Economic trends

The quarterly national accounts figures confirm previous impressions that the Norwegian economy passed a peak at about the end of last year. Household demand and mainland business investment in particular are now growing more slowly than in 2007. Housing investment has been falling for a while, at a rate that intensified in the first half of 2008. However, public sector spending on goods and services continues to provide stable and positive growth impulses, as does petroleum sector investment. Although employment growth has moderated, there are still no definite signs of an increase in unemployment. Nor can they be expected at such an early stage of a downturn, but the number of lay-offs has increased and the supply of vacancies has declined. Inflation has risen perceptibly, not least as a result of high energy and commodity prices. Inflation excluding energy products has also risen, due to strong wage growth as a result of a tight labour market and high corporate profitability. In consequence, monetary policy has been gradually tightened.

Global economic growth is now low, and developments in the euro area in particular have been more negative than many had envisaged earlier. GDP in a number of leading EU countries declined from the first to the second quarter of 2008. In the US, weak growth continues, and it does not appear as though the crisis in the financial sector will be over in the near future. Global inflation has also picked up, driven by some of the same factors as in Norway. Whereas interest rates in the US are low, they are substantially higher in the euro area, where they were surprisingly increased this summer despite weak developments in the real economy. Economic growth among our trading partners is expected to be slow for a while to come. Statistics Norway is still a little more pessimistic with regard to economic growth abroad than the general consensus of opinion. If the impulses generated by high energy and commodity prices moderate after a period and inflation falls toward more desirable levels, interest rates in the euro area may be lowered somewhat and thereby contribute to increased demand. However we do not envisage a new global upturn before 2010. In the period ahead the Norwegian economy will therefore receive less impetus from abroad.

We believe, as previously, that the slow growth in the Norwegian economy will continue through the coming year, 2009 and well into 2010, despite the fact that we expect the interest rate level in Norway to be reduced in pace with the reduction in interest rates in the euro area next year, and that fiscal policy will continue to provide moderate positive impulses to the economy. However, we have experienced a fairly strong cyclical upturn, and even with growth as weak as we forecast it to be, the Norwegian economic upturn will not end before 2010. Given a new global upturn in 2010, there will be no need for stronger than assumed Norwegian use of monetary and fiscal policy instruments to prevent a definite downturn in 2011. On the other hand, the fiscal rule provides scope for stronger impetus from fiscal policy than we have assumed in our baseline scenario. If, for example, global growth should be even weaker than we anticipate, the reduction in interest rates may be larger than we have assumed, or impulses from fiscal policy may be increased. The effects of increasing growth in public investment in infrastructure in the coming years are illustrated in a separate scenario. This would result in somewhat stronger growth, but also slightly higher interest rates. Thus the scenario illustrates some of the assessments the authorities must make in the period ahead with respect to the use of stabilization policy instruments.

Cyclical developments in Norway

The preliminary quarterly national accounts figures (QNA) for the second quarter confirm previous impressions that the Norwegian economy passed a cyclical peak at around the end of 2007. Growth in the first half of 2008 was substantially weaker than in 2007, and also lower than what is normally regarded as trend growth for the Norwegian economy. Mainland GDP did increase from the first to the second quarter of 2008, by an annualized 3.9 per cent, but output fell slightly in the first quarter. As a result of the unusual timing of Easter in 2008, the seasonally adjusted figures are slightly more uncertain than usual. The half-yearly figures clearly show the slowing of GDP growth and strengthen the impression that a cyclical turnaround has taken place. Household demand and mainland business investment in particular are now growing more slowly than in 2007. The lower demand growth is not only reflected in output figures. Growth in overall imports has levelled off, confirming the turnaround in Norwegian economic growth.

Tabel 1. **Macroeconomic indicators 2006-2008. Growth from previous period unless otherwise noted. Per cent**

	2006	2007	Seasonally adjusted			
			07:3	07:4	08:1	08:2
Demand and output						
Consumption in households etc.	4.7	6.4	0.9	1.0	0.0	0.3
General government consumption	2.9	3.6	1.4	0.7	0.7	1.0
Gross fixed investment	7.3	9.3	4.8	4.9	-2.7	-0.1
Mainland Norway	7.6	9.4	2.0	7.8	-3.8	-0.2
Extraction and transport via pipelines	2.9	5.5	6.7	-2.9	1.0	2.7
Final domestic demand from Mainland Norway[1]	4.8	6.2	1.3	2.2	-0.6	0.4
Exports	0.4	2.8	3.0	-0.4	1.3	-0.5
Crude oil and natural gas	-6.6	-2.8	3.2	-2.6	2.3	-2.6
Traditional goods	6.2	9.0	3.2	4.1	0.2	1.5
Imports	8.1	8.7	2.5	5.4	-0.7	0.1
Traditional goods	9.6	8.1	0.9	3.1	2.1	-1.1
Gross domestic product	2.5	3.7	1.6	1.0	0.0	0.6
Mainland Norway	4.8	6.2	1.9	0.8	-0.1	1.0
Labour market						
Man-hours worked	2.6	4.2	0.8	1.2	0.7	1.0
Employed persons	3.4	4.0	1.0	1.0	0.7	0.8
Labour force[2]	2.2	3.1	1.0	1.0	0.7	
Unemployment rate, level[3]	3.4	2.5	2.5	2.5	2.5	2.5
Prices and wages						
Wages per standard man-year[4]	4.9	5.6	5.5	5.3	4.9	5.5
Consumer price index (CPI)[4]	2.3	0.8	0.2	1.4	3.5	3.2
CPI adjusted for tax changes and excluding energy products (CPI-ATE)[4]	0.8	1.4	1.6	1.6	2.1	2.4
Export prices, traditional goods	11.4	2.2	-3.4	0.5	-0.7	1.8
Import prices, traditional goods	4.7	3.4	-1.9	-0.8	2.2	1.5
Balance of payment						
Current balance, bill. NOK	373.4	350.7	93.6	110.6	112.9	..
Memorandum items (unadjusted level)						
Money market rate (3 month NIBOR)	3.1	5.0	5.2	5.8	6.0	6.4
Lending rate, banks[5]	4.3	5.7	5.8	6.4	6.8	7.2
Crude oil price NOK[6]	413.8	423.4	435.3	483.2	516.4	616.8
Importweighted krone exchange rate, 44 countries, 1995=100	92.5	90.8	89.8	88.4	88.4	87.3
NOK per euro	8.05	8.02	7.92	7.88	7.96	7.94

[1] Consumption in households and non-profit organizations + general government consumption + gross fixed capital formation in Mainland Norway.
[2] Unemployed (Labour Force Survey) and employment (NA) excl. maritime personnel in ocean transport.
[3] According to Statistics Norway›s labour force survey (LFS).
[4] Percentage change from the same period the previous year.
[5] Period averages.
[6] Average spot price. Brent Blend.
Source: Statistics Norway and Norges Bank.

The cyclical upturn in Norway has resulted in increasing growth in the domestic cost level. Coupled with the rise in commodity prices in the global market and higher electricity prices, this has led to appreciably higher consumer price inflation in Norway than we have been used to for some years. Not since winter 2003 has overall inflation been higher than it is at present. Even excluding energy prices, the inflation rate has increased, and in July was higher than the inflation target of 2.5 per cent for the first time in six years. A very tight labour market with low unemployment, coupled with solid corporate earnings has resulted in the highest wage growth since 1998. When productivity growth declines, as it normally does at the end of a cyclical upturn and the beginning of a downturn, unit costs increase substantially, leading to increased inflation.

We are now also seeing signs of a turnaround in the labour market. According to the Labour Force Survey, employment growth has come to a halt, the supply of vacancies is clearly lower and the number of lay-offs has increased sharply in recent months. However there are no clear signs of increased unemployment. It is not unusual for the turning point for unemployment to come some quarters after the turning point for GDP. In the present cyclical situation, the unusually extensive inward labour migration may also be impacted more than persons resident in Norway. This would mean that a change in demand for labour might not necessarily affect observed unemployment in Norway as much as previously. One of the demand components that have fallen most sharply in the last few quarters – residential construction – will lead to lower demand for construction workers. The labour market for construction workers has experienced extensive inward labour migration. A reduction in demand may therefore cut the share of foreign workers considerably and thus ease the effect on demand for construction workers resident in Norway.

Both petroleum investment and public sector spending on goods and services have continued to generate growth impulses to the Norwegian economy. We expect this to continue in the period ahead. Somewhat surprisingly, perhaps, exports of traditional goods have remained at a high level despite weak international growth, a strong krone exchange rate and high cost inflation in Norway. We believe that in the period ahead there will be a shift towards lower export growth which will also slow the growth in the Norwegian economy. Mainland business investment will also fall and further dampen growth. We therefore forecast that in 2009 mainland economic growth may be under 2 per cent, compared with approximately 3 per cent in 2008. By way of comparison, the growth rate was twice as high in 2007. Although GDP growth rates are falling, they are appreciably higher than in most OECD countries.

In the course of the upturn monetary policy has been tightened by means of small, relatively frequent interest rate increases. Real interest rates have not risen very much nevertheless, because inflation has also increased, but higher nominal interest rates have a substantial impact on earnings in the household and enterprise sector. Higher interest rates, along with many other factors, also contribute to a strong krone, which has a contractionary effect on the Norwegian economy. Now that the Norwegian economy has peaked and the global economy is in a period of fairly slow growth, it is worth remembering that the Norwegian authorities have considerable scope for manoeuvre in economic policy. This is due both to the fact that the Norwegian interest rate level is higher than in surrounding countries, and to the fact that a moderately expansionary fiscal policy during the upturn, combined with record-high oil prices, have resulted in very high government budget surpluses. This has contributed to rapid accumulation of the Government Pension Fund – Global, which in the period ahead may provide a basis for a more expansionary fiscal policy, even within the 4 per cent limit.

However, the authorities may decide whether to stimulate the economy primarily through fiscal policy or through monetary policy. Monetary policy affects the economy with a considerable lag compared with some elements of fiscal policy, and may also affect other parts of the Norwegian economy. When groups in the economy are affected differently, the effects in the macroeconomy may also vary. It is not purely up to the economists to recommend how policy should be adapted in such a situation. Recently the public debate has revolved around different ways in which the government can improve the infrastructure in Norway. In the period ahead there will be scope in the real economy to increase public investment when the economy moves into another downturn. To illustrate how such action will affect the economy, we have constructed a scenario which shows the effects of higher public investment in infrastructure.

Stable fiscal policy impulses

Growth in general government purchases of goods and services was almost 4 per cent from the first half of 2007 to the same time this year. The seasonally adjusted figures show that growth compared with the second half of 2007 was approximately the same after adjusting for investment in new frigates. This is slightly higher than projected annual growth in 2008 in the Revised National Budget 2008 (RNB). We expect slightly lower growth in the second half of 2008 than in the first, and project growth in general government spending at 3.6 per cent in 2008, whereas investment growth will be just under 6 per cent. This is slightly higher than our previous projections, which were based on the RNB. So far this year, growth in transfers to households has risen in pace with general wage growth, but the social security settlement points to somewhat stronger growth in the second half of the year. We project the growth in transfers at about 7 per cent from 2007 to 2008.

Effects of increased public sector spending on infrastructure

Recently several parties have advocated that the government should increase general government investment in infrastructure. This box presents projections using the KVARTS quarterly model of the Norwegian economy, which show the macroeconomic effects of a permanent increase in such investments. The increase is not offset by tightening in other sectors of fiscal policy. Such investments may be considered to have two main purposes. First, to contribute to greater efficiency in the economy and, second, to contribute to increased welfare. The model does not take account of the productivity effects in private sector industries due to changes in public infrastructure. Many potential investment projects will also have such a long planning and production time that it is not realistic to include productivity effects of any significance within our projection horizon. According to the National Accounts description of the economy, public infrastructure capital will produce services, but with an assumed net return of zero. This means that the gross return and production contribution are equivalent to the depreciation of the increased capital stocks, and this is counted as consumption in general government. Thus the general government value added increases when the capital stock increases, and this mechanism is built into in KVARTS.

With the point of departure in the projections, extended to 2016, public sector investment in infrastructure is increased by NOK 10 billion in 2005 money in 2009, NOK 20 billion in 2010 and NOK 30 billion in 2011 and each following year. The effects are shown in the table below.

The activity in the Norwegian economy is stimulated through greater investment, but much of the increase is covered through increased imports. One reason for this is that a large proportion of the resources used in such projects are imported directly or indirectly, as a result of the fact that Norway is a small, open economy. Moreover, increased domestic activity will increase labour costs in Norway, thereby weakening competitiveness.

In KVARTS the exchange rate depends mainly on interest rate and inflation differentials between Norway and other countries. In the model, the money market rate in Norway is determined by striking a balance between the two objectives of attaining the inflation target of 2.5 per cent and of stabilizing employment and output, expressed here in terms of unemployment.

Low unemployment and increased inflationary pressures cause interest rates to rise and the krone to appreciate. Lower import prices eliminate most of the effects on consumer prices. The appreciation of the krone and rise in labour costs weakens the competitiveness of the Norwegian business sector, so that the import share rises and exports fall. These factors mean that even more of the increase in demand is gradually met by imports and not Norwegian production. Whereas output measured in terms of mainland GDP rises by 1.2 per cent in 2012 compared with the baseline scenario, the effect is down to 1.0 per cent in 2016. In 2016, the increase in value added in the mainland business sector is clearly lower than the increase in imports. Manufacturing output, which first increases slightly as a result of direct and indirect deliveries of capital goods, will be lower than in the baseline scenario after a few years because the effects of weakened competitiveness will then be strongest.

The increased pressure due to the demand stimulus will leak out through a number of channels. The increased demand will gradually be directed more and more at other countries, thereby increasing imports. Another factor that limits pressure effects is that the supply of labour increases so that the decline in unemployment is far less than the increase in employment alone would imply. The propensity to seek employment increases when there is more pressure in the labour market, thereby increasing the labour supply, and an increase in real wages has the same effect. Finally, we have the increased interest rate, which reduces pressures both through the appreciation of the krone and through the negative effects it has on corporate investment and household demand.

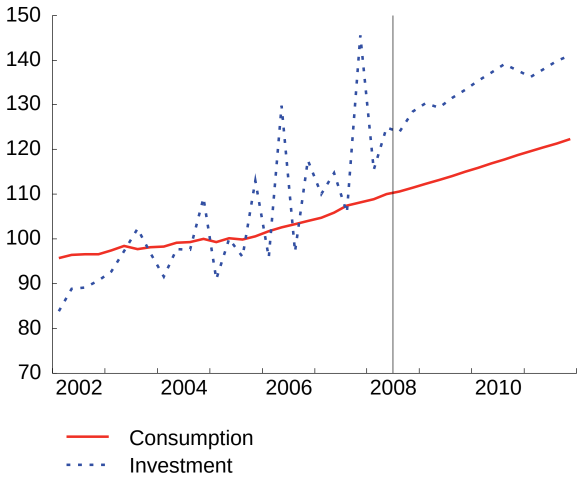
Our projection shows that the increased infrastructure investments push up interest rates by about one quarter of a percentage point after three years, increasing to half a percentage point in the sixth year. The growth in activity initially contributes to increasing household demand. After a while, however, the increased interest rate causes a gradual reduction in household demand and towards the end of the projection period the sum of consumption and housing investment is lower than in the baseline scenario.

Effects of increased investment in public transport. Deviation from baseline scenario unless otherwise indicated. Per cent

	2009	2010	2011	2012	2016
General government consumption	0.2	0.6	1.0	1.3	2.0
Household consumption	0.1	0.2	0.3	0.3	0.2
Housing investment	0.0	0.1	0.0	-0.6	-2.6
Mainland business investment	0.4	0.8	1.2	1.2	0.4
Exports traditional goods	-0.1	-0.2	-0.4	-0.5	-0.7
Imports	0.7	1.3	2.0	2.0	1.8
Mainland GDP	0.5	0.8	1.1	1.2	1.0
Added value manufacturing	0.2	0.3	0.2	-0.1	-0.8
Wages	0.2	0.4	0.5	0.6	1.0
Household real disposable income	0.3	0.5	0.8	0.8	0.6
CPI-ATE	0.0	0.0	0.0	-0.1	0.1
Exchange rate[1]	-0.4	-0.7	-1.2	-1.4	-1.4
Deviation in percentage points					
Unemployment rate, percentage points	-0.1	-0.2	-0.3	-0.3	-0.2
Money market rate, percentage points	0.1	0.2	0.3	0.3	0.5
Deviation in billions of NOK					
General government investment (constant 2005-kroner)	10.0	20.0	30.0	30.0	30.0
General government budget surplus	-9.6	-20.3	-33.0	-36.8	-50.5
Current account	-7.9	-16.8	-28.6	-32.8	-41.3

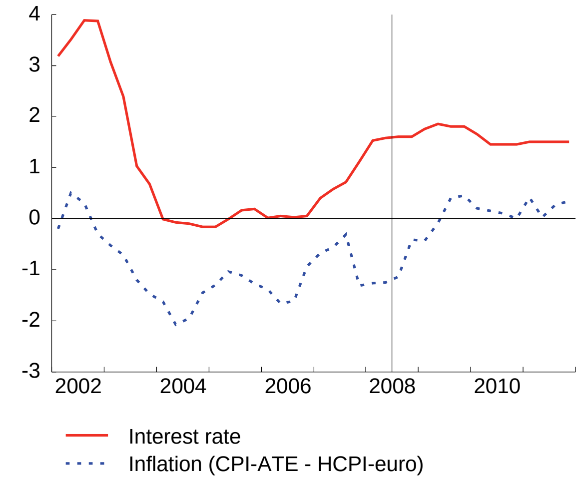
[1] Negative figures indicate a stronger krone.

Figure 1. **General government. Seasonally adjusted volume indices. 2005=100**



Source: Statistics Norway.

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



Source: Norges Bank and Statistics Norway.

As a result of the high oil price this summer, the budget surplus will probably be higher this year than assumed in RNB. In such case, the capital transferred to the Government Pension Fund – Global may be somewhat higher than assumed. Fiscal policy in 2008 is based on the structural non-oil budget deficit being slightly lower than permitted by the 4 per cent limit. Given the economic situation and a rising interest rate level in Norway, this is understandable. Now that the Norwegian economy has passed a cyclical peak and growth has clearly slowed since autumn 2007, the question is whether the economy can be stimulated by bringing the interest rate level down in the course of 2009, as opposed to stimulating the economy by means of fiscal policy. The fiscal rule provides scope for substantial stimulation of the economy in 2009 compared with 2008 without exceeding the 4 per cent limit. However, we have largely maintained our previous projections, which imply that government budget spending will continue at approximately the same rate in 2009 as in 2008, at the same times as we assume that direct and indirect taxes will be adjusted approximately in line with inflation. We estimate that the budget balance could have been reduced by about a further NOK 10 billion in 2009 without exceeding the 4 per cent limit.

For 2010 and 2011 we assume a continuation of fiscal policy for 2008 and 2009. The fact that general government investment does not increase from 2010 to 2011 according to our projections is attributable to the delivery in 2010 of the last frigate to the Norwegian Defence Forces. The growth rate excluding this investment is fairly stable.

Our fiscal policy assumptions thus imply fairly stable growth impulses to the Norwegian economy in the years ahead. Real growth in household transfers will increase a little towards the end of the projection period because the number of old-age pensioners is increasing for demographic reasons.

Downward shift in interest rates up to 2010

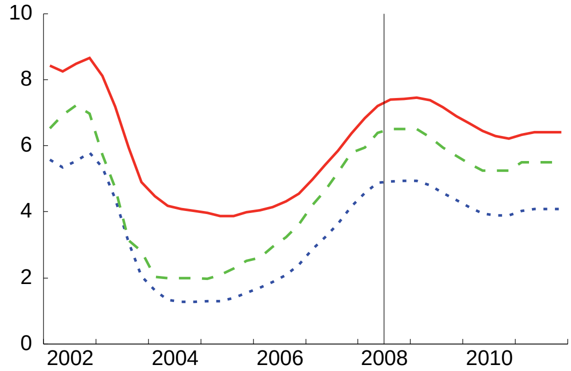
In its setting of interest rates, Norges Bank shall strike a balance between the objectives of stabilizing inflation, the krone exchange rate and developments in output and employment. The operational target of monetary policy is an annual rise in consumer prices of close to 2.5 per cent over time. Inflation measured by the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) was down to 0.4 per cent in August 2006. Since then inflation has gradually picked up and the year-on-year rise in the CPI-ATE was 2.9 per cent in July 2008. CPI-ATE inflation has thus moved close to the monetary policy target after several years of low inflation.

Since July 2005, Norges Bank has gradually raised its key policy rate from 1.75 per cent to 5.75 per cent in June 2008. The money market rate normally follows the key rate with a premium. This premium has normally hovered around ¼ percentage point, but is somewhat higher when the interest rate is expected to increase and somewhat lower when it is expected to fall. Since summer 2007, the premium has been considerably higher, however, as result of the turbulence in financial markets. In mid-August 2008 the money market rate was about 6.6 per cent, almost one percentage point higher than the key rate.

Domestic credit growth, as measured by 12-month growth in private sector gross debt (C2), was 13.3 per cent in June 2008, down from 14.0 per cent the previous month. Growth in household debt was 9.8 per cent in June 2008. This is the lowest twelve-month growth recorded since summer 2003 and indicates that the interest rate increases have put a damper on willingness to borrow.

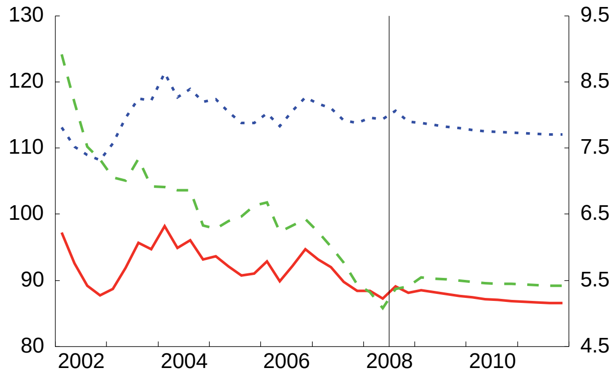
The ECB raised is key rate by 0.25 percentage point, to 4.25 per cent, in July 2008. Money market rates in the

Figure 3. **Norwegian interest rates. Per cent**



Source: Norges Bank and Statistics Norway.

Figure 4. **Exchange rates**



Source: Norges Bank.

euro area stood at about 5.0 per cent in mid-August. The difference between the money market rate and the key rate is thus almost the same as in Norway. The difference between the Norwegian money market rate and the EU money market rate was approximately 1.6 percentage points in mid-August.

Through 2007 the value of the krone varied between a little less than 7.70 and 8.40 against the euro, with the annual average at about NOK 8. From the end of 2007 to mid-August this year, a euro has cost an average of about NOK 7.95. The US dollar depreciated sharply against most currencies through 2007 and into 2008. The krone also appreciated against the US dollar. Whereas a dollar cost close to NOK 6.40 in January 2007, its value had fallen to NOK 5.00 – 5.10 in the second quarter of 2008, before rising again to around NOK 5.40 in mid-August this year. Measured by the import-weighted krone exchange rate, where weights are based on the composition of Norwegian imports, the krone has appreciated by about 5 per cent from the beginning of 2007 to mid-August 2008.

We assume that interest rates in the euro area will be reduced as a result of the weak economic developments. Money market rates in the euro area are expected to move down to 3.8 per cent in 2010, which is just over one percentage point lower than in August this year. Thereafter, interest rates are expected to edge up to 4.0 per cent in 2011, when global cyclical conditions improve.

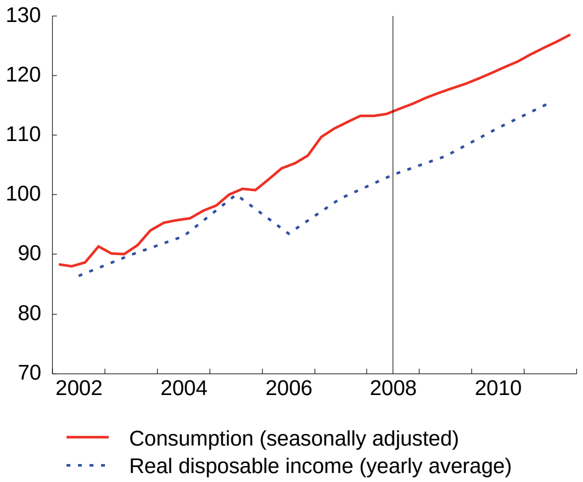
The interest rate level will probably also fall in Norway during the projection period. The decline will be a result partly of a gradual reduction in interest rate premiums and partly of a reduction in the policy rate by Norges Bank. These reductions will come about as a result of slowing of the inflation rate through 2009 and a weakening of mainland GDP growth in the years immediately ahead. Norges Bank shall be forward-looking in its interest rate policy, which means that the interest rate will be cut in 2009. Money market rates are assumed to fall steadily through 2009 and down to 5.25 per cent in spring 2010. In response to higher growth and increased external interest rates, interest rates in Norway will also edge up again, to around 5.5 per cent in 2011. The Norwegian money market rate will then hover around 1¾ percentage points above the euro-area interest rate in 2009, while the interest rate differential will narrow to about 1½ percentage points in 2010 and 2011. If the premium is reduced to 0.5 percentage point, these developments in money market rates imply four cuts of 0.25 percentage point in the key rate up to mid-2010.

We believe that the Norwegian krone will appreciate against other currencies partly owing to a higher interest rate level in Norway. On an annual basis, the krone is projected to appreciate by 3 per cent this year and a further 2 per cent in 2008, measured by the import-weighted krone exchange rate. The appreciation of the krone against the euro means that the exchange rate will gradually move down to around NOK 7.7 kroner per euro by the end of 2011.

Very weak developments in consumption so far in 2008

The strong growth in consumption of recent years, which peaked at as much as 6.4 per cent in 2007, has been sharply curbed so far in 2008. According to seasonally adjusted QNA figures, consumption for households and non-profit organizations rose by a modest 0.3 per cent from the first to the second quarter of 2008 compared with zero growth the previous quarter. The weak developments applied to consumption of both goods and services. Whereas important consumption groups such as food, clothing and footwear and hotel and restaurant services showed clear growth, the decline in purchases of cars and leisure services was particularly pronounced, and contributed strongly to curbing growth in consumption in the second quarter of 2008. A comparison reveals that the volume of

Figure 5. **Income and consumption in households. Volume indices. 2005=100**



Source: Statistics Norway.

Figure 6. **Residential market. Left axis adj. indices. 2005=100. Right axis per cent**

Source: Statistics Norway.

overall household consumption was only 0.6 per cent higher in the first half of this year than in the second half of 2007. AnnualIZED consumption is now expected to increase by about 2.5 per cent this year, of almost 4 percentage points less than last year. Developments in consumption in 2007 must primarily be viewed in the light of high underlying real income growth through the last cyclical upturn. Nevertheless, the saving ratio, i.e. saving as a percentage of disposable income, fell to a very low level of -0.3 per cent in 2007. However, consumer durables excluding dwellings are not included in this saving concept. The very strong growth in purchase of cars in 2007 is therefore an important reason for the low saving ratio last year.

Growth in household real disposable income is expected to be about 4 per cent in 2008, but to fall to 3.0 per cent in 2009. Income growth is thereafter expected to pick up again somewhat in pace with higher economic growth. Contributory factors will be continued strong growth in household wage earnings, but also in business earnings and public transfers, primarily owing to a steadily rising number of recipients of national insurance old-age pensions. However, high consumer price inflation will dampen the real growth in household income this year and in 2009. At the same time, household indebtedness will increase somewhat more than household interest-bearing assets, because housing investment will remain high even though it is now falling. Added to higher interest rates, this will translate into weak developments in net interest income, which will push down growth in disposable income. The real after-tax interest rate is expected to be just under 1.5 per cent in 2008, or markedly lower than in 2007, and then move up to an annual average of around 2.5 per cent in the period 2009-2011. The expected developments in income and interest rates point to consumption growth of about 3 per cent in the next few years. Our projections thus imply a pronounced decline in consumption growth compared with the high rate of growth in 2007 and previous years.

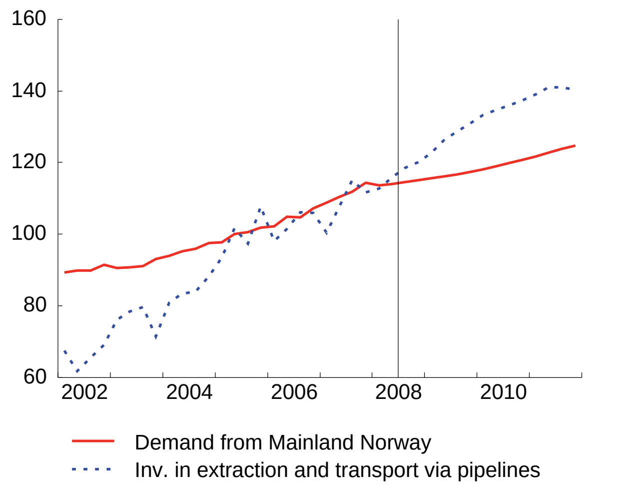
The saving ratio is projected to pick up gradually from -0.3 per cent in 2007 to a good 3.5 per cent in 2011. The rise in saving is reflected in a marked increase in household net lending. Measured at constant prices, household net lending, which was - NOK 73 billion in 2007 is projected at - NOK 19 billion in 2011. This trend in net lending is a result of consumption growing less than income. The expected fall in housing investment during the projection period compared with the level in 2007 will also increase household net lending.

Continued fall in housing investment

According to preliminary QNA figures, housing investment increased by 5.5 per cent in 2007 compared with 6.6 per cent in 2006 and a whole 10.8 per cent in 2005. The rapid growth in housing investment since the end of 2003, which has been driven by strong real income growth and low real interest rates, and which has been reflected in rapidly rising resale home prices, is now definitely over. According to seasonally adjusted QNA figures, housing investment has fallen quite sharply since the second quarter of 2007. Housing start statistics, which provide the main source for the QNA figures, show that the marked downward trend through 2007 continued in the first half of this year. The high level of housing capital and decline in building activity through 2007 and so far in 2008 point to a pronounced fall in housing investment through this year and next, albeit from a level that is still high. On the other hand, prospects of somewhat higher growth in real disposable income and relatively low real interest rates suggest that housing investment will pick up somewhat again towards the end of the projection period.

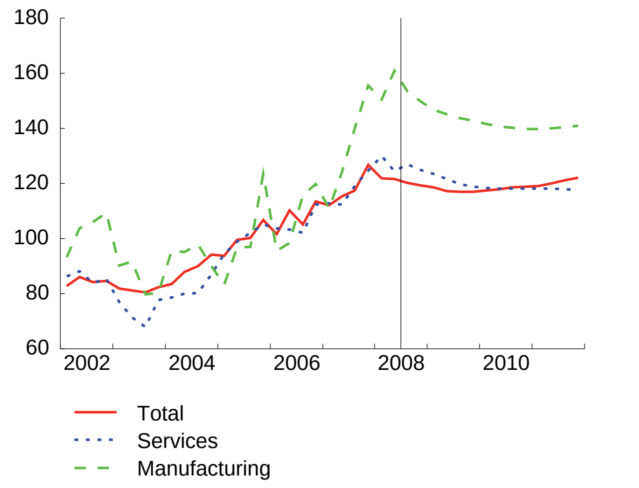
Resale home prices have risen sharply since 2003 and the rate of increase was a good 12 per cent in 2007. However, a comparison of the first half of this year with

Figure 7. **Domestic demand. Seasonally adjusted volume indices. 2005=100**



Source: Statistics Norway.

Figure 8. **Investment, Mainland Norway. Seasonally adjusted volume indices. 2005=100**



Source: Statistics Norway.

the first half of 2007 shows that house prices only rose by 2.5 per cent. During this period prices for detached houses and small houses rose by 3.8 per cent and 1.9 per cent respectively, while prices for flats showed a decline of 5.5 per cent. The rise in real prices for owner-occupier dwellings now appears likely to decline from about 11.5 per cent in 2007 to close to zero as an annualized average in the projection period.

Record-high oil prices make new projects profitable.

Growth in petroleum investment has been strong for a number of years. However, the seasonally adjusted figures show that investment in the first half of 2008 was on a level with the last half of 2007. If figures for the first half of 2008 are compared with the same period last year, however, petroleum investment is seen to have grown by 10 per cent. This increase is primarily attributable to a large increase in investment in oil platforms. There have been delays in several projects this year, which dampened investment. It is assumed that this lag will be caught up in the last half of 2008 and in 2009.

We have seen a formidable growth in petroleum investment since the last oil price trough in 2001. Despite the fact that the land facilities for two large developments – Ormen Lange and Snøhvit - have now been completed, growth in petroleum investment is expected to continue. In recent years there has been an influx of new oil companies that have specialized in exploring for new fields. This is one of the reasons that there has been strong exploration growth since 2004. A clear increase in the number of drilling rigs that satisfy Norwegian requirements is expected. If there is available labour, this may contribute to increasing investment in exploration and production drilling on the Norwegian continental shelf. However, lower exploration growth is expected, as the current level is historically high. Investment in new platforms and the development of existing fields is pushing up investment, with growth rates a little higher than those seen for the past two years. Our estimates for investment in 2008 have now been revised down to a growth of around 6 per cent. Growth in investment going forward is projected to remain at about the same level.

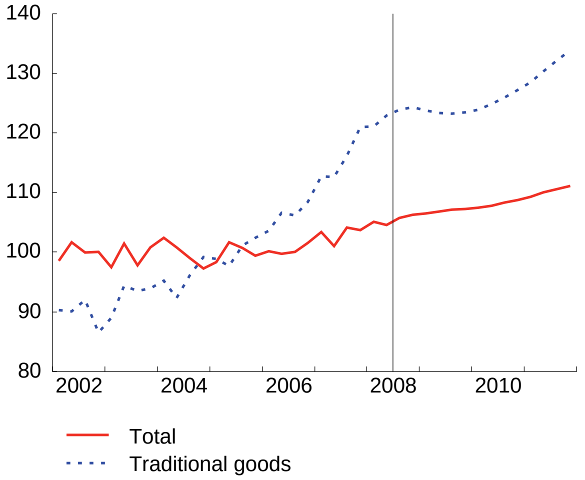
Petroleum production in Norway, measured as number of oil equivalents, has declined since the production peak in 2004, and is now at the same level as in 2000. Oil production has fallen since 2001 and is expected to fall further in the years ahead. Large developments have resulted in increased gas production in recent years, and with further development of the Gjøa and Skarv gas fields, among others, the increase in gas production makes up for the fall in oil production. As a result, total petroleum production will rise weakly in 2009 and then stabilize at that level for the remainder of the projection period.

Fall in business investment ahead

From 2003 to 2007, mainland business investment increased by close to 60 per cent. From 2006 to 2007 it rose by 12.5 per cent, and the strong growth continued into the first quarter of 2008. However, seasonally adjusted QNA figures now show a fall in mainland business investment of 0.8 per cent from the first to the second quarter of 2008. Whereas investment in manufacturing and mining rose by 6.9 per cent and in other goods production by 3.6 per cent, investment in service industries declined by 4.3 per cent.

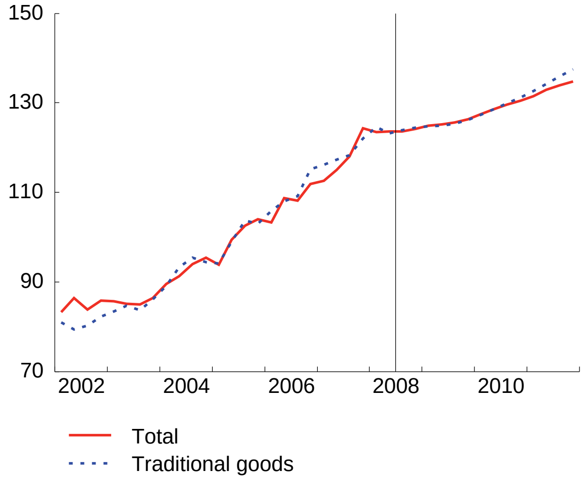
Statistics Norway's latest investment intentions survey in June this year indicates that growth in manufacturing investment will continue through 2008. A number of large oil refinery and chemical industry projects combined with a broad rise in investment in the food and beverage industry are the main reasons for the growth in investment. Other industries with pronounced investment growth are the wood and wood

Figure 9. **Exports. Seasonally adjusted volume indices. 2005=100**



Source: Statistics Norway.

Figure 10. **Imports. Seasonally adjusted volume indices. 2005=100**



Source: Statistics Norway.

products industry and the machinery manufacturing industry. The investment intentions survey for 2009 indicates a reduction in manufacturing investment.

According to our projections, manufacturing investment will increase by about 17 per cent this year and fall by 7½ per cent in 2009. This is somewhat lower than indicated by the investment intentions survey and must be viewed in the light of the cyclical developments upon which we base ourselves. In 2010 industrial investment will fall further, before levelling off in 2011. Because of the strong investment growth in the period 2003-2008, this implies a continued high level of investment throughout the projection period.

Investment in the power sector has risen by over 40 per cent over the last two years. In 2008 growth is projected at the same rate as in 2007, i.e. at well over 10 per cent. Thereafter investment is expected to remain approximately unchanged.

Sharp investment growth through the entire cyclical upturn has resulted in a 15 per cent increase in capital stock in the mainland private service sectors over the past four years. In the light of the high level of capital stock on the back of weaker cyclical conditions, investment in private sector services in the period ahead is expected to grow at a considerably slower pace than last year's rate of 11.4 per cent. For mainland industries as a whole, investment growth is projected at just under 9 per cent this year, followed by slackening growth later in the projection period in pace with slower growth in production.

Lower exports of traditional goods in 2009

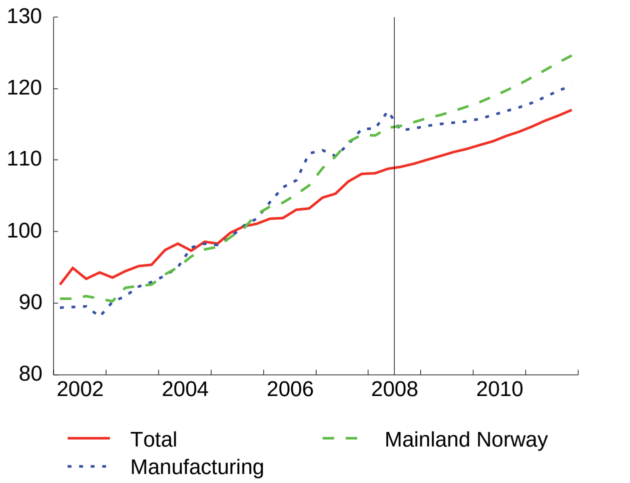
Exports of traditional goods rose by a seasonally adjusted 1.5 per cent in the second quarter of 2008, up from 0.2 per cent the previous quarter. The unusually early Easter makes the distribution between the first and second quarters particularly uncertain this time. The increase from the second half of 2007 to the first half of this year was almost 3 per cent. This represents a slowing compared with the strong developments from the first half to the second half of last year, when growth was over 5 per cent. The sharp rise in exports of traditional goods can be largely attributed to strong developments in exports of engineering products. Metal exports continue to fall, and declined in both the first and the second quarter. Exports of crude oil, natural gas and services declined, and contributed to total exports in the second quarter of 2008 being 0.5 per cent down on the first quarter.

Prices for traditional export goods rose by 1.8 per cent in the 2nd quarter this year compared with the previous quarter. A continued rise in oil and natural gas prices contributed to an increase of a full 5.2 per cent in overall export prices. The price of exported crude oil was over 50 per cent higher in the second quarter of 2008 than in the same period last year. Export prices for metal have fallen this past year, and in the second quarter of 2008 were 14.5 per cent lower than in the same quarter in 2007.

Activity growth among our most important trading partners is expected to decline in the next few years. We assume that market growth will be reduced through 2008 and decline to about an annualized 1.5 per cent next year. The growth of exports of traditional goods is remaining at a high level this year, however, and is expected to be close to 7 per cent. From next year, however, low growth among our trading partners coupled with weakened cost competitiveness and reduced export of electricity will contribute to slightly lower traditional goods exports in 2009 than this year.

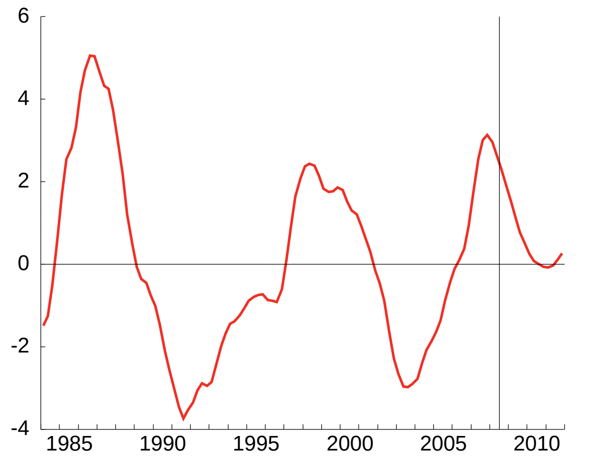
The global economic situation is expected to improve from 2008, pushing exports up again to about 5 per cent towards the end of the projection period. From

Figure 11. **Gross domestic product. Seasonally adjusted volume indices. 2005=100**



Source: Statistics Norway.

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



Source: Statistics Norway.

2009 the growth of traditional goods exports is expected to be lower than demand growth among our most important trading partners. This will mean reduced market shares.

Exports of oil and natural gas combined are expected to continue to decline this year. In 2009, however, these exports are projected to pick up in relation to the previous year. In the event, this will be the first time since 2002. Thereafter, and for the remainder of the projection period, petroleum exports are expected to be approximately on a level with 2009. In line with developments in recent years, growth in exports of services is projected to be higher than for traditional goods during the projection period. Overall, exports are expected to increase by 1-2 per cent annually in the projection period, approximately as in the preceding years.

Slower import growth ahead

Through the cyclical upturn since 2003, import growth has been over 8 per cent annually. Much of the increase in domestic demand during this period has been met through increased imports. Import growth shadows business cycles, and investment in particular accounts for a high share of imports. The turnaround experienced by the Norwegian economy in 2008 and the decline in total investment have therefore sharply reduced growth in imports.

In contrast to the strong import figures through the cyclical upturn, the half-year figures show that total imports from the second half of 2007 to the first half of 2008 increased by only an annualized 3.9 per cent after adjustment for normal seasonal variations. The slackening of import growth is clearly reflected in the quarterly figures, as total exports for the second quarter were at approximately the same level as for the first quarter.

Service imports increased by 1.7 per cent in the second quarter, but were balanced by a 1.1 per cent fall in imports of traditional goods. The increase in service imports is primarily attributable to increased imports of corporate services, while lower imports of engineering products accounted for most of the decline in traditional goods imports.

There has been a broad-based increase in import prices, which increased by 1.5 per cent overall in the second quarter of this year compared with the previous quarter. This price rise is partly due to a higher rise in costs among our trading partners and increased international commodity prices. This was particularly reflected in import prices for petrol, heating oil, diesel for vehicles and other petroleum products, which increased by between 13 and 26 per cent in the second quarter.

The cyclical downturn will have a negative impact on imports looking forward. In the current year we assume that import growth will fall to 5.3 per cent, and most of this growth can be explained by the carry-over from last year. Import growth is expected to decline further, to 1.5 per cent in 2009. From 2010 growth in domestic demand is expected to pick up. This, combined with an expected strengthening of the import-weighted krone exchange rate, will push import growth up relatively more than growth in the mainland economy, which means higher import shares.

Weaker output growth

Whereas economic growth in Norway measured as mainland GDP growth was record-high in 2007, the QNA figures show that the growth rate has slowed across the board since last autumn. As a result of the unusual timing of Easter this year, it is difficult to assess developments through the first and second quarters this year. Half-year figures show that growth rose by only 0.8 per cent from the second half of 2007 to the first half of 2008, equivalent to annual growth rate of

Table 2. **Main economic indicators 2007-2011. Accounts and forecasts. Percentage change from previous year unless otherwise noted**

	Accounts 2007	Forecasts								
		2008			2009		2010		2011	
		SN	MoF	NB	SN	NB	SN	NB	SN	NB
Demand and output										
Consumption in households etc.	6.4	2.6	3.7	2 3/4	2.9	2	2.9	2 1/4	3.5	3 1/4
General government consumption	3.6	3.6	3.2	3 1/4	3.1	3 1/2	3.3	..	3.1	..
Gross fixed investment	9.3	3.9	4.8	..	-0.9	..	2.3	..	2.6	
Extraction and transport via pipelines[1]	5.5	6.2	10.0	7 1/2	9.2	10	5.9	5	4.9	0.0
Mainland Norway	9.4	2.8	3.4	4 3/4	-3.6	-1 3/4	1.2	..	2.0	..
Industries	12.5	8.8	7.0	..	-5.9	..	-1.2	..	0.0	..
Housing	5.5	-9.3	-4.0	..	-6.5	..	1.9	..	7.3	..
General government	7.8	5.7	5.4	..	5.7	..	5.8	..	0.6	..
Demand from Mainland Norway[2]	6.2	2.9	3.5	3 1/4	1.7	1 3/4	2.7	2	3.1	3.0
Stockbuilding[3]	-1.3	0.0	..	..	0.0	..	0.0	..	0.0	..
Exports	2.8	2.2	2.4	..	1.5	..	0.9	..	2.2	..
Crude oil and natural gas	-2.8	-1.5	-0.2	..	2.5	..	0.0	..	0.0	..
Traditional goods[4]	9.0	6.9	4.3	5	-0.1	2	1.8	..	4.8	..
Imports	8.7	5.3	6.0	5 1/4	1.5	2	3.0	..	3.5	..
Traditional goods	8.1	4.6	6.1	..	1.3	..	3.4	..	4.6	..
Gross domestic product	3.7	2.5	2.4	2 3/4	1.9	2 1/2	1.9	2 1/4	2.6	2 1/2
Mainland Norway	6.2	3.1	3.2	3 1/4	1.7	2	2.4	2 1/2	3.2	3.0
Labour market										
Employed persons	4.0	2.6	2.4	2 3/4	1.4	1/2	1.2	-1/4	1.5	1/2
Unemployment rate (level)	2.5	2.7	2.4	2 3/4	2.8	1	3.1	1/2	3.0	1/2
Prices and wages										
Wages per standard man-year	5.6	6.0	5 1/2	6	5.0	5 1/2	4.4	5	4.5	4 3/4
Consumer price index (CPI)	0.8	4.0	3.2	4	3.1	3 1/4	1.9	2 1/2	2.3	2 1/2
CPI-ATE[5]	1.4	2.6	2.4	2 1/2	2.5	2 1/4	2.0	2 1/2	2.2	2 1/2
Export prices, traditional goods	2.2	1.3	-1.5	..	-2.8	..	3.1	..	7.7	..
Import prices, traditional goods	3.4	1.0	0.3	..	-0.6	..	1.1	..	3.2	..
Housing prices[6]	12.3	2.6	..	..	2.6	..	1.5	..	4.9	..
Balance of payment										..
Current balance (bill. NOK)	350.7	493.8	429.4	..	538.4	..	556.3	..	671.9	..
Current balance (per cent of GDP)	15.4	19.1	17.2	..	19.7	..	19.5	..	21.8	..
Memorandum items:										..
Household savings ratio (level)	-0.4	1.2	0.3	..	1.6	..	3.2	..	3.6	..
Money market rate (level)	5.0	6.3	6.4	6.3	6.1	6.4	5.3	5.7	5.5	5.4
Lending rate, banks (level)[7]	5.7	7.2	..	..	7.2	..	6.4		6.4	..
Crude oil price NOK (level)[8]	423	576	500	..	552	..	566	..	665	..
Export markets indicator	5.4	3.8	..	..	1.6	..	4.5	..	7.7	..
Importweighted krone exchange rate (44 countries)[9]	-1.7	-3.1	-3 1/4	-3.6	0.1	2	-1.1	1.7	-0.5	0.8

[1] Forecasts from Ministry of Finance incl. service activities incidential 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] Freeholder.

[7] Yearly average.

[8] Average spot price, Brent Blend.

[9] Increasing index implies depreciation. Ministry of Finance forecasts trade-weighted exchange rate.

Source: Statistics Norway (SN), Ministry of Finance, St.meld. nr.2 (2007-2008), (MoF), Norges Bank, Pengepolitisk rapport 2/2008 (NB).

1.6 per cent. Overall GDP did not increase as much in this period. The QNA figures for the second quarter strengthen the impression that the cyclical peak has passed. Just as the upturn was broad-based, in that growth was high in most private sectors of the economy, the slowing of growth is noticeable in a number of industries. Growth in household consumption is appreciably lower now than a year ago, and the fall in household investment continues. Mainland business investment is also growing less than previously, and fell a little in the second quarter. Exports of traditional goods continue to grow, but more slowly than before. Thus most end-user groups in the mainland economy excluding general government are showing weaker growth. This situation is also reflected to a large extent in the output figures, although stockbuilding impulses remain high and counteract slower demand growth. However, growth in petroleum investment continues to generate positive impulses to offshore-related industries.

In view of the weak growth in household overall demand, and lower export growth as a result of the cyclical downturn abroad, we expect mainland GDP growth to be about 3 per cent in 2008, i.e. half last year's figure. As a result of the strong growth through 2007, the carry-over from 2007 in mainland GDP was almost 2 per cent. The carry-over from the second quarter of 2008 is 2.6 per cent. Our projection for growth in the mainland economy therefore implies weak growth through the last two quarters of 2008. For the first time in several years, production growth in the public sector will be approximately on a level with growth in mainland industries.

In line with previous projections, we estimate that the weak growth will continue for the next couple of years. Weak cyclical developments internationally provide limited growth impulses to the export-oriented business sector in Norway. We expect high interest rates to continue to dampen growth in household consumer demand and housing investment. Weaker growth and higher interest rates will gradually curb growth in business sector investment. This is expected to fall a little in the next few quarters. Those demand components that will continue to provide growth impulses in line with previous years are public sector consumption and gross public sector investment and petroleum investment. As a result of weakened competitiveness for the past couple of years, there is reason to believe that import shares will increase so that also this dampens growth in Norwegian output. We anticipate that growth in manufacturing output, which has remained buoyant or a long time, will be reduced in the period ahead. However, our projections do not imply any fall in manufacturing output in 2009. On the contrary, the decline in housing investment and after a while also in business sector investment will push down the level of activity in the construction sector. Growth in service industries will be reduced, but a positive impetus from growth in service consumption by households, the public sector and petroleum activities will contribute to continued positive growth. We now envisage that mainland GDP growth may be appreciably under 2 per cent in 2009. A certain growth in gas production may push overall GDP growth up a little higher, to just under 2 per cent in 2009.

An assumed global downturn combined with a less contractionary monetary policy in both the euro area and Norway imply that the downturn will be checked somewhat in 2010 and gradually change to an upturn through 2011. The turnaround is largely a consequence of these two assumptions, but we assume that on the whole fiscal policy will generate approximately the same output and demand impulses as previously. Petroleum investment is expected to continue growing somewhat, but a little more slowly than in recent years. Lower interest rates will stimulate both household consumption growth and housing investment. We therefore believe that the decline in housing investment will come to a halt around late 2009/early 2010, and that investment will then edge up again. A moderate turnaround in foreign and domestic demand and output will bring the decline in business sector investment to a halt. This means that the decline in the construction sector will change to a moderate upturn again in 2010 and 2011. Manufacturing output will do the same as a result of increased exports of traditional goods. Mainland GDP growth is projected at 2.3 per cent in 2010, increasing to 3.2 per cent in 2011. This is close to what we currently perceive as potential economic growth. Approximately unchanged production of oil and gas combined will result in stable production in the petroleum sector so that overall GDP growth will generally be half a percentage point lower than growth in the mainland economy in these two years.

Decline in productivity points to slower employment growth

Whereas the statistics for many areas now show a clear cyclical downturn, seasonally adjusted figures from Statistics Norway's Labour Force Survey (LFS) show that unemployment has remained stable at around 2.5 per cent since May 2007. The number of registered unemployed, according to the Norwegian Labour and Welfare Organisation (NAV) was reduced somewhat during the first part of this period, but has been more or less unchanged since end-November 2007. However, NAV has noted a clear increase in the number of lay-offs. At end-July this year there were 25 per cent more persons laid off than at the same time last year. The number of vacancies has also been reduced. During the same period, the supply of vacancies advertised in the media fell by 15 per cent.

Seasonally adjusted QNA figures show that mainland productivity, measured as production per person-hour worked, was reduced by a whole 0.9 per cent from the second half of 2007 to the first half of this year. This is partly attributable to reduced power production, but there was a substantial decline also excluding the power industry. It is not abnormal for productivity growth to be reduced – or for the level to fall – when there is a negative change in the cyclical picture. As a rule, the decline in demand for corporate goods and services comes a while before cutbacks are considered. Thus the decline in productivity provides a warning of reduced employment growth looking forward.

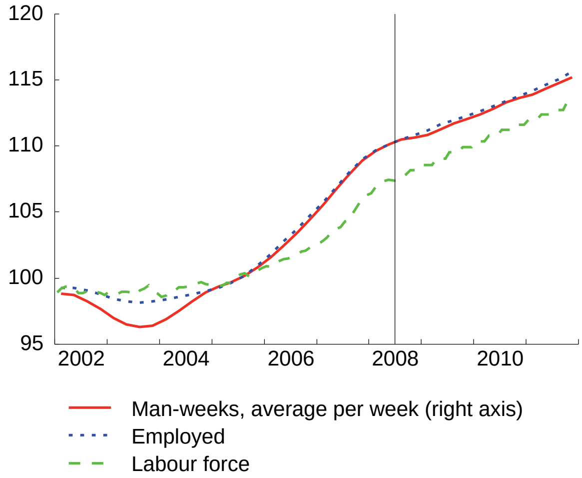
According to the QNA, employment growth was somewhat reduced in the first half of the year. Seasonally adjusted figures show that employment increased by 1.6 per cent from the second half of 2007 to the first half of this year. This implies a growth rate slightly lower than before the cyclical downturn commenced at around the end of the year. However, LFS shows that employment growth has come to a complete halt. Seasonally adjusted LFS figures are shown as a three-month moving average, and in the period May-July this year employment was at approximately the same level as in the period February-April this year.

The reduction in productivity has been accompanied by a sharp increase in the supply of labour from abroad. The increase in numbers of both residents and foreign workers on short-term stays has been record-high, and the supply of work over the past year has increased as much as employment. If companies have chosen to increase their production capacity by employing more people rather than by increasing their capital investment, it may explain some of the lower labour productivity so far this year. Although investment activity has been very high for the past year, the number of person-hours worked has increased more than capital stocks.

There are no definite signs that the high inward labour migration is waning. Now that an economic turnaround has occurred in Norway, at the same time as the labour market has improved markedly in the foreign workers' home countries, we expect lower inward labour migration in the future. There is also reason to believe that emigration is increasing, as the group of workers with links to other countries has increased strongly for a number of years. There is also uncertainty concerning whether and for how long foreign workers living in Norway will continue to offer labour if they become unemployed. If they have difficulty getting a new job, they may choose to withdraw from the labour market. We assume that growth in the labour force will be reduced by about 1½ per cent annually from 2009 to 2001, compared with just over 3 per cent in 2007 and 2008.

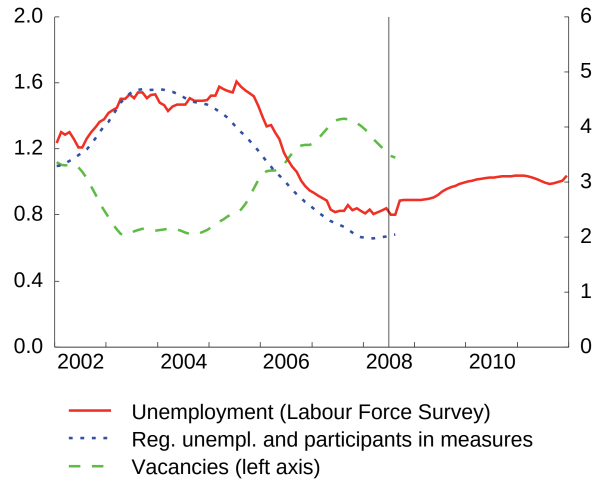
The construction industry is probably the first to have been affected by the cyclical turnaround at the end of 2007 . According to our forecasts, employment in the construction industry will be reduced by almost 10 000 persons in the projection period as a whole, which will create idle capacity in the industry. An alternative scenario with increased public investment in infrastructure up to 2016 is presented in a separate box. This would be a means of making use of this idle capacity.

Figure 13. **Labour force, employment and number of man-hours. Seasonally adjusted and smoothed indices. 2005=100**



Source: Statistics Norway.

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



Source: NAV and Statistics Norway.

Households cut their consumption growth sharply in the first half of this year. If the relatively weak developments in consumption continue, employment growth in private sector service industries will be reduced going forward. These industries employ almost half of all wage-earners in Norway. Nevertheless, increased household consumption will be one of the chief reasons for the growth rate in the Norwegian economy being relatively high for an economic downturn. Given that we also expect substantially increased public sector employment, overall employment growth will remain high according to our projections. Employment growth is nonetheless somewhat lower than growth in the labour force, so that unemployment will increase somewhat to 2010, when it will be a little over 3 per cent. A global upturn and increased manufacturing employment will reduce unemployment a little in 2011.

Towards more normal wage growth

This year wage growth per full-time equivalent person-year appears likely to be approximately 6 per cent. In the event, this will be the highest wage rise recorded since 1998. However there has been very high real wage growth all through the 2000s. If our projections are correct, this decade has seen the highest real wage growth since the 1960s. The high wage growth this year must be viewed in the light of the large business sector surpluses since 2003 the sharp tightening in the labour market since 2005.

With the exception of the strike by UNIO (Confederation of Unions for Professionals, Norway) in connection with the local government settlement, wage settlements this year have been without major conflicts. On the whole employers have accepted high wage demands. This may imply an ample ability to pay on the part of the business sector. The government has also participated in this year's wage settlement with a new early retirement scheme adapted to the pension reform, which employee organizations have received favourably. The private sector settlements ended with a framework of 5.6 per cent proposed by the parties themselves. The framework in the public sector was 6.2 per cent, and in municipal settlements as high as 6.4 per cent. Throughout the cyclical upturn since 2003, wage growth has been relatively similar among the main sectors of the Norwegian economy. However, high bonus disbursements in the financial services sector in 2005 and 2006 contributed to somewhat higher wage growth in the private sector than in the public sector in the 2008 settlement.

National accounts figures confirm that the business sector has had a high capacity to pay in the 2000s. The figures show that before 2001, labour costs constantly accounted for over 70 per cent of valued added in manufacturing. This share was gradually reduced, and in 2006 labour costs only accounted for 65 per cent of value added in the sector. The high wage growth in 2007 and 2008, coupled with the global downturn and strong krone exchange rate, have contributed to increasing the share represented by labour costs again. Our projections indicate that it will reach 70 per cent in 2009.

Reduced corporate profitability combined with somewhat increased unemployment will contribute to lower wage growth in the period ahead. The full annual effect of the pay increases in this year's main settlement will only be felt in 2009, however, so that given normal wage drift average wage growth from this year to 2009 will be relatively high – even with a negotiated pay increase of zero. Our projection of 5 per cent for wage growth from 2008 to 2009 implies that some pay increases will also be given in the interim wage settlement during that year.

A normalization of the cyclical situation, both in Norway and after a while also internationally, will stabilise wage growth at more normal levels after 2009. Wage growth in 2010 and 2011 is projected to be about 4½ per cent. Average CPI inflation of somewhat more than 2 per cent in these years implies real wage growth of approximately 2½ per cent. Such a real wage growth is close to the underlying productivity growth in the economy, and signals stable developments in cost competiveness for the Norwegian business sector in this period.

Electricity prices result in high inflation

Inflation as measured by the consumer price index (CPI) has been rising for the last three quarters, and developments in electricity prices will continue to a further rise in the course of the autumn. The year-on-year rise in the CPI in July was 4.3 per cent, whereas it was as low as -0.3 per cent in September 2007. Developments in energy prices account for most of the increase, but there has also been a clear rise in underlying inflation. The 12-month rise in the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) increased by almost 1½ percentage points during this period, and in July had reached 2.9 per cent. A breakdown of the CPI-ATE by supplier sector shows that there have been growing inflationary impulses from all main groups. The 12-month rise for domestically produced goods, including agricultural and fish products, has accelerated, while the rise in prices for imported consumer goods, house rents and other services has increased far more moderately.

The recent increase in underlying inflation is a continuation of a tendency to high inflation which has persisted since early 2004, i.e. about six months into the last cyclical upturn. The trend can to some extent be traced back to a faster rise in labour costs and weaker productivity developments through the upturn period. However, there have also been other strong forces driving these developments. The sharp appreciation of the krone shortly before the cyclical upturn probably contributed to the very low inflation in early 2004. The price-restraining effects of a steadily growing share of imports from low-cost countries have diminished in recent years. This is partly because the scale of changes in the trading pattern has decreased, and that the cost level in low-cost countries is rising. A pronounced appreciation of the krone through the past four-five years has meant that the rise in prices for imported consumer goods has only increased very slightly, however.

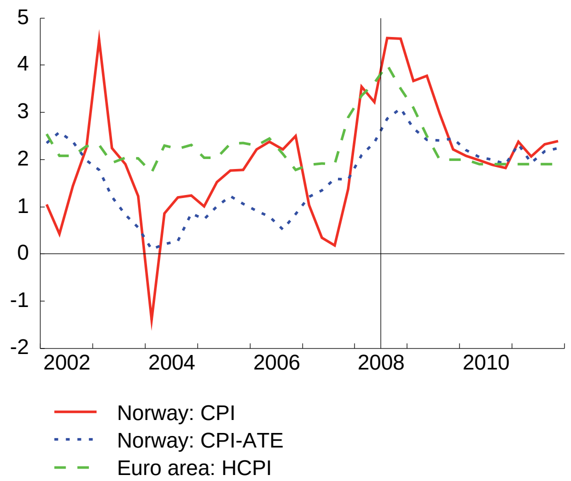
Global developments in commodity prices have influenced Norwegian inflation. The effect of the global rise in food prices has also been heightened recently by a marked increase in maximum prices for Norwegian agricultural products, which were one of the elements in this year's agricultural settlement. Much of the increase in oil prices through the past decade has taken place in parallel with the Norwegian economic upturn. Higher oil prices mean rising production costs in the great majority of sectors, both in Norway and abroad. Price rises for oil and coal have also helped to increase prices in the Nordic power market, even though local conditions have the strongest effect on the more short-term fluctuations in power prices. As a result of high winter temperatures, high inflow into reservoirs, high reservoir levels and technical problems associated with transmission capacity, the spot price in southern Norway was under 10 øre per kWh in May, following a previous peak in December 2007 of 38 øre per kWh. By mid-August prices had increased to approximately 35 øre per kWh. Forward prices just before the publication of this report point towards a price of about 60 øre per kWh at around the end of 2008.

Prices for standard electricity contracts react to spot prices with a considerable time lag. According to the CPI, average electricity prices to households, including taxes and grid rent, moved up a bare 11 per cent from May to July 2008, after falling by 26 per cent from January to May. Measured a year-on-year, the rise in electricity prices escalated from -43 per cent in September 2007 to +28 per cent in July this year, and will continue upwards for the next two-to-three months. Against the backdrop of the forward prices, we project that on an annual basis electricity prices will increase by about 30 per cent this year and around 20 per cent in 2009. After that a zero rise is likely for the following two years.

Developments in electricity prices will contribute to a rise in overall inflation in the coming months. A marked increase in electricity prices at the end of 2007 coupled with a decline in oil prices will probably lead to the 12-month rise in the CPI falling again right at the end of the year. On an annual basis, the CPI is projected to rise by 4 per cent in 2008.

Recent domestic cost and productivity development will contribute to a weak rise in underlying inflation, measured by the 12-month rise in the CPI-ATE, until the end of the year. Lower international commodity prices and inflation on the back of a stronger krone will soon curb this rise, however. We project an annualIZED rise of 2.6 per cent in 2008. Price inflation has not been this high since 2001. A weaker Norwegian economic situation and hence lower business sector profitability coupled with somewhat lower labour market pressures will have the effect of curbing cost inflation. Productivity growth will also pick up. Thus a number of factors, both in Norway and in the global market, will contribute to pushing down inflation. From a little way into 2009 we project that CPI-ATE inflation will remain at around 2 per cent. However, we assume that there will be a constant underlying tendency to slightly higher price impulses from imported finished goods. When the global economy shifts to an upturn again in 2010, there will probably be new inflationary impulses from commodities, including oil. This will also cause Norwegian cost inflation to rise. However, continued appreciation of the krone exchange rate due, among other things, to relatively high Norwegian interest rates, will curb inflation in Norway.

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



Source: Norges Bank and Statistics Norway.

The approved indirect tax programme for 2008 is assessed as broadly inflation-neutral, even though inflation will be considerably higher than assumed in the National Budget. It is also assumed that indirect taxes will be adjusted for inflation in the remainder of the projection period. On an annual basis, we expect the oil price, measured in Norwegian kroner, to fall a little in 2009, and thereafter to pick up. This will result in impulses that approximately counter those generated by developments in electricity prices. Developments in energy prices will thus result in a clearly higher rise in the CPI than in the CPI-ATE in 2008 and 2009, whereas the rise in 2010 and 2011 is expected to be fairly similar.

Historically high oil price results in record current account surplus

In recent years, foreign trade has generated large and growing surpluses. From 2002 to 2006 the trade surplus against other countries rose from just under NOK 200 billion to just under NOK 400 billion. In 2007 a weaker global economic situation contributed to reducing the export surplus measured in constant prices and weakening the terms of trade measured as export prices relative to import prices. As a result, the surplus fell by almost ten per cent compared with 2006. However, we expect that the current accounts surpluses will continue to grow again. Developments so far this year support this, with a surplus for each of the first two quarters of a full NOK 120 billion, according to the QNA. The sharp rise in oil and gas prices so far this year has contributed strongly.

The non-oil and gas balance of payments shows a deficit, from almost NOK 70 billion in 2002 to well over NOK 110 billion last year. The first two quarters of 2008 showed deficits of approximately NOK 20 billion and NOK 30 billion respectively. Thus the current account surpluses can be attributed to oil and gas exports.

Oil prices have risen steadily since 2002, when the price was USD 25 per barrel. In 2008 the oil price has fluctuated widely, from over USD 90 per barrel at the beginning of the year to almost USD 150 this summer. Recently it has fallen to about USD 115. The dollar exchange rate has weakened from almost NOK 9 in 2002, touching a bottom of NOK 5 in the second quarter of 2008. Translated into NOK, the oil price has nevertheless risen from NOK 200 to more than NOK 600 per barrel, which explains the surge in the current account surplus since 2002.

We project the current account surplus in 2008 at NOK 500 billion, a marked step up from last year's surplus of NOK 357 billion. In 2009 the surplus is expected to increase further to approximately NOK 540 billion as a result of a larger volumes of oil and gas exports. Given a projected rise in the oil price from USD 100 per barrel in 2009 to USD 130 per barrel at end-2011, a stable dollar exchange rate of just under NOK 5.5 and a strengthening of the terms of trade for other goods and services, we expect the surpluses to increase substantially and reach NOK 650 billion in 2011.

Net interest and transfers to other countries are the sum of net capital income, net income from employment and transfers/benefits. As a result of assistance to developing countries and non-residents higher average return (disbursed interest and share dividends) on investments in Norway than vice versa, the value of net interest and transfers has been negative for every year since 2002. However we expect increasing net foreign assets to improve net interest and transfers looking forward. The amounts will be small compared to the trade surplus, so that the current account surplus will be approximately the same as the trade surplus, and perhaps a little higher in 2010 and 2011.

Tabell 3. **National accounts: Final expenditure and gross domestic product. At fixed 2005 prices. Million kroner**

	Unadjusted		Seasonally adjusted							
	2006	2007	06.3	06.4	07.1	07.2	07.3	07.4	08.1	08.2
Final consumption expenditure of households and NPISHs	864 839	920 108	217 371	219 967	226 378	229 274	231 393	233 592	233 609	234 320
Household final consumption expenditure	828 966	882 331	208 354	210 860	217 121	219 893	221 880	223 956	223 934	224 606
Goods	428 799	461 680	107 975	109 164	113 941	114 983	116 450	116 792	116 510	116 836
Services	371 049	387 552	92 857	94 690	95 165	96 696	97 187	98 406	98 425	98 740
Direct purchases abroad by resident households	52 544	57 331	13 380	13 169	13 907	14 256	14 269	14 981	15 094	15 168
Direct purchases by non-residents	-23 426	-24 232	-5 857	-6 163	-5 892	-6 042	-6 025	-6 223	-6 096	-6 139
Final consumption expenditure of NPISHs	35 873	37 778	9 017	9 106	9 257	9 381	9 513	9 636	9 676	9 714
Final consumption expenditure of general government	398 571	412 731	100 038	100 724	101 431	102 541	104 016	104 695	105 428	106 486
Final consumption expenditure of central government	207 093	211 241	51 882	52 175	52 420	52 591	52 998	53 221	54 142	54 944
Central government, civilian	179 907	183 027	45 080	45 294	45 389	45 562	45 949	46 121	47 223	48 116
Central government, defence	27 186	28 213	6 802	6 881	7 031	7 029	7 049	7 100	6 920	6 828
Final consumption expenditure of local government	191 478	201 490	48 156	48 550	49 011	49 950	51 018	51 474	51 286	51 542
Gross fixed capital formation	392 400	428 803	98 046	100 964	100 300	104 454	109 447	114 803	111 731	111 625
Extraction and transport via pipelines	90 799	95 816	23 376	23 341	22 100	23 725	25 323	24 580	24 820	25 498
Service activities incidential to extraction	-259	-1 605	449	178	-403	9	-845	-366	-373	-473
Ocean transport	16 381	22 361	4 584	2 285	4 306	4 349	7 069	6 626	6 503	5 987
Mainland Norway	285 479	312 231	69 637	75 159	74 297	76 371	77 900	83 962	80 782	80 612
Mainland Norway excluding general government	227 167	249 376	56 790	59 594	59 734	61 195	63 887	64 707	65 511	64 092
Industries	139 305	156 684	34 799	36 941	36 396	37 749	40 454	41 933	43 670	43 336
Manufacturing and mining	23 943	29 191	6 364	6 586	6 097	6 831	7 706	8 560	8 280	8 848
Production of other goods	25 745	27 681	6 700	6 429	6 287	7 033	7 414	6 852	7 732	8 014
Services	89 616	99 812	21 734	23 926	24 013	23 885	25 333	26 521	27 657	26 474
Dwellings (households)	87 862	92 692	21 991	22 653	23 338	23 446	23 433	22 774	21 841	20 756
General government	58 312	62 855	12 847	15 565	14 563	15 177	14 013	19 256	15 271	16 521
Changes in stocks and statistical discrepancies	59 525	53 830	16 882	13 278	11 021	14 086	11 072	17 605	16 144	18 912
Gross capital formation	451 924	482 633	114 928	114 242	111 321	118 540	120 519	132 408	127 875	130 537
Final domestic use of goods and services	1 715 335	1 815 473	432 337	434 933	439 130	450 355	455 928	470 694	466 912	471 343
Final demand from Mainland Norway	1 548 889	1 645 070	387 046	395 850	402 107	408 186	413 309	422 249	419 819	421 418
Final demand from general government	456 883	475 586	112 885	116 289	115 994	117 718	118 029	123 950	120 699	123 007
Total exports	872 004	896 529	217 317	220 497	224 610	219 516	226 163	225 327	228 221	227 070
Traditional goods	243 615	265 463	60 820	62 131	64 569	64 487	66 541	69 289	69 393	70 400
Crude oil and natural gas	399 603	388 490	99 543	97 716	101 213	94 548	97 601	95 042	97 257	94 726
Ships, oil platforms and planes	12 608	12 837	3 357	4 124	2 548	3 808	4 019	2 462	1 927	2 906
Services	216 177	229 739	53 596	56 525	56 280	56 673	58 001	58 534	59 645	59 037
Total use of goods and services	2 587 339	2 712 001	649 654	655 430	663 741	669 871	682 091	696 022	695 134	698 413
Total imports	592 414	644 130	148 202	153 201	154 286	157 611	161 590	170 264	169 122	169 308
Traditional goods	384 920	416 197	95 857	101 105	102 058	102 975	103 907	107 159	109 379	108 160
Crude oil and natural gas	1 899	4 786	236	885	776	1 850	675	1 465	471	617
Ships, oil platforms and planes	14 907	19 812	3 808	2 005	2 891	3 275	5 954	7 692	6 625	7 013
Services	190 688	203 334	48 301	49 207	48 561	49 511	51 054	53 948	52 647	53 519
Gross domestic product (market prices)	1 994 924	2 067 872	501 452	502 229	509 455	512 261	520 501	525 758	526 011	529 104
Gross domestic product Mainland Norway (market prices)	1 520 691	1 615 455	381 470	385 987	394 996	400 702	408 347	411 602	411 362	415 312
Petroleum activities and ocean transport	474 233	452 416	119 981	116 242	114 459	111 558	112 155	114 156	114 650	113 793
Mainland Norway (basic prices)	1 296 145	1 375 482	323 790	330 054	335 969	341 253	347 302	351 102	351 182	354 204
Mainland Norway excluding general government	1 013 216	1 083 356	252 876	258 660	264 079	268 537	273 759	277 174	276 481	279 469
Manufacturing and mining	185 585	194 216	46 399	48 027	48 245	47 891	48 599	49 516	49 565	50 594
Production of other goods	144 921	158 393	35 482	36 065	38 098	39 541	40 920	40 154	40 292	40 673
Services incl. dwellings (households)	682 709	730 747	170 994	174 568	177 736	181 105	184 240	187 504	186 624	188 202
General government	282 929	292 126	70 914	71 394	71 890	72 716	73 543	73 928	74 701	74 735
Taxes and subsidies products	224 547	239 973	57 680	55 932	59 026	59 449	61 045	60 500	60 180	61 108

Source: Statistics Norway.

Tabell 4. **National accounts: Final expenditure and gross domestic product. At fixed 2005 prices. Percentage change from the previous period**

	Unadjusted		Seasonally adjusted							
	2006	2007	06.3	06.4	07.1	07.2	07.3	07.4	08.1	08.2
Final consumption expenditure of households and NPISHs	4.7	6.4	0.9	1.2	2.9	1.3	0.9	1.0	0.0	0.3
Household final consumption expenditure	4.6	6.4	0.9	1.2	3.0	1.3	0.9	0.9	0.0	0.3
Goods	4.1	7.7	1.3	1.1	4.4	0.9	1.3	0.3	-0.2	0.3
Services	4.1	4.4	0.4	2.0	0.5	1.6	0.5	1.3	0.0	0.3
Direct purchases abroad by resident households	13.1	9.1	0.9	-1.6	5.6	2.5	0.1	5.0	0.8	0.5
Direct purchases by non-residents	4.0	3.4	1.0	5.2	-4.4	2.5	-0.3	3.3	-2.0	0.7
Final consumption expenditure of NPISHs	6.5	5.3	1.0	1.0	1.7	1.3	1.4	1.3	0.4	0.4
Final consumption expenditure of general government	2.9	3.6	0.8	0.7	0.7	1.1	1.4	0.7	0.7	1.0
Final consumption expenditure of central government	1.7	2.0	0.4	0.6	0.5	0.3	0.8	0.4	1.7	1.5
Central government, civilian	2.5	1.7	0.4	0.5	0.2	0.4	0.8	0.4	2.4	1.9
Central government, defence	-3.3	3.8	0.4	1.2	2.2	0.0	0.3	0.7	-2.5	-1.3
Final consumption expenditure of local government	4.4	5.2	1.2	0.8	1.0	1.9	2.1	0.9	-0.4	0.5
Gross fixed capital formation	7.3	9.3	-2.2	3.0	-0.7	4.1	4.8	4.9	-2.7	-0.1
Extraction and transport via pipelines	2.9	5.5	4.7	-0.2	-5.3	7.4	6.7	-2.9	1.0	2.7
Service activities incidential to extraction	-74.2	520.8	-395.1	-60.3	-326.4	-102.2	..	-56.7	2.1	26.6
Ocean transport	25.3	36.5	-9.1	-50.2	88.5	1.0	62.5	-6.3	-1.9	-7.9
Mainland Norway	7.6	9.4	-4.6	7.9	-1.1	2.8	2.0	7.8	-3.8	-0.2
Mainland Norway excluding general government	7.0	9.8	1.7	4.9	0.2	2.4	4.4	1.3	1.2	-2.2
Industries	7.3	12.5	2.4	6.2	-1.5	3.7	7.2	3.7	4.1	-0.8
Manufacturing and mining	8.3	21.9	17.5	3.5	-7.4	12.0	12.8	11.1	-3.3	6.9
Production of other goods	13.8	7.5	1.9	-4.0	-2.2	11.9	5.4	-7.6	12.8	3.6
Services	5.3	11.4	-1.1	10.1	0.4	-0.5	6.1	4.7	4.3	-4.3
Dwellings (households)	6.6	5.5	0.6	3.0	3.0	0.5	-0.1	-2.8	-4.1	-5.0
General government	10.1	7.8	-25.2	21.2	-6.4	4.2	-7.7	37.4	-20.7	8.2
Changes in stocks and statistical discrepancies	28.1	-9.6	29.4	-21.3	-17.0	27.8	-21.4	59.0	-8.3	17.1
Gross capital formation	9.7	6.8	1.5	-0.6	-2.6	6.5	1.7	9.9	-3.4	2.1
Final domestic use of goods and services	5.5	5.8	1.0	0.6	1.0	2.6	1.2	3.2	-0.8	0.9
Final demand from Mainland Norway	4.8	6.2	-0.2	2.3	1.6	1.5	1.3	2.2	-0.6	0.4
Final demand from general government	3.8	4.1	-3.1	3.0	-0.3	1.5	0.3	5.0	-2.6	1.9
Total exports	0.4	2.8	0.3	1.5	1.9	-2.3	3.0	-0.4	1.3	-0.5
Traditional goods	6.2	9.0	-0.4	2.2	3.9	-0.1	3.2	4.1	0.2	1.5
Crude oil and natural gas	-6.6	-2.8	0.2	-1.8	3.6	-6.6	3.2	-2.6	2.3	-2.6
Ships, oil platforms and planes	13.5	1.8	82.5	22.8	-38.2	49.4	5.5	-38.8	-21.7	50.8
Services	8.1	6.3	-1.3	5.5	-0.4	0.7	2.3	0.9	1.9	-1.0
Total use of goods and services	3.8	4.8	0.8	0.9	1.3	0.9	1.8	2.0	-0.1	0.5
Total imports	8.1	8.7	-0.5	3.4	0.7	2.2	2.5	5.4	-0.7	0.1
Traditional goods	9.6	8.1	1.1	5.5	0.9	0.9	0.9	3.1	2.1	-1.1
Crude oil and natural gas	-50.9	152.0	1.9	274.2	-12.3	138.4	-63.5	117.0	-67.8	30.9
Ships, oil platforms and planes	24.1	32.9	-34.8	-47.4	44.2	13.3	81.8	29.2	-13.9	5.9
Services	5.4	6.6	0.5	1.9	-1.3	2.0	3.1	5.7	-2.4	1.7
Gross domestic product (market prices)	2.5	3.7	1.2	0.2	1.4	0.6	1.6	1.0	0.0	0.6
Gross domestic product Mainland Norway (market prices)	4.8	6.2	1.1	1.2	2.3	1.4	1.9	0.8	-0.1	1.0
Petroleum activities and ocean transport	-4.1	-4.6	1.5	-3.1	-1.5	-2.5	0.5	1.8	0.4	-0.7
Mainland Norway (basic prices)	4.8	6.1	0.7	1.9	1.8	1.6	1.8	1.1	0.0	0.9
Mainland Norway excluding general government	5.5	6.9	0.7	2.3	2.1	1.7	1.9	1.2	-0.3	1.1
Manufacturing and mining	7.1	4.7	0.9	3.5	0.5	-0.7	1.5	1.9	0.1	2.1
Production of other goods	-0.7	9.3	-0.9	1.6	5.6	3.8	3.5	-1.9	0.3	0.9
Services incl. dwellings (households)	6.5	7.0	1.0	2.1	1.8	1.9	1.7	1.8	-0.5	0.8
General government	2.2	3.3	0.5	0.7	0.7	1.1	1.1	0.5	1.0	0.0
Taxes and subsidies products	5.0	6.9	3.5	-3.0	5.5	0.7	2.7	-0.9	-0.5	1.5

Source: Statistics Norway.

Tabell 5. **National accounts: Final expenditure and gross domestic product. Price indices. 2005=100**

	Unadjusted		Seasonally adjusted							
	2006	2007	06.3	06.4	07.1	07.2	07.3	07.4	08.1	08.2
Final consumption expenditure of households and NPISHs	102.1	102.8	102.7	103.1	102.2	102.3	102.7	104.0	105.1	105.7
Final consumption expenditure of general government	104.2	108.9	104.9	105.9	107.3	108.5	109.2	110.5	111.9	113.4
Gross fixed capital formation	104.3	110.3	105.8	106.4	108.2	110.2	111.7	111.0	112.4	114.5
Mainland Norway	103.9	109.7	105.0	105.7	107.8	109.1	110.2	111.4	112.0	113.7
Final domestic use of goods and services	103.1	105.7	104.7	103.6	104.1	105.8	106.4	106.2	108.4	110.6
Final demand from Mainland Norway	103.0	105.6	103.7	104.3	104.5	105.1	105.7	107.1	108.1	109.2
Total exports	115.3	116.3	113.7	116.7	112.6	114.9	112.6	125.3	128.9	135.6
Traditional goods	111.4	113.9	114.7	115.8	114.5	116.3	112.4	113.0	112.2	114.2
Total use of goods and services	107.2	109.1	107.7	108.0	107.0	108.7	108.5	112.4	115.1	118.7
Total imports	103.3	106.5	104.1	107.6	107.2	107.7	105.9	105.6	107.6	109.1
Traditional goods	104.7	108.3	105.0	109.6	109.1	109.7	107.7	106.8	109.2	110.9
Gross domestic product (market prices)	108.4	110.1	108.8	108.2	106.9	109.1	109.3	114.6	117.5	121.8
Gross domestic product Mainland Norway (market prices)	103.6	106.1	104.3	104.4	105.1	105.9	105.7	107.6	108.8	109.9

Source: Statistics Norway.

Tabell 6. **National accounts: Final expenditure and gross domestic product. Price indices. Percentage change from previous period**

	Unadjusted		Seasonally adjusted							
	2006	2007	06.3	06.4	07.1	07.2	07.3	07.4	08.1	08.2
Final consumption expenditure of households and NPISHs	2.1	0.7	0.6	0.5	-0.9	0.1	0.3	1.3	1.0	0.6
Final consumption expenditure of general government	4.2	4.5	1.0	1.0	1.3	1.1	0.7	1.2	1.3	1.3
Gross fixed capital formation	4.3	5.8	3.0	0.6	1.7	1.8	1.3	-0.6	1.3	1.9
Mainland Norway	3.9	5.6	2.3	0.6	2.0	1.2	1.0	1.0	0.6	1.5
Final domestic use of goods and services	3.1	2.6	1.4	-1.1	0.5	1.6	0.6	-0.2	2.0	2.1
Final demand from Mainland Norway	3.0	2.6	1.0	0.6	0.2	0.6	0.6	1.3	1.0	1.0
Total exports	15.3	0.9	-0.2	2.7	-3.5	2.0	-2.0	11.3	2.8	5.2
Traditional goods	11.4	2.2	4.7	1.0	-1.1	1.6	-3.4	0.5	-0.7	1.8
Total use of goods and services	7.2	1.9	0.8	0.3	-1.0	1.6	-0.3	3.6	2.4	3.2
Total imports	3.3	3.1	3.3	3.4	-0.4	0.5	-1.7	-0.2	1.9	1.5
Traditional goods	4.7	3.4	3.1	4.4	-0.5	0.6	-1.9	-0.8	2.2	1.5
Gross domestic product (market prices)	8.4	1.6	0.2	-0.6	-1.1	2.0	0.2	4.9	2.6	3.7
Gross domestic product Mainland Norway (market prices)	3.6	2.4	0.4	0.1	0.6	0.8	-0.1	1.8	1.1	1.0

Source: Statistics Norway.