The wage index rose by 0.1% month-on-month in October and by 5.1% year-on-year. Real wages fell by 0.2% between months in October but rose by 0.9% year-on-year.

The nationwide Statistics Iceland house price index, published in late November, rose by 0.6% from the previous month, and by 0.2% adjusted for seasonality. The capital area real estate price index, calculated by Registers Iceland, rose by 0.9% month-on-month in October, and by 0.3% when adjusted for seasonality. The number of purchase agreements concluded nationwide rose 13% year-on-year in November, which is similar to the annual increase for the first 11 months of the year. The number of purchase agreements is still low in historical context, however.

According to the Capacent Gallup survey, consumer sentiment fell slightly in November, following a steep drop in October, but is still somewhat more upbeat than a year ago. Sentiment towards the economy declined most between months, and the only subcomponent that rose in November was the assessment of the labour market.

According to Capacent Gallup's household survey, carried out in November and December, household inflation expectations one year ahead were 5.5%, virtually unchanged since the last survey in September. Household inflation expectations two years ahead measured 5%, also unchanged since the last survey.

The consumer price index (CPI) rose by 0.3% month-on-month in November. Annual inflation measured 4.5%, up from 4.2% in October. Core index 3, which excludes the effects of taxes, volatile food items, petrol, public services, and real mortgage interest expense, rose by 0.6% between months, however. Underlying inflation according to this measure was 4.1% in November, having risen from 3.6% in October following a virtually uninterrupted decline since March 2012.

The effects of the depreciation of the króna in the autumn continued to emerge in imported goods prices, as imported food products, new motor vehicles, and other imports rose somewhat in price in November. Petrol prices fell month-on-month, however, leading to a nearly 0.2 percentage point decline in the CPI.

II The interest rate decision

The Governor informed Committee members of the status of work within the bank and with other authorities regarding the assessment of Iceland's external debt, the resolution of the failed banks' estates, and the liberalisation of the capital controls. The Committee also discussed the Central Bank's liquidity management and the status of the fiscal budget proposal following the second round of Parliamentary discussions.

The Committee discussed the possibility of keeping the Bank's interest rates unchanged or raising them by 0.25 percentage points. The main argument in favour of unchanged interest rates was that the most recent indicators suggested that economic developments had been well in line with the Bank's November forecast. According to preliminary figures from Statistics Iceland, output growth in the first three quarters of the year measured 2%, while in November the Central Bank forecast 2.1% growth for the period. Developments in the labour market were also broadly in line with expectations. Furthermore, the exchange rate of the króna had remained broadly stable since the last interest rate decision date and inflation had developed in line with the forecast.

In view of the discussion, the Governor proposed that rates be held unchanged: the current account rate at 5%, the maximum rate on 28-day certificates of deposit at 5.75%, the seven-day collateralised lending rate at 6%, and the overnight lending rate at 7%. All members voted in favour of the Governor's proposal, although one member would have preferred to raise rates by 0.25 percentage points at this time, in view of still-high inflation and long-term inflation expectations. This member agreed, however, that the difference was small enough to justify a vote in favour of the Governor's proposal.

Committee members agreed that the accommodative monetary stance had supported the economic recovery in the recent term. They also agreed that the rise in interest rates since August 2011 and the decline in inflation had withdrawn a considerable amount of that accommodation. As spare capacity disappeared from the economy, it would be necessary that monetary policy slack should disappear as well. The degree to which such normalisation took place through higher nominal Central Bank rates would depend on future inflation developments, which in turn would depend to a large extent on exchange rate movements and wage-setting decisions. Whether the Bank's nominal interest rates would remain unchanged in the near term would depend, among other things, on whether the outcome of the forthcoming wage settlement review at the beginning of next year was consistent with inflation declining to the target.

The following Committee members were in attendance:

Már Gudmundsson, Governor and Chairman of the Monetary Policy Committee

Arnór Sighvatsson, Deputy Governor

Thórarinn G. Pétursson, Chief Economist

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

In addition, a number of Bank staff members attended part of the meeting.

Rannveig Sigurdardóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 6 February 2013.

March, 27 2001

Declaration on inflation target and a change in the exchange rate policy

(From March 27, 2001 – as amended by agreement between between the Prime Minister of Iceland and the Board of Governors of the Central Bank of Iceland on November 11, 2005, cf. Press release no. 35/2005)

On March 27, 2001 the Prime Minister and the Governors of the Central Bank of Iceland signed a declaration on changes in the framework of monetary policy in Iceland. The declaration is as follows:

The Government of Iceland and the Central Bank of Iceland have decided the following changes in the framework of monetary policy in Iceland, effective March 28, 2001:

(1) The main target of monetary policy will be price stability as defined below. The Central Bank shall also promote financial stability and the main objectives of the economic policy of the Government as long as it does not deem it inconsistent with the Bank's main objective of price stability.

(2) Rather than basing monetary policy on keeping the exchange rate within a fluctuation band, the Central Bank will aim at keeping inflation within defined limits as specified below.

(3) The change described above implies that the fluctuation limits for the króna are abolished. Nevertheless, the exchange rate will continue to be an important indicator in the conduct of monetary policy.

(4) The Government grants full authority to the Central Bank to use its instruments in order to attain the inflation target.

(5) Later this week, the Government will submit to Parliament a bill on a new Central Bank Act which, once enacted, will legally confirm the decisions described above on making price stability the main objective of monetary policy and on the independence of the Central Bank to use its instruments.

(6) The inflation target of the Central Bank will be based on 12-month changes in the consumer price index as calculated by Statistics Iceland. Statistics Iceland will also be asked to calculate one or more indices which may be used to assess the underlying rate of inflation, as will be further agreed between the Central Bank and Statistics Iceland. The Central Bank will take note of such indices in its assessment of inflation and in the implementation of monetary policy.

(7) The Central Bank will aim at an annual inflation rate of about 2½ per cent.

(8) If inflation deviates by more than 1½ percentage point from the target, the Central Bank shall bring it inside that range as quickly as possible. In such circumstances, the Bank will be

obliged to submit a report to the Government explaining the reasons for the deviations from the target, how the Bank intends to react and how long it will take to reach the inflation target again in the Bank's assessment. The report of the Bank shall be made public.

(9) The Central Bank shall aim at attaining the inflation target of 2½ percent not later than by the end of 2003. In the year 2001, the upper Declaration on inflation target and a change in the exchange rate policy limit for inflation shall be 3½ percentage points above the inflation target but 2 percentage points above it in the year 2002. The lower limit for inflation will always be 1½ percentage point below the inflation target. Should inflation move outside the target range in 2001 and 2002, the Bank shall respond as set out in item 8 above.

(10) Despite the elimination of the fluctuation limits for the króna, the Central Bank will intervene in the foreign exchange market if it deems such action necessary in order to promote the inflation objective described above or if it thinks that exchange rate fluctuations might undermine financial stability.

(11) The Central Bank shall publish inflation forecasts, projecting inflation at least two years into the future. Forecasts shall be published in the Bank's Monetary Bulletin. This shall also contain the Bank's assessment of the main uncertainties pertaining to the inflation forecast. The Bank shall also publish its assessment of the current economic situation and outlook.

[Amended text by agreement between the Prime Minister of Iceland and the Board of Governors of the Central Bank of Iceland on November 11, 2005]

(12) The Central Bank shall in its publications explain how successful it is in implementing the inflation target policy. The Governors will also report to the Minister, the Government and committees of the Parliament on the policy of the Bank and its assessment of current economic trends and prospects.