Monetary Bulletin in a nutshell

Trading partner GDP growth has developed in line with the August forecast, and the outlook is broadly unchanged. GDP growth in trading partner countries is expected to inch upwards from 1.4% in 2024 to 1.7% by 2026. As before, robust output growth in the US weighs heavily, while the outlook for the eurozone remains relatively poor. Global inflation has continued to ease. It averaged 2.2% in Q3/2024, but as in the August forecast, it is projected to fall to 2% late in 2025.

In Iceland, GDP rose again between Q1 and Q2, but because of a sizeable Q1 contraction stemming from the negative effects of inventory changes due to the failed capelin catch, GDP was still down by 1.9% year-on-year in H1. This represents a significant reversal, as GDP growth measured 5% in 2023 and 9% in 2022. GDP is projected to be flat year-on-year in 2024, as compared with the August forecast of 0.5% growth. The poorer outlook is due primarily to the H1 contraction, which turned out larger than previously expected. As in August, GDP growth is projected to rebound to nearly 2% in 2025 and then average 2½% per year in the latter half of the forecast horizon. As was assumed in August, output growth during the forecast horizon will be driven largely by domestic demand – private consumption in particular.

According to pay-as-you-earn tax data, job numbers have fallen and unemployment continues to inch upwards. Thus the positive output gap continues to narrow, even though it is now wider than previously estimated because of Statistics Iceland's revision of 2023 GDP growth figures. The output gap is projected to close and a slack to open up in late 2025, slightly later than previously forecast.

Inflation measured 5.1% in October, after falling by nearly 1 percentage point since August and close to 3 percentage points since October 2023. Inflation excluding housing has fallen still further, and underlying inflation has continued to ease. Similarly, inflation expectations have fallen by most measures. In Q3, inflation was somewhat below the August forecast, and because of a more favourable initial position, the inflation outlook through 2025 has improved. This is supported by a slightly stronger króna but offset by a larger positive output gap. Therefore, the inflation outlook for the latter half of the forecast horizon is broadly as in August. Inflation is projected to fall below 3% in H1/2026 and return to target by the middle of that year.

The risk of a hard landing in the US has receded, but the global economic outlook remains quite uncertain, owing chiefly to concerns about the protracted war in Ukraine and escalation of the war in the Middle East. Global commodity prices could therefore rise more than is currently forecast, and imported inflationary pressures in Iceland could prove stronger. Furthermore, because inflation expectations are less firmly anchored, the effects of higher commodity prices and recent pay rises in Iceland could be underestimated in the Bank's forecast. Developments in domestic economic activity will also affect the inflation outlook. For instance, inflation could prove more persistent than is currently forecast if households draw down their recently accumulated savings more quickly. It could fall more rapidly, though, if tourism sector activity subsides more than currently expected.

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