Economic Outlook in the Nordic Countries 2014

The Nordic Working Group of Economic Trends Review, autumn 2013

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Content

1. The Nordic Region

1.1 Global economic development

The imbalances that led to the financial crisis in 2008 still weigh on the global economy. Global GDP added on average a mere 2½ per cent in the first half of 2013, which is at about the same pace as in the second half of 2012.

Conditions have improved in developed economies. At the same time emerging economies experience lower growth. As investments in developed markets get more attractive, access to capital is a growing concern for emerging economies with open capital accounts. In China growth is strong, but growing-pains are getting more visible.

In the US, UK and in Japan growth is picking up. In the Euro area GDP growth was positive in the second quarter of 2013, after 8 consecutive quarters of falling activity. In many countries growth is far from strong enough to bring about a reduction in unemployment. In the Euro area unemployment is more than 12 per cent of the labor force, but the differences are large between countries. Whereas unemployment in Spain and Greece is over 26 per cent of the labor force, German unemployment is less than 5½ per cent. In the UK unemployment has fluctuated around the OECD average of 8 per cent over the past year, whereas unemployment in the US has fallen to a current level of just over 8 per cent.

Inflation has been low in most developed economies, underpinned by low capacity utilization. Despite high credit-fueled economic growth, inflation in China has been stable. In other emerging economies inflation is high, and weakening currencies may lead to even higher price growth going forward.

Monetary policy is very expansionary in developed economies with policy rates close to zero. In the US, Euro area and UK, central banks have signaled that policy rates will be kept low for a prolonged period of time. In the US and in the UK, forward guidance is accompanied by announced thresholds for the level of unemployment, given that price inflation stays under control. In addition to low policy rates the central banks have used their balance sheets in extraordinary measures aimed at increasing the supply of credit and influencing certain asset prices.

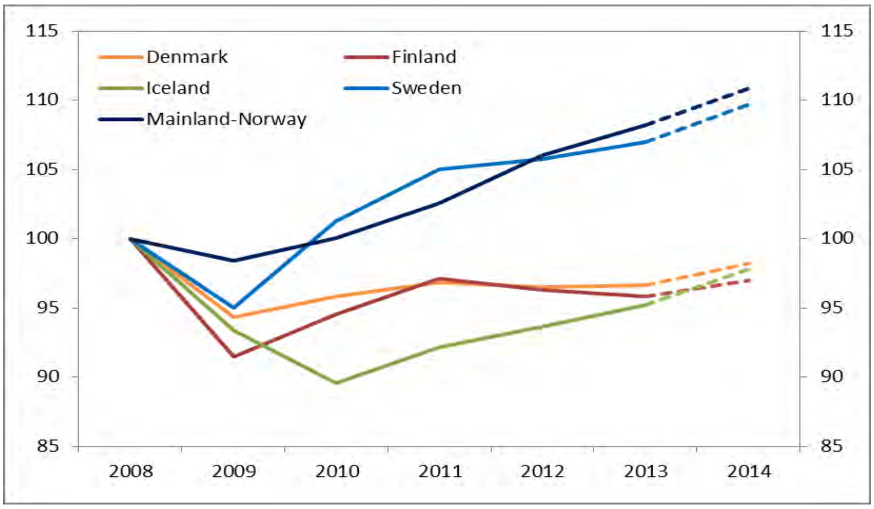
Tighter fiscal policies have brought deficits in the public sector down in recent years, aiming at curbing the strong public debt growth. Public finances are now on a sounder footing. However, higher public sector consolidation has reduced economic activity. At the same time prospects of more sustainable public finances may have induced higher consumption and investments in the private sector. To secure sustainable public finances, further reductions in public deficits are called for in some countries, notably Japan, the US and UK. According to IMF estimates, a tightening of 2½ per cent of GDP in the structural budget balance is expected in the US this year. The equivalent estimate for the Euro area and the UK is 1 and 2 per cent, respectively. In the medium term, sustainable public finances are a prerequisite for economic growth and the provision of public goods.

1.2 Nordic economic development

Five years after the financial crisis, several of the Nordic economies are struggling to recover. In Denmark, Iceland and Finland, GDP is still below the pre-crisis level, cf. figure 1.1. In Norway and Sweden the downturn was relatively brief, as activity was above the pre-crisis level already in 2010. However, economic growth weakened again in Sweden in 2012 led by worsening global economy growth, but is forecast to pick up next year. Hence Norway seems to be the exception, due to large terms of trade gains ever since the change of the millennium, largely due to an increasing oil price. Petroleum activity has given strong demand impulses to the rest of the Norwegian economy. As small open market economies, the Nordic countries rely heavily on developments in the global economy. Hence a recovery of the global economy will give great stimulus to growth in the Nordic economies.

A gradual turnaround is forecast for the *Danish economy*, as the economic outlook for major trading partners improves and consumer and business confidence rises. In the Economic Survey, August 2013, GDP is expected to grow by 0.2 per cent this year and 1.6 per cent next year. This year, particularly increasing business investments will contribute to growth. Also private consumption is expected to pick up. Inflation has fallen significantly through 2013, and cuts in taxes and lower interest rates have caused disposable income to increase. As the recovery abroad gains momentum, exports will gradually return as a key driving force behind growth in the Danish economy. In 2014 exports are once again expected to contribute significantly to GDP growth.

Figure 1.1 GDP in the Nordic countries. Indices. 2008=100. 2008-2014



After contracting from mid-2008 to the fourth quarter in 2010, the *Icelandic economy* has returned to modest economic growth. In the first half of this year a substantial drop in imports has contributed to strong growth in GDP. On the other hand, weaker growth in real wages, lower withdrawals of supplementary pension savings and heavily indebted households, have all subdued growth in private consumption. The economy is expected to grow by 1.7 pct. this year and 2.7 pct. next year. Consumer inflation is declining as exchange rate fluctuations have abated this year. Averaged consumer price inflation is expected to be 3.5 pct. this year, but fall back to the Central Bank Iceland's monetary policy target of 2.5 pct. in 2015.

For the *Finnish economy*, which is relying heavily on exports, the outlook for world trade is crucial for the developments ahead. As world trade picks up, the stage will be set for a recovery of the Finnish economy. This is however hard to realize without structural reforms. Production in the industrial sector is expected to continue sliding, both due to cyclical and structural factors. Finnish GDP is expected to fall moderately this year, as households hold back on consumption and businesses on investment. In 2014 GDP is expected to grow at 1.2 per cent, with investment being the only negative effect on the demand-side. Inflation is expected to be below 2 per cent this year, but above next year.

The *Norwegian economy* has shown some signs of weakening growth in the course of 2013, after growth above trend in 2011 and 2012. Moderate household consumption subdues growth, while the activity in the petroleum sector continues to give growth stimulus to the rest of the economy both this year and next year. Annual growth of the non-oil economy is expected at 2.0 per cent this year and 2.5 per cent next year, cf. table 1.1. Hence growth in 2014 is forecast to be close to the average for the past 40 years of 2.6 per cent. Inflation is projected to remain somewhat below the inflation target of 2½ per cent. Monetary policy is believed to be expansionary also going forward, with the policy rates remaining at the present low level until next summer.

In *Sweden* GDP growth is expected to remain weak, with both falling exports and investments. Domestic demand, primarily private consumption contributes to keeping up growth. Next year growth is expected to be stronger, as exports and business investments recover. Tax cuts on income are expected to boost private consumption, becoming the most important driving force behind the growth next year. CPI growth was below the Riksbank's target rate of 2per cent last year, and has remained low in the first half of 2013. Monetary policy is believed to be expansionary also going forward, with the repo rate remaining at 1 per cent during 2014.

1.3 The labor market

The labor market in *Denmark* has been remarkably stable since 2010, despite the downturn in the business cycle. A flexible labor market and growth among large employers in the private sector above that of GDP have made this development possible. Employment is expected to fall back somewhat from 2012 to 2013, before exceeding the 2012- level in 2014. The unemployment rate is expected to decline both this and next year.

In *Finland*, the labor market mismatch problems are expected to persist and hamper efficient resource allocation. The unemployment rate is expected to increase to 8.3 per cent this year, before gradually falling in the years ahead. Employment is expected to have a similar development, with a reduction in 2013 before moderately rising in the years ahead.

The labor market in *Iceland* is recovering as the unemployment declines and the labor participation rate improves. Registered unemployment is forecast to average 4.8 pct. this year, 1 percentage point lower than last year. The Directorate of Labor has stimulated employment by introducing various labor market programs. The registered unemployment rate has been reduced also because the extension of the period for which unemployment benefits can be claimed has expired. Job creation is also increasing.

In *Norway* employment is now significantly higher than prior to the financial crisis, and unemployment is low. Weaker economic growth has resulted in a somewhat more subdued growth in employment ever since the summer of last year. In the amendment to the National Budget 2014 employment is expected to further increase by about 1 per cent both this and next year. Unemployment is estimated to remain at the present level of about 3½ per cent in the years to come, which is clearly below the average for the last 25 years.

After falling at the beginning of the financial crisis, employment in *Sweden* has increased steadily since the end of 2009. Employment has been increasing in service industries and the public sector. The industrial sector has been struggling, holding employment back. The unemployment rate has remained unchanged, as employment has increased in line with population. The labor force has risen sharply in recent years. This is due to population growth, but also due to an increasing participation rate. The participation rate is now at the same level as prior to the crisis. Employment and the labor force are expected to grow at a good pace both this and next year. The unemployment rate is expected to remain at about 8 per cent both this and next year.

1.4 Public finances

In order to boost domestic demand during the downturn in 2008-2009, the *Danish Government* turned fiscal policy on to an expansionary path. As a result, the general Government deficit increased so much in the years to follow that it was considered excessive by the EU. The EU has urged, inter alia, Denmark to bring the General Government deficit below 3 per cent of GDP by 2013. The Danish Budget Act was adopted by a large majority of Parliament in 2012 and introduced expenditure ceilings for all levels of Government, as well as an upper limit for the structural deficit of ½ per cent of GDP. It is a fundamental premise for fiscal and expenditure policy that Denmark adheres to the Budget Act and complies with the EU-recommendations. Economic policy measures from 2012 an onwards are estimated to raise GDP by just under ½ per cent in both this and next year. In April 2013 an agreement was reached that on Growth Plan DK, which continues an ambitious Danish reform and modernization agenda.

A weak economy puts a strain on fiscal policy in *Finland*, and the economic outlook will continue eroding the financial balance of the General Government. In order to stimulate growth in the long run, the Government finds it imperative to work on structural reforms and has adopted a Program to do so. In the current economic outlook the General Government debt to GDP ratio is forecast to exceed the 60 per cent EU Treaty threshold in 2014.

In the years following the financial crisis, the *Icelandic Government* has made it a priority to spur growth through increased efficiency and exports, in addition to adhere to the plan agreed upon with the IMF in the year of 2008. The main goal was set for the primary balance of the General government (government spending exclusive net interest payments) to be positive by 2011, and the total balance to be positive by 2013. The goal of positive primary balance was achieved in 2012 and in 5-year period since the onset of the economic crisis, the accumulated fiscal recovery as measured by the primary balance is almost 14 pct. of GDP.

The Government Pension Fund Global and the fiscal policy rule together constitute *Norway's* fiscal framework. The state's current net cash flow from petroleum activities is saved in the Fund, while concurrent spending over the fiscal budget follows the expected real return of the wealth already accrued in the Fund. Expected real return is estimated at 4 per cent. With a non-oil activity growth close to normal next year, low unemployment and a record high increase in Fund capital the Norwegian Government in the amendment to the National Budget 2014 has proposed to limit spending of oil revenues to 2.9 per cent of the Government Pension Fund Global. The non-oil structural budget deficit is estimated at 139 bn. NOK, which amounts 56 bn. NOK below the estimated 4 per cent path. The increase in the structural non-oil budget deficit corresponds to 0.5 per cent of mainland trend-GDP, giving a somewhat stronger demand stimulus than the budget proposal put forward by the outgoing Government. The Government has proposed tax reductions to boost the growth potential of the economy.

With an expenditure ceiling, the *Swedish Government* has turned to tax reductions in order to boost growth and employment. In the Budget bill for 2014 the Government proposes, inter alia, a reduction in taxes for households. General Government net lending is forecast to fall from -0.6 per cent of GDP in 2012, to -1.2 per cent and -1.5 per cent in 2013 and 2014, respectively.

Table 1.1 Central macroeconomic variables

	2009	2010	2011	2012	2013*	2014*
GDP, percentage volume change						
Denmark	-5.7	1.6	1.1	-0.4	0.2	1.6
Finland	-8.5	3.4	2.7	-0.8	-0.5	1.2
Iceland	-6.6	-4.1	2.9	1.6	1.7	2.7
Mainland-Norway	-1.6	1.7	2.5	3.4	2.0	2.5
Sweden	-5.0	6.6	3.7	0.7	1.2	2.5
Percentage annual change in CPI inflation						
Denmark	1.3	2.3	2.8	2.4	1.0	1.5
Finland	0.0	1.2	3.4	2.8	1.6	2.1
Iceland	12.0	5.4	4.0	5.2	3.5	3.0
Norway	2.1	2.5	1.2	0.8	2.1	1.9
Sweden	-0.5	1.2	3.0	0.9	0.1	0.9
Unemployment, (LFS), as percentage of the labor force**						
Denmark	4.5	5.7	5.6	5.7	5.4	5.2
Finland	8.2	8.4	7.8	7.7	8.3	8.2
Iceland	8.0	8.1	7.4	5.8	4.8	4.5
Norway	3.2	3.6	3.3	3.2	3.5	3.6
Sweden	8.3	8.6	7.8	8.0	8.2	8.1
General Government net lending, as percentage of GDP						
Denmark	-2.8	-2.7	-2.0	-4.2	-1.7	-2.0
Finland	-2.7	-2.8	-1.0	-2.2	-2.6	-2.3
Iceland	-9.9	-10.1	-5.6	-3.8	-2.7	-0.8
Norway	10.5	11.1	13.6	14.4	11.5	10.1
Sweden	-1.0	0.0	0.0	-0.6	-1.2	-1.5
Current account balance, as percentage of GDP						
Denmark	3.4	5.9	5.6	5.8	5.4	5.7
Finland	2.0	1.7	-1.5	-1.8	-1.6	-1.3
Iceland	-11.5	-8.0	-6.2	-4.9	-1.0	-3.4
Norway	11.7	11.9	12.8	14.2	11.0	10.6
Sweden	6.7	6.8	7	6.9	6.7	6.4

* Forecasts

** Registered unemployment for Denmark and Iceland

2. Denmark

2.1 Fiscal policy and public finances

Economic policy in Denmark has been planned in order to support growth and employment within a framework of sound fiscal policy. Due to expansionary discretionary fiscal policy and large automatic stabilisers the actual balance has shown large deficits after the set-back in 2008-09 and Denmark has received an EU-recommendation to strengthen public finances. According to Denmark's EU-recommendation, the actual deficit should be brought sustainably below 3% of GDP by 2013 and public finances be improved by 1½% of GDP in structural terms from 2010 to 2013.

It is a fundamental premise for fiscal and expenditure policy that Denmark adheres to the Budget Act and complies with the EU-recommendation. The Danish Budget Act was adopted by a large majority of Parliament in 2012 and introduces expenditure ceilings for all levels of government as well as an upper limit for structural deficits of ½% of GDP.

The budget proposal for 2014 takes advantage of the possibilities that lie within the fiscal framework by, inter alia, having a structural deficit close to the limit in the Budget Act, *cf. figure 1.* Fiscal policy and other economic policy measures from 2012 and onwards are estimated to raise the level of GDP by just under ½% in both 2013 and 2014, *cf. figure 2,* and private employment by almost 15,000 persons in both years. Moreover, planned fiscal policy should be viewed in the context of an exceptionally expansionary monetary policy that contributes to economic activity.

Figure 1: Public and structural balance

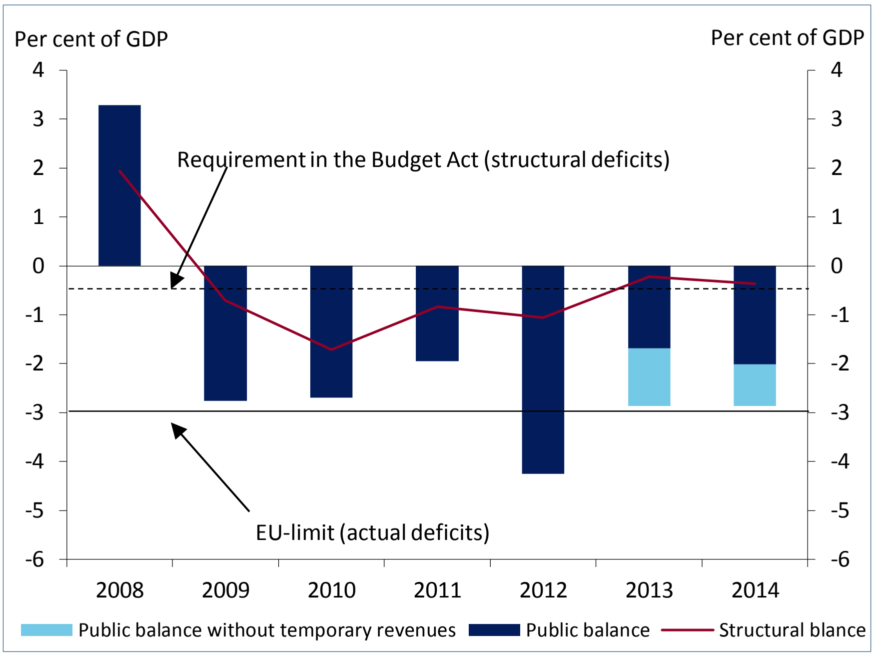
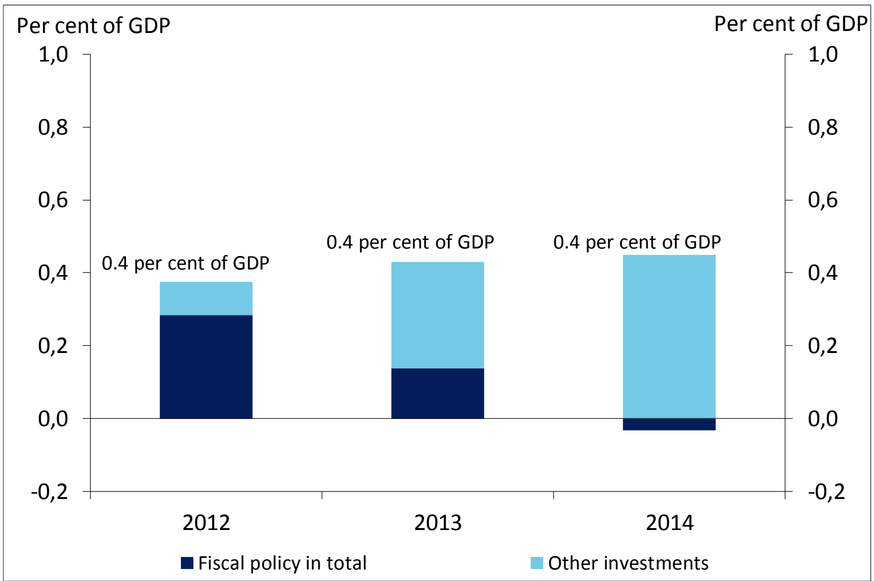


Figure 2: Effect on GDP level of fiscal policy and other economic policy measures from 2012 and onwards



Note: In *figure 1* the public balance is shown both incl. and excl. temporary revenues from the restructuring of the capital pen-sions taxation and from a reallocation within the pension sector. The temporary revenues amount to DKK 22 bn. in both 2013 and 2014. *Figure 2* shows the effect on the GDP level of public budgets (measured by the multiannual fiscal effect, other fiscal measures and other investments, i.e. investments outside the public sector initiated by political agreements). Source figure 1 and 2: Statistics Denmark and Ministry of Finance.

While fiscal policy and other economic policy measures are broadly neutral for GDP growth in 2014, the levels of planned public consumption and investments are high both compared to pre-crisis levels and to a level that can be sustainably financed from 2020 and onwards (given the planned tax policy and adopted reforms). Thus, in order to adhere to the medium term objective of a sustainable fiscal policy, *cf. section 2.3,* a gradual downward adjustment in these expenditures' share of GDP is required.

2.2 Short-term prospects for the Danish economy

A gradual turnaround is forecast for the Danish economy, in tandem with improved economic conditions abroad and rising consumer and business confidence. In the *Economic Survey,* August 2013, GDP is expected to grow by 0.2% in 2013 and 1.6% in 2014. The very low growth rate in 2013 is primarily a consequence of a large decline in GDP at the end of last year and continued sluggish growth during the first half of 2013. Growth is, however, expected to pick up during the second half of the year and into 2014.

This year, domestic demand is the main driver of growth, primarily due to higher business investments. Also, the basis for growth in private consumption has been strengthened. Inflation has fallen significantly through 2013, and disposable incomes increase as a result of tax cuts and lower interest rates. Improved consumer sentiment suggests that lack of confidence in the economic situation will not hold back private consumption. The improved sentiment is supported, amongst other things, by rising house prices and expectations of a fall in unemployment.

As the recovery abroad gains momentum, exports will gradually return as a key driver of growth in the Danish economy. In 2014 exports are once again expected to provide a significant contribution to GDP growth, making the Danish economy more self-sustained.

The growth forecast for the Danish economy is estimated to be sufficient to ensure gradually rising employment and falling unemployment over the forecast horizon. The labour market has been remarkably stable since 2010 in spite of the weak business cycle, *cf. figure 3*. This should be seen in light of past reforms, a flexible labour market, and that there has been room for manoeuvre in economic policy to support the labour market. It also reflects that the increase in production in some industries, which account for around 95% of private sector employment, has been somewhat higher than overall GDP growth, as is also expected to be the case in 2013 and 2014. While GDP rose by 3.0% from mid-2009 to mid-2013, gross value added

(GVA) in the private sector excl. financial services and mining and quarrying (mostly North Sea oil extraction) increased by 8.9%.

Figure 3: Private employment

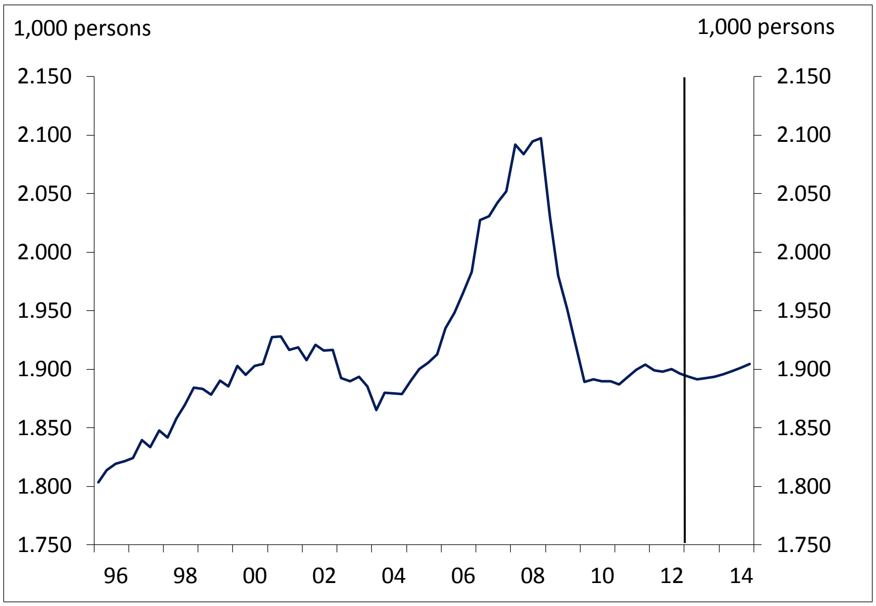
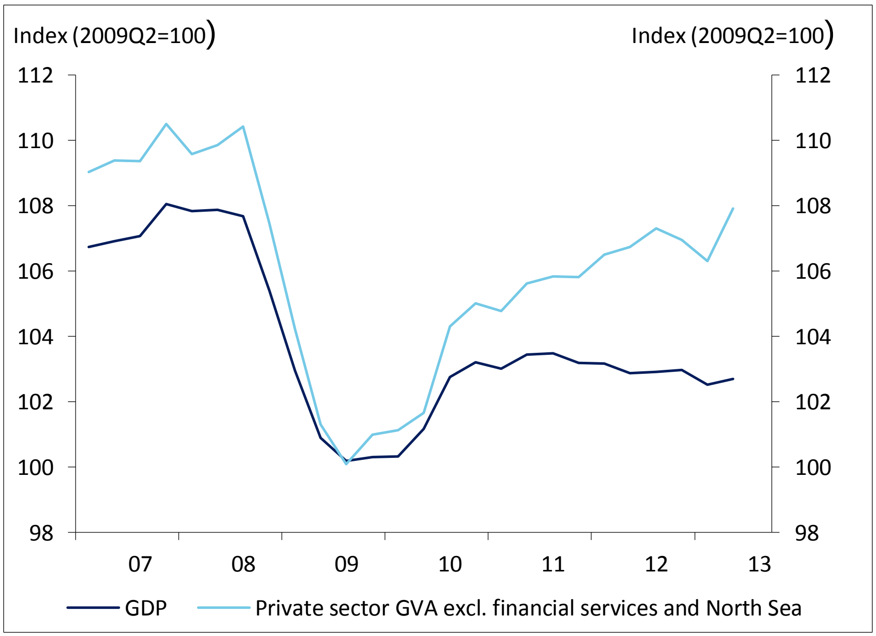


Figure 4: GDP and GVA in industries with 95% of private employment



Note: Two quarter moving average in figure 4.
Source: Figure 3 and 4: Statistics Denmark and Ministry of Economics and the Interior.

The forecast is based on the assumption that a recovery in the euro area will gradually manifest itself during the second half of 2013. If the European recovery is weakened, it will also have a negative impact on Denmark, and may imply that the expected turnaround is postponed, and that the pace of recovery will be slower. Compared to previous turning points in Danish economy, the forecast assumes a relatively slow increase in growth during the second half of 2013. Therefore, it is also possible that growth will be stronger, if, the appetite for consumption and investments in the domestic economy increases more strongly than expected after years of restraint.

2.3 Medium-term projection

In the latest medium-term projection for Denmark (*Convergence Programme Denmark 2013*) the Danish economy is expected to recover gradually with increasing employment and the output gap is assumed to close by 2019. The medium-term economic policy is planned in order to obtain at least structural balance in 2020 and to meet the key objectives and targets for public finances following from the Stability and Growth Pact.

The actual deficit is estimated to remain below the 3% of GDP threshold in the entire period towards 2020. At the same time, the structural balance is estimated to be between 0 and -½% of GDP in all years in compliance with the Budget Act and Denmark's MTO for public finances, *cf. figure 5*. The EMU-debt keeps a wide safety margin to the EU-limit of 60% of GDP and amounts to around 40% of GDP in 2020, while net public debt amounts to around 14% of GDP in 2020, *cf. figure 6.*

Figure 5: Public and structural balance in Denmarks' Convergence Programme, 2013

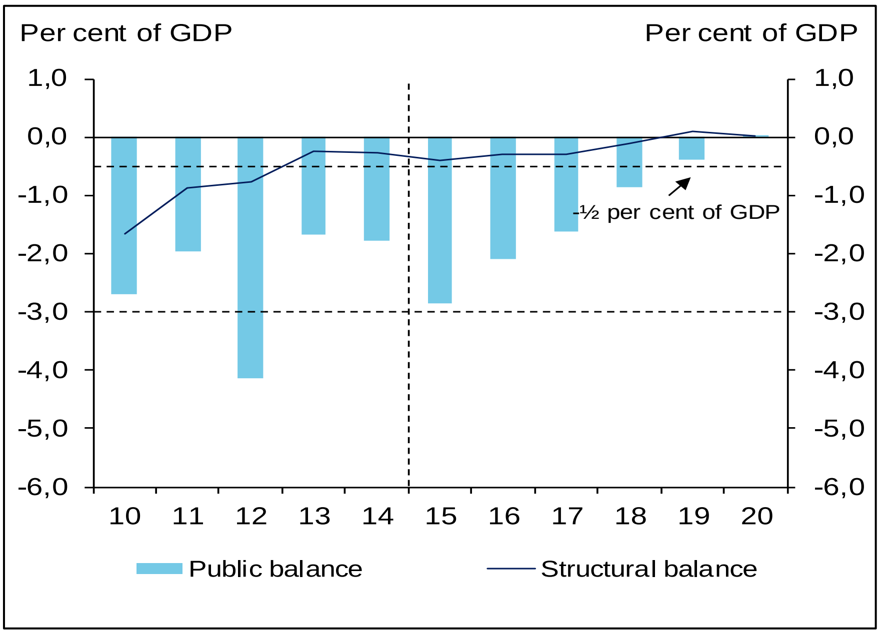
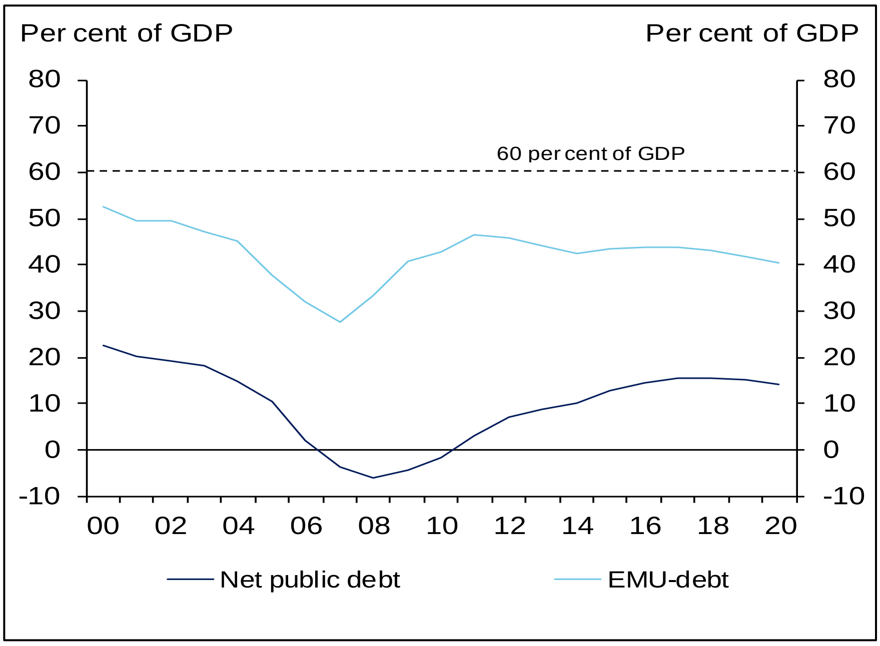


Figure 6: EMU debt and net public debt in Denmark's Convergence Programme, 2013



Source: Figure 5 and 6: Convergence Programme Denmark 2013 (April 2013).

In April 2013 an agreement was reached on *Growth Plan DK,* which continues an ambitious Danish reform and modernisation agenda. The Growth Plan introduces a new target of increasing GDP growth by DKK 40 billion towards 2020. That corresponds to increasing structural GDP growth by one third of a percentage point on average each year in the period 2014-20, so that the overall year-on-year growth amounts to 2% on average. The growth target is mainly to be achieved through two reform tracks:

1. *Reforms that improve the general business environment:*
   In order to strengthen competiveness and support economic recovery, reforms aimed at improving productivity growth are to contribute with DKK 20 billion to the overall growth target towards 2020. The initiatives in the Growth Plan are estimated to increase productivity (measured by GDP) corresponding to DKK 6 billion, which is attributed mainly to the lowering of the corporation tax. Later in the year, The Danish Productivity Commission appointed by the government will present their recommendations on how to boost productivity. These recommendations will be taken into account when considering how to raise the remaining reform contribution of DKK 14 billion.
2. *Reforms that increase the level of education and employment*:
   This track is to contribute with the remaining DKK 20 billion in order to reach the growth target of DKK 40 bn. This contribution is to be reached through reforms that improve structural employment. With the already implemented tax reform and reform of disability pensions from 2012 and the agreements on student benefits and the cash transfer reform in 2013 (part of the growth plan) – the remaining contribution to come from this reform track is DKK 3½ billion (corresponding to an increase in structural employment by approximately 6,000 persons).

The new growth target complements the fiscal objectives of at least structural balance in 2020 and fiscal sustainability, which remain the key targets in medium term fiscal planning.

The Growth Plan also introduces a third reform track, which is the continued modernisation of the public sector. The aim is to free up DKK 12 billion towards 2020 by modernising the public sector in order to improve highly prioritised public services.

Table 2: Key figures from the Economic Survey, August 2013

	2012	2009	2010	2011	2012	2013	2014
	DKK bn.			Real growth,%			
Private consumption	900.7	-3.6	1.7	-0.5	0.5	0.4	1.2
Public consumption	521.	2.1	0.4	-1.5	0.7	0.6	0.5
Fixed business investments	315.2	-15.9	-2.4	2.8	-0.1	1.0	2.8
Stock building (per cent of GDP)	-4.0	-2.3	1.0	0.5	-0.4	0.4	0.0
Total domestic demand	1,733.5	-7.0	1.6	0.3	0.0	1.0	1.3
Exports	991.8	-9.5	3.0	6.5	0.2	0.2	3.7
Total demand	2,725.3	-7.9	2.1	2.5	0.1	0.7	2.2
Imports	901.3	-12.3	3.2	5.6	1.0	1.7	3.3
GDP	1,824.0	-5.7	1.6	1.1	-0.4	0.2	1.6
Employment (1,000 persons)		2,811	2,741	2,736	2,729	2,724	2,733
Gross unemployment (per cent of labour force)		4.5	5.7	5.6	5.7	5.4	5.2
Consumer price index		1.3	2.3	2.8	2.4	1.0	1.5
Hourly compensation		3.0	2.7	1.2	2.0	1.8	2.0
Effective exchange rate (1980=100)		107.8	104.0	103.6	100.6	102.1	102.5
Terms of trade (goods)		1.3	0.6	-1.2	0.4	0.8	0.1
Current account (per cent of GDP)		3.4	5.9	5.6	5.8	5.4	5.7
3-month money market interest rate		2.2	1.1	1.4	0.6	0.3	0.5

Source: Statistics Denmark and Ministry of Economic Affairs and the Interior.

3. Finland

3.1 Economic outlook 2013–2015

The picture of last year's economic development has become clearer since the previous forecast made in June. Revised provisional figures from Statistics Finland indicate that the volume of GDP fell by 0.8% last year. Statistics Finland's earlier estimate put the figure at just 0.2%, meaning that the value of GDP in 2012 was in fact EUR 2 billion lower than indicated by the unrevised June estimate. Inevitably, this will have affected other indicators as well, such as central government debt to GDP. The same goes for the growth track. In the first quarter of the current year the economy still recorded growth over the previous quarter. Demand in the national economy was sluggish last year, with demand items showing no growth from the year before.

For a small open economy such as Finland's, forecasts of the development of the international economy are critical information for future growth projections. The current projection assumes that in 2013, global economic growth will continue to exceed the rate of world trade growth, which will also be reflected in poor Finnish export performance. Over the next two years the situation will return to normal and world trade will grow faster than the global economy – although the margin will not be as wide as in the pre-financial crisis years.

Both short and long-term real interest rates are expected to show only moderate growth over the next two years. The euro to dollar exchange rate is anticipated to fall slowly, and raw materials prices will rise moderately.

The financial markets, too, are expecting a macroeconomic revival, and once the signals of stabilisation get stronger, this trend of recovery will no doubt continue. However in the stock market in particular it is necessary to bear in mind the pricing risk, especially if expectations, for whatever reason, do not materialise. The gradual improvement of Target balances, reduced levels of ECB financing to banks and the convergence of interest differentials between government bonds also suggest that investors are cautiously moving back into the markets in at least some of the euro area's problem countries. Based on survey evidence it seems that the low level of lending is demand-driven rather than due to the reluctance of banks to refinance loans. Having said that, the situation probably differs in this regard between southern and northern Europe.

Finnish GDP in 2013 is projected to average 0.5% lower than last year. The carry-over effect into the current year was -1.1%, which means that the forecast predicts a turnaround to relatively slow growth. This assumption is supported by the evidence from the first half of the year. Imports will decline more sharply than exports, and therefore the contribution of net exports will remain marginally positive. Private consumption will show no growth at all in 2013, and demand for durables will fall by almost 3% from last year. The growth of consumption is curbed by increasing unemployment, a subdued outlook for the future and weak real purchasing power. Private investment will continue to fall and the private investment to GDP ratio will drop to around 16%. The slide in industrial production is set to continue in Finland due to both structural and cyclical factors. It is predicted that the volume of service production will remain unchanged from the previous year. Unemployment will start to rise slowly, with the average unemployment rate expected to come in at 8.3%. Employment will decline and the employment rate will also fall compared to last year.

Inflation in 2013 will be less than 2%. In 2014 GDP growth will edge up to 1.2%. This growth will be increasingly broadly based, with investment being the only demand item having a negative growth effect. Exports will pick up to show growth of 3.7%, and increasing economic activity will drive imports to growth of 3%. Improving confidence will contribute to lower the household savings rate and drive up consumption. Private consumption will increase by 0.8% and purchases of durables in particular will rise. The household debt ratio will climb to around 119% next year. Investment will continue to fall, particularly because of sluggish investment in machinery and equipment. Investment in building construction, on the other hand, will move into moderate growth. On the supply side, industrial production will turn around to post growth of around two%. This will also help to bring the service sector onto a growth track. The situation in the labour market will remain weak, and despite the slight improvement in the economy the unemployment rate will drop no lower than 8.2%. The labour market mismatch problems look set to persist and hamper efficient resource allocation. Inflation will pick up to around 2%.

In 2015 economic growth is expected to reach 1.9%. The GDP growth rate will exceed potential output growth, despite the historically sluggish rate of economic growth. The economy's growth potential is low because labour input is stagnant due to demographic factors, restructuring has destroyed existing production capacity and there is very little investment in new production capacity.

Despite the recent good news about the global economy, the risks in this outlook lean towards the downside. Domestically the main risks are presented by how the real economy reacts to a possible improvement in the global economic situation. Finland should seek to gain traction from the improving global economy as quickly as possible. This will require structural reforms in the open sector as well as quick moves to improve its competitiveness. Restructuring will only begin to have the desired effects in the medium term. In the competition for international market shares, business cost factors are a crucial consideration. The operation of the labour market presents another web of problems in the domestic economy. The labour market mismatch problem should be given increasing attention since it is a major cause of the underuse of resources. It is imperative that steps are taken in the coming years to improve the budgetary position of general government. Failure to do so would significantly increase Finland's country risk, and the sustainability problem in public finances would threaten to spiral out of control. However no effort to stabilise public finances must be allowed to jeopardise private sector activity, which is the foundation for sustainable economic growth. A firm and decisive plan to bridge the sustainability gap by structural measures would strengthen faith in the future and improve the long-term prospects of market-driven growth. In the absence of the necessary restructuring that is vital for the future, debt-financed stimulus, even if it is well-timed from a cyclical point of view, could remain a less effective intervention than expected.

3.2 Fiscal policy

The Finnish economy is being simultaneously troubled by structural problems in growth and public finance sustainability as well as a difficult economic climate. Population ageing is reducing the number of people of working age and driving up age-related public expenditure. This is putting a major strain on public finances and creating a so-called sustainability gap. According to the Ministry of Finance estimate, the sustainability gap currently stands at 4.7% of GDP. This means that the general government budgetary position should improve by over EUR 9 billion by 2017 in order that the authorities could meet their obligations without driving public debt onto an unsustainable path.

Public finances are also being strained by the weak economic situation. Even if output started to grow before the end of the year, annual total output will remain lower than last year. It seems that unemployment growth, which is eroding the financial position of general government, will continue into early 2014.

The main economic and fiscal policy challenges facing the Government of Prime Minister Jyrki Katainen are to improve the conditions for economic growth and to secure funding for the welfare state. The Government's principal policy objectives are laid down in the Government Programme. State budgets and central government spending limits are drawn up in line with these principles and policy objectives.

The Government has set itself the targets of restoring balance in central government finances and achieving a substantial reduction in the central government debt-to-GDP ratio by the end of the parliamentary term. In order to reach these targets the Government has committed itself to adjust revenue and expenditure and to restructure the economy so as to facilitate stronger than predicted economic growth. The Government will review the achievement of these targets on an annual basis. Furthermore the Government has undertaken to implement additional measures if the central government debt-to-GDP ratio does not start to decrease and if the central government deficit remains at over 1% of GDP.

Targets for general government finances are also set based on the medium-term objective (MTO) specified under the EU Stability and Growth Pact. This objective is specified for the general government structural balance. In connection with the spring 2013 Stability Programme this target was set at -0.5% of GDP, which meets the minimum requirements of both the Stability and Growth Pact and national legislation[1].

An improvement in the structural financial position of general government requires measures that will increase general government revenue and decrease general government expenditure. These may be either immediate adjustment measures impacting revenue and expenditure or steps designed to improve the framework conditions for economic growth.

In accordance with these guidelines, the Government has decided on immediate measures to reduce central government expenditure and to increase revenue. The most significant of these measures are included in the Government Programme as well as in the October 2011, April 2012

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[1] Act on the implementation of regulations under the Treaty on Stability, Coordination and Governance in the Economic and Monetary union (EMU) and on the application of the Treaty as well as requirements concerning multiannual frameworks for public finances.

and March 2013 spending limits decisions. The measures will be phased in by 2015 and will improve the central government's budgetary position by a net total of around EUR 4.8 billion from 2017 onwards. If earnings-related pension contribution rates are furthermore increased in line with earlier plans, the decisions taken will strengthen the budgetary position of general government (central government, local governments and social security funds) by around EUR 5½ billion.

According to the Ministry of Finance's forecast the ratio of central government as well as general government debt to GDP will increase throughout the outlook period. Furthermore, general government debt will in 2014 exceed the 60% reference limit set out in the EU Treaty. The deficit target specified for central government will not be reached. In addition the structural deficit of general government will expand beyond the target specified.

The sustainability problem cannot be resolved solely by immediate measures focused on general government revenue or expenditure. It is imperative to work on structural reforms aimed at improving the employment rate, the conditions for economic growth, and the productivity of public service provision. The more successful these restructuring efforts are, the lesser is the need for immediate adjustment.

The Government has taken a number of decisions aimed at restructuring the economy. It has lowered the corporate income tax rate, revised the dividend income tax system, launched a local government reform, a reform of social and health care services, and a housing policy reform, and decided on measures that will strengthen the social guarantee scheme for young people and facilitate the employment of employees with partial working capacity.

In connection with its budget discussions the Government took the decision to adopt a structural reform programme aimed at strengthening the foundations for economic growth, increasing the employment rate and bridging the sustainability gap in public finances. The programme defines a set of targets and specifies the measures needed to achieve them in the areas of central and local government financial administration, productivity in public service provision, working careers and labour supply, structural unemployment and the output potential of the whole economy.

It is important that the programme is clear, consistent and credible. This will contribute to reinforcing confidence in Finland's ability to meet its long-term obligations with respect to public finances and the provision of welfare services and social security and by the same token support economic growth and the improvement of living standards. This will require effective implementation of the programme.

3.3 Medium-term outlook

The Finish economy is expected to continue to contract during the current year, but to turn around and show growth in 2014. It is thought that in the medium term, economic growth will be subdued compared to the early 2000s. Growth will be slowed above all by the weak development of total factor productivity and by the stagnation of labour input growth as a result of population ageing.

Medium-term growth prospects can be viewed and considered via potential output growth. The Ministry of Finance uses the production function method jointly developed by the EU Commission and Member States to assess potential output growth. This method examines the separate roles played by labour input, capital and total factor productivity in potential output growth.

Change in labour input can be further broken down between change in the working-age population and changes in the labour force participation rate, structural unemployment and average number of hours worked. The number of people in working age (15–74) is expected to grow slightly over the outlook period due to net immigration. The growing share of the population aged 65–74 will lower the average labour force participation rate. It is expected that structural unemployment will remain at around 7.2% and that the average number of hours worked will show moderate growth. Indeed the supply of labour will remain almost unchanged over the medium term, and therefore labour input will not increase the economy's output potential. Nonetheless it is thought that cyclical employment and the average number of hours worked will increase somewhat in the medium term.

It is expected that following the sharp decline seen during the recession, investment will slowly pick up, and the impact of capital stock on potential output will increase to 0.5 % towards the end of the outlook period in 2017.

The recession has eroded employment to a lesser extent than anticipated. Productivity growth, on the other hand, has slowed significantly during the recession. Total productivity trend growth has slowed to historically low levels in Finland; in recent years it has actually been in negative territory. It is projected that total productivity trend growth will slowly recover towards the end of the outlook period, but still remain at a much lower level than the growth figures seen in earlier years. A number of factors have contributed to the slowdown of total productivity growth. Under conditions of recession, production capacity is underused, which has an adverse cyclical effect on productivity trends. Another factor underlying the slowdown of productivity growth has been the declining contribution of industry to total output and the lowered productivity in industrial production as a result of restructuring in the electronics industry. Over the ten-year period before the recession that started in 2008, i.e. in 1998–2007, total productivity trend growth averaged 2% a year.

The Ministry of Finance's latest potential output calculation does not expect to see any growth in total productivity during the current year, and in 2017 it is forecast that growth will reach no more than 0.6%. Overall it is projected that potential output will increase by 0.4% this year and slowly accelerate to 1.1% in 2017. The economy's resources continue to remain underused. The output gap, i.e. the difference between actual and potential output, is estimated to reach 2.9% in 2013. In 2014–2017 it is projected that economic growth will outpace potential output growth as demand picks up and idle production resources are put to use. It is anticipated that the output gap will close in 2017.

General government revenue decreased sharply during the recession at the same time as expenditure continued to grow. This scissors movement pushed the general government budgetary position into deficit. It seems that the deficit cannot be overcome without additional adjustment because the economy and by the same token general government revenue will continue to post slow growth over the coming years, at the same time as population ageing is driving up public expenditure.

Central government net lending is estimated to show a deficit of 2.1% and central government debt to be 50.2% of GDP in 2017. Local governments will also remain in deficit, and their debt will increase significantly over the outlook period. Public finances are bolstered by the surplus in earnings-related pension funds, although that surplus is now also shrinking. The Finnish economy is poorly prepared to meet the growing expenditure pressures from population ageing.

Table 3. Key forecast figures for the medium term

	2011*	2012*	2013**	2014**	2015**	2016**	2017**
GDP at market prices,change in volume,%	2.7	-0.8	-0.5	1.2	1.9	1.7	1.6
Consumer price index, change, %	3.4	2.8	1.6	2.1	2.0	1.8	1.8
Unemployment, %	7.8	7.7	8.3	8.2	7.9	7.7	7.5
Employment rate,%	68.6	69.0	68.7	69.0	69.5	69.8	70.1
General government net lending, % of GDP	-1.0	-2.2	-2.6	-2.3	-1.9	-1.6	-1.3
Central government	-3.4	-3.8	-3.8	-3.3	-3.0	-2.4	-2.1
Local government	-0.6	-1.1	-0.9	-1.1	-1.1	-1.2	-1.2
Social security funds	2.9	2.7	2.0	2.1	2.2	2.0	2.0
General government gross debt, %of GDP	49.2	53.6	58.3	60.7	62.0	62.4	62.9
Central government, % of GDP	42.2	43.6	47.5	49.3	50.1	50.3	50.4

4. Iceland

4.1 Recent economic development and medium-term outlook

The Icelandic economy has been growing since late 2010, albeit at a slower pace in 2012 and 2013 than previously anticipated. The economy expanded by 1.4% in 2012 according to updated estimated national accounts and preliminary figures for the first half of 2013 show a further 2.2% growth compared with the first half of 2012. This strong growth in the first half of the year is largely due to a 4.6% drop in imports compared with the same period in 2012 when large imports of ships and aircrafts were accounted for. The economy in now set to grow by 1.7% in 2013, followed by more robust growth of 2.7–2.8% in 2014 and 2015, driven largely by growth in investment and private consumption.

Private consumption grew by 1.2% in the first six months of 2013 compared with the year-earlier period after a slowdown in the rate of growth from the second half of 2012. This slowdown in growth reflects a slower growth in real wages in the first half of the year, compared to 2012 and 2011, lower withdrawals of supplementary pension savings and the heavy debt burden of households. Growth in private consumption is expected to pick-up in the latter half of the year. Growth in real wages is expected to be stronger in 2014 compared with 2013, contributing to a 3% growth in private consumption. The average wage index increased by 5.5% in the first eight months of the year compared with the same period in 2012. In 2014 a similar increase is expected even though lower inflation should put less pressure on raising nominal wages.

The labour market is gaining strength as the unemployment rate declines and the labour participation rate improves. Registered unemployment in August was down to 4% and the rate is forecasted to average 4.8% this year, one percentage point lower than in 2012. In the wake of the economic crisis, the period for which unemployment benefits could be claimed was temporarily extended from three years to four. In the end of last year this extension expired, except for those who had been unemployed for less than three and a half years. Through active labour market programs, The Directorate of Labour has contributed towards lower rates of unemployment. The registered rate has also declined because some individuals, who are still unemployed, have lost their rights to benefits. In 2014 registered unemployment is expected to decline to 4.5% and continue to decline over the forecast period.

Measured unemployment is also declining and in the first 8 months of the year the average rate was 5.7% compared to 6.7% in the same period last year. The number of jobs is also increasing, especially among women. In the wake of the economic crisis, labour force participation among women has increased substantially and the number of employed women is now higher than before the crisis. Employment among men is also on the rise although still significantly lower than in the years leading up to the crisis.

Investment is declining this year due to large investments in ships and aircrafts in the first half in 2012, which has not been repeated in 2013. Business investment is forecasted to decrease by over 14 percent this year. Excluding investment in ships and aircrafts, however, business investment is expected to grow at a relatively modest pace. Investment in large-scale industry fell by a quarter in 2012 and is not expected to pick up this year as some large-scale investment projects have either been delayed or scaled down. Residential investment grew modestly last year. It is expected to grow further this year, even though preliminary figures for the first half of the year indicate little growth. Public investment has been on a declining path since the economic crisis and reached a historic low of 1.8% of GDP in 2012. Public investment is expected to turn around in 2013, as indicated by preliminary figures showing modest growth in the first half of the year. In 2014 gross fixed capital formation is expected to increase by 14.1%, mostly because of an increase in large-scale investment and also because of an increase in general business investment and residential investment.

Table 4: Key forecast figures

Volume change, %	2012	2013	2014	2015	2016	2017
Private consumption	2.4	1.9	3.0	3.1	3.1	3.2
Public consumption	-1.4	0.5	0.0	0.2	1.3	1.5
Gross fixed capital formation	5.0	-3.6	14.1	12.5	2.5	6.9
Business sector investment	7.8	-14.3	13.4	13.3	-3.9	4.6
Residential investment	6.9	23.7	25.9	13.6	14.5	10.2
Public investment	9.1	20.9	0.2	7.1	13.1	11.2
National final expenditure	1.6	0.5	3.8	3.7	2.5	3.5
Exports of goods and services	3.8	2.3	2.6	2.9	3.8	3.9
Imports of goods and services	4.7	0.2	4.5	4.4	3.5	5.0
Gross domestic product	1.4	1.7	2.7	2.8	2.8	2.9
% of GDP						
Goods and service balance	6.3	6.6	5.5	4.8	5.3	5.1
Current account balance	-4.9	-1.0	-3.4	-3.9	-3.3	-2.8
Current account balance (excluding DMBs being wound up)	0.8	1.2	0.0	-0.7	-0.4	-0.4
Consumer price index	5.2	3.5	3.0	2.5	2.5	2.5
Exchange rate index	2.4	-0.6	0.6	0.2	0.0	0.0
Real exchange rate	0.6	1.9	1.0	0.5	0.6	0.5
Unemployment rate	5.8	4.8	4.5	4.2	3.8	3.7
Wage index	7.8	5.5	5.6	4.5	4.3	5.2

The goods and services balance has been positive since the economic crisis but on a declining path as imports have been growing faster than exports. This year the trade balance is expected to increase again due to lower imports compared to last year and reach 6.6% of GDP. Export of services and general merchandise benefit from a low real exchange rate. The number of tourists that have visited Iceland in 2013 has never been higher and the growth is expected to continue. Revenue from transport services has also increased. The low exchange rate will continue to support growth in general merchandise export but majority of merchandise exports come from the fisheries sector and large-scale industry which are both in short-term bound by capacity constraints. In 2014 and 2015 the trade balance is expected to decline as imports will grow faster than exports to support increased growth in domestic demand.

The exchange rate strengthened again in February and has been fairly stable since then. The Central Bank inducted a new policy last spring and increased market intervention with the objective to dampen exchange rate fluctuations. However, this new exchange rate strategy has not led to a noticeable decline in inflation expectations, which could result in higher wage demands in the upcoming wage negotiations. The exchange rate is assumed stable throughout the forecast period.

The Central Bank´s policy rates have been stable in recent months, or since the Bank started to use increased market intervention to counteract inflation and inflation expectations with less fluctuations in the foreign exchange rate. Consumer inflation is declining as the exchange rate fluctuations have abated this year. Averaged consumer inflation is expected to be 3.5% this year and to fall to the CBI's 2.5% inflation target level in 2015.

4.2 Economic policy

The Government has made it a priority to spur growth through increased efficiency and exports while public finances are consolidated and Treasury debt put on a firmly declining path. A new organic budget law will be presented to Parliament this fall to improve the budgetary process and streamline fiscal policy. Furthermore, the revenue side will be reviewed with an aim to simplify the tax system, remove loopholes, reduce means testing and prevent tax evasion. Proposed changes to the tax system include reducing taxes on income, goods and services, in order to improve disposable income and reforming the corporate tax system, thereby strengthening general business environment. During the electoral term (four years), social security contributions will be reduced, the minimum municipal income tax rate abolished and the income tax system reviewed. Consumption taxes and excise duties will be simplified in the aim of minimizing economic distortions.

Conditions need to be put in place to generate growth from the export sector and increase efficiency in the public and private sectors. The Government will make every effort to create a business environment which promotes investment and creates more jobs, particularly in small and medium-sized companies. Special emphasis will be placed on export-sector growth, innovation and utilisation of opportunities for future growth. The Government will initiate the review of business regulation, with the aim of simplifying it and increasing efficiency. The objective will be to cut red tape and streamline communications with public bodies, while at the same time keeping costs down. Efforts will be made to strengthen the competitive environment by combating serial incorporation, ensuring equal treatment in payment of public levies, preventing capital controls from distorting enterprises' competitive positions and preventing financial institutions from managing operating companies for a protracted period. Further private sector deleveraging is important in this regard and further actions on this front are being studied by a Government appointed committee.

Few issues are more important to increase efficiency and spur growth going forward than the removal of capital controls. The Government remains committed to this process and continue to work towards relieving the possible balance of payment pressures resulting both from pre-crisis capital inflows and the resolution of the old banks.

Despite numerous structural reforms in recent years, Iceland still has some important areas where efficiency gains can be achieved. The OECD and the IMF have recently pointed out the possibility of shortening the period of pre-university education, which is two years longer in Iceland than in most OECD countries. The Government is actively reviewing these proposals. The OECD has also recommended structural changes in the healthcare system, i.e. implementation of gate keeping in order to reduce high specialist costs in comparison with other countries.

4.3 General government finances

The fiscal position of both the Treasury and the municipalities has improved in line with economic growth. In the wake of the economic and financial crisis general government suffered substantial fiscal deficits as revenues slumped and expenditures escalated. In the original economic plan by the Icelandic government and the IMF, in the autumn of 2008, the main goal was set for the primary balance of the general government to be positive in 2011 and the total income balance to be positive in 2013. The goal of positive primary balance was achieved in 2012 and in 5-year period since the onset of the economic crisis, the accumulated fiscal recovery as measured by the primary balance is almost 14% of GDP.

In 2012 the total income balance of general government is in deficit by 3.8% GDP but in comparison the balance was negative by 5.6% of GDP in 2011 and 10% in 2010. Interest on foreign loans has accounted for a large share of the deficit in recent years. In 2012 the interest payment deficit of the general government amounted to 4.1% of GDP and the primary balance was therefore positive by 0.3% of GDP.

This year the total income balance deficit is expected to amount to 2.7% of GDP which is a somewhat worse outcome than originally aimed for in the 2013 budget. Tax revenues have been lower than previously estimated, mostly because of slowdown in domestic demand. Various other revenues, such as asset sales, are also lower than anticipated. The primary surplus is however expected to increase to 0.9% of GDP in 2013.

In the Treasury Budget proposal for 2014 the total income balance of the general government is expected to be negative by 0.8% of GDP as Treasury operations are balanced for the first time since 2007. The primary balance is on the other hand set out to be positive by 2% of GDP and to remain positive by 1 to 2% throughout the forecast period to

2017. Treasury expenditure will be reduced, as a share of GDP, through broad-based streamlining measures, decisions to abandon various recent projects undertaken by the previous government and measures to cut interest expense. Fiscal performance will also be improved through revenue-generating measures, in particular the bank tax which will be increased and, for the first time, levied on financial undertakings in winding-up proceedings. The budget also takes the first step towards lower taxes on households and companies. The middle bracket in the personal income will be reduced by 0.8 percentage points and SSC for companies will be reduced by 0.1 percentage points.

The total general government debt is now on a declining path and amounted to 129.6% of GDP in the end of 2012. According to the Maastricht-criteria, the debt-ratio amounts to 97% of GDP. It is estimated that the debt-ratio reached its peak in end-2011 and will continue to decline gradually throughout the forecast period and amount to approximately 80% of GDP in 2017.

Table 5: General government finances

					Pre.	Est.	Budget		Forecast	
In bn. ISK	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Total income	653.6	614.3	637.3	681.1	740.3	787.4	832.6	846.7	897.0	951.6
Total expenditure	853.7	763.3	791.9	771.8	805.6	835.0	848.3	882.8	925.5	969.8
Total balance	-200.2	-149.0	-154.6	-90.7	-65.3	-47.6	-15.7	-36.1	-28.5	-18.2
Interest income	49.6	47.0	32.1	24.6	25.1	31.0	32.8	35.0	36.0	37.0
Interest expenditure	49.5	98.6	84.8	84.2	95.8	94.3	85.7	89.0	94.8	98.1
Primary balance	-200.3	-97.5	-101.8	-31.2	5.4	15.7	37.2	17.9	30.3	42.9
% of GDP										
Total income	44.1	41.0	41.5	41.8	43.6	44.1	43.9	42.2	42.3	42.4
Total expenditure	57.7	51.0	51.6	47.4	47.4	46.7	44.7	44.0	43.7	43.2
Without interest cost	54.3	44.4	46.0	42.2	41.8	41.5	40.2	39.6	39.2	38.8
Total balance	-13.5	-9.9	-10.1	-5.6	-3.8	-2.7	-0.8	-1.8	-1.3	-0.8
Primary balance	-13.5	-6.5	-6.6	-1.9	0.3	0.9	2.0	0.9	1.4	1.9

5. Norway

5.1 Fiscal policy

Norway's petroleum industry gives large revenues to the Norwegian Government. At the same time it presents particular challenges for fiscal policy in ensuring a stable economic development. The Government Pension Fund Global and the fiscal policy rule together constitute Norway's fiscal framework. The state's current net cash flow from petroleum activities is saved in the Fund, while concurrent spending over the fiscal budget follows the expected real return of the wealth already accrued in the Fund. Expected real return is estimated at 4 per cent. Through the Fund, a large proportion of the State's oil and gas income is invested in other countries. Investing foreign exchange earnings abroad protects the krone against the large, varying foreign exchange earnings generated by the petroleum industry. The framework is designed to promote a stable development of the Norwegian economy. It gives room for a gradual increase in the spending of petroleum revenues, yet also cushions exposed industries from rapid downscaling and ensures that resource wealth will benefit future generations.

The framework allows automatic stabilizers to play out fully, as the spending of oil revenues is measured by the non-oil, structural budget deficit. It also allows for discretionary fiscal policy to counter fluctuations in economic activity. Fiscal policy was turned on to an expansionary path during the global recession in 2009. In the amendment to the National Budget 2014 the non-oil economy is forecast to grow in line with the average of the past 40 years, unemployment is forecast to stay low, while the Fund's capital is expected to grow rapidly.

The proposal implies a non-oil structural budget deficit of 139 bn. NOK, which amounts to 2.9 per cent of the estimated value of the Government Pension Fund Global, 56 bn. NOK below the estimated 4 per cent path. The increase in the structural non-oil budget deficit corresponds to 0.5 per cent of mainland trend-GDP, giving a somewhat stronger demand stimulus than the budget proposal put forward by the outgoing Government. The use of oil revenues corresponds to 5.7 pct. of mainland trend-GDP. According to macroeconomic model simulations, the amended budget is forecast to increase growth in the mainland economy by about ¼ percentage point in 2014.

5.2 Monetary policy

Norges Bank's implementation of monetary policy is aimed at low and stable inflation, defined as an annual increase in consumer prices that remains close to 2.5 per cent over time. In the short and medium term, monetary policy weighs low and stable inflation against production and employment stability.

Norges Bank has kept the key policy rate unchanged at 1.5 per cent since the spring of 2011. In its latest monetary policy report, published on September 19th, Norges Bank indicated that the policy rate will be kept at the present level until the summer of 2014 and then gradually be increased to 2¾ per cent towards the end of 2016.

The Norwegian interbank rate (NIBOR) has generally decreased since the summer of 2012 and stabilized at around 1.7 per cent the last couple of months. The decrease in the NIBOR is mainly due to lower risk markups in the money markets, causing interest rates on deposits in banks to fall. However, interest rates on bank loans have not been reduced correspondingly.

After reaching record strength in February, the krone has depreciated. As measured by the Trade Weighted Index, the Norwegian krone is now ¼ per cent stronger than the average in the period since the introduction of the inflation target for monetary policy in 2001, and 5½ per cent weaker than the average last year.

5.3 Economic outlook

Following the downturn in 2009 activity in the mainland economy swiftly rebounded. Employment is now significantly higher than prior to the financial crisis, and unemployment is low. Last year mainland GDP grew by 3.4 per cent, outperforming the four preceding years. Growth has however declined thus far this year. Moderate household consumption subdued growth in the first half of this year. Key indicators also point in the direction of weaker growth in Q3 than expected. Based on this the growth forecast for household consumption is revised downward compared to the National Budget 2014. Also the growth forecast for mainland business investment has been revised somewhat downward, while the activity in the petroleum sector continues to give growth stimulus to the rest of the economy both this year and next year.

On this background, the annual growth of the mainland economy is expected to be rather moderate this year, before picking up again next year. With low interest rates and growth in households' disposable income, private consumption is expected to keep growing. However, with households' record high debt burden and houses prices that have leveled off growth in private consumption is expected to be moderate. Also growth in housing investments is expected to diminish somewhat in the years ahead. With improving economic outlook for Norway's trading partners the export of traditional goods might pick up next year. Growth in mainland business investments is expected to diminish somewhat from last to this year, before picking up somewhat in 2014.

All in all, non-oil GDP is expected to grow by 2.0 per cent this year and 2.5 per cent next year, cf. table 5.1. Hence growth in 2014 is forecast to be close to the average for the last 40 years of 2.6 per cent. Petroleum production is expected to decline somewhat in 2013 before picking up in 2014.

Employment is still growing, but the weakening economic growth has dampened growth since the summer of last year. However, employment is still expected to increase by about 1 per cent both this and next year. According to the labor force survey, unemployment increased somewhat at the end of last year and in the beginning of this year, but has decreased thereafter. In the amendment to the National Budget 2014 unemployment is estimated to stabilize at today's level of about 3½ per cent in the years to come. This is low both historically and compared to other countries.

Labor migration from the EU has increased rapidly in recent years. About 2/3 of the increase in employment in Norway since 2004, can be attributed to labor migration. That has made the Norwegian labor market more flexible and eased impediments in the economy. However, high immigration flows might have contributed to less stability in the housing market, where prices continued to grew until this summer.

Following three years in which underlying consumer price growth, as measured by consumer price growth adjusted for tax changes and excluding energy products (CPI-ATE), has been less than 1½ per cent, price growth has picked up in recent months. CPI-ATE growth is expected to strengthen further next year. With expectations of weaker electricity price developments next year, increases in the overall price index are expected to decline somewhat from 2013 to 2014.

Strong growth in China and other emerging economies since the turn of the millennium has contributed to a substantial increase in prices for oil and other raw materials, and a significant improvement in Norway's terms of trade. During the same period terms of trade were also spurred by cheap imports from the same group of countries. The improvement in terms of trade has boosted both income and activity in the Norwegian economy. As much as 40 per cent of the growth in real disposal income for Norway since the turn of the millennium is due to terms of trade gains. Demand from the oil industry directed towards mainland businesses has flourished, and government has received large revenues and households' considerable increases in income. The increase in real wages has been well above the wage growth among our trading partners, resulting in a high cost level in Norway. This poses great challenges to many Norwegian exporters' profitability. In 2012 wages in manufacturing were on average almost 70 per cent higher than in a weighted average of Norway's trading partners in the EU, and close to 30 per cent higher than in Sweden, measured in common currency.

Housing prices plummeted in many countries in the wake of the international financial crisis. In Norway, housing prices contracted moderately from the autumn of 2007 until December 2008, but have thereafter continued to increase steeply and have reached record high levels. The price increases have leveled off recently, and for the first time in four and a half years the quarterly growth rate was negative in the 3rd quarter of this year. The sustained housing price increase has been accompanied by a high level of household debts, with gross debt amounting to more than twice the value of their income. The combination of high housing prices and a high level of household debt does increase the risk of a housing market slump. Housing starts remain high, but growth has abated somewhat over the last year. However, continued high labor immigration, low interest rates on mortgages and high income growth might contribute to a continued buoyant demand for housing.

Table 6: Key figures for the Norwegian Economy. Percentage change in volume from previous year

	Bn. NOK[1] 2012[1]	2012	2013	2014
Private consumption	1,175.0	3.0	2.0	2.4
Public consumption	619.5	1.8	2.6	2.1
Gross fixed instruments	598.0	8.0	5.1	4.8
Of which: Petroleum extraction and pipeline	171.8	14.5	9.0	7.5
Businesses in mainland Norway	180.9	3.2	1.6	3.7
Housing	139.8	7.4	5.0	3.0
Public sector	89.2	-0.6	5.9	4.8
Demand from mainland Norway[2]	2,204.4	2.8	2.5	2.6
Exports	1,183.0	1.8	-1.6	3.2
Of which: Crude oil and natural gas	604.4	0.9	-5.5	4.2
Traditional goods	310.3	2.6	0.1	2.5
Services excl. petroleum activities and shipping	135.4	1.3	2.9	2.3
Imports	798.8	2.4	3.2	3.8
Of which: Traditional goods	486.0	2.7	2.9	2.9
Gross domestic product	2,906.8	3.1	0.8	2.6
Of which: Mainland Norway	2,200.3	3.4	2.0	2.5
Mainland Norway excl. electricity	2,148.9	3.1	2.5	2.5
Other key figures:				
Employment, persons		2.2	1.1	1.0
Unemployment, LFS (level)		3.2	3.5	3.6
Annual wage		4.0	3½	3½
Consumer price index (CPI)		0.8	2.1	1.9
CPI adjusted for tax changes and excluding energy products (CPI-ATE)		1.2	1.6	2.0
Oil price. NOK per barrel[l, 3]		649	623	600
Current account balance (per cent of GDP)		14.2	11.0	10.6
Gross national income, bn. NOK		2,964	3,027	3,167
Three-months money market interest rate,%[4]		2.2	1.8	1.8
Trade-weighted index, percentage change from previous year[5]		-1.6	2.4	3.6

[1] Preliminary national account data in current prices.
[2] Excluding changes in inventory.
[3] Current prices.
[4] Technical assumptions based on forward rates in September.
[5] Positive figures indicate a weaker NOK.
Sources: Statistics Norway and Ministry of Finance

6. Sweden

6.1 Economic policy

The crisis in the world economy has had far-reaching consequences for the Swedish economy. After a sharp downturn in the economy in 2009 the following two years were marked by a recovery. But when the economic situation worsened once more around the world, the recession in the Swedish economy deepened once again, with higher unemployment as a result. This has worsened the public finances and according to the current forecast general government net lending will be -1.2% of GDP in 2013 and -1.5% of GDP in 2014.

The space for expenditure reforms under the expenditure ceiling is very limited in 2014. Consequently, most of the initiatives to support the economy should lie on the income side.

In the Budget Bill for 2014 the Government proposes measures worth a total of SEK 24 billion. These measures include an increase in the earned income tax credit, a rise in the lower threshold for state income tax and lower taxes for pensioners. The Government consider the easing of the household taxes to be relevant from both a stabilising and a structural point of view. Growth and labour market will be supported both in the short and the long run from the improved conditions for households. The combined effect of the proposals targeting the households will be to strengthen household finances by more than SEK 20 billion in 2014. Other measures taken are for instance a financial subsidy to employers focusing on stimulating employment of young people and 'new start zones' where firms meeting certain criteria will be allowed deductions when calculating social security contributions. New start zones are a tool for reducing exclusion in areas with the highest proportion of people who lack employment, have limited education and receive long-term income support.

6.2 Economic development

Although a somewhat brighter outlook can be sensed throughout the world in the second half of the year, Swedish growth for 2013 as a whole is expected to remain weak, with both falling exports and falling investments. Growth is kept up by domestic demand, primarily household consumption. Next year, both business and household confidence is expected to increase. As international demand is expected to increase next year so is Swedish export. Together with the improved business confidence this will result in a rise in investments next year. Further, household consumption is expected to grow more quickly compared to earlier phases of recovery. Household consumption will then be the key driver of the GDP growth; this is partly a result of the reductions in income tax proposed in the Budget Bill for 2014. The strong development of household consumption is also due to favourable household wealth, an improvement in household confidence as well as a relatively strong increase in real wages. All in all this will lead to a pick-up in GDP growth the coming year.

Although there has been a prolonged downturn in the world economy the development on the Swedish labour market has been relatively strong. At the beginning of the financial crisis employment fell, but has increased steadily since the end of 2009. Employment has increased at the pace of the population, thus the employment rate has been unchanged. The increase in employment is driven by the service industries and the public sector. Although the employment has increase it has not reduced the unemployment rate since the labour force has been increasing at the same time.

Forward-looking indicators of demand for labour, such as recruitment plans, redundancy notices and newly reported vacancies point to continued growth in employment in the months to come. GDP growth will be driven by service production the coming year while the contribution from industrial production is expected to be small due to weak export. As a result the labour demand will differ between the service and the manufacturing sector.

The labour force has risen strongly in recent years. This is due to population growth but also to an increased participation rate. Usually the participation rate falls during downturns, but this time the fall has been smaller. The participation rate is now at the same level as before the crisis.

On the whole, employment and the labour force are expected to grow at a good pace in 2013 and 2014. But GDP growth will initially be driven by productivity, and the increase in employment will not be strong enough to produce a significant reduction in unemployment. Unemployment is expected to remain at around 8% next year.

Both CPI and CPIF[2] were below the Riksbank's target rate of 2% in 2012. In the first half of 2013 inflation has remained low. The low price pressure is mainly due to a low capacity utilisation. Further, the Swedish krona has contributed to lower import prices, in addition to the already weak international price development. As a result of the low capacity utilisation, high unemployment and low inflation the Riksbank is believed to maintain an expansionary monetary policy. Thus, the repo rate will remain at 1% during 2014.

The protracted economic downturn is expected to result in a deficit in the public sector finances in both 2013 and 2014. Central government and the old-age pension system are expected to show a deficit in 2013, whereas the municipal sector is expected to show a small surplus.

6.3 Economic Outlook medium term

According to the forecast the recovery in OECD is believed to commence in 2014, although capacity utilisation will remain low. The recovery is expected to continue 2015-2017 and capacity utilisation will be balanced in 2017. The recovery in the euro area is expected to be prolonged. As 70% of Swedish export of goods is destined for Europe the slow recovery in the euro area will dampen Swedish export. During the forecast period the Swedish current account surplus is expected to decrease after a period with large surpluses. This effect is increased by a strong krona compared to many of the currencies in the Swedish export markets. Thus, export will not be the driver of the economic recovery it used to be.

A high level of household savings and a relatively strong development of disposable income give room for a larger increase in private consumption than is usually the case in Sweden during a phase of recovery. The improvement on the labour market during 2015-2017 is also expected to be a contributing factor to the increase.

[2] CPI with fixed mortgage rates.

As the export recovery is delayed so is the recovery in fixed capital formation, with its close ties to export manufacturers. But in 2015 the growth rate for investments will rise and will be relatively high for the remainder of the forecast period.

The increase in demand will eventually lead to an accelerated increase in private firm employment. Employment will grow faster than the population in 2015–2017, thus the employment rate will rise. At the same time the labour force is expected to grow at a lower rate resulting in a decrease in unemployment, the decrease is most pronounced during 2016 and 2017. However, unemployment is expected to be higher than the NAIRU level for the entire forecast period. Thus, there will be available resources in the labour market the coming years.

For the economy as a whole the resource utilisation is expected to be close to balance in 2017. Given the forecast, the Swedish economy will then have had below par resource utilization for nine years.

After most of the wage negotiations have been concluded wages are expected to increase at a dampened rate in 2015. During 2016 and 2017 wages are expected to increase at a gradually higher rate, as the economy improves. The average wage increase 2015–2017 is expected to be somewhat lower than the historical average from 1997, when the current model for wage negotiation was introduced. As the recovery picks up private firms can gradually carry over the wage increases to their customers via price increases and inflation, measured as CPIF, will then reach 2% at the end of 2017.

As resource utilisation and inflation increases monetary policy becomes less expansionary. The Riksbank raises the repo rate for the first time in 2015 and the rate will be 3.25 at the end of 2017. By 2015 the recovery has gained momentum which can be seen in the public finances. The net lending of the general government is believed to rise to -0.4% of GDP in 2015, from -1.5 in 2014. In 2016 the net lending will turn positive and for 2017 it will amount to 1.1% of GDP.

Table 7: Key figures. Percentage change if not else stated

	2012	2013	2014	2015	2016	2017
GDP	0.7	1.2	2.5	3.6	3.9	2.9
Productivity in private sector[1, 2]	1.1	1.3	2.7	2.5	2.0	1.8
Hours worked[2]	0.6	0.3	0.5	1.1	1.6	1.5
Employment[3]	0.7	0.8	0.8	1.0	1.3	1.3
Unemployment[4]	8.0	8.2	8.1	7.8	7.0	6.4
GDP gap[5]	-2.7	-3.5	-3.0	-2.1	-1.0	-0.2
Wages[6]	3.0	2.7	2.8	2.9	3.2	3.4
CPI[7]	0.9	0.1	0.9	1.7	2.7	3.2
Net lending[8]	-0.6	-1.2	-1.5	-0.4	0.4	1.1

[1] Value added at base prices per hour worked.
[2] Calendar adjusted.
[3] 15–74 years.
[4] Share of labor force 15–74 years.
[5] Difference between actual and potential GDP, as a percentage of potential GDP.
[6] According to short-term wage statistics.
[7] Annual average.
[8] Consolidated general government. % of GDP.
Source: Statistics Sweden and Ministry of Finance.

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Economic Outlook in the Nordic Countries 2014

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