



The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

Extraordinary meeting in March 2020 (93rd meeting)

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The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that “[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee’s decisions and the premises upon which they are based.” In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC’s extraordinary meeting held on 22 and 23 March 2020, during which the Committee discussed economic and financial market developments, decisions on the application of the Bank’s monetary policy instruments, and the communication of those decisions on 25 March.

I Decisions on the Bank’s monetary policy instruments

The Committee discussed the outlook relating to COVID-19, noting that the pandemic, measures taken to hinder the spread of the disease, and the economic repercussions of the disease are expected to call for a significant increase in Treasury expenditures, in view of the measures announced by the Government. In addition, deferred payment of various public levies would further increase the Treasury’s financing need. The Committee noted that the outlook was for the Treasury outcome to deteriorate this year and for the Treasury to need to acquire substantial credit financing through bond issuance. Members were quite concerned that, other things being equal, this would reduce liquidity in circulation and push Treasury bond yields upwards, which would disrupt normal monetary policy transmission at a time when the Central Bank’s policy actions were aimed at easing households’ and businesses’ financial conditions.

Committee members discussed the possibility that the Bank would begin a programme of quantitative easing; i.e., direct purchases of Treasury bonds in the secondary market. It emerged in the discussion that yields on longer bonds had risen in recent days and that the slope of the yield curve had turned somewhat upwards. The MPC noted that, with quantitative easing, it would be possible to have a direct effect further out the yield curve. In this way, it would be possible to prevent a rise in long-term yields in the wake of increased Treasury bond issuance, as such a rise would undermine the Committee’s monetary easing objectives. It was noted in the discussion that the Bank’s objective in purchasing Treasury bonds was to ensure

the transmission of monetary policy in the market, so that households and businesses could benefit from lower long-term interest rates while economic conditions were unfavourable. It emerged at the meeting that it could be useful to activate such a policy instrument, which could also be used for other purposes later; for instance, to sterilise foreign exchange market intervention or to affect the money supply. Members also discussed the possible disadvantages of using this tool; for instance, the increased money supply could push inflation higher than it would be otherwise. On the other hand, the Committee considered the inflationary risk limited under the current circumstances, with the significant slack in the economy and an ongoing contraction in lending and money supply.

In view of the discussion, the Governor proposed that the Bank begin direct purchases of Treasury bonds in the secondary market. All members voted in favour of the proposal and agreed to publish an announcement to this effect before the markets opened on 23 March. It emerged in the discussion that the MPC would do what was needed to ensure that the more accommodative monetary stance would be transmitted normally to households and businesses.

The Committee discussed the framework for quantitative easing in greater detail, and the Governor proposed thereafter that the Bank be authorised to purchase Treasury bonds for up to 150 b.kr., or about 5% of GDP. All members voted in favour of the proposal. The Central Bank would publish further information on the quantitative easing framework at a later date.

At the meeting, two scenarios illustrating the potential impact of the pandemic on unemployment, private consumption, GDP growth, and inflation were presented. It emerged that the situation was highly uncertain and that forecasting the most likely economic developments was difficult. Nevertheless, it was clear that the outlook was for a contraction in 2020, which could range from 2½-5%, according to the two scenarios. It was noted that work on the scenarios would continue, and it was considered likely that this work would reveal a larger contraction than was indicated in the scenarios as presented at the meeting. The MPC also considered that the inflation outlook for 2020 was relatively unchanged despite the current economic turbulence. It emerged at the meeting that this was due to a number of offsetting factors: exchange rate pass-through pushing inflation upwards, on the one hand; and lower global commodity and oil prices, lower global inflation, and the prospect of a sizeable slack in the domestic economy pushing it downwards, on the other.

Members also discussed the possibility of applying other monetary policy instruments but agreed to wait and see what impact the measures already decided would have, and how the economy would develop in the near future. The MPC would continue to monitor developments closely and would use the tools at its disposal to support the domestic economy.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gunnar Jakobsson, Deputy Governor for Financial Stability

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

Chief Economist Thórarinn G. Pétursson was present for the entire meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next scheduled Statement of the Monetary Policy Committee will be published on Wednesday 20 May 2020.