

Iceland's Economic Outlook

Presentation at the IACC Conference

7 April 2009

Mark Flanagan
European Department
International Monetary Fund



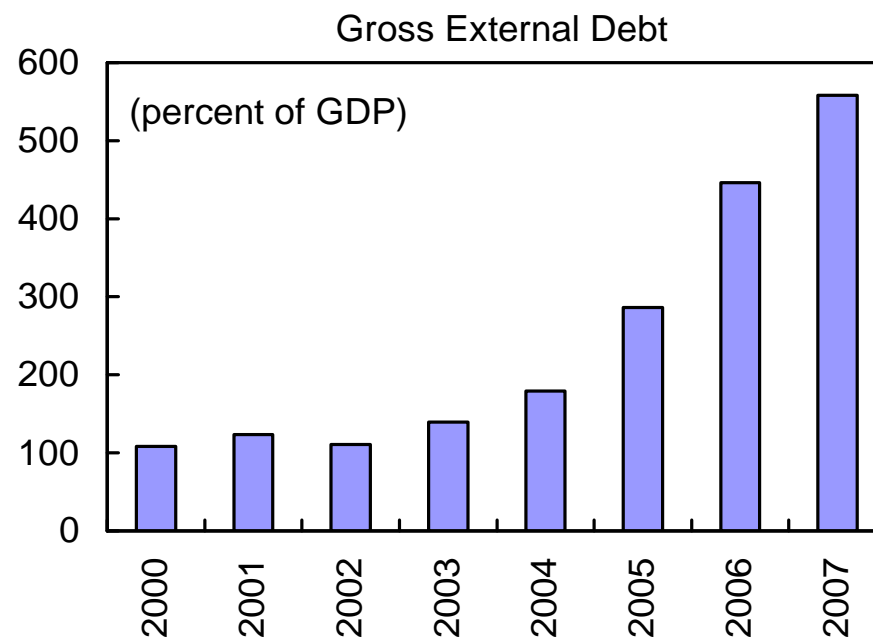
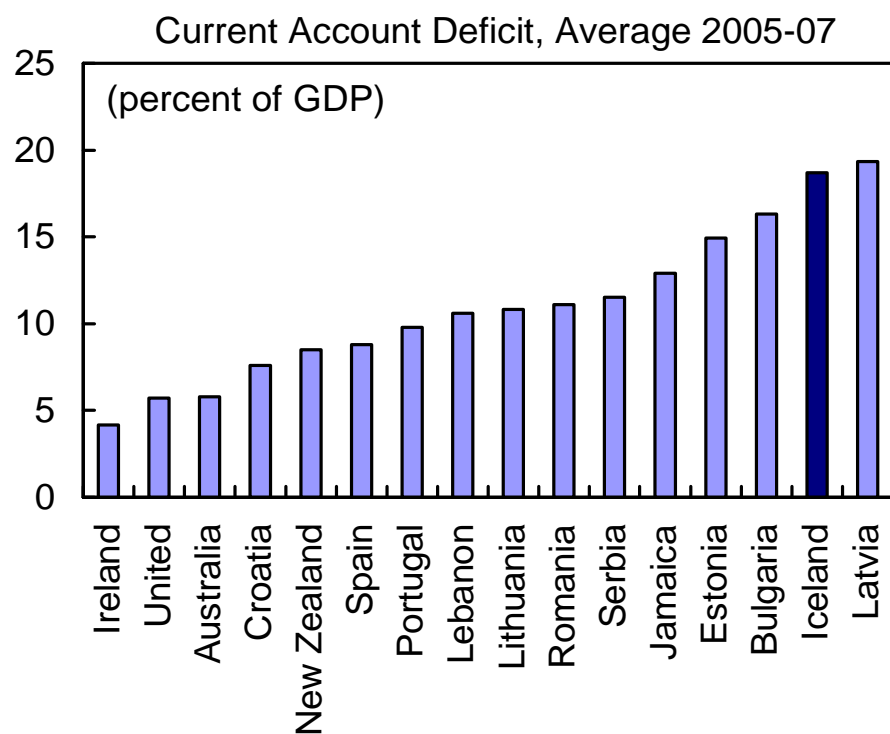
Overview

- I. Background to the crisis
- II. Crisis in Iceland: International Comparison
- III. The IMF Program: Adjustment and Policies



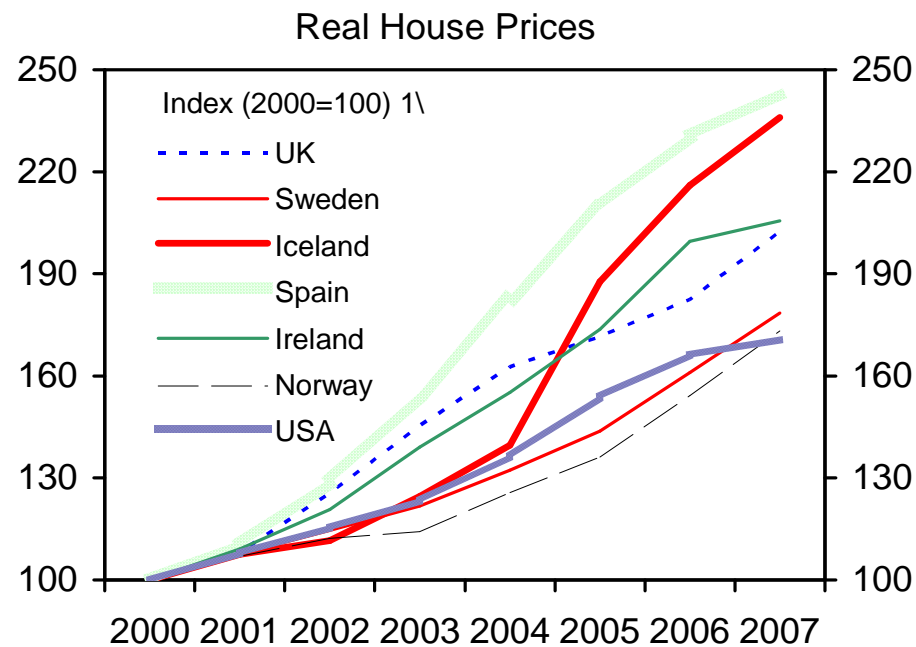
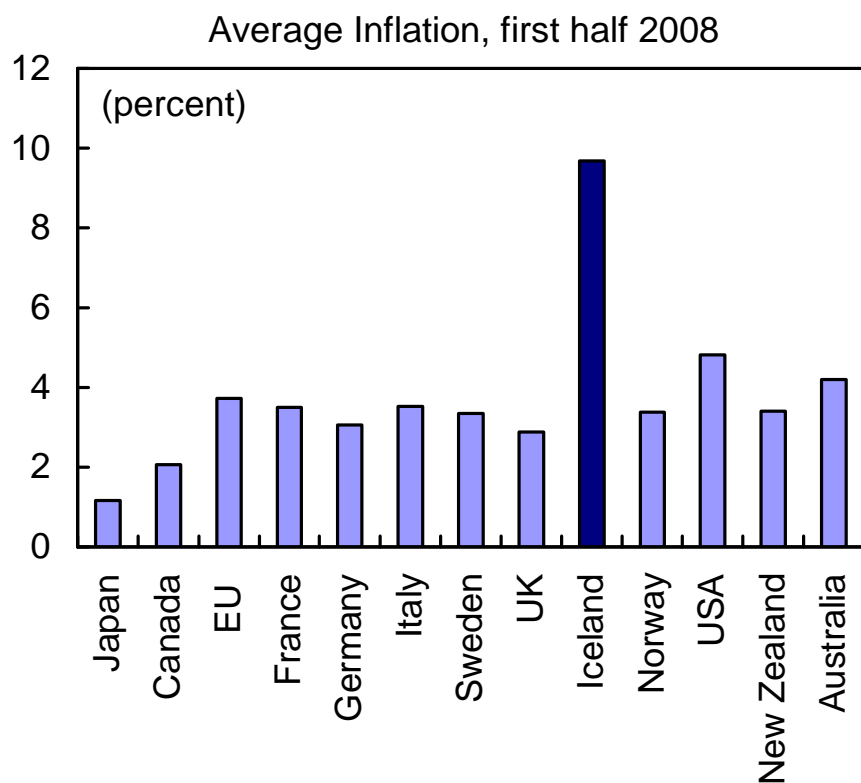
I. Background to the Crisis

A build up of large external imbalances...



Source: IMF and Central Bank of Iceland.

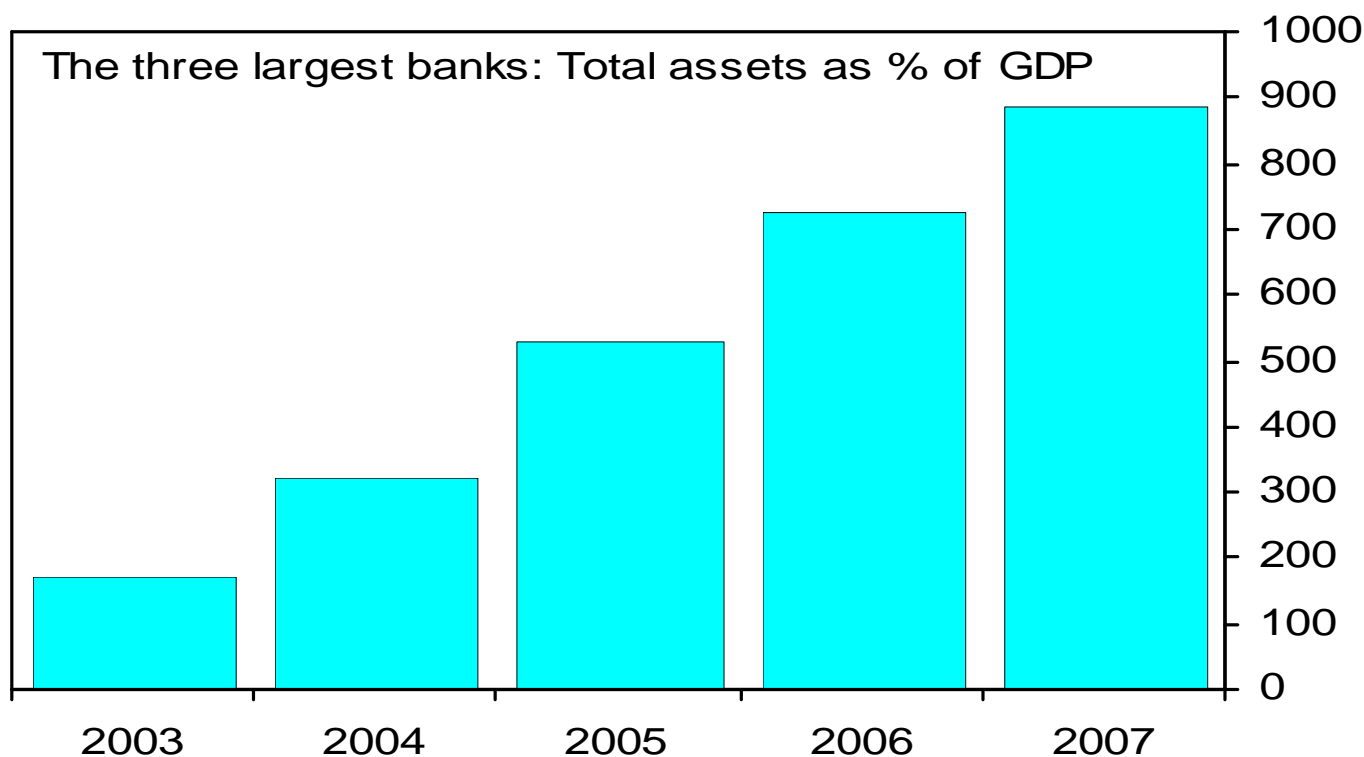
... and also internal imbalances.



Source: IMF.



Banks' balance sheets expanded out of all proportion to the economy...

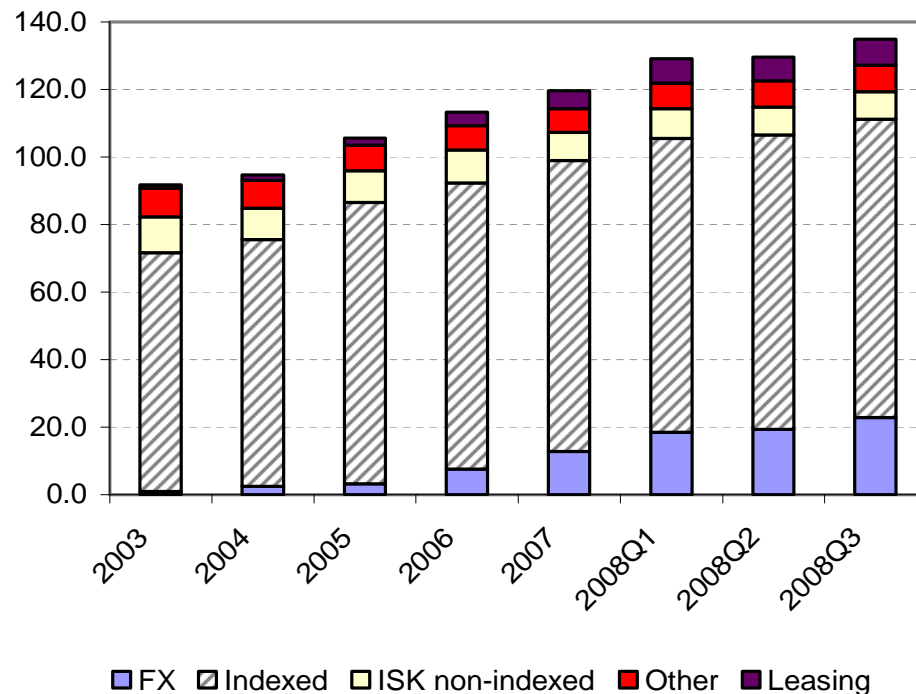


Source: Icelandic Authorities.

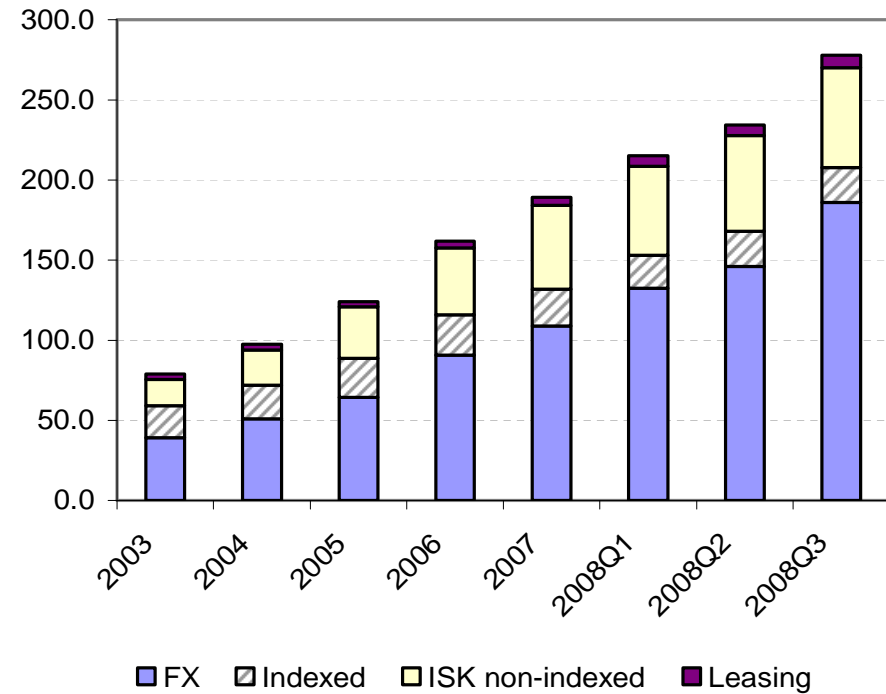
...while vulnerabilities also built up on corporate and household balance sheets.



Iceland: Household Borrowing from the Credit System
(In percent of GDP)



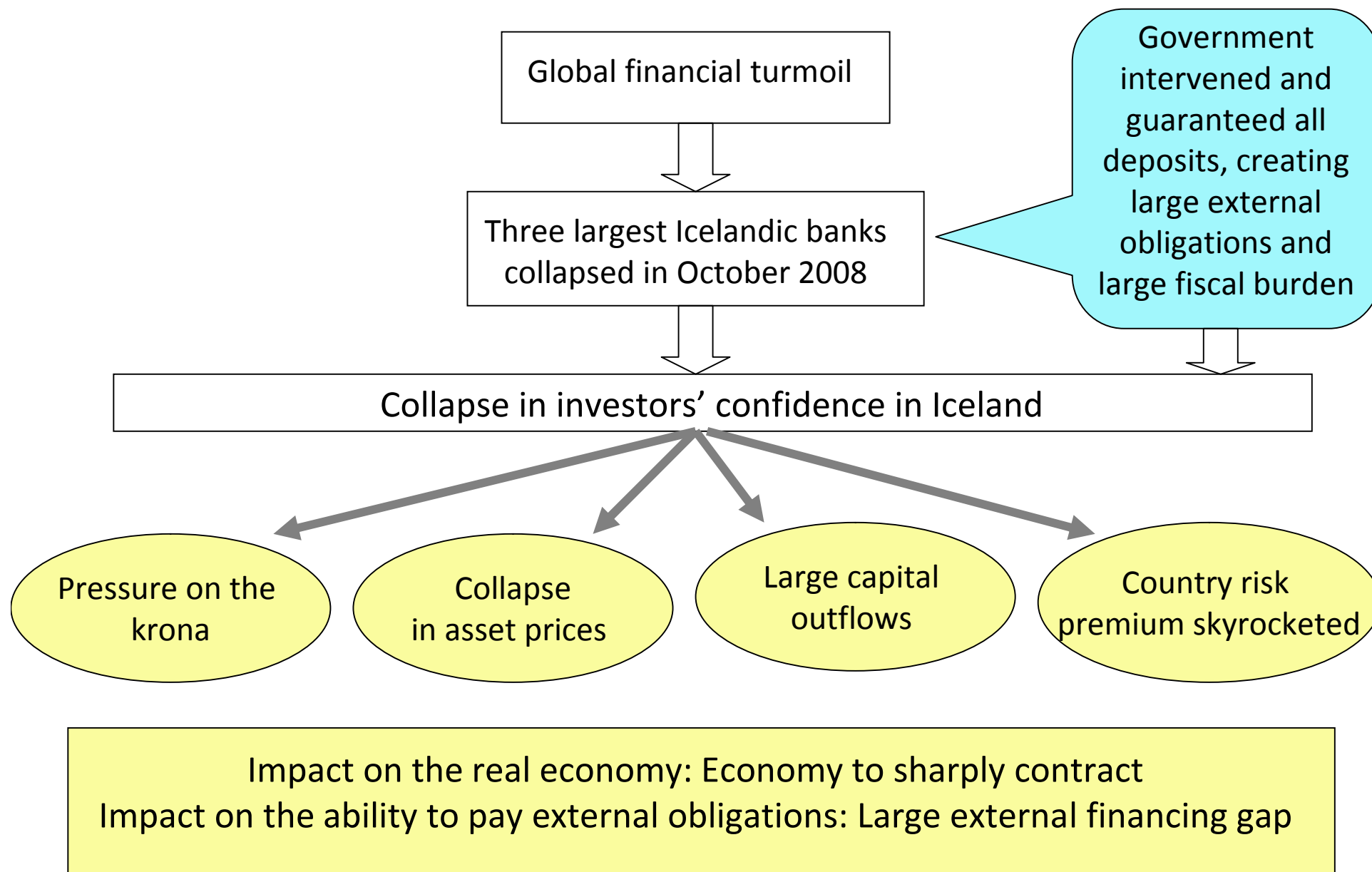
Iceland: Corporate Borrowing from the Credit System
(In percent of GDP)



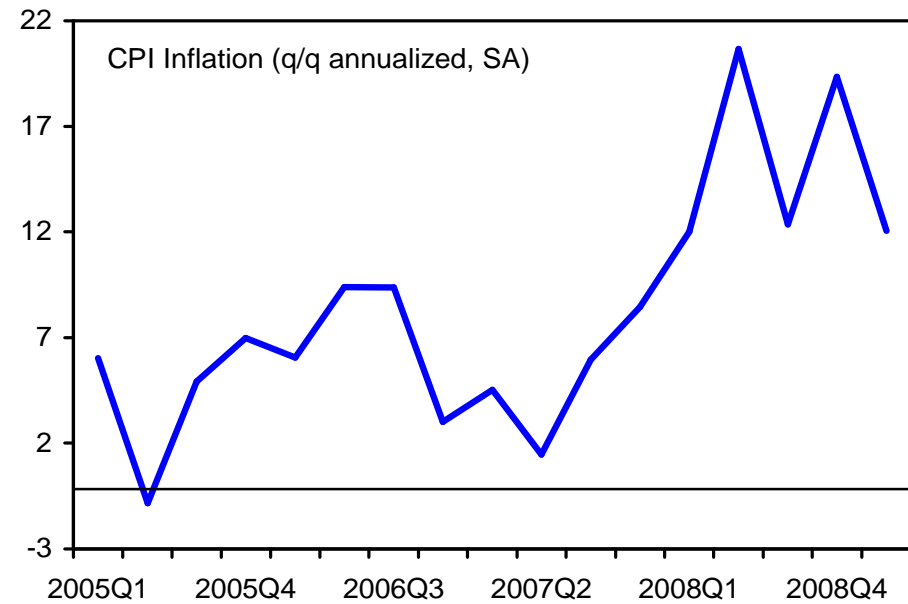
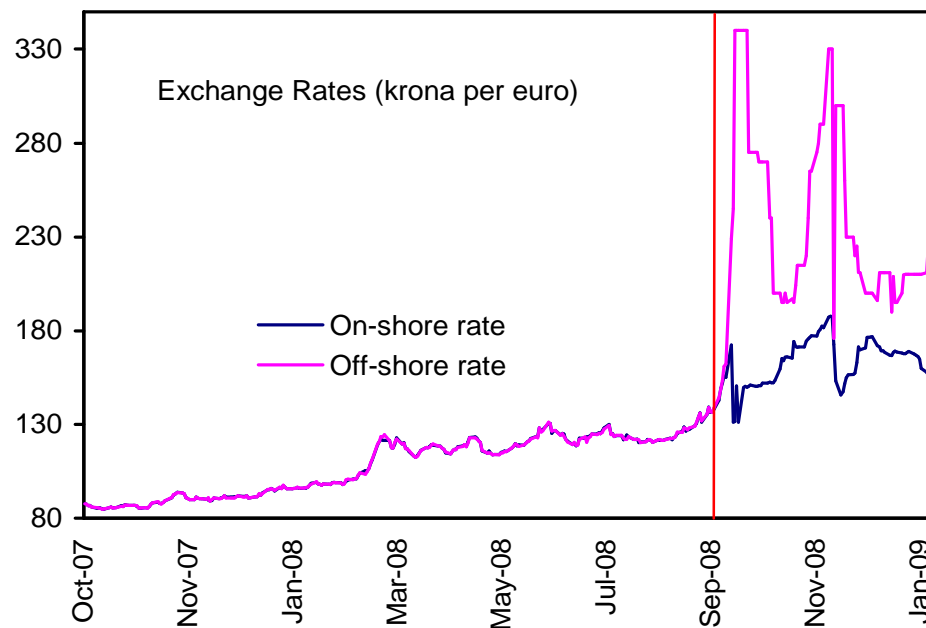
Source: Central Bank of Iceland.



II. The crisis

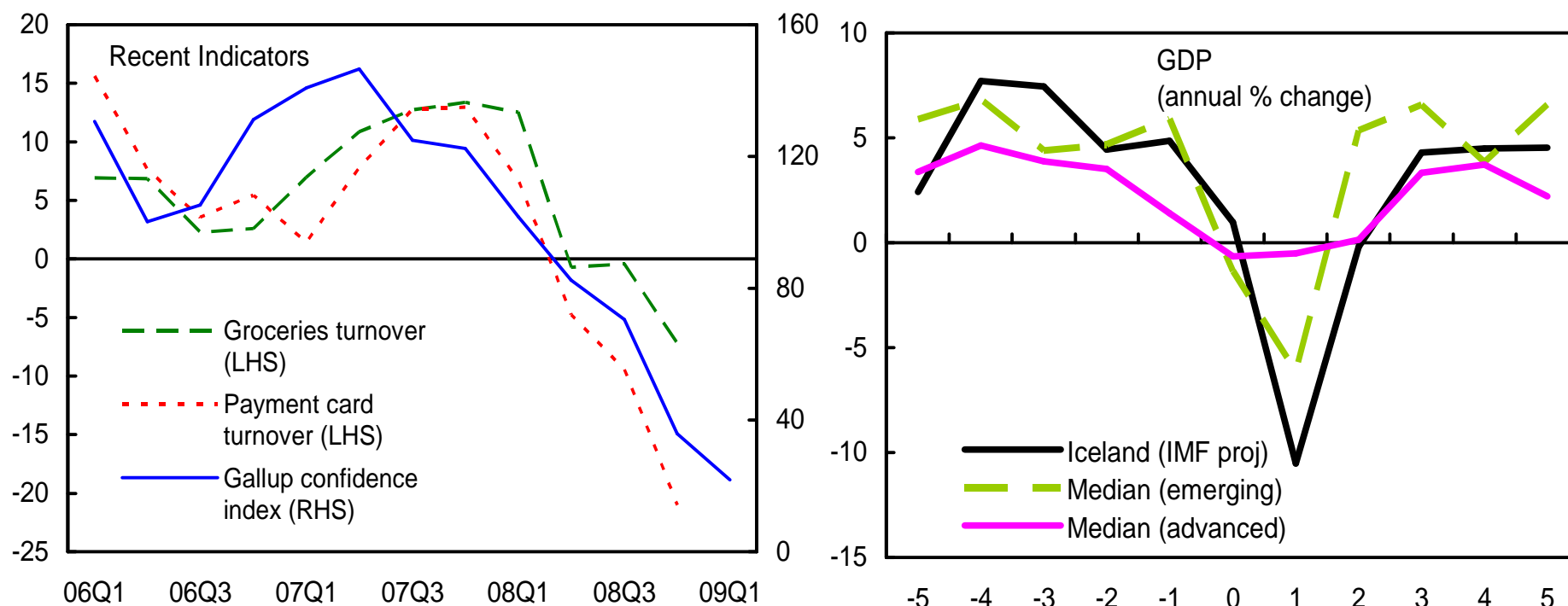


Immediate pressure on the currency and inflation, but signs of stabilization already.



Source: IMF and Central Bank of Iceland

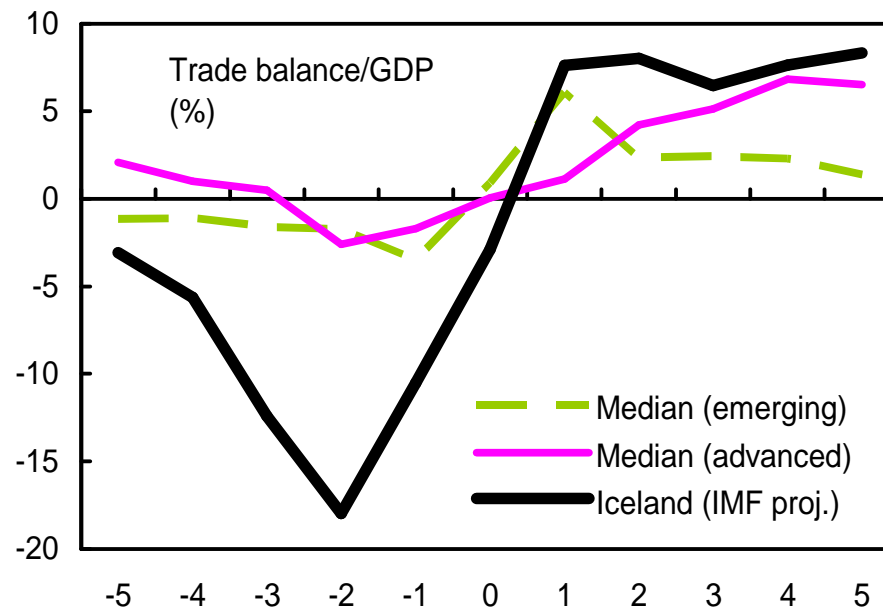
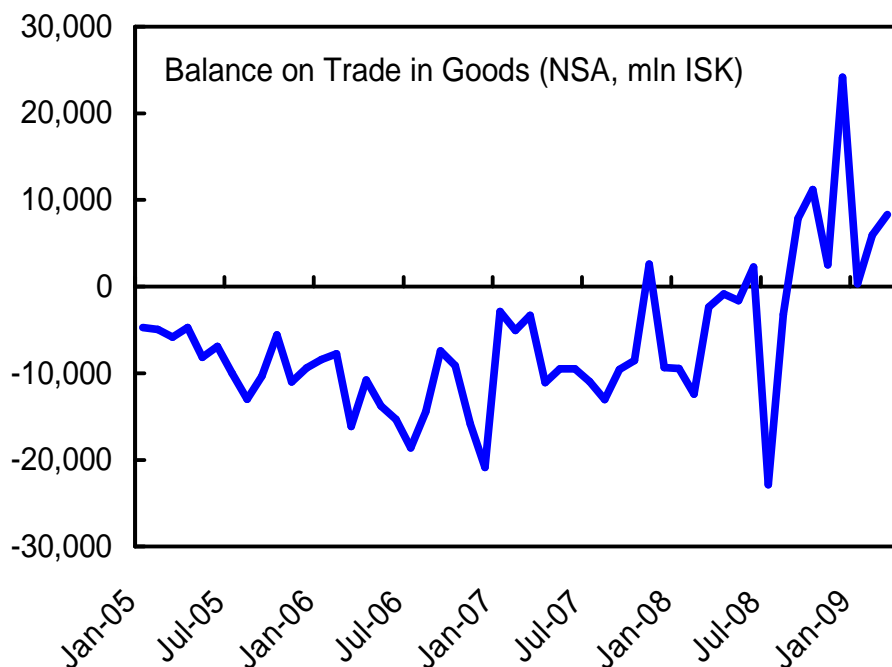
A sharp contraction of GDP, but recovery not far around the corner (based on international experience).



Source: IMF and Central Bank of Iceland



The trade balance has already improved substantially, and should remain in surplus.



Source: IMF and Central Bank of Iceland

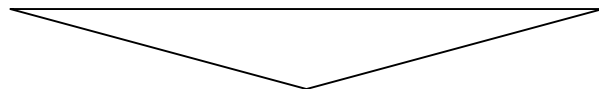


III. IMF Program: Adjustment and Policies



The IMF Program

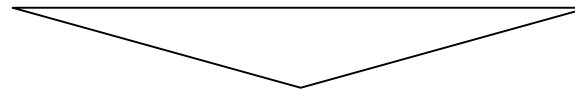
Financing



Two-year IMF Stand-by Arrangement totaling \$2.1 billion; \$827 million upfront, and remainder in 8 equal installments.

Official bilateral creditors commit an additional \$3.2 billion.

Adjustment

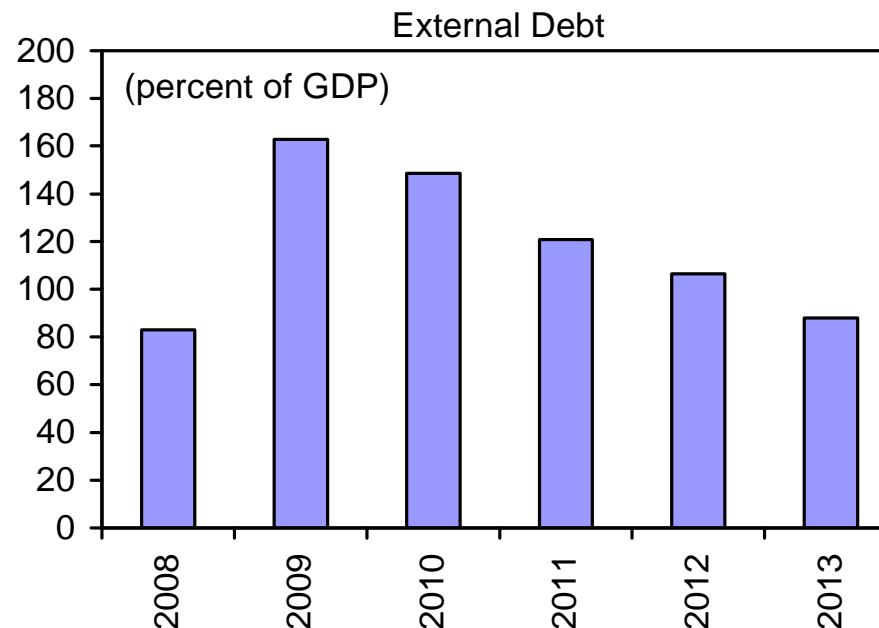
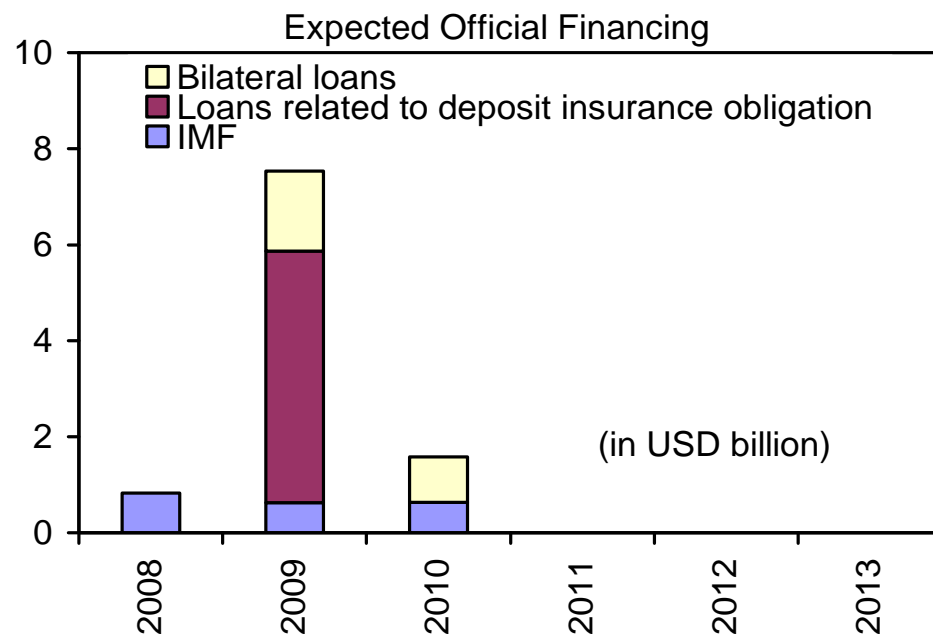


Monetary policy

Fiscal policy

Financial sector policy

Program financing



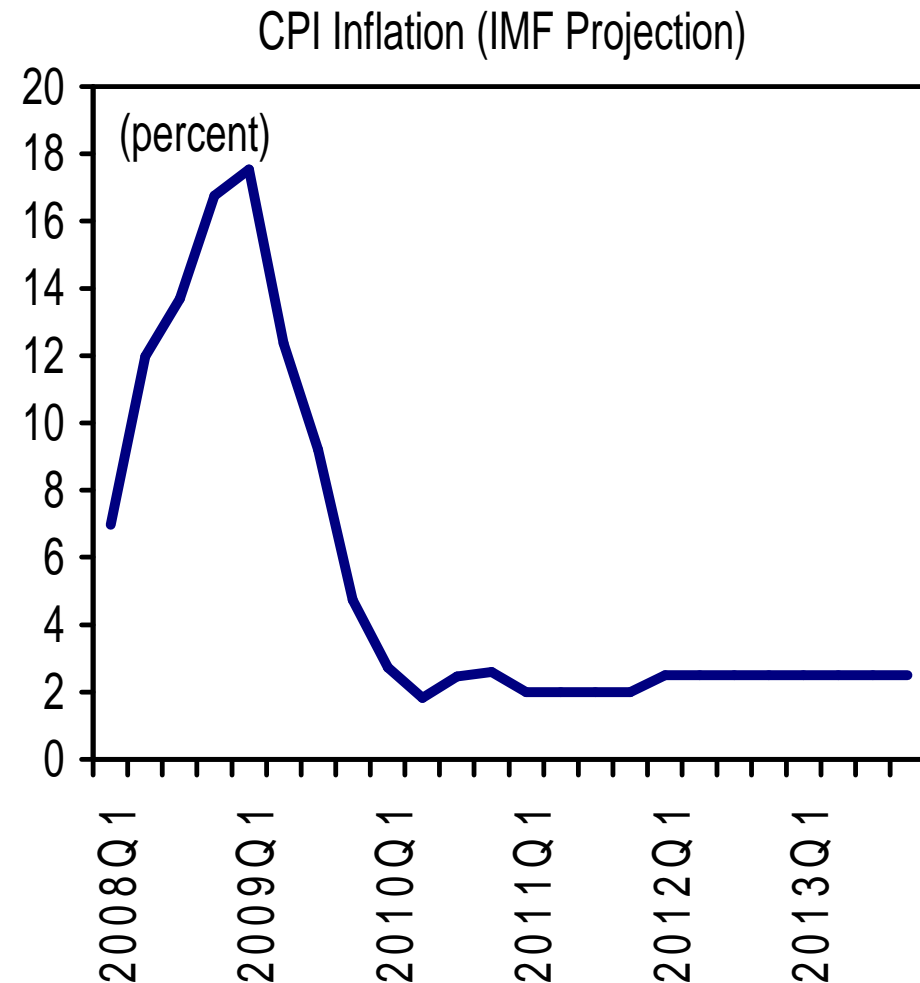
Source: Central Bank of Iceland and IMF Staff projections

- External debt sustainability is robust to a variety of shocks. Key factors:
 - High current account surpluses (fed by improvements in competitiveness)
 - Asset recovery in the banking sector; (conservative assumption made)
 - Asset repatriation (e.g. pension funds);

Monetary policy: Stabilization then support



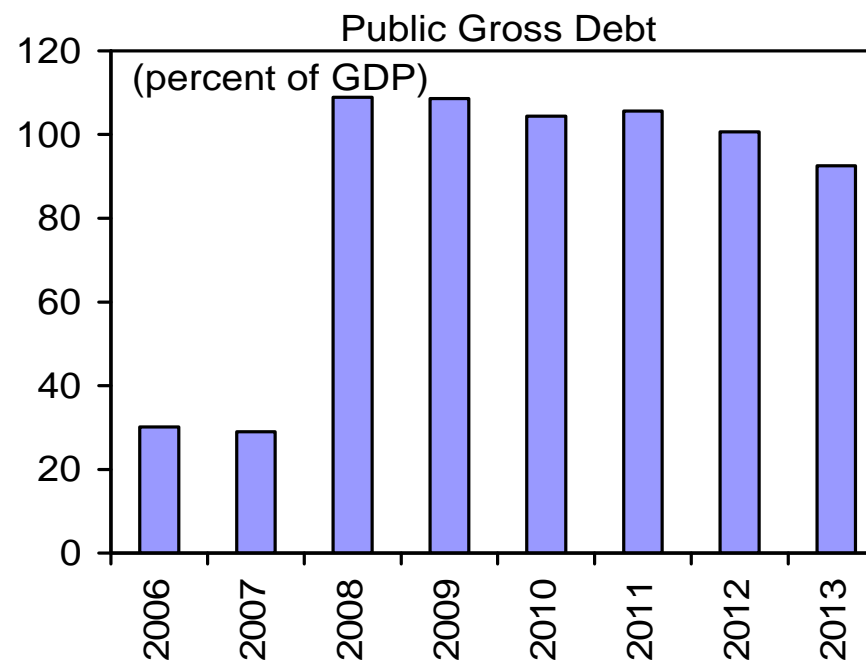
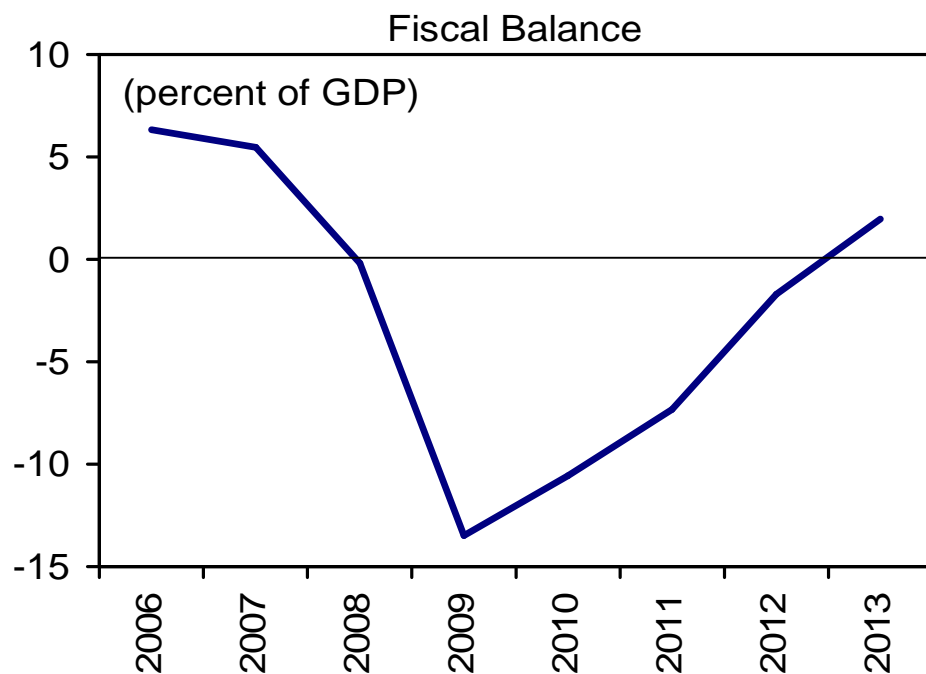
- Immediate objectives:
 - stabilize the exchange rate
 - Stabilize financial markets
 - Largely accomplished
- Program objectives:
 - Normalize the regime
 - Remove capital controls
 - Reduce interest rates
 - Keep inflation low
 - Support recovery
- Medium-term objective:
 - What monetary policy regime? To be determined.



Source: Central Bank of Iceland and IMF Staff projections

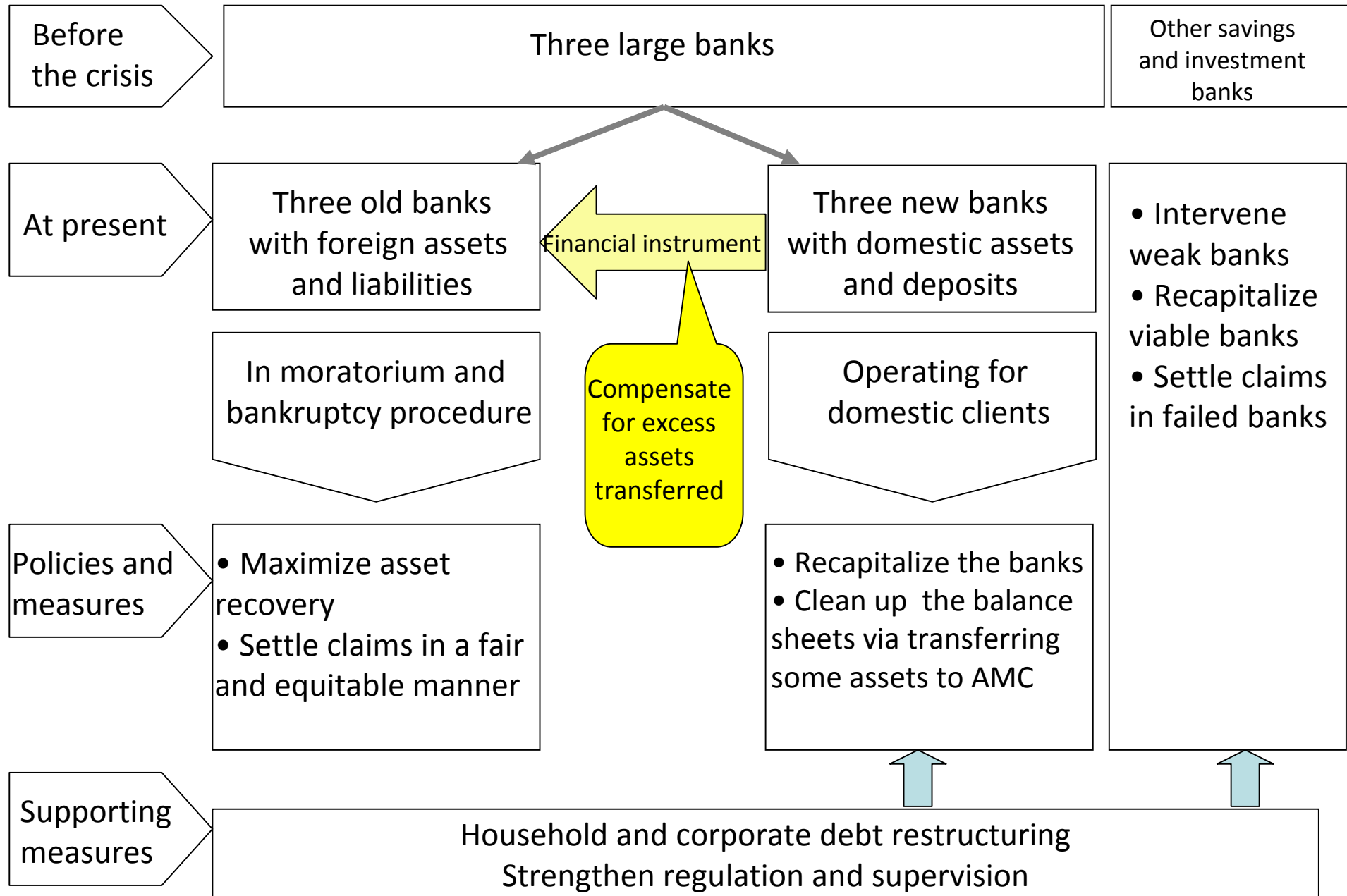


Fiscal policy: Gradual consolidation and reduction of public debt



Source: Iceland's Ministry of Finance and IMF Staff projections

Restoring the collapsed banking system





Where does the program stand?

Policies:

- Monetary policy: Plan being refined to gradually phase-out capital controls
- Fiscal policy: Developing consolidation plan.
- Financial sector: Finalizing the instrument of compensation between new and old banks.

Progress towards the next IMF disbursement

- Program has quarterly reviews
- Discussions on first/second program reviews now ongoing
 - Various technical issues being worked out
- The next loan tranche to be disbursed after IMF executive board approval of the reviews