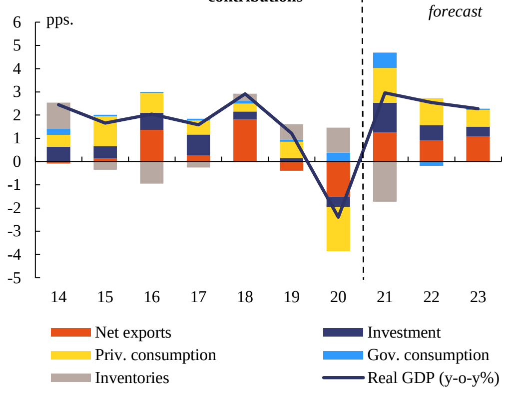
37. EFTA

All three EFTA countries are recovering from the COVID-19 crisis, which had hit their economies to different extents, largely reflecting the relative importance of tourism and the size of the fiscal response. The outlook is for a continued recovery during 2021-2023, benefitting from pent-up domestic and external demand and fiscal support measures. The solid output growth will help to bring public finances back towards more sustainable levels. However, significant uncertainties remain.

Switzerland

The Swiss economy weathered the COVID-19 crisis relatively well so far, with an output decline of just 2.4% in 2020. The key drags on growth were private consumption, dropping by 3.7% year-on-year, lower equipment investment (-4.5%) and lower exports (-6.0%). Nevertheless, exports performed better than expected initially, partly thanks to a solid performance of chemical and pharmaceutical products. Unemployment rose, in particular in tourism and construction. However, thanks to short-time working schemes, the crisis' overall impact on employment remained muted, with an increase in the unemployment rate from 4.4% in 2019 to 4.8% in 2020. The government adopted fiscal support measures amounting in total to about 5¼% of GDP for 2020 and 2021, and announced to spend more, if necessary.

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



The outlook is based on a supportive international environment, although supply bottlenecks and a resurgence of COVID-19 infections during the winter season could push the rebound further back into 2022. During the forecast period, the main driver of growth is expected to be domestic demand, in particular private consumption, benefitting from pent-up demand, as well as investment. Export growth is projected to recover in 2021 from the COVID-19 trade shock and to remain relatively strong in 2022 and 2023, reflecting solid external demand. However, due to strong import growth resulting from catching-up consumption and investment, the growth contribution of net exports is forecast to still remain subdued in 2022 and 2023. Overall, output is forecast to grow by nearly 3% in 2021 and to slow down to 2½% and 2¼% in 2022 and 2023, respectively.

In view of the muted labour market deterioration in 2020, reflecting governmental support measures, also the post-pandemic pick-up of employment will remain subdued, increasing by only about ¼% in 2021 and slightly higher employment growth of about 1% in 2022 and 2023. As a result of low employment growth, the unemployment rate is expected to increase to around 5% in 2021, but to decline in the following years, benefitting from the overall economic recovery. Consumer price inflation is forecast to slightly accelerate during 2022 and 2023, reflecting higher international price increases, in particular energy but also commodities.

The fiscal costs of fighting the pandemic and its economic implications will still be felt in the coming years, impeding the country's plans to achieve fiscal surpluses still during the forecast period. Nevertheless, thanks to low deficits and solid economic growth, gross debt ratios as likely to return to nearly pre-pandemic levels by 2023.

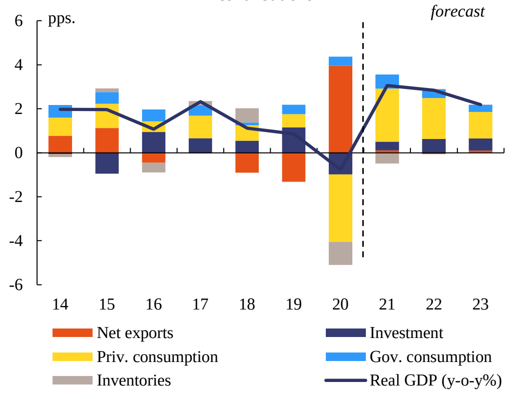
Country-specific risks to the outlook are largely on both sides, related to key trading partners, such as Germany, the USA and the United Kingdom, where the recovery could be faster or slower than expected. There is also a risk related to the Swiss franc's safe-haven status, which could lead to a rapid appreciation, eroding the country's price competitiveness.

Norway

The acceleration of vaccinations, lower infection rates and the gradual easing of COVID-19-related restrictions prompted a sharp rise in economic activity in the second quarter of 2021 when real GDP expanded by 6.1% year-on-year, compared to a 1.4% contraction in the preceding quarter. The recovery was largely driven by base effects as well as by a strong rebound in private consumption supported by the increase in employment and the return of consumer sentiment to positive territory. Investment fell, albeit at a much slower pace on a year-on-year basis compared to the first quarter. The external sector posed headwinds to growth as imports grew at a faster rate than exports, reflecting pent-up domestic demand.

Through summer, viral infections and hospital admissions increased as the Delta variant continued to spread but they were considerably lower than in the previous waves of the pandemic. A high vaccination rate has reduced the need for the re-imposition of some restrictions and the upswing in economic activity is expected to continue in the months ahead. Increased consumer confidence coupled with an improving labour market is set to boost household consumption while investment should recover on the back of the gradual lifting of uncertainty among investors. Net exports will add to growth as merchandise exports are set to increase at a faster pace than imports, benefitting from higher oil and gas prices. House price inflation accelerated to 12.5% year-on-year in the second quarter up from 11% in the first three months while it moderated through the summer. For the same period, residential investment rose by 6.2% year-on-year from 2.5% in the first quarter and it is expected to increase further in the near term, bolstered by high house prices and the still low interest rates.

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



Economic expansion is set to continue in 2022, mainly driven by buoyant household consumption and investment.

Overall, the economy is forecast to grow by 3.1% in 2021, before slowing to 2.8% in 2022 and 2.2% in 2023.

Inflation continued its upward trend in August (3.4% year-on-year) triggering Norges Bank's Executive Board decision on 22 September to raise the key policy rate from the historic low of 0.0% to 0.25%, after slashing it from 1.5% with three successive cuts of 150 basis points in total in 2020.

The economy will receive less support from government spending in 2022 mainly due to the unwinding of the extensive and temporary extraordinary COVID-19 measures introduced in 2020. The fiscal policy anticipates a fiscal impulse of -2.6% of mainland GDP, resulting in a structural non-oil deficit of 9.5% of mainland GDP and spending of oil revenues equivalent to 2.6% 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 a steep fall in house prices or interest rates rises. 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 both upside and downside risks while a deterioration in growth prospects of Norway's main trading partners caused by new virus variants would weigh materially on growth.

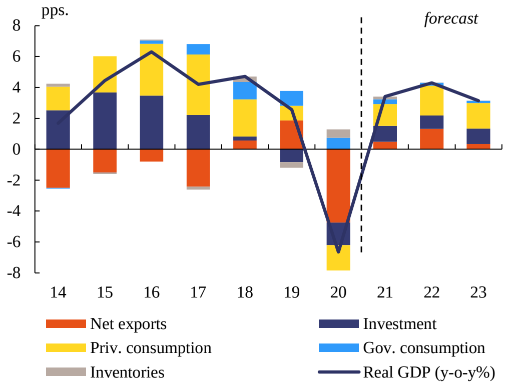
Iceland

Following a soft contraction in early 2021, Iceland's economy has gained momentum in the second quarter (7.3% year-on-year). Growth was driven by robust private consumption, recovering investment and public spending. Recovery of exports was supported by a rising number of tourist arrivals and a successful fishing season. The increase in gross fixed capital formation in 2021 has been mainly driven by public investment.

The outlook is for a mild recovery in 2021, which is likely to accelerate in 2022. Higher private consumption, investment and growing exports, on the back of increasing number of tourists and a positive outlook for marine products and aluminium, are set to be the key drivers of growth. The projected increase in investment will be supported by business and housing investment.

Recovery in tourism helped to reduce the elevated unemployment rate (peaking at 8.6% in January) to 2.8% in September. In the second quarter the labour force participation rate reached the pre-pandemic level of 80% while underemployment rate stood at 3.1%. In line with the strengthening recovery, employment is set to continue increasing, while the rate of unemployment should fall further.

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



The 2021 budget allows fiscal stimulus to support the economy, by using strong automatic stabilisers and targeted pandemic-related measures such as tax reductions, part-time unemployment benefits, closure subsidies, government guaranteed loans to companies and increased public investment. In 2022, the budget deficit should moderate, as most of the targeted measures will expire by the end of 2021 and government revenue is likely to recover in line with strengthening economic activity. Further fiscal consolidation is projected for 2023.

Monetary policy has been eased in response to the pandemic. In the course of 2020, the Central Bank of Iceland (CBI) cut the key interest rate (the rate on seven-day term deposits) to a record low of 0.75%, reduced reserve requirements and engaged in purchasing government bonds in the secondary market. The ISK depreciated sharply having an inflationary effect, in particular through housing and import prices, throughout 2021, bringing the CPI to over 4% since January, well above the CBI target of 2.5%. In subsequent steps the CBI raised the interest rate to 1.5% in October which, together with slightly appreciating ISK, should dampen inflationary pressures in 2022.

The balance of risks is tilted to the downside. Key risks stem from the external environment and uncertain outlook for Iceland's main exports, in particular tourism. Domestic risk relates to a possible overheating in the housing market.

Table II.37.1:

Main features of country forecast - EFTA

	Iceland				Norway				Switzerland			
(Annual percentage change)	**2020**	**2021**	**2022**	**2023**	**2020**	**2021**	**2022**	**2023**	**2020**	**2021**	**2022**	**2023**
GDP	-6.6	**3.4**	**4.3**	**3.1**	-0.8	**3.1**	**2.8**	**2.2**	-2.4	**3.0**	**2.5**	**2.3**
Private Consumption	-3.3	**2.8**	**3.8**	**3.2**	-6.9	**5.5**	**4.2**	**2.7**	-3.7	**3.0**	**2.3**	**1.4**
Public Consumption	3.1	**1.1**	**0.7**	**0.6**	1.7	**2.4**	**1.5**	**1.3**	3.5	**5.5**	**-1.5**	**0.4**
Gross fixed capital formation	-6.8	**4.7**	**3.9**	**4.5**	-3.8	**1.5**	**2.4**	**2.1**	-1.8	**5.0**	**2.5**	**1.5**
of which: equipment	-6.1	**:**	**:**	**:**	-7.5	**2.1**	**2.5**	**2.8**	-4.5	**1.1**	**0.6**	**0.7**
Exports (good and services)	-30.5	**10.2**	**15.9**	**7.9**	-0.5	**5.5**	**4.8**	**3.1**	-6.0	**6.5**	**5.7**	**5.0**
Imports (goods and services)	-22.0	**8.6**	**12.1**	**7.2**	-11.9	**5.1**	**5.1**	**2.9**	-4.5	**5.3**	**5.0**	**4.0**
GNI (GDP deflator)	-6.1	**3.4**	**4.3**	**3.1**	0.7	**2.9**	**2.8**	**2.2**	-2.4	**4.7**	**2.5**	**2.3**
Contribution to GDP growth: Domestic demand	-2.3	**2.7**	**3.0**	**2.8**	-3.7	**3.4**	**2.9**	**2.1**	-2.0	**3.4**	**1.6**	**1.2**
Inventories	0.5	**0.2**	**0.0**	**0.0**	-1.0	**-0.5**	**0.0**	**0.0**	1.1	**-1.7**	**0.0**	**0.0**
Net exports	-4.8	**0.5**	**1.3**	**0.3**	4.0	**0.1**	**-0.1**	**0.1**	-1.5	**1.2**	**0.9**	**1.1**
Employment	-4.7	**1.4**	**2.2**	**1.4**	-1.3	**0.5**	**1.2**	**0.8**	-0.5	**0.3**	**1.1**	**1.1**
Unemployment rate (a)	5.5	**6.1**	**5.1**	**4.1**	4.4	**4.1**	**3.9**	**3.8**	4.8	**5.0**	**4.6**	**2.9**
Compensation of employee/head	3.3	**2.3**	**5.7**	**4.5**	1.4	**3.0**	**3.1**	**3.0**	-0.8	**0.4**	**0.4**	**1.3**
Unit labour cost whole economy	5.5	**0.2**	**3.5**	**2.7**	0.9	**0.5**	**1.4**	**1.6**	1.2	**-2.3**	**-1.0**	**0.2**
Real unit labour cost	2.0	**-3.5**	**0.2**	**0.2**	4.6	**-2.8**	**-1.2**	**-0.8**	1.7	**-3.1**	**-2.0**	**-1.0**
Saving rate of households (b)	8.1	**7.3**	**7.9**	**7.8**	21.0	**19.7**	**19.3**	**19.2**	:	:	:	:
GDP deflator	3.4	**3.9**	**3.3**	**2.5**	-3.6	**3.4**	**2.7**	**2.4**	-0.5	**0.8**	**1.0**	**1.2**
National index of consumer prices	2.8	**4.2**	**3.6**	**2.8**	1.3	**3.1**	**2.4**	**2.0**	-0.7	**0.5**	**1.0**	**1.2**
Terms of trade goods	-0.8	**-0.2**	**-0.1**	**-0.1**	-21.5	**3.3**	**1.7**	**0.4**	-2.9	**-0.3**	**-0.1**	**-0.1**
Trade balance (goods) (c)	-3.1	**-2.9**	**-2.8**	**-3.4**	-0.9	**0.0**	**0.3**	**0.4**	8.1	**8.6**	**8.5**	**8.9**
Current account balance ©	1.1	**1.4**	**2.7**	**2.9**	2.0	**3.5**	**3.7**	**3.8**	2.2	**5.2**	**5.8**	**6.6**
Net lending (+) or borrowing (-) vis-a-vis ROW	1.0	**1.4**	**2.6**	**2.9**	1.9	**3.4**	**3.7**	**3.8**	2.2	**3.9**	**4.6**	**5.3**
General government balance (c)	-8.6	**-10.1**	**-6.5**	**-4.0**	-3.0	**-0.2**	**1.3**	**2.1**	-2.8	**-1.0**	**-0.3**	**0.0**
General government gross debt ©	58.5	**65.6**	**67.5**	**66.9**	46.9	**43.9**	**42.8**	**41.3**	27.9	**27.9**	**27.2**	**26.3**

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