



# Slower rhythm succeeds rapid turnaround

Macroeconomic and inflation forecast of  
Landsbankinn Economic Research, 24 April  
2023

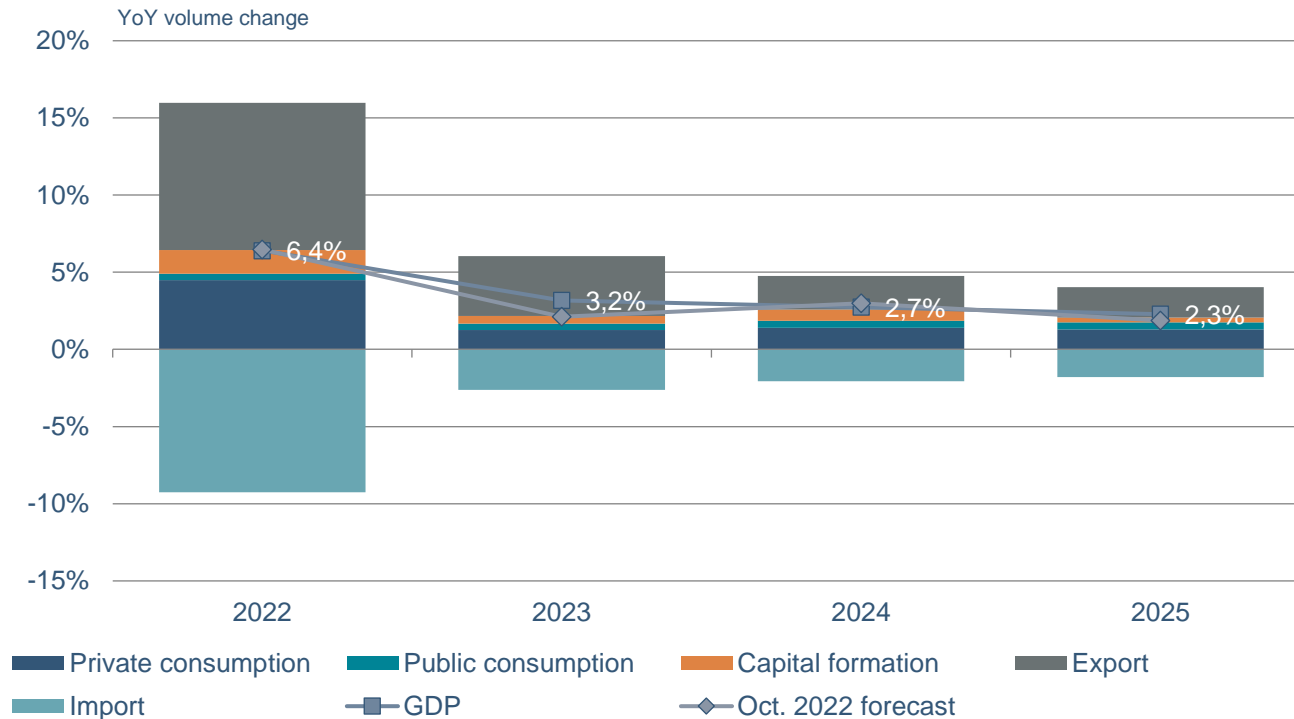
# Highlights

---

- Our forecast assumes continued economic growth in the coming years, 3.2% this year, 2.7% in 2024 and 2.3% in 2025.
- We expect 2.1 million tourists to visit Iceland this year. We expect this number to rise to 2.3 million in 2024 and 2.5 million in 2025, which would be a record year.
- Export increases by 8.4% between years this year, according to our forecast, and then by 4.7% next year. It will be driven by growing export of services.
- We anticipate slow appreciation of the Icelandic *króna* (ISK) and for the euro to cost ISK 146 at year end 2023.
- Foreign trade will be more or less balanced to the forecast horizon, neither a significant surplus nor deficit. We expect an increased deficit in trade in goods to be counterbalanced by an increased surplus from services.
- After high growth in the past two years, we expect much more conservative growth in private consumption in coming years, or 2.4% this year and 2.7% in 2024.
- Salaries have risen sharply recently, driven both by labour market tension and newly concluded collective bargaining agreements. We expect to see an 8.7% salary increase this year and 7.8% in 2024. Purchasing power will remain almost stable between years this year and rise slightly next year.
- We are of the opinion that inflation has peaked and will recede slowly but to stay above the upper tolerance interval of the CBI's inflation target, or at 4.5%, in the last quarter of 2025.
- The CBI will continue raising rates and we expect the policy rate to attain a high point at 8.5% before beginning to decrease again in the second quarter of next year.
- The housing market has cooled significantly and we expect nearly unchanged prices throughout the rest of the year, but that average housing prices will be 4.8% higher this year than in 2022.
- Uncertainty in our forecast lies mainly in the factors that influence inflation, such as salary development in coming years, the ISK exchange rate and domestic demand.

# Outlook for conservative economic growth

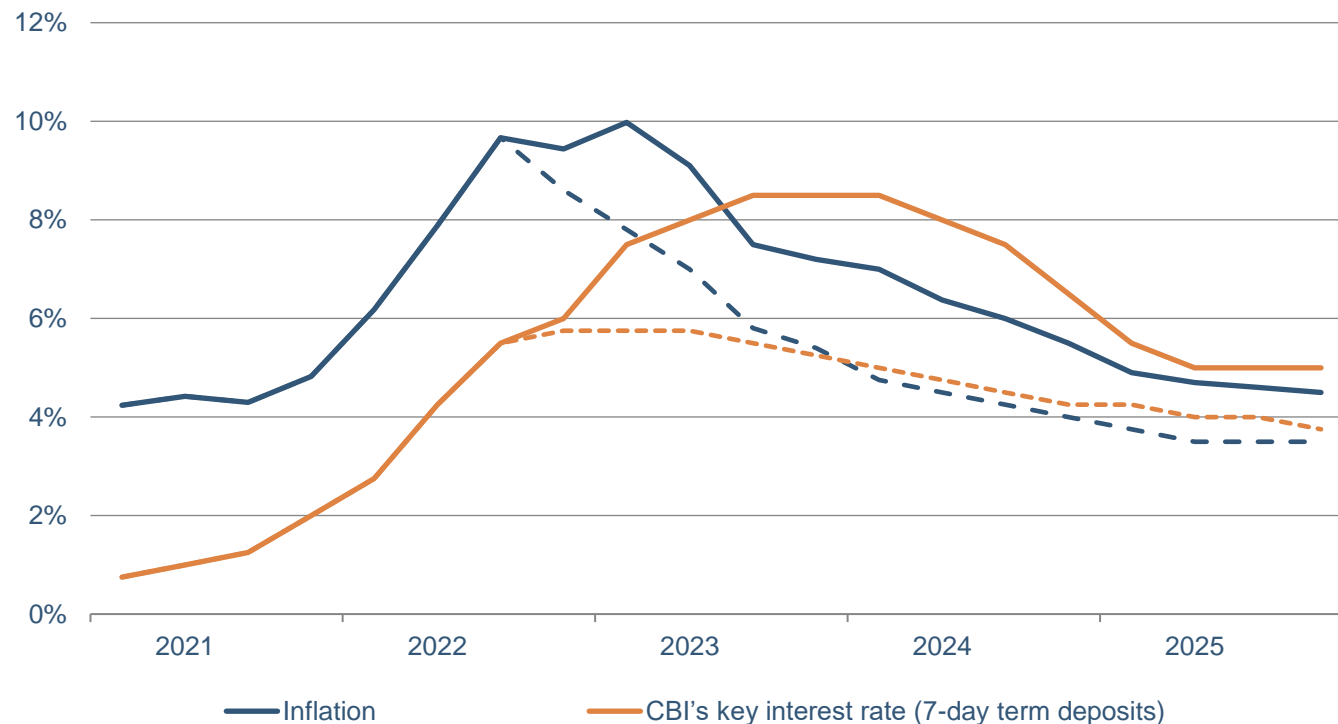
## Economic forecast and weight of components



- Economic growth measured 6.4% in 2022, the highest growth since 2007.
- We are of the opinion that we are entering a period of more conservative growth and that it will average 2.7% during the forecast period. Economic growth will be driven by export and private consumption, less so by public consumption and capital formation.
- While increased import reduces growth, the net effect of foreign trade on economic growth will be positive.
- The forecast assumes more growth this year than what we forecast in October, not least due to robust private consumption and a brighter outlook in the travel sector.

# Pervasive inflation and high interest levels going forward

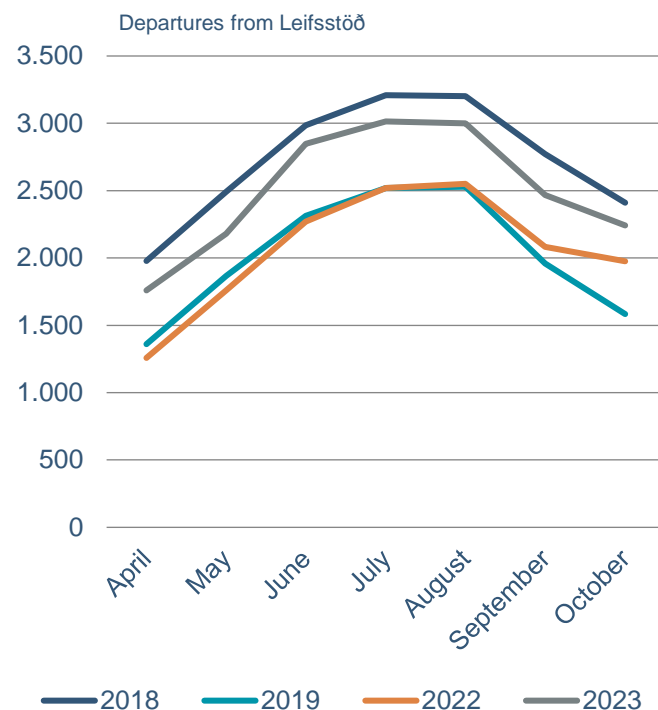
## Inflation and policy rate forecast



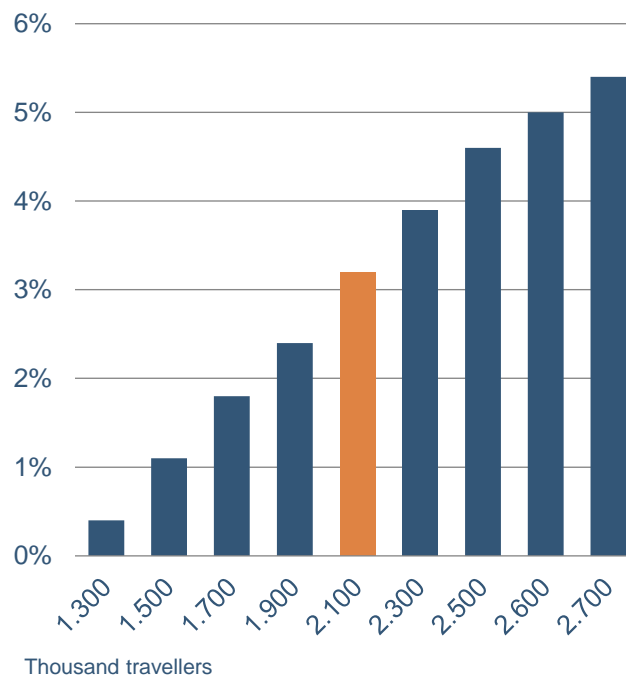
- We expect pervasive inflation to remain above the CBI's target. We thought inflation had peaked in October and expected it to slowly recede. This turned out not to be the case and inflation has far outstripped forecasts in the past few months. Some of the reasons include more extensive salary increases than anticipated, more robust private consumption and a weaker ISK. We expect inflation to recede slowly and to stand at 4.5% at the forecast horizon rather than 3.5% as in October.
- The CBI's key interest rate was 5.75% in October, which we considered to be the high point. The Monetary Policy Committee has since raised rates by 1.75 pp in response to much more pervasive inflation, and the policy rate is now 7.5%. We do not think that the current policy rate hike series is complete and expect that the Committee will continue to raise rates by a total of 1 pp. A rate-cutting cycle will not commence before the second quarter of next year.

# Seat capacity in air travel to Iceland promises a good year

## Seat capacity



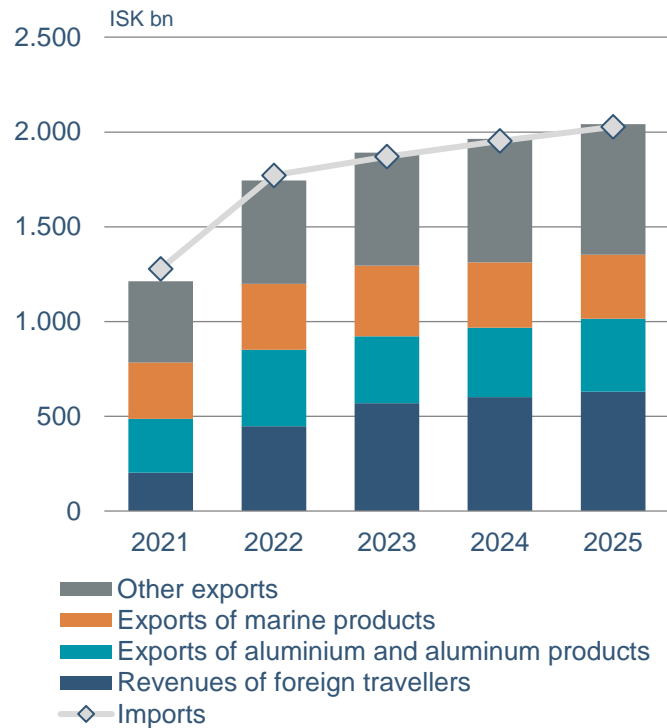
## Economic growth in 2023 as a function of tourist numbers



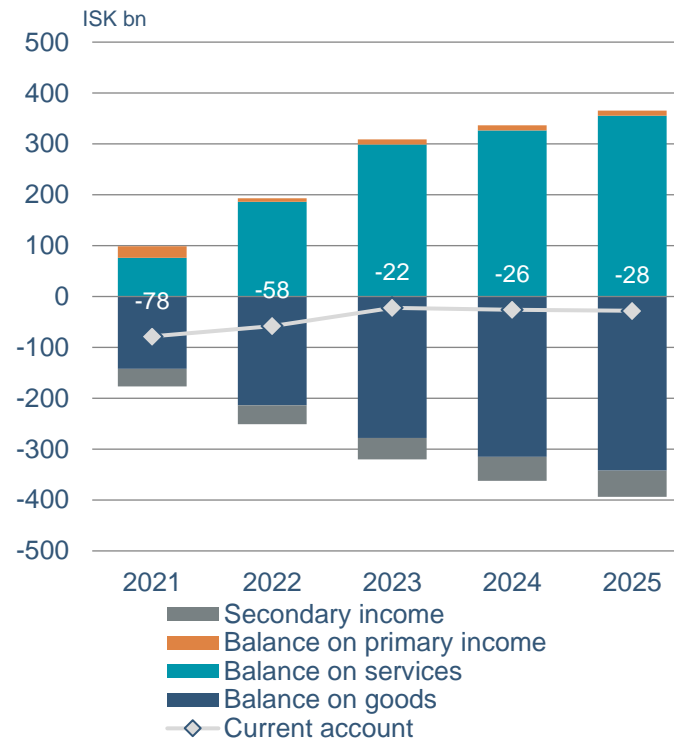
- As mentioned, export growth will contribute to continued economic growth in Iceland, led by the key industry, the travel sector. Scheduled seat capacity provides an indication of the number of travellers to Iceland. Looking to the short term, or to the end of October, seat capacity is considerably higher than during the same period last year and considerably higher than the same time in 2019, the last year before the pandemic.
- A total of around 17,500 departures are scheduled from Leifsstöð during the period from April to October this year. This is 92% of departures during the same period in 2018, when a record number of travellers visited Iceland, or 2.3 million. We expect a similar passenger load factor now and for the number of travellers through Leifsstöð to be 2.1 million.
- If our forecast proves correct, the increase in tourist arrivals will be 400,000 between years and economic growth can be expected to be 3.2%. If tourist numbers are higher, e.g. 2.3 million, economic growth can be assumed to increase as well, or to just under 4%. Conversely, economic growth can be expected to decrease with lower tourist numbers.

# Forecast a balance in foreign trade

## Export and import of goods and services



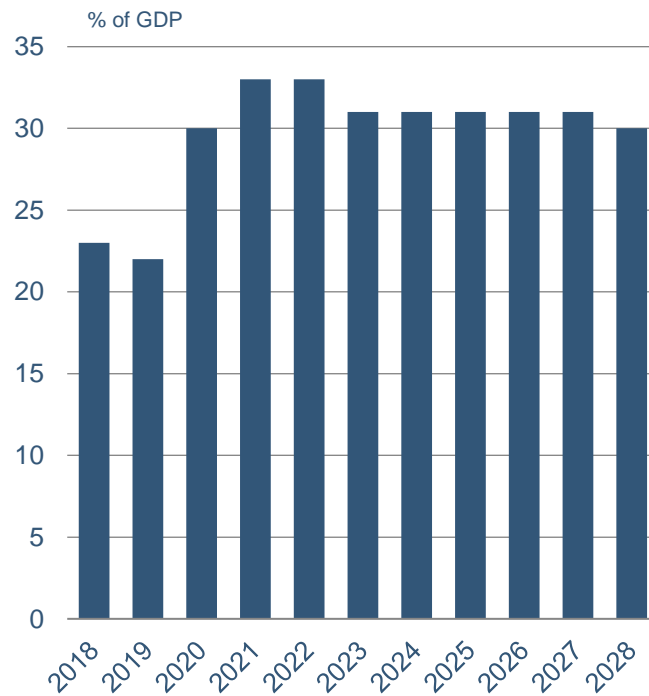
## Current account balance



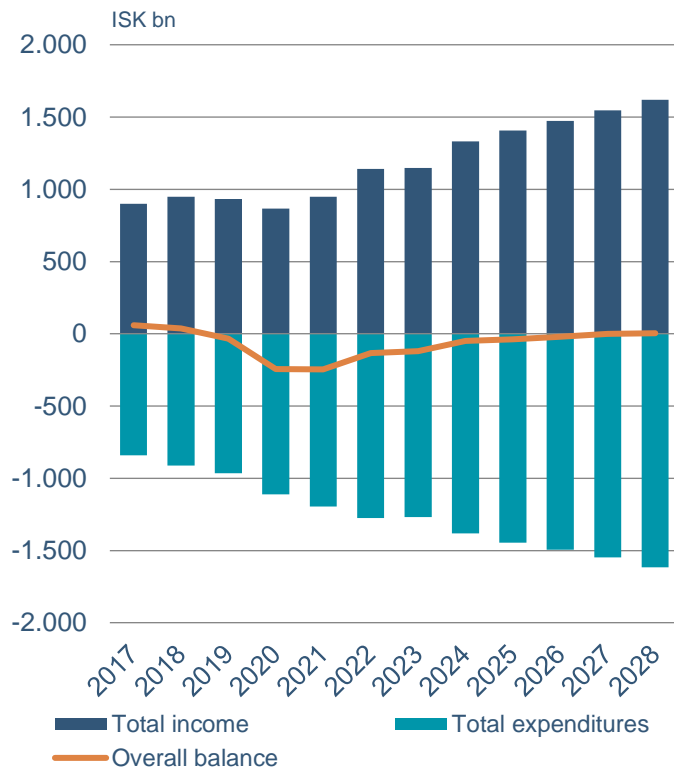
- In 2022, the current account deficit measured ISK 58 bn, slightly less than the ISK 77 bn deficit we assumed in our October forecast.
- We expect that foreign trade will be more or less balanced to the forecast horizon, neither a significant surplus nor deficit. We will see an increase in both import and export. We expect to see an increased deficit in trade in goods to be counterbalanced by an increased surplus from services.
- In total, we expect the deficit to amount to ISK 20-30 bn per annum for the duration of the forecast period.

# Treasury debt stable and slow improvement

## Treasury debt



## Treasury balance



- Treasury indebtedness grew quickly in the pandemic because of the burdens it took on to mitigate the economic impact. The debt ratio grew from 22% in 2019 to 33% in 2021.
- The new fiscal budget does not assume that the debt ratio can be lowered before 2028, and then by 1 pp only. This slow recovery stems primarily from heavy interest expenses. The primary balance is expected to be positive already this year, less interest expenses.
- The government assumes a slow recovery and that a positive position will not be achieved until 2028. The fiscal deficit is expected to be ISK 0.1 bn in 2027 - the previous budget assumed an ISK 25 bn deficit that year. Restraint was tightened slightly between budgets.
- Economic Research considers it unlikely that the planned restraint measures will succeed in suppressing inflation.

# Overview of Landsbankinn Economic Research's macroeconomic forecast

<b>Domestic product and key components</b>	ISK bn	Volume change from previous year (%)			
	2022	2022	2023	2024	2025
Gross domestic product	3,766	6.4 (6.5)	3.2 (2.1)	2.7 (3.0)	2.3 (1.9)
Private consumption	1,967	8.6 (6.7)	2.4 (2.0)	2.7 (3.3)	2.5 (3.0)
Public consumption	976	1.6 (1.5)	1.6 (1.6)	1.7 (1.7)	1.7 (2.0)
Capital formation	842	6.9 (6.6)	2.3 (1.1)	3.2 (-3.2)	1.4 (-3.1)
Investment in industry	507	15.2 (9.4)	2.5 (2.3)	2.6 (-4.4)	1.4 (-3.7)
Investment in residential housing	184	-6.3 (1.0)	5.9 (4.5)	5.1 (0.5)	1.0 (-1.5)
Public sector investment	151	-0.9 (5.0)	-3.0 (-7.0)	3.0 (-4.0)	2.0 (-3.0)
Total national expenditure	3,794	6.4 (5.3)	1.9 (1.7)	2.6 (1.4)	2.1 (1.4)
Export of goods and services	1,744	20.6 (22.4)	8.4 (3.7)	4.7 (7.0)	4.3 (3.1)
Import of goods and services	1,772	19.7 (18.6)	5.6 (2.7)	4.4 (3.5)	3.8 (2.2)
<b>Policy rate and inflation</b>		2022	2023	2024	2025
CBI's key interest rate, 7-day term deposits, year end, %		6.00 (5.75)	8.50 (5.25)	6.50 (4.25)	5.00 (3.75)
Inflation, annual average, %		8.3 (8.1)	8.4 (6.5)	6.2 (4.4)	4.7 (3.5)
EUR exchange rate, year end		152 (139)	146 (138)	143 (132)	140 (130)
Real estate prices, annual average, %		22.2 (21.9)	4.8 (4.9)	1.0 (3.5)	2.9 (5.3)
<b>Labour market</b>		2022	2023	2024	2025
Wage index, annual average, %		8.3 (7.6)	8.7 (7.1)	7.8 (6.4)	5.8 (5.0)
Purchasing power of wages, annual average, %		0.0 (-0.4)	0.2 (0.5)	1.5 (1.9)	1.0 (1.3)
Unemployment, annual average, %		3.9 (3.8)	3.6 (3.2)	3.6 (3.3)	3.6 (3.4)
<b>Current account balance</b>		2022	2023	2024	2025
Number of foreign travellers, thousand individuals		1,695 (1,700)	2,100 (1,900)	2,300 (2,300)	2,500 (2,500)
Goods and services balance, %GDP		-0.7 (-0.2)	0.2 (0.6)	0.2 (2.5)	0.3 (2.8)
Current account balance, %GDP		-1.5 (-2.2)	-0.5 (-0.4)	-0.5 (1.6)	-0.5 (1.9)

Numbers in brackets are from Economic Research's October 2022 forecast



# Disclaimer

---

The content and form of this document was produced by employees of Landsbankinn Economic Research (hagfraedideild@landsbankinn.is) and is based on information available to the public when the analysis was compiled. Assessment of this information reflects the views of Economic Research's employees on the analysis date, which may change without notice.

Neither Landsbankinn hf. nor its personnel can be held responsible for transactions based on the information and opinions expressed here as the content is not provided as personal advice on individual transactions.

Attention should be drawn to the fact that Landsbankinn hf. may, at any time, have direct or indirect interests at stake either on its own behalf or through its subsidiaries or customers, for instance as an investor, creditor or service provider. Nonetheless, all analyses are prepared independently by Landsbankinn Economic Research and in accordance with the bank's rules on separation of activities accessible on the Landsbankinn website.