Demand and GDP growth

III

Domestic private sector demand

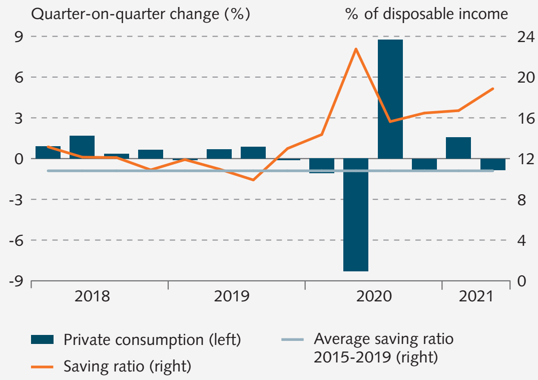
Private consumption contracted again in Q2/2021 …
Private consumption contracted by 0.8% quarter-on-quarter in Q2/2021, after growing by 1.6% in Q1 (Chart III-1). The household saving ratio therefore rose somewhat after having held broadly stable for the two preceding quarters. This is somewhat below the August forecast, and it appears to stem primarily from the fact that growth in households' spending abroad was more sluggish than payment card turnover data had implied.

Owing to a steep contraction in Q2/2020, private consumption grew 8.5% year-on-year but still below the August forecast of nearly 10%. Pulling in the other direction was Statistics Iceland's revision of historical data, which resulted in a smaller deviation in private consumption in H1. The Bank's August forecast assumed a growth rate of 5.2% year-on-year in H1, as opposed to the actual 4.7% according to Statistics Iceland's first figures.

The Government's public health measures have had a significant impact on the composition of consumption spending during the pandemic, but in Q2, household spending increased year-on-year in all categories, particularly those that had been affected by the ban on public gatherings (Chart III-2).

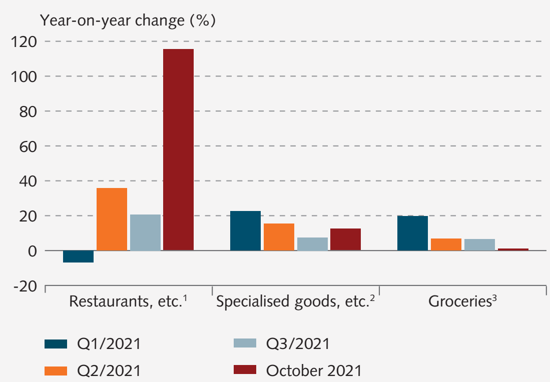
… but there are signs of robust growth in Q3 …
As Chart III-2 shows, household expenditures continued to rise year-on-year in Q3. There are signs that the impact of the pandemic and public health measures on consumption and travel patterns has subsided. Traffic data in the capital area in August and September suggest that more people returned to their workplaces and schools, following a long period of home-based

Chart III-1
Private consumption and household saving[1]
Q1/2018 - Q2/2021



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
Payment card turnover, by category



1. Restaurants, accommodation, transport, package tours, duty-free shopping, culture and recreation, and personal care and services. 2. Electronics, household appliances, furniture, clothing, and other specialised retail goods and services. 3. Grocery stores and supermarkets.
Source: Centre for Retail Studies.

work and study after the pandemic became entrenched in Iceland (Chart 2 in Appendix 1). The composition of consumption spending is also shifting increasingly towards services, non-durables purchased domestically, and consumption abroad, after having been concentrated largely in domestic purchases of consumer durables at the height of the pandemic. Furthermore, new motor vehicle registrations (excluding rental cars) were up nearly 18% year-on-year in July and August. Real incomes have also been on the rise, and the employment outlook has improved markedly. Consumers are also increasingly optimistic, and the Gallup Consumer Confidence Index is at its highest in five years (Chart III-3).

… and year-2021 private consumption growth is poised to be stronger than previously forecast

According to the Bank's baseline forecast, private consumption grew in Q3/2021 by nearly 6% between quarters and 7.5% between years. Year-on-year growth is projected at just under 5% in Q4 and 5.4% in 2021 as a whole, which is 1.2 percentage points above the August forecast. Thus the outlook is for considerably stronger private consumption growth in H2 than was forecast in August, in part because the pandemic's impact on households' appetite and opportunities for consumption is weaker than previously assumed.

Private consumption growth is projected to ease in 2022, partly because of base effects from this year's robust growth (Chart III-4). The outlook is for an annual growth rate of around 4%, on average, over the forecast horizon, up from the 3½% projected in August. The baseline forecast assumes that the household saving ratio will remain above its historical average during the forecast horizon instead of falling gradually back to its pre-pandemic level, as was considered likeliest just after the pandemic reached Iceland. This is highly uncertain, however, and Box 1 describes an alternative scenario based on the assumption that households will draw down their accumulated savings more rapidly than in the baseline forecast. If that scenario materialises, private consumption growth could turn out stronger over the forecast horizon than is assumed in the baseline. Growth could also turn out weaker if global prices rise faster and domestic inflation turns out more persistent, as is described in the other alternative scenario in Box 1.

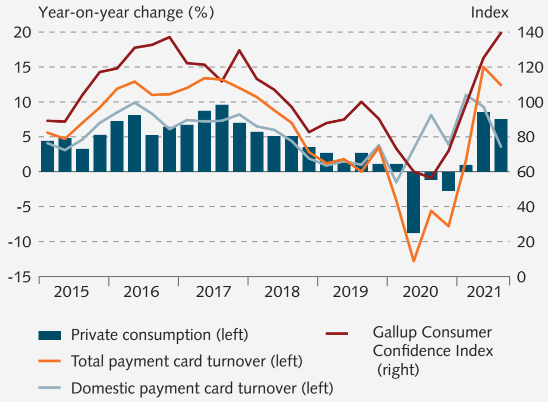
Business investment grows strongly in H1 …

Business investment grew by 21.7% year-on-year in H1/2021, more than double the rate assumed in August. The deviation is due for the most part to a change in Statistics Iceland's treatment of asset leasing agree-

Chart III-3

Private consumption and its indicators[1]

Q1/2015 - Q3/2021

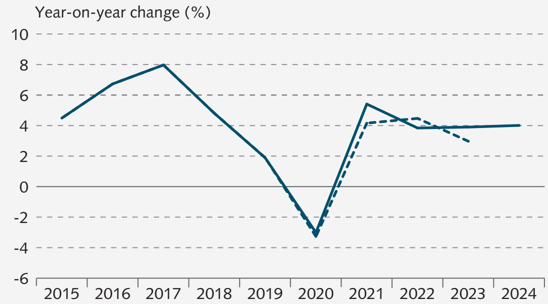


1. The Gallup Consumer Confidence Index is seasonally adjusted. Central Bank baseline forecast Q3/2021 for private consumption.

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 2021/3.

Sources: Statistics Iceland, Central Bank of Iceland.

ments in the national accounts, according to which leased operational assets are in some cases recognised as investments undertaken by the lessee. As a result of this change, investment in aircraft measured much stronger, which explains the lion's share of the more than 40% increase in business investment in Q2/2021 (Chart III-5). Although this is considerably more investment than was assumed in August, the deviation did not have a discernible impact on GDP growth estimates, as corresponding changes were made to goods imports.[1]

Other subcomponents of business investment in H1 were well in line with the Bank's August forecast. Furthermore, the outcome shows a marked rise in corporate investment early in 2021, as revised figures from Statistics Iceland revealed that general business investment (excluding energy-intensive industry, ships, and aircraft) grew much more in Q1 than previous figures had implied. As can be seen in Chart III-6, high-frequency indicators had already suggested that this would be the case. As a result, the expected revision for Q1 was included with Q2 investment in the Bank's August forecast. On the whole, general business investment grew by 16.1% in H1, in line with the August forecast.

… and the outlook for 2021 as a whole has improved since the spring

Leading indicators imply that investment remained strong in Q3. Imports of general investment goods were up 60% year-on-year at constant exchange rates in Q3, far outpacing the first two quarters of the year (Chart III-6). Likewise, the increase in job numbers since this summer indicates that activity in the construction sector has picked up.

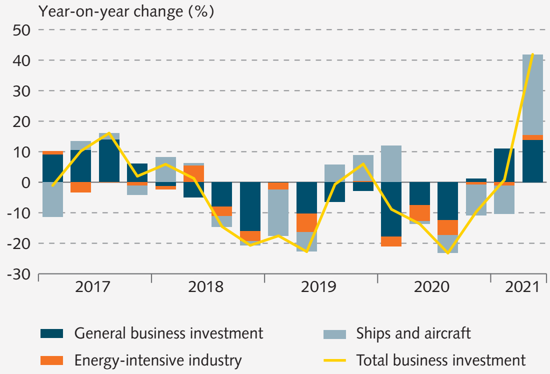
Growing investment activity is also in line with survey findings. The results of Gallup's September survey of Iceland's 400 largest firms suggest that executives are much more sanguine about year-2021 investment than they were in the survey taken in March. The Bank's survey of firms' investment plans, also conducted in September, points in the same direction. According to that survey, firms are planning to step up investment this year by over 16% in nominal terms. This is a larger increase than was suggested by the Bank's March survey (Chart III-7). The same survey also indicates that investment in 2021 will be driven by investment in tourism and transport, manufacturing, and information technology. On the other hand, a large contraction is expected in the fishing industry, although it should be noted that the

1 The change causes GDP to rise marginally, as payments of leasing costs previously included in services imports are no longer recorded in the expenditure approach to GDP calculation in the national accounts.

Chart III-5

Business investment and contribution of components

Q1/2017 - Q2/2021

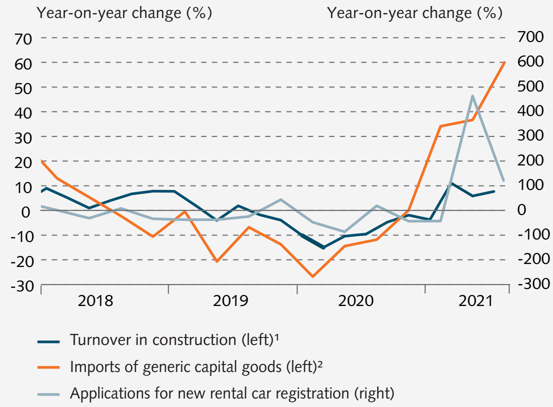


Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-6

Indicators of general business investment

Q1/2018 - Q3/2021

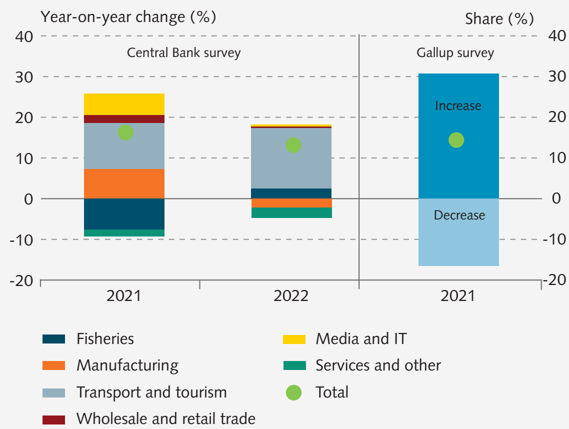


1. Total turnover in the construction sector. The data are according to two-month VAT periods and deflated with the building cost index. 2. Total value of imported capital goods and imported transport equipment excluding ships and aircraft, deflated with the exchange rate index.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-7

Indicators of investment plans in 2021-2022[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.

survey does not include investments in ships and related equipment. Neither does it capture the full impact of current plans for large-scale development in the aquaculture sector, where investment is estimated to double this year and grow still further in 2022. Hotel construction, however, is set to contract. It slowed markedly in 2020, after growing apace in the years beforehand, and several planned hotel projects were postponed or abandoned altogether.

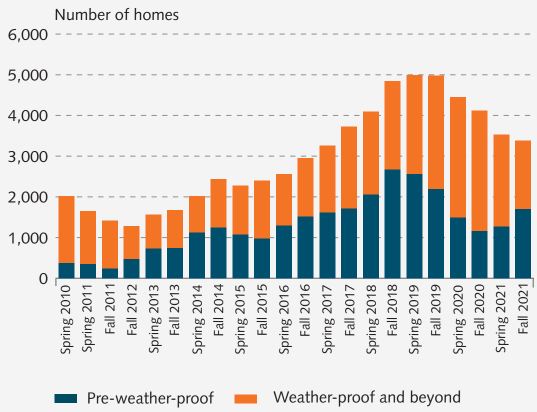
The improved outlook since this spring gives cause to assume that business investment will be stronger this year than was anticipated then. It is now expected to grow by 17.6% year-on-year, over 13 percentage points more than was forecast in August. The aforementioned change in Statistics Iceland's treatment of asset leasing agreements weighs heavily in this, but the outlook for general business investment has improved as well. It is estimated to have grown by a fourth year-on-year in Q3 and is projected to grow by 15½% in 2021 as a whole, up from just over 9% in the August forecast. Business investment spending is also expected to be slightly stronger next year than was assumed in August, but this year's strong investment will cause a larger year-on-year contraction between 2021 and 2022.

Residential investment to contract in 2021, broadly as was forecast in August

Residential investment contracted by 6.7% year-on-year in H1/2021, whereas the August forecast assumed a contraction of 8.6%. Year-2020 figures have been revised upwards in the national accounts, with the result that residential investment is now estimated to have increased by 1.2% between years instead of contracting by that amount. The Federation of Icelandic Industries' recent tally of flats under construction suggests that fewer homes are being built now than in the spring. Owing to robust sales in the recent past, contractors have prioritised construction of properties that are closer to completion. This can be seen in a reduction in the number of flats that are weather-proof and beyond (Chart III-8). The number of homes at the pre-weather-proof stage has begun to rise again, however, and there are signs of increased new construction activity. In spite of this, residential investment looks set to contract this year by about 8%, broadly as was projected in August. Over the next three years, however, the outlook is for growth averaging over 9% per year, which is above the August forecast. If the forecast materialises, the ratio of residential investment to GDP will have risen to 6%, or 2 percentage points above its twenty-five-year average, by the end of the forecast horizon.

Chart III-8

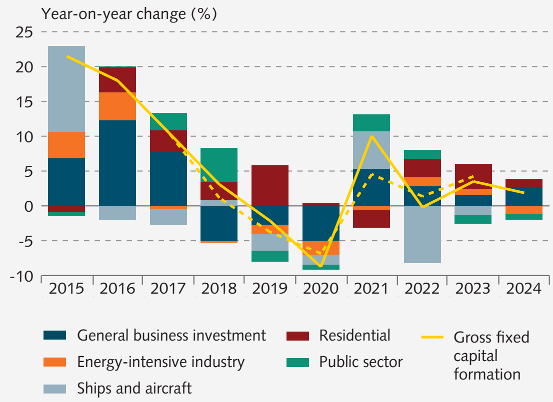
Residential housing under construction in the capital area[1]



1. According to residential construction tallies conducted by the Federation of Icelandic Industries.
Source: Federation of Icelandic Industries.

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 2021-2024. The broken line shows the forecast from MB 2021/3.
Sources: Statistics Iceland, Central Bank of Iceland.

Investment set to grow substantially in 2021

According to the baseline forecast, investment will be 10½% higher this year than in 2020 (Chart III-9). This is more than twice the growth rate projected in August, owing largely to the fact that investment in ships and aircraft has increased as a result of the aforementioned change made by Statistics Iceland. Excluding ships and aircraft, year-2021 investment is driven largely by businesses and the public sector (see below), albeit offset by reduced residential investment. Investment is now stronger over the entire forecast horizon, but because of base effects, the growth rate is projected to ease from 2022 onwards. By the end of the forecast horizon, the investment-to-GDP ratio will be around 21%, broadly in line with the August forecast.

Public sector

Brisk public sector activity during the pandemic

Public sector demand is projected to grow by 3.9% this year, up from 3.2% in 2020. The weight of public investment is expected to be greater this year than last year; however, public consumption spending growth is set to ease after accelerating in 2020. Public investment grew by 14% in H1/2021, driven mainly by central government investment expenditure. Although this increase was considerably smaller than was assumed in August, public investment spending in H1 was nevertheless in line with the August forecast. The deviation is due to Statistics Iceland's large upward revision of year-2020 investment. There is little change in the estimate of public investment for 2021 as a whole, but because of the aforementioned revision of last year's figures, year-on-year growth will be weaker, at 17% instead of the nearly one-fourth projected in August. Public consumption is expected to grow by just over 2% this year, somewhat more than was forecast in August. On the whole, growth in public sector demand will be nearly ½ a percentage point weaker than was assumed in August – again, owing to the aforementioned revision of year-2020 expenditure figures. The outlook for public sector demand growth in coming years is broadly in line with the August forecast.

As can be seen in Chart III-10, the baseline forecast assumes that the public sector share in GDP will continue to increase this year, after rising strongly in 2020, when the steep increase in public spending occurred alongside a contraction in other components of GDP. According to the baseline forecast, the ratio is set to decline again in 2022 but remain considerably above its twenty-year average.

Chart III-10

Public cosumption and investment as a share of GDP 2000-2024[1]

1. Central Bank baseline forecast 2021-2024.
Sources: Statistics Iceland, Central bank of Iceland.

Fiscal deficit due largely to COVID-related measures

Last year's economic contraction, together with the Government's broad-based measures to mitigate the impact of the COVID-19 pandemic, resulted in a central government deficit measuring 8% of GDP (Chart III-11). In H1/2021, the deficit was 7.4%, which represented an improvement of 1.3 percentage points year-on-year, whereas in both the fiscal plan introduced by the Government this past spring and the forecast in the May issue of *Monetary Bulletin*, it was assumed that the deficit would be larger this year than in 2020. This goes hand-in-hand with developments in economic activity, which generally have a strong impact on the Treasury outcome.

According to the baseline forecast, this year's Treasury deficit is estimated to be over 8% of GDP, broadly the same as in 2020. As in the Bank's previous forecasts and the Government's fiscal plan, it is expected that deficit operations will be unwound decisively in coming years as COVID-related measures are unwound and Treasury revenue sources grow stronger.[2]

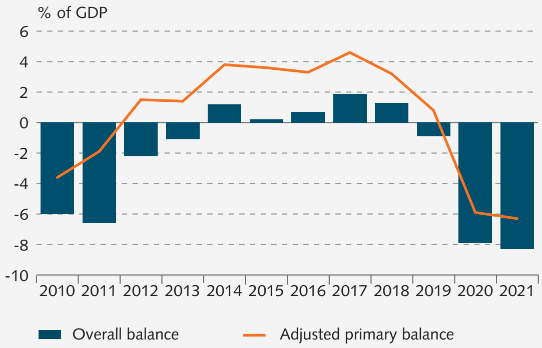
Continued fiscal easing in 2021, with a turnaround expected thereafter

The cyclically adjusted Treasury outcome deteriorated by 4.5% of GDP in 2020 (Chart III-12). This represents a more accommodative fiscal stance than was estimated when the stance was assessed this past spring, reflecting a larger rise in Treasury spending than Statistics Iceland's revised figures indicated. The bulk of last year's fiscal easing is attributed to COVID-related Government measures, although increased public consumption has some effect as well. This year, the fiscal stance is expected to ease by a further 1.7% of GDP, partly because of the previously approved reduction in the lowest personal income tax rate. The combined easing in 2020 and 2021 is therefore estimated at just over 6% of GDP, whereas the August forecast assumed a total of nearly 8%. Most of the Government's COVID-related measures will expire late this year, and all else being equal, the fiscal stance will then tighten once again. In the latter half of the forecast horizon, fiscal consolidation is assumed to increase by just over 1% of GDP per year, as the fiscal plan introduced this spring provided for annual tightening until the rise in the public debt ratio is halted in 2025.

2 Traditionally, the baseline forecast of the Treasury outcome in the November *Monetary Bulletin* is based in part on assumptions that can be found in the fiscal budget proposal for the coming year. This time, however, the proposal was not available when the forecast was prepared, and the fiscal plan from this spring was used instead. For the same reason, this issue of *Monetary Bulletin* does not contain the customary Box on the fiscal budget proposal.

Chart III-11

Treasury outcome 2010-2021[1]

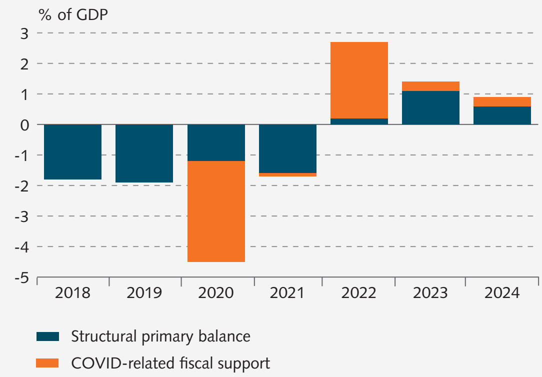


1. The primary balance is adjusted for one-off items. For 2016 through 2020, both the overall balance and the primary balance are adjusted for stability contributions, accelerated write-downs of indexed mortgage loans, a special payment to LSR A-division, dividends in excess of the National Budget, delivery of the Hvalfjarðargöng tunnel project and other discretionary measures. Central Bank baseline forecast 2021.

Source: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

Chart III-12

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



1. The primary balance is adjusted for one-off items. Central Bank baseline forecast 2021-2024.

Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

This assessment could change, however, with the fiscal plan prepared by the new Government (see also Box 1).

External trade and the current account balance

Exports recover gradually in H1 after last year's contraction …

Goods and services exports grew by 7.5% quarter-on-quarter in Q2/2021, after contracting in Q1 (Chart III-13). Stronger exports related to tourism and other services weighed heavily in the increase but were supplemented by marine product exports, which stemmed in particular from a strong capelin season. Year-on-year export growth measured nearly 28% during the quarter, some 9 percentage points below the August forecast. Year-on-year growth in services exports was also well below the forecast, owing in particular to weaker-than-expected exports relating to passenger transport by air. This is due in large part to Statistics Iceland's revision of year-2020 data.

Stringent public health measures were in place in the first half of the quarter, but they were eased as the pandemic subsided and vaccination rates rose in Iceland and trading partner countries, and tourist arrivals to Iceland began to increase rapidly as a result. Tourism-related exports surged by over 273% year-on-year during the quarter, concurrent with the increase in tourist visits. Even so, services exports measured only 23%, and tourist arrivals only 14%, of the respective totals for Q2/2019.

Developments in goods exports in H1/2021 were well in line with the Bank's August forecast, however. In Q2, goods exports were up 16.3% year-on-year, which is consistent with that forecast. The steep rise in marine product exports was a major factor in this, although exports of other goods grew as well, particularly to aquaculture products and manufactured goods other than aluminium.

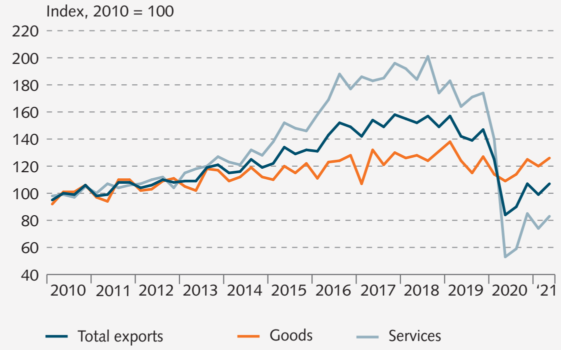
… and pick up in Q3

Export growth appears to have been stronger in Q3/2021 than was projected in August. Tourism recovered more decisively, and tourist arrivals trebled between years, although they were still barely more than half of the total for Q3/2019 (Chart III-14). Furthermore, there are indications that tourists stayed longer and spent more, on average, than in previous years. Moreover, exports of aluminium and other goods grew markedly during the quarter, concurrent with sharply rising prices, whereas marine product exports were weaker than in Q3/2020, after capelin exports peaked this spring.

Chart III-13

Exports of goods and services[1]

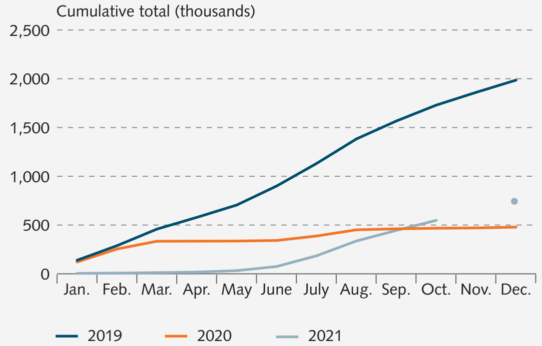
Q1/2010 - Q2/2021



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

Chart III-14

Foreign nationals' departures via Keflavík Airport 2019-2021[1]



1. Cumulative total for each year. The dot indicates the 2021 total according to the Central Bank's baseline forecast.
Sources: Icelandic Tourist Board, Central Bank of Iceland.

Stronger goods exports in 2022 due to increased capelin quota

The outlook for goods exports in 2021 and 2022 has improved since the last forecast, with year-on-year growth in 2021 expected to measure 7.6% instead of the previously projected 6.1%. For marine product exports, the outlook has improved because of this the increased capelin quota for this fishing year, which offsets the reduction in the cod quota. Furthermore, aluminium exports look set to be stronger than was forecast in August.

The impact of the increased capelin quota will show more clearly in 2022, although it will be offset by the reduced quotas for blue whiting, mackerel, and Norwegian summer-spawning herring. The Bank's August forecast had assumed an increase in the capelin quota, but based on the quota recently issued, the value of capelin exports is expected to be some 30 b.kr. more than in that forecast. As a result, marine product exports are estimated to increase by 4.5% year-on-year instead of contracting by that amount, as was projected in August. The outlook is also for total goods exports to grow by 4.5% in 2022, as opposed to 1.2% in the August forecast. The improved outlook is due almost entirely to increased exports of capelin products.

Recovery of tourism set to continue

Despite this summer's swift rise in infection rates following the spread of the Delta variant of COVID-19, and Iceland's inclusion in the European and American public health authorities' red list, tourist numbers rose faster over the course of Q3 than had been assumed in the August forecast. It is now estimated that some 720,000 tourists will visit Iceland in 2021 as a whole, instead of the 680,000 forecast in August. This means that Q4 arrivals will be about 65% of the Q4/2019 total, about the same percentage as in the latter half of Q3 (Chart 2 in Appendix 1). Other leading indicators also imply that the sector will recover faster than previously anticipated. For instance, the number of Google searches for flights to Iceland and hotels in the country has risen since the summer and is approaching the pre-pandemic level. Furthermore, now that vaccinated foreigners are authorised to travel to the US – for the first time since March 2020 – the outlook is for international air travel to pick up in coming quarters. Thus the outlook is for the number of transit passenger numbers to rise again over the coming winter. The outlook for 2022 is also slightly better than was assumed in August, with tourist arrivals estimated at 1.5 million, which is more than in the August forecast but in line with the May forecast.

Prospects for tourism are still highly uncertain worldwide, and a setback in the fight against the pandemic could upend these projections. Furthermore, a rise in oil prices could push airfares upwards in the coming term and put a damper on appetite for travel.

Even though the outlook for tourism is brighter in H2/2021, growth was more sluggish in Q2; therefore, services exports are now projected to grow by about one-fourth in 2021 as a whole instead of the 29% forecast in August. Prospects for 2022 have improved, however, and growth is forecast at just over 42%, up from the scant 40% assumed in August.

Export outlook broadly unchanged for 2021 but more favourable for 2022

Total exports are estimated to increase this year by 14.1%, similar to the August forecast, with weaker services exports in Q2 offsetting stronger goods exports in H2 (Chart III-15). The outlook for 2022 has improved, and total exports are projected to grow by nearly 20%, as compared with the 16.7% forecast in August. The substantially increased capelin quota is a major driver of the improvement, although the brighter outlook for services exports is also a factor. If the forecast materialises, total export volumes will have returned to their 2017 level by the end of the forecast horizon, which is broadly in line with the August forecast.

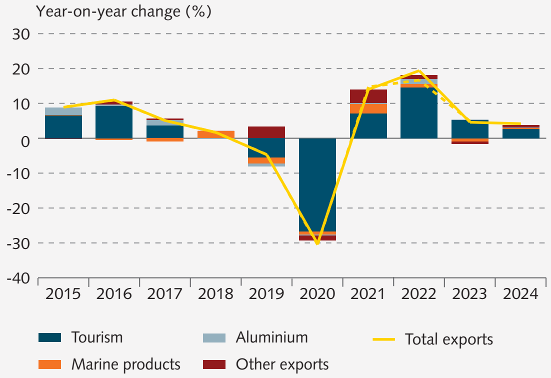
Continued growth in imports

Imports of goods and services grew by 10.4% quarter-on-quarter in Q2 (Chart III-16), led by imports of aircraft, although services imports and other goods imports grew as well. Imports were up by a third year-on-year, outpacing the August forecast of one-fourth. The difference is due mostly to stronger-than-expected aircraft imports, which in turn are due to the change in Statistics Iceland's treatment of aircraft leasing agreements.

Leading indicators imply that imports continued to grow in Q3, as Icelanders travelled abroad in far greater numbers and goods imports were stronger than previously anticipated. Icelanders' overseas travel is expected to increase still further in Q4, and more rapidly than was assumed in August. The outlook is also for considerably stronger growth in goods imports during the quarter. Aircraft imports are expected to increase, and there are signs of strong imports in many key goods categories as well. Total imports are therefore projected to increase by just over 18% this year, or 6 percentage points above the August forecast, and by 12% in 2022.

Chart III-15

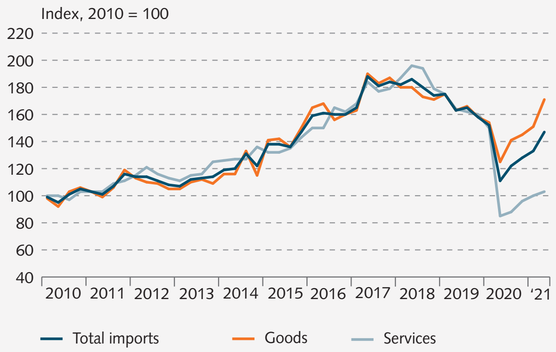
Exports and contribution of subcomponents 2015-2024[1]



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 2021-2024. The broken line shows the forecast from MB 2021/3.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-16

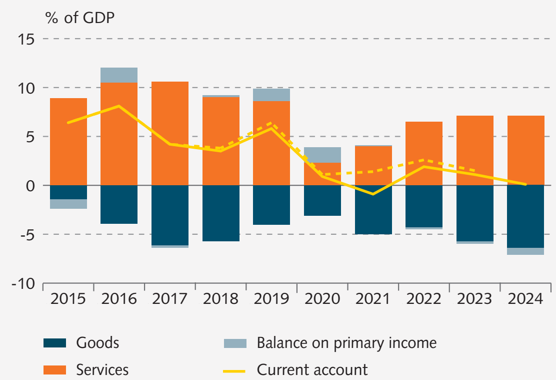
Imports of goods and services[1]
Q1/2010 - Q2/2021



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

Chart III-17

Current account balance 2015-2024[1]



1. Current account excluding the effects of failed financial institutions in 2015. The balance on secondary income is included in the balance on primary income. Central Bank baseline forecast 2021-2024. The broken line shows the forecast from MB 2021/3.
Sources: Statistics Iceland, Central Bank of Iceland.

Current account to show a small deficit in 2021

Iceland recorded a current account deficit of 3.9% of GDP in Q2/2021, whereas the August forecast assumed a 1% surplus. The difference was due mainly to weaker services exports and increased goods imports, the latter of which stems from the aforementioned methodology change made by Statistics Iceland. In addition, the surplus on primary income was smaller than previously forecast. A current account surplus is still expected in Q3, followed by a larger one in Q4. The main drivers of the improvement are tourism-related services exports and more favourable terms of trade. Even so, a deficit measuring 0.9% of GDP is expected for 2021 as a whole (Chart III-17). If this materialises, it will be Iceland's first full-year current account deficit since 2008. The current account balance is projected to turn positive again in 2022, fuelled by increased growth in services exports and improved terms of trade. The surplus for the year as a whole is forecast at 1.9% of GDP, ½ a percentage point below the August forecast. As in August, the surplus is expected to narrow again in the latter half of the forecast horizon.

GDP growth

H1 GDP growth weaker than was forecast in August

GDP grew by 4.2% quarter-on-quarter in Q2/2021, compared to the almost 9% growth expected in August (Chart III-18). The weaker growth rate is due in large part to unfavourable developments in private consumption and exports, as is discussed earlier in this chapter. GDP grew by 7.3% year-on-year during the quarter, with 9.4% growth in domestic demand offset by a negative contribution from net trade in the amount of 2.3 percentage points (Chart III-19). In Q2, GDP grew somewhat less year-on-year than had been assumed in August, in part because of Statistics Iceland's revision of Q1 GDP growth figures. The difference for H1 is therefore smaller, with Statistics Iceland's preliminary numbers indicating a 3.5% growth rate for H1 as compared with 4.7% in the August forecast. As is discussed above, the change in Statistics Iceland's treatment of aircraft leasing contracts affects the comparison of GDP growth subcomponents: investment increases as a result, albeit offset by stronger imports.

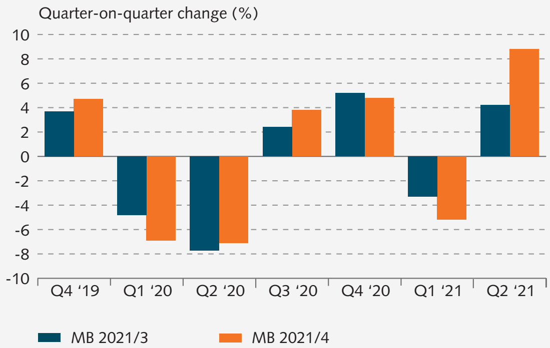
GDP growth set to outpace the August forecast in H2/2021 …

To a large extent, strong growth in private consumption and investment explains why Q3/2021 GDP growth appears to have exceeded the August forecast. A more

Chart III-18

Quarterly changes in GDP growth[1]

Q4/2019 - Q2/2021



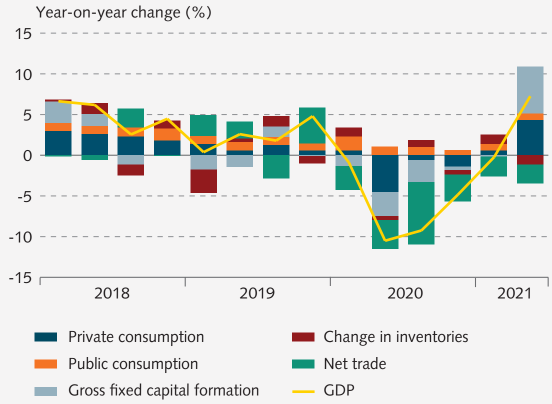
1. Seasonally adjusted figures. Data for the series MB 2021/4 show Statistics Iceland's measurement from August 2021, but data for the series MB 2021/3 show Statistics Iceland's measurement from May 2021, with the exception of Q2/2020 data, which are taken from the baseline forecast in MB 2021/3.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-19

GDP growth and contribution of underlying components[1]

Q1/2018 - Q2/2021

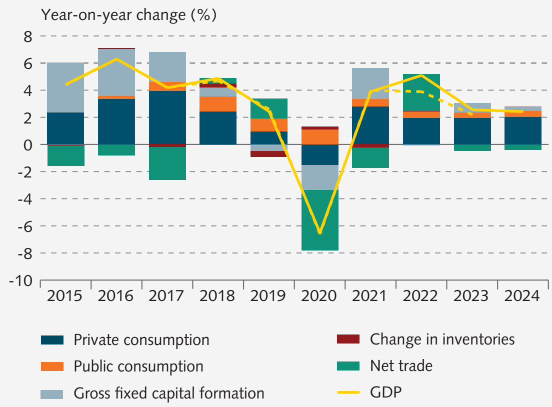


1. Because of chain-volume linking, the sum of expenditure components may not equal GDP growth.

Sources: Statistics Iceland, Central Bank of Iceland.

Chart III-20

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



1. Central Bank baseline forecast 2021-2024. The broken line shows the forecast from MB 2021/3.

Sources: Statistics Iceland, Central Bank of Iceland.

favourable contribution from net trade pulls in the same direction. The outlook is for a 6½% year-on-year increase in GDP in Q3. For 2021 as a whole, GDP growth is projected at 3.9%, some 0.1 percentage points below the August forecast (Chart III-20). The poorer outlook for 2021 reflects more sluggish growth in H1, although it will be offset in part by stronger GDP growth in H2.

… and in 2022 …

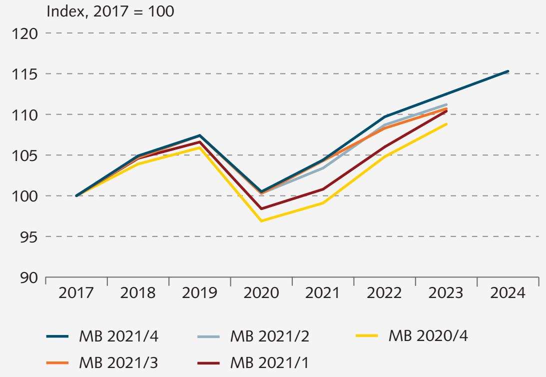
GDP growth is expected to accelerate still further in 2022, owing mainly to strong growth in exports as a result of increased revenues from tourism and a more favourable capelin season. The contribution of net trade to output growth will therefore be positive by 2.7 percentage points – the first positive contribution since 2019. The contribution of private consumption growth to GDP growth will also be positive, but less so than in 2021. GDP growth is projected to measure 5.1% in 2022, some 1.2 percentage points above the August forecast. About half of this revision is attributable to the expectation of an increased capelin catch.

… whereas the outlook further ahead is broadly unchanged

The GDP growth outlook for the long term is more or less unchanged. Growth is set to ease to 2.6% in 2023 and remain around that level in 2024. If this forecast materialises, GDP will return to its 2019 level slightly earlier in 2022 than was assumed in August. It will also remain higher over the entire period than in the Bank's previous forecasts (Chart III-21). As before, the outlook is subject to considerable uncertainty. Key uncertainties in the forecast are discussed in Box 1.

Chart III-21

Gross domestic product 2017-2024[1]



1. Central Bank baseline forecasts from November 2020 onwards.
Sources: Statistics Iceland, Central Bank of Iceland.