

# Economic trends

The global economic picture has changed in the course of summer. The cyclical downturn in the US has spread from the housing market to the credit market, and heightened uncertainty has spread to international financial markets. While most observers recently expected that developments in the world economy would be more balanced in 2008 – the OECD Economic Outlook in June is typical in this respect – there are now a growing numbers that fear a turn for the worse in the economic situation. Interest rate expectations in Europe have thus been lowered in recent weeks. Our forecasts for the Norwegian economy have over a longer period been based on the assumption of weaker global developments than consensus forecasts. This view has been based on the expectation that the weaker developments we have observed in the US will gradually have a dampening impact on growth in Europe. Growth in Asia remains robust. We maintain our previous assumption of a moderate cyclical downturn ahead. This will normally lead to a fall in prices for typical Norwegian exports goods from today's very high levels, but the fall in export prices is not expected to be as pronounced as that observed in many previous downturns.

Slower growth in the world economy will contribute to curbing growth in the Norwegian economy. This will help stabilize developments in a period when capacity utilisation in the mainland economy is very high. After several years of strong economic growth, the rate of growth of the mainland economy accelerated further in the first six months of 2007 and for 2007 as a whole growth may exceed 5 per cent, a rate that has not been witnessed since 1997. Growth is strong for almost all demand components and most main industries are growing with the exception of petroleum production which is still declining. Unemployment has declined to a level not seen since 1986, and the fall has taken place in spite of high inward labour migration. Over a longer time horizon, it is also interesting to note an increase in labour force participation among older workers. Even if there is still potential for an increase in the labour supply, there is reason to believe that growth will moderate to a considerable extent over the next few years. Against this backdrop, it is reasonable to assume that the Norwegian economy is now nearing a cyclical peak. Monetary policy tightening through increased interest rates and a stronger exchange rate also point to weaker growth ahead.

High profitability in the business sector and a markedly tighter labour market have led to higher wage growth. Real wage growth has been very high over several years and remains high. After a long cyclical expansion it is normal for productivity growth to slacken in relation to the pace prevailing at the beginning of the upturn. Combined with high wage growth, this is likely to result in higher domestic cost inflation, which will contribute to a higher rate of increase in prices, but from a very low level. A strong krone exchange rate works in the opposite direction as it has a dampening impact on imported price impulses. World market prices for most commodity-based consumer goods, including agricultural products, are now rising sharply. This will be reflected in the figures for consumer prices in Norway in the period ahead. With weaker cyclical developments internationally, there is no reason to interpret these price increases as an indication of a shift to a permanently higher level of inflation on the world market. In 2008, CPI inflation may increase as a result of a reversal of the sharp fall in domestic electricity prices, but this does not signal a shift to a generally higher rate of inflation.

While fiscal policy has generated moderate expansionary impulses to the economy over the past few years, monetary policy has been tightened. Up to this year, the tightening has come through parallel interest rate increases both in the euro area and Norway. In 2007, however, Norges Bank's key policy rate has been increased more than the ECB key rate, resulting in a clear interest rate differential. This has led to an appreciation of the krone, which is also having a contractionary impact on growth in the Norwegian economy. Market participants are probably also giving weight to Norges Bank's signals of further interest rate hikes ahead. If cyclical developments are weak in the euro area in the period ahead in line with our assumptions, the interest rate differential may widen markedly. Should the financial market turbulence continue, with a more pronounced downturn in the world economy, it may prove difficult to implement the signalled interest rate strategy in Norway. In that case, the need for that strategy may also diminish as weaker global growth will also curb growth in Norway.

# Cyclical developments in Norway

Growth in the Norwegian economy has continued at a fast pace so far in 2007. Such high growth rates for mainland GDP have not been seen for 10 years. Even after several years of expansion, growth accelerated in the first half of 2007. Growth in the economy is broadly based with strong growth in almost all demand components and in most main industries except the petroleum sector. Unemployment has declined to a low level not seen for 20 years. Labour force growth is high, reflecting both high foreign labour inflows and higher labour force participation rates, particularly among older age groups. This labour market flexibility makes it more difficult than earlier to assess the capacity limit for the Norwegian economy. Rising job

vacancies and wage growth indicate that the labour market is now very tight. Inflation measured by the consumer price index adjusted for tax changes and excluding energy products remains low, but is gently rising.

Monetary policy has been tightened gradually over the past two years. Interest rates have moved up both in nominal and real terms, and the strong krone exchange rate is also curbing demand growth in the Norwegian economy. Fiscal policy must be characterized as more or less cyclically neutral in 2007. It is the self-reinforcing effect of growth in the private sector that is now generating growth impulses to the main-

**Macroeconomic indicators 2005-2007. Growth from previous period unless otherwise noted. Per cent**

			Seasonally adjusted			
	2005	2006	06:3	06:4	07:1	07:2
<b>Demand and output</b>						
Consumption in households etc.	3.3	4.4	1.1	1.0	3.0	0.9
General government consumption	1.8	3.3	0.7	0.6	0.6	0.1
Gross fixed investment	11.2	7.4	-0.3	2.7	-1.3	3.9
Mainland Norway	9.1	8.0	-4.1	7.5	-2.3	2.3
Extraction and transport via pipelines	19.1	4.4	9.3	-0.8	-7.9	9.4
Final domestic demand from Mainland Norway <sup>1</sup>	3.9	4.7	0.0	2.0	1.4	1.0
Exports	0.7	1.6	1.2	1.3	1.3	-0.5
Crude oil and natural gas	-5.0	-6.5	0.2	-2.1	4.3	-6.3
Traditional goods	5.2	5.9	0.1	2.6	3.7	0.1
Imports	8.6	8.2	0.5	3.0	1.7	1.7
Traditional goods	8.2	9.7	1.1	5.7	1.6	0.5
Gross domestic product	2.7	2.8	1.6	0.4	0.8	0.9
Mainland Norway	4.5	4.6	1.5	1.2	1.6	1.3
<b>Labour market</b>						
Man-hours worked	1.2	2.1	0.7	0.9	1.1	1.0
Employed persons	1.0	3.1	0.9	0.7	0.9	1.2
Labour force <sup>2</sup>	1.1	1.8	0.3	0.3	0.8	1.0
Unemployment rate, level <sup>3</sup>	4.6	3.4	3.3	2.9	2.7	2.6
<b>Prices and wages</b>						
Wages per standard man-year <sup>4</sup>	4.0	4.3	4.9	5.2	6.1	5.6
Consumer price index (CPI) <sup>4</sup>	1.6	2.3	2.2	2.5	1.0	0.3
CPI adjusted for tax changes and excl. energy products (CPI-ATE) <sup>4</sup>	1.0	0.8	0.5	0.8	1.2	1.4
Export prices, traditional goods	4.0	11.7	3.1	0.9	-0.9	2.5
Import prices, traditional goods	0.4	4.7	2.1	4.1	0.1	1.2
<b>Balance of payment</b>						
Current balance, bill. NOK	300.8	353.5	93.7	93.1	83.9	71.1
<b>Memorandum items (unadjusted level)</b>						
Money market rate (3 month NIBOR)	2.2	3.1	3.2	3.6	4.2	4.6
Lending rate, banks <sup>5</sup>	3.9	4.3	4.4	4.7	5.3	5.6
Crude oil price NOK <sup>6</sup>	351.4	413.8	434.6	380.7	360.4	414.1
Importweighted krone exchange rate, 44 countries, 1995=100	91.8	92.5	92.2	94.7	93.2	92.0
NOK per euro	8.01	8.05	8.06	8.27	8.17	8.10

<sup>1</sup> Consumption in households and non-profit organizations + general government consumption + gross fixed capital formation in Mainland Norway.

<sup>2</sup> Unemployed (Labour Force Survey) and employment (NA) excl. maritime personnel in ocean transport.

<sup>3</sup> According to Statistics Norway's labour force survey (LFS).

<sup>4</sup> Percentage change from the same period the previous year.

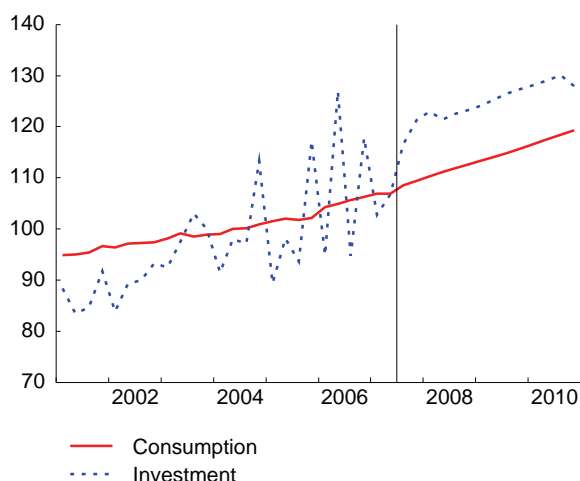
<sup>5</sup> End of period.

<sup>6</sup> Average spot price, Brent Blend.

Source: Statistics Norway and Norges Bank.

**General government**

Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

land economy. Against this background, there is reason to believe that these demand impulses will soften. Combined with a moderate international downturn, mainland GDP growth will slacken, but most likely only to slightly below trend growth. There is probably little spare capacity in the Norwegian economy at present, even though the completion of large investment projects boosts capacity and thereby supports continued growth. The high level of cost inflation that must be expected in the wake of the boom will also lead to slower real growth in the economy. The fact that the strong growth in the Norwegian economy has not yet resulted in markedly higher inflation is in part attributable to high productivity growth and in part to low and at times negative import price inflation. Following several years of expansion, it is normal for productivity growth to edge down. This will lead to somewhat higher inflation ahead. The krone exchange rate has appreciated recently and will strengthen further if the interest rate differential against other countries widens in line with our assumptions in the period ahead. Such a development will restrain inflation in Norway.

**Stable growth in public demand**

According to the quarterly national accounts (QNA), general government consumption increased by a little more than 2 per cent in the first six months of 2007, compared with the same period one year earlier. The growth estimate in the Revised National Budget (RNB) for 2007 as a whole is a good 3 per cent. There was no growth in central government consumption in the first half-year, which pushes down total growth. Growth in gross public investment has so far been more on par with previous projections, with growth at around 5 per cent in the first half of this year compared with the same period one year earlier when excluding frigate purchases. In the light of the moderate consumption figures for the first six months of

2007, our growth projection for general government consumption for 2007 has been revised down somewhat. Growth in public benefits and transferstn: is broadly in line with previous projections, with nominal growth approximately on a par with wage growth. Combined with low consumer price inflation, this makes a substantial contribution to household real income growth in 2007. The strong growth in the Norwegian economy is boosting government tax revenues.

Our fiscal policy assumptions for the years 2008-2010 are virtually the same as in the previous report. The assumptions imply fairly stable growth in public spending on goods and services, close to estimated trend growth in the Norwegian economy. We still assume unchanged overall real tax rates in the years ahead. The structural, non-oil budget deficit may be somewhat smaller than 4 per cent of the Government Pension Fund – Global this year and in the years ahead. The international stock market turbulence, coupled with a strong krone exchange rate, may entail a smaller increase in the «petroleum fund» than estimated in the RNB for 2007. A weaker increase in the value of the Fund will bring our assumptions concerning fiscal policy more closely into line with the 4 per cent fiscal rule.

**Moderate monetary policy tightening**

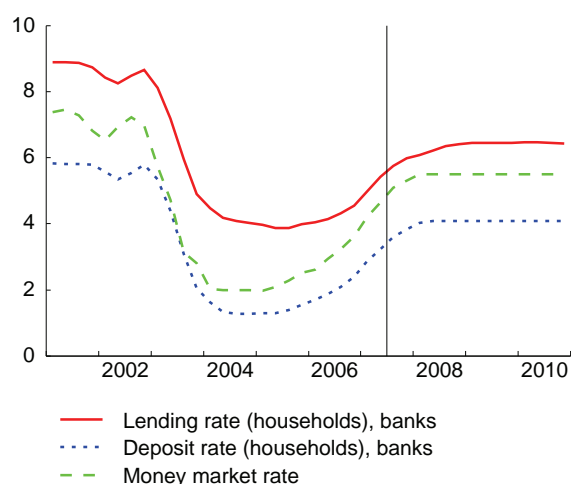
In interest-rate setting, Norges Bank shall strike a balance between stabilizing inflation, the exchange rate and developments in output and employment. The operational target of monetary policy is annual consumer price inflation of close to 2.5 per cent over time. Low inflation in recent years largely reflects supply-side shocks, partly through falling prices for some imports and high productivity growth. Such shocks can lead to a situation where inflation is low at the same time as capacity utilization is high. In its interest-setting, Norges Bank must then assess the trade-off in monetary policy between stabilizing inflation in relation to the operational target and stabilizing developments in output and employment. In this context, Norges Bank must also take into account the effect of the interest rate on the exchange rate.

Since July 2005, Norges Bank has raised its key policy rate gradually from 1.75 per cent to 4.75 per cent in August 2007. The money market rate has followed the key rate with a small premium, which has over time been a little less than 0.25 percentage point, but is somewhat higher when the interest rate is rising. At the end of August, the 3-month money market rate was 5.2 per cent.

The turbulence in financial markets has led to somewhat lower interest rate expectations in the US. The Norwegian money market has now priced in fewer interest rate increases than in July this year. The money market rate is expected to rise to 5.5 per cent in

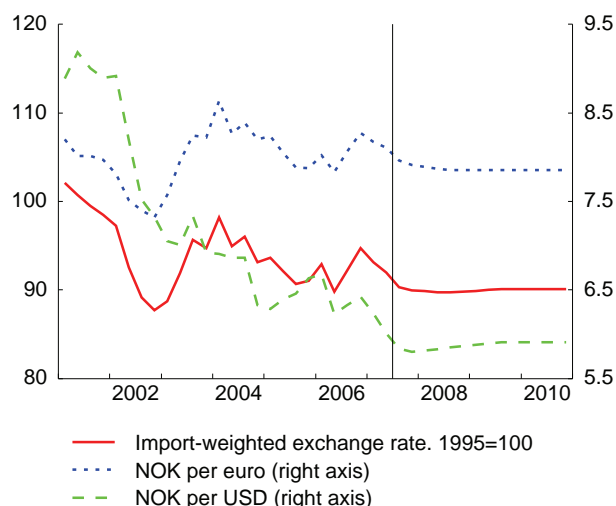
### Norwegian interest rates

Per cent



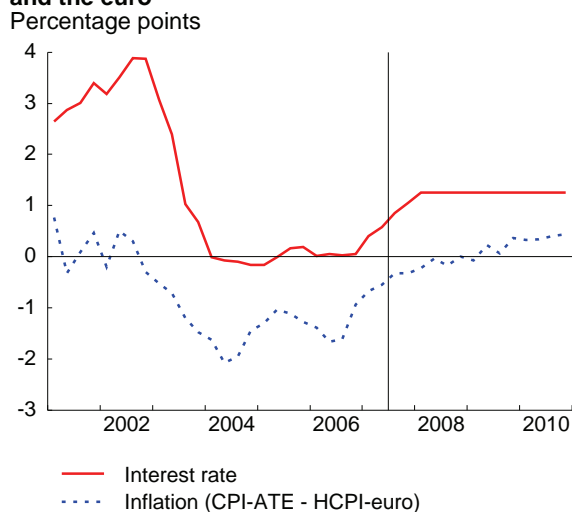
Source: Norges Bank and Statistics Norway.

### Exchange rates



Source: Norges Bank.

### Interest rate and inflation differential between NOK and the euro



Source: Norges Bank and Statistics Norway.

the course of the year and then to stabilize around this level. This implies two further increases in Norges Bank's key policy rate, given the assumption of a 0.25 percentage point difference between the key policy rate and the money market rate. We assume that interest rates will move in line with that priced into the market. One of these rate hikes is expected to occur in autumn, while the last interest rate increase in this round is expected to come in the beginning of 2008.

The average bank lending rate has increased from 4.7 per cent at beginning of this year to 5.6 per cent at the end of June. Deposit rates have increased somewhat less with the result that the interest rate margin has now increased slightly after narrowing over several years. With a normal premium on the key policy rate, the average bank blending rate is expected to move up to 6.5 per cent in 2009 and 2010.

The consumer prices index adjusted for tax changes and excluding energy products (CPI-ATE) was 0.8 per cent higher in 2006 than in 2005. Since April this year, the year-on-year rise in the CPI-ATE has hovered around 1.4 per cent. On an annual basis, CPI-ATE inflation is projected at 1.4 per cent between 2006 and 2007, gradually rising to 2.3 per cent in 2010.

Domestic credit growth, as measured by 12-month growth in private sector gross debt (C2), was 14.8 per cent in July 2007. Credit growth has remained around this level over the past year. Twelve-month growth in household gross domestic debt was 12.3 per cent, up from 12.0 per cent both in May and June. This is the highest rate of 12-month growth so far this year, but over a somewhat longer horizon growth in household gross debt has edged down. In March 2006, growth peaked at 13.5 per cent, while average growth was 13.0 per cent in 2006. Growth in credit to households is still clearly higher than income growth. The ratio of household gross debt to income has thus continued to increase.

The European Central Bank (ECB) raised its key rate by 0.25 percentage point to 4.0 per cent in June this year. We do not expect further interest rate hikes in 2007 and the key rate in the euro area is assumed to remain unchanged to the end of the projection period. Our interest rate assumptions for the euro area and Norway imply a one percentage point increase in the interest rate differential in the course of 2007, reaching 1.25 percentage points at the beginning of 2008. With an interest rate differential of this magnitude, the krone will appreciate and remain strong throughout the projection period.

The krone exchange rate is assumed to hover around 7.90 against the euro into autumn, bringing the annual average for 2007 to about 8.05 per euro. The euro is then expected to fall to 7.85 from spring 2009. The import-weighted krone exchange rate, as measured by

a weighted composition of Norwegian imports, will remain at about the same level as at end-August to the end of the projection period. As an annual average, this implies a 1.7 per cent appreciation of the krone in 2008.

### Brisk growth in oil investment

Since early 2002, the volume of investment in production and pipeline transport has moved on an upward trend. After expanding at relatively strong pace through 2004 and 2005, growth moderated somewhat in 2006. Preliminary QNA figures indicate that volume growth picked up again somewhat in the first half of this year. Compared with the same period one year earlier, the investment level was a good 6 per cent higher. While investment in exploration, production drilling and platforms showed a marked increase, investment in on-shore installations and pipeline transport sank. We assume that oil investment will continue to expand at about the same pace to the end of this year, followed by a further increase to about 10 per cent annually to the end of the projection period.

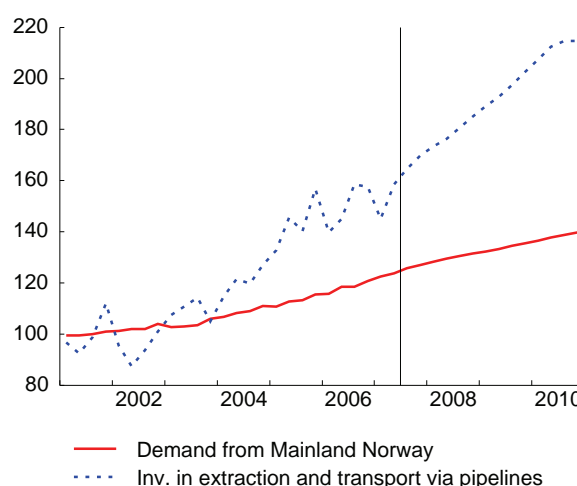
Oil companies' exploration activity has so far been limited by rig capacity. Exploration willingness is being stimulated by projected high oil prices over a long period ahead and the existence of many promising exploration fields. This is also confirmed in Statistics Norway's latest investment intentions survey. Exploration investment will probably show a clear increase as rig capacity rises. Investment in fields in operation is also expected to increase markedly in the period ahead. To a large extent this involves investment linked to tail-production at existing fields which is clearly profitable at today's oil prices. New finds in the vicinity of existing fields are also expected to boost investment linked to existing infrastructure. Vega, Tyrihans, Goliat, Skarv/Idun and Troll Fase 3 are among the largest new fields which are expected to be developed either fully or in part during the projection period. Several small field development projects are also likely to be initiated. The conditions are thus well in place for a continuation of the past two years' upswing in field development.

There are no signs of any new on-shore installations of significance that can prevent a marked fall in investment in on-shore projects once the on-shore installations on Nyhamna and Melkeøya are completed this year. Investment linked to pipeline transport is also assumed to fall through this year and next, but will then pick up again further out in the projection period. A new project for a pipeline to the EU may provide a further boost to this activity. Such a project may alone increase investment in pipeline transport by NOK 10-22 billion depending on the choice of route.

Growth in oil and gas-related investment will contribute to sustaining the expansion in the Norwegian

### Domestic demand

Seasonally adjusted volume indices, 2004=100



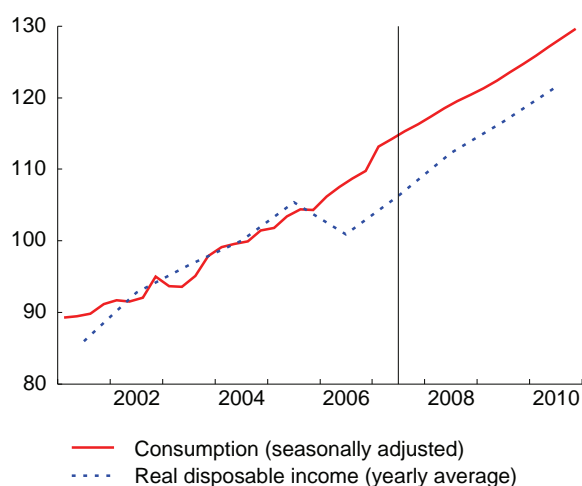
Source: Statistics Norway.

economy. As early as this year, the investment volume is expected to be higher than the previous peak year 1998. The relative contribution measured as a percentage of mainland GDP will nevertheless be smaller this time, at 6 per cent this year compared with 8 per cent in 1998. Even with a markedly higher investment level in 2010, the share will probably be somewhat lower than this. With sagging investment in on-shore installations in the period ahead, the import share in investment will most likely be higher than in recent years. Growth in oil investment in the projection period is estimated to make a 0.2 percentage point contribution to mainland GDP next year, rising to 0.4 percentage point in 2010.

QNA figures show that oil and gas production was 6 per cent lower in the first six months of 2007 than in the same period a year earlier. While gas production remained approximately unchanged, oil production dropped by close to 8 per cent. The decline in oil production is assumed to come to a halt and edge up again in 2008. Even though tail production of oil is rising and production is starting up at new fields, we do not believe this is sufficient to offset the expected production drop at the large, mature fields in subsequent years. Oil production is therefore expected to sink in both 2009 and 2010. With Snøhvit and Ormen Lange in commercial operation as from the fourth quarter of this year, gas production will jump up and then rise more moderately after a period. Overall, petroleum production is expected to fall by a little more than 4 per cent this year, followed by an increase of close to 7 per cent next year. This production level is assumed to be sustained through 2009 and 2010, when gas production will account for a steadily larger share of petroleum production. In value terms, gas production accounted for a little more than 21 per cent of total petroleum production in 2005. That share is expected to increase to almost 35 per cent in 2010.



**Income and consumption in households**  
Volume indices, 2004=100



Source: Statistics Norway.

### Sustained high consumption growth

The brisk rate of growth in consumption in recent years, which must be seen in the light of high underlying income growth and a sharp fall in real interest rates since 2002, has been sustained so far in 2007. Seasonally adjusted QNA figures show that consumption for households and non-profit institutions increased by 0.9 per cent from the first to the second quarter of this year, after rising by as much as 3.0 per cent in the previous quarter. The wide fluctuations reflect developments in goods consumption, while services consumption shows a more stable path. Spending on goods increased by 0.4 per cent in the second quarter of this year, while spending on services rose by 1.0 per cent. The fall in car purchases from the record-high level in the first quarter, influenced by the change in indirect taxes at the beginning of the year, partly explains the swings in goods consumption. Excluding car purchases, spending on goods rose by 1.5 per cent in the second quarter of this year. Consumption of financial services and hotel and restaurant services made the largest contribution to growth in spending on services in the same period, but growth was strong for almost all groups of services. Compared with the same period one year earlier, overall household consumption was close to 6.5 per cent higher in volume terms in the first half of this year. Goods consumption showed a seasonally adjusted fall of 1.8 per cent between June and July, but the goods consumption index was close to 8 per cent higher in July 2007 than in the same month one year earlier. On an annual basis, consumption growth is now put at 6.3 per cent this year, or about 2 percentage points higher than in 2006. This rate of volume growth in consumption has not been recorded since the cyclical expansion in the mid-1990s.

Growth in household real disposable income is estimated at around 5.5 per cent this year and next, and

**Household real disposable income. Percentage growth from the previous year**

	2006	2007	2008	2009	2010
Totalt	-4.3	5.3	5.7	3.9	4.1
Excl. dividends	2.6	5.4	3.5	3.5	3.7

around 4.0 per cent through the remainder of the projection period. Also when excluding dividend payments (see table), which probably have limited stimulatory impact on consumption, income growth will probably be high in the period ahead, reflecting strong growth in wage and corporate earnings and public transfers. At the same time, relatively low consumer price inflation, particularly in 2007, pushes up household real income. On the other hand, the household debt-to-asset ratio will increase during the projection period. Coupled with higher interest rates, this will translate into weak growth in net interest income, which bears down on growth in disposable income. The real after-tax interest rate is assumed to be a good 3 per cent in 2007, i.e. clearly higher than in the two preceding years, and then to drop to a level of close to 2.5 per cent as an annual average for the period 2008-2010. Overall, the income and interest rate assumptions applied here result in annual consumption growth of 3-4 per cent in the coming years.

The saving ratio dropped to a historically low level of 1.4 per cent in 2006, from a level of close to 9 per cent in the previous year. Tax-related adaptations to the re-introduction of dividend tax in 2006 explain this development. Our projections imply a further drop in the saving ratio this year to a level close to zero, followed by an increase to a little more than 3 per cent in 2010. The low level of saving during the projection period is reflected in a weak profile for household net lending. At current prices, household net lending will increase by about NOK 10 billion during the projection period from a level of about a negative NOK 50 billion in 2006. Households will thus continue to shift some of their wealth away from financial capital towards real capital, which will be reflected in a sustained high level of housing investment ahead.

### Housing investment levels off

Against the background of strong real income growth, lower real interest rates and rising real prices for resale homes, housing investment has expanded sharply since the end of 2003. According to provisional QNA figures, housing investment rose by 6.5 per cent in 2006, against as much as 14.5 per cent in 2005. Seasonally adjusted figures show that housing investment only moved up by 0.6 per cent between the first and second quarter of this year, which is appreciably weaker than in the preceding quarters when growth rates varied between 2-3 per cent. Compared with the first six months of 2006, housing investment was more than 7.5 per cent higher in the first six months of this year.

## The implications of interest rate developments for the housing market

Statistics Norway's house price index increased by close to 55 per cent between the second quarter of 2003 and the second quarter of 2007. At the same time, housing investment has surged, with the value of total housing capital in Norway rising by 74 per cent in the same period. The expansion in the housing market must be seen in connection with a marked fall in real interest rates and strong growth in real income in recent years. Since summer 2005, however, interest rates have steadily increased. Our projections are based on two further interest rate hikes of a total of 0.5 percentage point this year, before Norges Bank's key policy rate levels off at 5.25 per cent. In this box, we use our model KVARTS to quantify the effect on the housing market of the past four interest rate hikes of a total of 1 percentage point in our baseline scenario.

Resale home prices in KVARTS are modelled so that they clear the market for resale homes, and the model is quantified using historical data. In addition to the stock of housing capital, house prices are influenced by household real income and the real after-tax interest rate. The real interest rate seems to have a substantial impact on house prices. According to the model, a one percentage point increase in the real interest rate will over time reduce house prices by about 12 per cent. Here we do not take account of the interest rate effects on other variables that also influence house prices. For a given interest rate level and stock of housing capital, evidence suggests that house prices follow household real income. Over time, a twofold increase in income results in a twofold increase in house prices.

In the KVARTS model, housing investment is derived from a model of housing starts. Since housing starts are followed by investments that span up to three years, housing start figures are a leading indicator of housing investment. Housing starts are assumed to follow the ratio of house prices to construction costs as this ratio captures the profitability of building and selling new homes. The model-based calculations suggest that housing starts increase over time by one per cent if the rise in house prices is one per cent higher than the rise in construction costs. If construction costs increase more than house prices, housing starts eventually fall

to the same extent. Housing investment follows housing starts with a lag, and the effect of a change in house prices on investment will thus be the same as for housing starts over time. There are no direct interest rate effects on housing investment, but investment will still be influenced through the effect on house prices.

We compare the baseline scenario presented in this report with alternative scenarios where the key rate is held unchanged after it was raised to 4.25 per cent on 31 May this year. This allows us to quantify the effects of the two interest rate hikes in June and August this year and the additional two rate hikes assumed in the baseline scenario. The calculations show that the effect of an increase in the key rate of altogether one percentage point in the latter half of this year. In the alternative scenarios, it is assumed that the money market rate is 0.25 percentage point higher than the key rate. The calculations cover the period to 2010 and the table shows the effects of the interest rate hikes. It is the real interest rate and real income that have implications for the housing market. Changes in consumer prices influence both of these variables. We have estimated two alternative scenarios. In the first scenario, the exchange rate is held constant. This scenario illustrates the effect on the housing market when we disregard the exchange rate's effect on consumer prices. In the other scenario, we allow the exchange rate to change.

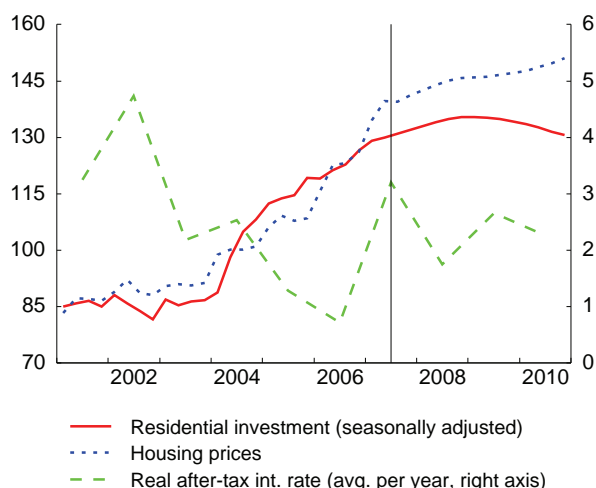
The main driver is changes in the real interest rate. An increase in real interest rates has a dampening impact on house price inflation and housing investment. Moreover, an increase in interest expenses also reduces household income growth and contributes to amplifying the negative effects on the housing market. If the exchange rate does not react, the interest rate increases will reduce house prices by 5.3 per cent in 2010 in relation to the price level in the baseline scenario. Housing investment will be 7 per cent lower the same year. If we open the exchange rate channel, the effects will more than double as the krone appreciates by a good 5 per cent and reduces the rise in prices by an average 0.6 percentage point.

### Effects in per cent unless otherwise stated

	Unchanged exchange rate				Model-based calculations			
	2007	2008	2009	2010	2007	2008	2009	2010
Money market rate, percentage points	0.4	1	1	1	0.4	1	1	1
CPI inflation, percentage points	0	0.1	0.1	0	-0.2	-1.1	-0.5	-0.6
Exchange rate	0	0	0	0	-1.3	-5.2	-5.1	-5.2
Household real disposable income	-0.1	-0.9	-1.3	-1.6	0.1	0	-0.8	-1.4
House prices	0	-1.1	-3.1	-5.3	-0.3	-4.3	-9.4	-12.9
Housing investment	0	-0.8	-3.5	-7	-0.1	-2.4	-9	-14.9
Household consumption	-0.1	-0.7	-1.2	-1.8	0	-1.1	-1.7	-2.1
Mainland GDP	0	-0.3	-0.6	-1	-0.1	-1	-1.6	-2.1

**Residential market**

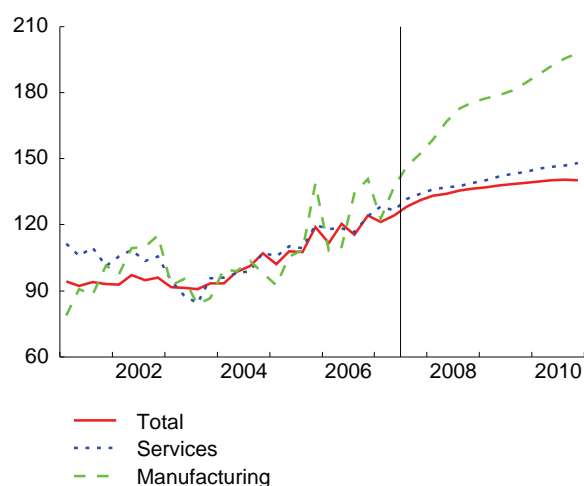
Left axis adj. indices, 2004=100, right axis per cent



Source: Statistics Norway.

**Investment, Mainland Norway**

Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

Building activity statistics seem to indicate that housing starts, both in terms of number of buildings and utility floor space, have flattened out. However, the scale of building activity through 2006 and the first half of 2007, combined with prospects for solid growth in real disposable income, indicates that housing investment will remain at a high level in the next years. The historically very high level of housing capital, coupled with a high real interest rate, may put a brake on both housing investment and the rise in house prices ahead (see box). We now expect housing investment to increase by around 6.5 per cent this year, or at the same pace as in 2006, and then to flatten out and gradually edge down slightly. Resale home prices are expected to increase by around 13 per cent this year, with approximately unchanged prices from the second quarter to the end of the year. Thereafter, the rate of increase in resale home prices is projected to slow and come to a virtual halt towards the end of the projection period.

**Rapid growth in investment**

Mainland business investment is still on the rise. Seasonally adjusted QNA figures show an increase in mainland gross business investment of close to 3 per cent between the first and second quarter of this year. From 2003 to 2006, the rate of growth was close to 30 per cent. In the second quarter of this year, investment was 9.6 per cent higher than in the same quarter one year earlier. Investment in manufacturing and mining expanded by close to 12 per cent from the first to the second quarter, while four-quarter growth was a little more than 23 per cent. According to seasonally adjusted figures, investment in services showed a small drop in the second quarter, but vigorous growth in the two preceding quarters contributed to an investment level of close to 7 per cent above the level recorded in the same quarter one year earlier.

Statistics Norway's latest investment intentions survey indicates that investment growth (volume) for both manufacturing and the power sector will be between 15 and 20 per cent this year and next. Our projections are based on a path for investment broadly in line with that of the investment intentions survey. In 2009 and 2010, the pace of investment growth for manufacturing will slow to around 5 per cent. Investment growth for service industries is projected to slacken somewhat ahead. For mainland industries as a whole, investment growth is put at 8-9 per cent this year and next, down to less than half that rate in 2009 and 2010. This implies that the investment level for mainland industries in general and manufacturing in particular will be very high throughout the projection period.

**Lower growth in traditional goods exports next year**

Seasonally adjusted national accounts figures show approximately unchanged traditional goods exports in volume terms between the first and second quarter of this year, i.e. a decline on the previous quarter when these exports grew by as much as 3.7 per cent. This reflects a fall in exports of important goods such as fish and fish products and various raw materials. Over the past quarter, however, exports of engineering products increased. Electricity exports account for a considerably smaller share, but owing to very strong growth over the past two quarters this export component has made a substantial contribution to total exports of traditional goods. Electricity exports rose by 90 per cent between the fourth quarter of 2006 and the first quarter of this year, and by more than 100 per cent between the first and second quarter. In the second quarter, electricity exports' contribution to growth in traditional goods exports came at as much as 1.5 percentage points. Total exports edged down by 0.5 per cent, primarily reflecting a drop in exports of



crude oil and natural gas of 6.3 per cent. An increase in exports of services, particularly commercial services and gross freights (shipping), dampened the impact on total exports.

After falling (seasonally adjusted) in the first quarter, prices for traditional export goods rose by 2.5 per cent in the second quarter. Metal prices continue to drift upwards, by 5.5 per cent in the second quarter compared with 2.3 per cent in the preceding quarter. Prices rose at a clearly slower rate compared with the previous year when the rate of increase was as high as 50 per cent. The sharp rise in prices for crude oil and natural gas and services resulted in a price rise for total exports of 3.3 per cent in the second quarter of this year.

Growth in traditional goods exports is projected to remain buoyant to the end of the year. Annual growth is put at a little less than 8 per cent. In 2008, the pace of growth will slow markedly to around 4 per cent, reflecting lower export market growth and a normalization of electricity exports. The fall in electricity exports will push down traditional goods exports by an estimated 0.6 percentage point. Underlying growth in exports will thus be a little higher than market growth. From 2009 to the end of the projection period, global cyclical conditions will strengthen and again boost export growth. Growth in traditional goods exports is projected to be slightly higher than market growth, which implies rising market shares. Exports of oil and natural gas will show a strong increase in 2008, followed by a mild decline to the end of the projection period. Export prices are expected to move down over the next two years, followed by a rise towards the end of the projection period.

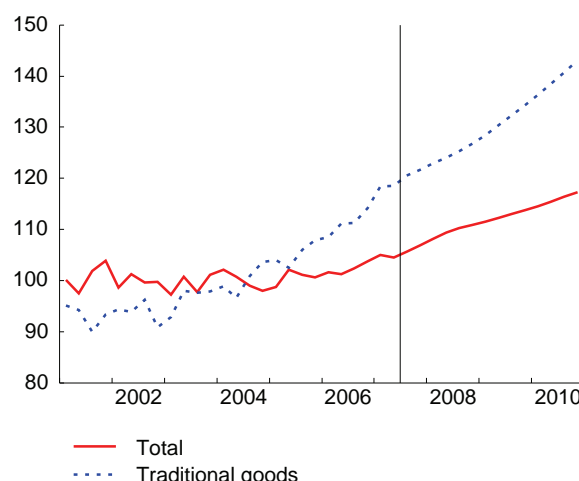
### Continued high growth in total imports

Growth in imports of traditional goods is now exhibiting a flattening tendency. Seasonally adjusted preliminary national accounts figures show that traditional goods imports increased by 0.5 per cent between the first and second quarter of this year, after growing by 1.6 per cent in the previous quarter. By comparison, these imports increased by more than 12 per cent through 2006. Imports of engineering products rose by 1.8 per cent and contributed to pushing up growth, but imports of electricity, industrial chemicals and metals shrank from the first to the second quarter. In the first half of this year, imports of traditional goods increased by almost 10 per cent compared with the same period one year earlier.

Service imports also grew at a fast pace in the second quarter, up by a seasonally adjusted 2.4 per cent on the first quarter. Travel and commercial services made a substantial contribution to growth, with both industries expanding by a rate of 3.1 per cent. All total, imports grew by 1.7 per cent in the second quarter, or at the same rate as in the first quarter and on a par

### Exports

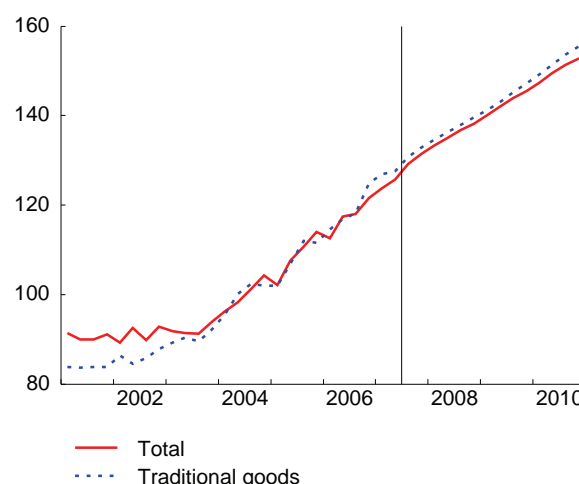
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

### Imports

Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

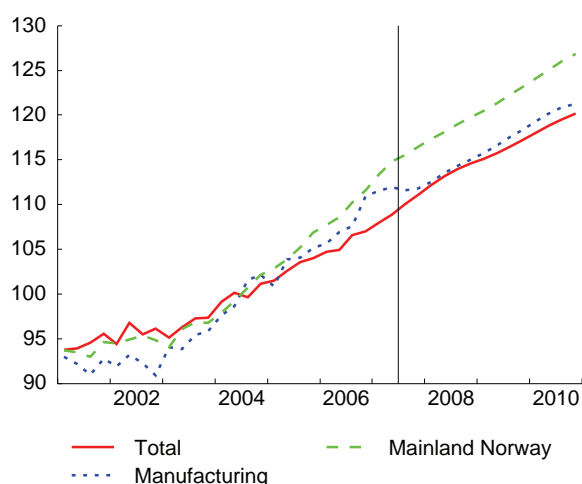
with growth through 2006. This implies an increase as high as 8.5 per cent in the first half of this year compared with the first half of 2006. Moreover, the volume of imports is still rising at a fast pace, in line with what can be expected around a cyclical peak with an attendant high level of consumption and investment.

Seasonally adjusted import price inflation was 1.0 per cent between the first and second quarter, primarily reflecting a rise in prices for traditional goods imports. Import prices for services fell by 0.5 per cent between the first and second quarter.

We assume that one frigate will be delivered to the Norwegian navy by the end of the year, which pushes up imports this year. We also assume that one frigate will be delivered per year to the end of the projection period, thus not contributing further to import

**Gross domestic product**

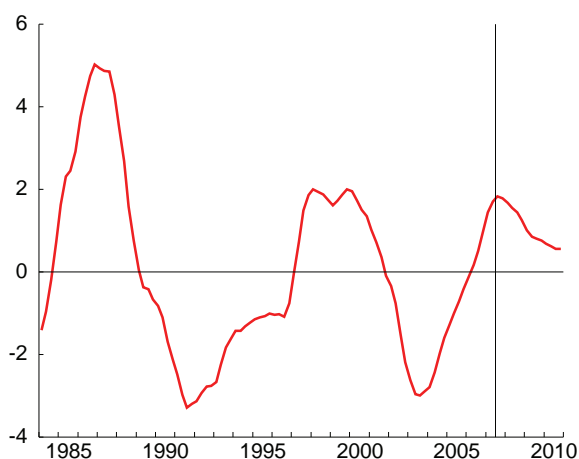
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

**Output gap, Mainland Norway**

Deviation from trend, per cent



Source: Statistics Norway.

growth. Our calculations show growth in traditional goods imports of about 9 per cent this year, which is slightly lower than in 2006. In the coming years, growth is expected to abate further in pace with slower growth in total demand. Moreover, total imports are expected to follow developments in traditional goods imports.

**Strong production growth in the mainland economy**

QNA figures show that mainland GDP growth has picked up so far in 2007. GDP for mainland Norway expanded by an annualized 6 per cent through the first half of the year and was about 5½ per cent higher than in the first half of 2006. In 2007, non-manufacturing goods and construction and power production in particular grew at a very fast rate, while growth in the mainland economy was strong and broad based. Looking back at developments over the

past few years, growth in private services has been especially strong. So far in 2007, growth in the Norwegian economy has been clearly higher than projected earlier. If mainland GDP expands at the same pace (seasonally adjusted) in the second half of the year, as indicated by preliminary QNA figures for the second quarter, annual growth will come to 4.6 per cent in 2007. Even with relatively moderate growth through the latter half of 2007, the annual growth rate might exceed 5 per cent between 2006 and 2007. Growth in total GDP is far more moderate and an unchanged (seasonally adjusted) level from the second quarter to end-year will result in an annual growth rate of 2¾ per cent in 2007. The fall in oil and gas production is the reason behind the more moderate growth rate. On the demand side, there is strong growth in domestic consumption, investment and exports of traditional goods and services.

In the coming quarters, we assume that the Norwegian economy will grow at a considerably more moderate pace, with GDP growth moving down towards or slightly below estimated trend growth in the economy. The main factors that are expected to contribute to this are a marked drop in household demand as a result of higher interest rates. Growth in housing investment is expected to come to a halt in the course of 2008, falling gently thereafter. Lower global growth will contribute to moderating growth through weaker market prospects for Norwegian mainland exports of goods and services. These factors will contribute to bringing down the growth rate of the mainland economy from about 5 per cent in 2007 to around 3 per cent in 2008. Gross investment in the business sector, including the petroleum sector, will continue to expand at a brisk pace in 2008, however. The contribution to growth from the public sector in 2008 is expected to be approximately the same as in 2007. The slowdown in growth is expected to have fairly broad impact on the business sector. Slower growth in housing investment will reduce growth in the construction sector, while weaker global growth will reduce manufacturing's growth potential even though traditional exports show continued clear growth in 2008. Strong growth in oil investment contributes to sustaining growth in manufacturing production even in the event of an international cyclical downturn. Even though growth is projected to show a clear slowdown in 2008, the growth rate of the mainland economy is still relatively high viewed over a longer period. The capacity limits in the economy, as measured by unemployment, suggest slower growth ahead. This will be the case even if inward labour migration proves to be relatively high.

While the mainland economy has expanded at a faster pace than total GDP over many years, the increase in oil and gas production is expected to result in a faster rate of growth in total GDP than in mainland GDP in 2008. Production growth in the petroleum sector and

a rising tendency for unit operating costs generate some growth impulses to the mainland economy in addition to growth in petroleum investment. After 2008, however, our assumption of approximately unchanged petroleum production results in a rate of growth for total GDP that is slightly lower than mainland GDP growth.

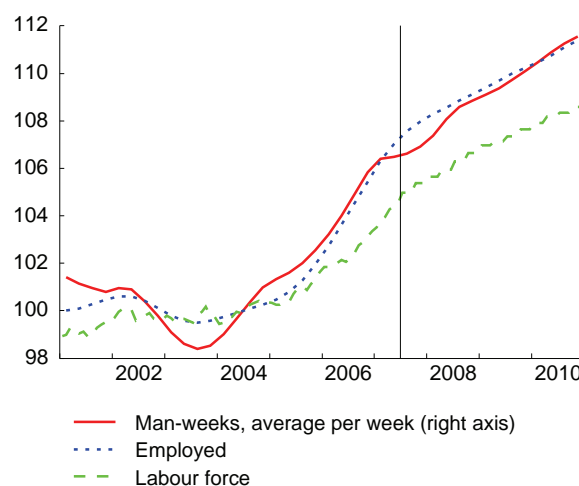
Monetary policy tightening is expected to continue into the beginning of 2008 through further hikes in the key policy rate. As from the first quarter of 2008, the key rate is assumed to remain constant at 5.25 per cent in nominal terms. Higher real interest rates will have a dampening impact on demand growth, and particularly on growth in the construction sector due to lower investment growth. In line with market expectations, we assume that the interest rate level in the euro area will not increase to the same extent as in Norway. As a result, the krone exchange rate against the euro will be strong in the period ahead and the krone will appreciate further from today's level just below NOK 8 due to a widening interest rate differential. A stronger krone will have a contractionary effect on the economy. As mentioned above, growth in general government consumption and investment is approximately unchanged in the period ahead. Our assumption of a renewed international cyclical upswing as from 2009 will have an expansionary impact. This will contribute to a pick-up in export growth and manufacturing production. Sustained high growth in petroleum investment will also contribute to growth in the manufacturing sector. Growth in the mainland economy will thus pick up towards the end of the projection period and may exceed 3 per cent in 2010.

### Slower employment growth, but unemployment still remains at a low level

According to seasonally adjusted QNA figures, employment increased by an annualized 4.2 per cent in the first half of this year. The increase so far this year has thus been even stronger than the record-high level in 2006. The 3.1 per cent increase from 2005 to 2006 is the strongest growth ever recorded in the national accounts. From the second quarter of 2005 to the second quarter of 2007, employment increased by close to 160 000 persons.

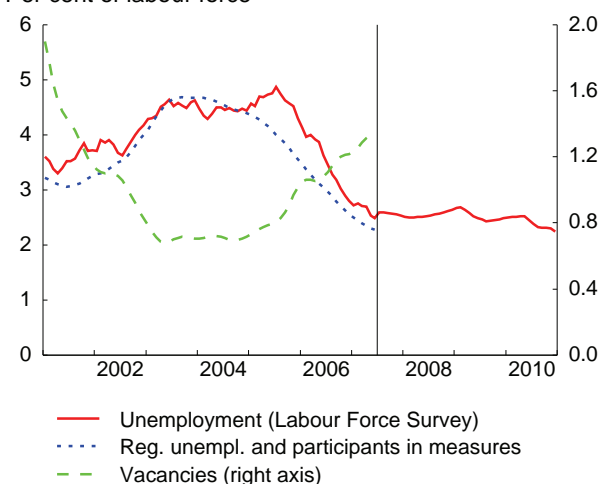
Employment growth has been particularly strong in the construction industry and commercial services. Growth was also solid for distributive trades and manufacturing. Combined, these two industries accounted for close to 70 per cent of overall employment growth from the second quarter of 2006 to the second quarter of this year. By way of comparison, the same two industries accounted for almost 45 per cent of total employment in the second quarter of this year. There is reason to believe that a large share of foreign labour inflows following EU enlargement on 1 May 2004 has been employed in these industries, partly satisfying

**Labour force, employment and number of man-hours**  
Millions. Seasonally adjusted and smoothed indices



Source: Statistics Norway.

**Unemployment and number of vacancies**  
Seasonally adjusted and smoothed  
Per cent of labour force



Source: The Directorate of Labour and Statistics Norway.

the demand for labour in the Norwegian business sector. In addition, labour force participation rates have increased for the Norwegian population. The increase has been strongest for older age groups, particularly among older women. While the population aged between 15-74 increased by 45 000 from the second quarter of 2006 to the second quarter of 2007, the labour force expanded by 51 000 in the same period. Of this, women between 55-66 accounted for 14 000 of the increase. Net inward migration came to about 30 000 between 1 July 2006 and 1 July 2007.

The population and labour force will probably continue to grow ahead, but most likely at a slower pace. According to our projections, the labour force increases by 87 000 from 2007 to 2010, and the average participation rate shows a slight increase. Updated estimates from Statistics Norway show that un-

**Main economic indicators 2006-2010. Accounts and forecasts. Percentage change from previous year unless otherwise noted**

	Accounts 2006	Forecasts								
		2007			2008		2009		2010	
		SN	MoF	NB	SN	NB	SN	NB	SN	NB
<b>Demand and output</b>										
Consumption in households etc.	4.4	6.3	4.0	4 3/4	3.7	3 1/4	3.3	2 1/2	3.9	2 1/2
General government consumption	3.3	2.7	3.1	3	3.2	3	2.7	.	3.0	.
Gross fixed investment	7.4	7.8	6.1	..	6.6	..	4.0	..	3.6	..
Extraction and transport via pipelines <sup>1</sup>	4.4	6.3	5.0	7 1/2	9.9	0	9.3	5	10.3	7 1/2
Mainland Norway	8.0	7.6	6.7	6	6.0	2 3/4	2.5	.	1.5	.
Industries	8.5	8.9	7.5	..	8.2	..	3.4	..	3.3	..
Housing	6.5	6.8	5.0	..	3.1	..	0.5	..	-2.3	..
General government	9.1	5.7	7.4	..	5.1	..	3.4	..	2.8	..
Demand from Mainland Norway <sup>2</sup>	4.7	5.6	4.3	4 1/2	4.0	3	3.0	2 1/4	3.2	2 1/4
Stockbuilding <sup>3</sup>	0.2	0.1	..	..	0.0	..	0.0	..	0.0	..
Exports	1.6	2.9	1.5	..	4.6	..	2.4	..	2.9	..
Crude oil and natural gas	-6.5	-2.5	-3.6	..	7.4	..	-0.4	..	-0.4	..
Traditional goods <sup>4</sup>	5.9	7.8	4.8	8 1/4	3.9	5 1/4	5.5	.	6.3	.
Imports	8.2	8.7	5.9	7 1/4	6.1	4 1/2	5.3	.	5.2	.
Traditional goods	9.7	8.8	6.0	..	5.8	..	5.1	..	5.8	..
Gross domestic product	2.8	3.5	2.5	3 1/4	3.7	3 1/2	2.2	1 3/4	2.7	1 1/2
Mainland Norway	4.6	5.1	3.7	4 1/4	3.1	2 1/2	2.7	2	3.1	2 1/4
<b>Labour market</b>										
Employed persons	3.1	3.1	2.1	2 3/4	1.3	1	1.1	0	1.0	0
Unemployment rate (level)	3.4	2.6	2.5	2 1/2	2.5	2 3/4	2.4	3 1/4	2.5	3 3/4
<b>Prices and wages</b>										
Wages per standard man-year	4.3	5.6	4 3/4	5 1/2	5.9	5 1/2	5.5	4 3/4	5.6	4 1/2
Consumer price index (CPI)	2.3	0.8	3/4	3/4	2.7	3	1.9	2 1/2	2.3	2 1/2
CPI-ATE <sup>5</sup>	0.8	1.4	1 1/2	1 1/2	1.8	2	2.0	2 1/2	2.3	2 1/2
Export prices, traditional goods	11.7	3.6	..	..	-6.0	..	-3.6	..	4.0	..
Import prices, traditional goods	4.7	4.4	..	..	-3.2	..	-0.8	..	2.0	..
Housing prices <sup>6</sup>	12.9	13.3	..	..	4.5	..	1.1	..	1.9	..
<b>Balance of payment</b>										
Current balance (bill. NOK)	353.5	335.9	..	..	359.3	..	320.8	..	350.4	..
Current balance (per cent of GDP)	16.4	14.9	12.9	..	15.1	..	13.2	..	13.6	..
<b>Memorandum items:</b>										
Household savings ratio (level)	1.3	0.0	1.8	..	2.0	..	2.7	..	3.1	..
Money market rate (level)	3.1	4.8	..	4 3/4	5.5	6	5.5	6	5.5	5 3/4
Lending rate, banks (level) <sup>7</sup>	4.3	5.5	..	..	6.3	..	6.5	..	6.5	..
Crude oil price NOK (level) <sup>8</sup>	414	401	370	..	380	..	358	..	381	..
Export markets indicator	8.2	6.8	..	..	3.9	..	4.4	..	6.7	..
Importweighted krone exchange rate (44 countries) <sup>9</sup>	0.6	-1.2	..	-1/4	-1.7	-1/4	0.3	1	0.1	..

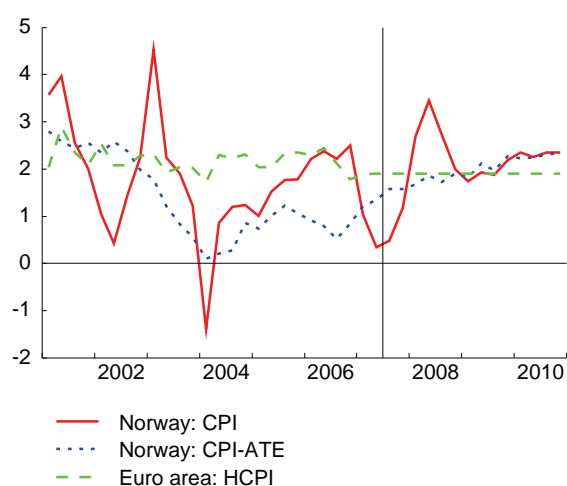
<sup>1</sup> Forecasts from Ministry of Finance incl. service activities incidental to extraction.<sup>2</sup> Consumption in households and non-profit organizations + general government consumption + gross fixed capital formation in Mainland Norway.<sup>3</sup> Change in stockbuilding. Per cent of GDP.<sup>4</sup> Nores Bank estimates traditional exports, which also includes some services.<sup>5</sup> CPI adjusted for tax changes and excluding energy products (CPI-ATE).<sup>6</sup> Freeholder.<sup>7</sup> Households' borrowing rate in private financial institutions. Yearly average.<sup>8</sup> Average spot price, Brent Blend.<sup>9</sup> Increasing index implies depreciation.

Source: Statistics Norway (SN), Ministry of Finance, St.meld. nr.2 (2006-2007), (MoF), Norges Bank, Inflasjonsrapport 2/2007 (NB).

changed participation rates by age, gender, education level, pension recipient status and an annual net inward migration of 16 000 will result in an increase in the labour force of about 43 000 persons over this three-year period. The projections are thus based on clear increases in labour force participation rates in addition to higher inward labour migration than in the updated estimates. Labour market pressures will provide more marginal groups with the possibility of closer attachment to the labour market. The reason

why there is still only a moderate increase in the average participation rate is that young and older age groups with lower participation rates will account for a large share of the projected population growth. In the second quarter of 2007, the labour force accounted for a good 53 per cent of the total population. In the projections, the changes in population composition imply that this portion declines by 2 percentage points in the period to 2020, when labour force participation rates are assumed to be at the 2001 level.

**Consumer price indices**  
Percentage growth from the same quarter previous year



Source: Norges Bank and Statistics Norway.

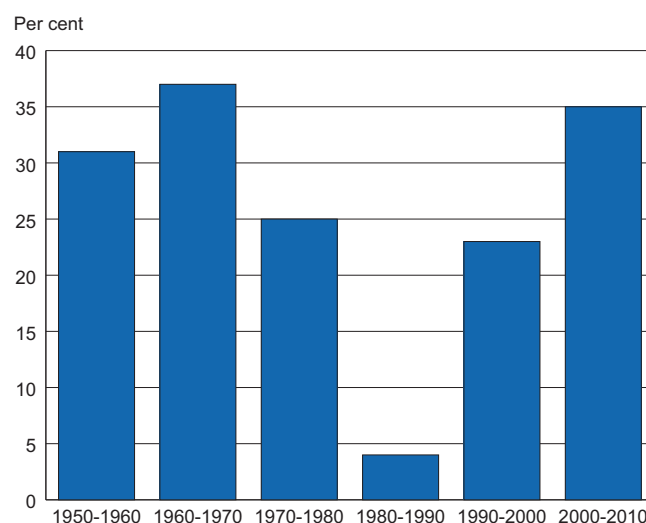
Employment growth has also led to a marked reduction in unemployment. From a level of around 4.5 per cent throughout 2005, LFS unemployment fell sharply through 2006 and has declined at a somewhat more moderate pace so far in 2007. In the period May-July this year, seasonally adjusted unemployment was 2.5 per cent. Registered unemployment has declined to the same extent. At the end of August this year, only 2 per cent of the labour force was unemployed, bringing the seasonally adjusted fall in registered unemployment to 2000 persons between end-July to end-August.

Measured as an annual average, LFS unemployment is estimated at 2.6 per cent in 2007. Employment growth is expected to be markedly lower in the years ahead compared with 2006 and 2007. Since the labour force is also expected to grow at a slower pace, unemployment still remains approximately unchanged from 2007 to 2010. As an annual average, unemployment is projected to move down to 2.4 per cent in 2009. This is the lowest annual average unemployment level recorded since 1980.

### High wage growth ahead

Provisional national accounts figures show an increase in wages per standard man-year of 5.8 per cent from the first half of 2006 to the first half of this year. In this period, there has been a main settlement in the two-year wage agreements, and negotiated wage increases are normally higher in a main settlement than in an interim settlement. However, growth has been close to 1 percentage point higher than in the same period in connection with the preceding main settlement. In this year's interim settlement pay increases were more moderate, which implies lower wage growth from the latter half of 2006 to the latter half of this year. Wage growth is projected at 5.6 per cent between 2006 and 2007, or about the same as in the previous report. In the period 2003-2006, annual

**Real wage growth, wage per standard man-year deflated by CPI**



wage growth was stable at around 4 per cent. The strong upturn in the Norwegian economy since summer 2003 did not lead to higher wage growth until 2007. A substantial increase in bonus payments in the first quarter is the main reason behind the jump in wage growth so far this year. Statistics Norway's quarterly wage index, which is based on information from a selection of enterprises in various industries (excluding financial services among others), shows particularly fast growth in extraordinary pay increases and bonuses in commercial services, property management, construction and distributive trades. There was also a clear rise in pay increases of this type in the manufacturing industry. The increase in bonus payments in most private industries reflects a generally high level of profitability in the Norwegian business sector combined with shortages of certain types of labour.

Experience shows that negotiated wage increases will also rise after a period of an increase in wage drift of this magnitude. This is necessary if the social partners want to limit the wage gap between employees whose wages are largely determined in local negotiations and those primarily covered by centralized wage determination. The increase in negotiated wages may thus continue for a period, even with lower wage drift. We project continued high growth in employment. In conjunction with the prospect of somewhat lower inward labour migration, this will contribute to a continued decline in unemployment and make a further contribution to higher wage growth ahead. In addition, higher consumer price inflation pushes up wage growth. The international cyclical downturn will weaken profitability in internationally exposed industries and have the opposite effect.

Wage growth is projected at about the same rate in the period 2008-2010 as in 2007. Growth in wages per normal person-year is projected at 5.9 per cent in



2008, but it may be slightly lower at an estimated 5.5 per cent in 2009 when there is an interim settlement. If our projection of an international cyclical upswing materializes, wage growth may edge up again in 2010.

Our projections for wage and price inflation imply an overall increase in real wages of 35 per cent between 2000 and 2010. By way of comparison, real wages rose by about 25 per cent through the 1970s and 1990s and by only 4 per cent in the 1980s. Real wage growth in the 2000s is thus more in line with that recorded in the 1950s and 1960s (see figure).

### Prospects of somewhat higher inflation

In spite of high capacity utilisation in the Norwegian economy, the underlying rise in prices for consumer goods is still very low. After edging up through autumn last year and winter this year, the 12-month rate of increase in the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) has been virtually stable and stood at 1.4 per cent in July. According to this index, inflation has varied between 0-1.5 per cent for more than four years, and has thus been outside Norges Bank's target range for monetary policy.

The strongest price rise so far this year has been for home maintenance and repair products. Prices for this group of products rose by 6.7 per cent on average between January and May, but have since edged down slightly. The year-on-year rise was 7 per cent in July, close to 5 percentage points higher than in January. This largely reflects the high level of building activity which has led to shortages of building materials both in Norway and many of our neighbouring countries.

A breakdown of the CPI-ATE by supplier sector shows that prices for domestically produced goods have tended to rise at a faster pace, while there has been a persistent underlying price fall for imported consumer goods.

The rate of increase in house rent prices has eased steadily over the past year, but moved up slightly between June and July this year. The price rise for other services has been very stable so far this year, after edging up somewhat around the turn of the year.

There are many factors that have contributed to the low level of underlying inflation over the past five years. Increased imports from low-cost countries, a somewhat stronger krone and low global inflation have contributed to low price inflation for imported consumer goods. Relatively low growth in hourly wage costs, coupled with high productivity growth, has also resulted in a subdued rise in prices for domestically produced goods and services, as long as energy products are excluded.

Growth in hourly wage costs has picked up somewhat in recent years and is set to remain relatively high in the period ahead. After a four-year long cyclical upturn, it now seems that the high level of productivity growth is being reduced. However, the krone appreciation may counter the impulses from domestic cost components. In addition, prices for building products will eventually normalize, which will also push down inflation.

After a sharp rise in industrial commodities, world market prices for food have also shown a clear increase. This has already fed through to Norwegian food prices and will probably also contribute to higher inflation in the period ahead. Moreover, we expect the negative price impulses in the wake of increased imports from low-cost countries to diminish ahead. According to our calculations, CPI-ATE inflation will move up to an annual average of 1.4 per cent this year and thereafter gradually pick up over the next three years. In 2010, inflation is projected at 2.3 per cent. While CPI-ATE inflation has been low and stable in recent years, fluctuating energy prices have resulted in wide variations in CPI inflation. The annual average rise in electricity prices was record-high in 2006, partly reflecting low inflows to water reservoirs. Ample inflows through autumn, a mild winter and high precipitation levels both in winter and summer have completely changed the situation. In the third week of August, water reservoir levels were up to 93.8 per cent, or as much as 9.4 percentage points higher than the median for the period 1990-2005. As a result, electricity prices charged to households fell continuously for 10 months. In July, prices were 41 per cent lower than in September 2006. Electricity price developments were the main factor behind the fact that the 12-month rise in the CPI was 1 percentage point lower than for the CPI-ATE, at only 0.4 per cent.

The forward market indicates that electricity prices will show a marked increase in the period to winter. As an annual average, electricity prices are projected to fall in the CPI by about 20 per cent in 2007 in relation to the previous year, while prices are projected to rise by about 25 per cent in 2008. With a weight of close to 4 per cent, this will make around a 1.0 percentage point contribution to CPI inflation next year. Oil prices are assumed to fall by a good NOK 14 from 2006 to 2007 and by a further NOK 20 in each year the following two years. On the whole, real indirect taxes are assumed to remain unchanged in the period 2008-2010.

Higher underlying inflation and the rise in electricity prices will result in a marked pick-up in inflation next year, with CPI inflation projected at 2.7 per cent in 2008. In 2009 and 2010, overall energy prices are assumed to evolve in line with the general rise in prices. CPI inflation will thus be approximately the same as CPI-ATE inflation.

**Reduced trade surplus**

Preliminary balance-of-payment figures show a surplus on the goods and services balance of about NOK 90 billion for the second quarter of this year. At end-June 2007, the figures show that the surplus had declined by NOK 20 billion in relation to the surplus in the first six months of 2006. For 2007 as a whole, the trade surplus is projected to come to NOK 350 billion, or a reduction of a good NOK 40 billion in relation to 2006. Last year's sizeable deficit on the interest and transfers balance of close to NOK 40 billion is to a large extent ascribable to extraordinary, large dividend payments to foreign shareholders. This year, the deficit is expected to be more than halved. As a result, the current account surplus will be reduced by a good NOK 14 billion in relation to 2006, bringing the surplus to a little less than NOK 336 billion in 2007.

In 2008, the trade surplus is expected to be more in line with this year's surplus. Thereafter, the strong growth in the Norwegian economy recorded in recent years is expected to moderate. A negative profile for net exports (volume) and a deterioration in the terms of trade (measured as export prices in relation to import prices) are expected to reduce the trade surplus to less than NOK 320 billion as from 2009. The interest and transfers balance is assumed to show a surplus as from 2008 as a result of higher foreign net interest income and a stabilization of net transfers and foreign dividend payments. As a result, the current account surplus will be at a level just below NOK 350 billion through the projection period.

**National accounts: Final expenditure and gross domestic product. At fixed 2004 prices. Million kroner**

	Unadjusted		Seasonally adjusted							
	2005	2006	05.3	05.4	06.1	06.2	06.3	06.4	07.1	07.2
Final consumption expenditure of households and NPISHs	812 122	847 569	204 704	204 644	208 268	210 912	213 158	215 361	221 914	223 982
Household final consumption expenditure	778 529	811 960	196 215	196 006	199 487	202 071	204 206	206 312	212 739	214 735
Goods	404 922	421 609	102 286	101 513	103 664	104 509	106 044	107 805	112 143	112 570
Services	348 998	361 259	87 569	88 390	88 792	90 184	90 608	91 583	92 617	93 535
Direct purchases abroad by resident households	46 583	51 958	11 775	11 709	12 404	13 020	13 229	13 067	13 689	14 504
Direct purchases by non-residents	-21 974	-22 866	-5 416	-5 606	-5 373	-5 642	-5 675	-6 143	-5 711	-5 874
Final consump. expenditure of NPISHs	33 593	35 609	8 489	8 637	8 781	8 840	8 952	9 049	9 175	9 246
Final consump. exp. of general government	379 939	392 660	94 923	95 243	97 184	97 819	98 533	99 081	99 634	99 707
Final consump. exp. of central government	200 424	203 979	50 007	50 122	50 790	50 973	50 999	51 200	50 910	50 748
Central government, civilian	172 548	176 510	43 102	43 208	43 859	44 080	44 171	44 386	44 204	44 085
Central government, defence	27 876	27 470	6 904	6 914	6 931	6 892	6 829	6 814	6 705	6 662
Final consump. expenditure of local government	179 514	188 681	44 916	45 121	46 394	46 846	47 533	47 881	48 724	48 960
Gross fixed capital formation	349 319	375 080	85 212	96 894	87 977	94 880	94 609	97 192	95 887	99 598
Extraction and transport via pipelines	84 924	88 700	20 685	23 121	20 615	21 393	23 387	23 207	21 380	23 382
Service activities incidental to extraction	-1 835	870	919	44	-527	25	478	894	103	439
Ocean transport	15 146	14 376	1 737	5 336	3 789	4 297	4 434	1 800	4 737	4 501
Mainland Norway	251 085	271 135	61 870	68 394	64 100	69 165	66 310	71 292	69 668	71 275
Mainland Norway excluding general government	200 683	216 155	50 049	53 588	52 115	53 123	54 338	56 409	56 687	57 788
Industries	120 056	130 312	29 949	32 689	31 238	31 841	32 806	34 202	34 055	35 008
Manufacturing and mining	23 440	26 110	5 681	7 252	5 658	5 752	7 036	7 366	6 426	7 181
Production of other goods	19 775	21 827	5 340	4 714	5 181	5 601	5 628	5 395	5 430	5 967
Services	76 840	82 375	18 928	20 723	20 398	20 488	20 142	21 441	22 200	21 860
Dwellings (households)	80 628	85 843	20 100	20 899	20 878	21 282	21 532	22 207	22 633	22 779
General government	50 401	54 980	11 821	14 806	11 985	16 042	11 972	14 882	12 980	13 487
Changes in stocks and statistical discrepancies	50 538	58 919	18 048	12 918	15 654	13 222	16 261	14 988	13 195	15 074
Gross capital formation	399 800	433 999	103 261	109 813	103 630	108 102	110 870	112 180	109 082	114 672
Final domestic use of goods and services	1 591 861	1 674 229	402 888	409 699	409 082	416 832	422 560	426 622	430 630	438 361
Final demand from Mainland Norway	1 443 145	1 511 364	361 497	368 280	369 552	377 896	378 000	385 733	391 215	394 964
Final demand from general government	430 340	447 640	106 744	110 048	109 169	113 860	110 505	113 963	112 614	113 195
Total exports	737 591	749 656	185 417	184 347	186 240	185 492	187 676	190 051	192 452	191 396
Traditional goods	220 746	233 721	55 630	56 586	56 908	58 321	58 388	59 884	62 112	62 162
Crude oil and natural gas	320 559	299 812	80 215	78 494	77 649	74 553	74 673	73 086	76 212	71 439
Ships, oil platforms and planes	10 781	12 192	3 316	1 055	3 188	1 770	3 261	3 974	1 963	3 135
Services	185 505	203 930	46 256	48 212	48 496	50 848	51 354	53 108	52 166	54 658
Total use of goods and services	2 329 451	2 423 884	588 304	594 046	595 322	602 325	610 237	616 673	623 082	629 756
Total imports	539 642	583 765	137 665	141 663	139 925	145 872	146 649	151 076	153 698	156 332
Traditional goods	349 862	383 849	90 571	90 212	92 660	94 474	95 499	100 952	102 580	103 082
Crude oil and natural gas	2 953	1 457	531	1 310	422	178	169	717	589	1 411
Ships, oil platforms and planes	10 421	12 232	2 669	3 030	2 711	4 682	3 145	1 694	2 468	2 617
Services	176 406	186 227	43 895	47 111	44 131	46 539	47 835	47 713	48 062	49 221
Gross domestic product (market prices)	1 789 867	1 840 119	450 639	452 383	455 398	456 452	463 588	465 597	469 384	473 424
Gross domestic product Mainland Norway (market prices)	1 415 739	1 480 321	355 793	361 176	364 126	367 104	372 721	377 188	383 127	388 242
Petroleum activities and ocean transport	374 128	359 798	94 846	91 207	91 272	89 349	90 866	88 409	86 257	85 182
Mainland Norway (basic prices)	1 206 438	1 258 437	303 291	307 843	309 888	311 998	315 542	320 923	325 562	330 139
Mainland Norway excluding general government	938 053	985 663	236 137	240 621	242 183	243 984	247 183	252 168	255 843	260 187
Manufacturing and mining	168 159	174 989	42 220	42 673	42 854	43 390	43 641	45 003	45 253	45 424
Production of other goods	141 641	142 285	35 477	36 701	35 895	35 496	35 303	35 470	36 662	38 086
Services incl. dwellings (households)	628 254	668 389	158 440	161 247	163 434	165 098	168 240	171 696	173 928	176 677
General government	268 385	272 774	67 154	67 221	67 705	68 015	68 358	68 755	69 719	69 952
Correction items	209 301	221 884	52 502	53 334	54 238	55 105	57 180	56 265	57 565	58 103

Source: Statistics Norway.

**National accounts: Final expenditure and gross domestic product. At fixed 2004 prices. Percentage change from the previous period**

	Unadjusted		Seasonally adjusted							
	2005	2006	05.3	05.4	06.1	06.2	06.3	06.4	07.1	07.2
Final consumption expenditure of households and NPISHs	3.3	4.4	1.0	-0.0	1.8	1.3	1.1	1.0	3.0	0.9
Household final consumption expenditure	3.2	4.3	0.9	-0.1	1.8	1.3	1.1	1.0	3.1	0.9
Goods	2.7	4.1	1.2	-0.8	2.1	0.8	1.5	1.7	4.0	0.4
Services	2.7	3.5	0.8	0.9	0.5	1.6	0.5	1.1	1.1	1.0
Direct purchases abroad by resident households	12.9	11.5	-1.3	-0.6	5.9	5.0	1.6	-1.2	4.8	6.0
Direct purchases by non-residents	4.0	4.1	-0.5	3.5	-4.2	5.0	0.6	8.2	-7.0	2.9
Final consumption expenditure of NPISHs	5.9	6.0	2.1	1.7	1.7	0.7	1.3	1.1	1.4	0.8
Final consumption exp. of general government	1.8	3.3	-0.3	0.3	2.0	0.7	0.7	0.6	0.6	0.1
Final consumption exp. of central government	1.6	1.8	-0.3	0.2	1.3	0.4	0.1	0.4	-0.6	-0.3
Central government, civilian	3.3	2.3	-0.0	0.2	1.5	0.5	0.2	0.5	-0.4	-0.3
Central government, defence	-7.9	-1.5	-1.6	0.1	0.2	-0.6	-0.9	-0.2	-1.6	-0.6
Final consumption exp. of local government	2.0	5.1	-0.3	0.5	2.8	1.0	1.5	0.7	1.8	0.5
Gross fixed capital formation	11.2	7.4	0.2	13.7	-9.2	7.8	-0.3	2.7	-1.3	3.9
Extraction and transport via pipelines	19.1	4.4	-3.5	11.8	-10.8	3.8	9.3	-0.8	-7.9	9.4
Service activities incidental to extraction	-165.2	-147.4	-132.2	-95.2	..	-104.7	..	86.8	-88.5	327.8
Ocean transport	50.0	-5.1	-60.9	207.1	-29.0	13.4	3.2	-59.4	163.1	-5.0
Mainland Norway	9.1	8.0	-0.3	10.5	-6.3	7.9	-4.1	7.5	-2.3	2.3
Mainland Norway excluding general government	11.9	7.7	0.8	7.1	-2.7	1.9	2.3	3.8	0.5	1.9
Industries	10.2	8.5	0.8	9.2	-4.4	1.9	3.0	4.3	-0.4	2.8
Manufacturing and mining	12.3	11.4	2.8	27.7	-22.0	1.7	22.3	4.7	-12.8	11.7
Production of other goods	3.9	10.4	4.0	-11.7	9.9	8.1	0.5	-4.1	0.6	9.9
Services	11.3	7.2	-0.6	9.5	-1.6	0.4	-1.7	6.5	3.5	-1.5
Dwellings (households)	14.5	6.5	0.8	4.0	-0.1	1.9	1.2	3.1	1.9	0.6
General government	-0.5	9.1	-4.7	25.2	-19.1	33.9	-25.4	24.3	-12.8	3.9
Changes in stocks and statistical discrepancies	50.1	16.6	87.8	-28.4	21.2	-15.5	23.0	-7.8	-12.0	14.2
Gross capital formation	14.9	8.6	9.1	6.3	-5.6	4.3	2.6	1.2	-2.8	5.1
Final domestic use of goods and services	5.6	5.2	2.6	1.7	-0.2	1.9	1.4	1.0	0.9	1.8
Final demand from Mainland Norway	3.9	4.7	0.4	1.9	0.3	2.3	0.0	2.0	1.4	1.0
Final demand from general government	1.5	4.0	-0.8	3.1	-0.8	4.3	-2.9	3.1	-1.2	0.5
Total exports	0.7	1.6	-0.9	-0.6	1.0	-0.4	1.2	1.3	1.3	-0.5
Traditional goods	5.2	5.9	3.5	1.7	0.6	2.5	0.1	2.6	3.7	0.1
Crude oil and natural gas	-5.0	-6.5	-2.0	-2.1	-1.1	-4.0	0.2	-2.1	4.3	-6.3
Ships, oil platforms and planes	11.2	13.1	-38.6	-68.2	202.1	-44.5	84.2	21.9	-50.6	59.7
Services	5.5	9.9	0.3	4.2	0.6	4.9	1.0	3.4	-1.8	4.8
Total use of goods and services	4.0	4.1	1.5	1.0	0.2	1.2	1.3	1.1	1.0	1.1
Total imports	8.6	8.2	3.0	2.9	-1.2	4.3	0.5	3.0	1.7	1.7
Traditional goods	8.2	9.7	4.8	-0.4	2.7	2.0	1.1	5.7	1.6	0.5
Crude oil and natural gas	55.0	-50.6	8.7	146.9	-67.8	-57.9	-4.8	323.8	-17.9	139.6
Ships, oil platforms and planes	-20.6	17.4	2.1	13.5	-10.5	72.7	-32.8	-46.1	45.7	6.1
Services	11.4	5.6	-0.6	7.3	-6.3	5.5	2.8	-0.3	0.7	2.4
Gross domestic product (market prices)	2.7	2.8	1.0	0.4	0.7	0.2	1.6	0.4	0.8	0.9
Gross domestic product Mainland Norway (market prices)	4.5	4.6	1.3	1.5	0.8	0.8	1.5	1.2	1.6	1.3
Petroleum activities and ocean transport	-3.5	-3.8	-0.0	-3.8	0.1	-2.1	1.7	-2.7	-2.4	-1.2
Mainland Norway (basic prices)	4.4	4.3	1.3	1.5	0.7	0.7	1.1	1.7	1.4	1.4
Mainland Norway excluding general government	5.3	5.1	1.5	1.9	0.6	0.7	1.3	2.0	1.5	1.7
Manufacturing and mining	3.4	4.1	0.2	1.1	0.4	1.3	0.6	3.1	0.6	0.4
Production of other goods	9.0	0.5	0.8	3.5	-2.2	-1.1	-0.5	0.5	3.4	3.9
Services incl. dwellings (households)	5.0	6.4	2.1	1.8	1.4	1.0	1.9	2.1	1.3	1.6
General government	1.5	1.6	0.5	0.1	0.7	0.5	0.5	0.6	1.4	0.3
Correction items	4.5	6.0	1.2	1.6	1.7	1.6	3.8	-1.6	2.3	0.9

Source: Statistics Norway.

**National accounts: Final expenditure and gross domestic product. Price indices. 2004=100**

	Unadjusted		Seasonally adjusted							
	2005	2006	05.3	05.4	06.1	06.2	06.3	06.4	07.1	07.2
Final consump. exp. of households and NPISHs	101.0	103.1	101.6	101.5	101.8	103.1	103.5	103.9	103.0	103.4
Final consump. exp. of general government	102.6	106.5	103.1	103.5	104.4	106.2	107.2	108.3	108.4	109.8
Gross fixed capital formation	102.8	106.6	103.4	103.5	103.8	106.0	107.8	108.2	108.6	111.3
Mainland Norway	102.0	105.5	101.9	102.8	103.9	105.1	105.8	107.2	107.9	109.1
Final domestic use of goods and services	101.9	105.1	102.6	101.9	103.0	105.8	105.8	105.4	105.9	107.7
Final demand from Mainland Norway	101.6	104.4	102.1	102.3	102.9	104.3	104.8	105.7	105.2	106.0
Total exports	117.3	133.7	119.5	128.0	135.5	132.1	132.6	134.8	132.2	136.6
Traditional goods	104.0	116.2	105.7	107.0	111.0	115.3	118.9	120.0	119.0	121.9
Total use of goods and services	106.8	113.9	107.9	110.0	113.2	113.9	114.1	114.5	114.0	116.4
Total imports	101.2	104.4	101.2	101.8	102.8	102.7	104.4	107.8	107.5	108.6
Traditional goods	100.4	105.0	100.4	100.2	102.9	102.8	104.9	109.2	109.3	110.6
Gross domestic product (market prices)	108.5	116.9	110.0	112.6	116.4	117.4	117.1	116.6	116.1	119.0
Gross domestic product Mainland Norway (market prices)	102.1	105.6	102.2	103.2	103.9	106.0	105.9	106.4	107.2	107.6

Source: Statistics Norway.

**National accounts: Final expenditure and gross domestic product. Price indices. Percentage change from previous period**

	Unadjusted		Seasonally adjusted							
	2005	2006	05.3	05.4	06.1	06.2	06.3	06.4	07.1	07.2
Final consump. exp. of households and NPISHs	1.0	2.0	0.5	-0.1	0.3	1.2	0.3	0.5	-1.0	0.4
Final consump. exp. of general government	2.6	3.8	1.0	0.3	0.9	1.7	1.0	1.0	0.1	1.4
Gross fixed capital formation	2.8	3.6	-0.1	0.1	0.3	2.1	1.7	0.4	0.3	2.5
Mainland Norway	2.0	3.4	-0.3	0.9	1.0	1.1	0.7	1.3	0.7	1.1
Final domestic use of goods and services	1.9	3.0	-0.7	-0.7	1.1	2.7	0.1	-0.3	0.4	1.7
Final demand from Mainland Norway	1.6	2.7	0.5	0.2	0.6	1.3	0.6	0.8	-0.4	0.8
Total exports	17.3	14.0	6.7	7.1	5.9	-2.5	0.4	1.6	-1.9	3.3
Traditional goods	4.0	11.7	3.4	1.3	3.7	3.9	3.1	0.9	-0.9	2.5
Total use of goods and services	6.8	6.6	1.7	1.9	2.9	0.6	0.2	0.4	-0.4	2.1
Total imports	1.2	3.2	0.2	0.6	1.0	-0.0	1.6	3.3	-0.2	1.0
Traditional goods	0.4	4.7	0.0	-0.2	2.6	-0.1	2.1	4.1	0.1	1.2
Gross domestic product (market prices)	8.5	7.7	2.1	2.3	3.4	0.9	-0.3	-0.4	-0.5	2.5
Gross domestic product Mainland Norway (market prices)	2.1	3.4	-1.2	1.0	0.8	2.0	-0.1	0.5	0.8	0.4

Source: Statistics Norway.