

The accompanying table shows the survey responses of financial market analysts in mid-March. Participants in the survey were the research departments of Glitnir (previously Íslandsbanki), Kaupthing Bank and Landsbanki, and Economic Consulting and Forecasting.

In addition to the information presented in the table, analysts were also asked to give an assessment of the Central Bank's policy interest rate path, i.e. on the timing of the policy rate cycle's peak and trough within the forecast horizon, and at what values.

The main changes from the survey in November is that analysts have revised their forecast for output growth downwards for this year but upwards for next year, as well as forecasting higher inflation this year and broadly the same rate in 2007, and a higher policy rate and a weaker króna.

Analysts expect higher inflation than in the Central Bank's baseline forecast

As in both September and November, analysts expect inflation to remain some way above the 2.5% target across the forecast horizon. Their projection for year-on-year inflation in 2006 has gone up considerably since November to 5.4%, somewhat above the Central Bank's forecast of 4.9%. In 2007, forecasters expect inflation to decline to 4.6%, while the Central Bank's baseline forecast is markedly higher at almost 6%. It should be underlined that the Central Bank assumes an unchanged policy interest rate and exchange rate over the forecast horizon, while the analysts do not. The Central Bank's alternative scenario, based on variable policy rate and exchange rate paths, gives a higher rate of inflation next year than the baseline forecast, and thus diverges even more strongly from the analysts' forecasts.

Growth outlook has changed

Analysts' forecasts for output growth have changed sharply since November – downwards for 2006 but upwards for 2007. Individual forecasts diverge quite widely, especially for 2007. On average, market analysts expect 4.6% growth this year and 2.5% in 2007. The Central Bank's output growth forecast is more pessimistic, at 4.2% in the current year but only 0.4% in 2007.

Forecasters expect an ongoing depreciation of the króna ...

Survey respondents have revised their forecasts for exchange rate developments sharply downwards since November after the recent depreciation of the króna and now expect it to be much weaker both one and two years ahead. They foresee an exchange rate index of 123 twelve months ahead and broadly the same value after two years. The exchange rate index stood at just over 116 on March 17. According to the Central Bank's alternative scenario, the exchange rate index will have risen past 127 two years ahead.

... policy rate hikes ...

The Central Bank has made two recent rises in its policy interest rate, by 0.25 percentage points each on December 2, 2005 and January 26. The policy interest rate is now 10.75%. Analysts expect further hikes and have upped their forecasts since November. Now they forecast an average rate of more than 12% one year ahead, moving back to just below 9% after two years. However, opinions are noticeably divided, especially over a two-year horizon. Analysts were also asked to forecast the peak and trough of the policy rate over the next two years. They are very much at odds about the peak, offering values in the range 11.25-14.75%. However, the majority expect the policy rate to peak in the second half of this year and even more

Box VIII-2

Financial market analysts' assessments of the economic outlook

forecast a low in the beginning of 2008 at around 8%. One respondent stood out by predicting that the policy rate is currently at its lowest value for the next two years and will peak in 2007.

... and slower asset price rises than often before

On March 15, the ICEX-15 share index stood at 6,154, which was 18% higher than when the analysts last made their forecasts in November. They do not regard this pace of growth as sustainable and forecast a slowdown. However, outlooks differ. One forecaster believes that equity prices will drop both one and two years ahead.

Finally, respondents expected real estate prices to increase by less than ever before in these surveys, which is in line with market developments. However, none expects real estate prices to decline.

Overview of forecasts by financial market analysts¹

	2006			2007		
	Average	Lowest	Highest	Average	Lowest	Highest
Inflation (within year)	6.1	5.2	7.0	4.1	3.2	5.1
Inflation (year-on-year)	5.4	4.7	5.8	4.6	2.9	5.6
GDP growth	4.6	4.0	5.1	2.5	0.8	3.5
	One year ahead			Two years ahead		
	Average	Lowest	Highest	Average	Lowest	Highest
Inflation	5.8	5.1	6.7	3.9	2.9	5.0
Effective exchange rate index of foreign currencies vis-à-vis the króna (Dec. 31, 1991=100)	123.4	120.0	127.5	122.8	116.0	125.0
Central Bank policy interest rate	12.1	10.8	14.5	8.7	7.0	12.0
Nominal long-term interest rate ²	8.1	7.0	9.5	7.4	6.4	8.5
Real long-term interest rate ³	4.1	3.6	5.2	3.8	3.4	4.6
ICEX-15 share price index (12-month change)	6,594	5,500	7,066	7,154	5,200	8,295
Housing prices (12-month change)	5.5	2.0	10.0	6.6	4.0	10.0

1. The table shows percentage changes between periods, except for interest rates (percentages) and the foreign exchange rate index and ICEX-15 index (index points). Participants in the survey were the research departments of Glitnir (previously named 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 150644).
Source: Central Bank of Iceland.