IV Demand and GDP growth

GDP growth slowed markedly last year, after a strong 2016. Export growth eased significantly after measuring about 10% in both 2015 and 2016, and domestic demand eased as well, although it remained robust. Consumer spending is still strong, as household income is rising swiftly, employment levels are high, and asset prices have surged. Investment has also grown rapidly, albeit less in 2017 than in the three years beforehand. Growth in private consumption and investment is expected to ease this year, as is export growth. GDP growth therefore declines from 3.6% in 2017 to 3.3% this year, which is broadly in line with the Bank's February forecast. As was the case then, it is forecast to keep easing in the coming two years and moving towards its long-term trend rate. Weaker private sector spending growth will be offset by increased public sector activity. The fiscal stance is expected to tighten slightly this year and then ease again in 2019.

Chart IV-1

National accounts 2017

Sources: Statistics Iceland, Central Bank of Iceland.

GDP growth and domestic private sector demand

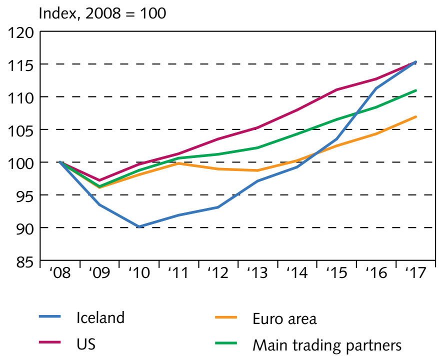
Year-2017 GDP slightly above the February forecast

After a very strong 2016, GDP growth slowed steadily over the course of last year. According to preliminary figures from Statistics Iceland, it measured 1.5% in Q4/2017 and 3.6% for the year as a whole. Compared with the prior year, 2017 GDP growth was considerably weaker, owing mainly to a slowdown in growth in business investment and exports, while the contribution of private consumption to GDP growth remained robust, as it had been in 2016. Public investment and residential investment grew markedly as well. Growth in domestic demand measured 6.8% over the year, whereas the contribution from net trade was negative by 2.7 percentage points. Year-2017 GDP growth was in line with the Bank's February forecast of 3.4% (Chart IV-1). Services exports were stronger than expected, whereas the contribution from inventory changes was more strongly negative.

GDP has grown by nearly 28% from its post-crisis trough in 2010. This is a much stronger rebound than in Iceland's main trading partner countries, where growth averaged slightly more than 12% over the same period (Chart IV-2).

Chart IV-2

GDP in Iceland and its main trading partners 2008-2017



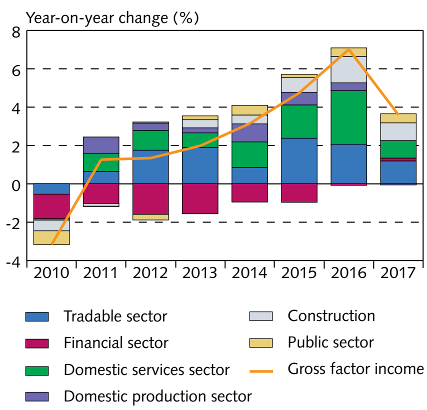
Sources: Statistics Iceland, Thomson Reuters, Central Bank of Iceland.

Broad-based GDP growth in 2017

The contribution of most sectors to GDP growth has slowed, albeit to varying degrees. The tradable sector and the domestic services sector contributed much less to GDP in 2017 than in the years beforehand, and the same is true of the construction industry. Even so, these sectors accounted for the lion's share of GDP growth (Chart IV-3). These developments resonate with the results of the 2017 expenditure accounts, which show a slowing of services exports and strong investment in residential housing.

Chart IV-3

Gross factor income and sectoral contributions 2010-2017[1]

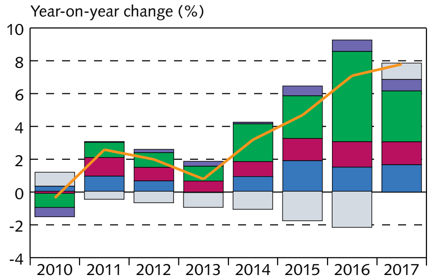


1. Gross factor income measures the income of all parties involved in production. It is equivalent to GDP adjusted for indirect taxes and subsidies. Included in the tradable sector are fisheries, fish product processing, manufacture of metals and pharmaceuticals, tourism, and 75% of electricity, gas, heat, and water utilities. Other sectors are considered non-tradable and are classified as construction, financial sector, services (excl. financial services), and production.
Sources: Statistics Iceland, Central Bank of Iceland.

Private consumption growth has been robust, yet more moderate than in previous cyclical upswings

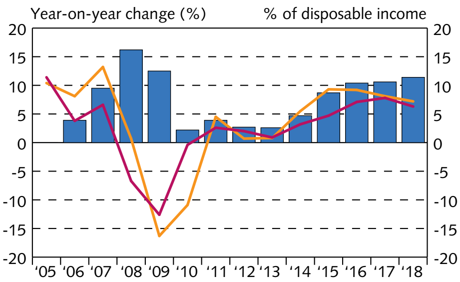
Private consumption grew by 7.8% year-on-year in 2017, even more than in the year before. In spite of this, growth eased in H2/2017.

Chart IV-4
Private consumption and its main components 2010-2017



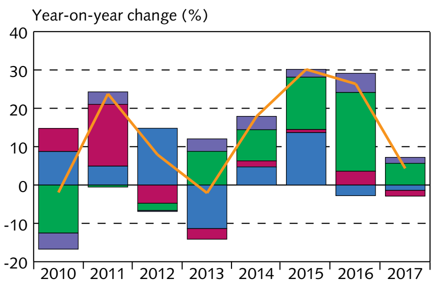
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-5
Private consumption, disposable income, and saving 2005-2018[1]



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 2018.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-6
Business investment and contribution by type 2010-2017



Sources: Statistics Iceland, Central Bank of Iceland.

Growth in Q4 was somewhat below the Bank's February forecast, but because figures for previous quarters were revised upwards, the growth rate turned out 0.3 percentage points above the forecast.

As in recent years, household demand was supported in 2017 by growing disposable income and favourable effects of households' improved equity position. Because of these factors, households are more optimistic about their own financial position and about the economy in general. 2017 was the seventh year of the ongoing cyclical upswing in private consumption, only the third episode of this length in the past sixty years. Although the current cycle is long in historical context, the pace of growth has not been as rapid as in previous cyclical episodes. To some extent, this is probably because spending on consumer durables has been less robust than in the two previous cycles (Chart IV-4), as it is well known that such spending is considerably more volatile than spending on non-durable consumer goods and more sensitive to economic conditions. This difference in private consumption patterns as compared with previous cycles is consistent with developments in household saving (Chart IV-5), which has increased considerably concurrent with the steep rise in real wages. Furthermore, lending to households has increased only modestly (see Chapter III).

Households' position still strong, but private consumption growth is expected to ease

Private consumption growth in 2018 is expected to continue more or less at the H2/2017 rate. If this projection is borne out, growth will be somewhat less this year than in 2017, as the outlook is for a continued slowdown in real disposable income growth. Furthermore, key indicators of private consumption suggest that the trend from H2/2017 continued in the first quarter of this year. Leading indicators such as consumer and corporate expectations surveys also suggest that growth will be somewhat slower in the near future than it was in Q2/2017, when private consumption growth peaked. It is projected to measure 6.3% in 2018 and slow still further in 2019. In spite of this, the ratio of private consumption to GDP will rise from last year's 50½% to about 51¾% by the end of the forecast horizon, yet this is nearly 3½ percentage points below the twenty-five-year average.

Business investment growth slowed significantly in 2017 ...

Growth in business investment eased markedly in 2017. It measured 4.3%, down from an average of about one-fourth per year in the past three years. Still, last year's growth was slightly stronger than was forecast in February, as it partly reflects Statistics Iceland's revision of investment figures for the first three quarters of 2017. Even though construction-related investment slowed significantly during the year, it was the main contributor to business investment in 2017 as a whole, as it was in 2016 (Chart IV-6). Offsetting this, investment in ships and aircraft contracted for the second year in a row.

... and the Bank's investment survey indicates a slowdown in 2018

The March 2018 survey of corporate investment plans suggests that firms invested more last year than the autumn 2017 survey had indicated (Table IV-1). The main difference was stronger investment in manufacturing and in other services. This year, firms expect a 5% year-on-year contraction in investment, whereas they expected a 4% increase in the Bank's autumn 2017 survey. In part, these changes can be attributed to the aforementioned base effects from last year's stronger investment, but to a large extent they are due to changes in plans from a very small number of companies that weigh heavily in the survey. Overall, the number of firms planning to step up investment this year is equal to the number planning to reduce it. In comparison with the Bank's last survey, investment plans in the tourism and transport sectors have declined, and manufacturing companies have reversed from planning an increase to planning a contraction. Firms in wholesale and retail trade, however, plan to increase their investment spending, whereas they indicated plans for a contraction in the previous survey.

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

Largest 102 (101) firms Amounts in ISK billions	2016	2017	2018	Change between 2016 and 2017 (%) (last survey)	Change between 2017 and 2018 (%) (last survey)
Fisheries (17)	15.4	14.4	12.4	-6.5 (-11.7)	-14.3 (-22.9)
Manufacturing (16)	4.6	8.5	6.9	84.5 (9.3)	-19.5 (56.8)
Wholesale and retail trade (23)	8.0	8.8	9.9	9.8 (-9.2)	13.5 (-10.4)
Transport and tourism (8)	44.0	40.7	42.3	-7.5 (4.1)	3.9 (10.3)
Finance/Insurance (9)	3.7	3.5	4.5	-5.4 (42.3)	28.2 (18.1)
Media and IT (7)	7.5	7.6	7.4	0.8 (-2.1)	-2.0 (0.1)
Services and other (22)	18.1	19.0	14.2	5.1 (-12.3)	-25.5 (-2.7)
Total 102 (101)	101.4	102.5	97.6	1.1 (-1.1)	-4.8 (4.2)

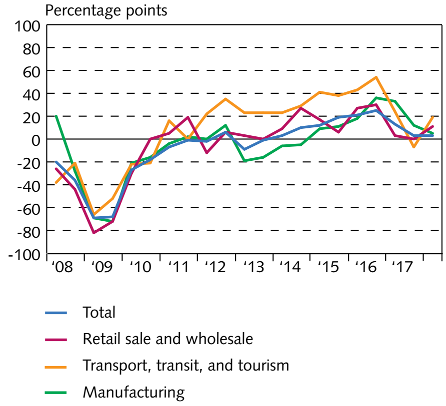
1. In parentheses are figures from the last survey, in which respondents from 101 firms were asked about investment plans for 2017-2018 (*Monetary Bulletin* 2017/4). A paired comparison between years is presented, but because the sample could change between surveys, this could affect the results. Investment in spare parts for ships and aircraft is included.
Source: Central Bank of Iceland.

The results of the Gallup survey of developments and prospects carried out in February among executives from Iceland's 400 largest firms were broadly in line with the Bank's survey; i.e., the groups of respondents planning to increase investment and reduce it were roughly equal in size, and more than half of firms expect to invest about the same this year as in 2017 (Chart IV-7). As before, there is a difference between the surveys as regards specific sectors, as the samples differ. According to the Gallup survey, 35% of companies in transport, transit, and tourism intend to invest more this year, an increase from the September survey. Many more companies are in this category in the Gallup survey than in the Central Bank survey, which focuses mainly on a few large companies. The difference may therefore reflect proportionally more investment growth among smaller firms than their larger counterparts. There are also signs of increased investment in hotels, which are included in the Gallup survey but not the Bank's survey.

Outlook for declining share of credit-financed corporate investment

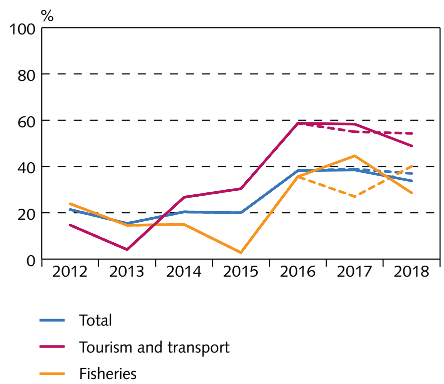
According to the Bank's investment survey, companies financed just under 40% of their investment with credit last year, as in 2016, but that ratio is expected to fall to 34% this year (Chart IV-8). Even though

Chart IV-7
Investment: balance of opinion, by sector[1]



1. Balance of opinion is the share who expect investment to increase between years less the share who expect it to decrease.
Source: Gallup.

Chart IV-8
Corporate investment plans: credit-financed investment 2012-2018[1]



1. Survey of corporate investment plans, excluding ships and aircraft. Broken lines show results from the last survey in MB 2017/4.
Source: Central Bank of Iceland.

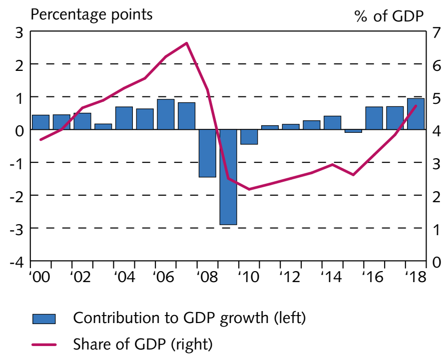
the share of credit financing is expected to fall, it is still much larger than it was during the period before 2016. As before, it is greatest among firms in tourism and transport, although these companies plan to reduce credit financing this year. Among firms in retail and wholesale trade, the outlook is for the ratio of credit financing to rise slightly this year as they step up their investment spending.

Total business investment projected to contract in 2018 but general business investment to continue growing

In view of the investment survey and other indicators of corporate investment, it is assumed that business investment will contract by 2.5% this year. The decline is due to reduced investment in ships, aircraft, and energy-intensive industry, whereas general business investment — i.e., investment apart from these sectors — will grow by 3.6% year-on-year. As a result, business investment be lower than was forecast in February, and the composition of investment will be somewhat different. This reflects the prospect of a smaller contraction in investment in ships and aircraft than was previously projected, versus the forecast of reduced growth in general business investment.

Chart IV-9

Residential investment 2000-2018[1]



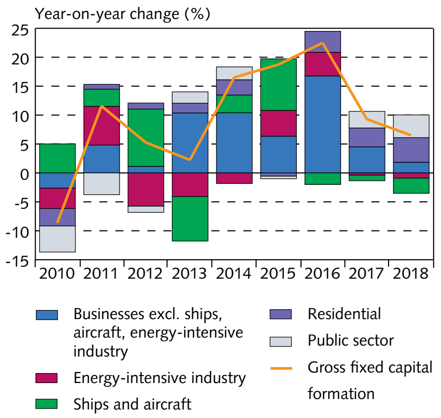
1. Central Bank baseline forecast 2018.
Sources: Statistics Iceland, Central Bank of Iceland.

Increased contribution of residential investment to GDP growth

The housing market boom continued in 2017. Investment in residential property increased by over a fifth, well in line with the Bank's February forecast. The contribution of residential investment to GDP growth has therefore risen steeply in the past two years and, by 2017, had reached its pre-crisis level (Chart IV-9). Alongside growing demand for housing, the ratio of house prices to construction costs has risen, thereby increasing the incentive for new construction. The outlook is for residential investment to grow by about one-fourth this year, slightly more than was assumed in February. If this forecast materialises, the ratio of residential investment to GDP will be about 5% this year, some 1 percentage point above its long-term average.

Chart IV-10

Gross fixed capital formation and contribution of main components 2010-2018[1]



1. Central Bank baseline forecast 2018.
Sources: Statistics Iceland, Central Bank of Iceland.

Investment-to-GDP ratio expected to fall marginally during the forecast horizon

After surging over the past three years, investment growth eased in 2017. It measured 9.3%, which is broadly in line with the Bank's last forecast, although the composition of growth was different: business investment grew faster than projected, while residential and public investment grew more slowly. Investment growth is forecast to continue easing this year, owing to the aforementioned contraction in business investment, whereas other investment spending is expected to increase year-on-year (Chart IV-10). If the forecast materialises, investment will grow by 6.5% this year, mainly as a result of residential and public investment. Although the rate of growth is expected to ease between years, the investment-to-GDP ratio will continue to rise in 2018, to 22.9%, which is 1½ percentage points above its historical average. The ratio of business investment to GDP will decline, however, to 14.3%, yet will still be 1 percentage point above its historical average.

Year-2018 GDP growth projected at just over 3%, as in the February forecast

As is discussed above, the outlook is for the main drivers of GDP growth to keep growing this year, albeit at a slower pace. Slower growth in private consumption, public consumption, and investment will reduce the contribution of domestic demand to this year's output growth by just over 1 percentage point as compared with 2017. On the other hand, the contribution from net trade will be more favourable than in 2017. Domestic demand is expected to grow by 5.2% this year and GDP by 3.3% (Chart IV-11). The GDP growth forecast is 0.1 percentage points higher than in February, owing to the prospect of increased investment tempered by weaker export growth. In coming years, GDP growth is expected to converge with its long-term trend rate, as was forecast in February.

Public sector

Public consumption growth expected to ease and public investment to grow more than assumed in February

Public consumption grew by 2.6% in 2017, in line with the Bank's February forecast. The pace of growth picked up between years, owing largely to the rise in public sector wage costs. Growth is expected to ease to about 2% in 2018 and the following two years, somewhat less than was forecast in February. Public investment, however, grew by 23.4% in 2017, the strongest growth rate since 2004. The ratio of public investment to GDP has been very low in historical terms since the financial crisis struck, but after last year's surge it rose from 2.6% to 3.2%. Public investment growth is projected to be even stronger this year, exceeding 27%, and then ease later in the forecast horizon. This is a much faster growth rate than was assumed in the last forecast. If the forecast is realised, the ratio of public investment to GDP will be about 4.3% by the end of the forecast horizon, just over the twenty-five-year average.

Treasury primary surplus expected to be similar this year to that in 2017

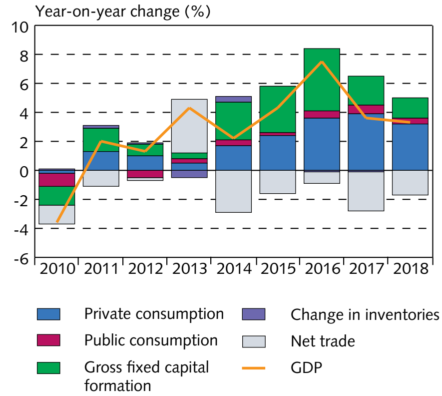
According to preliminary figures from Statistics Iceland, the surplus on general government operations measured 1.5% of GDP in 2017, an improvement over the Bank's previous estimate by 0.4% of GDP. Excluding dividends in excess of budgetary estimates, however, the underlying Treasury surplus for 2017 measures only 0.5% of GDP, as opposed to a surplus of 0.2% in 2016 and a deficit of 0.3% in 2015. This year, it is assumed that the underlying surplus will be similar to that in 2017, or 0.4% of GDP (Chart IV-12).

New fiscal plan for 2019-2023

In accordance with the Act on Public Finances, Parliamentary resolutions on a five-year fiscal strategy and a five-year fiscal plan were presented before Parliament in December 2017 and again in early April. According to the fiscal strategy, the Treasury outcome will be positive by 1.2% of GDP in 2018, and the local government outcome will be slightly positive. The surplus on general government operations will therefore amount to 1.4% of GDP. It is estimated that the Treasury

Chart IV-11

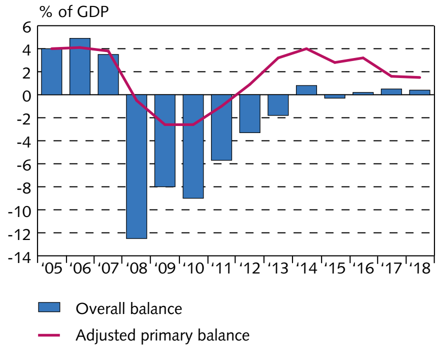
GDP growth and contribution of underlying components 2010-2018[1]



1. Central Bank baseline forecast 2018.
Sources: Statistics Iceland, Central Bank of Iceland.

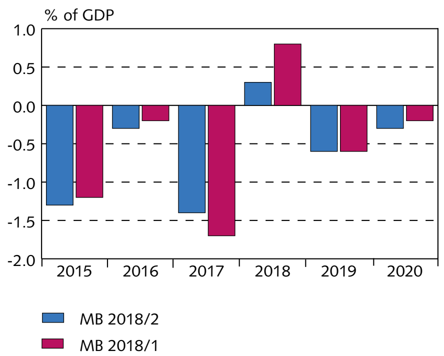
Chart IV-12

Treasury balance 2005-2018[1]



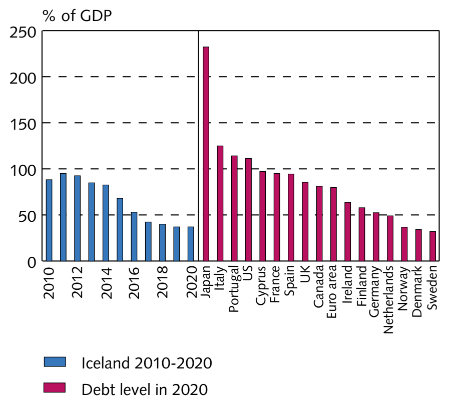
1. The primary balance is adjusted for one-off items. In 2016 to 2018, both the overall and primary balance is adjusted for stability contributions, accelerated write-downs of indexed mortgage loans, special payment to LSR A-division and dividends in excess of the National Budget. Central Bank baseline forecast 2018.
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

Chart IV-13
Change in central government cyclically adjusted primary balance 2015-2020[1]



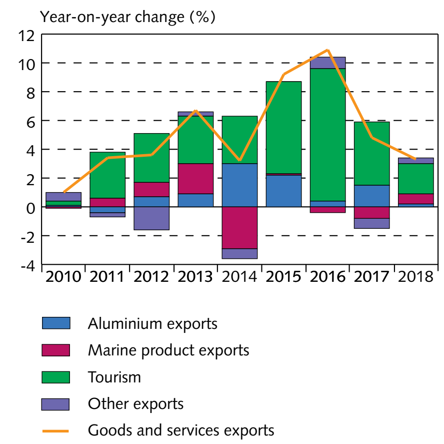
1. Primary balance is adjusted for one-off items (stability contributions, accelerated write-downs of indexed mortgage loans, special payment to LSR A-division and dividends in excess of the National Budget). Central Bank baseline forecast 2018-2020.
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

Chart IV-14
General government gross debt



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

Chart IV-15
Exports and contribution of subcomponents 2010-2018[1]



1. Aluminium exports as defined in the national accounts. Tourism is the sum of "travel" and "passenger transport by air". Central Bank baseline forecast 2018.
Sources: Statistics Iceland, Central Bank of Iceland.

and general government outcomes will have deteriorated by 0.4% of GDP by the end of this five-year period. The fiscal plan entails a virtually unchanged Treasury outcome from the current fiscal strategy; however, it is considerably weaker than in the last fiscal plan.

Fiscal stance expected to tighten this year and then ease again beginning in 2019

The Central Bank baseline forecast is based in large part on the Government's fiscal plan; however, it assumes more public consumption spending than the fiscal plan does, owing to the expectation that wage costs will rise more than is assumed in the fiscal plan. In addition, the underlying macroeconomic assumptions differ in some respects. As a result, the Treasury outcome as presented in the baseline forecast is poorer by 0.4% of GDP per year than in the fiscal plan. The Bank's forecast assumes that the Treasury primary surplus will continue to narrow to 0.3% of GDP by 2020, after adjusting for one-off measures.

The cyclically adjusted primary balance is expected to improve by 0.3% of GDP this year, less than half of what was assumed in the Bank's February forecast, which was based on the fiscal strategy presented in December 2017 (Chart IV-13). The difference is due to the fact that the new fiscal plan provides for a larger increase in spending than was included in the fiscal strategy from December. As in the Bank's February forecast, the fiscal stance is expected to ease again in 2019, owing to the planned personal income tax and payroll tax cuts and the substantial increase in investment spending, which are estimated to lead to fiscal easing in the amount of 0.6% of GDP. Significant expenditure growth will also lead to some easing in 2020, albeit less than in 2019, or 0.3% of GDP. If this forecast materialises, the combined fiscal easing over the next two years will total 0.9% of GDP, which is in line with the Bank's February forecast, even though it is no longer assumed that the upper value-added tax bracket will be lowered.

General government debt rapidly falls below fiscal rule criteria

The plan in the current Government's fiscal strategy concerning slower debt reduction is in line with the poorer performance outlook than under the previous Government's strategy. Even so, it is assumed that the general government surplus and the sale of assets will facilitate continued relatively rapid debt reduction. It is now estimated that Treasury debt will amount to 34% of GDP at the end of 2018. General government debt is projected to total 40% of GDP at the same time and fall to 37% by the end of the forecast horizon, if the plan materialises (Chart IV-14).

External trade and the current account balance

Export growth stronger in 2017 than assumed in February

Goods and services exports grew by 4.8% between years in 2017, driven mainly by an 8.1% year-on-year rise in services exports (Chart IV-15). Services exports grew more strongly than the Bank had forecast in February, owing to an unexpected jump in other services exports in Q4, after a marked contraction in the first three quarters of the year. The contraction in intellectual property exports in the pharmaceuticals industry, which was particularly pronounced in Q3/2017, reversed in full in Q4, whereas the February forecast assumed that the contraction would be permanent, as it was related to an international pharmaceuticals company's moving its operations out of Iceland. On the whole, other services contracted by 6.5% in 2017. The contraction mainly reflects a decline in exports of business services of pharmaceuticals companies and a contraction in exports of cultural and recreational services (including film-making). In addition, growth in goods exports slowed markedly year-on-year, measuring 0.9% in 2017, down from 3.7% the year before. A nearly 4% contraction in marine product exports was a major factor, as the fishermen's strike early in the year had a strong impact on exports, as has been discussed in previous issues of *Monetary Bulletin*. Moreover, other goods exports contracted more than had been assumed in February, particularly exports of ferrosilicon, pharmaceuticals, and medical equipment. Goods exports therefore grew more slowly in 2017 than had been forecast, partly offsetting stronger services exports.

Tourism-related export growth expected to ease this year ...

Indicators suggest that services exports will continue to grow this year, but if the forecast materialises, the growth rate will ease more than was projected in February. Figures on foreign tourist arrivals show a 4% year-on-year increase in the first four months of 2018, as opposed to a 56% increase during the same period in 2017. Analysts expected a larger increase in tourist arrivals; for example, Isavia, the operator of Keflavík Airport, projected a 15% increase in the first four months of this year. The rise in the real exchange rate has probably weakened demand for travel to Iceland, and airlines' passenger seat capacity has increased more slowly than over the same period in 2017. Other indicators also imply that tourism growth will lose pace. Internet searches for flights and accommodation in Iceland declined in Q1/2018, and foreign payment card turnover in Icelandic krónur contracted by 0.5% year-on-year during the quarter, after remaining unchanged in the previous quarter (Chart IV-16).

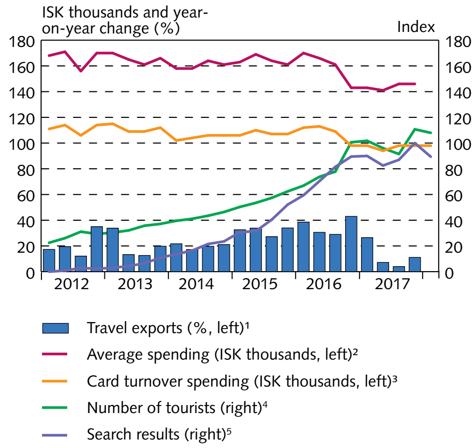
... and growth in goods and services exports is expected to ease more than previously projected

Preliminary external trade figures from Statistics Iceland suggest that goods exports grew by approximately 15% year-on-year in Q1/2018. To a large extent, this is due to base effects from the fishermen's strike early in 2017, which caused a 5% contraction in goods exports during Q1/2017. As in February, marine product exports are expected to recover in 2018 and increase by 4% year-on-year. The outlook is for slightly increased aluminium exports, and indicators suggest that other goods exports grew more strongly early in the year than was projected in February. As in February, goods exports are projected to increase by 1.6% in 2018 as a whole, whereas combined goods and services exports are expected to grow by 3.3%, a full 1 percentage point less than was forecast then.

Strong growth in domestic demand and a higher real exchange rate support continued import growth

Goods and services imports grew by nearly 12% in 2017, nearly twice the rate of growth in domestic demand over the same period. The

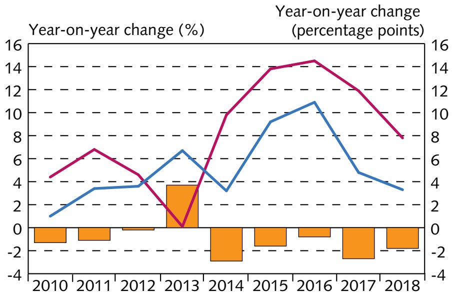
Chart IV-16
Indicators of tourism sector activity
Q1/2012 - Q1/2018



1. Year-on-year change in travel exports, at constant prices. 2. Seasonally adjusted average spending per tourist in Iceland, according to services export data. 3. Seasonally adjusted payment card turnover spending per tourist (excluding international airfares and public levies). 4. Seasonally adjusted passenger departures via Keflavík Airport. 5. A principal component model combining the frequency of five different Google search strings relating to travel to Iceland (seasonally adjusted).
Sources: Centre for Retail Studies, Google Trends, Isavia, Statistics Iceland, Central Bank of Iceland.

Chart IV-17

Exports, imports, and contribution of net trade 2010-2018[1]



Goods and services exports (left)

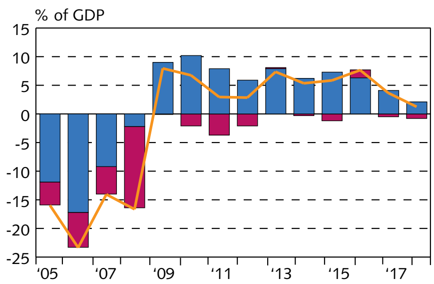
Goods and services imports (left)

Contribution of net trade to GDP growth (right)

1. Central Bank baseline forecast 2018.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-18

Current account balance 2005-2018[1]



Trade balance

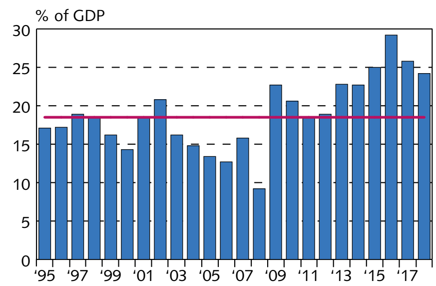
Primary income, net

Current account balance

1. Including secondary income. Current account excluding the effect of 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 2018.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-19

National saving 1995-2018[1]



National saving

25-year average (1993-2017)

1. Underlying national saving in 2008-2015, based on the estimated underlying current account balance (adjusted for the effects of failed financial institutions 2008-2015 and pharmaceuticals company Actavis in 2009-2012). Central Bank baseline forecast 2018.
Sources: Statistics Iceland, Central Bank of Iceland.

increase is due not least to imports of consumer durables such as motor vehicles and household appliances, demand for which generally correlates strongly with developments in the exchange rate of the króna.[1] Furthermore, strong growth in export sectors such as tourism and international airlines calls for substantial imports of goods and services. Goods and services imports are expected to grow by 7.7% this year, some 0.3 percentage points more than was forecast in February. To some extent, this reflects a higher import content of domestic demand than was assumed in February, as well as a slightly higher real exchange rate than was forecast then. Growing activity among domestic airlines also calls for increased imports in connection with the operation and leasing of aircraft. Furthermore, the Icelandic Tourist Board's figures on Icelanders' departures via Keflavík Airport plus Gallup's survey of individuals' planned overseas travel suggest that services imports will continue to grow strongly this year. The contribution of net trade to output growth will therefore remain negative throughout the forecast horizon despite robust export growth. If the forecast materialises, the contribution from net trade will be negative by 1.7 percentage points this year, making 2018 the fifth year in a row to see import growth outpace export growth (Chart IV-17).

Outlook for smaller current account surplus than was forecast in February

The surplus on goods and services trade amounted to 4.1% of GDP in 2017. The surplus turned out somewhat larger than was forecast in February, as services exports grew considerably more than assumed. It is expected to narrow to 2.1% of GDP this year, however, or 0.4 percentage points below the February forecast. A more negative contribution of net trade to output growth and poorer terms of trade (see Chapter II) outweigh the more favourable initial position. The trade surplus is expected to narrow still further, to 1½% of GDP in 2019.

The current account surplus measured 3.7% of GDP in 2017, well below the 2016 outcome of 7.7%, and below the post-crisis average of 5.6% of GDP (Chart IV-18). The declining trade surplus is compounded by a smaller surplus on the primary and secondary income balance. This is a noticeable turnaround from the previous year, as developments in foreign investment revenues were unusually favourable in 2016. The balance on primary and secondary income was negative in H2/2017 and is expected to remain so. The current account surplus will therefore narrow to 1.3% of GDP this year and 1% of GDP in 2019. This is just over ½ a percentage point less than was forecast in February.

The sizeable current account surplus in recent years has reflected increased national saving, which amounted to 25.8% of GDP in 2017, or 7 percentage points above the historical average (Chart IV-19). Increased saving is reflected in the transformation in Iceland's net international investment position, which was positive by 7.5% at the end of 2017.

1. See, for example, Bjarni G. Einarsson, Gudjón Emilsson, Svava J. Haraldsdóttir, Thórarinn G. Pétursson, and Rósa B. Sveinsdóttir (2013), "On our own? The Icelandic business cycle in an international context", Central Bank of Iceland *Working Paper* no. 63.