



Under unsettled skies

Macroeconomic forecast
2026-2028

January 2026

Íslandsbanki Research

Under unsettled skies

Summary

GDP growth tepid in 2026 but set to pick up later on

Temporary setback in exports and high real interest rates will impede output growth in the near term

Growth will pick up again when export sectors right themselves and interest rates start to ease

0.6% GDP growth in 2026

2.8% GDP growth in 2027

3.0% GDP growth in 2028

GDP growth



Smaller CA deficit than in the recent past

Short-lived contraction in tourism, metals manufacturing, and fishing

Intellectual property and land-based aquaculture among key drivers of export growth

Exports outpace imports in 2027-2028

CA deficit 1.1% of GDP in 2026

CA deficit to hover around 1% in 2027-2028

External trade



Inflation persistent but set to ease over time

Inflation is proving difficult to dislodge but will taper off steadily early in the forecast horizon

Housing market set to rebalance soon, with modest price hikes in the coming term

Moderate inflation abroad, weaker demand pressures cause a gradual decline in inflation – which will not reach the target during the forecast horizon

Inflation to average 4.0% in 2026, 3.6% 2027, and 3.5% in 2028

Inflation



Labour market slack, but with fairly hefty pay rises

Labour importation has slowed markedly, and worker shortages have eased

Unemployment is set to peak this year, averaging 4.5% in 2026, 3.8% in 2027, and 3.5% in 2028.

Moderate real wage gains over the forecast horizon despite slower growth in nominal wages

Wages to rise 6.6% in 2026, 6.0% in 2027, and 4.9% in 2028

Labour market



Central Bank needs to walk a fine line

Interest rate cuts on pause until spring, owing to persistent inflation

Gradual monetary easing from May 2026 through mid-2027

Policy rate projected at 5.5-6.0% in the latter half of the forecast horizon

The outlook is for 10-yr nominal rates to measure 5.9% and 10-yr real rates to measure 2.5% at the end of the forecast period

Interest rates



ISK likely to weaken gradually

CA deficit financed recently with net inflows via the financial account

Narrower CA deficit, with interest rate differential supporting the ISK in the near future

ISK depreciation to grow more likely over the forecast period

A euro could cost around ISK 150 at the end of 2026, roughly ISK 155 by the end of the horizon

The ISK



This equates to a depreciation of about 5-6% over the period as a whole

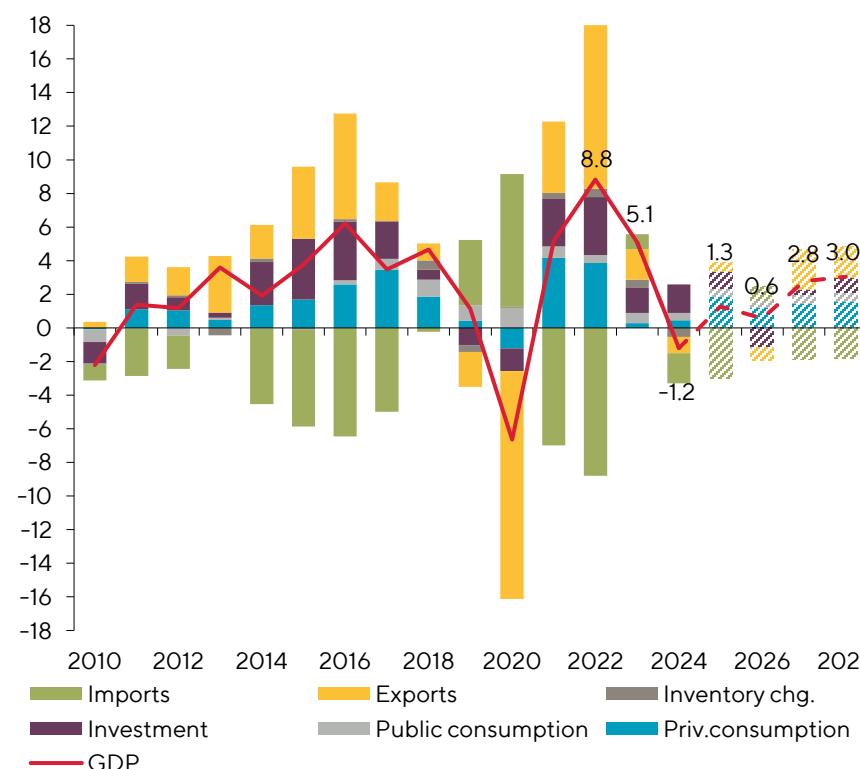


GDP growth weak in 2026 but set to gain steam later on

Temporary period of sluggish growth due to export sector setbacks and high real interest rates

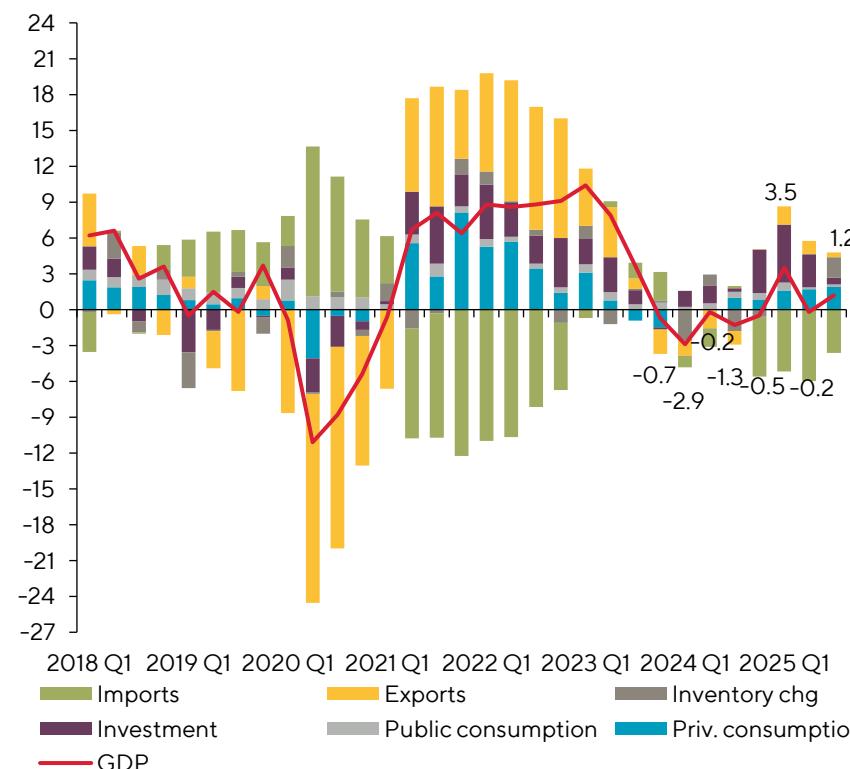
GDP and contribution of its subcomponents

Volume change from prior year (%)



GDP and contribution of subcomponents, by quarter

Volume change from prior year (%)



Sources: Statistics Iceland, ISB Research.

A mild downturn in 2024, with GDP contracting 1.2%, ended the brief but strong surge in output growth in the years beforehand. The dip stemmed from adverse developments in external trade, while investment and consumption kept growing modestly.

In 2025, output growth resumed, driven by robust private consumption growth coupled with a continued rise in investment and marginal growth in exports. GDP growth measured 1.5% in 9m/2025. Available indicators suggest moderate growth in Q4 as well, and we project growth for FY2025 at 1.3%. As in previous years, domestic demand was resilient, but growth was held back by a negative contribution from net trade.

The outlook is for very sluggish GDP growth in 2026, owing to setbacks in various export sectors, plus the impact of these setbacks and high real interest rates on domestic demand. We project GDP growth at 0.6% in 2026, but the margin for error is slim, and little would be needed to push it into the red.

In the next two years, growth will pick up again as exports recover and interest rates ease. We project GDP growth at 2.8% in 2027 and 3.0% in 2028. Export growth will be accompanied by an upturn in investment and stronger private consumption than in 2026.

As is noted above, more economic headwinds could tip 2026 GDP growth into negative territory. For instance, if tourism shrinks significantly or geopolitical unrest escalates, exports could contract more than we have projected.

As before, domestic uncertainties include seismic activity on Reykjanes peninsula. Delays in energy procurement later in the forecast horizon could impede investment growth – and ultimately, export growth – further ahead. A housing market slump could dampen residential investment and cause negative wealth effects to hinder private consumption. On the other hand, if inflation is more persistent than we anticipate, the real interest rate could rise, dampening medium-term investment and consumption more than we forecast here.

Even so, productivity growth due to exploitation of AI and growth in value added from intellectual property could do more to stimulate sustainable long-term growth than we have assumed in this forecast.

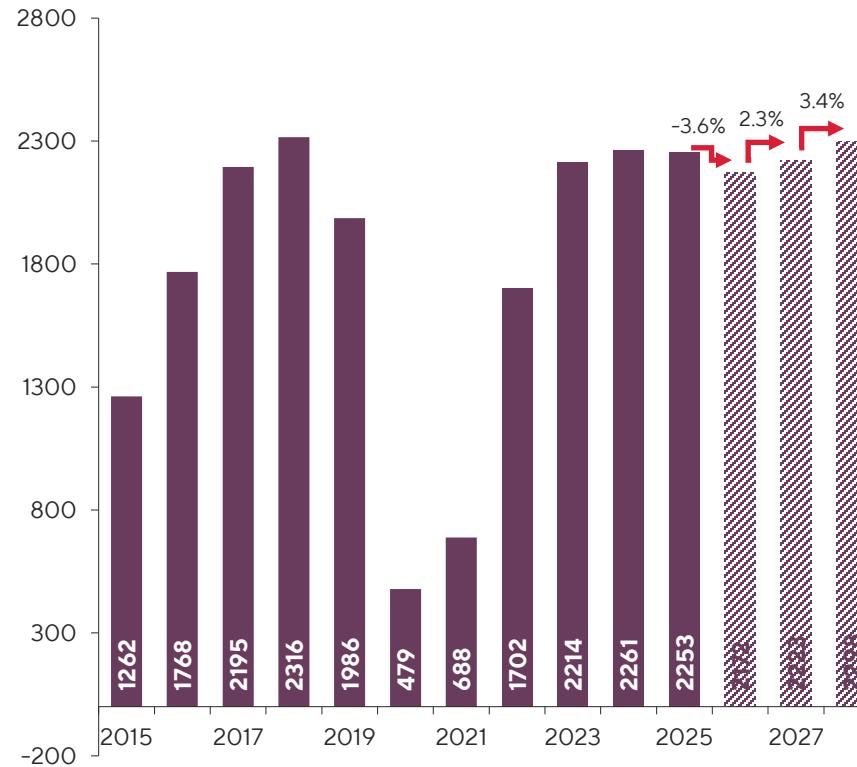


Tourism to languish while other export sectors blossom

Intellectual property and aquaculture will drive export growth, with legacy export sectors lagging behind

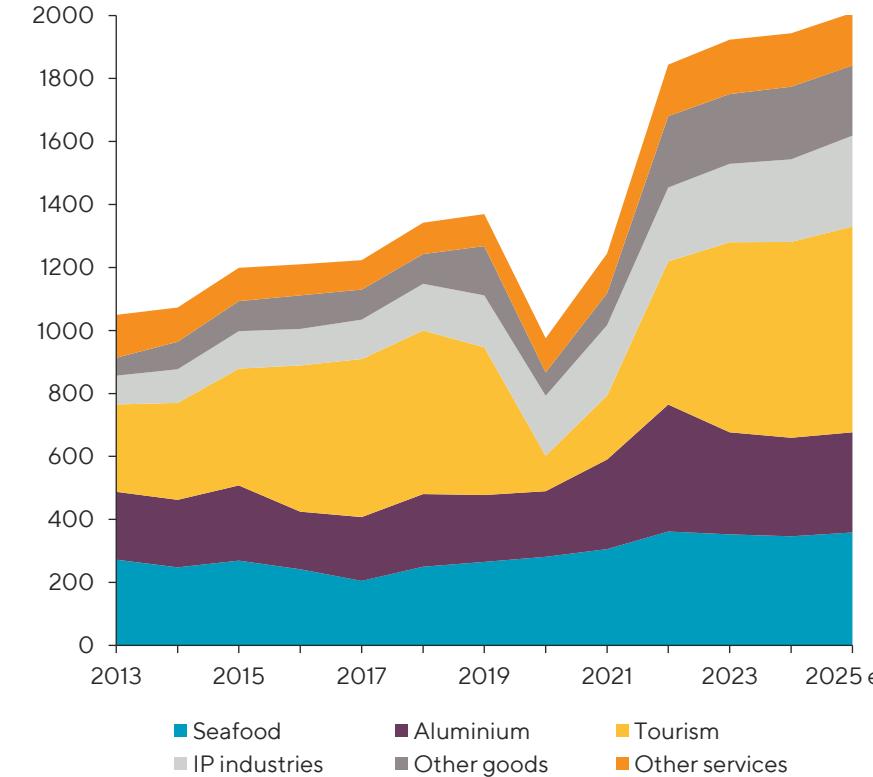
Foreign nationals travelling through Keflavík Airport

Thousands



Export revenues, by key sector

ISK bn at current prices 2025: ISB Research estimates.



After a disappointing first four months, the tourism industry performed well during the peak season of 2025, with a marked year-on-year increase in tourist arrivals over the summer. The boom reversed in the final months of the year, however, with a sizeable drop in visitor numbers. Based on Keflavík Airport departure figures, the number of tourists was virtually unchanged between 2024 and 2025.

The outlook is for a contraction in 2026. Figures on planned flight offerings, hotel bookings, and bookings with other service providers suggest a continued YoY contraction until spring. Prospects for the peak season are more favourable, though, and we expect virtually unchanged visitor numbers in June through September. For 2026 as a whole, we forecast a nearly 4% YoY drop in tourist numbers.

We then expect slow growth in 2027-2028. If these projections are borne out, the 2018 record for tourist visits will not be broken during the forecast horizon.

Although tourism and exports of manufactured goods and wild-caught fish will probably shrink this year, other export sectors are growing.

Among them is land-based aquaculture, which is expanding briskly, with export values set to grow steadily over the forecast horizon.

Also, exports of intellectual property products – i.e., goods and services based mostly on the harnessing of human intelligence and R&D – have been growing apace. These exports generated an estimated ISK 288bn in 2025, more than 14% of total export revenues for the year, as compared with 7% in 2010.

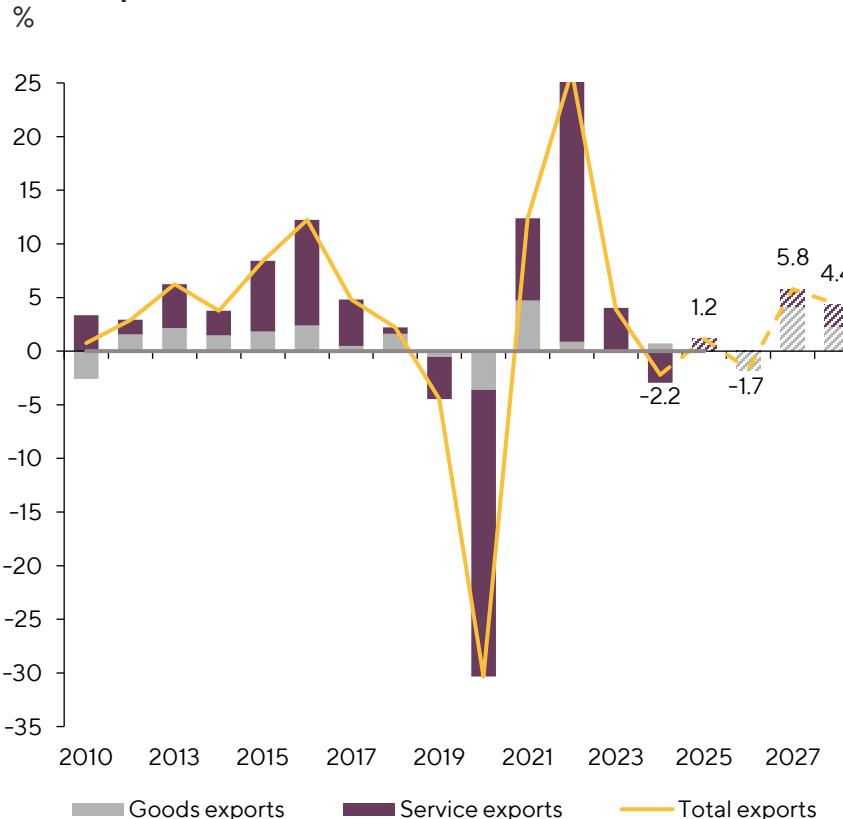
The intellectual property sector includes a cornucopia of firms ranging from medical equipment manufacturers to creators of television content and computer games. Among the drivers of growth in the sector is the pharmaceuticals industry, where activity is expected to grow strongly. The large-scale development of data centres currently underway will also generate substantially increased revenues for the intellectual property sector in the coming term.



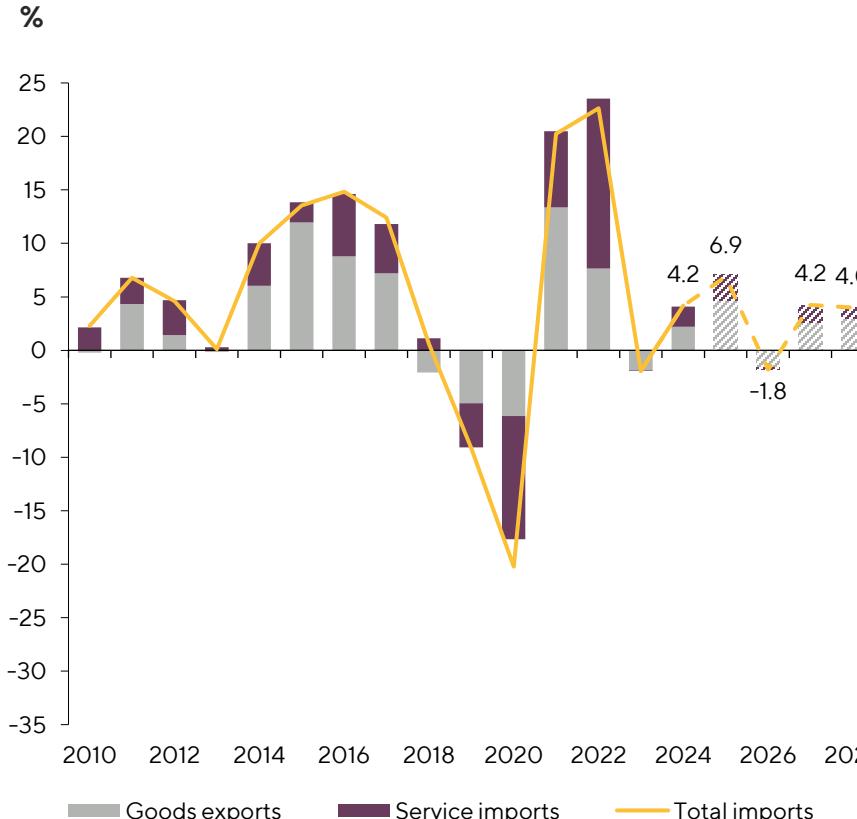
Better times ahead for external trade

Exports set to outpace imports in 2027 and 2028, after a contraction in both in 2026

Exports, YoY change, and contributions from key subcomponents



Imports, YoY change, and contributions from key subcomponents



Goods and services exports shrank just over 2% in 2024, after a three-year growth spurt. The capelin catch failure, electricity rationing to aluminium smelters, and a weak Q2 for tourism were the main reasons for the contraction.

We estimate that exports grew by just over 1% in 2025, owing entirely to a full 2% increase in services exports. Goods exports probably remained flat in 2025, driven by a contraction in marine product exports that offset growth in industrial exports apart from aluminium, exports of which were unchanged YoY.

For 2026, the outlook is for exports to shrink nearly 2%, due to a decline in exports of manufactured metals and marine products. The drop in metals exports was caused by the equipment breakdown at one of Iceland's three aluminium smelters, the closure of the ferrosilicon plant at Bakki, and production cutbacks at the ferrosilicon plant at Grundartangi. The downturn in marine product exports stemmed largely from small fishing quotas for pelagics and a YoY reduction in the cod quota. However, the capelin season might yield a larger-than-expected revenues and outweigh cuts in other pelagics.

Services exports will hold steady between years, according to our forecast, due to increased exports of intellectual property and other services, which will offset the downturn in tourism.

Exports will pick up again in 2027. We project export growth at nearly 6% in 2027 and over 4% in 2028. The resolution of production problems in the aluminium industry, larger catch quotas – especially for capelin – and growth in intellectual property, land-based aquaculture, and tourism will all pull in the same direction.

Imports are expected to shrink nearly 2% this year, after robust growth in 2025. A major factor in the slowdown is the projected conclusion of the recent surge in data centre development. Also envisioned is a reduction in importation of rental cars and miscellaneous equipment.

Imports will regain momentum in the years ahead, when economic activity picks up again. Nonetheless, the outlook is for exports to outpace imports, resulting in a positive contribution from net trade in both 2027 and 2028.

Sources: Statistics Iceland, ISB Research.

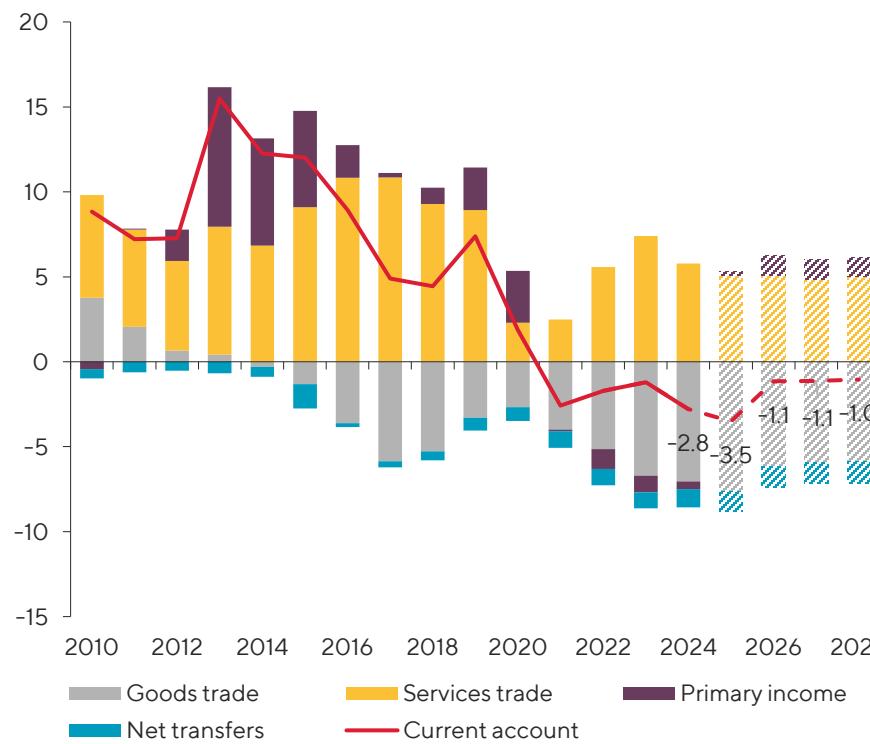


Modest current account deficit over the forecast horizon

Improving terms of trade offset the contraction in exports in 2026, but the high real exchange rate will maintain the deficit

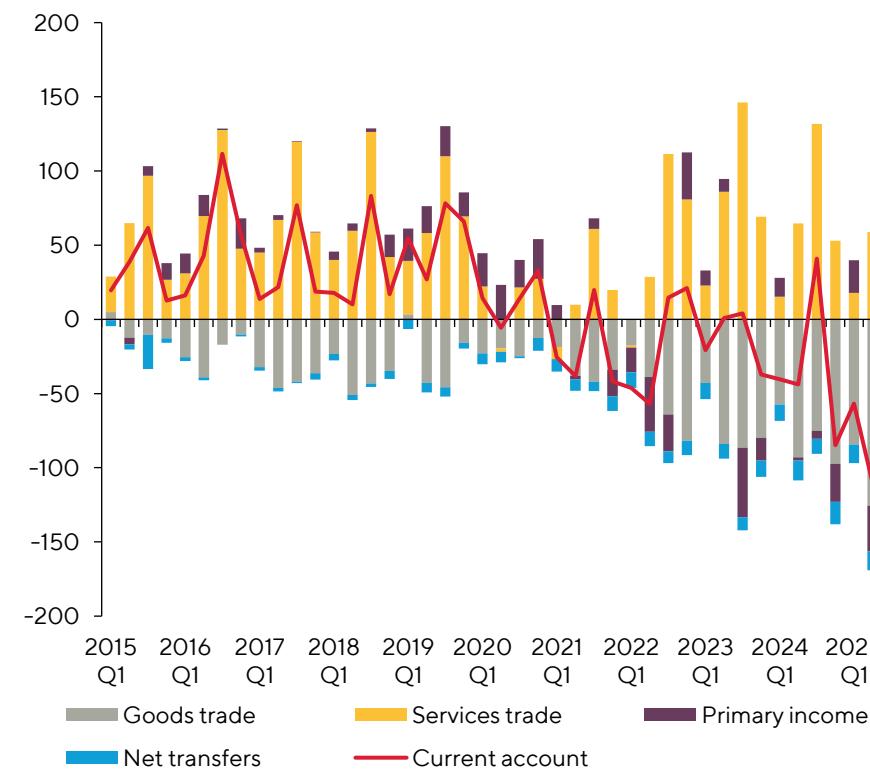
Current account balance and key subcomponents

% of GDP



Current account balance and key subcomponents, by quarter

ISK bn



After sustained surpluses for most of the 2010s, the current account has been persistently in deficit since 2021. In 2021-2024, the deficit averaged just over 2% of GDP. It widened in 2025, however, totalling ISK 140bn in the first nine months of the year. A hefty surplus on services trade did not fully offset the large goods account deficit and a modest deficit on net transfers to and from the country.

It is worth noting, though, that a large share of the recent goods account deficit is due to massive imports of computer equipment for data centres. These imports are fully financed by the data centres' foreign owners and customers and thus put no pressure on the ISK exchange rate.

We estimate the 2025 CA deficit at roughly ISK 170bn, or 3.5% of GDP for the year. It was Iceland's largest deficit-to-GDP ratio since before the collapse of the banks, but the picture is skewed significantly by the aforementioned computer equipment imports.

The current account balance is set to improve markedly over the forecast horizon. Favourable developments in terms of trade, with rising marine product and aluminium prices alongside a sizeable drop in fuel prices, will contribute to the improvement in 2026. In 2027 and 2028, the prospect of export growth exceeding import growth will help curb the deficit.

According to our forecast, the CA deficit will measure 1.1% of GDP in both 2026 and 2027 and then shrink marginally to 1.0% of GDP in 2028.

If external trade is to improve, however, the ISK must not appreciate significantly. Furthermore, a steeper-than-projected downturn in tourism in coming quarters could put a spanner in the works, at least temporarily.

Iceland's net external assets totalled nearly ISK 2,101bn, or 43% of GDP, at the end of September 2025. This strong asset position provides vital support for the ISK, as it is highly unlikely that capital flight would cause significant instability or require a new round of capital controls. The situation should not be changed materially by the modest CA deficit that we have projected.

Sources: Central Bank of Iceland, Statistics Iceland, ÍSB Research.

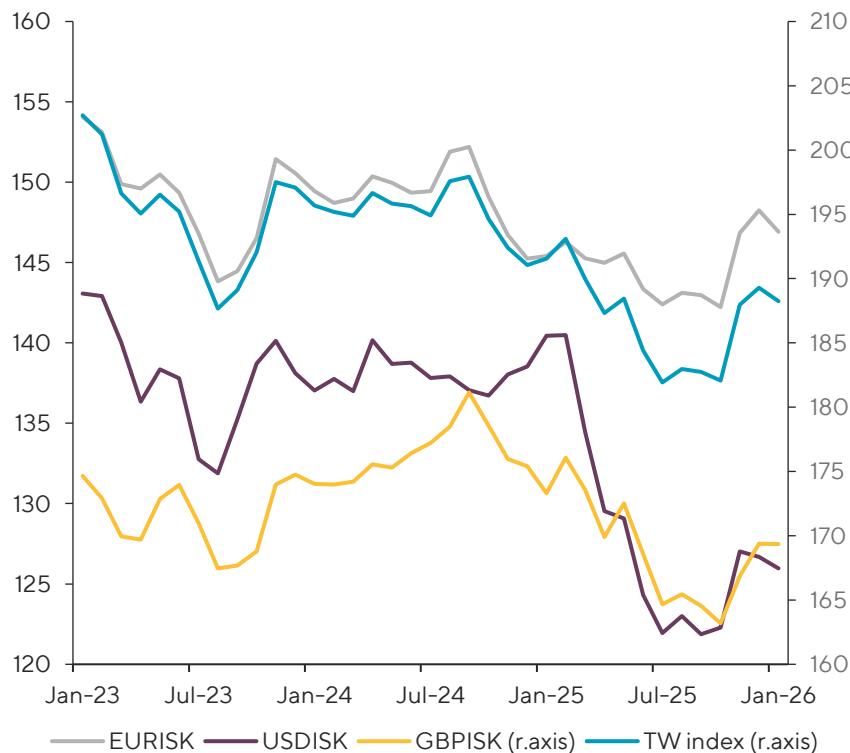


ISK likely to weaken gradually

A high real exchange rate is challenging for the export sector and puts downward pressure on the nominal exchange rate

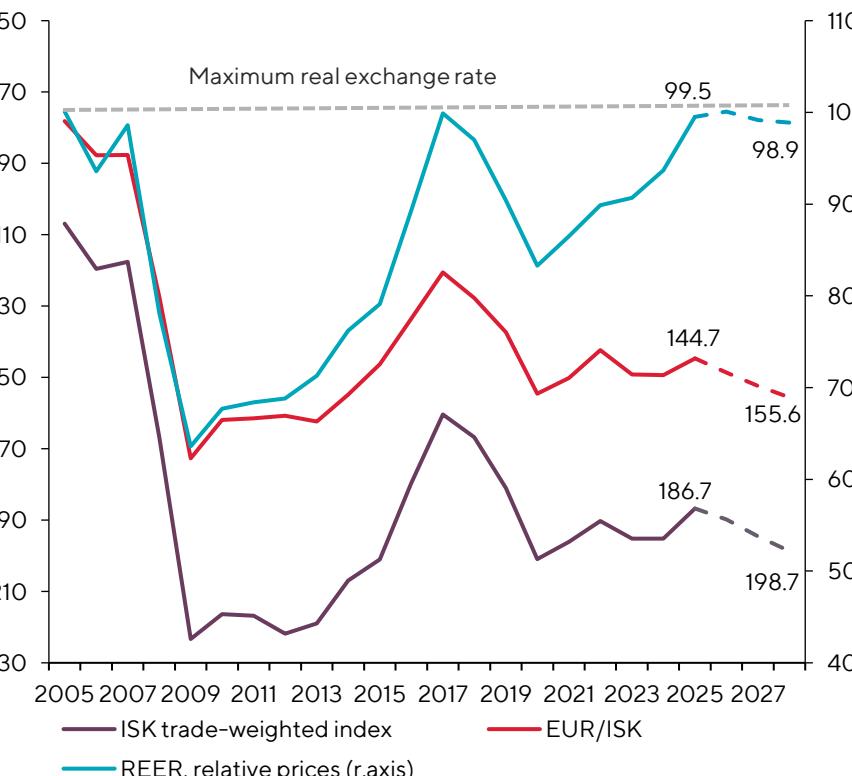
ISK exchange rate

Major currency exchange rates against the ISK and index values



Nominal and real ISK exchange rate

Yearly averages, EURISK and indices



Sources: Central Bank of Iceland, Statistics Iceland, ÍSB Research.

After a dip during the pandemic, the ISK exchange rate has been remarkably stable despite a range of domestic and foreign shocks. In terms of the Central Bank's (CBI) trade-weighted exchange rate index (TWI), it was virtually flat in 2023 and 2024, notwithstanding some intrayear fluctuations.

During 2025, the ISK appreciated marginally, or by 1.5% in trade-weighted terms. Movements against individual currencies diverged widely, however, owing to differing developments in the world's leading currencies. The ISK weakened by just over 1% against the euro, for instance, but strengthened by 10% against the US dollar and nearly 4% versus the pound sterling.

There are several reasons for the ISK's recent stability despite a sizeable CA account deficit. Trade-related foreign currency flows have been considerably more favourable than might have appeared at first glance, as a large share of the CA deficit was financed directly by foreign entities. Furthermore, the robust peak tourist season affected the FX market more than it would have otherwise because forward currency sales were so limited. In addition, the pension funds bought relatively little currency in 2025, and firms took fairly sizeable FX loans.

As before, the ISK will be supported in a number of ways in the coming term. The CA deficit is likely to narrow, Iceland's international investment position is strong, the CBI's FX reserves are ample, and the foundations of the economy are robust; moreover, the interest rate differential with abroad will remain fairly wide. The key short-term uncertainty is tourism, as a lacklustre peak season could cause the ISK to depreciate later in the year.

Therefore, the real exchange rate is likely to remain historically high, assuming that the setbacks in the export sector do not prove more damaging than we have forecast. Because wages and prices rise faster in Iceland than in trading partner countries, however, it is inescapable that the nominal exchange rate must give way over time – either gradually or with a more abrupt correction later on.

Our exchange rate forecast assumes that the former scenario will prevail; i.e., the ISK will depreciate gradually, reaching an average level 5-6% weaker at the end of the forecast horizon than at the end of 2025. This equates to prices of ISK 156-157 per EUR and about ISK 133 per USD, based on these currencies' end-2025 exchange rates.

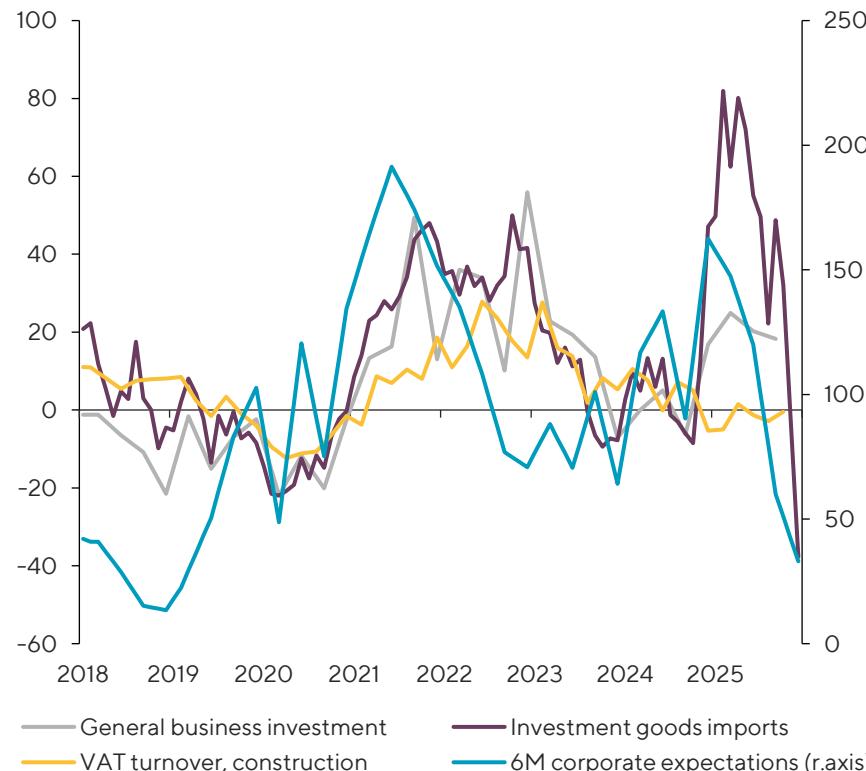


Investment to dip temporarily in 2026

Turning point in data centre development and a challenging environment will affect investment in the near term

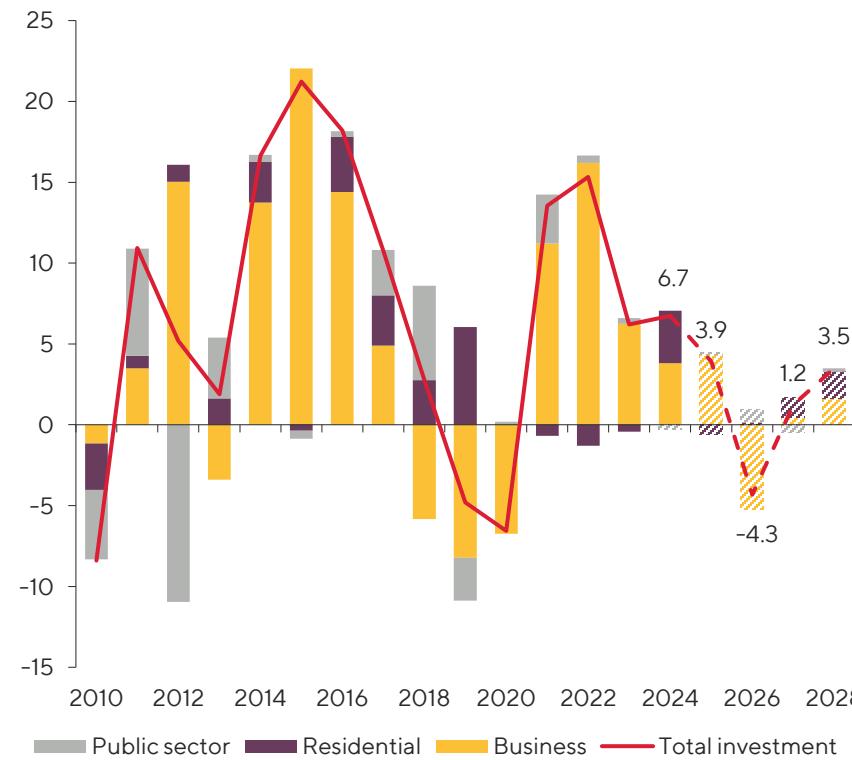
Business investment and related indicators

YoY change (%), left) and index (right)



Investment, real change, and contribution of subcomponents

%



Iceland has seen a strong upswing in investment in recent years. The mainstay of growth has been business investment, particularly in tourism, fishing, and IT. Rising real interest rates and greater challenges for export companies have damped growth in many sectors, while strong development in specific industries such as data centres and aquaculture has offset the slowdown in recent quarters.

In the first nine months of 2025, total investment grew by over 10%, led by nearly 16% growth in business investment. At the same time, residential and public investment were virtually flat YoY. The outlook is for total investment to have grown by just under 4% in 2025, driven mainly by the aforementioned development in data centres and aquaculture.

In 2026, though, the outlook is for investment to contract by just over 4%, fuelled by a nearly 8% drop in business investment concurrent with the prospect of flat residential investment and a modest increase in public investment.

The contraction in business investment is due, on the one hand, to the turning point in data centre development after the recent growth spurt, and on the other, to reduced investment in large and small transport equipment and various types of machinery, plus a slowdown in hotel and commercial property construction. This will be offset by a rise in infrastructure-related investment, which SI records variously under business or public investment.

Investment will regain steam in the latter half of the forecast horizon, buoyed by falling interest rates, better times for the export sector, and continued development of energy infrastructure and land-based aquaculture. Residential investment will also pick up again in the latter half of the period.

We forecast investment growth at just over 1% in 2027 and 3-4% in 2028. Whether the rebound turns out as strong as we project will depend, however, on factors such as possible delays in energy procurement and changes in firms' external environment.

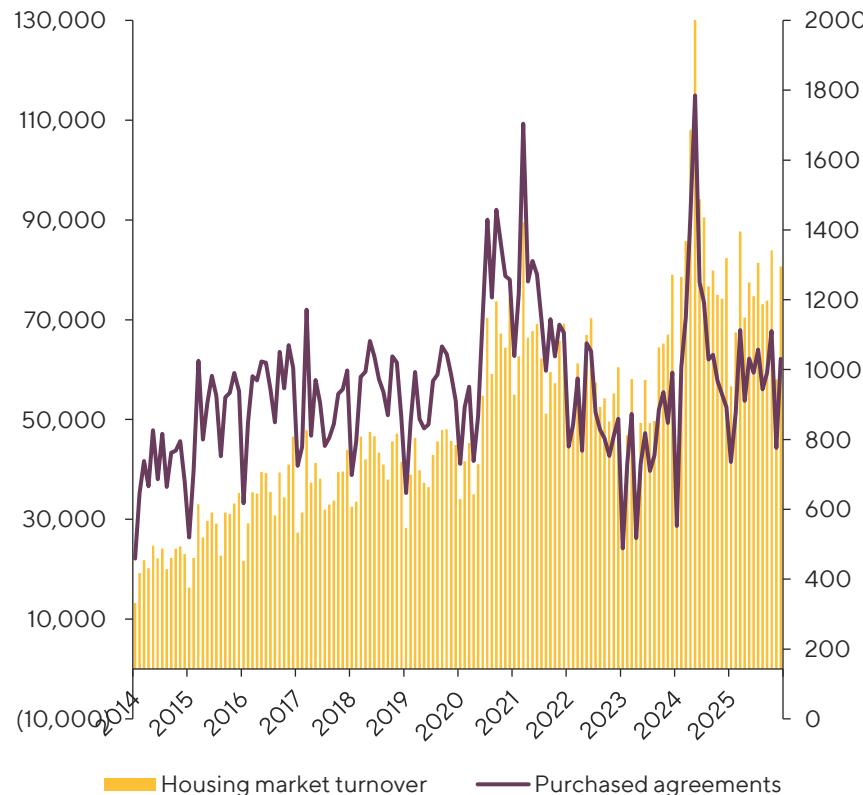


Housing market treading water in 2026?

House prices set to rise more rapidly in coming years

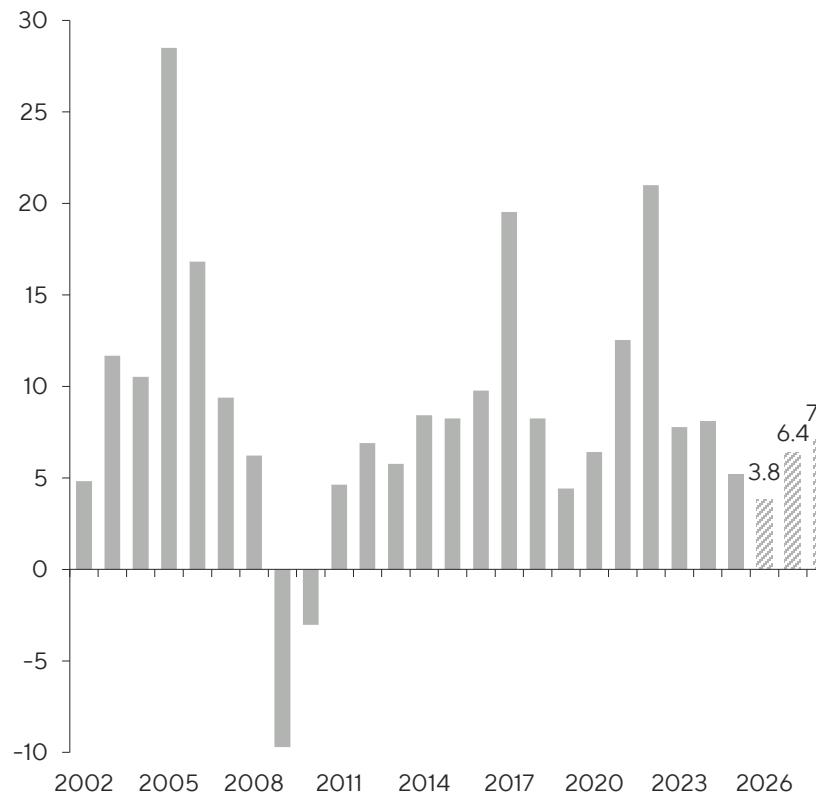
Housing market activity

Turnover (left) and number of contracts (right)



Nominal house prices

% change between years



The housing market turned a corner in 2025, finally cooling after several years of rapid price hikes. Prices rose by 5.3%, according to the house price index, or 1.1% in real terms. Prices started falling in H2, however, in response to shrinking demand stemming in part from the judgment in the so-called interest rate case, which caused a temporary spike in uncertainty and reduced access to credit. The decline in housing market activity in the final months of the year is clearly visible.

Residential investment was strong in 2024, and the housing supply mushroomed as a result. According to the Housing and Construction Authority (HMS), some 5,100 homes were available for sale in January, 51% of them new builds. The average time-to-sale has grown significantly longer, particularly for newly built homes, while other properties generally sell much more quickly. The share of new builds in the market has therefore risen. The emergence of investment funds whose purpose is to facilitate the sale of new properties prompted the CBI to tighten its rules on the calculation of debt service ratios.

All else being equal, we expect the housing market to be fairly tranquil this year, with prices rising 3.8%, the slowest rate of increase since 2013. High interest rates, stringent borrowing requirements, and reduced access to credit will keep demand in check, and the outlook is for population growth to be considerably slower than in recent years.

Despite the currently subdued level of activity, underlying housing demand remains. Demographic factors such as the age distribution of the population and first-time buyers' need to enter the market will support demand in the long run. The market will probably liven up again in the years ahead. Lower inflation, lower borrowing rates, and stronger economic activity will stimulate demand. We project house price inflation at 6.4% in 2027 and 7.2% in 2028. Based on our inflation and house price forecasts, real price hikes will be more modest over the forecast horizon than in recent years.

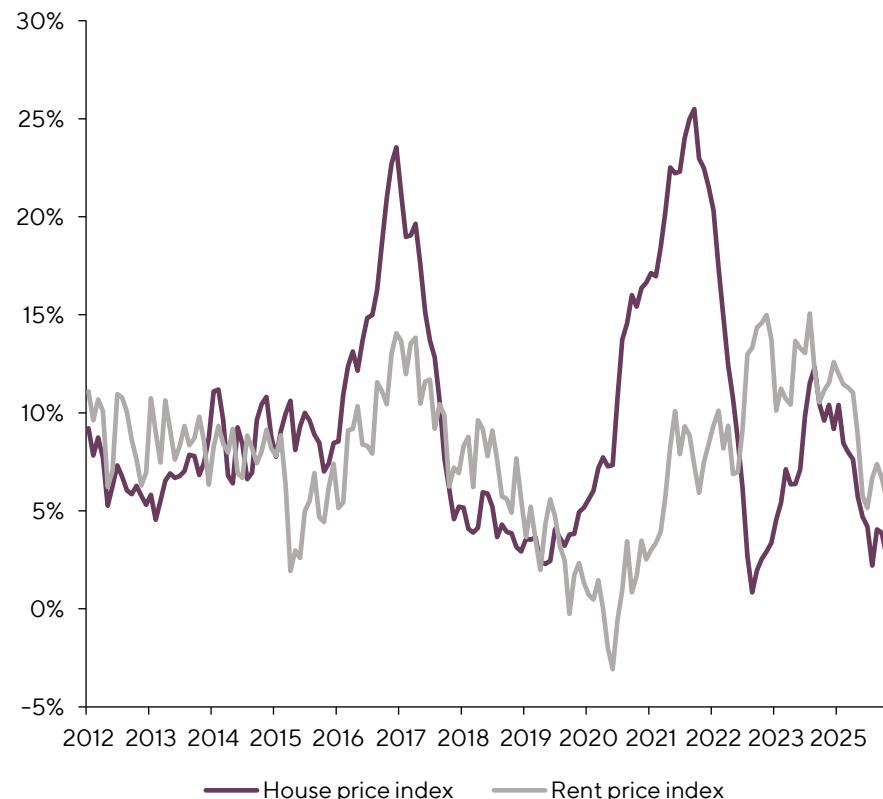


Rent prices to rise modestly in 2026

Developments in rent prices are now a key factor in the inflation outlook

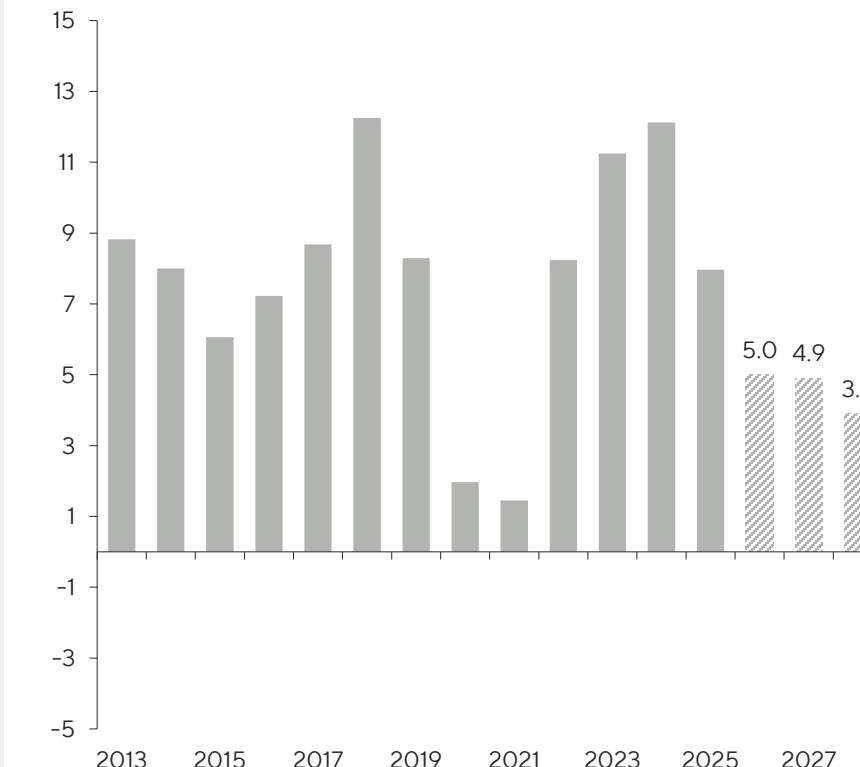
House price and rent price indices

Twelve-month change (%)



Nominal rent prices

% change between years



Over time, the prevailing assumption in Iceland has been that people will buy their own home rather than renting. In recent decades, however, that pattern has shifted to an extent, and the rental market has grown. The biggest change in the Icelandic rental market in recent years is the emergence of leasing companies, which have made renting a more realistic option than before. An estimated 20–25% of households in Iceland are in the rental market.

Owing to growth in the rental market and the availability of more detailed data on that market, SI changed its methodology for calculating the housing component of the CPI. It now uses rent prices in its calculations. SI uses the so-called rental equivalence method to estimate developments in the price of owner-occupied housing; i.e., it estimates the rent price that the homeowner in question would have had to pay in the rental market. With this change, movements in rent prices have become a more decisive factor in inflation than they were before.

In general, rent prices fluctuate less than house prices do. In the recent housing market upswing, house prices rose much more rapidly than rent did. Then the situation changed and rent prices started rising faster.

These price surges in the housing market have now eased. According to the rent price index, rent increased by 8% YoY in 2025, somewhat outpacing the rise in house prices over the same period. The pace of the increases has tapered off relative to previous years, however, and we expect the slowdown to continue.

We project that rent will increase in 2026 by 5%, slightly above our house price forecast. New statutory amendments passed at the turn of the year have generated some uncertainty, however, as they could affect rent prices.

As the forecast horizon advances, interest rates can be expected to fall and housing market activity to pick up, whereupon we project that rent price increases will be more moderate. For 2027 we expect an increase of 5% YoY and 3% from the beginning to the end of the year. In the final year of the forecast horizon, we expect rent prices to rise 3.9% YoY, in line with the general price level.

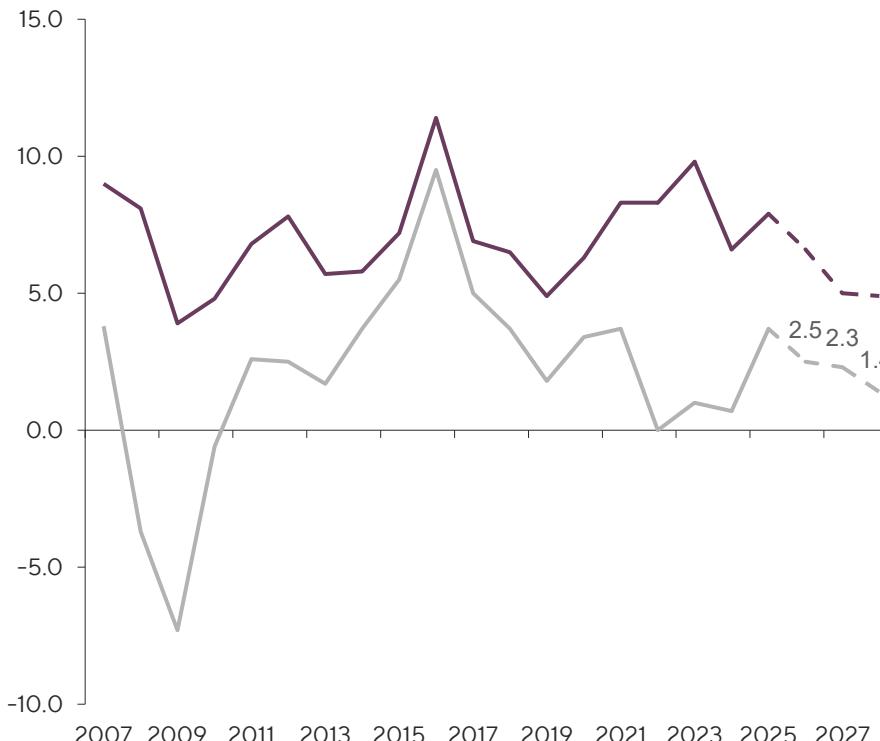
Sources: Housing and Construction Authority, Central Bank of Iceland, Statistics Iceland, ISB Research.



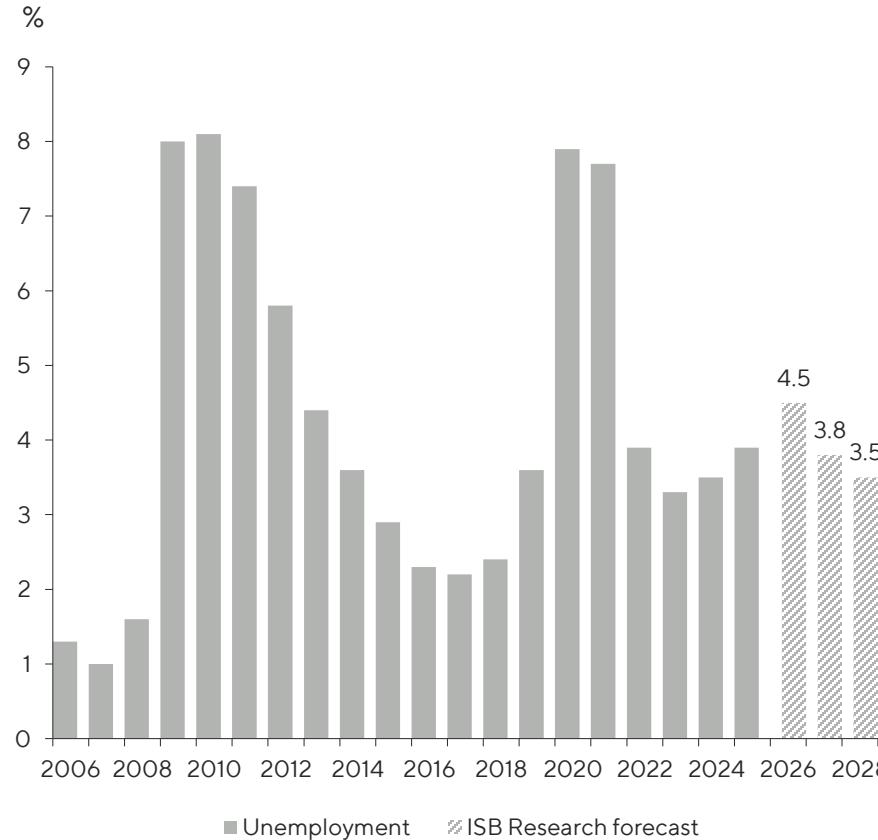
Unemployment to peak in 2026

Wage developments will be shaped by long-term contracts, and wage drift will be limited

Nominal and real wages
% change between years



Unemployment as a share of the labour force



Unemployment inched upwards in 2025, measuring 3.9% on average. The rise in unemployment was somewhat unexpected in H2, owing to export shocks, particularly in tourism and metals manufacture. In spite of this, the labour market has proven relatively stable, and many companies appear to have adjusted their staffing by introducing more flexibility instead of laying workers off.

Nonetheless, there are clear signs of a more pronounced slack in the labour market. Immigration has slowed markedly after the surge of recent years, and measurements from Gallup indicate that labour shortages have receded to a significant degree. Now only 10% of large firms' executives report being understaffed, the smallest share since 2020, when the pandemic hit. The fact that firms have an easier time filling jobs than before suggests that labour market tensions are easing.

We expect unemployment to keep rising in 2026, reaching an average of 4.5%. The downturn in labour demand in H1 is due primarily to changes in the export sector and a cooler economy. But the Icelandic labour market is well known for its flexibility, and the outlook is for unemployment to subside again from H2/2026 onward. The jobless rate looks set to average 3.8% in 2027 and approach its equilibrium level of 3.5% in 2028.

As in recent years, wage developments will continue to be shaped by long-term agreements extending through 2028, provided that the assumptions underlying the contracts hold. Despite a larger slack in the labour market, the outlook is for continued pay rises in line with wage agreements. Wages rose by 7.9% in 2025, and our forecast assumes an average increase of 6.6% in 2026. Wage drift will be modest over the forecast horizon, though, because of reduced tensions in the labour market.

We project that wages will rise by 6.0% in 2027 and 4.9% in 2028. If our forecast materialises, real wages will continue to grow, by 2.5% this year, 2.3% in 2027, and 1.4% in 2028.

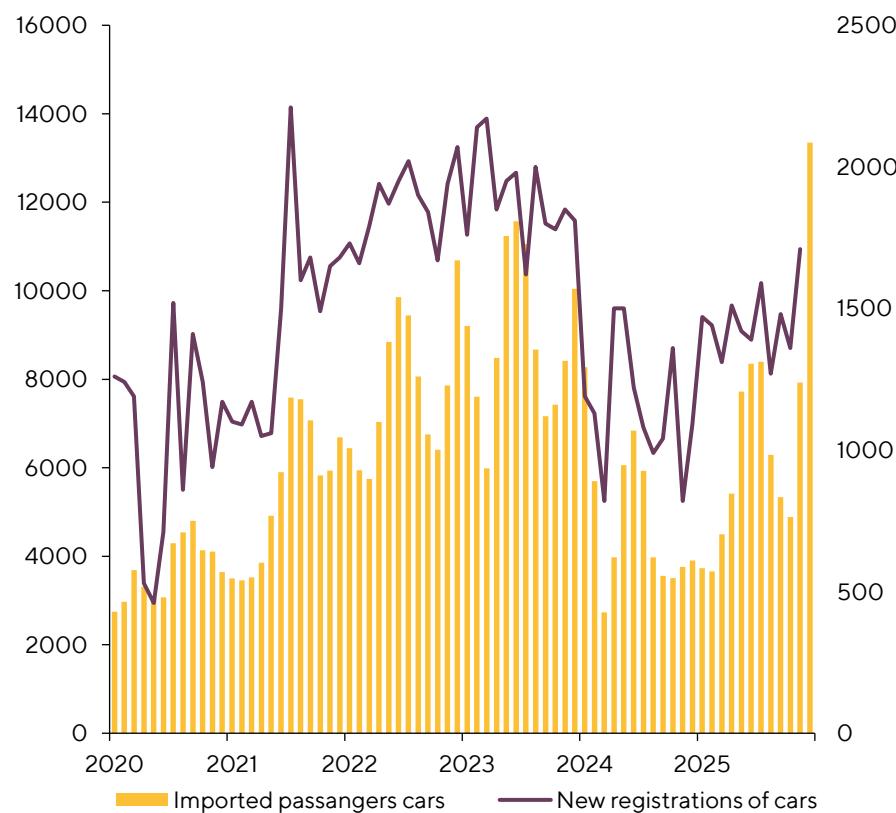


Private consumption growth to continue in 2026, but at a slower pace

Real wage growth and sizeable savings will support household consumption in the coming term

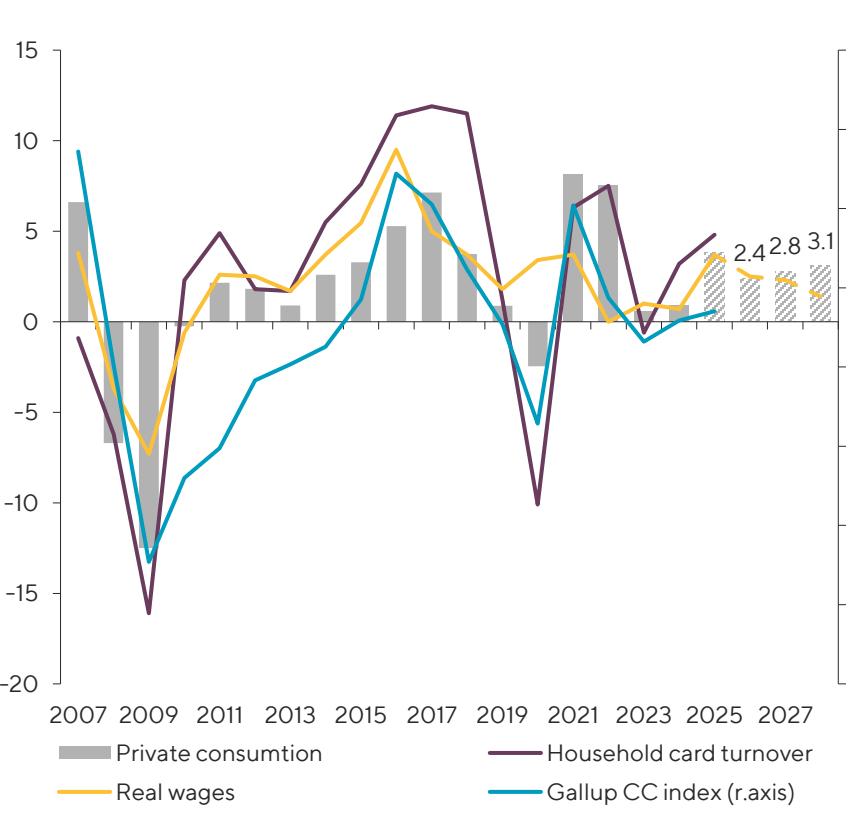
Personal vehicles, new registrations and imports

ISK m (left) and number of vehicles (right)



Private consumption and related indicators

% change year-on-year (left) and index value (right)



Private consumption picked up strongly in 2025, after a two-year lull characterised by high interest rates that prompted many households to curb consumption and shore up their savings. The situation changed in 2025, however, and household consumption began to rebound.

Private consumption grew 3.6% YoY in the first nine months of the year, and all signs indicate that Q4 was strong as well. Presumably, this stemmed from a surge in households' car purchases towards the end of 2025, in anticipation of the changes in public levies that took effect at the turn of the year. We therefore estimate year-2025 private consumption growth at 3.8% YoY.

Icelandic households spent rather freely last year, both at home and abroad. 2025 was a record year for international travel, with an average of nearly two trips abroad per Icelander.

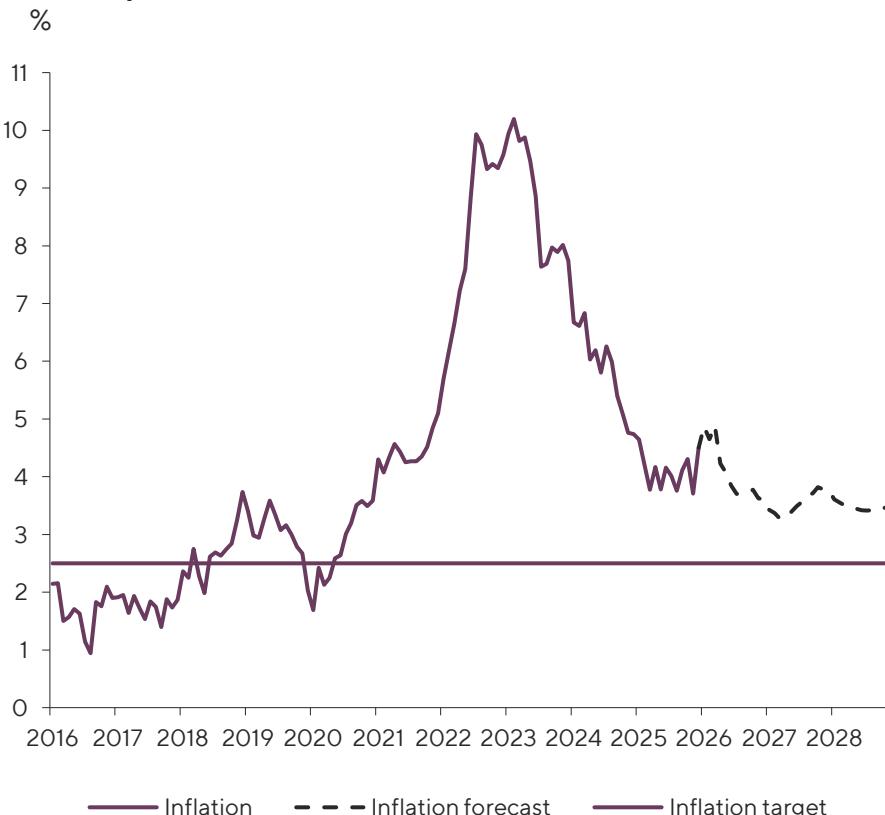
Icelandic households are generally well positioned and still hold significant savings. Real wages rose 3.7% in 2025 and look set to continue growing this year. Paradoxically, though, households' expectations have dimmed despite the upturn in demand. The Gallup Consumer Confidence Index has fallen considerably since last summer and is somewhat below its equilibrium value. It is likely that export shocks, persistent inflation, and heightened uncertainty in the lending market have eroded consumers' optimism.

We have revised our year-2026 private consumption forecast slightly downwards, and we now assume a growth rate of 2.4%, owing mainly to a cooling economy and, not least, a weaker job market. The front-loading of car purchases in anticipation of end-2025 changes in public levies is a factor as well and will probably cut into growth in consumer durables purchases in 2026. Further ahead, we expect private consumption growth to pick up as the economy gains steam. We forecast private consumption growth at 2.8% in 2027 and 3.1% in 2028.

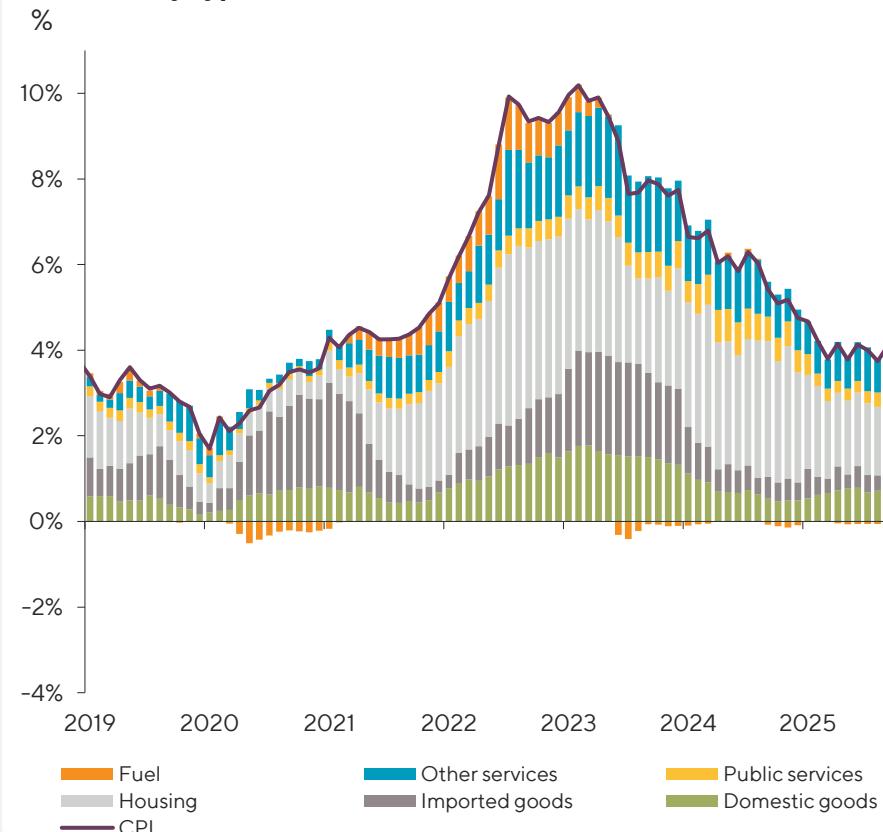
Inflation remains stubbornly above target

Something will probably have to give in order to bring inflation back to target

Developments in headline inflation and the inflation forecast



Inflation by type and source



Inflation was remarkably sticky in 2025, hovering almost constantly around the 4% upper deviation threshold of the CBI's Inflation target. November brought big news, when inflation plunged to 3.7%, its lowest in five years. But the backlash was just around the corner, and in December inflation soared back to 4.5%, the highest measurement of the year apart from January.

Services have accounted for a growing share of inflation in the recent term and are now the main driver, overtaking the housing component, which ranks second. The contribution of domestic goods to inflation has held virtually unchanged, while the contribution from imported goods has declined. A stable ISK and lower fuel prices have helped to contain price hikes in these two goods categories.

The outlook is for inflation to rise yet again in Q1/2026, primarily because of hikes in public levies. If our short-term forecast is borne out, headline inflation could reach its highest level since October 2024. Even so, we expect it to subside quickly in Q2. We project that inflation will average 4.0% in 2026 as a whole, broadly the same as in 2025.

In 2027 we expect inflation to subside further from the current level. We forecast that it will average 3.6% in 2027 and 3.5% in 2028. Underlying pressures will still be in evidence. Wage developments align poorly with the target, rent prices are not falling, and households and businesses appear relatively strong overall, despite high interest rates.

Inflation has now been above the CBI's 2.5% target since mid-2020, and the final leg of the race to the target will be gruelling. A series of shocks have complicated the battle against inflation in recent years, among them the pandemic, the impact on commodity prices of Russia's war on Ukraine, harvest failures, and the effects of seismic activity on Reykjanes peninsula. These shocks have contributed to sustained inflationary pressures and impeded disinflation.

In our opinion, something will have to give in order for inflation to return to target during the forecast horizon – a hard economic landing, perhaps, or a period of stagnant rent prices.

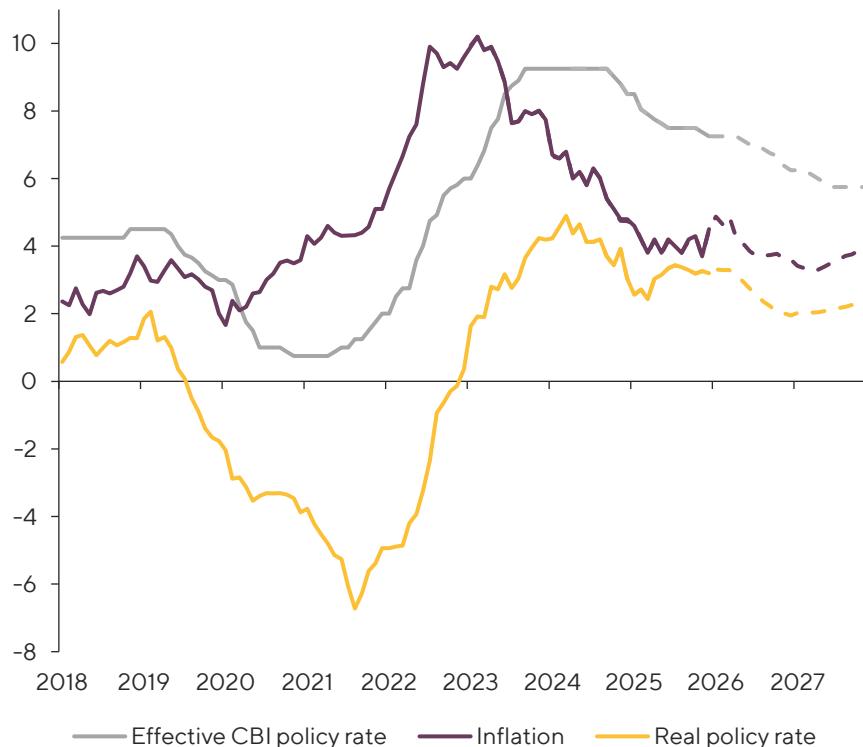


Central Bank needs to walk a fine line

Interest rate cuts to resume in spring, with slow and gradual monetary easing

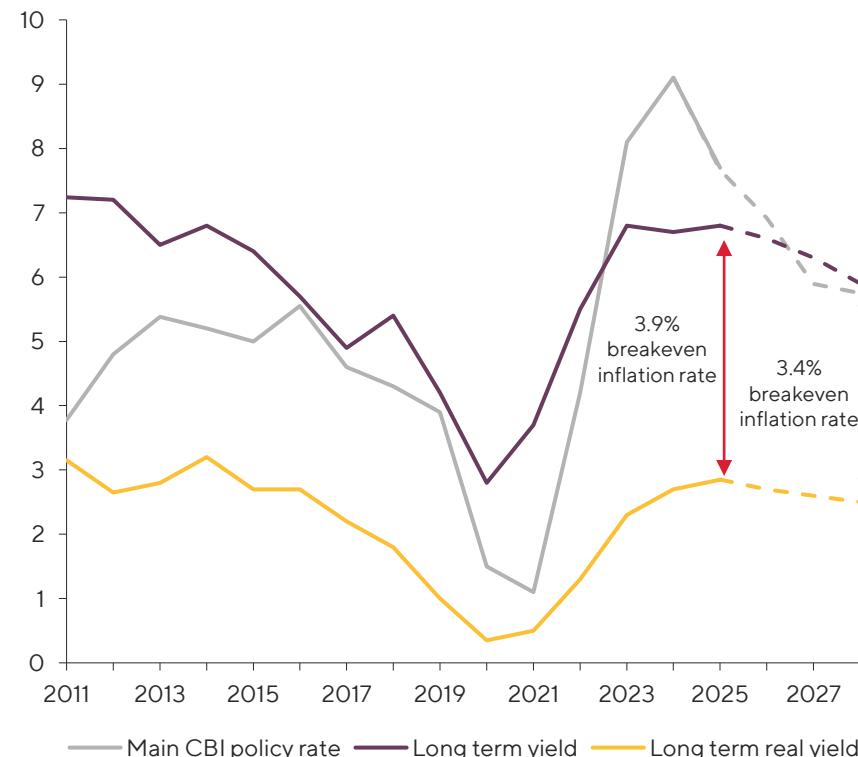
Policy rate, inflation, and real policy rate

% Real policy rate in terms of inflation forecast and policy rate forecast



Interest rates

% Long-term interest rates are rates on Government bonds with an average duration of 10 years



After a series of rate cuts starting in autumn 2024, the CBI put monetary easing on pause for six months, from May until November 2025. It lowered the policy rate by a total of 1.25 percentage points in 2025, to 7.25% at the year-end.

In its forward guidance from November, the Monetary Policy Committee (MPC) stated that further policy rate cuts would depend on the emergence of clear evidence that inflation was falling back to the target.

In recent weeks, neither the short-term Inflation outlook nor inflation expectations have suggested that such evidence was forthcoming. The breakeven inflation rate in the bond market has risen since the start of December, and long-term inflation expectations are still out of sync with the target. At the same time, there are clear signs that the economy is cooling fast.

We forecast that the MPC will keep the policy rate steady until inflation starts to fall again. We expect it to start unwinding interest rates again in spring 2026 and keep easing them cautiously until mid-2027.

That said, if inflation does not fall more than we have forecast, and if a sizeable slack does not develop in the economy, there are limits to how much the policy rate will fall. Based on the current outlook, the unwinding phase will probably conclude when the policy rate hits 5.5-6.0%.

Long-term interest rates remain elevated despite last year's decline in nominal rates. Based on Treasury yield curves, nominal ten-year base rates are now around 6.6%, and the corresponding rate on indexed bonds is 2.7%. Iceland's real interest rate is therefore still high by nearly all measures.

We estimate that long-term nominal rates could fall to 5.9% and real rates to 2.5% over the forecast horizon. Accordingly, the long-term breakeven inflation rate would be 3.4%, as compared with the current level of just over 3.8%. It should be noted, however, that long-term inflation expectations in the market are probably lower than this, as the breakeven rate includes an uncertainty premium.

On the other hand, we are convinced that the short-run equilibrium real interest rate will be higher than was generally expected in the recent term and that the above-described forecasts for 2028 are not far from the equilibrium rate.



Macroeconomic forecast summarised

GDP and its components

Volume change from prior year %	The year 2024 in ISK m	Estimate		Forecast	Forecast	Forecast
		2024	2025	2026	2027	2028
Private consumption	2,249,981	0.9	3.8	2.4	2.8	3.1
Public consumption	1,187,744	1.8	1.9	1.7	2.0	2.0
Investment	1,228,139	6.7	3.9	-4.3	1.2	3.5
- business investment	801,593	5.8	6.7	-7.9	0.7	2.5
- residential investment	244,258	18.2	-2.9	0.8	6.5	8.0
- public investment	182,288	-1.7	0.8	5.5	-3.0	1.5
Changes in inventories	-24,473	-0.5	0.0	0.0	0.0	0.0
Domestic demand, total	4,641,391	1.6	3.7	0.4	2.2	2.9
Exports of goods and services	1,943,768	-2.2	1.2	-1.7	5.8	4.4
- marine product exports (including aquaculture products)	400,352	0.4	-3.0	-3.2	13.3	7.5
- aluminium products	312,664	-3.4	0.5	-7.5	6.0	2.0
- other goods exports	248,036	14.1	4.1	0.3	4.9	3.5
- services exports	982,716	-5.8	2.3	0.2	3.1	4.0
Imports of goods and services	2,001,868	4.2	6.9	-1.8	4.2	4.0
- goods imports	1,283,896	3.4	7.0	-2.5	4.1	4.6
- services imports	717,972	5.5	6.7	-0.7	4.5	2.9
Gross domestic product	4,583,291	-1.2	1.3	0.6	2.8	3.0

Sources: Statistics Iceland, ÍSB Research.



Macroeconomic forecast summarised

Other economic variables

% of GDP	2024	Estimate 2025	Forecast 2026	Forecast 2027	Forecast 2028
Investment	28.0	28.1	26.7	26.4	26.5
Current account	-2.8	-3.5	-1.1	-1.1	-1.0
Trade account balance	-1.3	-2.6	-1.1	-1.1	-0.9
<i>Change between annual averages (%)</i>					
Consumer prices	5.9	4.1	4.0	3.6	3.7
Wages	6.6	7.9	6.6	6.0	4.9
Real wages	0.7	3.7	2.5	2.3	1.2
Real exchange rate, relative consumer prices	3.4	6.0	0.3	-1.0	-0.4
House prices	8.1	5.2	3.8	6.4	7.2
<i>Annual average (%)</i>					
Unemployment (Directorate of Labour)	3.5	3.9	4.5	3.8	3.5
Trade-weighted exchange rate index	195.3	186.8	189.8	194.6	198.7
EUR/ISK	149.3	144.7	148.6	152.4	155.6
CBI policy rate (7-day term deposits)	9.1	7.7	6.9	5.9	5.8
Long-term nominal interest rates (10-yr nominal Government bonds)	6.7	6.8	6.6	6.3	5.9
Long-term real interest rates (10-yr indexed Government bonds)	2.7	2.9	2.7	2.6	2.5



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