

Box 5 Financial market analysts' assessments of the economic outlook

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

Analysts have been revising their inflation forecasts for 2004 and 2005 upwards since the beginning of this year, in pace with the development of the CPI over this period. They expect an average rate of inflation of 3.7% over 2004, and 3.2% year-on-year. The Central Bank's forecast is virtually the same: 3.8% over the year and 3.2% year-on-year. There is more divergence in assessments for 2005. The Central Bank forecasts lower inflation in 2005, at 3.0%, compared with the analysts' average of 3.5%, while their year-on-year forecasts are broadly the same. All forecasts are above the Central Bank's inflation target.

The economic growth outlook has improved since August, in the analysts' view. They foresee average GDP growth of 5.0% this year and 5.1% in 2005, but with a considerable difference between the highest and

lowest forecast values. The Central Bank forecasts a higher rate of GDP growth, at 5.4% this year and 6.1% in 2005.

On average, respondents forecast an exchange rate index of 123 twelve months ahead, implying a slight depreciation of the króna from its recent value. Two years ahead they forecast a further slide to an exchange rate index of 128.

Although the Central Bank raised its policy interest rate to 7.25% on November 1, analysts expect further hikes in the medium term, forecasting a policy rate of 8.6% one year ahead and the same rate two years hence. As the range of figures in the table shows, opinions are divided about these developments.

The same applies to future equity prices, especially two years ahead. One forecaster expects a sizeable drop and the others predict rises – although to varying degrees. Also, financial market analysts expect real estate prices to continue trending upwards in the medium term.

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)	3.7	3.5	3.9	3.5	2.7	4.9
Inflation (year-on-year)	3.2	3.1	3.3	3.5	3.1	4.4
GDP growth	5.0	3.9	6.2	5.1	4.3	6.5
	<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	120.0	128.0	128.0	123.0	133.0
Central Bank policy interest rate	8.6	8.5	9.0	8.6	8.0	9.5
Nominal long-term interest rate ²	8.2	8.0	8.2	7.5	7.0	7.7
Real long-term interest rate ³	3.8	3.5	4.2	3.6	3.2	3.9
ICEX-15 share price index (12-month change)	2.5	-20.0	20.0	11.8	-10.0	35.0
Housing prices (12-month change)	8.8	5.0	10.0	12.3	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 13 0517). 3. Based on yield in market makers' bids on indexed HFF bonds (HFF 44 150644). *Source:* Central Bank of Iceland.