

Monetary Bulletin in a nutshell



Russia's invasion of Ukraine has pushed prices of energy, commodity, and food products higher. The risk is that, with the war and tightened public health measures in China, it will take longer to unwind the supply-chain disruptions that have plagued the global economy for the past two years. The economic outlook among trading partners, particularly in Europe, has therefore deteriorated relative to the Bank's February forecast. Inflation has risen sharply the world over, reaching highs not seen in decades. The war also erodes the global inflation outlook significantly.



Although steep rises in the price of marine and aluminium products offset the negative terms of trade effects of higher oil and commodity prices, the economic outlook for Iceland has worsened since February. Because the growth outlook for key trading partners has deteriorated, slower export growth is forecast, and greater uncertainty and higher input prices and living costs look set to impede growth in private consumption and investment. Offsetting this are, among other things, signs of robust activity in 2022 to date. GDP growth for this year is projected at 4.6% instead of the 4.8% in the February forecast. As in February, the domestic economy is estimated to be running at full capacity, and capacity constraints are likely to slow down GDP growth as the forecast horizon advances.



Job numbers continue to grow rapidly and are now above the pre-pandemic level. Job vacancies have also increased markedly. A steadily growing number of firms report being understaffed, and the foreign labour force is growing swiftly. Unemployment has fallen faster than was projected in February and is now estimated to be below its equilibrium level.



In April, inflation measured 7.2%, its highest since 2010. As before, it is driven mainly by surging house prices, plus sharply increasing global oil and commodity prices. The effects of strong domestic inflationary pressures are discernible as well, as can be seen, for instance, in steep wage rises. Underlying inflation has therefore risen rapidly, to 5.3% in April. Inflation expectations have also continued to rise. Inflation is projected to keep increasing, averaging 8.1% in Q3/2022, some 2.8 percentage points above the February forecast. It is not expected to fall below 3% until late-2024. The bleaker inflation outlook is attributable largely to the effects of the war in Ukraine; furthermore, the recent rise in long-term inflation expectations slows down the disinflation further ahead.



Economic uncertainty has escalated sharply following the invasion of Ukraine. The war has upended global commodity markets and thrown trade relationships and supply chains into disarray. It is difficult to predict how deep and lasting these effects will be. The same is true of the effects of the war on global financial markets and on households' and businesses' spending and investment decisions. Added to this is uncertainty about the impact tightened public health measures in China will have on important supply chains. Given the recent rise in long-term inflation expectations, there is greater risk that the inflation outlook as depicted in the Bank's forecast is overly optimistic. Furthermore, the risk of a wage-price spiral would grow if next winter's wage settlements provide for large pay hikes, which could cause high inflation to become more firmly entrenched.

The analysis presented in this *Monetary Bulletin* is based on data available at the end of April.