

34. EFTA

Past the crisis

The EFTA countries are slowly rebounding from the crisis, however, challenges remain and vary by country. A common challenge of all EFTA states is the mounting unemployment. Norway enjoys the relatively comfortable position related to its substantial oil-income, which continues to allow for a strong fiscal stimulus to support its economy. Switzerland has its banking sector still under pressure, following the eroding bank secrecy, and battles the effects of the strength of the Swiss franc. The outlook for the forecast period shows a return to moderate growth in Switzerland and Norway. Iceland is slowly stabilising after a deep recession. Iceland's GDP is forecast to stagnate in 2010 but is expected to return to growth in 2011, pending rigorous implementation of the internationally supported recovery plan.

Growth depends largely on fiscal spending in Norway

Norway has been hit hard by the global economic downturn even though it has fared better than most EU Member States. The export sector is severely affected, and domestic demand, in particular investment, has been contracting rapidly.

Domestic demand decreased through all its components, apart from government spending, and also external trade contributed to the contraction in 2009. Real GDP is forecast to return to moderate growth by the end of 2010. This growth is expected to be mostly driven by domestic demand, particularly government spending. Consumer spending, traditionally a driver of domestic growth in Norway, should pick up again but is constrained by high household indebtedness and rising interest rates. The challenge for Norway will be to keep growth momentum, when the fiscal stimulus fades towards the end of the forecast period.

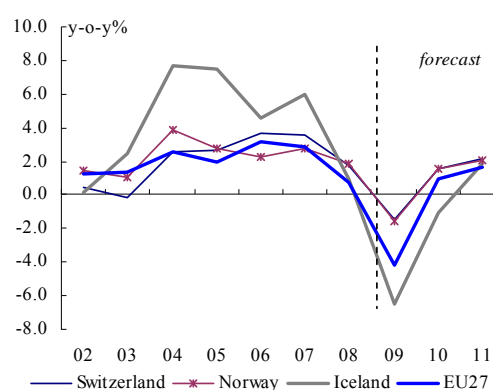
The decline in investments in Norwegian mainland industries that started in 2009 is expected to continue into 2010. The investments in the mainland industries should show a rebound in 2011 also due to growing foreign demand; however, they will remain de-leveraged, below the record high level of 2008. Investments in petroleum are expected to fall somewhat in the first half of 2010, but on an annual basis will increase slightly during the year and will remain slightly positive in 2011.

The aggressive expansionary fiscal policy exercised during the crisis is expected to be somewhat less expansive in 2010. The stance of the fiscal policy in 2011 is expected to return to relatively neutral.

Household consumption, which accounts for around 55% of the GDP in mainland Norway, is rebounding from its fall during the crisis. Low interest rates, increased incomes, increased wealth and better prospects all contributed to increased household consumption already in the second half of 2009, after posting declines in the previous years. However, for 2010 and 2011 consumer spending is expected to be under pressure by the gradual withdrawal of fiscal stimulus measures and increasing policy rates. This, in combination with the high consumer-debt levels in Norway, could pose a downside risk to growth in consumer spending.

Housing prices are expected to continue to increase in 2010 and 2011. Due to the relatively low interest rates the improvement in the housing market, which is financed largely by flexible interest rate mortgages, is expected to contribute to increased investments in housing, thus turning the decline of the past two years into a possible upswing in the next two years.

Graph II.34.1: EFTA - GDP growth



Unemployment is a main challenge

The Norwegian government budget for 2010 aims to secure a healthy labour market. Norway is among the countries in Europe with the lowest unemployment rates. Nevertheless, the

unemployment rate in Norway is expected to rise in the forecast years, from 3.1% this year to 4.3% in 2010. In 2011 it is likely to remain around or just under that level.

The recent slump in the Norwegian economy is partly responsible for the clear fall in wage growth. Wage growth is expected to slow down further in the forecast period. Consumer inflation is likely to fall, with an annual expected average in 2010 of 1.6%. The strength of the Norwegian Krona is expected to contribute to inflation falling below 2% in 2010 and 2011.

Switzerland, exports are the key

Switzerland's economy slipped into the worst recession in over three decades in mid-2008 as the global economic slump hit severely its exporters. Still, as compared to its European trade partners the economic dip was significantly less severe. Domestic demand did not collapse during the crisis, also due to the absence of a boom-bust cycle in residential construction as observed elsewhere before and during the crisis. The second half of 2009 already showed improvement in domestic demand whilst exports were outperforming imports. GDP shrunk by 1.5% in 2009, a much better outcome than expected in autumn 2009. Moderate growth, almost fully driven by domestic demand, is expected to reach 1.6% in 2010 and to accelerate slightly in 2011, with GDP growth increasing to 2.2%.

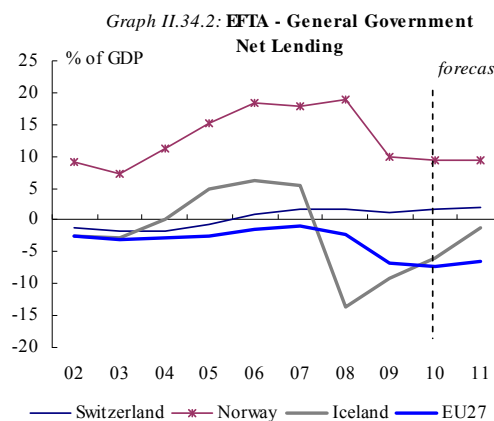
The biggest challenge for Switzerland might be to reverse the drop in real growth in exports of goods and services. In particular export of services is expected to return to growth only in 2011. The service sector remains a source of a serious downside risk to the total export growth in relation to the eroding bank secrecy, which may have a significant and permanent impact on the contribution of the financial sector to GDP in the longer term. Overall, net exports contributed positively to growth in 2009 and are likely to continue to contribute positively in 2010-11.

With the households saving rate on the increase and consumer confidence being low, growth of household consumption decelerated in 2009 but is expected to increase again slightly in 2010-11. Growth in public investment is expected to be modest in the forecast years despite the increased government focus on infrastructure investments. Weak export demand for Swiss machinery and

equipment will cause little extra incentive for Swiss corporations to invest and government investments alone will not be sufficient to offset the sharp fall in investment of the private sector. The Swiss National Bank is likely to continue fighting the threat of deflation using all available means, including currency interventions. Inflation rates are forecast to stay close to 1% both in 2010 and 2011.

Continued pressures in the labour market

The unemployment rate will rise significantly, and will be around 5% by the end of 2010, which has not happened since the mid-1990s. For 2011 unemployment is expected to decrease slightly, though to remain high. Wage growth is expected to diminish significantly in the same period, contributing to lowering the inflationary pressures.



Iceland's road to recovery

After a period of high growth rates supported by large investment projects and strong domestic demand, which have generated significant imbalances, Iceland is now facing the consequences of the currency crash of 2008 and the ensuing economic crisis. The shock to the economy should be regarded as permanent and the economy has de-leveraged to the level of around the year 2006. Domestic demand declined sharply in 2009 but is forecast to slightly increase in the forecast years driven mostly by investments in 2011, particularly in the energy sector. However, incomes are still under pressure and specifically pensioners are facing benefit cuts due to the worsened position of the Icelandic pension fund. Unemployment is set to continue to remain high in the forecast years in all sectors and in the banking sector in particular. Inflation remained high in

2009, averaging an increase of more than 16%, but is expected to ease to below 6% by the end of 2011. The current-account deficit, high in the previous years, is expected to continue to decline, following decreasing imports. It is expected to turn into a small surplus by the end of 2010, continuing into 2011.

Unemployment on a historic high

Unemployment rate in Iceland increased rapidly from a low of 1% in early 2008 to around 8.7% by the end of 2009. It is now at a similar level, on average, as in the neighbouring Nordic countries. However, due to the fact that the increase is relatively recent in Iceland, long-term unemployment is still considerably lower than in the euro area, or the EU as a whole. This should make it somewhat easier to reduce the present high unemployment as the economic situation improves. For 2010 and 2011, however, the unemployment rate is still expected to remain high, close to 10% of the workforce.

Debt cloud over Iceland

Downside risks to this forecast due the high debt, take the form of reduced growth as well as increased emigration. Iceland's total external gross debt recorded a level of about three times its GDP

at the end of 2009 and it is likely to remain around that level in 2010 before easing somewhat in 2011. Private and corporate-sector external debt is responsible for about two thirds of the overall debt, mostly reflecting old bank assets. Therefore, debt restructuring in 2010-11 will be key to reduce the burden and provide solid ground to support domestic demand growth. General government debt is increasing slower than expected in the previous forecast. At the end of 2009, it stood at over 107% of GDP which included about 15% of GDP of debt related to the much disputed Icesave financing. The improved outlook for public debt is likely to allow for a faster return to deficits in 2010-11 lower and more sustainable than previously anticipated. In particular interest expenditure is projected at a lower level, following extensive negotiations on the financing terms of the foreign depositor reimbursements.

Iceland will be slowly recovering from this crisis, pending risks generated by the lack of access to credit, the high debt levels and possible further sliding of the krona. The high unemployment rate entails a significant challenge to the economic recovery. However, Iceland has been able to turn around crisis situations rather smoothly in the past. Overall, the impact of the present crisis has been much less severe than previously anticipated which gives hope for a relatively fast recovery.

Table II.34.1:

Main features of country forecast - EFTA

(Annual percentage change)	Iceland			Norway			Switzerland		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
GDP	-6.5	-1.1	1.9	-1.5	1.6	2.1	-1.5	1.6	2.2
Private consumption	-14.6	1.8	1.8	0.0	3.5	3.1	1.2	1.8	1.5
Public consumption	-3.0	-2.5	-2.0	5.2	2.7	2.1	2.5	0.6	2.4
Gross fixed capital formation	-49.9	-4.5	16.7	-7.9	-2.8	0.6	-3.7	2.4	2.1
of which : equipment	-49.9	2.5	27.0	-11.1	-2.1	0.9	-3.7	1.5	2.5
Exports (goods and services)	6.2	0.8	0.9	-4.3	2.6	3.1	-10.0	1.7	3.5
Imports (goods and services)	-24.0	2.6	3.2	-9.7	3.4	4.1	-5.9	2.3	2.7
GNI (GDP deflator)	-1.3	7.9	-0.1	-1.3	1.5	2.3	5.8	1.6	2.2
Contribution to GDP growth :									
Domestic demand	-20.4	-0.4	2.6	-0.6	1.5	1.9	0.1	1.6	1.6
Inventories	-	-	-	-	-	-	-	-	-
Net exports	14.1	-0.7	-1.0	0.8	0.2	0.2	-2.9	0.0	0.6
Employment	-6.0	-0.8	1.4	-0.4	-0.3	1.8	0.9	-2.5	1.5
Unemployment rate (a)	7.2	9.7	9.0	3.1	4.3	4.1	4.1	4.8	4.4
Compensation of employees/head	-	-	-	3.5	1.8	3.4	2.5	2.7	3.4
Unit labour costs whole economy	-	-	-	4.7	-0.1	3.2	4.9	-1.4	2.6
Real unit labour costs	-	-	-	8.9	-3.5	0.8	4.6	-1.4	2.0
Savings rate of households (b)	-22.6	-10.1	-19.1	12.4	9.9	11.1	-	-	-
GDP deflator	8.6	1.7	7.8	-3.8	3.5	2.3	0.3	0.0	0.6
Harmonised index of consumer prices	16.3	8.7	5.7	2.3	1.6	1.8	-0.7	0.9	1.2
Terms of trade of goods	-12.2	-7.5	10.2	-16.5	4.7	0.1	5.5	-0.7	-2.3
Trade balance (c)	5.8	2.8	5.0	13.2	13.8	13.5	3.0	2.8	2.6
Current account balance (c)	-3.3	0.3	1.5	13.0	14.4	14.3	7.5	6.9	6.5
Net lending(+) or borrowing(-) vis-à-vis ROW (c)	-2.1	1.6	1.8	13.0	14.4	14.3	7.0	6.4	5.9
General government balance (c)	-9.1	-6.7	-2.1	9.8	9.3	9.3	1.2	1.7	2.1
Cyclically-adjusted budget balance (c)	-	-	-	-	-	-	-	-	-
Structural budget balance (c)	-	-	-	-	-	-	-	-	-
General government gross debt (c)	107.7	124.8	118.2	51.2	53.1	51.0	40.4	38.2	35.3

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.