INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/297

NORWAY

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NORWAY

September 2024

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Norway, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 13, 2024 consideration of the staff report that concluded the Article IV consultation with Norway.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 13, 2024, following discussions that ended on June 28, 2024, with the officials of Norway on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 31, 2014.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Norway.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR 24/333

IMF Executive Board Concludes 2024 Article IV Consultation with Norway

FOR IMMEDIATE RELEASE

Washington, DC – September 18, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Norway.

Real GDP growth slowed to 0.5 percent in 2023 from a cyclical peak of 3.5 percent on average over 2021–22. Private consumption and gross fixed investment, particularly residential investment, declined amid tighter financial conditions, with exports and public spending providing some support. The tighter financial conditions have also impacted the commercial real estate (CRE) sector amid rising debt-servicing costs and declining valuations. While retreating from its 2022 multiyear peak, headline inflation remains high and above the 2 percent target, with persistent services inflation keeping core inflation elevated. The weaker currency has also contributed to keeping inflation high, while inflation expectations remain above the inflation target. The fiscal policy stance is expansionary. Although easing since early 2024, financial conditions remain tight, reflecting a restrictive monetary policy stance following Norges Bank's cumulative 450 bps increase in its policy rate. Macroprudential policy settings have been tightened across several dimensions over the past two years, and systemic risks are not building up further. The financial system is sound, and bank buffers are robust but vulnerabilities remain high.

Economic activity is projected to rebound in 2024, and real GDP growth would rise to 1.5 percent, supported by a stronger offshore sector, while mainland activity would remain subdued and would rise by 0.8 percent, amid still tight financial conditions. Inflation is projected to reach 3.3 percent by end-2024 and return to the target by mid-2026. Amidst still high uncertainty, risks to the growth and inflation outlook are balanced.

Executive Board Assessment[2]

Directors agreed with the thrust of the staff appraisal. They welcomed the expected rebound in growth, noting that risks to the outlook are broadly balanced. Directors highlighted the need to carefully navigate policy trade-offs arising from elevated inflation and financial sector vulnerabilities. They underscored the importance of comprehensive structural reforms to address

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing ups can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

the challenges posed by population ageing, productivity slowdown, and geoeconomic fragmentation.

Directors underscored the need to maintain a tight monetary policy stance to ensure that inflation converges to target and to mitigate risks of a de-anchoring of inflation expectations. They encouraged the authorities to continue to employ a data-dependent approach, remaining ready to adjust the monetary policy stance as needed.

Directors welcomed that the financial system is stable, with robust buffers. Noting elevated systemic risks, Directors agreed that macroprudential policy settings should remain tight and recommended continued close monitoring. Elevated household indebtedness and high exposure to commercial real estate (CRE) underscored the need for continued prudent policies. Directors encouraged further progress on the implementation of 2020 FSAP recommendations and welcomed the strengthening of the Financial Stability Authority (Finanstilsynet).

Directors recommended adopting a neutral fiscal stance, highlighting that removing the current fiscal stimulus would support disinflation. They emphasized that discretionary fiscal stimulus should be well-targeted and temporary and deployed only if needed. Directors encouraged efforts to address the increased reliance on natural resource revenues and to adopt measures to ensure that higher defense and ageing-related spending needs can be accommodated. Important measures include increasing the efficiency of the tax system, restructuring the pension and social protection regimes, and complementing the fiscal policy framework with enhanced medium-term budgeting and an expenditure rule.

Directors underscore that comprehensive reforms are needed to foster diversification, raise productivity growth, and mitigate the impact of geoeconomic fragmentation. They emphasized that reforming the sickness and disability benefits systems would help to bolster labor supply. Directors welcomed the authorities' commitment to enhancing climate mitigation and adaptation.

Norway: Selected Economic and Social Indicators, 2021–2029[1/]

				Projections					
	2021	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Real economy									
Real GDP (change in percent)1/	3.9	3.0	0.5	1.5	1.8	1.7	1.6	1.4	1.4
Real mainland GDP (change in percent)	4.5	3.7	0.7	0.8	1.5	1.5	1.5	1.5	1.4
Final Domestic demand	3.9	5.1	0.3	0.4	1.5	1.7	1.7	1.6	1.6
Private consumption	5.1	6.2	-0.8	0.8	1.2	1.8	1.8	1.8	1.8
Public consumption	3.6	1.1	3.4	2.0	1.8	1.5	1.5	1.5	1.5
Gross fixed capital formation	1.6	7.6	-1.2	-2.2	1.7	1.6	1.7	1.4	1.3
Exports	7.3	9.3	4.6	2.5	2.4	2.4	2.4	2.4	2.4
Imports	2.8	14.7	0.6	1.3	2.1	2.3	2.3	2.3	2.3
Real Offshore GDP (change in percent)	-0.3	0.6	-0.1	4.2	2.9	2.2	1.8	1.0	1.0
Unemployment rate (percent of labor force)	4.4	3.3	3.6	3.8	3.8	3.8	3.8	3.8	3.8
Output gap(mainland economy-implies output below potential)	-0.7	1.5	0.6	-0.2	-0.2	-0.1	0.0	0.1	0.1
CPI (average)	3.5	5.8	5.5	3.3	2.4	2.0	2.0	2.0	2.0
Core Inflation (average)	1.7	3.9	6.2	3.9	2.8	2.4	2.2	2.0	2.0
Public finance									
Central government (fiscal accounts basis)									
Non-oil balance (percent of mainland GDP)	-11.1	-7.8	-7.5	-8.4	-8.7	-9.0	-9.2	-9.4	-9.6
Structural non-oil balance (percent of mainland trend GDP)	-10.1	-9.2	-9.7	-10.4	-11.1	-11.7	-12.0	-12.2	-12.3
2/									
Fiscal impulse	-1.0	-0.9	0.5	0.7	0.7	0.6	0.3	0.2	0.1
In percent of Pension Fund Global Capital 3/	-3.2	-2.7	-3.0	-2.7	-2.6	-2.6	-2.7	-2.7	-2.6
Gross Public Debt (percent of GDP)	41.6	36.3	44.0	42.7	42.7	42.7	42.3	41.6	40.9
Money and credit (end of period, 12-month percent change)									
Broad money, M2	10.4	5.6	0.3	...	...	...	...	...	...
Domestic credit, C2	4.9	5.6	3.8	...	...	...	...	...	...
Interest rates (year average, in percent)									
Three-month interbank rate	0.5	2.1	4.2	4.8	4.0	3.5	3.3	3.3	3.3
Ten-year government bond yield	1.4	2.9	3.4	3.7	3.2	2.8	2.6	2.6	2.6
Balance of payments (percent of total GDP)									
Current account balance	14.9	30.2	17.9	14.5	12.5	10.6	8.8	7.6	6.6
Balance of goods and services (percent of mainland GDP)	19.4	44.3	19.6	20.6	17.6	14.7	12.6	11.0	9.6
Terms of trade (change in percent)	50.8	44.1	-29.4	8.6	4.3	-0.6	-1.4	-1.6	-0.9
International reserves (end of period, in billions of US dollars)	83.0	72.1	77.4	77.4	77.4	77.4	77.4	77.4	77.4
Gross national saving	40.0	51.9	43.8	39.8	38.5	37.1	35.7	34.8	33.9
Gross domestic investment	25.1	21.7	25.9	25.3	26.0	26.6	26.9	27.2	27.3
Exchange rates (end of period)									
Bilateral rate (NOK/USD), end-of-period	8.6	9.6	10.6	...	...	...	...	...	...
Nominal effective rate (2010=100)	80.5	79.9	73.2	...	...	...	...	...	...
Real effective rate (2010=100)	83.1	80.9	74.1	...	...	...	...	...	...
Memo:									
Nominal GDP (in Billions of US Dollars)	503.4	593.7	485.3	504.3	507.6	509.4	521.3	534.9	549.5

Sources: Norwegian Authorities; International Financial Statistics; United Nations Development Programme; and IMF staff calculations.

1/ Based on information available as of July 30, 2024.

2/ Based on market prices which include "taxes on products, including VAT, less subsidies on products."

3/ Authorities' key fiscal policy variable; excludes oil-related revenue and expenditure, GPFG income, as well as cyclical effects. Non-oil GDP trend estimated by MOF.

4/ Over-the-cycle deficit target: 3 percent of Government Pension Fund Global.

INTERNATIONAL MONETARY FUND

NORWAY

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

July 31, 2024

KEY ISSUES

Context: Boosting labor supply, containing public expenditure pressures, and raising productivity will be required for Norway to be able to continue its strong economic performance and preserve its welfare model. A recent White Paper by the Ministry of Finance rightly raises these key issues facing Norway's economy in the longer term.

Outlook and risks: Real GDP growth slowed in 2023 and is expected to gradually rebound in the near term as private domestic demand strengthens supported by higher real incomes. While retreating, headline inflation remains high and above the 2 percent target, with core inflation, while falling, still elevated. Inflation is expected to converge to target by 2026. The risks to the growth and inflation outlooks are balanced, amidst high uncertainty.

Main policy recommendations:

Monetary: The monetary policy stance should remain restrictive, as reining in high inflation remains the most pressing policy challenge. Norges Bank was among the first advanced economy central banks to hike its policy rate, but inflation is receding slowly. Therefore, a tight monetary policy stance is required to ensure that inflation durably returns to target and to mitigate risks of de-anchoring of inflation expectations.

Financial sector: Tight macroprudential policies should remain in place to mitigate systemic vulnerabilities. The financial system appears resilient and banking system buffers are strong. However, systemic vulnerabilities remain elevated, which warrants continued close monitoring of risks to financial stability, including from elevated exposures to commercial real estate and from high levels of household debt in a context of a sustained period of high interest rates.

Fiscal: The 2024 budget envisions a continuation of the previous year's expansionary fiscal stance. A neutral fiscal stance, achieved through spending reprioritization and building buffers in case upside risks materialize, would significantly bolster efforts to reduce inflation.

Structural: Long-term fiscal challenges should be more forcefully addressed. Norway has the largest proportion of the population on disability-related benefits among OECD countries, and reforming costly and distortionary social benefit systems is possibly the most important and politically-difficult reform pending. Although Norway boasts one of the highest levels of labor productivity among its peers, it has slowed faster than in other countries. To reverse this trend, conditions should be improved to facilitate sectoral reallocation as well as innovation and technology adoption.

Approved By
Mark Horton (EUR) and Natalia Tamirisa (SPR)

The Article IV Consultation discussions took place in Oslo during June 18–28, 2024. The IMF staff comprised Emil Stavrev (head), Luisa Charry, Cristina Cheptea, and Mauricio Vargas (all EUR). Bjørnar Slettvåg (OED) joined the discussions. Chikako Baba, Allan Dizioli, Reza Yousefi (all EUR), Yao Deng and Alexander Malden (LEG) contributed from HQ. Rohan Srinivas and Rachelle Vega (both EUR) provided research and administrative support. The mission met with Governor Ida Wolden Bache and other senior officials at Norges Bank, State Secretary Erlend Trygve Grimstad and other senior officials from the Ministry of Finance and Finanstilsynet, members of parliament, representatives of labor unions, the business community, academia, CSOs and think-tanks.

CONTENTS

ANNEXES

Glossary

AE	Advanced Economy
BBM	Borrower-Based-Measure
CCyB	Countercyclical Capital Buffer
CRE	Commercial Real Estate
CET1	Common-Equity-Tier 1
DTI	Debt-to-Income ratio
DORA	Digital Operational Resilience Act
DSTI	Debt-Service-to-Income ratio
ETS	Emissions Trading Scheme
EU	European Union
FDI	Foreign Direct Investment
FSA	Financial Stability Authority (Finanstilsynet)
FSAP	Financial Sector Assessment Program
GPFG	Government Pension Fund Global
ICR	Interest Coverage Ratio
ICT	Information and Communication Technologies
IFRS	International Financial Reporting Standards
IRB	Internal-Ratings-Based
LTV	Loan-to-Value ratio
MoF	Ministry of Finance
MPC	Monetary Policy Committee
NDC	Nationally Determined Contribution
NBFI	Non-Bank Financial Intermediary
NPL	Non-Performing Loan
NOK	Norwegian Krone
REER	Real Effective Exchange Rate
RRE	Residential Real Estate
SRB	Systemic Risk Buffer
SREP	Supervisory Review Process
WEO	World Economic Outlook

CONTEXT AND RECENT DEVELOPMENTS

1. A cyclical slowdown has ensued from the tight monetary policy required to bring inflation under control. Against this backdrop, macroeconomic management will have to navigate policy trade-offs and near-term vulnerabilities arising from still elevated inflation, highly leveraged households under pressure from elevated interest rates and a weakening labor market, and the financial system's sizable exposures to firms in the struggling real estate sector.

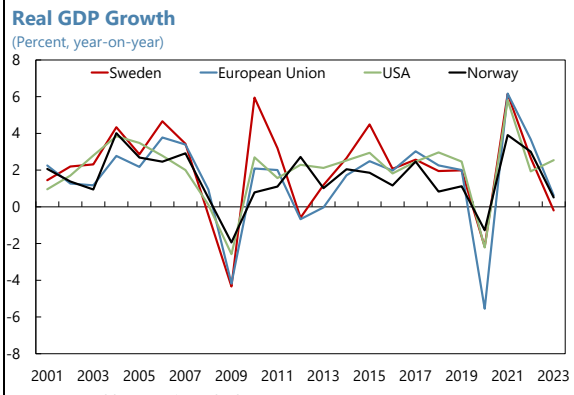
2. Economic activity slowed significantly in both the offshore and mainland segments in 2023 (Text Figure 1, Figure 1). Following strong performance in 2022, overall real GDP growth slowed to 0.5 percent in 2023 from a cyclical peak of 3.5 percent on average over 2021–22, driven by weaker mainland activity. While activity in the offshore segment fell 0.1 percent, mainland real GDP growth receded significantly to 0.7 percent in 2023 (from 3.7 percent in 2022). This reflected a downturn in private domestic demand driven by lower real incomes and tighter financial conditions that weighed on household consumption and construction investment. Higher public consumption and resilient exports on the back of still-favorable terms of trade provided some support.[1] The positive output gap is estimated to have closed. Although the level of employment remains high, the unemployment rate has increased from a low base and firms are reporting some easing of labor market conditions. Available data for the first half of 2024, including high frequency survey indicators, point to a stabilization in economic activity more recently.

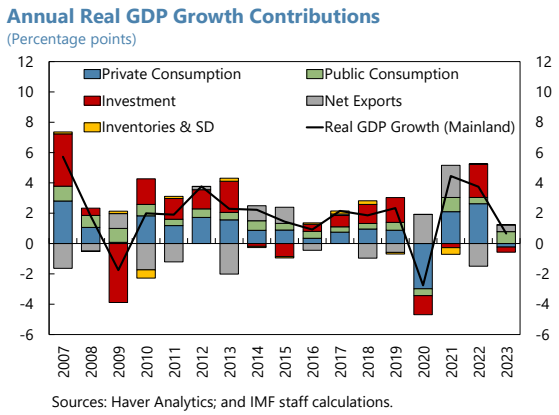
3. Both headline and core inflation eased in 2023 but remain above the 2 percent target. Headline inflation fell to 2.6 percent y/y in June 2024 from a peak of 7.5 y/y percent in October 2022, on the back of lower energy prices, falling imported inflation, and slowing domestic demand. Disinflation has been broad-based, except for some services that help explain still-elevated seasonally adjusted core inflation (3.4 percent as of June). Near and medium-term inflation expectations are above the inflation target and risk remaining persistently elevated partly due to wage pressures (Annex I). Nominal wages rose 5.2 percent on average in 2023 and are expected to rise a further 5.2 percent this year, resulting in the first increment in average real wages since 2021.

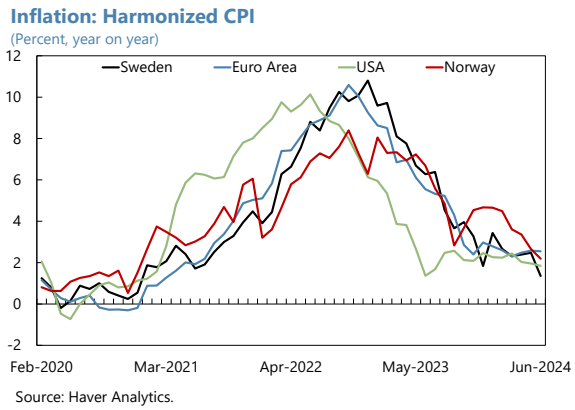
4. Although easing from late 2023, financial conditions remain tight, reflecting a restrictive monetary policy stance (Figure 2). Norges Bank continued a tightening cycle started in late 2021 and has delivered a cumulative 450 bps increase in its policy rate to 4½ percent as of end-July. The transmission of policy rate hikes to lending interest rates has been strong, reflecting a high share of variable-rate lending; deposit rates have lagged increases in policy and lending rates. Bank credit to the mainland economy contracted in real terms, both to households and corporates; lending standards have tightened. Bond financing has been weak but, after rising for much of 2022, corporate bond spreads have stabilized at above pre-pandemic levels. The tighter financial conditions have affected the real estate and construction sectors most notably.

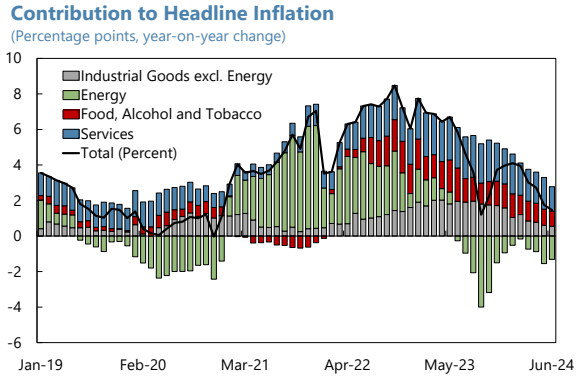
[1] Oil prices (Brent reference) fell some 17 percent in 2023 but they remain 20 percent above their 10-year average.

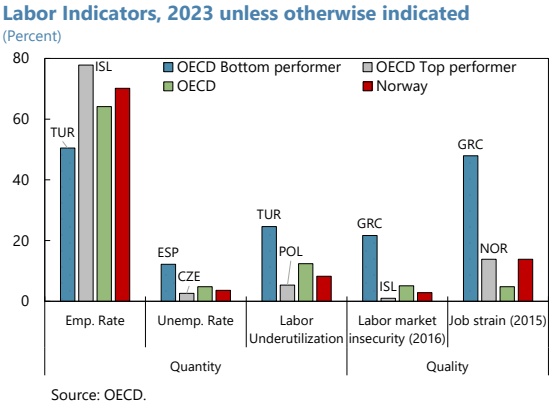
Text Figure 1. Norway: Real GDP, Labor Market, and Inflation Developments

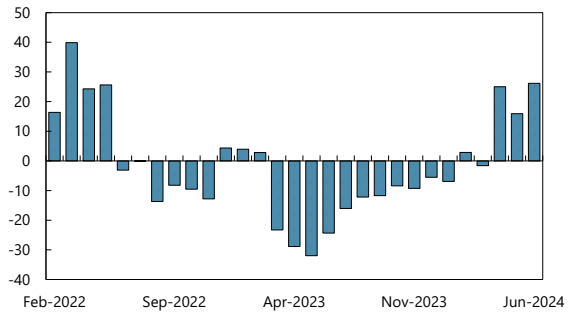












5. While the financial system is sound and buffers are robust, systemic vulnerabilities are elevated (Figures 3–4). Bank profitability rose to the highest level in 15 years, reflecting higher net interest income and contained operating expenses. While credit losses and NPLs are low, they are edging up, and the share of loans in stage 2 and 3 has increased. The average leverage ratio decreased, but it is still comfortably above the minimum requirement. CET1 capital ratios remain above the 15.5 percent regulatory requirement, including those of the largest banks (~18 percent),

although average risk weights have declined in IRB banks.[2] Banks meet liquidity and stable funding requirements by ample margins. Insurers and pension funds profitability improved in 2023 reflecting higher stock prices and interest rates. Average solvency requirements in both sectors have been met by a large margin. The main sources of systemic risk arise from elevated financial sector exposures to the real estate sector and from high levels of household debt in a context of a sustained period of elevated interest rates.

6. Prudential policy settings have been tightened further (Text Table 1). The CCyB was raised to 2.5 percent (from 0 percent) effective March 2023, the coverage of LTV limits was extended to loans with collateral other than real estate (i.e., auto loans) and secondary dwellings in Oslo, effective July 2023,[3] and the systemic risk buffer requirement for non-IRB banks was increased from 3 percent to 4.5 percent, effective December 2023.[4] Further stress tests of lending standards and an additional 34 requirements under Pillar 2 were introduced in 2023. A combined and customer-distributed buffer fund for private guaranteed pension products was set up in January 2024.[5]

Text Table 1. Norway: Summary of Main Prudential Measures (2022–2023)

Capital and Systemic Risk Buffers		
CCyB	Increased to 2.5 percent	Counteract procyclicality
SRB	Increased to 4.5 percent	Mitigate risks not covered by other capital requirements
Risk weight floors[1]	Floors of 35 percent and 20 percent on CRE and RRE exposures (under Pillar I)	Ensure banks hold sufficient capital against potential losses in these sectors
BBMs and Lending Standards		
LTV	Extended to loans collateralized by assets other than real estate	Mitigate risks arising from high leverage
Stress testing of lending standards[2]	Borrowers must be able to cover regular expenses (see fn. 2 for details)	Strengthen the assessment of a borrower's debt-service ability
Additional Regulatory Measures		
Pillar 2 requirements	34 additional requirements	Address specific risks not covered by Pillar 1 requirements
Buffer fund	Can be used to cover negative returns on private pension products	Enhance the resilience of pension products against market volatility

Sources: Country authorities, and IMF staff.
1/ Risk weight floors of 35 percent and 20 percent on CRE and RRE exposures were introduced in 2022.
2/ To assess a customer's debt-service ability lenders must ensure that the customer has sufficient funds to cover regular expenses after an interest rate increase of 3 percentage points. At a minimum, the customer must be able to be to cover regular expenses if the interest rate was 7 percent (from 5 percent previously). Lenders may deviate from the DTI requirement and stress test when issuing a residential mortgage loan where the purpose of the loan is to restructure existing debt held by borrowers that are not able to service the debt.

7. The fiscal position is strong, but the expansionary fiscal stance might increase risks of policy miscalibration (Figure 5). Fiscal space is substantial, and public debt is sustainable (Annex II). Following a record-high outturn in 2022, the 2023 general government budget surplus fell to about 22 percent of mainland GDP, and the structural non-oil deficit rose to 9.7 percent of mainland trend

[2] The reduction mainly reflects the removal of the Basel I floor from end-2019.

[3] See Amendments to the lending regulation. Following the BBMs introduction, there has been an accumulation of new residential mortgages with an LTV ratio and/or a DTI ratio just below the regulatory requirement indicating that the limits are binding.

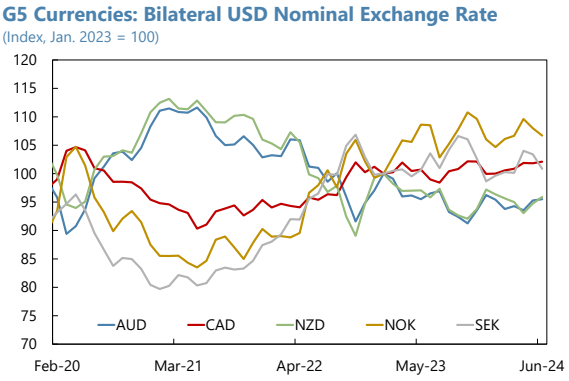
[4] See Banks' capital requirements unchanged.

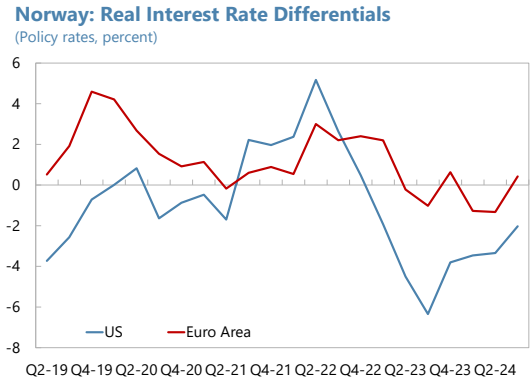
[5] The buffer funds replace the current supplementary provisions and fluctuation reserves.

GDP, within the limit allowed under the fiscal rule[6] and reflecting, among other factors, increased defense spending. Public debt levels remained low at around 44 percent of GDP. In turn, the value of the GPFG rose to 409 percent of mainland GDP, reflecting substantial petroleum revenues, a 16.1 percent return on assets, and the depreciation of the currency.

8. The weaker currency has contributed to keeping inflation high. In 2023, the NOK fell 10 percent against the USD and 13.1 percent against the EUR, a movement similar to other cyclical G-10 currencies such as the Swedish Krona and the Canadian dollar. The depreciation reflects negative real interest rate differentials against trading partners and lower oil prices, among other factors (IMF, 2023, Annex III). Studies for Norway indicate that a 1 percent depreciation of the currency results in a 0.1 percent increase in core inflation after a year, with evidence of asymmetric effects (i.e., higher pass-through during periods of large depreciation).

Text Figure 2. Norway: Exchange Rate Developments





9. Norway's external position is assessed to be stronger than the level implied by medium-term fundamentals and desirable policies. The current account surplus fell to 17.9 percent of GDP in 2023, down from a high of 30.2 percent of GDP in 2022, on a smaller trade surplus, attributable to lower natural gas prices and increased imports of goods and services. In 2023, both the average CPI-based and the ULC-based real effective exchange rate (REER) depreciated by 8.6 percent and 10 percent, respectively, pointing to an undervaluation of between 1.2 and 14 percent. The Net International Investment Position rose to a record of about 4 times mainland GDP at the end of 2023. With the caveat that the current account norm may be subject to significant bias due to country-specific characteristics, staff assesses Norway's external position as stronger than warranted by fundamentals (Annex IV).

[6] The fiscal rule stipulates that transfers from the GPFG to the central government budget shall, over time, follow the expected real return (3 percent).

OUTLOOK AND RISKS

10. Overall GDP growth is projected to rebound this year reflecting a stronger offshore sector, while mainland activity will remain subdued (Tables 1–4). In 2024, real GDP growth is expected to rise to 1.5 percent, supported by a recovery in the offshore sector as energy demand in trading partners increases, in line with the 2024 Fall WEO assumptions. Under current policy settings, mainland GDP growth will remain subdued at 0.8 percent as tight financing conditions continue to weigh on private domestic demand. The output gap would close this year, and aggregate demand pressures would remain contained until 2025. Over the medium-term, mainland real GDP growth is expected to strengthen to average of about 1½ percent as financial conditions ease and real incomes recover. Headline and core inflation are projected to remain above 3 percent in 2024, before gradually stabilizing around the 2 percent target by 2026.

11. In a context of high uncertainty, risks to the outlook are broadly balanced (Annex V).[7] The main sources of external risks include an intensification of regional conflicts, commodity price volatility, and deepening geoeconomic fragmentation. On the upside, higher oil prices and continued labor market resilience would provide support to growth. On the downside, the intensification of regional conflicts could weaken external demand and consumer confidence, leading to cautious spending behavior. This could undermine the anticipated recovery in consumption driven by rising real wages, particularly if the labor market slows rapidly. The downside effects would be partially mitigated if the conflicts result in higher oil and gas prices. On the domestic front the main risk to growth stem from a sharp correction in real estate prices (or a large increase in the unemployment rate) that could trigger a materialization of systemic stress. Regarding inflation, weaker-than-anticipated outcomes, both domestically and globally, could result in inflation falling below baseline projections. Conversely, a de-anchoring of inflation expectations could result from stronger-than-expected wage growth coupled with profits failing to decrease sufficiently to offset increasing labor costs in an environment of relatively low productivity, a weaker currency, above-target inflation, and fresh surges in commodity prices.

Authorities' Views

12. The authorities broadly shared staff's views regarding the economic outlook and associated risks. While acknowledging that tight financial conditions continue to weigh on private consumption, they noted that recent high-frequency indicators point to stabilization of economic activity. They also noted that labor market has been resilient, notwithstanding a slight increase in the unemployment rate. The authorities reasoned that Norway's wage bargaining system has been, overall, credited with having a disciplining effect on wage growth demands. However, to mitigate risks of a wage-inflation spiral, they recognized the need for an appropriate fiscal-monetary mix. Despite high levels of uncertainty, the authorities view the risks to growth and to the inflation outlook as balanced. They concurred with the staff's external sector assessment.

[7] Annex IV presents contingent policy advice in case specific risks materialize.

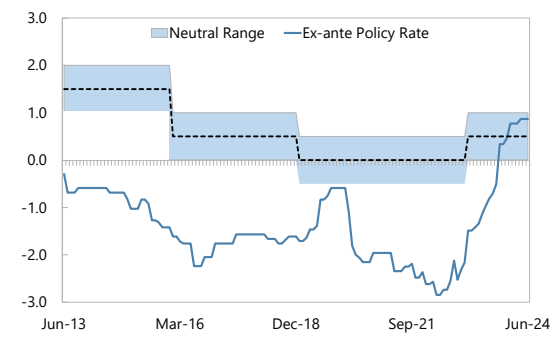
POLICY DISCUSSIONS

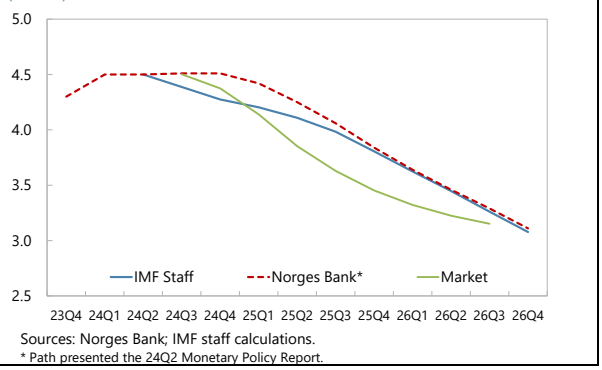
Reining in high inflation is the most pressing near-term policy challenge. To ensure a sustainable return to target inflation levels, maintaining a contractionary monetary policy in the short term is key. Furthermore, macroprudential policy settings should remain tight to contain elevated systemic vulnerabilities. Banks and NBFIs should prioritize the maintenance of robust capital buffers to safeguard against potential risks that may arise from an extended period of elevated interest rates. Adopting a neutral fiscal stance, including in the 2025 budget, would address the risks of policy miscalibration and significantly bolster efforts to reduce inflation. To navigate the challenges posed by an ageing population, the slowdown in productivity, and the repercussions of geo-economic fragmentation, comprehensive and far-reaching structural reforms are required. Key among them is the reform of the generous sickness and disability benefit systems.

A. Monetary Policy

13. The monetary policy stance is appropriately restrictive and should remain in place for some time. The ex-ante real policy rate (defined as the nominal policy rate deflated by 1-year ahead inflation expectations from the survey of professional economists) is somewhat above Norges Bank's revised estimates of the neutral rate, which range between 0 and 1 percent.[8] The central bank has communicated that the policy rate is likely to be maintained at 4.5 percent until the end of this year, before being gradually reduced. Under staff's baseline, the tight monetary policy stance should be maintained over the next couple of quarters to ensure that inflation durably returns to target within the forecast horizon (Annex VI).

Text Figure 3. Norway: Monetary Policy Stance





14. Continued above-target inflation and elevated inflation expectations argue against a relaxation of monetary policy in the very short term. This would help mitigate risks of de-anchoring inflation expectations and avoid forcing the central bank to resume tightening later, possibly with higher costs for output and unemployment. Keeping the policy rate at its current level

[8] The previous range was between -0.5 percent and 0.5 percent.

until the end of this year and cautious reductions thereafter, are consistent with maintaining a tight stance provided real rates remain appropriately restrictive. Given the continued high uncertainty around the outlook, the setting of monetary policy should operate in a data-dependent and meeting-by-meeting approach.

15. Norges Bank's updated monetary policy strategy elaborates on the policy trade-offs facing the central bank. The new strategy updates the 2020 version to reflect the post-pandemic economic landscape. Specifically, it more explicitly lays out the MPC's interpretation of the central bank's mandate and the guiding principles to assess policy trade-offs within the inflation targeting framework and the bank's financial stability mandate. While the updated strategy is not expected to have major implications on the conduct or implementation of monetary policy, it will further enhance transparency and bolster public confidence in the central bank. Going forward, Norges Bank could consider implementing regular periodic reviews of its monetary policy strategy to ensure its effectiveness is maintained.

Authorities' Views

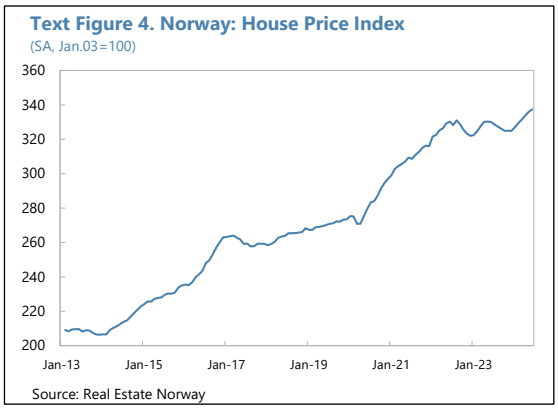
16. Norges Bank concurred that monetary policy would need to remain contractionary for some time. They noted that the significant increase in the policy rate has contributed to lowering inflation and cooling down the economy. At the same time, the employment ratio (employment to working age population) is high, inflation is still running above target, and the rapid rise in business costs (including wages) will contribute to keeping inflation elevated ahead. The central bank stands ready to adjust the monetary policy stance if risks to the outlook (on either side) materialize.

B. Financial Sector Policies

17. Household debt burdens have stabilized but high-for-long interest rates, further rate hikes, or rising unemployment could push some households into financial hardship. Norwegian households have the highest debt burden in the OECD, with over 95 percent of loans carrying a variable rate. Over the past year, household DTI ratios have stabilized, and the average DTI on new debt and the share of loans with high DTI ratios have declined. However, the average interest rate burden has increased since mid-2021, and the DSTI has risen markedly (Figure 3). While low unemployment and excess savings accumulated during the pandemic might have helped households weather the increased debt service burden initially, recent increases in the use of interest-only periods on residential mortgages point to increasing hardship for some households. Also, central bank analysis suggests that highly-leveraged households have spent most of their liquidity buffers. A sustained period of high interest rates could impact household cash flows, should the labor market falter significantly or if real incomes remain subdued. This would, in turn, weigh on economic activity and financial sector buffers.

18. The real estate sector faces complex challenges, notably in the CRE segment. RRE prices have stabilized after a long period of appreciation. While they have increased 3.4 percent year-to-date, they are expected to remain broadly flat in the near term. CRE prices have fallen for two consecutive years, but valuations remain uncertain as transaction levels remain low. Further price

corrections could materialize. On average, listed CRE companies have seen a significant drop in stock prices, which are down about 25 percent from their 2021 peak amid reduced profitability, rising interest expenses, and portfolio write downs. The share of companies with low ICRs has increased, underscoring the growing financial stress within the sector, and raising the risk of credit downgrades and stricter financing conditions. Firms, especially those with significant debt and large rollover needs in the coming years, face the challenge of refinancing their obligations under tight credit conditions, while asset valuations remain under downward pressure.



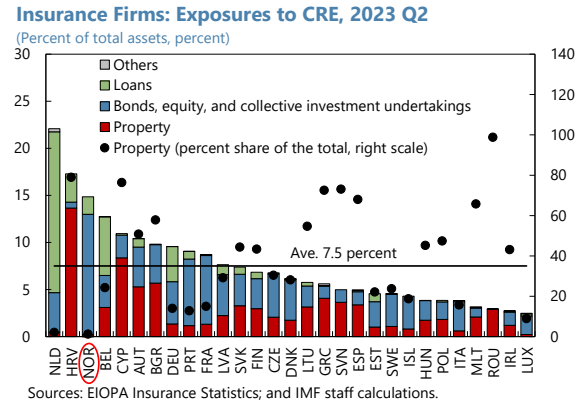
19. The ongoing real estate market correction, while proceeding in an orderly manner, is a significant source of systemic risk. Norwegian banks are, on average, highly exposed with over 60 percent of banks' lending associated with the RRE and CRE sectors. Pension funds and insurance companies also have a notably higher exposure to the sector than in most other European countries, although these still represent a small share of their portfolios (Text Figure 5). A further downturn in CRE could have adverse effects on banks with high exposure levels, especially on small- and medium-sized banks. A severe deterioration of conditions in both markets would negatively impact general economic activity and result in adverse feedback loops.

20. There are some mitigating factors. Losses on CRE loans have been low, suggesting that banks have managed their exposures effectively so far. Demand for office space remains, supported by still-high employment levels and limited adoption of remote working, which coupled with rent inflation could provide revenue support for CRE firms. In turn, the increased use of hedging by CRE firms to manage interest rate risks has allowed them to better predict and control financing costs. The authorities consider that the application of the Norwegian Accounting Act standards could potentially bolster Norwegian CRE firms' capital levels.[9] In staff's view, however, the impact of these standards the on CRE firms' operating cash flow, which provides a more accurate picture of their liquidity and debt service ability, may be limited in a weak or distressed market environment. Moreover, application of the Norwegian Accounting Act can potentially distort capital levels.

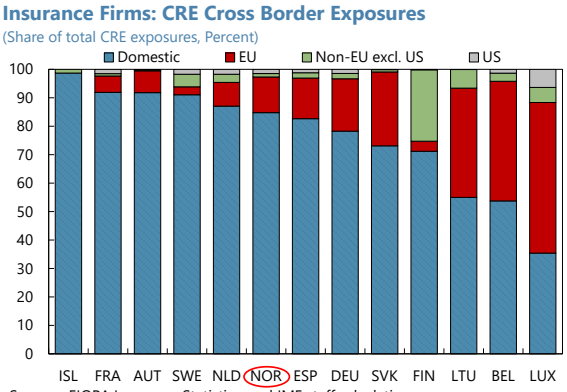
21. Firms outside the CRE sector are also facing more difficult conditions. Corporate profitability has fallen in several industries amid rising interest and input costs and the weaker currency. While bankruptcies rose in 2023, notably in the construction sector, they remain below the pre-pandemic levels, and so far, most of the firms in bankruptcy have been small. However, the share of firms facing debt collection is increasing and is now higher than pre-pandemic levels, indicating more challenging conditions going forward, and possibly increased loan losses.

[9] Under the Norwegian Accounting Act, properties are carried at historical cost, which can often be lower than fair value. Accordingly, falls in fair value do not immediately trigger impairment losses, potentially providing a buffer for non-listed companies. About half of CRE firms apply the Norwegian Accounting Act Standards, while the rest (including listed entities) apply IFRS, under which investment properties are carried at fair value.

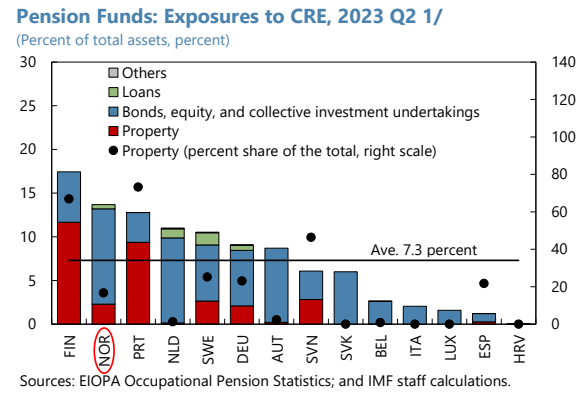
Text Figure 5. Norway: NBFIs CRE Exposures



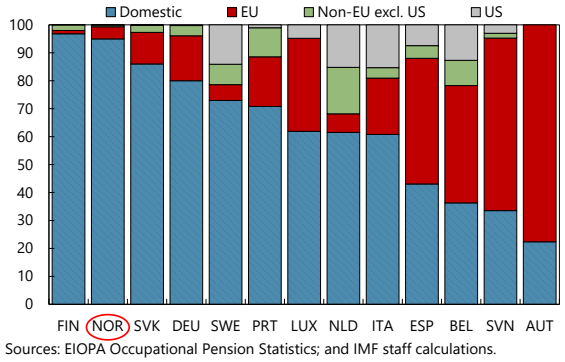
Sources: EIOPA Insurance Statistics; and IMF staff calculations.



Sources: EIOPA Insurance Statistics; and IMF staff calculations.



Sources: EIOPA Occupational Pension Statistics; and IMF staff calculations.
1/ For pension funds, the country coverage is limited compared to insurance firms.



Sources: EIOPA Occupational Pension Statistics; and IMF staff calculations.

22. Banks' record high profitability should be used to preserve capital buffers. Profitability has likely peaked, and the combination of subdued activity and high interest rates is likely to lead to higher loan impairments, and banks may need to increase provisions. Lower demand for loans and potential increases in funding costs could further reduce bank profits. Banks should reconsider or adjust their capital distribution strategies, such as dividends and share buybacks, to preserve capital buffers and help ensure they maintain adequate capital ratios to better position them to absorb future shocks. Capital conservation measures are vital at the current juncture, as solvency stress tests conducted by the FSA in 2024 show that a few non-systemic banks would not fulfill the overall CET1 capital requirement during stress periods, even if the CCyB is lowered to zero.[10] In staff's view, ad-hoc taxes on bank profits could be counterproductive, as they could reduce the available capital that banks might otherwise use to build buffers against potential future shocks and limit their resilience in the face of adverse economic conditions.

[10] The stress scenario assumes a decline of 2 percent in mainland real GDP during 2023–2025 and a gradual recovery thereafter so by 2028 real GDP is at the same level as in 2023, coupled with an increase of 350 bp in the banks' average lending rate, a 520 bp and 760 bp increase in households' and firms' interest burden and a 240 bp increase in the unemployment rate. House prices fall by 27 percent and commercial property prices by 38 percent in nominal terms. The banking system CET1 capital ratio falls from 18 percent at the start of the period to 14.6 per cent in 2026. The leverage ratio declines from 7.0 percent in 2023 to 5.8 percent in 2026. None of the banking groups fail to meet the minimum leverage ratio requirement of 3 per cent in the scenario.

23. The authorities' continued progress to implement the 2020 FSAP recommendations over the past year has improved financial sector resilience further (Annex VII). Legislation strengthening the independence of the FSA in the processing of individual cases and to clearly state its mandate was passed in June. The SREP for medium and small size banks has been bolstered with introduction of a risk dashboard, an updated early warning model, a watchlist, and improved daily reports. Supervisory activity has increased, including of banks' foreign branches, and through thematic inspections of banks and other intermediaries. Additional data gaps have been closed with new reporting requirements on banks' exposures to individual non-financial firms, mutual fund management companies, and completion of a mapping of the financial sector. The cybersecurity risk and oversight frameworks have been bolstered with allocation of additional resources, and further improvements are expected from the implementation of the EU's DORA.[11] Other milestones completed in 2023 include the launch of the FSA's bail-in mechanism, the completion of banks' bail-in playbooks, and the introduction of a process for acceptance of mortgage loan collateral for emergency liquidity support for solvent banks, which are set to reinforce the crisis management framework. Over the medium-term, continued progress in addressing the remaining FSAP recommendations, including making BBMs a permanent feature of the framework, would further help increase financial sector resilience against tail risks.

24. Against this backdrop, the tightening of prudential settings across several dimensions is appropriate. A systemic risk assessment indicates that while some risks have stabilized, vulnerabilities remain high. The comprehensive tightening of prudential policy settings during 2022–23 reflects a significant effort to strengthen the financial system's robustness. Collectively, the measures will enhance resilience by ensuring that banks maintain adequate buffers, adhere to prudent lending standards, and are prepared to withstand shocks. The expansion of LTV limits to a broader range of loans will help contain risks from excessive borrowing.

25. While elevated systemic vulnerabilities are not building up further and financial stability risks appear manageable, close monitoring of the financial system is warranted amid high interest rates. Any relaxation of macroprudential settings should be postponed until systemic risks meaningfully subside or if risks of financial disintermediation emerge. In case risks to households materialize, policymakers may need to consider measures to support those at risk of financial distress (e.g., targeted relaxation of regulations that facilitate renegotiations between stressed households and banks). Given sustained pressure on the CRE sector, the immediate priority should be to preserve bank buffers and strengthen contingency planning, including at the Baltic-Nordic level to address any risks that could arise from cross-border exposures. Once the credit cycle turns, BBMs for CRE (such as caps on LTV ratios and floors on debt service coverage ratios) should be explored. The insurance sector's high CRE exposure calls for introducing sector-specific capital surcharges, buttressing its risk and liquidity management strategies (including by broadening the investment portfolio to mitigate concentration risks), and conducting regular stress tests to assess the potential impact of adverse real estate market movements on solvency and profitability.

[11] A recent stress test exercise by Norges Bank shows that the large banks are well positioned to withstand a liquidity run in the case of a severe cyberattack.

Authorities' Views

26. The authorities broadly shared staff's assessment of elevated systemic vulnerabilities and increased uncertainty. They concurred that high household debt and elevated RRE and CRE prices remain the main vulnerabilities in the Norwegian financial system. They pointed out that, so far, there are few signs of serious debt servicing problems for the household sector overall, as low unemployment and households' savings have contributed to dampening the effects of high inflation and rising interest rates. However, they see risks that households' debt servicing capacity may be impaired if economic activity weakens, or interest rates are higher than expected. The authorities stressed that banks were resilient to large shocks and/or significant credit losses. Both the FSA and Norges Bank see scope for CRE prices to fall further, while Norges Bank assesses that RRE prices are broadly in line with fundamentals. Also, amidst the ongoing geopolitical tensions, they are aware that there are significant cyber risks and stressed that they have significantly increased work in identifying and mitigating these in cooperation with the financial services industry.

27. The authorities agreed with the thrust of staff's advice on financial policies. They noted that in case a systemic risk event materializes, regulations could quickly be amended to facilitate loan renegotiations between households in distress and their lenders, as was done during the Covid-19 pandemic. In turn, they consider that borrower-based measures (BBMs) have served the economy well and are likely to remain a feature of the macroprudential policy toolkit. The scheduled review of the relevant regulation is to be finalized in the second half of the year and will include discussions on the parameters for BBMs on mortgage and unsecured lending.[12] Regarding risks from the CRE, they noted that firms in the sector are well capitalized, are making increased use of interest rate hedging, and are smaller and have less dispersed ownership structures than those in other countries in the region. The authorities noted that they had observed a gradual reduction in NBFIs exposures to the CRE sector, and that they have set expectations for pension funds' capital planning strategies to factor in the risks in the RE market. Cross-border exposures from the CRE sector are viewed as contained, and Norway is participating in the Nordic-Baltic Crisis Simulation exercise scheduled in the second half of the year, which will test information sharing and collaboration during crisis and resolution between members and relevant EU authorities.

C. Fiscal Policy

28. Measures in the 2024 budget include several tax provisions and increased defense spending. The most significant measures include phasing out the temporary high-price contribution and extra employer's National Insurance contributions, which were implemented in 2023,[13] the

[12] The lending regulation has been routinely reviewed every 12–24 months since statutory requirements for mortgages were first introduced in 2015. The MOF has requested the FSA to provide advice on the lending regulation by August 23rd, 2024. The MOF has specifically requested the FSA to consider how the regulation has functioned with higher interest rates and the effects of the amendments from January 2023.

[13] Expenditures rose across various lines in 2023, notably on the National Insurance Scheme, refugee integration, and household electricity subsidies. The latter were financed with ad hoc taxes, namely the high-price contribution and higher employer's National Insurance contributions for salaries exceeding NOK 750,000. The high-price contribution

(continued)

introduction of a resource rent tax on onshore wind power, and higher environmental tax rates.[14] The Spring budget, released in May, also accommodates provisions in line with Norway's Long-Term Defense Plan (2025–2036),[15] accelerating the country's prior commitment to meet NATO's defense spending target of 2 percent of GDP by 2024, ahead of the previous target of 2026 (an increase of about 0.5 percent of GDP compared to the previous year).

29. The budget implies an expansionary fiscal stance this year; a neutral stance for next year would be more supportive of the disinflationary effort. In 2024, the expected increase in expenditure as a percent of mainland GDP more than offsets an expected uptick in revenues (Text Table 2). Transfers to households and the wage bill, the two largest expenditure items, continue to grow at a faster pace than the non-oil economy (Table 4). Under current policies, the structural non-oil fiscal deficit would widen to about 10.4 percent of mainland trend GDP (2.7 percent of the GPFG), implying a fiscal impulse of 0.7 percentage points. Leveraging the ongoing expenditure reviews to reprioritize spending and capitalizing on upside growth surprises or higher-than-expected revenues would help reduce the fiscal stimulus this year and improve the cohesiveness of the macroeconomic policy mix. In turn, the parameters of the 2025 Budget should be set in a prudent manner, ensuring that the role of fiscal policy in macroeconomic stabilization remains limited to the operation of the automatic stabilizers. Discretionary fiscal stimulus should be deployed only if large downside risks materialize and be well targeted and temporary.

30. A wide-ranging set of measures will be needed to accommodate additional defense spending and other multi-year spending commitments. Fiscal planning has to accommodate immediate and long-term needs, such as the anticipated increase in ageing-related and higher defense spending needs, while oil and gas revenues are projected to decline over the long term. Between 2017–24 the nominal value of the structural non-oil deficit has averaged just below the 3 percent limit (as a share of GPFG) set by the fiscal rule. However, expenditures and the structural non-oil deficit (as a share of mainland GDP) have increased significantly. In this regard, past IMF advice remains pertinent:

- Enact a comprehensive reform of the tax system to make the tax system more efficient, increase work incentives, and boost private investment.[16] Some options to be considered include

(tax on power generation) was an excise duty on power production when average price exceeded 0.70 NOK per kWh; it was discontinued as of October 2023.

[14] Taxes on non-ETS emissions were increased to NOK 1,176 per ton from 1 January 2024, in line with a planned linear escalation from NOK 590 in 2021 to NOK 2,000 in 2030.

[15] The plan reflects a substantial fiscal commitment, proposing an increase of 600 billion NOK (11 percent of 2024 GDP) in defense spending over a twelve-year period, resulting in a cumulative defense expenditure of 1,624 billion NOK (29 percent of 2024 GDP).

[16] The OECD's Economic Survey of Norway (2024) indicates that reducing income tax rate by 5 percent and increasing the basic allowance in the wealth tax might reduce the fiscal balance by 1.6 percent of GDP, however, the fiscal impact might be offset by improved real estate taxation, which could yield revenue gains as much as 1.8 percent of GDP.

strengthening work incentives by lowering marginal tax rates on income, and introducing a single Value-Added Tax (VAT) rate (consolidating multiple reduced rates and exemptions).

- Restructure the pension and social protection regimes (IMF 2019, 2022 and 2023). Implement provisions to limit early retirement schemes, and reduce disability and sickness benefits, which represent fiscal expenditures of ~8 percent of mainland GDP.

- Complement the fiscal policy framework with medium-term budgeting and an expenditure rule that caps the growth of aggregate public spending.

Text Table 2. Norway: Selected Non-Oil Fiscal Accounts
(Percent of Mainland GDP)

	2023 (est.)	Change in 2024 compared to 2023 1/	Change in 2025 compared to 2024 1/
Total revenue	53.5	0.4	0.0
Property income	4.4	-0.1	
Direct and indirect taxes incl. Social security contributions	43.3	0.3	
Transfers from the Bank of Norway	0.2	0.2	
Total expenditure	61.8	1.0	0.3
Interest and dividends	1.2	0.1	
Transfers abroad	1.8	-0.3	
Transfers to households	17.3	0.5	
Compensation of employees	17.2	0.3	
Intermediate consumption	9.8	0.1	
Social benefits in kind	2.6	0.0	
Gross fixed capital formation	6.8	0.3	
Non-oil balance	-8.3	-0.7	-0.3

Source: Norwegian authorities; and IMF staff calculations.
1/ Projected

Authorities' Views

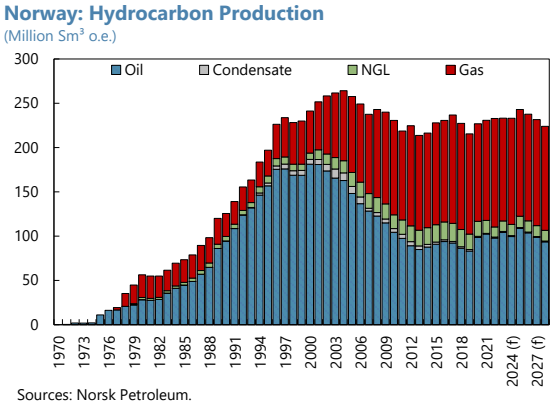
31. The authorities broadly concurred with staff's fiscal policy assessment. They noted that the adoption of an expansionary fiscal stance this year is to address multiple needs, including support for vulnerable populations, such as refugees from Ukraine, and increased defense spending. Nevertheless, they underscored that the annual transfer from the GPFG to the central government budget remains well below the 3 percent limit stipulated in their fiscal rule. They see limited scope for retracting fiscal stimulus this year and noted the staff's recommendation for adopting a neutral fiscal stance next year. Regarding structural fiscal reforms, they agreed to further consider staff's advice to complement the fiscal policy framework by introducing medium-term budgeting and an expenditure rule, emphasizing that any enhancements must retain flexibility to allow for an effective

policy response to macroeconomic shocks and not obscure the broad support for the current framework.

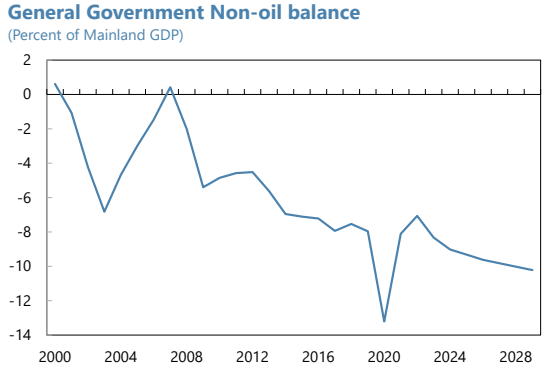
D. Structural Issues

32. Medium-term and structural policies should be set to facilitate Norway's ongoing transitions. Diversifying away from the energy sector, given the anticipated decline in oil production and the transition to a green economy, while addressing emerging challenges from an ageing population, geoeconomic fragmentation, and slowing productivity, will be necessary to ensure continued strong economic performance and the longer-term sustainability of Norway's welfare model.

Text Figure 6. Norway: Hydrocarbon Production and Fiscal Accounts



Sources: Norsk Petroleum.

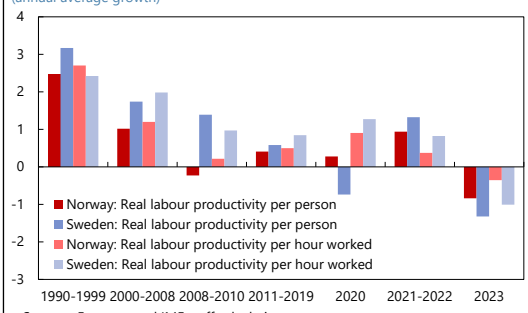


Sources: Norway Ministry of Finance; and IMF staff calculations.

33. Reforming generous sickness and disability benefits systems will bolster labor supply while helping contain public expenditure pressures (Annex VIII). Participation in the programs is very high, costly, and the systems lack strong incentives for returning to work. While the issue is long-standing, the costs of inaction are rising as the peak in oil production has likely passed, productivity has slowed down, and the population is ageing. In particular, reducing incentives for early retirement, properly phasing reforms that curtail inflows and encourage outflows, and providing stronger incentives for work will be key (OECD, 2022). Tackling the needed reforms will require deploying significant political capital and building the necessary social consensus.

34. Although Norway boasts one of the highest levels of labor productivity among OECD countries, it has slowed faster than in other Nordic countries (Annex IX). Following a notable surge in the 1990s driven by the adoption of ICT, the pace of productivity growth began to wane in 2006 and has persistently declined since. This decline in productivity is not unique to Norway, as many AEs have faced similar trends, but Norway's average productivity growth now ranks among the lowest in the OECD. Growth of both

Text Figure 7. Key Labor Productivity Indicators
(annual average growth)



Sources: Eurostat; and IMF staff calculations.

productivity per hour and per worker has slowed notably since the 1990s to around 1 and 0.5 percent, respectively, during 2021–22, from an annual average of 2.7 and 2.5½ percent, respectively, during 1990–99. In 2022, nearly two-thirds of Norway's productivity slowdown was attributed to a combination of factors: lower contributions of total factor productivity per worker; lower spillovers from intangible investment, and slower reallocation of labor towards more productive sectors. Boosting productivity growth will require improving the conditions for business start-ups; facilitating sectoral reallocation, developing comprehensive policies to promote business competition, innovation, and technology adoption; overhauling insolvency procedures, raising education outcomes and closing skill mismatches; and easing administrative burdens (OECD, 2024).

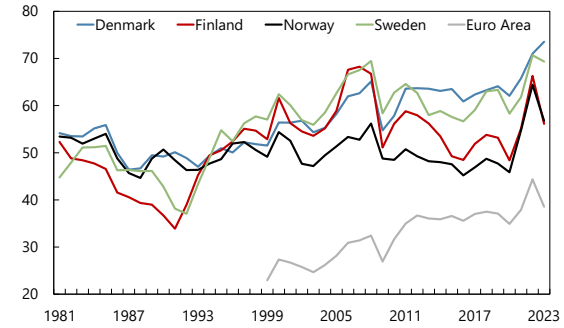
35. As a small open economy Norway is susceptible to changes in trade dynamics resulting from global geoeconomic fragmentation. Over the past 40 years, trade with the rest of the world has represented about half of Norway's GDP on average. Since the Global Financial Crisis, the country has been subject to an increased number of trade restrictions while its trade patterns have exhibited a redirection towards China. Norway's reliance on intermediate inputs from China for both the high tech and manufacturing industries rose from 1 percent to over 9 percent between 1995–2020. At the same time, reliance on intra-Nordic trade and other major European trading partners (such as Germany, the United Kingdom and France) has fallen. In turn, exposures to North American economies and Poland have increased (Text Figure 8). Limiting Norway's exposure from geoeconomic fragmentation will require adopting a multifaceted approach that combines strategic policy initiatives to strengthen supply chain resilience, increase economic diversification, and the fostering of economic alliances. Norway continues to address transnational aspects of corruption, including combatting foreign bribery and preventing laundering of foreign corruption proceeds, but more efforts are called for (Annex X).

36. Recent measures, including through international cooperation, will help Norway's climate mitigation and adaptation efforts but further actions are needed to achieve its NDCs. Measures at the international level include Norway's partnership with the EU to develop sustainable raw materials and battery value chains in the context of the Green Alliance, and participation in InvestEU to provide SME financing for the green and digital transitions. At the domestic level, recent measures include the continuation of the gradual phase-in of higher taxes on non-ETS emissions in the 2024 Budget, the increase in the sales requirement for biofuels for road traffic to 19 percent from 17 percent, the launch of tenders to develop the first two areas for offshore wind in the continental shelf, and the introduction of climate and environmental requirements in public procurement. Despite the significant efforts, under the policies envisioned in the latest Climate Action Plan,[17] the authorities own forecast indicates that further efforts will be required to achieve the 2030 NDC targets.[18]

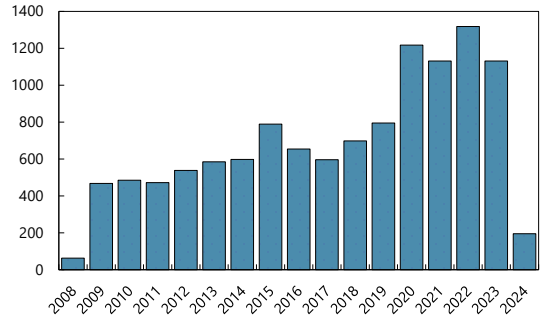
[17] The plan (available here - Norwegian only) lays out the policies to be implemented in the 2021–30 period.

[18] Norway updated its NDCs in late 2022 to strengthen its 2030 emissions target to a reduction of at least 55 percent below 1990 levels from 50 percent previously.

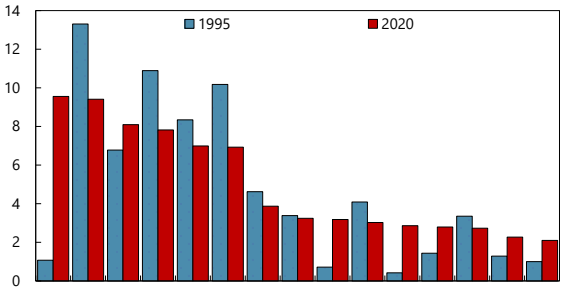
Text Figure 8. Norway: Exposure to Geoeconomic Fragmentation



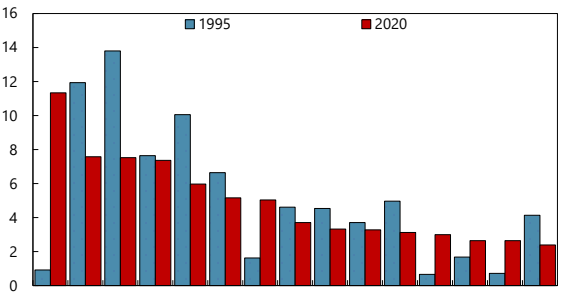
Sources: World Economic Outlook; and IMF staff calculations.



Sources: Global Trade Alert; and IMF staff calculations.
Note: 2024 data is up to May, 2024.



Sources: OECD Inter-Country Input-Output (ICIO) Tables 2020; and author's calculations following Baldwin and Freeman (2022).



Sources: OECD Inter-Country Input-Output (ICIO) Tables 2020; and author's calculations following Baldwin and Freeman (2022).

Authorities' Views

37. The authorities agreed with the thrust of staff's recommendations on structural reforms. They acknowledged the emerging longer-term labor force challenges, and noted that an upcoming Labor Market White Paper will discuss introducing incentives to participate in the labor force. They did not concur with the recommendation on capping the level of benefits, but noted that consensus is growing among the social partners to advance some reforms to the sickness and disability benefits systems. The authorities took note of the international discussion on boosting productivity growth. However, they noted that there are no quick-fixes nor Norwegian-specific solutions, and that any measures would have to be fiscally responsible. Among others, issues that would have to be considered in the discussion include the role of low-productivity firms, education, and R&D policies. The authorities concurred on the importance of improving communications on the interaction between Norway's commitments under the Paris Agreement and its domestic emission reduction goals.

STAFF APPRAISAL

38. Mainland real GDP growth is expected to remain below potential in the near term. Mainland real GDP is forecast to increase by 0.8 percent in 2024, as tight financing conditions

continue to weigh on private demand. Over the medium-term, growth is anticipated to gradually strengthen and would average about 1½ percent as private demand recovers supported by higher real incomes and easier financial conditions. Inflation is projected to average 3.3 percent in 2024 and return to target by 2026. Amidst high uncertainty, risks to the growth and inflation outlook are balanced. Norway's external position is assessed to be stronger than the level implied by medium-term fundamentals and desirable policies.[19]

39. Monetary policy will have to remain contractionary over the near term to ensure that inflation returns durably to its target. While progress has been made in bringing inflation under control, it remains high. Inflation expectations are elevated. Keeping the currently tight monetary policy stance in place for some time will be necessary to ensure inflation converges back to target in the forecast horizon and mitigate risks of de-anchoring of expectations. Monetary policy should operate in a data-dependent approach, with Norges Bank remaining ready to adjust the monetary policy stance as needed.

40. Macroprudential policy settings should remain tight, as systemic risks remain elevated. The financial system is stable and banking system buffers are robust. Vulnerabilities are not building up further and risks to financial stability appear manageable, but continued close monitoring is warranted as systemic risks could materialize in a context of a sustained period of high interest rates. Any relaxation of macroprudential settings should be postponed until risks meaningfully subside or if risks of financial disintermediation emerge. In case risks to households materialize, targeted measures to support those at risk of financial distress should be considered. Given sustained pressures on the CRE sector, the immediate priorities should be to preserve bank buffers and to strengthen contingency planning to mitigate risks that could arise from cross-border exposures.

41. The authorities continue to advance in the implementation of the 2020 IMF FSAP recommendations. The law strengthening Finanstilsynet is a welcome development. Continued progress in addressing the remaining recommendations, including making BBMs a permanent feature of the macroprudential toolkit and introducing sector-specific capital surcharges on the insurance sector's CRE exposures once the credit cycle turns should be considered. More efforts are needed to address transnational aspects of corruption.

42. Removing the fiscal stimulus in place would lower risks of fiscal-monetary policy miscalibration. In the near term, leveraging the ongoing expenditure reviews to reprioritize spending and capitalizing on revenue overperformance to build fiscal buffers would help reduce the fiscal impulse. The 2025 budget should aim for a neutral fiscal stance. Discretionary fiscal stimulus should be well-targeted and temporary and be deployed only if large downside risks materialize.

43. The fiscal position is strong, but it's increasingly reliant on natural resource revenues. Public debt is sustainable. Public spending and the structural non-oil deficit have increased significantly as a share of mainland GDP, while both higher defense and ageing-related public spending needs will have to be accommodated. Accordingly, past IMF advice to

[19] Data remains adequate for surveillance (Annex XII and Informational Annex).

address these challenges remains pertinent, namely: i) reforming the tax system to increase its efficiency; ii) restructuring the pension and social protection regimes; and iii) complementing the fiscal policy framework with medium-term budgeting and an expenditure rule.

44. Reforming the sickness and disability benefits systems would bolster labor supply and help contain public expenditure pressures. Among others, reform measures should include reintroducing caps on the total amount of benefits available to participants to incentivize returning to work, tightening requirements for entry and transitioning into the programs, reducing incentives for early retirement, and properly phasing other measures to curtail inflows and encourage outflows.

45. Comprehensive reforms are needed to raise productivity growth, mitigate the impact of geoeconomic fragmentation, and preserve Norway's high living standards for future generations. Conditions should be improved to facilitate the sectoral reallocation of resources as well as innovation and technology adoption, mindful of minimizing the fiscal burden. Strategic policy initiatives aimed at bolstering supply chain resilience and fostering economic alliances will be required to mitigate the impact from geoeconomic fragmentation. Promoting economic diversification will be crucial amidst the ongoing green transition. Strong policy frameworks, a robust track record of policy implementation, solid fiscal and banking system buffers, and a comprehensive social safety net provide underlying strengths that should allow Norway to successfully navigate the needed structural transformations.

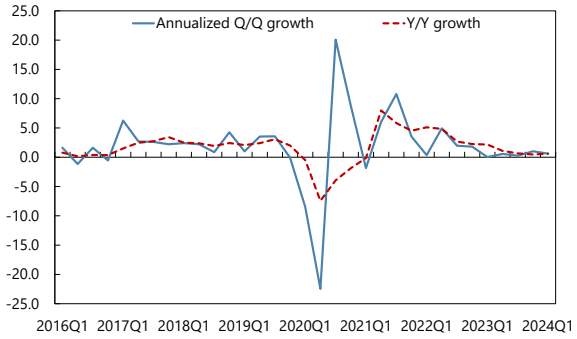
46. The next Article IV consultation with Norway is expected to be held on the standard 12-month cycle.

Figure 1. Norway: Selected Economic Indicators

Real GDP growth has stalled since mid-2023.

Real GDP Growth: Norway Mainland

(Percent)

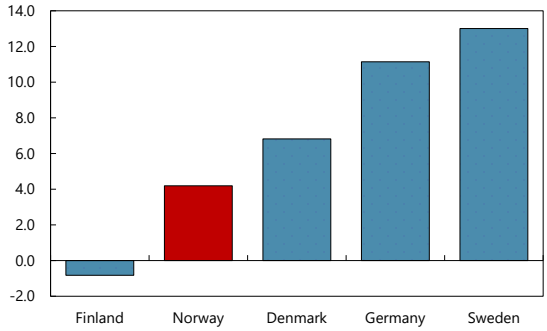


Sources: Statistics Norway; Haver Analytics.

Households added to their net wealth in 2023, although less than Norway's peers.

Household Net Savings, 2022

(Percent of disposable income)

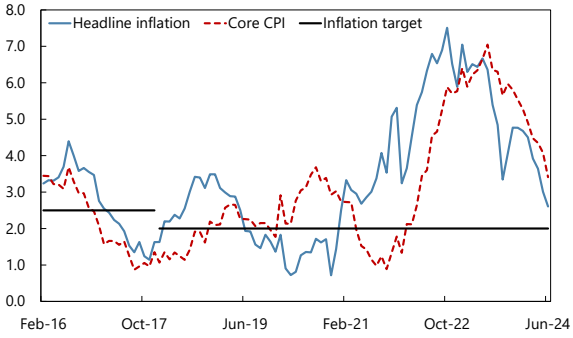


Source: OECD.

While moderating, core inflation remains significantly above target.

Annual Inflation

(Percent)

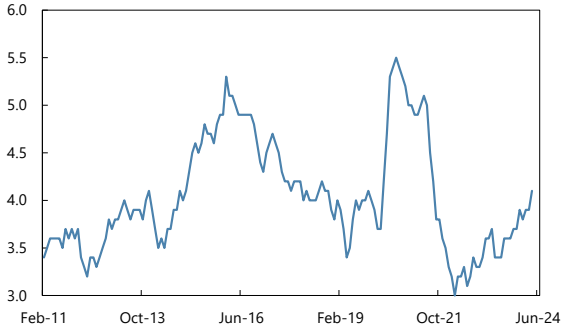


Sources: Statistics Norway; and IMF staff calculations.

The unemployment rate has increased slightly but is below pre-pandemic levels.

Unemployment Rate

(Percent, 3-month centered moving average, seasonally adjusted)

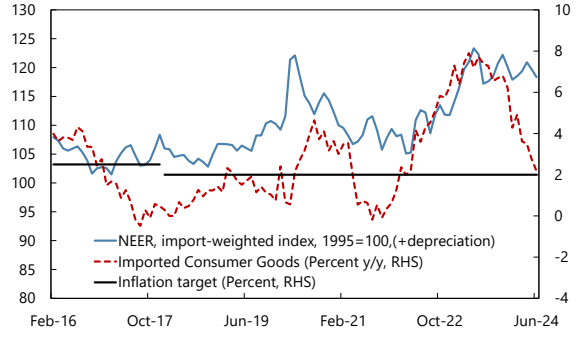


Sources: Statistics Norway; and Haver Analytics.

Despite the steady depreciation of the nominal effective exchange rate, import prices are falling.

Exchange Rate and Import Price

(Index)

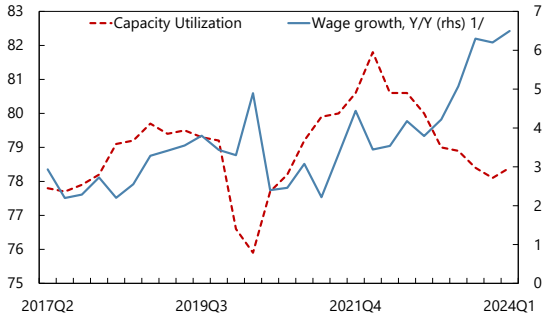


Sources: Norges Bank; Haver Analytics; and IMF staff calculations.

While capacity utilization passed its cyclical peak, nominal wage growth remains high.

Capacity Utilization Rate and Wage Growth

(Percent)



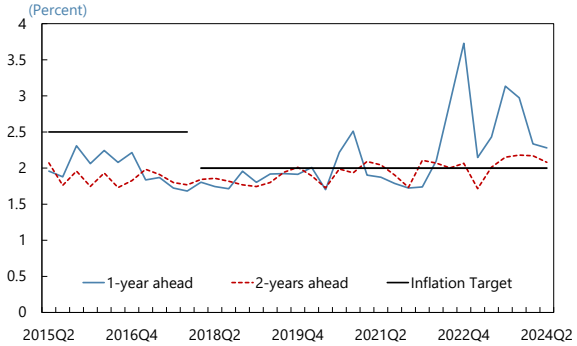
Sources: Statistics Norway; and IMF staff calculations.
1/ Wage growth is calculated from new index starting 2017.

Figure 2. Norway: Monetary Policy and Interest Rates

Short-term inflation expectations are above target…

Inflation Expectations

(Percent)

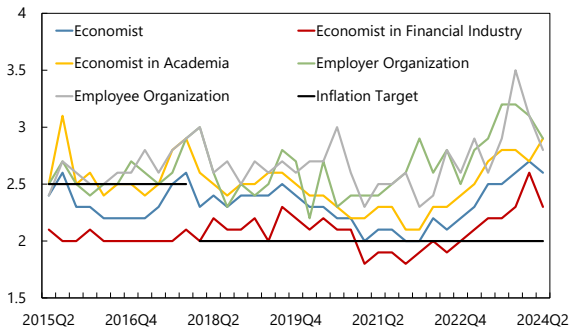


Source: Consensus Economics.

Including over the medium-term.

Inflation Expectations, 5-Years Ahead

(Percent)

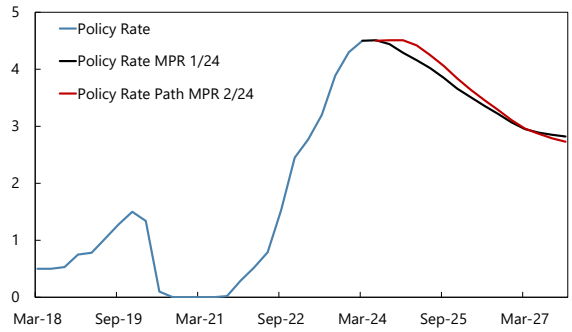


Sources: Norges Bank; and Haver Analytics.

Norges Bank's guidance is in line with market expectations

Key Monetary Policy Rate and Norges Bank Forward Guidance

(Percent)

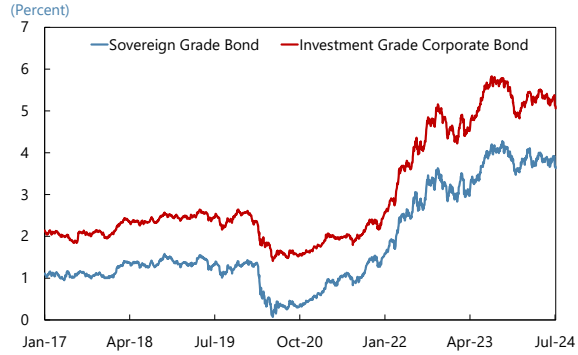


Source: Norges Bank.

Bonds spreads have stabilized above pre-pandemic levels

Corporate and Sovereign Bonds

(Percent)

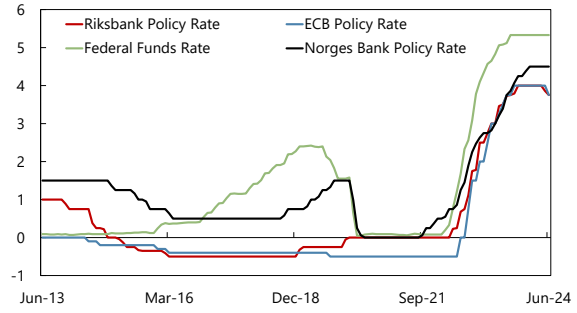


Source: S&P Dow Jones Indices.

Norges Bank was among the first advanced economy central banks to hike policy rates

Interest Rates

(Percent)

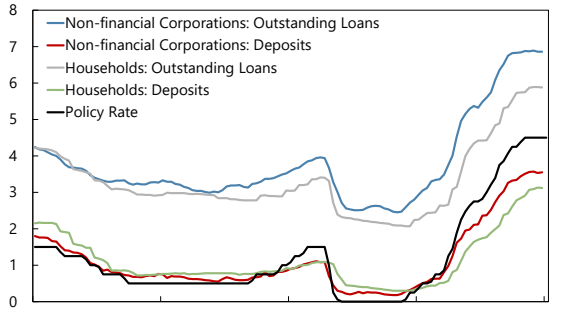


Sources: Norges Bank; Sveriges Riksbank; European Central Bank; Federal Reserve Board; and Haver Analytics.

Deposit and loan interest rates have increased

Interest Rates: Outstanding Loans and Deposits

(Percent)

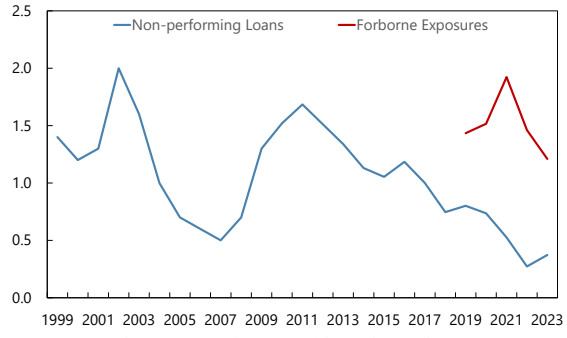


Sources: Statistics Norway; and Haver Analytics.

Figure 3. Norway: Selected Financial Indicators

The share of non-performing loans remains low

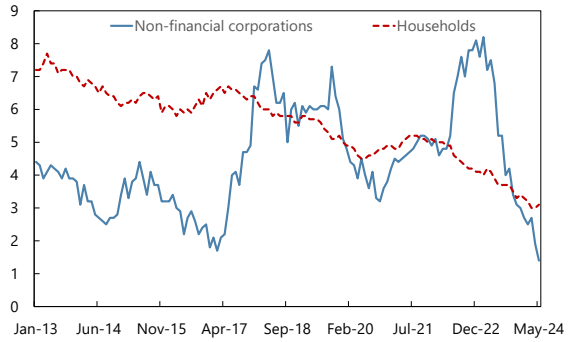
Non-performing Loans
(Percent of gross loans)



Sources: Finanstilsynet; FRED; and IMF Financial Soundness Indicators.

Credit to the economy is slowing down

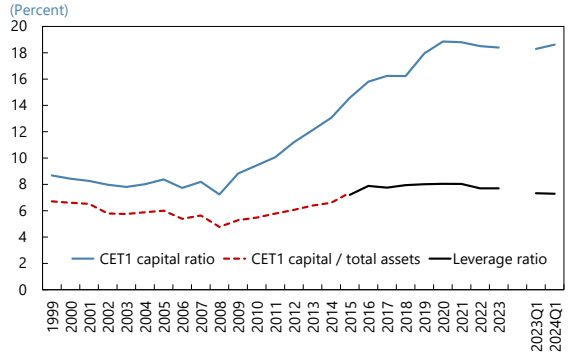
Growth in Domestic Credit
(Percent; y/y sa)



Source: Statistics Norway.

Banking system buffers remain high

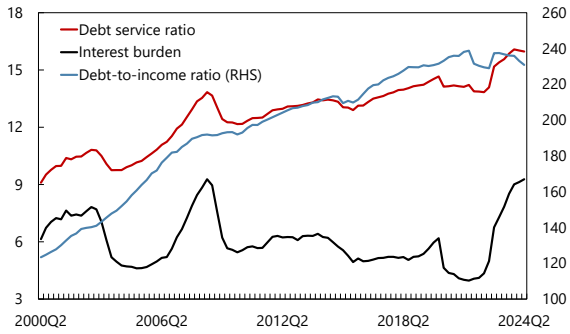
CET1 Ratio and Leverage Ratio
(Percent)



Source: Finanstilsynet.

Household interest rate burdens have increased markedly

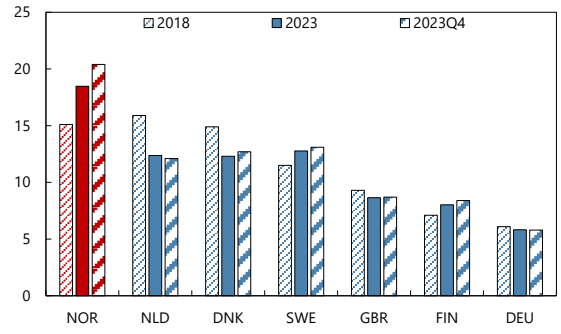
Norway: Household Debt Indicators
(Percent)



Sources: Statistics Norway; and Norges Bank.

Household debt service ratios are highest among peers

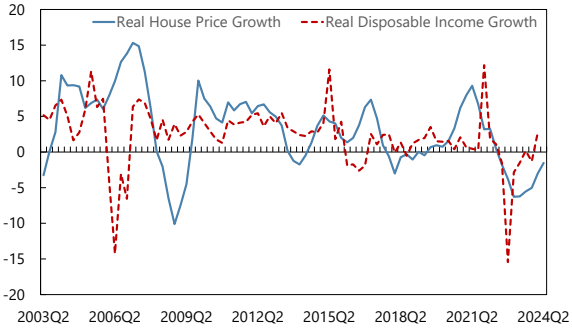
Household Debt Service Ratios
(Percent)



Source: Bank for International Settlements.

RRE prices appear to have bottomed out

House Price Growth
(Percent change, y/y)

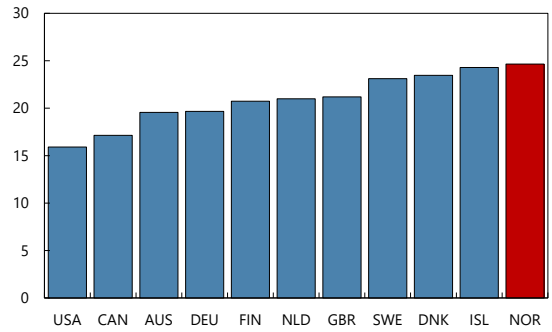


Sources: Statistics Norway; Haver Analytics; and IMF staff calculations.

Figure 4. Norway: Selected Banking Sector Indicators

Regulatory Capital Ratio

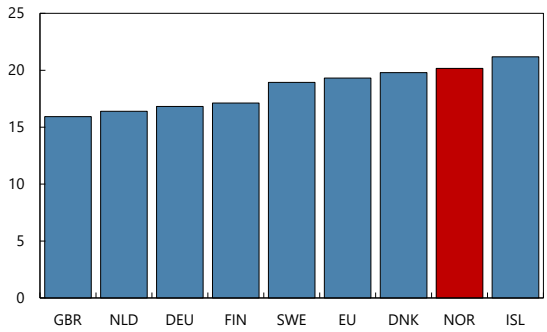
(Percent; 2023Q4 or latest available quarter)



Source: IMF Financial Soundness Indicators.

CET1 Ratio

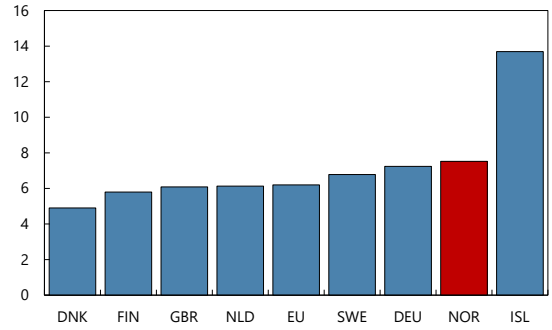
(Percent; 2023Q4 or latest available quarter)



Source: European Central Bank; and IMF Financial Soundness Indicators.

Leverage Ratio

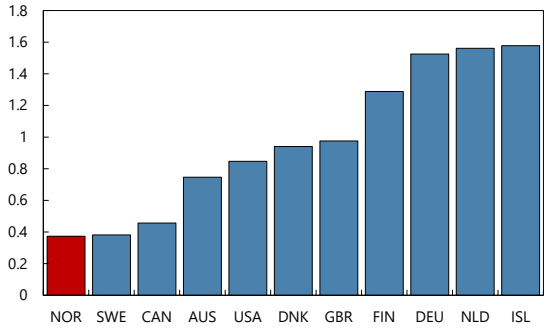
(Percent; 2023Q4 or latest available quarter)



Source: European Central Bank; and IMF Financial Soundness Indicators.

Asset Quality (NPL Ratio)

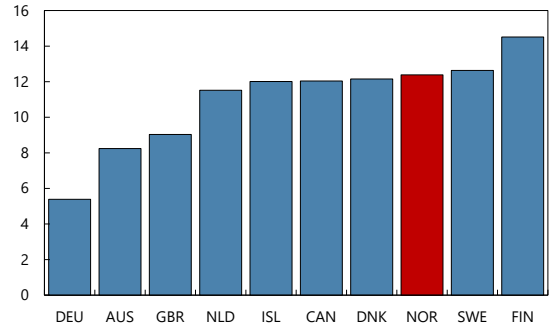
(Percent; 2023Q4 or latest available quarter)



Source: IMF Financial Soundness Indicators.

Profitability (Return on Equity)

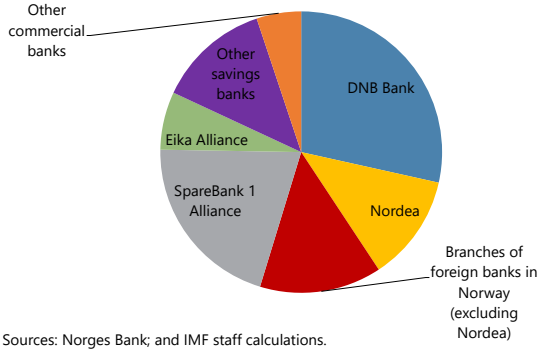
(Percent; 2023Q4 or latest available quarter)



Source: European Central Bank; and IMF Financial Soundness Indicators.

Lending Shares in Banking System (Overall)

(Percent of total; December 31, 2024)

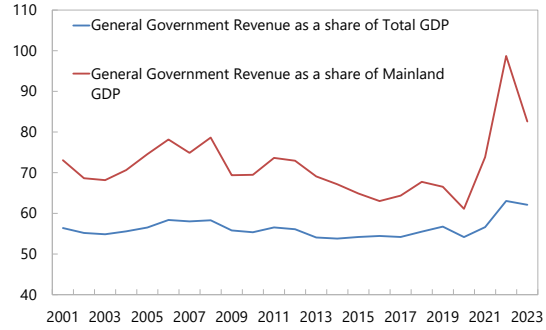


Sources: Norges Bank; and IMF staff calculations.

Figure 5. Norway: Selected Fiscal Indicators

Strong earnings from oil-related activities supported fiscal revenues.

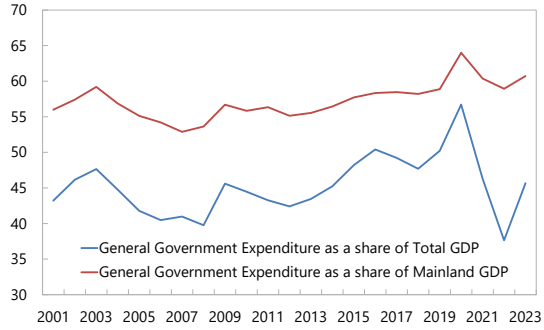
General Government Revenue
(Percent)



Sources: Haver Analytics; Ministry of Finance; and IMF staff calculations.

Expenditures rose on increased defense spending…

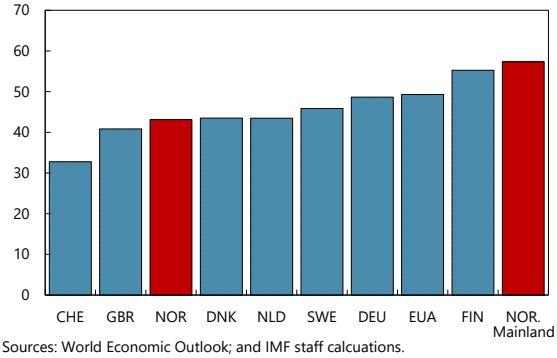
General Government Expenditure
(Percent)



Sources: Haver Analytics; Ministry of Finance; and IMF staff calculations.

…leading to the highest levels of public expenditure in the region…

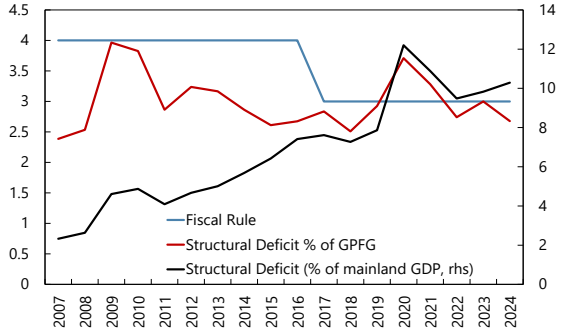
General Government Expenditure, 2023
(Percent of GDP)



Sources: World Economic Outlook; and IMF staff calcuations.

… and the structural deficit reaching the limit allowed under the fiscal rule.

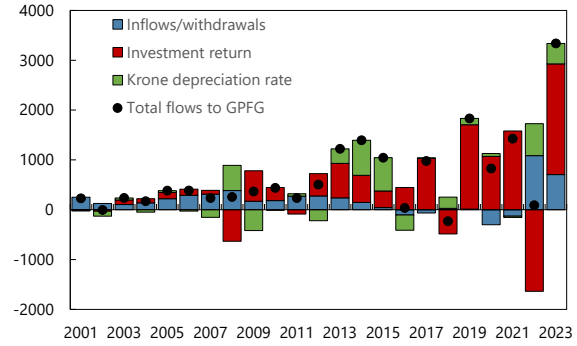
Fiscal Rule and Structural Deficit
(Percent)



Sources: Ministry of Finance; and IMF staff calculations.

The GPFG posted a strong performance in 2023.

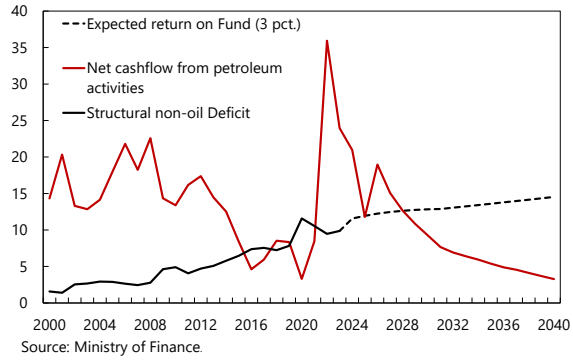
Annual Change in GPFG Market Value, by Source
(Billions of Norwegian Krone)



Source: Norges Bank Investment Management.

A steep decline in oil revenues is expected in the long-term.

Oil Revenues and Spending from the GPFG
(Percent of mainland GDP)



Source: Ministry of Finance.

Table 1. Norway: Selected Economic and Social Indicators, 2021–2029 [1/]

				Projections					
	2021	2022	2023	2024	2025	2026	2027	2028	2029
Real economy									
Real GDP (change in percent) 2/	3.9	3.0	0.5	1.5	1.8	1.7	1.6	1.4	1.4
Real mainland GDP (change in percent)	4.5	3.7	0.7	0.8	1.5	1.5	1.5	1.5	1.4
Final Domestic demand	3.9	5.1	0.3	0.4	1.5	1.7	1.7	1.6	1.6
Private consumption	5.1	6.2	-0.8	0.8	1.2	1.8	1.8	1.8	1.8
Public consumption	3.6	1.1	3.4	2.0	1.8	1.5	1.5	1.5	1.5
Gross fixed capital formation	1.6	7.6	-1.2	-2.2	1.7	1.6	1.7	1.4	1.3
Exports	7.3	9.3	4.6	2.5	2.4	2.4	2.4	2.4	2.4
Imports	2.8	14.7	0.6	1.3	2.1	2.3	2.3	2.3	2.3
Real Offshore GDP (change in percent)	-0.3	0.6	-0.1	4.2	2.9	2.2	1.8	1.0	1.0
Unemployment rate (percent of labor force)	4.4	3.3	3.6	3.8	3.8	3.8	3.8	3.8	3.8
Output gap (mainland economy, - implies output below potential)	-0.7	1.5	0.6	-0.2	-0.2	-0.1	0.0	0.1	0.1
CPI (average)	3.5	5.8	5.5	3.3	2.4	2.0	2.0	2.0	2.0
Core Inflation (average)	1.7	3.9	6.2	3.9	2.8	2.4	2.2	2.0	2.0
Public finance									
Central government (fiscal accounts basis)									
Non-oil balance (percent of mainland GDP)	-11.1	-7.8	-7.5	-8.4	-8.7	-9.0	-9.2	-9.4	-9.6
Structural non-oil balance (percent of mainland trend GDP) 3/	-10.1	-9.2	-9.7	-10.4	-11.1	-11.7	-12.0	-12.2	-12.3
Fiscal impulse	-1.0	-0.9	0.5	0.7	0.7	0.6	0.3	0.2	0.1
In percent of Pension Fund Global Capital 4/	-3.2	-2.7	-3.0	-2.7	-2.6	-2.6	-2.7	-2.7	-2.6
Gross Public Debt (percent of GDP)	41.6	36.3	44.0	42.7	42.7	42.7	42.3	41.6	40.9
Money and credit (end of period, 12-month percent change)									
Broad money, M2	10.4	5.6	0.3	...	...	...	...	...	...
Domestic credit, C2	4.9	5.6	3.8	...	...	...	...	...	...
Interest rates (year average, in percent)									
Three-month interbank rate	0.5	2.1	4.2	4.8	4.0	3.5	3.3	3.3	3.3
Ten-year government bond yield	1.4	2.9	3.4	3.7	3.2	2.8	2.6	2.6	2.6
Balance of payments (percent of total GDP)									
Current account balance	14.9	30.2	17.9	14.5	12.5	10.6	8.8	7.6	6.6
Balance of goods and services (percent of mainland GDP)	19.4	44.3	19.6	20.6	17.6	14.7	12.6	11.0	9.6
Terms of trade (change in percent)	50.8	44.1	-29.4	8.6	4.3	-0.6	-1.4	-1.6	-0.9
International reserves (end of period, in billions of US dollars)	83.0	72.1	77.4	77.4	77.4	77.4	77.4	77.4	77.4
Gross national saving	40.0	51.9	43.8	39.8	38.5	37.1	35.7	34.8	33.9
Gross domestic investment	25.1	21.7	25.9	25.3	26.0	26.6	26.9	27.2	27.3
Exchange rates (end of period)									
Bilateral rate (NOK/USD), end-of-period	8.6	9.6	10.6	...	...	...	...	...	...
Nominal effective rate (2010=100)	80.5	79.9	73.2	...	...	...	...	...	...
Real effective rate (2010=100)	83.1	80.9	74.1	...	...	...	...	...	...
Memo:									
Nominal GDP (in Billions of US Dollars)	503.4	593.7	485.3	504.3	507.6	509.4	521.3	534.9	549.5

Sources: Norwegian Authorities; International Financial Statistics; United Nations Development Programme; and IMF staff calculations.

1/ Based on information available as of July 30, 2024.

2/ Based on market prices which include "taxes on products, including VAT, less subsidies on products."

3/ Authorities' key fiscal policy variable; excludes oil-related revenue and expenditure, GPFG income, as well as cyclical effects. Non-oil GDP trend estimated by MOF.

4/ Over-the-cycle deficit target: 3 percent of Government Pension Fund Global.

Table 2. Norway: Medium-Term Macroeconomic Indicators, 2021–2029

				Projections					
	2021	2022	2023	2024	2025	2026	2027	2028	2029
Real GDP (change in percent)	3.9	3.0	0.5	1.5	1.8	1.7	1.6	1.4	1.4
Real mainland GDP	4.5	3.7	0.7	0.8	1.5	1.5	1.5	1.5	1.4
Real Domestic Demand (change in percent)	2.7	5.4	0.1	0.7	1.6	1.6	1.5	1.5	1.5
Public consumption	3.6	1.1	3.4	2.0	1.8	1.5	1.5	1.5	1.5
Private consumption	5.1	6.2	-0.8	0.8	1.2	1.8	1.8	1.8	1.8
Gross fixed investment	0.7	5.2	0.0	-1.0	2.0	1.7	1.4	1.3	1.1
Trade balance of goods and services (contribution to growth)	2.0	-1.6	0.4	1.0	0.6	0.1	0.1	0.1	0.1
Exports of goods and services	6.1	4.5	1.4	3.3	2.7	1.7	1.7	1.7	1.7
Mainland good exports	6.7	-2.5	6.1	2.5	2.4	2.4	2.4	2.4	2.4
Imports of goods and services	1.8	12.5	0.7	1.3	2.1	2.3	2.3	2.3	2.3
Potential GDP (change in percent)	1.5	1.6	1.6	1.6	1.6	1.6	1.6	1.5	1.5
Potential mainland GDP	1.6	1.6	1.6	1.5	1.5	1.5	1.5	1.4	1.4
Output gap (percent of potential mainland GDP)	-0.7	1.5	0.6	-0.2	-0.2	-0.1	0.0	0.1	0.1
Labor Market (percent)									
Employment	1.5	2.7	0.9	0.6	0.8	0.8	0.8	0.8	0.8
Unemployment rate LFS	4.4	3.3	3.6	3.8	3.8	3.8	3.8	3.8	3.8
Prices									
GDP deflator (mainland)	3.5	6.0	5.0	3.0	2.2	1.9	1.9	1.8	1.8
Consumer prices (average)	3.5	5.8	5.5	3.3	2.4	2.0	2.0	2.0	2.0
Core inflation (average)	1.7	3.9	6.2	3.9	2.8	2.4	2.2	2.0	2.0
Fiscal Indicators (percent of mainland GDP)									
Central government non-oil balance	-11.1	-7.8	-7.5	-8.4	-8.7	-9.0	-9.2	-9.4	-9.6
General government fiscal balance	13.4	40.1	21.9	16.0	14.3	12.4	10.9	9.6	8.6
of which: overall revenue	74.8	100.1	83.7	78.9	77.5	75.9	74.5	73.5	72.7
of which: overall expenditure	61.4	60.0	61.8	62.9	63.2	63.5	63.7	63.9	64.1
External Sector									
Current account balance (percent of mainland GDP)	19.4	47.2	23.8	19.4	16.4	13.6	11.1	9.5	8.1
Current account balance (percent of GDP)	14.9	30.2	17.9	14.5	12.5	10.6	8.8	7.6	6.6
Balance of goods and services (percent of mainland GDP)	19.4	44.3	19.6	20.6	17.6	14.7	12.6	11.0	9.6
Mainland balance of goods	-10.6	-10.4	-9.6	-9.7	-10.1	-10.4	-10.2	-10.1	-10.1
Crude Oil Price	69.2	96.4	80.6	82.9	78.1	74.1	71.6	69.9	68.8

Sources: Norwegian Authorities; and IMF staff calculations.

Table 3. Norway: Balance of Payments and External Sector Indicators, 2021–2029

				Projections					
	2021	2022	2023	2024	2025	2026	2027	2028	2029
				Bil. NOK					
Current account balance	644	1,722	917	779	683	585	496	438	389
Balance of goods and services	642	1,616	755	827	732	635	563	507	460
Balance of goods	622	1,627	814	888	829	763	718	687	663
Balance of services	20	-11	-59	-60	-97	-129	-155	-179	-203
Exports	1,861	3,166	2,420	2,537	2,497	2,460	2,452	2,464	2,488
Goods	1,495	2,652	1,863	1,958	1,929	1,896	1,885	1,890	1,904
of which oil and natural gas	981	2,014	1,194	1,288	1,262	1,222	1,186	1,166	1,155
Services	366	513	556	579	568	564	567	574	584
Imports	1,219	1,549	1,664	1,710	1,765	1,826	1,889	1,956	2,028
Goods	873	1,025	1,050	1,071	1,100	1,133	1,167	1,203	1,241
Services	346	524	615	639	666	693	722	753	787
Balance on income	2	106	162	-48	-49	-50	-68	-69	-71
Capital account balance	-1.2	-4.5	-4.4	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (excluding change in reserves)	532	1,445	1,010	779	683	585	496	438	389
Net direct investment	107	111	68	107	109	116	118	121	124
Net portfolio investment	353	1,421	930	392	363	390	431	441	451
Net other investment	71	-87	13	279	211	78	-54	-124	-186
Net errors and omissions	68	301	-130	0	0	0	0	0	0
Change in reserves	87	-27	33	0	0	0	0	0	0
				Percent of GDP					
Current account balance	14.9	30.2	17.9	14.5	12.5	10.6	8.8	7.6	6.6
Balance of goods and services	14.8	28.3	14.7	15.4	13.4	11.5	10.0	8.8	7.8
Balance of goods	14.4	28.5	15.9	16.5	15.2	13.8	12.7	11.9	11.2
Balance of services	0.5	-0.2	-1.1	-1.1	-1.8	-2.3	-2.8	-3.1	-3.4
Exports	43.0	55.5	47.2	47.2	45.7	44.5	43.5	42.8	42.2
Goods	34.6	46.5	36.3	36.5	35.3	34.3	33.4	32.8	32.3
of which oil and natural gas	22.7	35.3	23.3	24.0	23.1	22.1	21.0	20.2	19.6
Services	8.5	9.0	10.9	10.8	10.4	10.2	10.1	10.0	9.9
Imports	28.2	27.1	32.5	31.8	32.3	33.0	33.5	34.0	34.4
Goods	20.2	18.0	20.5	19.9	20.1	20.5	20.7	20.9	21.0
Services	8.0	9.2	12.0	11.9	12.2	12.5	12.8	13.1	13.3
Balance on income	0.0	1.9	3.2	-0.9	-0.9	-0.9	-1.2	-1.2	-1.2
Capital account balance	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (excluding change in reserves)	12.3	25.3	19.7	14.5	12.5	10.6	8.8	7.6	6.6
Net direct investment	2.5	1.9	1.3	2.0	2.0	2.1	2.1	2.1	2.1
Net portfolio investment	8.2	24.9	18.1	7.3	6.7	7.1	7.7	7.7	7.7
Net other investment	1.6	-1.5	0.2	5.2	3.9	1.4	-1.0	-2.1	-3.2
Net errors and omissions	1.6	5.3	-2.5	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves	2.0	-0.5	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Stock of net foreign assets (IIP)	269.4	203.0	298.2	323.3	339.4	353.4	364.1	372.4	378.7
Direct investment, net	7.5	7.9	10.2	11.7	13.5	15.4	17.2	19.0	20.6
Portolio investment, net	263.5	197.8	286.7	304.9	315.2	326.0	336.2	345.2	353.2
Other investment, net	-18.8	-15.2	-14.6	-8.7	-4.7	-3.3	-4.2	-6.2	-9.2
Official reserves, assets	17.2	12.5	16.0	15.4	15.4	15.2	14.8	14.4	14.1
Government Pension Fund Global (percent of mainland GDP)	372.2	340.9	408.7	446.2	458.1	467.1	473.4	478.2	481.1

Sources: Statistics Norway, Ministry of Finance, and IMF staff calculations.

Table 4. Norway: General Government Accounts, 2021–2029

(NOK and Percent of Mainland GDP)

				Projections					
	2021	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
General Government				*Percent of Mainland GDP*					
Revenue	74.8	100.1	83.7	78.9	77.5	75.9	74.5	73.5	72.7
Oil Related Revenue	21.5	47.2	30.2	25.0	23.6	22.1	20.7	19.6	18.8
Non-oil Related Revenue	53.3	52.9	53.5	53.9	53.9	53.9	53.9	53.9	53.9
Social Security	12.3	11.9	12.4	12.5	12.5	12.5	12.5	12.5	12.5
Interest	2.1	2.8	4.6	5.3	4.4	3.7	3.3	3.3	3.2
Expenditure	61.4	60.0	61.8	62.9	63.2	63.5	63.7	63.9	64.1
Non-oil Expenditure	61.4	60.0	61.8	62.9	63.2	63.5	63.7	63.9	64.1
Social Security	17.9	16.8	17.4	17.7	17.8	17.9	18.0	18.0	18.1
Interest	0.5	0.8	1.4	1.6	1.4	1.1	1.0	1.0	1.0
Overall Balance	13.4	40.1	21.9	16.0	14.3	12.4	10.9	9.6	8.6
Non-Oil Balance	-8.1	-7.1	-8.3	-9.0	-9.3	-9.6	-9.8	-10.0	-10.2
General Government				*Bil. NOK*					
Revenue	2,480	3,650	3,229	3,164	3,228	3,276	3,331	3,399	3,477
Oil Related Revenue	713	1,720	1,166	1,004	984	952	924	909	900
Non-oil Related Revenue	1,767	1,930	2,063	2,160	2,244	2,324	2,406	2,491	2,577
Social Security	409	435	480	502	522	540	559	579	599
Interest	71	102	178	213	183	159	148	150	154
Expenditure	2,036	2,188	2,384	2,522	2,633	2,739	2,845	2,954	3,066
Non-oil Expenditure	2,036	2,188	2,384	2,522	2,633	2,739	2,845	2,954	3,066
Social Security	595	614	672	711	743	773	802	833	865
Interest	18	30	55	66	57	49	46	47	48
Overall Balance	444	1,462	845	642	595	537	485	445	411
Non-Oil Balance	-269	-258	-321	-362	-388	-415	-439	-463	-489
Central Government									
Structural Non-Oil Balance as % of GPFG	-3.2	-2.7	-3.0	-2.7	-2.6	-2.6	-2.7	-2.7	-2.6

Sources: Norwegian Authorities: and IMF staff calculations.

* Projections do not include the recently announced additional defence spending during the next 12 years.

Table 5. Norway: Financial Soundness Indicators, 2019–2023

(Percent)

	2019	2020	2021	2022	2023
Capital Adequacy					
Regulatory Capital to Risk-Weighted Assets	24.2	24.8	25.0	25.9	24.7
Regulatory Tier 1 Capital to Risk-Weighted Assets	21.4	22.0	22.2	22.0	21.8
Total Capital to Total Assets	11.3	11.2	12.2	9.4	8.8
Asset Quality and Exposure					
Non-performing Loans to Total Gross Loans	0.8	0.7	0.5	0.3	0.4
Non-performing Loans Net of Provisions to Capital	0.7	0.3	0.3	-0.9	-0.1
Earnings and Profitability					
Return on Assets	1.6	1.1	1.3	1.1	1.3
Return on Equity	14.0	9.9	11.7	10.3	12.4
Non-interest Expenses to Gross Income, percent	42.1	44.0	45.6	33.4	30.4
Liquidity					
Liquid Assets to Total Assets (Liquid Asset Ratio)	10.0	9.8	11.1	7.0	6.7
Liquid Assets to Short Term Liabilities	20.0	18.9	19.0	20.3	21.0
Memorandum Items					
Change in Housing Price Index (in percent, year average)	2.5	4.3	10.5	5.2	-0.5
Total Household Debt (in percent of GDP)	108.1	118.4	100.4	79.4	91.5
Total Household Debt (in percent of disposable income)	243.7	250.0	248.5	253.4	0.0
Gross Debt of Non-financial Corporations (in percent of GDP)	145.2	170.4	147.6	123.5	147.7

Sources: ECB; IMF Financial Soundness Indicators; and OECD.

Table 6. Norway: Monetary Survey, 2021–2029

(Billion NOK)

	2018	2019	2020	2021	2022	2023
Central Bank balance sheet						
Assets	8,851	10,727	11,679	13,172	13,200	16,629
Liabilities	8,612	10,464	11,403	12,883	12,930	16,307
M3, Monetary aggregates (outstanding amounts)						
Households	1,294	1,348	1,467	1,575	1,640	1,689
Municipal government	105	107	115	133	141	125
Nonfinancial corporations	728	755	897	1,037	1,125	1,086
Other financial corporations	133	142	155	167	167	186
Broad Money (M3)	2,259	2,351	2,635	2,912	3,073	3,086
M2	2,253	2,348	2,633	2,908	3,069	3,078
M1	2,097	2,162	2,465	2,724	2,811	2,674
Currency in circulation	42	39	38	37	38	38
Transaction Deposits	2,055	2,123	2,427	2,686	2,773	2,636
Other Deposits	156	186	168	184	258	405
Certificates and bonds	7	3	0	2	3	3
Repurchase agreements	0	0	2	2	1	4
Memorandum item:						
M3 growth, percent	5.5	4.1	12.5	10.6	5.4	0.4

Source: Norges Bank and Statistics Norway.

Annex I. Wage Setting and Second Round Effects[1]

High inflation and tight labor markets have reignited discussions about the role of the wage bargaining system, labor market conditions, and inflation expectations in price setting. While Norway's wage bargaining system and above-target inflation expectations may have contributed to more persistent inflation, empirical evidence suggests the risks of a wage-price spiral appear limited.

1. Norway's wage bargaining system is characterized by a combination of sectoral and local negotiations, where both levels play significant roles in shaping labor agreements. The system, which is similar to those observed in other Nordic nations, is characterized by a high degree of coordination and extensive coverage, ensuring that collective agreements are widely applicable across the workforce. The wage bargaining process typically initiates with the industrial sector, particularly the manufacturing export industry, which sets the benchmark for other industries, in a practice known as the "*frontfag*" model. The agreements reached in this sector serve as a norm for subsequent negotiations in other sectors, including public services, construction, and retail, but are not binding. The approach helps maintain wage coordination and prevents excessive wage growth in individual sectors on the argument that labor cost should evolve in line with what the sector exposed to international competition can handle.

2. Compared to other Nordic countries, Norway shows lower levels of trade union density. Unlike other countries in the region, the Ghent system is not in place in Norway, which partly explains its relatively lower unionization rate. In contrast, the government actively supports collective agreements and facilitates their extension to non-unionized workers, particularly in industries employing significant numbers of foreign workers.

Comparison of Collective Wage Bargaining Systems in Nordic Countries

Country	First private sector basic agreement	Statutory Minimum Wage	Ghent System 1/	Collective Bargaining Coverage Rate (in percent) 2/	Days not Worked due to Strikes or lockouts (per 1000 employees) 3/	Extension of Collective Agreements 4/
Norway	1935	No	No	69-74	52	Yes
Sweden	1938	No	Yes	88-90	10	No
Denmark	1899	No	Yes	82-85	70	No
Finland	1944	No	Yes	85-92	80	Yes

1/ The Ghent system is a distinctive arrangement in which unemployment insurance is administered by trade unions rather than by the government or a state agency. The Ghent system in Sweden, Finland, and Denmark receive subsidies from their respective governments.
2/ Source: OECD. Min and max range between 2000-2021.
3/ Source: European Trade Union Institute.
4/ The extension of collective agreements means applying the terms of union-negotiated agreements to all workers in an industry, including those who are not union members.

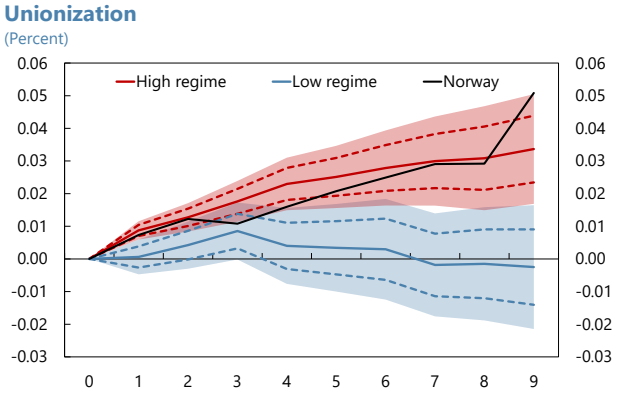
3. Trade union density is positively related to higher wage increases. In the Nordic countries, including Norway, wage-setting systems are generally more centralized compared to other advanced economies. This centralization significantly influences wage-inflation dynamics, as institutional frameworks for wage bargaining play a crucial role. Recent empirical evidence (Baba and Lee, 2022) indicates that the pass-through of oil price shocks to wages tends to increase with higher union density (left chart) and greater centralization in bargaining processes (right chart).[2] The impulse response functions from a model estimated for Norway are in line with the evidence from

[1] Prepared by Cristina Cheptea and Mauricio Vargas with inputs from Chikako Baba.

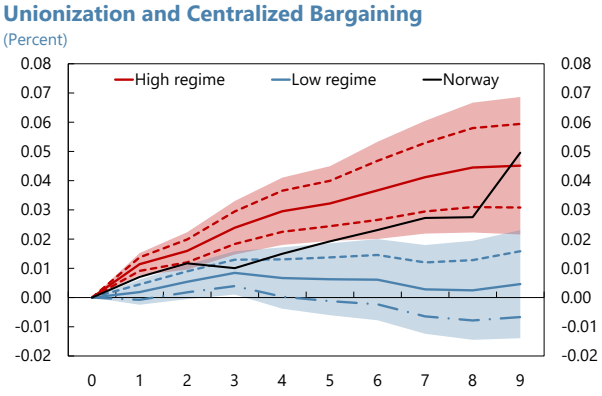
[2] However, the authors do not find evidence that the coverage of collective bargaining significantly affects the pass-through of inflation shocks to wages.

the literature. Notably, as shown by the charts below, Norway's wage growth responds to oil price shocks in a similar fashion to countries with high unionization and centralized bargaining systems.

Annex I. Figure 1. Cumulative Impulse Response of Wages Following Oil Price Shocks, by Labor Market Characteristics

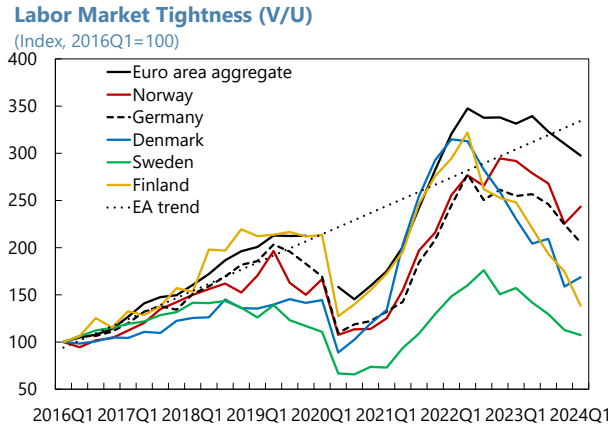


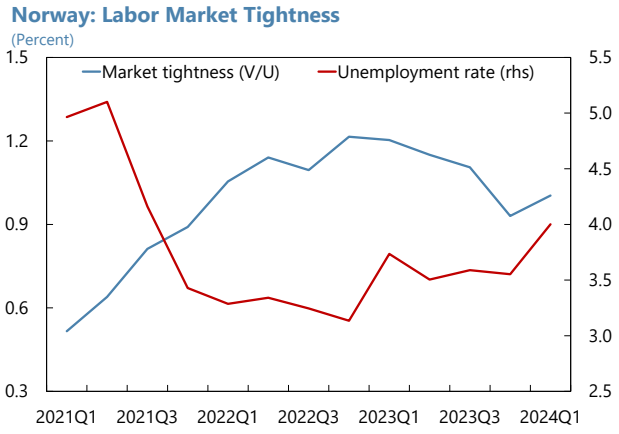
Sources: OECD; and IMF staff calculations.
Note: Wage inflation to USD oil price shock. # Countries= 24. 1961Q2-2019Q4.



Sources: OECD; and IMF staff calculations.
Note: Wage inflation to USD oil price shock. # Countries= 24. 1961Q2-2019Q4.

4. Wage growth is also affected by labor market conditions. Despite the adverse shocks of the past two years, both labor market tightness and inflation appear to have peaked. While Norway's labor shortages remain higher than those in other Nordic countries, they are lower than in the euro area and are gradually falling toward pre-pandemic levels. In 2023, a framework agreement with a 5.2 percent wage growth for industries competing internationally was reached within the collective bargaining process. For this year, a similar agreement was reached, slightly higher than expected. This will translate into real wage growth of about 1.1 percent, somewhat above the average productivity growth of 0.9 percent during 2006–2023.



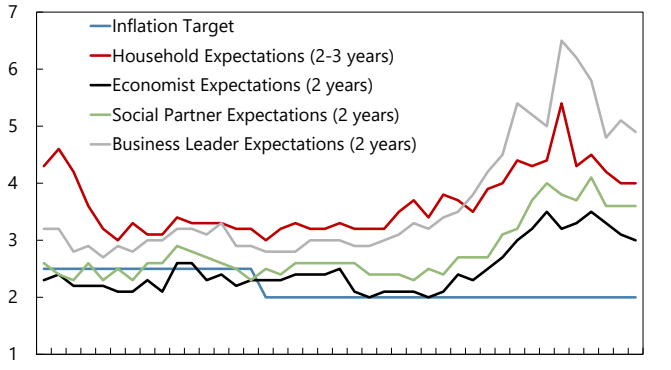


Sources: Eurostat; Haver Analytics; and IMF staff calculations.
Note: Market tightness is defined as the ratio between the number of vacancies and the number of unemployed aged 15–64. Job vacancies data may comprise all sectors or only industry-construction-services depending on data availability at the country level. The market tightness for the euro area is computed by summing the country-level data on number of vacancies and unemployed, and then computing the ratio.

5. While inflation expectations have remained elevated over the past few years, empirical results suggest limited risks of wage-price spiral. Cross-country analysis confirms that wage growth tends to rise with backward-looking inflation expectations (WEO, 2022). Also, during high-inflation episodes and elevated expectations, such as after the pandemic, inflation's contribution to wage growth is also higher. However, credibility of the central banks is an important factor in containing inflation pressures. Empirical results from a model as in Baba and Lee, 2022 estimated for Norway (left chart) suggest that within a year, wage growth in Norway responds to inflation shocks similarly to countries where inflation expectations are better anchored (the difference between high and low anchoring is less significant after a year). Also, Norway's high central bank independence could have mitigated wage inflation, as countries with high central bank independence experience lower wage inflation (right panel chart).

Inflation Target and Inflation Expectations

(Percent)

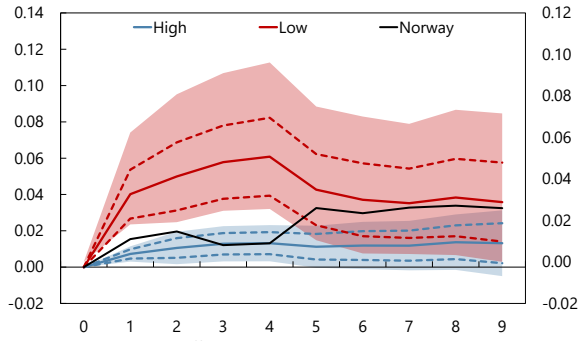


Source: Haver Anaytics; Norges Bank; and IMF staff calculations.

Annex I. Figure 2. Cumulative Impulse Response of Wages Following Oil Price Shocks, by Monetary Policy Credibility

Monetary Policy Anchoring

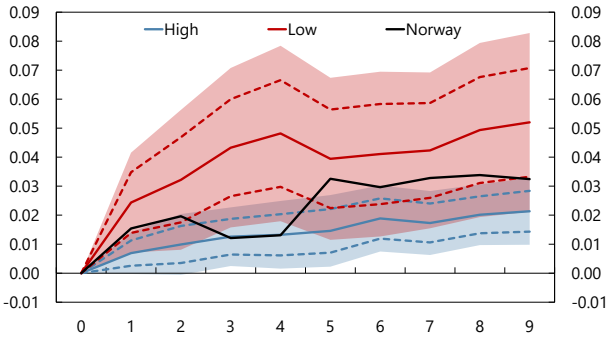
(Percent)



Sources: OECD; and IMF staff calculations.
Note: Wage inflation to USD oil price shock. # Countries= 23. 2000Q1-2019Q4.

Central Bank Independence

(Percent)



Sources: OECD; and IMF staff calculations.
Note: Wage inflation to USD oil price shock. # Countries= 36. 2000Q1-2019Q4.

References

Baba, C. and Lee J., 2022. "Second-Round Effects of Oil Price Shocks -- Implications for Europe's Inflation Outlook", IMF Working Paper 2022/173, International Monetary Fund.

International Monetary Fund, 2022, "World Economic Outlook", Chapter 2 "Wage Dynamics Post–COVID-19 and Wage Price Spiral Risks", October 2022.

Annex II. Sovereign Risk and Debt Sustainability Assessment

Annex II. Figure 1. Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting a low level of public debt and high buffers.
Near term 1/			
Medium term	Moderate	Low	Medium-term risks are assessed as low against a mechanical moderate (in the fan chart only) on the basis of the high buffers and stregnth of institutions.
Fanchart	High	...	
GFN	Low	...	
Stress test		...	
Long term	...	Moderate	Long-term risks are moderate as aging-related expenditures on health and social security feed into debt dynamics.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: Norway is at low overall risk of sovereign stress and debt is sustainable. Debt is expected to stabilize and decline over the medium term. Medium-term liquidity risks as analyzed by the GFN Financeability Module are low. Over the longer run, Norway should continue with reforms to tackle population aging and its impact on public spending, including the generous disability and sickness benefits. Large buffers contribute to keep risks low.

Source: IMF staff calculations.
Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.
1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.
2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex II. Figure 2. Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

		Subsectors captured in the baseline	Inclusion	
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
	2	Extra budgetary funds (EBFs)	Yes	Not applicable
	3	Social security funds (SSFs)	Yes	
	4	State governments	Yes	
	5	Local governments	Yes	
	6	Public nonfinancial corporations	No	
	7	Central bank	No	
	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on Intra-Government Debt Holdings

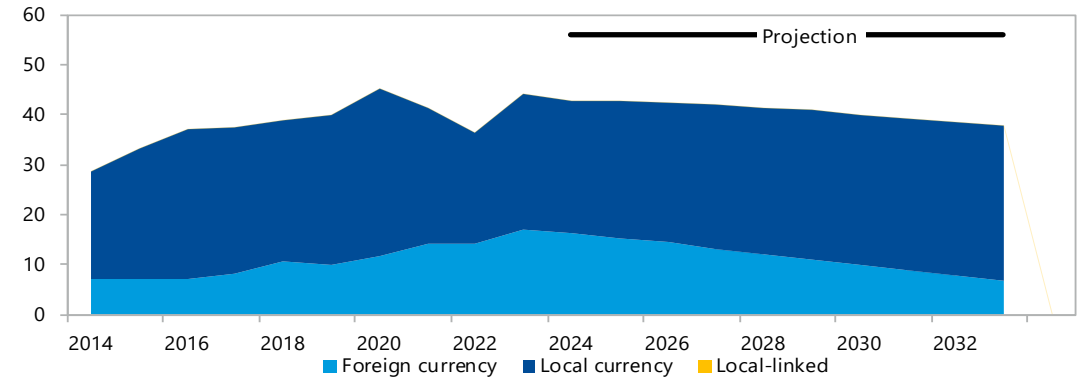
		Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
	2	Extra-budget. funds									0
	3	Social security funds									0
	4	State govt.									0
	5	Local govt.									0
	6	Nonfin pub. corp.									0
	7	Central bank									0
	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

Source: IMF staff calculations.
1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: N/A.

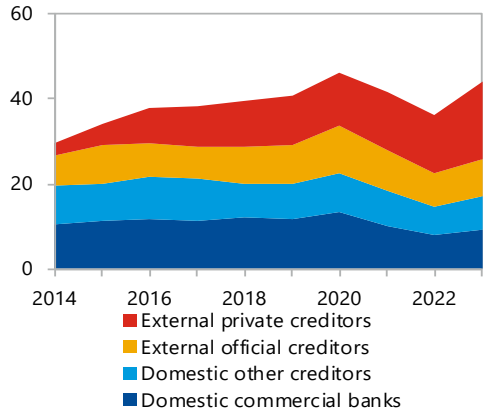
Annex II. Figure 3. Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



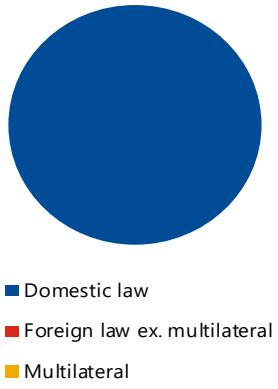
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



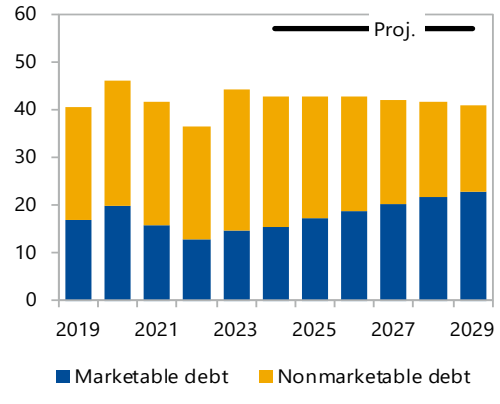
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



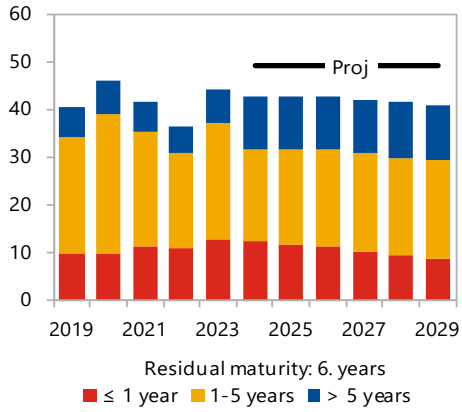
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

Commentary: Public debt is predominantly in domestic currency. Most of the public debt has a medium and long-term maturity.

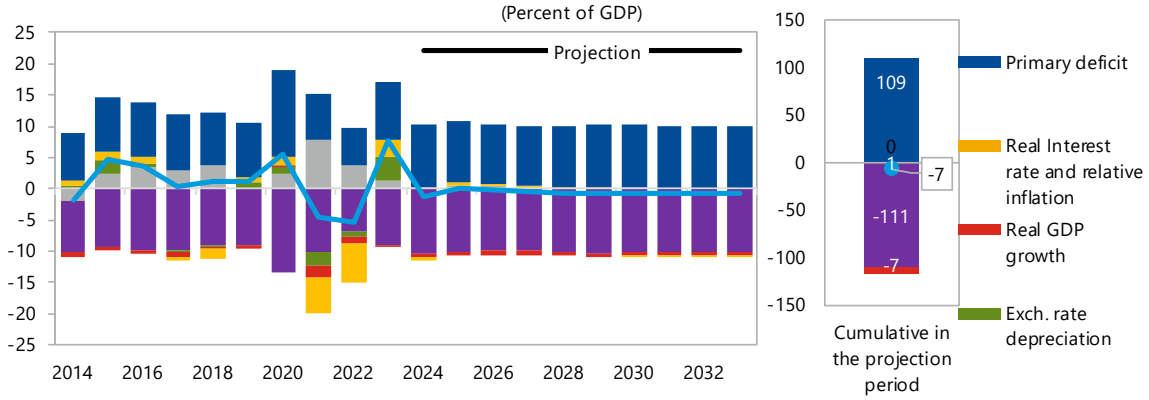
Source: IMF staff calculations.

Annex II. Figure 4. Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	44.0	42.7	42.7	42.5	42.0	41.4	40.6	40.0	39.2	38.5	37.7
Change in public debt	7.7	-1.3	0.0	-0.2	-0.5	-0.6	-0.8	-0.6	-0.8	-0.8	-0.8
Contribution of identified flows	6.3	-1.5	-0.6	-0.6	-0.6	-0.7	-0.7	-0.8	-0.8	-0.8	-0.8
Primary deficit	9.1	10.0	9.8	9.6	9.6	9.8	10.0	10.0	10.0	10.0	10.0
Noninterest revenues	35.9	35.4	36.9	38.1	39.0	39.6	40.0	40.0	40.0	40.0	40.0
Noninterest expenditures	45.0	45.5	46.7	47.7	48.6	49.4	50.0	50.0	50.0	50.0	50.0
Automatic debt dynamics	6.3	-1.3	-0.3	-0.3	-0.3	-0.4	-0.4	-0.7	-0.7	-0.7	-0.7
Real interest rate and relative inflatio	2.7	-0.6	0.4	0.4	0.3	0.2	0.1	-0.1	-0.1	-0.1	-0.1
Real interest rate	4.9	-0.7	0.7	0.6	0.6	0.4	0.2	-0.1	-0.1	-0.2	-0.2
Relative inflation	-2.2	0.1	-0.3	-0.3	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0
Real growth rate	-0.2	-0.7	-0.8	-0.7	-0.7	-0.6	-0.6 .	-0.6	-0.6	-0.5	-0.5
Real exchange rate	3.8	...	...	...	...	...	... .	...	...	...	...
Other identified flows	-9.1	-10.2	-10.0	-9.8	-9.9	-10.1	-10.3	-10.1	-10.1	-10.1	-10.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-3.5	-4.0	-3.3	-2.9	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
Other transactions	-5.7	-6.3	-6.7	-7.0	-7.3	-7.5	-7.7	-7.5	-7.5	-7.5	-7.5
Contribution of residual	1.4	0.2	0.6	0.4	0.1	0.0	0.0	0.2	0.0	0.0	0.0
Gross financing needs	9.2	8.9	10.2	10.8	11.4	11.6	11.9	11.8	11.7	11.7	11.6
of which: debt service	3.6	2.8	3.8	4.1	4.4	4.4	4.5	4.4	4.3	4.3	4.2
Local currency	2.2	1.7	2.2	2.6	2.9	3.0	3.0	3.0	2.9	2.9	2.8
Foreign currency	1.4	1.1	1.6	1.5	1.5	1.5	1.4	1.4	1.4	1.4	1.4
Memo:											
Real GDP growth (percent)	0.5	1.5	1.8	1.7	1.6	1.4	1.4	1.4	1.4	1.4	1.4
Inflation (GDP deflator; percent)	-10.6	3.2	-0.2	0.1	0.3	0.8	1.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	-10.2	4.8	1.6	1.8	1.9	2.2	2.4	3.4	3.4	3.4	3.4
Effective interest rate (percent)	1.6	1.5	1.6	1.7	1.7	1.7	1.7	1.6	1.6	1.6	1.6

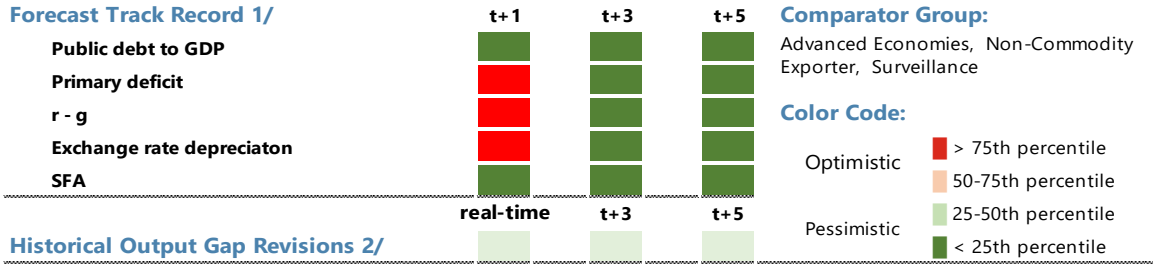
Contribution to Change in Public Debt

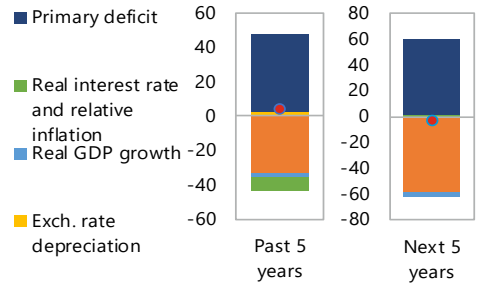


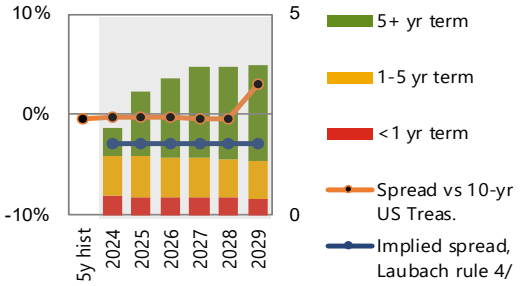
Commentary: Public debt will stabilize and decline over time, reflecting GDP growth, and low borrowing needs.

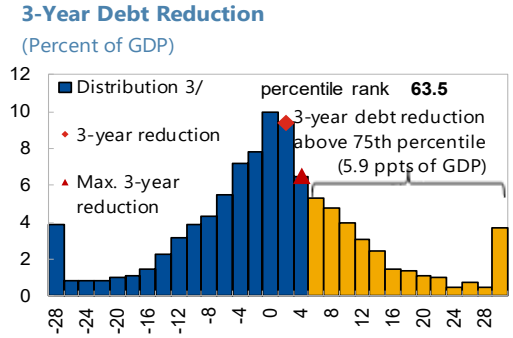
Source: IMF staff calculations.

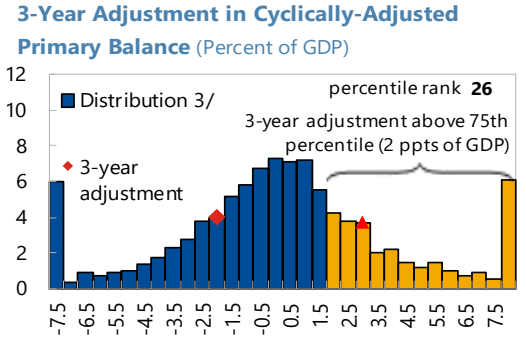
Annex II. Figure 5. Realism of Baseline Assumptions

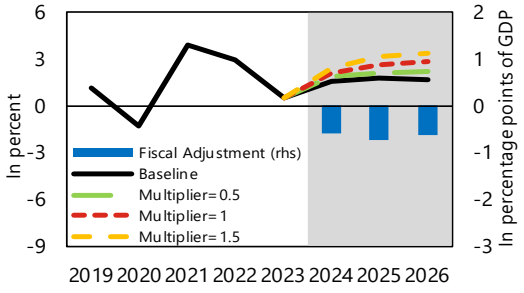


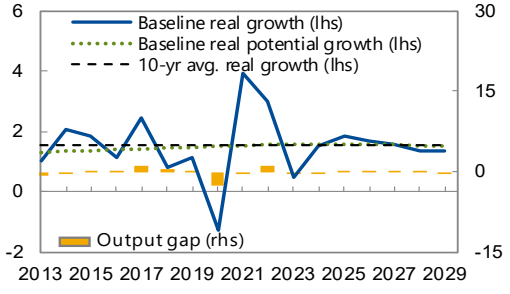












Commentary: This reflects large fluctuations due to oil price volatility.

Source : IMF staff calculations.

1/ Projections made in the October and April WEO vintage.

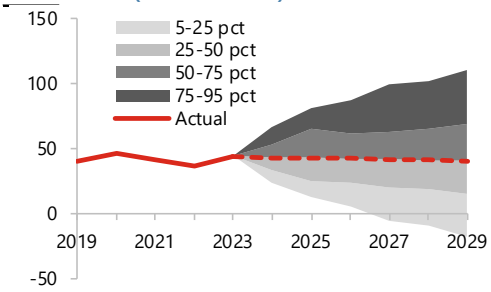
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

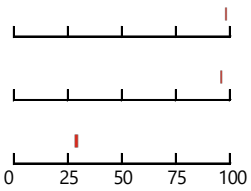
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Annex II. Figure 6. Medium-Term Risk Assessment

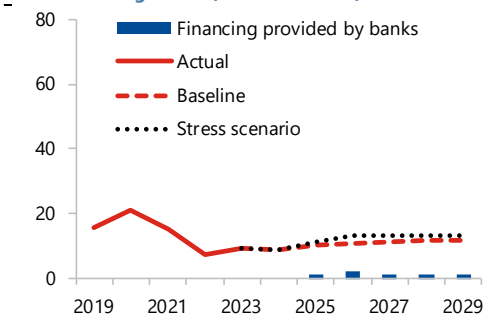
Final Fanchart (Percent of GDP)



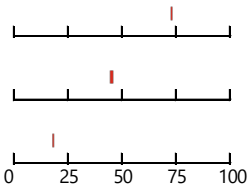
Debt fanchart module	Value	Contrib 1/	Percentile in peer group 2/
Fanchart width *(percent of GDP)*	128.1	1.9	
Probability of debt non-stabilization *(percent)*	99.6	0.8	
Terminal debt-to-GDP x institutions index	5.6	0.1	
Debt fanchart index (DFI)		2.8	
Risk signal: 3/		High	



Gross Financing Needs (Percent of GDP)



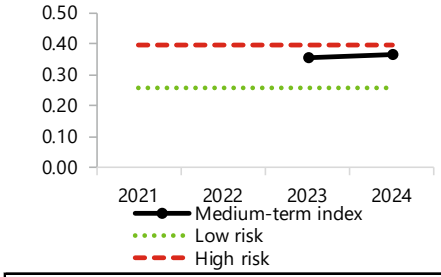
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	10.8	3.7	
Initial Banks' claims on the gen. govt *(pct bank assets)*	4.7	1.5	
Chg. In banks' claims in stress *(pct banks' assets)*	1.0	0.3	
GFN financeability index (GFI)		5.6	
Risk signal: 4/		Low	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	2.8	0.6	0.5	0.3
GFN finaceability index	5.6	0.1	0.5	0.1
Medium-term index		0.4		
Risk signal: 5/		Moderate		
Final assessment:		Low		

Prob. of missed crisis, 2024-2029, if stress not predicted: 27.3 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 17.0 pct.

Commentary: Debt fan chart results point to a high level risk, due to wide bands of confidence, but debt will remain relatively low even in the more extreme scenarios. The GFN Financeability model indicates a low level risk.

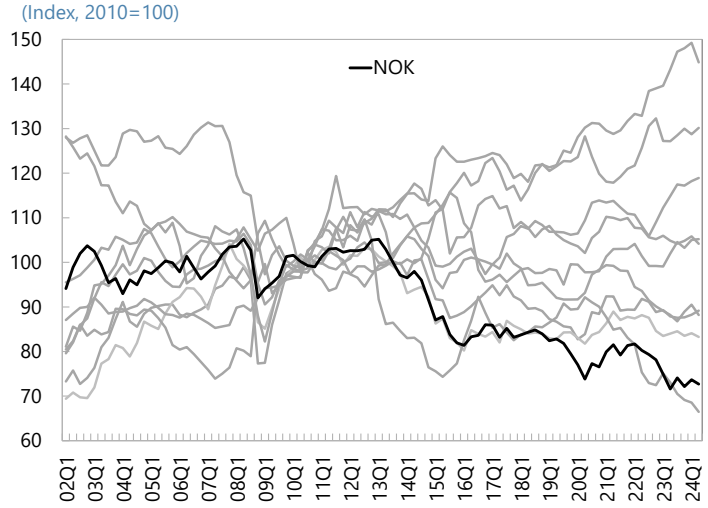
Source: IMF staff estimates and projections.
1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Annex III. Exchange Rate Determinants: A Principal Components Approach[1]

Global factors such as USD multilateral strength (and risk sentiment), trade patterns, and comovements with other Nordic countries also characterized by large current account surpluses and relatively small FX markets help explain the Norwegian krone dynamics over the recent past.

1. The Norwegian krone has exhibited a depreciating trend since 2014. On a nominal-effective-exchange rate basis, the Norwegian krone (NOK) was broadly stable since the turn of the century. However, starting in 2014, the NOK started to exhibit a depreciating trend (Figure 1). After a brief period during the Covid-19 pandemic, the weakening trend of the NOK accelerated and has only recently stabilized. From a cross-country perspective, the depreciation of the krone stands out as large compared to other G-10 currencies. This note analyzes the potential drivers of the weakness of the NOK from through the lens of a multilateral and data-driven approach that exploits the large covariation among the cyclical currencies of the G-10 using a Principal Components Analysis (PCA).[2,3]

Figure 1. G-10: Nominal Effective Exchange Rates



Sources: IMF staff calculations

[1] Prepared by Luisa Charry.

[2] See, for example, Cahill and Rosenberg (2023). Cordella and Gupta (2015) define a "cyclical" currency as one that comoves with the economic cycle, appreciating in times of higher GDP growth and vice versa. Among the G-10 countries, these include the Australian Dollar (AUD), the Canadian Dollar (CAD), the Norwegian Krone (NOK), the New Zealand Dollar (NZD) and the Swedish Krona (SEK). In contrast, "safe haven" currencies tend to appreciate in times of lower GDP growth, and include the US Dollar (USD), the euro (EUR), the Japanese Yen (JPY), and Swiss Franc (CHF). The British Pound (GBP) is generally considered acyclical.

[3] PCA is a dimensionality reduction technique recommended to extract information from datasets that include several correlated variables.

2. Global factors and commodity prices explain a large fraction of the variance of cyclical exchange rates, including of the krone. A simple PCA of the nominal effective exchange rates of the G-10 cyclical currencies (namely the AUD, CAD, NOK, NZD and SEK) for the 2002–2024 period shows that the first principal component (PC) explains about 60 percent of the variance across the five currencies (Table 1). In turn, the second and third components explain about 27 percent and 11 percent of the variance, respectively. The remaining two components appear to capture mostly noise.

Annex III. Table 1. G-10: Cyclical Currencies

Principal Components Analysis (Quarterly Averages, 2002–24)

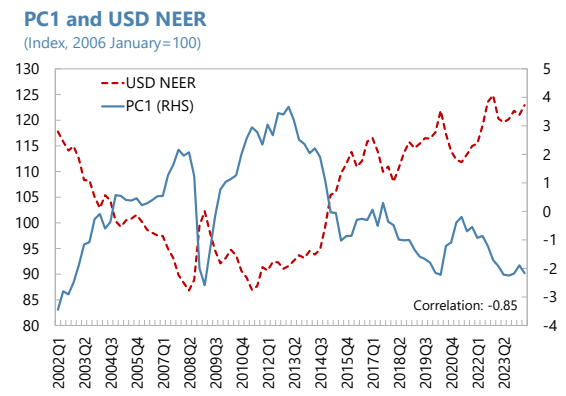
	Eigenvectors (Loadings)				
Variable	**PC1**	**PC2**	**PC3**	**PC4**	**PC5**
AUD	0.53	0.24	-0.27	-0.40	0.65
CAD	0.52	0.07	-0.58	0.13	-0.61
NOK	0.38	**-0.62**	**0.06**	0.60	0.31
NZD	0.27	0.70	**0.43**	0.50	0.00
SEK	0.48	**-0.24**	**0.63**	-0.46	-0.32
	Proportion of Explained Variance				
…	0.59	0.27	0.11	0.02	0.02
	Eigenvalues				
…	2.93	1.35	0.54	0.10	0.08

Source: IMF staff calculations.

3. The first principal component (PC1), which exhibits positive loadings for all five currencies, implies weaker currencies likely capture the USD's major role in international transactions (Figure 2, top left). As a stronger dollar is also associated with global risk-off episodes and differences in monetary policy settings (see Cerruti et al 2022), these were likely relevant drivers of NOK developments.

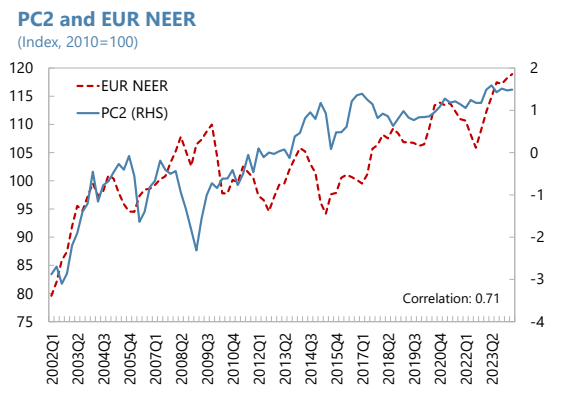
Annex III. Figure 2. First and Second Principal Components

The first PC is negatively correlated with the USD



Soruces: Haver Analytics; and IMF staff calculations.

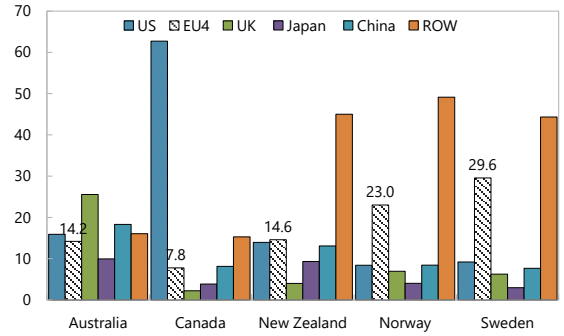
The second PC is positively correlated with the EUR



Sources: Haver Analytics; and IMF staff calculations.

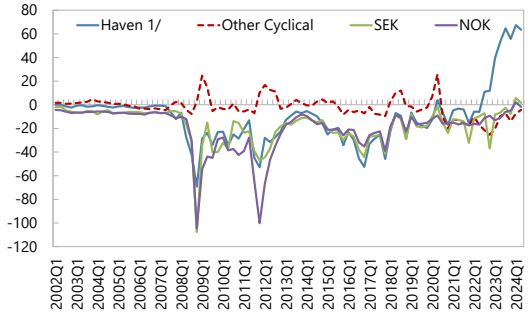
Annex III. Figure 2. First and Second Principal Components (concluded)

Higher trade shares with the EA...



Source: IMF staff calculations.

...negative currency bases...



Sources: Cerruti et all (2019); and IMF staff calculations.
1/ Includes GBP. The large post-pandemic jump is driven exclusively by the CHF.

4. The second principal component likely reflects Nordic-specific factors. The second component has negative loadings both for the NOK and the SEK, and positive loadings for the remaining currencies, and are likely capturing the high correlation between both currencies (0.73 on a quarterly basis during the sample period). Possible factors that explain this result include: i) the larger share of trade with the euro area (EA) of both countries, as confirmed by the high correlation of the component with the EUR nominal effective exchange rate (top right-hand chart in Figure 2); ii) Norway's and Sweden's large and sustained current account surpluses, and iii) market features that make foreign currency synthetic funding in both markets relatively costly (i.e., a weak performance of covered interest parity).

5. Deviations from covered interest parity set apart the Nordics from other cyclical currencies in the G-10 during part of the sample period. In line with other G-10 currencies, deviations from covered interest parity in the Nordics became systematic after the global financial crisis (see Figure 2, bottom right), although they appear to have returned to pre-GFC levels in the later part of the sample. Accordingly, in both Norway and Sweden the cost of direct funding in USD was lower than the cost of synthetic funding (via FX swaps), as indicated by the negative cross-currency basis. Particularly, and up to 2019, the deviations in the Nordics were like those of defensive currencies, rather than those of the cyclical group. This could be partially explained by Norway and Sweden's large current account surpluses, which make direct USD funding in local markets relatively more abundant than in the other cyclical markets, which tend to run current account deficits. At the same time, forward markets in both countries are characterized by relatively lower liquidity than the rest of the G-10 as measured by the bid-ask spreads on 3-month contracts,[4] which could result in relatively more expensive synthetic US funding. Other potential factors that could explain the covered interest rate deviations include regulations that limit financial intermediaries' risk-bearing capacity (see Cerruti et al) or lower liquidity in public debt markets reflecting both countries strong fiscal positions.

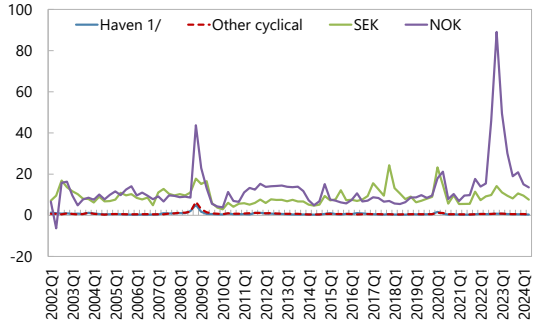
[4] On average, the bid-ask spread for the NOK/USD and SEK/USD pairs are 12 bp and 8 bps wider than that of the "*Haven*" and other cyclical currencies.

6. The third principal component appears to capture a cyclicality layer for the relatively smaller markets, including Norway. The third component (PC3) has positive loadings for the NOK, SEK and the NZD, and appears to capture a cyclical and size-related factor (Figure 3) as these currencies have in common their relatively smaller FX markets.

Annex III. Figure 3. Third Principal Component and FX Market Statistics

...wider forward bid-ask spreads point to less liquid markets in Sweden and Norway, signaling a Nordic-specific factor

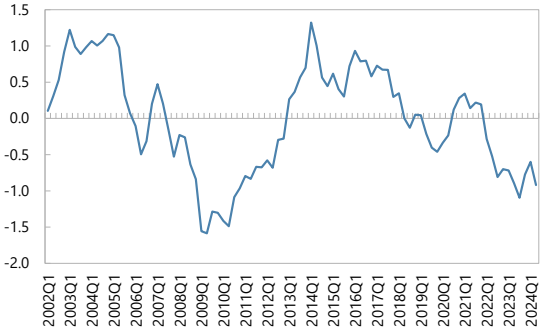
USD Forward Bid-Ask Spreads
(Basis points)



Sources: Cerruti et al (2019); and IMF staff calculations.
1/ Includes GBP.

The third PC captures a cyclical factor...

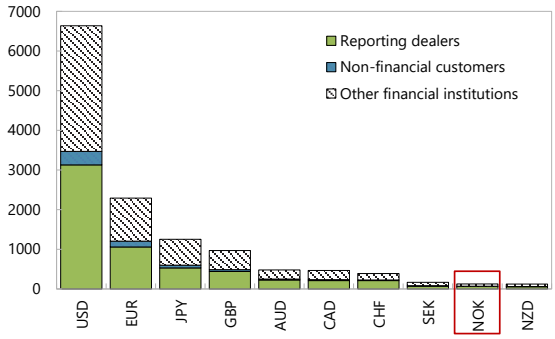
PC3



Source: IMF staff calculations.

...and a size-related component...

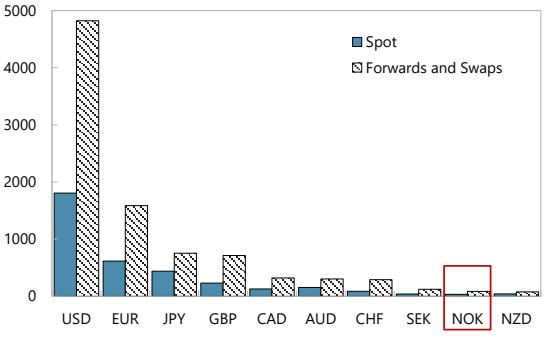
Exchange Market Turnover by Counterparty
(Billion USD, net-net basis, daily average in April 2022)



Sources: BIS; and IMF staff calculations.

...including the small spot market.

Exchange Market Turnover by Currency and Instrument
(Billion USD, net-net basis, daily average in April 2022)



Sources: BIS; and IMF staff calculations.

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Annex IV. External Sector Assessment

Overall Assessment: Norway's external position in 2023 is assessed as [stronger] than the level implied by medium-term fundamentals and desirable policies. The assessment is based on evaluations of both the current account and REER models. The projection of higher oil prices and steady growth in the medium term is expected to help maintain a strong and stable external balance over the forecast horizon.

Potential Policy Responses: Norway boasts a positive Net International Investment Position (NIIP) equal to four times mainland GDP. These substantial external buffers afford significant time to tackle competitiveness issues as the country gradually transitions away from hydrocarbon activities. To enhance competitiveness, fiscal and structural policies should focus on fostering productivity growth, increasing labor market participation, and encouraging wage moderation. Furthermore, as inflation decelerates, there is an opportunity for both the private and public sectors to invest in greener and growth-enhancing projects, facilitating the structural transformation of the economy.

Foreign Assets and Liabilities: Position and Trajectory

Background. Norway's Net International Investment Position (NIIP) reached a record of 396.2 percent of mainland GDP at the end of 2023. The value of the Government Pension Fund Global (GPFG) saw a 26.8 percent increase in 2023, attributed to a combination of strong market performance, helped by higher yields, substantial hydrocarbon inflows, and a weaker krone.

Assessment. The NIIP position is expected to rise in the medium term, reflecting sound management of the GPFG's portfolio. The risk of valuation losses is mitigated through the diversification of assets.

2023 (percent mainland GDP)	NIIP: 396.2	Gross Assets: 673.4	Debt Assets: 498	Gross Liab.: 277.2	Debt Liab.: 117.6

Current Account

Background. Norway's current account surplus has remained persistently high, averaging 10.9 percent of GDP from 2014 to 2023. In 2023, the current account surplus fell to 17.7 percent of GDP, from a high of 30.2 percent of GDP in 2022. This reduction was driven by a smaller trade surplus, explained by lower natural gas prices and increased imports of goods and services. Despite this, at almost 15 percent of GDP, the trade balance remained significantly elevated compared to pre-pandemic levels.

Assessment. The cyclically adjusted current account (CA) is estimated at 16.1 percent of GDP in 2023, which is 0.4 percentage points above the cyclically-adjusted External Balance Assessment (EBA) norm of 15.7 percent of GDP. However, staff analysis suggest that the estimation of the EBA norm may be subject to significant measurement bias due to country-specific characteristics, including: (i) the large size and unique composition of Norway's foreign assets, predominantly in portfolio equity, contributing 8.4 percent; (ii) oil and gas reserves contributing 7.2 percent; (iii) estimated IIP valuation changes, which inflate the amount of dividend yields estimated as part of the CA norm, leading to a considerable overstatement; and (iv) the productivity of the non-oil sector, which is lower than the average implied productivity. Adjusting for the measurement bias of retained earnings on portfolio equity and nominal income, the CA gap is assessed at 4 percent of GDP in 2023, with a model-estimated range of 2 to 6 percent of GDP, utilizing the model's standard error of ±2 percent of GDP. The gap can be attributed to policies totaling 3.9 percentage points, with fiscal policy contributing 0.5 percent, health expenditures 0.4 percent, and the negative credit gap an additional 2.9 percent.

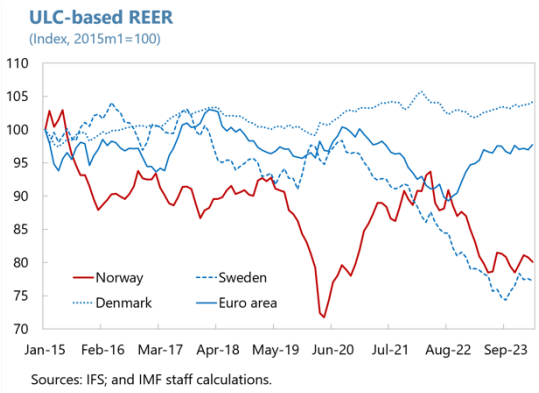
Norway: Model Estimates for 2023
(In percent of GDP)

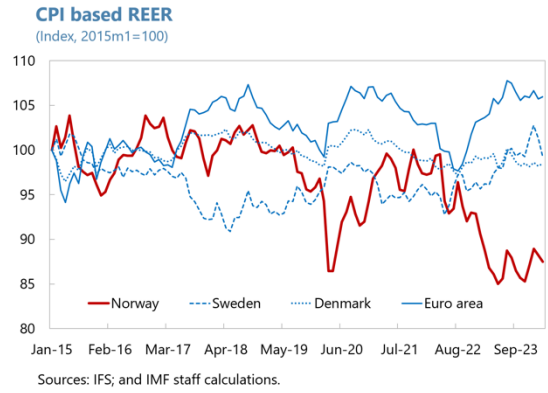
	CA model	REER model	ES model 1/
CA actual	**17.7**		
Cyclical contributions (from model)	1.6		
Adjusted CA	**16.1**		
CA Norm	**15.7**		
CA gap	**0.4**	**5.7**	**2.4**
o/w Policy gap	3.9		
Fiscal balance	0.5		
Health expenditure	0.4		
Credit	2.9		
Staff Gap 2/	**4.0**		
Adjustors	3.6		
Elasticity	-0.28		
REER gap (percent)	**-14.3**	**-20.3**	**-8.4**

1/ NFA-stabilizing CA.
2/ Adjusted for measurement bais of portfolio equity retained earnings, including multilareal consistency adjustments.

Real Exchange Rate

Background. In 2023, the average CPI-based real effective exchange rate (REER) depreciated by 8.6 percent relative to 2022, while the ULC-based REER saw a depreciation of 10 percent. Among its trading partners, the CPI-based REER experienced the most significant depreciation, especially when compared to Nordic and euro area countries. The depreciation coincided with a lower interest rate differential and is likely attributed to factors related to risk premia.





Assessment. Staff's CA gap analysis implies a REER gap of –14.3 percent, applying an estimated –0.28 elasticity. This analysis yields a range between –21.4 and –7.1 percent, factoring in the model's standard error of ±2 percent of GDP. For 2023, the REER index and level models suggest gaps of -20.3 percent and - 39.1 percent, respectively. Overall, IMF staff assess the krona to be undervalued by between -1.2 and - 14 percent, with a midpoint valuation of -7.6 percent, as determined by the ULC-based REER index and its standard deviation. However, it's important to note the considerable uncertainties surrounding these estimates. Specifically, the real exchange rate level approach may not be adequately suited for commodity exporters like Norway.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account surplus slightly narrowed from 24 percent of GDP to 20 percent of GDP in 2023. The capital account remained relatively unchanged and insignificant in 2023.

Assessment. Risks are limited given Norway's strong external position, but the banking sector's reliance on external wholesale funding is a source of vulnerability.

FX Intervention and Reserves Level

Background. The krone floats freely against other currencies. Norges Bank has not intervened in FX markets since 1999, with a brief exception in March 2020 due to unusually large movements spurred by the pandemic. As of March 2024, Norges Bank's international reserves and foreign currency liquidity stood at 23.3 percent of mainland GDP.

Assessment. Standard reserve adequacy metrics fail to adequately represent Norway's case, given the substantial GPFG fund, which is primarily invested in foreign markets and strategically diversified away from oil markets.

Annex V. Risk Assessment Matrix[1]

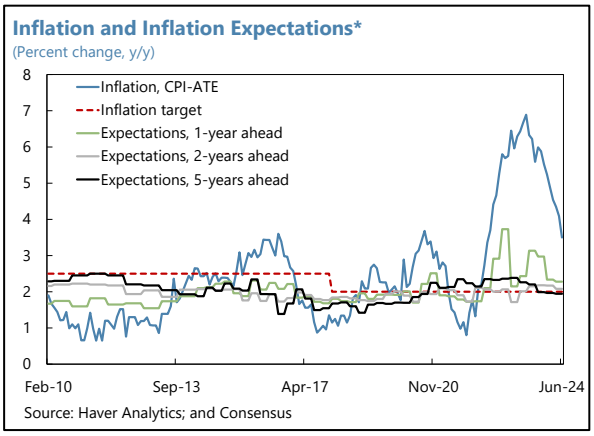
Source of Risks and Relative Likelihood (High, medium, or low)	Impact if Risk is Realized (High, medium, or low)	Policy Response
Global Conjunctural and Structural Risks		
High **Intensification of regional conflicts**. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	**Medium / Low** As one of the largest oil producers, Norway stands to benefit from increases in energy prices. However, broader disruptions could temper these gains by weakening consumer and business confidence in trading partners, dampening exports, and investment, ultimately stifling growth.	Provide targeted and temporary support to vulnerable households as needed to mitigate the impact of higher energy prices. Contingent on inflation developments, ease monetary policy. Continue to strengthen financial system resilience against cyberattacks.
High **Commodity price volatility**. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	**Medium / Low** As an oil-exporter, volatility in oil prices would impact Norway's economic performance, including its fiscal and external positions.	Allow automatic stabilizers to operate and provide targeted fiscal support to vulnerable households as needed. Monetary policy should continue to operate within the inflation targeting framework.
Medium **Abrupt global slowdown**. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs.	**Medium** Slower growth among trading partners would weaken external demand for Norwegian exports. Additionally, subdued sentiment, and tighter financial conditions would result in slower recovery in private consumption and investment.	Allow automatic stabilizers to operate fully, providing fiscal support in a significant downturn. This should be offset by other measures to avoid stimulating the economy if wage and inflation pressures persist. Deploy macro-prudential tools to manage financial stability risks. Monetary policy should continue to operate within the inflation targeting framework.
Medium **Monetary policy miscalibration**. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets, and weakening the credibility	**Medium** Premature easing of monetary policy could result in persistently high inflation, requiring further tightening and increasing economic uncertainty. Persistently high rates and tight financial conditions could adversely affect both corporate and household sectors	Maintain a flexible and data-driven monetary policy to anchor inflation expectations and ensure a return of inflation to target within a reasonable timeframe. Ensure that fiscal policy does not exacerbate inflationary pressures and is aligned with monetary policy.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Source of Risks and Relative Likelihood (High, medium, or low)	Impact if Risk is Realized (High, medium, or low)	Policy Response
of central banks.	through higher debt service and reduced demand.	
Medium **Systemic financial instability**. High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty (e.g., from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	**Medium** The tightening of financial conditions negatively affects leveraged households and firms, leading to a housing market correction, impairing banks' balance sheets, causing disruptions in financial markets, and weighing on firms' financial health and overall economic activity.	Intensify monitoring of banks' liquidity and capital positions, and risk management practices. Release cyclical macroprudential buffers, while providing targeted liquidity provision. Enable automatic stabilizers to function; deploy discretionary stimulus if demand deteriorates significantly.
High **Deepening geoeconomic fragmentation**. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	**High / Medium** Higher trade barriers or supply disruptions could increase costs, leading to shortages of crucial inputs, higher inflation, and production bottlenecks. These challenges could reduce economic activity with uneven effects across sectors and decrease confidence and could lower potential growth over the medium-term.	Promote supply chain resilience, including through encouraging diversification. Identify critical dependencies, assess their impact and transmission channels, and develop strategies to cope with the associated risks. Fiscal support should operate through automatic stabilizers. Monetary policy to operate within the inflation targeting framework.
Medium **Cyberthreats**. Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.	**Medium** As Norway is one of the most digitalized economies, cyberattacks could significantly impair the financial and other critical systems functioning, leading to substantial reputational risks and broader economic fallout.	Ensure that the financial system's liquidity is not impaired. Continue to invest in cyber defense by strengthening the operational resilience of the financial system, enhancing cyber risk mitigation through appropriate supervision, and promoting awareness and contingency planning for operational risks.
Domestic Risks		
Medium **Sharp correction in real estate prices**. Price declines due to structural changes could affect commercial property markets and/or residential property.	**High** Higher input and funding costs, reduced purchasing power, and a shift in risk sentiment could lead to price corrections in both CRE and RE markets. The impact of would be mitigated by households' high levels of income and financial wealth, along with strong labor markets.	Monitor recent developments and risks in the real estate sector and supervise banks' commercial real estate lending closely. Calibrate macroprudential policies to avoid the build-up of vulnerabilities.
Medium **De-anchoring of inflation expectations**. Supply shocks sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral.	**Medium** The un-anchoring of inflation expectations and adverse wage-price dynamics force the forcing the central bank to tighten monetary policy further, with negative implications on domestic economic activity and financial stability.	Maintain the current tight monetary policy stance for a sufficiently long period of time to ensure that inflation durably returns to target. Impress in the dialogue between social partners the importance of keeping wage adjustments contained.

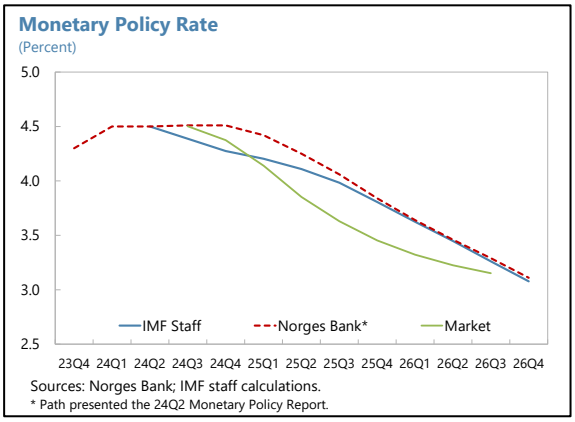
Annex VI. Inflation Expectations and Optimal Monetary Policy[1]

1. Despite a gradual decline, inflation expectations in Norway have consistently stayed above the inflation target for two years. Although short-term measures of inflation expectations, specifically at the one-year and two-year horizons have decreased alongside headline inflation, this downward trend has recently slowed. Moreover, five-year ahead inflation expectations seem to have stabilized just above the 2 percent target. This suggests that the prolonged period of elevated inflation levels could carry risks of exerting a lasting influence on the process of forming inflation expectations.



2. We explore monetary policy implications of a potentially weaker expectations channel using a model-based approach (using a heterogeneous agents DSGE model for Norway).[2] This model includes both backward and forward-looking agents with alternative information sets and expectations formation mechanisms, where backward-looking agents base their expectations on recent events and adjust their understanding of economic relationships through learning, while forward-looking agents' expectations are model-consistent and influenced by the proportion of backward-looking agents. The model features price and wage Phillips curves linking inflation to expectations, the gap between real wages and productivity, and a measure of economic slack; an aggregate demand curve that connects output with the nominal interest rate and inflation expectations; and a monetary policy reaction function.

3. The model-based simulations suggest that Norges Bank's current interest rate guidance is appropriate. Under the assumption that the central bank has complete information of the set of current and future shocks hitting the economy and the effects of its policies on expectations, optimal monetary policy is defined as the interest rate path that minimizes the central bank's loss function (which includes the output gap and deviations from the 2 percent inflation target) conditioned by staff's GDP and inflation forecasts. The forward policy rate path derived under these assumptions is well aligned with market expectations and Norges Bank policy rate guidance.



[1] Prepared by Luisa Charry with inputs from Alan Dizioli.

[2] Dizioli, Alan and Hou Wang. 2024. "How do adaptive learning expectations rationalize stronger monetary policy response in Brazil?" Latin American Journal of Central Banking, Volume 5, Issue 1.

Annex VII. Status of 2020 FSAP Recommendations

Recommendations and Authority Responsible for Implementation	Horizon*	Status
Systemic Risk Oversight and Macroprudential Policy		
Develop and publish a macroprudential policy strategy. (MoF, Norges Bank, FSA)	ST	The authorities have expanded on key aspects of macroprudential policy in the Ministry's annual Financial Markets Report. Norges Bank has published a framework for the SRB and the CCyB.
Use existing triparty meetings more effectively to discuss risks and policy actions needed to address them. (MoF, Norges Bank, FSA)	I	The authorities have implemented some adjustments to facilitate candid and targeted exchanges on risks, and to better align the meeting schedule with planned policy decisions.
Give Norges Bank recommendation powers over macroprudential policy tools that can be relaxed under stress, with a comply-or-explain mechanism. (MoF)	I	The Government tasked Norges Bank to advise the MoF on the SRB rate at least every other year in 2021. Norges Bank produced its first advice on the SRB in 2022, which was followed by MoF.
Make key household sector measures permanent features of the framework. (MoF)	ST	While the lending regulation is still temporary, it will be in force for a period of 4 years (from January 2021 until year-end 2024), up from 1.5 years previously. The regulation was evaluated in 2022 and amended in January 2023. The MoF will evaluate the regulation before its expiration and has requested input to that effect from the FSA by August 2024.
Consider broadening the toolkit for mitigating CRE vulnerabilities, including sectoral capital tools. (MoF)	MT	The MoF in December 2020 adopted a temporary floor for average risk weights for CRE exposures at 35 percent. The floor was renewed in 2022 and will be reviewed in 2024. According to Norges Bank's framework for the SRB, the buffer should serve as the main rule applying to all exposures in Norway as the effect of structural vulnerabilities on banks in a downturn is uncertain.
Banking and Insurance Supervision		
Strengthen the FSA's prudential powers, operational independence, and budgetary autonomy. (MoF)	ST	Following extensive consultations, legislation amending the FSA Act was passed in June, writing into law the long-standing practice of prohibiting instructions by the Government or the MoF in the processing of individual cases before the FSA, which would only be allowed in cases of fundamental or great societal importance. General instructions are still allowed. The FSA board would decide individual cases in the area where the FSA cannot, as a main rule, be instructed, and an independent appeals board is established to adjudicate most appeals against the FSA's decisions. The amendments clearly state the FSA's mandate to contribute to financial stability and well-functioning markets. Among others, current provisions relating to (i) the current division of responsibility for macro-supervision between the MoF, Norges Bank and the FSA, (ii) rules on the implementation of supervision and (iii) rules on the FSA's tools remain in place.
* I—Immediate (within 1 year); ST—Short term (1–3 years); MT—Medium Term (3–5 years).		

Recommendations and Authority Responsible for Implementation	Horizon*	Status
Expand review of banks' risks in supervisory activities to strengthen oversight over systemic foreign bank branches and domestic medium and small sized banks. (FSA)	ST	*Systemic foreign branches and subsidiaries:* The FSA has strengthened internal guidelines for monitoring, benchmarking, risk assessments and oversight of foreign branches and subsidiaries, as well as for information sharing with supervisory colleges. Discussions within the College Bank Committees have improved. Full scope AML/CFT supervisory on-site visits have been conducted in all foreign branches. The supervisory teams responsible have been provided additional resources. *Medium and small-size banks:* A risk dashboard, a new early warning model (with drill down functionality) for each institution, a watch-list to inform, and a new daily report that connects information from the public bankruptcy register with entity exposures are now available and inform the SREP. From 2024, institutions are required to report exposures on a quarterly basis, allowing for more granular analysis of risks.
Further enhance the oversight of banks' IRB models, in view of the implementation of CRD IV. (FSA)	I	The FSA has published a circular clarifying supervisory practice and expectations regarding IRB models and is following up on the circular.
Intensify oversight of banks' risk management of real estate loans and funding/liquidity conditions. (FSA)	ST	The FSA has introduced new supervisory modules based on EBA Guidelines for loan origination and monitoring (EBA/GL/202/06) and supervisory experience, and a Circular on requirements for valuation of immovable properties was issued in September 2021 (Circular 5/2021). The reporting frequency of banks' exposures to individual non-financial firms has been increased from yearly to quarterly. A thematic inspection of CRE exposures, specifically loans secured by office premises, was conducted in 2022/23, with a report published in June 2023. In 2023/24 on-site inspections were conducted in the largest savings banks, the largest commercial bank, and several small/medium sized banks, with special emphasis on loan-loss provisioning, credit risk governance/risk management, and assessment of RE exposures. Early in 2024, one of the two companies in specialized in CRE-covered bonds issuance was subject to an on-site inspection, and further on-site inspections are planned.
Strengthen risk-monitoring of individual insurers. (FSA)	ST	A project has been established to further develop the Early Warning Risk Dashboard.
Complement EIOPA efforts with Norway-specific in-house stress tests of the whole insurance sector. (FSA)	MT	An EIOPA stress test was conducted in 2021. The FSA will consider expanding the test to a larger share of the Norwegian market.
Cybersecurity Supervision		
Make processes for cybersecurity risk supervision and oversight more structured and comprehensive. (FSA, Norges Bank)	I	The FSA has strengthened the approach for cybersecurity risk supervision and provided further guidance on IT/ cybersecurity risk. The introduction of DORA in Norway will allow to further strengthen cybersecurity risk supervision. Norges Bank has established a more structured process for oversight and supervision. Important elements are annual risk-based planning, more active use of reports and other involvement from third parties and self-assessments by FMIs. The TIBER framework has been implemented in Norway and tests are ongoing, contributing to the oversight of cyber risk in the payment system. The allocation of additional resources has allowed to increase the number of assessments.

* I—Immediate (within 1 year); ST—Short term (1–3 years); MT—Medium Term (3–5 years).

Recommendations and Authority Responsible for Implementation	Horizon*	Status
Establish incident reporting and crisis management frameworks for systemic cyber incidents. (FSA, Norges Bank)	ST	Norges Bank and FSA have updated routines for reporting of incidents from FMIs to The Financial Infrastructure Crisis Preparedness Committee (BFI) in 2020. The FSA works closely with Nordic Financial CERT (NFCERT) on cyber-attacks/incidents with "open line" and monthly status meetings. FSA and BFI have enhanced incident reporting slightly by leveraging the EBA Guidelines, the European Commission's Digital Operational Resilience Act, and the ESRB's work on systemic cyber risk. Processes for handling incidents reported by FMIs to BFI have been strengthened, and the introduction of DORA will allow for further enhancements. Crisis management by FSA and BFI has improved.
Anti-Money Laundering / Countering Financing of Terrorism (AML / CFT) Supervision		
Enhance AML/CFT supervision by increasing the frequency of targeted and thematic inspections and improving the risk-based approach and tools for AML/CFT risk assessments. (FSA)	I	Full scope on-site inspections dedicated to AML/CFT, and off-site inspections are increasing. The FSA has increased the use of targeted and thematic inspections. The risk-based approach to AML/CFT has been strengthened and the risk classification model, supervisory tools and methodologies have been further developed.
Ensure appropriate use of sanctions, including monetary penalties, for AML/CFT violations. (FSA)	I	The sanctioning power has been used as appropriate in cases of serious breaches. Since 2019 FSA has imposed monetary penalties on nine banks, five investment firms, nineteen estate agents, and 40 audit or accounting firms. The supervisory manual sets out principles for the FSA's sanctioning practice, which is based on the EBA risk-based supervision guideline and principles for sanctioning set out by the FSA's board.
Financial Crisis Management and Safety Nets		
Make the new resolution tools operational and strengthen the crisis preparedness framework. (FSA, MoF)	ST	The first version of the FSA's bail-in mechanic was launched in 2023, and the first version of the bail-in playbooks from banks were received in 2023. A self-assessment on EBA's resolvability guidelines was conducted both in 2022 and 2023 with the aim of the banks being compliant by January 2024.
Ensure BGF's integration into the broader resolution framework. (BGF, FSA).	ST	Discussions on draft Memorandums of Understanding between Norges Bank and BGF and FSA are ongoing. Certain clarifications are being sought from the MoF. BGF also took part in a crisis simulation exercise together with Norges Bank, MoF and FSA in April 2021.
Systemic Liquidity		
Monitor banks' collateral eligible for central bank liquidity. (Norges Bank)	ST	Norges Bank has access to databases containing information on banks' assets, and detailed information is available on pledged securities through Norges Bank's system for collateral management. Information on the liquidity in the Norwegian bond market both through a semi-annual survey and daily issue and price data from commercial databases, and about foreign mortgage bonds (including information from Norges Bank's own management of foreign exchange reserves) is used to assess developments in mortgage securities. Norges Bank has introduced a banks' cash flow model to inform liquidity assessments. The FSA obtains information regarding an institution's holding of securities (in all currencies) and information on banks assets registered in the Norwegian CSD.
Develop, test, and implement a mechanism for acceptance of mortgage loan collateral for emergency liquidity support to solvent banks. (Norges Bank)	ST	Norges Bank has implemented a mechanism for acceptance of mortgage loan collateral for emergency liquidity support for solvent banks.
* I—Immediate (within 1 year); ST—Short term (1–3 years); MT—Medium Term (3–5 years).		

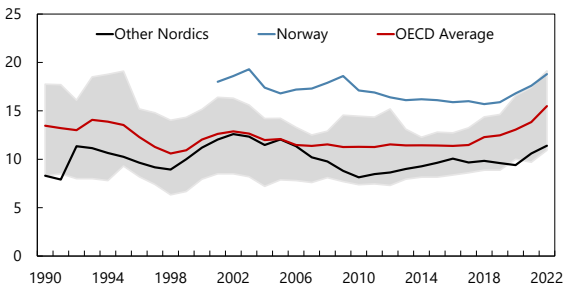
Recommendations and Authority Responsible for Implementation	Horizon*	Status
Financial Stability Analysis		
Improve collection and analysis of derivatives exposure data and analyze banks' margin arrangements. (FSA, Norges Bank)	ST	Norges Bank and the FSA are working on making more data on agents' derivatives contracts accessible and usable (EMIR data) and are collaborating to develop analysis and dashboards suitable for monitoring. Norges Bank is using EMIR data to (i) analyze the impact of rebalancing of currency hedging by NBFIs on exchange rates, and (ii) the effects of margining agreements (in combination with market data) for an internal evaluation of liquidity policy measures during the pandemic. Norges Bank has introduced quarterly reporting from large mutual fund management companies, covering hedged exposures, instruments used and margin requirements in case of sharp NOK weakening events. FSA has analyzed banks and insurance companies' derivatives exposures using EMIR-data.
Cybersecurity Risk Supervision (Finanstilsynet)		
Establish clear qualitative and/or quantitative thresholds, as well as clearer processes and formats, on the reporting of cybersecurity incidents.	I	FSA has established clear processes for reporting cybersecurity incidents and has clear requirements for reporting incidents. Given DORA's wider requirements on incident reporting and institutional coverage, the FSA has decided to postpone the revising of the incident reporting framework based on the revised EBA Guidelines until its implementation in Norway.
Supplement the 2003 regulation on the use of information and communication technology with more detailed guidelines, enacted by the FSA, that provide detail on the implementation of principles and set out minimum requirements.	ST	The FSA follows EBA's and EIOPA's guidelines for ICT security, outsourcing and governance in supervisory activities, as published on the FSA's website. DORA will substitute the 2003 regulation on the use of information and communication technology. The implementation of DORA will place more specific requirements on the institutions than the current Norwegian ICT regulation. It is assumed that existing guidelines from the ESAs will be revised in accordance with DORA or be included in level two regulations under DORA, and that it will set out sufficient minimum requirements for the companies' compliance.
Follow a more structured approach for cybersecurity risk supervision. This should include a clear description of how off-site supervision on cybersecurity should be conducted, and how assessments influence the overall risk assessments of institutions by the general supervisors.	ST	FSA has established a supervisory framework for ICT supervision with ICT security and risk (including cyber security and risk) as one of the modules (based on the NIST framework). A couple of sub-modules have been tested during inspection and the framework is now in use. The framework will be further enhanced when DORA enters into force in Norway.
Increase the intrusiveness of on-site cybersecurity risk inspections.	MT	See above.
* I—Immediate (within 1 year); ST—Short term (1–3 years); MT—Medium Term (3–5 years).		

Recommendations and Authority Responsible for Implementation	Horizon*	Status
Cybersecurity Risk Oversight (Norges Bank)		
Supplement the CPMI-IOSCO guidance with more detailed expectations of Norges Bank regarding cybersecurity risk oversight of FMIs.	I	Norges Bank has set the expectation that operators are to conduct self-assessments of cybersecurity-maturity using internationally recognized standards in its 2021 and 2022 Annual Reports on Financial Infrastructure. The assessed maturity level is expected to be mapped against the FMI's defined objectives, and necessary actions to close gaps are expected to be planned and performed. The oversight function regularly follows up on whether such assessments are undertaken as part of the oversight process. Further, Norges Bank expects that FMIs responsible for critical functions in the Norwegian financial system run security-tests according to the TIBER-framework.
Follow a more structured and comprehensive process for cybersecurity risk oversight. This includes utilizing a portfolio of tools and techniques to assess cybersecurity risk against set expectations, reaching clear conclusions and identifying specific remedial measures or thematic findings to inform future action.	I	Norges Bank has improved its process for planning of oversight and supervision of FMIs. An important element in the updated process is annual risk-based planning. Improved competence in IT and cybersecurity (through the hiring of additional staff) enables the oversight function to perform more thorough assessments. Testing based on the TIBER-framework is an important part of Norges Banks oversight of the financial sector and infrastructure. To ensure the right incentives for the FMIs and other entities' willingness to undergo TIBER-testing, TIBER-NO stresses that oversight and supervisory functions shall not take part in TIBER-NO-testing on an operational level neither have access to test-results.
Establish, operationalize, and exercise an incident reporting and a crisis management framework to maintain financial stability against potential systemic cybersecurity incidents.	ST	Norges Bank and the FSA have updated routines for reporting of incidents from FMIs to The Financial Infrastructure Crisis Preparedness Committee (BFI) in 2020. Routines in BFI for handling reported incidents from FMIs have been strengthened in 2024. Measures to maintain financial stability against potential systemic cybersecurity incidents require Norges Bank to collaborate with other authorities and entities in the financial sector. The European Systemic Risk Board (ESRB) has recommended to implement a "pan-European systemic cyber incident coordination framework (EU-SCICF)". Norges Bank follows the development of EU-SCICF as well as the implementation of DORA and will consider further action in collaboration with other national authorities based on the development of EU-SCICF and aligned with the implementation of DORA.
Train Norges Bank overseers in cybersecurity, to strengthen the oversight function's capabilities to conduct effective cybersecurity risk oversight.	ST	The oversight function's competence in IT and cybersecurity has been significantly improved. Competence in the cyber-area for the oversight function has been further improved by hiring one cybersecurity expert and two people with a combined IT and cybersecurity skill set. Three cybersecurity experts have been hired to the TIBER Cyber Team (TCT-NO), responsible for TIBER-testing in Norway. TCT-NO is organized as part of the oversight function and may work on assignments for the oversight function that are not specifically oversight or supervision of FMIs, hence contributing to the total cyber-competence in the function.
* I—Immediate (within 1 year); ST—Short term (1–3 years); MT—Medium Term (3–5 years).		

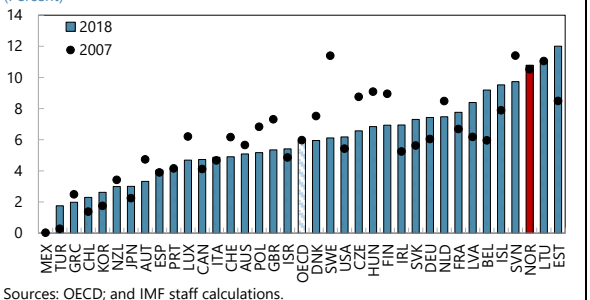
Recommendations and Authority Responsible for Implementation	Horizon*	Status
The oversight function should be given enough independence to conduct thorough oversight of the Norwegian RTGS system (NBO).	ST	Norges Bank's internal guidelines for oversight of the settlement function have been revised. Key objectives for the revision were to ensure that future oversight covers all areas as required by PFMI and that the oversight function has the necessary authority to fulfill its duties. According to the revised guidelines, the head of Financial Infrastructure will meet at least annually with top management.
Finalize the financial sector risk map, in collaboration with the FSA and Ministry of Finance.	ST	A project to complete the mapping of the financial sector, initiated by the MoF, was finalized in 2023.
Use the existing legal power of the oversight function to seek greater assurance and transparency from critical service providers for interbank payment systems.	ST	The oversight function has improved its supervision of the FMI responsible for clearing transactions from banks in the Norwegian financial sector, by direct meeting with key vendors to the FMI. For other FMIs, the oversight function does not maintain a direct dialogue with the FMIs' suppliers, due to resource constraints. Still, however, for all FMIs, supplier management including service-quality is a key subject in oversight, and highly prioritized.
Strengthen intrusiveness of the interactions of Norges Bank's risk management and internal audit functions with NBO's external service providers to seek greater assurance and transparency.	MT	A process has been established whereby Norges Bank's risk management is involved in meetings with NBO's critical external service providers and participates in the quarterly Risk Committee for the settlement system (NBO).
* I—Immediate (within 1 year); ST—Short term (1–3 years); MT—Medium Term (3–5 years).		

Annex VIII. Overview of Norway's Sickness and Disability Benefits Systems[1]

1. The generosity of Norway's social safety net offers significant income security for people with disabilities and illness. The disability replacement rate is topped at 66 percent of previous income (100 percent for the first 12 weeks of sickness absence), higher than many European counterparts. Furthermore, the acceptance rates into the disability program is about 90 percent,[2] higher than in other OECD countries and increasing over time, mostly reflecting the increase in young applicants with mental health conditions (OECD, 2022). In turn, Norway exhibits one of the highest rates of sickness absences and disability benefit receipts, highlighting potential areas for policy evaluation that balance social support and incentives for labor market participation (Hemmings and Prinz, 2020).



Source: OECD; and IMF staff calculations.
1\Other Nordics include Denmark, Finland and Sweden.
The shaded area represents the interquartile range for all OECD countries.

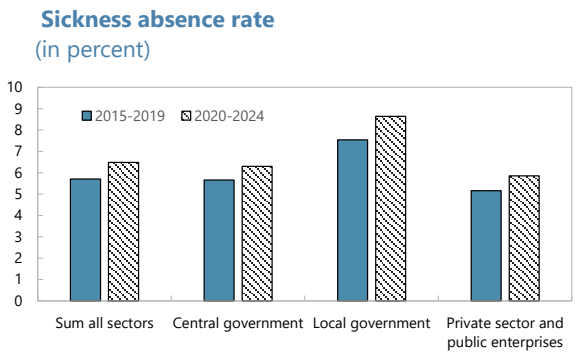


Sources: OECD; and IMF staff calculations.
Note: Disability benefit receipt over population aged 20-64 years. Disability benefits include contributory and non-contributory programmes specifically targeted to persons with disability.

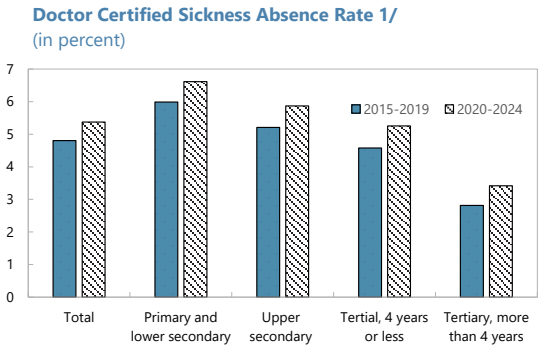
2. Recent data indicate a notable rise in sickness absence rates in Norway across various sectors and educational levels. The local and central government sectors have shown the highest sickness absence rate levels. The private sector and public enterprises have maintained relatively lower levels but have been steadily increasing. Additionally, individuals with primary and lower secondary education have exhibited the highest sickness absence rates, nearing 7 percent, whereas those with tertiary education of more than four years have demonstrated the lowest rates, just below 4 percent. Overall, while the rate of increase varies among different groups, all have grown. These trends indicate the need for a comprehensive strategy to reverse them. This strategy should include targeted interventions and policy measures across multiple beneficiary groups, such as government sectors and individuals with lower educational attainment.

[1] Prepared by Mauricio Vargas.

[2] When an application is sent in for disability benefit, the Labor and Welfare administration's local office has most likely concluded the person will qualify for receiving the benefit, therefore, the acceptance rate of 90 percent is not fully comparable to acceptance rates in other countries with a different prequalification system.

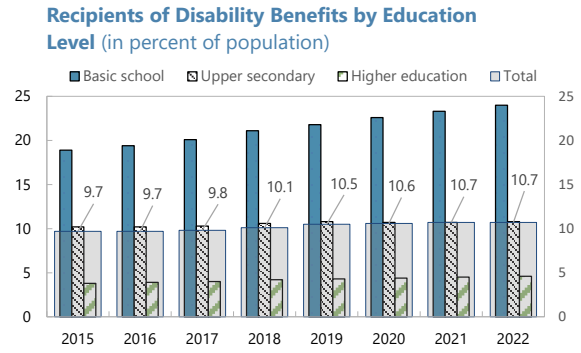


Source: Statistics Norway, IMF staff calculations.

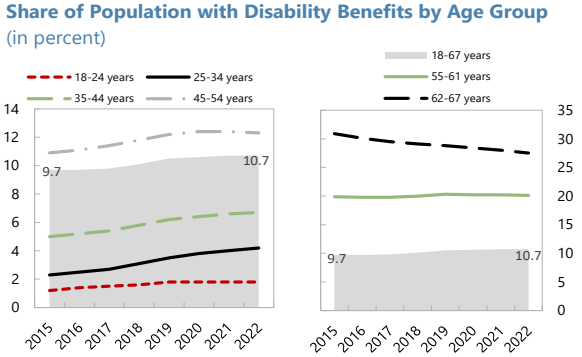


1/ For employees (16-69 years)
Source: Statistics Norway, IMF staff calculations.

3. Similarly, the share of recipients of disability benefits has been steadily increasing. The overall percentage of disability benefit recipients rose from 9.7 percent in 2015 to 10.7 percent of the working-age population in 2022. Individuals with basic school education consistently represent the highest proportion of recipients, and the share of beneficiaries in that group has been growing at a faster pace, in contrast to the other higher education level groups. Regarding recipients of disability benefits by age group, the elderly groups (those above 55 years) have the highest rates of disability benefit recipients, though their trends are stable to declining. The data also reflect a surprisingly increasing rate of recipients among the youngest age groups (18–54-year-olds). Hence, particular attention and targeted policies should be directed toward individuals with lower educational attainment and younger age groups, ensuring adequate support and reintegration measures into the workforce.



Source: Statistics Norway, IMF staff calculations.

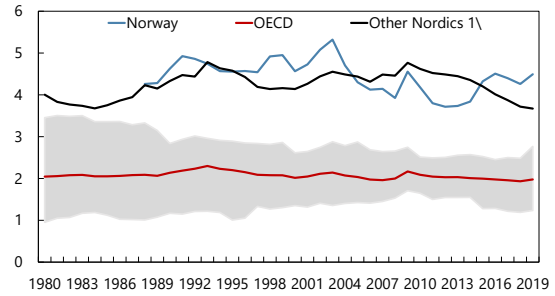


Source: Statistics Norway, IMF staff calculations.

4. Norway's sickness and disability benefit system carries substantial fiscal implications, calling for policy actions to ensure its sustainability. The cost of sickness and disability benefits as share of both GDP and public expenditure is considerably higher than the OECD average, marking it one of the most expensive in terms of social welfare expenditure. A potential area of reform to optimize the fiscal sustainability of the disability benefits system includes addressing further the lack of integration/reintegration of people with disabilities into the labor market, supporting early interventions, and designing features that maintain employability. This involves

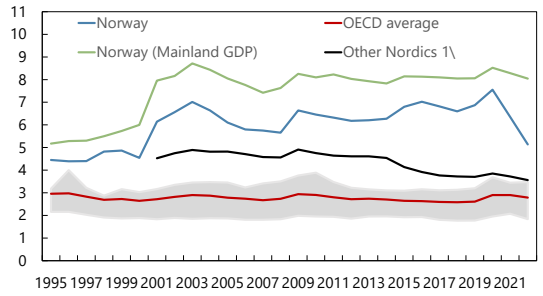
identifying health barriers to employment early on and using tools like sickness and unemployment insurance before transitioning to disability benefits.[3] The systems should also motivate those in disability to engage in work through financial incentives and reduce the income effect of benefit dependency by adjusting benefit generosity and eligibility. Strengthening the design of eligibility processes and adjusting benefit generosity would help reduce the high acceptance rates into disability programs and increase outflow rates. Key guiding principles include treating disability benefits as a transitional phase, implementing mandatory early interventions, introducing work incentives, and tackling the fragmentation of the social protection system to comprehensively address the needs of people with disabilities and prevent poverty (OECD, 2022).

Public Expenditure: Disability & Sickness Cash Benefits
(Percent of GDP)



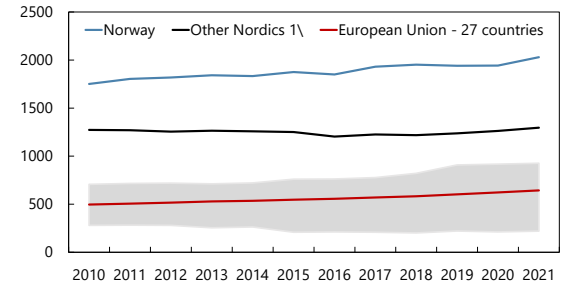
Source: OECD; and IMF staff calculations.
1\Other Nordics include Denmark, Finland and Sweden.
The shaded area represents the interquartile range for all OECD countries.

Total Sickness and Disability Expenditure
(Percent of GDP)



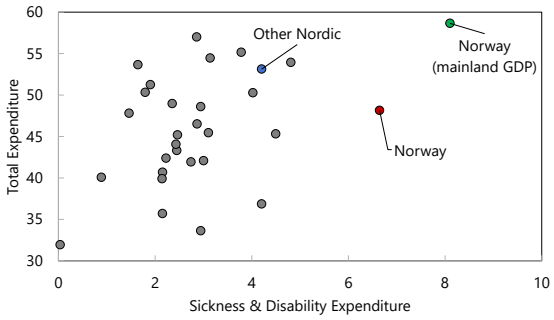
Source: OECD; and IMF staff calculations.
1\Other Nordics include Denmark, Finland and Sweden.
The shaded area represents the interquartile range for all EU-27 countries.

Social Protection Expenditure on Disability
(PPS per inhabitant)



Source: Eurostat; and IMF staff calculations.
1\Other Nordics include Denmark, Finland and Sweden.
The shaded area represents the interquartile range for all EU-27 countries.

Expenditure in OECD countries
(Percent of GDP, avg. 2010-2020)



Source: OECD; and IMF staff calculations.
Note: Gray dots represent other individual OECD countries.

[3] Norway's social programs include the Work Assessment Allowance (Arbeidsavklaringspenger, AAP) for those whose ability to work can improve so that they can retain or find work through various treatments, employment schemes, or acquiring new skills. This allowance ensures income during periods where the individual needs help from NAV (Norwegian Labor and Welfare Administration) due to illness or injury.

References

Hemmings P. and Prinz C., 2020. "Sickness and Disability Systems: Comparing Outcomes and Policies in Norway with those in Sweden, The Netherlands and Switzerland", Economics Department Working Paper No. 1601, OECD.

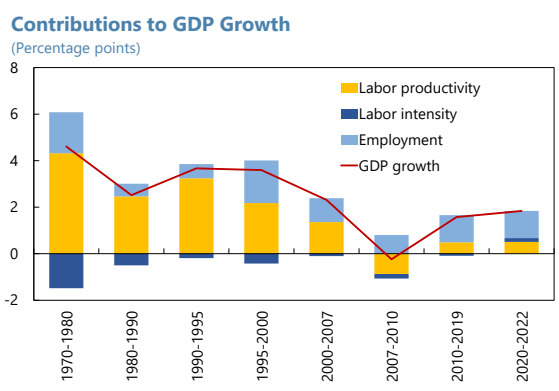
OECD, 2022. "Disability, Work and Inclusion: Mainstreaming in All Policies and Practices." OECD Publishing, Paris, https://doi.org/10.1787/1eaa5e9c-en.

Annex IX. Productivity Trends[1]

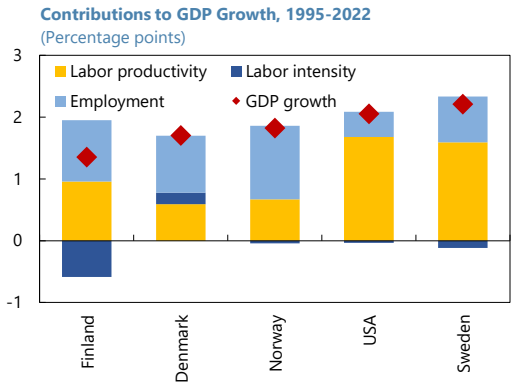
Despite high productivity levels, Norway has seen a slowdown in productivity growth post Global Financial Crisis (GFC). The decline in productivity growth has been driven largely by lower contributions of capital, ICT deepening, and TFP, suggesting falling efficiency of input utilization. Amidst the backdrop of global uncertainty and structural shifts such as the projected decline of the energy sector, Norway should pivot from traditional sectors to those with higher productivity potential, by optimizing resource utilization, advancing technological integration, enhancing skills, and fostering Total Factor Productivity (TFP).

1. Sustained economic growth and maintaining high living standards in Norway hinges on boosting potential output. This challenge could be addressed by actions on both the extensive and intensive margins of potential output. On the extensive margin, boosting labor supply (e.g., lowering the share of people on disability benefits) and optimizing resource utilization, including natural, human, and capital resources, would ensure that the economy operates at its full potential. This would involve not just increasing the quantity but also improving the quality of these resources through investments in education, technology, and infrastructure. On the intensive margin, focusing on labor productivity (e.g., through technological advancement, skill upgrades, more efficient workplace practices) and Total Factor Productivity (TFP) (i.e., the efficiency with which all inputs are used in the production process) is equally important. By facilitating innovation and adoption of new technologies and improving business environment, Norway can increase its TFP, making the economy more competitive on a global scale.

Annex IX. Figure 1. Contributions to Total GDP Growth



Source: OECD Compendium of Productivity Indicators.



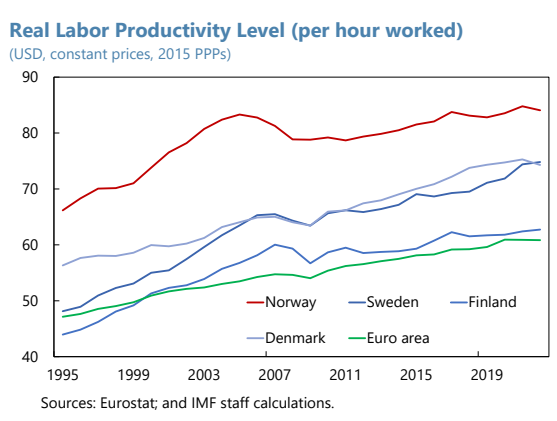
Source: OECD Compendium of Productivity Indicators.

2. While Norway has one of the highest levels of labor productivity among OECD countries, its growth rate has declined notably after the Global Financial Crisis (GFC). Norway witnessed a robust productivity growth during the 1990s and extending into the mid-2000s, driven by the widespread adoption of Information and Communications Technology (ICT). While Norway enjoys a high productivity level across peers, surpassing that of the euro area by a third (top left

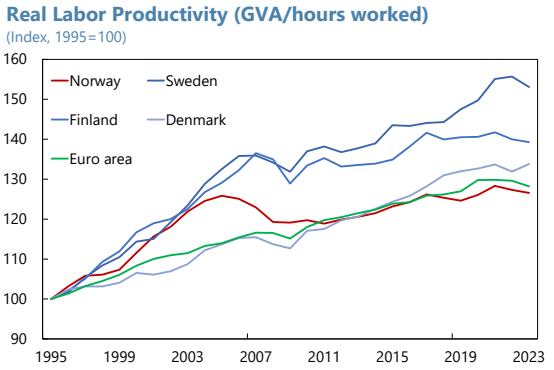
[1] Prepared by Cristina Cheptea.

chart), the peace of productivity growth has declined in the aftermath of the GFC and its growth has been notably slower relative to the 1990s. Growth of both productivity per hour and per worker have declined, from 2.7 percent and 2.5 percent, respectively in the 1990s, to around 0.5 percent and 1 percent, respectively in 2021–22 (bottom right chart).[2] The slowdown in productivity is not unique to Norway, as many advanced economies have faced similar trends. However, Norway's productivity growth ranked among the lowest in the OECD during 2020–22 (bottom left chart).

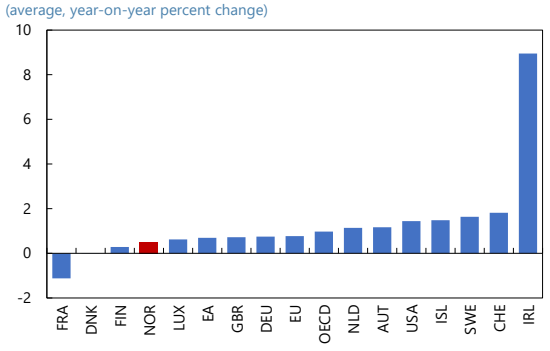
Annex IX. Figure 2. Evolution of Labor Productivity



Sources: Eurostat; and IMF staff calculations.



Sources: Eurostat; and IMF staff calculations.



Sources: OECD; and IMF staff calculations.

Sources: Eurostat; and IMF staff calculations.

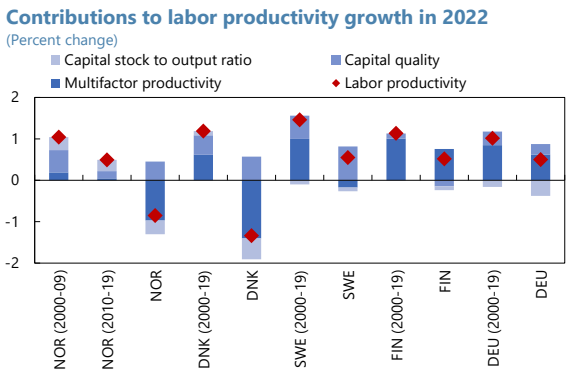
3. The decline of Norway's productivity growth has been driven largely by lower contributions of capital, ICT capital deepening, and TFP. This trend is evident when comparing the periods of 2000–2009 and 2010–2019, where a pronounced decline in the contributions of capital quality[3]/ICT capital deepening and TFP to labor productivity growth was observed. During the earlier period of 2000–2009, labor productivity growth hovered around 1 percent, only to halve to approximately 0.5 percent in the subsequent decade. This reduction underscores the critical role

[2] This broadly holds even after accounting for the petroleum sector.

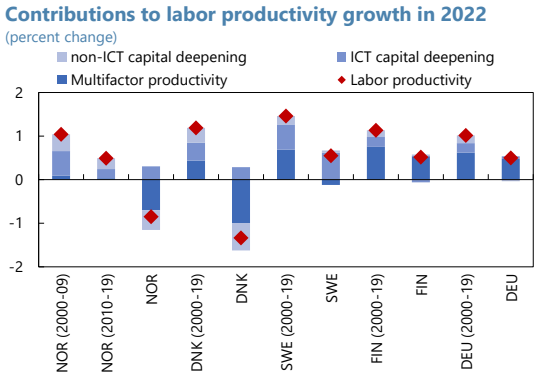
[3] Capital quality can be interpreted as the effectiveness and efficiency of an economy's capital assets in contributing to economic growth and productivity. High-quality capital is characterized by modern, efficient, and productive assets, both physical capital (e.g., machinery and infrastructure) and intangible assets (e.g., human capital and technology).

that both TFP and capital deepening play in sustaining productivity growth. Total Factor Productivity (TFP), which measures the efficiency and effectiveness with which labor and capital are utilized together for production, has notably shifted from being a positive force to a negative contributor to Norway's labor productivity, with nearly two-thirds of the productivity slowdown in 2022 being attributed to a decline in multifactor productivity. Meanwhile, approximately one-fifth of the slowdown could be traced back to slower capital deepening, despite higher capital quality contributing positively to productivity. This shift is in contrast with some of Norway's peers, where TFP has remained a primary driver of productivity enhancements.

Annex IX. Figure 3. Contributions to Labor Productivity Growth

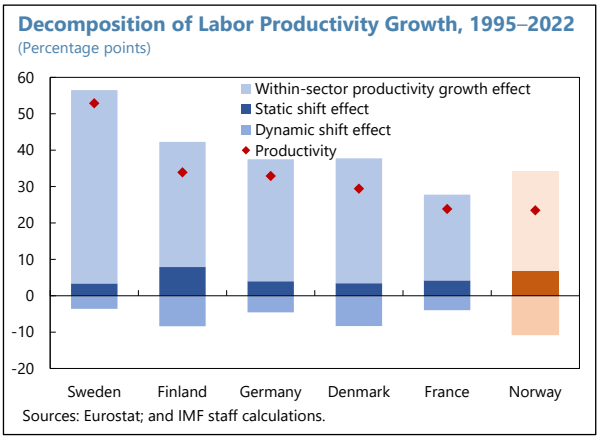


Sources: OECD; and IMF staff calculations.



Sources: OECD; and IMF staff calculations.

4. Norway's productivity growth has been primarily driven by within-sector contributions, while across sector effects have been negative, like in peers. Utilizing shift-share analysis, we can break down labor productivity growth into gains achieved within individual sectors (the within-sector effect) and the structural shifts resulting from the reallocation of resources across industries (the combined effect of static and dynamic shifts).[4] The significant productivity surge in the 1990s, the recovery in labor productivity between 2011–2019, and the modest growth observed in recent years can largely be attributed to productivity improvements within sectors. In contrast, the contribution of resource reallocation between industries on labor productivity in Norway has been minimal and even negative. This phenomenon mirrors a broader pattern observed in more advanced



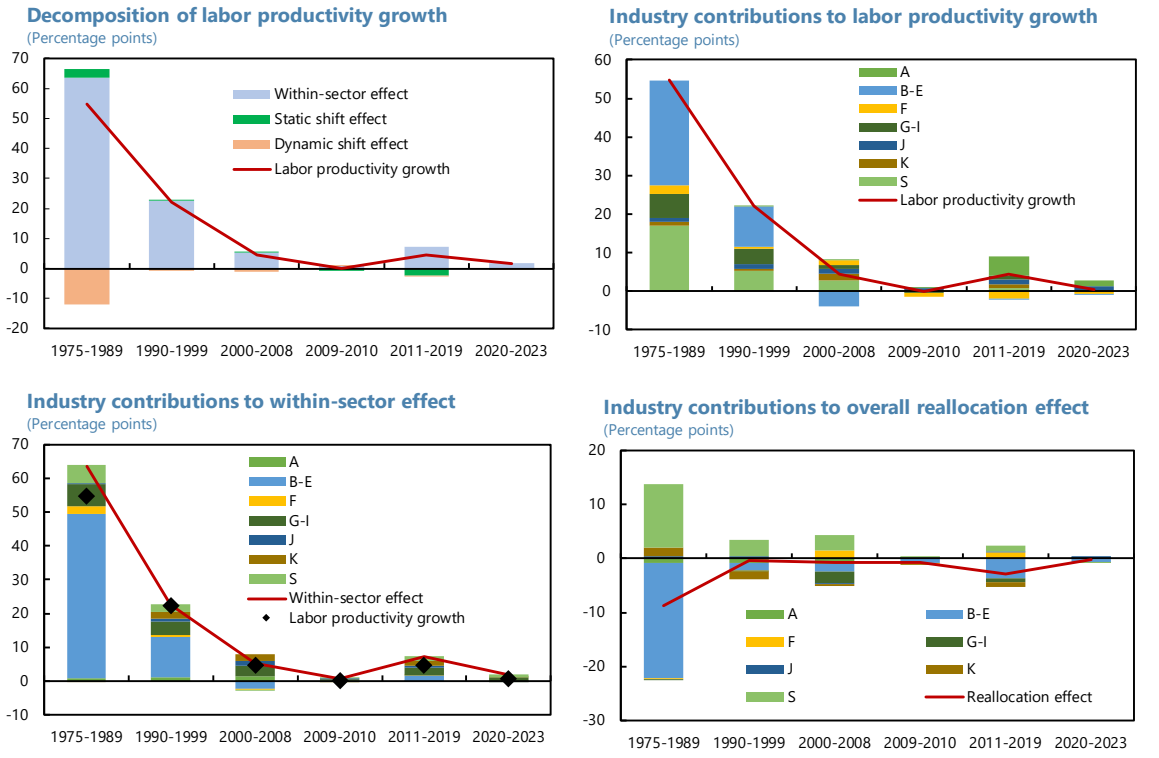
Sources: Eurostat; and IMF staff calculations.

[4] *Within-sector effect* captures the impact of productivity growth within different industries in the absence of structural change (i.e., assuming no changes in industries' employment shares). *Static shift effect* measures the contribution to aggregate labor productivity growth of a shift of employment resources towards sectors with lower/higher labor productivity levels. *Dynamic shift effect* (the interaction effect or the dynamic component of the structural change) measures the interaction of changes in labor productivity and employment across sectors. It measures the extent to which positive/negative efficiency gains interact with the expansion/contraction of industries.

economies, where shifts across sectors has increasingly played a lesser role in driving productivity. It could suggest that the exchange of technology and knowledge across sectors has been limited.

5. The sectors contributing to productivity growth shifted over time, with the role of industry declining and the share of services increasing (Figure 4). During 1975 to 1999, the industrial sector (B-E) was the primary driver of labor productivity, reflecting also high productivity growth in the petroleum sector. However, a marked transition occurred in the 2000s, leading to a decline in the industrial sector's contribution to productivity growth. Since the Global Financial Crisis (GFC), the contribution of the industrial sector has been relatively small, with the services sector (S) and wholesale and retail trade, transport, accommodation, and food service activities (G-I) emerging as leading contributors. The shift towards sectors traditionally associated with lower productivity levels could, in part, explain the observed decline in overall labor productivity in Norway. The overall decline over time of the within-sector effect offers additional insight into the recent slowdown in labor productivity.

Annex IX. Figure 4. Labor Productivity Decomposition Using Shift-Share Analysis



Sources: Eurostat and IMF staff calculations.
Note: The NACE codes refer to the following sectors, A: agriculture, forestry, and fishing; B-E: industry (except construction), F: construction; G-I: wholesale and retail trade, transport, accommodation and food service activities, J: information and communication, K: financial and insurance activities,

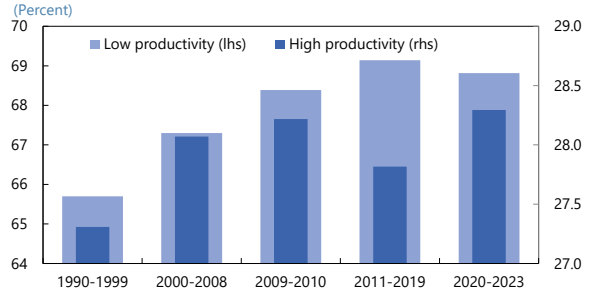
6. The impact of across sectors reallocation on boosting productivity growth seems to be minimal. Despite the shift in working hours and employment distribution across different sectors, there has been no significant reallocation towards industries with higher output per hour or those experiencing productivity enhancements. Specifically, by early 2020s, the share of low productivity has increased by 3 pps, while share of high productivity by about 1 pps relative to 1990s (Figure 5).

Also, the shift towards industries with improving productivity, after increasing initially, has declined since the GFC. One of the reasons for a slow sectoral reallocation could be the shift in more intensive skills demanded within industries rather than across industries. Also, Norway has the lowest wage differentiation among the OECD countries, shaping the incentives for labor mobility across sectors with varying skill demands.

Annex IX. Figure 5. Share of Hours Worked

Norway: Share of Hours Worked by Sector-level Productivity 1/

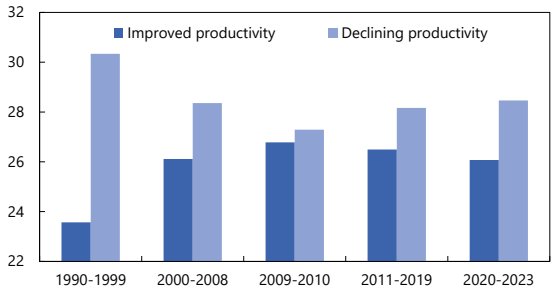
(Percent)



Sources: Eurostat; and IMF staff calculations.
1/ High/Low productivity sectors are relative to median Value added per hour worked. High sectors are: Industry (ex. construction); ICT, finance and insurance, real estate.

Norway: Share of Hours Worked by Sector-level Productivity 1/

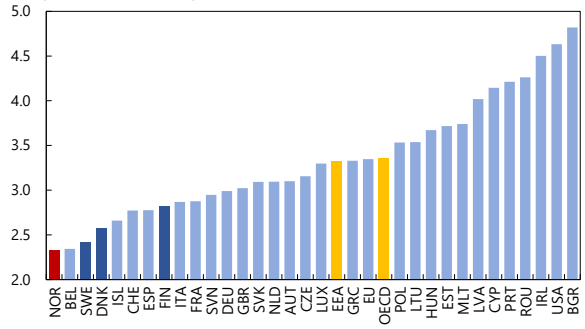
(Percent)



Sources: Eurostat; and IMF staff calculations.
1/ Improved/declining productivity sectors refer to sectors where productivity increased/decreased in 2020-2023 period.

Wage Compression, 2022

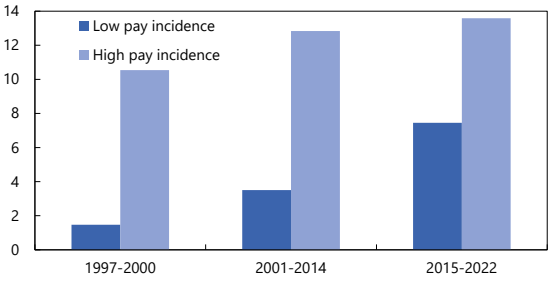
(interdecile ratio 90/10)



Source: OECD.

Norway: Incidence of Low and High Pay 1/

(Index)

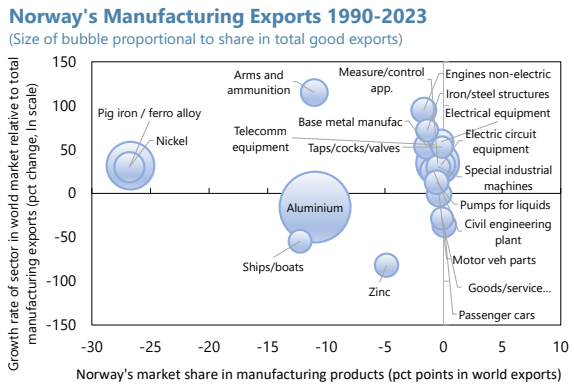


Sources: OECD; and IMF staff calculations.
1/ The incidence of low pay refers to the share of workers earning less than two-thirds of median earnings. The incidence of high pay refers to the share of workers earning more than one-and-a-half times median earnings.

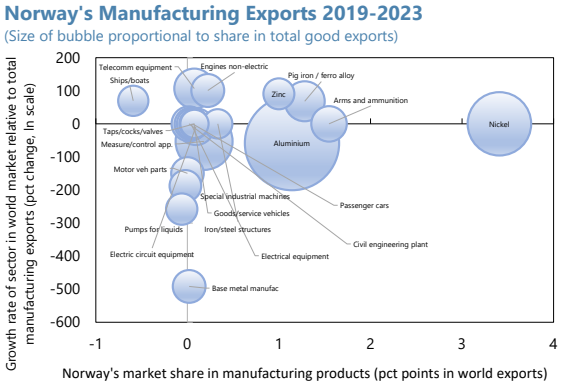
7. The loss in productivity may be, in part, related to Norway's patterns of specialization within the global trade (Figure 6). The sectors in the bottom two quadrants of the figure highlight sectors whose growth in total world manufacturing exports has declined during 1990 to 2023. Conversely, the sectors in the two right quadrants are those where Norway's export share has increased. In sum, Norway has experienced above industrial average growth in sectors where there share in global exports has declined. At the same time, while the top manufacturing sectors, in which Norway has specialized since 2019, are increasing their shares within the world manufacturing products, the share of these sectors in the global manufacturing trade is concurrently declining. This is the reverse from the pattern observed in 1990, where sectors experiencing a fall in their share of manufacturing products were growing in total world exports. This divergence in trends suggests a nuanced perspective on Norway's specialization and its impact on productivity. While Norway has successfully increased its share in specific manufacturing sectors, this specialization has not translated into an increased share in the broader context of world manufacturing trade. This

discrepancy may have contributed to the lower productivity growth, as sectors in which Norway is increasing its specialization face challenges in maintaining/enhancing their global competitiveness.

Annex IX. Figure 6. Share in Manufacturing Exports



Sources: UN Comtrade; and IMF staff calculations.



Sources: UN Comtrade; and IMF staff calculations.

8. In the current global landscape, the importance of productivity as essential for economic growth and resilience cannot be overstated. Recent challenges, including escalating geopolitical tensions, and long-term structural shifts such as aging populations, declining competition, and a slowdown in globalization, are weighing on productivity. These factors, coupled with potential long-term scarring effects, underscore the urgency of addressing productivity stagnation. As underscored by the 2023 OECD Economic Surveys, countries, including Norway, must prepare for a transition away from traditional industries such as oil and gas, and towards sectors with higher productivity potential. This involves a strategic reassessment of export strategies, aligning them with sectors showing high domestic growth and global competitiveness. Also, opportunities presented by digitalization and artificial intelligence, if harnessed effectively, offer a pathway to reignite productivity gains.

References

OECD, 2024. OECD Economic Surveys: Norway 2024, OECD Publishing, Paris, https://doi.org/10.1787/cb13475f-en.

OECD, 2024. OECD Compendium of Productivity Indicators 2024, OECD Publishing, Paris, https://doi.org/10.1787/5dd01cb4-en.

Annex X. Addressing Transnational Aspects of Corruption[1]

1. The authorities continue to mitigate the risks of foreign bribery as part of their voluntary assessment of transnational aspects of corruption.[2] Only one out of the 500 largest multinational enterprises (MNE) in the world is headquartered in Norway, and its FDI scale is limited (although there are non-negligible risks).[3] Since the 2020 Follow-up Phase 4 Report of the OECD Working Group on Bribery, the Norwegian authorities have amended the Penal Code to clarify its applicability to corruption and trading in influence committed abroad and the Auditors Act to clarify the obligation to follow good auditing principles. Further efforts were also made to promote detection of foreign bribery[4] and raise awareness, such as elaborating a comprehensive report with indicators for corruption to share experience-based knowledge.[5] The authorities are encouraged to enhance measures in the calculation of fines and sanctions and the transparency of penalty notices and to strengthen their enforcement actions against foreign bribery.

2. The authorities have strengthened Norway's AML/CFT framework, but further improvements are needed to mitigate money-laundering risks related to foreign proceeds of crimes including corruption. Following the conclusion of IMF regional AML/CFT technical assistance to the Nordic and Baltic countries, the Norwegian authorities have taken steps to strengthen risk-based supervision of the banking sector. The Norwegian parliament also recently endorsed a White Paper on preventing and combatting financial crime, which includes proposed measures to tackle foreign proceeds of corruption, such as strengthening the Financial Intelligence Unit and the use of technology. Authorities have made progress in enhancing beneficial ownership transparency, with the new Beneficial Owner (BO) Registry expected to be operational by the end of 2024; they should ensure that the registry is in-line with the revised FATF standards for BO transparency (Recommendations 24 and 25).

[1] Prepared by Yao Deng and Alexander Malden. Norway volunteered to have its legal and institutional frameworks assessed in the context of IMF bilateral surveillance for purposes of determining whether it: (a) criminalizes and prosecutes the bribery of foreign public officials; and (b) has an effective AML/CFT system that is designed to prevent foreign officials from concealing the proceeds of corruption.

[2] Information relating to supply-side corruption in this paragraph is based on information and data provided by the Norwegian authorities. IMF staff has provided additional views and information. The information in this paragraph has not been verified by the OECD Working Group on Bribery (WGB) or the OECD Secretariat and does not prejudice the WGB's monitoring of Norway's implementation of the OECD Anti-Bribery Convention.

[3] See OECD- UNSD Multinational Enterprise Information Platform, and International Financial Statistics - International Investment Position, Assets, Direct investment (BPM6). The OECD Phase 4 evaluation noted that Norway's export market and FDI sectors may entail non-negligible risks of foreign bribery.

[4] The authorities reported that two foreign bribery investigations were ongoing in 2023, with three natural persons and one legal person as suspects in one investigation and a natural person and a legal person as suspects in another investigation.

[5] See here (Norwegian only).

Annex XI. Implementation of Past IMF Recommendations

Main 2023 Article IV Recommendations	Authorities' Actions/Response
Monetary Policy	
Further tighten monetary policy to contain domestic demand and durably bring inflation down to the 2 percent target.	Norges Bank hiked the policy rate an additional 175 bps to 4.5 percent, taking the *ex-ante* real policy rate into contractionary territory.
Continue to clearly communicate how economic developments affect the current and future policy stance.	Norges Bank continued to clearly communicate the rationale for its policy decisions and background assessments.
Fiscal Policy	
The fiscal stance should be more supportive of disinflation efforts.	The fiscal policy stance in 2023 was expansionary, while the 2024 budget envisions an expansionary stance.
Improve targeting of electricity subsidies to vulnerable households.	The electricity subsidy scheme for all households has been extended to end-2024.
Make the tax system simpler and more efficient to accommodate increasing spending needs.	Not implemented.
Link retirement age benefits to life expectancy to ensure the sustainability of the pension system and improve labor force participation.	The government and social partners have agreed to reform the early retirement system, and there is broad agreement in Parliament to index retirement age to life expectancy.
Comprehensively reform the disability benefits regime.	Reforms to the disability benefits regime are important but politically difficult to implement.
Financial Sector Policies	
Continued vigilance is needed given heightened uncertainty.	Prudential policies have been tightened further, and supervisory activity has increased. Data gaps for systemic risk monitoring have been closed.
Gradually introduce a sectoral systemic risk or countercyclical buffer for CRE exposures.	Systemic risks from CRE exposures are assessed as broadly manageable. The SRB rather than a SSRB should serve as the main rule that applies to all exposures.
Make LTV limits on mortgages permanent.	The relevant regulation will be evaluated before it expires in 2024.
Further strengthen resilience to cyber-attacks.	Refer to Annex VI.
Structural Reforms	
Continue to assess the effectiveness of spending on retraining.	A spending review of labor market programs has been completed and will be used to inform the upcoming White Paper on active labor market policies.
Improve housing affordability.	The 2024 White Paper on housing policy lays out the government's priorities, including measures to increase home ownership, improve the functioning of the rental market, increasing housing supply (including through financing for developers), and widening access to housing for low-income and other disadvantaged households. The Tenancy Act is under review.

Annex XII. Data Adequacy Assessment for Surveillance

Annex XII. Table 1. Norway: Data Adequacy Assessment Rating 1/

A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	A	A	A	A	A		
Granularity 3/	A		A	A	B		
			A		A		
Consistency			B	B		A	
Frequency and Timeliness	A	A	A	A	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data provided by Statistics Norway, Norges Bank, the Ministry of Finance, Finanstylnet, and other national sources are adequate for surveillance.

Changes since the last Article IV consultation. No new data weaknesses have been identified since the last Article IV consultation.

Corrective actions and capacity development priorities. n.a.

Use of data and/or estimates different from official statistics in the Article IV consultation. Analytical work on exchange rate dynamics includes high frequency data on financial indicators for other G10 economies from Datastream and the IMF.

Other data gaps. n.a.

Annex XII. Table 2. Norway: Data Standards Initiatives

Norway subscribes to the Special Data Dissemination Standard (SDDS) since June 1996 and publishes the data on its National Summary Data Page. The latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).
Norway has expressed interest in adhering to SDDS Plus.

Annex XII. Table 3. Norway: Table of Common Indicators Required for Surveillance

As of July 18, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Norway[8]	Expected Timeliness[6,7]	Norway[8]
Exchange Rates	18-Jul-24	18-Jul-24	D	D	D	D	...	1D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May-24	05-Jun-24	M	M	M	M	1W	1W
Reserve/Base Money	May-24	25-Jun-24	M	M	M	M	2W	11D
Broad Money	May-24	25-Jun-24	M	M	M	M	1M	1M
Central Bank Balance Sheet	Jun-24	15-Jul-24	M	M	M	M	2W	11D
Consolidated Balance Sheet of the Banking System	Jun-24	15-Jul-24	M	M	M	M	1M	1M
Interest Rates[2]	18-Jul-24	18-Jul-24	D	D	D	D	...	1D
Consumer Price Index	Jun-24	12-Jul-24	M	M	M	M	1M	NLT 2W
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2024:Q1	07-Jun-24	Q	Q	A	Q	2Q	3M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	2024:Q1	23-May-24	Q	Q	M	M	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2024:Q1	23-May-24	Q	Q	Q	Q	1Q	90D
External Current Account Balance	2024:Q1	06-Jun-24	Q	Q	Q	Q	1Q	67D
Exports and Imports of Goods and Services	May-24	05-Jun-24	M	M	M	M	8W	2W
GDP/GNP	2024:Q1	16-May-24	Q	Q	Q	Q	1Q	50D
Gross External Debt	2024:Q1	06-Jun-24	Q	Q	Q	Q	1Q	1Q
International Investment Position	2024:Q1	06-Mar-24	Q	Q	Q	Q	1Q	1Q

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

INTERNATIONAL MONETARY FUND

NORWAY

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 31, 2024

Prepared By | European Department (in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of June 30, 2024)

Membership Status: Joined: December 27, 1945; Article VIII

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	3,754.70	100.00
Fund holdings of currency	2,761.74	73.55
Reserve tranche position	992.97	26.45
Lending to the Fund		

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	5,161.78	100.00
Holdings	5,447.33	105.53

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to the Fund:

SDR million; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2024	2025	2026	2027	2028
Principal	...	...	...	...	...
Charges/Interest	...	0.04	0.04	0.04	0.04
Total	**...**	**0.04**	**0.04**	**0.04**	**0.04**

Exchange Rate Arrangements: The *de jure* and *de facto* exchange rate arrangements in Norway are classified as freely floating. Norway accepted the obligations under Article VIII Section 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions other than restrictions notified to the Fund in accordance with Executive Board Decision No. 144-(52/51).

Article IV Consultation: 12-month cycle

Financial Sector Assessment Program (FSAP) Participation: 2020

Statement by Mr. Vitas Vasiliauskas, Executive Director for Norway,
and Ms. Ingrid Solberg, Senior Advisor to the Executive Director
September 13, 2024

On behalf of the Norwegian authorities, we would like to thank staff for a thorough report on the Norwegian economy, candid discussions, and insightful policy recommendations. We attach great importance to the IMF's assessments. Staff's reports contribute with high quality analysis and evaluations enabling authorities to identify shortcomings in economic policies. This adds value to the decision making and to the political debate in Norway. Although Norway is a rich and prosperous country, we are facing several challenges, including slow productivity growth, facilitating a green transition, and demographic headwinds.

Economic growth is set to improve next year, and unemployment is expected to remain low.

The Norwegian economy has experienced weak growth over the past two years, partly due to the tightening effects of monetary policy. Despite the slow-down, the level of employment has remained high and registered unemployment is low despite the recent uptick. Consumer price inflation is now significantly lower than at its peak in 2022 and is expected to decline further next year. However, the weakening of the krone and the rapid rise in business costs will likely slow further disinflation and it may take some time for inflation to return to target. The unemployment rate is expected to remain low but increase from its current level.

Going forward, household consumption is expected to contribute to a pickup in economic growth. Demand from the petroleum sector has helped prop up economic activity in the non-oil economy over the past year. Boosted revenues in the manufacturing sector, owing partly to the weakening of the krone, has provided a basis for high wage growth. Real wages are expected to increase both this year and the next, leading to an improvement in households' economic situation.

Fiscal restraint must be balanced against effective policy responses.

Fiscal policy has been restrained in order not to create unnecessary inflationary pressure, and spending of oil revenue this year is projected well below Norway's fiscal guideline. At the same time, the Norwegian Government puts strong emphasis on easing the burden of increased cost of living for vulnerable households and maintaining good public services. Imperative investments in defense and security also contribute to higher spending and an expansionary fiscal stance.

The latter is a consequence of Russia's attack on Ukraine, which has changed Norway's security landscape. In the revised budget, defense spending was significantly increased in line with an updated Long-Term Defense Plan that aims to step up defense spending sharply in the coming years. Norway meets NATO's defense spending target of 2 percent of GDP this year, ahead of the previous target of 2026.

Staff recommends expanding the fiscal framework with a medium-term expenditure framework. A recent white Paper on "Long Term Perspectives" analyses long-term challenges for the Norwegian economy and the public sector. The report illustrates that public spending is expected to increase faster than public income in a few years, mainly due to the aging of the population. Considering

the challenges ahead, more attention to medium-term expenditure growth could ease the transition and help ensure longer-term sustainability of fiscal policy. However, such an approach must not impede effective policy responses to macroeconomic shocks, and not obscure the broad support for the current framework.

The Central Bank will continue to carefully watch inflation pressures going forward.

The Norges Bank has raised the policy rate significantly to tackle high inflation. Since December 2023 the policy rate has been held at 4.5 percent.

Inflation has fallen back considerably from the peak. After rising moderately through 2022, long-run inflation expectations have fallen over the past year but are still somewhat higher than the inflation target.

Norges Bank's Monetary Policy and Financial Stability Committee's has stated that the policy rate will likely be kept at the current level for some time ahead to bring inflation down to target within a reasonable time horizon. The forecast from the June *Monetary Policy Report* implied that the policy rate will continue to lie at 4.5 percent to the end of the year, before gradually being reduced.

At the latest MPC meeting in August, the Committee was particularly concerned with developments in the krone exchange rate and the implications for inflation. If inflation seems to remain higher for longer, the policy rate may be increased. If there is a more pronounced slowdown in the economy or prospects suggest that inflation return to target faster, the policy rate may be lowered earlier. New forecasts will be published after the monetary policy meeting on 18 September.

Risks to financial stability appear to be manageable.

The Government has a broad policy approach to address financial stability issues. The 4.5 percent systemic risk buffer for all banks addresses structural vulnerabilities such as high household debt and substantial commercial real estate (CRE) exposure among banks. Risk weight floors on IRB-banks' real estate exposures prevent unjustifiably low risk weights when banks calculate their capital requirements. The lending regulation includes caps on the loan-to-value ratio and debt-to-income ratio. The regulation expires at the end of 2024. A proposal from the Financial Supervisory Authority to renew the regulation and make it permanent is currently subject to public consultation.

We agree with staff that the Norwegian financial system is stable and banking system buffers are robust. High household debt and banks' exposure to CRE remain important vulnerabilities. The current prudential toolkit to mitigate financial stability risks remains quite comprehensive to address the vulnerabilities. Well capitalized banks mitigate the risks to stability.

Ensuring a sustainable development in public finances will require several measures.

The Norwegian employment rate is at its highest in ten years. Still, many remain outside the labor force. What is more, labor productivity growth has declined, now ranking among the lowest in the OECD. This pose concerns, as high employment is a prerequisite for sustainable public finances and productivity growth is necessary for continued economic growth.

As described by staff, Norway will soon face fiscal challenges due to an ageing population and lower revenues from petroleum. The Government has just announced a goal to increase the employment rate. Reducing the number of people on disability schemes would improve the fiscal balance and increase the growth potential. Furthermore, fiscal challenges should be met without increasing the level of taxation.

Norway has carried out a major pension reform to expand labor participation among older workers. The reform entails increasing the minimum age to retire, while improving the social sustainability of the system for persons receiving disability benefits. The reform involves increasing the minimum pensions with the general wage growth and introducing a supplementary benefit for those that retire early.

An efficient public sector is crucial to manage future costs of an ageing population. Public policy, transfer programs, and investments should improve productivity. Several initiatives have already been taken. Spending reviews have been introduced to achieve a more efficient resource use and more effective policy instruments. Further efforts will aim to modernize the public sector and identify obsolete spending items.

Norway is committed to addressing global warming and aims to reduce domestic emissions to at least 55 percent by 2030 compared to 1990. Pricing emissions is the key policy instrument, and the government intends to gradually increase taxes on non-ETS emissions to USD 200 per ton CO2eq in 2030. By providing strong incentives, Norway is at the forefront in transitioning to electric vehicles – reaching 94 percent of new cars in August. The Government will continue its efforts to achieve Norway's climate targets.