

The accompanying table shows the economic forecasts of financial market analysts at the beginning of May. Participants in the survey were the research departments of Íslandsbanki, Kaupthing Bank, Landsbanki, and Economic Consulting and Forecasting.

After disagreeing quite sharply in the February survey about probable economic developments, analysts are now in closer agreement on the scenario over the next two years. They are generally more upbeat, forecasting lower inflation and a higher rate of GDP growth.

Analysts expect average inflation of 3.8% over 2005, and a virtually identical rate year-on-year – i.e. just within the upper tolerance limit of the inflation target. The Central Bank forecasts a somewhat lower rate of inflation for the year, but it should be underlined that it assumes an unchanged policy interest rate and exchange rate over the forecast horizon. The Central Bank forecasts 3% inflation over 2005 and 3.6% year-on-year. Respondents differ markedly about the inflation outlook for 2006. On average they forecast a considerable rise over 2006, at 5.3%, and 4.9% year-on-year. In contrast, the Central Bank forecasts 3.6% over 2006 and an average of 3.2% year-on-year.

Respondents have revised their forecasts for GDP growth upwards since November 2004, with less difference between the highest and lowest forecast values. On average they expect 6.2% growth in 2005 and 5.3% next year. The Central Bank's GDP growth forecast is rather higher at 6.6% this year and 6.2% 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 risen somewhat (i.e. the króna has weakened) in recent weeks after dipping to just over 106 in the second half of March. Subsequently they forecast a further slide, bringing the exchange rate index down to just above 130 after two years. This is very close to their exchange rate forecasts in February.

The Central Bank raised its policy interest rate to 9% on March 29. Analysts expect further hikes in the coming months, forecasting a policy rate of almost 10% one year ahead and little change in the following year.

Asset prices have soared so far this year but forecasters expect the rises to slow down. Opinions are sharply divided, however, with one analyst forecasting a decrease one year ahead and a further decline two years ahead.

As in recent surveys, forecasters agree that real estate prices will rise both one year and two years ahead – but at a slower rate than recently, when housing prices have surged over a very short period.

Box 4

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)	3.8	3.0	4.5	5.3	4.0	7.0
Inflation (year-on-year)	3.7	3.5	4.0	4.9	3.9	6.4
GDP growth	6.2	6.0	6.5	5.3	5.0	5.5
	<i>One year ahead</i>			<i>Two years ahead</i>		
Effective exchange rate index of foreign currencies vis-à-vis the króna (Dec. 31, 1991=100)	122.5	115.0	133.0	129.5	127.0	133.0
Central Bank policy interest rate	9.8	9.3	10.0	8.6	7.3	10.0
Nominal long-term interest rate ²	7.6	7.5	7.6	7.2	7.0	7.4
Real long-term interest rate ³	3.6	3.2	4.0	3.5	3.3	3.7
ICEX-15 share price index (12-month change)	6.8	-15.0	15.0	15.2	-19.3	35.0
Housing prices (12-month change)	10.9	7.5	15.0	14.6	7.5	20.8

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, Kaupthing Bank 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 15 0644).

Source: Central Bank of Iceland.