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The Chairman's Summing Up at the Conclusion of the
1983 Article IV Consultation with Iceland
Executive Board Meeting 83/171 - December 9, 1983

Executive Directors welcomed the set of strong--albeit belated--stabilization measures taken by the Icelandic authorities in mid-1983 in response to the large imbalance in the external current account and a dramatic acceleration of inflation. The statutory incomes policy--including the suspension of wage indexation--in conjunction with a pronounced depreciation of the krone, led to a marked decline in real disposable incomes, a narrowing of the current account deficit from the equivalent of 10 percent of GNP in 1982 to a projected 2.5 percent in 1983, and a sharp deceleration in inflation, while full employment conditions were maintained.

Directors commended the objectives adopted by the Icelandic authorities for 1984, namely, the elimination of the current account deficit and a reduction in the rate of inflation to one of single digits by year-end. They considered the elimination of the current account deficit to be vitally important, given Iceland's current high debt burden equivalent to 60 percent of GNP, and observed that the desired reduction in the rate of inflation would be necessary if continued adjustment was to be accompanied by stability.

Directors stressed that the recent gloomy outlook for the fish catch in 1984 made a determined pursuit of adjustment--particularly through significant strengthening of financial policies--all the more important; otherwise, the objectives of the authorities with regard to inflation and the balance of payments would be difficult to reach.

Directors characterized the progress made in 1983 as having largely rested on the use of incomes policies, supplemented by exchange rate depreciation; financial policies, they felt, had not provided adequate or sufficient support. They viewed with concern the continuing rapid expansion in the credit and monetary aggregates which, in their view, was inconsistent with the goal of sustained adjustment. Noting that interest rates in parts of the financial system were indexed, they considered that recent reductions in nonindexed interest rates might have contributed to the continued overaccommodating stance of monetary policy. Directors urged the authorities to make a prompt and determined effort to dampen liquidity through vigorous use of existing instruments, by introducing new instruments to sell government debt to the nonbank public, and by restricting central bank credit to the deposit money banks. Higher real interest rates were bound to be required for that purpose.

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The correction in the fiscal budget for 1984 was commended by Directors, who stressed the importance of limiting any deficit that might emerge should tax receipts show a shortfall from estimates, for example, as a result of lower fish catches. Noting that the budget was, nonetheless, accompanied by a sizable and growing gross financing requirement, Directors emphasized that it was particularly important to finance the borrowing requirement largely from outside the banking system and to adhere to the ceilings on foreign borrowing by the public sector. Several Directors regretted that the burden of fiscal adjustment had been falling in large part on public investment, and they pointed to the need to improve the efficiency of the tax system.

Directors stressed that the achievement of the authorities' inflation targets would depend on wage settlements in 1984 not exceeding the official guidelines. Excessive wage settlements would also call into question the policy of a relatively stable exchange rate in effective terms. Directors were in sympathy with the current exchange rate policy stance of the authorities, but warned that maintenance of competitiveness through determined pursuit of appropriate financial policies was vital for purposes of export diversification and in order to safeguard continued adjustments in the external accounts.

Directors noted that a request by Iceland might be forthcoming for use of Fund resources under the compensatory financing facility. A number of them indicated that, without prejudice to any possible decision on the matter, they would examine any such request with an open mind and on the merits of the case. Some Directors indicated that, in their view, Iceland had already met the test of cooperation under the compensatory financing facility. Some other Directors indicated that, in their view, Iceland's Article IV papers did not provide an adequate basis for judging at this time whether the upper tranche conditionality of the compensatory financing facility is satisfied.

Directors welcomed Iceland's recent acceptance of the obligations of Article VIII, and commended its maintenance of a largely free trading environment. They recommended that the next Article IV consultation with Iceland be held on the standard 12-month cycle.