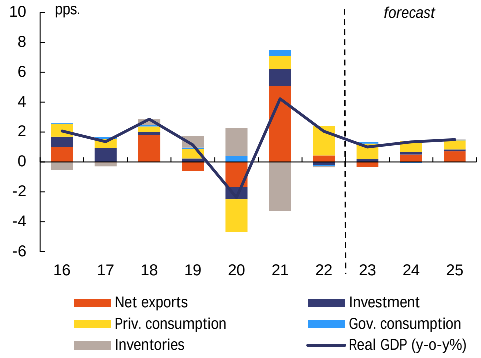
40. EFTA

EFTA countries have so far weathered the currently persistent headwinds well. The economic outlook for most EFTA countries is for moderate growth in 2023 and some acceleration in 2024 and 2025, partly reflecting strengthening external demand. In Iceland, booming tourism is supporting above-average growth. Public finances in EFTA countries are set to remain sound. Due to uncertainties surrounding the global outlook, the risks to the forecast are largely on the downside.

Switzerland

Economic growth remained sluggish in the first half of 2023, in particular due to a weak second quarter, which was also negatively affected by stress to the banking system following the *Crédit Suisse* turbulences. As a result, y-o-y output growth slowed down to 0.5%, compared to 1.5% in the first quarter. When adjusting for sport events, the slowdown was slightly less pronounced, from 1.8% in the first quarter to 1.1% in the second. Key factors behind the slowdown were lower growth of private consumption and investment, reflecting the impact of high inflation on disposable incomes, a deteriorating international environment and increasing interest rates impeding investment. Consumer price increases reached a peak of 3.4% in February, but have come down to 1.7% in September, bringing average inflation to 2.3% in the first 9 months of 2023. The exchange rate against the euro continued to appreciate in the first half of 2023, which helped to contain import-driven inflationary pressures. Tourism performed well so far. The labour market remained resilient.

Graph II.40.1: Switzerland - Real GDP growth and contributions



In 2023 as a whole, growth dynamics are likely to decelerate, mainly due to a less supportive international environment and tightening global financial conditions. In 2024 and 2025, output growth is set to accelerate to 1½% and 1¾%, respectively. The main growth driver during the forecast horizon is expected to be private consumption, benefitting from a resilient labour market and moderating inflation. Investment growth is projected to remain subdued, reflecting persistent global uncertainties that are expected to hold back business confidence. Export growth is set to accelerate in 2024, and to strengthen further in 2025. Import growth is projected to remain contained during the forecast horizon, partly reflecting weak investment and moderate consumption growth.

Annual consumer price inflation is forecast to fall to around 2.2% in 2023, mainly thanks to an expected moderation in energy prices and reflecting base effects. Employment growth accelerated to around 2½% during in the first half of 2023, with marked job creations in the areas of health care, trade and tourism. The forecast expects that this strong performance will continue in the second half of the year. However, in 2024 the base effect will contribute to a slight slowdown in employment growth, while in 2025 the moderately stronger output growth will support job creation. Switzerland's general government is expected to realise small surpluses during the forecast horizon, in line with the country's debt brake rule. The gross public debt-to-GDP ratio is set to decline, due to fiscal surpluses and solid output growth.

Besides risks related to the global economic environment, country-specific risks to the outlook mainly stem from the possibility of persistent upward pressure on the Swiss franc.

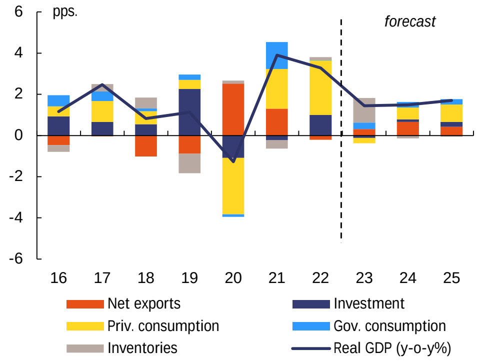
Norway

The Norwegian economy lost steam in the second quarter of 2023, with real GDP growth decelerating markedly to 0.7% year-on-year, compared to 3.3% in the first quarter. The key factor behind the slowdown was the contraction of household consumption due to the impact of high inflation on real disposable incomes as well as depressed consumer confidence. Investment growth further decelerated on a year-on-year basis compared to the preceding quarter, largely affected by the notable decline of housing investment. The external sector posed tailwinds to growth as imports grew at a slower rate than exports, reflecting subdued domestic demand.

Economic growth is projected to moderate further in 2023 compared to 2022. Household consumption is expected to decline due to the inflation-induced drop in real disposable incomes, low consumer sentiment and a slight increase in unemployment. Despite an expected rise in oil-sector investment in line with the initiation of new scheduled projects, higher interest rates and increased uncertainty about the economic outlook are set to curb investment. House prices fell by 1.3% year-on-year in the third quarter of 2023. Residential investment shrank by 13.3% year-on-year in the second quarter of 2023, and it is projected to fall markedly in 2023 due to concurrent headwinds such as higher interest rates and input prices. Net exports are expected to add to growth, also benefitting from still somewhat elevated oil prices.

Output growth is forecast to accelerate marginally in 2024 and 2025 mainly driven by the rebound of private consumption, on the back of higher real disposable incomes. Investment is projected to recover, bolstered by buoyant petroleum-sector investment coupled with the slowdown in the decline of housing investment. On the back of higher external demand, exports are set to grow at a faster pace than imports resulting in net exports adding to growth.

Graph II.40.2: Norway - Real GDP growth and contributions



Gradually decelerating global commodity prices supported a moderation of inflation in the second and third quarter of 2023, bringing average inflation in the first nine months of the year to 5.9%, still well above the central bank's target of 2%. On 20 September, the Norges Bank's Executive Board raised the key policy rate by another 25 basis points to 4.25%, after having lifted it by a cumulative 125 bps. in March-August.

To avoid creating any further inflationary pressures, the government's budget proposal for 2024 implies a roughly neutral fiscal effect on the level of economic activity. Policymakers anticipate a structural non-oil fiscal deficit of 10.3% of mainland GDP, with the overall balance remaining firmly in double-digit surplus, and spending of oil revenues equivalent to 2.7% of the sovereign wealth fund's assets.

Domestic risks to the outlook are clearly tilted to the downside. Uncertainties in the property market and sustained increases in households' debt service burden emanating from higher interest rates are likely to constrain domestic demand. A further depreciation of the Krone could fuel inflationary pressures and eat into private consumption. The volatility of energy prices presents both upside and downside risks, while sluggish growth among Norway's main trading partners points to downside risks overall.

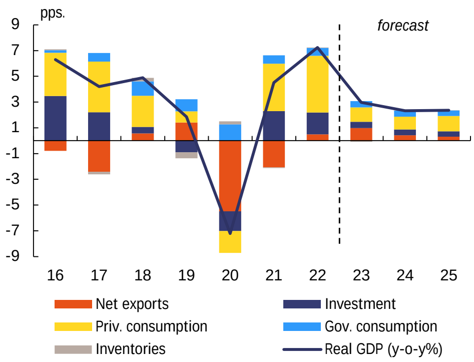
Iceland

Real GDP expanded by 5.8% y-o-y in the first half of 2023 on the back of very strong growth of both, exports and domestic demand. The solid export performance was driven by a large increase in tourist arrivals, while exports of goods remained flat. Private consumption increased rapidly in the first quarter (4.5% y-o-y) supported by a surge in population growth and increasing employment, although it moderated later due to tighter financial conditions.

The outlook is for a slowdown, which has already started in the second half of 2023. High inflation together with tight fiscal and monetary policies are set to restrict private consumption and investment. Weaker external demand is projected to result in a slower growth of services exports.

Economic growth resulted in a tight labour market with the unemployment rate projected to reach 3.4% in 2023. The labour force participation rate stood at 82.3% in August after peaking at a stellar 83.9% in June. Strong demand for labour was met with rapidly increasing inward migration. The labour marked started to show signs of cooling in the third quarter, as the rate of employment declined slightly below 80% in August from a peak of 82% in June. A slower growth of employment is likely to continue in 2024-2025, in line with decelerating GDP growth.

Graph II.40.3: Iceland - Real GDP growth and contributions



Strong GDP growth is set to result in higher than planned budget revenues and a substantial reduction of public deficit in 2023. A restrictive fiscal policy is projected to continue, in line with the 2024–2028 medium-term fiscal strategy, aiming to reduce public debt and bring inflation back to the target of 2.5%, while supporting the most vulnerable. Numerical fiscal rules, which were suspended during the pandemic, are set to be reinstated by 2025. The growth of budget revenue should benefit from new taxation of cars and reinstating taxes on hotel accommodation and cruises, which were abandoned during the pandemic. Public spending should moderate on the back of downscaling public investment projects and streamlining public wages and public procurement-related spending.

In response to persistent and widespread domestic price pressures, in August the central bank increased the key interest rate (the rate on seven-day term deposits) to a new record high of 9.25%. In July and August, inflation eased slightly to 7.6% and 7.7% year-on-year respectively but accelerated again to 8.0% y-o-y in September. The key drivers were prices of food and services, including accommodation and restaurants. Inflation is projected to moderate in 2024-2025 due to a stronger Krona, cooling housing market and stabilising commodity (oil, food) prices.

The balance of risks is tilted to the downside. Key risks stem from sluggish growth in main trading partners and the forthcoming wage negotiation round.

Table II.40.1:

Main features of country forecast - EFTA

		Iceland				Norway				Switzerland			
(Annual percentage change)		**2022**	**2023**	**2024**	**2025**	**2022**	**2023**	**2024**	**2025**	**2022**	**2023**	**2024**	**2025**
GDP		7.2	**3.6**	**2.4**	**2.3**	3.3	**1.4**	**1.5**	**1.7**	2.1	**1.0**	**1.4**	**1.7**
Private Consumption		8.5	**2.4**	**2.1**	**2.2**	6.9	**-0.8**	**1.6**	**2.0**	4.0	**2.0**	**1.5**	**1.2**
Public Consumption		2.2	**2.0**	**1.9**	**1.8**	0.1	**1.7**	**1.3**	**1.2**	-0.5	**1.0**	**-0.5**	**0.5**
Gross fixed capital formation		7.6	**2.2**	**2.0**	**1.9**	4.3	**-0.6**	**0.6**	**1.1**	-0.8	**0.0**	**1.0**	**1.5**
Exports (good and services)		22.3	**8.1**	**3.2**	**3.0**	5.9	**0.7**	**2.8**	**2.9**	5.5	**2.0**	**3.3**	**4.0**
Imports (goods and services)		19.9	**4.9**	**2.4**	**2.3**	9.2	**0.3**	**2.5**	**2.8**	5.9	**2.6**	**3.4**	**3.9**
GNI (GDP deflator)		6.9	**3.6**	**2.4**	**2.3**	3.2	**1.4**	**1.5**	**1.7**	1.6	**2.4**	**1.4**	**1.7**
Contribution to GDP growth:	Domestic demand	6.7	**2.2**	**2.0**	**2.0**	3.7	**-0.1**	**1.0**	**1.2**	1.7	**1.1**	**1.0**	**1.1**
	Inventories	0.0	**-0.1**	**0.0**	**0.0**	0.1	**1.2**	**-0.1**	**-0.1**	-0.1	**0.0**	**0.0**	**0.0**
	Net exports	0.5	**1.5**	**0.4**	**0.3**	-0.2	**0.3**	**0.7**	**0.6**	0.4	**-0.1**	**0.4**	**0.6**
Employment		6.8	**3.0**	**1.7**	**1.4**	3.9	**1.1**	**0.5**	**0.5**	1.5	**2.3**	**1.0**	**1.3**
Unemployment rate (a)		3.8	**3.4**	**3.6**	**3.9**	3.2	**3.6**	**3.8**	**3.8**	4.3	**4.1**	**3.9**	**4.1**
Compensation of employee/head		7.6	**8.3**	**4.6**	**5.2**	4.3	**4.4**	**4.2**	**4.1**	4.0	**0.0**	**1.0**	**1.2**
Unit labour cost whole economy		7.2	**7.7**	**3.9**	**4.3**	4.9	**4.0**	**3.2**	**2.8**	3.4	**1.2**	**0.7**	**0.9**
Saving rate of households (b)		5.9	**6.1**	**5.2**	**5.4**	15.1	**10.3**	**9.8**	**10.5**	:	:	:	:
GDP deflator		8.9	**8.8**	**4.7**	**4.0**	28.1	**-4.2**	**-0.7**	**2.3**	3.0	**2.1**	**2.1**	**2.4**
National index of consumer prices		8.3	**8.7**	**4.9**	**4.3**	5.8	**5.6**	**4.5**	**2.9**	2.8	**2.2**	**1.7**	**2.0**
Terms of trade goods		6.6	**0.0**	**0.1**	**-0.1**	61.1	**-20.6**	**-7.1**	**0.0**	1.5	**0.3**	**0.0**	**-0.1**
Trade balance (goods) (c)		-5.6	**-5.7**	**-5.4**	**-5.5**	28.2	**20.6**	**18.6**	**18.8**	14.7	**14.0**	**14.1**	**14.2**
Current account balance ©		-1.5	**-0.8**	**-1.0**	**-1.2**	28.9	**20.7**	**18.7**	**19.0**	9.2	**9.2**	**9.3**	**9.4**
General government balance (c)		-4.1	**-1.3**	**-1.0**	**-1.0**	26.0	**21.5**	**20.4**	**20.0**	1.2	**0.7**	**0.8**	**1.2**
General government gross debt (c)		68.2	**61.8**	**58.7**	**56.1**	37.4	**36.4**	**35.0**	**32.2**	27.9	**26.3**	**25.0**	**23.0**

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