

English translation of the Weekly Web Release



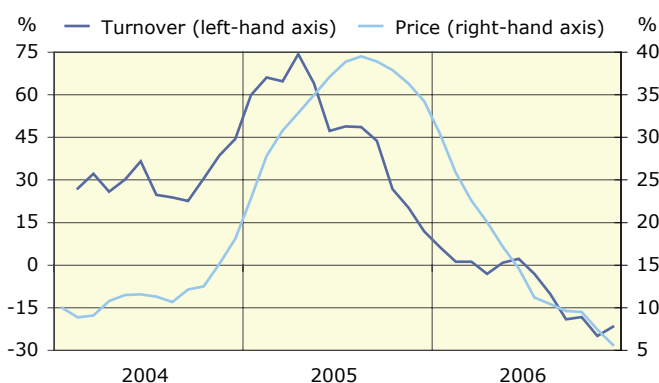
MINISTRY OF FINANCE IN ICELAND

January 25th 2007

The housing boom has subsided

As is discussed in the recently published [revised macroeconomic forecast](#) of the Ministry of Finance, the expansion of the housing market began to slow down in the course of last year. Following a substantial increase in the supply of new apartment buildings in 2006, supply appears to have caught up with demand and at present there is a surplus of unsold new apartments on the market. The nominal price of apartments has remained roughly stable since the middle of last year, whereas the price in real terms (i.e. nominal price deflated by consumer prices) has begun to decline. The rate of price change has also declined rapidly, and by December 2006 it had dipped below the inflation rate as measured by consumer prices. Housing investment is expected to decline in 2007. In view of the latest indications of household investment plans, the increase in indexed interest rates in the housing market and that housing supply has by far exceeded its long-term trend, a 5 per cent decline in housing investment is forecast for 2007 and further in 2008 by 2 per cent. The following chart clearly shows that the significant expansion in the housing market in 2005 has subsided by now.

Price (in nominal terms) and turnover in the housing market in the capital area (12-month increase) 2004–2006



A policy for efficiency in government operations

In accordance with the proposal of the Minister of Finance, the Government has approved a new policy for efficiency in government operations. The policy presents an overview of improvements in government operations under the headline simple and efficient service. The proposal presents five principal goals for improvements in government operations, both as they relate to internal operations as well as in their relations with individuals and business.

Government operations are of great importance for business and individuals and its development will have an impact on Iceland's competitive position over the next several years. The demands upon government are on the increase, both as regards improved service and care in the handling of individual issues. At the same time, cost- and service efficiency are being demanded. All this calls for increased flexibility in the arrangement of government operations. New avenues must be sought to improve government and means must be sought to outsource certain tasks of the government. The frame of government operations must therefore be clear and simple.

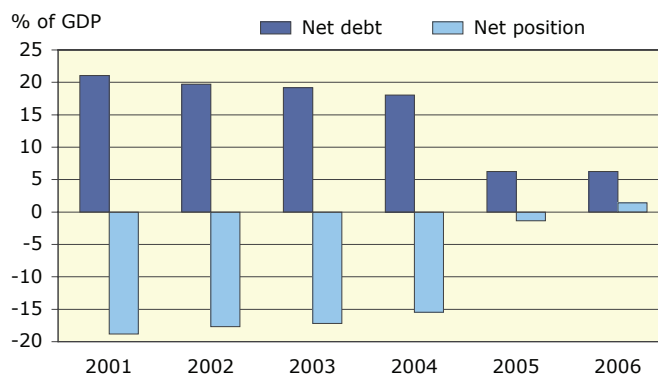
The five goals set forth in the new policy relate to the organisation of government, public governance, financial administration, human resource policy and the relations between government and the private sector. These goals are then divided further into sub-items and points of emphasis.

Further work for the implementation of the policy is expected to be underway soon.

The debt of the Treasury

The net debt of the Treasury in relation to GDP has been declining in recent years. It amounted to 21 per cent of GDP at the end of 2001, declining to an estimated 6 per cent of GDP at the end of 2006. The net debt amounted to 169 billion krónur at the end of 2001 and is estimated at just over 74 billion at the end of last year. The net position of the Treasury, consisting of its net debt plus cash at hand, has also improved from a negative balance equivalent to 19 per cent of GDP at the end of 2001 to an estimated surplus of 1 per cent at the end of 2006.

Treasury debt 2001–2006



A 250 million euro bullet loan issued in 2001 matured in 2006 and was fully repaid. Towards the end of October, the Central Bank was authorised to issue a medium-term note of up to one billion euros in the European market in order to strengthen the country's foreign exchange reserves. The interest and exchange rate risk was offset through portfolio investment of commensurable maturities. The issue was successful. Interest terms were one basis point below EURIBOR, carrying a fixed interest rate of 3.75 per cent paid annually until maturity, December 1st 2011.

The strong financial position of the Treasury in 2006 made it unnecessary to issue debt in the domestic market, but it was seen essential to issue government debt to maintain a market in government paper. Such issues form a benchmark for the bond market, by which other issuers can set their terms. A continual interest rate spectrum for risk-free interest rates thus forms a basis for the pricing of other debt issues and their derivatives. Due to the fact that the Treasury has had no need for financing in the domestic market in recent years, the issues of the Treasury have solely been in non-indexed notes, whereas the Housing Finance Fund has issued indexed bonds. The Housing Finance Fund operates under a government guarantee, and its issues therefore have a comparable position to that of Treasury issues for the formulation of an interest structure.

Last May, a debt issue programme was announced that aims at the regular issue of two-year Treasury notes and 3-month Treasury bills. Longer-term non-indexed notes were already in existence in the market. These issues are intended to support government economic policy by providing a continual non-indexed interest rate spectrum for up to seven years. Such information supports the formulation of expectations in the economy, which is important for economic policy, especially monetary policy.

For this year, the Treasury intends to continue issuing debt to maintain a resilient secondary market in Treasury issues. The interest rate spectrum will be strengthened through issues on a tender basis, as set forth in the programme of May last year. The issues will be offset by redemption of existing debt and purchases in the open market.

Treasury revenue January–November		
12 month changes (%)	2005	2006
Total tax revenue	21.3	12.9
Taxes on income & profit	24.8	20.1
Taxes on property	31.6	-42.6
Taxes on goods & services	19.6	12.9
Social contributions	16.4	16.1
Total revenue	45.6	-6.2

Treasury expenditure January–November		
12 month changes (%)	2005	2006
General public services	31.2	-21.2
Health	5.5	8.3
Social security & welfare	4.9	4.8
Economic affairs	-2.5	2.5
Education	14.7	12.1
Total expenditure	8.9	1.8

Treasury finances January–November		
Million krónur	2005	2006
Cash from operations	21,461	52,031
Net financial balance	70,420	49,893
Debt redemption	-61,597	-44,583
Gross borr. requirement	3,691	1,661
Net borrowing	7,734	21,587
Overall cash balance	11,425	23,248

Economic indicators		
12 month changes (%)	2005	2006
Inflation (Jan. '06 and '07)	4.4	6.9
Core inflation (Jan. '06 and '07)	4.3	7.1
Wage index (December)	7.2	9.8
Total turnover (Jan. – October)	12.1	13.7
Retail turnover (Jan. – October)	8.7	5.7
Unemployment rate, sa (Dec.)	1.5	1.2