

# English translation of the Weekly Web Release

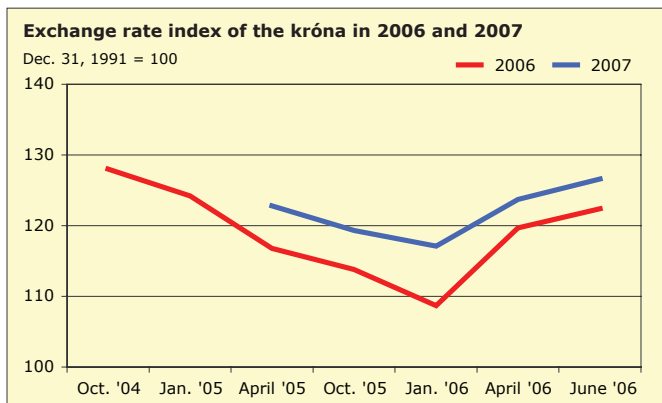
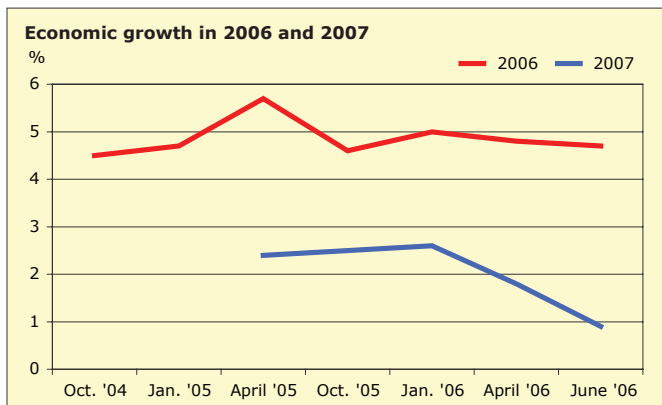


MINISTRY OF FINANCE IN ICELAND

June 22<sup>nd</sup> 2006

## A new forecast for the Icelandic economy

The Ministry of Finance released its [revised macroeconomic forecast](#) earlier this week, where it describes current economic developments and prospects up to 2008. The revision of the earlier forecast, published last April, has led to some changes for 2006 and 2007. Inflation this year is expected to be higher, 7.8 per cent instead of 5.9 per cent. This forecast is based on the assumption that wages in the general labour market will increase by an average of 4 per cent as of the beginning of July. The current account deficit this year is expected to reach 15.9 per cent of GDP instead of the earlier estimate of 14.4 per cent. Next year's GDP growth is forecast at 0.9 per cent instead of 1.8 per cent in the April forecast.



Since October 2004, the Ministry of Finance has issued a forecast for 2006 on seven different occasions. Another two forecasts will be issued before Statistics Iceland publishes its first national account estimates for 2006 in the spring of 2007. Five such forecasts have been issued for 2007 since April 2005. In reviewing the 2006 forecasts regarding economic growth, it turns out that they have been quite stable. The highest figure was forecast in April 2005, 5.7 per cent, and the lowest at the beginning of the forecast period, 4.5 per cent. The 2007 forecast is not as stable; the highest figure is 2.7 per cent, issued last January, and the lowest is 0.9 per cent in the most recent forecast.

Forecasts on the development of the current account balance in per cent of GDP are quite subject to change since this balance is the residual of many other forecast figures that in turn are dependent on several different assumptions. The forecasts of the current account

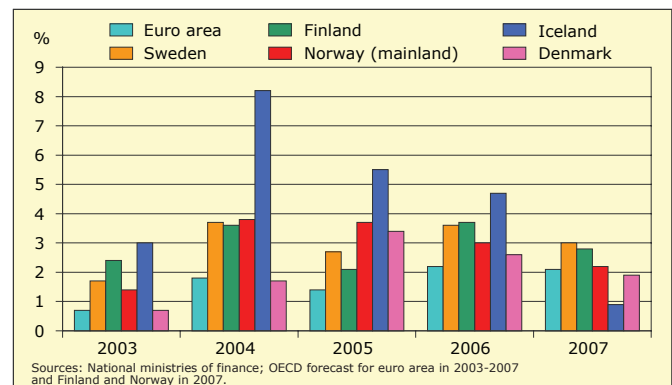
deficit have been in the range of 11.4 per cent to 15.9 per cent of GDP for 2006. For 2007, the forecasts have ranged from 6.2 per cent to 7.8 per cent.

Forecasting the nominal exchange rate of the króna has always turned out to be difficult. Experience shows that a number of different factors influence the exchange rate. The Ministry's exchange rate forecast for 2006 has changed considerably over time. The earliest forecast assumed an average exchange rate index number of 128 for 2006. Following the strengthening of the exchange rate, the forecast was revised to 109 last January. The exchange rate forecast for 2007 varies less.

## Good economic conditions in the Nordic countries

The Ministers of Finance of the Nordic countries met on June 20th and devoted part of their discussion to economic developments and prospects in the Nordic countries. Economic conditions are generally quite good in the Nordic countries. GDP growth is pronounced, as can be seen from the chart below, with Iceland standing out as the growth leader. Nordic economic growth is in all cases higher than the average for the Euro-area. As an example, Denmark today enjoys its highest rate of growth in eleven years. Increasing private consumption is the main driver of growth in all the Nordic countries. The consumption growth is in turn encouraged by low interest rates, rising disposable incomes and improving household balance sheets due to rising housing prices. Rising world economic growth has brought higher export earnings to the Nordic countries and strengthened their economic foundations.

Growth in the Nordic and Euro-areas 2003-2007



Except for Iceland, the Nordic countries run a current account surplus. Norway's surplus is estimated at 17 per cent of GDP, 6.5 per cent for Sweden and slightly lower in Denmark and Finland. Public sector finances are in surplus in all Nordic countries but lowest in Sweden where it is equivalent to 0.5 per cent of GDP. For this year, the public sector balance is expected to be better in Denmark and Finland than in this country. Norway's public sector surplus is expected to be 18 per cent of GDP due to high oil prices bringing the Treasury increased revenue. Nordic inflation, excepting Iceland, is forecast between 1.3 and 2.3 per cent. Inflation is rising in all the Nordic countries but at different rates.

Treasury revenue January-April	2004-2005	2005-2006
12 month changes (%)	2005	2006
Total tax revenue	21.0	15.0
Taxes on income & profit	18.0	34.0
Taxes on property	64.4	-29.1
Taxes on goods & services	19.7	6.5
Social contributions	23.1	14.3
Total revenue	25.4	9.0

Treasury expenditure January-April	2004-2005	2005-2006
12 month changes (%)	2005	2006
General public services	122.5	-30.7
Health	52.4	6.9
Social security & welfare	47.8	6.6
Economic affairs	46.0	-6.7
Education	41.0	10.4
Total expenditure	58.7	-2.7

Treasury finances January-April	2005	2006
Million krónur		
Cash from operations	13,092	24,347
Net financial balance	19,356	21,869
Debt redemption	-29,826	-31,685
Gross borr. requirement	-11,670	-11,136
Net borrowing	13,949	6,456
Overall cash balance	2,279	-4,680

Economic indicators	2004-2005	2005-2006
12 month changes (%)	2005	2006
Inflation (June)	2.8	8.0
Core inflation (June)	3.5	7.0
Wage index (May)	6.6	8.7
Total turnover (Jan. - Feb.)	5.9	9.2
Retail turnover (Jan. - Feb.)	1.8	6.5
Unemployment rate, sa (May)	2.1	1.2