Economic outlook 1/2010

Summary from NHO's Quarterly Economic Report March 2010

Economic Outlook 1/2010

A reduction in investment combined with a steep decline in the workforce participation rate

- The survey conducted among the NHO's 20,000 member companies provides a more optimistic outlook than that of the November Survey, but the outlook is still regarded as weaker than what the forecasts from central policy and analysis environments in Norway indicate. For the NHO member companies the employment rate is expected to remain unchanged throughout this year. The service providing sectors have switched to the positive side in relation to the estimated growth in the number of new jobs, while the tourism and manufacturing industries still view the employment outlook as negative.

- The developmental trend for the Norwegian labour market is characterised by rapid withdrawal from the workforce, but also by increasing unemployment. 72,000 more individuals did not participate in the workforce by the end of 2009 compared to the beginning of the year. Approximately 1/3 of these opted to enter full-time education or training.

- Throughout 2009, the employment rate dropped by 50,000 persons in the Norwegian private sector according to national accounting figures from Statistics Norway. The public sector employment in Norway increased by 25,000. The decline in employment is most severe in parts of the manufacturing industry. Several manufacturing industries experienced more than a 10 % decline in employment over the course of last year.

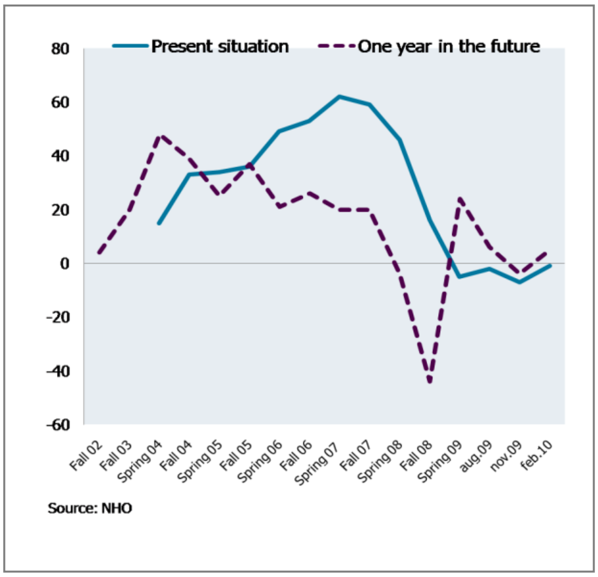
- The decline in corporate investments in Norway continues. Corporate investments for the mainland economy dropped by 12 percent last year. The NHO member companies expect a continued fall in investments for 2010. The petroleum investments may develop more positively than earlier presumed, but a great degree of uncertainty still exists.

- The collective corporate borrowing in Norway fell during 2009 after many years with a two-digit annual growth. Both the capital rules used in banking and the so-called gold card serve to provide banks with very strong incentives to go for household lending with security in real estate at the expense of corporate lending. The tax system also serves as an incentive for increased borrowing for housing purposes.

- The international cyclical upturn still remains uncertain and weak. The new figures for the US economy combined with a growing concern over state finances in many countries result in an economic outlook that may be even weaker than what we have presumed so far. There is an obvious risk of reinforcing negative effects within the area of international trade.

- The development in competitiveness measured in relative wage costs is clearly negative. The relative wage cost per unit produced will be over 50 % higher than those of our trading partners for 2010.

Fig. 1: The NHO companies' market assessment



Difference between number of positive and negative responses

Table 1: Employment, 1000 persons

	2008	2009	Changes 2008-2009
Employment	2615	2605	-10
Public sector	757	781	+24

Source: SSB

Summary

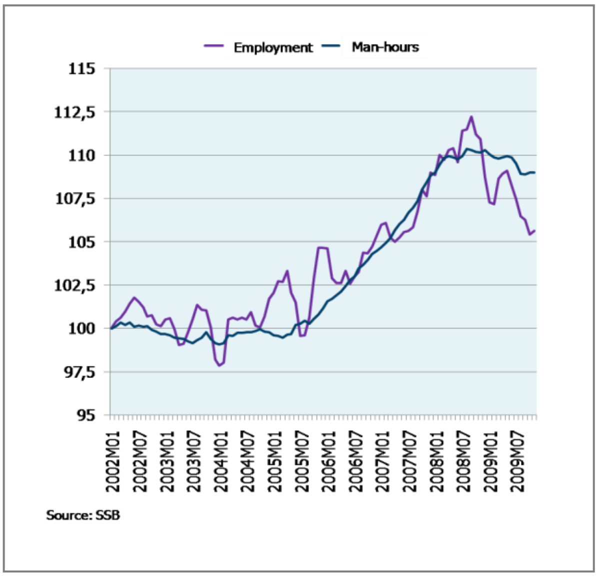
A somewhat brighter outlook, but increased investments have yet to materialize. Considerable cost and restructuring challenges regarding should characterize the Norwegian economic policy

The market situation for the first quarter of 2010 is regarded as unchanged by the NHO member companies overall compared to the last Economic Survey conducted by the NHO (see Figure 1). The fiscal and monetary policy measures introduced in Norway have contributed to a stabilization of the economic situation. The severe decrease in interest rates has in particular served to stimulate household purchasing of durable consumer goods and contributed to a renewed rise in housing prices. At the same time, the massive government spending of petroleum revenues over the state budget has contributed strongly to maintaining public demand in Norway. The budget policy has not only been directed at increased public investments and maintenance, but also the number of employees in the local and national government sector has seen a significant increase.

While part of the service providing and sheltered private sector views the market situation for the first quarter as positive, a majority of enterprises within manufacturing and construction has a negative view. The overall outlook for the NHO member companies is estimated to be somewhat more positive than that of the last quarter. Turnover-wise a rather flat development is expected from 2009 to 2010. A majority of the enterprises fear a decline in sales prices and profitability. A majority of enterprise also plan to cut back on their own corporate investments. The Norwegian manufacturing industry is somewhat less negative with regard to sales prices and profitability than it was in the fourth quarter of 2009, but many manufacturing enterprises plan are planning investment cutbacks in 2010.

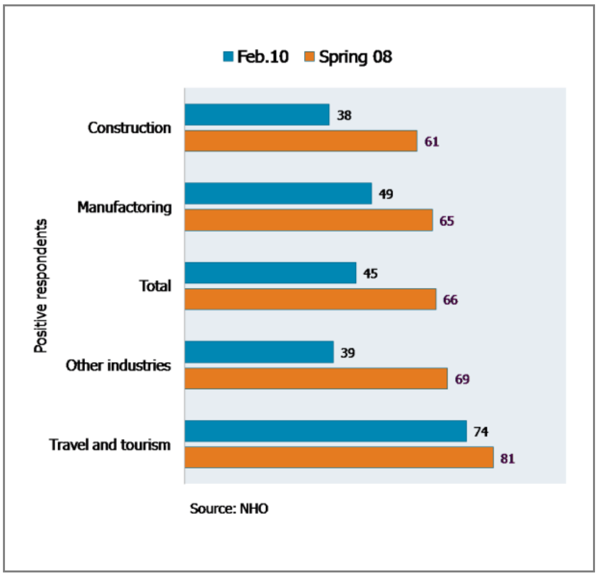
While the counties around us are experiencing an unemployment rate of approximately 10 percent of the workforce, thanks to an expansive economic policy and not least a strong growth in public sector employment, Norway has managed to maintain the overall labour demand. In spite of the financial crisis and difficult market conditions internationally, the employment rate as measured as the number of persons employed decreased only marginally from 2008 to 2009 (see Table 1). The most important cause for this marginal employment rate reduction can be found in that the

Fig.2: Employment and man-hours



Difference between number of positive and negative responses

Fig.3: The use of foreign labour



Difference between number of positive and negative responses

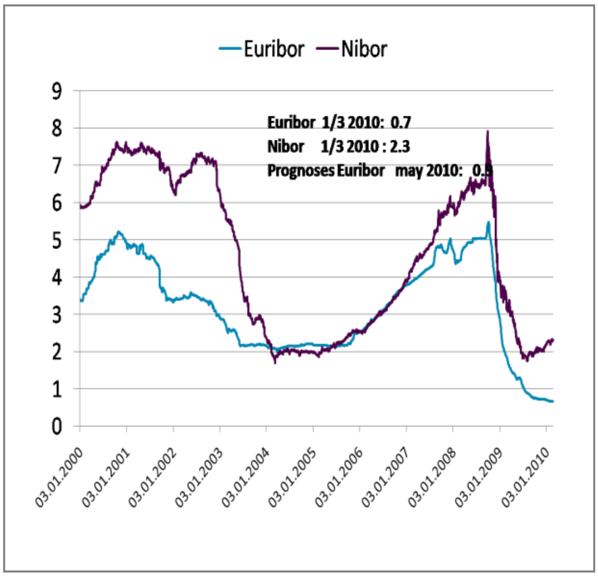
decline in private sector employment was being counteracted by a massive increase in public sector employment. According to national accounting figures, public sector employment increased by 24,000 persons in 2009. For the municipal sector, the increase was 17,000 persons.

Moreover, the labour market situation is characterised by a marked reduction in average working time. According to national accounting figures, the number of man-hours worked was reduced by 1.5 percent in 2009 whereas the decline in the number of persons employed was only 0.4 percent (see Figure 2). This decline has been particularly marked for enterprises in the manufacturing industry and the construction sector. This developmental trend might be interpreted to mean that enterprises have retained labour that they for market reasons strictly speaking do not need. This again might mean that we might be faced with a future development where cyclical improvements at first will fail to foster renewed demand for recruitment. The application of future dismissals and layoffs however seems to be somewhat less extensive than what our member companies reported in the last survey, We expect that the employment rate will have a weak development also in 2010. At the same time a continued rise in the employment rate is predicted. The unemployment rate had been significantly higher if the workforce dropout rate in the form of education and transfer to disability benefits and the like had not been as marked as it was for 2009. The NHO member companies currently report that their use of foreign labour is expected to decrease, especially within the construction industry. Compared to the spring of 2008, there has been a marked decline. This may serve to reduce the rise in the employment rate somewhat, but there is currently great uncertainty linked to how many of the foreign workers who will choose to leave the Norwegian labour market (see Figure 3) in particular because the labour market situation in their home countries is worse than it is in Norway

Credibility with regard to the fiscal policies an absolute must

The fiscal rule governing the in phasing and spending of government petroleum revenues over the state budget is a medium-term rule for the Norwegian fiscal policy. It is vital to maintain this fiscal rule as a framework for stability and predictability. In order to create credibility

Fig.4: In differential interest rate?



3 months' money market rate

> ### The room for manoeuvre in fiscal policy should be used for future-oriented investments:
>
> *"The majority therefore feels that an increase in the petroleum revenue spending should be directed towards measures that could serve to increase productivity and thus the capacity for growth in the rest of the economy"*
> **The Labour Party, the Conservative Party, the Liberal Party, the Norwegian Christian Democratic Party and the Coastal Party.**
>
> *"The Committee would like to point out that the tax policy along with efforts relating to infrastructure, education and research are important in order to achieve a well-functioning economy."*
> **The entire Committee**
>
> Source: Recommendation S No. 229 (2000-2001)

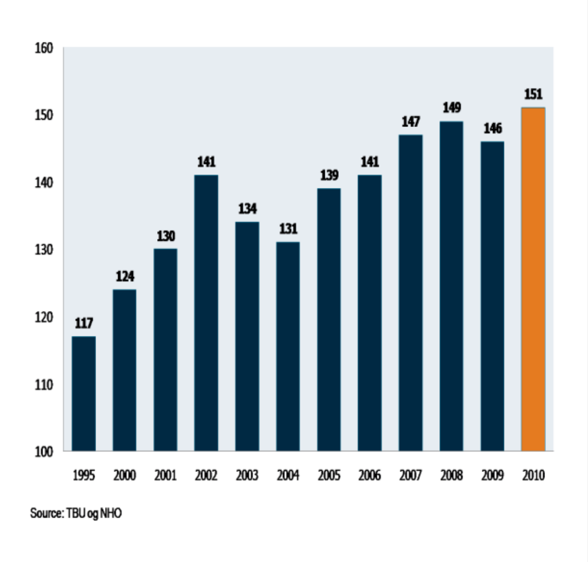
surrounding the fiscal rule it is important that expectations not be created signalling that the fiscal rule is a rule from which ii is easy to derogate. During 2009 and 2010 the rule was exceeded by NOK 84 billion following an underspending during the cyclical upturn during the three previous years of a total of NOK 29 billion. As the cyclical situation becomes more normalised, the petroleum revenue spending over the state budget must be reduced in order to maintain the credibility of the Norwegian fiscal policy.

Weak and partly sideways international cyclical trends combined with a high government debt in several European countries serve to indicate that the international interest rate level is likely to remain low for a long time to come. As a result Norway will therefore be faced with limited opportunities for increasing its national interest rate level without simultaneously severely damaging Norway's competitiveness caused by a strong exchange rate for the Norwegian krone as a result of an interest rate increase particular to Norway. Therefore it is absolutely vital that the Norwegian government and the Norwegian Storting withdraw stimuli as the cyclical conditions improve. When asked about important framework conditions, the enterprises participating in the NHO's Economic Survey state that a fiscal policy which serves to safeguard a low interest rate level and a competitive exchange rate for the krone is the most important policy area to give priority.

Profitable infrastructure should be protected from budget cuts

A common approach for implementation of budget cuts is to implement flat percentage cuts on all the main areas of the state budget and then leave it up to the relevant minister to determine how this may be done. Seen in relation to the economy's long-term capacity for growth, this method is not very desirable. Profitable infrastructure investments should be protected from budget cuts. When the fiscal rule was introduced in 2001, the majority of the Storting stated clearly that increased petroleum revenue spending over the state budget should be earmarked for growth promoting additional efforts within the areas of competence, research, transport and infrastructure and to promote the removal of taxes and duties that are particular to Norway that had a disadvantageous effect on the Norwegian capacity for growth (see Box 1). Unfortunately this has not happened so far; something

Fig.5: A sharp weakening of the Norwegian competitiveness next year.



Wage costs for manufactoring workers in Norway compared to trade weighted groups of countries

which is clearly demonstrated by the economic outlook prepared by Statistics Norway and by estimates included in this report.

A continued weak market situation in many important markets combined with a challenging situation in relation to costs mean that Norwegian enterprises are facing great restructuring needs. The enterprises hold the opinion that these challenges should be met by concentrating on and a restructuring towards a greater degree of knowledge and technology-based content within production. To achieve this it is important that Norwegian authorities give priority to framework conditions that can serve to support the choices which Norwegian enterprises view as part of the solution.

In order to facilitate for a faster return to the fiscal rule, modernisation reforms for budget management and organisation in the public sector are important.

It is important to avoid so-called soft budget constraints in public service production which serve to give the impression that it is easier to appeal to the relevant allocating authority than to implement necessary restructuring. A fixed budget framework serves to promote restructuring and real prioritisation.

Exposure to competition and alternative models for corporation between the public and the private sector should be tested as a tool for increased efficiency.

Increased public sector employment was mentioned as an important step in the strategy aimed at countering the effect of the financial crisis. While private sector employment has decreased relatively strongly, public sector employment has experienced growth. Failing markets, weakened competitiveness (see Figure 5) and profitability have served to reduce the corporate ability to pay wages for many enterprises. It is important that the wage formation for all segments of the labour market, also the public sector be made to reflect the real cost and market situation for the internationally exposed enterprises.