

CENTRAL BANK OF ICELAND



2021 | 3

MONETARY BULLETIN

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

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

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

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(+354) 569 9600, sedlabanki@sedlabanki.is, www.sedlabanki.is

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Statement of the Monetary Policy Committee 25 August 2021

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to raise the Bank's interest rates by 0.25 percentage points. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 1.25%.

The economic outlook has improved since the Bank's last forecast. According to the new macroeconomic forecast, published in the *August Monetary Bulletin*, the outlook is for GDP growth to measure 4% this year, some 0.9 percentage points above the May forecast. The improvement is driven mainly by tourist arrivals, which have increased more rapidly this summer than was previously expected. Unemployment has subsided more than previously forecast, although it remains high, and the slack in the economy has narrowed more quickly.

A large share of the population is now vaccinated against COVID-19. Even so, case numbers have risen once again, and there is still some uncertainty about the path the pandemic will take, owing to the increased spread of the Delta variant of the virus. Furthermore, the impact of temporary supply chain disruptions abroad, which have pushed manufacturing and distribution costs upwards all over the world, could persist longer than previously anticipated.

Inflation measured 4.4% in Q2/2021 but was 4.3% in July. Overall inflationary pressures appear to be subsiding, particularly according to underlying inflation, but nevertheless remain relatively high. The rise in inflation expectations earlier this year seems to be reversing. According to the Central Bank's forecast, however, the outlook is for inflation to ease somewhat more slowly than was projected in May. It is expected to remain above 4% through the year-end but align with the target in H2/2022.

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

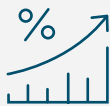
Table of contents

Monetary Bulletin in a nutshell	6
The global economy and terms of trade	7
Monetary policy and domestic financial markets	10
Demand and GDP growth	13
Labour market and factor utilisation	18
Inflation	20
Appendix	
1 Snapshots of domestic and foreign economic activity in the midst of a global pandemic	24
2 Forecast tables	26

Monetary Bulletin in a nutshell



Global GDP growth rebounded strongly in Q2/2021, as vaccination rollouts proceeded and public health restrictions were eased. The outlook for Q3 is weaker than was assumed in the May *Monetary Bulletin*, however, owing in part to the rapid spread of the Delta variant of the COVID-19 virus. Nevertheless, the growth outlook for the year as a whole is brighter than was forecast in May. At the same time, a strong recovery of domestic demand and persistent supply-side disruptions caused by the pandemic have pushed commodity prices and shipping costs sharply upwards. As a result, global headline inflation has risen swiftly in recent months.



In Iceland, GDP contracted more in Q1/2021 than was assumed in the May forecast. Growth appeared robust in Q2, however, reflecting declining infection rates, relaxation of public health measures, and rising tourist numbers. Although COVID case numbers rose again over the course of the summer, the outlook is for a continued economic recovery in H2/2021. GDP growth is projected at 4% for the year as a whole, some 0.9 percentage points above the May forecast. It is expected to hold close to that pace in 2022 and then ease back towards long-term trend growth in 2023.



Job numbers are rising quickly, and labour participation is back to the pre-pandemic rate. Job vacancies have increased markedly in number, and more firms indicate that they are short-staffed. Unemployment has fallen faster than was forecast in May and currently measures just over 6%, in terms of both the Statistics Iceland labour force survey (LFS) and the registered unemployment rate. It is expected to continue declining and reach the pre-pandemic rate by the end of the forecast horizon, which is well below the May forecast. The slack in the economy will therefore narrow more quickly than was projected then.



Although the exchange rate pass-through from last year's depreciation of the króna has weakened significantly, inflation has remained above 4% since the turn of the year, measuring 4.4% in Q2. The recovery of domestic demand is a major factor here, although the surge in shipping costs and global oil and commodity prices plays a part as well. Inflation eased to 4.3% in July and appears to have peaked in the spring. This pattern can be seen more clearly in the CPI excluding housing or in the underlying inflation rate, which had fallen to 3.8% by July. Measured inflation is expected to hover above 4% for the remainder of the year and therefore ease more slowly than was forecast in May. According to the Bank's forecast, it will align with the target in Q3/2022, slightly later than previously anticipated.



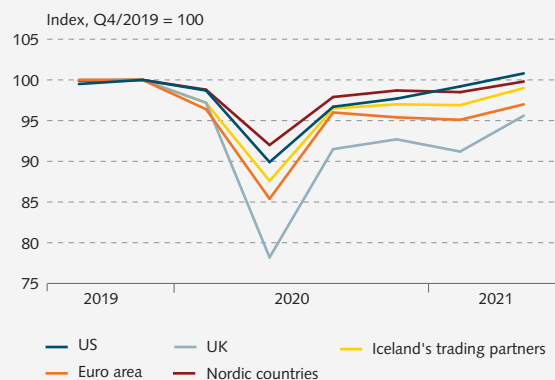
As before, both domestic and global economic developments will depend in large part on how successful efforts to control the pandemic prove to be. Although a large percentage of Iceland's population has been fully vaccinated, the current vaccines' effectiveness against the Delta variant and its potential successors remains uncertain. The Bank's baseline forecast assumes that the current set of public health measures will remain in place for a while but will have relatively little impact on domestic economic activity. This assessment could change, however, if there is a setback in the response to the pandemic and restrictions must be tightened once again, or if individuals refrain increasingly from their usual activities due to fear of contagion.

The analysis appearing here is based on the Bank's assessment of economic developments since the publication of *Monetary Bulletin* 2021/2 in May 2021, 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.

The global economy and terms of trade

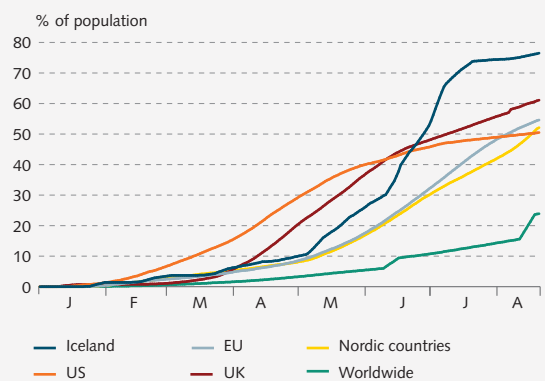
- Among Iceland's main trading partners, GDP contracted by 0.1% between quarters in Q1/2021, in the wake of tightened public health measures imposed to halt the increased spread of the pandemic. Economic activity softened in particular in the UK, Denmark, and Norway, but also in the euro area. GDP growth gained pace in the US, however, in tandem with broad-based fiscal stimulus measures. The contraction in trading partner countries in Q1 was nevertheless smaller than was assumed in the May *Monetary Bulletin*.
- Economic activity picked up again in major advanced economies in Q2, when new COVID case numbers started to fall, vaccination rollouts gained momentum, and public health measures were eased. Preliminary figures suggest that GDP increased by 1.6% quarter-on-quarter in the US, 2% in the eurozone, and nearly 5% in the UK. In the US, GDP had risen to nearly 1% above the pre-pandemic level, whereas in the eurozone and the UK it was still 3% and 4½% lower, respectively, than before the pandemic. Trading partner GDP is estimated to have grown by 2.2% quarter-on-quarter in Q2, or 0.5 percentage points more than was assumed in the May forecast.
- COVID-19 infection rates began once again to rise all over the world this summer, catalysed by the Delta variant of the virus, which appears to be more contagious than its predecessors (Chart V-1 in Appendix 1). The end of the pandemic is therefore not yet in sight, and by now more than 210 million people have been infected with COVID-19 and over 4.4 million have died of it.
- Despite increased case numbers, however, the outlook is for a continued economic recovery in leading advanced economies. This is due in particular to more widespread vaccination, which seems to have weakened the link between the number of infected people and the number who become seriously ill. In addition, households and businesses have grown more adept at keeping economic activity up and running despite tight public health restrictions. High vaccination levels have enabled governmental authorities to impose fewer restrictions on economic activities than in previous waves of the pandemic,

Chart 1
GDP in the wake of the pandemic¹
Q3/2019 - Q2/2021



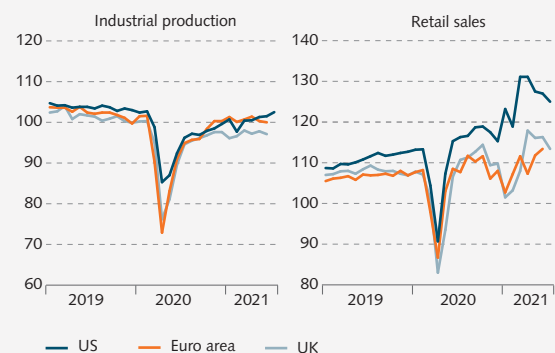
1. Seasonally adjusted data. The Nordic countries is the average for Denmark, Norway, and Sweden. Central Bank baseline forecast Q2/2021 for main trading partners.
Sources: Refinitiv Datastream, Central Bank of Iceland.

Chart 2
Share of the population fully vaccinated¹
1 January 2021 - 20 August 2021



1. Share of total population that have received all vaccine doses prescribed by the vaccination protocol. The Nordic countries is the average for Denmark, Norway, and Sweden. 7-day moving average.
Source: Our World in Data.

Chart 3
Industrial production and retail sales¹
January 2019 - July 2021

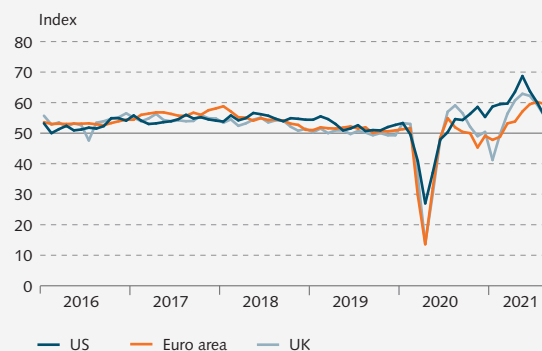


1. Seasonally adjusted volume indices (2016 = 100).
Source: Refinitiv Datastream.

and some countries have even eased public health measures despite rising case numbers (Chart V-1 in Appendix 1). In countries where vaccination efforts are less advanced, especially emerging and developing countries, the economic outlook has deteriorated as the pandemic has gained steam, and some countries have imposed harsher public health measures.

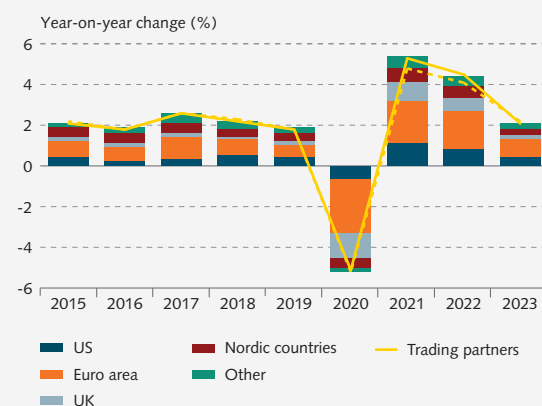
- GDP growth is expected to continue in major advanced economies. Retail sales have recovered strongly this year and are now above the pre-pandemic level. PMI indices have also risen in the wake of increased activity in the services sector. Manufacturing has largely retained its strength, as global demand has picked up decisively. On the other hand, shortages of important inputs and difficulties with goods transport have caused delays in production and lengthened delivery times. The labour market situation has improved, although unemployment is still high. Furthermore, people appear to be more mobile and are seeking out retail stores and recreational activities in greater measure (see Chart V-1 in Appendix 1). There is still considerable uncertainty, however, not least about how successfully the pandemic can be managed and whether onerous public health measures will have to be imposed again to ease strain on the healthcare system.
- According to the Bank's baseline forecast, year-2021 GDP growth among Iceland's main trading partners is projected at 5.3%, some 0.5 percentage points above the May forecast. The outlook has improved in most trading partner countries, but particularly in the UK, Canada, Denmark, and the eurozone. Stronger output growth is also expected among trading partners in 2022, especially in the US, which is set to benefit from even further fiscal stimulus. For 2023, however, the GDP growth outlook is broadly as in the May forecast.
- Global inflation has risen since May, outpacing the Bank's May forecast, particularly in the US, where underlying inflation is at its highest in three decades. The inflation spurt is due in large part to base effects from modest price hikes in 2020 and increased production costs because of supply-side disruptions, combined with growing global demand as public health restrictions are eased. As a result, oil and commodity prices have increased more than expected and shipping costs are many times higher

Chart 4
Composite PMI¹
January 2016 - August 2021



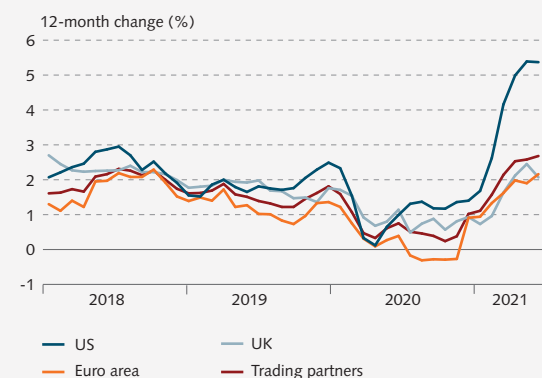
1. IHS Markit composite output purchasing managers' index. The index is published monthly and is seasonally adjusted. An index value above 50 indicates month-on-month growth in output, and a value below 50 indicates a contraction. Source: Refinitiv Datastream.

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



1. Trade-weighted contribution from selected countries. Central Bank baseline forecast 2021-2023. Broken line shows forecast from MB 2021/2. The Nordic countries is the average for Denmark, Norway, and Sweden. Sources: Refinitiv Datastream, Central Bank of Iceland.

Chart 6
Global inflation
January 2018 - July 2021

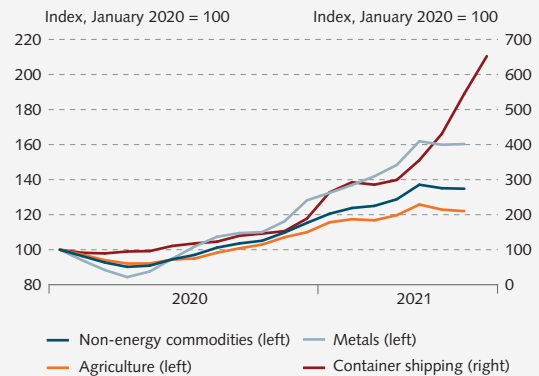


Sources: Refinitiv Datastream, Central Bank of Iceland.

than they were before the pandemic. Inflation is projected to average 2.3% among Iceland's trading partners this year, or 0.5 percentage points more than in the May forecast. It is still expected to ease in 2022, when the above-described effects taper off, but is set to remain more persistent than previously anticipated.

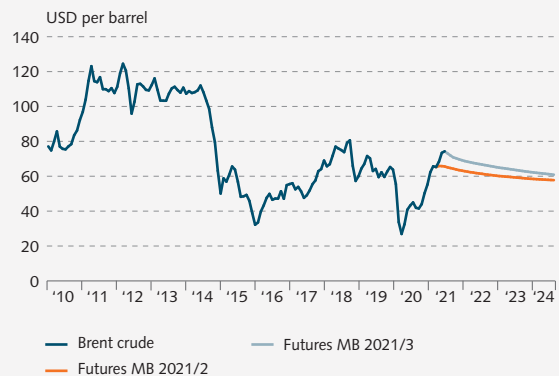
- Despite the improving economic outlook and higher inflation, central banks in leading advanced economies have held their policy interest rates and bond purchase programmes unchanged. Most of them expect the bulk of the current inflation spike to be temporary; therefore, they intend to keep their monetary stance unchanged until clearer signs that the economic recovery has gained a foothold come to the fore.
- Global share prices fell in mid-July, in tandem with the upsurge in the virus, but they have recovered and are higher than they were in May. Long-term bond rates have fallen since May, however, although in most cases they are higher than at the turn of the year. This could be due to expectations of a weaker economic recovery in the wake of rising COVID case numbers. Moreover, uncertainty about longer-term developments in inflation and interest rates may have receded, causing term premia to fall after a swift rise earlier this year.
- Global crude oil prices rose early this summer, bolstered by growing demand and greater uncertainty about developments in supply. The rise has reversed, though, probably because of expectations that the spread of the Delta variant of the coronavirus will weaken demand for oil at a time when OPEC countries and other oil producers have announced that they plan to ease oil production cuts. Oil prices are still higher than was forecast in May, however. Although oil futures suggest that prices will decline over the forecast horizon, the outlook is for prices to be higher throughout the horizon than was previously assumed.
- Global prices of aluminium and other commodities have risen more than was expected in May, in line with improved prospects for the global economy. Icelandic marine product prices are also expected to recover more quickly than previously projected. After a drop in the price of most product types in 2020 and into this year, there are signs that prices

Chart 7
Global shipping and commodity prices¹
January 2020 – August 2021



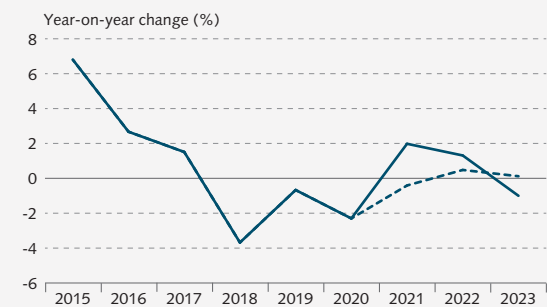
1. Agriculture commodities is divided into food (62%), beverages (13%) and raw materials (25%). Container shipping based on the Freightos Global Container Index. Based on data through 20 August 2021.
Sources: Freightos Limited, World Bank.

Chart 8
Global oil prices
January 2010 - September 2024



Sources: Refinitiv, Central Bank of Iceland.

Chart 9
Terms of trade for goods and services 2015-2023¹



1. Central Bank baseline forecast 2021-2023. Broken line shows forecast from MB 2021/2.
Sources: Statistics Iceland, Central Bank of Iceland.

of important demersal products are firming up. Foreign currency prices of marine product exports are expected to rise by about 2% this year instead remaining flat, as was forecast in May.

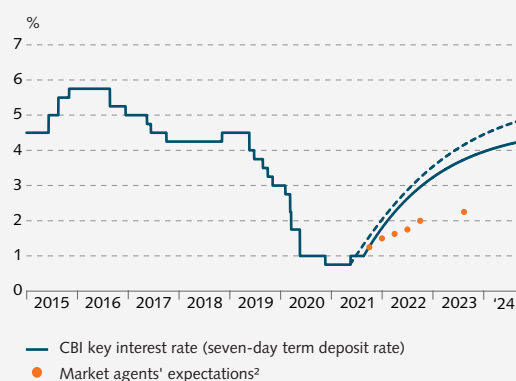
- Despite larger-than-expected rises in the price of oil and other commodities, Iceland's terms of trade are projected to improve by 2% this year instead of deteriorating by 0.4%, as was forecast in May. This is due to an improved outlook for export prices, which rose more in Q2 than was projected in May. More favourable developments in the price of marine products and aluminium play a major role in this, although the price of other exports, particularly ferrosilicon, has improved as well. Furthermore, the outlook is for terms of trade to improve more in 2022 than was forecast in May.

Monetary policy and domestic financial markets

- At its May meeting, the Central Bank Monetary Policy Committee (MPC) decided to raise the Bank's key interest rate (the rate on seven-day term deposits) by 0.25 percentage points, to 1%. The key rate is still 1.75 percentage points lower than when the COVID-19 pandemic reached Iceland in late February 2020. The Bank's real rate, based on the average real rate as calculated from various measures of inflation and one-year inflation expectations, is currently -2.5%. It has risen by 0.3 percentage points since just before the *May Monetary Bulletin* but is about 0.8 percentage points lower than in August 2020.
- According to the Bank's August survey, market agents expect the key rate to be raised by 0.25 percentage points in Q3 and then continue rising, to 2% a year from now. Forward interest rates also suggest that market agents expect rates to keep rising.
- The short-term interest rate differential vis-à-vis Iceland's main trading partners widened after the Central Bank's rate hike in May, but the long-term differential has remained broadly unchanged over the same period. Risk premia on Treasury foreign obligations have changed very little.
- The yield on ten-year nominal Treasury bonds was 3.8% just before this *Monetary Bulletin* was published. It rose from the turn of the year until the

Chart 10

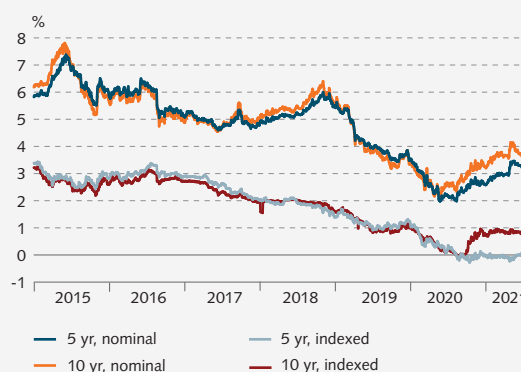
Central Bank of Iceland key interest rate¹
1 January 2015 - 30 September 2024



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 2021/2.
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 9-11 August 2021.
Source: Central Bank of Iceland.

Chart 11

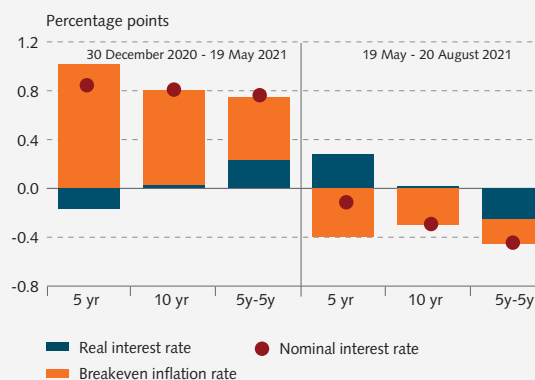
Government-guaranteed bond yields¹
2 January 2015 - 20 August 2021



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 12

Breakdown of changes in nominal bond interest rates¹



1. Change in nominal Treasury bond yields (based on the zero-coupon yield curve, estimated using the Nelson-Siegel method) and the contribution of corresponding changes in indexed bond yields and the breakeven inflation rate.
Source: Central Bank of Iceland.

Bank's May interest rate decision, mainly because of a rising breakeven inflation rate, which in turn was due to increased uncertainty about the inflation outlook. Since the May *Monetary Bulletin*, however, the yield has fallen by 0.3 percentage points, partly reflecting the lower breakeven rate since then. The yield curve has flattened over the same period, with higher short-term interest rates and lower yields on long bonds. The spread between one-year and ten-year nominal bond rates has narrowed by 0.6 points since May and is currently about 2 percentage points. The yield on ten-year indexed Treasury bonds is broadly unchanged since May, and was 0.8% just before this *Monetary Bulletin* was published.

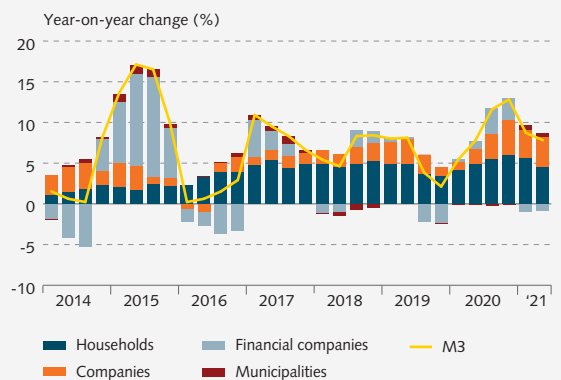
- The Central Bank has bought bonds for 22.6 b.kr. since it began buying Treasury bonds in the secondary market in May 2020. Its purchases year-to-date total 15 b.kr., the last one taking place in early July.
- Ever since mid-2020, there have been significant capital outflows relating to new investments, most of them due to foreign investors' sales of domestic equities and Treasury bonds. In June, however, there were inflows stemming largely from foreign investors' participation in the public offering of 35% of the State's holding in Íslandsbanki. Net outflows from new investments in H1/2021 total 50.4 b.kr. The pension funds have continued to buy foreign currency in order to boost the weight of their foreign investments to accord with their investment strategies. Over the first seven months of 2021, their total purchases came to 41.3 b.kr.
- The exchange rate of the króna has fallen by 0.3% in trade-weighted terms since the last *Monetary Bulletin*, but has risen by just under 3% year-to-date. The króna is still 5.6% weaker than when the pandemic reached Iceland in late February 2020, however. Since May, the Central Bank has bought larger amounts of foreign currency, particularly in June, in connection with the Íslandsbanki stock offering. The Bank's net foreign currency purchases since the last *Monetary Bulletin* total 20.6 b.kr.
- The exchange rate index was just under 194 points in Q2, which is in line with the Bank's May forecast. The outlook is for the króna to be about 1½% stronger in Q3, and according to the baseline forecast it will hold steady at roughly that level for the remainder of the forecast horizon.

Chart 13
Exchange rate of the króna¹



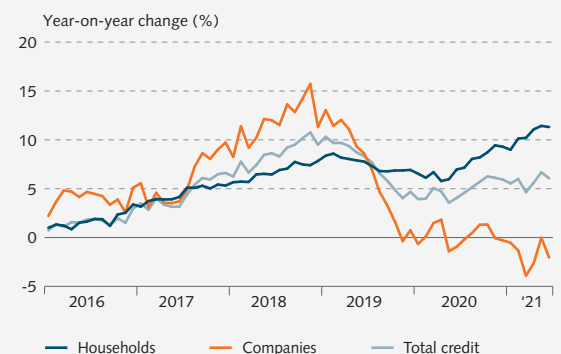
1. Price of foreign currency in krónur. Narrow trade index. Central Bank baseline forecast 2021-2023. Broken lines show forecast from MB 2021/2.
Source: Central Bank of Iceland.

Chart 14
Money holdings¹
Q1/2014 - Q2/2021



1. M3 is adjusted for deposits of failed financial institutions. Companies include non-financial companies and non-profit institutions serving households.
Source: Central Bank of Iceland.

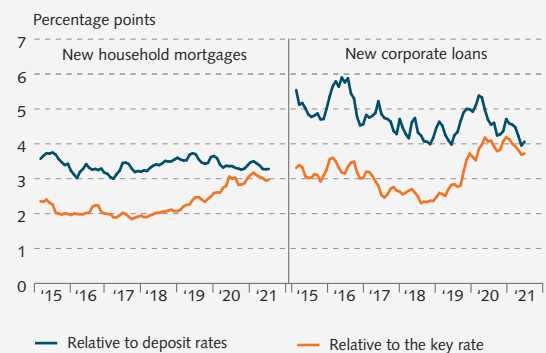
Chart 15
Credit system lending¹
January 2016 - June 2021



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.

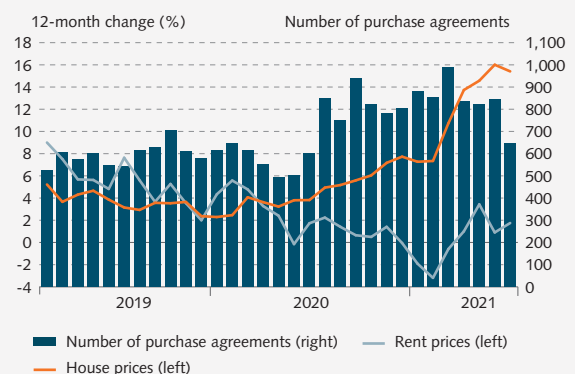
- M3 rose by 12.2% year-on-year in H2/2020. The rate of growth has slowed since the beginning of 2021, however, to an estimated 7.8% in Q2. As before, growth in money holdings is due largely to an increase in household and corporate deposits.
- Year-on-year growth in credit system lending to households has gained pace thus far in 2021, measuring 11.3% in Q2. The rise in household lending is due almost solely to increased mortgage lending, as mortgage rates fell steeply in 2020 and the housing market has been brisk. Demand for non-indexed variable-rate mortgages is still strong, and the commercial banks' share of the mortgage lending market continues to grow.
- Corporate lending was virtually flat in 2020, but preliminary figures imply that it contracted by 2% in Q2/2021, or 0.7% after adjusting for the effects of exchange rate movements on foreign-denominated loans. Corporate bond issuance has offset the contraction in lending to a degree, although only a small percentage of companies have access to this type of financing.
- Interest rates on non-indexed mortgage loans have risen marginally in the wake of the Bank's rate hike in May, but credit spreads on mortgages are broadly unchanged. Interest rates on new corporate loans also rose slightly in June, but credit spreads vis-à-vis deposit rates are still somewhat narrower than in recent years.
- At the end of June, just under 18% of corporate loans were classified as non-performing, about the same as in recent months. Company failures have been on the rise since the spring, however, and in H1/2021 there were 21% more insolvencies than over the same period in 2020. New company registrations have increased more strongly, however, or by over half. The share of household loans classified as non-performing remains low and has risen only slightly since the onset of the pandemic last year.
- The housing market has gained momentum as 2021 has progressed. The twelve-month rise in capital area house prices measured 16% in June but eased to 15.4% in July. Rent prices have risen much less, however, and were only 1.7% higher in July than in the same month of 2020. The number of flats available for sale has declined slightly, and

Chart 16
Credit spreads¹
March 2015 - June 2021



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

Chart 17
House prices, rent prices and number of purchase agreements¹
January 2019 - July 2021



1. Data for the capital area. Seasonally adjusted number of purchase agreements, by purchase date. Source: Registers Iceland.

turnover in the market has surged. In addition, first-time buyers continue to gain market share, accounting for just over a third of all purchases in the capital area in Q2/2021. Lower interest rates and various Government support measures have offset the adverse economic impact of the pandemic and, among other things, have made it possible for disposable income to keep rising despite the bleak employment situation.

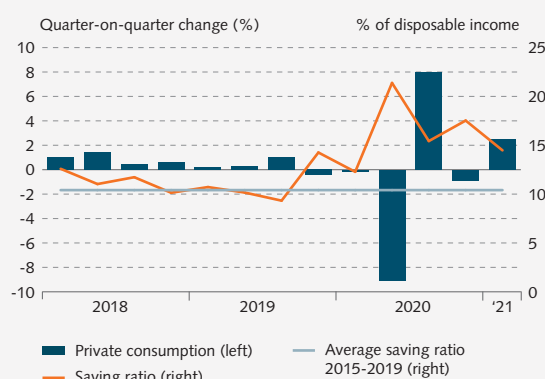
- House prices have risen in excess of wages and income in the recent term, and the imbalance between them has grown. Household debt has risen as well. As a result, the Central Bank's Financial Stability Committee decided in June to lower the maximum loan-to-value ratio on new mortgage loans from 85% to 80% for all borrowers except first-time buyers.
- Since autumn 2020, the domestic equity market has been characterised by strong turnover and rising prices. Furthermore, retail investors have boosted their shareholdings, partly by participating in initial public offerings, and the number of individuals who own listed shares has increased. In 2021 to date, stock market turnover totals 568 b.kr., an increase of 67% year-on-year. Moreover, the OMXI10 index has risen by 60% in the past twelve months, and by 11.5% since the *May Monetary Bulletin*.

Demand and GDP growth

- Private consumption grew by 2.5% between quarters in Q1/2021, after having contracted by 3.3% in 2020. Even so, this was only half the quarter-on-quarter growth rate forecast in the *May Monetary Bulletin*. That forecast took account primarily of strong growth in payment card turnover and other high-frequency indicators of economic activity, as well as surveys indicating improvements in households' financial position and overall sentiment. When Statistics Iceland's preliminary estimates of the quarter's consumption spending were released, however, data indicating strong growth in value-added tax turnover in March and April were not yet available. As a result, the possibility of an upward revision of Q1 figures cannot be ruled out. Year-on-year growth measured only 0.8%, well below the May forecast of 5% growth.
- Household consumption patterns changed radically in 2020, after the authorities imposed public health

Chart 18

Private consumption and household saving¹
Q1/2018 - Q1/2021



1. The saving ratio is calculated based on the Central Bank's disposable income estimates. Seasonally adjusted figures.

Sources: Statistics Iceland, Central Bank of Iceland.

measures in response to the first wave of the pandemic in Iceland. They stepped up their purchases of consumer durables but reduced spending on categories requiring close contact with other people. On the other hand, the impact of the pandemic on household spending patterns has diminished since last year. Households have adapted to a changed environment and are continuing to tap accumulated savings, and data from the Icelandic Centre for Retail Studies show that spending on goods and services previously restricted by public health measures is now above the pre-pandemic level (see also Chart V-2 in Appendix 1).

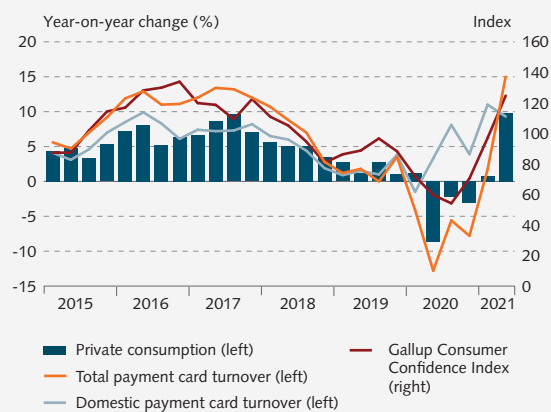
- Payment card turnover, both within Iceland and overall, has continued to increase. New motor vehicle registrations (excluding rental cars) have also increased markedly, and household sentiment has improved further. It therefore appears that private consumption increased somewhat between Q1 and Q2, and it looks set to measure about 10% higher in Q2 than in the same quarter of 2020, when it contracted by nearly 8% year-on-year. Although this is somewhat stronger year-on-year growth than was assumed in May, the outlook is for private consumption growth in 2021 as a whole to measure 4.2%, roughly 1 percentage point below the May forecast. This reflects not only weaker growth in Q1, but also the effects of the most recent wave of the pandemic and the tightening of public health measures in Q3. On the other hand, private consumption growth is forecast to grow more strongly in 2022 and 2023.
- Investment contracted by 2.9% year-on-year in Q1/2021, well below the 6.2% growth forecast in May. The deviation stemmed from weaker-than-forecast investment in all subcomponents apart from investment in ships and aircraft. Business investment contracted by 4.9% year-on-year and residential investment by 8.8%. This was offset by a nearly 19% increase in public investment, which was nevertheless below the growth rate expected this past spring.
- General business investment (excluding energy-intensive industry, ships, and aircraft) increased by 5.3% year-on-year in Q1. This is just shy of half of the growth projected in May, and markedly below the level suggested by high-frequency indicators. It is possible, though, that Statistics Iceland's preliminary figures will be revised upwards, in part

Chart 19
Payment card turnover, by category¹
January 2020 - July 2021



1. Seasonally adjusted. Change relative to Jan-Feb 2020 average. 2. Restaurants, accommodation, transport, package tours, duty-free shopping, culture and recreation, and personal care and services. 3. Electronics, household appliances, furniture, clothing, and other specialised retail goods and services. 4. Grocery stores and supermarkets.
Source: Centre for Retail Studies.

Chart 20
Private consumption and its indicators¹
Q1/2015 - Q2/2021

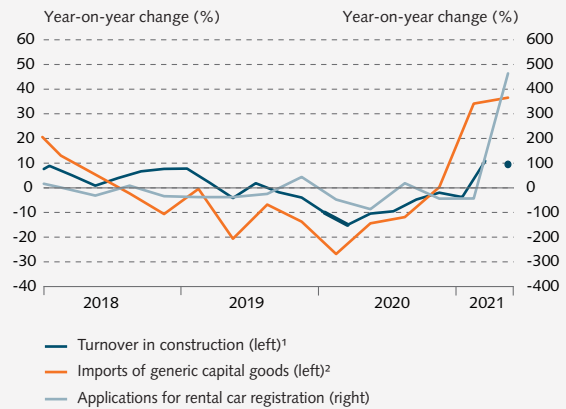


1. The Gallup Consumer Confidence Index is seasonally adjusted with an average of 100. Central Bank baseline forecast Q2/2021 for private consumption.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

because data on investment in buildings and other structures were based solely on construction companies' turnover figures for January and February, yet those figures rose markedly in March and April. Furthermore, there are signs that business investment was stronger in Q2 than was forecast in the spring.

- The outlook is for year-2021 business investment growth to outpace the May forecast, measuring 4.5% instead of just under 1%. Added to this is public investment growth measuring nearly a quarter, although the outlook for residential investment is weaker. It appears that construction companies are responding to increased demand and strong sales by placing greater emphasis on finishing residential projects already underway, while allowing new projects to proceed more slowly than was assumed in May. Residential investment is now forecast to decline by nearly 8% this year, more than double the contraction provided for in the May forecast. Total investment is therefore projected to grow by 4.5% in 2021 as a whole, which is broadly in line with the last forecast. The outlook for 2022 and 2023 is largely unchanged, however.
- In addition to robust growth in public investment in Q1/2021, public consumption rose by 2.9% year-on-year. The outlook is for public sector demand to grow by 4.2% this year, somewhat less than was forecast in May. This is mainly because public investment spending is now expected to be weaker than was anticipated then. Growth in public sector demand is forecast to lose pace in 2022, owing to a significant slowdown in investment growth, and in 2023 it is expected to remain flat year-on-year.
- The public sector deficit measured 8.2% of GDP in Q1/2021, owing mainly to a Treasury deficit of nearly 7%. The outcome deteriorated by 1.2 percentage points between years, reflecting both the impact of the pandemic-induced recession on public sector operations and the strong effects of mitigating measures introduced by the authorities.
- Exports of goods and services contracted by 18% quarter-on-quarter in Q1, after having increased somewhat in H2/2020. The contraction is due primarily to base effects from increased exports of intellectual property-related services in Q4/2020. The year-on-year contraction in exports in Q1/2021

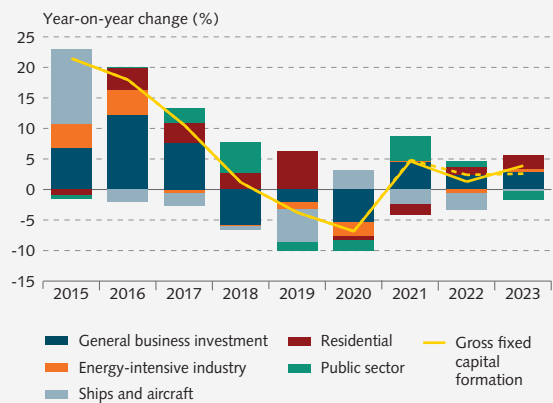
Chart 21
Indicators of general business investment
Q1/2018 - Q2/2021



1. Total turnover in construction. The data is published by two-monthly VAT periods and deflated using the building cost index. The point shows projection by the Central Bank for May and June. 2. Total value of imports of capital goods and imports of transport equipment excluding ships and aircraft, deflated using the exchange rate index.

Sources: Statistics Iceland, Central Bank of Iceland.

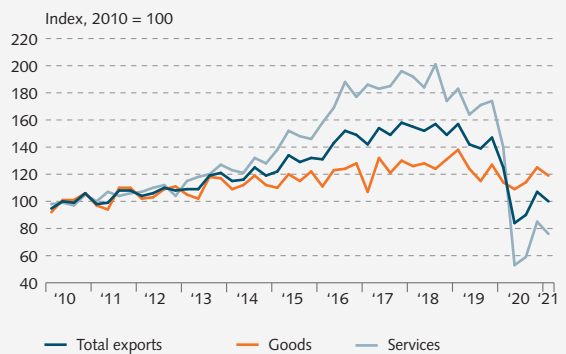
Mynd 22
Gross fixed capital formation and contribution of main components 2015-2023¹



1. General business investment excludes ships, aircraft, and energy-intensive industry. Central Bank baseline forecast 2021-2023. Broken line shows forecast from MB 2021/2.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart 23
Exports of goods and services¹
Q1/2010 - Q1/2021



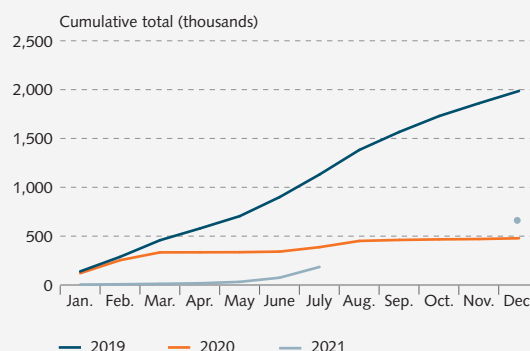
1. Seasonally adjusted volume indices.

Source: Statistics Iceland.

measured 20%, as was assumed in the Bank's May forecast. A large part of the contraction is due to tourism-related exports, as services exports were down 52% year-on-year in Q1/2021.

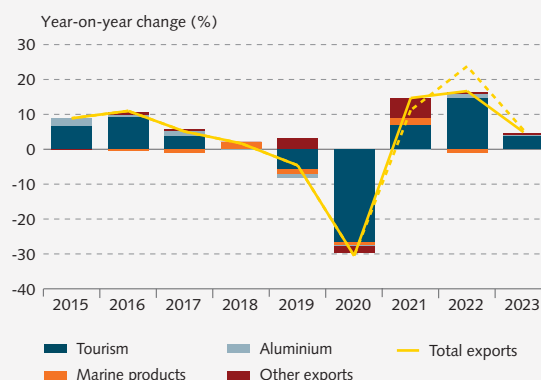
- Goods exports grew by 4.6% between years in Q1, in line with the Bank's May forecast – the first year-on-year increase since the beginning of 2019. Marine product exports grew by 5.6% year-on-year during the quarter, and the outlook is for considerably stronger growth in Q2, owing mainly to a successful capelin season. Growth in agricultural exports also appears to have accelerated further, and exports of industrial goods apart from aluminium seem to have gained momentum as well.
- There are signs that services exports have grown more strongly in the recent term than was projected in May. Tourist arrivals have increased rapidly in Q2 and Q3, outpacing the May forecast, as public health restrictions at the border were eased more quickly than expected. The increase in tourist numbers was therefore greater over the summer months, and export revenues for the summer season look set to be stronger than previously assumed. Furthermore, there are signs of robust growth in other services exports in Q2.
- It appears, though, that rising COVID case numbers and Iceland's inclusion in the European Centre for Disease Prevention's so-called red list will put a damper on tourist numbers as the autumn advances, and growth in tourism-related exports is therefore projected to be weaker in Q4/2021 than was assumed in May. For 2021 as a whole, tourist arrivals are projected at around 680,000, slightly above the May forecast. Services exports are therefore expected to increase by just over 29% for the year as a whole instead of the 22% provided for in the May forecast. On the other hand, the outlook is for more sluggish growth in 2022, owing to increased uncertainty about vaccine efficacy and its impact on appetite for travel. Base effects from the stronger recovery in Q2 and Q3/2021 will also affect next year's growth numbers.
- Because of the favourable capelin season, marine product exports are expected to be considerably stronger this year than was previously assumed. The outlook for exports of ferrosilicon and farmed fish has improved as well, although exports of alu-

Chart 24
Foreign nationals' departures via Keflavík Airport 2019-2021¹



1. Cumulative total for each year. The dot indicates the 2021 total according to the Central Bank's baseline forecast.
Sources: Icelandic Tourist Board, Central Bank of Iceland.

Chart 25
Exports and contribution of subcomponents 2015-2023¹

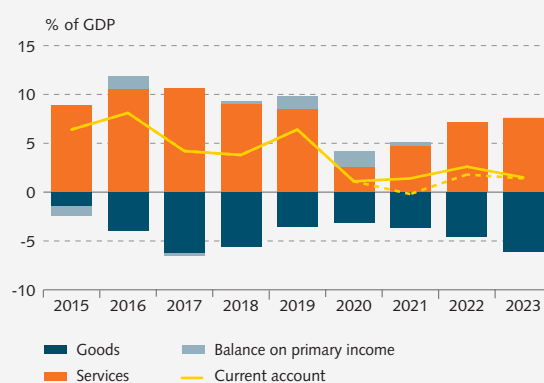


1. Because of chain-volume linking, the sum of components may not equal total exports. Tourism is the sum of "travel" and "passenger transport by air". Aluminium exports as defined in the national accounts. Central Bank baseline forecast 2021-2023. Broken line shows forecast from MB 2021/2.
Sources: Statistics Iceland, Central Bank of Iceland.

minium products are expected to be poorer than previously forecast. Goods exports as a whole are forecast to increase by 6.1% this year, about 1 percentage point more than was assumed in May. The outlook for 2022 is somewhat bleaker, however, owing to the expectation that next season's cod catch will be smaller than previously assumed.

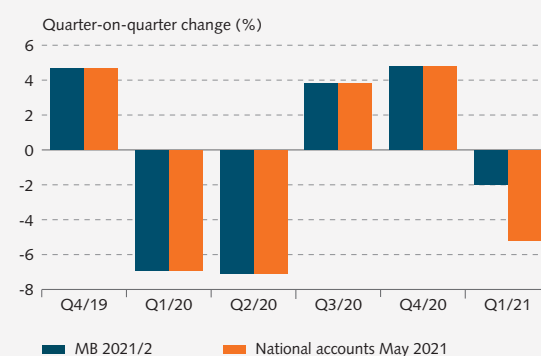
- The outlook is for total exports to grow by 14.7% this year, 3.5 percentage points above the May forecast. The growth rate is projected at just under 17% in 2022, well below the previously projected increase of nearly one-fourth.
- Goods and services imports contracted by 3.4% quarter-on-quarter in Q1, and by 11.3% year-on-year, which is well in line with the Bank's May forecast. Although services imports were down by nearly a third year-on-year, imports of goods other than ships and aircraft increased marginally, and leading indicators suggest a continued rise in Q2. As a consequence, the outlook for the year as a whole is for somewhat stronger goods imports than was forecast in May. On the other hand, this year's services imports are expected to be weaker than was assumed in May, as Icelanders' travels abroad later in the year will be hindered by the recent setback in the pandemic. Thus the outlook is for total imports to grow by slightly less than 12% this year, marginally below the May forecast, and the outlook for 2022 is weaker as well.
- The current account deficit in Q1 was slightly larger than was assumed in May, at 3.8% of GDP, due to an underestimation of services imports and a smaller surplus on primary income. The current account is estimated to have returned to positive territory in Q2, and the surplus is expected to widen further in H2. A surplus of 1.4% of GDP is forecast for 2021 as a whole, significantly above the May forecast. More favourable external trade is a major factor, as are more positive developments in terms of trade. The current account surplus is projected to widen even further in 2022, alongside a firmer recovery of services exports and improved terms of trade. It is expected to measure about 1½% of GDP in 2023, as was forecast in May.
- Preliminary figures from Statistics Iceland indicate that GDP declined by 5.2% quarter-on-quarter in Q1/2021, roughly twice the contraction provided

Chart 26
Current account balance 2015-2023¹



Current account excluding the effect of failed financial institutions in 2015. Balance on secondary income included in the balance on primary income. Central Bank baseline forecast 2021-2023. Broken line shows forecast from MB 2021/2.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 27
Quarterly changes in GDP growth¹
Q4/2019 - Q1/2021



1. Seasonally adjusted figures. Data for the series MB 2021/2 show Statistics Iceland's measurement from February 2021, with the exception of Q1/2021 data, which are taken from the baseline forecast in MB 2021/2.
Sources: Statistics Iceland, Central Bank of Iceland.

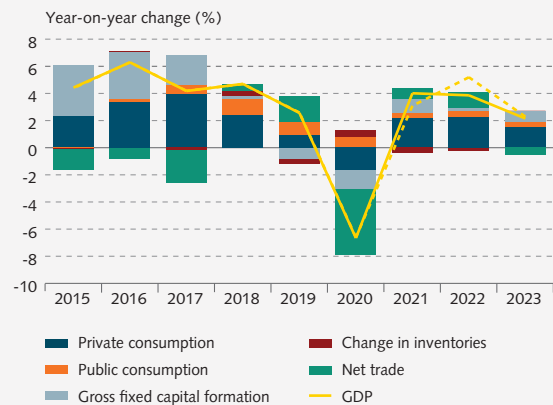
for in the Bank's May forecast. This was due largely to weaker-than-expected domestic demand, whereas external trade developed in line with the Bank's forecast. As a result, GDP was still 1.7% lower than in Q1/2020, whereas the May forecast assumed it would rise by 2% year-on-year.

- There are signs of strong growth in economic activity in Q2/2021, with GDP rising by 11% year-on-year. This strong growth rate is due partly to base effects from the sharp contraction in Q2/2020. GDP growth is projected at 4% for the year as a whole, some 0.9 percentage points above the May forecast, owing in large part to the more rapid opening of the country to tourists. As a result, the contribution of net trade to output growth will be over 1.4 percentage points more than previously forecast, although slightly weaker growth in domestic demand will pull in the opposite direction. Output growth is expected to be similar in 2022 and then taper off to just over 2% in 2023, as in the May forecast.

Labour market and factor utilisation

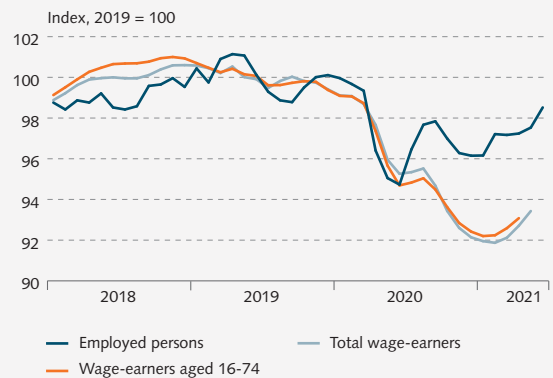
- According to the Statistics Iceland labour force survey (LFS), total hours worked increased by 2.7% year-on-year in Q2/2021, which is less than was forecast in May. This is largely because average hours worked declined by 1.2% at the same time, whereas they were expected to rise in tandem with the increase in domestic economic activity (Chart V-3 in Appendix 1). The number of employed persons rose markedly year-on-year during the quarter, however, or by 3.9%, and was close to its pre-pandemic level. The number of workers on the pay-as-you-earn (PAYE) register has also begun to rise, after declining more during the pandemic than the number of employed people according to the LFS. PAYE data imply that job creation is strongest in the tourism industry.
- According to seasonally adjusted LFS data, the labour participation and employment rates increased by nearly 1 percentage point between quarters in Q2. This brought labour participation more or less back to the pre-pandemic rate, whereas the employment rate was still down by about 2½ percentage points (Chart V-3 in Appendix 1).
- According to seasonally adjusted LFS data, unemployment measured 6.6% in Q2 and was therefore

Chart 28
GDP growth and contribution of underlying components 2015-2023¹



1. Central Bank baseline forecast 2021-2023. Broken line shows forecast from MB 2021/2. Sources: Statistics Iceland, Central Bank of Iceland.

Chart 29
Number of employed persons¹
January 2018 - June 2021



1. Employed persons according to Statistics Iceland's labour force survey and wage-earners according to the Directorate of Internal Revenue's PAYE register. Wage-earners aged 16-74 includes individuals on childbirth leave and self-employed persons. The category "all wage-earners" excludes these groups but covers all age groups. Three-month moving average of seasonally adjusted figures. Wage-earner data is seasonally adjusted by the Central Bank of Iceland. Sources: Statistics Iceland, Central Bank of Iceland.

Chart 30
Registered unemployment¹
January 2020 - July 2021

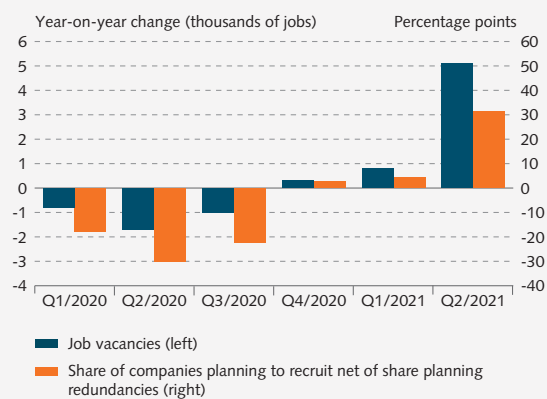


1. "Deregistered due to hiring subsidies" indicates the cumulative number of persons who have dropped off the unemployment register as a result of hiring subsidies. Source: Directorate of Labour.

1.8 percentage points below its Q4/2020 peak. Similarly, the LFS-based measure of the slack in the labour market narrowed by just above 3 percentage points over the same period (Chart V-3 in Appendix 1). Registered unemployment has declined by nearly half in the past six months. It measured 6.1% in July and was therefore only 1 percentage point higher than before the pandemic. The Government's part-time unemployment benefits programme expired in May 2021, but it has been replaced by hiring subsidies, which increased companies' willingness to hire workers. From April through July 2021, an average of half of those who dropped off the unemployment register benefited from hiring subsidies. It is estimated that without this support, unemployment would have been some 2½ percentage points higher in July. Long-term unemployment also declined during the month, to 2.6%, which is roughly equal to the peak in the wake of the financial crisis.

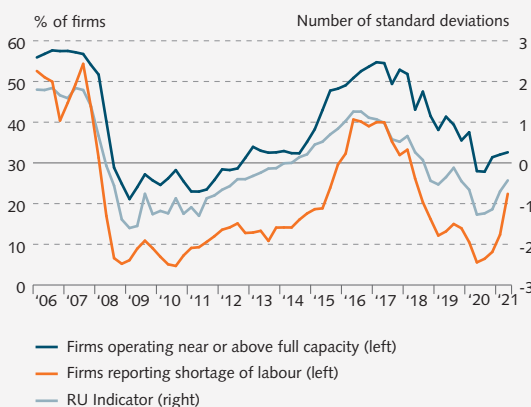
- Iceland's population grew by 1.3% year-on-year in Q2, slightly more than in the previous quarter. Year-on-year population growth had lost pace since Q1/2018, as fewer foreign nationals moved to Iceland and more of them left the country. The more rapid population growth in Q2/2021 is due mostly to a turnaround in immigration flows.
- The results of two surveys conducted in Q2 show a marked increase in firms' recruitment plans. According to the seasonally adjusted results of the Gallup survey carried out this summer among Iceland's 400 largest firms, 39% of firms are interested in adding on staff, while only 8% are planning redundancies. The balance of opinion is therefore positive by 31 percentage points, about the same as during the strong upswing in 2016. Job vacancies according to Statistics Iceland's company survey have also increased significantly in number. They are estimated at 7,600 in Q2, over 5,000 more than in the same quarter of 2020 and nearly double the figure from Q2/2019. The results of both surveys show that the recovery is strongest among companies in sectors related to tourism, retail and wholesale trade, and construction.
- According to the seasonally adjusted results of the Gallup survey, 22% of executives considered themselves short-staffed, which is some 10 percentage points higher than in the previous survey and at the historical average. The share increased most in the construction sector, although it also rose in

Chart 31
Firms' staffing plans¹
Q1/2020 - Q2/2021



1. Job vacancies according to Statistics Iceland company survey. Firms' recruiting plans in the coming 6 months according to Gallup survey of Iceland's 400 largest companies. The data are seasonally adjusted by the Central Bank of Iceland.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Chart 32
Capacity utilisation¹
Q1/2006 - Q2/2021



1. Indicators of factor utilisation are based on the Gallup Sentiment Survey conducted among Iceland's 400 largest companies. The resource utilisation indicator (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. Seasonally adjusted figures.
Sources: Gallup, Central Bank of Iceland.

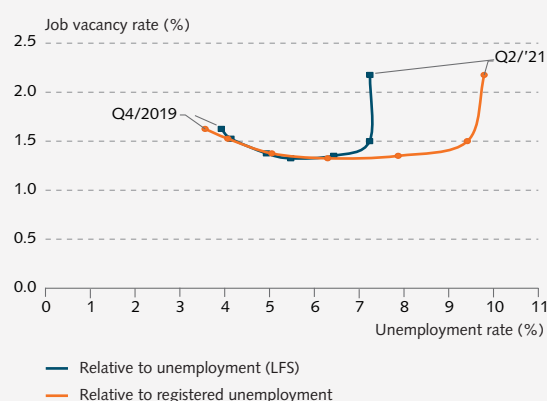
transport, transit, and tourism. In addition, a third of executives – roughly the same as in the previous survey – were of the view that their firms would have difficulty responding to an unexpected increase in demand. The resource utilisation (RU) indicator, which combines various indicators of factor utilisation, rose marginally between quarters, suggesting that the slack in the economy continues to narrow.

- An abrupt increase in firms' recruitment plans can therefore be observed and labour shortages have increased at a time of historically high unemployment. The labour market's ability to match job-seekers and potential employers therefore appears to have weakened temporarily, as can be seen in the shift in the Beveridge curve, which depicts the relationship between job vacancies and unemployment. It is likely, however, that this inefficiency in the labour market will recede again in the near future, as job numbers are rising rapidly in the tourism sector and registered unemployment is approaching its pre-pandemic level. As hiring increases, job vacancy numbers should decline and the Beveridge curve should shift closer to its pre-pandemic position. As a result, it is likely that equilibrium unemployment will decline faster than previously assumed, and that measured unemployment will follow suit. All of this is highly uncertain, however.
- Total hours worked are forecast to increase by 1.7% this year and by about twice that amount per year in 2022 and 2023. Furthermore, unemployment is projected to decline more than previously forecast, both this year and over the forecast horizon as a whole. The LFS-based unemployment rate is forecast to measure 6.5% in 2021 and fall to 5% by the final year of the forecast horizon. If this forecast materialises, registered unemployment will average just over 8% this year and 4.3% in 2023. It is assumed that the slack in output that opened up in 2020 will narrow rapidly, measuring 1% this year. As in the Bank's May forecast, a positive output gap is expected to open up in late 2022.

Inflation

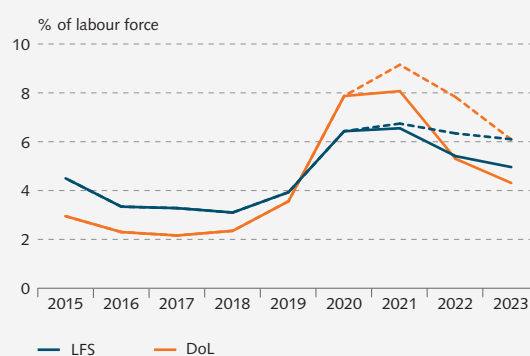
- Inflation measured 4.4% in Q2/2021, as was assumed in the *May Monetary Bulletin*. House prices were the main driver of the rise in the CPI during the quarter, owing to the aforementioned real estate market boom. Private services prices also

Chart 33
The Beveridge curve¹
Q4/2019 – Q2/2021



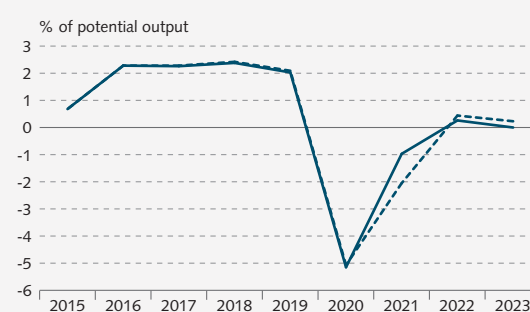
1. Four-quarter moving average of unemployment and the job vacancy rate. Registered unemployment excluding part-time benefits.
Sources: Directorate of Labour, Statistics Iceland, Central Bank of Iceland.

Chart 34
Unemployment 2015-2023¹



1. Unemployment according to Statistics Iceland labour force survey (LFS) and registered unemployment, excluding part-time benefits, according to the Directorate of Labour (DoL). Central Bank baseline forecast 2021-2023. The broken lines show the forecast from MB 2021/2.
Sources: Directorate of Labour, Statistics Iceland, Central Bank of Iceland.

Chart 35
Output gap 2015-2023¹

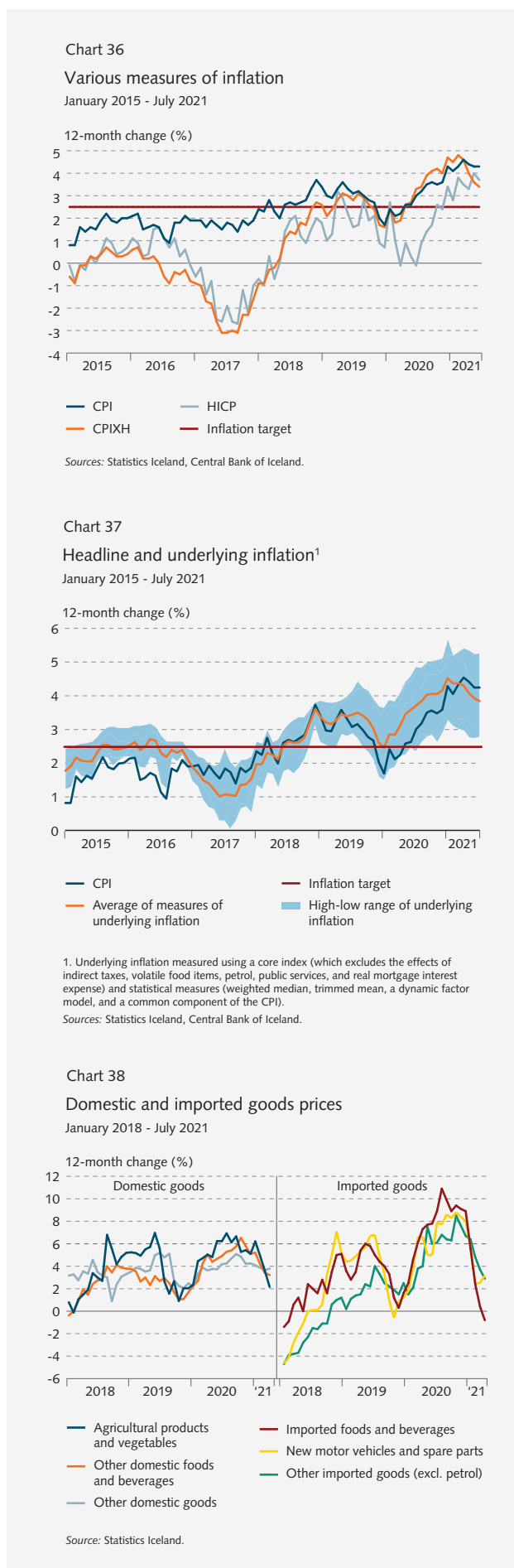


1. Central Bank baseline forecast 2021-2023. The broken lines show the forecast from MB 2021/2.
Source: Central Bank of Iceland.

rose in Q2, fuelled by increased demand for various services once public health measures were eased and the vaccination rollout gained momentum.

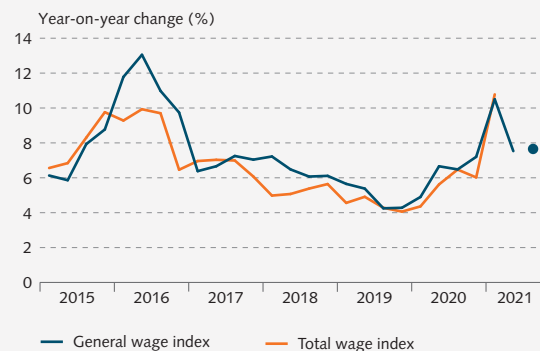
- The CPI rose by 0.16% month-on-month in July, and by 4.3% year-on-year. Twelve-month inflation has therefore tapered off since April, when it measured 4.6%. As was the case a year ago, summer sales had a far weaker downward impact on prices than before the pandemic – presumably owing in part to strong domestic demand. Housing and petrol prices rose month-on-month in July, as did international airfares. Airfares began rising as international travel started to recover, and are now up by nearly a fifth year-to-date.
- Inflation excluding housing measured 3.4% in July and has fallen more rapidly than measured inflation in the recent term. HICP inflation tells a different story, however. According to the HICP, which also excludes the cost of owner-occupied housing, inflation measured 3.7% in July and has risen since the spring. Developments in the HICP are coloured by base effects, however, as various tourism-related subcomponents have risen in price recently. This is different from the situation at the beginning of the pandemic, when many services prices either remained unchanged or declined.¹
- Underlying inflation measured 3.8% in July, according to the average of various measures, and has declined by 0.7 percentage points year-to-date. Therefore, overall inflationary pressures still appear to be present but are subsiding. Furthermore, inflation seems to be driven increasingly by the housing component. In July, over a third of headline inflation was attributable to the housing component, as compared with just under a fifth in January.
- The króna has been relatively stable since the last *Monetary Bulletin* and has strengthened by nearly 3% in 2021 to date. As a result, there has been a marked slowdown in the twelve-month rise in imported goods prices (apart from petrol), which have increased overall by 3.5% in the past year. The same is true of domestic goods prices, which have risen 2.9% in the past year, the smallest year-on-year increase since the beginning of the pandemic.

¹ Components relating to tourist spending weigh heavier in the HICP than in the CPI.



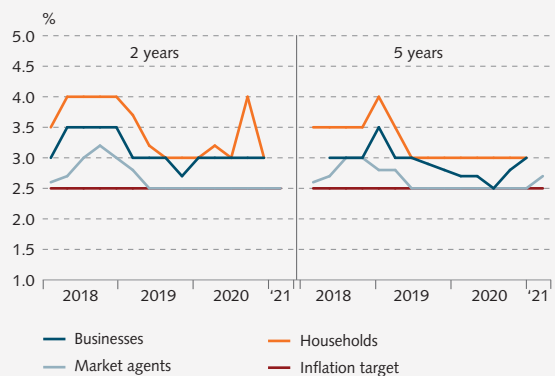
- The general wage index was up 7.5% year-on-year in Q2 and rose to 7.8% in July. The twelve-month rise lost considerable pace between Q1 and Q2, when last year's negotiated pay rises dropped out of the figures. The general wage index and the total wage index have more or less kept pace with one another and continued to do so in Q1, when the two indices rose in tandem. This indicates that the changed composition of jobs and the payments that are not captured by the general wage index make little impact on overall wage developments.
- The outlook is for wages per hour to increase somewhat more in 2021 than was forecast in May, as wages rose more in H1 than was assumed then. On the other hand, productivity growth has been stronger, thereby increasing unit labour costs somewhat less than was estimated in May, or just under 4%. This will turn around in 2022 and 2023, when unit labour costs are forecast to rise by 5% per year.
- According to the Central Bank's market expectations survey, respondents' inflation expectations one and two years ahead are unchanged from the May survey. Survey participants expect inflation to measure 3% in one year's time and align with the 2.5% inflation target after two years. Gallup's summer surveys indicate that households and businesses expect inflation to measure 3.5-4% a year from now and decline thereafter, to 3% in two years' time. Households' two-year inflation expectations have fallen by 1 percentage point between surveys.
- Market agents' and corporate executives' inflation expectations five years ahead rose slightly in the last survey, and corporate expectations are now 3%. On the other hand, market agents' ten-year expectations are still at target. The breakeven inflation rate in the bond market has begun to fall again after rising over the course of the year, and the five-year breakeven rate five years ahead has returned to target.
- The outlook is for inflation to measure just over 4% in H2/2021, slightly above the May forecast. The deviation is due in particular to higher inflation at the beginning of the forecast horizon, plus larger-than-expected rises in the price of oil and other commodities. The outlook is for inflation to ease further in H1/2022, albeit somewhat more slowly than was forecast in May. This reflects several fac-

Chart 39
Wages¹
Q1/2015 - Q3/2021



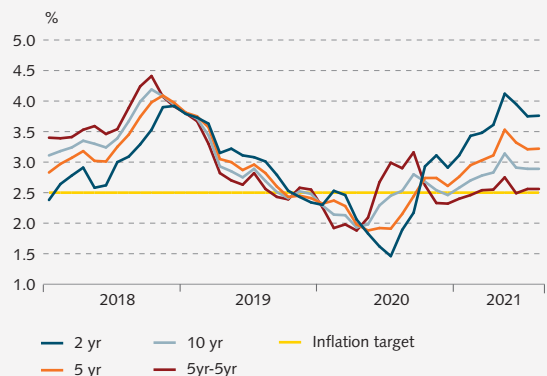
1. The Q3/2021 value is based on figures for July.
Source: Statistics Iceland.

Chart 40
Two- and five-year inflation expectations¹
Q1/2018 - Q3/2021



1. Gallup surveys of households' and businesses' inflation expectations and Central Bank survey of market agents' inflation expectations. Median responses.
Sources: Gallup, Central Bank of Iceland.

Chart 41
Breakeven inflation rate¹
January 2018 - August 2021

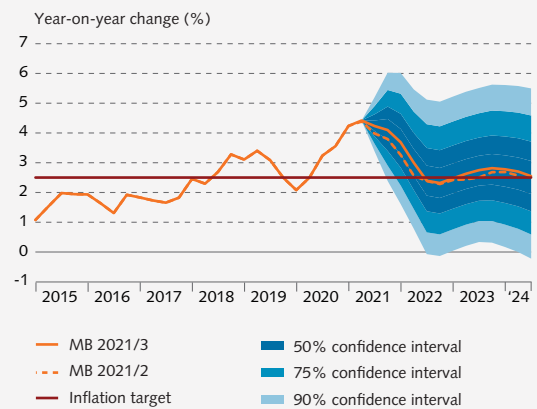


1. Monthly averages.
Source: Central Bank of Iceland.

tors, including larger rises in global commodity prices and more persistent cost pressures stemming from COVID-related supply chain disruptions. In addition, the slack in the domestic economy has narrowed faster than previously forecast. Inflation is projected to align with the target in Q3/2022, slightly later than was forecast in May. On the other hand, the baseline forecast assumes that the króna will be stronger in the coming term than was assumed in May.

- The inflation outlook for the latter half of the forecast horizon is somewhat poorer than was envisioned in May, but inflation is expected to hold close to target, on average, over the period. The outlook is highly uncertain, however, and as is customary with the Bank's updated forecasts, the risk assessment of the baseline forecast has not been revised. There is a roughly 50% probability that inflation will be in the 1½-3½% range in one year and in a similar range at the end of the forecast horizon.

Chart 42
Inflation forecast and confidence intervals
Q1/2015 - Q3/2024



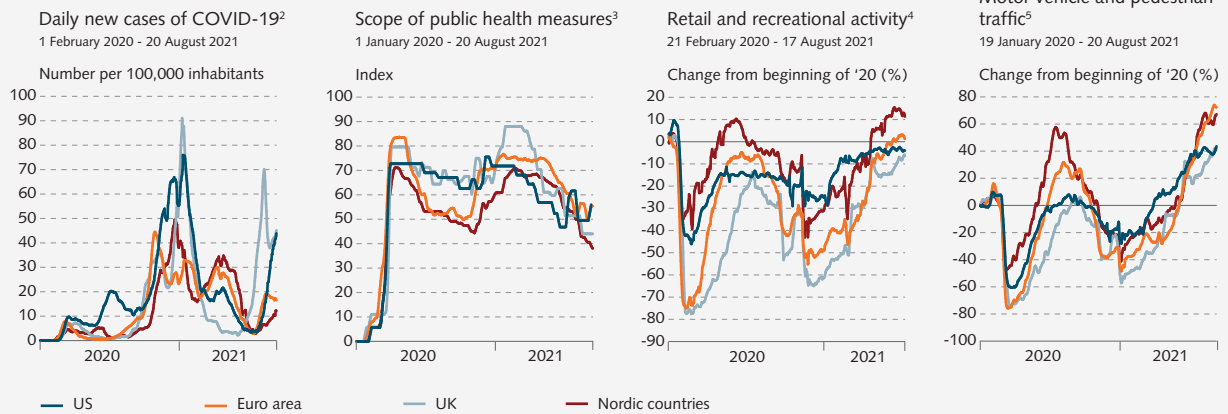
Sources: Statistics Iceland, Central Bank of Iceland.

Appendix

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

Chart V-1

Indicators of global economic activity¹

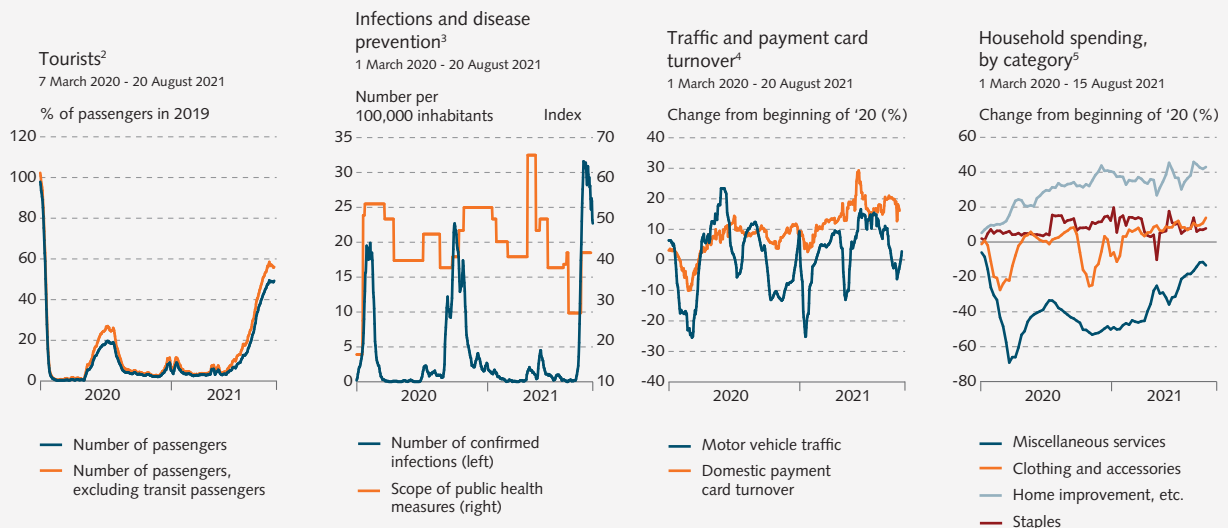


1. Seven-day moving average. Nordic countries include Denmark, Norway, and Sweden. 2. Confirmed new infections. 3. Scope of public health measures weights together various measures of the extent of government restrictions in order to curb the spread of COVID-19. 4. Number of visits to restaurants, cafés,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

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

Chart V-2

Indicators of domestic economic activity¹

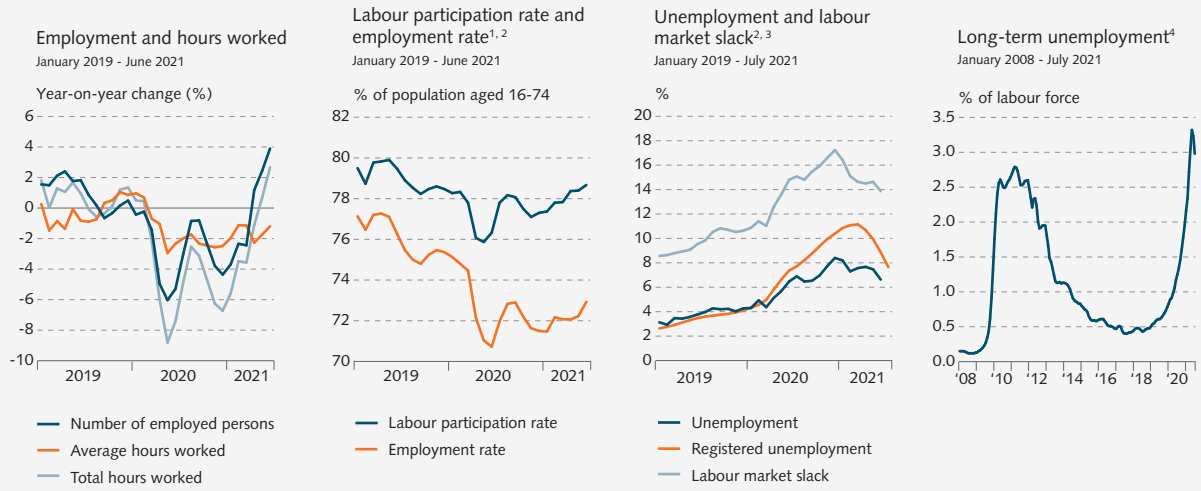


1. All data are seven-day moving averages except scope of public health measures (primary data), motor vehicle traffic (14-day), and domestic payment card turnover and household spending, by category (28-day). 2. Daily number of passengers travelling through Keflavik Airport. Figures for 2019 excluding WOW Air. 3. Scope of public health measures weights together various measures of the extent of government restrictions in order to curb the spread of COVID-19. 4. Daily motor vehicle traffic along three main routes in the capital area. Change from Jan-Feb 2020 average. Payment card figures are the sum of domestic-issued debit and credit cards (seasonally adjusted data). Change from Jan-Feb 2020 average. 5. Miscellaneous services includes restaurants, theatres, fitness centres, travel expenses, etc. Household spending includes electrical equipment, furnitures, and purchases in home improvement stores (seasonally adjusted data). Change from Jan-Feb 2020 average.

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

Chart V-3

Indicators from the domestic labour market¹



1. Figures from Statistics Iceland's labour force survey except registered unemployment (excl. part-time benefits) and long-term unemployment which are from the Directorate of Labour. Three-month moving average. 2. Seasonally adjusted figures. 3. Unemployment shown as a share of the labour force and labour market slack as a share of the extended labour force. 4. Number of persons on the unemployment register longer than 12 months.

Sources: Directorate of Labour, Statistics Iceland, Central Bank of Iceland.

2 Forecast tables

Table 1 Key economic variables¹

	2019	2020	2021	2022	2023
Private consumption	1.9 (1.9)	-3.3 (-3.3)	4.2 (5.2)	4.5 (3.6)	3.0 (2.9)
Public consumption	3.9 (3.9)	3.1 (3.1)	1.6 (1.5)	1.4 (1.1)	1.3 (1.2)
Gross capital formation	-3.7 (-3.7)	-6.8 (-6.8)	4.5 (4.9)	1.4 (2.4)	4.3 (2.6)
Business investment	-12.8 (-12.8)	-8.7 (-8.7)	4.5 (0.7)	-1.4 (3.5)	6.0 (6.0)
Residential investment	31.1 (31.1)	-1.2 (-1.2)	-7.7 (-3.1)	4.7 (3.6)	10.6 (5.5)
Public investment	-10.8 (-10.8)	-9.3 (-9.3)	24.6 (32.0)	5.1 (-1.8)	-7.8 (-10.1)
National expenditure	0.7 (0.7)	-1.9 (-1.9)	3.1 (3.5)	2.8 (2.6)	2.8 (2.4)
Exports of goods and services	-4.6 (-4.6)	-30.5 (-30.5)	14.7 (11.2)	16.7 (23.8)	4.9 (5.5)
Imports of goods and services	-9.3 (-9.3)	-22.0 (-22.0)	11.9 (12.4)	14.1 (16.4)	6.6 (5.7)
Gross domestic product (GDP)	2.6 (2.6)	-6.6 (-6.6)	4.0 (3.1)	3.9 (5.2)	2.2 (2.3)
Contribution of net trade to GDP growth (percentage points)	1.9 (1.9)	-4.9 (-4.9)	0.9 (-0.5)	1.1 (2.5)	-0.5 (0.0)
Unemployment (LFS, % of labour force) ²	3.9 (3.9)	6.4 (6.4)	6.5 (6.7)	5.4 (6.3)	5.0 (6.1)
Registered unemployment (% of labour force) ³	3.6 (3.6)	7.9 (7.9)	8.1 (9.1)	5.3 (7.8)	4.3 (6.1)
Output gap (% of potential output)	2.0 (2.1)	-5.2 (-5.1)	-1.0 (-2.0)	0.3 (0.4)	0.0 (0.2)
Current account balance (% of GDP)	6.4 (6.4)	1.1 (1.0)	1.4 (-0.2)	2.6 (1.8)	1.5 (1.4)
Trade-weighted exchange rate index ⁴	181.0 (181.0)	201.0 (201.0)	195.0 (196.8)	193.6 (197.0)	196.1 (198.7)
Inflation (consumer price index, CPI)	3.0 (3.0)	2.8 (2.8)	4.2 (4.1)	2.8 (2.6)	2.6 (2.5)
Inflation in main trading partners ⁵	1.5 (1.5)	0.7 (0.7)	2.3 (1.8)	1.8 (1.6)	1.7 (1.7)
GDP growth in main trading partners ⁵	1.8 (1.8)	-5.1 (-5.2)	5.3 (4.8)	4.5 (4.1)	2.1 (2.2)

1. Year-on-year change (%) unless otherwise specified (figures in parentheses are from the forecast in MB 2021/2). 2. Unemployment according to the Statistics Iceland Labour Force Survey (LFS). 3. Registered unemployment is from the Directorate of Labour and excludes persons on the partial unemployment benefit programme. 4. 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. 5. Forecast based on Consensus Forecasts, IHS Markit, IMF and OECD.

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

Table 2 Quarterly inflation forecast (%)¹

Quarter	Inflation (year-on-year change)	Inflation (annualised quarter-on-quarter change)
Measured value		
2020:3	3.2 (3.2)	4.3 (4.3)
2020:4	3.6 (3.6)	3.8 (3.8)
2021:1	4.2 (4.2)	2.9 (2.9)
2021:2	4.4 (4.4)	6.7 (6.6)
Forecasted value		
2021:3	4.2 (4.0)	3.5 (2.7)
2021:4	4.1 (3.8)	3.3 (3.1)
2022:1	3.7 (3.3)	1.2 (0.8)
2022:2	3.0 (2.6)	3.9 (3.7)
2022:3	2.4 (2.4)	1.1 (2.0)
2022:4	2.3 (2.3)	2.9 (2.7)
2023:1	2.5 (2.4)	2.0 (1.3)
2023:2	2.6 (2.4)	4.5 (3.8)
2023:3	2.7 (2.5)	1.5 (2.2)
2023:4	2.8 (2.7)	3.2 (3.4)
2024:1	2.7 (2.7)	1.8 (1.4)
2024:2	2.6 (2.6)	4.2 (3.3)
2024:3	2.5	1.0

1. Figures in parentheses are from the forecast in MB 2021/2.

Sources: Statistics Iceland, Central Bank of Iceland.

