1. This decision is taken by the Executive Directors in concluding the 1972 consultation with Iceland pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. Real gross national product showed a rapid increase, for the second consecutive year, rising by 9.5 per cent in 1971. The expansion was sustained largely by domestic demand factors which showed a sharp upturn in the second half of 1970. Imports in 1971 rose at about the same rapid pace as in 1970. The value of exports hardly expanded in 1971, a decline in volume was offset by another sharp rise in export prices of fish products. Official reserves continued to rise in 1971.

3. The incomes policy measures adopted in November 1970 to halt the price-wage spiral moderated the increase in nominal wage rates in 1971, but, since they also slowed down the rise in consumer prices, they helped sustain a rapid rise in real personal disposable income. These measures contributed to a significant worsening of the budget position compared with 1970. The weakness in general demand management policies also helped to bring to an end the contractionary influence of the Fish Price Equalization Fund in the second half of 1971.

4. The continued sharp increase in domestic demand and the renewal of the price-wage spiral in the first half of 1972 has been threatening Iceland's international competitiveness. To stem this threat and also to gain time for reassessment of economic policy, the authorities introduced in July 1972 a temporary price freeze, and higher consumer subsidies and family allowances. The Fund notes this action and also the Government's intention to finance the additional government expenditure by curtailment of other budget expenditure. In the light of developments so far in 1972, the central government budget accounts are likely to show a continued deficit even though there is already heavy pressure on resources. These pressures, together with the deterioration in the terms of trade, are likely to result in a balance of payments deficit on current account that may not be sustainable in the medium-term.

5. The Fund therefore expresses satisfaction with the intention of the Icelandic authorities to adopt a set of stabilization measures. The recent tax reform has increased the scope for effective fiscal action to slow down the recent excessive increase in consumption. The stabilization efforts of the Government would be greatly assisted by closer coordination of its investment program with the general condition of domestic demand. The Fund urges the Government to make full use of the available monetary instruments, including reserve requirements, and to adopt a more flexible interest rate policy.

6. The Fund welcomes the Government's decision to pursue a continued liberal trade policy.