

English translation of the Weekly Web Release



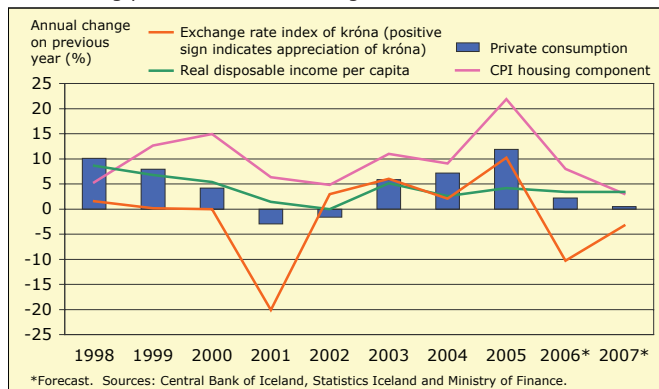
MINISTRY OF FINANCE IN ICELAND

April 27th 2006

The development of private consumption

The development of the economy of the next several years is discussed in the latest [macroeconomic forecast \(summary edition\)](#) of the Ministry of Finance. Several revisions have taken place since the Ministry issued its January forecast, mainly attributable to a revision of national accounts for previous years and to the disquiet in international financial markets that has touched upon Iceland. The exchange rate and share prices declined, although part of the decline has by now been reversed. For this reason, the forecast of growth in private consumption for this year and next has been revised downwards. The question is whether the growth in private consumption will not in fact turn out lower than forecast, to judge by the experience in the previous business cycle when private consumption declined in 2001 and 2002.

Private consumption, real disposable income per capita, housing prices and the exchange rate of króna 1998-2007

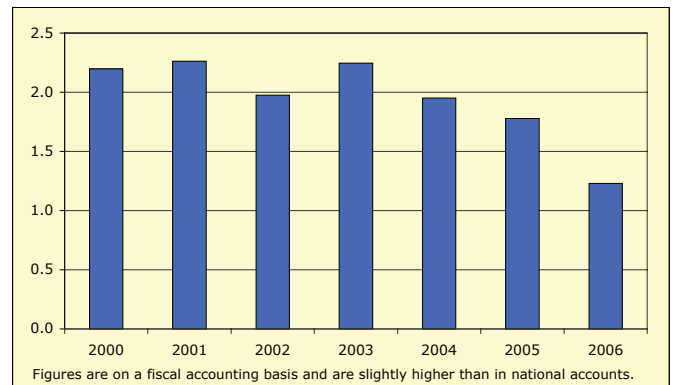


As can be seen from the above chart, there are many differences between the last business cycle and this one. It is assumed that the decline in the exchange rate this year will be about half that which took place in 2001. The exchange rate has a great influence on household purchasing power abroad. Housing prices have increased more than in the previous expansion. In this connection, it should be pointed out that the household net wealth, which in part consists of housing wealth and pension fund savings, has increased by 60 per cent in 2003-2005, compared with a 34 per cent increase in 1998-2000. The wealth effect on private consumption has therefore been greater in this expansion than in the previous one. Household wealth and housing prices are expected to grow slower in 2006-2007. Household liquidity has improved because their real interest cost in 2004-2005 was on average 25 per cent lower than in 2000-2001. It is expected to be lower this year and next than five years ago. Real disposable income is expected to increase considerably more this year and next than in the previous downturn, when it remained broadly unchanged. The tax cuts will increase disposable income by up to 2.7 per cent next year, which was not the case in the previous downturn. Finally, it should be kept in mind that the power project investments are still fully going on this year and will be completed next year. Power project investments were completed in the previous expansion in 1998 and, besides, those investments were much smaller than in the present instance. The forecast just published (full text available in English on Friday, April 28th) is based on all these factors.

Treasury investment

There has been some discussion recently on Treasury investment in connection with the expansion in the economy. In this regard, it should be pointed out that the Treasury has temporarily cut its investment budget during the period of power project construction. From 2000 to 2003, Treasury investment averaged 11 per cent of total investment, but last year it was down to 6.2 per cent and is estimated at 4.4 per cent this year. It should be noted however that

Treasury investment ratio to GDP 2000-2006



total investment has greatly increased over this period due to power project investments, in addition to an increase in housing construction. The ratio of Treasury investment to GDP declined from an average of 2.2 per cent in 2000-2003 to 1.8 per cent in 2005 and further to an estimated 1.2 per cent of GDP this year.

Treasury investment declined by 6 billion krónur from its peak in 2003 to the level of this year, or by more than 30 per cent in real terms. In this year's fiscal budget, investment and capital transfers of the Treasury are estimated at 13.6 billion of which close to 6 billion go to roads, 1.6 billion to health care, close to 1.6 billion to education and just over 800 million to harbours.

Treasury finances January-March 2006

According to the latest [Treasury cash accounts](#), the cash surplus from operations amounted to 23.8 billion krónur in the first quarter, 15.4 billion more than a year ago and 19.9 billion more than estimated in the cash flow projection within the year. Revenue was 20.3 billion krónur higher than last year whereas expenditure increased by 4.1 billion krónur. The net financial surplus amounted to 21.3 billion, 5.8 billion more than last year.

Taxes on income and profit amounted to 41 billion krónur and increased by 40 per cent on the previous year. Revenue from capital income tax amounted to 13.9 billion, increasing by 45.4 per cent. About 4.3 billion increase in corporate income tax is partly due to a shift in tax collection between months. Proceeds from social security tax increased also from the previous year by 16.1 per cent, at the same time as the wage index rose by 8.5 per cent. The revenue from net wealth tax and other taxes on assets amounted to 3 billion krónur, declining by 16.3 per cent from last year. Of this amount, 2.2 billion were proceeds from stamp tax, a decline of 8.9 per cent from the previous year.

The collection of indirect taxes broadly reflects the trend in domestic demand. They increased by a total of 20.5 per cent from the previous year. Revenue from value added tax increased by 25.1 per cent, equivalent to a 19.9 per cent increase in real terms. The excise duty at the point of import on motor vehicles increased by about one-third, a considerable increase; new registrations of motor vehicles rose by 37.4 per cent in the first three months of this year.

Total expenditure amounted to 74.4 billion and rose by 4.1 billion or 5.9 per cent. The largest increase was in expenditure on social security and welfare; it rose by 1.3 billion, followed by health and education. These three expenditure categories account for close to two-thirds of total expenditure. Expenditure on justice and the police rose by 0.5 billion, as did cultural spending. These increases were partially offset by a 1.2 billion decline in interest expenditure. A large issue of government savings bonds, along with accumulated interest, matured in January of last year, which accounts for most of the decline in interest cost.

Treasury revenue January-March			Treasury expenditure January-March			Treasury finances January-March			Economic indicators		
12 month changes (%)	2004-2005	2005-2006	12 month changes (%)	2004-2005	2005-2006	Million krónur	2005	2006	12 month changes (%)	2004-2005	2005-2006
Total tax revenue	22.8	25.9	General public services	12.0	-2.0	Cash from operations	9 301	23 741	Inflation (April '06)	4.3	5.5
Taxes on income & profit	23.3	40.0	Health	13.1	6.3	Net financial balance	15 511	21 286	Core inflation (April '06)	4.6	4.6
Taxes on property	51.4	-16.3	Social security & welfare	3.4	8.6	Debt redemption	-11 404	-9 070	Wage index (March '06)	6.5	8.6
Taxes on goods & services	20.7	20.5	Economic affairs	5.2	-4.4	Gross borr. requirement	3 257	11 226	Total turnover (Jan. - Dec. '05)	12.2	8.9
Social contributions	20.5	16.1	Education	11.5	13.9	Net borrowing	1 094	1 532	Retail turnover (Jan. - Dec. '05)	5.1	5.5
Total revenue	22.9	25.5	Total expenditure	8.0	5.9	Overall cash balance	4 351	12 758	Unemployment rate (March '06)	2.3	1.2