

Box 4 Financial market analysts' assessments of the economic outlook

The accompanying table shows the forecasts of financial market analysts around the middle of May. Participants in the survey were the research departments of Íslandsbanki, KB banki and Landsbanki, and Economic Consulting and Forecasting.

Analysts forecast 2.9% inflation over 2004, which is a higher rate than in the last survey conducted in late

February, but below the 3.9% rate in the Bank's current forecast. Opinions are divided about inflation in 2005, but on average the analysts forecast a rate of 2.9%, which is broadly in line with the Bank's latest forecast of 2.5%. In terms of average year-on-year price changes, analysts are fairly unanimous that the rate will be close to or above the inflation target. The Bank fore-

Overview of forecasts by financial market analysts¹

	2004			2005		
	<i>Average</i>	<i>Lowest</i>	<i>Highest</i>	<i>Average</i>	<i>Lowest</i>	<i>Highest</i>
Inflation (within year)	2.9	2.5	3.3	2.9	2.3	3.2
Inflation (year-on-year)	2.8	2.6	2.9	2.9	2.6	3.0
GDP growth	3.9	3.7	4.3	4.7	4.2	5.0
	One year ahead			Two years ahead		
Effective exchange rate of foreign currencies vis-à-vis the króna (Dec. 31, 1991=100)	124	122	128	124	120	133
Central Bank policy interest rate	6.6	6.2	7.0	7.4	7.0	7.5
Nominal long-term interest rate ²	7.8	7.5	8.0	7.9	7.3	8.5
Real long-term interest rate ³	3.8	3.4	4.0	3.9	3.3	4.5
ICEX-15 share price index (12-month change)	4.3	0.0	10.0	13.8	10.0	20.0
Housing prices (12-month change)	5.3	4.0	7.0	8.0	0.0	12.0

1. The table shows percentage changes between periods, except for interest rates (percentages) and the exchange rate index for foreign currencies (index points). Participants in the survey were the research departments of Íslandsbanki, KB banki and Landsbanki, and Economic Consulting and Forecasting.

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.

casts somewhat higher inflation year-on-year, at just above 3% in both 2004 and 2005. In comparing these figures it should be borne in mind that the Bank's forecast is based on an unchanged policy interest rate while analysts assume that it will be raised, which other things being equal will lead to lower inflation. The policy interest rate will of course rise over the forecast horizon, making the Bank's forecast less likely to hold.

Analysts have broadly the same outlook for growth. They forecast marginally less growth (3.9% on average) for 2004 than the Bank, which since March has revised its forecast upwards by three-quarters of a percentage point to 4¼%. For 2005, the financial analysts forecast growth of almost 5% and the Bank 4½%.

On average, respondents expect little change in the exchange rate of the króna twelve months ahead, forecasting an index value of 124. This represents a minor weakening from their previous forecasts in February, reflecting exchange rate developments since that time. Two years ahead, they expect the króna to remain unchanged on average, but differ about whether a minor weakening or strengthening will take place, forecasting index values ranging from a high of 133 to a low of 120.

Analysts are unanimous in expecting the Central Bank to continue to raise its policy interest rate. They all forecast a policy rate in the range 7-7.5% two years ahead, but disagree about how quickly the Central

Bank will announce its hikes. One year ahead their forecast range is much wider, from 6.2% to 7%.

Equity prices are expected to rise by an average of just over 4% over the coming twelve months, but forecasts differ, ranging from zero to 10%. All forecasters

expect equity price increases of 10-20% on a two-year horizon. Likewise, they all forecast that real estate prices will continue to climb over the next twelve months, but disagree about the scenario two years ahead.