

# **The Icelandic Economy**

## **Economic Forecast for 2005-2010**



Ministry of Finance  
October 2005

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The forecast is based on information available on 15 September

This report covers the developments and prospects for the Icelandic economy for the years 2005-2007 on the basis of a new economic forecast of the Ministry. Several changes from the April forecast are explained and projections up to 2010 are outlined. The main conclusions are as follows:

- The economic expansion is at its peak, with the rapid pace of growth continuing this year and next while the power project investments remain extensive. Growth will slow down in 2007 due to contracting construction activity and declining domestic demand.
- Provisional national accounts data indicate GDP growth in 2004 amounted to 6.2 per cent, due to rising private consumption and investment and in spite of sharply rising imports. GDP growth is expected to remain high this year, about 6 per cent, whereas it is expected to slow down next year, to 4.6 per cent. With contracting construction activity and domestic demand in 2007, the rate of GDP growth is projected to slow to 2.5 per cent.
- An unavoidable consequence of the large scale investments is a current account deficit estimated to peak at 13.3 per cent of GDP this year and amount to over 12 per cent of GDP next year. Increased aluminium exports and contracting imports and the resulting turnaround in foreign trade will drive the growth of GDP in 2007. In the years 2008-2010, the current account deficit is project average 2.2 per cent of GDP.
- The imbalances in the economy during the investment period are expected to be temporary. A tight economic policy is restraining domestic demand. The opening up of the economy has increased competition, limiting the scope for domestic agents to increase prices and wages. Along with flexible arrangements in the economy, which have increased productivity growth, the growth potential of the economy has increased.
- Unemployment has declined and is forecast to be below 2 per cent of the labour force in 2006. The emerging positive output gap is expected to narrow quickly after the power project construction activity has peaked. Unemployment is then forecast to increase.
- The consumer price index has increased mainly because of rising real estate prices. Year-on-year inflation is estimated at 3.9 per cent in 2005. The exchange rate and real estate prices are assumed to have peaked. The exchange rate is assumed to decline moderately in the course of 2006. Inflation is expected to average 3.8 per cent for that year and 4 per cent in 2007. The wage rate is not expected to change much in the upcoming revision of the wage agreements.
- The main elements of uncertainty in the forecast have to do with further power project investments and development of the exchange rate. In this connection, it should be pointed out that in spite of the high debt of households and business, the position of the Treasury is strong and the wealth of the country has increased. The foundations of the economy are sound and its flexibility is considerable.



*At the peak of the expansion*

The present expansion has developed broadly as expected in the Ministry's earlier forecasts but been slightly stronger in the early stages, according to the latest national accounts figures of Statistics Iceland<sup>1</sup>. GDP growth amounted to 6.2 per cent in 2004, and for this year a similar growth rate is expected, or 6 per cent. This is forecast to be followed with 4.6 per cent growth in 2006 when the power project construction begins to taper off. For these three years, GDP growth is estimated to average 5.6 per cent a year which is considerably higher than in neighbouring countries. Such a high growth rate tests the productive capacity of the economy and the ability of the public authorities to control domestic demand so as keep inflation within the inflation target. Power project investments are expected to decline in 2007 and hence economic growth will slow down. For the years 2007-2010 an average growth rate of 2.5 per cent is projected, characterizing the economy into with better balance.

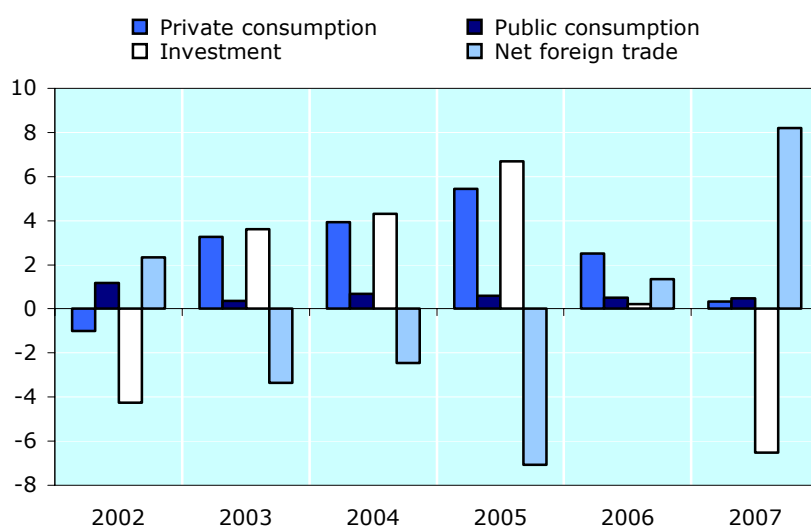
**Developments in 2004**

Provisional national accounts indicate that GDP growth was 6.2 per cent in 2004. National expenditure on consumption and investment rose by 8.4 per cent which explains the growing current account deficit, equivalent to 8 per cent of GDP. National income, which takes into account net factor income from abroad, rose slightly less or by 4.9 per cent in real terms. The lower growth rate of national income is in part due to the doubling of dividends paid abroad between 2003 and 2004. Incoming dividend payments rose at the same time by 50 per cent, according to the balance of payments data of the Central Bank.

Registered unemployment averaged 3.1 per cent last year. The number of unemployed declined by 330 from 2003. Viewing economic growth together with employment, it is evident that labour productivity has increased sharply in 2004 or by 4 per cent. Productivity has been considerable in recent years, exceeding the 1.5 per cent annual average in the 1990-2000 period. Inflation, as measured by the consumer price index, was 2.1 per cent in 2003 and 3.2 per cent in 2004. The increase in inflation is in part explained by the rise in real property prices above the trend of previous years and in part by the increasing positive output gap in 2004.

Real disposable income rose considerably last year, or by 3 per cent as a whole. Private consumption expenditures of households rose on the other hand by 6.9 per cent which indicates that the increase was in part credit-financed or through asset liquidation in 2004,

**Graph 1**



**Contribution to economic growth in per cent**

Source: Statistics Iceland and own forecast.

<sup>1</sup> Statistics Iceland has adopted a method of yearly chain-weighted indexes when assessing volume growth in the national accounts, based on historical data, instead of using a fixed base year. The new method has the effect of returning higher growth figures since the year 2000 but lowering growth for earlier years. A further explanation is to be found on the Statistic Iceland website.

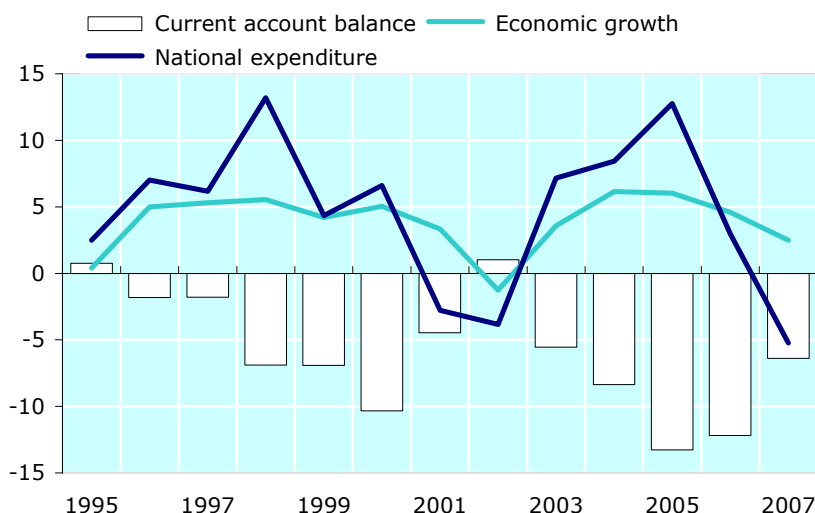
since real property prices and stock prices have risen sharply in recent years. Both have had an influence on consumer optimism and, last but not least, there are considerable expectations for increases in purchasing power in coming years.

### Prospects for 2005-2007

Economic growth is forecast to be similar to the rate of last year, about 6 per cent. It is expected to remain quite high next year, about 4.6 per cent but decelerate thereafter to some 2.5 per cent in 2007. For the years 2005-2007, growth is expected to average 4.4 per cent.

The construction of the Kárahnjúkar hydro-power project began in 2003 and will continue until 2008. Construction of the aluminium plant at Reyðarfjörður began in 2004 as well as the expansion of the Norðurál aluminium plant in Hvalfjörður and geothermal energy projects that are intended to supply the expanded Norðurál plant with power. The total cost of these projects is expected to amount to 235 billion krónur at 2003-prices. General business investment revived quite strongly in 2003 and continued its growth in 2004. Total business investment has increased by more than 58 per cent in these two years. The foreign cost share of the power projects is estimated at 60 per cent and for the aluminium plants at 69 per cent. The share of foreign labour with these projects is estimated at 55 per cent during the construction period. The total number of man-years is estimated at just over 8,000, equivalent to nearly 2 per cent of the employed labour force at the peak of the construction in 2005 and 2006.

**Graph 2**



### Economic growth and balance of current account

In per cent of GDP

Source: Statistics Iceland and own forecast.

total business investment has increased by more than 58 per cent in these two years. The foreign cost share of the power projects is estimated at 60 per cent and for the aluminium plants at 69 per cent. The share of foreign labour with these projects is estimated at 55 per cent during the construction period. The total number of man-years is estimated at just over 8,000, equivalent to nearly 2 per cent of the employed labour force at the peak of the construction in 2005 and 2006.

#### Large investment projects

No formal decision has been taken on further large power-based investment projects and they are therefore not incorporated into the Ministry's forecast. The second phase of the Norðurál plant expansion that would increase its production capacity by 40 thousand tonnes - on top of the 130,000 tonnes in the first phase - is therefore not included in this forecast, even if the second phase will most likely take place. If such projects are added in future years, economic growth will be higher than outlined above.

#### Further projects not excluded

The assumptions underlying the forecast incorporate an exchange rate that is slightly lower than last year. The exchange rate index is expected to average nearly 110 this year and rise to nearly 114 points in 2006 which is equivalent to a 3.5 per cent depreciation of the króna. When power project construction activity decelerates, the inflow of foreign exchange will decline and a gradual weakening of the króna may therefore be expected. A growing current account deficit will also exert downward pressure on the exchange rate. Another important assumption is that the recently concluded wage agreements will apply to those unions that yet have to renew their agreements and that the present agreements will not be abrogated

*A modest development of wages and exchange rates is assumed ...*

or markedly amended from their present form. On this basis, a continued increase in real disposable income is forecast and that inflation will remain close to the upper tolerance limit of the Central Bank.

In addition to the above assumptions, the forecast incorporates assumptions on a tight monetary and fiscal policy in order to maintain price stability. For purposes of the forecast, it is assumed that the Central Bank's policy interest rate will be increased to just over 10 per cent before the end of 2005 but will decline in the latter half of 2006. The pursuit of a tight fiscal policy has already begun through the fiscal budgets of previous years by the restraint on current operating and transfer expenditures and the considerable cutback in government investment. For this year, the Treasury surplus is estimated at 2.8 per cent of GDP which is higher than at the peak of the previous expansion. For 2006, a surplus of 1 per cent of GDP is forecast. The decision of the Government to allocate the sales proceeds from the privatisation of Iceland Telecom for 2005 and 2006 is in conformity with a tight fiscal stance for those years.

National expenditure is forecast to increase by close to 13 per cent this year. The largest component of the increase stems from pri-

*... and that a tight monetary and fiscal policy will yield results*

### Overview of the forecast

	Bn. kr.	Volume change from prev. year, %			
		Forecast			
		2004	2004	2005	2006
Private consumption	506.1	6.9	9.5	4.3	0.6
Public consumption	226.3	2.8	2.4	2.2	2.2
Investment	207.2	21.0	28.5	0.8	-23.8
Increase in stocks <sup>1)</sup>	-3.3	-0.2	0.4	0.0	0.0
<b>Total National Expenditure</b>	<b>936.2</b>	<b>8.4</b>	<b>12.8</b>	<b>2.9</b>	<b>-5.2</b>
Exports of goods and services	316.1	8.3	1.4	6.2	11.6
Imports of goods and services	367.3	14.2	18.3	1.9	-8.8
<b>Gross Domestic Product</b>	<b>885.0</b>	<b>6.2</b>	<b>6.0</b>	<b>4.6</b>	<b>2.5</b>
<b>Gross National Income</b>	<b>863.4</b>	<b>4.9</b>	<b>5.7</b>	<b>4.2</b>	<b>1.6</b>
Effects of changes in terms of trade <sup>2)</sup>	-	-0.6	0.5	-0.1	-0.9
<b>N I w. effects of ch. in terms of trade</b>	<b>-</b>	<b>4.3</b>	<b>6.3</b>	<b>4.1</b>	<b>0.6</b>
<b>Current account balance</b>	<b>-73.9</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
p.c. of GDP	-	-8.4	-13.3	-12.2	-6.4

1) Figures show increase in stocks between years as a percentage of GDP for the previous year, at fixed prices.

2) In per cent of national income for the previous year, at fixed prices.

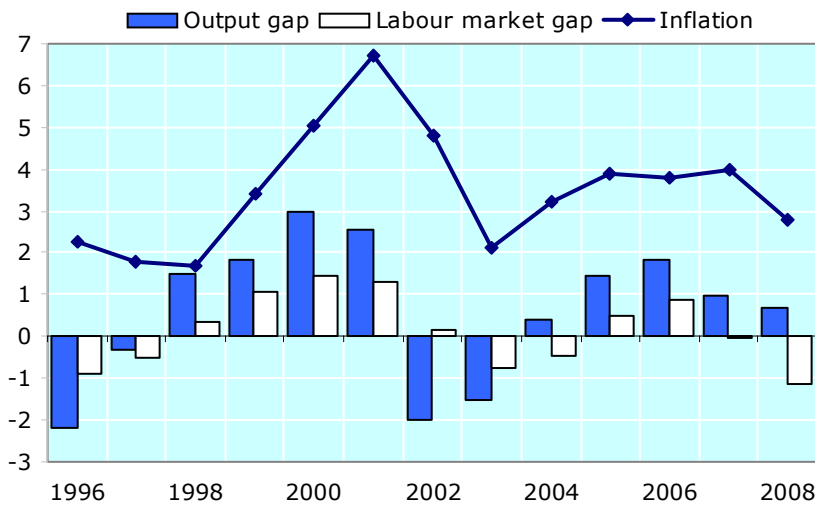
vate consumption which is expected to rise by 9.5 per cent. Total investment is expected to increase by 28.5 per cent of which business investment would increase by 48 per cent and residential construction by 12 per cent, whereas public investment is forecast to decline by 12 per cent. The increase in public consumption is estimated at 2.4 per cent. The current account deficit is estimated at the equivalent of 13.3 per cent of GDP this year, declining to 12.2 per cent in 2006 and 6.4 per cent in 2007. The increased current account deficit is directly and indirectly attributable to the ongoing power project and aluminium plant construction. The direct impact of this construction activity is estimated to account for 40 per cent of the current account deficit and to 70 per cent of the trade deficit

*Temporary increase in national expenditure and current account deficit*

when construction activity is at its peak in 2005 and 2006.

Unemployment is forecast to average 2.2 per cent of the labour force in 2005 and decline to 1.8 per cent next year. The estimates of the Ministry indicate that a positive output gap emerged in 2004 and the gap in both output and the labour market will increase both this year and next after which both the internal and external imbalances will be reduced in 2007. Last year's average inflation rate of 3.2 per cent is forecast to rise to 3.9 per cent this year and remain similar next year. This forecast is somewhat uncertain, mainly in association with the development of the exchange rate. A large change in the exchange rate will impact on prices, and inflation will thereby increase or decline. Fortunately, such fluctuations are usually temporary.

**Graph 3**



The estimates of the Ministry indicate that the positive gaps in output and the labour market will be lower in the present expansion than in 1998-2001. Such measurements are subject to some uncertainty since the economy can grow fast without inflation taking off and the level of unemployment can also dip quite low before a wage drift emerges. The opening of the economy has increased international competition which places pressure on the prices charged by Icelandic companies and on the development of wages. Experience shows that this challenge leads to increased productivity which in turn deepens the resilience of the economy and its ability to grow fast without inflation or a wage drift emerging. The increased globalisation of the economy will benefit both consumers and investors. This represents a profound change in the circumstances and behaviour of market activity from earlier times.

**Output gap**

In per cent of potential output

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*Equilibrium will be achieved at the end of the construction phase*

When the economy slows down in 2007, a better balance in the economy will be restored. The growth in domestic demand and imports is expected to slow down next year. Aluminium production will increase and show up in higher merchandise exports. Domestic demand will contract in 2007, but a continuing reversal in the trade balance will become an impetus to growth. The current account deficit will decline by half between 2006 and 2007, from 12.2 per cent of GDP to 6.4 per cent. Unemployment is forecast to increase from 1.8 per cent to 2.7 per cent which is close to the estimated equilibrium level in the labour market.

**Deviations from the previous forecast**

The Ministry's previous economic reports have included a table showing the main deviations of the latest forecast from previous forecasts so as to increase transparency into the Ministry's working methods in this area. This comparison is shown in an Appendix table to this report.

*The Ministry's forecasting methods*

The main change from the forecast presented this past spring is that private consumption is projected to increase more and the cur-



## Key economic indicators

Volume changes in p.c. over previous year unless otherwise indicated.

	2004	2005	2006	2007
<b>Macro-economic indicators</b>				
Economic growth	6.2	6.0	4.6	2.5
National expenditure	8.4	12.8	2.9	-5.2
Current account in p.c. of GDP	-8.4	-13.3	-12.2	-6.4
Net external debt in p.c. of GDP	-85.4	-83.6	-92.2	-98.4
National saving in p.c. of GDP	14.7	13.4	14.4	13.7
<b>Labour market</b>				
Labour force (1000 man-years)	147.7	151.9	154.6	155.1
Unemployment in p.c. of labour force	3.1	2.2	1.8	2.7
Purchasing power of hourly wages	1.4	2.3	1.2	0.5
Real disposable income per capita	2.6	3.7	2.7	2.1
<b>Foreign trade</b>				
Exports of marine products	5.4	2.0	2.0	2.0
Total merchandise exports	8.3	0.8	8.2	16.1
General imports	15.8	21.8	1.2	-12.4
<b>Money and prices</b>				
Consumer price index, per cent	3.2	3.9	3.8	4.0
Exchange rate index	121.0	109.8	113.8	119.3
<b>External conditions</b>				
Growth in European Union	2.5	2.0	2.5	2.7
Inflation in European Union	2.2	1.9	1.7	1.9
Export prices of marine products	0.3	6.0	2.0	2.0
Aluminium prices (USD)	13.0	6.3	1.1	-4.9
Oil prices	27.6	40.0	-4.0	2.0

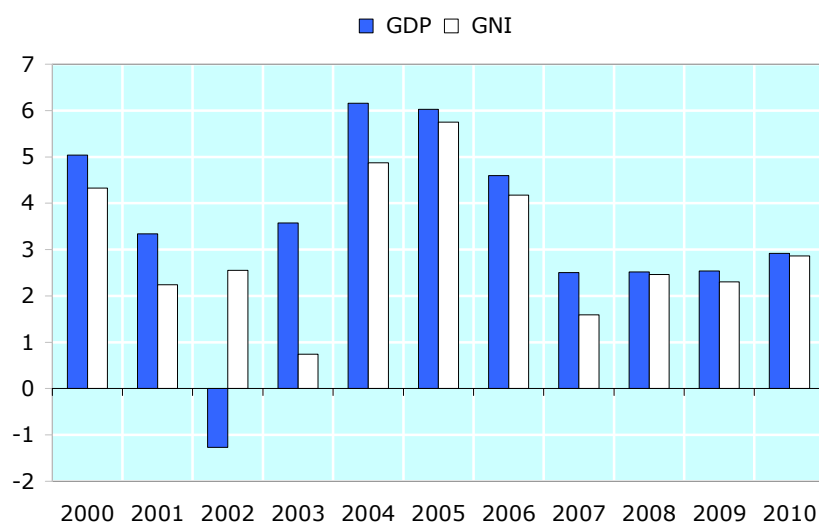
rent account deficit will be larger. Other changes on the disposal side of resources in the economy are minor. The 2005 growth rate is almost the same as forecast this spring. Unemployment is now estimated to be lower, 2.2 per cent instead of 2.4 per cent of the labour force. The inflation forecast for this year is unchanged at 3.9 per cent. Wage increases are thought to be marginally higher and the exchange rate slightly stronger. Deviations from previous forecasts for 2006 are more pronounced. Private consumption is now forecast to increase 1 per cent less than was projected last spring. Unemployment is now forecast at 1.8 per cent on average for 2006 instead of 2.2 per cent before. The development of prices and wages is expected to be similar in 2006 as expected earlier, except that the exchange rate is thought to be slightly stronger. The changes in the forecast for 2007 are minor. Inflation may possibly turn out to be slightly higher and unemployment lower than indicated earlier.

### Prospects until 2010

The extrapolations from the Ministry's forecasting model indicate that economic growth in 2004-2006, the first part of the extrapolation period, will average close to 5½ per cent a year. For the latter half of the period, 2007-2010, growth is expected to decline to 2½ per cent on average. The reason why GDP is not ex-

*Private consumption and the current account deficit exceed previous forecasts*

**Graph 4**



**Growth of GDP and GNI**

In per cent

Source: Statistics Iceland and own forecast

pected to contract following the power project construction period is partly that aluminium exports are going to increase and general imports are expected to decline. In addition, the timing of public investment is aimed at mitigating the slowdown after the power project construction period by increasing public investment in 2007-2008. The same applies to the last phase of the cut in taxes in the 2006-2007 period.

<b>Main economic aggregates 2004-2010</b>						
	<b>Annual averages</b>		<b>Vol. ch. from prev. yr., %</b>			
	<b>2004-2006</b>	<b>2007-2010</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Volume changes, %</b> unless otherwise stated						
Gross domestic product	5.6	2.6	2.5	2.5	2.5	2.9
Private consumption	6.9	1.8	0.6	1.2	2.3	3.1
Public consumption	2.5	2.2	2.2	2.2	2.2	2.2
Investment	16.1	-10.0	-23.8	-16.4	-1.0	4.0
Business sector	23.0	-15.7	-35.8	-27.4	0.3	7.8
Residential dwellings	8.0	-1.9	-3.4	-6.9	1.1	2.1
Public sector	-2.0	4.1	19.9	10.0	-7.3	-3.8
Total exports	5.3	6.2	11.6	9.1	2.4	2.1
Total imports	11.3	-2.4	-8.8	-2.7	0.1	2.2
Curr. acc. balance, % of GDP	-11.3	-3.3	-6.4	-2.5	-2.0	-2.1
Inflation, %	3.6	2.9	4.0	2.8	2.5	2.5
Unemployment, % of l. force	2.3	3.2	2.7	3.7	3.6	2.9

Global economic growth has been quite pronounced in recent years. For 2004, it is estimated to have exceeded 5 per cent. Recent OECD forecasts indicate that global growth may have slowed down this year and next to some 4 per cent. Should this turn out, the year 2006 will be the fourth in succession where global growth exceeds 4 per cent, a good record by historical standards. World trade is forecast to increase by 6-7 per cent in volume this year and next, thus providing an important stimulus for global growth. Although global growth prospects are promising, growth rates differ amongst countries. Growth in continental Europe, mostly in the euro-area, has been anemic in recent year, only 2 per cent last year and about 1 per cent this year. The same applies to Japan. US growth has on the other hand been close to 4 per cent last year. The most pronounced growth rates are in south-east Asia, in the new member countries of the EU and in several of the African developing countries.

<b>Economic growth</b>			
	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Worldwide</b> .....	<b>5.1</b>	<b>4.3</b>	<b>4.4</b>
<b>Euro zone</b> .....	<b>2.0</b>	<b>1.3</b>	<b>2.0</b>
Germany .....	1.6	1.0	1.3
France .....	2.1	1.6	2.2
Italy .....	1.2	0.2	1.5
Spain .....	3.1	3.2	3.1
UK .....	3.2	1.9	2.3
USA .....	4.2	3.6	3.5
Japan .....	2.6	1.8	1.7
Russia .....	7.1	5.5	5.3
China .....	9.5	9.0	8.5
India .....	7.3	7.0	6.6
Africa .....	5.3	4.4	5.8
Latin America .....	5.6	3.9	3.7

Source: IMF and OECD.

About 70 per cent of Iceland's merchandise trade is with the EEA-countries. Scant growth in these countries means that demand for Iceland's exports grows slowly. In the opinion of the OECD, there is a need for extensive organisational reforms in labour and goods markets in many of the larger European countries in order to encourage economic growth. Growth in Germany and Italy has been marginal this year, and forecasts for this year and next were scaled down earlier this year, both for 2005 and 2006. A number of critics place the blame on the euro. The root of the problem appears however to be that these slow-growth economies have had difficulty in adjusting to the demands of globalisation. OECD research indicates that labour markets, welfare systems and tax regimes must be reformed, all of which is difficult politically. The European Central Bank has kept its policy rate low, at 2 per cent since June 2003, with few indications of a further reduction. Spain is showing a slightly better growth rate, 3 per cent, whereas growth in France is closer to 2 per cent. UK growth has been quite good of late, although it appears to be slowing this year, following the rise in the Bank of England policy rate. Nordic economic growth has exceeded that of continental Europe.

In contrast to the slow growth of Europe, US growth has been around 4 per cent a year for several years now. This rate was forecast to slow down this year to some 3½ per cent prior to the New Orleans calamities. Taking those into account, preliminary assessments indicate that US growth may be ½-1 per cent lower than that for this year. For 2006, it may be assumed that reconstruction efforts in the Gulf area will constitute an important stimulus for the economy. This year, domestic demand has been the main impetus behind the rate of growth, for several reasons. Due to low long-term interest rate and rising incomes, real property prices have risen fast and encouraged consumers to assume rising debt and increase private consumption. The growing fiscal deficit, due to tax cuts and rising defense expenditure, has also provided an important stimulus to demand and growth. The main signs of caution in the US economy are high real property prices which could decline in the near future with an impact on domestic demand and growth. In spite of the low dollar exchange rate against the euro in the past two years it has not sufficed to increase US exports to Europe, due no doubt to scant European growth. The same may be said in the case of US exports to Japan. Although other countries may be enjoying rapid growth, their low level of income limits their ability to purchase from a high-income country such as the US. As a result, the US current account deficit is widening to 6 per cent of GDP, a source of concern. The financing of the deficit has mainly been based on the sale of Treasury securities to investors in China and Japan. The interest of these countries is based on the premise of maintaining their respective exchange rates stable against the dollar in order to support the exports of their manufacturers to the US market. At the same time, they have made it possible for the US to maintain a twin deficit, a fiscal deficit and a current account deficit. The danger is that this can not go on indefinitely, and that these countries will scale down their purchases of US Treasuries, that long-term interest rates will rise, the dollar exchange rate will fall and US growth will slow down which in turn would affect European growth.

The Federal Reserve has been taking the view that the US economy is running at close to its long-term productive capacity. It has therefore stepped lightly on the brakes and raised the discount rate in several deliberate steps from an historically low level. At the end of August they stood at 3.5 per cent, having increased gradually from 1 per cent in June 2004, the lowest level since 1958. Long-term dollar interest rates have their benchmark in US Treasuries and have only increased by a small margin in recent weeks, which could be related to oil price increases and their direct impact on inflation.

Global economic growth is therefore led by countries outside western Europe, North-America and Japan. China is expected to turn in a 8-9 per cent growth rate this year and next and India 6-7 per cent. Growth in Asian countries such as Pakistan, Bangladesh, Indonesia, Thailand, the Philipines and Malaysia are forecast to have 6 per cent growth this year and next, whereas countries that are slightly further ahead on the development path, such as South Korea, Taiwan, Hong Kong and Singapore will mostl likely be growing at a 5 per cent pace.

Growth in middle and eastern Europe is on the increase, following a

long period of stagnation after the demise of the Soviet Union and organisational reforms related to the entry of nations into the EU. Most countries in this area are currently expected to show growth rates of 6-7 per cent, which is somewhat less than in the past two years when their growth rates approached 10 per cent. They are generally bringing idle productive capacity into use and are gradually approaching their full use and must thus rely on new investment for further progress. The increasing trade of these countries in the European market is beginning to have an effect. Russian growth is forecast at 5.5 per cent both in 2005 and 2006. In spite of governance disturbances, economic stability appears to be improving.

Sub-Saharan countries have dealt with the most difficult economic conditions of developing countries for a long time and have been subject to very low economic growth and development progress. It appears now that the region as a whole is going through marginal improvements. For the area as a whole, economic growth is estimated at 6 per cent next year, following one of 4½ per cent this year. Still, these countries have a long way to go in order to achieve an adequate standard of living. The recent commitment of the G-8 nations to increase development aid to Africa should yield some tangible results. The richer nations of the world do not seem posed to relax their restrictions on trade in agricultural products, which would especially have benefited sub-Saharan countries.

The oil price increases in recent months have left a significant mark on international forecasts as well as on forecasts for Iceland. Forecasts of international institutions are based on the assumption that the average price of crude oil will be 35-40 per cent higher this year than last, whereas the price rose 30 per cent last year and 16 per cent in 2003. At this point, the forward price of oil indicates that it will rise further by 10-15 dollars a barrel over the next several months. The IMF expects the price of oil to increase by 4-5 per cent in 2006, a fairly optimistic prognosis in the current circumstances.

The increase in the price of oil that already is on the table is expected to deter world economic growth by ½-1 per cent on an annual basis. The slowdown in global growth in 2005 is believed to be mainly caused by the rising price of oil. Further increases may cause substantial production disturbances in the world, especially in the developing countries and oil-dependent countries such as China. Western countries have steadily reduced their oil dependency in recent decades and a jump in the price of oil is less likely to have the same impact as during the oil crises in the seventies. It should also be noted that the present price of oil, adjusted for inflation, is still lower than it was in 1974 and 1978.

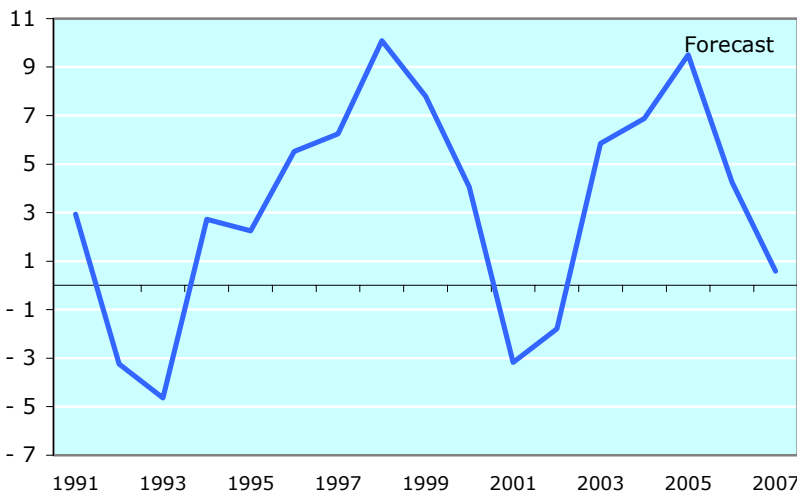
Despite the vicissitudes in the price of oil, no major inflation upheavals are expected in advanced countries. Inflation hovers around 2 per cent in western Europe and North America this year and next, according to IMF and OECD forecasts, a figure similar to that of 2004. Almost no major country is expected to have inflation in excess of 3 per cent. These historically low inflation rates may in part be due to increased globalisation in goods markets that have helped in hindering price increases. Countries that are currently experiencing rapid inflation are usually beset with governance problems, such as fiscal imbalances.

Private consumption

*There will be considerable growth of private consumption in 2005*

Private consumption has grown rapidly in the past two years. In 2003 it increased by 5.8 per cent in volume terms and further by 6.9 per cent in 2004. By comparison, the increase in private consumption in the last cyclical upswing was slightly higher; one of 10.1 per cent in 1998 and 7.8 per cent in 1999. The growth rate was far higher during the "tax-free" year of 1987, 16.2 per cent. The growth in private consumption appears to go on unabated in the course of this year. The year-on-year increase in the first two quarters was 11.6 per cent, in part due to a sharp increase in auto imports which in turn is due to the strong exchange rate and the general upswing in the economy.

Graph 5



There are strong indications that private consumption will continue to increase this year. Credit card turnover increased 11.9 per cent in real terms in the first seven months over a year ago. The domestic increase was 10.3 per cent and credit card spending abroad rose 35.8 per cent, reflecting an ebullient consumer mood both at home and abroad. New auto registrations, both of new and used autos, were at an historical high in the first eight months of the year, increasing by 63 per cent. Registrations of new passenger autos rose 53 per cent.

**Private consumption**  
Volume change in per cent  
Source: Statistics Iceland and own forecast.

The collection of indirect taxes also rose considerably in the first seven months of the year, by 14.7 per cent in real terms. Revenue from the value added tax alone rose by 18 per cent compared to 10.9 per cent a year earlier which indicates that private consumption is rising faster in real terms this year than last. Provisional import figures for the first eight months of the year support this indication further; imports rose by 27 per cent in real terms over a year ago. Real wages have also increased by 3.1 per cent in excess of inflation in the past twelve months. Real property prices have also been on the increase and the exchange rate has remained strong in spite of considerable fluctuations.

The Gallup consumer expectations index rose by 5.6 per cent in the first eight months over the corresponding period a year ago. The index stood at 134.2 points in August, rising by 5.5 points from the previous month and by 11.6 points in the past twelve months. The retail sales index indicates a similar trend. The index for non-durable consumer goods rose by 9.3 per cent in the first eight months, for liquor and spirits by 7.9 per cent and pharmacy sales rose by 1.4 per cent.

The Ministry's forecast indicates that private consumption will rise by 9.5 per cent this year, an increase of 1.5 percentage points from the Ministry's April forecast. This increase is due to the fact that real wages have increased. Present forecasts project a 2.3 per cent increase in real wages for this year. The strong exchange rate has

also played a role in encouraging consumption, especially of consumer durables such as autos and appliances. The unrelenting increase in real property prices has generated a wealth effect which undoubtedly has stimulated private consumption.

In this forecast, private consumption growth is expected slow down in 2006 to a 4.3 per cent increase. This growth is lower than had been forecast last April by 2 percentage points. This change is associated with the expectation that the exchange rate will weaken in the course of next year. Private consumption growth is expected to weaken still further in 2007 to 0.6 per cent as had been projected in the April forecast. For 2007, real wages are expected to increase by 3.3 per cent, in part because the personal income tax rate is going to be cut by 2 percentage points.

### Public consumption

Public consumption rose by 2.8 per cent in real terms in 2004, slightly less than the provisional estimate of Statistics Iceland of 3.6 per cent indicated last March. The difference is primarily due to the change in municipal public consumption which now is estimated to have increased by 2.5 per cent in volume terms instead of 7 per cent. This compares to the growth in municipal public consumption of 2.3 per cent in 2003 which also was a lower increase than earlier estimates indicated.

Public consumption					
		Prov.	Forecast		
Share of GDP	2003	2004	2005	2006	2007
Treasury and soc.sec. sector	17.5	17.2	16.7	16.3	16.2
Municipalities	9.1	9.1	8.8	8.6	8.7
Total public sector	26.6	26.3	25.5	24.9	24.9
Volume growth					
Treasury and soc.sec. sector	1.0	2.9	2.3	2.0	2.0
Municipalities	2.3	2.5	2.5	2.5	2.5
Total public sector	1.5	2.8	2.4	2.2	2.2

Sources: Statistics Iceland and own forecast.

The growth in the public consumption of the Treasury and the social security sector is estimated at 2.9 per cent in 2004. This exceeds the previous estimates of Statistics Iceland of 1.9 per cent. The medium-term goal of the Government is to keep the volume growth in public consumption below 2 per cent a year. The present assessment of Statistics Iceland shows that the 2003 volume growth in public consumption of these sectors was only 1 per cent, in contrast to the previous estimate of 3.5 per cent.

The public consumption of the Treasury and the social security sector is expected to be 2.3 per cent in volume terms, which exceeds the Government's medium-term goal by a slight margin. Viewing the years 2003-2005 together, the growth in public consumption is close to the Government's goal, about 2.1 per cent. This must be viewed as a result of the fact that much work has gone into improving government operations in recent years in order to increase expenditure control.

The growth in public consumption of the Treasury and the social security sector is expected to be 2 per cent a year in 2006 and 2007, as is the intention of the Government. Municipal public con-

*Private consumption growth is expected to slow down in future years*

*Public consumption is expected to conform to goals in coming years*

*... the share of public consumption in GDP is declining ...*

*Growth in 2004 public consumption below estimate*

*The growth in central government public consumption exceeded the medium-term goal in 2004 ...*

*... and will probably slightly exceed the medium-term goal this year*

sumption is expected to be 2.5 per cent this year as well as in the next two years. Although the public sector surplus is expected to be quite large this year, 2.4 per cent of GDP, it is nevertheless important that the central government and the municipalities improve their expenditure restraint, especially since next year's public sector surplus is projected to be 1 per cent of GDP.

As can be seen in the table above, public consumption is expected to amount to 25.5 per cent of GDP this year, more than one percentage point less than in 2003 when it peaked at 26.6 per cent of GDP. It is estimated to decline still further next year, to 24.9 per cent of GDP. This is heavily influenced by the Government's medium-term goal of holding the annual public consumption growth of the Treasury and the social security sector within 2 per cent.

### Business investment

The sharp increase in power-related investment - i.e. in power projects and the associated investment in aluminium production - has dominated business investment since 2004. For this year, business investment is estimated to increase by 48 per cent, mostly because a part of power-related investment, which earlier was thought to be distributed over the years 2004, 2006 and 2007, is taking place in 2005. The outlook for next year is that power-related investment will slow down and that total business investment will increase by 1.9 per cent.

Due to the acceleration in power-related investment, it will reach nearly 10 per cent of GDP this year. This is due to a faster pace of construction of the aluminium plant at Reyðarfjörður and the expansion of the Norðurál plant. Such investment will continue to be large next year, estimated at 8.5 per cent of GDP.

An agreement was reached in the spring of 2005 on the expansion of the Norðurál aluminium plant at Grundartangi to an annual production capacity of 260 thousand tonnes. Two power companies, Reykjavík Energy (Orkuveita Reykjavíkur) and the Suðurnes Regional Heating Company (Hitaveita Suðurnesja) will provide energy for the expansion of the plant. Investment in association therewith will take place in 2007 and 2008. Most of the power-related investment in the eastern part of the country and the first phase of the expansion of the Norðurál plant will be completed next year. Business investment is expected to decline by 35.8 per cent in 2007.

Imports of investment goods rose by close to 29 per cent in volume in the first seven months of this year over the same period last year. Most of this increase is related to power-related investment. Companies in the general market are taking advantage of the strong exchange rate to invest in imported investment goods. On the other hand, the strong exchange rate adversely affects company profits engaged in competition with imports which may be expected to deter them from investing in the near future.

Last year, business investment rose by 23.3 per cent, ten percentage points more than the provisional estimate of Statistics Iceland indicated last spring. The municipalities have established public companies that operate their sewage systems, which means that such investment is being reclassified as business investment, not as public investment. Secondly, leased motor vehicles for private use are now

*Business investment increases sharply in 2005 but less in 2006*

*Power-related investment nearly one-tenth of GDP this year and next ...*

*... but will decline rapidly in 2007*

*Sharp increase in imported investment goods*

*Investment accounting reforms affect the outcome*



classified as business investment and only lease payments are classified as private consumption. Other things being equal, they tend to increase business investment, whereas the use of private motor vehicles is distributed over a long period and is counted as private consumption.

### Public investment

Public investment amounted to 36 billion krónur in 2004, increasing by close to 27 per cent from the previous year. Road and street construction amounted to about 17 billion and other investment, such as buildings, to just over 19 billion. The volume increase in central government investment came to 15 per cent and to more than 40 per cent by municipalities. Part of the increase in municipal investment is explained with the sale of public assets by the town of Reykjanes in 2003 which reduced municipal investment sharply in that year. Aside from this asset sale, the real increase in public investment came close to 14 per cent in 2004.

*Public investment rose sharply in 2004 ...*

Public investment is forecast to contract by over 12 per cent in volume this year and amount to 33 billion krónur. This is primarily attributable to a cut in central government investment of 2.7 billion while municipal investment is forecast to remain unchanged in nominal terms between years. For next year, a sharp decline in public investment is forecast, one of 15.4 per cent in real terms for a total of 29 billion krónur. The decline is in accordance with the Government's intentions to hold back public investment at the peak of power project construction activity. Municipal investment is also expected to decline, following its peak in 2004 and 2005.

*... but this year and next it is expected to contract*

Central government investment is expected to increase sharply in 2007, or by 80 per cent. This increase is in accordance with the Government's plans to stimulate economic activity when power project construction decelerates. Municipal investment is expected to contract considerably in 2007. The total volume growth in public investment is estimated at 20 per cent for that year.

*Central government investment will increase by 80 per cent in volume in 2007*

### Housing investment and the real property market

Housing investment has increased sharply this year and is expected to increase further in 2006. The housing boom is attributable to two main factors. Mortgage financing has become easier, and economic growth and the purchasing power of the public is robust. Housing investment now constitutes about one-fourth of total investment and has grown fastest of all types of investment when power projects and aluminium plants are excluded.

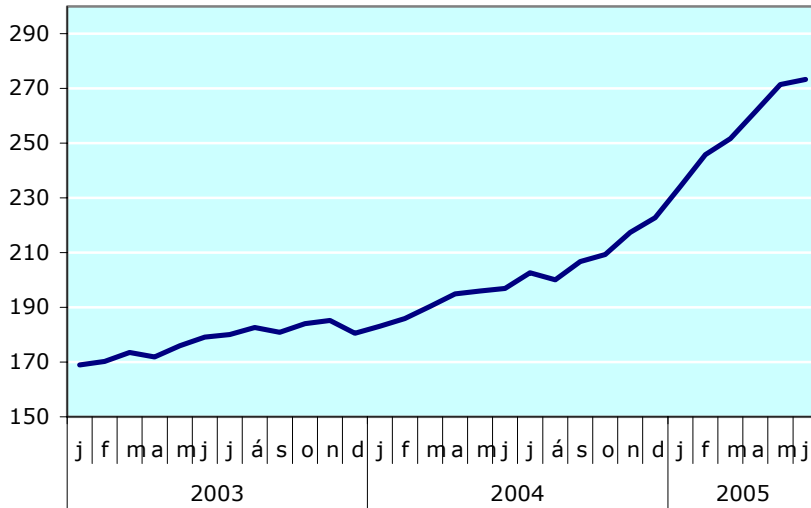
*Housing investment has increased sharply*

The increase is greatest in the south-western part of the country, but the location pattern is changing from previous years. Previously, the increase was most pronounced in the capital area, but lately the housing boom has spread throughout the entire South-West, from Akranes in the West to the towns of Hella and Hvalsvellur in the East. There is also a sharp increase in housebuilding on the Reykjanes peninsula, where the population has been on the increase in recent years. The increase is still considerable in the capital area, especially in the suburbs where new building areas have been opened up, whereas the growth in Reykjavik itself is slower due to a lack of development of new building land.

Housing investment has also increased on the eastern coast, both in the Fjarðarbyggð community – where the Alcoa aluminium plant is being built in Reyðarfjörður – as well as in the town of Egilsstaðir. Together the increase comes to 25-30 per cent from the previous year. Close to 300 housing units were built last year in Akureyri, but the increase this year is unclear.

For this year, a 12 per cent increase in housing investment is forecast, following a 3 per cent growth in 2004. Data on housing starts and plans by municipalities for offering new building land next year indicates that the growth in housing investment will continue.

**Graph 6**



and plans by municipalities for offering new building land next year indicates that the growth in housing investment will continue. The town of Kópavogur intends to open up land for some 1,000 housing units, whereas the plans for Reykjavík remain unclear at present. Other municipalities, especially outside the capital area, seem intent on offering land for further housing investment.

The latest data on property prices indicate that the real property market is gradually calming down after a spate of price increases in recent years. Housing investment has reacted to

**Housing prices in the capital area**

Dec 1998= 100

Source: Valuation Office

booming demand by increasing the supply of new housing. Nonetheless, housing investment is expected to increase by 6.5 per cent next year. In 2007, when growth is expected to slow down and unemployment increase, housing investment is expected to calm down after the boom of recent years; a decline of 3.4 per cent is forecast for that year. A total of 8-10 thousand housing units are expected to be completed in the years 2005-2007, well in excess of the long-term need for increase in the housing stock.

This year's current account deficit appears to be setting a record for the post-war period. It is estimated to amount to 128 billion krónur for the year as a whole or 13.3 per cent of GDP. The deficit is forecast to continue in 2006, also amounting to an estimated 128 billion krónur, equivalent to 12.2 per cent of GDP for that year. By comparison, the deficit amounted to 74 billion or 8.4 per cent of GDP in 2004. The rising current account deficit is reflected both in the trade as well as the services account. The strong exchange rate encourages imports of consumer goods at the same time as power project investments are at their peak. It is therefore expected that there will be a turnaround, once power project construction activity tapers off, the exchange rate begins to weaken and exports of aluminium increase sharply. The 2007 deficit is therefore expected to decline to the equivalent of 6 per cent of GDP and amount to 71 billion.

*A record current account deficit in 2005 ...*

The main reason for the rising deficit is that merchandise imports are increasing. Its volume is estimated to increase by one-fifth in 2005 over the previous year whereas export production is nearly unchanged. The strong exchange rate means that the export value is contracting. The trade deficit is estimated at 84 billion krónur, increasing by 48 billion from the previous year which accounts for close to 90 per cent of the increase in the current account deficit. Exports are expected to increase in 2006 with increased aluminium exports whereas imports are projected to remain nearly unchanged between years. Still, a 76 billion trade deficit is forecast. The trade deficit is expected to shrink close to balance in 2007 when aluminium exports are scheduled to increase further and imports are forecast to contract by 12 per cent. A deficit of 11 billion is forecast for that year.

*... but the trade deficit is projected to decline rapidly in coming years*

The volume of merchandise imports increased by about one-fifth in the first seven months of this year and by about 17 per cent in value terms. The rising exchange rate helps mitigate the rise in the import value in spite of considerable increases in oil prices. The growth in auto imports for private use is by far the largest import growth item, followed closely by rising imports of investment goods.

*Merchandise imports have increased sharply this year*

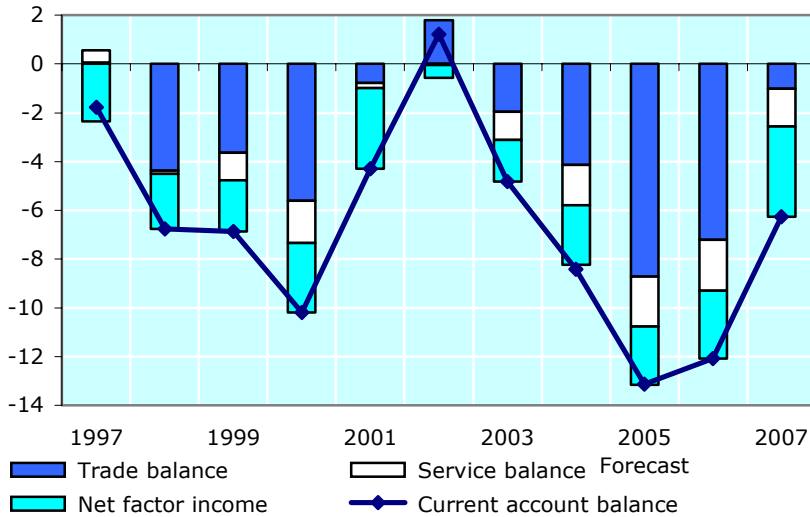
Export production is expected to grow by only 1 per cent in volume this year compared with 8 per cent last year. The category of other manufactured goods (i.e. other than aluminium and ferrosilicon) declined by 13 per cent in the first seven months of this year from the corresponding period a year earlier. A part of the decline is due to a large shipment of generic pharmaceuticals that were airlifted abroad early last year into major European markets, a feat not repeated this year. Exports of marine products are forecast to increase by 2 per cent this year, the same as was forecast last April.

*... whereas the growth in exports has been slow*

The services deficit is forecast to amount to nearly 20 billion krónur this year, compared to 15 billion last year. The revenue from services are growing at a good pace but the deficit is still rising which in part reflects increased travel expenditure by Icelanders abroad. In the first six months of this year, the number of Icelanders going abroad through Keflavik Airport increased by 4 per cent whereas travel expenditures abroad rose by about one-fifth in real terms. The services deficit amounted to 19 billion krónur in the first six

*Considerable deficit on services transactions*

**Graph 7**



months of this year, compared with over 11 billion last year. The main items of the services account are transport and communica-

tions, travel and other services, which cover commercial, computer and information services, culture and entertainment, public services and revenue from the Defence Force. The main item on the services export side consists of transportation that renders 60 per cent of service revenue. Tourism yields another 17 per cent and other services about one-fourth. The main item in the other services category is commercial service, yielding about two-thirds. Revenue from the Defence Force amounted to 2.3 billion krónur, 30 per cent less in real terms than last year. On the import side, other services cover about one-fourth whereas the remainder is almost evenly divided between communications and travel.

**Current account balance**

In per cent of GDP  
Source: Statistics Iceland and own forecast.

*... which is forecast to contract in future years*

For 2006 the growth in services revenue and expenditure is expected to be about the same, perhaps slightly higher on the expenditure side. A turnaround is forecast for 2007 when revenue is expected to grow whereas expenditure should decline in line with declining private consumption. The services balance would therefore improve by a slight margin but still be sizeable.

*Factor payments exceed income*

Provisional data indicate that the balance on factor income and payments amounted to nearly 22 billion krónur in 2004. This deficit is expected to increase to 26 billion this year and widen still further over the next two years. Factor payments exceeded income by 9 billion krónur in the first half of this year, an increase of more than 1 billion from the corresponding period last year. Factor payments have always exceeded income. Interest payments on foreign debt are the largest item on the payments side, accounting for 55 per cent. Dividends paid abroad have increased sharply in recent years. They account for 44 per cent and currently amount to 18 billion. The same change has taken place on the income side. Dividend income was a negligible item during the last decade but has multiplied in recent years, amounting to 22 billion krónur in the first half of this year. With increasing dividend income, the factor income side has grown. It amounted to one-third of expenditure during the last decade, rising to 73 per cent on average for the latest three years.

*Dividends constitute a growing item in factor income*

*Foreign assets are rising faster than debt*

The foreign debt of Iceland, net of foreign assets, amounted to 906 billion krónur at the end of June this year, an increase of 225 billion from the end of last year. Foreign assets increased by 37 per cent over these six months and debt by 35 per cent. The main element in the increase in debt is foreign debt financing of the banks. Their debt rose by 266 billion or 34 per cent in this period. Public debt declined on the other hand by 9 per cent. The foreign debt/GDP ratio stood at 92 per cent at the end of June, compared with 87 per cent at the end of last year.

The environment of the business sector has changed rapidly in recent months due to the strengthening of the exchange rate, a rising Central Bank policy rate and the increased interest rate differential between Iceland and other countries and, finally, the rise in oil prices.

*Sharp changes in the business environment*

The exchange rate is very strong at present. The rate during the first eight months of this year was similar to the 2000-average, a year before the emphasis of monetary policy was shifted from a fixed exchange rate target to an inflation target. The competitive position of Icelandic companies deteriorates as the currency gets stronger. This applies both to import-competing companies in the domestic market as well as to exporters. In reviewing the real exchange rate back to 1980, it is at present similar to the level of 1987 and 1988. Those were in many respects unusual years. The year 1988 was in part a tax-free year, when a pay-as-you-earn income tax system was adopted, replacing the earlier system where taxes were levied on the previous year's income. There were many that used this year to enter the labour market. As may be seen in the following table, the average real exchange rate in the first half of this year is considerably higher than the average real exchange rate for the past 25 years, and still higher than for the past five years. The real exchange rate was generally higher in the first part of the 25- year period.

*The real exchange rate is the highest in many years*

Real exchange rate of the króna		
On average	Relative CPI	Relative ULC
1980-1989	98.9	107.9
1990-1999	93.7	95.7
2000-2004	92.1	98.4
1980-2004	95.5	101.2
1990-2004	93.2	96.6
jan-jún 2005	105.8	119.7

Index 1991=100

Source: Central Bank

The adverse effect of the strong exchange rate upon profits of exporting and import-competing companies is mitigated by the fact that many of these companies have debt in foreign currencies. Foreign interest rates are considerably lower than here, and the interest rate differential has increased in line with a rising domestic policy rate.

*Foreign debt helps company accounts at present*

High oil prices have also had an impact on company profits in this country as elsewhere. This applies in particular to companies in transportation and fisheries. The cost of oil has averaged 11 per cent of total fisheries costs, the largest cost item after wages. It is therefore evident that sustained high oil prices will have a significant impact on the profits of those companies.

*High oil prices also weight heavily on the profits of some companies*

Real GDP rose by 6.2 per cent in 2004 and is forecast to increase by 6 per cent this year. In order to review the share of individual sectors in 2004-growth, it is useful to compare their relative shares of GDP with their five-year average. This comparison shows that sectors such as construction, communications and transportation as

*The sectoral shares in GDP-growth differ*

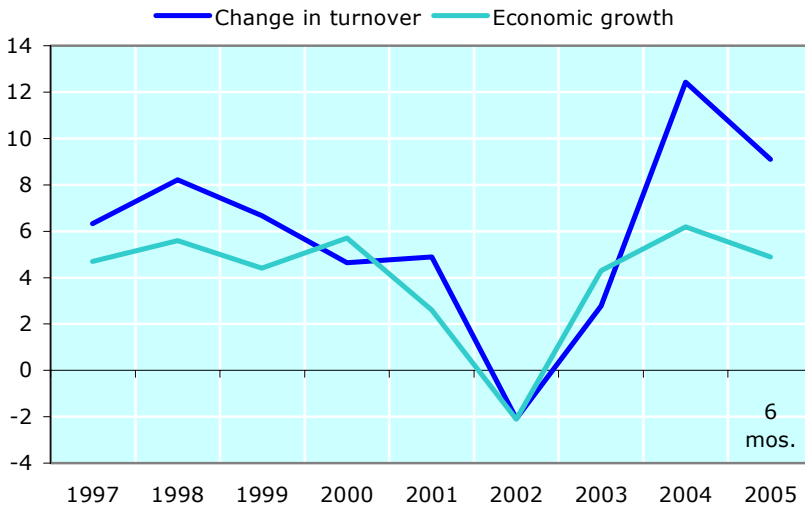
well as miscellaneous services exceed the five-year average. Fisheries and fish processing were considerably below the average, and aluminium and ferro-silicon production were also below average.

Company turnover in the first half of this year, based on VAT-returns, indicates a substantial increase in turnover over last year in many branches connected to the construction industry. Turnover in concrete production rose by close to 50 per cent, in construction as a whole by 30 per cent and the activity of architects and engineers by more than 50 per cent, all in real terms. Consumer-related activities seem also to be doing well. For example, auto dealer turnover rose 40 per cent, which is not surprising in view of new vehicle imports. Turnover in furniture and household accessories rose by about one-fourth. Total turnover for this year as a whole could reach 1,700 million krónur, according to these indicators, compared to 1,540 million in 2004. The chart in the margin shows that there is a fair correlation between changes in turnover and economic growth, except in 2000 and 2001.

The fisheries sector is Iceland's most important export industry, even if other industries are growing in importance. The export production of the fisheries sector is the basis for 60 per cent of merchandise exports in 2004 and in the first half of this year. Aluminium and ferro-silicon accounted for 22 per cent of the total in the first half of this year and other exports for 12 per cent. The fish catch and profits in the fisheries sector are therefore still of great importance. Companies in the fisheries sector are some of the most advanced in the world and have through time introduced technology-based production units as the sector has increasingly rationalised its operations. Product flexibility and marketing have improved in line with the changed conditions of the fish catch, export prices and exchange rate developments of individual currencies. The strength in their operations is of great help at present, when the exchange rate is at an historical high.

The total fish catch of Icelandic vessels was 2 per cent larger up to the end of July than at the same time last year. There are great fluctuations in the catch in individual species. Catches of deep-sea redfish and shrimp have collapsed between years. The deep-sea redfish catch is only half of what it was last year and the shrimp catch has declined 65 per cent. The cod catch declined slightly, whereas the catch of haddock and saithe rose by one-fourth and that of other redfish by more than a third. There is a slight increase in the catch of capelin and herring whereas that of blue whiting declined. The shrimp processing companies have in part met the catch decline by imports of shrimp for domestic processing. The catch quota for the newly begun fishing year permits an increase in the quota for several demersal species, particularly haddock and saithe. The cod quota declines by 7 thous. tonnes, 3.4 per cent, and

**Graph 8**



**Business turnover and economic**

Constant prices in per cent over

Source: Statistics Iceland and own

sector is the basis for 60 per cent of merchandise exports in 2004 and in the first half of this year. Aluminium and ferro-silicon accounted for 22 per cent of the total in the first half of this year and other exports for 12 per cent. The fish catch and profits in the fisheries sector are therefore still of great importance. Companies in the fisheries sector are some of the most advanced in the world and have through time introduced technology-based production units as the sector has increasingly rationalised its operations. Product flexibility and marketing have improved in line with the changed conditions of the fish catch, export prices and exchange rate developments of individual currencies. The strength in their operations is of great help at present, when the exchange rate is at an historical high.

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cod is by far the most valuable single species, yielding 40 per cent of the fish export value last year. The deep-sea shrimp quota was cut by half, from 40 to 20 thous. tonnes. Catching capelin during the summer season was not permitted. Nevertheless, the capelin catch this year already exceeds the catch for all of last year due to a successful catch during the winter season. This is offset by a smaller blue whiting catch this year than last. Prospects for the herring catch are promising. So far, the catch has been good and the catch quota for Atlantic-Scandian herring exceeds that of last year.

Prices for fish products in foreign currency began to increase towards the end of last year. For the first seven months of this year, the SDR-denominated price index for fish products was close to 9 per cent higher than in the corresponding period in 2004. The higher price in foreign currencies is offset by the stronger exchange rate which rose by close to 10 per cent between these periods, based on the exchange rate index. The krónur fish price index was on average 2 per cent lower at present than last year.

*Foreign fish prices have increased*

There is a wide variety of fish products, and markets are quite diverse. The price index for frozen herring, measured in SDRs, has risen so far this year by 55 per cent. The index for demersal fish species frozen at sea has increased by one-fourth, whereas from the middle of 2000 this index has been declining and shore-based freezing has retained its share during most years. The allocation of the catch for processing reflects this shift to a certain extent. The freezing of the catch at sea rose by one-fifth, both because of the rise in the demersal catch and also because the freezing at sea of capelin is rising. The catch that is allocated for processing to be exported by air has increased from year to year. Last year, the increase exceeded 50 per cent from 2003 and again by 10 per cent in the first five months of this year over the same period a year earlier.

*A wide variety of fish products*

The export value of fish products amounted to 59 billion krónur in the first six months of this year, slightly less than a year earlier. In volume terms, fish exports rose by 3 per cent. The Ministry forecasts an increase of 2 per cent for fish products for this year as a whole; this forecast is unchanged from this past spring. An increase in the foreign-currency denominated price is forecast at 6 per cent; a 5 per cent increase was forecast this past spring. Fish production for export is expected to increase by 2 per cent in 2006.

*The fish export value has declined by a small margin*

Aluminium production is expected to remain nearly unchanged this year whereas the dollar price is forecast to rise by more than 6 per cent. This is offset by the weak dollar against the króna which taken together means that the export value of aluminium may decline by one billion krónur or close to 4 per cent. Production in the former phase of the expansion of the Norðurál plant will commence in 2006, and total aluminium production will thereby increase 30 per cent from the previous year. Production at the Reyðarál plant in the north-eastern part of the country is scheduled to begin in the latter half of 2007 which will lead to an increase in production of close to 60 per cent between years. This forecast assumes that aluminium prices in foreign currency will rise by just over 1 per cent next year and decline by close to 5 per cent in 2007.

*Aluminium production expected to increase sharply in coming years*

Due to the rise in the real exchange rate, and also because the

wage cost is considerably higher in Iceland than in many other countries, a number of Icelandic companies have met increased demand by investing in subsidiaries in Europe or in other locations throughout the world. This has mainly applied to traditional manufacturing, although there are examples of high-tech companies that have followed the same path. Companies that previously manufactured goods in this country are now manufacturing abroad and import the products as well as marketing them abroad. These production units are often erected with foreign financing. These companies are therefore growing much faster than previously known. This is in conformity with one of the main characteristics of the globalisation trend that production is relocated throughout the world even if ownership does so to a lesser extent. The capital flow back to the home country increases through the participation in dividends from subsidiaries. Aside from the high wage cost, operating conditions in Iceland are quite good which slows down the outward movement and forms a basis for new industries in international competition.

*Exports of services and factor income are a growing share of total foreign exchange earnings*

The share of foreign exchange earnings from fisheries, aluminium, ferro-silicon and other merchandise export sectors is considerably less than indicated by their share in merchandise exports alone. This is because a growing share of foreign exchange earnings has its origin in services. Transportation is the single most important export earner on the services side. This sector has been growing rapidly in recent years. Software exports, which fall in the category of services, has also increased sharply. The growing portfolio investment abroad has also yielded increased income in recent years.

*Tourism services are increasing*

Last year was a record tourist year with 360 thousand tourists. Figures for the first seven months of this year indicate that they will be similar in number this year. Close to 200 thousand tourists came to Iceland through Keflavik Airport in this period, about 1 per cent fewer than last year. Although the króna exchange rate has risen most against the dollar in this period, the number of tourists from the US rose by 3,700 or 13 per cent. The number of tourists from, for example, Denmark increased but declined from most other countries and from some considerably, such as from Norway by 18 per cent and from Sweden by 12 per cent. Revenue from tourism amounted to about 15 billion krónur in the first half of the year, a decline of some 2 per cent in real terms. Tourism revenue per tourist remained unchanged between years, but tourists were 2 per cent fewer in number in the first six months of this year than last year.



Population

Iceland's population stood at 293,577 at the end of 2004, having increased by 1.0 per cent in that year, a slightly greater increase than the year before. In addition to the natural rate of increase – the difference between births and deaths – migration to and from the country has an increasing influence on Iceland's population growth. Provisional data from Statistics Iceland for the first seven months of this year indicate that the population continues to increase, mostly due to migration that is associated with the expansion of the economy. Last year, emigration by Icelanders exceeded their immigration, whereas this year a turnaround is expected and that repatriating Icelanders will exceed those who emigrate. That would be the first time since 1987 and 1988 that this happens. The number of foreigners coming to the country is at present rising to the same level as around the turn of the century, but the number of foreigners leaving is also increasing. Many construction labourers working on power projects only stay for a short while. Net immigration, both by repatriated Icelanders and immigrating foreigners is expected to amount to 2,000 persons this year. The total population could thereby increase by 3,500 or 1.4 per cent. At the present rate of increase, Iceland's population could pass the 300,000 mark by the end of 2006.

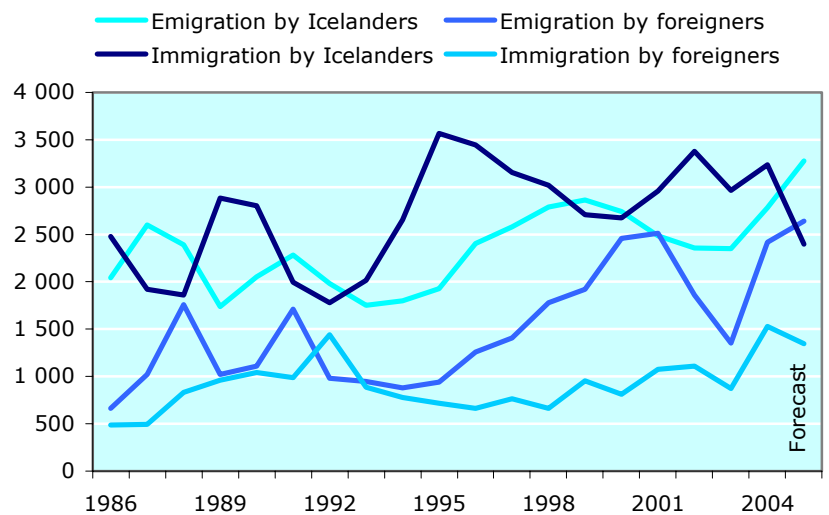
The development of the population by region differs somewhat from the pattern of previous years. The movement of population away from the capital area is expected to exceed the number of people moving to it, which has not happened since the end of the seventies. This turnaround is because an increasing number of people is moving to communities adjacent to the capital area. Net domestic migration to the Reykjanes peninsula came to 255 people in the first seven months of this year, compared with 47 for all of 2004. Another 280 are moving to communities in the South-West and 70 to the Mid-West for a total of nearly 600.

Except for the Fljótdals valley and Akureyri and its surroundings, the population is declining in nearly all rural communities outside of the South-West. The surge in population in Fjarðarbyggð on the East coast is explained by the influx of foreign construction workers.

Improving health and better health services have led to an increasing life expectancy for children born in this country. The average life span is getting longer every year. This has had a profound social impact in recent years for society as a whole and in particular for the pension funds, the social security system and services for the elderly. When the social security system was established in the late forties, the pensionable age was set at 67 years. At that time, the life expectancy of 65-year old men was 15 years and that of women

*Population growing rapidly due to immigration*

Graph 9



International migration by citizenship

Source: Statistics Iceland and own forecast.

*Icelandic life expectancy is rising*

16.5 years. At present this stands at 18 and 21 years respectively.

### Labour market

The active labour force increased by more than 12,000 from 1998 to 2004 or by 8.3 per cent to 158,000 in 2004, based on income taxes from wages. The number of men rose by 5.5 per cent in this period and that of women by 11.6 per cent. More than a third of the increase in the number of women stems from their increased labour market participation, whereas the participation rate for men has declined. The participation of women aged 25 to 39 has increased, most in the 30-34 age group, by 7 per cent. Participation by women over the age of 60 has also increased.

The participation of men and women in the labour market differs little by now, although more women than men have part-time jobs. This has been happening at the same time as women have attained more education. In previous years, the participation rate differed more, since women tended to stay at home with their young children, but today this difference is minimal. Women tend to acquire more education than men and are more active in the labour market while being educated.

The number of disabled persons has increased sharply in recent years, a source of some concern. Questions arise if this trend can be reversed and to what extent it deters the productive capacity of the economy. It appears that there is a correlation between the declining participation rate of older men and the increase in the number of disabled men of the corresponding age. The incidence of disabled women in each age group has increased at the same time as their labour market participation rate has been increasing.

Icelanders work longer than other nations, both the number of hours worked each year or if the number of years worked are counted. This notwithstanding, there is discussion as to whether the working life should be prolonged. Based on income tax data, 3-4 per cent of wage earners retire at the age of 60-64, 20 per cent when they are 65-69 years old and another 35 per cent before the age of 75. About 20 per cent of men and 8 per cent of women are still working in the 70-74 year age group. It is therefore clear that if the working life of older people is going to be extended it must take place in the age groups around 70. This is in contrast with neighbouring countries where the aim is to increase participation of people in the labour market and postponing their retirement when they are ten years younger than here.

The development of labour market participation in the present expansion was such at the beginning that there were signs that there was "jobless" growth under way. Sources do not agree on this, however. The labour market surveys of Statistics Iceland showed a decline in the labour force and the number of persons employed in 2004 from the previous year whereas income tax data showed the opposite. The receipts from the social security tax in excess of the growth in the wage index indicated that this growth was significant. This year, available sources tend to be more congruent. This year's labour market surveys indicate that the number of persons employed could approach 4,000, an increase of 2.3 per cent. Such surveys would tend to underestimate the number of foreigners work-

*The number of people in the labour force has increased sharply in recent years*

*Labour market participation by gender differs little*

*Large increase in the number of disabled a source of concern*

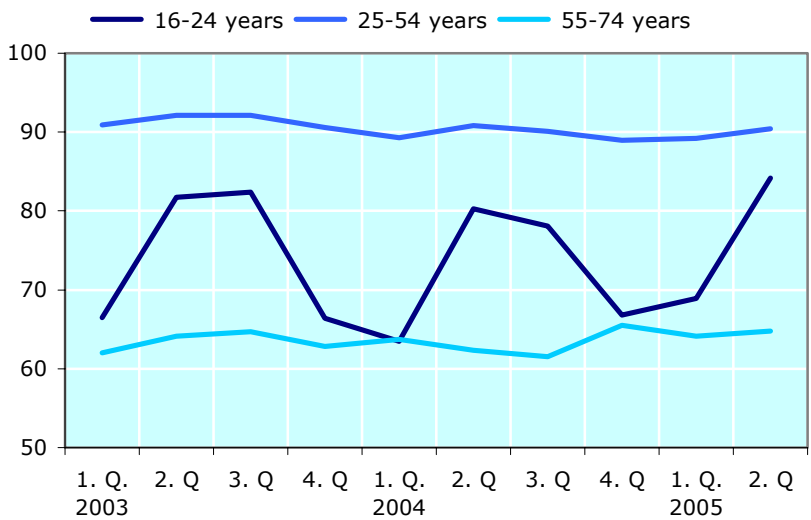
*Icelanders work longer than other nations*

*Labour market participation increasing rapidly*

ing in this country, both because they have not been registered yet in the sample survey and it is difficult to reach them. The response rate is therefore lower than income tax data would indicate.

**Graph 10**

The labour market participation of the 16-24 year age group has fluctuated in the course of the year. This year's measurement shows a significant increase in the participation rate of young people over the previous year. The fluctuations in this age group in labour market surveys has been greater than in other age groups, both in relation to those at work and those unemployed. Both groups are included in labour market participation. The participation rate of this age group rose by 5.4 per cent in the first quarter and the number of persons working by 4.5 per cent. Unemployment in the same age group rose by 0.9 per cent. The participation rate of this age group rose further by 3.9 per cent in the second quarter and the number of persons working rose by 6.3 per cent. Unemployment thus declined by 3.4 per cent in the second quarter. A large percentage of people in this age group are in school, and these figures therefore indicate that the number of job opportunities along with school work is increasing, although the number of school leavers may have increased. The seasonal fluctuation and the change in labour market participation is lower in other age groups.



**Activity rates by age**

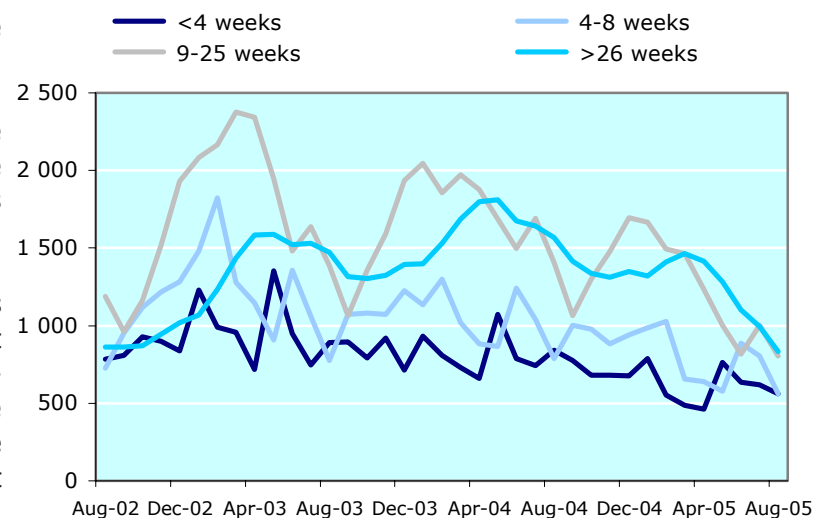
In per cent of each age group  
Source: Statistics Iceland.

### Unemployment

Registered unemployment has been declining this year. There were 2,932 persons on the unemployment registry at the end of August for the whole country, the lowest number since November 2001. The number of unemployed men has declined by half in one year and that of women by a fourth. The unemployment of women is increasing again since May in the capital area and since July in the regions. The number of unemployed women declined sharply in August, particularly in the capital area when labour shortages in the service sector was becoming acute. The number of longer-term unemployed has declined noticeably this year. Their number has not been as low for three years. The number of persons unemployed less than two months has changed little. It appears that employers are not as sensitive to persons quitting their jobs in the present employment situation. Average unemployment for this year is forecast at 2.2 per cent, whereas the April forecast predicted a 2.4 per cent rate. The 2006 rate is forecast at 1.8 per cent on average which, other things being equal, indicates increased pressure in the labour market.

*Unemployment has declined*

**Graph 11**



**Unemployment by duration**

Number of registered unemployed  
Source: Labour Directorate.

The present expansion in the Icelandic economy differs from previous expansions because Icelandic employers are now increasingly able to fill short-term jobs with foreign labourers. Through so-called service contracts, the need for work permits is avoided for persons coming from outside the EEA. The application for work permits takes time and is complicated. The Icelandic authorities are working on the facilitation of the work permit procedure. The upward pressure on wages is therefore lower in view of the influx of foreign labour than it would have been in its absence. This does not, of course, apply to jobs where knowledge of some Icelandic is a prerequisite.

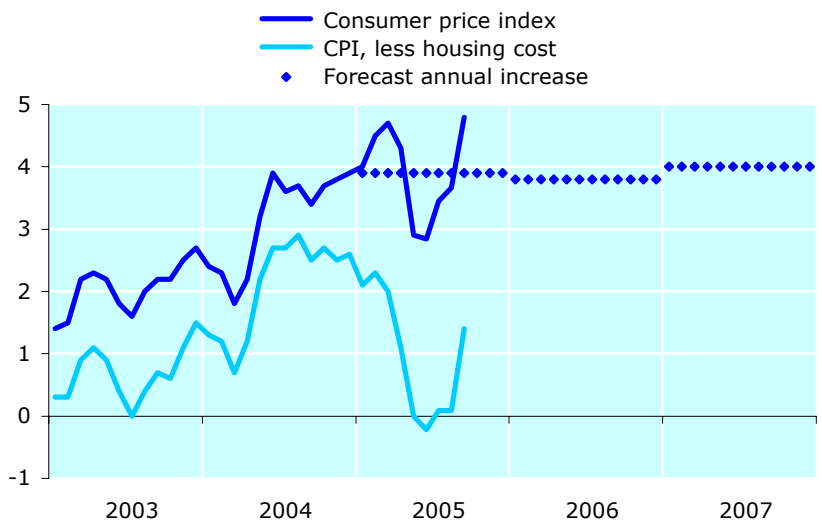
A number of price increases have made it difficult for the Central Bank to keep inflation within the upper limit of a 4 per cent annual rate. The rate began to exceed the 2.5 per cent inflation target in May of last year and exceeded the upper tolerance limit of 4 per cent in February to April of this year and again this past September. The Bank has reacted with a significant increase in its policy interest rate. The increase in inflation is concentrated in several items of the consumer price index, not in general increases in all categories of goods and services. Most important is the increase in real property prices, following the entry of the banks into the mortgage market in the autumn of 2004. Better mortgage terms increased the demand for housing and real property prices increased rapidly. The impact on the consumer price index has been substantial, since owner-occupied housing accounts for 15 per cent of the index basket. The sharp rise in oil prices this year has had a similar impact, although its weight in the index is only 5 per cent. These increases have been offset by the rising exchange rate which has led to declining prices for imported goods and services.

*A number of price increases make it difficult for the Central Bank to stay within inflation limits*

Inflation has been rising in recent months. The twelve-month increase stood at 2.8 per cent last June. By September, the increase was up to 4.8 per cent, breaching the upper 4 per cent limit again.

**Graph 12**

Prices of owner-occupied housing are the main cause of the rising consumer price index. The twelve-month increase in the price of owner-occupied homes was 25 per cent by September, accounting for 3.8 percentage points of the increase in the index. This index measurement is based on a three-month moving average of market housing prices and a twelve-month average of mortgage interest rates. By comparison, the twelve-month increase in housing prices for the country as a whole was 33 per cent up to September. The rising market price of housing increases the weight of housing costs in the consumer expenditures of households. The owner-occupied housing share in total consumer expenditures increased from 12.9 per cent in September of last year to 15.3 per cent this year. The housing component therefore has a greater impact on the consumer price index than before. At present, there are indications that the property market is calming down. The supply of new housing is increasing and market turnover is slowing. By the middle of September the real property price index dipped slightly from the month before for the first time since 1998.



**Inflation**  
12 month change in per cent  
Source: Statistics Iceland and own forecast

Statistics Iceland revised its calculation of the housing price component in the consumer price index as of last May. The mortgage interest rates incorporated into the index consist of a twelve-month moving average whereas previously a five-year average was used. This means that the impact of lower mortgage interest rates will

*The revised calculation of the housing price component shows a lower inflation rate than previously*

show up more quickly in the index. These changes have reduced inflation as measured by the index, since mortgage interest rates have declined.

Charges for public services have increased by 6.8 per cent in the past twelve months and by 3.9 per cent for other services. These components account for close to a third of the increase in the index, 1.4 percentage points.

The strong exchange rate and competition in the non-durable consumer goods market has helped reduce inflationary pressures. Excluding housing, the twelve-month increase in the index up to September was 1.4 per cent. All told, imported goods rose in price by 0.4 per cent over the period; excluding liquor and tobacco, they remained constant in price. Imported food and beverages declined by 7.4 per cent whereas new cars and spare parts declined by only 1.6 per cent. Imported fuels had a substantial impact on the index; they rose by 12.3 per cent.

By September, the twelve-month increase in domestic goods was 1.4 per cent, and 2 per cent excluding farm products and vegetables. Earlier declines in food prices have been reversed in recent months or since May when a "price war" erupted between supermarkets.

The two core inflation indices, 1 and 2, have developed similarly to the overall index. Core index 1 covers all goods except farm products, vegetables, fruit and petrol. It rose by 4.8 per cent. Core index 2 excludes public services on top of the exceptions in core index 1; it rose by 4.7 per cent. Housing prices impact on both core indices as well as on the overall index.

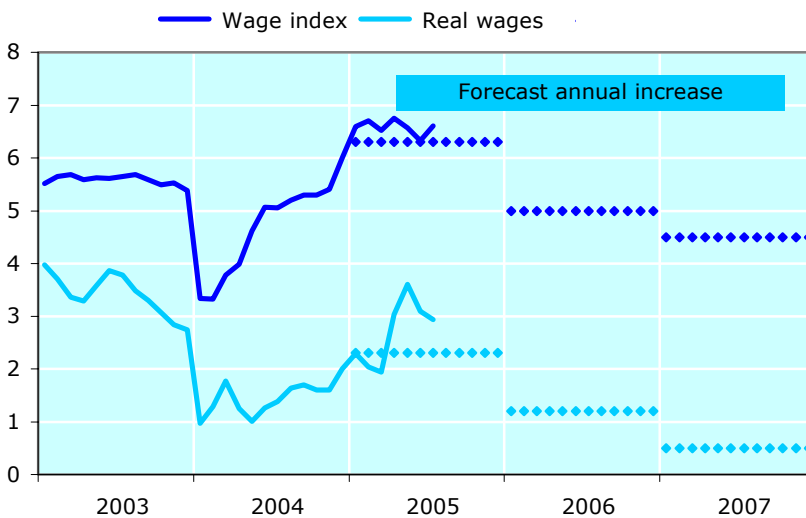
The consumer price index is expected to increase by 3.9 per cent between the averages of 2004 and 2005. Inflation is expected to develop at a similar pace in the next two years. Rates of 3.8 and 4 per cent are projected in this forecast. The forecast assumes that the Central Bank policy rate will average 9.4 per cent this year, 9.5 per cent in 2006 and 7.3 per cent in 2007 and that the exchange rate index declines by 9.2 per cent on average this year, rising by 3.6 per cent in 2006 and 4.8 per cent in 2007.

*Services prices are increasing ...*

*... but most import prices are declining ...*

*... as well as the prices for domestic goods*

**Graph 13**



**Real wages**

12 month changes in per cent

*Uncertainties remain regarding the exchange rate, the real property market and fuel prices*

The main elements of uncertainty in the inflation forecast are the exchange rate, real property and fuel prices. A lower exchange rate will soon show up in prices and would thereby increase inflationary pressures, at least in the short run, especially since it often happens in concert with reduced tensions in the economy. Housing prices are another element of uncertainty, since their impact on the index is larger than of other index components. At present, it appears that the housing market is cooling down, as evidenced by reduced property turnover. Fuel prices are, as before, subject to great uncertainty. World market prices have increased considerably of late in line with increasing demand, and substantial supply shocks have

exacerbated the situation. Since oil refining capacity is stretched, there is every likelihood that oil prices will remain high in the near future.

The average wage increase this year is forecast at 6.3 per cent, 5 per cent next year and 4.5 per cent in 2007.

Real wages have continued to increase in spite of increasing inflation. The wage index increased by 6.6 per cent in the twelve months up to July which leaves a real wage increase of 2.9 per cent for the same period. The increase in the wage index in recent months stems from contractual pay increases in the public sector as well as from pay agreements in the private sector. Most public employee unions have concluded pay agreements by now whereas most private sector agreements took effect in the first half of 2004.

On the basis of the present forecast, real wages can be expected to increase. This year's increase is forecast at 2.3 per cent and for the years 2006 and 2007 the increases are forecast at 1.2 and 0.5 per cent respectively.

Disposable income takes account of income after taxes. They are defined as income of households, including wages, income from capital and transfer payments, less taxes and capital expenses. Disposable income per capita is the average of total disposable income divided by the population. When corrected for inflation, real disposable income per capita is derived. Such income is forecast to increase by 3.7 per cent due to wage increases and the decline in the personal income tax by one percentage point for the year. The increase for 2006 is forecast at 2.7 per cent due to wage increases and another one percentage point income tax cut. For 2007, the increase is projected at 2.1 per cent, mostly on account of a 2 percentage point reduction in the income tax at the same time as demand pressure in the labour market is expected to abate.

*A greater wage increase is forecast for this year than last ...*

*... and real wages are expected to continue increasing*

*Real disposable income per capita will increase more*

Government finances<sup>1</sup> have been under frequent discussion recently due to the strong exchange rate of the currency. Government finances have been criticised for lack of restraint in the present circumstances of economic expansion which have led to the policy interest rate being higher than otherwise would have been necessary and this allegedly has exacerbated the imbalance of the economy. The Ministry of Finance does not share this opinion and bases its own opinion in part on research of the OECD<sup>2</sup>. The restraint of general government finances has increased in recent years, particularly those of the Treasury. The reason for the temporary imbalance is that Iceland's small open economy is rapidly expanding. There is every reason to believe that a flexible and responsible economic policy, along with the adaptability of business and labour will suffice to achieve a soft landing for the economy in the near future.

General government finances improved significantly in 2004, following a 16 billion krónur deficit in 2003. Provisional figures from Statistics Iceland show a half billion krónur deficit in 2004. The data from Statistics Iceland of this past March showed a surplus of 3.8 billion for 2004. Since then the figures have been revised downwards, mainly because municipal finances turned out worse than had been estimated earlier. Their deficit turned out to be much higher, 10.3 billion. This is offset by a Treasury surplus of 9 billion and one of 0.8 billion in the social security sector. The share of general government revenue in GDP rose by close to 1.7 per cent between years whereas the expenditure share declined by 0.4 per cent of GDP. The general government balance therefore improved by 2 per cent of GDP between these two years.

At present, the general government surplus is expected to be higher

*Government finances provide increasing restraint*

Public finances					
		Est.	Forecast		
<i>Billion króna</i>	2003	2004	2005	2006	2007
Total income	368.4	416.7	463.7	468.6	483.6
Total expenditure	385.1	417.2	440.8	458.2	493.0
Financial balance	-16.7	-0.5	22.9	10.5	-9.4
<i>Percentage of GDP</i>					
Total income	45.4	47.1	48.0	44.6	43.6
Total expenditure	47.5	47.1	45.6	43.6	44.4
Financial balance	-2.1	-0.1	2.4	1.0	-0.8

Source: Statistics Iceland and own forecast

than in earlier forecasts, 23 billion krónur or 2.4 per cent of GDP. This surplus is on par with the one of 1999, and the tightening of general government finances has thereby increased by 4.5 per cent of GDP between 2003 and 2005 which is the sharpest tightening amongst OECD countries during these years and far greater than in the previous cyclical expansion. Much of the improvement is due to

<sup>1</sup> General government finances cover the central and local levels of government and are presented here on a national accounts basis. A special Appendix explains its comparison with company accounts (not translated).

<sup>2</sup> Peter Hoeller, Claude Giorno and Christine de la Maisonneuve, „Overheating in Small Euro Area Economies: Should Fiscal Policy React” - OECD Economics Department Working Papers No. 323, February 2002, Paris.

*This year's surplus projected at 2.4 per cent of GDP*



### **A special section: The scope for using fiscal policy in the business cycle**

**Due to the substantial power project investments, demand pressures in the economy have temporarily increased. In order to prevent overheating, the Government has presented tight fiscal budgets for 2004-2006. The Central Bank has also significantly increased its policy rate in order to prevent an increase in inflation. The fiscal surplus has increased sharply and will peak this year. In spite of this record, there is much discussion that fiscal measures are insufficient. This section discusses what reasonably can be expected from fiscal restraint.**

#### **The fiscal budget is getting tighter**

Due to substantial power project construction which have the aim of increasing sustainable future growth, a temporary surge in domestic demand has emerged. The goal of economic policy is to prevent actual output from exceeding the trend in potential output to the extent that inflation emerges. The Central Bank has increased its policy rate from 5.3 per cent in May 2004 to 9.5 per cent in June 2005 and announced at the same time that further increases could not be excluded. The Government has pursued a tighter fiscal policy, and the 2005 fiscal surplus is estimated at 2.8 per cent of GDP. The surplus has increased by 5,6 per cent of GDP from 2003 to 2005, the largest fiscal tightening amongst OECD countries in this period. The 2006 fiscal surplus is estimated at 1.4 per cent of GDP. The sales proceeds from the privatisation of Iceland Telecom are not included in these figures.

#### **The Medium-Term Programme**

In addition to a tight fiscal policy in 2004-2006, the Government has outlined a Medium-Term Programme which postpones public investments in 2004-2006, again increasing them in 2007 and 2008 when power project construction has tapered off. The aim is to keep the growth in public consumption below 2 per cent a year and the income transfers below 2,5 per cent and to cut the personal income tax in 2005-2007 to let taxpayers share in the improvement in fiscal finances. Privatisation is to continue, following the sale of Iceland Telecom. This policy has met with success; the fiscal surplus has increased anew and will probably peak this year.

#### **The Treasury balance and automatic fiscal stabilisers**

The analysis of fiscal finances follows the traditional method of using national accounting standards. Such an analysis is subject to the limitation that it proves difficult to discern the interplay and impact of the business cycle on one hand and the underlying Treasury balance on the other. The business cycle has a significant impact both on public revenue and expenditure. The revenue side is more sensitive to cyclical swings, partly because the personal income tax is progressive. The structure of fiscal finances embodies an automatic stabiliser that serves to temper the business cycle and the balance of public finances thereby. One of the main advantages of automatic fiscal stabilisation is that it has an immediate impact on the business cycle. It is therefore

important to analyse fiscal finances once it has been corrected for the cyclical impact at each time. Such a correction is based on the positive or negative output gap in each instance and the elasticity of public revenue and expenditure with respect to the business cycle. Such an adjusted fiscal balance is generally known as a structural balance. It provides guidance for governments in gauging the scale of fiscal restraint. The question arises to what extent it is possible to apply fiscal finances with discrete measures in addition to automatic fiscal stabilisers. Recent research indicates that there are limits to how fiscal finances can be used to prevent overheating of the economy.

### **International research on the scope for fiscal policy in economic management**

A recent research report of the OECD<sup>1</sup> discusses as to what extent fiscal policy can be applied to counter overheating in small, open economies in the euro-area. The main conclusions of the report are as follows:

- i) Automatic fiscal stabilisation does little to help mitigating demand shocks.
- ii) The multiplier effect of fiscal finances is limited in small, open economies. Large swings in fiscal finances would be needed to dampen business cycles.
- iii) Large changes in government expenditures and revenue would be in conflict with the aim of fiscal stability.

### **The resilience of businesses reduces economic pressures**

The above-mentioned research report reviewed on one hand the market conditions that tend to prevent overheating of the economy and automatic fiscal stabilisation on the other. The reasoning is that market forces in small, open economies will more easily react to changed circumstances, once the proper market conditions are at hand. Strong competition, business integration between countries, a flexible labour market and wage comparison between larger areas all serve to temper economic imbalances. An active short-term fiscal policy with large swings in taxation and government expenditure would only distort the market mechanism, create uncertainty and undermine the credibility of fiscal policy in the longer term. Aside from automatic fiscal stabilisers, it is probably better to adhere to a long-term fiscal goal and let market forces deal with short-term cyclical correction.

### **Main conclusions**

*The main conclusion is that market forces in small, open economies will find it easier to react to changed circumstances, such as demand shocks, provided that the right market conditions are at hand. The multiplier effects of fiscal finances are rather small in such economies, and large swings in fiscal expenditure and revenue would be needed to mitigate the business cycle. Such swings in fiscal finances would tend to undermine the fiscal impact and would not be in conformity with their longer-term stability. A long-term goal for fiscal finances would yield better results and let the short-term correction of the business cycle take place through a contribution of market forces.*

<sup>1</sup> Peter Hoeller, Claude Giorno and Christine de la Maisonneuve, „Overheating in Small Euro Area Economies: Should Fiscal Policy React“ - OECD Economics Department Working Papers No. 323, February 2002, Paris.

an increase in revenue. Tax revenue is estimated to increase by 10 per cent between years and yield 392.4 billion for general government as a whole. The bulk of the increase stems from indirect tax receipts on consumption, imports and real property transactions. The revenue from income taxes on wages has also be more than expected. Expenditure is estimated to increase by 5 per cent and the real increase in public consumption is estimated at 2.3 per cent, government investment is thought to decline by 8 per cent in nominal terms and more than 12 per cent in real terms.

### General government tax revenue

<i>Billion krónur</i>	2003	Est.		Forecast	
		2004	2005	2006	2007
Tax revenue	313.0	355.6	392.4	400.7	414.1
Taxes on income	129.8	143.7	153.9	161.2	162.3
Tax on capital income	9.1	10.5	12.6	11.3	12.6
Taxes on property	13.2	15.0	18.3	16.2	17.4
Value-added taxes	84.0	100.0	112.1	118.5	120.1
Other taxes on goods and services	50.2	57.3	62.2	57.6	68.5
Social security contributions	26.9	29.1	33.2	36.0	33.3
<i>Tax revenue, % of GDP</i>	<i>38.6</i>	<i>40.2</i>	<i>40.7</i>	<i>38.1</i>	<i>37.3</i>

Source: Statistics Iceland and own forecast

The general government surplus is estimated at 1 per cent of GDP in 2006 or 10.5 billion which is considerably less than this year. This turnaround is primarily due to the fact that the turnover in consumer expenditures and imports is expected to be lower than this year, net wealth tax is going to be abolished and the personal income tax rate is going to be cut. Dividend income will also be considerably less, following the sale of Iceland Telecom. General government revenue is estimated to increase by just over 1 per cent between years or by some 5 billion krónur. Total expenditure is projected to increase by 4 per cent at the same time, slightly less than this year or by 17.5 billion krónur. The increase in public consumption is estimated at 2 per cent in real terms and at 5.7 per cent in transfer payments or slightly less than the rise in the wage index. Government investment is expected to contract by 4.3 billion.

A slowdown in the economy is expected in 2007 and the general government balance is therefore expected to go into deficit of 9.4 billion, 0.8 per cent of GDP. Most of the current power project investments will be completed by then and the Treasury's tax cuts will be fully implemented. General government revenue is expected to rise by only 3 per cent between years to 43.6 per cent of GDP compared with 44.6 per cent the year before. Expenditure is projected to increase by 7.6 per cent, increasing by 0.8 per cent of GDP to 44.4 per cent. Treasury investment will increase which will help in countering the slowdown in the economy.

The net debt of general government, excluding pension fund commitments, has greatly improved in the past decade. For this year, net debt is estimated at the equivalent of 13.4 per cent of GDP compared with 40 per cent in 1995. The net debt of the Treasury is expected to have improved more, declining to 7.9 per cent of GDP this year compared with 35 per cent in 1995. If cash at hand and

Treasury bank deposits are included in net debt, it stands at 5.4 per cent of GDP in 2005 compared to 33.8 per cent in 1995.

### Treasury finances

*The Treasury surplus improved by 2.7 per cent of GDP between 2003 and 2004*

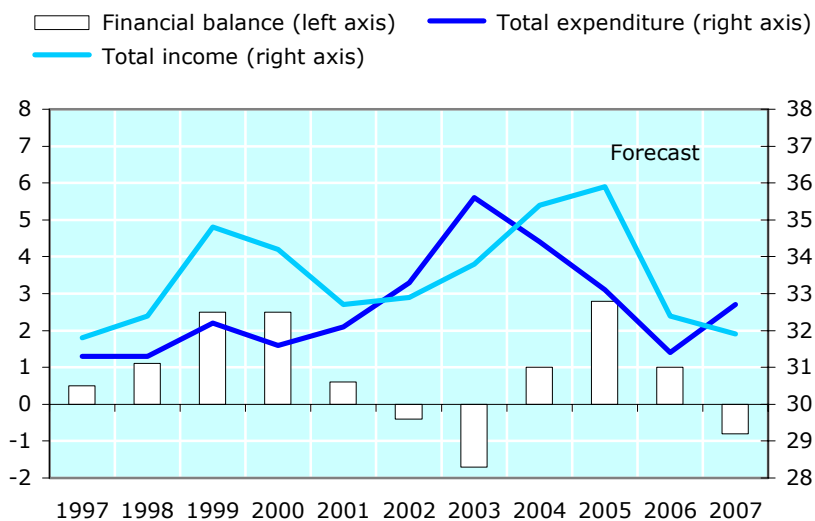
On a national accounts basis, the Treasury surplus amounted to 9 billion krónur in 2004, equivalent to 1 per cent of GDP. This surplus is slightly higher, by 1 billion, than previous estimates indicated. Total Treasury revenue is estimated to have increased by 39 billion from 2003, 35.4 per cent of GDP, compared with 33.8 per cent the year before. Tax revenue rose by 37 billion of which 16 billion came from the value added tax and 9.6 billion from the personal income tax. Total Treasury expenditure rose by close to 16 billion to 34.4 per cent of GDP compared with 35.6 per cent the year before. The Treasury's public consumption expenditure rose by 8 billion or 2.8 per cent in real terms and its investment by close to 3 billion or 15 per cent in real terms. Transfer payments contracted slightly, as measured by general wage increases.

*The Treasury surplus is estimated at 2.8 per cent of GDP in 2005*

The Treasury surplus is currently expected to exceed earlier estimates of the Ministry. It is estimated to amount to 27.1 billion krónur or 2.8 per cent of GDP. This improvement is primarily due to increased revenue on the basis of a larger turnover in the economy than anticipated earlier. Tax revenue is expected to increase by 26 billion over the previous year and amount to 302 billion of which the value added tax and excise taxes are expected to increase by 15

billion to 142 billion. Other Treasury revenue is also turning out to be higher than expected, mostly because the dividend payment from Iceland Telecom was four billion krónur higher than had been expected. On the expenditure side, the public consumption component of Treasury expenditure and that of the social security sector is expected to increase by 2.3 per cent, mostly on account of increasing expenditures for health and education. Transfer payments of the Treasury and social security are expected to increase by just over four billion krónur which is equivalent to a 1 per cent decline in real terms, as measured by general wage increases. The slower growth

**Graph 14**



### Treasury Finances

In per cent of GDP

Source: Statistics Iceland and own forecast.

*Treasury revenue is expected to decline in 2006*

is in part explained by reduced outlays for unemployment compensation. Investment expenditures are expected to decline by 2.7 billion this year. The profit from the sale of Iceland Telecom has no influence on the drawing up of the Treasury accounts on a national accounting basis (see Appendix (not translated)).

The 2006 Treasury surplus is projected to amount to 10.7 billion krónur, equivalent to 1 per cent of GDP which represents a considerable change from this year. Tax revenue is expected to remain about unchanged in nominal terms between years due to a cut in the personal income tax, the abolishment of the net wealth tax and declining turnover in vehicle imports and real property transactions.

Dividend income of the Treasury will decline from this year, but this is in part offset by increasing interest income from deposits with the Central Bank from the sale proceeds of the privatisation of Iceland Telecom. The aim is to keep public consumption and transfer expenditure within the limits of the Government's Medium-Term Programme. Interest paid on Treasury debt will also decline due to substantial repayments of foreign debt in 2005. Investment expenditure will be kept at a minimum, declining by 2.5 billion from this year.

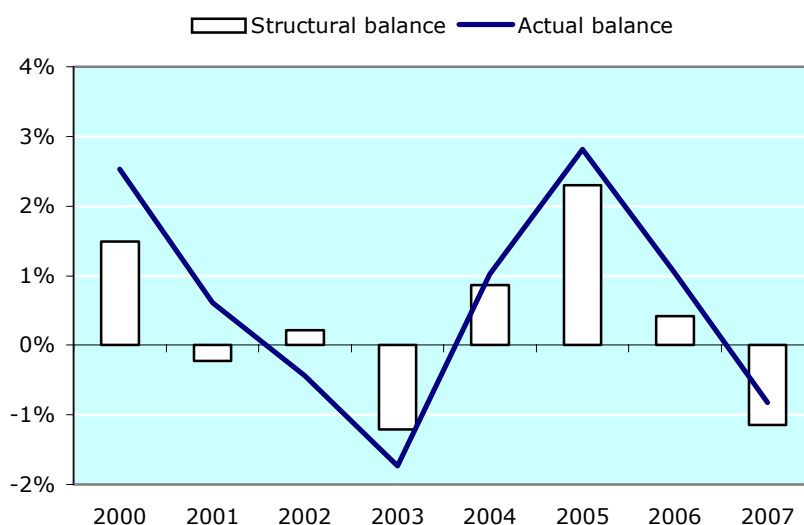
The Treasury balance will turn into deficit in 2007, estimated at 9.4 billion krónur or 0.8 per cent of GDP, mainly due to a further cut in the personal income tax, lower revenue from indirect taxes due to reduced private consumption, rising transfer payments because of increasing unemployment and higher investment expenditures. Treasury revenue is estimated to increase by 12.6 billion between 2006 and 2007 whereas expenditure may increase by 33 billion. These changes reflect the intent of the Government to use fiscal finances to offset some of the slower growth expected in that year.

### Municipal finances

The most recent data from Statistics Iceland indicate that the municipal deficit amounted to 10.3 billion krónur in 2004, 1.2 per cent of GDP. This outturn is much worse than the provisional figures of last March indicated, the reason being that municipal investment turned out to be higher than earlier thought. It increased by 8.5 billion krónur. Excluding the sale-and-leaseback of municipal assets in 2003, the increase was 5 billion or 37 per cent. The public consumption component increased far less than earlier data had indicated, or by only 2.4 per cent instead of 7 per cent. The total expenditure of municipalities rose by 15 billion between 2003 and 2004 whereas municipal revenue increased by only 8.5 billion.

This year's municipal deficit is estimated at 6.4 billion krónur or 0.7 per cent of GDP, slightly more than forecast last April. Municipal investment is still expected to be high by historical standards, although it is thought to decline from 16 per cent to 15 per cent of total municipal expenditure. The rate of investment is partly explained by substantial investment in municipal roads. Municipal total expenditure is expected to increase by 7.4 billion. The public consumption expenditure forecast has been revised in light of revised 2004 figures. Municipal public consumption expenditure is forecast to increase by 6.6 billion between 2004 and 2005, an increase of 2.5 per cent in real terms. Revenue is forecast to increase by 11.8 billion of which tax revenue amounts to 10.4 billion. The large expansion in housing investment and rising real property prices are expected to increase municipal revenue significantly. Most municipalities have also used the permissible tax rate in full and some

**Graph 15**



**Central government structural balance**  
In per cent of GDP

*The deficit of the municipalities amounted to 1.2 per cent of GDP in 2004*

*... and is expected to be equivalent to 0.7 per cent of GDP this year*

have increased their user charges.

Municipal finances are expected to improve in 2006. The deficit is projected to decline to 3.3 billion or 0.3 per cent of GDP. Revenue is forecast to increase by 8.5 billion, in part through a rising real property assessment and a change in property tax legislation. Municipal public consumption is projected to increase by 2.5 per cent but investment will contract in nominal terms. The municipal deficit is forecast to decline to 1.5 billion or 0.1 per cent of GDP in 2007 with revenue increasing by about 7 billion from the previous year, public consumption expenditure increasing by same rate as the year before in real terms and investment continuing its decline.

A developing financial market has a positive impact on the economy. It helps in the intermediation between savers and investors, improves the allocation of resources and thus strengthens economic growth. The rapid change of the Icelandic financial market in recent years is no exception. Ever since the financial market was liberalised and the banks were privatised, the market has expanded for the benefit of consumers and businesses alike. The globalisation impact on the economy along with technological progress in electronic communications have greatly enhanced the possibilities for Icelanders to transfer savings abroad and invest them there. At the same time, Icelandic investors have gained access to cheaper financing from abroad. The increase in bank credit has helped in raising real property prices and share prices, thus increasing the confidence of consumers and business.

The monetary measures of the Central Bank, raising the policy rate, have not had much of an influence on the expansion in bank credit, whereas the impact of the rising policy rate on the exchange rate has been all the more noticeable. This has helped in dampening inflation through favourable import prices. The strong exchange rate has increased the purchasing power of households and businesses and fuelled import demand, thus increasing the current account deficit.

At present, the main engines of growth are the power project investments along with the vigour and initiative of the business sector. At the beginning of this year, the analysts of the commercial banks expressed the opinion that the stock market was nearing its peak. Actual developments have exceeded their expectations by far. The stock market index has increased by about 40 per cent up to the end of August after having increased by nearly 60 per cent in 2004.

In contrast to the Icelandic stock market, foreign markets remain lacklustre. Following the presidential elections in the US last October, the US stock market began inching upward and continued doing so into the new year. Since then, stock prices stagnated in the wake of a rising discount rate of the Federal Reserve along with rising oil prices, both of which have an impact on economic growth and business profitability. European stock markets have developed in a similar manner. Economic growth in some of Europe's largest countries has been anaemic, as is further discussed in the chapter on the international economy. This, no doubt, means that Icelandic investors are slow in increasing their portfolio of foreign stocks, although the balance of payments statistics of the Central Bank show some tendency in that direction. Investors seem instead to concentrate on the domestic stock market to take advantage of and contribute to the upward trend in stock prices.

Total bank credit rose by 630 billion or 37 per cent in the first seven months of this year. Of this amount, 425 billion were in krónur and 200 billion in foreign currency. Domestic lending was higher in this period than for all of 2004 when domestic loans rose by 381 billion. The total increase in outstanding credit is about equal to two-thirds of the estimated 965 billion nominal GDP for all of this year.

*Improvements in the financial markets have helped growth*

*The Central Bank raises interest rates to counter the expansion*

*Domestic stock market marked by optimism ...*

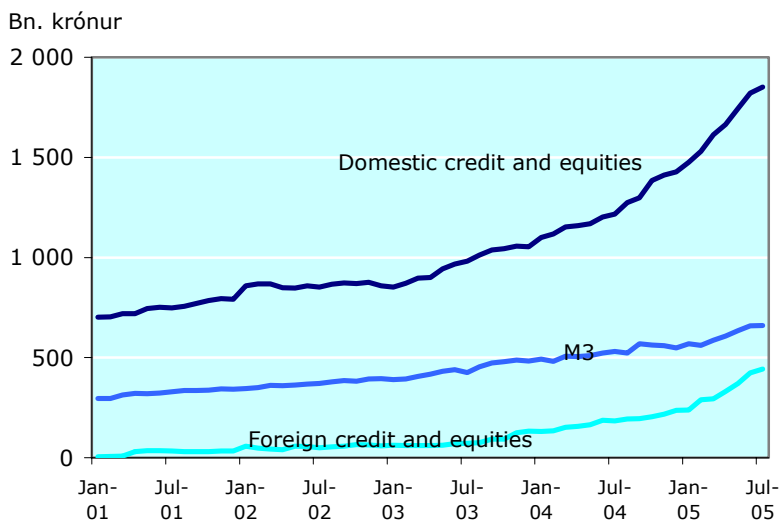
*... whereas foreign stock markets lack direction*

*Bank credit has risen very fast this year ...*

*... and is increasingly financed abroad*

The banks are increasingly resorting to foreign financing of domestic credit. In the first seven months of this year, deposits only rose by 111 billion, whereas at the same time the banks issued 545 billion in debt that was tied to exchange rates. The corresponding figures for the first seven months of 2004 were 47 and 156 billion. It is also noticeable that the foreign claims of the deposit money

**Graph 16**



**Bank credit and M3**

Source: Central Bank.

banks rose by 185 billion, compared to only 3 billion in the same period a year earlier. This reflects the fact that the commercial banks are gradually expanding their foreign business.

The bulk of domestic lending of the banks went to households, which is connected to the change in the mortgage market since August 2004, when the deposit money banks began offering mortgage credits at terms hitherto unknown. During the twelve-month period to the end of July of this year, the banks lent nearly 300 billion in the form of indexed credits, most of which were residential mortgage loans. This compares to only 15 billion in the previous twelve months. Part of this increase was at the expense of lending by the Housing Finance Fund; its outstanding credits declined by 92 billion in the twelve months up to the end of July this year.

*The rise in the policy rate has a limited impact*

This increase in credit has taken place despite the increase in the Central Bank policy rate which is intended to stem the increase in bank credit. The rate went from 5.3 per cent in May 2004 in several steps up to 9.5 per cent in June 2005. A further increase in the rate will undoubtedly be coming in the remainder of this year, peaking sometime next year and could begin to come down in the latter half of 2006. For the purpose of this forecast, the average 2006-rate is assumed at 9.5 per cent, slightly higher than this year's estimated average of 9.4 per cent. The economy is expected to cool down in 2007 and that there will be scope for a further reduction in the policy rate to an estimated 7.25 per cent for that year.

*The interest rate differential with other countries affects the exchange rate*

The experience in Iceland as well as in other countries where the policy rate is the main monetary policy instrument is that credit expansion in the wake of policy rate increases only work with a one to two-year lag. It must therefore be expected that the expansion in bank credit will continue for a while. The rising policy rate is however quickly translated into short-term interest rates and the differential between domestic and foreign rates in Iceland's main trading partner countries. The rising differential plays an important role in strengthening the exchange rate, although this was not the case in 2001. The average exchange rate index for the first eight months of this year was 110.5, 9 per cent lower than in 2004. The average for 2004 was in turn 8 per cent lower than in 2003. In addition to the foreign currency inflow in connection with the power project investments, the interest rate differential has affected the exchange rate. The differential has encouraged the banks to seek financing abroad. Foreign issues of debt in Icelandic krónur is also a novel twist in this



tale. Up to the middle of September, a total of 42 billion krónur were issued of such debt, most of it in the past four weeks and mostly with a one to three-year maturity. These issues have served to strengthen the exchange rate and may, conversely, weaken the rate at the time of maturity, when investors move their money into foreign securities.

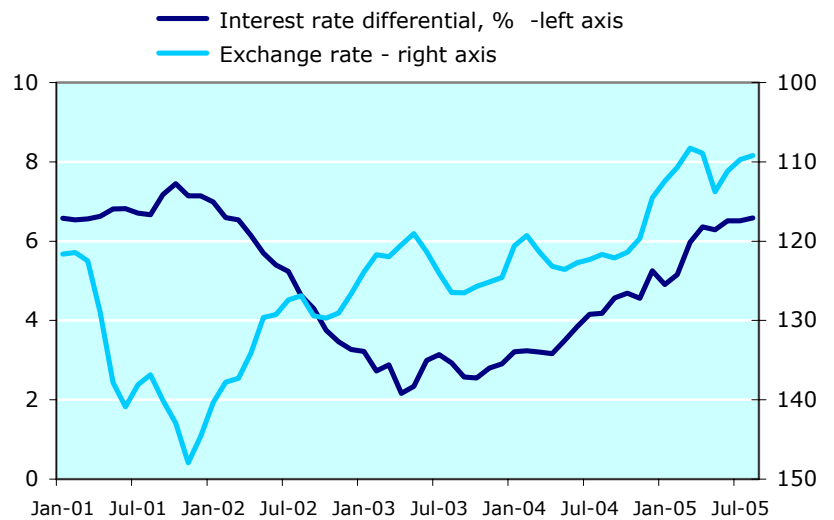
The Central Bank has recently announced that it will increase its weekly purchases of foreign currency from 2.5 to 10 million dollars. This decision is associated with the Treasury's intention to repay foreign debt this year which in turn reflects its surplus of this year. The Central Bank intends to purchase a total of 160 million dollars up to the end of this year. This decision will serve to counter the tendency of the exchange rate to rise in the remainder of the year.

The interrelationship between short- and long-term rates has been weak in recent years, both in Iceland and in other countries. The graph on interest rates shows that indexed long-term rates have been declining in recent months whereas short-term rates have edged up in line with the policy rate.

The decoupling of the short- and long-term rates is in part explained by the increasing globalisation of the Icelandic financial market. Although there is still a clear demarcation line between the domestic and foreign currencies, increasing capital flows have had a profound impact in this country. Foreign long-term rates are at present lower than they have been for decades which in turn has influenced domestic long-term rates. The market has reacted by sharply increasing issues of long-term indexed debt this year. Company debt issues have exceeded 100 billion krónur so far this year. The Housing Finance Fund has issued 40 billion krónur whereas the Treasury has only issued 7 billion. Company and HFF debt has been in the shorter end of the long-term market with a maturity of about ten years. The yield in this market segment has nevertheless stayed stable which probably reflects that the market for this type of debt is resilient.

Thirty-year housing bonds provide the best benchmark for gauging longer-term indexed yields which have been around 3.5 per cent in the course of this year. The same applies to ten-year HFF bonds. The yield on non-indexed medium-term government bonds with a 5-8 year maturity has stayed in the range of 7.5-8 per cent from the middle of last year until the spring of this year and declined somewhat over the past several months. The yield on two-year govern-

**Graph 17**

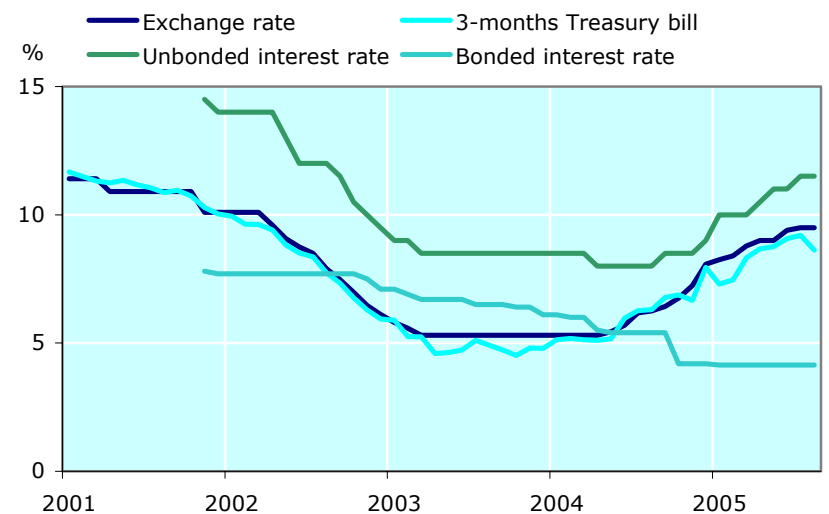


**Interest and exchange rates**

Source: Central Bank.

*Long-term rates are declining, short-term rates rising*

**Graph 18**



**Interest rate developments**

Source: Central Bank.

ment notes has risen from 7.5 per cent a year ago to about 8.5-9 per cent in August of this year, thus following the rise in the policy rate.

*The debt market and foreign participation*

Two events in the financial market have had a significant impact on the debt market. Iceland Telecom was privatised and foreign entities have begun issuing debt in the krónur market, as noted earlier. Iceland Telecom was sold for 66.5 billion krónur of which 34 billion was in krónur and 32.5 billion in euros and dollars. The domestic sale proceeds were deposited with the Central Bank where it will earn interest and be kept for later use when the economy will cool down. The foreign part of the proceeds will be used to repay foreign Treasury debt this year, mainly in the commercial paper market but also some longer-term debt. This will help the Treasury in improving its credit rating in foreign markets and lower its interest cost at the same time.

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**Table 1: Output and expenditure 2004 - 2007**

	Billion krónur current prices				Volume changes on previous year, %			
	Prov.	Forecast			Prov.	Forecast		
	2004	2005	2006	2007	2004	2005	2006	2007
1. Private consumption	506.1	568.9	609.8	638.3	6.9	9.5	4.3	0.6
2. Public consumption	226.3	243.3	259.9	277.3	2.8	2.4	2.2	2.2
i.e. Central government	126.5	135.8	143.8	152.6	2.5	2.0	1.6	1.8
i.e. Local government	78.2	84.0	90.6	96.8	2.5	2.5	2.5	2.5
3. Gross fixed investment	207.2	257.9	279.4	222.8	21.0	28.5	0.8	-23.8
Business sector investment	123.9	161.4	180.9	119.2	23.3	48.0	1.9	-35.8
Residential construction	47.1	63.7	69.9	68.7	5.7	12.0	6.5	-3.4
Public investment	36.1	32.8	28.6	34.9	26.9	-12.3	-15.4	19.9
4. Final domestic demand	939.5	1,070.1	1,149.0	1,138.3	8.7	12.2	2.9	-5.2
5. Stock changes <sup>1)</sup>	-3.3	0.0	0.0	0.0	-0.2	0.4	0.0	0.0
<b>6. Total national expenditure</b>	<b>936.2</b>	<b>1070.1</b>	<b>1149.0</b>	<b>1,138.3</b>	<b>8.4</b>	<b>12.8</b>	<b>2.9</b>	<b>-5.2</b>
7. Export of goods and services	316.1	307.4	342.4	397.6	8.3	1.4	6.2	11.6
8. Import of goods and services	367.3	411.5	440.2	426.1	14.2	18.3	1.9	-8.8
<b>9. Gross domestic product</b>	<b>885.0</b>	<b>966.1</b>	<b>1051.3</b>	<b>1,109.8</b>	<b>6.2</b>	<b>6.0</b>	<b>4.6</b>	<b>2.5</b>
10. Net factor income from abroad	-21.6	-23.0	-29.2	-41.0	-	-	-	-
11. Net current transfers	-1.2	-1.3	-1.3	-1.4	-	-	-	-
12. Current account balance (7.-8.+10.)	-73.9	-128.3	-128.3	-70.9	-	-	-	-
<b>13. Gross national income (9.+10.)</b>	<b>863.4</b>	<b>943.1</b>	<b>1022.1</b>	<b>1068.8</b>	<b>4.9</b>	<b>5.7</b>	<b>4.2</b>	<b>1.6</b>
14. Effects of changes in terms of trade	-	-	-	-	-0.6	0.5	-0.1	-0.9
15. Real gross national income	-	-	-	-	4.3	6.3	4.1	0.6
<b>16. Current balance, % of GDP</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-8.4</b>	<b>-13.3</b>	<b>-12.2</b>	<b>-6.4</b>

**Notes:**

<sup>1)</sup> Volume changes are based on 2000-prices.

<sup>2)</sup> In per cent of GDP of the previous year at constant prices.

**Table 2: Export production and foreign trade 2004 - 2007**

	Billion krónur current prices				Volume changes on previous year, %			
	Prov.	Forecast			Prov.	Forecast		
	2004	2005	2006	2007	2004	2005	2006	2007
<b>Export production</b>								
Marine products	118.7	116.6	125.6	137.0	5.4	2.0	2.0	2.0
Aluminium	36.5	35.1	47.7	75.4	2.0	-0.3	29.8	58.6
Other products	43.0	41.1	44.3	48.0	27.7	0.2	5.2	5.3
<b>Total</b>	<b>198.2</b>	<b>192.7</b>	<b>217.7</b>	<b>260.4</b>	<b>8.3</b>	<b>1.2</b>	<b>8.2</b>	<b>16.2</b>
Export of old ships and aircraft	0.8	1.3	1.4	1.5	-	-	-	-
Stock changes in export production	-3.3	0.0	0.0	0.0	-	-	-	-
<b>Merchandise exports, total</b>	<b>202.4</b>	<b>194.0</b>	<b>219.1</b>	<b>261.9</b>	<b>8.3</b>	<b>0.8</b>	<b>8.2</b>	<b>16.1</b>
<b>Merchandise imports, total</b>	<b>238.9</b>	<b>278.3</b>	<b>294.8</b>	<b>273.2</b>	<b>15.8</b>	<b>21.8</b>	<b>1.2</b>	<b>-12.4</b>
General merchandise imports	197.8	206.8	215.6	216.1	11.9	8.8	-0.7	-6.4
of which: Oil imports	20.7	27.5	28.2	30.5	13.5	3.5	3.2	1.0
of which: Other imports	177.1	179.4	187.4	185.6	11.7	9.4	-1.2	-7.2
Special imports	41.2	71.5	79.2	57.2	35.8	77.4	6.4	-27.1
<b>Balance of trade</b>	<b>-36.5</b>	<b>-84.4</b>	<b>-75.7</b>	<b>-11.3</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Export of services (excl. factor income)	113.7	113.5	123.3	135.7	6.7	6.6	2.9	3.3
Import of services (excl. factor income)	128.3	133.1	145.4	152.8	11.5	12.0	3.4	-1.7
<b>Balance of services (excl. factor income)</b>	<b>-14.6</b>	<b>-19.7</b>	<b>-22.1</b>	<b>-17.2</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net factor income from abroad</b>	<b>-21.6</b>	<b>-23.0</b>	<b>-29.2</b>	<b>-41.0</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net current transfers <sup>1)</sup></b>	<b>-1.2</b>	<b>-1.3</b>	<b>-1.3</b>	<b>-1.4</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Current balance</b>	<b>-73.9</b>	<b>-128.3</b>	<b>-128.3</b>	<b>-70.9</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

**Notes:**

<sup>1)</sup> Net transfers from abroad other than factor income.

**Table 3: Comparison of forecast for 2005 - 2007**

	Forecast for 2005										Forecast for 2006				Forec. for 2007	
	Oct-03	jan.04	mai.04	okt.04	jan.05	Apr-05	Oct-05	okt.04	jan.05	Apr-05	Oct-05	Apr-05	###	###		
<b>Volume change, %</b>																
Private consumption	5.0	3 1/2	3 1/2	5.0	6.8	7.6	9.5	5.0	5.6	6.1	4.3	0.6	0.6	0.6		
Public consumption	2.0	2.0	2.0	2.0	2.0	2.6	2.4	2.0	2.0	2.7	2.2	2.5	2.5	2.2		
Investment	16 1/2	7 1/4	15 1/2	18.0	22.5	30.3	28.5	9 1/4	7.1	-0.8	0.8	-24.9	-23.8			
Total national expenditure	7.0	4 1/4	6.0	7 1/2	9.5	11.6	12.8	5 1/2	5.3	3.8	2.9	-5.1	-5.2			
Total exports	3.0	1 1/2	4.0	4.0	3.8	4.3	1.4	5 3/4	7.1	7.5	6.2	12.5	11.6			
Total imports	6 1/4	3 1/4	6 1/2	10 1/2	13.7	18.0	18.3	8 1/2	8.0	2.9	1.9	-6.2	-8.8			
Gross domestic product (GDP)	5 1/2	3 1/2	5.0	5.0	5.5	5.9	6.0	4 1/2	4.7	5.7	4.6	2.4	2.5			
Current account balance, % of GDP	-4 3/4	-6 1/4	-9.0	-11	-10.7	-12.1	-13.3	-13 1/2	-12.8	-11.4	-12.2	-6.2	-6.4			
General government balance, % of GDP	1.0	1.0	1.0	1 1/2	1.5	0.9	2.4	1 1/2	1.6	1.1	1.0	-1.2	-0.8			
<b>Income and price changes, %</b>																
Disposable income per capita	7.0	6 1/2	6.0	6 3/4	7.1	5.7	7.7	7 1/4	7.2	5.0	6.6	4.6	6.2			
Wages	7.0	5 1/2	4 1/2	5 1/4	5.7	5.8	6.3	4.4	4.4	5.0	5.0	4.6	4.5			
Real disposable income per capita	4.0	3 3/4	2 3/4	3 1/4	3.9	1.8	3.7	4.0	3.7	3.3	2.7	2.5	2.1			
Inflation	3.0	2 3/4	3.0	3 1/2	3.2	3.9	3.9	3 1/4	3.5	3.8	3.8	3.4	4.0			
Exchange rate, index	127.0	127.0	125.0	125.0	119.4	111.3	109.8	128.0	124.2	116.8	113.8	122.8	119.3			
Unemployment, % of labour force	2.0	2 3/4	2 3/4	2 3/4	2.8	2.4	2.2	2 1/4	2.2	2.2	1.8	3.5	2.7			

**Table 4: Gross domestic product\***

Billion krónur at current prices, Volume and price indices 2000=100

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
1. Private consumption	244.7	255.4	276.7	296.6	331.0	366.3	400.0	417.1	429.6	460.4	506.1	568.9	609.8	638.3
2. Public consumption	93.8	99.0	105.6	112.8	127.8	142.4	157.9	176.7	200.5	211.5	226.3	243.3	259.9	277.3
3. Gross fixed investment	70.2	71.1	92.4	103.7	139.2	135.5	157.9	165.8	138.7	166.0	207.2	257.9	279.4	222.8
4. Stock changes	0.3	3.1	0.0	0.1	0.9	0.1	2.5	-2.1	-0.2	-1.5	-3.3	0.0	0.0	0.0
5. Total national expenditure	409.0	428.6	474.6	513.2	598.9	644.4	718.3	757.4	768.6	836.4	936.2	1070.1	1149.0	1138.3
6. Exports of goods and services	157.4	161.3	176.8	190.7	204.2	212.2	229.5	299.4	305.9	288.1	316.1	307.4	342.4	397.6
6.1 Goods, fob	112.7	116.6	125.7	131.2	136.6	144.9	149.3	196.6	204.3	182.6	202.4	194.0	219.1	261.9
6.2 Services	44.8	44.6	51.1	59.4	67.6	67.2	80.2	102.8	101.6	105.5	113.7	113.5	123.3	135.7
7. Less: Imports of goods and services	134.6	144.7	173.8	187.7	230.1	241.5	278.6	306.9	292.1	313.3	367.3	411.5	440.2	426.1
7.1 Goods, fob	93.0	103.3	124.5	131.0	161.6	167.3	186.8	202.5	190.2	198.5	238.9	278.3	294.8	273.2
7.2 Services	41.6	41.5	49.3	56.8	68.4	74.2	91.9	104.4	101.9	114.8	128.3	133.1	145.4	152.8
8. Gross domestic product	431.8	445.1	477.7	516.1	573.0	615.1	669.2	750.0	782.3	811.2	885.0	966.1	1051.3	1109.8
9. Net factor income from abroad	-13.7	-12.8	-11.3	-12.1	-13.0	-12.8	-19.2	-24.6	-4.2	-13.9	-21.6	-23.0	-29.2	-41.0
10. Gross national product (8.+9.)	418.1	432.3	466.4	504.0	560.1	602.2	650.0	725.3	778.2	797.3	863.4	943.1	1022.1	1068.8
11. Current account balance with net current t	9.1	3.7	-8.2	-9.2	-38.8	-42.2	-68.3	-32.1	9.6	-39.0	-72.7	-127.1	-127.0	-69.5
11.1 Balance of trade fob/fob	19.7	13.4	1.2	0.3	-25.0	-22.4	-37.5	-5.9	14.1	-15.9	-36.5	-84.4	-75.7	-11.3
11.2 Balance of services	3.1	3.2	1.9	2.7	-0.8	-6.9	-11.6	-1.5	-0.3	-9.3	-14.6	-19.7	-22.1	-17.2
11.3 Net factor income from abroad	-13.7	-12.8	-11.3	-12.1	-13.0	-12.8	-19.2	-24.6	-4.2	-13.9	-21.6	-23.0	-29.2	-41.0
11.4 Net current transfers from abroad	-0.6	-0.3	-0.5	-0.2	-1.0	-0.7	-0.8	-1.0	1.2	-1.2	-1.2	-1.3	-1.3	-1.4
12. Current balance, % of GDP	2.1%	0.8%	-1.7%	-1.8%	-6.8%	-6.9%	-10.2%	-4.3%	1.2%	-4.8%	-8.4%	-13.3%	-12.2%	-6.4%
<b>Volume indices 2000=100</b>														
1. Private consumption	70.6	72.2	76.2	81.0	89.2	96.1	100.0	96.8	95.1	100.6	107.6	117.8	122.8	123.5
2. Public consumption	83.9	85.3	86.1	88.3	91.3	95.8	100.0	103.1	108.3	109.9	113.0	115.7	118.3	120.9
3. Gross fixed investment	50.7	49.8	62.5	68.8	90.7	87.2	100.0	95.1	76.5	92.1	111.5	143.2	144.4	110.0
4. Total national expenditure	68.2	69.9	74.8	79.4	89.9	93.8	100.0	97.2	93.5	100.2	108.6	122.5	126.1	119.5
5. Exports of goods and services	79.4	77.6	85.3	90.0	92.3	95.9	100.0	107.4	111.6	113.1	122.5	124.2	132.0	147.3
5.1 Goods, fob	89.7	87.8	95.8	97.2	94.6	101.3	100.0	107.2	114.3	113.0	123.4	121.8	131.7	153.0
5.2 Services	61.3	59.8	66.9	77.5	88.2	86.0	100.0	107.7	106.3	113.3	120.8	128.8	132.5	136.9
6. Less: Imports of goods and services	55.0	56.9	66.3	71.6	88.4	92.2	100.0	90.9	88.6	98.1	112.0	132.5	135.0	123.2
6.1 Goods, fob	58.1	61.9	72.2	75.9	94.3	97.3	100.0	90.0	87.0	93.3	108.0	131.6	133.3	116.7
6.2 Services	48.8	47.5	55.2	63.6	77.0	82.3	100.0	92.8	91.7	107.4	119.8	134.1	138.6	136.3
7. Gross domestic product	78.0	78.3	82.2	86.6	91.4	95.2	100.0	103.3	102.0	105.7	112.2	119.0	124.4	127.5
8. Gross national income	77.2	78.0	81.4	86.4	92.9	96.8	100.0	102.2	104.9	105.6	110.8	117.1	122.0	124.0

**Table 4 continued**  
**Price indices 2000=100**

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
1. Private consumption	86.6	88.4	90.8	91.6	92.8	95.3	100.0	107.7	113.0	114.4	117.6	120.8	124.2	129.2
2. Public consumption	70.8	73.5	77.6	80.8	88.6	94.1	100.0	108.5	117.2	121.9	126.8	133.2	139.1	145.3
3. Gross fixed investment	87.7	90.4	93.6	95.5	97.2	98.4	100.0	110.4	114.8	114.1	117.7	114.0	122.6	128.3
4. Total national expenditure	83.5	85.4	88.3	89.9	92.7	95.6	100.0	108.5	114.5	116.2	120.0	121.6	126.8	132.6
5. Exports of goods and services	86.4	90.6	90.4	92.3	96.4	96.4	100.0	121.5	119.5	111.0	112.4	107.8	113.0	117.6
5.1 Goods, fob	84.1	89.0	87.9	90.5	96.7	95.8	100.0	122.8	119.7	108.3	109.9	106.7	111.4	114.7
5.2 Services	91.1	93.1	95.2	95.6	95.6	97.4	100.0	119.0	119.1	116.1	117.3	109.8	116.0	123.5
6. Less: Imports of goods and services	87.9	91.2	94.0	94.1	93.5	94.0	100.0	121.1	118.4	114.7	117.7	111.5	117.0	124.1
6.1 Goods, fob	85.7	89.3	92.4	92.4	91.8	92.1	100.0	120.4	117.1	113.9	118.4	113.2	118.5	125.4
6.2 Services	92.8	95.0	97.2	97.2	96.7	98.1	100.0	122.4	120.9	116.3	116.6	108.0	114.2	122.0
7. Gross domestic product	82.7	85.0	86.9	89.1	93.7	96.5	100.0	108.4	114.6	114.7	117.9	121.4	126.3	130.0
8. Gross national income	83.3	85.2	88.2	89.8	92.7	95.7	100.0	109.1	114.2	116.1	119.9	123.8	128.8	132.6
<b>%-change from prev. year, volume</b>														
1. Private consumption	2.7	2.3	5.5	6.2	10.1	7.8	4.1	-3.2	-1.8	5.8	6.9	9.5	4.3	0.6
2. Public consumption	4.0	1.7	1.0	2.6	3.4	4.9	4.4	3.1	5.0	1.5	2.8	2.4	2.2	2.2
3. Gross fixed investment	-0.3	-1.7	25.3	10.1	31.9	-3.8	14.7	-4.9	-19.6	20.5	21.0	28.5	0.8	-23.8
4. Total national expenditure	2.0	2.5	7.0	6.2	13.2	4.3	6.6	-2.8	-3.8	7.2	8.4	12.8	2.9	-5.2
5. Exports of goods and services	9.3	-2.3	9.9	5.6	2.5	3.9	4.3	7.4	3.9	1.4	8.3	1.4	6.2	11.6
5.1 Goods, fob	12.2	-2.2	9.1	1.5	-2.6	7.1	-1.3	7.2	6.6	-1.2	9.2	-1.3	8.2	16.1
5.2 Services	2.6	-2.4	12.0	15.8	13.8	-2.5	16.3	7.7	-1.4	6.6	6.7	6.6	2.9	3.3
6. Less: Imports of goods and services	3.8	3.6	16.5	8.0	23.4	4.3	8.5	-9.1	-2.6	10.7	14.2	18.3	1.9	-8.8
6.1 Goods, fob	7.5	6.5	16.6	5.1	24.3	3.2	2.8	-10.0	-3.4	7.3	15.8	21.8	1.2	-12.4
6.2 Services	-3.7	-2.7	16.2	15.2	21.1	6.9	21.5	-7.2	-1.2	17.2	11.5	12.0	3.4	-1.7
7. Gross domestic product	3.8	0.4	5.0	5.3	5.5	4.2	5.0	3.3	-1.3	3.6	6.2	6.0	4.6	2.5
8. Gross national income	3.2	1.0	4.3	6.1	7.6	4.1	3.3	2.2	2.6	0.7	4.9	5.7	4.2	1.6
<b>%-change from prev. year, price</b>														
1. Private consumption	1.6	2.1	2.6	0.9	1.4	2.7	4.9	7.7	4.9	1.2	2.9	2.7	2.8	4.1
2. Public consumption	1.8	3.8	5.6	4.2	9.6	6.3	6.3	8.5	8.1	3.9	4.1	5.0	4.5	4.4
3. Gross fixed investment	3.9	3.1	3.6	2.0	1.8	1.2	1.7	10.4	4.0	-0.7	3.2	-3.1	7.5	4.7
4. Total national expenditure	2.0	2.3	3.5	1.8	3.1	3.1	4.6	8.5	5.5	1.6	3.2	1.4	4.3	4.5
5. Exports of goods and services	6.2	4.8	-0.2	2.1	4.5	0.0	3.8	21.5	-1.7	-7.1	1.3	-4.1	4.8	4.0
5.1 Goods, fob	6.1	5.9	-1.2	2.9	6.9	-0.9	4.4	22.8	-2.5	-9.6	1.5	-2.8	4.4	2.9
5.2 Services	6.3	2.2	2.3	0.4	0.0	1.9	2.7	19.0	0.1	-2.5	1.0	-6.4	5.6	6.5
6. Less: Imports of goods and services	5.9	3.7	3.1	0.1	-0.6	0.6	6.3	21.1	-2.2	-3.1	2.7	-5.3	4.9	6.1
6.1 Goods, fob	5.0	4.3	3.4	0.1	-0.7	0.3	8.6	20.4	-2.8	-2.7	4.0	-4.4	4.6	5.8
6.2 Services	7.9	2.4	2.3	0.0	-0.5	1.3	2.0	22.4	-1.2	-3.8	0.3	-7.4	5.7	6.9
7. Gross domestic product	2.3	2.7	2.2	2.6	5.2	3.0	3.6	8.4	5.7	0.1	2.8	3.0	4.0	3.0
8. Gross national income	2.3	2.3	3.5	1.8	3.3	3.2	4.4	9.1	4.6	1.7	3.3	3.3	4.0	2.9



**Table 4 continued**

Per capita volume indices	Forecast													
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
1. Private consumption	74.7	76.0	79.7	84.0	91.5	97.5	100.0	95.5	93.0	97.8	103.4	112.3	116.1	115.9
2. Public consumption	88.7	89.7	90.1	91.7	93.8	97.2	100.0	101.7	105.9	106.8	108.5	110.3	111.9	113.4
3. Gross fixed investment	53.6	52.4	65.3	71.4	93.1	88.5	100.0	93.8	74.8	89.6	107.1	136.5	136.5	103.2
4. Total national expenditure	72.1	73.5	78.2	82.4	92.3	95.2	100.0	95.9	91.4	97.4	104.4	116.8	119.3	112.1
5. Exports of goods and services	83.9	81.6	89.1	93.4	94.8	97.3	100.0	105.9	109.1	110.0	117.7	118.4	124.8	138.2
5.1 Merchandise, fob.	94.9	92.3	100.1	100.8	97.1	102.8	100.0	105.8	111.8	109.8	118.6	116.1	124.5	143.5
5.2 Services	64.7	62.8	70.0	80.4	90.6	87.2	100.0	106.2	103.9	110.1	116.1	122.8	125.3	128.4
6. Less: Imports of goods and services	58.1	59.9	69.3	74.3	90.7	93.5	100.0	89.7	86.6	95.3	107.6	126.3	127.7	115.6
6.1 Merchandise, fob	61.4	65.1	75.4	78.7	96.8	98.7	100.0	88.8	85.1	90.7	103.8	125.5	126.0	109.5
6.2 Services	51.6	49.9	57.7	66.0	79.1	83.5	100.0	91.5	89.6	104.4	115.1	127.8	131.1	127.9
7. Gross domestic product	82.4	82.3	85.9	89.8	93.8	96.6	100.0	101.9	99.8	102.7	107.8	113.4	117.7	119.7
8. Gross national income	81.6	82.0	85.1	89.6	95.4	98.1	100.0	100.8	102.5	102.7	106.5	111.7	115.4	116.3
<b>Gross domestic product per capita, US dollars</b>														
1. GDP per capita, curr. exch. r.	23 208	25 733	26 711	26 840	29 430	30 642	30 178	26 912	29 748	36 535	43 137			
2. GDP per capita, current PPPs	21 805	22 178	23 642	24 902	26 443	27 356	28 604	29 633	29 515	29 862	33 580			

\* Corrections have been made due to change in base year of time series.

Source: Statistics Iceland and own forecasts.

**Table 5: Income, prices and exchange rate**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Forecast		
															2005	2007	
<b>I Indices 1990=100</b>																	
<b>Income</b>																	
Disposable income per capita	108.9	109.9	106.6	108.2	113.1	120.8	133.4	147.3	162.6	179.9	194.7	204.0	219.0	231.9	249.7	266.3	282.7
Wages <sup>1)</sup>	108.4	111.5	113.1	114.5	119.6	127.3	134.2	146.8	156.8	167.2	182.0	195.0	205.9	215.6	228.1	239.5	250.5
<b>Prices</b>																	
Consumer price index	106.8	110.8	115.3	117.0	119.0	121.7	123.9	126.0	130.3	136.8	146.0	153.0	156.2	161.2	167.7	174.2	180.3
<b>Purchasing power <sup>2)</sup></b>																	
Disposable income per capita	102.1	99.3	92.5	92.5	96.0	100.3	108.7	118.1	126.1	132.9	134.8	134.7	141.6	145.3	150.6	154.7	158.0
Wages <sup>1)</sup>	101.5	100.7	98.1	97.8	100.5	104.6	108.3	116.5	120.3	122.2	124.7	127.5	131.8	133.7	136.7	138.2	138.9
<b>Exchange rate</b>																	
Effective price of foreign currency	100.0	106.4	110.6	116.0	116.1	116.2	114.7	112.8	112.6	112.7	135.4	131.4	123.5	121.0	109.8	113.8	119.3
Real exchange rate relative to price	99.9	99.8	94.4	89.3	89.4	89.7	90.5	91.9	93.6	96.3	83.7	88.5	94.2	97.2	109.3	107.6	104.9
Real exchange rate relative to wages	89.6	92.5	84.3	77.6	81.0	81.9	84.5	89.0	90.5	91.3	79.1	85.2	89.2	91.9	105.6	103.4	99.8
<b>II Changes on previous year, %</b>																	
<b>Income</b>																	
Disposable income per capita	8.9	0.9	-3.0	1.5	4.4	6.8	10.4	10.5	10.4	10.6	8.2	4.7	7.4	5.9	7.7	6.6	6.2
Wages <sup>1)</sup>	8.4	2.9	1.4	1.2	4.5	6.4	5.4	9.4	6.8	6.6	8.9	7.1	5.6	4.7	6.2	5.0	4.5
<b>Prices</b>																	
Consumer price index	6.8	3.7	4.1	1.5	1.7	2.3	1.8	1.7	3.4	5.0	6.7	4.8	2.1	3.2	3.9	3.8	4.0
<b>Purchasing power <sup>2)</sup></b>																	
Disposable income per capita	2.1	-2.7	-7.6	0.0	2.7	4.4	8.5	8.6	6.8	5.4	1.4	-0.1	5.2	2.6	3.7	2.7	2.1
Wages <sup>1)</sup>	1.5	-0.8	-2.6	-0.3	2.8	4.1	3.5	7.6	3.3	1.6	2.0	2.2	3.4	1.4	2.2	1.2	0.5
<b>Exchange rate</b>																	
Effective price of foreign currency <sup>3)</sup>	6.4	0.0	4.0	4.9	0.1	0.1	-1.3	-1.6	-0.2	0.1	20.1	-3.0	-6.0	-2.0	-9.2	3.6	4.8
Real exchange rate relative to price	2.6	0.0	-5.4	-5.4	0.1	0.3	0.9	1.6	1.8	2.9	-13.0	5.7	6.3	3.2	12.5	-1.6	-2.5
Real exchange rate relative to wages	2.6	3.2	-9.0	-7.9	4.4	1.1	3.3	5.3	1.7	0.8	-13.3	7.7	4.7	3.0	15.0	-2.1	-3.5

**Notes:**

<sup>1)</sup> Wage index.

<sup>2)</sup> Deflated by price index.

<sup>3)</sup> Official exchange rate of the króna vis-à-vis foreign currencies. 31.12.1991=100.

**Table 6: Fish catch**

	2001	2002	2003	Forecast		
				2004	2005	2006
<b>Thousand tonnes</b>						
Cod	240	213	206	227	211	216
Haddock	40	50	60	84	100	100
Saithe	32	42	52	63	70	70
Redfish	50	66	63	48	54	54
Catfish	18	14	16	13	13	13
Greenland halibut	17	19	20	15	15	15
Herring	101	97	132	122	110	110
Shrimp	31	35	29	20	10	10
Capelin	924	1 079	681	524	650	650
Blue whiting	365	286	502	419	500	500
Atlantic-Scandian herring	78	127	118	103	130	130
Oceanic redfish	42	45	48	37	20	20
Other marine products	49	60	53	49	30	30
<b>Total marine product</b>	<b>1 987</b>	<b>2 133</b>	<b>1 980</b>	<b>1 724</b>	<b>1 913</b>	<b>1 918</b>
<b>Percentage change in total catch value from</b>						
<b>previous year, constant prices:*</b>		1.8	-0.7	-2.2	-0.4	1.0

\* Calculated by using fish prices from June 2004 to May 2005 from the Freshfish Price Directorate.

Source: Statistics Iceland and own forecast.

**Table 7: Gross fixed capital formation**

Million krónur

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Agriculture	1 618	1 884	1 805	1 607	2 543	3 184	4 979	5 280	6 185	2 990	3 906	5 164	3 605
Fishing	6 183	2 348	3 679	1 803	5 522	590	6 610	3 608	5 688	11 165	1 636	1 144	3 805
Fish processing	1 240	1 423	2 043	2 753	4 049	7 809	3 682	1 050	1 315	- 459	4 504	4 782	4 244
Food industry, other	464	635	521	571	664	915	1 954	2 779	3 550	2 950	1 360	1 614	1 651
Metal and power-intensive industry	881	1 090	885	1 107	7 116	11 018	11 673	4 021	6 223	4 363	1 651	1 410	8 147
Manufacturing, other	1 704	2 058	2 564	3 324	4 713	8 724	5 635	3 829	4 866	2 491	5 864	6 396	5 895
Electricity and water supply	3 637	3 196	3 487	4 165	5 702	3 258	5 197	4 491	5 364	5 387	5 139	4 374	4 899
Construction	3 921	3 561	3 090	3 554	5 216	9 521	17 559	15 708	12 495	16 489	16 258	27 892	34 348
of which: harbours and lighthouses	2 045	1 852	1 652	2 288	3 329	5 337	7 826	5 399	5 031	4 398	4 735	8 268	10 011
of which: airports	1 152	1 097	1 214	1 488	1 867	5 511	5 725	6 512	5 779	5 297	-1 812	1 871	2 118
Wholesale and retail trade, repairs	1 345	1 205	1 179	1 354	1 662	1 521	1 072	3 507	2 017	1 692	1 049	2 465	1 701
Hotels and restaurants	8 213	5 874	5 894	7 248	7 707	8 308	16 110	8 768	19 122	15 188	16 469	11 876	17 704
Transport and telecommunications	3 227	3 427	4 517	4 506	4 942	2 402	4 507	5 227	8 614	5 995	2 708	3 125	3 707
Financial intermediation and insuranc	1 070	1 053	1 176	1 365	1 633	1 218	2 424	3 910	967	2 103	2 067	4 218	4 943
Real estate and business activities	2 625	2 343	2 339	2 754	3 433	1 020	6 978	17 271	25 030	23 745	12 703	12 862	16 283
Education	12	11	13	16	20	82	36	277	5	41	17	82	82
Health services, social work	184	164	169	222	298	249	409	864	1 337	666	1 731	812	812
Other social work, recreational, cultural and sporting activities	79	61	59	78	107	265	407	133	312	301	3 016	2 255	4 085
Unclassified	488	441	455	548	691	1 850	741	1 755	2 054	3 271	- 213	1 275	1 694
	883	957	1 168	1 325	1 639	2 461	1 194	4 610	2 070	2 671	2 780	3 441	3 763
<b>Business sector investment, total</b>	<b>36 040</b>	<b>29 197</b>	<b>30 825</b>	<b>34 246</b>	<b>53 198</b>	<b>64 117</b>	<b>94 577</b>	<b>89 945</b>	<b>104 548</b>	<b>102 258</b>	<b>76 995</b>	<b>95 804</b>	<b>123 896</b>
Residential construction, total	20 184	19 541	20 858	19 619	22 060	20 678	21 573	22 217	25 886	31 714	35 683	42 774	47 118
<b>Public works and buildings</b>	<b>16 329</b>	<b>18 994</b>	<b>18 523</b>	<b>17 272</b>	<b>17 094</b>	<b>18 873</b>	<b>23 070</b>	<b>23 337</b>	<b>27 487</b>	<b>31 830</b>	<b>26 004</b>	<b>27 393</b>	<b>36 144</b>
Roads and bridges	2 641	4 442	3 982	3 546	3 268	3 485	3 547	4 196	4 595	6 248	5 359	8 509	10 803
Streets and sewers	3 157	3 291	3 548	2 690	2 887	3 752	4 122	4 378	5 333	7 188	6 627	5 794	6 239
Public buildings	8 770	9 300	9 100	8 800	8 735	9 291	12 799	11 486	14 286	15 255	11 025	9 950	15 578
Other	1 762	1 961	1 893	2 236	2 204	2 345	2 602	3 277	3 273	3 139	2 992	3 141	3 524
<b>Gross fixed capital formation, tot:</b>	<b>72 553</b>	<b>67 731</b>	<b>70 206</b>	<b>71 138</b>	<b>92 352</b>	<b>103 667</b>	<b>139 220</b>	<b>135 499</b>	<b>157 921</b>	<b>165 802</b>	<b>138 682</b>	<b>165 972</b>	<b>207 158</b>

Source: Statistics Iceland.



**Table 9: Balance of payments**

Million krónur

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>1 Balance on goods</b>	-3 074	- 77	12 272	19 662	13 356	1 201	254	-25 019	-22 382	-37 480	-5 936	14 082	-15 900	-36 548
<b>1.1 Merchandise exports f.o</b>	91 560	87 833	94 658	112 654	116 607	125 690	131 213	136 592	144 928	149 272	196 582	204 303	182 580	202 373
Marine products	73 236	69 880	74 572	84 838	83 872	92 580	93 648	99 233	97 683	94 498	121 844	128 592	113 693	121 746
Aluminium	8 076	8 053	8 259	10 833	12 305	12 105	15 197	18 416	22 538	27 691	39 361	38 583	34 252	36 487
Ships and aircrafts	158	523	1 248	3 368	4 109	4 146	5 201	2 246	6 391	3 136	3 311	2 330	1 382	787
Other goods	10 090	9 377	10 579	13 615	16 321	16 859	17 167	16 697	18 316	23 948	32 066	34 799	33 253	43 353
<b>1.2 Merchandise imports f.o</b>	-94 634	-87 910	-82 386	-92 992	-103 251	-124 489	-130 959	-161 611	-167 310	-186 752	-202 518	-190 221	-198 480	-238 921
Investment goods	18 739	16 786	16 332	19 143	22 072	28 239	32 794	42 343	41 472	44 330	44 357	38 597	46 067	52 824
Transport equipments	16 290	14 629	8 940	11 734	12 883	18 204	18 065	26 018	29 370	31 914	28 258	25 943	27 034	40 014
Fuels and lubricants	7 799	7 334	7 520	7 597	7 317	9 632	9 897	8 049	8 924	17 300	17 725	15 984	15 362	21 859
Industrial supplies	25 042	22 881	22 400	24 766	28 852	32 929	33 557	41 237	39 078	43 355	55 584	54 116	53 036	61 086
Consumer goods	19 694	19 265	18 991	20 549	21 869	24 200	25 452	29 895	33 092	35 139	39 101	37 570	39 736	43 318
Other goods	7 070	7 015	8 203	9 203	10 258	11 285	11 194	14 069	15 374	14 714	17 493	18 012	17 245	19 821
<b>2 Balance on services</b>	-1 746	- 110	956	3 143	3 169	1 880	2 682	- 822	-6 934	-11 637	-1 549	- 328	-9 263	-14 615
<b>2.1 Export of services, total</b>	34 111	33 764	41 036	44 782	44 643	51 146	59 440	67 622	67 238	80 248	102 830	101 561	105 534	113 730
Transportation	13 468	12 035	16 011	18 139	17 340	22 452	25 735	31 109	30 819	38 721	46 986	48 477	50 195	63 232
Air transport	7 945	7 390	9 428	10 642	10 847	14 963	17 380	22 692	23 097	30 194	36 959	38 658	41 118	54 148
Sea transport	5 523	4 645	6 583	7 497	6 493	7 489	8 355	8 417	7 722	8 527	10 027	9 819	9 077	9 084
Travel	8 684	8 124	9 764	10 595	12 004	11 722	12 021	14 633	16 070	17 967	22 881	22 835	24 531	26 079
Other receipts	11 959	13 605	15 261	16 048	15 299	16 972	21 684	21 880	20 349	23 560	32 963	30 249	30 808	24 419
Communications services	931	918	1 192	1 461	1 476	1 549	1 673	1 336	696	820	2 337	704	640	717
Insurance services	411	697	788	405	338	366	377	402	414	435	577	606	543	605
Government services	7 030	7 552	6 675	6 342	6 657	7 635	8 344	7 557	7 531	8 457	8 091	7 666	7 429	6 730
Other services	3 587	4 438	6 606	7 840	6 828	7 422	11 290	12 585	11 708	13 848	21 958	21 273	22 196	16 367

<b>Table 9 continued</b>	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>2.2 Imports of services, tota</b>	-35 857	-33 874	-40 080	-41 639	-41 474	-49 266	-56 758	-68 444	-74 172	-91 885	-104 379	-101 889	-114 797	-128 345
Transportation	-10 710	-9 421	-10 794	-12 077	-13 371	-16 614	-17 916	-22 766	-25 622	-32 697	-36 721	-38 610	-39 685	-48 799
Air transport	-4 899	-4 509	-5 151	-5 696	-6 596	-9 034	-10 623	-15 466	-15 426	-21 287	-27 258	-27 167	-29 407	-37 478
Sea transport	-5 811	-4 912	-5 643	-6 381	-6 775	-7 580	-7 293	-7 300	-10 196	-11 410	-9 463	-11 443	-10 278	-11 321
Travel	-17 685	-16 886	-18 261	-17 892	-18 194	-20 472	-22 893	-28 049	-31 487	-37 082	-36 401	-33 406	-39 818	-48 501
Other receipts	-7 462	-7 567	-11 025	-11 670	-9 909	-12 180	-15 949	-17 629	-17 063	-22 106	-31 257	-29 873	-35 294	-31 045
Communications services:	-773	-725	-1 001	-1 210	-1 192	-1 576	-1 738	-1 451	-529	-155	-2 742	-3 429	-3 480	-1 464
Insurance services	-1 297	-989	-1 172	-1 770	-1 304	-1 304	-927	-931	-740	-432	-714	-1 748	-1 865	-1 352
Government services	-572	-504	-454	-716	-746	-799	-845	-1 202	-1 077	-1 205	-1 560	-1 645	-1 692	-1 464
Other services	-4 820	-5 349	-8 398	-7 974	-6 667	-8 501	-12 439	-14 045	-14 717	-20 314	-26 241	-23 051	-28 259	-26 765
<b>3 Balance of factor income</b>	-10 661	-9 086	-10 108	-13 659	-12 829	-11 317	-12 116	-12 647	-12 792	-19 409	-25 285	-4 170	-14 001	-21 586
3.1 Receipts	4 928	5 642	5 715	5 228	5 277	6 923	7 132	8 509	9 328	11 603	16 914	27 163	28 419	41 197
Compensation of employe	2 994	3 037	3 175	2 993	3 260	4 242	4 128	4 742	4 901	5 516	5 772	5 417	6 236	5 624
Investment income	1 934	2 575	2 540	2 235	2 017	2 681	3 004	3 767	4 427	6 087	11 142	21 852	22 224	35 573
3.2 Expenditures	-15 589	-14 698	-15 823	-18 887	-18 106	-18 240	-19 248	-21 156	-22 120	-31 012	-42 199	-31 333	-42 420	-62 783
Compensation of employe	-883	-723	-702	-532	-365	-306	-391	-293	-341	-844	-533	-702	-465	-817
Investment income	-14 706	-13 975	-15 121	-18 355	-17 741	-17 934	-18 857	-20 863	-21 554	-30 242	-41 666	-33 436	-44 851	-61 966
<b>4 Current transfer</b>	-510	-269	-211	-626	-306	-464	-238	-1 003	-725	-762	-959	1 170	-1 166	-1 180
<b>A Current balance</b>	<b>-15 991</b>	<b>-9 542</b>	<b>2 909</b>	<b>8 520</b>	<b>3 390</b>	<b>-8 700</b>	<b>-9 418</b>	<b>-39 491</b>	<b>-42 833</b>	<b>-69 288</b>	<b>-33 729</b>	<b>10 754</b>	<b>-40 330</b>	<b>-73 929</b>

Source: Central Bank of Iceland, Statistics Iceland.

**Table 10: General government finances**

Billion krónur <sup>1</sup>	Forecast															
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 <sup>2</sup>	2004 <sup>2</sup>	2005	2006	2007
<b>Total income</b>	<b>163.9</b>	<b>161.4</b>	<b>169.7</b>	<b>179.7</b>	<b>197.2</b>	<b>213.2</b>	<b>242.9</b>	<b>278.6</b>	<b>301.1</b>	<b>328.5</b>	<b>350.6</b>	<b>368.4</b>	<b>416.7</b>	<b>463.7</b>	<b>468.6</b>	<b>483.6</b>
1. Direct taxes	55.1	59.6	62.7	68.0	76.3	86.0	98.6	115.6	128.8	149.3	157.5	168.7	188.6	204.6	208.5	208.2
2. Indirect taxes	84.3	77.5	79.7	83.1	90.7	96.1	109.3	124.5	131.0	129.7	133.1	144.3	167.0	187.8	192.2	206.0
3. Interest income	6.8	6.8	7.0	6.8	6.8	6.6	7.5	8.7	10.2	14.6	19.5	13.6	14.2	15.3	16.2	17.4
4. Other income	4.7	4.2	5.1	5.6	5.3	6.2	5.5	6.0	5.8	6.8	7.6	5.1	7.9	14.8	8.2	6.3
5. Sales of goods and service	13.0	13.4	15.3	16.2	18.1	18.4	22.0	23.8	25.4	28.0	32.9	36.7	39.0	41.2	43.4	45.7
<b>Total expenditure</b>	<b>175.1</b>	<b>179.9</b>	<b>190.4</b>	<b>193.1</b>	<b>204.9</b>	<b>213.3</b>	<b>240.0</b>	<b>264.0</b>	<b>284.6</b>	<b>327.2</b>	<b>357.1</b>	<b>385.1</b>	<b>417.2</b>	<b>440.8</b>	<b>458.2</b>	<b>493.0</b>
1. Operational costs	96.9	102.0	109.1	115.1	123.7	131.2	149.8	166.3	183.3	204.7	233.4	248.3	265.2	284.5	303.3	323.0
of which: public cons.	83.9	88.6	93.8	99.0	105.6	112.8	127.8	142.4	157.9	176.7	200.5	211.5	226.3	243.3	259.9	277.3
2. Interest expenditure	15.6	16.5	18.0	20.0	19.5	19.6	21.2	22.7	22.6	28.6	25.1	25.7	25.7	27.5	24.0	24.2
3. Subsidies	12.5	9.7	8.7	8.7	9.2	9.2	9.2	10.0	10.8	12.8	12.7	12.5	12.8	13.3	14.1	14.5
4. Income transfers	30.6	33.0	33.9	36.2	37.2	38.8	40.1	42.7	47.2	53.8	63.9	77.6	79.8	85.7	91.4	99.2
5. Gross investment	17.8	19.7	19.5	16.0	17.6	18.4	23.6	26.1	25.8	32.0	26.6	26.1	37.3	34.3	30.0	37.9
5. Depreciation(-)	7.9	8.6	9.3	9.9	10.5	11.1	11.9	12.6	13.5	14.5	15.2	16.0	17.2	18.3	19.1	20.8
7. Capital transfers	9.7	7.5	10.3	7.1	8.2	7.3	8.1	8.8	8.4	9.9	10.7	11.1	13.4	13.7	14.4	14.8
<b>Financial balance</b>	<b>-11.2</b>	<b>-18.4</b>	<b>-20.6</b>	<b>-13.4</b>	<b>-7.7</b>	<b>-0.1</b>	<b>2.8</b>	<b>14.6</b>	<b>16.6</b>	<b>1.3</b>	<b>-6.6</b>	<b>-16.7</b>	<b>-0.5</b>	<b>22.9</b>	<b>10.5</b>	<b>-9.4</b>
<b>Percentage of GDP</b>																
Revenue	42.0	40.1	39.7	40.8	41.7	41.8	42.8	45.3	45.0	43.8	44.8	45.4	47.1	48.1	44.6	43.6
Expenditure	44.8	44.7	44.5	43.8	43.4	41.8	42.3	42.9	42.5	43.6	45.7	47.5	47.1	45.7	43.6	44.4
Financial balance	-2.9	-4.6	-4.8	-3.0	-1.6	0.0	0.5	2.4	2.5	0.2	-0.8	-2.1	-0.1	2.4	1.0	-0.8
Taxes	35.7	34.0	33.3	34.3	35.3	35.7	36.6	39.0	38.8	37.2	37.1	38.6	40.2	40.7	38.1	37.3
Public consumption	21.5	22.0	21.9	22.5	22.3	22.1	22.5	23.2	23.6	23.6	25.6	26.1	25.6	25.2	24.7	25.0

<sup>1</sup> This table is in accordance with the national accounts standards of the EU, ESA 95.

<sup>2</sup> Provisional.



**Table 11: Central government finances**Billion krónur<sup>1</sup>

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 <sup>2</sup>	2004 <sup>2</sup>	2005	Forecast 2006	2007
<b>Total income</b>	<b>130.2</b>	<b>127.3</b>	<b>134.5</b>	<b>141.3</b>	<b>155.7</b>	<b>162.4</b>	<b>183.9</b>	<b>213.8</b>	<b>228.7</b>	<b>245.4</b>	<b>257.3</b>	<b>274.4</b>	<b>313.1</b>	<b>347.2</b>	<b>341.1</b>	<b>353.7</b>
1. Direct taxes	39.3	39.8	42.8	46.9	53.2	54.3	61.7	74.2	82.8	95.2	99.2	107.6	122.5	131.4	130.2	126.8
2. Indirect taxes	72.7	70.6	72.5	74.8	82.1	87.3	98.9	113.5	117.5	116.2	120.9	131.6	153.3	170.7	171.8	184.1
3. Interest income	5.9	5.9	6.4	6.2	6.2	5.9	6.7	7.6	8.7	12.4	12.9	9.0	9.2	10.8	12.0	13.0
4. Other income	3.7	2.8	3.4	3.3	3.1	3.8	3.2	3.6	3.5	3.3	3.9	4.4	5.3	10.5	2.6	4.3
5. Sales of goods and services	8.5	8.3	9.4	10.1	11.1	11.1	13.5	14.9	16.1	18.3	20.3	21.8	22.8	23.8	24.5	25.5
<b>Total expenditure</b>	<b>139.7</b>	<b>141.1</b>	<b>147.9</b>	<b>152.9</b>	<b>163.0</b>	<b>159.6</b>	<b>177.8</b>	<b>198.2</b>	<b>211.7</b>	<b>240.9</b>	<b>260.7</b>	<b>288.4</b>	<b>304.1</b>	<b>320.0</b>	<b>330.2</b>	<b>362.9</b>
1. Operational costs	61.0	64.2	67.6	72.1	74.7	75.2	87.4	97.3	106.9	120.0	134.0	140.3	149.4	159.6	168.3	178.1
of which: public cons.	52.5	55.9	58.2	62.1	63.6	64.1	73.9	82.4	90.8	101.7	113.7	118.5	126.5	135.8	143.8	152.6
2. Interest expenditure	14.0	14.8	16.0	17.8	17.4	17.4	18.8	20.2	19.5	23.1	21.9	23.1	23.0	23.9	19.8	19.6
3. Subsidies	11.8	9.0	8.0	8.0	8.1	8.2	7.9	8.6	9.0	10.8	11.5	11.1	11.4	11.8	12.5	12.8
4. Income transfers	41.2	42.5	43.8	47.1	52.1	51.9	54.3	60.2	66.2	73.5	81.9	99.8	101.8	109.2	116.4	128.7
5. Gross investment	7.6	9.4	9.5	8.9	9.9	8.0	10.1	12.4	11.9	14.1	13.7	14.6	17.5	14.8	12.3	23.7
5. Depreciation(-)	5.9	6.3	6.8	7.3	7.7	8.1	8.7	9.2	9.8	10.4	11.1	11.7	12.6	13.3	13.8	15.1
7 Capital transfers	10.0	7.5	9.7	6.2	8.4	7.0	7.9	8.7	8.1	9.7	8.9	11.2	13.7	14.0	14.7	15.1
<b>Financial balance</b>	<b>-9.6</b>	<b>-13.8</b>	<b>-13.4</b>	<b>-11.6</b>	<b>-7.3</b>	<b>2.7</b>	<b>6.2</b>	<b>15.6</b>	<b>16.9</b>	<b>4.6</b>	<b>-3.4</b>	<b>-14.0</b>	<b>9.0</b>	<b>27.2</b>	<b>10.9</b>	<b>-9.2</b>
<b>Percentage of GDP</b>																
Revenue	33.3	31.6	31.4	32.1	32.9	31.8	32.4	34.8	34.2	32.7	32.9	33.8	35.4	36.0	32.4	31.9
Expenditure	35.8	35.0	34.6	34.7	34.5	31.3	31.3	32.2	31.6	32.1	33.3	35.6	34.4	33.2	31.4	32.7
Financial balance	-2.4	-3.4	-3.1	-2.6	-1.6	0.5	1.1	2.5	2.5	0.6	-0.4	-1.7	1.0	2.8	1.0	-0.8
Taxes	28.7	27.4	26.9	27.6	28.6	27.7	28.3	30.5	29.9	28.2	28.1	29.5	31.2	31.3	28.7	28.0
Public consumption	13.4	13.9	13.6	14.1	13.5	12.5	13.0	13.4	13.6	13.6	14.5	14.6	14.3	14.1	13.7	13.7

<sup>1</sup> This table is in accordance with the national accounts standards of the EU, ESA 95.<sup>2</sup> Provisional.

**Table 12: Local government finances**

Billion krónur <sup>1</sup>

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 <sup>2</sup>	2004 <sup>2</sup>	2005	2006	2007
<b>Total income</b>	<b>35.9</b>	<b>36.0</b>	<b>37.7</b>	<b>40.9</b>	<b>46.9</b>	<b>55.5</b>	<b>62.9</b>	<b>69.9</b>	<b>77.7</b>	<b>89.5</b>	<b>99.8</b>	<b>104.3</b>	<b>112.7</b>	<b>124.5</b>	<b>135.0</b>	<b>141.7</b>
1. Direct taxes	15.8	19.8	19.9	21.2	23.1	31.7	36.9	41.5	46.0	54.1	58.2	61.1	66.1	73.1	78.3	81.4
2. Indirect taxes	11.6	6.9	7.2	8.3	8.7	8.8	10.4	11.0	13.5	13.5	12.2	12.7	13.7	17.1	20.4	21.9
3. Interest income	0.8	0.8	0.5	0.5	0.5	0.6	0.7	0.9	1.2	1.6	6.1	4.1	4.4	3.9	3.6	3.8
4. Other income	3.3	3.4	4.3	5.0	7.8	7.2	6.5	7.6	7.8	10.6	10.8	11.6	12.5	13.1	13.9	14.6
5. Sales of goods and service	4.4	5.0	5.8	6.0	6.9	7.2	8.5	8.9	9.2	9.6	12.5	14.8	16.0	17.3	18.8	20.1
<b>Total revenue</b>	<b>37.6</b>	<b>40.7</b>	<b>44.6</b>	<b>42.3</b>	<b>47.4</b>	<b>58.5</b>	<b>67.2</b>	<b>72.8</b>	<b>80.3</b>	<b>94.8</b>	<b>103.2</b>	<b>108.0</b>	<b>123.0</b>	<b>130.9</b>	<b>138.3</b>	<b>143.2</b>
1. Operational costs	25.2	27.6	30.8	31.5	36.5	44.5	49.8	54.9	60.7	68.4	81.1	88.0	94.2	101.4	109.6	117.1
of which: public cons.	20.8	22.6	25.0	25.6	29.6	37.3	41.3	46.1	51.5	58.7	68.6	73.2	78.2	84.2	90.8	97.0
2. Interest expenditure	1.6	1.7	2.0	2.2	2.1	2.2	2.4	2.6	3.1	5.4	3.2	2.6	2.8	3.6	4.2	4.6
3. Subsidies	0.7	0.7	0.7	0.7	1.0	1.0	1.2	1.4	1.8	2.1	1.2	1.3	1.4	1.5	1.6	1.7
4. Income transfers	2.3	2.6	3.0	2.7	3.0	3.1	3.3	3.6	4.2	5.0	8.3	9.1	9.7	10.1	10.8	11.5
5. Gross investment	10.1	10.3	10.0	7.1	7.7	10.4	13.5	13.7	13.9	17.9	12.9	11.5	19.9	19.5	17.8	14.2
5. Depreciation(-)	2.1	2.2	2.5	2.6	2.7	3.0	3.2	3.4	3.7	4.1	4.1	4.3	4.6	5.0	5.3	5.6
7. Capital transfers	-0.4	0.0	0.6	0.8	-0.2	0.3	0.2	0.2	0.3	0.2	0.5	-0.2	-0.3	-0.3	-0.3	-0.3
<b>Financial balance</b>	<b>-1.7</b>	<b>-4.7</b>	<b>-6.8</b>	<b>-1.4</b>	<b>-0.4</b>	<b>-3.0</b>	<b>-4.3</b>	<b>-2.9</b>	<b>-2.6</b>	<b>-5.3</b>	<b>-3.4</b>	<b>-3.8</b>	<b>-10.3</b>	<b>-6.4</b>	<b>-3.3</b>	<b>-1.5</b>
<b>Percentage of GDP</b>																
Revenue	9.2	8.9	8.8	9.3	9.9	10.9	11.1	11.4	11.6	11.9	12.8	12.9	12.7	12.9	12.8	12.8
Expenditure	9.6	10.1	10.4	9.6	10.0	11.5	11.8	11.8	12.0	12.6	13.2	13.3	13.9	13.6	13.2	12.9
Financial balance	-0.4	-1.2	-1.6	-0.3	-0.1	-0.6	-0.7	-0.5	-0.4	-0.7	-0.4	-0.5	-1.2	-0.7	-0.3	-0.1
Taxes	7.0	6.6	6.3	6.7	6.7	7.9	8.3	8.5	8.9	9.0	9.0	9.1	9.0	9.3	9.4	9.3
Public consumption	5.3	5.6	5.8	5.8	6.3	7.3	7.3	7.5	7.7	7.8	8.8	9.0	8.8	8.7	8.6	8.7

<sup>1</sup> This table is in accordance with the national accounts standards of the EU, ESA 95.

<sup>2</sup> Provisional.

**Table 13: Central government debt, claims and cash at hand <sup>1</sup>**

Million krónur, year-end values

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Prov. 2004	Forec. 2005	Forec. 2006
<b>Gross debt</b>	<b>166 116</b>	<b>195 569</b>	<b>213 924</b>	<b>232 585</b>	<b>239 246</b>	<b>241 566</b>	<b>237 793</b>	<b>225 968</b>	<b>228 530</b>	<b>298 314</b>	<b>281 108</b>	<b>277 187</b>	<b>252 990</b>	<b>197 300</b>	<b>202 700</b>
Central Bank	13	6	-	-	-	-	-	-	-	-	-	-	-	-	-
Treasury bonds	51 793	60 796	69 008	74 140	73 889	84 424	82 865	82 618	68 898	64 243	50 818	47 402	37 910	27 700	29 500
Treasury notes	2 487	6 012	5 563	5 768	8 366	11 258	15 846	11 018	11 430	19 588	32 482	41 075	55 400	66 900	68 400
Treasury bills	12 545	13 742	14 630	16 406	15 811	12 296	15 209	9 899	5 970	12 003	12 004	20 504	14 504	18 000	18 000
Other domestic liabilities	12 005	12 709	11 090	9 010	8 962	6 960	6 555	4 297	2 907	4 191	3 799	3 977	3 888	3 800	3 700
Foreign debt	87 273	102 304	113 633	127 261	132 218	126 628	117 318	118 136	139 325	198 289	182 005	164 229	141 288	80 900	83 100
<b>Total claims</b>	<b>67 700</b>	<b>64 968</b>	<b>69 066</b>	<b>77 196</b>	<b>71 021</b>	<b>69 309</b>	<b>86 496</b>	<b>107 159</b>	<b>101 172</b>	<b>129 542</b>	<b>131 600</b>	<b>118 023</b>	<b>95 514</b>	<b>121 700</b>	<b>130 200</b>
Long term credit	41 654	46 875	55 469	64 065	63 661	65 278	64 739	69 347	70 919	93 049	80 874	76 381	51 633	72 600	73 400
Indexed to domestic prices	22 774	26 405	37 016	45 357	50 565	52 885	53 215	57 699	59 262	79 517	73 799	70 909	47 698	70 700	71 600
In foreign currency	18 880	20 470	18 453	18 708	13 096	12 393	11 524	11 648	11 657	13 532	7 075	5 472	3 935	1 900	1 800
Short-term claims	26 046	18 093	13 597	13 131	7 360	4 031	21 757	37 812	30 253	36 493	50 726	41 642	43 881	49 100	56 800
<b>Cash at hand, net</b>	<b>4 116</b>	<b>5 821</b>	<b>5 901</b>	<b>4 677</b>	<b>4 309</b>	<b>4 553</b>	<b>13 044</b>	<b>15 354</b>	<b>16 830</b>	<b>18 046</b>	<b>16 468</b>	<b>16 848</b>	<b>23 800</b>	<b>28 200</b>	<b>27 200</b>
<b>Net debt</b>	<b>98 416</b>	<b>130 601</b>	<b>144 858</b>	<b>155 389</b>	<b>168 225</b>	<b>172 257</b>	<b>151 297</b>	<b>118 809</b>	<b>127 358</b>	<b>168 772</b>	<b>149 508</b>	<b>159 164</b>	<b>157 475</b>	<b>75 600</b>	<b>72 500</b>
Claims as a percentage of debt	40.8	33.2	32.3	33.2	29.7	28.7	36.4	47.4	44.3	43.4	46.8	42.6	37.5	61.7	64.2
<b>Net financial position</b>	<b>-94 300</b>	<b>-124 780</b>	<b>-138 957</b>	<b>##</b>	<b>##</b>	<b>-167 704</b>	<b>-138 253</b>	<b>-103 455</b>	<b>##</b>	<b>-150 726</b>	<b>-133 040</b>	<b>#####</b>	<b>-133 675</b>	<b>-47 400</b>	<b>-45 300</b>
<b>Percentage of GDP</b>															
<b>Gross debt</b>	<b>42.2</b>	<b>48.1</b>	<b>49.5</b>	<b>52.3</b>	<b>50.1</b>	<b>46.8</b>	<b>41.5</b>	<b>36.7</b>	<b>34.1</b>	<b>39.8</b>	<b>35.9</b>	<b>34.2</b>	<b>28.6</b>	<b>20.4</b>	<b>19.3</b>
of which: foreign debt	22.2	25.2	26.3	28.6	27.7	24.5	20.5	19.2	20.8	26.4	23.3	20.2	16.0	8.4	7.9
<b>Total claims</b>	<b>10.3</b>	<b>11.3</b>	<b>12.8</b>	<b>14.3</b>	<b>13.3</b>	<b>12.6</b>	<b>11.3</b>	<b>11.1</b>	<b>10.4</b>	<b>12.0</b>	<b>10.3</b>	<b>9.3</b>	<b>5.8</b>	<b>7.5</b>	<b>6.9</b>
of which: In foreign currency	4.6	4.9	4.3	4.2	2.8	2.4	2.0	1.9	1.6	1.7	0.9	0.7	0.5	0.2	0.2
<b>Short term credit, net</b>	<b>6.6</b>	<b>4.4</b>	<b>3.1</b>	<b>2.9</b>	<b>1.5</b>	<b>0.8</b>	<b>3.8</b>	<b>6.0</b>	<b>4.5</b>	<b>4.7</b>	<b>6.4</b>	<b>5.1</b>	<b>4.9</b>	<b>5.0</b>	<b>5.3</b>
<b>Net debt</b>	<b>25.3</b>	<b>32.4</b>	<b>33.6</b>	<b>35.0</b>	<b>35.3</b>	<b>33.5</b>	<b>26.4</b>	<b>19.6</b>	<b>19.3</b>	<b>23.1</b>	<b>19.2</b>	<b>19.8</b>	<b>18.0</b>	<b>7.9</b>	<b>7.1</b>
<b>Net financial position</b>	<b>-23.2</b>	<b>-29.9</b>	<b>-32.0</b>	<b>-33.8</b>	<b>-34.4</b>	<b>-32.3</b>	<b>-24.0</b>	<b>-17.3</b>	<b>-15.3</b>	<b>-19.2</b>	<b>-18.0</b>	<b>-17.5</b>	<b>-16.0</b>	<b>-5.4</b>	<b>-4.8</b>

<sup>1</sup> Including accrued interest liabilities.

**Table 14: General government debt and claims <sup>1</sup>**

Million krónur, year-end values

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Prel. 2004	Forec. 2005	Forec. 2006
<b>General government gross debt</b>	<b>185 639</b>	<b>220 084</b>	<b>245 071</b>	<b>267 611</b>	<b>274 447</b>	<b>279 351</b>	<b>280 460</b>	<b>271 455</b>	<b>277 950</b>	<b>354 610</b>	<b>340 712</b>	<b>336 008</b>	<b>321 317</b>	<b>269 973</b>	<b>276 994</b>
Domestic debt	95 466	113 296	126 467	135 881	138 088	145 149	153 144	141 472	125 047	138 274	146 107	160 277	168 479	178 270	183 514
Foreign debt	90 173	106 788	118 604	131 730	136 359	134 202	127 316	129 983	152 903	216 336	194 605	176 790	152 868	91 826	93 600
<b>General government total claims</b>	<b>79 127</b>	<b>76 905</b>	<b>79 577</b>	<b>88 313</b>	<b>82 925</b>	<b>82 820</b>	<b>99 746</b>	<b>124 477</b>	<b>119 287</b>	<b>155 328</b>	<b>158 558</b>	<b>139 692</b>	<b>119 825</b>	<b>145 700</b>	<b>154 200</b>
Long-term claims	48 346	54 091	61 559	70 760	71 249	74 449	74 482	80 429	81 007	113 424	101 832	92 050	69 900	90 600	91 400
Taxes outstanding and other short-term	30 781	22 814	18 018	17 553	11 676	8 371	25 264	44 048	38 280	41 904	56 726	47 642	49 925	55 100	62 800
<b>General government net debt</b>	<b>106 512</b>	<b>143 179</b>	<b>165 494</b>	<b>179 298</b>	<b>191 522</b>	<b>196 531</b>	<b>180 714</b>	<b>146 978</b>	<b>158 663</b>	<b>199 282</b>	<b>182 154</b>	<b>196 316</b>	<b>201 492</b>	<b>124 273</b>	<b>122 794</b>
Central government	98 416	130 601	144 858	155 389	168 225	172 257	151 297	118 809	127 358	168 772	149 508	159 164	157 475	75 500	72 500
Local governments	10 195	14 552	22 185	25 131	24 189	25 037	30 089	28 663	31 654	30 712	32 790	37 289	44 147	48 896	50 414
Social security system	-2 099	-1 974	-1 549	-1 222	-892	-763	-672	-494	-349	-202	-144	-137	-130	-123	-120
<b>Gross debt at 1998-prices</b>															
General government gross debt	203 802	227 796	250 494	270 731	274 588	278 889	280 460	268 189	258 622	291 641	296 548	289 392	280 633	223 234	220 584
General government net debt	115 536	146 593	166 943	179 232	189 773	195 389	180 714	149 322	149 740	161 968	165 840	177 196	187 609	113 474	110 097
<b>Percentage of GDP</b>															
<b>General government gross debt</b>	<b>46.0</b>	<b>52.9</b>	<b>56.5</b>	<b>60.0</b>	<b>57.4</b>	<b>53.8</b>	<b>48.7</b>	<b>44.1</b>	<b>39.8</b>	<b>45.5</b>	<b>44.5</b>	<b>41.2</b>	<b>37.0</b>	<b>28.4</b>	<b>26.5</b>
Domestic debt	24.1	27.5	29.2	30.4	28.8	28.0	26.7	22.5	18.4	17.8	18.6	19.5	18.7	18.3	17.1
Foreign debt	21.9	25.4	27.3	29.6	28.7	25.9	22.1	21.6	21.4	27.6	25.9	21.7	18.3	10.1	9.4
<b>General government total claims</b>	<b>19.8</b>	<b>18.6</b>	<b>18.4</b>	<b>19.8</b>	<b>17.3</b>	<b>16.0</b>	<b>17.4</b>	<b>19.9</b>	<b>17.5</b>	<b>20.0</b>	<b>20.2</b>	<b>17.0</b>	<b>13.3</b>	<b>15.0</b>	<b>14.4</b>
<b>General government net debt</b>	<b>26.2</b>	<b>34.3</b>	<b>38.2</b>	<b>40.2</b>	<b>40.1</b>	<b>37.9</b>	<b>31.4</b>	<b>24.3</b>	<b>22.3</b>	<b>25.4</b>	<b>24.3</b>	<b>24.2</b>	<b>23.7</b>	<b>13.4</b>	<b>12.2</b>

<sup>1</sup> The general government is defined according to the ESA-definition. Government enterprises and financial institutions are excluded.