

# Monetary Bulletin 2020/1<sup>1</sup>

The global GDP growth outlook is broadly unchanged from the forecast in the November *Monetary Bulletin*. Despite rising concerns about the impact of a new virus originating in China, global uncertainty has receded since November and the risk of a further softening of global GDP growth has eased. A key factor in this is the recent agreement reached by the US and China in partial resolution of their trade dispute, which reduces the likelihood of further escalation and even more severe repercussions for the global economy.

The Icelandic economy experienced a major setback in 2019, with the collapse of airline WOW Air and further shocks to the airline industry, coupled with the failure of the capelin catch and a deterioration in terms of trade. GDP growth slowed markedly, measuring only 0.2% for the first three quarters of the year. It outpaced the November forecast, however, which assumed a 0.1% contraction. Owing to more rapid growth in economic activity in the first three quarters, together with signs of stronger growth in private consumption and more favourable external trade in Q4, the GDP growth outlook for the year as a whole has improved since November. GDP is now projected to have grown by 0.6% in 2019 instead of contracting by 0.2%.

The outlook for 2020 and 2021 has deteriorated, however. Goods and services exports now appear set to contract this year instead of growing marginally, and if they do, it will be the first time since the early 1990s that exports have contracted two years in a row. A slower recovery of tourism, production difficulties in the aluminium industry, and the second consecutive capelin catch failure play a major role in explaining the deteriorating outlook. Furthermore, corporate interest rate spreads rose sharply in late 2019, leading to a downward revision of business investment in 2020 and 2021 relative to the November forecast. Year-2020 GDP growth is assumed to measure only 0.8%, compared to 1.6% in the November forecast. Although growth is projected to increase to 2.4% in 2021, it remains 0.5 percentage points below what was expected in November. The forecast for 2022, however, is broadly unchanged.

Unemployment has risen markedly in the past twelve months and is expected to keep increasing through this year, averaging just over 4% in 2020 and 2021. It will therefore be higher and take longer to subside than was projected in November. Thus the outlook is for the slack in the economy to persist longer than previously anticipated.

As was forecast in November, inflation continued to ease in late 2019, measuring 2.5% in Q4. It declined further in January, to 1.7%, and is expected to remain below the inflation target over the forecast horizon, before inching back up to the target towards the end of the period. Inflation will therefore be below the November forecast for much of the forecast horizon, as the slack in the economy is expected to be more persistent than was assumed in November.

1. The analysis appearing here is based on the Bank's assessment of economic developments since the publication of *Monetary Bulletin* 2019/4 in November 2019, and on the updated forecast presented here. It is based on data available at the end of January. The risk assessment in the updated forecast is based on the risk assessment in the November forecast.