International economy

Global economic activity has picked up appreciably through the autumn. All of the major economies are again expanding after the euro area also recorded positive GDP growth in the third quarter. In the US, the economic upswing has been in evidence through the summer and autumn, and the US is at the forefront in the international cyclical recovery. Some Asian countries are also showing strong growth, particularly China. In the euro area, on the other hand, growth is still relatively weak, but the international upswing will result in higher activity in these countries as well.

US

Fragile growth in the US economy through 2002 and the beginning of 2003 was largely fuelled by substantial monetary and fiscal policy stimulus. The business sector has now finally started to invest again. This is the key to a self-driven upturn, indicating that the upswing has moved into a more robust phase.

In the third quarter, the US economy gathered considerable momentum, with GDP expanding by 8.2 per cent at an annual rate after showing a more moderate rise in the second quarter. Growth was broadly based, with household consumption, investment and exports making the strongest contribution. Household demand has been particularly focused on car purchases, motivated by very favourable financing terms made possible by low interest rates. Exports rose for the first time in four quarters, underpinned by the depreciation of the US dollar. Housing investment has picked up over the last two quarters, and investment in machinery and IT equipment has shown a sharp rise.

There is, however, some uncertainty associated with private consumption, which has been the main growth factor through the downturn. Consumption growth was strong in the third quarter as a whole. However, consumption fell somewhat in September, a development that continued in October. The decline was due to lower car sales. Retail trade, excluding cars, also rose somewhat in these two months, but growth slowed markedly compared with previous months. This may be because the possibility of refinancing home mortgages at steadily lower interest rates has been exhausted as we have probably reached an interest rate trough, and the effect of the tax cuts this summer my have waned. In addition, demand for cars may be approaching a «saturation point» inasmuch as many households may have purchased cars «in advance» due to favourable funding terms.

Industrial output rose for the fourth consecutive month in October, and several factors will underpin manufacturing in the period ahead. The depreciation of the dollar will boost global demand. New orders are moving up. Moreover, inventories are very low, which means that it will not take very long before production increases when demand picks up. There are signs that capacity utilization is rising, but it is still so low that there is no risk of inflationary pressures in manufacturing in the near future.

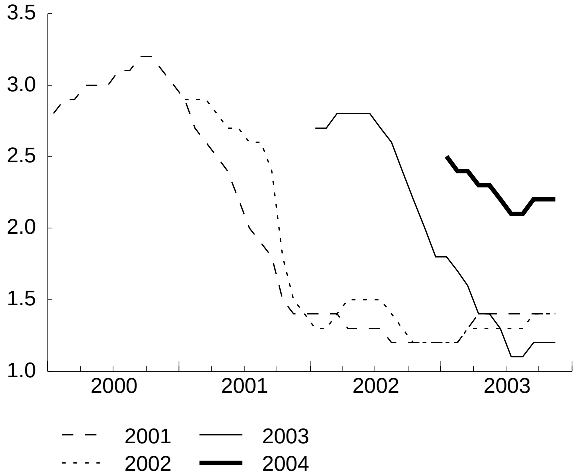
Employment has started to rise, and unemployment has fallen by 0.5 percentage point since peaking in June, standing at 5.9 per cent in October. So far, the increase in employment has taken place in service industries. Manufacturing employment is still falling, but the decline appears to be slowing. Continued strong productivity growth and the relocation of jobs to low-cost countries may, however, limit employment growth in the short term.

Domestic demand is being buoyed by an expansionary fiscal and monetary policy. The tax cuts for households and the business sector this summer contributed to vigorous economic growth in the third quarter. Military spending rose sharply in the second quarter as a result of the war in Iraq, and spending has been maintained at approximately the same level through the autumn. The budget balance has deteriorated considerably and there is limited scope for new stimulus. Some tightening of fiscal policy is not likely before 2005.

The US dollar has depreciated substantially since the beginning of 2002, by about 22 per cent on a trade-weighted basis and 35 per cent against the euro. This has provided a considerable stimulus to the business sector. Several Asian central banks, particularly the banks in China and Japan, have intervened extensively in the foreign exchange market to prevent their own currency from strengthening against the dollar in order to protect business sector competitiveness. The Japanese yen has nevertheless appreciated by 10 per cent against the dollar since mid-August. The Chinese currency, however, is pegged to the dollar at least for the time being. The dollar exchange rate against the euro is assumed to be 1.17 through the projection period. This corresponds to the level in October and November and is in accordance with estimates from Consensus Forecasts.

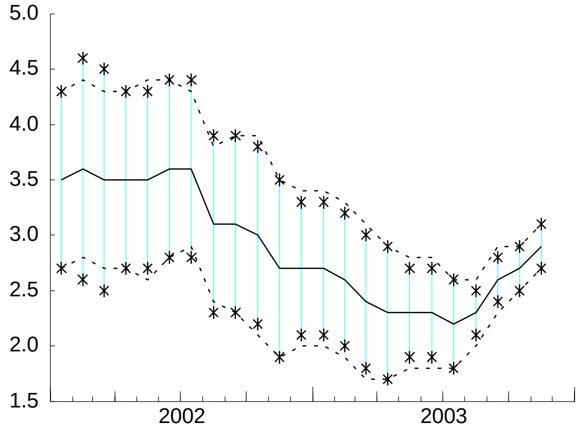
In isolation, the depreciation of the dollar will lead to higher inflation. As a result of excess capacity in the economy, however, the Federal Reserve does not fear inflationary pressures and will keep interest rates low

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.

for a considerable period. The current key rate of 1 per cent is the lowest in more than 40 years. However, interest rates are expected to increase from the summer of next year.

Financial imbalances in the US economy continue to mount, with large government budget and current account deficits and the build-up of household debt. The tax cuts and high level of government spending are important factors behind the ongoing upswing, but are not sustainable in the long run. It is therefore essential that other sectors in the economy can provide some growth momentum in the period ahead. Global demand for the US dollar depends on how long the build-up of US debt can continue. Previously, foreign investment in the US business sector financed a large share of the deficit, but Asian central banks' purchases of government bonds now account for a large share of US dollar demand. If demand for US securities declines due to waning confidence in the US economy and policy, this may lead to a further depreciation of the dollar. This would contribute to improving the balance of payments, but may also undermine the fragile recovery we are observing in the euro area and Japan, which would also have repercussions for the US economy as a result of lower demand for US goods.

Growth in the US economy is being stimulated by temporary factors, such as tax cuts in the form of discount cheques and the conversion of loans at steadily lower interest rates. Growth is therefore expected to slow somewhat in the period ahead, but will not bring the economic upswing to a halt. As a result of low interest rates and a weaker dollar, the rise in investment is expected to contribute to a self-driven upturn. Based on a normal cyclical pattern, the US economy will pass a cyclical peak during the first half of 2005. Against this background, a clear slowdown is projected in 2006.

Euro area

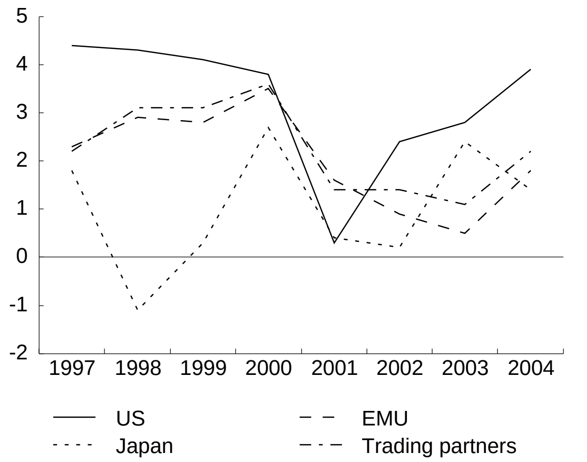
It appears that the euro area is finally expanding again after Germany, Italy and France recorded positive GDP growth in the third quarter. The three largest economies in the euro area all experienced a decline in GDP in the second quarter and in Germany's case the first quarter as well. The euro area as a whole also showed positive growth in the third quarter, at 0.4 per cent. Growth is primarily being fuelled by exports. Unemployment remains high and household consumption growth is weak.

Global economic developments represent the key to the turnaround in the euro area. Higher demand will help to sustain the positive trend for European export industries and will spread to the rest of the economy and contribute to a gradual pick-up in domestic demand. In particular, developments in the US are important, which is the main export market for the euro area. The strong euro, however, is curbing demand, but so far it appears that strong global growth is dominant.

Unemployment stood at 8.8 per cent in October for the euro area as a whole, the highest level since unemployment began to rise in autumn 2001. However, unemployment has not risen since May and appears to have stabilized. Unemployment varies considerably across member states, from Luxembourg and the Netherlands with 3.9 and 4 per cent (in September) respectively, to Germany and Spain with 10.5 and 11.2 per cent. Unemployment is expected to decline in the wake of the economic upturn that appears to be materializing.

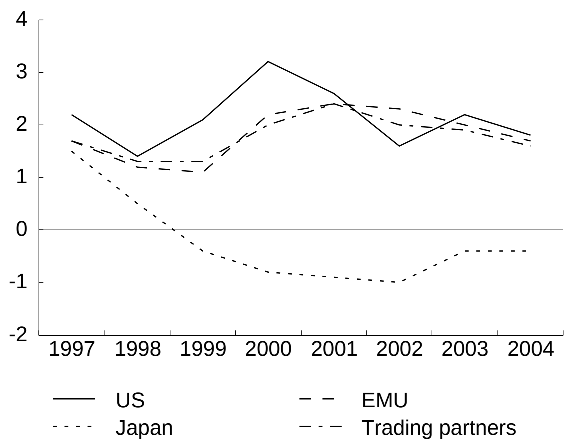
Household demand is expected to show moderate growth. Households want to see an improvement in the labour market and falling unemployment before consumption is increased. Reforms in the labour market, which will involve restructuring in the business

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



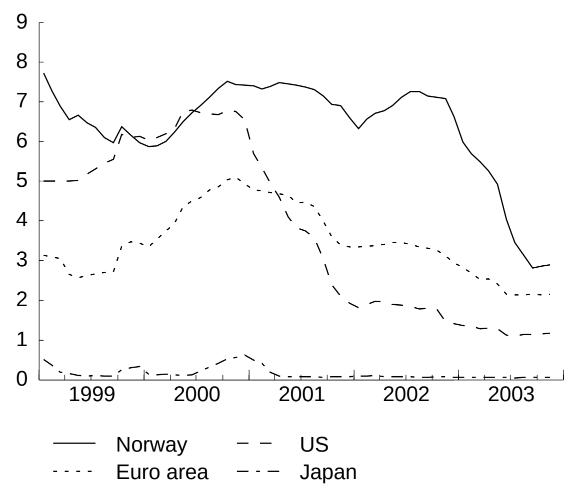
Sources: Average of projections from the NIESR in October 03, CF, the EC and the OECD in November 03.

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



Sources: Average of projections from the NIESR in October 03, CF, the EC and the OECD in November 03. NIESR estimates apply to the consumption deflator.

International interest rates
3-month Eurorate



Source: Norges Bank.

sector and reduced unemployment benefits, may increase uncertainty among households and limit consumption in the short term. Unlike the US, however, European consumers have tightened their belts through the downturn. Pent-up needs may therefore have arisen, which may provide an extra boost to consumption.

The Stability and Growth Pact has been under considerable pressure over the past year. In October, the German and French authorities announced that they would exceed the pact's budget deficit ceiling of 3 per cent of GDP for the third consecutive year in 2004. At a meeting on 25 November, a majority of the euro area's ministers of finance supported a suspension of the pact's sanction mechanism, which would have entailed sizeable fines for the two countries. Instead, a declaration was adopted in which Germany and France have been instructed to bring their budget deficits below the ceiling in 2005. However, this requirement may be waived if economic growth is lower than expected. The decision, which in practice means that the Stability and Growth Pact has been substantially diluted, was met with severe criticism from the EU Commission and several of the small countries. Germany and France, which combined account for about half of the euro economy, will thereby avoid a considerable tightening of fiscal policy, which might have jeopardized the fragile growth taking place in the euro area. The budget deficits, which also generate demand impulses to the rest of the euro area, have contributed to limiting the downturn.

In October, the year-on-year rise in prices was 2 per cent. This is identical to the upper limit for the European Central Bank's price stability objective. In Germany, which accounts for a third of the euro economy, inflation was a little more than 1 per cent. Several factors point to subdued inflation in the euro area in the period ahead despite the fact that economic growth appears to be moving up. The recovery is still sluggish, unemployment is high and there is excess capacity in the economy. The appreciation of the euro will also contribute to restraining inflation ahead.

The European Central Bank's key rate is now 2 per cent, unchanged since June. The Central Bank wants to see that an upturn is well under way before considering an increase in interest rates. The appreciation of the euro in itself represents a tightening of monetary policy. The recovery is at an early stage and there is a need for low interest rates for a considerable period ahead. The suspension of the Stability and Growth Pact's budget requirements may in isolation point to higher interest rates in the medium term. The key rate is expected to remain unchanged in the period to summer 2004. The three-month money market rate is projected to edge up from autumn 2004, but the increase in interest rates is expected to be moderate against the background of low inflation expectations.

Macroeconomic projections according to selected sources
Annual change in per cent

	GDP-growth						Consumer prices					
	1999	2000	2001	2002	2003	2004	1999	2000	2001	2002	2003	2004
USA												
NIESR	4.1	3.8	0.3	2.4	2.7	3.4	1.6	2.5	2.0	1.4	2.0	2.9
ConsF	4.1	3.8	0.3	2.4	2.9	4.2	2.2	3.4	2.8	1.6	2.3	1.7
EC	4.1	3.8	0.3	2.5	2.8	3.8	2.2	3.4	2.8	1.6	2.3	1.4
OECD	4.1	3.8	0.3	2.4	2.9	4.2	2.2	3.4	2.8	1.6	2.3	1.7
Japan												
NIESR	0.2	2.8	0.4	0.2	2.5	0.9	-0.7	-1.3	-1.5	-1.5	-0.9	-0.5
ConsF	0.2	2.8	0.4	0.2	2.4	1.3	-0.3	-0.7	-0.7	-0.9	-0.3	-0.4
EC	0.2	2.8	0.4	0.2	2.6	1.7	-0.3	-0.7	-0.7	-0.9	-0.3	-0.4
OECD	0.2	2.8	0.4	0.2	2.7	1.8	-0.3	-0.7	-0.7	-0.9	-0.2	-0.2
EMU												
NIESR	2.8	3.5	1.6	0.8	0.4	1.8	1.2	2.2	2.4	2.3	1.9	1.6
ConsF	2.8	3.5	1.6	0.9	0.5	1.7	1.1	2.2	2.4	2.3	2.0	1.6
EC	2.8	3.5	1.6	0.9	0.4	1.8	1.1	2.2	2.4	2.3	2.1	2.0
OECD	2.8	3.5	1.6	0.9	0.5	1.8	1.1	2.2	2.4	2.3	2.0	1.5
Trading partners												
NIESR	3.0	3.5	1.4	1.4	1.1	2.1	1.2	1.8	2.3	1.9	1.7	1.6
ConsF	3.1	3.5	1.4	1.4	1.2	2.2	1.3	2.2	2.5	2.0	2.0	1.7
EC	3.1	3.5	1.4	1.4	1.1	2.2	1.3	2.2	2.5	1.9	1.9	1.6
OECD	3.1	3.5	1.4	1.4	1.1	2.3	1.3	2.2	2.5	2.1	2.0	1.5

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

Interest rates are projected to fall again from the second quarter of 2006, in line with the expected slowdown in the euro area through 2006.

The upswing in the US and some Asian countries is the most important driving force behind the moderate turnaround in the euro area. The strong euro, however, is curbing growth. High unemployment is contributing to sluggish growth in household demand, and new fiscal stimulus may be limited even though the Stability and Growth Pact has been put on hold. However, confidence indicators show increased optimism in the business sector. Investment in production equipment has been low since 2001, and expectations of stronger growth may lead to higher investment. Moreover, unemployment is expected to edge down and higher household demand will contribute to underpinning growth ahead. Growth is projected to be higher in 2004 and 2005, but the upswing will be moderate. The projected slowdown in the US economy from the first half of 2005 will spread to the euro area where growth is expected to slow from the beginning of 2006.

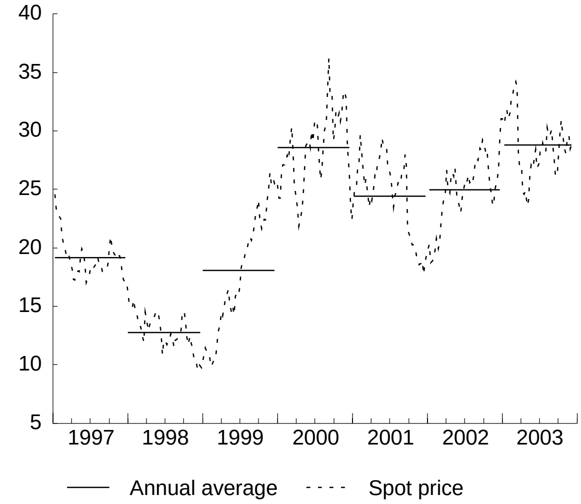
Asia
The Japanese economy has improved to a greater extent through 2003 than assumed earlier. GDP expanded by 0.6 per cent in the third quarter, primarily fuelled by investment and exports. Growth in household consumption was moderate, but public sector demand fell by 4.1 per cent annualized. Even though GDP growth was somewhat weaker than in the second quarter, the Japanese economy still grew at a faster pace than trend growth.

Export growth remains buoyant despite the considerable appreciation of the yen against the dollar. This is primarily due to higher demand from other Asian countries, particularly China. Exports to China area show rapid growth and China is in the process of taking over the role of the US as the most important source of export growth if we disregard cars. As the Chinese economy is modernized, the growth potential for demand for Japanese technological products will be enormous.

Industrial output moved on a sluggish trend through the summer, but has picked up somewhat through the autumn. Higher global demand provides some hope that industrial output will pick up further in the period ahead. Investment has risen sharply this year, but the Japanese business sector is reporting plans to reduce investment. Moreover, capacity utilization is not particularly high, and uncertainty surrounding developments in the medium term means that investment growth is expected to slow in the period ahead. Earnings in the business sector are already showing signs of decline. Economic growth is therefore expected to be lower in 2004 and 2005 than this year.

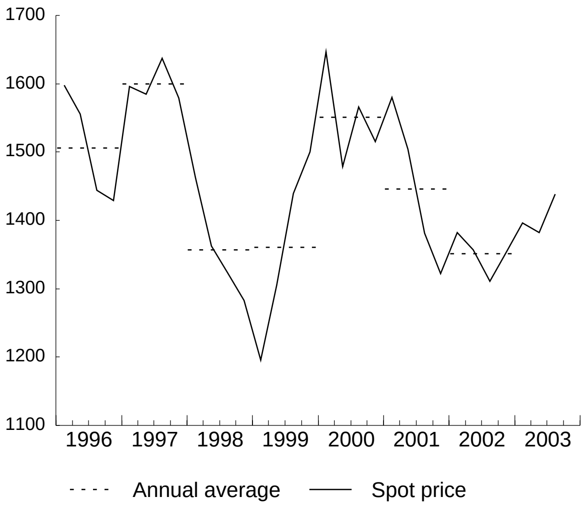
The greatest threat to developments in Japan is the yen. A sharp appreciation will undermine competitiveness and push down prices further. The yen has appreciated by 10 per cent against the US dollar since Au-

Spot price crude oil, Brent Blend
Dollar per barrel



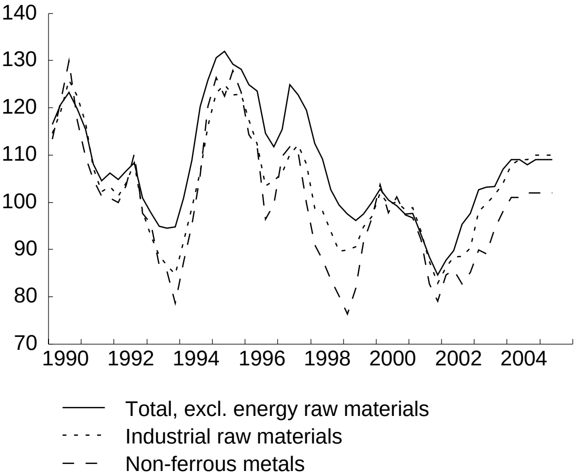
Source: Norges Bank.

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



Source: IMF.

Commodity prices on the world market 1990 - 2005
Dollar based indices. 2000 = 100



Sources: HWWA-Institut fur Wirtschaftsforschung and AIECE.

gust and 19 per cent since the «peak» at the beginning of 2002 despite repeated interventions of the Japanese central bank in the foreign exchange market. The Japanese authorities are also facing considerable political pressures from the US to refrain from further interventions.

China appears to be recording continued sharp growth. Growth picked up again in the third quarter, fuelled by exports, household demand and investment, following a somewhat weaker second quarter as a result of the SARS epidemic. GDP expanded by 9.1 per cent at an annual rate in the third quarter, against 9.9 and 6.7 per cent respectively in the first two quarters.

Inexpensive Chinese export goods are contributing to low inflation throughout the western world. The fact that the currency is pegged to the US dollar, which has depreciated considerably against most other currencies, has amplified this. Exports grew by about 30 per cent from October 2002 to October 2003. Growth is being underpinned by a nascent recovery in neighbouring countries and higher demand from the US. Chinese exports are no longer confined to clothing, footwear and toys. Information technology, such as computers and communication equipment, is the fastest growing segment, rising by around 45 per cent in October compared with the same month a year earlier. Textile exports rose by 20 per cent in the same period.

Turnover in retail trade rebounded in the third quarter following a somewhat weaker second quarter. Household demand for cars has risen sharply, and considerable investments are being made in the car industry despite substantial excess capacity on a global basis. The building boom in towns is resulting in strong demand growth for the steel and cement industry. Manufacturing industry as a whole has shown relatively stable growth through 2003, about 16 per cent at an annual rate, with the exception of a small decline in the second quarter.

There are several factors that may threaten strong growth. Chinese banks have a large volume of bad loans, which may jeopardize stability in financial markets. China has a large trade deficit with the US, and China's fixed exchange rate policy against the US dollar has provoked the US authorities for some time. The US has now decided to introduce quota restrictions for some textile goods. If the US were to introduce tariffs on a number of Chinese goods, this would have consequences for the Chinese economy. However, this is not considered to be very probable. Moreover, there is concern that the rate of investment, particularly in the car, cement and steel industries, may create excess capacity in manufacturing.

Developments in the oil market

The spot price of Brent Blend rose from about USD 24 per barrel at the end of April to about USD 31 in mid-October. The oil price has fallen somewhat since then and was USD 28-29 at the beginning of December. For the first 11 months of the year, the price has averaged USD 28.50 per barrel, against about USD 25 last year.

The most important reason for the high level of oil prices in recent months was the low level of stocks of both crude oil and finished products, particularly in the US. Many analysts pointed to the low stocks of petrol during the driving season in the US, and later there was concern surrounding the build-up of stocks of heating oil prior to the winter season. Some analysts also indicate that there is a risk premium as a result of the terrorist attacks in Saudi Arabia, Iraq and Turkey this autumn, which may have contributed to some concern about future supply security.

Iraq has managed to increase production to just below the level prevailing before the toppling of the former regime. Exports are now about 0.6 million b/d less than earlier. OPEC decided to reduce production by 0.9 million b/d as from November, but the cartel is still producing about 1 million b/d more than the stipulated quotas. Even though Iraq is not covered by OPEC's quota system, it appears that member countries take Iraq's production into account when discussing quota discipline. Moreover, the price of a basket of OPEC oil grades is now around the upper limit of the cartel's desired interval of between USD 22-28 per barrel, which corresponds to about USD 23-29 per barrel for Brent Blend.

The International Energy Agency (IEA) expects demand for oil to increase by 1 million b/d from 2003 to 2004. The increase is primarily expected to occur in North America, Asia and the Middle East. At the same time, the IEA expects production in non-OPEC countries to increase by 1.4 million b/d, particularly in the former Soviet Union and Africa. This means that the residual demand for OPEC oil will be somewhat lower next year, with the cartel losing market shares to other producers.

According to the IEA, stocks of crude oil and finished products in the OECD area are now rising. So far, winter has been fairly mild in the western hemisphere, and it appears that stocks of heating oil are being restored to acceptable levels before demand rises. If OPEC manages to reduce overproduction to about 75 per cent of the announced cuts, and if Iraq maintains production at the current level, stocks of crude oil could nevertheless rise somewhat in the fourth quarter of 2003 and first quarter of next year as a whole. This is a period when stocks are normally reduced by between 0.5 and 1 million b/d. Later in 2004, it would appear that OPEC must undertake new production cuts to prevent the oil price from falling below the lower range of the cartel's price interval. Continued confidence in OPEC's ability to act is resulting in expectations of an average oil price in the middle range of the interval in the period ahead. The oil price is therefore projected to fall to around USD 26 per barrel during the first half of 2004 and thereafter remain unchanged at this level through the projection period.