

Economic forecast
2026-2029

Slow growth but improving outlook

Landsbankinn Economic Research, 19 October 2026



Highlights



Economic growth will be 1.3% this year and 1.5% in 2027, supported by foreign trade. Growth in domestic demand will remain subdued while interest rates remain high. Economic growth will pick up in the latter years of the forecast in tandem with lower rates.



We forecast 5.5% average inflation this year, 4.2% next year and 3.4% in 2028. Moderate increases in wages and public fees alongside falling demand will bring inflation down. A great deal of uncertainty remains about oil prices.



Aluminium exports pick up and various growth sectors, such as data centres, pharmaceuticals and aquaculture will boost exports in coming years.



We forecast 4.5% average unemployment this year followed by slowly improving figures as the economic environment improves. Wages improve but little over the forecast period, as wage drift is low.

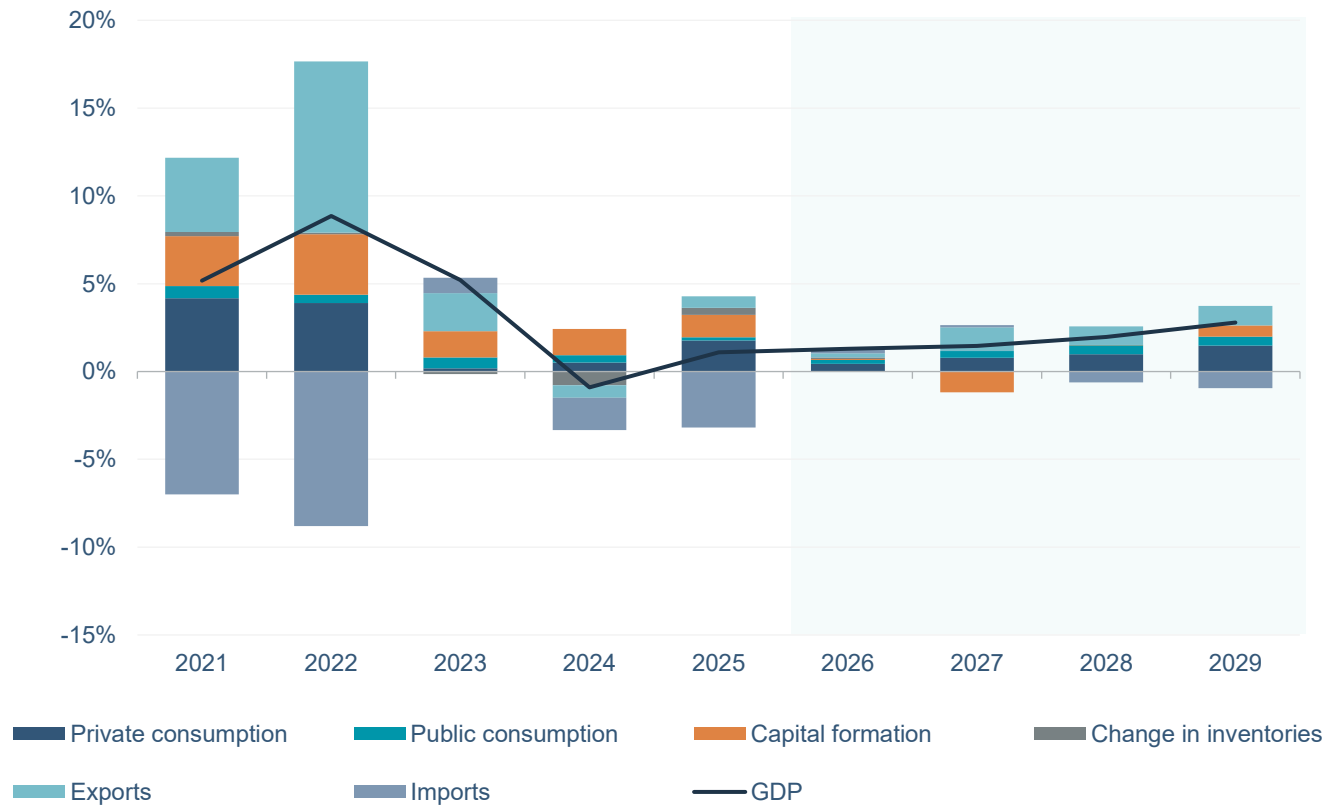


The housing market remains quiet and we expect moderate price increases in the near term. Housing supply has grown rapidly while demand has dropped. We assume that nominal prices will increase by 1.9% this year and 2% next year.

Slow growth but improving outlook

Economic forecast and contribution of components

YoY volume change



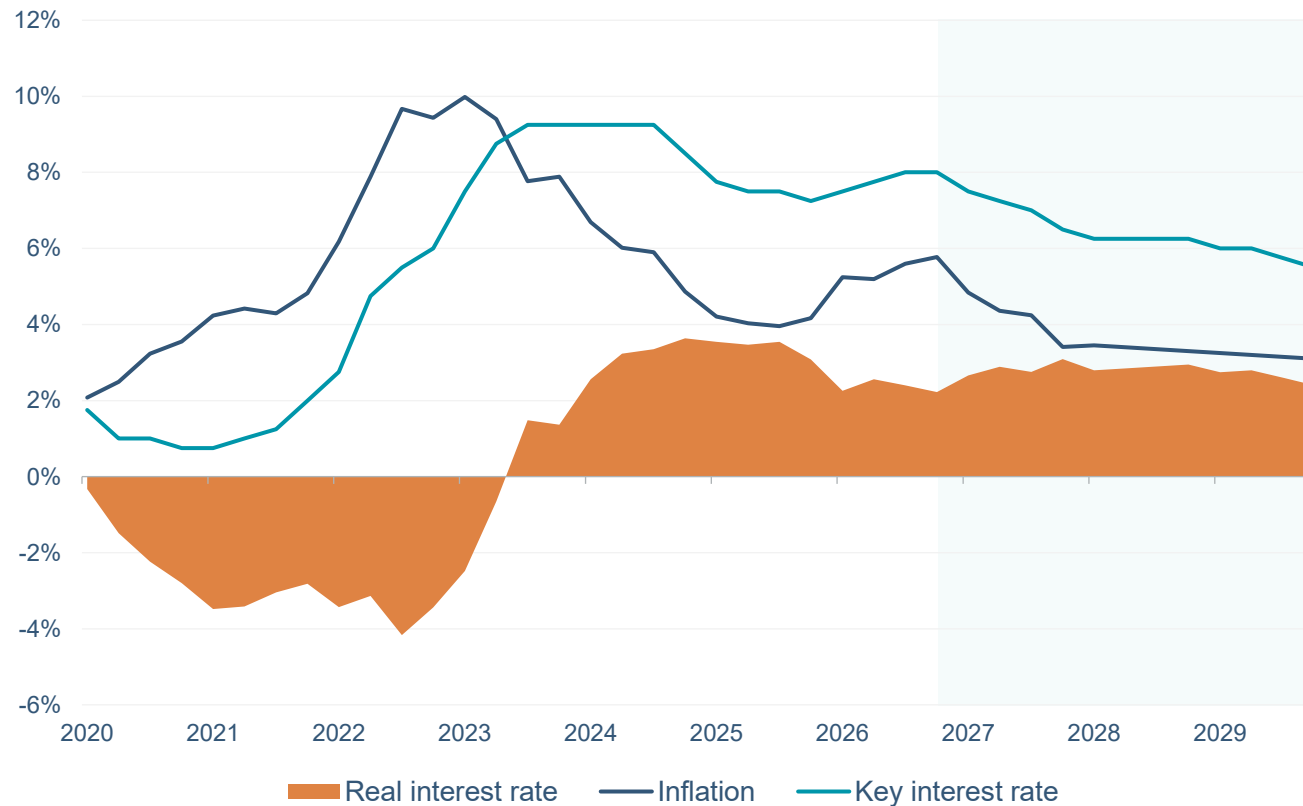
We forecast 1.3% economic growth this year and 1.5% next year. In a historical context, this is very modest growth, but it will be supported by diverse exports, including increased exports of aluminium, pharmaceuticals and aquaculture products, alongside moderate growth in tourism.

We forecast a contraction in residential investment over the next few years and very modest increases in housing prices. A number of larger investment plans are expected to continue progressing, including projects related to power generation and data centres.

Uncertainty has decreased considerably in recent weeks and, in many respects, there is reason to view the future positively. We believe the outlook has improved. We consider the interest rate hiking cycle to be over and uncertainty regarding the continuation of wage agreements has declined significantly. We therefore expect slow growth but simultaneously an improving outlook. The improvement primarily reflects a greater likelihood of interest rate cuts early next year.

Interest rates follow the decline in inflation

Inflation, key interest rates and real interest rates



We expect inflation to recede slowly over the forecast period. This expectation is based, among other things, on moderate wage growth and favourable external conditions.

We forecast that the Central Bank will begin cutting interest rates in February next year. If the forecast materialises, rates could decline fairly steadily throughout the year.

According to the forecast, real interest rates will range between 2-3% over the entire forecast period. This represents the degree of monetary restraint that we consider necessary for inflation to move towards target under current conditions.

Lower growth and higher unemployment than usual

Apart from the financial crisis and pandemic years, unemployment is expected to be rather high and economic growth low compared to the period 1996-2025. Inflation and key interest rates show more usual developments.



Dots show unemployment, GDP, inflation and the key interest rate each year since 1996. Yearly average. 2026-2029 is Economic Research's forecast.
Source: Statistics Iceland, Central Bank of Iceland, Directorate of Labour, Landsbankinn Economic Research.

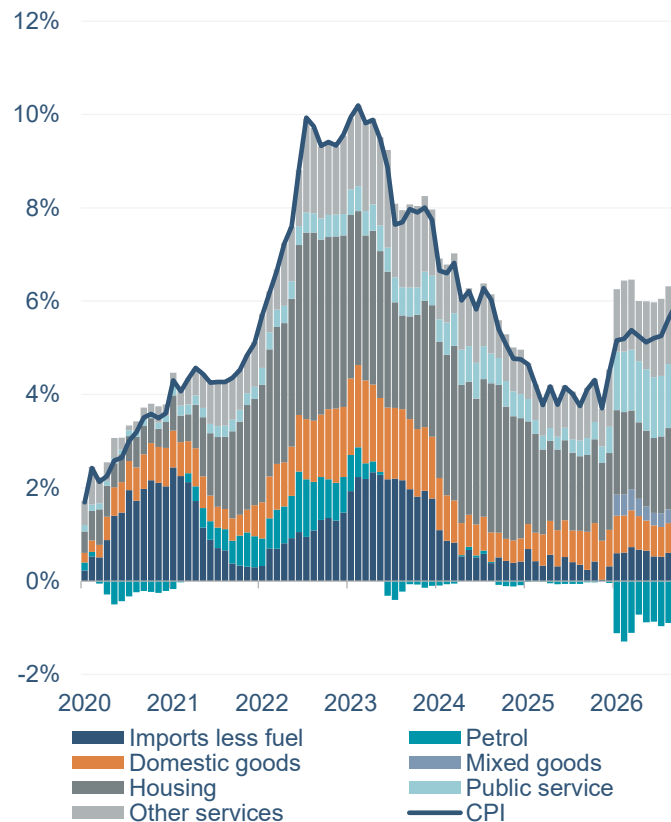
Overview of Landsbankinn Economic Research's forecast

	ISKbn	Volume change from previous year (%)				
	2025	2025	2026	2027	2028	2029
Domestic product and key components						
Gross domestic product	4,941	1.1	1.3	1.5	2.0	2.8
Private consumption	2,440	3.6	0.9	1.6	2.0	3.0
Public consumption	1,284	0.7	0.8	1.5	2.0	2.0
Capital formation	1,327	4.8	0.2	-4.5	0.1	2.5
Investment in industry	875	7.8	3.2	-5.3	-0.7	2.4
Investment in residential housing	250	-5.4	-6.7	-5.5	0.8	3.0
Public sector investment	202	5.4	-4.0	0.6	2.6	2.5
Total national expenditure	5,047	3.6	0.8	0.0	1.5	2.6
Export of goods and services	1,997	1.5	0.6	3.3	2.6	2.7
Import of goods and services	2,103	7.3	-0.6	-0.3	1.5	2.3
Key interest rate and inflation		2025	2026	2027	2028	2029
Key interest rate, 7-day term deposits, year end, %		7.25	8.00	6.50	6.25	5.50
Inflation, annual average, %		4.1	5.5	4.3	3.4	3.4
EUR exchange rate, year end		147.2	137	140	142	144
Housing price, nominal price, YoY change, annual avg., %		5.3	1.9	2.0	4.1	4.8
Housing price, real price, YoY change, annual avg., %		1.2	-3.3	-2.2	0.5	1.3
Labour market		2025	2026	2027	2028	2029
Wage index, YoY change, annual avg., %		7.9	5.8	5.1	5.6	5.6
Purchasing power of wages, YoY change, annual avg., %		3.7	0.4	0.8	1.9	2.1
Unemployment, annual average, %		3.9	4.5	4.4	4.1	3.7
Trade balance		2025	2026	2027	2028	2029
Number of foreign travellers, thousand individuals		2,267	2,260	2,300	2,330	2,400
Goods and services balance, %GDP		-2.1	-0.3	1.7	1.9	1.9
Current account balance, %GDP		-4.0	-2.9	-1.0	-0.8	-0.6

Inflation under 5% in the first quarter of 2027

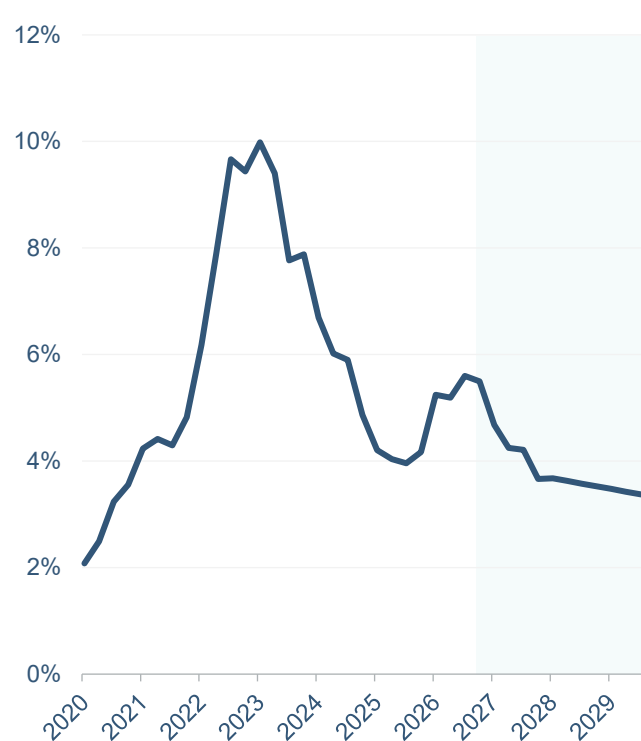
Inflation by type and origin

YoY change and contribution of components



Inflation

Quarterly average



Inflation measured 5.9% in September after having fallen to 5.1% in May. The increase since spring is primarily explained by higher oil prices, rising airfares, the end of the temporary VAT reduction on fuel and higher public fees. We expect inflation to remain above 5% for the remainder of this year.

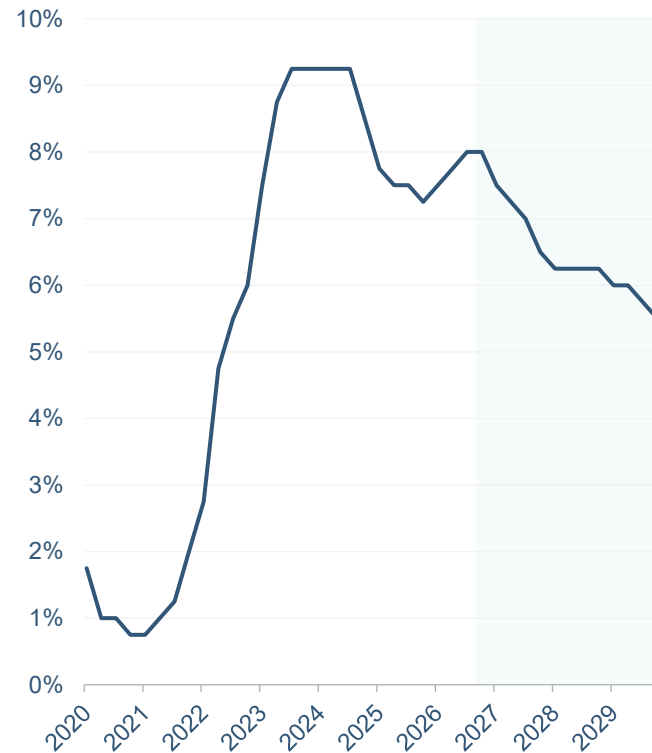
We then expect it to fall below 5% in the first quarter of next year, partly due to favourable base effects. Other factors also point to continued easing: current wage agreements remain in place, slack has emerged in both the labour and housing markets and oil prices are expected to decline gradually.

Inflation will likely rise temporarily around the middle of next year because of base effects from the VAT discount on petrol in the summer of 2026. After that, we forecast continued disinflation, with inflation at around 3.5% at the end of next year.

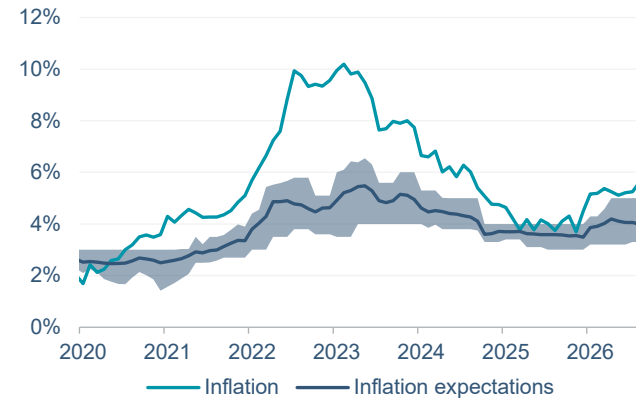
Expect to see the first rate cut early next year

Key interest rate

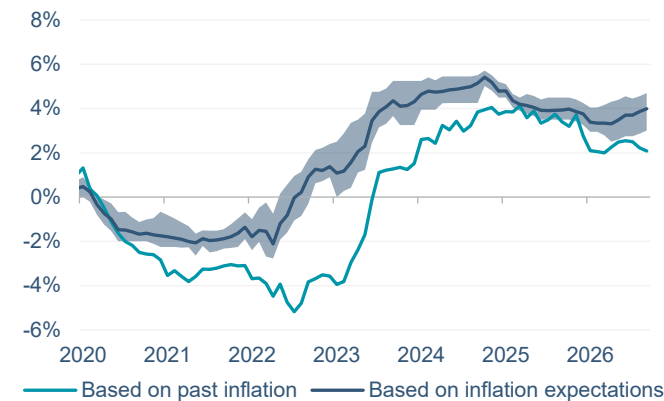
End-of-quarter values



Inflation and inflation expectations



Real interest rate



The Central Bank of Iceland has raised interest rates by 0.75 percentage points since spring in response to higher inflation. Inflation expectations have remained fairly stable this year, despite rising early in the year before the rate hikes were implemented. Monetary policy has tightened somewhat this year when assessed using real interest rates based on inflation expectations, but the stance is now broadly the same as at the start of the year when assessed using past inflation.

The Monetary Policy Committee decided to leave rates unchanged earlier this month despite higher inflation in light of clear signs that the economy is cooling. Increased inflation was caused by the effects of conflict in the Middle East and higher public fees, rather than increased underlying inflationary pressure.

We believe the rate hiking cycle has ended and that rates will remain unchanged until next year. We expect inflation to decline in January and to be at 5% when the MPC meets in February. The initial rate cut could come as early as at that meeting. We expect the MPC to lower rates by a total of 1.5 percentage points next year and for the CBI's key interest rate to stand at 6.5% by year-end 2027.

Inflation expectations are the average of the 2Y and 5Y inflation premium on the bond market, the results of a market expectation survey for 1Y and 5Y, household expectations for the next 5Y and companies for the next 5Y. The shaded area shows the highest and lowest values.

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

Quiet housing market

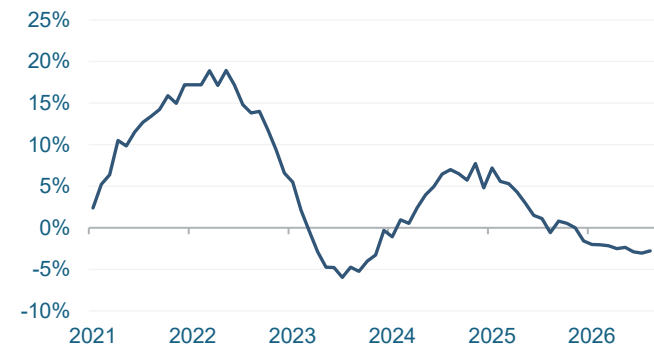
Months of supply

3M running average



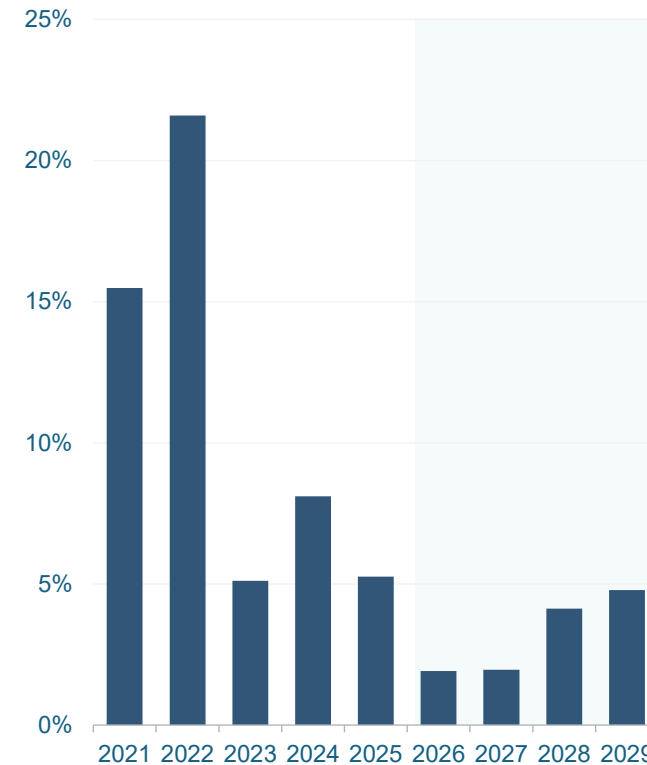
Real housing prices

YoY change, discounted by CPI excluding housing



Housing prices

YoY change, annual average



We expect price increases in the housing market to stay moderate in the near term. Real housing prices have declined year-on-year since November 2025 and we expect that trend to continue in the coming months.

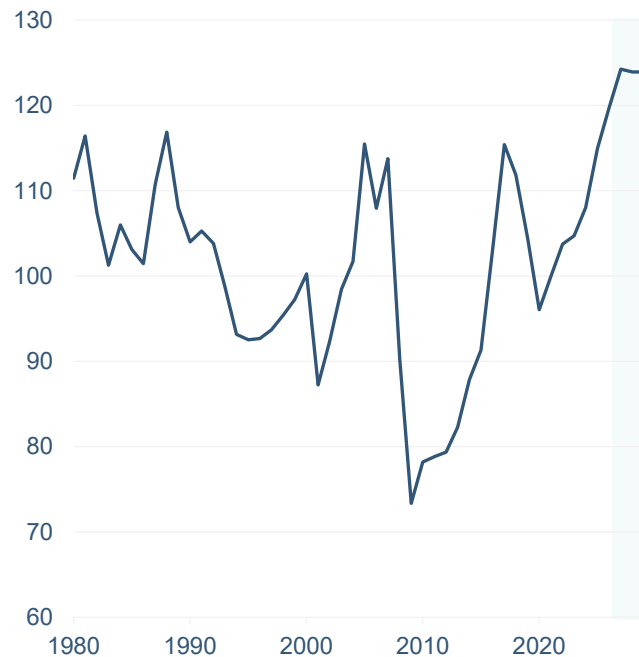
The supply of residential housing for sale has increased rapidly, while the number of purchase agreements has declined between years. Concomitantly, the time properties remain on the market has lengthened, particularly for new housing. A large stock of completed new-build properties limits price increases in the housing market and reduces incentives for further construction.

High interest rates, rising unemployment and generally weaker economic activity curtail demand in the short term. However, we expect interest rates to begin decreasing next year, which will gradually support demand. Nominal housing price increases are therefore expected to remain moderate initially, before increasing as the forecast period progresses.

Real exchange rate soars towards historic heights

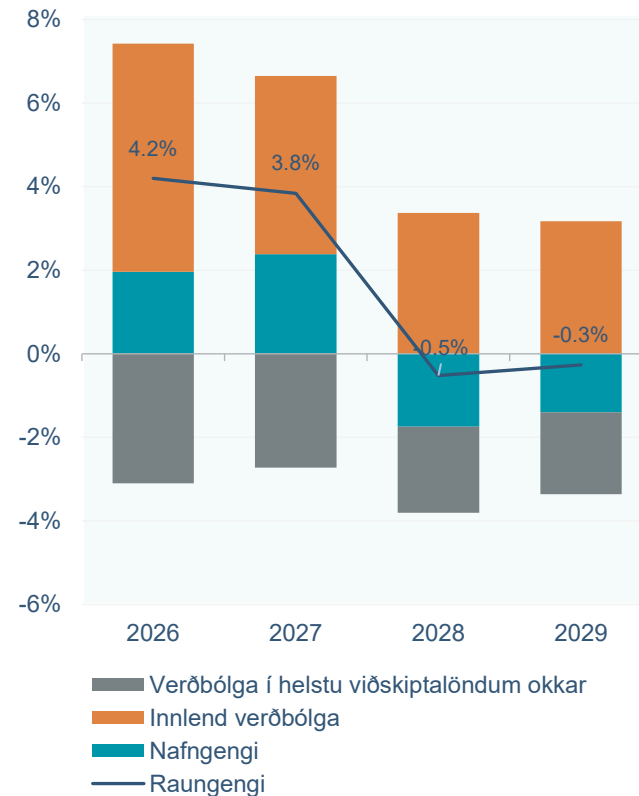
Real exchange rate

Index, average 1980-2025 = 100



Real exchange rate

YoY change and contribution of components



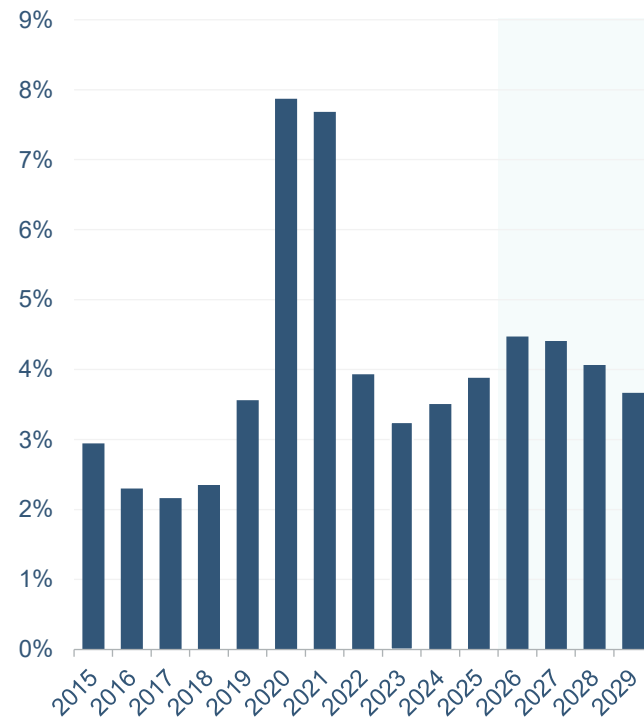
Last year, the real exchange rate based on relative prices was around 15% above its 1980-2025 average. It has been higher on only four occasions during that period: in 1981, 1988, 2005 and 2017.

This year, the real exchange rate will almost certainly increase markedly between years, as the króna has appreciated and inflation has been higher than in Iceland's trading partner countries. We forecast a further increase next year. Based on our inflation forecast, the króna would need to depreciate significantly and the euro would have to average ISK 145 next year, for the real exchange rate not to rise.

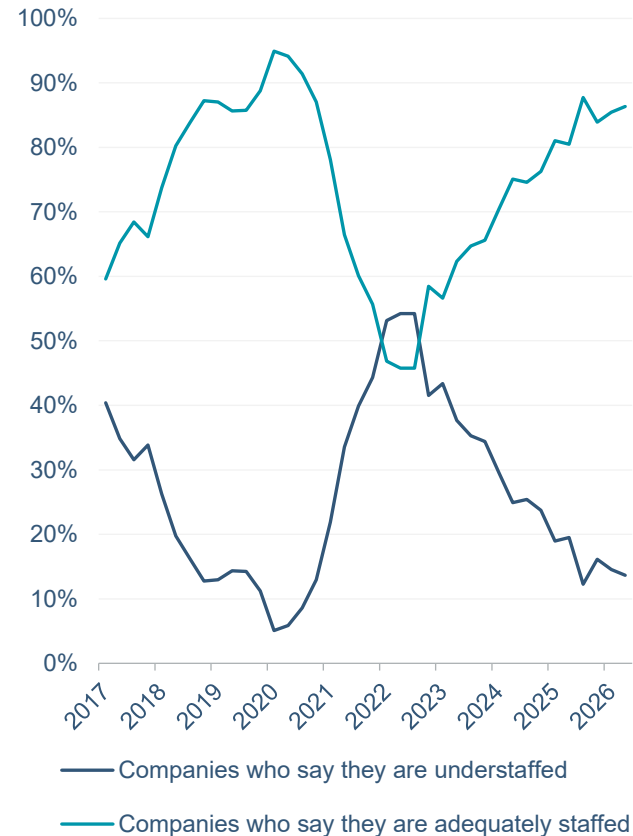
If the forecast materialises, the real exchange rate will reach a level higher than seen in recent decades. We expect the real exchange rate to remain broadly unchanged over the final two years of the forecast period.. Continued strength of the real exchange rate is clearly a risk factor for the export outlook.

Labour market cools down

Registered unemployment



Available workers



According to registered unemployment as per the Directorate of Labour, unemployment has been 0.5-0.7 percentage points higher so far this year than during the same period last year. We expect this trend to continue in the coming months, with unemployment peaking at around 5% this winter before beginning to decline again. We expect the weakening of the labour market to slow next year as monetary restraint eases and economic activity gradually picks up.

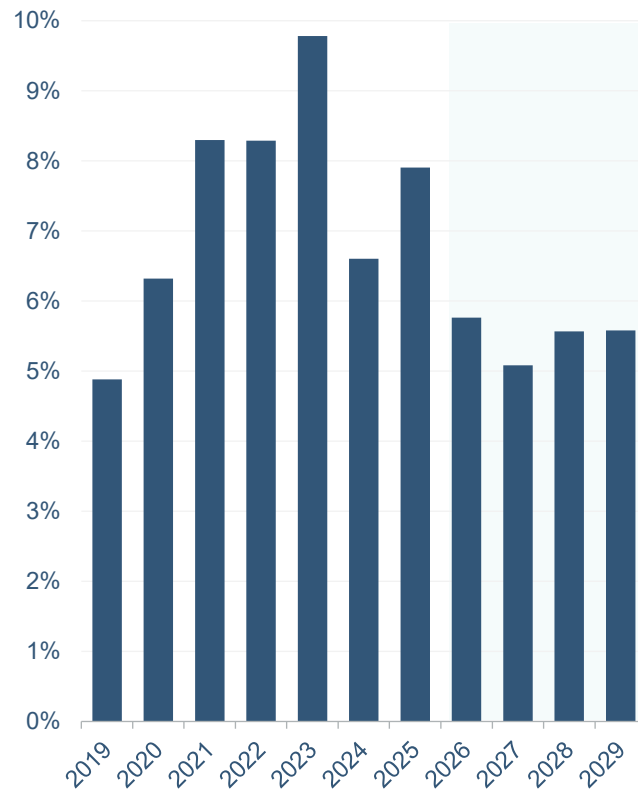
We forecast 4.5% average unemployment this year and only slightly lower next year, or 4.4%. In the final two years of the forecast period, we expect unemployment to keep gradually decreasing, to 4.1% and 3.7%, respectively.

According to a Gallup survey, 86% of companies consider the supply of labour sufficient. This percentage has not been higher since the pandemic, when economic activity slumped significantly. Similarly, only 14% of companies report a shortage of staff.

Wage hikes slow yet purchasing power continues to grow

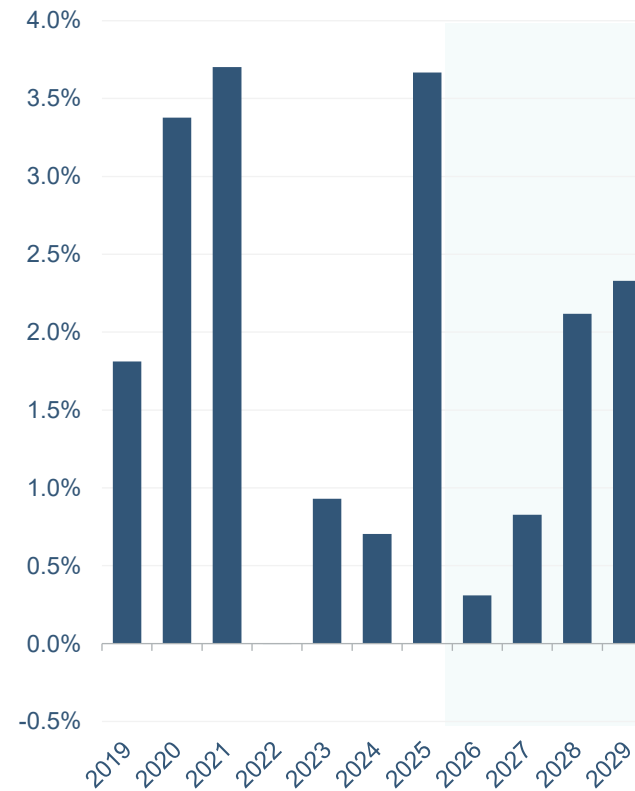
Wage development

YoY change to wage index



Purchasing power of wages

YoY change



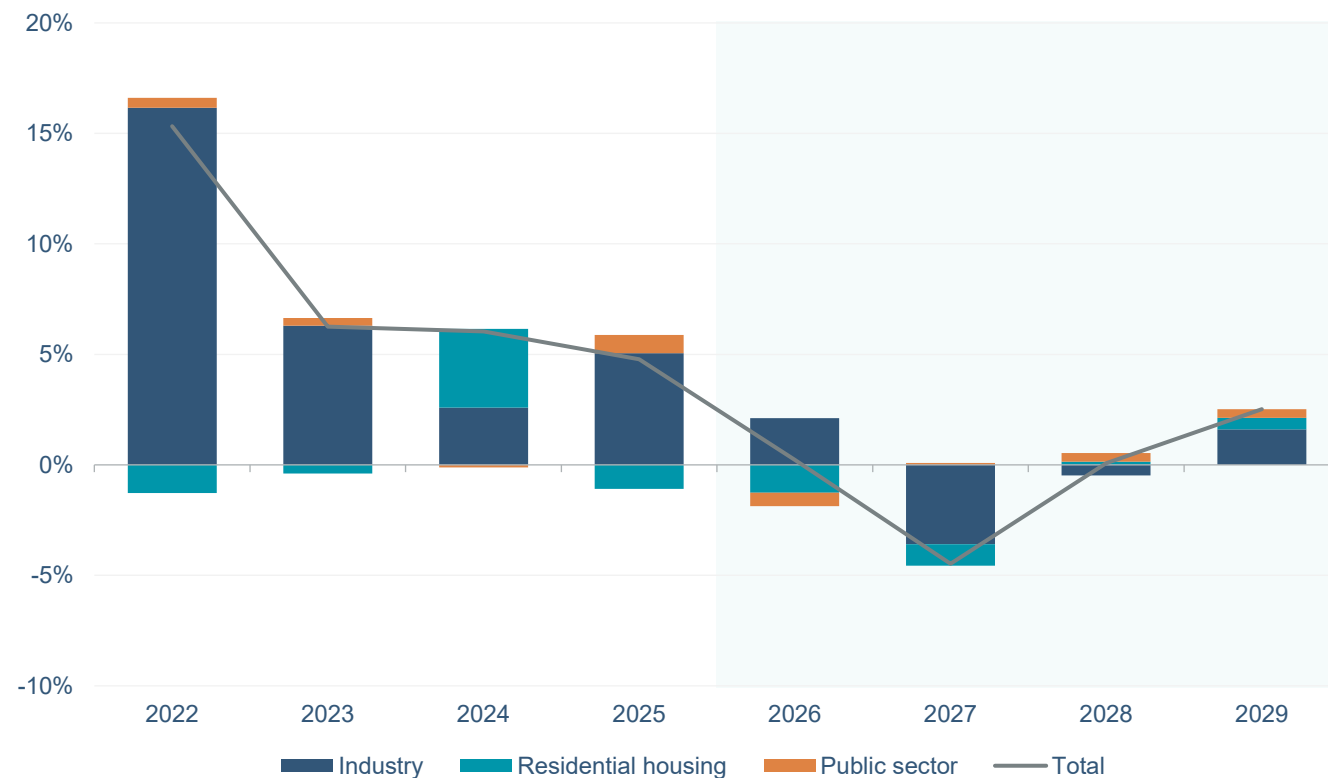
An Agreement was reached in the labour market earlier this month so that current collective agreements remain in force. As a result, we expect wages to follow those agreements, supplemented by moderate wage drift while unemployment remains high and the economy continues at a slow pace.

If this forecast materialises, wages will nevertheless increase substantially, by 5.8% this year and 5.1% next year. This will result in purchasing power increasing by 0.3% this year and 0.8% next year. We expect stronger growth in purchasing power in the final two years of the forecast period, alongside lower inflation and a stronger economic recovery.

Capital formation contracts next year

Capital formation

YoY change and contribution of components



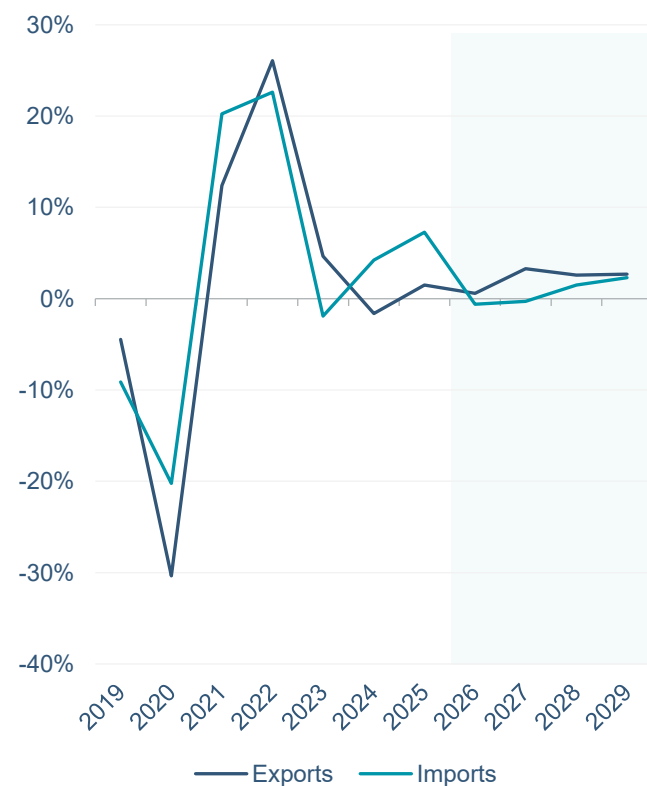
Capital formation remains broadly unchanged year-on-year this year. Business investment will increase, driven by continued investment in data centres and large-scale industrial projects. By contrast, residential housing and public sector investment are expected to decline if the forecast holds. Contraction in public investment this year is primarily due to base effects following a significant increase last year. Public investment is expected to remain at broadly similar levels in the coming years as in the recent past.

Next year, we forecast a decline in capital formation as data centre investment slows and residential housing construction continues to contract. Modest growth in capital formation is then expected in the final two years of the forecast period.

Export growth increases next year

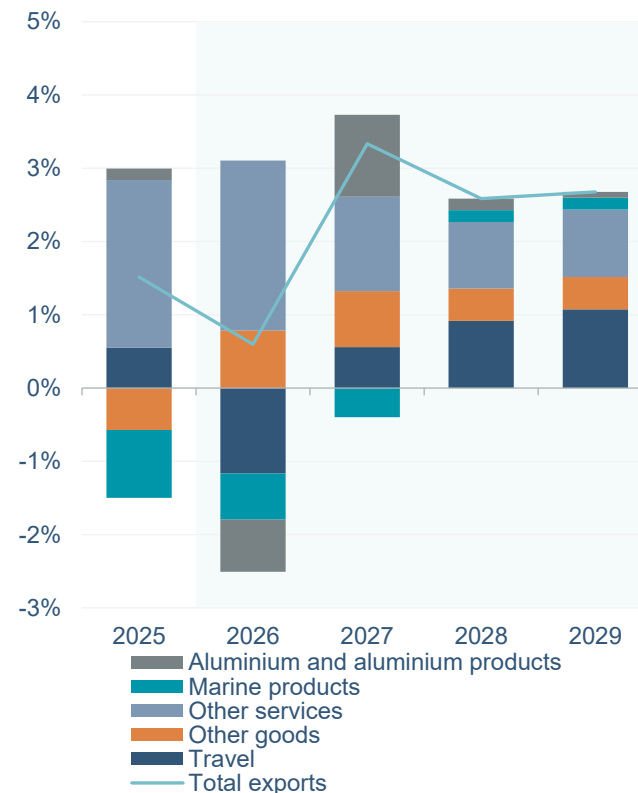
Exports and imports

YoY volume change



Exports

YoY volume change
and contribution of components



We forecast only a slight increase in exports this year, or 0.6%. We expect a contraction in tourism, as both flight capacity and tourist spending have declined since last year. Seafood exports have also decreased between years despite a reasonably good capelin season. By contrast, aluminium exports have begun to increase following a production decline caused by an outage last year. Aquaculture exports will grow strongly this year and the outlook for pharmaceutical exports will improve as the year progresses. We also expect continued growth in other service exports, particularly those related to data centres.

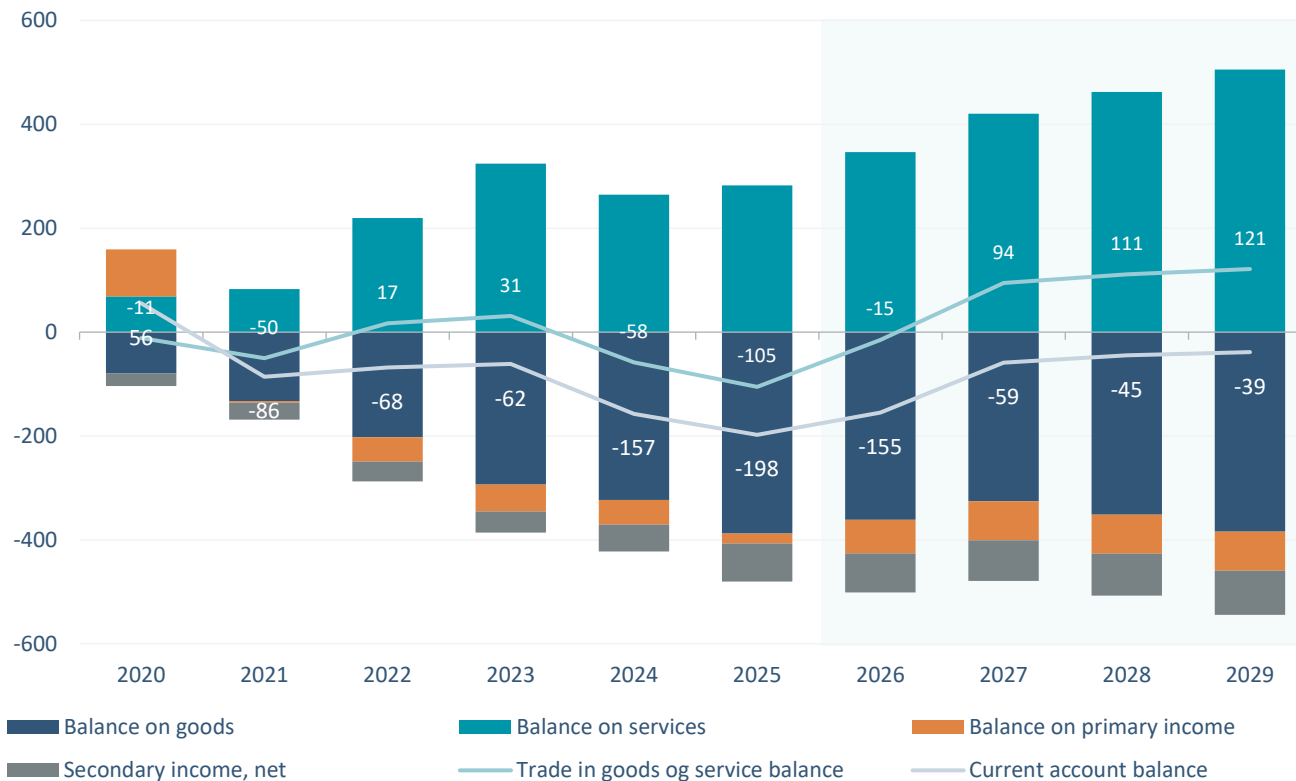
Next year, we expect growth in most export sectors, with total exports increasing by 3.3%. Exports from aluminium, pharmaceutical and aquaculture sectors are all expected to rise. Tourism is expected to grow slowly, while other service exports are expected to increase strongly.

Imports increased significantly last year, primarily in connection with data centre construction. We forecast only a slight contraction this year, as data centre development remains strong. A substantial decline in Icelanders' travel abroad will also restrain further growth in service imports.

Continued current account deficit - surplus on goods and services balance

Current account balance

ISKbn



Last year, the current account deficit was ISK 198 billion. There were deficits in the goods balance, primary and secondary income, while the services balance was in surplus. We expect a deficit this year, followed by a significant narrowing next year. The large current account deficit has not been reflected in foreign currency flows, partly because imports related to data centre investment are largely financed abroad.

As noted, we expect import volumes to decline slightly next year, export volumes to increase and the terms of trade to improve between years. Together, these developments will improve the current account balance by ISK 96 billion in 2027 compared with 2026. The balance of goods and services will move into surplus, but the current account will remain in deficit because of deficits in primary and secondary income. In the final two years of the forecast period, we expect slightly better outcomes than in 2027 yet continued current account deficits.

2026-2029 is Economic Research's forecast.

Source: Central Bank of Iceland, Landsbankinn Economic Research

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