Monetary Bulletin in a nutshell

Global GDP growth was stronger in H1/2021 than was assumed in the August *Monetary Bulletin* but looks set to sag in H2, largely because of the persistent supply-chain disruptions that can be seen, for example, in shortages of intermediate inputs for industrial manufacturing and in shipping bottlenecks. The interaction between these factors and the strong recovery of demand for goods has pushed commodity prices and shipping costs sharply upwards. As a result, inflation has risen steeply worldwide.

In Iceland, GDP growth was a full 1 percentage point lower in H1 than was projected in August. Although there are signs of robust growth in H2, the outlook is for year-2021 GDP growth to be marginally below the August forecast, at 3.9% instead of 4%. The outlook for 2022 has improved markedly, however, owing to better prospects for the tourism and fishing industries. GDP growth is forecast to measure 5.1% in 2022 and ease to around 2½% from 2023 onwards.

Job numbers continue to rise, and unemployment is approaching its pre-pandemic level. The number of job vacancies has also risen steeply, as has the number of firms that consider themselves short-staffed. The outlook is for unemployment to keep falling, and towards the end of the forecast horizon it is expected to measure about 4%, close to its estimated equilibrium level. Leading indicators also imply that the slack in output is narrowing quickly and may even have closed already.

Inflation has been more persistent than was assumed in August. Although the effects of last year's depreciation of the króna have disappeared, global oil and commodity prices have risen more than expected, and shipping costs are far higher than could have been foreseen. Furthermore, some domestic inflationary pressures remain, as can be seen in steeply rising wages and house prices. Inflation measured 4.5% in October and has therefore remained above 4% throughout 2021. Although inflation excluding housing and underlying inflation have eased, there are signs that long-term inflation expectations have risen. The inflation outlook is therefore considered to have deteriorated since the Bank's last forecast, owing primarily to persistent global price rises, larger wage increases, and the expectation of a larger output gap in 2022. Inflation appears set to measure 4.7% in Q4/2021, or 0.6 percentage points above the August forecast. It is not expected to fall below 4% until next spring, and it will not fall below 3% until Q4/2022.

Forecasts of the economic recovery in Iceland and elsewhere are based to some extent on the assumption that there will not be a setback in the fight against the pandemic. Another major uncertainty lies in how quickly the supply-chain disruptions underlying the surge in global commodity prices and shipping costs can be unwound. Added to this is uncertainty about fiscal policy in the wake of Iceland's recent Parliamentary elections, as well as about wage developments and how rapidly households will tap into the savings they built up during the pandemic. The inflation outlook could therefore be overly optimistic, particularly if inflation expectations have become unmoored from the target.

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