

## Box 4 Financial market analysts' assessments of the economic outlook

The accompanying table shows the forecasts made in October by a number of financial market analysts. Analysts were given a free choice as to whether to include investments on the Norðurál smelter in their forecasts, and three of the five opted to do so.

The forecast for inflation over 2003 is unchanged from July and almost identical to the Central Bank's forecast of 2.2%, after having been revised upwards since the summer in light of global inflation developments and changes in the oil markets. Forecasts for 2004 show a greater divergence, with the Bank forecasting 2.1% inflation over the year and market participants 2.8%, which is above the Bank's target. The Bank also forecasts lower average year-on-year inflation, but the difference is slight.

As usual, analysts were also asked about the outlook for other key economic aggregates. Their growth forecasts have been revised upwards since July and for both 2003 and 2004 their current forecasts are somewhat higher than that of the Bank, which has in fact been revised downwards after excluding the Norðurál smelter expansion. The Bank forecasts output growth of 2% this year, but financial analysts 2.9%. The corresponding figures for 2004 are 3% and 3.9% respectively.

The difference of opinion among financial companies about growth prospects has widened since the summer, but this is explained by the fact that some of them take the Norðurál expansion into account while others do not. The forecast range has widened because of both a rise in the highest value – especially for 2003 – and a drop in the lowest value.

On average, the respondents expect little change in the exchange rate of the króna for the next 1-2 years, forecasting an index value in the range 120-125 and inching upwards as the period progresses. There is a closer consensus on exchange rate developments than in the past.

As in the past three surveys, the respondents expect the Central Bank to raise its policy rate soon. They forecast a policy rate of 6.4% in October next year and 7.4% a year thereafter.

Analysts expect equity prices to follow a trend broadly in line with the surveys in April in July. 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 all forecast continuing price increases, both one and two years ahead.

Overview of forecasts by financial market analysts<sup>1</sup>

	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	2.3	2.2	2.8	3.1	2.5
Inflation (year-on-year) .....	2.1	2.2	2.0	2.5	2.8	2.3
GDP growth .....	2.9	4.2	2.5	3.9	4.3	3.5
	<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)...	123.0	125.0	120.0	125.0	125.0	120.0
Central Bank policy interest rate .....	6.4	6.8	6.2	7.4	7.6	6.8
Nominal long-term interest rate <sup>2</sup> .....	7.2	7.5	6.8	7.7	8.3	7.3
Real long-term interest rate <sup>3</sup> .....	4.2	4.7	3.9	4.4	5.0	3.7
ICEX-15 share price index (12-month change) ...	6.0	15.0	0.0	12.4	25.0	5.0
Housing prices (12-month change) .....	5.5	10.0	3.0	8.0	10.0	5.0

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 (Reykjavik 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.