International economy

The global economy is now showing clear signs of recovery and growth is expected to pick up in 2002 and 2003. The US economy has fared better than first feared following the terrorist attacks on 11 September last year. The downturn in 2001, which was milder than expected, has been reversed to growth. Extensive tax cuts and last year's interest rate reductions have contributed to the swift turnaround. Growth is also expected in the euro area, fuelled by the recovery in the US. Among our most important trading partners, GDP is likely to expand by about 1.6 per cent this year, compared with 1.4 per cent in 2001. For 2003, the projection is 2.8 per cent. Growth in the US is expected to be stronger than in the euro area; for 2002, the OECD's projections are 2.5 and 1.3 per cent respectively, while growth in 2003 is projected at 3.5 and 2.9 per cent respectively. Japan's GDP is estimated to grow by 0.3 per cent next year, compared with a decline of 0.7 per cent this year.

Private consumption remained fairly buoyant in the US through 2001. In the euro area, consumption growth has been relatively subdued and is not expected to pick up until next year. Inflation has been higher than the European Central Bank's (ECB) upper limit of 2 per cent since May 2000, but the OECD expects inflation to be 1.9 per cent in 2003. However, the spring wage settlement in the euro area constitutes a risk of higher inflation. Key rates internationally are expected to be raised in 2002 from the current low level, but expectations of relatively low inflation may allow the tightening of monetary policy on both sides of the Atlantic to take place gradually so that a dampening of the economic recovery can be avoided.

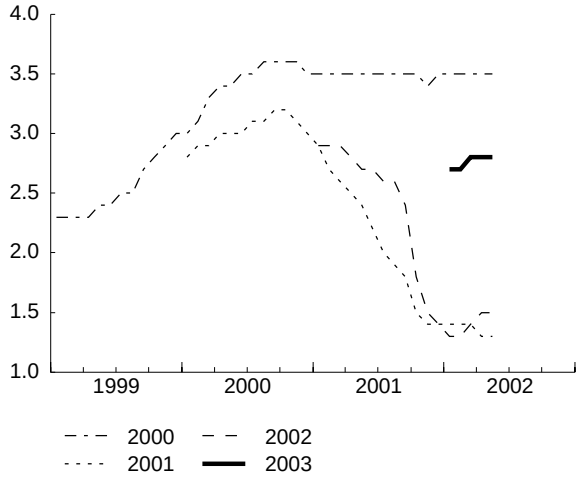
The US economy is of considerable importance to the global economic situation. Developments in the US will therefore largely determine the growth outlook in the period ahead. Several factors may restrain growth in the US economy. The growth potential of private consumption is limited by the current very low saving ratio and a high debt burden. The prospect of large, persistent current account deficits also constitutes an element of uncertainty. The same applies to the stock market. Another, more immediate threat to a swift upswing in the global economy is the risk of higher oil prices, viewed in the light of growing tensions in the Middle East.

International trade

Following last year's growth pause, world trade is expected to expand both in 2002 and 2003. The OECD estimates that world trade will increase by 2.5 per cent this year and 9.5 per cent next year. Higher US imports are a decisive factor, and expectations of higher growth in the US are the main reason for the projected higher growth in world trade. However, imbalances in world trade appear to persist, with large trade deficits in the US and large surpluses in Japan. A weaker dollar exchange rate, however, may contribute to reducing the trade deficit in the US.

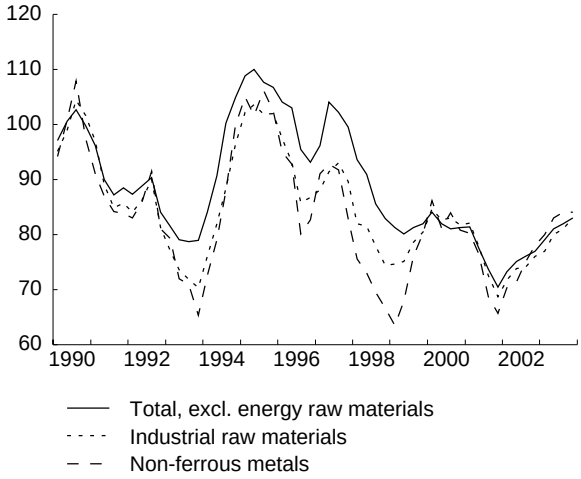
Commodity prices fell last year as a result of reduced growth in the global economy. In pace with the upswing in international demand, commodity prices rebounded in the first quarter of 2002. The AIECE projects a moderate rise in commodity prices in both 2002 and 2003.

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



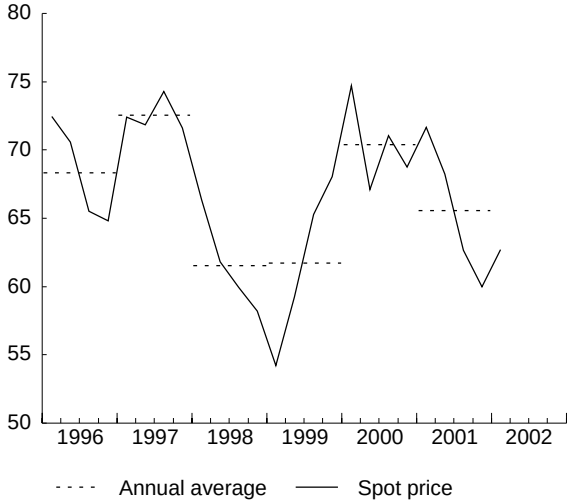
Source: Consensus Forecasts.

Commodity prices on the world market 1990 - 2003
Dollar based indices. 1990 = 100



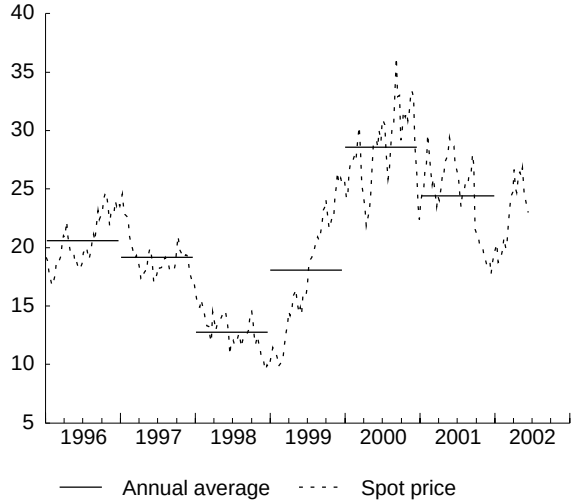
Sources: HWWA-Institut fur Wirtschaftsforschung and AIECE.

Spot price aluminium. 1996 - 2002
Dollar per 100 lbs.



Source: IMF.

Spot price crude oil, Brent Blend
Dollar per barrel



Source: Norges Bank.

Developments in the oil market

The spot price of Brent Blend fell from about USD 27 per barrel in September to USD 18 per barrel in December. Even though the main reason for the fall in oil prices was the terrorist attacks in the US, many analysts had revised down their projections for the demand for oil even prior to the attacks. Since then, the price of oil has risen and at the beginning of June it stood at around USD 24 per barrel. As an average for the first five months of 2002, the price has been just above USD 22 per barrel compared with an average of about USD 24.50 per barrel last year.

Several factors have contributed to the rise in prices through the first quarter of 2002. First, OPEC decided to reduce production by 1.5 million b/d for a period of six months beginning in January, while Norway, Russia, Mexico, Angola and Oman decided to reduce exports or production by a total of just under 0.5 million b/d. It has later proven to be the case that OPEC satisfied just under 80 per cent of its announced cuts, while among non-OPEC producers it appears that only Russia did not fulfil its announced reductions. Second, unrest in the Middle East and speculation that the US would attack Iraq contributed to greater concern about future oil production in the area, and this contributed to increased purchases in the crude oil futures market. Third, economic growth, and hence the demand for oil, picked up in the US at an earlier-than-expected stage.

According to the IEA, total stocks of crude oil and finished products in the OECD area are at the same level as the average at this time of the year over the last five years. The IEA expects a normal cold winter in the western hemisphere, which will contribute to higher demand for heating oil. At the same time, many analysts expect Iraq to continue its exports under a new and revised oil-for-food agreement with the UN in June. Among non-OPEC countries, only Oman has signalled that it will maintain its production cuts through the second half of the year. If OPEC also decides to maintain its cuts after June, global stocks of crude oil may be reduced by just under 0.4 million b/d when the second and third quarter are considered as a whole. This is a period when stocks of crude oil normally increase by between 0.5 and 1.0 million b/d, which is particularly important for ensuring supplies to refineries that are to produce heating oil.

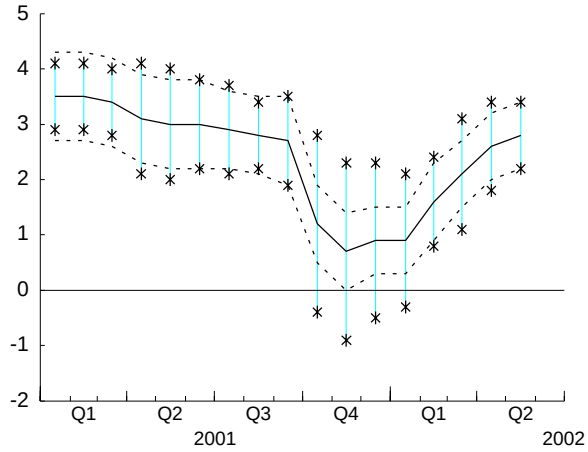
If it is assumed that OPEC succeeds in increasing production to a sufficient extent and in time to prevent increased concern about future deliveries of heating oil and thereby price pressures, the oil price may remain at approximately the current level in the period ahead. This is also contingent on no heightened turbulence in the Middle East or further speculation about an open conflict between the US and Iraq.

US

The US economy has experienced a swifter recovery than expected following the slump through 2001. The feared downturn following the terrorist attacks on 11 September did not materialize, and GDP growth was again positive in the fourth quarter of 2001. Based on the deviation between actual and trend (potential) GDP, the cyclical turnaround took place in the first quarter of 2002. Growth is expected to increase gradually, and the OECD estimates that GDP will expand by 2.5 per cent this year compared with 2001. In 2003, growth is expected to pick up further, to 3.5 per cent.

Growth in private consumption was relatively high throughout 2001, fuelled by substantial tax cuts and low interest rates following interest rate reductions through the year. In the labour market, wages rose in March for the first time in eight months, and it ap-

GDP growth forecasts
for the US for 2002 at different points in time
Average forecast (solid line) with +/- 2 standard deviation (star points) and +/- 2 "normal" deviation (dashed line)



Source: Consensus Forecasts.

pears that unemployment has stabilized. The NIESR estimates that productivity growth was 1.9 per cent in 2001. This is unusually high in a period of low economic growth. The estimate is 2.5 per cent in 2002 and 2003, on a par with average annual productivity growth since 1995.

Manufacturing industry, which was an important factor behind the slump recorded last year, showed positive tendencies as early as the fourth quarter of 2001 and the negative trend now appears to have been reversed. Private sector investment contracted last year, but is expected to increase from the second half of 2002. Inventory build-ups are also making a positive contribution to economic activity following the sharp reduction in inventories last year. Confidence indicators show that confidence in the US economy has picked up in both the business sector and among consumers. Nor is there an imminent risk of inflationary pressures, and the tightening of monetary policy will take place gradually so that the upswing in the economy will not be dampened by high interest rates. As the upswing gradually takes hold in the global economy, higher exports will contribute to further growth.

There are several factors that can restrain growth. The US has had a current account deficit of about 4 per cent of GDP in recent years, and the deficit is expected to remain high in the period ahead. The OECD estimates that as a result of faster growth in domestic demand than among trading partners, the trade deficit will rise to 4.9 per cent next year. There does not appear to be any immediate risk that the capital supply which is necessary to finance the current account deficit will dry up; productivity growth in the US is fairly high and foreign investors still find US capital markets attractive. However, very optimistic expectations concerning future corporate earnings are still being priced into the stock market. If sentiment changes and investors expect a sharp correction in the stock market, foreign investment may fall considerably and the dollar will depreciate further. A moderate depreciation of the dollar may have a positive impact through improved competitiveness in US export industries and a lower trade deficit. A sharp depreciation, however, may result in higher inflation and the risk of financial instability internationally. A fall in equity prices may, in conjunction with a high debt burden, also contribute to an increase in consumer saving in the US, which will result in lower demand for goods and services and reduced economic growth.

Europe

Moderate growth is expected in the euro area, fuelled by the recovery in the US. A subdued upswing is expected in the second half of 2002 followed by somewhat stronger growth in 2003. The OECD estimates GDP growth at 2.9 per cent next year, compared with only 1.3 per cent in 2002.

The international upswing will result in higher exports and stronger demand in the euro area. Business confidence in the economy has improved considerably in recent months, and the low real interest rate will pave the way for higher investment and increased domestic demand. In 2003, growth is expected to take root in most sectors.

However, there is uncertainty associated with the upswing. Growth is largely dependent on higher growth in the global economy and higher exports as well as developments in the oil price in the period ahead. Inflation has been higher than the ECB's objective of between zero and two per cent since May 2000. In the first quarter of 2002, consumer price inflation was around 2.5 per cent, partly due to special factors such as the introduction of euro notes and coins and high oil prices. However, consumer price inflation is expected to fall in the course of 2002 and is estimated by the OECD at 2 per cent in 2002 and 1.9 per cent in 2003. The inflation projections are based on moderation in this year's wage negotiations. Large pay increases may generate cost pressures, with consequences not only for prices but also for employment and GDP growth.

The euro has appreciated against the US dollar recently, a factor that may counter the upswing in the euro area through weaker developments in export industries. However, a strengthening of the euro may reduce the likelihood that the ECB will raise interest rates as a result of lower imported inflation.

In the euro area, Germany was the most severely affected by the international downturn last year. It appears, however, that Germany is also emerging from a slump, with growth of 0.2 per cent in the first quarter of 2002 compared with the previous quarter.

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	2003
USA										
NIESR	4.1	4.1	1.2	2.4	3.5	1.6	2.7	1.9	0.7	1.6
ConsF	4.1	4.1	1.2	2.8	3.5	2.2	3.4	2.8	1.6	2.4
EC	4.1	4.2	1.2	2.7	3.1	2.2	3.4	2.8	1.4	2.4
OECD	4.1	4.1	1.2	2.5	3.5	2.2	3.4	2.8	1.8	2.4
Japan										
NIESR	0.7	2.2	-0.4	-1.2	1.3	-0.5	-1.0	-1.6	-1.4	-0.3
ConsF	0.7	2.4	-0.5	-1.0	1.1	-0.3	-0.7	-0.7	-1.0	-0.6
EC	0.7	2.4	-0.5	-0.8	0.6	-0.3	-0.7	-0.5	-0.9	-0.1
OECD	0.7	2.4	-0.4	-0.7	0.3	-0.3	-0.7	-0.7	-1.2	-1.2
EMU										
NIESR	2.6	3.4	1.5	1.4	2.5	1.1	2.4	2.5	2.3	2.1
ConsF	2.6	3.4	1.4	1.3	2.8	1.1	2.2	2.6	2.0	1.9
EC	2.7	3.4	1.6	1.4	2.9	1.1	2.4	2.5	2.2	2.0
OECD	2.7	3.5	1.6	1.3	2.9	1.1	2.4	2.5	2.0	1.9
Trading partners										
NIESR	2.9	3.5	1.4	1.5	2.5	1.2	1.9	2.3	1.8	1.9
ConsF	3.0	3.5	1.3	1.5	2.8	1.4	2.2	2.5	2.0	2.0
EC	3.0	3.5	1.3	1.6	2.8	1.2	2.0	2.4	2.0	1.9
OECD	3.0	3.5	1.4	1.6	2.8	1.4	2.2	2.5	2.0	2.1

Sources: NIESR, European Commission and OECD from April 2002 and Consensus Forecasts from May 2002. The inflation projections for the US and Japan from NIESR apply to the consumption deflator.

It is primarily the export industry that must bear the brunt. Germany has also to a large extent experienced sluggish private consumption, but figures for the first quarter also show that private consumption is picking up.

Outside the euro area, both Sweden and Denmark recorded growth in the fourth quarter of 2001. In Sweden, this largely reflected the depreciation of the Swedish krona against the euro, while higher public spending was the main factor in Denmark. In Denmark, higher private consumption and higher investment are expected to result in a gradual increase in economic activity, underpinned by the international upswing. Unemployment has remained low and may be a limiting factor. In Sweden, higher domestic demand and exports will also result in higher growth in the first half of 2002. Sweden has low unemployment, and there is a risk that wage growth will contribute to high inflation. The OECD estimates that inflation will rise to 2.8 per cent in 2003, 0.8 percentage point higher than the inflation target of the Swedish central bank.

Japan

The economic situation deteriorated further through 2001 and Japan recorded the largest contraction in GDP in 40 years. This resulted in lower investment and higher unemployment. The banking sector is still experiencing considerable problems, with large volumes of non-performing loans. There is some risk that the implementation of structural reforms will result in increased deflationary tendencies in the economy. However, some growth is expected next year, based on higher demand from the US and Europe. The OECD projects GDP growth at 0.3 per cent next year, compared with a decline of 0.7 in 2002.