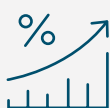


Monetary Bulletin in a nutshell



Global GDP growth lost pace in Q4/2020, after the resurgence of the COVID-19 pandemic, and indicators imply that it turned negative again in Q1/2021. Iceland's trading partners' economic activity has proven stronger than was forecast in the February *Monetary Bulletin*, however, and the outlook for 2021 has improved. Vaccination efforts are moving forwards, and substantial fiscal stimulus in the US will support the economic recovery all over the world.



In Iceland, GDP grew more between Q3 and Q4/2020 than was assumed in the Bank's February forecast. Furthermore, the contraction in the first three quarters of 2020 turned out smaller than previous estimates had indicated. The contraction in GDP over the year as a whole was therefore smaller than anticipated, or 6.6% instead of the 7.7% provided for in the February forecast. Moreover, the outlook for this year has improved, owing primarily to indications of stronger growth in private consumption. Offsetting this, infection rates are still rising rapidly in many parts of the world, and tourism is now expected to recover more slowly than previously forecast. GDP growth is projected at 3.1% in 2021, as compared with the February forecast of 2.5%. As in February, GDP is expected to grow just over 5% in 2022 but ease again in 2023.



Unemployment has begun to taper off after peaking in January, and indicators imply continuing growth in labour demand. Registered unemployment excluding recipients of part-time benefits is forecast to average just over 9% this year and gradually subside over the forecast horizon, although it will still be above the pre-pandemic rate at the end of the forecast period. The slack in output that opened up in the wake of the pandemic is estimated to have peaked at the end of 2020. Even so, it is smaller than was estimated in the February forecast and is now expected to close late in 2022, about a year earlier than was forecast in February.



Inflation picked up in H2/2020 and measured 4.2% in Q1/2021. It rose still further in April, reaching 4.6%, the highest inflation rate since early 2013. It has therefore been above the upper deviation threshold of the inflation target for all of 2021 to date. Inflation is higher than was forecast in February and has systematically exceeded forecasts ever since the pandemic struck. Domestic demand has withstood the shock better than expected, and oil and other commodity prices have risen faster than previously assumed. Cost increases due to pandemic-related supply disruptions have also been underestimated. Inflation is now expected to measure 3.8% in Q4/2021 and will not return to the target until mid-2022, about half a year later than was forecast in February.



To a large extent, economic developments will depend on how successful efforts to control the pandemic prove to be, both in Iceland and elsewhere. As in February, a majority of the local population is expected to be vaccinated by mid-2021. For the most part, the current public health measures within Iceland are assumed to remain in place through mid-year, whereupon they will gradually be relaxed. As in February, the measures currently in place at the border are expected to remain broadly unchanged through the end of Q3, but with increased exemptions, depending on the state of the pandemic in tourists' country of origin. All of these assumptions are highly uncertain, however, and economic developments will depend to a large degree on how successful efforts to control the pandemic prove to be.