

37. EFTA

The EFTA countries entered the COVID-19 crisis with their economies already in a downswing, largely resulting from a deteriorating international environment. The pandemic puts further strain on growth prospects, primarily in 2020, but also still in 2021. Key transmission channels include trade of goods and services, such as aluminium demand and tourism in the case of Iceland, but also lower oil prices in the case of Norway. Fiscal support packages amounting up to 10% of GDP have been adopted. Risks are largely on the downside.

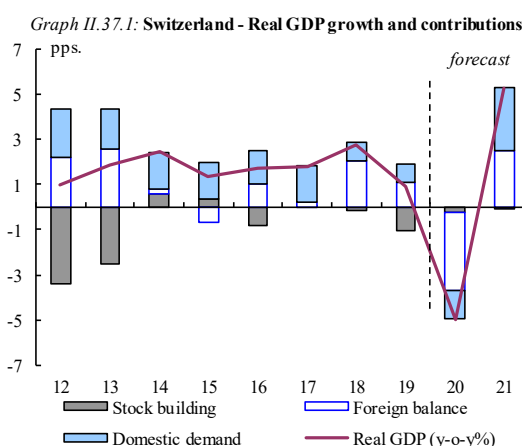
Switzerland

Output growth continued to decelerate during the second half of 2019, bringing annual growth to 0.9%, compared to 2.8% the year before. Key factors for the slowdown were a deteriorating international environment, and a base-year effect, related to international sports events in 2018. Domestic demand remained subdued, reflecting moderate wage growth, weak investment spending in view of the overall uncertain international environment and the end of a construction boom. Inflation remained low, largely due to low import prices, in particular for energy. Faced with rapidly increasing cases of COVID-19 infections, Switzerland announced a lockdown on 16 March, among others cancelling all private and public events and closing schools, restaurants and bars.

In addition to the costs of the domestic shut-down, Switzerland's high integration into the global economy makes it vulnerable to the effects of the global recession. So far, the Swiss government has presented three packages to cushion the economic consequences with an overall amount of CHF 62 billion (about 10% of GDP). The Swiss Central Bank has taken measures to improve the financial sector's liquidity and has been intervening in the foreign exchange markets to stem the currency's tendency to appreciate, resulting from the CHF's safe-haven status.

Based on a scenario of a sharp drop in external and domestic economic activity in the second quarter and a gradual recovery thereafter, output growth is expected to drop by some 5% in 2020, followed by a subdued rebound in 2021. A sharp drop in exports is set to be a key driver of the decline in 2020, while on the domestic side, the fall in working hours, weaker private demand and lower investment will weigh further on output. Due to the lockdown, employment could decline markedly, leading to an increase in the number of unemployed by nearly 20%. Inflation is likely to remain low in 2020, given recent declines in oil

and food prices. In 2021, a subdued rebound in output growth is expected, largely based on pent-up private consumption and investment. The fiscal costs of fighting the pandemic and its economic implications will result in a substantial, but temporary increase in the deficit and debt ratios, which will still be felt in 2021.



Country-specific risks to the outlook are primarily on the downside and are related to the recovery of key trading partners, such as Germany but also the USA and the United Kingdom. Further risks are a marked appreciation of the Swiss currency, given its status as a safe-haven in times of crisis. This could have a negative affect on the country's price competitiveness.

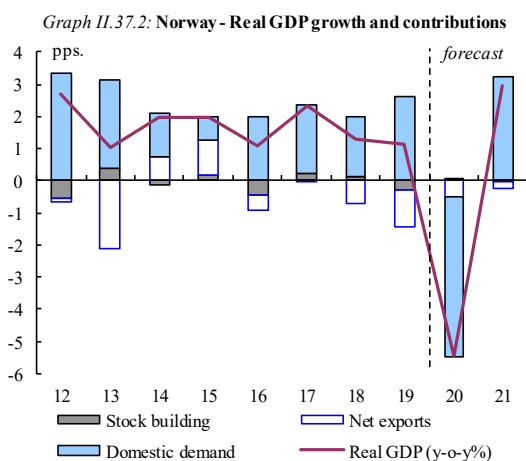
Norway

Real GDP grew by 1.2% in 2019, almost the same growth rate as in 2018, driven by a pickup in domestic demand. This was largely on the back of a surge in hydrocarbons-related investment and solid private consumption. The latter reflected the tight labour market supporting wage growth as well as elevated consumer confidence. Still, the external sector posed headwinds to growth due to sluggish export demand across main trading partners.

The outbreak of the COVID-19 pandemic in early March interrupted the growth momentum abruptly. The government swiftly imposed quarantine measures to stem the spread of the virus that had substantial disruptive effects on the mainland economy. Worsening labour market conditions combined with the economic fallout from the pandemic and negative consumer sentiment are expected to suppress private consumption while the concerns over the duration of the crisis among investors will weigh heavily on investment. Net exports will continue to subtract from growth as merchandise exports are expected to suffer due to the collapse in oil and gas prices so far this year. The recovery in housing investment will likely be slow due to concurrent headwinds including modest population growth and restrictions to business operations delaying a restart in construction.

As the damage done by the virus is assumed to abate in the second half of the year, a return to growth is expected in 2021 mainly driven by the rebound in household spending and investment.

Overall, the economy is forecast to shrink sharply by about 5½% in 2020, before recovering by 3% in 2021.



Worsening domestic economic conditions, plunging oil prices and recent monetary easing by other major central banks due to the COVID-19 pandemic triggered Norges Bank's Executive Board emergency decisions to slash the key policy rate from 1.5% to the historic low of 0.25% with two successive cuts of 50 and 75 basis points on 12 and 19 March, respectively.

The Norwegian authorities announced fiscal stimulus measures in several steps to mitigate the

virus crisis' negative effects on growth and employment. The budget now anticipates a fiscal impulse of around 4½% of GDP and spending of oil revenues equivalent to around 4% of the sovereign wealth fund's (Government Pension Fund Global) assets at the beginning of the year.

Domestic risks to the outlook are clearly tilted to the downside. A further depreciation of the Krone could eat into private consumption. Uncertainties in the property market and high household debt levels raise financial stability concerns, which are however mitigated by the significant capital and liquidity buffers held by the 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 major export markets continues to point to downside risks.

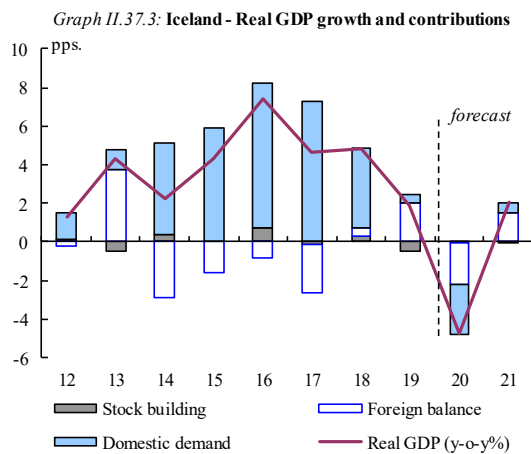
Iceland

After several years of robust growth, Iceland entered into a cyclical slowdown in 2019. Real GDP decelerated to 1.9% due to deteriorating tourism activity (bankruptcy of domestic airlines, declining number of tourist arrivals) and shrinking business investment. Moreover, further headwinds came from poor growth of goods exports, such as aluminium and marine products. Growth of private consumption softened in line with the cyclical slowdown, but continued to contribute positively to GDP growth. Further positive contributions came from increasing public consumption and declining imports, which were driven by lower investment and contraction of aluminium related imports.

The pandemic is set to trigger a recession in 2020. There is high uncertainty concerning the magnitude of the contraction. The shutdown in the second quarter will have a strong negative impact on key export items such as tourism, marine products and aluminium. Increasing lay-offs, falling incomes and lowered confidence will weigh on private consumption. Uncertainty is likely to deter business and residential investment.

In 2019, unemployment had already risen in line with the weaker cyclical position of the economy. Given the negative growth outlook for 2020, the unemployment rate is expected to increase to more than 7% in 2020 and adjust only slowly thereafter.

In response to the crisis, the government launched a fiscal package of nearly 8% of GDP, aiming to mitigate the crisis impact on firms and workers. The government will provide tax reductions and increased benefits (up to 75% of salaries), state-backed bridging loans to companies, deferrals of tax payments, financial support for the tourism sector, access to third-pillar pension savings during the next 15 months and refunds of value-added tax (VAT) for construction projects. The government will also accelerate public infrastructure investment.



The central bank lowered the policy interest rate by half a percentage point, bringing it to a record low of 1.75% in March. In addition, the 2% requirement on the countercyclical capital buffer for commercial banks has been lifted. In response to a sharp drop of the ISK exchange rate, the central bank intervened massively in the foreign exchange market, but the intervention didn't prevent the ISK from sliding. Between January and March the ISK depreciated by 12% against the euro, and it is likely to slide further this year. Given the depreciating currency and rising import prices, inflation is set to spike in 2020 and moderate in 2021, despite a faltering demand outlook.

The balance of risks is tilted to the downside. Key external risk stems from a gloomy outlook for Iceland's exports, in particular tourism with the largest group of visitors coming from the US. Upside risk is related to the depreciating ISK, which could raise the country's attractiveness for tourists towards the end of the year. The timid recovery, which is foreseen for 2021, is surrounded by high uncertainty.

Table II.37.1:

Main features of country forecast - EFTA

(Annual percentage change)	Iceland				Norway				Switzerland			
	2018	2019	2020	2021	2018	2019	2020	2021	2018	2019	2020	2021
GDP	3.8	1.9	-5.0	2.4	1.3	1.2	-5.5	3.0	2.8	0.9	-5.0	4.5
Private Consumption	4.7	1.6	-5.3	0.2	1.9	1.7	-7.4	3.3	1.0	1.0	-2.5	3.0
Public Consumption	3.9	4.1	4.7	2.4	1.4	1.7	2.8	2.2	0.3	1.3	2.0	1.5
Gross fixed capital formation	-1.1	-6.3	-4.9	-1.1	2.8	6.2	-8.9	4.5	1.1	0.6	-7.0	8.8
of which: equipment	-	-	-	-	7.8	7.4	-2.2	3.0	2.7	2.1	-5.0	7.9
Exports (good and services)	1.7	-5.0	-10.5	6.5	-0.2	1.5	-13.5	7.1	2.9	0.5	-10.5	8.5
Imports (goods and services)	0.8	-9.9	-5.9	2.6	1.9	5.2	-12.6	7.7	-0.3	-1.4	-8.8	9.2
GNI (GDP deflator)	4.1	1.9	-5.0	2.4	1.3	1.2	-5.5	3.0	2.4	0.9	-5.0	4.5
Contribution to GDP growth: Domestic demand	3.1	0.4	-2.6	0.5	1.9	2.6	-5.0	3.2	0.8	0.8	-2.8	3.9
Inventories	0.3	-0.5	0.0	0.0	0.1	-0.3	0.0	0.0	-0.1	-1.0	0.0	0.0
Net exports	0.4	2.0	-2.4	1.8	-0.7	-1.1	-0.5	-0.2	2.1	1.1	-2.2	0.6
Employment	2.9	0.8	-4.7	0.8	1.6	1.7	-3.1	2.9	0.9	1.0	-1.0	2.5
Unemployment rate (a)	2.9	3.3	7.3	6.7	3.7	3.5	7.1	5.5	4.7	4.7	5.5	5.0
Compensation of employee/head	6.1	4.6	0.2	1.7	3.3	3.8	0.3	1.6	1.2	1.1	0.0	1.5
Unit labour cost whole economy	5.2	3.4	0.5	0.2	3.6	4.4	2.9	1.6	-0.6	1.2	4.2	-0.5
Real unit labour cost	2.5	-1.0	-6.1	-5.0	-2.0	5.4	3.6	-0.3	-0.9	0.8	5.3	-1.3
Saving rate of households (b)	4.1	4.0	2.6	3.6	12.6	13.3	12.7	13.6	:	:	:	:
GDP deflator	2.6	4.4	7.0	5.5	5.8	-0.9	-0.7	1.8	0.2	0.4	-1.0	0.8
Harmonised index of consumer prices	2.7	3.7	5.5	4.2	3.0	2.3	0.3	1.5	0.9	0.4	-0.5	1.0
Terms of trade goods	-3.1	0.8	-0.6	-0.2	12.6	-11.7	-5.5	0.0	0.3	-1.7	0.4	-0.1
Trade balance (goods) (d)	-5.8	-3.3	-3.7	-3.0	7.0	2.8	1.1	1.0	8.6	9.4	8.4	8.2
Current account balance (d)	2.8	4.7	2.4	3.9	8.1	3.5	1.9	1.7	8.2	8.4	6.4	6.5
Net lending (+) or borrowing (-) vis-a-vis ROW	2.8	4.6	2.3	3.9	8.0	3.5	1.8	1.7	8.9	7.6	5.5	5.7
General government balance (d)	0.8	-0.9	-5.9	-2.9	7.8	6.4	4.7	9.2	1.4	-0.2	-4.0	-1.5
General government gross debt (d)	40.8	40.2	48.5	48.8	39.3	40.6	46.7	43.2	31.2	31.0	37.0	36.7

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