

REGIONAL NETWORK

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INTERVIEWS WERE CONDUCTED IN THE PERIOD
29 JULY – 23 AUGUST



NORGES BANK

Continued solid growth in the business sector

According to Regional Network contacts, high oil industry activity contributed to sustaining growth this summer. The international turbulence does not appear to have acted as a substantial drag on activity, even though some enterprises have noted a decline in external demand. Contacts expect growth to slow slightly over the next six months.

According to Regional Network contacts, activity in the business sector continued to increase at a solid pace through the summer months (Chart 1). Growth has picked up gradually since the cyclical trough in 2016. In this round of interviews, contacts reported annual output growth of 3.0%, approximately the same as in May. The oil service sector in particular experienced a sharp rise in recent months and activity remains high in the services sector (Chart 2). On the other hand, growth in construction and domestically-oriented manufacturing has slowed somewhat. Employment growth was slightly lower in most sectors. The exception is the oil service sector, which increased its workforce by more than in the previous three-month period.

Contacts expect slightly lower growth over the next six months. This is particularly apparent in oil services, but retail trade and the export industry also expect growth to slow slightly ahead. Some contacts are concerned about trade tensions between the US and China, which have recently deepened. The UK's withdrawal from the EU (Brexit) is also a source of concern. The uncertainty surrounding the consequences of the global turbulence appears to be greater in the somewhat longer term (see box on page 5). At the same time, many contacts believe that other driving forces, such as digitalisation, increasing competition from abroad and the focus on climate and health are just as important for developments ahead.

So far, there are few clear indications that global uncertainty is dampening enterprises' willingness to invest. There are plans to increase investment in most sectors in the year ahead, and many are investing in technology and automation, in addition to capacity expansion.

Oil investments and technological advances are supporting growth

In the oil service sector, activity has increased in most segments this year (Chart 3). Growth has picked up considerably in recent months, particularly for companies providing services to the Norwegian continental shelf, reflecting many orders related to field development and modifications. While contacts expect activity to be high for the rest of the year, they also expect growth to slow slightly. Not many large discoveries will be developed ahead and enterprises therefore signal incipient uncertainty surrounding order intake further out. At the same time, a number of contacts continue to move into other business areas. Many contacts highlight their continued reluctance to take on costs and risk after cutting costs substantially in response to the fall in oil prices in 2014.

Chart 1

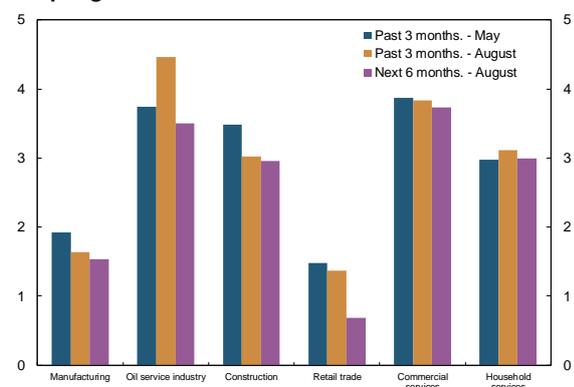
Total output growth



Growth past three months and expected growth next six months. Annualised. Seasonally adjusted. Percent.

Chart 2

Output growth. All sectors



Growth past three months and expected growth next six months. Annualised. Seasonally adjusted. Percent.

In manufacturing, growth among export enterprises remained firm through the year, despite global turbulence and weaker developments in a number of export markets (Chart 4). At the same time, there is considerable variation among export enterprises regarding the impact of or concerns about trade tensions and Brexit, since they serve very different markets. Some have noticed the decline in the European auto industry, but most report that global uncertainty has so far not led to changed demand, referring in part to strengthened competitiveness owing to the weaker krone. Export enterprises nevertheless expect slightly lower growth ahead, with some citing weaker global prospects. For the majority however, there does not appear to be a clear relationship between the global turbulence and lower growth expectations for the next six months.

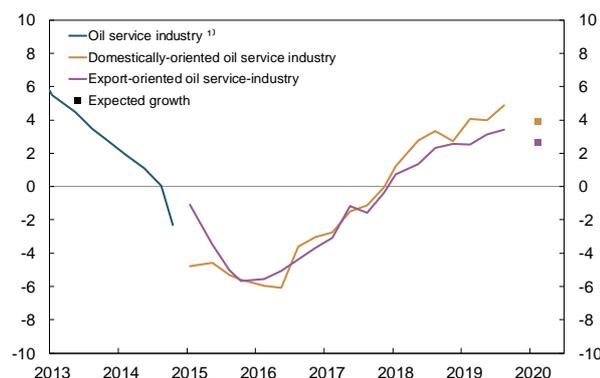
In domestically-oriented manufacturing, growth has slowed slightly in recent months (Chart 4). The food industry is affected by weak growth in the grocery market, which is facing competition from abroad and more climate-conscious consumers. Some manufacturing enterprises are also experiencing slower growth in demand from construction than before.

Retail trade enterprises reported weak sales at the beginning of the year. Growth nevertheless picked up at the time of the May survey and has remained firm through summer (Chart 5). A number of enterprises report poor sales leading up to summer but add that the change in weather lifted activity in the latter part of the period. Nevertheless, most indicate that the sector is under pressure and that slightly lower growth is expected ahead. A number of contacts believe that trends like recycling and sustainability are making consumers more conscious of their shopping habits (see box on page 5). At the same time, competition from foreign online retailers is still cited as a challenge for many. However, some reported that there is greater awareness surrounding emissions related to freight and packaging, and that a number of online retailers are struggling with profitability.

Service sector contacts have experienced strong growth in recent years, particularly since activity in the oil sector picked up at the beginning of 2018. Commercial activity in particular is increasing (Chart 5). The consulting sector continues to be an important contributor to growth. The need for external expertise is increasing in pace with technological advances, new regulations and customer needs. Solid activity in the Norwegian business sector and a shift from goods consumption to experiences are also contributing to lifting activity in the sector as a whole. A weaker krone exchange rate is also making Norway an attractive destination for both domestic and foreign tourists.

Chart 3

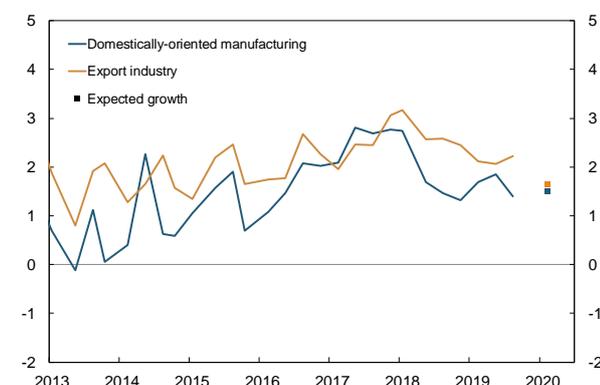
Output growth. Oil service industry



Growth past three months and expected growth next six months. Annualised. Seasonally adjusted. Percent. 1) Terminated series (2003-2014)

Chart 4

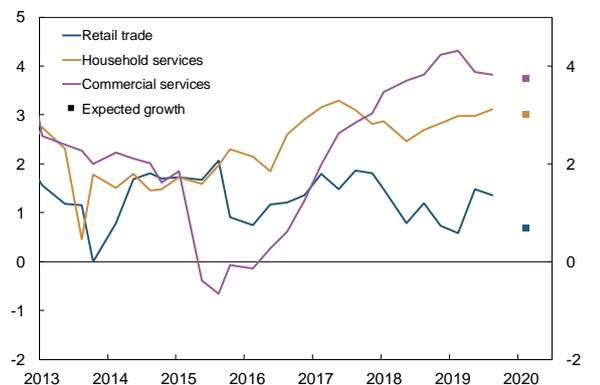
Output growth. Manufacturing



Growth past three months and expected growth next six months. Annualised. Seasonally adjusted. Percent

Chart 5

Output growth. Retail trade and services



Growth past three months and expected growth next six months. Annualised. Seasonally adjusted. Percent

Public investment in infrastructure, health and social construction continue to create high construction activity. However, some also point out that parts of the construction sector are beginning to approach a capacity limit. Residential construction activity is still high, but some contacts have started to notice a slight slowdown in home sales. The impression is that buyers in general are slightly more cautious and price sensitive than they were before.

Continued high capacity utilisation

In recent years, enterprises' utilisation of production capacity has increased. A growing number of enterprises will thus not be able to grow without modifying equipment or making workforce adjustments. Capacity utilisation has remained firm through summer, and is still higher than its historical average (Chart 6). In August, around two-thirds of oil service contacts reported close to full capacity utilisation (Chart 7). However, an increasing number of contacts in other manufacturing are also held back by capacity constraints, since a period of solid growth led to persistently higher utilisation of machinery.

In pace with the decline in unemployment, enterprises have experienced greater difficulty recruiting qualified labour. The share of enterprises reporting recruitment difficulties is nevertheless virtually unchanged since the previous survey, and is close to its historical average (Chart 6). Oil service and construction sector contacts in particular report labour shortages as constraints on further growth and cite difficulties recruiting engineers, electricians and plumbers (Chart 7). Many are also experiencing increasing difficulty recruiting IT specialists, in addition to experienced project managers and health professionals. For a number of contacts, this does not restrain activity because expertise is often contracted or recruited from abroad. Some contacts solve recruitment difficulties by transferring tasks or bringing in expertise from foreign units in their own corporate groups.

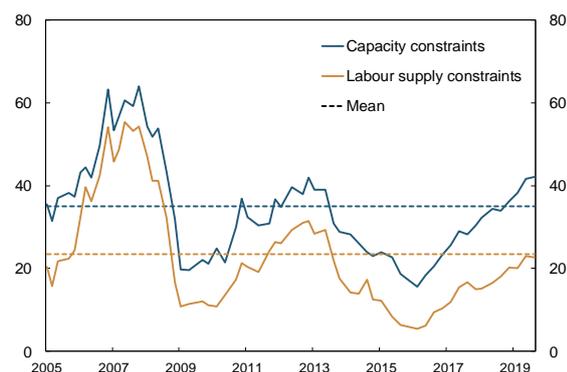
Rising wage growth

Wage growth has gradually picked up again after a number of years with moderate settlements in the wake of the fall in oil prices. In 2019, enterprises expect wage growth to continue to rise further. As before summer, they expect wages to increase by around 3.2% (Chart 8). A number of contacts cite the recovery of the oil industry in particular as having pushed up wage growth.

Continued solid growth in demand has increased the scope for enterprises to raise prices somewhat over the past year, although the rise in prices has slowed slightly since spring. In retail trade, online shopping and strong growth in budget retailers have created a highly competitive environment. As a result, many are reluctant to raise prices despite the increased costs from higher wage growth and a weaker krone. Retail trade enterprises nevertheless believe that a slightly higher rise in prices ahead is necessary for profitability. Service enterprises, however, believe that the rise in prices for households will be slightly lower in the coming year. A number of contacts cite substantial capacity expansion, particularly in the hotel and restaurant industry, which has led to persistently increasing competition for customers.

Chart 6

Capacity utilisation ¹⁾ and labour supply constraints ²⁾

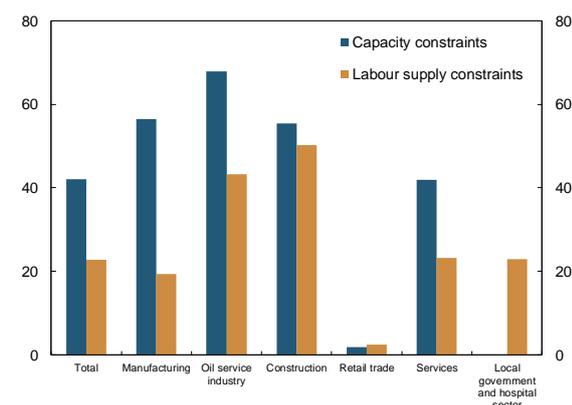


Percentage shares. 1) The local government and hospital sector is omitted from the capacity utilisation series. 2) The question about labour is asked only of the enterprises reporting full capacity utilisation, but the series shows the share of all contacts included in the interview period.

Chart 7

Capacity utilisation ¹⁾ and labour supply constraints ²⁾

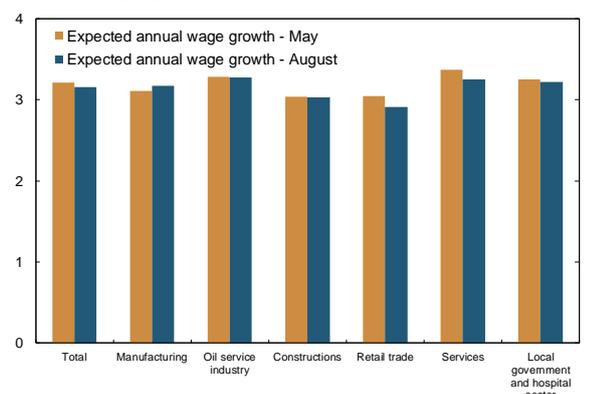
All sectors



Percentage shares. 1) The local government and hospital sector is omitted from the capacity utilisation series. 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 interview period.

Chart 8

Annual wage growth



Expected wage growth for 2019. Percent

GLOBAL TURBULENCE CREATES UNCERTAINTY

Trade tensions between the US and China and the UK's withdrawal from the EU (Brexit) are creating uncertainty surrounding economic developments. This also affects a number of Regional Network enterprises:

Oil service and other export-oriented manufacturing enterprises are particularly affected by global turbulence and Brexit. Turbulence and lower external growth may dampen demand for Norwegian goods and services, particularly if Norway's main EU trading partners are affected. Some enterprises have already experienced a loss of or decline in demand from European markets where growth is weak. Looking ahead, there is a risk that Brexit will lead to delivery delays and prevent the servicing of customers. Some contacts have implemented measures to hedge against unpredictable outcomes ahead:

- Some have built up new stockpiles in the UK
- Some have drawn up separate trade agreements with their counterparts in the UK
- Some have also added clauses into contracts that provide protection in the event of deepening trade tensions

Enterprises without activities abroad also report that they may be affected. Those that are part of an international corporate group might be required to reduce investments and costs. Lower demand for intermediate goods from the export sector may cause negative spillovers to domestically-oriented manufacturing. Some enterprises would also be affected by the higher prices of certain raw materials caused by increased tariff barriers.

However, many enterprises also cite the positive effects that the turbulence may have on the business sector. The weaker krone increases the competitiveness and/or profitability of exporters. The krone depreciation also makes Norway a more attractive destination for both domestic and foreign tourists. For some domestically-oriented enterprises, trade tensions have also resulted in lower purchase prices as a number of Chinese manufacturers have turned to the European market. Service providers to markets that are protected by increased tariff barriers against US goods entering the EU have also received a boost as the barriers stifle competition.

A number of contacts also point out that Norwegian public finances are robust, and that if a downturn reaches Norway, fiscal policy may counteract much of the negative impact on the Norwegian economy.

SUSTAINABILITY INCREASINGLY IMPORTANT

Climate and sustainability are high on the social and political agenda and are increasingly cited as an important issue by Regional Network contacts.

New emissions limits are creating the need for larger investment for a number of enterprises. In addition, requirements from customers have led enterprises to opt for investment in environmentally friendly production, even when not required by law. A number of enterprises point out that the public sector in particular is including sustainability requirements in contracts. In this way, climate considerations are given weight in the selections of construction methods, materials and other factors. Moreover, a number of enterprises also report that customers are paying more attention to products' environmental certification, which has an impact on their production methods.

In retail trade, a number of contacts believe that a focus on sustainability is having a dampening effect on sales, and that discussions about climate and the environment have made many think twice about purchasing anything new. The impression is that an increasing number of consumers are against uncritical consumption, which sales figures are beginning to reflect. For example, the desire to reduce meat consumption has given a boost to fish farming and aquaculture. In addition, consumption is shifting towards services. However, the picture is not straightforward - many believe that sustainability is still a buzzword, and that prices continue to weigh heaviest in purchase decisions, which is reflected by strong growth in low-price concepts.

A contact in tourism reported polls showing sustainability's greater importance in deciding on a holiday destination. However, there is no sign that "flight shame" has resulted in any particular reduction in travel activity. Many cite geography as an explanation. Norway is a very long and narrow country, and alternatives to air travel are often limited.

Some see sustainability as a business opportunity. An increasing number of enterprises wish to be associated with sustainability and need help with strategies, reporting and communications. For some, focusing on waste may even be a way of improving profitability.

Table 1 Economic indicators

| | This survey | Previous survey |
|--|-------------|-----------------|
| Output and demand | | |
| Output growth past three months (annualised percentage growth) | | |
| Total | 3.0 | 3.0 |
| Domestically-oriented manufacturing | 1.4 | 1.9 |
| Export industry | 2.2 | 2.1 |
| Domestically-oriented oil service industry | 4.9 | 4.0 |
| Export-oriented oil service industry | 3.4 | 3.1 |
| Construction | 3.0 | 3.5 |
| Retail trade | 1.4 | 1.5 |
| Commercial services | 3.8 | 3.9 |
| Household services | 3.1 | 3.0 |
| Expected output growth next six months (annualised percentage growth) | | |
| Total | 2.7 | 3.1 |
| Domestically-oriented manufacturing | 1.5 | 2.1 |
| Export industry | 1.6 | 2.1 |
| Domestically-oriented oil service industry | 3.8 | 4.3 |
| Export-oriented oil service industry | 2.6 | 3.6 |
| Construction | 3.0 | 3.6 |
| Retail trade | 0.7 | 1.5 |
| Commercial services | 3.7 | 4.0 |
| Household services | 3.0 | 3.0 |
| Labour market and output growth | | |
| Employment growth past three months | 0.4 | 0.5 |
| Expected employment growth next three months | 0.4 | 0.5 |
| Labour supply constraints | 22.7 | 23.0 |
| Capacity constraints | 42.1 | 41.7 |
| Costs and prices | | |
| Estimated annual wage growth for current calendar year (percent) | 3.2 | 3.2 |