

The baseline forecast published in this issue of *Monetary Bulletin* is not based on the assumption that further investment in aluminium smelter and power plant construction will take place over the forecast horizon, which extends until 2010. In general, the Central Bank has not included such development plans in the baseline forecast until they are virtually a certainty and the scope and time frame have been decided. The awareness that such plans are in existence can affect the risk profile for the inflation forecast, however. It is therefore appropriate at this point in time to discuss briefly the aluminium smelter and power plant construction projects that could begin in coming years and could make an impact during the forecast horizon.

There are plans or ideas to build three aluminium smelters in the next few years. The preparation for the Century Aluminum smelter (Norðurál-Helguvík sf.) at Helguvík, near Keflavík, is farthest along. New ideas concerning an expansion of the Alcan smelter in Straumsvík or the construction of a new Alcan facility are under scrutiny in the wake of the narrow defeat of the expansion proposal in the referendum held recently in Hafnarfjörður, and the future of the project is uncertain. Preparatory work on a new smelter at Bakki, near Húsavík, is also in the early stages, and it appears unlikely that construction will begin during the next few years. If that project goes ahead, it will fall outside the forecast horizon for this issue of *Monetary Bulletin*. The same applies to Alcan's plans for expansion or new construction.

In the first week of October, the National Planning Agency published its opinion on the environmental impact assessment for the Helguvík aluminium smelter. In that opinion, the NPA states that the proposed aluminium smelter will not have any significantly negative externalities or cause irrevocable damage to environment or society. However, the Agency expresses reservations concerning the environmental impact of related construction, such as that stemming from energy procurement, transmission lines, and harbour construction. The publication of this generally positive opinion has considerably enhanced the likelihood that the project will go forward, despite the stated reservations. The municipalities involved have yet to issue the required development and construction permits, however, and the proposed operations are dependent upon the granting of greenhouse gas emissions allocations. Energy procurement is guaranteed, at least in part, as Norðurál-Helguvík sf. has concluded a binding energy sales agreement with Suðurnes Regional Heating (Hitaveita Suðurnesja) and Reykjavík Energy (Orkuveita Reykjavíkur) for the delivery of sufficient energy to start up the first phase of the smelter. It is therefore likely that the Helguvík aluminium smelter will indeed be built. The project proposal allows for the construction, in two phases, of a smelter with annual production capacity of 250,000 mtpy. Construction of the first phase, 150,000 mtpy, is scheduled for mid-2008. Construction related to energy procurement could begin at roughly the same time. The estimated construction time for the first phase is approximately three years, but production could begin in mid-2010. The cost of smelter construction and energy procurement is roughly estimated at around 70-75 b.kr. While most of the cost of the first phase will be incurred in 2009 and 2010, it is expected that most or all of phase two construction will fall outside the forecast horizon.

The July 2007 issue of *Monetary Bulletin* presented an alternative scenario that takes into account the effects of the Helguvík smelter. The premises presented in that scenario have changed little since that time; thus the conclusions drawn there should give a fair indication of the possible impact of the Helguvík smelter on monetary policy in the event that the project proceeds.

Box IV-2

Further investment in aluminium and power plants?