

Appendix 2

Financial market analysts' assessments of the economic outlook

For each issue of *Monetary Bulletin*, the Central Bank surveys financial market analysts' assessments of the economic outlook. The latest survey was conducted in mid-October, and participants were Askar Capital and the research departments of Glitnir, Kaupthing Bank and Landsbanki. The main changes from the previous survey in June are that analysts forecast somewhat higher inflation and a higher policy rate along the forecast horizon. For 2007, they forecast more output growth but slightly less growth in the next two years.

Outlook for higher inflation in the short-term

The inflation outlook across the forecast horizon has deteriorated since last summer. When the year is drawing to a close, the analysts forecast year-on-year inflation in 2007 of almost 5%, $\frac{1}{2}$ percentage point higher than in the previous survey. On average they forecast 4.2% year-on-year inflation in 2008, as in the Central Bank's baseline forecast. In the baseline forecast, the inflation target is attained in 2009, when year-on-year inflation measures 2.7%. The analysts expect on average, 3.2% inflation in 2009 and 2.8% inflation in 2010. Inflation is on target in 2010 in the Central Bank's baseline forecast. It should be noted that the monetary stance in the baseline forecast is considerably tighter in 2008 than the analysts forecast. One analyst, however, expects the inflation target to be attained next year because of a considerable drop in real estate prices.

Increasing output growth along the forecast horizon

Analysts have revised their June forecasts for growth in 2007 upwards to an average of 2.2%. They expect just over 2½% annual growth in the next two years, rising to over 3% in 2010. Interestingly, the projected disinflation along the forecast horizon mentioned above is supposed to occur without any unwinding of imbalances in the economy. The outlook for output growth diverges quite markedly from the Central Bank's baseline forecast, which projects almost 1% growth in 2007 and ½% in 2008. For 2009, a 2% contraction is expected, but output growth picks up in 2010 to almost 2½%. The analysts' forecasts for output growth in 2009 range from 1.5-4%. It should also be noted that, unlike the Central Bank the analysts assume further investments in the aluminium and power sectors.

Analysts forecast a relatively strong króna over the forecast horizon

In recent months the exchange rate of the króna has fluctuated considerably due to turmoil in financial markets. Analysts agree that the króna will weaken somewhat in 2008, and they forecast an average exchange rate index of almost 125 one year ahead. Most analysts ex-

pect the króna to appreciate subsequently and remain relatively strong over the forecast horizon. On average, they forecast an exchange rate index of 123 two years ahead. The exchange rate path in the Central Bank's baseline forecast differs markedly from this scenario. There the króna remains strong throughout next year and weakens in 2009. On average, the exchange rate index in the baseline forecast is almost 119 in 2008 and 127 in 2009.

Analysts expect the policy rate to be lowered in Q2/2008

The Central Bank's policy rate has been unchanged at 13.3% since December 2006. On average, analysts forecast a policy rate of 11½% one year ahead, 8½% two years ahead, and then almost unchanged thereafter throughout the forecast horizon. In the short term, their forecasts are broadly in line with the policy rate path published in *Monetary Bulletin* in July. All analysts expect the policy rate to be lowered in Q2/2008, whereas in the previous survey they projected a policy rate drop at the end of this year.

Diverging views of housing price developments

The analysts have somewhat diverging views of housing price developments. On average they forecast that real estate prices will increase by almost 2% over the next twelve months. However, one analyst projects an almost 9% decline in house prices, while another expects a 10% rise. Analysts' views of long-term developments also vary, but on average they forecast a year-on-year increase of 3% at the end of 2009.

Like the exchange rate of the króna, equity prices have fluctuated considerably in recent months. On average, analysts forecast an OMXI15 index value of almost 9,500 one year ahead and just over 11,000 two years ahead. The forecast is almost unchanged from the previous survey in June.

Overview of forecasts by financial market analysts¹

	2007			2008			2009			2010		
	Average	Lowest	Highest	Average	Lowest	Highest	Average	Lowest	Highest	Average	Lowest	Highest
Inflation (year-on-year)	4.9	4.9	5.0	4.2	3.5	4.5	3.2	2.7	3.7	2.8	2.2	3.8
GDP growth	2.2	1.5	2.7	2.6	2.0	3.7	2.7	1.5	4.0	3.3	2.1	4.0
	October 2008			October 2009			October 2010					
	Average	Lowest	Highest	Average	Lowest	Highest	Average	Lowest	Highest	Average	Lowest	Highest
Inflation	3.4	2.0	4.5	3.0	2.7	3.3	2.8	2.5	3.8			
Effective exchange rate index of foreign currencies vis-à-vis the króna (Dec. 31, 1991=100)	125	123	126	123	118	127	122	117	130			
Central Bank policy rate	11.5	10.8	12.0	8.5	8.0	9.5	8.5	7.0	9.5			
Nominal long-term interest rate ²	8.9	8.7	9.2	8.3	8.0	8.5	8.1	7.6	8.7			
Real long-term interest rate ³	4.3	4.2	4.5	4.0	3.8	4.2	4.1	4.0	4.3			
OMXI15 share price index	9,451	7,500	10,600	11,089	9,000	12,700	12,638	10,000	15,000			
House prices (12-month change)	1.7	-8.7	10.0	3.1	-0.5	6.0	2.9	0.0	7.0			

1. The table shows percentage changes between periods, except for interest rates (percentages), the foreign exchange rate index and OMXI15 index (index points). Participants in the survey were Askar Capital and the research departments of Glitnir, Kaupthing Bank and Landsbanki. 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 Housing Financing Fund bonds (HFF150644).

Source: Central Bank of Iceland.