



# MONETARY BULLETIN

2010 • 1

## Contents

- 3 *Statement of the Central Bank of Iceland Monetary Policy Committee*  
Central Bank rates lowered
- 5 *Economic and monetary developments  
and prospects – updated forecast*  
Outlook broadly unchanged but uncertainty is greater

*Appendix 1: Baseline macroeconomic and inflation forecast 2010/1*

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 by the Government of Iceland and the Central Bank of Iceland on March 27, 2001, it is explained that the Central Bank's aim shall be that annual inflation, measured as the twelve-month increase in the CPI, remains as close to 2½% as possible.

Professional analysis and transparency are important prerequisites for credible monetary policy. In publishing *Monetary Bulletin*, the Central Bank attempts to fulfil these principles. Twice a year, in early May and early November, *Monetary Bulletin* includes an in-depth analysis of economic and monetary developments and prospects. In January and August, an updated forecast is published together with an abbreviated report on economic and monetary developments and prospects. The Monetary Policy Committee of the Central Bank bases its interest rate decisions to a great extent on this analysis. The publication of *Monetary Bulletin* also represents a vehicle for the Bank's accountability towards government authorities and the public.

The framework of monetary policy and its implementation and instruments are described further on the Central Bank's website: [www.sedlabanki.is/?PageID=179](http://www.sedlabanki.is/?PageID=179).

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**Icelandic letters:**

ð/Ð (pronounced like th in English this)

þ/Þ (pronounced like th in English think)

In *Monetary Bulletin*, ð is transliterated as d and þ as th in personal names, for consistency with international references, but otherwise the Icelandic letters are retained.

**Symbols:**

- \* Preliminary or estimated data.
- 0 Less than half of the unit used.
- Nil.
- ... Not available.
- . Not applicable.

## Central Bank rates lowered

The Monetary Policy Committee (MPC) has voted to lower Central Bank interest rates by 0.5 percentage points. The deposit rate (current account rate) will be lowered to 8%. The maximum bid rate for 28-day certificates of deposit (CDs) will be 9.25%. The seven-day collateral lending rate will be 9.5% and the overnight lending rate 11%.

The króna has been broadly stable since the last MPC meeting, and indeed since last summer, without any Central Bank intervention since early November. This stability has continued despite internal and external developments that could have been expected to affect the króna negatively, in particular the recent turmoil caused by the president's decision not to sign the Icesave legislation. This reflects the effectiveness of the capital controls, as well as a gradual improvement in the underlying current account balance.

The failure to resolve the dispute over compensation of depositors in foreign branches of Landsbanki has already triggered a sovereign credit rating downgrade to non-investment grade by one of the rating agencies and could delay the second review of the IMF programme. Consequently, access to bilateral and multilateral financing, a prerequisite for successful access to international capital markets, might also be delayed. Given the effectiveness of the capital controls, the short-run effect on the króna should be modest; however, further steps towards removing the capital controls would be risky given the above uncertainties.

Inflation continued to decline in December and January, slightly more than in the November forecast, measuring 6.6% year-on-year in January, or 5.2% excluding the impact of higher consumption taxes. The 0.3% drop in the CPI in January was unexpected; however, underlying inflation is forecast to subside more slowly than in the November forecast throughout 2010, although it is still expected to reach the inflation target late this year.

If the króna remains stable or appreciates, and if inflation continues to fall as forecast, there should be scope for continued gradual monetary easing. However, as long as there is significant uncertainty about Iceland's future access to foreign capital markets, the MPC will have limited room for manoeuvre. As always, the MPC stands ready to adjust the monetary stance as required to achieve its interim objective of exchange rate stability and ensure that inflation is close to target over the medium term.



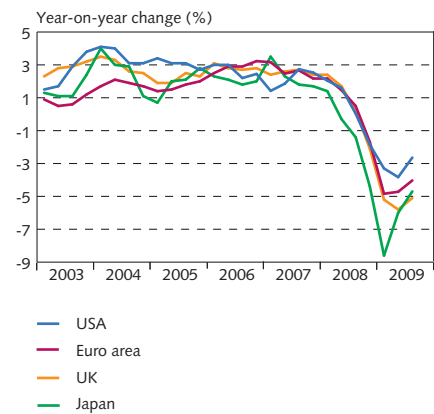
## Outlook broadly unchanged but uncertainty is greater

The economic outlook is broadly unchanged since November. While last year's contraction was smaller than previously estimated, the contraction in 2010 will be larger. Recovery will be weaker, due in particular to delays in investments in the aluminium and power sectors. Inflation will be lower in Q1/2010 but will subsequently remain higher throughout 2011 than was projected in November, owing to larger rises in unit labour costs, a somewhat weaker króna, and higher inflation expectations. Uncertainty about the economic outlook has also increased because of greater uncertainty about the progress of the economic programme set forth by the Government and International Monetary Fund (IMF). An important assumption underlying the baseline forecast is a relatively rapid reduction in this uncertainty; otherwise, the outlook is for a slower pick up in investment, larger contraction in GDP and higher unemployment than assumed in the baseline forecast.

### The global economy and international trade

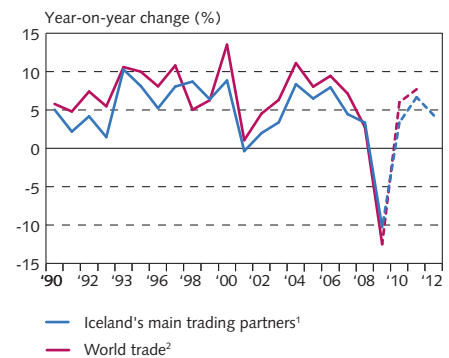
- Conditions in the global financial markets continue to improve, and risk premia have fallen back to pre-crisis levels.
- In the euro area, positive output growth was measured once again in Q3/2009, primarily due to growth in Germany. Recovery has therefore begun in the euro area after a contractionary period lasting five quarters. The US also recorded positive GDP growth in Q3/2009 and the UK in Q4/2009. Growth had also increased in Japan in the second quarter.
- Rising optimism appears to dominate most analysts' outlook for GDP growth in the coming year. The most recent forecast from the Organisation for Economic Co-operation and Development (OECD) assumes 1-2½% GDP growth in Iceland's main trading partner countries in 2010. That forecast and the one from Consensus Forecasts are very similar to the forecast in the November *Monetary Bulletin*.
- The inflation outlook in Iceland's main trading partner countries has changed little since early November 2009. Deflation appears to be coming to an end in most countries. In the US and the euro area, prices began rising again in November, and in the UK, inflation continued to rise, measuring 2.9% in December.
- Although the major industrial countries have kept their policy interest rates unchanged in recent months, many other countries have continued to cut their rates, while a few central banks, such as Norges Bank and the Reserve Bank of Australia, have begun raising them.

Chart 1  
International growth  
Real GDP growth Q1/2003 - Q3/2009



Source: Reuters EcoWin.

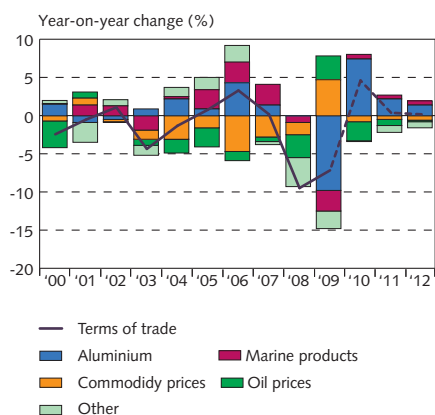
Chart 2  
World Trade



1. Imports of goods in services in Iceland's main trading partners.  
2. Arithmetic average of merchandise import and export volumes in OECD countries and the largest non-OECD countries.  
Sources: OECD, Central Bank of Iceland.

1. The analysis appearing here is based in large part on the Bank's assessment of economic developments, published in November 2009 in *Monetary Bulletin* 2009/4, and on the updated forecast presented here. It is based on data available on 26 January.

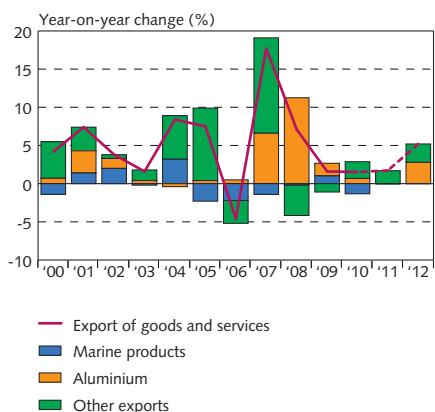
Chart 3  
Terms of trade and its main components 2000-2012<sup>1</sup>



1. Central Bank baseline forecast 2009-2012. The contribution of the main sub-indices to year-on-year changes in terms of trade is determined by weighting the annual change in the sub-index concerned together with its weight in the import or export of goods and services. The item "other" is a residual.

Source: Statistics Iceland, Central Bank of Iceland.

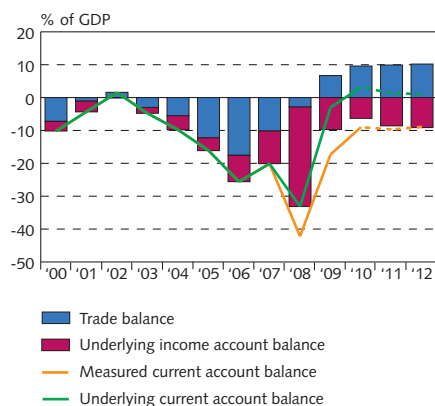
Chart 4  
Export development and its main components 2000-2012<sup>1</sup>



1. Central Bank baseline forecast 2009-2012.

Source: Statistics Iceland, Central Bank of Iceland.

Chart 5  
Current account balance 2000-2012<sup>1</sup>



1. Net current transfer is included in balance of income. Central Bank baseline forecast 2009-2012.

Source: Statistics Iceland, Central Bank of Iceland.

- According to the most recent forecast from OECD, prospects for global trade have improved markedly. The OECD forecast assumes that global trade began improving late in 2009, led by non-OECD countries in Asia, whereas the November *Monetary Bulletin* assumed that world trade would begin recovering in mid-2010. The current Central Bank forecast assumes that global trade contracted by 10% in 2009 and will grow by 3½% in 2010, whereas the November forecast projected an 11½% contraction in 2009 and assumed trade would be essentially flat in 2010.
- Commodities prices rose considerably more in Q4/2009 than was assumed in the last forecast. Economic recovery in emerging Asian markets and developing countries has bolstered demand for commodities, pressing prices more sharply upwards than global forecasts had projected.
- Aluminium prices are expected to be some 27% higher in 2010 than in 2009. This is a somewhat larger increase than in the November forecast, which assumed a 20% rise in aluminium prices. Crude oil prices have risen as well, as have prices of other commodities. Oil prices are now expected to rise by 30% in 2010, whereas in November they were expected to rise by 22%. The outlook is for a 10% rise in 2011, while the November forecast assumed a 5% increase. The forecast for marine products prices is unchanged, however, and assumes a 2% year-on-year increase in 2010.
- Terms of trade are assumed to be more or less unchanged from the last forecast. After considerable deterioration in 2009, they are expected to improve by slightly less than 5% in 2010. Rising aluminium prices play an important role in this development, although they are offset to a degree by rising oil prices. The outlook is for continuing improvement in terms of trade over the coming two years, as was forecast in November.
- The real exchange rate appears to have hit bottom in August 2009 and has gradually recovered since. The real exchange rate for the year 2009 is the lowest on record, some 28% below the average for the past three decades.
- Marine exports are estimated to have increased by over 4% in 2009, while the last forecast projected a 2% contraction. This abrupt turnaround is attributable in large part to heavier fishing early in the current fishing year (September 2009 to August 2010) than in previous years. However, forecasts for goods and services exports in 2010 have changed little since the last forecast. The outlook for 2011 and 2012 is somewhat bleaker, however, due to delays in aluminium and power sector development.
- The first three quarters of 2009 saw a substantial trade surplus and a dramatic turnaround from the year before. The present

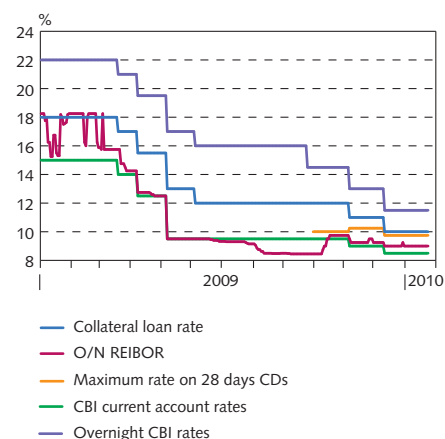
forecast assumes a trade surplus in Q4/2009 as well. On the other hand, the deficit on the income account was greater in 2009 than previously estimated, as revised statistics for the first half of the year reveal a much larger deficit than previously published figures indicated. Furthermore, the current forecast includes an estimate of accrued interest on loans due to obligations stemming from the Icesave liabilities.<sup>2</sup> The measured current account deficit is therefore somewhat larger than was projected in the last *Monetary Bulletin*. The underlying current account deficit was also slightly larger than in the last forecast. In 2010, however, the measured current account deficit is projected to narrow significantly and an underlying surplus to develop, in line with the November forecast.

## Domestic financial markets

- Since the last *Monetary Bulletin* was published in November, the Central Bank's interest rates have been lowered twice: first, upon the issue of *Monetary Bulletin*, and then, at the Monetary Policy Committee's December meeting. The Bank's deposit rate has fallen from 9.5% to 8.5%, and the rate on certificates of deposit (CDs) has been reduced from 10% to 9.75%. At the same time, the 7-day collateral lending rate has been cut to 10% from 12% and the overnight loan rate from 14.5% to 11.5%. Thus the Bank's interest rate corridor has narrowed, and the CD rate has been moved closer to the collateral lending rate and the centre of the corridor.
- Financial institutions' deposits with the Central Bank have declined since the autumn, concurrent with increased demand for CDs. At the same time, liquidity has diminished and turnover in the interbank market for krónur increased, although trading is still limited to overnight lending activity.
- The trade-weighted exchange rate index has fallen by 1.2% since *Monetary Bulletin* was published in November, although the Central Bank has not intervened in the FX market during the interim. The króna has appreciated by 2.7% against the euro on the domestic FX market and has held broadly unchanged against the US dollar. The updated forecast assumes, as did the November forecast, that króna will remain weak over the forecast period.
- The króna has depreciated by 9.6% against the euro on the offshore market since *Monetary Bulletin* was published in November. This depreciation is likely due to tougher enforcement of the capital controls since the beginning of November rather than to increased pessimism about the exchange rate outlook.
- The risk premium on Icelandic financial assets, as measured by the CDS spread, has increased significantly in recent weeks and is

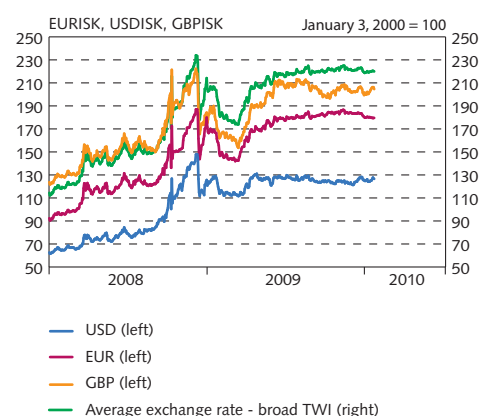
2. The Icesave dispute is not yet resolved. If a more advantageous agreement is negotiated, interest expense could be lower than is assumed here.

Chart 6  
Central Bank of Iceland interest rates and  
short-term market interest rates  
Daily data January 1, 2009 - January 22, 2010



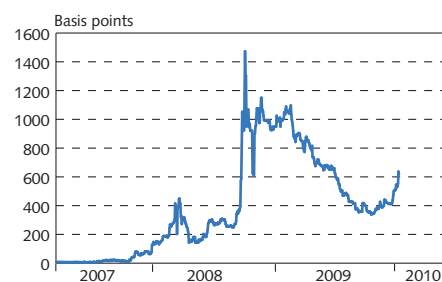
Source: Central Bank of Iceland.

Chart 7  
Exchange rate of the króna  
Daily data January 3, 2008 - January 22, 2010



Source: Central Bank of Iceland.

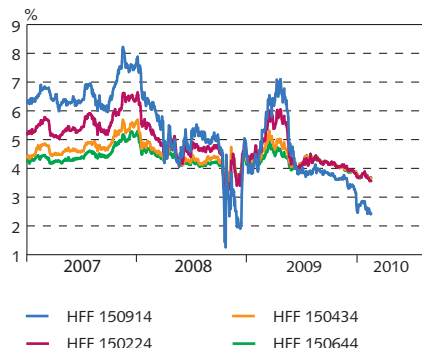
Chart 8  
CDS Iceland  
Daily data March 29, 2007 - January 22, 2010



Source: Central Bank of Iceland.

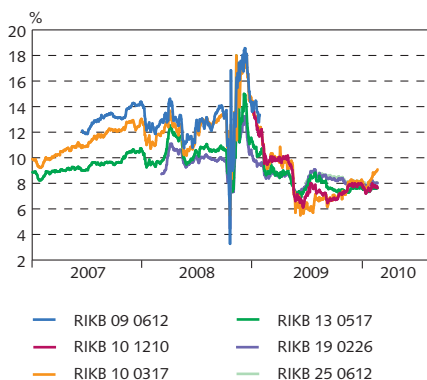


Chart 9  
Yields on indexed HFF bonds  
Daily data January 3, 2007 - January 22, 2010



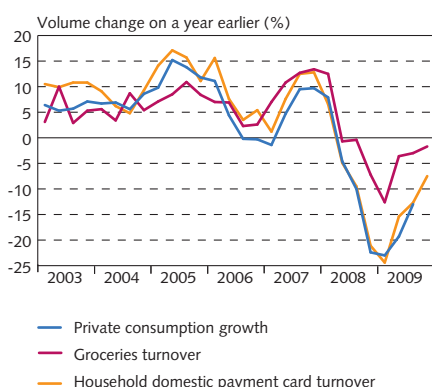
Source: Central Bank of Iceland.

Chart 10  
Long-term nominal Treasury bond yields  
Daily data January 3, 2007 - January 22, 2010



Source: Central Bank of Iceland.

Chart 11  
Private consumption, groceries and payment card turnover  
Q1/2003 - Q4/2009



Sources: Federation of Trade and Services, Statistics Iceland, Central Bank of Iceland.

now about 2.8 percentage points higher than at the publication of the last *Monetary Bulletin*. At the same time, the Republic of Iceland's sovereign credit rating has either been downgraded or the outlook changed to negative.

- Short-term interbank rates and yields in Treasury bill auctions have fallen since the November issue of *Monetary Bulletin*, in line with declining Central Bank interest rates. On the other hand, yields on longer non-indexed Treasury notes are broadly unchanged. Likely explanations for this are the temporary spike in inflation at the beginning of the year, due to increases in taxes and levies; rising long-term inflation expectations; increased uncertainty owing partly to deteriorating credit ratings; and uncertainty about the supply of bonds. Indexed Housing Financing Fund bond yields have fallen since November, however, particularly the 2014 maturity, as trading in those bonds depends heavily on investors' expectations about the short-term inflation outlook.
- The Treasury published its 2010 issuance calendar in early January. The Treasury plans to increase T-bill issuance by 20 b.kr. and to issue T-notes for about 120 b.kr. nominal value during the year; thus the net balance will decline by 11 b.kr. in 2010. Plans also include issuing a new indexed bond series with a maturity of roughly ten years.

## Domestic economy and inflation

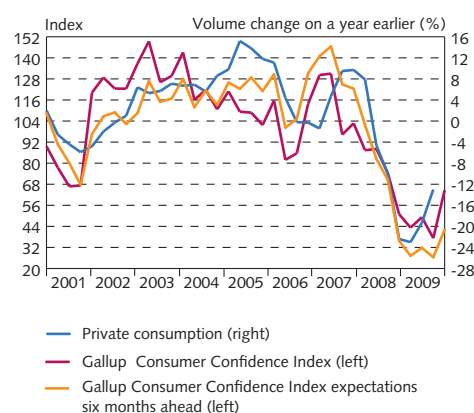
- The economy was somewhat more resilient in 2009 than was assumed in the last *Monetary Bulletin*. According to revised national accounts for the first two quarters and the first preliminary figures for Q3/2009, GDP contracted by about 6% year-on-year during the first nine months of the year. The year-on-year contraction in Q3 measured 7.2%, somewhat less than was projected in November. The present forecast assumes that the contraction in year-2009 GDP was 7.7% rather than 8.5%, as in the November forecast. The forecast for domestic demand has changed little, however.
- The downturn in private consumption, which began in early 2008, concluded in mid-2009. Seasonally adjusted private consumption rose 2.8% between Q2 and Q3, according to Statistics Iceland. A number of economic indicators, such as payment card and groceries turnover, retail sales, and unemployment suggest that private consumption remained relatively stable between Q3 and Q4/2009.
- Private consumption is expected to contract somewhat less in 2010, and grow rather more in 2011, than in the November forecast. The more positive outlook reflects the impact of measures to ease the payment burden of household debt and the smaller contraction in real disposable income in the updated forecast. A number of factors contribute to more positive developments in real disposable



income than in the Bank's last projection. Tax hikes are more modest, wage rises larger, private pension fund payouts greater, and unemployment lower for most of the forecast horizon.

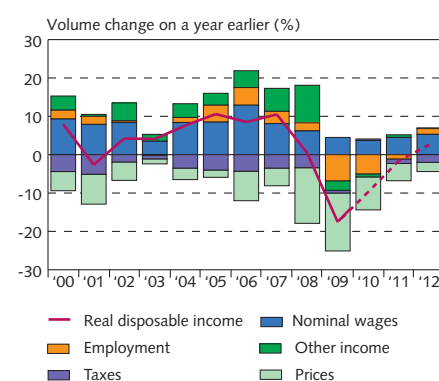
- Public consumption grew more in the first three quarters of 2009 than previously assumed. It appears that consolidation measures were implemented later than expected; nonetheless, the signs of a turnaround are clear: Seasonally adjusted public consumption contracted by 4.5% between Q2 and Q3/2009, declining year-on-year for the first time since Q4/2003. The updated forecast assumes that public consumption will contract by 3-4% per year throughout the forecast horizon.
- The outlook for aluminium and power sector investment has changed significantly since the November forecast. It is now projected at about 25 b.kr. less in 2010 because of a delay in the Straumsvík aluminium smelter expansion and related construction work at Búðarhálsvirkjun power station. Considerable uncertainty remains about developments in aluminium and power sector investment and in aluminium exports.
- As a result, developments in general business investment are uncertain as well. The most recent Capacent Gallup survey among managers of the country's largest firms, carried out in December, indicates greater pessimism than in the surveys done prior to the Bank's last forecast. Firms assume that demand will contract even further, and they are more pessimistic about profits than they were in the autumn. Executives from export firms remain rather more optimistic than those selling in the domestic market. The prospects for public sector investment and residential investment are considered similar to those in the November forecast, however.
- Gross capital formation is expected to contract by just below 6% in 2010, while the November forecast assumed 4.4% growth. The bleaker outlook is attributable in large part to delays in aluminium and power sector investment. Investment growth will gain pace in 2011 and 2012, however, when aluminium and power projects begin in earnest.
- Economic recovery will begin one quarter later than assumed in the last forecast. Seasonally adjusted quarterly GDP growth will be positive in Q2/2010. The contraction in GDP in 2010 is now expected to be larger than in the last *Monetary Bulletin*, or 3.4% instead of 2.4%. The larger contraction is due mainly to a more negative contribution from external trade, as the forecast of an almost 3% contraction in domestic demand is virtually unchanged from the last forecast. In 2011, however, more robust growth in domestic demand will result in half a percentage point more GDP growth than was forecast in November, while the more negative contribution from net exports in 2012 partly explains the lower GDP growth forecast for that year.

Chart 12  
Private consumption and consumer confidence  
Q1/2001 - Q4/2009<sup>1</sup>



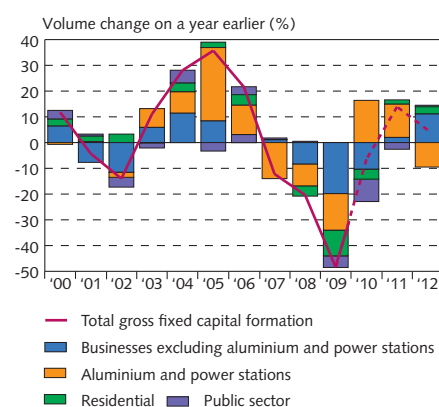
1. Three-month average of Gallup Consumer Confidence index.  
Sources: Capacent Gallup, Central Bank of Iceland.

Chart 13  
Developments in real disposable income and contribution of underlying components  
2000-2012<sup>1</sup>



1. Central Bank baseline forecast 2009-2012. The contribution of the main underlying factors in the yearly changes in real disposable income is calculated based on each factor's weight in disposable income. The combined contribution of underlying factors does not add up to the total change due to rounding and incomplete income accounts for households from Statistics Iceland.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 14  
Gross fixed capital formation and contribution of its main components  
2000-2012<sup>1</sup>



1. Central Bank baseline forecast 2009-2012.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 15  
Output growth and contribution of underlying components 2000-2012<sup>1</sup>

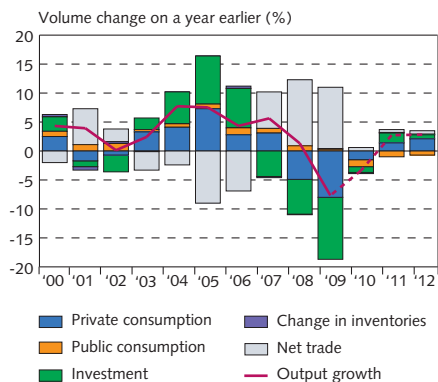


Chart 16  
Economic growth<sup>1</sup>

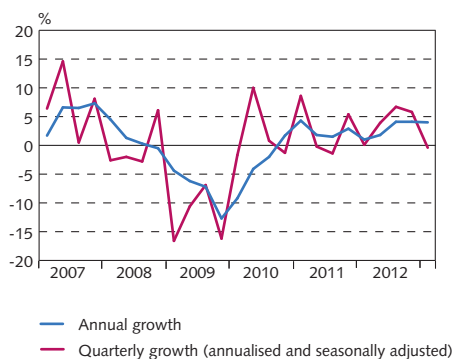
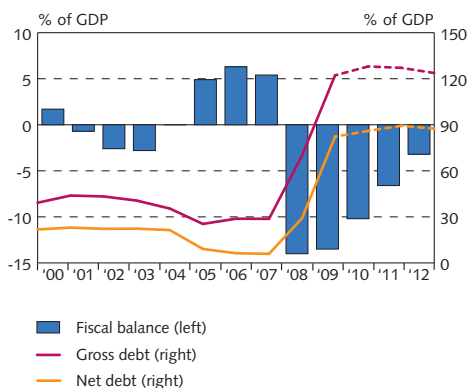


Chart 17  
Public sector finances 2000-2012<sup>1</sup>

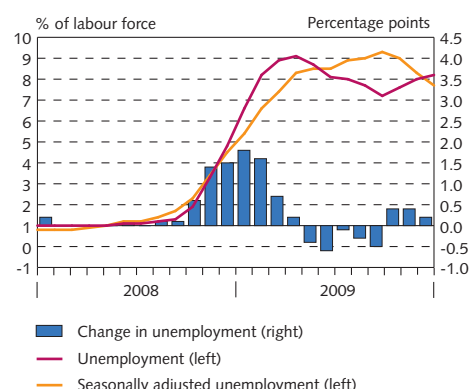


- The baseline forecast assumes that uncertainty surrounding the progress of the Government and IMF's economic programme will soon subside. It is very difficult to assess the economic outlook if that assumption does not hold. The effects would depend in part on the duration of the delay. For example, gross capital formation could contract by one-fourth and GDP by 5% if large investment projects are delayed until the latter half of 2011, and if other business investment proves 10% smaller than in the baseline forecast. Unemployment would also be roughly 2 percentage points higher at year-end than in the baseline forecast.
- According to the updated forecast, there will be a more pronounced slack in the economy during the forecast horizon. The negative output gap is expected to peak at just over 4% this year before narrowing and finally disappearing towards the end of the forecast horizon. It should be noted that estimates of the output gap are especially uncertain at present, in the aftermath of the financial crisis.
- The National Budget was approved in December, with various amendments from the budgetary bill used as a basis for the November forecast. The increase in direct taxes will be somewhat smaller than previously anticipated. This is also true of indirect taxes, although the difference is smaller. The expenditure estimate was also raised by 5 b.kr.
- The Treasury deficit is estimated at 100 b.kr. for 2010, some 12 b.kr. larger than according to the original budget bill. The original bill assumed a primary deficit of 1.5% of GDP, whereas it is now forecasted at 3% of GDP. The future interest burden for the banks' recapitalisation is expected to be smaller than originally thought and that provided some scope to ease restraint. The fiscal stance will therefore be somewhat looser than in the November forecast.
- The fiscal deficit is now estimated at 11% of GDP in 2010, as opposed to just under 10% in the last forecast. This will not affect the long-term prospects of a surplus on the primary balance in 2011 and in the overall balance by 2013.
- According to the Statistics Iceland labour market survey, demand for labour continued to contract in Q4/2009, with the total number of hours work declining by 5.5% year-on-year, due to reductions in staffing and shorter working hours.
- Registered unemployment according to Directorate of Labour statistics rose by 0.3 percentage points between Q3 and Q4/2009, to 7.9%, roughly a percentage point lower than estimated in the Bank's November forecast. Unemployment has been overestimated since Q2/2009, as forecasts have assumed that firms' financial restructuring would proceed more quickly than has actually been

the case. Now that the recapitalisation of the banks is complete, however, this should change. Other indicators suggest that the labour market has yet to weaken further. According to the Capacent Gallup survey carried out in December among Iceland's 400 largest firms, more companies are considering layoffs than in the same survey in September, and fewer are considering adding on staff. Moreover, general labour market sentiment is more pessimistic than in October, according to the Gallup Consumer Sentiment Index. Directorate of Labour figures on new unemployment registrations so far in 2010 indicate that the jobless rate is on the rise again.

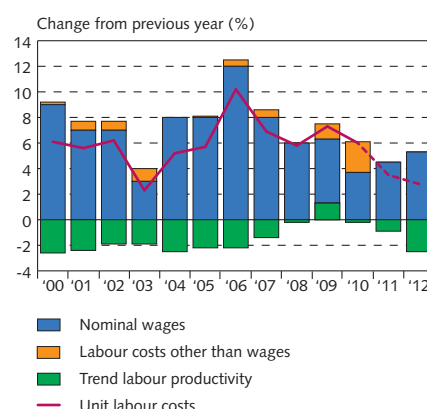
- The updated unemployment forecast is similar to the November forecast. Unemployment is expected to rise as the year progresses, peaking at about 10% in mid-2010. It is projected to remain in the 9-10% range until Q2/2011 and then taper off as economic activity increases.
- Firms' wage costs are expected to rise more sharply than was assumed in the last forecast. There are two main reasons for this. Even though the wage rise that took effect in November was smaller than the negotiating parties assumed when preparing wage agreements in early 2008, it was larger than the Central Bank assumed in November, due to changed labour market conditions. Furthermore, payroll taxes were raised by 1.6% on 1 January 2010, but the hike was not announced until after the last issue of *Monetary Bulletin* was published. Thus the payroll tax has been raised from 5.34% to 8.65% since June 2009. It is likely that firms' wage costs have dropped more than the Statistics Iceland wage index, which measures only changes in regular day wages. Companies have resorted to a variety of measures to reduce wage costs, including laying off staff, increasing the share of part-time workers, and lowering wages.
- Since *Monetary Bulletin* was published in November 2009, new measures of the consumer price index (CPI) have been published three times. It decreased by 0.31% in January, or 1.05% excluding indirect tax effects. Annual inflation therefore measures 6.6%, or 5.2% excluding the tax effects. Inflation is therefore lower than expected in the November forecast.
- Inflation was, however, higher in Q4/2009 than had been forecast. An important reason for the deviation is the fact that the exchange rate depreciation of early 2009 has been more persistent than previous experience has suggested it would be. Inflation was 12% for the whole of 2009 and 8.6% in Q4, whereas the November forecast assumed 8.4% for the fourth quarter.
- Another reason for more persistent inflation at the end of last year is that house prices fall more slowly than projected. Moreover, rents and real estate maintenance have risen steeply. Consequently, the

Chart 18  
Unemployment



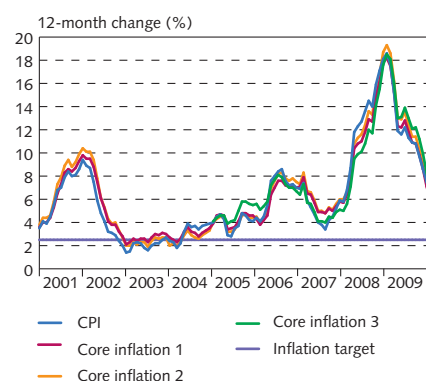
Sources: Directorate of Labour, Central Bank of Iceland.

Chart 19  
Unit labour costs and contributions of underlying components 2000-2012<sup>1</sup>



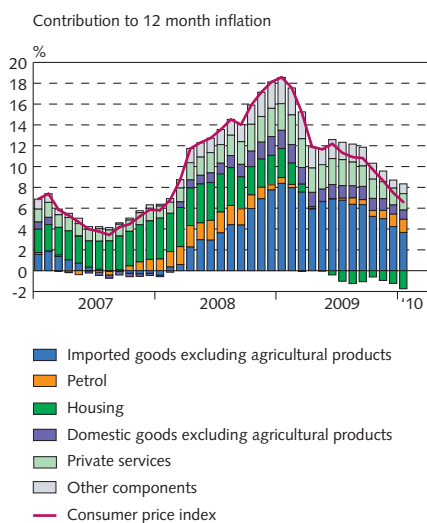
1. Central Bank baseline forecast 2009-2012.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 20  
Inflation January 2001 - January 2010<sup>1</sup>



1. The core indices are compiled on the same basis as the CPI, with Core Index 1 excluding prices of agricultural products and petrol, and Core Index 2 excluding prices of public services as well. Core Index 3 also excludes the effect of changes in mortgage rates.  
Source: Statistics Iceland.

Chart 21  
Components of CPI inflation  
January 2007 - January 2010

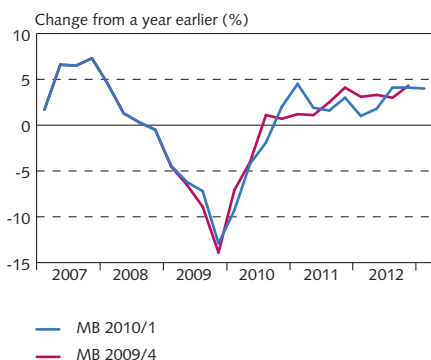


Source: Statistics Iceland.

housing component of the CPI has not dropped as sharply as market real estate prices. This misalignment between subindices of the housing component has subsided in the past few months, however.

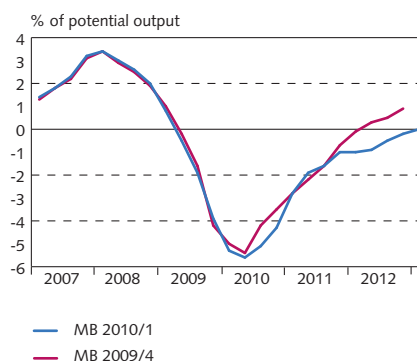
- By December 2009, house prices had declined by one-third in real terms since peaking in October 2007. The revised forecast assumes, as before, that real estate prices will continue to fall in 2010 and 2011.
- According to Capacent Gallup's quarterly survey of household inflation expectations, last carried out in November 2009, the median household expects inflation to be about the same as in the previous survey, or 10%. On the other hand, according to a similar Capacent Gallup survey conducted in December, businesses' inflation expectations have risen. Managers from the country's largest firms projected 6% inflation twelve months ahead, according to the median figure in the December survey, while they expected 4% inflation in the same survey in September. Breakeven inflation rates on the bond market, both five-year rates and five-year rates five years ahead, have also risen and are now just above 4%.
- The outlook is for underlying inflation (inflation excluding indirect taxes) to be lower in Q1/2010 but subsequently to be somewhat higher throughout 2011 than was forecast in November, owing to a weaker króna, larger rises in unit labour costs, and increased inflation expectations. The slack in the economy and the relatively stable exchange rate should support a continued decline in underlying inflation, however. Underlying inflation is projected at around 4½% for 2010 and at the inflation target by Q4/2010. Underlying inflation will temporarily fall below target, as assumed in November.
- The newly passed National Budget for 2010 will affect headline inflation in the quarters to come. The present forecast assumes smaller increases in indirect taxes, however. As a result, it is assumed that these tax measures will have a more modest direct effect on prices; that is, about 0.74% in Q1/2010, or almost a percentage point less than in the November forecast. Headline inflation will therefore be somewhat lower in the first half of 2010 compared to the November forecast. It will, however, be higher in 2011 due to higher underlying inflation pressures, as previously discussed.

Chart 22  
Output growth - comparison with MB 2009/4



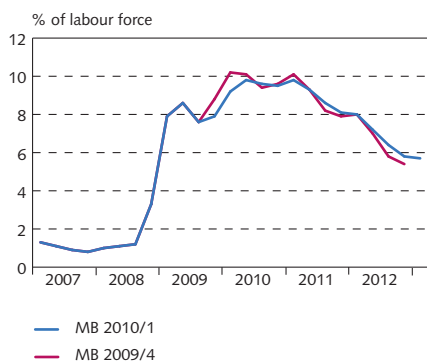
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 23  
Output gap - comparison with MB 2009/4



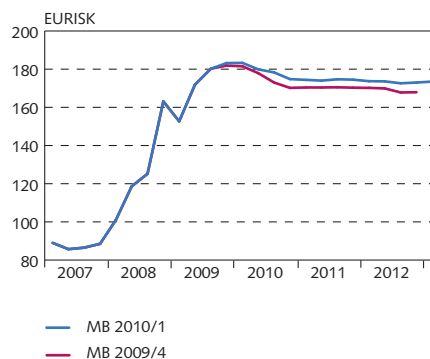
Source: Central Bank of Iceland.

Chart 24  
Unemployment - comparison with MB 2009/4



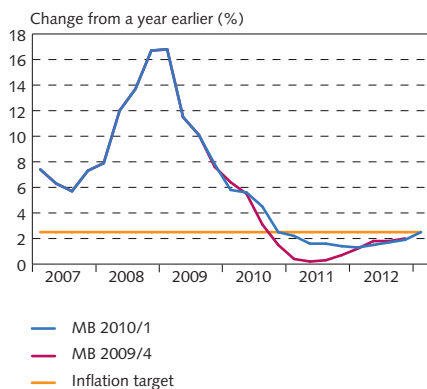
Sources: Directorate of Labour, Central Bank of Iceland.

Chart 25  
The ISK exchange rate against the euro - comparison with MB 2009/4



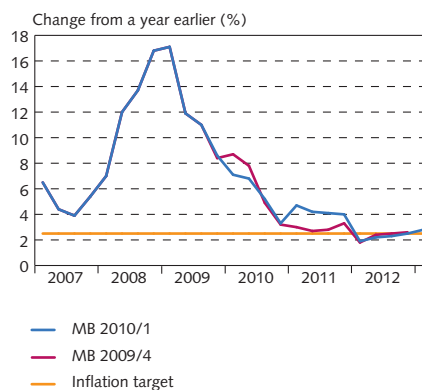
Source: Central Bank of Iceland.

Chart 26  
Inflation excluding tax effects - comparison with MB 2009/4



Sources: Statistics Iceland, Central Bank of Iceland.

Chart 27  
Inflation - comparison with MB 2009/4



Sources: Statistics Iceland, Central Bank of Iceland.

## Appendix 1

### Baseline macroeconomic and inflation forecast 2010/1

Table 1 Macroeconomic forecast<sup>1</sup>

	B.kr		Volume change on previous year (%) unless otherwise stated			
	2008	2008	2009	2010	2011	2012
<i>GDP and its main components</i>						
Private consumption	789.5	-7.8 (-7.8)	-16.0 (-16.2)	-1.2 (-4.0)	2.7 (1.9)	4.2 (4.4)
Public consumption	367.3	4.6 (4.6)	-0.4 (-1.2)	-3.2 (-3.8)	-3.8 (-2.9)	-3.2 (-2.4)
Gross capital formation	357.3	-20.4 (-20.4)	-48.3 (-48.0)	-5.7 (4.4)	12.6 (3.6)	4.9 (1.8)
Business investment	211.0	-25.1 (-25.1)	-53.6 (-52.3)	12.6 (26.1)	20.7 (6.6)	2.3 (-1.9)
Residential investment	80.9	-21.8 (-21.8)	-50.6 (-44.3)	-18.7 (-13.4)	9.5 (6.1)	16.3 (14.1)
Public investment	65.5	0.8 (0.8)	-28.6 (-38.2)	-34.3 (-32.3)	-14.9 (-14.6)	4.4 (3.3)
National expenditure	1,517.5	-8.6 (-8.6)	-19.4 (-19.7)	-2.8 (-3.0)	2.3 (0.9)	2.5 (2.2)
Exports of goods and services	657.8	7.1 (7.1)	1.6 (1.3)	1.5 (1.4)	1.7 (3.9)	5.2 (5.9)
Imports of goods and services	698.8	-18.3 (-18.3)	-25.4 (-25.7)	0.0 (-2.3)	0.6 (0.9)	5.3 (3.6)
Gross domestic product	1,476.5	1.3 (1.3)	-7.7 (-8.5)	-3.4 (-2.4)	2.6 (2.2)	2.8 (3.4)
<i>Other key aggregates</i>						
Trade account balance (% of GDP)		-2.8 (-2.8)	6.7 (6.7)	9.6 (10.6)	9.9 (12.0)	10.2 (13.1)
Current account balance (% of GDP)		-42.2 (-42.2)	-17.3 (-14.0)	-9.0 (-10.2)	-9.7 (-8.3)	-8.9 (-5.6)
Underlying current account balance (% of GDP)		-33.1	-3.0 (-1.0)	3.2 (2.1)	1.3 (3.0)	1.1 (4.6)
Output gap (% of potential output) <sup>2</sup>		2.0 (1.9)	-3.9 (-4.2)	-4.3 (-3.5)	-1.0 (-0.7)	-0.2 (0.9)
Unit labour cost (change in average year-on-year)		5.8 (5.9)	7.3 (7.6)	6.0 (2.8)	3.5 (3.2)	2.8 (3.0)
Real disposable income (change in average year-on-year)		0.5 (0.6)	-17.6 (-19.2)	-9.7 (-15.8)	-1.6 (0.0)	2.6 (2.6)
Unemployment (% of labour force)		1.6 (1.6)	8.0 (8.2)	9.5 (9.8)	9.0 (8.9)	6.8 (6.6)
EURISK exchange rate		127.0 (127.0)	172.0 (171.7)	179.1 (175.6)	174.4 (170.4)	173.2 (168.9)

1. Figures in parentheses are from the forecast in *Monetary Bulletin* 2009/4.

2. Current account without accrued interests due to deposit institutions' undergoing winding-up proceedings and domestic subsidiary.

Table 2 Inflation forecast (%)<sup>3</sup>

Quarter	Inflation (change year-on-year)	Inflation excluding tax effects (change year-on-year)	Inflation (annualised quarter-on-quarter change)
<i>Measured value</i>			
2008:3	13.7 (13.7)	13.7 (13.7)	12.1 (12.1)
2008:4	16.8 (16.8)	16.7 (16.7)	20.5 (20.5)
2009:1	17.1 (17.1)	16.8 (16.8)	9.6 (9.6)
2009:2	11.9 (11.9)	11.5 (11.5)	5.9 (5.9)
2009:3	11.0 (11.0)	10.1 (10.1)	8.6 (8.6)
2009:4	8.6 (8.4)	7.8 (7.6)	10.4 (9.8)
<i>Forecasted value</i>			
2010:1	7.1 (8.7)	5.8 (6.4)	3.7 (10.4)
2010:2	6.8 (7.8)	5.6 (5.5)	4.7 (2.4)
2010:3	5.2 (4.9)	4.5 (3.1)	2.3 (-2.5)
2010:4	3.3 (3.2)	2.5 (1.5)	2.4 (2.7)
2011:1	4.7 (3.0)	2.2 (0.4)	9.7 (9.6)
2011:2	4.2 (2.7)	1.6 (0.2)	2.5 (1.3)
2011:3	4.1 (2.8)	1.6 (0.3)	2.2 (-2.1)
2011:4	4.0 (3.3)	1.4 (0.7)	1.7 (4.7)
2012:1	1.9 (1.8)	1.3 (1.2)	1.3 (3.5)
2012:2	2.2 (2.4)	1.5 (1.8)	3.4 (3.6)
2012:3	2.3 (2.5)	1.7 (1.8)	3.0 (-1.7)
2012:4	2.5 (2.6)	1.9 (2.0)	2.4 (5.3)
2013:1	2.8	2.5	2.3
<i>Annual average</i>			
2009	12.0 (12.0)	11.4 (11.3)	
2010	5.6 (6.1)	4.5 (4.1)	
2011	4.3 (2.9)	1.7 (0.4)	
2012	2.2 (2.3)	1.6 (1.7)	

3. Figures in parentheses are from the forecast in *Monetary Bulletin* 2009/4.