CONCLUDING STATEMENT

Norway: Staff Concluding Statement of the 2022 Article IV Mission

FOR IMMEDIATE RELEASE

Washington, DC – June 9, 2022: *The economy bounced back strongly from the Covid-19 pandemic, and the recovery is well entrenched in 2022. However, uncertainty over spillovers from the war in Ukraine, the intensity of the pandemic globally, and particularly in Europe, and supply bottlenecks is high. Given its strong fundamentals, Norway is relatively shielded, and risks are balanced. If downside risks materialize, fiscal and monetary policies should be flexibly adjusted. Otherwise, in a context of high capacity utilization, fiscal policy should be tightened to prevent overheating risks. Monetary policy has been responding in a timely manner, with effective communication and safeguarding against financial risks and should continue to do so. Over the longer-term, policies will need to focus on making the labor market more inclusive, improving educational opportunities, completing climate commitments, and ensuring intergenerational fairness by reining in public spending. The regulatory toolkit could be further enhanced to mitigate vulnerabilities such as high mortgage and corporate debt.*

Risks are balanced in the short term and ample policy space provides room to mitigate adverse shocks. Mainland real GDP is expected to grow around by 4 percent in 2022, driven primarily by strong domestic demand, especially private consumption. The war in Ukraine, a potentially lower demand from Europe for non-energy exports, and continued supply bottlenecks have increased uncertainty to the outlook. The forecast is particularly sensitive to where energy prices settle. Thus far, high energy prices have resulted in a hefty windfall in public revenue, which could lead to higher petroleum investment and energy exports in the medium term. While household consumption could be affected by high global energy prices, electricity subsidies, together with the agreed wage increase, should help support real incomes and spending. The current account is projected to remain in a large surplus.

Fiscal management has been strong and policy accommodative, but spending should be lowered significantly, and the policy stance should return to neutral over the medium term. The revised 2022 budget aims at a reduction in the structural non-oil deficit. However, a tighter fiscal policy is needed to counter the risks of overheating. Expansion of the green transition and associated technologies, and the overall objectives to pursue inclusive growth and tackle inequality are welcome. In this context, support to households to compensate for high electricity prices should be targeted rather than across-the-board.

The challenges ahead relate to adverse demographic trends and the transition away from oil, which, if unaddressed, may put a serious strain on public finances. Over the past decade, growth in transfers from the Government Pension Fund Global (GPFG) and tax revenues has exceeded growth in pension and aging-related spending, creating policy space to finance additional initiatives to promote long-term growth. However, with GPFG transfers projected to decline over the coming decades, the ability to finance the current high level of spending will be challenged. Furthermore, future increases in aging and healthcare spending will require some fiscal adjustment in the longer term. Reforms that increase labor supply (including changes to sickness and disability benefit schemes) will boost growth prospects, but more is needed to improve long-term fiscal sustainability. In addition, it will be key to continue to promote improvements in the quality and cost efficiency of public services delivery. Expanding the mandate of the Advisory Panel on Fiscal Policy Analysis to advise on long-term fiscal sustainability is a step in the right direction. To contain spending going forward, the authorities could consider further strengthening their fiscal framework by complementing it with a medium-term expenditure framework guided by an operational rule.

Monetary policy should continue to balance overheating risks and financial stability. The policy rate has been raised a timely manner to maintain price stability and address financial stability risks. Further gradual tightening, as per current forward guidance, is appropriate, given the inflation outlook under the baseline. The high uncertainty surrounding the outlook calls for continued flexibility in decision making accompanied by clear communication. Providing the Norges Bank with new policy setting powers on the countercyclical capital buffers are a welcome addition to its regulatory toolkit.

Risks to financial stability appear to be broadly manageable. A sharp tightening of global financial conditions will put pressure on balance sheets. However, the banking system is well capitalized and, according to recent stress tests by the authorities, should withstand the potential shock, despite the high level of household debt and exposure to commercial real estate. It is commendable that steps have continued to be taken to improve the macroprudential policy framework, but more could be done to broaden the toolkit to mitigate these vulnerabilities, including introducing sectoral capital tools. To better monitor risks, recent efforts to improve data collection are important. While house price growth moderated somewhat and will probably recede further in light of interest rate increases, efforts should continue to alleviate the constraints on the supply of new housing. It would be appropriate to preserve tighter mortgage regulation limits for Oslo, and consideration should be given to a gradual phasing out of mortgage interest deductibility. While bankruptcies have been low, there is room to enhance the framework to facilitate the exit for businesses, especially small- and medium-size enterprises. The application of the new anti-money laundering/combating the financing of terrorism law is welcome, especially the increased frequency and coverage of inspections. To mitigate cybersecurity risks, the authorities are rightly testing critical infrastructure and are working with the private sector, encouraging them to boost cyber security capabilities.

The longer-term structural policy agenda should be wide-ranging. The new government's policy objectives are focused on instilling progressivity in the tax system, encouraging full-time and permanent employment, and providing greater support for families and rural communities. While these are important goals, structural objectives should focus more strongly on boosting and diversifying labor force participation, including among vulnerable groups, and raising non-oil productivity, for example by reducing school dropouts, upskilling, and changing the sickness and disability benefit system. It will be important to implement the provisions under the new Integration Act to give more opportunities to immigrants. Closing remaining digitalization gaps will help further improve productivity.

Norway is actively promoting climate adaptation and mitigation strategies, including globally. Plans to support innovation and digitalization for increased climate-smart productivity within agriculture, strengthen the ability of low-income countries to adapt to climate change, as well as manage climate-related risks, fund research, technology, and innovation by actively involving Norwegian and international research communities are welcome. Current efforts to achieve climate objectives through 2030 are appropriately centered on carbon taxation and other important initiatives such as research and development of carbon capture options, but more effort is needed as gaps in the coverage of carbon taxation remain. Norway also endorsed the EU's objectives of reorienting financial capital towards sustainable investment, managing financial risks stemming from climate change, and fostering transparency in financial and economic activity.

The IMF mission thanks the authorities and other counterparts for a constructive policy dialogue.