

## ICELAND

Following two years of deep recession, the economy returned to buoyant economic growth in 2011. The recovery, which is being led by private consumption and business investment, is projected to moderate, with growth easing to 2¾ per cent by 2013. Inflation should fall but remain above the authorities' target in 2013.

The government should ensure that it remains on track to meet its fiscal objectives and pass the proposed law to strengthen the fiscal framework. Monetary policy should be gradually tightened to reduce inflation and support capital account liberalisation. Prudential rules and supervision, including macro-prudential arrangements, should be strengthened.

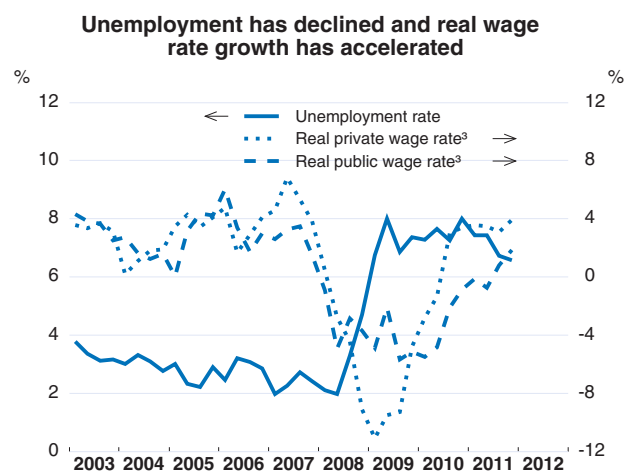
### The economic recovery is gaining strength

Growth is being led by private consumption, which has been boosted by debt write-downs, temporary access to pension savings and high wage settlements, and by business investment. Residential investment has also been strong owing to the resumption of work on incomplete housing projects. Total hours worked have increased and employers plan to expand employment over coming months. The unemployment rate fell to 6½ per cent in the final quarter of 2011 but long-term unemployment remains high. Large collective wage increases, currency depreciation and rising commodity prices have pushed up inflation to well above the central bank's 2.5% target.

### The drag from fiscal consolidation is set to diminish

Fiscal consolidation is set to continue but at a more moderate pace than over the past two years. The government plans consolidation amounting to 2½ per cent of GDP in 2012, bringing the primary balance into surplus (abstracting from write-offs of 2% of GDP), and to another

### Iceland



1. Year-on-year percentage change.

2. Estimate of inflation expectations based on principal components analysis, measuring the common trend of a number of measures of inflation expectations.

3. Deflated by the consumer price index, year-on-year percentage change.

Source: OECD Economic Outlook 91 database; Statistics Iceland.

## Iceland: Demand, output and prices


	2008	2009	2010	2011	2012	2013
	Current prices ISK billion	Percentage changes, volume (2005 prices)				
<b>GDP at market prices</b>	1 482.0	-6.8	-4.0	3.1	3.1	2.7
Private consumption	789.9	-14.9	-0.4	4.0	3.2	2.3
Government consumption	367.3	-1.7	-3.4	-0.6	-0.3	0.3
Gross fixed capital formation	362.5	-51.6	-8.1	13.4	16.5	10.3
Final domestic demand	1 519.8	-20.9	-2.6	4.0	4.2	3.1
Stockbuilding <sup>1</sup>	3.3	0.0	-0.2	0.6	0.0	0.0
Total domestic demand	1 523.0	-20.5	-2.7	4.7	4.0	3.1
Exports of goods and services	657.3	6.6	0.4	3.2	3.9	3.2
Imports of goods and services	698.3	-24.0	4.0	6.4	5.9	4.0
Net exports <sup>1</sup>	- 41.0	14.2	-1.5	-1.1	-0.7	-0.2
<i>Memorandum items</i>						
GDP deflator	—	8.3	6.9	3.1	6.0	4.8
Consumer price index	—	12.0	5.4	4.0	6.0	4.1
Private consumption deflator	—	13.7	3.4	4.1	6.7	4.2
Unemployment rate	—	7.2	7.5	7.0	5.8	5.1
General government financial balance <sup>2</sup>	—	-10.0	-10.1	-4.4	-2.6	-1.4
General government gross debt <sup>2</sup>	—	120.0	125.2	128.3	126.7	124.7
Current account balance <sup>2</sup>	—	-11.7	-8.0	-7.1	-4.7	-1.1

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook Sources and Methods* (<http://www.oecd.org/eco/sources-and-methods>).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

2. As a percentage of GDP.

Source: OECD Economic Outlook 91 database.

StatLink  <http://dx.doi.org/10.1787/888932610330>

1% of GDP in 2013. To reach the government's goal of overall budget balance by 2014, further consolidation of only one-half of a per cent of GDP would be required. On the basis of these plans, general government gross debt should have peaked in 2011 and fall to the government's target of 60% of GDP towards the end of the decade.

### Monetary policy needs to be tightened

To counter inflationary pressures, the central bank has been raising its policy interest rates. Nevertheless, real rates remain negative. Monetary policy will need to be tightened further to reduce the risk of high wage increases flowing into second-round price increases and to pave the way for the gradual liberalisation of capital controls. While much progress has been made in debt restructuring, firms and households remain highly leveraged and banks still have a high level of non-performing loans.

### The recovery should continue at a moderate pace

Growth is projected to ease to 2¼ per cent by 2013 as the factors that boosted consumption in 2011 and the surge in private investment pass. Unemployment should fall to 5% by the end of 2013 and inflation should be on the way to the authorities' target.

**There are mainly downside risks**

The main risks to the economic outlook are that energy-intensive investment projects could be delayed and that there could be further wage increases in excess of productivity growth, which would fuel inflation, erode export competitiveness and undermine labour market performance. Capital account liberalisation could also affect growth through currency depreciation and confidence effects.



**From:**  
**OECD Economic Outlook, Volume 2012 Issue 1**

**Access the complete publication at:**  
[https://doi.org/10.1787/eco\\_outlook-v2012-1-en](https://doi.org/10.1787/eco_outlook-v2012-1-en)

**Please cite this chapter as:**

OECD (2012), "Iceland", in *OECD Economic Outlook, Volume 2012 Issue 1*, OECD Publishing, Paris.

DOI: [https://doi.org/10.1787/eco\\_outlook-v2012-1-21-en](https://doi.org/10.1787/eco_outlook-v2012-1-21-en)

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to [rights@oecd.org](mailto:rights@oecd.org). Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at [info@copyright.com](mailto:info@copyright.com) or the Centre français d'exploitation du droit de copie (CFC) at [contact@cfcopies.com](mailto:contact@cfcopies.com).