

2 | Economic developments

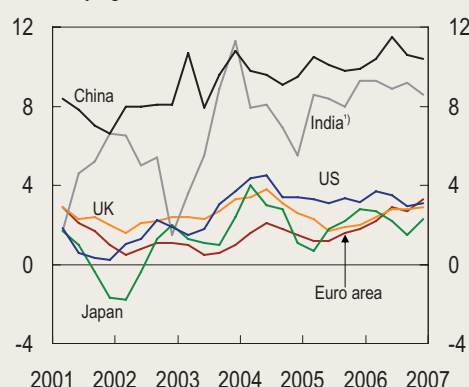
Table 2.1 Projections for GDP growth in other countries. Change from previous year. Per cent

	2007	2008	2009	2010
US	2¼	2¾	2¾	2½
Japan	1¾	1¾	1½	1½
Germany	1¾	2¼	2	1½
France	2¼	2¼	2½	2¼
UK	2½	2½	2½	2¼
Sweden	3½	2¾	2¼	2
China	9¾	9½	9	8½
Trading partners ¹⁾	3	2¾	2½	2¼
Euro area	2¼	2¼	2	1¾

¹⁾ Export weights, 26 important trading partners

Sources: Eurostat and Norges Bank

Chart 2.1 GDP. 4-quarter growth. Per cent. Quarterly figures. 01 Q1 – 06 Q4



¹⁾ Measured by factor price.

Source: Reuters (EcoWin)

Table 2.2 Projections for consumer prices in other countries. Change from previous year. Per cent

	2007	2008	2009	2010
US	2	2½	2¼	2¼
Japan	½	1	1¼	1¼
Germany	2¼	1½	1½	1½
France	2	2	1¾	1¾
UK	2¼	2	2	2
Sweden	1½	2	2	2
China	2	2½	3¾	3½
Trading partners ¹⁾	2	2	2	2
Euro area ²⁾	2¼	2	2	2

¹⁾ Import weights, 26 important trading partners

²⁾ HICP. Weights from Eurostat (each country's share of total euro area consumption)

Sources: Eurostat and Norges Bank

Continued solid growth in the global economy

Demand for goods and services has so far remained high among our main trading partners. This can be partly attributed to the fall in oil prices since summer 2006. Growth picked up towards the end of 2006 and is stronger than projected in *Inflation Report* 3/06 (see Table 2.1 and Chart 2.1). International financial markets have been marked by some unrest in recent weeks.

High international activity has contributed to employment growth and a decline in unemployment. This has boosted household optimism and supported private consumption. Solid corporate profitability and favourable funding conditions are expected to contribute to a further increase in the investment rate. Robust growth in China and India is helping to sustain global economic growth. Reforms in European product and service markets are also expected to lead to higher domestic demand. The softening of the US housing market has so far only had limited spillover effects on both the wider US economy and the world economy as a whole. However, growth in private demand is likely to slow somewhat due to a weaker housing market. This will lead to a short period of below-trend growth in the US economy.

Growth forecasts imply full capacity utilisation in 2007 for Norway's trading partners as a whole, based on OECD estimates of potential growth. Capacity utilisation will increase somewhat in 2008, before levelling off and then declining in 2010. Globalisation is still one of the most prominent driving forces behind international economic developments. The global labour supply has seen a sharp rise as China and other emerging economies have become increasingly integrated into the world labour market. Changes in international production and trade patterns are fuelling economic growth and inflation is easing among our trading partners. The strong expansion in Asia has probably reduced other countries' dependence on the US (see box on page 40).

Inflation is projected to remain around 2% among our main trading partners (see Table 2.2). Core inflation is moderate in most countries (see Chart 2.2). Projections for economic growth imply higher capacity utilisation than previously projected. In isolation, this will contribute to higher inflationary pressures. In the US and the UK, a tight labour market is expected to contribute to somewhat higher wage growth. We also expect wage growth to pick up somewhat from low levels in e.g. Germany. However, structural

factors such as globalisation, increased labour mobility and stronger competition in European goods and service markets will restrain inflation and contribute to continued moderate wage growth for our trading partners as a whole.

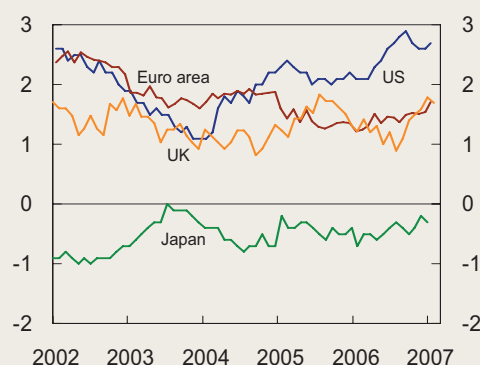
Following a long period of expansion, international financial markets were marked by unrest around the end of February. Equity prices fell markedly and are now only slightly higher than at the time of the November *Inflation Report*. The decline has been broadly based (see Chart 2.3). Risk premia have been reduced in recent years. This may partly reflect market participants' optimistic assessment of the global macroeconomic outlook. Structural features, such as more integrated and liquid markets combined with improved possibilities for risk diversification, may also have contributed. At the same time, risk willingness has been high. In fixed income markets, the premium on corporate bonds has been historically low, and in foreign exchange markets, market participants have largely borrowed in currencies with a low interest rate and then invested in currencies with a high interest rate.

Financial market turbulence has contributed to reducing risk willingness and triggered an unwinding of high-risk positions. The reduction in these positions has led to a higher pricing of risk on a broad range of securities, and the yield spread between corporate bonds and government bonds has widened. Uncertainty, as measured by implied volatility, has increased in bond, foreign exchange and stock markets (see Chart 2.4). So far, however, the recent increase in risk premia appears to be relatively modest from a historical perspective.

Interest rates among trading partners have fluctuated considerably, but have on the whole increased somewhat since *Inflation Report* 3/06. Increased optimism concerning the growth outlook led to a broad yield increase through December and January. Yields have declined again since the beginning of February as a result of e.g. rising oil prices, renewed uncertainty regarding the housing market in the US and weak indicators for US industry. In February, yields showed a steeper decline in the US than in Europe and Asia, where uncertainty concerning economic developments has not increased to the same extent. The recent fall in global stock markets has led to increased demand for government bonds and the yield decline has been reinforced (see Chart 2.5).

Key commodity prices have moved on different paths since *Inflation Report* 3/06, and overall commodity prices remain broadly unchanged. Prices for agricultural products have drifted up, while metal prices are now slightly lower. However, oil and energy prices remain virtually unchanged. The levels are still markedly lower than last summer. Both

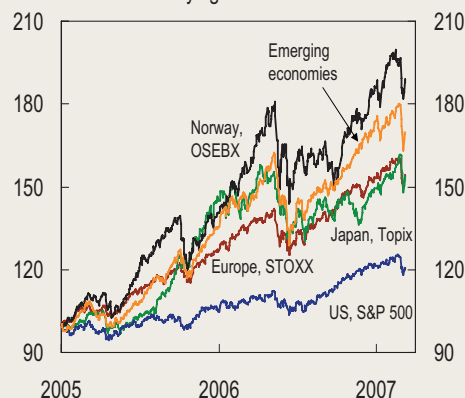
Chart 2.2 Core inflation.¹⁾ 12-month change. Per cent. Monthly figures. Jan 02 – Jan 07



¹⁾ US and Japan: CPI excl. food and energy. Euro area and UK: CPI excl. energy, food, alcohol and tobacco.

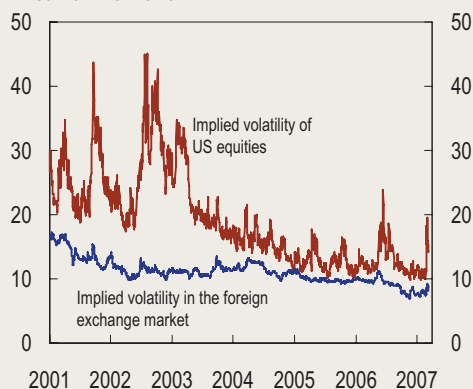
Source: Reuters (EcoWin)

Chart 2.3 Developments in international equity indices. 2 Jan 05 = 100. Daily figures. 2 Jan 05 – 9 Mar 07



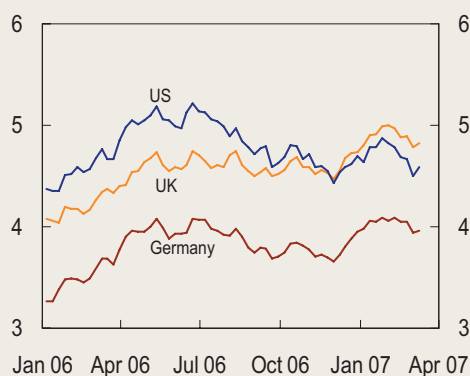
Source: Reuters (EcoWin)

Chart 2.4 Implied volatility in the foreign exchange market and the US equity market. Daily figures. 2 Jan 01 – 9 Mar 07



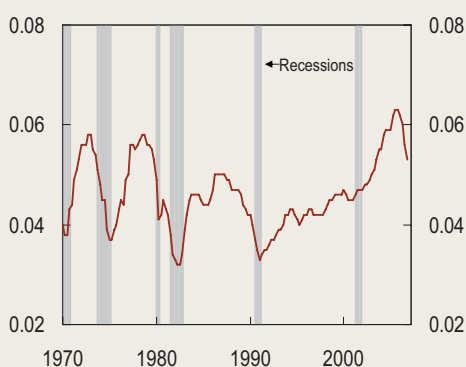
Sources: Reuters (EcoWin) and Norges Bank

Chart 2.5 10-year government bond yields.
Per cent. Weekly figures.
Week 1 2006 – Week 10 2007



Source: Bloomberg

Chart 2.6 Housing investment as a share of US
GDP. Current prices. Quarterly figures.
70 Q1 – 06 Q4



Sources: US Department of Commerce, Reuters (EcoWin) and Norges Bank

spare OPEC capacity and oil stocks in OECD countries have increased. For a period, energy prices were heavily influenced by mild winter weather, while metal prices were affected by the withdrawal of financial investors from the market. Developments in energy and commodity markets are discussed in detail in a box on page 22.

Underlying growth may be stronger than assumed in this report, following the strong global expansion of recent years. The growth engines in Asia are becoming increasingly important for overall developments in the global economy. It may be that we are underestimating the impulses from structural changes such as globalisation, high productivity growth in China and intensified competitive pressures in European product markets. If this proves to be the case, growth may be stronger than projected. There is also a risk that we are underestimating the resulting price pressures from the increase in capacity utilisation.

Nevertheless, it is uncertain whether the US housing market will recover as quickly as expected and whether it will eventually adversely affect other parts of the US economy (see Chart 2.6). The US still has a substantial balance-of-payments deficit, while many oil exporters and a number of Asian countries have large surpluses. Stronger growth outside the US has eased global imbalances, but they are still pronounced. A disorderly unwinding of global imbalances might have strong negative spillover effects on the world economy, particularly through sizeable changes in exchange rates. The US housing market and global imbalances are still the main sources of uncertainty with regard to the projections ahead.

Developments in financial markets at around end-February have brought into evidence the uncertainty associated with risk premia in bond, equity and foreign exchange markets. An abrupt and sharp reduction in risk willingness may lead to strong and negative effects on growth. There is also considerable uncertainty surrounding oil prices. The risk of oil production disruptions, for instance due to unrest in the Middle East, may again exert upward pressure on oil prices.

Developments in energy and commodity markets

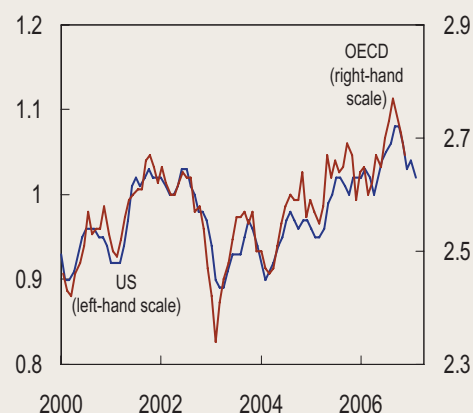
The average oil price so far this year is USD 56 per barrel, about USD 9 lower than the average in 2006. The price rose to over USD 75 in summer 2006, reflecting uncertainties about oil production in several regions. Later in autumn, prices fell as unrest in the Middle East subsided, BP's production problems in Alaska were resolved more rapidly than expected and the hurricane season in the Gulf of Mexico passed without major destruction.

Oil inventories increased in pace with high production in both OPEC and non-OPEC countries, while demand slackened (see Chart 1). OPEC therefore decided to cut production by a total of 1.7 million barrels per day – 1.2 million barrels from November 2006, and a further 0.5 million barrels from February this year. Lower demand for heating oil as a result of a record-mild winter in the US and Europe contributed to a further fall in prices.

High inventories and an increase in spare OPEC capacity following the production cuts also influenced price expectations in the oil futures market, where participants unwound their positions substantially at the beginning of 2007 (see Chart 2). A less tight oil market also reduced the impact on oil prices of news that would normally have received considerable attention – for example a halt in Russia's transport of oil exports through Belarus, increased government involvement in oil activities in Venezuela and recurring problems in Nigeria.

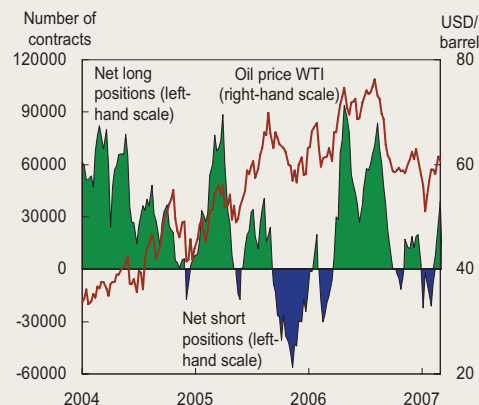
The underlying balance in the oil market changed later in January. Demand for oil rose as more normal winter weather set in. A somewhat brighter world economic outlook and the price fall in the second half of 2006 also boosted demand. The supply of oil was reduced because OPEC continued to implement the approved production cuts, while growth in production in non-OPEC countries was somewhat lower than expected. The US plan to double its strategic oil reserves over time also pushed up prices. This was not only due to the effect on demand for oil.¹ The plan was interpreted by some market participants as indicating that the US was increasing stockpiles to guard against possible further reductions in oil production, particularly in the Middle East.

Chart 1 Oil inventories. In billions of barrels. Monthly figures. Jan 00 – Feb 07



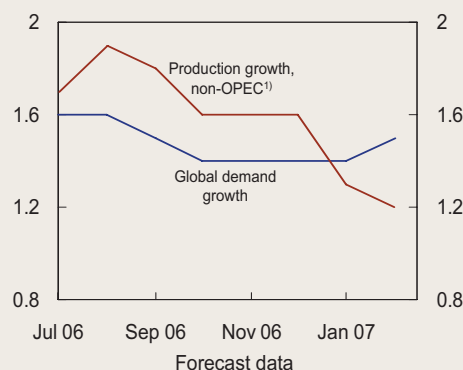
Sources: International Energy Agency (IEA), Energy Information Agency (EIA) and Reuters (EcoWin)

Chart 2 Oil price (WTI in USD per barrel) and net positions of non-commercial traders in the futures market for WTI (number of contracts). Weekly figures. Week 1 2004 – Week 10 2007



Sources: Reuters (EcoWin), Commodity Futures Trading Commission (CFTC) and NYMEX

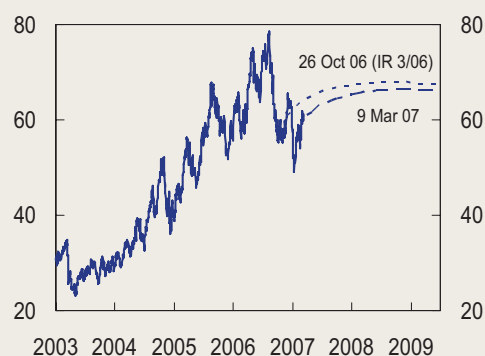
Chart 3 IEA's forecasts for growth in demand and production in 2007. Change in million barrels per day from previous year. Monthly figures. Jul 06 – Feb 07



¹) See notes to Table 1 below.

Sources: International Energy Agency (IEA) and Norges Bank

Chart 4 Oil price (Brent Blend) in USD per barrel. Daily figures. 2 Jan 03 – 9 Mar 07. Futures prices from 26 Oct 06 and 9 Mar 07. Monthly figures. Dec 06 – Sep 09



Sources: Reuters (EcoWin) and Norges Bank

Whether OPEC decides on further production cuts – particularly at the beginning of the second quarter, when demand for oil shows a seasonal decline – will primarily depend on whether prices fall again. In addition, OPEC will place emphasis on developments in oil inventories, projected growth in global oil demand and growth in supplies from non-OPEC countries.

According to statements from a number of member countries, OPEC will seek to keep the oil price over USD 50, possibly close to USD 60 per barrel. Although spot prices and short-term futures prices have fallen to USD 50 – 55 in periods, the longer futures prices have remained at over USD 60 per barrel for the most part. Thus, market participants appear to believe that OPEC is willing and able to defend its price ambitions. Oil inventories have fallen since OPEC reduced production in November last year. Growth in global demand for oil appears to remain firm, while estimated growth in the supply of oil from non-OPEC countries has been revised down recently (see Chart 3). This would indicate that the need for further OPEC cuts to prevent an increase in oil inventories in the period ahead has declined.

In the table, forecasts from the International Energy Agency (IEA) are compared with those of the US Energy Information Administration (EIA) and OPEC.

The forecasts of the various institutions indicate that there is no need for further OPEC production cuts in 2007 as a whole, as crude oil production in

Table 1 Global demand and supply from non-OPEC countries in 2007. Growth in millions of barrels per day from 2006, unless otherwise specified¹)

	IEA	EIA	OPEC
Global demand	1.5	1.6	1.2
Supply from non-OPEC²)	1.2	0.7	1.2
Call on OPEC, level³)	30.6	30.5	30.2
OPEC's crude oil production, January 2007, level⁴)	30.2	30	30

1) The projections are based on the different institutions February reports. As of January, Angola is a member of OPEC, and is therefore not included in non-OPEC. The growth in supply from this group is thus considerably smaller than earlier, as Angola has had and is expected to have high production growth. Angola is not yet covered by OPEC's quotas.

2) Non-OPEC supply includes crude oil, NGL (including from OPEC), condensates and oil from non-conventional sources.

3) Call on OPEC is the difference between global demand and non-OPEC supply. OPEC's production quotas only include the cartel's crude oil production.

4) The figures may vary as the institutions use different data sources

Sources: Oil Market Report, International Energy Agency, February 2007; Short-Term Energy Outlook, Energy Information Administration, February 2007; and Monthly Oil Market Report, OPEC, February 2007

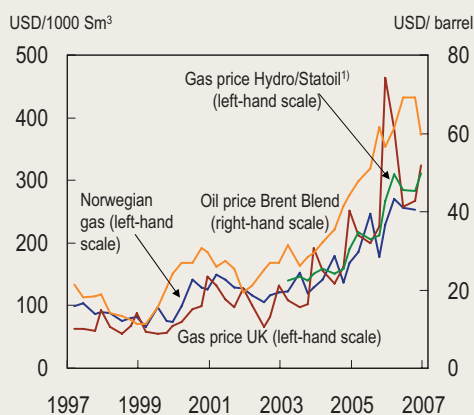
January 2007 was lower than the average need for OPEC production in 2007. Both the IEA and the EIA envisage a tighter oil market than OPEC.

Futures prices are used in this report as a technical assumption (see Chart 4). These prices now indicate an oil price of USD 62 in 2007 and USD 66 in 2008, somewhat lower than in *Inflation Report* 3/06. At the beginning of each month, *Consensus Forecasts* publishes a forecast for the most likely price of US benchmark oil West Texas Intermediate (WTI) three months and one year ahead. These forecasts are currently fairly consistent with corresponding futures prices. Oil options prices at the beginning of March show a much higher probability that the price of WTI will be over USD 90 in December 2008 than that it will be under USD 30. This may reflect some concern about possible supply disruptions. However, the potential for a dramatic fall in oil prices is limited by a fairly positive outlook for the world economy and by OPEC's central market position.

The price of Norwegian gas follows the oil price with a certain lag because gas is largely sold under oil-indexed contracts (see Chart 5). However, some of the gas is sold in spot markets, particularly in the UK. The gas price in the UK fell through 2006 as a result of higher import capacity, mild weather and lower oil prices. However, the price of Norwegian gas is expected to hold up in tandem with oil prices.

A fall in prices in a number of commodity markets at the beginning of 2007 raised the question of whether the pronounced price rise of recent years was being reversed (see Chart 6). The experience of previous commodity price cycles indicates that rising prices gradually lead to increased supply and reduced demand. This in turn leads to a fall in prices. Futures prices that are lower than spot prices for several industrial metals indicate expectations of a price fall, which is consistent with a moderate slowing of the global economy. This development may also reflect lower risk premia on prices as a result of somewhat higher inventories and increased supply-side capacity. However, prices for food and other agricultural products have showed some increase recently, reflecting two factors in particular. Increased demand for biofuels leads indirectly to higher food prices. Climatic conditions have also resulted in poor harvests in some regions.

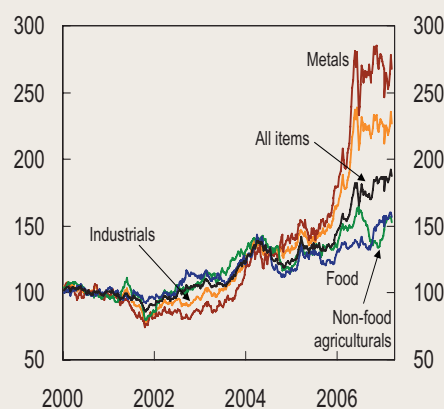
Chart 5 Prices for crude oil and natural gas. Gas price in USD/1000 Sm³. Oil price in USD/barrel. Quarterly figures. 97 Q1 – 06 Q4



¹) Weighted average gas price. Statoil weighted with 0.7, Hydro weighted with 0.3.

Sources: Statistics Norway, Statoil, Norsk Hydro, Reuters (EcoWin) and Norges Bank

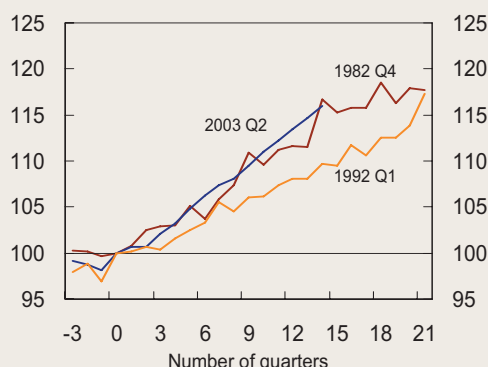
Chart 6 The Economist commodity price index. 2000 = 100. USD. Weekly figures. Week 1 2000 – Week 10 2007



Sources: Reuters (EcoWin) and The Economist

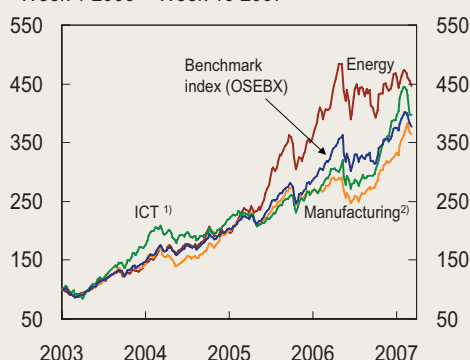
¹ In his State of the Union address, President Bush proposed increasing strategic oil reserves to 1.5bn barrels by 2027. At end-January 2007, reserves totalled 688m barrels. The proposal requires congressional approval. Approval will imply an increase in demand for oil of about 110 thousand barrels per day up to 2027, according to the US Department of Energy's Energy Information Administration.

Chart 2.7 Mainland GDP. Developments after the start of a cyclical upturn. Index. Quarter 0 = 100. Seasonally adjusted



Sources: Statistics Norway and Norges Bank

Chart 2.8 Developments in some sub-indices on the Oslo Stock Exchange. Week 1 2003 = 100. Week 1 2003 – Week 10 2007

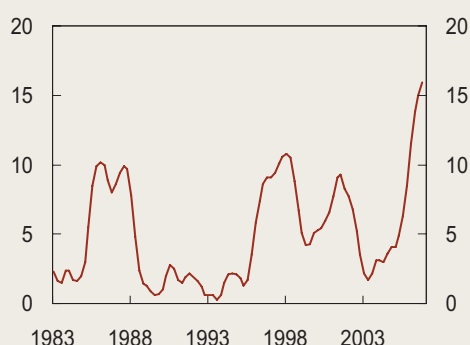


¹⁾ Average of IT and telecommunications indices.

²⁾ Average of industrials and materials indices.

Sources: Reuters (EcoWin) and Norges Bank

Chart 2.9 Business tendency survey. Labour shortages in manufacturing.¹⁾ Smoothed. Per cent. Quarterly figures. 83 Q1 – 06 Q4



¹⁾ Share of companies reporting that labour shortages are a production constraint.

Source: Statistics Norway

Strong growth and high capacity utilisation in the Norwegian economy

Since summer 2003, economic activity in Norway has picked up markedly. Growth has been stronger than during the economic upturn in the mid-1990s (see Chart 2.7). The continuous growth period of recent years is the longest ever recorded in the quarterly national accounts, which includes figures back to 1978. At the same time, the growth capacity of the economy has been high. Strong productivity growth and in turn also the supply of labour have contributed to high growth in potential output.

The upturn is broad-based. The global expansion of recent years has resulted in strong growth in export industries and high prices for many Norwegian export goods. Norway's terms of trade have improved by almost 40% since 2002. Investment in the petroleum sector has risen sharply. Strong demand growth and solid profitability have gradually also resulted in higher business fixed investment. Statistics Norway's business tendency survey and order statistics show high order reserves, and a high level of new orders suggests that both manufacturing investment and output may rise further through winter and spring 2007. Low interest rates and high real income growth have contributed to strong growth in housing investment and household consumption. Increased employment and wage growth continue to contribute to high growth in household demand, as indicated by the most recent goods consumption figures from Statistics Norway. Information from Norges Bank's regional network indicates that growth in general government demand has also picked up somewhat. However, the rise in housing investment is levelling off, primarily as a result of capacity problems in the building sector.

The upturn has resulted in high activity growth in many sectors of the economy, including the industries supplying goods and services to the petroleum sector, shipbuilding, construction and service production. Companies listed on the Oslo Stock Exchange have reported solid results. The energy index has shown the strongest rise, but the sub-indices for manufacturing and ICT have also contributed to the gains in the benchmark index (see Chart 2.8).

The use of economic resources has increased markedly since summer 2003, and capacity utilisation is now very high in most industries. In the most recent rounds of the regional network, a large share of companies reported that they would have difficulty accommodating an increase in demand. The labour market has tightened further in recent months. Employment increased sharply last year, and growth was also strong towards the end of the year. Such a high a level of employment growth from one year to the next has not been recorded since 1985-1986 and 1997-1998.

Unemployment has fallen further since the previous *Report*. Since September 2006, seasonally adjusted registered unemployment has been lower than around the previous cyclical peak. In February, seasonally adjusted registered unemployment was 2.1 per cent of the labour force.

The number of unfilled vacancies is rising, and a growing number of enterprises report a shortage of qualified labour (see Chart 2.9). There were signs of accelerating wage growth through autumn. In the business tendency survey, the manufacturing indicator that shows shortages of intermediate goods and electricity is about twice as high as in previous expansions. The regional network reports that the building industry is having problems procuring building materials.

The output gap reflects our assessment of overall capacity utilisation in the economy in relation to a normal level (see Chart 2.10). New national accounts figures show that activity in the Norwegian economy increased at a faster-than-projected pace in the period 2004 – 2006. The figures also indicate that productivity growth, and hence potential growth, have been higher than expected. As a result, the output gap was somewhat more negative in 2003 than envisaged earlier. The low rise in prices for domestically produced goods and services in spite of a high level of activity also points to high productivity growth. Considerable labour inflows have also added to the growth potential of the economy. On balance, we assume that the output gap through 2006 was approximately as estimated in *Inflation Report 3/06*.

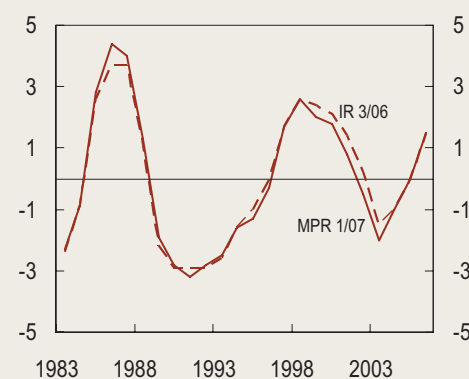
On the basis of current economic indicators, various statistical models indicate that GDP growth may remain solid in the first half of 2007 (see Chart 2.11). The enterprises in the regional network report continued growth in demand and production. On the other hand, unemployment has now declined to a very low level, and limited slack in the economy is probably exerting downward pressure on growth. It is our assessment that the output gap will be somewhat higher in the first half of the year than projected in *Inflation Report 3/06* (see Chart 2.12), but still lower than around the previous cyclical peak.

High activity level, but gradual slowdown up to 2010

Petroleum investment at a high but stable level

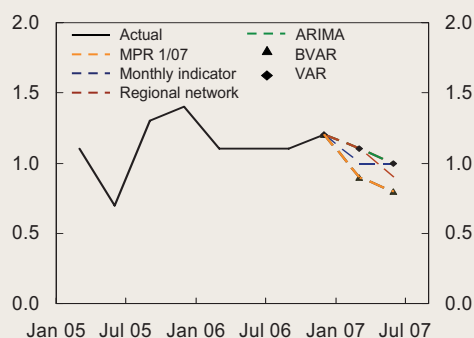
Increased investment activity on the Norwegian continental shelf has accounted for a large share of growth in domestic activity in recent years. The investment intentions survey in 2007 Q1 indicates that growth in petroleum investment will be a little higher in 2007 than projected earlier.

Chart 2.10 Estimates for the output gap. Per cent. Annual figures. 1983 – 2006



Source: Norges Bank

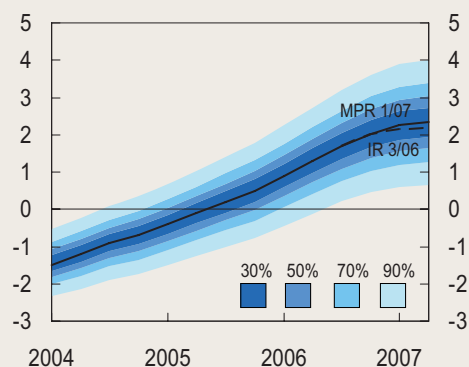
Chart 2.11 Mainland GDP. Growth on previous quarter. Seasonally adjusted. Per cent. Quarterly figures. 05 Q1 – 07 Q2¹⁾



¹⁾ Projection for period 07 Q1 – 07 Q2. See box "Short-term forecasts for mainland GDP in Norway" in *Inflation Report 2/06* for a description of the different models

Sources: Statistics Norway and Norges Bank

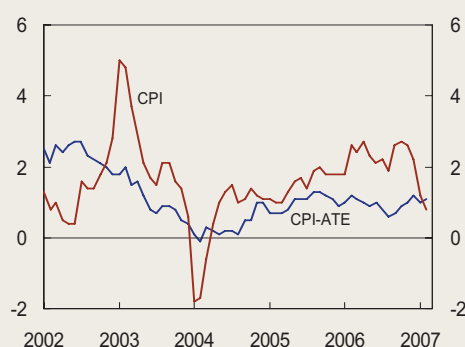
Chart 2.12 Estimates for the output gap in IR 3/06 and MPR 1/07 with fan chart. Per cent. Quarterly figures. 04 Q1 – 07 Q2



Source: Norges Bank

Recent price developments

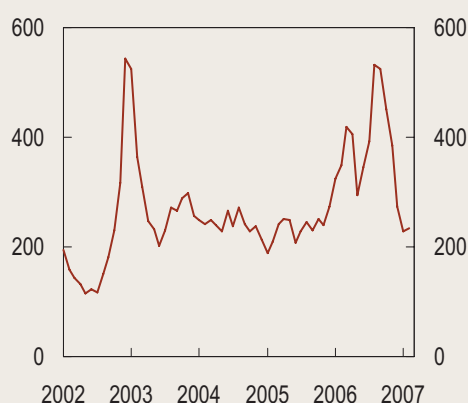
Chart 1 CPI and CPI-ATE¹⁾. 12-month change. Per cent. Monthly figures. Jan 02 – Feb 07



¹⁾ CPI-ATE: CPI adjusted for tax changes and excluding energy products. A further adjustment is made for the estimated effect of reduced maximum day-care rates in 2006.

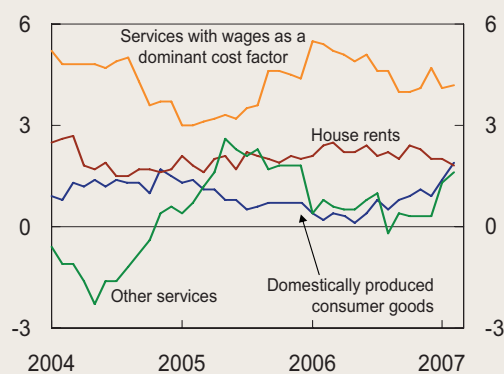
Sources: Statistics Norway and Norges Bank

Chart 2 Electricity prices. Nordpool. NOK/MWh. Monthly figures. Jan 02 – Feb 07



Source: Nordpool

Chart 3 Domestic supplier sectors in the CPI-ATE¹⁾. 12-month change. Per cent. Monthly figures. Jan 04 – Feb 07



¹⁾ CPI-ATE: CPI adjusted for tax changes and excluding energy products.

Source: Statistics Norway

The 12-month rise in the consumer price index (CPI) was 0.8% in February 2007 (see Chart 1). CPI inflation has been considerably lower than projected in the previous report, primarily reflecting a stronger-than-expected fall in electricity prices (see Chart 2).

Our assessment is that underlying inflation is now in the interval 1 – 1½%. Inflation adjusted for tax changes and excluding energy products (CPI-ATE) was somewhat higher than expected last autumn, but has been broadly in line with projections so far in 2007. The year-on-year rise was 1.1% in February, and has picked up from 0.7% in September. Adjusted for the reduction in day-care rates in January 2006, inflation was 0.7% in September. Inflation measured by a trimmed mean was 1.6% in December, but slowed to 1.2% in January and fell further to 1.1% in February. Inflation measured by a weighted median has varied somewhat in the past six months, however. In October and November 2006, inflation measured by this indicator was 2.3%, while it was 1.7% in January and February this year.

Increasing domestic inflation

After ranging between 1.6% and 1.7% since September 2006, the 12-month rise in prices for domestic goods and services moved up to 2.0% in February. The rise in prices for domestically produced consumer goods has accelerated markedly since September (see Chart 3).

The VAT rate for food was increased from 13% to 14% from December to January. While food prices in the CPI only rose by 0.4% from December to January, the rise was 1.2% from January to February. This may indicate that some grocery chains did not price in the VAT increase for food until February.

The 12-month rise in prices for services where wages are the dominant cost factor was 4.2% in February. The rise in house rents has varied between 2.0% and 2.5% over the past year, but the annual rate of increase slowed to 1.8% in February. The rise in prices for other services (services with dominant price components other than wages) has increased somewhat so far in 2007. In February, the year-on-year rise was 1.6%. The introduction of lower maximum day-care rates contributed to a lower rise in prices for this group in 2006.

Fall in prices for imported consumer goods

The 12-month rise in prices for imported consumer goods increased sharply in the last months of 2006, but fell markedly in January 2007. Some of the fall from December to January is probably attributable to extraordinary sales activity. In February, prices were 1% lower than in the same period one year earlier. In *Inflation Report 3/06*, the price fall was projected to be somewhat smaller.

Clothing prices rose by 1.5% in February, after falling sharply by 12.0% in the previous month. The fall in these prices in January is the steepest fall ever recorded. According to Statistics Norway, some clothing sales were still recorded in February and clothing prices were then 6.3% lower than the same month one year earlier (see Chart 4). Furniture prices rose by 5.9% in February, after declining by 3.8% in January.

Fall in electricity prices

The rise in electricity prices was very high through the first six months of 2006 and peaked in September when electricity prices in the CPI were 48% higher than in the same month one year earlier. Mild weather and high precipitation levels through autumn led to a marked fall in electricity prices. In February 2007, electricity prices were 11.5% lower than one year earlier.

Petrol prices have edged down over the past six months. In February, petrol prices were 0.5% lower than in the same month one year earlier.

Other indicators of inflation

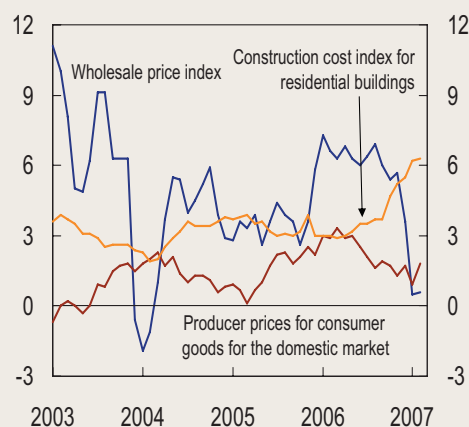
Lower energy prices through autumn 2006 pushed down the rise in both the producer price index and the wholesale price index (see Chart 5). However, the rate of increase in these indices edged up again in February 2007. Since September the annual rate of increase in producer prices for consumer goods slowed from 1.9% to 1.8% in February 2007. The rise in wholesale prices slowed from 6.9% to 0.6% in the same period. The construction cost index for residential buildings increased in the last six months of 2006, and was 6.3% higher in February 2007 than in the same month one year earlier.

Chart 4 Prices for clothing and footwear. 12-month change. Per cent. Monthly figures. Jan 05 – Feb 07



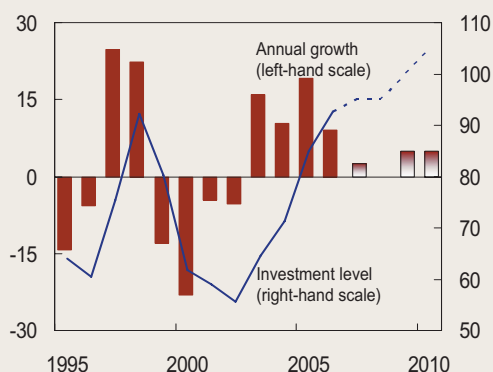
Source: Statistics Norway

Chart 5 Different price indices. 12-month change. Per cent. Monthly figures. Jan 03 – Feb 07



Source: Statistics Norway

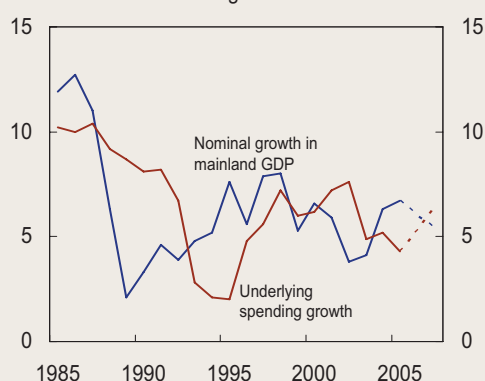
Chart 2.13 Investment in oil and gas recovery including pipeline transport. Investment level in billions of NOK (constant 2004-prices) and annual growth (per cent). Annual figures. 1995 – 2010¹⁾



¹⁾ Projections for 2007 – 2010.

Sources: Statistics Norway and Norges Bank

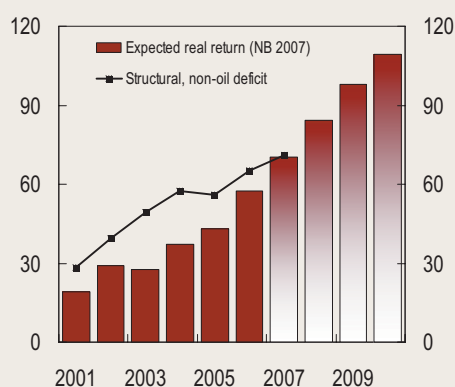
Chart 2.14 Underlying spending growth in the government budget and nominal growth in mainland GDP. Per cent. Annual figures. 1985 – 2007¹⁾



¹⁾ Projections for 2006 and 2007 from the Ministry of Finance.

Sources: Ministry of Finance (National Budget 2007) and Statistics Norway

Chart 2.15 Expected real return on the Government Pension Fund - Global. In billions of 2007-NOK. Annual figures. 2001 – 2010



Source: Ministry of Finance (National Budget 2007)

The number of exploration wells increased twofold between 2005 and 2006, and the number will probably increase again this year. The large number of wells is making a positive contribution to the resource base, and may in turn underpin investment activity. Fewer-than-planned wells are nevertheless being drilled owing to a shortage of rigs. The supply of rigs will increase during the projection period, which may boost investment in exploration.

Petroleum investment is expected to remain at a high level in the years ahead, but growth is expected to be moderate compared with recent periods (see Chart 2.13). Oil prices are lower than in summer 2006, but are still substantially higher than the prices on which oil companies normally base their investment plans. The number of companies with interests on the Norwegian continental shelf has increased in recent years. The emergence of new, smaller companies will probably contribute to a steady level of investment in the period ahead, with a number of small and medium-sized projects.

There is substantial uncertainty associated with future petroleum investment. Major new projects may be launched sooner than expected and result in stronger-than-expected growth in investment. New forecasts from the Norwegian Petroleum Directorate indicate that oil production on the Norwegian continental shelf may be appreciably lower in the next few years than indicated by earlier forecasts. At the same time, the large oil companies have high production targets, which may demand higher investment than previously assumed. Nevertheless, it is uncertain whether companies will decide to invest more on the Norwegian continental shelf or whether they will prefer to increase investment in foreign fields.

Public sector underpins demand

Public sector demand is still contributing to supporting domestic demand (see Chart 2.14). According to the final budget bill, the structural, non-oil government budget deficit was NOK 62.5bn in 2006. This implies nominal underlying spending growth in the government budget of 5.2%. Local government nominal revenue growth can be estimated at 8.5%. Tax revenues in 2006 probably increased more than previously estimated, entailing an upward revision in growth in local government revenues.

According to the supplementary budget proposition, changes in the proposal to tighten the sick pay scheme will result in a higher-than-expected increase in government expenditure in 2007 compared with that estimated in the National Budget. However, the estimate for tax revenues has also been revised up. The estimate for the structural, non-oil government budget deficit has not been changed.

According to preliminary national accounts figures, growth in public demand in 2006 was a little lower than budgeted. Norges Bank's projections are based on the assumption that some of the underspending in 2006 will result in higher public sector demand in 2007.

According to the fiscal rule, petroleum revenue spending shall be limited to the expected real return on the capital in the Government Pension Fund – Global. According to the government budget for 2007, petroleum revenue spending will be close to this level (see Chart 2.15). In the National Budget for 2007, it is estimated that the expected real return on the Government Pension Fund – Global will increase sharply in the years ahead. Oil futures prices are higher than assumed in the National Budget. In isolation, the capital transfers to the Pension Fund, and hence the real return, may be somewhat higher than estimated in the National Budget. On the other hand, new forecasts from the Norwegian Petroleum Directorate show that petroleum production in the next few years may be significantly lower than assumed in the National Budget. As from 2008, this will push down the expected real return to about the level estimated in the National Budget.

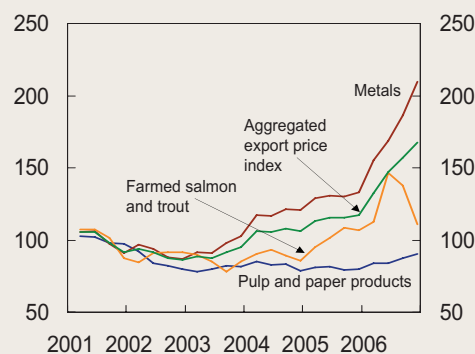
In a situation with a high level of domestic economic activity, petroleum revenue spending in the period ahead will be consistent with the fiscal rule if it increases at a slower pace than the expected real return on the Fund, which is estimated at 4%. In the next few years, growth in the structural, non-oil budget deficit is therefore assumed to be somewhat lower than implied by the 4% rule. However, public sector demand is still expected to make a positive contribution to total demand and production through the projection period.

External developments point to continued solid export growth

Strong growth in global markets and a high rise in prices for a number of our traditional export products have resulted in solid earnings for the export industry in recent years (see Charts 2.16 and 2.17). Prices will probably remain high, but will increase at a more moderate pace. There has been some unrest in metal markets since the beginning of the year, but prices for Norway's main metal exports have remained relatively stable.

Growth among our trading partners remains strong, providing a basis for high prices and continued strong growth in mainland exports. Capacity constraints in some export industries may dampen growth. On the other hand, investment and the re-opening of temporarily closed production facilities may add to capacity. In the period ahead, weak competitiveness may contribute to dampening export growth.

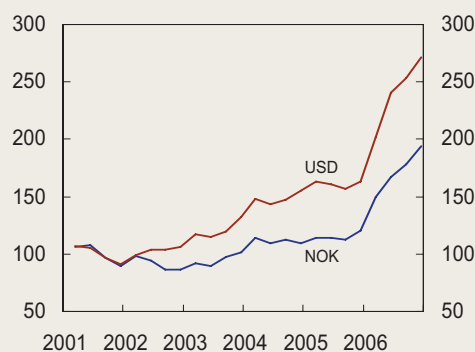
Chart 2.16 Price indices¹⁾ for exports from Norway in NOK. 2001 = 100. Quarterly figures. 01 Q1 – 06 Q4



¹⁾ Norges Bank's estimates based on world market prices.

Sources: Reuters (EcoWin), Statistics Norway and Norges Bank

Chart 2.17 Price index¹⁾ for exports of non-ferrous metals²⁾ from Norway in USD and NOK. 2001 = 100. Quarterly figures. 01 Q1 – 06 Q4

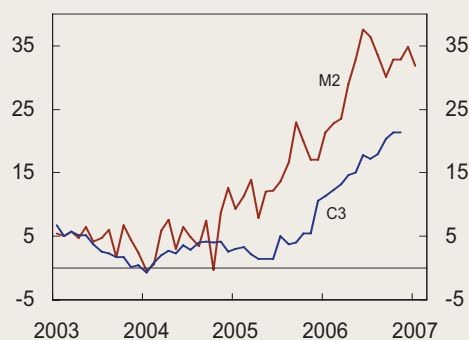


¹⁾ Norges Bank's estimates based on world market prices.

²⁾ Aluminium, nickel, copper and zinc.

Sources: Reuters (EcoWin), Statistics Norway and Norges Bank

Chart 2.18 Credit to enterprises¹⁾ and enterprises' liquid assets²⁾. 12-month change. Per cent. Jan 03 – Jan 07

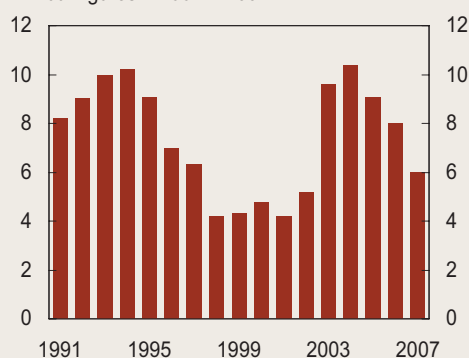


¹⁾ Total debt of non-financial enterprises mainland Norway (C3).

²⁾ Non-financial enterprises' liquid assets (M2).

Source: Statistics Norway

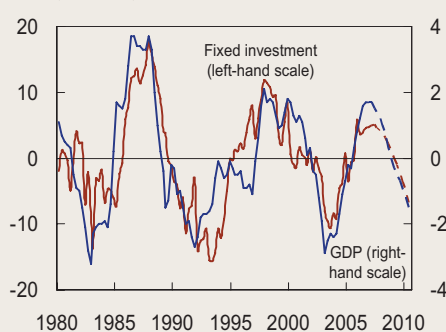
Chart 2.19 Vacant office premises in Oslo, Asker and Bærum. Share of total real estate stock. Annual figures.¹⁾ 1991 – 2007



¹⁾ As at February.

Source: Eiendomsspar AS

Chart 2.20 Mainland GDP and fixed investment. Percentage deviation from trend.¹⁾ Quarterly figures. 80 Q1 – 10 Q2²⁾

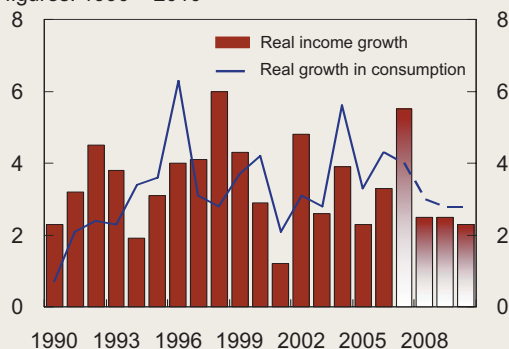


¹⁾ Trend calculated using Hodrick-Prescott filter. See *Staff Memo* 2005/2 (www.norges-bank.no) for further details.

²⁾ Based on annual projections for 2007 – 2010.

Sources: Statistics Norway and Norges Bank

Chart 2.21 Household real disposable income^{1,2)} and consumption. Annual rise. Per cent. Annual figures. 1990 – 2010³⁾



¹⁾ There is a break in the series between 1998 and 1999.

²⁾ Adjusted for estimated reinvested share dividends for 2000 – 2005.

³⁾ Projections for 2007 – 2010.

Sources: Statistics Norway and Norges Bank

Slower growth in business investment

Growth in business fixed investment will probably remain at a high level again this year. High export prices, low interest rates and cost efficiency measures following restructuring during the previous downturn have contributed to strong profitability growth. Preliminary accounts figures for the largest companies on the Oslo Stock Exchange indicate some levelling off in operating margins, but at a high level. Growth in credit to enterprises is on the rise. The stock of liquid assets is growing even faster (see Chart 2.18). The financial position of enterprises appears to be solid. A number of surveys, including the investment intentions survey for manufacturing, Statistics Norway's business tendency survey and the regional network, show that enterprises generally expect continued solid production growth and a high level of new orders. One exception is suppliers to the petroleum industry, where lower growth in petroleum investment may curb investment growth.

Strong growth in employment has reduced the excess capacity in the commercial property market, and there is now relatively limited vacant office space in some parts of Norway (see Chart 2.19). Figures for commercial property starts point to continued growth in investment in commercial buildings in the near term. After a period, however, growth may stagnate as a result of limited capacity in the building industry.

Business investment normally fluctuates in pace with the level of economic activity, with wider fluctuations through the business cycle (see Chart 2.20). After a period, a higher interest rate level and lower mainland GDP growth will probably reduce investment growth. Profitability will decline as a result of a higher rise in costs. Towards the end of the projection period, business investment will probably decline.

Interest rate hikes will curb growth in household consumption

High employment and real wage growth are contributing to strong growth in private consumption again this year (see Chart 2.21). Low unemployment and a high level of job security are bolstering growth in consumption. This also applies to higher asset prices, particularly for dwellings (see Chart 2.22). According to TNS Gallup's trend indicator, households are optimistic with regard to the outlook for their own financial position and the Norwegian economy.

Further out in the projection period, the gradual rise in interest rates is expected to restrain growth in household demand. Growth in household disposable income will slacken when interest rates rise and employment growth slows. With higher interest rates, it will be less attractive to debt-finance consumption and more attractive to save. In

2006 Q3, household debt came to 190% of household disposable income. The high debt level amplifies the impact of higher interest rates on household disposable income. More intense competition in the financial sector and adaptation to new capital adequacy requirements have reduced bank lending margins. Household borrowing rates have risen less than Norges Bank's policy rate for the past two years. It is assumed that a larger share of interest rate increases will be passed on to lending rates in the period ahead.

The household saving ratio is low and was negative in the second half of 2006, probably for the first time since the 1980s. Household net lending has fallen over the past few years and is now negative (see Chart 2.23). It is assumed that the saving ratio will remain at a low level in the period ahead and that net lending will level off around the current level.

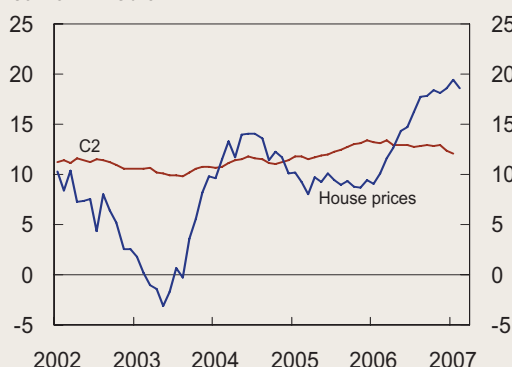
High demand for dwellings has contributed to a sharp rise in prices for both new and existing dwellings. House prices are expected to remain high over the next few years, but to rise more slowly as a result of higher interest rates. There is a substantial need for new dwellings, partly because of rapid population growth and increased urban migration. Because of capacity problems in the building industry and higher construction costs, growth in housing investment is expected to slow. Housing investment may drop towards the end of the projection period.

Tight labour market and little spare production capacity

So far, the sharp growth in demand for labour has been accommodated by both an increase in the labour supply and a decline in the number unemployed. Labour force participation has increased in recent years, but is still somewhat lower than during the previous expansion. Over a longer period, the share of the population on early retirement or disability benefit has been on the rise. In isolation, this leads to lower participation rates. After adjusting for this factor, labour force participation rates are now just below the levels recorded during the previous economic boom. There are still some available person-hour resources as a result of underemployment.

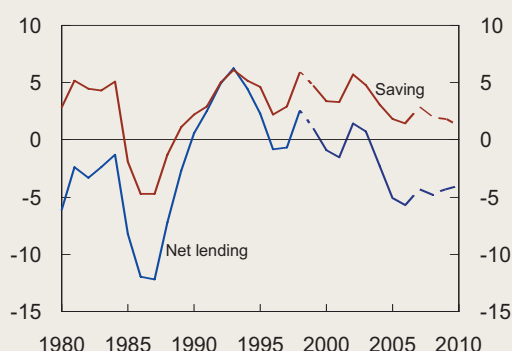
Labour force growth is expected to slow in the period ahead. The working-age population (16-74) is expected to increase by about 1% each year until 2010. The youngest and oldest age groups, which feature low participation rates, will account for a growing share of the labour force. In the case of the oldest groups, a high propensity towards disability benefit pushes down labour force participation. From 2008, the large post-war cohorts will gradually approach the age when they can retire under the contractual early retirement scheme (see Chart 2.24). The change in age composition will contribute to curbing labour force growth.

Chart 2.22 House prices and credit to households (C2). 12-month change. Per cent. Monthly figures. Jan 02 – Feb 07



Sources: Norwegian Association of Real Estate Agents, Association of Real Estate Agency Firms, Finn.no, ECON and Statistics Norway

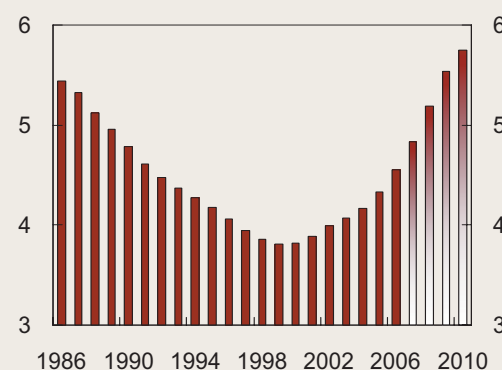
Chart 2.23 Household saving and net lending as a share of disposable income.^{1,2)} Annual figures. 1980 – 2010³⁾



¹⁾ There is a break in the series between 1998 and 1999.
²⁾ Adjusted for estimated reinvested share dividends for 2000 – 2005.
³⁾ Projections for 2007 – 2010.

Sources: Statistics Norway and Norges Bank

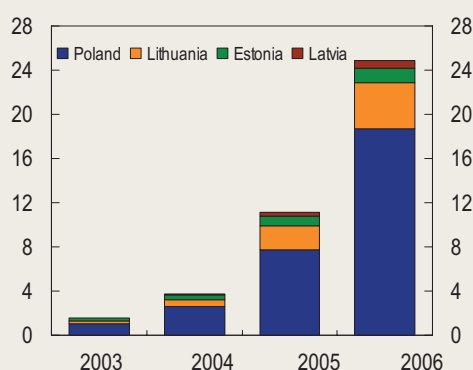
Chart 2.24 Population aged 62 to 67. Share of total population. Mean population. Annual figures. 1986 – 2010¹⁾



¹⁾ Projections for 2007 – 2010.

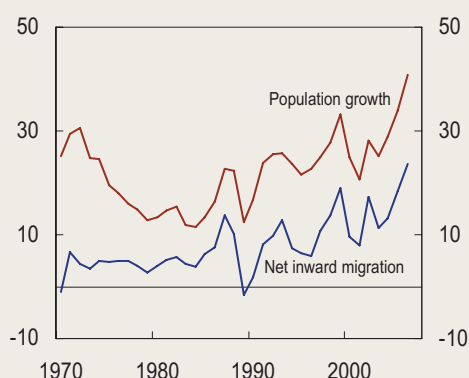
Sources: Statistics Norway and Norges Bank

Chart 2.25 Registered employees from new EU countries. In thousands. Annual figures. 2003 – 2006



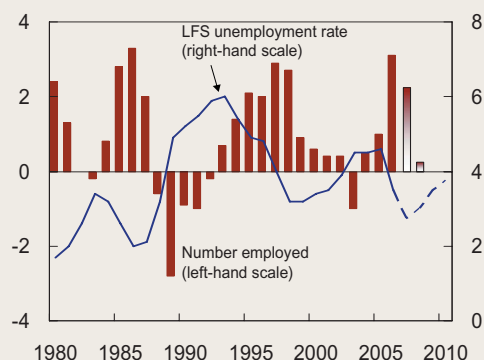
Source: Central Office - Foreign Tax Affairs

Chart 2.26 Population growth and net inward migration. In thousands. Annual figures. 1970 – 2006



Source: Statistics Norway

Chart 2.27 Percentage change in employment on previous year and unemployment (LFS) as a percentage of the labour force. Annual figures. 1980 – 2010¹⁾



¹⁾ Projections for 2007 – 2010.

Sources: Statistics Norway and Norges Bank

In periods of high employment growth, favourable conditions for finding employment will in itself contribute to increasing the labour supply. This makes a cyclical contribution to labour force growth. It is assumed that this effect will taper off in the course of 2007, but will still contribute to growth in the labour force from 2006 to 2007.

In the past three years, inward labour migration, particularly from the new EU member states, has increased the supply of labour and eased pressures in the labour market. In 2006, the number of persons from new EU member states on short-term assignments in Norway was 15 000 higher than in 2005 (see Chart 2.25). This is equivalent to an increase in the labour supply of about ½ percentage point in excess of growth in the traditional labour force of 1.6%. However, some of this inflow is not defined as employment in the national accounts. Work in the form of short-term assignments carried out by foreigners who are employed in foreign enterprises is defined as imported services. Irrespective, these workers increase the supply of labour in Norway.

It is assumed that the number of foreigners on short-term assignments may increase further by about 10 000 persons in 2007. In addition, a number of those on short-term assignments have decided to settle here, resulting in population growth that is higher than previously assumed in Statistics Norway's population projections (see Chart 2.26). If this trend continues, the working-age population will increase faster than indicated by Statistics Norway's current population projections.

Demand for labour is now increasing in the countries of origin of this labour. At the same time, it is assumed that demand for labour and employment growth in Norway will moderate (see Chart 2.27). With an already high number of workers on short-term assignments, the growth rate will probably abate gradually.

Capacity utilisation may peak in 2007

A lack of spare capacity will probably dampen output growth later in 2007. Despite high growth in the labour supply and inflows of labour from other countries, a shortage of labour will probably act as a constraint on further growth in a number of enterprises. Many enterprises report shortages of qualified labour as well as a shortage of intermediate goods and electricity.

To what extent growth in demand in 2007 can be met by higher growth in domestic production depends on productivity growth and the labour force. Both these variables have increased sharply in recent periods. After growing at a fast pace, productivity growth will normally edge down. Productivity growth has also slowed earlier when approaching the cyclical peak, for example in 1998 and

1999. It is assumed that productivity growth in 2007 will be somewhat lower than the average for the last 15 years. Coupled with somewhat lower labour force growth, this will lead to somewhat lower potential GDP growth in 2007 than in 2006.

Data shortcomings make it difficult to measure productivity growth. National accounts figures are highly uncertain and prone to extensive revision over time. For several of the years between 2000-2005 productivity growth has later been revised up (see Chart 2.28). The high productivity growth registered in the Norwegian economy since the end of the 1990s may be an expression of a more permanent shift (see Chart 2.29). In the event, the potential for sustained high economic growth will be greater than assumed, and the output gap, which is an expression of capacity utilisation in the economy, will be somewhat lower.

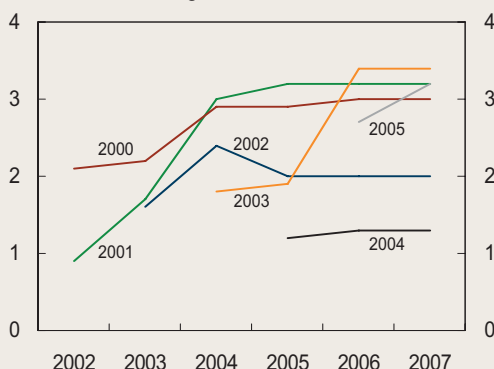
The output gap will show a further increase from 2006 to 2007 and the cyclical peak will be reached in the course of 2007 according to our projections. Economic growth remains buoyant, supported by robust demand growth. In the light of the constraints on further growth in domestic production, imported goods and services will probably account for a rising share of demand. It is therefore assumed that import shares in 2007 will increase at a somewhat faster pace than trend.

The number employed also increased sharply in 2006 (see Chart 2.30), and employment growth will also be high this year. According to the regional network, all industries are planning to increase employment, but at a somewhat slower pace than at the end of 2006. It is estimated that unemployment will reach its lowest level in this cyclical upturn in the course of the year.

As from 2008, slower growth in domestic demand and the gradual rise in the interest rate will result in production growth that is below potential growth. Unemployment may thus increase somewhat, but will probably remain at a low level up to 2010. The output gap will gradually close. Slower growth in private consumption and housing investment and lower investment growth in private enterprises are the primary forces behind slower growth in domestic demand towards the end of the projection period. Weak competitiveness may gradually depress growth in export-oriented industries.

It is assumed that growth in private consumption and investment will ease towards the end of 2007. If growth in these demand components remains at a high level for a longer period than expected, the decrease in the output gap may come at a later time than expected. In isolation, this might lead to a stronger rise in domestic costs and a

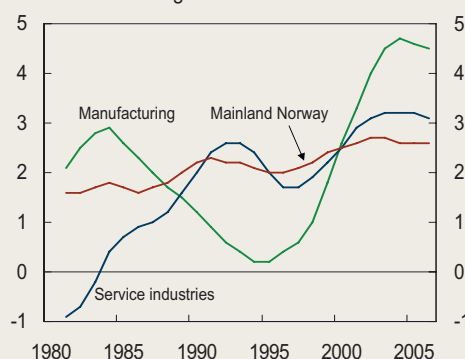
Chart 2.28 Mainland productivity growth.¹⁾
Per cent. Annual figures. 2002 – 2005



¹⁾Value added per person-hour from 2000 to 2005 from different versions of the national accounts published in the period 2002 – 2007.

Sources: Statistics Norway and Norges Bank

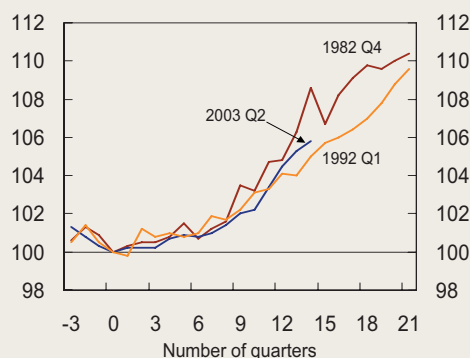
Chart 2.29 Productivity growth in manufacturing, service industries and mainland Norway. Trend.¹⁾
Per cent. Annual figures. 1981 – 2006



¹⁾ Trend calculated using Hodrick-Prescott filter. See Staff Memo 2005/2 (www.norges-bank.no) for further details.

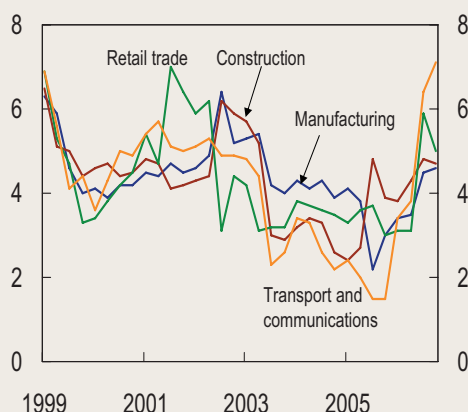
Sources: Statistics Norway and Norges Bank

Chart 2.30 Number employed (from quarterly national accounts). Developments after the start of a cyclical upturn. Index. Quarter 0 = 100.
Seasonally adjusted



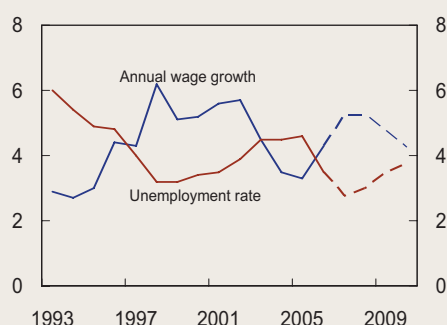
Sources: Statistics Norway and Norges Bank

Chart 2.31 Monthly pay, 4-quarter change. Per cent. Quarterly figures. 99 Q1 – 06 Q4



Source: Statistics Norway

Chart 2.32 Annual wage growth¹⁾ and LFS unemployment. Per cent. Annual figures. 1993 – 2010²⁾

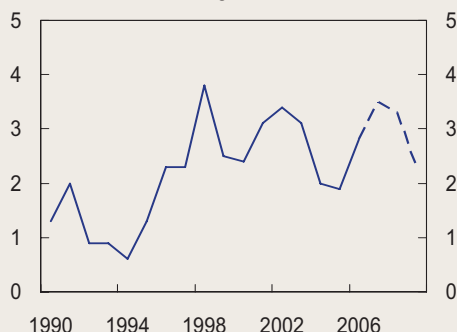


¹⁾ Average for all groups. Including estimated costs of increase in number of vacation days and introduction of mandatory occupational pension.

²⁾ Projections for 2007 – 2010.

Sources: Technical Reporting Committee on Income Settlements, Statistics Norway and Norges Bank

Chart 2.33 Annual wage growth¹⁾ deflated by the CPI²⁾. Per cent. Annual figures. 1990 – 2009



¹⁾ Average for all groups. Including estimated costs of increase in number of vacation days and introduction of mandatory occupational pension. Projections for 2007 – 2009.

²⁾ 3-year centered moving average. CPI projections 2007 – 2010.

Sources: Technical Reporting Committee on Income Settlements, Statistics Norway and Norges Bank

loss of competitiveness, which in turn may contribute to closing the gap and reducing demand for labour. On the other hand, household debt accumulation has been high for a long period. Further ahead, it is assumed that investment in financial assets will be negative. A rapid increase in household saving could result in markedly lower growth in domestic demand. The output gap will then close more rapidly.

Wage and price inflation will pick up

Wage growth is picking up

In recent years, increased inward labour migration and possibilities for relocating parts of production abroad have led to increased labour market competition. It is likely that this has contributed to restraining wage growth (see box on page 44). Last years' negotiated pay increases do not appear to fully reflect labour market tightening through the year. This may also be attributable to the fact that unemployment did not fall markedly until after the wage negotiations had begun. A tight labour market is likely to contribute to higher wage demands in 2007 and prompt companies to offer higher pay to many groups. Wage growth is now high in industries with solid profitability and in industries that make extensive use of bonuses, such as the petroleum sector and the financial sector (see Chart 2.31). Wage drift through 2006 was relatively high in several industries, especially for sought-after labour such as engineers and other workers with technical skills. The wage carry-over into 2007 is slightly higher than projected in *Inflation Report* 3/06.

The wage share in Norwegian companies has fallen in recent years and is now at the level prevailing in the mid-1990s. Unemployment is low. The number of job vacancies is increasing, while productivity growth in the business sector remains high. These factors, together with the decline in unemployment through the second half of 2006, form the basis for our current projection of some increase in wage growth this year (see Chart 2.32). With consumer price inflation of an estimated $\frac{3}{4}\%$, real wage growth may prove to be very high. The increase in net interest expenses will curb growth in household real disposable income. Consumer price inflation varies somewhat from year to year due to large fluctuations in electricity prices. These fluctuations are not likely to be fully reflected in nominal pay increases. In 2008, nominal wage growth is projected at $5\frac{1}{4}\%$, while real wage growth will moderate somewhat. For the two years as a whole, annual real wage growth is projected at $3\frac{1}{2}\%$ (see Chart 2.33), which is higher than projected growth in productivity.

In that case, wage growth in 2007 and 2008 implies deteriorating profitability and an increase in the wage share in the business sector. In addition, rising prices for a number

of intermediate goods and services, such as building materials and transport services, will contribute to an erosion of profitability in parts of the business sector. As resource utilisation in the economy declines and unemployment rises somewhat through 2009 and 2010, wage growth is also likely to decline.

Foreign competition, combined with possibilities for relocating production, may contribute to curbing wage growth ahead. However, it cannot be ruled out that labour shortages and expectations of high income growth may result in higher-than-projected wage growth.

Higher inflation from 2008

Consumer price inflation remained around 2.5% through much of 2006 (see Chart 2.34). The high rate of increase in electricity prices and oil prices pushed up the consumer price index (CPI). At the beginning of 2007, CPI inflation fell sharply owing to lower electricity prices.

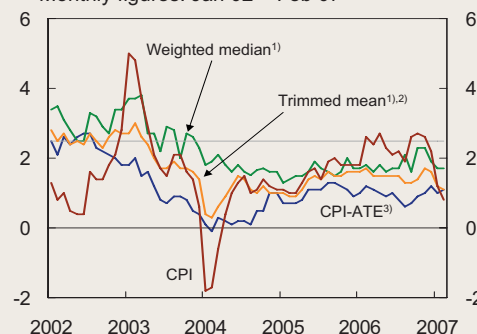
Following a period of slightly higher-than-projected inflation, underlying inflation is now approximately at the same level as projected in *Inflation Report 3/06*. Our overall assessment is that underlying inflation is now in the interval 1 – 1½%. Adjusted for tax changes and excluding energy products, the year-on-year rise in consumer price inflation (CPI-ATE) was 1.1% in February. CPI-ATE inflation has remained around this level in the past year. The rate of increase in prices measured by a trimmed mean of the rise in the sub-indices in the consumer price index was 1.1 per cent in February. As measured by the weighted median, the rate of increase was 1.7 per cent in February.

Forward electricity prices point to considerably lower electricity prices in 2007 than in 2006. This may result in very low inflation measured by the CPI through summer (see Chart 2.35). Fluctuations in electricity prices contribute to considerable uncertainty regarding CPI developments. Uncertain variables such as temperature and precipitation levels ahead will have a large impact on forward prices, and hence on our projections.

Consumer price inflation adjusted for tax changes and excluding energy products shows a more stable path. In the baseline scenario, the rise in the CPI adjusted for tax changes and excluding energy products gradually picks up towards 2½% over the next three years.

As the policy rate is gradually raised to a more normal level, demand and employment growth will abate, and wage growth will again moderate. This contributes to stabilising inflation close to target in the period to 2010.

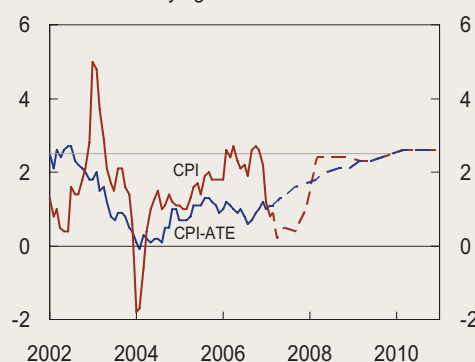
Chart 2.34 CPI and indicators of underlying inflation. 12-month change. Per cent. Monthly figures. Jan 02 – Feb 07



¹⁾ Estimated on the basis of 146 sub-groups of the CPI-AT
²⁾ Price changes accounting for 20% of the weighting base are eliminated.
³⁾ CPI-ATE: CPI adjusted for tax changes and excluding energy products. A further adjustment is made for the estimated effect of reduced maximum day-care rates in 2006.

Sources: Statistics Norway and Norges Bank

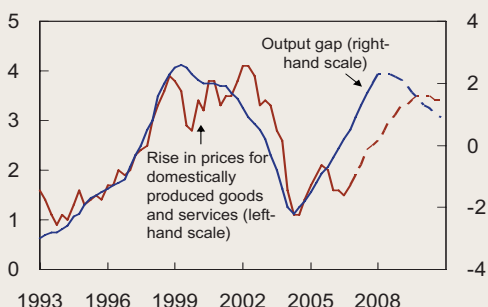
Chart 2.35 CPI and CPI-ATE¹⁾. 12-month change. Per cent. Monthly figures. Jan 02 – Dec 10²⁾



¹⁾ CPI-ATE: CPI adjusted for tax changes and excluding energy products. A further adjustment is made for the estimated effect of reduced maximum day-care rates in 2006.
²⁾ Projections for March 2007 – December 2010.

Sources: Statistics Norway and Norges Bank

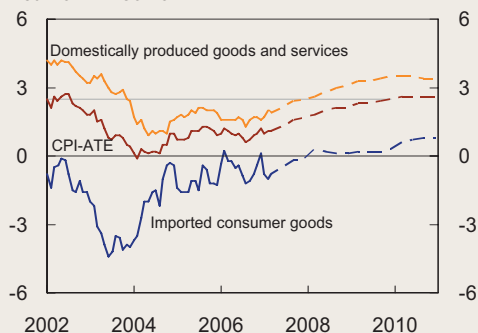
Chart 2.36 Rise in prices for domestically produced goods and services measured by the CPI-ATE¹⁾ (4-quarter rise) and output gap level (lagged by 4 quarters). Quarterly figures. 93 Q1 – 10 Q4²⁾



¹⁾ CPI-ATE: CPI adjusted for tax changes and excluding energy products. A further adjustment is made for the estimated effect of reduced maximum day-care rates in 2006.
²⁾ Projections for period 2007 Q1 – 2010 Q4.

Sources: Statistics Norway and Norges Bank

Chart 2.37 CPI-ATE.¹⁾ Total and by supplier sector²⁾. 12-month rise. Per cent. Monthly figures. Jan 02 – Dec 10³⁾



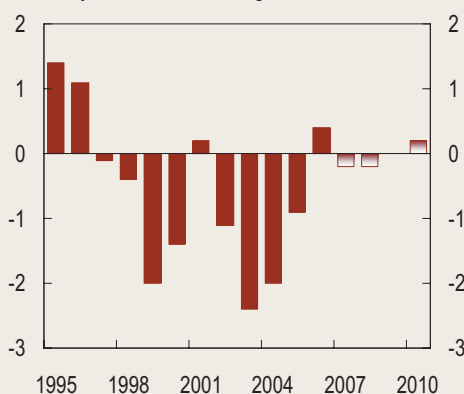
¹⁾ CPI-ATE: CPI adjusted for tax changes and excluding energy products. A further adjustment is made for the estimated effect of reduced maximum day-care rates in 2006.

²⁾ Norges Bank's estimates.

³⁾ Projections for March 2007 – December 2010.

Sources: Statistics Norway and Norges Bank

Chart 2.38 Indicator of external price impulses to imported consumer goods measured in foreign currency. Per cent. Annual figures. 1995 – 2010¹⁾



¹⁾ Projections for 2007 – 2010.

Source: Norges Bank

Adjusted for the introduction of maximum day-care rates, the rise in prices for domestically produced goods and services was around 1.6% through most of 2006. In February 2007, domestic inflation rose to 2.0 per cent. There are probably several reasons why the rise in prices for domestically produced goods and services is picking up somewhat later during this cyclical expansion than the historical relationship between the rise in these prices and capacity utilisation would imply (see Chart 2.36). Moderate wage growth has contributed to low price increases in recent years, and accelerating wage growth through 2006 is probably not yet fully reflected in prices. It is likely that the subdued rise in prices for imported, processed intermediate goods has curbed the rise in prices for goods and services. In recent years, competition has increased in many product markets (see box on page 46). In many industries, high productivity growth has also had a dampening impact on inflation.

Some of these factors may continue to influence inflation in the period ahead, albeit to a lesser extent than earlier. While higher wage growth and more moderate productivity growth are contributing to increasing unit labour costs, continued strong competition may prevent this cost increase from fully feeding through to prices. However, it is assumed that competition will curb inflation to a lesser extent, and that high capacity utilisation along with accelerating wage growth will gradually push up the rise in domestically produced goods and services ahead (see Chart 2.37).

Developments in producer and wholesale prices may provide information on developments in consumer prices ahead. In the course of 2006, producer prices for consumer goods and the wholesale price index rose more than the rise in prices for domestically produced goods that are included in the CPI. Towards the end of 2006, the rise in both the producer price index and the wholesale price index was pushed down by the fall in energy prices. According to the regional network, expectations of a rise in selling prices ahead have increased in a number of industries, particularly in building and construction, domestically oriented manufacturing and corporate services. The rise in prices for these products may gradually be passed on to prices for household goods and services.

Imported consumer goods will continue to curb inflation

Trade liberalisation and a shift in imports towards low-cost countries have over a longer period resulted in negative price impulses from imported consumer goods, measured in foreign currency (see Chart 2.38). However, the shift in imports was somewhat less pronounced in 2006 than in previous years. This may indicate that price effects from trade

shifts will be more moderate ahead. In 2006, the rise in prices for oil and other commodities over several years led to a somewhat sharper rise in producer and export prices among our traditional trading partners. Price impulses from imported goods, excluding the effects of exchange rate changes, were therefore positive.

We assume that the shift towards imports from low-cost countries will continue, but that it will gradually diminish through the projection period. Lower energy prices and a stabilisation or fall in other commodity prices will lead to slightly weaker imported price impulses in 2007 than in 2006. On balance, it is assumed that price impulses from imported consumer goods, measured in foreign currency, will be close to zero in the years ahead.

The krone appreciation through 2004 and 2005 contributed to cheaper imported consumer goods in 2006. The krone depreciated through the latter half of 2006, and on the whole previous exchange rate movements will have limited influence on price developments for imported goods in 2007. Further ahead, the krone is expected to be relatively stable. We project that higher domestic cost and price inflation will also lead to higher selling prices for imported goods. Selling prices for imported consumer goods will probably fall a little this year. These prices are expected to increase by between $\frac{1}{4}\%$ and $\frac{3}{4}\%$ in each year between 2008 and 2010.