

The Norwegian economy is now in its fourth year of strong growth. Mainland GDP has expanded by around 10 per cent over the past three years. Growth in production and domestic demand is continuing at a brisk pace. Employment has risen by a net 125 000, ie by a little more than 6 per cent. The largest share of the increase in employment reflects an expansion in the labour force, but unemployment has also been reduced from 6 per cent in 1992 to a little more than 4 per cent in 1996.

If growth in demand continues to be strong, higher capacity utilisation and a shortage of labour will, sooner or later, lead to a sharp increase in price and wage inflation rather than higher value-added. There may already be signs that we are entering such a phase of the business cycle: housing and property prices have surged, credit growth is rising and real wage growth is high. In eastern Norway, the ratio of vacancies to the number of unemployed is nearly the same as in 1988, which could also indicate that high unemployment figures conceal a growing mismatch between job-seekers' skills and those required by employers.

Estimates in Norges Bank's third quarter *Inflation Report* indicate that the growth in labour costs in manufacturing industry may be higher than among our trading partners both this year and in 1997 and the analysis shows that wage growth may be as high as 5 per cent next year. It also seems that price inflation may rise in the period ahead, even though it is still relatively low. These estimates are based on the assumption that wage moderation will not have a substantial impact on price and wage inflation in 1997. On the other hand, it has not been assumed that there will be any further catch-up from the wage moderation shown in the early 1990s.

Thus far, the strong growth in employment has been possible as a result of higher labour force participation rates among young people and women in response to improved job prospects. This is a positive development as more people have found employment and value-added has increased. To a large extent, we have also managed to avoid pressures which may otherwise have arisen during such a prolonged period of strong growth. It is difficult to project precisely how much longer this will continue. There is considerable uncertainty as

to whether structural changes in recent years have resulted in a more permanent rise in unemployment, as has been the case in other European countries. If there is more wage moderation than anticipated and wage growth is lower than projected in this Report, this would reinforce the basis for a sustainable lower level of unemployment.

The experience of the 1980s, both in Norway and in other countries, shows that putting the economy back on the right track once price and wage inflation has accelerated is a long and difficult process. There has therefore been a long-standing consensus as to the importance of ensuring a sustainable basis for employment by conducting an economic policy which is oriented towards long-term economic stability and improved competitiveness. It is vital that we do not lose what we have gained now that the economy is expanding at a brisk pace. It is therefore essential to act with foresight by using economic policy to curb pressures in the economy.

Growth in the Norwegian economy is now considerably stronger than among our European trading partners, which makes it more demanding than otherwise to maintain price and wage inflation on a par with our trading partners. A further rise in demand would make this even more difficult.

Monetary policy is oriented towards stabilising the krone exchange rate against European currencies. Within the limits set by the objective of a stable exchange rate, monetary policy is geared towards confining growth and activity to a level consistent with stable, low price and wage inflation. There are, however, limits to the extent to which monetary policy can help stabilise the economy when the primary objective is to stabilise the exchange rate.

The main responsibility for stabilising the economy lies with fiscal policy. Against the background of accelerating growth in the Norwegian economy thus far in 1996, it is clear that the budget for the current year could have been tighter than it actually was. The risk of further pressures in the economy next year underlines the need for a tight fiscal policy stance in 1997, which is at least in line with the tightening originally called for in the 1996 budget.

*Kjell Storvik*

## **Norges Bank's Inflation Report**

Pursuant to the Norges Bank Act, the central bank has an advisory function in the area of monetary, credit and foreign exchange policy. In its executive capacity, Norges Bank shall ensure the stability of the krone's value measured against European currencies. Sustained low price and wage inflation in line with or lower than that of trading partners is a necessary condition for a stable krone exchange rate.

The *Inflation Report* provides a survey of price trends and factors that influence price and wage inflation. It contains a broad review of the situation in the Norwegian economy and provides Norges Bank's professional evaluation of the outlook for prices for the next 12-18 months.

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The cut-off date for the Inflation Report was 19 September 1996

**Our projections for the average rise in prices remain unchanged at 1<sup>1</sup>/<sub>4</sub>% this year, rising to 2<sup>1</sup>/<sub>2</sub>% in 1997. One of the main factors behind the rise in price inflation is higher wage growth. Based on historical trends for wage formation, wage growth may increase from 4<sup>1</sup>/<sub>4</sub>% this year to about 5% in 1997.**

**Following a 10% growth in mainland GDP over a three-year period, it appears that the level of activity will pick up further in 1996. The upswing is now broadly based, with private consumption, investment and exports all recording buoyant growth. Employment gains seem to be higher than previously anticipated.**

**As a result of sluggish activity and moderate price inflation internationally, price impulses from imports will partly offset the effect of higher domestic wage inflation on prices.**

**Higher electricity prices will push up consumer prices by about 1<sup>1</sup>/<sub>4</sub>% this year and close to 1<sup>1</sup>/<sub>2</sub>% in 1997.**

## 1.1 The economic news

Consumer prices rose by a somewhat slower than expected pace in the first six months of 1996, partly reflecting slightly lower import prices than assumed earlier. The subdued rise in prices is mainly due to lower clothing and footwear prices, in addition to the reduction in car taxes. The elimination of VAT compensation for a number of food products and higher electricity prices pushed up consumer price inflation in July and August, whereas a fall in petrol prices due to price competition contributed to moderating the rise in prices.

In the June *Inflation Report*, economic growth was projected to pick up again this year following a somewhat slower pace of expansion in the last half of 1995. The main driving forces behind this were high real income growth, a slight reduction in the household saving ratio and high commercial building starts. The quarterly national accounts for the second quarter and the latest short-term indicators confirm this picture:

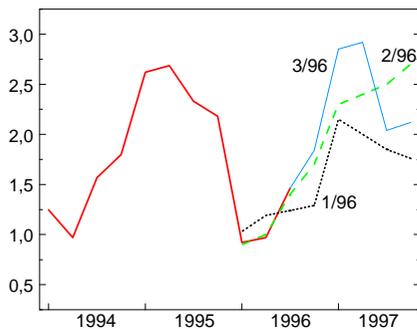
- Mainland GDP expanded by almost 3% in the 12 months to the second quarter of 1996, in spite of the strikes in the spring and a fall in electricity production. However, production and demand appeared to stabilise in the second quarter after rising sharply in the first quarter.
- Growth in domestic demand is now expected to be sub-

stantially higher than last year. In the first half of 1996 private consumption was a good 4<sup>1</sup>/<sub>2</sub>% higher than in the same period one year earlier. Mainland business fixed investment is still growing at a brisk pace, and housing starts now seem to be moving on an upward trend after declining in the first half of this year.

- Higher credit growth also points to stronger demand. Credit growth primarily reflects high business fixed investment, although part of the rise is probably related to higher levels of activity and rising house prices in addition to a surge in car purchases.
- Although growth among major trading partners has been fairly subdued, traditional merchandise exports have so far this year remained at a good 10% above the level prevailing in the same period last year.

The strong expansion has also resulted in a tighter labour market. Employment has risen at a far faster pace this year than projected in the last *Inflation Report*. In the first six months, employment rose by 65 000 compared with the same period last year. However, unemployment is declining by a smaller margin than the rise in employment would imply because a large share of employment growth has been accompanied by an increase in labour force participation by women and youths. Labour force participation rose by 50 000 in the first half of 1996.

**Chart 1.1** *Current and earlier projections of consumer price inflation. 12-month rise in per cent*



Source: Statistics Norway and Norges Bank

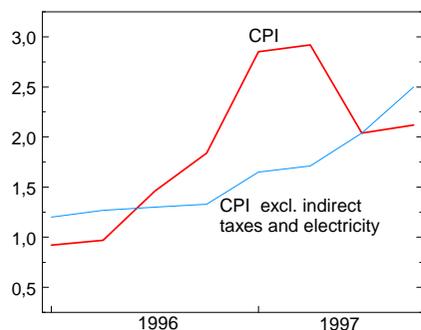
## 1.2 Norges Bank's inflation projections

In the June *Inflation Report*, the average rise in consumer prices was projected at 1<sup>1</sup>/<sub>4</sub>% in 1996 and 2<sup>1</sup>/<sub>2</sub>% in 1997. The projections implied a scenario where the rise in prices would accelerate in the last half of 1996, reaching 1<sup>3</sup>/<sub>4</sub>% towards the end of the year. The rise in prices was 1.1% in the first 8 months of this year, which was slightly lower than projected in the last issue.

The average rise in prices between 1995 and 1996 is still projected at 1<sup>1</sup>/<sub>4</sub>%. The lower-than-expected rise in consumer prices so far this year will be offset by higher electricity prices in the latter half of 1996 than assumed earlier. Electricity prices are also expected to be higher in 1997 than assumed in the last *Inflation Report*. In addition, wage growth has been adjusted upwards. On the other hand, import prices are expected to rise at a slightly slower pace both in 1996 and 1997. The average rise in prices between 1996 and 1997 is therefore still projected at 2<sup>1</sup>/<sub>2</sub>%. This means that price inflation next year will reach a slightly higher level than among trading partners.

The trend in consumer prices through 1997 will thus diverge substantially from the path projected in the June issue,

**Chart 1.2 Consumer price inflation. Projections for CPI, total and excluding indirect taxes and electricity prices. 12-month rise in per cent**



Source: Norges Bank

**Table 1.1 Consumer prices. Norges Bank's projections. Percentage rise from previous year. Projections from private forecasting institutions in brackets<sup>1)</sup>**

	1996		1997	
USA	2 <sup>3</sup> / <sub>4</sub>	(3.0)	2 <sup>3</sup> / <sub>4</sub>	(3.1)
Japan	1 <sup>1</sup> / <sub>4</sub>	(0.3)	1 <sup>1</sup> / <sub>4</sub>	(1.2)
Germany	1 <sup>1</sup> / <sub>2</sub>	(1.5)	1 <sup>3</sup> / <sub>4</sub>	(1.8)
UK	2 <sup>1</sup> / <sub>4</sub>	(2.3)	3 <sup>1</sup> / <sub>4</sub>	(2.9)
Sweden	1	(1.3)	2 <sup>1</sup> / <sub>4</sub>	(2.1)
Finland	1	(0.9)	2 <sup>1</sup> / <sub>4</sub>	(1.7)
Denmark	2	(2.1)	2 <sup>1</sup> / <sub>4</sub>	(2.4)
Norway's trading partners	1 <sup>3</sup> / <sub>4</sub>	(1.9)	2 <sup>1</sup> / <sub>4</sub>	(2.2)
EU-12-countries <sup>2)</sup>	2 <sup>1</sup> / <sub>4</sub>	(2.2)	2 <sup>1</sup> / <sub>4</sub>	(2.2)

<sup>1)</sup> The average projection for consumer price inflation from various private institutions as of September 1996.

<sup>2)</sup> ECU index weights.

Source: Norges Bank and Consensus forecast

see Chart 1.1. The rise in electricity prices will entail that the 12-month rise in prices will reach 3% at the beginning of 1997. If electricity prices fall in 1997, as we have assumed, the rise in prices will move down towards 2<sup>1</sup>/<sub>4</sub>% at the end of 1997. Adjusted for indirect taxes and electricity prices, average price inflation will rise from 1<sup>1</sup>/<sub>4</sub>% this year to 2% next year, resulting in an underlying rise in prices of a little more than 2<sup>1</sup>/<sub>2</sub>% towards the end of 1997, see Chart 1.2.

A number of significant factors influencing price trends in the period ahead are discussed below.

**Wage growth.** This year's wage settlement points to a total annual wage growth of a little more than 4<sup>1</sup>/<sub>4</sub>% in 1996. A slightly tighter labour market in conjunction with higher price inflation point to higher wage growth next year. Based on historical information about wage formation during a cyclical upturn, as derived from Norges Bank's macroeconomic model RIMINI, wage growth is projected to reach about 5% in 1997.

**Other domestic conditions.** Changes in indirect taxes continue to influence movements in the consumer price index. In addition to the reduction in car taxes at the beginning of the year, which in isolation has reduced the rise in the CPI by about 0.4 percentage point this year, the removal of VAT compensation for some food products as from 1 July may contribute to a rise in prices of 0.1 percentage point in both 1996 and 1997. Electricity prices are projected to rise by an average of 6% this year, contributing about 1<sup>1</sup>/<sub>4</sub> percentage point to the total rise in prices. Electricity prices are expected to show a moderate decline in the second half of next year, but with a carry-over into 1997 and the high level of prices in the first half of the year, the annual rise in electricity prices may reach 9% next year. The contribution to the rise in the CPI will in this case be closer to half a percentage point in 1997.

**Import prices.** Price inflation among trading partners remains moderate, with consumer price inflation projected at 1<sup>3</sup>/<sub>4</sub>% in 1996 and 2<sup>1</sup>/<sub>4</sub>% in 1997. The estimates for 1996 and 1997 have been lowered by a quarter of a percentage point compared with the last *Inflation Report*. Commodity prices, excluding oil, fell sharply between the first and second quarter of this year, which has resulted in weaker price impulses from Norway's traditional merchandise imports in the first half of the year than assumed earlier. Import prices are now estimated to rise by 1<sup>1</sup>/<sub>4</sub>% between 1995 and 1996. For 1997, import prices are projected to rise by 1%. The corresponding figures in the June *Inflation Report* were 1% for 1996 and 1<sup>1</sup>/<sub>2</sub>% for 1997.

**Profit margins.** As in the last *Inflation Report*, profit margins

are not expected to generate any substantial impetus to consumer price inflation. On the one hand, higher demand growth may provide scope for increases in prices and lower import prices might also prompt importers to raise their margins. On the other hand, ongoing structural changes and sound profitability will contribute to continued pressure on margins in the retail sector. A moderate rise in import prices may also contribute to continued pressure on margins for Norwegian production.

### 1.3 Inflation expectations

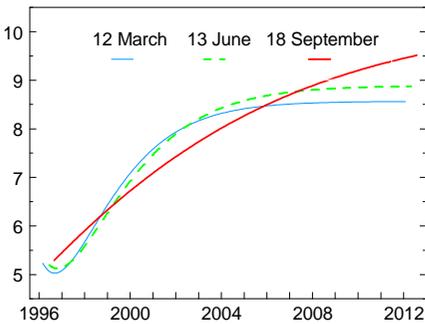
Statistics Norway's cyclical barometer provides an overview of enterprises' expectations of price changes for their own products for the next quarter. The cyclical barometer shows that price movements in the second quarter were largely in line with business expectations. An increasing share of enterprises expect higher prices for their products in the third quarter, both for products sold on the domestic and export markets. The share of enterprises expecting a decline in prices for their products has fallen considerably.

The forward rate curve can provide information about inflation expectations in the money and foreign exchange markets. This curve, which shows expectations about future short-term rates, is based on the effective yield on capital instruments in Norway with various maturities, including government bonds. Forward rates may - under certain conditions - be interpreted as the sum of the expected real rate of interest and expected future inflation. At a constant real interest rate, the changes in forward rates can be interpreted as changes in inflation expectations. Chart 1.3 shows changes in forward rates over the last six months. Since the last *Inflation Report*, forward rates for the next few years have edged up, which may indicate a rise in inflation expectations in this period.

However, forward rates must not be taken as a strict measure of inflation expectations because changes in Norwegian rates must also be seen in connection with foreign rates. As a result, changes in Norwegian forward rates may reflect changes in international rates. An alternative indicator is thus the differential between Norwegian and foreign forward rates, which may indicate changes in inflation expectations vis-à-vis other countries. The forward rate differential against Germany has widened since mid-June particularly for the first years, see Chart 1.4. This may reflect higher inflation expectations in Norway compared with Germany. However, this may indicate that the economic slump has lowered inflation expectations in Germany. Divergent cyclical conditions also imply that some of the difference in forward rates over the next years may be ascribable to different expectations about real interest rates in Norway and Germany.

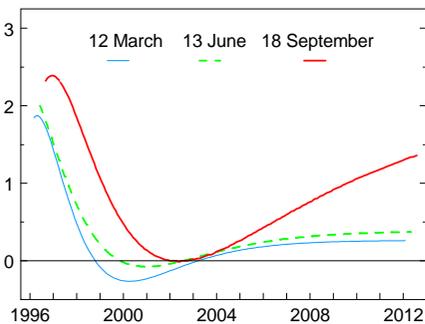
Price inflation estimates for 1996 and 1997 published by

**Chart 1.3** *Forward rates in Norway. Expected short-term rates in per cent*



Source: Norges Bank

**Chart 1.4** *Differential between expected short-term rates in Norway and Germany in percentage points*



Source: Norges Bank

**Table 1.2** Various institutions' projections for consumer price inflation in Norway in 1996 and 1997<sup>1)</sup>. Percentage change from previous year

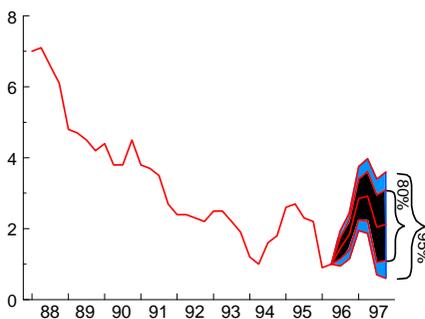
	1996		1997
	Last published estimate up to		
	Sept 1996	June 1996	Sept 1996
Ministry of Finance	1 1/4	-	-
Statistics Norway	1.4	2.0	2.2
OECD <sup>2)</sup>	1.7	2.4	-
IMF	2.0	2.3	-
Norges Bank	1 1/4	2 1/2	2 1/2
Private institutions <sup>3)</sup>			
highest estimate	1.6	3.0	3.0
lowest estimate	1.2	1.8	2.2
average	1.3	2.2	2.4

<sup>1)</sup> Latest official projections from the respective institutions.

<sup>2)</sup> Consumer deflator.

<sup>3)</sup> Based on projections from 13 institutions.

**Chart 1.5** Uncertainty in the inflation projections. 12-month rise in per cent



Source: Statistics Norway and Norges Bank

13 private institutions indicate an expected average price inflation of 1.3% in 1996, with the lowest rate at 1.2% and the highest estimate at 1.6%. For 1997, private institutions expect prices to rise by 2.4%, compared with 2.2% in the last *Inflation Report*. The estimates vary between 2.2% and 3.0%. Whereas the average estimate for the private institutions was lower than Norges Bank's projection in the last *Inflation Report*, the two are now virtually the same for 1997.

## 1.4 The risks to the inflation outlook

The uncertainty in Norges Bank's inflation projections for the next 12-18 months is shown in Chart 1.5. The confidence intervals are based on Norges Bank's macroeconomic model RIMINI and express the uncertainty of historical relations which are incorporated in the model. There is an 80% probability that the innermost interval will reflect actual inflation rates and a 95% probability that inflation rates will be within the outermost interval. The intervals do not reflect the uncertainty attached to the estimates for exogenous variables. The most important upside risks that may point to higher-than-projected price inflation are:

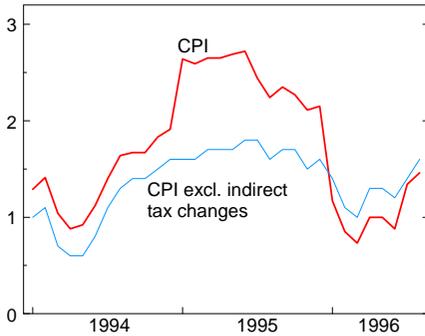
- A catch-up in pay following moderate wage increases in the first half of the 1990s may entail even higher wage growth.
- If fiscal policy is more expansionary than assumed in our projections, domestic demand is likely to be higher than projected.
- The sharp rise in local government revenues may lead to higher municipal demand than expected, and after a period result in higher price and wage inflation, see section 4.5.
- Strong demand growth and a low rise in import prices may push up price inflation as a result of higher profit margins in enterprises.
- Electricity prices may rise by a greater margin than we have assumed for next year.

Downside risks that may lead to a lower rise in prices than projected are:

- Wage growth in 1997 may be lower than previous experience would indicate, if the moderation shown in earlier wage settlements is resumed. Wage growth may also be lower as a result of weaker-than-assumed profitability in the export industry.

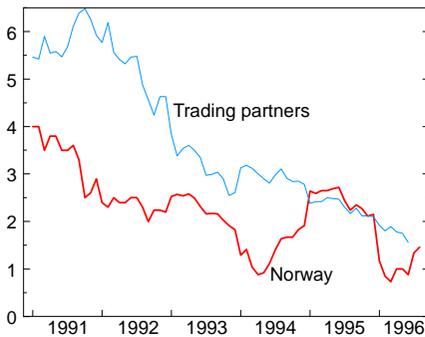
- We may have overestimated the tightness of the labour market.
- A tighter-than-projected budget may reduce pressures in the economy during 1997.
- Substantial precipitation this autumn and winter may result in a lower rise in electricity prices than we have assumed.
- Price inflation among our trading partners, and hence the price impetus from imports, may be lower than our forecast indicates.

**Chart 2.1** *CPI, total and excluding indirect tax changes. 12-month rise in per cent*



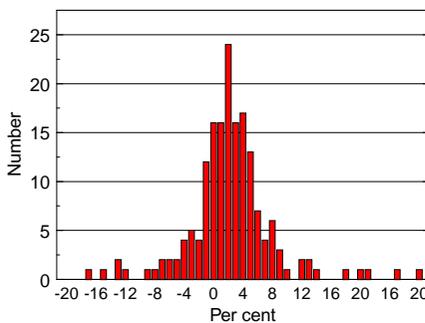
Source: Statistics Norway and Norges Bank

**Chart 2.2** *Consumer prices. 12-month rise in per cent*



Source: Statistics Norway and OECD

**Chart 2.3** *CPI. Groups of goods ranked by 12-month rise. August 1996*



Source: Statistics Norway

## 2.1 Consumer prices

So far this year consumer prices have been 1.1% higher than in the same period last year. The 12-month rise, which reached a low of 0.7% in March, edged up in subsequent months and was 1.5% in August, see Chart 2.1.

Price movements this year have been influenced by changes in indirect taxes. Lower car taxes with effect from the beginning of this year contributed to a 0.4 percentage point decline in the year-on-year rise. The removal of VAT compensation for some food products contributed to a higher rise in prices as from July. Adjusted for changes in indirect taxes, the average rise in prices has been about 1<sup>1</sup>/<sub>4</sub>% so far this year, which is half a percentage point lower than for the same period in 1995. Lower prices for clothing, footwear and white goods accounted for a large share of this decline. The rise in consumer prices over the last two months reflects higher electricity prices in addition to the removal of VAT compensation.

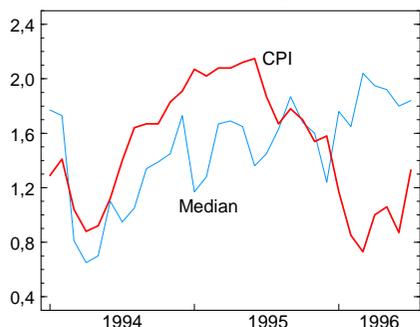
The rise in consumer prices is slightly lower than price inflation among trading partners, see Chart 2.2. In recent months the difference has narrowed, partly because the rate in Norway has risen, but also because price inflation among several trading partner countries has declined. In Finland and Sweden, the rise in consumer prices has dipped to below 1%. Average price inflation in the EU fell from 3% at the beginning of the year to 2.5% in June.

The rise in retail prices has been moderate, up 0.4% in August compared with one year earlier. The slightly higher rise in the consumer price index primarily reflects a higher rise in prices for services than for goods.

Chart 2.3 shows a number of groups of goods included in the CPI ranked according to the rise in prices. The year-on-year rise for most groups of goods lies within the interval -1 to 4%, with the median observation at 1.5%. The chart shows that some groups of goods exhibit particularly large price variations.

A measure of underlying price trends adjusted for such wide variations is referred to as median inflation. This measure was discussed in a separate box in the June *Inflation Report*. Chart 2.4 shows median inflation and the rise in the CPI. Both measures are adjusted for general changes in the VAT rate. Whereas the rise in the CPI slowed from mid-1995 to the beginning of 1996, median inflation has shown a steady rise in the same period. The CPI has again risen slightly in recent months, partly reflecting higher electricity prices and the removal of VAT compensation for some food products. Median inflation is not influenced to the same ex-

**Chart 2.4** *Different measures of inflation. 12-month rise in per cent*



Source: Norges Bank

tent by such one-off increases in prices, and therefore shows a flatter trend.

The rise in the CPI is still much more subdued than the rise in prices as measured by median inflation. This may be related to the fact that some groups of goods with high weights in the index, such as cars, food and clothing, have shown a pronounced price decline over the last year. Most groups of goods have thus shown a higher rise in prices than the rise in the CPI. If the price decline for the goods mentioned is temporary, it is likely that the rise in prices as measured by the CPI will move up fairly rapidly towards the underlying trend in median inflation.

## 2.2 Import prices

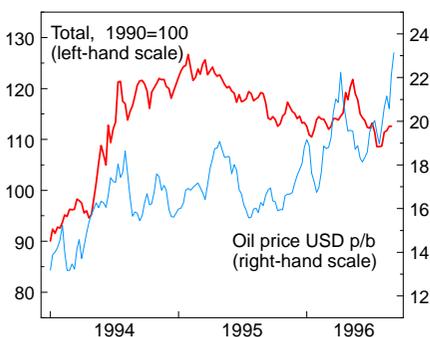
Prices of traditional merchandise imports rose by 0.7% in 1995 and 0.2% in the first half of this year. Sluggish cyclical trends in Europe and moderate international price inflation have contributed to curbing the rise in import prices. The slight appreciation of the effective krone exchange rate in 1995 may also have had the same effect. The main contribution, however, came from lower non-fuel commodity prices and a price decline for office machinery and electronic equipment.

The subdued rise in prices of imported goods is reflected in consumer price trends. The index for imported goods in the CPI fell by 2.3% over the past year, mainly as a result of reduced car taxes and lower retail margins in the clothing and footwear sector.

*The Economist's* all-items index, measured in SDRs, has fallen by close to 3% through the last three months, see Chart 2.5. Metals have shown the steepest fall, down 9.3%, primarily due to lower aluminium and copper prices.

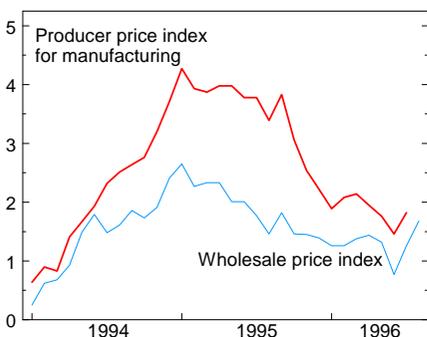
Oil prices have varied widely this year. Oil prices hovered above USD 23 or NOK 150 p/b in April, but then declined in later months. Oil prices resumed an upward trend at the beginning of September as a result of the unrest in the Middle East, and were back at USD 23 p/b in mid-September. This is a little more than USD 3 above the level prevailing at the beginning of the year.

**Chart 2.5** *Commodity prices*



Source: The Economist

**Chart 2.6** *Wholesale and producer price indices. 12-month rise in per cent*



Source: Statistics Norway

## 2.3 Wholesale and producer prices

Producer and wholesale price trends can provide an indication of future consumer price movements. The year-on-year rise in producer prices in manufacturing industry slowed from the beginning of 1995 to mid-1996, see Chart 2.6. In the last two months an upward movement has been recorded, with the sharpest rise for prices of goods sold on the domestic market.

Wholesale prices have also edged up over the last two months, primarily reflecting higher food and fuel prices. The

**Table 2.1** *National accounts deflators. Percentage growth from same period previous year*

	1995		1996	
	Q3	Q4	Q1	Q2
Domestic demand	2.4	2.9	1.6	1.8
Household consumption	2.2	2.5	0.6	1.7
Public consumption	3.2	3.1	3.1	3.5
Gross fixed investment	3.1	3.5	3.0	1.8
Exports	6.0	3.8	-3.1	-1.0
Imports	0.4	0.4	0.4	0.0
GDP	1.8	2.6	1.7	3.0
Mainland GDP	3.6	3.9	1.0	2.0

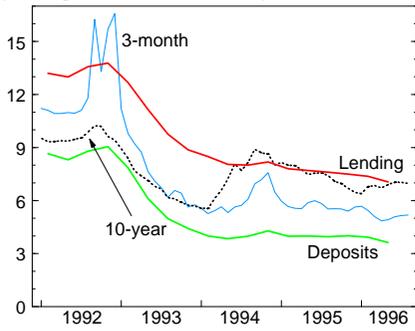
Source: Statistics Norway

rise in prices for consumer goods has been slightly higher at the wholesale stage than for the retail sector.

## 2.4 National accounts deflators

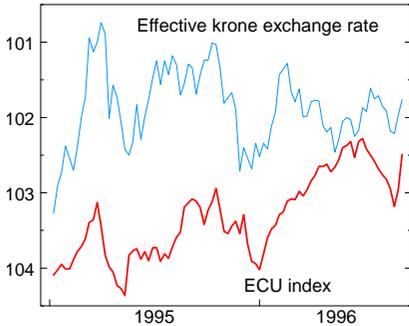
The national accounts price deflators indicate a higher rise in prices for private consumption in the second quarter than in the first quarter of this year, see Table 2.1. The price deflators underline the substantially higher rise in prices for services than for goods, as indicated by the CPI. Prices for services were 3.4% higher than in the second quarter of this year than one year earlier. The rise in prices for public consumption edged up to 3.5%, whereas the price indices for business fixed investment indicate a much slower rise. This may be due to the fact that investment has a relatively high import content and that import prices are moving on a very moderate trend. The low rise in prices for mainland GDP reflects a fall in prices for traditional merchandise exports.

**Chart 3.1** Interest rate movements in Norway. Banks' deposit and lending rates. 3-month Euro-rate and 10-year government bond yield



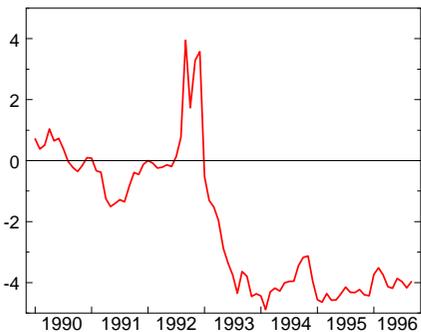
Source: Norges Bank

**Chart 3.2** ECU index and manufacturing industry's effective exchange rate. Rising curve denotes appreciation



Source: Norges Bank

**Chart 3.3** Norges Bank's Monetary Conditions Index. January 1992=0



When aggregating, the real interest rate is given a weight of  $\frac{3}{4}$  and the real effective exchange rate a weight of  $\frac{1}{4}$

Source: Norges Bank

pared with the penultimate three-month period, reaching 5.3% on 18 September. This is still about 0.4 percentage point lower than the average for 1995, see Chart 3.1. For longer maturities, the rise in money market rates has been slightly greater in recent months.

The upward movement in money market rates in recent months has not resulted in a rise in rates on loans to households and enterprises in Norway. Norges Bank's second quarter interest rate statistics show that the average commercial and savings bank lending rate fell by 0.3 percentage point between the first and second quarter.

Movements in long rates may influence Norwegian borrowing patterns as they reflect expectations about short-term rates and because long-term investments are often linked to these rates. Norwegian bond yields have moved upwards in 1996, rising by a greater margin than corresponding German and ECU yields.

The effective krone exchange rate has firmed somewhat since the June *Inflation Report*, see Chart 3.2. In recent weeks the ECU index has appreciated following a slight weakening through the summer, and has now returned to the same level prevailing three months ago.

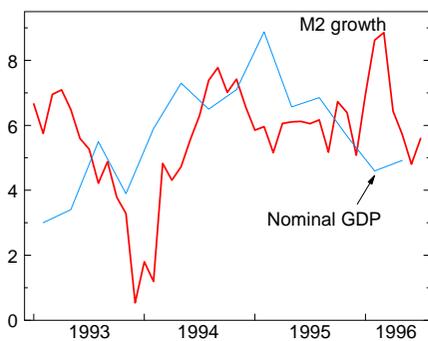
The effects of interest and exchange rate changes on the real economy are summarised in Norges Bank's Monetary Conditions Index, see Chart 3.3. A fall in the index indicates that interest and exchange rate movements are having a more expansionary effect on the real economy. The index has only shown minor short-term variations in the last three years, and the level has generally shown little change.

Interest and exchange rate movements are discussed in greater detail in a separate survey in this issue of *Economic Bulletin: Financial market developments and Norges Bank's operations*.

## 3.2 Monetary growth

Changes in the money supply are used in many countries as an indicator of future inflation. Econometric studies of Norwegian data indicate that historically there has not been a close correlation between monetary growth and inflation in Norway. However, a fairly stable relationship between changes in monetary growth and growth in nominal main-

**Chart 3.4** Money supply (M2) and nominal mainland GDP. 12-month growth in per cent

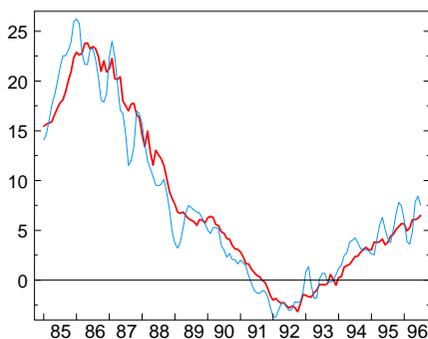


Source: Statistics Norway and Norges Bank

land GDP has been observed. Combined with other economic indicators, monetary variables may provide information about economic developments. However, caution must be exercised in attaching excessive importance to individual observations as growth rates tend to vary widely. At the beginning of 1996 several finance companies were converted into banks, which in isolation will contribute to higher monetary growth in 1996.

The year-on-year growth in M2 reached almost 9% at the end of the first quarter of this year after hovering around 6% through 1995. Annualised growth showed a decline in the second quarter, falling to 5.6% at the end of June, see Chart 3.4. The decline in monetary growth may indicate that a higher share of accumulated savings is now being used to buy consumer goods, accompanied by a fall in the household saving ratio. The decline in monetary growth may also reflect a shift away from bank deposits towards investments in financial assets such as securities and unit trusts.

**Chart 3.5** Domestic credit (C1) with underlying growth. 12-month growth in per cent



Source: Norges Bank

### 3.3 Credit growth

The upward trend in credit growth has become more pronounced in recent months, reflecting the high growth in domestic demand. In July, the year-on-year rate of growth in the credit indicator (C1) was 6.5%, see box on credit growth.

## Credit growth

Private and municipal gross domestic debt in NOK (C1) rose by 6.5% in the 12 months to end-July 1996, which is the highest nominal year-on-year growth recorded since May 1989. Such a high level of real credit growth (deflated by the rise in consumer prices) has not been seen since May 1988. The underlying growth in domestic credit (annualised growth in the last three-month period compared with the penultimate three-month period) was almost 8%. Although lending growth has been moving upward, the real value of private and municipal gross domestic debt is still lower than at the beginning of the 1990s, see chart.

Lending to the business sector has shown stronger growth thus far than lending to the household sector. Loans in NOK and foreign currency from Norwegian financial institutions expanded by a good 8% in the year to end-June, whereas the corresponding figure for loans to households was 4.5%. The growth in loans measured in NOK produces slightly different figures, with loans to enterprises rising by a good NOK 23bn and loans to households by NOK 25bn.

Growth in loans to the business sector reflects the continued growth in investment. Mainland business fixed investment expanded by 14% last year and is projected to rise by 7% this year. Figures for lending by industry indicate that a fairly large share of lending growth has come in service industries. The banks' loans to the property management sector, distributive trades

and the hotel and restaurant industry grew by a good NOK 13bn in the year to June 1996. The corresponding figure for loans to manufacturing industry was about NOK 5bn.

Lending to the household sector has shown slightly higher growth, but thus far has not been particularly high in relation to the pronounced rise in purchases of consumer durables. Although growth in total lending to the household sector has been fairly modest, growth in loans secured by housing mortgages has been higher than growth in other types of loans. The rise in house prices has engendered a rise in the value of the housing stock, which has provided greater scope for borrowing using housing as collateral at more favourable interest rates than for other types of loans. In the year to June 1996 Norwegian financial institutions' volume of lending secured by housing mortgages rose by almost 10%.

Key figures for households' debt servicing capacity, measured eg by interest expenditure in per cent of income and the ratio of debt to disposable income, have exhibited a favourable trend in the 1990s. At the end of 1990 household debt was 154% of disposable income, whereas the figure for end-1995 was 128%. Interest expenditure as a share of households' cash surplus<sup>1</sup> declined from 20 to 10% from 1988 to 1995. The expansion in private consumption in recent years has thus partly been financed by higher income and partly by drawing on financial assets. Against this background, there are no clear signs that households are in the process of repeating the behaviour exhibited in the 1980s when the accumulation of large debt burdens followed by financial consolidation contributed to an economic recession. On the other hand, the solid financial position of households in addition to relatively low after-tax real interest rates means that there is a substantial potential for continued growth in debt-financed demand in the period ahead. Our estimates imply a continued rise in house prices, which may contribute to a further rise in household credit demand.

<sup>1</sup> Cash surplus is defined as the sum of earned income, interest income and transfers less taxes. See H. Johansen: «Debt servicing capacity in the household sector» in Economic Bulletin 2/96.

*The real value of private and municipal gross domestic (C1), 1993=100*



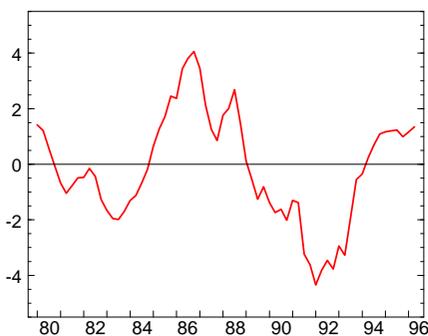
Source: Norges Bank

**Table 4.1** *Supply and use of goods and services. Percentage growth from previous year*

	1995	1996	1997
Mainland demand	3.8	4	2 <sup>1</sup> / <sub>4</sub>
Private consumption	2.6	4 <sup>1</sup> / <sub>4</sub>	2 <sup>3</sup> / <sub>4</sub>
General government consumption	0.2	1 <sup>3</sup> / <sub>4</sub>	1
Mainland fixed investment	13.5	6	2 <sup>1</sup> / <sub>2</sub>
Accrued oil investment	-13.1	2 <sup>1</sup> / <sub>4</sub>	2
Exports	3.8	8 <sup>1</sup> / <sub>4</sub>	5
Of which:			
Oil, gas and pipeline transport	8.4	15	4 <sup>1</sup> / <sub>2</sub>
Traditional goods	4.1	8 <sup>1</sup> / <sub>4</sub>	6 <sup>1</sup> / <sub>2</sub>
Imports	5.1	4	3 <sup>3</sup> / <sub>4</sub>
Traditional goods	9.1	5 <sup>1</sup> / <sub>4</sub>	4 <sup>1</sup> / <sub>2</sub>
GDP	3.3	5	3
Mainland GDP	2.7	3 <sup>1</sup> / <sub>4</sub>	2 <sup>1</sup> / <sub>2</sub>

Source: Statistics Norway and Norges Bank

**Chart 4.1** *Output gap. Difference between actual and trend mainland GDP. Per cent*



Source: Statistics Norway and Norges Bank

## 4.1 Main features

The quarterly national accounts (QNA) for the second quarter of 1996 show a high level of activity in the Norwegian economy. Mainland GDP expanded by close to 3% in the year to the second quarter of 1996. However, output and demand showed signs of levelling off in the second quarter after exhibiting sharp growth in the first quarter. The second-quarter GDP figures, however, were influenced by the strikes this spring and the fall in electricity production, which may have reduced mainland GDP growth by an estimated <sup>3</sup>/<sub>4</sub> percentage point.

Mainland GDP is anticipated to grow by 3<sup>1</sup>/<sub>4</sub>% this year, or at the same rate as projected in the June *Inflation Report*. Lower electricity production will reduce growth by an estimated quarter of a percentage point. Traditional merchandise exports now appear to be higher than forecast in June, whereas growth in mainland business fixed investment is likely to expand at a slower pace. The pronounced growth in real income and the decline in the household saving ratio may contribute to consumption growth of 4<sup>1</sup>/<sub>4</sub>% between 1995 and 1996. Employment growth is projected to reach 2<sup>3</sup>/<sub>4</sub>% between 1995 and 1996, and the number of unemployed is expected to edge down to 4<sup>1</sup>/<sub>4</sub>% this year.

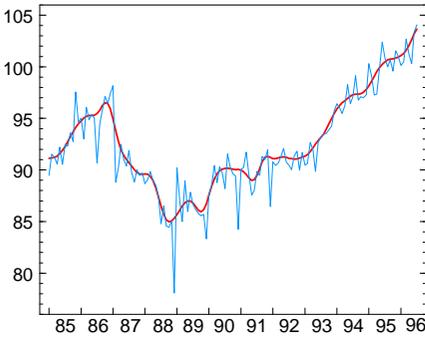
Growth is expected to continue next year. Gross mainland output is estimated to expand by 2<sup>1</sup>/<sub>2</sub>%, whereas continued high growth in real income may help boost consumption growth to nearly 3%. An estimated 1<sup>1</sup>/<sub>2</sub>% growth in employment in 1997 may reduce unemployment to well below 4% towards the end of next year.

Output is expanding in an environment of an already high level of capacity utilisation in the economy. Chart 4.1 shows the calculations for the relationship between actual output and the estimated level of capacity utilisation which is consistent with stable price and wage inflation. There is a large degree of uncertainty associated with such estimations, but the output gap may still provide an indication of pressures in the economy. The figures show that capacity utilisation is now rising following a temporary decline through last year. The above estimates for output growth imply a rise in capacity utilisation in Norway over the next 12-18 months in spite of a slight decline in production growth.

## 4.2 Households

Growth in household consumption has picked up so far this year, primarily driven by the buoyancy of domestic demand. Retail sales are now projected to rise by over 5% in 1996. New car registrations have so far this year been at a le-

**Chart 4.2** Retail sales index. Trend and seasonally adjusted. Index 1995=100



Source: Statistics Norway

vel corresponding to 140 000 on an annual basis, or 45% higher than in 1995. This rise may primarily be ascribed to the reduction in car taxes at the beginning of the year, but may also indicate that households have a greater capacity and propensity to consume. Consumption of goods other than cars showed a more moderate growth rate in the first half of 1996, but the retail sales index now points to higher growth also in other goods. Services have shown a stable growth of about 2<sup>1</sup>/<sub>2</sub>% so far this year.

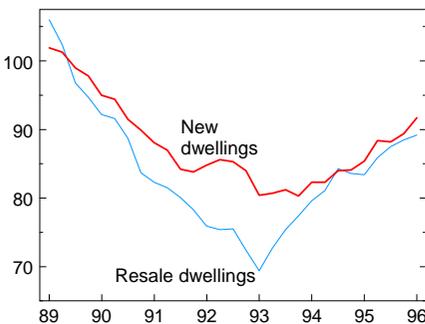
The growth in consumption reflects several successive years of fairly high growth in real income and a substantial improvement in household wealth. Household net wealth as a share of disposable income rose to the end of 1995. A further contribution came from positive saving in financial assets and higher share prices, in addition to the rise in house prices.

A continued sharp growth in household income is expected as wage and employment trends will provide a substantial contribution to the rise in real income even if price inflation edges up. House prices are also expected to show a sharper rise than consumer prices over the next 12-18 months. Car purchases, which are often looked upon as investment rather than consumption, account for a substantial share of consumption growth. Households' underlying saving behaviour has therefore not changed to the extent indicated by consumption figures alone.

Total consumption growth for this year is now projected at 4<sup>1</sup>/<sub>4</sub>%, which is a slight upward adjustment on the June *Inflation Report*, mainly as a result of higher growth in real income due to higher-than-projected employment gains. The household saving ratio is expected to fall by about half a percentage point between 1995 and 1996.

Consumption is projected to grow by 2<sup>3</sup>/<sub>4</sub>% for 1997, accompanied by a further marginal decline in the saving ratio. The decline in consumption growth between 1996 and 1997 mainly reflects the levelling off in car purchases and slightly slower growth in real income as a result of higher price inflation and slower employment growth.

**Chart 4.3** Real prices of dwellings. Index 1989=100



Source: Statistics Norway and ECON

### 4.3 Housing market

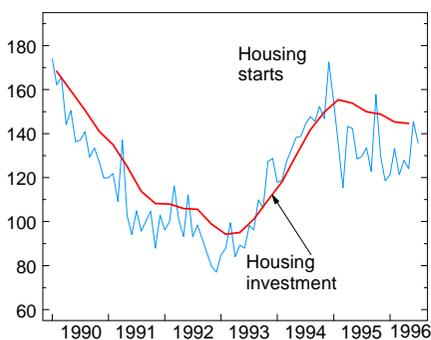
According to Statistics Norway's house price index, house prices were 8% higher in the first quarter of this year than one year earlier. Other house price indices indicate that the rise in house prices may have accelerated through the spring and summer. ECON's price index was 9% higher in the second quarter than one year earlier, and the indices used by OBOS, EXACT and NBBL show a 9-19% rise in house prices over the last 12 months.

With the prospect of continued high growth in real income, a decline in the State Housing Bank's lending rates, stable or declining interest rates at private financial instituti-

ons, and a generally optimistic household sector, housing demand should remain robust in the period ahead. On this basis, house prices are projected to continue to rise by a slightly higher margin than the general rise in prices. In real terms, house prices are projected to increase by 8% in 1996, slowing to 5% in 1997. Based on these projections, real house prices will still be about 20% lower at the end of 1997 than in 1987 when house prices started to decline.

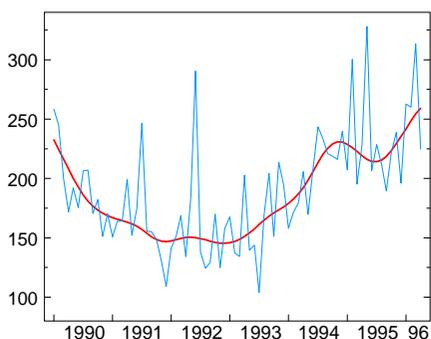
Following the sharp investment growth in the housing market in 1993-1994, housing starts fell in the latter part of 1995 and beginning of 1996 in spite of the improvement in households' financial position, which would normally engender a rise in housing investment. The shortage of serviced sites, the cold winter and buoyant demand for skilled construction workers for large building projects, such as the Gardermoen main airport and the National Hospital, may explain why residential construction was relatively low. Housing starts showed signs of picking up in June and July, see Chart 4.4. Housing investment is expected to edge down this year and rise by 6% in 1997. Our estimates imply housing starts of 19 000 in 1996 and a little more than 20 000 in 1997.

**Chart 4.4** *Housing starts and housing investment. Seasonally adjusted. Index 1993=100*



Source: Statistics Norway

**Chart 4.5** *Commercial building starts. 1000 sq.m. Seasonally adjusted and trend. Per month*



Source: Statistics Norway

#### 4.4 Business fixed investment

Preliminary national accounts figures show that mainland business fixed investment was 7% higher in the first half of this year compared with the first half of 1995. The main contribution came from distributive trades, transport and communications as well as manufacturing. Robust earnings, high capacity utilisation and the prospect of continued output growth both this year and next point to a continued high level of investment.

The investment intentions survey points to a high level of manufacturing investment this year and in 1997, though at a slower rate. The high level of imports of machinery and transport equipment also indicates a continued high level of investment. Commercial building starts were moderately higher in the first seven months of this year, and new orders for commercial buildings have exhibited brisk growth. The rise in commercial building rents also points to a high level of construction activity in the period ahead.

Mainland business fixed investment is projected to expand by 7<sup>1</sup>/<sub>2</sub>% this year, and continue to grow next year at a rate of about 3<sup>1</sup>/<sub>2</sub>%.

#### 4.5 Fiscal policy

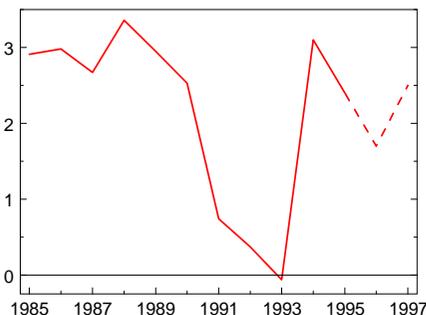
The proposed fiscal policy programme for 1996 in the Revised National Budget was briefly discussed in the June *Inflation Report*. Our estimates for public sector demand reflect

the budget programme in the Revised National Budget where public consumption is projected to expand by  $1\frac{3}{4}\%$  this year and about 1% next year. Growth in public investment is estimated at about 11% in 1996 and  $-2\frac{3}{4}\%$  in 1997. The sharp growth in public investment this year is primarily due to the vigorous rise in local government investment in connection with the school reform.

Tax receipts have been substantially higher in the first seven months of this year compared with the same period one year earlier. Whereas municipal tax revenues from income and wealth taxes rose by only 0.5% last year, these revenues so far this year have been almost 6% higher than in the same period last year. The pronounced rise in municipal tax revenues partly reflects the buoyant growth in employment so far this year. Higher local government revenues may result in higher expenditure. According to the quarterly national accounts, public consumption has expanded by 2% so far this year compared with the same period last year, with a substantial contribution coming from local government.

Along with tax receipts, growth in local government revenues is determined by municipal fees and transfers from the central government, which for 1997 will be decided in the budget deliberations this autumn. In the light of the sharp rise in municipal revenues this year, a growth in public consumption of only 1% next year, as called for in the Revised National Budget, will probably require a very tight local government programme in the 1997 budget. Higher growth in total local government revenues will translate into both higher GDP growth and higher employment growth in 1997 than our current projections would indicate, see section 1.4 on risks to the inflation outlook.

**Chart 4.6** GDP growth among trading partners. 12-month rise in per cent

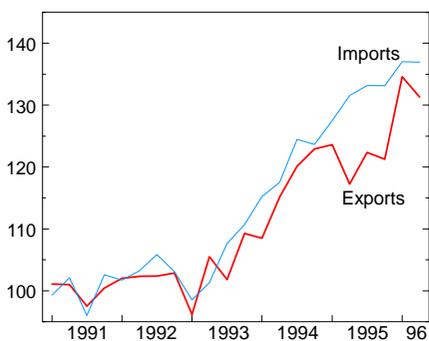


Source: OECD

## 4.6 Foreign trade

Continental Europe was hit by a cyclical downturn last autumn, mainly reflecting the absence of domestic growth impulses after exports started to decline. In spite of sluggish growth in the first half of this year, we assume that growth will pick up towards the end of the year and continue into 1997, partly driven by a more expansionary monetary policy in many countries. However, it is still uncertain to what extent fiscal retrenchment, which is being pursued in several countries at the same time, will influence economic trends. The robust growth of recent years is expected to continue in the US both this year and next. The Japanese economy is now showing signs of a recovery, with solid GDP growth in the first quarter. Our growth projection for the Japanese economy has been raised to  $3\frac{1}{2}\%$  this year, with GDP growth among trading partners projected at  $1\frac{3}{4}\%$  this year and  $2\frac{1}{2}\%$  next year, ie unchanged compared with the last *Inflation Report*.

**Chart 4.7** *Traditional merchandise exports and imports. Seasonally adjusted. Index 1991=100*



Source: Statistics Norway

Although economic growth among many trading partners has been sluggish, Norway's traditional merchandise exports have been at a substantially higher level so far this year than at the same time last year, see Chart 4.7. Exports to the UK, the US and smaller countries in Europe and Asia account for the largest share of the growth, but exports to other Nordic countries have also risen somewhat. The main contribution has come from fishery products, machinery and metals.

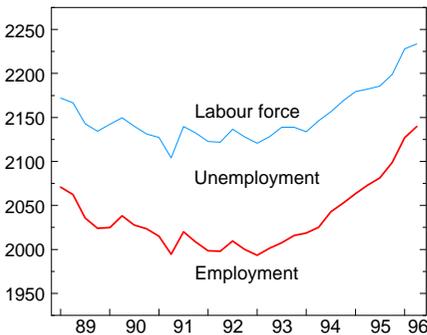
Foreign trade figures for July and August confirm signs of a levelling off and slight decline in the volume of exports in the second quarter from the high level in the first quarter. Exports are expected to continue levelling off in the second half of 1996, although annual growth may still reach 8<sup>1</sup>/<sub>4</sub>% this year. However, exports may rise to even higher levels as economic growth among trading partners picks up in 1997.

The level of export growth in the period ahead is somewhat uncertain. Exports of fish have made a substantial contribution to total export growth, and if other countries win support for their dumping accusations, fish exports may fall. In addition, higher electricity prices may curb the production of energy-intensive metal products, which may entail a gradual fall in exports.

Against this backdrop, traditional merchandise exports are projected to rise by about 6<sup>1</sup>/<sub>2</sub>% next year. Lower-than-projected export growth will primarily affect the current account. The impact on the domestic economy will mainly be determined by the effects of lower earnings in the export industry on wage growth.

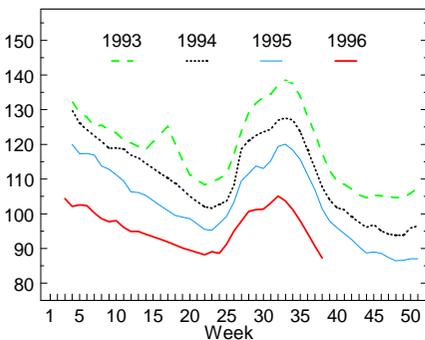
Traditional merchandise imports have been slightly lower thus far this year in relation to the projections in the June *Inflation Report*. Compared with the same period last year, imports of cars, capital goods and commodities still exhibited solid growth. Traditional merchandise imports are projected to rise by 5<sup>1</sup>/<sub>4</sub>% in 1996 and 4<sup>1</sup>/<sub>2</sub>% in 1997.

**Chart 5.1 Labour market.**  
Seasonally adjusted. Figures in 1000 persons



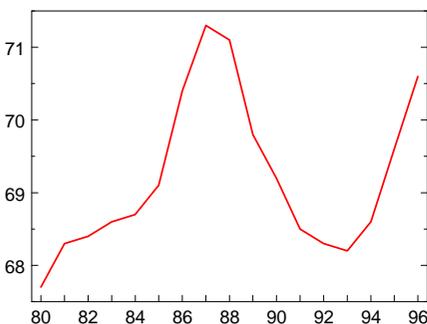
Source: Statistics Norway

**Chart 5.2 Registered unemployment.**  
Weekly figures, 1000 persons



Source: Directorate of Labour

**Chart 5.3 Participation rates.**  
Labour force in per cent of working-age population. Per cent



Source: Statistics Norway

second quarter of 1996. In the first half of 1996 employment grew by more than 3%, or 65 000, compared with the same period last year, with the highest growth recorded for distributive trades, manufacturing and health and social services. The number employed showed substantially higher growth than the number of man-hours worked. This partly reflects higher absenteeism due to illness and a larger share of part-time work, although the strikes this spring also had some impact. As a result of the change in the LFS at the beginning of the year, comparisons with earlier years are more uncertain. Statistics Norway has attempted to adjust for the effects of the changes, but the LFS figures should still be interpreted with caution. This report uses Statistics Norway's adjusted LFS figures. The official figures deviate slightly from this.

Although a large share of the rise in employment has been accompanied by higher labour force participation rates, seasonally adjusted unemployment fell from 4.8% in the first quarter to 4.3% in the second quarter. The Directorate of Labour's figures also show a decline in unemployment. In August, seasonally adjusted unemployment stood at 4.1%. The sum of unemployed and persons participating in ordinary labour market measures has fallen by 0.9 percentage point since the end of last year, and is now down to 5.6 per cent.

Slightly more moderate demand growth and a smaller decline in average working hours next year will probably contribute to curbing employment growth from an estimated 2<sup>3</sup>/<sub>4</sub> this year to about 1<sup>1</sup>/<sub>2</sub>% next year. A large share of the rise in employment is still expected to be offset by an expansion in the labour force. Demographic trends point to a growth in the labour force of about 1/2% annually. However, we also expect a continued rise in labour force participation rates. Unemployment is projected to fall from 4.9% in 1995 to 4<sup>1</sup>/<sub>4</sub>% in 1996. Unemployment is expected to continue to decline in 1997, and we estimate that the unemployment rate may be reduced to well below 4% towards the end of next year.

## 5.2 Wages

Total wage growth was projected at 4<sup>1</sup>/<sub>4</sub>% in 1996, rising to 4<sup>3</sup>/<sub>4</sub>% in 1997, in the June *Inflation Report*. The estimate for 1996 was based on the outcome for this year's wage settlements and historical information about wage drift. Higher

price inflation and a somewhat tighter labour market next year were two of the factors underlying the projected rise in wage growth in 1997.

Wage statistics from the Confederation of Norwegian Business and Industry for the first quarter showed an hourly wage growth for manufacturing workers of 4.2% compared with the first quarter of 1995. The average growth in wages in 1995 was 3.4%. A number of enterprises reported that annual bonuses were the reason behind the relatively high wage growth in the first quarter. Wage growth in the construction industry was on a par with that of the manufacturing sector in the first quarter. Wage growth in this sector has shown a steady rise since the first quarter of 1994.

Based on the wage growth recorded up to the first quarter of 1996 and the wage settlements concluded, the Technical Reporting Committee on Income Settlements estimates annual wage growth in manufacturing at 3.3% *not including* wage drift for the last three quarters of 1996. Last year, wage drift contributed 0.9 percentage point to annual wage growth in the last three quarters. A large share of the local negotiations in manufacturing have now been completed and the outcome indicates that wage drift will contribute slightly more to annual wage growth this year than in 1995. On this basis, annual wage growth in manufacturing industry is projected at 4<sup>1</sup>/<sub>2</sub>% this year. For the public sector, service industries and distributive trades, wage growth is estimated at about 4%. Combined, this implies an annual wage growth for mainland Norway of about 4<sup>1</sup>/<sub>4</sub>% in 1996.

Several factors point to higher nominal wage growth next year compared with this year:

- The wage carry-over in several sectors will be substantially higher in 1997 than the carry-over into 1996. If wage growth in 1997 is the same as in 1996, annual wage growth will then be higher next year.
- Price inflation is projected to rise from 1<sup>1</sup>/<sub>4</sub>% this year to 2<sup>1</sup>/<sub>2</sub>% next year.
- Employment is projected to show continued buoyant growth. This will result in both higher labour force participation rates and a decline in unemployment.
- Regional figures for the ratio of unemployed to the number of vacancies may indicate the build-up of pressures in some regional labour markets, particularly in the densely populated eastern region of Norway, see box on regional variations in the labour market. Statistics Norway's cyclical barometer shows that 4% of enterprises report a shortage of skilled labour as a factor limiting production. This share has been around 1% for a good number of years.

## Regional variations in the labour market

The most common measure of tightness in the labour market is unemployment. This indicator, however, does not capture any growing mismatch resulting from such factors as skills requirements. One indicator of labour market tightness which can to some extent capture such factors is the ratio of the number of registered unemployed to the number of vacancies.

This can be illustrated by comparing the two counties Østfold and Oslo. In 1995, the unemployment rates for these two counties were the same. Measured in terms of unemployment the tightness of the labour market was also the same. The ratio of the number of unemployed to the number of vacancies in Østfold was, however, close to 24 in 1995, whereas the figure for Oslo was about 8. This indicator reflects a much higher degree of tightness in the labour market in Oslo than in Østfold, although the unemployment rates for the two counties are the same. It therefore seems that labour market mismatches are greater in Oslo than in Østfold.

The ratio of unemployed to vacancies was about 3 for the country as a whole in 1986. The ratio then rose in pace with the rise in the number of unemployed, reaching almost 20 in 1992, see Chart 1. Subsequently, the ratio gradually declined, and has on average remained just below 10 thus far this year.<sup>1</sup> On a national basis the ratio of unemployed to vacancies has thus returned to the level prevailing at the end of 1988.

<sup>1</sup> There is a break in vacancy statistics as from 1995.

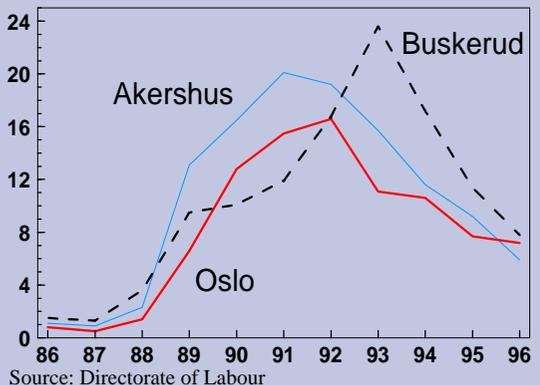
**Chart 1** Ratio of number unemployed to vacancies. Entire country. Per cent



As illustrated by the example above, the ratio shows wide regional variations both in terms of level and change over time. In the densely-populated eastern region of Norway (Oslo, Akershus and Buskerud), the ratio has decreased considerably in recent years, see Chart 2. The chart illustrates that the labour market in these three counties, which account for about 30% of the working population in Norway, experienced a shortage of labour up to 1988. Subsequently, the ratio of unemployed to vacancies rose to the end of 1992. The chart shows that this ratio is now lower than in 1989, both in Akershus and Buskerud, whereas the ratio for Oslo is now close to the level prevailing in 1989. However, it is still substantially higher than the level in 1988. All three counties are below the national average. Only in Sogn and Fjordane and in Møre and Romsdal is the shortage of labour greater measured by this indicator. However, the indicator shows a less dramatic decline in the northwestern region of the country than the densely-populated eastern region.

The ratio is also declining in most other parts of the country, but is still higher than the levels in the eastern counties. In Østfold, for example, the ratio has declined from 25 in the first half of last year to 18 in the first half of 1996, while the ratio for Nord-Trøndelag dropped from 17 to 15. The ratio for Finnmark, on the other hand, has risen over the last year.

**Chart 2** Ratio of number unemployed to vacancies. Selected counties. Per cent



Wage growth is projected at about 5% next year, based on previous experience relating to wage formation during a cyclical upturn as embodied in Norges Bank's macroeconomic model RIMINI.

Wage growth in manufacturing industry in major trading partner countries is projected at about 3<sup>3</sup>/<sub>4</sub>% this year and 4<sup>1</sup>/<sub>4</sub>% next year. On the technical assumption that manufacturing industry's average effective exchange rate the past month remains at an unchanged level to the end of the year, our estimate for wage growth implies that competitiveness as measured by relative unit labour costs in a common currency will weaken by a little more than 1% in the period 1996-1997.

The social partners recognise that a continued high level of competitiveness and low price and wage inflation will make a significant contribution to durable employment growth. This means that the moderation shown in wage settlements may continue to influence wage growth in the years ahead and that wage growth may thus be lower than our current projections.

### 5.3 Productivity

Wage growth which is not offset by equivalent productivity gains may influence the prices charged by enterprises and thereby fuel price pressures in the economy. So far in this cyclical upturn productivity has not shown any substantial rise. Nor is productivity growth expected to accelerate substantially this year or next. Mainland productivity growth is estimated at 1<sup>1</sup>/<sub>4</sub>% both in 1996 and 1997. Based on our estimates for wage growth, unit labour costs for mainland Norway will rise by about 3% this year and 3<sup>3</sup>/<sub>4</sub>% next year.

### 5.4 Profit margins

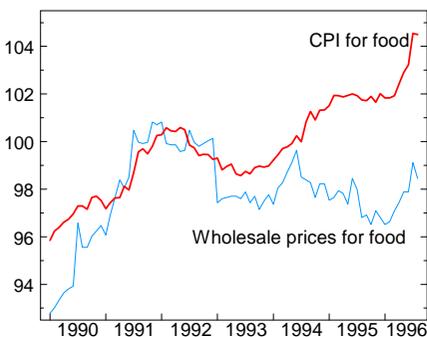
Changes in profit margins have an impact on price trends. This section presents various indicators of profit margins in some sectors.

Charts 5.4-5.6 show the movement in wholesale price indices for various consumer goods and the consumer price index for the same goods. There is a slight divergence between these two indices with regard to the goods included. Furthermore, changes in the VAT rate will have an impact on the consumer price index but not on wholesale prices.

In the food sector, profit margins have tended to rise since mid-1994 and through 1995. Since the beginning of 1996 food prices have increased by 3% in the wholesale sector and by a little less than 5% in the retail sector. The sharp rise in the retail sector partly reflects the removal of VAT compensation for some food products.

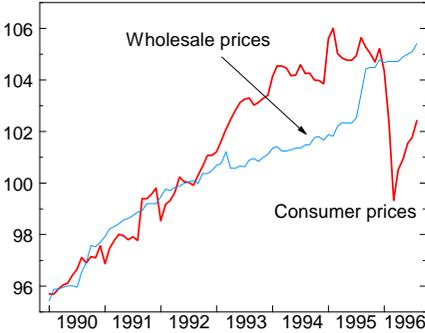
In the clothing and footwear sector, the indices reflect a sharp rise at the wholesale stage in mid-1995, whereas prices

**Chart 5.4** *Indicators of profit margins in food retailing. Seasonally adjusted. Index 1992=100*



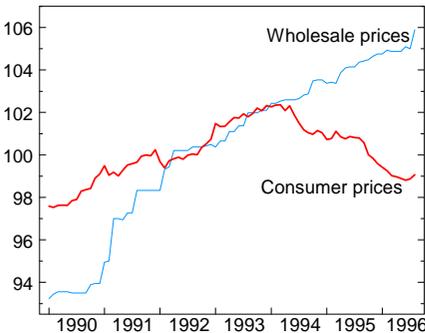
Source: Statistics Norway

**Chart 5.5** Indicators of profit margins in clothing and footwear retailing. Seasonally adjusted. Index 1992=100



Source: Statistics Norway

**Chart 5.6** Indicators of profit margins in furniture retailing. Seasonally adjusted. Index 1992=100



Source: Statistics Norway

at the retail stage plummeted from January 1996. The profit margins in this sector have therefore fallen sharply through the winter months. In recent months retail prices for clothing have edged up, accompanied by an improvement in profit margins.

In the furniture sector, it would appear that profit margins have moved on a downward trend since the beginning of 1994, which has continued into this year. This may reflect intensified competition in this sector, with an increased concentration of large furniture outlets.

The prices of new detached dwellings have risen by a greater margin than building costs since the beginning of 1995. This may reflect an improvement of profit margins in the construction industry. However, some of the rise in prices of new dwellings may be due to higher building site prices. This is not captured in the building cost index.

All in all, the changes in profit margins are not expected to make any significant contribution to the rise in consumer prices this year or next. On the other hand, stronger demand growth may lead operators to raise their mark-ups. Lower import prices may also prompt importers to increase their margins. Ongoing structural changes and sound earnings will contribute to continued pressure on margins in the retail trade. A moderate rise in import prices may also contribute to continued pressure on margins for Norwegian production.

## Main macroeconomic aggregates

*Percentage change from previous year, if not otherwise stated*

	Accounts 1995	1996	1997
<b>Real economy</b>			
Private consumption	2.6	4 <sup>1</sup> / <sub>4</sub>	2 <sup>3</sup> / <sub>4</sub>
Public consumption	0.2	1 <sup>3</sup> / <sub>4</sub>	1
Total gross investment	4.5	4 <sup>1</sup> / <sub>4</sub>	2 <sup>1</sup> / <sub>2</sub>
Accrued oil investment	-13.1	2 <sup>1</sup> / <sub>4</sub>	2
Mainland Norway	13.5	6	2 <sup>1</sup> / <sub>2</sub>
Enterprises	19.5	7	3 <sup>1</sup> / <sub>2</sub>
Dwellings	12.7	-2 <sup>1</sup> / <sub>4</sub>	6
General government	-0.5	11 <sup>1</sup> / <sub>4</sub>	-2 <sup>3</sup> / <sub>4</sub>
Mainland demand	3.8	4	2 <sup>1</sup> / <sub>4</sub>
Exports	3.8	8 <sup>1</sup> / <sub>4</sub>	5
Oil, gas and pipeline transport	8.4	15	4 <sup>1</sup> / <sub>2</sub>
Traditional goods	4.1	8 <sup>1</sup> / <sub>4</sub>	6 <sup>1</sup> / <sub>2</sub>
Imports	5.1	4	3 <sup>3</sup> / <sub>4</sub>
Traditional goods	9.1	5 <sup>1</sup> / <sub>4</sub>	4 <sup>1</sup> / <sub>2</sub>
GDP	3.3	5	3
Mainland Norway	2.7	3 <sup>1</sup> / <sub>4</sub>	2 <sup>1</sup> / <sub>2</sub>
<b>Labour market<sup>1)</sup></b>			
Employment, LFS	2.1	2 <sup>3</sup> / <sub>4</sub>	1 <sup>1</sup> / <sub>2</sub>
Labour force, LFS	1.6	2	1
Unemployment, LFS	4.9	4 <sup>1</sup> / <sub>4</sub>	4
<b>Prices and wages</b>			
Consumer prices	2.4	1 <sup>1</sup> / <sub>4</sub>	2 <sup>1</sup> / <sub>2</sub>
Annual wages	3.0	4 <sup>1</sup> / <sub>4</sub>	5
Import prices, traditional goods	0.7	<sup>1</sup> / <sub>4</sub>	1
Export prices, traditional goods	7.1	-1 <sup>1</sup> / <sub>4</sub>	1 <sup>1</sup> / <sub>2</sub>
Crude oil prices, NOK	107.5	127	118
<b>External account</b>			
Trade surplus, NOK bn	56	88	90
Current account surplus, NOK bn	28	69	76
Current account surplus, % of GDP	3.1	7	7 <sup>1</sup> / <sub>4</sub>
<b>Memorandum item</b>			
Household saving ratio	7	6 <sup>1</sup> / <sub>2</sub>	6 <sup>1</sup> / <sub>4</sub>

<sup>1)</sup> The figures for the labour market are based on Statistics Norway's adjusted LFS figures, which may diverge slightly from official LFS figures.

Source: Statistics Norway and Norges Bank