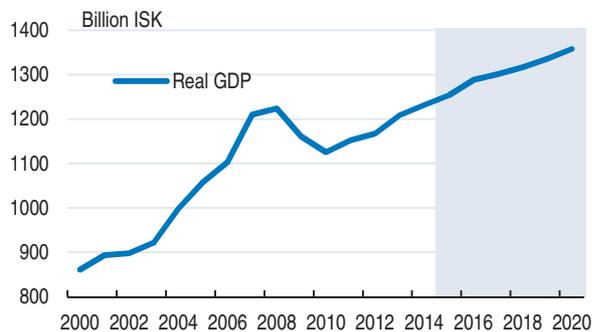


Economic survey of Iceland 2015

Main findings

Iceland's economic prospects are good, but capital controls and wage increases are key challenges

Output has recovered



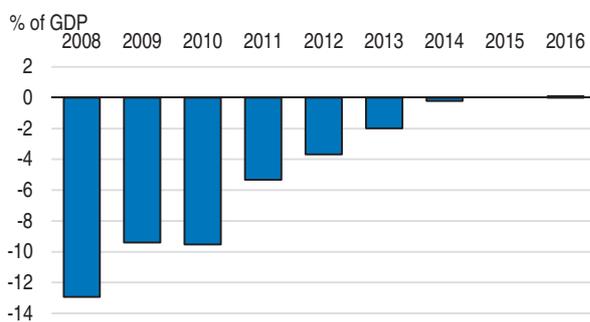
Source: OECD Economic Outlook 97 database and long term baseline.

StatLink <http://dx.doi.org/10.1787/888933258386>

Iceland has entered its 5th year of economic recovery and prospects are for continuing growth. Progress has been made on many fronts: inflation has come down, external imbalances have narrowed, public debt is falling, full employment has been restored and fewer families are facing financial distress. Lifting the capital controls introduced in 2008 in an orderly way is a challenge due to the complexity of the problem and the size of potential capital outflows. Large wage increases awarded during the recent collective bargaining round that are well in excess of productivity will require growth-weakening monetary tightening.

Fiscal policy has become more sustainable, but contingent liabilities remain a risk

The budget deficit has been eliminated



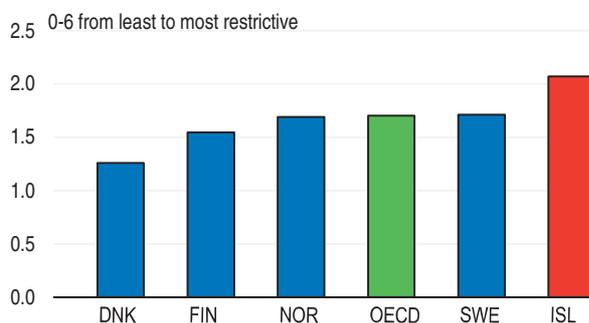
Source: OECD Economic Outlook 97 database.

StatLink <http://dx.doi.org/10.1787/888933258394>

Iceland has considerably improved its fiscal position. A budget surplus is about to be achieved and public debt has been lowered. Long-term projections suggest that fiscal policy had been on track to achieve sustainability before subsequent changes were made to secure wage settlements. The simulations also show that it would not take much to derail fiscal policy. In addition, spending pressures, notably future pension entitlements, remain a risk and contingent liabilities, such as the HFF guarantee, could have severe consequences. Staying the fiscal course by bringing down public debt levels further is therefore important to reap the gains of past efforts.

Barriers to entrepreneurship, lack of competition and weaknesses in education undermine productivity

Barriers to entrepreneurship are high



Source: OECD, Product Market Regulation indicators database.

StatLink <http://dx.doi.org/10.1787/888933258402>

Despite the recovery, income per capita remains lower than in other Nordic countries and near the OECD average, reflecting weaker productivity. While Iceland has a business-friendly environment, it can be difficult for new firms to enter markets, thus deterring innovation. Due to the small size of the economy, ensuring competition can be a challenge. Also undermining productivity are low skills in some of the labour force due to high drop-out rates from upper-secondary school.