

English translation of the Weekly Web Release



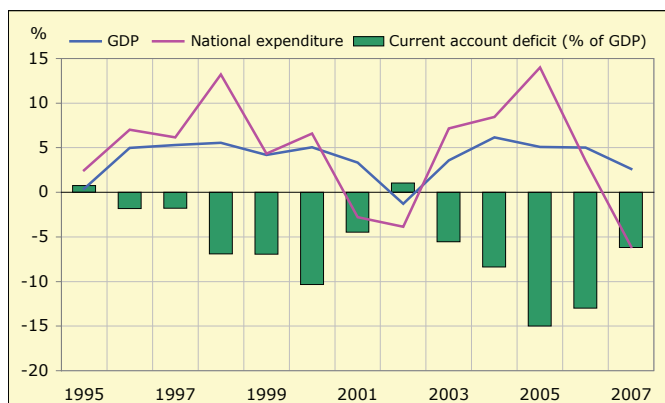
MINISTRY OF FINANCE IN ICELAND

January 26th, 2006

Revised forecast for the economy 2005-2007

The [revised forecast](#) is largely in line with the Ministry's October forecast. It is now expected that GDP growth will be around 5.1% in 2005 due to the robust growth of national expenditure, both private consumption and investment. On the other hand, increased imports and a reduction in the exports of marine products and delays in power project construction, had the effect of reducing GDP growth last year. This year GDP growth is expected to continue at a high rate, or around 5% when growth in national expenditures is expected to slow down and increased aluminum exports will begin to make their mark. A considerable reduction in activity is forecast for 2007 when the continuing recovery in foreign trade will propel GDP growth to around 2.6%. The current account deficit peaked last year when it reached 15% of GDP. It is expected to decline this year to 13% but to decrease rapidly in 2007 when it is forecast to be around 6% of GDP. Unemployment has decreased sharply and is expected to be 1.7% of the work force this year but will increase to 2.6% in 2007 when the economy slows down. The pressures in the economy will be high at the end of this year but are expected to decline rapidly when power plant construction is completed. Large increases in real estate prices led to an inflation rate of a around 4% in 2005 which is above the 2.5% inflation target of the Central Bank. According to the forecast, inflation will be 3.9% this year, when real estate prices are expected to peak and the exchange rate of the króna to decline. Inflation is forecast to remain around 4% in 2007 due to the continuing decline in the exchange rate. In the projections, no further power plant construction is assumed beyond what has already been approved. The major uncertainty in the forecast revolves around the króna exchange rate.

Growth of GDP and national expenditure and the current account deficit as a percentage of GDP 1995-2007

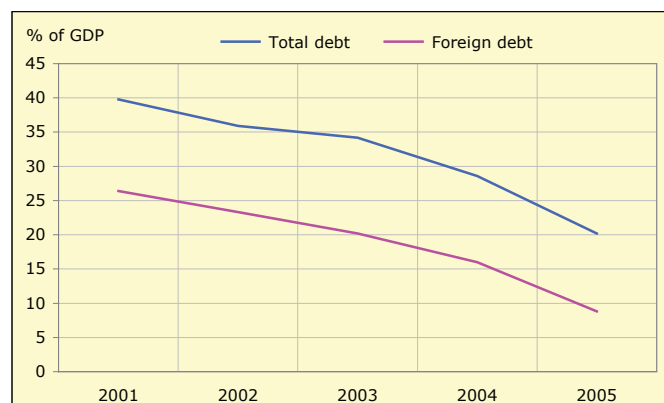


Central government debt

Central government debt as a percentage of GDP has been reduced by half over the past five years. In 2001 government debt reached 40% of GDP but in 2005 it was 20%. Over the same period, foreign debt decreased by 67% in the same period, from being around 26% of GDP in 2001 to less than 9% by the end of last year. The total debt of the central government was 196,5 billion krónur at the end of 2005, and thereof foreign debt amounted to 85.5 billion krónur.

Foreign debt has been repayed as circumstances have allowed with privatization proceeds and when debts have become due. The ratio of foreign debt to total debt has declined at a steady pace, from around 66% in 2001 to around 43% in 2005. The largest decline took place in 2005. During that year the króna strengthened against foreign currencies in addition to large loan repayments. Last year, the Ministry of Finance announced that foreign loans in the amount of 5 billion krónur would not

Central government debt as a percentage of GDP 2001-2005



be refinanced. By spring the amount had been increased by roughly 6 billion krónur and during the summer, by an additional 3 billion. Last september, increased purchases of currency in the interbank market by around 10 billion krónur was announced. In september, around half of the amount from the sale of Iceland Telecom was paid in foreign currencies, about 32 billion krónur. A decision was made to use all the amount to repay foreign debt. The repayment of foreign debt in 2005 was about 48 billion krónur, in addition to that the government had 9 billion krónur in foreign currency accounts at the end of 2005, which will be used to repay foreign debts in 2006. Foreign loans due to be repayed in 2006 amount to nearly 20 billion krónur and it is expected that they will not be refinanced. Therefore it is expected that the ratio of foreign debts to total debts of the central government will continue to decrease.

The forecasts of the Ministry of Finance for 2005

In appendix table 3 in the Ministry's [revised forecast](#), an overview of the development of the Ministry's forecasts can be found. It is interesting to look at the development for 2005 from when it was first forecast in October 2003 to the present day. GDP growth was first forecast to be 5.5%, but in January 2004 the forecast was reduced to 3.5%. The forecast rose to 5% again in May 2004 and remained at that level in October of that year. However, the growth rate was increased in 2005 and ended in 6% in October of that year. In the recently published revised forecast of the Ministry, GDP growth is expected to have been 5.1% last year. It is interesting to note the various reasons behind each forecast. At the start of 2004 there was still uncertainty about individual power projects in 2005, but that uncertainty diminished and forecasts on the growth of investment went up as the period progressed. By the end of 2005 it however became evident investment would grow at a slower pace because of delays in power plant construction. Due to increased activity and the Central Bank's interest rates hikes the exchange rate of the króna strengthened beyond expectation, which in turn stimulated private spending and imports. Also, the value of marine products decreased in 2005, which reduced exports as a whole during that year. In September 2005, Statistics Iceland introduced a new method, a yearly chain weighted method for estimating volume increases in national accounts instead of the previous base year methodology, but this change influenced the recorded economic development. The Ministry's forecast for GDP growth in 2005 over this period was mostly between 5% to 6%. As seen above there were numerous factors behind the evolving forecast. It is worth mentioning that the Ministry's inflation forecasts for 2005 started at 3% but increased gradually to about 4% in April 2005 and that forecast remained unchanged in October of that year. This figure was the final outcome. Statistics Iceland will publish estimates of economic growth for 2005 next March.

Treasury revenue, January-November		
12 month changes (%)	2003-2004	2004-2005
Total tax revenue	13.7	21.3
Income taxes	13.3	24.6
Social security taxes	10.3	16.4
Asset taxes	44.2	31.6
Indirect taxes	12.7	19.5
Total revenue	8.0	45.6

Treasury expenditure, January-November		
12 month changes (%)	2003-2004	2004-2005
Administration	8.2	4.8
Social affairs	9.2	6.4
Economic affairs	1.9	-2.0
Interest	-6.1	35.7
Other	6.0	63.4
Total expenditure	6.9	8.9

Treasury finances, January-November		
Million krónur	2004	2005
Cash from operations	-8,177	21,461
Net financial balance	9,557	70,420
Debt redemption	-32,321	-61,597
Gross borr. requirement	-29,639	3,691
Net borrowing	27,567	7,734
Overall cash balance	-2,072	11,425

Economic indicators		
12 month changes (%)	2004-2005	2005-2006
Inflation (Jan. '06)	4.0	4.4
Core inflation (Jan. '06)	4.0	4.3
Wage index (Dec. '05)	6.0	7.2
Total turnover (Jan. - Oct. '05)	10.0	9.5
Retail turnover (Jan. - Oct. '05)	4.5	5.2
Unemploy., % (Dec. '05)	2.7	1.7