

Box 2 Financial market analysts' assessments of the economic outlook

The accompanying table shows the forecasts of financial market analysts in the latter half of February. There is a slight difference in their assumptions, since four of the five analysts surveyed included the Norðurál aluminium smelter expansion in their forecasts, but one did not.

Presented first is the analysts' evaluation of the inflation outlook for this year and 2005. The forecast for inflation over 2004 is lower than in the last survey (made in October and published in *Monetary Bulletin* in November 2003) and is virtually identical to the Central Bank's inflation forecast, which is unchanged since then at 2.1%. Analysts are unanimous that the rate of inflation will accelerate next year, and at 2.9% their forecast is again almost the same as the Bank's 2.8%. They forecast inflation above the inflation target in 2005. The Bank expects rather lower average year-on-year inflation in 2004, at 1.8% compared with 2.3%. There is little divergence between the forecasts for 2005, when an increase is expected.

As usual, analysts were also asked about the outlook for other key economic aggregates. They forecast marginally higher growth for 2004 than the Bank,

which has in fact made an upward revision with the inclusion of the Norðurál smelter expansion, an assumption also made by most forecasters. The Bank forecasts output growth of 3½% this year, but financial analysts 3.8%. Forecasts for 2005 are very close, with the Bank projecting GDP growth of 4½% and the financial analysts 4.6%.

On average, the respondents expect the exchange rate of the króna to remain almost unchanged twelve months ahead, forecasting an index value of 122. There is less consensus on exchange rate developments than in the October forecast. Two years ahead, they broadly expect the króna to weaken, but forecast index values ranging from a high of 133 to a low of 119.

As in several past surveys, the respondents expect the Central Bank to raise its policy interest rate soon. They forecast a policy rate of 6.4% around the same time next year and 7% two years ahead.

All the analysts expect some rise in equity prices over the next two years, but their expectations vary widely. 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 analysts¹

	2004			2005		
	Average	Lowest	Highest	Average	Lowest	Highest
Inflation (within year)	2.2	2.0	2.5	2.9	2.5	3.3
Inflation (year-on-year)	2.3	2.0	2.8	2.7	2.4	3.0
GDP growth	3.8	2.0	4.3	4.6	4.0	5.2
	One year ahead			Two years ahead		
The effective exchange rate index of foreign currencies vis-à-vis króna (Dec. 31, 1991=100) ...	122	119	126	126	119	133
Central Bank policy interest rate	6.1	5.8	6.5	7.0	6.3	8.3
Nominal long-term interest rate ²	7.4	6.5	8.0	7.7	6.5	8.5
Real long-term interest rate ³	3.8	3.5	4.4	4.0	3.6	4.4
ICEX-15 share price index (12-month change)	8.4	5.0	10.0	9.9	3.0	24.3
Housing prices (12-month change)	4.1	2.5	5.0	7.2	2.5	10.3

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, KB banki, 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 authority bonds (IBN 38 0101). Source: Central Bank of Iceland.