

Box 2 Financial market analysts' assessments of the economic outlook

The accompanying table shows the economic forecasts of financial market analysts in the second half of August. Participants in the survey were the research departments of Íslandsbanki, KB banki and Landsbanki, and Economic Consulting and Forecasting.

On average, respondents foresee a very slight weakening of the króna over the next twelve months, with an exchange rate index of just over 123, marginally above its recent value. Opinions are more divided on this point than in the May survey, and also over a longer horizon.

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)	3.5	3.4	3.6	3.2	3.0	3.5
Inflation (year-on-year)	3.2	3.0	3.7	3.2	2.9	3.3
GDP growth	4.3	3.9	4.6	4.7	4.3	5.0
	<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) ...	123.3	120.0	128.0	123.8	120.0	133.0
Central Bank policy interest rate	7.8	7.5	8.0	7.8	7.5	8.0
Nominal long-term interest rate ²	7.8	7.5	8.0	7.5	7.0	8.5
Real long-term interest rate ³	3.8	3.5	4.2	3.7	3.5	4.0
ICEX-15 share price index (12-month change)	12.6	5.0	18.0	18.0	10.3	35.0
Housing prices (12-month change)	7.5	5.0	10.0	11.3	10.0	15.0

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.

Analysts were very close in their forecasts for inflation over 2004, which is 3.5% on average. This is higher than their forecasts in the last survey conducted in May, and much higher than at the beginning of this year, which is hardly surprising in light of housing and oil price hikes so far in 2004. They are also unanimous about a slight slowing of inflation in 2005. These forecasts are above the Central Bank's inflation target, but within the upper tolerance limit. Inflation measured between annual averages is quite close to the rate over the year, as the table shows, but the forecast range is wider.

Analysts have revised their growth prospects for 2004 upwards since May, but their forecasts for next year are unchanged. The average forecast is for 4.3% growth this year and 4.7% in 2005, with broadly the same deviation towards the lowest and highest values.

The Central Bank's policy rate is currently 6.25% and analysts are unanimous that it will be raised in the next few months. On average they expect it to reach 7.8% twelve months ahead, and remain there 24 months hence.

All respondents in the survey expect some rise in equity market prices over the next 12 and 24 months, even though the ICEX-15 index has already gained more than 60% so far this year and is now at a historical high. Expectations differ widely, however, as the lowest and highest values show, but the average forecast rise is 12% over a twelve-month horizon and 18% over 24 months. Analysts disagree about real estate price developments, but all forecast ongoing increases both one and two years ahead.