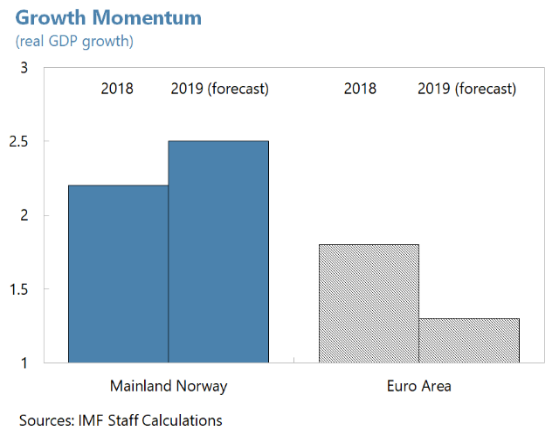
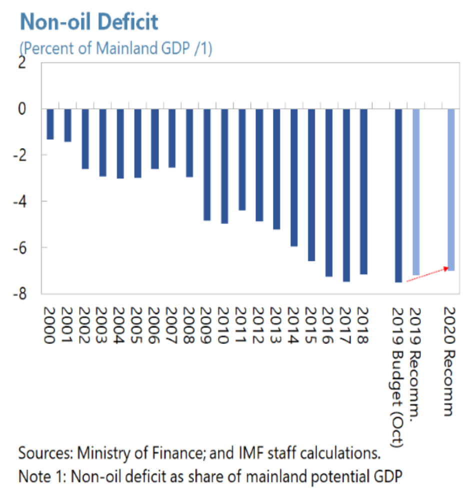
Summary of conclusions of the IMF Mission (April 25–May 6 2019)

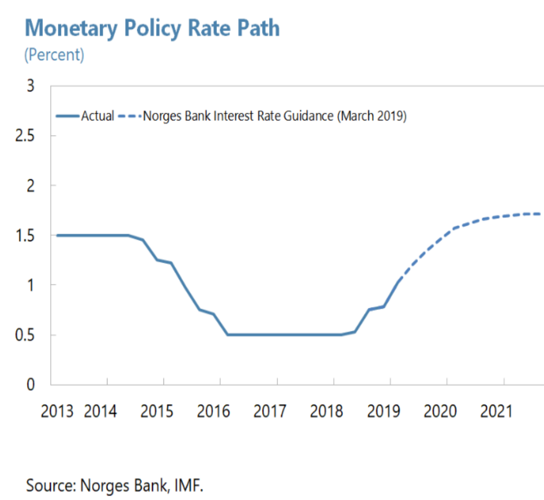
While many advanced economies around the world are experiencing slower growth, Norway's output has continued to expand strongly. Rising oil prices are boosting investment in the continental shelf, the weaker krone is helping Norwegian exporters, and low unemployment is boosting household incomes. There are clouds on the horizon, such as global trade tensions and uncertainty about European growth, but despite these risks the outlook remains quite positive.



In good times as these, it is important to avoid complacency. Take fiscal policy for example. In recent years, the budget has been broadly neutral, neither adding nor subtracting from economic growth. This is an improvement relative to years past, when the budget deficit kept rising even when the economy was healthy. However, given the recent robust growth, there is a strong case for going further and reducing the deficit during the upturn. Smaller deficits now would, among other benefits, generate fiscal space that will help counteract adverse risks when they eventually materialize.



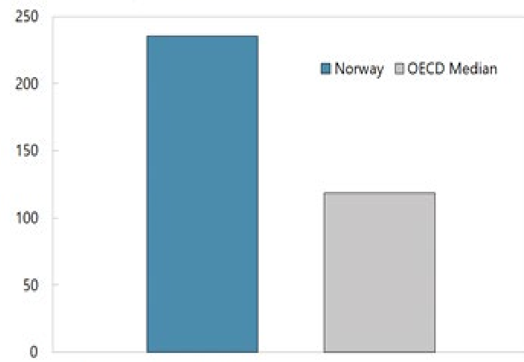
Low unemployment and rising wages are contributing to higher inflation. In this context, Norges Bank has understandably hiked interest rates twice in the last eight months. How fast should the central bank lift rates going forward? The monetary authorities need to navigate a tricky path between raising rates too slowly, which could lead to excessive inflation, and acting too aggressively, which would expose households to sharp increases in interest rates, including on their mortgages. In our view, the



tightening projected by the central bank charts the right course between these risks.

House price gains have slowed in the last year. This is a good thing, as they had been growing too fast before, raising concerns about a disruptive price fall. Yet, despite the recent slowdown, house prices are still overvalued in our view. Moreover, Norwegian households have one of the highest levels of debt in the world, and indebtedness keeps rising. For these reasons, the mortgage regulations should not be relaxed; doing so could reignite house appreciation, and lead to an even faster build-up of household debt. Developments in commercial real estate markets should also be monitored closely, as valuations appear stretched, notably in Oslo's prime segment.

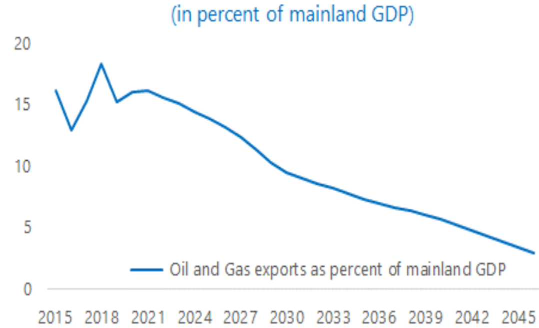
Household Debt
(Percent of net disposable income, in 2017)



Sources: OECD and IMF staff calculations.

Current good times also provide the ideal opportunity to address longer-term challenges. Going forward, oil and gas revenues are expected to drop, as reserves in the continental shelf are progressively depleted. Simultaneously, pensions and health-related costs will continue to climb because of population aging. These two forces—lower revenues and higher spending—imply that over time Norway's budget will face increasingly hard choices, which will require finding new sources of revenues or savings to accommodate new spending initiatives.

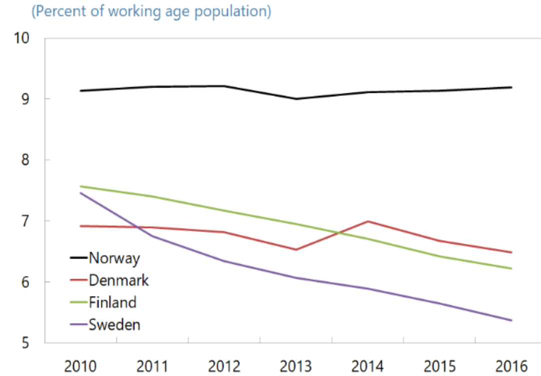
Projected Oil and Gas Revenues
(in percent of mainland GDP)



Source: IMF Staff Estimates

Sustaining living standards and a vibrant economy in the face of population aging will require getting more people included in the labor force, to the degree that they can contribute given their situation. Reforming sickness and disability benefits is a priority in this regard. Compared to other Nordic countries, a significantly higher share of Norwegians is on these schemes and not working. A particular concern is the growing number of young people on these schemes,

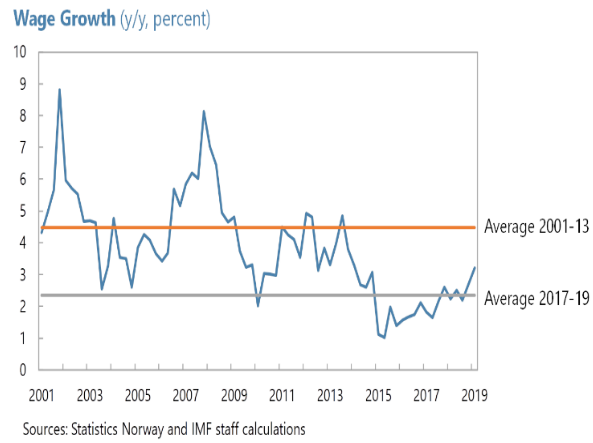
Recipients of Permanent Disability Benefits
(Percent of working age population)



Sources: Eurostat; and IMF staff calculations.

with the risk that their failure to gain experience and develop skills will leave them locked out of the workplace for many years. In this context, it is welcome that social partners will soon convene to discuss the reform proposals of an expert commission. In our view, these recommendations are a good starting point for a reform. As was emphasized by the commission, poorer and less educated people are more likely to be on the schemes, hence the distributional consequences of any reform will have to be carefully weighted.

Finally, as the economy continues to transition away from oil and gas, other sectors will have to improve their competitiveness. The weak kroner has helped on this front, but this won't be enough on its own. Wage moderation will also be needed. Social partners have shown in recent years that the collective bargaining system can strike a good balance between fair and widely shared wage increases, and preserving competitiveness. This effort should continue.



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