

English translation of the Weekly Web Release



MINISTRY OF FINANCE IN ICELAND

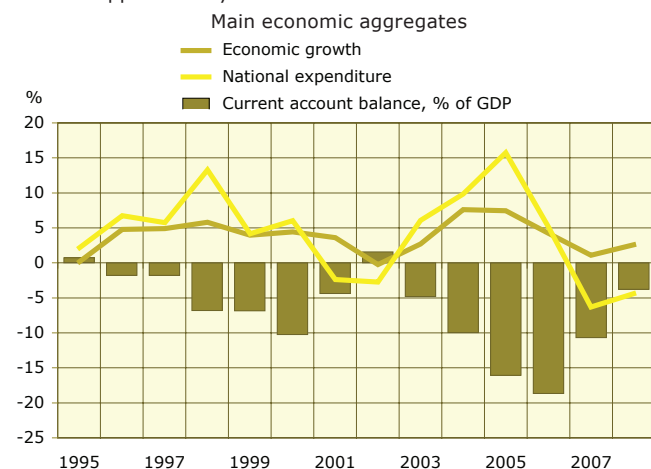
November 16th 2006

Further on financial stability in Iceland

At the beginning of 2006 a discussion took place concerning whether Iceland was on its way towards a hard landing and a period of financial instability. Reports from Fitch Ratings, Merrill Lynch and Danske Bank in the spring months all concluded that there was a high likelihood of this happening. At that time Fitch Ratings changed its outlook on sovereign debt from stable to negative while maintaining its good rating. In this respect, it was pointed out that the Icelandic economy was becoming increasingly imbalanced, foreign debt had increased and restraint in public finances was insufficient. At that time the exchange rate and stock prices began to decline significantly.

Another conclusion was presented in the Ministry's Web release on February 23rd and its [Spring Economic Outlook 2006](#). It was pointed out that the instability was most likely temporary, that Treasury finances were strong, that the restrictiveness of fiscal policy had been considerable, the tightness of monetary policy had been increased, the pension fund system was fully funded, that the net asset of businesses and households were significant, that the Icelandic economy was resilient and efficient and the international financial market would "probably continue liquid and thus contribute to progress, both internationally and for the Icelandic economy." It was therefore concluded that there was "little danger the achievements of recent years would be halted or reversed."

Over the summer months, the exchange rate and share prices began to recover and have continued to do so through the autumn. Moreover, indications have emerged that the economy is slowing down, which is consistent with the forecast of the Ministry. The graph below shows the latest forecast on growth of GDP and of national expenditure as well as the current account balance as share of GDP over the next several years. In view of developments during the year, the forecast still appears likely to be realised.



Recent reports by Fitch Ratings and Merrill Lynch have painted a more positive picture of the outlook for the Icelandic economy, although they still warn of risks. It is pointed out that Icelandic banks have made improvements in some areas criticised in earlier reports. For example, the cross-ownership ties have been reduced and uncertainty regarding the refinancing of debt maturing this year and next has been eliminated. Last July, Moody's announced that its good credit rating for the Treasury remained unchanged as was the stable outlook. The country report of Standard & Poor's, issued at the end of October, observed that the ratings for Iceland are supported by its stable and flexible political institutions, healthy public finances, high per capita income and strong long-term growth prospect.

Economic prospects in the Nordic countries

Economic developments in the Nordic countries have been quite favourable in recent years. Economic growth has been close to its lon-

ger-term potential, unemployment has been declining, inflation low and public finances in surplus. Growth is estimated at 3.4 per cent in 2006 and 3 per cent in 2007. Growth is expected to slow down in all the Nordic countries in 2007 except in Norway. Inflation has been low in all the Nordic countries except in Iceland. Unemployment is declining rapidly except in Finland and Sweden. These countries have been unable to reduce unemployment in spite of good growth. This information may be seen in a recent report of the Nordic Economic Committee, *Ekonomiska utsikter i Norden 2007*.

Key economic indicators for the Nordic countries 2004-2007

Weighted averages	2004	2005	2006	2007
<i>Economic growth, per cent</i>	3,1	2,9	3,4	3,0
Denmark	1,7	3,6	2,7	2,0
Finland	3,5	2,9	4,5	3,0
Iceland	7,7	7,5	4,2	1,0
Norway	3,1	2,3	2,4	3,6
Sweden	3,7	2,7	4,0	3,3
<i>Inflation, per cent</i>	0,6	1,2	1,9	2,0
Denmark	1,2	1,8	2,0	1,8
Finland	0,2	0,9	1,5	1,3
Iceland	3,2	4,0	7,3	4,5
Norway	0,4	1,6	2,5	1,8
Sweden	0,4	0,5	1,6	2,5
<i>Unemployment, per cent</i>	6,2	6,0	5,2	5,1
Denmark	6,1	5,4	4,4	4,1
Finland	8,8	8,4	7,7	7,4
Iceland	3,1	2,1	1,3	2,1
Norway	4,5	4,6	3,5	3,3
Sweden	6,0	6,0	5,6	5,8
<i>Public finance surpluses*</i>	4,0	6,2	6,8	6,3
Denmark	1,7	4,0	3,1	2,8
Finland	2,1	2,5	2,9	2,7
Iceland	0,5	5,5	3,8	1,5
Norway	11,4	16,4	19,5	18,6
Sweden	1,6	2,8	2,8	2,3

* In per cent of GDP

Public finances have seldom been in better shape in the Nordic countries than at present. The aging of the population is a problem that all these countries are dealing with. Relatively fewer taxpayers will have to finance pensions and other public services for an increasing number of retirees. This problem is not as serious in Iceland which enjoys a fully funded pension system and a young population.

The Nordic countries compare quite favourable with the average of the euro-area for the main economic aggregates. Economic growth has in recent years been about 2 per cent higher in the Nordic countries than in the euro-area. The same applies to growth prospects for the present year and the next. Nordic unemployment is about 2 percentage points lower than in the euro-area and inflation has been considerably lower, although the Nordic rates are expected to converge considerably with those of the euro-area next year. The largest difference is in the area of public finances. The surplus amounted to an average of more than 6 per cent in of GDP in the Nordic countries compared with a 2 per cent deficit in the euro-area. This sharp differential is expected to continue in 2006 and 2007.

Treasury revenue January-September			Treasury expenditure January-September			Treasury finances January-September			Economic indicators		
12 month changes (%)	2005	2006	12 month changes (%)	2005	2006	Million krónur	2005	2006	12 month changes (%)	2005	2006
Total tax revenue	22.0	13.8	General public services	36.3	-24.8	Cash from operations	14,581	43,872	Inflation (November)	4.2	7.3
Taxes on income & profit	24.1	19.6	Health	6.0	7.6	Net financial balance	59,746	41,627	Core inflation (November)	4.6	7.2
Taxes on property	44.8	-36.6	Social security & welfare	4.4	3.1	Debt redemption	-47,939	-38,071	Wage index (September)	6.9	10.8
Taxes on goods & services	20.5	14.1	Economic affairs	-3.7	1.6	Gross borr. requirement	8,857	586	Total turnover (Jan. - June)	8.0	12.5
Social contributions	16.4	16.0	Education	14.8	12.5	Net borrowing	11,698	24,978	Retail turnover (Jan. - June)	6.4	5.1
Total revenue	51.8	-9.2	Total expenditure	9.7	0.0	Overall cash balance	20,555	25,564	Unemployment rate, sa (Oct.)	1.6	1.1