

## International economy

So far, 2000 appears to be a year with higher economic growth in large parts of the world. Prospects are that our main trading partners will record GDP growth of 3 1/2 per cent this year and 3 per cent next year, compared with 2 1/2 per cent the previous two years. The growth forecasts have been revised upwards through the first half of 2000, primarily as a result of stronger-than-expected growth in the US. Compared with last year, however, the turnaround in the European economy is the most obvious difference. Moreover, the forecasts indicate considerably more uniform growth next year as markedly slower growth is expected in the US, while the GDP growth projection for the EU is just a few tenths lower for 2001 than for 2000.

The higher growth rate has resulted in a faster rise in commodity prices and in consumer and producer prices in both the US and Europe. The strongest effect has been seen in crude oil prices, which averaged more than USD 27 in the first eight months of 2000, compared with USD 18 in 1999. Following many years of economic expansion, price inflation in the US has quickened, and in Europe the European Central Bank's inflation target of 2 per cent has been exceeded the last two months. Accelerating inflation has been accompanied by interest rate increases on both sides of the Atlantic. Expectations of slightly lower activity next year may mean that the period of interest rate increases is drawing to a close, but some further increase in interest rates are still expected in the euro area and perhaps in the US as well.

The greatest uncertainty is still linked to whether the expansion in the US can be sustained, albeit with a

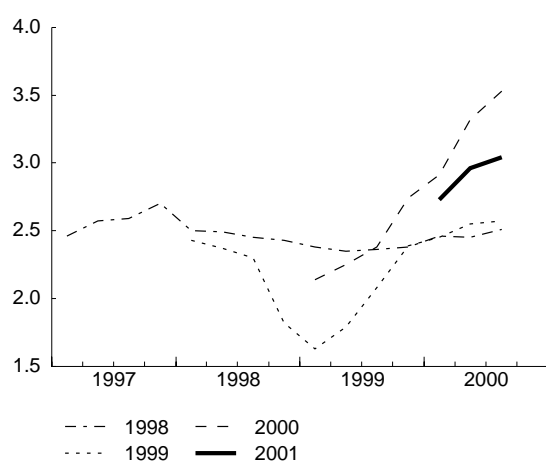
gradual slowing of growth. This uncertainty is particularly important since Europe and the rest of the world still appear to be very dependent on the situation in the US. An additional uncertainty is the risk that interest rates will rise too sharply in the euro area and stifle the upturn.

### Increased international trade and rising commodity prices

Since the end of last year, the upturn in the global economy has also translated into increased trade. This trend continued in the first quarter of 2000, and there are no signs of any marked turnaround. In June, the OECD estimated that the volume of world trade would expand by more than 10 per cent this year and about 8 per cent next year. Continued high US imports have been an important driving force behind growth in world trade. However, important growth impulses have also come from Asia, Latin America and Central and Eastern Europe. The depreciation of the euro has in isolation reduced the demand for imports in the EU and given the EU a competitive edge for taking advantage of import growth in other areas.

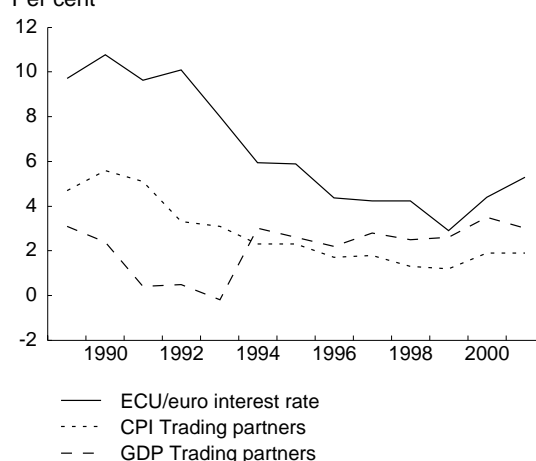
In step with the expansion in international demand, the fall in commodity prices was reversed to an increase in the course of 1999. In addition to crude oil prices, this particularly applied to industrial raw materials, while food and agricultural prices lagged behind until the end of the year. Measured in USD, prices have stabilized and for some commodity groups edged down this year, while they have risen in other currencies as a result of the dollar appreciation. It is worth noting that, with the exception of crude oil,

**GDP growth forecasts for Norway's main trading partners for 1998 - 2001 given on different dates**



Source: Consensus Forecasts.

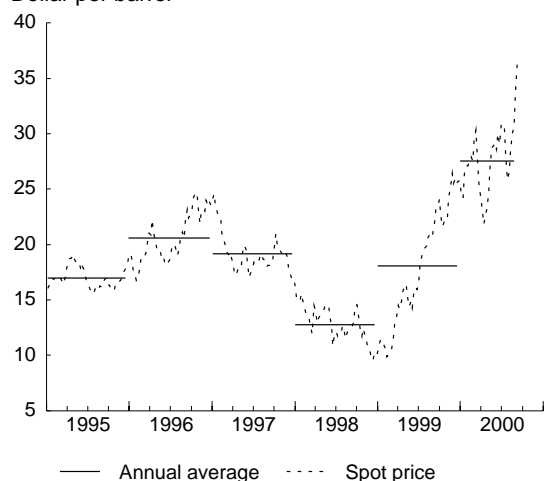
**GDP and consumer price growth for Norway's main trading partners, and 3 months ECU/euro rate**  
Per cent



Sources: OECD and Statistics Norway.

**Spot price, Brent Blend. 1995-2000**

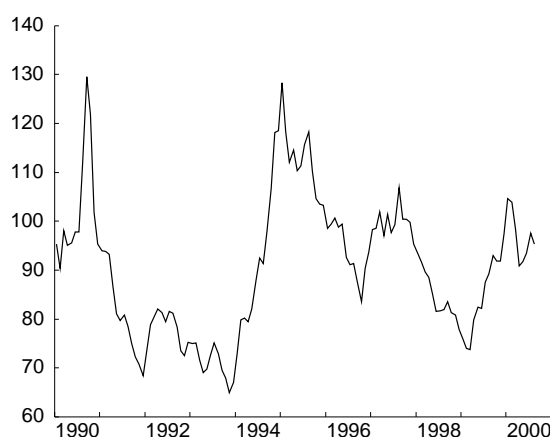
Dollar per barrel



Source: Norges Bank.

**Aluminium price. 1990 - 2000**

Dollar based index. 1979=100



Source: Norges Bank.

commodity prices are still relatively low compared with the average level in the 1990s.

**Continued high oil prices**

Averaged over the first eight months of this year, the spot price of Brent Blend was more than USD 27 per barrel, or more than USD 9 higher than the average for 1999. From a low of less than USD 10 per barrel in December 1998, the oil price surged up to March this year when it for the first time in nearly a decade exceeded USD 30 per barrel. Following a pronounced fall in April, the price has generally moved up, nearing USD 35 at the end of August. This is the highest oil price recorded since the Gulf war in 1990-1991, both in nominal and real terms.

Several factors have contributed to the surge in oil prices. The most important reason was OPEC's decision in March 1999 to reduce production by 1.7 million b/d, with some non-OPEC countries following suit by reducing production by altogether 0.4 million b/d. Second, demand in Asia rebounded following a decline in the wake of the crisis in 1997-1998. Moreover, economic growth in North America remained brisk. As a result of these factors, global oil stocks in the first quarter of 2000 were almost as low as the level in 1996, the lowest level recorded in the 1990s. So far, OPEC's decision in March this year to increase production to the level prevailing prior to the last production cuts does not appear to have resulted in an increase in stocks, a factor that helps to explain the swift reversal of the fall in prices in April.

In March, OPEC indicated that if the oil price should remain outside the range USD 22-28 per barrel for twenty days, the cartel would adjust production to the level required to bring prices back to that range. Even though the oil price remained above this range this summer, there were conflicting reports as to the cartel's official policy. There was disagreement as to

whether OPEC would automatically increase production or merely analyze the situation to assess whether measures were necessary. This resulted in greater uncertainty and nervousness in an already tight oil market. Part of the disagreement stems from the fact that only Saudi Arabia and a few other countries have the capacity to increase production. In June, OPEC decided to increase quotas, but since the cartel was already producing more than the level implied by the new quotas, this had little or no impact on the market.

Due to the uncertainty surrounding OPEC's official policy, market participants have to a greater extent than earlier focused on the stocks of both crude oil and finished products. In particular, the low stock figures in the US, and to some extent Europe, for refined oil products such as petrol and heating oil resulted in growing concern and price pressures. Moreover, several refineries have experienced various disruptions in addition to necessary maintenance. A third factor has been the introduction of new environmental standards for petrol in the US and Europe, which have made it difficult to obtain suitable crude oil.

As a result of the high oil price, the International Energy Agency (IEA) has lowered its projection for global oil demand, while the projection for non-OPEC production has been revised upwards. The IEA expects stocks to increase by 2.3 million b/d in the second quarter of this year and by 1.1 million b/d in the third quarter. This build-up of stocks is slightly higher than the normal level for that time of year. If the winter is normal, the use of stocks is expected to be only marginal in the fourth quarter of 2000 and first quarter of 2001 as a whole, a period when stocks are normally reduced considerably. Some analysts forecast that if the oil price remains above USD 28 up to OPEC's next semi-annual ministerial meeting on 10 September, the cartel will provide clearer signals concerning produc-

tion increases than at its last meeting in March. Both higher stocks and some confidence in OPEC's ability to act are generating expectations of downward pressures on oil prices in the period ahead.

### Heading for slower growth in the US economy?

Once again the US economy has defied forecasts of a slowdown. GDP growth was well above 5 per cent in the year to the second quarter, and the latest projections from Consensus Forecasts indicate that growth for the year as a whole will also be around this level. However, other economic data – particularly figures for unemployment, sales of consumer durables and housing investment – point to slower growth ahead. This underpins earlier expectations of appreciably lower growth next year than in 2000, but the cooling may take longer than expected earlier. There is also considerable uncertainty, with many conflicting indicators.

Higher-than-expected GDP growth in the second quarter was particularly due to the build-up of inventories and higher public sector demand. It is unlikely that this growth will persist. Developments in private consumption will probably be of greater importance in coming quarters. Consumption growth has been the most important driving force behind the economic expansion in recent years, but growth in this component slowed in the second quarter. High consumption growth may to some extent be ascribed to the sharp rise in equity prices. It appears that this impulse will wane in the period ahead, albeit without any strong reversal. So far this year, we have seen some correction of US equity prices, without a resulting dramatic price fall or change in consumption patterns. The increase in consumption has also been fuelled by higher employment and rising real wages, factors that are expected to make a positive contribution next year as well. Moreover, business investment has pushed up growth so far this year, but this impetus is also expected to be slightly weaker in 2001. On the other hand, the upturn in Europe may imply that exports will make a positive contribution in the period ahead. The slowdown is thus expected to be very mild, with the prospect of continued higher GDP growth in the US than in the EU in 2001. The question is whether the cooling will be sufficient to qualify as a landing or whether continued high growth will ultimately overstretch the US economy, with steep interest rate increases and a recession as a result.

The US dollar has continued to appreciate markedly against the euro this year, partly as a result of continued robust growth in the US. The dollar has also appreciated against some other currencies, albeit to a lesser extent. Even though the strong dollar is contributing to curbing inflationary impulses from commodity markets, inflation in the US has picked up considerably the last few years. The year-on-year rise in the

### Economic forecasts for Norway's main trading partners

Annual percentage change

Country (Share of Norwegian exports <sup>1</sup> )	1998	1999	2000	2001
<b>USA (8.0)</b>				
GDP	4.4	4.2	5.1	3.4
Consumer prices	1.6	2.2	3.2	2.6
Unemployment rate <sup>2</sup> (level)	4.5	4.2	4.0	4.2
<b>Japan (4.5)</b>				
GDP	-2.5	0.2	1.6	1.9
Consumer prices	0.6	-0.3	-0.4	0.0
Unemployment rate <sup>2</sup> (level)	4.1	4.7	4.8	4.7
<b>Germany (11.3)</b>				
GDP	2.2	1.5	3.0	3.0
Consumer prices	1.0	0.6	1.7	1.6
Unemployment rate <sup>2</sup> (level)	11.1	10.5	9.7	8.9
<b>France (6.0)</b>				
GDP	3.2	2.9	3.7	3.3
Consumer prices	0.6	0.5	1.3	1.2
Unemployment rate <sup>2</sup> (level)	11.8	11.2	9.7	8.7
<b>United Kingdom (11.7)</b>				
GDP	2.6	2.1	3.0	2.6
Consumer prices <sup>3</sup>	2.6	2.3	2.1	2.4
Unemployment rate <sup>2</sup> (level)	4.7	4.3	3.8	3.8
<b>Italy (3.1)</b>				
GDP	1.5	1.4	3.0	2.9
Consumer prices	1.8	1.6	2.5	1.9
Unemployment rate <sup>2</sup> (level)	11.8	11.4	10.7	10.0
<b>Sweden (12.9)</b>				
GDP	3.0	3.8	4.3	3.5
Consumer prices	0.4	0.3	1.4	1.9
Unemployment rate <sup>2</sup> (level)	6.5	5.6	4.8	4.3
<b>Denmark (7.6)</b>				
GDP	2.5	1.7	2.2	2.3
Consumer prices	1.8	2.4	2.8	2.3
Unemployment rate <sup>2</sup> (level)	6.4	5.5	5.4	5.4
<b>The Netherlands (5.5)</b>				
GDP	3.7	3.6	4.1	3.5
Consumer prices	2.0	2.2	2.5	3.0
Unemployment rate <sup>2</sup> (level)	4.2	3.2	2.5	2.1
<b>Memorandum items:</b>				
GDP EU	2.7	2.4	3.4	3.1
GDP trading partners	2.5	2.6	3.5	3.0
Consumer prices trading partners	1.3	1.2	1.9	1.9
ECU/Euro interest rate	4.2	2.9	4.4	5.3

<sup>1</sup> Exports of traditional goods. Figures for 1999 in per cent, according to Monthly Bulletin of External Trade, Statistics Norway.

<sup>2</sup> Per cent of labour force.

<sup>3</sup> Exclusive interest rates.

Sources: Consensus Forecasts. Unemployment rates for Sweden, Denmark and the Netherlands from OECD.

consumer price index has been above 3 per cent since February this year, with high oil prices representing an important underlying factor. However, domestic pressures are also beginning to have an impact, and the rise in core inflation, excluding food and energy, reached nearly 2 1/2 per cent in June and July. Very high utilization of resources, with unemployment at

historically low levels, may contribute to amplifying domestic inflationary impulses in the period ahead. Admittedly, brisk productivity gains have resulted in only a moderate rise in labour costs so far, but the acceleration in recent months is still noticeable. It is worth noting that the perception of what is to be considered problematically high inflation differs from that of the EU. The current level of inflation is described as muted and does not appear to worry either the authorities or analysts to any great extent. Furthermore, expectations of lower oil prices and more moderate growth provide the prospect of a slightly lower rise in prices again next year. The Federal Reserve has therefore kept interest rates unchanged in recent months, but this does not mean that the possibility of additional interest rate increases has been eliminated. In addition, large trade deficits are of concern.

### **Weak recovery in Japan**

In sharp contrast to economic developments in the US, GDP growth in Japan barely exceeded zero last year. However, a turnaround is expected, and the latest projections from Consensus Forecasts indicate GDP growth of 1 1/2 per cent this year and 2 per cent in 2001. These projections mean that the forecasts have been revised upwards considerably over the past year. The moderate improvement in the Japanese economy has primarily been fuelled by higher exports. The increase in imports in the rest of Asia and in the US has more than offset the negative contribution from the yen appreciation the last few years. Domestic investment has also made an important positive contribution. Consumption, on the other hand, has pushed down the growth rate as a result of falling wages, higher unemployment and an unusually high saving ratio, even though tax reductions have had the opposite effect. In the period ahead there is also the prospect of marginally positive wage growth, which may boost consumption. On the other hand, high government debt is limiting the possibility of stimulating the economy through public sector demand. Despite growing optimism, the situation in Japan is highly uncertain. For the first time in ten years the Japanese central bank raised its key rates in August this year, abandoning its 18-month policy of zero interest rates. Both the authorities and economic analysts expressed considerable scepticism about this increase in interest rates. It is likely that the price level in Japan will continue to fall this year, and even nominal interest rates of zero thus mean positive real interest rates. In addition, the strong yen is having a tightening effect.

Unlike the Japanese economy, many other Asian economies showed a strong improvement in 1999, with growth rates of more than 10 per cent in some countries. The favourable developments appear to have continued in 2000, and in June the OECD projected growth in several of the earlier crisis-hit economies of about 5 per cent in both 2000 and 2001. The Chinese

economy is set to record GDP growth of more than 8 per cent this year, representing the end of a seven-year long cyclical downturn, albeit at high levels of growth. However, an important driving force is public sector demand, and a key question is whether the upturn will be self-reinforcing. One good sign is that deflation appears to have come to an end, allowing lower real interest rates.

### **Rising prices in Europe**

The projections for GDP growth in EU countries have been revised upwards since our last quarterly report, and growth this year is set to be a percentage point higher than in 1999. However, Consensus Forecasts' projections point to slightly lower growth again in 2001. It is reasonable to link this to expectations of lower economic growth in the US. Higher export demand has been and still is the main factor behind the upturn in Europe. Expectations of slower growth in the US next year will therefore also lower growth projections for the EU. Spillover effects, however, are also emerging, with increases in corporate investment as a result of favourable market opportunities. In some countries, for example in the EU's second largest economy, France, household demand has also made an important contribution.

Higher growth has been accompanied by a pronounced acceleration in prices, and in the last two months inflation has been higher than the ECB's target of 2 per cent. The economic picture in 2000 and 2001 is therefore substantially different from the situation at the end of the 1990s. Part of the reason is a shift in economic policy. Fiscal policy was clearly tightening the last few years, but is now slightly expansionary. The depreciation of the euro has also made a welcome contribution to growth, which more than offsets the effect of higher interest rates.

Germany is an important trading partner for Norway in addition to being the EU's largest economy. The improvement in the German economy is therefore particularly important for Norway. Along with Italy, Germany recorded very low growth in the wake of the Asian crisis, and GDP growth was only 1 1/2 per cent last year. Growth in the second quarter of 2000, on the other hand, was the highest in more than two years. Growth is set to be 3 per cent in both 2000 and 2001, thereby approaching the EU average. Increased activity levels the past year may primarily be ascribed to higher exports, and a weak euro and brisk international activity are likely to result in strong growth in German exports in the period ahead too. Household demand has exhibited sluggish growth for a long time, but rose considerably in the second quarter and is expected to gradually play a more important role as a driving force in the economy. Falling unemployment and tax reductions will contribute to this. In addition, investment may continue to expand as a result of higher demand and lower taxes. Despite a positive

overall picture, the signs of a German upturn are not clear-cut, and some figures have suggested that a cyclical peak was passed already in the second quarter. The German economy may therefore be vulnerable to interest rate increases by the European Central Bank.

France has been the front-runner among the major euro countries and the outlook points to continued robust growth the next few years. In contrast to Germany, growth in France is primarily being fuelled by domestic demand, with household consumption in particular showing brisk growth. Like in Germany, falling unemployment is an important factor behind consumption growth, in addition to subdued inflation and a reduction in indirect taxes. Consensus Forecasts expects the positive trend in unemployment to continue, although an unexpected rise in the unemployment rate in July provides grounds for questioning this estimate.

Unlike countries in the euro area, UK exports have been hampered by a strong currency. GDP growth is nevertheless set to increase this year following a very soft landing in 1999. This is related to domestic factors, particularly household consumption. Sweden is also experiencing an upturn. It appears that the country will be one of the fastest growing EU countries in the projection period, with growth in household consumption, investment and exports. While higher GDP growth in the EU has been long-awaited, the increase in inflation in the euro area is considered worrying. The year-on-year rise in prices was 2.4 per cent in both June and July. Due to the low rise in prices earlier this year, the average for 2000 may be lower, although it is highly uncertain whether the European Central Bank's target of 2 per cent will be met for the year as a whole. Another interesting feature is that price pressures are now being felt in the entire euro area, albeit to a varying extent. In July, inflation was 2 per cent or more in all EMU countries. The increase in producer prices in Germany was the fastest in nine years. The oil price is naturally an important reason for higher prices, but the weak euro and increased economic activity are also generating inflationary impulses. Expectations of an appreciation of the euro and falling oil prices in the period ahead point to slightly lower inflation again next year.

The European Central Bank raised interest rates as recently as August, but it is still unlikely that we have witnessed the last interest rate increase. The contrast to the US is striking. Inflation in the euro area is a good 1 percentage point lower than in the US, but still provides grounds for greater concern. Even though the European Central Bank formally steers its policy solely on the basis of averages, the difference between the various countries complicates interest rate policy further. Ireland represents the outer extreme and has a definite need for tightening, with the

prospect of GDP growth of more than 8 per cent and an inflation rate of 4.5 per cent. At the same time, higher interest rates run the risk of stifling the incipient growth in large countries like Germany and Italy. Developments in August also serve as an illustration of the difficulty in reversing the depreciation of the euro, thereby eliminating one source of higher prices: Rumours of an interest rate increase led to a fall in the euro exchange rate. The fear that an increase in interest rates would stifle growth overshadowed the prospect of higher returns. Combined with dependence on the US, the interest rate policy is thus one of the greatest elements of uncertainty for European economic developments in the near term.