Box VII-2

The balance of payments outlook

The Central Bank has assessed potential developments in the balance of payments over the coming years. The assessment is subject to considerable uncertainty because the assumptions underlying the forecast could easily change and could strongly affect developments in the balance of payments.

Table 1 presents the Bank's forecast for the balance of payments until year-end 2012. Numbers are shown as percentages of GDP. It is forecast that the underlying current account balance will be positive throughout the period, although the income account deficit will grow somewhat over time.[1] The capital account, however, will be negative in 2011-2012, and net capital outflows in the latter year are projected to total 13% of GDP.

The capital account fluctuates widely between years. One of the main explanations for this is the estimated inflow and outflow of the assets of banks undergoing winding-up proceedings. The assumptions in the forecast allow for considerable recovery of foreign assets in 2010 and 2011, and that outflows will be greatest in 2011-2012. This estimate is based on the technical assumption that all loan facilities related to the IMF programme will be fully drawn, without stating that this will be the case, and that repayment of the IMF loan facilities will begin in 2012. It is assumed that a portion of foreign debt will be refinanced during the period, including half of the Treasury loans maturing in 2011-2012. It is also assumed that the largest companies enjoying Treasury guarantees will be able to refinance their debt to a large extent in coming years. Developments in foreign direct investment in the forecast are determined mainly by the outlook for investments related to power-intensive industries. It is also assumed that some foreign assets will be sold, which entails inflows of capital. The assumptions concerning the repayment profile for the Icesave debt are based on the most recent estimates and on the offer from the British and Dutch governments that has been discussed publicly.

Table 1 Balance of Payments (% of GDP)

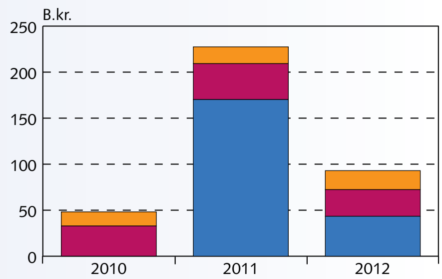
	2009	*2010*	*2011*	*2010*
Current Account[1]	3.0	5.0	2.4	1.6
Trade balance	8.0	9.8	9.7	9.6
Balance on income	-4.4	-4.8	-7.3	-8.0
Capital and financial account (excl. reserves)	-8.5	41.4	-6.7	-13.2
Net debt[2]	28	75	68	56
Total debt[2]	234	301	269	235

1. The table shows the underlying balance on income and underlying current account balance. (i.e., calculated interest income and accured interest expence due to banks in winding-up proceedings).
2. Total debt and net debt are underlying debt and underlying net debt (i.e., debts from banks in winding-up proccedings are only included if it is considered likely that they will be covered by assets).

Source: Central Bank of Iceland.

As can be seen in Chart 1, in 2011 there will be sizeable payments due on foreign loans taken by the Treasury, the municipalities, and companies with a Treasury guarantee. The chart shows the combined debt service burden of these parties' loans in 2010-2012. The bulk of the payments will be due in late 2011 and early 2012.

Chart 1
Debt repayments 2010-2012[1]



1. Central Bank of Iceland baseline forecast 2010-2012.
Source: Central Bank of Iceland.

1. The underlying current account balance is the current account balance less calculated interest revenues and accrued expenses due to banks in winding-up proceedings. Further discussion of the underlying current account balance and the official current account balance can be found in Section VII.

According to this estimate, the net debt position will peak at 75% of GDP in 2010 and then subside steadily during the years thereafter. The decline in the net debt position will be drivenin part by the recovery of the assets of banks in winding-up proceedings and the restructuring of private sector debt. Drawing on the loans that are available means that financing debt in the near term will not be a source of worry. If the loans associated with the Second Review of the IMF programme had not been available, however, there would have been little room for manoeuvre. In this context, it must be borne in mind that large foreign reserves will only be needed for a short period of time, while confidence is being restored, the capital controls are being phased out, and large loan payments are being made. For the longer term, a strong current account surplus will improve Iceland's debt position.