

Economic trends

The high rate of growth in the mainland economy has been sustained thus far in 2006, at 4 per cent annualized. Employment growth has been unusually strong and unemployment has fallen sharply, nearing the level prevailing at the cyclical peak towards the end of the 1990s. Consumer price inflation (CPI) has varied somewhat through the year owing to pronounced changes in energy prices, and adjusted for tax changes and excluding energy products (CPI-ATE) the rise in prices has been low. By this measure, it appears that inflation will be 0.8 per cent on an annual basis in 2006. As a result of high commodity prices and not least high oil prices, the current account surplus will break all previous records, and Norway's foreign assets will increase substantially.

The cyclical upturn in the Norwegian economy has continued since spring/summer 2003. Recently published revised national accounts figures have not changed this picture, although both the cyclical downturn in 2001/2002 and the subsequent upturn have been more pronounced than projected earlier. The economic upturn has broadened to include many industries such as goods production, where manufacturing and building and construction activity has increased substantially, and private services. Petroleum extraction has continued to fall however, and growth in services production in the public sector has increased only moderately.

Most observers now expect more moderate global growth in 2007, particularly in the US. A moderate downturn in the US already seems to have started judging by the latest national accounts figures. In Europe, growth has picked up steadily this year, but is also expected to moderate next year. The risk of rising inflation now seems to be smaller than earlier. Many observers now expect that the pace of interest rate hikes will be slow or even be reversed towards the end of next year. In Norway, however, interest rates are being raised steadily, albeit in small steps. We expect that interest rates will continue to increase for a period into 2007.

It now appears that demand impulses from the petroleum sector may be stronger than previously assumed. As a result, growth in the mainland economy may also be somewhat higher than we projected earlier. GDP growth is now estimated to reach such a high level that the Norwegian economy will continue to boom over the next few years, although growth is expected to be slightly more moderate than in 2006. As a result, unemployment will be somewhat lower than projected. Wage growth may thus be somewhat higher than previously projected.

In this report, we have attempted to focus on the effect on the krone exchange rate of a wider interest rate differential between Norway and the euro area. In a box in this report, we discuss developments in the euro/krone exchange rate ahead under various assumptions concerning the interest rate differential, also taking into account that other variables will influence the exchange rate over the next three years. Interest rate increases in Norway with a view to restraining a booming Norwegian economy will also result in a stronger krone exchange rate, which will reduce externally generated inflationary impulses and thereby the likelihood of nearing the inflation target in years ahead. This may also be perceived as problematic for competitiveness and thereby industry structure, and illustrates the economic policy dilemmas at hand.

Cyclical developments in Norway

The revised quarterly national accounts (QNA), which were presented in early December 2006, show that growth in the Norwegian economy has been stronger in recent years than projected earlier. The upward revision of growth estimates is partly attributable to changes to the national accounts system. However, even after attempting to adjust for definitional differences on a discretionary basis, the impression is now that the cyclical upturn in the Norwegian economy seems to have been more pronounced than previously implied by QNA figures. This picture is also in line with the impression of growing pressures in the econ-

omy as reflected in the sharp decline in unemployment through 2005 and 2006. Mainland GDP growth rates are now about a half percentage point higher than projected both in 2004 and 2005. Mainland GDP has been a good 4 per cent on an annual basis, and the figures for the third quarter show clear signs of moderating growth rates. As a result, it appears that 2006 will be the third consecutive year of mainland GDP growth of more than 4 per cent, which has not been witnessed since the previous boom in the latter half of the 1990s.

Macroeconomic indicators 2004-2006. Growth from previous period unless otherwise noted. Per cent

			Seasonally adjusted			
	2004	2005	05.4	06.1	06.2	06.3
Demand and output						
Consumption in households etc.	5.6	3.3	-0.4	1.9	1.4	0.7
General government consumption	1.5	1.8	0.3	0.7	0.2	-0.1
Gross fixed investment	10.2	11.2	12.6	-7.4	6.2	0.1
Mainland Norway	9.3	9.2	9.3	-5.4	7.7	-3.8
Extraction and transport via pipelines	10.2	19.3	14.6	-13.3	5.1	8.4
Final domestic demand from Mainland Norway ¹	5.0	3.9	1.4	0.2	2.2	-0.3
Exports	1.1	0.6	-0.2	-0.5	0.9	-0.5
Crude oil and natural gas	-0.5	-5.0	-2.7	0.0	-3.4	0.1
Traditional goods	3.4	5.2	2.3	-0.1	1.7	1.4
Imports	8.8	8.6	3.2	-0.7	3.8	0.4
Traditional goods	10.9	8.2	0.3	3.1	1.2	1.1
Gross domestic product	3.9	2.4	0.1	0.7	0.5	1.3
Mainland Norway	4.4	4.1	1.2	0.9	1.1	0.9
Labour market						
Man-hours worked	1.8	1.2	0.3	0.8	0.7	0.7
Employed persons	0.5	1.0	0.4	1.1	0.9	0.7
Labour force ²	0.5	1.1	0.2	0.5	0.8	0.2
Unemployment rate, level ³	4.5	4.6	4.5	3.9	3.8	3.3
Prices and wages						
Wages per standard man-year ⁴	4.6	3.7	2.7	2.8	3.7	4.9
Consumer price index (CPI) ⁴	0.4	1.6	1.8	2.2	2.4	2.2
CPI adjusted for tax changes and excluding energy products (CPI-ATE) ⁴	0.3	1.0	1.1	0.9	0.8	0.5
Export prices, traditional goods	8.5	4.0	1.7	4.3	3.8	1.9
Import prices, traditional goods	4.0	0.4	1.0	2.0	-0.4	1.8
Balance of payment						
Current balance, bill. NOK	221.6	300.8	99.2	81.8	88.5	92.5
Memorandum items (unadjusted level)						
Money market rate (3 month NIBOR)	2.0	2.2	2.5	2.6	2.9	3.2
Lending rate, banks ⁵	4.1	3.9	4.0	4.1	4.2	4.4
Crude oil price NOK ⁶	257.3	351.4	377.1	409.7	432.2	434.6
Importweighted krone exchange rate, 44 countries, 1995=100	95.6	91.8	91.0	92.9	89.8	92.2
NOK per euro	8.37	8.01	7.88	8.02	7.83	8.06

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

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

³ According to Statistics Norway's labour force survey (LFS).

⁴ Percentage change from the same period the previous year.

⁵ End of period.

⁶ Average spot price, Brent Blend.

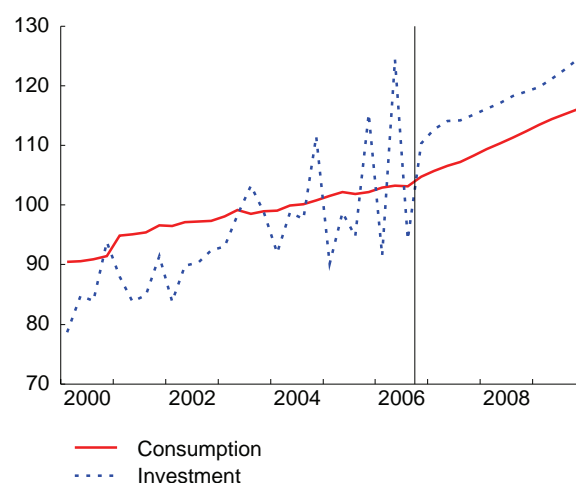
Source: Statistics Norway and Norges Bank.

Unemployment, as measured by the number of unemployed registered with the Norwegian Labour and Welfare Organisation and LFS unemployment, is still falling rapidly. Unemployment levels are almost down to the levels prevailing during the previous boom. We believe that unemployment will edge down further, but that growth in the economy will soften in the period ahead. As a result, the decline in unemployment will probably come to a halt in the course of 2007. Inflation measured by the consumer price index (CPI) has been close to the inflation target of 2.5 per cent through autumn, but adjusted for tax changes and excluding energy products (CPI-ATE), inflation has been a little less than 1 per cent. While CPI-ATE inflation is on the rise, CPI inflation will ease in the period ahead because energy prices and not least oil prices are declining from a high level. Owing to the fall in electricity prices, total CPI inflation was not as high as projected in our previous report, where the projections were based on forward electricity prices.

Where will this cyclical upturn end? This is a question raised ourselves repeatedly over the past two years. One way of answering this has been to invoke the uncertainty surrounding a number of key macroeconomic developments that are influencing the Norwegian economy. International cyclical developments have contributed to pushing up traditional Norwegian exports. It has not been volume growth, but primarily price developments that have been surprisingly strong. Commodity prices have reached a high level and, not least, oil prices remain high. This has resulted in a strong improvement in profitability in Norwegian business and industry, which is now pushing up wage growth. High crude oil prices have also boosted investment profitability on the Norwegian continental shelf and elsewhere in the world. It now seems that oil investment may be somewhat higher than previously estimated, and the upward revision of oil investment is an important factor behind the upward adjustment of our growth estimate for the Norwegian economy in this report. As a result, unemployment has been revised down, which entails an upward revision of our estimates for wage growth.

With respect to the outlook for the global economy, we have not revised our projections to any noteworthy extent. The US appears to have shifted into a downturn, but the amplitude of the downturn is uncertain. We still assume that the downturn will be moderate and that the US economy will not move into recession (i.e. two consecutive quarters of negative GDP growth), but only experience a period of low GDP growth rates in relation to estimated trend growth. Against this background, the likelihood of further interest rate hikes in the US is marginal. It is more likely that the Federal Reserve will lower interest rates in the course of 2007. Such a development in US rates will reduce the likelihood of substantial interest rate hikes in the euro area. Signals from the

General government
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

ECB can now be interpreted to mean that ECB will be slightly less vigilant ahead than it has been in 2006, and there is also a possibility that interest rates in the euro area may be lowered towards the end of 2007 or the beginning of 2008.

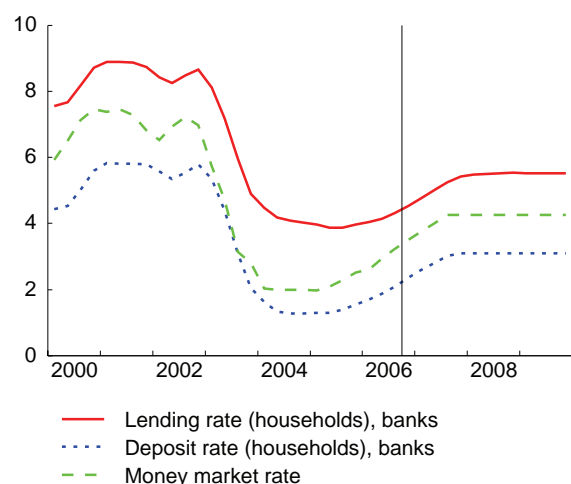
In such a situation, Norges Bank will have difficulties in realizing its interest rate path in the latest *Inflation Report*. Even if CPI-ATE inflation is now rising, the increase will be wholly dependent on exchange rate developments ahead. If Norges Bank's interest rate path materializes at the same time as euro-area interest rates increase only marginally from today's level, the krone exchange rate against the euro is likely to appreciate to well below 8 kroner per euro in 2008. In that case, CPI-ATE inflation will not exceed 1.5 per cent two-three years ahead according to our calculations, and CPI inflation could be even lower as a result of low energy price inflation. However, in the interest of stability in the real economy, it would be of benefit to have a higher interest rate level in Norway. Even if incomes policy can make some contribution to stabilisation policy, the experience of the previous boom demonstrated that it is unrealistic to believe that it can make a contribution when neither monetary policy nor fiscal policy is making a sufficient contribution to curbing the upturn. This is not least the case when sustained growth in oil investment is an important driving force behind the cyclical upturn. When a renewed cyclical upturn is then likely to commence in 2009, there may be a need to tighten economy policy in several areas in relation to the scenario presented in this report.

Fiscal policy – moderate impulses in the near term, stronger in a few years?

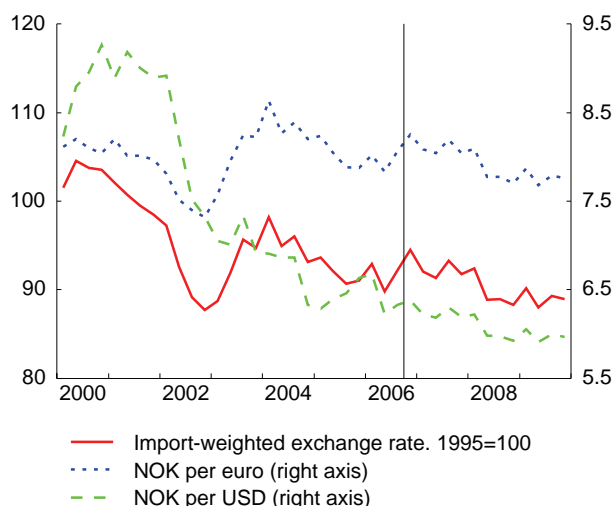
Thus far in 2006, growth in general government consumption has been moderate and lower than estimated. In the National Budget for 2007, consumption growth was estimated at 2.7 per cent between 2005

Norwegian interest rates

Per cent



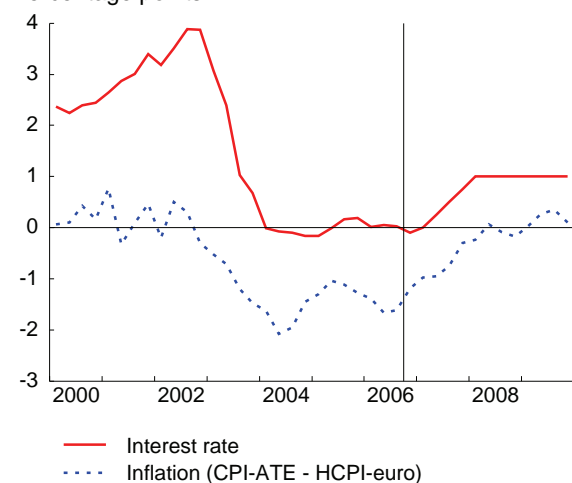
Source: Norges Bank and Statistics Norway.

Exchange rates

Source: Norges Bank.

Interest rate and inflation differential between NOK and the euro

Percentage points



Source: Norges Bank and Statistics Norway.

and 2006. With a seasonally adjusted unchanged level from the third to the fourth quarter, growth was only slightly higher than 1 per cent. Even with a strong increase in the fourth quarter this year, as assumed here, it is unlikely that growth will be higher than 2 per cent on annual basis. General government gross investment shows a substantial increase owing to the purchase of a frigate in the second quarter of 2006. Growth in total investment is estimated at a good 6 per cent, which is lower than estimated earlier because the next frigate delivery has been postponed.

Our projection for spending growth in 2007 is based on the estimates in the National Budget for 2007. However, as consumption growth proved to be slightly lower in 2006 than implied by the budget limits, consumption growth will be slightly higher in 2007 than estimated in the National Budget for 2007. We now assume that the investment level will be slightly higher than in the previous report, in line with the estimates in the National Budget for 2007. The VAT rate for food will be increased further by one percentage point as from 2007. This has been incorporated in the projections and push up CPI inflation in isolation by one tenth percentage point next year. Special taxes increase largely in pace with the projection for CPI inflation in the National Budget for 2007, and this has also been incorporated in our estimations. In 2008 and 2009, we have allowed special taxes to increase in pace with CPI inflation, while tax rates are otherwise held constant. We have thus applied the assumption that the real tax level will remain unchanged after 2007.

The growth projections for the Government Pension Fund- Global have been revised up somewhat in the National Budget for 2007 compared with earlier estimates. We have nevertheless applied the same volume growth in general government spending on consumption and gross investment as previously. These growth rates are now about 1 percentage point higher than estimated trend mainland GDP growth. This implies approximately the same fiscal leeway provided by a growing Government Pension Fund within the limit allowed under the fiscal rule. If the growth path described below materializes, the Norwegian economy will be booming for several years ahead. In isolation, this suggests that fiscal policy should be somewhat tighter than implied by the fiscal rule, either through somewhat lower spending growth or somewhat higher taxes than assumed here. An alternative could be to leave the task of stabilising the real economy to the central bank, but monetary policy leeway may be limited if, for example, the ECB does not increase its policy rate ahead.

Continued rise in interest rates

Thus far in 2006, Norges Bank has raised its key rate in four increments of 0.25 percentage point to 3.25 per cent. We assume that the key rate will be raised

Exchange rate with Norges Bank's interest rate path and Statistics Norway's models

Our projections are based on the assumption that Norges Bank increases the key rate by 0.25 percentage point each quarter up to and including the second quarter of 2007, and that the interest rate is thereafter left unchanged to end-2009. The projections in Norges Bank's latest *Inflation Report 3/2006* are based on the assumption that interest rates will be raised at about the same frequency to end-2008. The difference between Norges Bank's interest rate forecasts and Statistics Norway's forecasts will then be about 1¼ percentage points. In an article by Bjørnstad and Jansen in the Norwegian issue of *Economic Survey*, a model for the krone/euro exchange rate is documented, where the interest rate differential and inflation differential between Norway and the euro area are important explanatory variables. The model is part of Statistics Norway's macro-econometric quarterly model KVARTS and is used to produce our exchange rate projections.

In the following, our calculations illustrate the impact of Norges Bank's interest rate path on the exchange rate. Both calculations are made using the exchange rate model referred to above. In calculation A, the explanatory variables are assumed to move broadly in line with that projected by Norges Bank¹. In this calculation, it is assumed that there are no repercussive effects from exchange rate changes on the explanatory variables. Developments in the explanatory variables thus remain the same as Norges Bank's projections irrespective of exchange rate movements. If our exchange rate model provides a reasonably good description of exchange rate developments, this calculation can be interpreted as a consistency check of Norges Bank's forecasts, i.e. to what extent Norges Bank's exchange rate projections are in accord with the forecasts for the interest rate differential and inflation differential between Norway and the euro area.

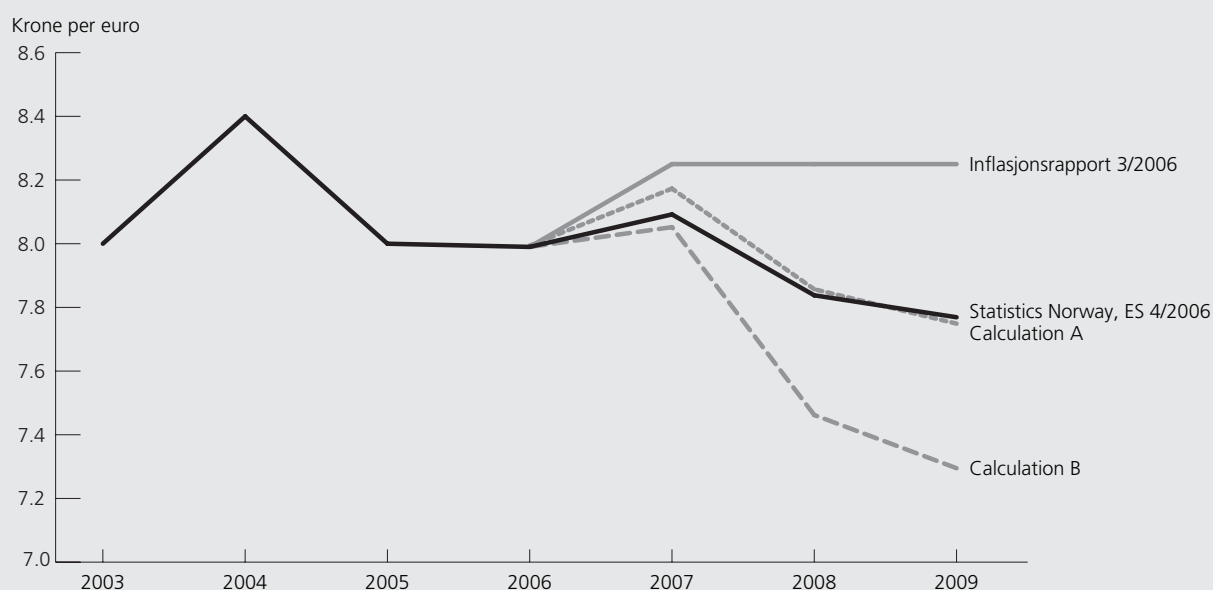
Calculation B is also based on Norges Bank's interest rate path for Norwegian interest rates, but is otherwise based on our projections. Moreover, KVARTS is used to estimate the repercussive effects from exchange rate changes on consumer prices, which is one of the explanatory variables in the exchange rate model. Consumer prices will thus move on a different path in this calculation compared with our initially projected path. The calculation can be interpreted as an estimation of the effect of Norges Bank's maintaining its

interest rate path even if developments in the Norwegian and global economy are otherwise consistent with our projections/models.

Developments in the krone/euro exchange rate in the two calculations in the period to end-2009 are shown in the figure below together with Norges Bank's exchange rate projection and the projection in this report. A falling value denotes an appreciation of the krone against the euro. Norges Bank has only made projections for the import-weighted exchange rate, but since the exchange rate is assumed to remain constant at around the level in the fourth quarter of 2006, we assume that the same also applies to the krone/euro exchange rate. In calculation A, the krone depreciates against the euro from 8.0 in 2006 to 8.2 in 2007 and then appreciates to 7.9 in 2008 and 7.7 in 2009. With the same projections for the other variables, Norges Bank assumes that the krone/euro exchange rate will remain at about 8¼ throughout the projection period. The exchange rate movements in calculation A are very close to the projections in this report, and illustrate that even if Norges Bank's interest rate and inflation forecasts are higher than ours, the forecasts for the interest rate differential and inflation differential are more similar. According to our exchange rate model, however, the forecasts are not consistent with an unchanged exchange rate.

According to calculation B, the krone/euro exchange rate will appreciate further if Norges Bank's interest rate path materializes and our projections/model are otherwise accurate. The krone will then appreciate to 7.5 in 2008 and 7.3 in 2009. In relation to calculation A, euro-area interest rates are reduced by up to 1/2 percentage point in this calculation. The krone appreciation affects the Norwegian economy through two main channels. First, the exchange rate has an impact on manufacturing's international competitiveness, and second it influences prices for imported goods in NOK. Calculation B in relation to our projections shows that the krone appreciation results in a decline in CPI-ATE inflation from 1.4 to 0.6 per cent in 2008 and from 1.7 to 1.1 per cent in 2009.

¹ Norges Bank has generally produced projections for all the explanatory variables in the exchange rate model, but some recalculations have been necessary in order to provide the same form as in the model.



by a further 0.25 percentage point at Norges Bank's Executive Board meeting on 13 December, bringing the key rate to 3.5 per cent after this meeting. The interest rate increase has been priced into the money market. In addition, 3-4 interest rate hikes have been priced into the market in the period to September next year.

In interest-rate setting, Norges Bank shall strike a balance between stabilizing inflation, the exchange rate, output and employment. The operational objective of monetary policy is annual consumer price inflation of close to 2.5 per cent over time. The low inflation rate prevailing in recent years can primarily be looked upon as the result of a supply-side shock. Such shocks can lead to both low inflation and high capacity utilisation, and when setting interest rates Norges Bank must weigh the objective of stabilizing inflation around the operational target against stabilizing output growth.

The year-on-year rise in the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) has increased somewhat since summer. In November this year, the CPI-ATE was 0.8 per cent higher than in the same month one year earlier. CPI-ATE inflation was thus well below target. In isolation, the low inflation rate suggests that the key rate should be kept at a low level.

Domestic credit growth, as measured by 12-month growth in private sector gross debt (C2), was 14.6 per cent in October this year. In the previous month, C2 growth was as high as 15.0 per cent. This is the largest increase in C2 since the 1980s and probably the highest since the measure was introduced in the mid-1980s when adjusting for inflation. Persistently strong debt growth can lead to instability in the economy. Since growth in private sector gross debt partly depends on the interest rate level, this suggests further interest rate increases.

The European Central Bank (ECB) raised its policy rate by 0.25 percentage point in early December. This is the sixth interest rate hike the last 12 months. The latest increase brought the policy rate up to 3.5 per cent in the euro area. Money market rates in Norway and the euro area have thus moved in close tandem over the past year. The money market has not priced in further rate increases by the ECB.

The krone exchange rate has varied somewhat this year. In May, 1 euro cost around 7.80 Norwegian kroner, but the euro was worth more than 8.40 kroner through most of October. In the beginning of December the exchange rate was a little more than 8.10 per euro. The import-weighted krone exchange rate showed about the same development through 2006. From the beginning of the year to mid-May, the krone appreciated by 4 per cent and then depreciated by 9

per cent to mid-October. Over the past two months, the krone has appreciated again and was at the same level on 10 December as in the beginning of January.

Our projections are based on unchanged key rates in the euro area during the projection period. An article in the Norwegian issue of *Economic Survey* "Renta bestemme det meste" (The interest rate rules) by Roger Bjørnstad and Eilev S. Jansen shows that the interest rate differential between Norway and the euro area has a pronounced impact on the euro/krone exchange rate. This makes it difficult to keep the euro/krone exchange rate stable if interest rates increase in Norway and remain unchanged in the euro area (see box).

We assume that Norges Bank will increase the key rate in two increments in 2007. The interest rate hikes are expected to take place in the first six months of next year. Money market rates are assumed to increase to 4.25 per cent as from the third quarter of next year and remain at that level to the end of the projection period. The average lending rate is assumed to follow the money market rate with a one percentage point mark-up. New capital adequacy rules from the beginning of 2007 will contribute to keeping this margin low and may also lead to a margin reduction. Banks' lending rates are assumed to increase to 5.5 per cent through 2007 and to remain at this level in 2008 and 2009.

A widening interest rate differential between Norway and the euro area implies an appreciation of the krone. We apply a euro/krone exchange rate of 8.10 in 2007 and a strengthening of the krone to about 7.80 in 2009.

Oil investment up to 100 billion – and even higher

Statistics Norway's latest investment intentions survey indicates that oil and gas investment will amount to about NOK 100 billion in 2006, or about the same estimate implied by the previous survey. After relatively weak growth in the first half of the year, preliminary QNA figures show that investment growth gained momentum in the third quarter. Investment volumes are now almost 6 per cent higher in the first three quarters of this year, compared with the same period one year earlier. Investment is assumed to show a further strong increase in the final quarter of this year, bringing growth in the volume of investment close to 7 per cent on an annual basis. The survey also shows that the value of oil investment will remain at the same level next year. Exploration investment will show a particularly strong increase, while investment in both on-shore installation and pipelines will fall markedly with the completion of the on-shore installations linked to the Ormen Lange and Snøhvit fields and the Langeled pipeline system. Experience shows that estimates for that many quarters ahead are mark-

edly lower than the final estimates. We therefore apply an investment level that is about 5 per cent higher in volume in terms in 2007 than in 2006. Capacity constraints in the rig market are likely to limit exploration activity, and exploration activity will also be competing for production drilling rigs, where a considerable increase is also expected. The reported exploration estimates will be difficult to realize, but we nevertheless apply a 50 per cent increase, at constant prices, in exploration activity. We also expect a marked increase in investment in fields in operation and field development.

For the remainder of the projection period, we now have broader information than earlier. Oil companies' investment plans and projects for this period have become more concrete in recent months, both with regard to time schedule and the size of investments. In 2008, the investment volume is estimated to increase by close to 5 per cent and by a further 7 per cent in 2009. In addition to higher exploration investment, investments in pipelines, field development and fields in operation are expected to increase. Investments relating to Tyrihans (already approved), Gjøa and related oil fields, Goliat, Skarv, Idun, Troll Phase 3 and Snøhvit Oil will probably be the largest new field development projects in the years ahead. A number of smaller projects are also in the planning phase. We also allow for unforeseen investment projects that are not yet in the planning phase. Given the prospect of sustained high oil prices, many new field discoveries are considered to be viable. Promising exploration areas and a growing rig fleet are also underpinning continued growth in oil investment.

This path for oil investment will contribute to amplifying the boom throughout the projection period, and at constant prices the investment record set in 1998 will be broken already in 2007. Measured as a percentage of mainland GDP, the 8 per cent record from 1998 will remain intact, and in the baseline scenario investment growth is highest in 2009 at 6.5 per cent.

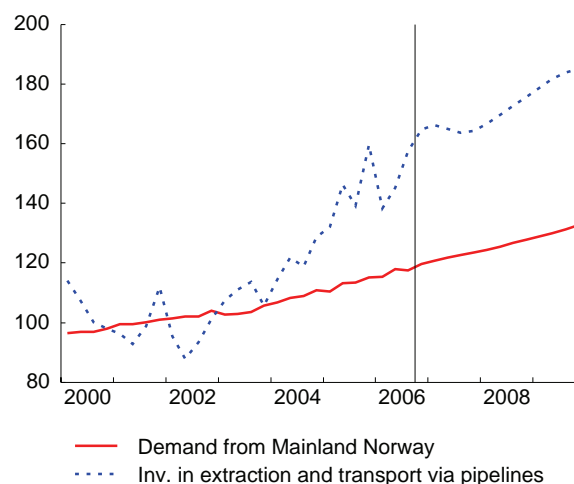
According to QNA figures, total oil and gas production fell by a little more than 4 per cent between 2004 and 2005. This tendency continued during the first six months of this year, but now seems to have reversed. Production is expected to increase further in the fourth quarter, but will still be clearly below the level in the final six months of the year compared with the same period in 2005. For the year as a whole, production is expected to be close to 5 per cent lower in 2006 than in 2005. In 2007, both oil and gas production is expected to increase, with the overall increase estimated at a little less than 6 per cent. This is lower than assumed earlier, and primarily reflects a downward adjustment of Hydro's and Statoil's 2007 production estimates in recent months. Gas production is expected to show a marked increase through 2008 and 2009, while oil production will gradually fall.

Household real disposable income. Percentage growth from the previous year

	2005	2006	2007	2008	2009
Total	4.7	-3.8	6.2	4.5	3.8
Excl. dividends	1.2	3.2	4.1	4.2	3.5

Domestic demand

Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

Overall, production is expected to increase further by close to 6 per cent between 2007 and 2008 and to fall by close to 2 per cent in 2009.

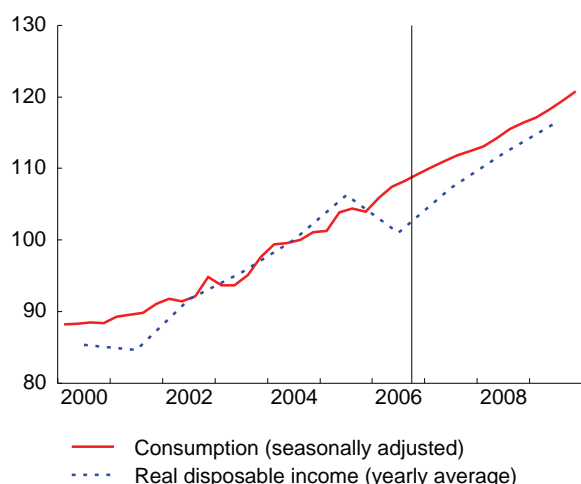
Consumption growth remains buoyant

Seasonally adjusted QNA figures show that consumption for households and non-profit institutions increased by 0.7 per cent between the second and third quarter of 2006, after growing by 1.9 per cent and 1.4 per cent, respectively, in the previous two quarters. Goods consumption increased by 1.2 per cent and accounted for almost the entire increase in consumption in the third quarter of this year. Most groups of goods showed an increase, but the main contributors to growth in goods consumption were clothing and footwear, cars and food. On the other hand, spending on services showed close to zero growth during the same period. For the first three quarters of the year as a whole, total consumption was about 3.9 per cent higher than in the same period one year earlier. The brisk rate of growth in consumption over the past few years has thus continued so far in 2006. On an annual basis, consumption growth is now estimated at a good 4 per cent this year.

Looking back, consumption grew by 3.3 per cent between 2004 and 2005, which probably reflected growth in household real disposable income, excluding record-high share dividend payments (see table). The unusually high level of share dividend income, which must be seen in the light of the re-introduction

Income and consumption in households

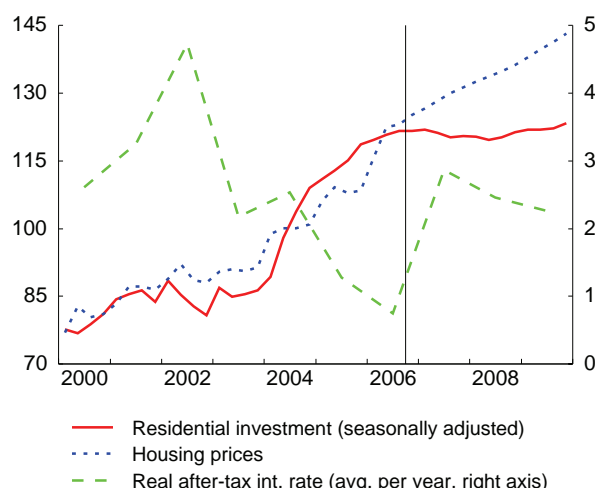
Volume indices, 2004=100



Source: Statistics Norway.

Residential market

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



Source: Statistics Norway.

of dividend tax in 2006, has probably generated only a marginal stimulus to consumption. The sharp fall in the real interest rate after tax in recent years is the main explanatory factor behind consumption growth in 2006.

Growth in household real disposable income is now expected to gain further momentum through the projection period, also when excluding dividend payments. In the period ahead, growth will be boosted by stronger growth in self-employment income and public transfers. Wage growth is also projected to accelerate in 2007. Higher consumer price inflation, particularly in 2006, will push down growth in household real disposable income, however. Household debt will show a fairly large increase in relation to assets through the projection period which, combined with a

rise in interest rates, will translate into a weak increase in net capital income. This will push down growth in real disposable income. Higher direct taxes will also push down disposable income in the period ahead. Real interest rates after tax will be considerably lower this year than in the two preceding years, and will then increase markedly through 2007 before edging down again to a level of around 2.5 per cent in 2008 and 2009. The income and interest rate path applied here results in a growth path for consumption of around 3.5 per cent in the next few years, i.e. sustained high consumption growth ahead.

Against the background of our projections, the household saving ratio will fall from 8.6 per cent in 2005 to almost 1 per cent in 2006, and will then vary between 3-5 per cent in the period 2007-2009. The decline in the saving ratio between 2005 and 2006 is reflected in a marked fall in household net lending. Measured at current prices, household net lending is assumed to fall from NOK 24 billion in 2005 to -44 billion in 2006. However, the decline primarily reflects estimated changes in dividend payments to households, but increased debt to finance the strong rate of growth in housing capital has probably also contributed to the decline. The shift in household assets away from financial assets to real assets will probably continue, which will be reflected in a continued high level of housing investment ahead.

Housing investment levels off

The main driving forces behind the strong growth in housing investment observed since the end of 2003 have been strong real income growth, lower real interest rates and the rise in real resale home prices. The high level of housing starts recorded since the end of 2005 implies a sustained, high level of housing investment also through 2006. In line with this development, seasonally adjusted QNA figures so far in 2006 show that housing investment has levelled off somewhat and stabilized at a growth rate of a little less than one per cent in the third quarter. For the first three quarters as a whole, housing investment was still close to 7 per cent higher than in the same period one year earlier. On an annual basis, housing investment is now estimated to expand by a little less than 6 per cent in 2006, compared with 14.5 per cent in 2005.

In a historical context, housing capital is now at a very high level, also in relation to income levels. Coupled with the prospect of higher real interest rates, this will restrain both house price inflation and housing investment in the period ahead. The flattening-out tendency for housing investment observed so far in 2006 is thus expected to continue, with housing investment projected to hover around a stable, high level of about NOK 90 billion in NOK-2006 through the projection period. This corresponds to a little less than 6 per cent of mainland GDP. The rate of increase

in nominal resale home prices is projected at around 5 per cent in the years ahead, i.e. a markedly slower rate than the estimated increase of a good 12 per cent in 2006.

Pace of investment slows

The strong pace of growth in mainland gross investment now appears to have slowed after three years of rapid expansion. After growing sharply in the fourth quarter of 2005, investment growth has levelled off in 2006 and mainland business investment was only 2.3 per cent higher in the third quarter of 2006 than in the fourth quarter of 2005, adjusted for seasonal variations. Compared with mainland investment growth of 10.3 per cent in 2005 as a whole, the figures so far indicate a marked slowdown in investment growth. This profile reflects developments in investment in manufacturing, mining and quarrying and private services. National accounts figures for investment in manufacturing and mining and quarrying show that investment was 5.5 per cent higher in the third quarter of 2006 than in the fourth quarter of 2005, while investment in private services fell somewhat during the same period. For other goods production, unadjusted national accounts figures show virtually unchanged investment growth in the third quarter of this year, compared with the same quarter one year earlier.

Statistics Norway's investment intentions survey indicates that growth in manufacturing investment will be about 5 per cent between 2006 and 2007. For the power supply industry, investment growth is estimated at 30 per cent this year, but the growth rate will slow to around 10 per cent next year according to the survey. Investment in private services is expected to grow at a somewhat slower pace. All in all, business investment is estimated to expand by around 5 per cent in the coming year.

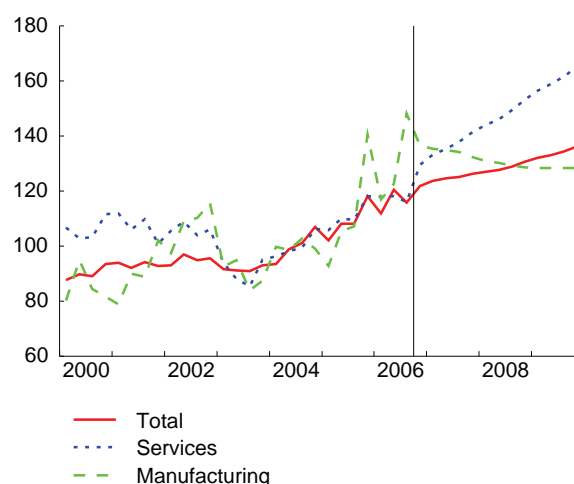
Lower growth in traditional goods exports ahead

Traditional goods exports increased sharply also in the third quarter of this year, with growth at close to 1.4 per cent against the same quarter one year earlier. This primarily reflects high exports of engineering products. Growth in total exports still slowed by 0.5 per cent owing to lower exports of services, while the export volume of services is still at a high level. For the first time in five quarters, the export volume of oil and natural gas also increased, but growth was moderate at 0.1 per cent.

Prices for traditional goods exports rose by 1.9 per cent in the third quarter, after rising sharply during the preceding five quarters. The main contribution comes from a marked increase in metal prices over the past year. Metal prices have risen by around 10 per cent in each of the past three quarters. Overall, export prices still fell by 0.3 per cent in the third quarter

Investment, Mainland Norway

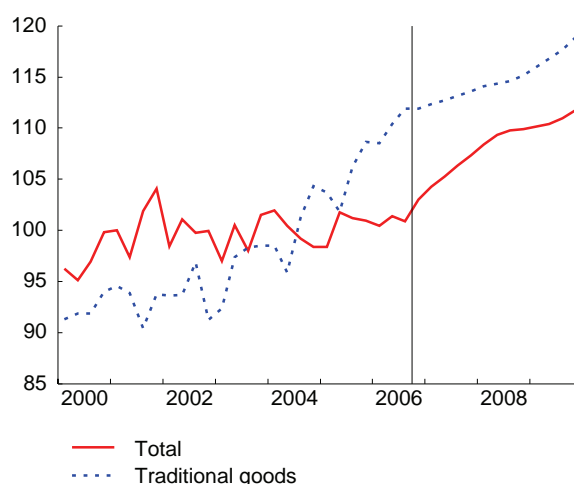
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

Exports

Seasonally adjusted volume indices, 2004=100



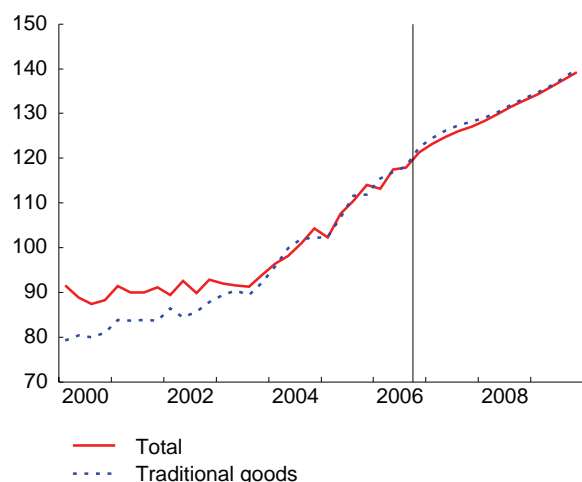
Source: Statistics Norway.

ter as a result of a continued fall in oil and natural gas prices.

Volume growth in traditional goods exports is expected to edge down to the end of the year, bringing growth for 2006 to 5.6 per cent. In 2007 and 2008, growth will continue to slow to 1.8 and 1.3 per cent, respectively. This is attributable to lower demand growth among our main trading partners as the world economy moves into a downturn, but also implies a loss of market shares. Towards the end of the projection period, a cyclical turnaround in the world economy is projected which will fuel export growth. Total exports will only show a small increase in 2006 owing to a decline in exports of oil and gas, while continued strong growth in service production will have the opposite effect. In 2007, oil and gas exports will increase for the first time since 2002 and, combined with high-

Imports

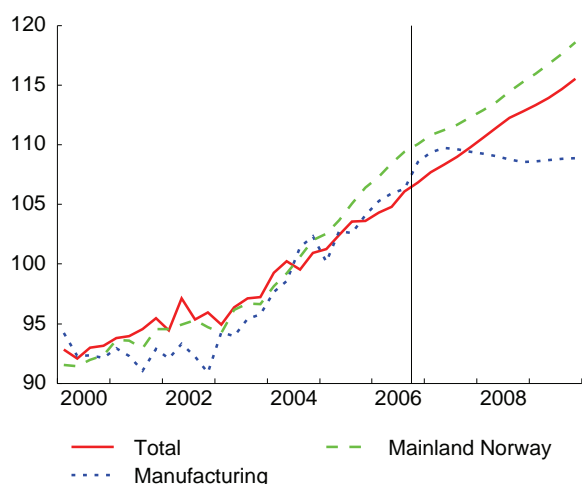
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

Gross domestic product

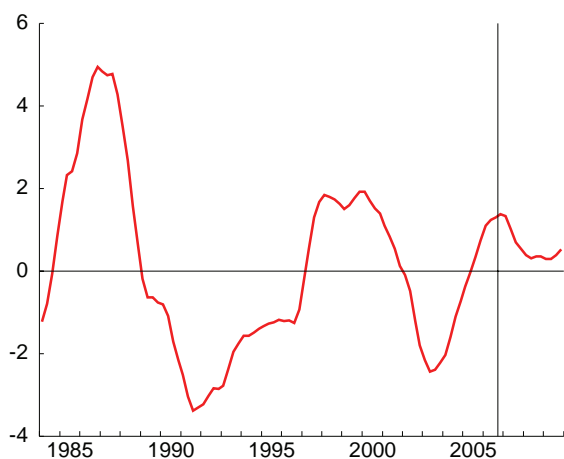
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

Output gap, Mainland Norway

Deviation from trend, per cent



Source: Statistics Norway.

er service exports, will push up overall growth to a little more than 4 per cent. Sustained oil and natural gas exports will contribute to holding up overall export growth in 2008, but a clear decline in 2009 will result in total export growth of a little less than 1 per cent.

Imports grow at a sustained strong pace in 2007

The volume of traditional goods imports increased by 1.1 per cent between the second and third quarter of this year, compared with a 1.2 per cent in the previous quarter. The main growth contributors were metals, office and computer equipment and engineering products. This reflects buoyant growth in business investment in the second and third quarter. Imports of textiles and footwear edged down for the first time since the second quarter of 2005, however. Overall growth in goods imports between the second and third quarter was negatively influenced by the fact that one frigate was delivered to the defence industry in the second quarter while no deliveries were made in the third quarter. Services imports increased by 2.3 per cent with a particularly strong increase of 12.8 per cent in the import volume of commercial services. Indirectly measured banking and insurance services, which are now distributed by use as a result of the main revision, fell by 0.4 per cent.

Prices for traditional goods imports rose by as much as 1.8 per cent between the second and third quarter. Metals, electricity, textiles and footwear and clothing made the main contribution to the rise in prices. The rise in electricity prices was particularly high at 41.7 per cent.

Growth in traditional goods imports is assumed to be as high as 9.4 per cent in 2006. In 2007, import growth will slow somewhat in pace with easing growth in domestic demand, but will still be relatively high at around 6 per cent. In 2008, import growth will slow further to a little more than 3 per cent, followed by a slight increase again in 2009 when the cyclical upturn in Norway is amplified. In the years to 2009, we assume that one frigate will be delivered in each year. This extraordinary military investment will thus not make a contribution to import growth in those years.

Intensified boom

According to revised QNA figures, mainland GDP has continued to grow at a steady high rate since 2004. Through the first three quarters of 2006, growth shows no clear signs of easing. On an annual basis, growth can now be estimated at a little more than 4 per cent between 2005 and 2006, or at about the same rate as in the two previous years. Growth in 2006 is particularly high in some private service segments such as retail trade and financial and commercial services, but growth has also been buoyant in

Main economic indicators 2005-2009. Accounts and forecasts. Percentage change from previous year unless otherwise noted

	Accounts 2005	Forecasts									
		2006			2007			2008		2009	
		SN	MoF	NB	SN	MoF	NB	SN	NB	SN	NB
Demand and output											
Consumption in households etc.	3.3	4.1	3.7	4	3.6	3.0	3 1/2	3.2	2 3/4	3.4	2 1/4
General government consumption	1.8	1.9	2.7	2 3/4	2.9	2.7	2 3/4	3.8	3	3.7	3 1/4
Gross fixed investment	11.2	9.2	8.2	..	4.2	1.8	..	3.0	..	4.4	..
Extraction and transport via pipelines ¹	19.3	6.7	5.0	5	5.0	-2.5	0	4.6	-5	7.0	0
Mainland Norway	9.2	8.3	9.3	7 3/4	4.7	2.9	5 1/2	2.8	1	4.2	-3/4
Industries	10.3	11.0	7.1	..	7.6	6.1	..	4.5	..	5.7	..
Housing	14.5	5.6	8.4	..	-0.7	0.0	..	-0.6	..	1.9	..
General government	-0.4	6.4	16.1	..	6.2	0.2	..	3.4	..	3.6	..
Demand from Mainland Norway ²	3.9	4.2	4.4	4 1/4	3.6	2.9	3 3/4	3.2	2 1/2	3.6	2
Stockbuilding ³	0.5	0.8	..	..	0.0	..	..	0.0	..	0.0	..
Exports	0.6	0.6	1.8	..	4.6	5.3	..	3.8	..	0.7	..
Crude oil and natural gas	-5.0	-5.2	-2.7	..	6.3	6.8	..	6.2	..	-2.2	..
Traditional goods ⁴	5.2	5.6	5.5	6 1/2	1.8	4.0	4 1/2	1.3	2 3/4	2.4	2 3/4
Imports	8.6	8.6	7.4	6 1/4	6.0	3.5	4 1/4	4.2	2 1/4	4.5	2 1/4
Traditional goods	8.2	9.4	6.8	..	6.7	5.2	..	3.3	..	4.5	..
Gross domestic product	2.4	2.5	2.4	2 3/4	3.1	3.6	3 3/4	3.1	3	2.0	1
Mainland Norway	4.1	4.2	3.4	4	2.4	2.9	3 1/4	2.4	2	2.8	1 3/4
Labour market											
Employed persons	1.0	2.9	2.6	2 3/4	1.7	1.3	1 1/2	0.9	1/4	1.5	0
Unemployment rate (level)	4.6	3.5	3.3	3 1/2	3.0	3.0	3	3.0	3 1/4	2.7	3 3/4
Prices and wages											
Wages per standard man-year	3.7	4.0	3 3/4	4 1/4	5.3	4 1/2	5	4.1	5 1/4	4.8	4 3/4
Consumer price index (CPI)	1.6	2.3	2 1/2	2 1/4	0.8	1 3/4	1 1/4	1.5	2	1.7	2 1/2
CPI-ATE ⁵	1.0	0.8	1	1	1.4	1 1/2	1 1/4	1.4	2 1/4	1.7	2 1/2
Export prices, traditional goods	4.0	11.3	..	..	-4.5	..	..	-6.6	..	-1.4	..
Import prices, traditional goods	0.4	3.2	..	..	-0.9	..	..	-4.7	..	-2.0	..
Housing prices ⁶	7.9	12.4	..	..	6.4	..	..	3.7	..	4.7	..
Balance of payment											
Current balance (bill. NOK)	300.8	366.9	..	..	415.0	..	..	371.4	..	343.9	..
Current balance (per cent of GDP)	15.5	17.0	17.8	..	18.7	16.9	..	16.5	..	14.9	..
Memorandum items:											
Household savings ratio (level)	8.6	0.9	3.0	..	3.4	4.2	..	4.6	..	4.9	..
Money market rate (level)	2.2	3.1	..	3	4.1	..	4 1/4	4.3	5 1/4	4.3	5 1/2
Lending rate, banks (level) ⁷	3.9	4.3	..	..	5.1	..	..	5.5	..	5.5	..
Crude oil price NOK (level) ⁸	351	415	425	..	355	390	..	301	..	299	..
Export markets indicator	6.3	8.0	..	..	5.1	..	..	2.3	..	3.4	..
Importweighted krone exchange rate (44 countries) ⁹	-3.9	0.5	..	3/4	-0.3	..	2 1/2	-2.7	1/4	-0.6	0

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

Source: Statistics Norway (SN), Ministry of Finance, St.meld. nr.1 (2006-2007), (MoF), Norges Bank, Inflasjonsrapport 3/2006 (NB).

building and construction and some manufacturing segments. Labour market pressures have increased substantially in recent quarters and labour shortages will place increasing constraints on continued high growth. On the demand side, the expansion is broadly based, with strong growth in investment, household consumption and mainland exports. As a result, import growth has also been strong, as described above.

We still expect growth in mainland domestic demand to soften somewhat in the period ahead, primarily

owing to lower investment growth. Housing investment appears to be nearing a peak and manufacturing investment is not expected to show an appreciable increase. It is true that investment in the power supply industry will increase markedly next year, but from already low levels. Investment in other industries will continue to edge up, but labour shortages could limit growth next year. Growth in household consumption is expected to slow somewhat as a result of higher real interest rates, but the slowdown is likely to be moderate.

At this juncture, it appears that growth impulses from oil investment to the mainland economy will persist in 2007 and in the following years. This impetus to the economy comes from an already high investment level and was not incorporated in our projections earlier. In line with that previously assumed, international cyclical developments are expected to curb growth in mainland exports and thereby growth in manufacturing. With the projected strong growth in oil investment, manufacturing may also continue to grow through most of 2007. Previously, the pace of the expansion of the Norwegian economy was projected to ease in the course of 2007. This is still the case, but the output gap is now projected to be higher in 2007 than estimated earlier.

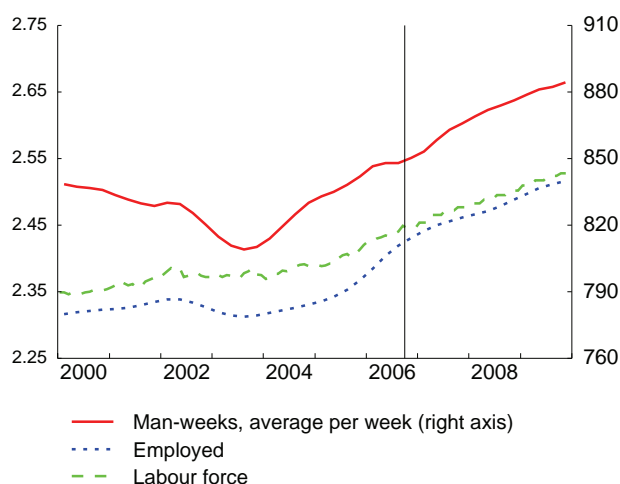
In 2009, the stimulus from fiscal policy and a continued increase in oil investment will contribute to a further small increase in mainland growth. Norges Bank is expected to raise its key policy rate somewhat further through 2007 than we assumed earlier, which in isolation will curb growth. With weaker cyclical developments in the OECD area, policy rates abroad may not be increased to any considerable extent and may even be reduced somewhat towards the end of 2007 or the beginning of 2008. In Norway, however, economic growth will remain buoyant because fiscal policy and increased oil investment more than offset the moderate cyclical downturn in OECD countries. With sustained growth impulses from fiscal policy and the petroleum sector, it may be desirable to tighten policy to a further extent than we have assumed, particularly in 2009 when the business cycle is expected to shift again and move into an upturn.

Low unemployment ahead

The labour market has tightened considerably over the past year. In the third quarter of 2006, unemployment measured by the Labour Force Survey (LFS) was 3.4 per cent (3.3 per cent excluding the revision in January this year (see *Economic Survey* 1/2006)). In the same period one year earlier, unemployment stood at 4.8 per cent. Such a pronounced fall in unemployment over four quarters has never previously been registered in the LFS.

Thus far in the current boom, the LFS unemployment rate has not come down as far as around the previous cyclical peak at the turn of the year 1998/99. The number of unemployed registered with the Norwegian Labour and Welfare Organisation is now somewhat lower than at that time. According to seasonally adjusted figures from the quarterly national accounts, the number of employed has increased by close to 125 000 over the past 8 years. Between 2005 and 2006 alone, employment is estimated to rise by 67 000. This is the strongest annual increase registered for more than 40 years.

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



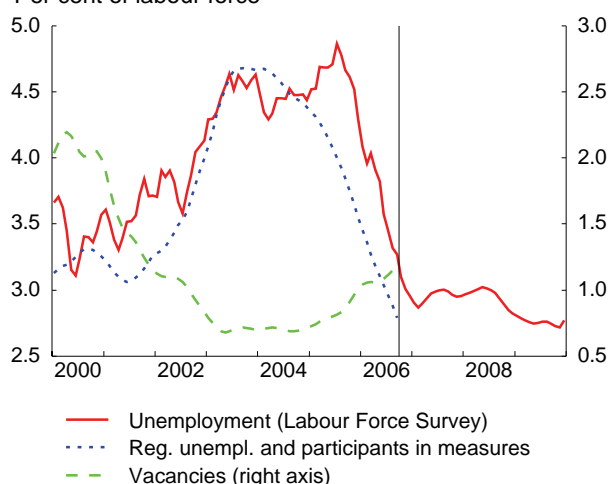
Source: Statistics Norway.

Since 1998, the population in the age group 15-74 has increased slightly more than employment, with some decline in labour force participation rates. However, lower average labour force participation is primarily due to an increase in the average age of the working population. While the age group 55-74 accounted for 13.5 per cent of the working population in 1998, the share increased to 18.3 per cent in 2005. A growing share of older workers will contribute to reducing the average labour force participation rate. Increased inward labour migration may have the opposite effect and will probably be an important factor in satisfying the need for labour ahead.

There have been marked shifts in industry structure during the latest business cycle. Between the first quarter of 1999 and the third quarter of 2006, seasonally adjusted QNA figures showed that manufacturing employment fell by 46 000. Other industries have also witnessed a clear fall during the same period, with employment falling by 10 000-20 000, notably in agriculture and forestry and defence and postal and telecommunications services. Services account for virtually the entire growth in employment. Health and social services account for the largest share of growth, with an increase of 79 000 in the number employed. Employment has also increased markedly in commercial services (53 000), retail trade (36 000) and building and construction (28 000). As a percentage, growth was highest in commercial services. The shift in employment away from manufacturing and into services will probably continue in the years ahead.

Our projections show stable, low unemployment in the period to end-2009. Unemployment is projected to fall from 3.5 per cent in 2006 to 3.0 per cent in 2007 and 2008. Unemployment is then projected to fall to an average rate of 2.7 per cent in 2009. Sustained growth in oil investment will contribute to offsetting

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



Source: The Directorate of Labour and Statistics Norway.

the negative demand impulses from the global cyclical slowdown. As a result, manufacturing employment will only show a moderate decline during the period as a whole. Strong growth in the public sector, particularly in 2008 and 2009, but also in 2007, necessarily means that the largest share of the increase in the labour force will be employed in the central and local government sectors. While total employment is projected to increase by close to 60 000 between 2007 and 2009, employment growth in the public sector is estimated at a good 50 000 in the same period. The strong rate of growth in private services observed in recent years will thus not continue at the same pace, partly reflecting an easing of consumption growth through the projection period.

Wage growth accelerates in 2007

According to quarterly national accounts figures, annual growth in wages per normal person-year worked showed a clear increase between the second and third quarter of this year. In the third quarter, wage growth by this measure was 4.9 per cent compared with 3.7 per cent in the previous quarter. However, in years with main wage settlements this pattern is normal. The increase between the third and fourth quarter of this year was the same as in 2004, which was also a main settlement year. The level of wage growth was 0.7 percentage point lower this year, however. In 2004, annual growth in wages per normal person-year was 4.6 per cent. Wage growth is still estimated at 4.0 per cent in 2006.

Several revisions of national accounts figures since 2002 have shown that income in the enterprise sector has been far higher than previously anticipated. In this respect, the moderate rate of wage growth since 2003 may indicate that there has been a change in wage formation. However, preliminary studies indicate that it is rather the composition of enterprises'

income that has changed, with marked growth in income from sources other than traditional production.

As previously, it is assumed that wage growth will closely follow enterprises' production income with some lag. However, growth in production income also appears to be very high, particularly over the past year. According to preliminary national accounts figures for the first three quarters of this year, prices for traditional goods exports have increased by as much as 15 per cent annualized, and productivity growth has also been high.

In addition to enterprises' income, labour market developments are a key determinant of wage growth. The sharp fall in unemployment over the past year will contribute to pushing up wage growth next year. In a box in this report, our calculations show the impact of a decline in unemployment on wage growth. In the long term, the unemployment level only affects the wage level in our models, and not wage growth, but after a fall in unemployment it normally takes time for wages to adjust to the new level. According to our calculations, the decline in unemployment between 2005 and 2006 will push up wage growth by 0.7 percentage point in 2007.

Increased inward labour migration has placed a limitation on wage growth, and this is also likely to apply ahead. Since foreign labour is often compensated at a lower wage level than other labour, this reduces the average wage level. In addition, increased labour market competition may limit wage growth in general. We assume that our models largely capture this as unemployment has thus been higher than would otherwise have been the case. Consequently, we assume that unemployment has the same impact as earlier.

Both enterprises' income and the labour market have improved to a further extent than assumed in the previous report, and it now seems that wage growth will be markedly high between 2006 and 2007 than in recent years, and more on a par with the cyclical peak around the turn of the millennium. In 2007, growth in wages per normal person-year worked is estimated at 5.3 per cent, i.e. an upward revision of 0.3 percentage point of the figure in the September report.

The decline in unemployment between 2005 and 2006 will provide a sustained positive contribution to wage growth throughout the projection period, i.e. 0.3 percentage point in 2008 and 0.4 percentage point in 2009. The easing of growth in the world economy will, however, reduce profitability for manufacturing enterprises. World market prices for Norwegian export products swing widely with international cyclical fluctuations. In addition, the krone is likely to appreciate in the course of 2008. This will push down

The impact of a decline in unemployment on wage growth and inflation

After remaining steady at about 4.5 per cent, the LFS unemployment rate has declined sharply over the past year. The average annual rate is now projected to fall by as much as 1.1 percentage points, from 4.6 to 3.5 per cent. In the economic literature, there is disagreement as to the impact of a permanent change in unemployment on wage growth. Some economists argue that wage growth will remain high as long as unemployment is low. Others expect the wage level to stabilize after a period at a higher trajectory so that the effect on wage growth gradually unwinds.

In Statistics Norway's empirical, quantified wage models, there is a clear relationship between the level of unemployment and wage growth in the short term, but in the long term unemployment only affects the wage level and not wage growth. However, it takes time for the wage level to adjust to a new unemployment level. In the wage models, the wage level can take a very long time to stabilize, which we illustrate here. Using the macro-econometric model KVARTS, we have quantified the effect of the decline in unemployment between 2005 and 2006 on wage growth and inflation in the period to 2009. The quantification is based on two different unemployment paths. In one alternative, unemployment is held at the 2005 level throughout the projection period. In the other, unemployment is left at the 2006 level. This allows us to compare wage growth and inflation in the two calculations, which are illustrated in figures 1 and 2. The decline in unemployment influences many of the model variables. The decline may influence exogenous variables, which must therefore be determined outside the model. The interest rate and economic policy in general are examples of such variables. They are held at the same level in the two calculations. The calculations show that a decline in unemployment rapidly leads to higher wage growth. In 2006, wage growth accelerates by 0.8 percentage point as a result of the unemployment fall between 2005 and 2006. In 2007 and 2008, annual wage growth is 1.0 percentage point higher. In 2009, wage growth accelerates by 0.7 percentage point.

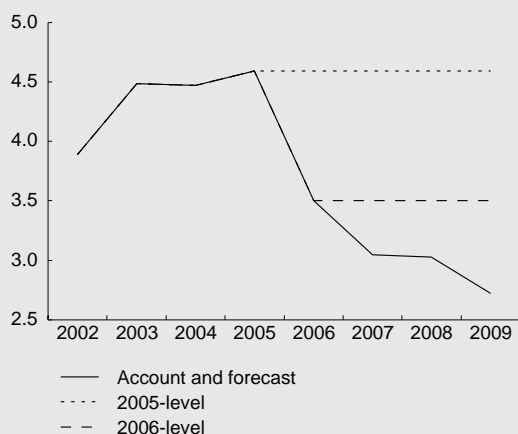
The impact on inflation is considerably more moderate. It takes a long time for wage changes to feed fully through to the economy. In 2006, inflation accelerates by 0.2 percentage point, but the acceleration is 0.4 per cent in each of the other years in the projection period. The acceleration in

inflation triggers a wage-price spiral, which contributes to the acceleration in wage growth after a period. As inflation accelerates, the krone also depreciates as nominal interest rates in the calculation are held constant. This in turn contributes to amplifying the inflationary impulses from higher wage growth. A weaker krone also contributes to curbing the fall in profitability in internationally exposed industries, which also prolongs the impact of the decline in unemployment.

According to sterilized calculations of this type, the inflationary effects that are triggered will persist over a very long period. It takes about 10 years before the impact on wage growth is halved, while the increase in inflation is even more long-lasting.

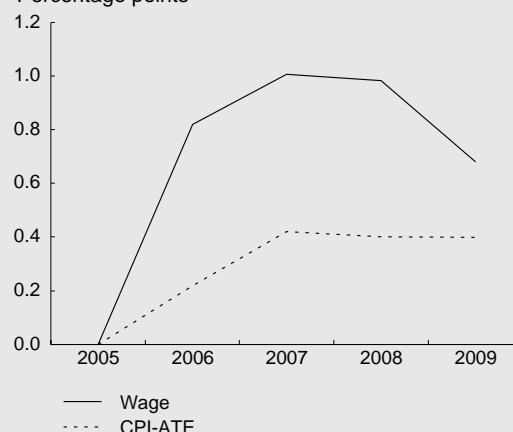
Our projections are based on the assumption that unemployment will show a further fall to 3 per cent in 2007 and 2008, with a slight fall also in 2009. A final calculation shows the contribution to wage growth from unemployment developments after 2006. As shown in figure 3, the decline in unemployment after 2006 pushes up wage growth by about 0.5 percentage point in 2007 and 2008 and by 1 percentage point in 2009.

Figure 1. Unemployment rate
Per cent



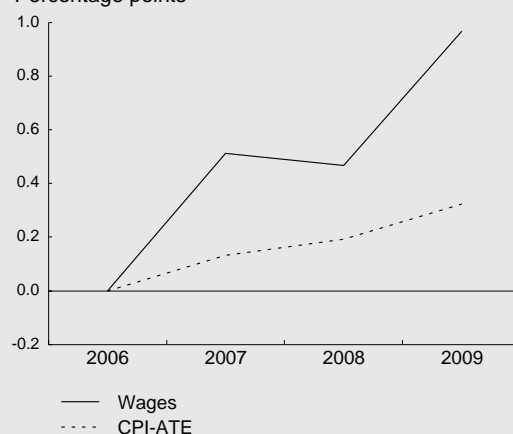
Source: Statistics Norway.

Figure 2. The wage and price effect of the decline in unemployment from 2005 to 2006
Percentage points



Source: Statistics Norway.

Figure 3. The wage and price effect of the decline in unemployment after 2006
Percentage points



Source: Statistics Norway.

wage growth. In 2008, wage growth is projected at 4.1 per cent, rising to 4.8 per cent in 2009, when a renewed upturn will amplify labour market pressures. With an inflation rate of around 1.5 per cent, real wage growth will be high in these years.

Inflation remains low

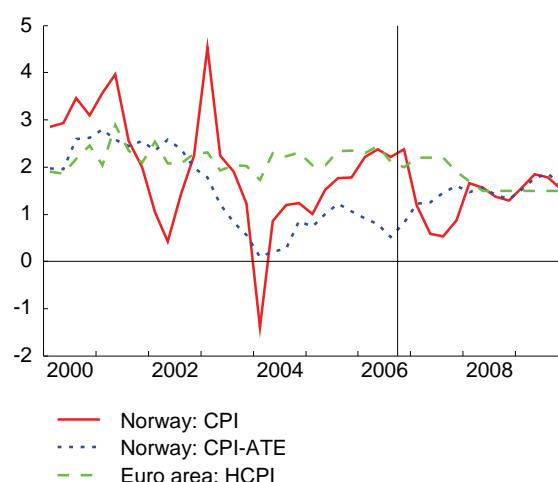
In spite of a booming economy and high energy prices over the past year or so, underlying inflation has now started to edge up. Inflation measured by the consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) has been below the inflation target of 2.5 per cent for more than four years. In August 2006, the year-on-year rise in the CPI-ATE had moved down to 0.4 per cent. Thereafter, underlying inflation has picked up somewhat and the index was 0.8 per cent higher in November compared with one year earlier. Partly owing to high energy prices and indirect tax increases from the beginning of the year, CPI inflation has been markedly higher through the entire year, with the year-on-year rate of increase at 2.6 per cent in November. The contribution from real tax changes this year can be estimated at a quarter percentage point.

The low rate of CPI-ATE inflation over the past four years partly reflects the subdued rise in prices for imported consumer goods. A stronger krone, increased imports from low-cost countries and low international inflation are factors behind this development. However, the rise in prices for domestically produced goods and services has also been low when adjusted for tax changes and excluding energy products. Prices for domestically produced goods and services were 1.1 per cent higher in November compared with the same month one year earlier, when excluding agricultural and fish products which showed only a marginal price increase in the same period. House rents increased by 2.3 per cent, while the price index for other services rose by 1.2 per cent. Low growth in hourly wage costs, combined with high productivity growth, particularly in retail trade, has contributed to the low rate of inflation.

Inflationary tendencies over the past three months primarily reflect price developments for goods, and only to a limited extent service prices. Hourly wage costs are now rising at a slightly faster pace than earlier and productivity growth is expected to slow in the period ahead. Inflation is being fuelled by increased unit labour costs and higher interest rates, which are pushing up house rents and costs in retail trade. On the downside, lower energy prices are pushing down inflation. Somewhat further ahead, a slightly stronger krone is also expected to push down inflation. The negative impulses to inflation from external prices in the form of lower average prices for finished goods, in foreign currency, are also expected to ease.

Consumer price indices

Percentage growth from the same quarter previous year



Source: Norges Bank and Statistics Norway.

As an annual average, CPI-ATE inflation is projected at 0.8 per cent this year, i.e. slightly lower than in 2005. At the turn of the year, the direct downward effect on inflation from reduced maximal day-care rates will unwind, which will push up inflation by about 0.2 percentage point. Against this background, total CPI-ATE inflation may rise and fairly rapidly remain relatively steady around 1.5 per cent.

So far in 2006, CPI inflation has moved between 1.8 per cent in January and 1.9 per cent in August and 2.7 per cent in April and October, primarily reflecting varying price impulses from energy products. Electricity prices spiked up in two rounds this year; in February and March and in August and September. Both spikes were followed by a marked price fall. Prices are expected to drop markedly again between November and December. Prices charged to households shadow with some lag developments in spot prices in the electricity market. Developments in electricity prices have again been influenced by precipitation and temperature levels, oil prices and CO₂ quota prices. As an annual average, electricity prices rose by around 27 per cent this year, but are expected to fall about 13 per cent in 2007. Average CPI inflation will probably be 2.3 per cent in 2006. Higher VAT on food as from the beginning of 2007 will push up price inflation, but overall CPI inflation is still expected to move down to 0.8 per cent next year.

We assume that real indirect taxes will remain unchanged in 2008 and 2009. CPI and CPI-ATE inflation are thus expected to move more closely in tandem. In 2008, lower oil prices measured in NOK will virtually counterbalance the increase in electricity prices, while they are expected to show virtually the same movement in 2009. A stronger krone will contribute to keeping CPI inflation at below 2 per cent.

Lower trade surplus?

Preliminary balance-of-payments figures for the third quarter of this year show a current account surplus of more than NOK 92 billion. This is an increase of NOK 4 billion on the previous quarter and an increase of NOK 16 billion on the third quarter one year earlier. The trade surplus for goods and services was reduced by NOK 9 billion between the second and third quarter of this year, and came to a good NOK 86 billion. In the same quarter of 2005, the surplus stood at NOK 76 billion. The interest and transfers balance recorded a surplus of NOK 6 billion in the third quarter, i.e. an increase of NOK 15 billion in relation to the second quarter. Compared with the third quarter of last year, the increase comes to NOK 5 billion. Owing to the surplus on the interest and transfers balance, the current account surplus shows an increase on the previous quarter despite a reduced trade surplus.

The reduction in the trade surplus primarily reflects a 2 per cent increase in service imports, primarily accounted for by travel services. A reduction in the volume of oil and gas exports also contributed to the decline. The improvement on the interest and transfers balance is primarily attributable to lower dividend payments to foreign shareholders, but also to an increase in foreign interest income and transfers.

New information and revised figures have resulted in changes in balance-of-payments figures for previous years. The changes are marginal for 2005 and 2006, with the exception of the value of service imports, which reduces the trade surplus for services by NOK 1 billion to NOK 4 billion in the quarter. The interest and transfers balance has been revised up by a few NOK billion in the quarter in favour of abroad. The surplus on the current account has thus been revised down to NOK 300 billion in 2005 and down by a good NOK 11 billion in the first six months of this year.

Increased import volumes and rising import prices account for the largest share of the fall in the export surplus through 2006. With balance in trade in services, the trade balance will be close to NOK 98 billion in the fourth quarter. As a result, the surplus on the trade and services balance could exceed NOK 400 billion for 2006 as a whole. However, a deficit on the interest and transfers balance both in the fourth quarter and the for the year as a whole is expected to bring this year's current account surplus down to about NOK 367 billion.

The balance of payments will still run high surpluses in the years ahead. However, we do not expect surpluses to show the same strong gains as witnessed in recent years. An expected easing of global growth will lead to slower growth in demand for Norwegian export goods, while import growth remains firm. In addition, prices for export goods are expected to fall at a

faster pace than prices for import goods. Under the assumption of an oil price fall in USD to USD 50 per barrel through 2007 and an appreciation of NOK against USD, the oil price may fall from today's level by up to a quarter towards the end of the projection period. This will substantially reduce the trade surplus in 2008 and 2009. The reduction will be partly offset by the expected large surpluses on the interest and transfers balance. The current account surplus is estimated to exceed NOK 400 billion in 2007 and then to shrink gradually through the remainder of the projection period.

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

	Unadjusted		Seasonally adjusted						
	2004	2005	05.1	05.2	05.3	05.4	06.1	06.2	06.3
Final consumption expenditure of households and NPISHs	785 950	811 537	198 662	203 726	204 787	203 871	207 742	210 692	212 246
Household final consumption expenditure	754 220	777 977	190 496	195 423	196 296	195 257	198 986	201 881	203 347
Goods	394 424	404 919	99 464	102 091	102 331	101 187	103 733	104 692	105 910
Services	339 659	348 450	85 577	86 727	87 503	88 370	88 196	89 627	89 783
Direct purchases abroad by resident households	41 275	46 583	10 890	12 030	11 842	11 498	12 312	13 181	13 327
Direct purchases by non-residents	-21 138	-21 974	-5 435	-5 424	-5 380	-5 797	-5 255	-5 619	-5 674
Final consumption expenditure of NPISHs	31 730	33 560	8 166	8 303	8 491	8 614	8 756	8 811	8 900
Final consumption expenditure of general government	373 295	380 172	94 637	95 252	94 997	95 303	95 999	96 238	96 152
Final consumption expenditure of central government	197 362	200 611	50 191	50 194	50 060	50 172	50 058	50 105	49 597
Central government, civilian	167 112	172 765	43 163	43 181	43 163	43 265	43 783	43 834	43 294
Central government, defence	30 252	27 847	7 027	7 013	6 898	6 907	6 275	6 271	6 302
Final consumption expenditure of local government	175 934	179 562	44 447	45 058	44 937	45 131	45 941	46 133	46 555
Gross fixed capital formation	314 239	349 464	81 641	85 340	85 704	96 525	89 352	94 919	94 968
Extraction and transport via pipelines	71 285	85 021	19 457	21 537	20 507	23 501	20 366	21 396	23 188
Service activities incidental to extraction	2 813	-1 832	53	-2 851	922	44	-34	-24	233
Ocean transport	10 100	15 030	3 406	4 507	2 096	5 021	4 726	4 313	4 954
Mainland Norway	230 041	251 245	58 725	62 148	62 180	67 959	64 294	69 234	66 593
Mainland Norway excluding general government	179 393	200 805	47 353	49 689	50 219	53 417	52 743	53 537	54 701
Industries	108 971	120 177	27 793	29 817	29 944	32 523	31 663	32 263	33 277
Manufacturing and mining	20 866	23 431	4 848	5 498	5 599	7 342	6 115	6 409	7 746
Production of other goods	19 038	20 182	4 660	5 340	5 431	4 781	5 170	5 450	5 474
Services	69 067	76 565	18 284	18 979	18 913	20 400	20 378	20 404	20 057
Dwellings (households)	70 422	80 628	19 560	19 873	20 275	20 894	21 080	21 274	21 424
General government	50 648	50 440	11 372	12 458	11 961	14 542	11 551	15 697	11 892
Changes in stocks and statistical discrepancies	33 671	46 534	12 304	8 396	16 576	11 552	17 031	14 053	19 733
Gross capital formation	347 910	395 998	93 945	93 736	102 281	108 076	106 383	108 971	114 702
Final domestic use of goods and services	1 507 155	1 587 708	387 245	392 715	402 064	407 251	410 124	415 902	423 100
Final demand from Mainland Norway	1 389 286	1 442 955	352 024	361 126	361 964	367 134	368 035	376 164	374 991
Final demand from general government	423 943	430 613	106 009	107 710	106 958	109 845	107 550	111 935	108 044
Total exports	732 669	737 002	180 301	186 510	185 481	185 027	184 139	185 824	184 963
Traditional goods	209 835	220 746	54 400	53 418	55 707	57 010	56 950	57 930	58 716
Crude oil and natural gas	337 274	320 559	80 478	81 869	80 527	78 359	78 337	75 655	75 748
Ships, oil platforms and planes	9 696	10 340	954	5 185	3 183	1 018	1 143	1 756	2 413
Services	175 864	185 357	44 469	46 038	46 065	48 639	47 709	50 483	48 086
Total use of goods and services	2 239 824	2 324 709	567 545	579 225	587 546	592 278	594 263	601 726	608 063
Total imports	496 783	539 390	127 069	133 599	137 205	141 617	140 628	146 018	146 547
Traditional goods	323 346	349 862	82 771	86 213	90 141	90 450	93 253	94 411	95 465
Crude oil and natural gas	1 905	2 953	665	503	520	1 305	424	194	159
Ships, oil platforms and planes	13 128	10 445	2 112	2 623	2 674	3 036	2 708	4 638	3 068
Services	158 404	176 130	41 521	44 259	43 870	46 826	44 243	46 774	47 855
Gross domestic product (market prices)	1 743 041	1 785 319	440 476	445 626	450 341	450 661	453 636	455 708	461 516
Gross domestic product Mainland Norway (market prices)	1 355 314	1 411 476	346 611	350 492	355 194	359 614	362 709	366 582	369 840
Petroleum activities and ocean transport	387 727	373 843	93 865	95 134	95 147	91 047	90 927	89 126	91 676
Mainland Norway (basic prices)	1 155 106	1 204 271	295 709	299 015	303 003	306 813	309 942	312 923	315 512
Mainland Norway excluding general government	890 598	935 802	228 106	232 176	235 891	239 850	242 218	244 968	247 836
Manufacturing and mining	162 580	166 115	40 605	41 653	41 577	42 193	42 671	42 930	43 085
Production of other goods	129 944	141 617	34 525	35 476	35 475	36 341	36 300	35 912	35 805
Services incl. dwellings (households)	598 074	628 070	152 976	155 046	158 839	161 316	163 247	166 127	168 946
General government	264 508	268 469	67 603	66 840	67 112	66 964	67 725	67 955	67 676
Correction items	200 208	207 205	50 902	51 476	52 191	52 801	52 767	53 659	54 327

Source: Statistics Norway.

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

	Unadjusted		Seasonally adjusted						
	2004	2005	05.1	05.2	05.3	05.4	06.1	06.2	06.3
Final consumption expenditure of households and NPISHs	5.6	3.3	0.2	2.5	0.5	-0.4	1.9	1.4	0.7
Household final consumption expenditure	5.5	3.1	0.1	2.6	0.4	-0.5	1.9	1.5	0.7
Goods	5.1	2.7	-0.4	2.6	0.2	-1.1	2.5	0.9	1.2
Services	5.1	2.6	0.2	1.3	0.9	1.0	-0.2	1.6	0.2
Direct purchases abroad by resident households	17.4	12.9	5.8	10.5	-1.6	-2.9	7.1	7.1	1.1
Direct purchases by non-residents	10.7	4.0	1.4	-0.2	-0.8	7.8	-9.4	6.9	1.0
Final consumption expenditure of NPISHs	6.6	5.8	1.1	1.7	2.3	1.4	1.7	0.6	1.0
Final consumption expenditure of general government	1.5	1.8	0.7	0.6	-0.3	0.3	0.7	0.2	-0.1
Final consumption expenditure of central government	2.3	1.6	1.4	0.0	-0.3	0.2	-0.2	0.1	-1.0
Central government, civilian	3.0	3.4	3.0	0.0	0.0	0.2	1.2	0.1	-1.2
Central government, defence	-1.5	-7.9	-7.6	-0.2	-1.6	0.1	-9.1	-0.1	0.5
Final consumption expenditure of local government	0.6	2.1	-0.2	1.4	-0.3	0.4	1.8	0.4	0.9
Gross fixed capital formation	10.2	11.2	-7.2	4.5	0.4	12.6	-7.4	6.2	0.1
Extraction and transport via pipelines	10.2	19.3	2.7	10.7	-4.8	14.6	-13.3	5.1	8.4
Service activities incidental to extraction	635.0	-165.1	-98.0	..	..	-95.2	..	..	..
Ocean transport	4.6	48.8	-30.2	32.3	-53.5	139.5	-5.9	-8.7	14.9
Mainland Norway	9.3	9.2	-4.4	5.8	0.1	9.3	-5.4	7.7	-3.8
Mainland Norway excluding general government	11.3	11.9	0.0	4.9	1.1	6.4	-1.3	1.5	2.2
Industries	8.4	10.3	-1.2	7.3	0.4	8.6	-2.6	1.9	3.1
Manufacturing and mining	11.9	12.3	-6.3	13.4	1.8	31.1	-16.7	4.8	20.9
Production of other goods	-1.1	6.0	1.4	14.6	1.7	-12.0	8.1	5.4	0.4
Services	10.2	10.9	-0.5	3.8	-0.3	7.9	-0.1	0.1	-1.7
Dwellings (households)	16.3	14.5	1.8	1.6	2.0	3.1	0.9	0.9	0.7
General government	2.5	-0.4	-19.2	9.6	-4.0	21.6	-20.6	35.9	-24.2
Changes in stocks and statistical discrepancies	138.3	38.2	51.9	-31.8	97.4	-30.3	47.4	-17.5	40.4
Gross capital formation	16.2	13.8	-2.2	-0.2	9.1	5.7	-1.6	2.4	5.3
Final domestic use of goods and services	6.7	5.3	-0.3	1.4	2.4	1.3	0.7	1.4	1.7
Final demand from Mainland Norway	5.0	3.9	-0.5	2.6	0.2	1.4	0.2	2.2	-0.3
Final demand from general government	1.6	1.6	-1.9	1.6	-0.7	2.7	-2.1	4.1	-3.5
Total exports	1.1	0.6	0.0	3.4	-0.6	-0.2	-0.5	0.9	-0.5
Traditional goods	3.4	5.2	-0.6	-1.8	4.3	2.3	-0.1	1.7	1.4
Crude oil and natural gas	-0.5	-5.0	0.7	1.7	-1.6	-2.7	0.0	-3.4	0.1
Ships, oil platforms and planes	-38.2	6.6	-29.1	443.7	-38.6	-68.0	12.3	53.5	37.5
Services	5.0	5.4	0.3	3.5	0.1	5.6	-1.9	5.8	-4.7
Total use of goods and services	4.9	3.8	-0.2	2.1	1.4	0.8	0.3	1.3	1.1
Total imports	8.8	8.6	-2.0	5.1	2.7	3.2	-0.7	3.8	0.4
Traditional goods	10.9	8.2	0.3	4.2	4.6	0.3	3.1	1.2	1.1
Crude oil and natural gas	-13.7	55.0	3.1	-24.2	3.2	151.1	-67.5	-54.1	-18.3
Ships, oil platforms and planes	26.4	-20.4	-49.0	24.2	2.0	13.5	-10.8	71.3	-33.9
Services	3.8	11.2	-1.8	6.6	-0.9	6.7	-5.5	5.7	2.3
Gross domestic product (market prices)	3.9	2.4	0.3	1.2	1.1	0.1	0.7	0.5	1.3
Gross domestic product Mainland Norway (market prices)	4.4	4.1	0.5	1.1	1.3	1.2	0.9	1.1	0.9
Petroleum activities and ocean transport	1.7	-3.6	-0.4	1.4	0.0	-4.3	-0.1	-2.0	2.9
Mainland Norway (basic prices)	3.6	4.3	0.7	1.1	1.3	1.3	1.0	1.0	0.8
Mainland Norway excluding general government	4.4	5.1	0.4	1.8	1.6	1.7	1.0	1.1	1.2
Manufacturing and mining	5.7	2.2	-2.1	2.6	-0.2	1.5	1.1	0.6	0.4
Production of other goods	2.0	9.0	4.4	2.8	0.0	2.4	-0.1	-1.1	-0.3
Services incl. dwellings (households)	4.5	5.0	0.3	1.4	2.4	1.6	1.2	1.8	1.7
General government	1.1	1.5	1.4	-1.1	0.4	-0.2	1.1	0.3	-0.4
Correction items	9.1	3.5	-0.3	1.1	1.4	1.2	-0.1	1.7	1.2

Source: Statistics Norway.

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

	Unadjusted		Seasonally adjusted						
	2004	2005	05.1	05.2	05.3	05.4	06.1	06.2	06.3
Final consumption expenditure of households and NPISHs	100	101.1	100.3	100.7	101.5	101.8	102.0	103.1	103.4
Final consumption expenditure of general government	100	102.7	101.9	102.2	103.2	103.7	105.0	106.7	108.1
Gross fixed capital formation	100	102.7	100.7	103.1	103.2	103.8	103.0	106.0	107.8
Mainland Norway	100	101.9	101.1	102.0	101.4	103.3	103.0	104.9	105.6
Final domestic use of goods and services	100	102.1	99.3	103.0	103.2	102.1	102.7	105.3	106.0
Final demand from Mainland Norway	100	101.7	100.9	101.3	101.9	102.6	102.9	104.3	105.0
Total exports	100	117.4	110.7	112.1	119.0	127.5	135.8	133.3	132.9
Traditional goods	100	104.0	101.2	102.6	104.9	106.8	111.4	115.7	117.9
Total use of goods and services	100	106.9	102.9	105.9	108.2	110.0	113.0	114.0	114.2
Total imports	100	101.3	101.2	100.9	100.8	102.2	102.9	102.3	103.8
Traditional goods	100	100.4	100.4	100.4	99.8	100.8	102.9	102.4	104.3
Gross domestic product (market prices)	100	108.6	103.4	107.5	110.4	112.5	116.1	117.7	117.5
Gross domestic product Mainland Norway (market prices)	100	102.2	99.9	103.1	102.5	103.0	104.3	105.9	106.1

Source: Statistics Norway.

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

	Unadjusted		Seasonally adjusted						
	2004	2005	05.1	05.2	05.3	05.4	06.1	06.2	06.3
Final consumption expenditure of households and NPISHs	0.7	1.1	-0.4	0.4	0.7	0.3	0.1	1.1	0.3
Final consumption expenditure of general government	2.6	2.7	0.5	0.3	1.1	0.4	1.3	1.6	1.3
Gross fixed capital formation	3.3	2.7	-1.5	2.4	0.0	0.6	-0.7	2.9	1.6
Mainland Norway	3.9	1.9	-1.1	0.8	-0.6	1.9	-0.3	1.9	0.6
Final domestic use of goods and services	1.8	2.1	-1.9	3.7	0.1	-1.1	0.6	2.6	0.6
Final demand from Mainland Norway	1.7	1.7	-0.2	0.4	0.6	0.6	0.4	1.4	0.6
Total exports	12.9	17.4	3.4	1.2	6.2	7.2	6.5	-1.8	-0.3
Traditional goods	8.5	4.0	-0.3	1.4	2.3	1.7	4.3	3.8	1.9
Total use of goods and services	5.2	6.9	-0.2	2.9	2.1	1.7	2.7	0.9	0.2
Total imports	4.8	1.3	-0.3	-0.3	-0.1	1.4	0.7	-0.6	1.4
Traditional goods	4.0	0.4	-0.2	0.0	-0.5	1.0	2.0	-0.4	1.8
Gross domestic product (market prices)	5.3	8.6	-0.1	3.9	2.8	1.9	3.2	1.4	-0.2
Gross domestic product Mainland Norway (market prices)	1.8	2.2	-1.4	3.2	-0.6	0.5	1.3	1.5	0.1

Source: Statistics Norway.

