STABILE NORWEGIAN ECONOMIC SYSTEM AND CHALLENGES OF FRAGILE GLOBAL FINANCIAL FLOW

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Norway is one of the healthiest economies in Europe due to its low unemployment rate, interest rates, and inflation. However, in terms of per head, proportionally, Norway is one of the wealthiest countries in Europe. Strong growth in consumer spending, fiscal stimulus and recovery in the housing markets are contributing to the healthy economic growth. Against this background, the key policy rate is kept unchanged at 1.5%. After growing at an annual rate of 2-3% over the last several years, the economy is expected to grow at 2.25% this year, as per the IMF. This is well ahead of the euro zone that could contract by 0.5%. Norway is among the richest countries in the world i.e. the third-richest nation per capita has an unemployment rate of less than 3 percent and offers its citizens free health care and education). It has a lock on the top spot in the annual United Nations human development index and has amassed a $582.7 billion sovereign-wealth fund from its oil revenue, amounting to $128,000 per inhabitant. The government limits spending of oil revenue to 4 percent of the fund, to ease the effects of wealth on the economy.

Despite the challenging global economic environment, the Norwegian economy continues to go ahead well due to benefits of the government pension fund. The fund comprises the government pension fund global (GPFG) and the government pension fund Norway (GPFN). The fund capital is invested abroad in international equities, bonds and real estate. The fund is managed with a view to achieving the highest possible return over time, subject to a moderate level of risk. The time horizon of the fund investments is very long.

Key words: economic flow, Norway's financial system, financial sector. Government Pension Fund Norway (GPFN),

INTRODUCTION

The Norwegian economy is an example of capitalist wealth and prosperity, created in a combination of free market activity and government intervention. Government manages the key areas, such as the vital petroleum sector through state-majority-owned oil companies. The country is rich in natural resources: oil, gas, hydropower and minerals, but mostly depends on the oil sector, which accounts for nearly half of exports and over 30% of state revenues. Norway is the world's second largest exporter of gas, and is located on the 9th place in the world according to the amount of oil exported. Norway's most important trading partner in the EU-27 (UK 26.7%, Netherlands 12.1%, Germany 11.4%, Sweden 7%, and France 6.6%) with a total coverage of 81.2% (80.1 billion euros) of the total Norwegian exports (98.664 billion euros). From other countries, the export of goods is directed towards the United States (5%), China (1.7%), Canada (1.7%), South Korea (1.6%) etc. Similarly, the import of goods, mostly dominated by EU-27 countries (Sweden 14.1%, Germany 12.4%, Denmark 6.3%, UK 5.9%) with a share of 63.9% (36 9

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billion. euros) of total imports. Followed by China (8.6%), USA (5.5%), Canada (3.2%), South Korea (3.1%), Russia (2.6%), Japan (2.2%) and etc. [2]

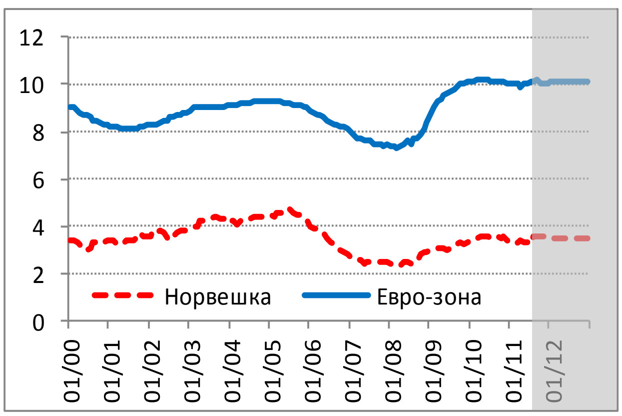
Given the fact that the EU is Norway's largest trading partner, imports occurs with the most important export resource and mineral fuels (oil, natural gas) with 64.3%, agricultural products and food, dominated by fish, while Norway imports from the countries of the Union machinery and transport equipment (41.6%), semi-products and chemical products (19.7%), iron and steel (3%) and others.

It is envisaged that Norway by 2020 could take place the Russian position and to become a major supplier of gas to the European Union’s needs. European countries are dependent on Russian gas delivery, and this dependence of Russia is often used by political pressures.

NORWEGIAN CROWN PILLAR OF THE NORWEGIAN ECONOMY

Norwegian Crown is one of the most stable currencies in the world. Unlike other countries that are making strenuous efforts to maintain the stability of their currencies due to the strong pressure of devaluation of the debt crisis, the Norwegian authorities have forced the opposing actions, spending or the activation of the Government Pension Fund, to maintain the stability of its currency, hazard due to revaluation.

Unemployment rate



GDP

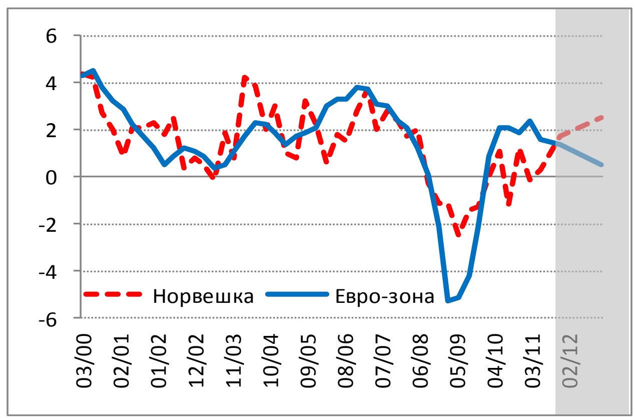


Figure 1. Unemployment and GDP rate in Norway
Source: Eurostat (projection MMF)

The Norwegian currency is attractive because of last year's budget surplus of 10.5% in terms of gross domestic product and the highest AAA rating assigned by the rating agencies. Norway has the lowest unemployment rate in Europe, and is protected from the economic crisis thanks to its oil reserves. Everything goes in addition to the rating of the lowest risk of bankruptcy, which is measured by the value of credit default swaps.

Norwegian authorities take various measures and instruments to deal with the negative tendencies of the debt crisis. Norwegian experts have roundly criticized Switzerland's decision to stop the rise of the Swiss franc, because the consequences of such a move by the authorities in Basel reflect the money markets around the world. Norwegian crown rose against the euro after the Swiss central bank has said it will proceed to the unlimited spending as would have prevented the collapse of the value of the euro against the franc after the limit of 1.20 francs per euro. Such a move prompted investors to turn to other currencies in economies governing fiscally healthy, and was among the first such Norway. For months the money is moving to Switzerland and other countries that are rated as safe for investors investing, and

[2] Eurostat DG Trade statistics: *EU Trade with the World and EU Trade with Norway*. 21 March 2012. p.1-11.

withdraw from the Euro-zone that are affected by the economic crisis. What is common to Norway, Sweden and others? Countries where capital finds shelter is a high surplus in the balance of current payments, which means that they are much less reliant on foreign funding and are therefore considered reliable for investment.

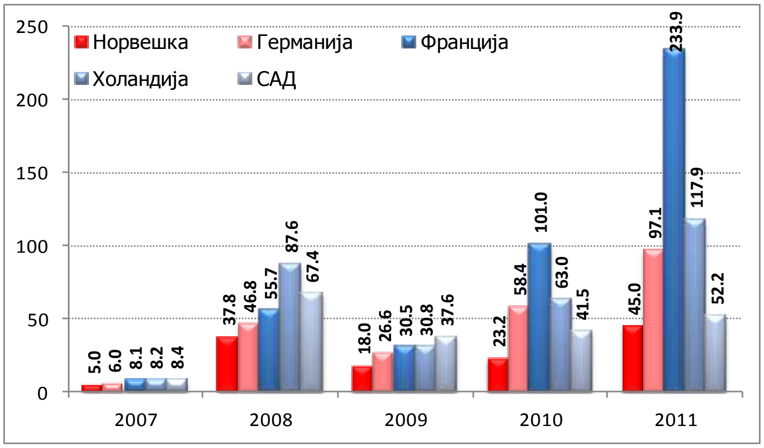


Figure 2. Price movement of CDS (Credit default swaps) (base points)
Source: Eurostat (projection MMF)

Governor of the Norwegian central bank warned investors that the strengthening of the value of the national currency would threaten the country's economy, so it will reduce exports and recommends a reduction of the interest if the value of the crown continued to grow. However, the Norwegian central bank abandoned the planned increase in the reference interest rate and left the benchmark 2.25%, in response to the growing turbulence on world markets and the weak outlook for the recovery of the global economy.

According to the Norway's central bank expectations of the economic growth (excluding oil and shipbuilding) for 2012 were at the level of 3%, and for the next 2013 of 3.75%.

On the other hand, there are some limitations, such as the Norwegian currency market is less liquid compared to other reliable markets, taking with him the status of the top ranked reliable market. In addition is the fact that trading in Norwegian kroner accounts for 0.7% currency in global trade in 2010, which is significantly less than the Swiss franc, which contributed 3.2%.[3]

Norway probably did not intend to join the European Union in the near future (twice Norway's citizens voted in referendums to join the EU in 1972 and 1994), [4] but stands for close cooperation in the field of energy and protection of the natural environment, as well as better alignment of the Norwegian Krone with Euro. Many citizens of Norway believe that the country should be a close partner with the EU, but is not considered particularly necessary Norway to join the EU soon. Membership in the European Economic Area (EEA) is accepted as a contractual relationship between Norway and the EU, but there is a commitment to connecting the Norwegian Krone with Euro mainly because Norwegian economy is heavily exposed to the

[3] Danske Markets Foreign Exchange Research. FX Crossroads: Go with the krone flow. 07 September 2011. http://danskeresearch.danskebank.com/abo/FXC070911/$file/FXC_070911.pdf
[4] Темјановски Р.(2013):*Економска географија*. Штип: УГД:Економски факултет, 2013.стр. 162.

economies that depend on the euro. Although membership in the euro zone also is not in the plan, if Norway joins the EU, it took the single currency.

After solid GDP growth in the period 2004-2007, economic growth has slowed in 2008 and 2009 before they regain positive growth in 2010. It only confirms that even extra rich countries that are based on hundreds of billions of dollars from the export of "black gold", are not immune to the crisis.

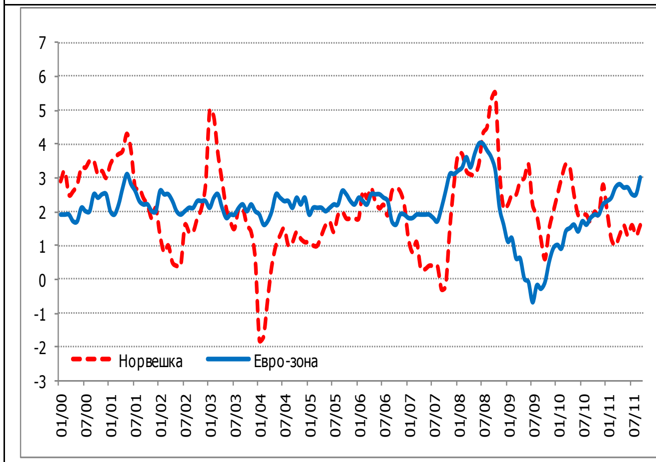
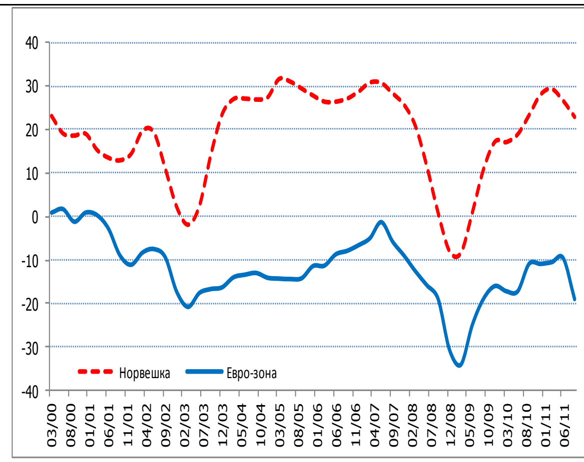
Retail price index (CPI-Consumer price index)	Consumer confidence index (CCI)
	

Figure 3. Retail price index and consumer confidence

Source: Eurostat (projection MMF)

The rate of inflation as measured by the retail price index (CPI-Consumer Price index), shows that it in Norway is around 1.5 which is about half of the Euro-zone is 3 (underlying inflation was between 1% and 1.5% throughout 2012).[5]

GOVERNMENT PENSION FUND OF NORWAY AGAINST SOVEREIGN CAPITAL FUNDS

Norway’s Government Pension Fund was established in 1990. Since January 2006, this fund includes the Government Pension Fund–Global (formerly Government Petroleum Fund, established in 1990) and the Government Pension Fund–Norway (formerly National Insurance Scheme Fund). The fund receives central government revenues from petroleum activities.[6]

Sovereign capital funds (SWF) are government investment funds that differ from the holdings of central banks and pension funds. They do not require short-term liquid assets that central banks require interventions on the foreign exchange markets. Nor a specific future debt as pension funds. Sometimes sovereign capital funds are complex to understand because some of the funds combine the functions of central bank instruments and certain financial institutions.

[5] http://www.norges-bank.no

[6] European central Bank: *Impact of sovereign wealth funds on global financial markets*. Occasional paper series. No 91 / july 2008. p.10.

Table 1.The world's largest sovereign capital funds (SWF)

Земја Country	Име на Суверениот капитален фонд Sovereign Wealth Fund Name	Капитал во милијарди Assets $ Billion	Почетен капитал Inception	Потекло на капиталот Origin	Лин. Мад. трансп. инд. Linaburg-Maduell Transp.Index
Норвешка Norway	Governeme Pension Fund - Global	664.3	1990	Нафта Oil	10
УАЕ – Абу Даби UAE Abu Dhabi	Abu Dhabi Investment Authority	627	1976	Нафта Oil	5
Кина China	SAFE Investment Company	567.9	1997	Non-Commodity	4
Саудиска Арабија Saudi Arabia	SAMA Foreign Holdings	532.8	н/п	Нафта Oil	4
Кина China	China Investment Corporation	482	2007	Non-Commodity	7
Кина - Хонг Конг China – Hong Kong	Hong Kong Monetary Authority Investment Portfolio	298.7	1993	Non-Commodity	8
Кувајт Kuwait	Kuwait Investment Authority	296	1953	Нафта Oil	6
Сингапур Singapore	Government of Singapore Investment Corporation	247.5	1981	Non-Commodity	6
Сингапур Singapore	Temasek Holdings	157.5	1974	Non-Commodity	10
Русија Russia	National Welfare Fund	149.7	2008	Нафта Oil	5
Кина China	National Social security Fund	134.5	2000	Нафта Oil	5
Катар Qatar	Qatar Investment Authority	115	2005	Нафта Oil	5
Австралија Australia	Australian Future Fund	83	2006	Non-Commodity	10
ОАЕ – Дубаи UAE Dubai	Investment Corporation of Dubai	70	2006	Нафта Oil	4
ОАЕ – Абу Даби UAE Abu Dhabi	International Petroleum Investment Company	65,3	1984	Нафта Oil	9

SWF Institute, 2013. http://www.swfinstitute.org/fund-rankings/

Sovereign capital funds (SWF) soon developed as a major international financial institutions. Their volume of capital in particular began to rise rapidly over the past 10-15 years, but the trend of progressive growth in the future. It is estimated that the total capital of these funds is approximately $ 3 billion. This capital is greater than hedgers funds ($ 2 billion) but significantly lower than official monetary reserves of central bank (about U.S. $ 6 billion). Estimates from the International Monetary Fund (IMF, 2008) that the capital value of the sovereign capital funds will range between U.S. $ 6-10 billion. Norway, Saudi Arabia, United

Arab Emirates (UAE) and Kuwait have the largest national funds. The fact remains feka revenues from oil and gas, are the main source of most funds, with the exception of China and some Asian exporters.[7]

All countries have equal access to capital, generated by oil exports. Norwegian government perceives the experience of this field from other countries. For example, the Russian government established a capital fund separate from the central bank, and other countries such as Japan and India are considering creating separate institutions. Conversely however, the Mexican government uses 80% of the revenue of the national oil company (Pemex) to finance 40% of the state budget.

The question is what means the Norwegian Fund for financial investors? What is the relative rate of risk in alternative investments?

It is considered that the rate of return on capital in these funds are higher than average rate of return on equity in the global commodity markets, but these funds is significantly more risky portfolio of world commodity markets.

Norway has tried to ensure the creation of a fund with clear objectives, which will vary from those who take the policy of the central bank. The purpose of the Norwegian capital fund is providing max. income portfolio in terms of risk and certain restrictions lay down by the Norwegian Ministry of Finance. Norwegian authorities evaluating the unstable nature of the oil revenues. North Sea crude oil production has been declining since 2001, and the price of oil is extremely fickle world markets. One of the objectives of the Fund is allow Norwegians to harmonize their costs in terms of income nation.

Norway achieved state revenues from oil and gas exports kept in a separate State Pension Fund in the amount of over $ 500 billion in 2010. Government Pension Fund is an independent monetary fund, where it accumulates excess cash received from the Norwegian oil production. The Fund changed its name in 2006 from the Petroleum Fund of Norway Government Pension Fund. This fund is one of the largest pension funds in Europe and the second largest in the world, with a value of 3.496 billion crowns ($ 582.7 billion U.S. dollars, although the latest data from the SWF Institute show that this fund increase its value of 664.3 billion U.S. dollars). It is counted as one of the most transparent and profitable investment funds. The Fund invests in various types of fixed income and stocks. Up to 5% of the funds are earmarked for international real estate. Currently, this fund does not invest in private equity. With this fund managed by the Central Bank of Norway on behalf of the Government. Fund mostly invests in European securities, taking into account the large stream of income due to the oil price increase. The main reason for the existence of this fund is about seeking to avoid the danger of so-called "Dutch disease". The large inflow of foreign currency from exports of oil and gas would lead to overheating the Norwegian economy and growth would cause the value of the Norwegian crown. The strong currency would more expensive domestic products with which they would be uncompetitive in world markets.

INVESTMENT OPPORTUNITIES IN THE NORWEGIAN CAPITAL

As to securities with an explicit guarantee of the state, such issues Kommunalbanken Norway (KBN), an agency that is 100% owned by the state and which possesses supreme credit rating AAA. KBN was founded in 1926 and is mandated by the central government to the local government provides funds under very favorable conditions[8]. KNB is the largest lender to local government in Norway, more than 95% of the municipalities and counties have loans with KNB. However, the securities issued by KBN in very low

[7] *Caner M., Grennes T.:* Sovereign Wealth Funds: the Norwegian Experience. *Social Science Researche network. 2008. p.1-2.*

[8] Moody's investors service. Credit analysis: Kommunalbanken AS Oslo, Norway. August 29, 2012. http://www.kommunalbanken.no/media/77049/moodys_aug_29__2012.pdf

emissions (highest emission amounts to 540 million Norwegian kroner, or about 70 million euros), which is below the minimum specified in the Rules for handling and managing the foreign reserves.

Remains the possibility of placing portfolio Norwegian crowns in deposits with a maximum maturity of up to 3 months. Interest rates on deposits in Norwegian crowns are given in the table:

Table 2. Interest rates on deposits in Norwegian kroner

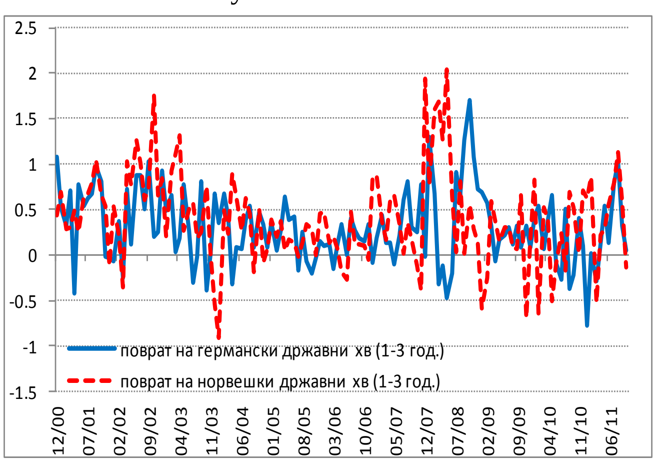
overnight	1.9995
7 days	1.9550
1 month	2.8014
2 months	2.8823
3 months	3.0281

According to some polls in prestigious economic magazine Bloomberg Market, the world's largest investors recommended by Capital in 2012 to focus in Norwegian securities. Having regard to the limits set by the rules on handling and managing the foreign exchange reserves (amount of emissions, the difference between purchase and selling price at the time of purchase, residual maturity), there are very large benefits for investing in 10-year government securities and it:

Table 3. Issuance of government securities with a maturity date of issuance and

Amount of emission NOK	Night Emission Amount (expressed in EUR)	Release Date	Maturity Date	Coupon
60,544,000,0000	7,810,080,910	05/16/2002	05/15/2013	6.500
54,125,000,000	6,982,039,992	05/19/2004	05/15/2015	5.000
36,737,280,000	4,739,051,421	05/08/2006	05/19/2017	4.250
29,000,000,000	3,740,954,453	05/13/2008	05/22/2019	4.500
30,000,000,000	3,869,952,882	05/10/2010	05/25/2021	3.750

In National currency



in EUR

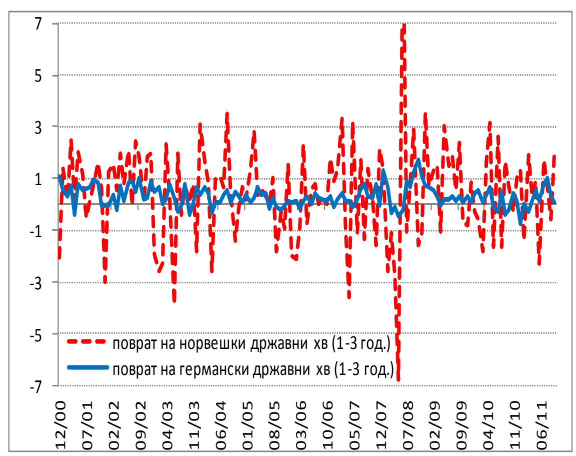


Figure 4. Return on equity in government securities

Извор: Norges bank - www.norges-bank.no

With such stable economic indicators, Norway enjoys the highest trust of the international rating agencies. In April 2012, the international rating agency "Standard & Poor's"[9] confirmed the highest "AAA" rating Norway with stable prognosis. "Standard & Poor" indicates strong fiscal and external position of the Norwegian government, which continues to benefit from significant tax revenues associated with oil and gas sectors.

According to the agency, Norway's greatest weakness is the relatively high level of private sector debt. "Standard & Poor's," said the government's fiscal flexibility could be limited due to unfavorable demographic structure, particularly the growing number of adult population, unless the authorities take further measures to reform the pension, health and social system.

SUMMARY

Norway has large oil reserves, robust fiscal and monetary balance sheet, zero public debt and substantial accumulated wealth. The economic strength is still attracting lots of foreign capital, especially from investors who view most of Scandinavia as a safe haven for their money.

Petroleum production has added more than $1.5 trillion to Norway’s gross domestic product over the past four decades, according to the government and an estimated 250,000 people work in jobs directly or indirectly linked to the oil industry.

Norway’s financial system appears sound, well managed, and competitive and shorter-term vulnerabilities appear low overall. Improved macroeconomic conditions and historically low interest rates, coupled with generally prudent and transparent frameworks for monetary, fiscal and financial stability policies contribute to financial stability.

In addition, the existence of The Government Pension Fund (former Government Petroleum Fund - GPF) provides significant insulation against the effects of sharp movements in oil prices. The Government Pension Fund is a sovereign wealth fund where the surplus wealth produced by Norwegian petroleum income is held. The fund changed name in January 2006 from its previous name The Petroleum Fund of Norway. As of the valuation in 2012, it is the largest pension fund in Europe and the second largest in the world with a value of NOK 3496 billion (US$582.7 billion, but the latest data shows an increase in valuation to US$664.3 billion), although it is not actually a pension fund as it derives its financial backing from oil profits and not pensioners. It is among the most transparent of the SWFs in its holdings & investments. The fund invests a large portion of assets in fixed income and equities. Up to 5% has been allocated to international real estate. They currently do not invest in private equity.

The regulation of financial sector is closely in line with EU norms, as required by Norway’s participation in the European Economic Area (EEA). Main task of this instrument noted “Sovereign wealth fund” is to managed stable economy and maintain the competitive national currency. A sovereign wealth fund is a state-owned pool of money that is invested in various financial assets. The money typically comes from a nation's budgetary surplus. When a nation has excess money, it uses a sovereign wealth fund as a way to funnel it into investments rather than simply keeping it in the central bank or channeling it back into the economy. Sovereign credit ratings play an important part in determining a country’s access to international capital markets, and the terms of that access. Sovereign ratings help to foster dramatic growth, stability, and efficiency of international and domestic markets.

Standard&Poor’s: Global Credit Portal: RatingsDirect on Global Credit Portal. June 20, 2012. p 8.

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