

Statement of the Monetary Policy Committee

14 November 2012

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to raise the Bank's interest rates by 0.25 percentage points.

The Bank's macroeconomic forecast indicates that output growth in 2012 will be somewhat weaker than was projected in August. In 2013, however, it is expected to be stronger than previously forecast; hence the outlook over the forecast horizon is broadly unchanged in spite of global headwinds. The economic recovery will continue, with growing investment and stable private consumption growth, and the slack in the economy will disappear during the forecast horizon.

Inflation has been somewhat lower than was forecast in August. Looking ahead, a greater margin of spare capacity in the economy compared to August and a significantly lower exchange rate of the króna will have offsetting effects on inflation developments. On the whole, the inflation outlook is deemed broadly unchanged. Uncertainty about exchange rate developments during the forecast horizon leads to corresponding uncertainty about developments in inflation and inflation expectations. Inflation expectations are still above the Bank's inflation target, although they have fallen somewhat by some measures.

The accommodative monetary stance has supported the economic recovery in the recent term. The rise in interest rates since August 2011 and the decline in inflation have withdrawn a considerable amount of that accommodation.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. The current baseline forecast indicates that the Bank's present nominal interest rate is sufficient to bring inflation back to the inflation target during the forecast horizon. However, this depends, among other things, on whether the outcome of the forthcoming wage settlement review at the beginning of next year is consistent with inflation declining to the target.

