

# Statement of the Monetary Policy Committee

## 17 May 2017

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to lower the Bank's interest rates by 0.25 percentage points. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 4.75%.

The outlook is for strong GDP growth this year, as in 2016, with growth for both years exceeding the February forecast. The deviation from the forecast stems mainly from stronger-than-expected growth in tourism, while there is also the prospect of more fiscal easing in 2017 than was previously projected. Demand pressures in the labour market and the general economy have therefore grown despite increased importation of labour and strong productivity growth. This is offset by the appreciation of the króna. The króna has played a key role in the economy's adjustment to positive shocks deriving from improved terms of trade and growth in the tourism sector.

Inflation measured 1.9% in April, broadly similar to the level in the past six months. Underlying inflation appears to have declined in recent months, however. The currency appreciation and low global inflation continue to offset domestic inflationary pressures, and the gap between domestic price developments – housing costs in particular – and external factors has widened even further since the MPC's last meeting. Two opposing forces affect the inflation outlook. Demand pressures in the economy have turned out stronger than previously forecast, but they are offset by the higher exchange rate. The inflation outlook has improved for 2017 and 2018 but has deteriorated further out the forecast horizon.

Clear signs of increased demand pressures in the economy call for a tight monetary stance so as to ensure medium-term price stability. The Central Bank's real rate has risen slightly since the MPC's last meeting. The appreciation of the króna also contains demand.

The Central Bank has scaled down its intervention in the foreign exchange market in view of its strong foreign exchange reserves, as the appreciation of the króna is considered to reflect economic fundamentals. As before, the Bank will intervene in the market in order to mitigate volatility when it considers such intervention warranted.

A stronger anchor for inflation expectations at target and the appreciation of the króna have enabled the MPC to achieve its legally mandated price stability objective with a lower interest rate than would otherwise have been possible. The monetary stance in the coming term will be determined by economic developments and actions taken in other policy spheres.