



MONETARY BULLETIN

2009 • 1

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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 its main objective. In the joint declaration by the Government of Iceland and the Central Bank of Iceland on March 27, 2001, it is explained that the Central Bank's aim shall be that annual inflation, measured as the twelve-month increase in the CPI, remains as close to 2½% as possible.

Professional analysis and transparency are important prerequisites for credible monetary policy. In publishing Monetary Bulletin, the Central Bank attempts to fulfil these principles. Twice a year, in early May and early November, *Monetary Bulletin* includes an in-depth analysis of economic and monetary developments and prospects. In January and August, an updated forecast is published together with an abbreviated report on the economic and monetary developments and prospects. The Board of Governors of the Central Bank bases its interest rate decisions to a great extent on this analysis. The publication of Monetary Bulletin also represents a vehicle for the Bank's accountability towards government authorities and the public.

The framework of monetary policy and its implementation and instruments are described further on the Central Bank's website: www.sedlabanki.is/?PageID=179.

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Icelandic letters:

ð/Ð (pronounced like th in English this)

þ/Þ (pronounced like th in English think)

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

Symbols:

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

Monetary policy statement by the Board of Governors of the Central Bank of Iceland

Policy rate remains unchanged

The Board of Governors of the Central Bank of Iceland has decided to leave the Bank's policy interest rate unchanged at 18%.

Since the beginning of November, when the Board of Governors last announced its policy interest rate decision and the Central Bank published its macroeconomic and inflation forecasts, various economic factors have become clearer, although substantial uncertainty naturally persists. The króna strengthened markedly after interbank trading resumed in December. It retreated somewhat thereafter, but in the last two weeks it has appreciated again by some 10%. The real exchange rate is still very low, however, and far below historical averages. Furthermore, there is a growing surplus in the trade account. Thus the premises exist for considerable appreciation of the króna. Offsetting this, however, is the fact that terms of trade have deteriorated – sharply in some sectors – as output growth has slowed among Iceland's trading partners. The main task of monetary policy at this time is to contribute to exchange rate stability and foster the appreciation of the króna. The Central Bank's moderate intervention in the foreign exchange market has had a positive effect. Its net foreign exchange transactions only amount to about 3 million euros this year.

Inflation was lower than forecast in the fourth quarter of 2008, or 16.8% instead of the projected 19%, in spite of the fact that foreign currencies were approximately 9% stronger against the króna than the November forecast projected. Most likely, this is largely attributable to external conditions and to the dampening impact of the financial crisis on demand. Today's policy rate decision does not reflect a need to contain domestic demand, as private consumption has fallen off abruptly, for obvious reasons. The wealth effect – caused by constantly rising real estate and equity prices and itself a cause of a surge in consumption – has vanished. Real estate prices have already fallen and are clearly set to fall much further. Unemployment has risen much faster than was forecast in November. Due to these factors and to high inflation, real disposable income has contracted sharply and will continue to shrink. There is good reason to hope that the labour market will respond to these developments in a responsible manner. The damage caused by the fall of the banks has been severe, and it has made a palpable impact on domestic demand, as was forecast. Access to credit from abroad is extremely limited.

Inflation appears to have peaked, and it will decline quickly in the period ahead. For the year 2009 as a whole, inflation is expected to be more modest than was projected in November. In a year's time, it may have retreated to approximately 2½%.

In spite of the substantial trade surplus that has developed in the past few months, the obligation to submit foreign currency, and the restrictions on cross-border capital movements, the króna has appreci-

ated more slowly than the Central Bank expected and considers justified. There may be a variety of reasons for this. Among other things, importers' payment deadlines have become shorter while exporters' have lengthened. Terms of trade have deteriorated, and Iceland's trading partners are faced with mounting difficulties because of the financial crisis currently sweeping the globe. Accumulation of exporters' inventories may also play a part in this trend. Although the exchange rate of the króna has risen more slowly than previously assumed, there is every reason to expect further appreciation in the months to come. This is extremely important.

For the reasons cited above, the Board of Governors of the Central Bank deemed it timely to begin easing the policy rate downwards, and it informed the International Monetary Fund of its position. However, the Managing Director of the Fund recommended keeping the policy rate unchanged at present, due in part to the uncertainty currently surrounding the Icelandic political scene. The Board of Governors considers it appropriate to take note of this.

In the Central Bank's assessment, as inflation continues to lose pace, it will be possible to lower the policy rate relatively quickly without jeopardising the Bank's exchange rate and price level objectives. It is conceivable that the Bank will declare supplementary interest rate decision dates in addition to those previously announced so as to ensure that the policy rate follows inflation trends and eases downward in suitably small increments. Because of the temporary restrictions on movement of capital to and from Iceland and the adoption of a requirement to submit foreign currency, the link between the policy rate and the exchange rate has been weakened for the present. On the other hand, it is essential to consider this link when contemplating future policy rate decisions, as the exchange rate must have sufficient support from the policy rate when foreign exchange restrictions are lifted.

Outlook for lower inflation than previously forecast

Although inflation has mounted swiftly in the past few months, it has risen more slowly than was assumed in the Central Bank's November forecast, which was published soon after the collapse of Iceland's three largest banks. This is interesting in view of the fact that the exchange rate of the króna has been lower than was projected at that time. Unemployment has risen more rapidly than previous projections implied, which could indicate a swifter and sharper contraction in demand than was forecast in November. The króna plummeted in November. It recovered in December, after the interbank foreign exchange market was re-established and restrictions on current account foreign exchange transactions were lifted, but remained extremely volatile. During the first weeks of 2009, the króna has appreciated but remains weaker than was assumed in the November forecast. The aims of monetary policy are to foster the continuing appreciation of the króna and to promote exchange rate stability. At present, exchange rate movements are determined primarily by the external trade balance and net interest payments. However, there is considerable uncertainty about the policy rate level needed to support the króna once capital account restrictions are removed. As inflation subsides, it will most likely be possible to lower the policy rate quickly without jeopardising exchange rate stability. Because inflation is currently driven almost entirely by exchange rate movements, it will taper off quickly as soon as the króna appreciates, and could disappear for the most part during the current year.

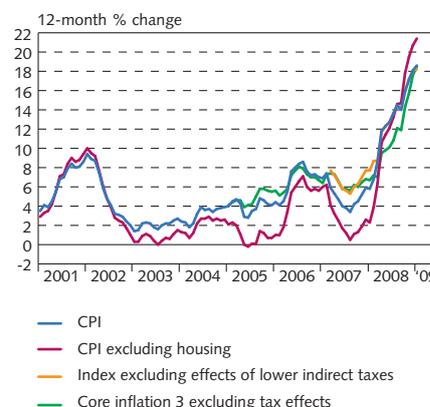
Inflation rose more modestly than forecast in November

Inflation rose over the past three months, measuring 18.6% in January. In Q4/2008 it stood at 16.8%, more than two percentage points below the Central Bank's November projections, despite the fact that the króna was, on average, significantly weaker during the quarter than the forecast had allowed for.

The question of what these developments imply for the inflation outlook and monetary policy depends to some extent on the relative importance of several conceivable explanations. Among the factors that have reduced inflationary pressures recently are the dramatic drop in global oil and commodities prices and the resulting decline in inflation among Iceland's chief trading partners. In the euro area, for example, inflation dropped from 4% in summer 2008 to 1.6% in December, while in the United States it fell from 5½% to 0% over the same period. Core inflation is just over 1½% in both areas, however. The effects of falling energy and commodities prices can be felt in Iceland as well, although they are more than offset by the depreciation of the króna. Approximately one-third of the divergence of actual measurements from the last inflation forecast can be explained by these exogenous factors.

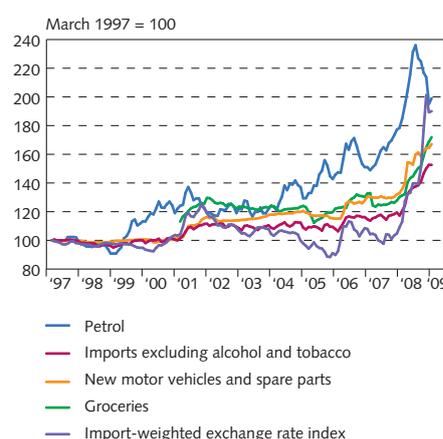
A further explanation for unexpectedly modest inflation is that an abrupt drop in demand has a much more profound effect on retail profits than a more gradual contraction under less extreme circumstances. Such a sudden contraction in demand also enables retailers to negotiate more advantageous contractual agreements with suppliers. Mark-ups therefore decrease at the same time as the foreign-currency price of many supplies is falling. A sharp, sudden contraction in demand can also mean that inventories last longer. Inventories appear to have been ample prior to the exchange rate collapse that accompanied the failure of the banks, and goods imports seem to have been quite limited afterward, partly because of temporary currency ration-

Chart 1
Various inflation measurements
January 2001 - January 2009



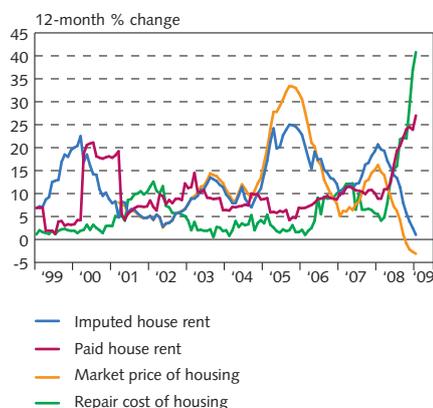
Source: Statistics Iceland.

Chart 2
Import-weighted exchange rate and
import prices March 1997 - January 2009



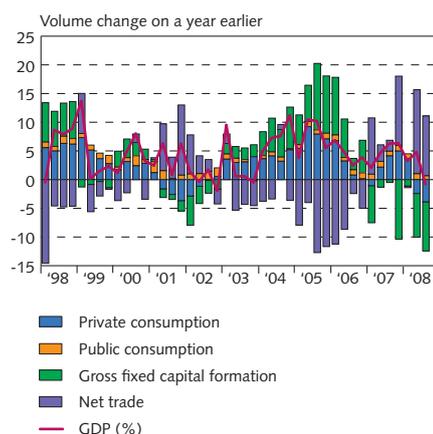
Source: Statistics Iceland.

Chart 3
Housing prices
January 1999 - January 2009



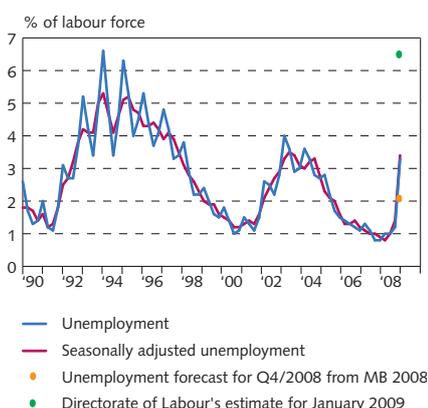
Source: Statistics Iceland.

Chart 4
Contributions to GDP growth
Q1/1998 - Q3/2008



Source: Statistics Iceland.

Chart 5
Unemployment



Sources: Directorate of Labour, Central Bank of Iceland.

ing measures. If inventories purchased at a relatively advantageous exchange rate last longer and the currency depreciation is expected to be temporary, this may slow down the pass-through effect, although a full pass-through will eventually occur if the exchange rate does not recover promptly; therefore, the repurchase price level will be higher than assumed.

It is also possible that inflation has been more temperate than expected in the past two months because house price inflation is on the wane and forecasting models do not fully reflect the past several years' housing bubble and its subsequent reversal. The market value of housing has fallen year-on-year, and the impact of real interest costs on the housing component of the CPI is dissipating. Therefore, owner-equivalent rent has only risen by 1% in the past twelve months. The roughly 40% increase in maintenance costs caused by króna depreciation and the 27% rise in paid rent have slowed the pace of overall housing price disinflation, however.

Output growth in Q3/2008 in line with November forecast

GDP contracted by just under a percentage point in the third quarter of 2008, in line with the November forecast. The contraction in private consumption was less pronounced than projected, however, and the contraction in investment greater. On the whole, the contraction in domestic demand was slightly less than forecast but was offset by the weaker net effects of external trade. Currently available indicators for Q4/2008 suggest that domestic demand contracted rather more than was projected in November but that the net contribution from external trade will be greater; thus it appears that GDP growth in Q4 was somewhat stronger than the November forecast indicated.

Unemployment has risen much faster than projected

As expected, the labour market underwent profound changes in the fourth quarter of 2008, but unemployment has risen considerably faster than forecasts suggested. In December, registered unemployment measured 4.8%, with average unemployment in January estimated at 6.4 – 6.9%; therefore, unemployment for Q1/2009 will probably approach 8%, approximately 4½ percentage points higher than assumed in the November forecast. Post-crisis developments in unemployment levels are shrouded in uncertainty, partly because of the influx of foreign workers to Iceland in recent years. Unemployment figures indicate that the proportion of unemployed foreign nationals is more or less in line with the percentage of foreign nationals in the sectors concerned. The growing contagion of the global economic crisis to the immigrants' countries of origin reduces the likelihood that a sizeable share of foreign workers will return home after becoming unemployed. The unexpectedly sharp downturn in the construction industry could also explain the spike in unemployment.

The króna has been weaker than forecast

In the past few months, the exchange rate of the króna has been rather lower than projected in November. In the fourth quarter, the króna was about 6% weaker against the euro than in the November

forecast. The hefty trade surplus in the fourth quarter could have been expected to shore up the exchange rate; however, it was offset by substantial net interest payments to abroad and other factors that are explained below. It is difficult to gauge the strength of the króna at this point in time due to the capital account restrictions still in effect. As long as the restrictions are largely maintained, the exchange rate should be determined primarily by underlying trade flows and by the balance on interest payments.

The link between underlying trade and derived currency flows is not unambiguous, however. There is anecdotal evidence that exporters' payment deadlines have lengthened at the same time as importers' payment deadlines have become shorter, and this, in addition to sizeable interest payments, may have delayed the effect of the growing trade surplus on the exchange rate. Importers have had difficulty in obtaining payment insurance and have thus been forced to pay for goods in cash to an increasing degree. Furthermore, there are doubts about whether all foreign currency has been submitted to domestic financial institutions in accordance with the Rules on Foreign Exchange. Hence the net inflow of foreign exchange driven by the trade surplus takes a longer time to emerge than it would otherwise. It should also be noted that wide fluctuations in aluminium exports do not necessarily call forth corresponding fluctuations in foreign currency inflow, which is determined primarily by domestic wage and energy costs.

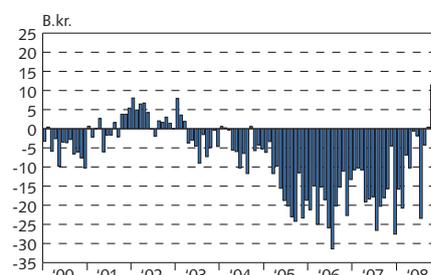
Inflation will subside quickly during the year

Inflation looks set to peak in Q1/2009 at 18-19%, approximately 4 percentage points lower than was forecast in November. Monthly inflation figures will drop sharply, with twelve-month inflation declining considerably in April due to very strong base effects. Twelve-month inflation will probably fall to approximately 2½% by early 2010. According to the current forecast, inflation will dip below the inflation target in 2010 and then rise back to target levels in 2011.

The forecast published in this Monetary Bulletin assumes that the exchange rate of the króna versus the euro will be 4% lower in Q1/2009 than was assumed in November, but that the exchange rate path will resemble the November forecast in other respects; that is, the króna will gradually appreciate. Because the króna is weaker at the outset, the entire path is somewhat lower than was projected in November. The exchange rate path reflects both the Central Bank's objective of promoting the appreciation of the króna and the fact that the real exchange rate is currently far below estimated real equilibrium levels, as well as being extremely low in a historical context.

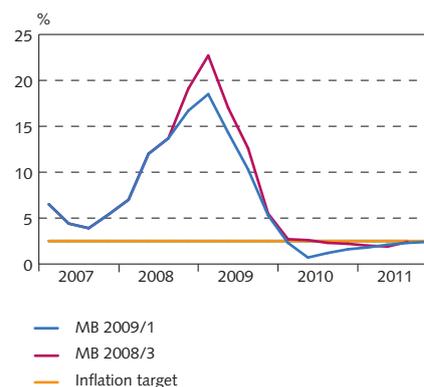
In spite of a lower exchange rate, the outlook is for inflation to remain below the November forecast virtually throughout the horizon. This is attributable to a deeper output slack and more advantageous wage developments, in addition to lower inflation at the beginning of the forecast horizon. Wage costs are projected to rise somewhat less than in the November forecast, as unemployment significantly exceed projections made at that time. Unemployment is likely to peak at 11% in Q1/2010 and remain high longer than projected in November.

Chart 6
Merchandise trade balance 2000-2008¹
At fixed exchange rate



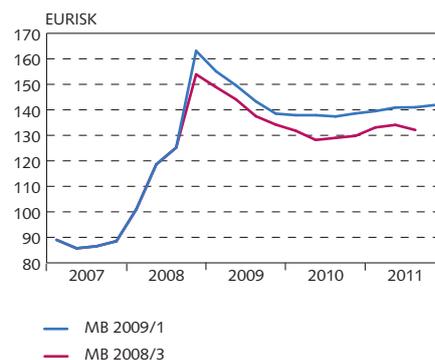
1. Statistics Iceland preliminary data for December 2008.
Source: Statistics Iceland.

Chart 7
Inflation - comparison to MB 2008/3



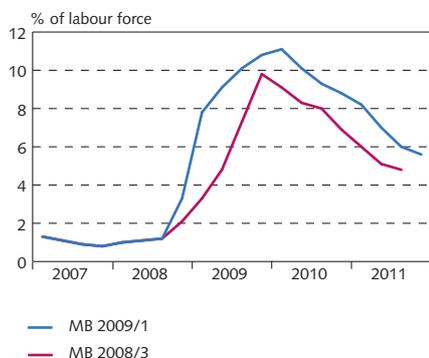
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 8
Exchange rate of the euro - comparison
with PM 2008/3



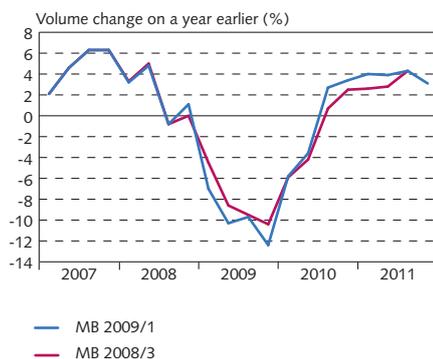
Source: Central Bank of Iceland.

Chart 9
Unemployment - comparison with PM 2008/3



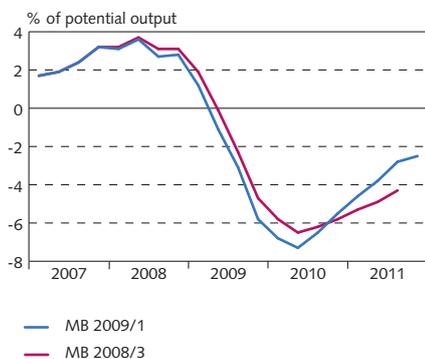
Sources: Directorate of Labour, Central Bank of Iceland.

Chart 10
Economic growth - comparison with PM 2008/3



Sources: Statistics Iceland, Central Bank of Iceland.

Chart 11
Output gap - comparison with PM 2008/3



Sources: Statistics Iceland, Central Bank of Iceland.

Housing inflation, one of the chief drivers of inflation in the past few years, is projected to taper off quickly in 2009. At present, however, real estate transactions are largely limited to housing swaps. Measured real estate values are somewhat lower than they were a year ago, and the effects of real interest costs on the housing component of the CPI are receding markedly. Anecdotal evidence indicates that rent will also taper off in the months to come. Still remaining, however, is the exchange-rate-sensitive maintenance and repair sub-component of the housing component, which has soared by just over 40% in the past year but can be expected to peter out quickly as the króna appreciates.

Because of the contraction in demand (which contributes to falling house prices), diminished external pressure on price levels, and swiftly rising unemployment, inflation in 2009 will be driven almost solely by exchange rate movements. Under these conditions, inflation should abate more quickly than it has often done in the past.

Domestic demand to contract more than previously projected

The Central Bank continues to forecast a sharp downturn in GDP and domestic demand in 2009. GDP is expected to contract by just over 10% during the year, rather more than was estimated in November. Private consumption is projected to shrink by about the same amount as in the previous forecast, although the recovery in 2011 will be somewhat less vigorous due to higher unemployment levels. The current forecast assumes a considerably more dramatic contraction in investment than was projected in November. Although this is attributable in part to delays in the construction of the Helguvík aluminium smelter, other investment is likely to contract as well. Offsetting this are the net effects of foreign trade, which will be slightly more positive than was assumed in the last forecast. The current forecast also allows for a slightly less decisive contraction in GDP in 2010, or 0.8%. As a result of these developments, the negative output gap in 2009 will be slightly wider than indicated in November. The trough should be reached around mid-2010, whereupon the slack should begin to diminish, but roughly four years will pass before GDP rebounds to pre-crisis levels.

Terms of trade deteriorate

Among Iceland's chief trading partners, prospects for output growth have deteriorated markedly since the last forecast was prepared. According to Consensus Forecast, GDP will contract by 1.3% in the European Union and by about 1.8% in the United States. Within the EU, the contraction will be most pronounced in some of the principal markets for Icelandic marine products, such as the United Kingdom and Spain.

This situation has already begun to press marine products prices downward and will probably continue to do so. Aluminium prices as measured in US dollars have fallen by 50% from the highs of early 2008. The forecast estimates an average drop of just over 40% between 2008 and 2009. Declining prices of fuel, raw materials for aluminium manufacture, and numerous other imported commodities

counteract this somewhat, but the net effect is unambiguously negative. Terms of trade deteriorated by an estimated 7% in 2008 and are projected to worsen by another 3½% this year, far more than was forecast in November.

Deterioration in terms of trade has a negative effect on the trade balance. On the other hand, marine product exports are expected to grow because of the recent decision to raise the total allowable catch for cod. Investment will contract more than previously projected, in part as a result of the delay in the Helguvuk construction project, and imports of capital goods will decline commensurably. According to the forecast, the trade surplus will be rather larger than previously projected, amounting to nearly 10% of GDP.

The deficit on income is a subject of enormous uncertainty, both in 2009 and in 2010. The settlement of the old and new banks, the results of negotiations relating to deposit insurance protection of foreign deposit accounts, and various other unknowns will not be clarified until well into the current year. The current forecast does not attempt to reassess the income account deficit but is predicated on previous estimates used as a basis for the economic plan drafted by the government and the International Monetary Fund. According to that plan, the current account should be nearly in balance this year. The outlook for the balance on income will be explored in greater depth in the upcoming May 2009 forecast.

Budgetary restraint will be greater in 2009 than assumed in November

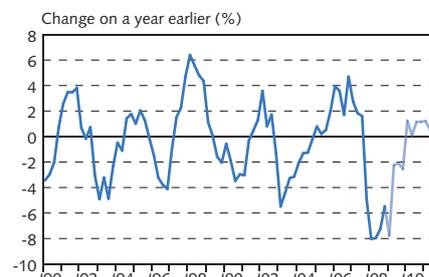
The fiscal budget for 2009 was approved with a 153 b.kr. deficit. It implies more restraint in public consumption and investment than previously assumed. The income tax percentage was raised by 1.25 percentage points, while the personal deduction was adjusted to take account of past year's inflation. There is tremendous uncertainty about various aspects of fiscal affairs, particularly to include interest expense.

According to the current Central Bank forecast, the estimated 2009 fiscal deficit is nearly 200 b.kr. The deficit is projected to remain large over the next several years, exceeding 12% of GDP during the forecast horizon. The primary deficit constitutes nearly half of the total deficit. Increased interest expense has shifted the cyclically adjusted budget balance, which amounts to over 5% of GDP. Hence, the cyclically adjusted public sector deficit will be large in the absence of substantial revenue-enhancing measures and expenditure restraint. Hence, the cyclically adjusted budget deficit will be large in the absence of substantial revenue-enhancing measures and expenditure restraint, unless further measures are adopted, as is the aim of the economic programme agreed by the government and the International Monetary Fund.

The policy rate will decline rapidly as the year progresses

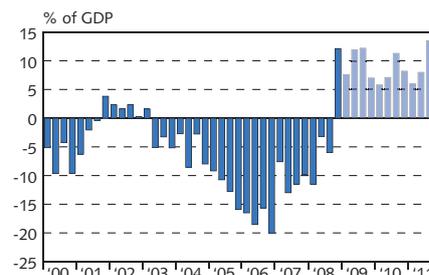
The policy rate is currently 18%, roughly equal to inflation. The real policy rate is therefore close to zero in terms of past inflation, and quite modest in terms of business and household inflation expecta-

Chart 12
Terms of trade of goods and services
1990-2011¹



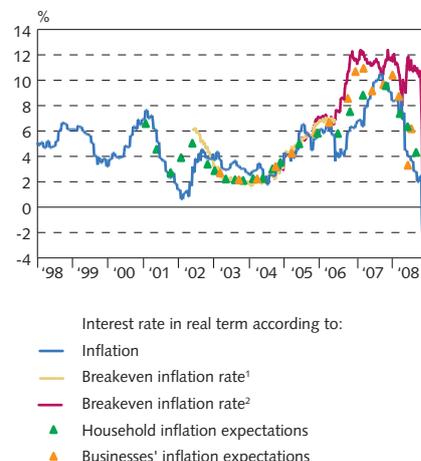
1. Central Bank baseline forecast 2008-2011.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 13
Balance of trade and services 2000-2011¹



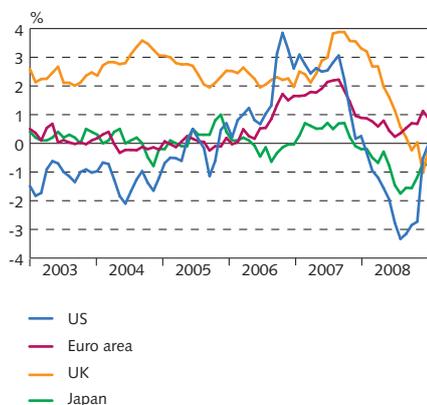
1. Central Bank baseline forecast 2008-2011.
Sources: Statistics Iceland, Central bank of Iceland.

Chart 14
Central Bank policy interest rate in real terms
Weekly data January 7, 1998 - January 27, 2009



1. Spread between RIKB 13 0517 and RIKS 15 1001. 2. Spread between RIKB 13 0517 and HFF150914.
Sources: Capacent Gallup, Statistics Iceland, Central Bank of Iceland.

Chart 15
Central banks' real interest rates
Monthly data



Source: Global Insight.

tions. This is broadly in line with the trends in Iceland's trading partner countries. However, the real interest rate differential with abroad has narrowed significantly because of soaring inflation. It is difficult to pinpoint the optimum level of monetary policy restraint at present because of the capital account restrictions and the uncertainty surrounding the transmission of monetary policy throughout the domestic financial system. As long as the capital account restrictions remain in effect (and are observed), the link between domestic and foreign interest rates is greatly weakened. As a result, large depreciation is less likely to occur as the real interest rate differential narrows. When the restrictions are lifted, however, this link will be re-established. Thus it would be imprudent to conduct monetary policy without concern for the real interest rate differential, as this could result in drastic depreciation of the króna after the restrictions are lifted. Under the current conditions, it is also likely that lowering the policy rate enough to create a negative real policy rate would erode investor confidence and intensify the pressure on the króna from non-resident owners of króna-denominated securities, as well as reducing their incentive to reinvest. A negative real policy rate could also tempt owners of deposits in Icelandic banks to circumvent foreign exchange rules.

At present, the real interest rate differential with abroad is quite small in terms of past inflation, and it will probably be slightly negative during the first half of 2009. If interest rates remain unchanged, however, it will turn positive once again when inflation subsides. Thereafter, inflation expectations should taper off as well, although they could prove more resistant to change because of the blow dealt to confidence in monetary policy. Expanded issuance of Treasury securities will probably bolster real interest rates during the year. Thus the real interest rate differential could widen during the course of the year, even if the policy rate is lowered.

The pace at which the policy rate can be eased is determined to a large extent by responses in the foreign exchange market. The aims of monetary policy in the quarters to come are to strengthen the króna and promote enhanced exchange rate stability. The Bank's policy rate decisions will not jeopardise those aims and will take into account the intention to lift capital movement restrictions in stages. As long as confidence in monetary policy is lacking and the removal of capital movement restrictions remains indeterminate – which makes the connection between interest rates and exchange rate movements more uncertain than it would otherwise be – it is crucial to proceed with caution in matters relating to the policy rate. Because of this uncertainty, the Central Bank has decided not to publish a policy rate forecast as it did before the banking and currency crisis struck. Policy rate decisions must simply reflect the level of support needed to promote exchange rate developments that are consistent with the assumptions in the forecast once the restrictions are revoked. If inflation approaches 2½% at the beginning of 2010 and lies below the inflation target until mid-2011, as the forecast projects, by late 2009 or early 2010 the policy rate could be lower than it has been in a number of years, even as low as 5%. Whether this materialises, however, depends on developments in the exchange rate.

Appendix 1

Baseline macroeconomic and inflation forecast 2009/1

Table 1 Macroeconomic forecast¹

	B.kr.	Volume change on previous year (%) unless otherwise stated				
		2007	2008	Forecast		
		2007	2008	2009	2010	2011
<i>GDP and its main components</i>						
Private consumption	749.0	4.3 (4.3)	-6.7 (-7.6)	-25.2 (-24.8)	-4.3 (-3.8)	5.5 (9.9)
Public consumption	316.8	4.2 (4.2)	3.5 (3.5)	1.5 (2.9)	1.8 (2.9)	1.7 (2.9)
Gross fixed capital formation	356.9	-13.7 (-13.7)	-23.5 (-19.2)	-28.9 (-20.2)	10.8 (6.9)	-1.6 (-21.2)
Business sector investment	211.6	-26.0 (-26.0)	-29.0 (-21.7)	-31.9 (26.2)	27.7 (21.1)	-5.7 (-31.6)
Residential construction	90.6	13.2 (13.2)	-30.5 (-32.4)	-24.3 (-24.4)	-14.3 (-10.4)	6.4 (13.3)
Public works and buildings	54.7	19.2 (19.2)	10.6 (11.4)	-25.2 (1.4)	-8.0 (-12.9)	5.5 (-13.5)
National expenditure	1,429.4	-1.4 (-1.4)	-8.7 (-8.3)	-20.3 (-17.6)	0.4 (0.6)	3.0 (0.8)
Exports of goods and services	451.7	18.1 (18.1)	10.3 (9.6)	0.4 (-0.5)	4.9 (2.6)	4.2 (5.5)
Imports of goods and services	587.9	-1.4 (-1.4)	-16.5 (-16.8)	-26.9 (-24.5)	10.7 (10.6)	2.2 (-0.1)
Gross domestic product	1,293.2	4.9 (4.9)	2.0 (1.8)	-9.9 (-8.3)	-0.8 (-1.7)	3.8 (3.2)
<i>Other key aggregates</i>						
Trade balance (% of GDP)		-10.5 (-10.5)	-1.4 (-1.6)	9.7 (9.3)	8.2 (6.6)	9.3 (8.5)
Current account balance (% of GDP)		-15.4 (-15.4)	-21.2 (-16.3)	0.1 (-1.3)	0.2 (-2.0)	4.8 (3.4)
Output gap (% of potential output)		3.2 (3.2)	2.8 (3.1)	-5.8 (-4.7)	-5.5 (-5.8)	-2.5 (-4.2)
Unit labour cost (change between annual averages in %)		6.8 (6.8)	8.4 (7.1)	3.8 (6.3)	2.9 (4.4)	2.1 (2.4)
Real earnings (change between annual averages in %)		8.0 (8.0)	-6.7 (-8.2)	-17.1 (-13.7)	4.7 (5.6)	6.3 (8.1)
Unemployment (% of labour force)		1.0 (1.0)	1.7 (1.4)	9.4 (6.3)	9.8 (8.1)	6.7 (5.1)
EURISK exchange rate		87.4 (87.4)	127.0 (124.6)	146.6 (141.1)	138.0 (129.7)	140.8 (133.0)

1. Figures in parentheses show forecast in *Monetary Bulletin* 2008/3.

Table 2 Inflation forecast (%)²

Quarter	Inflation (Change on same period of previous year)	Annualised quarterly inflation
		Measured value
2007:1	6.5 (6.5)	2.0 (2.0)
2007:2	4.4 (4.4)	5.8 (5.8)
2007:3	3.9 (3.9)	5.6 (5.6)
2007:4	5.4 (5.4)	8.3 (8.3)
2008:1	7.0 (7.0)	8.2 (8.2)
2008:2	12.0 (12.0)	27.0 (27.0)
2008:3	13.7 (13.7)	12.1 (12.1)
2008:4	16.8 (19.1)	20.5 (30.7)
		Forecast value
2009:1	18.5 (22.7)	14.9 (21.7)
2009:2	14.3 (17.0)	9.8 (5.0)
2009:3	10.3 (12.6)	-2.8 (-3.7)
2009:4	5.3 (5.5)	0.3 (0.6)
2010:1	2.3 (2.7)	2.4 (9.4)
2010:2	0.7 (2.6)	3.0 (4.6)
2010:3	1.2 (2.3)	-0.7 (-4.9)
2010:4	1.6 (2.2)	1.8 (0.2)
2011:1	1.8 (2.0)	3.3 (8.7)
2011:2	2.1 (1.9)	4.3 (4.0)
2011:3	2.3 (2.4)	-0.2 (-3.0)
2011:4	2.4	2.3
<i>Annual average</i>	<i>Verðbólga</i>	
2007	5.0 (5.0)	
2008	12.4 (13.0)	
2009	11.9 (14.1)	
2010	1.5 (2.4)	
2011	2.2 (2.2)	

2. Figures in parentheses show forecast in *Monetary Bulletin* 2008/3.