

Monetary Bulletin in a nutshell



Global GDP growth has softened due to steep cost hikes and rising household living expenses. As in August, trading partner GDP growth is forecast at roughly 1% in both 2023 and 2024. Global inflation is also expected to continue easing. Underlying inflation has fallen less, however, and the outlook is for policy rates in major advanced economies to remain high.



GDP growth in Iceland measured 5.8% in H1/2023, or 0.4 percentage points above the Bank's August forecast. Although private consumption growth has eased, domestic demand has been a major driver of economic activity in 2023. Added to this is favourable external trade, fuelled by strong growth in tourism. The outlook is for 3.7% GDP growth in 2023 as a whole, up from 3.5% in the August forecast. This represents a sharp decline relative to 2022, although it remains well above the trend growth rate of the economy. As in August, GDP growth is expected to keep slowing, averaging 2¾% per year over the next three years.



The labour market remains tight and unemployment is low. Job growth has slowed, however, and unemployment appears to have bottomed out. The baseline forecast assumes that as the output gap narrows, unemployment will start rising, reaching 4.8% in 2024 and then easing to 4% in the latter half of the forecast horizon.



Inflation measured 7.9% in October and fell slightly between months. Underlying inflation fell also, and there are signs that momentum is easing, although inflation remains high and broad-based. It looks set to hold broadly unchanged for the rest of the year and fall more slowly in 2024 than previously expected. The output gap appears somewhat wider than was assumed in August, and the króna has been weaker. There are also signs that cost increases have a stronger and more persistent impact on inflation than before. According to the baseline forecast, inflation will measure just under 5% at the end of 2024 and not fall below 3% until H2/2026.



The supply side of the global economy has largely normalised after recent shocks, and non-energy commodity prices have fallen. The outlook is uncertain, however, not least because of the wars in Ukraine and the Middle East. The resilience of the recovery in major advanced economies and China remains uncertain as well. Although measured inflation has eased, underlying inflation has proven stubborn. The inflation outlook is uncertain in Iceland as well, as inflation expectations appear less firmly anchored to the target and the upcoming wage negotiations could throw the prospect of continued disinflation into disarray.

Domestic uncertainty has also escalated due to increased seismic activity on the Reykjanes peninsula. If a large eruption takes place near key infrastructure, the resulting damage could be substantial. The economy could also be strongly affected by a protracted eruption. The impact on tourism, other exports, public sector performance, the exchange rate, and inflation could be significant.

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