Box 1 Survey of financial market analysts' assesement of the economic outlook

The Central Bank is now publishing the findings of its second survey of financial market analysts' assessment of the economic outlook for the next two years. The survey was sent to analysts at six institutions: Búnadarbanki, Economic Consulting and Forecasting, Íslandsbanki, Kaupthing Bank, Landsbanki and SPRON (Reykjavík and Environs Savings Bank). Results of the survey are given in the table. It should be pointed out that the analysts' assessment was based on the assumption that no power-intensive industrial projects will take place, which is in line with the Central Bank's forecast assumptions.

Firstly, the table shows the analysts' evaluation of inflation prospects for this year and next year. Their forecasts for inflation over the year and between annual averages closely resemble the new Central Bank forecast. All the analysts consider that the Bank's 2½% inflation target will be attained before the end of the year. Likewise, they expect the Bank to succeed in keeping inflation around the target until the end of next year. Those who predict the highest value expect inflation to begin rising again next year and exceed the target at the end of 2003, while remaining within the 4% upper tolerance limit.

Analysts were also asked their views about other key aggregates for economic developments. Their responses show an assessment of growth prospects for this year and next that very closely matches the new national economic forecast. Equal numbers apparently expect the króna to strengthen over the next year and to weaken. However, more believe that the króna will weaken somewhat from its current position over the next two years. Most seem to be rather more optimistic about the exchange rate of the króna over the next two years than they were when the last survey was made in April.

Furthermore, analysts expect that the Central Bank will continue cutting interest rates and that its policy interest rate will have declined to about 7% after one year. As in the last survey, on average they do not expect interest rate cuts to continue two years hence. Opinions vary somewhat on this point, however. Half the respondents expect the policy rate to be down to about 6½% by the middle of next year, which is probably close to a neutral monetary stance (cf. the discussion in the last *Monetary Bulletin*). Others do not expect a neutral stance to be reached until after two years. Interestingly, some analysts foresee a reversal of

Overview of forecasts by financial market analysts

	Average	*Highest*	*Lowest*	*Average*	*Highest*	*Lowest*
		2002			*2003*	
Inflation (within year)	2.4	2.5	2.2	2.5	3.5	2.1
Inflation (year on year)	4.8	5.3	4.0	2.8	3.5	2.4
Economic growth	-0.6	0.0	-1.0	2.2	2.5	1.8
		One year forward			*Two years forward*	
The effective exchange rate index of foreign currencies vis-à-vis króna (Dec. 31, 1991=100)	128.2	132.0	124.0	129.2	135.0	120.0
Central Bank policy interest rate	7.0	7.5	6.5	7.1	8.5	6.5
Nominal long-term interest rate	7.1	7.7	6.5	7.2	8.5	6.4
Real long-term interest rate	4.7	5.0	4.2	4.7	5.0	4.0
ICEX-15 share price index (12-month change)	7.4	19.8	-10.0	14.2	25.0	3.0
Housing prices (12-month change)	2.9	5.0	0.0	1.6	4.0	-2.0

The table shows percentage changes, except for interest rates (percentages) and the exchange rate index for foreign currencies (index points). Participants in the survey were the research departments of Búnadarbanki, Economic Consulting and Forecasting, Íslandsbanki, Kaupthing, Landsbanki and SPRON (Reykjavík and Environs Savings Bank). *Source*: Central Bank of Iceland.

the declining trend in interest rates within two years, with rates beginning to rise again in the second half of the period, even though no power-intensive development projects are assumed in their forecasts. This probably reflects their assessment of a growing risk of inflation more than two years ahead. Nonetheless, the Central Bank ought to have the opportunity to respond to such an inflation risk before it becomes a reality. This evaluation is also reflected in the expectation that the inflation premium on long-term nominal rates will go up slightly. However, in all cases the inflation premium is very close to the Bank's inflation target.

The survey reveals different views about equity price developments over the next two years. Most analysts expect equity prices to rise over the next twelve months, by 7-20%. Some are more pessimistic and the lowest expectation is for a decline of 10% over the next twelve months. Over the medium term, they are unanimous that equity prices will rally, although there is considerable variation. Their assessment of real estate price developments is fairly unanimous with most assuming some increase. However, some expect a slight fall in real estate prices two years hence.