

Plans to construct a new aluminium smelter at Helgúvík together with the necessary power plant have recently been subject to enormous uncertainty on a number of fronts: funding, access to harnessable geothermal energy, ownership, and permits from the authorities. All of these factors have contributed to repeated delays in the project. In this forecast, it is assumed that the first phase of the Helgúvík smelter would be delayed still further, as would energy procurement and construction of transmission lines. It is assumed that construction will be delayed by one year but will proceed in accordance with the developers' plans in 2012. As Chart 1 illustrates, the investment has been delayed a number of times, and the scale of the project has contracted during the forecast horizon.

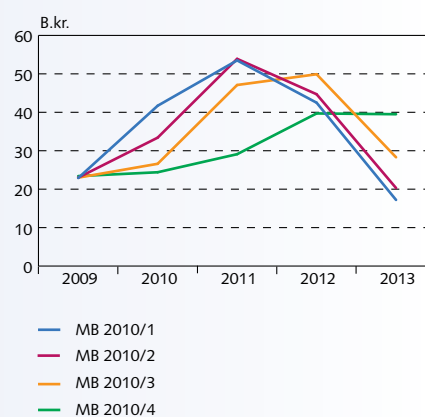
As a consequence, investment in heavy industry will rise by only 4% in 2010, as opposed to the nearly 14% presumed in the August forecast. The difference will be even greater in 2011, when investment in heavy industry will rise by roughly 19% instead of the previously assumed 77%. The overall investment scenario changes in that development is distributed more evenly over the next three years, with investment still peaking in 2012 but at a lower level than in the last forecast. In 2013, however, the investment level will be higher than was assumed in August. Incorporating the August heavy industry profile into the current baseline forecast gives about 0.2 percentage points higher GDP growth for 2010, and about 1 percentage point higher growth for 2011, than in the current baseline forecast. Growth would be stronger, however, in 2012-13, and in 2011 and 2012, unemployment would be 0.7 percentage points lower than in the current baseline forecast, whereas it would be broadly in line with the forecast in 2013. Thus the delay in investment in heavy industry in the current baseline forecast compared to the August forecast does not imply a reduction in the medium-term growth outlook, but it will delay recovery.

The baseline forecast presented here continues to assume that the planned projects will come to fruition; however, it is expected that they will be postponed by one year and that only one of four construction phases will be completed. This assumption is subject to considerable uncertainty, however. As is described in the alternative scenario in Section I, economic developments over the next three years would be affected if these projects did not materialise. The Helgúvík investments also have a proportionally greater impact on total gross capital formation and economic developments at the current juncture, when domestic investment level is at a low ebb, than they would during a period of greater economic activity.

Box IV-1

Assumptions concerning investment in heavy industry in the Central Bank's baseline forecasts

Investment in heavy industry 2009-2013
At constant prices



Sources: Statistics Iceland, Central Bank of Iceland.