

CENTRAL BANK OF ICELAND



2022 | 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 one of its main objectives. 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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Statement of the Monetary Policy Committee 24 August 2022

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to raise the Bank's interest rates by 0.75 percentage points. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 5.5%.

According to the updated macroeconomic forecast, published in the August *Monetary Bulletin*, GDP growth looks set to measure nearly 6% this year, some 1.3 percentage points above the May forecast, owing mainly to more robust private consumption growth and a more rapid rebound in tourism than was projected then. Job numbers continue to rise and unemployment to fall, and a wider positive output gap has developed in the domestic economy than was estimated in May.

The inflation outlook has continued to deteriorate. Inflation rose to 9.9% in July and is forecast to peak at nearly 11% late this year. The bleaker inflation outlook reflects stronger economic activity than was forecast in May, as well as more persistent house price inflation and higher global inflation. In addition, inflation expectations have risen even further by most measures.

The MPC considers it likely that the monetary stance will have to be tightened even further so as to ensure that inflation eases back to target within an acceptable time frame. Near-term monetary policy decisions will depend on developments in economic activity, inflation, and inflation expectations. Decisions taken at the corporate level, in the labour market, and in public sector finances will be a major determinant of how high interest rates must rise.

Symbols:

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

Icelandic letters:

ð/Ð (pronounced like th in English this)

þ/Þ (pronounced like th in English think)

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

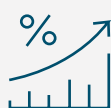
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Monetary Bulletin in a nutshell



Global GDP growth has slowed since mid-2021, and pessimism about the economic outlook has increased despite the recent decline in oil and commodity prices and reduced strain on global supply chains. Inflation has risen worldwide, and more rapidly than previously anticipated. The outlook is for GDP growth among Iceland's main trading partners to be weaker in 2022 and 2023 than was forecast in the *May Monetary Bulletin*, and for inflation to be higher and more persistent than was assumed then.



In spite of the bleaker global outlook, Iceland's GDP growth prospects have improved since the May forecast. Preliminary national accounts figures suggest that economic activity was stronger in Q1/2022 than had been assumed in May, primarily because of robust growth in household consumption. There are also signs of continued strong private consumption in Q2, and it appears that households have drawn down their savings faster than was assumed in the Bank's previous forecast. Furthermore, tourist visits to Iceland increased more rapidly this summer than previously forecast, and domestic firms appear to have been more successful in resolving the supply chain problems that developed in the wake of the war in Ukraine. GDP growth is forecast at 5.9% this year, some 1.3 percentage points above the May forecast. As in May, GDP growth is projected to measure around 2% per year in 2023 and 2024.



Job numbers continued to rise in Q2, and average hours worked rose year-on-year for the first time since 2019. Total hours worked rose by 9.1% year-on-year, the steepest increase in the history of Statistics Iceland's labour force survey (LFS). Unemployment kept falling, and the share of firms considering themselves understaffed is at its second-highest ever.



Inflation has risen still higher, climbing to 9.9% in July. Although the surge in the housing component of the CPI and in global oil and commodity prices weighs heavily, inflation remains widespread: inflation excluding housing measures 7.5%, and underlying inflation is 6.5%. Inflation expectations have also continued to rise by most measures. Inflation is forecast to move still higher, to 10.8% in Q4, and then subside gradually. The inflation outlook has therefore deteriorated yet again, reflecting considerably stronger growth in domestic demand than was projected in May, the prospect of a slower easing of house price inflation, and a bleaker inflation outlook for Iceland's main trading partners.



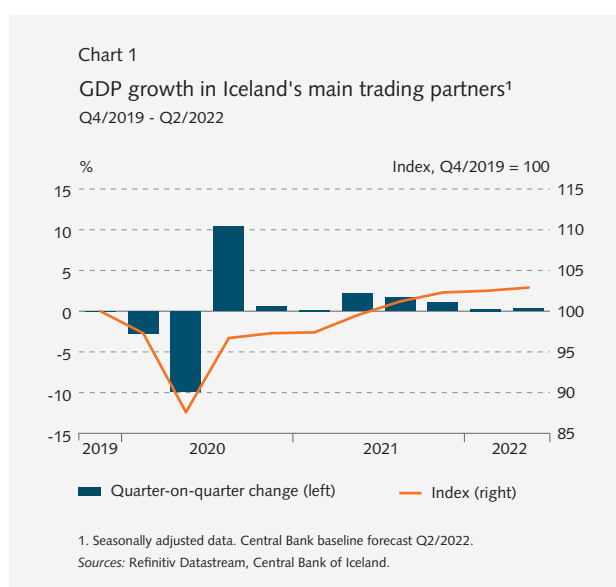
Economic uncertainty has escalated due to the war in Ukraine. The war has upended global commodity markets and thrown trade relationships and supply chains into disarray. It is difficult to predict how deep and protracted these effects will be, and the outlook could deteriorate even more if natural gas imports from Russia to Europe are shut off. Furthermore, household sentiment in Iceland and abroad has deteriorated in the wake of the invasion, and it is difficult to assess the extent to which increased pessimism will affect consumers' spending decisions later this year and into 2023. The inflation outlook as depicted in the Bank's forecast could also prove overly optimistic, particularly if companies pass higher costs through to prices to an increasing degree and if a wage-price spiral develops, potentially causing high inflation to become even more firmly entrenched.

The analysis appearing here is based on the Bank's assessment of economic developments since the publication of *Monetary Bulletin* 2022/2 in May 2022, 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.

Economic developments and updated forecast

The global economy

Among Iceland's main trading partners, GDP grew by 0.3% quarter-on-quarter in Q1/2022. Although this is far weaker growth than in the quarters beforehand, it is in line with the Bank's May forecast.



Although GDP growth in the euro area exceeded expectations in Q2, the outcome for trading partner growth during the quarter appears to have been weaker on average than was forecast in May, and the outlook for all trading partner countries have deteriorated since the spring. To a large extent, the poorer outlook is due to the effects of the continued rise in global inflation, but worsening financial conditions are a factor as well. Households' real disposable income has declined even further with the rise in the cost of living, which has slowed growth in domestic demand. Households in major advanced economies have never been as pessimistic about the economic outlook as they are now. Increased uncertainty, rising borrowing costs, and high input costs also weaken companies' appetite for investment.

On the other hand, households' significant accumulated savings provide a cushion against the effects of the rising cost of living on domestic demand. Furthermore, conditions in the labour market have improved in major advanced economies, and there are signs that strain on global supply chains has eased once again following the setback brought on by the war in

Ukraine and re-tightening of public health measures in China. Disruptions in manufacturing are still common, however, and it is uncertain how quickly global supply chains will return to normal.

The economic outlook has deteriorated most especially in Europe because of the repercussions of the war in Ukraine. The price of natural gas has risen sharply on the Continent this summer as supplies from Russia were cut back further, and uncertainty about supply over the coming winter has increased. The price has more than doubled since May and is about five times higher than in August 2021. As a result, global economic uncertainty remains pronounced and will depend to a large extent on developments in and consequences of the war. The outlook could grow even bleaker if energy imports to Europe are curtailed further. Inflation could then prove more persistent, and financial conditions could deteriorate even more.

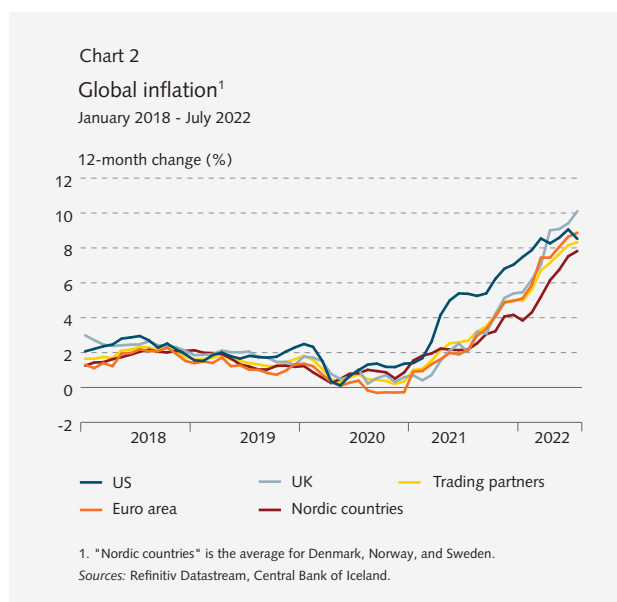
According to the Bank's baseline forecast, year-2022 GDP growth among Iceland's main trading partners is projected at 2.9%, some 0.2 percentage points below the May forecast. Trading partner GDP growth is expected to soften further in 2023, measuring only 1.2%, or just over 1 percentage point below the May forecast. Weaker output growth is also expected for 2024.

Global inflation

Trading partner inflation has risen higher than was forecast in May and is now at a forty-year high. As before, higher inflation is due in large part to rising energy prices, although food prices have surged as well. Underlying inflation has also risen since May, not least because of services prices, which have risen alongside increased demand following the relaxation of public health measures.

The inflation outlook has deteriorated for all of Iceland's trading partners since the spring – particularly in Europe, owing to the aforementioned rise in natural gas prices. On the other hand, because of the weaker global economic outlook, the rise in the price of oil and other commodities reversed more quickly this summer than was forecast in May. Agricultural commodity prices have also fallen, owing to better-than-expected harvests and greater optimism about exportation of wheat and

other agricultural products from Ukraine. Furthermore, shipping costs have tapered off from their peak, and strain on supply chains has eased somewhat.



Trading partner inflation is projected to average 7.1% in 2022, or 1.3 percentage points above the May forecast. For 2023, it is forecast at 3.8%, more than 1 percentage point higher than was assumed in May. According to the forecast, trading partner inflation will not reach 2% until 2024.

Global interest rates

Central banks in most advanced economies have tightened their monetary stance further and faster in response to the ever-worsening inflation outlook and increasingly tight labour markets. The US Federal Reserve raised its key interest rate by 0.75 percentage points twice this summer, bringing the total increase since the beginning of May to 2 percentage points. The European Central Bank (ECB) discontinued its net bond purchases in July and raised its key interest rate by 0.5 percentage points. Not only was this a larger increase than generally expected, it was the ECB's first rate hike in over a decade. The Bank of England has also raised rates, by a total of 1 percentage point since the beginning of May.

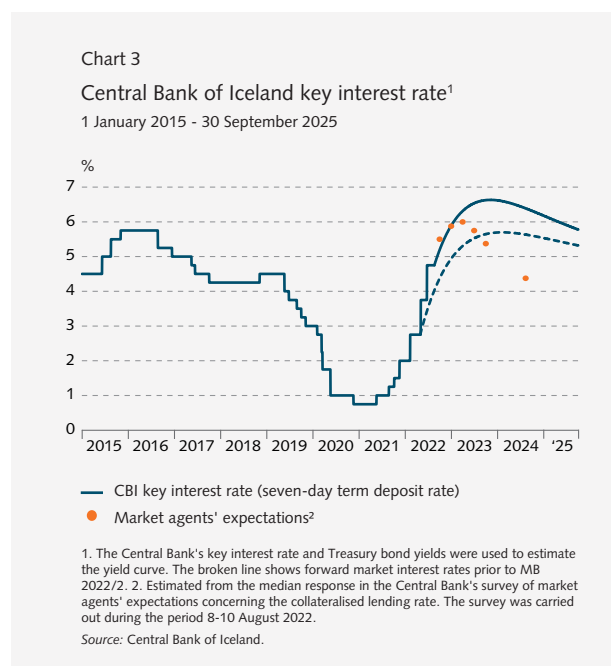
Market agents expect central banks to raise interest rates higher and faster than they expected in May. Nevertheless, long-term government bond yields have fallen since mid-summer. This may reflect increased concerns about the economic outlook, but it could also indicate lower inflation expectations in view of widespread monetary tightening.

Terms of trade

Terms of trade for goods and services are expected to improve by 1.9% this year, slightly less than was assumed in May. The outlook is for a larger rise in the price of exports – particularly marine product and various other goods exports – owing to abrupt increases in H1. This is offset, however, by considerably larger rises in import prices. On the other hand, terms of trade are not expected to deteriorate as much in 2023 and 2024 as was forecast in May.

Domestic interest rates

At its May and June meetings, the Central Bank Monetary Policy Committee (MPC) decided to raise the Bank's key interest rate (the rate on seven-day term deposits) by 1 percentage point both times. The key rate was 4.75% prior to the publication of this *Monetary Bulletin*. Even though the Bank's nominal interest rates have increased by 2.75 percentage points this year, the real rate has declined marginally in 2022 to date, as higher inflation and inflation expectations have offset the nominal rate hikes. Based on the average real rate as calculated from various measures of inflation and one-year inflation expectations, the Bank's real rate is currently -2.3%. Both the Central Bank's market expectations survey and forward interest rates suggest that rates are expected to keep rising and to peak in 2023.

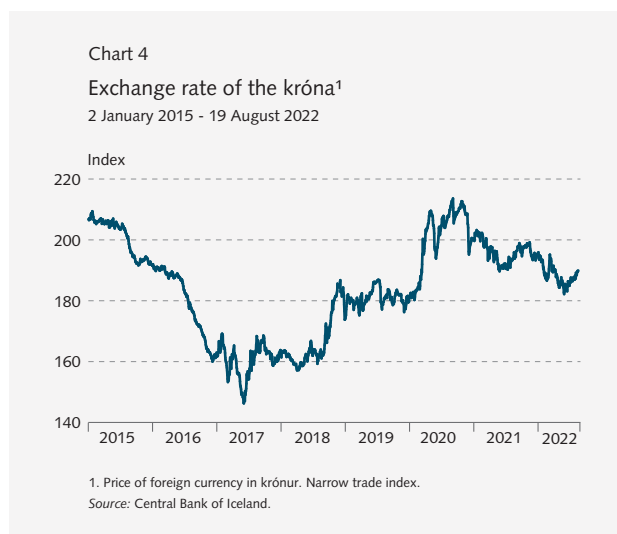


The yield on ten-year nominal Treasury bonds was 5.3% just before this *Monetary Bulletin* was published. Yields started rising steeply in 2021 and have continued

upwards this year. A large share of the rise in long nominal yields is due to the increase in the breakeven inflation rate, although the breakeven rate has fallen somewhat since June. Inflation-indexed yields have risen over the same period, and five-year indexed yields are now 1.3%, after having hovered around 0% ever since mid-2020.

Exchange rate of the króna

The exchange rate of the króna has fallen by 3% in trade-weighted terms since the *May Monetary Bulletin* but is 3% higher than at the beginning of the year. Foreign exchange market transactions in connection with new investment have been limited in recent months, but the pension funds have stepped up their foreign currency purchases. Net foreign currency inflows due to payment card use have been stronger so far this summer than they were at the same time in 2021, and forward currency sales are still significant. The króna is a full 2% stronger now than was assumed in the May forecast, but according to the current baseline forecast it will remain broadly stable throughout the forecast horizon.



Money holdings and lending

Annual growth in M3 averaged about 11½% in H1/2022. Growth in corporate deposits has continued to gain pace, but household deposit growth has been flat.

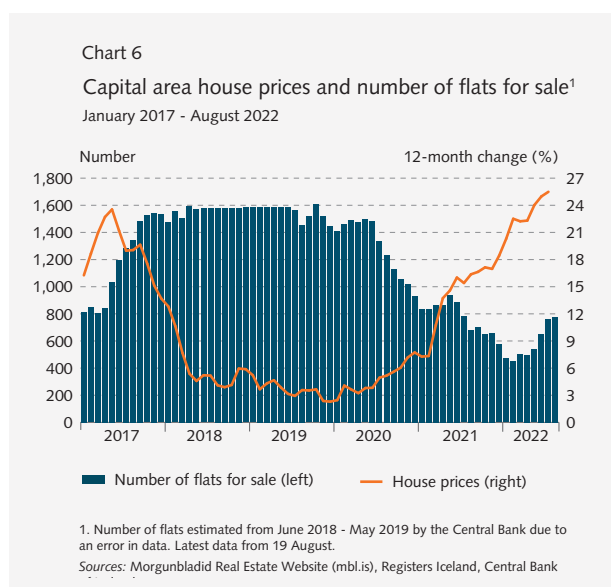
Growth in credit system lending to households is still strong, although the pace of the increase has eased marginally since mid-2021. Year-on-year growth in corporate lending started to gain steam in March, after having contracted in 2021. Since then, the pace has accelerated to more than 5% in June. Lending to nearly all sectors has grown, although the increase is greatest in lending to companies in construction and services.



Interest rates on non-inflation-indexed mortgages and rates on corporate loans have continued to rise in tandem with the increase in the Central Bank's key rate.

Asset prices

House price inflation has not lost steam in spite of interest rate hikes and tightening of borrower-based measures. Capital area house prices were up by 25.5% year-on-year in July, the largest increase between years since December 2005. The number of properties on the market has increased in the past three months, however, and the supply of new homes looks set to grow in the coming term. Furthermore, the average time-to-sale appears to be growing longer, although it is still very short. The Bank's baseline forecast assumes

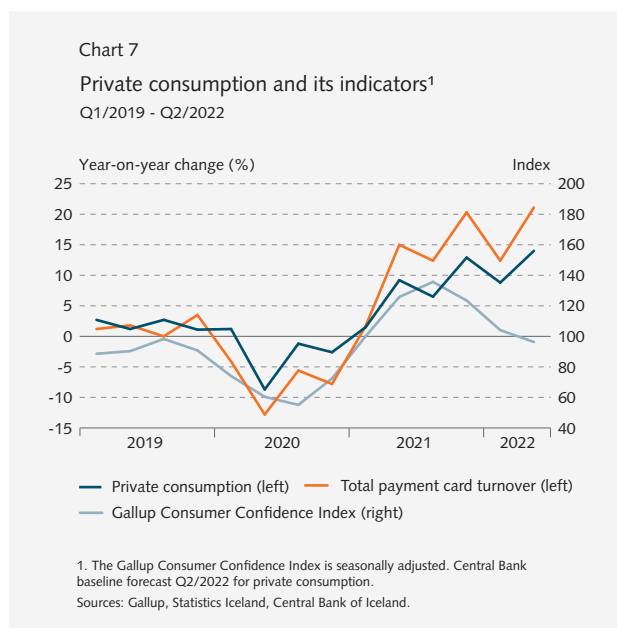


that house price inflation will subside over the course of 2023.

The Nasdaq Iceland OMXI10 index has fallen markedly in 2022 to date. It is now lower than at the time of the *May Monetary Bulletin* despite the upturn in share prices in July, both in Iceland and in many foreign markets.

Private consumption

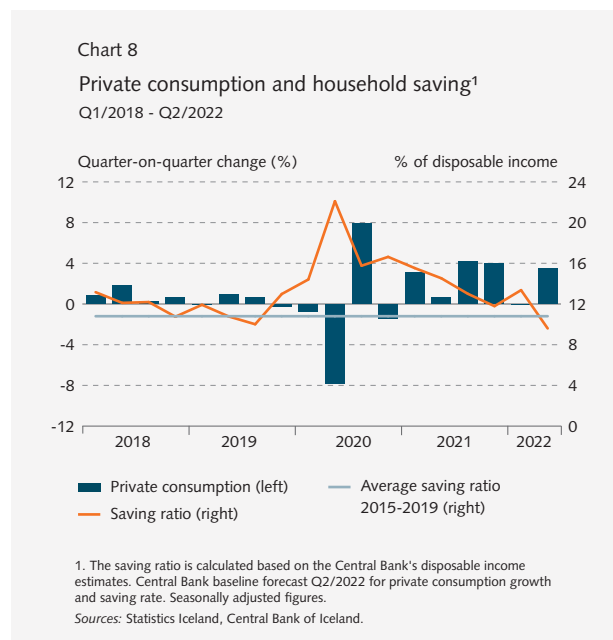
According to preliminary data from Statistics Iceland, seasonally adjusted private consumption contracted by 0.1% quarter-on-quarter in Q1/2022, after growing strongly in the two quarters beforehand. The contraction was smaller than had been forecast in May, however, reflecting, among other things, unexpectedly strong payment card turnover in March. Households' new motor vehicle purchases also surged in March, presumably in response to tax concessions for eco-friendly car purchases concurrent with steeply rising petrol prices due to the war in Ukraine. Households' consumption spending therefore grew by 8.8% year-on-year in Q1, well above the 3.8% increase forecast in May.



Indicators also suggest that private consumption remained strong in Q2. A major driver of the trend was the marked increase in overseas travel during the spring and summer, although the continued surge in consumption spending in Iceland was a factor as well, as can be seen, for instance, in the strong growth in payment card turnover and an even larger increase in new motor vehicle registrations.

Private consumption is estimated to have increased by 14% year-on-year in Q2, far more than was fore-

cast in May. Therefore, households appear to have drawn down their savings more rapidly than previously assumed, but as has been discussed previously in *Monetary Bulletin*, how much and how quickly they would cut back on saving or tap excess savings accumulated during the pandemic has been highly uncertain.



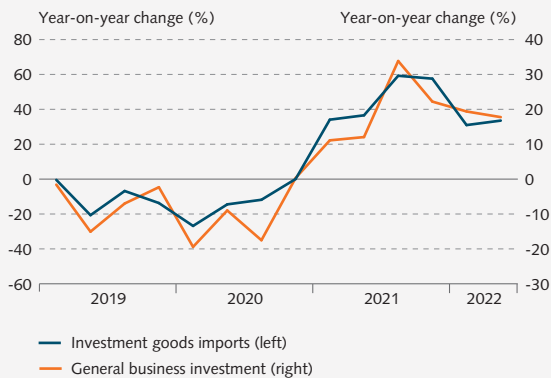
Because of robust growth in H1, the outlook is for private consumption growth in 2022 as a whole to exceed the previous forecast. It is expected to measure 7.2% this year and not 3.1%, as was projected in May. On the other hand, the pace of growth is expected to ease in H2, as inflation has risen swiftly and financial conditions have grown tighter. As a consequence, households are now more pessimistic about the economic outlook than they were earlier in the year. The outlook is also for weaker private consumption growth in 2023 than was forecast in May.

Investment

Investment grew by 20.3% in Q1/2022, which is in line with the May forecast. Growth in business investment was slightly above the forecast, while residential investment growth turned out below it. Investment goods imports and other leading indicators suggest that general business investment (i.e., excluding energy-intensive industry, ships, and aircraft) turned out stronger in Q2 than was forecast in May. Furthermore, there are signs that the uncertainty about investment plans that developed in the wake of Russia's invasion of Ukraine has receded, and that efforts to resolve supply chain issues have been more successful than was assumed in May.

Chart 9

Investment goods imports and investment¹
Q1/2019 - Q2/2022



1. Imported investment goods and transport equipment for commercial use (excluding ships and aircraft). Business investment excluding energy-intensive industry and ships and aircraft. Figures for Q2 are estimated.

Sources: Statistics Iceland, Central Bank of Iceland.

It is now assumed that growth in general business investment will measure 15.3% in 2022, more than 4 percentage points above the May forecast. Total investment is projected to grow by 9.1% in 2022, over 2 percentage points more than in the last forecast. Increased aircraft imports and strong general business investment weigh heavily in this forecast, although they are offset by a poorer outlook for investment in energy-intensive industry. The outlook for 2023 has improved as well.

Public sector finances

Public sector operations showed a deficit of 2.4% of GDP in Q1/2022, but the outcome has improved markedly in the recent term, owing to the withdrawal of the Government's pandemic-related support measures, an increase in economic activity, and a substantial increase in dividend payments from State-owned financial institutions. Furthermore, public sector demand declined alongside the reduction in the deficit during the quarter. Public consumption and investment increased by a combined 1.5% year-on-year in Q1, about half the rate generally seen in the recent term. Growth in both public consumption and public investment eased during the quarter, as State investment contracted while municipal investment grew.

For 2022 as a whole, the outlook is for public sector demand to grow by 2%, marginally more than in the May forecast, with stronger investment offsetting marginally weaker growth in public consumption. On the other hand, the outlook is for weaker growth in 2023, owing to a change in the fiscal plan prepared this summer. Along with other measures aimed at strengthening

the Treasury outcome, the change to the fiscal plan entails less State investment in 2023 than was previously envisioned.

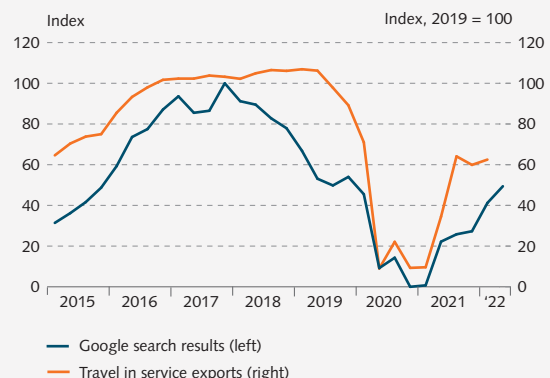
Exports of goods and services

According to preliminary figures from Statistics Iceland, total exports grew by 28.3% year-on-year in Q1/2022, or roughly 1 percentage point below the May forecast. As before, the surge in exports is due largely to the recovery of the tourism industry. Newly published external trade figures indicate, however, that Q1 marine product exports were more sluggish than previously estimated and that growth in total exports was therefore about 4 percentage points weaker during the quarter than preliminary national accounts data had indicated.

The Omicron variant of COVID-19 hampered the recovery of tourism at the beginning of the year, but tourist arrivals grew strongly over the course of Q2, when flight availability to and from Iceland increased and the US authorities stopped requiring COVID test results for passengers entering the country. A total of 870,000 tourists visited Iceland in the first seven months of 2022, and July arrivals exceeded the total for the same month in 2019. As a result, the outlook is for an even stronger recovery than was assumed in May, with tourism-generated export revenues set to exceed the May forecast. The outlook for this autumn has also improved. Google searches for flights to Iceland and accommodation in the country have continued to increase in number, and the volcanic eruption in Meradalir has piqued travellers' interest in Iceland as a destination.

Chart 10

Google searches and travel to Iceland¹
Q1/2015-Q2/2022



1. Search results are based on a factor model combining the frequency of five different Google search strings relating to travel to Iceland. Travel exports at constant prices. Seasonally adjusted figures.

Sources: Google Trends, Statistics Iceland, Central Bank of Iceland.

Just under 1.7 million tourists are expected to visit Iceland this year, whereas the May forecast assumed a total of 1.4 million. The war in Ukraine and the worsening global inflation and growth outlook are still expected to make their mark on prospects for 2023, but nearly 1.9 million tourists are expected to visit Iceland that year, as opposed to the 1.7 million provided for in the May forecast.

Offsetting the improved outlook for year-2022 services exports is the bleaker outlook for goods exports, which is due largely to a revision of previously published numbers for Q1 but also to reduced farmed salmon production in Q2 because of a viral infection in East Iceland. Total exports look set to grow by 16.4% in 2022, broadly as was forecast in May. The outlook for 2023 is also in line with the May forecast, with a small contraction in goods exports offsetting the continued rebound in tourism.

Current account balance

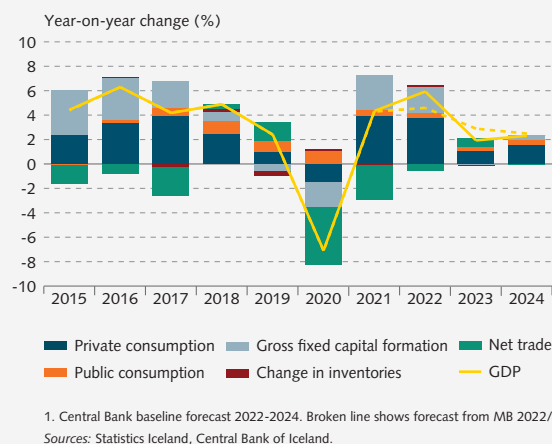
The outlook is for nearly 17% growth in imports this year, well above the May forecast of just over 12%. The increase is due mainly to the expectation of much stronger growth in services imports, which in turn is due to increased spending by Icelanders abroad, as overseas travel has grown faster this spring and summer than was forecast in May. Furthermore, other services imports have grown more strongly than previously projected. On the other hand, the outlook for goods imports is similar to the May forecast.

The current account deficit in Q1 was larger than was assumed in May, at 5.9% of GDP, due to an underestimation of services imports and a larger deficit on primary income. The outlook is for a deficit of 3.7% in 2022 as a whole, nearly 3 percentage points more than previously estimated. The difference is due largely to the prospect of stronger import growth, while a weaker improvement in terms of trade is also forecast. In addition, the outlook is for a larger deficit in primary and secondary income than was previously expected, mainly as a result of stronger returns at foreign-owned domestic companies. The outlook for the next two years has also deteriorated.

GDP growth

According to preliminary figures from Statistics Iceland, GDP grew by 1.1% quarter-on-quarter in Q1/2022, and by 8.6% relative to Q1/2021. The year-on-year increase is larger than was forecast in May, mainly because

Chart 11
GDP growth and contribution of underlying components 2015-2024¹



domestic demand turned out stronger than previously projected, although it was offset by a more negative contribution from net trade. Because of the aforementioned overestimation of marine product exports in Q1, however, it is likely that GDP growth for the quarter is overestimated by approximately 1 percentage point in the preliminary national accounts data.

It appears that domestic demand growth exceeded expectations in Q2 as well, driven largely by a strong increase in private consumption. Year-on-year GDP growth for the quarter is estimated at 7.7%, although the growth rate is expected to ease in H2. GDP growth is forecast at 5.9% for 2022 as a whole, up from 4.6% in the May forecast. It is expected to subside to about 2% over the next two years, however.

Chart 12
Employment and hours worked¹
Q1/2006 - Q2/2022



Employment and unemployment

According to the Statistics Iceland labour force survey (LFS), job numbers rose 8.3% year-on-year in Q2, and average hours worked increased between years for the first time since 2019. Total hours worked therefore rose by 9.1% year-on-year, marginally above the May forecast but the steepest increase in the history of the LFS. The labour participation rate is back to its historical average after rising sharply in the recent term. It fell marginally quarter-on-quarter, but because the employment rate remained flat, unemployment declined relative to Q1. Seasonally adjusted unemployment according to the LFS measured 3.3% in Q2, or 0.7 percentage points lower than in the previous quarter. Registered unemployment measured 3.7% after adjusting for seasonality, about the same as in mid-2019.

According to Gallup's summer survey among Iceland's 400 largest firms, respondents plan to add even more staff in the next six months, and according to Statistics Iceland's corporate survey, job vacancies rose by just over 5,000 quarter-on-quarter in Q2. Jobs appear to be filled to some extent with imported workers, as net immigration of foreign nationals was positive by 3,510 during the quarter. This is the largest number of immigrants coming to Iceland since Statistics Iceland began publishing the data.

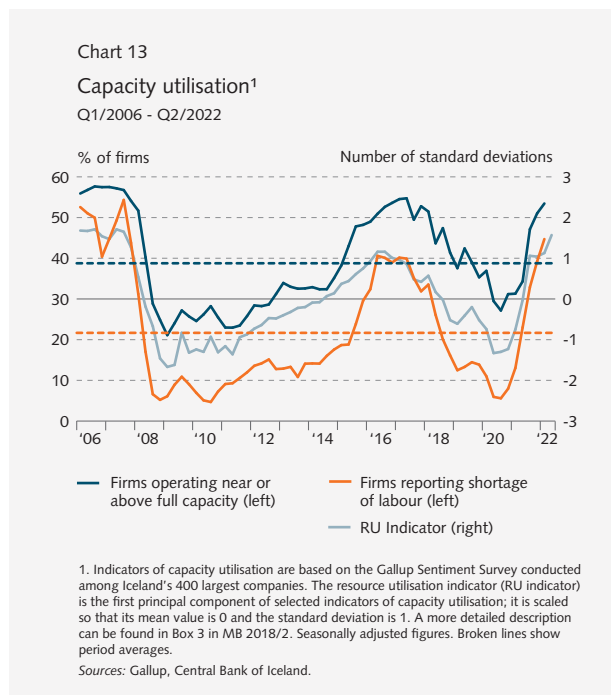
Unemployment is projected to average 3.8% this year and then inch upwards to just over 4%, the rate considered consistent with price stability, later in the forecast horizon.

Resource utilisation

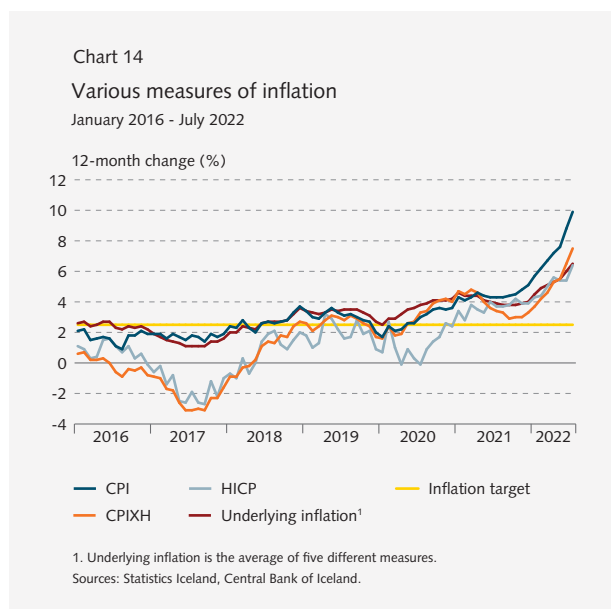
According to the seasonally adjusted results of Gallup's summer survey, 54% of corporate executives consider themselves short-staffed. Only once has this ratio been higher. In addition, an all-time record of just over 60% of respondents reported that their firms would have difficulty responding to an unexpected increase in demand. The resource utilisation (RU) indicator, which combines various indicators of factor utilisation, therefore rose between quarters and is now at its highest since mid-2007. Thus, there are clear signs that an output gap is opening up. It is expected to peak this year at around 1.5% of capacity, which is more than the Bank forecast in May.

Inflation

Headline inflation has risen rapidly in recent months. It averaged 7.9% in Q2/2022, as compared with the



forecast of 7.5% in the *May Monetary Bulletin*. In July, the CPI rose by 1.17% month-on-month, pushing inflation up to 9.9%, Iceland's highest inflation rate since September 2009. Inflation excluding housing has also risen rapidly, measuring 7.5% in July, and underlying inflation has risen as well, to 6.5%.



As before, rising house prices are the main driver of higher inflation, although the relative contribution of the housing component to the headline inflation rate has held steady. The price of goods and services has also risen somewhat. In July, private services prices were up 8.5% year-on-year, owing in large part to a surge in

airfares in the wake of increased air travel and higher fuel prices.

Domestic goods prices have risen by 8.7% in the past twelve months, with food prices weighing heaviest. Fuel prices continued to climb rapidly in early summer, prompted by soaring global oil prices, and were 41% higher in July than in the same month of 2021. On the other hand, the year-on-year rise in imported goods prices eased marginally in July, to 6.6%, owing in part to stronger effects from summer sales than in 2021.

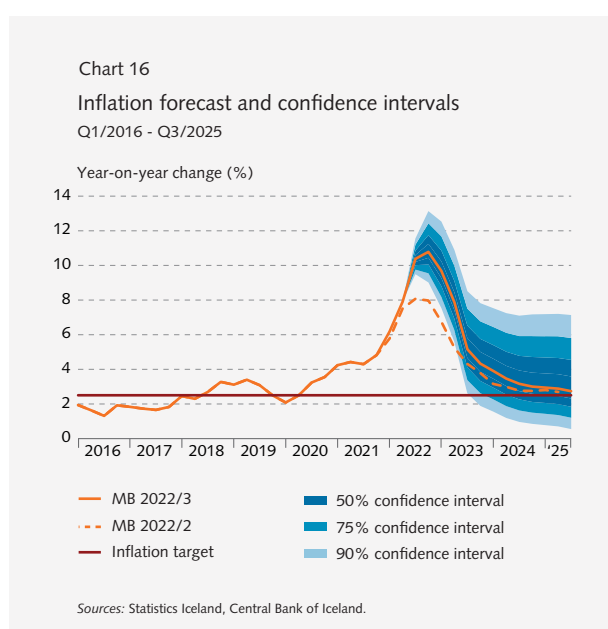
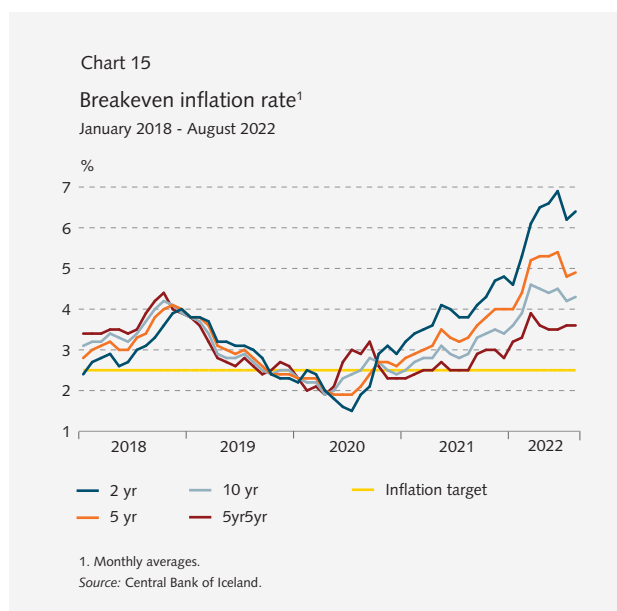
The general wage index rose by 8.4% year-on-year in Q2, some 0.8 percentage points more than in Q1, as the clause in wage agreements providing for a supplemental pay rise based on last year's GDP growth was triggered in April. As in the May forecast, wages are projected to rise by roughly 7% between annual averages in 2022, and by an average of 5½% in the two years thereafter.

Surveys suggest that inflation expectations have risen by nearly all measures since the last *Monetary Bulletin*. The results of Gallup's summer surveys, conducted in May and June, indicated that both households and corporate executives expect inflation to measure 5% in two years' time. Corporate respondents expected it to average 4% over the next five years, whereas households projected that it would average 5% over the same period. According to the Central Bank's market expectations survey, carried out in early August, respondents expect inflation to measure 4% two years ahead and then average 3.8% over the next five years and 3.5% over the next ten years. Market agents' long-term inflation expectations have therefore continued to rise. On the other hand, the five- and ten-year break-

even inflation rate in the bond market has fallen since June, while the five-year breakeven rate five years ahead was broadly unchanged at 3.6% in mid-August.

The inflation outlook

Inflation has been unexpectedly high in the recent past, and the outlook has deteriorated yet again: inflation is expected to measure 10.4% in Q3 and rise to 10.8% in Q4. The bleaker inflation outlook reflects the fact that economic activity has been stronger than was assumed in May, and the output gap is now forecast to be wider than was forecast then. By the same token, house prices have risen more than previously anticipated, various tourism-related items have increased more than expected, and global inflation has been markedly higher. This is partially offset by the recent decline in oil and commodity prices, however. Inflation is forecast to peak at the end of this year and then subside as the housing market cools, the effects of global price hikes taper off, and the output gap in the domestic economy narrows. Inflation is projected to average 6.7% in 2023 and not fall below 4% until early 2024, but it is expected to be close to target at the end of the forecast horizon.



Appendix

Forecast tables

Table 1 Key economic variables¹

	2020	2021	2022	2023	2024
Private consumption	-2.9 (-2.9)	7.6 (7.6)	7.2 (3.1)	2.0 (3.0)	2.8 (2.7)
Public consumption	4.2 (4.2)	1.8 (1.8)	1.7 (1.9)	1.5 (1.7)	1.6 (1.7)
Gross capital formation	-9.5 (-9.5)	13.6 (13.6)	9.1 (6.9)	-0.1 (-0.5)	1.9 (3.1)
Business investment	-16.4 (-16.4)	23.1 (23.1)	11.9 (9.5)	-4.1 (-5.3)	-0.3 (1.8)
Residential investment	1.2 (1.2)	-4.4 (-4.4)	5.9 (5.5)	14.3 (13.7)	7.8 (7.8)
Public investment	-2.2 (-2.2)	12.4 (12.4)	4.2 (0.3)	-6.0 (-3.5)	-0.3 (-0.1)
National expenditure	-2.4 (-2.4)	7.2 (7.2)	6.3 (3.5)	1.2 (1.9)	2.3 (2.5)
Exports of goods and services	-30.2 (-30.2)	12.3 (12.3)	16.4 (15.9)	5.3 (5.2)	3.9 (5.7)
Imports of goods and services	-21.6 (-21.6)	20.3 (20.3)	16.8 (12.4)	3.6 (3.5)	3.8 (5.7)
Gross domestic product (GDP)	-7.1 (-7.1)	4.3 (4.3)	5.9 (4.6)	1.9 (2.6)	2.3 (2.5)
GDP at current prices (ISK billion)	2,928 (2,928)	3,233 (3,233)	3,706 (3,645)	3,972 (3,869)	4,209 (4,083)
Contribution of net trade to GDP growth (percentage points)	-4.8 (-4.8)	-2.9 (-2.9)	-0.5 (1.1)	0.7 (0.8)	0.0 (0.0)
Exports of goods	-8.6 (-8.6)	7.6 (7.6)	1.5 (4.4)	-0.7 (-1.7)	2.1 (2.6)
Exports of services	-50.5 (-50.5)	20.3 (20.3)	40.6 (34.6)	13.5 (14.7)	5.8 (9.2)
Unemployment (LFS, % of labour force) ²	6.4 (6.4)	6.0 (6.0)	3.8 (4.3)	4.1 (4.2)	4.2 (4.2)
Registered unemployment (% of labour force) ³	7.9 (7.9)	7.7 (7.7)	3.8 (4.5)	3.9 (3.7)	4.1 (3.6)
Output gap (% of potential output)	-5.8 (-5.6)	-1.2 (-0.9)	1.5 (0.5)	0.7 (0.0)	0.0 (-0.3)
Current account balance (% of GDP)	0.8 (0.8)	-2.9 (-2.8)	-3.7 (-0.9)	-3.4 (-1.4)	-3.3 (-1.8)
Trade-weighted exchange rate index ⁴	201.0 (201.0)	196.1 (196.1)	188.7 (191.5)	189.8 (194.1)	189.7 (194.1)
Inflation (consumer price index, CPI)	2.8 (2.8)	4.4 (4.4)	8.8 (7.4)	6.7 (5.0)	3.4 (2.9)
Inflation in main trading partners ⁵	0.7 (0.7)	2.8 (2.8)	7.1 (5.8)	3.8 (2.5)	1.9 (1.9)
GDP growth in main trading partners ⁵	-4.9 (-5.0)	5.7 (5.6)	2.9 (3.1)	1.2 (2.3)	1.7 (1.9)

1. Year-on-year change (%) unless otherwise specified (figures in parentheses are from the forecast in MB 2022/2).

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		
2021:3	4.3 (4.3)	3.8 (3.8)
2021:4	4.8 (4.8)	5.9 (5.9)
2022:1	6.2 (6.2)	8.3 (8.3)
2022:2	7.9 (7.5)	13.7 (12.1)
Forecasted value		
2022:3	10.4 (8.1)	13.7 (6.0)
2022:4	10.8 (8.0)	7.5 (5.6)
2023:1	9.7 (6.7)	4.1 (3.5)
2023:2	7.9 (5.2)	6.4 (6.0)
2023:3	5.2 (4.3)	2.7 (2.3)
2023:4	4.3 (3.8)	4.2 (3.4)
2024:1	3.9 (3.2)	2.4 (1.0)
2024:2	3.5 (3.0)	4.6 (5.3)
2024:3	3.2 (2.8)	1.5 (1.4)
2024:4	3.0 (2.8)	3.5 (3.4)
2025:1	2.9 (2.8)	2.2 (1.2)
2025:2	2.9 (2.7)	4.4 (4.8)
2025:3	2.7	0.9

1. Figures in parentheses are from the forecast in MB 2022/2.

Sources: Statistics Iceland, Central Bank of Iceland.

