INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/272

NORWAY

September 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

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 2013 Article IV consultation with Norway, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 24, 2013, 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 17, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Press Release** summarizing the views of the Executive Board as expressed during its August 30, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Norway.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

NORWAY

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

July 17, 2013

KEY ISSUES

Context: The Norwegian economy continues to perform well with mainland (i.e., non-oil) GDP growing steadily at 2½–3 percent, low and stable unemployment at 3–3½ percent, and core inflation running well below the 2.5 percent target. However, the continuing buildup of assets in the sovereign wealth fund and the increasing share of the mainland economy that is supplying goods and services to the oil sector are leading to competitiveness pressures in other industries exposed to international competition. Other risks to the economy relate mostly to a continuing housing boom and a large drop in oil prices.

Fiscal policy: Norway's fiscal institutions were designed to smooth spending from the oil wealth and insulate the economy from Dutch disease. However, high oil prices have led to steady rise in the fiscal impulse and the share of the mainland economy that is providing supplies and services is increasing. The authorities should use the flexibility that they have to reduce the rate of fiscal transfer from the sovereign wealth fund to the budget to lessen the pressures on traditional industries.

Monetary policy: With inflation well below the 2.5 percent target, the authorities have held the policy rate at 1.5 percent. The current stance is appropriate in balancing the below-target inflation for an economy near potential. Overheating in property markets should be addressed through financial sector policies.

Financial sector policy: The authorities' plans to increase capital buffers even more rapidly than required by Basel III and tighten prudential measures for mortgage lending are good, but cooperation among the Nordic authorities is necessary for fully effective macroprudential policy.

The Article IV discussions were coordinated with the Nordic Regional Report discussions; the latter covers cross-border financial sector issues in the region and house prices and household debt in a cross-country context.

Approved By
Mahmood Pradhan and David Marston

Discussions took place in Oslo during May 13–24, 2013. The staff team comprised of Mr. Dorsey (head), Mmes. Shirono, Mordonu, and Cheptea (all EUR). Mr. Groenn (Executive Director) joined the discussions.

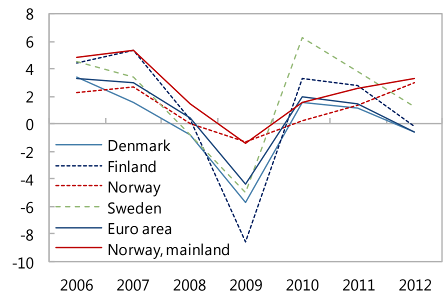
CONTENTS

TABLES

RECENT DEVELOPMENTS

A. Macroeconomic Setting

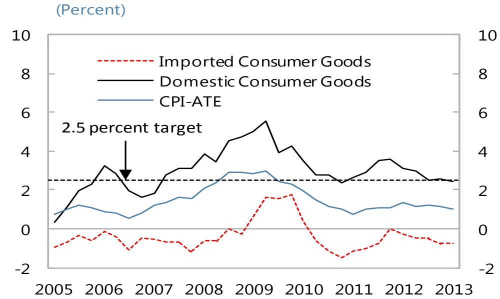
Real GDP Growth
(Percent)



Sources: IMF World Economic Outlook and IMF staff calculations.

1. The Norwegian economy continues to grow steadily (Figures 1 and 2). Norway's real GDP grew at 3 percent in 2012, with mainland and offshore (i.e., oil and gas) activities growing at 3.3 percent and 1.8 percent, respectively.[1] Mainland growth has been driven by private consumption and investment, supported by rising house prices and low interest rates. More recent data confirms that the robust growth continued in the first quarter of 2013, supported by steady private consumption growth.

Annual Inflation of CPI Components
(Percent)



Sources: Norges Bank and IMF staff calculations.

2. Despite strong domestic demand, inflation remains subdued (Figure 3). Headline CPI inflation and inflation excluding energy products and tax changes (CPI-ATE) have been running at 2.0 percent and 1.4 percent, respectively, well below the authorities' target as of May 2013.[2] Inflation has been held down mostly by declining import prices in the face of an appreciating exchange rate; inflation in imported consumer goods has been negative for the past year while inflation in domestic goods has been running at close to 2.5 percent.

3. The buoyant domestic economy has supported employment (Figure 4). The unemployment rate remains at around 3–3 ½ percent, although the participation rate is still below pre-crisis peak levels. Wage growth has been strong in past years, but the recent bargaining agreement for 2013 resulted in an average annual wage increase of 3.4 percent in nominal terms for unionized industry and service workers in the private sector, a somewhat lower level than in 2012.

[1] Norway's offshore sector produces oil, natural gas, and other hydrocarbons, but the term "oil" is used as shorthand for all hydrocarbons in the balance of this report.

[2] The authorities have an inflation-targeting rule with a 2.5 percent target for consumer price inflation; stabilization of output and employment are also included in the rule but as subordinate objectives (see Box 1).

Box 1. The Fiscal and Monetary Policy Rules

Norway introduced policy rules in 2001 that set quantitative targets for fiscal and monetary policy. The rules provide for some flexibility and judgment in both cases to take into account the business cycle in the case of the fiscal rule and output and employment stabilization in the case of the monetary policy rule.

The Fiscal Policy Rule—The fiscal policy rule provides that: "Fiscal policy is guided by the fiscal rule, stipulating a gradual phasing-in of oil revenues in the Norwegian economy in line with the expected real returns on the Government Pension Fund Global, estimated at 4 pct. The fiscal rule permits spending more than the expected return on the Fund in a cyclical downturn, while the use of oil revenues should lie below the expected return when capacity utilisation in the economy is high." [1/]

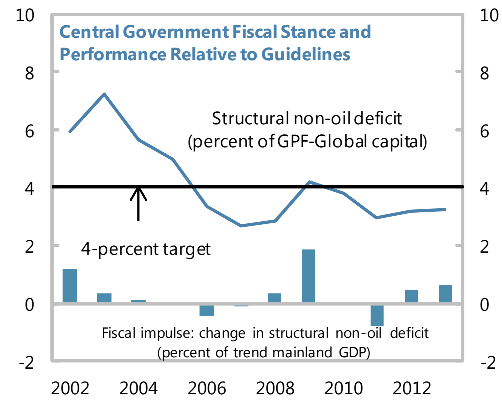
The fiscal policy rule constrains the non-oil deficit as a share of GPFG assets, but not as a share of GDP. To the extent that the GPFG grows more rapidly than the economy as a whole over an extended period, the rule permits a trend increase in the non-oil deficit as a share of GDP. Should GPFG assets decline relative to GDP, the reverse would be true. The fiscal implications of the rule are also sensitive to the real rate-of-return assumption. Real returns over the brief life of the fund have not generally met the 4 percent assumption, and there is no automatic mechanism to recalibrate the rate-of-return assumption to experience.

The Inflation Targeting Rule—The price stability mandate of the Norges Bank provides that: "Monetary policy shall be aimed at stability in the Norwegian krone's national and international value, contributing to stable expectations concerning exchange rate developments. At the same time, monetary policy shall underpin fiscal policy by contributing to stable developments in output and employment." It also provides that: "The operational target of monetary policy shall be annual consumer price inflation of approximately 2.5 per cent over time." It also indicates how inflation should be measured in some detail: "In general, the direct effects on consumer prices resulting from changes in interest rates, taxes, excise duties and extraordinary temporary disturbances shall not be taken into account." [2/]

In practice, Norges Bank sets an interest rate path to maintain inflation close to 2.5 percent following the three criteria: (i) the inflation target is achieved; (ii) the inflation targeting regime is flexible; and (iii) monetary policy is robust. The first weighs on the current level of inflation. The second criterion gives weight to avoiding excessive fluctuations in output and employment. The last criterion seeks to mitigate the risk of a build-up of financial imbalances so that acceptable developments in inflation and output are also likely under alternative assumptions about the economy. [3/]

[1/] 2012 National Budget
[2/] Norges Bank website
[3/] See Monetary Policy Report 3/12.

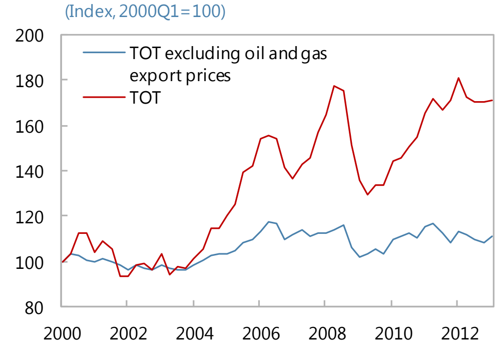
4. The 2012 fiscal outturn was in line with the authorities' fiscal policy rule. The fiscal rule limits the structural non-oil deficit to the expected trend income from the sovereign wealth fund, at an assumed real rate of return of 4 percent.[3] The structural non-oil deficit was 3.2 percent of Government Pension Fund Global (GPFG) capital, or 4.8 percent of trend mainland GDP. The fiscal impulse as measured by changes in the structural non-oil deficit as a share of trend mainland GDP was slightly positive, but broadly as envisaged at the time of the 2012 budget.



Sources: 2013 Revised Budget and IMF staff calculations.

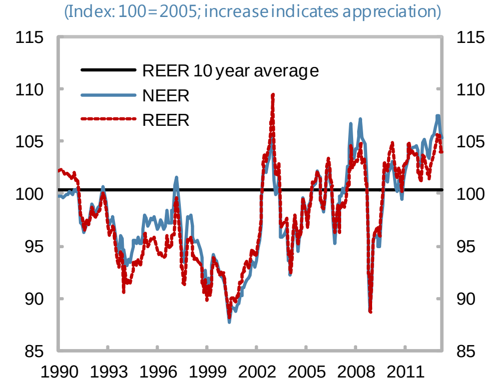
5. Norway's overall fiscal position continues to be strong. The general government surplus was about 14 percent of GDP in 2012. The value of GPFG also grew substantially in 2012 to 173 percent of mainland GDP.

6. The overall current account remains in surplus, supported by favorable terms of trade developments (Figure 5). The overall current account surplus rose to 19 percent of mainland GDP in 2012, reflecting robust oil demand and high oil prices. However, the non-oil trade balance worsened slightly in 2012, reflecting in part weaker external demand and recent exchange rate appreciation. More generally, non-oil exports have lost market share over the past two decades, raising competitiveness concerns.



Sources: Haver; and IMF staff calculations.

7. The exchange rate appears to be broadly in line with fundamentals. The real effective exchange rate (REER) based on the CPI is only slightly above the 10-year historical average at end-2012. Results from External Balance Assessment (EBA) are mixed, with the three methods pointing to different directions. These results suggest that there is no obvious sign of misalignment as far as REER-CPI is concerned.



Sources: INS database and IMF staff calculations.

[3] The authorities' fiscal policy rule limits the non-oil deficit to the average income from its sovereign wealth fund—the Government Pension Fund—Global (GPFG)—at an assumed real rate of return of 4 percent to help ensure "high capacity utilization and low unemployment" (see Box 2).

Box 2. Government Pension Fund Global

Norway's sovereign wealth fund, the (somewhat misleadingly-named) Government Pension Fund Global – is believed to be the world's largest or second largest such fund with total assets of $713 billion at end–2012. The GPFG serves variously as a vehicle for investment or resource income for future generations, a source of fiscal financing for the non-oil fiscal deficit according to Norway's fiscal rule (see Box 1), and as a means of insulating the economy from "Dutch disease." Notwithstanding its name, there is no direct connection between the GPFG and the state's pension obligations.

History and governance—The governance of the GPFG partially insulates decisions about the investment of oil income from political considerations. Oil production in Norway began in 1971, and revenues from oil and gas were treated as fiscal ordinary revenue in the first decades of production. The authorities adopted a new structure in 1990, establishing the GPFG under the ownership of the government through the Ministry of Finance but managed by the Norges Bank. The Ministry sets the investment strategy and broad asset allocations, but delegates the actual investment management to the Norges Bank which is charged with achieving the highest possibly return, subject to the limitations included in the investment strategy. The government also has guidelines to incorporate good corporate governance and environmental and social concerns (e.g., creating an investment reservation for "environment-related investments" on the order of 1 percent of the portfolio), and also to preclude investment in firms engaged in certain activities (e.g., tobacco and nuclear weapons production). An independent Council on Ethics advises the Ministry on the exclusion of specific firms.

Investment strategy—The value of the GPFG has grown rapidly on the strength of rising oil and gas prices and increased production over the last two decades. The first transfers to the fund took place in 1996 and assets were originally invested in a manner similar to central bank reserves. However, the investment strategy rapidly evolved into something like a diversified global index fund with target allocations of equities and fixed-income securities (and more recently real estate) across geographic regions.

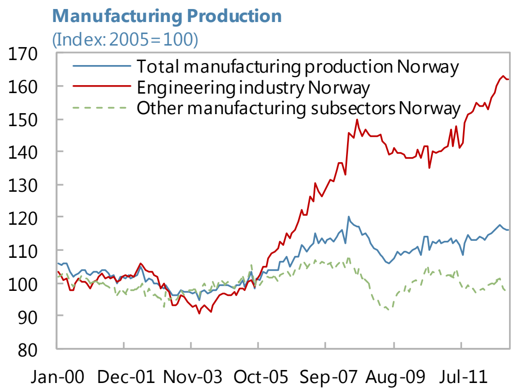
Income and "Dutch Disease"—The GPFG receives all of the government's oil- and gas-related income, including taxes, ownership shares, and the state's dividends from the majority government-owned Statoil. The transfers to the budget are not related to the inflows of oil- and gas-income but instead to the value of the fund's assets. As the stock of assets in the GFPG grows relative to the inflows of new funds, the income from the GPFG will be influenced more and more by global asset returns and less and less by oil prices or production volumes. Nevertheless, the indirect effects of oil and gas production through employment and investment in oil production firms and the trend increase in the non-oil deficit resulting from the fiscal rule both tend to create a real appreciation and a loss of competitiveness.

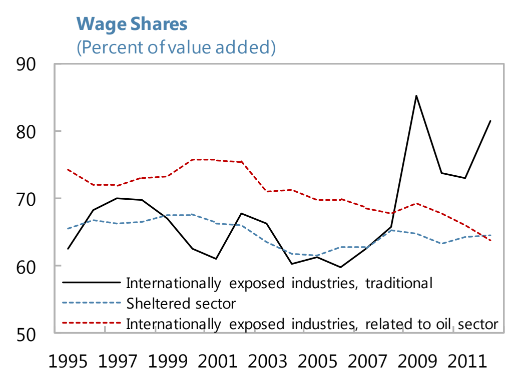
Norway: External Balance Assessment

	EBA
Macro Balance 1/	2
Equilibrium RER 2/	0
Eextnernal Sutainability 3/	11

Source: IMF staff calculations.
1/ The number shows the difference between cyclically adjusted current account and current account norm in % of GDP. A positive sign suggests exchange rate undervaluation.
2/ The number captures REER gaps between actuals and model predicted values. A positive sign means exchange rate overvaluation.
3/ The external sustainability approach is the same under both EBA and CGER. The number captures exchange rate overvaluation in percent. A positive sign means exchange rate overvaluation.

8. **However, the overall strength of the mainland economy masks divergent trends.** A strong and growing set of industries supplying goods and services to the offshore sector coexists with a non-oil-related subset of the mainland economy under increasing cost and competitiveness pressures. Indicators that distinguish between the oil-related (e.g., engineering industries) and other parts of the mainland economy show strong growth in the output of the former with stagnant output in the non-oil-related mainland economy. The divergence is also evident in cost pressures in the context of rapidly rising unit labor costs; while the oil-related parts of the mainland economy have had a falling wage share of value added over the last decade, the traditional industries that are exposed to international competition have seen the wage share rise by roughly 20 percentage points over the same period.[4]



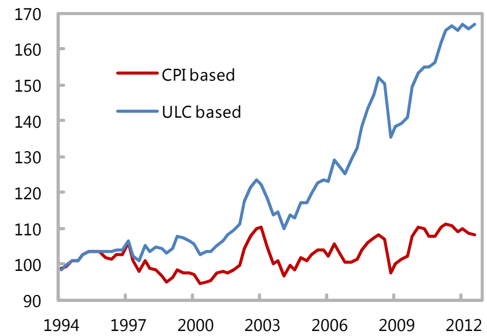


9. **Norway's ULC-based real effective exchange rate gives a very different picture of competitiveness, suggesting an erosion of long-term cost competitiveness.** Reflecting strong wage growth, the ULC-based REER appreciated by 60 percent over the past decade, and it is

[4] Chapter 1 of the Selected Issues paper examines long-term competitiveness issues for Norway.

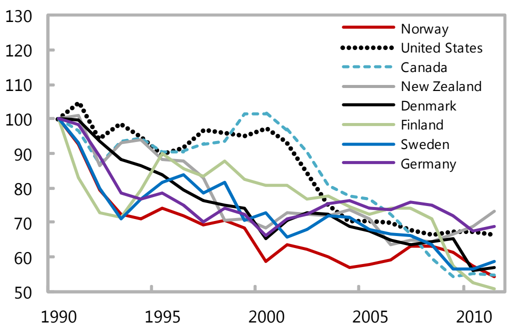
significantly above its 30-year average. At the same time, the market share of Norway's non-oil exports have dropped substantially for the past two decades. The loss of non-oil market share is largely explained by the decline in manufacturing exports, which lost almost 60 percent of its market share during the same period (Figure 6).

Real Effective Exchange Rates
(index 1994=100)



Sources: Price and Cost Competitiveness database and IMF staff calculations.

Non-oil Export Market Share in world
(Index, 1990=100)

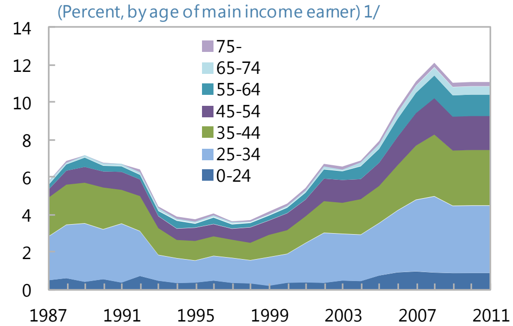


Sources: Comtrade and IMF staff calculations.

B. Housing Markets and Financial Sector

10. The housing boom continues raising overheating concerns (Box 3 and Figures 7, 8, and 9). Real house prices increased by almost 6 percent in 2012, and household debt remains elevated at about 200 percent of disposable income. Household credit continues to grow steadily. While rising house prices are supported by high income growth, increasing population due to immigration, low interest rates and supply constraints, some households are highly indebted and vulnerable to a possible house price reversal.

Norway: Share of Households with Debt-to-Income Ratio > 5
(Percent, by age of main income earner) 1/



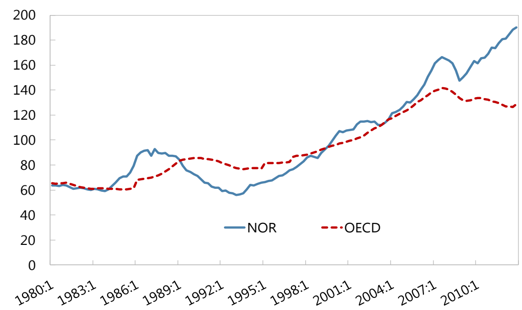
Sources: Norges Bank Financial Stability Report 2/12.
1/ Estimates for 2011.

11. Financial sector balance sheets are improving and the funding structure of banks has improved, but financial institutions are vulnerable to property price reversals (Figures 10 and 11.) Banks have improved their resilience by raising capital and are in the process of strengthening their capital further. Common Equity Tier 1 (CET1) capital ratio reached 11 percent in 2012. Norway's largest bank (DNB) had earlier fallen short of a 9 percent CET1 ratio recommended by European Banking Authority (EBA), but the recommendation was met as of June 2012 by using internal resources. Banks continue to rely on wholesale funding, but the funding structure has become more robust recently; funding maturities have risen, and banks are increasingly matching short-term wholesale funding with liquid assets. Nevertheless, banks could be vulnerable in the event of a large property price correction or an interest rate shock given the high level of household debt and banks' credit exposure to the commercial property market.

Box 3. House Prices in Norway

Real house prices continue to rise in Norway, growing at about 6 percent on average during 2010–2012. In contrast with many other OECD peers, house prices in Norway recovered quickly after the global financial crisis. High prices are partially explained by "fundamentals," such as high income and wage growth, immigrant inflows, and supply constraints. For example, real household disposable income in Norway grew at 3.8 percent on average during 2008–2012 while it was only 0.8 percent on average in other OECD countries.

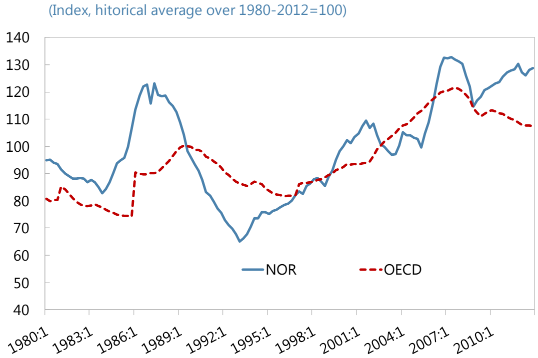
Real House Price in Norway and OECD Average
(Index, historical average over 1980-2012=100)



Sources: OECD and staff calculations

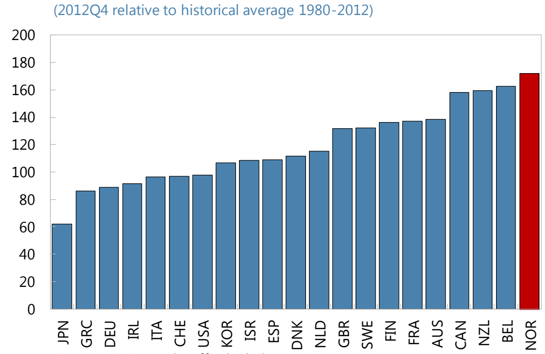
However, there are signs of overvaluation of house prices in Norway. The price-to-income ratio has a similar increasing trend to real house prices, and Norway's price-to-rent ratio relative to the historical average in 2012 was the highest among the OECD countries.

Price-to-Income Ratio in Norway and OECD Average
(Index, hitorical average over 1980-2012=100)



Sources: OECD and staff calculation

Price-to-Rent Ratio
(2012Q4 relative to historical average 1980-2012)

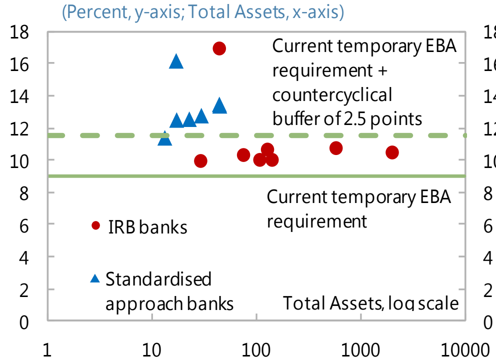


Sources: OECD and staff calculation

Staff's estimates of house price valuation gaps based on an average of three methods, including a time-series model consistent with IMF's Vulnerability Exercise, indicates that house prices in Norway may be overvalued by about 40 percent. While this estimate is subject to considerable uncertainty, a large house price correction could significantly impact the economy, dampening consumption and residential investment. The negative impact could be significant given the high level of household debt and the fact that a certain segment of households is heavily indebted with debt to income ratio higher than 5 (see Chapter 2 of the Selected Issues paper).

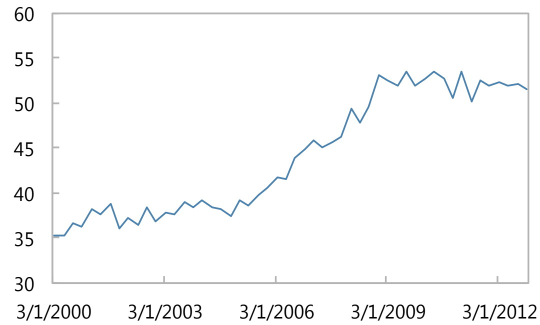
The authorities are gradually adopting measures to cool the housing market, including tighter macroprudential guidelines. The FSA lowered the cap on the loan-to-value (LTV) ratio on mortgages to 85 percent in December 2011, along with other tightening measures. The LTV guideline is not legally binding, but loans with LTV higher than 85 percent seem to be declining. Higher risk weights on residential mortgages are also currently under consideration and banks have strengthened their capital significantly to meet Basel III requirements. The government has also recently proposed an increase in taxation on non-owner occupied properties.

Banking Groups Common Equity Tier 1
(Percent, y-axis; Total Assets, x-axis)



Sources: Norges Bank Monetary Policy Report 1/13 and IMF staff calculations.

Banks Wholesale Funding as a Share of Total Assets
(Percent)



Sources: Norges Bank, Monetary Policy Report 1/13 and IMF staff calculations.

OUTLOOK AND RISKS

12. **Growth is likely to continue at a moderate pace.** Mainland GDP growth is projected at 2.8 percent in 2013, largely supported by strong domestic demand. Growth is likely to remain domestic-led in the near term, reflecting weak growth in major trading partners. The output gap is estimated to be slightly positive for mainland economy, and growth is projected to rebalance gradually as macroeconomic and macroprudential policies tighten, house price increases moderate to a more normal pace, and external demand recovers.

13. **Inflation is expected to be below target for some time and gradually rise to the target in the medium term, reflecting pressures from steady wage growth and a more stable exchange rate.** Staff expects inflation to return to the 2.5 percent target by 2018.

14. **Norway's fundamentals remain strong, but the central scenario is subject to key risks.**

- ***A substantial and prolonged reduction in oil prices:*** This could occur if downside risks to the global growth outlook materialize. This would undercut growth directly, through a reduction in oil-related demand for mainland goods and services, and indirectly, through a possible reduction in demand for housing due to confidence effects or a reversal of immigrant inflows.

- ***A significant reduction in housing prices:*** Real house prices continue to increase in Norway even as they have stabilized or declined elsewhere (Box 3). The price-to-income ratio stabilized somewhat in 2012, but a composite indicator, based on multiple measures, suggests that Norway's real house prices were overvalued by about 40 percent in 2012. A house price correction could be triggered by a reduction of oil prices or other shocks to demand or confidence. Given the elevated level of prices and high household debt, such a decline would likely reduce household consumption with adverse consequences for retail trade, construction, commercial real estate, and lenders to those sectors.[5]

- ***Re-emergence of financial stress in the euro area or slower emerging market growth:*** Norway's direct exposure to the euro area is limited, but stalled or incomplete implementation of policy commitments by euro area countries could trigger a re-emergence of financial stress. Norway's export exposure to emerging markets is also relatively small, but these economies, particularly China, drive changes in oil demand and thus oil prices in the world market. Slower growth in the euro area or emerging markets could have negative impacts on oil prices and demand for oil related exports.[6] A re-emergence of financial stress in the euro area could also reduce foreign funding for Norwegian banks and tighten lending conditions.

Authorities' views

15. The authorities broadly agreed with staff on the risk assessment but gave particular emphasis to risks related to a protracted decline in oil prices. They see direct risks given the increasing dependence of much of the mainland economy on providing supplies and services to the oil sector. They also see indirect risks as a possible trigger for a house price correction, which could further weaken private consumption and possibly undermine financial stability in light of elevated household debt. They noted that recent policy measures such as the strengthening of bank capital should mitigate the build-up of potential vulnerabilities.

POLICY DISCUSSIONS

Good fortune and good economic management have yielded strong economic performance, but Norway also faces new economic challenges. Near-term prospects remain favorable, but managing an overheating housing market will be challenging, especially in the context of high household debt and below-target inflation.[7] High wage costs are eroding competitiveness in the traditional sector, and the mainland economy has become more exposed to oil prices as oil-related activity in the mainland economy increased. Over the longer-term, the implementation of the authorities' fiscal rule might be reconsidered in light of its implication of rising non-oil deficits, the optimism of the long-term real rate of return assumption, and a mismatch between the timing of long-term fiscal needs and the path of fiscal financing implied by the fiscal rule.

[5] House prices and household balance sheets are considered in Chapter 2 of the Selected Issues paper and in a cross-country context in the Nordic Regional Report. Chapter 2 of the Selected Issues paper for the Nordic Regional Report estimates the possible impact of a house price correction on macro variables and finds an average impact of a house price reversal to the "equilbriium" level on consumption would be about -4 percent for Norway.

[6] The IMF's G35 model suggests that re-emergency of financial stress in the euro area would imply a simulated peak output loss of 0.6 percent for Norway relative to the baseline.

[7] See Box 4 for the authorities' policies implemented in the past year.

Box 4. Authorities' Response to Past IMF Policy Recommendations

The authorities' macroeconomic policies for the last eighteen months are gradually shifting toward the direction consistent with recommendations by the Fund at the time of the last Article IV consultations.

Monetary and financial sector policies—The Norges Bank reduced the policy rate by 25 basis points to 1.5 percent in March 2012, against the background of continuing downturn abroad and a strong krone that were keeping inflation low and weighing on growth in Norway. The 2011 Article IV consultation recommended monetary tightening in absence of macroprudential tightening. The FSA lowered the cap on LTV from 90 percent to 85 percent in December 2011, together with tightening other mortgage lending guidelines. The LTV cap remains a soft cap, but the share of new residential mortgage loans with LTV higher than 85 percent fell in 2012.

The authorities are also gradually moving toward further macroprudential tightening. In December 2012, the Ministry of Finance requested the FSA to review macroprudential measures to curve the risks stemming from the overheating of housing markets. The authorities are currently considering various proposals for raising risk weights for residential mortgage, which was one of the last Article IV recommendations.

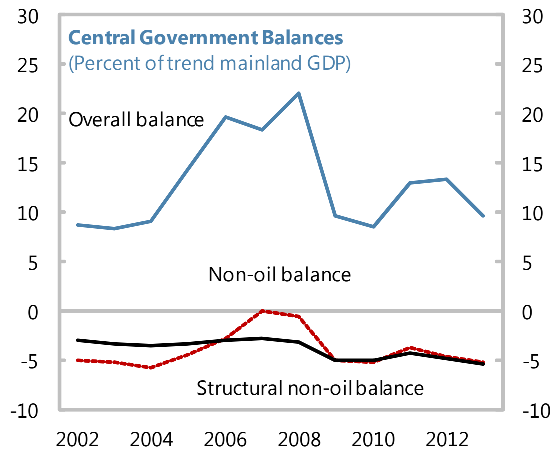
Tougher capital requirements are also underway. A legislative proposal on new capital requirements for credit institutions and investment firms was put forward in March 2013 to implement the Basel III standards (CRD IV). It is proposed that a 9 percent CET1 capital requirement become effective from July 2013, and the requirements will be gradually increased. The authorities plan to target core capital requirements of 10 percent by July 2014. For systemically important banks, which have yet to be defined, this target will rise to 11 percent in 2015 and 12 percent in 2016. A counter-cyclical buffer of as much as 2.5 percent is also proposed to be effective in July 2014.

Fiscal policies—Both 2012 fiscal outturn and 2013 budget are in line with the authorities' fiscal rule, (i.e. below 4 percent of the GPFG capital). The 2013 revised budget also entails a small positive fiscal impulse while the 2011 Article IV consultation recommended fiscal tightening starting from 2013.

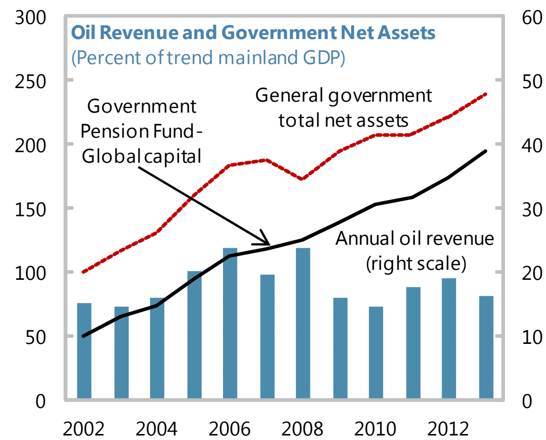
Gradually reducing tax subsidies for housing is a long-standing Fund recommendation. The tax code remains biased toward owner-occupied housing, but the government recently announced a proposed tax increase for non-owner occupied houses. The tax change is small, but it is in the right direction to reduce incentives for housing investment

A. Fiscal Policy

16. The 2013 revised budget envisages a mildly expansionary fiscal stance, but still in line with the fiscal rule. The non-oil deficit is projected to be 5.4 percent of potential mainland GDP, less than the full 4 percent of GPFG assets, while the general government surplus is projected to be 11 percent of GDP. The fiscal impulse is projected at 0.6 percentage points in 2013.



Sources: 2013 Revised Budget and IMF staff calculations.



Sources: 2013 Revised Budget and IMF staff calculations.

17. The government has implemented its fiscal rule flexibly, with a structural non-oil deficit closer to 3 percent of GPFG assets in 2011 and 2012 and plans to do so in 2013. Because the fiscal rule sets the transfer to the budget as a share of expected trend earnings from the GPFG, it stabilizes the non-oil deficit relative to GPFG assets but not relative to mainland GDP. The increase in the size of the GPFG relative to the economy implies a large and rising stimulus to the economy that would further add to wage and cost pressures. In light of this, a continuation of the cautious fiscal stance would reduce the extent to which fiscal policies add to competitiveness pressures coming from the expansion of the oil-related parts of the mainland economy (see also Chapter 1 of the Selected Issues paper).

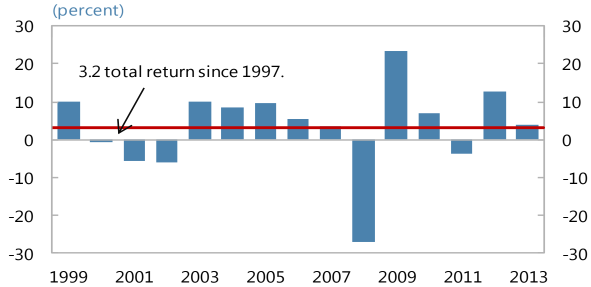
18. A still lower rate of spending in the 2014 budget and beyond would be appropriate in light of the wage pressures and other competitiveness concerns. This would also support the current monetary policy stance, which is constrained by below-target inflation and exchange rate appreciation pressures. The government has recently proposed new tax measures to scale back the preferential tax treatment for residential investment and increase taxation of the oil sector. While both proposed tax changes are small, they remove some of the relative disincentive for productive investment in the non-oil related sector of the mainland economy. At the same time, tax preferences for owner occupied houses remain generous. The staff urged the authorities to gradually reduce these tax preferences by lowering interest deductibility over time.

19. Norway's fiscal institutions, in particular the GPFG and the fiscal rule, are models for other natural resource-exporters. The avoidance of off-budget spending or special purpose funds are also critical elements of the Norwegian model. However, these institutions are not sufficient to fully contain the pressures on competitiveness of the non-oil economy, particularly given the increased role of the mainland economy as a supplier of goods and services to the offshore sector. There are risks to the current approach, including the 4 percent rate of return assumption, a possible oil price decline, and the long-run costs associated with an aging population. [8]

- ***Non-oil deficit target:*** Because the fiscal rule stabilizes the non-oil deficit relative to GPFG assets but not relative to mainland GDP, the likely path of GPFG assets implies a steady widening of non-oil fiscal deficits over the medium-term and into the next decade. This would not bode well for competitiveness in the mainland economy. The investments of oil and gas income in the GPFG and the expenditure rule have helped to insulate Norway from "Dutch disease" effects, but the insulation has not been complete. Private investment and employment are increasingly concentrated in oil-related industries in the mainland economy and non-tradable services. While this boom in the oil-related parts of the mainland economy is good for employment and income, it is putting the non-oil-related parts of the economy under strain. Although fiscal policy is not the main source of these pressures of the non-oil mainland economy, it represents the best policy instrument to address it under the current conditions.

- ***Real rate of return assumption:*** The expected real return assumption of 4 percent is too optimistic. The average rate of return over the life of the GPFG has been below 3.2 percent, and experience with similar asset portfolios also indicates that returns are likely to be lower than 4 percent (see Chapter 3 of the Selected Issues paper).

Evolution of Real Returns of GPFG 1/
(percent)

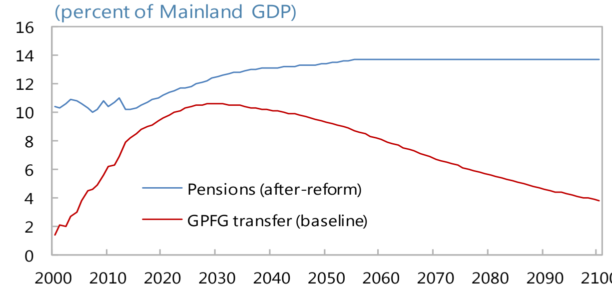


Source: Norges Bank Investment Management (NBIM).
1/ Data for 2013 are as of March 31.

- ***Uncertainty about oil prices:*** In the event of a prolonged decline in oil prices during the remaining years of near-peak production, the total long-run assets of the GPFG could be considerably lower than projected. The long-run value of the fund would be lower still to the extent that the fiscal transfers from the GPFG exceed the real rate of return.

- ***Aging-related expenditures:*** The long-run health, pension, and other costs associated with an aging population will entail costs far in excess of what could be financed from the GPFG.[9] Unless taxes are raised – from already high levels – or other expenditure is cut

Age-related Expenditures Relative to GPFG Transfers
(percent of Mainland GDP)



Sources: Ministry of Finance and IMF staff calculations.

[8] Chapter 3 of the Selected Issues paper examines the fiscal rule by considering various scenarios. See also Box 5.

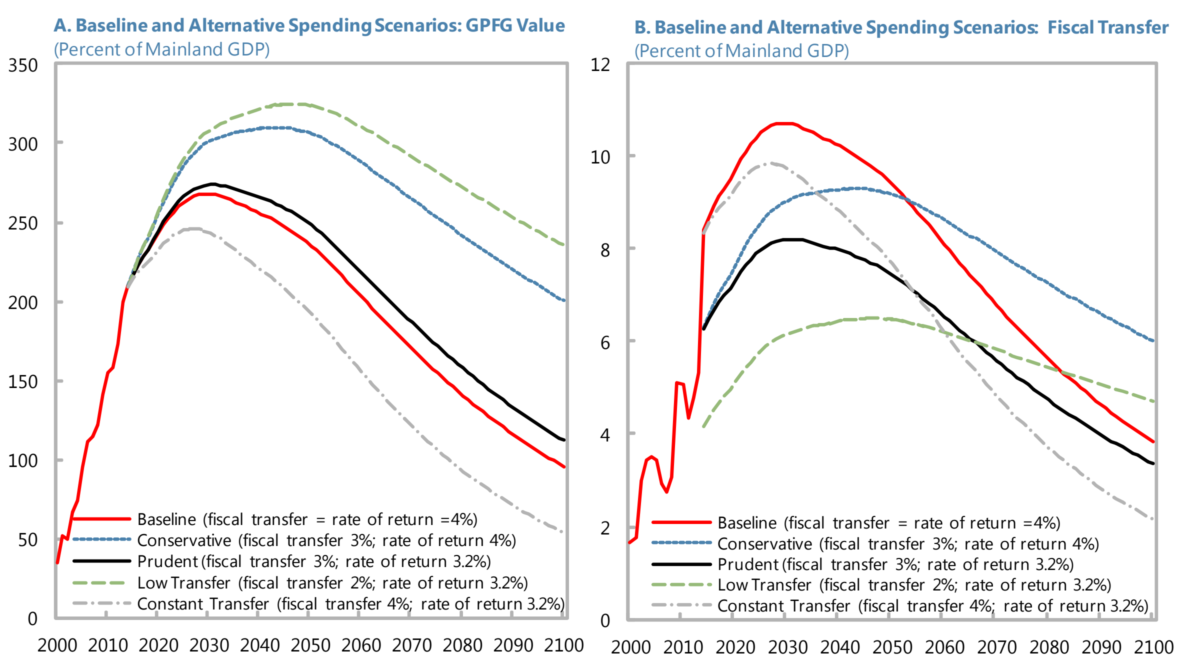
[9] The latest European Commission Ageing Working Group (AWG) report estimates that Norway faces the highest increases in age-related expenditures during 2010–60 period among a large group of European countries.

sharply, some additional measures will be needed to contain health and aging-related expenditure. The recent pension reform is a substantial down payment on this very tall challenge, but it will be many years before its full impact on spending and labor force participation is clear.

Box 5. The Implications of the Fiscal Rule Under Different Assumptions

The implications of the fiscal rule for the ultimate size of the GPFG and the fiscal resources it can provide in the long term are very sensitive to assumptions and parameter choices. The real rate of return, the size of fiscal transfer from the GPFG, and other assumptions and parameters (e.g., oil prices) all have an important effect on the long run value of the GPFG and the fiscal transfer (e.g., in the latter part of the century). However, the size of the fiscal transfer over the next decade is only modestly affected by the true real rate of return or the oil price assumption under plausible parameter values.

The various challenges posed by the fiscal rule are affected differently by different parameters. Because the only variable that would have much effect on the size of the fiscal transfer over the next two decades is the amount of the annual fiscal transfer itself as a share of GPFG assets, this parameter is the key to addressing concerns about the effect of the fiscal transfer on the competitiveness of non-oil related parts of the mainland economy. However, the true real rate of return becomes more important at longer time horizons, and the difference between the real rate and the fiscal transfer would be more important in addressing concerns related to intergenerational equity or aligning the fiscal transfers more closely with aging-related costs. This is illustrated in a baseline projection and four alternative combinations of ex post rates of return and annual fiscal transfers. These and other scenarios (e.g., varying oil prices) are discussed in greater detail in Chapter 3 of the Selected Issues Paper.



Sources: IMF World Economic Outlook, Ministry of Finance, Norges Bank, and IMF staff calculations.

20. In light of the above considerations, a more conservative approach to implementation of the fiscal rule would be desirable. Various aspects of the current rule could be reassessed, including the realism of the 4 percent real rate of return assumption. However, the only change that would make much difference for the fiscal impulse in the near- and medium-term would be a change in the rate of fiscal transfer as a share of the GPFG's assets. The authorities have sufficient flexibility to reduce the rate of transfer so long as current conditions persist. This would help contain pressures on competitiveness and promote long-run stability within the real economy.

Authorities' views

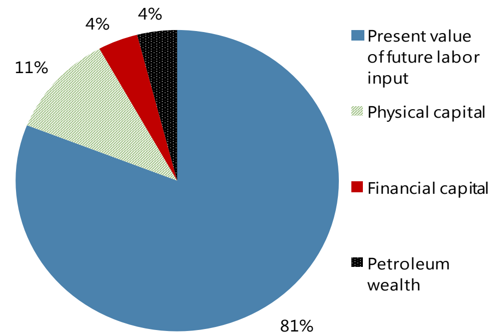
21. The authorities agreed with much of the staff's stance, but had difference of emphasis and degree, particularly as regards the fiscal rule. They shared the concerns about the long-term competitiveness problem and high wage costs, and they had put particular emphasis on the growing divide between oil- and non-oil-related parts of the mainland economy for that reason. For the near term, the Finance Minister had signaled the intention to spend less than the expected long-term return on the GPFG in 2014 and announced a reduction of taxes on mainland businesses and a slight increase of oil-related taxes recently.

22. The authorities emphasized the success of the fiscal rule over the medium- and longer term in containing and smoothing spending from oil-related revenues since its introduction in 2001. They also noted that the rule is not rigid, and allows for variation in the share of GPFG assets transferred to the budget in light of economic conditions, as has been the case in recent years. They did not disagree that the difference between the 3.2 percent real rate of return experienced thus far and the assumed 4 percent would have large consequences if it persisted over the very long run; however, they took the view that the observed difference thus far fell well short of statistical significance given the high volatility of assets returns and the short history of the GPFG. They had concerns that reopening it risked ending up with a worse outcome and one that would go in the opposite direction from the staff's advice. They agreed strongly that oil-related revenue would not be the solution to aging-related expenditures. They also made the point that most of the wealth of the Norwegian economy was in the human capital of Norwegians rather than oil or the proceeds from its sale (Box 6).

Box 6. A Norwegian Perspective on Oil and Gas, the GPFG, and National Wealth

Most of the real wealth of the Norwegian economy is in its people rather than in the hydrocarbons from the continental shelf or the financial proceeds from their sale. "Although the value of the Government Pension Fund Global and the remaining petroleum reserves are considerable assets, they are modest compared with revenue generated by the mainland economy. Activity in the mainland economy is the primary basis for production, employment, and income. As for most other countries, the main component of national wealth is the value of the work performed, now and in the years to come.." /1

Net National Wealth per Capita, 2010
(Percent)



Sources: *Long-term Perspectives on the Norwegian Economy*: Ministry of Finance and IMF staff calculations.

1/Long-term Perspectives on the Norwegian Economy, Ministry of Finance, 2013

B. Monetary Policy

23. **Norges Bank's monetary policy stance has been unchanged since March 2012.** The policy rate is currently 1.5 percent. Wage growth, a positive output gap, and the stabilization of the exchange rate appreciation should increase inflation gradually to the 2.5 percent target by 2018. The staff agreed with the authorities that the current policy stance is appropriate in light of below-target CPI inflation. While overheating in property markets is a concern, monetary policy is constrained by the lower-than-target inflation and the appreciating exchange rate.

Authorities' views

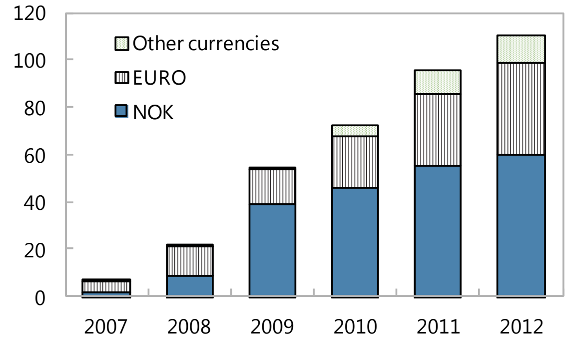
24. **The authorities reemphasized that the current monetary policy stance is appropriate in light of low CPI inflation.** The authorities noted that the current policy rate is higher than what would have been implied by a rule that focused only on inflation and output, and vulnerabilities stemming from rising house prices need to be addressed through macro prudential and other financial sector policies.

C. Financial Sector Issues

25. **The proposed legislation to increase capital requirements for banks in line with, but ahead of, the Basel III requirements, including the proposed counter-cyclical buffer is welcome.** The authorities are preparing to implement a counter-cyclical buffer rule in 2014 that will require banks to build up additional capital in line with the draft EU banking regulations (CRD IV). More capital to support exposures will strengthen banks and might help to appropriately tighten lending standards, including for housing. This should not be disruptive to credit as banks have already begun raising capital ratios in anticipation of higher capital requirements.

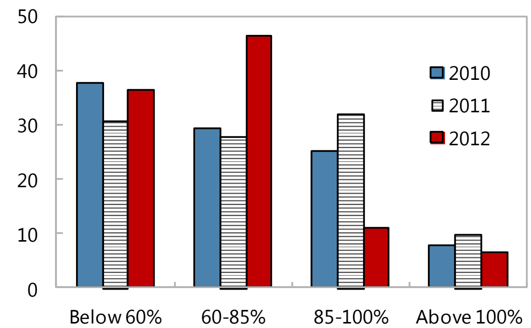
26. Notwithstanding its strength, there remain risks in the financial system. Banks' and their mortgage company subsidiaries have increased securities issuance, including covered bonds. Two-thirds of this is foreign debt. While this is largely hedged against exchange rate movement, the reliance on wholesale funding exposes the system to a risk of a sharp rise in interest rates. Moreover, the rapid rise of covered bonds creates incentives to shift lending toward households rather than corporates and increases risks to unsecured creditors and depositors. The use of covered bonds should be monitored closely and limits on issuance should be considered for individual banks or the banking system if the issuance of covered bonds leaves too few unencumbered high-quality assets on banks' balance sheets or otherwise increases risks. Some scaling back of the generous tax incentives for housing would also help limit overinvestment in housing relative to other assets.

Outstanding Amount of Covered Bonds by Currency
(Billion euro)



Sources: Norwegian Covered Bond Council and IMF staff calculations

Distribution of LTV for New Loans 1/
(Percent)



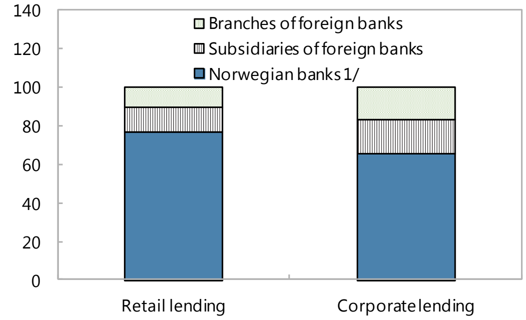
Sources: Norway FSA and IMF staff calculations.
1/ Based on FSA's annual survey.

27. Residential mortgage lending should continue to be closely monitored. The FSA tightened guidelines for residential mortgage lending in December 2011, by lowering the maximum LTV on mortgages to 85 percent and recommending that banks ensure borrowers can withstand an interest rate increase of 5 percentage points when assessing borrower's debt service capacity. Mortgage loans exceeding the recommended 85 percent ceiling fell in 2012, even though they still accounted for 17 percent of new loans. Interest-only mortgage loans have been close to 20 percent of all new loans for the past few years. In light of already elevated household debt, the staff urged the authorities to consider tighter limits on interest-only mortgage loans to limit risks.

28. The staff welcomed the authorities' proposals to reassess relatively low risk weights on residential mortgages. These create creating incentives to shift lending toward households rather than corporates. The size of risk weights on residential mortgages needs to be assessed in the context of strengthening banks' capital to minimize incentives for banks to reduce corporate lending to meet the new capital requirement.

29. The authorities emphasized and staff agreed on the need for better coordination within the Nordic region on macroprudential measures for banks.[10] Banks headquartered in other Nordic countries, mostly organized as branches, account for a substantial share of banking in Norway. EU banking regulations apply to Norway under the European Economic Area (EEA) agreements, and the home country supervisors are responsible for most macroprudential policies for branches. In this context, more regional cooperation, including minimum regulatory standards, would help minimize regulatory arbitrage. The staff welcomed the ongoing Nordic cooperation on macroprudential and financial supervisory issues, including a high-level working group to assess various aspects of the Basel III/CRD IV framework in the Nordic context.

Market Shares of Banks and Covered Bond Mortgage Companies
(Percent, as of Sep 2012)



Sources: Financial Stability Report 2/12 and IMF staff calculations.
1/ Including DNB Bank, SpareBank 1-alliansen, Terra-Gruppen, other savings banks, and other commercial banks.

Authorities' views

30. The authorities considered that an early implementation of Basel III requirements, including the counter cyclical capital buffer, would mitigate a build-up of financial vulnerabilities in the near- and medium-term. While taking the view that tightening of risk weights preferably should be done in a Nordic context to minimize regulatory arbitrage and ensure a level playing field for all Nordic banks, they took the view that taking actions to increase capital against housing and credit risks on their own was important. The authorities forcefully agreed with a need for cooperation within the Nordic region on macroprudential measures to ensure foreign branches in Norway to operate in line with Norwegian prudential requirements.

D. Other Structural Policies

31. Work has been done to identify areas that offer potentially large gains from structural reforms. These areas include labor and pension policies, competition and trade policies, and the efficiency of public sector services. These have been subject to recent and thorough analysis by the OECD and WTO, among others. The staff discussed with the authorities reforms taken in the areas identified by the OECD and WTO, and prospects for future reforms.

- **Labor market and pensions:** Participation rates remains high; however, total work hours are low and sickness leave and disability-related early retirement are at levels that seem inconsistent with Norway's otherwise excellent health indicators. The recent pension reforms introduced an adjustment of pensions for changes in life expectancy, flexible retirement starting at age 62 based on actuarial principles, and new rules for indexation of pensions. The full impact of the

[10] The Nordic Regional Report considers financial risks from regional perspectives.

reform is yet to be known, but Statistics Norway estimates that total man-hours will increase by roughly 7 percent in 2050.[11] The staff urged the authorities to complete the pension reform by fully aligning the rules for public sector pensions with the principles of the recent pension reform. Further reform to sickness and disability benefits should be considered, including strengthening the monitoring of eligibility for sickness benefits.

- **Competition and trade policies:** Norway's trade policies compare favorably with peer countries. However, trade policies for agricultural products competing with Norwegian farms are more restrictive than those of the EU and have recently become still more restrictive for some products. A recent study by Eurostat ranked Norway's food costs as the highest in Europe. Reduction of agricultural trade barriers could help contain the rising cost of living.

- **Public sector efficiency:** There is scope for greater efficiency in the provision of public services, including making more effective use of cost-benefit, quality assurance, and other methods of assessing spending efficiency in prioritizing public current and capital expenditure.

Authorities' views

32. The authorities agreed the need for furthering reforms of pension, sickness, and disability benefits given the long-run contingent obligations. They reported that there are no plans to change policies for agricultural products although they agreed with the economic assessment of their effects. They generally agreed with the importance of improving public sector efficiency, but also noted that many assessment and evaluation tools are already in place.

STAFF APPRAISAL

33. Norway's economy continues to perform well. Over the last two years, mainland GDP has grown steadily and looks likely to continue to do so over the medium term. Inflation is below the 2.5 percent target and unemployment has been low and stable at around 3 –3½ percent, and the value of the krone seems broadly appropriate for current macroeconomic conditions.

34. The monetary policy stance remains appropriate in light of below-target core CPI inflation. Monetary policy is constrained by possible upward pressure on exchange rates and the lower-than-target inflation rate. A tightening of policy might help cool housing markets, but at the cost of likely exchange rate appreciation and additional pressure on the non-oil-related sectors of the mainland economy. In this context, risks from house prices should be addressed instead through macroprudential policies.

[11] See also Holzmann, Robert, Edward Palmer and David Robalino, 2012, *Nonfinancial Defined Contribution Pension Schemes in a Changing Pension World* : *Volume 1. Progress, Lessons, and Implementation,* the World Bank. Chapter 4 of this volume discusses Norway's 2011 pension reform.

35. The government has used the flexibility in the fiscal rule prudently. A continuation of the prudent fiscal stance would not offset the pressures on competitiveness, but it would limit how much fiscal policies added to them. A lower rate of spending in the 2014 budget and beyond would be appropriate in light of the wage pressures and other competitiveness concerns. In this regard, the recently proposed tax measures to limit preferential tax treatment for residential investment and increase taxation of the oil sector should help slow the erosion of competitiveness.

36. Competitiveness concerns and future fiscal liabilities from an aging population also argue for a slower rate of spending than the strictest interpretations of the fiscal rule would suggest. A more conservative approach would not only guard against the risk to competitiveness for sharply rising transfers to the budget from the GPFG but would also provision against long-run downside risks. Further reform to sickness and disability benefits would likely improve the efficiency and competitiveness of the economy, but they would also help contain the large fiscal liabilities from an aging population. A slower rate of fiscal transfers from the GPFG would complement such reforms by better aligning long-run spending obligations with fiscal transfers.

37. The staff supports the proposed legislation to increase capital requirements for banks in line with the Basel III requirements. Financial sector balance sheets are improving and the funding structure of banks is now more robust, but they would still be vulnerable in the event of property price reversals or a disruption to external wholesale funding. More capital to support exposures will further strengthen banks and might encourage banks to appropriately tighten lending standards, including for housing. In this context, the staff also welcome the proposal to reassess risk weights for residential mortgages.

38. There is also a need for more cooperation within the Nordic region on macroprudential measures for banks. The Norwegian authorities can tighten risk weights and other conditions for Norwegian banks (including subsidiaries of foreign banks), but a substantial part of the banking system in Norway consists of branches of foreign banks. Regional cooperation is needed to ensure that foreign-headquartered bank branches lend in line with Norwegian economic conditions.

39. Reforms in disability benefits, lower trade barriers, and more efficient public services could improve cost competitiveness and improve the efficiency of the economy. In particular, the pension reform needs to be completed by fully aligning the rules for public sector pensions with the principles of the recent pension reform. Further reform to sickness and disability benefits are needed, including strengthening the monitoring of eligibility for sickness benefits.

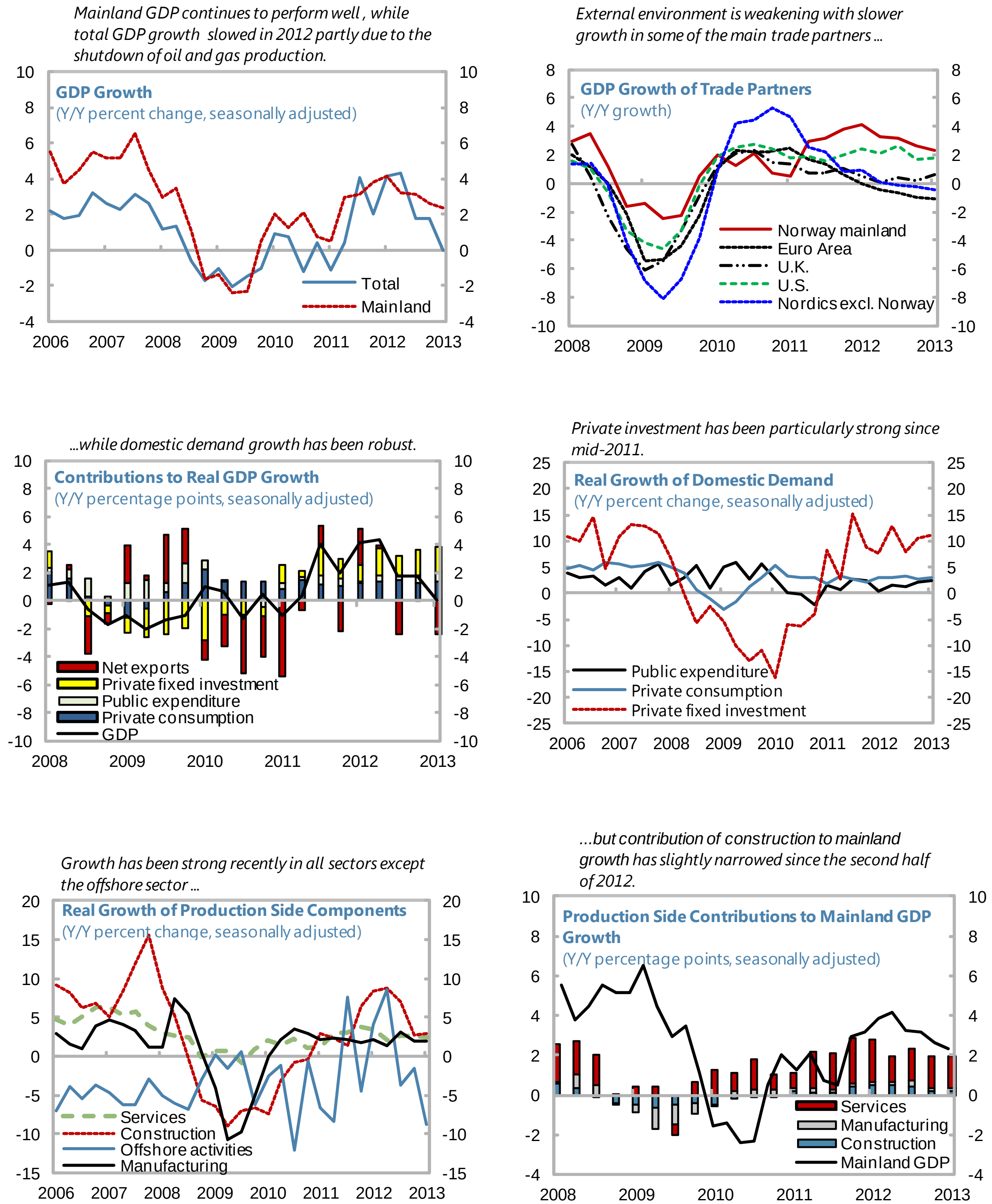
40. It is recommended that the next Article IV consultation with Norway be held on the 24 month cycle.

Norway: Risk Assessment Matrix

Source of Risks	Overall Level of Concern	
	Relative Likelihood (high, medium, or low)	**Expected Impact if Risk is Realized** (high, medium, or low)
1. Protracted period of slower European growth	**High** ● The adverse impact of the ongoing public and private sector deleveraging on the real economy could be larger than currently expected, reducing potential output and lowering growth in the euro area over the medium term.	**Medium** ● Slower European growth in an extended time period would affect Norway, through weaker non-oil exports and lower oil prices. Lower asset prices would have negative impacts on the rate of return to GPFG.
2. Significant reduction in house prices	**Medium** ● Norway has the highest house price-to-rent ratio relative to its historical average among all OECD economies. ● Although this can be partly explained by fundamentals, there is a risk of significant overvaluation.	**High** ● A fall in house prices would dampen private consumption and reduce residential investment. ● The high level of household debt may cause households to cut consumption sharply, and reduced retail sales could lead to an increase in default rates that would severely hurt banks' balance sheets.
3. Financial stress in the euro area re-emerges	**Medium** ● If euro area policy commitments are only partially met, fiscal stress could re-emerge and bank-sovereign links could re-intensify, resulting significant negative shocks to growth.	**Medium** ● Re-emergence of euro zone stress and an associated slowdown in growth would affect Norway via shaken consumer confidence, lower non-oil exports, and falling oil prices. This could also reduce foreign funding for Norwegian banks and tighten lending conditions.
4. Sharp slowdown in growth in China	**Medium** ● A sharp slowdown in growth in China could occur if excess capacity through investment builds up over the medium term, eventually resulting in increased bankruptcies and large financial losses.	**Medium** ● A sharp slowdown in growth in China could have negative impacts on oil prices and aluminum prices.
5. Substantial and prolonged reduction in oil prices	**Low** ● A considerable and prolonged reduction in oil prices could occur if downside risks to the global growth outlook were to materialize.	**High** ● This would undercut growth directly, through a reduction in the oil-related demand for mainland goods and services, and indirectly through a possible reduction in demand for housing due to confidence effects or a reversal of immigrant inflows.

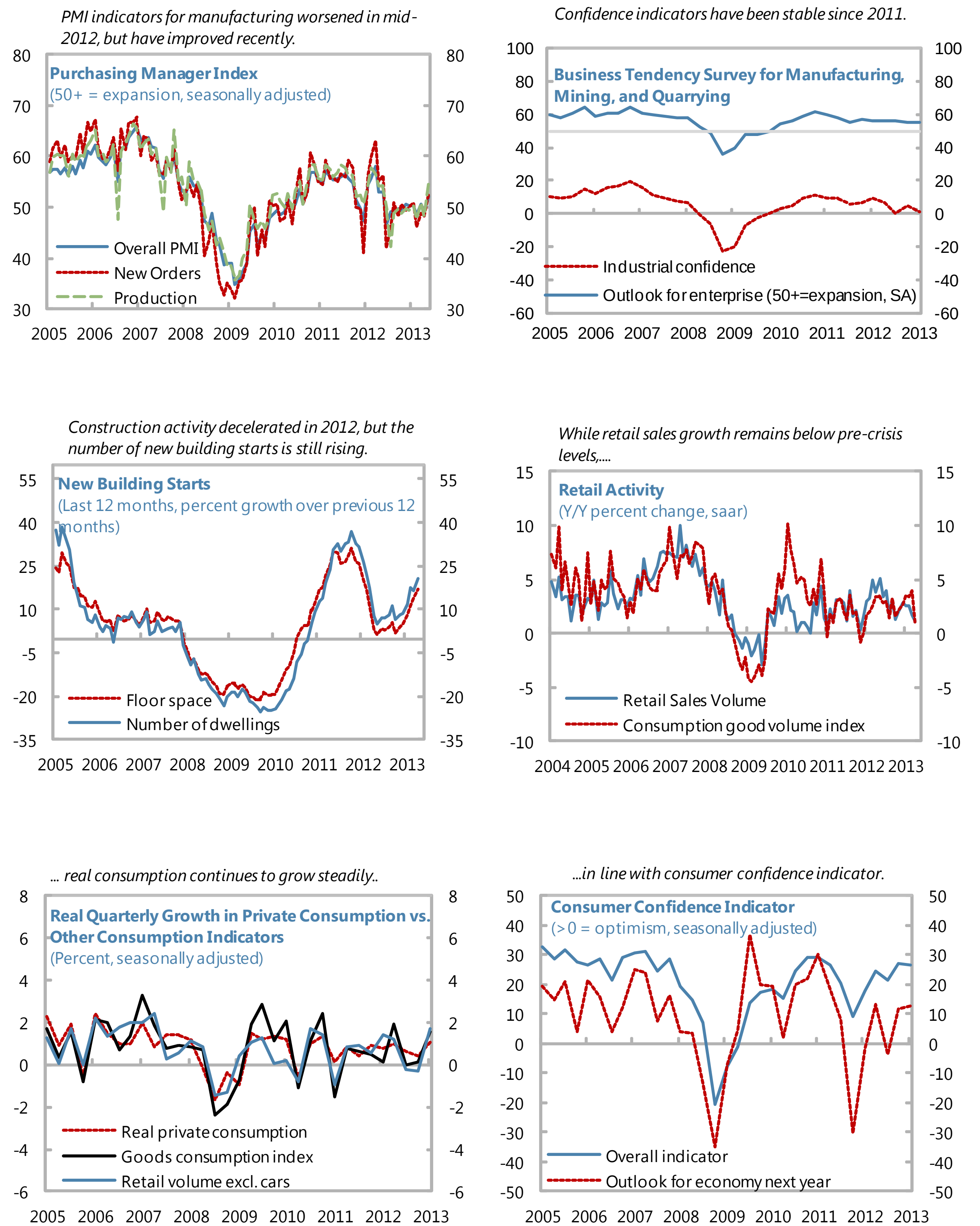
Note: The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

Figure 1. Norway: GDP



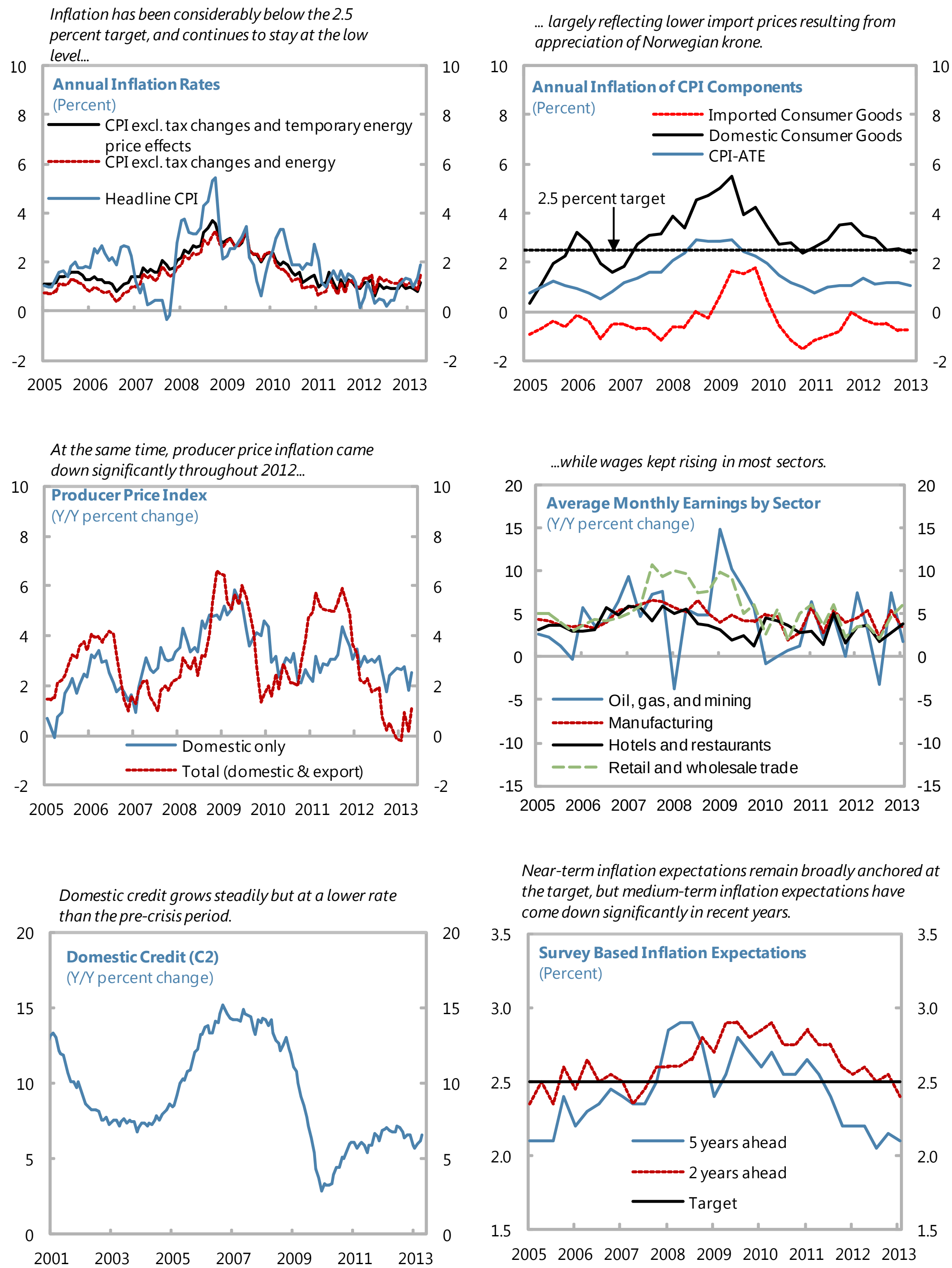
Sources: Haver Analytics and IMF staff calculations.

Figure 2. Norway: Key Activity Indicators



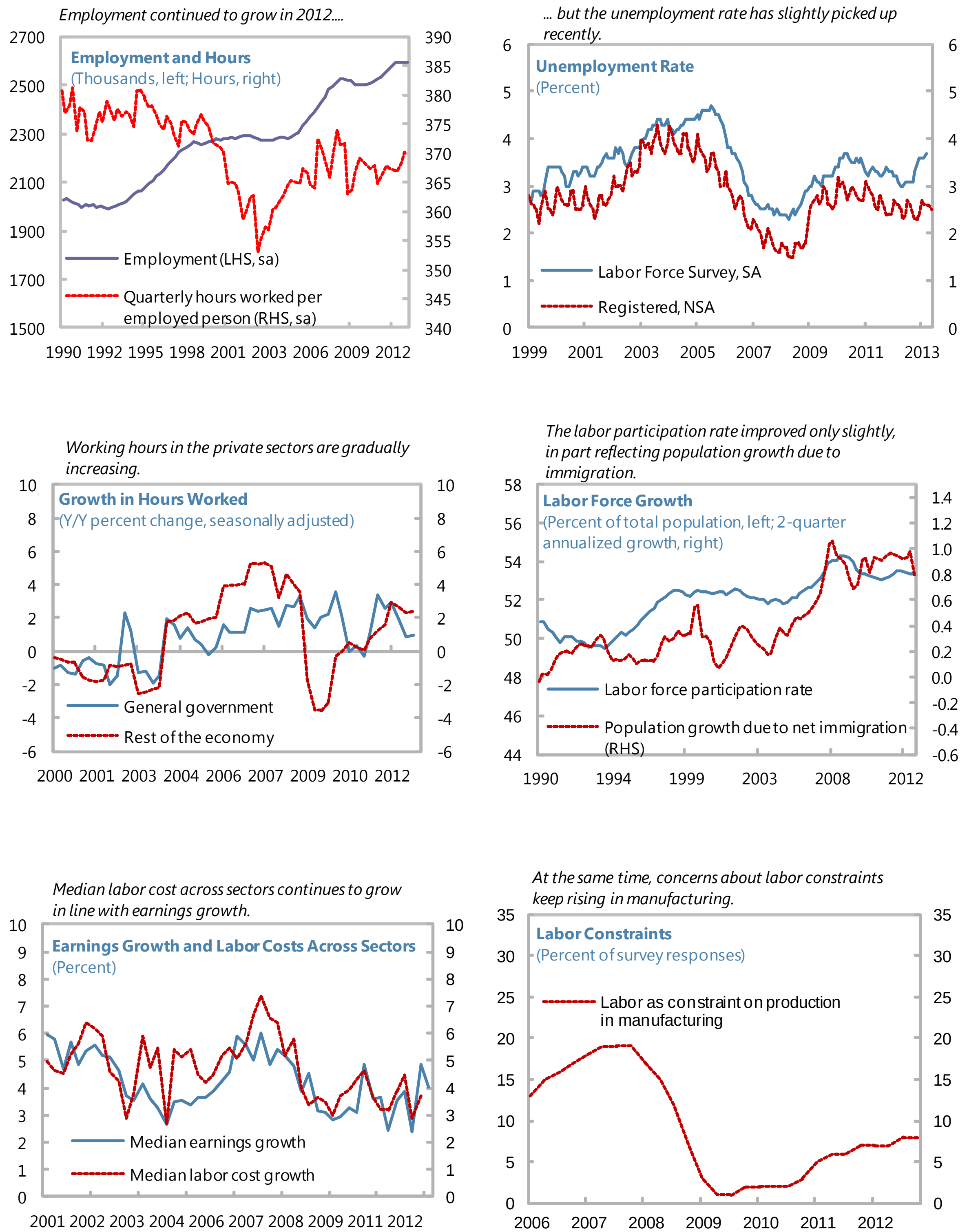
Sources: Haver Analytics and IMF staff calculations.

Figure 3. Norway: Price Developments



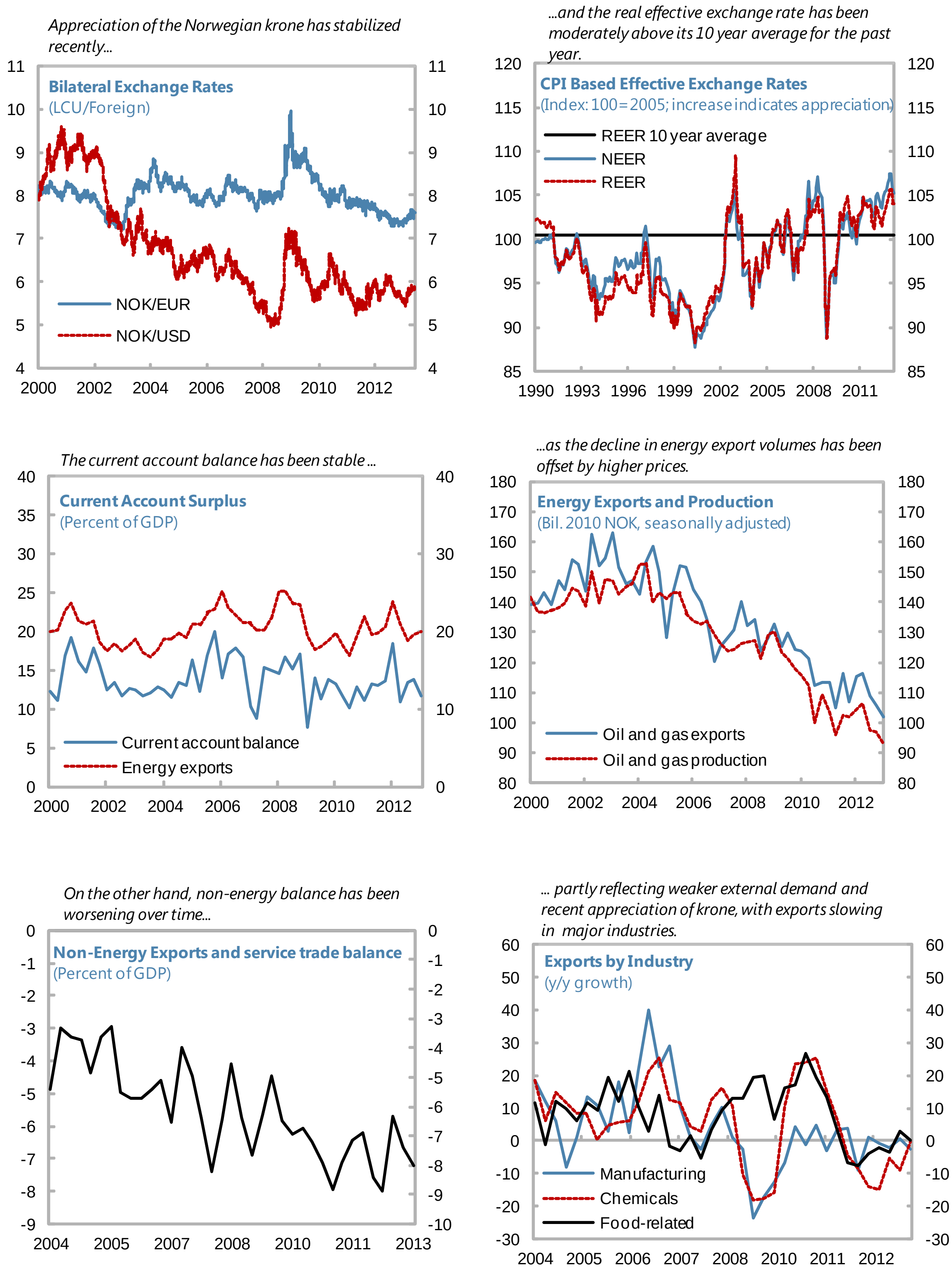
Sources: Haver Analytics, Norges Bank, and IMF staff calculations.

Figure 4. Norway: Labor Market



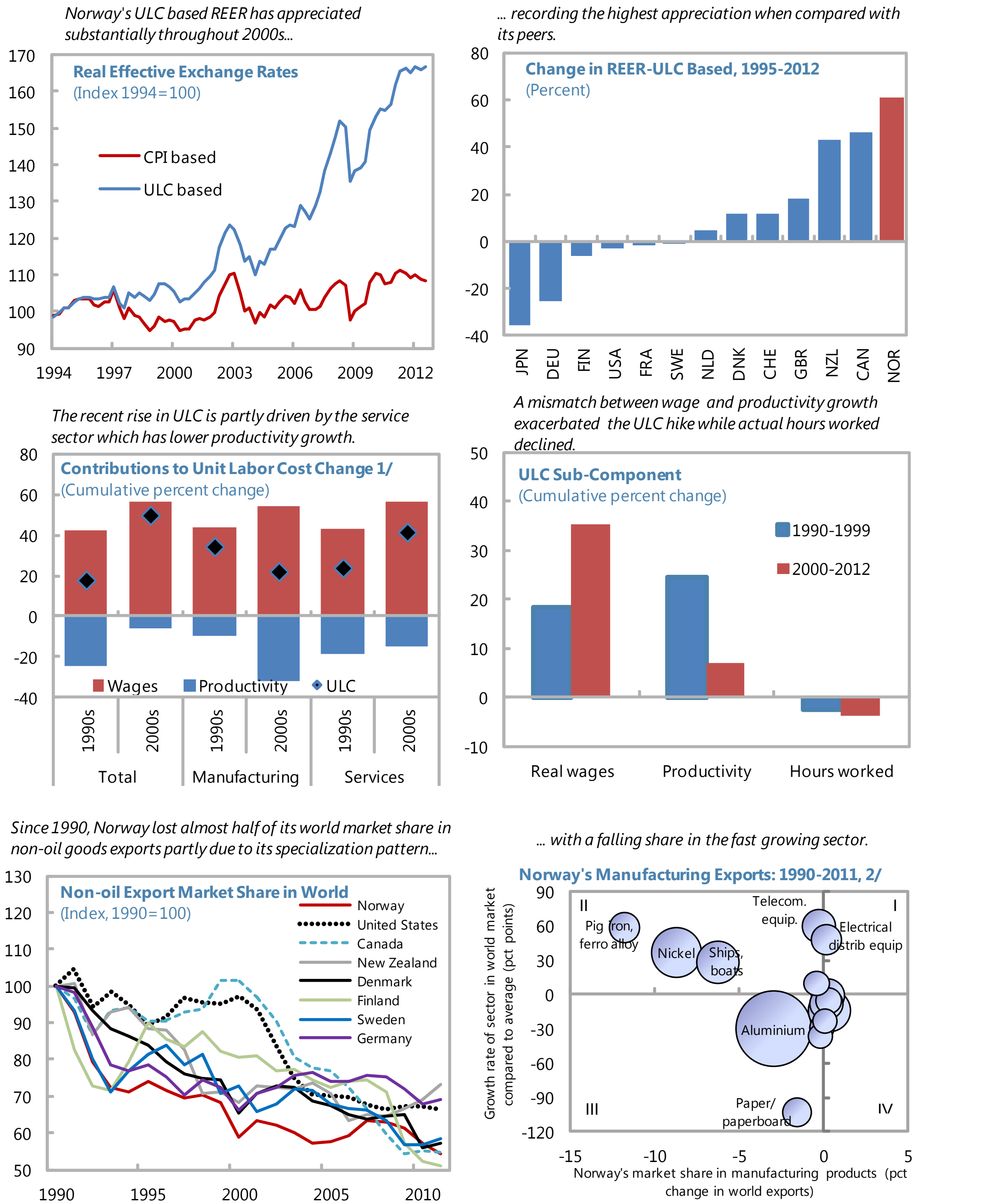
Sources: Haver Analytics and IMF staff calculations.

Figure 5. Norway: External Developments



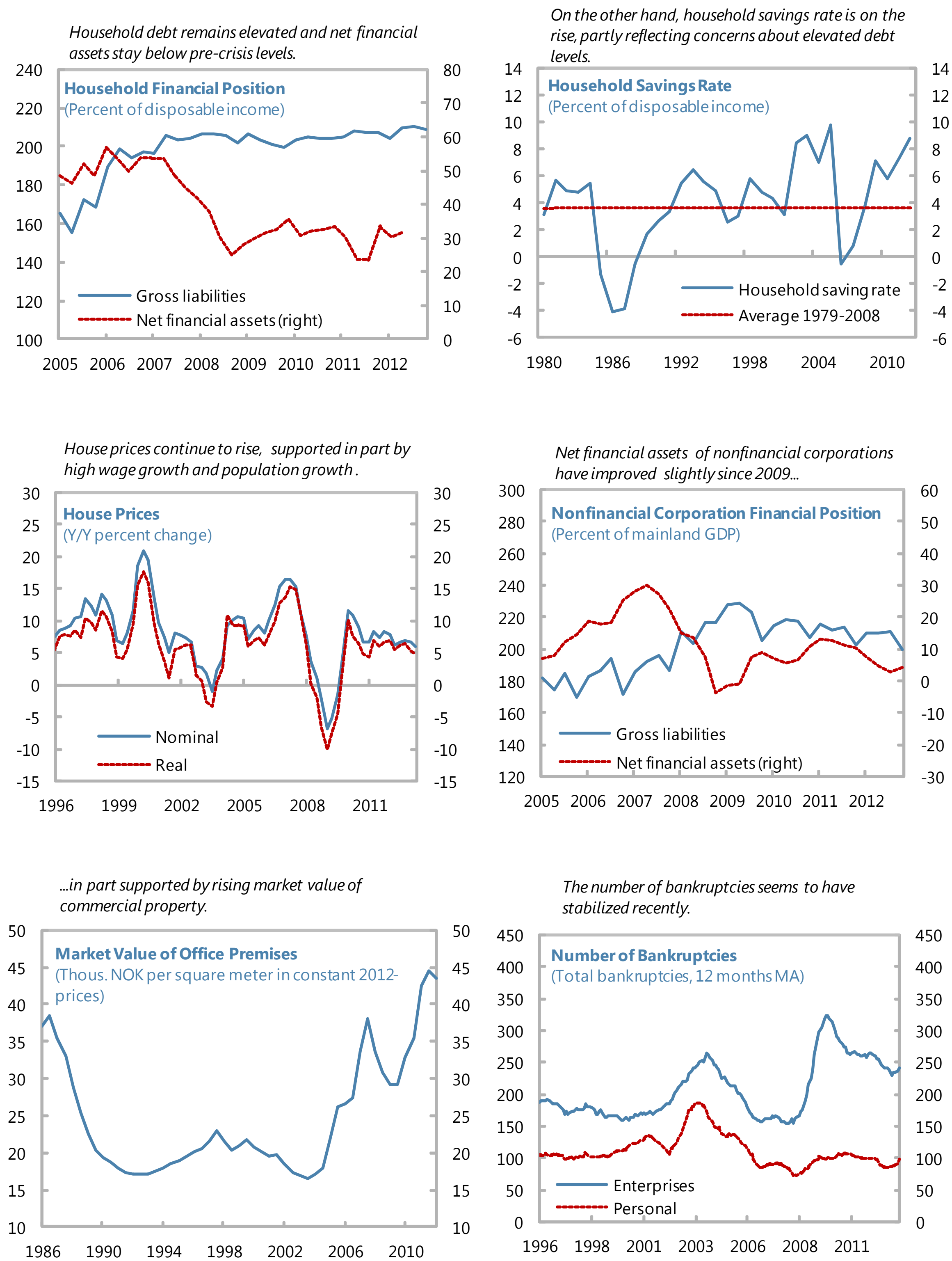
Sources: Haver Analytics, IMF Institute, and IMF staff calculations.

Figure 6. Norway: Competitiveness Indicators



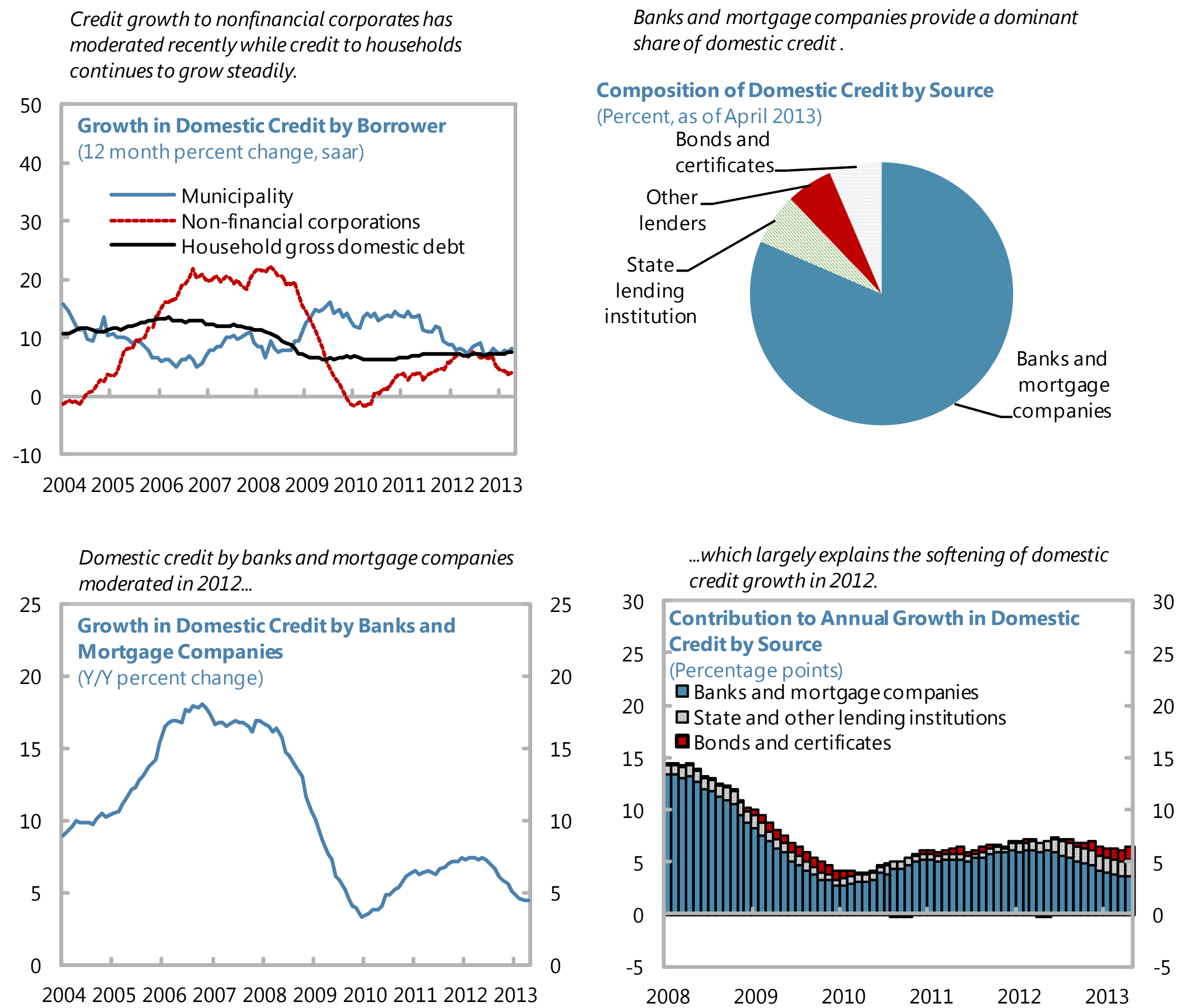
Sources: Ameco, Comtrade, EC commission, and IMF staff calculations.
1/ Negative sign for productivity means growth, not decline.
2/ Based on the largest 15 (SITC-3) sectors in manufacturing. Size of bubble proportional to share in total goods exports. I-quadrant captures Norway's growing share and fast growing sector in world demand. Similarly, II-quadrant captures falling share and fast growing sector. III-quadrant captures falling share and slow growing sector. IV-quadrant captures growing share and slow growing sector.

Figure 7. Norway: Household and Corporate Sector



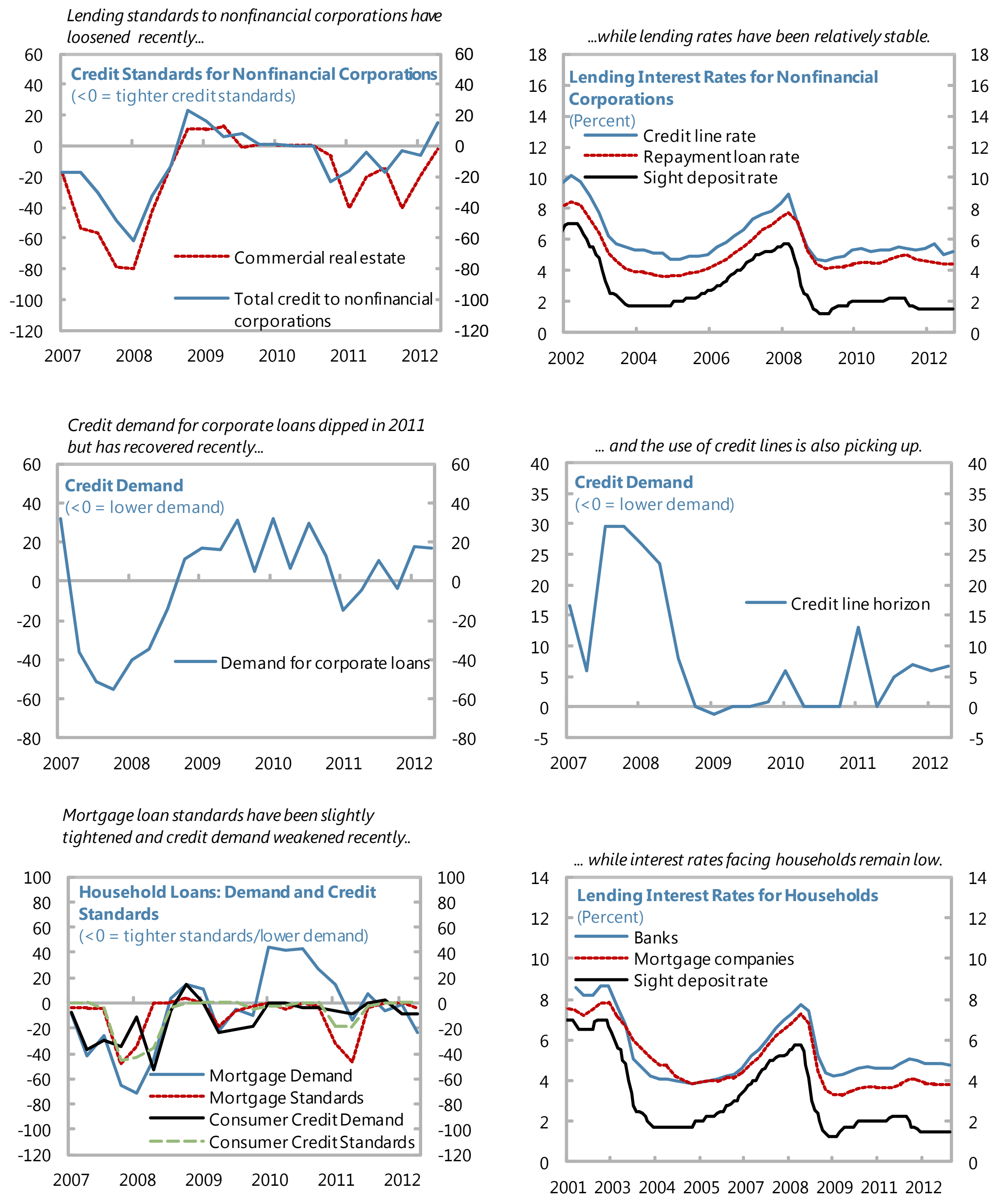
Sources: Haver Analytics, Norges Bank, Statistics Norway, and IMF staff calculations.

Figure 8. Norway: Credit Market Developments



Sources: Statistics Norway and IMF staff calculations.

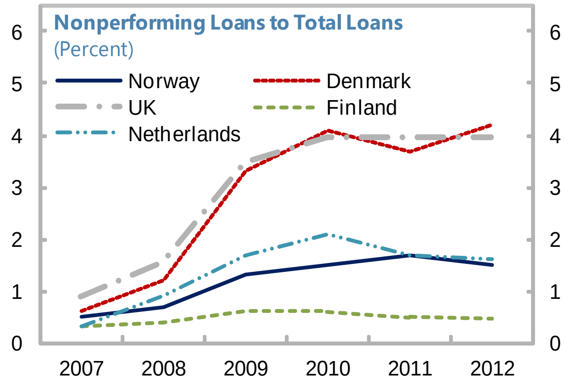
Figure 9. Norway: Credit Standards and Lending



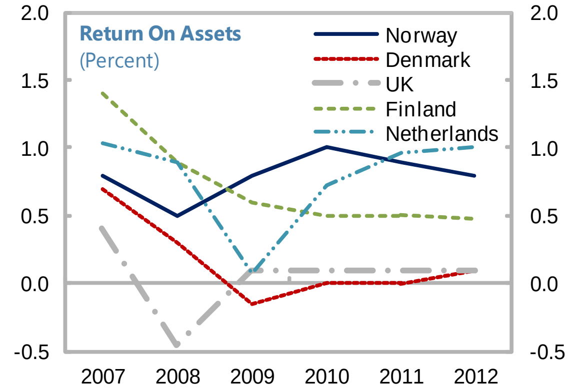
Sources: Haver Analytics, Statistics Norway, and IMF staff calculations.

Figure 10. Norway: Nordic Banks' Relative Performance

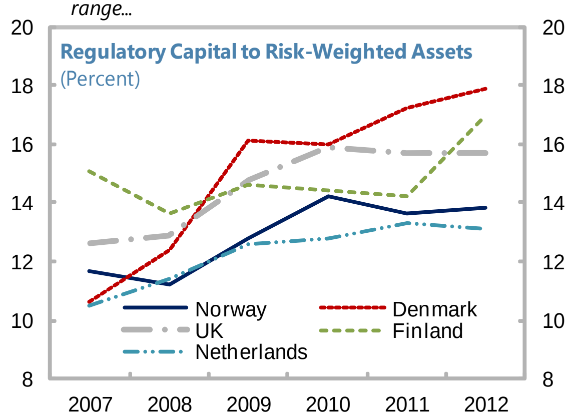
The level of nonperforming loans is relatively low, but is gradually rising after the crisis.



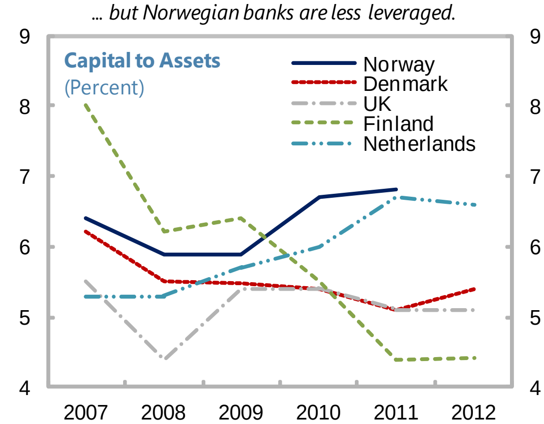
Return on assets is higher than other countries in the region, but it fell somewhat recently.



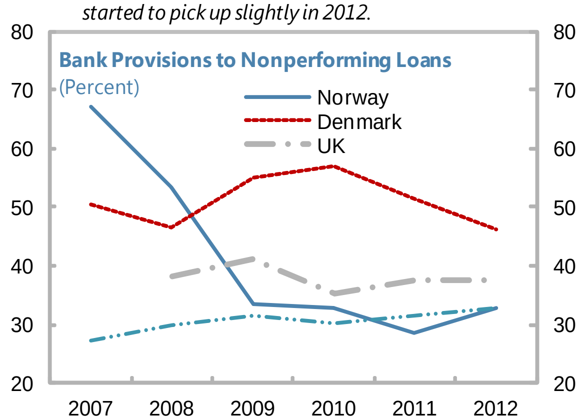
The capital adequacy ratio is within the regional range...



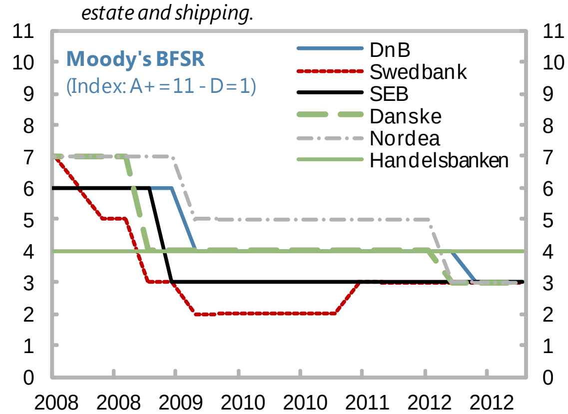
... but Norwegian banks are less leveraged.



On the other hand, provisioning is relatively low but started to pick up slightly in 2012.

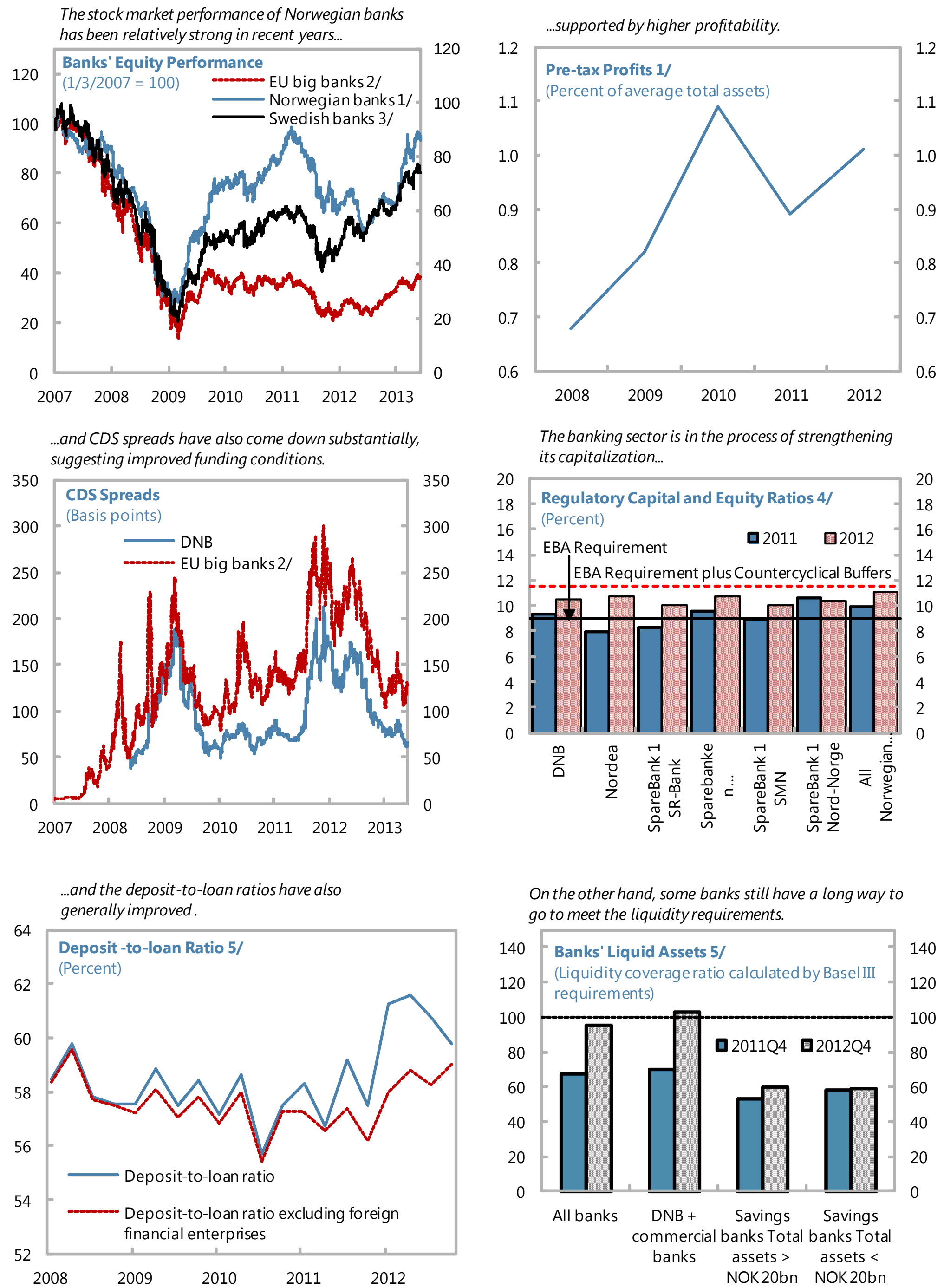


DnB was downgraded in May 2012 partly due to exposures to volatile assets such as commercial real estate and shipping.



Sources: IMF Financial Soundness Indicators, Moody's Analytics, and IMF staff calculations.

Figure 11. Norway: Bank Performance



Sources: Bloomberg LP, DataStream, Norges Bank, and IMF staff calculations.
1/ Includes DNB, Sparebank SMN, Sparebank Norge, and Sparebank SR.
2/ Simple average of RBS, Lloyds, Barclays, HSBC, and UBS.
3/ Simple average of Danske, Swedbank, SEB, and Handelsbanken.
4/ All Norwegian banks and Norwegian banking groups with assets greater than 60 billion NOK.
5/ All banks and mortgage companies in Norway, excluding branches and subsidiaries of foreign banks in Norway.

Table 1. Norway: Selected Economic and Social Indicators, 2006–14

Population (2012): 5 million
Per capita GDP (2012): US$ 99,462
Literacy: 100 percent
Main products and exports: Oil, natural gas, fish (primarily salmon)

								Projections	
	2006	2007	2008	2009	2010	2011	2012	2013	2014
Real economy (change in percent)									
Real GDP 1/	2.3	2.7	0.0	-1.4	0.2	1.3	3.0	1.9	2.3
Real mainland GDP	4.8	5.3	1.5	-1.4	1.5	2.6	3.3	2.8	2.8
Domestic demand	6.0	5.7	1.1	-4.1	3.4	3.6	3.3	3.8	2.9
Private consumption	5.1	5.4	2.0	-0.1	3.6	2.5	3.1	3.6	3.3
Private mainland fixed investment	10.7	14.7	-2.4	-18.4	-3.9	10.4	5.1	5.7	5.1
Government consumption	1.9	2.7	2.4	4.5	1.2	1.9	1.6	2.1	2.1
Unemployment rate (percent of labor force)	3.4	2.5	2.6	3.2	3.6	3.3	3.2	3.3	3.3
Output gap (mainland economy, - implies output below potential)	1.2	2.6	1.7	-0.9	-1.0	0.0	0.3	0.2	0.2
CPI (average)	2.3	0.7	3.8	2.2	2.4	1.3	0.7	1.5	1.5
CPI (end of period)	2.2	2.8	2.1	2.0	2.8	0.2	1.4	1.5	1.5
Gross national saving (percent of GDP)	39.4	38.3	40.4	34.0	35.2	36.9	39.2	37.6	37.5
Gross domestic investment (percent of GDP)	23.0	25.8	24.5	22.3	23.3	24.1	25.0	26.7	27.5
Public finance									
Central government (fiscal accounts basis)									
Overall balance (percent of mainland GDP) 2/	19.4	17.9	21.7	9.8	8.6	13.0	13.4	9.7	...
Structural non-oil balance (percent of mainland trend GDP) 3/	-3.0	-2.8	-3.1	-5.0	-5.0	-4.3	-4.8	-5.4	...
in percent of Pension Fund Global capital 4/	-3.4	-2.7	-2.8	-4.2	-3.8	-2.9	-3.2	-3.3	...
General government (national accounts basis)									
Overall balance (percent of mainland GDP)	24.9	22.7	25.8	13.4	14.2	17.6	18.4	14.8	13.3
Net financial assets (percent of mainland GDP)	181.7	182.2	170.0	196.6	209.8	207.7	220.7	238.5	241.2
of which: capital of Government Pension Fund Global (GPFG)	111.2	114.8	122.0	140.6	154.7	158.3	173.8	194.1	199.1
Money and credit (end of period, 12-month percent change)									
Broad money, M2	13.7	16.7	3.8	2.4	5.2	6.2	3.7	...	...
Domestic credit, C2	14.3	14.0	12.0	2.9	6.1	6.9	5.9	...	...
Interest rates (year average, in percent)									
Three-month interbank rate	3.1	5.0	6.2	2.5	2.5	2.9	2.2	...	...
Ten-year government bond yield	4.1	4.8	4.5	4.0	3.5	3.1	2.1	...	...
Balance of payments (percent of mainland GDP)									
Current account balance	22.3	16.4	21.9	14.9	15.3	16.8	18.7	14.1	12.8
Balance of goods and services	23.4	17.9	23.7	15.6	15.3	17.5	17.5	14.1	12.6
Mainland trade balance of goods	-8.0	-8.0	-7.8	-6.5	-6.8	-7.4	-8.0	-7.5	-7.3
Offshore trade balance of goods	30.4	25.8	31.4	21.7	22.0	25.5	26.0	21.8	20.0
Exports of goods and services (volume change in percent)	-0.8	1.3	0.7	-3.7	-0.7	-1.8	1.8	-1.3	1.4
Imports of goods and services (volume change in percent)	9.2	10.1	4.1	-12.7	9.1	3.9	2.3	3.3	3.0
Terms of trade (change in percent)	12.0	-2.3	13.1	-17.4	7.9	9.7	3.2	...	...
International reserves (end of period, in billions of US dollars)	56.8	60.8	50.9	48.9	52.8	49.4	51.9	...	...
Fund position									
Holdings of currency (percent of quota)	91.8	93.3	88.4	80.6	76.6	71.4	71.1	...	...
Holdings of SDR (percent of allocation)	179.5	138.6	169.0	102.4	102.0	97.5	96.1	...	...
Quota (SDR millions)	1,672	1,672	1,672	1,672	1,672	1,884	1,884	...	...
Exchange rates (end of period)									
Exchange rate regime					Floating				
Bilateral rate (NOK/USD), end-of-period	6.3	5.4	7.0	6.2	5.8	5.7	5.8	...	...
Nominal effective rate (2005=100)	99.0	103.4	88.7	101.2	101.3	102.8	106.9	...	...
Real effective rate (2005=100)	99.0	102.8	88.8	102.2	102.6	101.5	105.1	...	...

Sources: Ministry of Finance, Norges Bank, Statistics Norway, International Financial Statistics, United Nations Development Programme 2011, and IMF staff calculations.

1/ Based on market prices which include "taxes on products, including VAT, less subsidies on products".
2/ Projections based on authorities's 2013 revised budget.
3/ Authorities' key fiscal policy variable; excludes oil-related revenue and expenditure, GPFG income, as well as cyclical effects.
4/ Over-the-cycle deficit target: 4 percent.

Table 2. Norway: Medium-Term Indicators, 2010–18

(Annual percent change, unless otherwise noted)

				Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP	0.2	1.3	3.0	1.9	2.3	2.3	2.2	2.2	2.2
Real mainland GDP	1.5	2.6	3.3	2.8	2.8	2.8	2.7	2.7	2.7
Real Domestic Demand	3.4	3.6	3.3	3.8	2.9	2.8	2.7	2.7	2.7
Public consumption	1.2	1.9	1.6	2.1	2.1	2.1	2.1	2.1	2.1
Private consumption	3.6	2.5	3.1	3.6	3.3	3.1	2.9	2.8	2.8
Gross fixed investment	-8.0	7.5	8.1	6.6	3.4	3.5	3.3	3.4	3.4
Public	-6.6	2.0	-0.3	2.5	2.5	2.5	2.5	2.5	2.5
Private mainland	-3.9	10.4	5.1	5.7	5.1	5.2	4.9	4.9	4.9
Private offshore	-15.4	5.3	18.6	10.0	1.0	1.0	1.0	1.0	1.0
Final domestic demand	0.1	3.5	3.9	3.9	3.0	3.0	2.8	2.8	2.8
Stockbuilding (contribution to growth)	2.8	0.2	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Trade balance of goods and services (contribution to growth)	-2.7	-1.8	0.0	-1.5	-0.4	-0.3	-0.3	-0.3	-0.3
Exports of goods and services	-0.7	-1.8	1.8	-1.3	1.4	1.5	1.6	1.6	1.6
Mainland good exports	2.7	-0.1	2.5	2.0	2.6	2.8	2.8	2.8	2.8
Offshore good exports	-8.2	-4.9	-0.1	-5.9	-0.3	-0.3	-0.2	-0.2	-0.2
Imports of goods and services	9.1	3.9	2.3	3.3	3.0	3.0	2.9	2.8	2.8
Potential GDP	0.4	0.3	2.7	2.0	2.3	2.3	2.3	2.3	2.3
Potential mainland GDP	1.7	1.6	3.0	2.9	2.8	2.8	2.7	2.7	2.7
Output Gap (percent of potential)	-1.0	0.0	0.3	0.2	0.2	0.1	0.1	0.0	0.0
Labor Market									
Employment	0.0	1.4	1.9	1.1	1.1	1.1	1.1	1.1	1.1
Unemployment rate LFS (percent)	3.6	3.3	3.2	3.3	3.3	3.3	3.4	3.5	3.5
Prices and Wages									
GDP deflator	6.6	6.7	2.7	1.5	1.7	2.1	2.3	2.7	3.0
Consumer prices (avg)	2.4	1.3	0.7	1.5	1.5	2.0	2.0	2.3	2.5
Consumer prices (eop)	2.8	0.2	1.4	1.5	1.5	2.0	2.0	2.3	2.5
Manufacturing wages									
Hourly compensation	2.2	4.2	...	...	...	...	...	...	...
Productivity	6.4	2.4	...	...	...	...	...	...	...
Unit labor costs	-3.9	1.8	2.4	...	...	...	...	...	...
Fiscal Indicators									
General government fiscal balance (percent of GDP)	11.1	13.4	13.9	11.4	10.4	9.5	8.6	7.8	7.1
of which: nonoil balance (percent of mainland GDP)	-5.1	-5.0	-5.3	-5.2	-5.0	-4.9	-4.8	-4.8	-4.8
External Sector									
Current account balance (percent GDP)	11.9	12.8	14.2	10.9	10.0	9.6	8.9	8.8	8.3
Balance of goods and services (percent of GDP)	11.9	13.3	13.2	10.9	9.9	9.0	8.3	7.7	7.3
Mainland balance of goods 1/	-6.8	-7.4	-8.0	-7.5	-7.3	-7.2	-7.0	-6.7	-6.3

Source: Statistics Norway, Ministry of Finance, and IMF staff estimates.
1/ Percent of mainland GDP.

Table 3. Norway: External Indicators, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
				Projections 1/					
	(Billions of USD)								
Current account balance	50.2	62.7	70.8	56.7	53.3	52.9	51.1	52.1	51.7
Balance of goods and services	50.2	65.1	66.0	56.4	52.6	49.3	47.2	46.0	45.5
Balance of goods	49.9	66.3	68.3	57.3	52.7	48.7	45.7	43.6	42.0
Mainland balance of goods	-22.5	-27.4	-30.2	-30.3	-30.5	-31.4	-31.9	-32.2	-32.3
Balance of services	0.3	-1.2	-2.3	-0.9	-0.1	0.6	1.5	2.4	3.4
Exports	170.4	203.6	203.3	200.3	202.0	206.6	212.7	219.5	227.5
Goods	128.9	159.2	158.8	152.1	150.9	152.0	154.2	157.1	160.8
of which oil and natural gas	78.0	100.3	103.9	93.1	88.4	85.1	82.6	80.5	79.0
Services	41.5	44.3	44.6	48.2	51.1	54.6	58.4	62.4	66.7
Imports	120.2	138.5	137.3	143.9	149.4	157.3	165.4	173.6	182.1
Goods	79.0	93.0	90.4	94.8	98.3	103.3	108.5	113.5	118.8
Services	41.2	45.5	46.9	49.1	51.1	54.0	57.0	60.0	63.2
Balance of factor payments	-0.1	-2.4	4.8	0.3	0.7	3.6	3.9	6.1	6.2
Capital account balance	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Financial account balance	-38.1	-72.1	-70.5	-56.4	-53.0	-52.7	-50.9	-51.8	-51.5
Net direct investment	-6.2	-6.9	-10.3	-10.7	-11.0	-11.4	-11.8	-12.3	-12.8
Net portfolio investment	-13.4	-39.4	-67.6	-32.6	-29.1	-27.9	-25.2	-25.1	-23.7
Net other investment	-15.2	-29.5	8.5	-11.9	-11.9	-12.3	-12.8	-13.3	-13.9
Change in reserves (- implies an increase)	-3.4	3.7	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Net errors and omissions	-11.8	9.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(Percent of Mainland GDP)								
Current account balance	15.3	16.8	18.7	14.1	12.8	12.1	11.1	10.8	10.2
Balance of goods and services	15.3	17.5	17.5	14.1	12.6	11.3	10.3	9.5	8.9
Balance of goods	15.2	17.8	18.1	14.3	12.6	11.1	10.0	9.0	8.3
Mainland balance of goods	-6.8	-7.4	-8.0	-7.5	-7.3	-7.2	-7.0	-6.7	-6.3
Services balance	0.1	-0.3	-0.6	-0.2	0.0	0.1	0.3	0.5	0.7
Exports	51.8	54.6	53.8	49.9	48.5	47.3	46.3	45.5	44.7
Goods	39.2	42.7	42.0	37.9	36.3	34.8	33.6	32.5	31.6
of which oil and natural gas	23.7	26.9	27.5	23.2	21.2	19.5	18.0	16.7	15.5
Services	12.6	11.9	11.8	12.0	12.3	12.5	12.7	12.9	13.1
Imports	36.5	37.1	36.3	35.9	35.9	36.0	36.0	35.9	35.8
Goods	24.0	24.9	23.9	23.6	23.6	23.6	23.6	23.5	23.4
Services	12.5	12.2	12.4	12.2	12.3	12.3	12.4	12.4	12.4
Balance of factor payments	0.0	-0.6	1.3	0.1	0.2	0.8	0.9	1.3	1.2
Capital account balance	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Financial account balance	-11.6	-19.3	-18.7	-14.1	-12.7	-12.0	-11.1	-10.7	-10.1
Change in reserves (- implies an increase)	-1.0	1.0	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2
Net errors and omissions	-3.6	2.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(Percent of GDP)								
Stock of net foreign assets (IIP)	88.6	93.8	...	...	...	...	...	...	...
Direct investment, net	3.1	5.6	...	...	...	...	...	...	...
Portolio investment, net	91.2	87.8	...	...	...	...	...	...	...
Other investment, net	-18.6	-11.1	...	...	...	...	...	...	...
Official reserves, assets	12.8	11.5	...	...	...	...	...	...	...
Government Pension Fund Global, percent of mainland GDP 2/	155.0	158.3	173.8	...	...	...	...	...	...

Sources: Statistics Norway; Ministry of Finance; and IMF staff estimates.

1/ IMF staff projections as of May 2013.

2/ Projections from the 2013 National Budget.

Table 4. Norway: Key Fiscal Indicators, 2006–13

(Percent of mainland GDP, unless otherwise indicated)

								Projections
	2006	2007	2008	2009	2010	2011	2012	2013
Central Government 1/								
Revenue	62.1	58.6	63.5	56.1	53.6	58.5	58.7	55.4
Oil revenue	23.5	19.2	23.5	16.2	14.9	17.8	19.1	16.3
Non-oil revenue	38.6	39.4	40.0	39.8	38.7	40.7	39.5	39.2
Expenditure	42.6	40.7	41.8	46.3	44.9	45.6	45.3	45.8
Oil Expenditures	1.3	1.2	1.2	1.3	1.0	1.0	1.2	1.3
Non-oil expenditures	41.3	39.5	40.6	45.0	43.9	44.5	44.1	44.5
Balance	19.4	17.9	21.7	9.8	8.6	13.0	13.4	9.7
Non-oil balance	-2.7	-0.1	-0.6	-5.1	-5.2	-3.8	-4.6	-5.3
Structural nonoil balance 2/	-2.9	-2.7	-3.1	-5.1	-5.1	-4.3	-4.8	-5.4
In percent of Pension Fund Global capital 3/	-3.4	-2.7	-2.8	-4.2	-3.8	-2.9	-3.2	-3.3
In percent of trend mainland GDP 4/	-3.0	-2.8	-3.1	-5.0	-5.0	-4.3	-4.8	-5.4
Fiscal impulse 5/	-0.5	-0.2	0.3	1.9	0.0	-0.7	0.5	0.6
General Government 6/								
Revenue	79.2	75.5	80.3	71.7	71.7	75.1	75.2	71.6
Oil revenue	26.5	22.6	28.3	19.0	19.4	22.6	23.7	20.0
Non-oil revenue	52.7	52.9	52.0	52.7	52.3	52.4	51.5	51.5
Expenditure	54.3	52.8	54.5	58.3	57.5	57.5	56.9	56.8
Oil expenditures 7/	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Non-oil expenditures	54.2	52.7	54.4	58.3	57.4	57.5	56.9	56.8
Balance	24.9	22.7	25.8	13.4	14.2	17.6	18.4	14.8
Non-oil balance	-1.5	0.2	-2.4	-5.6	-5.1	-5.0	-5.3	-5.2

Sources: Statistics Norway, Ministry of Finance and IMF staff estimates.
1/ Budget definition; excludes Pension Fund Global. Projections are based on the 2013 revised budget.
2/ Estimated by the Ministry of Finance.
3/ Key policy indicator under Norway's fiscal guidelines, which set an over-the-cycle target for the structural nonoil deficit of 4 percent.
4/ Trend output as estimated by the Ministry of Finance.
5/ Annual change in the structural balance as a percentage of trend mainland GDP
6/ National accounts definition. In addition to central government, includes also Government Pension Fund, other social security and central government accounts, state enterprises, and local government.
7/ Differently from the budget definition, investments in State Direct Financial Interest are considered as net lending, and not as expenditures.

Table 5. Norway: General Government Accounts. 2006–12

(Percent of mainland GDP)

	2006	2007	2008	2009	2010	2011	2012
Revenue	79.3	75.5	80.3	71.7	71.6	75.4	75.2
Taxes	47.5	44.6	45.7	40.8	42.2	43.8	43.1
Social contributions	11.8	11.8	12.2	12.5	12.3	12.5	12.7
Other	20.0	19.1	22.4	18.4	17.2	19.1	42.3
Expense	53.0	51.2	52.8	56.5	56.1	56.0	55.7
Compensation of employees	16.0	16.1	16.6	17.6	17.5	17.7	17.9
Use of goods and services	8.0	7.5	7.6	8.4	8.2	8.0	7.8
Consumption of fixed capital	2.3	2.4	2.5	2.6	2.6	2.7	2.7
Interest	2.1	1.7	2.0	1.8	1.6	1.5	1.2
Subsidies	2.6	2.3	2.4	2.6	2.6	2.6	2.5
Grants	1.2	1.3	1.3	1.5	1.6	1.4	1.3
Social benefits	19.3	18.4	18.6	20.2	20.2	20.4	20.4
Other	1.6	1.6	1.7	1.8	1.8	1.8	1.9
Gross operating balance	28.6	26.7	30.0	17.8	18.2	22.1	22.2
Net operating balance	26.3	24.3	27.5	15.2	15.6	19.4	19.4
Net acquisition of nonfinancial assets	1.4	1.6	1.7	1.8	1.4	1.4	1.2
				Net financing			
Net lending/borrowing	24.9	22.7	25.8	13.4	14.2	17.9	17.9
Net acquisition of financial assets	46.9	27.2	14.7	4.7	18.4	2.2	21.3
Currency and deposits	3.5	0.0	-0.9	-0.8	0.5	-2.4	2.8
Securities other than shares	33.3	3.3	10.8	-17.8	9.0	0.7	7.2
Loans	4.0	8.0	-27.6	5.7	3.3	-9.9	1.4
Shares and other equity	3.9	14.7	30.0	18.2	4.4	12.0	10.6
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	2.1	1.2	2.4	-0.6	1.2	1.8	-0.8
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	22.7	4.8	-11.7	-8.3	4.1	-15.8	3.4
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares	1.3	-0.8	3.7	11.1	1.1	-3.9	2.5
Loans	19.9	3.8	-15.1	-19.4	2.3	-10.9	0.7
Shares and other equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	1.5	1.8	-0.2	0.0	0.6	-1.0	0.2
				Balance sheet			
Net financial worth	184.2	182.2	169.9	196.5	209.5	209.7	220.3
Financial assets	265.7	256.5	245.7	258.7	272.5	254.1	266.1
Currency and deposits	16.0	13.3	12.1	11.1	11.0	8.1	10.5
Securities other than shares	76.2	67.0	90.0	62.7	67.5	67.8	69.8
Loans	55.3	53.7	32.6	37.5	38.6	26.9	27.4
Shares and other equity	99.4	106.6	95.8	133.3	140.7	135.8	145.6
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	18.8	16.0	15.3	14.2	14.6	15.5	12.8
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilites	81.5	74.3	75.8	62.2	62.9	44.3	45.9
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares	15.5	13.4	16.8	27.5	27.3	22.4	23.6
Loans	59.0	52.9	50.0	27.4	28.1	15.8	15.9
Shares and other equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	7.0	8.0	9.0	7.3	7.5	6.1	6.3

Source: IMF *Government Finance Statistics, Ministry of Finance.*

Table 6. Norway: Financial System Structure, 2006–12

(Percent of assets, unless otherwise noted)

	2006	2007	2008	2009	2010	2011	2012
Assets of all financial institutions (billions of NOK)	4,236	5,004	6,112	5,201	6,424	7,042	7,351
Share of assets owned by							
Banks	62.0	62.4	62.5	71.1	56.7	56.1	55.1
Mortgage companies	10.7	12.4	16.4	21.6	21.5	22.9	23.3
Finance companies	3.1	2.8	2.5	2.8	1.7	1.7	1.7
State lending institutions	4.8	4.2	3.7	4.5	3.8	3.7	3.7
Life insurance companies	16.0	14.9	12.1	15.2	13.4	12.9	13.5
Non-life insurance companies	3.4	3.3	2.9	3.5	2.9	2.7	2.7
Balance sheet structure							
Banks excluding foreign subsidiaries							
Assets							
Cash and deposits	5.9	8.0	11.6	9.9	8.5	14.2	13.7
Securities (current assets)	11.2	10.8	11.6	19.3	19.7	17.8	19.0
Lending to households, municip. and non-finan. firms	72.9	68.6	59.5	53.7	53.7	50.3	48.5
Other lending	7.3	9.8	11.3	10.0	10.7	10.5	11.8
Loan loss provisions	-0.4	-0.3	-0.3	-0.4	-0.5	-0.4	-0.4
Fixed assets and other assets	3.1	3.0	6.4	7.5	7.8	7.7	7.3
Equity and liabilities							
Customer deposits	44.2	43.2	43.4	43.1	46.6	45.7	46.8
Deposits/loans from domestic credit institutions	3.6	4.7	2.9	3.1	3.0	2.6	1.9
Deposits/loans from foreign credit institutions	11.9	11.0	12.9	15.2	12.2	17.1	16.7
Deposits/loans from Norges Bank	0.9	1.2	1.8	1.6	1.3	0.7	0.2
Other deposits/loans	2.7	2.9	1.2	6.3	6.1	3.8	2.9
Notes and short-term paper debt	3.1	5.1	5.4	3.1	3.4	3.9	4.6
Bond debt	20.7	18.3	19.0	15.5	14.7	12.7	13.2
Other liabilities	4.1	5.3	5.5	3.9	3.9	4.9	4.8
Subordinated loan capital	2.5	2.2	2.5	2.3	2.2	1.7	1.5
Equity	6.3	6.0	5.4	5.9	6.7	6.8	7.3
Covered bond companies							
Assets							
Cash and deposits	…	3.7	3.6	3.2	1.6	1.5	2.3
Securities (current assets)	…	1.4	8.4	2.4	3.2	4.3	5.1
Gross lending	…	94.7	87.5	93.6	94.7	93.6	92.1
Loan loss provisions	…	0.0	0.0	0.0	0.0	0.0	0.1
Fixed assets and other assets	…	0.3	0.5	0.7	0.4	0.5	0.5
Equity and liabilities							
Notes and short-term paper debt	…	2.6	0.2	0.1	0.1	0.5	0.5
Bond debt	…	44.7	59.0	66.6	70.0	73.3	70.0
Loans	…	46.2	37.0	27.1	22.2	19.0	21.1
Other liabilities	…	1.6	0.1	1.1	2.7	2.4	3.4
Subordinated loan capital	…	1.0	0.7	0.6	0.5	0.4	0.3
Equity	…	4.0	2.9	4.5	4.5	4.4	4.7

Sources: Norges Bank and Statistics Norway.

INTERNATIONAL MONETARY FUND

NORWAY

July 17, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of [June 30], 2013)

Membership Status

Joined: December 27, 1945; Article VIII

General Resources Account SDR Percent Million Quota

	SDR Millions	Percent Quota
Quota	1,883.70	100.00
Fund holdings of currency	1,358.55	72.12
Reserves tranche position	525.17	27.88
Lending to the Fund		
New Arrangements to Borrow	485.89	

SDR Department	**SDR Millions**	**Percent Allocation**
Net cumulative allocations	1,563.07	100.00
Holdings	1478.52	94.59

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				
	2013	2014	2015	2016	2017
Principal					
Charges/Interest	0.03	0.06	0.06	0.06	0.06
Total	0.03	0.06	0.06	0.06	0.06

Implementation of HIPC Initiative

Not applicable

Implementation of Multilateral Debt Relief Initiative

Not applicable

Implementation of Post-Catastrophe Debt Relief

Not applicable

Exchange Arrangements

Norway has a freely floating exchange rate. The exchange system is free of restrictions on the making of payments and transfers for current international transactions other than restrictions notified to the Fund in accordance with Decision No. 144-(52/51).

Article IV Consultation

Norway is on the 24-month consultation cycle.

FSAP Participation

A review under the Financial Sector Assessment Program (FSAP) was completed in 2005.

Technical Assistance

None

Resident Representative

None

STATISTICAL ISSUES

Norway—STATISTICAL ISSUES APPENDIX (As of June 28, 2013)	
I. Assessment of Data Adequacy for Surveillance	
General: Data provision is adequate for surveillance.	
National Accounts: Breakdowns for oil-related parts of the mainland economy and other traditional sectors would be useful, in light of growing needs to better understand the impact of oil and gas activity on the mainland economy. Work is under way in this area, and the authorities are looking into this issue.	
II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since 1996. Uses SDDS flexibility options on the timeliness of the general government operations and central government debt. SDSS metadata are posted on the Dissemination Standard Bulletin Board (DSBB).	Data ROSC completed in 2003 is publicly available.

Norway: Table of Common Indicators Required for Surveillance

(As of June 28, 2013)

	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8]	
						Data Quality – Methodological soundness[9]	Data Quality – Accuracy and reliability[10]
Exchange Rates	May 2013	6/3/13	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Apr. 2013	5/24/13	M	M	M		
Reserve/Base Money	31/10/11	14/11/11	M	M	M	O, O,O, LO	O, O, O, O, O
Broad Money	31/10/11	29/11/11	M	M	M		
Central Bank Balance Sheet	31/10/11	14/11/11	M	M	M		
Consolidated Balance Sheet of the Banking System	30/09/11	07/11/11	M	M	M		
Interest Rates[2]	May 2013	6/19/13	Q	Q	Q		
Consumer Price Index	May 2013	6/18/13	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2010	03/06/11	A	A	A	LO, LNO, O, O	LO, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Apr. 2013	6/17/13	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2010	03/06/11	A	A	A		
External Current Account Balance	Q3 2012	1/9/13	Q	Q	Q	O, O, O, O	LO, O, O, O, LO
Exports and Imports of Goods and Services	Q3 2012	1/9/13	Q	Q	Q		
GDP/GNP	Q1 2013	5/20/13	Q	Q	Q	O, O, O, O	O, O, O, O, LO
Gross External Debt	Q2 2011	16/09/11	Q	Q	Q		
International Investment Position[6]	2011	1/17/13	A	A	A		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

[8] These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

[9] This reflects the assessment provided in the data ROSC or the Substantive Update (published on ..., and based on the findings of the mission that took place during...) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

[10] Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Press Release No.13/326
FOR IMMEDIATE RELEASE
September 5, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Norway

On August 30, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Norway.[1]

The Norwegian economy continues to perform well with mainland (i.e. non-oil) GDP growing steadily at 2.5–3 percent, driven by private consumption, investment, and low interest rates. Despite strong domestic demand, inflation remains subdued, running below the 2.5 percent target, mostly due to declining import prices. Unemployment remains low at around 3–3.5 percent. The current account surplus was 19 percent of mainland GDP in 2012, boosted by strong oil prices and production. The general government balance was in surplus in 2012 and the non-oil structural fiscal deficit was 4.8 percent of mainland GDP or about 3.2 percent of the sovereign wealth fund (Government Pension Fund Global or GPFG) capital. This is below the deficit permitted under the authorities' fiscal policy rule, but it still implies a slightly positive fiscal impulse due to the strong growth in GPFG assets.

However, the overall strength of the mainland economy masks divergent trends. A strong and growing set of industries supplying goods and services to the offshore sector coexist with a non-oil related subset of the mainland economy under increasing cost and competitiveness pressures. This divergence is also evident in cost pressures especially because of rapidly rising unit labor costs (ULC). Norway's ULC-based real effective exchange rate appreciated substantially over the past decade, suggesting an erosion of long-term cost competitiveness.

House prices are high and increasing, and household debt is also high. The authorities tightened lending guidelines for mortgage loans in December 2011, and they are considering options for further tightening macroprudential limits including by increasing risk weights on

[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. 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 summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

mortgage loans. They are also consulting with other Nordic countries on how to regulate the operations of bank branches operating in Norway but headquartered elsewhere in the region.

Growth in the mainland economy is projected to continue at a moderate pace, largely supported by high activity in the petroleum sector and strong domestic demand. However, this central scenario is subject to key risks. A substantial and prolonged reduction in oil prices could undercut growth in the event that downside risks to the global growth outlook materialize. Also, a correction in the buoyant housing market could reduce household consumption with adverse consequences for retail trade, construction, commercial real estate, and lenders to those sectors.

Executive Board Assessment

Executive Directors appreciated the additional context provided by the Nordic Regional Report. They welcomed Norway's sound macroeconomic management, which has underpinned steady growth and low unemployment in a difficult global environment. Directors agreed that the main challenge is to maintain macroeconomic and financial stability while containing vulnerabilities stemming from elevated house prices and high household indebtedness. In the longer run, competitiveness pressures on the mainland economy and the fiscal impact of population aging need to be addressed.

Directors concurred that the current monetary policy stance is appropriate. Inflation remains below target and is likely to increase only gradually as the economy approaches its potential and upward pressures on the exchange rate recede. Directors agreed that overheating in the property market should be addressed by tightening macroprudential policies and reducing the tax advantage of residential investment.

Directors welcomed the authorities' prudent use of flexibility in the fiscal rule. Most Directors considered that wage pressures and eroding competitiveness in the non-oil sector argue for a slower rate of spending—in the 2014 budget and beyond—than the strictest interpretations of the fiscal rule would suggest. In addition, a conservative approach would help address future spending pressures connected with population aging.

Directors stressed the importance of further strengthening supervision and the regulatory framework in the financial sector. They supported the proposed legislation to increase capital requirements for banks in line with Basel III requirements. They also noted that more capital would appropriately support exposures and hedge against risks such as property price reversals or a disruption to external wholesale funding. In this context, Directors welcomed the proposal to reassess risk weights for residential mortgages and the consideration of measures to address risks related to covered bonds. In addition, they encouraged the authorities to enforce tighter limits on loan-to-value ratios and interest-only mortgages. Directors concurred that greater cross-border coordination on macroprudential measures—as recommended by the Nordic Regional Report—is necessary to limit regulatory arbitrage and ensure that foreign-headquartered bank branches lend in line with economic conditions in Norway.

Directors agreed that structural reforms are needed to enhance the competitiveness of the mainland economy. Priority areas include labor market, pensions, trade in agriculture products, and public sector services. Sickness and disability benefits could be further reformed to improve efficiency and help contain future pressures on government spending.

Norway: Selected Economic and Social Indicators, 2009–14

Population (2012): 5 million
Main products and exports: Oil, natural gas, fish (primarily salmon)

Per capita GDP (2012): US$ 99,462
Fund Position: 1,883.7 SDR Quota/72.12% of quota holdings of currency/94.59% of allocation holdings of SDR

					Projections	
	2009	**2010**	**2011**	**2012**	**2013**	**2014**
Real economy (change in percent)						
Real GDP 1/	-1.4	0.2	1.3	3.0	1.9	2.3
Real mainland GDP	-1.4	1.5	2.6	3.3	2.8	2.8
Domestic demand	-4.1	3.4	3.6	3.3	3.8	2.9
Private consumption	-0.1	3.6	2.5	3.1	3.6	3.3
Private mainland fixed investment	-18.4	-3.9	10.4	5.1	5.7	5.1
Government consumption	4.5	1.2	1.9	1.6	2.1	2.1
Unemployment rate (percent of labor force)	3.2	3.6	3.3	3.2	3.3	3.3
Output gap (mainland economy - implies output below potential)	-0.9	-1.0	0.0	0.3	0.2	0.2
CPI (average)	2.2	2.4	1.3	0.7	1.5	1.5
CPI (end of period)	2.0	2.8	0.2	1.4	1.5	1.5
Gross national saving (percent of GDP)	34.0	35.2	36.9	39.2	37.6	37.5
Gross domestic investment (percent of GDP)	22.3	23.3	24.1	25.0	26.7	27.5
Public finance						
Central government (fiscal accounts basis)						
Overall balance (percent of mainland GDP) 2/	9.8	8.6	13.0	13.4	9.7	…
Structural non-oil balance (percent of mainland trend GDP) 3/	-5.0	-5.0	-4.3	-4.8	-5.4	…
in percent of Pension Fund Global capital 4/	-4.2	-3.8	-2.9	-3.2	-3.3	…
General government (NA, percent of mainland GDP)						
Overall balance	13.4	14.2	17.6	18.4	14.8	13.3
Net financial assets	196.6	209.8	207.7	220.7	238.5	241.2
of which: capital of Government Pension Fund Global (GPFG)	140.6	154.7	158.3	173.8	194.1	199.1
Money and credit (EOP, Y/Y percent change unless specified)						
Broad money, M2	2.4	5.2	6.2	3.7	…	…
Domestic credit, C2	2.9	6.1	6.9	5.9	…	…
Three-month interbank rate, percent	2.5	2.5	2.9	2.2	…	…
Ten-year government bond yield, percent	4.0	3.5	3.1	2.1	…	…
Balance of payments (percent of mainland GDP)						
Current account balance	14.9	15.3	16.8	18.7	14.1	12.8
Balance of goods and services	15.6	15.3	17.5	17.5	14.1	12.6
Mainland trade balance of goods	-6.5	-6.8	-7.4	-8.0	-7.5	-7.3
Offshore trade balance of goods	21.7	22.0	25.5	26.0	21.8	20.0
Terms of trade (change in percent)	-17.4	7.9	9.7	3.2	…	…
International reserves (end of period, in billions of US dollars)	48.9	52.8	49.4	51.9	…	…
Exchange rates (end of period)						
Exchange rate regime			Free-floating			
Bilateral rate (NOK/USD), end-of-period	6.2	5.8	5.7	5.8	…	…
Nominal effective rate (2005=100)	101.2	101.3	102.8	106.9	…	…
Real effective rate (2005=100)	102.2	102.6	101.5	105.1	…	…

Sources: Ministry of Finance, Norges Bank, Statistics Norway, International Financial Statistics, United Nations Development Programme 2011, and IMF staff calculations.
1/ Based on market prices which include "taxes on products, including VAT, less subsidies on products".
2/ Projections based on authorities' 2013 revised budget.
3/ Authorities' key fiscal policy variable; excludes oil-related revenue and expenditure, GPF-G income, as well as cyclical effects.
4/ Over-the-cycle deficit target: 4 percent.

Statement by Audun Groenn, Executive Director for Norway
August 30, 2013

On behalf of my Norwegian authorities, I would like to thank staff for a very well-written report on the Norwegian economy. Norwegian authorities broadly agree with staff's findings and analysis in the report, and welcome the recommendations.

Economic developments and main challenges

The description of current economic developments and the outlook for the Norwegian economy are broadly in line with those of my authorities. Prospects for a balanced development in the Norwegian economy in the medium run are indeed good. But, as staff also notes, these are subject to some key risks. The risk assessment matrix presented on page 23 gives a good summary.

One main challenge for the Norwegian economy is an increased dependence of the Mainland economy on providing supplies and services to the oil sector. While these sectors are prospering, other industries exposed to international competition are under increasing cost and competitiveness pressure. High wage cost levels and a strong krone exchange rate constitute a threat to a balanced development in the years ahead. These challenges will become even more pronounced some years from now, when oil investments are expected to decline, or if prices should fall and remain low for an extended period.

Another challenge is high house prices and households' high debt levels, thoroughly addressed by staff in selected issues. House prices have increased steadily over the last two decades, only interrupted by a slight decline starting in mid-2007 and ending in late 2008. In recent months, however, house price increases have slowed down. Several factors have contributed to the rise in real house prices; income has grown rapidly and the real interest rate has been low for several years. Furthermore, since 2007 the supply of housing in Norway has been lagging behind the number of households. Nevertheless, the risk that house prices are substantially overvalued is significant. Norwegian authorities do share staff's view that household's high debt burden could amplify a possible economic downturn, and they stress the need to strengthen financial market regulation; see below.

Monetary policy

My Norwegian authorities generally concur with staff's assessment of monetary policy.

Despite robust growth in the Norwegian economy, inflation has been low for a long time. In the June 2013 *Monetary Policy Report*, Norges Bank's baseline outlook was that the Mainland economy will be growing at a somewhat slower pace than in previous years, but still remain rather robust and close to its potential. Inflation is low and wage growth has come down. It is primarily external factors that are holding down price and cost inflation in the Norwegian economy. As long as the crisis in Europe persists and labor immigration remains high, wage growth and inflation in Norway are expected to be dampened. In such a situation, a pronounced decrease in the key policy rate is likely necessary to bring up inflation more rapidly. Such an interest rate response may lead to a further acceleration in house prices and debt, augmenting the risk that financial imbalances trigger or amplify an economic downturn. This suggests a less pronounced response in interest rate setting.

Against this background, the Executive Board of the Bank was of the view that it is appropriate to allow more time to bring inflation up to target. In the baseline outlook, there are prospects of a gradual rise in inflation and a capacity utilization that is close to a normal level through the period to 2016.

Fiscal policy

Norway's fiscal institutions, including the Government Pension Fund Global (GPFG) mechanism and the fiscal rule, support a stable development of the Mainland economy by containing and smoothing spending of oil-related revenues. As emphasized in the staff's report, avoidance of off-budget spending or special purpose funds is a crucial element of the fiscal framework.

The imbedded flexibility of the fiscal rule allowed for using fiscal policy measures to dampen the cyclical downturn following the financial crises in 2008 and 2009. The validity of the fiscal rule was confirmed by the subsequent fiscal restraint when growth and employment picked up again, reducing structural non-oil deficits to well below 4 percent of the GPFG in 2011, 2012 and 2013.

The large petroleum revenues necessitate a plan for how to handle them. Petroleum revenues are set aside in the GPFG, while the fiscal rule links the development in the non-oil budget deficit to the expected real return on GPFG assets. This feature makes it easier to communicate how petroleum revenues are dealt with and how they benefit both current and future generations. It has shown to be politically robust.

As noted in the report, the fiscal rule implies a gradual widening of non-oil fiscal deficits into the next decade, however following a gradual and smooth path. The limiting of spending to the expected real return accumulated in the GPFG, nevertheless gives a more prudent path than those followed by other petroleum producers. Currently, spending is even lower than this, since structural non-oil deficits are closer to 3 than to 4 percent of the GPFG.

As noted in the report, fiscal policy is not the main source of pressure in the non-oil Mainland economy. Increased demand from the petroleum sector is the major growth driver. With GPFG increasing as a share of GDP, the flexibility of the fiscal rule allows for containing transfers from the GPFG relative to expected real rate of return as long as the current high capacity utilization persists.

The substantial fiscal challenges associated with an ageing population cannot be dealt with solely by increased savings in the GPFG. The ageing of the population mainly reflects that we live longer and healthier lives. Measures aiming at providing incentives for work and structural changes in expenditure arrangements are thus crucial for sustainable government finances. The reform of old age pensions provides an important example of recent measures in this direction, and we take note of reform proposals in other expenditure areas in the staff report.

Future developments of GPFG value and transfers from the GPFG to the budget are uncertain. This is illustrated in the report by means of applying alternative assumptions for oil price and real rate of return. A comparison of the baseline projections in the report and national projections presented in a recent white paper on long-term perspectives for the Norwegian economy also illustrates how assumptions on GDP developments may influence projections. In particular, assumptions related to domestic price developments seem to imply a higher nominal GDP growth – and a less pronounced peak towards 2030 – in the national projections compared to the baseline presented by the staff.

The report compares the real rate of return assumption of 4 percent in the fiscal rule with the average real rate of return of 3.2 percent for GPFG for the period 1997 – 2012. Offering a longer time perspective, the report also refers to an average real rate of return of 3.7 percent earned by a global benchmark portfolio mix of 60 percent equities and 40 percent bonds for the last 113 years. These calculations are however sensitive to country weights applied and currency applied for measurement. For instance, a calculation carried out by the Ministry of Finance, based on the same dataset, gives a real rate of return of approximately 4 percent for a global portfolio mix of 60 percent equities and 40 percent bonds over the same period. This calculation uses the global equity return series in USD and the country-specific bond return series in local currency, the latter being GDP-weighted.

Financial sector issues

Norwegian financial institutions have continued to strengthen their solvency over the last years, primarily by retaining profits and issuing equity. The institutions have also improved their funding structure.

As already mentioned, the Norwegian authorities generally concur with staff's assessment of the risks and vulnerabilities associated with households' indebtedness and a possible house price reversal, as well as on financial institutions' reliance on wholesale funding. Continued low interest rates may influence expectations and contribute to further increases in housing prices and household debt. This poses a significant risk to financial stability in Norway. New rules on capital requirements in line with the Basel III standards were implemented on July 1of this year, well ahead of international transposition dates. Today, there is a common equity capital requirement of 9 percent, including buffer requirements. This combined requirement will increase to 10 percent next year. For systemically important institutions the common equity capital requirement will rise to 11 percent in 2015, and finally to 12 percent in 2016. The Norwegian authorities are now drafting detailed rules and assessment methodologies for the identification of systemically important institutions, in line with recommendations of the Basel Committee.

The Norwegian authorities will shortly adopt a regulation on the use of the counter-cyclical capital buffer requirement in Norway. The Ministry of Finance will set the buffer requirement, based on policy advice, and a buffer guide and other relevant analysis produced by Norges Bank. The central bank will, in the preparation of this analysis, exchange information and assessments with the financial supervisory authority. As noted in staff's report, Norwegian IRB banks' risk weights on residential mortgages are relatively low, which may give further incentives for banks to shift credit supply towards residential mortgages if the current Basel I floor rules are abolished. The Ministry of Finance has recently conducted a public consultation on alternative draft rules for strengthening IRB risk weights on residential mortgages. These draft rules may – like a possible continuation of the Basel I floor rules for the whole capital requirement – subdue such a potential shift in lending. The Ministry is also considering measures to address risks from the growing importance of the covered bonds market as a funding source for Norwegian financial institutions.

My authorities are pleased to note that staff recognizes one of the most important financial sector policy issues for Norway today, namely the need for more cooperation within the

Nordic region on prudential requirements for credit institutions. As I have explained, the Norwegian authorities are taking important steps to improve the soundness of Norwegian institutions. However, a substantial part of the banking system in Norway consists of branches of institutions that are based in other Nordic countries and with weaker capital requirements. Norway is therefore working together with the Nordic countries on the possibility of establishing a greater degree of host country regulation, especially for mortgage loan risk weights. The Norwegian authorities believe that different national circumstances may require different prudential policy responses, and that a greater degree of host country regulation will contribute to securing financial stability and leveling the playing field in national credit markets.