

Statement of the Monetary Policy Committee 15 March 2017

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 5%.

According to national accounts figures from Statistics Iceland, GDP growth measured 7.2% in 2016, a full percentage point more than was projected in the February issue of *Monetary Bulletin*. The deviation from the forecast is attributable largely to stronger-than-projected services exports and private consumption. Indicators imply continued strong growth thus far in 2017. Job creation is strong, unemployment is low, and the labour participation rate has risen above the pre-crisis peak. Even though importation of foreign labour pulls in the opposite direction, demand pressures in the economy are growing.

Inflation measured 1.9% in February, broadly similar to the level in the past six months. As before, the inflation outlook reflects two offsetting forces. GDP growth has turned out stronger than previously forecast, but the exchange rate of the króna is higher. 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. In addition, a tight monetary stance has anchored inflation expectations and contained both credit growth and demand growth.

It is too early to predict the economic impact of the most recent steps in the capital account liberalisation process. It is possible that a better balance will develop between foreign exchange market inflows and outflows, but short-term volatility could increase, as appears to have happened in the past few days. The Central Bank will continue to mitigate short-term volatility when conditions warrant it.

Rapid growth in economic activity and clear signs of demand pressures in the economy call for a tight monetary stance so as to ensure medium-term price stability. On the other hand, uncertainty in the labour market has abated.

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.