

Box 2 Financial market analysts' assessments of the economic outlook

The accompanying table shows the forecasts made in July by a number of financial market analysts. It should be pointed out that the merger of Kaupþing and Búnaðarbanki has reduced the number of forecasters to five from six.

Presented first is the analysts' evaluation of the inflation outlook for this year and 2004. The forecast for inflation over 2003 is lower than in the last survey, which was made in April, but on average in line with their forecasts in January and below the Central Bank's inflation target. The Central Bank's inflation forecast for the same period is somewhat lower, or 1.7%, which is marginally less than its projection published in *Monetary Bulletin* in May this year. Analysts forecast average year-on-year inflation of 2.1% between 2002 and 2003 but the Bank slightly less. The Bank also forecasts lower year-on-year inflation between 2003 and 2004, at 1.9%, compared with just over 2½% by the analysts.

As usual, analysts were also asked about the outlook for other key economic aggregates. Their growth forecasts are broadly in line with that of the Bank, which expects ¼% more growth for both 2003 and 2004.

On average, the respondents expect little change in the exchange rate of the króna for the next two years. However, they apparently assume that the króna will strengthen rather more in the long term than in their previous forecasts. The considerable discrepancy between the highest and lowest values should be pointed out. Analysts forecast an exchange rate index value in the range 115 to 125 two years ahead. As in their January and April forecasts, they consider that the lowering of Central Bank interest rates has come to an end. They forecast that the policy interest rate will be 6.3% a year ahead and 7.1% after two years.

Analysts expect a similar equity market price trend to the last survey. Expectations vary widely, however, as indicated by the wide range between the highest and lowest values. Views on the outlook for housing prices also differ, but they forecast rather larger increases than they expected in both January and April, undoubtedly bearing in mind price developments in recent months.

Overview of forecasts by financial market analysts¹

| | 2003 | | | 2004 | | |
|--|-----------------------|----------------|---------------|------------------------|----------------|---------------|
| | <i>Average</i> | <i>Highest</i> | <i>Lowest</i> | <i>Average</i> | <i>Highest</i> | <i>Lowest</i> |
| Inflation (within year) | 2.3 | 2.7 | 2.0 | 2.7 | 3.1 | 2.0 |
| Inflation (year-on-year) | 2.1 | 2.3 | 2.0 | 2.6 | 2.9 | 2.0 |
| GDP growth | 2.4 | 2.6 | 2.0 | 3.3 | 3.7 | 3.0 |
| | <i>One year ahead</i> | | | <i>Two years ahead</i> | | |
| The effective exchange rate index of foreign currencies vis-à-vis króna (Dec. 31, 1991=100)... | 121.3 | 123.5 | 120.0 | 119.7 | 125.0 | 115.0 |
| Central Bank policy interest rate | 6.3 | 6.8 | 5.8 | 7.1 | 7.4 | 6.8 |
| Nominal long-term interest rate ² | 6.9 | 7.5 | 6.4 | 7.3 | 7.8 | 6.6 |
| Real long-term interest rate ³ | 4.3 | 4.8 | 4.0 | 4.4 | 5.1 | 3.8 |
| ICEX-15 share price index (12-month change) ... | 6.1 | 7.0 | 4.5 | 11.4 | 20.0 | 5.0 |
| Housing prices (12-month change) | 6.4 | 10.0 | 3.0 | 6.8 | 12.0 | 3.0 |

1. 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 Economic Consulting and Forecasting, Íslandsbanki, Kaupþing Búnaðarbanki, Landsbanki and SPRON (Reykjavík and Environs Savings Bank). 2. Based on yield in market makers' bids on non-indexed T-notes (RIKB 07 0209). 3. Based on yield in market makers' bids on indexed housing bonds (IBH 41 0315). *Source:* Central Bank of Iceland.

are not engaged in fishing operations as well. Cod for processing, for example, was priced 4% higher over the first four months of 2003 than a year before, at the same time as demersal fish prices fell in export markets and the króna strengthened. Prices of shrimp for processing over the first four months of 2003 decreased by only 4% from the same period the year before, which is far less than the fall in product prices in króna terms. This is a structural problem within the fisheries sector and exchange rate policy cannot rectify it. High fuel prices in Q1 also had a negative effect on the profitability of fishing operations.

All the above shows that the fisheries sector is not beset by a single problem which the buoyant króna can

be identified as causing. Admittedly the stronger exchange rate has squeezed fisheries profitability since last year, when it was at one of its highest levels. Nonetheless the problem lies in revenue imbalances within the fisheries sector as a whole and specific problems in various segments such as the shrimp industry which cannot be blamed on exchange rate developments. The flexibility of the fisheries sector will also determine how it fares – for example, in the success of new market penetration, exchange rate hedging and product development. It may be added that fisheries companies are now generally much better equipped to tackle temporary setbacks than they have been in the past.