

CENTRAL BANK OF ICELAND



2021 | 1

MONETARY BULLETIN

The objective of the Central Bank of Iceland's monetary policy is to contribute to general economic well-being in Iceland. The Central Bank does so by promoting price stability, which is its main objective. In the joint declaration made by the Government of Iceland and Central Bank of Iceland on 27 March 2001, this is defined as aiming at an average rate of inflation, measured as the 12-month increase in the CPI, of as close to 2½% as possible.

Professional analysis and transparency are prerequisites for credible monetary policy. In publishing *Monetary Bulletin* four times a year, the Central Bank aims to fulfil these principles.

Monetary Bulletin includes a detailed analysis of economic developments and prospects, on which the Monetary Policy Committee's interest rate decisions are based. It also represents a vehicle for the Bank's accountability towards Government authorities and the public.

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Statement of the Monetary Policy Committee 3 February 2021

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to keep the Bank's interest rates unchanged. The Bank's key interest rate – the rate on seven-day term deposits – will therefore remain 0.75%.

According to the Bank's new macroeconomic forecast, published in the February *Monetary Bulletin*, domestic demand appears to have been stronger in 2020 than was previously assumed, and the economic contraction therefore smaller than the Bank forecast in November. For 2021, the outlook is also for domestic demand to grow more than previously projected, whereas the outlook for exports has deteriorated. Economic developments will be affected by the path the pandemic takes, however.

Inflation rose in January, measuring 4.3%, as the exchange rate pass-through from the depreciation of the króna still weighs heavily in imported goods prices. At the same time, domestic goods prices have risen as well, to some extent reflecting strong domestic demand. This is compounded by the rise in global oil and commodity prices and unfavourable base effects from January 2020. According to the Bank's forecast, the outlook is for inflation to measure 3.9% in Q1/2021 but then fall relatively quickly over the course of the year, as there is still a sizeable slack in the economy and the króna has appreciated in recent months.

The MPC will apply the tools at its disposal to support the domestic economy and ensure that inflation eases back to the target within an acceptable time frame.

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Monetary Bulletin in a nutshell



Global economic activity rebounded strongly in Q3/2020, after COVID-19 infection rates began to fall, but then softened again in Q4, when case numbers started to rise once more. Despite a weakening outlook for Q1/2021, a robust recovery is expected among Iceland's main trading partners as the year progresses and widespread vaccination is achieved.



In Iceland, GDP grew more strongly in Q3/2020 than had been forecast in the November *Monetary Bulletin*. Nevertheless, it was still 10.4% lower than in Q3/2019. Statistics Iceland's revision of GDP growth figures for H1/2020 resulted in a larger year-on-year contraction than had been assumed in November. Indicators imply that GDP continued to grow in Q4 and that it contracted by 7.7% in 2020 as a whole, as opposed to the 8.5% contraction forecast in November. The outlook for 2021 has also improved somewhat, with a poorer outlook for exports offset by more favourable prospects for domestic demand. GDP growth is forecast to measure 2.5% in 2021 as a whole and then rise to 5.1% in 2022 before easing back to 4.1% in 2023.



Job numbers have fallen steeply since the pandemic struck. Registered unemployment excluding persons on the partial unemployment programme measured nearly 11% in December, up by 6.4 percentage points year-on-year. According to the baseline forecast, unemployment will begin to ease in mid-2021 but will be above pre-pandemic levels throughout the forecast horizon. The slack in output that opened up in the wake of the pandemic peaked in H2/2020 and is not expected to close until very late in the forecast horizon.



Inflation rose in H2/2020 and averaged 3.6% in Q4. It rose further in January, to 4.3%, partly because of unfavourable base effects from the prior year. This is the first time since December 2013 that inflation has breached the upper deviation threshold of the inflation target. In spite of this, it appears that the exchange rate pass-through from the depreciation of the króna has begun to ease and that inflation will decline rapidly in the near future, as there is a sizeable slack in the economy. Furthermore, inflation expectations have remained relatively stable. Inflation is expected to ease back to the inflation target in Q4/2021 and fall briefly below it in 2022.



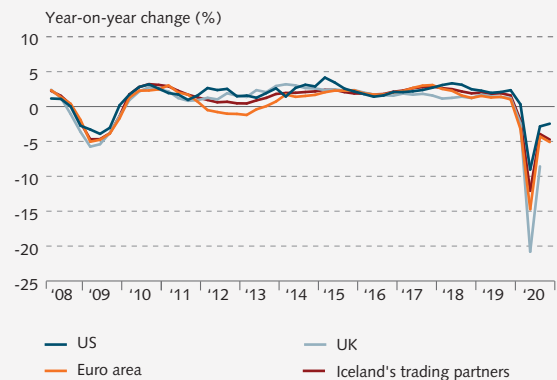
To a large extent, economic developments will depend on how successful efforts to control the pandemic prove to be, both in Iceland and elsewhere. Vaccinations began in late 2020 and, as in the Bank's November forecast, it is assumed that a majority of the population in Iceland and trading partner countries will be vaccinated by mid-year. The forecast also assumes that the current public health restrictions at the border will remain in effect broadly unchanged until then. All of these assumptions are highly uncertain, however, as the pandemic has been spreading strongly in many areas and new variants have appeared. Furthermore, vaccine distribution has been erratic in some places, and there is some uncertainty about participation levels among the general public. As a result, the economic outlook as presented in the baseline forecast could prove to be overly optimistic. On the other hand, the recovery could be swifter and stronger if efforts to control the pandemic are more successful.

The analysis appearing here is based on the Bank's assessment of economic developments, published in November 2020 in *Monetary Bulletin* 2020/4, and on the updated forecast presented here. It is based on data available at the end of January. The risk assessment in the updated forecast is based on the risk assessment in the November forecast. Owing to the high level of uncertainty about the effects of the COVID-19 pandemic on the economic outlook, the forecast appendix shows fewer economic variables than usual.

The global economy and terms of trade

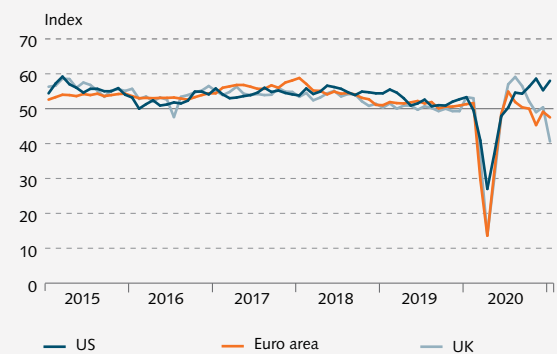
- After a record contraction in H1/2020, global economic activity picked up strongly during the summer, once COVID-19 case numbers declined and public health measures were relaxed. Among Iceland's main trading partners, GDP grew by nearly 10%, on average, between Q2 and Q3 – the strongest single-quarter growth rate ever measured in those countries, and somewhat more than had been assumed in the bank's November forecast. Because of the steep contraction in H1, however, trading partners' GDP was still about 4% below its pre-pandemic level.
- In many countries, case numbers began to rise again in the autumn, outpacing the first wave of the pandemic (Chart V-1 in Appendix 1). Over 103 million people have now been diagnosed with the disease, and more than 2.2 million have died of it.
- This surge in case numbers and the more restrictive public health measures imposed as a result have greatly hampered the economic recovery among developed countries. Purchasing managers' indices (PMI) have fallen, retail sales have lost ground, and the recovery of the labour market has stalled. Furthermore, high-frequency indicators suggest that people are once again moving about less than they were before the pandemic struck (Chart V-1 in Appendix 1). Activity in the services sector has slowed most, while manufacturing has more or less held its ground. This is different from the situation last spring, when public health restrictions strongly affected manufacturers as well as service providers. In most cases, however, the impact on the services sector will probably be less pronounced now than it was last spring, as households and businesses are better prepared than before to keep business activity up and running under current conditions.
- The near-term GDP growth outlook has therefore deteriorated in virtually all of Iceland's trading partner countries, particularly the euro area and the UK, where public health measures have been the most stringent. According to newly published preliminary figures for Q4/2020, GDP contracted by 0.7% quarter-on-quarter in the eurozone and the Bank's baseline forecast assumes a ½% contraction among Iceland's main trading partners in Q4. Because of the

Chart 1
Global GDP growth¹
Q1/2008 - Q4/2020



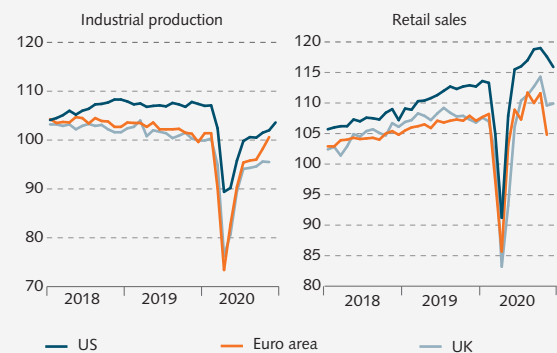
1. Seasonally adjusted data. Central Bank baseline forecast Q4/2020 for main trading partners.
Sources: Refinitiv Datastream, Central Bank of Iceland.

Chart 2
Composite PMI¹
January 2015 - January 2021



1. IHS Markit composite output purchasing managers' index. The index is published monthly and is seasonally adjusted. An index value above 50 indicates month-on-month growth in output, and a value below 50 indicates a contraction.
Source: Refinitiv Datastream.

Chart 3
Industrial production and retail sales¹
January 2018 - December 2020

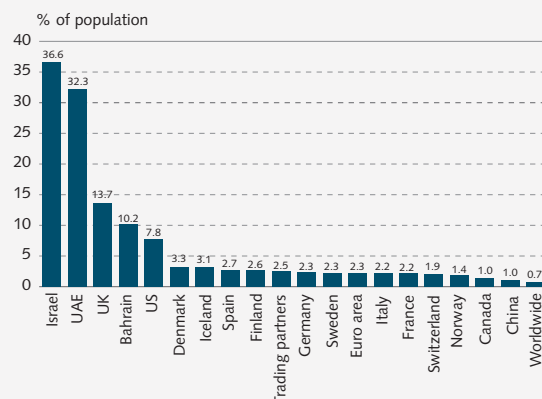


1. Seasonally adjusted volume indices (2016 = 100).
Source: Refinitiv Datastream.

continuing spread of the pandemic early this year and the aggressive public health measures in place, a contraction is also expected in Q1/2021.

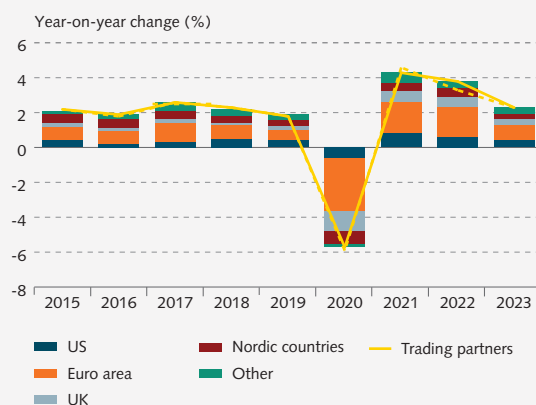
- On the other hand, the outlook is for economic activity to pick up swiftly later in the year, as more people are vaccinated and public health measures are eased. Iceland's main trading partner countries have already vaccinated about 2.5% of the population (almost 5% if China is excluded), and a majority are expected to have been fully vaccinated by mid-year. Increased government support will also buttress the expected economic recovery, particularly in the US, where additional fiscal stimulus measures are in preparation. The uncertainty level remains high, however, particularly as regards how successful efforts to quell the pandemic will prove to be.
- For Iceland's main trading partners, growth in 2021 is projected at 4.3%, down by 0.3 percentage points from November. The outlook for this year has deteriorated for all trading partner countries except the US, Japan, and China, where GDP growth is forecast to be ½-1½ percentage points higher than in the Bank's November forecast. On the other hand, trading partner growth is expected to be stronger in 2022, while the outlook for 2023 is broadly in line with the November forecast. The outlook for trading partner imports has also changed, in line with the changed GDP growth outlook.
- The inflation outlook is largely unchanged since November, however. Inflation among trading partners is projected at 1.3% in 2021, followed by 1.7% in the latter half of the forecast horizon.
- Central banks in major industrialised economies have held their policy interest rates unchanged in recent months but have continued to use other stimulative measures to support the economic recovery. The Bank of England announced an increase in bond purchases in November 2020, and the European Central Bank (ECB) did the same in December, as well as further easing financial institutions' access to liquidity facilities. In addition, the US Federal Reserve announced in December and reiterated in January that it intended to continue adding to its securities holdings at a roughly unchanged pace until it is closer to achieving its inflation and employment objectives.

Chart 4
COVID-19 vaccinations¹



1. Share of the total population who have received at least one vaccine dose.
Source: Our World in Data.

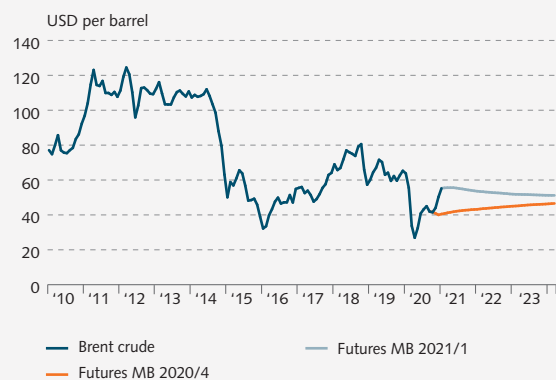
Chart 5
GDP growth in Iceland's trading partners
and contribution from selected countries 2015-2023¹



1. Trade-weighted contribution from selected countries. Central Bank baseline forecast 2020-2023. Broken line shows forecast from MB 2020/4. The Nordic countries is the average for Denmark, Norway, and Sweden.
Sources: Refinitiv Datastream, Central Bank of Iceland.

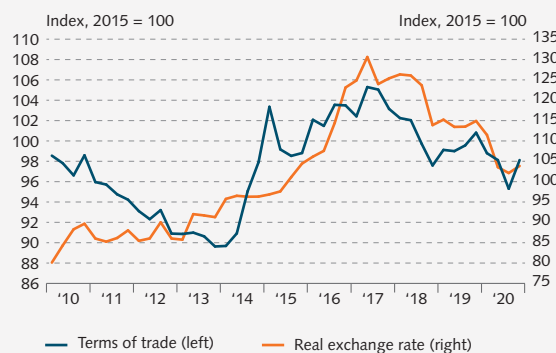
- In spite of the escalation of the pandemic and tighter public health measures, global share prices have risen since November. Positive signs about vaccinations have supported markets and boosted optimism about the economic outlook. Mitigating action taken by governments and central banks have had a major impact as well. Furthermore, the agreement between the UK and the European Union (EU) concerning their future trade relationship, reached just before the turn of the year, has had a positive effect on markets. Moreover, long-term interest rates in leading advanced economies have inched upwards in line with increased optimism about the economic outlook, not least in the US, where rates are at their highest since March 2020.
- Global crude oil prices started rising again in November and are now at their highest level since February 2020. The increase reflects expectations that demand for oil will recover more quickly than previously thought, owing to success with the development of COVID-19 vaccines. Reduced production among OPEC countries and other oil producers has also supported prices. Oil futures prices suggest, however, that prices will dip slightly during the forecast horizon, yet remain above the November forecast over the entire period.
- The price of aluminium and other commodities has also risen more than was projected in November and looks set to rise more in 2021 than was assumed in the November forecast. The outlook for Icelandic marine product prices has deteriorated markedly, however, as market conditions have been complicated by reduced hotel and restaurant sector activity in trading partner countries. Marine product export prices are expected to fall by 2% year-on-year in 2021, instead of rising by 4%, as was forecast in November. On the other hand, prices are projected to rise more strongly in 2022 and 2023.
- According to revised figures from Statistics Iceland, terms of trade deteriorated by nearly 1% in Q2/2020, whereas previous numbers had indicated an improvement of just over 1%. Because of this revision, terms of trade are now estimated to have deteriorated by 2% in 2020 as a whole, and not by 0.6%, as was forecast in November. In a departure from the November forecast, terms of trade are now projected to continue worsening this year, in line with the poorer outlook for marine product

Chart 6
Global oil prices
January 2010 - March 2024



Sources: Refinitiv, Central Bank of Iceland.

Chart 7
Terms of trade and real exchange rate¹
Q1/2010 - Q4/2020



1. Real exchange rate in terms of relative consumer prices. Q4/2020 terms of trade based on Central Bank baseline forecast.
Sources: Statistics Iceland, Central Bank of Iceland.

prices and larger increases in oil and other commodity prices.

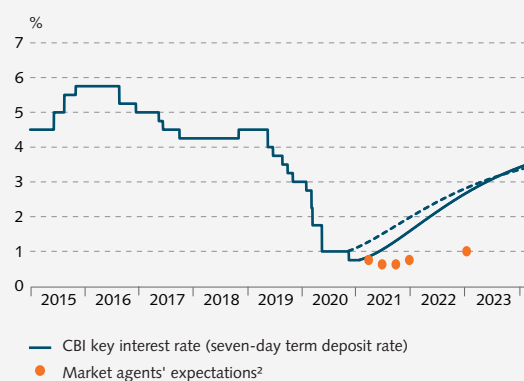
- The real exchange rate in terms of relative consumer prices rose by 5.4% month-on-month in December but was nearly 7% lower than in the same month of 2019. It is expected to be slightly higher over the forecast horizon than was projected in November.

Monetary policy and domestic financial markets

- At its November meeting, the Central Bank Monetary Policy Committee (MPC) decided to lower the Bank's key interest rate (the rate on seven-day term deposits) by 0.25 percentage points, to 0.75%. The key rate has therefore fallen by a total of 2 percentage points since the COVID-19 pandemic reached Iceland in late February 2020. The Bank's real rate in terms of the average of various measures of inflation and one-year inflation expectations is now -2.5%. It has fallen by 0.4 percentage points since just before the November *Monetary Bulletin* and by about 3.1 percentage points since early February 2020.
- According to the Bank's market expectations survey, carried out in January 2021, respondents expect the Bank's key rate to remain unchanged until Q2/2021 and then either remain unchanged or be lowered to 0.5%, where it would remain until end of Q3. They expect the key rate to be 0.75% at the end of the year and rise to 1% in two years' time. Forward interest rates imply, however, that market agents do not expect further rate cuts but instead expect an increase in Q2/2021.
- The yield on ten-year nominal Treasury bonds was 3.5% just before this *Monetary Bulletin* went to press and has risen by about 0.7 percentage points since the pandemic reached Iceland. Because of the rise in long-term bond yields and the reduction in short-term interest rates, the slope of the yield curve has grown steeper: the spread between long and short Treasury bond yields is currently 2.1 percentage points, whereas it was negative by 0.4 percentage points a year ago. The yield on ten-year indexed Treasury bonds has also risen year-on-year, to 0.9% just before this *Monetary Bulletin* was published. On the other hand, the yield on five-year indexed bonds has hovered around zero since mid-2020.

Chart 8
Central Bank of Iceland key interest rate and expected developments¹

1 January 2015 - 31 March 2024

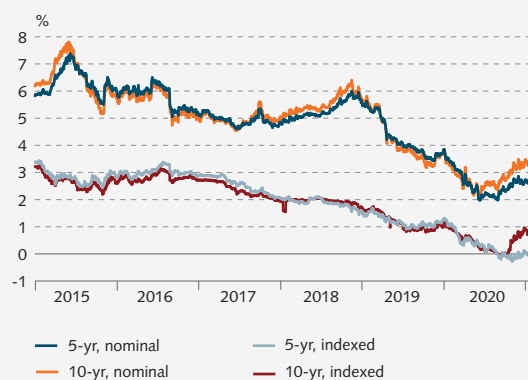


1. The Central Bank's key interest rate and Treasury bond yields were used to estimate the yield curve. Broken line shows forward market interest rates prior to MB 2020/4.
2. Estimated from the median response in the Central Bank's survey of market agents' expectations concerning the collateralised lending rate. The survey was carried out during the period 18 - 20 January 2021.

Source: Central Bank of Iceland.

Chart 9
Government-guaranteed bond yields¹

2 January 2015 - 29 January 2021



1. Based on the zero-coupon yield curve, estimated with the Nelson-Siegel method, using money market interest rates and interest rates on Government-guaranteed bonds.

Source: Central Bank of Iceland.

- The Government Debt Management Prospect for 2021 assumes that 200 b.kr. in Treasury bonds will be issued during the year. Given that some of the Treasury's increased financing need for the next few years will be met with foreign borrowing, a foreign bond in the amount of 117 b.kr. was issued at the beginning of 2021.
- In H1/2020, the Central Bank bought Treasury bonds in the secondary market for about 900 m.kr., but from the latter half of July until early November, the Bank did not place any bids in the market. Since November, the Bank has been more active in the bond market as the foreign exchange market has grown more stable. The Bank's Treasury bond purchases since March 2020 total 9.1 b.kr.
- The short-term interest rate differential versus Iceland's main trading partners has continued to narrow, while the long-term differential has widened since mid-2020. Risk premia on Treasury foreign obligations have changed very little.
- There were significant outflows due to new investments in Q4/2020, mainly because of a foreign investor's sale of domestic Treasury bonds. In 2020 as a whole, net registered new investment was negative by 57 b.kr., whereas in 2019 it was positive by 29 b.kr.
- The króna began to appreciate in early November, bolstered by positive news about the development of COVID-19 vaccines, but it has been relatively stable since early December. Before then, there had been downward pressure on the króna, as foreign investors had been closing out bond positions and exporting the proceeds. In addition, the pension funds stepped up their foreign currency purchases in August, although some of them also sold foreign currency late in the year.
- The Central Bank intervened more actively in the foreign exchange market in H2/2020, and in September it also began a programme of regular foreign currency sales with the aim of deepening the market and improving price formation.
- The average exchange rate of the króna is currently about 4% higher than it was just before the November *Monetary Bulletin*, but nearly 9% lower than in late February 2020, when Iceland's first

Chart 10
Exchange rate of the króna¹

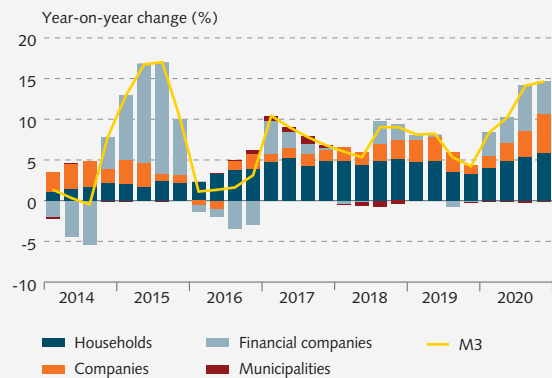


1. Price of foreign currency in krónur. Narrow trade index. Central Bank baseline forecast 2021-2023. Broken line shows forecast from MB 2020/4.
Source: Central Bank of Iceland.

COVID-19 case was diagnosed. The trade-weighted exchange rate index (TWI) measured 206.4 points in Q4/2020; therefore, the exchange rate was nearly 2% above the Bank's November forecast and looks set to be almost 5% above that forecast in Q1/2021. According to the baseline forecast, the exchange rate will be somewhat lower, on average, in 2022 than in 2021, but it will rise slightly in the latter half of the forecast horizon and will be above the level projected in November throughout the entire period.

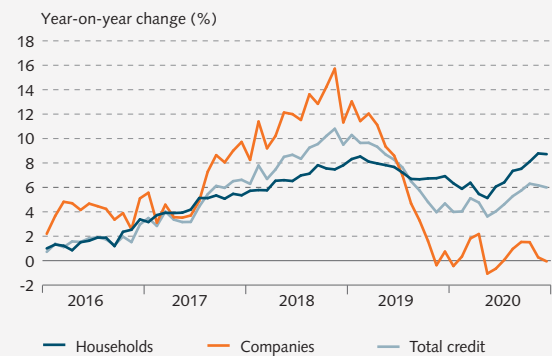
- Growth in broad money holdings picked up over the course of 2020. In Q4, estimated growth in M3 is 14.6%, more than three times the end-2019 level. The rise was driven mainly by increased household and financial sector deposits, although corporate deposits also began to increase towards the end of the year.
- Twelve-month growth in credit system lending to households has measured just over 6% since the beginning of 2020, but by the end of the year it had risen to more than 8½%, as interest rates have fallen steeply and real estate market activity has been brisk. On the other hand, corporate lending has been virtually flat since the end of 2019. To some extent, though, Government measures have eased access to credit for the companies most severely affected by the pandemic. Since July, nearly 12 b.kr. in bridge loans and support loans bearing partial or full Treasury guarantees have been granted. In addition, corporate bond issuance was lively towards the end of the year, although financing through institutional investment funds lost pace.
- Households' borrowing terms have improved markedly with Central Bank rate cuts, and households have increasingly refinanced their mortgages. Demand for non-indexed mortgage loans from the commercial banks has risen, and the share of variable-rate loans has increased. The banks' share in the mortgage lending market continued to grow over the course of 2020, as in most cases the banks now offer lower interest rates than the pension funds do.
- Although credit spreads on new household loans have risen slightly relative to the Bank's key interest rate, they are broadly unchanged relative to average rates on household deposits in the banking

Chart 11
Money holdings¹
Q1/2014 - Q4/2020



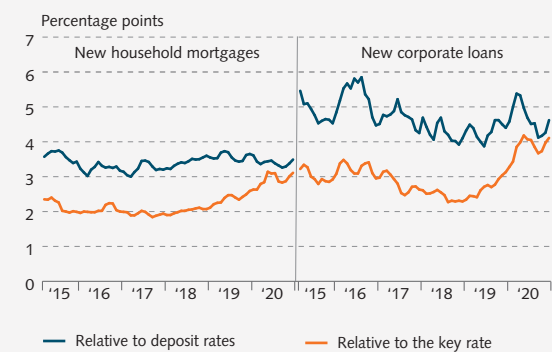
1. M3 is adjusted for deposits of failed financial institutions. Companies include non-financial companies and non-profit institutions serving households. In December 2020, Government credit funds were reclassified, which affects the calculation of M3. The changes have been assessed, and adjustments have been made for them here.
Source: Central Bank of Iceland.

Chart 12
Credit system lending¹
January 2016 - December 2020



1. Credit stock adjusted for reclassification and effects of Government debt relief measures. Excluding loans to deposit institutions, failed financial institutions, and the Government. Companies include non-financial companies and non-profit institutions serving households. December 2020 figures are Central Bank estimates.
Source: Central Bank of Iceland.

Chart 13
Credit spreads¹
March 2015 - December 2020



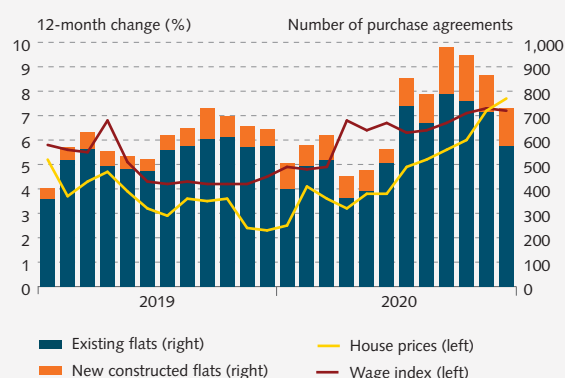
1. The difference between a weighted average of the large commercial banks' non-indexed lending rates and, on the one hand, the Central Bank's key rate, and on the other, a weighted average of their deposit rates. Three-month moving average.
Source: Central Bank of Iceland.

system. The spread between new corporate loans and corporate deposit rates in the banking system has narrowed, however, after peaking in H1/2020. Nevertheless, recent developments may suggest that credit spreads have started to widen again.

- The share of non-performing corporate loans rose steeply in the final months of 2020, to 18% at the end of December (see *Financial Stability 2020/2* for more detail). The spike occurred mainly because special pandemic-related payment deferral measures have been fully utilised, and many of the loans previously protected by those measures are now considered non-performing. In January, however, about 1.6% of corporate loans were still protected by active COVID-related payment deferral measures. Even though default levels have risen, the number of corporate insolvencies has declined. The share of non-performing household loans rose marginally in 2020 but is still low.
- Capital area house prices rose by 7.7% year-on-year in December, while rent prices remained flat. House prices have risen considerably since the pandemic struck, as Central Bank interest rate cuts have stimulated demand and offset the negative economic impact of the pandemic. Furthermore, Government measures have fostered continued growth in disposable income despite a deteriorating labour market situation. Home purchase agreements declined somewhat in number right after the pandemic struck but then started to rise markedly in summer and autumn 2020. The total number of purchase agreements increased by 16% year-on-year in 2020, while the number of contracts for new construction soared 76%. In the capital area, first-time purchasers accounted for 33% of the total number of buyers in Q4/2020, the largest share since measurements were introduced in 2008.
- The OMXI10 share price index rose by a fifth in 2020. Share prices plummeted in March but soon began to rebound, and by mid-year they were back to early 2020 levels. They have continued to rise since the autumn, and the OMXI10 is now about 11.8% higher than at the time of the November *Monetary Bulletin*.

Chart 14

House prices, wages, and number of purchase agreements¹
January 2019 - December 2020



1. House prices and number of purchase agreements (by date of purchase) in the capital area.

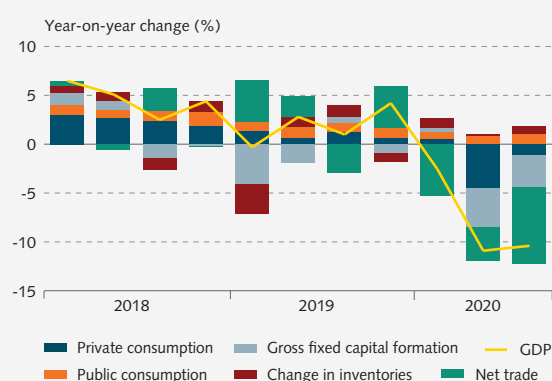
Sources: Registers Iceland, Statistics Iceland.

Demand and GDP growth

- According to preliminary figures published by Statistics Iceland, GDP contracted by 10.4% year-on-year in Q3/2020. Domestic demand contracted by 2.7%, but this was compounded by a nearly 8 percentage point negative contribution from net trade. The pandemic continued to have a strong impact in Q3, albeit somewhat less so than in Q2, as GDP grew by 2.6% quarter-on-quarter. In the first three quarters of 2020, GDP contracted by 8.1% year-on-year, with domestic demand shrinking by 2.6 percentage points and net trade making a negative contribution in the amount of 5.6 percentage points.
- GDP recovered more strongly in Q3 than was forecast in November, owing largely to more than 8% growth in private consumption between quarters. As a result of Statistics Iceland's revision of figures for H1/2020, the contraction in GDP over the first three quarters of the year was adjusted upwards by 1.3 percentage points relative to the November forecast, to 8.1% instead of 6.8%. The change was due mainly to less favourable external trade, with a smaller contraction in goods imports and weaker services exports pulling in one direction and a smaller contraction in domestic demand pulling in the other.
- Following a strong contraction in private consumption in Q2, household demand rebounded over the summer, after the pandemic receded and public health measures were eased (Chart V-2 in Appendix 1). Although consumption spending rose considerably between quarters, private consumption was still 2.3% weaker in Q3 than in the same quarter of 2019. The contraction was less pronounced than had been forecast in November, indicating that households drew considerably on the savings they had accumulated after the pandemic struck (for further discussion, see *Monetary Bulletin* 2020/4).
- During the autumn, COVID-19 case numbers began to rise once again, and public health measures were tightened as a result. As was the case in spring 2020, high-frequency indicators for Q4/2020 suggest a downturn in demand for services requiring close physical proximity between people and activities subject to public health restrictions (Chart V-2 in Appendix 1). On the other hand, turnover in grocery stores and specialty goods shops has increased,

Chart 15

GDP growth and contribution of underlying components¹
Q1/2018 - Q3/2020

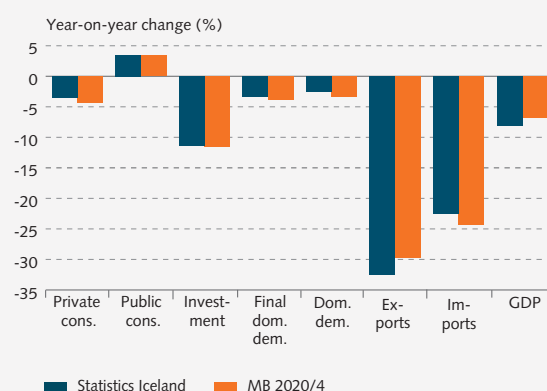


1. Because of chain-volume linking, the sum of expenditure components may not equal GDP growth.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart 16

National accounts for Q1-Q3/2020

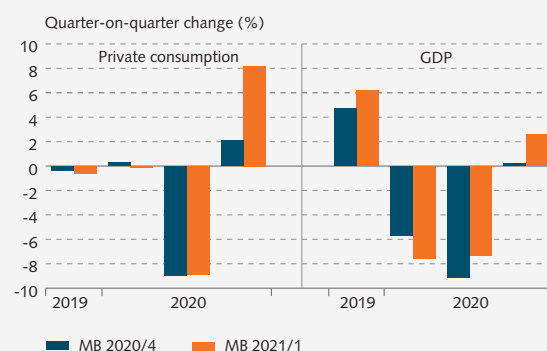


Sources: Statistics Iceland, Central Bank of Iceland.

Chart 17

Quarterly changes in private consumption and GDP growth¹

Q4/2019 - Q3/2020



1. Seasonally adjusted figures. Data for the series MB 2020/4 show Statistics Iceland's measurement from August 2020, with the exception of Q3/2020 data, which are taken from the baseline forecast in MB 2020/4.

Sources: Statistics Iceland, Central Bank of Iceland.

as it did in the spring. There are signs that private consumption picked up again after public health measures were eased slightly in late November, as can be seen in daily domestic payment card turnover and traffic patterns in the greater Reykjavik area (Chart V-2 in Appendix 1). Developments within the quarter therefore varied, but on the whole, private consumption is assumed to have declined relative to Q3. In 2020 as a whole, private consumption is estimated to have contracted by 4.4%, a full 1 percentage point less than was forecast in November.

- Vaccination against COVID-19 began in Iceland in late 2020, and as in the November forecast, it is expected that a majority of the population of Iceland will have been inoculated by mid-2021. It is also expected that public health restrictions will be eased gradually over the course of the year, although it is assumed that public health measures and restrictions on public gatherings will remain in effect in some form until Q4/2021.
- As a result, private consumption will recover slowly, and although it is expected to grow quarter-on-quarter in Q1/2021, it will continue to contract year-on-year until Q2/2021. For 2021 as a whole, private consumption is forecast to grow by 3.7%. The growth rate is expected to ease in 2022 and 2023 but remain above 3% per year.
- Business investment developed in line with the Bank's November forecast in Q3/2020, but the contraction in H1 proved smaller than had been projected. General business investment (i.e., excluding energy-intensive industry, ships, and aircraft) contracted less than was forecast, although this was offset by weaker-than-anticipated investment in energy-intensive industry. In all, investment contracted by 11.4% in the first three quarters of 2020, whereas the November forecast assumed a contraction of 11.6%. More favourable developments in residential and business investment were offset by a significantly larger contraction in public investment.
- Developments in 2021 to date and imports of investment goods in late 2020 suggest that the impact of the pandemic on investment and construction plans turned out less severe than previously projected. In 2020 as a whole, business investment is estimated to have contracted by nearly 16% and total investment by 11.7% – nearly 4 percentage points less than

Chart 18

Payment card turnover, by category
January - December 2020

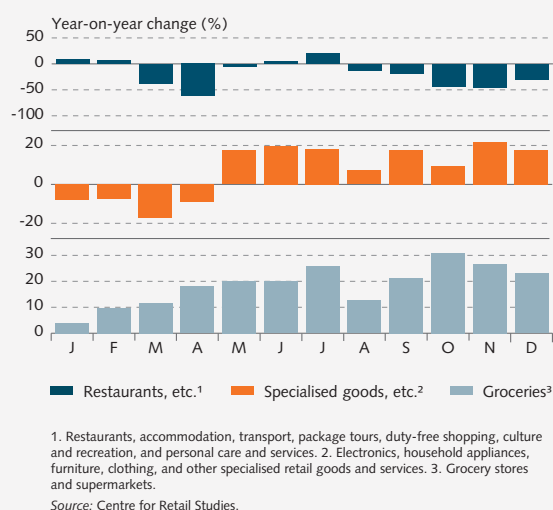


Chart 19

Private consumption 2005-2023¹

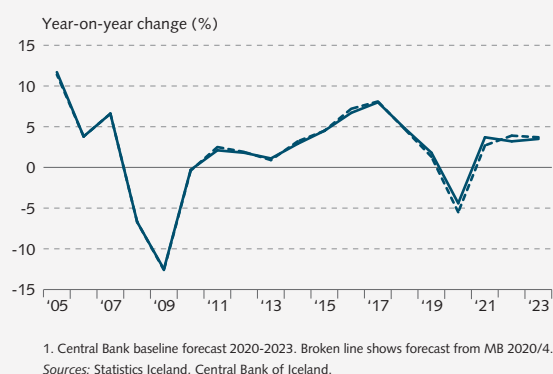
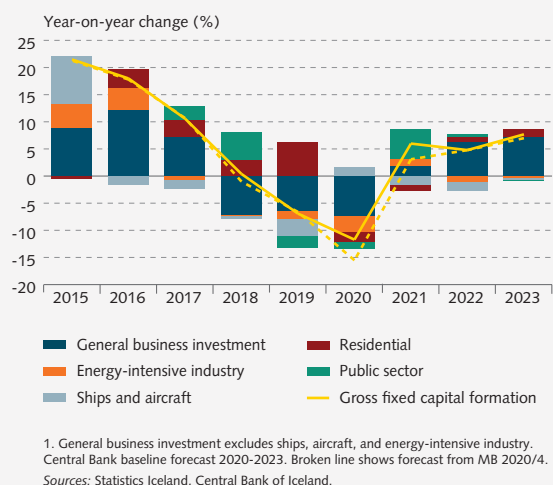


Chart 20

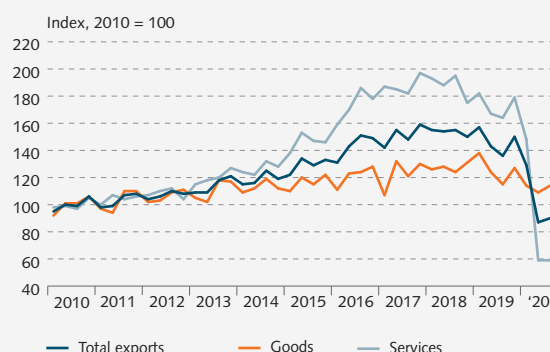
Gross fixed capital formation and contribution of main components 2015-2023¹



previously assumed. The outlook for 2021 has also improved. Total investment is projected to grow by 6% this year and by an average of just over 6% per year in 2022 and 2023.

- Public consumption grew by 3.5% year-on-year in the first three quarters of 2020, in line with the Bank's November forecast. According to preliminary figures from Statistics Iceland, public investment (both State and municipal investment) contracted by 17.6%, however, considerably more than had been assumed. In H1/2020 indicators suggest that there were unscheduled delays in investments at both levels of government. The largest municipalities' budgets imply that investment proceeded more smoothly in H2, although many local authorities actually cut back on investment, while others added on projects. Public investment is now estimated to have contracted by over 7% last year, contrary to the authorities' estimates, which causes a shift in investment timetables.
- The National Budget for 2021 was passed with a deficit of 10.8% of GDP, which is 2 percentage points larger than the deficit assumed in the original fiscal budget proposal and 1 percentage point larger than the 2020 deficit. With the passage of the 2021 Budget, it is clear that the deficit will be larger than was laid down in the Government's fiscal strategy and will therefore breach the permissible 3% uncertainty buffer in the strategy.
- Goods and services exports grew by 3.6% quarter-on-quarter in Q3/2020, after a steep contraction in the two preceding quarters. Despite this, exports were down 38.8% compared to Q3/2019, whereas the Bank's November forecast assumed a year-on-year contraction of just under 32%. The larger year-on-year contraction is due mainly to less favourable services exports, which in turn can be attributed largely to an overestimation of intellectual property exports in the pharmaceuticals industry. Furthermore, revenues from passenger transport by air contracted between quarters, even though the number of tourist visits rose in Q3 (Chart V-2 in Appendix 1).
- Goods exports have developed in line with the November forecast, increasing by nearly 5% quarter-on-quarter in Q3, but are still 1.2% below their Q3/2019 level. The year-on-year contraction in goods exports has therefore eased significantly from

Chart 21
Exports of goods and services¹
Q1/2010 - Q3/2020

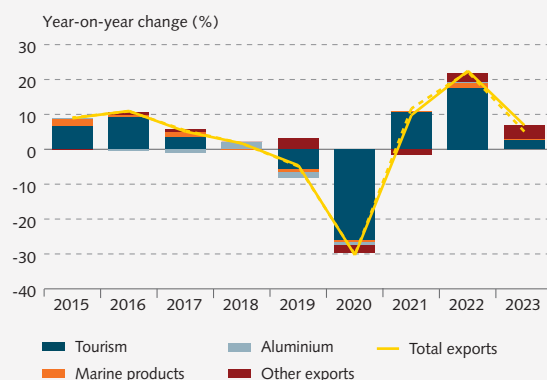


1. Seasonally adjusted volume indices.
Source: Statistics Iceland.

the Q1/2020 contraction of 17%. For the first time since 2018, aluminium exports increased year-on-year in Q3, and the contraction in marine product exports eased markedly. There are also signs that the lower real exchange rate supported other export sectors.

- As in the November forecast, goods and services exports are estimated to have contracted by a full 30% in 2020. Intellectual property exports in the pharmaceuticals industry that were expected in Q3 are assumed to have shifted to Q4, and the slow recovery of goods exports is projected to continue.
- The outlook for exports in 2021 has deteriorated since November, however. COVID-19 case numbers have surged in Iceland's main trading partner countries, and the outlook for tourism has therefore worsened despite positive news about vaccines. It is assumed that tourist numbers will not increase to any significant degree before well into this summer, when travel restrictions between the US and Europe are lifted and border restrictions are eased. Some 480,000 tourists visited Iceland in 2020, and just over 700,000 are expected this year, somewhat fewer than was assumed in the November forecast. Services exports as a whole will therefore increase by just under one-fourth, which is less than previously projected. As in November, services exports are expected to grow by nearly 50% in 2022, as tourism sector capacity has largely been preserved.
- The outlook for goods exports in 2021 has deteriorated as well, owing largely to weaker demersal fish catches and the expectation that pelagic quotas will either remain unchanged or be lowered. Furthermore, there is increased pessimism about conditions in global marine product markets, and the outlook for aluminium exports has worsened. Total goods exports are projected to increase by nearly 1%, as opposed to 2% in the November forecast. Total exports will therefore grow by 9.8% in 2021, some 2 percentage points less than previously forecast. As in November, export growth is forecast to measure 22% in 2022 and then ease to just under 7% in 2023.
- Goods and services imports grew by 9.9% between Q2 and Q3/2020, driven largely by imports of petrol and consumer goods. Total imports were nevertheless a full 26% less than in Q3/2019, which is well in line with the Bank's November forecast. Because of Statistics Iceland's revision of external trade fig-

Chart 22
Exports and contribution of subcomponents 2015-2023¹

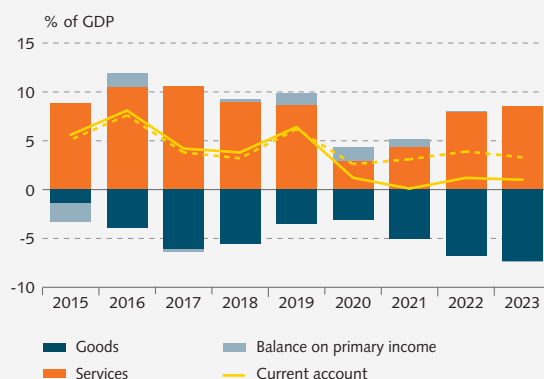


1. Because of chain-volume linking, the sum of components may not equal total exports. Tourism is the sum of "travel" and "passenger transport by air". Aluminium exports as defined in the national accounts. Central Bank baseline forecast 2020-2023. Broken line shows forecast from MB 2020/4.
Sources: Statistics Iceland, Central Bank of Iceland.

ures for H1/2020, the contraction for the year is 22.5% instead of the 24% projected in November. Goods imports are expected to continue recovering slowly this year, and services imports are projected to rebound later in the year, once Icelanders begin travelling abroad in greater numbers. Total imports will therefore grow by 11.3% in 2021 and by 17% in 2022, when the pandemic draws to an end.

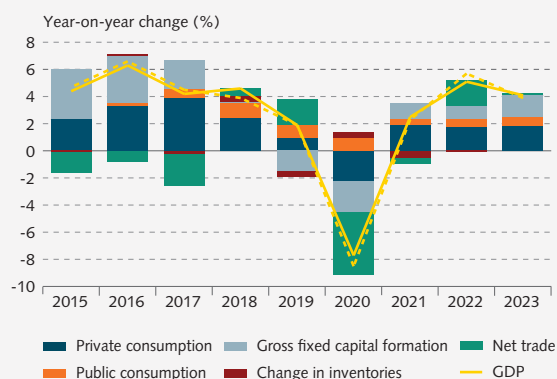
- The trade balance is estimated to have been negative by 0.2% of GDP in 2020 – Iceland’s first trade deficit since 2008. The November forecast assumed a trade surplus of 0.8%, and the deviation stems both from Statistics Iceland’s revision of H1/2020 external trade figures and from a more pronounced deterioration in terms of trade than had been expected. However, because of favourable developments in primary and secondary income, the current account is estimated to remain in surplus. A small surplus is also forecast this year, and is expected to widen to roughly 1% of GDP in the next two years. This is a significantly smaller surplus than was forecast in November, owing primarily to more unfavourable developments in net trade and terms of trade.
- Leading indicators imply that, after having grown by 4.5% between Q2 and Q3, domestic demand contracted again in Q4/2020, to a level nearly 5% lower than in Q4/2019. The contribution of net trade to annual GDP growth is also estimated to have been negative, and GDP is therefore assumed to have contracted by over 6% year-on-year during the quarter. If these projections materialise, GDP will have contracted by 7.7% in 2020 as a whole, whereas the November forecast assumed a contraction of 8.5%. This more favourable outcome is attributable to stronger private consumption and a smaller-than-expected contraction in investment.
- The GDP growth outlook for 2021 is broadly as it was in November, however, with more positive prospects for growth in domestic demand pulling against a bleaker outlook for international trade. Year-on-year GDP growth is now expected to turn positive again in Q2/2021 and to measure 2.5% for the year as a whole, as compared with the November forecast of 2.3% growth. In 2022, domestic demand will continue to grow, as the contribution from net trade is expected to strengthen due to robust growth in exports. If this forecast materialises, GDP growth will measure 5.1% in 2022 and 4.1% in 2023.

Chart 23
Current account balance 2015-2023¹



1. Balance on secondary income included in the balance on primary income. Central Bank baseline forecast 2020-2023. Broken line shows forecast from MB 2020/4. Sources: Statistics Iceland, Central Bank of Iceland.

Chart 24
GDP growth and contribution of underlying components 2015-2023¹



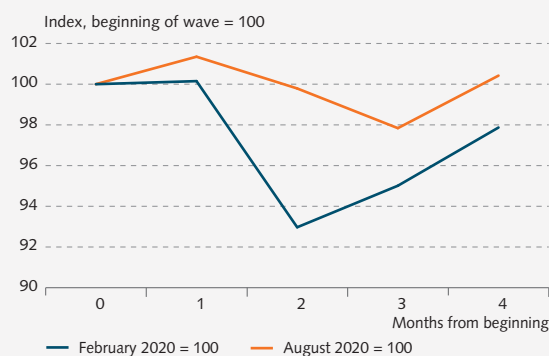
1. Central Bank baseline forecast 2020-2023. Broken line shows forecast from MB 2020/4. Sources: Statistics Iceland, Central Bank of Iceland.

Labour market and factor utilisation

- According to the Statistics Iceland labour force survey (LFS), total hours worked declined by 5.9% year-on-year in Q4/2020, reflecting a 3.6% drop in the number of employed persons and a 2.4% shortening of the average work week. The pandemic was spreading rapidly at the beginning of the quarter, and it was clear that the labour market situation would worsen as a result. As was assumed in the November forecast, the decline in total hours worked was not as abrupt as in the first wave of the pandemic: a large number of jobs had already been lost, public health measures were not as onerous, and both individuals and companies were probably better prepared.
- The impact of higher infection rates in the autumn proved even less damaging than was expected, however, and as a result, job numbers and total hours worked declined less in 2020 than was forecast in November. There is still a considerable difference between measurements of the number of employed persons, as the relative decline in job numbers according to the pay-as-you-earn (PAYE) register is nearly twice the size indicated by the LFS data. This is partly because the LFS does not fully capture the status of the foreign labour force, who have lost jobs at a much higher rate than people of Icelandic background (Chart V-3 in Appendix 1).
- Seasonally adjusted LFS data show that the labour participation rate declined between quarters in Q4/2020, but the employment rate fell somewhat more. Unemployment according to the LFS therefore rose by just over 1 percentage point between quarters, to 7%. On the other hand, seasonally adjusted registered unemployment rose by nearly 2 percentage points quarter-on-quarter, to 10.5%. The difference between these two measures of unemployment has therefore widened further and is now at its largest ever. It stems in part from differing definitions of unemployment, but as is discussed in *Monetary Bulletin 2020/4*, the LFS is also considered to underestimate unemployment due to non-response errors. In December, registered unemployment had risen to nearly 11%, some 2.4 percentage points above the post-financial crisis peak.
- Population growth has slowed markedly since the pandemic struck. Iceland's population grew by 1.2% year-on-year in Q4/2020, well below the 2019 aver-

Chart 25

Total hours worked in two COVID-19 waves¹

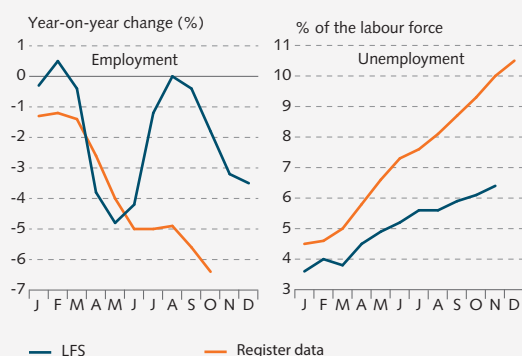


1. Seasonally adjusted figures.
Source: Statistics Iceland.

Chart 26

Employment and unemployment¹

January - December 2020

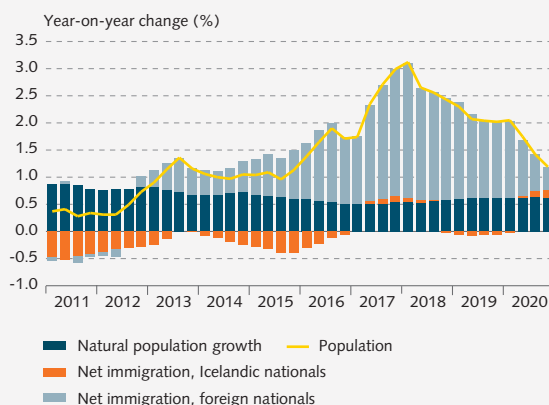


1. LFS stands for Statistics Iceland's labour force survey. Register data refers to the PAYE register for employment and Directorate of Labour unemployment register for unemployment. Unemployment is seasonally adjusted. Registered unemployment excludes persons on the partial unemployment programme and is seasonally adjusted by the Central Bank. Three-month moving average.
Sources: Directorate of Labour, Statistics Iceland, Central Bank of Iceland.

Chart 27

Population

Q1/2011 - Q4/2020



Source: Statistics Iceland.

age of 2.1%. Among foreign nationals, net migration was slightly negative in Q4, whereas for Icelandic nationals it was positive for the third quarter in a row.

- According to seasonally adjusted results from Gallup's winter survey among Iceland's 400 largest companies, the employment outlook brightened significantly between surveys. Responses on staffing plans (i.e., firms planning to recruit as compared with those planning redundancies) were broadly in balance in the winter survey, whereas the balance of opinion had been negative by 21 percentage points in the autumn. The shift can be traced to both a larger number of firms planning to add staff and a smaller number planning redundancies, as each group contains about a fifth of firms represented in the winter survey. The improvement was distributed across economic sectors, but there was a particularly strong turnaround among executives in transportation, transit, and tourism. In the autumn survey, the balance of opinion in that sector was negative by nearly 50 percentage points – the bleakest outlook in the entire survey – whereas in the winter, the same balance of opinion was positive by 10 percentage points – this time, the best outlook in the entire survey.
- The number of job vacancies declined steeply when the first wave of the pandemic struck, but the resurgence of COVID cases in the autumn appears not to have affected labour demand as strongly. According to Statistics Iceland's company survey, there were about 2,800 available jobs in Q4/2020, an increase of roughly 300 year-on-year. In the first three quarters of 2020, however, the number of available jobs had fallen steeply between years. The uptick in Q4 is due in large part to an increase in jobs in wholesale and retail trade, information and communications, and miscellaneous specialised services; furthermore, job numbers in public service-related sectors declined more slowly. There were no available positions in the tourism industry during the quarter, a year-on-year decline of 100 vacancies for the second quarter in a row.
- After adjusting for seasonality, 8% of executives considered themselves short-staffed, a slightly higher percentage than in the previous survey but still relatively close to the historical low. In addition, 32% of executives reported that their firms would have difficulty responding to an unexpected increase in demand, an increase of 4 percentage points from

Chart 28
Firms planning recruitment net of firms planning redundancies within 6 months¹

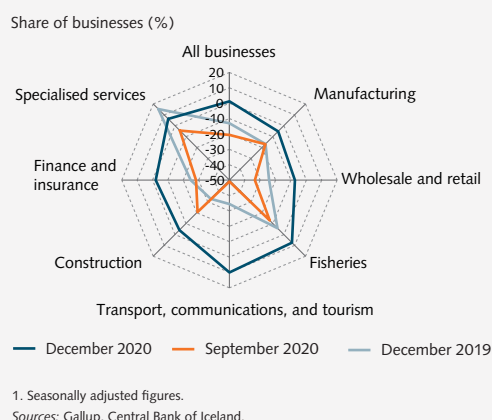
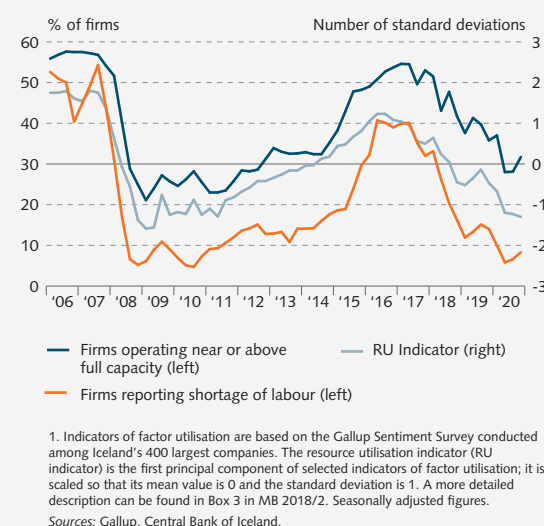


Chart 29
Job vacancies



Chart 30
Capacity utilisation¹
Q1/2006 - Q4/2020



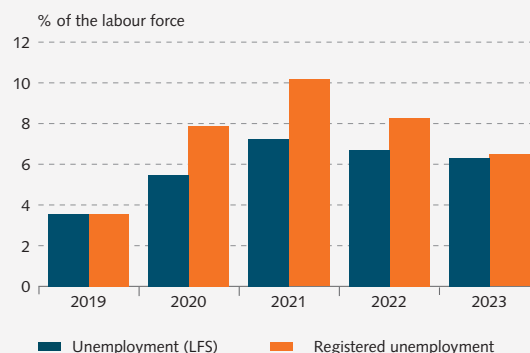
the previous survey. On the other hand, the resource utilisation (RU) indicator, which combines various indicators of factor utilisation, fell marginally during the quarter, although the pace of the decline eased in H2/2020.

- Clearly, corporate executives have become more optimistic as positive news of COVID-19 vaccines have emerged, and there are signs that job losses may be coming to a halt. By the same token, there are signs that the domestic economy is approaching a cyclical trough, as spare capacity in the economy and a small increase in insolvencies create the foundations for a recovery. The slack in the domestic economy is still significant, however, and it will take time to unwind the unemployment that has accumulated.
- Total hours worked are expected to fall by just under 1% this year and then begin to rise in 2022. Because the difference between the registered and LFS-based unemployment rates has continued to widen, the Bank has revised its unemployment forecast. Unemployment according to the LFS is expected to peak in H1/2021 and average just over 7% in 2021 as a whole, whereas registered unemployment is projected at just over 10%, as it was in November. Unemployment is forecast to start falling in mid-2021 and continue to ease throughout the forecast horizon. A sizeable slack in output developed in 2020 but is expected to narrow over the course of this year. Nevertheless, it is expected to measure about 2% of potential output by the year-end. This is a larger slack than was assumed in the November forecast, owing to more rapid population growth versus more favourable developments in GDP growth.

Inflation

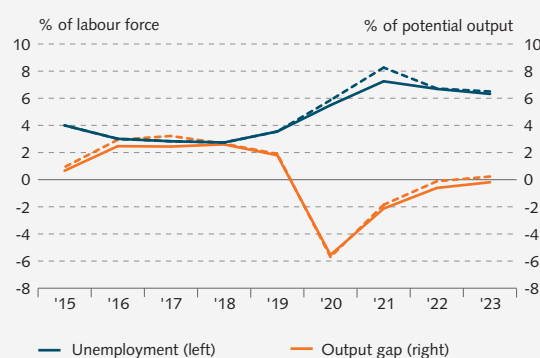
- Inflation measured 3.6% in Q4/2020, slightly below the November forecast of 3.7%. As before, price increases were concentrated in imported goods, particularly to include clothing, miscellaneous housewares, and recreational goods. In spite of this, the exchange rate pass-through from the depreciation of the króna to imported goods prices appears to have receded recently, as the króna appreciated in November and December. House prices continued to climb towards the end of the year, reflecting the strong activity in the housing market discussed earlier.

Chart 31
Unemployment 2019-2023¹



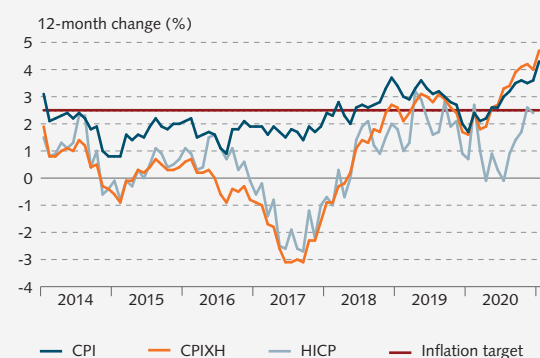
1. Registered unemployment excludes persons on the partial unemployment benefits programme. Central Bank baseline forecast 2021-2023.
Sources: Directorate of Labour, Statistics Iceland, Central Bank of Iceland.

Chart 32
Unemployment and output gap 2015-2023¹



1. Central Bank baseline forecast 2020-2023. Broken lines show forecast from MB 2020/4.
Sources: Statistics Iceland, Central Bank of Iceland.

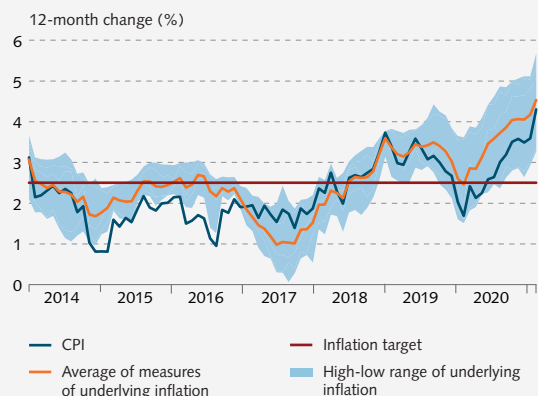
Chart 33
Various measures of inflation
January 2014 - January 2021



Sources: Statistics Iceland, Central Bank of Iceland.

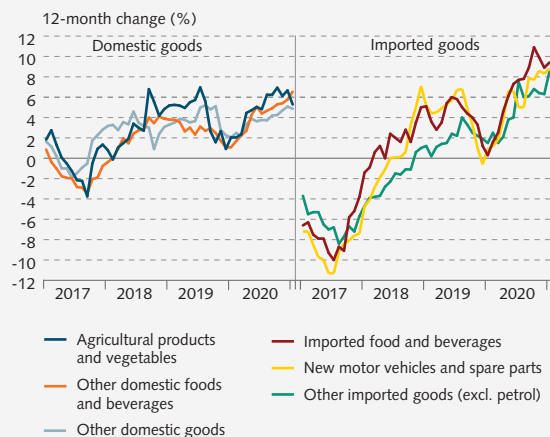
- The CPI declined by 0.06% month-on-month in January, and twelve-month inflation measured 4.3%. This was the first time since December 2013 that inflation has risen above the upper deviation threshold of the inflation target, requiring that the Central Bank send an explanatory report to the Government. Inflation therefore rose markedly between December and January, owing to unfavourable base effects, among other factors, as the CPI had fallen steeply in January 2020. Winter sales affected prices in January but were smaller in scope than those held a year ago, however. This may be due in part to stronger-than-expected domestic demand. In addition, the price of housing, food, and petrol rose in January.
- Inflation excluding housing measured 4.7% this January and has risen slightly less than headline inflation in recent months. Inflation according to the HICP, which also excludes owner-occupied housing costs, measured 2.4% in December. HICP inflation is lower, mainly because various tourism-related sub-components weigh more heavily in the HICP. These items have been under limited inflationary pressures during the COVID-19 pandemic; for instance, international airfares are down 5½% year-on-year.
- Underlying inflation in terms of the average of various measures was 4.5% in January, the highest since June 2012. Some measures of underlying inflation exclude the effects of real mortgage interest expense, which has fallen steeply in the recent term, thereby lowering CPI inflation. Because of this, twelve-month inflation was an estimated 0.9 percentage points lower than it would have been otherwise.
- Imported goods prices have risen by 6.9% in the past twelve months. Imported inflation was higher in January largely because winter sales were smaller in scope than they were in 2020. Domestic goods prices have also risen in the recent term, or by 5.6% since January 2020, driven largely by rising domestic food prices.
- In Q4/2020, the general wage index rose by 1.6% between quarters, owing in part to newly concluded wage agreements for primary school teachers and to the arbitrated resolution of the dispute between the Icelandic Nurses' Association and the State. As compared with Q4/2019, the index therefore rose

Chart 34
Headline and underlying inflation¹
January 2014 - January 2021



1. Underlying inflation measured using a core index (which excludes the effects of indirect taxes, volatile food items, petrol, public services, and real mortgage interest expense) and statistical measures (weighted median, trimmed mean, a dynamic factor model, and a common component of the CPI).
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 35
Domestic and imported goods prices
January 2017 - January 2021



Source: Statistics Iceland.

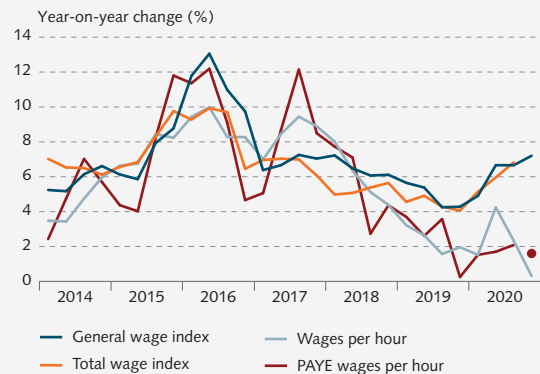
by 7.2%. In addition, the total wage index indicates that average private sector wages rose in Q3/2020 because of a reduction in the number of low-paying jobs. These effects cannot be seen in the labour market as a whole, however, due to countervailing developments in the public sector. In the first ten months of 2020, PAYE wages per hour rose much less, however, or 1.8% year-on-year. This is nearly 1 percentage point less than the hourly wage increase assumed for the year in the Bank's November forecast. The outlook for wage developments is broadly unchanged, but because of the smaller decline in total hours worked, wages per hour are now estimated to have risen by just over 2% in 2020 and are expected to rise by slightly more than 3% this year.

- Market agents' inflation expectations one and two years ahead are still at the target, according to the Bank's most recent survey. Gallup's winter surveys indicate that executives expect inflation to measure 3% in one year, while households project it at 4%. Both figures are unchanged from the autumn surveys.
- Market agents' long-term inflation expectations are at target and have been there since autumn 2019. In the winter survey, corporate executives' expectations concerning average inflation over the next five years had fallen to the target, whereas households still expect it to measure 3%. The ten-year breakeven inflation rate in the bond market has averaged 2.6% in Q1/2021 to date, roughly the same as in Q4/2020. Most measures of long-term inflation expectations have therefore remained at target despite the depreciation of the króna in 2020.
- The outlook is for inflation to measure 3.9% in Q1/2021, somewhat above the November forecast, and then taper off relatively quickly, to 3.3% in Q2. Inflation is then expected to align with the target in Q4. The short-term inflation outlook has therefore deteriorated slightly due to a higher initial position and the prospect of stronger domestic demand in H1/2021 than was previously projected. Furthermore, global oil and other commodity prices have risen more than anticipated in recent months. On the other hand, the exchange rate pass-through from last year's depreciation has receded, and the króna is somewhat stronger now than was previously forecast.

Chart 36

Wages¹

Q1/2014 - Q4/2020

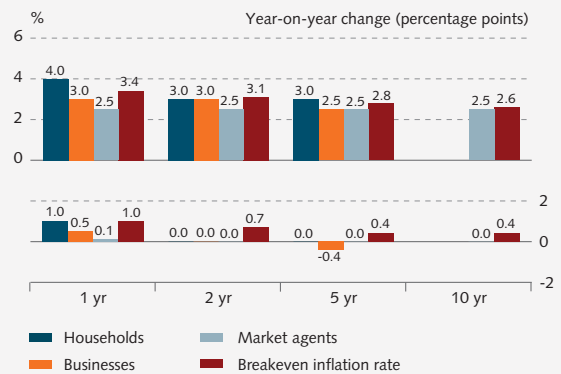


1. Wages per hour worked are based on annual figures for the wage portion of the "wages and related expenses" category from the production accounts, as a share of total hours worked according to the Statistics Iceland labour force survey, and are estimated for the year 2020. PAYE wages per hour are PAYE wages per total hours worked according to the LFS. The dot for Q4/2020 shows the October figure.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart 37

Inflation expectations¹



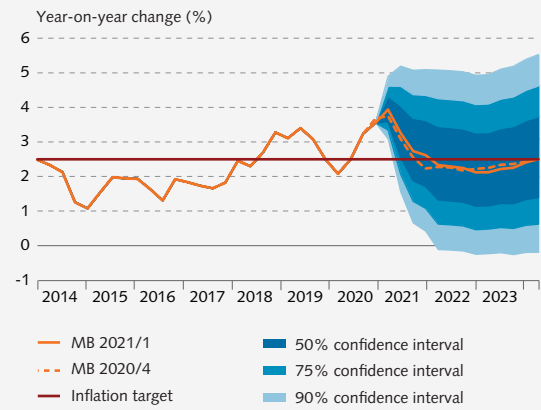
1. The most recent Gallup surveys of corporate and household inflation expectations were carried out in December 2020. The most recent Central Bank survey of market agents' expectations is from mid-January 2021. Households and businesses are not asked about ten-year inflation expectations. The most recent value for breakeven inflation is the average in Q1/2021 to date. The lower part of the chart shows the year-on-year change.

Sources: Gallup, Central Bank of Iceland.

- The inflation outlook over the latter half of the forecast horizon is broadly similar to that in November, however. As was forecast then, domestic inflation will continue to fall in 2022, due to a higher exchange rate, a continued slack in the domestic economy, and low global inflation, and will be just below the target until the end of the forecast horizon.
- The outlook is highly uncertain, however, and as is customary with the Bank's updated forecasts, the risk assessment of the baseline forecast has not been revised. There is a roughly 50% probability that inflation will be in the 1½-3½% range in one year and in a similar range at the end of the forecast horizon.

Chart 38

Inflation forecast and confidence intervals
Q1/2014 - Q1/2024



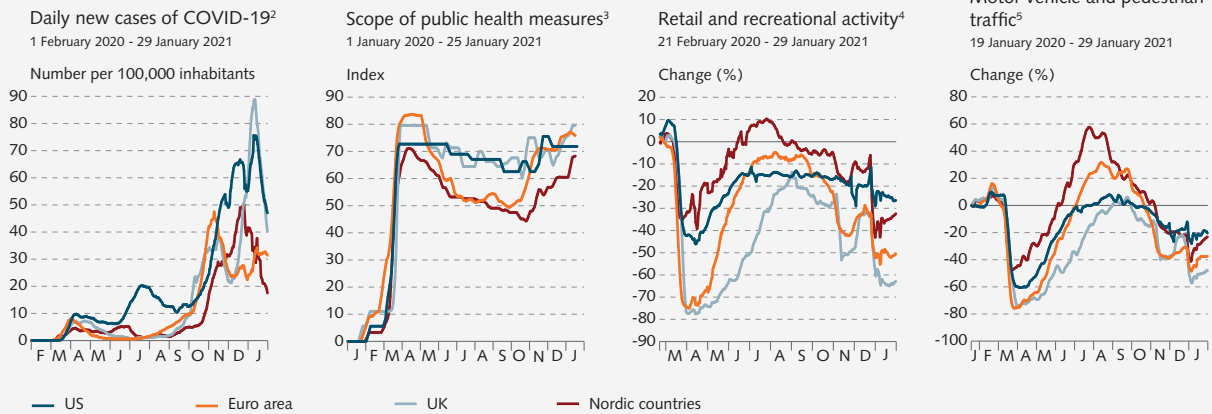
Sources: Statistics Iceland, Central Bank of Iceland.

Appendix

1 Snapshots of domestic and foreign economic activity in the midst of a global pandemic

Chart V-1

Indicators of global economic activity¹

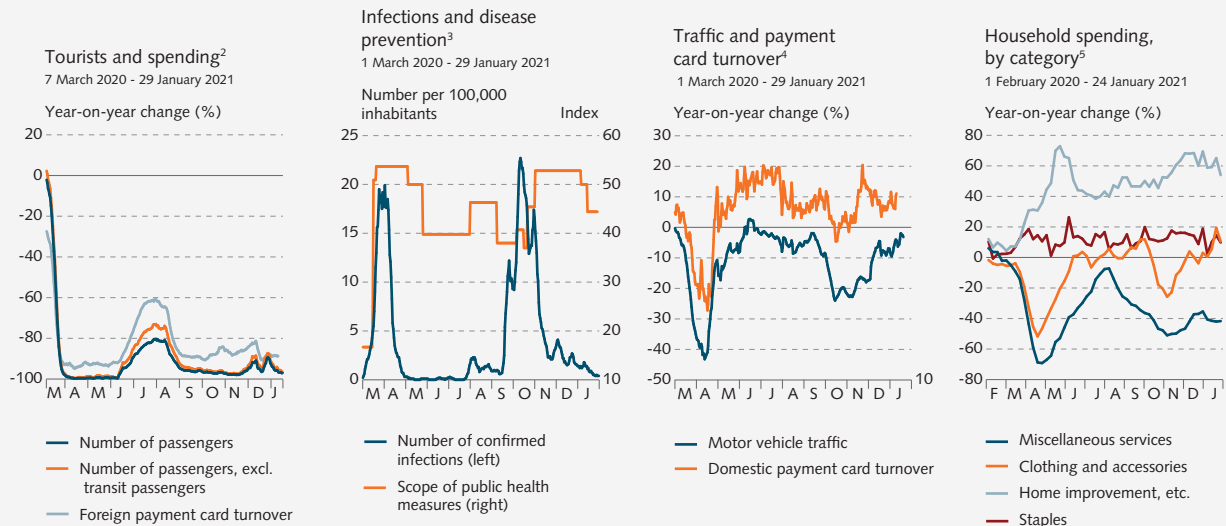


1. Seven-day moving average. Nordic countries include Denmark, Norway, and Sweden. 2. Confirmed new infections. 3. Scope of public health measures weights together various measures of the extent of government restrictions in order to curb the spread of COVID-19. 4. Number of visits to restaurants, cafés, shopping centres, amusement parks, museums, and cinemas, according to Google. Change from the period 3 January-6 February 2020. 5. Vehicle and pedestrian traffic according to Apple Mobility Trends. Change since 19 January 2020.

Sources: Apple Mobility Trends, Google, Johns Hopkins University, OECD, Oxford COVID-19 Government Response Tracker, World Health Organization.

Chart V-2

Indicators of domestic economic activity¹

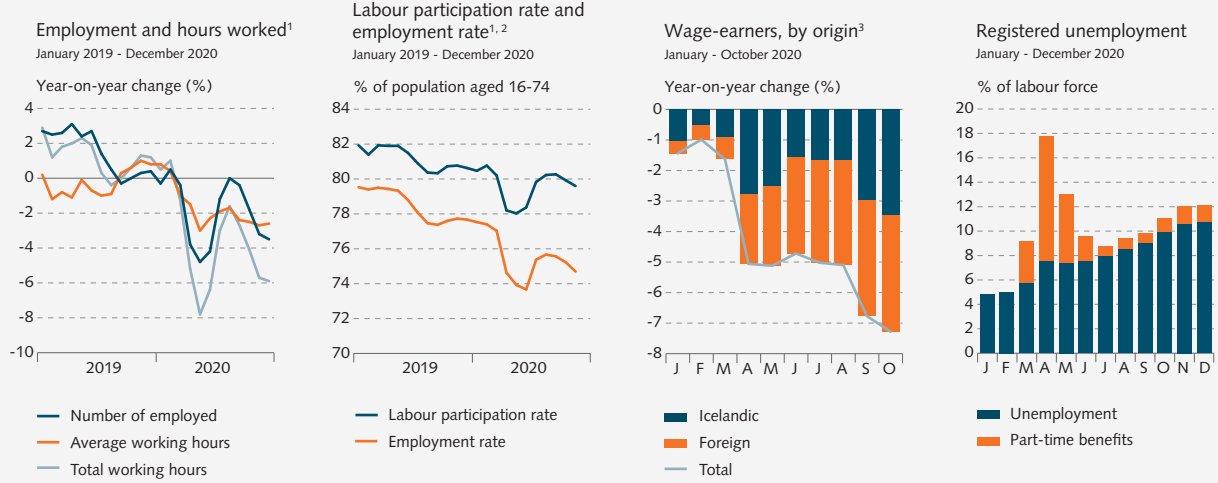


1. All data are seven-day moving averages except scope of public health measures (primary data), domestic payment card turnover, motor vehicle traffic (fourteen-day moving average), and household spending by category (four-week moving average). 2. Number of passengers travelling through Keflavik Airport each day. Passenger numbers for 2019 excluding WOW Air. Payment card figures are the sum of foreign-issued debit and credit cards. 3. Scope of public health measures weights together various measures of the extent of government restrictions in order to curb the spread of COVID-19. 4. Daily motor vehicle traffic along three main routes in the capital area. Payment card figures are the sum of domestic-issued debit and credit cards. 5. Miscellaneous services includes restaurants, theatres, fitness centres, etc. Home improvement includes purchases of electronics, furniture, and in hardware stores.

Sources: Covid.is, Icelandic Road and Coastal Administration, Isavia, Meniga Marketwatch, Oxford COVID-19 Government Response Tracker, Statistics Iceland, Central Bank of Iceland.

Chart V-3

Indicators from the domestic labour market



1. Based on Statistics Iceland's labour force survey. Three-month moving average. 2. Seasonally adjusted figures. 3. Based on the Iceland Customs and Revenue PAYE register.
Sources: Directorate of Labour, Statistics Iceland.

2 Forecast tables

Table 1 Key economic variables¹

	2019	2020	2021	2022	2023
Private consumption	1.8 (1.3)	-4.4 (-5.5)	3.7 (2.7)	3.2 (3.9)	3.5 (3.7)
Public consumption	4.2 (4.2)	3.8 (3.9)	1.4 (1.0)	2.2 (2.2)	2.5 (2.5)
Gross capital formation	-6.9 (-6.6)	-11.7 (-15.5)	6.0 (3.1)	4.8 (4.8)	7.7 (7.0)
Business investment	-18.0 (-18.0)	-15.9 (-19.9)	2.9 (-0.1)	6.4 (14.5)	12.4 (12.2)
Residential investment	31.1 (31.2)	-6.1 (-18.8)	-4.0 (-10.3)	3.9 (0.8)	5.7 (4.7)
Public investment	-11.5 (-9.8)	-7.2 (3.6)	30.6 (28.6)	2.2 (-11.8)	-0.9 (-4.5)
National expenditure	0.1 (-0.2)	-3.2 (-4.7)	3.0 (1.9)	3.2 (3.6)	4.1 (4.0)
Exports of goods and services	-4.6 (-4.9)	-30.3 (-30.1)	9.8 (11.7)	22.5 (22.2)	6.9 (5.1)
Imports of goods and services	-9.3 (-10.2)	-22.5 (-23.9)	11.3 (10.7)	17.0 (17.7)	6.8 (5.6)
Gross domestic product (GDP)	1.9 (1.9)	-7.7 (-8.5)	2.5 (2.3)	5.1 (5.7)	4.1 (3.9)
Contribution of net trade to GDP growth (percentage points)	1.9 (2.2)	-4.6 (-4.0)	-0.5 (0.4)	1.9 (2.2)	0.1 (0.0)
Unemployment (% of labour force)	3.6 (3.6)	5.5 (5.9)	7.3 (8.3)	6.7 (6.7)	6.3 (6.5)
Output gap (% of potential output)	1.8 (1.9)	-5.6 (-5.7)	-2.1 (-1.9)	-0.6 (-0.1)	-0.2 (0.2)
Current account balance (% of GDP)	6.4 (6.2)	1.2 (2.6)	0.1 (3.1)	1.2 (3.9)	1.0 (3.3)
Trade-weighted exchange rate index ²	181.0 (181.0)	201.0 (201.9)	204.8 (213.0)	206.7 (211.3)	205.3 (207.4)
Inflation (consumer price index, CPI)	3.0 (3.0)	2.8 (2.9)	3.1 (2.9)	2.2 (2.2)	2.2 (2.3)
Inflation in main trading partners ³	1.5 (1.5)	0.7 (0.8)	1.3 (1.4)	1.7 (1.7)	1.7 (1.6)
GDP growth in main trading partners ³	1.9 (1.8)	-5.7 (-5.9)	4.3 (4.6)	3.8 (3.3)	2.3 (2.3)

1. Year-on-year change (%) unless otherwise specified (figures in parentheses are from the forecast in MB 2020/4). 2. Narrow trade-weighted basket. The index has been recalculated so that on 2 January 2009 it was assigned a value equivalent to that of the now-discontinued Exchange Rate Index. 3. Forecast based on Consensus Forecasts, IHS Markit, IMF, and OECD.

Sources: Consensus Forecasts, IHS Markit, International Monetary Fund, OECD, Refinitiv Datastream, Statistics Iceland, Central Bank of Iceland.

Table 2 Quarterly inflation forecast (%)¹

Quarter	Inflation (year-on-year change)	Inflation (annualised quarter-on-quarter change)
Measured value		
2020:1	2.1 (2.1)	0.2 (0.2)
2020:2	2.5 (2.5)	6.0 (6.0)
2020:3	3.2 (3.2)	4.3 (4.3)
2020:4	3.6 (3.7)	3.8 (4.3)
Forecasted value		
2021:1	3.9 (3.7)	1.7 (0.5)
2021:2	3.3 (3.1)	3.2 (3.3)
2021:3	2.7 (2.5)	2.2 (2.1)
2021:4	2.6 (2.2)	3.3 (3.0)
2022:1	2.3 (2.3)	0.6 (0.7)
2022:2	2.3 (2.3)	3.1 (3.2)
2022:3	2.2 (2.2)	2.0 (1.8)
2022:4	2.1 (2.2)	2.9 (3.2)
2023:1	2.1 (2.2)	0.6 (0.8)
2023:2	2.2 (2.3)	3.5 (3.6)
2023:3	2.3 (2.4)	2.1 (1.9)
2023:4	2.4 (2.4)	3.5 (3.5)
2024:1	2.5	1.0

1. Figures in parentheses are from the forecast in MB 2020/4.

Sources: Statistics Iceland, Central Bank of Iceland.

