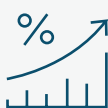


Monetary Bulletin in a nutshell



Although trading partner GDP growth has softened recently, it has been more resilient than was assumed in the February forecast. The GDP growth outlook for 2023 has therefore improved. Nevertheless, growth is still expected to be sluggish in 2023 and 2024, averaging about 1% per year. Global inflation has eased but underlying inflation remains high, indicating that there is still some ground to cover before measured inflation can be brought back to target.



In Iceland, GDP growth measured 6.4% in 2022, the strongest growth rate since 2007. It was driven by a surge in domestic demand – especially private consumption, which grew by 8.6% year-on-year. GDP growth was slightly below the Bank's February forecast, however, reflecting less favourable external trade and the effects of changes in Statistics Iceland's treatment of intellectual property in the pharmaceuticals sector, offset by stronger growth in domestic demand. GDP growth for Q1/2023 appears to have far outpaced the February forecast and therefore looks set to exceed it for the year as a whole as well. Output growth for 2023 is forecast at 4.8%, as compared with 2.6% in the February forecast. This mainly reflects the impact of stronger growth in domestic demand, plus improved prospects for tourism and the effects of the above-mentioned methodological changes by Statistics Iceland. The outlook for output growth in the coming two years is broadly unchanged from the February forecast, however.



Total hours worked continued to rise in Q1/2023, on top of a steep increase in Q4/2022. Labour supply has increased as well, and unemployment has therefore held broadly unchanged in the past year. As before, it is estimated to be just below its equilibrium level. The labour market remains tight, but job growth is expected to ease, unemployment to rise, and demand pressures in the economy to subside as the forecast horizon advances.



Inflation continued to climb in February, to 10.2%, its highest since autumn 2009. It has eased slightly since then, to 9.9% in April. Inflation excluding the housing component has risen year-to-date, measuring 8.7% in April. Underlying inflation has increased as well, and steep price hikes can be seen in a steadily growing share of the consumption basket. Although offset by declining global inflation, domestic inflationary pressures remain strong, and more so than was assumed in the February forecast. As a result, the outlook is for inflation to exceed that forecast in both 2023 and 2024. This is due largely to an unfavourable initial position, but also to greater demand pressures in 2023, albeit mitigated by a stronger króna. According to the forecast, inflation will exceed 8% throughout this year. It will not fall below 4% until late in 2024 and will not fall below 3% until well into 2026.



The global economic situation has been unusually uncertain for quite some time and still remains so. The shocks of recent years have been numerous and unprecedented: a global pandemic and war in Europe led to severe supply chain disruptions and soaring energy and commodity prices, which the global economy is still grappling with. The global economic outlook could therefore be overestimated. The same is true of the domestic inflation outlook, as the anchoring of inflation expectations to the target has weakened, thereby exacerbating the risk of larger pass-through of exchange rate and wage shocks, which in turn increases the risk that a wage-price spiral will develop.

The analysis presented in this *Monetary Bulletin* is based on data available in mid-May.