

The accompanying table shows the survey responses of financial market analysts in mid-June. 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 what the Central Bank's next policy rate decision on July 6 would be.

The main changes from the survey in March are that analysts have revised their forecast for output growth downwards, especially for next year, with a much higher rate of inflation in both 2006 and 2007, and a marginally higher policy rate and a weaker króna across the forecast horizon.

Analysts expect inflation to surge across the forecast horizon

Analysts forecast year-on-year inflation in 2006 of roughly 7%, significantly above their expectations in the previous survey in March. The Central Bank's baseline forecast, which is now based on analysts' forecasts for the medium-term policy rate path and an exchange rate path calculated from it using the Central Bank's macroeconomic model, projects inflation of 8% over 2006. For 2007 the divergence between the analysts' forecasts and the baseline forecast is even wider. Survey respondents expect an inflation rate of just under 6% while the Central Bank's baseline forecast is much higher, at almost 10%. Two years ahead, analysts also expect somewhat lower inflation (just over 3%) than the Central Bank's baseline forecast of almost 7%. However, in the Central Bank's alternative scenario with an endogenous monetary policy rule inflation will be 5½% two years ahead.

Growth outlook for 2007 has changed

The analysts' forecast for output growth for 2006 is broadly unchanged since March. They are quite unanimous about the growth outlook, apart from one who expects a contraction next year. On average, market analysts expect 4½% growth this year and 1% in 2007, which is close to the Central Bank's baseline forecast.

Forecasters expect an ongoing depreciation of the króna ...

There has been a slight shift since March in the survey respondents' forecasts of the exchange rate, particularly 2006. The króna has continued to depreciate in recent months and they now forecast a correspondingly lower value. They foresee an exchange rate index of 130 twelve months ahead but a small appreciation a year later. Opinions are rather divided about exchange rate developments, especially for next year.

... a rise in the Central Bank policy rate ...

The Central Bank has raised its policy interest rate twice in the past few months, on March 30 and May 18, 2006. The policy interest rate is now 12.25%. Analysts have revised their March forecasts marginally upwards for one year ahead, but left their forecast two years ahead unchanged. On average, they expect the policy rate to be 12½% one year ahead, dropping back to around 9% two years hence. They were also asked to forecast the next policy rate decision, and the peak and trough of the policy rate over the next two years. Most forecast a hike of 0.5 percentage points on July 6, but one expects 0.75 percentage points. Opinions about the peak are quite close, in the range 13-14.5%. Most expect the policy rate to peak in the second half of this year with a low in 2008 in the range 7.5-9%.

Box VIII-2

Financial market analysts' assessments of the economic outlook

... and a sharp slowdown in asset price rises

On June 15, the ICEX-15 share index stood at 5,413, which was 12% lower than when the analysts last made their forecasts in March. On the present occasion they expect considerably less rise in equity prices over the forecast horizon. 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 in previous surveys, which is in line with indications that the market is cooling. One forecaster expects real estate prices to decline both one and two years ahead.

Overview of forecasts by financial market analysts¹

	2006		2007			
	<i>Average</i>	<i>Lowest</i>	<i>Average</i>	<i>Lowest</i>	<i>Average</i>	<i>Lowest</i>
Inflation (year-on-year)	7.1	6.7	7.3	5.9	5.0	6.7
GDP growth	4.5	4.0	5.1	1.0	-0.1	1.7
	<i>One year ahead</i>		<i>Two years ahead</i>			
Inflation	5.8	4.7	7.1	3.2	2.4	4.5
Effective exchange rate index of foreign currencies vis-à-vis the króna (Dec, 31. 1991=100)	130	124	135	125	115	127
Central Bank policy interest rate	12.4	11.3	14.5	9.1	7.5	12.0
Nominal long-term interest rate ²	8.5	7.6	9.5	7.6	6.6	8.5
Real long-term interest rate ³	4.1	3.8	4.5	4.0	3.5	4.5
ICEX-15 share price index (12-month change)	5,811	4,500	6,500	6,556	4,000	7,924
Housing prices (12-month change)	1.9	-5.0	5.0	2.0	-10.0	8.0

1. The table shows percentage changes between periods, except for interest rates (percentages) and the foreign exchange rate index (index points) 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.