



MINISTRY OF FINANCE

Economic Outlook for Iceland

Autumn 2002



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1. Introduction and main conclusions

As of July 1, 2002, official macroeconomic forecasts of the National Economic Institute were transferred to the Ministry of Finance and the compilation of national accounts to Statistics Iceland. This report outlines the economic situation and prospects, i.a. based on the Government's economic policy presented in its economic plan. It also forms the basis underlying the 2003 fiscal budget.

Recent economic developments primarily reflect a rapid adjustment of the economy following a sharp upswing in recent years. Inflation has declined rapidly this year and prospects for next year point to a 2¼ per cent inflation rate. Unemployment has temporarily in-

creased, but indications are that this trend will be reversed.

The sharp turnaround in the current account since 2000 reflects the increased degree of flexibility of the Icelandic economy in recent years. This rapid adjustment also shows that the economy is heading for a new upswing in the coming years.

The following are the main conclusions of the economic forecast for 2002-2003 as well as the medium-term projections. It should be emphasised that this forecast does not incorporate the impact of possible investment in power intensive industries in the near future.

- Real GDP is expected to remain unchanged in 2002, whereas earlier forecasts indicated a slight decline. For 2003, a growth of 1½ per cent is projected, and an average of 3 per cent for the period 2004-2007.
- National expenditure is expected to decline by 3 per cent in 2002, due mainly to a fall in investment, particularly in the business sector where a fall of 20 per cent from 2001 is estimated. National expenditure is expected to rise by 1½ per cent in 2003.
- One of the main conclusions of the 2002 forecast is that the current account will be in balance for the first time since 1995, primarily because of a sharp increase in exports. The outlook for 2003 indicates a continued balance in foreign trade.
- Inflation is rapidly declining, both in 2002 and 2003. Consumer prices are expected to increase by 4¾ per cent on average between 2001 and 2002 and by 2¼ per cent between 2002 and 2003.
- The purchasing power of disposable household income has increased consistently since 1994 and shows no signs of abating. The present forecast is for a 1½ per cent increase in 2002 and a 2 per cent increase in 2003.
- National savings have increased sharply, following a decline in national expenditure. It is expected to amount to 19 per cent of GDP compared with 14 per cent in 2000. The favourable development of the current account has led to a reduced net external debt, which is forecast to continue next year.
- The 2003 fiscal budget projects a continued surplus, despite the slow recovery of the economy and a substantial reduction in income and net wealth taxes of business and individuals.

2. Overview of the forecast¹

2.1 Economic developments in 2002

This forecast projects that real GDP will remain unchanged in 2002, following a growth of 3.6 per cent in 2001, according to the latest figures. The previous forecast, in June, however projected a 0.8 per cent decline. This change is primarily due to stronger exports, which in turn is expected to bring the current account into balance for the year as a whole.

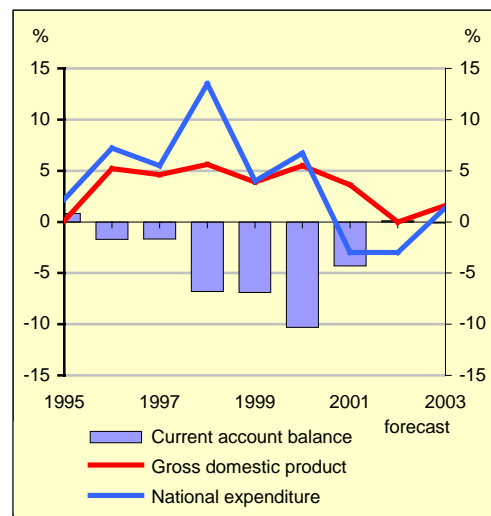
The external conditions of the economy have been quite favourable in the course of the year. The terms of trade have improved by close to 1 per cent, mainly because of rising prices for fish exports. This is reflected in the development of gross national income, which is forecast to rise by 1¼ per cent this year.

National expenditure is expected to decline by 3 per cent in 2002 for the second year in a row due to a sharp decline in business sector as well as public investment. Residential construction is, however, expected to remain roughly unchanged from the previous year. All told, total investment is estimated to decline by 15 per cent, which is similar to what was projected in the previous forecast.

Private consumption has continued to decline in 2002, although not as sharply as in the previous year when it declined by 3 per cent. This year the decline is assessed at close to 1 per cent which represents a considerable reversal from the expansion years 1996-2000 when private consumption rose by an average of 4 per

cent a year. The decline in private consumption in 2001 and 2002 is taking place at the same time as the purchasing power of disposable income is increasing, indicating that household savings are on the rise. Public consumption, however, is expected to increase by 2¾ per cent in 2002, which is less than in several previous years.

Figure 1: National expenditure, GDP and the current account 1995-2003



The decline in national expenditure increases national savings, which are now estimated at close to 19 per cent of GDP in 2002, compared to 14 per cent in 2000. This adjustment has had a favourable impact upon the economy, helping to bring the current account into balance.

¹ Cut-off date for this report is September 20.

Table 1. A summary of the forecast

	Bn. kr. 2002	Volume changes on previous year, %			
		2000	Preliminary 2001	Forecast 2002	Forecast 2003
Private consumption	423.6	4.0	-3.0	-1	1¼
Public consumption	188.9	3.7	3.2	2¾	1
Investment	148.6	14.8	-4.4	-14¾	1¾
Business sector investment	82.2	14.9	-9.3	-20¾	3½
Residential construction	33.0	10.5	12.9	-¼	-2
Public investment	33.4	18.1	-0.7	-7	½
Stock changes ¹⁾	-0.2	0.4	-0.8	¼	0
Total national expenditure	760.9	6.7	-3.0	-3	1½
Exports of goods and services	318.4	5.0	7.8	5¼	3½
Imports of goods and services	292.4	8.0	-9.0	-2¾	3
Gross domestic product	786.9	5.5	3.6	0	1½
Gross national income	762.0	4.6	3.0	½	1½
Effects of changes in terms of trade.....	-	-1.0	0.2	¾	-¼
Real gross national income.....	762.0	3.5	3.1	1¼	1¼
Current balance	0.4	-	-	-	-
% of GDP.....	-	-10.3	-4.3	0	0

1) In per cent of GDP of the previous year at constant prices.

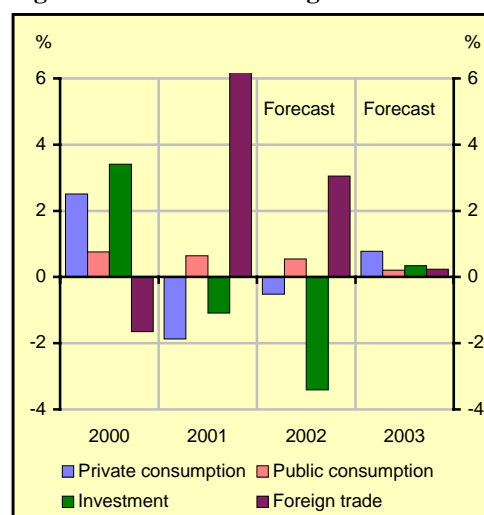
2.2 The 2003 forecast

The 2003 forecast envisages a slow recovery and a growth of about 1½ per cent or about 1 per cent less than in the previous forecast. National expenditure is forecast to rise by some 1½ per cent, half as much as forecast earlier. The reduced growth prospects are primarily due to a downward revision of investment and public consumption. It should also be noted that this forecast does not incorporate the impact of possible energy investment over the next several years.

Private consumption is expected to increase by 1¼ per cent in 2003. The growth in the purchasing power of disposable household income is expected to exceed that of private consumption by a small margin and savings would thereby rise for the third year in a row.

Public consumption is expected to increase by only 1 per cent in 2003, considerably less than in recent years; for 1999-2002 it rose by an average of 3½ per cent.

Figure 2: Contribution to growth of GDP



A close to 2 per cent increase in gross investment is forecast for 2003. Residential construction is expected to decline by 2 per cent, whereas public investment will increase by a small margin, or about ½ per cent. As always, there is great uncertainty about where business sector investment is headed. Improved

external conditions, including lower income and net wealth tax rates and an expected decline in real interest rates, give rise to expectations that business investment will increase. This forecast assumes a 3½ per cent increase for 2003. By comparison, the previous 2003 forecast projected a 10 per cent increase in total investment, where residential construction was thought to increase by 7½ per

cent, public investment by 2 per cent and close to 14 per cent in business sector investment.

The current account is expected to be roughly in balance in 2003. This is based on the important assumption that the krona exchange rate will be unchanged from its present value, which is equivalent to an exchange rate index of 130 for next year.

Table 2. Key national economic indicators

Volume changes from previous year in per cent, unless otherwise indicated

	2000	2001	Provis. 2002	Forec. 2003
Macro-economic indicators				
Economic growth	5.5	3.6	0	1½
National expenditure	6.7	-3.0	-3	1½
Current account, % of GDP	-10.3	-4.3	0	0
Net external debt, % of GDP	91.0	103.3	97½	95
National saving, % of GDP	13.8	17.7	19	18¾
Labour market				
Labour force (in thousands of man-years)	141.7	144.1	145.5	147.2
Unemployment, % of labour force	1.3	1.4	2½	2½
Purchasing power of disposable income per capita	1.3	2.3	1½	2
Share of wages in total factor income	66.3	61.4	62¼	62¼
Foreign trade				
Exports of marine products	-3.1	3.4	3	½
Total exports	-1.3	7.1	6½	2½
General imports	2.5	-12.0	-2¼	3¾
Terms of merchandise trade	-3.9	2.0	2	-1
Money and prices				
Consumer prices, %	5.0	6.7	4¾	2¼
Exchange rate index	112.7	135.4	132	130
Real long-term interest rates, %	5.9	5.9	5	4½
External conditions				
Economic growth in the European Union	3.4	1.7	1½	2¾
EU inflation rate	1.9	2.2	2	2
Foreign prices for marine products	0.5	3.9	4	2
Foreign import prices, excluding oil	4.5	1.2	1¼	2

2.3 Medium-term prospects

A medium-term projection gives an indication of economic prospects for the next several years, which, in turn, serves as an important signal for the direction of economic policy. By its nature, such a projection is subject to great uncertainty. The following projection covers the years 2004-2007.

The main assumptions behind the projection are that public consumption will increase by 2½ per cent, based on historical experience. Marine production is expected to increase by 2 per cent a year. At this stage, no increase in large-scale manufacturing is incorporated into the projection. The krona exchange rate is fixed during the entire period. External conditions are based on OECD forecasts assuming 2½ per cent growth in the EU and that inflation in the OECD countries will be just short of 2 per cent a year for the 2004-2007 period.

As noted earlier, a slow recovery is foreseen for 2003 with a growth rate of about 1½ per cent, well under the long-term trend of about 4 per cent a year since 1945. A growth rate of 3 per cent a year is projected for the medium term of 2004-2007.

Table 3. Summary of medium-term projections for 2004-2007

Average annual volume changes in per cent unless otherwise indicated

	Baseline scenario	Alternative scenario
Assumptions		
Public consumption.....	2½	1½
Exchange rate index, actual	130	135
Conclusions		
Economic growth.....	3	3
National expenditure.....	3¼	2¾
Investment as % of GDP.....	20¾	20½
National saving as % of GDP ..	20½	21¼
Inflation, annual average	2¼	2¾
Unemployment, %	2	2
Purch. power of wage rates	2	1½
Current account as % of GDP.	-¼	½

Inflation is expected to average 2¼ per cent and unemployment is projected to be stable at 2 per cent. Real disposable income is projected to increase by an average of 2 per cent a year and the current account is expected to be in fairly good balance for the period as a whole, with a deficit not exceeding ½ per cent of GDP. This indicates that the exchange rate index will be at about 130 in long-term equilibrium, although this rate will not suffice to allow national saving to finance the investment of the economy over the period.

An alternative scenario envisages changes in two basic assumptions. The growth in public consumption is scaled down from 2½ per cent to 1½ per cent and the exchange rate index is set at 135 instead of 130.

This scenario indicates that economic growth will be the same, whereas national expenditure will be ½ a per cent lower and national savings would suffice to finance the investment of the economy. Inflation, however, will be ½ a per cent higher under this alternative. Unemployment would be the same and real hourly wage rates would slightly fall. Labour productivity would increase in both scenarios by about 1½ per cent a year, an increase similar to the annual average for the years 1999-2002. The current account would yield a surplus, which is an important prerequisite for reducing the economy's external debt.

These two scenarios indicate that a tight fiscal policy, in this instance by restraining the growth of public consumption, would have a positive impact on the economy. A similar result would develop if public investment were constrained. Although such scenarios are by nature uncertain, they are important in assessing the effect of various external factors, such as large-scale energy investments, upon the economy.

3. International economic developments

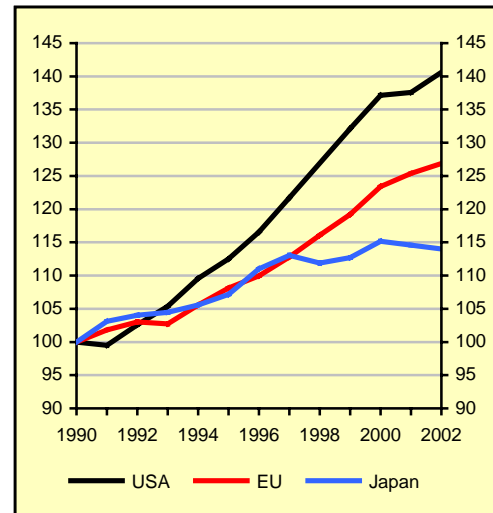
The outlook for the world economy is improving. Economic growth began to accelerate towards the end of 2001 and the first quarter of 2002 looked promising. Since then, however, the pace has slowed. The latest forecast of the International Monetary Fund projects a slower growth in world output and trade in 2002 and 2003 than it forecast last April. This is primarily attributable to weaker financial markets, lower growth in the USA and Europe and increasing economic difficulties in several emerging economies. Nonetheless, the growth in output has been positive and is expected to accelerate in 2003. The IMF forecast calls for a 2¾ per cent growth in world output in 2002 and 3¾ per cent in 2003.

The source of acceleration in 2002 is primarily based on improving growth prospects for the United States, rising industrial production and increased growth in world trade. The rapid response of governments has aided in this respect since interest rates and taxes were lowered early on, especially in the United States. Demand outside the United States has, however, been sluggish, and a recovery in the world economy has to a large extent been based on rising US demand. Investment has also been slow and its acceleration is a necessary prerequisite for continued output growth.

The state of financial markets has deteriorated and share prices have generally declined since March, partially because of a dimmer profit outlook, following a host of accounting scandals. The risk aversion of investors has therefore increased, and the financing conditions of emerging economies tightened. Nonetheless, economic growth is expected to increase. In-

flation has been low and interest rates are therefore expected to continue at low levels.

Figure 3: GDP growth in the USA, EU and Japan 1990-2002



Source: IMF and OECD.

3.1 The United States

Private consumption has been instrumental in maintaining economic growth and the recession has therefore not been deep. Government measures to reduce interest rates and taxes have obviously been important in this respect. Productivity has continued to increase, especially towards the end of 2001 and at the beginning of 2002. The increase in unemployment has been limited.

Economic growth has been slower in the second quarter, which is partially reflected in increased imports but also due to a slight decline in consumption. The deteriorating state of the financial markets has undermined investor confidence in the wake of financial scandals.

Lower share prices have probably had an impact upon private consumption, since household share ownership is common in the USA, thus impacting upon household assets and thereby private consumption.

Government finances have deteriorated due to tax reductions, cost increases in wake of the terrorist attacks and due to the recession in general. The Federal deficit is expected to reach 1½ per cent of GDP this year.

The International Monetary Fund forecasts a 2¼ per cent growth in the USA in 2002 and 2½ per cent in 2003. The forecast is based on the assumption that aggregate demand will expand and increased investment will offset a slower growth in private consumption. The drop in share prices will have an adverse effect upon demand but low long-term interest rates and the fall in the dollar exchange rate are expected to offset these influences to some extent. Inflation and interest rates are expected to remain low, which, in turn, will have a stimulating impact on economic activity.

Table 4: Economic situation and outlook in the world

Percentage changes unless otherwise stated

	2000	2001	Forecast 2002	Forecast 2003
Economic growth	4.7	2.2	2.8	3.7
Industrialised economies	3.8	0.8	1.7	2.5
USA	3.8	0.3	2.2	2.6
European Union	3.5	1.6	1.2	2.4
Japan	2.2	-0.5	-0.5	1.1
Developing economies	5.7	3.9	4.2	5.3
in Asia	6.7	5.6	6.2	6.2
in Africa	3.0	3.5	3.1	4.2
Transition economies	6.6	5.0	3.9	4.5
Russia	9.0	5.0	4.4	4.9
World trade	12.6	-0.2	2.4	6.1
Inflation				
Industrialised economies	2.3	2.2	1.5	1.8
Developing economies	6.1	5.7	5.8	6.0
Transition economies	20.2	15.9	11.4	8.9
Interest rates, LIBOR, six-month rate, p.a.				
US dollars	6.6	3.7	2.1	3.2
Japanese yen	0.3	0.2	0.1	0.1
Euro	4.6	4.1	3.4	3.8
Crude oil prices (USD)	57.0	-14.0	0.5	-0.8

Source: International Monetary Fund.

3.2 Europe

Forecasts for growth have been scaled down for Europe since earlier this year. Public finances have deteriorated and unemployment is relatively high. The floods in late summer have led to unexpected increases in public outlays.

European economies are expected to grow slowly in the near future.

The upturn has not been as pronounced in Europe as elsewhere, particularly in the USA and Asia. Exports have been the main stimulus

to growth whereas imports have declined, due to weak domestic demand, as both private consumption and investment have continued to contract. Inflation has hovered close to the 2 per cent target rate of the European Central Bank. Wage increases in excess of productivity have been a source of concern, but inflation is expected to abate in the near future, given that oil prices remain stable. Public finances are forecast to improve in most countries of the Euro area, where some countries have been beset by deficits, although the state of public finances is quite different from country to country.

The IMF forecasts that economic growth in the EU countries will accelerate towards the end of this year and reach 2½ per cent in 2003. The projected acceleration this year is i.a. based on indicators of production and purchase orders, as well as business and consumer expectations. Private consumption should rise since profits have increased, inflation abated and labour market conditions improved. Business investment is expected to pick up as business profits improve.

The factors of risk are whether foreign demand will continue to strengthen and whether the Euro exchange rate will rise, which could have an adverse impact on growth. Share prices have also fallen more than in the USA which could have a negative impact on expectations and demand, although share ownership by households is not as common as in the USA. Finally, the outlook for industrial production and demand in Germany is uncertain, a factor which could have a widespread impact in Europe.

3.3 Japan

For Japan, there are prospects for a slow recovery, following the third and deepest recession in a decade. Industrial production is increasing on the basis of rising exports. Continued growth will depend to a large extent on exports, which could be slowed down by a rise in the yen exchange rate. The financial sector is still

weak, having an adverse impact upon the Japanese economy. Government policy has sought to stimulate the economy through tax and interest rate reductions, which has placed a considerable burden on fiscal finances and public debt.

It appears that economic recovery has commenced early this year. Exports and public consumption rose during the first quarter and private consumption appears to be on the rise, although this trend is uncertain. Price deflation is still underway. There has been a great fall in asset prices, both share prices and real property.

The IMF forecasts that Japan's GDP will fall by ½ per cent this year and increase by just over 1 per cent next year. This forecast is based on the assumption that demand will gradually recover, and private consumption as well as business investment will revive towards the end of this year. The relative contribution of exports to growth will probably decline, whereas domestic demand and imports are expected to increase. The main risk factors are that the yen exchange rate will rise, world growth will be slower than expected and share prices will decline still further.

3.4 Other countries

Economic difficulties in Argentina have had an impact in neighbouring countries such as Brazil and Uruguay. Prospects seem better in some other Latin American countries such as Mexico and Chile. The turnaround in Asia's emerging economies has been faster than expected, partially because of increasing world trade and a turnaround in the information sector. Domestic demand in many of these countries is lacking, however, and they are thus very dependent on export demand for reviving their economies.

China is experiencing a rapid rate of growth on the basis of increasing exports, following China's accession to the World Trade Organisation. Public investment has increased and productivity increases should continue over the

next several years. The distribution of income between regions is, however, still very uneven in China.

In India, there has also been rapid growth. Privatisation is underway and foreign direct investment is now permitted to an increasing extent. Public finances, however, are still not firm and the fiscal deficit has increased.

The economies of the Middle East suffer from the ongoing conflicts in the region with an adverse effect upon Israel and its neighbours. The economies of the region have been helped by continuing high oil prices.

Economic growth in the Russian Federation has been considerable as well as in Middle and Eastern Europe where foreign investment has been substantial.

The developing countries are experiencing increasing growth, especially in Africa where it has exceeded expectations. This is primarily due to lower oil prices, reduced inflation, new export markets and the cessation of hostilities in many areas. Economic conditions are, however, still dire in many countries and a famine is still endemic in many parts of southern Africa.

4. Financial markets

4.1 Money market and exchange rates

A year and a half has passed since a new monetary policy regime was instituted in Iceland. The exchange rate bands were abolished and replaced by an inflation target whereby the twelve-month change in the consumer price index of 2½ per cent is aimed at in the longer term, with a limit of 1½ per cent in each direction. The upper limit was initially higher; 6 per cent for 2001 and 4½ per cent for 2002.

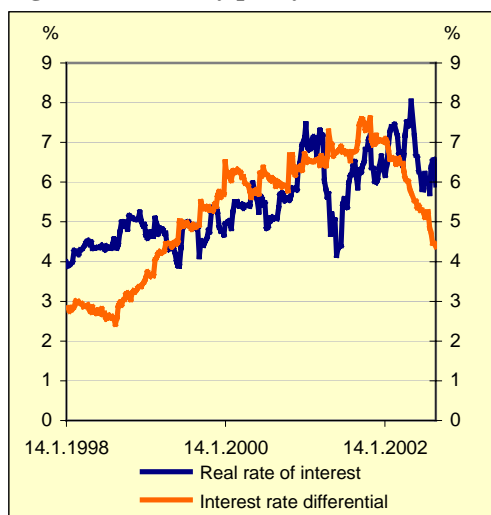
The krona exchange rate has been subject to considerable fluctuations over the past year and a half. The exchange rate index reached its low at the end of April 2000 when it stood at 107.7 points. A period of devaluation followed thereafter and by the end of 2001 the exchange rate had declined by close to 30 per cent when the exchange rate index stood at 151. Since then, the rate has strengthened, reaching 124.6 points in August 2002, weakening slightly thereafter to 128-130 points when this is written.

The Central Bank has reduced its repo rate seven times in the first nine months of 2002 by a total of 3 per cent within the year and by 4.3 per cent from the time it began bringing down the base rate, in April 2001. The repo rate of the Central Bank stood at 10.1 per cent at the beginning of 2002 and the Central Bank was under considerable pressure to loosen its grip on monetary policy. The tight policy stance was primarily based on the high rate of inflation at that time, reaching 9.4 per cent for the twelve months up to January 2002 which implied that the real rate of interest was very low. The inflation rate, however, quickly subsided and inflationary prospects brightened. The repo rate at present is 7.1 per cent.

The news release of the Central Bank of September 18, 2002, at the time of the latest bank rate reduction, states that further reductions may be expected, assuming that the Bank's inflation target will be reached and other economic developments will be in accordance with the Bank's forecasts. In addition to the reductions in interest rates the Bank declared its intention to purchase 20 billion kronur worth of US dollars in the foreign exchange market before the end of 2003. The Bank further declared that this was not meant to influence the krona exchange rate but to strengthen the Bank's foreign exchange reserves up to the average of three months' merchandise imports. These measures, i.e. interest rate reductions and foreign exchange purchases, may lead to a weakening of the krona in the near future. This may be offset by decisions on energy-intensive investments and the sale of the government's stakes in the commercial banks, both of which may strengthen the exchange rate.

Despite the interest rate reductions of the Central Bank, the monetary policy stance, as measured by the repo rate in real terms, is still quite high. The repo rate in real terms, i.e. the rate less the inflation premium on government bonds, has in fact fluctuated considerably during this year. The real repo rate stood at 6.3 per cent in January of this year; towards the end of September it was only down to 6.1 per cent. The real rate has declined less than the nominal rate since inflation has declined faster. The interest rate differential with other countries has declined sharply; based on 90-day Treasury bills it was 7 per cent at the beginning of the year compared to 3.9 per cent at present.

Figure 4: Monetary policy stance



Source: Central Bank of Iceland.

Credit demand has declined in recent months. Lending of deposit banks in domestic currency has declined by 2 per cent in the first seven months of 2002 compared to the same period a year ago. During the same period, lending of foreign funds has declined by 8.7 per cent. Savings, however, appear to be on the rise with bank deposits increasing by 8 per cent during the first seven months of this year over a year earlier.

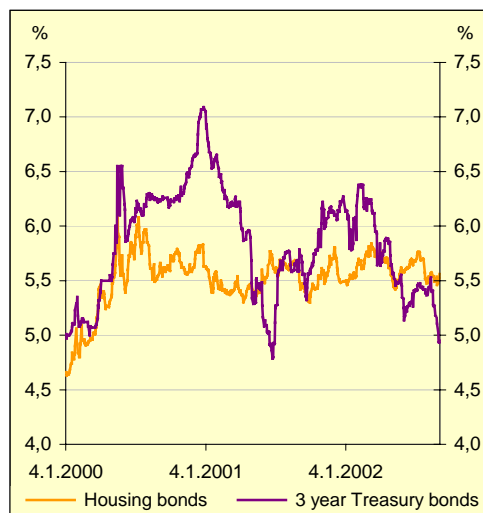
4.2 The bond market

Trading in the bond market has been lively so far in the course of 2002. Total turnover of housing bonds, housing fund bonds indexed government savings bonds and non-indexed government bonds rose by 27 per cent in the first eight months compared to the same period a year ago, amounting to 384 billion kronur this year and 302 billion last year. The turnover in housing bonds was most pronounced, accounting for 46 per cent of the turnover so far this year.

A new issue of non-indexed government bonds came on the market with a maturity of 11 years, maturing in 2013. This is the longest maturity of non-indexed government bonds so far. This

bond issue is in accordance with the government's intention to build up an Icelandic bond market similar to bond markets in other countries. The terms of the issue are similar to issues of other European nations and should represent an ideal investment opportunity for foreign investors interested in Icelandic bonds.

Figure 5: Yields on indexed bonds



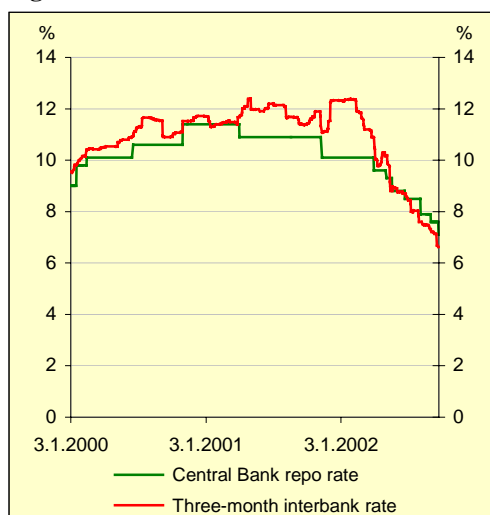
Source: Central Bank of Iceland.

The decline in general interest rates has led to an increase in bond prices. Non-indexed government bonds have thus strengthened in the market. Furthermore, lower inflation has influenced non-indexed bond prices. The yield on non-indexed government bonds has declined most, from 10.1 per cent in September 2001 to 7 per cent in late September 2002. The reduction in the base rate has also influenced the yield on indexed government savings bonds with shorter maturities. Three-year savings bonds yielded 4.9 per cent in late September 2002, having declined from 5.4 per cent a year earlier. The yield on savings bonds issues with longer maturities currently stands at 5.3 per cent, having risen from 5 per cent a year ago.

Credit demand in the real property market has not declined, contrary to forecasts. The increased issue of housing bonds has therefore had an impact upon their yield. Trading in

housing bonds has been quite strong, and in addition, the maximum lending limit of the Housing Fund was increased by 20 per cent in the middle of 2001, thus increasing demand for housing loans. The total amount of approved housing bond swaps rose by 17 per cent in the first eight months of the year over the corresponding period in 2001. The yield on housing bonds and housing fund bonds has fluctuated somewhat during this year and now stands at between 5.3-5.5 per cent, in late September 2002.

Figure 6: Interest rates



Source: Central Bank of Iceland.

4.3 The stock market

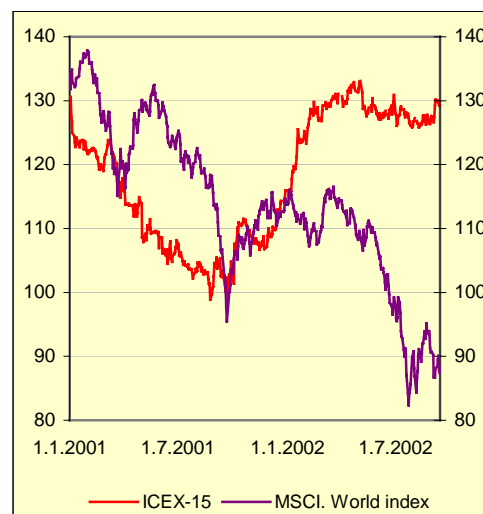
The total turnover in the stock market has been quite large in the course of 2002. It amounted to 202 billion kronur in the first eight months of the year, compared to 138 billion for all of the year 2001 and 198 billion for all of the year 2000.

Share prices declined steadily from April 2000, reaching a low in August 2001. Domestic share prices moved in concert with world prices until this year, where the two began to diverge and domestic prices have turned out to be more fa-

vourable than in world markets. The ICEX index has fluctuated between 1150 and 1330 in the course of 2002 and increased by 13 per cent from the beginning of the year to late September.

Figure 7: Share price indices

1.1.2001=100



Sources: Iceland Stock Exchange and Morgan Stanley Capital International Inc.

Several factors have contributed to the positive development of share prices in Iceland. The corporate income tax was reduced, interest rates have been lowered and inflation has receded, the exchange rate has strengthened and so have corporate profits. The turbulence in markets in USA in the wake of the terrorist attacks, corporate fraud and bankruptcies have had an adverse influence upon the US stock market, which, in turn, has carried over into European markets which have roughly moved in concert with the US market. Moreover, economic fundamentals have not improved as had been expected. This shows that there is no strong correlation between the Icelandic stock market and foreign markets, at least not in the short run, although such a correlation could be expected in the longer run.

5. Foreign trade and the balance of payments

One of the main conclusions of the new economic forecast is that the current account will be in balance in 2002 for the first time since 1995. No major changes are envisaged for 2003. This represents a major change from the year 2000 when the current account deficit amounted to more than 10 per cent of GDP or 80 billion kronur at current prices. Furthermore, the foreign exchange market has calmed down after a period of turbulence and the krona exchange rate has been fairly stable since spring.

5.1 Merchandise exports

Merchandise exports rose by 11 per cent in real terms in the first seven months of 2002, compared to the corresponding period a year earlier. In value terms, the increase came to 16 per cent, mostly because of a 17 per cent increase in exports of marine products; their volume increase amounted to 9 per cent. Exports of general manufactured products also increased, most notably in exports of pharmaceuticals, medical equipment, fisheries gear and electronic scales.

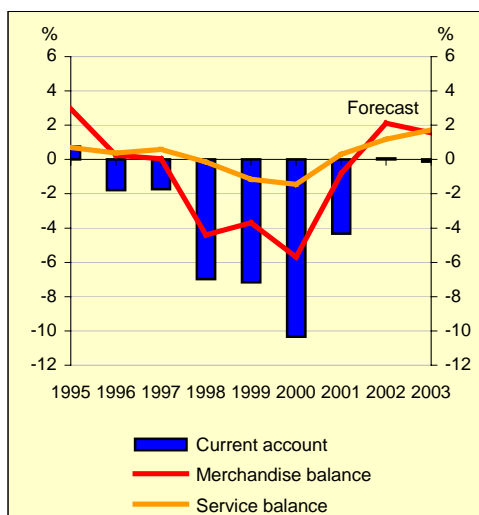
For the year as a whole, exports of marine products are not expected to increase as much as they did in the first seven months. The fishermen's strike in the spring of 2001 distorts the comparison between the two years. The present forecast estimates that export production of marine products will increase by 3 per cent in real terms in 2002. Aluminium production is forecast to increase by 7 per cent and ferro-silicon by 1 per cent.

Exports of pharmaceuticals valued 3.5 billion kronur in the first seven months of the year, an amount about equal to exports for all of 2001.

This represents 3 per cent of total merchandise exports in the first seven months of 2002. The increase in 2002 comes after a doubling of exports in 2001 over 2000. Other manufactured exports are expected to increase by 28 per cent in 2002.

Taking into account the changes in stocks and exports of ships and aircraft, the total merchandise exports are expected to increase by 6½ per cent in 2002.

Figure 8: Current account balance 1995-2003, % of GDP



Source: Statistics Iceland.

Exports are forecast to continue increasing in 2003, although at a slower pace than in 2001 and 2002. The volume increase is projected at 2½ per cent between 2002 and 2003. Marine production is estimated to increase by a small margin, ½ per cent, based on allocated catch quotas in the fishing year that began on September 1. Production of ferro-silicon is not ex-

pected to increase, whereas aluminium production is forecast to rise by 2 per cent. Other exports are expected to continue their rapid increase with a 10 per cent rise.

5.2 Merchandise imports

Total merchandise imports declined in volume by 10 per cent in 2001 from the previous year, the first contraction for seven consecutive years, or from 1994. This trend has continued in the course of 2002 with imports declining by 4 per cent in the first seven months. The fall in imports of investment goods explains the largest part of this reduction. For example, imports

of transport equipment other than private cars declined by one-fifth. Imports of ships, however, increased by a third. Total imports of investment goods declined by 15 per cent.

Imports of consumer goods have also declined, particularly of private cars and other consumer durables. Imports of private cars declined by 11 per cent in the first seven months of the year, other durable goods by 9 per cent and semi-durables by 10 per cent. Imports of foodstuffs and beverages rose, on the other hand, by 7 per cent and imports of industrial supplies by 4 per cent.

Table 5: Current account balance 2000-2003

Billions of kronur

	2000	2001	Forecast 2002	Forecast 2003
Merchandise exports	149.3	196.4	207.5	211.6
Merchandise imports	-186.8	-202.5	-190.8	-198.8
Balance of trade.....	-37.5	-6.1	16.7	12.8
Export of services.....	82.4	107.1	110.9	117.8
Import of services	-91.9	-104.8	-101.5	-103.8
Balance of services.....	-9.5	2.3	9.3	14.0
Net factor income from abroad	-20.2	-27.4	-24.9	-27.0
Current account balance	-68.0	-32.2	0.4	-1.0
As per cent of GDP	-10.3	-4.3	0	0

Source: Central Bank of Iceland.

For the year as a whole, total merchandise imports are projected to decline by 3¼ per cent. General imports are expected to fall by 2¼ per cent, with oil imports expected to increase slightly whereas other general imports may fall by 2½ per cent. So-called special imports – such as ships, aircraft and industrial supplies for power-intensive industry – are expected to contract by 8 per cent.

The forecast assumes that imports will gradually revive in the coming months with total merchandise imports forecast to increase by 3¾ per cent in 2003.

5.3 Balance of services

The largest items on the service account are transportation and tourism. Service revenue and expenditure have increased rapidly in recent years. Up to the year 2000, imports rose faster than exports with a resulting deficit on the service account that peaked at 9 billion kronur in that year. This trend was reversed in 2001 when revenue began to exceed expenditures and the service account was in surplus by 2 billion kronur. The revenue from services rose by a small margin in the first six months of this year, or about ½ a per cent, whereas expenditure declined by 3 per cent, at fixed exchange

rates. Reduced expenditures are primarily attributable to less travel abroad, which declined by 15 per cent.

For the year as a whole, revenue from services is expected to increase by 3 per cent and expenditure to decline by 1¾ per cent. The surplus on the service account would therefore rise to 9 billion kronur for the year as a whole.

For 2003, an increase both in revenue and expenditure is expected, revenue by 5½ per cent and expenditure by 1½ per cent whereby the service account would yield a surplus of 14 billion kronur.

5.4 Net factor income from abroad

Factor income includes wages of Icelandic nationals from abroad, interest and dividend income from Icelandic assets abroad, whereas factor payments include interest on foreign debt, dividends paid to abroad on foreign assets in Iceland as well as wages of foreigners in Iceland. Interest paid to abroad on foreign debt is by far the largest item on this account which has been in deficit for decades in concert with increasing foreign debt of the economy. This increase was reversed in the first six months of the year in addition to the fact that interest rates abroad have also declined. Net factor income from abroad was negative by 11.3 billion kronur in the first six months of 2002 compared with 16.5 billion kronur a year ago. This change is both due to rising income and lower payments, primarily due to reduced interest payments in the first six months of the year, compared with a year earlier.

For the year as a whole net factor income is expected to be negative by 25 billion kronur compared with 27 billion in 2001. The deficit is expected to increase in 2003 by a small margin, to 27 billion kronur.

5.5 Current account

In 2002, a surplus on the current account is expected, for the first time since 1995. Following a long period of deficits, surpluses were recorded in 1993-95 after which the deficit rose in concert with a sharp upswing peaking in 2000 when the current account deficit passed 10 per cent of GDP. The deficit shrunk by half in 2001 when domestic demand began to contract and this trend has continued in 2002 resulting in an estimated, albeit very small, surplus on the current account for the year as a whole.

This reversal is primarily attributable to the sharp turnaround of the trade balance, where a 17 billion surplus is predicted for this year. The balance on the service account has also improved sharply, from a deficit of nearly 10 billion in 2000 to a surplus of more than 9 billion in 2002.

For 2003, a slight current account deficit may emerge. The overall balance of trade and services should again render a substantial surplus, some 27 billion kronur, equivalent to more than 3 per cent of GDP. The net factor income will, however, continue to be negative, leading to a small current account deficit of about 1 billion kronur.

5.6 Foreign debt

The current account deficits of recent years have led to increased foreign debt for the economy as a whole. This is primarily due to the rising debt of households and businesses, whereas foreign debt of the public sector has shrunk. The foreign debt position will, however, improve as a result of turnaround of the current account. According to the present forecast, net external debt is expected to fall from 103 per cent of GDP in 2001 to 97 per cent in 2002 and 95 per cent in 2003.

6. Business sector

6.1 Production and earnings

The business environment has changed markedly in recent months. Inflation and interest rates have declined, the krona is stronger and corporate taxes have been reduced. All these factors have a positive influence on business activity. In order to shed some light on the situation in 2002, a survey of 52 companies trading on the Icelandic Stock Exchange has been assembled. The survey excludes investment funds and investment companies as well as companies with an accounting year other than the calendar year. Since the accounting rules of banks and insurance companies are different from those of other companies, the results of the survey is divided into two parts with six companies in the financial sector on one hand and 46 other public companies on the other. As some public companies registered on the Stock Exchange have merged in the course of the year, the comparison with last year is distorted and therefore not included in this presentation.

Profitability of the above companies is generally healthy. Out of the above 46 companies, 44 show improved results in the first six months of 2002 compared with the corresponding period in 2001 with total profits of these companies up 17 per cent from last year. Total profits for the first six months of this year amounted to 24 billion kronur, compared with a loss of 6 billion in the first six months of 2001. This improvement is largely attributable to exchange rate developments which in turn have improved the financial items in company accounts owing debt to abroad.

Manufacturing

Earnings of manufacturing companies have increased sharply, or by 36 per cent in the first six months of this year over a year ago. The main cause of this increase lies in the purchase by Bakkavör Group hf of a British food producer. The pharmaceuticals sector has grown sharply in recent years; turnover increased by 40 per cent in the first half of 2002 from a year earlier. The growth is primarily due to increased exports which rose from 849 million kronur in the first seven months of 2001 to 3,550 million in the first seven months of this year. Profits in this sector improved sharply, rising to 5.6 billion kronur in the first six months of this year compared to 1.2 billion in the first six months of 2001.

Fisheries

The operating environment of the Icelandic fisheries sector is influenced by several different factors, such as the price of oil, world market prices for fisheries products and by the fish catch. The sector is also sensitive to exchange rate fluctuations, since both revenue and debt is largely in foreign exchange. Mergers have been common in the fishing industry in recent years, a trend that has continued into this year.

The above mentioned survey indicates that profits of fisheries companies improved sharply in the first half of 2002. In the first half of 2001, all of these companies except one operated at a loss, particularly because of losses recorded on foreign debt due to the fall in the exchange rate. In the first half of this year, however, all companies showed net profits before taxes, equivalent to 33 per cent of total reve-

nue. Since the fisheries sector owes considerable foreign debt, the strengthening of the exchange rate has had a favourable influence upon the equity ratio of the sector, although the

stronger exchange rate tends to reduce the domestic proceeds from foreign exchange earnings, as is the case with all exporters.

Table 6. Profitability for the first six months of the year 2001-2002
52 companies registered on the Iceland Stock Exchange

	Number of firms	Revenue million kronur	Post-tax profit		Changes in working capital		Cash flow from operating activities	
			million kronur	% of revenue	million kronur	% of revenue	million kronur	% of revenue
Marine production								
2002	14	33,244	10,955	33	6,968	21	7,912	24
2001	14	25,123	-3,409	-14	3,313	13	2,044	8
Seafood distribution								
2002	2	57,326	539	1	766	1	-225	0
2001	2	56,230	545	1	876	2	230	0
Manufacturing								
2002	14	41,139	5,592	14	4,338	11	4,077	10
2001	14	30,248	1,207	4	3,470	11	-320	-1
Information technology								
2002	5	10,380	459	4	485	5	821	8
2001	5	7,244	-855	-12	-531	-7	52	1
Commerce and services								
2002	6	15,006	1,469	10	3,282	22	2,864	19
2001	6	13,894	455	3	2,489	18	245	2
Oil distribution								
2002	3	20,776	2,722	13	1,730	8	1,764	8
2001	3	21,030	-746	-4	1,557	7	-1,007	-5
Transport.....								
2002	2	8,375	1,945	7	2,500	9	4,855	17
2001	2	22,056	-3,653	-17	-720	-3	1,515	7
Financial institutions								
2002	6	56,609	6,029	11	-	-	9,406	17
2001	6	56,709	3,741	7	-	-	5,790	10
Total								
2002.....	52	262,854	29,709	11	20,068	8	31,473	12
2001	52	232,535	-2,716	-1	10,342	4	8,522	4
Total less financial institutions								
2002.....	46	206,245	23,680	11	20,068	10	22,067	11
2001	46	175,826	-6,457	-4	10,342	6	2,732	2

Source: Icelandic Stock Exchange.

Communications

There are only two communications companies registered on the Stock Exchange, Eimskip and

Icelandair. Their profits improved considerably between 2001 and 2002. With total turnover rising by 29 per cent, a 3.7 billion loss in the

first six months of 2001, was turned into nearly 2 billion net profits over the same period in 2002. The turnaround by Icelandair is primarily attributable to a reorganisation of the company and improved external conditions such as lower fuel costs and a favourable development of exchange rates. Eimskip's profit situation has similarly improved because of favourable exchange rate developments in addition to cost-cutting and increased freight charges. Also, the purchase by Eimskip of the fisheries company Útgerðarfélag Akureyringa hf is only included in the 2002 accounts which favourably affects the profit situation. These improvements are partly offset by a contraction in imports in the course of 2002.

Other sectors

The operating environment of the high-tech and information sectors has been difficult this year. Turnover has, on the other hand, increased and so have profits, amounting to 460 million kronur in the first six months of this year compared with an 855 million loss a year earlier.

The contraction in private consumption has affected retail and services sectors as turnover in these sectors has not changed much from the previous year. Profits, however, have improved. The retail sector has benefited from the favourable development of the exchange rate and lower import prices in kronur terms.

The development of the exchange rate has also worked favourably for the oil distribution companies; their net profits amounting to 2.7 billion kronur in the first six months of this year compared to a loss of 750 million a year ago. Their revenue, however, has declined slightly.

Profits of financial companies have improved sharply except for insurance companies, rising by 2.2 billion in the first six months of this year compared with the previous year.

The fish catch

The total fish catch came to 1,750 thousand tons in the first eight months of 2002, up from 1,578 thousand the year before. The capelin

catch rose by 126 thousand tons, or 14 per cent. The redfish catch increased by close to 16 thousand tons, or 46%, and the herring catch rose by 49 thousand tons, or 57 per cent. The six week strike by fishermen in 2001 distorts the comparison between these two periods. Only 60 per cent of the herring catch quota could be caught in 2001 and redfish fisheries began unusually late that year. The transfer of cod catch quotas between fisheries years (which begin on September 1) was also greater last year than this year and the cut in catch quotas during the last fisheries year did not have their full impact during that year.

This year's catch quotas include a 6 per cent cut in the cod catch. The redfish catch is also cut, whereas the haddock catch increases by a third. The total catch of demersal species is reduced by close to 1 per cent. Catch quotas for Greenland halibut increase by 15 per cent and quotas for flatfish species by 12 per cent. The herring quota is reduced by 16 per cent, whereas quotas for shrimp, scallops and lobster increase by nearly a third. Catch quotas increase by 1½ per cent in cod equivalency units, including the initial quota allocation for shrimp in both years. Capelin is not included in this total.

The catch quota for the Norwegian-Icelandic herring stock amounts to 132 thousand tons in 2002 of which 126 thousand tons are within Iceland's fisheries limits. By September of this year, a total of 123 thousand tons had been caught in Icelandic waters at which time the main herring season was completed. The quota for Norwegian waters is 6 thousand tons which will probably be caught this autumn. The blue whiting catch has been placed under quota for the first time, one of 282 thousand tons in 2002 of which 76 per cent were caught in the first eight months of the year. The total blue whiting catch came to 365 thousand tons in 2001. According to the Marine Research Institute, the outlook for the capelin catch is unchanged. The main catch of pelagic species in the last quarter of 2002 will be herring and capelin. The herring season starts in the autumn months.

Table 7: Total Allowable Catches (TACs) for 2001/02 and 2002/03 and total catch of Icelandic vessels January-August 2001 and 2002, thousand tons

	2001 / 2002	2002 / 2003	Percentage Change	January-August			
				2001	2002	Percentage Change	
Cod	190.0	179.0	-5.8	Total catch.....	1.578	1.752	11.0
Haddock	41.0	55.0	34.1	Demersal catch	298	309	3.6
Saithe	37.0	37.0	0	Cod.....	161	145	-10.2
Redfish	65.0	60.0	-7.7	Haddock	25	27	6.9
Greenland halibut	20.0	23.0	15.0	Saithe.....	20	25	21.6
Plaice	5.0	5.0	0	Redfish.....	34	50	46.1
Wolffish	16.1	16	-0.6	Other demersal	58	64	9.1
Witch	1.4	1.5	11.1	Flatfish.....	23	25	8.1
Dab	3.0	4.0	33.3	Herring.....	86	135	56.5
Long rough dab	5.0	5.0	0	Capelin.....	908	1.034	13.9
Lemon sole	1.4	1.6	14.3	Blue whiting	235	213	-9.1
Tusk	4.5	3.5	-22.2	Shellfish catch	28	37	32.6
Ling	3.0	3.0	0				
Monkfish.....	1.5	1.5	0				
Herring.....	125.0	105.0	-16.0				
Shrimp*	18.4	24.7	34.2				
Lobster.....	1.5	1.6	6.7				
Scallop	6.5	4.2	-36.2				

* Provisional TAC both years.

Source: Statistics Iceland and Ministry of Fisheries.

Exports of marine products

Exports of marine products amounted to 78 billion kronur in the first seven months of 2002, an increase of 17 per cent from the previous year. Prices for marine products rose by close to 8 per cent; hence the volume increase amounted to 9 per cent. Exports of fish products frozen on land increased by 8½ per cent and of products frozen at sea by 44 per cent. This last increase is accounted for by the fishermen's strike in 2001, mainly in sea-frozen redfish.

Exports of salted fish declined by 8½ per cent in the first seven months of 2002. Prices for salted fish rose sharply in 2001 and peaked in the latter half of the year. Thereafter prices declined and were by June 15 per cent lower in kronur terms than in December. Prices rose slightly in July, declining again in August to a low comparable to mid-2000. The main export season for salted fish is in the autumn and sales prospects appear good since prices have declined and stocks are low.

Table 8: Changes in value of exported marine products January-July 2001 and 2002 at current prices, %

Land freezing.....	12.3
Sea freezing	49.4
Salting.....	-12.0
Fresh, iced fish.....	13.1
Drying.....	53.0
Salted herring	80.4
Fish meal and oil	38.8
Other products	68.7
Total	17.3

Source: Statistics Iceland.

The production of herring for export rose sharply in value in 2001. The average price for each exported kilo was 42 kronur in 2000 and 68 kronur in 2001. The price for frozen herring was 80 per cent higher in December 2001 than in the same month a year earlier and the price for salted herring 45 per cent higher. These are prices in kronur and are therefore influenced by the exchange rate development. The price for frozen herring has declined slightly in the first months of 2002; by August it was 7½ per cent lower than in December 2001. The price for salted herring has not declined over this period. Prices for herring products are expected to decline since stocks in Europe have accumulated. The strengthening of the krona also contributes to the price decline.

The forecast assumes an increase of 3 per cent in marine production and that prices in foreign exchange terms rise by 4 per cent between 2001 and 2002. The increase in production between 2002 and 2003 is forecast at only ½ per cent and prices in export markets are projected to increase by 2 per cent.

Energy-intensive industry

Production of energy-intensive industry has done well in recent years. The newly enlarged aluminium plant in Hvalfjörður is expected to operate at full capacity of 90 thousand tons in 2002. Total production of aluminium is expected to increase by close to 7 per cent in 2002 and 2 per cent in 2003. Prospects are for

rising aluminium prices in the medium term, although the average price of the past three years has not been reached.

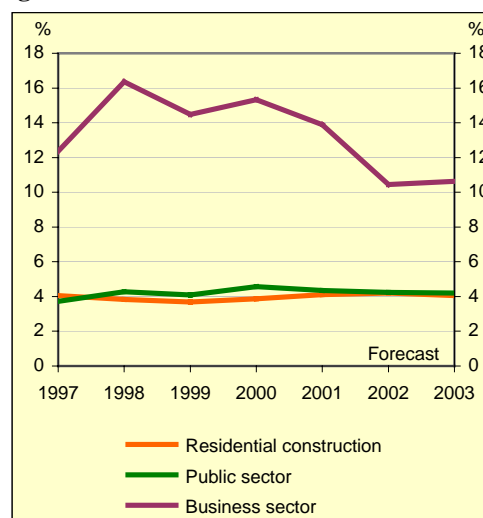
Tourism

Hotel overnight stays by foreign tourists declined by 1.6 per cent in the first six months of 2002 from a year ago. Since the middle of this year, there has been an increase in the number of tourists and there is cautious optimism in the travel industry. Hotel room capacity in the top season has been a bottleneck. Hotel space utilisation has exceeded 90 per cent in the summer months which indicates that many tourists have been turned away. An additional 200 hotel rooms will be completed in Reykjavík in the near future, an increase of 15 per cent.

6.2 Business investment

Business investment has fluctuated considerably in recent years, whereas residential construction and public sector investment have both been more stable. Business investment rose by 14.9 per cent in 2000, declining by 9.3 per cent in 2001. This decline has continued in 2002 with a 21 per cent decline expected for the year as a whole. Business investment amounted to 13.9 per cent of GDP in 2001, dropping to an expected 10½ per cent in 2002.

Figure 9: Investment as % of GDP



Source: Statistics Iceland.

Although business investment appears to be shrinking across the board in 2002, the decline is most pronounced in power projects and energy-intensive industries. Investment in metal production is expected to drop by 50 per cent, largely because last year the enlargement of the aluminium plant in Hvalfjörður was completed and no new projects have been undertaken in 2002. Power project investments have decreased by 40 per cent between 2001 and 2002. The National Power Company (Landsvirkjun) completed several investments in 2001, such as the Vatnsfell power station, and no new power projects have been started in 2002. Investment in telecommunications is also expected to contract by a third in 2002, following large investments in 2001.

Investment in the fisheries sector has not changed much this year. Several new vessels have been imported and older ones are being refitted. Transport investment is expected to rise this year since Icelandair has acquired a

new aircraft, and a new oil distribution vessel is expected before the end of this year. Investment in hotels and restaurants is expected to rise from last year. Several hotels are under construction, both in and outside the capital area.

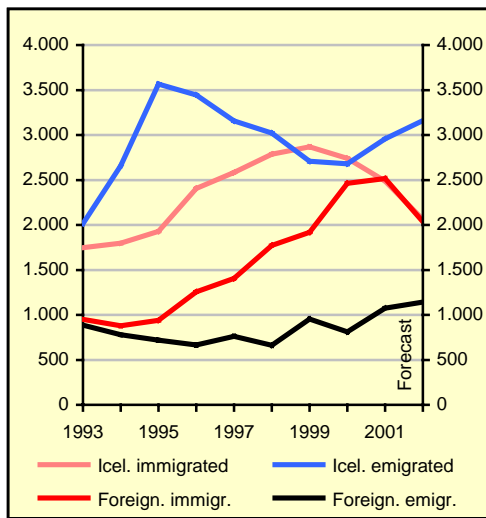
The present forecast for 2003 assumes that the two-year decline in business investment is gradually coming to an end and that there will be a 3½ per cent increase for the year as a whole. The main reasons for this reversal are a more favourable operating environment of companies where taxes on business have been reduced, while interest rates are declining and the exchange rate has developed favourably. These factors help create an environment where business firms are likely to enter into new investments. This forecast, however, does not incorporate any further power or energy-intensive industrial investment than have already been decided.

7. Population and the labour market

7.1 Population development

Iceland's population development has in recent years been marked by a substantial immigration of foreign nationals. During the period when immigration was at its peak, immigrants came from Middle and Eastern Europe as well as the Far East. The demand for labour began to recede by the middle of 2001 and immigration declined. Still, the immigration of foreign nationals amounted to 2,500 in 2001, a new record.

Figure 10: International migration

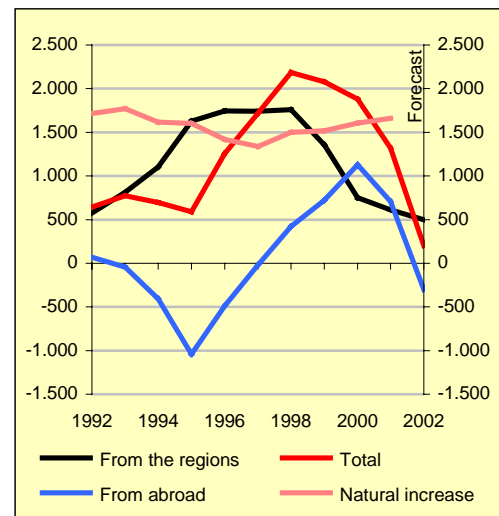


Source: Statistics Iceland.

Immigration has declined by 20 per cent in the first half of 2002 whereas emigration increased by 7 per cent, both compared to the first half of 2001. The return migration of Icelandic nationals continues to shrink but emigration has increased. The immigration of foreign nationals has declined whereas emigration has not in-

creased significantly. For 2002 as a whole, the net emigration of Icelandic nationals is estimated at 1,100 whereas the net immigration of foreign nationals is estimated at 900, leaving total migration roughly in balance for the year.

Figure 11: Population development in the capital area



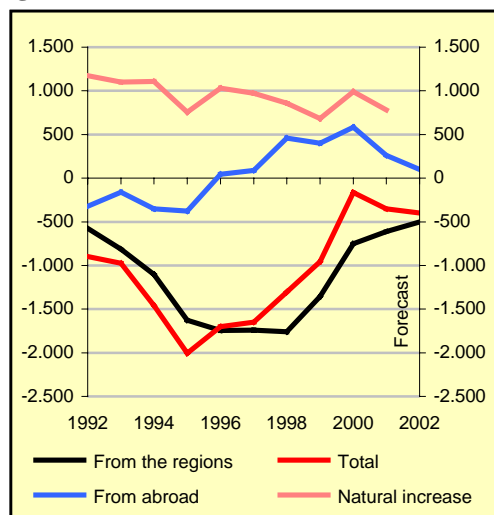
Source: Statistics Iceland.

The natural rate of increase of the population has fluctuated between 0.8 and 1 per cent a year in recent years to which considerable net immigration has been added since 1997. The population increased by 1.1 per cent in 2001, following a 1.6 per cent increase in 2000. Births are 4,200-4,500 in number each year and have been for many years and deaths average 2,000 a year, leaving a natural increase of 2,000-2,500 a year, excluding migration. The population of working age increases relatively faster than the population increase as a whole

or by 2,400-2,800 a year, an increase of 1¼-1½ per cent, excluding migration.

For 2003, a population increase of ¾ per cent is projected, excluding migration. Forecasting migration has proved difficult, even within a year. Most indications are that migration will be in balance in concert with the economic situation.

Figure 12: Population development in the regions



Source: Statistics Iceland.

So far in 2002, emigration to abroad from the capital area has been greater than from the regions outside the capital area and immigration to the capital area has declined more than to the regions. The migration from the capital area to the regions has been similar this year and last, and the migration from the regions to the capital area continues to decline. The net internal migration from the regions to the capital area is expected to amount to 500 this year, the lowest for a decade. A net emigration from the capital area to abroad of 300 is expected this year, whereas net emigration from the regions will probably be negligible.

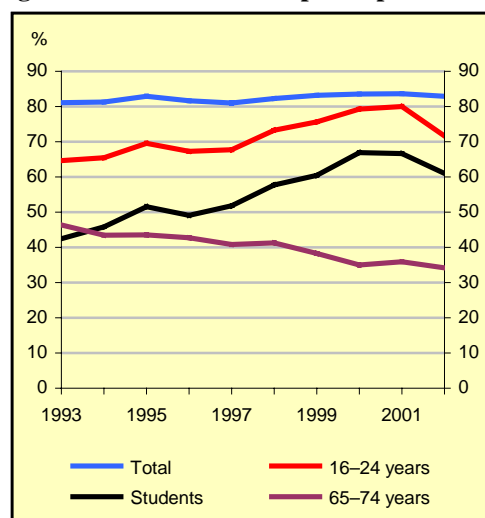
Due to the age structure of the population, the increase in the population of working age (16-74 years) is expected to be greater than for the

population as a whole, or about 1 per cent. Naturally, this increase is greatly influenced by migration between countries. If this forecast is realised, the population of working age will increase by 2,000 in number in 2003 to about 205,000 at the end of that year.

7.2 The labour market

Following a sharp increase in employment since 1997, the labour market has stabilised in the course of this year. The labour market surveys of Statistics Iceland indicate that total employment has declined in the first half of 2002 for various reasons.

Figure 13: Labour market participation



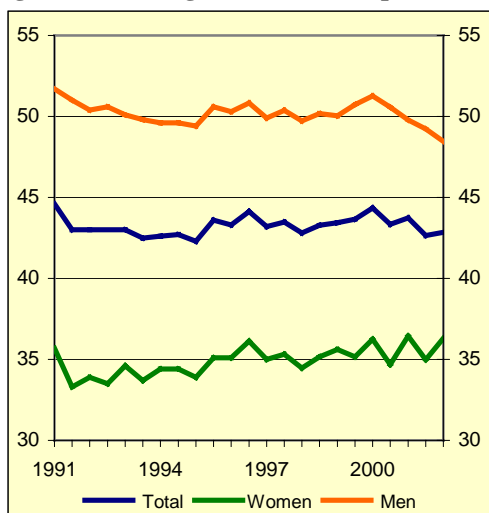
Source: Statistics Iceland.

Labour market participation has declined. It has been stable in recent years, rising slightly for the youngest age groups and declining for seniors. Figure 13 shows that the April labour market survey reveals a substantially reduced labour market participation for the youngest generation, whereas its participation has grown steadily until 2000. The figure also shows the decline in participation by the oldest group. The twice-yearly labour market surveys, in April and November, have in recent years sometimes indicated substantial shifts that have offset each other when the year is viewed as a

whole. This one survey can therefore not be viewed as proofing a shift in the market.

Participants in the labour market have thus decreased in number, after having increased in recent years. This is to be expected, since the population has increased in recent years and labour market participation also. Total labour market participation has risen from 137,000 at the beginning of the nineties to 159,000 in 2001, an increase of about 1½ per cent per year on average. Female labour force growth exceeded that of males, 1.7 per cent against 1.3 per cent. Almost all of the increase took place in the capital area during this period. The April labour market survey shows a 1.2 per cent decline in the number employed since 2001. The decline is greater for men than women which is in concert with their reduced participation. Almost all of the decline was in the capital area, whereas there was a slight increase in the countryside.

Figure 14: Average hours worked per week



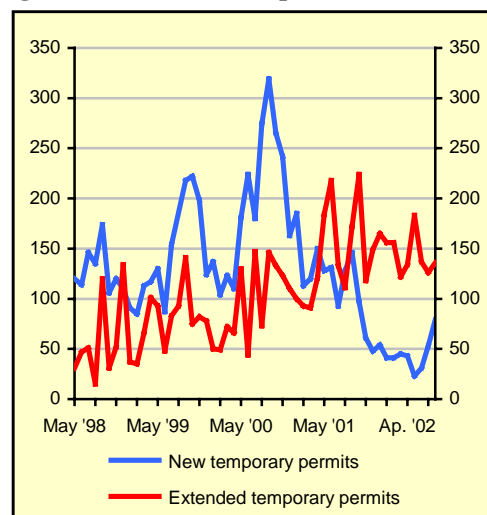
Source: Statistics Iceland.

Figure 14 shows the average working hours of respondents in the labour market survey. The average working hours of females has been increasing whereas for males it declined since 2000 when it peaked. No comparable change

has taken place in the working hours for females.

During the last expansion, immigration was substantial in order to meet the excess demand for labour. Immigrants came both from the EEA countries and from outside. EEA-country residents do not require a work permit whereas those from outside do. Statistics for the latter group are therefore more exact than for those who need no permit.

Figure 15: Issue of work permits



Source: Labour Office.

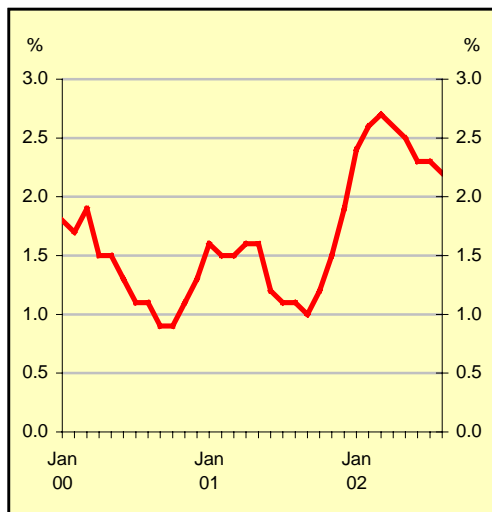
The issue of work permits declined sharply late in 2001, approaching zero last spring. Since then, a slight revival in such issues has taken place. The number of renewed work permits is on the increase, indicating that those immigrants already here wish to stay for the future. Relatives of immigrants already here apply for work permits in greater numbers.

Unemployment

Unemployment has increased this year from the level of previous years. It began to increase in excess of a normal seasonal variation late in 2001 and rose steadily until March of this year when it amounted to 2.7 per cent of the labour force. Since then, it has declined and is esti-

mated at 2½ per cent for the year as a whole, compared to 1.4 per cent in 2001.

Figure 16: Unemployment rate



Source: Labour Office.

Unemployment differs by region. It has declined steadily in the countryside since January this year, while it has been rather stable in the capital area and higher than in the countryside.

Unemployment also differs by sex. In August it amounted to 1.8 per cent for males and 2.9 per cent for females. In the capital area, female unemployment was 3.4 per cent. The main trend in registered unemployment in 2002 has been that, after peaking in January, it has declined for both sexes in the countryside as well as for males in the capital area, whereas for females it increased until August.

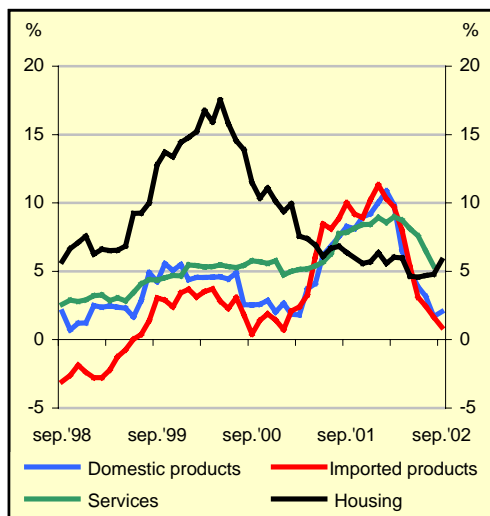
International comparisons of unemployment are based on labour market surveys where uniform standards apply. Laws on unemployment compensation differ sharply from country to country and influence registered unemployment to a significant extent. Statistics Iceland measures unemployment in accordance with such standards with the latest survey taken last April. At that time, about 4,000 persons were registered as unemployed. In addition, 2,400 were unemployed but not registered. A part of those registered as unemployed were in fact employed part-time. (It is possible to register as part-time unemployed.) Another group was not interested in employment. These groups are not included under the uniform international standards. The number of unemployed was therefore counted at 5,300 this year or 3.2 per cent of the labour force, whereas registered unemployment was 2.6 per cent.

Unemployment has been low in this country in recent years. In fact, one cannot talk of a shortage of employment when several thousand immigrants have come to the country to fill vacancies. This could better be described as a mismatch between supply and demand in particular sectors. This year's increase was therefore more symbolic for the change taking place after the end of the last economic expansion. Registered unemployment appears to be on the decline. The national economic forecast predicts that unemployment will amount to 2½.

8. Prices

Inflation has receded rapidly in the course of this year with the consumer price index only increasing by 0.6 per cent so far. For the year as a whole, it appears that the increase will only be about 1½ per cent. By comparison, last year's increase came to 9.4 per cent from the beginning to the end of the year. The main reason for the sharply reduced rate of inflation is the stronger krona exchange rate. Following a sharp devaluation last year, the krona has strengthened substantially this year which, in turn, is reflected in import prices. Moreover, a slack has emerged in the economy and wage drift has receded. Next year's inflation is forecast at 2¼ per cent, both within the year and between 2002 and 2003.

Figure 17: 12-month increase in selected categories 1998-2002



Source: Statistics Iceland.

The fall in the exchange rate from March to November 2001 led to an increase in import

prices. The fall in the rate was reversed in November which was followed by a decline in import prices. Other factors also contributed towards containing inflation. Most important was the agreement between employers and unions to the effect that collective bargaining contracts would not be reviewed if the consumer price index could be kept below 222.5 points by May 2002. This effort succeeded, which along with a favourable development of the exchange rate, has managed to limit price increases.

Most price increases are domestic in origin, mostly in services in the first half of the year. The housing component of the consumer price index has also increased, due to the strength of the real property market in recent months. This is offset by lower prices of imported foodstuffs and beverages which have declined by 10 per cent since the beginning of the year. The reduction in tariffs on imported vegetables has helped in this respect. Prices of other imports have also declined, although not as much as on foodstuffs, since turnover of these goods is slower. The price of petrol declined at the beginning of the year but has increased again in line with world prices.

As noted above, inflation from the beginning to the end of 2002 is estimated at 1½ per cent. The course of inflation in the coming months is to a large extent dependent upon the exchange rate which has been strengthening in the course of this year until in the past few weeks when it has weakened slightly. Inflation in Iceland's main trading partner countries has declined, and cost increases from abroad are therefore

unlikely. Domestic increases, particularly wage increases, have also been limited of late in concert with reduced demand pressures. The slack in the labour market indicates that wage increases and wage drift will be negligible. Seasonal unemployment will probably increase in the next few months and wage drift will therefore be little or none for the remainder of this year. It should also be mentioned that a decline in private consumption this year along with an increasing debt burden of households has served to abate demand pressures upon prices, thus limiting the scope for price increases.

Table 9: Forecast for annual changes in consumer prices

	Changes, %	
	Between years	Within year
2002	4¾	1½
2003	2¼	2¼

For next year, inflation is forecast at 2¼ per cent, both during the year and between years. This assumes that the exchange rate index will remain at 130, i.e. nearly unchanged from the present level; that contractual wage rates will increase by 3½ per cent and wage drift will be less than 1 per cent. The rise in wages is due to contractual increases at the end of the year. A new round of collective bargaining will not begin until towards the end of next year. It is estimated that productivity will increase again with renewed economic growth and reach nearly 1 per cent next year. Continued slack is expected in domestic demand as well as a tight monetary stance. The forecast assumes that no

power projects or energy-intensive investments will commence in 2003.

The main factors of uncertainty in the inflation forecast pertain to the exchange rate, real property prices and fuel prices which may depend upon tension in the Middle East and elsewhere. Moreover, the uncertainty surrounding energy investments could lead to demand strains in the economy. Uncertainty regarding the exchange rate has been discussed earlier in this report. Real property prices have been increasing and property demand is still considerable along with an increasing issue of housing bonds. Since the housing market is dependent upon the development of purchasing power which is expected to increase in the near future, this increase could continue. The price of petrol has increased recently, but increased output by Russia has served to dampen the world price. Hostilities in the Middle East have, on the other hand, begun to increase fuel prices. Finally, prospective power investments could lead to demand pressures in the economy, in turn causing wage drift, rising property prices and thereby raising inflation.

Table 10: Main assumptions of the inflation forecast

	Changes between annual averages, %	
	2002	2003
Exchange rate (imports)	-2½	-1½
Labour productivity*	½	¾
Foreign inflation	-1	2
Contractual wage increases	4	3½

*Underlying productivity growth.

9. Household sector

9.1 Wage developments

Present wage agreements expire late in 2003 and early 2004. A review of the contracts with respect to price developments will take place in February 2003. The present inflation forecast indicates that the assumptions underlying the agreements regarding a slowdown in inflation will hold and the wage clauses of the agreements will therefore hold.

At the time of the latest review of the wage agreements of the Federation of Labour and the Employers' Confederation in December 2001, the government issued a declaration stating that all means would be sought to bring down inflation and ensure economic stability. Increases in several public service charges were, for example, retracted. The contracting parties also agreed on an additional contribution by employers into individual pension accounts of employees and that the previously agreed upon wage increase at the beginning of January 2003 should be raised by 0.4 per cent. As is well known, the "red line" of the consumer price index, drawn at 222.5 points for May 2002, held and a review of the wage clauses of the agreements was thereby avoided.

Wage developments this year have largely been in concert with forecasts. The wage index rose by 9.6 per cent from the beginning to the end of 2001 and from December 2001 through August 2002 it has increased by 4.5 per cent. The average wage increase between 2001 and 2002 is estimated at 7 per cent and the increase from the beginning to the end of 2002 at close to 5 per cent. The difference between 2001 and 2002 is both due to lower increases in wage

rates and less wage drift. Including the wages of fishermen, the wage increase between 2001 and 2002 is expected to be about 7½ per cent since fishermen's wages are not included in the wage index and have increased slightly more than wages in general.

Although wages have been rising less in 2002 than 2001, their purchasing power has been rising more, since inflation is lower in 2002. So far this year, real wages have increased by 3.6 per cent, whereas in the corresponding period a year ago they rose by 1.3 per cent. Real wages are expected to increase by slightly more than 2 per cent between the averages of 2001 and 2002.

Figure 18: Real wages
Index 1990=100



Source: Statistics Iceland.

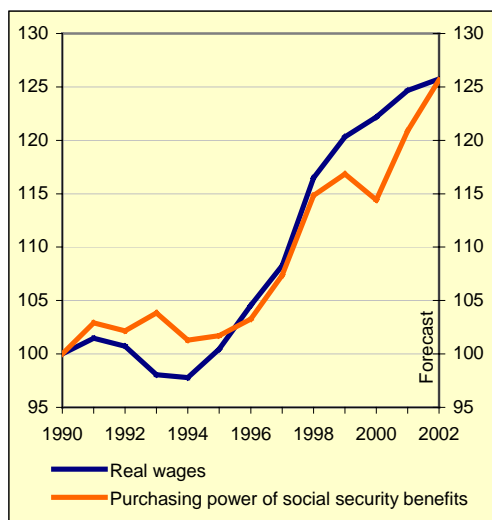
In 2003, wages are expected to increase by 4½ per cent and real wages by more than 2 per cent. If this forecast turns out to be correct, this will be the ninth year in succession that real wages increase.

Social security benefits

Following the review of the social security system in 2001, legislation on social security and welfare benefits was amended. These changes came into effect on July 1, 2001. Emphasis was placed upon raising the benefits of the most disadvantaged. The changes were mainly related to reducing the income-linkage of benefits and raising the minimum supplementary welfare payment and relaxing conditions for qualifying for it. These changes are now fully operative and social security and welfare benefits have increased as a result. The rule still applies that social security and welfare benefits shall increase in step with wage developments, although never less than prices as measured by the consumer price index. Accordingly, social security benefits increased by 8.5 per cent on January 1, 2002.

Figure 19: Purchasing power of wages and social security benefits

Index 1990=100



Source: Statistics Iceland and State Social Security.

Payments of unemployment benefits have increased in 2002 in line with rising unemployment. Unemployment was low in 2001, 1.4 per cent, and benefits amounted to 1.3 billion kronur, a similar amount as the year before. For 2002, unemployment is estimated to be about 1 per cent higher and benefits will therefore increase considerably. Unemployment is expected to decline slightly in 2003 and benefits will be similar to the amount this year. Welfare payments are also expected to increase in line with rising unemployment.

Disposable household income

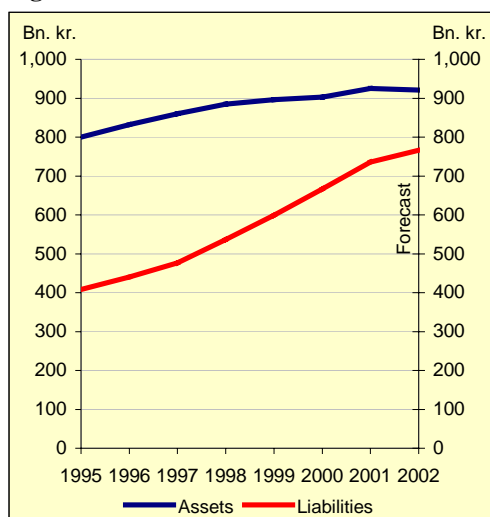
Disposable household income, i.e. total household income, including benefits less direct taxes, increased by just over 9 per cent in 2001. The increase for 2002 is estimated at 6¼ per cent and at 4¼ per cent for 2003. Real disposable income has increased slightly less in 2002 than real wages as unemployment has increased while labour market participation and working hours have declined. Real disposable per capita income is projected to increase by 1½ per cent in 2002 and 2 per cent in 2003.

9.2 Assets, debt and saving

Private consumption increased rapidly in the years 1996-2000 in line with the upswing in the economy. This was supported by the rise in disposable household income at the same time as household debt also rose. The increase in debt was due to several factors. The access of households to the credit market has eased considerably in recent years. Credit offered by the Housing Financing Fund as well as other financial institutions has also become more generous. This made it easier to acquire real property and probably contributed to the rise in real property prices. The rise in household debt is in part balanced by increasing assets, although a part of the debt increase undoubtedly went towards the financing of rising consumption in excess of rising disposable income. Household debt as a percentage of disposable income has been increasing. It amounted to 170 per cent of disposable income in 2001, having doubled in a decade.

When the upswing slowed in 2001, households began to scale down their borrowing. This must be seen as a normal reaction to changed economic circumstances. Data on household saving are uncertain but statistics on household debt with the financial system are available. Investment in housing is accounted for in the national accounts whereas financial assets other than in pension funds are subject to more uncertainty. The following figure therefore gives only a limited indication of the direction of household assets and debt.

Figure 20: Assets and liabilities of households



Source: Central Bank of Iceland.

The figure shows the increase in household debt and assets (excluding pension funds) since 1995 at constant 2002 prices. Debt rose considerably faster than assets from 1998 to 2001 or by an average of 12 per cent a year whereas assets rose only by 2 per cent on average. For 2002, it is evident that both the rise in assets and debt has slowed down. Assets are expected to decline by ½ a per cent whereas debt may increase by 4 per cent.

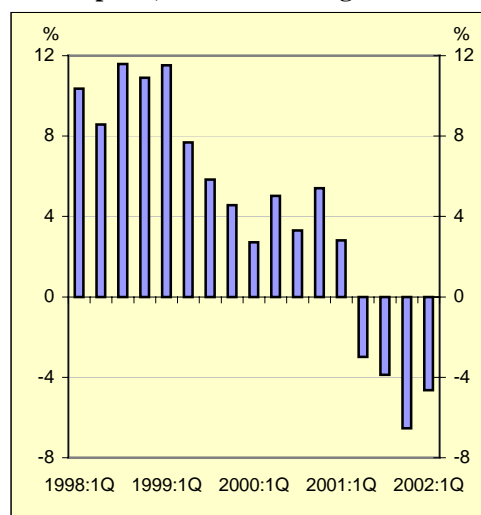
The development of financial markets in recent years has primarily been directed towards creating means of financial saving for individuals. The market value of shares rose rapidly until the first half of 2000 after which it declined

sharply. This does not change the fact that household financial saving has become a substantial part of total household saving.

9.3 Private consumption

Despite a continued increase in real disposable income in 2002, most indicators point to a decline in private consumption for the second year in a row. The contraction took place in the last three quarters of 2001 and the first quarter of 2002 as shown in figure 21. The contraction will, however, be much lower in 2002 than the year before, and present indications point to a revival in private consumption in the latter half of 2002. The decline in private consumption can to a large extent be attributed to increased household debt in recent years. The debt service of households leads to increased saving and restricts the growth in private consumption. There are also indications that the high cost of consumer debt is beginning to restrict the propensity of households to finance consumption with expensive consumer credit.

Figure 21: Quarterly developments of private consumption, 12-month changes



Source: Statistics Iceland.

Data on VAT turnover in consumer-related sectors for the first six months of 2002 indicate that the decline in private consumption is receding. Turnover rose by 0.7 per cent in the

first six months of 2002 from the previous years; excluding private cars, the increase is 2.2 per cent. The decline in car purchases and other durables explains the projected decline in private consumption to a large extent. Imports of consumer goods for the period January to July 2002 show a 4 per cent volume decline since 2001. Excluding private car imports, which declined by 11 per cent, there is a 2½ per cent fall in imports of other consumer goods. Imports of consumer durables has declined by 9 per cent and imports of semi-durables by 10 per cent. Purchases of foodstuffs and beverages rose however by 7 per cent.

The use of credit cards has declined considerably in the first seven months of 2002 or by 6½ per cent, of which 5 per cent is domestic use. The use of credit cards abroad declined by 18 per cent. This is consistent with balance of payments statistics which show that travel expenditures of Icelanders abroad have contracted by 15 per cent in the first six months of this year over a year ago. The use of debit cards has declined less than that of credit cards in the first seven months of 2002 or by 2 per cent. The use of debit cards by Icelanders abroad has increased by 2 per cent over a year ago, although such use is relatively small.

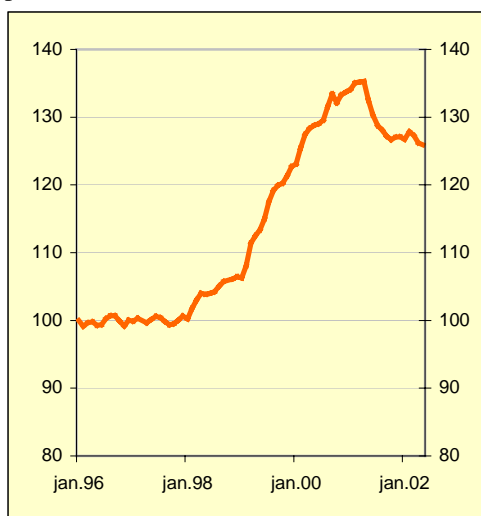
For 2003, a small increase in private consumption is forecast, or 1¼ per cent. The increase is less than the one projected for real disposable income since household debt will continue to be a burden. Accordingly, it is estimated that saving will continue to increase for the third year in a row which can best be seen from the observation that real disposable income per capita is expected to increase by more than 5 per cent from 2000 to 2003 at the same time as private consumption will shrink by 5 per cent. These developments have contributed towards re-establishing an equilibrium in the external balance.

9.4 Residential construction and the real property market

The expansion in residential construction in recent years appears to be receding in the course of 2002. Present estimates indicate that residential construction will be unchanged in 2002 from the previous year. A small contraction is forecast for 2003, although the number of units completed is expected to be about the same. All the same, residential construction will continue at a high level.

There are numerous reasons for this course of events. The economic upswing, along with migration to the capital area, domestic and from abroad, created considerable tension in the capital area property market. Property prices rose sharply since the supply of new housing units was insufficient to meet increasing demand. In 2002, it appears that the capital area market has begun to stabilise with prices moving back towards stability. The growth in residential construction appears to have abated for the time being.

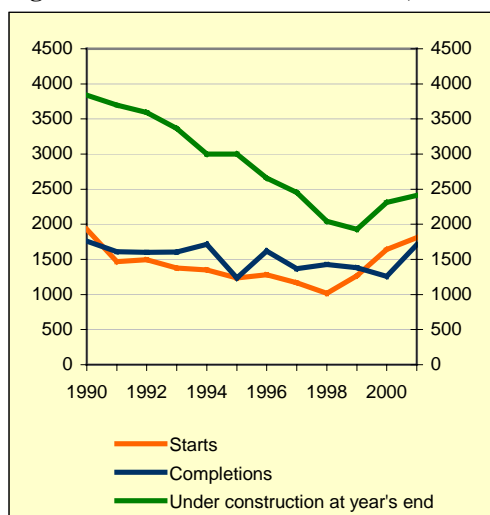
Figure 22: Property prices in the capital area
Index: Jan 1996=100, deflated by the consumer price index.



Source: Valuation Office.

Comprehensive data on residential construction in the course of 2002 are not at hand. Nonetheless, there are clear indications that the construction boom is receding. There are many reasons for this. Several new building areas in the capital area are being completed. New areas are in the process of opening up, but construction activity in those areas will not be well underway until sometime in 2003, creating a brief lull. Construction outside the capital area appears also to be on the decline and no increase can be expected in 2003.

Figure 23: Residential construction, units



Source: Valuation Office.

The lending activity of the Housing Financing Fund gives a good indication as to where residential construction is heading. Credit applications for new housing units were about 1,000 in the first seven months of 2002, a similar number as in 2001. The credit limit was raised by 20 per cent in the middle of 2001 so that the total amount of housing bonds for new units increased by 19 per cent in this period. The forecasts of the Fund indicate a fairly stable flow of credit applications for new units for the remainder of 2002. They are expected to decline slightly in early 2003. The revised projection of the Housing Financing Fund for 2002 from the middle of that year projects that housing bonds exchanged for mortgage notes will exceed the estimate of the 2002 fiscal budget by 2 billion kronur, whereas the issue of so-called Housing Financing Fund bonds – used to finance straight cash loans of the Fund – will fall short of fiscal budget estimates by a similar amount.

10. The public sector

10.1 Central government finances

The 2002 fiscal budget was passed with an 18.5 billion kronur revenue surplus. Total revenue was estimated at 257.9 billion and expenditure at 239.4 billion. The financial surplus was budgeted at 40.2 billion of which 20 billion were planned asset sales held over from 2001 and another 20 billion were projected for 2002. Revised budget estimates indicate that the revenue surplus may amount to 17.2 billion kronur, 1.3 billion less than in the original budget. Total revenue is estimated at 263.6 billion, 5.7 billion more than in the budget. This increase is primarily due to increased collection of personal and corporate income as well as social security taxes. The value added tax appears to be developing in line with original projections and the same may be said for other indirect taxes on the whole.

Total expenditure is estimated to exceed the budget by 7 billion and amount to 246.3 billion for 2002. About half of the increase is due to cost overruns of hospitals, nursing homes and the health insurance system. Other increases are due to wage agreements and related measures, increased unemployment and increased contributions to the Municipal Equalisation Fund caused by rising tax revenues.

Important revisions will be made to the financial surplus since the sale by the government of the state telephone company did not come to pass in 2001 and the planned proceeds therefrom that were expected to be paid into the Treasury in 2002 will therefore not take place. The cash surplus from operations is estimated to be nearly 3 billion lower than estimated earlier due to an early redemption of savings bonds.

The 2003 fiscal budget projects a 10.7 billion kronur revenue surplus, 6½ billion less than in the revised budget estimate for 2002. The reduction is primarily due to two factors: First, profits from sale of assets is estimated to be 7 billion lower in 2003 than in 2002 and second, tax reductions are estimated to cost the Treasury 4 billion.

The revenue projection of the 2003 budget is based on the main assumptions of the new forecast that the economy is gradually reviving after a minor downturn and that growth will resume next year. Tax revenue is expected to increase by 5.3 billion to 232.5 billion, in part because of rising revenue from personal income taxes and an increase in the social security tax. This is offset by a reduction by half of the net wealth tax on individuals and companies and the reduced corporate income tax. Sale of government assets is also expected to be lower than in 2002.

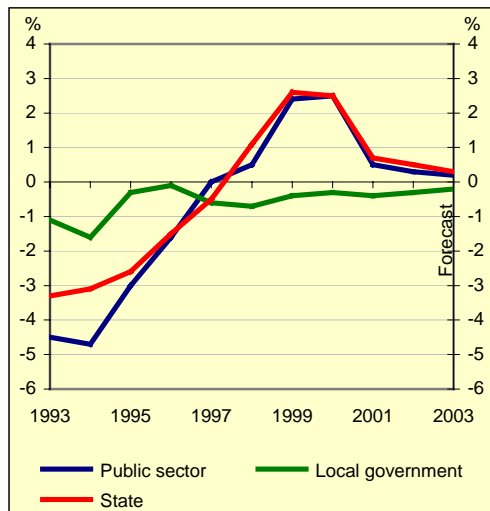
Total expenditure in 2003 is estimated at 253.3 billion kronur, an increase of 7 billion and 3 per cent from the 2002 revised estimate, indicating that expenditure in real terms will remain constant. The share of expenditure to GDP is therefore expected to decline by 0.3 per cent from 2002 and by 0.7 per cent from the 2001 outcome. General operating expenditures increase slightly in real terms, or by ½ a per cent, investment and maintenance are budgeted to remain unchanged, interest payments decline, whereas current transfer payments increase.

10.2 Municipal finances

Municipal finances have been in deficit for several years. Provisional figures show a 2.9 billion deficit for 2001, equivalent to 3.7 per

cent of total revenue which increased by close to 7½ per cent whereas expenditure rose by 8 per cent, both in real terms. The increase in revenue is primarily due to the rise in the municipal income tax whereas on the expenditure side, current expenditures and investment are the main causes of increase.

Figure 24: Financial balance of the public sector, % of GDP



Source: Statistics Iceland.

Estimates for 2002, based on the budgets of the largest municipalities, indicate that public consumption will increase by close to 3 per cent. Investment, however, is expected to decline slightly. Total revenue is expected to increase in excess of expenditure by a small margin and the revenue balance could thereby shrink somewhat from 2001, to about 1½ billion kronur.

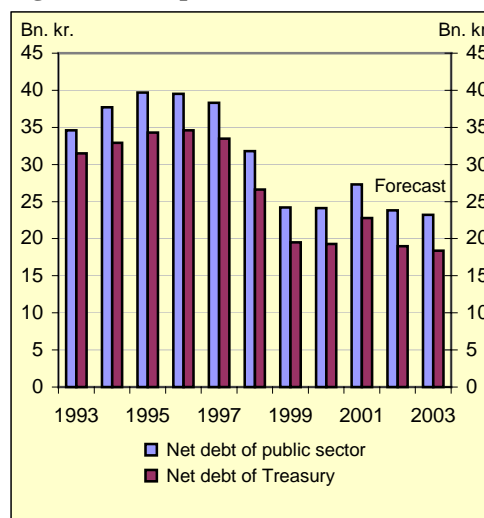
Current expenditure is expected to increase slightly less in 2003 or by 1½ per cent. Present budget projections indicate that municipal investments will contract next year. The municipal revenue outlook for 2003 is uncertain as it is not clear whether municipalities will exercise their right to raise municipal income taxes to the legal maximum. Present projections assume that the income tax rate will remain unchanged. Based thereon, the overall municipal deficit

will continue to shrink in 2003 down to about 1 billion kronur.

10.3 Public sector finances

This section discusses the finances of the total public sector, i.e. those of the central government together with the municipalities, according to the definitions of the Standard National Accounts of the United Nations. The main deviations in this approach from the central government accounts are that profits from central government asset sales and an extraordinary reassessment of the value of government enterprises are not entered as revenue in the national accounts. Tax claims written off are not expensed and only those pension commitments associated with salary payments of the accounting year are entered as expenditure.

Figure 25: Net public debt



Source: Statistics Iceland.

On a national accounts basis, the revenue surplus of the public sector in 2002 is estimated at close to 2 billion kronur, equivalent to about ½ a per cent of GDP. This is about the same as in 2001, but considerably less than in 1999 and 2000, as shown in figure 24. For 2003, the revenue surplus of the public sector is expected to decline to 1½ billion kronur. The improvement in public sector finances is wholly attributable to the central government; municipal

finances have, on the other hand, been in deficit for a number of years.

Consumption of the public sector is expected to increase by $2\frac{3}{4}$ per cent in real terms in 2002, the increase being similar for both the central government and municipalities. For 2003, the growth is expected to be considerably less, about 1 per cent, which is based on the projections of the 2003 fiscal budget of a $\frac{1}{2}$ per cent growth in public consumption. Public consumption of municipalities is however expected to increase by a slightly higher margin.

The public debt of the central government and municipalities has been subjected to some fluctuations in recent months due to exchange rate changes and changing operating results.

The central government surpluses of recent years have been used to reduce debt, as shown in figure 25. The net debt of the Treasury has thus been cut nearly in half since 1996, from $34\frac{1}{2}$ per cent of GDP to 19 per cent in 2002 and a projected $18\frac{1}{2}$ per cent according to the 2003 budget. This is reflected in public sector indebtedness for this period.

Appendix tables

Table 1. Output and expenditure 2000-2003

	Billion krónur current prices				Volume changes on previous year, per cent ¹⁾			
	Provis.		Est. Forecast		Provis.		Est. Forecast	
	2000	2001	2002	2003	2000	2001	2002	2003
1. Private consumption	389.6	408.4	423.6	439.5	4.0	-3.0	-1	1¼
2. Public consumption	156.7	175.5	188.9	196.1	3.7	3.2	2¾	1
3. Gross fixed investment	156.5	166.2	148.6	154.2	14.8	-4.4	-14¾	1¾
Business sector investment	101.0	103.3	82.2	86.9	14.9	-9.3	-20¾	3½
Residential construction	25.5	30.5	33.0	33.0	10.5	12.9	-¼	-2
Public investment	30.0	32.3	33.4	34.3	18.1	-0.7	-7	½
4. Final domestic demand	702.8	750.1	761.1	789.8	6.2	-2.2	-3¼	1½
5. Stock changes ²⁾	2.5	-2.1	-0.2	0	0.4	-0.8	¼	0
6. Total national expenditure	705.3	748.0	760.9	789.8	6.7	-3.0	-3	1½
7. Exports of goods and services	231.6	303.4	318.4	329.4	5.0	7.8	5¼	3½
8. Imports of goods and services	278.6	307.3	292.4	303	8.0	-9.0	-2¾	3
9. Gross domestic product	658.3	744.2	786.9	816.6	5.5	3.6	0	1½
10. Net factor income from abroad	-20.2	-27.4	-24.9	-27.0	-	-	-	-
11. Net current transfers ³⁾	-0.8	-1.0	-0.7	-0.8	-	-	-	-
12. Current account balance (7.-8.+10.+11.)	-68.0	-32.2	0.4	-1	-	-	-	-
13. Gross national income (9.+10.)	638.1	716.8	762.0	789.6	4.6	3.0	½	1½
14. Effects of changes in terms of trade ⁴⁾	-	-	-	-	-1.0	0.2	¾	-¼
15. Real gross national income	-	-	-	-	3.5	3.1	1¼	1¼
16. Current balance, % of GDP	-10.3	-4.3	0	0	-	-	-	-

Notes:

- ¹⁾ Volume changes are based on 1990 prices.
- ²⁾ In per cent of GDP of the previous year at constant prices.
- ³⁾ Net transfers from abroad other than factor income.
- ⁴⁾ As a percentage of previous year's GNI, constant prices.

Table 2. Export production and foreign trade 2000-2003

	Billion krónur current prices				Volume changes on previous years per cent ¹⁾			
		Provis.	Est.	Forec.	Provis.		Est.	Forec.
	2000	2001	2002	2003	2000	2001	2002	2003
Export production								
Fish products	94.5	121.8	127.3	128.6	-3.1	3.4	3	½
Aluminium	30.2	37.3	36.9	37.8	8.8	7.5	7	2
Ferrosilicon	3.9	5.0	5.0	5.0	41.7	12.9	1	0
Other products	20.2	26.8	37.1	38.8	34.6	4.3	28	9¾
Total	148.8	191.0	206.3	210.3	4.7	4.7	7¼	2½
Export of old ships and aircraft	3.0	3.3	1.0	1.3	-	-	-	-
Stock changes in export production	2.5	-2.1	-0.2	0.0	-	-	-	-
Merchandise exports, total	149.3	196.4	207.5	211.6	-1.3	7.1	6½	2½
Merchandise imports, total	186.8	202.5	190.8	198.8	2.8	-10.0	-3¼	3¾
General merchandise imports	160.0	170.2	163.1	169.8	2.5	-12.0	-2¼	3¾
Of which: Oil imports	16.6	17.0	15.9	16.4	2.4	-11.5	1	5
Of which: Other imports	143.4	153.2	147.2	153.3	2.5	-12.1	-2½	3½
Special imports	26.7	32.4	27.8	29.1	4.1	1.3	-8	3¾
Balance of trade	-37.5	-6.1	16.7	12.8	-	-	-	-
Export of services	82.4	107.1	110.9	117.8	19.3	9.1	3	5½
Import of services	91.9	104.8	101.6	103.8	21.5	-6.9	-1¾	1½
Balance of services	-9.5	2.3	9.3	14.0	-	-	-	-
Net factor income from abroad	-20.2	-27.4	-24.9	-27.0	-	-	-	-
Net current transfers ²⁾	-0.8	-1.0	-0.7	-0.8	-	-	-	-
Current balance	-68.0	-32.2	0.4	-1.0	-	-	-	-

Notes:

¹⁾ Volume changes are based on 1990 prices.

²⁾ Net transfers from abroad other than factor income.

Table 3. Income, prices, purchasing power and exchange rate 1994-2003

	1994	1995	1996	1997	1998	1999	2000	2001	Prov. 2002	Forec. 2003
I Indices 1990=100										
Income										
Disposable household income per capita	108.2	114.3	121.6	126.9	140.2	149.4	158.9	173.4	184	192
Wages ¹⁾	114.4	119.6	127.2	134.2	146.8	156.8	167.2	181.9	195	203
Prices										
Consumer price index	117.0	119.0	121.7	129.9	126.0	130.3	136.8	146.0	153	156
Purchasing power ²⁾										
Disposable household income per capita	92.5	96.0	99.9	102.4	111.3	114.6	116.1	118.8	121	123
Wages ¹⁾	97.8	100.5	104.6	108.3	116.5	120.3	122.1	124.5	127	130
Exchange rate										
Effective price of foreign currency	116.0	116.1	116.2	114.7	112.6	112.4	112.5	135.1	132	130
Real exchange rate relative to price	91.8	91.9	92.1	92.9	94.4	96.1	98.9	85.9	90	92
Real exchange rate relative to wage	89.1	93.0	94.0	96.9	101.7	103.8	105.4	92.4	99	102
II Changes on previous year, %										
Income										
Disposable household income per capita	1.5	5.5	6.4	4.3	10.5	6.5	6.4	9.2	6¼	4¼
Wages ¹⁾	1.2	4.5	6.4	5.4	9.4	6.8	6.6	8.8	7	4½
Prices										
Consumer price index	1.5	1.7	2.3	1.8	1.7	3.4	5.0	6.7	4¾	2¼
Purchasing power ²⁾										
Disposable household income per capita	0.0	3.8	4.1	2.5	8.7	3.0	1.3	2.3	1½	2
Wages ¹⁾	0.3	2.8	4.1	3.6	7.6	3.3	1.5	2.0	2¼	2¼
Exchange rate										
Effective price of foreign currency	4.9	0.1	0.1	-1.3	-1.8	-0.2	0.1	20.1	-2½	-1½
Real exchange rate relative to price	5.4	0.1	0.2	0.9	1.6	1.8	2.9	-13.1	5	2¼
Real exchange rate relative to wage	-7.9	4.4	1.1	3.0	5.0	2.1	1.5	-12.3	6¾	3

Notes:¹⁾ Wage index.²⁾ Deflated by price index.³⁾ Official exchange rate of the króna vis-à-vis foreign currencies. 31.12.1991 = 100

Table 4. General government finances 1994-2003

Billion krónur ¹	1994	1995	1996	1997	1998	1999	2000	2001	Est.	Forec.
									2002	2003
Total income	154.5	163.6	179.1	194.8	220.8	252.8	272.8	298.4	321.2	334.0
1. Direct taxes	62.7	68.0	76.3	86.0	98.6	115.6	128.8	146.9	160.8	169.3
2. Indirect taxes	79.7	83.1	90.7	96.1	109.3	122.5	128.0	128.5	136.6	140.9
3. Interest income	7.0	6.8	6.8	6.6	7.5	8.7	10.2	13.6	11.8	12.1
4. Other income	5.1	5.6	5.3	6.2	5.5	6.0	5.8	9.4	12.0	17.7
Total expenditure	175.1	177.0	186.8	194.9	218.0	238.1	256.6	295.1	319.2	338.5
1. Public consumption of which depreciation	93.8 9.3	99.0 9.9	105.6 10.5	112.8 11.1	127.7 11.8	142.1 12.6	156.7 13.5	175.5 14.8	188.9 15.9	196.1 16.8
2. Interest expenditure	18.0	20.0	19.5	19.6	21.2	22.7	22.8	27.2	30.1	30.9
3. Subsidies	8.7	8.7	9.2	9.2	9.2	10.6	11.6	13.7	14.6	14.9
4. Income transfer	33.9	36.2	37.2	38.8	40.1	42.6	47.2	55.4	61.0	67.6
5. Investment	19.5	16.0	17.6	18.4	23.6	25.3	24.8	29.4	31.7	36.7
6. Capital transfer	10.3	7.1	8.2	7.3	8.1	7.4	6.9	8.7	8.8	9.2
Financial balance	-20.6	-13.4	-7.7	-0.1	2.8	14.7	16.3	3.4	2.0	1.5
Percentage of GDP										
Revenue	35.2	36.2	36.9	38.0	38.9	41.7	41.4	40.1	40¾	41½
Expenditure	39.9	39.1	38.5	38.0	38.4	39.3	39.0	39.6	40½	41½
Financial balance	-4.7	-3.0	-1.6	0.0	0.5	2.4	2.5	0.5	½	¼
Taxes	32.4	33.4	34.4	35.5	36.6	39.3	39.0	37.0	37¾	38
Public consumption	21.4	21.8	21.8	22.0	22.5	23.4	23.8	23.6	24	24

Note:

¹⁾ Based on the Standard National Accounts of the United Nations