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Meld. St. 1

(2022–2023)

Report to the Storting (white paper)

The National Budget 2023

2 The Norwegian Economy

The Norwegian economy has recovered rapidly following the pandemic. The labour market is now very tight, wage growth appears to be on the rise and inflation has reached its highest levels in decades. Tighter economic policy is now necessary. Growth is expected to be lower going forward, but how strong the slowdown will be and how quickly it will come is uncertain.

Inflation is now markedly higher than both the Ministry of Finance and other forecasters projected only a short time ago. Consumer price growth has been driven up by higher electricity prices in southern Norway and increased fuel prices, but inflation excluding energy goods has also risen. Initially, price increases were highest for imported goods, but in recent months price growth for domestically produced goods and services has accelerated and is now higher than for imported goods. Going forward, even more of the inflation impulses are expected to come from domestic conditions, including higher wage growth.

High inflation is a burden for households and businesses. Previous periods of high inflation illustrate that hard priorities in economic policy may be needed. Should inflation remain high it may be necessary to tighten policy substantially in order to rein in wage and price growth. This could lead to a contraction in output and an increase in unemployment. Norges Bank increased interest rates before many other central banks. The key policy rate is currently 2.25 per cent, following increases since last autumn. Further interest rate hikes have been announced due to prospects for more sustained high price growth. In setting interest rates Norges Bank also emphasises consideration of high and stable employment. In light of prospects for weaker economic developments, Norges Bank has stated that the interest rate will not be raised as much in future as inflation targeting in isolation might suggest.

Russia's invasion of Ukraine has had a major effect on the European economy. Suspension of gas deliveries has led to enormous price increases for energy and has raised the question of energy rationing in Europe this winter. Norway has increased its gas production as much as

possible to remedy the situation in Europe. Overall, an increase in gas sales of around 8 per cent is expected from 2021 to 2022. Energy prices affect the prices of many goods and services and are one of the contributing factors to the strong increase in inflation in many parts of the world.

A strong increase in demand for goods during the pandemic combined with supply side bottlenecks contributed to increases in the prices of internationally traded goods. Over the past year food prices have increased significantly. Extreme drought has resulted in poor harvests in many regions, while the war in Ukraine, also referred to as the breadbasket of Europe, has helped push up food prices. While lockdowns limited household spending opportunities, expansionary monetary and fiscal policy helped maintain purchasing power. When societies reopened, pent-up household demand boosted consumption of goods and services, without supply being able to keep up.

High inflation was long considered to be transitory. Just a few months ago central banks assumed that interest rates could be normalised gradually. Recently it has become clear that inflation has become more broad-based. Central banks have therefore changed their strategy and are now resolutely increasing interest rates and communicating that they will stand by their mandates to bring inflation down, even if this entails significantly weakening growth. A situation where wage and price growth spiral out of control would be even more costly and demanding. Global growth is expected to slow considerably going forward and the risk of a sharp drop in the activity of our trading partners has become greater. If the tightening needed to curb inflation weakens global growth substantially this would also impact the Norwegian economy.

Although economic developments in Norway are similar to those of our trading partners, the forecasts in this report are for the Norwegian economy to avoid a marked setback and a significant increase in unemployment. Norges Bank began monetary policy tightening before many other central banks. As Norway is a net exporter of energy, high gas prices in isolation will contribute to increased activity in the petroleum sector and significant revenue for both energy companies and the state. Conversely, periods of large falls in energy prices hit the Norwegian economy harder than other countries, as witnessed during the oil price declines of 2014.

While gas prices in Europe have reached record highs, weaker global growth prospects have pulled oil prices down, see figure 2.1. Market expectations are for a continued decline in oil prices to levels lower than we projected in the revised national budget in May of this year. Investment on the Norwegian continental shelf is expected to increase in 2024. This will boost activity in the non-oil economy after four years of negative contributions. The increase should be seen against a backdrop of high gas prices and the temporary and favourable changes in petroleum taxation that were adopted when the oil price declined in spring 2020.

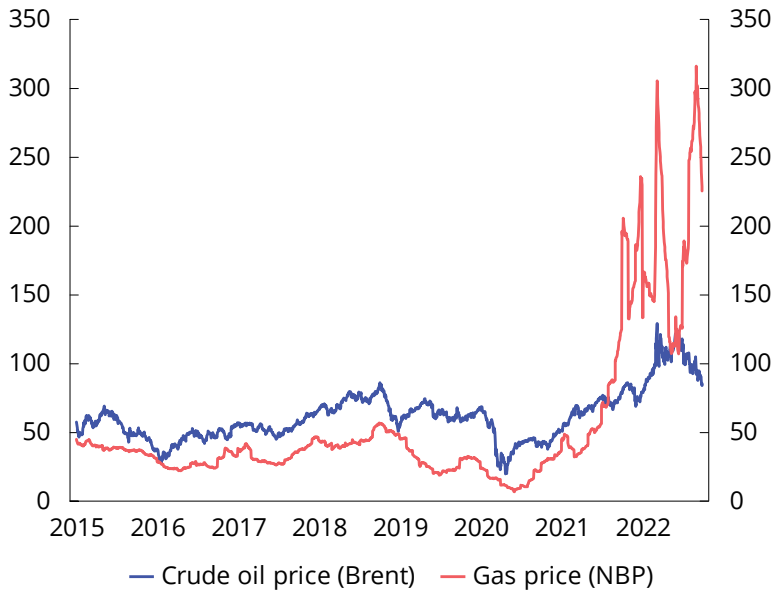


Figure 2.1 Crude oil price (Brent) and gas price in Europe. USD per barrel. Daily observations

Sources: Intercontinental Exchange (ICE) and Macrobond.

The labour market is tight, and unemployment is very low. After falling significantly through the first half of this year, registered unemployment was 1.6 per cent in August and September, its lowest level since 2008, see figure 2.2. The number of employees increased further through the summer, but at a more subdued pace than earlier this year, see figure 2.3. Since the second quarter of last year employment has grown by 150,000 persons. The employment rate has increased substantially the last half a year, see figure 2.3. There is a record number of vacancies, see figure 2.4, and employers report major problems in recruiting within several professions. Short-term immigration is still significantly lower than before the pandemic. This may have made it more difficult to fill vacancies. Since the revised budget, the unemployment forecast for this year has been revised downwards, while the employment forecast has been revised upwards.

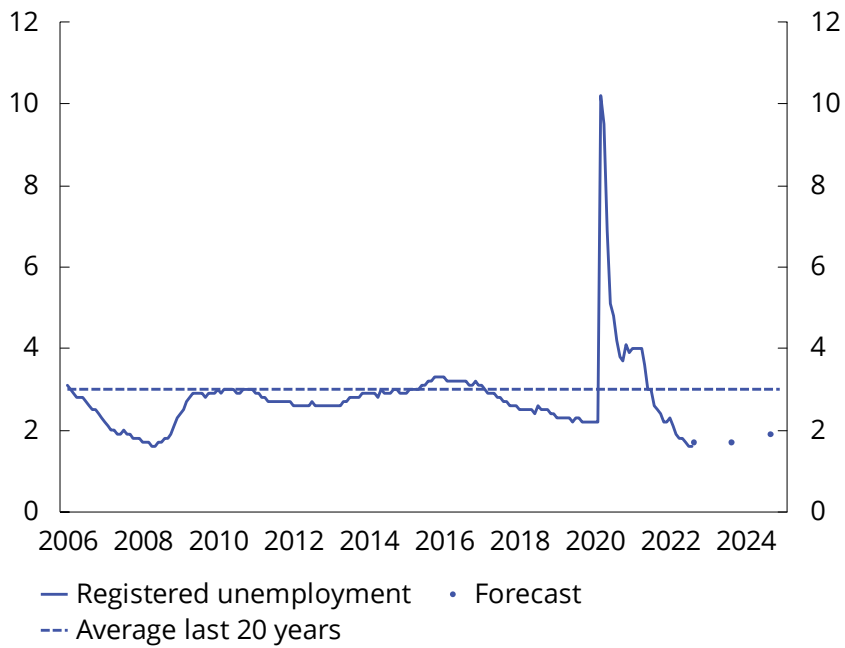


Figure 2.2 Registered unemployment as pct. of the labour force. Jan. 2006 - Jul. 2022. Seasonally adjusted. Annual forecasts for 2022, 2023 and 2024

Sources: The Norwegian Labour and Welfare Administration and the Ministry of Finance.

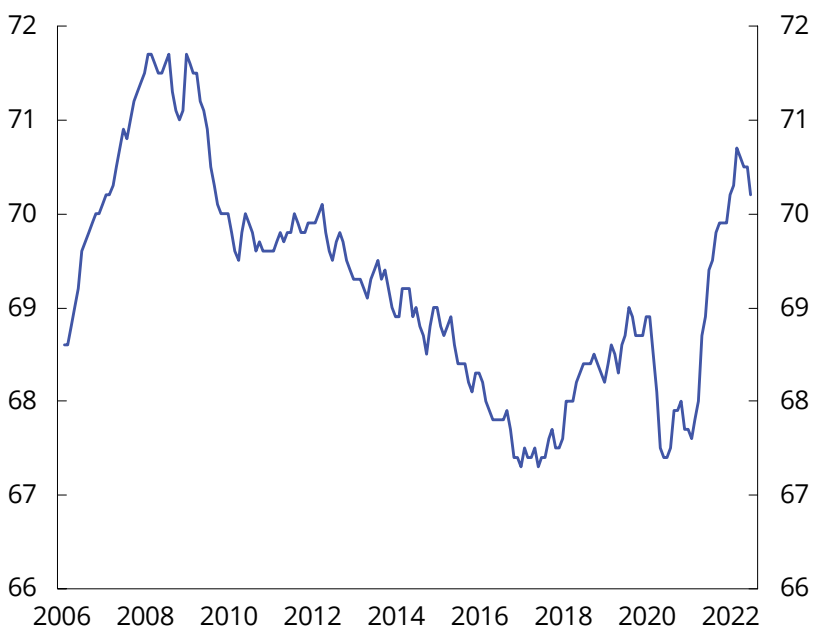


Figure 2.3 Employed as a percentage of the population 15-74 years old. Feb. 2006 - Jun. 2022. Three month moving average. Adjusted for seasonality and breaks

Source: Statistics Norway

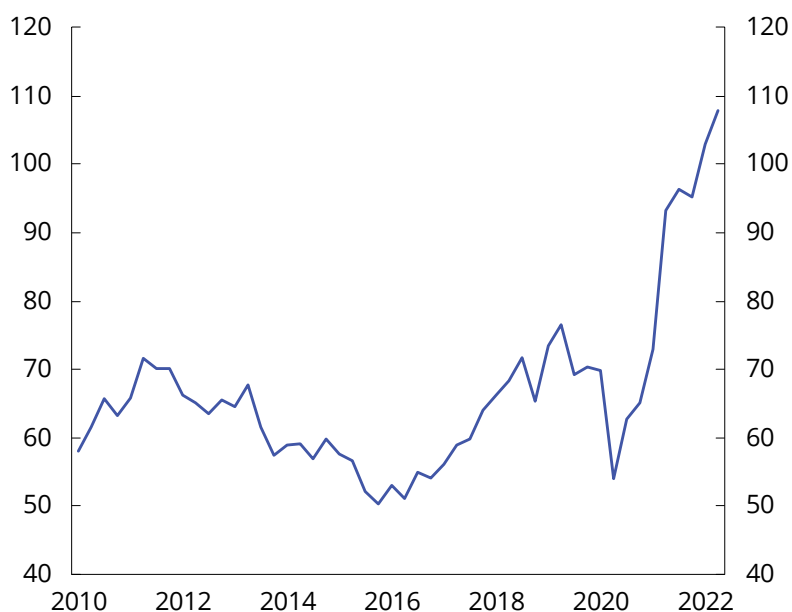


Figure 2.4 Vacant positions. 1,000 persons. Seasonally adjusted. 2010 Q1–2022 Q2

Source: Statistics Norway

Labour market pressure is expected to boost wage growth. According to Norges Bank's expectations survey, which was carried out in the third quarter, the social partners expect wage growth of 4.4 per cent next year. This is an upward revision of 0.7 percentage points from the previous quarter. In the current year overall wage growth is expected to be higher than the wage norm of 3.7 per cent. This is in part due to the settlement in the state and municipal sector ending somewhat higher and because wage growth is also affected by additions that are granted outside the central collective bargaining settlements. Given labour market tightness, employers may be willing to increase wages significantly in order to attract or retain well-qualified labour. High demand for goods and services may also allow firms to pass on cost increases to their customers, leading to further price increases. This can trigger higher wage demands, which in turn can increase price. Economic policy currently aims to mitigate the risk of such wage-price spirals. Wage growth is projected to be 4.2 per cent next year.

Table 2.1 Main aggregates for the Norwegian economy. Percentage volume change from the previous year, unless stated otherwise

	Billion NOK ¹				
	2021	2021	2022	2023	2024
Private consumption	1,616.0	4.9	5.9	1.4	2.3
Public consumption.....	968.3	3.8	0.0	1.3	.
Gross investment in fixed capital.....	960.5	-0.9	2.3	0.3	3.5
Of which: Petroleum extraction and pipeline transp.	178.7	-2.7	-4.5	-2.2	7.8
Businesses, mainland Norway	353.5	2.2	6.8	0.3	4.1
Housing.....	206.5	0.6	-0.7	1.6	0.3
Public sector.....	219.5	-4.0	3.2	0.8	.
Mainland demand ²	3,363.8	3.4	3.7	1.3	2.1
Exports.....	1,721.9	4.7	2.1	5.6	2.3
Of which: Crude oil and natural gas	861.7	2.8	1.6	8.3	2.0
Mainland exports	717.7	4.9	1.5	4.1	3.5
Imports.....	1,214.2	2.3	8.3	1.1	3.2
Gross domestic product.....	4,141.9	3.9	2.7	2.8	1.9
Of which: mainland Norway.....	3,267.4	4.1	2.9	1.7	2.0
Other key figures:					
Employment, persons.....		1.2	3.3	0.8	0.3
Unemployment rate, LFS (level)		4.4	3.2	3.2	3.4
Unemployment rate, registered (level).....		3.1	1.7	1.7	1.9
Annual wage		3.5	3.9	4.2	.
Consumer price index (CPI)		3.5	4.8	2.8	2.4
CPI-ATE		1.7	3.2	3.1	2.8
Crude oil price, NOK per barrel (current prices)		609	986	912	845
Crude oil price, USD per barrel (current prices)		71	103	91	85
Three-month money market rates, pct. ³		0.5	2.1	3.7	3.6
Import-weighted exchange rate, annual change. ⁴		-5.7	1.5	1.7	0.0

¹ Provisional figures from the national accounts in current prices.

² Excluding inventory changes.

³ Assumption used in calculations based on forward prices.

⁴ Positive figures indicate weaker NOK.

Sources: Statistics Norway, OECD, IMF, international central banks, national sources, Norges Bank, the Norwegian Labour and Welfare Administration, Reuters and the Ministry of Finance.

Inflation has in recent months reached its highest levels since 1988. From August last year to August this year, the consumer price index (CPI) rose by 6.5 per cent, see figure 2.5. Excluding the support scheme for electricity, Statistics Norway has calculated that the increase would have been 9.0 per cent. Underlying inflation, measured by the CPI adjusted for tax changes and excluding energy products, has also risen markedly since last autumn and indicates that inflation is broad-based. The underlying inflation rate was 4.7 per cent in August, the highest level recorded since measurements began in 2001. The prices of both domestically produced goods and imported goods have risen markedly. Developments should, among other things, be viewed in the context of higher prices abroad.

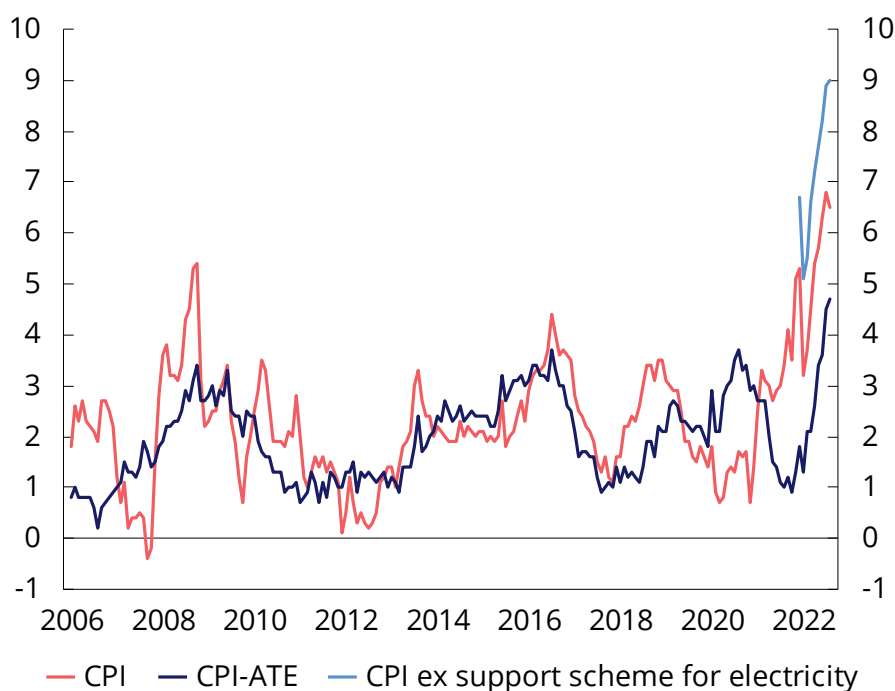


Figure 2.5 Consumer price growth with and without support scheme for electricity¹. Percentage change from the same month the year before. Jan. 2006 – Aug. 2022

¹ In order to calculate the electricity subsidy scheme's effect on the CPI Statistics Norway has calculated a hypothetical index where the electricity subsidy has been removed so that electricity is measured at market prices and the grid rent is at the same level as before the electricity subsidy scheme, all other things being equal. Statistics Norway caution that they do not know what the market price of electricity would have been in the absence of the government's measures.

Source: Statistics Norway.

The futures market for electricity indicates that electricity prices will remain high through 2023. The government proposes that the household support scheme for electricity be extended through 2023, with a threshold of 70 øre in all quarters and a subsidy rate of 90 per cent (of costs above 70 øre, up to a ceiling of electricity consumption per household) in the first and fourth quarters and 80 per cent in the second and third quarters.

Going forward, a larger part of the inflation impulses is expected to come from domestic conditions, including from higher wage growth. While favourable labour market developments and increased aggregate demand will help maintain underlying inflation high, headline inflation is estimated to decline over the next few years. Underlying inflation is projected to be around 3 per cent in the next few years, while headline inflation is projected to fall from 4.8 per cent in 2022 to 2.8 per cent in 2023. Without the electricity support scheme, the forecast for the CPI would have been 7.2 per cent in 2022 and 5.2 per cent in 2023. The inflation forecasts in this report are finalised early because they are included in many calculations in the state budget. The high inflation figures that came in for July and August,

after the inflation forecasts were finalised, indicate that CPI growth may be somewhat higher than projected in this report.

Increased electricity prices affect Norwegian business in different ways. In the Norwegian Confederation of Enterprises' member survey for August, more than half of members in southern Norway responded that electricity prices will result in a large or medium-sized reduction in operating profit, while one in five companies responded that increased electricity prices will result in lower activity. Nevertheless, figures from Statistics Norway show that for the vast majority of companies in southern Norway consequences of increased electricity prices are relatively limited. They find that 91 per cent of revenue in southern Norway occurs in companies where the increase in electricity costs amounts to less than 2 per cent of the company's revenues. Less than 5 per cent of revenue in southern Norway occurs in companies where the cost increase amounts to more than 4 per cent of revenues. The calculations are based on an average price increase from 40 to 160 øre per kilowatt hour, which was the increase in the average annual area price from the first half of 2019 to the first half of 2022. With a spot price of 400 øre per kilowatt hour, the cost increase is three times as great. This is still moderate compared to revenue. For some companies, electricity makes up a larger proportion of the input factors. The schemes proposed by the government, which includes improved access to fixed price agreements for all end users and an energy subsidy loan guarantee scheme for companies with electricity costs that correspond to at least 3 per cent of turnover in the first half of 2022, are estimated to help around 20,000 companies in areas with particularly high electricity prices. Around 100 Norwegian firms in power-intensive industry consume almost as much electricity as all Norwegian households combined. These firms have such a high electricity consumption that it is reasonable to assume that they have entered into fixed price agreements.

The latest survey of Norges Bank's regional network shows that activity in Norwegian business is still very high and that labour shortages are the main factor limiting production. Several industries expect lower demand to lead to a fall in production in the next six months, see figure 2.6. The proportion of companies reporting that a lack of labour and production inputs is limiting production has decreased somewhat from the preceding quarter, see figure 2.7. At the same time, both Norges Bank's regional network and Statistics Norway's survey of manufacturing firms indicate that manufacturing investment will increase going forward.

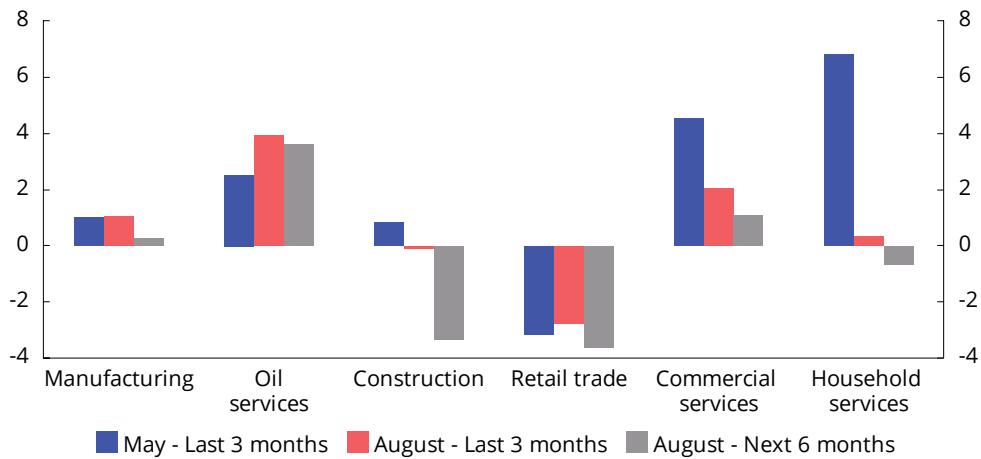


Figure 2.6 Output growth the last three months and expected growth the next six months in Norges Bank’s regional network. All sectors. Seasonally adjusted. Annualised. Per cent

Source: Norges Bank.

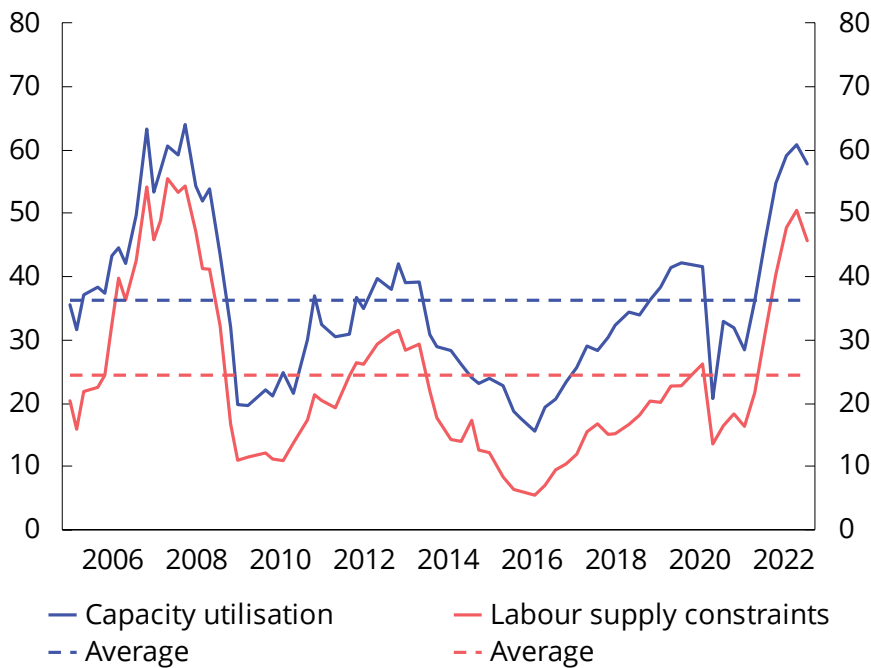


Figure 2.7 Capacity utilisation and labour supply constraints in Norges Bank’s regional network. Per cent. 2005 Q1 – 2022 Q3

Source: Norges Bank.

After two years of infection prevention measures and historically high savings, household consumption increased rapidly as measures were eased, see figure 2.8. Going forward, consumption growth is expected to moderate, partly as pent-up demand is gradually being depleted and partly due to higher prices, higher interest rates and increased economic

uncertainty. Households' assessment of their own financial situation has fallen to historically low levels recently, both in Norway and abroad.

Uncertainty and deteriorating confidence can lead to increased precautionary savings. At the same time, Norwegian households still have larger financial buffers than before the pandemic, better equipping them to face higher interest rates and consumer prices. In 2020 and 2021, households saved a total of over NOK 360 billion, or NOK 140,000 on average per household. Still, there are large differences between households, and not all have had the opportunity to save.

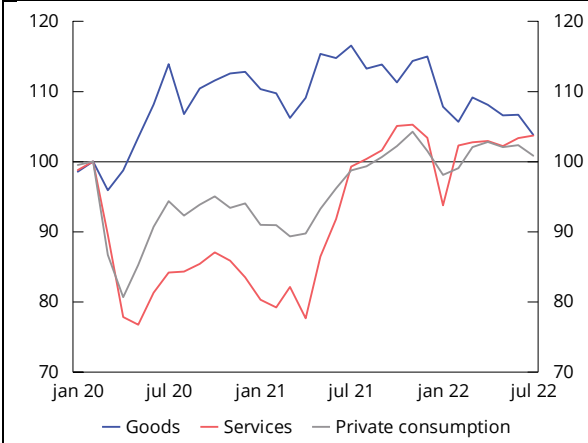


Figure 2.8 Private consumption.
Seasonally adjusted. Index. February 2020 = 100

Source: Statistics Norway.

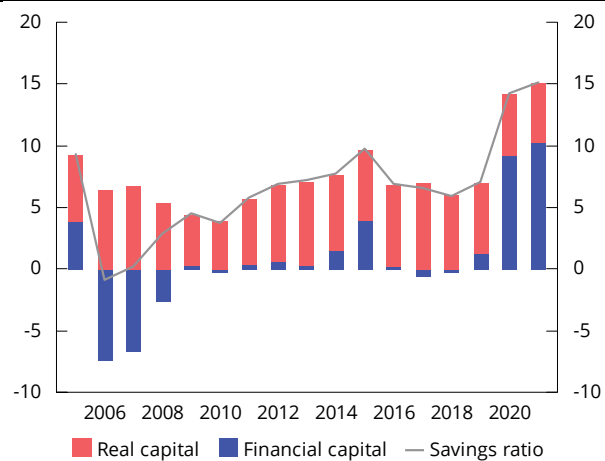


Figure 2.9 Household¹ savings ratio.
Real and financial capital².

- 1) Includes non-profit organisations.
- 2) Excluding capital transfers, including net acquisition of high-value objects.

Source: Statistics Norway.

Norwegian households have a lot of debt and spend a relatively large proportion of their income on servicing interest and repayments. Measured as a share of income, debt has reached a very high level and higher than in most other OECD countries. In addition, floating interest rates on mortgages are far more common in Norway than abroad. Overall, this means that the effect of interest rate increases for Norwegian households has increased and is greater than in most other OECD countries. The normalisation of interest rates and the further increases that have been projected by Norges Bank will contribute to a significant increase in monthly mortgage payments.

Higher interest rates also contribute to greater uncertainty about future developments in the housing market. House price growth was strong throughout the pandemic but slowed through the autumn of last year. Price growth has again been high so far this year, see figure 2.10. The strong price increase so far this year must be seen in the context of a low supply of housing, see figure 2.11. Low supply is probably linked to the new Disposal Act, which came into

force on 1 January. The act imposes stricter requirements on condition reports for property sales. The new requirements appear to have delayed the process of listing homes for sale. This has contributed to temporarily reducing supply leading to price pressure in the market. Going forward supply is likely to increase as the effects of the Disposal Act gradually dissipate.

A further increase in mortgage rates will probably dampen the demand for housing. If the interest rate is raised higher and more rapidly in future, this could dampen demand so much that prices start to fall, as we have seen in Sweden, following almost 30 years of near-continuous growth. A marked fall in house prices, with subsequent tightening of consumption and increased losses in the banks, could trigger a strong economic setback.

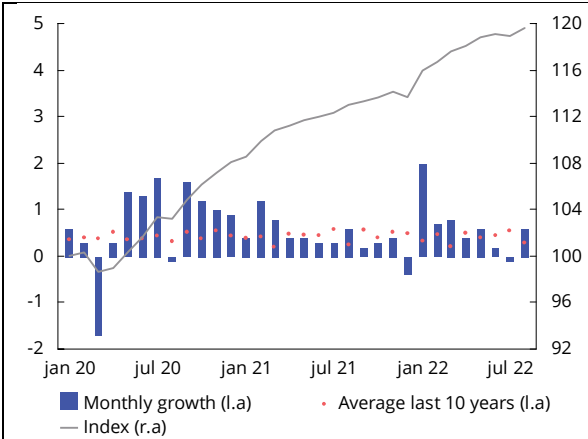


Figure 2.10 Seasonally adjusted monthly growth and price index for existing homes. January 2020 = 100. Per cent

Sources: Real Estate Norway, Finn.no and Eiendomsverdi.

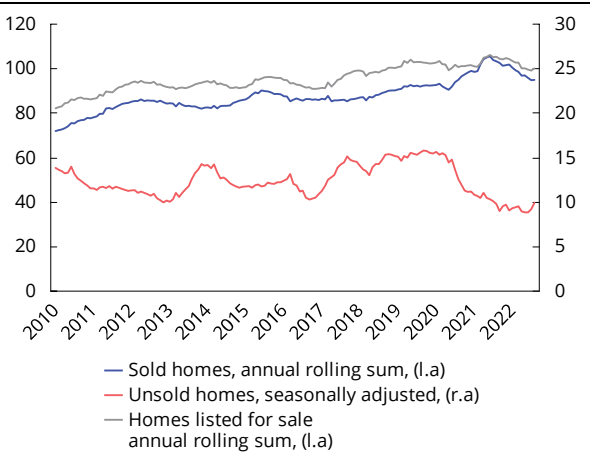


Figure 2.11 Turnover and number of homes listed for sale. Jan. 2020 – Aug. 2022. 1,000 homes

Sources: Real Estate Norway, Finn.no and Eiendomsverdi.

Overall, activity growth in the Norwegian non-oil economy, measured by mainland GDP, has moderated recently after a strong recovery at the beginning of the year. Growth in the non-oil economy is nevertheless projected to remain somewhat higher than the estimated trend growth of around 1¾ per cent.

Uncertainty about future economic developments is unusually high. The economic slowdown may come sooner than projected in this report. Very weak consumer confidence and more subdued expectations from the companies in Norges Bank's regional network suggest that economic growth may already be slowing, while labour market pressure remains high. Unemployment is estimated to remain very low in the future, and many employers will still have great difficulty in recruiting labour.

Russia's warfare in Ukraine and the suspension of gas supplies to Europe contribute to uncertainty about future developments. A rapid end to the war and restoration of gas supply to

Europe would help bring inflation down. However, if the conflict escalates and becomes more long-lasting than anticipated this would lead to a more significant setback for Europe than projected in this report.

There is a clear expectation among Norwegian forecasters that growth in the Norwegian economy will slow, although it is difficult to estimate how quickly and by how much. Slower growth would be a natural development in a situation where production is facing capacity constraints, firms are struggling to recruit, inflation is very high and economic policy is being tightened. Growth in the Norwegian economy is nevertheless expected to decline less than growth abroad.