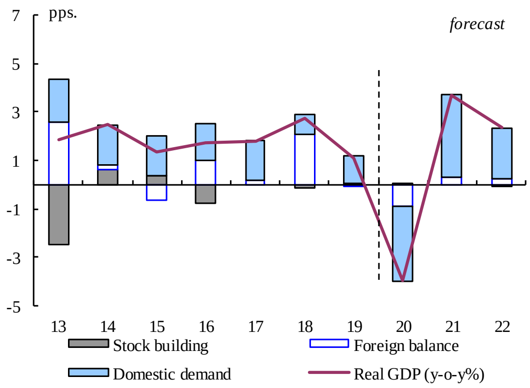
37. EFTA

The EFTA countries weathered the first half of 2020 rather well, benefitting from rapid and determined COVID-19 containment measures and substantial fiscal support schemes, amounting up to 10% of GDP. However, countries with a large tourism sector are set to be hit harder by the crisis than more diversified economies.

Switzerland

In the first half of 2020, real GDP was 4½% lower than a year before, largely due to a sharp and broad drop in demand, affecting nearly all components. Private consumption dropped by 7%, while gross capital formation declined by nearly 8%. Imports of goods and services were 5½% lower than a year before, while the decline in exports was less pronounced at 3%, partly thanks to a solid export performance of chemical and pharmaceutical products. The compensation of employees fell by nearly 5% in the first half of 2020, although thanks to short-time work compensation, the actual income losses for employees were much lower, at some –¼%. Unemployment rose, in particular in tourism and construction. However, thanks to short-time working schemes, the overall impact on employment appears to have remained muted (-1.2% y-o-y in the second quarter of 2020). So far, the government has presented fiscal support measures amounting to up to 11% of GDP.

Graph II.37.1: **Switzerland - Real GDP growth and contributions**



Based on a scenario of a persistent need for continued containment measures over the winter months, the recovery in the second half is expected to be subdued. This would lead to a decline in GDP by some 4% for the whole year. A marked drop in domestic demand is a key factor behind the contraction in 2020, largely reflecting weaker private consumption and lower investment. In 2021, pent-up private consumption and investment, as well as revenues from international sport events will support a partial recovery, while in 2022 the economy will operate closer to its potential. In view of the muted labour market response, which benefitted from support measures, also the pick-up of employment after the pandemic will remain subdued. Inflation is likely to remain low in 2020, given recent declines in oil and food prices. The fiscal costs of fighting the pandemic and its economic implications will still be felt in the coming years and will result in a substantial, but temporary rise in the deficit and debt ratios.

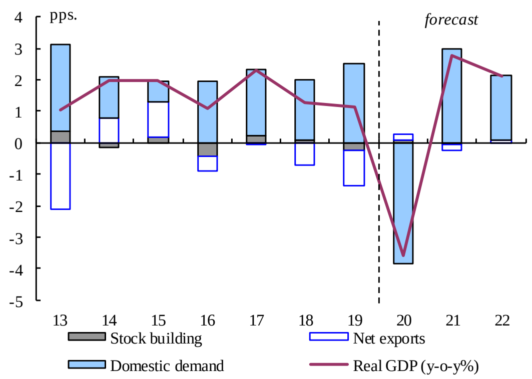
Country-specific risks to the outlook are largely on the upside and are related to the recovery of key trading partners, such as Germany, the USA and the United Kingdom. A downside risk is a reversal of the Swiss currency's recent depreciation during the summer months, given its status as a safe-haven, which could negatively affect the country's price competitiveness.

Norway

The substantial disruptive effects of the COVID-19 crisis on the Norwegian economy became more visible in the second quarter of 2020 as real GDP shrank by 5.1% q-o-q, the sharpest decline ever recorded, compounding a contraction of 1.7% in the first quarter. The sharp downturn was largely driven by a steep fall of private consumption due to worsening labour market conditions combined with the economic fallout from the pandemic and negative consumer sentiment. Investment also fell albeit at a slower pace compared to the first quarter. The external sector had a positive contribution to growth as imports dropped at a faster rate than exports, reflecting weak domestic demand.

Following the easing of restrictions since 16 June, the economy showed signs of recovery during the summer months. Nevertheless, the increase in viral infections in September, the re-imposition of some social distancing measures as well as the long-term disruptive effect of the pandemic are expected to dent economic activity in 2020. Household consumption is expected to shrink significantly while concerns over the duration of the crisis among investors will weigh on investment. Still, net exports will add to growth as merchandise exports will fall at a slower pace than imports, benefitting from the recovery in oil and gas prices. House prices rose by 1.5% q-o-q in the second quarter compared to an almost flat growth rate in the first quarter and they continued to increase through the summer. The recovery in residential investment will likely be very slow due to concurrent headwinds including lower population growth and the increased uncertainty about economic developments going forward. In 2021, a return to growth is expected, mainly driven by a rebound in household consumption and investment. Overall, the economy is forecast to shrink by around 3½% in 2020, before recovering by around 2¾% in 2021 and around 2% in 2022.

Graph II.37.2: **Norway - Real GDP growth and contributions**



The sharp economic downturn and the considerable uncertainty around the pace of economic recovery triggered Norges Bank's Executive Board decision on 23 September to keep the key policy rate unchanged at the historic low of 0.0% for the third consecutive meeting, after slashing it from 1.5% with three successive cuts between March and May.

The economy will receive less support from government spending in 2021 mainly due to the phasing out of most of the extensive and temporary extraordinary COVID-19 measures introduced in 2020. The fiscal policy anticipates a fiscal impulse of -2.9% of mainland GDP, resulting in a structural non-oil deficit of around 9½% of mainland GDP and spending of oil revenues equivalent to the fiscal rule of 3.0% of the sovereign wealth fund's assets (Government Pension Fund Global).

Domestic risks to the outlook primarily stem from the uncertainties in the property market and the historically high household debt levels leaving households vulnerable in the event of interest rates rises or a steep fall in house prices. Sustained increases in the debt burden indicate that financial imbalances have accumulated raising concerns over financial stability, which are however mitigated by the significant capital and liquidity buffers held by Norwegian banks. Regarding the external environment, the volatility of energy prices presents upside and downside risks while a continued severe disruption caused by the spread of the virus across Norway's main trading partners would weigh materially on growth.

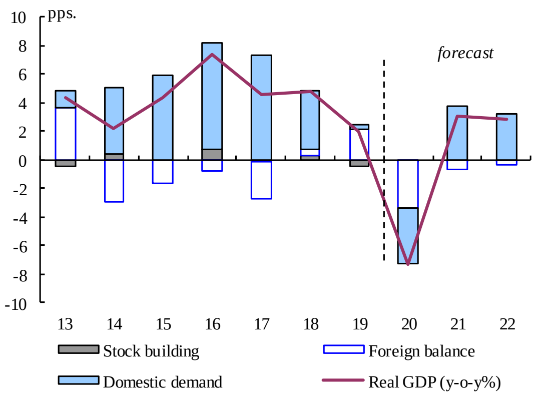
Iceland

Iceland's cyclical recession, which started in the first quarter of 2020, was severely amplified by COVID-19 related disruptions. In the second quarter GDP contracted by more than 10% y-o-y with all demand components, except public consumption, contributing negatively. Exports and imports dropped by nearly 40% and 30% y-o-y, respectively, resulting in a negative contribution from foreign trade. Due to the collapse in tourism, exports of services fell by 64%, while exports of goods, in particular marine products, fared better with an estimated drop of 13%, y-o-y.

With renewed increase in COVID-19 cases in the autumn, the outlook is for a deep recession in 2020. Iceland's exports, in particular tourism, are set for dramatic contraction, while suppressed private consumption and investment will be only partially offset by higher government consumption. The timid recovery in 2021 relies on the assumption of partial export recovery, but exports are not expected to return to their 2019 level before 2022. The projected rebound in investment will be supported by public and housing investment, the latter due supported by the low interest-rate environment.

Pandemic-related disruptions led to declining labour force participation, only partially mitigated by the part-time benefits programme. The unemployment rate stood at nearly 8% while underemployment increased to 4.2% of the labour force in mid-2020. In line with the gloomy outlook, a further increase in unemployment is projected for 2020, with a gradual decline expected afterwards. Due to strong automatic stabilisers and discretionary measures, such as tax reductions, part-time unemployment benefits, closure subsidies, government guaranteed loans to companies, and accelerated public investment, the general government deficit is set to widen to nearly 10% of GDP in 2020. A similar budget gap is projected for 2021 as the draft budget targets a deficit of some 9% of GDP. Despite a sharp decline in public revenue, amplified by a planned temporary reduction in the social security tax rate for employers by 0.25%, the government has announced that it will not cut expenses in 2021. Nearly 60% of public spending will be allocated to social welfare, healthcare and education.

Graph II.37.3: **Iceland - Real GDP growth and contributions**



The government also plans to accelerate public infrastructure investment.

The Central Bank of Iceland (CBI) undertook a number of monetary and macroprudential policy measures in response to the crisis. The policy rate was cut by 175 basis points bringing it to a new record low of 1% while the 2% requirement on the countercyclical capital buffer for commercial banks has been lowered to 0%. Furthermore, the CBI has announced the envelope for purchasing of government bonds in the secondary market, which amounts to around 5% of GDP in 2020. By end-September, around 13% of the envelope has been spent. Despite CBI interventions in the foreign currency market, the ISK has continued sliding creating inflationary pressures that partially offset the disinflationary impact of the pandemic in 2020. Going forward, inflation is set to ease due to the persisting sizeable slack in the economy.

The balance of risks is tilted to the downside. Key risks stem from the external environment and gloomy outlook for Iceland's main exports, in particular tourism. An upside risk is related to the depreciating ISK, which could raise the country's attractiveness for tourists in 2021-2022.

Table II.37.1:

Main features of country forecast - EFTA

	Iceland				Norway				Switzerland			
(Annual percentage change)	**2019**	**2020**	**2021**	**2022**	**2019**	**2020**	**2021**	**2022**	**2019**	**2020**	**2021**	**2022**
GDP	1.9	-7.3	3.1	2.9	1.2	**-3.6**	**2.8**	**2.1**	1.1	**-4.0**	**3.7**	**2.3**
Private Consumption	1.3	**-5.7**	**2.9**	**3.2**	1.5	**-6.8**	**3.9**	**2.4**	1.4	**-4.0**	**3.5**	**2.5**
Public Consumption	4.2	**3.4**	**3.7**	**2.7**	1.7	**3.0**	**2.0**	**1.9**	0.9	**2.0**	**1.5**	**1.0**
Gross fixed capital formation	-6.6	**-9.2**	**6.1**	**4.2**	6.1	**-5.8**	**2.9**	**1.9**	1.2	**-5.0**	**5.5**	**2.8**
of which: equipment	-	-	-	-	9.0	**-2.3**	**2.0**	**3.2**	1.9	**-7.5**	**6.8**	**4.0**
Exports (good and services)	-4.9	**-26.1**	**11.1**	**9.6**	1.5	**-9.2**	**4.5**	**2.5**	-0.2	**-8.0**	**8.2**	**3.8**
Imports (goods and services)	-10.2	**-21.0**	**13.3**	**10.8**	5.2	**-10.2**	**5.2**	**2.3**	-0.1	**-8.2**	**9.5**	**4.2**
GNI (GDP deflator)	1.9	**-7.3**	**3.1**	**2.9**	1.2	**-3.6**	**2.8**	**2.1**	1.1	**-4.0**	**3.7**	**2.3**
Contribution to GDP growth: Domestic demand	0.3	**-3.9**	**3.7**	**3.2**	2.5	**-3.8**	**3.0**	**2.0**	1.1	**-3.1**	**3.4**	**2.1**
Inventories	-0.5	**0.0**	**0.0**	**0.0**	-0.2	**0.1**	**0.0**	**0.0**	0.1	**0.0**	**0.0**	**0.0**
Net exports	2.2	**-3.3**	**-0.6**	**-0.4**	-1.1	**0.2**	**-0.2**	**0.1**	-0.1	**-0.9**	**0.3**	**0.2**
Employment	-0.4	**-6.4**	**1.4**	**1.4**	1.6	**-2.1**	**0.6**	**1.3**	1.0	**-0.4**	**0.4**	**0.7**
Unemployment rate (a)	3.3	**10.1**	**9.5**	**8.6**	3.5	**5.3**	**4.8**	**4.1**	4.7	**5.2**	**5.5**	**5.4**
Compensation of employee/head	4.5	**-3.1**	**0.3**	**3.8**	3.5	**1.9**	**2.1**	**3.4**	1.9	**-0.6**	**0.4**	**1.5**
Unit labour cost whole economy	2.1	**-2.2**	**-1.3**	**2.4**	4.0	**3.4**	**0.0**	**2.6**	1.9	**3.1**	**-2.8**	**-0.2**
Real unit labour cost	-2.4	**-5.1**	**-4.1**	**-0.4**	4.6	**2.1**	**-2.3**	**0.2**	2.0	**4.5**	**-2.7**	**-0.5**
Saving rate of households (b)	4.2	0.0	-0.7	-0.5	13.2	**14.7**	**13.2**	**16.3**	:	:	:	:
GDP deflator	4.5	**3.1**	**2.9**	**2.8**	-0.6	**1.2**	**2.3**	**2.3**	-0.1	**-1.3**	**-0.2**	**0.4**
Harmonised index of consumer prices	2.7	3.0	2.8	2.6	2.3	**1.3**	**1.8**	**2.0**	0.4	**-0.8**	**0.0**	**0.5**
Terms of trade goods	0.8	**-0.5**	**-0.3**	**-0.1**	-10.8	**-4.0**	**0.0**	**0.0**	-1.1	**0.4**	**0.0**	**-0.1**
Trade balance (goods) (d)	-3.4	**-1.4**	**-2.0**	**-2.7**	3.0	**2.4**	**2.3**	**2.4**	10.3	**9.6**	**9.4**	**9.4**
Current account balance (d)	5.1	**1.8**	**1.1**	**0.6**	3.9	**3.1**	**2.9**	**3.0**	8.2	**7.5**	**7.5**	**7.4**
Net lending (+) or borrowing (-) vis-a-vis ROW	5.1	**1.7**	**1.0**	**0.6**	3.8	**3.1**	**2.9**	**3.0**	7.4	**6.6**	**6.7**	**6.7**
General government balance (d)	-1.0	**-9.4**	**-9.2**	**-5.0**	6.4	**3.1**	**7.8**	**8.5**	-0.1	**-4.0**	**-1.5**	**-0.5**
General government gross debt (d)	46.2	**60.6**	**67.3**	**68.7**	40.4	**46.2**	**43.7**	**40.5**	30.9	**36.6**	**36.9**	**36.3**

(a) as % of total labour force. (b) gross saving divided by adjustd gross disposable income. (c) for Iceland national consumer price index.
(d)as a % of GDP.