



# INFLATION FORECAST

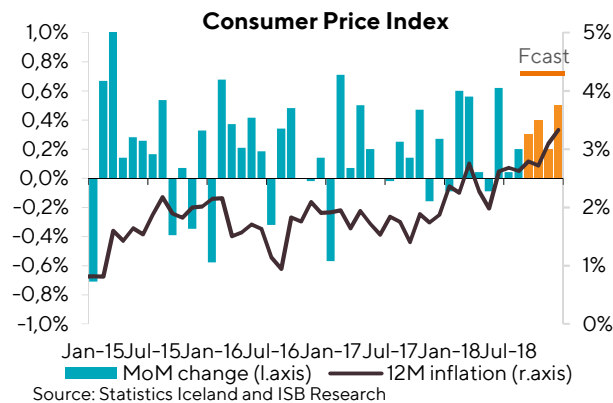
12 September 2018 | Íslandsbanki Research

## Summary

- We project a 0.3% rise in the CPI in September
- Headline inflation will rise from 2.6% to 2.8%
- End-of-sale effects, housing, food, and petrol push the CPI upwards
- Airfares pull downwards
- Inflation 3.2% in 2018 and 3.4% in 2019

	1m	3m	6m	12m	24m
Change in CPI	0.3%	0.9%	2.0%	3.3%	5.7%
Annualised	3.7%	3.7%	4.0%	3.3%	2.8%
2017 2018 2019					
Inflation at yr-end (Dec-Dec)		1.9%	3.3%	3.4%	
Average YoY inflation		1.8%	2.6%	3.5%	
Average YoY wage rise		6.9%	6.1%	5.3%	
Imputed rent (owner-occupied housing costs), YoY		14.8%	7.3%	4.3%	
Trade-weighted ISK index (TWI) (average)		160	164	170	

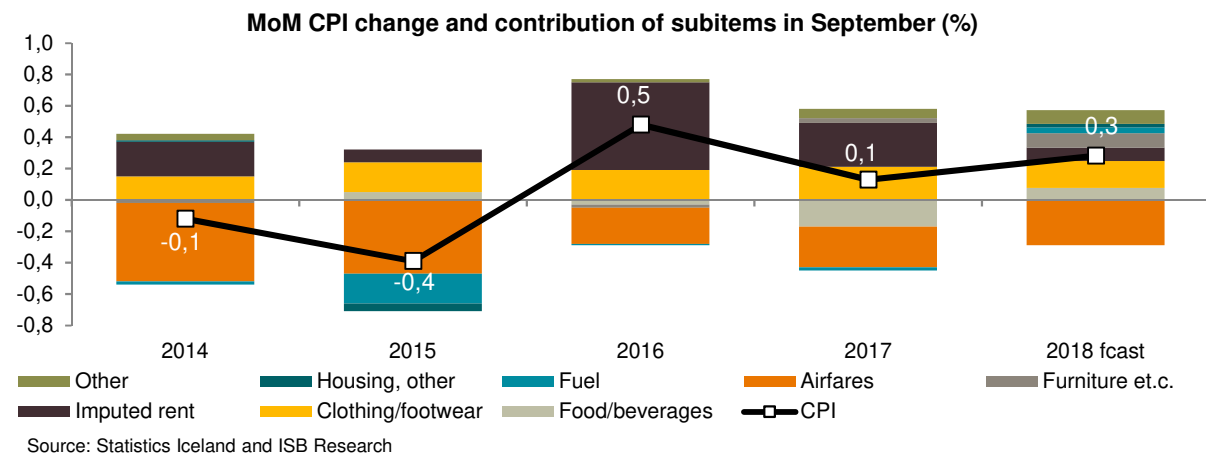
## CPI to rise 0.3% in September



We project that the consumer price index (CPI) will rise by 0.3% month-on-month in September, raising headline inflation from 2.6% to 2.8%. The inflation outlook for the next few quarters has worsened somewhat, in our opinion, and uncertainty has increased because of the recent depreciation of the ISK. The outlook is for inflation to measure 3.2% at the end of 2018 and average 3.5% in 2019.

## End-of-sale effects among upward-pushing items

End-of-sale effects will push the CPI strongly upwards, as is customary in September. Rising clothing and footwear prices will push the index upwards by 0.17%, and furniture and housewares prices by another 0.09%. We also expect food and beverages to raise the CPI by 0.08%.



The CPI has fluctuated widely in recent months, and the modest increase in August took us rather by surprise. We expect imputed rent, which mainly reflects the market price of residential housing, to rise by 0.4% in September (0.09% CPI effect). On the whole, we expect



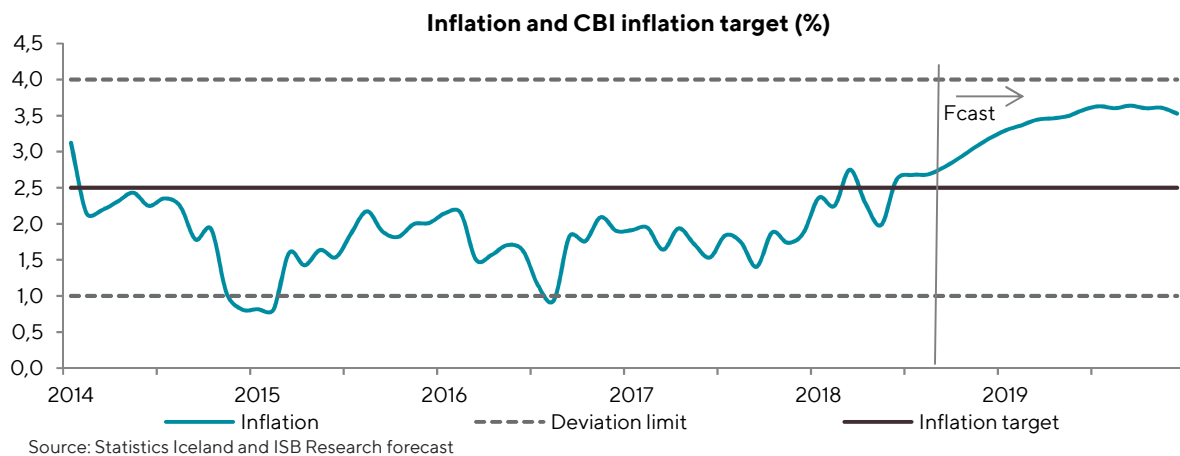
the housing component to push the CPI upwards by 0.11% in September. Petrol prices have also risen somewhat in recent weeks, and we expect them to raise the CPI by 0.04% this month. Another factor is the annual increase in recreational activities, which will raise the index by 0.05%, according to our forecast.

### Seasonal decline in airfares

The outlook is for a 17% seasonal drop in airfares in September (-0.29% CPI effect). In addition, we expect the decline in telephone and internet prices and lower hotel prices to lower the index by 0.01% each during the month.

### Inflation picks up steam, and uncertainty rises

The depreciation of the ISK in September to date has greatly increased the uncertainty about near-term developments in inflation after the relative exchange rate stability of the past year. At the time this forecast was completed, the exchange rate had fallen by an average of over 5% against major currencies during the month. If this trend does not reverse, it will clearly push goods and services prices higher in the quarters to come, and naturally, the impact will be stronger if the currency continues to weaken.



In this forecast, we assume that, in the coming term, the ISK will remain broadly unchanged at the closing exchange rate on 11 September. The effects of recent exchange rate movements will therefore taper off over the course of 2019, and inflation will subside again after mid-year. It need hardly be said, however, that after the past few weeks' unrest in the foreign exchange market, there are no guarantees with respect to the ISK. Our assumptions reflect first and foremost our opinion that uncertainty about near-term exchange rate developments is broadly symmetric.

The outlook is for an uptick in inflation over the next few months. We forecast that the CPI will rise 0.4% in October, 0.2% in November, and 0.5% in December, leaving headline inflation at 3.3% by the end of the year.

Thereafter, we expect inflation to average 3.5% in 2019 and 3.2% in 2020. Our long-term forecast is based on the assumption that wages and house prices will rise rather modestly and the ISK will behave as is described above. Uncertainty about wages is concentrated on the upside, however, and if next year's pay rises turn out larger than we project, inflationary pressures will increase further ahead.



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