

34. EFTA

Different paths towards recovery

While all EFTA countries have been severely hit by the crisis in their path to recovery, challenges vary by country. Norway enjoys the relatively comfortable position related to its substantial oil-income, which allows a strong fiscal stimulus to reboot the economy. Switzerland is struggling with a banking sector under pressure following the eroding bank secrecy and feels the threat of deflation this year. The outlook for the forecast years, shows a return to moderate growth in Switzerland¹, and Norway. Iceland faces a severe recession. Iceland's GDP is forecast to grow significant in 2010 and 2011 but much depends on the successful implementation of the IMF programme. Also, Iceland's application for EU membership on July this year may help raise confidence.

Growth depends largely on fiscal spending in Norway

Norway has been hit hard by the global economic downturn. The export sector has been severely affected, and domestic demand, mainly investment, has been contracting rapidly.

Domestic demand is shrinking through all its components, apart from government spending, and also external trade is contributing to the contraction. Real GDP for 2009 is forecast to contract by 2.2% to only return to slight growth by the end of 2010. This growth is expected to be mostly driven by domestic demand, particularly government spending. The challenge for Norway will be to keep growth momentum, even when the fiscal stimulus fades away.

The decline in investment in Norwegian mainland industries that started earlier this year is expected to continue into 2010. Afterwards investment in the mainland industries (offshore excluded) is expected to increase in 2011 however without reaching the record high 2008 level. Investments in petroleum are expected to fall somewhat from the first half of this year, but on an annual basis will increase slightly this year to remain stable in 2010.

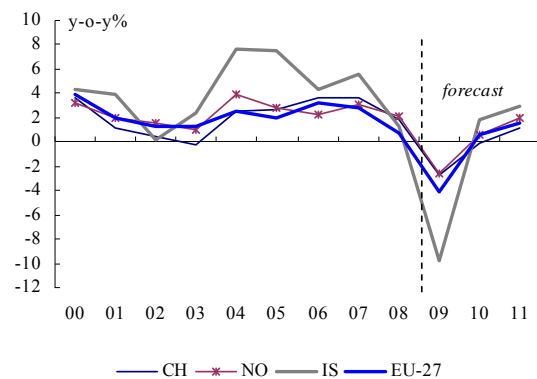
The fiscal policy has been expansionary this year, with estimated growth in public consumption and investments of 5.2% and 12% respectively. The policy is expected to be far less expansive in 2010.

The stance of the fiscal policy in 2011 is expected to be relatively neutral.

Household consumption, responsible for around 55% of the GDP in mainland Norway, is likely to increase significantly in the second part of the forecast period. Low interest rates, increased incomes, increased wealth and better prospects all contributed to increased household consumption in the second quarter of 2009, after being in decline for a year. While for 2009 consumer spending is expected to decrease slightly, in 2010 and 2011 a rebound to growth is expected in house hold consumption.

Housing prices fell during the second half of 2008, but have subsequently increased since. However, no further increase is expected for the rest of 2009 though housing prices are expected to continue to increase in 2010 and 2011. The improvement in the housing market is expected to contribute to increased investments in housing, thus turning the decline of the past two years into an upswing next year.

Graph II.34.1: EFTA - GDP growth



Whilst unemployment is the main challenge

The Norwegian government budget for 2010 top priority aims to secure jobs and Norway is among the countries in Europe with the lowest unemployment. However, unemployment in Norway is expected to be relatively high in the forecast years, from 4.8% of the total work force this year to 5.0% in 2010 and 2011.

The current slump in the Norwegian economy is partly responsible for the clear fall in wage growth. Wage growth will be slowing further in the

forecast period. Consumer inflation is expected to fall, with an annual average in 2009 of 1.9%. A strong Norwegian Krona is expected to contribute to inflation falling below 1% next year.

Switzerland, exports are key

Switzerland's economy slipped into its worst recession in over three decades in mid-2008 as the global economic slump hit its exporters hard. The economy is expected to shrink by 2.4% this year, to stagnate in 2010, to finally rebound slightly only in 2011 with GDP growth of 0.6%.

In the first quarter of 2009 exports, key economic factor for Switzerland, declined by 14 % and imports were down by 11%. However, Switzerland's deep recession unexpectedly slightly eased in the second quarter driven by an increase in private and public spending, while a drop in imports outstripped the decline in export. The biggest challenge ahead for Switzerland might well be the drop in real growth in exports of goods and services. Export growth is expected to decelerate significantly in the forecast years with a serious downside risk to the service sector in relation to the eroding bank secrecy, which may have a serious impact on the contribution of the financial sector to GDP. Overall external trade should continue to provide a positive, and growing, net contribution in the forecast years.

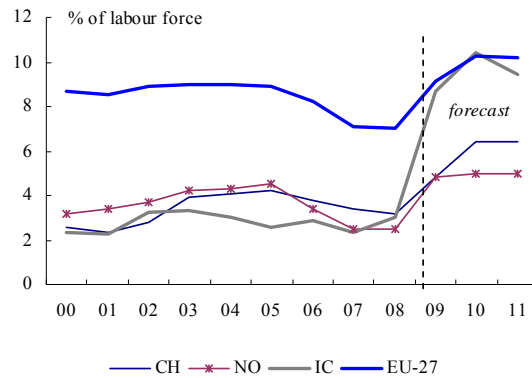
With saving rates on the increase and consumer confidence being low household consumption is dropping in 2009 and 2010. However, in 2011 it is likely to return to growth. Growth in public investment is expected to be modest in the forecast years despite increased government spending on infrastructure. Weak export demand for Swiss machinery and equipment will cause little extra incentive for Swiss corporations to invest and government investments 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 should stay close to zero in 2009, 2010 and 2011.

Worsening labour market

The unemployment rate is expected to continue to rise significantly, and for 2010 and 2011 unemployment is expected to breach the 5% level, these levels have not been observed since 1997.

Wage growth is expected to diminish significantly in the same period, having a decreasing impact on inflation subsequently.

Graph II.34.2: EFTA - Unemployment



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. For the economic recovery to take hold, the banking system needs to function again. During the early days of the crisis, the authorities nationalised the three biggest banks and created three new, holding all domestic deposits and claims from the old banks. Privatisation of these new banks, possibly with foreign banks participation, is likely to contribute to restoring a sound financial sector in Iceland.

Domestic demand declined sharply in 2008 and is forecast to further decrease significantly in the forecast years, due to high interest rates and collapsed private consumption. Incomes are under pressure and specifically pensioners are facing benefit cuts following the worsened position of the Icelandic pension fund. Unemployment is set to increase significantly in the forecast years, following the impact of the crisis, in all sectors and the banking sector in particular. Inflation peaked in 2008 and is expected to remain high in 2009 easing to around 2% by the end of 2011. The current account deficit, high in the previous years, is expected to decline significantly, following decreasing imports and is expected turn into a small surplus by the end of 2010 which may not be sustained in 2011.

Jobs wanted

Unemployment in Iceland increased within months from a low 1% to around 8.7% in May 2009. Unemployment in Iceland is now at a similar level on average as in the neighbouring 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 as the economic situation improves. For 2010 and 2011 however the unemployment is still expected to remain high, around the 10% level.

Capital restrictions

Capital controls were introduced early on in the crisis, within the framework of the IMF Stand-By Arrangement. Whilst being in place, they helped to prevent massive outflows and support the exchange rate. However, it is likely that these restrictions will be lifted during the forecast period, to re-introduce normal financial relations with foreign markets. This may impose further pressure on the exchange rate and further sliding of the currency and as such constitute a downside risk to this forecast.

EU Membership

The outcome of Iceland's bid for an EU membership is not part of this forecast, nevertheless it is likely that Iceland's application bid may have a positive effect, boost confidence levels and provide an upside risk to this forecast.

Challenges

Iceland will be facing challenges generated by the current credit crisis and possible further krona depreciation, as well as the mounting unemployment, entailing significant downside risks to this forecast.

Table II.34.1:

Main features of country forecast - EFTA

	Iceland			Norway			Switzerland		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
(Annual percentage change)									
GDP	-9.8	1.9	2.9	-2.2	0.6	2.0	-2.4	-0.1	1.1
Private consumption	-16.5	1.6	2.6	-0.5	1.3	1.5	-0.9	-0.9	1.5
Public consumption	-0.7	2.8	3.8	5.2	4.3	3.5	2.9	0.6	2.4
Gross fixed capital formation	-36.4	5.0	6.0	-5.7	-3.2	0.1	-5.7	-1.4	-0.4
of which : equipment	-39.0	5.6	6.6	-5.5	-0.5	2.6	-5.9	-2.5	-1.5
Exports (goods and services)	1.4	1.9	2.9	-8.4	0.5	3.8	-9.3	0.8	2.2
Imports (goods and services)	-15.5	3.7	4.7	-6.1	1.5	3.7	-7.7	-0.6	2.6
GNI (GDP deflator)	21.1	5.9	1.4	-1.8	0.8	2.2	-2.1	0.8	1.3
Contribution to GDP growth :									
Domestic demand	-17.3	2.1	3.1	-0.4	0.8	1.4	-1.4	-0.7	1.0
Stockbuilding	-	-	-	-	-	-	-	-	-
Foreign balance	8.0	-0.2	-0.2	-2.3	-0.2	0.5	-1.8	0.7	0.1
Employment	-2.0	-2.5	-0.1	-1.8	0.5	1.6	-0.8	-1.0	1.5
Unemployment rate (a)	8.7	10.4	9.4	4.8	5.0	5.0	3.9	5.2	5.2
Compensation of employees/head	-	-	-	3.2	2.8	3.6	-	-	-
Unit labour costs whole economy	-	-	-	3.6	2.7	3.2	-	-	-
Real unit labour costs	-	-	-	11.8	-2.7	0.7	-	-	-
Savings rate of households (b)	-20.6	-46.9	-70.1	15.9	11.9	12.6	17.4	18.1	15.1
GDP deflator	25.1	2.8	9.5	-7.4	5.5	2.4	2.5	-0.2	0.4
Harmonised index of consumer prices	12.0	7.0	3.0	1.7	1.1	1.7	0.1	0.4	0.6
Terms of trade of goods	47.2	-12.2	6.9	-25.3	15.8	1.3	7.6	-1.4	-1.4
Trade balance (c)	14.2	10.2	11.2	7.5	11.1	12.0	3.9	4.9	4.9
Current account balance (c)	-1.7	-2.3	-1.5	9.5	13.4	14.3	7.3	7.0	6.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)	-2.2	-2.6	-1.8	9.5	13.4	14.3	7.1	6.8	6.7
General government balance (c)	-21.2	-16.9	-14.1	7.9	10.4	11.8	-2.9	-3.6	-3.9
Cyclically-adjusted budget balance (c)	-	-	-	-	-	-	-	-	-
Structural budget balance (c)	-	-	-	-	-	-	-	-	-
General government gross debt (c)	53.3	65.4	70.1	54.3	50.6	45.2	42.8	44.9	46.7

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