Economic trends

Perspectives

The economic boom in Norway continued to intensify through 2006. Economic growth was high, employment increased at a near-record pace and unemployment fell to a level close to the trough recorded in the cyclical upturn in the latter half of the 1990s. Inflation, as measured by changes in consumer prices, remained low and showed few signs of rising, when excluding a transitory increase in electricity prices. However, Norwegian export prices increased sharply through 2006, and far more than import prices. Norway's terms of trade improved substantially, and contributed to an increase of as much as 8 per cent in real disposable income for Norway in 2006. The marked terms-of-trade gains are probably transitory and in the event the income increase last year is temporary. This has been taken into account in the orientation of economic policy in that large portions of petroleum revenues are invested in foreign financial assets. This mechanism renders Norway fairly robust to income shocks to which we are exposed as a result of our oil dependence. The capital in the Government Pension Fund – Global has grown to around NOK 1 800 billion. This group insurance that Norway's substantial foreign assets represent provides the country with welfare gains, even though they are difficult to measure.

The cyclical upturn in the Norwegian economy has been stimulated by low interest rates, a considerable increase in investment in petroleum activities and strong global growth, particularly in China and other emerging economies in Asia. The latter has made a substantial contribution to the low level of domestic price inflation and high prices for major Norwegian export goods. Uncertainty surrounding future cyclical developments in Norway is also closely linked to external impulses. The US economy is expected to show somewhat weaker growth ahead, but recent developments do not point to an imminent pronounced slowdown. The European economy is exhibiting stronger growth than earlier, and an increased supply of cheap labour from eastern European countries is stimulating economic growth. In Asia, economic growth remains buoyant and is having an ever stronger impact on global economic developments.

Norway, with its open economy and substantial exports of raw materials and semi-finished goods, is now reaping substantial gains from globalisation. First, strong global growth provides Norwegian exporters of traditional goods and services with good market outlets. Second, developments in international prices are crucial to earnings in the internationally exposed sector. With strong growth in the world economy and high export prices, profitability is high which increases the room for higher salaries in Norway. Third, high oil prices as a result of increased activity in the world economy will contribute to sustaining petroleum revenues at a high level. Under the fiscal rule, this provides scope over time for phasing in a higher share of petroleum revenues into the Norwegian economy. Fourth, higher oil prices boost profitability in the oil industry and in turn contribute to pushing up petroleum investment. All in all, these mechanisms may contribute to amplifying and prolonging the economic boom in Norway.

This is where the risk of a less balanced path for the Norwegian economy lies. With further strong growth impulses, both from domestic and foreign sources, economic policy will be faced with challenges. So far in this cyclical upturn, increased profitability in the business sector has had little impact on wage growth. However, this could occur in the period ahead. Low unemployment intensifies wage pressures. With persistently high oil prices, fiscal policy may have a procyclical impact, unless it is actively oriented in cyclical management as provided for in fiscal policy guidelines. Both the level and the orientation of petroleum revenue spending are of importance in this respect. If fiscal policy nevertheless makes a substantial expansionary contribution, the need for monetary policy tightening will increase. The room for manoeuvre in this area will depend on international developments. If the global expansion is accompanied by interest rate hikes, it should be possible for orienting monetary policy in Norway with a view to moderating the boom without substantial changes in the exchange rate. The dilemma facing the conduct of monetary policy will increase considerably in a situation where there is cyclical divergence between Norway and its trading partners and high oil prices increasingly reflect supply-side conditions. Norges Bank will then have greater difficulties countering the oil-driven stimulus to the Norwegian economy without associated adverse effects on the traditional internationally exposed sector.

High growth in the Norwegian economy in recent years has taken place in an environment of very low inflation without accelerating wage growth. This represents a break with historical experience. One of the main reasons can be found in the high and rising labour inflows to Norway over the past few years. 2006 was a record-year not only in terms of income levels, but also for population growth. Never before in history has the population in Norway increased as much as in 2006. New EU countries, where income levels are well below Norway's, account for a rising share of labour immigration. These labour inflows to Norway have contributed to keeping wage growth at a moderate level in a situation where unemployment has fallen markedly.

Hence, globalisation does not only result in an increased supply of goods and services which curbs imported inflation, but it also leads to higher labour mobility which reduces the pressures on the most important resource in the economy. The sharp increase in the labour supply as a result of labour immigration will compel both the authorities in Norway and other countries to reassess the inflationary consequences of high economic growth.

Should the labour inflows observed in the past few years continue in the years ahead, this might also have an implication for the demographic structure in Norway in the longer run. It could change and postpone the ageing of the population that has for many years been at the heart of and motivated the discussion on the need for pension reforms. Labour immigration is no permanent solution to the problems associated with population ageing, but it might contribute to putting a brake on the sharp increase in the dependency burden on the working population that is expected over the next decades.

High economic growth and globalisation also have their adverse effects. 2006 joined a succession of years of unusually high global mean temperatures. The scientific evidence suggesting that the observed climate changes are man-made was strengthened in 2006. Long periods of strong economic growth have been accompanied by increased use of fossil fuels. While the industrialized world accounts for a large share of emissions today, low and middle-income countries will account for the largest share of the growth in emissions as a result of expected economic progress. In the latter group are many of the countries that will be hardest hit by global warming. Moreover, these countries have the most limited economic and technological capacity to implement emissions-reducing measures. The climate problem, and measures to solve it, is thus a key aspect of questions relating to economic growth, the diffusion of technology and global income distribution.

Measures aimed at reducing emissions of greenhouse gases should be applied where they have the greatest impact. Several studies show that emissions can be reduced markedly in poor countries at a far lower cost than in rich countries. Today's international agreement under the Kyoto Protocol has clear shortcomings, however, which in many cases make it uncertain whether measures really reduce emissions. Norway should contribute to improving the agreement and to establishing effective institutions and mechanisms that make it possible for rich countries to finance an effective reduction in emissions in developing countries. This can be achieved through development mechanisms or fund structures, by making environmentally friendly technology available at lower costs than development costs or by increasing quota markets to include poor countries.

Through the Framework Convention on Climate Change and the Kyoto Protocol, we have undertaken to lower emissions in Norway. From an economic perspective, all countries producing greenhouse gases should face the same emission costs. Today, exemptions are granted for activities where taxes and quota prices would actually have been the most effective. Differentiated pricing of emissions increases the social costs linked to a defined emissions target. Moreover, the effect of some enterprises not having to pay for emission is that the costs are passed on to others. If other countries apply exemptions to their enterprises for a period, this can cause problems for Norwegian enterprises that are exposed to international competition. In the long term, restructuring that implies a shift away from the most emissions-intensive activities is still necessary if climate challenges are to be taken seriously. All parties should ultimately be faced with the same greenhouse gas emissions price.

The climate issue is in broad terms an energy problem. If Norway and other countries are to lower emissions substantially, energy must be used far more efficiently than is the case today. This means that the energy prices paid by consumers will have to increase ahead. Today, some forms of energy production are heavily subsidised. In Norway, the aim of the subsidy policy is often to promote more environmentally friendly forms of energy production. Such a subsidy policy will also result in lower energy prices and hence put a drag on rationalising energy use. The continued application of energy price subsidisation in manufacturing will also undermine a coherent policy to promote energy efficiency and cost-effective solutions to climate problems.

Without substantial technological advances linked to energy production and consumption, it is clear that the cost of stabilizing the concentration of greenhouse gases at an acceptable level will be very high. What may appear to be costly measures may therefore be necessary to reduce the cost of emissions in the longer run. The most important instrument for achieving this is to put a sufficiently high price on emissions-intensive energy production and energy use. Moreover, it may be sensible to provide government support for research and development of climate-friendly technologies when the positive effects are expected to be higher than the individual stakeholder is willing to recognize. The results of such research should be made available both at home and abroad. Technological development will primarily take place in industrialized countries. For a rich country such as Norway, it is reasonable to make a contribution to such an effort in areas that we have a natural or technological advantage. Research addressing these issues is also being carried out in many other countries. Here – as in other areas – the return on the resources invested must be carefully assessed.

Cyclical developments in Norway

2006 was the third consecutive year of strong growth in mainland GDP in Norway. Seasonally adjusted quarterly national accounts (QNA) figures show that growth remained stable through 2006. Employment growth, measured in terms of the number employed, was the highest ever in 2006, and unemployment dropped markedly through the year. At the beginning of 2007, unemployment is at the lowest level recorded since the previous cyclical peak at the end of the 1990s. In spite of strong growth in the real economy, wage growth and consumer price inflation adjusted for energy prices have not shown any noteworthy increase.

Developments suggest that cyclical conditions may change somewhat in the course of 2007. There are now resource shortages in several industries, which will curb growth capacity ahead. With growing labour market pressures and high profitability in the business sector, markedly higher wage growth can be expected ahead. Higher cost growth will to some extent be passed on to prices so that inflation will edge up, but competition in product markets may attenuate the pass-through. Thanks to labour inflows from northern European countries, employment can increase without a corresponding decline in unemployment or an increase in labour force participation among the regis-

Macroeconomic indicators 2005-2006. Growth from previous period unless otherwise noted. Per cent

			Seasonally adjusted			
	2005	2006	06:1	06:2	06:3	06:4
Demand and output						
Consumption in households etc.	3.3	4.3	2.1	1.4	0.8	0.8
General government consumption	1.8	2.2	1.6	0.3	0.0	0.0
Gross fixed investment	11.2	8.9	-7.6	8.3	-0.6	5.2
Mainland Norway	9.1	8.9	-5.5	8.8	-3.8	6.3
Extraction and transport via pipelines	19.1	9.1	-10.6	5.5	11.4	12.4
Final domestic demand from Mainland Norway[1]	3.9	4.5	0.6	2.4	-0.2	1.6
Exports	0.7	1.5	0.7	0.3	-0.9	3.4
Crude oil and natural gas	-5.0	-5.4	-0.4	-3.5	-0.2	-1.7
Traditional goods	5.2	6.5	1.5	1.8	0.4	2.7
Imports	8.6	9.1	-0.1	3.8	0.4	4.7
Traditional goods	8.2	10.6	3.9	1.3	1.7	5.7
Gross domestic product	2.7	2.9	0.8	0.4	1.3	0.5
Mainland Norway	4.5	4.6	1.1	1.1	1.1	1.2
Labour market						
Man-hours worked	1.3	2.1	1.1	0.8	0.7	0.4
Employed persons	1.0	3.1	1.2	1.0	0.8	0.5
Labour force[2]	1.1	1.9	0.6	0.9	0.3	0.1
Unemployment rate, level[3]	4.6	3.4	4.0	3.8	3.3	2.9
Prices and wages						
Wages per standard man-year[4]	4.0	4.1	2.9	3.7	4.9	4.9
Consumer price index (CPI)[4]	1.6	2.3	2.2	2.4	2.2	2.5
CPI adjusted for tax changes and excluding energy products (CPI-ATE)[4]	1.0	0.8	0.9	0.8	0.5	0.8
Export prices, traditional goods	4.0	11.1	3.6	4.0	3.3	0.4
Import prices, traditional goods	0.4	4.1	2.0	-0.1	1.9	4.4
Balance of payment						
Current balance, bill. NOK	300.8	365.7	82.5	88.4	92.9	101.9
Memorandum items (unadjusted level)						
Money market rate (3 month NIBOR)	2.2	3.1	2.6	2.9	3.2	3.6
Lending rate, banks[5]	3.9	..	4.1	4.2	4.4	..
Crude oil price NOK[6]	351.4	413.8	409.7	432.2	434.6	380.7
Importweighted krone exchange rate, 44 countries, 1995=100	91.8	92.5	92.9	89.8	92.2	94.7
NOK per euro	8.01	8.05	8.02	7.83	8.06	8.27

[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.

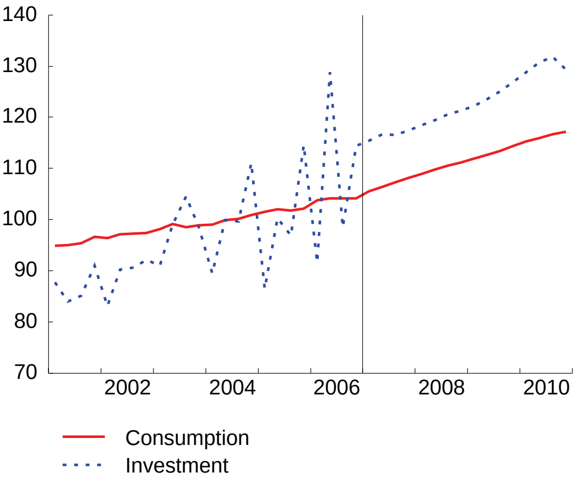
tered resident population. In isolation, this will curb wage growth. Economic growth will probably slacken after a period both as a result of somewhat weaker global growth and weaker growth impulses from oil activities than in recent years. Furthermore, higher interest rates will contribute to moderating household demand growth even though rising real income growth will have the opposite effect. In spite of these contributions to somewhat lower growth, we now believe that growth in the mainland economy will be higher than trend growth in 2007.

An important factor that might be of particular importance for the Norwegian economy is world market prices for the raw materials and semi-finished goods that have traditionally accounted for a large portion of Norwegian exports. These prices are important for profitability in the internationally exposed business sector and hence for wage growth for trend setters in pay negotiations. In previous reports, we assumed that weaker growth in the world economy would result in a clear fall in prices from their current high level. In this report, we have changed this assumption. Even though we have not revised up our projection for global growth substantially compared with the previous report, we do not apply the assumption of a marked decline in international commodity prices. The exception is the oil price, which is assumed to fall somewhat in USD terms between 2006 and 2007 and somewhat more in NOK terms as a result of the dollar depreciation in 2006. In 2009, prices for traditional Norwegian goods exports are thus 12 per cent higher than in the previous report. As a result, the projections for export growth and manufacturing production have been revised up and unemployment is put at a somewhat lower level ahead. The projections for wage growth have been revised up both as a result of lower unemployment and not least as a result of higher profitability. Consumer price inflation has also been revised up somewhat, but is still clearly lower than the inflation target of 2.5 per cent over the entire path. Owing to higher commodity prices, external inflation is assumed to be higher than previously and external interest rates are not assumed to fall back in 2008 as expected earlier. Against the background of prospects for a more pronounced boom in Norway, we now assume that monetary policy will be more contractionary and fiscal policy less expansionary than assumed earlier. According to our projections, GDP growth will thus show a clear moderation as from 2008.

Fiscal policy – the fiscal rule is not the limitation

The overall general government budget surplus came to about NOK 400 billion in 2006, or almost 20 per cent of GDP. The surplus on the central government budget accounts for practically the entire surplus, while the local government budget is roughly in balance. Underlying real growth in spending over the

General government
Seasonally adjusted volume indices, 2004=100



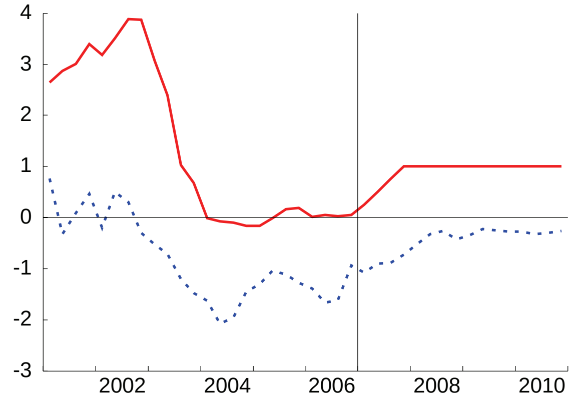
Source: Statistics Norway.

central government budget is estimated at about 2 per cent from 2005 to 2006. General government consumption increased by a good 2 per cent according to preliminary national accounts figures for 2006, i.e. about the same as in the previous year. Imports of frigates account for about half the increase. Local government consumption growth showed the largest increase in 2006. The Government Pension Fund – Global, which stood at about NOK 1 400 billion at the beginning of 2006, increased sharply through the year and can be estimated at around NOK 1 800 billion at end-2006. The structural, non-oil budget deficit is estimated at NOK 62.5 billion in 2006, while the expected real return on the Fund was NOK 56 billion. This brings spending in excess of the fiscal rule to 0.4 per cent of mainland GDP in 2006.

For 2007, the Government has put the deficit at a level that roughly corresponds to the expected return on the Fund. If the projections prove accurate, 2007 will be the first year this occurs since the fiscal rule was introduced in March 2001. In the Government's budget programme, underlying real growth in central government spending is estimated to increase more in 2007 than in 2006 and will thus have an expansionary impact. Our projections are based on the approved tax changes in 2007, including the increase in VAT on food and some increase in personal taxation in relation to 2006. As in the previous report, growth in general government consumption is assumed to increase by close to 3 per cent, while investment growth is put at close to 6 per cent in 2007. Growth in the number of benefit recipients is expected to be relatively modest, but as a result of higher real wage growth in 2007 real growth in benefits is still expected to increase in relation to 2006.

The National Budget for 2007 presents projections for developments in the structural, non-oil budget deficit in the period 2008-2010 based on the assumption that

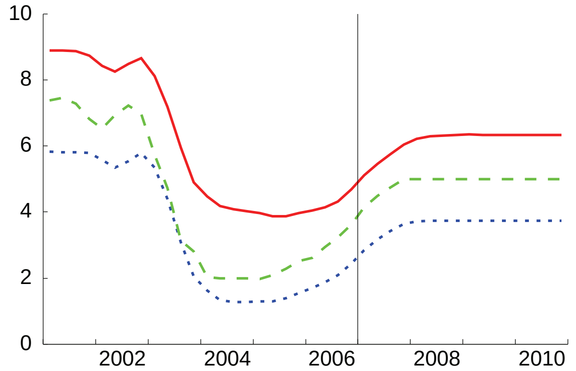
Interest rate and inflation differential between NOK and the euro
Percentage points



Interest rate
Inflation (CPI-ATE - HCPI-euro)

Source: Norges Bank and Statistics Norway.

Norwegian interest rates
Per cent



Lending rate (households), banks
Deposit rate (households), banks
Money market rate

Source: Norges Bank and Statistics Norway.

Exchange rates

Import-weighted exchange rate. 1995=100
NOK per euro (right axis)
NOK per USD (right axis)

Source: Norges Bank.

the fiscal rule is adhered to mechanically. Such a budget policy implies fairly considerable fiscal stimulus, particularly in the light of the expected economic developments in the Norwegian economy in the period ahead. We project the expected real return on the Government Pension Fund – Global as a share of trend level in mainland GDP growth to increase by 0.7 per cent in both 2008 and 2009, while the increase is put at a half per cent in 2010.

In previous analyses, we assumed that the entire fiscal leeway will be used. We have now revised this assumption against the background of stronger-than-expected economic developments in the coming years. Fiscal policy is now assumed to be somewhat less expansionary than implied by a mechanical interpretation of the fiscal rule. It is reasonable to assume that fiscal policy will also contribute to stabilising the Norwegian economy in the years ahead so that the entire responsibility for stabilisation policy is not left to monetary policy as this could have unfavourable consequences for the exchange rate and bring inflation even farther away from the inflation target of 2.5 per cent.

In relation to previous projections, we have thus roughly reduced growth in general government consumption by 1 percentage point in 2008 and 2009. This means that the growth rates for 2007 will continue in the coming years and do not project a further increase as previously. In 2010, the deficit is three-quarters lower as a share of mainland GDP. In line with previous practice, we apply unchanged real direct and indirect tax rates as from 2008. The basic pension in the national insurance scheme is assumed to follow general wage growth.

Continued rise in interest rates

The latest interest rate increase in January brought Norges Bank's key policy rate to 3.75 per cent. This was the eighth interest rate hike and the key rate is now 2.0 percentage point higher than at its lowest level in 2004-2005.

In interest-rate setting, Norges Bank shall strike a balance between stabilizing inflation, the exchange rate, output and employment. The operational target of monetary policy is annual consumer price inflation of close to 2.5 per cent over time. Low inflation in recent years largely reflects supply-side shocks from falling prices for some imports and high productivity growth. Such shocks can lead both to low inflation and high capacity utilization. Norges Bank must then assess the trade-off in monetary policy between stabilizing inflation in relation to the operational target and stabilizing developments in output.

The consumer price index adjusted for tax changes and excluding energy products (CPI-ATE) was 0.8 per cent higher in 2005 than in 2006. In January, the 12-

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

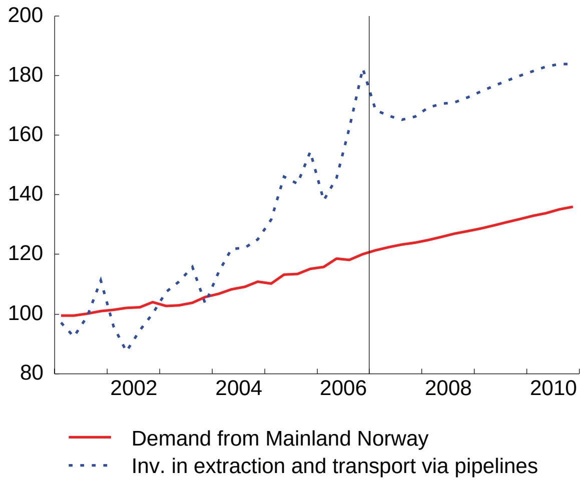
		Forecasts							
	Accounts	2007			2008		2009		2010
	2006	SN	MoF	NB	SN	NB	SN	NB	SN
Demand and output									
Consumption in households etc.	4.3	3.8	3.0	3 1/2	3.1	2 3/4	3.5	2 1/4	3.3
General government consumption	2.2	2.8	2.7	2 3/4	3.0	3	2.6	3 1/4	3.0
Gross fixed investment	8.9	5.8	1.8	..	2.3	..	2.5	..	3.3
Extraction and transport via pipelines[1]	9.1	3.8	-2.5	0	2.9	-5	4.4	0	3.6
Mainland Norway	8.9	5.7	2.9	5 1/2	2.3	1	2.1	-3/4	3.5
Industries	10.5	6.6	6.1	..	3.1	..	2.3	..	2.5
Housing	6.4	4.4	0.0	..	0.3	..	0.9	..	3.5
General government	8.9	5.8	0.2	..	3.4	..	3.5	..	5.9
Demand from Mainland Norway[2]	4.5	3.9	2.9	3 3/4	3.0	2 1/2	3.0	2	3.2
Stockbuilding[3]	0.6	0.0	..	..	0.0	..	0.0	..	0.0
Exports	1.5	3.6	5.3	..	3.4	..	0.5	..	3.4
Crude oil and natural gas	-5.4	3.8	6.8	..	3.7	..	-2.9	..	2.3
Traditional goods[4]	6.5	3.1	4.0	4 1/2	3.1	2 3/4	3.6	2 3/4	5.0
Imports	9.1	5.2	3.5	4 1/4	4.1	2 1/4	4.2	2 1/4	4.7
Traditional goods	10.6	5.6	5.2	..	3.4	..	4.2	..	5.0
Gross domestic product	2.9	3.3	3.6	3 3/4	2.6	3	1.5	1	2.7
Mainland Norway	4.6	3.3	2.9	3 1/4	2.3	2	2.4	1 3/4	2.7
Labour market									
Employed persons	3.1	2.0	1.3	1 1/2	1.0	1/4	1.2	0	0.8
Unemployment rate (level)	3.4	2.7	3.0	3	2.8	3 1/4	2.7	3 3/4	2.8
Prices and wages									
Wages per standard man-year	4.1	5.5	4 1/2	5	4.8	5 1/4	5.4	4 3/4	4.6
Consumer price index (CPI)	2.3	0.3	1 3/4	1 1/4	1.9	2	1.7	2 1/2	1.7
CPI-ATE[5]	0.8	1.3	1 1/2	1 1/4	1.6	2 1/4	1.7	2 1/2	1.7
Export prices, traditional goods	11.1	-0.1	..	..	-3.1	..	0.4	..	1.2
Import prices, traditional goods	4.1	2.6	..	..	-1.9	..	-1.4	..	-1.1
Housing prices[6]	12.9	10.7	..	..	6.0	..	4.8	..	5.6
Balance of payment									
Current balance (bill. NOK)	365.7	297.6	..	..	288.8	..	264.2	..	271.6
Current balance (per cent of GDP)	17.0	13.8	16.9	..	13.0	..	11.5	..	11.2
Memorandum items:									
Household savings ratio (level)	1.4	4.3	4.2	..	4.9	..	5.1	..	5.6
Money market rate (level)	3.1	4.6	..	4 1/4	5.0	5 1/4	5.0	5 1/2	5.0
Lending rate, banks (level)[7]	4.3	5.6	..	..	6.3	..	6.3	..	6.3
Crude oil price NOK (level)[8]	414	338	390	..	332	..	329	..	326.0
Export markets indicator	9.4	6.5	..	..	3.7	..	4.2	..	6.5
Importweighted krone exchange rate (44 countries)[9]	0.6	-0.1	..	2 1/2	-1.4	1/4	-1.0	0	-0.9

[1] Forecasts from Ministry of Finance incl. service activities incidential 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).

monht increase in the CPI-ATE was 1.0 per cent. CPI-ATE inflation has thus edged up, but remains well below the inflation target of 2.5 per cent. The low rate of increase in the CPI-ATE and fears of a sharp appreciation of the krone exchange rate are factors that might induce Norges Bank to show some restraint when increasing interest rates. On the other hand, high activity in the economy and labour market tightening suggest higher interest rates ahead, as signalled by Norges Bank.

Domestic credit growth, as measured by 12-month growth in private sector gross debt (C2), was 14.6 per cent in December 2006. This is the same rate of growth as in December 2005. Household credit growth was the lowest since August 2005, but was still as high as 12.5 per cent. Thus, the credit growth has remained high despite the rise in interest rates throughout 2006. Persistently strong debt growth can lead to instability in the economy. Since growth in private sector gross debt partly depends on the inter-

Domestic demand
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

est 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 was the seventh interest rate hike in little over a year, bringing the key rate to 3.5 per cent in the euro area. We assume that interest rates in the euro area will be raised by one additional increment in early 2007. This interest rate increase, combined with a normal markup, results in a money market rate in the euro area of about 4 per cent. The interest rate euro area is then expected to remain at this level throughout the projection period.

We assume that Norges Bank will increase the key rate by one percentage point through the remainder of 2007. This is approximately in line with market expectations. In this case, the key rate will stand at 4.5 per cent towards the end of this year. Money market rates will remain at about 0.25 percentage point above the key rate, bringing money market rates to 5.0 per cent around the beginning of 2008 where they are expected to remain throughout the projection period.

Our projections for interest rate developments in the euro area and in Norway imply that the interest rate differential will widen to one percentage point during 2007. With such an interest rate differential, we assume that the krone will strengthen and remain strong throughout the entire projection period. In 2007, the euro is projected to be slightly higher than NOK 8, followed by a gradual strengthening of the krone to about 7.80 against the euro in 2010. The import-weighted krone exchange rate, as measured by the weighted composition of Norwegian imports, will appreciate by about 1 per cent annually during the projection period.

Oil investment contributes to sustaining the upturn

Preliminary national accounts figures show that investment in oil and gas activities increased by close to 20 per cent from 2004 to 2005, and by close to a further 10 per cent in 2006. Investment is expected to rise by about 4 per cent in 2007, i.e. a small downward adjustment compared with earlier projections. Through the remainder of the projection period volume growth is expected to pick up further by close to 4 per cent annually.

Investments in both onshore installations and pipelines are assumed to fall markedly with the completion of the onshore installations linked to the Ormen Lange and Snøhvit fields and the Langeled pipeline system. Exploration investment will show a particularly strong increase ahead, but will be limited in the very short term by rig capacity. A sharp increase is expected in production drilling, investment in field development and fields in operation in the period ahead. Against the background of prospects for sustained high oil prices, many fields are considered profitable, including fields that have previously been considered unprofitable. Combined with high oil prices, new technology to increase the production level at existing fields is profitable to implement. Promising exploration areas and a growing rig fleet are also underpinning continued growth in oil investment. Investments relating to Tyrihans, 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.

This path for oil investment will contribute to amplifying the boom throughout the projection period. The investment peak in 1998 has been passed, but measured as a percentage of mainland GDP the record of 8 per cent from that time remains in tact. During the projection period it will be highest in 2009, at an estimated 6.5 per cent.

Total production of oil and gas has fallen during the past years. In 2006, production declined by over 4 per cent on the previous year. There was a falling tendency in production throughout 2006, when adjusted for normal seasonal variations. Production in the fourth quarter was about 3 per cent lower than the previous quarter. Since 2001, oil production has fallen, while gas production has gained momentum. For 2007, we assume that both oil and gas production will rise, so that total petroleum production will increase by a good 3 per cent. This is lower than assumed earlier and is due to revised production estimates from Hydro and Statoil in recent months. In the period following 2007, oil production is expected to decline gradually, while gas production will increase. Overall, production is expected to increase by a further 4 per cent from 2007 to 2008 and then to fall by close to 3 per cent in 2009. In 2010, overall production of oil and gas is projected to edge up again.

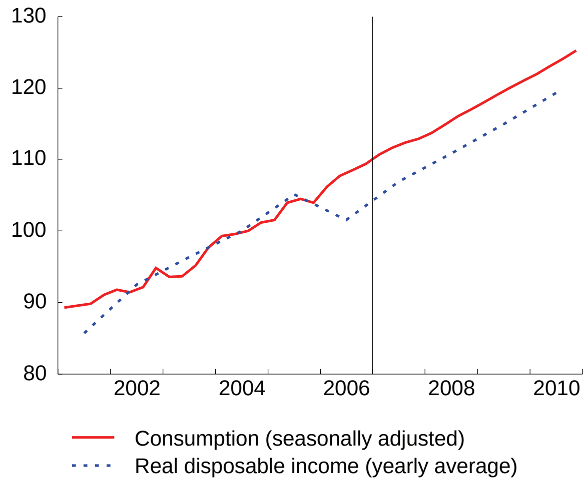
Strong consumption growth ahead

Real disposable income for households and non-profit institutions declined by 3.5 per cent in 2006, according to preliminary national accounts figures, compared with an increase of as much as 5.1 per cent in the previous year. Household net capital income made the clearly largest negative contribution to income growth in 2006, which primarily reflects a sharp fall in dividend payments. In the national accounts, household dividend income is estimated at about NOK 36 billion in 2006, which corresponds to a decrease of a good 60 per cent on the previous year when dividend payments were record-high in a historical context. Tax-related adaptations in connection with the re-introduction of dividend tax in 2006 account for the bulk of this decline. Household wage income made a strong positive contribution to growth in real disposable income in 2006, with solid growth in both the number employed and average real wages per normal person-year. The contributions to growth from self-employment income, public transfers and income and wealth tax were more moderate.

According to preliminary figures, consumption for households and non-profit institutions grew by 4.3 per cent in 2006, or was 1 percentage point higher than in the previous year. Consumption growth in 2006 must be seen against the background of high income growth and a marked fall in the real interest rate (after tax) through recent years. Excluding dividend payments, which probably have little influence on consumption, real income increased by 3.5 per cent in 2006 and 1.7 per cent in 2005 (see table). The saving ratio fell to a historically low level of 1.4 per cent in 2006, from a high level of a little less than 9 per cent in the previous year. This must also be seen in the light of low dividend payments.

Growth in household real disposable income is projected to exceed 5 per cent in 2007 and be close to 4 per cent in the remainder of the projection period. Excluding dividend payments, which are expected to pick up to a more normal level, income growth is expected to remain high in the period ahead. The high level of income growth primarily reflects strong growth in wage and self-employment income and public transfers. Relatively low consumer price inflation, particularly in 2007, will push up real growth in household income. Households will increase debt relative to assets through the projection period. In conjunction with higher interest rates, this will translate into weak growth in net capital income, which pushes down growth in disposable income in 2007. Higher direct taxes will also contribute to pushing down growth in disposable income somewhat in 2007. The real after-tax interest rate is assumed to be around 4 per cent in 2007, i.e. markedly higher than in the two previous years, and will then fall to a level of about 3 per cent in the period 2008 to 2010. The projections for income and interest rates result in a path for consumption growth between 3 and 4 per cent in the coming years, i.e. continued high consumption growth ahead.

Income and consumption in households
Volume indices, 2004=100



Source: Statistics Norway.

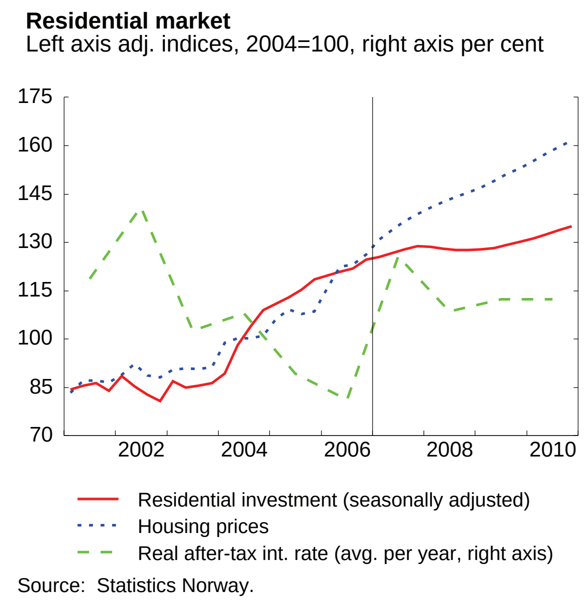
Household real disposable income. Percentage growth from the previous year

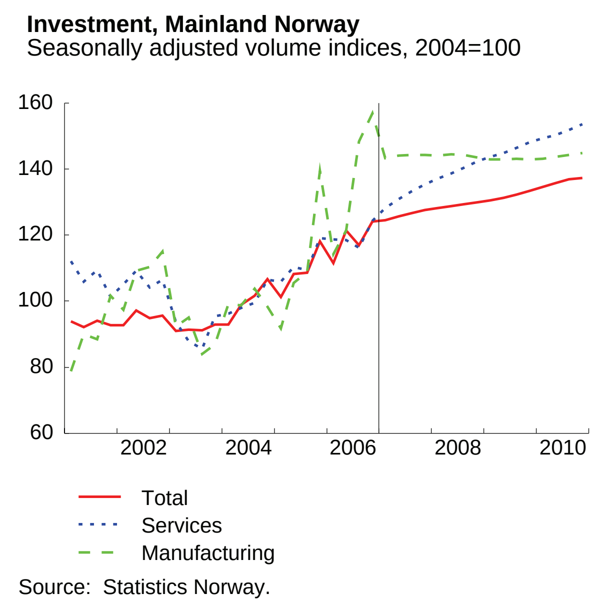
	2005	2006	2007	2008	2009	2010
Totalt	5.1	-3.5	5.4	3.7	3.7	3.8
Excl. dividends	1.7	3.5	3.4	3.2	3.2	3.3

Our projections imply a gradual rise in the saving ratio from 1.4 per cent in 2006 to a level of a good 5.5 per cent in 2010. The fall in the level of saving between 2005 and 2006 reflects a marked fall in household net lending. At current prices, household net lending declined from NOK 23 billion in 2005 to -50 billion in 2006. The decline in dividend payments to households accounts for the lion's share of this fall. Higher debt to finance the strong growth in housing capital has also played a part. Households will probably continue to shift portions of their assets away from financial assets to real assets, which will be reflected in a continued high level of housing investment ahead.

High level of housing investment

According to preliminary figures for the building industry, housing starts came to about 33 400 in 2006, which corresponds to an increase of 5.5 per cent on the previous year. In comparison, the increase was 7.3 per cent in 2005 and 31 per cent in 2004. In line with developments in building activity in recent years, preliminary national accounts figures show that housing investment increased by 6.4 per cent in 2006, compared with 14.5 per cent in 2005 and 16.3 per cent in





2004. The driving forces behind the vigorous growth in housing investment recorded since the end of 2003 have primarily been strong real income growth, lower real interest rates and a sharp rise in prices for existing dwellings.

High and rising housing start figures through the fourth quarter of 2006, combined with prospects for continued solid growth in real disposable income, point to sustained high housing investment through the projection period. Housing capital is historically at a very high level, however. Combined with higher real interest rates, this is likely to curb both housing investment and house price inflation ahead. All in all, housing investment is still projected to increase by close to 10 per cent in the projection period. There are now reports of shortages of and long delivery times for building materials. This may lead to lower-than-expected investment in the period ahead. Prices for existing dwellings are expected to increase by around 11 per cent in 2007, compared with 12.9 per cent in 2006, implying a continued high rate of increase in real prices in 2007. Thereafter and to the end of the projection period, the rise in prices for existing dwellings is expected to moderate, but the real price rise will still be positive.

Lower investment growth

After three years of strong growth in gross investment in mainland industries, there are now signs of moderating growth. After expanding sharply in the fourth quarter of 2005, there have been tendencies of somewhat slower growth in 2006, and investment in mainland industries was 8.6 per cent higher in the fourth quarter of 2006 compared with the same quarter one year earlier. On an annual basis, this investment component increased by 10.5 per cent in 2006, i.e. at almost the same pace as in the previous year. This pattern can be seen in both manufacturing and private services. National accounts figures for investment in manufacturing and mining and quarrying show that investment was 15.0 per cent higher in the fourth quarter of 2006 than in the same quarter one year earlier. This is markedly lower than the annual growth rate of 22.5 per cent between 2005 and 2006. Investment in private services was 4.3 per cent higher in the fourth quarter of 2006 in relation to the same quarter of 2005, while annual growth was 7.5 per cent between 2005 and 2006.

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 sector, the investment intentions survey indicates an increase of around 10 per cent this year, which is considerably lower than the investment growth rate of almost 30 per cent in 2006.

Investment growth is expected to continue to slow in the coming years. Investment growth for mainland industries is projected at a little more than 6.5 per cent this year, slowing to about 2.5 per cent in 2009 and 2010. With somewhat slower growth in the economy in the period ahead, the need to increase capacity will diminish and thereby curb investment growth.

Lower growth in traditional goods exports ahead

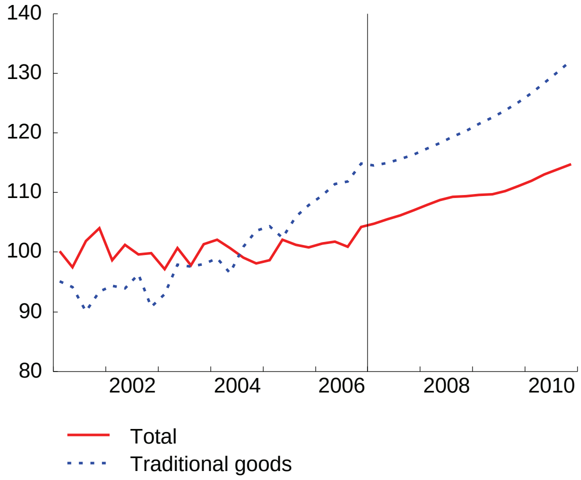
According to preliminary national accounts figures, the volume of traditional goods exports rose in volume terms by 6.5 per cent in 2006, i.e. at a somewhat faster pace than in 2005. Seasonally adjusted figures indicate that growth was 2.7 per cent in the fourth quarter compared with the previous quarter. This growth rate is stronger than in the three previous quarters. Engineering products accounted for the clearly largest share of growth in export goods, rising at a rate of as high as 17.8 per cent in 2006. The strong pace of growth in exports reflects buoyant demand among our main trading partners. Growth in total exports was somewhat lower in 2006 than growth in traditional export goods despite a pronounced increase in service exports. The reason is a marked decline in the volume of exports of crude oil and natural gas, which at current prices accounted for about half of total exports in 2006.

The volume of service exports rose by as much as 7.6 per cent in 2006, which primarily reflects a sharp rise in exports of commercial services. After expanding markedly in the fourth quarter, growth in exports of commercial services came to as much as 25 per cent in 2006.

World commodity prices showed a marked rise in 2006, which benefited Norway's relatively commodity-based industry. After rising sharply throughout 2006, export prices for metals were a good 30 per cent higher than in the previous year. The rise in prices for crude oil and natural gas was also substantial at 20 and 13 per cent, respectively.

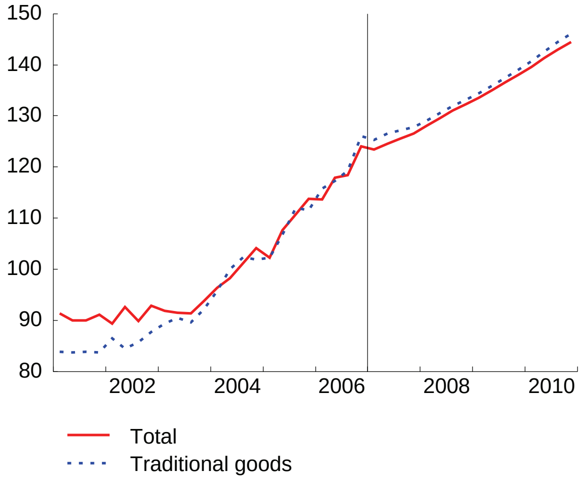
This year, growth in traditional goods exports is expected to slow to about 3 per cent and remain at about this level in 2008 and 2009, as a result of slower demand growth among our main trading partners in these years. Towards the end of the projection period, growth in the international economy will pick up again and stimulate export growth. In 2007, oil and gas exports are expected to increase for the first time since 2002. Combined with service exports, this will bring overall growth to around 3.5 per cent. Export growth will remain at this level to the end of the projection period, with the exception of 2009 when the fall in oil and gas exports will push down total export growth to close to zero.

Exports
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

Imports
Seasonally adjusted volume indices, 2004=100



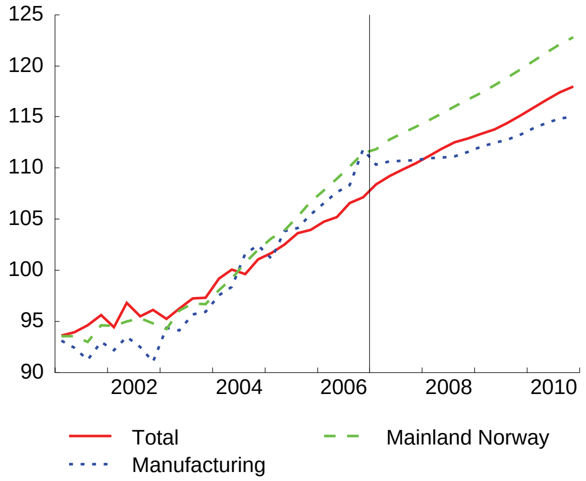
Source: Statistics Norway.

Somewhat slower import growth ahead

The volume of traditional import goods rose by 10.6 per cent in 2006, compared with 8.2 per cent in 2005. Growth was particularly high in the fourth quarter. Service imports, which rose by 7.1 per cent, pushed down total import growth to 9.1 per cent. On the upside, imports of ships, platforms and aircraft expanded by 14.7 per cent, primarily reflecting the delivery of one frigate to the defence sector. Import growth was strongest for engineering products, commercial services, chemical and mineral products and travel. Metal imports fell in volume terms in 2006, after rising sharply in 2005. The strong growth in the volume of imports reflects high growth in domestic demand, particularly as a result of buoyant growth in business investment. Capacity problems in the business sector and weaker cost competitiveness have also contributed to this development. Import prices for traditional goods rose by 4.1 per cent in 2006, compared with an increase of 0.4 per cent in 2005. Metal prices showed a particularly sharp increase of 20.1 per cent. Prices for refined petroleum products and industrial chemicals also exhibited a clear rise, while electricity prices rose by as much as 61.6 per cent. As in 2005, prices for typical consumer goods rose by much less on average.

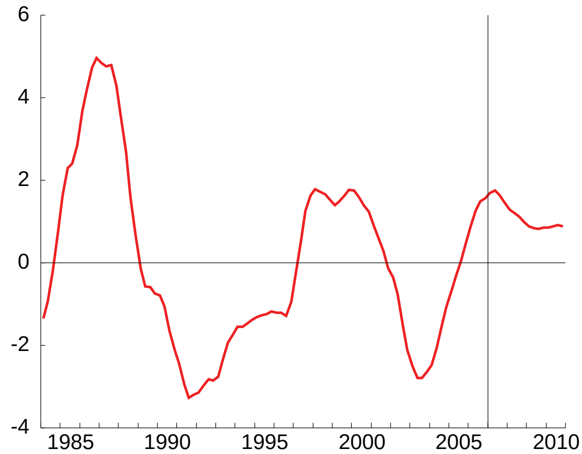
Growth in imports of traditional goods is expected to slacken in 2007 to a little less than 6 per cent. In 2008, growth will slow further in pace with lower growth in domestic demand. In 2009 and 2010, import growth is projected to edge up again. One frigate should be delivered in each year in the projection period and hence will not influence growth in imports ahead. With a decline in import prices in the coming period, partly reflecting a stronger krone, the import share will increase and imports will increase at a faster pace than domestic demand.

Gross domestic product
Seasonally adjusted volume indices, 2004=100



Source: Statistics Norway.

Output gap, Mainland Norway
Deviation from trend, per cent



Source: Statistics Norway.

The boom continues

Preliminary QNA figures show an increase in total GDP of 2.9 per cent between 2005 and 2006, which is somewhat higher than in the previous year. Mainland GDP growth was as high as 4.6 per cent, which was also slightly higher than in the previous year. 2006 was the third consecutive year of strong growth in mainland output. Quarterly growth rates show that growth was unusually uneven. Owing to a decline in electricity production as a result of low rainfall levels, underlying growth in the mainland economy is even higher. There were no signs of a slowing tendency in growth in the Norwegian economy through 2006. There was generally high growth in all demand components, with the exception of total exports. The decline in exports of crude oil and gas pushes down total export growth.

Economic growth can be expected to be high also in 2007, but perhaps not as strong as in 2006. Fiscal impulses to growth may be stronger in 2007 than in 2006, while monetary policy will gradually generate weaker impulses, particularly via household demand. In 2008, interest rate increases are expected to translate into lower growth in consumption and housing investment in the first round. Even though oil investment will continue to move up somewhat, growth is expected to be somewhat slower ahead compared with previous years. This will result in somewhat weaker growth impulses to offshore-related industries, but activity will be sustained at a high level. It still appears that international economic growth will slacken somewhat in 2007 compared with 2006, but to a lesser extent than previously projected. As a result, exports of both traditional goods and services may show a marked increase again in 2007, and the tradable goods sector may expand somewhat more ahead than previously projected. Manufacturing production will probably continue to increase in 2007, albeit at a somewhat slower pace than in 2006. Growth in the mainland economy is projected at 3.3 per cent in 2007.

Higher estimates for growth in housing investment and exports excluding oil and gas are the main factors behind the upward revision of the growth projection for 2007 in relation to our previous report. Total GDP is also projected to grow by a little more than 3 per cent, and this projection has only been raised marginally owing to a downward revision of oil and gas exports. These projections imply a sustained boom in the Norwegian economy through 2007, while previous projections indicated that the cyclical peak would be reached around the turn of the year.

Developments in the Norwegian economy, as projected here, imply a somewhat higher degree of economic policy tightening than previously assumed. We now assume that Norges Bank will increase its key rate through 2007 and into 2008, without a corresponding increase in external interest rates. Moreover, we assume that fiscal policy will be somewhat less expansionary than implied by a mechanical interpretation of the fiscal rule. In conjunction with small changes in petroleum investment, somewhat weaker international growth, albeit higher than previously projected, will contribute a clear moderation in mainland GDP growth in Norway in 2008. Growth will slow, perhaps to below trend growth, so that the boom will lose some pace as from 2008. In isolation, monetary policy tightening will push down growth in household demand, but at the same time both export growth and real wage growth will be higher than projected earlier. As a result, our GDP growth forecast for 2008 shows little change. With stronger-than-projected growth in the global economy, manufacturing will continue to expand again in 2008. Lower growth in fixed capital investment in 2008 will push down growth somewhat in the building and construction industry.

In 2009, growth in the OECD area is projected to pick up again after a short growth pause in 2007 and 2008. Exports of goods and services excluding oil and gas are then expected to pick up somewhat, while contributions to growth from oil and gas exports will diminish. A somewhat higher interest rate level than expected earlier will influence household demand again in 2009. The household saving ratio will thus continue to edge up. Fiscal policy will not make a substantial contribution to stimulating growth beyond trend growth as the fiscal leeway provided by the return on the Government Pension Fund – Global will not be fully utilized. Somewhat weaker economic growth in 2008 will moderate investment growth further in 2009, and contribute to below-trend growth in the mainland economy. Developments in 2009 will by and large continue in 2010, but global growth will make an even larger contribution to pushing up export growth and production in the internationally exposed sector. Output growth in 2010 is thus projected at close to trend growth.

Stable, low unemployment – as in the 1970s

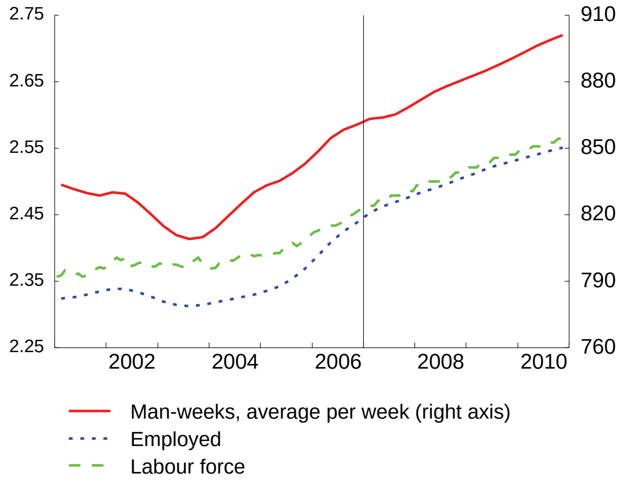
According to the Labour Force Survey (LFS), the unemployment rate was 3.4 per cent in 2006. Unemployment figures are somewhat lower due to a revision of the LFS in January 2006. According to the previous definition, the unemployment rate was 3.5 per cent in 2006, down from 4.6 per cent in 2005. In the fourth quarter of 2006, seasonally adjusted unemployment was 2.9 per cent, the lowest rate since the previous cyclical peak at the turn of the year 1998/1999, when unemployment fell to 2.8 per cent.

From the fourth quarter of 2005 to the fourth quarter of 2006, the number of unemployed fell by 37 000. According to preliminary national accounts figures, employment rose by close to 84 000 in the same period, i.e. an increase of 3.6 per cent. This is the sharpest decrease in unemployment and the strongest rise in employment ever recorded in the course of four quarters.

The labour force is influenced by demographic developments, such as changes in the size and composition of the population, and by changes in labour force participation within different groups. Inward labour migration has contributed to an increase in the labour force in recent years. However, some short-term inward labour migration is recorded in the national accounts as services imports. And not all inward labour migration is registered. If labour participation rates for the various gender, age, level of education, student and pensioner categories remain unchanged, population developments are estimated to contribute to an annual increase in the labour force of approximately 13 000 in the next few years. This estimate is based on a migration forecast from December 2005, and it is assumed that about 60 per cent of the increase in the labour force can be attributed to the population increase resulting from inward migration. The labour force expanded by 39 000 from 2005 to 2006, implying a clear increase in labour force participation rates, but also indicating that the estimate for inward labour migration was too low.

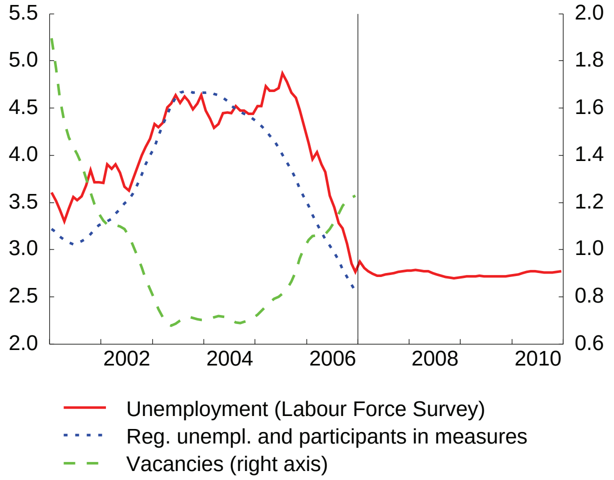
According to the national accounts, employment has risen in particular in service industries in the public and private sectors, but also in building and construction. From the fourth quarter of 2005 to the fourth quarter of 2006, employment growth was strongest in the building and construction industry and commercial services, reaching 8.9 and 8.3 per cent respectively. Employment growth of between 2 and 3 per cent in

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



Source: Statistics Norway.

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



Source: The Directorate of Labour and Statistics Norway.

retail trade, financial services and the hotel and restaurant industry reflects to some extent higher household income that has been used to increase housing investment rather than consumption.

In the period 2001-2005, employment in the public sector remained virtually unchanged. In 2006, however, this sector also witnessed strong employment growth. Local government employment rose by 3.1 per cent, and central government employment (civilian) rose by 1.4 per cent. Measured on an annual basis, manufacturing employment rose in 2005 for the first time since 1998. It continued to rise in 2006, increasing by 1.3 per cent. Growth of close to 11 per cent in the shipbuilding and oil platform construction industries made the largest contribution to the increase in employment. In most of the other industries, employment fell.

Employment is estimated to rise by more than 120 000 from 2006 to 2010, i.e. an overall increase of more than 5 per cent. The increase in employment is more or less equally distributed between the public and private sectors. Manufacturing employment is estimated to fall by approximately 15 000 in the projection period due to a gradual deterioration in competitiveness in Norwegian manufacturing enterprises.

Unemployment is projected to remain approximately unchanged for the next four years. On an annual basis, unemployment is projected at 2.7 per cent in 2007 and to remain virtually unchanged until the end of the projection period. Unemployment has not been low for such a long period since the 1970s. These relatively stable developments reflect very moderate cyclical movements in our projections, both in Norway and internationally.

The marked rise in employment and the small changes in unemployment in our projections indicate that there now may be little to be gained in terms of available labour by reducing unemployment further. Higher demand for labour will probably have to be satisfied by higher labour force participation rates and increased inward labour migration. The labour force is expected to increase by approximately 115 000 from 2006 to 2010. The average labour force participation rate in Norway is expected to rise from 74.4 per cent in 2006 to 74.9 per cent in 2010. As mentioned above, it is important to be aware that this variable is influenced by many factors in addition to changes in various groups' labour force participation rates.

Real wage growth of 15 per cent from 2006 to 2010

According to preliminary national accounts figures, wages per normal person-year increased by 4.1 per cent from 2005 to 2006, or about the same as in the previous year. Compared with the same half-year period in 2005, wage growth showed a marked increase in the second half of last year, when wages rose by 4.9 per cent, as against an annual growth rate of 3.3 per cent in the first six months of the year. The settlement last year, however, was a main wage settlement. Since a relatively large share of wage growth is in the form of spring wage increases in main settlement years, annual wage growth follows a different seasonal pattern than in interim wage settlement years. In the second half of 2004, which was a main settlement year, growth in annual wages per normal person-year was 5.5 per cent, or 0.6 percentage point higher than last year. This implies that so far there are no clear signs that a tighter labour market has translated into higher wage growth.

However, a number of factors indicate that wage growth may pick up in the years ahead. In addition to the expectation that a low level of unemployment will persist, income in the business sector has shown strong growth for several years. Experience indicates that income growth of this nature results in higher wage growth in the subsequent period. Over time this will contribute to an increase in labour costs' share of income to previous levels. Experience also indicates that it takes time for higher incomes and lower unemployment to translate into higher wage growth, and the effects are long-lasting. In the long term, analyses indicate that the level of unemployment only influences wage levels, not wage growth. According to calculations in *Economic Survey* 4/2006*,* the decline in unemployment from 2005 to 2006 will push up wage growth by 1.0 percentage point in 2007 and 2008, and by 0.7 percentage point in 2009.

Increased inward labour migration will probably contribute to slower wage growth in the period ahead. Since wage levels are lower for labour migrants than for other wage earners, this will in itself reduce the average wage level. In addition, intensified competition in the labour market may restrain wage growth in general. The effects on wage growth are not expected to differ from the effects of previous changes in unemployment. We therefore assume that our models generally capture the impact of increased inward labour migration.

Growth in wages per normal person-year is projected at 5.5 per cent in 2007. This is slightly higher than projected in the previous report in December 2006. However, a more marked upward revision has been made for projected wage growth in 2008 and 2009. Growth in wages per normal person-year is now projected at around 5 per cent in the years ahead. Higher wage growth is a result of a tighter labour market and more optimistic forecasts for the global economy. A moderate decline in growth among Norway's most important trading partners will be offset by continued high demand from China and other low-cost countries. This will contribute to holding up world market

The importance of international prices for the Norwegian economy

Norway is a small, open economy. What does that really mean? It is not difficult to understand the importance of oil prices for the Norwegian economy. Even earlier it was a common perception that movements in prices for Norwegian export goods have a substantial impact on the Norwegian economy, not least for developments in nominal terms. In order to illustrate the importance of changes in prices for traditional Norwegian export goods for the Norwegian economy, we have used our macroeconomic model KVARTS in stylized calculations. As shown in the forecasts up to 2010 in this survey, our projections for wage growth have been revised upwards somewhat compared with those in December 2006, primarily as a result of higher projections for world market prices for commodities and semi-manufactures.

Historically, there have been wide cyclical fluctuations in export prices for traditional goods, and these prices were at a high level in 2006. In our economic analyses over the past three years, we have assumed that a moderate recession would result in a sharp fall in export prices. We have gradually revised this assumption. We now assume that economic growth will only be more subdued in 2007 and 2008 and then be followed by a renewed moderate upturn. In isolation, this implies that international commodity prices will remain at a higher level than assumed earlier. Moreover, it is conceivable that commodity prices, to a greater extent than prices for finished goods, will be influenced by developments in the world economy as a whole. Vigorous growth in Asia may thus imply that many of Norway's export prices will not fall to any extent in the period ahead.

The table shows developments in export prices for traditional goods in calculations where the benchmark scenario resembles our December report, but where export prices are increased so that we approximately recreate the export prices in our current benchmark scenario. Stylized, we have assumed that export prices will be 5 per cent higher in 2007 and 10 per cent higher in 2008 to 2010. Higher export prices for commodities and semi-manufactures (excluding oil and gas) boost profitability in the internationally exposed sector. Through wage formation, this results in higher wages in these industries. As a result of relatively centralized wage formation in Norway, these wage increases spill over to wages in public and private services. The table indicates that the total wage level shows little increase in 2007, but is a good 4 per cent higher in 2010. Higher labour costs push up prices for domestically produced goods and services. The CPI-ATE rises gradually and is 1.2 per cent higher in 2010. Higher real wages leads to higher consumption and housing investment. As a result, production increases and mainland GDP rises by 0.4 per cent in 2010. Employment shows little change because higher wages lead to substitution away from labour and this effect counters the effect of higher production. In these calculations, we have assumed that the exchange rate, the policy rate and fiscal policy are unchanged in order to isolate the effect of altered price assumptions. This is done in order to show the effect of how this traditional form of terms-of-trade gains is transferred from the internationally exposed sector to the household sector.

Effects of assumptions of higher world market prices for industrial commodities. Deviation in level from benchmark scenario in per cent

	2007	2008	2009	2010
Export prices, traditional goods	5.0	10.0	10.0	10.0
Wage level	0.2	1.2	2.8	4.3
CPI-ATE	0.0	0.2	0.6	1.2
Mainland GDP	0.0	0.1	0.1	0.4

prices for typical Norwegian export products and thereby to high profitability in the manufacturing sector, which is a wage leader. Combined with continued low unemployment, this will result in high wage growth ahead.

In the period from 2006 to 2010, labour productivity will on average grow by approximately 1½ per cent according to our forecasts. This is well below trend productivity growth, which is normal once the economy has passed the cyclical peak. With average annual wage growth at 5 per cent and an annual rise in consumer prices of 1½ per cent, unit labour costs, both in terms of real wages and hourly wage costs, will increase by as much as 3½ per cent measured as an annual average in the period. If this is the case, real wages will rise by a resounding 15 per cent in the course of these four years. High real wage growth is also a normal feature of the phase of the business cycle that will be in progress then, but real wage growth has not been that high over a four-year period since the 1970s.

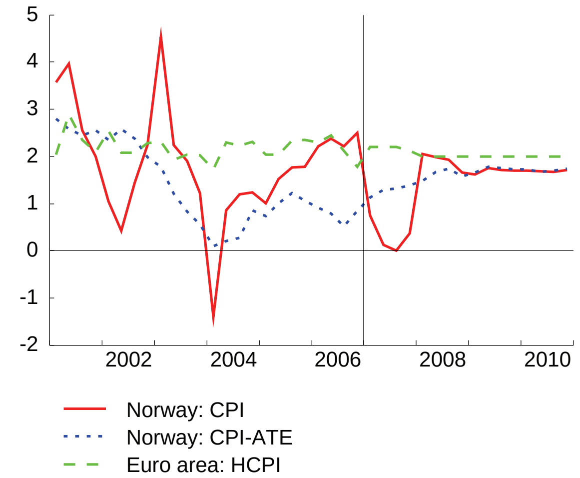
Inflation not likely to reach 2.5 per cent

Inflation, measured by the consumer price index adjusted for tax changes and excluding energy (CPI-ATE), has for the past four years hovered around an average of 0.8 per cent, which was also the average for 2006. Due to high energy prices and tax changes, total annual CPI inflation in these years was close to one percentage point higher. A sharp rise in electricity prices contributed to a rise in the total CPI of 2.3 per cent in 2006, but higher oil prices and tax changes also pushed up inflation.

The 12-month rise in the CPI-ATE decelerated from late summer 2005 up to as late as August last year, when it stood at only 0.4 per cent. Inflation has since shown a tendency to pick up somewhat, but in January this year it had still only risen to 1.0 per cent. Substantial changes in electricity prices through the past year contributed to pushing down the year-on-year rise in the CPI to 1.8 per cent in January 2006 and 1.9 per cent in August, although it increased to 2.7 per cent in both April and October. Spot prices for electricity peaked in August last year and have since fallen markedly. Prices to households began to edge down in October, and have fallen at an increasing pace since then. In January 2007, the electricity price index in the CPI had fallen by 28 per cent since September the previous year. Thus, in spite of an increase in the VAT rate for food of 1 percentage point, the year-on-year rise in the CPI had fallen to 1.2 per cent in January this year.

Low underlying inflation in the past four years may partly be attributed to a low rise in prices for imported consumer goods. A stronger krone, increased imports from low-cost countries and low global inflation are factors behind these developments. Low growth in

Consumer price indices
Percentage growth from the same quarter previous year



Source: Norges Bank and Statistics Norway.

hourly wage costs and high productivity growth, particularly in retail trade, have also contributed to keeping prices for domestically produced goods and services low, as long as energy products are excluded. The tendency towards higher inflation through the past year, however, can largely be attributed to price developments for these domestically produced goods and for services excluding house rents.

Growth in hourly wage costs has picked up somewhat and seems set for a clear increase in the years ahead. It must also be expected that, after several years of a strong cyclical upturn, high productivity growth will be reduced. Higher unit labour costs combined with higher interest rates, which are pushing up rents and costs in retail trade, may contribute to pushing up inflation. An appreciation of the krone, however, may offset developments in domestic cost components. Lower energy prices will push down overall inflation sharply in 2007. This will also contribute to pushing down CPI-ATE inflation, through reduced costs for other production sectors. A key question is whether externally generated negative inflationary impulses, in the form of lower average prices for manufactured goods, calculated in foreign currency, will be reduced. The fall in prices is expected to slow, but externally generated negative price impulses are expected to continue to have an impact.

According to our calculations, inflation should pick up somewhat in the period ahead. As an annual average, CPI-ATE inflation is projected at 1.3 per cent this year, 0.5 percentage point higher than last year. In 2008, inflation is expected to rise to 1.6 per cent. In the following years, developments in domestic costs will continue to generate inflationary impulses, but these effects will be offset by an appreciation of the krone. For these years, the calculations indicate CPI-ATE inflation of around 1.7 per cent.

Electricity prices charged to households seem set to continue to fall through spring, although at a slower pace than in the past months. Thus, as an annual average, the decrease in 2007 is expected to be 20 per cent. Oil prices are assumed to remain at a clearly lower level this year than last year. CPI inflation will thus be very modest. The year-on-year rise may decline to around zero in both spring and autumn. On an annual basis, CPI inflation is now projected at 0.3 per cent.

For the period 2008 to 2010, we assume that no real tax changes will be implemented. Oil prices are assumed to remain at USD 55 per barrel. Forward prices in the energy market indicate a rise in electricity prices to households of close to 10 per cent in 2008, with prices remaining virtually unchanged in real terms thereafter. CPI inflation will thereby be somewhat higher than underlying inflation in 2008, and may rise to approximately 2 per cent. Since we at this time cannot predict any clear impulses to energy prices far ahead, the CPI is projected to move parallel with the CPI-ATE in the last two years of the calculation period.

Lower surplus in the balance of payments ahead

The large trade surplus for goods and services fell each quarter through 2006, from NOK 112 billion in the first quarter to a preliminary estimate of NOK 86 billion in the fourth quarter. The interest and transfers balance on the other hand improved throughout 2006, from a deficit of NOK 30 billion in the first quarter to an estimated surplus of NOK 15 billion in the fourth quarter. Owing to the strong developments in the interest and transfers balance, the current account balance also improved through 2006, increasing from NOK 82 billion in the first quarter to approximately 102 billion in the fourth quarter. The surplus in the fourth quarter of last year was NOK 9 billion higher than in the preceding quarter, but only NOK 3 billion more than in the fourth quarter of 2005.

The trade surplus was reduced through last year because imports continued to increase in value through 2006, while the 2005 increase in the value of exports did not continue. For 2006 in total, the value of overall exports grew by NOK 132 billion compared with the previous year, reaching close to NOK 1 trillion. A rise in prices of almost 14 per cent contributed more than the 1.5 per cent increase in volume. For total imports, the opposite was the case. The volume of imports increased by 9 per cent, while prices rose by 3 per cent. Imports thus increased by NOK 68 billion in value, reaching an end-total of NOK 614 billion. The trade surplus for goods and services thereby shows a surplus of NOK 383 billion for the year as a whole. This is an increase of NOK 64 billion. The interest and transfers balance shows the same deficit in 2006 as in 2005, NOK 18 billion. This implies that the surplus on the current account in 2006 will be NOK 366 billion, an increase of NOK 64 billion or 21 per cent in relation to 2005. The balance of payments for 2006 is the strongest ever recorded, and as much as 17 per cent of GDP is attributed to the surplus on the current account balance.

We have assumed that the global economy will exhibit weaker developments than we have seen in recent years. We expect the trade surplus to be reduced by more than a quarter in the years ahead, due to stronger volume growth in imports than in exports combined with weaker developments in export prices compared with import prices. An assumed reduction in oil prices from more than NOK 400 per barrel to below NOK 350 per barrel through the projection period will make a relatively large contribution towards reducing the trade surplus. On the other hand, the interest and transfers balance will probably begin to show a surplus, primarily as a result of the large and increasing size of the Pension Fund. Growing wealth brings higher income in the form of interest income and share dividends. According to our calculations, the annual surplus on the current account balance will be below NOK 300 billion towards the end of the projection period.

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

	Unadjusted		Seasonally adjusted							
	2005	2006	05:1	05:2	05:3	05:4	06:1	06:2	06:3	06:4
Final consumption expenditure of households and NPISHs	812 122	847 014	199 078	203 836	204 847	203 943	208 307	211 149	212 831	214 576
Household final consumption expenditure	778 529	811 394	190 907	195 530	196 355	195 302	199 507	202 297	203 882	205 546
Goods	404 922	420 956	99 513	102 053	102 287	101 154	103 890	104 654	105 923	106 657
Services	348 998	361 054	85 951	86 919	87 681	88 212	88 586	90 151	90 423	91 794
Direct purchases abroad by resident households	46 583	51 958	10 898	11 990	11 783	11 668	12 313	13 125	13 236	13 004
Direct purchases by non-residents	-21 974	-22 574	-5 454	-5 433	-5 397	-5 731	-5 282	-5 632	-5 699	-5 909
Final consumption expenditure of NPISHs	33 593	35 620	8 171	8 307	8 492	8 641	8 799	8 852	8 948	9 030
Final consumption expenditure of general government	379 939	388 213	94 642	95 155	94 911	95 255	96 771	97 103	97 150	97 148
Final consumption expenditure of central government	200 424	201 973	50 160	50 143	50 007	50 122	50 785	50 826	50 176	50 178
Central government, civilian	172 548	174 527	43 123	43 123	43 102	43 208	43 858	43 941	43 353	43 365
Central government, defence	27 876	27 446	7 038	7 019	6 904	6 914	6 926	6 885	6 822	6 813
Final consumption expenditure of local government	179 514	186 240	44 482	45 013	44 904	45 133	45 986	46 277	46 974	46 970
Gross fixed capital formation	349 319	380 568	81 185	85 648	86 377	95 813	88 509	95 862	95 290	100 218
Extraction and transport via pipelines	84 924	92 639	19 397	21 527	21 174	22 748	20 342	21 468	23 923	26 881
Service activities incidential to extraction	-1 835	-1 408	53	-2 851	919	44	-904	-17	-395	-91
Ocean transport	15 146	16 022	3 510	4 677	1 814	5 105	4 890	4 564	4 537	1 981
Mainland Norway	251 085	273 315	58 225	62 295	62 471	67 916	64 181	69 848	67 225	71 447
Mainland Norway excluding general government	200 683	218 409	47 283	49 621	50 227	53 439	52 590	53 564	54 762	56 976
Industries	120 056	132 607	27 727	29 741	29 931	32 573	31 512	32 279	33 306	35 022
Manufacturing and mining	23 440	28 718	4 805	5 523	5 698	7 295	5 981	6 353	7 760	8 212
Production of other goods	19 775	21 322	4 630	5 158	5 340	4 694	5 015	5 447	5 482	5 320
Services	76 840	82 567	18 292	19 060	18 894	20 584	20 516	20 479	20 064	21 490
Dwellings (households)	80 628	85 802	19 557	19 880	20 296	20 866	21 078	21 285	21 455	21 953
General government	50 401	54 906	10 942	12 674	12 244	14 477	11 591	16 284	12 463	14 471
Changes in stocks and statistical discrepancies	50 538	66 559	13 566	7 827	16 717	13 654	17 239	13 426	20 539	16 931
Gross capital formation	399 800	447 060	94 751	93 475	103 095	109 467	105 747	109 289	115 830	117 149
Final domestic use of goods and services	1 591 861	1 682 288	388 472	392 466	402 853	408 665	410 825	417 541	425 810	428 873
Final demand from Mainland Norway	1 443 145	1 508 543	351 946	361 287	362 229	367 114	369 258	378 100	377 206	383 171
Final demand from general government	430 340	443 119	105 585	107 829	107 155	109 732	108 361	113 387	109 613	111 619
Total exports	737 591	748 353	180 803	187 052	185 456	184 736	185 948	186 476	184 836	191 074
Traditional goods	220 746	235 021	54 732	53 684	55 577	56 578	57 408	58 445	58 689	60 262
Crude oil and natural gas	320 559	303 128	80 495	81 829	80 262	78 624	78 323	75 557	75 394	74 102
Ships, oil platforms and planes	10 781	10 626	1 009	5 401	3 316	1 055	2 244	1 786	3 256	3 355
Services	185 505	199 579	44 567	46 138	46 301	48 480	47 972	50 689	47 497	53 355
Total use of goods and services	2 329 451	2 430 641	569 275	579 518	588 309	593 401	596 773	604 017	610 646	619 947
Total imports	539 642	588 868	127 078	133 756	137 682	141 296	141 117	146 485	147 130	154 086
Traditional goods	349 862	386 884	82 667	86 320	90 523	90 078	93 561	94 804	96 395	101 868
Crude oil and natural gas	2 953	1 210	669	488	528	1 311	425	178	167	469
Ships, oil platforms and planes	10 421	11 952	2 106	2 616	2 669	3 030	2 713	4 680	3 152	1 410
Services	176 406	188 822	41 637	44 332	43 961	46 877	44 418	46 824	47 417	50 338
Gross domestic product (market prices)	1 789 867	1 841 840	442 197	445 763	450 627	452 105	455 655	457 532	463 516	465 860
Gross domestic product Mainland Norway (market prices)	1 415 739	1 480 943	348 558	351 082	355 660	360 513	364 352	368 186	372 240	376 773
Petroleum activities and ocean transport	374 128	360 898	93 638	94 680	94 967	91 592	91 304	89 345	91 275	89 087
Mainland Norway (basic prices)	1 206 438	1 257 837	296 282	299 361	303 126	307 550	309 669	313 112	314 765	320 091
Mainland Norway excluding general government	938 053	985 228	228 957	232 432	236 006	240 387	241 974	245 048	246 505	251 597
Manufacturing and mining	168 159	175 860	40 921	42 020	42 147	42 681	43 134	43 559	43 840	45 247
Production of other goods	141 641	143 564	34 438	35 391	35 378	36 616	36 264	35 785	35 685	35 597
Services incl. dwellings (households)	628 254	665 803	153 598	155 021	158 480	161 090	162 576	165 703	166 979	170 752
General government	268 385	272 609	67 325	66 929	67 120	67 163	67 695	68 064	68 260	68 494
Correction items	209 301	223 106	52 276	51 721	52 534	52 962	54 683	55 075	57 476	56 683

Source: Statistics Norway.

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

	Unadjusted		Seasonally adjusted							
	2005	2006	05:1	05:2	05:3	05:4	06:1	06:2	06:3	06:4
Final consumption expenditure of households and NPISHs	3.3	4.3	0.3	2.4	0.5	-0.4	2.1	1.4	0.8	0.8
Household final consumption expenditure	3.2	4.2	0.3	2.4	0.4	-0.5	2.2	1.4	0.8	0.8
Goods	2.7	4.0	-0.2	2.6	0.2	-1.1	2.7	0.7	1.2	0.7
Services	2.7	3.5	0.5	1.1	0.9	0.6	0.4	1.8	0.3	1.5
Direct purchases abroad by resident households	12.9	11.5	4.9	10.0	-1.7	-1.0	5.5	6.6	0.8	-1.8
Direct purchases by non-residents	4.0	2.7	2.6	-0.4	-0.7	6.2	-7.8	6.6	1.2	3.7
Final consumption expenditure of NPISHs	5.9	6.0	0.9	1.7	2.2	1.7	1.8	0.6	1.1	0.9
Final consumption expenditure of general government	1.8	2.2	0.6	0.5	-0.3	0.4	1.6	0.3	0.0	0.0
Final consumption expenditure of central government	1.6	0.8	1.3	0.0	-0.3	0.2	1.3	0.1	-1.3	0.0
Central government, civilian	3.3	1.1	2.9	0.0	0.0	0.2	1.5	0.2	-1.3	0.0
Central government, defence	-7.9	-1.5	-7.4	-0.3	-1.6	0.1	0.2	-0.6	-0.9	-0.1
Final consumption expenditure of local government	2.0	3.7	-0.1	1.2	-0.2	0.5	1.9	0.6	1.5	0.0
Gross fixed capital formation	11.2	8.9	-7.1	5.5	0.9	10.9	-7.6	8.3	-0.6	5.2
Extraction and transport via pipelines	19.1	9.1	5.3	11.0	-1.6	7.4	-10.6	5.5	11.4	12.4
Service activities incidential to extraction	-165.2	-23.3	-98.0	..	-132.2	-95.2	..	-98.1	..	-76.9
Ocean transport	50.0	5.8	-29.3	33.2	-61.2	181.5	-4.2	-6.7	-0.6	-56.3
Mainland Norway	9.1	8.9	-5.0	7.0	0.3	8.7	-5.5	8.8	-3.8	6.3
Mainland Norway excluding general government	11.9	8.8	0.0	4.9	1.2	6.4	-1.6	1.9	2.2	4.0
Industries	10.2	10.5	-1.2	7.3	0.6	8.8	-3.3	2.4	3.2	5.2
Manufacturing and mining	12.3	22.5	-6.7	14.9	3.2	28.0	-18.0	6.2	22.1	5.8
Production of other goods	3.9	7.8	2.0	11.4	3.5	-12.1	6.8	8.6	0.6	-3.0
Services	11.3	7.5	-0.5	4.2	-0.9	8.9	-0.3	-0.2	-2.0	7.1
Dwellings (households)	14.5	6.4	1.9	1.7	2.1	2.8	1.0	1.0	0.8	2.3
General government	-0.5	8.9	-22.1	15.8	-3.4	18.2	-19.9	40.5	-23.5	16.1
Changes in stocks and statistical discrepancies	50.1	31.7	48.9	-42.3	113.6	-18.3	26.3	-22.1	53.0	-17.6
Gross capital formation	14.9	11.8	-1.8	-1.3	10.3	6.2	-3.4	3.3	6.0	1.1
Final domestic use of goods and services	5.6	5.7	-0.1	1.0	2.6	1.4	0.5	1.6	2.0	0.7
Final demand from Mainland Norway	3.9	4.5	-0.5	2.7	0.3	1.3	0.6	2.4	-0.2	1.6
Final demand from general government	1.5	3.0	-2.3	2.1	-0.6	2.4	-1.2	4.6	-3.3	1.8
Total exports	0.7	1.5	0.5	3.5	-0.9	-0.4	0.7	0.3	-0.9	3.4
Traditional goods	5.2	6.5	0.7	-1.9	3.5	1.8	1.5	1.8	0.4	2.7
Crude oil and natural gas	-5.0	-5.4	0.6	1.7	-1.9	-2.0	-0.4	-3.5	-0.2	-1.7
Ships, oil platforms and planes	11.2	-1.4	-25.0	435.4	-38.6	-68.2	112.7	-20.4	82.4	3.0
Services	5.5	7.6	1.0	3.5	0.4	4.7	-1.0	5.7	-6.3	12.3
Total use of goods and services	4.0	4.3	0.1	1.8	1.5	0.9	0.6	1.2	1.1	1.5
Total imports	8.6	9.1	-1.8	5.3	2.9	2.6	-0.1	3.8	0.4	4.7
Traditional goods	8.2	10.6	0.4	4.4	4.9	-0.5	3.9	1.3	1.7	5.7
Crude oil and natural gas	55.0	-59.0	3.3	-27.1	8.3	148.2	-67.6	-58.2	-6.1	181.6
Ships, oil platforms and planes	-20.6	14.7	-49.1	24.2	2.1	13.5	-10.4	72.5	-32.6	-55.3
Services	11.4	7.0	-1.5	6.5	-0.8	6.6	-5.2	5.4	1.3	6.2
Gross domestic product (market prices)	2.7	2.9	0.6	0.8	1.1	0.3	0.8	0.4	1.3	0.5
Gross domestic product Mainland Norway (market prices)	4.5	4.6	1.1	0.7	1.3	1.4	1.1	1.1	1.1	1.2
Petroleum activities and ocean transport	-3.5	-3.5	-1.1	1.1	0.3	-3.6	-0.3	-2.1	2.2	-2.4
Mainland Norway (basic prices)	4.4	4.3	0.8	1.0	1.3	1.5	0.7	1.1	0.5	1.7
Mainland Norway excluding general government	5.3	5.0	0.8	1.5	1.5	1.9	0.7	1.3	0.6	2.1
Manufacturing and mining	3.4	4.6	-1.3	2.7	0.3	1.3	1.1	1.0	0.6	3.2
Production of other goods	9.0	1.4	3.6	2.8	0.0	3.5	-1.0	-1.3	-0.3	-0.2
Services incl. dwellings (households)	5.0	6.0	0.8	0.9	2.2	1.6	0.9	1.9	0.8	2.3
General government	1.5	1.6	0.8	-0.6	0.3	0.1	0.8	0.5	0.3	0.3
Correction items	4.5	6.6	2.6	-1.1	1.6	0.8	3.2	0.7	4.4	-1.4

Source: Statistics Norway.

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

	Unadjusted		Seasonally adjusted							
	2005	2006	05:1	05:2	05:3	05:4	06:1	06:2	06:3	06:4
Final consumption expenditure of households and NPISHs	101.0	103.1	100.2	100.7	101.5	101.6	101.8	103.1	103.4	104.3
Final consumption expenditure of general government	102.6	106.9	101.7	102.1	103.1	103.5	104.7	106.4	107.6	108.9
Gross fixed capital formation	102.8	106.2	101.4	103.1	102.6	104.0	103.8	105.6	106.9	108.1
Mainland Norway	102.0	105.1	102.1	101.8	100.9	103.3	104.0	104.4	104.7	107.3
Final domestic use of goods and services	101.9	104.9	100.2	102.7	102.5	102.3	103.1	105.0	105.3	105.6
Final demand from Mainland Norway	101.6	104.4	100.9	101.2	101.8	102.4	102.9	104.2	104.7	106.0
Total exports	117.3	133.2	109.5	112.2	119.5	127.5	134.3	133.2	133.7	132.6
Traditional goods	104.0	115.6	100.5	102.3	106.0	106.6	110.5	114.8	118.6	119.1
Total use of goods and services	106.8	113.6	103.2	105.8	107.8	110.2	112.9	113.7	113.9	113.9
Total imports	101.2	104.2	101.1	100.8	101.2	101.7	102.4	102.1	104.2	107.9
Traditional goods	100.4	104.5	100.4	100.4	100.3	100.3	102.3	102.2	104.2	108.8
Gross domestic product (market prices)	108.5	116.6	103.8	107.3	109.9	112.8	116.1	117.4	117.0	115.9
Gross domestic product Mainland Norway (market prices)	102.1	105.5	100.1	102.9	102.3	103.1	104.1	105.6	105.8	106.5

Source: Statistics Norway.

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

	Unadjusted		Seasonally adjusted							
	2005	2006	05:1	05:2	05:3	05:4	06:1	06:2	06:3	06:4
Final consumption expenditure of households and NPISHs	1.0	2.1	-0.5	0.5	0.8	0.1	0.2	1.2	0.3	0.8
Final consumption expenditure of general government	2.6	4.1	0.4	0.4	1.0	0.4	1.1	1.7	1.1	1.2
Gross fixed capital formation	2.8	3.3	-1.1	1.6	-0.5	1.4	-0.2	1.8	1.3	1.1
Mainland Norway	2.0	3.0	-0.2	-0.3	-0.8	2.4	0.6	0.4	0.3	2.5
Final domestic use of goods and services	1.9	2.8	-1.0	2.5	-0.3	-0.1	0.8	1.8	0.3	0.3
Final demand from Mainland Norway	1.6	2.8	-0.2	0.3	0.6	0.6	0.5	1.2	0.5	1.2
Total exports	17.3	13.6	2.3	2.5	6.4	6.7	5.4	-0.9	0.4	-0.9
Traditional goods	4.0	11.1	-1.1	1.8	3.6	0.6	3.6	4.0	3.3	0.4
Total use of goods and services	6.8	6.3	0.1	2.5	1.9	2.2	2.5	0.7	0.2	0.0
Total imports	1.2	3.0	-0.1	-0.3	0.3	0.5	0.7	-0.3	2.0	3.6
Traditional goods	0.4	4.1	0.2	0.0	-0.1	0.0	2.0	-0.1	1.9	4.4
Gross domestic product (market prices)	8.5	7.4	0.1	3.4	2.4	2.7	2.9	1.1	-0.4	-0.9
Gross domestic product Mainland Norway (market prices)	2.1	3.3	-1.2	2.8	-0.6	0.8	0.9	1.5	0.1	0.7

Source: Statistics Norway.