

Economic trends

An expansionary policy designed to combat the economic downturn ensuing from the financial crisis has created fiscal deficits in many countries. Many European countries have therefore signalled fiscal tightening to achieve or maintain policy credibility so that financing costs do not become too high. This tightening has probably had little effect on the macroeconomic indicator figures observed so far, but the effects will be more pronounced going forward. The recent high growth figures for some EU countries therefore cannot be taken as an indication of a robust economic recovery. Developments in the USA are weaker than last winter. The burgeoning upturn we saw then may have given way to a new downturn. In Asia, too, growth is slowing, but on the whole from high growth rates.

Thus the cyclical situation abroad gives a mixed picture at present. There is also reason to suppose that growth in the near future will be slow compared with what is usual at the beginning of a cyclical upturn. We assume that growth among Norway's trading partners will be a good 2.5 per cent in 2010, but will then slow to about 2 per cent annually for the next two years. Growth in the euro countries is expected to be approximately one percentage point lower in both years. There is still a risk of a new global downturn. In the event, it would not be possible to shift economic policy in a more expansionary direction to the extent we saw in autumn 2008. Key policy rates are already very low and budget deficits problematic, so most countries have few measures in reserve to call upon. The reaction of the global economy to new shocks might thus be asymmetrical: given more positive developments, stronger consolidation of government finances would have a dampening effect, while more negative impulses could not easily be countered.

The most recent figures for the Norwegian economy show that the cyclical downturn is far more moderate than just over a year ago. If adjustments are made for special factors in the second quarter of the year, the quarterly national accounts figures can be interpreted as indicating that the Norwegian economy is close to a trough. A central feature of economic developments for a while has been that gross investment in mainland industries and dwellings has fallen, while consumption growth has been fairly high. In the second quarter of 2010, however, investment showed a clear increase, while consumption fell. We expect that investment will continue to increase during the second half of 2010 and that the weak household consumption figures in the second quarter will prove to have been transitory. This will keep mainland GDP growth near trend for a good while to come, which makes it difficult to pinpoint an exact time for a turnaround. In 2013, however, we expect the recovery to be more pronounced.

In view of the marked slump in the Norwegian economy through 2008 and 2009, the increase in unemployment has been moderate. LFS unemployment is now about 3.5 per cent. However, given moderate growth for a while to come, unemployment must be expected to rise somewhat from the current level, but nevertheless to remain appreciably below the level during the previous **recession**. This will have a dampening effect on domestic wage and cost inflation, which is still higher than that of trading partners. The cyclical downturn and appreciation of the krone both contributed to the fact that underlying inflation, measured by the CPI-ATE, is moderate. Inflation will probably remain low for a good while. Productivity growth in the period ahead can be expected to be higher than in recent years, which will lower inflation and boost real wage growth. Weaker energy price movements have already had a dampening effect on overall consumer price inflation. This will contribute to continued growth in household real income, thereby stimulating growth in household demand.

The economic situation in Norway: have we bottomed out?

Following an increasingly pronounced cyclical downturn in 2008 and into 2009 with a fall in output, mainland GDP began to rise again in the second half of 2009. Growth was moderate, however, so that the cyclical downturn in Norway continued, albeit at a slower pace. The preliminary quarterly national accounts (QNA) figures show that the moderate growth continued in the first half of 2010. However, the second

quarter figures are influenced by special factors associated with electricity production, the cold winter and strikes in connection with the annual wage settlement. Adjusted for these factors, the QNA figures indicate growth close to what we estimate to be trend growth for the Norwegian economy and which is equivalent to annual growth of just over 2.5 per cent. Although it is too early to state definitely that the economic downturn

Table 1. **Macroeconomic indicators 2008-2009. Growth from previous period unless otherwise noted. Per cent**

	2008*	2009*	Seasonally adjusted			
			09:3	09:4	10:1	10:2
Demand and output						
Consumption in households etc.	1.6	0.2	1.1	1.3	0.4	-0.6
General government consumption	4.1	4.7	1.1	-0.6	1.4	1.2
Gross fixed investment	2.0	-9.1	-4.6	3.2	-10.4	7.3
Mainland Norway	-1.4	-11.7	-5.5	6.3	-11.2	7.3
Extraction and transport via pipelines	5.1	5.7	-6.7	0.4	-5.2	1.3
Final domestic demand from Mainland Norway¹	1.6	-1.1	-0.1	1.6	-1.5	1.2
Exports	1.0	-4.0	3.2	0.8	-0.3	-2.4
Crude oil and natural gas	-2.0	-1.2	3.5	-2.0	-1.5	-1.2
Traditional goods	4.2	-8.2	7.5	0.1	0.1	0.8
Imports	4.3	-11.4	2.0	2.2	0.2	5.5
Traditional goods	-0.5	-13.1	2.1	-0.4	3.4	6.4
Gross domestic product	0.8	-1.4	0.4	0.1	0.2	0.1
Mainland Norway	1.8	-1.4	0.4	0.5	0.2	0.5
Labour market						
Man-hours worked	3.5	-1.8	-0.3	-0.2	-0.2	-0.1
Employed persons	3.2	-0.4	-0.3	0.0	-0.1	-0.1
Labour force²	3.4	0.0	-0.8	0.2	0.4	0.3
Unemployment rate, level²	2.6	3.2	3.2	3.3	3.5	3.6
Prices and wages						
Wages per standard man-year³	6.0	3.6	3.0	2.9	3.8	2.8
Consumer price index (CPI)³	3.8	2.1	1.8	1.4	2.9	2.6
CPI adjusted for tax changes and excluding energy products (CPI-ATE)³	2.6	2.6	2.4	2.3	2.0	1.5
Export prices, traditional goods	2.4	-6.1	2.4	-4.2	2.8	1.7
Import prices, traditional goods	4.7	-1.3	-0.8	-2.7	1.3	1.5
Balance of payment						
Current balance, bill. NOK	449.1	311.8	66.8	92.0	85.0	83.1
Memorandum items (unadjusted level)						
Money market rate (3 month NIBOR)	6.2	2.5	1.9	2.1	2.3	2.5
Lending rate, banks⁴	7.3	4.9	4.2	4.3	4.4	4.6
Crude oil price NOK⁵	536.4	388.1	421.2	429.2	452.5	493.8
Importweighted krone exchange rate, 44 countries, 1995=100	90.8	93.8	94.1	90.0	89.3	89.9
NOK per euro	8.2	8.7	8.7	8.4	8.1	7.9

¹ Consumption in households and non-profit organizations + general government consumption + gross fixed capital formation in Mainland Norway.

² According to Statistics Norway's labour force survey(LFS).

³ Percentage change from the same period the previous year.

⁴ Period averages.

⁵ Average spot price, Brent Blend.

Source: Statistics Norway and Norges Bank.

has come to a halt, several indicators suggest that the Norwegian economy is close to bottoming out.

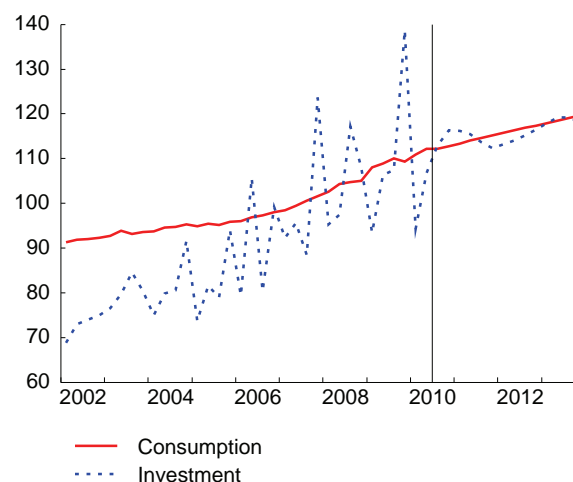
The turnaround from a fall in mainland GDP to moderate growth this past year is fairly broad-based. A certain increase in global growth has pushed up Norwegian exports and manufacturing output. Gross capital formation increased appreciably in the second quarter after following a generally falling trend since the start of 2008. This has generated positive impulses to building and construction. Figures for non-residential construction starts now show a clear upturn, while figures for dwellings are more stable. The fall in housing investment has stopped, however, and that is important to a turnaround in the Norwegian economy. Resale home prices are showing a fairly high rise and are providing a stimulus for new construction project starts. Fiscal policy has resulted in high public sector growth and stimulated private sector activity. The weak developments in household consumption in the second quarter were surprising, and curbed growth appreciably. Special factors can explain some of this decline, but not all. We expect household consumption to increase appreciably in the period ahead. Failing that, it is difficult to envisage an economic recovery. A boost of this kind from household consumption is particularly important because the contribution from public sector growth will be reduced in 2011, when fiscal policy will probably undergo some tightening.

The downturn in the Norwegian and global economy has caused a rise in unemployment, but the increase in Norway has been very moderate on a global scale, and the level is not high. The most recent Labour Force Survey (LFS) figures show a levelling off of unemployment at about 3.5 per cent of the labour force. This reflects slow labour force growth, partly as a consequence of an increased propensity for education and partly for other cyclical reasons. The decline in employment has halted. However, there are no grounds for expecting any significant employment growth. Output growth, if any, tends rather to coincide with higher productivity growth at around the cyclical trough.

Inflation has slowed considerably over the last couple of years. If the CPI adjusted for taxes and excluding energy products is used as an indicator, inflation has fallen from just over the inflation target to appreciably below the target at present. The overall rise in the CPI has also slowed appreciably following the fall in electricity prices during the spring and summer from the high level of last winter. Nominal wage growth has probably almost halved from the high level in 2008 to a bare 3.5 per cent in 2010. Real wage growth is estimated to have fallen from 2.5 to 1 per cent from 2008 to 2010, but may increase slightly going forward because CPI inflation is expected to edge down.

The monetary and fiscal policy impetus will wane gradually over the next few quarters. The interest rate has bottomed out, and fiscal policy will be tightened

Figur 1. **General government. Seasonally adjusted volume indices. 2007=100**



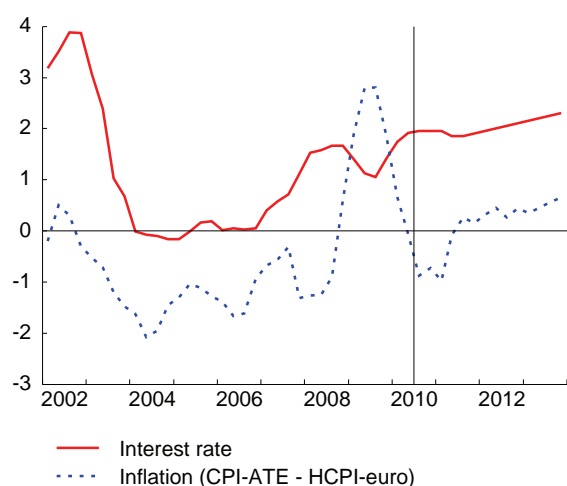
Source: Statistics Norway.

somewhat. It appears reasonable to assume that policy will be approximately cyclically neutral. Because of reduced fiscal policy impetus, the reverse of the fall in mainland investment will make an important contribution to the turnaround in the growth rate. We believe that the high second quarter figures were not just a short-term phenomenon, but the beginning of a period of increasing investment. The electricity supply sector, in particular, may exhibit considerable growth in the period ahead, while manufacturing investment will continue to fall, albeit at a slower pace than up to the present. Petroleum sector investment will probably rise somewhat and generate growth impulses to the Norwegian economy.

A broad-based economic turnaround is dependent on a moderate global upturn involving higher Norwegian exports. Large budget deficits in Europe are leading to fiscal tightening and greater uncertainty in financial markets. This may dampen the weak upturn in the euro countries and reduce the likelihood of strong growth in Norwegian exports in the period ahead. Signs of weak developments in the USA point the same way. Growth in Asia is high, but nonetheless somewhat weaker than at the end of 2009. Growth among Norway's trading partners is assumed to be fairly moderate in the period ahead, as it is often observed to be in the wake of financial crises.

Given moderate growth in the Norwegian economy, unemployment will probably increase somewhat over the next few quarters. Wage growth will probably remain at approximately the current level for a period ahead, which implies slightly rising real wage growth. With moderate growth abroad, a low rise in prices for imported goods and a weak rise in domestic costs, inflation in Norway will remain low for a while to come. Towards the end of the projection period the inflation rate will again be close to the inflation target.

Figur 2. Interest rate and inflation differential between NOK and the euro. Percentage points



Source: Norges Bank and Statistics Norway.

We estimate mainland GDP growth at approximately 1.5 per cent in 2010. From next year, growth in the mainland economy could almost double and hence rise to just over trend. In 2013, we expect the Norwegian economy to be in a pronounced cyclical upturn, so that we approach a cyclically neutral situation towards the end of the year. In the event, the coming cyclical upturn will be moderate compared with the upturn from 2003 to 2005 when the Norwegian economy last moved from a cyclical trough to a cyclically neutral situation. In 2004-2005 we experienced annual mainland economic growth of 4.5 per cent, compared with only 3 per cent according to the projections for the years 2011-2013. Thus the overall increase in output is about 9 per cent for both periods, but we now believe that it will take longer to reach a cyclically neutral situation than we did seven years ago. The explanation for the differences lies in the following factors:

- Impetus from market growth among trading partners is expected to be appreciably lower and to curb exports.
- Growth in petroleum investment is now expected to be weak.
- Real wage growth is expected to be more moderate now because the terms of trade gain is smaller.
- A higher debt burden results in weaker household income and consumption growth even though the real interest rate after tax is approximately the same as during the previous cyclical upturn.
- Fiscal policy generated a positive growth stimulus in 2004 and 2005, but in the future it will provide a weaker stimulus.

Less expansionary fiscal policy

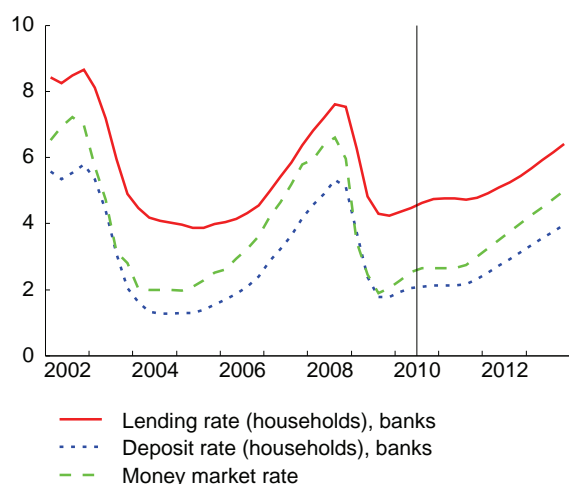
Preliminary QNA figures show that annualised growth in general government consumption was at approximately the same level in the first half of 2010 as in 2009. Consumption growth in the first half of 2010 primarily took place in municipal government. Gross general government investment was at the same level in the

first half of this year as in the same period in 2009. Real growth in public transfers to households was almost 4 per cent in the first half of this year compared with the same period in 2009. Thus fiscal policy has continued to generate a clear stimulus to the mainland economy so far this year. In the Revised National Budget 2010 (RNB), underlying real growth in expenditure in the government budget for 2010 was estimated at 2.5 per cent. The preliminary figures imply that growth may have been somewhat higher than this in the first half of 2010, and there is therefore reason to believe that the impulses may be somewhat weaker through the remainder of 2010. Our projection for growth in general government spending implies virtually zero growth through the second half of 2010 compared with the same level in the second quarter. Excluding military investment in frigates, our projection for gross general government investment implies investment growth of just over 1 per cent from 2009 to 2010. Public sector purchases of goods and services are assumed to generate insignificant demand impulses in the second half of 2010, while real growth in transfers to households will result in roughly the same impulses as in the first half of the year.

According to the RNB, the structural non-oil budget deficit (SNOBD) measured in relation to the capital in the Government Pension Fund Global was 4.8 per cent in 2009. The SNOBD projection in the RNB was 5 per cent, which is somewhat lower than in the period 2001-2005. The Government has indicated that it is aiming for a less expansionary policy from 2011 onwards in order to return relatively rapidly to the 4 per cent path prescribed by the fiscal rule. This forms the basis for our projections. Fiscal policy for 2011 is expected to be tightened somewhat compared with 2010 through reduced growth in public spending. Growth in public purchases of goods and services is expected to be lower than trend growth in the Norwegian economy. Consumption growth is estimated to be just over 2 per cent, while gross general government investment adjusted for changes in purchases of frigates is approximately unchanged compared with 2010. Our assumptions are based on direct and indirect taxes adjusted for inflation throughout the forecast period.

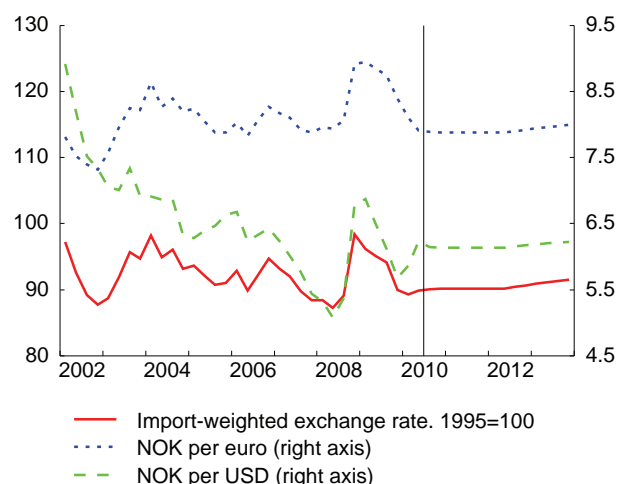
Fiscal policy is expected to provide less impetus also in 2012, as economic growth picks up. Our projections are based on budgetary tightening taking place through moderate growth in public sector purchases of goods and services. Our projections indicate that, given increased capital in the Government Pension Fund – Global, we will be approximately on the 4 per cent path in 2012. According to our projections, the Norwegian economy will be in a close to cyclically neutral situation at the end of 2013. We anticipate that the increased scope for manoeuvre in fiscal policy in 2013 will be partly used for higher gross general government investment, but the projections imply that somewhat less than 4 per cent of the projected value in 2013 of the Government Pension Fund – Global will be used.

Figur 3. Norwegian interest rates. Per cent



Source: Norges Bank and Statistics Norway.

Figur 4. Exchange rates



Source: Norges Bank.

In the years ahead, old age pension expenses will increase substantially because large cohorts born at the end of World War II and succeeding years will reach retirement age. Growth in old-age pensions measured as number of G (basic amount in the National Insurance Scheme) may increase from about 2.5 per cent annually to over 4 per cent by the end of our projection period. However, individual freedom in determining the time of retirement, coupled with new rules, adds great extra uncertainty to the projections for old age pension expenses. A decline in sickness absence together with a levelling off of growth in expenditure for unemployment benefit from next year (in real terms) and a slowing of the rise in the number of disability pensioners mean that the overall real growth in transfers to households will probably not be as high as 4 per cent in the period ahead.

One year without interest rate increases

Norges Bank's setting of the key policy interest rate is aimed at stabilising inflation at 2.5 per cent in the medium term, while promoting stable developments in output and employment.

Inflation measured by the 12-month change in the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) has fallen somewhat since the beginning of the year and was 1.3 per cent in July. At the same time, mainland GDP is appreciably below trend.

Prompted by the global financial crisis and the sombre economic outlook, Norges Bank cut the key policy rate by 4.5 percentage points over a nine month period from autumn 2008, bringing it to 1.25 per cent in June 2009. Since then, the policy rate has been raised three times, most recently at the beginning of May this year. Each of the interest rate hikes has been 0.25 percentage point, so that the key rate is now 2.0 per cent.

As a direct result of the financial crisis, the differential between the money market rate and the key policy rate

widened. Before the financial crisis, money market rates largely shadowed the policy rate with a premium of 0.25 percentage point. Since the summer of 2007, the premium has been substantially larger, and at the end of September 2008 it was over 2 percentage points. Since November 2009 the premium has been between 0.5 and 0.75 percentage point. The money market rate was between 2.6 and 2.7 per cent in August 2010.

Through its effect on total demand, the setting of interest rates influences private and municipal sector credit growth, which is important for the financial stability of the economy. Domestic credit growth, measured by the 3-month moving average of gross domestic debt growth in the private and municipal sector (C2), was just under 1.5 per cent from the first to the second quarter of this year. This is approximately the same as from the fourth quarter of 2009 to the first quarter of this year, but higher than the growth from the third to the fourth quarter of 2009, which was less than 0.5 per cent. Credit growth is nevertheless substantially less than in the years prior to the financial crisis, when growth was over 2.5 per cent each quarter, or over 10 per cent measured as an annual rate. Credit growth in non-financial enterprises increased by 0.9 per cent from the first to the second quarter of this year, after falling by almost 2 per cent from the third to the fourth quarter of 2009. Household credit growth, on the other hand, is slowing somewhat and was less than 1.5 per cent from the first quarter to the second quarter of this year.

The Norwegian krone depreciated strongly against the US dollar and the euro through the second half of 2008. This weakening was largely reversed through 2009. Measured in terms of the import-weighted krone exchange rate, the krone appreciated by over 12 per cent from December 2008 to January 2010. From the beginning of 2010 and up to mid-May this year there were only short-term fluctuations around a relatively stable level in the value of the krone measured by the import-weighted krone exchange rate. During this

period the krone strengthened against the euro and weakened against the US dollar. In mid-May the krone weakened by about 2 per cent, measured by the import-weighted krone exchange rate, and since then the value of the krone has again only displayed short-term fluctuations around a fairly stable level.

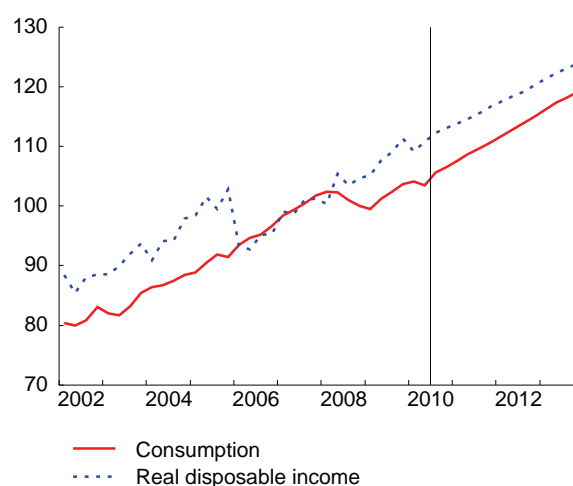
Fiscal policy tightening in many countries – rendered necessary by high government debt – will probably mean that interest rates worldwide will remain at a low level in the period ahead. This points to interest rates in Norway also being kept low in order to avoid a high interest rate differential strengthening the krone exchange rate. We therefore do not believe that there will be any further increases in the key policy rate before next summer. As a result, money market rates will probably remain at the current level for the remainder of 2010 and into 2011. Two or three interest rate hikes in the latter half of 2011 will bring money market rates up to 3-3.25 per cent by the end of 2011. The interest rate level will gradually normalise in line with normalisation of the cyclical situation, and short rates are projected to rise to 5 per cent by the end of 2013. The money market rate is assumed to lie about 2 percentage points higher in Norway than in the euro area throughout the projection period.

Our projections imply small changes in the value of the krone from the current level. We assume that one euro will cost between NOK 7.85 and NOK 8.00 through the projection period, while the krone will fluctuate in line with the euro against other currencies. This nonetheless represents a substantial strengthening of the krone as an annual average from 2009 to 2010 of 9 per cent against the euro and 4 per cent measured in terms of the import-weighted krone exchange rate. The krone will strengthen approximately 1 per cent against the euro in 2011 and weaken by about 1 per cent in 2013. The depreciation is due to the fact that some of the effect of the persistent interest rate differential will be depleted and that Norwegian inflation will then be higher than that in the euro area.

Appreciable consumption growth ahead

The most recent seasonally adjusted QNA figures show that consumption by households and non-profit organisations fell by 0.6 per cent in the second quarter of 2010 compared with the previous quarter. High electricity bills and abnormally high advance tax payments undermined household liquidity and contributed to the decline in consumption. This second quarter decline followed four consecutive quarters of solid consumption growth and is largely attributable to the fall in goods consumption. This in turn was due to the fall in electricity consumption that followed the high consumption of the two previous quarters due to the cold winter. Other important product groups such as food, furniture and white goods also showed a decline in the second quarter of 2010. Vehicle purchased, however, increased, albeit weakly, during the same period. In contrast to goods consumption, consumption of services showed a

Figur 5. **Income and consumption in households. Volume indices. 2007=100**



Source: Statistics Norway.

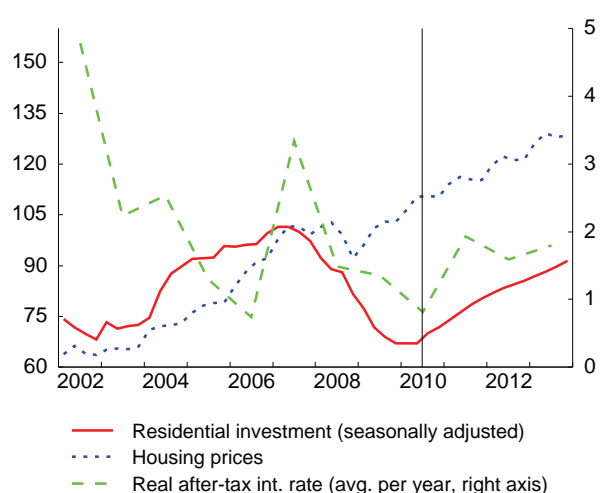
certain upswing in the second quarter. Postal and telecommunication services and hotel and restaurant services made the largest contribution to this development.

According to preliminary QNA figures, household real disposable income increased by 4.6 per cent in 2009 compared with 3.4 per cent in 2008. Substantially lower interest expenses in the wake of the financial crisis and almost a halving of consumer price inflation contributed to the increase in real income growth. Wage income, the primary source of household income, contributed to a more moderate extent to income growth since the cyclical downturn resulted in weaker wage growth and lower employment in 2009 than the previous year. Growth in household real disposable income is expected to be around 3 per cent annually in 2010 and for the remainder of the projection period.

Housing wealth will continue to grow with rising house prices and as a result consumption growth in 2010 may rise to just over 3 per cent as an annual average, compared to approximately zero growth last year. Although growth in wage income is expected to pick up more markedly with an improved economic situation, somewhat higher interest rates and gradually increasing consumer price inflation will moderate growth in real disposable income in 2011-2013. Increasing household wealth will continue to push up consumption growth, so that it is projected to remain stable overall at around 4 per cent annually in the period 2011-2013.

The financial consolidation that followed in the wake of the financial crisis led to a doubling of the saving ratio from 2008 to 2009. Even given higher real interest rates, the household saving ratio (saving as a share of disposable income) is expected to fall by about half a percentage point this year, from a level of around 7.5 per cent in 2009. The saving ratio is then expected to fall gradually to about 5 per cent in 2013, in line with rising house prices, which in isolation reduces the need

Figur 6. **Residential market. Left axis adj. indices. 2007=100. Right axis per cent**



Source: Statistics Norway.

for household financial consolidation. Net financial investment will fall through the projection period in line with the decline in saving and rise in housing investment. Households are projected to reduce their net financial investment from a level of around NOK 46 billion in 2009 to a level of around NOK 6 billion in 2013.

Housing investment is rising

In 2008 and 2009 housing investment fell by 12 and 19 per cent, respectively, compared with the previous year. According to seasonally adjusted QNA figures, the decline has gradually slowed and housing investment increased by 0.1 per cent from the first to the second quarter of this year after falling 0.2 per cent in the previous quarter. Housing starts levelled off through 2009 but for the present show no definite signs of rising. Prospects of a more favourable economic situation and a further rise in house prices now point to an increase in housing starts, so that housing investment will probably pick up again in the course of 2010 and for the remainder of the projection period. We project an increase of about 10 per cent in both 2011 and 2012, while growth will probably be somewhat lower in 2013. Despite this impending growth in housing investment, the level in 2013 will be about 10 per cent lower than the peak level in 2007.

According to Statistics Norway's house price index, house prices as a whole fell steeply through the second half of 2008 in the wake of the financial crisis. Prices declined about 10 per cent from the second to the fourth quarter of that year but have since shown a pronounced increase that outweighed the preceding decline. House prices rose by 3.7 per cent from the second to the fourth quarter of this year. They rose by 19.6 per cent from the fourth quarter of 2008 to the second quarter of 2010. In the second quarter of this year, house prices were 7.5 per cent higher than at the previous price peak two years earlier.

We expect house prices to rise further for the remainder of the year, resulting in an annual average rise of 8-9 per cent. For the remainder of the projection period we estimate that house prices will climb by just over 5 per cent annually, in line with an improvement in the economic situation and steady and moderately high income growth.

From decline to slight increase in petroleum investment

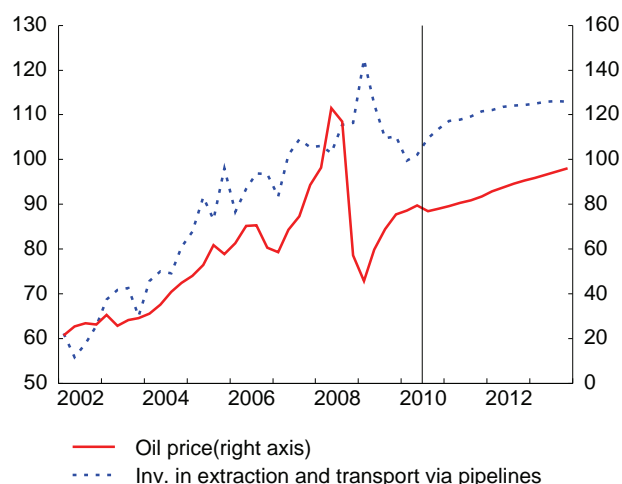
Petroleum investment has shown consistently weak developments since the investment peak in the first quarter of 2009. According to the most recent QNA figures, petroleum investment fell by 5.2 per cent from the fourth quarter of 2009 to the first quarter of 2010, but rose by 1.3 per cent from the first to the second quarter of 2010. The moderate developments through the winter can be attributed to the fact that oil exploration activity and the production of new platforms has declined appreciably. This is partly because exploration investment was very high in 2009, and there were only a limited number of construction starts on new platforms in 2010 following the completion of a number of oil platforms in 2009. According to the QNA, investment in oil production platforms, rigs and modules fell by over 23 per cent from the first half of 2009 to the first half of this year. As a result of high oil drilling activity during the spring 2010, investment in drilling and exploration for oil and in pipelines only fell by 3.8 per cent.

Petroleum investment is expected to pick up in the second half of 2010. A number of new projects are already under way, and in the course of the year will contribute to increasing investment in oil platforms. The increase is not expected to be large enough to prevent a definite decline in investment from 2009 to 2010.

Steadily lower oil production and higher oil prices are expected to characterise developments in petroleum investment in the next few years. Natural gas production, on the other hand, is expected to increase for several years to come, and a number of the new fields being developed will produce gas. It is less certain how gas prices will develop, however. New gas recovery technology may lead to a steep increase in the supply, but the uncertainty associated with these projects is still high. In our projections we have assumed an 18 per cent increase in the export price of gas through the projection period compared with an increase of 24 per cent in the export price of oil.

We have assumed that minor discoveries and satellites to existing discoveries will be developed as prices rise. An extension of production also entails a need to upgrade the oldest fields. This means that growth in overall investment will primarily take the form of new oil platforms and further development of existing fields. Developments in the near future will be moderate. Investment will not reach the peak level of 2009 until 2012.

Figur 7. Oil price and oil investment. 2007=100



Source: Statistics Norway.

Crude oil and natural gas production are now equivalent in size, measured in terms of energy content. Because of the substantially higher price of oil, however, the production value this year is far higher than for gas. This means that although gas will account for an increasing share of Norwegian petroleum production, it is nevertheless oil production that generates the high income.

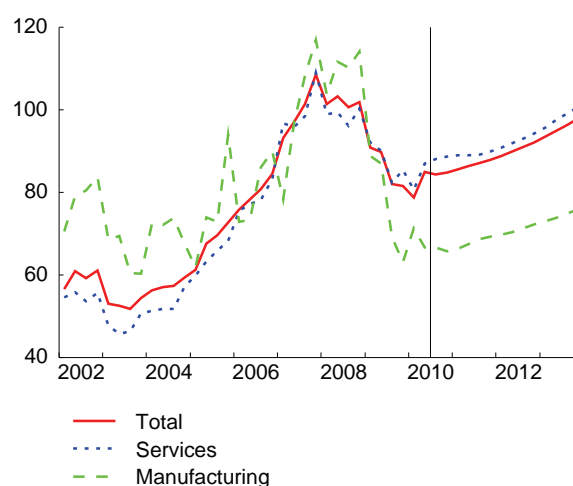
Increased mainland investment going forward

On the whole, mainland business investment fell throughout 2008 and 2009. This trend was not broken until the second quarter of 2010. Mainland business investment, adjusted for normal seasonal variations, increased by just under 8 per cent compared with the previous quarter.

Manufacturing and mining investment fell by 6.7 per cent in the second quarter of 2010. Nevertheless, the level in the second quarter was 5.7 per cent higher than that in the fourth quarter of 2009, but also a full 43 per cent lower than the investment peak observed in the fourth quarter of 2007. Statistics Norway's most recent investment intentions survey indicates that manufacturing investment will be approximately 10 per cent lower in 2010 than in 2009. In 2009, investment fell by about 30 per cent. Given the normal under-reporting in the investment intentions survey in the August prior to the investment year, the level is likely to be approximately unchanged in 2011. Manufacturing investment has accounted for around 15 per cent of total mainland business investment for the past five years.

The investment intentions survey also indicates an increase in investment in electricity supply of around 10 per cent in 2010 and a further 25 per cent in 2011. This must be viewed in light of high projections for investment in the transmission and supply of electricity because of the focus on upgrading and developing the

Figur 8. Investment, Mainland Norway. Seasonally adjusted volume indices. 2007=100



Source: Statistics Norway.

electricity grid. Our investment projections for manufacturing and power supply are in line with Statistics Norway's most recent investment intentions survey.

Following the decline since 2008, an upswing was recorded in the second quarter of this year in construction starts for virtually all types of commercial buildings. After office buildings, the biggest increase, both in area and as a percentage, was in manufacturing and warehouse facilities. Construction starts for manufacturing and warehouse facilities accounted for a 30 per cent increase in the second quarter of 2010 on the same quarter of the previous year.

Investment is expected to increase as the domestic economic situation improves. We estimate a decline in investment of 3.9 per cent in 2010 for mainland Norway as a whole, and that investment will increase by about 5 per cent in the years ahead. Growth in mainland business investment will increase from just over 3 per cent in 2011 to about 6 per cent in 2013.

Rise in export prices boosts the trade surplus

The overall volume of Norwegian exports in the second quarter of 2010 was 2.4 per cent lower than in the first quarter. The seasonally adjusted QNA figures show that the decline can largely be attributed to reduced exports of petroleum products and business services. Exports of traditional goods, which include large product groups such as metals and chemical and mineral products, increased by almost 1 per cent. The volume of exports fell in both the first and second quarters of this year compared with the previous quarter, but because of the upswing in the second half of last year, total exports in the first half of 2010 were almost 1 per cent higher than the volume in the first half of 2009 – but far lower than that in the first half of 2008, before the financial crisis precipitated the global contraction. In the first half of this year, exports of traditional goods and natural gas

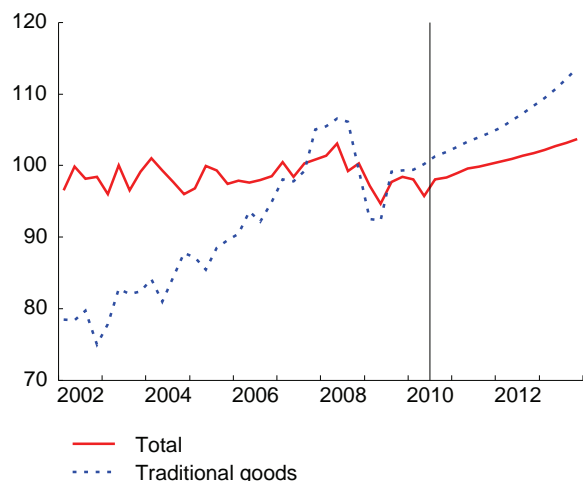
Table 2. **Main economic indicators 2009-2013. Accounts and forecasts. Percentage change from previous year unless otherwise noted**

	Accounts 2009	Forecasts								
		2010			2011		2012		2013	
		SN	MoF	NB	SN	NB	SN	NB	SN	NB
Demand and output										
Consumption in households etc.	0.2	3.3	4.3	3 1/2	3.9	4	3.7	3 1/4	4.0	2 3/4
General government consumption	4.7	2.7	2.4	2 1/2	2.2	2 1/4	1.9	..	1.9	..
Gross fixed investment	- 9.1	-5.5	-3.6	..	4.0	..	4.4	..	5.1	..
Extraction and transport via pipelines ¹	5.7	-5.9	-2.5	-2 3/4	4.5	4	3.2	5	0.9	4
Mainland Norway	- 11.7	-3.9	-3.5	-4 1/4	5.3	6 1/2	4.2	..	5.5	..
Industries	- 15.4	-4.2	-7.8	..	3.1	..	4.3	..	5.8	..
Housing	- 18.9	-3.7	-1.5	..	11.6	..	8.7	..	5.9	..
General government	7.0	-3.5	5.1	..	4.6	..	-0.4	..	4.6	..
Demand from Mainland Norway ²	- 1.1	1.8	2.3	1 3/4	3.7	4	3.3	3 1/4	3.7	2 1/2
Stockbuilding ³	- 2.1	1.6	..	..	0.2	..	0.0	..	0.0	..
Exports	- 4.0	1.0	0.8	..	1.9	..	1.5	..	1.7	..
Crude oil and natural gas	- 1.2	-2.2	-3.0	..	-1.3	..	-0.9	..	-1.0	..
Traditional goods ⁴	- 8.2	5.3	4.7	4 3/4	2.8	2 1/4	3.0	..	4.2	..
Imports	- 11.4	6.8	3.7	2 3/4	5.4	5 1/4	4.4	..	4.8	..
Traditional goods	- 13.1	7.8	4.7	..	6.8	..	5.3	..	6.2	..
Gross domestic product	- 1.4	1.0	0.9	3/4	2.4	1 3/4	2.2	2 1/4	2.5	1 3/4
Mainland Norway	- 1.4	1.5	2.1	1 3/4	2.9	2 3/4	2.8	2 3/4	3.3	2 3/4
Labour market	- 0.4	-0.6	-0.1	-1/4	0.8	3/4	1.4	1	2.2	1/2
Employed persons	3.2	3.6	3.5	3 1/2	3.7	3 3/4	3.8	3 1/2	3.4	3 1/2
Unemployment rate (level)										
	4.2	3.5	3 1/4	3 1/2	3.4	4	3.7	4 1/2	4.7	4 3/4
Prices and wages	2.1	2.5	2.2	2 1/2	1.5	1 1/2	2.1	2 1/4	2.5	2 1/4
Annual earnings	2.6	1.4	1.3	1 1/2	1.4	1 3/4	2.0	2 1/4	2.4	2 1/4
Consumer price index (CPI)	- 6.1	3.0	1.9	..	5.3	..	5.1	..	4.3	..
CPI-ATE ⁵	- 1.3	-0.4	-0.4	..	1.3	..	1.4	..	2.2	..
Export prices, traditional goods	1.9	8.6	..	..	5.3	..	5.1	..	5.5	..
Import prices, traditional goods						..		..		..
Housing prices	311.8	350.4	385.6	..	367.1	..	396.3	..	426.8	..
	13.1	14.0	15.2	..	14.0	..	14.3	..	14.4	..
Balance of payment						..		..		..
Current balance (bill. NOK)	7.5	7.0	5.9	..	6.0	..	5.5	..	5.0	..
Current balance (per cent of GDP)	2.5	2.5	2.7	2.6	2.8	2.9	3.6	3.7	4.6	4.2
	4.9	4.6	..	..	4.8	..	5.2	..	6.0	..
Memorandum items:	388	475	475	..	499	..	543	..	584	..
Household savings ratio (level)	- 8.9	6.4	..	..	4.5	..	4.7	..	6.0	..
Money market rate (level)	3.3	-4.2	-5.1	-4	0.4	1	0.2	0	0.9	1
Lending rate, banks (level) ⁶	4.9	4.6	..	..	4.8	..	5.2	..	6.0	..
Crude oil price NOK (level) ⁷	388	488	475	..	530	..	578	..	621	..
Export markets indicator	-9.0	5.6	..	..	4.2	..	4.7	..	6.2	..
Importweighted krone exchange rate (44 countries) ⁸	3.3	-4.0	-5.1	-5	0.5	2 1/4	0.3	1	0.7	1

¹ Forecasts from Ministry of Finance incl. service activities incidental to extraction.² Consumption in households and non-profit organizations + general government consumption + gross fixed capital formation in Mainland Norway.³ Change in stockbuilding. Per cent of GDP.⁴ Norges Bank estimates traditional exports, which also includes some services.⁵ CPI adjusted for tax changes and excluding energy products (CPI-ATE).⁶ Yearly average.⁷ Average spot price, Brent Blend.⁸ Increasing index implies depreciation. Ministry of Finance forecasts trade-weighted exchange rate.

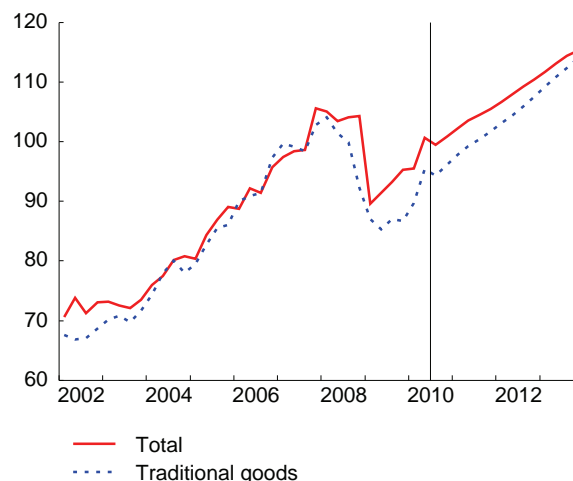
Source: Statistics Norway (SN), Ministry of Finance, St.meld. nr.2 (2009-2010), (MoF), Norges Bank, Pengepolitisk rapport 2/2010 (NB).

Figur 9. Exports. Seasonally adjusted volume indices. 2007=100



Source: Statistics Norway.

Figur 10. Imports. Seasonally adjusted volume indices. 2007=100



Source: Statistics Norway.

increased slightly compared with the same period in 2009, while exports of services edged down. Oil production and exports continue along the same weakly declining trend of many years, and it is this trend decline that dominates developments in total exports this year. Gas recovery and exports continue to grow, however, and are now equivalent to about 2/3 of the value of oil exports.

So far this year, the increase in the value of exports of traditional goods and services has been greatest for exports to major trading partners like the USA, Sweden and the UK, while exports to China and South Korea show the largest decline. The global downturn in the wake of the financial crisis and weakened demand for Norwegian export products affected both prices and volumes last year. In the first half of 2010 prices rose, however, more so in the second quarter than in the first. The price rise is broad-based. Oil, gas and petroleum products have contributed most, and the rise in prices measured in Norwegian kroner was reinforced by a rising dollar exchange rate. The rise in prices measured in Norwegian kroner was almost 7 per cent in the second quarter. Export prices for services and traditional goods rose by just over 2 per cent in the first quarter and just over 4 per cent in the second quarter.

The international business situation remains weak. Although developments among a number of important trading partners are now showing positive signs, we maintain the outlook from the previous report of weak business developments globally during the projection period. According to our model-based projections, total export volumes for the years 2010-2013 will roughly reproduce the levels from the years 2005-2008, but with growth of 1-2 per cent each year. Whereas oil exports are following a declining trend, we expect growth of about 3-5 per cent annually in exports of traditional goods and 4-5 per cent growth in service exports from 2011 onwards. Owing to strong growth in the fourth

quarter of last year and a fall in the first quarter of this year, exports of services in 2010 are expected to be lower than last year. The projected growth in total exports excluding oil and gas is lower than the projected growth in imports among our trading partners, with the result that Norwegian export companies will probably lose market shares through the projection period. We expect a rise in prices for all export products, most for oil and gas and least for services. The rise in prices for traditional export goods, which is largely driven by domestic cost inflation, is projected to be from 3 to just over 5 per cent annually, and this rise will exacerbate the loss of market shares.

Whereas the total volume of Norwegian exports has largely remained constant since the turn of the century, overall import volumes showed trend growth up to the time of the economic downturn in 2008. Growth continued through 2009 and into 2010 - but this time from a much lower level - and topped 5 per cent in the second quarter of this year, according to seasonally adjusted QNA figures. The import growth was broad-based, with strong impetus from investments on the way up from the trough in 2009. Imports of traditional goods increased by 3 per cent and 6 per cent, respectively, in the first two quarters of the year. Imports of services remained at roughly the same level as in 2009.

Prices for imports of traditional goods fell through 2009. The decline stopped in the first quarter of this year, and prices rose 1.5 per cent in the second quarter. The rise in prices in the second quarter was largely attributable to higher prices for commodities such as ore and metals, which are largely used as inputs in manufacturing. Commodity prices are on the way up from a low level in the wake of the financial crisis. Substantially reduced import prices for services, ships, oil platforms and aircraft caused the price index for total Norwegian imports to fall by almost 1 per cent in the second quarter compared with the previous quarter.

The growth we project for household consumption and particularly investment will provide impetus to imports in the years ahead. The Armed Forces will be importing a frigate, a Hercules aircraft and 14 helicopters during the projection period. The airline Norwegian has ordered 44 passenger aircraft for a total of almost NOK 20 billion for delivery by 2014. We expect growth in total imports of between 4.5 and 7 per cent annually during the projection period 2010-2013, with roughly 1 per cent higher growth in imports of traditional goods. While growth in the volume of imports continues to be higher than growth in the volume of exports throughout the projection period, prices for imports are expected to rise substantially less than prices for exports. This will mean a terms of trade gain each year in the projection period. We still expect relatively low import prices – and growing import shares – for consumer goods from China and other low-cost countries in Asia and eastern Europe.

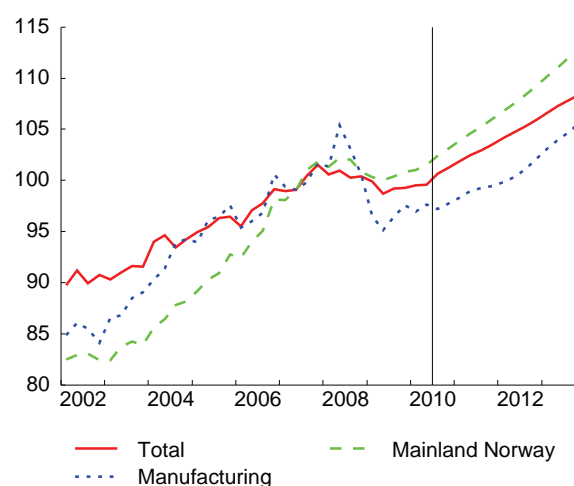
The financial crisis and economic downturn contributed to prices for oil and gas and traditional Norwegian export goods falling more than prices for import products in 2009. This reduced the trade surplus by more than a quarter last year. During the projection period, an annual terms of trade gain will outweigh developments in trade volumes, causing the trade surplus to grow again. The growth rate will be substantially more moderate than in most years since the turn of the century because growth worldwide has been reduced since the financial crisis in 2008. The trade surplus is expected to rise from almost NOK 365 billion this year to approaching NOK 420 billion in 2013, a good NOK 60 billion less than the peak level in 2008. Given an expected falling net factor income and transfers deficit, the current account will show a surplus of around 14 per cent of GDP each year during the projection period.

Has the economy bottomed out?

The Norwegian economy is still in a downturn, but activity growth has gathered pace. Four quarters of falling mainland GDP reversed in the third quarter of 2009 into moderate growth. The 0.5 per cent growth in the second quarter of 2010 is equivalent to an annualised 1.9 per cent. This is still lower than what we regard as trend growth in the Norwegian economy, which is estimated at just over 2.5 per cent. However, the national accounts figures for mainland GDP growth may underestimate the underlying production growth in the economy. A cold, dry winter caused electricity production to fall markedly from the first to the second quarter. Mainland GDP growth in the second quarter, excluding electricity supply, was an annualised 3.0 per cent. Strikes also reduced activity in municipal government and in construction in the second quarter. However it is too soon to say that the cyclical downturn has come to a halt.

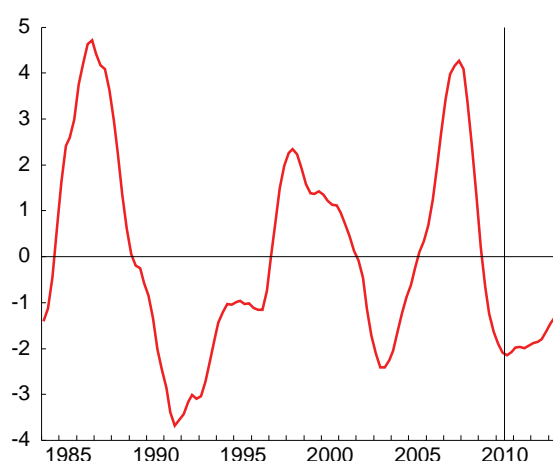
Excluding electricity supply there was growth in activity in all major groups of mainland industries in the second quarter, and hence a more consistent picture

Figur 11. **Gross domestic product. Seasonally adjusted volume indices. 2007=100**



Source: Statistics Norway.

Figur 12. **Output gap, Mainland Norway. Deviation from trend, per cent**



Source: Statistics Norway.

than in previous quarters. As a result of the municipal strike, activity increased least in general government, at 0.3 per cent – markedly down from the first quarter growth of 0.9 per cent. Value added in private services increased by 0.9 per cent, approximately the same as the previous quarter. The picture for the different industries within manufacturing and mining was mixed, but the combined growth for these industries was 0.7 per cent, following a decline of the same magnitude in the previous quarter. The increase in “other goods production” excluding electricity supply was a whole 2.8 per cent, after an almost equally large decline in the previous quarter.

We define a recession as when the activity level is lower than trend. However, the trend level cannot be observed; it has to be estimated. The fact that mainland GDP in the second quarter was lower than the level in the second quarter of 2008, the quarter before the financial

crisis took hold in earnest, is an indication that the Norwegian economy is still in recession. There are large differences in output developments between the major industries in this two-year perspective. Value added in manufacturing and mining was a full 7 per cent lower than the level two years earlier. Output in 'Other goods production' was also appreciably lower, but excluding electricity supply the level is the same. Underlying these developments, however, is the fact that value added in the construction industry was almost 2 per cent lower than two years earlier, but was offset by a strong increase in fishing and fish-farming. Value added in private services was 1 per cent higher than two years earlier, while general government was 5 per cent higher.

Growth in private domestic demand is expected to pick up slightly in the immediate future and growth in public sector demand to fall back. The overall result may be relatively stable demand growth. Growth in demand in Norwegian export markets, which increased appreciably in the first half of the year, is expected to decline for the next year but then to rise for the remainder of the projection period. Higher cost growth in Norway than among competing countries will curb output developments in internationally exposed industries, however. New manufacturing orders were 33 per cent higher in the second quarter of 2010 than at the same time in 2009, and this has slowed down the fall in order reserves. This is partly attributable to an increase in new orders from operators on the Norwegian continental shelf. At the same time, statistics show that the decline through 2009 of stocks for Norwegian manufacturing working on orders came to a halt in the first half of 2010. Manufacturing output is therefore expected to grow moderately over the next couple of years, and more strongly in 2013.

Construction activity will continue to increase when the decline in investment turns into an upswing. Mainland-based service production is largely focused on the domestic market and activity is expected to increase in the time to come, but not as strongly as in the first half of the year. On an annual basis, we expect growth rates to gather pace gradually in the years ahead. As private sector activity picks up in the period ahead and growth in public sector production is reduced in pace with a less expansionary fiscal policy, the increase in general government value added is expected to account for a considerably smaller share of overall activity growth.

Growth in mainland GDP is expected to remain at approximately the same level as in the second quarter for the remainder of 2010, and then to increase somewhat. We now expect a moderate recovery in 2011 and 2012 which will be slightly more pronounced in 2013, when mainland GDP growth is projected to be 3.3 per cent. Towards the end of 2013, the Norwegian economy may be approximately cyclically neutral, with the level of mainland economic activity close to trend.

Unemployment up before it falls

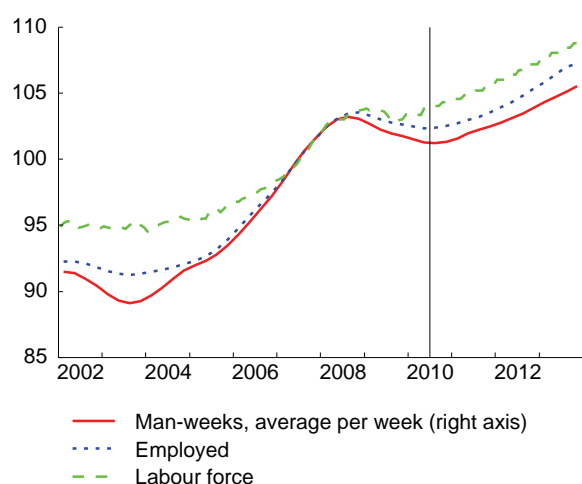
Statistics Norway's Labour Force Survey (LFS) shows that the unemployed constituted 3.5 per cent of the labour force in the period May-July this year, after adjustment for normal seasonal variations. Unemployment was virtually unchanged through the first half of the year, but was 0.5 percentage point higher than in the same period in 2009. This past year the number of LFS employed has remained virtually unchanged, while the labour force (sum of employed and unemployed) increased by 12 000 persons. The labour force, measured as number of persons, is at a historically high level. Measured as a share of the working-age population, it was 72.5 per cent in the second quarter of this year, down from 73.6 per cent in the same quarter of 2009. The decline must be viewed in light of an increase of 57 000 in persons aged 15-74 during the period and changes in the composition of the population. Of those outside the labour force, 22 000 more reported education as their main activity in the second quarter of 2010 than one year earlier, while 27 000 reported some type of pension as their main activity.

Statistics Norway's population statistics show that the population was 62 500 higher as at 1 July 2010 than one year earlier. Net immigration accounts for about two thirds of the increase in the total number of residents in Norway. Net immigration of close to 20 000 persons in the first half of this year indicates that net immigration in 2010 may end up at the same high level as the years 2007 to 2009, i.e. about 40 000 persons. Poland, Sweden and the Baltic states are the nations with highest net emigration to Norway. The population figures for the first half of the year show a high level of both immigration and emigration.

The numbers of applicants for higher education are high this year again. The Norwegian Universities and Colleges Admission Service (NUCAS) has registered around 105 000 applicants for higher education. This is roughly the same level as in 2009, when NUCAS registered over 100 000 applicants by the applications deadline for the first time since 1996. There is reason to believe that the tighter labour market and large cohorts of adolescents are part of the reason that application numbers have remained high. An increased propensity to start higher education contributes to lowering unemployment and labour force participation. The number of applicants for tertiary education who have been offered places by NUCAS is 6 500 higher than last year.

Seasonally adjusted figures for fully unemployed persons registered with the Labour and Welfare Organisation (NAV) show a decline of 2 500 persons between the end of April and the end of July this year. This was the first time since the second quarter of 2008 that seasonally adjusted registered unemployment had shown a decline for three consecutive months. At the end of July, 78 200 were registered with NAV as being fully unemployed. This is equivalent to an increase of 1

Figur 13. Labour force, employment and number of manhours. Seasonally adjusted and smoothed indices. 2007=100



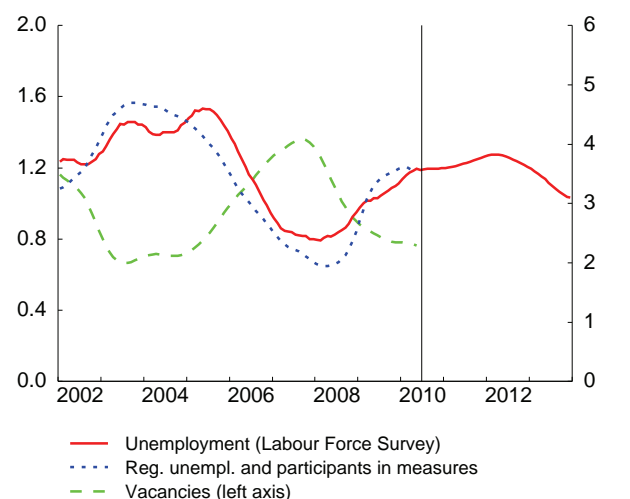
Source: Statistics Norway.

per cent on the same month last year, when registered unemployment accounted for 3.0 per cent of the labour force. Just under 90 000 persons were either unemployed or on labour market programmes. In the course of this past year, the number registered with NAV as unemployed has declined, but there is still strong growth in the number of persons who have been unemployed for between one and two years. This indicates that some of those who became unemployed during or straight after the global financial crisis are having difficulty in finding work. A little way into a cyclical upturn the LFS unemployment figures are normally higher than unemployment registered with NAV. LFS follows definitions for unemployment that apply globally (a person must have been completely without work, have been seeking work for the last four weeks, and be able to begin working in the course of two weeks).

Seasonally adjusted QNA figures show a decline in employment of 1 500 persons from the first to the second quarter of this year. The distribution by industry shows a rise in employment in the petroleum business, construction, and private and public services. Municipal government administration employed 14 000 more persons in the second quarter of 2010 than in the second quarter of 2009, largely as a result of developments in healthcare services. Employment continues to decline in retail trade and manufacturing. Although manufacturing has scaled down the workforce, there is reason to believe that many companies have the available capacity and labour to increase production. Thus when manufacturing activity picks up again, productivity will begin to increase first. Companies will make new appointments when production again approaches the capacity limit.

Seasonally unadjusted QNA figures for the second quarter of 2010 show a decline in the number employed of 0.4 per cent in the second quarter compared with the same quarter in 2009, but the number of man-hours

Figur 14. Unemployment and number of vacancies. Seasonally adjusted and smoothed. Per cent of labour force



Source: The Norwegian Labour and Welfare Service and Statistics Norway.

worked was virtually unchanged during the same period. The number employed is a stock variable, while the number of man-hours worked measures the work that the stock has delivered. Factors such as agreed working hours, sickness absence and vacation days affect the ratio between number of man-hours worked and number employed. Industrial disputes push down the ratio, since an employee in a dispute is still employed according to the national accounting definitions. Sickness absence statistics show a decline in sickness absence of 8.9 per cent from the first quarter of 2009 to the first quarter of 2010. In the QNA estimates for the second quarter it has been assumed that this positive tendency will continue. After a year almost without labour conflicts, there were strikes in several trades and sectors during this year's wage settlement. Table 2.3 provides an overview of nationwide conflicts during the first half of the year. The vacation days in the second quarter of this year were fewer than in the same quarter of the previous year because Easter came earlier this year. This – coupled with an assumption that the decline in sickness absence will continue – more than outweighed the man-hours that were lost during this year's industrial disputes.

Higher productivity as a result of idle capacity means that it will take time before the increase in production is fully reflected in increased employment. Over time, the rise in activity will result in higher employment in labour-intensive industries such as construction and retail trade. However, we will probably have to wait until 2012 and 2013 before this brings down unemployment. Developments in unemployment also depend on growth in the labour force. The level of inward labour migration is a particular uncertainty factor. Other demographic factors, a propensity to take tertiary education, and the manner in which older employees will respond to the changes in the early retirement scheme in connection with the pension reform also affect labour force developments. On balance, we assume that

Table 3. **Nationwide disputes 2010**

Employee	Employer	Strike initiated	Duration	Number called out on strike ¹
Norwegian Nurses' Organisation	National Federation of Service Industries (NHO Service)	26 January	10 days	144
Norwegian United Federation of Trade Unions (Fellesforbundet)	Federation of Norwegian Construction Industries	13 April	4 days	18 759
Norwegian Transport Workers' Union	Norwegian Logistics and Freight Association	15 May	19 days	1 703
Norwegian Union of General Workers	National Federation of Service Industries (NHO Service)	20 May	7 days	2 556
Federation of Norwegian Professional Associations	Norwegian Association of Local and Regional Authorities (KS)	27 May	13 days	243
Norwegian Union of Municipal and General Employees (LO kommune)	Norwegian Association of Local and Regional Authorities (KS)	27 May	13 days	26 348
Unio	KS	27 May	13 days	17 417
Norwegian Confederation of Municipal Employees (YS-K)	Norwegian Association of Local and Regional Authorities (KS)	27 May	13 days	1 723
Unio	Spekter	27 May	5 days	2 120
Norwegian Federation of State Employees' Unions	Spekter	7 June	7 days	37
Norwegian Union of General Workers	National Federation of Service Industries (NHO Service)	12 June	7 days	2 274
YS Spekter	Spekter	29 June	15 days	563

¹ Number of employees on strike at the end of the dispute, including announced escalation. The figures include members of companies that are bound by direct agreements with the confederation in the same agreement areas.

Source: National Mediator (Riksmeklingsmannen)

growth in the labour force will be somewhat higher than employment growth up to 2011. Unemployment is estimated to be 3.6 per cent in 2010, gradually increasing to about 3.8 per cent in 2012, before the cyclical upturn contributes to a fall to 3.4 per cent in 2013.

Extended period of moderate wage growth

In light of new figures from the Register of Pay and Tax Deduction Statements, growth in annual wages for all wage-earners in 2009 was revised down in connection with the publication of the QNA for the second quarter of 2010. Growth was then estimated at 4.2 per cent, as opposed to estimated growth of 4.5 per cent at the time when the first quarter figures were published. Annual wage growth in 2008 was 6.3 per cent, and this year wage growth is estimated at 3.5 per cent. Thus wage growth has slowed substantially in the course of the cyclical downturn. This also applies in real terms, as the rise in consumer prices has been more sustained.

Developments in wage growth in recent years are similar to those observed earlier when the economy has moved from a cyclical upturn to a downturn. In the 1990s, too, there was a wage growth difference of about 3 percentage points between good and bad times. Studies have shown that wages in Norway are among the most flexible in the world when there are cyclical fluctuations. The reason for this is the coordinated and centralised forms of settlement, where wage growth in manufacturing sets the trend. Developments in manufacturing profitability also provide much of the data underlying our wage growth projections for the years ahead.

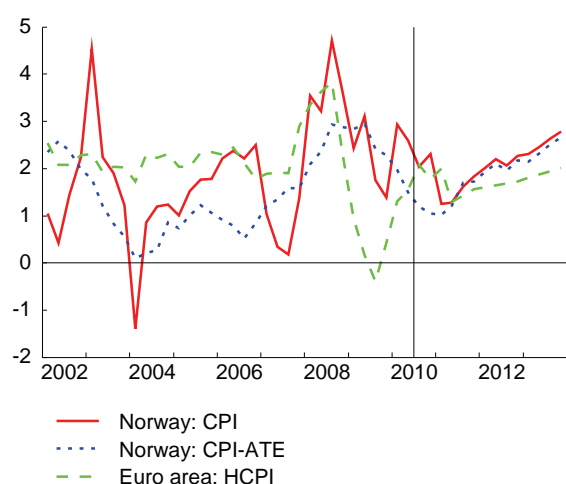
Although the financial crisis has affected the Norwegian economy to a relatively mild degree, manufacturing output in Norway has been reduced more in line with the decline among trading partners. The

manufacturing output of the OECD countries this year, measured in constant prices, was about 10 per cent lower than the level prior to the financial crisis in 2008. Manufacturing output in Norway was 7 per cent lower in the first half of 2010 than in the first half of 2008. Despite the fact that manufacturing provides strong guidelines for overall wage growth, there is reason to believe that wage growth among trading partners will be reduced more than in Norway, since they have been hit generally harder by the global downturn. In isolation, this will reduce the competitiveness of many Norwegian manufacturing companies and place a further damper on wage growth in the period ahead.

Manufacturing output among trading partners has been on the way up for a number of quarters. We believe this tendency will continue. We also believe that prices for Norwegian export goods will develop favourably and contribute to higher profitability in manufacturing. Demand from the petroleum industry is also assumed to increase going forward, which will have a stimulating effect on overall Norwegian manufacturing. Relatively solid growth in the service industries and stable unemployment developments also point to more normal wage growth levels.

A two-track economy, with pressure on the competitiveness of manufacturing and relatively solid growth in service industries, may make coordination of wage formation more difficult. In such case, overall wage growth could be higher than that in manufacturing. In this year's municipal settlements, for example, all the major trade union confederations called their members out on strike. The strike lasted for almost two weeks (see Table 2.3). However, it is assumed that the close relationship between wage growth in the various sectors will persist. We project that annual wage growth will remain at about 3.5 per cent up to and including 2012.

Figur 15. **Consumer price indices. Percentage growth from the same quarter previous year**



Source: Statistics Norway.

In the main settlement in 2012, and in 2013, we may find a change in the size of pay increases. By that time the global economy will probably have entered a cyclical upturn and unemployment in Norway will be on its way down. We therefore project wage growth of 4.7 per cent in 2013. Coupled with our projections for consumer price inflation, this wage development implies an improvement in wage-earners' purchasing power of about 1.7 per cent as an annual average over the projection period. This is more than one percentage point lower than in the previous four-year period.

Very low inflation

Underlying inflation has shown a clear falling tendency through the past year. The 12-month rise in the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) has been 1.3 per cent for the past two months, down from 3.3 per cent in June 2009. Seasonally adjusted figures show that underlying inflation has been close to zero through the summer.

A breakdown of the CPI-ATE by supplier sector shows lower year-on-year inflation for all main groups since the summer of 2009. The rise in prices for imported consumer goods in particular has fallen through the last half year, but rents and developments in prices for domestically produced goods have also contributed to falling inflation. The rise in prices for other services during this period has been fairly stable.

During the last half year, the rise in prices has slowed in all the main product groups in the CPI except hotel and restaurant services. Prices for a number of product groups were lower in July than 12 months earlier. By far the sharpest fall in prices was 4.5 per cent for clothing and footwear, but prices for food and non-alcoholic beverages, furniture and household articles and postal and telecommunication services were also lower than they were a year ago. The combined weight

of these four product groups accounts for more than 25 per cent of the CPI.

The temporary weakening of the krone in the wake of the financial crisis in autumn 2008 caused inflation first to rise, in the first half of last year, and then to decline through this past year. The exchange rate primarily affects prices for imported goods. However, imported goods are factor inputs in Norwegian production, and experience shows that it takes a good while before the impact on Norwegian consumer prices of changes in the exchange rate is exhausted. The international downturn has also contributed to reducing underlying price inflation in Norway through generally lower prices for commodities and weaker developments in prices for finished goods in the global market than would otherwise have been the case. Slower growth in labour costs in Norway has also helped to dampen inflation.

We now assume that the time-lagged effects of last year's movements in the krone exchange rate will not generate any further strongly negative impulses to Norwegian inflation. On the contrary, we expect a slower rise in Norwegian labour costs and higher productivity growth to curb underlying inflation for a while to come. Sharper competition over airfares points the same way.

Wage growth will pick up in line with improvements in the economic situation, and this will push up inflation towards the end of the projection period. Energy is a input factor in all production. We have assumed that prices for electricity and oil will rise faster than inflation generally. This will contribute to a higher rise in prices of other products too. According to the projections, a certain weakening of the krone towards the end of the projection period will push inflation up a little.

Throughout the projection period we expect imports from low-cost countries to continue increasing more than imports from other countries. In isolation, this will contribute to a continued low rise in import prices and hence to low Norwegian inflation. The year-on-year rise in the CPI-ATE is expected to fall to an annual average of 1.4 per cent this year and to remain at about that level in 2011. Thereafter it is expected to rise gradually to 2.5 per cent in 2013.

Developments in the CPI-ATE provide information about underlying price inflation, but it is developments in the consumer price index (CPI) relevant to purchasing power. Energy prices, and electricity prices in particular, often impart strong direct impulses to the CPI. In March this year electricity prices were 35 per cent higher than in the same month in 2009 and accounted for almost 40 per cent of the year-on-year rise in the CPI, which was 3.4 per cent. With the easing of the tight electricity market of this past winter, with high demand because of the cold winter and low reservoir levels, electricity prices have fallen. Household total

electricity prices dropped by 18 per cent from April to July this year. As a result, CPI inflation in the same period fell more than CPI-ATE inflation, and was measured at 1.9 per cent in July.

Nordpool futures prices at end-August point to a moderate rise in electricity prices for the next half year. We project that average annualised prices will be about 20 per cent higher this year than in 2009. CPI inflation is estimated to be 2.5 per cent this year. Over the next two years, we expect the fall in the prices of electric power to be more than outweighed by increased grid rent, but that the total prices paid for electricity by households will not increase very much more than prices for other goods. In 2013 we expect electricity prices to rise somewhat more. We base our projections on a gradual increase in real oil prices in the period ahead. Taxation rates are assumed to be adjusted for inflation. On balance, this will result in a slightly higher rise in the CPI than in the CPI-ATE in the next few years, and according to our projections CPI inflation will be 2.5 per cent in 2013.

Table 4. **Macroeconomic indicators. Seasonally adjusted. Constant 2007 prices. Million kroner**

	Unadjusted		Seasonally adjusted							
	2008	2009	08.3	08.4	09.1	09.2	09.3	09.4	10.1	10.2
Final consumption expenditure of households and NPISHs	954 892	956 360	237 626	235 294	233 880	238 133	240 769	243 808	244 733	243 381
Household final consumption expenditure	916 348	916 510	227 963	225 710	224 113	228 262	230 754	233 589	234 658	233 166
Goods	470 808	469 721	116 604	114 756	113 471	116 395	118 801	120 975	120 926	120 246
Services	412 405	415 841	103 165	103 362	103 100	103 907	104 349	104 617	105 029	105 251
Direct purchases abroad by resident households	59 632	55 602	14 647	14 203	13 668	13 950	13 643	14 523	14 904	14 110
Direct purchases by non-residents	-26 498	-24 654	-6 453	-6 612	-6 126	-5 990	-6 040	-6 527	-6 202	-6 441
Final consumption expenditure of NPISHs	38 544	39 850	9 663	9 584	9 767	9 871	10 015	10 219	10 076	10 214
Final consumption expenditure of general government	465 010	487 047	116 906	117 171	120 512	121 555	122 838	122 047	123 735	125 164
Final consumption expenditure of central government	240 789	252 609	60 504	60 720	62 536	62 984	63 355	63 681	63 647	63 847
Central government, civilian	208 700	220 368	52 594	52 492	54 551	54 673	55 260	55 832	55 799	56 097
Central government, defence	32 089	32 241	7 909	8 228	7 985	8 311	8 095	7 849	7 848	7 750
Final consumption expenditure of local government	224 221	234 438	56 402	56 451	57 976	58 570	59 483	58 367	60 088	61 317
Gross fixed capital formation	514 203	467 383	127 318	131 502	119 817	118 141	112 696	116 348	104 248	111 906
Extraction and transport via pipelines	113 765	120 231	29 155	29 262	33 084	30 380	28 340	28 450	26 963	27 312
Service activities incidental to extraction	5 385	1 770	120	1 222	149	142	1 593	-113	858	497
Ocean transport	24 749	18 464	3 776	9 313	4 193	4 842	4 525	4 860	2 625	4 911
Mainland Norway	370 304	326 919	94 266	91 704	82 391	82 777	78 237	83 152	73 802	79 186
Mainland Norway excluding general government	295 724	247 139	73 378	72 467	65 750	63 831	59 103	58 451	56 989	60 174
Industries	207 453	175 541	51 240	51 919	46 323	45 771	41 775	41 570	40 149	43 324
Manufacturing and mining	34 069	23 834	8 559	8 864	6 896	6 751	5 370	4 892	5 541	5 172
Production of other goods	34 861	28 806	8 984	7 879	7 110	7 423	7 519	6 748	6 364	7 642
Services	138 524	122 902	33 697	35 177	32 317	31 597	28 886	29 930	28 245	30 511
Dwellings (households)	88 270	71 597	22 138	20 548	19 427	18 060	17 328	16 880	16 839	16 849
General government	74 581	79 780	20 888	19 237	16 641	18 947	19 135	24 701	16 813	19 012
Changes in stocks and statistical discrepancies	25 451	-24 524	9 826	6 214	-4 381	-4 888	-5 477	-9 078	2 851	10 735
Gross capital formation	539 654	442 859	137 144	137 716	115 436	113 252	107 219	107 270	107 099	122 641
Final domestic use of goods and services	1 959 555	1 886 265	491 675	490 181	469 828	472 940	470 826	473 125	475 567	491 185
Final demand from Mainland Norway	1 790 206	1 770 325	448 798	444 169	436 783	442 465	441 844	449 007	442 271	447 730
Final demand from general government	539 590	566 827	137 794	136 408	137 153	140 501	141 973	146 748	140 549	144 176
Total exports	1 050 041	1 007 997	257 632	260 418	252 397	245 918	253 671	255 619	254 761	248 626
Traditional goods	315 175	289 338	80 101	74 965	69 852	69 688	74 886	74 979	75 063	75 690
Crude oil and natural gas	470 309	464 838	112 167	119 392	118 587	113 557	117 485	115 109	113 428	112 047
Ships, oil platforms and planes	14 203	14 756	4 697	3 638	5 158	3 428	2 930	3 239	7 905	2 764
Services	250 353	239 066	60 668	62 423	58 800	59 246	58 369	62 292	58 366	58 125
Total use of goods and services	3 009 596	2 894 262	749 308	750 599	722 225	718 858	724 496	728 744	730 328	739 811
Total imports	720 923	638 407	179 816	180 152	154 840	157 978	161 096	164 647	164 956	173 984
Traditional goods	455 782	396 194	114 316	105 603	99 604	97 645	99 651	99 294	102 629	109 147
Crude oil and natural gas	3 722	4 893	654	1 662	625	809	1 894	1 590	823	1 925
Ships, oil platforms and planes	39 458	27 569	9 026	17 109	4 584	6 580	5 719	10 685	8 695	9 831
Services	221 961	209 751	55 819	55 779	50 026	52 943	53 832	53 078	52 809	53 081
Gross domestic product (market prices)	2 288 673	2 255 855	569 492	570 447	567 385	560 880	563 401	564 097	565 373	565 826
Gross domestic product Mainland Norway (market prices)	1 755 470	1 731 648	439 813	434 759	432 443	431 289	432 821	434 786	435 537	437 549
Petroleum activities and ocean transport	533 203	524 207	129 679	135 687	134 942	129 590	130 580	129 312	129 836	128 277
Mainland Norway (basic prices)	1 500 270	1 484 387	376 725	373 058	370 654	369 662	370 816	372 898	373 891	375 957
Mainland Norway excluding general government	1 168 208	1 143 743	293 009	289 530	286 118	284 730	285 518	287 008	287 192	289 005
Manufacturing and mining	214 593	201 844	53 903	52 558	50 481	49 749	50 453	51 021	50 687	51 064
Production of other goods	172 874	167 637	43 800	42 370	42 164	40 728	42 265	42 587	41 537	41 271
Services incl. dwellings (households)	780 741	774 262	195 306	194 602	193 473	194 253	192 799	193 401	194 968	196 670
General government	332 062	340 644	83 716	83 529	84 536	84 932	85 298	85 890	86 699	86 951
Taxes and subsidies products	255 200	247 261	63 087	61 701	61 789	61 627	62 005	61 887	61 646	61 593

Source: Statistics Norway.

Table 5. **Macroeconomic indicators. Seasonally adjusted. Constant 2007 prices. Percentage change from previous period**

	Unadjusted		Seasonally adjusted							
	2008	2009	08.3	08.4	09.1	09.2	09.3	09.4	10.1	10.2
Final consumption expenditure of households and NPISHs	1.6	0.2	-1.2	-1.0	-0.6	1.8	1.1	1.3	0.4	-0.6
Household final consumption expenditure	1.5	0.0	-1.2	-1.0	-0.7	1.9	1.1	1.2	0.5	-0.6
Goods	0.5	-0.2	-2.3	-1.6	-1.1	2.6	2.1	1.8	0.0	-0.6
Services	1.9	0.8	0.1	0.2	-0.3	0.8	0.4	0.3	0.4	0.2
Direct purchases abroad by resident households	6.3	-6.8	-2.9	-3.0	-3.8	2.1	-2.2	6.5	2.6	-5.3
Direct purchases by non-residents	0.0	-7.0	-3.6	2.5	-7.3	-2.2	0.8	8.1	-5.0	3.9
Final consumption expenditure of NPISHs	3.8	3.4	-0.5	-0.8	1.9	1.1	1.5	2.0	-1.4	1.4
Final consumption expenditure of general government	4.1	4.7	0.4	0.2	2.9	0.9	1.1	-0.6	1.4	1.2
Final consumption expenditure of central government	3.4	4.9	-0.1	0.4	3.0	0.7	0.6	0.5	-0.1	0.3
Central government, civilian	3.5	5.6	0.5	-0.2	3.9	0.2	1.1	1.0	-0.1	0.5
Central government, defence	2.8	0.5	-3.3	4.0	-3.0	4.1	-2.6	-3.0	0.0	-1.2
Final consumption expenditure of local government	4.9	4.6	1.0	0.1	2.7	1.0	1.6	-1.9	2.9	2.0
Gross fixed capital formation	2.0	-9.1	0.2	3.3	-8.9	-1.4	-4.6	3.2	-10.4	7.3
Extraction and transport via pipelines	5.1	5.7	6.2	0.4	13.1	-8.2	-6.7	0.4	-5.2	1.3
Service activities incidental to extraction	14.1	-67.1	-93.5	915.2	-87.8	-4.8	..	-107.1	-856.5	-42.1
Ocean transport	60.3	-25.4	-30.7	146.6	-55.0	15.5	-6.5	7.4	-46.0	87.1
Mainland Norway	-1.4	-11.7	2.1	-2.7	-10.2	0.5	-5.5	6.3	-11.2	7.3
Mainland Norway excluding general government	-2.8	-16.4	-2.1	-1.2	-9.3	-2.9	-7.4	-1.1	-2.5	5.6
Industries	1.7	-15.4	-2.6	1.3	-10.8	-1.2	-8.7	-0.5	-3.4	7.9
Manufacturing and mining	9.9	-30.0	-1.2	3.6	-22.2	-2.1	-20.5	-8.9	13.3	-6.7
Production of other goods	7.0	-17.4	-0.9	-12.3	-9.8	4.4	1.3	-10.3	-5.7	20.1
Services	-1.3	-11.3	-3.4	4.4	-8.1	-2.2	-8.6	3.6	-5.6	8.0
Dwellings (households)	-12.1	-18.9	-1.1	-7.2	-5.5	-7.0	-4.1	-2.6	-0.2	0.1
General government	4.7	7.0	20.3	-7.9	-13.5	13.9	1.0	29.1	-31.9	13.1
Changes in stocks and statistical discrepancies	-22.3	-196.4	..	-36.8	-170.5	11.6	12.0	65.8	-131.4	276.6
Gross capital formation	0.5	-17.9	7.5	0.4	-16.2	-1.9	-5.3	0.0	-0.2	14.5
Final domestic use of goods and services	1.9	-3.7	1.5	-0.3	-4.2	0.7	-0.4	0.5	0.5	3.3
Final demand from Mainland Norway	1.6	-1.1	-0.1	-1.0	-1.7	1.3	-0.1	1.6	-1.5	1.2
Final demand from general government	4.2	5.0	3.0	-1.0	0.5	2.4	1.0	3.4	-4.2	2.6
Total exports	1.0	-4.0	-3.8	1.1	-3.1	-2.6	3.2	0.8	-0.3	-2.4
Traditional goods	4.2	-8.2	-0.4	-6.4	-6.8	-0.2	7.5	0.1	0.1	0.8
Crude oil and natural gas	-2.0	-1.2	-5.9	6.4	-0.7	-4.2	3.5	-2.0	-1.5	-1.2
Ships, oil platforms and planes	11.4	3.9	39.7	-22.5	41.8	-33.5	-14.5	10.5	144.1	-65.0
Services	2.3	-4.5	-6.4	2.9	-5.8	0.8	-1.5	6.7	-6.3	-0.4
Total use of goods and services	1.6	-3.8	-0.4	0.2	-3.8	-0.5	0.8	0.6	0.2	1.3
Total imports	4.3	-11.4	0.6	0.2	-14.1	2.0	2.0	2.2	0.2	5.5
Traditional goods	-0.5	-13.1	-1.5	-7.6	-5.7	-2.0	2.1	-0.4	3.4	6.4
Crude oil and natural gas	-35.3	31.5	-13.2	154.0	-62.4	29.4	134.0	-16.0	-48.3	134.0
Ships, oil platforms and planes	100.3	-30.1	31.9	89.5	-73.2	43.6	-13.1	86.8	-18.6	13.1
Services	6.8	-5.5	1.3	-0.1	-10.3	5.8	1.7	-1.4	-0.5	0.5
Gross domestic product (market prices)	0.8	-1.4	-0.7	0.2	-0.5	-1.1	0.4	0.1	0.2	0.1
Gross domestic product Mainland Norway (market prices)	1.8	-1.4	-0.2	-1.1	-0.5	-0.3	0.4	0.5	0.2	0.5
Petroleum activities and ocean transport	-2.6	-1.7	-2.5	4.6	-0.5	-4.0	0.8	-1.0	0.4	-1.2
Mainland Norway (basic prices)	2.4	-1.1	0.2	-1.0	-0.6	-0.3	0.3	0.6	0.3	0.6
Mainland Norway excluding general government	2.1	-2.1	-0.2	-1.2	-1.2	-0.5	0.3	0.5	0.1	0.6
Manufacturing and mining	2.6	-5.9	-2.2	-2.5	-4.0	-1.4	1.4	1.1	-0.7	0.7
Production of other goods	2.5	-3.0	0.2	-3.3	-0.5	-3.4	3.8	0.8	-2.5	-0.6
Services incl. dwellings (households)	1.9	-0.8	0.3	-0.4	-0.6	0.4	-0.7	0.3	0.8	0.9
General government	3.5	2.6	1.5	-0.2	1.2	0.5	0.4	0.7	0.9	0.3
Taxes and subsidies products	-1.5	-3.1	-2.2	-2.2	0.1	-0.3	0.6	-0.2	-0.4	-0.1

Source: Statistics Norway.

Table 6. **Macroeconomic indicators. Seasonally adjusted. Price indices. 2007=100**

	Unadjusted		Seasonally adjusted							
	2008	2009	08.3	08.4	09.1	09.2	09.3	09.4	10.1	10.2
Final consumption expenditure of households and NPISHs	103.6	106.2	104.1	105.6	105.3	106.2	106.4	106.3	108.5	107.7
Final consumption expenditure of general government	105.8	109.5	106.7	109.2	108.6	109.3	109.8	110.2	110.5	110.5
Gross fixed capital formation	106.1	109.1	107.1	109.8	108.3	109.0	111.	108.5	112.3	1120.
Mainland Norway	105.5	108.1	106.5	107.5	107.7	108.0	109.3	107.7	109.3	109.6
Final domestic use of goods and services	103.9	107.5	105.8	105.2	107.2	107.4	108.5	106.9	109.9	108.9
Final demand from Mainland Norway	104.5	107.4	105.3	106.9	106.7	107.4	107.8	107.6	109.2	108.8
Total exports	116.6	100.1	120.1	113.3	103.2	98.7	98.1	99.7	101.3	104.5
Traditional goods	102.4	96.1	105.8	104.0	98.3	95.3	97.6	93.5	96.1	97.8
Total use of goods and services	108.3	104.9	110.8	108.0	105.8	104.4	104.8	104.3	106.9	107.4
Total imports	103.0	102.8	104.2	105.0	105.1	104.2	102.9	99.0	101.8	100.9
Traditional goods	104.7	103.3	105.7	108.9	106.	103.8	102.9	100.1	101.5	102.9
Gross domestic product (market prices)	110.0	105.5	112.8	108.9	106.	104.5	105.4	105.9	108.4	109.4
Gross domestic product Mainland Norway (market prices)	103.2	106.6	104.6	104.8	105.3	106.6	107.5	107.4	108.6	109.1

Source: Statistics Norway.

Table 7. **Macroeconomic indicators. Seasonally adjusted. Price indices. Percentage change from previous period**

	Unadjusted		Seasonally adjusted							
	2008	2009	08.3	08.4	09.1	09.2	09.3	09.4	10.1	10.2
Final consumption expenditure of households and NPISHs	3.6	2.5	1.5	1.5	-0.3	0.9	0.1	-0.1	2.1	-0.7
Final consumption expenditure of general government	5.8	3.5	2.3	2.3	-0.5	0.6	0.5	0.3	0.3	0.0
Gross fixed capital formation	6.1	2.8	2.0	2.5	-1.3	0.6	1.9	-2.3	3.5	-0.2
Mainland Norway	5.5	2.5	1.8	0.9	0.2	0.3	1.2	-1.5	1.5	0.2
Final domestic use of goods and services	3.9	3.5	2.9	-0.6	1.9	0.2	1.0	-1.5	2.8	-0.9
Final demand from Mainland Norway	4.5	2.8	1.8	1.6	-0.3	0.7	0.4	-0.2	1.5	-0.3
Total exports	16.6	-14.1	0.1	-5.7	-8.9	-4.3	-0.6	1.6	1.7	3.1
Traditional goods	2.4	-6.1	4.5	-1.7	-5.5	-3.0	2.4	-4.2	2.8	1.7
Total use of goods and services	8.3	-3.1	1.6	-2.5	-2.1	-1.3	0.4	-0.5	2.4	0.5
Total imports	3.0	-0.2	1.8	0.8	0.1	-0.8	-1.3	-3.8	2.8	-0.8
Traditional goods	4.7	-1.3	2.3	3.0	-2.6	-2.1	-0.8	-2.7	1.3	1.5
Gross domestic product (market prices)	10.0	-4.0	1.6	-3.4	-2.7	-1.4	0.9	0.5	2.4	1.0
Gross domestic product Mainland Norway (market prices)	3.2	3.3	2.1	0.2	0.5	1.2	0.9	-0.1	1.2	0.4

Source: Statistics Norway.