

Monetary Bulletin in a nutshell



GDP growth among key trading partner countries continued to soften over the course of 2023. Since November, the GDP growth outlook has deteriorated somewhat for most trading partners apart from the US, where growth has exceeded expectations. Global inflation has continued to ease, as has underlying inflation, albeit more slowly. The war in the Middle East could impede the decline in global inflation, partly because of the recent rise in shipping costs.



In Iceland, GDP growth measured 4.2% for the first three quarters of 2023, in line with the Bank's November forecast. The growth rate slowed markedly as Q3 advanced, measuring 1.1% for the quarter, somewhat less than was forecast in November. GDP growth is estimated to have picked up marginally in Q4 and is projected at 3.6% for 2023 as a whole, broadly in line with the November forecast. Domestic demand appears to have declined more rapidly, however, than was anticipated then, which is the main reason for the downward revision of this year's growth outlook. GDP growth for the year is now projected at 1.9%, as compared with the November forecast of 2.6%. The GDP growth outlook for the next two years is broadly unchanged overall, however.



Unemployment has inched upwards since mid-2023. Job growth has lost pace, and indicators imply that the positive output gap of the past two years is narrowing. The baseline forecast assumes that unemployment will keep rising this year and that a negative output gap will open up towards the year-end.



Inflation subsided in December, and even more so in January, when it measured 6.7%. Underlying inflation has also fallen but inflation expectations remain well above target. The inflation outlook has improved markedly, as growth in economic activity looks set to taper off more quickly than was projected in November. On the other hand, the outlook is for larger pay rises over the forecast horizon than was assumed then. Inflation is now projected to align with the target in H2/2026, more than half a year earlier than in the November forecast.



The global economic situation remains uncertain, not least because of the wars in Ukraine and the Middle East. Trading partner GDP growth has been muted, and it is unclear how solid the foundations for growth are. In Iceland as well, uncertainty has mounted in the wake of the volcanic eruptions on the Reykjanes peninsula. Actions taken by the Government in response to the situation could cause the economic outlook to differ from that provided for in the baseline forecast, but it is difficult to assess the impact of such measures before their scope and execution have been determined. The results of the ongoing wage negotiations and possible fiscal measures related to them could also cause the economic and inflation outlook to change relative to the baseline forecast. Another source of concern is still-high inflation expectations, which could make bringing inflation to target more difficult than is assumed in the baseline scenario.

The analysis appearing here is based on the Bank's assessment of economic developments since the publication of *Monetary Bulletin 2023/4* in November 2023, and on the updated forecast presented here. It is based on data available in early February. The risk assessment in the updated forecast is based on the risk assessment in the November forecast.