

ICELAND

Domestic demand collapsed following the failure of Iceland's three main banks in October 2008, plunging the economy into a very deep recession. The economy is projected to shrink until early-2010, when it should be buoyed up somewhat by investment in large energy-related projects. The unemployment rate is likely to soar to 10% next year. Inflation should fall to very low levels and the current account should improve to near balance in 2010.

Restoring the smooth functioning of the banking system is the top priority. This entails completing the bank restructuring process quickly so that the new banks can resume lending, especially to firms. Removing exchange controls as soon as feasible would facilitate access to foreign credit markets. The large, and necessary, fiscal consolidation programme provides an opportunity to enhance the efficiency of public expenditure, but will also require significant spending cuts and tax increases.

Iceland: Demand, output and prices

	2005	2006	2007	2008	2009	2010
	Current prices ISK billion	Percentage changes, volume (2000 prices)				
Private consumption	610.6	3.9	5.6	-7.7	-16.2	-1.9
Government consumption	252.6	4.0	4.2	2.8	-2.2	-3.3
Gross fixed capital formation	291.3	21.7	-12.8	-21.8	-51.3	7.0
Final domestic demand	1 154.5	8.4	0.0	-9.0	-21.0	-0.9
Stockbuilding ¹	- 0.9	1.1	-0.6	-0.4	1.0	0.1
Total domestic demand	1 153.7	9.4	-0.6	-9.3	-18.6	-0.8
Exports of goods and services	323.9	-4.9	17.7	7.1	-1.0	0.8
Imports of goods and services	451.3	10.4	-1.0	-18.0	-26.3	1.2
Net exports ¹	- 127.4	-6.1	6.2	10.6	12.1	-0.1
GDP at market prices	1 026.3	4.5	5.5	0.3	-7.0	-0.8
GDP deflator	—	9.0	5.6	12.2	9.2	3.6
<i>Memorandum items</i>						
Consumer price index	—	6.7	5.1	12.7	10.8	2.4
Private consumption deflator	—	7.5	4.7	14.0	11.4	2.4
Unemployment rate	—	2.9	2.3	3.0	8.4	9.9
General government financial balance ²	—	6.3	5.4	-14.3	-10.7	-7.2
Current account balance ²	—	-25.0	-15.4	-34.6	-3.0	-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 85 database.