ACI Nordic Congress. Panel discussion

Introduction by Governor Svein Gjedrem. Göteborg, 24. August 2002

Please note that the text below may differ slightly from the actual presentation.

For outsiders, it may be convenient to see the Nordic region as consisting of countries with very similar characteristics. However, the countries are different in several ways.

First, they differ in their relations to the EU and with respect to their monetary policy regimes. Sweden, Denmark and Finland are members of the EU. Finland is also a member of EMU. The euro has replaced the markka as legal tender, and Finland and the other 11 member countries of EMU have a common monetary policy. Denmark is in ERM II while Sweden, Iceland and Norway have inflation targets.

In Norway the inflation target of 2½ per cent was adopted on 29 March 2001 and now functions as the nominal anchor for the Norwegian economy. The introduction of the inflation target did not imply a significant shift in the way monetary policy was conducted. However, the introduction of the inflation target brought monetary policy in Norway more in line with common practice internationally, and facilitated communication.

Although the approaches differ, inflation has been relatively low and stable in the Nordic countries in recent years.

Second, the Nordic countries are different in terms of industrial structure. The sector composition of the three Scandinavian stock exchanges provides an illustration. The Oslo Stock Exchange is heavily dominated by the energy sector, which is practically absent in Stockholm, Copenhagen and the two other Nordic exchanges. Norway has small traditional industries, but the IT and telecom sector is comparable to the other countries' in relative size. The different sector composition of the stock exchanges also illustrates the potential for diversification by investing across the Nordic countries. The differences in industrial structure imply that international economic developments will affect the Nordic countries differently. Most notably, an oil price shock will have the opposite effect in Norway than in the other Nordic economies.

In 2001, the petroleum sector in Norway accounted for around 20 per cent of total investments, 45 per cent of exports, 24 per cent of GDP and 35 per cent of central government revenues. The government net cash flow from the petroleum sector has increased in recent years. Since 1995, the fiscal surplus has been invested in the Government Petroleum Fund. The size of the Fund has increased rapidly in the last few years, and will reach close to 100 per cent of GDP towards the end of this decade, according to estimates from the Ministry of Finance. By investing a substantial part of petroleum revenues abroad, the Government Petroleum Fund limits the effect of the current account surplus on the exchange rate.

GDP growth in Norway has been relatively high since 1990, also when excluding the petroleum sector. GDP for Mainland-Norway has on average increased by 2.8 per cent annually since 1990. This compares to 1.7 per cent in Sweden, 2.1 per cent in Denmark, 1.9 per cent in Finland and 2.5 per cent in Iceland over the same period. The differences for average GDP growth since 1995 are somewhat smaller.

Although GDP growth in Norway was moderate in 2001, capacity utilisation in the Norwegian economy remains high. So far, the impact of the international slowdown on the Norwegian economy has been limited, partly due to high oil prices. Unemployment has been low since the mid-1990's. Private consumption is expected to remain buoyant due to high wage growth and an expansionary fiscal policy in the years ahead. Prices for domestically produced goods and services are rising fast. Inflation in Norway is being dampened by a close to zero rise in prices for imported consumer goods.

The different cyclical developments in Norway are also reflected in the stock market. Norwegian stock prices have become much less correlated with world markets over the last years. The correlation is considerably lower than in the other Nordic countries. The correlation for Denmark is also rather low, but this is partly due to low exchange rate correlation. When looking at the correlations using national currencies, the Danish correlation is higher and more in line with that for Sweden and Finland.

Iceland and Norway have the highest key interest rates among the Nordic countries, at 7.9 and 7.0 per cent respectively. Rates are considerably lower in Sweden (4.25), Denmark (3.50) and Finland (3.25). Wage developments over the last few years can contribute to explaining the differences. In Norway wage growth has been high over the last five years, reflecting a tight labour market. Looking at data for wage growth from the OECD, the ranking of interest rate levels in the Nordic region corresponds to the ranking of average wage growth since 1998.

The Norwegian krone has appreciated by around 15 per cent since mid-2000. Seen over a longer period, the krone has been rather stable. The present level is only around 6 per cent stronger than in 1990. Over this longer period, other Nordic currencies have shown larger fluctuations.

Over the last two years, the appreciation of the Norwegian krone has been driven by the wide and increased interest rate differential between Norway and other countries. The interest rate differential reflects high growth in wages and aggregate demand in Norway. There is thus a clear link between cost pressures in the Norwegian economy and the exchange rate. The link works through interest rate expectations driving the krone upwards. The appreciation of the krone has a dampening effect on inflation. At the same time, profitability in the internationally exposed sector is under pressure both due to higher wage costs and the appreciation of the krone.

But the krone can move in both directions. It will not appreciate indefinitely. If the krone follows the path of the forward rate, it will depreciate in the years ahead. The forward effective krone exchange rate two years ahead is close to the average level of the effective exchange rate during the 1990's.