International economy

Following a period of sluggishness at the end of last year and the beginning of 2003, it now appears that the international economic situation is improving. Developments in global financial markets, with rising equity prices and an increase in long rates, indicate expectations of higher growth. Domestic demand is rising in the US and some positive signals have also come into evidence in Japan. However, developments in the euro area remain weak, and second-quarter figures indicate that GDP contracted for the euro area as a whole.

Economic growth in the US is expected to pick up in the period ahead, but the recovery is still fragile. The depreciation of the dollar against the euro and Canadian dollar and an expansionary fiscal policy will make a positive contribution. However, a precondition for a robust upturn in the US economy is that the higher level of investment activity recorded in the second quarter is maintained. In the euro area, growth is expected to pick up gradually from the first half of next year, buoyed by higher global growth.

Developments in the oil market

The spot price of Brent Blend rose from about USD 24 per barrel at the end of April to around USD 30 at the beginning of September. For the first eight months of the year, the price has averaged just under USD 29 per barrel, against about USD 25 last year.

The most important reason for the rise in prices over the last few months was that Iraq did not succeed in maintaining production at the level prevailing before the toppling of the former regime, which meant that exports fell by a little less than 2 million b/d. Iraq is not covered by OPEC's quota system. Since OPEC kept its production quotas unchanged, global stocks of both crude oil and finished products increased less in the past few months than would otherwise have been the case. In particular, many analysts have pointed to the low stocks of petrol in the US during the driving season, which is now drawing to a close.

According to the Energy Information Administration in the US, stocks of crude oil in the OECD are at their lowest level for 15 years. In the period ahead, it is particularly important that stocks of heating oil are restored to acceptable levels before winter arrives in the northern hemisphere. If Iraq does not manage to increase exports over the next few months, OPEC will probably have to increase production to keep oil prices within the desired interval of USD 22-28 per barrel. Irrespectively, oil prices have been particularly high so far this year, and it appears that the average price for 2003 as a whole will be in the upper range of this price interval. In the projection period, oil prices are projected to be about USD 25 per barrel.

US

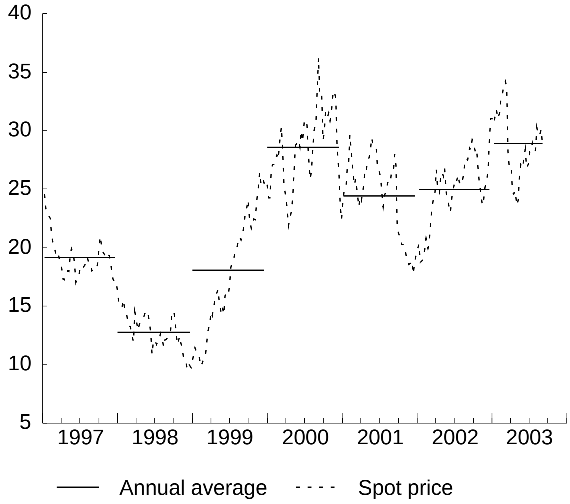
In recent months there have been signs of an upturn in the US economy. Figures for the second quarter show that GDP growth has picked up following two fairly weak previous quarters. The stock market has rallied and surveys indicate that consumer and business confidence has improved. Long interest rates have moved up and the deflation scenario appears to have been "priced out" of the market.

GDP growth in the second quarter was primarily fuelled by household consumption and public expenditure. Consumer spending has been the most important growth factor during the period of sluggishness in the US economy over the last three years. This was also the case in the previous quarter, which showed a pronounced rise compared with the previous two quarters. Car purchases were the main sub-component. The rise in public spending primarily related to higher defence expenditure linked to the war in Iraq. Growth in private investment also picked up compared with the first quarter. Growth was particularly strong for machinery and construction. This represents the key to a robust upswing in the US economy.

The balance of trade continues to deteriorate. It may seem surprising, taking into account the sharp depreciation of the dollar, but it primarily reflects a different cyclical phase for the US economy compared with its trading partners. US imports rose considerably in the second quarter as a result of higher domestic demand, while sluggish global developments affected demand for US goods and services, with exports showing a decline. The trade deficit is also consistent with a J-curve effect. This implies that a weaker currency initially results in a worsening trade balance because the value of imports is higher and the value of exports is lower measured in dollar terms, but that higher exports and reduced imports in the somewhat longer term result in an improvement in the trade balance. However, this effect is smaller in the US than in other countries inasmuch as a high share of US imports is priced in dollars.

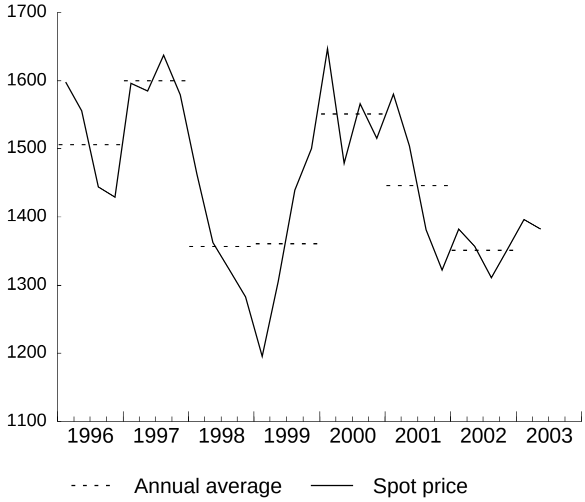
Retail trade continued to expand, and was 1.4 per cent higher in July than in the previous month. This is the highest increase since March. There was broad growth across a number of groups, but cars are still making the main contribution. Continued low interest rates and expectations of higher growth will help to sustain consumption. However, there are several factors that point to the opposite, particularly the weak labour market. Unemployment is now higher

Spot price crude oil, Brent Blend
Dollar per barrel



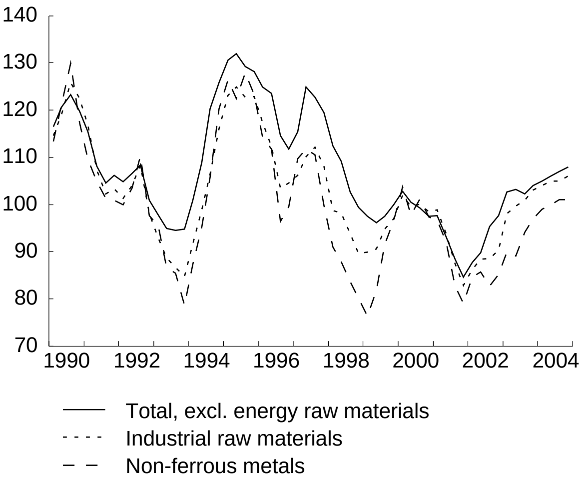
Source: Norges Bank.

Spot price aluminium. 1996 - 2003
Dollar per 100 lbs.



Source: IMF.

Commodity prices on the world market 1990 - 2004
Dollar based indices. 2000 = 100



Sources: HWWA-Institut fur Wirtschaftsforschung and AIECE.

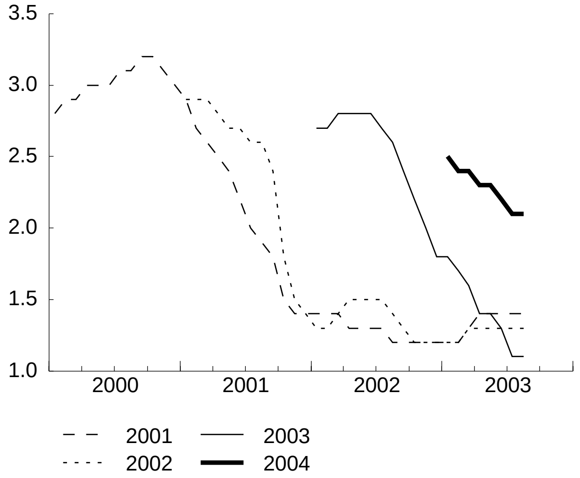
than 6 per cent, and employment continues to fall. Negative developments in the labour market reduce growth in household income and lead to lower expectations concerning economic developments. Debt-burdened households in the US have lost part of their wealth in the stock market in the last few years. If the stock market should again fall following the rally this spring, growth in consumer spending may slow. The tax cuts this summer will contribute to maintaining demand growth in the short term. In the longer term, however, it is essential that labour market conditions improve.

The housing market is also a good indicator that monetary policy is still having an impact. Despite weak developments in other parts of the economy, historically low interest rates are resulting in a continued rise in residential construction, which is now at a very high level. House prices also rose considerably through the second quarter. The sharp rise in prices is not sustainable and has led to concerns that a price bubble is developing in the housing market. House sales were record-high in July, but higher long rates in recent months are expected to curb demand ahead. In recent years, a steady fall in interest rates has enabled households to refinance their loans at lower interest rates. This has been an important factor behind strong consumption growth. Higher long rates will curb demand both for refinancing and dwellings and may trigger a correction in house prices. A sharp fall in house prices will have a negative impact on household consumption and may ruin the prospect of an economic upswing. If overall growth in the US economy picks up as expected, the financial position of households will improve and hopefully offset the effect of higher interest rates, thereby preventing a sharp fall in house prices.

Industrial output expanded by a strong 0.5 per cent in July after having exhibited sluggish developments over the past year. The upswing was broadly based, with car production making the largest contribution. Viewed in relation to other positive signs in the macroeconomic picture, this may be an indication that manufacturing is heading for better times. There are several factors that may underpin an improvement in manufacturing. Inventories are very low, which means that higher demand will quickly translate into higher output. Moreover, conditions are in place, with low interest rates and subdued inflation, a weak dollar and an expansionary fiscal policy. Robust growth in investment is important for a continued and vigorous upturn. Capacity utilization, however, is still low. This limits the need for new investment. Weak international demand and falling exports may also hamper a robust upswing in manufacturing for the moment.

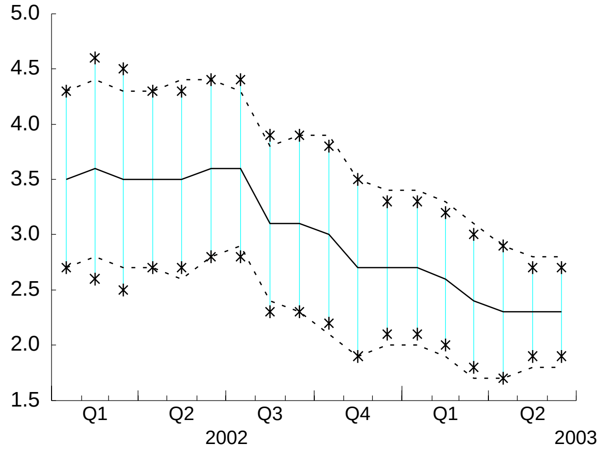
The US dollar has depreciated sharply since the beginning of 2002. Up to mid-June 2003, it depreciated by close to 20 per cent on a trade-weighted basis and

GDP growth forecasts for Norway's main trading partners for 2001 - 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.

35 per cent against the euro. Since then, however, it has appreciated somewhat, by about 4 and 7 per cent respectively. At the beginning of September, one euro cost USD 1.10. The depreciation of the dollar means that US producers' international competitiveness has improved considerably. Admittedly, the positive effects are being moderated in the short term as a result of weaker demand from the euro area and Canada (whose currencies account for most of the depreciation) due to sluggish economic developments in these countries. All the same, a weaker dollar will gradually help to improve the balance of trade. Foreign demand may therefore contribute to maintaining total demand.

Domestic demand is being bolstered by an expansionary fiscal policy. Recently approved tax cuts are already on their way to taxpayers' pockets. Most of them are in the form of discount cheques, paid directly to households. There are also other measures, including a reduction in the marriage tax penalty, but these will first take effect at the beginning of next year and are of less importance for the overall picture. Higher military spending is also having expansionary effects. All in all, the budget balance has deteriorated and a number of states are struggling with unsustainable budget deficits. Substantial fiscal tightening will therefore have to take place in the US over the next few years.

Improved key figures for the US economy have led to a rise in long rates. Yields on ten-year government bonds have risen markedly since the end of July, albeit from historically low levels. Core inflation has remained at around 1.5 per cent in the last four months. This underpins the impression that the economy has stabilized and that the risk of deflation has diminished. Long interest rates are now discounting higher growth and inflation. The Federal Reserve is still keeping short interest rates at a record-low level in order to stimulate the economy. Growth remains fragile, and interest rates will probably not be raised before the labour market shows a noticeable improvement.

Europe

European stock markets have risen sharply since March. Long interest rates have also increased this summer. Positive signals from the US economy are an important reason for this. However, economic data have not matched this optimism, and second-quarter figures revealed sluggish developments in large parts of the euro area. In the second quarter, GDP contracted in Germany, France and Italy, the euro area's three largest economies, and GDP is expected to fall for the euro area as a whole. Weak global demand, a tighter monetary policy than in the US and the effects of the strong euro have contributed to sluggish developments.

The gap between optimistic expectations, reflected in rising equity prices and rising long interest rates, and weak figures for the second quarter, gives grounds for concern. The risk that we will see a renewed decline in European stock markets in the period ahead has increased, which would also affect consumption and investment.

The euro has appreciated by nearly 30 per cent against the dollar over the past one and a half years, despite some depreciation in the last two months. The sharp appreciation of the euro is having an adverse impact on the internationally exposed sector. Competitiveness has particularly deteriorated against the US and countries that have pegged their currency to the US dollar, such as China and to some extent Japan, but also against the UK. The appreciation of the euro has negated a large part of the easing of monetary conditions provided by the interest rate cuts so far.

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	2.4	3.0	1.6	2.5	2.0	1.4	2.1	3.0
ConsF	4.1	3.8	0.3	2.4	2.3	3.7	2.2	3.4	2.8	1.6	2.2	1.7
EC	4.1	3.8	0.3	2.4	2.4	2.5	2.2	3.4	2.8	1.6	2.0	1.7
OECD	4.1	3.8	0.3	2.4	2.5	4.0	2.2	3.4	2.8	1.6	2.4	1.7
Japan												
NIESR	0.2	2.8	0.4	0.1	0.7	1.0	-0.7	-1.2	-1.5	-1.6	-0.9	-0.7
ConsF	0.8	2.4	0.4	0.2	1.0	0.7	-0.3	-0.7	-0.7	-0.9	-0.4	-0.6
EC	0.7	2.4	0.4	0.3	1.5	1.3	-0.3	-0.7	-0.6	-0.9	-0.6	-0.7
OECD	0.7	2.6	0.4	0.3	1.0	1.1	-0.3	-0.7	-0.7	-0.9	-0.9	-1.0
EMU												
NIESR	2.8	3.5	1.5	0.8	0.6	1.8	1.2	2.2	2.5	2.3	1.8	1.0
ConsF	2.8	3.5	1.4	0.8	0.6	1.6	1.1	2.2	2.7	2.3	1.9	1.4
EC	2.8	3.5	1.5	0.9	1.0	2.3	1.1	2.4	2.5	2.2	2.1	1.7
OECD	2.8	3.6	1.5	0.9	1.0	2.4	1.1	2.4	2.5	2.4	2.0	1.6
Trading partners												
NIESR	3.0	3.7	1.4	1.3	1.1	2.1	1.2	1.8	2.1	1.8	1.9	1.3
ConsF	3.1	3.5	1.3	1.3	1.1	2.1	1.3	2.2	2.5	2.0	2.0	1.6
EC	3.1	3.5	1.3	1.3	1.4	2.3	1.2	2.0	2.4	1.9	2.0	1.6
OECD	3.1	3.5	1.3	1.3	1.4	2.5	1.4	2.1	2.5	2.1	2.0	1.6

Sources: EC from April, OECD from June, NIESR from July and Consensus Forecasts from August 2003 . All the inflation projections from the NIESR apply to the consumption deflator.

The strong euro, coupled with sluggish economic developments, has curbed inflation. The fairly tight monetary policy over the past few years has made investments in European securities relatively attractive and thus contributed to the appreciation of the euro. At the same time, it has led to lower inflation by curbing investment and consumption. Germany, where the economic situation is weakest, also has the lowest inflation rate.

The European Central Bank has cut its key rate by 0.75 percentage point so far this year, to 2 per cent. In May, inflation was below the ECB's upper limit of 2 per cent for the first time in more than three years. Inflationary pressures clearly appear to be abating. Stagnation in manufacturing in particular, but also the generally weak economic performance, point to low interest rates for an extended period ahead. It is assumed that interest rates will rise gradually from the third quarter of next year.

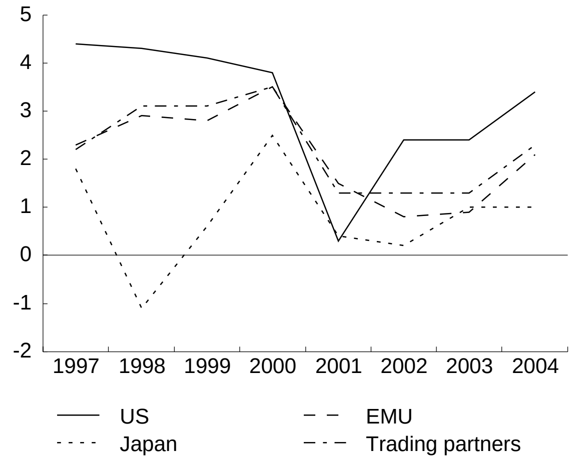
Germany, France and Portugal are set to exceed the Stability and Growth Pact's budget deficit ceiling of 3 per cent of GDP this year. Italy is also at risk. Recently, Germany and France have signalled that the limit will probably be exceeded again next year. In the event, this means a breach with the Stability and Growth Pact for the third consecutive year. Strict budgetary requirements may prolong the downturn and the Pact has been subject to severe criticism. The budget deficits have contributed to limiting the downturn, but are not sustainable in the long term. The scope for a more expansionary fiscal policy in the euro area is therefore limited.

In Germany, GDP contracted by 0.1 per cent in the second quarter, which is the third consecutive quarter showing negative economic growth. The weak global economy, combined with a strong euro, has resulted in sluggish exports, and the moderate increase in domestic demand was not sufficient to offset the negative contribution from foreign trade. Germany is the largest economy in the euro area, and sluggish developments are therefore having contagion effects on the rest of the region.

Germany's problems are due to a mixture of structural problems and weak economic developments. The Government is seeking to introduce a reform, "Agenda 2010", in which key points include cutbacks in social security schemes, such as sick pay and unemployment benefits, and a relaxation of job-protection rules. Such reforms may have an expansionary effect in the longer term, but the relatively export-oriented German economy seems dependent on stimulus from an international recovery in order to emerge from the downturn.

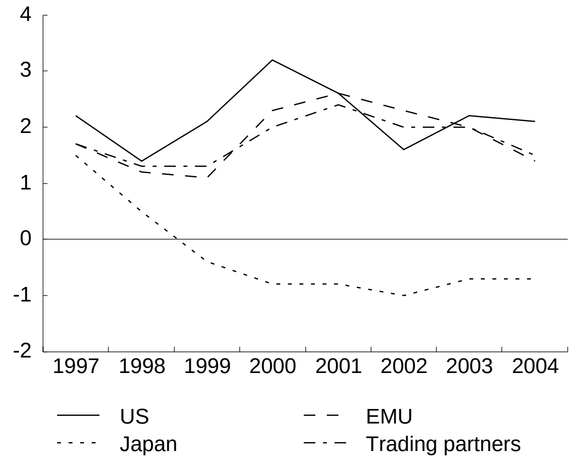
Growth in the euro area is expected to remain weak in the second half of 2003. Household demand will remain subdued as a result of high unemployment. Sentiment indicators have provided some signs of improved confidence in the business sector, but there are still no signs that investment is picking up. The

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



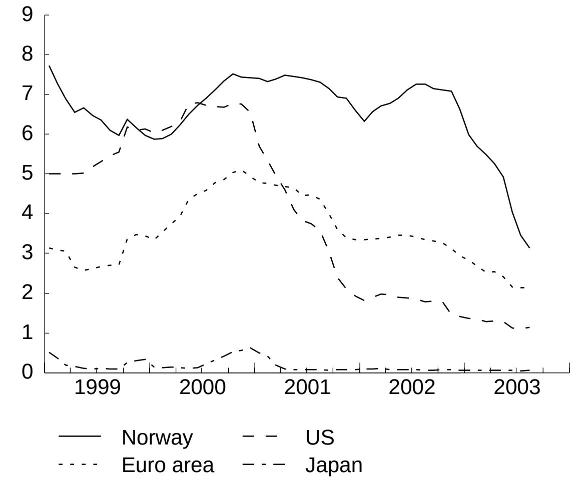
Sources: Average of projections from the NIESR in July 03, CF in August 03, the EC in April 03 and the OECD in June 03.

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



Sources: Average of projections from the NIESR in July 03, CF in August 03, the EC in April 03 and the OECD in June 03.

International interest rates
3-month Eurorate



Source: Norges Bank.

ECB's interest rate cuts so far this year will stimulate activity somewhat, and further cuts may be made during the autumn. However, the contribution from fiscal policy is of a limited nature. High unemployment is curbing income growth and household consumption, and the growth impetus will initially come from higher exports as activity in the global economy, and particularly in the US, picks up. There are thus few indications of a swift turnaround in the euro area. Growth is not expected to pick up until the first half of next year.

Outside the euro area, the UK has recorded sluggish growth in the first half of 2003, partly reflecting weak global demand. Heightened uncertainty concerning the war in Iraq may also have been of importance. The labour market is still buoyant. Unemployment has remained at a little more than 3 per cent over the past few years. Employment in service industries and the public sector has increased, while manufacturing is still shedding labour. Manufacturing is being adversely affected by sluggish developments in the euro area. The depreciation of the pound has led to improved competitiveness and industrial output appears to be stabilizing. After having declined for six consecutive months, industrial output rose by 0.1 per cent in June. Household consumption has remained buoyant through the international downturn, fuelled by the sharp rise in house prices. High debt levels and a slower rise in house prices since spring 2003 may curb household consumption in the period ahead. The strong labour market and low interest rates point to the opposite. The Bank of England has reduced its key rate by 0.25 percentage point on two occasions since the beginning of the year, most recently in June, and the key rate is now 3.5 per cent. The expansionary monetary policy, coupled with higher international demand, will fuel growth in the period ahead, and growth is expected to pick up from the first half of next year.

In Sweden, economic growth has been weak since the third quarter of 2002, but edged up during spring 2003. Household consumption and net exports contributed to stronger overall demand in the second quarter even though investment and public consumption had the opposite effect. Local government strikes led to a fall in public consumption in the second quarter. This will be compensated by higher consumption in the third quarter, but public consumption is expected to expand at a relatively slow pace thereafter. Consumer confidence indicators suggest optimism among households, and low interest rates will result in a continued rise in household consumption in the period ahead. Gross investment contracted in the second quarter and has moved on a sluggish trend over the past year. Weak developments in manufacturing are contributing to this picture. Growth in the service sector has held up, and manufacturing output is expected to rise as global growth gradually picks up. The Swedish central bank reduced its key rate by one percentage point from March to July. This must be seen in connection with a slower rate of inflation, which is now close to the target of 2 per cent. The Swedish krona has appreciated, but is not back to the level recorded in 2000 when the krona began to depreciate. The krona is expected to appreciate further irrespective of the outcome of the referendum on participation in EMU on 14 September. A mild global upturn and a stronger krona will result in only a moderate rise in exports. All in all, the growth outlook has improved somewhat since spring. This primarily reflects a brighter global outlook and higher household consumption.

Japan

In Japan, GDP growth picked up in the second quarter, to 0.6 per cent, or 2.3 per cent at an annual rate, after having slowed gradually through the previous three quarters. Higher exports made the most important contribution. Household consumption is also showing a positive trend, and rose for the second consecutive quarter. Bond yields have also risen in Japan as a result of positive key figures in recent months. Developments in the stock market also indicate expectations of higher growth. Since the beginning of May, the Nikkei index has climbed by 25 per cent. However, structural problems in the Japanese economy are still unresolved, implying that a robust turnaround is still not imminent.