Economic trends

The international economy

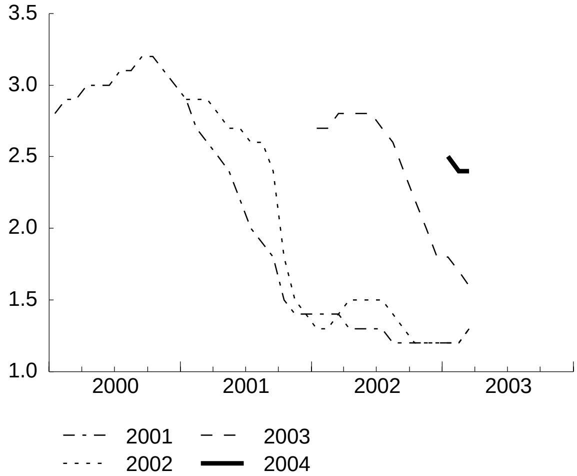
There were wide variations in economic developments internationally in 2002. After weak growth in 2001, economic growth in the US and some areas of Asia picked up last year, but slowed further in the EU, Japan and South America. From the beginning of the summer 2002, the prospects for an international upswing weakened. Sluggish investment growth in many OECD countries and a sharp decline in world stock markets contributed to the slowdown. Unemployment increased on both sides of the Atlantic. Weak developments in Japan and Germany are now being amplified by the appreciation of the yen and particularly the euro against the US dollar, pushing a recovery forward in time. The uncertainty surrounding the situation in Iraq is also restraining growth.

Inflation is low in most countries. This year, price inflation in the euro area is expected to fall below the European Central Bank's (ECB) upper limit of 2 per cent for the first time since 1999, to a large extent thanks to the appreciation of the euro. In Japan, inflation has fallen over the past four years, and it seems that this will continue to be the case this year. In the US, consumer price inflation edged up in the second half of the year, but core inflation has slowed. The rise in oil prices has, in isolation, pushed up price inflation internationally, but if the conflict with Iraq is resolved fairly rapidly, oil prices are expected to fall. However, if the conflict drags on, or a war should lead to lower production capacity in Iraq, oil prices may remain high for a longer period.

There is considerable uncertainty associated with future developments in the global economy, which is reflected in low interest rates in the US and Europe. Consensus Forecasts has adjusted downwards its growth forecasts for both the euro area and the US. A pick-up in growth in the euro area seems to be dependent on an increase in global demand. There is still a risk that the US economy will experience a new period of negative GDP growth like in 2001, i.e. a double-dip recession. The world economy may then be facing a longer downturn than previously assumed. However, it is our judgement that it is more likely that growth will pick up somewhat towards the end of the year, first in the US and then in Europe, while growth in Japan will continue on a weak trend.

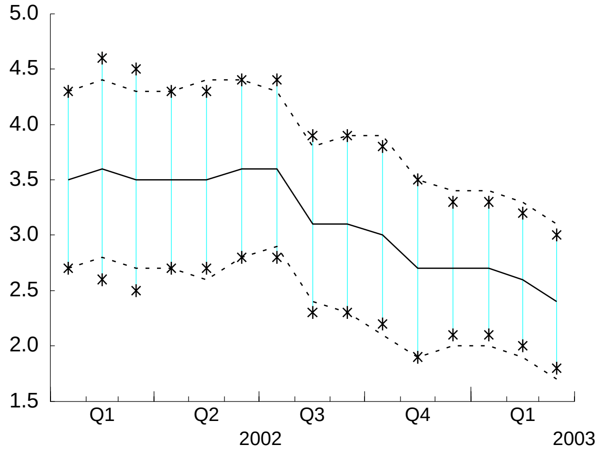
The conflict with Iraq is creating uncertainty. At present, it seems that a US-led attack will start in the near future. Even if the Iraq crisis has influenced and will continue to influence oil prices and world stock markets, our forecasts are based on the assumption that the conflict will be local, with limited real economic consequences for the international economy. This would be in line with the experience of the Gulf War in 1991. The downturn in the US at the beginning of the 1990s started before Iraq invaded Kuwait in the summer of 1990, and there is no evidence that economic developments were influenced by the war. If the war drags on, and particularly if it leads to conflicts in other regions, the consequences may be more substantial. But even with this scenario, one must be cautious about overstating the economic effects: The world economy did not come to a halt even though the US conducted a war in Vietnam for close to 15 years; economic growth continued and cyclical upturns were followed by downturns as previously.

GDP growth forecasts for Norway's main trading partners for 2000 - 2004 given on different dates
Per cent



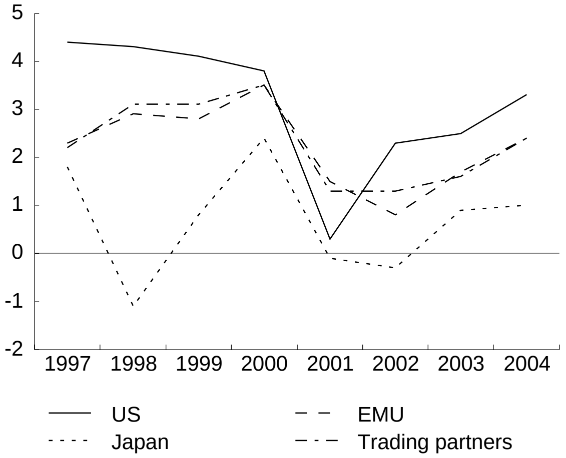
Source: Consensus Forecasts.

GDP growth forecasts for the US for 2003 at different points in time
Average forecast (solid line) with +/- 2 standard deviation (star points) and +/- 2 "normal" deviation (dashed line)



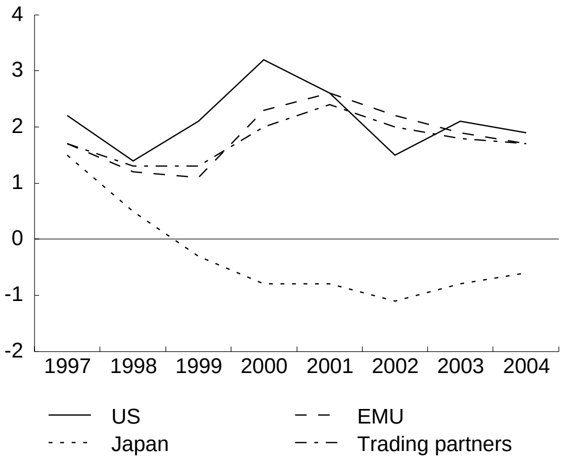
Source: Consensus Forecasts.

GDP growth for the US, Japan, the euro area and Norway's trading partners



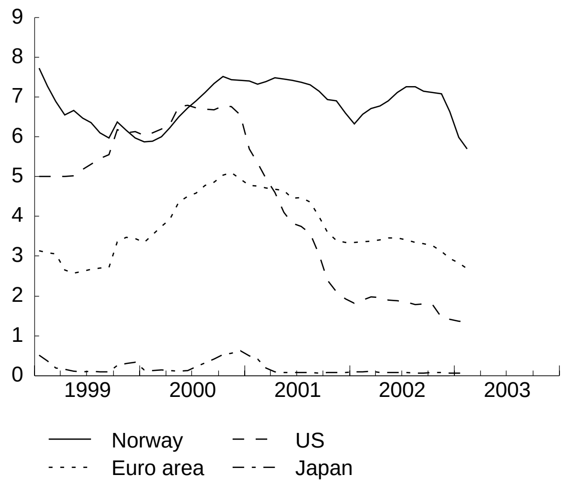
Sources: Average of projections from the NIESR in Jan. 03, CF in March 03 and the EC and the OECD in Nov. 02.

Consumer price inflation for the US, Japan, the euro area and Norway's trading partners



Sources: Average of projections from the NIESR in Jan. 03, CF in March 03 and the EC and the OECD in Nov. 02.

International interest rates
3-month Eurorate



Source: Norges Bank.

However, the experience of the Vietnam War points to the possibility of entirely different types of effects of considerable importance for the world economy: It led to the collapse of the fixed exchange rate cooperation under the Bretton Woods Agreement, which was replaced with floating exchange rates between major currencies. This was an effect of the war, which occurred as a result of changes in international political cooperation. Our analysis does not take into account that the present conflict with Iraq might have similar political effects with subsequent economic consequences.

US

Following nine years of robust growth, the downturn started in 2000. The stock market bubble burst, with a particularly sharp decline in technology shares. In the latter half of 2000, GDP growth slowed and the economy entered into recession in the first quarter of 2001, with negative GDP growth. The Federal Reserve cut interest rates sharply through 2001, but GDP continued to fall over three consecutive quarters. The development changed in the fourth quarter of the same year, and in the first quarter of 2002 economic growth was strong, supported by high productivity growth, low interest rates, an expansionary fiscal policy, high private consumption and a build-up in inventories. In the period to the summer, growth slowed again. Confidence in the US economy weakened in response to accounting irregularities, lower-than-expected profits and bankruptcies. Investment slumped, equity prices continued to fall and the US dollar started to weaken. Moreover, the growth impulses from inventory investment faded. The heightening conflict with Iraq intensified the uncertainty. High household consumption contributed to a pick-up in growth in the third quarter, but activity slowed again in the fourth quarter. In spite of the considerable uncertainty and wide fluctuations, GDP growth for 2002 as a whole was 2.4 per cent compared with 0.3 per cent in 2001. Growth was still well below the average for the latter half of the 1990s.

Imbalances in the US economy are still in evidence. Buoyant household consumption has made a considerable contribution to holding up growth, but in conjunction with high housing investment, this has resulted in high household debt. The brisk rise in house prices has also led to concerns that a bubble is developing in the housing market. It seems that the large government budget and current account deficits will persist over the next years. Against a background of weak corporate profitability and geopolitical uncertainty, the business sector is taking a wait-and-see attitude.

Weak developments also reflect high oil prices, which have been pushed up by the situation in Iraq. High oil prices are placing additional pressure on already squeezed airlines. Petrol prices have shown a marked increase in the US in recent months. For consumers, higher petrol prices are having a noticeable impact on disposable income. Lower equity prices have also affected household wealth and combined with rising unemployment may push down consumption growth in the period ahead.

Industrial output exhibited weak growth last autumn, with moderate growth in new orders. Capacity utilization remains low, reflecting limited demand for new investment. On the other hand, investment in the previous cyclical upturn was to a large extent related to ICT equipment, which tends to have a relatively short life. We assume that investment will show a moderate increase in the course of 2003. In addition, inventory levels are low. This may mean that output will rise rapidly in response to signs of higher demand.

The dollar appreciated markedly during the latter half of the 1990s. Investment returns in the US were solid, foreign investors' showed a strong willingness to invest and the dollar appreciated in spite of a rising current account deficit in the US. As a result of the persistent, sharp fall in equity prices and low interest rates, foreign investment in the US has started to slow. At the beginning of 2002, the dollar started to weaken and has since depreciated by around 12 per cent against trading partners and 20 per cent against the euro. The depreciating dollar was accompanied by a further fall in returns on USD investments, with a risk of an accelerated weakening in the dollar. A more moderate correction in the dollar, as has been the case so far, may contribute to improving the current account balance through a strengthening of competitiveness. A sharp depreciation may, however, have a destabilising effect on the economy, but has been avoided this far, partly because several Asian countries have intervened to prevent an appreciation of their own currencies. The depreciation will also contribute to keeping deflation at bay. We assume that the dollar will continue to depreciate somewhat, and than level off at 1.12 against the euro during the projection period, against about 1.06 on 18 March 2003.

The Federal Reserve cut its key rate by a further 0.5 percentage point in February to 1.25 per cent, or the lowest level for 40 years. Extensive tax relief will contribute to holding up domestic demand in the period ahead. It is unclear how high the costs of a war in Iraq will be for the US government. The war will increase the budget deficit, which in isolation will have an expansionary impact on the economy, at least in the short term. In the Gulf War in 1991, a large share of the costs was borne by alliance countries. This time, the US will have to bear the largest share of the costs alone, unless Iraqi oil revenues are used for this purpose. The macroeconomic consequences of a short war in Iraq are expected to be limited, however.

Varying developments in 2002 indicate that a cyclical upturn has not taken hold. Weak figures for the US economy have been reported recently, and growth appears to be relatively modest in the first quarter of 2003. Unemployment has risen, and consumer confidence has weakened. Consensus Forecasts has lowered its GDP growth forecast for 2003. There is still a risk of a double-dip recession in the US. If this materializes, the world economy may witness a longer period of sluggish growth. We assume that growth will pick up somewhat in the latter half of 2003. This is conditional on continued growth in household consumption and a pick-up in investment. With a swift resolution of the conflict with Iraq, increased confidence in the economy and higher-than-projected investment growth, an upswing may be more pronounced than we have assumed.

Europe

After falling sharply in 2001, GDP growth in the euro area recovered somewhat into 2002, primarily fuelled by higher exports. The nascent upswing lost momentum, however, and growth for 2002 as a whole proved to be weak. The sharp decline in equity prices and sluggish investment activity are important factors behind the weak growth performance. Higher oil prices and a rise in food prices also contributed to lower demand. Confidence in the economy weakened, both in the business and household sectors. In autumn, external demand also stagnated. Against the background of weak growth and subsiding inflationary pressures, the European Central Bank lowered its key rate. The euro has appreciated markedly over the past year, which has led to a substantial deterioration in competitiveness. Geopolitical uncertainty and high oil prices have contributed to stagnation.

Unemployment in the euro area increased last year, averaging 8.3 per cent in 2002. In December, unemployment was 8.5 per cent, and a further rise is expected this year. There are wide variations in unemployment across the euro area, with unemployment higher than 10 per cent in Germany and Spain and around 3 per cent in the Netherlands. The sharp fall in stock prices has probably restrained investment activity. The rise in oil prices pushed up price inflation somewhat in February, to a year-on-year rate of 2.3 per cent. The appreciation of the euro will, however, continue to have a dampening impact on inflation through lower import and producer prices. Moderate economic growth is having the same effect. If oil prices do not continue to exert upward pressure on inflation, it is expected to fall below the ECB's upper limit of 2 per cent in the period to summer. This will contribute to holding up real disposable income, which will underpin household consumption.

The Stability and Growth Pact has come under considerable pressure. Lower-than-expected growth in 2002 was followed by lower tax revenues and higher expenditure than expected. In 2002, the EU Commission activated the excessive deficit procedure for Germany and Portugal, which both recorded a deficit in excess of 3 per cent of GDP. In the first round, this means that

Macroeconomic projections according to selected sources
Annual change in per cent

	GDP-growth						Inflation (consumer prices)					
	1999	2000	2001	2002	2003	2004	1999	2000	2001	2002	2003	2004
USA												
NIESR	4.1	3.8	0.3	2.4	2.6	3.1	1.6	2.5	2.0	1.4	1.8	1.5
ConsF	4.1	3.8	0.3	2.4	2.4	3.7	2.2	3.4	2.8	1.6	2.3	2.1
EC	4.1	3.8	0.3	2.3	2.3	2.8	2.2	3.4	2.8	1.6	2.3	2.3
OECD	4.1	3.8	0.3	2.3	2.6	3.6	2.2	3.4	2.8	1.6	1.9	1.8
Japan												
NIESR	0.8	2.4	-0.3	-0.2	0.7	0.9	-0.5	-1.1	-1.5	-1.5	-0.7	0.0
ConsF	0.8	2.4	0.3	0.3	0.6	0.7	-0.3	-0.7	-0.7	-0.9	-0.6	-0.6
EC	0.7	2.4	-0.1	-0.6	1.2	1.4	-0.3	-0.7	-0.6	-1.0	-1.0	-0.8
OECD	0.7	2.6	-0.3	-0.7	0.8	0.9	-0.3	-0.7	-0.7	-1.1	-1.1	-1.1
EMU												
NIESR	2.8	3.5	1.4	0.8	1.4	2.2	1.2	2.2	2.5	2.2	1.7	1.3
ConsF	2.8	3.5	1.4	0.8	1.1	2.1	1.1	2.1	2.4	2.2	1.8	1.6
EC	2.8	3.5	1.5	0.8	1.8	2.5	1.1	2.4	2.5	2.3	2.0	1.8
OECD	2.8	3.6	1.5	0.8	1.8	2.7	1.1	2.4	2.5	2.4	2.2	2.0
Trading partners												
NIESR	3.0	3.6	1.3	1.2	1.7	2.4	1.2	1.8	2.1	1.9	1.5	1.4
ConsF	3.1	3.5	1.3	1.3	1.6	2.4	1.3	2.2	2.5	2.1	2.1	1.8
EC	3.1	3.5	1.2	1.2	2.0	2.5	1.2	2.0	2.4	1.9	1.9	1.8
OECD	3.1	3.5	1.2	1.2	2.1	2.7	1.4	2.1	2.5	2.1	1.9	1.8

Sources: NIESR from January 2003, Consensus Forecasts from March 2003, EC from November 2002 and OECD from November 2002. All the inflation projections from the NIESR apply to the consumption deflator.

the countries must make non-interest-bearing deposits with the EU Commission, on the basis of the size of GDP and the budget deficits, which can be converted to fines if the deficit is not corrected within two years. France and Italy have received a warning from the EU Commission, fearing that the budget deficit ceiling would be exceeded in 2003 and 2004. Concerns that the Stability and Growth Pact might prolong the downturn have compelled the EU Commission to consider a more flexible interpretation. There have been proposals suggesting that countries with low public debt should be able to operate with moderate budget deficits in periods of weak growth. However, there are few euro area countries whose public debt is substantially lower than the 60 per cent of GDP ceiling set out in the Stability and Growth Pact. Moreover, this would not help any of the countries mentioned above. Thus, fiscal policy is not expected to provide further stimulus in the euro area in the period ahead.

The ECB was for a long period somewhat reluctant to cut interest rates as inflation has hovered above the upper limit in recent years. However, the appreciation of the euro has contributed to easing inflationary pressures, and since December 2002 the ECB has cut its key rate by 0.75 percentage point, most recently on 6 March when the key interest rate was reduced to 2.5 per cent. The considerable uncertainty surrounding global economic developments makes it particularly difficult to predict when a new upturn will take hold. In the light of recent developments, the growth outlook for 2003 is somewhat weaker than in December when the previous *Economic Survey* was published. The euro area is largely dependent on impetus from the world economy. Developments ahead are thus to a large extent contingent on an upswing in the US.

In 2002, the German economy grew by 0.2 per cent, which is the lowest growth rate for 10 years. Household consumption, investment and industrial output exhibited weak growth, and unemployment rose to 10.3 per cent in January 2003. Germany accounts for one third of the euro area economy and is an important trading partner for most countries in the region. Sluggish growth in Germany thus had negative spillover effects on the rest of the euro area. Germany is struggling with structural problems, particularly in the labour market according to many observers. In addition, the German economy is conducting an economic policy that is not adapted to the economic situation. Monetary policy, which is conducted by the ECB, has long been too tight for the German economy, while fiscal policy is limited by the Stability and Growth Pact. In addition, Germany, which has a relatively large share of trade with countries outside the euro area, is being affected by the appreciation of the euro in particular. A tightening of German fiscal policy has recently been signalled, which will dampen short-term growth prospects. Structural reforms may also be forthcoming, which would contribute to higher growth in the longer term.

Outside the euro area, the UK has so far fared relatively well during the global downturn. Economic growth has been higher than in the euro area, and unemployment has remained low. High household consumption, fuelled by the sharp rise in house prices, combined with public demand, has been the main driving force in recent years. Growth in household consumption has to a large extent been debt-financed, partly through mortgage debt. House price inflation was 23 per cent in 2002, and is not sustainable, with a considerable risk of a correction in house prices. While the service sector is expanding, manufacturing industry has exhibited a negative trend in recent years. The pound sterling started to depreciate from the beginning of this year, and has depreciated by around 5 per cent against trading partners by mid-March. This has improved the outlook for manufacturing industry. The sharp rise in house prices poses a dilemma for monetary policy. The need to curb house price inflation must be weighed against the risk of stifling an already slowing economy. Towards the end of last year, inflation was higher than the 2.5 per cent target, partly reflecting rising house rents and oil prices. Inflation is projected to fall below target at the two-year horizon. In February, Consensus Forecasts lowered its growth forecast for the UK economy for 2003 and 2004, but growth is expected to show a moderate increase this year and next.

So far, Sweden and Denmark have also fared better than the euro area during this international downturn. In Sweden, growth improved markedly in the second quarter of last year, following a year of low growth. Later in the autumn, it seemed that growth was moderating again. The international slowdown had reduced exports. At the same time, investment and consumption growth has slowed. Against this background, the Swedish central bank lowered its key rate by a total of 0.5 percentage points to 3.75 per cent in the fourth quarter. Weak global developments have also dampened growth prospects in Denmark. High domestic demand and low interest rates, that primarily shadow euro area interest rates, have contributed to holding up growth. Nevertheless, it appears that sluggish trends in Germany are feeding through to the Danish economy. GDP growth was weak in the latter half of the year, and manufacturing output fell. Unemployment has increased since the summer, and both business and household confidence in the economy has weakened.

Japan

The Japanese economy is still struggling. Last year was the fourth consecutive year with deflation, and GDP grew by as little as 0.3 per cent. Household confidence in the economy is weak. Falling prices and wages and an ageing population with high pension savings are holding down consumption. Industrial output fell for the second consecutive year, and unemployment is still on the rise. A culture that counters bankruptcies is keeping alive a large number of unprofitable enterprises, and the banking sector has accumulated a large volume of bad loans. Interest rates seem to be remaining steady at zero. An expansionary fiscal policy, partly thanks to public works projects, has not been sufficient to stimulate domestic demand, while public debt is rising to a level that is causing concern. Economic reforms were promised already in 2001, but effective measures are still lacking. The Japanese central bank has repeatedly intervened in the foreign exchange market to counter the appreciation of the yen against the US dollar. In spite of this, the yen has tended to appreciate since the end of 2002, which is weakening the export industry in Japan.

The Japanese economy will continue to be marked by low growth and deflationary tendencies over the next years. Domestic demand is expected to remain low. Exports will thus be important for growth in the period ahead. If growth in the US and the rest of the world economy picks up, GDP growth in Japan is expected to stabilize at a low, but positive level in the years ahead.

Developments in the oil market

The spot price for Brent Blend rose from about USD 25 per barrel at the end of November 2002 to about USD 34 per barrel in mid-March. In the first 10 weeks of this year, the oil price has averaged a little less than USD 32 per barrel compared with about USD 25 per barrel in 2002. In recent days, oil prices have shown a marked fall to a little more than USD 27 per barrel on 18 March.

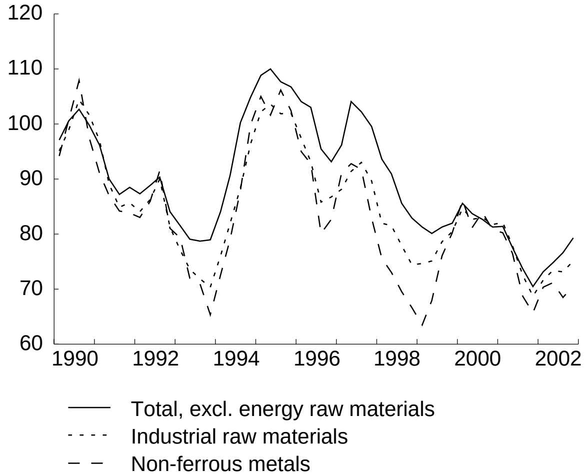
The high level of oil prices must be seen against the background of the conflict with Iraq. The Petroleum Intelligence Weekly (PIW) estimates that the oil prices have been USD 3-6 per barrel higher owing to fears of war and thereby supply concerns.

However, the strike in Venezuela made the most important contribution to the *increase* in oil prices over the past three months. The strike entailed a reduction in the country's oil production, by about 2 million b/d in December last year and in January of this year compared with the level prevailing in the preceding months. This affected oil exports to the US in particular, and as a result US crude oil reserves were at their lowest level for 27 years in January. In addition, as a result of a cold winter in North America and Northeast Asia, heating fuel reserves in these regions were lower than the average for the past five years.

OPEC decided to increase production quotas from 1 January and 1 February this year by total of 2.8 million b/d. Even though the cartel already produced more than its quotas, the aim was that the effective increase in production would compensate for reduced supply from Venezuela and improve the reserve situation, particularly in the US. Since the largest share of the production increase comes from the Middle East and Saudi Arabia in particular, it will take four to six weeks for the oil to reach North America.

The International Energy Agency (IEA) estimates that global oil demand will increase by 1.1 million b/d

Commodity prices on the world market 1990 - 2002
Dollar based indices. 1990 = 100



Sources: HWWA-Institut fur Wirtschaftsforschung and AIECE.

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

Source: IMF.

from 2002 to 2003. The bulk of the increase is expected to take place in North America, Asia and the Middle East. The IEA expects non-OPEC production to increase by 1.3 million b/d, particularly in the former Soviet Union and to some extent in North America, Latin America and Africa. This means that the residual demand for oil from OPEC countries will be somewhat smaller this year, and that the cartel will lose market shares to other producers.

Venezuela managed to increase production in February, to about 75 per cent of the level prior to the strike in the oil sector. According to the PIW, it will probably take several months before they can produce their allotted quota. Iraq produces about 2.5 million b/d under the UN oil-for-food programme. If the rest of OPEC adheres to production quotas in the months ahead, it appears that crude oil reserves will increase by a little more than 2 million b/d in the second and third quarter combined. This is a period when reserves normally increase by 0.5-1 million b/d before demand for heating oil increases in the northern hemisphere. Although oil prices have been higher than USD 30 per barrel since the beginning of the year, it appears that the market supply of oil will be more than sufficient in the period ahead. This is why OPEC has suspended its price mechanism that stipulates that if oil prices have been higher than USD 28 per barrel for a basket of OPEC oil for twenty days, the cartel shall increase production to bring oil prices back to the interval USD 22-28 per barrel.

If a full-scale war is launched in Iraq, the country's oil exports of about 1.7 million b/d will come to a total halt. OPEC has signalled that they would compensate for this reduction in supply. According to the IEA, this reduction in overall production is approximately equal to idle capacity in OPEC in the short term. In addition, the IEA has assured the market that they can rapidly supply the market with 10-15 million b/d from its strategic reserves if the need should arise. If the conflict does not drag on and does not affect oil production in Middle Eastern countries other than Iraq, it seems that there would be sufficient supply of oil in the market to avoid even higher oil prices over a longer period. This is contingent on the absence of oil production disruptions in other countries, for example as a result of the conflict concerning the election that will take place in Nigeria in April. On this set of assumptions, it appears that OPEC will be able to bring oil prices to below USD 28 per barrel. Irrespectively, oil prices will be particularly high for a period this year, which suggests that the average price for 2003 as a whole will be in the upper range of OPEC's interval.

The uncertainty surrounding oil production in Iraq over the next two years is especially prominent. If Iraqi production remains broadly at the current level and residual demand for oil from other OPEC countries does not rise, the cartel is likely to lose market shares to other countries. If countries such as Algeria, Nigeria and Libya, which are eager to increase their quotas, do not prevail, it is likely that OPEC will succeed in maintaining its policy, which implies an average oil price of about USD 25 per barrel.

Other commodity prices

Commodity prices excluding energy products rose last year. However, this must be seen in connection with the depreciation of the US dollar. Measured in euros, commodity prices fell somewhat during the year. Aluminium prices rose in the beginning of 2002, but edged down in the second and third quarter, before moving up somewhat towards the end of the year. Weak demand, combined with higher supply, has pushed down aluminium prices. We assume that aluminium prices, measured in USD, will edge up during the projection period, if global demand picks up.