

Macro Monitor

Iceland

- The recovery of the Icelandic economy has been challenged by the deteriorating conditions in the European trading partners, which account for a large share of the Icelandic exports. It looks like growth in Iceland will perform above average over the next few years and that its recovery will continue but the level is still well below the pre-crisis level. We expect growth rates of 2.5% y/y in 2012 and 2.2% in 2013. It is also worth noting that recent national account revisions showed that growth in 2011 was adjusted down.
- While investment activity and inventories have been rather volatile recently, private consumption has held up relatively well and 2012 should show about 3.8% y/y growth. We expect it will slow somewhat in the following years, to a growth level just below 3%. Investment activity should be fairly solid too and we expect growth rates of about 8-9 % y/y in 2012 and 2013, perhaps with a slightly increasing trend.
- Inflation remains above the central bank's 2.5% target, and has been so for a while, but inflationary pressures have eased somewhat in 2012 and we expect this trend to continue. Our forecast for the GDP deflator is currently 3.7% y/y in 2012 and 3.1% in 2013.
- As the economy has been undergoing recovery, the labour market has improved significantly too. While we do not see this trend ending, we do expect it to slow gradually as the unemployment rate comes down. Consequently, our year-end unemployment rate forecast is 5.8% for 2012, falling to 5.3% in 2013.

Macro forecasts

	2011	2012	2013	2014
GDP [% y/y]	2.6	2.5	2.2	2.9
GDP deflator [% y/y]	3.6	3.7	3.1	2.6
Private consumption [% y/y]	2.7	3.8	2.6	2.9
Fixed investments [% y/y]	12.8	8.7	9.2	10.7
Unemployment [%]	7.4	5.8	5.3	5.0
Current account [% of GDP]	-7.0	-8.0	-5.5	-5.1
Public balance [% of GDP]	-5.4	-3.7	-2.8	-1.6
Public debt [% of GDP]	99.2	96.9	94.6	91.1

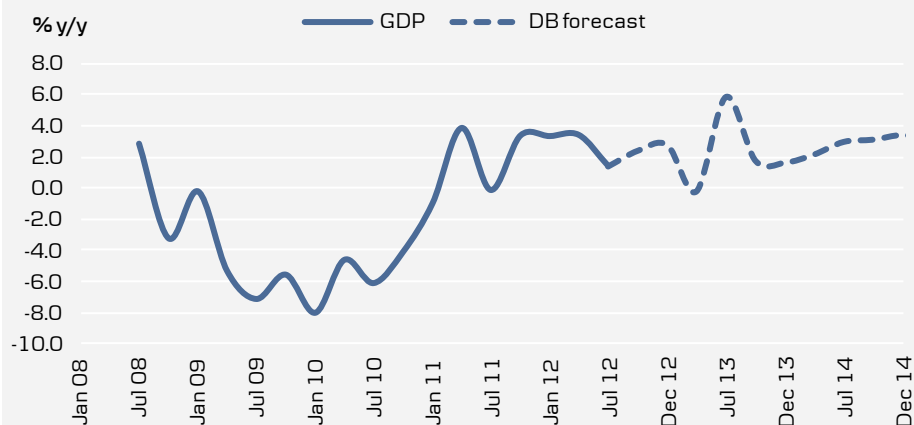
Source: Reuters EcoWin, Danske Bank Markets

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Economic growth

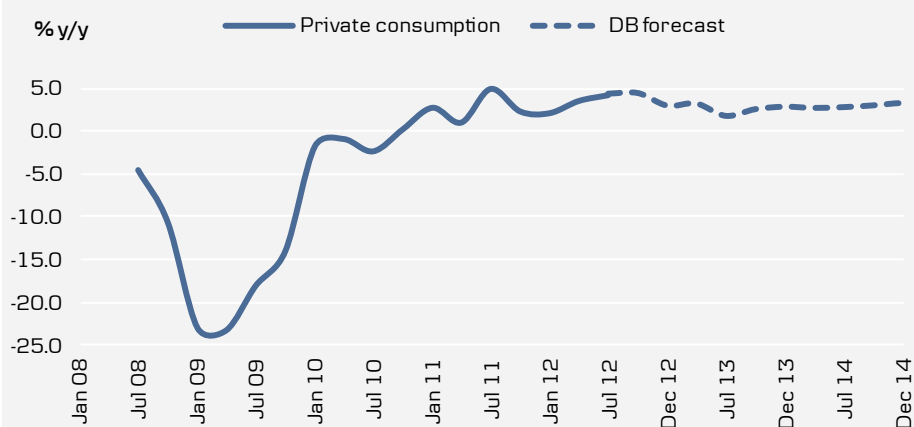
Gross domestic product



Source: Reuters EcoWin, Danske Bank Markets

- Q2 GDP numbers showed a marked decline in the Icelandic recovery, as GDP declined 6.5% q/q. However, this was driven by inventory changes and a drop in investment activity, while private consumption remained on track.
- GDP is still well below the pre-crisis level, and we expect the recovery to continue in 2013, with expected growth rates of 2.5% y/y in 2012 and 2.2% in 2013.

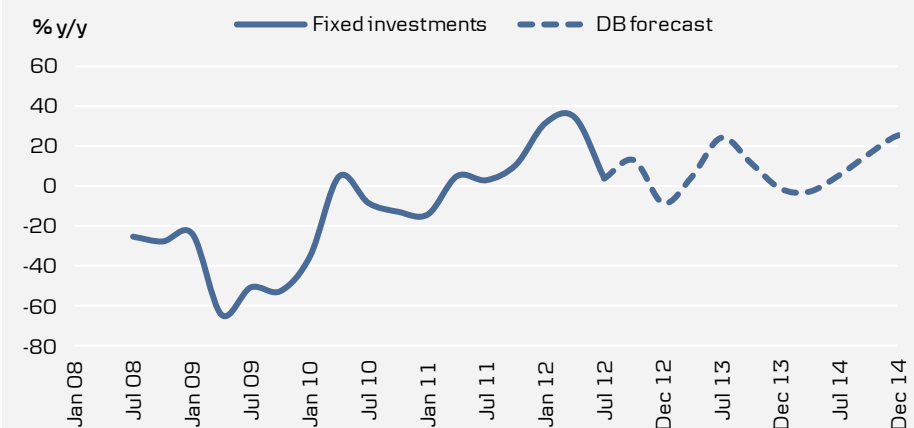
Private consumption



Source: Reuters EcoWin, Danske Bank Markets

- While private consumption growth in Iceland in 2011 was recently revised down, the recovery in the first half of 2012 was relatively sound.
- We expect this to have continued in H2 12 and from here we see a stable but moderate consumption growth of just below 3%.

Investments

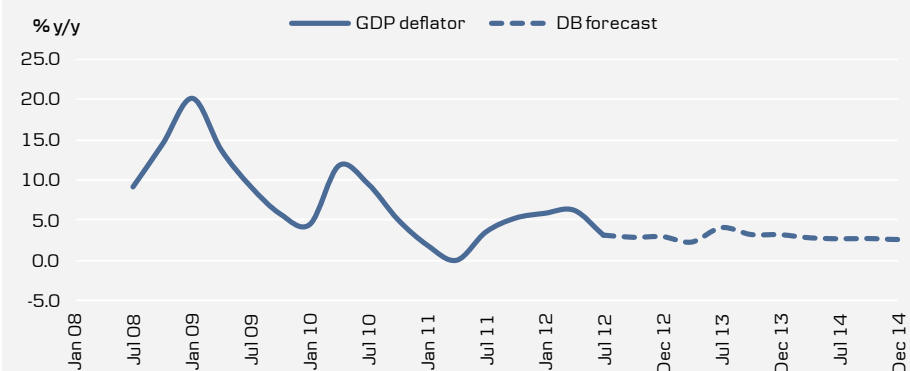


Source: Reuters EcoWin, Danske Bank Markets

- The volatile Icelandic investment activity slowed significantly in H1 12.
- While forecasts of investment activity should be treated rather cautiously, we expect it to be relatively solid in 2012 and 2013, at just under 10%.

Prices

GDP deflator

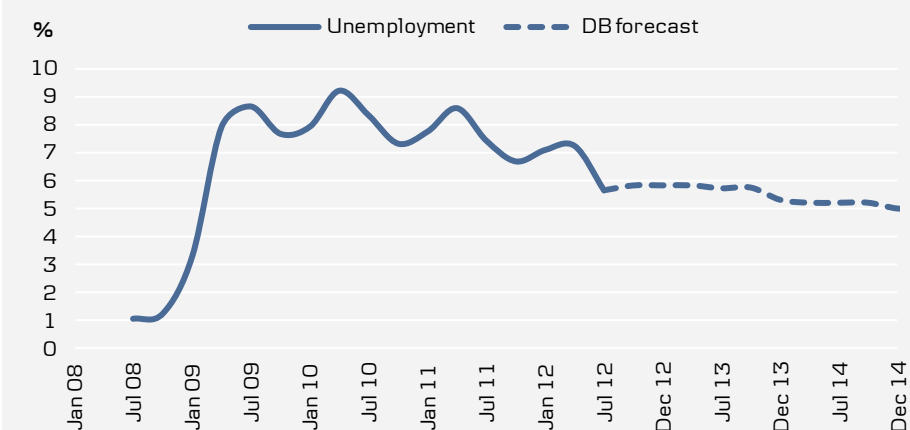


Source: Reuters EcoWin, Danske Bank Markets

- Icelandic inflation has remained above the central bank's target of 2.5% (CPI) for a while, although it has come down somewhat in 2012.
- We expect inflation to slow, as our GDP deflator forecasts are 3.7% y/y in 2012 and 3.1% y/y in 2013.

Labour market

Unemployment (% of labour force)



Source: Reuters EcoWin, Danske Bank Markets

- Unemployment in Iceland has continued its downward trend. We expect this to continue, but slower, in 2013 and our year-end forecasts for 2012 and 2013 are 5.8% and 5.3%.

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