



# NORWAY

September 2015

## 2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; INFORMATIONAL ANNEX; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NORWAY

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 2015 Article IV consultation with Norway, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 4, 2015 consideration of the staff report that concluded the Article IV consultation with Norway.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 4, 2015, following discussions that ended on May 28, 2015, 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 30, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Norway.

The documents listed below have been or will be separately released.

### Selected Issues

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### **IMF Executive Board Concludes 2015 Article IV Consultation with Norway**

On September 4, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Norway.

The Norwegian economy performed well in 2014 despite the sharp fall in oil prices toward the end of the year. Mainland (i.e. non-oil) GDP grew at 2.2 percent, with weaker investment demand being offset by stronger government consumption. Unemployment stayed at a low level in 2014, but has recently edged up to 4.5 percent in June according to the labor force survey. The registered unemployment rate is lower at 2.9 percent in June and more stable, having risen only 0.1 percentage points since June 2014. Inflation has been stable and close to the 2.5 percent target, helped by moderate wage growth. The exchange rate depreciated significantly in late 2014 and early 2015 with the decline in oil prices, pushing up prices of imported consumer goods. Meanwhile, house prices are rising rapidly again, albeit with large regional dispersion.

The 2014 structural non-oil deficit was 2.9 percent of Government Pension Fund Global (GPF) assets and 5.8 percent of trend mainland GDP. This is below the deficit permitted under the authorities' fiscal policy rule, but it still implies a positive fiscal impulse due to strong growth in GPF assets. Banks' profitability has been solid and banks have strengthened their capital ratios, but reliance on wholesale funding continues. This makes banks vulnerable to turbulence in global financial markets.

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<sup>1</sup> 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.

The near term outlook has weakened due to lower oil prices. Mainland GDP growth is projected to slow to 1.3 percent this year with weaker private investment and consumption as demand for mainland inputs to offshore sector declines. Looking further ahead, the medium and longer term presents challenges of managing a transition away from the oil-dependent growth model. With oil investment expected to decline further, resources need to shift from supplying the oil and gas sector and move toward other tradable sectors or exports of oil-related goods and services. Unemployment will likely increase in the process, and common currency unit labor costs will need to adjust downward from the current high level to facilitate this transition.

Downside risks remain. Deceleration of global demand or excess oil and gas supply could lead to a protracted period of low oil prices, which would undercut growth through a further reduction in the oil-related demand for mainland goods and services. A significant reduction in property prices could also occur, which could depress private demand. In addition, there is the risk that the expected decline in oil-related output in the mainland economy would not be offset by a pick-up elsewhere in the mainland economy.

### **Executive Board Assessment<sup>2</sup>**

Executive Directors commended Norway's strong economic performance last year with steady growth, low inflation, and low unemployment. However, they noted that the near-term outlook has weakened, with lower oil prices and an ongoing slowdown in offshore investment, while risks in the housing and financial sectors present a challenge. Directors urged vigilance and prudent policies to safeguard growth and financial stability. They also highlighted the need for reforms to raise productivity and transition away from the oil-dependent growth model.

Directors supported the current monetary policy stance, while urging a careful monitoring of inflation and financial stability risks. They agreed that monetary policy should be the first line of defense if growth turns out significantly weaker than projected, as long as inflation expectations remain well anchored. They recommended the timely implementation of macroprudential

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<sup>2</sup> 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>.

measures to contain rising household credit, in order to leave room for monetary policy to support growth while pursuing the inflation target.

Directors noted that fiscal policy this year is broadly appropriate given the projected slowdown. A number of Directors also considered that maintaining the fiscal impulse next year would be appropriate in view of the risks to economic growth. Over the medium term, a more neutral stance would be necessary to allow the shift of resources to other tradable industries.

Directors welcomed the recent recommendations of the commission on the fiscal rule, which would help smooth the spending of oil revenues, and looked forward to the authorities' adoption of rules along those lines. Directors welcomed the conclusions of the FSAP update that the Norwegian financial system is generally sound and well managed, and commended the significant measures that the authorities have taken to address financial stability risks. Nevertheless, they agreed that further measures are needed to reduce risks, including improving liquidity stress tests, stricter loan-to-value, loan-to-income or debt service ratios, more frequent comprehensive assessments of small banks, and strengthening the toolkit and funding arrangements for bank resolution.

Directors emphasized the importance of further structural reforms to support the transition to a new growth model and improve the efficiency of the economy. In particular, they saw merit in reducing the preferential tax treatment for residential properties relative to productive investments, as well as further reforms to the pension system and sickness and disability benefits. They also stressed that investment in infrastructure, education, and research is key to raising productivity. Lowering Norway's extensive agricultural protection and subsidies and relaxing unnecessary supply restrictions in the housing market would also be important.

## Norway: Selected Economic and Social Indicators, 2009–16

Population (2014): 5.2 million									
Per capita GDP (2014): US\$ 97,720		Quota (1883.7 mil. SDR/0.79 percent of total)							
Main products and exports: Oil, natural gas, fish (primarily salmon)		Literacy: 100 percent							
								Projections	
		2009	2010	2011	2012	2013	2014	2015	2016
<b>Real economy (change in percent)</b>									
Real GDP 1/		-1.6	0.6	1.0	2.7	0.7	2.2	1.0	1.3
Real mainland GDP		-1.6	1.8	1.9	3.8	2.3	2.2	1.3	1.7
Domestic demand		-3.2	3.0	2.7	3.5	3.6	1.9	1.0	1.6
Unemployment rate (percent of labor force)		3.2	3.6	3.3	3.2	3.5	3.5	4.0	4.1
Output gap (mainland economy, - implies output below potential)		-1.1	-1.3	-0.9	0.2	0.0	-0.1	-0.6	-0.8
CPI (average)		2.2	2.4	1.3	0.7	2.1	2.0	2.3	2.3
Gross national saving (percent of GDP)		35.4	36.3	38.2	39.0	38.3	37.9	36.8	36.5
Gross domestic investment (percent of GDP)		24.8	25.4	25.8	26.5	28.3	28.4	28.1	28.3
<b>Public finance</b>									
Central government (fiscal accounts basis)									
Overall balance (percent of mainland GDP) 2/		9.3	8.3	12.6	12.8	9.4	6.1	3.8	3.9
Structural non-oil balance (percent of mainland trend GDP) 3/		-5.1	-5.1	-4.5	-5.0	-5.1	-5.8	-6.4	...
Fiscal impulse			0.0	-0.6	0.5	0.2	0.7	0.6	...
in percent of Pension Fund Global capital 4/		-4.4	-4.1	-3.2	-3.4	-3.3	-2.9	-2.6	...
<b>General government (national accounts basis, percent of mainland GDP)</b>									
Overall balance		12.8	13.6	17.1	17.5	14.0	10.9	8.0	8.1
Net financial assets		194.7	208.6	209.4	220.5	259.3	303.6	317.5	318.5
of which: capital of Government Pension Fund Global (GPF-G)		134.2	148.2	153.3	166.1	207.8	254.3	269.8	...
<b>Money and credit (end of period, 12-month percent change)</b>									
Broad money, M2		2.4	5.2	6.2	3.8	6.1	5.3	...	...
Domestic credit, C2		2.9	6.1	6.9	5.9	6.8	6.0	...	...
<b>Interest rates (year average, in percent)</b>									
Three-month interbank rate		2.5	2.5	2.9	2.2	1.8	1.7	1.4	1.4
Ten-year government bond yield		4.0	3.5	3.1	2.1	2.6	2.5	2.5	2.5
<b>Balance of payments (percent of mainland GDP)</b>									
Current account balance		13.1	13.6	16.0	16.1	12.7	11.8	10.8	10.1
Exports of goods and services (volume change in percent)		-4.1	0.7	-0.8	1.4	-3.0	2.7	1.4	1.4
Imports of goods and services (volume change in percent)		-10.0	8.3	4.0	3.1	4.3	1.9	1.6	2.4
Terms of trade (change in percent)		-16.8	6.7	9.1	2.8	-0.6	-5.2	-2.0	-0.9
International reserves (end of period, in billions of US dollars)		48.9	55.6	52.8	51.7	57.9	66.8	67.7	77.3
<b>Fund position</b>									
Holdings of currency (percent of quota)		80.6	76.6	71.4	71.1	78.2	85.6	...	...
Holdings of SDR (percent of allocation)		102.4	102.0	97.5	96.1	95.1	94.8	...	...
Quota (SDR millions)		1,672	1,672	1,884	1,884	1,884	1,884	...	...
<b>Exchange rates (end of period)</b>									
Exchange rate regime		Floating							
Bilateral rate (NOK/USD), end-of-period		6.3	6.0	5.6	5.8	5.9	6.3	...	...
Real effective rate (2010=100)		95.2	100.0	100.6	100.2	98.9	94.1	...	...

Sources: Ministry of Finance, Norges Bank, Statistics Norway, International Financial Statistics, United Nations Development Programme, 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 2015 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.



# NORWAY

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

July 30, 2015

### KEY ISSUES

**Context:** The Norwegian economy grew steadily in 2014 despite the sharp fall in oil prices. Nevertheless, the near term outlook has weakened, and the medium and longer term present challenges related to shifting away from a growth model dependent on oil- and gas-related demand.

**Monetary policy:** The current monetary policy stance is appropriately supportive. Inflation has been relatively stable and close to the target. Lower wage growth this year is likely to reduce the risk of imported prices spilling over to higher domestic inflation. If growth turns out significantly weaker than currently projected, monetary policy should be the first line of defense against economic weakness, provided that inflation expectations are well-anchored.

**Financial sector policy:** The Financial Sector Assessment Program (FSAP) update concluded that the Norwegian financial system is generally sound and well managed. Nevertheless, high house prices and household debt and banks' reliance on wholesale funding are areas of concern, and additional measures are needed to further mitigate risks.

**Fiscal policy:** Fiscal policy is broadly appropriate this year in light of the projected economic slowdown, but a shift to a neutral fiscal stance would be more appropriate in the medium term on the basis of current projections. If growth is weaker than expected in 2016, the authorities should allow automatic stabilizers to operate, but stop short of using fiscal stimulus to replace what would seem to be declining oil-related demand in the mainland economy. Any fiscal stimulus would also put appreciation pressures on the exchange rate.

**Structural reforms:** Structural reforms would support the transition to a growth model less reliant on oil- and gas-related demand and also further improve the efficiency of the economy. More neutrality in the taxation of assets, agricultural policy reforms, reducing the cost of new real estate construction, and further reforms to the pension system and sickness and disability benefits would all help.

Approved By  
**Philip Gerson**  
 and **Mary Goodman**

Discussion took place in Oslo during May 19–28, 2015. The staff team was comprised of Mr. Dorsey (head), Mmes. Ho and Shirono supported by Mr. Dowling and Ms. Rojas at headquarters (all EUR). Mr. Groenn (Executive Director) joined the discussions and Mr. Pinon (MCM) joined part of the mission to follow up on the FSAP.

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## RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

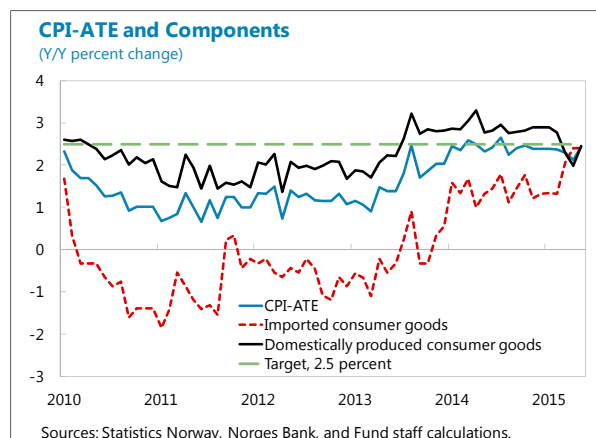
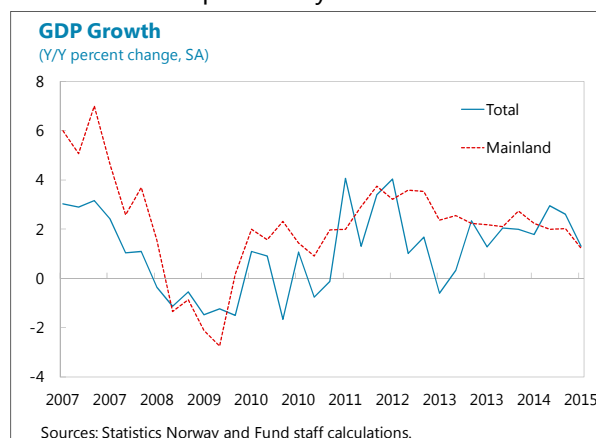
### A. Recent Economic Developments

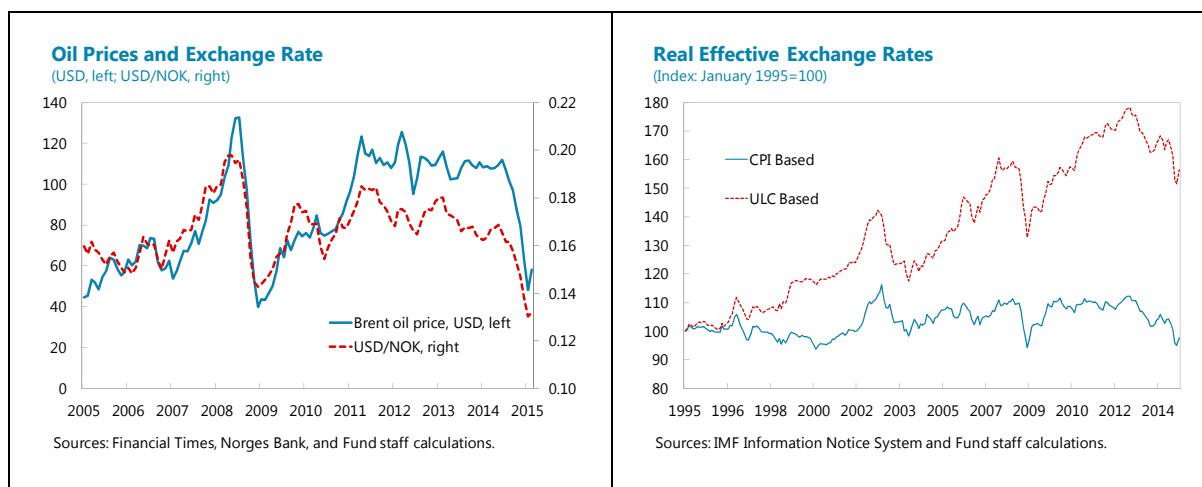
**1. A sharp oil price drop materialized toward the end of 2014.** Oil prices have recovered somewhat in 2015, but remain about 40 percent lower than their peak in mid-2014. However, the impact of the oil price drop on the real economy has been limited so far.

**2. The Norwegian economy grew steadily in 2014 despite the fall in oil prices.** The mainland economy grew at 2.2 percent—about the same rate as in the previous year. Weaker investment demand was offset by stronger government consumption with private consumption roughly unchanged (Figure 1). Mainland GDP continued to grow at 0.5 percent (q/q) in the first quarter of 2015, supported by moderate growth in private consumption. Labor-force survey unemployment stayed low in 2014, but it has recently edged up to 4.2 percent (Figure 2). Registered unemployment shows a lower and more stable trend, however.

**3. Inflation has been relatively stable and close to the 2.5 percent target.** CPI inflation excluding tax changes and energy products (CPI-ATE) averaged 2.3 percent during the first five months of 2015. While inflation in domestically produced consumer goods has been edging down, imported consumer goods recorded strong price growth in early 2015, partly reflecting the recent exchange rate depreciation. Inflation expectations remain well anchored (Figure 3), and nominal wage growth slowed to 3.1 percent last year.

**4. The exchange rate has depreciated significantly with the decline in oil prices.** The CPI-based real effective exchange rate (REER) is about 13 percent below its 10-year historical average, reflecting the recent depreciation (Figure 4). External Balance Assessments (EBA) suggest that exchange rate is now slightly undervalued (Box 1). At the same time, the depreciation of the krone has offset some of the deterioration in unit labor cost (ULC) competitiveness over recent years. The current account surplus narrowed in 2014, driven mostly by declining oil and gas prices in the latter part of the year. However, the deficits on services and non-oil goods trade also widened modestly (Figure 4).

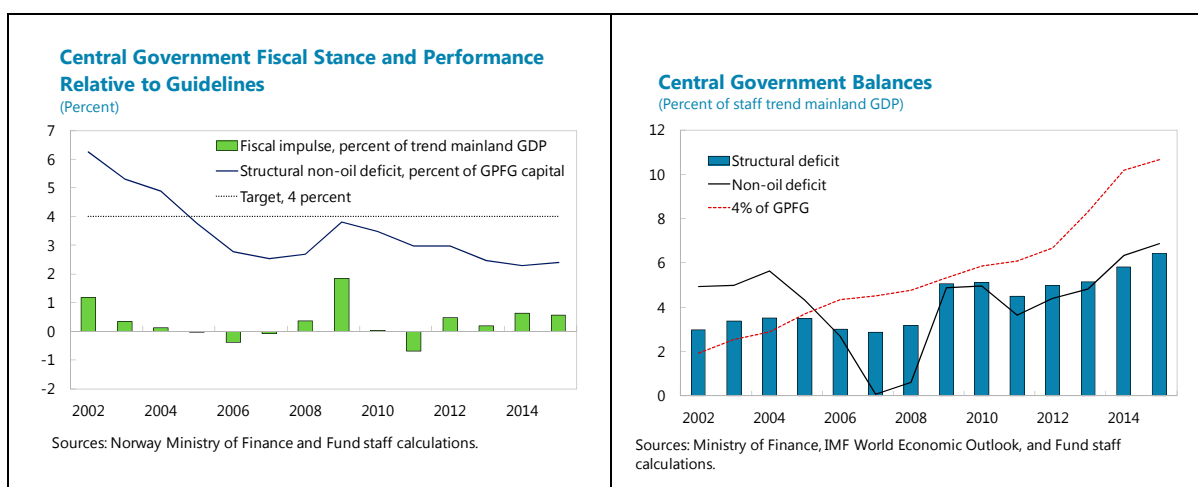




**5. The housing market revived in 2014.** House prices briefly leveled out in late 2013 but started to rise again, growing at 7 percent in nominal terms in the first quarter of 2015. House price developments vary considerably across regions, with the Oslo area recording relatively more robust price growth while the Stavanger area where petroleum activity is concentrated showing more subdued growth. Household debt continues to rise, reaching about 220 percent of disposable income (Figure 5).

**6. The 2014 fiscal outturn entailed a positive fiscal impulse.** However, the expansionary fiscal stance was within the fiscal policy rule that targets a structural non-oil deficit equal to 4 percent of Government Pension Fund Global (GPF) assets. Debt sustainability is not an important consideration (Annex I); gross public debt is about 30 percent of GDP and net financial assets are about 250 percent of GDP.

**7. The budget is well insulated from oil and gas prices through the fiscal rule.** However, GPF assets have been growing much faster than mainland GDP, and a transfer of even a constant share of its assets implies a trend toward a positive fiscal impulse. Moreover, because the GPF is invested abroad, the decline in the krone exchange rate results in a large increase in the size of the fund relative to GDP.

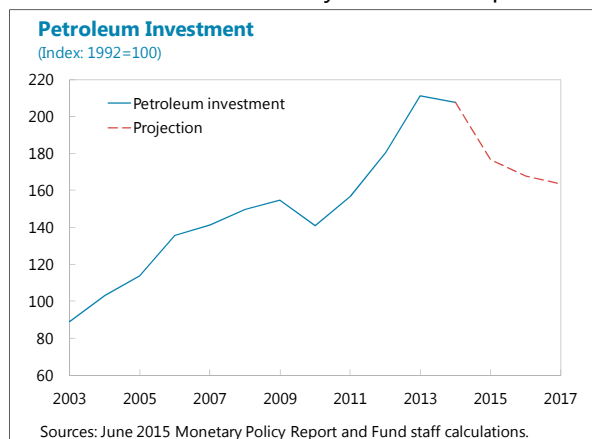


**8. Banks' profitability has been solid and banks have strengthened their capital ratios, but reliance on wholesale funding continues.** Roughly 60 percent of funding is wholesale funding, more than half of it in foreign currency. This makes banks vulnerable to turbulence in global financial markets.

## B. Outlook and Risks

**9. The near term outlook has weakened due to lower oil prices.** The impact of the oil price decline on the mainland economy has been limited so far, and the fiscal position is almost fully insulated from oil price volatility. Nevertheless, mainland GDP growth is projected to slow to 1.3 percent this year with weaker private investment and consumption as demand for mainland inputs to the offshore sector declines. Mainland growth is projected to recover moderately next year as private consumption rebounds in line with a modest increase in oil prices. Inflation is expected to increase slightly as import prices rise with the exchange rate depreciation but stay below the 2.5 percent target. Unemployment is expected to rise further but remain at a relatively low level.

**10. The medium and longer term presents complex challenges and uncertainties, particularly given lower oil prices and slowdown of offshore investment.** Steadily increasing oil and gas investment over the last decade has provided persistent demand stimulus to the increasingly oil- and gas-focused mainland economy (see Annex III for the real sector links between the offshore and mainland economies). However, investment flattened out last year and is expected to decline significantly in the coming years, and impulse from the offshore sector to the mainland economy has turned from positive to negative. Oil and gas production will continue for many decades to come, so the problems of managing the oil dependency of the mainland economy are not yet over. However, they will abate—particularly if the recent drop in oil prices is sustained—and will be replaced by the challenges of managing a transition away from the oil-dependent growth model. The staff's central forecast is a recovery of growth in the medium term with somewhat higher unemployment in the transition process, and inflation that remains close to the target. However, this is based on a scenario in which the sources of growth shift smoothly away from supplying the oil and gas sector and move toward other tradable sectors of the economy or exports of oil-related goods and services.



**11. There are downside risks to this central scenario (also see Box 2 for the Risk Assessment Matrix).**

- **Deceleration of global demand or excess oil and gas supply could lead to a protracted period of low oil prices.** This would undercut growth through a further reduction in the oil-

related demand for mainland goods and services. A deceleration in global demand could also make it more difficult for non-oil and gas export industries to expand.

- **A significant reduction in property prices could occur.** House prices rose rapidly over the last decade and most estimates suggest that house prices are significantly overvalued. The recent FSAP update finds that risks to financial stability are contained. However, with high household debt, a large fall in house prices—for example, due to a slowdown in real income growth, higher unemployment, or a large increase in interest rates—could depress private demand with adverse consequences for retail trade, domestic services, construction and commercial real estate and lenders to these sectors.
- **The expected decline in oil-related output in the mainland economy may not be offset by a pick-up elsewhere in the mainland economy.** Resources need to shift from oil-related to non-oil related tradable sectors to realize the transformation, and labor market flexibility in particular will be tested in the process. A less smooth transition might lead to further increase in unemployment, with consequences for income and consumption.
- **Tighter or more volatile global financial conditions** stemming from, for example, asymmetric monetary policy exit or the re-emergence of sovereign and financial sector stress across the Euro area could cause renewed stress in the global wholesale funding markets, leading to liquidity strains for Norwegian banks that rely on wholesale funding.

### Authorities' views

**12. The authorities generally agreed with the risk assessment.** They noted that the oil price drop has curbed economic growth in some regions. Even though the impact of the oil price drop on the macro economy has been limited so far, sustained lower oil prices will slow oil investment further. The authorities stressed that a decline in oil investment was expected even before the recent oil price fall, and the Norwegian economy will need to shift to a new growth model less dependent on offshore activity in any event. In this regard, current fiscal and monetary policies are supportive of the transition. The authorities agreed that high household debt is a risk but also noted that both banks and households had increased buffers through higher capital and saving respectively.

## POLICY DISCUSSIONS

*Norway has a sound policy framework in place, but policymakers face a complicated task of maintaining macroeconomic stability while facilitating the transition to a less oil-dependent economy. Businesses in the mainland economy will need to adapt to lower demand from offshore activity, and adjustments will need to take place sooner than previously anticipated if low oil prices persist. Policy measures need to support structural adjustments, and fiscal policy in particular needs to strike the delicate balance between maintaining macroeconomic stability and allowing market forces to operate without inhibiting adjustment.*

## A. Monetary Policy: Maintaining Price Stability and Supporting Growth

**13. The Norges Bank cut the policy rate twice by a quarter point in December 2014 and June 2015 bringing it to 1.00 percent.** The rate was lowered in December to counter the risk of a pronounced economic downturn, but the March and May 2015 decisions to hold the rate at 1¼ percent took into account relatively limited impacts of low oil prices on the economy so far as well as financial stability concerns. Updated projections in June showed only slightly weaker output (and an upward revision of petroleum investment in the medium-term), but inflation is now projected to be lower and slightly below the inflation target for the year, and annual wage settlements in May were very restrained and look likely to deliver a small real wage reduction over the period of the wage settlement.

**14. The current monetary policy stance is appropriately supportive.** Going forward, monetary policy will need to balance different objectives. Inflation has been stable and close to the target, and staff's baseline forecast is for inflation to stay slightly below target this year and next. On the one hand, the recent weakening of the Norwegian krone has exerted upward pressures on the prices of imported consumer goods, and staff analysis suggests that the exchange rate pass-through to imported prices in Norway—although limited—can be persistent.<sup>1</sup> On the other hand, interest rates in key trading partners are low or even negative, growth is moderating, and lower wage growth this year—the spring 2015 wage agreements are likely to result in 2.7 percent growth in nominal wages (y/y), down from 3.1 percent last year—is likely to reduce the risk of imported prices spilling over to higher domestic inflation. In the scenario that growth turns out significantly weaker than currently projected, monetary policy needs to be the first line of defense against economic weakness, provided that inflation expectations are well anchored.

**15. Financial stability concerns, at the current juncture, need to be addressed primarily through macroprudential policy.** However, Norway's inflation targeting framework contains an element of mitigating the risk of the buildup of financial imbalances, and monetary policy could take financial stability into account if macroprudential policies have limited effects. In such an event, any increase in the policy rate would need to be gradual and balance the negative impact on growth against that of a further buildup of financial sector risks. More generally, the current policy stance implies a slightly negative real rate, but a negative real rate is unlikely to be sustainable or desirable in the medium-term, and a gradual return to a normal (nominal) interest rate of about 4 percent—corresponding to a normal real interest rate of about 1½ percent given the inflation target—is needed over time.

### Authorities' views

**16. The authorities broadly agreed with the staff assessment.** They noted that the June decision to lower the policy rate was based mainly on the assessment that growth prospects and the

<sup>1</sup> See fourth chapter of Selected Issues Paper for detail.

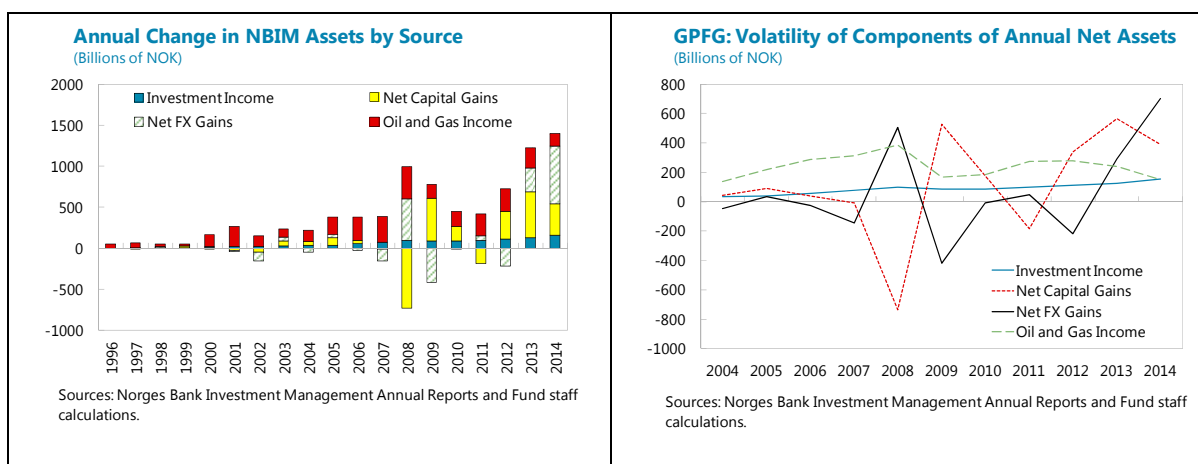
forces driving inflation further ahead have weakened. To counter the risk that a lower interest rate may fuel house price inflation and debt growth, the government has strengthened the guidelines on mortgage loan-to-value limits by changing them into requirements as of July 1, 2015 (see Annex IV), and increased the countercyclical capital buffer from 1 percent to 1½ percent from July 1, 2016.

## B. Fiscal Policy: Facilitating Structural Adjustment

**17. The moderate fiscal expansion this year is broadly appropriate in light of the expected economic slowdown due to the sharp and largely unanticipated decline in oil prices.** The 2015 budget entails an expansionary fiscal stance with a non-oil structural deficit of 6.4 percent of trend mainland GDP. This is estimated to be equivalent to 2.6 percent of the value of the GPFG, much less than the full amount targeted under the fiscal rule (4 percent) but still implies a fiscal impulse of about 0.6 percentage point.

**18. In the medium term, a shift to a broadly neutral fiscal stance would be more appropriate on the basis of current projections.** Should growth turn out weaker than projected in 2016, the authorities should allow automatic stabilizers to operate. However, fiscal stimulus cannot substitute for lower structural demand, and therefore, the authorities should refrain from using stimulus to offset any decline in demand that appears to be due to a drop in oil-related demand for mainland goods and services. Replacing declining oil-related employment with public sector employment would inhibit the necessary shift of resources from oil-related to other tradable industries. Also, any fiscal stimulus would add appreciation pressures on the exchange rate.

**19. The government's fiscal policy has generally been prudent with the non-oil structural deficit maintained well below 4 percent of GPFG assets in recent years.** However, the fact that GPFG is growing much faster than the economy has allowed widening non-oil deficits as a share of trend GDP. Also, as the size of GPFG grew, market returns, capital gains, and foreign exchange valuation effects have replaced oil and gas income as both the main sources of annual growth in the GPFG and the main contributors to its volatility. The staff took the view that this may call for



supplementary provisions for the fiscal rule. In particular, some consideration of smoothing over asset price cycles and exchange rate volatility in addition to the business cycle would be in order. Consideration should also be given to a more explicit approach to avoiding fiscal stimulus at times when the economy is at or near potential. Staff stressed that proposals along these lines from the Fiscal Rule Commission would be welcome.

### Authorities' view

**20. The authorities agreed that using fiscal stimulus to replace declining oil-related demand in the mainland economy could inhibit the necessary shift of resources to other tradable goods sectors.** They emphasized that the 2015 budget takes into account this consideration and strikes the right balance while supporting the economy. On the fiscal rule, the government created a Commission to recommend modifications or supplementary provisions to the fiscal rule because they were aware of the evolving pressures as the GPFG has grown. The Commission's report in mid-June 2015 recommended supplementary rules to (i) limit use of the GPFG over the next 10–15 years to better align the peak use of the GPFG resources with the costs of population aging; and (ii) set a limit on the fiscal impulse to 0.1–0.2 percent of mainland GDP (see Annex V). They also noted that they were studying the recommendations of the Commission carefully, and have issued a public consultation document soliciting input on the Commission's recommendations.

## C. Financial Sector Policy: Addressing Stability Risks

**21. The FSAP update concluded that the Norwegian financial system is generally sound and well managed (Figure 6).** The authorities have taken significant measures to address financial stability risk, including early implementation of the CRD IV. More recently, risk weights for residential mortgages used in banks' IRB models have been tightened. A countercyclical capital buffer of 1 percent took effect on July 1, 2015, and the buffer will be increased to 1½ percent from July 1, 2016. FSAP bank stress tests suggest that financial institutions' capital needs in the face of severe shocks would be nontrivial but manageable.

**22. Nevertheless, there are important challenges with a potential impact on financial stability.** High house prices and household debt and banks' reliance on wholesale funding are areas of concern. House prices remain elevated, and the household debt-to-disposable income ratio is one of the highest among the OECD countries. To finance this, banks have relied extensively on wholesale funding. In particular:

- **High household indebtedness makes households potentially vulnerable to house price and income corrections and interest rate risks.**<sup>2</sup> Lower house prices or income could force households to cut consumption sharply, negatively affecting retail businesses and construction,

<sup>2</sup> See second chapter of Selected Issues Paper for household stress tests that assess household vulnerability under various scenarios.

and creditors to these sectors. Staff's empirical analysis suggests that a 10 percent decline in real house prices could reduce private consumption by 0.9 percent in Norway (see Annex VI). Although this is smaller than the estimated impact for other Nordic countries (e.g., 3.5 percent for Denmark), the aggregate analysis ignores the distributional impact: the effect could be substantially larger for younger families with more debt and fewer assets.

- **Banks are vulnerable to turbulence in foreign financial markets as 60 percent of wholesale funding is from foreign sources.** Reliance on wholesale funding in part reflects relatively small domestic markets for liquid assets. Given the low stock of high-quality liquid assets denominated in krone, Norges Bank has proposed that the Liquid Coverage Ratio (LCR) requirement should be set at 60 percent in domestic currency and the total "all currency" LCR requirement at 100 percent. The FSA has recently proposed that Norwegian SIFIs and other large institutions shall fulfill a 100 percent LCR from January 1, 2016 while LCR should be phased in for other institutions in line with the EU regulation. The FSA proposal does not specify LCR requirements for individual currencies in the regulation. These proposals are currently under consideration.

**23. In light of these concerns, continued vigilance and proactive efforts toward mitigating systemic risks are warranted.** Staff recommended further measures to reduce risks as follows (also see Annex VII):

- **Bank stress tests:** The authorities should improve data on cross-border ownership of bank-issued unsecured and covered bonds, and resume regular monitoring of bank-to-bank direct and indirect exposures. They should consider regional stress test exercises, as well as further steps in liquidity monitoring, such as performing liquidity stress tests using the structure of cash flows at various maturities.
- **Macroprudential policy:** The authorities should take additional measures to contain systemic risks from the growth of house prices and household indebtedness, including stricter LTV and loan-to-income or debt service ratio to supplement the affordability test. The authorities have recently adopted regulation on requirements for residential mortgage loans, which converts the FSA's existing guidelines into explicit requirements, taking effect on July 1, 2015. Staff noted that this is in the right policy direction in the current context. They should also take additional measures to contain risks related to banks' wholesale funding; and improve the existing institutional structure for macroprudential policies, including a transparent "comply or explain" approach by decision-makers. Finally, they should consider greater delegation of decision-making powers over macroprudential instruments in due course to Norges Bank or the FSA.
- **Micro-supervision:** They should ensure de jure operational independence of the FSA, strengthen the FSA's supervision of small banks through the conduct of more frequent comprehensive assessments, and upgrade its approach to AML/CFT supervision.
- **Crisis management and bank resolution:** They should initiate resolution planning for the largest banks, including assessing impediments of resolvability, and make explicit delegations to



the FSA regarding its role. They should also enhance the legal framework for resolution to comply with the FSB Key Attributes with regard to certain areas including the resolution toolkit. The Bank Guarantee Fund (BGF) should adopt policies specifying under what conditions board members must recuse themselves, considering actual and prospective conflicts of interest.

### Authorities' view

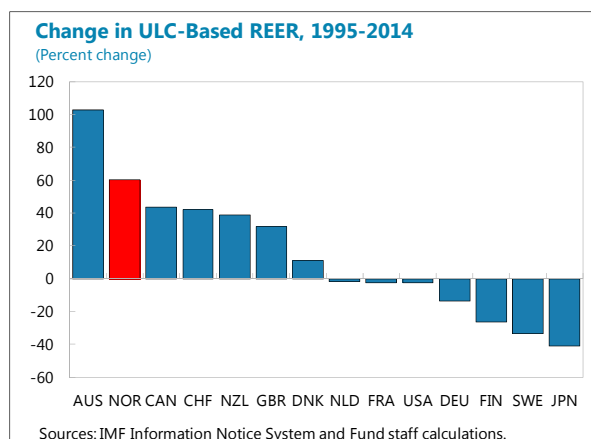
**24. The authorities generally agreed with staff's conclusions.** They noted that FSAP recommendations will be carefully examined in due course. On macroprudential policy, the authorities noted that new measures to strengthen mortgage lending practices have been implemented with effect from July 1, 2015 and that the countercyclical buffer will be increased to 1½ percent from July 1, 2016. The work for implementing the EU Banking Recovery and Resolution Directive (BRRD) is underway, and the transposition of the BRRD into national law would address some of the staff's recommendations on the bank resolution framework. More generally, the authorities stressed that measures such as countercyclical buffers should not be seen as a tool to fine-tune financial cycles.

## D. Structural Reforms and Competitiveness: Supporting Transition and Improving Efficiency

### 25. Competitiveness and the flexibility of the Norwegian labor market will be tested with the decline in oil prices and investment demand from the offshore economy.

The recent depreciation of the krone has offset some of the deterioration in ULC competitiveness over recent years, but Norway's ULC measured in common currency remains high relative to trading partners. While there may be some scope for expanding exports of oil-related goods and services to other oil and gas producers in a more favorable price environment, labor will need to

shift away from supplying the oil and gas sector as investment on the Norwegian continental shelf declines gradually over time.<sup>3,4</sup> Ideally, an adjustment in common currency ULC could be achieved mostly through increased productivity growth, but that is hard to deliver, especially in the short run. Staff noted that continued restraint in wage settlements may be necessary for several years instead. The collective bargaining system demonstrated the needed wage flexibility this year by delivering a



<sup>3</sup> First chapter of Selected Issues Paper examines the competitiveness of the supply and services sectors.

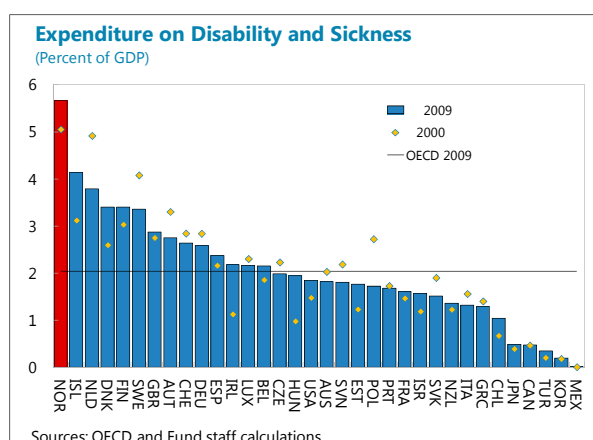
<sup>4</sup> Statistics Norway estimates that about 9 percent of total employment in the Norwegian economy is linked to the activity in the Norwegian petroleum industry. Including exports of oil-related goods and services, other sources estimate the figure at 13 percent.

substantial reduction in real wage growth with a nominal increase in the national negotiations of only 0.3 percent.

**26. More neutrality in the taxation of assets would help promote efficiency and support the transition to a new growth model.** A reduction in the extent to which the tax system promotes housing rather than productive investment would help redeploy new investment toward tradable industries that will need to replace oil- and gas-related industries as an engine of growth. This could include less preferential tax treatment for residential properties. The 2015 budget took a step in this direction by reducing the valuation discount for commercial property and second dwellings from 40 to 30 percent of market value. Staff welcomed the recent recommendations of the Tax Commission to shift the tax burden toward indirect taxes and further reduce preferential tax treatment for residential real estate relative to other assets.

**27. Further reform to the pension system and sickness and disability benefits is needed.**

Staff urged the authorities to complete the pension reform by fully aligning the rules of public sector pensions with the principles used in private sector pensions. In addition, Norway's expenditure on health-related benefits is the highest among the OECD countries, with large inflows into disability cases and high sickness absence incidence. This has resulted in a large group of people being left out of the labor market. The large immigration inflows to Norway in recent years have also put pressures on the welfare system, particularly in the context of the ongoing transition that could result



in higher unemployment in the process.<sup>5</sup> Further reforms to sickness and disability benefits would help address these challenges and maintain the participation rate in the face of aging population. In this context, staff welcomed the Productivity Commission's focus on improved use of manpower resources and took note of the authorities' recent measure of replacing disability pensions with disability benefits which are designed to create incentives to work while receiving disability benefits. The Productivity Commission's final report is expected to be presented early next year.

**28. Other structural reforms would help improve efficiency.** Restrictions on new real estate construction have slowed the building of new units and raised the cost of housing; these policies are currently under review, and staff would welcome new measures that could take some of the pressure off of housing prices by relaxing unneeded supply restrictions. In addition, Norway's extremely high trade restrictions and subsidies in agriculture are diverting private and public

<sup>5</sup> Third chapter of the Selected Issues Paper discusses challenges facing the Norwegian labor market in more detail.

resources away from more productive sectors and raising the cost of living, particularly for lower-income groups.

### Authorities' view

**29. The authorities agreed on the need to improve productivity and efficiency.** They noted that work is already underway in this area, including the work of the Productivity Commission which will present its final report in early 2016. Regarding the labor market, the authorities stood ready to take measures if necessary but at the same time cautioned against the unintended consequences of locking in parts of the labor force and undermining the warranted structural shift of the economy to the non-oil competitive industries.

## STAFF APPRAISAL

**30. The Norwegian economy has so far seen limited impact from lower oil prices, but the near term outlook has weakened.** Economic growth held steady in 2014, with inflation close to target, robust house price growth, and unemployment—although edging up—remaining at a low level. The sharp depreciation of the krone improved competitiveness, and staff assessed the krone to be moderately undervalued or close to its equilibrium level. Despite the solid performance last year, lower oil prices and the ongoing slowdown in offshore investment are expected to put a drag on mainland growth this year.

**31. The medium and longer term presents challenges of managing a transition away from the oil-dependent growth model.** These challenges have become more urgent with the recent sharp decline in oil prices. After a decade of steadily providing demand stimulus to the mainland economy, oil and gas investment has started to decline, and this trend is expected to accelerate in the years ahead. Resources thus need to shift from supplying the oil and gas sector and move toward other tradable sectors of the economy or exports of oil-related goods and services. To facilitate this process, common currency unit labor costs will need to adjust downward from their current high level, either through higher productivity growth or continued wage restraint for several years.

**32. The current monetary policy stance is appropriately supportive.** A challenge going forward would be to manage the tensions across different objectives: while growth is moderating, exchange rate depreciation has exerted upward pressures on imported prices, and overheating risks in the housing market persist. If growth turns out significantly weaker than currently projected, monetary policy needs to be the first line of defense against economic weakness, as long as inflation expectations are well anchored. The prompt implementation of macroprudential measures to contain rising household credit would leave room for monetary policy to more freely support growth and pursue its inflation target.

**33. Fiscal policy is broadly appropriate this year given the projected slowdown, but should shift to a more neutral stance in the medium term.** If growth is weaker than expected in 2016,

the authorities should allow automatic stabilizers to operate but should stop short of using fiscal stimulus to replace declining oil-related demand in the mainland economy, as that would inhibit the necessary shift of resources from oil-related to other tradable industries. More generally, supplementary provisions for the fiscal rule would be needed to limit the impact of the GPFG's year-to-year asset return volatility on the fiscal position. The recommendations of the commission on the fiscal rule would go a long way to addressing these concerns, and staff would welcome the authorities' adoption of rules along these lines after the public consultation.

**34. The FSAP update concluded that the Norwegian financial system is generally sound and well managed, but further measures to reduce risks would be helpful.** The authorities have taken significant measures to address financial stability risks, including early implementation of the CRD IV. However, additional measures in the area of (i) bank stress tests; (ii) macroprudential policy; (iii) prudential supervision; and (iv) crisis management and bank resolution would reduce risks further. Specifically, further steps in liquidity monitoring including improving liquidity stress tests, stricter LTV, loan-to-income or debt service ratio to supplement the affordability test, more frequent comprehensive assessments of small banks, and strengthening the toolkit and funding arrangements for bank resolution would all be welcome.

**35. Structural reforms would support the transition to a new growth model and further improve efficiency of the economy.** Less preferential tax treatment for residential properties relative to other assets, along the lines of the Tax Commission's recommendations, would help redeploy new investment toward other tradable industries. In addition, the pension reform needs to be completed, and further reforms to sickness and disability benefits would prevent people from dropping out of the labor market and maintain the participation rate in the face of aging population. There is also scope for efficiency gains from lowering Norway's extensive agricultural protection and subsidies as well as relaxing unnecessary supply restrictions in the housing market.

**36. It is proposed that the next Article IV consultation with Norway be held on the standard 12-month cycle.**

**Box 1. External Sector Assessment and Competitiveness**

**Norway’s external position in 2014 remains strong, despite unfavorable terms of trade movements.** The current account surplus narrowed to 11.8 percent of (mainland) GDP, driven by lower oil exports. Meanwhile, the net international investment position (NIIP) increased to 213 percent of GDP (up from 160 percent in 2013), benefiting from profitable foreign equity investment by the Government Pension Fund Global (GPF) and the depreciating exchange rate, even as the banking sector is a net external debtor. International reserves increased to over 19 percent of GDP.

**The IMF’s External Balance Assessment (EBA), using data up to March 2015, suggests a wide range of estimates for misalignment of the Norwegian krone.** The EBA analysis of the current account and the REER index estimate that the krone is mildly undervalued relative to the value consistent with medium-term fundamentals and desirable policies (by 1.0 and 4.8 percent, respectively). The recent real exchange rate depreciation in late 2014—driven by the oil price decline—contributed to the assessment. At the same time, the new EBA analysis of the REER level suggests a much larger undervaluation (19.3 percent), whereas the ES approach points to the opposite—an overvaluation of 38 percent.

**External Balance Assessment (EBA) Methodologies 1/**

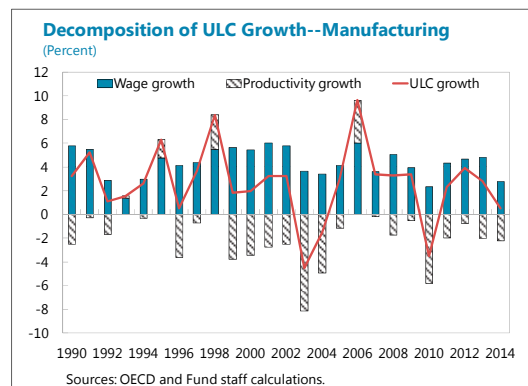
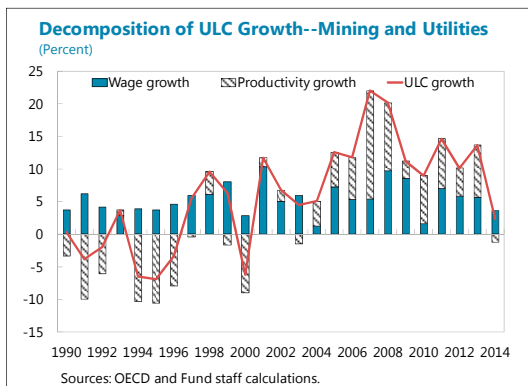
Methodology	CA gap (Percent of GDP)	REER gap (Percent)
EBA CA Analysis	0.3	-1.0
EBA REER (Index) Analysis	--	-4.8
EBA REER (Level) Analysis	--	-19.3
EBA External Sustainability (ES) Approach	-13.4	38.0

Source: Fund staff calculations.

1/ CA gaps: minus indicates overvaluation. REER gaps: minus indicates undervaluation. EBA estimates are based on data available in March

**Staff judgment puts greater emphasis on the first two estimates, in view of the uncertainty surrounding the REER level and ES approaches.** Compared to the CA and REER index analysis, the model fit of the REER level approach is substantially poorer for Norway. In addition, the ES estimate of optimal current account level—estimated using the precautionary savings framework described in Bems and de Carvalho Filho (2009)<sup>1</sup> and applied for countries that are exporters of exhaustible resources—is subject to considerable uncertainty coming from model and parameter assumptions, including those about the quantity and price path of exhaustible resources. Thus, in both cases, staff considers the uncertainty too large for the REER gaps estimated from these approaches to reflect the actual degree of misalignment.

**While the CPI-based REER may be moderately undervalued, the ULC-based REER measure has been pointing to worsening long-term cost competitiveness.** Norway’s ULC-based REER has appreciated by over 50 percent during the past two decades—although this has reversed somewhat due to the recent depreciation, and ULC growth has been among the highest in the OECD. Much of this phenomenon is confined to the mining and utilities industry (which includes oil and gas extraction as well as services activities incidental to oil and gas), where not only strong wage growth but also declining productivity contribute to the rapid increase in unit labor cost. However, despite the fiscal rule’s help in insulating the mainland’s non-oil sector from Dutch disease effects, productivity growth in non-oil tradable sectors (e.g., manufacturing) has slowed and export shares have been on the decline.



<sup>1</sup>“Current Account and Precautionary Savings for Exporters of Exhaustible Resources,” IMF Working Paper 09/33.

## Box 2. Risk Assessment Matrix<sup>1</sup>

### Potential Deviations from Baseline

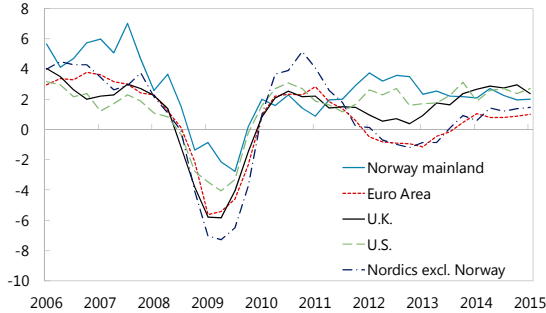
Source of Risks and Relative Likelihood	Expected Impact if Risk is Realized
<b>Medium</b>	<b>Medium/High</b>
<b>Risks to energy prices:</b> <ul style="list-style-type: none"> <li>• <b>Persistently low prices</b> triggered by supply factors reversing only gradually, and weaker demand.</li> </ul>	<ul style="list-style-type: none"> <li>• Prolonged low oil prices would undercut growth through a reduction in the oil-related demand for mainland goods and services, and undermine confidence.</li> </ul> <p><b>Policy response:</b> Monetary policy is the first line of defense while there is ample fiscal space.</p>
<b>Medium</b>	<b>High</b>
<b>Significant reduction in house prices:</b> <ul style="list-style-type: none"> <li>• House prices picked up in 2014 and remain at high levels with a risk of significant overvaluation.</li> <li>• Household debt continues to stay elevated at 200 percent of household disposable income.</li> </ul>	<ul style="list-style-type: none"> <li>• Substantial falls in house prices would dampen private consumption and reduce residential investment. Reduced retail sales could lead to an increase in default rates that would hurt banks' balance sheets.</li> </ul> <p><b>Policy response:</b> Take additional macroprudential measures to contain risks from a further buildup of high household debt.</p>
<b>High/Medium</b>	<b>High</b>
<b>Protracted period of slower growth in key advanced and emerging economies:</b> <ul style="list-style-type: none"> <li>• <b>Euro area and Japan:</b> Weak demand and persistently low inflation from a failure to fully address crisis legacies and appropriately calibrate macro policies, leading to "new mediocre" rate of growth.</li> <li>• <b>Emerging markets:</b> Maturing of the cycle, misallocation of investment, and incomplete structural reforms leading to prolonged slower growth.</li> </ul>	<ul style="list-style-type: none"> <li>• Protracted slower global growth would weaken non-oil exports and contribute further to lower oil prices. This would result in economic slowdown and higher unemployment.</li> <li>• Lower asset prices may have negative impact on GPFG's rate of return.</li> </ul> <p><b>Policy response:</b> When this risk materializes, allow automatic stabilizers to operate.</p>
<b>High</b>	<b>Medium</b>
<b>Side-effects from global financial conditions:</b> <ul style="list-style-type: none"> <li>• <b>A surge in financial volatility:</b> as investors reassess underlying risk and move to safe-haven assets given slow and uneven growth as well as asymmetric monetary exit, with poor market liquidity amplifying the effect on volatility.</li> </ul>	<ul style="list-style-type: none"> <li>• Renewed stress in global whole sale funding markets could lead to liquidity strains for Norwegian banks that rely on whole sale funding. The large presence of foreign-owned banks increases spillover risks.</li> <li>• Volatility in financial markets may have negative impacts on the rate of return of GPFG.</li> </ul> <p><b>Policy response:</b> Further strengthen monitoring of liquidity in line with FSAP recommendations. Consider supplements to the fiscal rule to limit the impact of GPFG volatility on the budget.</p>
<b>Medium</b>	<b>Medium</b>
<b>A failure of non-oil-related parts of the mainland economy to pick up slack resulting from lower oil prices</b> <ul style="list-style-type: none"> <li>• A shift to a less oil-dependent growth model could stall if wages fail to adjust or if exchange-rate induced inflation in imports becomes generalized inflation.</li> </ul>	<ul style="list-style-type: none"> <li>• Resources need to shift from oil-related to non-oil related sectors, and labor market flexibility will be tested in the process. Exchange rate depreciation should also help the process unless offset by higher domestic inflation.</li> </ul> <p><b>Policy response:</b> Stop short of using fiscal stimulus to replace declining oil-related demand in the mainland economy. Adopt competitiveness and productivity enhancing reforms.</p>

<sup>1</sup> 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 ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non mutually exclusive risks may interact and materialize jointly.

**Figure 1. GDP and Activity Indicators**

Mainland growth has been similar to or above that of peers...

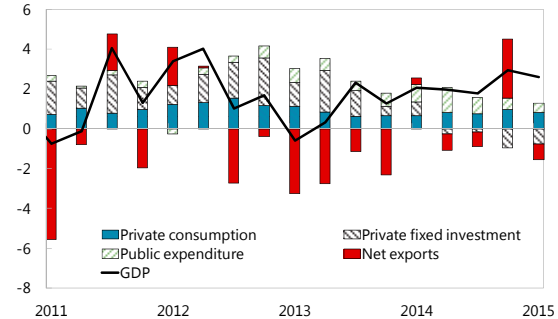
**GDP Growth of Trade Partners**  
(Y/Y growth)



Sources: Eurostat, Statistics Denmark, Statistics Finland, Statistics Norway, Statistics Sweden, U.K. Office of National Statistics, U.S. Bureau of Economic Analysis, and Fund staff calculations.

...with support coming mostly from private consumption and public spending.

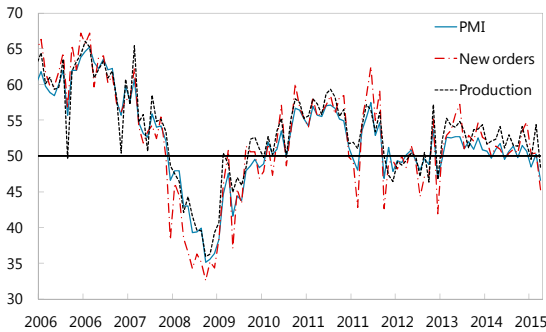
**Contributions to Total Real GDP Growth**  
(Y/Y percentage points, SA)



Sources: Statistics Norway and Fund staff calculations.

Business demand has dropped...

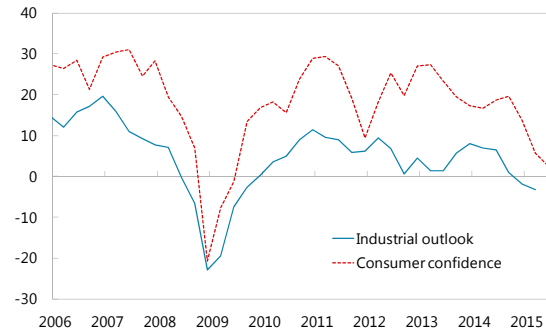
**Purchasing Manager Index**  
(50+ = expansion, SA)



Sources: Danske Bank and Fund staff calculations.

... and confidence indicators have worsened recently.

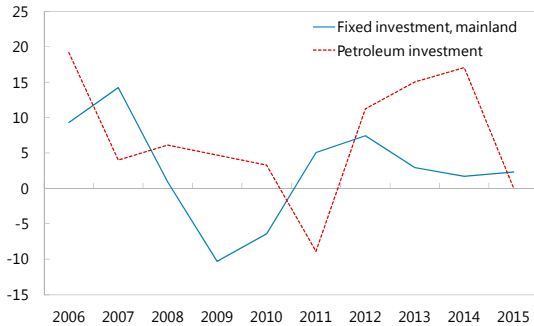
**Business and Consumer Sentiment**  
(>0 = optimism)



Sources: Statistics Norway, TNS Gallup, and Fund staff calculations.

Petroleum related investment growth has been high but projected to fall in coming years.

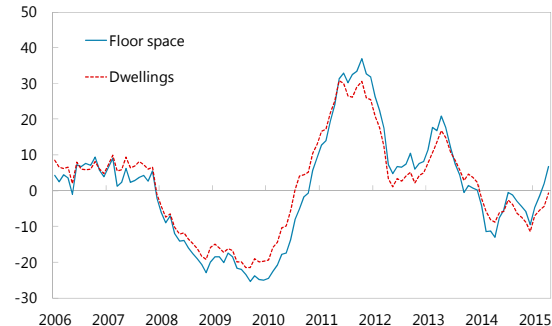
**Investment Growth**  
(Percent change)



Sources: IMF World Economic Outlook, Norges Bank, and Fund staff calculations.

Building starts are also weakening suggesting possible cooling in the housing market.

**Building Starts**  
(Last 12 months growth over previous 12 months)



Sources: Statistics Norway and Fund staff calculations.

### Figure 2. Labor Market Developments

Employment growth is solid while average hours have been stable.

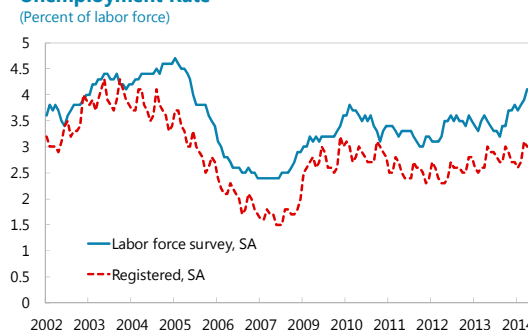
#### Employment and Hours



Sources: Statistics Norway and Fund staff calculations.

Unemployment rate has been low and stable...

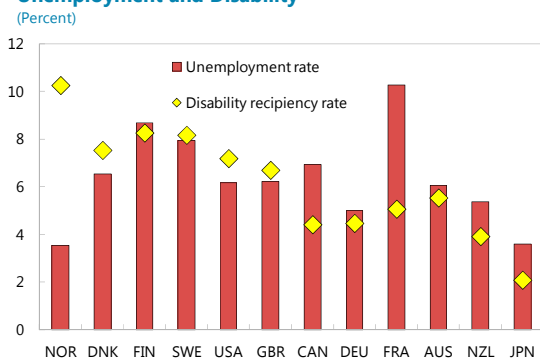
#### Unemployment Rate



Sources: Labor and Welfare Administration, Statistics Norway, and Fund staff calculations.

...but disability claims are a bigger drag on participation than in peers.

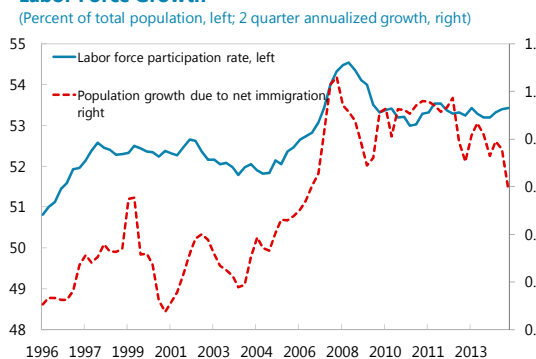
#### Unemployment and Disability



Sources: IMF World Economic Outlook, OECD, and Fund staff calculations.

The participation rate is holding steady partly due to immigration.

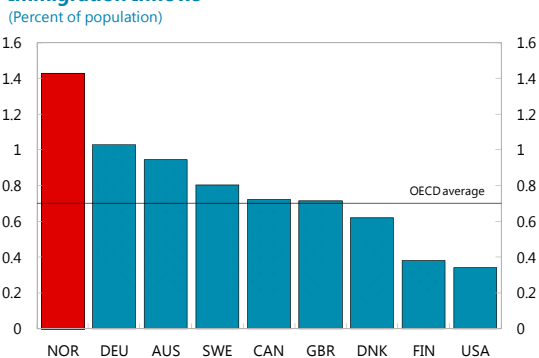
#### Labor Force Growth



Sources: Statistics Norway and Fund staff calculations.

Recent immigration inflows are high among OECD peers...

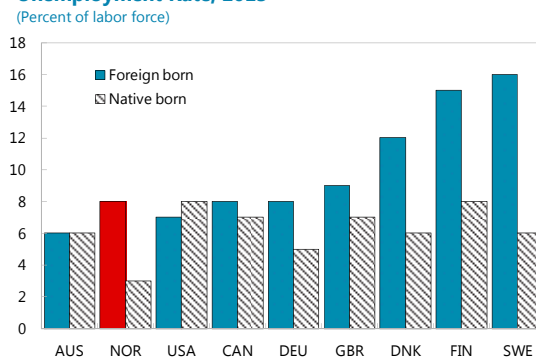
#### Immigration Inflows



Sources: OECD and Fund staff calculations.

...posing challenges to the labor market.

#### Unemployment Rate, 2013



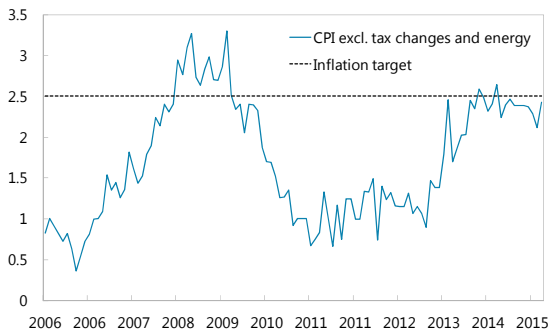
Sources: OECD and Fund staff calculations.



**Figure 3. Price Developments**

*Inflation is near the target...*

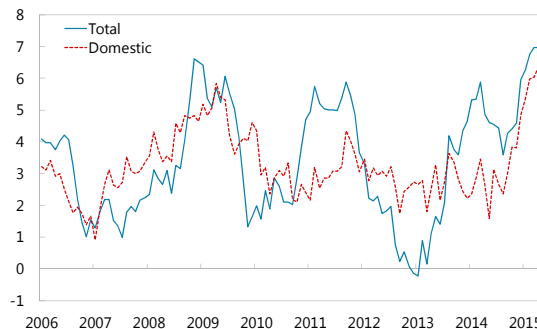
**Annual Inflation**  
(Percent change)



Sources: Statistics Norway and Fund staff calculations.

*...but producer prices are trending up...*

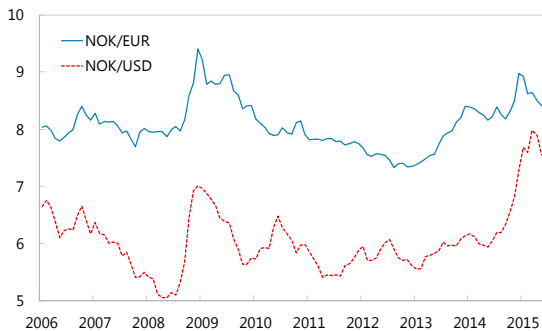
**Producer Price Index: Consumer Goods**  
(Y/Y percent change)



Sources: Statistics Norway and Fund staff calculations.

*...with the exchange rate depreciation.*

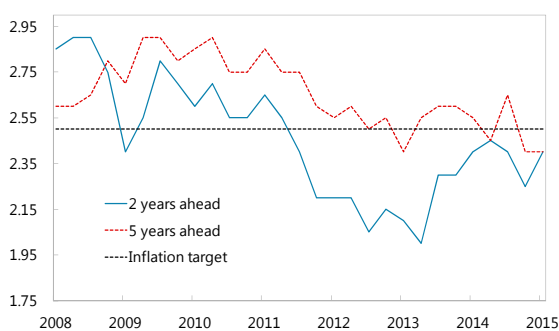
**Bilateral Exchange Rates**  
(LCU/foreign)



Sources: Norges Bank and Fund staff calculations.

*However, inflation expectations are still well anchored.*

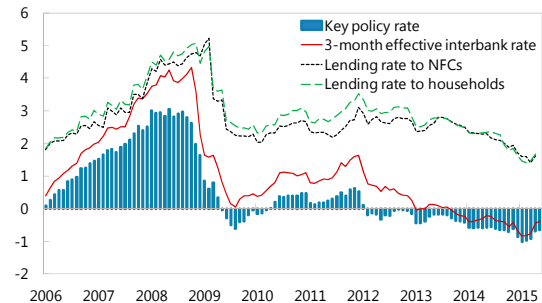
**Survey-Based Inflation Expectations**  
(Percent)



Sources: Norges Bank, TNS Gallup, and Fund staff calculations.

*Real interest rates are low...*

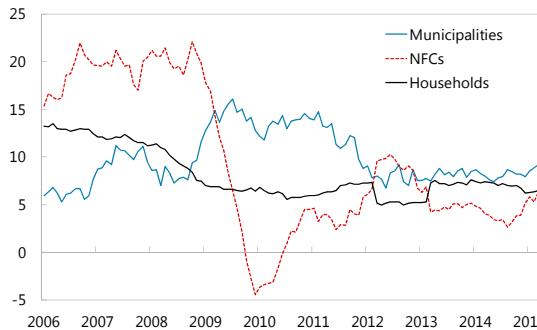
**Real Interest Rates**  
(Percent, adjusted for Norway's 1 year ahead inflation)



Sources: Consensus Forecasts, Haver Analytics, Norges Bank, Oslo Bors, Statistics Norway, and Fund staff calculations.

*...and credit growth is stable.*

**Growth in Domestic Credit**  
(Y/Y percent change)



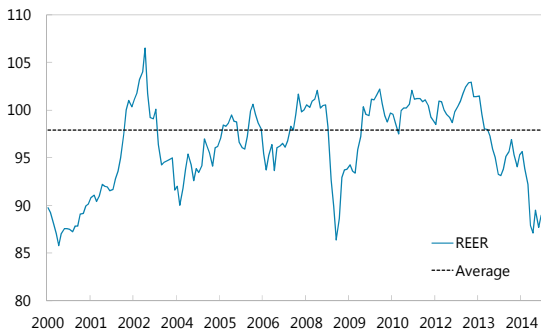
Sources: Norges Bank and Fund staff calculations.

**Figure 4. External Indicators**

*The REER has been relatively stable until recently...*

**CPI Based Real Effective Exchange Rate**

(Index: 2010=100)

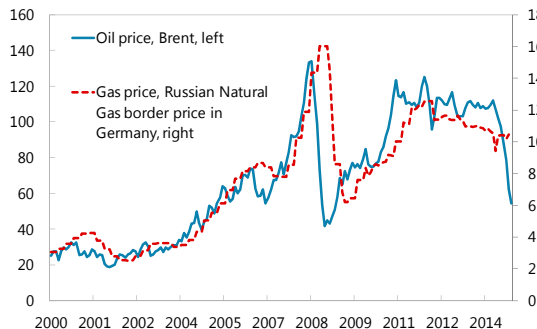


Sources: IMF Information Notice System and Fund staff calculations.

*...when oil and gas prices fluctuated significantly.*

**Oil and Gas Prices**

(USD)

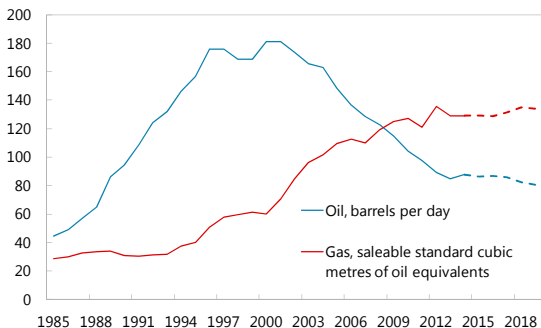


Sources: IMF Global Economic Assumptions and Fund staff calculations.

*Oil and gas production continues...*

**Oil and Gas Production**

(Millions)

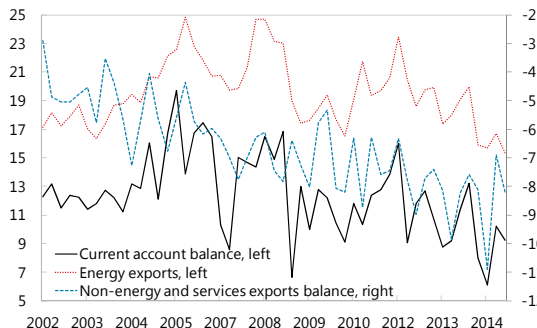


Sources: Norwegian Petroleum Directorate and Fund staff calculations.

*...supporting the current account surplus.*

**Current Account Balance**

(Percent of GDP)

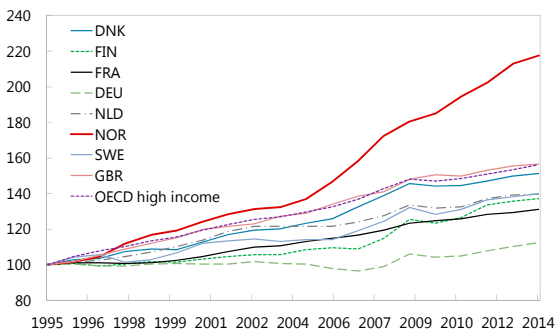


Sources: Statistics Norway and Fund staff calculations.

*However, labor costs are eroding competitiveness...*

**Unit Labor Costs**

(Index: 1995=100)

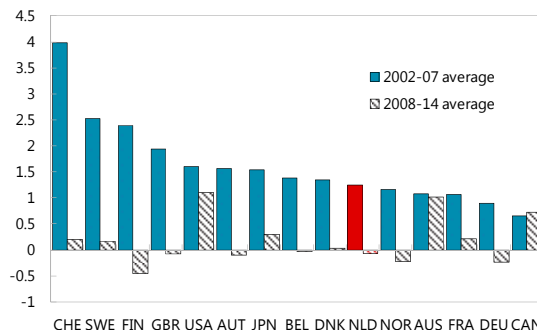


Sources: OECD and Fund staff calculations.

*... and productivity has declined post-crisis.*

**Productivity Growth Before and After the Crisis**

(Percent change)



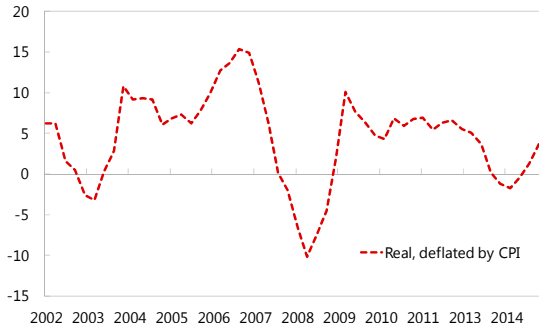
Sources: OECD and Fund staff calculations.

**Figure 5. Household and Corporate Sectors**

House prices have picked up recently after moderating in 2013 ....

**House Price Growth**

(Y/Y percent change)

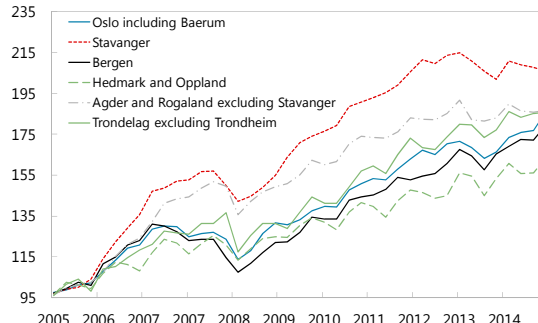


Sources: Statistics Norway and Fund staff calculations.

... while some regional markets are tighter than others.

**Regional House Prices**

(Index: 2005=100)

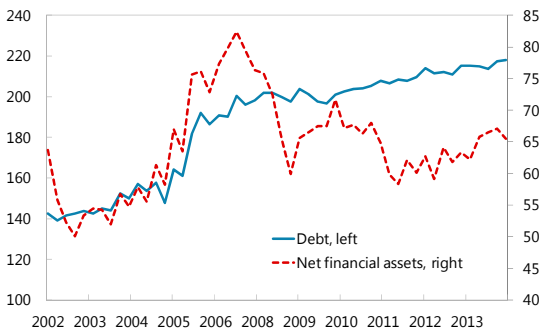


Sources: Statistics Norway and Fund staff calculations.

Household debt reached more than 200 percent of disposable income...

**Household Financial Position**

(Percent of disposable income)

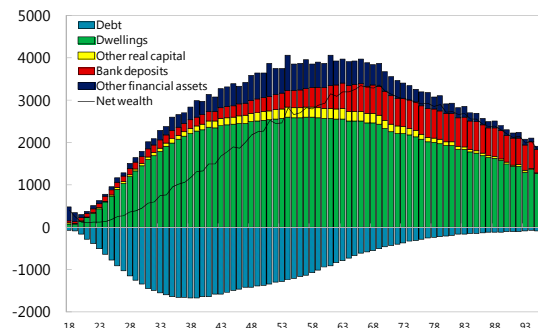


Sources: Statistics Norway and Fund staff calculations.

... and debt is skewed toward younger households with limited liquid assets.

**Balance Sheet by Age of Main Income Earner, 2012**

(Thousands of NOK)

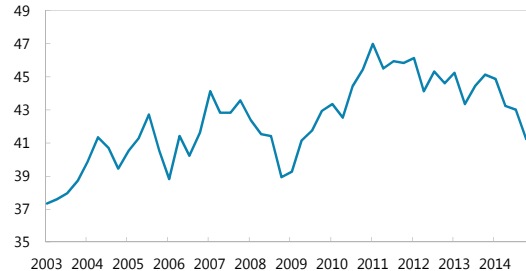


Sources: Norges Bank and Fund staff calculations.

The debt-service capacity of NFCs has declined somewhat...

**Debt Servicing Capacity of Listed Companies 1/**

(Percent)

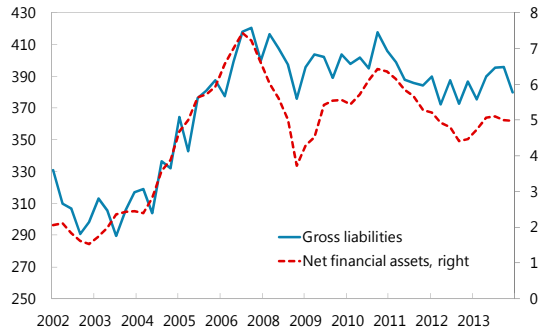


Sources: Norges bank and Fund staff calculations.  
1/ Pre-tax profit plus depreciation and amortization of the previous 4 quarters as a percent of interest-bearing debt for non-financial enterprises.

...while corporate financial positions have been relatively stable.

**Nonfinancial Corporation Financial Position**

(Percent of mainland GDP)

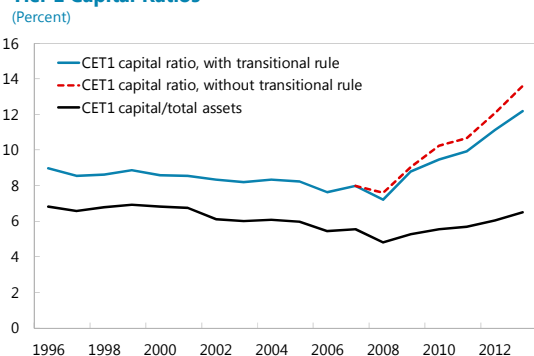


Sources: Statistics Norway and Fund staff calculations.

**Figure 6. Banking Sector Developments**

Regulatory capital ratios have improved...

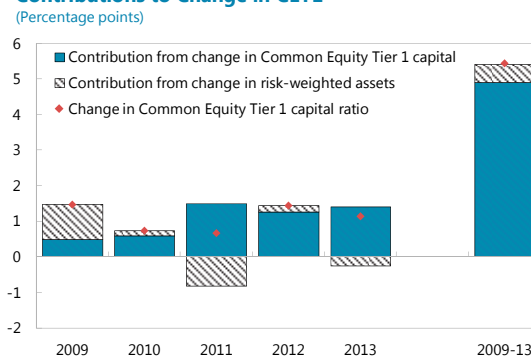
**Tier 1 Capital Ratios**



Sources: Norges Bank and Fund staff calculations.

... partly due to changes in risk weighted assets.

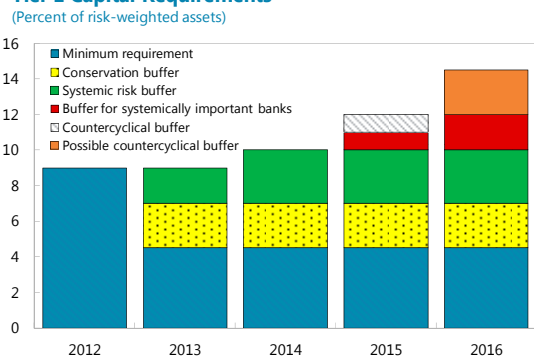
**Contributions to Change in CET1**



Sources: Norges Bank and Fund staff calculations.

While new capital requirements are being phased in...

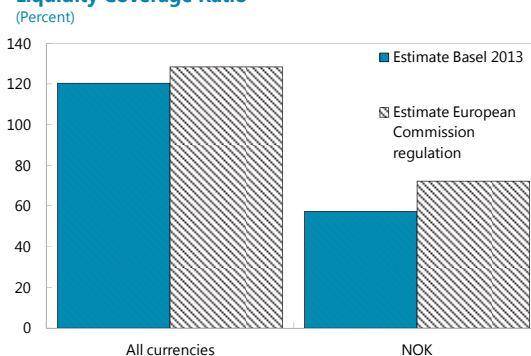
**Tier 1 Capital Requirements**



Sources: Norges Bank and Fund staff calculations.

...banks may face challenges meeting new liquidity requirements in Norwegian krone.

**Liquidity Coverage Ratio**



Sources: Norges Bank and Fund staff calculations.

Nonperforming loans have declined recently...

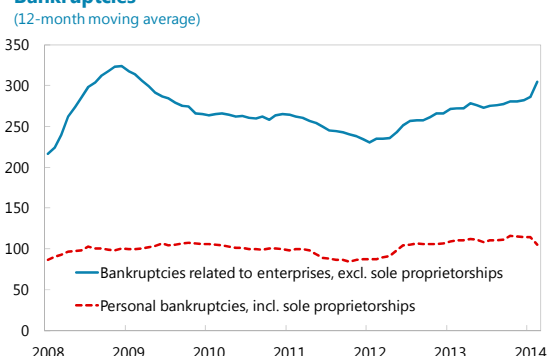
**Nonperforming Loans**



Sources: IMF Financial Soundness Indicators and Fund staff calculations.

...while corporate bankruptcies are gradually rising.

**Bankruptcies**



Sources: Statistics Norway and Fund staff calculations.

**Table 1. Norway: Selected Economic and Social Indicators, 2009–16**

Population (2014): 5.2 million  
 Per capita GDP (2014): US\$ 97,720  
 Main products and exports: Oil, natural gas, fish (primarily salmon)

Quota (1883.7 mil. SDR/0.79 percent of total)  
 Literacy: 100 percent

	2009	2010	2011	2012	2013	2014	Projections	
							2015	2016
<b>Real economy (change in percent)</b>								
Real GDP 1/	-1.6	0.6	1.0	2.7	0.7	2.2	1.0	1.3
Real mainland GDP	-1.6	1.8	1.9	3.8	2.3	2.2	1.3	1.7
Domestic demand	-3.2	3.0	2.7	3.5	3.6	1.9	1.0	1.6
Unemployment rate (percent of labor force)	3.2	3.6	3.3	3.2	3.5	3.5	4.0	4.1
Output gap (mainland economy, - implies output below potential)	-1.1	-1.3	-0.9	0.2	0.0	-0.1	-0.6	-0.8
CPI (average)	2.2	2.4	1.3	0.7	2.1	2.0	2.3	2.3
Gross national saving (percent of GDP)	35.4	36.3	38.2	39.0	38.3	37.9	36.8	36.5
Gross domestic investment (percent of GDP)	24.8	25.4	25.8	26.5	28.3	28.4	28.1	28.3
<b>Public finance</b>								
Central government (fiscal accounts basis)								
Overall balance (percent of mainland GDP) 2/	9.3	8.3	12.6	12.8	9.4	6.1	3.8	3.9
Structural non-oil balance (percent of mainland trend GDP) 3/	-5.1	-5.1	-4.5	-5.0	-5.1	-5.8	-6.4	...
Fiscal impulse		0.0	-0.6	0.5	0.2	0.7	0.6	...
in percent of Pension Fund Global capital 4/	-4.4	-4.1	-3.2	-3.4	-3.3	-2.9	-2.6	...
General government (national accounts basis, percent of mainland GDP)								
Overall balance	12.8	13.6	17.1	17.5	14.0	10.9	8.0	8.1
Net financial assets	194.7	208.6	209.4	220.5	259.3	303.6	317.5	318.5
of which: capital of Government Pension Fund Global (GPF-G)	134.2	148.2	153.3	166.1	207.8	254.3	269.8	...
<b>Money and credit (end of period, 12-month percent change)</b>								
Broad money, M2	2.4	5.2	6.2	3.8	6.1	5.3	...	...
Domestic credit, C2	2.9	6.1	6.9	5.9	6.8	6.0	...	...
<b>Interest rates (year average, in percent)</b>								
Three-month interbank rate	2.5	2.5	2.9	2.2	1.8	1.7	1.4	1.4
Ten-year government bond yield	4.0	3.5	3.1	2.1	2.6	2.5	2.5	2.5
<b>Balance of payments (percent of mainland GDP)</b>								
Current account balance	13.1	13.6	16.0	16.1	12.7	11.8	10.8	10.1
Exports of goods and services (volume change in percent)	-4.1	0.7	-0.8	1.4	-3.0	2.7	1.4	1.4
Imports of goods and services (volume change in percent)	-10.0	8.3	4.0	3.1	4.3	1.9	1.6	2.4
Terms of trade (change in percent)	-16.8	6.7	9.1	2.8	-0.6	-5.2	-2.0	-0.9
International reserves (end of period, in billions of US dollars)	48.9	55.6	52.8	51.7	57.9	66.8	67.7	77.3
<b>Fund position</b>								
Holdings of currency (percent of quota)	80.6	76.6	71.4	71.1	78.2	85.6	...	...
Holdings of SDR (percent of allocation)	102.4	102.0	97.5	96.1	95.1	94.8	...	...
Quota (SDR millions)	1,672	1,672	1,884	1,884	1,884	1,884	...	...
<b>Exchange rates (end of period)</b>								
Exchange rate regime								
Floating								
Bilateral rate (NOK/USD), end-of-period	6.3	6.0	5.6	5.8	5.9	6.3	...	...
Real effective rate (2010=100)	95.2	100.0	100.6	100.2	98.9	94.1	...	...

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

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

2/ Projections based on authorities' 2015 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.

**Table 2. Norway: Medium-Term Indicators, 2012–20**  
(Annual percent change, unless otherwise noted)

	2012	2013	2014	Projections					
				2015	2016	2017	2018	2019	2020
Real GDP	2.7	0.7	2.2	1.0	1.3	1.7	1.9	2.0	2.0
Real mainland GDP	3.8	2.3	2.2	1.3	1.7	2.2	2.4	2.5	2.5
Real Domestic Demand	3.5	3.6	1.9	1.0	1.6	2.2	2.4	2.5	2.5
Public consumption	1.6	1.7	2.7	2.5	2.2	2.1	2.0	2.0	2.0
Private consumption	3.5	2.1	2.0	1.4	1.5	2.6	2.8	2.8	2.8
Gross fixed investment	7.6	6.8	0.6	-1.0	1.6	2.1	2.6	3.0	3.0
Stockbuilding (contribution to growth)	-0.3	0.5	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Trade balance of goods and services (contribution to growth)	-0.3	-2.4	0.5	0.1	-0.1	-0.3	-0.3	-0.2	-0.3
Exports of goods and services	1.4	-3.0	2.7	1.4	1.4	1.4	1.4	1.5	1.5
Mainland good exports	-0.2	1.0	2.3	2.5	2.8	2.8	2.8	2.9	2.9
Imports of goods and services	3.1	4.3	1.9	1.6	2.4	2.8	2.8	2.8	2.8
Potential GDP	1.7	0.9	2.3	1.5	1.5	1.2	1.6	2.0	2.0
Potential mainland GDP	2.7	2.4	2.3	1.9	1.9	1.7	2.1	2.5	2.5
Output Gap (percent of potential)	0.2	0.0	-0.1	-0.6	-0.8	-0.3	0.0	0.0	0.0
Labor Market									
Employment	1.9	0.7	1.1	0.5	0.7	0.9	1.0	1.0	1.0
Unemployment rate LFS (percent)	3.2	3.5	3.5	4.0	4.1	4.0	3.9	3.8	3.8
Prices and Wages									
GDP deflator	3.4	2.7	0.4	1.4	2.1	2.1	2.3	2.3	2.3
Consumer prices (avg)	0.7	2.1	2.0	2.3	2.3	2.3	2.5	2.5	2.5
Consumer prices (eop)	1.4	2.0	2.1	2.3	2.3	2.3	2.5	2.5	2.5
Manufacturing wages									
Hourly compensation	0.0	-0.1	0.1	...	...	...	...	...	...
Productivity	0.9	13.3	-2.1	...	...	...	...	...	...
Unit labor costs	-4.6	-4.6	-2.7	...	...	...	...	...	...
Fiscal Indicators									
General government fiscal balance (percent of GDP)	13.5	11.0	8.8	6.5	6.6	6.3	6.3	5.9	5.5
of which: nonoil balance (percent of mainland GDP)	-5.8	-6.1	-8.3	-8.2	-8.3	-8.8	-8.8	-8.8	-8.7
External Sector									
Current account balance (percent GDP)	12.4	10.0	9.4	8.7	8.1	7.4	6.6	6.4	6.0
Balance of goods and services (percent of GDP)	12.9	10.2	8.7	8.0	7.4	6.7	5.9	5.1	4.4
Mainland balance of goods 1/	-9.0	-9.2	-8.9	-3.9	-5.3	-6.1	-6.9	-7.2	-7.3

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

Table 3. Norway: External Indicators, 2012–20

	2012	2013	Projections 1/						
			2014	2015	2016	2017	2018	2019	2020
	<i>Bil. NOK</i>								
Current account balance	368.6	307.7	297.0	281.4	271.2	255.8	238.6	242.1	236.2
Balance of goods and services	383.3	312.5	275.2	258.8	247.9	231.5	213.3	194.0	172.6
Balance of goods	401.6	339.1	299.8	285.9	280.3	271.2	260.8	249.8	237.6
Balance of services	-18.3	-26.6	-24.6	-27.1	-32.5	-39.7	-47.5	-55.8	-65.1
Exports	1204.4	1190.7	1207.6	1230.3	1272.6	1316.6	1362.5	1411.0	1461.5
Goods	929.0	901.6	890.8	900.1	926.4	953.6	981.7	1011.4	1042.2
of which oil and natural gas	610.8	570.4	537.9	399.0	434.3	454.9	474.4	483.3	486.0
Services	275.3	289.2	316.8	330.2	346.2	363.0	380.8	399.7	419.3
Imports	821.0	878.2	932.4	971.4	1024.7	1085.2	1149.2	1217.0	1288.9
Goods	-1.3	-1.4	-1.1	-1.4	-1.4	-1.5	-1.5	-1.6	-1.7
Services	293.6	315.8	341.4	357.3	378.7	402.7	428.3	455.4	484.3
Balance on income	-14.7	-4.8	21.8	22.6	23.3	24.3	25.3	48.1	63.6
Capital account balance	-1.3	-1.4	-1.1	-1.4	-1.4	-1.5	-1.5	-1.6	-1.7
Financial account balance	266.3	255.7	354.6	280.0	269.8	254.3	237.1	240.5	234.5
Net direct investment	4.6	38.5	66.6	33.3	41.3	51.0	45.1	50.1	53.8
Net portfolio investment	301.0	284.5	116.3	245.5	185.4	194.5	197.3	200.2	152.8
Net other investment	-47.9	-81.2	134.0	-27.1	-34.6	43.4	8.6	7.6	13.3
Change in reserves (- implies an increase)	7.7	15.2	40.1	28.3	77.6	-34.5	-13.9	-17.3	14.6
Net errors and omissions	-101.0	-50.6	58.8	0.0	0.0	0.0	0.0	0.0	0.0
	<i>Percent of Mainland GDP</i>								
Current account balance	16.1	12.7	11.8	10.8	10.1	9.1	8.1	7.9	7.3
Balance of goods and services	16.7	12.9	10.9	9.9	9.2	8.2	7.3	6.3	5.3
Balance of goods	17.5	14.0	11.9	10.9	10.4	9.6	8.9	8.1	7.3
Balance of services	-0.8	-1.1	-1.0	-1.0	-1.2	-1.4	-1.6	-1.8	-2.0
Exports	52.5	49.2	47.8	47.1	47.2	46.8	46.5	45.9	45.1
Goods	40.5	37.2	35.2	34.5	34.3	33.9	33.5	32.9	32.2
of which oil and natural gas	26.6	23.5	21.3	15.3	16.1	16.2	16.2	15.7	15.0
Services	12.0	11.9	12.5	12.6	12.8	12.9	13.0	13.0	12.9
Imports	35.8	36.3	36.9	37.2	38.0	38.6	39.2	39.6	39.8
Goods	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Services	12.8	13.0	13.5	13.7	14.0	14.3	14.6	14.8	15.0
Balance on income	-0.6	-0.2	0.9	0.9	0.9	0.9	0.9	1.6	2.0
Capital account balance	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Financial account balance	11.6	10.6	14.0	10.7	10.0	9.0	8.1	7.8	7.2
Net direct investment	0.2	1.6	2.6	1.3	1.5	1.8	1.5	1.6	1.7
Net portfolio investment	13.1	11.7	4.6	9.4	6.9	6.9	6.7	6.5	4.7
Net other investment	-2.1	-3.4	5.3	-1.0	-1.3	1.5	0.3	0.2	0.4
Change in reserves (- implies an increase)	0.3	0.6	1.6	1.1	2.9	-1.2	-0.5	-0.6	0.5
Net errors and omissions	-4.4	-2.1	2.3	0.0	0.0	0.0	0.0	0.0	0.0
	<i>Percent of GDP</i>								
Stock of net foreign assets (IIP)	95.0	127.3	170.6	181.3	183.4	184.0	183.8	182.7	180.9
Direct investment, net	3.2	3.3	4.8	6.0	7.0	8.3	9.3	10.2	11.2
Portfolio investment, net	94.0	126.7	159.6	169.0	168.9	168.3	167.6	166.0	162.8
Other investment, net	-12.0	-14.3	-9.2	-10.2	-10.9	-9.2	-8.6	-8.0	-7.3
Official reserves, assets	9.8	11.6	15.4	16.5	18.3	16.6	15.6	14.4	14.2
Government Pension Fund Global, percent of mainland GDP 2/	166.6	207.7	254.4	268.1	...	...	...	...	...

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

1/ IMF staff projections as of \*\*\*

2/ Projections from the 2013 National Budget.

**Table 4. Norway: General Government Accounts, 2006–14**  
(Percent of mainland GDP)

	2006	2007	2008	2009	2010	2011	2012	2013	2014
Revenue	77.7	74.5	78.2	68.9	69.1	73.2	72.5	69.3	67.4
Taxes	45.7	42.9	44.0	39.1	40.7	42.5	41.6	39.3	36.5
Social contributions	11.4	11.2	11.6	11.9	11.7	12.0	12.1	12.1	12.4
Other	20.6	20.3	22.7	17.9	16.7	18.8	18.9	18.0	18.6
Expense	52.4	50.9	51.4	54.1	53.9	54.4	53.5	53.4	54.2
Compensation of employees	15.3	15.1	15.5	16.4	16.4	16.8	16.8	16.8	16.9
Use of goods and services	6.8	6.7	6.8	7.3	7.3	7.2	7.0	7.0	7.1
Consumption of fixed capital	3.2	3.2	3.3	3.5	3.5	3.7	3.8	3.8	3.8
Interest	3.3	3.4	2.8	1.8	1.5	1.5	1.2	1.1	1.0
Subsidies	2.4	2.2	2.3	2.5	2.5	2.5	2.4	2.4	2.3
Grants	1.1	1.2	1.3	1.4	1.5	1.4	1.3	1.4	1.4
Social benefits	18.7	17.6	17.8	19.3	19.4	19.7	19.5	19.3	19.6
Other	1.6	1.5	1.6	1.8	1.7	1.7	1.7	1.7	2.1
Gross operating balance	28.5	26.7	30.1	18.3	18.8	22.5	22.8	19.7	17.0
Net operating balance	25.3	23.5	26.8	14.8	15.3	18.8	19.0	15.9	13.2
Net acquisition of nonfinancial assets	1.3	1.5	1.7	2.0	1.5	1.4	1.1	1.5	1.8
<i>Net financing</i>									
Net lending/borrowing	24.0	22.0	25.1	12.8	13.7	17.4	17.9	14.4	11.4
Net acquisition of financial assets	45.1	26.7	15.3	3.2	18.2	1.9	21.2	17.2	9.1
Currency and deposits	3.4	0.0	-0.8	-0.8	0.5	-2.3	2.9	-1.9	1.4
Securities other than shares	32.1	3.2	10.3	-17.0	8.5	0.7	6.9	14.2	3.0
Loans	3.9	7.7	-26.5	5.4	3.2	-9.1	1.4	2.8	-2.3
Shares and other equity	4.6	14.8	28.5	17.6	4.3	11.5	10.0	2.2	6.4
Insurance technical reserves	0.1	0.0	-0.1	0.0	0.1	0.0	0.0	0.1	0.1
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	1.1	1.0	3.9	-2.2	1.6	1.1	0.0	-0.2	0.5
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	21.7	4.6	-9.6	-9.5	4.5	-14.9	3.3	2.2	-2.3
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares	1.3	-0.8	3.5	10.6	1.1	-3.8	2.5	-0.5	0.3
Loans	19.0	3.9	-14.7	-18.4	2.5	-10.2	1.1	2.4	-2.7
Shares and other equity	0.0	0.0	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	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	1.4	1.5	1.6	-1.7	0.8	-0.9	-0.3	0.3	0.1
<i>Balance sheet</i>									
Net financial worth	175.9	176.4	163.4	188.3	201.8	203.8	215.5	258.8	302.2
Financial assets	253.0	247.7	236.1	247.7	262.2	247.5	260.0	303.1	342.9
Currency and deposits	13.9	12.7	11.6	10.6	10.6	7.8	10.3	7.9	9.0
Securities other than shares	73.5	64.3	86.2	59.8	64.6	65.6	66.8	80.2	95.5
Loans	53.2	51.5	31.1	35.7	37.0	26.5	26.4	28.2	25.1
Shares and other equity	95.7	102.8	91.9	127.4	135.2	131.9	141.2	171.8	198.3
Insurance technical reserves	1.2	1.2	0.7	0.9	1.0	1.5	1.6	2.2	2.5
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	15.4	15.1	14.5	13.4	13.8	14.2	13.8	12.8	12.5
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities	77.1	71.4	72.7	59.4	60.5	43.8	44.6	44.3	40.7
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares	14.9	12.9	16.1	26.3	26.1	21.6	22.7	20.8	20.6
Loans	54.9	50.3	47.2	25.6	26.8	15.7	15.9	17.7	14.4
Shares and other equity	0.0	0.0	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	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	7.3	8.2	9.3	7.5	7.6	6.4	5.9	5.9	5.7
Mainland GDP	1661.7	1829.8	1943.3	1964.6	2074.0	2157.8	2295.4	2422.6	2527.4

Sources: IMF *Government Finance Statistics*, Ministry of Finance, and Fund staff calculations.



## Annex I. Debt Sustainability Analysis

### Norway Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

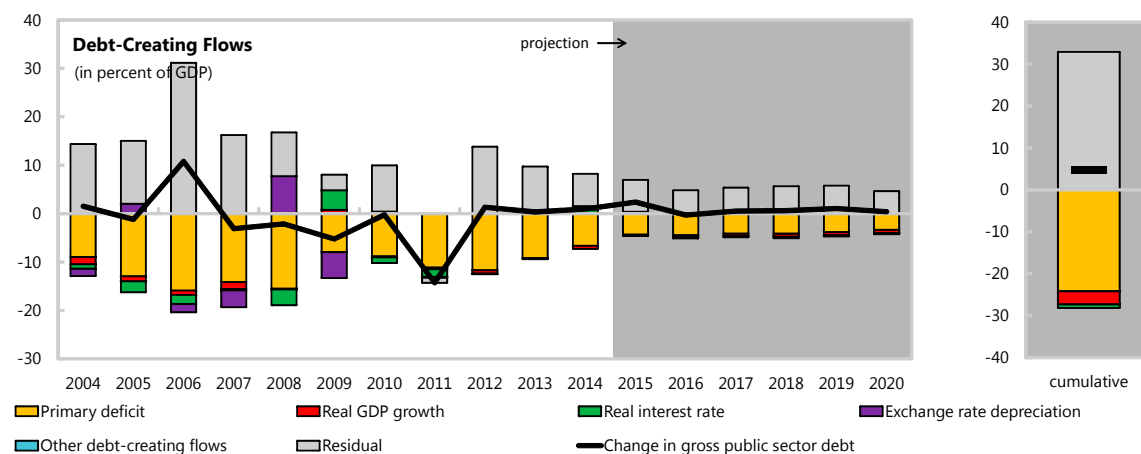
(in percent of GDP unless otherwise indicated)

#### Debt, Economic and Market Indicators <sup>1/</sup>

	Actual			Projections						As of April 01, 2015		
	2004-2012 <sup>2/</sup>	2013	2014	2015	2016	2017	2018	2019	2020	Sovereign Spreads		
Nominal gross public debt	41.5	29.2	30.1	32.5	32.2	32.7	33.3	34.4	34.8	EMBIG (bp) <sup>3/</sup> 119		
Public gross financing needs	-10.6	-10.6	-14.4	-3.8	-1.5	-1.1	-0.7	-0.1	1.9	5Y CDS (bp) 258		
Real GDP growth (in percent)	1.7	0.7	2.2	1.0	1.3	1.7	1.9	2.0	2.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	5.3	2.7	0.4	1.4	2.1	2.1	2.3	2.3	2.3	Moody's	Aaa	Aaa
Nominal GDP growth (in percent)	7.1	3.5	2.6	2.4	3.5	3.9	4.3	4.4	4.4	S&Ps	AAA	AAA
Effective interest rate (in percent) <sup>4/</sup>	3.2	3.3	3.3	2.8	1.4	1.6	1.3	1.5	1.7	Fitch	AAA	AAA

#### Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance <sup>9/</sup>
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020		
Change in gross public sector debt	-1.4	0.3	1.0	2.4	-0.3	0.5	0.6	1.1	0.4	4.7	
Identified debt-creating flows	-13.5	-9.1	-5.7	-4.2	-5.1	-4.9	-5.1	-4.7	-4.2	-28.2	
Primary deficit	-11.9	-9.2	-6.6	-4.3	-4.4	-4.1	-4.1	-3.8	-3.4	-24.2	
Primary (noninterest) revenue and grants		52.6	50.7	48.8	48.8	49.0	49.0	49.0	48.8	293.4	
Primary (noninterest) expenditure		40.7	44.0	44.4	44.4	44.9	44.9	45.1	45.5	269.2	
Automatic debt dynamics <sup>5/</sup>	-1.7	0.1	0.9	0.1	-0.7	-0.7	-0.9	-0.9	-0.9	-4.0	
Interest rate/growth differential <sup>6/</sup>	-1.4	-0.1	0.2	0.1	-0.7	-0.7	-0.9	-0.9	-0.9	-4.0	
Of which: real interest rate		-0.8	0.2	0.4	-0.3	-0.2	-0.3	-0.3	-0.2	-0.8	
Of which: real GDP growth		-0.6	-0.2	-0.3	-0.4	-0.5	-0.6	-0.6	-0.7	-3.1	
Exchange rate depreciation <sup>7/</sup>	-0.2	0.2	0.7	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of dep)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroare)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes <sup>8/</sup>	12.1	9.4	6.7	6.6	4.8	5.4	5.7	5.8	4.7	32.9	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as  $(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+g\pi)$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $a$  = share of foreign-currency denominated debt; and  $e$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

7/ The exchange rate contribution is derived from the numerator in footnote 5 as  $ae(1+r)$ .

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

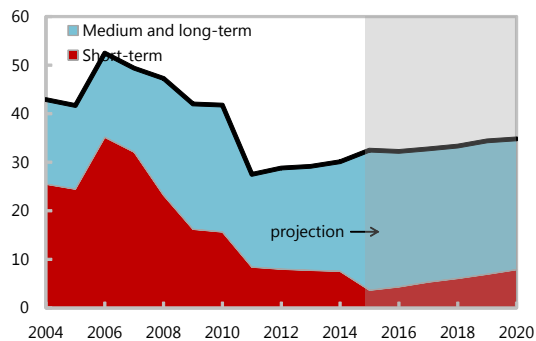
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

## Norway Public DSA - Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

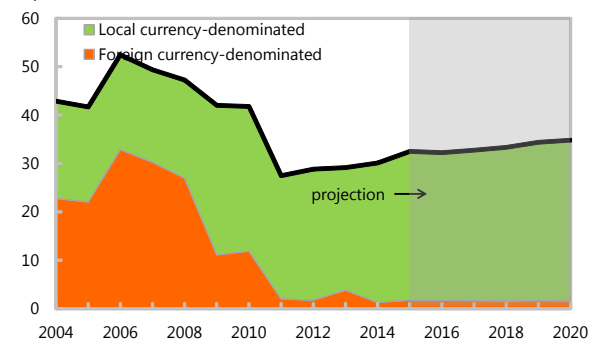
#### By Maturity

(in percent of GDP)



#### By Currency

(in percent of GDP)



### Alternative Scenarios

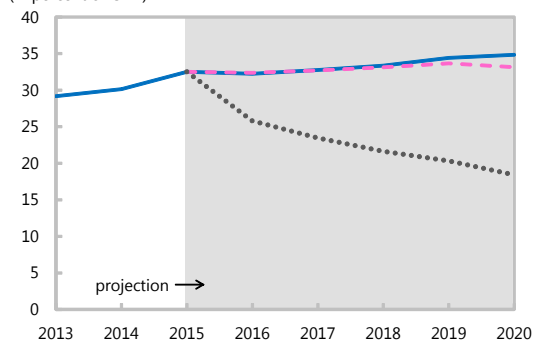
— Baseline

..... Historical

- - - Constant Primary Balance

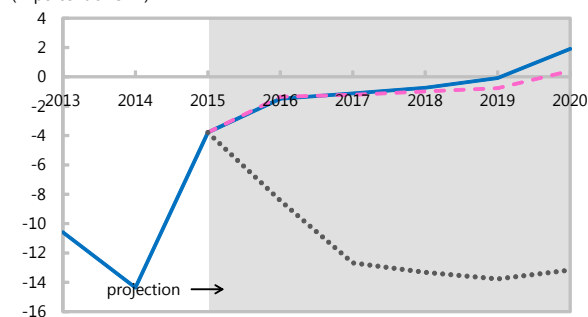
#### Gross Nominal Public Debt

(in percent of GDP)



#### Public Gross Financing Needs

(in percent of GDP)



### Underlying Assumptions

(in percent)

	2015	2016	2017	2018	2019	2020
<b>Baseline Scenario</b>						
Real GDP growth	1.0	1.3	1.7	1.9	2.0	2.0
Inflation	1.4	2.1	2.1	2.3	2.3	2.3
Primary Balance	4.3	4.4	4.1	4.1	3.8	3.4
Effective interest rate	2.8	1.4	1.6	1.3	1.5	1.7
<b>Constant Primary Balance Scenario</b>						
Real GDP growth	1.0	1.3	1.7	1.9	2.0	2.0
Inflation	1.4	2.1	2.1	2.3	2.3	2.3
Primary Balance	4.3	4.3	4.3	4.3	4.3	4.3
Effective interest rate	2.8	1.4	1.6	1.3	1.5	1.7

	2015	2016	2017	2018	2019	2020
<b>Historical Scenario</b>						
Real GDP growth	1.0	1.4	1.4	1.4	1.4	1.4
Inflation	1.4	2.1	2.1	2.3	2.3	2.3
Primary Balance	4.3	11.4	11.4	11.4	11.4	11.4
Effective interest rate	2.8	1.4	1.5	0.9	1.0	1.1

Source: IMF staff.

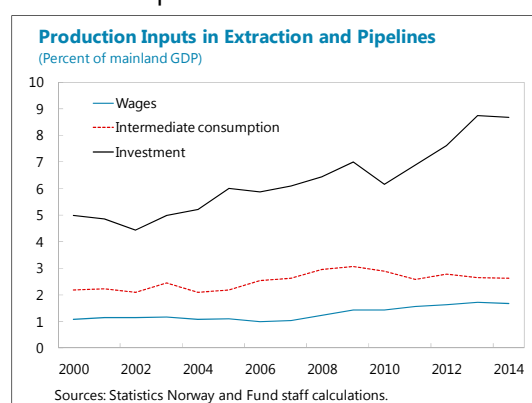
## Annex II. Authorities' Response to Past IMF Recommendations

Fund Policy Advice from 2014 Consultation	Authorities' Actions
<p><b>Macroprudential Policy:</b> Directors agreed that tighter capital standards and loan-to-value limits on mortgages should be maintained given the vulnerabilities stemming from high house prices and household debt and banks' reliance on wholesale funding, even if the housing market softens further.</p>	<p>In addition to early implementation of the CRD IV, more recently, risk weights for residential mortgages used in banks' IRB models have been tightened. A countercyclical capital buffer of 1 percent became effective from July 1, 2015, and will be increased to 1½ percent from July 1, 2016. The current FSA guidelines on residential mortgage lending were recently converted to a regulation, which also take effect on July 1, 2015.</p>
<p><b>Fiscal Policy:</b> While acknowledging the availability of resources for additional investments, most Directors saw merit in a more neutral fiscal policy stance as long as the economy remains near capacity.</p>	<p>The 2014 fiscal outturn implied a positive fiscal impulse of 0.7 percent of GDP, and the 2015 budget also entails a positive fiscal impulse of about 0.6 percent of GDP. However, in light of the expected economic slowdown in 2015 this is viewed by staff as broadly appropriate.</p>
<p><b>Structural Reforms:</b> Directors emphasized the importance of further structural reforms to improve productivity and competitiveness, and to promote the non-oil economy. Priorities include further reforms of the labor market, pensions and public services, greater wage differentiation across sectors, and reducing protection and subsidies in agriculture. Directors also recommended increased use of cost-benefit analysis in the selection of infrastructure projects, and a simpler income tax system with fewer incentives for promoting housing to encourage productive investment.</p>	<p>The authorities recently replaced disability pensions with disability benefits to create incentives to work while receiving disability benefits. The Productivity Commission is expected to present its final report in early 2016, with focus on improving the use of manpower resources, among other reforms.</p> <p>The 2015 budget reduced the valuation discount for commercial property and second dwellings from 40 to 30 percent of market value. The Tax Commission report recommended measures to further reduce preferential tax treatment for housing.</p>

## Annex III. Real Sector Links Between the Offshore and Mainland Economies<sup>1</sup>

**There are multiple real-sector linkages between the oil and gas sector and the real economy on the mainland and abroad.** The value of the income flows through these linkages is considerably larger than the fiscal transfer from the GPFG to the budget, but they are more complicated and harder to measure. Available data tend to capture either a subset of the various flows, also include flows unrelated to oil and gas, or both.

**Total expenditure by the oil and gas sector on goods and service is large.** 2014 wages, intermediate consumption (non wage, non-investment inputs), and investment were equal to 1.7, 2.6, and 8.7 percent of mainland GDP respectively for a total of 13 percent—a substantial increase from 8.3 percent a decade earlier. However, the oil and gas industry and its suppliers are highly integrated on a global basis, and not all of these expenditures were made in mainland Norway. Assuming all wage payments are to residents of mainland Norway and deducting imports of oil-related goods and services from the sum of intermediate consumption and investment (using a rough assumption of 40 percent imported content) give an approximation of the net income flows for supply and service from the offshore sector to the mainland of about 8.5 percent of GDP in 2014. However, there is large uncertainty around this estimate. Exports of oil-related goods and services probably something on the order of another 4 percent on some estimates.



**Measuring mainland income from the offshore sector from the mainland supply side is even more challenging.** Goods and services supplied to the oil and gas industry do not map neatly into standard industrial classification schemes. Instead, firms within individual industries have evolved to produce goods and services for the offshore sector while remaining in the same industrial classification as other firms that produce goods and services for other sectors. To get around this problem, researchers at Statistics Norway used an input-output model approach to estimate not only the initial gross revenues, but also the net impact on the Norwegian economy, taking into account imported content and value added from other sectors indirectly. Results show that a wide range of Norwegian industries have links to oil and gas, ranging from ship building and engineering, manufacturing, to a variety of services industries (e.g., banking and insurance, IT services, retail). In terms of employment, it is estimated that in 2014, about 240,000 workers—or 9 percent of the labor force—may be directly or indirectly linked to oil and gas activity. As with GDP, exports of oil-related goods and services would add to this figure.

<sup>1</sup> See first chapter of the Selected Issues Paper for detail.

## Annex IV. Regulation on Mortgage Lending

On June 15, 2015, the Ministry of Finance adopted a regulation on requirements for residential mortgage loans, based on current guidelines from the FSA. The regulation takes effect from July 1, 2015 to December 31, 2016 (with possibility of extension), and has the following features:

- The loan-to-value ratio on residential mortgage loans is capped at 85 percent.
- Lenders should adopt a mortgage rate increase of 5 percentage points when stress testing a borrower's debt servicing capacity.
- Lenders are required to demand repayments for residential mortgage loans with a loan-to-value ratio above 70 percent.

The regulation allows for 10 percent of the volume of a lender's approved loans per quarter to be loans that do not meet the regulatory requirements above for debt-servicing capacity, loan-to-value ratio or repayments.

The regulation will continuously be evaluated taking into account regional developments in the housing market, household borrowing, and the impact on competition between lenders.

## Annex V. Recommendations by Fiscal Rule Commission

On June 18, 2015, an expert commission tasked with how to apply the fiscal rule for use of oil revenues delivered its report to the Minister of Finance. The commission was appointed on October 17, 2014 with the mandate to consider supplementary provisions for the current fiscal framework, taking into account the large year-to-year fluctuations in GPFG value, the interests of future generations, and the various challenges facing the Norwegian economy in the short and long term.

The commission makes three main recommendations:

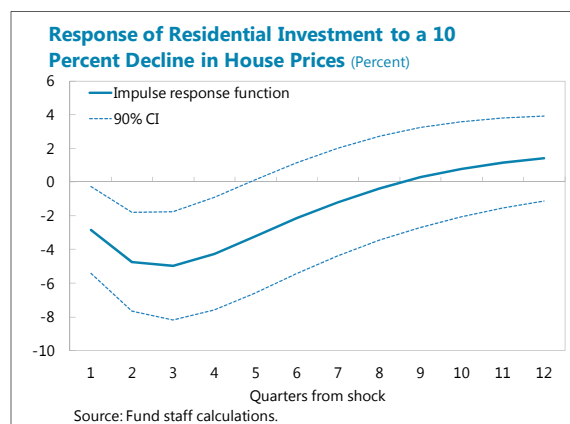
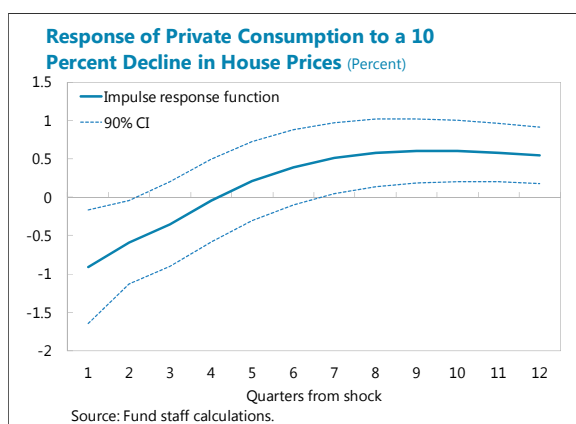
- When deviations from the 4 percent path are large, the government should plot an explicit course to gradually return to the path. This will give fiscal policy an operational target in the short and medium term. This is well in line with staff advice from the past.
- The course should be based on a more gradual phasing in of oil revenues. A more gradual increase in spending is better suited to uncertainty regarding GPFG future real return and outlook for the economy, population aging, and declining offshore activity.
- Additional rules can provide useful guidance when setting such a course. In particular, two considered rules include (i) limited Fund withdrawal and (ii) gradual phasing-in. These rules allow an extension of the period where the spending of oil revenues gradually increase (as a share of GDP), and set a limit on the fiscal impulse to 0.1-0.2 percent of mainland GDP. They are not designed, however, to replace discretion in setting fiscal policy, which must give consideration to the business cycle, among other factors.

The Ministry of Finance will shortly issue a public consultation on the commission's report.

## Annex VI. The Impact of House Price Correction on Consumption<sup>1</sup>

**A Vector Auto-Regression (VAR) framework is used to assess the average impact of a house price shock.** Following Igan and Loungani (2012)<sup>2</sup>, the model includes four variables: GDP/private consumption/residential investment, CPI, short-term interest rate, and house prices, and uses a Cholesky identification scheme in which variable ordering is as listed. The model is estimated using quarterly data for all four Nordic countries over 1986Q1–2014Q4.

**Estimation results suggest that for Norway, a 10 percent decline in real house prices would lead household consumption to fall by almost one percent on impact.** The effect is relatively short-lived, reaching cumulative 1½ percent after two quarters before rebounding. The impact on residential investment is estimated to be larger, lasting about a year with a cumulative decline of 17 percent. Thus, if the past is any indication of the future, the aggregate consumption impact of a potential house price turnaround in Norway would not be overly severe, perhaps due to the availability of other household assets that can be drawn to avoid a drastic cutback in household consumption. Nevertheless, the effect could be large for younger families with more debt and fewer assets, which is not captured in this aggregate analysis. In addition, a house price shock now may have larger real impact than in the past, especially given the high household debt burden.



**The estimated macroeconomic impact of a house price correction appears milder for Norway compared to Nordic peers.** For example, in response to a 10 percent drop in house prices, the maximum decline in private consumption in a given quarter is estimated at 0.9 percent in Norway, compared to 2.1 percent in Sweden and 3.5 percent in Denmark. The cross-country heterogeneity in responses is even more pronounced in the case of residential investment. Previous literature

<sup>1</sup> See second chapter of the Selected Issues Paper for detail.

<sup>2</sup> Igan, D. and P. Loungani, 2012, "Global Housing Cycles," IMF Working Paper 12/217.

suggests that mortgage market characteristics defining the ease of access to credit (e.g., typical loan-to-value ratio, availability of mortgage equity withdrawal to finance consumption, prevalence of variable vs. fixed rate mortgages) could be among factors explaining why economic activity in some countries may be more vulnerable to declining house prices than in others.

**Maximum Impact of a 10 Percent Decline in Real House Prices**

*(Percent)*

	<b>Private consumption</b>	<b>Residential investment</b>	<b>GDP</b>
Norway	-0.90	-4.97	-0.42*
Sweden	-2.06	-9.35	-3.99
Denmark	-3.54	-12.30	-3.52
Finland	-2.03	-6.23	-2.34

Source: Fund staff calculations.

Note: \* indicates not statistically significant.



## Annex VII. FSAP Recommendations

**Macroprudential policy:** Take additional measures to contain systemic risks from the growth of house prices and household indebtedness, including stricter LTV and amortization guidelines; take additional measures to contain risks related to bank's wholesale funding; improve the existing institutional structure for macroprudential policies, including a transparent "comply or explain" approach by decision-makers; and greater delegation of decision-making powers over macroprudential instruments in due course to Norges Bank or the FSA.

**Bank stress tests:** Consider options to discourage cross-ownership of covered bonds; improve data on cross-border ownership of bank-issued unsecured and covered bonds, and resume regular monitoring of bank-to-bank direct and indirect exposures. Consider regional stress test exercises. Consider further steps in liquidity monitoring, such as performing liquidity stress tests using the structure of cash flows at various maturities.

**Insurance stress tests:** Continue to enhance the stress test framework for the insurance sector; allocate more resources to the FSA to assess the liability side risks and validate models and assumptions used in the bottom-up stress tests by insurance companies; achieve recapitalization of weakly capitalized insurance companies in the current benign environment.

**Micro-supervision:** Enhance de jure operational independence, powers in particular regard to corrective actions and sanctions, and supervisory resources of the FSA; strengthen the FSA's supervisory attention over small banks through conducting comprehensive assessment of them more frequently; upgrade substantially the FSA's supervisory approach towards the AML/CFT issues, including by increasing the supervisory activities and providing guidance on the topic.

**Financial market infrastructure (FMI):** Strengthen operational risk management related to outsourcing in systemically important payment systems.

**Crisis management and bank resolution:** Initiate resolution planning for the largest banks, including assessing impediments to resolvability, and make explicit delegations to FSA regarding its role; define expectations for the Norway-specific elements of recovery and resolution plans of foreign bank subsidiaries and branches; enhance legal framework for resolution to comply with the FSB Key Attributes with regard to certain areas including the resolution toolkit; the BGF should adopt policies specifying under what conditions board members must recuse themselves, considering actual and prospective conflicts of interest.



# NORWAY

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 30, 2015

Prepared By

European Department  
(In consultation with other departments)

### CONTENTS

<b>FUND RELATIONS</b>	<b>2</b>
<b>STATISTICAL ISSUES</b>	<b>4</b>

## FUND RELATIONS

(As of June 30, 2015)

### Membership Status

Joined: December 27, 1945; Article VIII

### General Resources Account SDR Percent Million Quota

	<b>SDR Millions</b>	<b>Percent Quota</b>
Quota	1,883.70	100.00
Fund holdings of currency	1,685.54	89.48
Reserves tranche position	198.18	10.52
Lending to the Fund		
New Arrangements to Borrow	372.02	

### SDR Department

	<b>SDR Millions</b>	<b>Percent Allocation</b>
Net cumulative allocations	1,563.07	100.00
Holdings	1481.07	94.75

### 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				
	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.02	0.07	0.07	0.07	0.07
Total	0.02	0.07	0.07	0.07	0.07

**Implementation of HIPC Initiative**

Not applicable

**Implementation of Multilateral Debt Relief Initiative**

Not applicable

**Implementation of Catastrophe Containment and Relief (CCR)**

Not applicable

**Exchange Arrangements**

The de jure and de facto exchange rate arrangements in Norway are classified as freely floating. 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 12-month consultation cycle.

**FSAP Participation**

A review under the Financial Sector Assessment Program (FSAP) was completed in 2015.

**Technical Assistance**

None

**Resident Representative**

None

## STATISTICAL ISSUES

<b>Norway—Statistical Issues Appendix</b> (As of July 13, 2015)	
<b>I. Assessment of Data Adequacy for Surveillance</b>	
<b>General:</b> Data provision is adequate for surveillance.	
<b>National Accounts:</b> 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. The authorities are making progress in this area.	
<b>II. Data Standards and Quality</b>	
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 July 13, 2015)

	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data <sup>7</sup>	Frequency of Reporting <sup>7</sup>	Frequency of Publication <sup>7</sup>	Memo Items: <sup>8</sup>	
						Data Quality – Methodological soundness <sup>9</sup>	Data Quality – Accuracy and reliability <sup>10</sup>
Exchange Rates	07/15	07/15	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	06/15	07/15	M	M	M		
Reserve/Base Money	03/15	04/15	M	M	M	O, O, O, LO	O, O, O, O, O
Broad Money	03/15	04/15	M	M	M		
Central Bank Balance Sheet	05/15	06/15	M	M	M		
Consolidated Balance Sheet of the Banking System	09/11	11/11	M	M	M		
Interest Rates <sup>2</sup>	05/15	06/15	M	M	M		
Consumer Price Index	06/15	07/15	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	2014	2015	A	A	A	LO, LNO, O, O	LO, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	05/15	07/15	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	Q1 2015	06/15	Q	Q	Q		
External Current Account Balance	Q1 2015	06/15	Q	Q	Q	O, O, O, O	LO, O, O, O, LO
Exports and Imports of Goods and Services	Q1 2015	06/15	Q	Q	Q		
GDP/GNP	Q1 2015	05/15	Q	Q	Q		
Gross External Debt	Q1 2015	06/15	Q	Q	Q		
International Investment Position <sup>6</sup>	Q1 2015	06/15	Q	Q	Q		

<sup>1</sup> 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.

<sup>2</sup> Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Includes external gross financial asset and liability positions vis-à-vis nonresidents.

<sup>7</sup> Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

<sup>8</sup> These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

<sup>9</sup> 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).

<sup>10</sup> 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.

**Statement by Mr. Groenn, Executive Director of Norway**  
**September 4, 2015**

*On behalf of my Norwegian authorities, I would like to thank staff for well-written reports on the Norwegian economy and the financial system. My authorities thank staff for their engagement and are in general agreement with the analyses and policy recommendations.*

*The analysis of current economic conditions and the forecasts in the staff report are broadly in line with those of my authorities. The decline in the oil price has given a significant slow-down in mainland sectors delivering to the petroleum sector, but so far the impact on total activity and employment in the non-oil economy has been limited. However, the economy faces important challenges and the outlook is subject to some key risks.*

*My authorities are pleased to note the conclusion in the FSAP update that the Norwegian financial system has coped well with the global financial crisis, while also acknowledging that the prolonged period of low interest rates and high oil prices have fueled credit and asset price growth leading to higher vulnerabilities.*

***Economic Developments and Main Challenges***

The Norwegian non-oil economy grew on trend at around 2¼ percent both last year and the year before. This year, growth is expected to weaken to around 1¼ percent, while picking up again next year to just below trend growth. According to the Labor Force survey, the unemployment rate stayed low in 2014 at 3½ percent, but has increased lately to 4½ percent. The registered unemployment rate has remained more stable, currently just below 3 percent of the labor force. This difference is partly due to an increased number of young people searching for part-time employment beside studies and school.

Economic policy is supporting economic growth. Interest rates are at a historically low level and fiscal policy is slightly expansionary. In addition, a weaker Norwegian krone (12 percent depreciation over the last 12 months) and moderate wage settlements this year have offset some of the deterioration in unit labor costs competitiveness over recent years.

Norway experienced large terms of trade gains during the first 10-15 years of this millennium. This fortunate development has turned. Currently, the oil price (Brent Blend) is fluctuating around USD 50 per barrel, down from around 65 during the staff mission in May and 110 a year ago. Norway's revenues have fallen accordingly, although a stronger dollar dampens the revenue fall in Norwegian kroner. Most of the decline is reflected in lower public savings in the Government Pension Fund Global, and revenues of oil companies have fallen as well. Oil companies and their suppliers have cut back on investments and employment, curbing growth in the Norwegian mainland economy.

Already before the sharp fall in oil prices in 2014, petroleum investments were expected to peak in the near future, and demand impulses from the petroleum sector to the mainland economy were expected to decrease. The drop in the oil price accelerates and



reinforces this development and makes it even more important to succeed in managing a smooth transition to a less oil-dependent growth model. According to my authorities' most recent forecast, oil investments will fall this year and next year and the demand from the petroleum sector will fall relative to the size of the mainland economy. The decline in the coming 3-4 years is dampened somewhat by large investments in a new field, Johan Sverdrup, the third largest field on the Norwegian continental shelf. Even so, an important growth engine for the Norwegian economy has lost its momentum. Thus, Norwegian businesses must adapt to the new situation in order to maintain growth. The weaker Norwegian krone and a more moderate wage growth help, but the cost level is still high compared to trading partners and productivity growth is still subdued.

High house prices and a high debt level among households represent other key challenges to the economy. As recognized below, these pose a risk to financial stability. As pointed out in the staff report, household debt continues to stay elevated at more than 200 percent of disposable income. The debt burden is unevenly distributed, and young households are vulnerable to adverse shocks. There is a risk that a fall in house prices can amplify or trigger a downturn in the Norwegian economy.

### ***Monetary policy***

My authorities generally concur with staff's assessment of monetary policy, which finds the current monetary policy stance appropriately supportive. The key policy rate was lowered by 25 basis points to 1 percent in June, a historically low level, and the Norges Bank Executive Board's assessment suggested that the key policy rate could be reduced further in the course of the fall. Both the objective of keeping inflation close to target and the aim of sustaining capacity utilization could imply a lower key policy rate. However, the Bank's Executive Board also pointed out that a lower interest rate could fuel house price inflation and debt growth. Norway has a floating exchange rate. Due to lower oil prices, a more uncertain growth outlook and a lower interest rate differential, the Norwegian currency has depreciated considerably since the beginning of last year.

### ***Fiscal policy***

A continued low oil price will over time have a significant impact on Norway's national wealth and the room for maneuver in fiscal policy. Still, as noted in the report, the short term impact on fiscal policy is limited. The Norwegian fiscal framework is designed to insulate fiscal policy and the economy from the inherent volatility in petroleum prices. In recent years, the Government Pension Fund Global has grown considerably, and spending of oil money in line with the 4 percent path of the fiscal rule would not have been consistent with a stable development in the economy. Spending in 2015 is estimated at 2.6 percent of the Fund, i.e. well below the 4 percent path.

The staff's report advises a more neutral fiscal policy in the medium term. Given the abating non-oil economic activity, the rise in unemployment and the uncertain outlook for 2016, the current circumstances might not be the right ones to make this move. A continuation of a slightly expansionary fiscal policy, as in the last few years, may be better adapted to the current economic situation. However, my authorities acknowledge that fiscal policy cannot be the main tool to deal with a structural decline in the demand from the Norwegian petroleum sector. A too expansionary fiscal policy could interrupt and counteract the needed transition.

The upward tendency in unemployment, especially among young people, is of special concern, and the Norwegian government has signaled new measures against this increase that will be presented as part of the fiscal budget in early October. The Norwegian government will also follow up on plans for increased spending on infrastructure, education, and research. Such measures may facilitate necessary structural adjustments, and support activity in the short term.

As noted in the staff report, the government last year appointed a Commission to consider the application of the fiscal rule and to recommend modifications or supplementary provisions. The Commission's majority is of the view that phasing-in of petroleum revenues has to be slower in the future than in the past, with a recommended fiscal impulse of 0.1-0.2 per cent of non-oil GDP in a normal cyclical situation, compared to an average of 0.33 in the years after the fiscal rule was introduced in 2001. The Commission's report was submitted for public consultation in July, and the government will present its views on this issue to the Parliament next year.

### ***Tax policy and structural reforms***

My authorities place great emphasis on the growth-enhancing potential of structural policy measures, and have since they came into position introduced several measures in this regard. An important goal is to strengthen productivity and growth in both the private and the public sector. A main strategy to achieve this is giving higher priority to lower taxes, education, and investments in infrastructure.

In tax policy, focus has been on lowering taxes that hamper productivity and economic growth. The relatively high corporate tax rate is an area of particular concern. As noted in the staff report, a Tax Commission has recommended a significant reduction in this rate. Its proposals also include adjustments in taxation of personal income and some balancing measures. My authorities are currently in the process of evaluating the commission's report, and will summarize their plans for future tax reform in a white paper to the Parliament this fall. In the forthcoming years my Government will continue to reduce taxes.

As noted in the staff report, steps have been taken toward a more neutral taxation of assets by reducing the valuation discount in the net wealth tax for commercial properties and second dwellings. A significant reduction in tax incentives for home ownership is however not on the government's agenda.

As regards the labor market, the government has started technical discussions with the social partners in order to explore the possibility of a comprehensive reform of occupational pensions in the public sector next spring. It has also taken steps to soften labor market regulations. Norwegian legislation on temporary contracts is today among the strictest in the OECD area, but will be liberalized from 2016. Regulations on working hours will be modified in order to make it easier for businesses to use overtime and compressed work-week schedules.

Last year the government appointed a Productivity Commission. This Commission was given a mandate to look into causes for the slowdown in productivity growth in Norway, and to analyze the development in an international perspective. It was also asked to give

advice on where in the economy the government should implement measures, or adjust policy, to increase productivity.

The Productivity Commission published its first report in February this year. It concluded that although the Norwegian productivity level is high in an international perspective, Norway performs only on average among OECD countries in the comparison of several key factors for growth, including areas such as innovation, entrepreneurship and the level of research in industries. The Commission points out that when the growth impulse from the petroleum industry diminishes in the future, the Norwegian economy must improve its performance in these areas to maintain a high income level.

The Government is in the process of assessing the advice from this first report. A second report will be presented February 2016, and an overview of the government's structural policy is planned to be included the budget documents for 2016.

A productivity reform is implemented at the central government level, obliging all public service providers to increase productivity by 0.5 percentage point per year.

A local government reform for simplification of the government system and establishment of fewer and larger municipalities, which will then have enhanced governance capacity and capability, will also be important for productivity in both the private and the public sector.

Also, measures to increase efficiency in the agricultural sector, and to reduce costs and shorten the planning process in the construction sector, have been introduced. To get more out of the resources used in the transport sector, the government has taken steps to establish a publicly owned company that will plan, build, operate, and maintain major stretches of the road network.

#### ***Financial sector policy – Addressing stability risks***

My Norwegian authorities are pleased to note the conclusion of staff's assessment that the Norwegian financial system is generally sound and well managed. My authorities greatly appreciate receiving external views of this scope and detail on the Norwegian financial system. The authorities broadly agree with the analyses in the FSSA, and will carefully study the policy recommendations.

My authorities generally concur with staff's assessment of the risks and vulnerabilities associated with Norwegian households' indebtedness, a possible house price reversal and banks' reliance on wholesale funding. Household debt is growing faster than household incomes, and households will be vulnerable in the event of an income decline and higher interest rates. Staff notes that the new requirements on banks' residential mortgage lending practices is a policy move in the right direction in the current context, and recommends additional measures to contain systemic risks from the growth of house prices and household indebtedness, including stricter LTV and LTI or debt ratio limits to supplement the required affordability test. My authorities note that the new regulation will be continuously evaluated in light of future developments. They are prepared to make appropriate adjustments in the regulation as informed by the evaluation, including imposing stricter limits and other requirements.

Norwegian banks must continue their efforts to strengthen their capital base, and assure more robust funding and improved liquidity. Loan losses are still low, but banks should

be prepared for the possibility of increased losses in the next few years. My authorities have addressed financial stability risks, i.a. through early implementation of new capital requirements for banks (the CRD IV package), Pillar 2 add-ons and higher IRB risk weights for residential mortgage lending for both domestic and foreign banks through host country treatment. The Ministry of Finance announced in June this year that the counter-cyclical buffer will be increased from today's 1 percent to 1½ percent on June 30, 2016. Staff notes that authorities should continue to restrict dividend pay-outs in weakly capitalized insurance undertakings and achieve recapitalization of these undertakings. My authorities note that a new more risk-based solvency framework for insurers (Solvency II) will enter into force in 2016 and require more capital in life-insurance undertakings. The solvency situation in insurance undertakings is monitored closely.

Staff recommends improved liquidity monitoring and consideration of measures to contain risks related to banks' wholesale funding. My authorities note that the micro- and macroprudential supervision of liquidity risks in Norwegian banks has improved significantly since the international financial crisis, and that there are continuous efforts to improve the systems and procedures in place to supervise and monitor such risks, including through increased cooperation between the FSA and Norges Bank. Proposals on the implementation of binding LCR requirements are currently under consideration, and the authorities foresee to introduce such requirements next year.

Staff recommends that Norwegian authorities could improve institutional arrangements for macroprudential policies, including introducing a transparent "comply or explain" approach and greater delegation of decision-making powers over macroprudential instruments in due course to Norges Bank or the FSA. The existing institutional structure for macroprudential policies in Norway builds on a long tradition and clear division of responsibilities, which has proven to deliver timely micro- and macroprudential measures, with no signs of inaction bias. My authorities, however, take due note of staff's advice regarding possible reforms to further improve institutional arrangements for macroprudential policies.

On the Norwegian crisis management and bank resolution arrangements, staff concludes that they are generally well developed, but that more work is needed. My authorities note that work is underway to revise our legal framework, and that this will encompass the issues raised by staff. The revision includes, but is not limited to, an implementation of the EU Bank Recovery and Resolution Directive.

Staff concludes that Norway should ensure de jure operational independence of the FSA, strengthen the FSA's supervision of small banks through the conduct of more frequent comprehensive assessments, and upgrade its approach to AML/CFT supervision. My authorities note that a more intensive off-site monitoring of small banks has been established, and that Norway's AML/CTF regulation is under revision. Finally, on staff's conclusion on the operational independence of the FSA, my authorities note that the FSA has operational independence in supervision. The issue of delegating further authority to the FSA is subject to continuous assessment.