments and analyses. The conduct of monetary policy has been significantly refined since these early days of inflation targeting.

In 2003, the Centre for Economic Policy Research (CEPR) published a report commissioned by Norges Bank on how inflation targeting central banks write[8]. It compared inflation reports of 20 central banks and ranked them on various measures. The report concluded *inter alia* that inflation targeting imposes a tight process and reasoning discipline inside the central bank and that it requires a very high degree of transparency. Taken together, these requirements established the need for a detailed presentation of the data and procedures that go into the policy decision process. "Good central banks do almost everything right, including policy-making and the writing of the IR [inflation reports]. In the end, successful IT [inflation targeting] and publication of a high-quality IR are part and parcel of a virtuous circle."

The report suggested among other things clarity in the discussion of the objectives of the policy and of the decision making processes. Inflation reports should contain a concise executive summary, maintain continuity, avoid excessive length, and include boxes on special topics. Recommendations in the report are reflected in Norges Bank's Monetary Policy Report.

The main policy challenge in March 2010 and in the PPR 1/10 process

In the preparation of PPR 1/10, Norges Bank faced an inflation rate below target and likely to remain so for some time, and a wider negative production gap, more modest wage increases, and a stronger kroner than earlier envisaged. The task within the framework set for monetary remained to "nudge" inflation over time towards the target. "Norges Bank sets the interest rate with a view to stabilizing inflation close to the target in the medium term"[9].

The interest rate path was shifted downwards in PPR 1/09 from the previous report. In each of the two subsequent reports, PPR 2/09 and PPR 3/09, it was shifted upwards again, signaling in each case a more rapid move towards a "normal" interest rate than anticipated in the preceding report. In the preparations of the interest rate decision on March 24, 2010, it emerged that conditions had changed such as to warrant a shift in the interest rate path somewhat down again, thus implying a slight delay in the process of "normalizing" the interest rate from what was anticipated in PPR 3/09. For the sake of the clarity of the policy of the Bank and the transparency of the process, it became vital to analyze and present in a clear

[7] David Longworth and Asbjørn Rødseth: Report to the Executive Board of the Norges Bank on the Decision-Making Process and the Strategy Document, June 3, 2003.
[8] Andrea Fracasso, Hans Genberg and Charles Wyplosz: HOW DO CENTRAL BANKS WRITE? – An Evaluation of Inflation Targeting Central Banks; Centre for Economic Policy Research 2003.
[9] Monetary Policy Report 2010/1; March 24, 2010, p. 6

manner the factors behind the shift in the interest rate path. The main underlying projection remained unchanged, however, i.e. that interest rates would gradually rise towards normal levels.

Markets seemed to have adjusted at least partially if not fully to these prospects. Following the interest rate decision in December 2009, a further quarter percentage point rise in the policy rate could at that time have been anticipated on the March decision date. However, developments in the early part of the year were such that by March, markets and analysts had discounted the likelihood of an interest rate increase on the March decision date. In a preparatory PPO memo in the latter half of February, it was established *inter alia* that forward rates in trading partner countries had declined by 50 basis points since the publication of PPR 3/09 because central bank policy rate hikes were expected later than had been thought earlier[10]. A few days later, another memo reiterated that forward rates among trading partners had declined and added that the krone exchange rate was higher than had been expected.[11] In the first draft of PPR 10/1, submitted to the Governor and Deputy Governor on March 1, it was again stated that forward rates in trading partner markets had fallen significantly since the publication of PPR 3/09, and that this in isolation would imply a stronger krone, lower inflation and weaker growth. The draft text also stated that new information entailed that interest rate increases should come somewhat later than projected in PPR 3/09. This entailed an interest rate path ¼ - ½ percentage points below the path proposed in PPR 3/09 for the end of 2010[12].

In a memo to the Governor and Deputy Governor on his advice on the interest rate path and the monetary policy strategy, the PPO Executive Director stated that market expectations for Norges Bank's policy rate had fallen significantly and below the path projected in PPR 3/09 over the whole forecast period. Subsequent recommendation for the interest path mirrored that in the first draft of PPR 1/10 referred to above; i.e. that interest rate increases would come somewhat later than envisaged in PPR 3/09. The recommendation to the Governor and the Deputy Governor was that the new path would be consistent with a rise in the policy rate to 2% in June and with two possible further increases of 0.25 percentage points each until the end of the year. This also entailed an interest rate path which would at the end of 2010 be ¼ to ½ percentage point below the path projected in PPR 3/09. Cross checks based on simple monetary policy/interest rate rules indicated a somewhat higher policy rate in 2010 than implied by the recommended path[13].

This same recommendation was included in the draft PPR submitted to the Executive Board on March 3, 2010, and this was the message which the Governor conveyed to the Executive Board in the Seminar on the monetary policy strategy on March 11.

In the presentation to the Executive Board and in the draft PPR, the change in the interest rate path was graphically decomposed in a diagram[14] showing the main factors behind the shift: Primarily changes in interest rates abroad and in the exchange rate of the krone for the forecast period as a whole, with a marked contribution from changes in productivity, wages and prices in the early part of the period.

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[10] Tilrådning til PPR fra MOA, 18. februar 2010

[11] PA memo til Jon Nicolaisen: Tilrådning om rentebanen og strategiintervall i PPR 1/10, 23. februar 2010

[12] First draft of PPR 1/10, submitted by PPO to the Governor and Deputy Governor on March 1, 2010.

[13] Memo from PPO (JN) to the Governor and Deputy Governor: Tilrådning om rentebanen og strategiintervall i PPR 1/10, March 1, 2010

[14] Reproduced in PPR 1/10 as chart 2 on p. 16..

The process leading to the conclusion that the interest rate path should be shifted back following an upward shift in the two most recent PPRs followed logically from the analysis in meetings in the preparatory process. That includes the meetings with the Governor and Deputy Governor on February 23. The setting of the path also seemed to meet the defined criteria for choosing a good interest rate path.[15]

Summary and conclusions

When I was asked to observe the process leading up to the publication of the PPR 1/10 I did not expect to find or identify flaws in the work of the Bank and I certainly did not.

I did not specifically look at the use and significance of models in the process, long-term and short-term. I only observed the presentations of conclusions which built on the extensive use of models. I did not observe the preparatory work and meeting processes in individual departments of the PPO. Thus, I have no specific observations on these aspects. As mentioned, I discussed some elements of the process with the directors of PA and ØKA. I also had a brief discussion with the Executive Director of the FST.

A few general observations are as follows, not in any particular order of significance:

- Three PPRs a year is felt to be about appropriate. More than three would be too resource demanding and not offer any breathing space between issues.
- The contribution of FST in the meetings where it participates might possibly be better coordinated with or integrated into the general preparations in the PPO; some of the analysis presented by the FST might perhaps be a logical part of the analytical preparatory work in the PPO.
- The PPO directors which I spoke with were satisfied with the feedback they received in PPO meetings.
- The risk of and potential for "Group Think" is recognized to exist.
- The importance of confidentiality is duly recognized as well as risks to confidentiality.

Since joining Norges Bank in the middle of 2009, I have had the opportunity to attend several reviews of recent developments ("faktapresentasjoner") which provide the Governor and the Deputy Governor with a broad overview prior to interest rate decisions in between PPR publication dates. The presentations were normally not made by the same persons in successive sessions, that responsibility rotates, and they were generally not made by senior department staff. The responsibility to make the presentations offers the respective staff members both a challenge and an opportunity and provides them with valuable experience which can be and is put to use in the PPR process. Generally the presentations have been very good, the presenters very well prepared and very well able to answer questions put to them. At times, there have been some overlaps between presentations from different departments. There may also be some gray zones regarding the coverage of issues in these sessions.

[15] (1) Inflation should be stabilized near the target within a reasonable time horizon, normally 1-3 years, and should be moving towards the target well before the end of the three-year period. (2) The inflation gap and the output gap should be in reasonable proportion to each other. (3) Robust to alternative assumptions. (4) The interest rate should normally be changed gradually. (5) Interest rate setting must be assessed in the light of developments in property prices and credit. (6) Cross-check: simple monetary policy rules. (The criteria was copied from Governor Gjedrem's speech: Monetary Policy in Norway, 30 March 2006, available on Norges Bank's website.)

The FST participates in the main policy meetings and presents information which it deems relevant from a financial stability viewpoint. There is some cooperation and coordination at the department level in the FST and the PPO. Nevertheless, judging from only the PPR 1/10 preparatory process, it appears that there may be scope for better consolidation of FST's presentations with those of the PPO.

More specifically, my responses to the questions posed in the assignment (shown on p. 1) are as follows (at the risk of repeating some points already mentioned):

- The advice of the PPO on the interest rate and the rate path was thoroughly and professionally prepared. The objectives and strategy are clear and build on a nine years experience with inflation targeting the conduct of which has been developed and refined over the period. The decision in March to shift the rate path followed logically from the analysis and projections and was consistent with the Bank's practice, transparency and predictability.

    - As earlier mentioned, I did not participate in meetings in individual departments of the PPO, but the process at the PPO level was very thorough. The preparation of the PPO's advice to the Governor and the Executive Board was based on comprehensive analysis of domestic and external factors and on projections which are obviously rooted in thorough ground work and experience in conducting monetary policy on the basis of an inflation target for the past nine years. There are many meetings and potential overlaps, but they all serve the purpose of crystallizing the analysis and recommendations.

    - The quality of the analysis of economic developments is impressive and the same applies to the projections as far as I am able to judge them. The Bank relies on short and medium term models and the regional network in assessing conditions and making projections. The preparatory meetings at PPO level were good and served the purpose *inter alia* of indentifying weaknesses or inconsistencies in the analyses and projections. These meetings are a vital part of the process. If anything, more active discussions might be encouraged of both the analyses and the projections, or a more active scrutiny. This could also potentially reduce the risk of "group think". One possibility would be to designate specific staff members as commentators (or "Devil's advocates") in these meetings.

    - The organization of the preparation of the advice on the interest rate and the rate path struck me as logical and effective. In the process leading to the interest rate decision on March 24, it emerged that – following two upward shifts in the interest rate path - developments since PPR 3/09 supported a downward shift in PPR 1/10. However, looking further ahead, they did not change the prospects for a gradual rise in the policy rate towards normal levels; it would only come somewhat later than projected in PPR 3/09.

- There is little reason to question that the Governor and the Deputy Governor and subsequently the Executive Board as a whole are provided with a sound basis on which to base their decisions on the policy interest rate and the rate path.

    - All relevant information is made available. When it comes to the rate setting meeting itself, the information is necessarily in condensed form. However, at the preceding seminar on the monetary policy strategy, the Executive Board was presented with a thorough overview of developments and prospects and a draft PPR. It is in the Executive Board seminar where differences of view, if any, among its members should emerge. It is also in the seminar where the Executive Board members have the best opportunity to question and/or comment on the analysis and projections and underlying assumptions.

- The standard of the presentations to the Executive Board, both in the seminars and in the rate setting meeting, was of a high quality and they were obviously thoroughly prepared. They benefit *inter alia* from the preparatory meetings where the same issues have been presented and discussed. In the meetings themselves, the presentations were mainly in a graphic format (Power point presentations). This is an effective way in which to present both analyses and projections and the production reflected skill and clarity of purpose. On a technical note, one should only be careful not to overload individual frames. It is easy to blur the message with excessive detail or an overloaded picture. The written background material was also very clear and concise.

- On the external communication I have the following observations:

    - Among the strengths of the PPR is its brevity. The analysis and projections are concise and clear, the sequence of the text logical and the wide use of diagrams enhances the presentation of the content of the report. The content of the report is thoroughly focused on the pursuit of the inflation target.

    - The background and general assessment note published with the interest rate decision is somewhat long in detail in all the bullet points. The assessment ("avveiing") is the interesting part – the policy part - of the background statement. While the bullet points may be useful for the Executive Board members in their final deliberations, the published statement on the decision might become more appealing – and more effective – by leaving out the detailed bullet points. If they are not left out entirely, an alternative option would be to move them to the back, as an annex, thus giving the assessment a deserved prominence. The assessment could also be combined with the briefer text of the press release itself through a remodeling of its composition or formulation. The PPR, when published, contains all the analysis and projections which the Bank deems relevant for the communication to the public of its conduct of monetary policy, including the strategy for the coming months. On those occasions at least, the bullet points would appear to be of secondary importance in the communication strategy of the Bank.

      On the policy rate decision dates between PPR publication dates, it is presumably most important in the statement on the decision of the Board to relate developments to the analysis and projections in the most recent PPR, as is in fact done, whether they have deviated from what was expected, and how they relate to the monetary policy strategy. On these occasions, the bullet points would also appear to be of secondary significance for the communication of the Bank's policy. The thrust of the most important information they contain might be packaged differently.

A quick review of the press releases on the policy rate decisions of some other inflation targeting central banks reveals that they are generally short and include a continuous text rather than a detailed list of observations or indicators like the Norges Bank one. Transparency of the decision making process and the decisions themselves is important, but the bullet point format does not add very much in and of itself. I have also observed how the bullet points are being repeatedly updated in the final days and hours before an interest rate decision meeting, sometimes well beyond the time when the changes can have any bearing whatsoever on the decision itself. It might suffice to summarize the main and relevant bullet points in a short paragraph.

- The press conferences follow an expected format, with presentations of the main content of the PPR when it is published at the time of interest rate decisions. The custom of granting individual interviews with a part of the media immediately after the press conference proper may lead the "privileged" journalists to save their questions until after the private interview. Personal interviews should either be granted with all the interested members of the media or none at all. Granting no private interviews would force all questions being asked in the conference itself, where everyone hears all the questions and thus all the answers. This could "improve" the conference itself. It also appears to be only fair vis-à-vis the press and also ensures that no important information that may be revealed by the Governor or the Deputy Governor in a private interview bypasses the rest of the media.

  At the press conference on March 24, two important messages were revealed very clearly in what was otherwise a relatively uninspired conference: Interest rates will rise in the period ahead, and a firmer implementation of the fiscal rule could slow the rise in the policy rate towards normal levels.

The Executive Board is the decisions making body. The Governor and the Deputy Governor are a part of the internal processes while the external members only come into the picture at an advanced stage in the process. Through their competence the external members should be able to discover and identify weaknesses or inconsistencies in the recommendations presented to them. Their best opportunity is in the Executive Board seminars normally held two weeks prior to the publication of the PPR and the associated interest rate decision.

In conclusion, if I were to imagine myself being an outside member of the Executive Board, my assessment would be that the information provided and presented in the seminars on March 10 and 11, and subsequently in formal Board meetings, including the decision meeting itself on March 24, was very thorough and professional and gave a clear picture of the environment in which the Executive Board had to take its decision. I was impressed by the ambition and motivation of the staff as well as its respect for the Bank's mission. This reflects an ambitious and motivated leadership in the PPO and in the Bank as a whole.

The implementation of monetary policy is a continuous process where new information feeds into the decision making process and accordingly leads to adjustments in expectations and projections. The advice to the Board was rooted in comprehensive analyses and projections, including cross checks.

Annex:

Brief description of individual meetings and seminars

To reflect the evolution towards the decisions of the Executive Board on March 24, the following paragraphs briefly review the thematic sequence of the preparatory meetings. Presentations in individual meetings followed the organizational division of responsibilities between departments in the PPO. Times are shown to indicate the number of hours devoted to the meetings.

On February 9 (morning (9:00-11:00) and afternoon (14:00-16:00)), the external environment was presented in a PPO meeting, i.e. projections for the external economy, for interest rates and exchange rates and the current situation and prospects in the Norwegian economy. Among the issues covered were the prospects for government finances and the implications of the fiscal rule and its application. The presentations were very clear, well organized and well prepared. I do not have a feeling for whether these meetings were better or worse attended than usually; they were not “crowded”. The Executive Director of the PPO chaired the meetings, asked probing questions, and gave clear signals. There was some give and take and requests made for greater detail, longer series and so on.

On February 16 (9:00-9:40), there was a PPO meeting on special topics/themes in PPR 10/1 and on their presentation to the Executive Board seminar, chaired by the Executive Director of PPO.

On February 16 (10:00-11:30) there was a PPO meeting on the international and domestic economic outlook. Presentations were made on the analyses and projections. The main conclusion of the meeting was that the analyses “produced” an interest rate path which was roughly 50 basis points below the one presented in PPR 09/3.

On February 17 (12:30-14:30) there was a seminar with the Governor and the Deputy Governor on international economic and market developments. The international presentation included *inter alia* the conclusions of a specific government debt study which was eventually published in the „Aktuell kommentar“ series on the website of theBank.

On February 17 (16:00-17:00), there was a PPO meeting on the interest rate path. The broad analysis was well prepared, clear and comprehensive and presented in an organized manner. The PPO Executive Director chaired the meeting and asked probing questions.

On February 19 (13:00-14-30) there was a PPO meeting on the interest rate advice and the proposed path chaired by the Executive Director of PPO. At this meeting, the PPO entered into the phase of directly discussing its advice to the Governor.

Presentations were made on the international projections, on the projections for the NOK, on the GDP outlook in the light of the latest figures for 2009, and on the inflation outlook indicating a somewhat more moderate inflation than in the last PPR, and on government finances and petroleum related investment. All of these were discussed in some detail and areas identified which should be checked further, where either there was insufficient information available, or where there appeared to be inconsistencies in figures. Consideration was also given to the potential impact of selected shocks to the global economy and markets, including sovereign debt shocks. Deadlines were set for the completion of the work.

On February 23 (8:00-10:00) there was a seminar with the Governor and the Deputy Governor on current developments and prospects - comprehensive presentations based on earlier presentations and discussions in PPO meetings: Developments of GDP components, production gap, investment, consumption, incomes, the labor market, oil related investment projections and public sector finances, including the fiscal rule and its implications and interpretation.

On February 23 (13:00 – 14:00) there was a seminar with the Governor and the Deputy Governor where various projections were presented for the interest rate path, substantially the same as in the PPO late afternoon meeting on February 17, including different alternative scenarios. These were strictly analytical presentations.

On March 1 (15:00-16:00) there was a meeting with the Governor and the Deputy Governor on the policy advice and recommendations for the monetary policy strategy. Present were the Executive Director of PPO and his Deputy, one department director and a director from the Financial Stability Wing (FST).

The Executive Director presented PPO's proposals and the arguments which supported them, and the signals from the markets. The proposed interest rate path was below the most recent one. The path would shift largely back to where it was in June 2009. It entailed interest rate increases in June and October and possibly in December (50/50). The possibility of an interest rate increase in May should not be excluded. If fiscal policy were to be tightened beyond what was expected at the current time, then an interest rate increase in December would be unlikely. An important production gap would prevail for a while. Should the NOK strengthen further, then inflation would be lower and well under the objective.

The FST/FIM director commented on continued household borrowing and related aspects. Measures which restrain household borrowing and house price developments would be desirable.

In the ensuing discussion, references were made to the current relative conditions in the Norwegian economy and to the fact that the long term outlook remained relatively good and not affected by temporary changes in factors influencing the monetary policy strategy in the short term. It was also emphasized that the Bank had to be consistent in its policy implementation, be transparent and avoid surprising markets. At the present juncture, the Bank was facing lower interest rates abroad than had been expected and more moderate wage developments and a higher NOK exchange rate than earlier projected.

On March 1, immediately following the meeting with the Governor and the Deputy Governor, the PPO Executive Director convened a meeting in his office with department directors. The discussion in the previous meeting was reviewed and what further information might be needed or useful for the discussion which was to continue the next day.

On March 2 (14:00-15:00) there was a meeting with the Governor and the Deputy Governor on the first draft of 1/10. Before the attention turned to the PPR, however, the discussion was continued from the meeting on March 1. The main theme of the discussion was that three factors stood out: i) Lower wage growth forecast for 2010; ii) Greater interest rate differentials and a stronger NOK, and a greater risk of an even higher NOK at an unchanged interest rate path; iii) Growth prospects had not materially changed but growth in 2009 had been more moderate than earlier thought. Thus, Norway entered 2010 with a more negative output gap than earlier expected. All of the above dampened the prospects for inflation. This supported the downward shift in the interest rate path but did not change the earlier predictions that interest rates would rise over time towards a normal level. They would only do so slightly later than expected in PPR 3/09. The Governor concluded the discussion by stating that the Bank should be committed to the interest rate interval entailed in the recommended monetary policy strategy with a rise to be expected in May or June.

Subsequently, the discussion turned to the draft of PPR 10/1 and additional staff joined the meeting. The Governor commented on the draft. He emphasized that the report had to be very clear on what had changed since PPR 3/09, relating in particular to the interest rate path. The Bank had to be fully transparent.

On March 3 (10-11) there was a meeting with the Governor on preparations for the Executive Board seminar on March 10. The agenda was discussed and agreed.

On March 10 (16:00-18:45) there was an Executive Board Seminar. Present were, in addition to the Executive Board members, various staff, including the PPO Executive Director and department directors.

The Executive Director of PPO reviewed main developments since the last report, and the basic premises of monetary policy. This was followed by presentations by PPO directors on the international picture (focusing on the three major imbalances); exchange rate developments; effects of NOK exchange rate changes on the Norwegian economy, i.a. dependent on the nature of the exchange rate change, and on the normal interest rate and about robustness and consistency. The presentations were well prepared and well presented and stimulated the engagement of the members of the Board through comments and questions.

Separate from the PPO presentations was one from an FST deputy director on the housing market and finance in particular.

On March 11 (9:00-10:00) the Executive Board seminar was continued from the day before. Present were, in addition to the Executive Board members, various staff, including the PPO Executive Director and PPO department directors. The seminar started with presentations on the conclusions from the survey conducted through the regional network. It was preceded by a short briefing by the Governor on the network and its purpose. The network presentation was very thorough. This was followed by a clear and concise presentation of projections for the Norwegian economy, based on presentations and discussions in the preparatory meetings.

On March 11, immediately following the seminar, there was a formal Executive Board meeting on the monetary policy assessments and strategy.

The Governor introduced the strategy discussion. He took as a starting point what had been explained in the seminars, i.e. that there had been a slight change in the short term outlook, as *inter alia* captured in the Bank’s short term models. Longer term prospects had not materially changed. He briefly explained the models used by the Bank for its short-term and long-term projections and emphasized that they were not exact. Therefore, one also had to rely on intuition. He made a brief reference to the fiscal rule and the fact that it was not, in his view, being observed. He drew particular attention to the fact that inflation is below the target and that the production gap is wider than earlier anticipated. Interest rates would remain low for some time still. Price increases would be below earlier forecasts until the fall, mainly because of exchange rate and wage developments and a wider production gap than anticipated. Inflation would eventually move towards the target. The longer term impact of an extended period of very low interest rates was uncertain. In closing, he reminded the Board that it had to take a position on the strategy in the rate setting meeting on March 24.

There was considerable discussion of the main message served in the meeting with every member of the Board participating. The assessment was agreed and supported by everyone.

On March 15 (11:30 – 12:10) there was a "debriefing", or a review meeting, with the Governor after the Executive Board meeting. Present were the Governor, the Executive Director of PPO and most department directors. The Governor reviewed the presentations. On the whole their form had in his view been better than in the past and the meeting succeeded well in its purpose. There was more time for questions and comments. More Executive Board members were present than before with the presence of both principal and alternate members.

On March 24 (9:00 – 10:15[16]) there was a formal Executive Board Meeting, an interest rate decision meeting. The Governor presented the background information. He reviewed why the interest rate path was adjusted downwards from the last PPR and what the new path entailed for policy rate changes in coming months. The Governor emphasized *inter alia* the shift in market expectations of policy rate developments in major countries. He also explained the expected stable interest rate differential between Norway and the rest of the world. Finally, he proposed the adoption of the strategy as presented and that the policy rate should remain unchanged at this time.

There was relatively brief discussion following the presentation and all Executive Board members supported the proposed decision. References were made to the fact that the substantive discussion had taken place at the Executive Board seminar a couple of weeks earlier. The Deputy Governor characterized the decision such that the news was that the rate path had been shifted down somewhat but the main message was that interest rates would rise, albeit a bit later than earlier expected.

On March 24 (14:00) the rate decision was made public.

Subsequent meetings/gatherings

On March 24 (14:00-14:15) the Governor briefed the staff on the decision of the Executive Board.

On March 24 (14:45-15:15) there was a press conference where the Deputy Governor and the Executive Director of the PPO presented the interest rate decision and the PPR. The clear messages conveyed at the press conference were that interest rates would rise and that one should be prepared for them also rising at some stage above their long term normal level; they could just as well be 3 percentage points above that level as below. Moreover, the message that an early observation of the fiscal rule would lead to lower interest rates than otherwise was conveyed very clearly.

Questions at the press conference were rather uninspired and the conference relatively short.

I saw and heard only limited coverage of the interest rate decision on TV and radio news. There was not much in the printed press either and it mainly reflected the responses of analysts that the decision had been as expected. The headline in one paper stated that the interest rate on housing loans could rise to 9%.

[16] The time spent on the monetary policy decision. Subsequently, the meeting continued with the Board turning to other matters on its agenda.

On March 24 (16:30-18:00) the Executive Director of PPO presented the main message of the PPR to financial market analysts at a meeting arranged by them. The presentation was well received. The main points made and questions posed by commentators were:

- Normally when a rate increase is on the horizon, the Bank states in its public statement that the Board considered a rate increase. Why was that not done now?
- What international projections does the Bank use and does it make its own?
- Will the Bank do like the Riksbank and undertake a thorough study of the housing market?
- Does Norges Bank believe its own projections for the I-44?
- Why is Norges Bank pessimistic about the growth prospects in the world?
- The Bank must explain its message to the international audience.

The meeting was well attended, virtually a full meeting hall (Høyres hus - perhaps 100 attendees). Very few questions came from the audience (surprisingly few).