Iceland faces rising unemployment and rampant inflation

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20 December 2008

Weekly protests continue in Reykjavík to demand the resignation of the government and central bank chiefs and the holding of fresh elections. Opposition has also been expressed to the privatisation drive resulting from the government's acceptance of an IMF-backed loan.

At its peak in late November, approximately 10,000 people were taking part in the protests, some of the largest Iceland has ever seen. Many are now smaller in the absence of any perspective that could sustain them, but social anger has not abated.

Unemployment in October remained at the relatively low level of 1.9 percent. Within a month it had risen to 3.3 percent. Recent reports show no signs of this trend slowing. Thanks to Iceland's labour laws requiring three months notice before a worker can lose his job, many are predicting that the real impact of unemployment will not be felt until in to the new year.

In a bid to quell public outrage at the handling of the crisis, a bill was passed in parliament by 49 votes out of a total of 63 authorising an investigation into the financial collapse. A team of economic "experts" from Iceland and abroad will be called in to investigate the circumstances surrounding the collapse of Iceland's major banks. A token gesture of MPs and government officials to take a 10 percent pay cut stalled in parliament as it was declared "illegal".

As the population face economic ruin, the government and central bank has been working to re-float the krona on international markets. This was completed on December 1 when the central bank (Sedlabanki) began trading krona again. However, trading is subject to numerous stipulations, with traders unable to change krona into foreign currency. The *Economist* has expressed concern that the capital controls imposed by Sedlabanki threatens to drive more investment away from Iceland. While Sedlabanki has been quoting exchange rates of 150 ISK to the euro, the actual rate when traded freely is much higher. The European Central Bank (ECB) has been quoting the rate at 290 ISK per euro, although trading in the Krona remains very limited.

The decline of the krona, which has lost half of its value since the start of 2008, has resulted in rampant inflation, which is now over 20 percent. Many people are seeing costs skyrocket, particularly on imported goods. Due to the high interest rates in Iceland, many people took out loans in foreign currencies where interest was lower. For them, costs have doubled

The economy is set to suffer a severe contraction in the coming year. Lars Christensen, an economist from Dansk bank commented, "Given the base now, GDP will then fall at least 10 percent, or even 15 to 20 percent."

The crippling level of debt from the collapsed banks will exacerbate this problem. Recent analyses indicate that in total the banks' liabilities will cost Iceland 80 percent of its GDP.

Iceland faces the largest budget deficit on record. A government forecast predicts a deficit of between 165 and 170 billion ISK (approximately $1.5 billion). This means that virtually the entire loan of $2.1 billion granted by the IMF last month will disappear, leaving the government with little choice but to launch an offensive on public spending.

Such a deficit, which would amount to nearly 15 percent of GDP, would force the government to seek additional loans. Without such support, the government would go bankrupt. Although a total of $10.2 billion of funds have been made available by a number of countries, including the IMF loan, analysts have indicated the belief that at least $20 billion will be

needed to stabilise the economy.

Already public spending cutbacks have been launched. At its press conference announcing the projected 2009 budget deficit, the government revealed plans to cut spending by 45 billion krona. Prime Minister Geir Haarde outlined the seriousness of the situation, stating, "The income basis of the previous budget proposal has been greatly distorted in the wake of the collapsed banking system. Whole revenue contributions are disappearing; we need to react."

These cutbacks will only be the prelude to a vast scaling back of public service provision and the privatisation of social services. While the IMF made available $820 million of its $2.1 billion loan immediately, the rest of the funds will only be paid out in eight equal instalments and will be conditional on quarterly reviews of Iceland's performance.

Debates within the ruling establishment as to the best means to deal with Iceland's economic crisis are continuing. The question of European Union membership is being seriously considered as well as adopting the euro. Even the Independence party, which has been traditionally hostile to the EU due to its close links to the fishing industry, has brought forward its party congress to January with the aim of discussing EU membership. The party's vice-chairman has given her support to Iceland's application to become a member and fears have been expressed that the party could split over the issue.