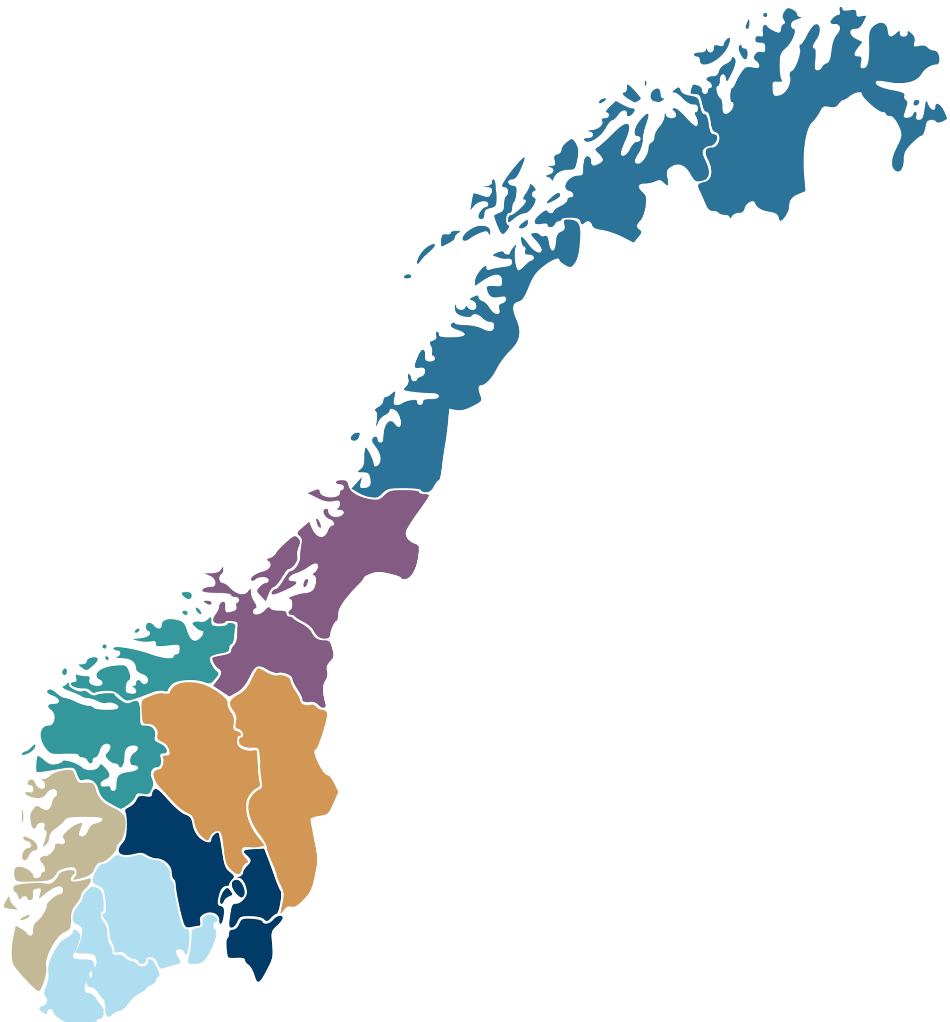
REGIONAL NETWORK

National report

NO. 4 | 2019

INTERVIEWS WERE CONDUCTED IN THE PERIOD
25 OCTOBER – 20 NOVEMBER



NORGES BANK

Lower growth in the business sector

According to Regional Network contacts, growth has slowed through autumn, primarily owing to lower retail sales and postponements of transport development projects. In addition, oil sector demand is increasing less than previously. Enterprises expect growth to continue to slow slightly ahead.

Regional Network enterprises have reported gradually higher growth since the cyclical trough in 2016 and to summer 2019 (Chart 1). Through autumn, growth has slowed and is now back at the same level as spring 2017. During the three autumn months, activity increased by an annual rate of 2.1%, down from 3.0% in summer. Developments have been weaker than enterprises envisaged in August. Growth has slowed in all sectors, but most in retail trade, construction, domestically-oriented manufacturing and domestically-oriented oil services (Chart 2).

Contacts also expect slightly lower growth in the next six months. The construction and domestically-oriented oil service industries expect the most pronounced slowdowns. A number of contacts describe the economic prospects as more uncertain than one year ago. Even though the number of contacts that expect to be directly affected by the trade tensions between the US and China is relatively small, a number of contacts are more concerned about contagion effects from global trade turbulence.

Employment growth has been high over the past two years, but has slowed since spring. In the past three months, growth in the number of employees has declined in all of the private sector industries, and staffing in retail trade has been reduced (Chart 3). Contacts are also planning fewer new hires ahead. Weaker growth prospects are prompting a number of contacts to delay workforce expansion. Moreover, increased automation is reducing the need for labour for a number of enterprises.

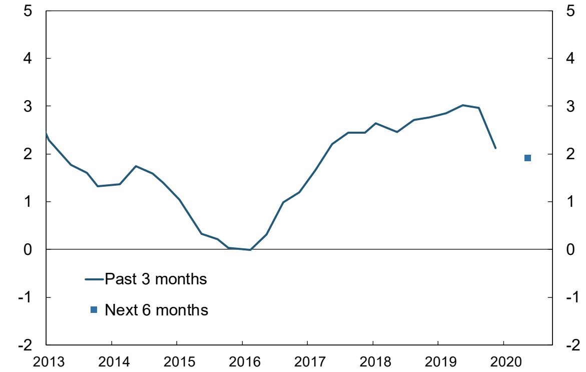
Despite dampened growth prospects, there are plans to increase investment in most sectors. Enterprises are investing in capacity expansion, adaptations to environmental requirements and technology.

Lower retail sales and postponements of transport development projects

Retail trade has faced challenges for a number of years, and sales have declined in recent months (Chart 4). Among other things, contacts note the decline in new car sales since summer. As a reason for the decline, a number of contacts cite temporary delivery problems owing in part to the introduction of new tax classifications for commercial vehicles based on the Worldwide Harmonised Light Vehicle Test Procedure (WLTP). Turnover volume in the grocery trade has declined, and contacts point to increased border trade and greater attention to reducing food waste. The sector's loss of turnover to cafés and restaurants is also cited. More recycling and strong competition from foreign online retailers have pushed down demand for clothing and other consumer goods.

Chart 1

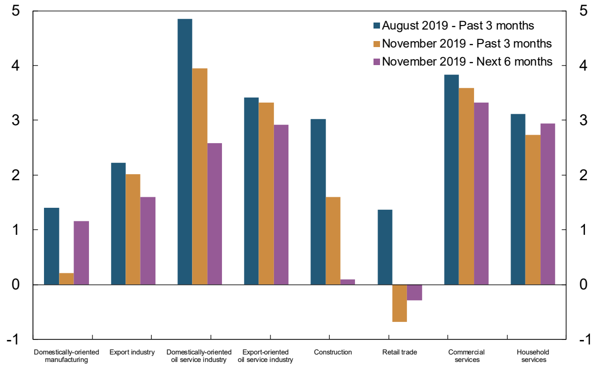
Total output growth



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

Chart 2

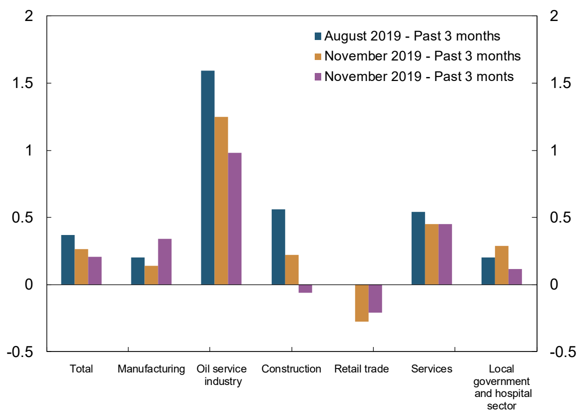
Output growth. All sectors



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

Chart 3

Employment growth. All sectors



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

In *construction*, growth has declined by almost half since August, and contacts expect activity to level off over the next six months (Chart 4). Large transport development projects have in part lifted growth in recent years. A number of these projects will be completed through autumn and towards spring, while a few new projects have been postponed. Many of the projects have become large and complex, and there is a shortage of sufficiently skilled project managers. At the same time, a number of contacts point out stronger competition from foreign companies. Construction contractors therefore expect a period of lower activity. In the housing market, buyers are described as more selective about location and quality, and weak housing start figures are dampening expectations for housing starts ahead.

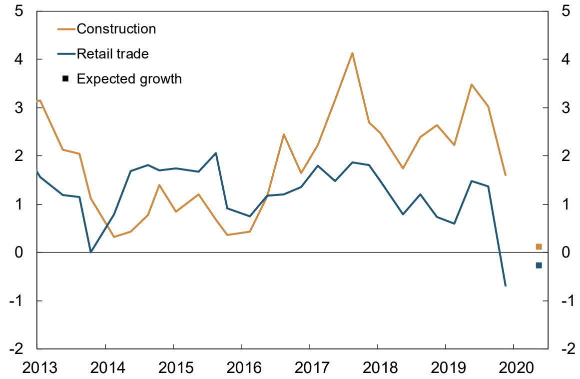
Growth in *commercial services* has been strong over the past two years (Chart 5). Growth remains elevated, but has edged down slightly since August and is expected to slow slightly more in the next six months. Professional services increased slightly less than previously, partly reflecting the difficulty faced by employment agencies in recruiting the occupational groups for which demand is highest. In addition, certain market participants are noting greater cost-consciousness in some business sectors resulting from uncertain prospects for the future. This is reflected, for example, in reduced travel activity by some enterprises. Contacts also cite the shift of the advertising and media market away from traditional advertising and towards new channels such as social media and influencers, thus resulting in a smaller share of enterprises' marketing budgets reaching Norwegian companies. On the other hand, enterprises' demand for consultancy services is increasing. Enterprises need greater assistance in adapting to changes in circumstances, such as greater use of technology and new laws and regulations.

Growth in the *export industry* remained elevated through the year (Chart 6). Some contacts have been impacted by trade tensions, but at the same time, the weak krone exchange rate has boosted the competitiveness of many exporters. The fisheries and aquaculture sector fared well in autumn and reported higher output. Global nutrition trends are contributing to greater demand for fish, and capacity constraints are the main drag on growth ahead. In addition, energy projects outside of Norway have contributed to sustaining growth in the export industry. In *domestically-oriented manufacturing*, growth has slowed somewhat in the past two surveys, primarily reflecting lower growth in demand from construction and weak developments in the grocery trade.

Over the past two years, the *oil service sector* experienced sharp growth (Chart 7). In recent months, however, growth began to slow, particularly in the domestic market. Few new discoveries of significant size have been made on the Norwegian continental shelf, and many enterprises are nearing the completion of their deliveries to large projects such as Johan Sverdrup. Enterprises therefore expect growth ahead to be strongest in the export market. In the wake of the fall in oil prices in 2014, the oil industry implemented large cost-cutting measures such as simplifying and standardising work processes and equipment. This had a particular dampening effect on operation and maintenance activities. Even

Chart 4

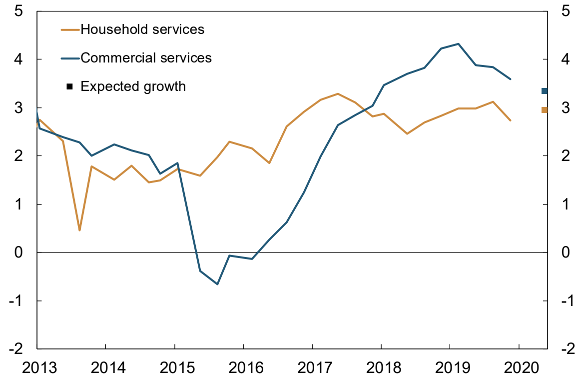
Output growth. Retail trade and construction



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

Chart 5

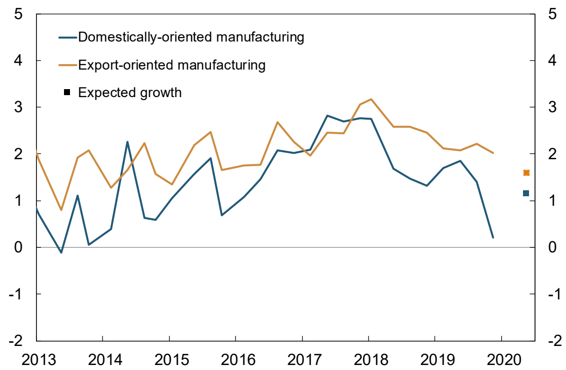
Output growth. Services



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

Chart 6

Output growth. Manufacturing



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

though this segment is now growing, contacts do not believe that activity will return to levels prevailing before the fall in oil prices. The market for offshore vessels remains characterised by considerable surplus capacity and little construction activity, although servicing activity is increasing somewhat. A number of conversions to more environmentally-friendly propulsion systems are also under way.

Segments of the labour market have tightened

Since the beginning of 2016, enterprises' capacity utilisation has gradually risen, in pace with increased activity (Chart 8). Over the past six months, capacity utilisation has stabilised. Around four out of ten enterprises now report that they cannot increase output or sales without using additional labour and machinery resources, for example. At the same time, the labour market appears to have tightened slightly. In this survey, close to one-fourth of contacts report difficulty recruiting needed labour, and for the first time since spring 2013, the indicator for labour shortages is higher than its historical average. The general labour supply is sufficient, although some occupational groups are difficult to recruit.

Capacity utilisation among oil service contacts has picked up through the year, and in this survey, seven of ten enterprises report capacity constraints (Chart 9). Since the beginning of the year, an increasing share report that the capacity constraints reflect challenges in recruiting qualified labour. Many oil service enterprises reduced their workforces in connection with the fall in oil prices and have struggled with recruiting sufficient labour as activity gradually picked up. A number of contacts believe that the uncertainty surrounding future prospects have made it less attractive to work in the oil service industry.

Capacity utilisation is also high in construction. Over half of enterprises are experiencing capacity constraints and most are constrained by a shortage of appropriate labour. Recruiting experienced project managers has long been difficult and recruiting those with vocational training, such as electricians and plumbers continues to be difficult.

The supply of labour is also a growing challenge in services and in the local government and hospital sector. In services, a shortage of IT skills is the greatest challenge, while the shortage of educators and nurses is the main constraint for local governments and hospitals. In addition, many local governments are finding it more difficult to recruit technical expertise.

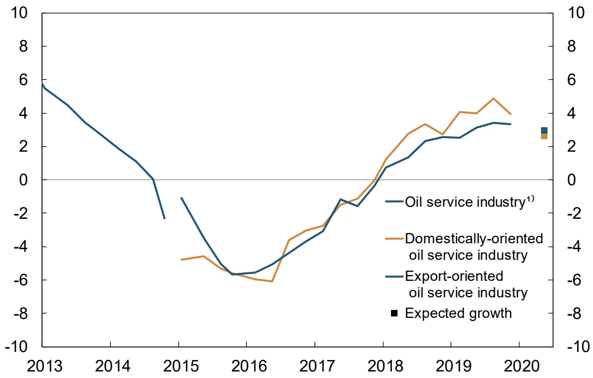
Moderate wage growth in 2020

In recent years, wage growth among contacts has risen, in parallel with the pick-up in business sector activity. Contacts expect annual wage growth of 3.1% for 2019 and around 3.2% for 2020 (Chart 10). Wage expectations for 2020 are highest in the local government and hospital sector, services and construction. Competition is fierce for selected occupational groups among enterprises in both services and construction, which puts extra pressure on wages.

In retail trade, the rise in prices has picked up slightly since August. For a number of years, keen competition and ample opportunity to compare prices online

Chart 7

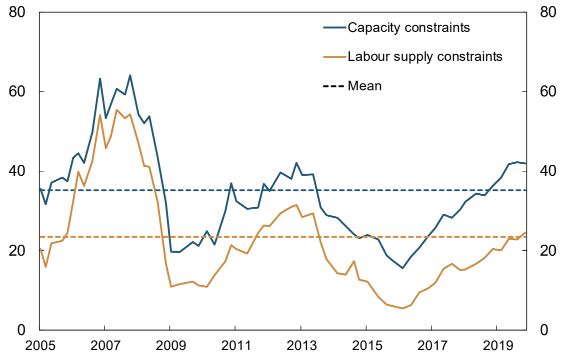
Output growth. Oil service industry



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

Chart 8

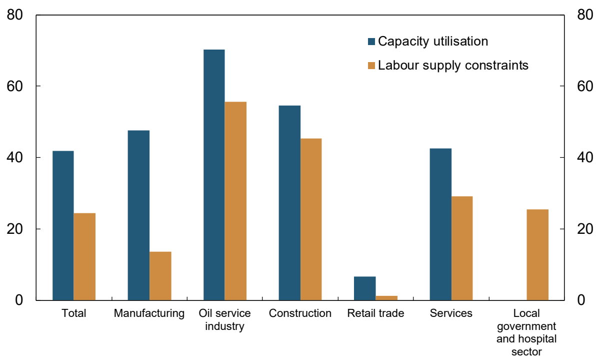
Capacity utilisation[1)] and labour supply constraints [2)]



Percentage shares.1) Share of contacts that will face some or considerable difficulty meeting growth in demand. 2) Share of contacts citing shortage of labour as a production constraint. 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 9

Capacity utilisation[1)] and labour supply constraints [2)] .All sectors



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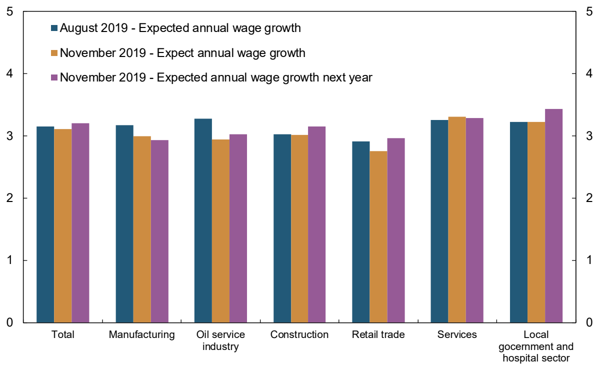
have provided little leeway to pass on cost increases to higher prices. For many contacts, however, the krone depreciation in recent years has resulted in higher purchasing costs, and the exchange rate movements in recent months have led the majority to see a need for raising prices.

In household services, the rise in prices has declined slightly in the past two interview periods, and this trend is expected to continue. Despite a growing shift in recent years from goods purchases to experiences, increased supply in sectors such as hotels and restaurants in particular, has pulled down on the rise in prices.

Chart 10

Annual wage growth



Expected wage growth. Percent

TABLE 1 Economic Indicators

	This survey	Previous survey
Output and demand		
Output growth past three months (annualised percentage growth)		
Total	**2.1**	**3.0**
Domestically-oriented manufacturing	**0.2**	**1.4**
Export industry	**2.0**	**2.2**
Domestically-oriented oil service industry	**3.9**	**4.9**
Export-oriented oil service industry	**3.3**	**3.4**
Construction	**1.6**	**3.0**
Retail trade	**-0.7**	**1.4**
Commercial services	**3.6**	**3.8**
Household services	**2.7**	**3.1**
Expected output growth next six months (annualised percentage growth)		
Total	**1.9**	**2.7**
Domestically-oriented manufacturing	**1.2**	**1.5**
Export industry	**1.6**	**1.6**
Domestically-oriented oil service industry	**2.6**	**3.8**
Export-oriented oil service industry	**2.9**	**2.6**
Construction	**0.1**	**3.0**
Retail trade	**-0.3**	**0.7**
Commercial services	**3.3**	**3.7**
Household services	**2.9**	**3.0**
Labour market and output gap		
Employment growth past three months	**0.3**	**0.4**
Expected employment growth next three months	**0.2**	**0.4**
Labour supply constraints	**24.5**	**22.7**
Capacity constraints	**41.8**	**42.1**
Costs and prices		
Estimated annual wage growth for current calendar year (percent)	**3.1**	**3.2**
Estimated annual wage growth for next calendar year (percent)	**3.2**	