

REGIONAL NETWORK

National report

NO. 3 | 2021

INTERVIEWS WERE PRIMARILY CONDUCTED IN THE PERIOD
2 - 20 AUGUST



NORGES BANK

Stronger growth – growing bottlenecks

According to Regional Network contacts, business sector activity has increased substantially in recent months. The reopening of society has boosted demand, and output growth has picked up in all sectors. Contacts expect demand to increase further. At the same time, close to half of the contacts report capacity constraints, which is the highest share since spring 2008. Contacts are facing recruitment difficulties, as well as logistics challenges and raw materials shortages. Looking ahead, enterprises are planning for solid growth in both employment and investment. The estimate for annual wage growth in 2021 has been revised up to 2.9%, up from 2.7% in May.

Since March 2020, the Covid-19 pandemic and measures to contain it have weighed heavily on activity among Regional Network enterprises (Chart 1). Activity rose through spring 2021, but the pandemic continued to limit output growth. Since May, growth has picked up in all sectors in pace with the reopening of society (Chart 2). The rise has been most pronounced for services, but growth in manufacturing and retail trade has also been solid. The weakest growth was reported by oil services and construction enterprises. Activity levels in most sectors now appear to be higher than pre-pandemic levels (Chart 3). The exceptions are oil services and household services, where the recent rise in activity levels has not been as steep as the decline earlier in the pandemic.

Contacts expect continued solid growth through autumn and winter. Retail trade contacts expect a slight decrease from the current unusually high sales levels, while other sectors expect a rise. Services contacts also expect the largest increase ahead, with rising growth in commercial services and continued strong growth in household services.

Survey periods and time of interviews

Since March 2020, there have been unusually large changes in Regional Network enterprises' turnover from month to month as infection rates and related restrictions change. In this survey, most of the interviews were carried out in the period between 2 and 20 August. May, June and July are the past three months, but many of the interviews also included information from the first part of August. The data are compared with the preceding three months, ie February, March and April. The next six months refers to the period to January.

Employment growth has picked up over the past three months (Chart 4). All private industry sectors now report rising employment. Looking ahead, stable developments are expected in retail trade and the local government and hospital sector, while higher employment is expected in other sectors. Developments are strongest for services enterprises, but construction enterprises also expect moderate employment growth. However, a number of contacts in both construction and services report that some of the increase in employment will depend on whether there is an improvement in labour supply.

At the beginning of the pandemic, Regional Network contacts made substantial cuts in their investment plans (Chart 5). Through 2021, contacts'

Chart 1

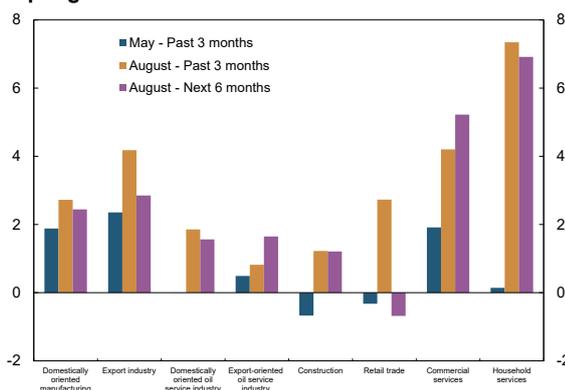
Total output growth



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

Chart 2

Output growth. All sectors



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

investment plans have been gradually revised up and considerable investment growth is now expected in the coming year. All sectors are planning for higher investment levels ahead, and as reported in the previous survey, among the private sector industries, manufacturing enterprises expect the highest growth. Investment growth continues to reflect some postponed investment by many enterprises, partly because market uncertainty and Covid-related restrictions made some investment projects difficult to carry out.

High household demand

Turnover for many retail trade enterprises was at record-high levels in 2020. However, at the beginning of 2021, turnover fell because of stricter Covid-related restrictions in some parts of Norway (Chart 6). Since May, most shops have been open, and most Norwegians have holidayed in Norway. Retail trade turnover has therefore increased through summer. Retail trade contacts expect a slight decline in turnover volume, albeit from high levels. During the pandemic, the grocery trade has taken market shares from both cross-border trade and canteens and restaurants. In pace with the reopening of Norway, grocery trade contacts expect market shares to decline. A large share of retail trade enterprises expect that long delivery times and higher cost of goods, for example of building materials, will have a dampening effect on turnover in the coming six months. On the other hand, sectors such as clothing, footwear and gifts have shown weak performance during the pandemic. Contacts in these sectors envisage higher turnover owing to less remote working and more social events.

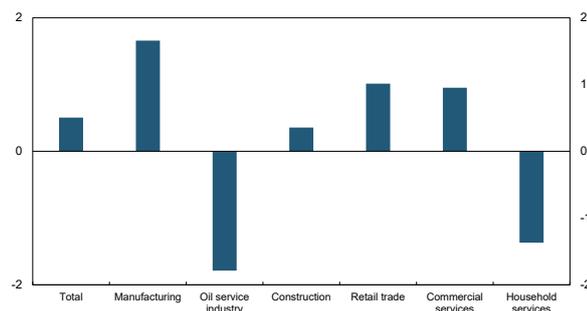
Many of the household services contacts have been hard hit by strict containment measures during the pandemic. The easing of Covid-related restrictions in recent months has therefore led to a sharp rise in activity and sales in for example restaurants, hotels, recreational parks and health and fitness facilities. Moreover, as in 2020, activity levels have been pulled up by the many Norwegians who have holidayed in Norway. Contacts expect that further reopening will continue to contribute to strong growth. At the same time, a number of travel and tourism contacts expect that low international tourist arrivals through autumn will curb growth.

Further increase in business sector demand

Commercial services activity has continued to rise over the past three months, and output growth has picked up since the previous survey (Chart 7). A number of contacts reported a weak start to 2021, with a gradual improvement through spring and summer. The reopening of society is the main growth driver, and demand for marketing and staffing services, for example, has increased sharply. Many projects by both private and public entities that were stopped during the pandemic are now being launched. Contacts report increasing order levels related to for example infrastructure development, projects to reduce harmful emissions and not least digitalisation projects. This results in higher activity for technical consultancy and IT services, but also for other sectors, such as legal and banking. Within

Chart 3

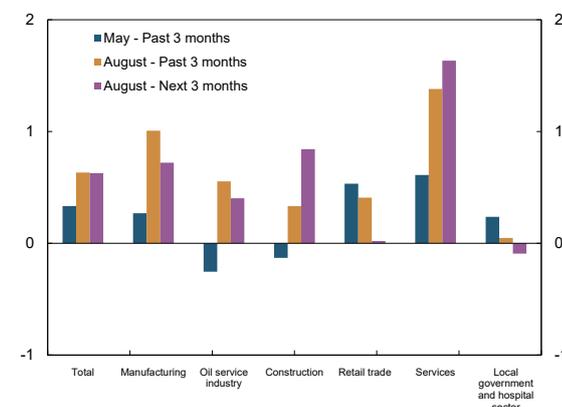
Output level compared with pre-pandemic levels



The 1/2020 survey is set at index 100. Output growth has then resulted in a new index in the subsequent surveys. Chart 3 shows the difference between the index in the 3/2021 and in the 1/2020 surveys.

Chart 4

Employment growth



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

Chart 5

Investment growth



Expected growth next 12 months. Percent.

business travel and hotels and restaurants, business sector demand has, for the time being, not picked up to any significant extent, but contacts anticipate a sharp rise through autumn. A number of contacts expect that the business sector will spend more money than usual on events and employee activities this autumn. Overall, commercial service providers expect rising growth, but a third of providers fear that labour supply constraints may dampen growth.

For the first time since August 2020, construction enterprises report rising activity, primarily boosted by public infrastructure projects and residential construction and renovation. With regard to new residential construction and renovation, a number of contacts expect activity to decline ahead, owing to fewer available residential projects, higher construction costs and signalling of higher interest rates. At the same time, contacts report that many public construction projects are planned, and they expect higher activity within this segment ahead. During the pandemic, the level of orders in private commercial building construction has been low, but in this survey, some contacts have received new orders. Low yields in the commercial real estate (CRE) market make CRE investment more attractive. In addition, a large number of construction projects were postponed earlier in the pandemic and some of these have now been launched. Contacts also expect that new ways of working will lead to a need to modify office premises.

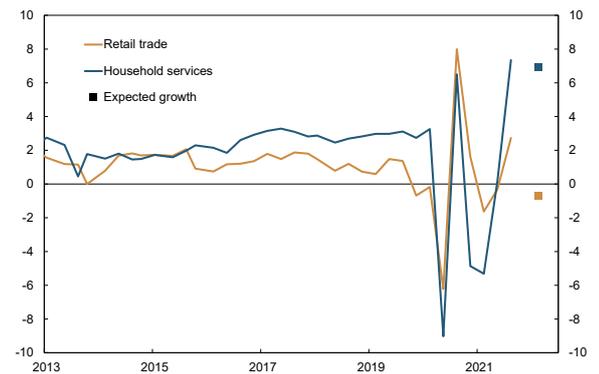
Increasing delivery problems in manufacturing

Manufacturing output has increased substantially in the two previous rounds (Chart 8). In this survey, contacts report that growth has picked up and is strongest in the export market. The reopening of society in large parts of the world was the most important reason behind the pick-up in growth. Government stimulus is boosting growth in many countries. There are also a number of examples of Norwegian manufacturers whose competitive position has strengthened because external competitors have had to halt production periodically during the pandemic. On the other hand, an unusually large share of manufacturing contacts report capacity constraints, which are reducing opportunities for further growth. High raw materials prices and long delivery times will likely dampen growth ahead, in both domestic and export markets. Moreover, contacts expect that a further opening of national borders will lead to lower turnover volume in the food industry. Fisheries contacts expect higher demand from restaurants, which will primarily result in higher prices. However, fish grow faster when ocean temperatures are high, which also boosts output volumes in the fishing industry.

Oil service activity has recently increased and growth has picked up since May (Chart 9). Weak developments in oil services over the past year and a half were to some extent a result of the pandemic, but they were also attributable to the completion of large projects. Such large projects are unlikely to be launched ahead, although there are prospects for a higher number of small and medium-sized projects. Enterprises early in the value

Chart 6

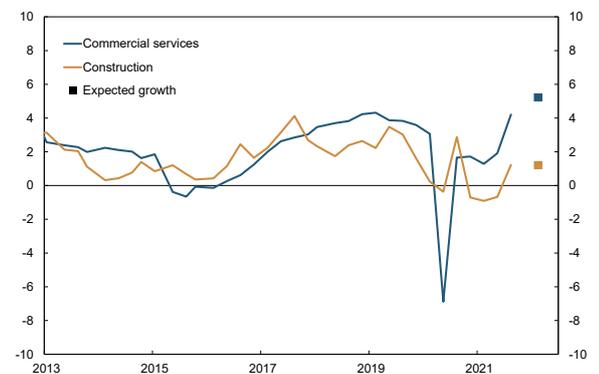
Output growth. Retail trade and household services



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

Chart 7

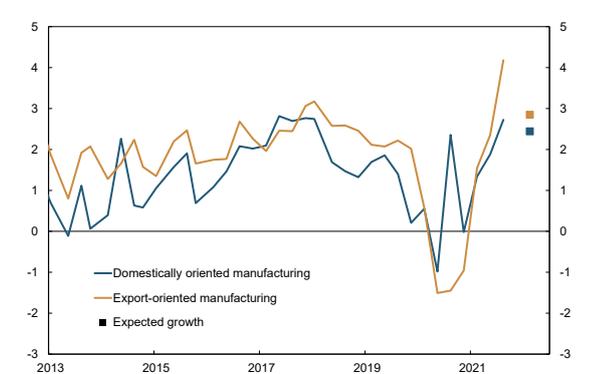
Output growth. Commercial and construction services



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

Chart 8

Output growth. Manufacturing



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

chain report higher activity, particularly in the domestic market. At the same time, some contacts report growth related to field development outside of the Norwegian continental shelf. Maintenance activity that was postponed earlier in the pandemic has now become necessary to complete. A number of contacts cite a ketchup bottle effect in the market as a result of these delays. Oil platform electrification and the transition to battery-powered offshore vessels also results in higher order levels for some enterprises.

High capacity utilisation

The indicator for enterprises' capacity utilisation shows the share reporting full utilisation of resources such as labour, available intermediate goods and machinery. In this survey, this share was 46% of enterprises (Chart 10), which is higher than in May and the highest share since May 2008. All sectors, except for oil services, reported higher capacity utilisation in this survey than in the previous survey. Manufacturing and retail trade are contributing most to the upward adjustment since the previous survey, with manufacturing contacts reporting the highest capacity utilisation (Chart 11).

All sectors reported greater recruitment difficulties, which are most pronounced in construction. Even though national borders are starting to reopen, recruiting from abroad is more difficult than previously. Services and manufacturing contacts also reported similar difficulties. Service sector enterprises have reduced their workforces substantially during the pandemic and are concerned that many former employees have now found new occupations. In the local government and hospital sector, an increasing number of contacts reported difficulty recruiting nurses.

In addition to recruitment difficulties, recurring reports from contacts cited raw materials shortages and delivery problems as capacity constraints. Raw materials shortages impact manufacturing in particular, but also lead to goods shortages in construction and retail trade. Delivery problems are particularly related to retail trade and imported goods. Delivery times for a range of goods are far longer than previously.

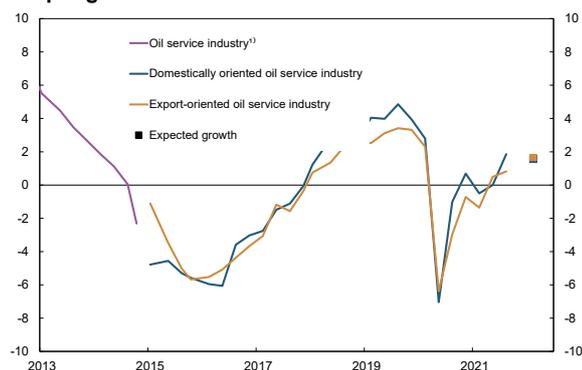
The normal indicator for capacity utilisation does not measure how much spare capacity there is in enterprises that do not report full capacity utilisation. In this survey, Norges Bank asked Regional Network contacts about capacity utilisation relative to a normal situation (Chart 12). Contacts were asked similar questions in some previous surveys, most recently in the previous survey in May. The responses indicate that the share of enterprises below normal capacity utilisation has declined further but remains higher than the pre-pandemic level. On the other hand, 40% of enterprises are above normal capacity utilisation, which is almost twice the number of enterprises with lower-than-normal capacity utilisation.

Higher raw materials prices affect selling prices and profitability

Contacts expect annual wage growth in 2021 to be 2.9% (Chart 13). The estimate has been revised up from 2.7% in May. Many enterprises reported that they follow the result of the annual wage settlement, while some

Chart 9

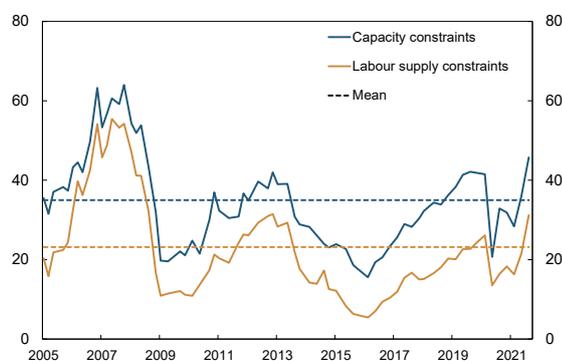
Output growth. Oil services



Growth past three months and expected growth next six months. Seasonally adjusted. Annualised. Percent. 1) Discontinued series.

Chart 10

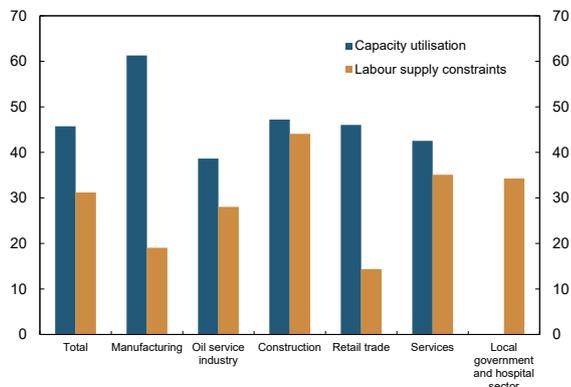
Capacity utilisation¹⁾ and labour supply constraints²⁾



Percentage shares. 1) Share of contacts that will face some or considerable difficulty increasing output/sales without committing additional resources such as labour or machinery. 2) Share of contacts citing shortage of labour as a constraint on production/sales. 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. The local government and hospital sector is omitted from the capacity utilisation series, but is, however, included in the labour force series.

Chart 11

Capacity utilisation¹⁾ and labour supply constraints²⁾. All sectors



Percentage shares. 1) Share of contacts that will face some or considerable difficulty increasing output/sales without committing additional resources such as labour or machinery. 2) Share of contacts citing shortage of labour as a constraint on production/sales. 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. The local government and hospital sector is omitted from the capacity utilisation series, but is, however, included in the labour force series.

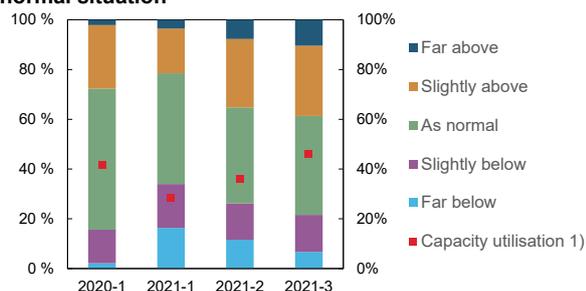
enterprises see that solid profitability in the most recent period will put greater pressure on wages. Other contacts point out that the weak wage settlement in 2020 and intense competition for highly skilled workers will put upward pressure on wages. The highest estimate is reported in services (3.2%) and the lowest in oil services (2.7%).

The rise in prices is generally increasing, driven by manufacturing, retail trade and construction. A very large number of contacts refer to increased raw materials prices and higher freight rates. In the timber industry, for example, prices have approximately doubled over the past year. Prices for steel, particularly non-renewable, and other raw materials have also risen sharply, which naturally affects prices in construction and retail trade segments. However, prices in retail trade are being pulled down by groceries prices, which are lower than a year ago. Higher demand has recently led to a slightly higher rise in prices among service enterprises, although this rise remains moderate. Overall, contacts expect the rise in prices to pick up slightly ahead.

Over the past three months, profitability, as measured by operating margins, has improved compared with the same period in 2020. As in the previous survey, this survey compares with a period that was heavily influenced by the pandemic, when many contacts experienced large income losses without being able to reduce costs as quickly. In a number of sectors, profitability is being dampened by higher raw materials prices that have been offset to a limited extent by increased selling prices, particularly in construction.

Chart 12

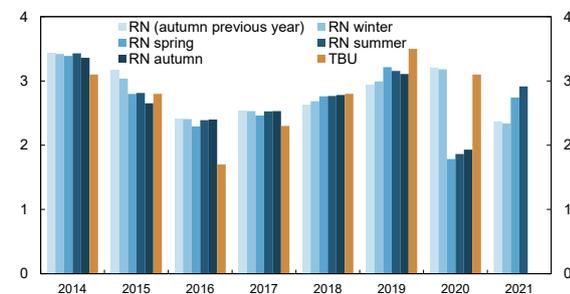
Capacity utilisation¹⁾ and capacity utilisation relative to a normal situation



Percentages. 1) Share of contacts that will face some or considerable difficulty increasing output/sales without committing additional resources such as labour or machinery.

Chart 13

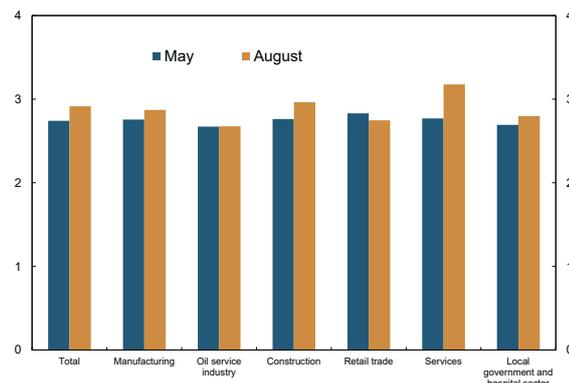
Expected annual wage growth



Technical Reporting Committee for Wage Settlements (TBU) and Regional Network (RN). Percent.

Chart 14

Expected annual wage growth



Expected annual wage growth. Percent.

TABLE 1 Economic indicators

| | This survey | Previous survey |
|--|-------------|-----------------|
| Output and demand | | |
| Output growth past three months (annualised percentage growth) | | |
| Total | 3.6 | 0.9 |
| Domestically oriented manufacturing | 2.7 | 1.9 |
| Export industry | 4.2 | 2.4 |
| Domestically oriented oil service industry | 1.9 | 0.0 |
| Export-oriented oil service industry | 0.8 | 0.5 |
| Construction | 1.2 | -0.7 |
| Retail trade | 2.7 | -0.3 |
| Commercial services | 4.2 | 1.9 |
| Household services | 7.3 | 0.1 |
| Expected output growth next six months (annualised percentage growth) | | |
| Total | 3.3 | 3.8 |
| Domestically oriented manufacturing | 2.4 | 3.8 |
| Export industry | 2.9 | 3.1 |
| Domestically oriented oil service industry | 1.6 | 1.6 |
| Export-oriented oil service industry | 1.6 | 0.9 |
| Construction | 1.2 | 2.6 |
| Retail trade | -0.7 | 2.7 |
| Commercial services | 5.2 | 4.4 |
| Household services | 6.9 | 6.6 |
| Labour market and output gap | | |
| Employment growth past three months | 0.6 | 0.3 |
| Expected employment growth next three months | 0.6 | 0.7 |
| Labour supply constraints | 31.2 | 21.6 |
| Capacity constraints | 45.7 | 36.1 |
| Costs and prices | | |
| Estimated annual wage growth for current calendar year (percent) | 2.9 | 2.7 |