

COUNTRY PROFILE: REPUBLIC OF ICELAND**DATED: JUNE 2008****CREDIT GUARANTEE:**

	<i>Country Rating</i>	<i>U/W Method</i>
<i>Short-term</i>	1A	No Restriction

Recent Political Highlights

- Prime Minister Geir Haarde, head of the conservative Independence Party took office in June 2006. The Independence Party has dominated politics since Iceland declared full independence from Denmark in 1944. It ruled in a coalition with the Progressive Party from 1995 to 2007. In the May 2007 parliamentary elections, the coalition held onto its majority with a single seat, but the Progressive Party left the coalition after its poor showing. Subsequent negotiations led to a coalition between the Independence Party and the Social Democratic Alliance (SDA). The new government has a strong majority and wants to concentrate on children, the elderly and the environment. Mr Haarde is a staunch opponent of EU membership, but the new coalition has set up a commission to look at the advantages and disadvantages of joining the EU; one of government's primary concerns about joining the EU is the loss of control over fishing resources.
- Mr Haarde's former government supported the building of smelters powered by geothermal and hydroelectric resources by aluminium giants such as Alcoa. His new SDA coalition partners want such developments halted as environmentalists have protested that the projects are being pushed through at the expense of fragile wildlife habitats. So far nothing has been done and no announcements have been made to stop or reconsider them.

Recent Economic Highlights

- The population of Iceland is estimated at 304,000 with an annual growth rate of 0.87%. Iceland enjoys a standard of living among the highest in the world. Its per capita income is remarkably evenly distributed and is the fifth highest among OCED countries.
- For many years its prosperity depended on the fishing industry. While the fishing industry still makes up a large proportion of exports (about 70%), it now accounts for less than 10% of gross domestic product. The other main exports are aluminium, animal products and ferrosilicon. Diversification remains one of the government's major policies. Banking and finance reforms have helped to fuel exceptional growth, though there have been worries about economic overheating.
- Despite growing turbulence in financial markets in 2007, investment, private consumption and exports increased more than expected. GDP growth was 3.8% in 2007, slightly less than the 4.5% average growth rate for the previous ten years. A two-year period of sluggish growth is forecast in the Icelandic economy; a period when the economy will reach equilibrium after rapid economic growth and overheating in recent years. In 2008, domestic demand is expected to contract by 2.3% due to a decline in private consumption, housing and business investment. The economy is expected to grow slowly in 2008, with real GDP rising by a small margin of 0.5% and contracting by 0.7% in 2009. Economic growth should revive considerably in 2010 and 2011 when domestic demand and favourable external trade will join forces. The Glitnir Bank expects GDP to grow at 0% this year and 0.2% next year.
- Depreciation of the krona in 2007 along with persisting demand and labour market pressures resulted in inflation reaching 5% in 2007. It is forecast at 8.3% in 2008. Inflation in Iceland has been above the central bank's target of 2.5% since the spring of 2004.
- A number of investment projects based on energy supply are under consideration in Iceland, namely an aluminium smelter, expansion of the Alcan smelter, and two silicium plants. The proposed projects are estimated to lead investment equivalent to 5-6% of GDP per year over 2009-2011 and this ratio will decline up to 2015 when these projects are expected to be completed.
- Tax cuts in early 2007 eased the fiscal stance, although the general government budget is still in substantial surplus. The fiscal surplus narrowed to 4% of GDP in 2007. The 2008 budget proposal implies a further decline in the surplus to around 1% of GDP, as expenditure is planned to increase by 8% in real terms.
- The current account deficit is estimated to have amounted to 15.5% of GDP in 2007 and is forecast to decline to 13.2% in 2008 and 7.7% in 2009, as the export of goods and services grows faster than imports. Aluminium production has also increased with total production now estimated at close to 65,000 tonnes per month, compared to production of roughly 27,000 tonnes per month in 2006.

Latest Trade Developments

- Main imports: machinery and equipment, petroleum products, foodstuffs and textiles.
- Major trade partners: UK, Germany, Netherlands, US, Spain, Denmark, Sweden, Norway and China.