MONETARY BULLETIN

2020•3

Contents

26 August 2020

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 twelve-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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This is a translation of a document originally written in Icelandic. In case of discrepancy or difference in interpretation, the Icelandic original prevails. Both versions are available at www.cb.is.

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.

Statement of the Monetary Policy Committee 26 August 2020

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 1%.

According to the Central Bank's new macroeconomic forecast, published in the August *Monetary Bulletin*, the outlook is for a 7% contraction in GDP this year and roughly 10% unemployment by the year-end. Although the outlook for H2 is somewhat poorer than was forecast in May, the contraction for the year as a whole is expected to be smaller than was projected then. This is due mainly to the more robust private consumption seen this spring and summer. Uncertainty is unusually pronounced, however, and economic developments will depend on the path the pandemic takes.

Inflation measured 2.5% in Q2 but had risen to 3% by July, driven largely by a more than 12% depreciation of the króna since the pandemic reached Iceland. Medium- and long-term inflation expectations are broadly unchanged, however, and appear to remain anchored to the Bank's inflation target. According to the Bank's forecast, inflation is expected to average about 3% over the remainder of 2020. However, because of the significant slack in the economy and low global inflation, it will taper off in 2021 and is projected to average 2% in the latter half of the forecast horizon.

More firmly anchored inflation expectations provide monetary policy the scope to respond decisively to the deteriorating economic outlook. Lower interest rates, together with actions taken by the Bank this spring, have supported domestic demand. The impact of these measures has yet to emerge in full, however, and they will continue to support the economy and facilitate a more rapid recovery than would otherwise occur.

The MPC will continue to monitor economic developments and will use the tools at its disposal to support the domestic economy and ensure that the more accommodative monetary stance is transmitted normally to households and businesses.

Monetary Bulletin 2020/3[1]

The COVID-19 pandemic and governmental measures to curb the spread of the disease have had a profound impact on the global economy. In Q2/2020, GDP among Iceland's main trading partners is estimated to have contracted by nearly 13%, more than in any single quarter since quarterly measurements were introduced. Indicators imply that global economic activity picked up as the quarter progressed, but the outlook for H2/2020 has deteriorated since the May *Monetary Bulletin* because of the resurgence of the pandemic in many parts of the world.

Domestic economic activity had begun to slow before the pandemic reached Iceland, contracting by just over 1% year-on-year in Q1/2020. The effects of the pandemic started to show towards the end of that quarter and intensified in April. On the other hand, there are signs that domestic demand gained momentum in May and June, when the pandemic eased and public health measures were relaxed. Nevertheless, the outlook is for a nearly 11% year-on-year contraction in GDP in Q2. This is a smaller contraction than was forecast in May, mainly because household consumption spending did not suffer as much as was feared at that time. Although the outlook for H2 is rather poorer than was forecast in May, GDP is expected to contract by 7.1% in 2020 as a whole, instead of the previously projected 8%.

Because economic developments in H1 were more favourable than expected, unemployment has not risen as much as was feared in May, although the Government's part-time unemployment benefits scheme, a lower labour participation rate, and an increase in part-time jobs all played a role in keeping the jobless rate lower than it would have been otherwise. Even so, unemployment is expected to keep rising, peaking at around 10% towards the year-end. As in May, robust GDP growth is projected for 2021, as the economy will be rising from a deep trough and production factors are therefore underutilised. Nevertheless, GDP is not expected to return to the end-2019 level until late in 2023. But the outlook remains extremely uncertain, and developments will depend not least on the success of efforts to quell the pandemic. The Bank's forecast assumes that there will not be a major resurgence of the illness, although the possibility of recurring small-scale outbreaks cannot be ruled out.

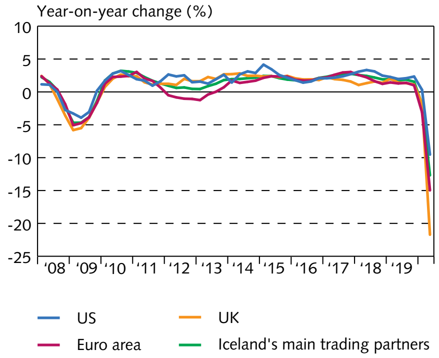
Inflation measured 2.5% in Q2 but had risen to 3% by July, probably in large part because the króna is now about 14% weaker than it was a year ago. In spite of the inflation spurt, medium- and long-term inflation expectations have held broadly unchanged. The outlook is for inflation to average about 3% over the remainder of 2020. However, because of the significant slack in the economy and low global inflation, it will taper off in 2021 and is projected to average 2% in the latter half of the forecast horizon. For the first half of the forecast period, this is a higher inflation rate than was projected in May, as inflation is higher at the outset and the slack in the economy is smaller now than previously expected.

1. The analysis appearing here is based on the Bank's assessment of economic developments since the publication of *Monetary Bulletin* 2020/2 in May 2020, and on the updated forecast presented in this report. It is based on data available as of mid-August. The risk analysis in the updated forecast is based on the risk analysis in the May forecast. As was the case in May, 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

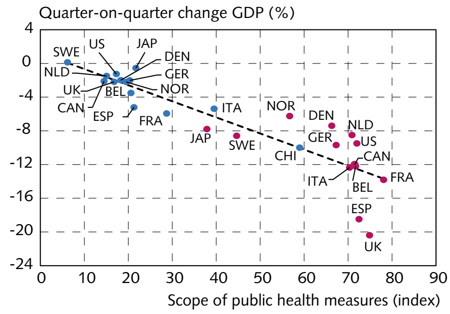
- The spread of COVID-19 and the broad-based public health measures put in place by governmental authorities the world over in a bid to contain the disease have had colossal implications. By just after mid-August, the number of confirmed infections exceeded 23 million, and over 800,000 people had died of the disease. Among Iceland's main trading partners, GDP shrank by an average of 1.9% year-on-year in Q1 and is estimated to have shrunk by nearly 13% in Q2. Not only is this the steepest decline measured among advanced economies in the history of quarterly national accounts data, it is nearly three times the size of the biggest single-quarter contraction during the global financial crisis over a decade ago. It also exceeds the projected contraction of just over 11% in the Bank's May forecast.
- The contraction varied from one country to another, but in part it reflects how swiftly and aggressively governmental authorities have implemented public health measures in an attempt to bring the disease under control. The composition of each national economy is also important, particularly the weight of tourism and sectors requiring close personal interactions.
- Leading indicators imply that economic activity picked up in key advanced economies as COVID-19 case rates fell and public health restrictions were eased early in the summer. Purchasing managers' indices (PMI) have risen in both services and manufacturing sectors, after having hit all-time lows in April. Retail sales have also picked up, in line with indications that people have been moving about more, and industrial manufacturing has begun growing again (see Chart A-1 in Appendix 1). Furthermore, the labour market has rebounded faster than generally expected, particularly in the US, although US unemployment remains high in historical context.
- Despite the aforementioned indicators, it is assumed that the recovery among Iceland's trading partners will be slower in H2/2020 than was forecast in May. After tapering off in most countries, the pandemic has regained momentum in some areas, particularly the US (Chart A-1), but in core eurozone countries as well. A number of countries have therefore reinstated public health restrictions or paused plans to ease them. As a result, the economic recovery looks set to stall, although increased government stimulus will help to keep economies moving. In addition, trade tensions between the US and China have escalated, and the UK and the European Union (EU) have yet to reach a permanent post-Brexit trade agreement. Global economic uncertainty therefore remains significant, particularly to include uncertainty about how successful efforts to control the pandemic will be.
- Iceland's trading partners are forecast to see a 7.1% contraction in 2020, some 0.7 percentage points more than was projected in May. GDP growth in 2021 and 2022 will be stronger than in the May forecast, however. The outlook for trading partner imports

Chart 1
Global GDP growth[1]
Q1/2008 - Q2/2020



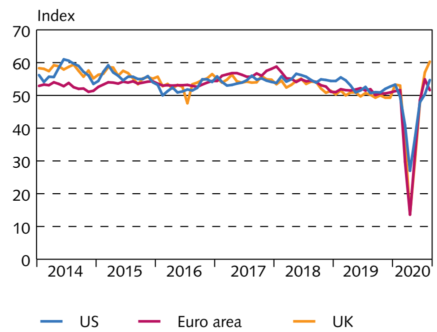
1. Central Bank baseline forecast Q2/2020 for main trading partners.
Sources: Refinitiv Datastream, Central Bank of Iceland.

Chart 2
Global GDP growth and scope of public health measures, Q1-Q2/2020[1]



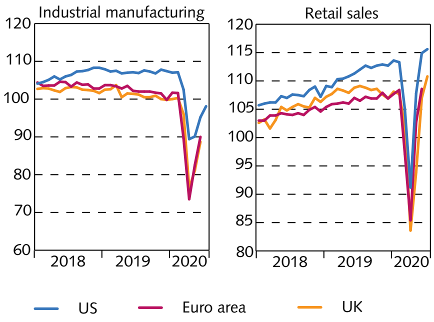
1. The blue dots show developments in Q1, and the red dots show developments in Q2. The countries are the United States (US), Belgium (BEL), the United Kingdom (UK), Denmark (DEN), France (FRA), the Netherlands (NLD), Italy (ITA), Japan (JAP), China (CHI), Norway (NOR), Spain (ESP), Sweden (SWE), and Germany (GER).
Sources: OECD, Oxford COVID-19 Government Response Tracker.

Chart 3
Composite PMI[1]
January 2014 - August 2020



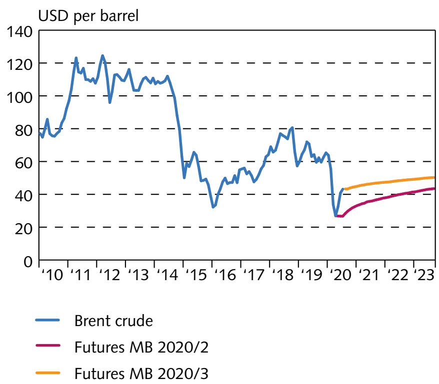
1. Markit composite output purchasing managers' index. The index is published monthly and is seasonally adjusted. An index value above 50 indicates month-on-month growth, and a value below 50 indicates a contraction.
Source: Refinitiv Datastream.

Chart 4
Industrial manufacturing and retail sales[1]
January 2018 - August 2020



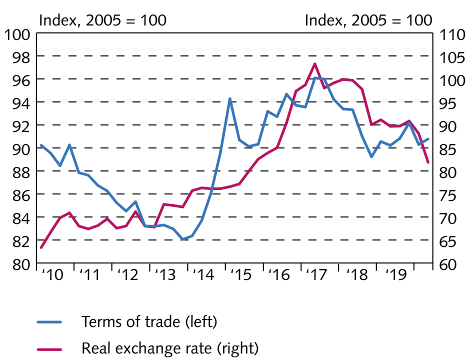
1. Seasonally adjusted volume indices (2016 = 100).
Source: Refinitiv Datastream.

Chart 5
Global oil prices
January 2010 - September 2023



Sources: Refinitiv, Central Bank of Iceland.

Chart 6
Terms of trade and real exchange rate[1]
Q1/2010 - Q2/2020



1. Real exchange rate in terms of relative consumer prices. Q2/2020 terms of trade based on Central Bank baseline forecast.
Sources: Statistics Iceland, Central Bank of Iceland.

has also changed during the forecast horizon, in line with the changed GDP growth outlook. The global inflation outlook has changed little since the spring, however. Among Iceland's main trading partners, inflation is projected to average 0.7% this year and rise to 1.7% by 2022.

- Major advanced economies' central banks have kept interest rates unchanged after lowering them substantially when the pandemic broke out. They have also applied other stimulative policy measures that have significantly expanded their balance sheets. The Bank of England and the European Central Bank (ECB) both announced further stimulative measures in June. In addition, the US Federal Reserve has just announced plans to continue buying bonds at or above the pace recently established, and to continue providing special liquidity facilities to financial institutions.

- After being thrown into disarray by the COVID-19 outbreak, international financial markets began to rally again in response to increased economic activity, relaxation of public health measures, and greater optimism about the development of a COVID vaccine. Broad-based support measures implemented by central banks and governments have played a major role as well. Share prices have risen again, and volatility has receded, although it is still above its historical average. The rise in risk premia and interest rate spreads on riskier assets has largely reversed. Long-term interest rates in major advanced economies have remained at or near historical lows, and forward interest rates suggest that market agents expect central bank rates to remain low for the foreseeable future. Financial conditions have therefore improved since the spring, although they are still worse than before the pandemic hit.

- Global crude oil prices have risen since May but are still down by about a third in 2020 to date. The recent increase reflects both a surge in demand following the relaxation of public health measures and the impact of reduced production among leading oil manufacturing countries. Futures prices indicate that oil prices will ease slowly upwards during the forecast horizon and be higher over the period as a whole than was forecast in May.

- The price of aluminium and other commodities has also risen more than was projected in May and looks set to be above that forecast in 2020 as a whole. The outlook for Icelandic marine product prices in H2/2020 has improved as well. Prices of other goods and services exports are now expected to rise less, however. This, together with a larger rise in oil prices, is the main reason terms of trade are projected to improve more slowly in 2020 than was forecast in May.

- The real exchange rate in terms of relative consumer prices was down 8.5% year-on-year in July, owing largely to the nominal depreciation of the króna in March and April, after the pandemic struck. As in the May forecast, the real exchange rate is expected to remain broadly unchanged over the forecast horizon, albeit nearly 2% higher at the end of the period than was assumed in May.

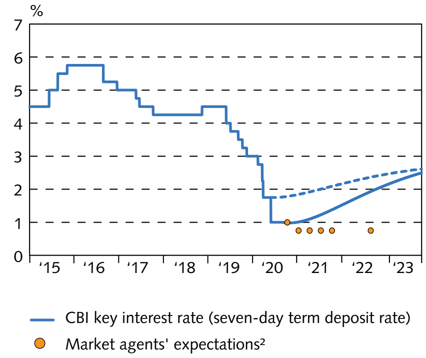
Monetary policy and domestic financial markets

- At its May meeting, the Central Bank Monetary Policy Committee (MPC) decided to lower the Bank's key rate by 0.75 percentage points, to an all-time low of 1%. The Bank's key rate has therefore been lowered by 1.75 percentage points since the pandemic reached Iceland, and by 2.75 percentage points in the past year. The Committee also decided in May to stop offering one-month term deposits so as to increase market liquidity and strengthen monetary policy transmission. The Bank's real rate has fallen in tandem with the decline in the nominal policy rate. It is now -1.7% in terms of the average of various measures of inflation and one-year inflation expectations and -1.9% in terms of past twelve-month inflation.
- According to the Central Bank's August survey, market agents expect the Bank's key rate to be lowered by a further 0.25 percentage points in Q4/2020 and then remain unchanged until H2/2022. Forward interest rates suggest, however, that market agents expect no further rate cuts but instead expect rates to begin rising in H2/2021.
- Yields on nominal ten-year Treasury bonds are currently 2.6%. They have risen slightly since just before the May *Monetary Bulletin* but are about 0.7 percentage points lower than at the turn of the year. Yields on shorter bonds have fallen faster in the recent term, and the slope of the yield curve has therefore grown steeper. This may reflect greater pessimism about the near-term economic outlook, but in addition, the decline in short-term rates coupled with increased market liquidity has boosted demand for Treasury bills and short-term Treasury bonds. The Central Bank's secondary market purchases of Treasury bonds have focused primarily on the shortest maturities, as the Treasury has addressed its increased financing needs largely by issuing bills and short-term bonds. Long-term real rates have fallen as well, and the yield on ten-year indexed Treasury bonds is now 0%, after falling by 1.2 percentage points since the beginning of the year.
- The nominal and real interest rate differential with key trading partners has narrowed with the decline in domestic interest rates. Risk premia on Treasury foreign obligations remain broadly unchanged.
- Outflows relating to new investments increased after the pandemic reached Iceland, albeit offset by inflows due to investment in a domestic real estate company. The outflows are attributable in large part to sales of domestic equity securities and Treasury bonds. In the first seven months of the year, net registered new investment was negative by 14 b.kr., whereas it was positive by nearly 37 b.kr. over the same period in 2019.
- The króna began to depreciate when the pandemic spread to Iceland, as did the currencies of many other countries in a similar situation. As of early May, it had fallen nearly 12% since end-Feb-

Chart 7

Central Bank of Iceland key interest rate and expected developments[1]

1 January 2015 - 30 September 2023

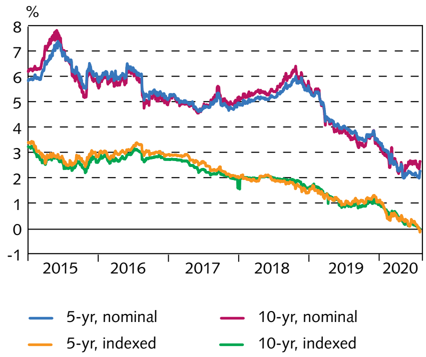


1. The Central Bank's key interest rate and Treasury bond yields were used to estimate the yield curve. Broken lines show forward market interest rates prior to MB 2020/2. 2. Estimated from the median response in the Central Bank's survey of market agents' expectations concerning the collateralised lending rate. The survey was carried out during the period 10-12 August 2020.
Source: Central Bank of Iceland.

Chart 8

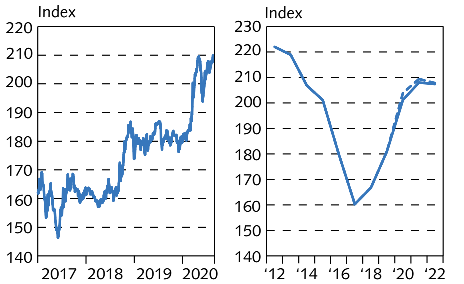
Government-guaranteed bond yields[1]

2 January 2015 - 21 August 2020



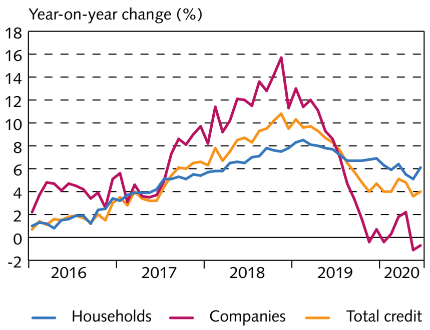
1. Based on the zero-coupon yield curve, estimated with the Nelson-Siegel method, using money market interest rates and Government-guaranteed bonds.
Source: Central Bank of Iceland.

Chart 9
Exchange rate of the króna[1]



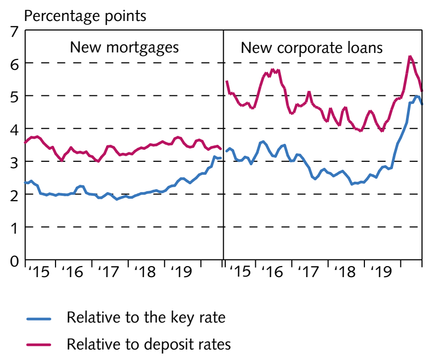
1. Price of foreign currency in krónur. Narrow trade index. Central Bank baseline forecast 2020-2022. Broken lines show forecast from MB 2020/2.
Source: Central Bank of Iceland.

Chart 10
Credit system lending[1]
January 2016 - June 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.
Source: Central Bank of Iceland.

Chart 11
Credit spreads[1]
March 2015 - July 2020



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

ruary, but it appreciated over the course of the month, possibly in response to increased optimism following successful public health measures and a steep decline in the domestic infection rate, as well as the hope of a stronger recovery of tourism than had previously been expected. The appreciation reversed course over the summer months, however, and just before this *Monetary Bulletin* went to press, the króna had fallen in trade-weighted terms by just over 12% since end-February and by more than 14% year-to-date.

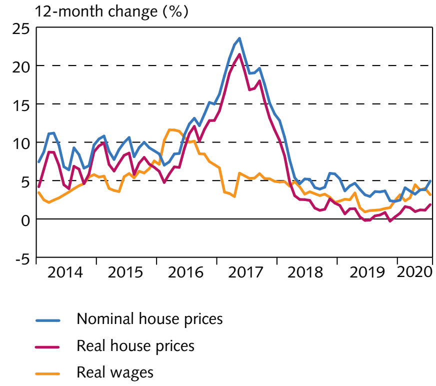
- The Central Bank has intervened more in the foreign exchange market this year than in the past two years. In 2020 to date, the Bank's net sales of foreign currency total nearly 29 b.kr., and its share in total market turnover is about one-fifth.
- In Q2, the trade-weighted exchange rate index stood at just over 203 points, and the króna was therefore a full 2% stronger than was forecast in May. The index has been around 207 thus far in August, and the baseline forecast is based on the assumption that it will remain close to that level throughout the forecast horizon.
- Growth in M3 has gained pace as the year has progressed, measuring 10.2% in Q2, up from 4.2% in Q4/2019. The main difference was continued strong growth in household deposits.
- Growth in credit system lending to domestic borrowers lost pace over the course of 2019 but has been relatively stable at around 4% year-on-year thus far in 2020. At mid-year 2019, however, it was roughly twice as strong as it is now. Year-on-year growth in household lending has been above 5% since mid-2017, and there are few signs of a slowdown, as interest rates have declined steeply and real estate market activity has been brisk. Growth in corporate lending has slowed markedly, however, and was negative by 0.7% year-on-year in June. The Government's pandemic response measures are expected to support corporate lending in coming months, and about 4.3 b.kr. in bridge loans and support loans have been issued since July. These loans are partially or fully guaranteed by the Government. Furthermore, companies have obtained financing through marketable bond issuance and special investment funds, offsetting reduced credit system lending.
- Households' borrowing terms have improved markedly with Central Bank rate cuts. As a result, many households have refinanced their mortgages, and demand for non-indexed mortgages from the commercial banks has increased. The banks' market share in the mortgage lending market has therefore grown swiftly in recent months, as they now offer more favourable rates than the pension funds in most cases. The decline in interest rates on new mortgages has been smaller than the decline in the Bank's key rate, but relative to average household deposit rates, the interest premium on new household mortgages has been broadly flat in recent years. However, the interest premium on new corporate loans began rising in 2019, relative to both the Central Bank's key rate and average corporate deposit rates, although it appears to have perhaps reached its peak.

- The share of non-performing corporate loans was nearly twice as high this July as it was a year earlier. In addition, a number of companies have taken advantage of special pandemic-related debt measures from lenders, and the loans thus protected are not considered non-performing. Corporate insolvencies have also been on the rise, while the number of firms on the default register has fallen. The number of households on the default register has fallen as well. In addition to availing themselves of debt measures, households have taken advantage of a pandemic-related authorisation to tap their third-pillar pension savings, withdrawing over 12 b.kr. from April through July.
- Capital area house prices rose by 4.9% year-on-year in July, and rent prices by 2.2%. House prices are up slightly in 2020 to date, as interest rates have fallen steeply and real wages have risen despite the worsening employment situation. Housing market turnover seized up after the pandemic began spreading in Iceland and public health measures were imposed. The contraction was greatest in April, when finalised purchase agreements were down by nearly half between years. Market activity began to pick up again in May, however, and by July the number of purchase contracts was up one-fifth year-on-year.
- Share prices fell precipitously after COVID-19 reached Iceland in late February but then rebounded in late March, following announcements of economic measures to offset the effects of the pandemic. The OMXI10 index is now 5.2% higher than it was when the May *Monetary Bulletin* was published. Equity market turnover began to ease in late March, and over the first seven months of 2020 it was down nearly 7% year-on-year.

Demand and GDP growth

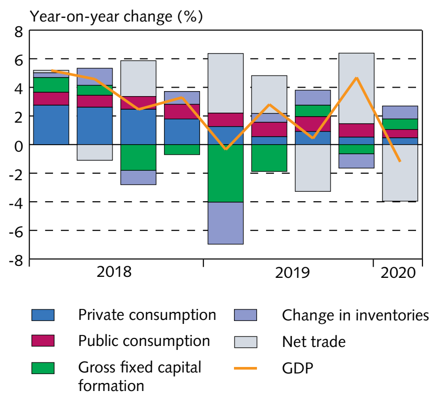
- According to preliminary figures published by Statistics Iceland, GDP contracted by 1.2% year-on-year in Q1/2020. Domestic demand grew by 2.9%, including a 0.9% year-on-year increase in private consumption and a 4.1% increase in investment spending. Offsetting robust growth in domestic demand was a negative contribution from net trade amounting to 4 percentage points, owing to the severely negative impact of the pandemic on Iceland's export sector.
- This is a somewhat smaller contraction in GDP than the 1.9% assumed in the May forecast. The main difference was in private consumption, which was considerably stronger than had been anticipated in May, but it is not impossible that those figures will be revised downwards when more complete data on consumption spending in March become available.
- Household demand and spending changed radically when public health measures were introduced in March, with the impact of the measures peaking in April. Road traffic declined markedly, and payment card data suggest that household spending fell by a fifth

Chart 12
Capital area house prices and real wages
January 2014 - July 2020



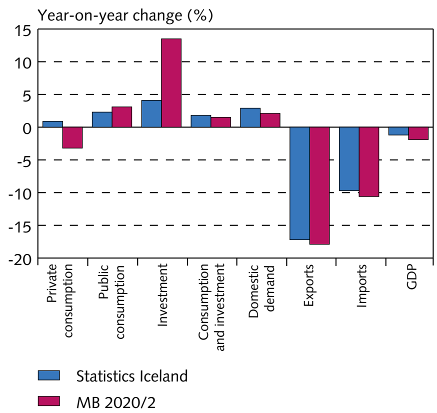
Sources: Statistics Iceland, Registers Iceland.

Chart 13
GDP growth and contribution of underlying components[1]
Q1/2018 - Q1/2020



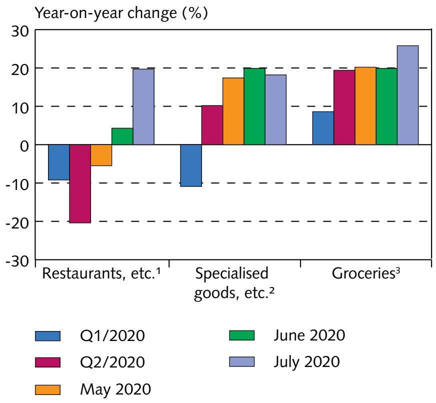
1. Because of chain-volume linking, the sum of expenditure components may not equal GDP growth.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 14
National accounts Q1/2020



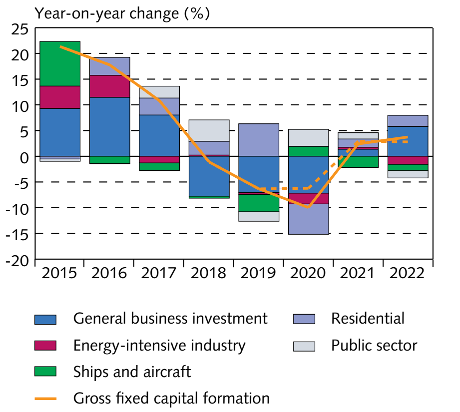
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 15
Payment card turnover by main categories[1]



1. Restaurants, accommodation, transport, package tours, duty-free shopping, culture and recreation, personal care, and other personal services. 2. Electronics, household appliances, furniture, clothing, and other specialised retail goods and services. 3. Grocery stores and supermarkets.
Source: Centre for Retail Studies.

Chart 16
Gross fixed capital formation and contribution of main components 2015-2022[1]



1. General business investment excludes ships, aircraft, and energy-intensive industry investment. Central Bank baseline forecast 2020-2022. Broken line shows MB 2020/2 forecast.
Sources: Statistics Iceland, Central Bank of Iceland.

year-on-year in April (see Chart A-2 in Appendix 1). However, the same high-frequency indicators imply that households stepped up their spending in May and June, when the infection rate began to drop and public health measures were eased. Since early July, for example, domestic payment card turnover within Iceland has averaged more than 10% higher than it was a year ago.

- Growth in consumption spending has varied by spending category in the recent past. Purchases of various kinds of consumer durables have increased, partly due to pent-up need following the drop in spending during the peak of the pandemic in the spring. As payment card turnover data indicate, it is likely that households used some of their overseas travel budget to purchase consumer durables, as domestic turnover has increased while turnover abroad has fallen significantly. Purchases of various services requiring close personal interactions have also increased since the public health measures were relaxed (Chart A-2). Furthermore, real estate market activity has increased in the recent past.

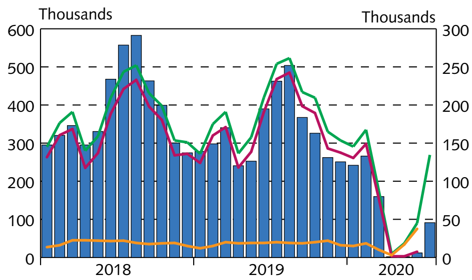
- Private consumption is estimated to have contracted by 10% year-on-year in Q2. This is a considerably smaller contraction than was forecast in May, reflecting in particular the rapid retreat of the COVID-19 infection rate this spring and the unexpected success in meeting household demand through online shopping. Before this *Monetary Bulletin* went to press, Iceland's COVID infection rate started rising again and public health measures were tightened, although not to the same degree as in the spring (Chart A-2). Developments in private consumption in H2/2020 will depend largely on the success of measures to contain the pandemic. Private consumption is expected to contract by nearly 7% year-on-year in H2, and by 5.8% in 2020 as a whole. This is a slightly smaller contraction than was forecast in May, reflecting to a large degree the more favourable developments in H1. The recovery in 2021 will be weaker, however.

- Business investment grew by 9.5% in Q1/2020, but its main subcomponents contracted between years, apart from investment in ships and aircraft. The surge in investment in ships and aircraft stems from negative base effects due to the sale of aircraft from WOW Air's fleet in Q1/2019. General business investment (i.e., investment excluding energy-intensive industry, ships, and aircraft) therefore contracted by nearly 24% year-on-year, more than was projected in May. Public investment was weaker as well, but residential investment contracted less than expected.

- Declining sales and revenues, together with increased uncertainty about the pandemic and the economic outlook, are estimated to have caused business investment to contract by almost one-fifth in Q2. For the year as a whole, business investment is expected to contract by over 13% and total investment by 10%. This is a somewhat larger contraction than was forecast in May, owing largely to the poorer outlook for business investment. The outlook for the next two years is broadly unchanged, however.

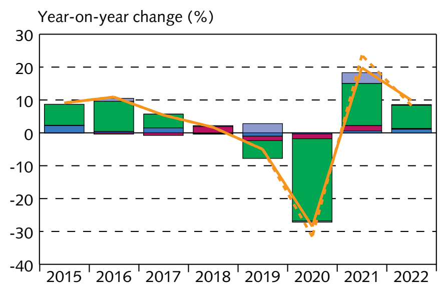
- The authorities have adopted a wide range of measures to mitigate the economic impact of the pandemic (see Box 2 in *Monetary Bulletin* 2020/2). No new measures have been announced, but the fiscal plan will be introduced on 1 October 2020. The Bank's forecast of public expenditure is therefore broadly unchanged since May. Public consumption spending is forecast to grow by just over 3% and public investment spending by about one-fifth.
- Goods and services exports shrank 17.2% year-on-year in Q1, the largest single-quarter contraction since quarterly national accounts were introduced in 1995. This aligns with the forecast in the May *Monetary Bulletin*, while exports excluding ships and aircraft contracted by 10.1%. Services exports contracted by 16.2%, owing mainly to the collapse of tourism and international air travel in mid-March. The effects of the pandemic on goods exports were less pronounced, however. Excluding exports of ships and aircraft, goods exports were down 4.5% during the quarter, driven mostly by a contraction in marine product exports.
- In Q2/2020, the number of passenger flights to and from Iceland fell by nearly 96% year-on-year and 98% fewer tourists visited the country. Foreign travellers' overnight stays in hotels also declined, although this was mitigated in part by an increase in Icelanders' domestic travel. As a result, the overall decline in overnight stays during the quarter came to 86%.
- Airline seat capacity has increased well in excess of expectations in Q3 to date. Once tourists were allowed to take a COVID test at the border instead of being subjected to a 14-day quarantine, the number of international airlines flying through Keflavík Airport rose significantly. That said, traffic through Keflavík is still much sparser than in a normal season, and the daily number of passengers travelling through the airport is only a fifth of what it was a year ago (Chart A-2). If transit passengers are excluded, the contraction is smaller, and the downturn in foreign payment card use in Iceland has eased even more rapidly. As of mid-August, foreign card turnover in the country was down just under 40% year-on-year. The smaller decline in spending and overnight stays suggests that tourists have been staying longer and spending more than usual.
- The next few months are highly uncertain for the tourism industry. As in many other European countries, the number of COVID infections in Iceland increased in late July. This prompted a re-tightening of public health measures, both at the border and inside the country, and in some markets Iceland has been designated a high-risk area. As a result, passenger numbers began to fall again in late August. For 2020 as a whole, tourist numbers are expected to fall by approximately 75% year-on-year, as opposed to more than 80% according to the May forecast.
- The contraction in marine product exports in 2020 is expected to be smaller than previously estimated. Distribution of marine products internationally has gone more smoothly than initially

Chart 17
Hotel bed-nights and foreign tourists
January 2018 - July 2020



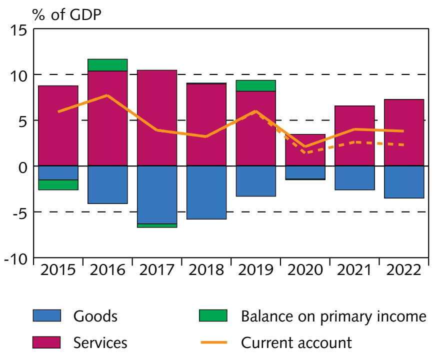
Sources: Icelandic Tourist Board, Statistics Iceland.

Chart 18
Exports and contributions from underlying components 2015-2022[1]



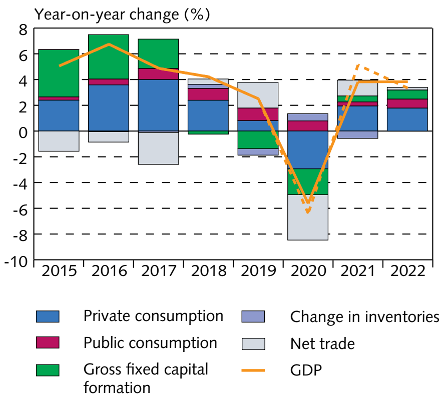
1. Because of chain-volume linking, the sum of components may not equal total exports. Aluminium exports according to national accounts definition. Tourism is the sum of "travel" and "passenger transport by air". Central Bank baseline forecast 2020-2022. The broken line shows the forecast from MB 2020/2.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 19
Current account balance 2015-2022[1]



1. Balance on secondary income included in the balance on primary income. Central Bank baseline forecast 2020-2022. Broken line shows forecast from MB 2020/2.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 20
GDP growth and contribution of underlying components 2015-2022[1]



1. Central Bank baseline forecast 2020-2022. Broken line shows MB 2020/2 forecast.
Sources: Statistics Iceland, Central Bank of Iceland.

feared, and demand – particularly for fresh and land-frozen products – has been more resilient than previously projected. As a consequence, inventories have accumulated less and the decline in fishing has been smaller. Offsetting this is the expectation of reduced industrial goods exports this year. Furthermore, the outlook for aluminium manufacturing is somewhat poorer, and weak demand for ferrosilicon caused a more rapid downturn in production in Q2. Moreover, a further decline is expected after the PCC plant at Bakki halted production temporarily in July.

- On the whole, exports are estimated to have contracted by almost 40% year-on-year in Q2, and the contraction for 2020 as a whole is projected at just over 28%, slightly less than was forecast in May. The outlook for the next two years is broadly unchanged, however.

- Imports of goods and services shrank by 9.7% in Q1/2020, owing largely to a steep drop in imports of investment goods, tourism-related inputs, and Icelanders' overseas travel. Preliminary figures indicate a further contraction in Q2. According to those figures, goods imports fell by a fourth, the largest contraction in over a decade. As in the May forecast, imports of goods and services are projected to fall by almost a fourth in 2020 as a whole.

- The current account surplus is projected to shrink from last year's 5.9% of GDP to 2% this year. This represents a somewhat larger surplus than was forecast in May, owing to more favourable developments in exports, albeit offset by poorer terms of trade. The current account surplus is expected to grow in 2021, to nearly 4% of GDP.

- Domestic demand is estimated to have contracted by just over 8% year-on-year in Q2. Due to this, plus the negative contribution from net trade, GDP is estimated to have contracted by nearly 11%. If this forecast materialises, it will be the largest single-quarter contraction in the history of Iceland's quarterly national accounts data. Even so, it is smaller than the nearly 15% forecast in May, mainly because household consumption spending turned out more resilient in H1 than anticipated. For the year as a whole, the contraction is expected to be slightly smaller than was forecast this spring, or about 7% instead of the 8% assumed in May, although the outlook for H2 is rather poorer than was projected then.

- This projection is based on the assumption that there will not be a major resurgence of the pandemic, although the possibility of recurring small-scale outbreaks this year and in 2021 cannot be ruled out. The smaller contraction this year means that next year's recovery will start from a higher level than was forecast in May. This, in turn, explains in part why next year's GDP growth is projected to be below the May forecast. GDP growth is expected to measure 3½% per year in 2021 and 2022. If this forecast materialises, GDP will not return to its end-2019 level until the end of the forecast horizon.

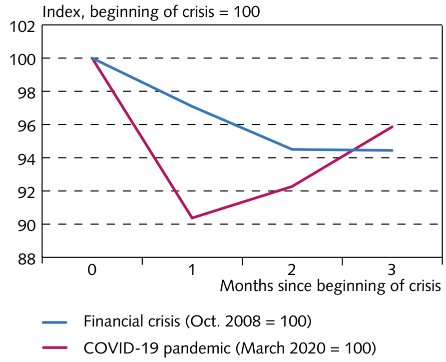
Labour market and factor utilisation

- According to the Statistics Iceland labour force survey (LFS), total hours worked fell by 7.2% between years in Q2/2020, the largest single-quarter contraction since Q3/2009. Yet this is a smaller decline than was forecast in May, when it was extremely unclear how the pandemic and the Government's part-time unemployment benefits programme would affect jobs and working hours. Total hours fell precipitously in April, at the peak of the public health measures, and were down by nearly 10% relative to March. They recovered more strongly than anticipated in the latter half of the quarter, however. Although strong participation in the part-time benefits programme probably mitigated the reduction in total hours worked, monthly LFS data indicate that the decline was both larger and steeper in the first wave of the pandemic than at the beginning of the financial crisis just over a decade ago.[2] Job numbers and total hours worked appear to have bottomed out in April, but for the quarter as a whole, job numbers were a full 5% lower than at the same time in 2019 (see Chart A-3 in Appendix 1). The steep reduction in working hours, some of it due to the part-time option, showed more clearly in the working hours of those at work during the reference week, as they were a full 7% shorter than at the same time in 2019. The more than 6% decline in the number of people remitting pay-as-you-earn (PAYE) tax in Q2 also indicates that the LFS could underestimate the decline in jobs during the quarter.

- According to seasonally adjusted LFS data, the labour participation rate was 78.3% in Q2, its lowest since Statistics Iceland began the quarterly labour force survey in 2003. This is also true of the employment rate, which measured 72.8% at the same time (Chart A-3). Both ratios are therefore just over 1 percentage point below their post-crisis trough. Presumably, the participation rate has declined in part because of the public health measures, or because people consider it pointless to look for work, as those not looking for a job are measured as outside the labour market. For instance, 13% of those outside the labour market during the quarter gave non-standardised reasons for being outside the market, whereas the percentage who gave non-standardised answers was close to 3% throughout 2019. Unemployment rose less as a result, measuring 5.1%, an increase of 1.2 percentage points from the previous quarter. The unemployment rate would presumably have risen even more if the adjustment of the labour market following the economic shock had not taken place through declining labour participation and the Government's part-time option. A portion of the adjustment also showed in a rise in the number of underemployed (part-time workers who would like to work more), which increased by over 1 percentage point between quarters, to 4.2% of the labour force.

Chart 21

Contraction in total hours worked following the financial crisis and the pandemic

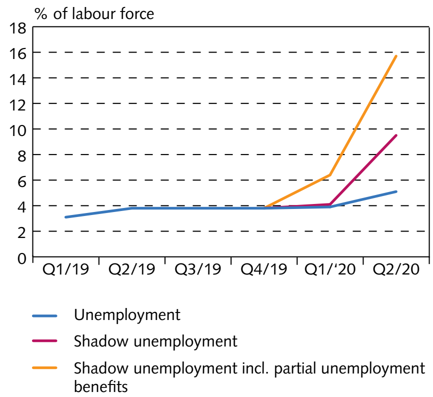


Sources: Statistics Iceland, Central Bank of Iceland.

Chart 22

Unemployment and "shadow" unemployment[1]

Q1/2019 - Q2/2020

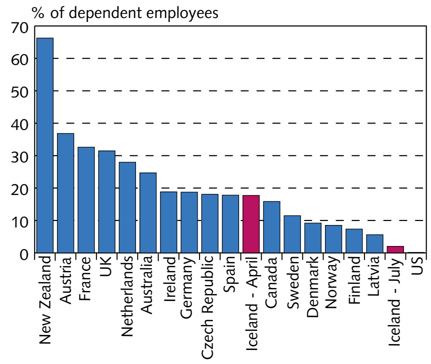


1. Shadow unemployment accounts for the increase in the number of persons measured as being outside the labour force. Shadow unemployment including partial unemployment benefits adds persons receiving those benefits, weighted by the ratio of reduction in hours to previous hours. Seasonally adjusted figures.

Sources: Statistics Iceland, Central Bank of Iceland.

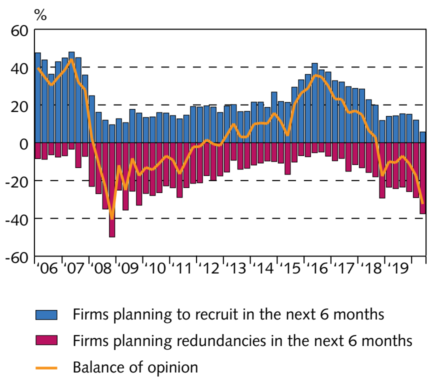
2. It should be noted that monthly LFS figures can fluctuate widely, and figures for individual months can give a misleading view of the situation, not least under circumstances like those currently prevailing, where volatility and uncertainty are unusually pronounced.

Chart 23
Job retention programme take-up rates in selected OECD countries[1]



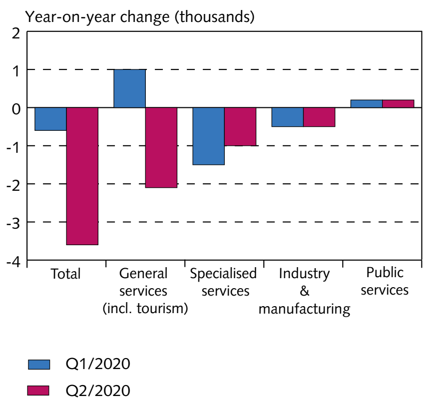
1. For countries other than Iceland, the data refer to the period from April through June. Figures from May are most common. Percentage of dependent employees in Q4/2019.
Sources: Directorate of Labour, OECD, Statistics Iceland, Central Bank of Iceland.

Chart 24
Firms' recruitment plans[1]
Q1/2006 - Q2/2020



1. The share of firms planning redundancies is shown with a negative sign. Seasonally adjusted figures.
Sources: Gallup, Central Bank of Iceland.

Chart 25
Job vacancies[1]



1. General services includes Nace Rev. 2 sections G-I, R-S, and division N79. Specialised services include sections J, K, L, and M-N (excl. division N79). Industry & manufacturing include sections A, B-E, and F, and puclic services includes sections O-Q.
Sources: Statistics Iceland, Central Bank of Iceland.

- The number of persons on part-time benefits has fallen steeply in the recent past, but registered unemployment has risen, to 7.9% in July (Chart A-3). The Directorate of Labour (DoL) expects unemployment to rise still further in August. It may be approaching a peak, though, if Google search data are any indication, as the frequency of unemployment-related search strings declined markedly this summer.

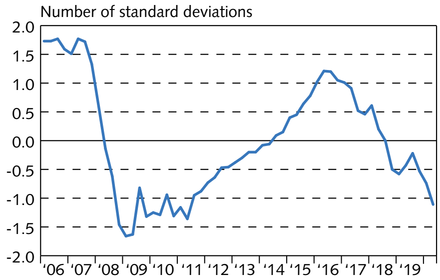
- Most OECD countries have responded to the pandemic with part-time benefits or comparable measures aimed at maintaining the employment relationship between workers and employers. Participation has varied from one country to another, but at the peak in April, nearly 18% of Icelandic wage-earners – close to the OECD average – were receiving part-time benefits. Since April, however, the number of part-time benefits recipients in Iceland has fallen steeply. At the end of July, only 2% of wage-earners received such payments, a decline of roughly 30,000 workers. Some of these people have probably lost their jobs, as group lay-offs increased in the tourism industry after late April, when the authorities announced support for wage payments during workers' termination notice period. On the other hand, various high-frequency indicators suggest that demand recovered more strongly than expected after the first wave of the pandemic subsided. Therefore, it is likely that a large share of those previously receiving part-time benefits have returned to their former jobs. This is particularly the case for jobs in grocery stores and specialty shops and in services companies forced to shutter their operations as a result of public health measures. It is highly uncertain, however, what share of these workers are on their termination notice period and will be unemployed after it ends, and what share have been called back to work or have found new jobs.

- Net migration of foreign nationals was negative in Q2/2020, for the first time since Q2/2012. This is due primarily to a smaller number of foreign immigrants and a slight increase in emigration during the quarter. Indicators imply, however, that emigration could increase more in the near future. In July, the DoL issued 350 certificates enabling the holder to seek work in other EEA countries without losing their entitlement to unemployment benefits in Iceland. This is the largest number of such certificates issued in a single month since they were introduced at the beginning of 1994.

- According to the seasonally adjusted results of the Gallup survey carried out this summer among Iceland's 400 largest firms, the balance of opinion on staffing plans (i.e., share of firms planning to recruit less the share planning redundancies) was negative by 32 percentage points. The same balance of opinion was negative by just over 17 points in the spring and has therefore nearly doubled between surveys. Only 6% of companies are interested in hiring workers, the lowest percentage since quarterly measurements were introduced in 2006. Some 38% of companies are interested in downsizing. About half of companies were planning to downsize at the peak following the financial crisis, when the balance of opinion was negative by more than 40 percentage points. Strong demand for the Government's part-time benefits programme probably reduced the number of companies forced to lay off workers, thereby narrowing the balance of opinion in the summer survey.

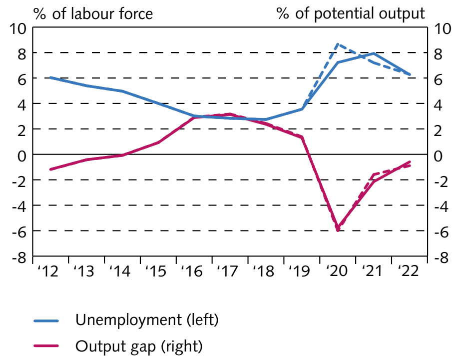
- The Gallup survey therefore indicates that job numbers will continue to fall in H2, particularly in tourism-related sectors and in domestic retail/wholesale trade and services. Statistics Iceland's survey of available jobs tells a similar tale. According to that survey, the number of available jobs declined by 3,600 between years in Q2, far more than in the preceding quarter. The largest decline was in general services sectors, which include tourism and retail and wholesale trade. On the other hand, labour demand in industry and manufacturing and in public services has remained flat, while in specialised services it has increased.
- After adjusting for seasonality, only 5% of executives considered themselves short-staffed, 5 percentage points less than in the previous survey. This ratio bottomed out again in the summer survey, when it fell back to the post-financial crisis trough. About 28% of executives report that their firms would have difficulty responding to an unexpected increase in demand, about 10 percentage points less than in the last survey. This percentage bottomed out at 21% in the spring 2009 survey. As a result, there appears to be substantial spare capacity in the economy, and the RU indicator, which is a composite of various indicators of factor utilisation, has fallen three quarters in a row.
- Total hours worked are expected to fall by over 7% this year. In addition, unemployment is expected to rise as the year progresses, peak at around 10% towards the year-end, and average just over 7% for 2020 as a whole. This represents a smaller decline in total hours and a lower unemployment rate than in the May forecast, and it is due for the most part to the economy's having weathered the pandemic better than was feared in May. Job numbers are expected to rise slightly and unemployment to fall again in 2021. But the recovery will be a slow one, as it is highly uncertain how strongly demand will pick up, and companies will probably be cautious in hiring workers.
- The pandemic has caused a number of firms to close their doors or scale down their operations. In addition, many have been forced to modify their activities and production methods, and immigration of foreign workers has slowed. As a result, the pandemic has probably cut into productivity growth and slowed growth in potential output. The steep decline in the RU indicator and the surge in unemployment indicate, however, that a sizeable output slack has developed and will continue to grow over the course of this year. It is expected to measure just under 6% in 2020, slightly less than was forecast in May. As was forecast then, the slack in

Chart 26
RU indicator[1]
Q1/2006 - Q2/2020



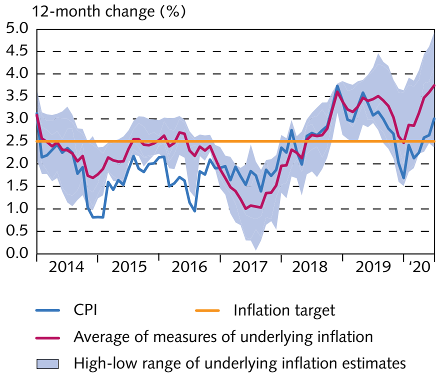
1. The resource utilisation (RU) indicator is the first principal component of selected indicators of factor utilisation; it is scaled so that its mean value is 0 and the standard deviation is 1. A more detailed description can be found in Box 3 in MB 2018/2.
Source: Central Bank of Iceland.

Chart 27
Unemployment and output gap 2012-2022[1]



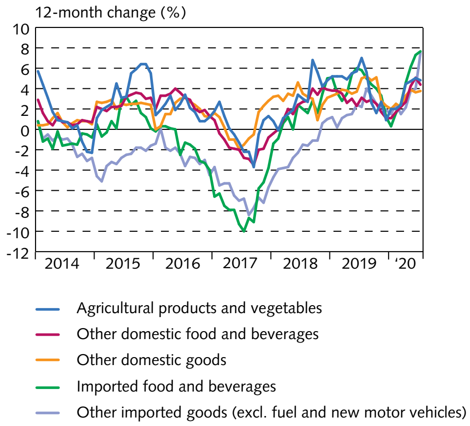
1. Central Bank baseline forecast 2020-2022. Broken lines show forecast from MB 2020/2.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 28
Headline and underlying inflation[1]
January 2014 - July 2020



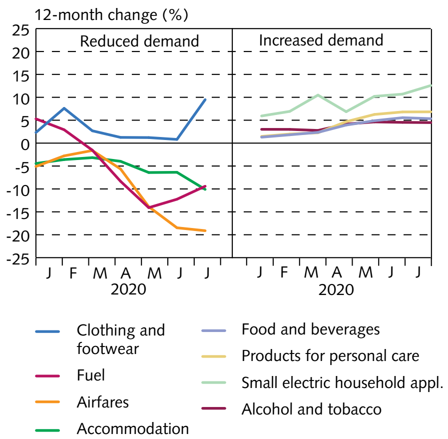
1. Underlying inflation measured using a core index (which excludes the effects of indirect taxes, volatile food items, petrol, public services, and real mortgage interest expense) and statistical measures (weighted median, trimmed mean, a dynamic factor model, and a common component of the CPI).
Sources: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

Chart 29
Developments in domestic and imported goods prices
January 2014 - July 2020



Source: Statistics Iceland.

Chart 30
Impact of COVID-19 on prices of various subcomponents of the CPI[1]



1. Selected subcomponents. Airfares and small electrical household appliances are 3-month moving averages.
Source: Statistics Iceland.

the economy is expected to narrow in 2021 and more or less close by the end of the forecast horizon. This forecast is more uncertain than usual, however.

Inflation

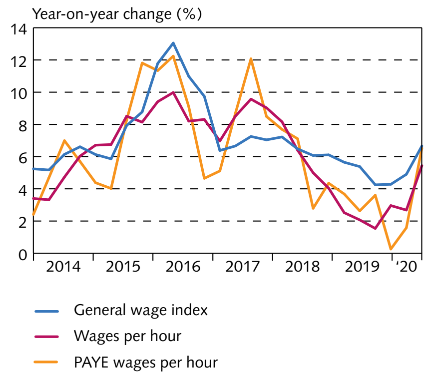
- Inflation measured 2.5% in Q2/2020, slightly above the May forecast of 2.4%. Rising imported goods prices following the depreciation of the króna played a leading role in the twelve-month increase in the CPI – particularly to include food, clothing, furniture, and housewares prices.
- The CPI rose by 0.15% month-on-month in July, and twelve-month inflation measured 3%, an increase of 0.8 percentage points since the May *Monetary Bulletin.* The main reason for the inflation spike in July was that summer sales lowered the CPI far less than in the same month of 2019. This could be due to the depreciation of the króna, but the aforementioned increase in spending on consumer goods could have been a factor as well. Overall, imported goods prices have risen by 5% year-on-year. Domestic goods prices have also risen somewhat in the recent past and were up 4.4% year-on-year in July.
- Presumably, increased demand for certain goods categories – food, for example – during the height of the ban on gatherings pushed prices upwards. There have also been shortages of certain goods as a result of production and supply chain issues relating to the pandemic, and all else being equal, these could have caused prices to rise as well. The impact on observed inflation is not expected to be significant, however, as these factors are estimated to affect less than a fifth of the index. For some CPI components, however, inflation fell because of a drop in demand or because the goods or services concerned were unavailable as a result of public health measures.
- Inflation excluding housing measured 3.3% in July and has risen more rapidly in the recent term than inflation including housing. The spread between the two is at its widest since spring 2013. HICP inflation tells an entirely different story, however. The HICP, which also excludes the cost of owner-occupied housing, fell by 0.1% year-on-year in July. HICP inflation has been highly volatile in recent months, owing primarily to large fluctuations in airfares, which weigh heavily in the index.[3]
- Underlying inflation measured 3.7% in July, according to the average of various measures, an increase of 0.3 percentage points year-on-year. It is therefore noticeably above observed inflation, partly because some measures of underlying inflation exclude the impact of lower petrol prices and real mortgage interest expense.

3. Components relating to tourist spending weigh heavier in the HICP than in the CPI, and these components have fluctuated widely in price recently. A major factor is the base effects in the "travel and transport" component, as airfares were held all but unchanged in Q2, when air transport was virtually at a standstill, whereas they rose sharply at the same time in 2019.

In the recent past, the latter of these has lowered inflation by an estimated 0.7 percentage points.

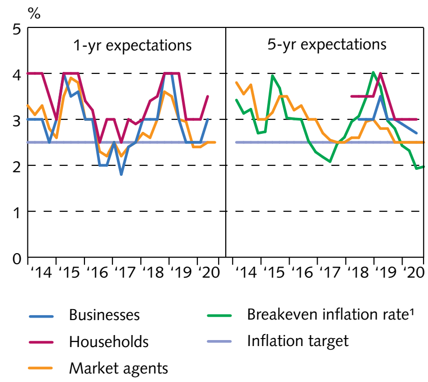
- Contractual wage rises in April showed in the wage index, as was forecast in May. The index rose in Q2 by 3.8% quarter-on-quarter and 6.7% year-on-year, but the twelve-month rise in the index regained momentum after wage agreements were reached with a number of public sector labour unions. Contracts are still pending for a number of State and municipal employee groups. Other measures of year-on-year wage inflation show similar developments, although they suggest smaller rises than the wage index does. Wage increases in Q2 were in line with the May forecast, and the outlook for 2020 as a whole is therefore broadly unchanged. Wages per hour are expected to rise by an average of 3% this year, significantly below the average over the past decade.
- According to Gallup's summer surveys, households and businesses expect inflation to measure 3-3.5% in one year's time, or 0.5 percentage points more than in the last survey. Their long-term inflation expectations have either remained unchanged or fallen, however. Market agents' short- and long-term inflation expectations have also remained unchanged at 2.5%. The five- and ten-year breakeven rate in the bond market is now at target or slightly below it, although it has risen marginally in the recent term. It is noteworthy that all measures of inflation expectations are either unchanged or lower than they were a year ago, even though the króna is weaker.
- The near-term outlook is for slightly higher inflation than was forecast in May. This is because inflation is higher at the outset of the forecast and the slack in the economy appears smaller now than was assumed in May. Furthermore, global oil, commodity, and food prices have risen faster than was projected then. Nevertheless, oil and commodity prices are still much lower than they were a year ago, lowering domestic input costs and inflation.
- Inflation is forecast to average 3% through 2020, but owing to the sizeable slack in the economy and low global inflation, it will start to ease early in 2021, when the effects of the depreciation of the króna have tapered off. It is expected to average 2% in the latter half 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 1-3¼% range in one year and in the 1-3½% range by the end of the forecast horizon.

Chart 31
Wages[1]
Q1/2014 - Q2/2020



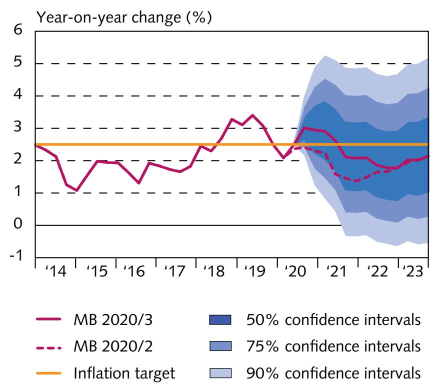
1. Wages per hour worked are based on annual figures for the wage portion of the "wages and related expenses" category from the production accounts. They are presented as a share of total hours worked according to the Statistics Iceland labour force survey and are estimated for the year 2020. PAYE wages per hour are PAYE wages per total working hours from the LFS.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 32
Inflation expectations
Q1/2014 - Q3/2020



1. The most recent value is the average of daily values from 1 July through 21 August 2020.
Sources: Gallup, Central Bank of Iceland.

Chart 33
Inflation forecast and confidence intervals
Q1/2014 - Q3/2023



Sources: Statistics Iceland, Central Bank of Iceland.

Appendix 1

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

Chart A-1

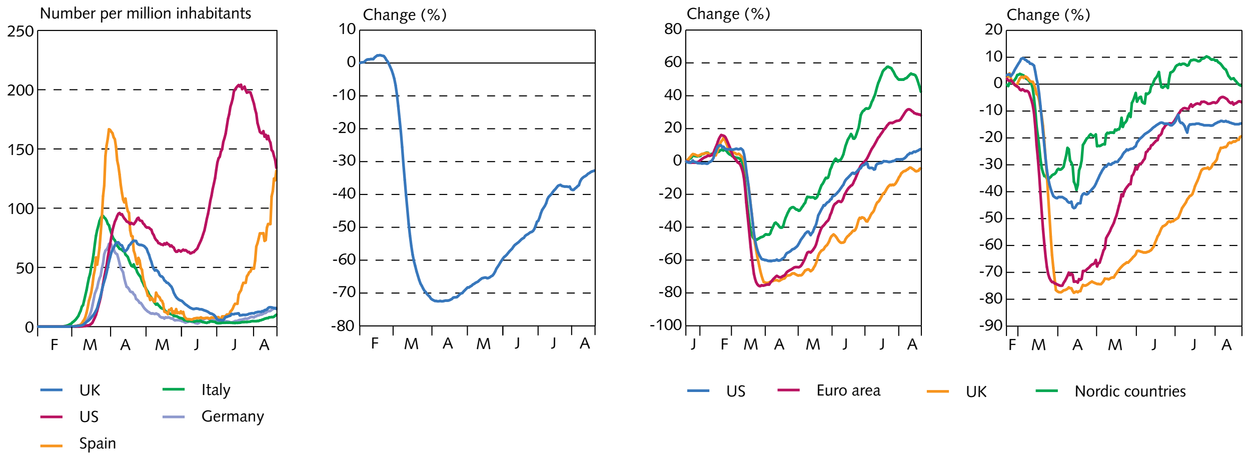
Indicators of global economic activity[1]

Daily new cases of COVID-19[2]
1 February - 21 August 2020

International air traffic[3]
19 February - 21 August 2020

Motor vehicle and pedestrian traffic[4]
19 January - 21 August 2020

Demand for retail and entertainment[5]
21 January - 21 August 2020



1. Seven-day moving average. Figures for the Nordic countries are the average from Denmark, Norway, and Sweden. 2. Confirmed new infections. 3. Change since 19 February 2020. 4. Vehicle and pedestrian traffic according to Apple Mobility Trends. Change since 19 January 2020. 5. 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.
Sources: Apple Mobility Trends, Flight Radar, Google, Johns Hopkins University, WHO.

Chart A-2

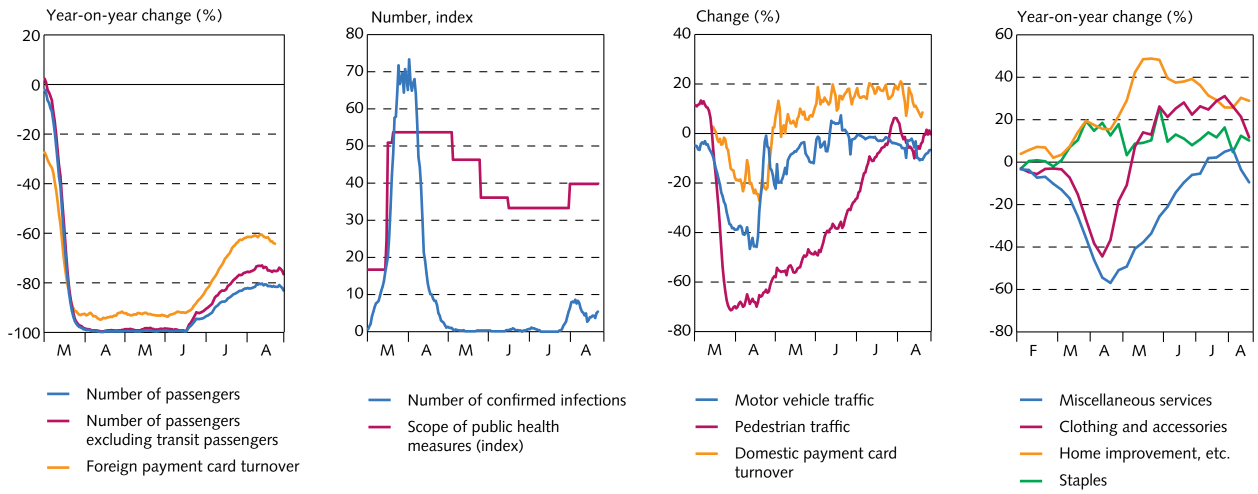
Indicators of domestic economic activity[1]

Tourists and spending[2]
7 March - 21 August 2020

Infections and disease prevention[3]
1 March - 21 August 2020

Traffic and payment card turnover[4]
1 March - 21 August 2020

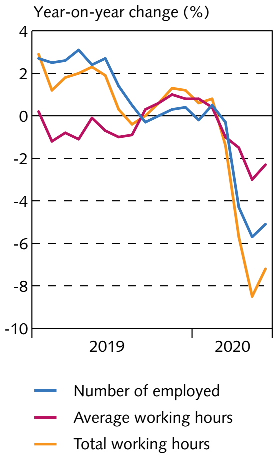
Household spending, by category[5]
1 February - 15 August 2020



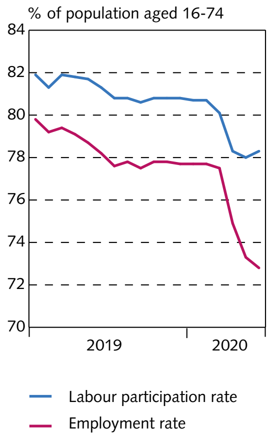
1. All data are seven-day moving averages except scope of public health measures (primary data) and domestic payment card turnover (fourteen-day moving average) and household spending, by category (28-day moving average). 2. Number of passengers travelling through Keflavík Airport each day. Passenger 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 aggressiveness of the authorities' disease control measures. 4. Daily motor vehicle traffic along three main routes in the capital area. Pedestrian traffic according to Apple Mobility Trends. Payment card figures are the sum of domestic-issued debit and credit cards. Pedestrian traffic: change since 13 January 2020; other series: year-on-year change. 5. Miscellaneous services includes restaurants, theatres, fitness centres, etc. Home improvement includes purchases of electronic equipment, furniture, and building supplies.
Sources: Apple Mobility Trends, covid.is, Icelandic Road and Coastal Administration, Isavia, Meniga Marketwatch, Oxford COVID-19 Government Response Tracker, Statistics Iceland, Central Bank of Iceland.

Chart A-3
Indicators from the domestic labour market

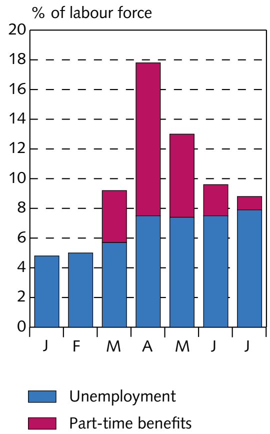
Employment and hours worked[1]
January 2019 - June 2020



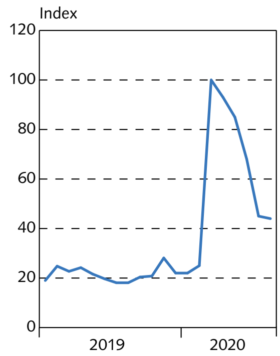
Labour participation rate and employment rate[2]
January 2019 - June 2020



Registered unemployment
January - July 2020



Google searches related to unemployment[3]
January 2019 - August 2020



1. Three-month moving average. 2. Seasonally adjusted three-month moving average. 3. Google searches based on relative popularity of the search strings “unemployment benefits” and “Directorate of Labour” in Google’s search engine. The August figure shows data for the month to date.
Sources: Directorate of Labour, Google Trends, Statistics Iceland, Central Bank of Iceland.

Appendix 2

Forecast tables

Table 1 Key economic variables[1]

	2018	*2019*	*2020*	*2021*	*2022*
Private consumption	4.7 (4.7)	1.6 (1.6)	-5.8 (-7.3)	3.8 (6.4)	3.5 (3.4)
Public consumption	3.9 (3.9)	4.1 (4.1)	3.2 (3.1)	1.2 (1.2)	2.7 (2.6)
Gross capital formation	-1.1 (-1.1)	-6.3 (-6.3)	-10.0 (-6.2)	2.4 (2.9)	3.7 (2.8)
Business investment	-11.5 (-11.5)	-17.5 (-17.5)	-13.4 (-6.3)	-0.8 (-0.1)	5.9 (4.2)
Residential investment	15.5 (15.5)	31.2 (31.2)	-21.2 (-23.0)	6.6 (9.5)	8.7 (8.2)
Public investment	30.6 (30.6)	-10.4 (-10.4)	19.5 (21.5)	5.6 (3.8)	-6.4 (-6.4)
National expenditure	3.5 (3.5)	-0.1 (-0.1)	-3.8 (-3.9)	2.2 (3.7)	3.3 (3.0)
Exports of goods and services	1.7 (1.7)	-5.0 (-5.0)	-28.5 (-31.6)	19.8 (23.6)	9.9 (8.3)
Imports of goods and services	0.8 (0.8)	-9.9 (-9.9)	-23.1 (-24.6)	17.4 (21.2)	10.3 (9.2)
Gross domestic product (GDP)	3.8 (3.8)	1.9 (1.9)	-7.1 (-8.0)	3.4 (4.8)	3.4 (2.8)
Contribution of net trade to GDP growth (percentage points)	0.4 (0.4)	2.0 (2.0)	-3.5 (-4.3)	1.2 (1.2)	0.2 (-0.1)
Unemployment (% of labour force)	2.7 (2.7)	3.6 (3.6)	7.2 (8.7)	7.9 (7.2)	6.3 (6.3)
Output gap (% of potential output)	2.4 (2.4)	1.3 (1.4)	-5.8 (-6.0)	-2.2 (-1.6)	-0.6 (-0.9)
Current account balance (% of GDP)	3.1 (3.1)	6.0 (5.8)	2.0 (1.3)	3.9 (2.5)	3.7 (2.2)
Trade-weighted exchange rate index[2]	166.7 (166.7)	181.0 (181.0)	201.2 (203.9)	208.0 (209.4)	207.4 (207.8)
Inflation (consumer price index, CPI)	2.7 (2.7)	3.0 (3.0)	2.6 (2.3)	2.4 (1.7)	1.9 (1.6)
Inflation in main trading partners[3]	2.0 (2.0)	1.5 (1.5)	0.7 (0.7)	1.3 (1.4)	1.7 (1.7)
GDP growth in main trading partners[3]	2.3 (2.3)	1.8 (1.8)	-7.1 (-6.4)	5.5 (5.0)	3.2 (2.4)

1. Year-on-year change (%) unless otherwise specified (figures in parentheses are from the forecast in MB 2020/2). 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, Global Insight, IMF, and OECD.

Sources: Consensus Forecasts, Global Insight, IMF, 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	
2019:3	3.1 (3.1)	1.3 (1.3)
2019:4	2.5 (2.5)	2.5 (2.5)
2020:1	2.1 (2.1)	0.2 (0.2)
2020:2	2.5 (2.4)	6.0 (5.4)
	Forecasted value	
2020:3	3.0 (2.4)	3.4 (1.5)
2020:4	2.9 (2.3)	2.3 (2.1)
2021:1	2.9 (2.2)	0.1 (0.0)
2021:2	2.6 (1.6)	4.8 (2.8)
2021:3	2.1 (1.5)	1.3 (1.0)
2021:4	2.1 (1.4)	2.1 (1.7)
2022:1	2.1 (1.5)	0.1 (0.5)
2022:2	1.9 (1.6)	3.9 (3.4)
2022:3	1.8 (1.7)	1.0 (1.1)
2022:4	1.8 (1.8)	2.1 (2.2)
2023:1	2.0 (1.9)	1.1 (1.1)
2023:2	2.0 (2.0)	3.8 (3.8)
2023:3	2.1	1.5

1. Figures in parentheses are from the forecast in MB 2020/2.

Sources: Statistics Iceland, Central Bank of Iceland.