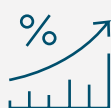


Monetary Bulletin in a nutshell



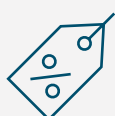
Global GDP growth has slowed since mid-2021, and pessimism about the economic outlook has increased despite the recent decline in oil and commodity prices and reduced strain on global supply chains. Inflation has risen worldwide, and more rapidly than previously anticipated. The outlook is for GDP growth among Iceland's main trading partners to be weaker in 2022 and 2023 than was forecast in the *May Monetary Bulletin*, and for inflation to be higher and more persistent than was assumed then.



In spite of the bleaker global outlook, Iceland's GDP growth prospects have improved since the May forecast. Preliminary national accounts figures suggest that economic activity was stronger in Q1/2022 than had been assumed in May, primarily because of robust growth in household consumption. There are also signs of continued strong private consumption in Q2, and it appears that households have drawn down their savings faster than was assumed in the Bank's previous forecast. Furthermore, tourist visits to Iceland increased more rapidly this summer than previously forecast, and domestic firms appear to have been more successful in resolving the supply chain problems that developed in the wake of the war in Ukraine. GDP growth is forecast at 5.9% this year, some 1.3 percentage points above the May forecast. As in May, GDP growth is projected to measure around 2% per year in 2023 and 2024.



Job numbers continued to rise in Q2, and average hours worked rose year-on-year for the first time since 2019. Total hours worked rose by 9.1% year-on-year, the steepest increase in the history of Statistics Iceland's labour force survey (LFS). Unemployment kept falling, and the share of firms considering themselves understaffed is at its second-highest ever.



Inflation has risen still higher, climbing to 9.9% in July. Although the surge in the housing component of the CPI and in global oil and commodity prices weighs heavily, inflation remains widespread: inflation excluding housing measures 7.5%, and underlying inflation is 6.5%. Inflation expectations have also continued to rise by most measures. Inflation is forecast to move still higher, to 10.8% in Q4, and then subside gradually. The inflation outlook has therefore deteriorated yet again, reflecting considerably stronger growth in domestic demand than was projected in May, the prospect of a slower easing of house price inflation, and a bleaker inflation outlook for Iceland's main trading partners.



Economic uncertainty has escalated due to the war in Ukraine. The war has upended global commodity markets and thrown trade relationships and supply chains into disarray. It is difficult to predict how deep and protracted these effects will be, and the outlook could deteriorate even more if natural gas imports from Russia to Europe are shut off. Furthermore, household sentiment in Iceland and abroad has deteriorated in the wake of the invasion, and it is difficult to assess the extent to which increased pessimism will affect consumers' spending decisions later this year and into 2023. The inflation outlook as depicted in the Bank's forecast could also prove overly optimistic, particularly if companies pass higher costs through to prices to an increasing degree and if a wage-price spiral develops, potentially causing high inflation to become even more firmly entrenched.

The analysis appearing here is based on the Bank's assessment of economic developments since the publication of *Monetary Bulletin* 2022/2 in May 2022, and on the updated forecast presented in this report. It is based on data available as of mid-August. The risk analysis in the updated forecast is based on the risk analysis in the May forecast.