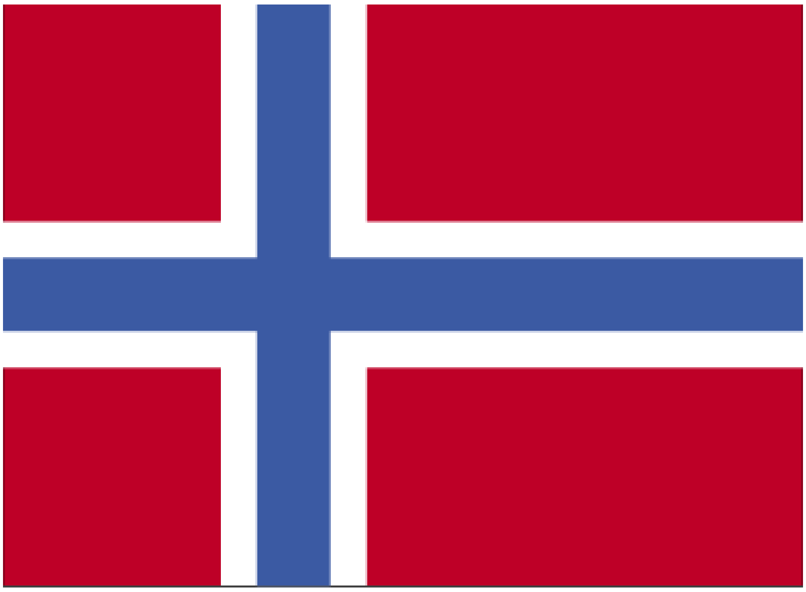
Rabobank

Country report **NORWAY**



Summary

So far the effects of the European debt crisis on the Norwegian economy have been relatively modest, mostly due to robust growth of private consumption. Rising house prices boosted the domestic recovery but have also led to an increasing risk of overvaluation of house prices. The housing market should be a key policy area in the coming years. That said, from a risk perspective, the position of Norway remains very solid amid a financially extremely healthy public sector and a competitive private sector.

Things to watch:

- Risk of overvaluation of the housing market
- Relatively high level of household (mortgage) debt
- Development of reform of the public early retirement scheme

Author: **Michiel Verduijn**
International Macro Economic Research
Economic Research Department
Rabobank Nederland

Contact details: P.O.Box 17100, 3500 HG Utrecht, The Netherlands
+31-(0)30-21-30522
M.P.Verduijn@rn.rabobank.nl

Norway

National facts	
Type of government	Constitutional monarchy
Capital	Oslo
Surface area (thousand sq km)	304.3
Population (millions)	4.9
Main languages	Norwegian
Main religions	Church of Norway (85.7%)
	Other Christian (2.4%)
	Muslim (1.8%)
Head of State (president)	King Harald V
Head of Government (prime-minister)	Jens Stoltenberg
Monetary unit	NOK

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	484	0.70
Nominal GDP at PPP	289	0.37
Export value of goods and services	215	0.98
IMF quotum (in mln SDR)	1884	0.87
Economic structure	*2011*	*5-year av.*
Real GDP growth	1.7	0.8
Agriculture (% of GDP)	3	2
Industry (% of GDP)	40	41
Services (% of GDP)	58	57
Standards of living	*USD*	*% world av.*
Nominal GDP per head	97316	902
Nominal GDP per head at PPP	58163	471
Real GDP per head	64769	797

Social and governance indicators	rank / total
Human Development Index (rank)	1 / 187
Ease of Doing Business Index (rank)	6 / 183
Index of Economic Freedom (rank)	40 / 179
Corruption Perceptions Index (rank)	6 / 183
Press Freedom Index (rank)	1 / 178
Gini index (income distribution)	25.8
Population below $1.25 per day (PPP)	n.a.

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
UK	27	Sweden	14
Germany	12	Germany	12
Netherlands	11	China	8
France	7	Denmark	6

Main export products (%) 2009	
Mineral fuels, lubricants and related materials	68
Machinery and road vehicles (% share)	12
Manufactured goods (% share)	9
Food and beverages (% share)	6
Main import products (%) 2009	
Machinery and transport equipment (% share)	40
Manufactured goods (% share)	15
Chemical and mineral products (% share)	10
Food and beverages (% share)	7
Openness of the economy 2011	
Export value of G&S (% of GDP)	45
Import value of G&S (% of GDP)	31
Inward FDI (% of GDP)	75.5

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Full report:

After a relatively modest contraction as a consequence of the financial crisis (GDP contracted by 1.7% in 2009), the Norwegian economy experienced a strong recovery. The recovery was led by budgetary stimulus and by strong household consumption growth on the back of robust nominal wage growth, rising house prices, low inflation (partly due to the strong krone) and low interest rates. Although the pace of growth slowed in the second half of 2011, strong domestic demand was able to limit the negative effects of the European debt crisis on the Norwegian economy. The labor market performed extremely well during the last couple of years, also reflected by the lowest unemployment rate (3.2%) across Europe.

The growth outlook for the coming years is solid and remains mainly based on robust growth of business investment and household consumption. Private domestic spending is necessary for growth as the government budget for 2012 is fiscally neutral and export growth will be hampered by weak foreign demand due to the debt crisis and the strong appreciation of the krone. The krone appreciated more than 16% against the euro from June 2009 until April 2012. As a response to the weakening external environment and the relatively large interest rate differentials with e.g. the eurozone, the Norges Bank (central bank) reduced its key policy rate from 1.75% to 1.50% after a first rate cut in December 2011. Future oil price movements – both a rise due to further tensions between Iran and Israel and a drop if the debt crisis spins out of control – have consequences for the inflows to the sovereign wealth fund. Only a very large drop in oil prices (the IMF states below

$70 per barrel) might have consequences for the real economy through lower oil-related investments.

The large oil and gas resources (many of which are state-owned) make the Norwegian government financially very healthy (net public financial assets amount to 164%-GDP). To ensure revenues from the exploitation of non-renewable resources for future generations, the key anchor (since 2001) regarding the government budget is the rule which stipulates that the non-oil structural government deficit should not exceed the annual expected return (4%) on the Government Pension Fund Global (GPFG). This anchor was violated in 2009 and 2010 due to the stimulus measures, but was met again in 2011. Although Norway is an example for many countries how to exploit a country's non-renewable resources in a sustainable way, it is inevitable that in the future the return on the GPFG as a share of GDP will decline as new oil revenues will slow. The government estimates that a 4% return on the GPFG will peak at more than 7%-GDP around 2025 and will gradually decline afterwards to less than 5%-GDP by 2060. So, in the long term the budgetary use (as a %-GDP) of oil resources will decline, while aging will put more pressure on public finances. However, it should be noted that Norwegian aging is relatively modest from an OECD-perspective, while high labor participation (80.7% in 2010) and an average effective retirement age (64.7 for men, 64.5 for women) show that Norway is well prepared to counter this demographic trend. Only the retirement schemes in the public sector should be reformed to increase labor participation above 62 years. Although the government bond market is relatively illiquid due to its small stock of outstanding debt, it has reaped some benefits of safe haven flows with yields comparable to Dutch bonds.

The financial position of Norwegian firms is average from a European perspective. Due to robust wage growth, unit labor costs rose strongly during the last decennium. Despite this loss of price competitiveness, it is remarkable that Norway's world market share of non-oil exports remained more or less stable since 2000 while market shares of almost all other European countries dropped during this period. So firms managed to maintain their strong competitive position, which might be partly explained by good connections with growing Asian markets. The fraction of exports which is directed to Asia increased from 9.8% in 2000 to 14.5% in 2011. Although the contribution of non-oil trade to the current account is structurally negative, Norway is running large current account surpluses since the early 1990's. The financial position of households (+13%-GDP) is far less solid than the European average (+108%-GDP), which is partly the result of relatively large debt (93%-GDP, of which 70% is mortgage debt). This large mortgage debt should be considered as a threat, to both home owners and banks, as there exists a risk of overvaluation of housing prices. This risk is confirmed by both the IMF and Norway's financial supervisor. If a price correction occurs, there will be adverse effects on both the real economy (via lower consumption and residential investment) and on the financial sector. Although the banking sector is well-capitalized (and profitable), the effects of a substantial price correction on bank's balance sheets can be significant. Therefore, policy should be focused on reducing loan-to-value ratios, gradually changing or reducing the tax deductibility of mortgage interest payments and further strengthening the financial position of the banking sector.

Norway

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	2.7	0.0	-1.7	0.7	1.7	1.6	1.6
Consumer prices (average % change pa)	0.8	3.8	2.2	2.4	1.2	1.3	1.6
Current account balance (% of GDP)	14.1	17.5	11.9	12.3	12.7	12.3	11.3
Economic growth							
GDP (% real change pa)	2.7	0.0	-1.7	0.7	1.7	1.6	1.6
Gross fixed investment (% real change pa)	11.5	0.0	-7.4	-5.3	7.0	6.7	4.5
Private consumption (real % change pa)	5.4	1.7	0.0	3.5	2.3	2.5	2.8
Government consumption (% real change pa)	2.7	2.5	4.3	1.7	1.6	1.9	2.0
Exports of G&S (% real change pa)	1.4	0.7	-4.7	1.6	-1.0	0.8	1.5
Imports of G&S (% real change pa)	10.1	4.1	-12.7	9.9	2.6	4.3	5.6
Economic policy							
Budget balance (% of GDP)	18.5	20.1	12.1	11.7	12.7	11.8	11.7
Public debt (% of GDP)	51	48	44	44	58	56	58
Money market interest rate (%)	5.0	6.2	2.5	2.5	2.9	2.4	2.7
M2 growth (% change pa)	17	4	2	5	6	6	6
Consumer prices (average % change pa)	0.8	3.8	2.2	2.4	1.2	1.3	1.6
Exchange rate LCU to USD (average)	5.9	5.6	6.3	6.0	5.6	5.9	6.2
Recorded unemployment (%)	2.5	2.6	3.2	3.6	3.3	3.3	3.5
Balance of payments (mln USD)							
Current account balance	55429	79236	44544	51444	61500	58400	53000
Trade balance	58321	85619	48819	58391	69800	68000	62900
Export value of goods	136953	172747	116030	132691	170900	169000	171800
Import value of goods	78630	87126	67212	74301	101100	101000	108900
Services balance	1427	233	1793	-3109	-4200	-4200	-4000
Income balance	-711	-3148	-1660	871	1400	-100	-600
Transfer balance	-3607	-3471	-4409	-4711	-5500	-5300	-5300
Net direct investment flows	-6362	-16196	-15135	-505	-2869	-6960	-9710
External position (mln USD)							
International investment position	226157	219150	323841	405589	n.a.	n.a.	n.a.
Total assets	1012760	916524	1048370	1173610	n.a.	n.a.	n.a.
Total liabilities	786603	697374	724529	768021	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	14.8	18.9	13.0	14.0	14.4	14.4	13.4
Current account balance (% of GDP)	14.1	17.5	11.9	12.3	12.7	12.3	11.3
Inward FDI (% of GDP)	1.7	1.7	4.0	2.8	1.4	1.4	1.3
International investment position (% of GDP)	57.5	48.3	86.4	97.2	n.a.	n.a.	n.a.

Source: EIU