IV Demand and GDP growth

After several robust years, GDP growth slowed markedly in H1/2019. Developments year-to-date have been broadly in line with the Bank's August forecast, although imports have contracted more than previously expected and demand has shifted more towards domestic goods and services. As a result, GDP growth was somewhat stronger than expected in H1. The reversal that has taken place in the economy can be attributed in large part to reduced activity in tourism and its effect on household demand and firms' investment plans. This is expected to continue in H2, and GDP could contract marginally in 2019 as a whole.

GDP growth and domestic private sector demand

H1 GDP growth the weakest since early 2014 …

According to preliminary figures from Statistics Iceland, GDP growth measured 0.9% in the first six months of 2019; however, developments in the two quarters of that half diverged markedly, with a contraction of 0.9% in Q1, followed by a rebound to 2.7% in Q2 (Chart IV-1). The contraction in Q1 is due largely to a decline in inventories in Q1, which in turn was attributable to the failure of the capelin catch, while in Q2 a sharp contraction in imports resulted in a positive contribution from net trade despite negative external shocks and a sizeable contraction in exports.

Total consumption and investment declined by 1.4% in H1, but because of the aforementioned inventory changes, the contraction in domestic demand was larger, at 2.4%. Exports shrank by 2.8% during the half, yet the contribution from net trade was positive by 3.3 percentage points, as imports contracted by 10.6% during the period. GDP growth in H1/2019 was the weakest since Q1/2014, and well below the five-year average of 4.5%.

… but stronger than was projected in the Bank's August forecast

GDP growth measured 1.7% in Q1, according to Statistics Iceland's preliminary estimates from August. Based on this figure, the Bank projected a contraction of nearly 1% for Q2 in its August forecast. Because Statistics Iceland's revision of Q1 GDP growth figures was so large – owing mainly to a reassessment of residential investment and its distribution within the period – it is more informative to examine the first two quarters together. Doing so reveals that GDP growth for H1 was stronger than had been forecast in August, at 0.9% instead of the projected 0.5% (Chart IV-2). Business investment turned out somewhat weaker than anticipated, while the contribution from net trade to output growth was considerably more positive.

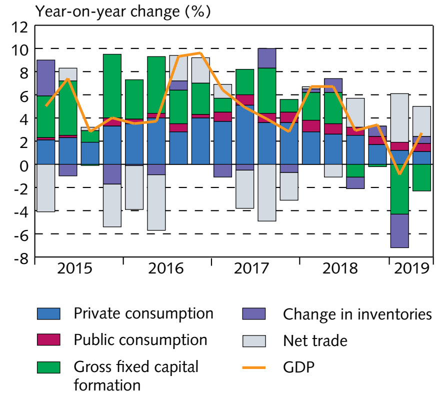
Disposable income growth has eased after rising steeply for several years

In 2018, households' real disposable income increased by 4.5%, well below the 2015-2017 average of 9.5%. A major factor in this was a decline in investment income (Chart IV-3). Inflationary effects played

Chart IV-1

GDP growth and contribution of underlying components[1]

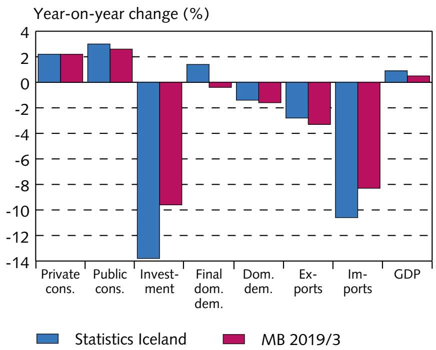
Q1/2015 - Q2/2019



1. Because of chain-volume linking, the sum of components may not equal GDP growth.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-2

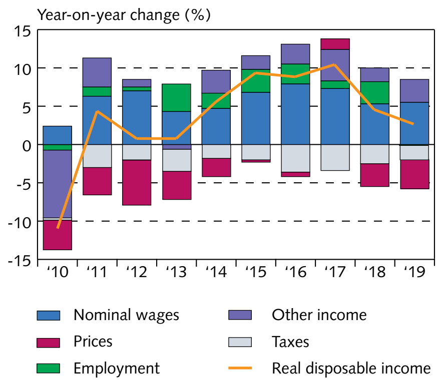
National accounts for H1/2019



Sources: Statistics Iceland, Central Bank of Iceland.

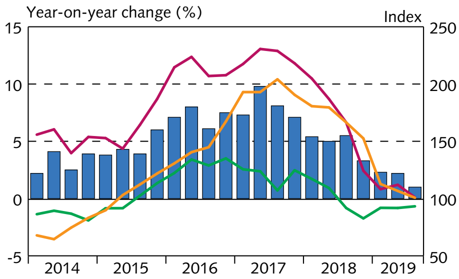
Chart IV-3

Real disposable income and its main components 2010-2019[1]



1. The contribution of the main underlying components in annual changes in real disposable income is calculated based on each component's weight in disposable income. The combined contribution of underlying components does not equal the total change due to rounding and incomplete household income accounts from Statistics Iceland. Disposable income is deflated using the private consumption price index. Central Bank baseline forecast 2019.
Sources: Statistics Iceland, Central Bank of Iceland.

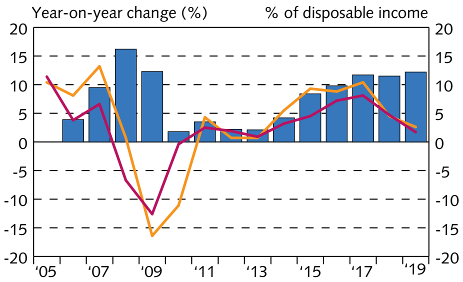
Chart IV-4
Private consumption and its indicators[1]
Q1/2014 - Q3/2019



- Private consumption (left)
- Payment card turnover (left)
- New motor vehicle registrations (right)
- Gallup Consumer Confidence Index (right)

1. Private consumption and payment card turnover are year-on-year changes, while the figure for new motor vehicle registrations is a seasonally adjusted index with a mean of 100. New motor vehicle registrations net of car rental agencies' applications for new registrations in each quarter. Central Bank baseline forecast Q3/2019 for private consumption.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Chart IV-5
Private consumption, disposable income, and saving 2005-2019[1]



- Household saving (right)
- Private consumption (left)
- Real disposable income (left)

1. There is some uncertainty about Statistics Iceland's figures on households' actual income levels, as disposable income accounts are not based on consolidated income accounts and balance sheets. The saving ratio is calculated based on the Central Bank's disposable income estimates, as Statistics Iceland figures are rescaled to reflect households' estimated expenses over a long period. Central Bank baseline forecast 2019.
Sources: Statistics Iceland, Central Bank of Iceland.

an important role as well, as the private consumption price deflator rose last year, whereas it had fallen in 2017. This year, wage income is expected to grow more slowly than in 2018, owing largely to a reversal in demand for labour (see Chapter V). As a result, growth in real disposable income is projected to ease year-on-year. This is offset in part by reduced payments of debt interest and increased transfer income for households. If this is borne out, households' real disposable income will increase by 2.6% this year.

Private consumption growth has eased, as anticipated …

Private consumption grew by 2.2% in H1/2019, in line with the Bank's August forecast, whereas private consumption per capita was virtually unchanged between years. After several strong years, private consumption growth has slowed in recent quarters to its weakest since H2/2013. The slowdown in real disposable income growth, increased uncertainty about the economic outlook, and saturation in the market for consumer durables are probably the main reasons for the change.

… and looks set to slow further in H2

Leading indicators imply that private consumption growth slowed still further in Q3 (Chart IV-4). Setbacks in the tourism industry have affected the labour market, which in turn affects household income. By the same token, sentiment among both consumers and retail and wholesale executives has been tepid. The forecast assumes that private consumption will grow by 1.2% year-on-year in H2 and that the full-year increase will measure 1.7%, slightly below the August forecast of 1.9%. If this materialises, household saving will increase slightly this year, as disposable income will rise more than consumption spending (Chart IV-5).

All categories of business investment contract year-on-year

Total investment was down 13.8% year-on-year in H1/2019, a somewhat larger contraction than the Bank had assumed in August. The main difference was in business investment, which contracted by nearly a third, whereas the August forecast had assumed a contraction of a fourth. Most of the deviation was due to general business investment (i.e., excluding energy-intensive industry, ships, and aircraft), which contracted by 15% in H1. The contraction in business investment was distributed across all of its major categories: in addition to the downturn in general business investment, investment in energy-intensive industry and related sectors declined by over 17%, and sales of ships and aircraft were recorded as a contraction in investment during the period. Offsetting this reduction in business investment were a nearly one-third increase in residential investment and a more than 6% rise in public investment.

Firms expect to invest less in 2019 than they anticipated this spring

The results of the Bank's autumn survey of businesses' investment plans suggest that their nominal investment spending will be about

Table IV-1 Survey of corporate investment plans (excluding ships and aircraft)[1]

Sector (number of companies)	*2018 (b.kr.)*	*2019 (b.kr.)*	*2020 (b.kr.)*	*Change 2018-2019 (%) (last survey)*	*Change 2019-2020 (%)*
Fisheries (16)	9.8	11.2	12.0	13.6 (21.4)	7.6
Manufacturing (14)	7.4	5.2	4.9	-30.4 (-34.9)	-6.1
Wholesale and retail trade (22)	7.8	11.8	9.2	51.3 (68.7)	-22.4
Transport and tourism (8)	19.6	13.0	15.5	-33.5 (-4.1)	19.2
Finance/Insurance (10)	3.3	4.7	8.4	41.7 (63)	77.8
Media and IT (6)	8.0	9.2	8.9	15 (20.7)	-3.8
Services and other (21)	14.1	16.6	11.5	18 (15.4)	-30.7
Total (97)	70.1	71.8	70.4	2.4 (14.3)	-1.9

1. Paired comparison with the survey discussed in *Monetary Bulletin* 2019/2.
Source: Central Bank of Iceland.

2.4% more this year than in 2018. The main difference lies in increased investment plans by firms in trade and services, whereas firms in tourism and transport, as well as in manufacturing, plan to reduce their investment spending this year (Table IV-1). The previous survey, conducted by the Bank this spring, indicated a much larger increase in planned investment than the autumn survey did. The change between surveys is due in large part to a change in plans by a small number of large companies in trade, tourism, and transport.[1] Even though the survey results indicated an increase in planned investment, firms intending to scale down investment between years outnumbered those planning to step it up.

The Gallup survey among Iceland's 400 largest firms, taken in September, gives a somewhat different picture of respondents' investment plans (Chart IV-6). According to the survey, executives expect to invest less this year than in 2018. Only in the fishing industry does the number of firms planning increased investment exceed the number planning to scale investment down. Compared with the Gallup survey conducted this spring, the number of executives in all sectors who expect to invest less than in 2018 has fallen. As a result, the balance of opinion on investment plans (those planning an increase net of those planning a reduction) was less negative this autumn than it was in the spring survey. This does not apply to the construction and utilities sector, however, where the share of firms intending to scale down investment has risen further. This accords with the sentiment among executives in these sectors concerning demand for their products and services, and it indicates that construction activity may slow still further (Chart IV-7).

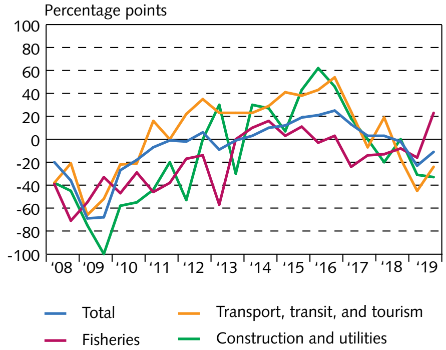
Outlook for business investment weaker than in the last forecast

The outlook for business investment in 2019 has therefore worsened in comparison with the Bank's investment survey findings from the spring, although the Gallup survey indicates a less pronounced change. The surveys do suggest, however, that the contraction in business investment has already abated (Chart IV-8). Based on these surveys and other indicators of developments in investment and firms' investment

1. It should be noted that the Bank's survey does not include firms' planned investment in ships, aircraft, heavy industry, or hotel construction.

Chart IV-6

Investment: balance of opinion, by sector[1]

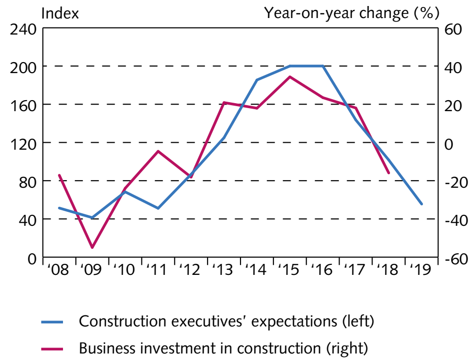


1. The balance of opinion is the share of firms that expect to increase investment between years net of the share that expect to reduce investment.
Source: Gallup.

Chart IV-7

Expectations within construction sectors and developments in construction[1]

2008-2019

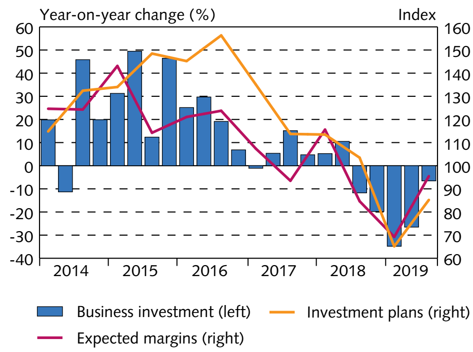


1. Expectations of executives in the construction and utilities sectors on developments in domestic demand for their firms' goods and/or services in the next six months. The index takes a value between 0 and 200, with a value of 100 indicating parity between those expecting an increase and those expecting a decrease.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Chart IV-8

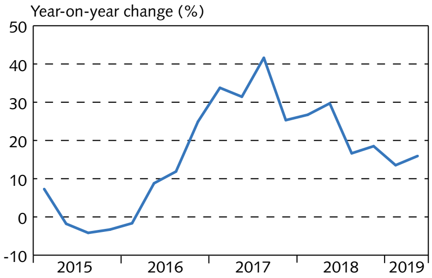
Business investment and its indicators[1]

Q1/2014 – Q3/2019



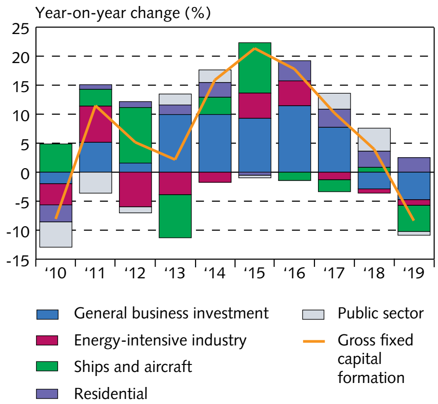
1. Figures on expected margins (EBITDA) and investment plans are indices that measure expectations six months ahead as reported by executives from Iceland's 400 largest companies. The indices are rescaled so that their average from 2006 onwards equals 100. Central Bank baseline forecast Q3/2019 for business investment.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Chart IV-9
Residential investment[1]
Q1/2015 - Q2/2019



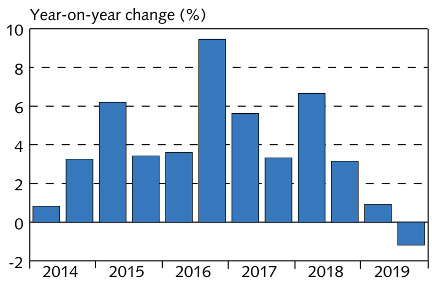
1. Four-quarter moving average of year-on-year changes.
Source: Statistics Iceland.

Chart IV-10
Gross fixed capital formation and contribution of main components 2010-2019[1]



1. General business investment excludes ships, aircraft, and energy-intensive industry investment. Central Bank baseline forecast 2019.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-11
GDP growth[1]
H1/2014 - H2/2019



1. Central Bank baseline forecast H2/2019.
Sources: Statistics Iceland, Central Bank of Iceland.

plans, it is assumed that general business investment will contract by nearly 4% in H2 and close to 10% in 2019 as a whole. Overall business investment is projected to contract by a full 16%, although the adverse impact of ship and aircraft sales and the contraction in energy-intensive investment weigh heavily as well. In comparison with the Bank's August forecast, the outlook is poorer for all key categories of business investment, which mainly reflects a larger contraction in H1, as the outlook for H2 is broadly unchanged.

Growth in residential investment appears to have begun to ease

Residential investment grew by just under a third year-on-year in H1/2019, broadly as was forecast in August. Year-on-year growth has eased somewhat (Chart IV-9), and key indicators imply that construction activity lost pace further still in Q3. The Federation of Icelandic Industries' most recent figures suggest, for instance, that the number of flats in the first stages of construction has fallen since March, when the previous count was taken. Residential investment is projected to grow by 13% this year, roughly as was forecast in August. If the forecast materialises, the contribution of residential investment to output growth will be slightly less positive this year than in 2018 and the residential investment-to-GDP ratio just under 5%.

Gross capital formation to contract in 2019 after several years of strong growth

Gross capital formation is projected to decrease year-on-year by 2.6% in H2 and by 8.4% in 2019 as a whole. This would be the first contraction between years since 2010. Setbacks in the airline industry have a significant impact, and a large share of the contraction is attributable to the sale of ships and aircraft, which is added to the sizeable contraction in general business investment (Chart IV-10). This contraction, which is somewhat larger than was forecast in August, extends to all categories of investment. If the forecast materialises, the investment-to-GDP ratio will decline by just over 1½ percentage points between years, to 20.8%, slightly less than 1 percentage point below its twenty-five-year average.

GDP set to contract in 2019 despite expansion in H1

As is mentioned above, output growth in H1 somewhat exceeded the August forecast. GDP is assumed to have contracted again in Q3, owing largely to a sharp contraction in goods exports (see below). As a result, it is projected to contract by 1.2% in H2 (Chart IV-11), giving a contraction of 0.2% for the year as a whole. A contraction in investment and the negative impact of inventory changes weigh against continued growth in consumption spending and a positive contribution from net trade (Chart IV-12).

The GDP growth outlook for 2019 as a whole is therefore unchanged since August, even though H1 growth was stronger than previously projected. The outlook for H2 has deteriorated, however, owing in particular to more sluggish growth in domestic demand and a poorer outlook for exports, although this is offset in part by the prospect of a larger contraction in imports. If the forecast materialises, the year will see Iceland's first economic contraction since 2010.

Public sector

Public consumption growth set to grow faster in 2019 than forecast in August

In the first half of the year, public consumption growth measured 3%, slightly more than was forecast in August. This was offset, however, by weaker growth in public investment. Total public spending according to the national accounts increased by 3.3%, in line with the Bank's forecast. The outlook for 2019 as a whole is for a 3.2% increase in public consumption and a positive contribution to output growth of 0.8 percentage points (Chart IV-13). This would be the third consecutive year with public consumption growth exceeding 3% year-on-year. The new fiscal plan contains consolidation plans that appear likely to materialise, as growth in central government consumption spending is below 2% year-to-date. Municipal and social security spending has grown much more, however.

The outlook is for a contraction of nearly 4% in public investment in 2019. The contraction is due to a large increase in 2018, when the Hvalfjarðargöng tunnel was transferred from private to public ownership. Excluding the effects of the transfer, public investment is projected to increase by 5.7% this year. The public investment-to-GDP ratio is expected to return to its pre-crisis level for the first time in a decade.

Treasury primary surplus smaller in 2019 than in 2018

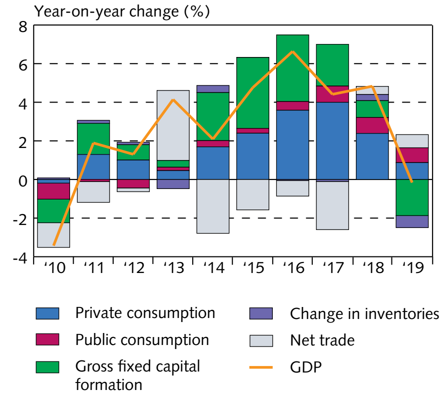
According to figures from Statistics Iceland, the Treasury operated at an overall surplus of 0.9% of GDP in 2018, some 0.4 percentage points less than preliminary figures had indicated. This year, the surplus is expected to shrink by 0.5 percentage points year-on-year, to 0.4% of GDP (Chart IV-14). At the same time, the primary surplus is expected to decline to 1.9% of GDP. This is a poorer outcome than the Bank had forecast in May, when it last assessed the fiscal stance. The change in the forecast is due for the most part to the aforementioned changes in last year's outcome and the base effects those changes entail.

Fiscal stance set to ease during the forecast horizon

It is assumed that the cyclically adjusted primary balance will deteriorate by 0.2% of GDP this year, broadly as was forecast in May (Chart IV-15). The easing in 2020 reflects discretionary measures outlined in the fiscal plan, which were decided in connection with the private sector wage settlements finalised in the spring. These measures entail increased expenditures and tax cuts (the fiscal budget proposal is discussed in Box 3). As a result, the assessment of the fiscal stance over the forecast horizon is broadly unchanged from the Bank's previous assessment. According to the baseline forecast, public sector debt will continue to fall and, by the end of the forecast horizon, will be within the limits provided for in the debt rule in the Act on Public Finances.

Chart IV-12

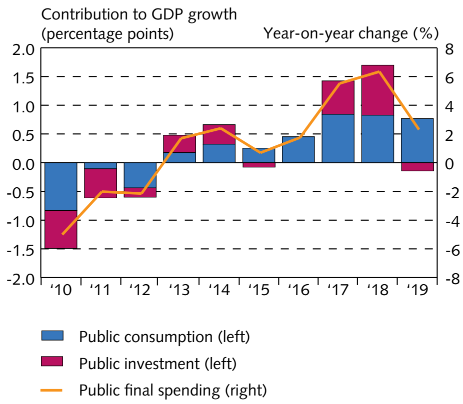
GDP growth and contribution of underlying components 2010-2019[1]



1. Central Bank baseline forecast 2019.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-13

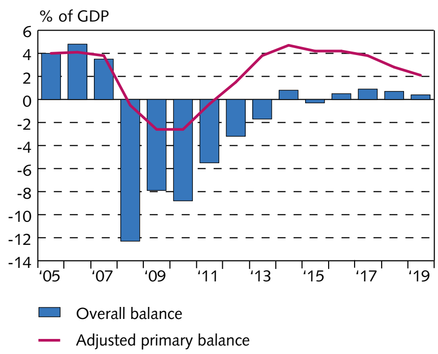
Public consumption and investment 2010-2019[1]



1. Central Bank baseline forecast 2019.
Sources: Statistics Iceland, Central Bank of Iceland.

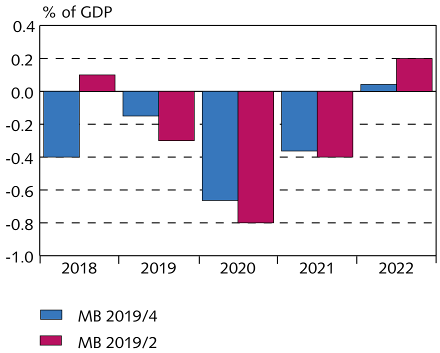
Chart IV-14

Treasury balance 2005-2019[1]



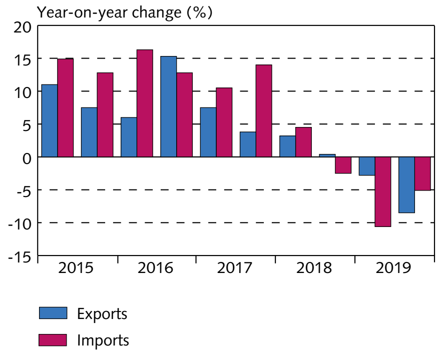
1. The primary balance is adjusted for one-off items. For 2016-2018, the primary and overall balances are adjusted for stability contributions, accelerated write-downs of indexed mortgages, a special payment to LSR Pension Fund Part A, and dividend payments over and above budgetary allocations. Central Bank baseline forecast 2019.
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

Chart IV-15
Change in central government cyclically adjusted primary balance 2018-2022[1]



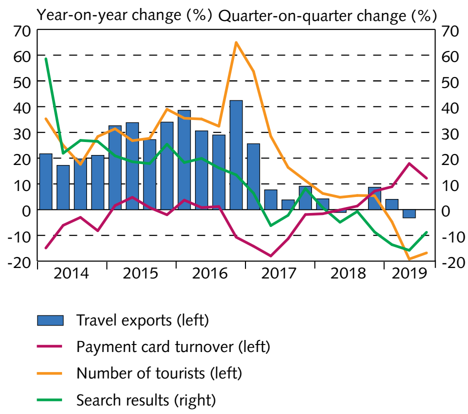
1. The primary balance is adjusted for one-off items. Central Bank baseline forecast 2019-2022.
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

Chart IV-16
Imports and exports of goods and services[1]
H1/2015 - H2/2019



1. Central Bank baseline forecast H2/2019.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-17
Indicators of tourism sector activity[1]
Q1/2014 - Q3/2019



1.Travel exports are at constant prices, and card turnover per tourist (excluding passenger transport and public levies) is deflated with the CPI. Tourist numbers are derived from foreign nationals' departures via Keflavík Airport. Search results are based on a factor model combining the frequency of five different Google search strings relating to travel to Iceland (seasonally adjusted two-quarter moving average).
Sources: Centre for Retail Studies, Google Trends, Icelandic Tourist Board, Isavia, Statistics Iceland, Central Bank of Iceland.

External trade and the current account balance

Q2 contraction in goods and services exports the largest in a decade

Goods and services exports contracted by 6.9% year-on-year in Q2 and by 2.8% in H1, a slightly smaller contraction than was projected in August (Chart IV-16). Services exports contracted by 9.2% in H1, owing largely to the contraction in tourism-related services exports. The lion's share of the downturn in tourism exports can be traced to the collapse of airline WOW Air and the smaller increase in Icelandair seat capacity following the grounding of its new Boeing 737 Max jets. In addition, export revenues from foreign tourists in Iceland contracted, although steep decline in visitor numbers was offset by a marked increase in average spending per tourist.

Goods exports declined by 2.9% in Q2, particularly because of a steep contraction in marine product exports, as no capelin quotas were issued this year. Aluminium exports also contracted between years, albeit partly offset by increased exports of miscellaneous manufactured goods. Even though goods exports contracted in Q2, they grew by just over 3% year-on-year in H1. This increase, however, stemmed in large part from the exportation of ships and aircraft, which in turn was due mainly to the sale of aircraft from WOW Air's operations. Excluding exports of ships and aircraft, combined goods and services exports contracted by 7.1% in H1/2019.

Contraction in tourism expected to peak in H2 …

Based on developments in foreign tourists' spending in Iceland, the outlook is for travel exports to contract further in H2/2019, but less than was forecast in August. Foreign tourists declined in number by 17% year-on-year in Q3 (Chart IV-17). This was a smaller contraction than in Q2, as well as being smaller than was projected in the August forecast. At the same time, payment card turnover figures suggest that average spending per tourist increased more than had been assumed in August. Other indicators also imply that tourism revenues shrank less than could have been expected given the drop in visitor numbers. For instance, a survey carried out by the Icelandic Tourist Board and Statistics Iceland suggests that tourists' average stay has grown longer. In addition, the number of hotel bed-nights booked by foreign tourists rose by 0.7% year-on-year in Q3, although a contraction in non-hotel accommodation pulled in the other direction. Foreign tourists' overnight stays in all types of accommodation also declined much less in H1/2019 than the number of tourists did. The increased demand for hotel accommodation and the rise in turnover per tourist may reflect a change in the composition of the tourist group and its consumption patterns, owing in turn to the reduced presence of budget airlines at Keflavík Airport. Furthermore, the number of Google searches for travel to Iceland suggests that interest in Iceland may be on the rise again.

The outlook for air travel has deteriorated, however, and is still highly uncertain. Key indicators for Q3, which is Iceland's peak tourist season, show that domestic carriers' export revenues from air transport declined more than was expected in August, owing to larger reductions in airfares and a declining load factor. The number of flights to and from Iceland fell by 29% year-on-year in Q3. The reduction in domestic carriers' seat capacity was offset to a degree by an increase in foreign carriers' seat capacity. Seat capacity on flights to and from Keflavík Airport is expected to be 22% lower in the next two quarters than it was over the same period last year (Chart IV-18). The reduction in domestic carriers' seat capacity is offset in part by an increase in foreign carriers' capacity. All else being equal, foreign carriers appear on track for a market share of one-third of Keflavík Airport's winter schedule. The grounding of the Max jets still affects Icelandair's flight schedule, and uncertainty about the airline's fleet, coupled with the bleaker outlook for the global economy, has prompted a downward revision of the forecast for travel exports in 2019 and 2020. On the whole, then, the outlook is for the contraction in tourism to deepen in H2/2019 and for total services exports to shrink by nearly 12% in 2019 as a whole, as opposed to just over 11% in the August forecast.

… and goods exports to grow more slowly this year

In addition to a stronger contraction in services exports, goods exports are now expected to grow more slowly than was forecast in August. Goods exports in H1 were slightly stronger than was assumed in the August forecast, but preliminary net trade figures for Q3 suggest a much larger contraction than was projected then. This is due primarily to a larger contraction in aluminium exports, the result of manufacturing difficulties at a domestic smelter this summer, and the prospect of a larger-than-expected contraction in marine product exports in H2. On the other hand, other goods exports – farmed fish and equipment for fisheries and food processing in particular – are expected to grow more than previously assumed.

On the whole, it is assumed that goods and services exports will contract this year by 5.8% and not 5.1%, as in the August forecast (Chart IV-19).

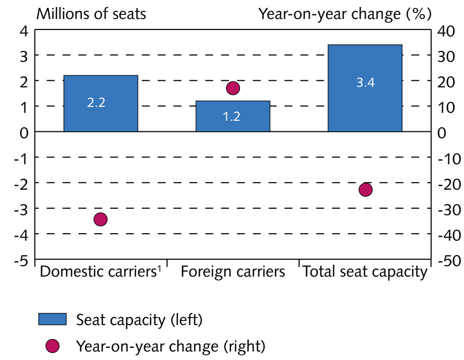
Largest single-quarter contraction in imports in a decade …

Imports of goods and services contracted by 12.4% between years in Q2, the largest single-quarter contraction in a decade. This comes on the heels of an 8.4% contraction in Q1, making for a downturn of 10.6% for the first half of the year (Chart IV-16). One of the main causes was a reduction in aircraft leasing, coupled with a larger-than-expected contraction in Icelanders' spending while travelling abroad. Reduced activity in tourism also affected goods imports, particularly imports of fuel and transport equipment (such as rental cars), which contracted by nearly a fifth year-on-year in Q2. The impact of reduced investment activity and slower growth in private consumption also shows in imports of investment goods and other consumer durables and semi-durables, which shrank by nearly a fifth in Q2. Preliminary goods trade figures indicate that the contraction in imports eased in Q3, and the outlook is for total goods and services imports to contract by 7.8% in 2019 as a whole, 2.4 percentage points more than was assumed in the August forecast (Chart IV-20). The larger contraction

Chart IV-18

Airline seat capacity to and from Keflavík

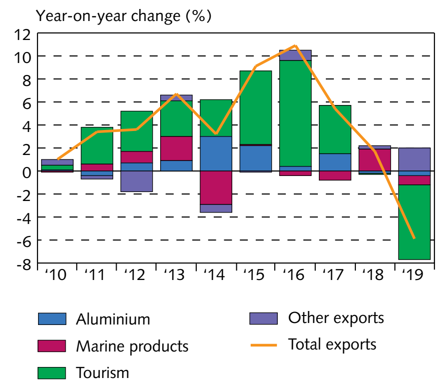
1 October 2019 – 28 March 2020



1. According to Isavia's flight schedule, Icelandair expects to use its Max jets beginning in January 2020. WOW Air became insolvent on 28 March 2019.
Sources: Isavia, Central Bank of Iceland.

Chart IV-19

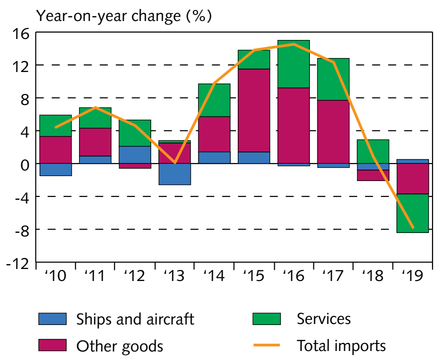
Exports and contribution of subcomponents 2010-2019[1]



1. Because of chain-volume linking, the sum of components may not equal total exports. Aluminium exports as defined in the national accounts. Tourism is the sum of the services category "travel", i.e., revenues from foreign tourists in Iceland, and "passenger transport by air", i.e., Icelandic airlines' revenues from transporting foreign passengers. Central Bank baseline forecast 2019.
Sources: Statistics Iceland, Central Bank of Iceland.

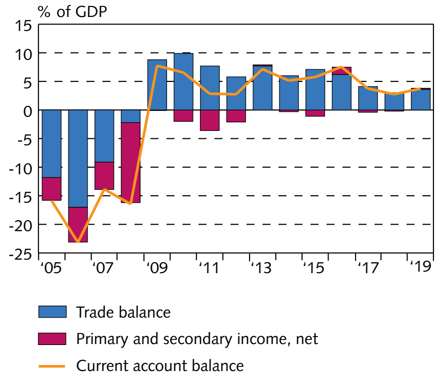
Chart IV-20

Imports and contribution of subcomponents 2010-2019[1]



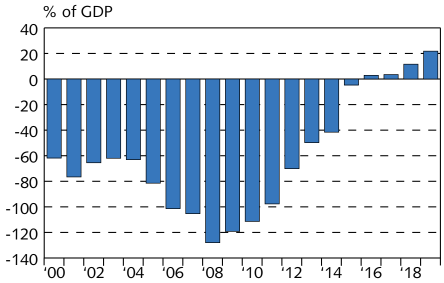
1. Because of chain-volume linking, the sum of components may not equal total imports. Central Bank baseline forecast 2019.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-21
Current account balance 2005-2019[1]



1. Current account excluding the effects of the failed financial institutions (2008-2015) and the pharmaceuticals company Actavis (2009-2012) on primary income. Also adjusted for the failed financial institutions' financial intermediation services indirectly measured (FISIM). Central Bank baseline forecast 2019.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-22
Iceland's net international investment position (NIIP) 2000-2019[1]



1. Underlying NIIP for 2008-2014. The figure for 2019 is the end-Q2 position.
Sources: Statistics Iceland, Central Bank of Iceland.

is due primarily to a stronger contraction in the travel component of services imports.

… and the prospect of a larger current account surplus in 2019

The surplus on combined goods and services trade measured 3% of GDP in H1/2019 – more than was forecast in August and up from H1/2018, when it measured only 0.2% of GDP. The trade surplus for 2019 as a whole is now expected to measure 3.6% of GDP, 0.4 percentage points more than was forecast in August. A larger surplus on services trade, which stems in particular from reduced imports, is the main reason for a larger trade surplus than was previously forecast, although weaker terms of trade and a poorer outlook for goods exports pull in the opposite direction.

The outlook is for the current account surplus to increase again this year, after shrinking for the previous two years. It measured 3.6% of GDP in H1 and is projected to measure 3.8% in 2019 as a whole, which is on a par with 2017 (Chart IV-21). Its composition is different, however, as the services account surplus has narrowed and the goods account deficit has shrunk as well. To some extent, the smaller deficit on goods trade is due to the sale of aircraft from WOW Air's fleet, but the contraction in goods imports has also deepened over the course of the year, in line with weaker economic activity and a lower real exchange rate. In addition, the balance on primary and secondary income has turned positive after having shown a deficit for the past two years.

If the forecast materialises, 2019 will be Iceland's eleventh consecutive year with a current account surplus, the longest uninterrupted surplus in its history. The persistent current account surplus largely reflects the post-crisis increase in domestic saving. Gross national saving has averaged 25½% of GDP in the past five years but is expected to ease to 24½% this year. The large current account surplus, together with the settlement of the failed financial institutions' estates and their stability contributions, has yielded a net international investment position that is positive by 21.8% of GDP, the strongest in Iceland's history (Chart IV-22).