

Norwegian economy

Growth impetus from fiscal policy

In March 2001, the Government presented new guidelines for economic policy, which appear to have received broad political support. It introduced a guideline for the use of revenues from the Petroleum Fund and an explicit inflation target for monetary policy. According to the new rules, the structural, non-oil government budget deficit shall be equal to the expected real return on the Petroleum Fund at the beginning of the fiscal year. Previously, it could be said that fiscal policy was oriented so that the structural non-oil budget deficit should expand over time in step

with mainland GDP trend growth and hence not be influenced by changes in petroleum revenues/wealth. Fiscal policy shall also continue to contribute to stabilizing fluctuations in the economy, a factor that may result in deviations from the level implied by the long-term guideline.

The new guidelines for economic policy imply that the impetus from fiscal policy will be somewhat stronger in 2002 than assumed in our earlier analyses, a more expansionary stance due not least to high petroleum revenues in recent years. The Revised National Bud-

Macroeconomic indicators 1999-2001

Growth from previous period unless otherwise noted. Per cent

			Seasonally adjusted			
	1999	2000	00.2	00.3	00.4	01.1
Demand and output						
Consumption in household and non-profit organizations	2.2	2.4	0.0	-0.1	-0.5	2.0
General government consumption	3.3	1.4	0.1	0.5	0.5	0.1
Gross fixed investment	-8.2	-1.1	-8.0	-5.7	-0.7	1.9
- Mainland Norway	-2.6	1.4	0.4	-2.8	2.8	-1.9
- Petroleum activities ¹	-19.9	-17.1	-32.7	-1.8	-2.9	9.1
Final domestic demand from Mainland Norway ²	1.5	1.9	0.1	-0.5	0.3	0.8
Exports	2.8	2.7	-1.4	1.8	4.1	1.5
- Crude oil and natural gas	-0.1	6.4	-5.4	4.4	5.0	2.2
- Traditional goods	3.2	2.1	2.8	-1.9	1.2	5.0
Imports	-1.6	2.5	-1.8	-2.0	-1.5	0.9
- Traditional goods	-1.3	1.7	4.6	-1.2	-0.9	1.4
Gross domestic product	1.1	2.3	-0.9	0.8	0.1	0.2
- Mainland Norway	1.0	1.8	0.4	0.1	-0.3	0.5
Labour market³						
Man-hours worked	0.4	-0.8	0.7	-1.2	-0.9	1.3
Employed persons	0.6	0.5	0.4	-0.3	0.1	0.3
Labour force	0.5	0.8	0.0	-0.2	0.3	0.2
Unemployment rate, level ⁴	3.2	3.4	3.2	3.4	3.6	3.4
Prices						
Consumer price index ⁵	2.3	3.1	2.9	3.5	3.1	3.6
Export prices, traditional goods	0.0	13.8	4.0	1.5	2.3	-1.9
Import prices, traditional goods	-2.3	6.0	0.6	1.4	1.1	3.9
Balance of payment						
Current balance, bill. NOK	47.3	203.6	40.3	56.9	66.3	60.5
Memorandum items (Unadjusted, level)						
Money market rate (3 month NIBOR)	6.4	6.6	6.4	7.0	7.4	7.3
Average borrowing rate ⁶	8.4	8.2	7.7	8.3	8.9	9.1
Crude oil price NOK ⁷	141.2	251.7	236.0	272.6	277.8	229.4
Importweighted krone exchange rate, 44 countries, 1997=100	101.1	103.6	104.9	104.0	103.6	102.2
NOK per ECU/euro	8.31	8.11	8.20	8.10	8.04	8.20

¹ Figures for petroleum activities now covers the sectors oil and gas extraction proper, transport via pipelines and service activities incidental to oil and gas extraction.

² Consumption in households and non-profit organizations + general government consumption + gross fixed capital formation in Mainland Norway.

³ Figures for 1999 and 2000 are from national accounts. The quarterly figures are from Statistics Norway's Labour force survey (LFS), since the new quarterly national accounts series for employment are too short for seasonal adjustment.

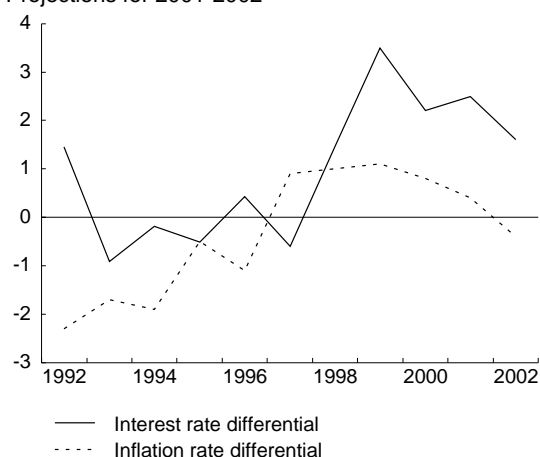
⁴ According to Statistics Norway's labour force survey (LFS).

⁵ Percentage change from the same period the previous year.

⁶ Household's borrowing rate in private financial institutions.

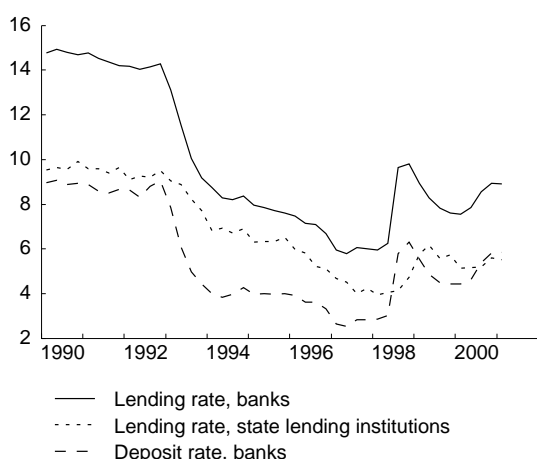
⁷ Average spot price, Brent Blend.

Interest rate and inflation differential between NOK, and the ECU/euro. 1992-2002
Projections for 2001-2002



Sources: Norges Bank and Statistics Norway.

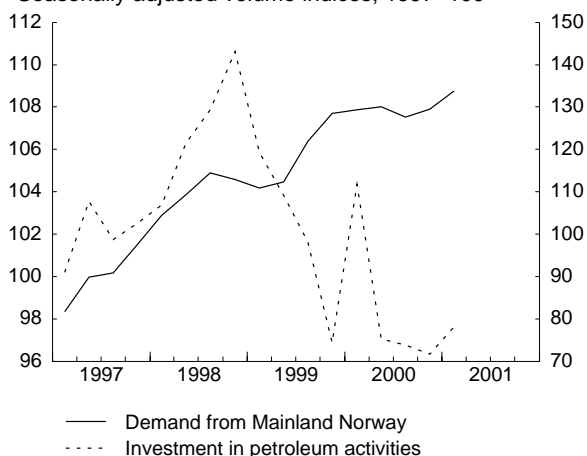
Lending rate and deposit rate
Per cent



Source: Norges Bank.

Demand from Mainland Norway and investment in petroleum activities. 1997 - 2001

Seasonally adjusted volume indices, 1997=100



Source: Statistics Norway.

get (RNB) estimates the structural non-oil budget deficit at NOK 16.8 billion in 2000 and NOK 20.4 billion in 2001. The expected real return on the Petroleum Fund is estimated in the RNB at NOK 25.2 billion at the end of 2001 and NOK 34.0 billion the following year. If oil prices remain at a high level and the Petroleum Fund increases sharply, the stimulus from fiscal policy might increase further in 2003.

In the forecasts, the orientation of fiscal policy for 2001 is in line with the RNB, which may be characterized in cyclical terms as fairly neutral or mildly expansionary. In keeping with the new guideline for the use of petroleum revenues, we have thereafter allowed fiscal policy in 2002 and 2003 to assume a somewhat more expansionary stance, with an approximately equal distribution on higher expenditure and reduced revenues. General government consumption and investment as a whole are assumed to increase in volume by 2.4 per cent in 2002, nearly per cent more than our projection for mainland GDP trend growth. Moreover, the continuation of the revision of the VAT system with effect from 1 July this year, with a halving of VAT on food and introduction of VAT on a number of services, combined with a reduction in fuel taxes, implies that this year's indirect tax programme will have an expansionary effect again next year; the tax and excise duty programme is otherwise adjusted for inflation. All in all, this implies an indirect tax relief for households in the order of NOK 3-4 billion next year. In 2003, general government consumption and investment as a whole increases in volume by 2.9 per cent, with excise duties being adjusted for inflation, while direct taxes are reduced by the same magnitude as the indirect tax relief in 2002.

Money market rates and exchange rates

Our assumptions concerning foreign and Norwegian money market rates as well as exchange rates are based on the estimates in Consensus Forecasts from May. For exchange rates, the estimates imply a slight depreciation of the krone against the euro, while the euro appreciates substantially more against the dollar over the next year. This means that the Norwegian krone appreciates against the US dollar. However, since the publication of these estimates exchange rates have moved in the opposite direction of that implied by these forecasts. All in all, the estimates imply that the import-weighted krone exchange rate will appreciate somewhat in 2001 and marginally in 2002 and then remain approximately unchanged in 2003.

The estimates for money market rates now indicate that no decline in Norwegian rates can be expected this year as many observers had assumed earlier. A number of market participants consider an increase in interest rates in Norway to be more probable in the short term. However, we have assumed unchanged interest rates until the end of the year. We have thereafter assumed a slight decline in nominal interest

rates, although the interest rate differential against the euro will remain substantial in both 2002 and 2003 despite the moderate inflation differential. The estimates for interest rates and exchange rates presented here, and which are thus reasonably in line with the Consensus estimates, do not deviate to any extent from what we would have assumed if we had applied the interest rate equation that is modelled for Norwegian money market rates for the period when the policy objective was a fixed exchange rate against the euro. The calculations also show that these assumptions result in an inflation rate in 2003 that is within the target range for Norges Bank, and hence compatible with the objective of monetary policy.

Nevertheless modest impetus from petroleum investment?

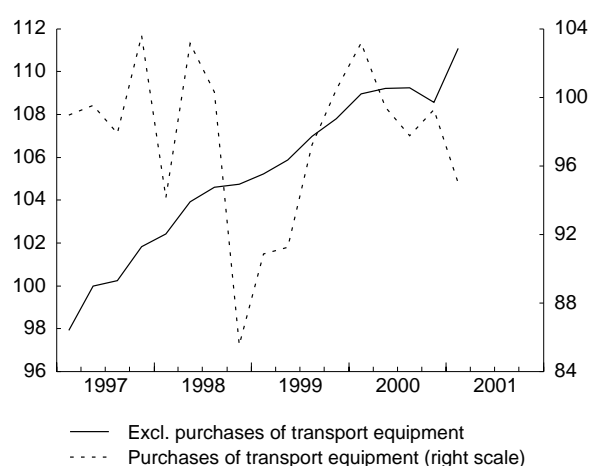
Seasonally adjusted figures from the quarterly national accounts show that the investment peak was reached in the fourth quarter of 1998. In the wake of low and falling oil prices through 1998, petroleum investment fell sharply through 1999, but also to some extent through 2000. Seasonally adjusted quarterly national accounts figures from the first quarter of 2001 indicate that this contraction, at least temporarily, has come to a halt. The increase in oil prices during the previous two years and the prospect of continued high prices are expected to contribute to a slight pick-up in petroleum investment through the remainder of 2001 and into 2002. Due to the sharp decline in petroleum investment last year, petroleum investment on an annual basis may nevertheless fall slightly this year. It is assumed that in 2002 petroleum investment will expand by a good 5 per cent at an annual rate followed by zero growth in 2003.

In recent years there has been a clear tendency to reduce the development of new fields, but to increase investment in fields that are already on stream. On the basis of the oil companies' reported estimates for Statistics Norway's investment statistics, this tendency is expected to continue in the period ahead. Investment in onshore installations and pipeline transport was at a historically low level in 2000 and is assumed to remain subdued in 2001 and next year. It appears that exploration investment will remain at last year's level in the period ahead.

Rising consumption growth and high saving

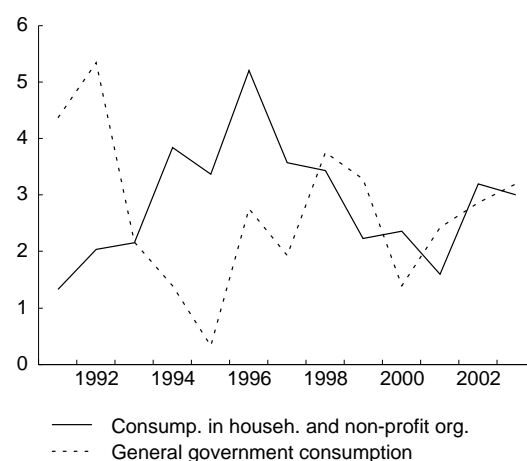
New figures from income accounts in the national accounts for 2000 show a considerable upward adjustment of household disposable income and saving compared with the figures published in *Economic Survey 1/2001*. The household saving ratio in 2000 was above 7 1/2 per cent, which is the highest saving ratio observed in many decades. Several factors have contributed to the high saving ratio, with the high real after-tax interest rate representing an important element. In the next few years, we assume that the real interest rate (also after tax since we do not assume

Consumption in households, 1997 - 2001
Seasonally adjusted volume indices, 1997=100



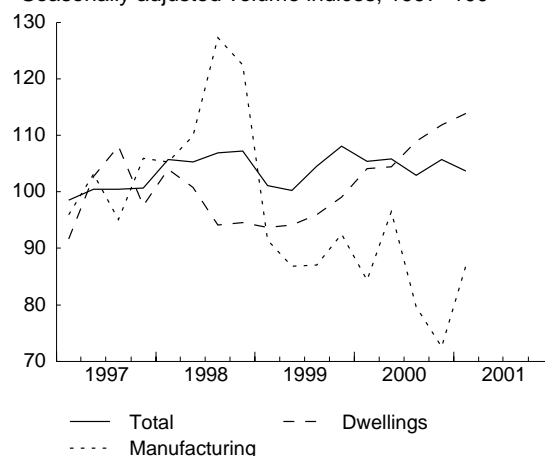
Source: Statistics Norway.

Consumption
Percentage growth



Source: Statistics Norway

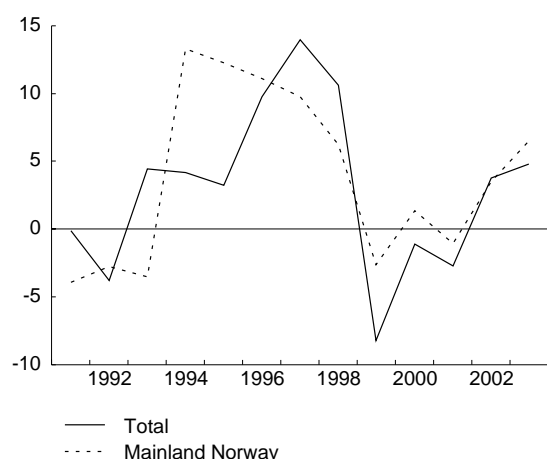
Gross fixed capital formation, Mainland Norway, 1997 - 2001
Seasonally adjusted volume indices, 1997=100



Source: Statistics Norway.

Gross fixed capital formation

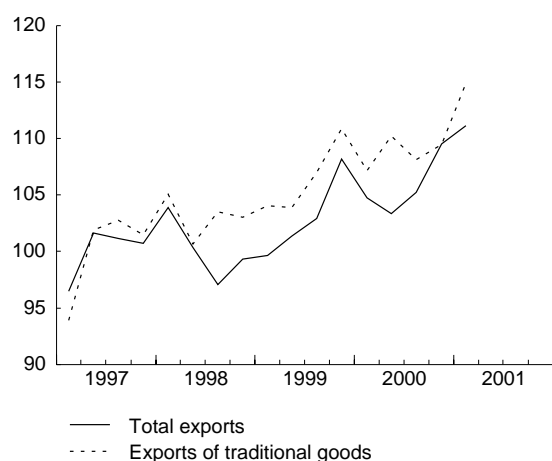
Percentage growth



Source: Statistics Norway

Exports. 1997 - 2001

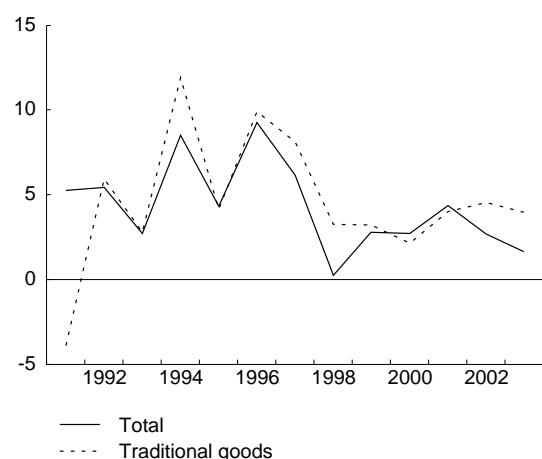
Seasonally adjusted volume indices, 1997=100



Source: Statistics Norway.

Exports

Percentage growth



Source: Statistics Norway

that the tax rate on ordinary income will change) is approximately constant. It may increase slightly next year as a result of a projected lower inflation and a slight decline in nominal interest rates, but all in all, according to our forecasts, there will be no new impulses from interest rate policy to any particular extent. Slightly higher interest rates in the period ahead than assumed earlier are expected to contribute to this and are due to our assumption that attempts will be made to counter the increased fiscal stimulus through higher interest rates. In isolation, this will contribute to maintaining the saving ratio at a high level.

In 2001, preliminary first-quarter figures show fairly high growth in household consumption. Part of the growth, however, is influenced by high electricity consumption due to climatic conditions and therefore in isolation do not indicate an increase in consumption growth. Household disposable income is increasing relatively moderately this year due to high consumer price inflation and an increase in vacation days. As a result, our projection for growth in real wages per normal man-year is now 1.3 per cent, with the number of normal man-years increasing only marginally. The downward adjustment compared with earlier is primarily due to the upward revision of our projection for total consumer price inflation due to higher energy prices than assumed earlier. The estimate for growth in household consumption is slightly weaker than income growth and thus entails a slightly higher saving ratio than in 2000.

The revision of economic policy, with somewhat greater fiscal policy stimulus than assumed earlier, will contribute to stronger growth in household income and consumption than in earlier calculations. In 2002, growth in the mainland economy will be slightly higher than estimated earlier. This will result in higher employment and wage growth and hence higher disposable income as a whole even though nominal interest rates will also be higher than assumed earlier. Whereas in *Economic Survey 2000* it was estimated that unemployment might edge up in the years ahead, it is now assumed that unemployment will fall marginally compared with the level in 2000. This will boost income growth and hence household consumption as well. Consumption growth is therefore estimated at about 3 per cent in 2002 and 2003.

Housing investment showed appreciable growth through 2000 and growth has continued into 2001 in spite of high interest rates. The reason is that prices in the resale market have continued to rise so that the price of building new dwellings has fallen relative to the price of buying an existing dwelling. Income growth and the likelihood that it will continue to be easy to find employment will increase households' willingness to debt-finance house purchases and

residential construction. It is therefore assumed that housing investment will continue to expand in the years ahead in spite of high interest rates. House prices are also expected to rise in real terms in the period ahead, but at a noticeably slower pace than was the case in 2000.

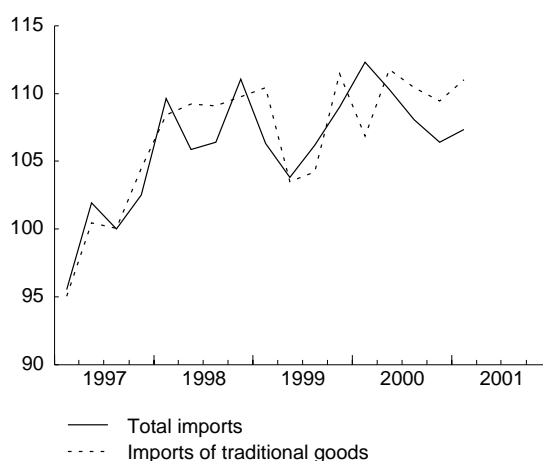
Manufacturing investment is rising, other enterprises following

Mainland business investment contracted through the autumn of 2000 and up to the first quarter of this year, and it is assumed that investment will continue to fall during the remainder of 2001 before picking up in 2002. However, manufacturing investment – which has been declining since 1998 – was reversed as early as the first quarter of 2001, and Statistics Norway's investment survey indicates that this expansion will continue through the year and increase further next year, particularly in commodity-oriented industries. Investment in service industries, which has shown signs of levelling off at a historically high level the past year, is estimated to exhibit a sluggish trend through the remainder of 2001 and then expand the next two years, albeit at a noticeably slower pace than manufacturing. Continued uncertainty as to if and when the investment tax will be removed next year in itself points to a postponement of investment from 2001 to 2002; in our calculations, however, we have not assumed that the tax is actually eliminated.

Mixed picture for enterprises

Stronger cost inflation than among our competitors has contributed to considerably slower growth in traditional merchandise exports than growth in export markets in recent years. Admittedly, exports picked up markedly in the first quarter of 2001, but this primarily reflected a sharp rise for metals and pulp and paper products. According to the quarterly national accounts, the counterpart to this was in particular a decline in the domestic use of these products including inventories; current production was not affected to any significant extent. Moreover, commodity-oriented manufacturing is the segment of industries exposed to international competition that can best hold its own in the cost-squeezed situation now facing these industries as they are not very labour-intensive. In the years ahead, this pressure is expected to continue to result in markedly slower growth in traditional merchandise exports than international market growth. An equivalent loss of market shares will take place to an even greater extent on the domestic market. Admittedly, traditional merchandise imports have expanded only marginally in recent years, but this is primarily due to the pronounced slowdown in demand – including the effect of the decline in petroleum investment – which all in all has been reflected in a decline in manufacturing output of about 3 per cent per year over the last two years. Norwegian manufacturing enterprises are expected to continue to lose market shares in coming years, with imports

Imports. 1997 - 2001
Seasonally adjusted volume indices, 1997=100



Source: Statistics Norway.

growing at a substantially higher rate than domestic market growth.

Despite growth in both export and domestic markets, the varying sensitivity to stronger cost inflation in Norway than in other countries will result in highly varying developments for the different sectors of the economy.

Following a contraction in recent years, the accounts figures for the fourth quarter of 2000 and first quarter of this year indicate a turnaround in manufacturing output. However, the calculations indicate that growth in the period ahead will be modest, with an uneven distribution among the various sectors; it is estimated that some commodity-oriented manufacturing sectors will record the strongest growth. On the other hand, non-manufacturing industries, which are generally less exposed to competition from foreign enterprises, will in general show appreciable growth. In these industries, growth also remained relatively high during the cyclical slowdown of recent years. The service sector, which recorded annual output growth of 2 - 3 per cent the last two years, is expected to continue to expand at the same pace in 2001 and the next two years, whereas growth in the construction sector is estimated to be above this interval. It may appear surprising that growth in service production will not be even stronger in the period ahead in view of the general upswing in domestic demand that has been assumed, but this can be ascribed to the effects of a lower VAT on food and the introduction of VAT on services. Both factors contribute to shifting demand from services to goods.

Total production – stronger than it appears

Mainland GDP growth, which came to 1.0 per cent in 1999 and 1.8 per cent in 2000, is estimated at 1.0 per cent in 2001, 2.1 per cent in 2002 and 2.5 per cent in 2003. However, these figures are heavily influenced

Main economic indicators 2000-2002. Accounts and forecasts

Percentage change from previous year unless otherwise noted

		Forecasts							
		2001			2002			2003	
		SSB	MoF	NB	SSB	MoF	NB	SSB	NB
Accounts 2000									
Demand and output									
Consumption in households and non-profit organizations	2.4	1.6	1.6	1 1/2	3.2	2.6	2 1/2	3.0	3
General government consumption	1.4	2.4	2.3	3	2.9	2.1	2	3.2	2
Gross fixed investment	-1.1	-2.7	0.7	-3/4	3.8	1.3	3/4	4.8	1/4
Petroleum activities	-17.1	-1.8	-1.2	0	5.4	0.0	-2	0.0	-2
Mainland Norway	1.4	-1.1	0.3	-1	3.5	0.5	1 1/2	6.5	1
Firms	1.8	-3.6	-0.8	-1 1/4	2.7	0.2	1 1/2		1 1/4
Housing	12.2	8.7	6.8	4	7.5	0.9	4 1/2	11.3	2 1/2
General government	-7.9	-1.6	-2.2	-4 1/2	2.1	1.1	-1 1/2	3.2	-1 1/2
Demand from Mainland Norway ¹	1.9	1.3	1.5	1 1/4	3.2	2.2	2 1/4	3.7	2 1/2
Stockbuilding ²	0.8	-0.5	0.1	..	0.0	0.0	..	0.0	..
Exports	2.7	4.3	4.9	4 1/4	2.7	5.1	3	1.6	2 1/4
Crude oil and natural gas	6.4	5.4	8.2	6	0.3	6.9	2	-0.8	0
Traditional goods	2.1	4.0	3.2	3 1/4	4.5	4.5	3 3/4	4.0	3 3/4
Imports	2.5	1.7	3.1	2 1/4	6.3	3.7	4	5.5	3 3/4
Traditional goods	1.7	3.8	3.5	2 3/4	5.3	4.2	4	6.1	3 3/4
Gross domestic product	2.3	1.4	2.4	2	1.9	2.8	1 3/4	1.9	1 1/2
Mainland Norway	1.8	1.0	1.5	1 1/4	2.1	1.8	1 3/4	2.5	2
Labour market									
Employed persons	0.5	0.6	0.5	3/4	0.5	0.7	1/2	0.6	1/2
Unemployment rate (level)	3.4	3.3	3.3	3 1/4	3.3	3.2	3 1/4	3.3	3 1/4
Prices and wages									
Wages per standard man-year	4.3	4.6	4 1/2	4 1/4	4.2	..	4 3/4	4.1	4 1/2
Consumer price index	3.1	3.3	3	3	1.8	2 1/4	2 1/2	2.2	2 1/4
Export prices, traditional goods	13.8	2.4	0.2	2	-2.0	0.0	-1/4	0.4	0
Import prices, traditional goods	6.0	3.6	1.8	1 3/4	-0.9	1.4	0	-0.1	1
Real prices, dwellings	13.7	5.5	..	4	6.6	..	4	5.7	4
Balance of payment									
Current balance (bill. NOK)	203.6	214.0	221.8	195	202.3	193.8	155	184.3	120
Current balance (per cent of GDP)	14.3	14.4	15.0	13	13.2	12.8	10	11.6	8
Memorandum items:									
Household savings ratio (level)	7.7	8.8	6.3	7 1/4	9.6	6.4	7 1/2	10.2	7 1/4
Money market rate (level) ³	6.6	7.3	7.3	7.2	6.6	7.1	6.3	6.4	5.9
Average borrowing rate (level) ⁴	8.2	9.2	..	..	8.8	..	..	8.5	..
Crude oil price NOK (level) ⁵	252.0	236.0	225	230	227.0	194	200	221.0	..
Export market indicator	10.3	7.5	..	..	5.8	..	..	6.2	..
Importweighted krone exchange rate (44 countries) ^{3, 6}	2.5	-2.0	..	-1.0	-0.4	..	0.0	-0.1	0.0

¹ Consumption in household and non-profit organizations + general government consumption+ gross fixed capital formation in Mainland Norway.² Change in stockbuilding. Per cent of GDP.³ The NB figures are technical assumptions. The interest rate forecast reflects the implicit expectations of the market participants.⁴ Households' borrowing rate in private financial institutions.⁵ Average spot price Brent Blend.⁶ Increasing index implies depreciation.

Sources: Statistics Norway (SN), Ministry of Finance, Revidert nasjonalbudsjettet 2001 (MoF), Norges Bank, Inflasjonsrapport 1/2001 (NB).

by a number of "random" factors. First, the unusual precipitation situation last year contributed to exceptionally high electricity production, a phenomenon we assume that will not recur. Excluding electricity production, mainland GDP expanded by 1.4 per cent in 2000, and the corresponding estimate for 2001 is 1.6 per cent, i.e. a slight increase. The second special factor is the effects of changes in the number of working days from year to year, either as a result of calendar effects and/or as a result of the phasing in of two new

vacation days in both 2001 and 2002. The maximum effect of this on the number of working days can be estimated at nearly 1 per cent for 2000, nearly 1 1/2 per cent for 2002, nearly 1 per cent for 2002 and nearly 1/2 per cent for 2003. Not all employees and production enterprises will be affected by these changes in the number of working days, but they probably contribute to keep GDP growth down in each of these years.

Productivity growth is higher

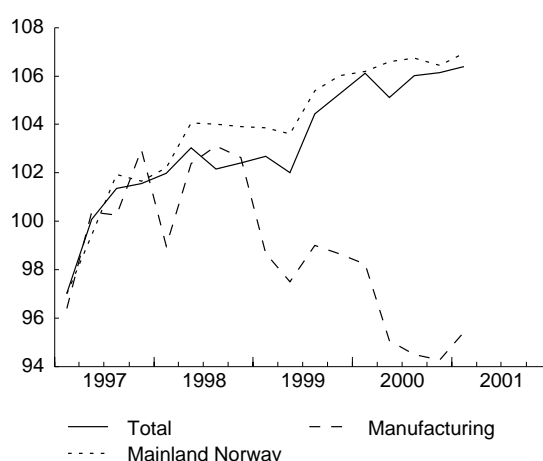
Through the last half of the 1990s, productivity growth in the private sector of mainland Norway fell after having remained at a very high level in the first part of the decade. In 2000, productivity growth again increased markedly and was a good 3 per cent. Part of this growth, however, reflects temporary conditions associated with high electricity production. Preliminary figures also indicate robust growth in labour productivity again this year, despite a decline in electricity production. Our estimates imply that productivity growth will be about 2.5 per cent in the years ahead, which is approximately the same as in 2000 when adjustments are made for random factors. These developments reflect in part normal growth in total factor productivity, the use of other factors of production to replace the use of labour as well as normal cyclical conditions. A separate figure shows growth in labour productivity in the private sector of mainland Norway along with a curve for the output gap measured as the deviation of output from its trend value. The figure shows that when the economy has entered a period of strong expansion (1985-1987 and 1996-1999), productivity growth falls and is particularly low towards the end of this period. Depending in part on how steep the contraction is, productivity growth in the actual cyclical downturn is fairly high. Declining productivity growth in the period 1996-1999 was therefore an entirely normal phenomenon. If anything, productivity growth in 2000 seems to have been unusually high taking into account that output growth was lower than trend growth, with the Norwegian economy close to trend at the beginning of 2001. Given that the economy in the period ahead will not expand at a rate that is very different from trend growth, it is likely that labour productivity will also rise at a rate close to its trend value, which is about 2.5 per cent annually.

Stable unemployment

After passing a trough at the beginning of 1999, unemployment, according to the Labour Force Survey, has risen slightly. However, part of the increase in the period to the beginning of 2000 reflects random factors. In the following quarters, the unemployment rate was approximately constant, but the most recent figures may point to a slight decline again in unemployment. This also applies to seasonally adjusted figures for registered unemployment according to the labour market authorities. Unemployment is therefore estimated to edge down in 2001, whereas we previously projected a slight increase. It is particularly the estimates for the supply of labour that explain the change in projected unemployment.

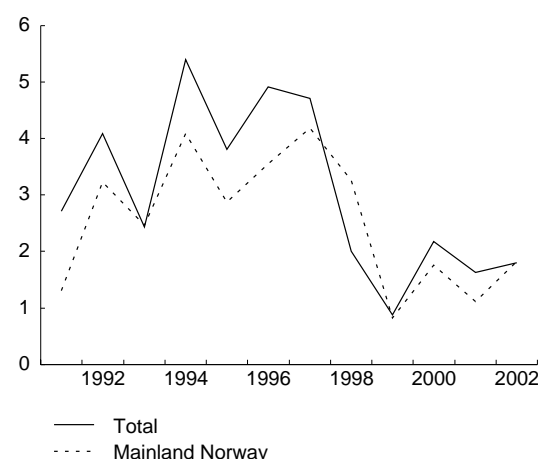
For 2002, our estimates for both growth in the economy and employment growth have been revised upwards to some extent. The growth estimates are now close to mainland GDP trend growth. Admittedly, growth in labour productivity is also approximately at

Gross domestic product. 1997 - 2001
Seasonally adjusted volume indices, 1997=100



Source: Statistics Norway.

Gross domestic product
Percentage growth



Source: Statistics Norway

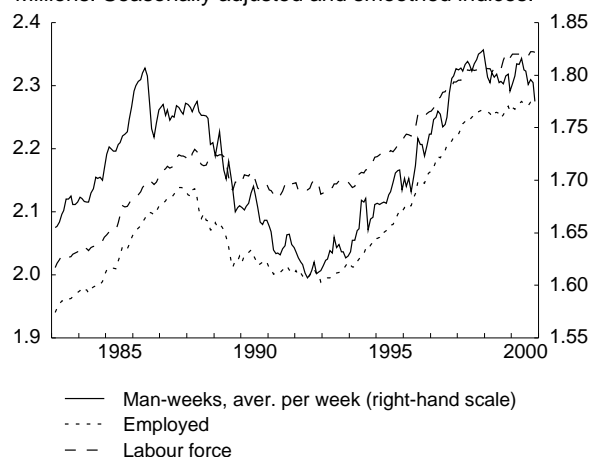
Productivity and Output Gap
Per cent



Source: Statistics Norway.

Labour force, employment and number of man-weeks. 1983-2000

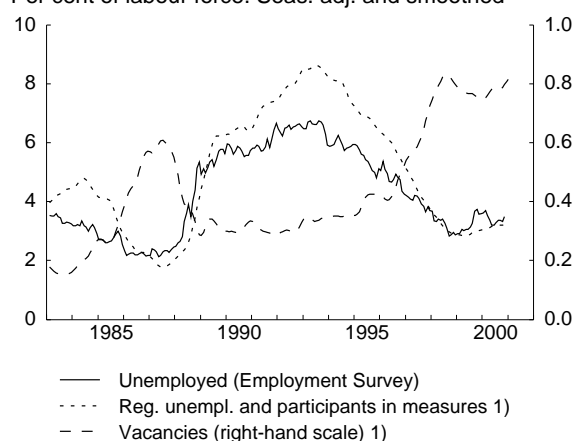
Millions. Seasonally adjusted and smoothed indices.



Source: Statistics Norway.

Unemployed and number of vacancies, monthly figures. 1983-2001

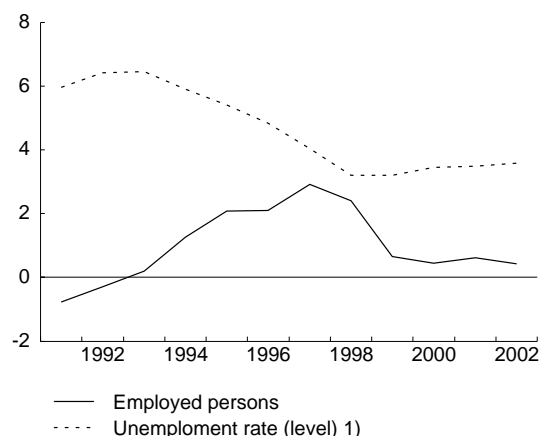
Per cent of labour force. Seas. adj. and smoothed



1) Backwards adjusted for breaks in the series from January 1999.
Sources: The Directorate of Labour and Statistics Norway.

Labour market

Percentage change



1) Adj. for stat. rev. from 1996.
Source: Statistics Norway

its trend level, a factor which curbs employment growth. However, growth in the labour supply is estimated to be relatively moderate. Demographic conditions are an important factor underlying these developments. This means that unemployment will continue to remain at a low level in 2002. The same factors will also apply in 2003 at approximately the same magnitude as in 2002.

With such low levels of unemployment as implied by these forecasts, positive demand shocks or policy changes that reduce the supply of labour will normally contribute to a substantial increase in wage growth. For example, a reduction in unemployment from 3.5 to 3.0 per cent will push up the level of real wages by 2.3 per cent in the course of a few years. If unemployment were to be reduced further to 2.5 per cent from 3.0 per cent, real wages would increase by a further 2.7 per cent. With unchanged import prices, nominal wage changes would be approximately doubled.

Sizeable variation in consumer price inflation but stable wage growth

After the year-on-year rise in the consumer price index (CPI) was reduced to 1.9 per cent in August 1999, the rate of inflation has moved on a clear upward trend. The most recent measurement as of 15 May 2001 showed that price inflation reached 4.3 per cent, the highest rate of increase in nearly 10 years. The increase in inflation has largely been fuelled by higher energy prices, but increases in excise duties, higher interest rates (through higher house rents) and high wage growth have also contributed. The usual seasonal decline in electricity prices through the spring months has so far this year not materialized and is not likely to occur in the period ahead. In May, electricity prices were 36 per cent above the level in May last year. In May, the CPI excluding energy goods was 3.1 per cent higher than one year earlier; the increase in excise duties is estimated to have contributed about 0.6 percentage point to this rise.

According to figures from the quarterly national accounts, import prices rose substantially for a number of consumption-related groups. In spite of this, the rise in consumer prices for imported goods has been subdued; in recent months, the rate of increase for these goods has been further reduced, which may partly be due to a stronger krone. A further appreciation of the krone as well as continued low inflationary impulses from trading partners will contribute to a falling trend in import prices, and hence to a slower rise in Norwegian prices in the period ahead.

It is assumed that the year-on-year rise in the CPI will be reduced as early as next month. Petrol prices showed a steep rise from May to June last year – which has probably not been the case this year – and there are many indications that the pronounced rise

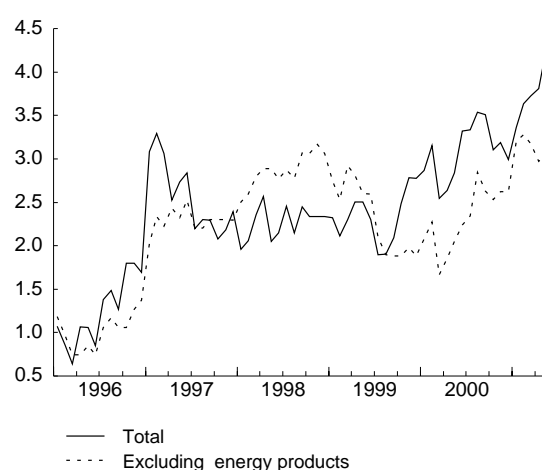
in food prices in May will be reversed in June. The rate of consumer price inflation is expected to show far greater changes from June to July when the effect of a halving of VAT on food, a lower fuel tax and the introduction of VAT on some services as a whole are expected to reduce the CPI by about 1 percentage point. The year-on-year rise in the CPI may be less than 2 per cent towards the end of the year. On an annual basis, it is estimated that the consumer price index will show a rise of 3.3 percentage points this year.

At the beginning of 2002, it is assumed that the inflation rate will be reduced further as the direct effect of the increase in the general VAT rate from 1 January this year will then have been exhausted, and we assume that VAT on food will remain low and that there will be no real changes in excise duties. A projected normal seasonal decline in electricity prices through the spring months of next year is expected to contribute to a further reduction in price inflation. In our forecast, the rate of increase is reduced to 1.0-1.5 percentage points in the second quarter of 2002 compared with the same period one year earlier. In the second half of the year, all the direct effects of excise duty changes will have been exhausted and the inflation rate will then increase markedly and again be more than 2 per cent. In our calculations, both the indirect tax relief and developments in energy prices contribute to reducing the annual rate of increase in the CPI to 1.8 percentage points. It is likely that the rise in the CPI may be around 2-2.5 per cent in 2003 and that changes in energy prices may again contribute to pushing down price inflation that year as well.

Recent developments in energy prices, and particularly electricity prices, illustrate how difficult it is to draw up inflation forecasts. The upward adjustment of our inflation projection for 2001 from 2.5 per cent in February to 3.3 per cent in June may virtually in its entirety be ascribed to the erroneous assessment of changes in electricity prices. However, there are also a number of other uncertain factors, including Norges Bank's changes in interest rates: if interest rates are increased this year on the grounds that inflation in the future will otherwise be too high and if this increase in interest rates does not result in an appreciation of the krone, this may result in higher inflation one or two years ahead, partly because house rents will increase. It takes time before the contractionary effect of higher interest rates translates into a lower rise in the CPI, according to our calculations.

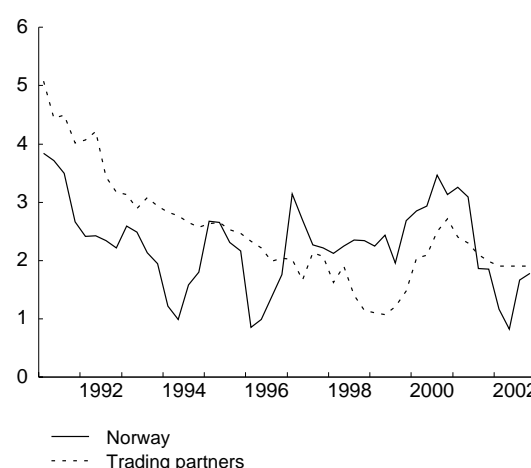
According to the national accounts, wages per normal man-year rose by 4.3 per cent last year. The wage carry-over into 2000 for all groups combined was estimated at 1.3 per cent by the Technical Reporting Committee for Income Settlements. In this year's first report from the Committee, the carry-over into 2001 was estimated at about 2 per cent. In isolation, the

The consumer price index
Percentage change from the same month the previous year



Source: Statistics Norway .

The consumer price index
Percentage change from the same quarter the previous year



Source: Statistics Norway and Norges Bank.

higher carry-over points to higher wage growth in 2001 than in 2000. However, the fact that this year's wage increases for most groups were agreed last year and that these increases were lower than in 2000 points to the opposite. High consumer price inflation and continued pressures in the labour market may, however, contribute to high wage drift. It is estimated that wage growth per normal man-year at an annual rate will be slightly higher this year than in 2000. We nevertheless assume that the wage carry-over into 2002 will be lower than in 2001, which in conjunction with far lower price inflation will contribute to lower wage growth even though a main settlement will take place that year. According to our calculations, wage growth will be at approximately the same level as the previous year. The increase in vacation days in 2001 and 2002 combined with one less working day this year than in the previous year implies

that wage growth per hour will be noticeably higher than per normal man-year in these years.

Compared with our previous report, the estimates for wage growth in both 2001 and 2002 have been revised up. This can largely be ascribed to the prospect of somewhat increased pressures in the labour market and the higher rate of price inflation we have witnessed and will record compared with the estimates in the February report.

Large current account surpluses

In the first quarter of 2001, Norway recorded a current account surplus of a good NOK 60 billion, compared with NOK 40 billion in the same period last year. As a result of valuation changes in foreign assets and liabilities, however, Norway's net assets only increased by a good half of the current account surplus and amounted to NOK 360 billion at the end of the quarter. The estimates for oil prices along with high exports of oil and gas will contribute to a current account surplus of NOK 214 billion for 2001 as a whole, which is even slightly higher than the record from 2000. Even though import prices are expected to rise slightly more in 2001 than export prices as a whole, the difference is not substantial. This means that the record terms-of-trade gain recorded by Norway in 2000 will largely be maintained in 2001 and continue to be the case over the next two years. Admittedly, oil prices are expected to edge down measured in krone terms because the Norwegian krone will appreciate slightly against the dollar, but this will also contribute to a fall in import prices in the period ahead.

Growth in domestic demand will contribute to stronger growth in imports in the period ahead, while the loss of market shares will contribute to moderate growth in traditional exports. Growth in total oil and gas exports is assumed to show little change over the next two years. Oil exports are projected to fall marginally, while gas exports will increase. All in all, the trade surplus, measured at current prices, is therefore expected to fall by about NOK 20 billion each year after 2001, when the estimate is a good NOK 214 billion. The current account surplus is projected at a good NOK 184 billion in 2003. Norway's net foreign assets are estimated at about NOK 900 billion at the end of 2003 when the effects of possible valuation changes are disregarded.