

Statement of the Monetary Policy Committee

22 August 2012

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to keep the Bank's interest rates unchanged.

The outlook for 2012 is for somewhat stronger output growth than in the Bank's May forecast, but the outlook for 2013 and 2014 as a whole is broadly unchanged. The domestic labour market has also recovered more strongly than previously forecast. The economic recovery therefore continues to gain momentum. The global economic outlook remains uncertain, however, in part due to the financial crisis in Europe, which creates potential headwinds for the domestic economic and inflation outlook.

The inflation outlook for the next two years has improved since the MPC's last meeting, although inflation is not expected to reach the Bank's inflation target until the end of the period. The expectation of more rapid disinflation this year and next is due largely to the more than 8% rise in the trade-weighted exchange rate index since May, when the Bank published its last macroeconomic and inflation forecast.

As before, the inflation outlook is uncertain, and inflation could subside more quickly; for instance, if the króna strengthens further. On the other hand, it is uncertain how much of the recent appreciation will be sustained over the coming winter. Furthermore, inflation inertia could be underestimated, partly in view of long-term inflation expectations, which are still noticeably above the target.

The accommodative monetary stance has supported the economic recovery. The interest rate increases in May and June, together with reduced inflation, have withdrawn some of that accommodation. As spare capacity disappears from the economy, it is necessary that monetary policy slack should disappear as well. The degree to which such normalisation takes place through higher nominal Central Bank rates will depend on future inflation developments.