

# International economy

In 2001, the international economy was dominated by the cyclical downturn in the US and its effects on the rest of the world. GDP growth slowed sharply in most countries. Growth forecasts for 2001 were lowered, and expectations concerning 2002 were reduced, particularly following the terrorist attacks in the US on 11 September. Oil prices were at a high level at the beginning of the year but fell markedly through the year. International commodity prices also declined, and consumer price inflation moved on a clear downward trend after showing a sharper rise through the previous two years. Central banks' key rates were in some cases reduced sharply.

## US

The cyclical downturn was the dominant feature of the US economy in 2001. The US did not record negative GDP growth until the third quarter, but based on a more extensive set of indicators the National Bureau of Economic Research (NBER) officially declared that the US entered a recession as early as March 2001. The upturn had then lasted for ten years, a record-long expansionary phase for the US economy in the postwar period. Based on the deviation between actual and trend (potential) GDP, however, the cyclical peak was passed as early as the second quarter of 2000. Measured in this way, the past decade has consisted of two business cycles where the previous peak was passed in the third quarter of 1994, with a subsequent trough in the fourth quarter of 1995, resulting in an upturn of 4½ years and a full cycle from peak to peak of nearly 6 years. Measured as the deviation from trend, US business cycles normally last 4-5 years, based on the NBER's dating somewhat longer. Ir-

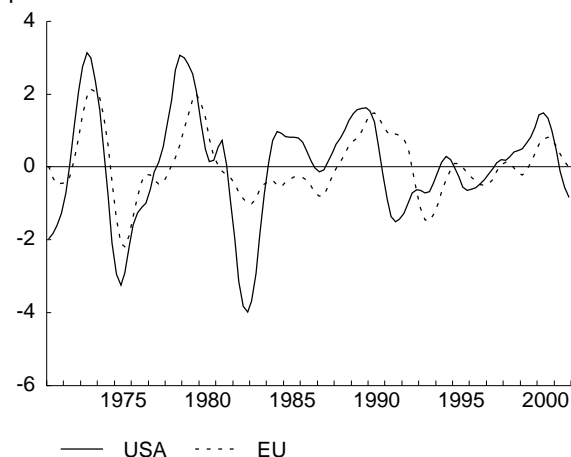
respective of the dating system applied, the last upturn has lasted for an unusually long time.

The prolonged period of expansion partly reflects a supply side-driven upturn, particularly fuelled by large investment in ICT equipment, which contributed to countering capacity constraints and restraining inflation. However, it was probably also due to the fact that the Asian crisis in 1998, which for the US was primarily a financial crisis, was met by an expansionary monetary policy that contributed to extending the demand-driven component of the upturn. The subsequent tightening of monetary policy through 1999 contributed to curbing the most interest-sensitive components of the demand for goods and services. Housing starts passed a peak as early as the end of 1998, housing investment in the second quarter of 1999, while new car registrations and purchases of consumer durables passed a peak in the first quarter of 2000. The subsequent downturn has been amplified by the fall in ICT investment, but it is too early to say whether this is primarily due to normal adjustment mechanisms during a downturn or whether it means that the underlying, prolonged supply side-driven upturn is over.

As the slowdown gradually became more pronounced, the Federal Reserve reduced its rates by almost 5 percentage points, from 6.5 per cent at the beginning of 2001 to 1.75 per cent at the end of the year. The latest cut in interest rates came partly in response to the deteriorating outlook following the terrorist attacks on 11 September. Fiscal policy, which was revised in an expansionary direction in the form of tax reductions as early as summer 2001, became even more

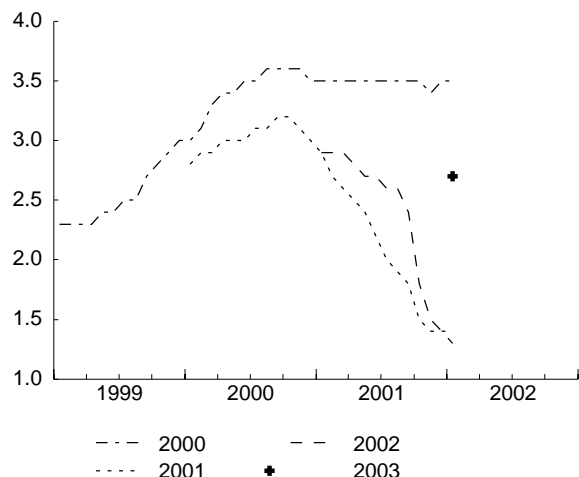
### GDP - cyclical deviations

5 quarter moving average of deviation from trend per cent\*



\* Trend based on HP(1600)-filter.  
Source: OECD.

### GDP growth forecasts for Norway's main trading partners for 2000 - 2003 given on different dates



Source: Consensus Forecasts.

**Macroeconomic projections according to selected sources**

Annual change in per cent

|                         | GDP-growth |      |      |      |      | Inflation (consumer prices) |      |      |      |      |
|-------------------------|------------|------|------|------|------|-----------------------------|------|------|------|------|
|                         | 1999       | 2000 | 2001 | 2002 | 2003 | 1999                        | 2000 | 2001 | 2002 | 2002 |
| <b>USA</b>              |            |      |      |      |      |                             |      |      |      |      |
| NIESR                   | 4.1        | 4.1  | 1.1  | 1.2  | 3.7  | 1.6                         | 2.7  | 1.9  | 0.6  | 1.0  |
| ConsF                   | 4.1        | 4.1  | 1.0  | 0.9  | 3.5  | 2.2                         | 3.4  | 2.9  | 1.6  | 2.5  |
| EC                      | 4.1        | 4.2  | 0.9  | 0.5  | 3.4  | 2.2                         | 3.3  | 3.0  | 1.8  | 2.0  |
| OECD                    | 4.1        | 4.1  | 1.1  | 0.7  | 3.8  | 1.6                         | 2.7  | 1.8  | 1.0  | 1.4  |
| <b>Japan</b>            |            |      |      |      |      |                             |      |      |      |      |
| NIESR                   | 0.7        | 2.2  | -0.3 | -0.8 | 0.8  | -0.5                        | -1.0 | -1.6 | -1.3 | 0.4  |
| ConsF                   | 0.7        | 2.4  | -0.3 | -1.2 | 0.7  | -0.3                        | -0.7 | -0.7 | -0.9 | 0.7  |
| EC                      | 0.8        | 1.5  | -0.6 | -0.9 | 0.5  | -0.3                        | -0.7 | -0.6 | -0.8 | 0.2  |
| OECD                    | 0.8        | 1.5  | -0.7 | -1.0 | 0.8  | -0.7                        | -1.1 | -1.3 | -1.5 | -1.5 |
| <b>EMU</b>              |            |      |      |      |      |                             |      |      |      |      |
| NIESR                   | 2.6        | 3.4  | 1.6  | 1.4  | 2.6  | 1.1                         | 2.4  | 2.7  | 1.8  | 1.9  |
| ConsF                   | ..         | 3.4  | 1.5  | 1.2  | 2.7  | ..                          | 2.2  | 2.6  | 1.6  | 1.8  |
| EC                      | 2.7        | 3.4  | 1.6  | 1.3  | 2.9  | 1.2                         | 2.4  | 2.8  | 1.8  | 1.8  |
| OECD                    | 2.7        | 3.5  | 1.6  | 1.4  | 3.0  | 1.1                         | 2.1  | 2.5  | 1.6  | 1.7  |
| <b>Trading partners</b> |            |      |      |      |      |                             |      |      |      |      |
| NIESR                   | 2.9        | 3.5  | 1.5  | 1.4  | 2.5  | 1.2                         | 1.9  | 2.3  | 1.5  | 1.6  |
| ConsF                   | 3.0        | 3.5  | 1.4  | 1.3  | 2.8  | 1.4                         | 2.2  | 2.5  | 1.7  | 1.9  |
| EC                      | 3.0        | 3.4  | 1.4  | 1.3  | 2.8  | 1.3                         | 2.3  | 2.5  | 1.7  | 1.9  |
| OECD                    | 2.9        | 3.5  | 1.4  | 1.3  | 2.8  | 1.2                         | 1.7  | 2.2  | 1.8  | 1.8  |

Sources: NIESR from February 2002, Consensus Forecasts from January 2002, European Commission and OECD from November 2001. All the inflation projections from OECD apply to the consumption deflator, the same holds for NIESR's forecasts for the US and Japan.

expansionary through various packages of measures that were approved after the attacks.

After lasting for one and a half years, it may now appear that the downturn in the US is bottoming out. According to preliminary estimates, GDP growth was again marginally positive in the fourth quarter, fuelled by higher private consumption and public expenditure on goods and services. The fall in total industrial production almost came to a halt in December and many of the more leading sub-indices showed a rise. Admittedly, inventories continued to be reduced through November, but this may rapidly change and generate a positive contribution to growth if the recovery materializes. Various indicators for the housing market have for a period again shown a somewhat firmer trend following the uncertainty that arose after 11 September last year. Housing starts appear to have passed a trough as early as the fourth quarter of 2000. Residential construction is usually a leading component in the business cycle, and declines in housing starts, housing investment and the production of intermediate goods were also among the variables that reacted ahead of this downturn. However, it is still too early to conclude that the trough has been passed. Part of the increase in activity is related to very short-term after-effects of the events in September, for example interest-free financing of car loans. If a recovery is already under way in the US economy, the latest downturn must generally be characterized as fairly moderate compared with earlier downturns.

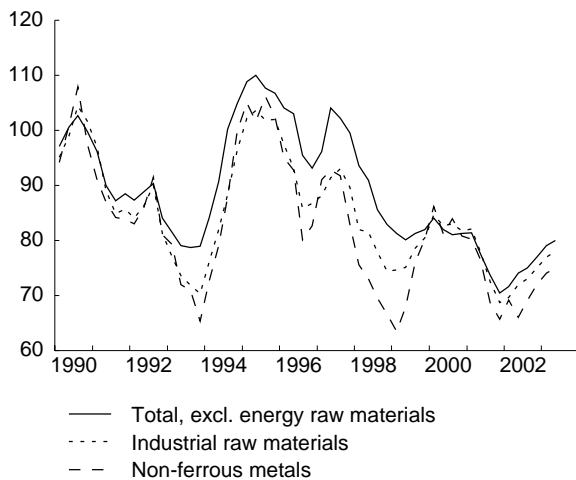
The combination of strong monetary and fiscal policy stimulus should normally result in a pronounced cyclical upswing in the US early in the first half of this year, but the after-effects of the terrorist attacks may contribute to postponing the turnaround. The fact that the reduction in interest rates in the US has this time been accompanied by a stronger – compared with a normally weaker – dollar will also contribute to curbing the stimulus of the decline in interest rates for US enterprises. Moreover, it is doubtful whether conditions in the private sector in the US are conducive to generating an upturn that will be as strong as would normally be expected. Low household saving, only a moderate fall in housing investment, a historically high level of corporate investment and a stock market that is not likely to pick up sharply raise the question of whether the turnaround – when it comes – will be strong enough to allow an upturn to be self-propelled. Even though there is little reason to doubt that a turnaround will take place, the strength and duration of the future upturn thus remain unclear. The effects on the international and Norwegian economy of a one year postponement of an upswing in the US were discussed in *Economic Survey* 4/2001.

**EU countries**

The cyclical downturn in the US spread to other industrialized countries in late autumn 2000, but with the exception of Japan they have so far generally continued to record some growth. Based on deviations from GDP trend, EU countries as a whole now appear to have passed a cyclical peak towards the end of the

### Commodity prices on the world market 1990 - 2003

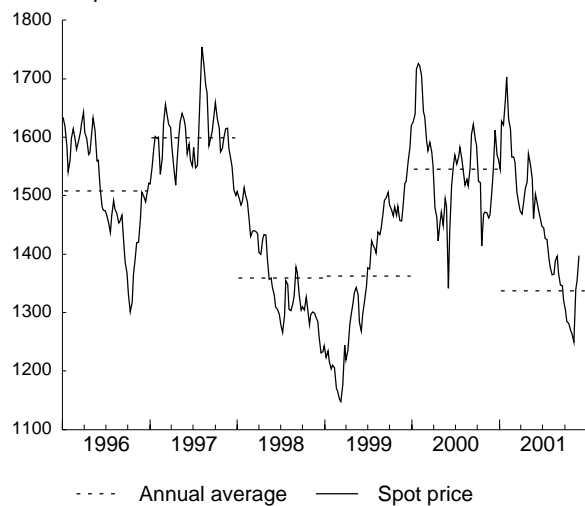
Dollar based indices. 1990 = 100



Sources: HWWA-Institut für Wirtschaftsforschung and AIECE.

### Spot price aluminium. 1996 - 2001

Dollar per ton



Source: Norges Bank.

third quarter of 2000, a little faster in relation to the US than the average lag of a good two quarters over the past 30 years. Growth was particularly curbed in countries that traditionally have the strongest links to the US economy – albeit with the important exception of the UK – or to the ICT sector. Economic growth was more than halved in Germany, the Netherlands, Belgium, Denmark, Sweden and Ireland from 2000 to 2001, and declined to zero in Finland. So far, however, growth has remained at a higher level in countries like France, Italy, Spain and Greece.

With a recovery in the US economy, it is likely that EU countries will also experience a turnaround after a few quarters, i.e. in late summer 2002 at the latest. This turnaround is now serving as the basis for the projections of most forecasters. In the event, the cyclical downturn for EU countries will be moderate. This must partly be ascribed to the relatively weak euro, which has allowed European enterprises to counter the decline through a stronger competitive position. Admittedly, interest rates in the euro area have declined to a lesser extent than in the US, with a reduction from 4.75 to 3.25 per cent during 2001, but the importance of this should not be exaggerated as euro countries are generally less sensitive to changes in short money market rates. A more important factor is that price inflation is now slowing, so that bond yields are also being reduced.

High oil prices and the depreciation of the euro through 1999 and the first half of 2000 were important reasons for the higher rate of price inflation in euro countries in 2000 and 2001. However, inflation in these years was particularly high for countries that showed the strongest economic growth through the last half of the 1990s, particularly Greece, Ireland, the Netherlands, Portugal and Spain. With the exception of the Netherlands, these are countries that initially had noticeably lower income levels than the other

euro countries and where stronger growth reflected the development of a more efficient internationally exposed sector, partly as a result of successful increased integration into the European market. It is a known effect in economic theory that with fixed exchange rates such countries may record relatively high inflation because income growth in sharply expanding industries “spreads” to wage growth in other sectors of the economy, allowing employees in these sectors to benefit from economic growth. However, for these sectors, which primarily produce services that are sheltered from international competition, the result is higher prices.

At the moment, there is thus little reason to be concerned about the high rate of inflation in these countries other than the implications this has for overall inflation in the euro area: if the European Central Bank (ECB) is to maintain its objective of inflation of 0-2 per cent, inflation in other countries must be correspondingly lower. This factor may be the reason behind, for example, new French initiatives urging the ECB to permit slightly higher inflation than the level that has been targeted so far. Inflation is in any case expected to be within the target zone this year and next.

### Trading partners

For 2002-2003, we have based our projections on the NIESR's February estimates for Norway's trading partners, which on the whole seem to correspond to Consensus expectations. This implies average GDP growth for trading partners that falls from 1.6 per cent in 2001 to 1.4 per cent this year, rising to 2.5 per cent in 2003. The estimate for 2003 is slightly lower than the Consensus projection. The rise in consumer prices is expected to slow from 2.3 per cent in 2001 to 1.5 per cent in 2002, edging up to 1.6 per cent in 2003. These projections are based on a mixture of private con-

sumption deflators and harmonized consumer price figures. Estimates based on ordinary CPI figures appear to be a few tenths higher.

### Developments in the oil market

The spot price of Brent Blend averaged close to USD 25 per barrel in 2001, compared with a little more than USD 28 per barrel in 2000. The oil price fell from USD 28 per barrel to about USD 20 from mid-September 2001 to the beginning of October. At the end of January this year, the oil price was USD 19-20 per barrel.

The terrorist attacks in the US were the main reason behind the fall in oil prices in September, which resulted in reduced demand for aviation fuels. Even before the attacks many analysts had revised down their estimates for global economic growth, and therefore expected weaker developments in the demand for oil.

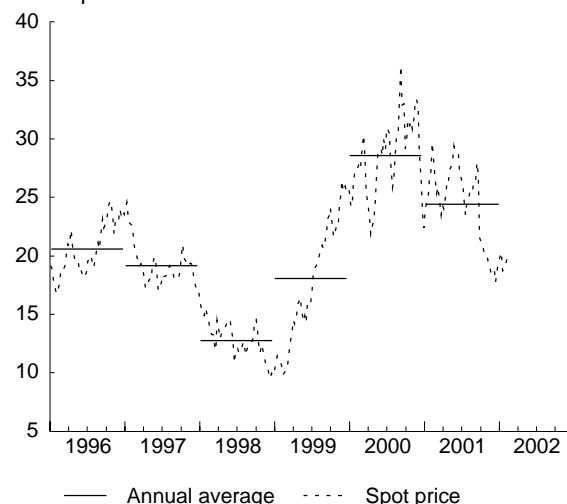
Following the terrorist attacks in the US, OPEC suspended its guideline which implies that if the oil price should remain outside the range USD 22-28 per barrel on average for more than 20 days, the cartel would adjust production to the level required to bring prices back to that range. In November 2001, OPEC signalled that if non-OPEC countries agreed to production cuts of altogether 0.5 million b/d, OPEC would reduce production by 1.5 million b/d. Since then, Russia, Norway, Mexico, Oman and Angola decided to reduce exports or production by 462 500 b/d, prompting OPEC to cut production by 1.5 million b/d from 1 January until end-June. With the latest reductions, OPEC has approved production cuts of altogether 5 million b/d the last 12 months. Previously, OPEC has succeeded in fulfilling about 80 per cent of its announced cuts.

In November 2001, the UN and Iraq signed a new oil-for-food agreement that will make it easier for the country to import spare parts and necessary equipment for the country's oil sector. Iraq's production capacity is approximately 2.8 million b/d. The country is not covered by OPEC's quota system, but it is uncertain to what extent it will succeed in increasing production as early as 2002.

The International Energy Agency (IEA) projects that total global demand for oil will increase by 0.6 million b/d in 2002 in relation to 2001. China and the Middle East are expected to account for most of the increase, whereas demand in North America and Europe is not expected to rise until the second half of the year after declining through the first six months of 2002. If the announced non-OPEC cuts are taken into account, it appears that the non-OPEC oil supply may increase by about 0.6 million b/d, primarily in Russia but also in Canada to some extent. If Iraq only manages to increase exports through the new agreement to a limited extent, it will mean that residual demand for

### Spot price crude oil, Brent Blend

Dollar per barrel



Source: Norges Bank.

OPEC oil will decline slightly in 2002 compared with 2001.

Stocks of crude oil, and to some extent heating oil, are now higher than the average for this time of winter over the past five years. If OPEC maintains its production cuts until the end of the year, and the cartel continues to fulfil about 80 per cent of its announced cuts, global stocks of crude oil will be reduced somewhat for the year as a whole. On the basis of these assumptions, the oil price can be expected to remain at approximately the current level through the first six months and edge up through the second half of the year when most of the reduction in stocks will take place.