

# Statement of the Monetary Policy Committee

## 23 August 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 4.5%.

The outlook is for GDP growth to be strong this year, as it was in 2016, albeit somewhat weaker than was forecast in the May issue of *Monetary Bulletin*. GDP growth is driven in particular by growth in tourism and private consumption; furthermore, the outlook is for fiscal easing this year.

Inflation was marginally lower in Q2 than was projected in May. It measured 1.8% in July, up from 1.5% in June. Underlying inflation appears to have continued to fall, however. The króna has depreciated since the MPC's last meeting but remains almost 8% stronger than it was a year ago. As before, opposing forces affect the inflation outlook, with the appreciation of the króna in the past year and low global inflation offsetting domestic inflationary pressures. The gap between domestic price developments – housing costs in particular – and external factors has continued to widen in recent months, exacerbating uncertainty about the near-term inflation outlook.

Since the MPC's last meeting, short-term inflation expectations have risen slightly, probably reflecting the impact of the recent depreciation of the króna. Long-term inflation expectations are broadly unchanged, however, according to the Central Bank's most recent survey of market agents' expectations. The long-term breakeven inflation rate in the bond market has risen in the past few days, although it has been well in line with the inflation target over the quarter to date.

Demand pressures in the economy call for a tight monetary stance so as to ensure medium-term price stability. The foreign exchange market has been volatile, and there are signs that changes in external trade and the housing market could be in the offing. It is too early to draw conclusions about the scope and implications of such changes, however. The Bank's real rate has eased slightly since the last MPC meeting but, under current conditions, appears to be at a level ensuring inflation broadly at target. The monetary stance in the coming term will be determined by economic developments and actions taken in other policy spheres.