Economic Forecast
2025-2028

Cooling Economy but Strong Consumption

Landsbankinn Economic Research
22 October 2025

Main conclusions

Economic growth will be 1.5% this year, 1.7% next year, 2.2% in 2027, and 2.4% in 2028, assuming the forecast holds. Economic growth will be driven by domestic consumption, while the labour market will show signs of a gradual slow-down at the same time.

Inflation will remain persistent in the coming quarters and is unlikely to reach the Central Bank's target during the forecast period. As a result, real interest rates are expected to remain high. Inflation will be 3.2% at the end of 2028 and real interest rates 2.6%.

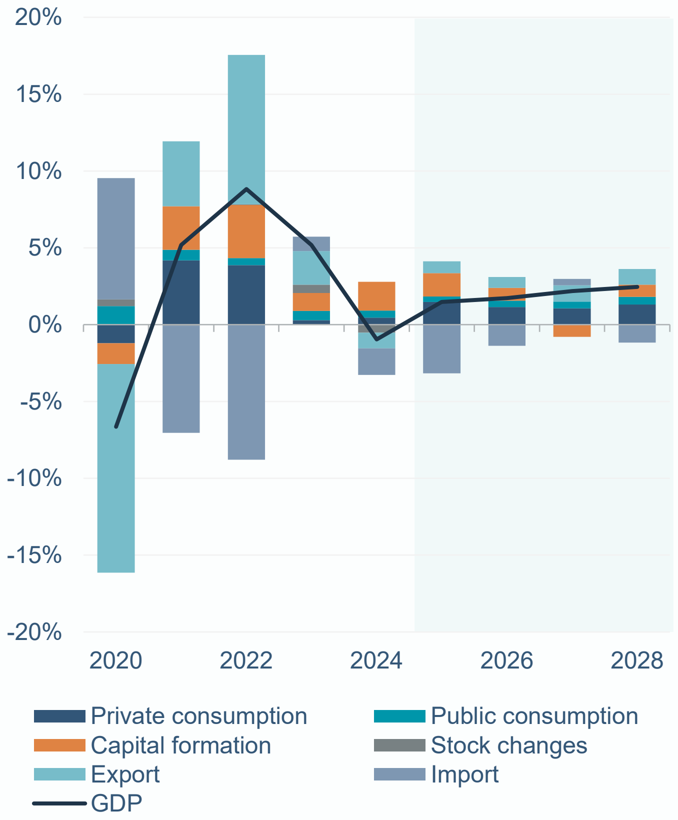
We expect modest export growth in the coming years. This growth will mainly stem from the export of pharmaceuticals, medical products, farmed fish, aluminium and data centre services. The outlook is for a contraction in seafood exports and tourism is likely to remain stable. In general, the strong ISK and turbulence in global trade are expected to restrain growth in various export sectors.

Industrial investment will variously increase slightly or decline over the next few years. Robust data centre development distorts the overall picture, but in other sectors, there are signs that high real interest rates will curb activity in the coming 1-2 years.

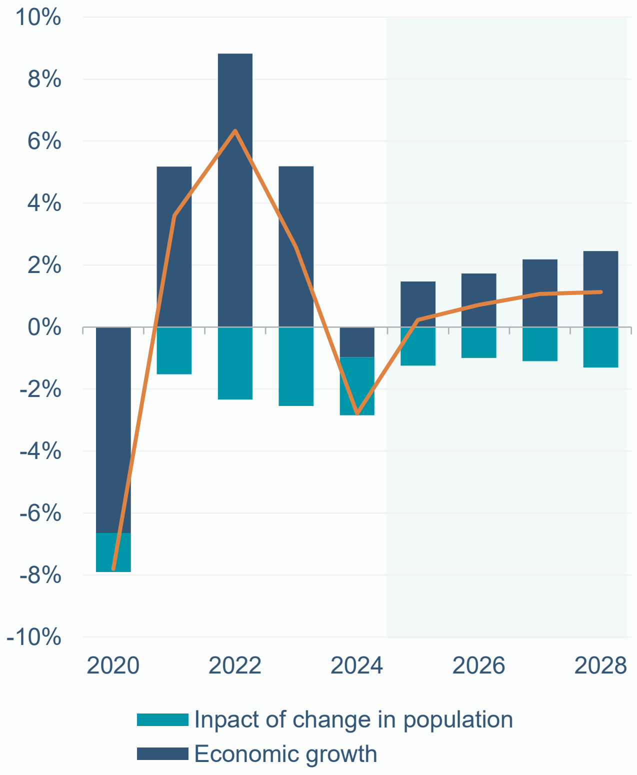
As before, uncertainty persists regarding global economic prospects, ongoing war efforts and access to some of Iceland's key export markets. Even though it appears that Icelandic export will not suffer any great direct effect from tariffs, the uncertainty alone can be expected to restrain investment and export plans.

Soft landing and easy-going economy

Economic growth and contribution of components



GDP per capita



2025-2028 is Economic Research's forecast.
Source: Statistics Iceland, Landsbankinn Economic Research

GDP growth will be 1.5% this year and 1.7% next year if the forecast holds. We expect the population of Iceland to grow relatively little over the next three years and project modest per capita economic growth throughout the forecast period.

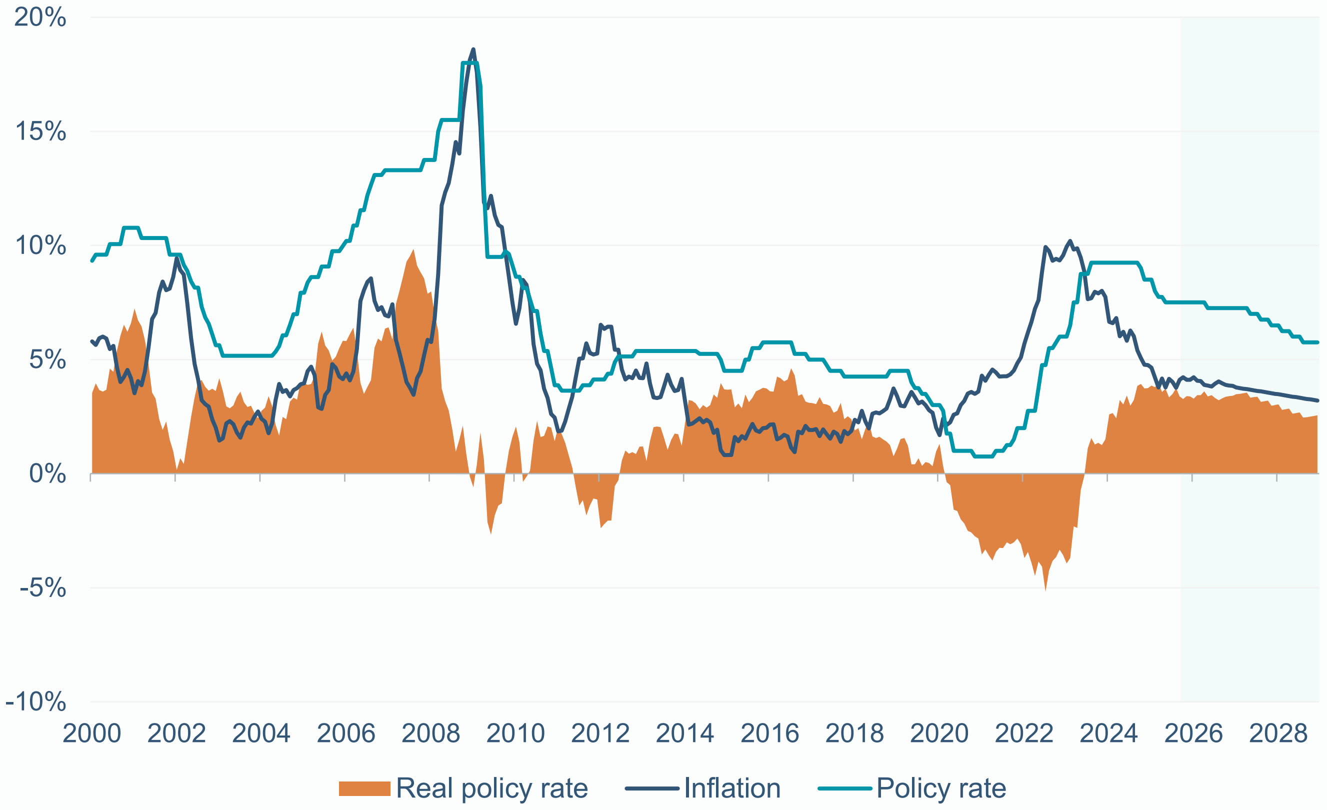
This growth will be driven mainly by increased private consumption, the same consumption momentum that has characterised this year. Purchasing power is expected to continue rising - its rise in recent years has not only led to higher consumption but also given households more room for savings.

There are several signs that tension in the labour market is beginning to ease: There are less investment and hiring plans in various sectors, and imports of investment goods have started to decline, except for products related to the construction of data centres. Despite this trend, we forecast that investment in the economy will increase in most years of the forecast period. In the near term, we believe that much of the increased investment will be due to data centre construction. Such investment requires a substantial increase in imports of computer equipment, which offsets the short-term GDP impact of the investment itself. It should be noted that investment in data centres lays the groundwork for greater service exports, which will support long-term economic growth.

Although the export outlook is fair, export sectors may face headwinds in the coming 1-2 years. The strong ISK makes conditions more difficult and fishing quotas are expected to be limited. The travel sector has had a good year to date but the outlook for the next couple of months has likely worsened slightly with the bankruptcy of Play.

Central Bank treads carefully

Inflation, policy rate and the real policy rate



We believe that inflation will remain difficult to control, though it is expected to ease gradually next year. The decline will be slow, with inflation averaging 3.8% over the year. We do not expect the Central Bank's inflation target of 2.5% to be reached during the forecast period and project real interest rates to be around 2.6% at its horizon.

Households are generally in a solid position - despite persistently high interest rates - and with increasing purchasing power, strong demand for goods and services is likely to maintain inflation in the coming quarters. On the other hand, a strong ISK has helped restrain imported inflation and housing price increases have slowed significantly.

The Central Bank will act cautiously in lowering interest rates while inflation declines only sluggishly, maintaining a similar monetary stance to recent months. Although the inflation target will likely remain out of reach for some time, we do not expect the Central Bank to tighten policy further; rather, it will maintain a relatively firm tone.

We do not anticipate any further rate cuts this year but forecast one 0.25 percentage point reductions next year.

Real policy rate compared to past inflation. October 2025 to December 2028 is Economic Research's forecast.
Source: Central Bank of Iceland, Statistics Iceland, Landsbankinn Economic Research

Average years ahead

The outlook for this year and the next three years is average, having regard for four key metrics: GDP, unemployment, inflation and the policy rate. Economic growth will be lower than the general rate over the past 30 years and unemployment higher.

Dots show unemployment, GDP, inflation and the policy rate each year since 1996. Annual average. 2025-2028 is Economic Research's forecast.
Source: Statistics Iceland, Central Bank of Iceland, Directorate of Labour, Landsbankinn Economic Research.

Overview of Landsbankinn Economic Research's forecast

Domestic product and key components	ISKbn 2024	Volume change from previous year (%) 2024	2025	2026	2027	2028
Gross domestic product	**4,588**	**-1.0**	**1.5**	**1.7**	**2.2**	**2.4**
Private consumption	2,250	0.9	3.0	2.3	2.1	2.6
Public consumption	1,189	1.9	1.4	1.6	1.7	2.0
Capital formation	1,222	7.6	5.7	3.0	-2.8	2.9
Investment in industry	796	7.0	9.6	2.2	-5.6	2.4
Investment in residential housing	244	18.1	-3.5	1.5	4.0	5.5
Public sector investment	182	-1.7	1.0	8.5	1.5	2.0
Total national expenditure	4,637	1.8	3.8	2.3	0.7	2.5
Export of goods and services	1,948	-2.3	1.8	1.7	2.5	2.4
Import of goods and services	1,996	4.0	7.3	3.0	-0.9	2.6

Policy rate and inflation	2024	2025	2026	2027	2028
CBI’s key interest rate, 7-day term deposits, year end, %	8.50	7.50	7.25	6.50	5.75
Inflation, annual average, %	5.9	4.1	4.0	3.6	3.3
EUR exchange rate, year end	143.9	142	144	146	148
Housing price, YoY change, annual avg., %	8.1	5.6	4.1	5.0	6.0

Labour market	2024	2025	2026	2027	2028
Wage index, YoY change, annual avg., %	6.6	7.8	6.2	5.5	5.4
Pruchasing purchasing power of wages, YoY change, annual avg., %	0.7	3.5	2.2	1.8	2.0
Unemployment, annual average, %	3.5	3.8	4.1	4.2	4.2

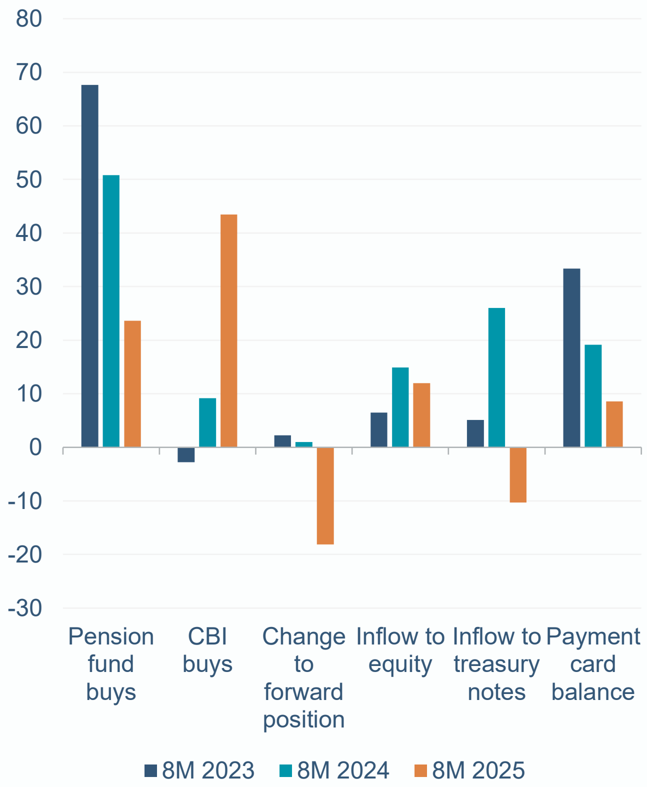
Trade balance	2024	2025	2026	2027	2028
Number of foreign travellers, thousand individuals	2,261	2,260	2,270	2,300	2,330
Goods and services balance, %GDP	-1.1	-1.8	-1.1	0.5	1.2
Current account balance, %GDP	-2.6	-1.9	-1.5	-0.1	0.6

Outlook for a stable ISK in the coming months

Exchange rate development

Influencing factors

ISKbn



Despite a trade deficit of nearly ISK 120 billion in the first six months of the year, the ISK has strengthened so far this year. This is partly because the deficit largely stems from imports of investment goods that are financed abroad and therefore do not involve foreign exchange flows. Moreover, foreign currency inflows have accompanied domestic costs of investments financed from abroad, such as those related to data centres and land-based aquaculture. Another significant factor is that pension funds acquired foreign currency earlier in the year, reducing their need for further foreign exchange purchases.

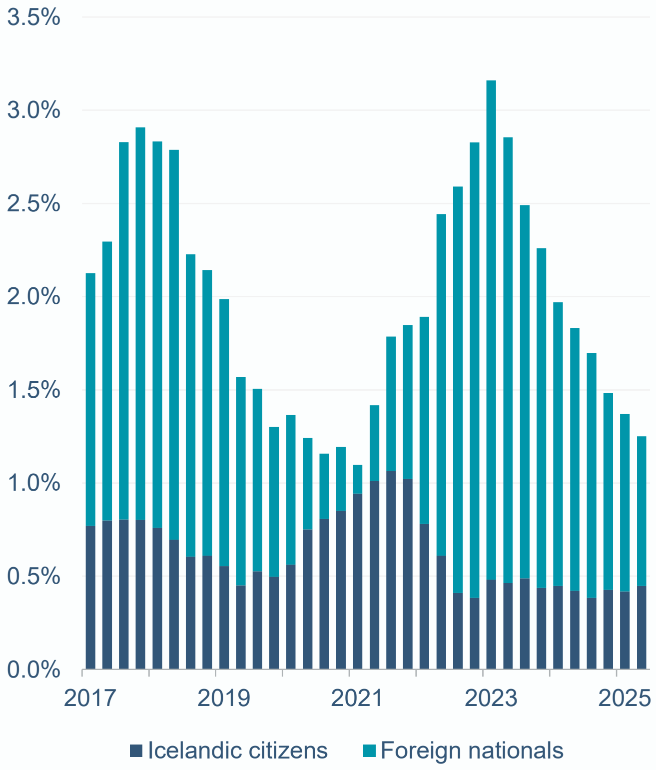
The forward position in foreign currency, where exporters or investors sell currency in advance, is minimal. This should support the ISK in the coming months, as there will be little need for investors to buy foreign currency to close forward positions. The ISK has remained unusually stable recently and the fact that the ISK did not weaken on the day the bankruptcy of Play was announced may indicate market confidence.

We expect the ISK to remain strong in the coming months and forecast a stable exchange rate through the end of this year and into next year. In the 1-2 years after that though, pension funds are likely to resume foreign currency purchases and the high real exchange rate may further erode activity in the export sectors. The ISK can be expected to weaken and we forecast depreciation in the latter half of 2026 as well as in the last 2 years of the forecast period.

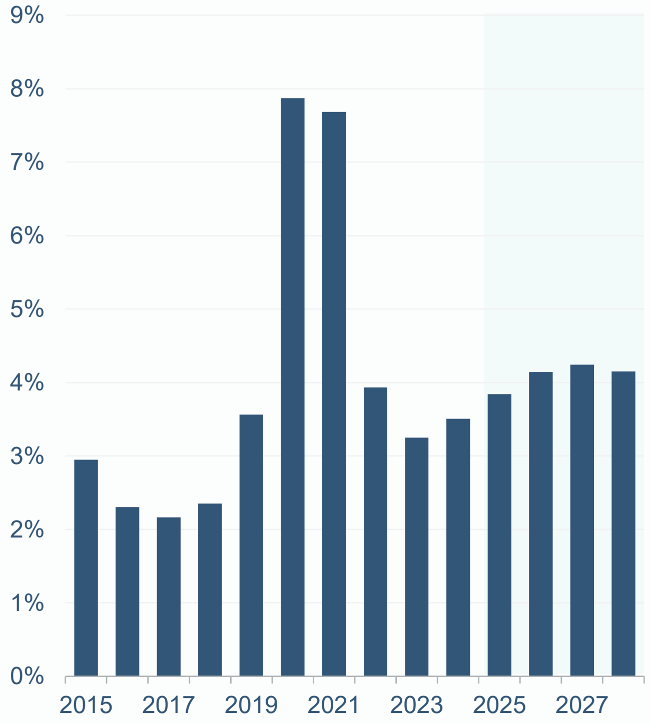
Exchange rate at the end of 2025, 2026, 2027 and 2028 is Landsbankinn's Economic Research forecast.
Source: Central Bank of Iceland, Landsbankinn Economic Research.

Outlook for higher unemployment and lower population growth

Population growth
Population growth between years and weight of Icelandic and foreign nationals



Registered unemployment and forecast



Despite various signs that labour market pressure has begun to ease, unemployment has not increased significantly. One contributing factor is the substantial immigration to Iceland in recent years: Cross-border migration tends, all else being equal, to dampen fluctuations in unemployment.

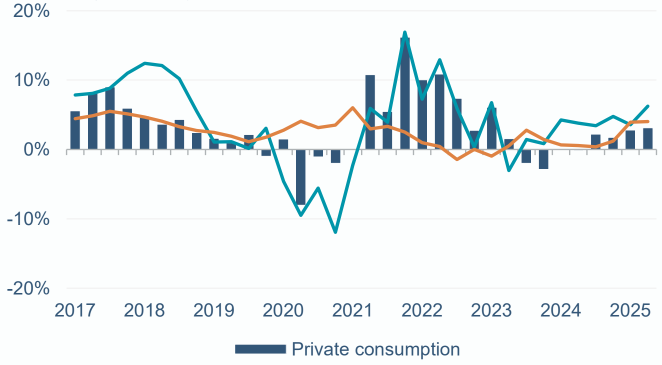
Thus far, the slower pace of economic activity has been reflected more in slower population growth than in rising unemployment. We expect unemployment to increase slightly in the coming months, not only due to seasonal factors but also because of the collapse of Play. Next year, we anticipate that the slack in the labour market will become more evident in unemployment figures and we forecast that the registered unemployment rate will average 4.1%. After that, we expect unemployment to continue rising slowly, reaching 4.2% in 2027.

Slower population growth affects not only the labour market but also a variety of economic indicators. For example, it helps explain our projection that public consumption will grow somewhat less this year and in the coming years than it has in the recent past. Similarly, population growth will no longer provide as strong a boost to private consumption as it did in the years immediately following the pandemic.

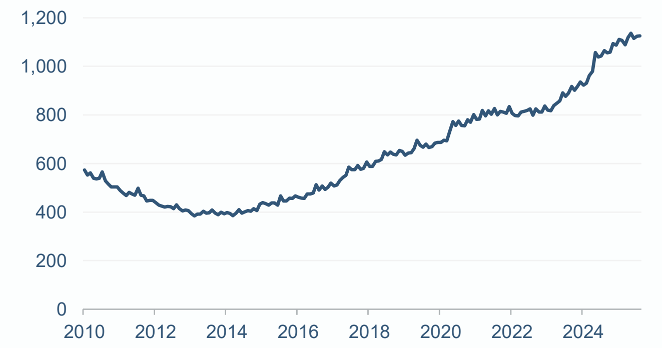
2025-2028 is Economic Research's forecast.
Source: Directorate of Labour, Statistics Iceland, Landsbankinn Economic Research.

Increased purchasing power maintains private consumption

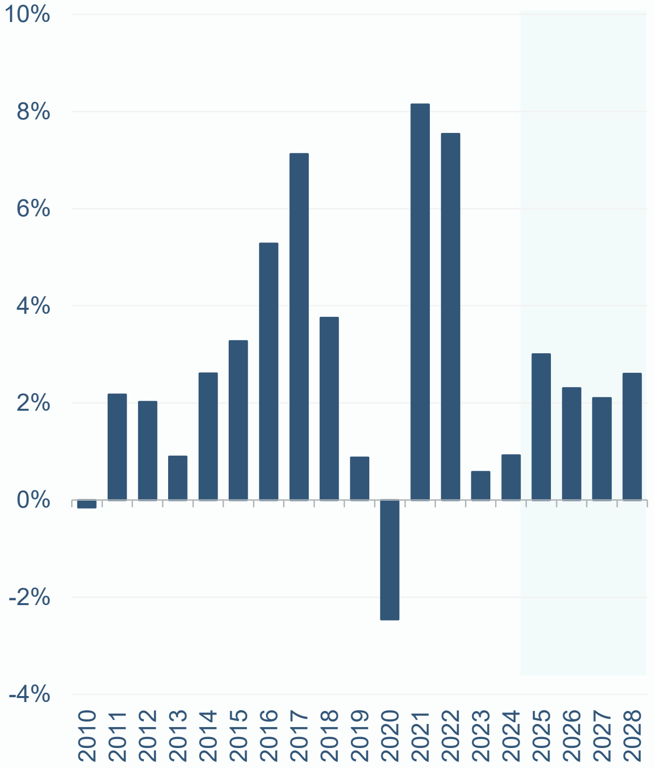
Private consumption, payment card turnover and wages
YoY change, quarterly data



Current and sight household deposits
ISKbn at fixed prices



Development of private consumption
YoY change



Private consumption grew by 0.9% last year and by 0.6% the year before that. Inflation restrained purchasing power growth while interest rates were at an all-time high.

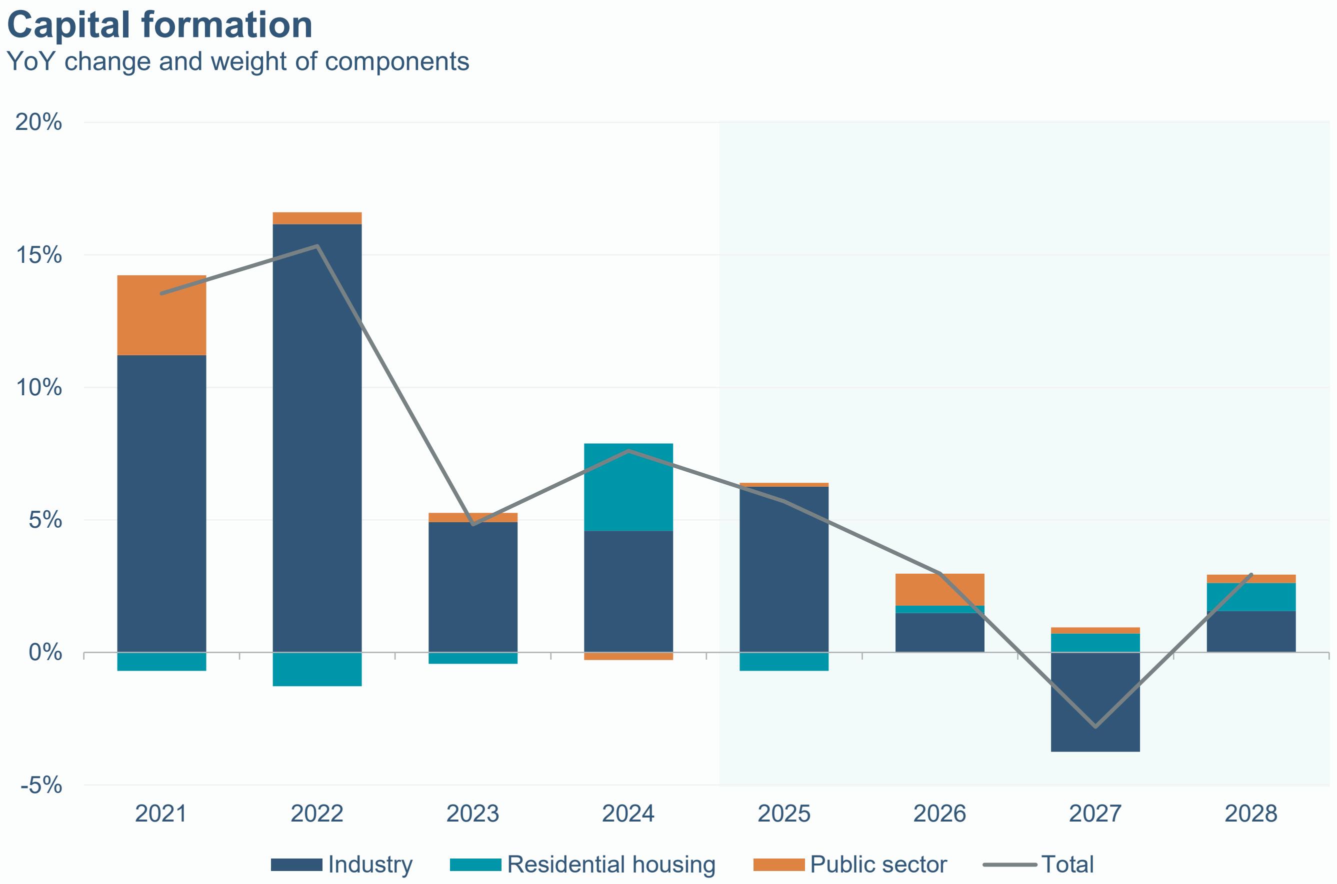
There are indications that private consumption could increase considerably this year and the coming years. At the same time that payment card turnover shows a robust increase and international travel rises sharply, household savings continue to grow in real terms. In addition, both private and corporate defaults are historically low, according to new data from collection agency Motus.

The national accounts for the first half of this year show clear signs of growing consumption. In the first half of the year, private consumption has been 3.0% higher than the same time last year and we consider it likely to increase at a similar pace in the latter half of the year.

We forecast 3.0% growth in private consumption this year. In the coming years, we can expect increased purchasing power to continue to fuel consumption, yet at a slower pace. We forecast 2.3% growth next year, 2.1% in 2027 and 2.6% in 2028.

2025-2028 is Economic Research's forecast.
Source: Statistics Iceland, Landsbankinn Economic Research

Calm in business investment and residential housing development



We believe that investment growth in the Icelandic economy will slow considerably in the coming years. The most notable changes are expected in business investment. We expect that it will increase by 9.6% this year, driven almost entirely by the continued construction of data centres. Next year, this wave of development is expected to reach its final phase and, in 2027, we forecast a 5.6% contraction in business investment, as data centre construction winds down.

There are several indications that residential housing investment will decline this year, following a strong performance last year. In coming years, it is likely to increase slightly with each passing year.

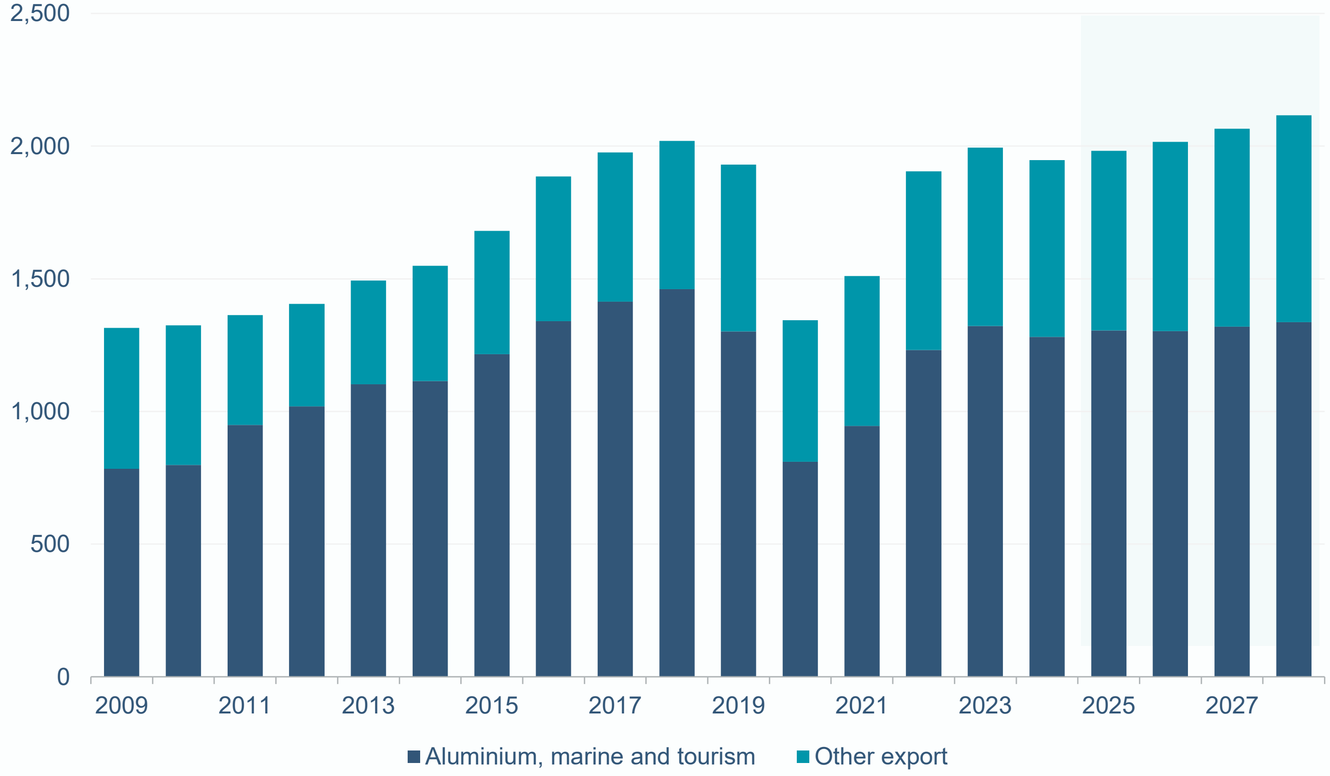
Public investment is expected to grow modestly throughout the forecast period, with the largest increase projected for next year, primarily due to heavy investment in the construction of the new National University Hospital, as well as planned investment in energy and transportation infrastructure.

Overall, we expect capital formation to make a positive contribution to economic growth during the forecast period, except in 2027.

2025-2028 is Economic Research's forecast.
Source: Statistics Iceland, Landsbankinn Economic Research.

Newest growth sectors continue to expand

Exports and forecast
ISKbn at fixed prices for 2024



Exports of pharmaceuticals, medical products and farmed fish have increased significantly in recent years and are expected to remain among the main drivers of goods exports.

Production for export in these sectors continued to grow in volume during the first half of this year, although the growth in pharmaceutical and medical production slowed somewhat in the second quarter. It is worth noting that exports of goods other than marine products and aluminium declined in the second quarter of this year. This contraction can likely be explained in part by a reclassification of Alvotech's pharmaceutical exports - some of which now appear to be categorized as service exports - and service exports in fact grew more than expected. There was also a sharp decline in exports of silicon products following the closure of the silicon plant at Bakki. In addition, indirect effects of higher tariffs in the US may have had various impacts on goods exports.

We expect that exports of goods classified as "other goods" will contract by 3% this year, before beginning to grow again in the coming years. This growth is expected to continue to be driven by increased exports of pharmaceuticals, medical products and farmed fish, while in the later years of the forecast period, data centre services are also expected to contribute to higher service exports.

Source: Statistics Iceland, Central Bank of Iceland, Landsbankinn Economic Research

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