

## IV Demand and GDP growth

Although GDP growth eased over the course of 2018, it was still robust, measuring 4.6% for the year as a whole, the same as in 2017 and more than was forecast in the February *Monetary Bulletin*. The outlook for 2019 has changed markedly from the previous forecast, however. Output is expected to contract by 0.4% this year, and if this forecast materialises, it will be Iceland's first economic contraction since 2010. This sharp turnaround in the economy is due to negative external shocks in the tourism and fishing industries. Exports are forecast to shrink nearly 4% year-on-year, owing in large part to the contraction in tourism.

### GDP growth and domestic private sector demand

#### GDP growth unchanged between years, but its composition has changed ...

According to preliminary figures from Statistics Iceland GDP growth measured 4% in Q4/2018, and even though it was up relative to Q3, it was only half as strong in H2 as in H1 (Chart IV-1). It measured 4.6% for 2018 as a whole, the same as in 2017, but the composition of growth changed. In the past few years, GDP growth has been driven by a robust increase in private consumption, strong export growth, and a rising investment level. All of this was offset by a strong growth in imports. The contribution from these main drivers of growth weakened in 2018, but import growth slowed markedly at the same time, and the contribution from net trade was therefore positive during the year. The contribution from the public sector was broadly unchanged between years in 2018, although public expenditure growth has picked up in the past two years. GDP growth for the year was stronger than in the Bank's February forecast, but to a large extent the deviation is due to Q4 imports, which turned out weaker than projected. While private consumption and the contribution from inventory changes were stronger than expected, public consumption and investment were weaker, and domestic demand growth was therefore in line with the forecast (Chart IV-2).

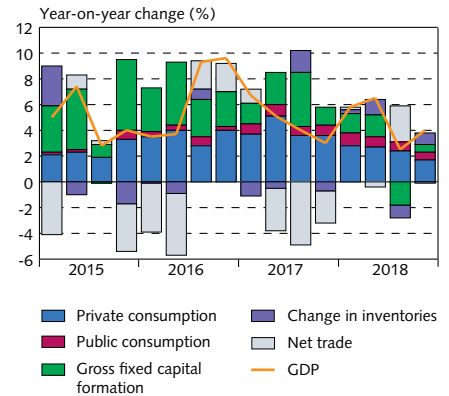
#### ...as have sectoral contributions

In recent years, growth in the services sector and construction has been a major contributor to GDP growth, but growth was relatively broad-based in 2018 (Chart IV-3). The contribution from individual sectors therefore changed somewhat year-on-year in 2018, with fishing, energy-intensive industry, and pharmaceuticals gaining ground and domestic services losing it. The contribution from other competitive sectors, including those related to tourism, was weaker than in the previous year. These developments are reflected to a large degree in the expenditure accounts, which show weaker growth in private consumption and services exports.

Chart IV-1

GDP growth and contribution of underlying components<sup>1</sup>

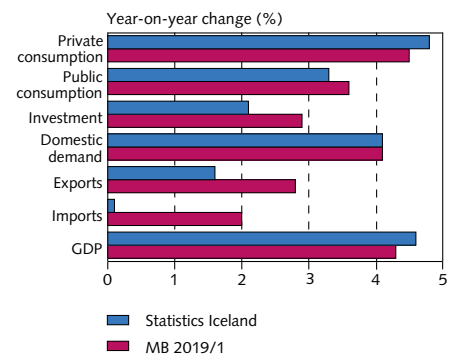
Q1/2015 - Q4/2018



1. The contribution of expenditure components do not have to sum exactly to GDP growth as these are chain-volume measures.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-2

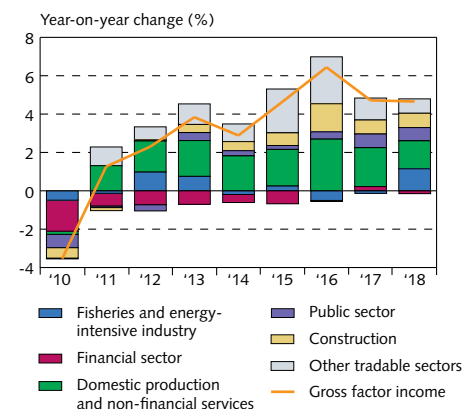
National accounts 2018



Sources: Statistics Iceland, Central Bank of Iceland.

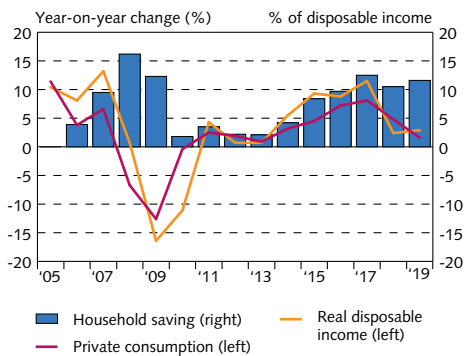
Chart IV-3

Gross factor income and sectoral contributions 2010-2018<sup>1</sup>



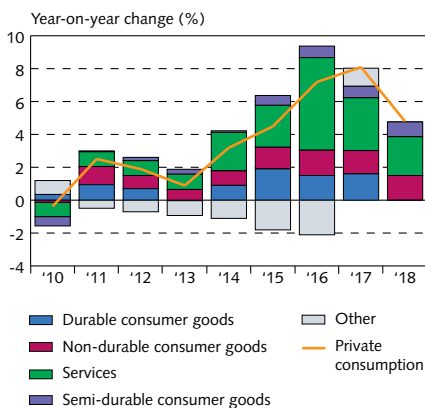
1. Gross factor income measures the income of all parties involved in output. It is equal to GDP adjusted for indirect taxes and production subsidies. 75% of utilities are classified with energy-intensive industry and 25% with domestic production. Other tradable sectors include tourism and pharmaceuticals production.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-4  
Private consumption, disposable income,  
and saving 2005-2019<sup>1</sup>



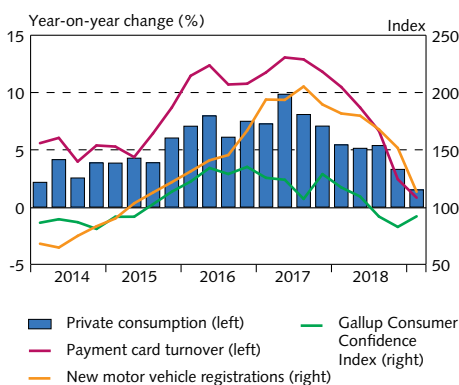
1. There is some uncertainty about Statistics Iceland's figures on households' actual income levels, as disposable income accounts are not based on consolidated income accounts and balance sheets. The saving ratio is calculated based on the Central Bank's disposable income estimates, as Statistics Iceland figures are rescaled to reflect households' estimated expenses over a long period. Central Bank baseline forecast 2019.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-5  
Private consumption and its main components  
2010-2018<sup>1</sup>



1. Non-profit institutions and Icelanders' spending abroad net of foreign tourists' spending in Iceland.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-6  
Private consumption and its indicators<sup>1</sup>  
Q1/2014 - Q1/2019



1. Private consumption and payment card turnover are year-on-year changes, while the figure for new motor vehicle registrations is a seasonally adjusted index with a mean of 100. New motor vehicle registrations net of car rental agencies' applications for new registrations in each quarter. Central Bank baseline forecast Q1/2019 for private consumption.  
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

## Private consumption growth eased in 2018 following years of robust growth ...

Private consumption growth has tapered off after the boom of the past several years. It measured 3.3% in Q4/2018, down from a full 5% early in the year and about 6½%, on average, over the past three years. For 2018 as a whole, it measured 4.8%, up from the 4.5% growth rate in the Bank's February forecast (Chart IV-4). The real wage growth that has supported private consumption in recent years eased, and consumer optimism receded over the course of the year. In addition, household demand may be showing signs of saturation, as the growth spurt in 2015-2017 was driven to a large degree by increased spending on consumer durables, which was flat in 2018 (Chart IV-5).

## ... and is expected to ease even more in 2019

Leading indicators imply that private consumption growth eased even further in Q1/2019 (Chart IV-6), owing mainly to increased uncertainty about the economic outlook early in the year, including uncertainty about the labour market, headwinds in the tourism industry, and the slowdown in real disposable income growth. Recent news reports of insolvencies and layoffs in the tourism sector will probably cut into household demand, and increased uncertainty about the economy will prompt households to exercise caution in their spending decisions, although the recent finalisation of wage agreements may pull in the opposite direction. Household saving is therefore expected to increase marginally and private consumption growth to slow significantly this year (Chart IV-4). Private consumption growth for 2019 is forecast at only 1.6%, its weakest since 2013 and 2.4 percentage points below the February forecast. The poorer outlook is attributable to weaker real disposable income growth in 2018 and 2019, a much bleaker employment outlook, and elevated economic uncertainty.

## Business investment shrank in 2018, after several years of strong growth ...

Business investment began to contract in H2/2018, and for the year as a whole it shrank by 5.4%, somewhat more than was assumed in the February forecast. The contraction stemmed for the most part from general business investment (i.e., excluding energy-intensive industry, ships, and aircraft). Investment in energy-intensive industry also weakened, although it was offset in H1 by increased investment in ships and aircraft. A large share of the contraction is due to reduced activity in the construction sector, which grew rapidly in 2013-2017 (Chart IV-7).

## ... and the outlook for 2019 is highly uncertain

The results of the Bank's spring 2019 survey of businesses' investment plans suggest that respondents plan to step up investment spending this year, but to a lesser degree than in the previous survey. On the whole, the increase measured just under 16% in nominal terms, much of it due to planned investment by firms in trade and services (Table IV-1). Firms in tourism, transport, and manufacturing plan to scale down investment spending this year, while other sectors expect to increase it.

The Bank's survey suggests that firms are more optimistic about investment plans for this year than Gallup's February survey of Iceland's 400 largest firms does. According to the Gallup survey, planned investment will also be weaker than was indicated by surveys taken last year (Chart IV-8). The same is true of firms' expected profit margins (Chart IV-9). Fewer firms plan unchanged or increased investment between years, while the number of firms planning to cut back on investment has risen. The balance of opinion – i.e., the difference between the share of respondents expecting to increase investment and the share expecting to reduce it – has narrowed in all sectors. It is negative in all of them, but most negative in transport, transit, and tourism.

Table IV-1 Survey of corporate investment plans (excluding ships and aircraft)<sup>1</sup>

Largest 98 (99) firms Amounts in ISK billions	2017	2018	2019	Change	Change
				between 2017 and 2018 (%)	between 2018 and 2019 (%)
Fisheries (15)	14.4	10.3	11.1	-28.4 (-10.8)	8.1 (6.5)
Manufacturing (16)	8.5	7.5	4.9	-12.5 (-23.0)	-34.7 (-17.0)
Wholesale and retail trade (21)	8.6	6.8	12.2	-21.0 (-12.9)	79.3 (19.5)
Transport and tourism (8)	28.7	19.6	18.8	-31.7 (-36.7)	-4.1 (34.0)
Finance/Insurance (10)	3.6	3.3	5.4	-7.4 (54.3)	63.0 (9.6)
Media and IT (6)	7.6	8.0	9.7	5.8 (3.1)	20.7 (-3.3)
Services and other (22)	18.2	14.7	19.2	-18.9 (-22.2)	30.6 (34.6)
Total 98 (99)	89.5	70.2	81.3	-21.6 (-19.0)	15.8 (17.2)

1. In parentheses are figures from the last survey, in which respondents from 99 firms were asked about investment plans for 2018-2019 (*Monetary Bulletin* 2018/4). A paired comparison between years is presented, but because the sample could change between surveys, this could affect the results.

Source: Central Bank of Iceland.

### Outlook for business investment to decline this year ...

Surveys taken by the Central Bank and Gallup sketch out differing pictures of firms' investment plans in the coming term, as is discussed above. In part, this is because the Bank's survey does not include activities related to the energy-intensive sector, where a marginal contraction is expected this year. Nor does the Bank's survey include firms' planned investment in ships, aircraft, or hotel construction. Leading indicators imply that investment in hotels will be weaker than previously assumed. By the same token, investment in ships and aircraft is expected to contract sharply this year. Plans in this area have changed markedly, as it has emerged that the aircraft Icelandair had intended to acquire this year will be leased instead of purchased and will therefore not be included in the national accounts data for investment and goods imports. Furthermore, the sale of WOW Air's aircraft in late 2018 shows up among exports in Q1/2019 and will therefore measure as disinvestment in Q1.

In view of Gallup's spring survey and other leading indicators, plus the fact that the Bank's investment survey does not include small companies, the baseline forecast assumes weaker growth in general business investment than is implied in the Bank's survey. Business investment as a whole is expected to contract by 6.7% year-on-year instead of increasing by 4%, as in the February forecast. A large share of the change is due to the aforementioned changes in figures on

Chart IV-7  
Business investment and contribution by type 2010-2018

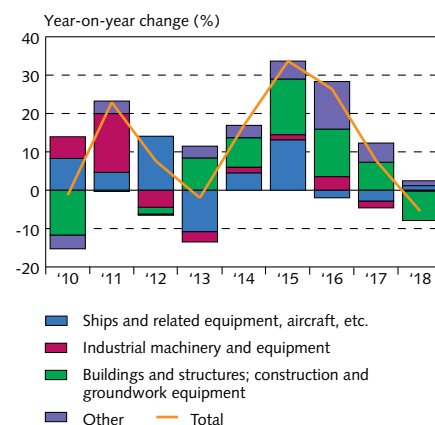


Chart IV-8  
Business investment and surveys of corporate investment plans<sup>1</sup>  
H1/2009- H1/2019

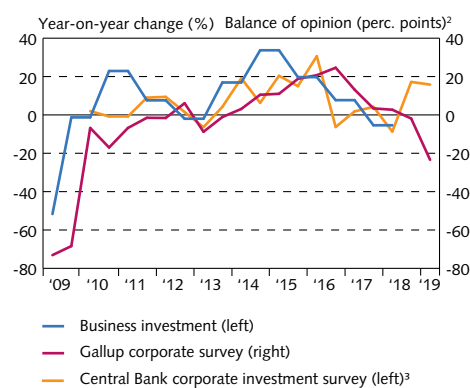


Chart IV-9  
Business investment and its indicators<sup>1</sup>  
Q1/2014 – Q1/2019

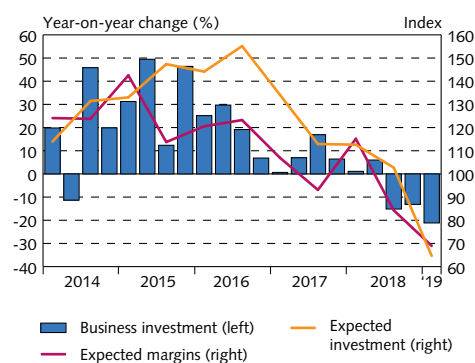
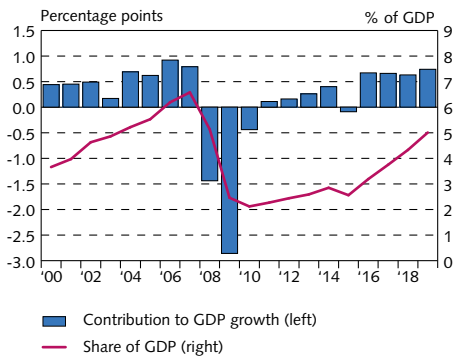
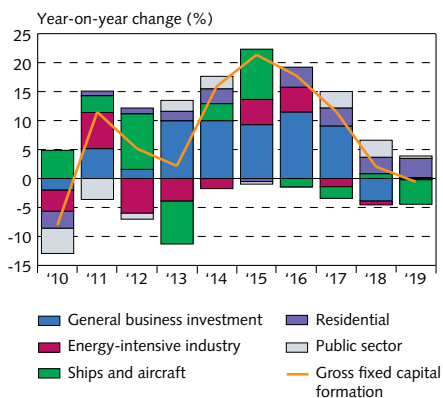


Chart IV-10  
Residential investment 2000-2019<sup>1</sup>



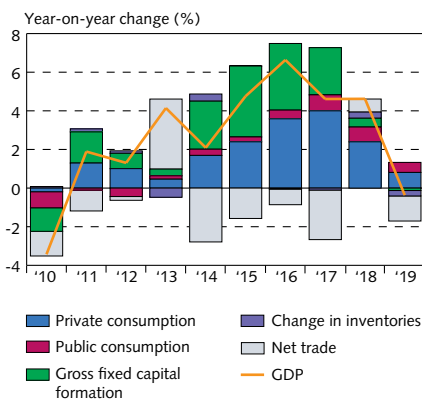
1. Central Bank baseline forecast 2019.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-11  
Gross fixed capital formation and contribution of main components 2010-2019<sup>1</sup>



1. General business investment excludes ships, aircraft, and energy-intensive industry. Central Bank baseline forecast 2019.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-12  
GDP growth and contribution of underlying components 2010-2019<sup>1</sup>



1. Central Bank baseline forecast 2019.  
Sources: Statistics Iceland, Central Bank of Iceland.

aircraft imports in the national accounts and the sale of WOW Air's aircraft out of the country.

### ... but residential investment is still growing

In the past several years, residential investment has grown strongly, supported by rising house prices, population growth, and improvements in households' financial conditions. In 2018, it grew by 16.7% year-on-year, slightly less than was assumed in the February forecast. In line with indicators, including the Federation of Icelandic Industries' figures on the number of flats under construction, growth is still projected to be strong this year, or around 17%. If this forecast materialises, this year's residential investment-to-GDP ratio will be about 5%, highest since 2008 (Chart IV-10).

### Total investment projected to contract slightly in 2019

Total investment grew by 2.1% in 2018, down from the 2015-2017 average of nearly 17%. The outlook is for a marginal contraction this year, owing to a downturn in business investment and continued robust growth in residential and public investment (Chart IV-11). This is a weaker outlook than in the February forecast, but it stems mainly from the aforementioned change in the treatment of aircraft imports and the sale of aircraft out of the country.

Although this can be attributed in part to the turnaround in tourism and related sectors, the investment level had risen rapidly in the past few years and a slowdown in growth was to be expected. If the forecast materialises, the investment-to-GDP ratio will be around 22% this year, some ½ a percentage point above its twenty-five-year average.

### Outlook for Iceland's first economic contraction since 2010

The outlook is for a marked slowdown in domestic demand growth this year, as well as in services exports, which have been the main driver of output growth in recent years. Output growth is estimated to have eased in Q1, and GDP is expected to contract in Q2. The outlook is for a 0.4% contraction in 2019 as a whole, owing to a 1% increase in domestic demand offset by a negative contribution from net trade of more than 1 percentage point (Chart IV-12). If the forecast materialises, the year will see Iceland's first economic contraction since 2010.<sup>1</sup> This is also a significant change from the 1.8% growth assumed in the February forecast. The reversal is due to much weaker growth in domestic demand, private consumption in particular, than previously forecast. As is discussed in Chapter I, the change in outlook is due to the negative external shocks that have hit the economy, especially the turnaround in tourism and the failure of the capelin catch.

1. Previous economic contractions are discussed in Box 1, and the economy's resilience to economic shocks is covered in Box 2.

## Public sector

### Public consumption set to grow less than was forecast in February, but offset by stronger public investment growth

In 2018, public consumption grew by more than 3% year-on-year for the second year in a row, and its contribution to GDP growth measured 0.8 percentage points (Chart IV-13). This is the fastest rate of public spending growth since 2008. Based on statements in the Government's new fiscal plan, public consumption growth is projected to ease this year to 2.2%, somewhat below the February forecast. The reduction in public consumption will be used to bolster investment in transport. The public investment-to-GDP ratio is expected to rise this year to the level last seen in 2009, after having been very low in historical terms since the financial crisis struck.

### Treasury primary surplus smaller than in 2018

According to preliminary figures from Statistics Iceland, the Treasury operated at a surplus of 1.3% of GDP in 2018, or 0.4 percentage points more than in the Bank's previous estimate. Excluding dividends in excess of budgetary estimates, however, the underlying Treasury surplus measures 1.1% of GDP, as opposed to a surplus of 0.9% in 2017 (Chart IV-14). For this year, the underlying overall surplus is expected to narrow again to 0.8% of GDP, and the underlying primary surplus to shrink by 1.1 percentage points, to 2.5% of GDP.

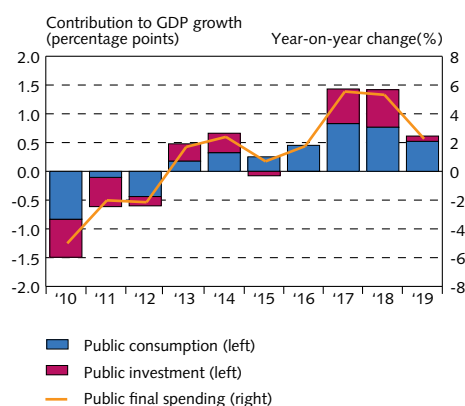
### New fiscal plan for 2020-2024

In accordance with the Act on Public Finances, a Parliamentary resolution on a fiscal plan for the next five years was introduced before Parliament in March. According to the plan, the Treasury outcome will be positive by 0.9% of GDP in 2020, and the local government outcome will also be slightly positive. The surplus on general government operations will therefore amount to 1.1% of GDP. By 2024, the end of the five-year period, it is estimated that the central and general government outcome will have remained unchanged. The fiscal plan assumes that the Treasury outcome will be virtually unchanged from the current fiscal strategy, but this may be subject to review in light of the discretionary measures announced in connection with private sector wage agreements, as well as potential changes in economic fundamentals (the measures are discussed in Box 3).

### Fiscal stance set to ease over the forecast horizon

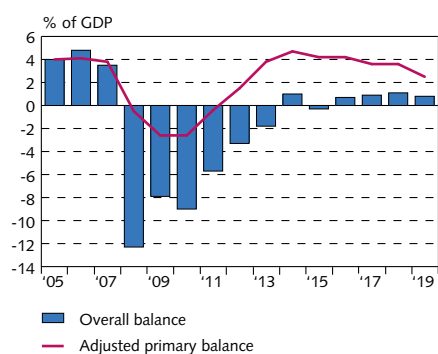
The Central Bank baseline forecast is based in large part on the Government's fiscal plan; however, underlying macroeconomic assumptions are different, as the forecast on which the fiscal plan was based is more favourable than the forecast in *Monetary Bulletin*, which also takes account of the aforementioned measures in connection with wage agreements. It is assumed that the cyclically adjusted primary balance will deteriorate by 0.3% of GDP this year, broadly as was forecast in November, when the fiscal stance was last assessed (Chart IV-15). It is assumed that the discretionary measures earmarked in the fiscal plan for possible allocation in connection with private sector

Chart IV-13  
Public consumption and investment  
2010-2019<sup>1</sup>



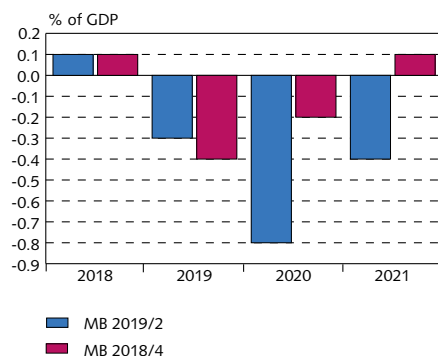
1. Central Bank baseline forecast 2019.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-14  
Treasury balance 2005-2019<sup>1</sup>



1. The primary balance is adjusted for one-off items. In 2016 to 2018, both the overall and primary balance is adjusted for stability contributions, accelerated write-downs of indexed mortgage loans, special payment to LSR A-division and dividends in excess of the National Budget.  
Central Bank baseline forecast 2019.  
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

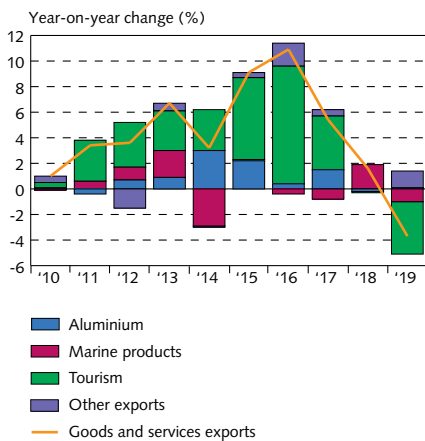
Chart IV-15  
Change in central government cyclically adjusted primary balance 2018-2021<sup>1</sup>



1. Primary balance is adjusted for one-off items (stability contributions, accelerated write-downs of indexed mortgage loans, special payment to LSR A-division and dividends in excess of the National Budget).  
Central Bank baseline forecast 2018-2021.  
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.



Chart IV-16  
Exports and contribution of subcomponents  
2010-2019<sup>1</sup>



1. Aluminium exports as defined in the national accounts. Tourism is the sum of the services category "travel", i.e., revenues from foreign tourists in Iceland, and "passenger transport by air" i.e., Icelandic airlines' revenues from transporting foreign passengers. Central Bank baseline forecast 2019. Sources: Statistics Iceland, Central Bank of Iceland.

wage agreements will be implemented. These measures entail spending increases and tax cuts amounting to 1.6% of GDP in the next two years. Because of this, the assessment of the fiscal stance for the next two years has changed relative to both the Bank's last assessment and the fiscal plan presented by the Government in March.

According to the baseline forecast, general government debt will continue to fall and will approach a desirable minimum treasury debt level by the end of the forecast horizon. As a result, it can be assumed that the Government will shift its emphasis to paying down its pension obligations, which amount to nearly a fourth of GDP.

## External trade and the current account balance

### 2018 exports weaker than was forecast in February

Goods and services exports grew by 1.6% year-on-year in 2018, compared to the 2.8% forecast in February. Strong growth in marine product exports carried virtually all of the weight (Chart IV-16). Exports of marine products were up 11.6% between years and goods exports as a whole by 3.5%, broadly in line with the February forecast. Services exports grew by only 0.1%, however, markedly below the February forecast, owing mainly to the slowdown in tourism growth in Q4. This in turn stemmed from a larger-than-expected contraction in passenger transport by air, which shrank by nearly 13% year-on-year in spite of a continued increase in domestic airlines' passenger numbers. The travel component of services exports – i.e., services revenues from foreign tourists after their arrival in the country – also grew less than expected. Furthermore, other services exports grew less than anticipated, particularly to include exported financial services.

### Tourism set to contract sharply this year ...

The outlook for services exports has deteriorated markedly since the February forecast. This is due in very large part to the poorer outlook for tourism following the collapse of WOW Air in March. WOW had already downsized its fleet of aircraft by half, which was reflected in the Bank's February forecast. Even though Icelandair and several foreign airlines have increased their seat offerings since WOW fell, the outlook is for a contraction of up to a third in seat offerings to and from Iceland this year. This reduction will probably have relatively less impact on the number of foreign tourists visiting Iceland, in part because Icelandair has revised its flight schedule so as to prioritise Iceland-bound passengers over transit passengers. Foreign visitors to Iceland declined in number by nearly 8% year-on-year in the first four months of 2019, and the baseline forecast assumes a 10½% decline for the year as a whole. This is significantly more than the 2½% decline assumed in February. The number of passengers travelling via Keflavik Airport to other destinations is projected to decline by nearly half.

If the forecast materialises, it is clear that domestic airline passenger numbers will fall steeply between years. Other indicators also suggest that this year's contraction in tourism will be sharper than previously estimated. Google searches for hotels in Iceland and flights to the country have declined further, and the number of hotel bed-nights

has fallen between years (Chart IV-17). On the other hand, average spending per tourist in Iceland rose year-on-year in Q4/2018, and payment card turnover figures imply that it rose still further in Q1/2019. Presumably, the weaker króna has mitigated the negative impact of passenger numbers on the domestic tourism sector. The composition of tourists and their spending behaviour may also have changed with the reduction in WOW Air's activities: in 2018, according to a survey taken by the Icelandic Tourist Board, WOW's passengers generally stayed in the country for shorter periods and spent less, on average, than other tourists did. On the whole, then, the outlook for 2019 is for a 10.5% contraction in tourism and an 8.7% contraction in total services exports. The outlook is highly uncertain, however, and the contraction could turn out stronger if, for instance, Icelandair cannot begin using its new Boeing 737 Max jets this summer (see Chapter I).

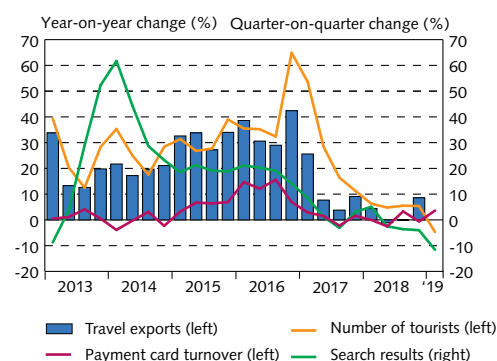
### ... and growth in goods exports to lose pace

In addition to a stronger contraction in services exports, it is now expected that goods exports this year will grow more slowly than was projected in February, or by 2% instead of the previous estimate of 2.4%. To some extent, this is affected by the above-mentioned sale of WOW Air's aircraft out of the country, as without those transactions, goods exports would contract by 1%. The larger-than-expected contraction in marine product exports is the most important factor here, as no capelin quotas were issued this year and the outlook is for weaker catches of other important pelagic species. The outlook for aluminium exports has also been revised downwards since February because technological modifications at one of the domestic smelters require a temporary reduction in output this year. In addition, growth in other goods exports is expected to weaken, particularly silicon metals and prosthetics. Exports of goods and services are expected to contract by 3.7% this year, whereas in February they were projected to grow by 0.3% year-on-year. If this forecast materialises, 2019 will be the first year since 2006 to see a year-on-year contraction in exports. It will also mean that Iceland's exports as a share of trading partner imports will fall even further this year, after rising virtually uninterrupted for a decade (Chart IV-18).

### Imports broadly flat in 2018, after several years of robust growth ...

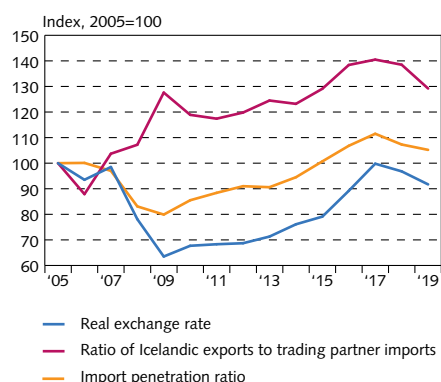
After growing strongly in recent years, imports of goods and services were virtually unchanged in 2018 (Chart IV-19). This is 2 percentage points less growth than was assumed in the February forecast, and 4 percentage points below domestic demand growth. The main factor is a contraction in goods imports, particularly in Q4, when they shrank by over 9%. The contraction in 2018 was due largely to a downturn in imports of motor vehicles for personal use, which were unusually strong in 2017. Imports of other consumer durables and semi-durables also contracted, as did imports of most other goods apart from fuels and lubricants. In addition, services imports contracted more than was forecast in February. The deviation from the forecast is due primarily

Chart IV-17  
Indicators of tourism sector activity<sup>1</sup>  
Q1/2013 - Q1/2019



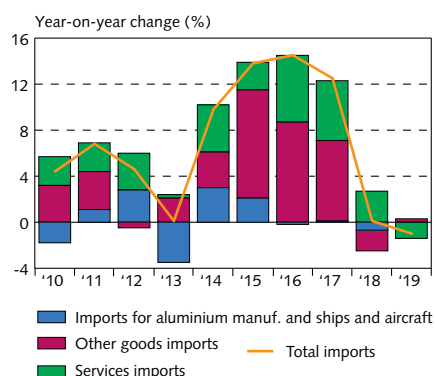
1. Travel exports at constant prices and payment card turnover per tourist in Iceland (excl. transport and public levies) in foreign currency (in terms of the trade weighted exchange rate index). Number of tourists is the number of passenger departures via Keflavik Airport. Search results according to a principal component model combining the frequency of five different Google search strings relating to travel to Iceland (seasonally adjusted, two-quarter moving average).  
Sources: Centre for Retail Studies, Google Trends, Icelandic Tourist Board, Isavia, Statistics Iceland, Central Bank of Iceland.

Chart IV-18  
External trade and real exchange rate  
2005-2019<sup>1</sup>



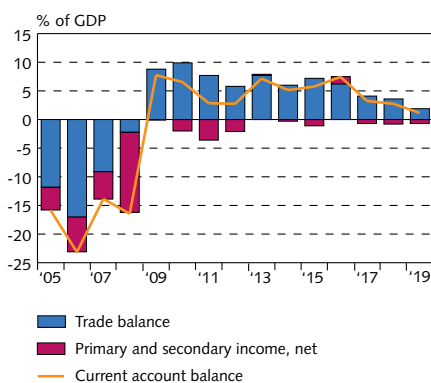
1. Real exchange rate in terms of relative consumer prices. Central Bank baseline forecast 2019.  
Sources: Statistics Iceland, Thomson Reuters, Central Bank of Iceland.

Chart IV-19  
Imports and contribution of subcomponents  
2010-2019<sup>1</sup>



1. Aluminium imports according to national accounts definition. Central Bank baseline forecast 2019.  
Sources: Statistics Iceland, Central Bank of Iceland.

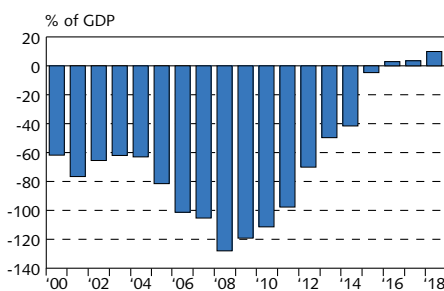
Chart IV-20  
Current account balance 2005-2019<sup>1</sup>



1. Current account excluding the effect of failed financial institutions 2008-2015 and the pharmaceuticals company Actavis 2009-2012 on primary income. Also adjusted for the failed financial institutions' financial intermediation services indirectly measured (FISIM). Central Bank baseline forecast 2019.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-21  
Net international investment position  
2008-2018<sup>1</sup>



1. Underlying net international investment position 2008-2014.

Sources: Statistics Iceland, Central Bank of Iceland.

to an unexpected contraction in Q4/2018, when services exports fell to the lowest single-quarter level in over five years. The main factor in the decline was a contraction in the travel component of services imports in spite of a continued increase in Icelanders' overseas travel.

### ... and set to contract in 2019

Preliminary external trade figures from Statistics Iceland suggest that goods imports excluding ships and aircraft contracted by 4% year-on-year in Q1/2019. According to the baseline forecast, goods and services imports will contract by nearly 1% this year, a major change from the Bank's previous forecast of 5.6% growth. Icelandair's aforementioned decision to lease aircraft instead of purchasing it is an important factor in the change. Other imports are also expected to contract this year, owing largely to weaker growth in domestic demand but also to a turnaround in import penetration; i.e., the share of imports in domestic demand. That share had risen virtually without interruption since the onset of the financial crisis in autumn 2008 but then fell in 2018, in line with the decline in the real exchange rate (Chart IV-18). As a result, it appears that domestic spending has shifted increasingly towards domestic production. Furthermore, it is clear that the contraction in domestic tourism and in international airline operations calls for reduced goods imports, including jet fuel. Moreover, the failure of WOW Air leads to reduced services imports in connection with aircraft operation and leasing, although the increase in aircraft leased by Icelandair offsets this to a degree. Services imports in connection with Icelanders' overseas travel are likely to contract as well, with reduced seat offerings and higher ticket prices. This is supported by figures on Icelanders' departures via Keflavík Airport and Gallup's survey of households' overseas travel plans.

### Trade surplus narrowed in 2018 ...

The surplus on goods and services trade amounted to 3.1% of GDP in 2018, Iceland's tenth year in a row with a trade surplus of 3% or more (Chart IV-20). The surplus narrowed by 1 percentage point year-on-year and turned out smaller than had been forecast in February, owing to poorer terms of trade, although this was offset by a more positive contribution of net trade to output growth.

The current account surplus for 2018 was 2.9%, down by 0.7 percentage points from the prior year. The surplus was slightly larger than was forecast in February, however, due to a more positive balance on primary income. This mainly reflected both an increase in net revenues from foreign direct investment in Q4 and an upward revision of historical figures for the first three quarters of the year. Net interest income also increased between years, concurrent with improvements in Iceland's external position and interest rate hikes abroad. The large current account surplus and increased national saving over the past decade have caused a turnaround in Iceland's net external position, which was positive by about 4% of GDP at the end of 2018 (Chart IV-21).



**... and is expected to narrow further this year**

The surplus on goods and services trade is projected to narrow still further this year, to 1.9% of GDP, about 0.7 percentage points above the February forecast, reflecting the offsetting impact of poorer terms of trade and a more positive contribution of net trade to output growth. The current account surplus is expected to narrow as well, to 1.3% of GDP. If the forecast materialises, gross national saving will decline from 25.5% of GDP in 2018 to 23.3% this year, which is nevertheless more than 4 percentage points above the twenty-five-year average.