Demand and GDP growth

III

Domestic private sector demand

Private consumption grew strongly in Q4/2021 …

Households' consumption spending grew throughout 2021, picking up the pace in H2 (Chart III-1). Households continued to tap into the savings they had accumulated after the pandemic struck, and the saving ratio has edged closer to its pre-pandemic level. The composition of consumption spending has also begun to return to the pre-pandemic pattern, as spending in 2020 was strongly affected by the impact of public health measures on households' consumption options (Chart III-2).

Private consumption grew by 12.9% year-on-year in Q4/2021, the fastest rate since Q2/2005 and well in excess of the 11% provided for in the Bank's February forecast. For the year as a whole, it grew by 7.6%, as compared with the February forecast of 6.8%. In part, this sharp rebound in private consumption reflects strong base effects following the 2.9% contraction in the prior year, but it also reflects the impact of interest rate cuts, job creation, rising real wages, and greater optimism among households.

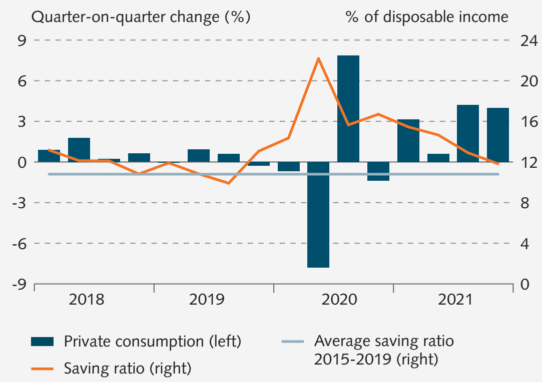
… but there are signs that growth eased in Q1/2022 …

COVID case numbers began to surge over the course of the autumn, and in mid-November public health measures were tightened again. In late February, though, all public health measures were lifted, both within Iceland and at the border, even though case numbers had continued to rise rapidly, as the harmful effects of the pandemic were diminishing. Even so, people appeared to have been cautious about resuming activities, owing both to widespread illness and to inclement weather. This can be seen in traffic data, which show reduced mobility in Q1/2022 relative to the same quarter in

Chart III-1

Private consumption and household saving[1]

Q1/2018 - Q4/2021

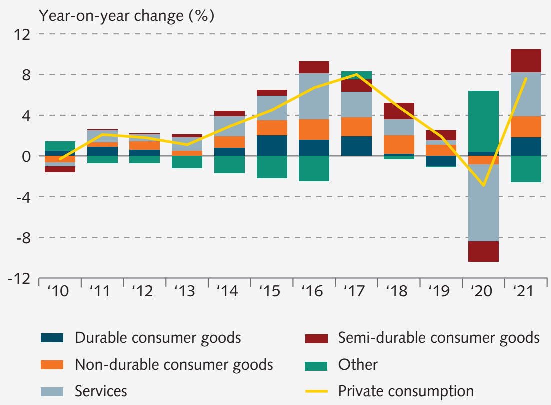


1. The saving ratio is calculated based on the Central Bank's disposable income estimates. Seasonally adjusted figures.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-2

Private consumption and contribution of components 2010-2021[1]



1. "Other" refers to activities of NGOs and Icelanders' spending abroad net of foreign tourists' spending in Iceland.

Sources: Statistics Iceland, Central Bank of Iceland.

2021. Payment card turnover within Iceland grew slowly as well, and total card turnover was driven by a surge in card use abroad (Chart III-3). This trend accords both with data from the Icelandic Centre for Retail Studies, which show a marked increase in card use at travel agencies, and with the Gallup index of planned overseas travel. New motor vehicle registrations (excluding car rental agencies) also suggest increased consumption spending, with new registrations rising by just under 16% year-on-year in the first two months of 2022. However, households appear less optimistic than they were last autumn, although they are still considerably more upbeat than they were in late 2020. The Bank's baseline forecast therefore assumes that private consumption grew by 3.8% year-on-year in Q1, or 0.4 percentage points more than in the February forecast, as public health measures were eased more rapidly than was projected at the time the forecast was prepared.

… and the outlook for 2022 as a whole has deteriorated since February

The outlook for private consumption growth in 2022 has deteriorated slightly relative to the February forecast. The war in Europe may prompt households to be more cautious about spending as the steep rise in inflation erodes their purchasing power. This is offset, however, by the high saving rate and the strong financial position of most households. Furthermore, the effects of higher energy costs on households' cost of living will be less pronounced here than in mainland Europe, as hydroelectric and geothermal power are used far more widely for home heating in Iceland than oil and natural gas are (see Box 2).

According to the baseline forecast, private consumption will grow by 3.1% in 2022, some 0.4 percentage points less than was projected in February (Chart III-4). This reflects the offsetting impact of stronger growth in Q1 versus the weaker outlook for the remainder of the year. Also at play are base effects from stronger private consumption growth in 2021. The outlook for the next two years is also bleaker than was assumed in February, with growth forecast at 3% in 2023 and 2.7% in 2024.

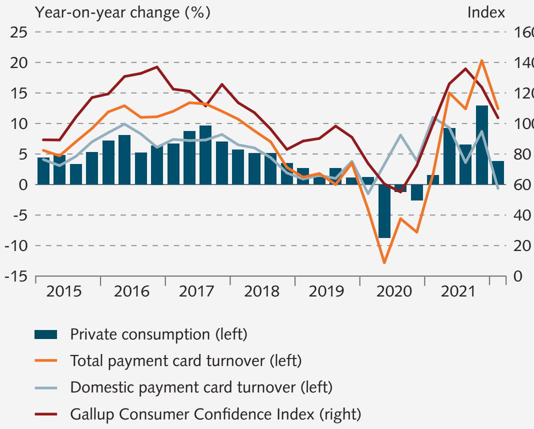
Business investment grew strongly in 2021 …

Business investment grew by 23.1% in 2021, after contracting in each of the three years beforehand. General business investment (excluding ships, aircraft, and energy-intensive industry) grew by 19.7% but the contribution from investment in ships and aircraft was sizeable as well (Chart III-5). Year-on-year growth

Chart III-3

Private consumption and its indicators[1]

Q1/2015 - Q1/2022

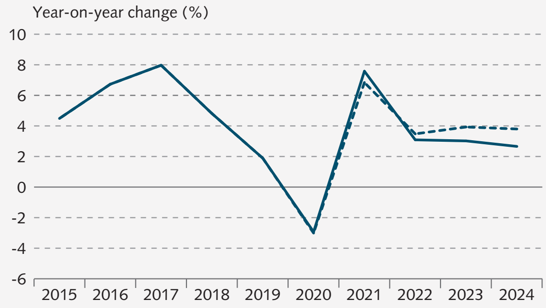


1. The Gallup Consumer Confidence Index is seasonally adjusted. Central Bank baseline forecast Q1/2022 for private consumption.

Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Chart III-4

Private consumption 2015-2024[1]



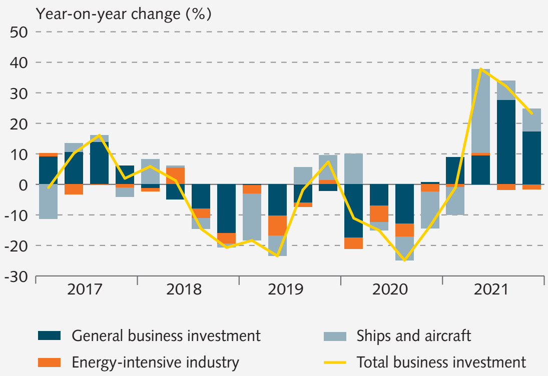
1. Central Bank baseline forecast 2021-2024. The broken line shows the forecast from MB 2022/1.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-5

Business investment and contribution of components

Q1/2017 - Q4/2021



Sources: Statistics Iceland, Central Bank of Iceland.

peaked in Q2, with the importation of a significant amount of aircraft to Iceland, while in H2 the contribution from general business investment increased. Growth in business investment was somewhat stronger in 2021 than had been assumed in the Bank's February forecast.

… and looks set to keep growing in 2022

It appears that investment was strong in Q1/2022 as well, even though indicators imply that the year-on-year pace eased relative to Q4/2021. Imports of generic investment goods increased less year-on-year in Q1/2022 than they did in Q1/2021 for example (Chart III-6). Furthermore, activity in the construction sector may well have been weaker than anticipated, owing to inclement weather.

According to the bank's survey of firms' investment plans, taken in February and March, business investment will increase in nominal terms by approximately 30% year-on-year in 2022 (Chart III-7). This is a far larger increase in investment spending than was indicated by a comparable survey taken in September. The survey results suggest that growth will extend to most sectors, although the contribution from tourism and transport will be strongest. The results of Gallup's February/March survey of Iceland's 400 largest firms imply as well that executives are optimistic about year-2022 investment. According to that survey, about a third of executives expect to invest more this year than in 2021, while only half as many expect to invest less this year.

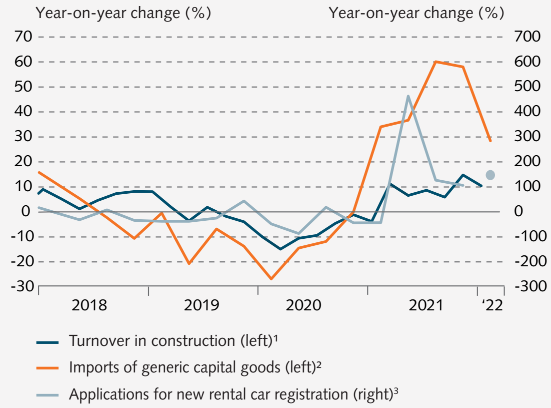
These surveys were conducted either before Russia invaded Ukraine or shortly after the invasion began, and it is uncertain what impact the invasion will have on businesses' investment plans (see Box 2). Some companies may postpone their investment plans due to increased uncertainty about domestic and foreign demand, rising input prices, or a shortage of inputs.

Nevertheless, indicators give cause to assume that business investment will be stronger in 2022 than was forecast in February. It is now expected to grow by 9.5 year-on-year, over 6 percentage points above the February forecast. General business investment is estimated to have increased by 12.7% in Q1, which is below the February forecast, but growth for the year as a whole is projected to be slightly stronger than was forecast in February, or 10.8%. Added to this is robust investment growth in the energy-intensive sector, which is estimated by companies in the industry at 43% year-on-year. Business investment is expected to contract less in 2023 than was assumed in the last forecast, but strong investment in ships and aircraft in 2022 will cause the investment-to-GDP ratio to decline between years.

Chart III-6

Indicators of general business investment

Q1/2018 - Q1/2022

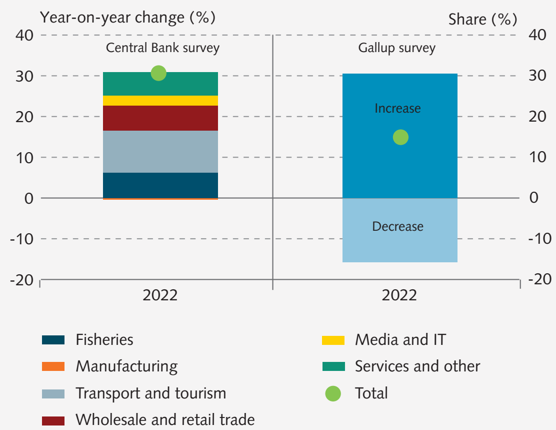


1. Total turnover in the construction sector. The data are according to two-month VAT periods and deflated with the building cost index. 2. Total value of imported capital goods and imported transport equipment excluding ships and aircraft, deflated with the exchange rate index. 3. The dot indicates an estimate for Q1.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-7

Indicators of investment plans in 2022[1]



1. Central Bank survey of firms' investment plans (excluding investments in ships and aircraft). Gallup survey of Iceland's 400 largest firms' investment plans. The chart shows the share of firms intending to increase investment and the share intending to decrease it.

Sources: Gallup, Central Bank of Iceland.

Residential investment to grow less in 2022 than was forecast in February

Residential investment contracted by 4.4% year-on-year in 2021, broadly as was forecast in February. Indicators imply that the pace of new construction has picked up in recent months, and a new tally taken by the Federation of Icelandic Industries and the Housing and Construction Authority shows that the number of properties in early stages of construction has risen since last autumn (Chart III-8). The outlook is uncertain because of the war in Ukraine, however, which has already caused steep rises in the price of inputs from Eastern Europe that are needed for the construction industry. In addition, shortages of important inputs could cause delays in construction activity. Added to this are executives' concerns about rising wages in the construction sector, according to Gallup's spring survey. The outlook for residential investment in 2022 is poorer than in the February forecast, with growth projected at 5.5% instead of the nearly 10% assumed in February. The outlook for the remainder of the forecast horizon is more favourable than in February, however. If the forecast materialises, the ratio of residential investment to GDP will have risen to 6½%, just over 2 percentage points above its twenty-five-year average, by the end of the forecast horizon.

Outlook for stronger investment growth over the forecast horizon than was projected in February

According to the baseline forecast, investment will be 6.9% higher this year than in 2021 (Chart III-9). For this year, it is driven mainly by an increase in general business investment and investment in the energy-intensive sector. This is offset by a contraction in investment in ships and aircraft, owing to base effects from strong imports in 2021. The outlook is for investment to grow more rapidly throughout the forecast horizon and for the investment-to-GDP ratio to rise to nearly 23% by the end of the period, or 1 percentage point above the February forecast.

Public sector

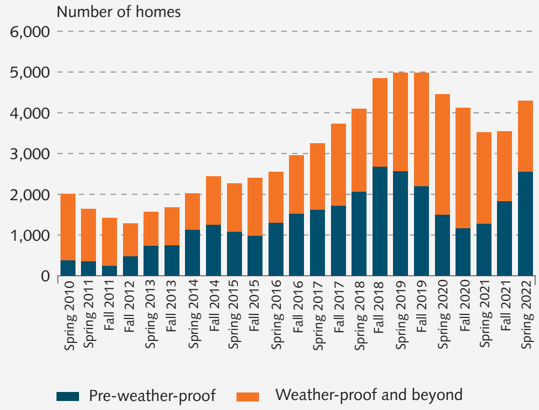
Modest growth in public sector demand over the forecast horizon

Public sector demand grew by just over 3% in 2021, owing to public consumption and investment in roughly equal measure. For 2022, demand growth is projected to ease to 1.6%, reflecting the expectation that investment will remain virtually flat year-on-year.

The share of public consumption and investment in GDP grew markedly in the wake of the pandemic. In

Chart III-8

Residential housing under construction in the capital area[1]

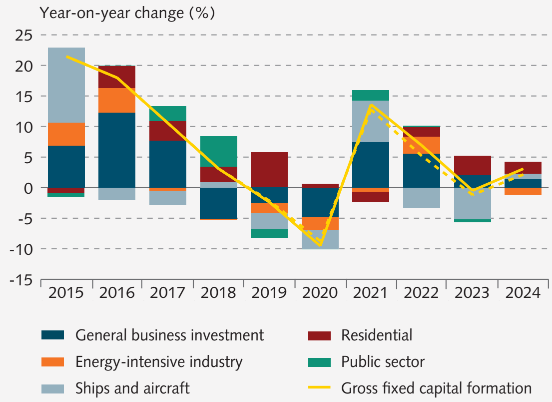


1. According to residential construction tallies conducted by the Federation of Icelandic Industries and the Housing and Construction Authority.

Sources: Federation of Icelandic Industries, Housing and Construction Authority.

Chart III-9

Gross fixed capital formation and contribution of main components 2015-2024[1]



1. General business investment excludes ships, aircraft, and energy-intensive industry. Central Bank baseline forecast 2022-2024. The broken line shows the forecast from MB 2022/1.

Sources: Statistics Iceland, Central Bank of Iceland.

2022, this increase will reverse to a degree, and over the next few years public sector demand is set to grow more modestly than in recent years. According to the forecast, public consumption growth will measure 1½-2% per year, and public investment will contract marginally. If this forecast materialises, the share of public consumption and investment in GDP will be close to 30% at the end of the forecast horizon, far above the twenty-five-year average.

Treasury deficit spending will slow markedly when discretionary measures expire this year

The fiscal deficit totalled 8.2% of GDP in 2021, about the same as in 2020 (Chart III-10). In addition to the effects of the pandemic-related economic contraction, the Government's discretionary countermeasures were a major driver of the deficit.

The Bank's baseline forecast assumes that the deficit will measure 4.7% of GDP in 2021, with the year-on-year improvement stemming from both reduced pandemic-related countermeasures and the continued strengthening of the Treasury's revenue base as economic activity rebounds. In addition, dividends to be paid by Government-owned companies are expected to increase considerably. This is offset by budgetary spending increases, value-added tax reimbursements in connection with the "Back to Work" initiative, and other smaller revenue changes provided for in the National Budget, all of which are estimated to increase the deficit by just over ½% of GDP.

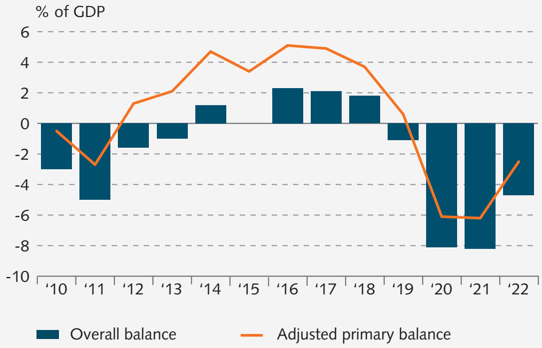
Fiscal stance set to tighten markedly

Discretionary fiscal policy was actively used to support households and businesses while the impact of the pandemic and related public health measures was at the forefront. Over the past two years, fiscal support as measured in the change in the cyclically adjusted Treasury performance is estimated at nearly 6% of GDP, owing mostly to the temporary discretionary measures introduced in connection with the pandemic (see *Monetary Bulletin* 2021/2 and 2021/4). But as is mentioned above, a large share of these measures will expire this year, and the fiscal stance will tighten as a result, by just over 3% of GDP (Chart III-11).

Treasury revenues are projected to increase in line with GDP and developments in underlying revenue bases in 2023 and 2024. As the economy works through the circumstances created by the pandemic, pressure on public spending will ease. The baseline forecast therefore assumes that the ratio of Treasury expenditures to GDP will fall slightly in the next few years. Fiscal consolida-

Chart III-10

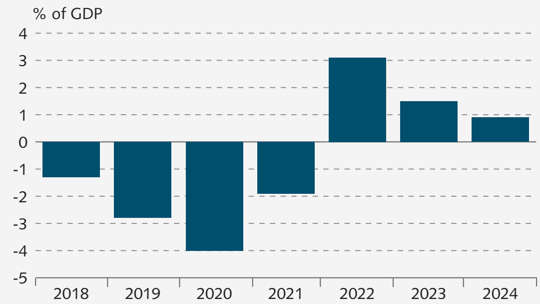
Treasury outcome 2010-2022[1]



1. Adjusted for irregular and one-off items. Central Bank baseline forecast 2022.
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

Chart III-11

Change in central government cyclically adjusted primary balance 2018-2024[1]



1. Adjusted for irregular and one-off items. Central Bank baseline forecast 2022-2024.
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

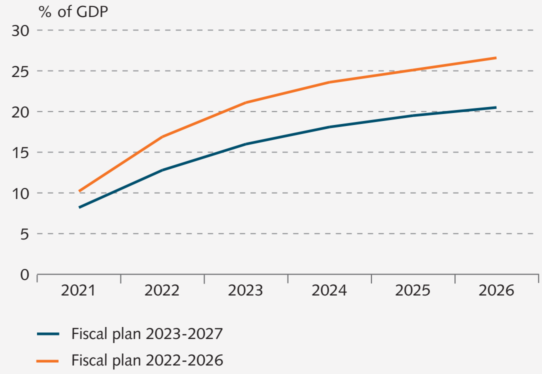
tion will therefore keep increasing in the next two years, albeit less than in 2022.

Accumulated deficit in the new fiscal plan narrows significantly from the previous plan

The fiscal plan recently published by the Government contains an updated assessment of Treasury performance for this year. It assumes that the fiscal deficit will be smaller by ½% of GDP than was provided for in the National Budget for 2022, or 4.6% (Part A total). The Treasury performance improves year by year according to the fiscal plan, and the rise in the Treasury debt-to-GDP ratio is estimated to halt in 2025. The outlook has changed significantly from the previous fiscal plan, mainly reflecting changes in the economic outlook. As a result, the accumulated Treasury deficit for 2021-2026 is now estimated to be smaller by more than 6% of GDP than in the plan presented a year ago (Chart III-12).

Chart III-12

Cumulative Treasury deficit 2021-2026 according to Fiscal Plan



Sources: Fiscal Plan 2022-2026, Fiscal Plan 2023-2027.

External trade and the current account balance

Tourism continued to recover in Q4, albeit offset by a contraction in other services

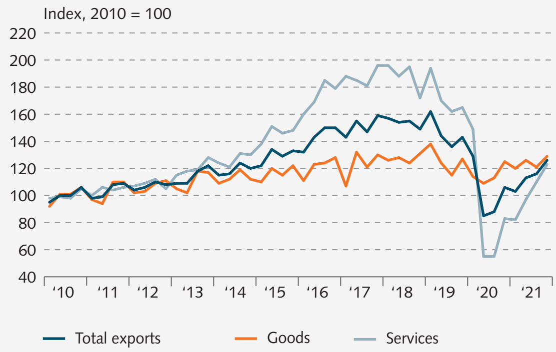
Goods and services exports grew by 8.6% quarter-on-quarter in Q4/2021 (Chart III-13). The year-on-year growth rate for 2021 as a whole measured 12.3%, nearly 2 percentage points below the February forecast. Services exports grew by 36% year-on-year during the quarter, somewhat less than in the quarters beforehand, and by 20.3% over the year as a whole. Even so, it remains about one-fourth less than at the end of 2019, before the onset of the COVID-19 pandemic. Growth in services exports during the quarter is attributable mainly to the recovery of tourism, which was in line with expectations. The recovery lost a little momentum, however, in the wake of rising case numbers and the spread of the Omicron variant of the virus, and total tourism-generated revenues came to 62% of revenues for the same period in 2019, at constant exchange rates. Average spending per tourist rose significantly in the wake of the pandemic, but the effects of this have diminished with rising tourist numbers, and in Q4/2021 the average was about one-fifth higher than before the pandemic.

Other services exports continued to contract during the quarter, however, and measured 9.2% lower in 2021 as a whole than in 2020, owing mainly to a contraction of one-fourth in exports relating to intellectual property leasing revenues in the pharmaceuticals industry, as well as a contraction of nearly one-third in research and development services. The deviation from

Chart III-13

Exports of goods and services[1]

Q1/2010 - Q4/2021



1. Seasonally adjusted volume indices.
Source: Statistics Iceland.

the Bank's February forecast of export growth is due primarily to the fact that these items were expected to contract less markedly.

Omicron slowed the recovery of tourism in early 2022 …

As expected, the rise in tourist numbers slowed somewhat in Q1/2022 amid the rise in COVID case numbers. They totalled roughly 245,000 for the quarter, just over half of that in Q1/2019. Foreign card turnover data suggest that average spending per tourist was slightly lower than in the previous quarter. On the other hand, indicators imply that domestic airlines' revenues contracted more than expected between quarters, and the number of transit passengers fell considerably more than other passenger numbers, which can also be attributed to disruptions in air traffic over Iceland due to the inclement weather in February. On the other hand, restrictions on cross-border travel were eased substantially in the first few months of the year, and vaccinated passengers are permitted to travel to the largest market areas in Europe without undergoing quarantine or having to show COVID test results.

… and the war affects the outlook, even though a robust recovery of tourism is still expected

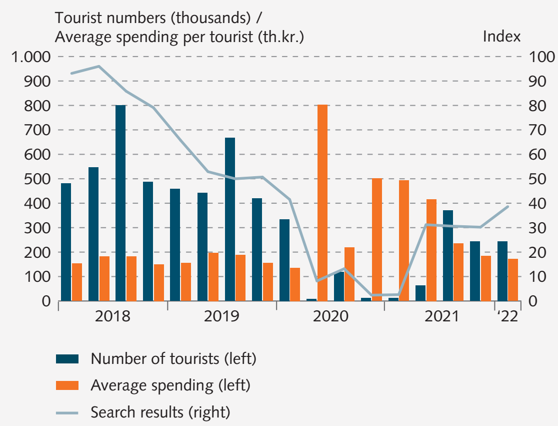
In spite of reduced restrictions on travel and a brighter outlook regarding the pandemic, the outlook for 2022 has deteriorated since February, owing to Russia's invasion of Ukraine and its impact on prospects for global inflation and GDP growth (see also Chapter I and Box 2). The war has not yet made a discernible impact on the Icelandic tourism industry, and domestic airlines' flight schedules are broadly unchanged since February. Flight offerings are still expected to increase considerably over the course of Q2, and the outlook is for the spring and summer seasons to resemble the same period in 2019. The number of Google searches for flights to Iceland and accommodation in the country has increased since H2/2021 and is now comparable to that during the pre-pandemic period (Chart III-14).

It is therefore still assumed that the tourism sector will recover strongly this year, although the effects of increased uncertainty and declining real incomes among Iceland's main trading partners, as well as the oil-price-induced rise in airfares, are expected to come to the fore later in the year. Because of this, the recovery will be slightly weaker than previously forecast. It is assumed that 1.4 million foreign tourists will visit Iceland in 2022 and that average spending per tourist will be slightly below the previous forecast (Chart III-15). The effects

Chart III-14

Indicators of tourism sector activity[1]

Q1/2018 - Q1/2022

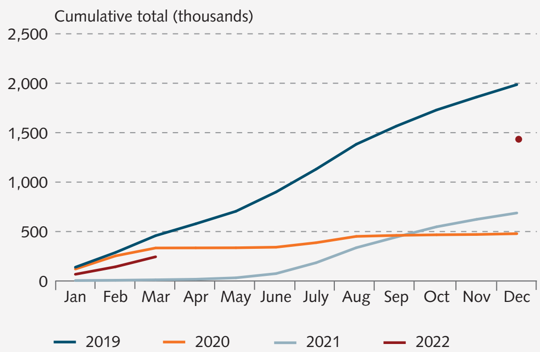


1. Average spending based on travel exports at constant exchange rates, Q1/2022 estimated from foreign payment card turnover. Tourist numbers are derived from foreign nationals' departures via Keflavík Airport. Search results are based on a factor model combining the frequency of five different Google search strings relating to travel to Iceland (seasonally adjusted).

Sources: Google Trends, Icelandic Tourist Board, Isavia, Statistics Iceland, Central Bank of Iceland.

Chart III-15

Foreign nationals' departures via Keflavík Airport 2019-2022[1]



1. Cumulative total for each year. The dot indicates the 2022 total according to the Central Bank's baseline forecast.

Sources: Icelandic Tourist Board, Isavia, Central Bank of Iceland.

are expected to show until H1/2023, but their strength and duration will depend on how quickly the global economic outlook improves. As before, the recovery of tourism is projected to continue next year, with tourist numbers rising year-on-year, albeit at a slightly slower pace than previously envisaged. According to the forecast, a total of nearly 1.7 million tourists will visit Iceland in 2023.

Because of a somewhat weaker outlook for tourism and a poorer outlook for other services in the wake of the 2021 contraction, growth in services exports is assumed to lose pace this year, measuring just under 35% instead of just over 39% projected in February. Because of base effects, the growth rate will be stronger in 2023, or 15% instead of the 11% provided for in the February forecast.

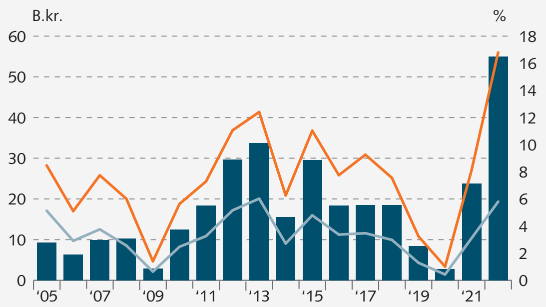
Marginal growth in goods exports in Q4, as expected …

Goods exports increased by 2.8% year-on-year in Q4/2021, and by 7.6% in 2021 as a whole, as was forecast in February. Marine product exports were up 9.7% during the year, owing largely to an increase in capelin exports, although it was offset somewhat by a contraction in exports of cod, primarily in Q4, owing to a reduced quota in the current fishing year. Exports of silicon products also continued to increase in Q4, whereas aluminium exports were all but flat year-on-year, both in Q4 and in 2021 as a whole.

… but the outlook for 2022 as a whole has improved because of robust growth in other goods exports in Q1

The outlook is still for stronger marine product exports in 2022, owing to a historically large capelin quota, but the growth rate now looks set to be marginally lower than was forecast in February, as inclement weather and a difficult season prevented the capture of the entire quota. Even so, the capelin catch was the largest since the 2011-2012 season (Chart III-16). As is discussed in Chapter I, the reduction in product prices has been slightly smaller than previously anticipated, and the total value of the fishing season is therefore broadly in line with the last forecast. The invasion of Ukraine is expected to have limited direct impact on goods exports, and if trade with Russia, Belarus and Ukraine is halted, it is assumed that most of the marine products intended for these markets will be sold elsewhere (see Box 2). The outlook is also for aluminium production to be slightly below the February forecast, and it appears that cutbacks in energy sales has reduced the production of silicon products in the first few months of the year.

Chart III-16
Export value of capelin 2005-2022[1]



1. Central Bank baseline forecast 2022.
Sources: Statistics Iceland, Central Bank of Iceland.

However, unusually strong exports of other industrial goods in Q1 somewhat offset the poorer outlook in other sectors; therefore, goods exports as a whole are projected to increase by 4.4% in 2022 and not 3.7%, as was forecast in February. Because of base effects, the contraction in 2023 is expected to be larger, but exports in the pharmaceuticals sector are still forecast to rise from 2023 onwards.

Total export growth set to be weaker in 2022 but in line with the February forecast in 2023

Total exports are projected to increase this year by just under 16%, which is below the February forecast. The deviation is due mainly to weaker services exports, although the outlook is for slightly weaker growth in marine and aluminium product exports as well (Chart III-17). The outlook for 2023 is for just over 5% growth, which is broadly in line with the February forecast. As in the February forecast, total export volume is projected to be similar to that in 2019 by the end of the forecast horizon.

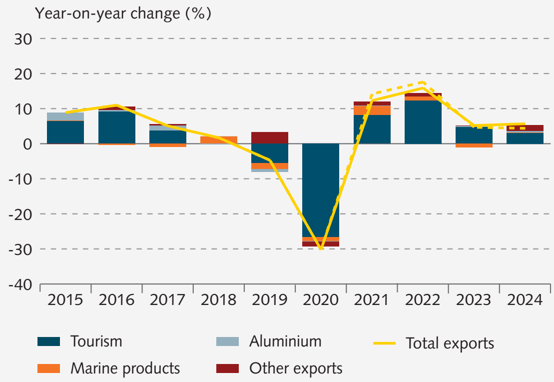
Import growth loses pace

Goods and services imports grew by 8.9% quarter-on-quarter in Q4/2021, and by 20.3% year-on-year in 2021 as a whole (Chart III-18). By H2, total imports had risen above the pre-pandemic level. This was due largely to stronger goods imports, which increased by 21% year-on-year, as was forecast in February. Increased imports of ship and aircraft were a major factor, but other imports were also unusually strong. Indicators imply that strong growth in goods imports has continued in Q1/2022, while it is assumed that it will lose pace faster in H2 than was forecast in February. The change is due in part to the slightly more sluggish recovery of tourism in addition to likely delays in imports of certain goods due to the war in Ukraine. Goods imports are therefore expected to increase by 6.4% for the year as a whole instead of the 8.2% forecast in February.

Services imports grew by 55% year-on-year in Q4/2021, far more than in the quarters beforehand, and by 18.6% in 2021 as a whole, over 3 percentage points more than was forecast in February. The difference is due largely to one-off effects of increased imports of telecom and IT services in Q4. Growth in the quarter stemmed mainly from increased spending by Icelanders during their travels abroad, which grew rapidly in Q3 and Q4. Other components of services imports also grew markedly, however. Indicators suggest that services imports also grew more strongly in Q1/2022 than was forecast in February, as Icelanders began travelling

Chart III-17

Exports and contribution of subcomponents 2015-2024[1]



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 2022-2024. Broken line shows forecast from MB 2022/1.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-18

Imports of goods and services[1]

Q1/2010 - Q4/2021

1. Seasonally adjusted volume indices.

Source: Statistics Iceland.

abroad in greater numbers than previously anticipated and the effects of the Omicron variant of the coronavirus on people's appetite for travel appeared to be less than expected. The outlook is therefore for Icelanders' overseas travel to increase even more in 2022 than was previously expected, and for services imports to grow accordingly. Imports as a whole are projected to grow somewhat more slowly than was forecast in February, or by 12.4% in 2022 and 3.5% in 2023.

Current account deficit expected for the entire forecast horizon

The current account deficit measured 5.1% of GDP in Q4/2021 and 2.8% for the year as a whole. It was Iceland's first full-year current account deficit since 2008. The composition of the current account balance changed markedly between years, owing to a larger goods account deficit and a reversal in the primary income balance, although the surplus on services trade was slightly larger than in 2020 (Chart III-19). The smaller primary income surplus is due mainly to increased profits among foreign-owned domestic companies, and the outlook is for this trend to continue in the coming term, given the steep rise in aluminium product prices.

Last year's current account deficit was considerably larger than was assumed in February, owing both to a smaller services account surplus because of the aforementioned items falling under other services trade, and a larger-than-expected primary income deficit in Q4.

The outlook for 2022 has also deteriorated, driven by a smaller services account surplus coupled with a larger deficit of the primary and secondary income balance, which is offset by a smaller goods account deficit. The current account is projected to show a deficit measuring 0.9% of GDP in 2022, whereas the February forecast provided for a surplus of 0.5%. The outlook has worsened for 2023 and 2024 as well, and the current account is now expected to be in deficit for the entire forecast horizon.

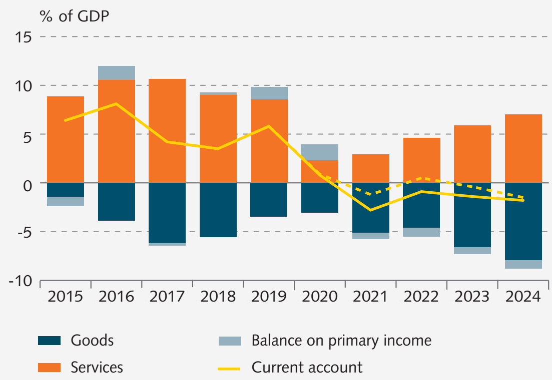
GDP growth

Year-2021 GDP growth weaker than forecast in February

Even though domestic demand grew more strongly in Q4/2021 than was assumed in the February forecast, GDP growth was weaker, according to preliminary figures from Statistics Iceland (Chart III-20). This is because the contribution from net trade was considerably more negative than previously assumed. Less favourable external trade can be attributed in part to a stronger-

Chart III-19

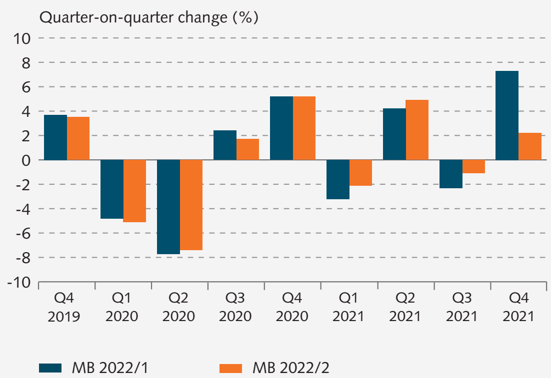
Current account balance 2015-2024[1]



1. 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 2022-2024. Broken line shows forecast from MB 2022/1.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-20

Quarterly changes in GDP growth[1]
Q4/2019 - Q4/2021



1. Seasonally adjusted figures. Data for the series MB 2022/2 show Statistics Iceland's measurement from February 2022, but data for the series MB 2022/1 show Statistics Iceland's measurement from November 2021, with the exception of Q4/2021 data, which are taken from the baseline forecast in MB 2022/1.
Sources: Statistics Iceland, Central Bank of Iceland.

than-expected contraction in other services exports, compounded by the aforementioned one-off effects of increased imports of telecom and IT services. GDP was up 4.4% year-on-year in Q4/2021, the third quarter in a row to see an increase between years (Chart III-21).

For 2021 as a whole, GDP growth measured 4.3%, with domestic demand growing by 7.2%, albeit offset by a 2.9 percentage point negative contribution from net trade. All subcomponents of domestic demand increased markedly, except for a marginally negative contribution from inventory changes. GDP growth for the year turned out 0.6 percentage points less than was assumed in the February forecast, with the difference attributable mainly to a more negative contribution from net trade. GDP in 2021 was still 3% below its 2019 average and 1 percentage point below the February forecast. In addition to weaker output growth in 2021, Statistics Iceland revised year-2020 figures, and the contraction in GDP turned out to be 7.1% instead of the previous figure of 6.5%.

Increased output in most sectors after a sharp contraction in the wake of the pandemic

According to the production accounts, output grew in the majority of sectors in 2021, following a substantial contraction in 2020 (Chart III-22). Although GDP growth was relatively robust last year, output in about a third of sectors was still lower than before the pandemic. The sectors hit hardest by the Government's public health measures, most of them tourism-related, are the ones that still have some ground to cover before returning to the year-2019 level. In culture and recreation and related sectors, however, output grew by nearly 10%. These developments are reflected to a large degree in the expenditure accounts, which show stronger growth in private consumption and weaker growth in services exports.

Output growth in 2022 set to fall short of the February forecast

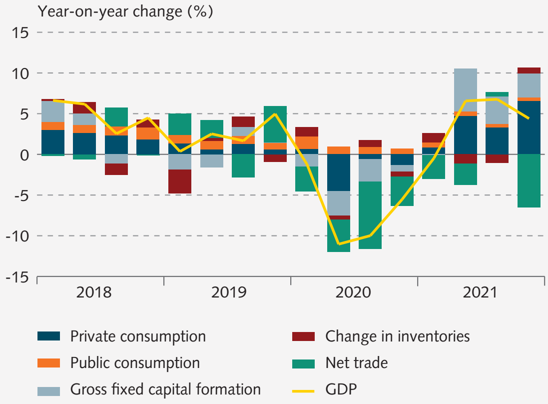
GDP is estimated to have grown by 5.5% year-on-year in Q1/2022, a full 1 percentage point below the February forecast. Public health measures were eased more rapidly than anticipated during the quarter, and private consumption therefore grew more strongly than in the last forecast; however, this was offset by a considerably more negative contribution from net trade. GDP growth is expected to pick up further in Q2 but then ease again in H2/2022.

As is discussed in Box 2, the war in Ukraine is likely to have an adverse impact on economic activity worldwide. With more sluggish growth in global demand and

Chart III-21

GDP growth and contribution of components[1]

Q1/2018 - Q4/2021

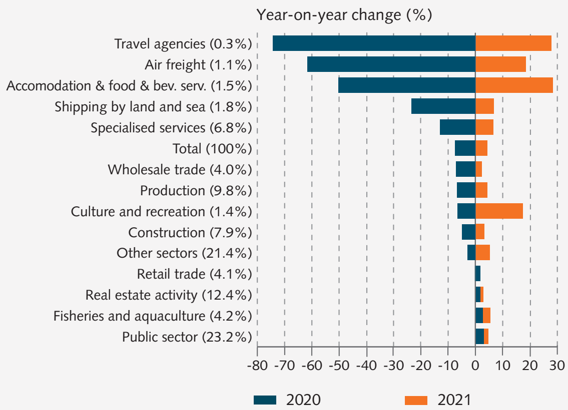


1. Because of chain-volume linking, the sum of expenditure components may not equal GDP growth.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-22

Change in GNI in selected sectors[1]



1. The change in gross national income (GNI) in 2020 and 2021, by economic sector. GNI measures the income of all parties involved in output. It is equal to GDP adjusted for indirect taxes and production subsidies. Figures in parentheses show the share of individual sectors in nominal GNI in 2020.

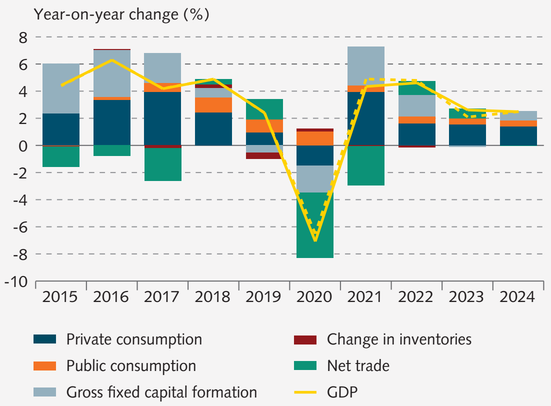
Sources: Statistics Iceland, Central Bank of Iceland.

elevated economic uncertainty, the GDP growth outlook for Iceland deteriorates as well. Added to this are the negative effects of increased supply-chain disruptions, potential shortages of manufacturing inputs, and rising commodity prices. Offsetting this, the war will lead to an improvement in terms of trade, and higher energy prices will affect Iceland less than they will most of mainland Europe (see Chapter I). This is compounded by indications of brisk economic activity so far this year, and by positive base effects since GDP growth was somewhat weaker in 2021 than had been assumed in the Bank's February forecast. According to the baseline forecast, domestic demand will grow by 3.5% in 2022, and the contribution from net trade will be positive for the first time since 2019. GDP growth for 2022 as a whole is therefore estimated at 4.6%, or 0.2 percentage points less than was forecast in February (Chart III-23). The outlook for 2023 and 2024 has improved slightly, however, and GDP growth is forecast at roughly 2½% for both years.

If the forecast materialises, year-2022 GDP will be 1½% above the 2019 average, although it will be below the February forecast for the entire forecast horizon. As before, the GDP growth outlook is subject to considerable uncertainty, as is discussed further in Box 1.

Chart III-23

GDP growth and contribution of underlying components 2015-2024[1]



1. Central Bank baseline forecast 2022-2024. Broken line shows forecast from MB 2022/1.

Sources: Statistics Iceland, Central Bank of Iceland.