

Statement of the Monetary Policy Committee 25 August 2021

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to raise 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 1.25%.

The economic outlook has improved since the Bank's last forecast. According to the new macroeconomic forecast, published in the *August Monetary Bulletin*, the outlook is for GDP growth to measure 4% this year, some 0.9 percentage points above the May forecast. The improvement is driven mainly by tourist arrivals, which have increased more rapidly this summer than was previously expected. Unemployment has subsided more than previously forecast, although it remains high, and the slack in the economy has narrowed more quickly.

A large share of the population is now vaccinated against COVID-19. Even so, case numbers have risen once again, and there is still some uncertainty about the path the pandemic will take, owing to the increased spread of the Delta variant of the virus. Furthermore, the impact of temporary supply chain disruptions abroad, which have pushed manufacturing and distribution costs upwards all over the world, could persist longer than previously anticipated.

Inflation measured 4.4% in Q2/2021 but was 4.3% in July. Overall inflationary pressures appear to be subsiding, particularly according to underlying inflation, but nevertheless remain relatively high. The rise in inflation expectations earlier this year seems to be reversing. According to the Central Bank's forecast, however, the outlook is for inflation to ease somewhat more slowly than was projected in May. It is expected to remain above 4% through the year-end but align with the target in H2/2022.

The MPC will apply the tools at its disposal to ensure that inflation eases back to the target within an acceptable time frame.