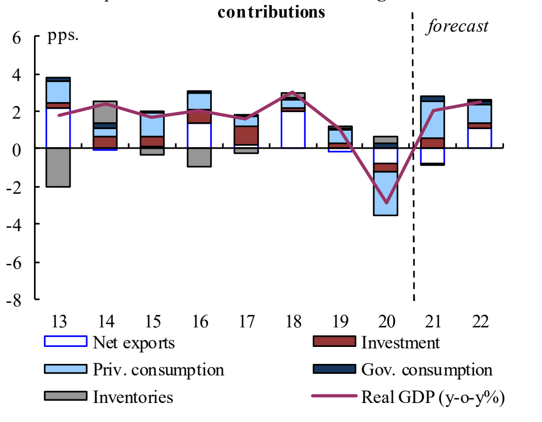
37. EFTA

The pandemic affected the EFTA countries in quite an asymmetric way. Countries with a stronger reliance on tourism (Iceland and Switzerland) experienced larger output losses, while net exports cushioned the economic fallout in the more resource-based Norwegian economy. In addition, the fiscal response was quite different, with Norway and Switzerland containing the fiscal deficit at around 3½% of GDP, while substantial COVID-19-related support measures and weaker revenues brought Iceland's deficit to 7.3% of GDP. The outlook is for the recovery to start in 2021. However, in the harder hit economies, Iceland and Switzerland, it will take until 2022 to reach pre-crisis output levels.

Switzerland

The Swiss economy registered a drop in output by 2.9% in 2020, largely reflecting weaker private consumption (-4.4%) and lower revenues from service exports (-17.3%) due to domestic and international containment measures. However, the decline in goods exports was less pronounced at 2.2%, partly thanks to a solid export performance of chemical and pharmaceutical products. Unemployment rose, in particular in tourism and construction. However, thanks to short-time working schemes, the overall impact on employment remained muted (-0.3% y-o-y in 2020). The government adopted fiscal support measures amounting to about 5¼% of GDP for 2020 and 2021, but announced to spend more, if necessary. Overall, the economy weathered the pandemic-related crisis better than expected, partly thanks to a resilient export sector and a good management of containment and support measures.

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



The outlook is based on a supportive international environment, although there is a risk that a persisting third wave of COVID-19 infections could delay the domestic and international recovery, pushing the rebound into the second half of 2021. During the forecast period, the main driver of growth is expected from the domestic side, in particular private consumption, benefitting from pent-up demand, as well as investment. Export growth is expected to benefit in 2021 from strengthening international demand and maintain a positive momentum in 2022. However, due to strong import growth as a result of catching-up consumption and investment, the growth contribution of net-exports will still be negative in 2021. Overall, output is projected to grow by 2¾% and 2½% in 2021 and 2022 respectively. In view of the muted labour market response in 2020, reflecting governmental support measures, also the post-pandemic pick-up of employment will remain subdued. Due to expected international price pressures, such as for raw materials and freight, consumer price increases are set to accelerate, but to remain at a still moderate level, reaching some 1½% in 2021 and 2022 respectively. 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.

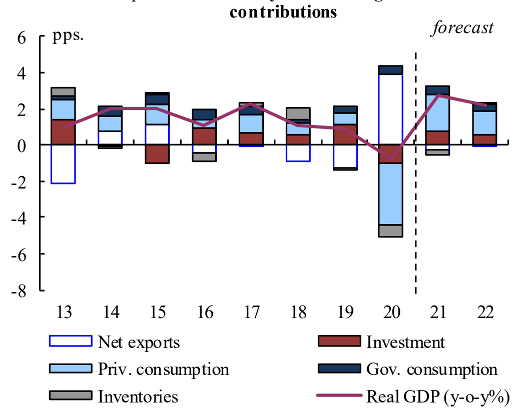
Norway

The disruptive effects of the COVID-19 crisis subsided in the last two quarters of 2020 and the economy registered a mild contraction of 0.8% for the whole year, down from a growth rate of 0.9% in 2019. This has brought the ten-year-long expansion in the country's GDP to an end. The downturn was largely driven by a steep fall in private consumption due to worsening labour market conditions combined with negative consumer sentiment, while concerns over the duration of the crisis weighed heavily on investment. The external sector had a notable positive contribution to growth as exports broadly held up while imports dropped at a much faster pace, reflecting weak domestic demand.

Because of the aggravation of the epidemiological situation in February and March, the authorities re-imposed containment measures lasting from 25 March until at least 12 May. Nevertheless, economic activity is expected to recover strongly in the months ahead as a larger share of the population will be vaccinated and restrictions lifted. Increased consumer confidence coupled with an improving labour market is set to boost private consumption while the gradual easing of uncertainty among investors should prompt a rebound in investment. Net exports are expected to subtract from growth, as imports are set to increase at a faster pace than exports, largely driven by pent-up domestic demand. House prices rose markedly by 3.9% in 2020, compared to 2.5% a year earlier while they continued to increase in the first months of 2021. After contracting by 4% in 2020, the recovery in housing investment is expected be slow in 2021 due to concurrent headwinds including weak population growth and the uncertainty about economic developments going forward.

Expansion is expected to continue in 2022, mainly driven by buoyant household spending and investment. Overall, the economy is forecast to grow by 2.7% in 2021 and 2.2% in 2022.

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



The considerable uncertainty around the trajectory of the pandemic and the pace of economic recovery triggered Norges Bank's Executive Board decision on 17 March to keep the key policy rate unchanged at the historic low of 0.0%, after slashing it from 1.5% with three successive cuts between March and May 2020.

The economy is expected to 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 for 2021 a fiscal impulse of -1.4% of mainland GDP, resulting in a structural non-oil deficit of 10.9% of mainland GDP and spending of oil revenues equivalent to 3.3% of the sovereign wealth fund's (Government Pension Fund Global) assets.

Domestic risks to the outlook are clearly tilted to the downside. Uncertainties in the property market and high household debt levels raise financial stability concerns, which are alleviated 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 potential delays in the vaccination progress across Norway's major export markets continue to point to downside risks.

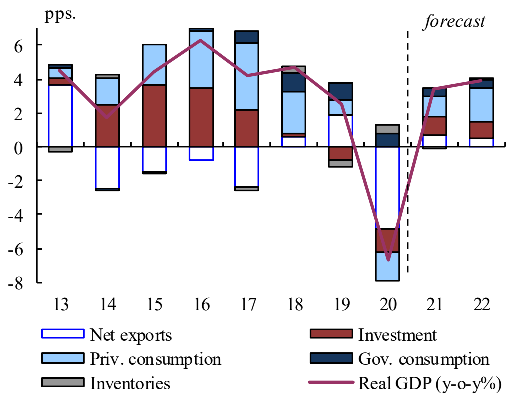
Iceland

Iceland's economy shrank by 6.6% in 2020 with all demand components, except public consumption and inventories, contributing negatively. The largest negative impact came from foreign trade with exports falling by 30.5%, significantly outweighing the still substantial 22% decline in imports. Due to the collapse in tourism, exports of services fell by 51%, while exports of goods fared better with an estimated contraction of 8.5%.

The outlook is for a modest recovery in 2021, partially due to the base effect, and strengthening growth in 2022. Increasing private consumption and investment are projected to drive domestic demand, while further support is set to come from government consumption. The recovery of exports is likely to be more gradual, as the outlook for tourism services remains clouded by the speed of vaccine rollout, but exports of aluminium should benefit from positive developments in global trade in goods. The outlook for exports of marine products is still subdued due to COVID-19 related restrictions and weaker demand for fresh products in restaurants. Overall, exports are not expected to return to their 2019 level before 2022.

Pandemic-related disruptions resulted in declining labour force participation and rising unemployment. The unemployment rate increased more rapidly among foreign workers, even as some of them left the country in 2020. In line with the gradual recovery, unemployment is projected to continue rising in the first half of 2021, and decline slowly afterwards.

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



Due to strong automatic stabilisers and targeted discretionary measures, focusing on short-term support for businesses and workers, as well as infrastructure investment, the general government deficit has widened to more than 7% of GDP in 2020. A similar budget shortfall is projected for 2021, as the government has announced to continue to support the economy with the fiscal stimulus. Nearly 60% of public spending is planned to be allocated to healthcare, social welfare and education. Fiscal consolidation is foreseen to start from 2022 onwards with a view to reducing the public debt-to-GDP ratio below 60%.

In November, the Central Bank of Iceland (CBI) cut the key interest rate (the rate on seven-day term deposits) by 0.25 basis points, bringing it to a new record low of 0.75%. Moreover, the CBI engaged in purchasing government bonds on the secondary market, but the overall intervention amounted to only 0.3% of GDP in 2020. The ISK depreciated sharply which had an inflationary effect and partially offset the disinflationary impact of the pandemic in 2020. Real estate prices were supported by low interest rates. Going forward, inflation is likely to remain elevated in 2021, as supply chains for domestic consumption are expected to remain disrupted and the ISK remains weak due delayed recovery of tourism services. In 2022, inflation is projected to ease in line with recovering exports and stronger ISK.

The balance of risks is tilted to the downside. Key risks stem from the external environment and uncertain recovery of Iceland's main exports, in particular tourism. Domestic risk relates to a possible bubble in the housing market. An upside risk is related to the depreciated 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	2.6	**-6.6**	**3.4**	**3.9**	0.9	**-0.8**	**2.7**	**2.2**	1.1	**-2.9**	**2.7**	**2.5**
Private Consumption	1.9	**-3.3**	**2.3**	**3.9**	1.4	**-7.6**	**4.7**	**3.0**	1.4	**-4.4**	**3.0**	**2.5**
Public Consumption	3.9	**3.1**	**1.9**	**1.8**	1.9	**1.7**	**1.8**	**1.5**	0.9	**2.9**	**3.3**	**-0.5**
Gross fixed capital formation	-3.7	**-6.8**	**5.2**	**4.5**	4.8	**-3.9**	**2.8**	**2.0**	1.2	**-1.7**	**2.2**	**1.5**
of which: equipment	-25.6	**-6.1**	:	:	2.9	**-7.0**	**1.1**	**2.2**	0.9	**-22.0**	**16.8**	**4.2**
Exports (good and services)	-4.6	**-30.5**	**10.3**	**13.5**	0.5	**-0.9**	**6.0**	**3.2**	-0.2	**-6.4**	**7.5**	**6.0**
Imports (goods and services)	-9.3	**-22.0**	**8.1**	**12.1**	4.7	**-12.2**	**6.6**	**3.4**	-0.1	**-6.5**	**8.5**	**5.6**
GNI (GDP deflator)	3.6	**-6.2**	**3.4**	**3.9**	0.0	**0.8**	**2.5**	**2.2**	3.9	**-6.1**	**2.7**	**2.5**
Contribution to GDP growth: Domestic demand	1.1	**-2.3**	**2.8**	**3.4**	2.2	**-4.0**	**3.3**	**2.2**	1.1	**-2.4**	**2.5**	**1.6**
Inventories	-0.4	**0.5**	**0.0**	**0.0**	0.0	**-0.7**	**-0.3**	**0.0**	0.1	**0.3**	**0.0**	**0.0**
Net exports	1.9	**-4.9**	**0.7**	**0.5**	-1.3	**3.9**	**-0.2**	**-0.1**	-0.1	**-0.8**	**0.3**	**0.8**
Employment	-0.1	**-4.0**	**1.4**	**1.9**	1.6	**-1.3**	**0.5**	**1.0**	0.7	**-0.3**	**0.2**	**1.0**
Unemployment rate (a)	3.5	**5.5**	**7.0**	**6.0**	3.7	**4.4**	**4.2**	**3.9**	4.4	**4.8**	**5.0**	**4.7**
Compensation of employee/head	3.6	**2.7**	**1.0**	**4.4**	4.1	**1.6**	**1.7**	**1.9**	1.8	**-1.8**	**2.8**	**2.2**
Unit labour cost whole economy	0.9	**5.6**	**-1.0**	**2.4**	4.9	**1.0**	**-0.5**	**0.7**	1.4	**0.8**	**0.2**	**0.8**
Real unit labour cost	-3.4	**2.1**	**-3.7**	**0.1**	5.4	**4.9**	**-3.8**	**-1.8**	1.5	**1.4**	**-1.4**	**-0.6**
Saving rate of households (b)	4.1	**1.7**	**1.5**	**1.8**	13.7	**21.2**	**19.3**	**18.7**	:	:	:	:
GDP deflator	4.5	**3.4**	**2.8**	**2.3**	-0.4	**-3.7**	**3.4**	**2.6**	-0.1	**-0.5**	**1.6**	**1.4**
National index of consumer prices	3.0	**2.8**	**3.0**	**2.5**	2.2	**1.3**	**2.2**	**1.7**	0.4	**-0.8**	**1.5**	**1.4**
Terms of trade goods	0.7	**-2.9**	**0.0**	**0.0**	-10.2	**-21.7**	**4.0**	**1.0**	-1.1	**-4.0**	**-0.2**	**-0.1**
Trade balance (goods) (c)	-3.5	**-3.1**	**-2.7**	**-3.2**	3.1	**-1.1**	**-0.3**	**-0.1**	10.3	**9.2**	**9.6**	**9.3**
Current account balance ©	7.0	**1.1**	**1.7**	**2.2**	2.8	**1.9**	**3.1**	**3.3**	10.0	**4.8**	**4.9**	**5.3**
Net lending (+) or borrowing (-) vis-a-vis ROW	6.2	**1.0**	**1.7**	**2.2**	2.8	**1.9**	**3.0**	**3.2**	8.0	**3.8**	**3.9**	**4.5**
General government balance (c)	-1.5	**-7.3**	**-7.7**	**-3.2**	6.6	**-3.4**	**0.9**	**1.8**	1.4	**-3.6**	**-2.5**	**-0.5**
General government gross debt ©	45.0	**58.5**	**63.8**	**63.2**	40.2	**46.9**	**46.0**	**44.7**	25.9	**28.1**	**29.4**	**28.8**

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