

Monetary Bulletin in a nutshell



The global GDP growth outlook is broadly unchanged since November, but developments differ from one country to another, with the US showing robust growth and the eurozone lagging behind. Trading partner GDP growth is expected to inch upwards relative to 2024, to an average of 1.7% this year. The global inflation outlook is also largely unchanged, and inflation is expected to keep falling. Central banks in major advanced economies have therefore continued to lower interest rates in line with the improved inflation outlook, but rates still remain well above pre-pandemic levels.



According to preliminary figures from Statistics Iceland, GDP shrank by 1% in the first three quarters of 2024. This is a larger contraction than was forecast in November, owing mainly to a more negative contribution from inventory changes and net trade. Year-on-year GDP growth is estimated to have turned positive again in Q4, but a contraction of 0.4% is projected for the year as a whole. In November, however, GDP was forecast to remain flat between years. Year-2025 output growth is also forecast to be slightly weaker than previously assumed, or 1.6%. The poorer outlook is due mainly to more muted growth in private consumption and a more negative contribution from net trade, although stronger investment will pull in the opposite direction. As in November, GDP growth is forecast to continue gaining pace in the coming two years.



Job numbers are rising in line with the historical average, and unemployment has inched upwards in the recent term. There are signs that labour supply and demand are better balanced than before. The baseline forecast assumes that unemployment will continue to rise to an average of 4.5% in 2025, concurrent with a slack developing in the economy around mid-year, somewhat earlier than previously estimated.



Inflation fell in Q4/2024 and averaged 4.9%, slightly above the forecast published in the November *Monetary Bulletin*. It continued to fall between months in January, to 4.6%. Underlying inflation has also declined, to 4.1% in January. Households' and businesses' inflation expectations have fallen, but market agents' long-term inflation expectations rose again in January as compared with the November survey. Inflation is expected to keep falling but to be slightly higher in coming quarters than in the November forecast. The outlook for the latter half of the forecast horizon is broadly as in November, however, and inflation is still projected to align with the target in mid-2026.



The global economic outlook is highly uncertain, owing largely to wars and geopolitical uncertainty. Concerns about growing trade protectionism have escalated, and the risk is that trading partner GDP growth will be weaker and inflation higher than previously forecast. Developments on this front will also affect the outlook for Iceland. The baseline forecast assumes that GDP contracted in 2024, and prospects for 2025 are slightly poorer than previously projected. Economic activity could be underestimated, though, if earlier figures on exports and investment are revised upwards. The pace of disinflation is uncertain as well.

The analysis appearing here is based on the Bank's assessment of economic developments since the publication of *Monetary Bulletin* 2024/4 in November 2024, and on the updated forecast presented here. It is based on data available at the end of January. The risk assessment in the updated forecast is based on the risk assessment in the November forecast.