

Statement of the Monetary Policy Committee 20 March 2019

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to keep the Bank's interest rates unchanged. The Bank's key interest rate – the rate on seven-day term deposits – will therefore remain 4.5%.

According to the newly published national accounts, GDP growth slowed between H1 and H2/2018. It measured 4.6% for the year as a whole, whereas the Bank had projected a growth rate of 4.3% in its February forecast. Recent indicators of economic activity and the labour market suggest that demand pressures in the economy continue to subside.

Inflation measured 3% in February, down from 3.7% in December 2018. The main factors in the decline are the reduced effect of the rise in import prices stemming from the depreciation of the króna last autumn, and a weaker contribution of housing to inflation. The króna has appreciated by just under 3% since the MPC's February meeting. Inflation is still likely to rise somewhat over most of the year, however, although actual developments will depend on the results of the ongoing wage negotiations.

Households' and businesses' long-term inflation expectations have risen, but the breakeven inflation rate in the bond market has fallen. Long-term inflation expectations are still above target by all measures. Short-term inflation expectations are broadly unchanged since the MPC's last meeting, and the monetary stance in terms of the Bank's real rate is therefore unchanged between meetings.

The near-term monetary stance will depend on the interaction between a narrower output gap, wage-setting decisions, and developments in inflation and inflation expectations.

The MPC reiterates that it has both the will and the tools necessary to keep inflation and inflation expectations at target over the long term. This could call for a tighter monetary stance in coming months. Other decisions, particularly those relating to the labour market and fiscal policy, will be important in determining whether that will be the case and will affect the sacrifice cost in terms of lower employment.