Economic Forecast
2026-2028

Slow Economic Growth in Iceland

Landsbankinn Economic Research
17 April 2026

Key conclusions

Our forecast is for economic growth of 1.7% this year, 1.6% next year, and 1.8% in 2028. Growth will be driven by exports which look to be strong at the same time that high interest rates cool domestic demand significantly.

We forecast 4.8% average inflation this year with uncertainty about the development of inflation depending to a large degree on the armed conflict in the Middle East. We expect that the policy rate will be raised even higher this year and that rate cuts will not commence until next year.

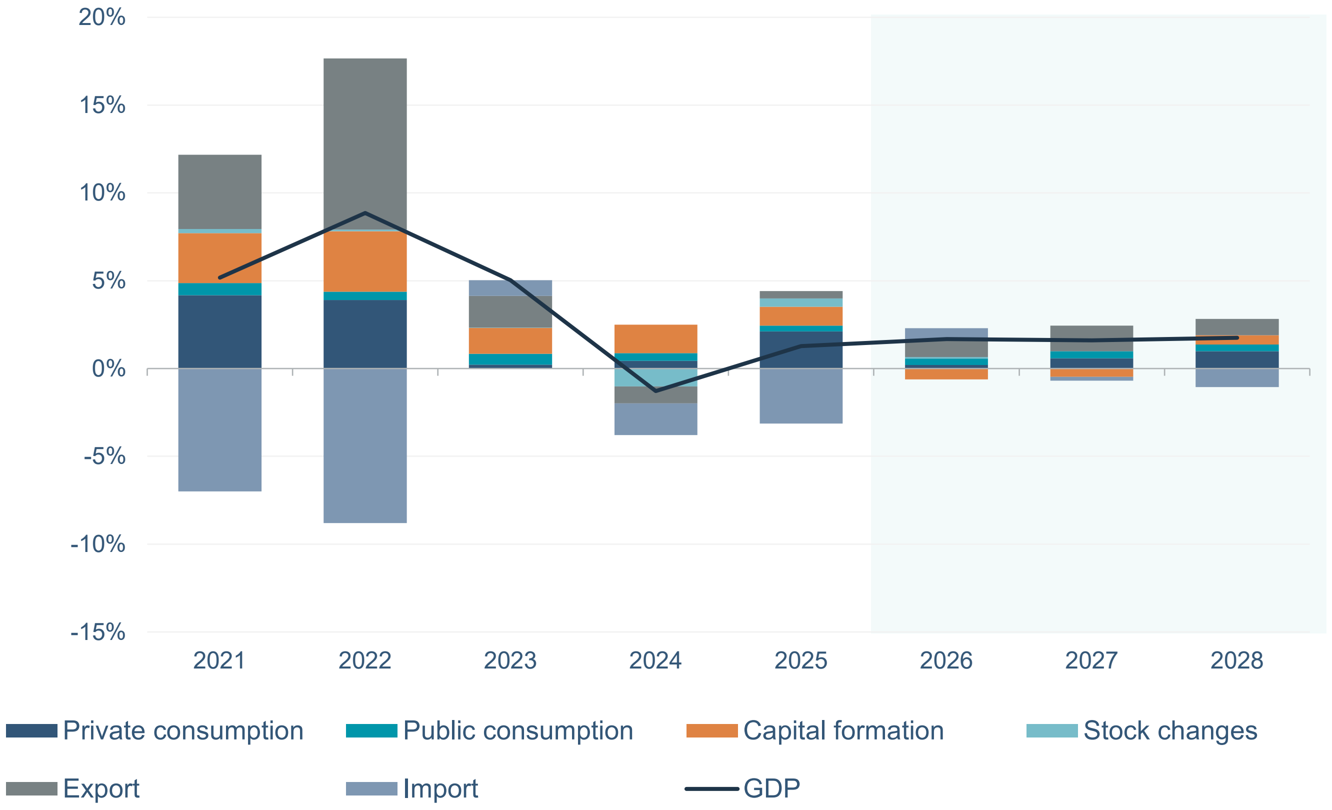
We forecast 2.5% export growth this year. We expect to see robust growth in service exports, mainly from data centre services. The capelin season was also good this year. Next year, we forecast 3.6% growth, including from aluminium smelters which will again be at full capacity.

We expect very modest price increases in the housing market, a mere 2% nominal increase this year and 2.6% next year. This will lead to a decrease in real prices both years. High interest rates and altered credit provision are strong factors here.

As before, there is uncertainty about global economic developments, not least because of conflict in the Middle East and rising oil prices. The scope of the impact depends on the longevity of the conflict.

Moderate growth in coming years

Economic forecast and weight of components



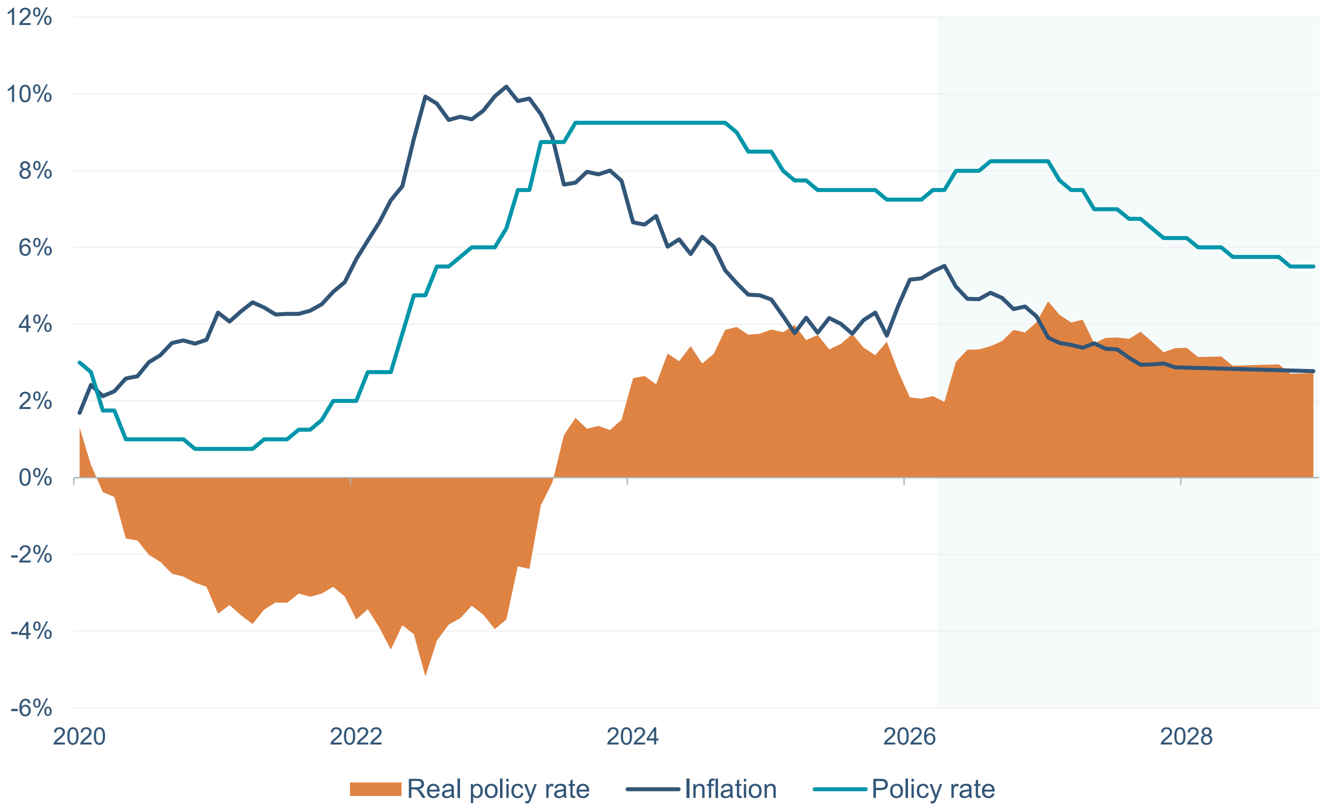
We anticipate moderate economic growth and for the slowness of recent years to continue throughout the forecast period. Even so, growth this year will outpace 2025 at 1.7% compared to 1.3% last year. The improvement this year is mainly from a stronger outlook for exports. Economic growth will be fairly stable to the forecast horizon, or 1.6% next year and 1.8% in 2028.

High real policy rates will put a damper on domestic consumption and investment. Increased slack is already being felt the labour market. Under such conditions, companies are likely to be cautious.

2026-2028 is Economic Research's forecast.
Source: Statistics Iceland, Landsbankinn Economic Research.

Forecast further policy rate hikes this year

Inflation, policy rate and the real policy rate



We consider it likely that the real policy rate will rise somewhat during the period. It had dwindled to just over 2% at the beginning of the year while inflation and inflation expectations rose. A tighter stance is likely necessary in the current environment.

We expect another policy rate hike in May, by 0.50 pp, and again by 0.25 pp in August. If inflation and inflation expectations trend downward, we deem it possible for the Central Bank to halt the rate hike but that rates will not be cut before 2027.

The real policy rate will thus approach 4%, which is close to what it was when inflation was receding. We forecast that the rate will be around 3-4% all 2027 and dwindle to below 3% in the final year of the forecast period.

Real policy rate compared to past inflation. April 2026 to December 2028 is Economic Research's forecast.
Source: Central Bank of Iceland, Statistics Iceland, Landsbankinn Economic Research

Unemployment rather higher and low economic growth

Four important measurements - GDP, unemployment, inflation and policy rate - show that economic growth will be on the low side during the forecast period while unemployment will be on the higher side. Inflation and policy rates will not deviate much from the 30-year average if our forecast holds.

Dots show unemployment, GDP, inflation and the policy rate each year since 1996. Avg. during year 2026-2028 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

	ISKbn	Volume change from previous year (%)			
Domestic product and key components	2025	2025	2026	2027	2028
Gross domestic product	**4,956**	**1.3**	**1.7**	**1.6**	**1.8**
Private consumption	2,459	4.3	0.4	1.2	2.0
Public consumption	1,292	1.2	1.4	1.5	1.5
Capital formation	1,321	4.0	-2.3	-1.9	2.2
Investment in industry	883	7.5	-3.1	-4.0	2.5
Investment in residential housing	244	-5.9	-3.5	2.1	0.8
Public sector investment	195	2.3	2.8	2.5	2.4
Total national expenditure	5,068	3.9	0.0	0.5	1.9
Export of goods and services	1,988	1.0	2.5	3.6	2.2
Import of goods and services	2,100	7.2	-1.5	0.5	2.6

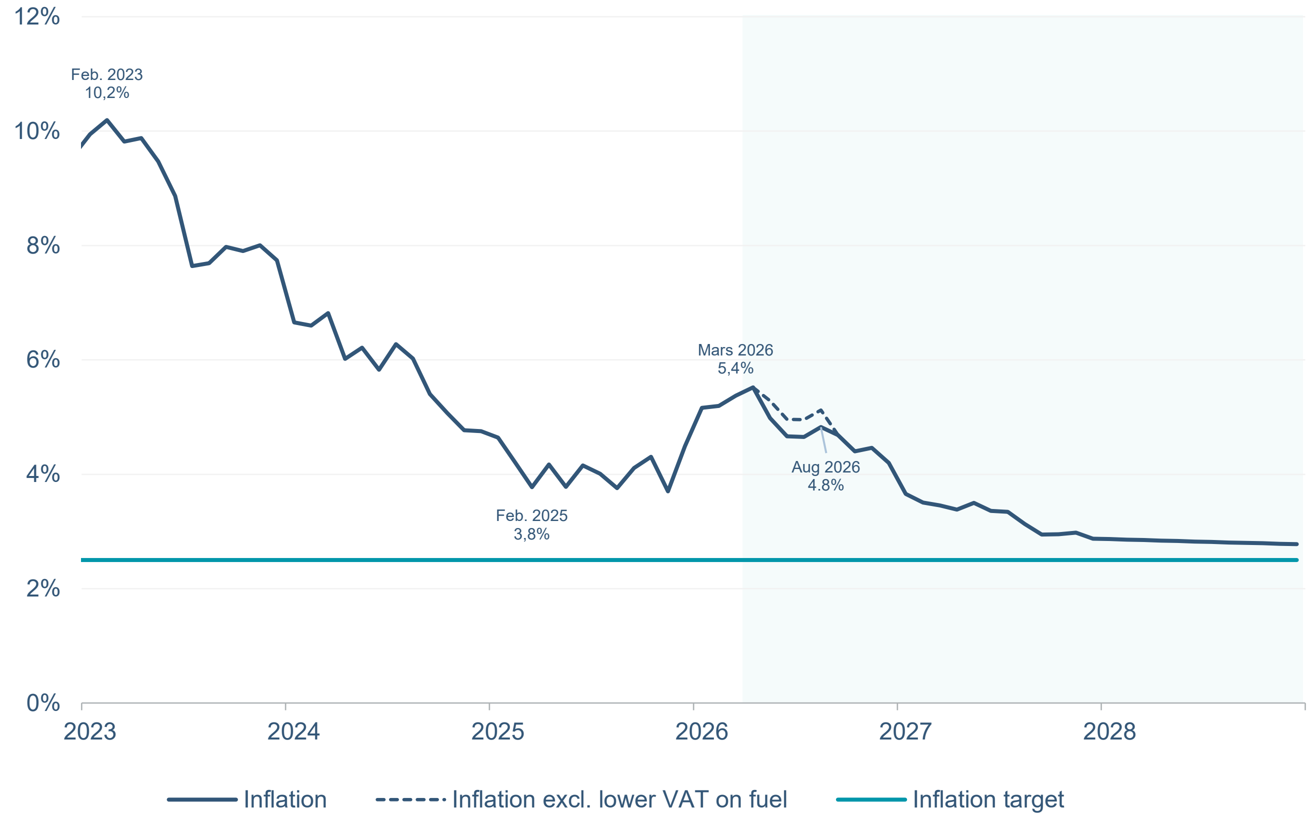
Policy rate and inflation	2025	2026	2027	2028
CBI’s key interest rate (7-day term deposits, year end, %)	7.25	8.25	6.25	5.50
Inflation, annual average, %	4.1	4.8	3.3	2.8
EUR exchange rate, year end	147.2	146	148	150
Housing price, nominal prive, YoY change, annual avg., %	5.3	2.0	2.6	4.0
Housing price, real price, YoY change, annual avg., %	1.2	-2.7	-0.7	1.1

Labour market	2025	2026	2027	2028
Wage index, YoY change, annual avg., %	7.9	5.2	4.9	4.8
Purchasing power of wages, YoY change, annual avg., %	3.7	0.4	1.6	1.8
Unemployment, annual average, %	3.9	4.5	4.3	4.1

Trade balance	2025	2026	2027	2028
Number of foreign travellers, thousand individuals	2,267	2,270	2,300	2,330
Goods and services balance, %GDP	-2.3	-1.8	-1.9	-1.7
Current account balance, %GDP	-3.6	-2.9	-2.8	-2.6

Revision provision in collective bargaining agreements triggered

Inflation, developments and forecast



Inflation receded fairly smoothly from 10.2% to 3.8% in February 2025. Almost a year of around 4% inflation followed before it picked up again and rose to 5.4% in March of this year.

The recent increase is largely traceable to individual components, including higher heating prices in December, the rising price of new cars around the turn of the year as a result of changes in vehicle excise duties, higher airfares following the failure of Play and rising fuel prices driven by the conflict in the Middle East. Value-added tax on gasoline will be lowered in May which should temporarily quell inflation.

Current collective bargaining agreements contain a revision provision that is triggered if inflation measures over 4.7% in August 2026. We consider that a likely scenario though it may be touch and go. In our forecast, we do not expect this to lead to unrest in the labour market but if it does, uncertainty increases.

All in all, we expect inflation to be 4.8% on average throughout the year. We then expect it to recede slightly to 3.3% in 2026 and 2.8% in 2028.

April 2026 to December 2028 is Economic Research's forecast.
Source: Statistics Iceland, Landsbankinn Economic Research.

FX market in balance

Exchange rate development

Despite a current account deficit of ISK 178 billion last year, the foreign exchange market has remained fairly balanced. One explanation is that the current account does not always translate into corresponding foreign currency flows. In addition, significant inflows related to infrastructure investment and data centre development offset the deficit.

In our view, the main exchange rate risk this year is whether foreign investors will sell their holdings in Iceland, particularly government bonds. Such capital is highly liquid and outflows could occur rapidly.

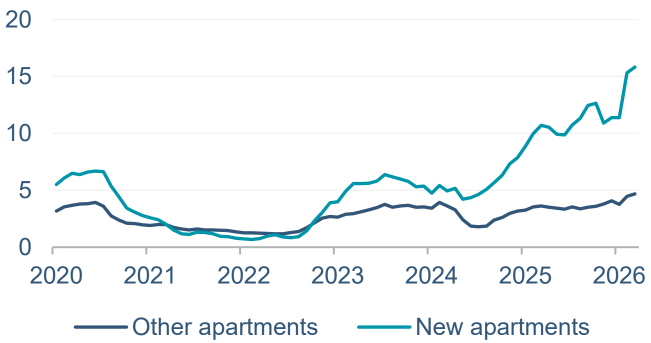
The real exchange rate of the ISK is currently at a historical high. This situation reduces competitiveness and is not sustainable in the long term. A correction can be expected sooner or later, although the timing is uncertain.

In our baseline forecast, we assume that the current account deficit will be slightly lower than last year throughout the forecast horizon. We also expect continued inflows due to infrastructure investment. We therefore anticipate that the foreign exchange market will remain in balance. We do not forecast major changes in the ISK exchange rate, but do expect a slight depreciation, particularly in light of the high real exchange rate.

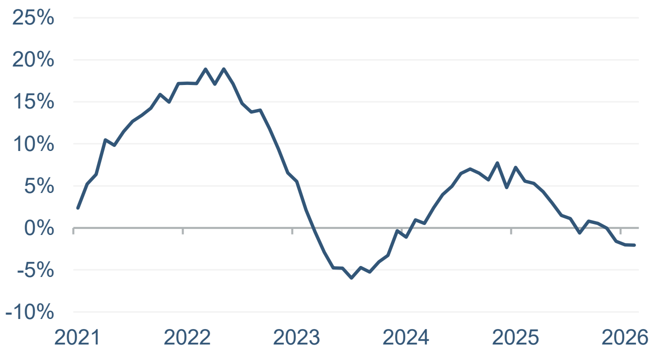
Exchange rate at year-end 2026, 2027 and 2028 is Economic Research's forecast.
Source: Central Bank of Iceland, Landsbankinn Economic Research

Prices decrease in real terms in the housing market

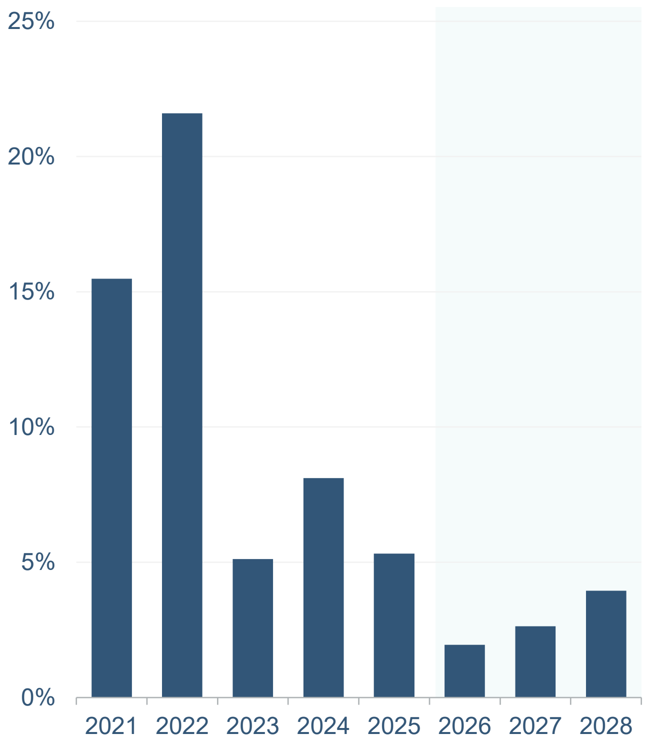
Time-on-market for the entire country
Months (3 month moving average)



Real housing prices
YoY change (discounted by CPI excluding housing)



Housing prices
YoY change (annual average)



We expect slower price increases in the housing market in the coming year or two. Supply of homes for sale is increasing rapidly and time-on-market is lengthening, especially for new properties. Real housing prices have now declined between years for several consecutive months and we expect that trend to continue.

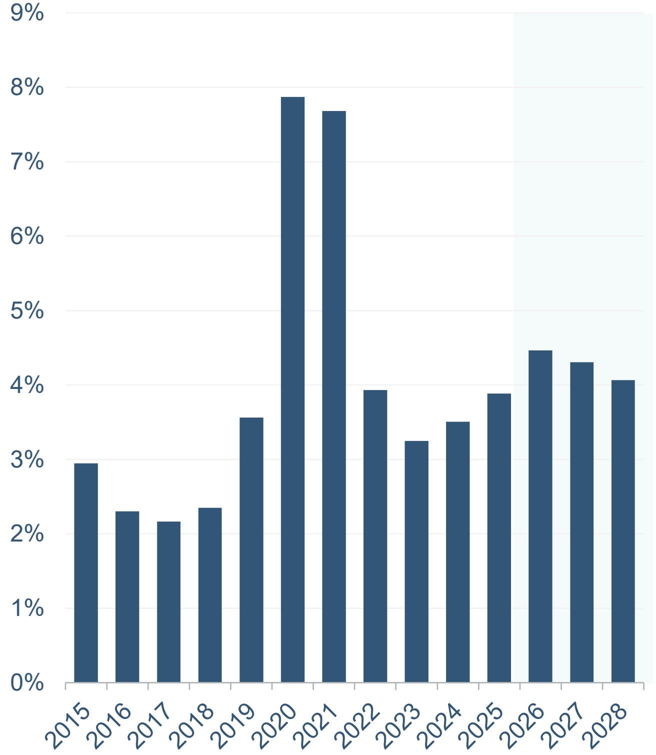
We believe that expectations of lower price increases and persistently high real policy rates, together with forecasts of further rate hikes this year, may incentivise developers to lower prices rather than hold on to unsold inventory.

High real interest rates, tight borrowing conditions and changes in credit supply are reducing demand in the market, which is the primary driver of price developments. We forecast moderate nominal price increases in the coming years, or an average increase of 2.0% this year, 2.6% next year and 4.0% in 2028. This implies that real prices will decline this year and next.

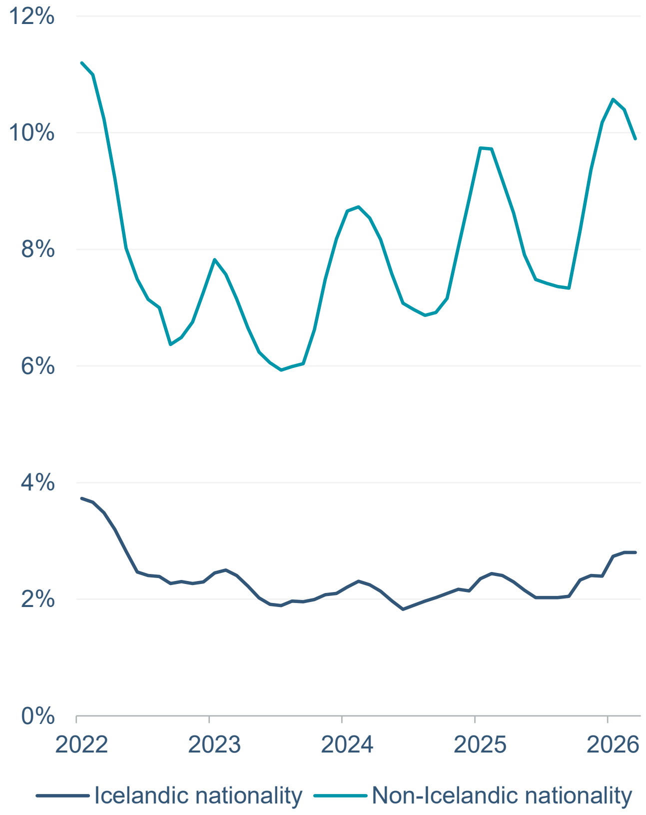
2026-2028 is Economic Research's forecast.
Source: The Housing and Construction Authority, Statistics Iceland, Landsbankinn Economic Research.

Forecast 4.5% unemployment this year, the highest since the pandemic

Registered unemployment and forecast



Registered unemployment



Signs of increasing slack in the labour market are becoming increasingly clear. Unemployment has been rising since 2024 and in the most recent months it has increased more rapidly. Unemployment in the first months of the year was 0.6–0.7 percentage points higher than a year earlier, compared to 0.2–0.4 percentage points for most of last year.

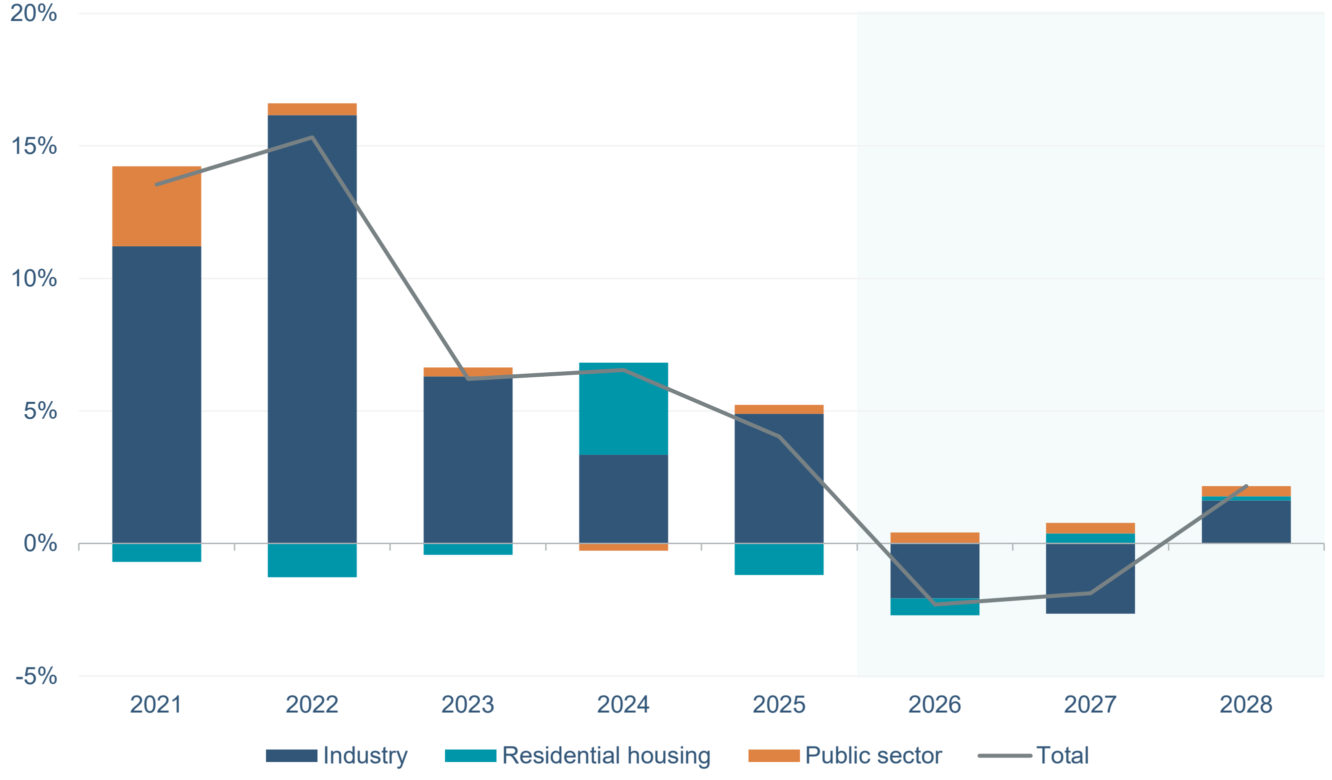
It is expected that unemployment will decline once interest rates are lowered and economic activity picks up. However, we do not anticipate major changes throughout the forecast period. We forecast 4.3% unemployment in 2027 and 4.1% in 2028.

Higher unemployment should reduce demand and thereby cool the economy. However, these effects have not been evident in recent quarters, as private consumption, for example, grew significantly last year. One possible explanation is that the labour market is somewhat split, with unemployment considerably higher among foreign nationals than among Icelandic citizens.

2026-2028 is Economic Research's forecast.
Source: Directorate of Labour, Landsbankinn Economic Research.

Capital formation contracts

Capital formation
YoY change and weight of components



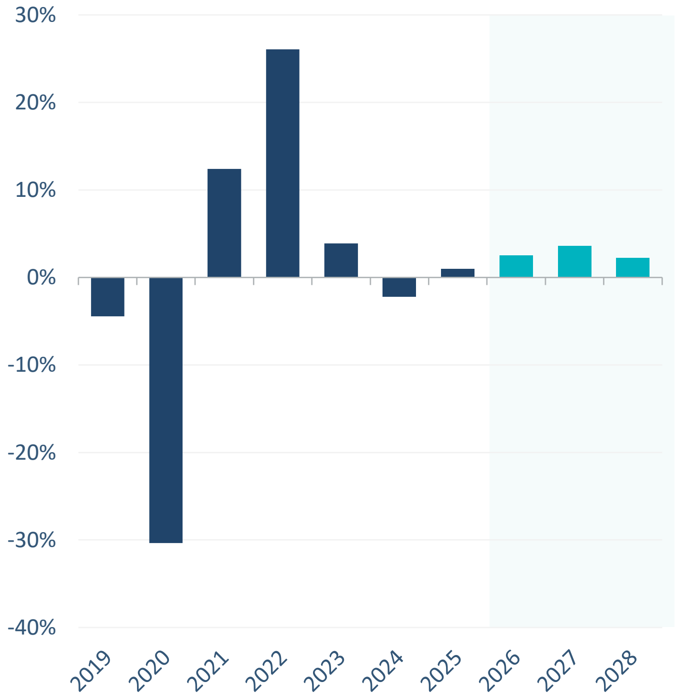
We forecast a contraction in capital formation this year and next, following significant growth last year, particularly in business investment, which increased by 7.5%. We expect a decline in residential housing investment this year and only modest growth in the coming years. We consider it likely that high real policy rate will continue to restrain growth in these components.

We expect public investment to increase throughout the forecast period, in line with plans for expansion in energy and transport infrastructure, as well as the construction of a new national hospital.

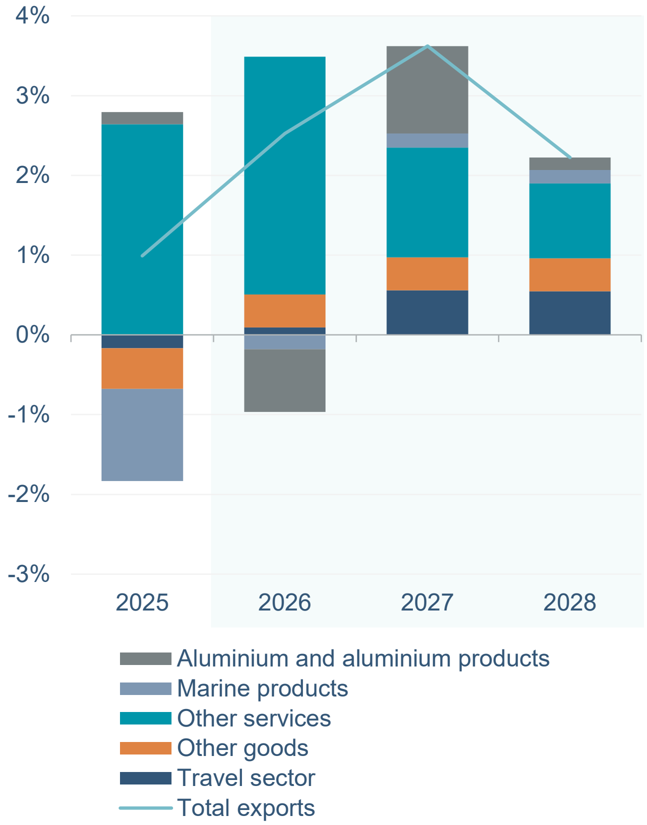
2026-2028 is Economic Research's forecast.
Source: Statistics Iceland, Landsbankinn Economic Research.

Less export of goods but growing service exports

Export
YoY volume change



Export forecast
Inflation and weight of components



Last year was characterised by considerable uncertainty in global markets. Icelandic exports have largely avoided import tariffs, as a significant share of exports to the US is exempt. Uncertainty has by no means diminished and is now mainly related to the development of oil prices, which could have negative implications for export growth.

That said, export prospects have improved somewhat since last autumn, not least due to a strong capelin season. It also appears that repairs to the malfunction at the aluminium smelter in Grundartangi will take less time than initially expected. We assume that, despite reduced flight supply in the first half of the year, tourism will remain roughly unchanged between years. There was strong growth in data centre service exports in the latter half of last year and we expect continued growth this year.

We forecast export growth of 2.5% this year, driven largely by increased service exports, primarily attributable to data centre services. Next year, we expect stronger export growth, particularly as aluminium exports return to normal.

2026-2028 is Economic Research's forecast.
Source: Statistics Iceland, Landsbankinn Economic Research.

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