

The accompanying table shows the economic forecasts of financial market analysts at the end of February. Participants in the survey were the research departments of Íslandsbanki, KB banki, Landsbanki, and Economic Consulting and Forecasting. An immediately striking feature of the forecasts is the wide divergence between the highest and lowest values, in particular for inflation and GDP growth but also for the exchange rate index and ICEX-15 equity index. There is more disagreement than often before about economic developments over the next two years.

Analysts have revised their inflation forecasts for 2005 and 2006 upwards in line with the recent development of the CPI, which has been characterised by a surge in housing prices. They expect an average rate of inflation of 4.1% over 2005, and 4% year-on-year – i.e. at or above the upper tolerance limit of the inflation target. The Central Bank forecasts a much lower rate of inflation, but it should be underlined that it assumes an unchanged policy interest rate and exchange rate over the forecast horizon. The Central Bank forecasts 2.6% inflation over 2005, and 3.6% year-on-year. Respondents differ markedly about the inflation outlook for 2006. They forecast a sharp rise in inflation over 2006, at 5.9%, and 4.9% year-on-year. In contrast, the Central Bank forecasts 3.1% over 2006 and an average of 2.7% year-on-year.

Forecasters are more upbeat about GDP growth than they were in November, expecting 5.8% growth in 2005 and 4.3% next year. As before there is a considerable difference between the highest and lowest forecast values. The Central Bank's GDP growth forecast is rather higher, at 6.4% this year and 6.1% in 2006.

On average, respondents forecast an exchange rate index of 122 twelve months ahead, implying a sizeable depreciation of the króna from its value in recent weeks – the exchange rate index has fallen steadily (i.e. the króna has strengthened) since the beginning of December. Two years ahead they forecast that

Box 3

Financial market analysts' assessments of the economic outlook

Overview of forecasts by financial market analysts¹

	2005			2006		
	Average	Lowest	Highest	Average	Lowest	Highest
Inflation (within year)	4.1	3.2	5.0	5.9	4.5	8.2
Inflation (year-on-year)	4.0	3.5	4.8	4.9	3.5	7.3
GDP growth	5.8	4.5	6.5	4.3	2.5	5.5
	<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)	122.0	115.0	130.0	130.6	125.0	137.0
Central Bank policy interest rate	9.9	9.8	10.0	8.8	7.0	10.0
Nominal long-term interest rate ²	7.9	7.5	8.8	7.3	7.0	7.8
Real long-term interest rate ³	3.5	3.2	3.7	3.5	3.3	4.0
ICEX-15 share price index (12-month change)	5.0	-15.0	20.0	10.7	-19.3	29.0
Housing prices (12-month change)	13.8	10.0	20.0	16.5	5.0	26.0

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 HFF bonds (HFF 150644).

Source: Central Bank of Iceland.

almost unanimously forecasting a policy rate of 9.9% one year ahead, then expect a reduction to 8.8% two years hence.

Opinions are sharply divided over future equity prices. Two forecasters expect them to rise next year, while one predicts the status quo and one a decrease. Forecasts two years ahead are even more divergent.

As in recent surveys, forecasters agree that real estate prices will rise both one year and two years ahead.
