

# Statement of the Monetary Policy Committee

## 21 August 2013

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

According to the updated forecast published in *Monetary Bulletin* today, output growth will measure just under 2% in 2013, which is broadly in line with the Bank's May forecast. The outlook for output growth over the next two years has deteriorated, however, with growth projected at just under 3% per year instead of slightly more than 3%, owing primarily to less investment in the energy-intensive sector in the near term. The recovery of the labour market has been more robust than was forecast in May and is expected to continue on that path.

According to the current forecast, inflation will rise slightly in the latter half of the year and then begin subsiding towards the target early in 2014. If wage increases are consistent with the inflation target, inflation will fall more quickly and interest rates will be lower than would otherwise be necessary, other things being equal.

The Central Bank's foreign exchange market strategy, introduced in May, has contributed to reduced exchange rate fluctuations, and the króna has remained relatively stable since the MPC's last meeting. As yet, however, this development has not led to lower inflation expectations.

Monetary policy must always take account of fiscal policy and other factors that affect aggregate demand. There is some uncertainty about the path public sector finances will take in coming years, but that should diminish with the presentation of the fiscal budget proposal in early October. It is critical that Treasury finances be brought into balance as soon as possible so that the monetary and fiscal policy mix contributes to external balance of the economy, fosters overall economic stability, and delivers inflation close to target, at the lowest possible cost.

The accommodative monetary stance has supported the economic recovery in the recent term. It is still the case that as spare capacity disappears from the economy, it is necessary that slack in monetary policy should disappear as well. The degree to which such normalisation takes place through changes in nominal Central Bank rates will depend on future inflation developments, which in turn will depend on wage developments and exchange rate movements.