

2 The Norwegian economy

The reopening of society has given a huge boost to the Norwegian economy. The economic crisis is over, although some businesses in the services sector, particularly in tourism and transport, are still facing challenges due to the pandemic. Registered unemployment is falling rapidly and has now almost returned to pre-pandemic levels. Unemployment has fallen faster than we assumed in the revised national budget in May 2021. However, some repercussions of the pandemic will continue into 2022. Large parts of the business sector expect strong growth ahead. Many industries are experiencing issues with bottlenecks, partly because recruiting skilled labour is proving problematic. The pandemic is also still contributing to uncertainty about the future economic outlook, but, as a result of the rapid pace of vaccination and high vaccination rates, uncertainty is now markedly lower than it was earlier this year.

It appears likely that the Norwegian economy will enter a moderate boom next year and that registered unemployment will come down to low levels. This means that this recession will be shorter than previous deep recessions in the Norwegian economy. We expect the rate of economic growth to be higher than normal in both 2023 and 2024, see Figure 2.3B. This will lead to an increase in employment and a further decrease in unemployment, see Figures 2.1C and 2.1D. According to Statistics Norway's Labour Force Survey (LFS), the employment rate amongst residents in Norway is higher than before the pandemic. However, the number of employees on short-term stays is currently well below pre-pandemic levels.

While expansionary fiscal and monetary policy measures helped dampen the harmful economic effects of the pandemic, *economic policy* is now being restructured to prevent the economy from overheating and to avoid a permanent rise in public spending. The economic measures introduced in response to the pandemic are now being unwound and the use of oil revenues has been markedly reduced. Norges Bank has increased its policy rate and has projected further increases going forward.

Growth in the global economy has been stronger than anticipated and will lead to higher growth in mainland exports than projected in the revised national budget. Goods exports have recovered particularly strongly and now exceed pre-pandemic levels. However, exports of services are markedly lower than before the pandemic, as foreign tourists have yet to return to Norway in any significant numbers, see Figure 2.2A. The marked improvement in competitiveness since 2014 will help boost activity in sectors that are exposed to international competition, see Figure 2.2B.

High growth in the global economy has contributed to an increase in demand and higher prices for commodities. The price of aluminium is at a 10-year high, probably also due to higher freight rates. At the beginning of October, the price of oil (Brent Blend) was at about 80 dollars per barrel, around 10 dollars higher than when the revised budget was published. Oil price futures have also increased. The price of gas in Europe has increased by even more

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than the price of oil so far this year, see Figure 2.1B. This must partly be viewed in the context of weather conditions and lower supply of liquid natural gas (LNG) to Europe. Petroleum investments are expected to increase slightly this year before falling in 2022. The temporary changes in petroleum taxation which were introduced last year have incentivised companies to carry out planned investment projects.

Tabell 2.1 Main table for the Norwegian economy. Percentage change in volume from the previous year, unless stated otherwise

	Billion NOK ¹			
	2020	2020	2021	2022
Private consumption	1 496,4	-6,9	4,0	11,1
Public consumption.....	905,6	1,7	3,9	-0,2
Gross fixed investment	907,0	-3,8	0,9	-0,4
Of which: Petroleum extraction and pipeline transp.	180,8	-4,1	1,0	-14,4
Business sector Mainland Norway.....	313,6	-6,1	0,9	4,4
Hosting	190,7	-4,0	4,2	4,1
Public sector.....	216,4	-1,0	-2,5	-0,2
Demand from Mainland Norway ²	3 122,7	-3,9	3,4	6,0
Exports.....	1 110,0	-0,5	5,2	7,1
Of which: Crude oil and natural gas	353,0	10,1	3,5	4,8
Goods and services from Mainland Norway	637,0	-8,2	6,4	9,9
Imports.....	1 125,3	-11,9	3,7	10,6
Gross domestic product.....	3 413,5	-0,8	3,8	4,0
Of which: Mainland Norway	3 043,0	-2,5	3,9	3,8
Other key figures:				
Employment, persons.....		-1,3	0,8	1,4
Unemployment rate, LFS (level) ³		4,6	4,7	4,1
Unemployment rate, registered (level) ⁵		5,0	3,2	2,4
Annual wage		3,1	2,8	3,0
Consumer price index (CPI)		1,3	2,8	1,3
Underlying inflation (CPI-ATE).....		3,0	1,8	1,6
Crude oil price, NOK per barrel (level)		407	568	559
Crude oil price, USD per barrel (level)		43	68	67
Three-month money market rates, pct.. ⁴		0,7	0,5	1,1
Import-weighted exchange rate (yearly change) ⁵ ...		6,3	-6,4	-0,3

¹ Provisional figures from the national accounts at current prices.

² Excluding change in inventory

³ Changes were made to the Norwegian Labour Force Survey with effect from 1 January 2021, with the result of a break in the data from this date on. The figures for 2021 and 2022 are not comparable with those for 2020.

⁴ Assumption used in calculations based on forward prices from June.

⁵ A positive figure indicates a weaker Norwegian krone.

Sources: Statistics Norway, ICE, Norges Bank, Nav, Reuters, Macrobond and the Ministry of Finance.

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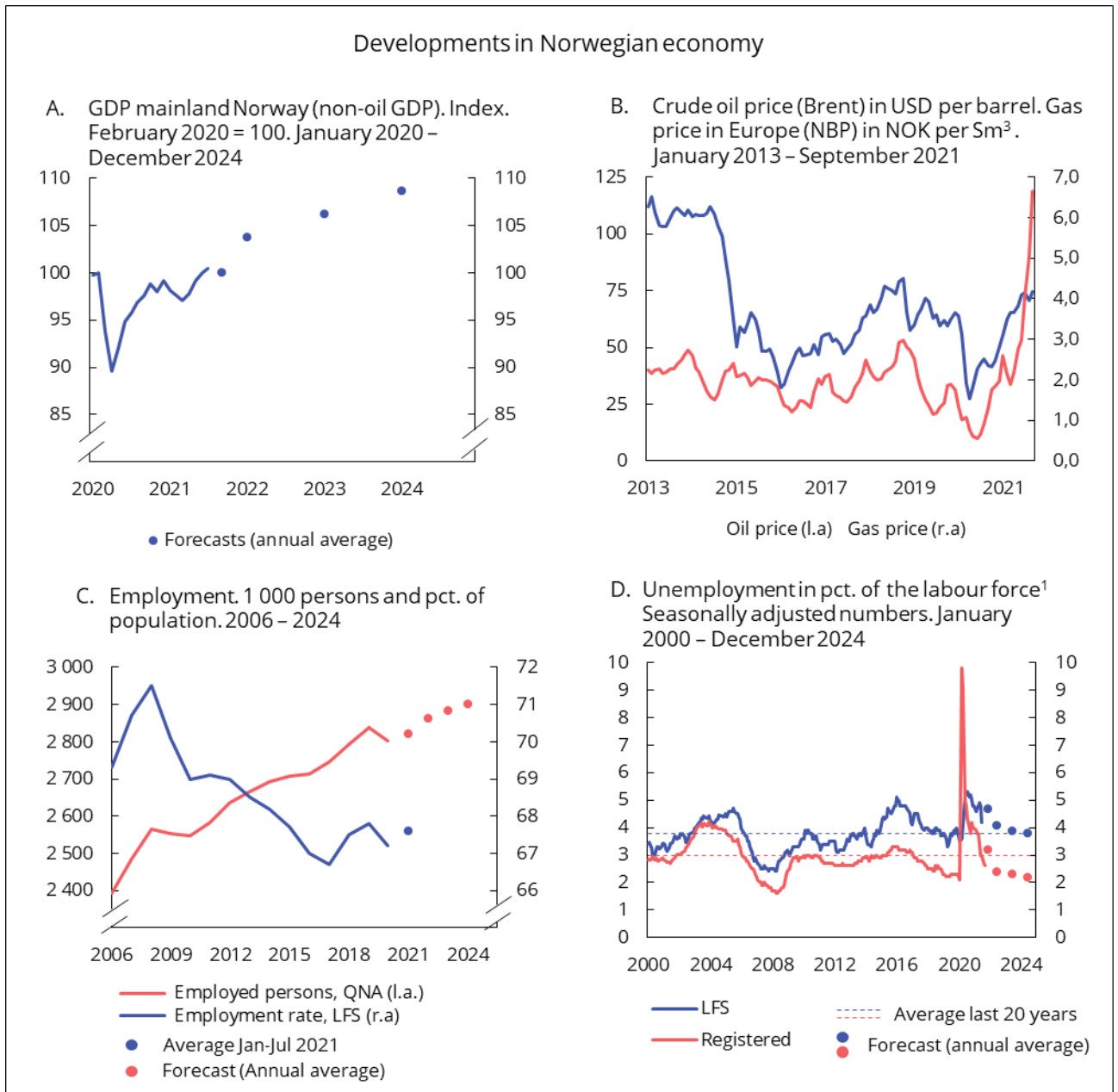


Chart 2.1 Trends in the Norwegian economy

¹ Changes were made to the Norwegian Labour Force Survey with effect from 1 January 2021 which meant that the statistics have not been comparable with previous statistics since this date. It is assumed that the changes are contributing to an increase in the proportion of those in employment of around one per cent, as well as an increase in the level of Labour Force Survey unemployment of around 0.3 per cent.

Sources: Statistics Norway, Norwegian Labour and Welfare Administration, ICE and the Ministry of Finance.

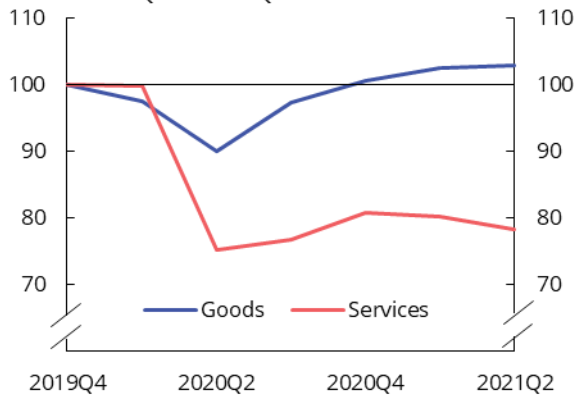
Activity in the business sector has picked up markedly as the strictest infection control measures have been eased. Activity in the mainland economy was 0.5 per cent higher in July than before the pandemic. However, there are major differences between sectors. Although activity in many of the service sectors which were hardest hit by the infection control

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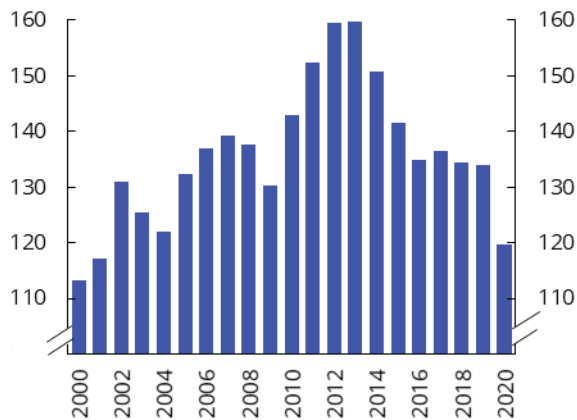
measures picked up noticeably during the summer, activity in these sectors was collectively around 20 per cent lower in July than before the pandemic. These sectors account for 10 per cent of mainland GDP and around a sixth of total employment. The other 90 per cent of the mainland economy had already returned to pre-pandemic activity levels before the summer and recorded growth of 2.1 per cent between February 2020 and July 2021.

Exports, competitiveness and investments

A. Exports from mainland Norway. Seasonally adjusted. Index. 2019 Q4 = 100. 2019 Q4 - 2021 Q2



B. Wage costs per hour in manufacturing in Norway relative to manufacturing at the trading partners in common currency. Trading partners = 100. 2000 - 2020



C. Investments. Fixed 2015 prices. Billion NOK. 2000 - 2022

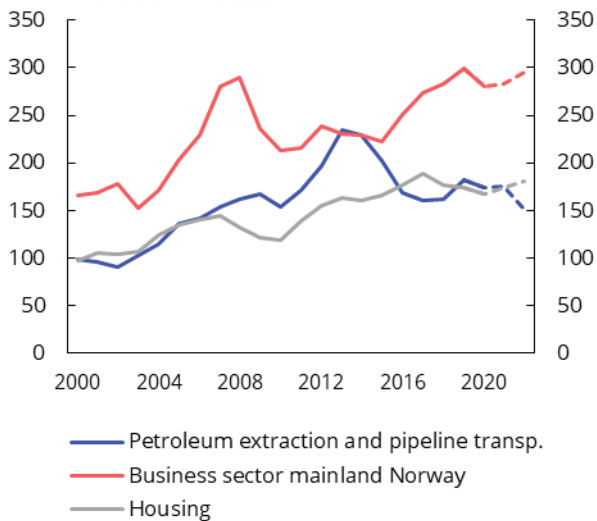


Chart 2.2 Competitiveness, mainland exports and investments

Sources: Statistics Norway, Technical Calculation Committee for Wage Settlements (TBU), Macrobond and the Ministry of Finance.

Business investments fell markedly during the coronavirus pandemic, but are expected to increase going forward. This view is supported by several surveys, including Norges Bank's regional network, which indicates that all sectors are planning to increase investments ahead. Substantial investments in manufacturing are expected as a result of climate and energy transition, in particular within battery and hydrogen production.

Registered *unemployment* has fallen faster than forecast in the revised budget and is now well below the average rate of the past 20 years. The decrease is due to a fall in the number of furloughed workers as well as a decline in the number of ordinary fully unemployed persons. Adjusted for seasonal variations, 39 000 fewer people are fully unemployed than at year-end, with 73,300 people being fully unemployed at the end of September. This corresponds to 2.6 per cent of the workforce and is just 0.5 percentage points higher than before the pandemic. The number of partially unemployed persons has also declined, but is still somewhat higher than before the pandemic. Going forward, we expect registered unemployment to decline further. At the same time, *employment* has risen in recent months, measured through both the Labour Force Survey and figures for registered employees. According to the Labour Force Survey, the employment rate among residents in Norway is now higher than before the crisis and at its highest since 2012. The number of registered employees, which also includes those on short-term stays, has risen by more than 50,000 persons over the last three months up to and including July of this year, seasonally adjusted. This strong upturn has resulted in the number of employees in July being slightly above 10,000 fewer than before the pandemic. Nevertheless, there are still markedly fewer labour immigrants on short-term stays in Norway than before the pandemic.

The Norwegian economy is going from a situation where *capacity utilisation* is lower than normal, to a situation where it is higher than normal. Not since May 2008 has a higher proportion of businesses in Norges Bank's regional network reported full capacity utilisation, see Figure 2.3A. Statistics Norway's Business tendency survey also shows that the proportion of manufacturing firms that are now reporting capacity constraints is above the historical average. Bottlenecks in the labour market and elsewhere are contributing to the capacity constraints and are now suppressing growth in the Norwegian economy. Production is particularly being limited by difficulties obtaining foreign labour, especially in construction and services. Access to commodities and delivery challenges are other limiting factors. With such clear signs of bottlenecks developing, it is important that economic policy is tightened in time. If not, pressure on wages and prices could increase, potentially leading to higher unemployment and lower employment.

Capacity utilisation in the economy can also be assessed on the basis of the output gap, which shows the difference between the actual development in mainland GDP and an estimated trend path. In this budget, trend growth is estimated to be 1¾ per cent per year. By as early as next year, we forecast the output gap to be positive. We expect the economy to continue to

grow faster than its trend rate even in 2024, causing the output gap to widen. The upturn over the next few years will particularly be driven by a rise in household spending.

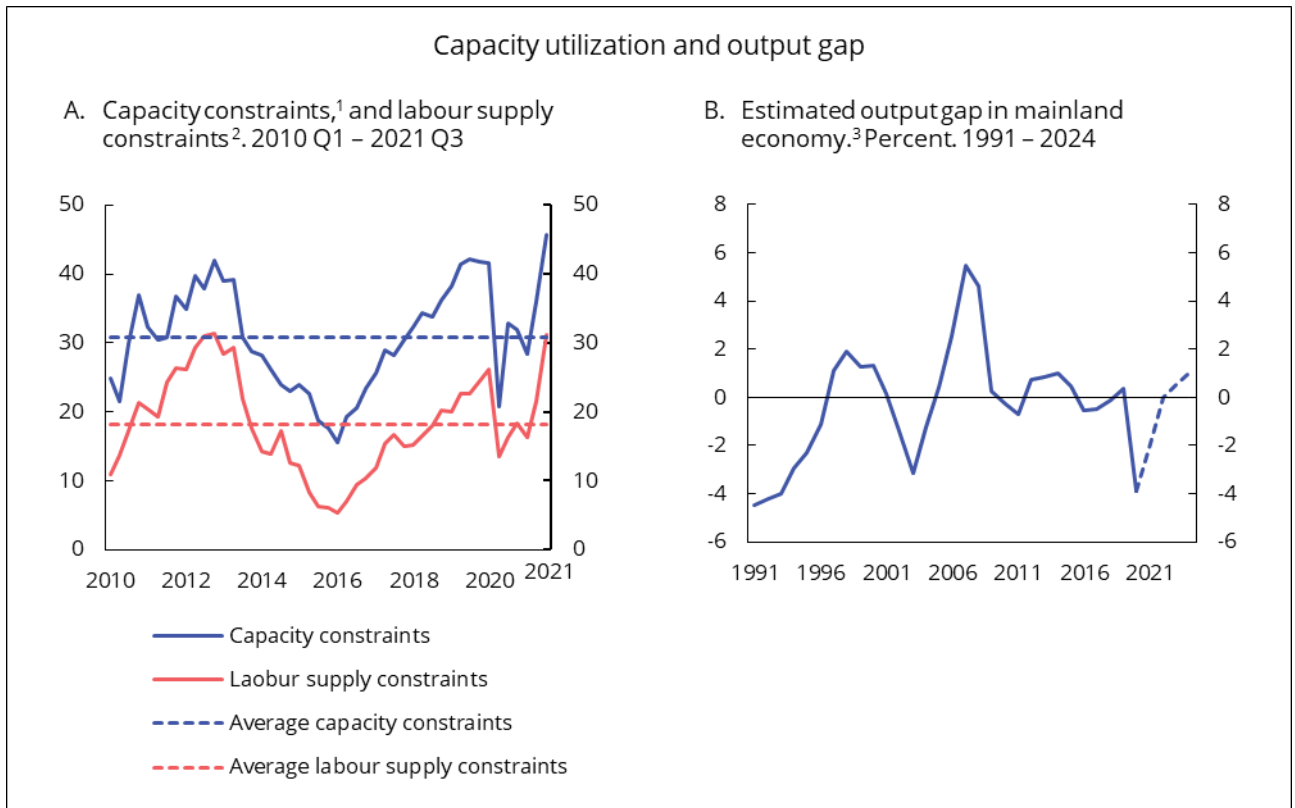


Chart 2.3 Capacity utilisation and the Production Gap

¹ The proportion of mainland companies in Norges Bank’s regional network responding that they expect to experience problems meeting growth in demand.

² The question about labour is asked only of the enterprises reporting full capacity utilisation, but the series shows the share of all contacts included in the interviews period.

³ The output gap measures the percentage difference between mainland GDP and an estimated trend path. The trend is estimated using a Hodrick-Prescott filter. The smoothing parameter lambda was set to 400.

Sources: Statistics Norway, Norges Bank and the Ministry of Finance.

Most wage settlements this year have been consistent with an *annual wage growth* of 2.7 per cent. The average agreed monthly wage during the first half of 2021 was 2.5 per cent higher than during the same period in the previous year. Composition effects, with employment increasing more in professions with low wages than in those with high wages, could reduce overall wage growth both this year and next. On the other hand, labour shortages could contribute to an increase in wage growth. Wage growth is expected to rise by 2.8 per cent this year and 3 per cent next year, as unemployment falls.

Electricity prices have risen to record levels in recent months. The increase has been particularly strong in southern parts of Norway. In combination with higher oil prices, this has contributed to a marked increase in *inflation*. These driving forces are expected to reverse next year, but the

strong increase in electricity prices recently contributes to uncertainty about future developments. Underlying inflation, growth in CPI adjusted for energy products and tax changes (CPI-ATE), has simultaneously dropped to a low level. That must be viewed in context with developments in the Norwegian krone exchange rate, which has dampened imported inflation. The inflation rate of domestically produced goods and services has also declined. This could change going forward. Many companies are now experiencing sharp cost growth. Higher costs for businesses may eventually be passed on to consumer prices. Conversely, expectations of higher productivity growth may dampen inflation going forward.

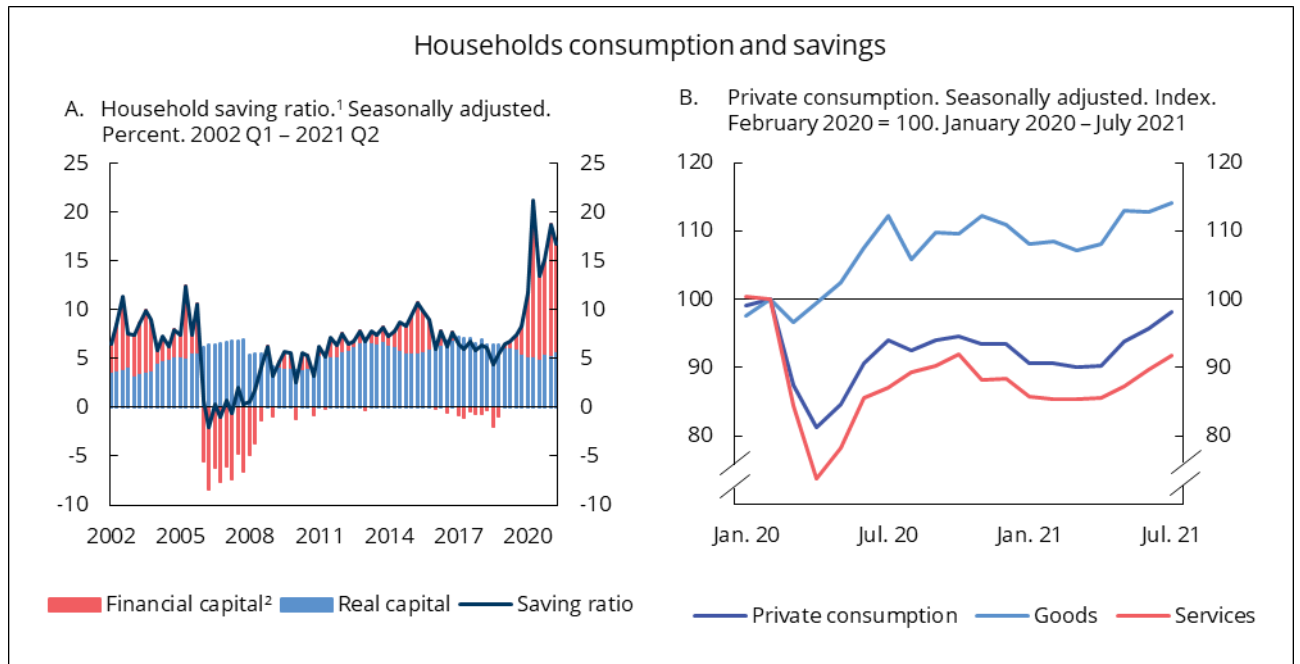


Chart 2.4 Household saving and spending

¹ Includes non-profit organisations.

² Excluding capital transfers, including net acquisition of high-value objects.

Sources: Statistics Norway and the Ministry of Finance.

Household income has remained steady through the pandemic. The fall in household wage income due to furloughs has largely been offset by higher social security payments and benefits. Low interest expenses have also offset the drop in income. Together with the downturn in consumption, this has resulted in record levels of household saving. The household saving rate rose from 7.8 per cent in 2019 to 16.6 per cent over the past 18 months. This increase has come through financial saving, with a sharp upturn in bank deposits, amongst other things, see Figure 2.4A. As activity levels and employment increase, household wage income is expected to rise both this year and next. Together with lower consumer price growth, this is expected to contribute to an increase in the purchasing power of households, although the upturn will be dampened by higher interest expenses.

Relaxation of the infection control measures contributed to a substantial rise in *private consumption* over the spring and summer, see Figure 2.4B. The fact that many Norwegians again spent their holiday in Norway this summer strengthened the upturn. Data from BankAxept and Vipps AS indicate that consumption in Norway has, as expected, declined after the summer holiday. The value of card purchases has recently been close to the levels from last year, but spending on certain services appears to be significantly higher. Spending by Norwegians abroad has almost been close to non-existent over the past year and a half. This is largely due to strict travel restrictions, but also because many Norwegians have put their plans to travel abroad on hold. Although spending by Norwegians abroad rose sharply in July, the level was still significantly below pre-pandemic levels. Spending by foreign nationals in Norway also remains at a low level.

The reopening of society gives prospects of a marked upturn in private consumption. In addition to increased purchasing power, changes in household saving behaviour are a key assumption behind our projections for private consumption. During the pandemic, infection control measures severely limited household consumption. We expect that many households will want to catch up on at least some of their lost consumption. Overall, we expect households to spend a higher proportion of their income than they did before the pandemic and that the saving rate over the coming years will be positive, but lower than the average for the period 2010-2019. The projections indicate that, by 2024, households will have added spending corresponding to just under one third of the extraordinary savings of 2020 and 2021. These assumptions are based on Norges Bank's analyses of household saving behaviour presented in the Monetary Policy Report of December 2020. These assumptions are subject to considerable uncertainty.

Changes in the composition of private consumption will impact the Norwegian economy over the coming years. We expect spending on services to continue to grow, while spending on goods will decline somewhat from a very high level during the pandemic. Spending abroad is also likely to pick up as travel restrictions are relaxed, and we anticipate a sharp upturn next year. While higher spending on services is leading to an increase in activity levels in the mainland economy, spending by Norwegians abroad is entirely imported and will not contribute directly to Norway's GDP.

During the pandemic, *housing market* activity has been strong. House prices have risen markedly and sales have reached record levels. Price growth has tailed off in recent months, yet sales have remained high. The decrease in house price growth may be linked to expectations of higher mortgage rates. The reopening of society may also have contributed, with prospects of lower savings and a normalisation of household consumption patterns. Record low interest rates and high activity in the housing market have contributed to an increase in the growth rate of household debt over the past year, after having declined over an extended period of time. The household debt burden is at a historically high level and represents a vulnerability to the Norwegian financial system.

Investment in residential property has picked up, after having declined every year since 2017. Sales of new homes fell sharply following the start of the virus outbreak, but then rapidly recovered. Alongside the increase in the number of building permits for new homes, many

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households have also refurbished existing residential properties. Growth in the prices of construction products has been high recently. If the upturn in prices continues, many construction projects may be put on hold. Lower growth in house prices and higher interest rates could also slow the upturn going forward. Nevertheless, we expect investment in residential property to increase both this year and next, but not by significantly more than the increase in mainland GDP.

The pandemic continues to provide uncertainty about developments in the Norwegian economy. However, the increasing vaccination rate has reduced the downside risk to the economy since the revised budget. If the pandemic should once again necessitate the introduction of strict new infection control measures, either in Norway or abroad, growth will be more sluggish than projected in this budget. Nevertheless, through experience we now have a better understanding of the virus and how we can best adapt. This has probably reduced the downside risk to the outlook. Even if the infection rate does not rise again, there is uncertainty about the future recovery. If Norwegian households increase their domestic spending by less than we expect, growth could be more sluggish than projected. On the other hand, there is also upside risk which could reinforce the upturn that we are now seeing in the Norwegian economy. For instance, foreign tourists may return to Norway sooner than expected, or households may spend a larger share of savings in Norway than anticipated. The upturn in investment in the business sector, which has historically proved sensitive to developments in the economy, may also turn out to be stronger than expected. Particularly petroleum investments may be higher than expected, due to the sharp increase in oil and gas prices.