



Monetary Policy Strategy

1. The objective of the monetary policy of the Central Bank of Iceland is to promote price stability, and in so doing contribute to general economic well-being in Iceland. Act no. 92/2021, on the Central Bank of Iceland, states that price stability is the objective of monetary policy. Decisions on applying the Bank's monetary policy instruments are taken by the Monetary Policy Committee of the Central Bank of Iceland.
2. The price stability objective of monetary policy is specified in the Declaration on inflation target and a change in the exchange rate policy, adopted by the Prime Minister and the Board of Governors of the Central Bank on 27 March 2001. The Declaration sets a target annual inflation rate generally as close as possible to 2½%. The Bank's inflation target is based on the broadest measure of households' consumption basket, which is the 12-month change in the Consumer Price Index as calculated by Statistics Iceland.
3. Given the symmetrical nature of the inflation target, the Monetary Policy Committee regards deviations, whether on the upside or downside, as equally undesirable. If inflation deviates by more than 1½ percentage points from the target, the Central Bank must publicly explain to the Government the reasons for this, how the Bank intends to respond and how long it expects it will take to reach the inflation target again.
4. Decisions on the application of the Bank's monetary policy instruments taken by the Monetary Policy Committee are aimed at ensuring inflation will be as close as possible to the 2½% target in the medium term. The Committee also considers other price indicators and measures of underlying inflation when formulating monetary policy, as these often provide indications of likely medium-term inflation developments.
5. Inflation can deviate from the target in the short term. In assessing an appropriate response in such circumstances, the Monetary Policy Committee takes into account the overall economic situation and an assessment of how persistent the deviation can be expected to be. The length of time the Committee allows itself to reach the inflation target depends, for instance, on the magnitude of the deviation, the Committee's assessment of how costly it could prove in terms of lost economic activity, and whether adjustment could undermine financial stability. The Committee recognizes that persistent deviations can undermine the credibility of the inflation target, and therefore other factors can only be given consideration in the formulation of monetary policy as long as they do not undermine the price stability objective and the anchoring of inflation expectations.
6. The Monetary Policy Committee makes an independent assessment of the economic situation and prospects, and the development of all factors that can affect the inflation outlook. The Committee takes into account that the effects of the Central Bank's interest rate decisions and market actions on inflation and the economy appear with a delay. For

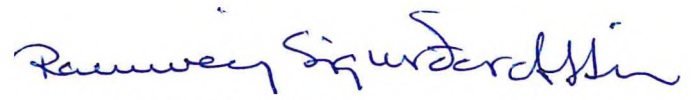
this reason, decisions in monetary policy are taken with regard to the Bank's forecast for economic developments and inflation. A professional and high-quality analysis is a prerequisite for appropriate decisions and credible monetary policy.

7. The Monetary Policy Committee's main instrument in achieving its inflation target is the Central Bank's key interest rate, i.e. the interest rate used by the Bank in transactions with other financial undertakings. To achieve its inflation target and ensure effective transmission of monetary policy, the Committee can also apply other tools which it has at its disposal, or propose that the Central Bank apply other policy instruments.
8. Interventions in the interbank foreign exchange market can strengthen the efficacy of monetary policy in small open economies, reducing short-term fluctuations in the ISK exchange rate due to the lack of depth of the market. If the Committee believes that the exchange rate of the ISK has moved too far from a level reflecting the underlying economic situation, it can also decide to have the Central Bank intervene to attempt to influence the exchange rate.
9. Ensuring that inflation expectations are firmly anchored to the inflation target is a prerequisite for successful monetary policy. When inflation expectations are firmly anchored, it gives more scope for effective counter-cyclical policy implementation. The transmission of monetary policy through the expectations channel is therefore essential for monetary policy implementation.
10. Transparency regarding monetary policy decisions and their assumptions are important conditions for a credible monetary policy. The Monetary Policy Committee is committed to providing clear and easily understood communication. This applies both to the publication of statements and minutes of the Committee's meetings, as well as to other information disclosure concerning monetary policy and its implementation. Additionally, the Central Bank's publication of its analysis of the economic situation and outlook in the quarterly Monetary Bulletin is an important part of ensuring transparency concerning the basis of the Monetary Policy Committee's decisions.
11. This strategy will be reviewed at least at five-year intervals, or when the Monetary Policy Committee sees occasion to do so.

Approved by the Monetary Policy Committee on 22 November 2022.



Asgeir Jónsson,
Governor



Rannveig Sigurðardóttir,
Deputy Governor for Monetary Policy