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ECONOMIC OUTLOOK FOR ICELAND

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The latest data used in this report are from 15 April. All projections are made by the Ministry of Finance unless otherwise stated.

INTRODUCTION

A summary of the forecast

In this report The Ministry of Finance presents a new macroeconomic forecast covering the years 2003-2004 and incorporates the assumption that the power project at Kárahnjúkar and an aluminium plant at Reyðarfjörður will be built and in addition, the Norðurál aluminium plant at Grundartangi will be expanded. This report also outlines a medium-term forecast until 2010 at which time the above investments are scheduled to be completed.

· Economic growth is expected to accelerate sharply in 2003 to 2¾ per cent, 1 per cent more than in the previous forecast. Next year, growth is expected to accelerate further to 3¾ per cent. If these expectations come to pass, it marks the beginning of a new growth era where power projects and aluminium plant investment will be predominant in the economy up to 2010.

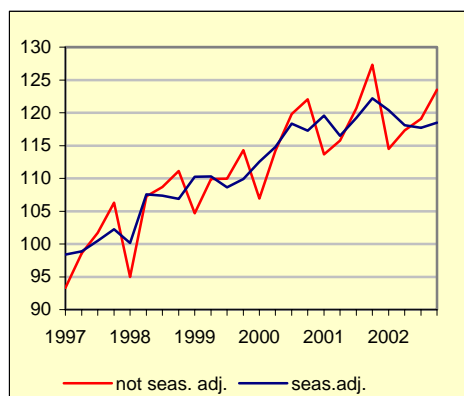
- National expenditure increases again, following a decline in the past two years; it is expected to increase by 3½ per cent in 2003 and 4¾ per cent in 2004. This is primarily led by a more than 11 per cent increase in investment each year. Moreover, private consumption is forecast to increase by 1¼ per cent in 2003 and 3¼ per cent in 2004, a total of 4½ per cent. Public consumption is expected to increase by a similar percentage.
- As expenditure increases, the current account of the balance of payments is forecast to return to deficits, albeit small. For 2003, a deficit of 1¼ per cent of GDP is forecast and 2 per cent for 2004. National saving is however expected to increase to 19½ per cent of GDP in 2003 and 20 per cent in 2004 as against 18 per cent in 2001 and 19 per cent in 2002.
- Unemployment is expected to average 3 per cent of the labour force in 2003, declining in the course of the year when the impact of power project investments begins to take effect as well as the accelerated investment measures of the government. Unemployment is expected to decline further in 2004 and average at about 2 per cent.
- Inflation, as measured by the consumer price index, is expected to be 2 per cent in 2003, both within the year and over the previous year. For 2004 a slight increase is expected, to 2½ per cent, as domestic demand accelerates. This forecast is based on the assumption that the average króna exchange rate index will be unchanged from its present level of 122 points, both in 2003 and 2004.
- Wages are forecast to rise by 5 per cent on average in 2003 and 6 per cent in 2004, including both contractual wage increases and wage drift. Accordingly, purchasing power of wages is expected to increase, by 3 per cent in 2003 and 3½ per cent in 2004, making 2004 the tenth year in succession when purchasing power increases, an Icelandic record.

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- Business earnings were good in 2002, increasing substantially over 2001. Earnings prospects are generally thought to be good this year, despite a strong exchange rate of the króna which has an adverse effect on export and import-competing sectors.
 - The Ministry of Finance estimates that the combined public sector ran a deficit of about 2 billion krónur last year. Central government finances were close to balance whereas municipalities continued in deficit. For 2004, however, a surplus of up to 3 billion in public finances is forecast, mainly because of improved central government finances. These figures exclude the impact of government asset sales upon the public sector balance.
 - The assessment of the impact of power project investments has now been reviewed in light of additional information revealing a more favourable picture of events than initially thought. Exchange rate assumptions have changed, the distribution of investment expenditures is more even than assumed earlier and the economy begins the investment upswing with excess productive capacity, not with demand pressures as thought earlier. All of these factors mitigate the impact of the investment projects upon domestic demand. Nonetheless, it is important to follow a tight monetary and fiscal policy at the time when investments reach their peak and, conversely, ease policies to soften the downturn at the time when investments are completed.

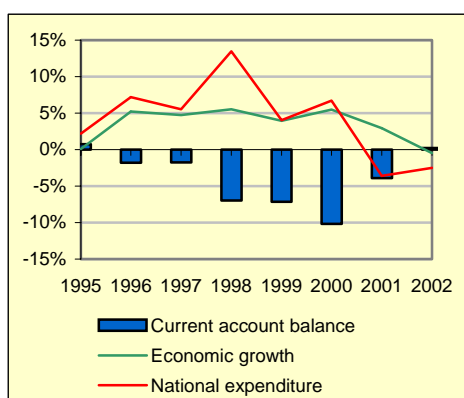
OVERVIEW OF FORECAST

Developments in 2002

Quarterly economic growth index 1997 = 100

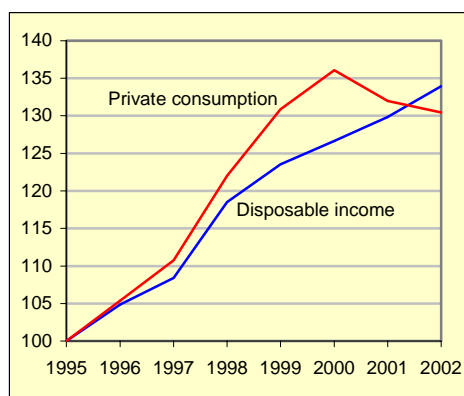


Economic growth, national expenditure and current account balance



Private consumption and disposable income

Index 1995 = 100



Following the strong upswing in 1996-2000, the economy slowed in 2001/2002. The vigorous increase in exports prolonged the pace of economic growth up to the middle of last year, whereas GDP declined in the second half of 2002 by some 2 per cent in real terms at an annual rate.

There are increasing indications that this brief downturn has come to an end and a new expansion has begun. This is in part due to the decision of the government to accelerate public investment this year and into next year. Preparations for large energy investments are also under way which will have a profound impact on the Icelandic economy in the next several years. The latest figures appear to indicate that unemployment has peaked and that private consumption is reviving.

Provisional national accounts record a ½ per cent decline in real GDP last year. Gross national income increased, however, by 1.2 per cent, primarily due to a substantial decline in interest payments to abroad. In light of the latest data, there was a negative output gap, i.e., excess productive capacity, in 2002, whereas earlier estimates indicated a slightly positive gap. In light of employment data it is assumed that the business cycle reached its trough towards the end of 2002 and at the beginning of this year. The output gap is expected to persist for some time into this year and disappear in the course of 2004.

One of the main characteristics of the economy in recent years has been the sharp reversal of the current account of the balance of payments. It shifted from a 10.2 per cent deficit of GDP in 2000 to an 0.2 per cent surplus in 2002. This resilience of the economy may be ascribed to the economic policy of the Government and comprehensive structural reforms in recent years. In addition, export growth has been vigorous, the terms of trade favourable and interest rates abroad have been low, all of which are favourable factors.

National expenditure has declined in the past two years. Gross investment contracted by 7 per cent and private consumption by 3 per cent in 2001. This continued in 2002 when investment contracted by a further 12.4 per cent and private consumption by 1.2 per cent. Public consumption increased on the other hand by about 3 per cent in both years whereas public investment declined by a total of 10 per cent at the same time.

Household purchasing power has increased considerably in recent years. It increased further by 2 per cent both in 2001 and 2002. Private consumption declined at the same time which indicates that household savings were increasing, which appears in the form of reduced consumer debt and increased optional pension savings in voluntary pension savings accounts.

Inflation has been abating and the Central Bank's 2.5 per cent inflation target was reached last November. Inflation has come down further since then, undoubtedly because the króna exchange rate is strengthening, in addition to the effects of the slack in the economy along with increased unemployment.

A summary of the forecast

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

	Billion krónur. 2002	Volume change from previous year in p.c.			
		Prov. 2001	Est. 2002	Forec	
				2003	2004
Private consumption	419.5	-3.0	-1.2	1¼	3¼
Public consumption	194.7	2.9	3.1	2¼	2
Gross fixed investment	146.5	-6.9	-12.4	11¼	11
Change in stocks ¹	-0.2	-0.8	0.4	0	0
National expenditure	760.6	-3.6	-2.5	3½	4¾
Exports of goods and services	307.3	7.9	2.9	1	2¼
Imports of goods and services	293.5	-9.0	-2.4	2½	5
Gross domestic product	774.4	2.9	-0.5	2¾	3¾
Gross national income	761.2	2.7	1.2	2¾	3½
Impact of the terms of trade ¹		0.2	0.2	-½	¼
GNI, including the terms of trade impact.....		2.8	1.4	2¼	3¾
Current account balance.....	1.8	-	-	-	-
In per cent of GDP.....	-	-3.9	0.2	-1¼	-2
Change in per capita purchasing power in p.c.	-	2.3	2.1	2	3½
Change in consumer prices, p.c.	-	6.7	4.8	2	2½

The economic outlook for 2003 and 2004

The macroeconomic forecast predicts that economic growth resumes in 2003 and is forecast at 2¾ per cent for the year, 1 per cent higher than in the December forecast. For next year, growth will be higher still and is at present estimated at 3¾ per cent. This forecast marks the beginning of a new growth era where power projects and aluminium plant investments will predominate up to 2010.

The forecast incorporates the assumption that an aluminium plant at Reyðarfjörður will be built with a production capacity of 322 thousand tons a year. The aluminium plant at Grundartangi will be expanded in two phases with a total expansion in production capacity of 150 thousand tons a year. Along with these investments, hydropower and geothermal electricity generation facilities will be constructed. The total cost of all these projects is estimated at 280 billion krónur at 2003 prices. The assumption is made in the forecast for 2003 and 2004 that the index for the average króna exchange rate will be about unchanged from its present level of 122 points.

National expenditure is forecast to increase by 3½ per cent in 2003, primarily due to investment rising by 11 per cent. Industrial investment is forecast to rise by 15½ per cent, public investment by more than 14 per cent and residential construction by 1¼ per cent. Private and public consumption is forecast to increase by 1½ per cent in 2003. The current account is expected to go into a slight deficit, equivalent to 1¼ per cent of GDP, and the terms of trade are thought to deteriorate by close to ½ per cent of GDP. The current account deficit is due

to increased national expenditure and an unchanged production of marine products for export. Despite low inflation in major customer countries and relatively low import prices in most categories, it is forecast that the terms of trade will deteriorate between 2002 and 2003 because of rising world oil prices. Aluminium prices are also thought to decline and export prices for fish products are not thought to increase in line with inflation in our trading countries.

Unemployment is forecast at 3 per cent of the labour force in 2003, although it is expected to decline in the course of the year. Demand for labour is expected to increase as a result of increased construction activity at a power project in the North-east and due to special government measures to accelerate public investment activity in order to create employment demand. Prices are forecast to increase by 2 per cent between 2002 and 2003. Excess productive capacity will still be in place in the course of this year. A slack is expected in the labour market, i.e. registered unemployment in per cent of the labour force will exceed equilibrium unemployment.

Key economic indicators

Volume changes in per cent over previous year unless otherwise indicated.

<i>Macro-economic indicators</i>	2001	2002	2003	2004
Economic growth	2.9	-0.5	2¾	3¾
National expenditure	-3.6	-2.5	3½	4¾
Current account in p.c. of GDP	-3.9	0.2	-1¼	-2
Net external debt in p.c. of GDP	-75.4	-75.0	-69	-68
National saving in p.c. of GDP	17.8	19.1	19½	20

<i>Labour market</i>	2001	2002	2003	2004
Labour force (1000's)	144.1	145.4	147.5	150.8
Unempl. in p.c. of labour force	1.4	2.5	3	2
Purch.power of hourly wages	2.0	2.2	3	3½

<i>Foreign trade</i>	2001	2002	2003	2004
Exports of marine products	3.4	4.2	0	2
Total merchandise imports	7.2	6.1	¾	2¼
General imports	-12.0	-4.6	4	5¼
Terms of merchandise trade	2.0	0.2	-½	¾

<i>Money and prices</i>	2001	2002	2003	2004
Consumer price index. per cent	6.7	4.8	2	2½
Exchange rate index	135.4	131.4	122	122
Real interest rate on 3-5 yr. Treasury bonds, %.	5.9	5.5	4	4¼

<i>External conditions</i>	2001	2002	2003	2004
Growth in the EU	1.5	1.0	1¼	2½
EU inflation	2.2	2.0	1½	1¼
Export prices of marine products	4.0	3.5	1	2
Foreign prices excl. oil	1.1	2.1	1¾	2

As noted above, economic growth is expected to increase by 1 percentage point to 3¾ per cent next year since investment activity will increase significantly in that year. Industrial investment is expected to rise by close to 20 per cent and private consumption by 3¼ per cent. National expenditure is forecast to increase by 4¾ per cent in real terms and the current account deficit of the balance of payments is expected to

reach 2 per cent of GDP. The terms of trade are expected to improve by a small margin since the rise in oil prices in 2003 is thought to cancel out in 2004.

Increased power project investments are expected to lead to a considerable decline in unemployment next year which is expected to fall to 2 per cent from this year's 3 per cent. If this forecast is realised, demand pressure will arise in the labour market and the output gap will be negligible. Inflation is expected to accelerate to 2½ per cent in 2004.

The economic outlook until 2010

The Ministry of Finance has recently reviewed its medium-term forecast which was based on different alternatives of investment projects. The forecast incorporates both the aluminium plant at Reyðarfjörður and the expansion of the Grundartangi plant along with associated power project constructions.

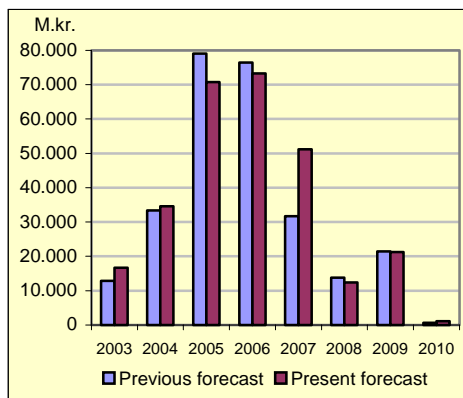
The conclusions of the forecast differ considerably from previous projections since several important assumptions have changed, including exchange rate assumptions. Earlier projections assumed, for simplicity's sake, that the exchange rate index would be unchanged throughout the investment period since the purpose of those projections was to display the economic impact of different investment alternatives. At the same time it was argued that the exchange rate would undoubtedly strengthen before and at the beginning of the investment activity which in turn would have a dampening impact on inflation. This projection has indeed been realised and the exchange rate has strengthened considerably.

The present calculations only cover one investment scenario. Therefore, a certain exchange rate adjustment is assumed for the entire period. As noted earlier, the exchange rate that is assumed for 2003 and 2004 is similar to the average rate for the first quarter of this year, i.e. an exchange rate index of 122. The rate is expected to strengthen slightly in 2005-2007, to an average of 120 for the period. Thereafter, the rate is projected to weaken gradually and close in on the value of 128 in 2010. It must, however, be emphasised that these are assumptions, not forecasts.

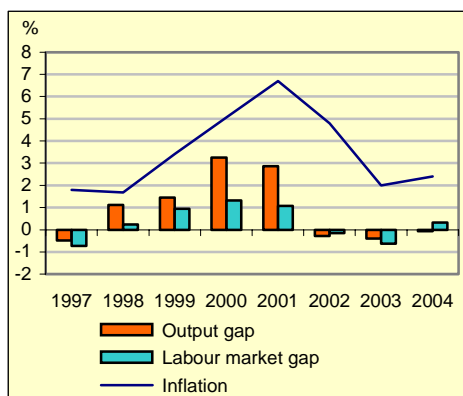
Another important factor that has changed from earlier projections relates to the total investment amounts and the distribution of construction activity in the Northeast. The latter part will be more even and hence easier to manage than earlier assumed. The pace of activity will be quicker in the early part of the period, i.e., in 2003 and 2004. The pace will decelerate in 2005 and 2006 compared with previous projections, whereas investment in 2007 will be substantially higher than thought earlier. On the whole, these changes will lead to milder fluctuations for the economy than thought earlier.

An output gap can be expected in the initial phase of the construction period instead of excessive demand pressures. It is also assumed that when power project and aluminium plant investments are at their peak they will crowd out other investments more than earlier thought.

**Investment in electricity and aluminium production
2003 prices**



Output gap and inflation.



Key figures of the forecast

Annual rates of change unless otherwise specified

	Average	
	2003-2006	2007-2010
Gross domestic product	3½	2
Private consumption.....	3	2½
Public consumption	2	2
Gross fixed investment.....	11½	-5
Enterprises	18	-9¼
Residential construction	2½	2¼
Public investment.....	-1½	4½
Exports.....	2¾	6¼
Imports	5½	2¾
Current account, per cent of GDP	-3	-2¾
Unemployment, p.c. of labour force ...	2	2¾
Annual rate of inflation, p.c.	3	3

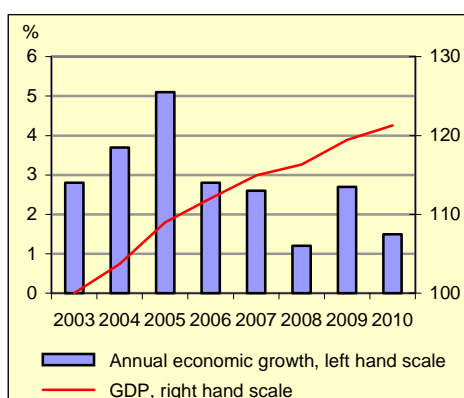
All of these factors serve to dampen their effect upon domestic demand. It will nevertheless be important to follow a tight monetary and fiscal policy during the peak period of investment activity and pursue those policies with ease when investment activity decelerates. The projections of the Ministry are based on these assumptions. It is thus assumed that the acceleration of public investments that were recently announced will be reversed in 2005-2006 and that public investment will be restrained in those years. It is also assumed that interest rates may increase temporarily when investment activity is at its peak and decline upon their completion.

On the basis of these assumptions, a vigorous growth rate is forecast up to 2007. The growth pace will slow down in 2008 and accelerate again in 2009. Unlike in the previous projection, there will not be a significant contraction in the economy towards the close of the period which can be attributed to a more even distribution of investments and the above-noted economic policy responses.

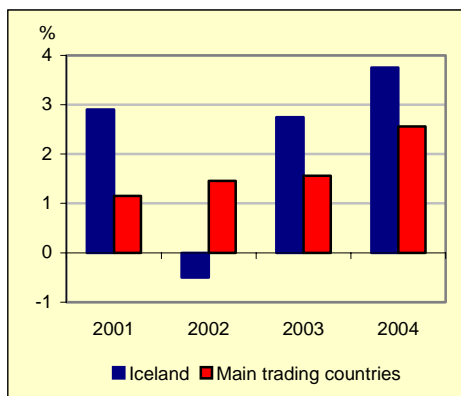
According to this forecast, growth would be 3½ per cent on average in the first part of the investment period in 2003-2006. It is expected to peak at 5 per cent in 2005. When investment activity slows down in 2007-2010, so will economic growth to an average of 2 per cent a year. The annual increase in private consumption is expected to range between 1 and 4 per cent. Investment is expected to fluctuate most. Investment in industry is projected to increase by 34 per cent in 2005 and contract by 24 per cent in 2008. The current account deficit will increase and is expected to reach 5 per cent of GDP at the peak of investment activity.

This forecast indicates that inflation may exceed the upper target limit set by the Central Bank in 2006 and 2007. Demand pressures could be lower if more foreign labour were used. As in the earlier simulation, it is assumed that 25 per cent of all the manpower for the construction projects will come from abroad. If this assumption is increased to 50 per cent, inflation is thought to be ¼-½ per cent lower at its peak.

Economic growth and index of GDP



Weighted economic growth in main trading countries and Iceland¹⁾



Source: IMF, April 2003.

1) Weighted mean based on the Central Bank's currency basket.

Uncertain international prospects

Inflation continues to recede

Stock prices are declining

The Icelandic economy is in many ways dependent on the development of Iceland's main export markets as well as the overall development of prices and exchange rates. In addition to economic growth and related conditions in main customer countries, there are several external factors of influence that pertain more to the Icelandic economy than others, such as international oil prices and interest rates in foreign financial markets. Furthermore, certain foreign developments have a direct bearing upon Iceland, such as prices abroad for fish products and, increasingly, the world price of aluminium. This chapter summarises recent international developments and immediate prospects¹ and special developments affecting the Icelandic economy.

Most recent international economic forecasts predict lower growth for this year and next than they had forecast earlier, following a slowdown in 2001 and a slow recovery in 2002. The most recent IMF forecast predicts 1.1 per cent growth in the euro area this year and 2.3 per cent in 2004. US growth is forecast at 2.2 per cent this year and is expected to pick up next year, reaching 3.6 per cent.

The recent slow growth pace is in part due to the uncertainty arising from the war in Iraq but also due to the sharp decline in stock prices. Unemployment has increased, industrial production stagnated and international trade declined. The slowdown in the international economy has weakened fiscal finances in most countries, led to deficits and a renewed accumulation of debt. The room for maneuver in economic policy has at the same time narrowed. Economic growth was anaemic in most major industrial countries in the first quarter of this year but a pickup is forecast in the course of the year. US growth may have increased slightly in the first quarter of this year but remained stagnant in Europe and Japan.

Inflation has been very low and is expected to be below 2 per cent in developed countries this year. It could increase slightly in the US due to the fall in the dollar exchange rate and rising oil prices, but this development is expected to reverse. In Europe, the rise in the euro exchange rate has done much to mitigate the rise in oil prices. A further decline in inflation is forecast, to 1½ per cent next year. Deflation continues in Japan and could turn into a widespread problem. In Germany, inflation was close to zero in the latter half of 2002.

Conditions in financial markets deteriorated again at the beginning of this year, following some increases in the last quarter of 2002. Stock prices are now 40-60 per cent below their peak at the beginning of 2000. The latest slump is particularly due to uncertainty from the war in Iraq and the recent slow pace of growth. The trade-weighted dollar exchange rate continued its decline in December and by mid-March it had declined by 14 per cent from its peak at the beginning of 2002. The euro had at the same time risen by 13 per cent and the yen by 4 per cent.

Public deficits increase

Public deficits are generally on the rise in most countries and further deterioration is expected this year. The US public deficit is expected to amount to 4.6 per cent of GDP this year, declining slightly in 2004 due to a slower increase in public expenditure. The deficit in the euro area countries is expected to amount to 2.4 per cent of GDP this year and somewhat less next year, whereas in Japan it is forecast at 7.4 per cent this year and a little less next year.

Unemployment is increasing

Unemployment continued to increase last year, especially in the United States where it rose by 1 per cent, continuing to increase this year to a forecast average of 6.2 per cent. The increase is not as large in the euro area, although an unemployment rate of 8.8 per cent is forecast. In Japan, the unemployment rate is at an historical high of an estimated 5.5 per cent this year.

Economic prospects hinge upon the outcome of the war in Iraq

The Iraqi war will do much to influence immediate prospects for the world economy. The latest news indicate that the war is about to come to an end. If that is the case, oil prices are likely to decline quickly, investment should revive and so should economic growth. Should the war turn out to be protracted, a revival will inevitably be postponed, dampening business and consumer confidence, reducing stock prices and making investors increasingly risk-averse.

Stock prices are another element of uncertainty

The development on stock markets is another factor of uncertainty, quite apart from the war in Iraq. It is thought likely that the negative effect from stock prices declines upon demand will have peaked around the end of last year. Doubts still linger on the state of Japan's banking and insurance sectors and to some extent in Europe. Further declines can thus not be excluded. Excess productive capacity in the business sector and heavy business debt are also likely to discourage business investment.

The US economy has a substantial impact upon the rest of the world

Uncertainties about US growth prospects are of major importance since the health of the US economy is crucial to developments in other countries. The growing imbalances in international trade are a source of concern since the US current account deficit is growing with a commensurate surplus in Europe and Japan.

Mildest slowdown in the US

Compared to other countries the slowdown in the US economy is milder than in other countries. The tax and interest rate reductions have been larger than elsewhere with a commensurate impact on the economy. Private consumption was the main engine of growth, but towards the end of 2002 unemployment edged up to 6 per cent and unstable stock markets had a negative effect on consumers. Growth thus slowed in the fourth quarter at the same time as investment was declining due to slow demand and excessive productive capacity in many companies. Demand for exports has also been slow despite the decline in the dollar exchange rate. Immediate prospects are that growth will resume slowly, probably driven by increased investment. Investment prospects are uncertain, however, since business confidence is still weak and many companies are debt-laden. Tax reductions should help and,

Developments and prospects in the international economy

Volume changes unless otherwise indicated.

moreover, productivity has increased. The contribution of consumption to growth will probably be reduced since consumer debt has increased in excess of disposable income.

	2001	2002	Forecast 2003	Forecast 2004
GDP growth	2.3	3.0	3.2	4.1
Advanced economies	0.9	1.8	1.9	2.9
United States	0.3	2.4	2.2	3.6
Euro area	1.4	0.8	1.1	2.3
Japan	0.4	0.3	0.8	1.0
Developing countries	3.9	4.6	5.0	5.8
Africa	3.6	3.4	3.9	5.2
Asia	5.7	6.5	6.3	6.5
Countries in transition	5.1	4.1	4.0	4.1
Russia	5.0	4.3	4.0	3.5
International trade	0.1	2.9	4.3	6.1
Inflation				
Advanced economies	2.2	1.5	1.9	1.7
Developing countries	5.8	5.4	5.8	5.1
Countries in transition	16.3	11.1	9.4	7.4
Six-month LIBOR rates, p.c. a year				
US dollars	3.7	1.9	1.7	3.5
Euro	4.2	3.3	2.4	2.5
Yen	0.2	0.1	0.1	0.3
Crude oil prices, US dollars	-13.9	2.8	24.2	-19.4

Source: IMF, April 2003

Weak growth in the euro area

Growth is still weak in the euro area, especially in Germany. Increased exports stimulated growth early in 2002 but demand in the euro area has been subdued. Despite the increase in private consumption due to rising real wage income, investment has continued to decline. Growth this year is expected to be slow this year and next, although this varies from country to country. German, Dutch and Italian growth is expected below average, whereas in France and Spain it may turn out better. Although consumer confidence is subdued, private consumption is expected to spur growth due to rising real disposable incomes. Exports are also forecast to increase due to rising foreign demand which should offset the rise in the euro exchange rate. Prospects for investment are limited since companies possess excess productive capacity and business confidence is low. Growth forecasts have therefore been lowered, especially for Germany where economic growth this year is forecast at below 1 per cent for the third year in succession. For the UK, a growth rate of 2 per cent is forecast. Domestic demand has stimulated growth there so far but public consumption and increased exports are now expected to be the main growth engines. For Denmark, Norway and Sweden, a growth rate of about 1½ per cent is forecast for this year.

Deflation continues in Japan

Economic growth in Japan was higher in the first half of 2002 than had been forecast. It slowed down thereafter due to slower private consumption which in turn was because of scant wage increases and unemployment which reached an historic high of 5½ per cent. Economic growth was marginally positive in the fourth quarter of 2002, mainly because of price deflation. Deflation has reigned in Japan for the past four years. Since it threatens to persist, the risk exists that consumer and business spending decisions will continue to be put off. In addition the real value of debt would tend to increase due to deflation. GDP is expected to shrink in the first half of this year, since consumer and business expectations are declining. Investment is forecast to decline and the stock market prospects are dim. Stock prices are at a 20-year low due to high corporate debt and a shaky banking system. Exports, however, are expected to increase and help growth prospects.

Fairly strong growth in Asia and Africa; less in Latin America

Economic growth in the Asian region has outpaced expectations and prospects for continued growth are strong despite the slowdown in the information technology sector. Moreover, the share of Asia in international trade has been large. Growth in China has mainly been driven by domestic demand despite a growing current account surplus. Public investment and rising real property prices have also supported growth. These growth factors are expected to decline in importance and future growth therefore depends upon necessary economic restructuring. Russian growth has been substantial and is expected to continue, mainly due to investment, particularly in the oil sector, and rising private consumption. Continued investment, however, is dependent upon no further delays in structural reforms. Inflation should continue to decline since the exchange rate appears to be strengthening. An inflow of foreign investment is holding up growth in Middle and Eastern Europe. Rising oil prices have benefited the Middle East, whereas hostilities in the area have hampered growth. Prospects are brighter for Latin America at present after a deep recession in 2001 and 2002. Weaknesses are, however, still at hand in countries like Argentina, Brazil and Venezuela where demand is still weak. The outlook is promising for a number of developing countries, particularly in Africa, where growth is proceeding due to better public governance, a cessation of hostilities, rising raw material prices and the cancellation of some foreign debt under the HIPC-initiative of the IMF and the World Bank. Economic growth is expected to increase in Africa this year despite ongoing difficulties, such as bad weather conditions, diseases and famine.

Oil prices are set for an uncertain decline

Oil prices rose sharply in the second half of 2002 and early in this year due to the risk of war in Iraq and strikes in Venezuela, which restricted supply. At the end of last year, world oil stocks were at their lowest level for a number of years. Oil prices began to decline after the Iraqi war began, and prospects are that it will continue to decline if the war is short-lived. This present forecast of the Ministry assumes that oil prices will rise by 10 per cent this year to 26½ dollars a barrel, declining to 24 dollars in 2004.

Rising króna exchange rate and lower international interest rates reduce Iceland's debt service

International interest rates have been declining which in turn reduces Iceland's interest cost on foreign debt. The decline in the dollar exchange rate also helps since it reduces the service of dollar debt. The dollar declined by 25.5 per cent against the króna in 2002 and 40 per cent of Iceland's foreign debt is in dollars. Close to 40 per cent of foreign debt is in euros and the euro/króna rate declined by 7.5 per cent in 2002. The average interest rate on foreign debt was just over 5 per cent in 2001. Since most of the debt is on a floating rate basis, the interest cost will have declined in 2002 and so far this year. As can be seen in the table above, the dollar interest rate is expected to decline by 0.2 per cent this year, euro rates by 0.9 per cent and yen rates are assumed unchanged. The current level of interest rates is expected to remain broadly unchanged for the remainder of this year until the middle of next year when they should begin to gradually rise.

No major change in marine products expected in the near future

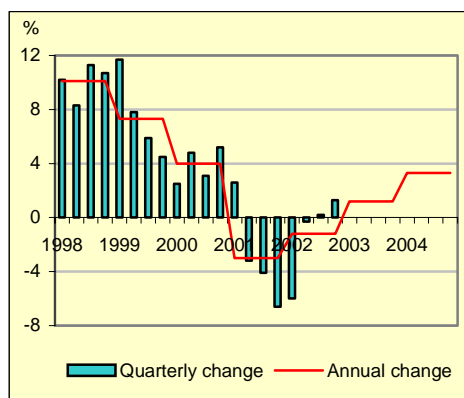
Prices for marine products, calculated in foreign currency, rose by 4 per cent in 2001 and 3.5 per cent in 2002. For this year, a 1 per cent increase is assumed and 2 per cent in 2002. This is broadly in line with general price changes and prices are therefore expected to remain largely unchanged in real terms. The rising króna exchange rate will mean, however, that the domestic currency proceeds from exports will decline. The present forecast assumes that the króna exchange rate will appreciate slightly until 2005-2006 after which it is likely to decline.

Aluminium prices are declining

Aluminium prices declined by 4.3 per cent in foreign currency terms in 2001 and by a further 3.4 per cent in 2002. The present forecast assumes a further decline of 3 and 2 per cent this year and next, respectively. Since the forecast for world inflation is about 1½-2 per cent, the real price decline is slightly higher. In the long run the nominal price increase is estimated at about 1½ per cent a year. Forecasts on aluminium prices are, however, subject to much uncertainty and forecasters disagree widely; some predict increases and others declines between 2003 and 2004.

Private consumption

Development of private consumption



Source: Statistics Iceland.

Provisional figures indicate that private consumption declined in 2002 for the second year in a row, by 1.2 per cent. This follows a 3 per cent decline in 2001, or 4.2 per cent for the two years together. By comparison, the purchasing power of disposable income rose in both years, by 5.8 per cent total or 4.4 per cent per capita.

The contraction in private consumption is largely attributable to increased household indebtedness in previous years. This led to an increased debt service burden which in turn meant that the increase in purchasing power was not translated into increased consumption. The rise in purchasing power has thus increasingly been used to repay household debt. The increase both in household asset accumulation and debt slowed down in 2002. Debt rose by 7 per cent and assets by 3 per cent. The slow increase in assets is due to the fact that the increase in pension fund assets was close to none whereas housing and vehicle assets increased by close to 5½ per cent.

The voluntary private pension savings accounts have also contributed to increased household saving. In 1998 up to 2 per cent of employee pay could be put into such accounts that are tax exempt. This was increased to 4 per cent at the beginning of 2000 and as of May of the same year, employers were obligated to pay a 1 per cent counter-contribution against 2 per cent employee savings. The employer contribution was increased to 2 per cent at the beginning of 2002. In addition, the government contributes up to 0.4 per cent on top of the employee contribution. This means that an individual who saves 2-4 per cent of his pay in an individual retirement account will get a counter-contribution of 2.2-2.4 per cent from the employer and the government. Participation in such optional saving rose sharply last year. It is now estimated that 70 per cent of employees contribute a part of their pay to such accounts. Although it is possible that other forms of saving have suffered in competition with this savings form, the total savings of households have undoubtedly increased as a result of the introduction of this saving option.

There are several indicators in the early part of this year that point towards a renewed upturn in the Icelandic economy. Merchandise imports were 1.2 billion higher in the first two months of this year than in the corresponding period a year ago, an increase of 5 per cent at constant prices and exchange rates. Imports excluding ships and aircraft, also measured at constant prices and exchange rates, amounted to 14.7 billion, a 16 per cent real increase from last year. Vehicle imports have increased rapidly from last year, by 87 per cent, and the same goes for fuel imports. Imports of durable consumer goods rose by 29 per cent in February over the previous year and imports of foods and beverages rose by close to 6 per cent. Provisional figures on the collection of value added tax proceeds for March 2003 indicate that general imports rose sharply in that month. Imports other than ships and aircraft amounted to 15.5 billion as against 14.2 billion last year, a real increase of 21 per cent.

Other consumption indicators, such as the turnover on debit and credit cards for the first two months of this year are also increasing by 7 per cent in real terms over the previous year. The Gallup index of consumer expectations also rose in March for the third month in a row and has never been as high since measurement began in March 2001. The retail index of the Retailer and Service Association also shows that turnover in consumer non-durables increased by 4 per cent in February from last year, measured at constant prices. This index has been recorded since November 2001 on the basis of information from most retail establishments in the country dealing in consumer non-durables as well as from liquor stores and pharmacies. The index is deflated by the consumer price index for each product category by the consumer price index.

All told, it is forecast that private consumption will gradually revive, increasing by 1¼ per cent in 2003. The purchasing power of disposable income is expected to increase by close to 3 per cent which indicates that household saving will continue to increase this year. For 2004, a higher increase in private consumption is forecast in line with increasing purchasing power, one of 3¼ per cent in real terms, since the economy is forecast to accelerate increasingly in that year.

Public consumption

Public consumption rose by 2.9 per cent in real terms in 2001. It is estimated to increase by 3.1 per cent in 2002 of which the central government increase is less than that of the municipalities. For 2003, the increase in public consumption is expected to be less, or about 2¼ per cent in real terms. This forecast is based on the central government budget and the financial plans of the municipalities. Public consumption is expected to increase less in 2004, or by about 2 per cent. Both central government public consumption and municipalities' consumption is expected to increase less in 2004.

The following table shows the development of public consumption as a share of GDP.

	Prov.	Est.	Forec.	Forec.
Billion krónur, current prices	2001	2002	2003	2004
Public consumption.....	175,0	194,7	205	216
Share of GDP.....	23,6	25,2	25 ¼	25
Central government consumption	100,5	111,5	117	122 ¾
Share of GDP.....	13,6	14,4	14 ½	14 ¼
Municipal consumption.....	58,4	65,5	69 ¼	73 ¼
Share of GDP.....	7,9	8,5	8 ½	8 ½
Social security consumption.....	16,1	17,7	19	20
Share of GDP.....	2,2	2,3	2 ¼	2 ¼

Source: Statistics Iceland and Ministry of Finance.

The share of public consumption in GDP is measured at 25.2 per cent in 2002, up from 23.6 per cent a year earlier. For 2003, public consumption is expected to be a similar share of GDP but in 2004 the increase is expected to be lower. The share of central government consumption in GDP is declin-

ing after having increased marginally in 2001 and 2002, whereas the share of municipalities and the social security sector is expected to remain constant, following an increase in 2002.

The following table shows the estimated breakdown of public consumption in 2001-2004.

Wages and associated benefits make up the largest part of public consumption. Their share comes to nearly 63 per cent in 2001 and has been increasing since then, or to 63½ per cent in 2002 and is expected to reach 64 per cent in 2003 and 2004.

	Prov. 2001	Est. 2002	Forecast 2003	Forecast 2004
Billion krónur, current prices				
Public consumption	175,0	194,7	204 ¾	215 ¾
- Wages and benefits.....	109,5	123,7	131 ¾	138 ¼
- Depreciation.....	14,8	16,3	17 ¼	17 ¾
- Purch. of goods and services..	50,7	54,7	55 ¾	59 ¾
Percentage breakdown				
Public consumption	100,0	100,0	100,0	100,0
- Wages and benefits.....	62,6	63,5	64 ¼	64
- Depreciation.....	8,5	8,4	8 ½	8 ¼
- Purch. of goods and services..	29,0	28,1	27 ¼	27 ¾

Investment

Following a sharp upturn in 1999 and 2000, business investment has declined in the past two years, or by 14 per cent in 2001 and by a further 19 per cent in 2002. By that year, business investment had declined to 10 per cent of GDP compared with 16 per cent in 1998.

The decline is evident in most branches of the business sector, following a sharp increase in most branches in 1998-2000. Investment in the fisheries sector declined by 14 per cent in 2001 and 56 per cent in 2002. In the metals sector the decline was 19 per cent in 2001 and 24 per cent in 2002. Investment in power projects and electricity distribution tends to fluctuate between years. Investment by power companies rose by 16 per cent in 2001 but declined by 7.6 per cent in 2002. Investment in hotels and restaurants increased however and the supply of hotel space in the capital area rose by 10 per cent last year and is estimated to increase further by 5 per cent this year.

Business investment has declined

Rising investment is forecast for coming years

Business investment is forecast to increase by 15½ per cent in 2003 and further by close to 20 per cent in 2004. This increase is already showing up in investment goods imports which rose by 6 per cent in volume in the first two months of this year over a year ago.

Following the decline in business investment in past years, the need for renewal investment is increasing as to maintain productive capacity of enterprises. It is therefore forecast that business investment not connected to the power investment projects will increase marginally in the next two years. This will be offset by the strong exchange rate of the króna which will have an adverse effect upon export companies and discourage them from investing. Investment in fishing and fish

Increasing activity of real property and leasing firms

processing is thus thought to decline this year. Construction of new fishing boats and renewals of older ones is at a low this year. Investments in the communications sector rose sharply in the latter half of the nineties in the wake of technological innovation and increased liberalisation in that sector. These investments declined sharply in 2001 and 2002 but it appears that these investment are reviving this year. In this connection, the proposed undersea cable between Iceland, the Faeroe Islands and Scotland is a major project in this sector. Furthermore, plans for the construction of a steel pipe plant at Helguvík are under way. The plant is expected to produce 175 thousand tons of steel pipes annually. The total cost of the project amounts to 6.5 billion krónur, the bulk of which will be spent in 2004. The plant is scheduled to begin production at the beginning of 2005.

Real property and leasing firms have grown rapidly in recent years. The investment of such firms has increased and investment of other sectors, have commensurably declined. Increased privatisation of the public sector has transferred investment from the public to the private sector. This may be expected to continue over the next several years.

As noted earlier, some of the largest investments ever undertaken in Iceland are to take place over the next several years. The estimated cost of electrical power generating plants and aluminium plants at Reyðarfjörður and Grundartangi is expected to total 280 billion, over half of which will be in the form of imported investment goods. The investment will be distributed over the period 2003 to 2010, with the peak of construction taking place in 2005 and 2006.

Power project and aluminium plant investments in the East...

The estimated cost of the Kárahnjúkar power plant and the Reyðarfjörður aluminium plant amounts to 184½ billion krónur, of which the power plant accounts for 98½ billion and the cost of the aluminium plant and harbour facility to 86 billion at the average March exchange rate. Preparatory work on the power plant has already begun and the aluminium plant will commence construction in 2005 and is scheduled for completion in 2007. Full production capacity of 322 thousand tons a year is expected by 2008.

... with simultaneous expansion of the Grundartangi plant

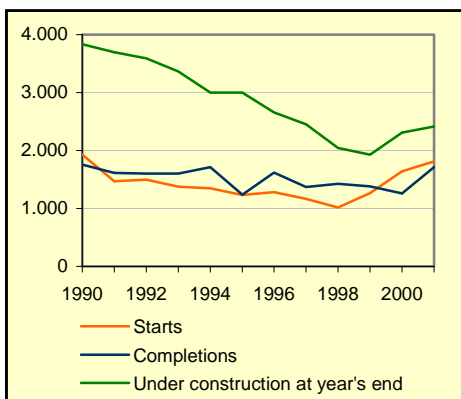
The Norðurál company's plant at Grundartangi is scheduled for expansion from 90 thousand to 240 thousand tons in two phases. The first phase will increase the plant's production capacity by 90 thousand to 180 thousand tons and be completed by 2005 with the latter phase of 60 thousand to 240 thousand tons scheduled for completion in 2009. The main part of the first phase will take place in 2004 and 2005 and the second phase mostly in 2008 and 2009. A government bill passed by the Althingi this spring states that the investment cost of expansion to 240 thousand tons is estimated at 41 billion krónur at the average March 2003 exchange rate. The cost of the first phase of the expansion is estimated at 26 billion and the latter phase at 15 billion krónur. The power for the expansion will be provided by Landsvirkjun through the construction of a reservoir at Norðlingaalda which will ex-

pand the production capacity of existing power plant in the Þjórsá river basin. In addition the Suðurnes Power Company plans to construct a geothermal power station at Reykjanes and expand its facility at Svartsengi, whereas the Reykjavík Power Company intends to expand its power station at Nesjavellir.

As noted earlier, the first phase of the Norðurál expansion at Grundartangi and the construction of the Alcoa aluminium plant at Reyðarfjörður will to some extent coincide, with about half of the total investment taking place in 2005 and 2006. The total investment in power projects and aluminium plants over the 2003-2010 period would amount to 280 billion at 2003-prices. Needless to say, investments of such magnitudes will have a profound impact on total investment over the next several years. The share of these investments in gross fixed investment is estimated at 10 per cent in 2003 and 18 per cent in 2004. This proportion is expected to increase considerably at the peak of the construction period, up to 31 per cent in 2005 and 2006. These investments are expected to peak at 7.7 per cent of GDP in 2005.

Residential construction and the real property market

Residential construction, number of housing units



Source: Statistics Iceland, Valuation Office.

The economic expansion from 1996 to 2001 brought with it a sharp increase in residential construction in 2000 and 2001 or by nearly one-fourth over the two years. The upswing took some time to be reflected in the housebuilding sector, in part because at the beginning of the upswing there was already a substantial supply of housing on the market, thus delaying demand pressures with commensurate price increases in real property.

The slowdown in the economy since early 2002 has set its mark upon housebuilding. The supply of new housing increased much less in that year than in the previous two years, although housing prices have continued to increase. According to provisional figures, housing investment is estimated to have increased by some 5 per cent in real terms in 2002. A survey of construction activity indicates that there will be a slight increase, of 1¼ per cent, in 2003 whereas a larger increase, 4½ per cent, is forecast for 2004 due to the impact of power project investments upon the overall economy.

Investment in housing is not only influenced by the business cycle but also by the supply of building land among other factors. Housebuilding activity in Reykjavík is expected to be similar to last year's level. A total of 850-900 housing starts are estimated for Reykjavík in 2002, a volume similar to last year. A large part thereof will be built in a new subdivision that will not commence until late in the year. Housebuilding activity is expected to pick up in the suburbs surrounding Reykjavik and be quite lively in the course of this year, as is also expected to be the case in towns in the Southwest region of the country, whereas in other areas housebuilding activity is expected to be moderate. The power projects in the Northeast region are not expected to have much of an impact this year, but housebuilding is expected to revive in coming years after a number of years of almost no construction of homes.

A comparison with other countries reveals that residential construction in per cent of GDP is about average, at 4-5 per cent of GDP, as is shown in the following table.

Residential construction in selected countries

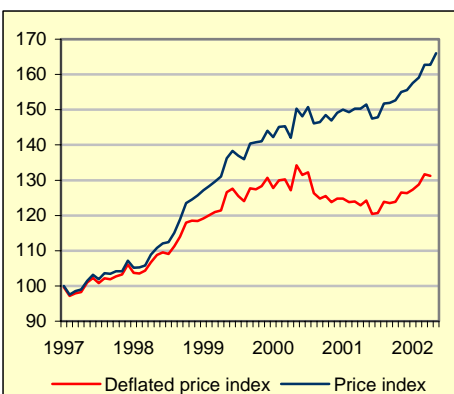
In per cent of GDP	1985-2001	1990-1995	1996-2001
Germany	6.7	7.1	7.2
Finland	5.1	4.8	4.2
Iceland	4.6	4.8	4.1
Denmark	3.9	3.4	3.8
U.K.	3.3	3.2	2.9
Sweden	3.2	3.9	1.6

Source: OECD, Statistics Iceland

Real Property Prices and housing credits

Although inflation has receded rapidly this past year, real property prices have continued to edge upwards, reflecting in part increasing demand for housing at the same time as overall consumer demand has been waning, especially for consumer durables. There are a number of explanations for this disparity. The rules of the government-run Housing Fund were relaxed in 2001 when low-income buyers were granted credits of up to 90 per cent of the purchase price. This has had a substantial impact upon the real property market by increasing demand from low income buyers who are now able to obtain 40-year mortgages at favourable terms. On the supply side, the sales restrictions on owner-occupied social housing units were lifted. Previously, such housing units, which originally were sold to owners at comparably favourable terms, could only be sold back to municipalities at an imputed, cost-plus price which generally was below market value in expansion areas. Following the elimination of such restrictions the supply of such housing units increased. The relaxed credit rules of the Housing Fund have particularly increased demand for smaller apartments, which is where price increases have been particularly pronounced.

Real property prices



Source: Valuation Office

The accompanying chart shows real property prices for the entire country and these have consistently been rising on a nominal basis. This index is based on all real property sales agreements which are registered with the Valuation Office. This index rose by 8.3 per cent in the twelve months up to December 2002 and by 3.4 per cent in the twelve months a year earlier. For comparison, an index of the property price in multi-unit apartment houses in Reykjavik, deflated by the consumer price index, is also shown. This latter index shows that the real property price peaked early in 2001, declined until the spring of 2002 after which it resumed its increase. The twelve-month increase until December 2002 amounted to 6.2 per cent. The price increase in real terms must be seen against the fact that the consumer price index rose rapidly in the course of 2001 whereas from early 2002 the pace of consumer price increases slowed down rapidly. Nominal real property prices progressed more evenly.

The government-run Housing Fund is the main lender in the home property market. Its loans to purchases of pre-owned housing have increased rapidly in the past two years whereas housebuilding credits have not increased as much. The num-

Mortgage lending for pre-owned housing increases sharply

ber of loans for pre-owned housing increased by 8 per cent in 2002 and the total amount by 18 per cent. The increase in the total amount reflects higher property prices, an increase in the maximum amount lent in each transaction since early in 2001 and, last but not least, the rise in the credit ceiling up to 90 per cent for low-income purchasers. Such low-income supplemental mortgages rose by 65 per cent from 2001 to 2002 to an amount of 4,836 million krónur, and the number of such supplemental credits rose from 1,747 in 2001 to 2,592 in 2002 or by 48 per cent. This is undoubtedly one of the main reasons why real property prices continued to rise in 2002 despite a slowdown in aggregate demand.

Credits from the Housing Fund are, with certain minor exceptions, actually not paid out in cash. Instead, the borrower hands in a mortgage note and receives government-guaranteed housing bonds with a 4.75 per cent interest rate in return. The borrower actually pays 5.1 per cent. The difference

Lending activity by the State Housing Fund

	2000	2001	2002	Change % 2001-02
Number of loans				
Pre-owned housing.....	7,112	7,353	7,951	8.1
New construction by individuals...	1,861	2,250	2,062	-8.4
New construction by contractors ...	115	183	119	-35.0
Refurbishments	195	269	270	0.4
New constr. and refurb., total	2,171	2,702	2,451	-9.3
All credits, total	9,283	10,055	10,402	3.5
Amounts in millions of krónur				
Pre-owned housing.....	19,561	20,097	23,698	17.9
New construction by individuals...	7,650	9,454	10,229	8.2
New construction by contractors ...	588	1,166	814	-30.2
Refurbishments	385	553	539	-2.7
New constr. and refurb., total	8,622	11,173	11,582	3.7
All credits, total	28,183	31,270	35,280	12.8

Source: State Housing Fund

of 35 basis points is used to cover the costs and eventual defaults incurred by the Fund. The borrower uses the housing bonds in lieu of currency to pay the seller who in turn can sell them in the market, keep them as an investment or use them in turn in another property transaction. Since the actual yield on such bonds in the market will fluctuate according to supply and demand, the yield is of considerable importance in the real property market. The higher the yield, the lower is the market price. In other words, the market yield and the market price are actually mirror images of each other.

The graph next page shows the discounts on housing bonds (issue IBH 37 1215) from the beginning of 2000. The discounts rose rapidly in the first half of 2000, peaking at 15 per cent and fluctuating between 8 and 12 per cent up to the middle of 2002 when they began to decline in concert with a declining market yield. By the end of March 2003 the discount was down to about 2 per cent. A lower discount means that the buyer has a more valuable means of exchange – the housing bonds- to pay with which, ceteris paribus, must facilitate his transaction with the seller.

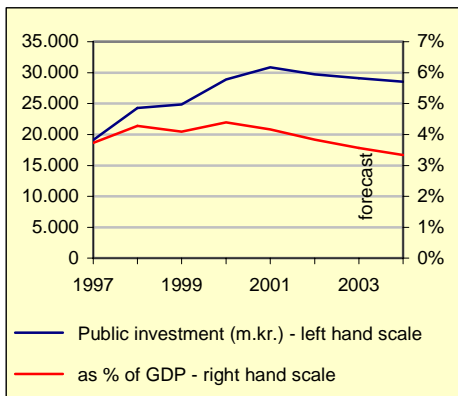
Housing bond discounts in per cent from par value



Source: Íslandsbanki.

Public investment

Public investment



Source: Statistics Iceland.

Merchandise exports

It is difficult to forecast the development of property prices for the near future. The present forecast assumes that property prices will rise in concert with general prices, i.e., by about 2-2½ per cent a year. This may be assumed to be on the low side, especially in 2004 when the forecast predicts a marked increase in residential construction.

Public investment covers all investment activity of the central and municipal governments, such as roads, bridges, sewers and related construction, buildings and other tangible investments. Investment by public enterprises, such as power projects, electricity, cold and hot water distribution systems, harbours, airports etc. is classified as business investment outside the public sector.

According to the 2003 central government budget, total investment amounts to 17.9 billion, an increase of 3.7 per cent over the 2002 estimate. Furthermore, a supplementary budget was passed in March of this year, providing for an additional 4.7 billion in investment in 2003 and a further 1.6 billion is scheduled for investment in the first half of next year, a total of 6.3 billion. The investment of the central government therefore amounts to a total of 22.6 billion in 2003, an increase of about one-third over the 2002-estimate.

In national accounting terms, central government investments are expected to amount to 16½ billion in 2003, about a third more than in 2002. For 2004, a decline is expected from the relatively high level of accelerated investment activity scheduled for this year.

Plans by municipalities for 2003 indicate that their investment activity will be unchanged in volume terms from 2002. Several municipalities have, as the central government, accelerated their investments for this year, but most of those are in municipally-run services that are classified as business investment. Plans by municipalities for 2004 are not at hand, but the Ministry of Finance forecast assumes that municipal investment will increase by 2 per cent in real terms.

Total public investment, of both the central and municipal governments, is forecast to increase by just over 14 per cent in 2003 and contract by close to 9 per cent in 2004.

Merchandise exports amounted to 203 billion krónur in 2002, an increase of 7 billion over the previous year. Exports rose by 6 per cent in volume terms but only by 3 per cent in value, reflecting a 2 per cent reduction in export prices. In constant exchange rate terms, exports rose in all four quarters from a year earlier except in the fourth quarter when they declined by close to 6 per cent.

As before, marine products provided the bulk of exports, 63 per cent, increasing by 5 billion in value and 4 per cent in volume. Fishmeal and herring products increased most, by 30 per cent in value and 6 per cent in volume, reflecting a large price increase. The value of fish products frozen at sea

increased on the other hand by 15 per cent in value and 19 per cent in volume, indicating that prices declined by 3 per cent.

Aluminium exports accounted for about one-fifth of total exports last year, declining by 2 per cent in value and increasing by 10 per cent in volume; prices dropped by 11 per cent.

Exports of other manufactured goods accounted for 14 per cent of total merchandise exports in 2002. Pharmaceuticals, medical equipment and electronic weighing scales are large items in this group, in addition to ferro-silicon. Exports of pharmaceuticals nearly doubled in volume from the previous year, increasing by 74 per cent in value and amounting to 6 billion krónur. Medical equipment exports amounted to 3 billion krónur, a volume increase of 30 per cent. Exports of electronic scales contracted by 33 per cent in volume and amounted to 2 billion.

In the first two months of this year, merchandise exports increased by 4 per cent over the corresponding period in 2002, calculated at a constant rate of exchange. The present forecast indicates a rather slow increase in exports, one of 0.8 per cent for the whole of this year. Marine production is forecast to be about unchanged and the same may be said for aluminium. Exports of other goods are forecast to increase by 4 per cent, particularly of manufactured goods.

Production of marine products is expected to increase by a small margin, 2 per cent in volume. Aluminium production is forecast to remain unchanged and other export production is expected to increase by 5 per cent. Total exports are therefore estimated to increase by $2\frac{1}{4}$ per cent in 2004.

Merchandise imports

Total merchandise imports amounted to almost 191 billion in 2002, a decline of 12 billion from the previous year. The decrease in volume was just over 3 per cent. It appears that the decline was reversed in the closing months of the year. Imports declined by 6 per cent in the first nine months of the year, calculated at a constant rate of exchange, whereas in the last quarter imports increased by 6 per cent over the corresponding quarter a year earlier.

General imports, i.e., excluding ships and aircraft, declined by 10 billion in 2002. Imports of investment goods made up the bulk of the drop, 8 billion krónur or 16 per cent in real terms. Total imports of consumer goods only declined by 1 per cent, following a 10 per cent drop in 2001. Imports of durable and semi-durable consumer goods, which includes appliances and clothes, declined most, by 6 and 8 per cent respectively.

Import figures for the first three months of this year indicate that domestic demand is gradually reviving with general imports increasing by 10 per cent in real terms over the corresponding period in 2002. The present forecast expects this to continue. Total imports are forecast to increase by $3\frac{3}{4}$ per

cent in 2003 and 6¼ per cent in 2004 which primarily reflects rising general imports, although the influence of power project imports are also of importance, particularly in 2004.

Trade balance

Last year's trade surplus amounted to 12½ billion krónur, 1.6 per cent of GDP. This is the first such surplus since 1997 and represents a substantial reversal from the record of recent years; in 2000 the trade deficit amounted to 6 per cent of GDP. The surplus in 2002 is both due to reduced import demand and increased exports. Merchandise exports have increased by 14 per cent since 2000 and imports declined by 13 per cent, both calculated at a constant rate of exchange. The present forecast predicts a 6 billion krónur trade surplus this year but next year's trade is expected to be about in balance.

The balance on services

The largest items on the services accounts are transportation and travel, but it also includes computer and commercial services as well as culture. The surplus on services amounted to just over 1 billion krónur in 2002, down from 2 billion in 2001. Travel by Icelanders abroad declined by 6 per cent at a constant exchange rate in 2002, whereas travel income from foreigners rose by close to 3 per cent. The foreign exchange earnings of airlines and shipping companies rose by nearly 5 per cent and expenditure by close to 10 per cent. Other service income declined by 4 billion, partly because of a decline in revenue from telecommunications and computer services.

No major changes are expected in the balance of services this year. It is forecast to yield a small surplus, one of about half a billion krónur. Rising transportation costs, partly due to increased investment goods imports related to power projects, is expected to leave services about in balance in 2004.

The balance of factor income and payments

Factor income includes repatriated wages of Icelanders from abroad, interest and dividends of Icelandic assets abroad, whereas factor payments cover interest on foreign debt, dividends paid to abroad on foreign assets in Iceland and exported wage incomes of foreigners in this country. Net factor income has been in deficit for many years due to interest payments on external debt which constitutes the largest item on this account. The decline in debt and declining interest rates did much to reduce such expenditures in 2002, by about one-fourth, calculated at a constant exchange rate. Incoming interest and dividend payments from Icelandic assets abroad increased by 3 billion krónur or 19 per cent at a constant exchange rate. All told, the balance on factor income and payments was in deficit by 13.2 billion krónur in 2002. This year, it is expected to deteriorate to 15¼ billion and further to 16¼ billion in 2004.

The current account yielded a surplus last year for the first time since 1995, equivalent to 0.2 per cent of GDP, reflecting the turnaround in the trade balance since 2000 plus reduced interest payments in 2002. These two items were instrumental in winding down the current account deficit which amounted to 67 billion krónur in 2000, 10 per cent of GDP.

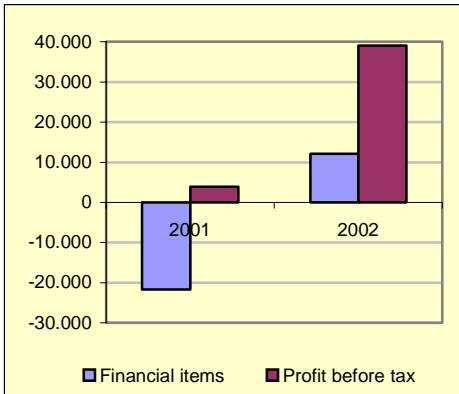
The current account balance

Prospects for the current account balance in 2003 and 2004 are primarily influenced by the forecast upswing forecast for the economy. The sharp increase in investment forecast this year is expected to lead to a 9½ billion krónur deficit, equivalent to 1¼ per cent of GDP. The same applies to 2004 at which time private consumption is expected to be rising which may increase the current account deficit to 17 billion or 2 per cent of GDP.

External position

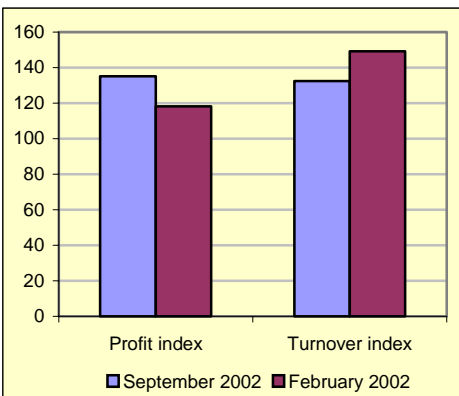
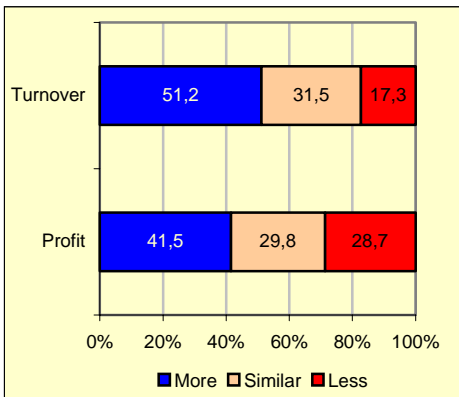
The external position of the economy has improved as a result of the turnaround in the current account deficit. The external debt inevitably rose in the upturn until the year 2000, mostly because of increased indebtedness of households and businesses. The decline in the króna exchange rate in 2001 also led to a deteriorating debt position; in that year the net external position amounted to 76 per cent of GDP. This ratio declined marginally in 2002, to 75 per cent. The ratio is expected to edge downward both in 2003 and 2004 in spite of an increase in the current account deficit; It is forecast at 69 per cent this year and 68 per cent in 2004.

Profits of companies listed on the Stock Exchange, excluding financial and insurance firms, million krónur.



Source: Icelandic Stock Exchange.

Gallup survey results



The operating environment of business enterprises has changed considerably in the past two years. Inflation increased sharply in 2001 following a decline in the króna exchange rate. Export competitiveness thus improved and their revenue increased. Inflation receded rapidly in 2002 and the exchange rate strengthened. Interest rates have declined and corporate taxes have been reduced. Export revenue in krónur terms was hurt by the strengthening króna exchange rate and the competitiveness of export firms weakened. The impact of these fluctuations is clearly discernible in the financial items on company statements and in their foreign debt.

In order to show the development of company earnings in 2002, a summary of 53 companies listed on the Stock Exchange has been compiled in addition to two companies that have listed their debt issues with the Exchange. The compilation seeks to adjust for differences in accounting practices as well as in cases when companies merge and no consolidation of accounts for earlier years is shown. Earnings of these companies were generally favourable in 2002. Their total profits before tax amounted to 54 billion krónur compared with 13 billion a year earlier. Operating income did not increase as much but financial items were considerably more favourable than in 2001 which did much to improve their profits. An important factor was that the exchange rate index declined by 12 per cent from the beginning to the end of 2002 after having increased by 18 per cent in 2001. These changes in the exchange rate have naturally impacted upon company revenues and costs, even if the króna exchange rate only strengthened by 3 per cent between the averages of 2001 and 2002. The króna strengthened by 13½ per cent from the beginning to the end of the year which does much to explain the turnaround from a net deficit on financial items of 22 billion in 2001 to a surplus of 11 billion in 2002. The combined profits before tax of all the above companies increased from 3 per cent of revenue in 2001 to 11 per cent in 2002. Excluding financial firms, profits rose from 1 per cent to 9 per cent, respectively. The graph in the margin shows clearly how financial items affected profits.

The Ministry of Finance in co-operation with the Central Bank, has hired IMG Gallup to regularly survey more than 300 companies with the largest turnover regarding their expectations and intentions. The first survey was conducted last autumn and the second in February of this year. The surveys are summarised into an index which in due course will give comparison over time. The index is computed by counting the number of positive and negative answers, dividing the former with the sum of the two to form an index number ranging between zero and 200. A number of 100 would indicate an equal number of positive and negative answers. The February survey reveals that 51 per cent of the companies surveyed thought that their turnover would increase this year and 17 per cent thought it would decline. The rest, 32 per cent, assumed that turnover would be about the same as in 2002. The turnover index stood at 149.5 as against 132.4 last September.

Summary of accounts of 55 companies listed on the Stock Exchange

				Gross profits	Financial items	Profits before tax	Profits before tax	Cash flow from operating activities
	Number of firms	Operating revenue, million kr.		p.c. of revenue	p.c. of revenue	p.c. of revenue	p.c. of revenue	p.c. of revenue
Marine production								
	2002	19	188.779	10	4	9	8	8
	2001	19	183.634	12	-6	2	9	4
Manufacturing								
	2002	15	94.625	14	0	10	10	8
	2001	15	75.854	14	-3	7	11	2
Commerce and services								
	2002	12	94.242	13	3	8	11	14
	2001	12	91.586	13	-7	-1	8	5
Transportation								
	2002	2	56.224	13	2	9	14	12
	2001	2	56.363	5	-4	-6	4	5
Finance and insurance								
	2002	7	70.185	-	-	21	17	31
	2001	7	59.253	-	-	15	30	29
Total								
	2002	55	504.055	-	-	11	11	13
	2001	55	466.690	-	-	3	11	7
Total excl. financial firms								
	2002	48	433.870	12	3	9	10	10
	2001	48	407.437	12	-5	1	9	4

The profits index was on the other hand lower in February than last September, 118.2 as against 135.1. Nevertheless, 41 per cent of the companies expect greater profits this year than last, 29 per cent that they will decline and 30 per cent about the same.

Manufacturing

Revenues of manufacturing companies rose substantially last year, to a large extent because of increased exports. Their gross profits (i.e., profits before depreciation and financial items in per cent of revenue) remained unchanged, whereas depreciation increased and profits before tax increased by 3.7 billion krónur or 72 per cent. Three-fourths of this increase is attributable to improved financial items, the rest to increased revenue. Cash flow from operating activity in per cent of revenue increased by 6 per cent between years.

The pharmaceuticals changed radically last year through a merger of the largest companies. The Icelandic companies also took over foreign companies and erected new factories in Europe. The assets of pharmaceutical companies doubled and revenue increased by 15 per cent. The full benefits of these changes have yet to emerge.

In the above summary, 15 companies are classified as manufacturing and production companies. The Gallup survey covers 67 companies in this category of which 55 per cent anticipate increased turnover this year and 24 per cent about the

same. About half or 46 per cent expect profits to increase this year and one-fourth that it will be about the same. Half the companies believe that the number of staff members will be about the same but the number of companies that expect to add staff is slightly greater than last September.

Commerce and services

This group covers commerce, information services and the oil companies. Their revenue increased little, gross profits remained unchanged but profits before tax increased significantly, from a loss equivalent to 1 per cent of operating revenue to an 8 per cent profit. This is explained by a turnaround of 9 billion krónur in financial items.

The combined revenue of companies in the information services category increased between 2001 and 2002 due to an increase in revenue of only a handful of companies; those of the rest declined. Gross profits of these companies increased from 17 per cent of revenue to 19 per cent between the years. Oil company revenue declined by 5 per cent between years and their gross profits by 1 per cent. Oil company profits before tax increased on the other hand which is primarily due to exchange rate profits and asset stakes in other companies. Revenue of companies in the commerce sector increased marginally between years; their gross profits remained unchanged and profits before tax amounted to 8 per cent of revenue as against a loss the year before.

Of the 90 companies in commerce and services surveyed, 54 per cent thought that turnover would increase this year and 9 per cent that it would decline. The turnover index for this sector was the highest at 175 points as against an average of 150 for all sectors. Companies in this sector were generally optimistic as regards profits; 58 per cent thought they would increase and 20 per cent that they would decline, giving a profits index of 142 compared with 152 in the last survey. Only companies in the finance and insurance sectors have a higher index of profit expectations.

Transportation

The two transportation companies listed on the Stock Exchange, Icelandair and Eimskip (The Icelandic Steamship Company), turned from a combined loss of 1.7 billion krónur in 2001 to a profit of 3.3 billion in 2002. Gross profits increased by 11 per cent of revenue. Three fish processing companies merged with Eimskip, but the fisheries activities of the merged company have been separated from the company's accounts and included in the fish processing sector.

The gross profit of these two companies, excluding fish processing activities, increased by 8.3 billion krónur to 9 per cent of operating revenue compared with a 6 per cent loss in 2001. This is primarily attributable to a change in financial items which reverted from a 2.4 billion krónur expense in 2001 to a 1.3 billion krónur surplus in 2002. Gross profits increased from 5 per cent to 13 per cent. The change in working capital also increased from 4 to 14 per cent of revenue.

Finance and insurance

Operating revenue of financial and insurance firms increased by close to 11 billion krónur, most of which is attributable to the banks. Profits before tax increased to 21 per cent of operating revenue compared with 15 per cent in 2001. According to the Gallup survey, companies in this sector generally expected a similar or increased turnover this year than last and that profits will be higher or similar. Only 13 per cent of companies expect profits to decline, the lowest for all the sectors surveyed. The profits index turned out to be highest in this sector at 160 compared to an average of 118 for all sectors as noted earlier.

Fisheries sector

The operating revenue of the fisheries sector as a whole increased little between years. Profits before tax rose on the other hand by 14 billion krónur which is attributable to financial items which reverted from a an expense of 11 billion in 2001 to a surplus of 7 billion in 2002. Gross profits declined from 12 per cent of revenue in 2001 to 10 per cent in 2002. Cash flow from operating activities increased by 4 per cent between the two years.

There was a sharp difference in the financial items of fisheries and fish processing companies on the one hand and the fisheries sales companies on the other. They were nearly unchanged with fisheries sales companies whereas with the fisheries and fish processing companies they made a turnaround of 18 billion krónur between the two years.

There were 34 companies in the fish processing sector in the Gallup survey as against 19 in the above summary. The February survey revealed that fish processing companies were mainly inclined to assume that turnover and profits would decline this year from 2002. About 53 per cent of the companies surveyed thought that turnover would contract and the same proportion that profits would decline. Only 9 per cent of the companies assumed that profits would increase and 18 per cent anticipated an increase in turnover. This contrasts to expectations last autumn when 52 per cent thought that profits would increase and 44 per cent expected an increase in turnover this year. There are few sectors that are as dependent upon the exchange rate, and expectations in this sector are primarily based on expected exchange rate developments. The turnover index for this sector was 41 as against 150 for all companies and the profits index was 23 against an average of 118.

Company profits 2000 - 2001

A summary of operating statements and balance sheets of companies that filed electronic tax returns in 2000 and 2001 has been compiled. The following table shows profits of about 10,500 companies that filed electronic returns for both years.

The equity of these companies improved between years in spite of losses. Equity capital increased from 24 per cent in 2000 to 29 per cent of total assets in 2001. The same applies to companies excluding finance, insurance and energy producers their equity ratio rose from 35 per cent to 42 per cent between 2000 and 2001.

Billion krónur	All companies			Excl. finance, insurance and energy generation		
	2000	2001	P.c. change	2000	2001	P.c. change
Operations:						
Revenue	809	956	18	740	874	18
Expenditure	780	912	17	718	834	16
Post-tax profit.....	-7	-12	72	-15	-16	3
In p.c. of revenue...	-0.9	-1.2	46	-2.1	-1.8	-13
Balance sheet:						
Balance sheet total	1,941	2,462	27	1,046	1,397	34
Debt	1,476	1,750	19	677	815	20
Equity	465	712	53	369	582	58

Profits by sector

The table below shows operating revenue and the ratio of profits after taxes to operating revenue for several sectors that filed electronic tax returns for both years.

	Operating revenue			Post-tax profit in p.c. of revenue	
	2000	2001	% change	2000	2001
Agriculture and forestry	5	6	24	-4	-15
Fisheries	34	48	42	-4	1
Food and beverages.....	108	133	23	-6	-1
Metals processing	14	17	21	-4	0
Construction.....	61	70	15	2	1
Other industry.....	67	78	15	-10	0
Commerce and diverse services.....	282	324	15	1	-1
Real property sales, leasing and computer services	28	32	16	-8	-12
Finance and insurance.....	70	82	18	12	5
Other commerce and professional services.....	30	34	13	16	1
Hotels and restaurants	19	20	7	-3	-6
Communications.....	68	83	23	-1	-2

The largest turnover by far is in commerce and diverse services which includes the sale and repair of motor vehicles, petrol stations, wholesalers, commission agents and retailers. The food and beverage industry is another large sector which includes fish processing. The profit after tax in commerce and services reverts from 1 per cent in 2000 to a 1 per cent loss in 2001 whereas in the food and beverage industry the loss is reduced from 6 per cent in 2000 to 1 per cent in 2001.

The profit after tax is reduced in eight sectors. The largest change is in the sector “Other commerce and professional services” where the profit after tax declines from 16 per cent to 1 per cent. This sector includes professional services such as those of lawyers, architects, advertising agencies and photographers. Profits in agriculture also deteriorated substantially, from a 4 per cent loss in 2000 to 15 per cent in 2001. Four sectors improve their profits after tax between years,

for example fisheries – from a 4 per cent loss to 1 per cent profit – and “Other manufacturing” which broke even in 2001 following a 10 per cent loss in 2000.

Fisheries and fish processing

Statistics Iceland has compiled a summary of operations of the main branches of fisheries for 2001, based on accounts of 160 companies as shown in the following table where fisheries proper and fish processing is shown separately.

	Fisheries				Fish processing			
	2000		2001		2000		2001	
		p.c. of revenue		p.c. of revenue		p.c. of revenue		p.c. of revenue
Total revenue	64.3		76.0		Total revenue	68.8	93.2	
Total expenditure	51.5	80	57.5	76	Total expenditure	63.7	75.1	81
Wages	24.2	38	28.7	38	Wages	10.8	11.9	13
Oil	6.2	10	6.6	9	Raw materials	43.2	50.2	54
Maintenance	5.1	8	5	7	Maintenance	1.6	2.2	2
Fishing gear	3.2	5	3.1	4	Packaging	1.2	1.8	2
Foreign sales costs	2.7	4	3.2	4	Transport costs	1.0	2	2
Other	10.1	16	10.9	14	Other	5.9	7	8
Gross profits	12.9	20	18.6	24	Gross profits	5.1	18.1	19
Depreciation	9.3	14	8.7	11	Depreciation	4.1	2.6	3
Financial items	8.2	13	11.5	15	Financial items	4.2	7.4	8
Net profits	-4.6	-7	-1.6	-2	Net profits	-3.2	8	9

Source: Statistics Iceland.

Profits from regular operations of both fisheries and fish processing improved in 2001, especially of fish processing which recovered from a 4.7 per cent loss in 2000 to an 8.6 per cent profit in 2001. Revenue increased by 18 per cent in fisheries and 36 per cent in fish processing and expenditures in both sectors declined in relation to revenue, especially in fish processing. The largest cost item in fisheries are wages and the crew’s share of the catch proceeds. This item increased by 19 per cent between years but is a similar percentage of revenue by fisheries companies in both years. The cost of raw materials is the largest item amongst fish processing inputs. It increased by 16 per cent between year but declined in relation to revenue. Wages in relation to revenue declined also whereas wage costs rose 10 per cent between the two years.

Fish processing has been run with meagre profits in recent years. Since 1997, fish processing has been run at a loss for two years, in 1999 and 2000. Profits in 1997 were 0.8 per cent of revenue from regular operations, 3.2 per cent in 1998 and 8.6 per cent in 2001. All branches of fish processing were run at a profit in 2001 except for shrimp processing which ran at a 2 per cent loss.

Fisheries did better in the first half of this period, making a 7-9 per cent profit in 1997-1999, whereas losses were incurred in 2000 and 2001, as is shown in the table. Not all branches of the fisheries sector were run at a loss. Freezing trawlers made a 6 per cent profit in 2001 whereas boats in excess of 200

gross register tons, capelin boats and trawlers that iced their catch operated at a considerable loss, 11-13 per cent of revenue.

The impact of the exchange rate on companies in marine production is crucial. A part of fisheries revenue is due to direct sales of the catch abroad, particularly from freezing trawlers. The domestic price of landed catches is also to some extent exchange-rate related. The same applies to the landed catch bought by fish processors. The revenue of fish processing is therefore mostly export earnings and thus subject to fluctuations in the exchange rate. Seamen's pay is based on a share of the fish catch whereas workers in fish processing ashore are paid according to general wage agreements. Oil prices are determined by the exchange rate and world market prices whereas maintenance, the cost of fishing gear, packaging and other inputs follow general domestic cost changes. It has been pointed out that a strong króna exchange rate tends to lead to the sale of unprocessed fish catch directly abroad or that the catch will be processed at sea. There is some truth to the assertion that the cost of fish processing at sea moves more in line with the exchange rate than the cost of fish processing ashore and fish processing at sea is therefore able to adjust earlier and better to changes in revenue as a result of changes in the exchange rate.

The total fish catch came to 2.1 million tons in 2002, the second largest catch by Icelandic vessels in one year. The previous record was reached in 1997 when 2.2 million tons were caught. The difference in the fish catch from year to year is largely due to the catch of pelagic species such as capelin and, in recent years, blue whiting.

The catch of demersal species is estimated at 448 thousand tons in 2002 of which cod was 206 thousand tons, 28 thousand less than the year before. The total demersal catch is estimated to have been 9 thousand tons greater than the year before. The latest report of the Marine Research Institute (June 2002) indicates that catches of cod, haddock and saithe may be increased in the next several years. The latest research expedition of the Institute this past March indicates that the 2002 cod class is average and haddock stronger than average. The same expedition confirms that the 2001 class of both cod and haddock are poor.

The flatfish catch amounted to 35 thousand tons in 2002, 2,500 tons more than the year before, all of which is due to an increase in the Greenland halibut catch. The Marine Research Institute estimates that the catch of the Greenland halibut may be increased to 30 thousand tons over the next several years after which the stock of this species will remain in balance. The catch of other flatfish changed little.

The catch of pelagic species amounted to 1,592 thousand tons in 2002 as against 1,467 thousand tons the year before. The capelin and herring catch increased and that of blue whiting declined, since the blue whiting catch was subjected to quota for the first time. In 2002, 94 thousand tons of the Icelandic

Catch and catch prospects

Catch of Icelandic vessels

Thousand tons	2001	2002	Changes %
Cod.....	234	206	-12
Cod from Barents Sea.	6	6	0
Haddock.....	40	50	25
Saithe.....	32	43	34
Redfish.....	50	67	34
Oceanic redfish.....	42	44	5
Wolffish.....	18	14	-22
Other demersal.....	16	19	19
Greenland halibut.....	17	19	12
Plaice.....	5	5	0
Other flatfish.....	11	11	0
Herring.....	101	94	-7
Atlantic-Scandian herring.....	78	127	63
Capelin.....	924	1.083	17
Blue whiting.....	365	286	-22
Shrimp.....	26	29	12
Shrimp from the Flemish Cap.....	5	6	20
Lobster.....	1	2	100
Scallops.....	7	5	-29
Other.....	9	13	44
Total.....	1.987	2.129	7

Source: Directorate of Fisheries.

Pelagic catch

summer spawning herring was caught compared with 101 thousand tons in 2001. The catch season is soon coming to an end; last year it ended in February. The catch has been meagre as in previous years; at the end of March, 30 per cent of the quota was still not caught. The catch of the Norwegian-Icelandic herring was considerably larger, 127 thousand tons, increasing by 49 thousand tons from the previous year. The total herring catch was 42 thousand tons larger last year than in 2001.

Prospects for the catch of Norwegian-Icelandic herring and capelin are somewhat unclear. An agreement has not been reached with the Faroe Islands, Norway, Russia and the European Union regarding the catch. Last year, none of the catch was caught within Iceland's economic zone. It was last caught there in 1998. About one-fifth was caught in international waters. The Icelandic catch therefore depends on where the herring is going to be found if an agreement cannot be reached. The capelin catch quota in the present fisheries year is 765 thousand tons as against 1,096 thousand tons last year, a decline of 30 per cent. The Marine Research Institute has conducted two expeditions in search of capelin this year and has found almost none. Ocean temperatures are unusually high and the capelin may therefore stay in other waters than usual. Little can therefore be said about the coming capelin season which starts at the end of June.

The shrimp catch

The shrimp fleet competes for its catch with certain fish species in the ocean, mainly cod. The catch of shrimp in shallow waters has declined sharply in recent years. It amounted to 10 thousand tons a decade ago and has come down to 2 thousand tons last year. This is thought due to the inroads of cod and haddock into shallow waters of fjords and bays where shallow-water shrimp has been caught. Deep-sea shrimp catches have also declined, from 55-65 thousand tons in 1994-1997 to 23 thousand tons in 2001. The catch increased to 27 thousand tons in 2002. The quota for this year is 30 thousand tons and was 35 thousand tons in the last fisheries year. Prospects for the scallops catch are poor since the external conditions in nature have caused the stock to collapse. This year's quota is sharply reduced from last year and has nearly been exhausted. The 2002 catch is just over 5 thousand tons.

Exports of marine products

Exports of marine products amounted to 127.7 billion krónur in 2002, an increase of 4.6 per cent. Prices increased marginally between years and volume rose by 4.5 per cent. The share of marine products in total merchandise exports came to 63 per cent. The main export of marine products were fish products frozen ashore. Fish frozen at sea, salted fish and meal and fish oil each account for 21-24 billion. Exports of fish meal increased most, by 39 per cent.

As noted earlier, the króna exchange rate strengthened in 2002 and so far in 2003. The average exchange rate index was 122 in March compared with 129 last November. The stronger króna has a positive impact on various cost items such as oil which should decline in price as well as prices of other im-

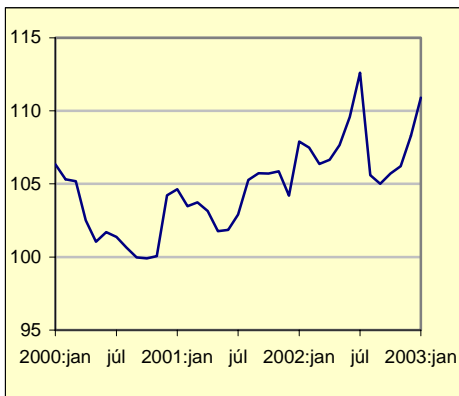
ports. This is offset by rising world oil prices in recent months due to the situation in the Middle East. The cost of oil amounted to 11 per cent of total fisheries expenditures in 2001. A stronger exchange rate also positively affects the financial items as 65 per cent of the fisheries sector's debt is in foreign currency.

Price indices for fisheries products

Price indices for fisheries products, calculated in SDR-terms, tended to fluctuate from month to month in the course of last year. They peaked in mid-summer after which they dropped sharply but have been increasing recently. Last January the price was 3 per cent higher than at the same time last year. The price index of fisheries products was 3.3 per cent higher on average in 2002 than the year before. Prices differ between products. For demersal species (60 per cent total value) prices were 1 per cent lower than in 2001, whereas demersal fish products frozen ashore rose by 2 per cent and of salted fish by 5 per cent. Shrimp prices are still quite low; last year's price was lower than in the previous year and 24 per cent below the 1999-price. Shrimp exports still made up 10 per cent of the value of all fish exports, a similar share as in 2001, compared with 11 per cent in 1999.

In spite of the stronger króna exchange rate, the krónur price index for fish products has remained fairly stable since last August. The average index from August 2002 to January 2003 was 153, compared with the six-month peak, from September 2001 to February 2002 of 175, a difference of 13 per cent. The average index for 2002 declined by 2 per cent from 2001 but was 22 per cent higher than in 2000.

**Marine product price index in SDR
1990=100**



Source: Statistics Iceland.

There are few signs that prices for fish products will change significantly this year. According the expectations index of Europeans for their personal finances this year, there are six nations that expect their finances to remain unchanged, two expect them to improve and seven to deteriorate somewhat. A decline in the catch quota of European Union nations will probably be offset by a decline in private consumption. Fish from fish farms has not become a significant competitor to the sales of caught fish. The health properties of fish products should also contribute to more consumption. Increased knowledge of the nutrition value of different foods and a more informed discussion of health problems should contribute in the same direction. The discussion of overfishing could discourage consumption of fish products since the public does not realise that there are many different species of fish. This discussion has been going on for several years and is increasing in the wake of the decision of the European Union to reduce catch quotas.

Power-intensive industry

The production of power-intensive companies increased by 8 per cent in volume in 2002. This is mostly due to the Norðurál plant at Grundartangi which reached full productive capacity during the year. Production of the Alcan plant at Straumsvík rose also. Aluminium prices have been declining

in the past two years. Prices are expected to decline further in real terms over the next several years due to ample supply in the world market.

As noted earlier in this report, large-scale investments in the aluminium industry are being planned over the next several years. Alcoa intends to construct a 322 thousand ton-a-year plant at Reyðarfjörður and Norðurál at Grundartangi plans to expand its plant in two phases from 90 thousand to 240 thousand tons. The Alcoa plant is scheduled for completion in 2007 and to reach full productive capacity by 2008. The former phase of the Norðurál expansion is scheduled to be completed in 2005 and the latter in 2009. These investment will increase aluminium production by nearly 180 per cent from the 2002-level.

When both these projects are completed, the share of aluminium in merchandise exports is forecast to reach 32 per cent compared with 19 per cent in 2002. The share of the aluminium industry in GDP is projected to reach 9 per cent.

Tourism

The number of foreign travellers to Iceland reached 278 thousand in 2002. Data for 2001 are not available since Iceland joined the so-called Schengen agreement in that year which meant that the number of incoming travellers were no longer counted. Counting was resumed in February 2002 at the time of departure. The estimated number for 2001 is 295 thousand which means that the number of travellers declined by 6 per cent, following a 3 per cent decline in 2001. The number of overnight stays in hotels increased however by 7 per cent in 2002 and 2 per cent in 2001.

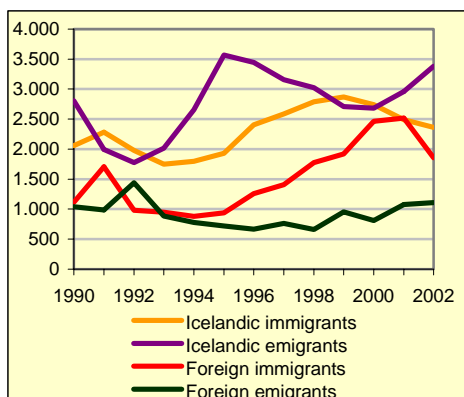
There was a temporary downturn in world tourism from the middle of 2001 until the middle of last year. Tensions in the Middle East have done much to discourage tourism and it is apparent that in April and May of this year there is going to be a slump. A revival will depend on the progress of the Iraqi war. The lung epidemic in China has also dampened tourism.

The króna exchange rate has a major impact on tourism services in Iceland. Most of the tourist service companies are small with little equity. Revenue is in foreign currency and contracts with tour operators are often concluded many months in advance so that the local operators must carry the exchange risk. Tourists are also able to cancel their trips at short notice. The cost of forward cover for small companies is generally high, partly because of the cancellation risk, and therefore not a realistic alternative. Domestic cost and debt is usually in krónur terms for small companies. Only the larger companies can avail themselves of foreign capital. Exchange rate fluctuations make tourism operations especially difficult since they affect marketing in competition with other countries.

THE LABOUR MARKET

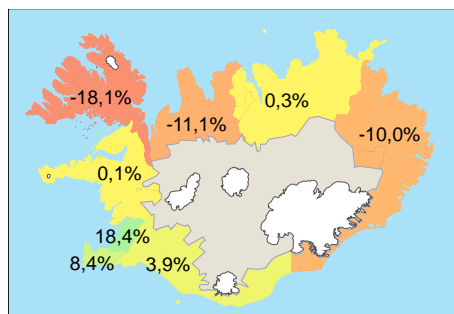
Population developments

Migration by citizenship



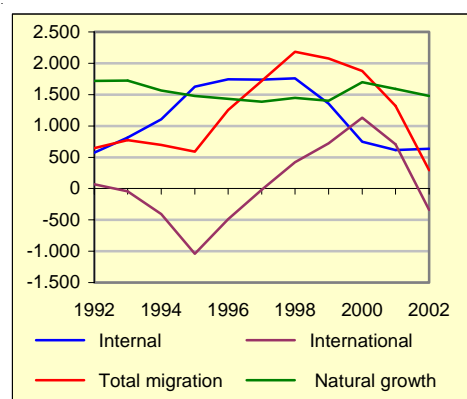
Source: Statistics Iceland.

Population development 1992-2002, %



Source: Statistics Iceland.

Migration and natural population growth in the capital area



Source: Statistics Iceland.

Iceland's population increased by 0.7 per cent in 2002. The rate of increase in the population has been steadily declining since 2000 when it came to 1.5 per cent. This is mainly due to reduced immigration in spite of fewer births than for a long time or since 1986. The natural rate of increase (births in excess of deaths) has been between 2,000 and 2,500 in the last seven years.

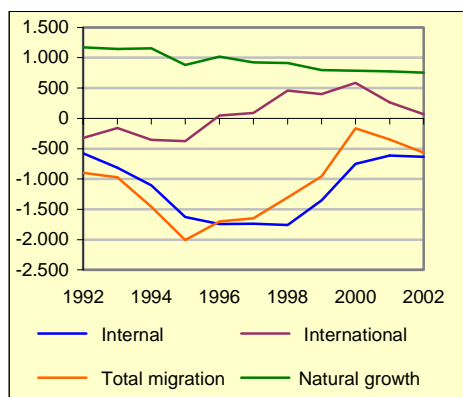
The rate of population increase in Iceland is still considerably higher than nearly everywhere else in Europe, due to a high birthrate in recent years in addition to considerable immigration. Net immigration has been reversed. It amounted to 1,714 persons in 2000 whereas in 2002 net emigration came to 275 persons. In 2002 net immigration of foreign citizens amounted to 750 and net emigration of Icelanders amounted to 1,020. The chart shows the development in recent years. Immigration of foreign citizens declined sharply last year to 1,855 whereas emigration remained constant. The number of Icelandic citizens emigrating increased whereas immigration declined. A breakdown of immigration of foreign citizens by sex shows that such immigration is fairly evenly divided between men and women whereas in earlier years there were more women immigrants than men.

Population developments have diverged widely by region. The map in the margin shows population shifts by region in the past ten years. The total population has increased by 10.2 per cent in this period. In the capital area, there has been a population boom, an increase of 18.4 per cent. Population in the capital area grew faster in 1995-2000 than in any other region in the Nordic countries (see www.nordregio.se). Population on the Western Peninsula declined by almost a fifth, and on the East Coast and in the North-West by 10 and 11 per cent, respectively. Population remained about the same in the North-East and the Mid-West, whereas it increased marginally in the South. Outside the capital area, the increase was greatest on the Reykjanes Peninsula, 8.4 per cent. Population increases in urban centres have almost exclusively taken place in the capital area and its environs, from Akranes to the western part of the Árnes county to the Reykjanes Peninsula.

The composition of the population has changed radically in the decade shown in the chart. The graph in the margin shows several factors that explain this. Migration from the outlying regions to the capital area were greater in the mid-nineties than ever before, when 1,700-1,800 persons moved to the capital area each year. This internal migration has largely subsided since 1999 and the net migration has come down to about 600 a year in the past two years. It is not certain whether this migration can be any less in the long run.

The graphs also show the impact of immigration and emigration on the development of the population. Net immigration from abroad added more than 1,100 to the capital area in 2000, a record number. This influx has subsided; last year, net emigration to abroad from the capital area came to 340 persons.

Migration and natural population growth in the peripheral areas



Source: Statistics Iceland.

The regions outside the capital area have had a net influx of immigrants since 1996, although it has declined in recent years in line with declining demand for foreign labour.

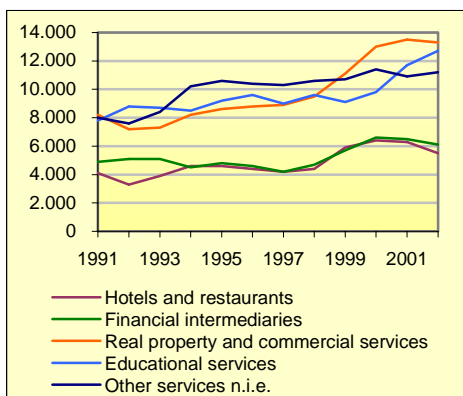
These figures on population shifts in recent years seem to indicate that there are fewer regions that are experiencing population declines. The presently planned power-intensive investment in the Northeast will contribute to a different population distribution over the next several years. A decline in population is mainly to be expected on the Western Peninsula and the Northwest region.

In recent years, migration has been the principal determinant in population developments. This applies both to the country as a whole and individual regions as well as to the labour force. Net migration has now subsided for a while. The eastern part of the country will experience new investment activity which will attract population to that area which in turn will reduce migration from the outlying regions to the capital area. The substantial economic growth that is expected to take place over the next several years will deter Icelanders from emigrating. To some extent, a renewed influx of foreign immigrants will depend on the need for additional labour in sectors primarily served by foreigners.

The labour force

According to the labour market surveys of Statistics Iceland, the labour force declined by 2,300 persons in 2002. The same surveys show that unemployment increased by 1,600 persons. This represents a sharp reversal, since from 1997 to 2001 there was a steady increase in employment which rose by 17,000 persons, or 12 per cent. The increase was mostly in the services sector, as the share of services in the labour force rose from 65 to 70 per cent.

Employment in selected services



Source: Statistics Iceland.

The accompanying figure shows the development of selected industries in recent years. There has been a large increase in the number of persons in the category *real estate and business activities*, which includes leasing and rental services, research and development, computer services and software development, accounting and legal services, a variety of professional and consulting activity for enterprises, advertising and security services. This sector employed 7,200 persons in 1992; a decade later it had increased to 13,300 or by 85 per cent. Yet, employment in this sector declined by 200 in 2002 and in fact the rate of increase in employment in this sector had slowed down before that time.

On the other hand, there seems to be no slowdown in the growth of the education sector where there seems to be no decline in employment in 2002 although it is evident elsewhere in the labour market. The increase in the number of employed in this sector since 1999 is about 3,600 or 40 per cent. This increase is in line with a large increase in the number of students at the secondary and higher education stages, in addition to a sharp increase in education outside the traditional school system. The number of students in secondary education increased by 5.6 per cent in 2002 and by 15 per cent at the university level.

The financial sector expanded rapidly from 1997 to 2000. During this period, employment increased by 2,400 or 57 per cent despite the fact that traditional banking went through considerable rationalisation in this period. A part of this increase has now been reversed. By 2002, employment was down to 6,100, a decline of more than 7 per cent from its peak. The hotel and restaurant sector developed closely in line with financial services throughout the nineties. These sectors are about equal in size. Employment in the hotel and restaurant sector peaked at about 6,400 in 2000. Since then, employment has declined by 900 or about 14 per cent.

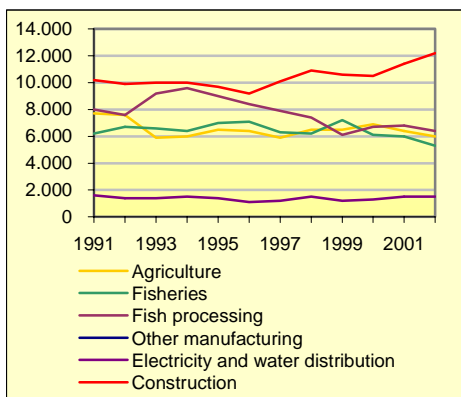
The category *other services* includes non-profit associations, sports, arts and cultural activity and personal services. Employment in this category increased in the first half of the nineties but from then on growth has been slower and has fluctuated. The largest service sector in employment terms is *health and social services*. Employment there increased in the first half of the nineties, but from 1994 to 2000 it was nearly unchanged at 21,000. Employment in 2002 came to 21,600 persons, a decline of 500 from the previous year.

Developments have not been as rapid in the more traditional sectors of the economy as in the services sectors. Nevertheless, employment has increased in the construction sector in the past three years, after being nearly unchanged for a decade. Since 2000, employment has increase by 1,700, or 16 per cent. In manufacturing excluding fish processing, employment has declined by 1,500 since 2000, from 17,500, or by 8.5 per cent. Employment in fish processing declined almost steadily through the nineties, and also in 2002. Employment in this sector peaked in 1994 at 9,600, but by 2002 it had declined by one-third to 6,400. Total output of marine products for export has however increased in volume in recent years, indicating that productivity is increasing. Employment in fisheries has been fairly steady in recent years, about 6-7,000, whereas that number shrunk by 700 in 2002. The total catch, which is largely made up of capelin and other pelagic species, increased with large fluctuations in the nineties. There is therefore not much of a correlation between the total catch and manpower in fisheries.

According to labour market surveys, employment in agriculture has been fairly steady in recent years until 2000, after which it declined from 6,900 by 500 or 7 per cent. Employment in traditional farming has declined and meat production has been substantially rationalised, whereas vegetable and hot house production has increased. Tourist services by farmers have increased sharply in recent years. The value of agricultural production at constant prices increased by 11 per cent from 1993 to 2000 according to the Agricultural Service Board.

The composition of the labour force has changed considerably in recent months. There were clear signs that employment growth had receded whereas different sources of information were in conflict. The labour market surveys of Statistics Iceland have indicated that labour market participation

Employment in traditional industries



Source: Statistics Iceland.

has been reasonably stable, although participation by older age groups has increased while that of the below-25 years group has declined sharply.

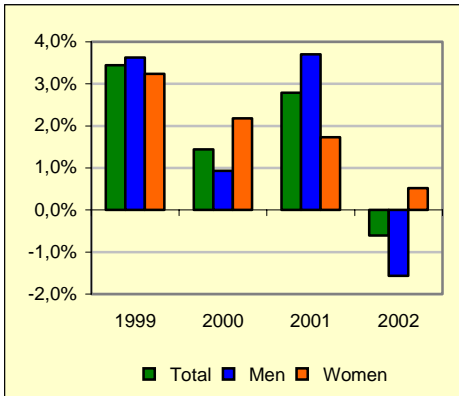
Another estimate by Statistics Iceland, based on PAYE tax records, presents a different picture. From 1999 on, the annual growth rate was 3 per cent, far above the natural increase in the population of working age. The rate of increase in the male labour force declined already in the first quarter of 2000 down to the natural rate of increase whereas the number of women increased faster. The increase over the natural rate can only take place through immigration or increased participation or both at the same time. The participation rate rose again in 2001 in excess of the natural rate, particularly among men. This was reversed in 2002 as regards men although the number of women continued to increase. The number of men declined in the first three quarters of 2002 from the corresponding period of the previous year whereas the number of women still continued to increase, even faster than in the two previous years. In the fourth quarter of 2002, however, employment shrinks for both sexes by 2 per cent. For the year as a whole, labour force participation by men declined by 1.6 per cent whereas for women there was an increase of 0.5 per cent.

The labour market surveys of Statistics Iceland indicate that labour market participation by men has been declining in recent years but increasing for women. This information leads to the conclusion that the increase in the number of men in the labour market in excess of just over 1 per cent a year is all due to immigration of foreign labour. Labour market participation by women increased up to 2002, both due to immigration and increased domestic participation. In 2002, the participation rate of women declined and therefore up to half of the increase in the number of women in the labour market is explained by immigration.

Contrary to the usual pattern, unemployment did not decline over the summer in 2002. Unemployment continued to increase in the autumn months by 10-15 per cent each month. It is not until March of this year that there are signs that unemployment has ceased to increase. At the time of writing, the number of unemployed stands at about 6,100 and has not increased for five weeks.

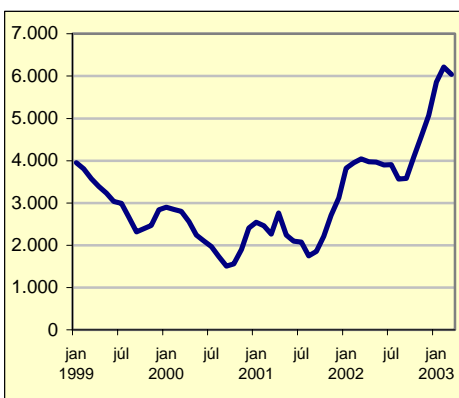
A closer inspection of unemployment data shows that the number of unemployed for less than one month has not increased markedly. For men, the number has been around 400-500 in recent months with the exception of January when 760 men had been unemployed less than four weeks. Unemployed women have been 200-400 in number for most of the period shown in the charts. From this, one may conclude that the number of those who have lost their jobs and registered unemployed has not increased significantly, although the total number of unemployed has increased considerably. The difference is that those who re-entered the labour market after a month or more have not been able to get a job and are still

Annual change in labour force



Source: Statistics Iceland.

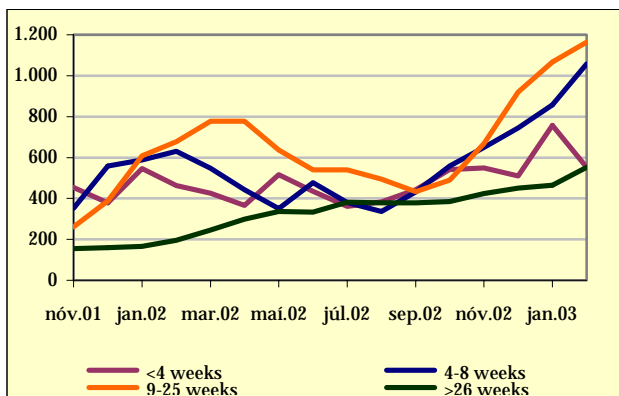
Registered unemployed at the end of each month



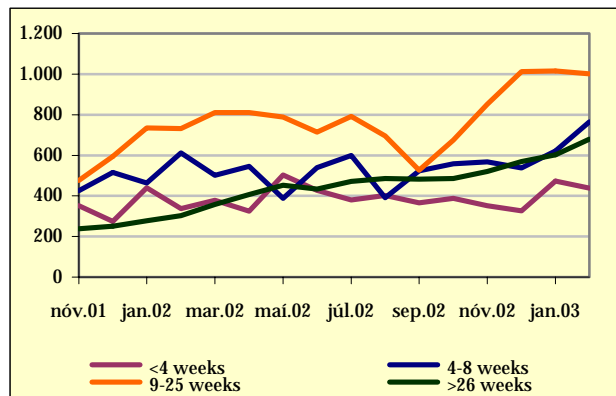
Source: Labour Directorate.

Unemployment by duration

Men



Women

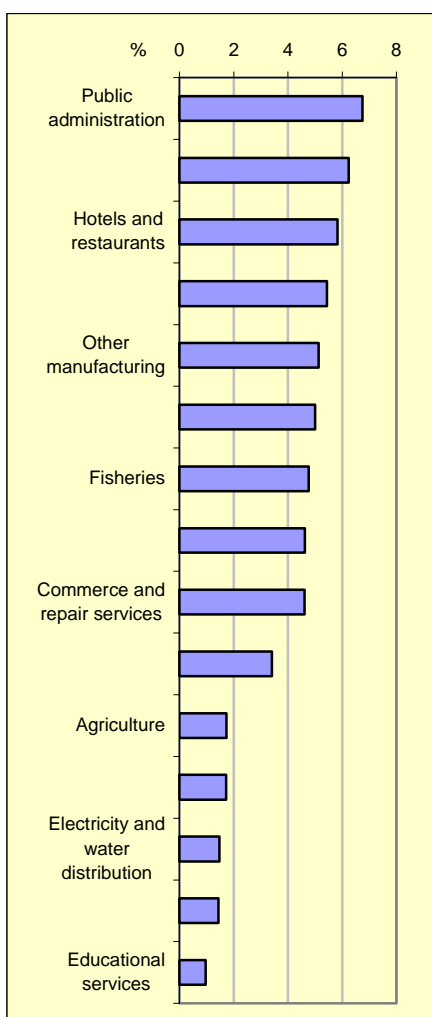


Source: Labour Directorate.

unemployed. The number of men and women who have been unemployed one to two months has steadily increased since August 2002 and the number of those who have been unemployed two to six months began to increase significantly about a month later.

Long-term unemployment, i.e. those who have been unemployed for more than half a year, has steadily increased during the period under consideration and the increase in total unemployment seems not to have significantly affected this group which consists of about 1,200 persons. Women outnumber men in this group but the number of men has increased faster than of women. It is generally thought that those who have been unemployed more than half a year will need special assistance to re-enter the labour market, such as re-training and counselling.

Relative unemployment by industry, March 2003



Source: Labour Directorate and Finance Ministry calculations.

Unemployment is registered by employment sectors. Data on the number of jobs in each sector, however, is lacking except for the labour market surveys which makes a further analysis difficult. The labour market surveys can only categorise imprecisely and are subject to uncertainty as all other data based on sample surveys. The sectoral classification of the Employment Office is not in line with the one used in the labour market surveys. This may create a discrepancy in the registration of the unemployed by sector according to the last place of employment. The Ministry of Finance has regrouped industrial sectors so as to make them as similar to those used by Statistics Iceland as possible. Discrepancies may still exist that can not be helped.

When unemployment was at its lowest in 2000 and 2001, its sectoral distribution was similar, in a range between 0.7 and 2 per cent in each sector and 1.8 per cent for all sectors, with the exception of fish processing, where unemployment exceeded 4 per cent, but towards the end of 2001 it had become similar to other sectors. Unemployment had begun to increase in various service sectors before it began to increase in general. It began to increase significantly in nearly all sectors at the beginning of 2001 which indicates a general contraction

throughout the economy. Exceptions were in the financial sector, education, health and social services and public administration.

Unemployment declined slightly over the summer of 2002, although not in all sectors. It rose again in the autumn and grew considerably from the previous winter. A sharp increase in public administration unemployment may be due to registration discrepancies. Unemployment in the education sector is still little, since growth in that sector has been pronounced. The financial sector has the second lowest unemployment, but those who have lost their jobs in that sector are less likely to register as unemployed than those in other sectors. There is also little unemployment in the health and social services sector. This sector, as education, uses trained personnel and is more likely to suffer from a lack of labour supply.

At present unemployment seems to have peaked, both in terms of numbers and per cent of the labour force. The acceleration in public investment, increased residential construction and power project investment will all help reduce unemployment this year. Unemployment is expected to continue its decline until power project investment reach their peak in 2006. Unemployment is expected to average 3 per cent of the labour force in 2003 but is forecast to have declined to 2¼ per cent by year's end. An average rate of 2 per cent is forecast for 2004. Discrepancies between supply and demand may, however, persist in the labour market, both in sectors and regions.

Inflation receded rapidly in the course of last year. The twelve-month increase in the consumer price index was 1.4 per cent last January compared with 9.4 per cent in the previous twelve months. The main cause of this reversal lies in the appreciation of the króna exchange rate which in turn affected prices of imports. For the first time in years, Icelandic inflation is below the EEA average. Inflation is forecast at 2-2½ per cent this year and next.

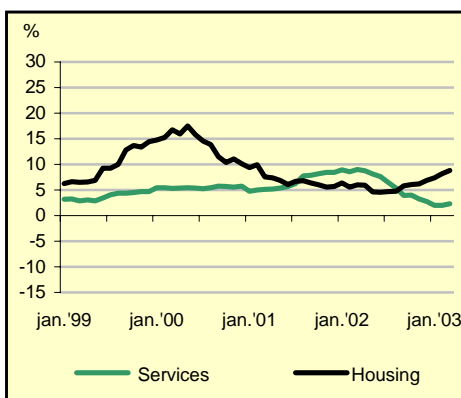
The rise in consumer prices last year was primarily due to price increases in housing and services. Property prices – as imputed into the consumer price index – rose by 7.4 per cent, public service charges by 4.8 per cent and other services by close to 5 per cent. The housing component accounts for about 15 per cent in the consumer price index and rising housing costs therefore amount to a 1.2 percentage point increase in consumer prices. As explained in the section on housing and the real property market, housing prices have risen in 2002 due to liberalised lending rules by the Housing Fund and declining long-term bond yields.

The services items in the consumer price index account for about one-third of the index basket which amounts to a 1.6 percentage point increase in consumer prices. In addition, liquor, wines and tobacco prices increased due to higher excise charges. So did petrol in line with rising world prices.

Prices

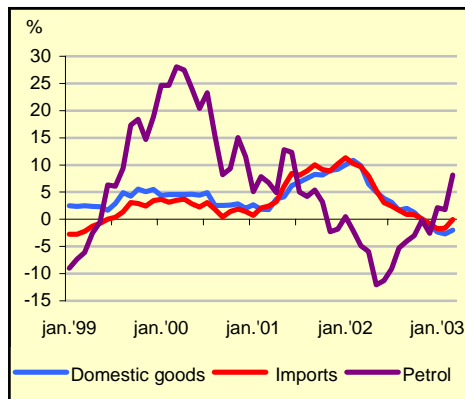
Property prices and services are the main causes of inflation

12 month price changes



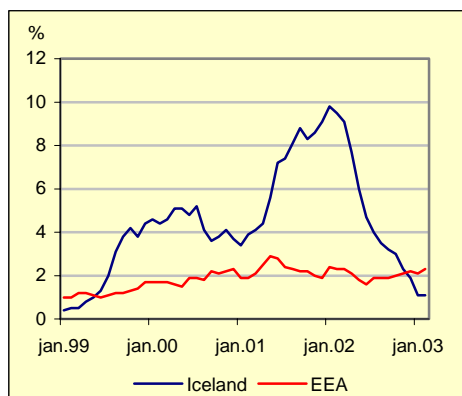
Source: Statistics Iceland.

12 month price changes



Source: Statistics Iceland.

Inflation



Source: Statistics Iceland.

Inflation forecast at 2 per cent 2003 and 2½ per cent in 2004

Merchandise prices declined in 2002 by a considerable margin, offsetting housing costs and services to a substantial extent. The decline was largely due to the appreciation of the króna exchange rate which reduced import prices. Average prices of foreign currencies declined by 12 per cent last year which led to a 1.8 percentage point decline in the import component of the consumer price index. Excluding alcohol, tobacco and petrol, import prices declined by more than 5 percentage points. Prices of imported food declined most, by close to 10 per cent.

Domestic food prices also declined, by 3 per cent, in part because of increased competition resulting from the exchange rate effect. Prices of vegetable produce declined most, by 24 per cent, farm products by 1.3 per cent and other domestic foods and beverages by 2.5 per cent.

All told, the consumer price index rose by 1.4 per cent from the beginning to the end of 2002. Two indices of core inflation are now calculated. Core index 1 consists of the consumer price index excluding domestic farm goods, vegetable produce, fruits and petrol. Core index 2 also excludes public service charges. Both core indices increased by 2 per cent, reflecting the rise in prices for indigenous services by 5 per cent and wages by 8 per cent.

The countries in the European Economic Area have computed a commonly defined consumer price index for each member country. According to this measure, Iceland's inflation came to 1.1 per cent in 2002 as against an EEA-average of 2.1 per cent.

The Ministry's present forecast predicts that consumer price inflation will be around 2 per cent in 2003, both within the year and on average from the previous year. The twelve month increase in the consumer price index was 2,3 per cent in April 2003 and it is therefore assumed that the rate of inflation will slow in the second half of the year. Inflation is expected to accelerate marginally in 2004 to 2½ per cent, both from this year and within the year. The increase is thought to come from increasing domestic demand in concert with power project construction activity. The inflation forecast is based on the assumption that the exchange rate index remains unchanged at 122 points, both this year and next and that nominal wages per capita will increase by 5 per cent this year and 6 per cent in 2004, including wage drift. Housing prices are also assumed to develop in concert with general prices, despite the fact that housing prices have proved to be one of the main causes of rising consumer prices in 2002.

The Ministry's forecast is similar to that of the Central Bank and other forecasters in the financial market. The forecast is also in line with general inflation expectations, such as is reflected in the inflation component of Treasury bond yields which fluctuates around 2 per cent for a 2-year paper.

Main uncertainties relate to the war in Iraq and the exchange rate

The uncertainty in the forecast centers around oil prices which in turn are related to hostilities in the Middle East. The development of domestic demand and the exchange rate could also affect inflation.

Oil prices increased sharply in the latter half of 2002 in line with increased war tensions and reduced supply. World oil stocks are lower than they have been for many years. Should the Iraqi war be brief, oil prices may rise in the first half of the year and then decline when the war is over. At this point, oil price developments are, however, uncertain and some have even maintained that the war may lower oil prices. The duration of the war is also uncertain and thus the extent of the impact on the international economy. Negative effects cannot be excluded if oil prices rise substantially and business and consumer confidence dampens.

The exchange rate of the króna constitutes another uncertainty. In addition to uncertainty due to the Iraqi war, it is thought possible that investors are overreacting to the impact of power project and aluminium investment in the short run, since the peak of the construction activity will not take place until in 2005-2006. Somewhat weaker prospects for the fisheries sector and reduced export earnings may also lower the exchange rate.

The present economic forecast projects a considerable increase in domestic demand, both this year and next. This is mostly due to increased investment. On the other hand, the increasing levels of household debt and the possible increase in private pension savings may constrain private consumption, particularly this year. Should the growth in private consumption turn out to be greater than forecast, it would lead to more imports and a larger current account deficit which in turn could affect domestic cost developments.

Household income

Wage agreements in effect until autumn 2003 and into 2004

Most wage agreements in the labour market will be in effect until the autumn of this year and into early 2004. These agreements included an annual revision clause stating that if prices rose above a certain limit, their wage clauses would come up for renegotiation. Such a revision would have been possible last February, but by that time the annual rate of inflation was down to 1.5 per cent on a twelve-month basis and 2.3 per cent for the past six months. These increases were well within the bounds of the agreements and a revision of the wage clauses therefore did not come to pass.

Additional wage increases at the turn of the year

Contractual wage increases at the turn of the year amounted to 3-3.4 per cent, 0.4 per cent more than originally agreed. This was because at a review of the wage agreements in December 2001 it was agreed, in light of the uncertain inflation outlook at that time, to raise previously agreed wage increases by 0.4 per cent. At that time it was also agreed to raise the employer counter-contribution to optional individual retirement accounts in pension funds to 2 per cent of wages as of the beginning of 2002 so as to match a 2 per cent contribution by employees. As of the middle of 2002, employers have paid

a 1 per cent contribution into private pensions schemes, regardless of whether employees contribute to these schemes at all.

Wage developments were broadly in line with expectations in 2002. The wage index of Statistics Iceland rose by 5.4 per cent in the twelve months up to December 2002, compared to 9.6 per cent twelve months earlier. The yearly averages diverged less; for 2002 the increase was 7.1 per cent and 8.9 per cent for 2001. The lower increase in 2002 was both due to lower wage rate increases as well as less wage drift.

Despite lower nominal wage increases in 2002, real wages – i.e. their purchasing power – continue to increase, averaging 2.2 per cent between 2001 and 2002, a similar increase as the year before. Lower nominal increases in 2002 were outweighed by reduced inflation. The difference is more pronounced when year-end figures are considered; purchasing power rose by 3.6 per cent in the year up to the end of 2002 compared with 0.5 per cent in 2001.

The two latest wage agreement rounds, in 1997 and 2000, have emphasised additional wage increases for the lowest paid. This has unquestionably paid off. The minimum wage amounted to 54,700 krónur a month in 1996; today it is close to 97,000 krónur, an increase of 77 per cent, compared with a 61 per cent increase in the general wage index. The increase in the purchasing power of the lowest paid thus amounted to 38 per cent in this period as against 26 per cent for average wages.

A comparison of the purchasing power of wages in Iceland with other OECD-countries shows that since 1994 it has increased by 25 per cent in Iceland as against 9 per cent in the OECD.

In the Ministry's forecast, wage costs per man-year are predicted to increase by 5 per cent between 2002 and 2003 and 6 per cent between 2003 and 2004. This forecast does not distinguish between contractual wage increases and wage drift. The large wage increases between 2003 and 2004 are primarily attributable to the impact of power project and aluminium plant investments. On the basis of the inflation forecast for 2003 and 2004, purchasing power would increase by 3 per cent in 2003 and further by 3½ per cent in 2004. Should this forecast turn out as expected, 2004 will be the tenth year in succession when purchasing power increases, a record for Iceland.

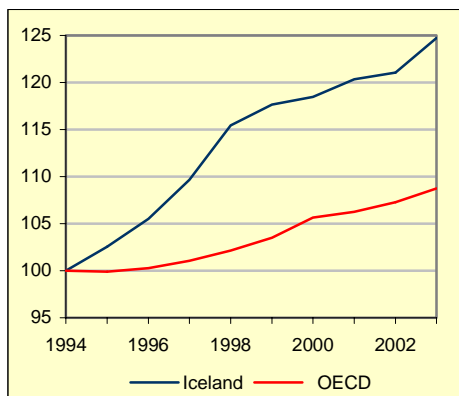
Social security benefits increased last year, following amendments to the Social Security Act and the Social Benefits Act in 2001. The changes were primarily aimed at reducing the cut in benefits as other income increased. Disability benefits are scheduled to increase next year in accordance with a recent agreement between the Government and the Association of Disabled Persons. This agreement is designed to benefit those in particular who become disabled early in life. The basic ben-

Lower wage increases in 2002

Purchasing power continues to increase

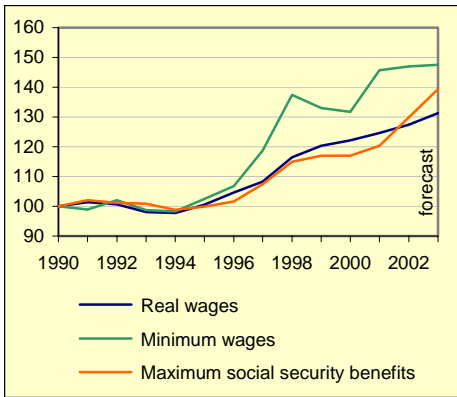
The lowest wages have increased more than general wages

Purchasing power of wages in Iceland and OECD



Source: Statistics Iceland and OECD.

Purchasing power of wages and benefits



Source: Statistics Iceland and State Social Security Institute.

enefit of the youngest disabled is scheduled to double. The estimated cost of these changes amounts to one billion krónur; they take effect at the beginning of 2004.

Total unemployment benefit expenditures increased sharply in 2002 in line with increased unemployment. Unemployment rose to 2.5 per cent, just over a percentage point more than in 2001, and benefit payments increased from 1.3 billion krónur in 2001 to 2.4 billion in 2002. Unemployment is forecast to average 3 per cent in 2003 with a commensurate increase in unemployment benefits and related payments. Unemployment is expected to decline in 2004 to about 2 per cent.

On the basis of developments outlined above, the Ministry has forecast the development of household income for the next two years. Household disposable income is estimated to have increased in 2002 for the eighth year in a row despite increased unemployment and reduced labour participation, by about 2 per cent per capita. This is forecast to continue this year with a 2 per cent increase in 2003 and 3½ per cent in 2004.

The Treasury

In the 2002 fiscal budget, revenue was projected at 258 billion krónur, expenditure at 239½ billion with a revenue surplus of 18½ billion on an accruals basis. The final Treasury accounts on an accruals basis will not be available until later this year. The accounts on a cash basis indicate that the main objectives of the fiscal budget have been attained, although certain deviations have taken place both on the revenue and the expenditure side.

The Treasury accounts on a cash basis are comparable to general cash flow accounts but not to the Treasury accounts or the fiscal budget, both of which are on an accruals basis. According to the cash accounts, total revenue amounted to 223.7 billion in 2002 and rose by close to 13 billion from the previous year or by 5.8 per cent. Of this amount, 212 billion were tax revenues, rising by 4.3 per cent. By comparison, general prices rose by 4.8 per cent on average between the two years. On the revenue side, the outcome was slightly less favourable than had been assumed. Tax revenue yielded less than expected due to a deeper recession than had been anticipated in the fiscal budget. The cash inflow due to asset sales was also lower than expected since such sales took place later in the year than had been assumed. Treasury expenditure amounted to 247 billion, rising by 25½ billion from the previous year and turned out to be 4.1 billion below budget payout ceilings (including the supplementary budget).

In the 2003 fiscal budget it is assumed that economic growth will revive after last year's downturn. On that basis, Treasury revenue is projected at 272 billion and expenditure at 260 billion. In addition, a supplementary budget was passed in March of this year to increase public investment and regional support. The budget calls for an additional expenditure of 4.7 billion krónur and revenue from asset sales of 2.6 billion krónur, bringing the projected surplus for the year to 9.6 billion.

Municipalities

Municipalities have experienced financial difficulties for several years. Since 1980 they have mostly been in deficit except for individual years when they have barely broken even. Provisional data from Statistics Iceland indicate that the deficits of municipalities amounted to 5½ billion krónur in 2001 and close to 4 billion in 2002. Present municipal budgets for 2003 indicate that total municipal expenditures will increase by nearly 6 per cent in 2003 but slightly less in 2004, 4½ per cent. Total revenue is expected to increase by 7½ per cent in 2003 and 5 per cent in 2004, a similar increase as expected for the central government. It should be noted here that the central government is increasing its appropriation to the Municipal Equalisation Fund from 0.64 per cent of tax revenue to 0.72 per cent which partly explains the increase in municipal revenue in 2003 and 2004. Other changes in municipal finances also became effective at the beginning of this year. Rent subsidies were increased and the capital contribution of mu-

municipalities to health facilities was abolished. All told, these changes led to a 2.3 per cent increase in the government appropriation to the Municipal Equalisation Fund.

On this basis it is estimated that the combined deficit of municipalities will be slightly less in 2003 than in the previous two years, 2.7 billion krónur, and a similar deficit will be incurred in 2004.

The overall public sector

This account of the public sector is prepared on a so-called national accounts basis which differs from the Treasury accounts in several important respects. The main adjustments that must be made to the Treasury accounts are that profits from sales of government assets and a reassessment of the net value of government stakes in enterprises and government agencies are not entered as revenue but only over the capital account. Sales of real property, machinery, equipment, land etc. is offset against purchases of similar items which are expensed. Tax claims written off due to bankruptcies are not expensed in the national accounts but entered over the capital account and in part offset against revenue. Only those pension commitments that are related to wage and salary payments in any given year are expensed and, finally, user charges that the government receives are entered net against expenditure.

The Ministry of Finance estimates that the combined public sector deficit amounted to 2.1 billion krónur in 2002, equivalent to 0.3 per cent of GDP. Central government finances were largely in balance, whereas municipalities were run with a deficit. Present forecasts indicate that the public sector deficit will decline slightly in 2003 to 1 billion krónur. The Treasury is expected to yield a surplus of about 1 billion whereas municipalities will be in deficit. The finances of the public sector are expected to improve in the course of this year and for 2004 a surplus of 3 billion, 0.4 per cent of GDP, is forecast.

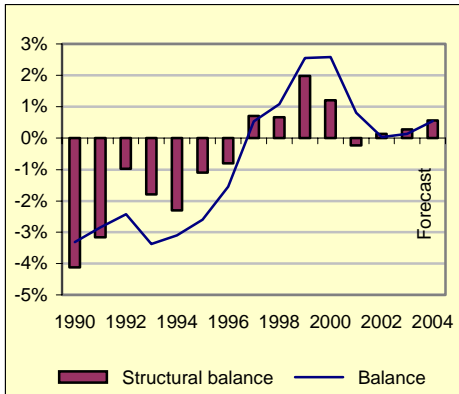
Public debt

The level of public debt has changed dramatically for the better in recent years, particularly that of the Treasury. Persistent deficits of the public sector from the middle-eighties inevitably led to large increases in debt. This continued in the recession years in the first half of the nineties, although deficits declined. After the middle of the nineties the public debt situation began to improve, and public debt has declined significantly as a percentage of GDP. This is primarily due to improved Treasury finances in those years which made it possible to reduce debt.

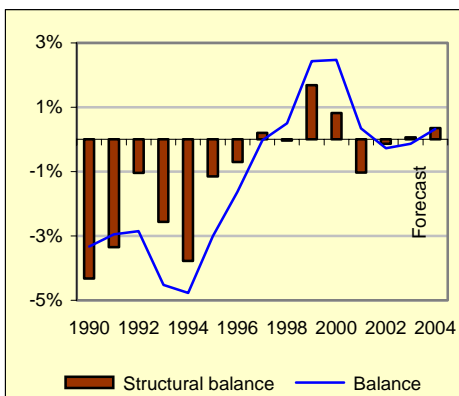
Total Treasury gross debt amounted to 32½ per cent of GDP in 1990, rising to 52 per cent in 1995 and declining to an estimated 36 per cent in 2002. In the 2003 fiscal budget it is estimated that the Treasury debt-to-GDP ratio will decline to less than 32 per cent of GDP. The development of the Treasury's net debt presents a similar picture and is estimated to come down to 18 per cent of GDP in 2003, a level similar to that of 1990.

Structural balance

Balance of the Treasury, % of GDP



Balance of the public sector, % of GDP



Total public debt, that of the Treasury and the municipalities combined, also peaked in 1995 at close to 60 per cent of GDP. Since then, the ratio has declined rapidly to 43 per cent at the end of 2002 and is estimated to decline to below 40 per cent at the end of 2003. The net debt of the public sector has shown a similar decline, from 40 per cent in 1995 to 23-24 per cent in 2002 and 2003.

An analysis of public sector finances is usually conducted along conventional lines, based on accounts drawn up by national accounting standards. Such an analysis is limited by the fact that it is difficult to discern the impact of the business cycle upon public finances and identify the underlying structural balance. The business cycle has a significant impact both on public revenue and expenditure. The revenue side is more sensitive to business cycles, in part due to the progression of the personal income tax. The structure of fiscal finances incorporates automatic cyclical stabilisers and thus has an impact on public finance balances. The main advantage of such stabilisers is that they immediately help to mitigate the impact of the business cycle.

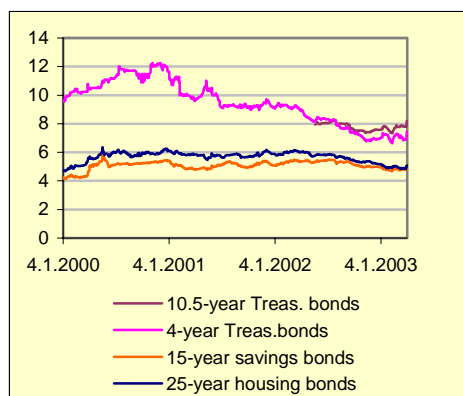
It is therefore important to identify public sector balances when adjusted for the impact of the business cycle at each time. In principle, such an adjustment takes account of the output gap, negative or positive, and the elasticity of revenue and expenditure within the business cycle. Such an adjusted balance is often called the structural balance. Identifying such a balance helps the authorities assess the impact of public finances in the short term and thus provides a guide for the authorities in measuring the fiscal stance of public finances.

The following chart shows the inter-relationship between the structural balance and the actual balance of the Treasury and the public sector since 1990. It clearly shows the gradual improvement in Treasury finances with gradually reducing deficits, both structural and actual. From 1997 to 2000 there is a structural surplus, followed by a small structural deficit in 2001. For 2002-2004 the Treasury is expected to revert again to a structural as well as an actual surplus.

THE DOMESTIC FINANCIAL MARKET

The króna is getting stronger

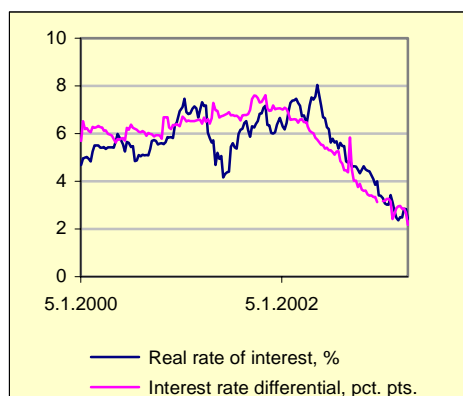
Yields on bonds



Source: Central Bank of Iceland.

Interest rate differentials with other countries are narrowing

Monetary policy stance



Source: Central Bank of Iceland.

The Icelandic financial market has undergone profound changes in recent years. Two years have passed since the Central Bank removed the exchange rate bands and adopted inflation targeting. The króna exchange rate weakened as a result by 15 per cent from the beginning to the end of 2001. The economy regained its balance in 2002 and the króna exchange rate strengthened considerably, or by 14 per cent at the same time as the current account deficit was wiped out. This development has continued so far in 2003, and at the time of writing the exchange rate is at a similar level as it was before the change of regime; the exchange rate index stands at 120-122 points. Among reasons for the stronger exchange rate are expectations of an economic expansion and interest rate increases, a rising fishing quota and increased capital imports on account of the power project constructions. Net capital imports in the years 2003-2010 are estimated at 130 billion at 2003 prices, half of which will be imported in 2005-2006. It may therefore be expected that the impact of construction activities on the exchange rate will increase when they draw towards their peak in 2005-2006. In the latter half of the construction phase one may expect a slight weakening of the króna.

The Central Bank reduced its base rate ten times in 2002 by a total of 4.3 per cent from a level of 10.1 per cent at the beginning of the year. The monetary ease has continued in 2003 with the Central Bank reducing the base rate further by 0.5 per cent down to 5.3 per cent. In view of expectations for an economic upswing, interest rates are more likely to rise than decline in the near future.

Monetary policy eased in 2002. The base rate in real terms, i.e., the nominal base rate deflated by the inflation margin on four-year Treasury bonds, averaged 6-7.5 per cent in the first half of 2002 and declined to 3.4 per cent towards the end of last year and further to 2.4 per cent at the time of writing. This is a lower real rate than the Central Bank believes an equilibrium rate should be at. Moreover, the interest rate differential with other countries declined from 7 per cent at the beginning of 2002 down to 3.2 per cent at the end of the year, even if short-term interest rates abroad declined considerably during this period. The short-term interest rate differential has continued to decline and stands now at 2.2 per cent.

The Central Bank has announced that it will consider conditions on the foreign exchange market when it buys foreign exchange to strengthen the Bank's foreign reserves. The Bank has been buying foreign exchange on a regular basis since September 2002 and intends to buy US dollars for the equivalent of up to 20 billion krónur before the end of 2003. The aim of these purchases is not to influence the exchange rate of the króna but to strengthen the foreign reserves.

The Central Bank has recently announced changes in its reserve requirements in order to align the operating environment of the financial institutions to that of Europe. Reserve requirements have therefore declined, and the Central Bank's rules on the reserve base and reserve ratio have been brought

into conformity with the rules of the European Central Bank. A part of the changes have already been brought into effect and the remainder will become effective before the end of this year.

Lending to households increasing and declining to enterprises

The growth of credit demand declined last year. Credits and purchases of securities increased by 2.2 per cent in 2002 of which domestic credits rose by a scant 0.8 per cent. For the entire credit system the credit increase amounted to only 3.5 per cent in that year. The reasons for the low increase include the rise in the exchange rate which reduced the krónur equivalent of outstanding debt in foreign currency. Stable prices helped hold down the increase in indexed debt. Credits to households increased most or by 7 per cent and to enterprises by 1.3 per cent. This is a reversal of the trend in 1997-2001 when credits to enterprises rose faster than to households. This is however in line with increased activity in the housing market at the same time as business investment is declining. Credit has begun to rise so far this year; the twelve-month increase in credits and securities purchases came to 2.7 per cent by the end of February with domestic credits increasing 1.9 per cent.

Turnover on the Stock Exchange still increasing

The turnover in bonds and money market paper was quite lively in 2002, increasing by 33 per cent and amounting to 811 billion krónur in 2002 as against 610 billion in 2001. Trading in housing bonds constituted close to 40 per cent of total bond and money market paper turnover. The expansion in turnover has continued into this year; in the first quarter total turnover was 57 per cent in excess of the turnover a year earlier and the trade in bonds and money market paper rose by 64 per cent for the same period.

The impact of energy investments on the bond market

The reduction in the Central Bank base rate has had an impact on bond yields, particularly shorter maturities. Reduced credit demand and increased demand for domestic bonds has helped bring down the yield as well as increased demand from abroad. The yield on 25-year housing bonds was about 5.8 per cent at the beginning of 2002, declining to just over 5 per cent at the end of the year, around which it has fluctuated so far in 2003. The yield on non-indexed Treasury bonds fluctuated around 9-9.5 per cent early in 2002 but has been about 7-7.5 per cent in the final months of 2002. The yield has risen slightly early this year and stands at 7½-8 per cent at the time of this writing, in spite of reductions in the Central Bank base rate in February. It may be assumed that the proposed energy investments have played a role here and that a higher yield is an indication that players in the market are expecting increased inflation and higher nominal interest rates.

Turnover in the Icelandic stock market more than doubled between 2001 and 2002. Total turnover amounted to 321 billion krónur in 2002 compared to 138 billion in 2001, an all-time record. The stock index rose by 17 per cent in the course of the year compared with a decline of 9 per cent in 2001. So far this year, the index has increased by 5 per cent. Financial and insurance stocks have risen most, by 9.4 per cent and

Share price indices
Beginning of 2000 = 100



Source: Búnaðarbanki Íslands and Morgan Stanley Capital International

pharmaceutical stocks by 11.2 per cent. Foreign and domestic stock prices have differed widely as can be seen in the graph here in the margin, where the Icelandic index (ICEX 15) is compared to the Morgan Stanley world index. Up to the beginning of last year, the Icelandic market moved largely in concert with foreign markets but after that the Icelandic index rose whereas the world index declined by 25 per cent in 2002 and further by 2½ per cent so far this year. This indicates that there is no obvious correlation between the Icelandic and foreign stock markets, at least not in the short term. The world political situation is such at the present time that it is difficult to conclude anything about longer-term interrelationships between the Icelandic and other stock markets, since the hostilities in the Middle East do not have the same influence here as they do in larger markets abroad.

Ever since the nations of the world agreed in Rio de Janeiro in 1992 to aim at sustainable development, the concept has been gradually gaining ground in Iceland. The second policy programme of the Icelandic authorities, setting aims and seeking ways and means towards a sustainable future, *Welfare for the future*, was issued in the latter half of 2002.

Sustainable development is based on three foundations: the environmental, the social and the economic, all of which must be viewed in conjunction with each other with the aim of improving the welfare of society, both social and economic, without harming the environment. Increased emphasis is placed upon the economic and social aspects in international fora. Discussions abound on the sustainability of, for example, pension systems in many countries. The economic and social foundation aspects are related to discussions about problems such as that of integrating immigrant groups into economic and social life. Their exclusion tends to lead to increased social costs and burden the productive capacity of the economy.

In this light, the following discussion deals with the state of the environment and its sustainability. Although measurements of sustainability are still being developed, the present emphasis is upon searching for means of decoupling the development of one part of society from having an impact upon another. A society as a whole would therefore be progressing towards sustainability if economic growth does not degrade the environment.

The above-mentioned policy programme, *Welfare for the future*, places its goals into four categories: A healthy and safe environment, protection of Iceland's nature, a sustainable use of natural resources and global tasks.

Iceland compares well with other countries when it comes to a healthy and safe environment with the exception that air pollution in the capital area is increasing. Carbon dioxide levels, mainly from vehicle traffic, has measured above reference levels in Reykjavik since 1998 and is increasing despite the fact that levels of carbon monoxide (CO), volatile organic compounds and lead have decreased. Particulate matter and ozone are also above EU reference levels. Emissions of sulphur dioxide and carbon dioxide in relation to GDP is substantial in this country compared to other OECD-countries and these emissions can not be decoupled from economic growth to the same extent as there. This is to a considerable extent due to the development of power-intensive industry.

Iceland's nature is invaluable to the country's society and culture and provides an important foundation for the self-image of the nation. It also has an economic value, particularly for tourism, since both Icelanders and foreigners travel around the country to enjoy its nature. It is difficult to place measurements upon individual aspects of nature. About 40 per cent of the country are defined as natural habitats by definition of law and more than 5,000 square kilometres are defined as protected areas.

The most important natural resources of Iceland are used in a sustainable manner. Energy production is almost exclusively based on renewable hydro- and geothermal energy, although 35 per cent of the country's energy use is based on fossil fuels. Fisheries husbandry aims at the sustainable development of the fish stocks. As a result, nearly all fish stocks have improved in recent years with the possible exception of scallops and shallow-water shrimp. Highland sheep grazing has declined, thus reducing pressure on environmentally vulnerable land which will take a long time to recover.

The authorities have begun to apply measures that affect the environment in a global sense. Chemicals that are most harmful to the ozone layer have been eliminated. A problem for the immediate future is to find refrigeration substances for the fishing fleet that meet the latest environmental standards. Iceland signed the Kyoto Protocol after it was amended to the effect that power-intensive industry could be allowed if it were based on clean and renewable energy. Emissions from such industry would not be counted as part of the carbon emissions of the country. Iceland has thus committed itself to limiting carbon emissions in 2008-2012 to a level 10 per cent above that prevailing in 1990. As matters stand, Iceland should be able to attain that goal, but that would in part be based on better combustion technology. The industry that is not exempted under the Kyoto Protocol must reduce its greenhouse emissions (fluorocarbons) and relatively less fossil fuels must be used by the fishing fleet than at present.

The so-called "Icelandic amendment" to the Kyoto Protocol means that the power-intensive industry that presently is planned will be in accordance with the amendment. However, the room for maneuver provided by the amendment is thereby limited.

TABLE ANNEX

Table 1. Output and expenditure 2001 - 2004

	Billion krónur current prices				Volume changes on previous year, per cent			
	Provis.	Est.	Forecast	Forecast	Provis.	Est.	Forecast	Forecast
	2001	2002	2003	2004	2001	2002	2003	2004
1. Private consumption	408,4	419,5	433,7	457,0	-3,0	-1,2	1¼	3¼
2. Public consumption	175,0	194,7	204,9	215,9	2,9	3,1	2¼	2
3. Gross fixed investment	163,0	146,5	167,7	190,3	-6,9	-12,4	11¼	11
Business sector investment	98,9	79,4	94,3	116,0	-14,3	-19,5	15½	19¾
Residential construction	33,2	37,4	38,7	41,2	17,8	5,2	1¼	4¼
Public investment	30,9	29,7	34,8	33,1	-1,5	-8,3	14¼	-6¾
4. Final domestic demand	746,5	760,7	806,3	863,1	-2,8	-2,8	3½	4¾
5. Stock changes ²⁾	-2,1	-0,2	0,1	0,0	-0,8	0,4	0	0
6. Total national expenditure	744,4	760,6	806,2	863,1	-3,6	-2,5	3½	4¾
7. Export of goods and services	303,6	307,3	297,1	307,9	7,9	2,9	1	2¼
8. Import of goods and services	307,3	293,5	290,5	307,8	-9,0	-2,4	2½	5
9. Gross domestic product	740,7	774,4	812,8	863,2	2,9	-0,5	2¾	3¾
10. Net factor income from abroad	-24,4	-13,2	-15,2	-16,3	-	-	-	-
11. Net current transfers	-1,0	1,1	-0,9	-0,9	-	-	-	-
12. Current account balance (7.-8.+10.+11.)	-29,0	1,8	-9,4	-17,1	-	-	-	-
13. Gross national income (9.+10.)	716,3	761,2	797,7	846,9	2,7	1,2	2½	3½
14. Effects of changes in terms of trade ³⁾	-	-	-	-	0,2	0,2	-¼	¼
15. Real gross national income	-	-	-	-	2,8	1,4	2¼	3¾
16. Current balance, % of GDP					-3,9	0,2	-1¼	-2

Notes:

¹⁾ Volume changes are based on 1990-prices

²⁾ In per cent of GDP of the previous year at constant prices

³⁾ As percentage of previous year's GNI, constant prices

Table 2. Export production and foreign trade 2001 - 2004

	Billion krónur current prices				Volume changes on previous year per cent ¹⁾			
	Provis. 2001	Est. 2002	Forec. 2003	Forec. 2004	Provis. 2001	Est. 2002	Forec. 2003	Forec. 2004
Export production								
Marine products	122,0	127,7	122,3	127,3	3,4	4,2	0	2
Aluminium	37,3	38,5	35,5	34,8	7,5	9,8	¼	0
Other products	31,8	34,8	36,9	39,7	6,0	10,7	4	5½
Total	191,2	200,9	194,7	201,8	4,7	6,6	¾	2¼
Export of old ships and aircraft	3,3	2,3	1,8	1,9	-	-	-	-
Stock changes in export production	-2,1	-0,2	-0,1	0,0	-	-	-	-
Merchandise exports, total	196,6	203,4	196,6	203,6	7,2	6,1	¾	2¼
Merchandise imports, total	202,5	190,7	190,6	203,5	-10,0	-3,2	3¾	6¼
General merchandise imports	170,2	159,6	160,8	170,5	-12,0	-4,6	4	5¼
of which: Oil imports	17,0	16,0	16,3	15,0	-12,2	3,8	2¼	2¼
Of which: Other imports	153,2	143,7	144,4	155,5	-12,0	-5,4	4	5½
Special imports	32,4	31,0	29,8	33,0	1,3	3,6	2½	10¼
Balance of trade	-6,0	12,7	6,1	0,1	-	-	-	-
Export of services (excl. factor income)	107,1	103,9	100,6	104,2	9,1	-3,0	1½	2
Import of services (excl. factor income)	104,8	102,8	99,9	104,3	-6,9	-0,7	½	2¼
Balance of services (without factor income)	2,3	1,1	0,7	0,0	-	-	-	-
Net factor income from abroad	-24,4	-13,2	-15,2	-16,3	-	-	-	-
Net current transfers ²⁾	-1,0	1,1	-0,9	-0,9	-	-	-	-
Current balance	-29,0	1,8	-9,3	-17,1	-	-	-	-

Notes:

¹⁾ Volume changes are based on 1990-prices

²⁾ Net transfers from abroad other than factor income

Table 3. Gross domestic product 1991-2002 *

Millions of krónur at current prices and volume and price indices 1990=100

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Est. 2002
1. Private consumption	235.542	236.290	233.462	243.708	253.929	274.031	293.221	325.905	358.687	389.574	408.413	419.474
2. Public consumption	81.501	83.926	88.618	93.824	98.961	105.563	112.776	127.752	142.088	156.740	175.048	194.735
3. Gross fixed investment	80.242	73.961	70.082	72.428	72.708	92.705	103.349	138.850	134.979	156.444	163.025	146.532
4. Stock changes	1.233	122	2.307	260	3.052	25	102	906	120	2.494	-2.084	-182
5. Total national expenditure	398.518	394.299	394.469	410.220	428.650	472.324	509.448	593.413	635.874	705.252	744.402	760.559
6. Exports of goods and services	125.671	121.597	135.694	157.436	161.250	176.836	190.948	204.214	212.166	231.632	303.632	307.320
6.1 Goods, fob	91.560	87.833	94.658	112.654	116.607	125.690	131.213	136.592	144.928	149.272	196.582	203.393
6.2 Services	34.111	33.764	41.036	44.782	44.643	51.146	59.735	67.622	67.238	82.360	107.050	103.927
7. Less: Imports of goods and services	130.491	121.784	122.466	134.631	144.725	173.755	187.717	230.055	241.482	278.637	307.287	293.461
7.1 Goods, fob	94.634	87.910	82.386	92.992	103.251	124.489	130.959	161.611	167.310	186.752	202.518	190.673
7.2 Services	35.857	33.874	40.080	41.639	41.474	49.266	56.758	68.444	74.172	91.885	104.769	102.788
8. Gross domestic product	393.698	401.025	413.331	439.108	452.139	452.139	512.679	567.572	606.558	658.247	740.747	774.418
9. Net factor income from abroad	-10.661	-9.086	-10.108	-13.659	-12.828	-11.317	-11.918	-12.647	-12.567	-19.353	-24.424	-13.169
10. Gross national product (8.+9.)	383.037	391.939	403.223	425.449	439.311	440.822	500.761	554.925	593.991	638.894	716.323	761.249
11. Current account balance with net current transfers	-15.991	-9.542	2.909	8.520	3.391	-8.700	-8.925	-39.491	-42.608	-67.120	-29.038	1.772
11.1 Balance of trade fob/fob	-3.074	-77	12.272	19.662	13.356	1.201	254	-25.019	-22.382	-37.480	-5.936	12.720
11.2 Balance of services	-1.746	-110	956	3.143	3.169	1.880	2.977	-822	-6.934	-9.525	2.281	1.139
11.3 Net factor income from abroad	-10.661	-9.086	-10.108	-13.659	-12.828	-11.317	-11.918	-12.647	-12.567	-19.353	-24.424	-13.169
11.4 Net current transfers from abroad	-510	-269	-211	-626	-306	-464	-238	-1.003	-725	-762	-959	1.082
12. Current balance, % of GDP	-4,1%	-2,4%	0,7%	1,9%	0,7%	-1,9%	-1,7%	-7,0%	-7,0%	-10,2%	-3,9%	0,2%
Volume indices 1990=100												
1. Private consumption	102,9	99,7	95,1	97,8	100,0	105,4	110,7	122,0	130,9	136,1	132,0	130,4
2. Public consumption	103,1	102,3	104,7	108,9	110,8	112,1	114,9	118,8	124,2	128,9	132,7	136,9
3. Gross fixed investment	103,3	91,8	82,0	82,4	81,5	102,4	112,6	149,8	144,2	165,4	154,0	134,9
4. Total national expenditure	103,8	99,1	95,3	97,3	99,5	106,6	112,5	127,7	132,8	141,7	136,6	133,2
5. Exports of goods and services	94,1	92,2	98,2	107,5	105,1	115,4	121,7	124,1	129,1	135,5	146,2	150,5
5.1 Goods, fob	92,1	91,2	95,8	107,4	105,1	114,6	116,3	113,3	121,3	119,7	128,4	136,2
5.2 Services	99,7	95,2	104,9	107,7	105,1	117,7	136,9	155,0	151,2	180,5	196,9	191,0
6. Less: Imports of goods and services	105,3	99,0	91,3	95,0	98,7	115,0	123,9	153,0	159,4	172,2	156,8	153,0
6.1 Goods, fob	104,9	99,8	87,2	93,7	99,7	116,3	122,3	152,0	156,9	161,2	145,1	140,5
6.2 Services	106,2	96,7	102,4	98,7	96,0	111,5	128,4	155,6	166,4	202,1	188,2	187,0
7. Gross domestic product	100,1	96,8	97,6	101,5	101,6	106,9	111,9	118,1	122,8	129,5	133,3	132,7
8. Gross national income	101,9	98,8	98,1	101,5	102,3	107,0	113,0	121,7	126,4	130,8	134,3	136,2

Table 3 continued

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Est. 2002
Prices indices 1990=100												
1. Private consumption	106.7	110.5	114.5	116.2	118.4	121.2	123.5	124.6	127.8	133.5	144.3	150.0
2. Public consumption	108.2	112.3	115.9	118.0	122.3	128.9	134.4	147.2	156.6	166.4	180.6	194.7
3. Gross fixed investment	106.1	109.3	114.3	117.8	120.8	124.7	127.3	128.7	129.9	131.2	146.9	150.8
4. Total national expenditure	106.9	110.7	114.7	116.9	119.7	123.5	126.5	129.8	133.7	139.0	152.2	159.5
5. Exports of goods and services	106.9	105.5	110.6	117.2	122.8	122.6	125.6	131.7	131.6	136.8	166.2	163.5
5.1 Goods, fob	107.5	104.2	106.9	113.4	120.1	118.6	122.0	130.4	129.2	134.9	165.6	161.5
5.2 Services	105.3	109.2	120.4	128.0	130.8	133.8	134.3	134.3	136.9	140.5	167.3	167.5
6. Less: Imports of goods and services	103.3	102.6	111.9	118.1	122.2	125.9	126.3	125.4	126.3	134.9	163.4	159.9
6.1 Goods, fob	102.9	100.5	107.8	113.2	118.1	122.1	122.2	121.3	121.7	132.2	159.2	154.8
6.2 Services	104.5	108.4	121.1	130.6	133.8	136.8	136.8	136.2	138.0	140.7	172.3	170.2
7. Gross domestic product	108.1	111.7	114.2	116.6	120.0	122.4	126.3	132.5	136.2	140.1	153.2	160.9
8. Gross national income	106.9	110.7	114.6	117	119.8	123.6	126.5	130.1	130.5	135.1	142.4	141.6
%-change from prev. year, volume												
1. Private consumption	2.9	-3.1	-4.7	2.9	2.2	5.4	5.1	10.1	7.3	4.0	-3.0	-1.2
2. Public consumption	3.1	-0.8	2.3	4.0	1.7	1.2	2.5	3.4	4.5	3.8	2.9	3.2
3. Gross fixed investment	3.3	-11.1	-10.7	0.6	-1.1	25.7	10.0	32.9	-3.7	14.8	-6.9	-12.4
4. Total national expenditure	3.8	-4.5	-3.8	2.1	2.3	7.1	5.5	13.5	4.0	6.7	-3.6	-2.5
5. Exports of goods and services	-5.9	-2.0	6.5	9.5	-2.3	9.9	5.4	2.0	4.0	5.0	7.9	2.9
5.1 Goods, fob	-7.9	-1.0	5.0	12.1	-2.1	9.0	1.5	-2.6	7.1	-1.3	7.3	6.1
5.2 Services	-0.3	-4.5	10.2	2.7	-2.4	12.0	16.3	13.2	-2.5	19.4	9.1	-3.0
6. Less: Imports of goods and services	5.3	-6.0	-7.8	4.1	3.9	16.5	7.7	23.4	4.2	8.0	-9.0	-2.4
6.1 Goods, fob	4.9	-4.9	-12.6	7.5	6.4	16.6	5.2	24.3	3.2	2.7	-10.0	-3.2
6.2 Services	6.2	-8.9	5.9	-3.6	-2.7	16.1	15.2	21.2	6.9	21.5	-6.9	-0.6
7. Gross domestic product	0.1	-3.3	0.8	4.0	0.1	5.2	4.7	5.5	3.9	5.5	2.9	-0.5
8. Gross national income	1.9	-3.0	-0.7	3.5	0.8	4.6	5.6	7.7	3.9	3.5	2.7	1.4
%-change from prev. year, prices												
1. Private consumption	6.7	3.6	3.6	1.5	1.9	2.4	1.9	0.9	2.6	4.5	8.1	4.0
2. Public consumption	8.2	3.8	3.2	1.8	3.6	5.4	4.3	9.5	6.4	6.3	8.5	7.8
3. Gross fixed investment	6.1	3.0	4.6	3.1	2.5	3.2	2.1	1.1	0.9	1.0	12.0	2.7
4. Total national expenditure	6.9	3.6	3.6	1.9	2.4	3.2	2.4	2.6	3.0	4.0	9.5	4.8
5. Exports of goods and services	6.9	-1.3	4.8	6.0	4.8	-0.2	2.4	4.9	-0.1	4.0	21.5	-1.6
5.1 Goods, fob	7.5	-3.1	2.6	6.1	5.9	-1.2	2.9	6.9	-0.9	4.4	22.8	-2.5
5.2 Services	5.3	3.7	10.3	6.3	2.2	2.3	0.4	0.0	1.9	2.6	19.1	0.1
6. Less: Imports of goods and services	3.3	-0.7	9.1	5.5	3.5	3.0	0.3	-0.7	0.7	6.8	21.1	-2.1
6.1 Goods, fob	2.9	-2.3	7.3	5.0	4.3	3.4	0.1	-0.7	0.3	8.6	20.4	-2.8
6.2 Services	4.5	3.7	11.7	7.8	2.5	2.2	0.0	-0.4	1.3	2.0	22.5	-1.2
7. Gross domestic product	8.1	3.3	2.2	2.1	2.9	2.0	3.2	4.9	2.8	2.9	9.4	5.0

Table 3 continued

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Provis. 2001	Est. 2002
Per capita volume indices												
1. Private consumption	101.6	97.3	91.8	93.7	95.3	99.8	104.1	114.7	121.8	125.1	119.6	116.6
2. Public consumption	101.8	99.9	101.1	104.3	105.6	106.2	108.0	111.7	115.6	118.5	120.3	122.3
3. Gross fixed investment	102.0	89.6	79.2	79.0	77.7	97.0	105.9	140.9	134.2	152.1	139.5	120.5
4. Total national expenditure	102.6	96.7	92.0	93.2	94.8	101.0	105.8	120.1	123.6	130.3	123.8	119.1
5. Exports of goods and services	92.9	90.0	94.8	103.0	100.1	109.4	114.4	116.7	120.1	124.6	132.5	134.5
5.1 Merchandise, fob.	91.0	89.0	92.5	102.9	100.1	108.6	109.4	106.5	112.9	110.0	116.3	121.8
5.2 Services	98.5	92.9	101.4	103.2	100.1	111.5	128.8	145.8	140.7	165.9	178.5	170.7
6. Less: Imports of goods and services	104.0	96.6	88.2	91.0	94.1	109.0	116.6	143.9	148.4	158.3	142.0	136.8
6.1 Merchandise, fob	103.6	97.4	84.2	89.7	95.1	110.2	115.0	142.9	146.0	148.2	131.5	125.6
6.2 Services	104.9	94.4	98.9	94.5	91.5	105.6	120.8	146.4	154.9	185.8	170.6	167.1
7. Gross domestic product	98.9	94.5	94.2	97.2	96.8	101.3	105.3	111.1	114.2	119.0	120.8	118.6
8. Gross national income	100.7	96.4	94.8	97.2	97.5	101.4	106.3	114.5	117.6	120.2	121.7	121.8
Gross domestic product per capita, US dollars												
1. GDP per capita, current exchange rates	25.796	26.106	22.671	23.085	25.567	26.537	26.661	29.150	30.219	29.684	26.582	29.446
2. GDP per capita, current PPPs	17.758	18.078	18.489	19.199	21.792	22.978	24.418	25.912	26.949	28.140	28.874	28.378

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

Source: Statistics Iceland

Table 4. Gross fixed capital formation 1991-2002

Million krónur at current prices

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Est. 2002
Gross fixed capital formation total	83.940	76.885	71.776	74.398	75.386	97.867	103.366	138.849	134.977	156.442	163.024	146.532
I Business sector investment	48.765	42.134	35.202	36.911	40.731	60.917	63.438	92.809	87.794	100.955	98.929	79.392
1. Agriculture and forestry	1.943	1.618	1.884	1.804	1.606	2.542	3.184	4.065	5.202	5.993	5.463	5.133
2. Fishing and fishfarming	2.911	5.950	2.146	3.471	1.546	5.174	590	6.610	3.608	6.536	7.707	3.290
3. Manufacture of food products and beverages							8.724	5.635	3.829	4.302	2.748	4.833
4. Manufacture of basic metals							11.017	11.673	4.025	5.852	4.446	2.667
5. Manufacturing other than 3.-4.	5.122	4.585	4.121	4.443	5.098	6.905	3.258	5.197	4.673	4.985	4.570	4.691
6. Production and distribution of electricity and water	5.651	2.352	2.052	1.609	1.833	3.359	9.521	17.559	15.708	12.748	16.421	15.477
9. Construction	2.473	1.562	1.528	1.274	1.749	2.624	8.397	12.794	8.269	8.246	8.238	7.937
10. Retail and wholesale	...	...	...	...	...	...	5.511	5.725	7.504	3.664	5.525	4.617
11. Hotels and restaurants	...	...	...	...	...	...	1.521	1.072	3.507	2.384	1.143	1.624
12. Transport	13.265	8.787	5.266	4.133	6.398	7.919	2.846	6.635	670	9.558	6.697	7.559
13. Telecommunications	...	...	...	...	...	...	2.402	4.507	4.956	8.658	5.014	4.662
14. Financial intermediation and insurance	...	...	...	...	...	...	1.218	2.424	3.910	955	2.250	1.977
15. Real estate activities	...	...	...	...	...	...	432	2.214	7.561	9.091	13.896	4.383
16. Research and development	...	...	...	...	...	...	-17	1.301	2.224	4.936	3.151	1.619
17. Other business activities	...	...	...	...	...	...	605	3.464	5.957	9.324	7.294	3.829
18. Other n.e.c.	...	...	...	...	...	...	4.212	1.934	6.191	3.723	4.366	5.094
II Residential construction	20.401	20.184	19.541	20.858	19.619	22.060	20.807	21.788	22.327	26.574	33.226	37.426
III Public works and buildings	14.774	14.568	17.033	16.630	15.036	14.890	19.121	24.272	24.856	28.913	30.869	29.714
1. Roads and bridges	2.602	2.641	4.442	3.982	3.546	3.268	3.485	3.547	4.196	4.595	6.067	6.809
2. Streets and sewers	3.373	3.157	3.291	3.548	2.690	2.887	3.752	4.122	4.378	5.333	5.107	5.436
3. Public buildings	8.800	8.770	9.300	9.100	8.800	8.735	9.291	12.799	11.656	13.257	14.146	11.732
4. Other	...	...	...	...	...	...	2.592	3.804	4.627	5.728	5.549	5.738

... Data not available

Source: Statistics Iceland

Table 5. Balance of payments 1991-2002

Million krónur

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
1 Balance on goods	-3,074	-77	12,272	19,662	13,356	1,201	254	-25,019	-22,382	-37,480	-5,936	12,720
1.1 Merchandise exports f.o.b.	91,560	87,833	94,658	112,654	116,607	125,690	131,213	136,592	144,928	149,272	196,582	203,393
Marine products	75,236	69,881	74,571	84,838	83,872	92,582	93,648	99,233	97,682	94,497	122,046	127,682
Aluminium	8,076	8,053	8,259	10,833	12,303	12,104	15,197	18,417	22,539	27,691	39,361	38,583
Ships and aircrafts	157	523	1,093	3,370	4,108	4,146	5,201	2,245	6,390	3,136	3,311	2,330
Other goods	10,095	9,375	10,447	13,613	16,323	16,754	17,167	16,696	18,317	23,948	31,864	34,794
1.2 Merchandise imports f.o.b.	-94,797	-88,224	-82,576	-93,243	-103,251	-124,489	-130,959	-161,611	-167,310	-186,752	-202,518	-190,673
Investment goods	-35,027	-31,257	-25,213	-30,792	-21,994	-28,139	-32,704	-42,223	-41,356	-44,233	-44,233	-38,489
Transport equipments	-16,291	-14,628	-8,940	-11,734	-12,883	-18,205	-18,065	-26,018	-29,370	-31,824	-28,181	-25,871
Fuels and lubricants	-7,801	-7,334	-7,518	-7,596	-7,318	-9,633	-9,896	-8,049	-8,924	-17,250	-17,677	-15,940
Industrial supplies	-25,042	-22,879	-22,401	-24,765	-28,750	-32,810	-33,460	-41,123	-38,970	-43,236	-55,429	-53,967
Consumer goods	-19,695	-19,284	-18,990	-20,550	-32,378	-35,799	-36,912	-44,293	-48,796	-50,238	-56,998	-56,406
2 Balance on services	-1,746	-110	956	3,143	3,169	1,880	2,977	-822	-6,934	-9,525	2,288	1,139
2.1 Export of services, total	34,111	33,764	41,036	44,782	44,643	51,146	59,735	67,622	67,238	82,360	107,049	103,927
Transportation	13,468	12,035	16,011	18,139	17,340	22,452	25,735	31,109	30,819	40,833	50,878	51,848
Air transport	...	...	...	...	10,847	14,963	17,380	22,692	23,097	30,194	37,782	38,957
Sea transport	...	...	...	...	6,493	7,489	355	8,417	7,722	10,639	13,096	12,891
Travel	8,684	8,124	9,764	10,595	12,004	11,722	12,316	14,633	16,070	17,967	22,881	22,844
Other receipts	11,959	13,605	15,261	16,048	15,299	16,972	21,684	21,880	20,349	23,560	33,290	29,235
Communications services	...	...	...	...	1,476	1,505	1,673	1,336	696	820	2,337	704
Insurance services	...	...	...	...	338	366	377	402	414	435	577	606
Government services	...	...	...	...	6,657	7,635	8,344	7,557	7,531	8,457	8,091	7,666
Other services	...	...	...	...	6,828	7,466	11,290	12,585	11,708	13,848	22,285	20,259
2.2 Imports of services, total	-35,857	-33,874	-40,080	-41,639	-41,474	-49,266	-56,758	-68,444	-74,172	-91,885	-104,761	-102,788
Transportation	-10,710	-9,421	-10,794	-12,077	-13,371	-16,614	-17,916	-22,766	-25,622	-32,697	-37,106	-39,564
Travel	-17,685	-16,886	-18,261	-17,892	-18,194	-20,472	-22,893	-28,049	-31,487	-37,082	-36,401	-33,263
Other receipts	-7,462	-7,567	-11,025	-11,670	-9,909	-12,180	-15,949	-17,629	-17,063	-22,106	-31,254	-29,961
Communications services	...	...	...	...	-1,192	-1,576	-1,738	-1,451	-529	-155	-2,742	-3,429
Insurance services	...	...	...	...	-1,304	-1,304	-918	-931	-740	-432	-714	-1,748
Government services	...	...	...	...	-746	-799	-845	-1,202	-1,077	-1,205	-1,560	-1,645
Other services	...	...	...	...	-6,667	-8,501	-12,448	-14,045	-14,717	-20,314	-26,238	-23,139

Table 5 continued

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
3 Balance of income	-10.655	-8.911	-9.750	-13.635	-12.826	-11.349	-12.116	-12.647	-12.567	-19.353	-24.424	-13.169
3.1 Receipts	4.929	5.771	6.053	5.251	5.277	6.880	7.132	8.509	9.328	11.603	17.202	19.883
Compensation of employees	2.994	3.037	3.175	2.993	3.260	4.242	4.128	4.742	4.901	5.516	5.772	5.417
Investment income	1.935	2.734	2.878	2.258	2.017	2.638	3.004	3.767	4.427	6.087	11.430	14.466
3.2 Expenditures	-15.584	-14.682	-15.803	-18.886	-18.103	-18.229	-19.248	-21.156	-21.895	-30.956	-41.626	-33.052
Compensation of employees	-883	-723	-702	-532	-365	-306	-391	-293	-341	-844	-533	-702
Investment income	-14.701	-13.959	-15.101	-18.354	-17.738	-17.923	-18.857	-20.863	-21.554	-30.112	-41.093	-32.350
4 Current transfer	-510	-269	-211	-626	-306	-464	-238	-1.003	-725	-762	-959	1.082
A Current balance	-15.990	-9.540	2.909	8.519	3.390	-8.684	-8.899	-39.565	-43.448	-67.120	-29.038	1.772

... Data not available

Source: Central Bank of Iceland. Statistics Iceland

Table 6. Operation of 55 companies listed on the Iceland Stock Exchange, 2001 and 2002

	Number of firms	Revenues million kr.	Gross profits		Financial items		Pre tax profit		Changes in working capital		Cash flow from operating activities	
			% of revenue	million kr.	% of revenues	million kr.	% of revenues	million kr.	% of revenues	million kr.	% of revenues	
Marine production												
	2002	188.779	10	6.862	4	17.009	9	15.150	8	14.891	8	
	2001	183.634	12	-11.033	-6	2.921	2	16.502	9	7.061	4	
Industrial production												
	2002	94.625	14	250	0	9.018	10	9.659	10	7.668	8	
	2001	75.854	14	-2.378	-3	5.255	7	8.230	11	1.704	2	
Commerce and services												
	2002	94.242	13	2.734	3	7.799	8	10.318	11	12.935	14	
	2001	91.586	13	-6.229	-7	-1.281	-1	7.524	8	4.441	5	
Transportation												
	2002	56.224	13	1.262	2	5.230	9	8.146	14	6.946	12	
	2001	56.363	5	-2.443	-4	-3.110	-6	2.398	4	2.895	5	
Finance and insurance												
	2002	70.185	-	-	-	14.743	21	12.153	17	21.727	31	
	2001	59.253	-	-	-	8.678	15	17.637	30	16.909	29	
Total												
	2002	504.055	-	-	-	53.800	11	55.426	11	64.167	13	
	2001	466.690	-	-	-	12.463	3	52.290	11	33.010	7	
Total without the finance and insurance												
	2002	435.699	12	12.099	3	39.040	9	43.283	10	42.603	10	
	2001	408.687	12	-21.699	-5	3.937	1	34.981	9	16.514	4	

Table 7. Income, prices and exchange rate 1991-2004

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	
														Forec.	Forec.
I Indices 1990=100															
Income															
Disposable household income	109,0	109,9	106,6	108,2	114,3	121,6	126,9	140,2	149,4	158,9	173,4	185,5	192	206	
Wages ¹⁾	108,3	111,5	113,1	114,4	119,6	127,2	134,2	146,8	156,8	167,2	181,9	194,8	205	217	
Prices															
Consumer price index	106,8	110,8	115,3	117,0	119,0	121,7	123,9	126,0	130,3	136,8	146,0	153,0	156	160	
Purchasing power²⁾															
Disposable household income	102,1	99,3	92,5	92,5	96,0	99,9	102,4	111,3	114,6	116,1	118,8	121,3	124	128	
Wages ¹⁾	101,4	100,7	98,1	97,8	100,5	104,6	108,3	116,5	120,3	122,1	124,5	127,2	131	136	
Exchange rate															
Effective price of foreign currency ³⁾	100,0	100,7	110,6	116,0	116,1	116,1	114,7	112,8	112,7	112,7	135,3	131,2	122	122	
Real exchange rate relative to price	102,7	102,6	97,0	91,8	91,9	92,1	92,9	94,4	96,1	98,9	86,4	91,2	99	100	
Real exchange rate relative to wage	103,0	106,3	96,6	89,1	93,0	94,0	96,9	101,7	103,8	105,4	92,4	97,6	107	110	
II Changes on previous year, %															
Income															
Disposable household income	9,0	0,9	-2,5	1,5	5,5	6,4	4,3	10,5	6,5	6,4	9,2	6,9	3¼	6	
Wages ¹⁾	8,3	2,9	1,4	1,2	4,5	6,4	5,4	9,4	6,8	6,6	8,8	7,0	5	6	
Prices															
Consumer price index	6,8	3,7	4,1	1,5	1,7	2,3	1,8	1,7	3,4	5,0	6,7	4,8	2	2½	
Purchasing power²⁾															
Disposable household income	2,1	-2,7	-7,6	0,0	3,8	4,1	2,5	8,7	3,0	1,3	2,3	2,1	2	3½	
Wages ¹⁾	1,4	-0,7	-2,6	-0,3	2,8	4,1	3,6	7,6	3,3	1,5	2,0	2,2	3	3½	
Exchange rate															
Effective price of foreign currency ³⁾		0,7	9,8	4,9	0,1	0,1	-1,3	-1,8	-0,2	0,1	20,1	-3	-7	0	
Real exchange rate relative to price	2,7	-0,1	-5,4	-5,4	0,1	0,2	0,9	1,6	1,8	2,9	-12,6	5,6	8	1	
Real exchange rate relative to wage	3,0	3,2	-9,2	-7,9	4,4	1,1	3,0	5,0	2,1	1,5	-12,3	5,6	9¼	2¾	

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 8. General government finances 1991–2004Million krónur, current prices ¹

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Provis.		Est. Forec.	
											2001	2002	2003	2004
Total income	148.541	150.911	148.079	154.455	163.562	179.106	194.799	220.841	252.831	272.826	295.016	313.047	335¼	354½
1. Direct taxes	53.151	55.112	59.584	62.690	68.040	76.319	85.956	98.552	115.605	128.822	148.378	160.373	171¼	181
2. Indirect taxes	84.470	84.275	77.480	79.696	83.092	90.739	96.119	109.264	122.534	128.045	128.835	132.411	141¾	150
3. Interest income	7.324	6.827	6.794	7.014	6.803	6.784	6.556	7.479	8.669	10.150	14.338	12.453	13¾	14¼
4. Other income	3.594	4.698	4.222	5.056	5.626	5.264	6.168	5.545	6.023	5.810	5.465	7.811	8½	9¼
Total revenue	160.165	162.132	166.518	175.091	176.958	186.834	194.906	218.012	238.107	256.567	292.465	315.159	336¼	351¼
1. Public consumption	81.501	83.926	88.618	93.824	98.961	105.563	112.775	127.721	142.088	156.740	175.048	194.735	204	216
Of which: Depreciation	7.367	7.945	8.560	9.255	9.887	10.482	11.146	11.843	12.569	13.462	14.804	16.348	17¼	17¾
2. Interest expenditure	15.719	15.609	16.536	18.007	19.955	19.541	19.613	21.204	22.731	22.762	28.559	27.657	26½	27
3. Subsidies	11.592	12.495	9.678	8.740	8.672	9.172	9.197	9.153	10.626	11.566	13.133	13.055	14	15
4. Income transfers	29.019	30.617	33.020	33.938	36.241	37.200	38.761	40.106	42.575	47.224	51.161	60.554	67½	70
5. Investment	17.982	17.778	19.708	19.540	15.951	17.620	18.415	23.619	25.252	24.806	30.767	27.514	32¼	30¾
6. Capital transfers	11.719	9.653	7.519	10.296	7.066	8.220	7.292	8.052	7.404	6.932	8.600	7.992	8½	10½
Financial balance	-11.624	-11.221	-18.439	-20.636	-13.396	-7.729	-107	2.829	14.724	16.259	2.550	-2.112	-1	3¼
Percentage of GDP	-3.0	-2.8	-4.5	-4.8	-3.0	-1.6	0.0	0.5	2.4	2.5	0.3	-0.3	-0.1	0.4

¹ Accrual basis

Table 9. Central government finances 1991–2004

Million krónur, current prices ¹

	Billion krónur													
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Provis. 2001	Provis. 2002	Est. 2003	Forec. 2004
Total income	119.931	121.621	119.008	125.071	131.259	144.604	151.287	170.479,16	196.956,79	209.648	223.059	233.630	249	262½
1. Direct taxes	38.199	39.345	39.763	42.778	46.871	53.237	54.286	61.670	74.152	82.842	94.230	101.504	108½	114¾
2. Indirect taxes	73.128	72.705	70.575	72.508	74.834	82.077	87.331	98.906	111.531	114.580	113.370	117.349	124	132½
3. Interest income	6.210	5.868	5.870	6.387	6.211	6.203	5.888	6.729	7.634	8.693	11.990	9.996	11	11½
4. Other income	2.393	3.704	2.801	3.398	3.342	3.087	3.782	3.174	3.640	3.534	3.470	4.781	4½	3½
Total revenue	131.118	131.184	132.789	138.511	142.819	151.943	148.540	164.327	181.458	193.314	217.059	233.380	248	258
1. Public consumption	51.921	52.504	55.943	58.183	62.075	63.648	64.053	73.892	82.267	89.919	100.496	111.534	117	122¾
Of which: Depreciation	5.515	5.870	6.312	6.777	7.287	7.736	8.124	8.639	9.151	9.779	10.697	11.765	12½	12½
2. Interest expenditure	13.964	13.975	14.834	15.997	17.780	17.440	17.414	18.833	20.155	19.665	23.120	21.465	20	20¼
3. Subsidies	10.879	11.773	8.981	8.042	8.017	8.148	8.227	7.904	9.268	9.721	11.438	11.208	12	12¾
4. Income transfers	40.011	41.153	42.456	43.774	47.097	52.083	51.914	54.326	60.103	66.296	71.587	80.745	86½	90
5. Investment	8.349	7.645	9.386	9.546	8.891	9.934	8.043	10.136	11.574	10.861	12.639	12.286	16½	14½
6. Capital transfers	11.508	10.004	7.501	9.745	6.247	8.426	7.012	7.875	7.242	6.630	8.476	7.907	8½	10¼
Financial balance	-11.187	-9.563	-13.781	-13.440	-11.560	-7.339	2.748	6.152	15.499	16.334	6.000	250	1	4¾
Percentage of GDP	-2.8	-2.4	-3.4	-3.1	-2.6	-1.5	0.5	1.1	2.6	2.5	0.8	0.0	0.1	0.5

¹ Accruals basis

Table 10. Local government finances 1991–2004Million krónur, current prices ¹

	Provis.											Est.		
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total income	30.144	31.482	30.996	31.935	34.924	40.027	48.243	54.369	61.038	68.513	78.777	85.449	92	97
1. Direct taxes	14.952	15.767	19.820	19.912	21.170	23.082	31.670	36.882	41.453	45.979	54.148	58.869	62¼	66¼
2. Indirect taxes	11.342	11.570	6.905	7.188	8.258	8.662	8.788	10.359	11.002	13.465	13.466	15.061	16¼	17¼
3. Interest income	1.067	808	833	547	517	528	633	660	942	1.242	1.789	1.977	2	2
4. Other income	2.783	3.337	3.438	4.287	4.980	7.756	7.151	6.467	7.641	7.826	9.374	9.541	10½	11½
Total revenue	30.759	33.195	35.737	38.765	36.370	40.453	51.230	58.620	63.752	70.784	84.283	89.311	94¼	99½
1. Public consumption	18.639	20.839	22.619	24.972	25.558	29.604	37.304	41.271	45.838	51.111	58.355	65.498	69¼	73¼
Of which: Depreciation	1.853	2.075	2.249	2.478	2.600	2.746	3.022	3.204	3.418	3.683	4.107	4.583	4¼	5
2. Interest expenditure	1.755	1.633	1.703	2.010	2.174	2.101	2.199	2.372	2.576	3.096	5.439	6.192	6½	6¼
3. Subsidies	714	721	697	699	655	1.024	969	1.249	1.357	1.845	1.695	1.848	2	2
4. Income transfers	1.661	2.294	2.628	3.018	2.703	2.990	3.128	3.274	3.559	4.169	4.648	5.043	6	6¼
5. Investment	9.633	10.133	10.321	9.994	7.059	7.685	10.372	13.483	13.678	13.945	18.129	15.228	15½	16¼
6. Capital transfers	210	-351	17	550	819	-206	280	177	162	301	124	85	0	0
Financial balance	-614	-1.713	-4.741	-6.831	-1.446	-425	-2.987	-4.252	-2.714	-2.271	-5.506	-3.862	-2¼	-2¼
Percentage of GDP	-0.2	-0.4	-1.2	-1.6	-0.3	-0.1	-0.6	-0.7	-0.4	-0.3	-0.7	-0.5	-0.3	-0.3

¹ Accrual basis

Table 11. Central government debt and claims ¹

Million krónur, year-end values

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Budget 2003
Gross debt	137 530	166 116	195 569	213 924	232 585	239 246	241 566	237 764	225 968	227 908	296 480	279 130	268 000
Central Bank	757	13	6	-	-	-	-	-	-	-	-	-	-
Treasury bonds	46 175	51 793	60 796	69 008	74 140	73 889	84 424	82 865	82 618	68 898	64 243	49 960	-
Treasury notes	1 257	2 487	6 012	5 563	5 708	8 366	11 258	15 846	11 018	11 430	19 588	32 880	-
Treasury bills	8 244	12 545	13 742	14 630	16 406	15 811	12 296	15 209	9 899	5 970	12 003	11 890	-
Other domestic liabilities	13 144	12 005	12 709	11 090	9 010	8 962	6 960	6 526	4 297	2 285	2 357	2 310	-
Foreign debt	67 953	87 273	102 304	113 633	127 261	132 218	126 628	117 318	118 136	139 325	198 289	182 090	-
Total claims	63 091	67 700	64 968	69 066	77 266	71 023	69 309	86 496	107 152	100 696	126 760	123 390	114 200
Long term credit	37 902	41 654	46 875	55 469	64 134	63 663	65 278	64 739	69 347	70 443	90 248	78 750	76 000
Indexed to domestic prices	22 071	22 644	26 405	36 965	45 176	50 565	52 885	53 215	57 699	59 262	79 517	-	-
In foreign currency	15 831	19 010	20 470	18 504	18 958	13 098	12 393	11 524	11 648	11 657	13 532	-	-
Taxes outstanding and other short-term claims	25 189	26 046	18 093	13 597	13 132	7 360	4 031	21 757	37 805	30 253	36 512	44 640	38 200
Net debt	74 439	98 416	130 601	144 858	155 319	168 223	172 257	151 268	118 816	127 212	169 720	155 740	153 800
Claims as a percentage of debt	45,9	40,8	33,2	32,3	33,2	29,7	28,7	36,4	47,4	44,2	42,8	44,2	42,6
Percentage of GDP ²													
Gross debt	34,9	42,1	48,0	49,4	52,2	50,3	47,1	41,9	37,3	34,6	40,0	36,0	33,0
Of which: foreign debt	17,3	22,1	25,1	26,2	28,6	27,8	24,7	20,7	19,5	21,2	26,8	23,5	-
Total claims	9,6	10,6	11,5	12,8	14,4	13,4	12,7	11,4	11,4	10,7	12,2	10,2	9,3
Of which: In foreign currency	4,0	4,8	5,0	4,3	4,3	2,8	2,4	2,0	1,9	1,8	1,8	-	-
Short term credit, net	6,4	6,6	4,4	3,1	2,9	1,5	0,8	3,8	6,2	4,6	4,9	5,8	4,7
Net debt	18,9	25,0	32,0	33,5	34,9	35,4	33,6	26,7	19,6	19,3	22,9	20,1	18,9

¹ Including accrued interest liabilities.² Based on average price and average exchange rate of foreign currency.

Table 12. General government debt and claims ¹

Million krónur, year-end values

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
General government gross debt.....	154 183	185 639	220 084	245 071	267 611	274 447	279 351	280 460	272 031	277 715	349 298	334 829	324 958
Domestic debt.....	85 612	95 466	113 296	126 467	135 881	138 088	145 149	153 144	142 048	124 812	136 709	137 659	-
Foreign debt.....	68 571	90 173	106 788	118 604	131 730	136 359	134 202	127 316	129 983	152 903	212 589	197 170	-
General government total claims.....	74 931	79 127	76 905	79 577	88 313	82 925	82 820	99 746	125 046	119 199	145 523	142 137	132 931
Long-term claims.....	44 546	48 346	54 091	61 559	70 760	71 249	74 449	74 482	79 505	80 569	100 879	90 903	86 631
Taxes outstanding and other short-term claims.....	30 385	30 781	22 814	18 018	17 553	11 676	8 371	25 264	45 541	38 630	44 644	51 234	46 300
General government net debt.....	79 252	106 512	143 180	165 494	179 298	191 522	196 531	180 713	146 984	158 516	203 775	192 692	192 027
Central government.....	74 439	98 417	130 602	144 858	155 390	168 224	172 256	151 297	118 815	127 212	169 720	155 740	153 800
Local governments.....	7 288	10 194	14 552	22 185	25 130	24 190	25 038	30 089	28 663	31 653	34 387	37 268	38 527
Social security system.....	-2 475	-2 099	-1 974	-1 549	-1 222	- 892	- 763	- 672	- 494	- 349	- 332	- 315	- 300
Real values of gross debt, constant price													
General government gross debt.....	198 003	232 928	246 475	261 809	279 517	280 653	282 748	280 460	264 153	259 592	312 210	286 097	266 588
General government net debt.....	102 813	134 014	160 472	176 756	187 237	195 839	198 890	180 713	142 743	147 976	181 123	163 770	157 534
Percentage of GDP													
General government gross debt.....	39,2	47,1	54,0	56,6	60,1	57,7	54,5	49,4	44,8	42,2	47,2	43,2	40,0
Domestic debt.....	21,7	24,2	27,8	29,2	30,5	29,0	28,3	27,0	23,4	19,0	18,5	17,8	-
Foreign debt.....	17,4	22,9	26,2	27,4	29,6	28,7	26,2	22,4	21,4	23,2	28,7	25,5	-
General government total claims	19,0	20,1	18,9	18,4	19,8	17,4	16,2	17,6	20,6	18,1	19,6	18,4	16,4
General government net debt.....	20,1	27,0	35,1	38,2	40,3	40,3	38,3	31,8	24,2	24,1	27,5	24,9	23,6

¹ The general government is defined according to the SNA-definition. Government enterprises and financial institutions are excluded.² Domestic debt is converted to constant price based on consumer price index and foreign debt is based on foreign prices and average exchange rate.