Norwegian inflation forecast. July 2006

This is the fifth of a sequence of forecasts of the Norwegian rate of inflation using a small scale econometric model to produce automatized inflation forecasts, AIRs. The approach taken, and model used, is the same as has been useful in analyzing the recent forecasts failure affecting Norges Bank's inflation forecasts, see Nymoen (2005).

The forecasted variable is the four quarter rate of change in the Norwegian consumer price index, adjusted for taxes and energy prices (CPI-ATE). The forecast horizon is 18 quarters, from 2006(3) to 2010(4).

The July 2006 AIR inflation forecast is shown in the fan-chart below. The point forecasts are shown as a black line, and the 90% prediction intervals are indicated by the symmetric fans. The inflation target of 2.5% is also indicated, as well as the recent inflation history, from 2002(1) to 2006(2) (red line). In the second half of 2006 inflation is projected to increase from its present level of 0.8% to a more brisk 1.4% annual change. In the second part of 2007, CPI-AET inflation in the range of 1.50%-2.5% becomes a quite likely event in this projection. The main impetus to the forecasted rate of inflation is provided by the forecasted rate of unemployment, which falls in 2006. The leveling-off of the inflation forecast in 2008-2010 is also a reflection of the forecasted rate of unemployment, which is more or less constant (seasonal variation aside) in the period 2007-20010.
The forecasted interest rate is shown below. The projected interest rate is increasing in the second half of 2006 and in 2007, as a response to lower unemployment and the moderate rise inflation. For the rest of the period it is more or less constant. In this forecast, it is a likely event that the interest rate stays below its 2002 peak for the length of the forecast horizon.

14 July 2006, AIR interest rate forecast.

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