MONETARY POLICY COMMITTEE REPORT TO PARLIAMENT

2020•1

Monetary Policy Committee Report to Parliament

3 July 2020

The Act on the Central Bank of Iceland stipulates that the Monetary Policy Committee (MPC) of the Central Bank of Iceland shall submit to Parliament (Alþingi) a report on its activities twice a year and that the contents of the report shall be discussed in the Parliamentary committee of the Speaker's choosing.

According to the new Act on the Central Bank of Iceland, which entered into force on 1 January 2020, the Committee is now required to meet at least six times a year instead of the previous eight. Furthermore, the Chief Economist left the Committee at the end of 2019 because of provisions in the new Act, and was replaced by the Deputy Governor for Financial Stability, who joined the Bank in March 2020. Since the last Report was sent to Parliament, the Committee has held three regular meetings, the last of them on 20 May, and four extraordinary meetings. The following report discusses the work of the Committee between January and June 2020.

Monetary policy formulation

According to the Act on the Central Bank of Iceland, the principal objective of monetary policy is to promote price stability. This objective is further described in the joint declaration issued by the Bank and the Icelandic Government on 27 March 2001 as an inflation target of 2½%, based on the consumer price index. By law, the MPC takes decisions on the application of the Bank's monetary policy instruments; furthermore, the MPC's decisions shall be based on a thorough and careful assessment of developments and prospects for the economy, including the assessment published in the Bank's *Monetary Bulletin*. The MPC's statements and minutes, enclosed with this report, contain the arguments for the Committee's decisions in the first half of 2020.

Developments from January to June 2020

At its February meeting, the MPC decided to lower the Bank's key interest rate by 0.25 percentage points.[1] At that time, the GDP growth outlook had deteriorated, owing primarily to headwinds faced by export sectors and worsening financing conditions for domestic firms. Since the effects of the COVID-19-pandemic began to emerge in

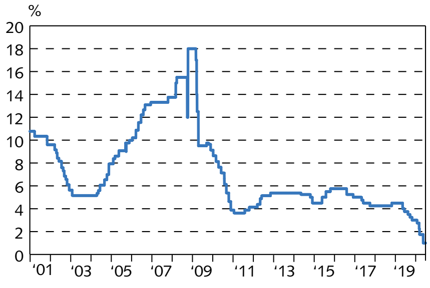
Table 1. Central Bank of Iceland interest rate decisions in H1/2020 (%)

Date	*Current accounts*	*Seven-day term deposits*	*Collateral-ised loans*	*Over-night loans*
5 Feb.	2.50	2.75	3.50	4.50
11 March	2.00	2.25	3.00	4.00
18 March	1.50	1.75	2.50	3.50
20 May	0.75	1.00	1.75	2.75

Chart 1

Central Bank of Iceland key interest rate[1]

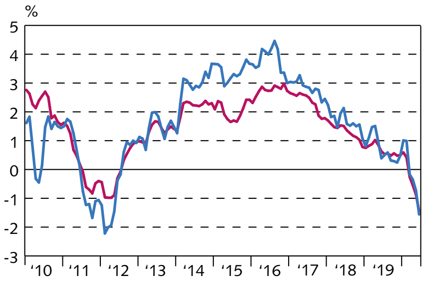
3 January 2001 - 30 June 2020



1. The Central Bank's key interest rate is defined as follows: the 7-day collateralised lending rate (until 31 March 2009), the rate on deposit institutions' current accounts with the Central Bank (1 April 2009 - 30 September 2009), the average of the current account rate and the rate on 28-day certificates of deposit (1 October 2009 - 20 May 2014), and the rate on 7-day term deposits (from 21 May 2014 onwards).
Source: Central Bank of Iceland.

1. The key rate is the interest rate that is the most important determinant of short-term market rates and therefore is the best measure of the monetary stance. At present, this is the interest rate on seven-day term deposits with the Central Bank.

Chart 2
Real Central Bank of Iceland interest rates[1]
January 2010 - June 2020

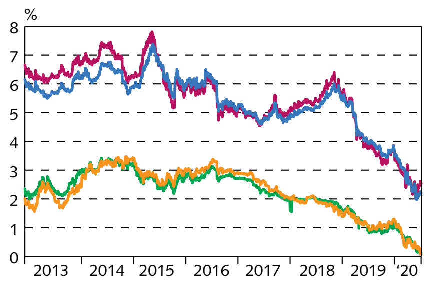


Real Central Bank of Iceland interest rate in terms of twelve-month inflation

Real Central Bank of Iceland interest rate in terms of various measures of inflation and inflation expectations[2]

1. From 2010 to May 2014, the nominal policy rate was the average of the current account rate and the maximum rate on 28-day CDs. From May 2014, the policy rate has been the seven-day term deposit rate.
2. Until January 2012, according to twelve-month inflation, one-year business inflation expectations, one-year household inflation expectations, the one-year breakeven inflation rate, and the Central Bank forecast of twelve-month inflation four quarters ahead. From February 2012 onwards, according to the above criteria, plus one-year market inflation expectations based on a quarterly Central Bank survey.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Chart 3
Government-guaranteed bond yields[1]
2 January 2013 - 30 June 2020



5-yr, nominal
10-yr, nominal
5-yr, indexed
10-yr, indexed

1. Based on the zero-coupon yield curve, estimated with the Nelson-Siegel method, using money market interest rates and government-guaranteed bonds.
Source: Central Bank of Iceland.

Iceland, the Committee has lowered interest rates three times, by a combined 1.75 percentage points. It lowered interest rates by 0.5 percentage points at its first meeting in March, in response to the poorer outlook due to the pandemic. As the month progressed and the economic outlook darkened still further, the MPC lowered interest rates by another 0.5 percentage points. When the Bank's new macroeconomic forecast was published, at the MPC's regular meeting in May, the Committee lowered interest rates by an additional 0.75 percentage points in order to support the economy still further. Therefore, in the first half of 2020, interest rates were lowered by 2 percentage points. A favourable inflation outlook enabled the Committee to respond decisively to the deteriorating economic outlook. The Central Bank's key rate was therefore 1.0% at the end of June, or 2.75 percentage points lower than at the end of June 2019.

The Bank has also taken a number of other actions to ease the monetary stance and boost financial system liquidity, in order to shore up demand, support increased access to credit, and preserve financial system stability. At its regular March meeting, the MPC decided to lower deposit institutions' minimum reserve requirements, thereby easing their liquidity position and giving them greater scope to respond to the ongoing crisis. Later that month, the Committee announced that, with the prospect of a poorer fiscal outcome this year and the foreseeable need for the Treasury to acquire substantial credit financing through bond issuance, the Bank would begin buying Treasury bonds in the secondary market, so as to ensure that the more accommodative monetary stance was transmitted to households and businesses. The Bank began buying Treasury bonds in the market on 11 May 2020. At its May meeting, the Committee decided to stop offering one-month term deposits so as to increase liquidity in circulation and further strengthen monetary policy transmission. The Bank has also taken a number of other actions, such as lowering deposit institutions' capital requirements by lifting the countercyclical capital buffer, thereby providing increased scope for lending (for further discussion of the economic measures, see Box 2 in *Monetary Bulletin* 2020/2).

The monetary stance as measured in terms of the Bank's real rate eased in the first half of the year, concurrent with the decline in the Bank's nominal interest rates. In terms of the average of various measures of inflation and one-year inflation expectations, the Bank's real rate was -1.5% at the end of June, as opposed to 0.6% at the beginning of the year. The Bank's real rate in terms of twelve-month inflation fell by 2.5 percentage points over the same period, to -1.6% at the end of June.

Nominal Treasury bond yields have fallen markedly in the past year. They rose temporarily in mid-March, in the wake of news about the Treasury's increased borrowing need, which investors were concerned would reduce financial system liquidity and push long-term interest rates upwards. The rise in yields reversed, however, after the MPC announced the Bank's intention to begin buying Treasury bonds in the secondary market. The yield on ten-year nominal Treasury bonds was 2.5% at the end of June, having fallen by 0.8 percentage points since the beginning of the year and by 1.2 percentage points since end-June 2019. Long-term indexed rates also fell during the year. The yield on indexed ten-year Treasury-guaranteed bonds was 0.1% at the end of June, 1 percentage point lower than at the beginning of the year.

Growth in lending to households has remained in the 5-7% range since mid-2019, and mortgage lending rates have continued to fall in line with Central Bank rate cuts. The spread between interest rates on new corporate loans and the Bank's key rate has widened even further during the year, and growth in corporate lending has been limited.

Capital inflows for new investment totalled about 24 b.kr. in the first five months of 2020, broadly similar to inflows in H2/2019, which totalled just under 21 b.kr. Over the same period, outflows of capital previously imported for new investment amounted to 29 b.kr., an increase relative to H2/2019. In H1/2020, inflows were mostly due to loans, while outflows were due primarily to the sale of listed equities and Treasury bonds.

The króna began to depreciate in late February, after the COVID-19 pandemic arrived in Iceland, and by the end of April it had fallen just over 12%. Pandemic-related shocks to the tourism industry and other export sectors probably weigh heaviest in the recent depreciation of the króna. At the end of June, the króna had depreciated by 11% since the beginning of the year, and by 9% since 28 February, when the first case of COVID-19 was diagnosed in Iceland.

In line with the MPC's decision to intervene in the market to mitigate excess short-term exchange rate volatility, the Bank traded in the interbank foreign exchange market eighteen times in H1/2020. It bought foreign currency for 9.1 b.kr. and sold it for 22.9 b.kr. The Bank's transactions accounted for about 18% of total foreign exchange market turnover during the period.

Inflation measured 2.6% in June and has risen since the MPC submitted its last report to Parliament, when it measured 2%. It has therefore been close to the Central Bank's target or below it since November 2019. Twelve-month inflation excluding housing has also risen year-to-date, measuring 2.7% in June. Inflation excluding housing is therefore higher than inflation including housing for the first time in about seven years. Underlying inflation was even higher, measuring 3.6% in terms of the average of various measures in June. This is partly because this metric excludes the decline in petrol prices and the impact of lower real mortgage interest expense.

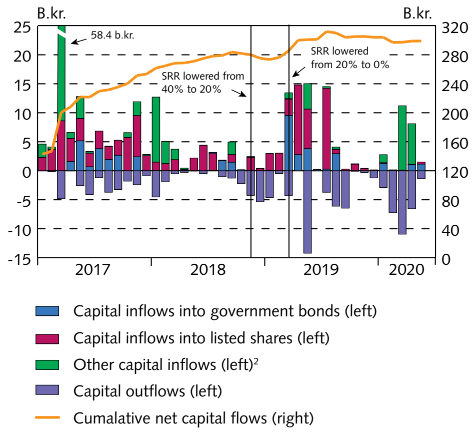
Imported goods prices have risen somewhat following the depreciation of the króna — imported food, furniture, housewares, and new motor vehicles in particular. Pulling in the opposite direction, however, is the marked decline in global oil prices after the pandemic set in. By June, domestic petrol prices had fallen by almost 10% since the turn of the year.

The contribution to inflation of the rise in the housing component was about the same in H1/2020 as it was in H2/2019. The twelve-month rise in imputed rent, which represents the cost of owner-occupied housing and consists of the market value of housing plus

Chart 4

Capital flows due to registered new investments[1]

January 2017 - May 2020

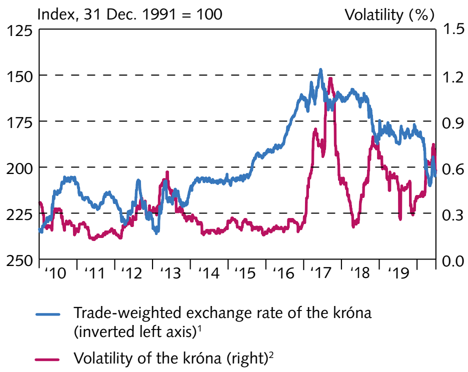


1. Investment commencing after 31 October 2009 and based on new inflows of foreign currency that is converted to domestic currency at a financial instititution in Iceland. 2. Other inflows in March 2017 derive almost entirely from non-residents' acquisition of a holding in a domestic commercial bank.
Source: Central Bank of Iceland.

Chart 5

Exchange rate and volatility of the króna

4 January 2010 - 30 June 2020

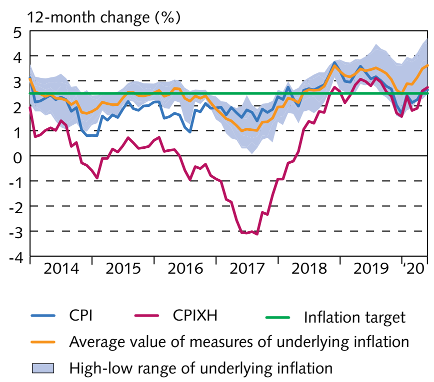


1. Price of foreign currency in terms of the króna. Inverted axis shows a stronger króna as a rise. 2. Volatility is measured by the standard deviation of daily changes in the past 3 months.
Source: Central Bank of Iceland.

Chart 6

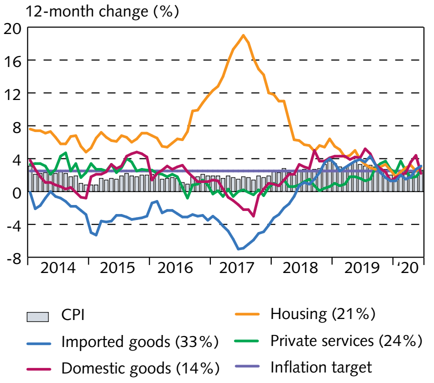
Headline and underlying inflation[1]

January 2014 - June 2020



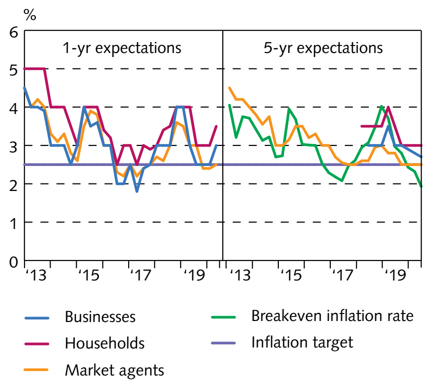
1. Underlying inflation measured using a core index (which excludes the effects of indirect taxes, volatile food items, petrol, public services, and real mortgage interest expense) and statistical measures (weighted median, trimmed mean, a dynamic factor model, and a common component of the CPI).
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 7
Imported and domestic inflation[1]
January 2014 - June 2020



1. Imported inflation is estimated using imported food and beverages and the price of new motor vehicles and spare parts, petrol, and other imported goods. The figures in parentheses show the current weight of these items in the CPI.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 8
Inflation expectations
Q1/2013 - Q2/2020



Sources: Gallup, Central Bank of Iceland.

real mortgage interest expense, measured 2.8% in June, as compared with 2.3% in December. The interest component of imputed rent has lowered inflation recently, as real mortgage interest expense has fallen in response to Central Bank rate cuts. Because of this, twelve-month inflation was an estimated 0.6 percentage points lower than it would have been otherwise.

Inflation averaged 2.5% in Q2/2020, as opposed to the 2.4% assumed in the Central Bank's baseline forecast, published in *Monetary Bulletin* on 20 May. Because of the depreciation of the króna, inflation will be somewhat higher in coming months than was forecast in February, but it is expected to be close to the target through the end of 2020. As the year progresses, however, the impact of the sizeable slack that has opened up in the economy will carry the day, and inflation is therefore projected to fall to 1½% by mid-2021 and remain below 2% in the second half of the forecast horizon.

In spite of the uncertainty caused by the COVID-19 pandemic in H1/2020, one-year inflation expectations have risen only slightly, and long-term expectations are unchanged since before the pandemic struck, according to recent surveys. Market agents' one-year inflation expectations were still at target in the May survey, while households' and corporate executives' expectations were 3-3.5%, according to Gallup's summer surveys. Market agents' long-term inflation expectations according to surveys and bond pricing are also still at target, whereas long-term corporate and household expectations are around 2.7-3%. At the end of June 2020, the five- and ten-year breakeven inflation rate measured 2.1-2.4%, similar to what it was at the end of December 2019.

At its May meeting, the MPC was of the opinion that more firmly anchored inflation expectations provided monetary policy the scope to respond decisively to the deteriorating economic outlook. Committee members were of the opinion that lower interest rates and other measures taken by the Bank would support the economic recovery and promote a faster recovery than would otherwise occur. In addition, fiscal policy measures had pulled in the same direction. The MPC monitors economic developments closely and will use the tools at its disposal to support the domestic economy and ensure that the more accommodative monetary stance is transmitted normally to households and businesses.

Accompanying documents

The following documents are enclosed with this report:

1. Monetary Policy Committee statements from January to June 2020.
2. Minutes of Monetary Policy Committee meetings from January through June 2020.[2]
3. Central Bank memorandum on minimum reserve requirements, 11 March 2020.
4. Presentation on recent monetary policy measures and economic

2. Minutes of the Monetary Policy Committee meeting in June will be published on the Central Bank's website on 8 July.

developments and prospects, 25 March 2020.

5. Chief Economist's speech at the presentation on recent monetary policy measures and economic developments and prospects, 25 March 2020.
6. Press release on reduction in supply of one-month term deposits with the Central Bank, 27 March 2020.
7. Press release on the special temporary Central Bank collateralised loan facilities for financial institutions, 17 April 2020.
8. Press release on the agreement between the Ministry of Finance and Economic Affairs and the Central Bank concerning Treasury guarantees of credit institutions' supplemental lending to businesses in response to the COVID-19 pandemic, 17 April 2020.
9. Press release on the Central Bank's Treasury bond purchases, 22 April 2020.
10. Press release on the agreement between credit institutions and the Central Bank concerning the granting of guarantees on bridge loans, 12 May 2020.
11. Speech given by the Deputy Governor for Monetary Policy on medium-term economic developments and prospects at a meeting of Samiðn, 4 June 2020.
12. Press release on the extension of the hiatus in pension funds' foreign currency purchases, 15 June 2020.
13. Press release concerning Central Bank purchases of Treasury bonds, 30 June 2020.
14. Macroeconomic policy measures in response to the COVID-19 pandemic. Box 2 in *Monetary Bulletin* 2020/2.
15. Joint declaration by the Government and the Central Bank on inflation targeting, March 2001.

On behalf of the Central Bank of Iceland Monetary Policy Committee,

Ásgeir Jónsson

Governor of the Central Bank of Iceland
and Chair of the Monetary Policy Committee

Accompanying documents

No. 4/2020
5 February 2020

Statement of the Monetary Policy Committee
5 February 2020

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 2.75%.

Leading indicators suggest that GDP growth was stronger in 2019 than previously assumed, while the outlook for 2020 and 2021 has deteriorated, according to the Bank's new macroeconomic forecast, published in the February *Monetary Bulletin.* According to the new forecast, GDP growth will measure only 0.8% this year, compared to 1.6% in the November forecast. The poorer outlook is due primarily to headwinds facing the export sector and tighter financing conditions for domestic firms.

Inflation declined rapidly over the course of 2019 and aligned with the target in Q4. It continued to fall in January, measuring 1.7%, the lowest observed inflation rate since autumn 2017. Underlying inflation has also fallen and is now at target, as are most measures of inflation expectations. According to the Bank's new forecast, inflation will be lower than was projected in November and below the target for most of the forecast horizon.

The monetary stance as measured in terms of the Bank's real rate has therefore tightened somewhat since the MPC's last meeting. The rise in corporate credit spreads has tightened the monetary stance even further.

Because inflation expectations are more firmly anchored to the target than before, monetary policy has had the scope to respond to the deteriorating economic outlook. The task of monetary policy is to secure medium-term price stability, but also to use the scope that it has to support a normal level of capacity utilisation.

Near-term monetary policy decisions will depend on the interaction between developments in economic activity, on the one hand, and inflation and inflation expectations, on the other.

No. 6/2020
11 March 2020

Statement of the Monetary Policy Committee
11 March 2020

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to lower the Bank's interest rates by 0.50 percentage points. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 2.25%.

Furthermore, the Committee has decided to lower deposit institutions' average reserve requirement from 1% to 0%. The fixed reserve requirement will remain unchanged at 1%. The reduction in the average reserve requirement and changes in the treatment of the fixed reserve requirement in liquidity rules will ease the banks' liquidity position and give them greater scope to respond to changed conditions in the domestic economy.

With these actions, the Bank is easing the monetary stance in view of the worsening economic outlook following the accelerated spread of the COVID-19 virus.

The MPC will continue to monitor economic developments and will use the tools at its disposal to support the domestic economy.

No. 7/2020
18 March 2020

Statement of the Monetary Policy Committee
18 March 2020

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to lower the Bank's interest rates by 0.50 percentage points. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 1.75%.

This action eases the monetary stance still further, in view of the continued deterioration in the economic outlook following the accelerated spread of COVID-19 and the broad-based actions taken by Iceland and other countries in an attempt to slow the spread of the virus.

The MPC will continue to monitor economic developments and will use the tools at its disposal to support the domestic economy.

No. 9/2020
23 March 2020

Statement of the Monetary Policy Committee
23 March 2020

The COVID-19 pandemic, the measures taken to hinder the spread of the disease, and the economic repercussions of the disease are expected to call for a significant increase in Treasury expenditures. As a result, the outlook is for the Treasury outcome to deteriorate this year and for the Treasury to need to acquire substantial credit financing through bond issuance. Other things being equal, this will reduce liquidity in circulation and push Treasury bond yields upwards, which disrupts normal monetary policy transmission at a time when the Central Bank's policy actions are aimed at easing households' and businesses' financial conditions.

The Monetary Policy Committee will do what is needed so that the more accommodative monetary stance is transmitted normally to households and businesses. The Committee therefore decided at an extraordinary meeting yesterday that it would begin direct purchases of Treasury bonds in the secondary market. Further information will be published at a later date.

No. 11/2020
8 April 2020

Statement of the Monetary Policy Committee
8 April 2020

In accordance with the recommendations of the Financial Stability Committee, the Monetary Policy Committee agreed at an extraordinary meeting held on 2 April that it is appropriate to establish special temporary credit facilities in the form of collateralised loans, with a temporary expansion of the list of securities eligible as collateral for Central Bank of Iceland facilities for financial institutions.

No. 16/2020
20 May 2020

Statement of the Monetary Policy Committee
20 May 2020

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to lower the Bank's interest rates by 0.75 percentage points. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 1%.

The Committee has also decided to stop offering one-month term deposits. This entails that the Bank's key rate will be more effective and the Bank's policy rate signal clearer. Other things being equal, this measure should increase liquidity in circulation and further strengthen monetary policy transmission.

According to the Bank's new macroeconomic forecast, published in the May issue of *Monetary Bulletin*, the outlook is for an 8% contraction in GDP in 2020. The predominant factor underlying this forecast is a more than 80% decline in tourist visits to Iceland. The outlook is for a steep rise in unemployment, which appears set to reach 12% in Q3 and measure just under 9% for the year as a whole. According to the Bank's forecast, economic activity will gradually normalise starting in H2/2020. GDP growth is forecast at nearly 5% in 2021. Uncertainty is unusually pronounced, however, and economic developments will depend on the path the pandemic takes and the progress made in unwinding the associated public health measures.

Inflation measured 2.2% in April and has been below the Bank's inflation target since December 2019. The króna has depreciated since the pandemic reached Iceland, but this is offset by a steep decline in oil prices, as well as a decline in food and commodity prices. Furthermore, inflation expectations are broadly unchanged, and they appear to be firmly anchored to the target. According to the Bank's forecast, inflation will rise marginally in coming months due to exchange rate pass-through from the depreciation of the króna. The increased slack in the economy will weigh heavier as 2020 progresses, however, and the outlook is for inflation to measure below 2% in the latter half of the forecast horizon.

More firmly anchored inflation expectations provide monetary policy the scope to respond decisively to the deteriorating economic outlook. Lower interest rates, together with other actions taken by the Bank, will support the economic recovery and contribute to a more rapid recovery than would otherwise occur. Fiscal policy measures have pulled in the same direction.

The MPC will continue to monitor economic developments and will use the tools at its disposal to support the domestic economy and ensure that the more accommodative monetary stance is transmitted normally to households and businesses.

No. 22/2020
24 June 2020

Joint statement of the Monetary Policy Committee and the Financial Stability Committee
24 June 2020

On 25 May 2020, the Central Bank of Iceland and the Ministry of Finance and Economic Affairs made an agreement under which the Bank will handle the granting of Treasury guarantees vis-à-vis credit institutions in connection with COVID-19-related support loans to business operators. Because of the uniqueness of support loans bearing a 100% Treasury guarantee and the circumstances currently prevailing due to the pandemic, the Monetary Policy Committee and the Financial Stability Committee have decided that the Central Bank will develop a special temporary collateralised lending framework for support loans, subject to the terms offered at any given time on seven-day term deposits with the Central Bank.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

February 2020 (90th meeting)

Published 19 February 2020

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each interest rate decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC meeting held on 3 and 4 February 2020, during which the Committee discussed economic and financial market developments, the interest rate decision of 5 February, and the communication of that decision.

I Economic and monetary developments

Before turning to the interest rate decision, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the 11 December 2019 interest rate decision, as published in the updated forecast in *Monetary Bulletin* 2020/1 on 5 February.

Financial markets

Since the December meeting, the króna had depreciated by 2.2% in trade-weighted terms. Over this same period it fell 2.3% against the euro, 2.5% against the US dollar, and 1.3% against the pound sterling.

In terms of the Central Bank's real rate, the monetary stance had tightened since the MPC's December meeting. The Bank's real rate in terms of the average of various measures of inflation and one-year inflation expectations had risen by just under 0.3 percentage points between meetings, to 0.7%. In terms of twelve-month inflation, it was 1.3% and had risen by 1 percentage point between meetings.

Interest rates in the interbank market for krónur were broadly unchanged since the December meeting, and there was no turnover in the market between meetings. Yields on long-term nominal Treasury bonds had fallen by 0.7 percentage points since the December meeting, and yields on long-term indexed Treasury and Housing Financing Fund (HFF) bonds had declined by 0.2 percentage points. Average rates on non-indexed mortgage loans had fallen slightly between meetings, whereas average rates on indexed mortgage loans were broadly unchanged.

In terms of three-month interbank rates, the interest rate differential with abroad was largely unchanged between meetings, at 4.1 percentage points against the euro and 1.9 percentage points against the US dollar. The long-term interest rate spread versus Germany had narrowed by 0.5 percentage points, however, to 3.6 percentage points, and the spread versus the US had narrowed by 0.4 percentage points, to 1.6 percentage points. Measures of the risk premium on the Treasury's foreign obligations had fallen marginally between meetings. The CDS spread on the Treasury's five-year US dollar obligations was 0.8%, and the spread between the Treasury's eurobonds and comparable bonds issued by Germany was 0.4-0.6 percentage points.

Financial institutions' analysts expected the MPC either to lower the Bank's interest rates by 0.25 percentage points or to hold them unchanged, noting that inflation had fallen more than previously anticipated and was now below the Bank's target, that inflation expectations had subsided, and that the monetary stance had therefore tightened between meetings. They also assumed that the Bank's new forecast would provide for a slower economic recovery than the November forecast had. Among the main arguments in favour of unchanged interest rates were signs of stronger-than-expected private consumption and increased uncertainty in the labour market.

Year-on-year growth in broad money (M3) was just over 4% in Q4, after adjusting for deposits held by the failed financial institutions. This is a weaker growth rate than in the past year. Although lending growth has eased in the recent term, the stock of credit system loans to domestic borrowers grew in nominal terms by an estimated 4½% year-on-year in Q4/2019, after adjusting for the effects of the Government's debt relief measures. Over the same period, household lending grew by just under 7% year-on-year and corporate lending by slightly over ½%, somewhat less than in recent quarters.

The Nasdaq OMXI10 index had fallen by 3.3% between meetings. Turnover in the Main Market totalled 603 b.kr. in 2019 as a whole, nearly 23% more than in 2018.

Global economy and external trade

According to the forecast published by the International Monetary Fund (IMF) in mid-January, the global GDP growth outlook has deteriorated slightly relative to the Fund's October forecast. Global output growth in 2019 is estimated at 2.9%, and the forecast for 2020 is 3.3%, which is 0.1 percentage points below the Fund's October forecast. The bleaker outlook is due for the most part to poorer prospects for some emerging market economies, India in particular. In spite of this, the IMF is of the view that uncertainty about the global economic outlook has receded since October and the risk of a further softening of GDP growth has eased. Uncertainty is still considerable, however, and remains concentrated on the downside.

Iceland's goods trade deficit totalled 10.7 b.kr. in December, about the same as in December 2018, at constant exchange rates. The deficit for 2019 as a whole amounted to 108 b.kr., some 78 b.kr. less than in 2018. The smaller deficit in 2019 was due partly to the exportation of aircraft early that year, although import values also contracted by 10.6%. The contraction in import values excluding ships and aircraft grew stronger in December. Import values have contracted by 19.8% year-on-year in the past three months, the largest contraction thus measured since

2009. All subcategories of imports contracted, with the strongest contraction in the import value of commodities, operational inputs, and petrol, although the import value of automobiles and consumer goods also declined. Export values contracted by 1.7% year-on-year in 2019. Excluding ships and aircraft, export values contracted by 5.4% between years, particularly as a result of reduced industrial product values. Marine product export values were flat between years, however, while agricultural goods export values rose 40%, largely due to aquaculture products.

Between MPC meetings, the listed global price of aluminium fell just over 5% and was 12.5% below the price seen at the beginning of February 2019. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products were up 7.9% year-on-year in 2019. Global oil prices had fallen by 16% since the December meeting, due to expectations of reduced demand following the outbreak of a new virus in China. At the time of the February meeting, the price of oil was down nearly 14% between years, to 54 US dollars per barrel.

The real exchange rate in terms of relative consumer prices rose by 0.6% month-on-month in December, when it was 10.5% above its 25-year average but 13.7% below its June 2017 peak. It fell by 6.7% year-on-year in 2019, as the nominal exchange rate of the króna fell by 7.9%, while inflation in Iceland was 1.4 percentage points above the trading partner average.

Domestic economy and inflation

According to the Statistics Iceland labour force survey (LFS), total hours worked increased by 1.2% year-on-year in Q4/2019. The rise in total hours is due to a 0.4% increase in the number of employed persons and a 0.8% lengthening of the average work week. Data from the pay-as-you-earn (PAYE) register give a different impression, however. According to PAYE data, job numbers began to decline between years in Q2/2019 and, by October, were down 1.8% year-on-year. According to seasonally adjusted LFS figures, the labour participation rate rose and the employment rate increased marginally between Q3 and Q4/2019. In 2019 as a whole, the participation rate fell by 0.6 percentage points year-on-year, however, and the employment rate fell by 1.3 percentage points over the same period.

Seasonally adjusted unemployment was unchanged between quarters, measuring 3.8% in Q4/2019. Registered unemployment rose by 0.4 percentage points over the same period, however, to a seasonally adjusted 4.1%. For 2019 as a whole, unemployment measured 3.6% on both scales, rising somewhat year-on-year in the wake of the shocks that struck the economy. It rose by 0.8 percentage points according to the LFS and 1.2 percentage points according to the unemployment register.

In Q4/2019, year-on-year population growth measured 2%, including 1.4 percentage points due to immigration of foreign nationals. Growth in the foreign population is therefore still close to the level in the first half of 2017, the year that saw the largest single-year increase recorded to date. The number of active employees of employment agencies and foreign services firms has fallen, however. There were almost 950 such workers at the end of 2019, or about 300 fewer than at the end of Q3. This group is now at its smallest since mid-2016.

The general wage index rose by 0.3% month-on-month in December but had risen by 4.5% year-on-year, and real wages were 2.4% higher during the month than at the same time in 2018. The index rose by 4.9% between annual averages in 2019, and real wages grew by 1.8%.

Key indicators of private consumption in Q4/2019 suggest that it firmed up after a period of weaker growth in the previous year. For example, payment card turnover picked up during the quarter, and the decline in new motor vehicle registrations lost pace. The Gallup Consumer Confidence Index rose in January, to 94.9 points, after falling in the previous month. The index was also slightly higher year-on-year.

Statistics Iceland's nationwide house price index, published in late January, rose by 0.2% month-on-month when adjusted for seasonality, but rose 4% year-on-year. The capital area house price index, calculated by Registers Iceland, rose by 0.3% month-on-month in December, when adjusted for seasonality, and by 2.3% year-on-year. The number of purchase agreements registered nationwide fell by 3.4% year-on-year in 2019, while the number of contracts for new construction increased by 7.2% over the same period.

The consumer price index (CPI) rose by 0.11% month-on-month in December, lowering twelve-month inflation to 2%. Inflation continued to fall in January, when the CPI declined by 0.74% month-on-month, bringing the inflation rate to 1.7%, or 1 percentage point lower than at the time of the MPC's last meeting. This recent plunge in inflation was due in part to base effects, as inflation rose steeply a year ago. The CPI excluding the housing component had risen by 1.6% year-on-year in January. Underlying inflation had fallen more slowly, measuring 2.5% in January, according to the average of various measures.

The interest component of imputed rent has lowered inflation recently, as real mortgage interest expense has fallen in response to Central Bank rate cuts. Because of this, twelve-month inflation was an estimated 0.4 percentage points lower in January than it would have been otherwise.

Winter sales and lower owner-occupied housing costs were the main factors in the January price measurements. Owner-occupied housing costs have risen by 1.6% in the past twelve months. Various other subcomponents also declined in January, including airfares, health-related items, new motor vehicles, and telephone and internet services.

The Bank's most recent market expectations survey, conducted in January, suggests that, as in the October survey, market agents expect inflation to be at target in both one and two years' time. Market agents' long-term inflation expectations are also still at target. The breakeven inflation rate in the bond market has fallen in recent months, however. The five- and ten-year breakeven rate has averaged 2.1% in Q1 to date, or 0.3 percentage points lower than in Q4/2019.

According to the forecast published in *Monetary Bulletin* on 5 February 2020, the outlook is for somewhat lower inflation than was projected in November, owing to a more pronounced and persistent slack in the economy, as well as a more favourable initial position. Inflation is projected at 1.9% in H1/2020, some 0.5 percentage points less than in the previous forecast. It is expected to pick up again early in 2021 and measure 2.1% over the year as a whole, which is similar to the last forecast. It will therefore be below the target during the forecast horizon but then inch up to it towards the end of the period.

The global GDP growth outlook is broadly unchanged from the forecast in the November *Monetary Bulletin,* owing to the offsetting effects of growing concerns about the impact of the spread of a new virus originating in China versus the positive impact of the recent agreement reached by the US and China in partial resolution of their trade dispute. Terms of trade for goods and services are estimated to have deteriorated slightly more in 2019 than was forecast in November, owing mainly to a larger-than-expected increase in imported goods prices. The exchange rate of the króna was relatively stable in 2019, after having fallen in autumn 2018. In Q4/2019, it was about 0.5% lower than had been assumed in the November forecast. The Bank's baseline forecast assumes that the exchange rate index will average just under 183 points this year and that the króna will depreciate slightly in 2021. It is projected to be about 1½% weaker than in the November forecast by the end of the forecast horizon.

GDP growth slowed markedly in 2019, measuring only 0.2% for the first three quarters of the year. It outpaced the November forecast, however, which assumed a 0.1% contraction. Because of this, together with signs of stronger growth in private consumption and more favourable external trade in Q4, the GDP growth outlook for the year as a whole has improved since November. GDP is now projected to have grown by 0.6% in 2019 instead of contracting by 0.2%. The GDP growth outlook for 2020 and 2021 has deteriorated, however, owing to a poorer outlook for exports and the rise in corporate credit spreads in late 2019, which has led to a downward revision of the forecast for business investment. Year-2020 GDP growth is expected to measure only 0.8%, compared to 1.6% in the November forecast. Growth is expected to pick up in 2021, measuring about 2.5% in the next two years, somewhat below the November forecast.

Because of base effects and delays in public sector wage agreements, wages rose slightly less in 2019 than was projected in November. The wage agreements are now expected to be finalised before the end of Q1/2020, and this year's pay rises are therefore projected to be larger than was assumed in November. Productivity growth is expected to weaken this year and unit labour costs to rise more than was projected in November, or 5.4% instead of 4%. In 2021 and 2022, however, wage costs are expected to rise less than in the November forecast, or an average of 3¾% per year instead of 4%.

Unemployment has risen markedly in the past twelve months and is expected to rise further through this year, averaging just over 4% in 2020 and 2021. It will therefore be higher and take longer to subside than was projected in November. Thus the outlook is for the slack in the economy to persist longer than previously anticipated.

II The interest rate decision

The Governor discussed the new Act on the Central Bank of Iceland that entered into force at the turn of the year, noting that the new Deputy Governor for Financial Stability would begin work in March and would take a seat on the Monetary Policy Committee at that time.

MPC members discussed the monetary stance in view of economic developments and the fact that the Bank's real rate had risen slightly since the December meeting. They discussed whether the monetary stance was appropriate in view of the inflation outlook, as they had decided in December to keep interest rates unchanged because the inflation outlook and the monetary stance had been broadly unchanged between meetings.

The Committee discussed economic developments and prospects as outlined in the Bank's new macroeconomic forecast, published in *Monetary Bulletin* on 5 February. According to the forecast, leading indicators suggested that GDP growth had been somewhat stronger in 2019 than previously assumed, while the outlook for 2020 and 2021 had deteriorated. It was noted that according to the baseline forecast, year-2020 GDP growth was expected to measure only 0.8%, as compared to 1.6% in the November forecast. Committee members agreed that the poorer outlook was due primarily to headwinds facing the export sector and tighter financing conditions for domestic firms. It emerged in the discussion that the repercussions of the shocks that had struck the tourism, aluminium, and fishing sectors would apparently be both more severe and more persistent than previously anticipated. Although global economic uncertainty had receded since November, there were growing concerns about the impact of the spread of the new coronavirus originating in China.

The MPC discussed developments in inflation, which had declined rapidly over the course of 2019 and had aligned with the target in Q4. It continued to fall in January, measuring 1.7%, the lowest observed inflation rate since autumn 2017. Members noted as well that underlying inflation had also fallen and was now at target, as were most measures of inflation expectations. They mentioned that according to the Bank's new forecast, inflation would be lower than was projected in November and below the target for most of the forecast horizon, and they agreed that this was because the slack in the economy was expected to be more persistent than had been previously assumed. The MPC considered it positive that inflation expectations were at target by most measures.

Committee members observed that the monetary stance as measured in terms of the Bank's real rate had tightened somewhat since the last meeting. The Committee discussed in particular the causes of the rise in credit spreads on the commercial banks' new corporate loans, agreeing that the increase had tightened the monetary stance still further. It emerged in the discussion that the widening of credit spreads reflected, among other things, a revaluation by financial institutions of loan pricing and credit risk in the wake of recent changes in their operating environment and reductions in their profitability. At the same time, growth in credit system lending had continued to ease, particularly corporate lending, which could be attributed in part to changes in the supply of corporate loans due to the aforementioned factors, plus the changed economic situation. As a result, there was the possibility that expected returns on firms' activities could now be lower than before, owing to declining demand. The MPC considered it likely that credit spreads would have widened even if the Bank's key rate had not been lowered in the recent past, but that the policy rate cuts had mitigated the impact of the wider credit spreads on companies.

The Committee discussed two possibilities: keeping interest rates unchanged or lowering them by 0.25 percentage points. The main argument in favour of keeping interest rates unchanged was that despite the deterioration of the economic outlook, domestic costs were high, partly because of the past few years' steep wage rises, which had weakened export companies' competitiveness. The economic adjustment would therefore have to take place increasingly through the real economy, with cost-cutting and higher unemployment. A policy rate reduction in and of itself would not solve the cost problems in the economy; instead, a decline in the real exchange rate, among other things, would be needed. Under these conditions, the current interest rate should suffice to ensure medium-term price stability and full capacity utilisation, provided that domestic costs declined in the coming term. The domestic economy had been stronger than expected in 2019, and the slack was still relatively small. Furthermore, the outlook was for unit labour costs to rise somewhat in excess of the inflation target over the forecast horizon, and wage agreements with some public employees were still pending. Labour market unrest had also increased recently.

The main arguments in favour of lowering interest rates further were that the economic outlook had deteriorated and inflation looked set to be lower in coming years than had previously been assumed. Moreover, inflation was projected to be somewhat below the target for most of the forecast horizon. Because the monetary stance had tightened and firms' financial conditions had deteriorated, it was appropriate to ease the monetary stance. The fact that inflation expectations were at target by most measures enabled monetary policy to use the scope available to it.

In view of the discussion, the Governor proposed that the Bank’s interest rates be lowered by 0.25 percentage points. The Bank’s key rate (the seven-day term deposit rate) would be 2.75%, the current account rate 2.5%, the seven-day collateralised lending rate 3.5%, and the overnight lending rate 4.5%. Ásgeir Jónsson, Rannveig Sigurdardóttir, and Katrín Ólafsdóttir voted in favour of the proposal. Gylfi Zoëga voted against the Governor’s proposal, preferring to keep interest rates unchanged.

The MPC was of the view that because inflation expectations were anchored to the target more firmly than before, monetary policy had had the scope to respond to the deteriorating economic outlook. The task of monetary policy was to secure medium-term price stability, but also to use the scope that it had to support a normal level of capacity utilisation.

In the MPC’s view, near-term monetary policy decisions would depend on the interaction between developments in economic activity, on the one hand, and inflation and inflation expectations, on the other.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

The Chief Economist was in attendance for the entire meeting. In addition, a number of Bank staff members attended part of the meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 18 March 2020.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

March 2020 (91st meeting)

Published: 25 March 2020

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each interest rate decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC meeting held on 9 and 10 March 2020, during which the Committee discussed economic and financial market developments, decisions on the use of monetary policy instruments, and the communication of those decisions on 11 March. The Committee's scheduled March meeting was moved forward by one week from the previously decided date.

I Decisions on monetary policy instruments

The Committee discussed the situation that had developed with the accelerated spread of COVID-19 and the substantial uncertainty about the global and domestic economic outlook. The global economic outlook had deteriorated sharply, and financial markets had weakened in recent days. A number of different scenarios on the potential impact of the pandemic on tourism and GDP growth were presented at the meeting. It emerged in the discussion that the impact of the pandemic on tourism would probably be more severe in Iceland than in many other countries because of the sector's relative importance in Iceland. It was pointed out that the decline in oil prices would offset this to some extent and that on the whole, firms in Iceland were less dependent on global supply chains than firms in many other economies. The choice of fiscal measures adopted in an attempt to support households and businesses was also important. It emerged at the meeting that uncertainty was at an unusually high level and that the situation was changing rapidly day by day; therefore, it was possible that the outlook could worsen even more than the presented scenarios indicated. The situation in the domestic aluminium market was discussed as well, and in this context, the potential economic impact of the closure of the Rio Tinto aluminium smelter in Straumsvík.

Committee members also discussed the position of the commercial banks in view of the imminent tightening of households' and businesses' financial situation, and the key risks in connection with the spread of the virus. It emerged in the discussion that the impact had not yet surfaced in the form of loan losses but that corporate lending growth had continued to contract, with a 0.8% year-on-year contraction in January. MPC members noted that the banks had built up a strong capital position in recent years and were well positioned to respond to loan losses, but that it was important to ensure that they would have enough liquidity to support households and businesses experiencing liquidity problems due to COVID-19.

The Committee discussed foreign exchange market intervention, as the Bank had intervened in the market twice after the króna began to depreciate further at the beginning of March. It emerged in the discussion that some depreciation would be unavoidable under the current circumstances. The Committee's intervention policy would continue to focus on mitigating excessive foreign exchange market volatility, as it had in the past. It was pointed out that a lower exchange rate could help some export sectors at present, as domestic costs were relatively high. On the other hand, it would give cause for concern if the depreciation led to a steep and persistent rise in inflation and a rise in long-term inflation expectations.

The MPC discussed the recently published national accounts, according to which output growth measured 1.9% in 2019. Committee members noted that this was stronger growth than the Bank had forecast in February. They noted as well that this increased growth was due in part to base effects, as year-2018 GDP growth figures had been revised downwards. Also, the contribution of residential investment and public consumption to GDP was stronger than previously assumed. To some extent, however, growth in residential investment is considered to reflect lags in registration of new construction rather than a strong surge in construction activity.

The MPC discussed possible adjustments to minimum reserve requirements, as both the prudential role and the liquidity management role of reserve requirements have weakened in importance in recent years, in light of changed conditions and the introduction of new macroprudential tools. Conditions had therefore developed that allowed for a reduction in reserve requirements without significant opportunity costs, as was discussed in greater detail in a Central Bank memorandum on reserve requirements that was presented to Committee members. It emerged in the discussion that lowering minimum reserve requirements would increase the commercial banks' liquidity coverage ratios and could therefore give them greater scope to respond to the current situation. The MPC also noted that it would be inadvisable for the commercial banks to use the increased scope for dividend payments.

In view of the discussion, the Governor proposed that deposit institutions' average reserve maintenance requirement be lowered from 1% to 0% and that the fixed reserve requirement be held unchanged at 1%. All Committee members voted in favour of the proposal. The Governor also stated that, based on the authorisation provided for in liquidity rules, the Bank would designate deposits held in fixed reserve accounts with the Central Bank by entities subject to reserve requirements as high-quality liquid assets. The fixed reserve requirement could thereby be considered a liquidity buffer according to liquidity rules. The Committee agreed that the reduction in the average reserve requirement and changes in the treatment of the fixed reserve requirement in liquidity rules would ease the banks' liquidity position and give them greater scope to respond to changed conditions in the domestic economy.

The Governor also proposed that the Bank's interest rates be lowered by 0.5 percentage points. The Bank's key rate (the seven-day term deposit rate) would be 2.25%, the current account rate 2%, the seven-day collateralised lending rate 3%, and the overnight lending rate 4%. All Committee members voted in favour of the proposal.

The Committee agreed that with these actions, the Bank was easing the monetary stance in view of the worsening economic outlook following the accelerated spread of the COVID-19 virus. It was stated at the meeting that the MPC would continue to monitor economic developments closely and would use the tools at its disposal to support the domestic economy.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gunnar Jakobsson, Deputy Governor for Financial Stability

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

Chief Economist Thórarinn G. Pétursson was in attendance for the entire meeting. In addition, a number of Bank staff members attended part of the meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next scheduled Statement of the Monetary Policy Committee will be published on Wednesday 20 May 2020.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

Extraordinary meeting in March 2020 (92nd meeting)

Published 1 April 2020

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each interest rate decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC's extraordinary meeting held on 17 March 2020, during which the Committee discussed economic and financial market developments, decisions on the application of the Bank's monetary policy instruments, and the communication of those decisions on 18 March. In addition, the Committee's new rules of procedure were approved at the meeting.

I Decisions on the Bank's monetary policy instruments

The Committee discussed developments since its last meeting, with the spread of COVID-19 accelerating even further, both in Iceland and abroad. They discussed the impact of the authorities' measures to slow the further spread of the disease, including the impact of worldwide border closures on tourism and transport. It was pointed out that both the recently implemented ban on gatherings and self-quarantine among Icelanders would reduce domestic demand significantly. The Committee discussed different scenarios illustrating the pandemic's possible impact on GDP growth, noting that Iceland was highly likely to see an economic contraction in 2020. It emerged in the discussion that marine product exports were also affected, both by a drop in demand, particularly for fresh products, and by disruptions in product distribution in export markets. It was pointed out that households' and businesses' financial conditions had deteriorated and that there were signs that interest premia on corporate loans had risen, offsetting declining real rates. Both future developments and the repercussions of the pandemic were still highly uncertain, and the situation was changing rapidly day by day.

The MPC discussed the foreign exchange market situation, as the króna had depreciated since the last meeting and the Bank had intervened in the market three times. Members considered the intervention to have been successful in mitigating excess volatility in the market. It was noted in the discussion that a depreciation of the króna was part of a necessary adjustment of the real exchange rate to the current circumstances. However, it would give cause for concern if the depreciation should prove excessive and lead to a persistent increase in inflation and a rise in long-term inflation expectations. It was pointed out that the recent decline in oil and commodity prices would, to some extent, pull in the other direction. It emerged at the meeting that, after meeting with the Governor to discuss the current economic uncertainty, the Icelandic Pension Funds Association had issued a unilateral statement strongly encouraging pension funds to refrain from purchasing foreign currency for the next three months. The MPC agreed that with this action, the pension funds had taken a responsible position for the good of the economy.

The Committee discussed the commercial banks' situation, noting that their position was sound because of the strong capital and liquidity positions they had built up in recent years. Members agreed on the importance of ensuring that the banks had enough liquidity to support households and businesses. It was pointed out that recent actions by the Central Bank – including lifting the countercyclical capital buffer, easing minimum reserve requirements, and lowering interest rates – should give the commercial banks scope to grant grace periods and to restructure their loan portfolios. Members agreed that it was very important that financial institutions not use that scope to pay out dividends.

The Governor proposed that the Bank's interest rates be lowered by 0.5 percentage points. The Bank's key rate (the seven-day term deposit rate) would be 1.75%, the current account rate 1.5%, the seven-day collateralised lending rate 2.5%, and the overnight lending rate 3.5%. All Committee members voted in favour of the proposal.

The Committee agreed that this action would ease the monetary stance still further, in view of the continued deterioration in the economic outlook following the accelerated spread of COVID-19 and the broad-based actions taken by Iceland and other countries in an attempt to slow the spread of the virus. It was stated at the meeting that the MPC would continue to monitor economic developments closely and would use the tools at its disposal to support the domestic economy.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gunnar Jakobsson, Deputy Governor for Financial Stability

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

Chief Economist Thórarinn G. Pétursson was in attendance for the entire meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next scheduled Statement of the Monetary Policy Committee will be published on Wednesday 20 May 2020.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

Extraordinary meeting in March 2020 (93rd meeting)

Published 6 April 2020

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC's extraordinary meeting held on 22 and 23 March 2020, during which the Committee discussed economic and financial market developments, decisions on the application of the Bank's monetary policy instruments, and the communication of those decisions on 25 March.

I Decisions on the Bank's monetary policy instruments

The Committee discussed the outlook relating to COVID-19, noting that the pandemic, measures taken to hinder the spread of the disease, and the economic repercussions of the disease are expected to call for a significant increase in Treasury expenditures, in view of the measures announced by the Government. In addition, deferred payment of various public levies would further increase the Treasury's financing need. The Committee noted that the outlook was for the Treasury outcome to deteriorate this year and for the Treasury to need to acquire substantial credit financing through bond issuance. Members were quite concerned that, other things being equal, this would reduce liquidity in circulation and push Treasury bond yields upwards, which would disrupt normal monetary policy transmission at a time when the Central Bank's policy actions were aimed at easing households' and businesses' financial conditions.

Committee members discussed the possibility that the Bank would begin a programme of quantitative easing; i.e., direct purchases of Treasury bonds in the secondary market. It emerged in the discussion that yields on longer bonds had risen in recent days and that the slope of the yield curve had turned somewhat upwards. The MPC noted that, with quantitative easing, it would be possible to have a direct effect further out the yield curve. In this way, it would be possible to prevent a rise in long-term yields in the wake of increased Treasury bond issuance, as such a rise would undermine the Committee's monetary easing objectives. It was noted in the discussion that the Bank's objective in purchasing Treasury bonds was to ensure the transmission of monetary policy in the market, so that households and businesses could benefit from lower long-term interest rates while economic conditions were unfavourable. It emerged at the meeting that it could be useful to activate such a policy instrument, which could also be used for other purposes later; for instance, to sterilise foreign exchange market intervention or to affect the money supply. Members also discussed the possible disadvantages of using this tool; for instance, the increased money supply could push inflation higher than it would be otherwise. On the other hand, the Committee considered the inflationary risk limited under the current circumstances, with the significant slack in the economy and an ongoing contraction in lending and money supply.

In view of the discussion, the Governor proposed that the Bank begin direct purchases of Treasury bonds in the secondary market. All members voted in favour of the proposal and agreed to publish an announcement to this effect before the markets opened on 23 March. It emerged in the discussion that the MPC would do what was needed to ensure that the more accommodative monetary stance would be transmitted normally to households and businesses.

The Committee discussed the framework for quantitative easing in greater detail, and the Governor proposed thereafter that the Bank be authorised to purchase Treasury bonds for up to 150 b.kr., or about 5% of GDP. All members voted in favour of the proposal. The Central Bank would publish further information on the quantitative easing framework at a later date.

At the meeting, two scenarios illustrating the potential impact of the pandemic on unemployment, private consumption, GDP growth, and inflation were presented. It emerged that the situation was highly uncertain and that forecasting the most likely economic developments was difficult. Nevertheless, it was clear that the outlook was for a contraction in 2020, which could range from 2½-5%, according to the two scenarios. It was noted that work on the scenarios would continue, and it was considered likely that this work would reveal a larger contraction than was indicated in the scenarios as presented at the meeting. The MPC also considered that the inflation outlook for 2020 was relatively unchanged despite the current economic turbulence. It emerged at the meeting that this was due to a number of offsetting factors: exchange rate pass-through pushing inflation upwards, on the one hand; and lower global commodity and oil prices, lower global inflation, and the prospect of a sizeable slack in the domestic economy pushing it downwards, on the other.

Members also discussed the possibility of applying other monetary policy instruments but agreed to wait and see what impact the measures already decided would have, and how the economy would develop in the near future. The MPC would continue to monitor developments closely and would use the tools at its disposal to support the domestic economy.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gunnar Jakobsson, Deputy Governor for Financial Stability

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

Chief Economist Thórarinn G. Pétursson was present for the entire meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next scheduled Statement of the Monetary Policy Committee will be published on Wednesday 20 May 2020.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

Extraordinary meeting in April 2020 (94th meeting)

Published 22 April 2020

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC's extraordinary meeting held on 2 April 2020, during which the Committee discussed economic and financial market developments, and decisions on the application of the Bank's monetary policy instruments.

I Decisions on the Bank's monetary policy instruments

The Committee discussed economic developments since its previous meeting and the impact of Government measures to curb the spread of COVID-19. Members also discussed new scenarios describing the potential impact of the pandemic on unemployment, private consumption, GDP growth, and inflation, and they agreed that the outlook for 2020 had deteriorated since the previous two scenarios were presented in late March. The MPC noted that the global economic outlook had deteriorated further, as the pandemic had continued to spread around the world and governments had adopted stringent measures in response to it. The domestic inflation outlook for 2020 was relatively unchanged under the new scenarios, despite the current economic turmoil, as plunging commodity and oil prices, lower global inflation, and the prospect of a significant slack in the domestic economy could offset the inflationary impact of the depreciation of the króna. In the MPC's opinion, however, developments would depend on keeping inflation expectations firmly anchored and securing long-term inflation expectations at the target.

Committee members also discussed different scenarios for potential developments in the balance of payments following the crisis. They discussed the foreign exchange market as well, as the Bank had intervened in the market once since the MPC's last meeting. It was noted in the discussion that the depreciation of the króna in recent weeks was part of a necessary adjustment of the real exchange rate to the current circumstances.

The Governor updated the Committee on the status of the ongoing work on a framework for the quantitative easing programme announced on 23 March and said that proposals would be presented to the Committee when they were ready. The MPC also discussed changes in the supply of one-month term deposits and the potential impact on the monetary stance. Members decided to discuss the execution and impact of such changes at a later date.

The Governor requested the Committee's approval of the Bank's establishment of a special temporary collateralised lending facility, with a temporary expansion of the list of collateral deemed eligible for Central Bank facilities for financial institutions. All members approved the measure.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gunnar Jakobsson, Deputy Governor for Financial Stability

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

Chief Economist Thórarinn G. Pétursson was present for the entire meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next scheduled Statement of the Monetary Policy Committee will be published on Wednesday 20 May 2020.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

May 2020 (95th meeting)

Published 3 June 2020

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC meeting held on 18 and 19 May 2020, during which the Committee discussed economic and financial market developments, decisions on the application of the Bank's monetary policy instruments, and the communication of those decisions on 20 May.

I Economic and monetary developments

Before discussing decisions on the application of the Bank's monetary policy instruments, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the Committee's last meeting, held on 2 April 2020, as published in the new forecast and analysis of uncertainties in *Monetary Bulletin* 2020/2 on 20 May.

Financial markets

The króna had depreciated by 1% in trade-weighted terms since the April meeting, and by 10% since the end of February. Between meetings, it fell 1.1% against the pound sterling, 0.5% against the US dollar, and 0.8% against the euro. Over the same period, the Bank sold foreign currency for just under 46 million euros (7.2 b.kr.). The Bank's transactions accounted for roughly 30% of total turnover in the foreign exchange market.

In terms of the Bank's real rate, the monetary stance was virtually unchanged since the early April meeting. The Bank's real rate in terms of the average of various measures of inflation and one-year inflation expectations was -0.6%, and in terms of current twelve-month inflation it was -0.4%. On the other hand, the Bank's real rate had fallen year-to-date by 1.2 percentage points in terms of various measures and by 1.4 percentage points in terms of current twelve-month inflation.

Interest rates in the interbank market for krónur were virtually unchanged between meetings, and there was no turnover in the market during that period. Yields on long-term nominal Treasury bonds had fallen by 0.4 percentage points since the April meeting, and yields on long-term indexed Treasury bonds had fallen by up to 0.3 percentage points. Average rates on non-indexed mortgage loans had fallen between meetings, and average rates on indexed mortgage loans had also fallen slightly.

In terms of three-month interbank rates, the interest rate differential had narrowed against the euro by 0.3 percentage points between meetings, to 2.5 percentage points, but had widened by 0.8 percentage points against the US dollar, to 1.9 percentage points. The long-term interest rate spread versus Germany had narrowed by 0.2 percentage points, to 3 percentage points, and the spread versus the US had narrowed by 0.3 percentage points, to 1.8 percentage points. Risk premia on the Treasury's foreign obligations had risen between MPC meetings. The CDS spread on the Treasury's five-year US dollar obligations was unchanged at 0.8%, and the spread between the Treasury's eurobonds and comparable bonds issued by Germany had widened to 0.3-1.2 percentage points.

Financial institutions' analysts expected a policy rate cut ranging from 0.25 percentage points to 1 percentage point, citing the prospect of a severe economic contraction, increased unemployment, and a contraction in both private consumption and investment. Because inflation and inflation expectations had been stable at the Bank's target, analysts considered it appropriate to use the existing scope to lower interest rates further in order to support the economy.

According to the Central Bank's quarterly market expectations survey, conducted in early May, respondents expected the Bank's key rate to be lowered by 0.5 percentage points in Q2/2020, to 1.25%, followed by another rate cut of 0.25 percentage points in the latter half of the year. This is a significant change from the January survey, when participants expected interest rates to be 2.75% this year. In the survey, 11% of respondents considered the monetary stance too loose at present, whereas in the previous survey, 4% were of that opinion. About 19% of respondents considered the monetary stance appropriate, as compared with 35% in the last survey. The share that considered the monetary stance too tight or far too tight was about 71%, up from 61% in the January survey.

Annual growth in broad money (M3) has gained pace in the past half-year, measuring about 9½% in March, after adjusting for deposits held by the failed financial institutions. The main cause of the more rapid growth in the past three months is an increase in financial sector deposits; i.e., those held by other credit institutions, pension funds, and money market funds. Although lending growth has eased since the beginning of 2019, the stock of credit system loans to domestic borrowers grew in nominal terms by an estimated 5% year-on-year in March, after adjusting for the effects of the Government's debt relief measures. Over the same period, household lending grew by just under 7% year-on-year. Corporate lending grew by 1½% but contracted by just over ½% at constant exchange rates.

The Nasdaq OMXI10 index had risen by 14.2% between meetings but had fallen by 7% since the beginning of the year. Turnover in the Main Market totalled 241 b.kr. in the first four months of 2020, some 13% more than over the same period in 2019.

Global economy and external trade

According to the forecast published by the International Monetary Fund (IMF) in early April, the global economic outlook has deteriorated sharply due to the COVID-19 pandemic. The IMF expects the global economy to shrink by 3% in 2020, whereas in January it projected 3.3% growth for the year. Advanced economies are forecast to shrink by 6.1% and emerging economies by 1%. The IMF forecast assumes that the pandemic will peak in Q2 and then begin to subside. As it tapers off, public health measures adopted worldwide to curb the spread of the disease will be phased out gradually. According to this, the Fund assumes that global GDP growth will rebound to 5.8% in 2021. Uncertainty about global economic developments is unusually pronounced at present, however, and depends on how persistent the pandemic proves to be. Many economies are dealing with various other pandemic-related shocks as well, including large-scale capital outflows and a steep drop in commodity prices. As a result, the Fund considers the risk to its macroeconomic forecast to be concentrated on the downside.

The listed global price of aluminium had held broadly unchanged since the MPC’s early April meeting. It was therefore still nearly one-fifth lower than at the beginning of 2020 and in May 2019. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products were up 6% year-on-year in Q1/2020. Global Brent crude prices had risen 16% since the MPC’s April meeting, to just under 35 US dollars per barrel at the time of the May meeting, Even so, oil prices were still about half of what they were at the beginning of 2020 and in May 2019. In particular, the decline reflects falling worldwide demand for oil, which in turn reflects measures taken by governments around the world to slow the spread of COVID-19, although reduced production in leading oil manufacturing countries pulls in the other direction.

The real exchange rate in terms of relative consumer prices fell by 5.4% month-on-month in April, when it was 2.9% below its 25-year average and 12% below its end-2019 level. In the first four months of 2020, it was down by 5.2% compared with the same period in 2019, as the nominal exchange rate of the króna was 6.3% lower and inflation in Iceland was 0.9 percentage points above the trading partner average.

Domestic economy and inflation

According to the Statistics Iceland labour force survey, total hours worked declined by 1.4% year-on-year in Q1/2020. The decline in total hours stemmed from a 0.3% reduction in the number of employed persons and a 1% shortening of the average work week. The number of individuals on the pay-as-you-earn (PAYE) register fell by 2.1% year-on-year in January, however. In addition, the labour participation rate fell by 1.8 percentage points between years in Q1, and the employment rate fell even more, or by 2.3 percentage points over the same period.

Seasonally adjusted unemployment measured 3.9% in Q1/2020, after rising by 0.5 percentage points between quarters and 0.7 percentage points between years. The number of individuals on the Directorate of Labour’s (DoL) unemployment register rose more quickly, measuring just over 17.8% of the labour force in April. In this context, however, it should be noted that the DoL classifies recipients of part-time benefits as unemployed even though they still have jobs. If this group is excluded, the unemployment rate rose from 5% at the beginning of the year to 7.5% in April.

Iceland's foreign labour force continued to grow in Q1/2020. Year-on-year population growth measured 2% during the quarter, including 1.4 percentage points due to immigration of foreign nationals.

The wage index rose by 1.1% between quarters in Q1, and by 4.9% year-on-year, and real wages in terms of the index were 2.8% higher in Q1/2020 than at the same time last year.

Early in Q1, key indicators of private consumption had developed broadly the same as in H2/2019. The situation changed dramatically in March, however, when COVID-19 began to spread in Iceland and the authorities introduced broad-based public health measures that affected a large share of households' consumption spending. Payment card turnover contracted year-on-year in March, and even more in April. Daily card turnover figures indicate, however, that use of domestic cards in Iceland picked up again in the first half of May and was only slightly less than at the same time in 2019. The contraction in new motor vehicles deepened markedly in April.

The Consumer Confidence Index rose by over 17 points between months, to 61.5 in May. This increase comes in the wake of a steep decline in recent months, with April showing the lowest index level since October 2010. The index was 34.5 points lower in May than in the same month of 2019. All subindices rose month-on-month apart from the assessment of the current situation.

Statistics Iceland's nationwide house price index, published in late April, rose by 0.7% month-on-month when adjusted for seasonality, and by 6.3% year-on-year. The capital area house price index, calculated by Registers Iceland, rose by 0.3% month-on-month in March when adjusted for seasonality, and by 3.6% year-on-year. The number of purchase agreements registered nationwide fell by 6.2% year-on-year in the first three months of 2020, while the number of contracts for new construction increased by 39.2% over the same period.

The CPI rose by 0.48% month-on-month in April, and twelve-month inflation increased to 2.2%. The CPI excluding the housing component had risen by 1.9% year-on-year in April. Underlying inflation has risen somewhat in recent months, however, measuring 3.1% in April, in terms of the average of various measures. This is partly because these measures exclude the decline in petrol prices and the impact of lower real mortgage interest expense. The interest component of imputed rent has lowered inflation in the past year, causing twelve-month inflation to be lower by an estimated 0.5 percentage points.

To an extent, the impact of the recent weakening of the króna surfaced in April, in higher prices of food, furniture, electronics, and new motor vehicles. Among the items pulling in the opposite direction were petrol prices, which had fallen by 7.5% year-to-date and had lowered the CPI by 0.25 percentage points over that period.

According to the Bank's most recent survey, market agents expect inflation to be at target in the next few years. Market expectations are therefore broadly unchanged despite the recent depreciation of the króna. Surveys of corporate and household expectations sketch out a similar picture. The breakeven inflation rate in the bond market has fallen in recent months. The five- and ten-year breakeven rate has averaged 1.8% in Q2 to date, or 0.3 percentage points lower than in Q1/2020.

According to the forecast published in *Monetary Bulletin* on 20 May, the recent depreciation of the króna will cause inflation to be somewhat higher in coming months than was forecast in

February, although it is still expected to be at or below the Bank's target. Offsetting the lower exchange rate are the plunge in global oil prices and an overall decline in global food and commodity prices, although shortages and various types of production problems have pushed some goods prices upwards. As 2020 progresses, however, the impact of the sizeable slack that has opened up in the economy will carry the day, and inflation is therefore expected to be below 2% in the latter half of the forecast horizon.

The króna began to depreciate in late February, after the pandemic spread to Iceland, and by the time *Monetary Bulletin* was published it had fallen 12%. The baseline forecast is based on the assumption that the trade-weighted exchange rate index will remain broadly unchanged throughout the forecast horizon. If this assumption is borne out, the real exchange rate in 2020 will be relatively close to the level seen in H2/2015, when the tourism boom had just begun.

The global economic outlook changed abruptly when COVID-19 began to spread, and there is significant uncertainty about when economic activity will return to near-normal. Future developments will depend not least on how the pandemic is finally quelled. The forecast in *Monetary Bulletin* assumes that the contraction among Iceland's main trading partners will measure 6.4% this year, followed by a rebound to 5% GDP growth in 2021. The changed outlook and increased uncertainty have put global financial markets into a tailspin.

In Iceland, as in other countries, the economic outlook has changed radically. According to the baseline forecast, a contraction of 8% is expected in Iceland, instead of just under 1% growth, as was forecast in February. If this forecast materialises, it will be Iceland's largest single-year contraction in a century. A major factor in this is the prospect of a more than 80% year-on-year decline in tourist visits in 2020. Exports as a whole will therefore contract by nearly one-third, the largest single-year contraction in the history of Iceland's national accounts. Furthermore, domestic demand is expected to contract by nearly 4%, mainly as a result of the direct impact of pandemic-related public health measures on a significant part of private consumption. Economic activity is expected to normalise gradually in H2, but tourist visits are not expected to resume to any significant degree until 2021. Because of this year's deep economic contraction and the resulting slack in the economy, the outlook for 2021 is for robust GDP growth of about 4.8%. In spite of a strong recovery, GDP is projected to be some 6% lower at the end of the forecast horizon than it would have been without the pandemic and associated measures.

The current account surplus will be affected by the steep decline in exports, but imports are also expected to contract alongside the slowdown in economic activity. This, together with an improvement in terms of trade stemming mainly from lower oil prices, will prevent a further deterioration in the surplus on goods and services trade, which is expected to measure 1½% of GDP this year. The current account surplus is set to shrink even further, as the primary income flips from a surplus to a deficit, owing to a weaker operating performance from Icelandic-owned foreign companies.

The impact on the labour market is colossal. Unemployment is expected to peak at around 12% in Q3/2020 and average just under 9% for the year as a whole, the highest unemployment rate since measurements were introduced.

Disruption such as that caused by shocks like the pandemic make it unusually difficult to estimate normal capacity utilisation. It is likely, though, that departures of foreign workers and increased long-term unemployment due to the pandemic will cause growth in potential output to slow markedly this year. Nevertheless, a sizeable slack in output will open up this year because of the deep economic contraction that is forecast. The slack in output is estimated to measure about 6% of potential output this year. It is assumed to narrow somewhat in 2021 but remain open throughout the forecast horizon.

The baseline forecast assumes that economic activity will start to return gradually to normal in Q3/2020. This forecast could prove overly optimistic, however, if the pandemic turns out more persistent than is currently assumed. Two alternative scenarios are presented in *Monetary Bulletin*. In one of them, the public health measures imposed by the authorities will remain in place through much of the year, and uncertainty will be further exacerbated, triggering a larger rise in risk premia in the financial markets and greater caution among households as regards spending decisions. In this example, the economic contraction will measure just over 10% this year, and the recovery in 2021 will be weaker. The other alternative scenario assumes that the turnaround will be stronger, which could happen if the pandemic tapers off more quickly and tourism recovers more strongly. Reduced uncertainty and greater optimism about the economic outlook could provide an incentive for increased consumption and investment spending. In this example, the contraction in 2020 could measure just under 6% and the recovery in 2021 could turn out stronger.

II Decisions on the Bank's monetary policy instruments

The Governor updated the Committee on the work relating to the finalisation of agreements between the Central Bank and the commercial banks concerning the provision of supplemental bridge loans to businesses. The loans were intended for companies – primarily small and medium-sized enterprises – that were facing temporary operational difficulties as a result of the COVID-19 pandemic.

MPC members discussed the monetary stance in view of economic developments and the fact that the Bank's real rate was virtually unchanged since the early April meeting. They discussed whether the monetary stance was appropriate in view of the inflation outlook, as the Committee had decided to lower interest rates twice in March, in response to the deteriorating economic outlook following the spread of COVID-19.

The Committee discussed the execution of the Central Bank's quantitative easing (QE) programme, as the Bank had recently begun buying Treasury bonds in the secondary market pursuant to the MPC's decision to this effect. According to the announcement published by the Bank on 22 April, the bond purchases would be carried out either through submittal of bids to the Nasdaq Iceland trading system or by holding auctions, and that it had been decided to begin with the former method. Members emphasised that the objective of the purchases was to ensure monetary policy transmission across the yield curve, so that reductions in Central Bank interest rates were transmitted normally to households and businesses, as it was foreseeable that, all else being equal, the Treasury's increased borrowing need could reduce the amount of liquidity in circulation and push market yields upwards. The Committee agreed that the announcement regarding the purchases had been effective and had unwound the spike in yields that followed the Government's announcement of increased bond issuance. Since then, it appeared that there had been no further signs of pressure on bond yields. Therefore, the Committee considered it appropriate to begin slowly and buy relatively small amounts, while monitoring the impact of the purchases on the bond market and determining whether difficulties in monetary policy transmission should develop. It was also pointed out that attention should be paid to the interactions between the QE programme and other Central Bank measures. Furthermore, the near-term impact of the pandemic on the domestic economy and the Treasury's borrowing need was highly uncertain. It emerged at the meeting that the Bank had bought bonds for about 400 m.kr. in the first half of May, particularly short-term non-indexed Treasury bonds, and that developments in yields had not displayed any clear trend thereafter. MPC members agreed that the bond purchases should be aligned with economic developments, Treasury issuance, and the impact on the market, so as to ensure that the objective of the purchases was achieved.

The Committee discussed economic developments and prospects and, in this context, considered the Bank's new macroeconomic forecast, published in *Monetary Bulletin* on 20 May. According to the forecast, the outlook is for an 8% contraction in GDP in 2020, and the outlook has worsened since the MPC's previous meeting. The predominant factor underlying this forecast was a more than 80% decline in tourist visits to Iceland. Members also noted that the outlook was for a steep rise in unemployment, which appeared set to reach 12% in Q3 and measure just under 9% for the year as a whole. According to the Bank's forecast, economic activity would gradually normalise starting in H2/2020, with GDP growth projected at nearly 5% in 2021. The Committee emphasised, however, that uncertainty was unusually pronounced and that economic developments would depend on the path the pandemic took and the progress made in unwinding the associated public health measures.

The MPC discussed developments in inflation, which measured 2.2% in April and had been below the Bank's inflation target since December 2019. Members noted that the króna had depreciated since the pandemic reached Iceland, but that this was offset by the deflationary effect of the steep decline in oil prices and the decline in food and commodity prices. It emerged in the discussion, however, that the króna had appreciated slightly since the beginning of May, and that the foreign exchange market was relatively stable. Members also noted that inflation expectations were broadly unchanged and appeared to be firmly anchored to the target. It emerged at the meeting that, according to the Bank's forecast, inflation would rise marginally in coming months, due to exchange rate pass-through from the depreciation of the króna. The increased slack in the economy would weigh heavier as 2020 progressed, however, and the outlook was for inflation to measure below 2% in the latter half of the forecast horizon.

All members were of the opinion that it was appropriate to lower the Bank's interest rates still further. They agreed that the outlook for 2020 was for a sharp contraction in GDP and elevated unemployment, with below-target inflation during the forecast horizon. There was some discussion of the probable path the economic recovery would take, and it came to light that there was the risk of a fragile recovery, with protracted economic headwinds in the coming term. The MPC therefore considered it appropriate to lower interest rates significantly this time, as such a move could support the economy and expedite the recovery once the turnaround took hold. Concerns were expressed about how lower interest rates had not been transmitted effectively enough to businesses, and how the banking system had greater difficulty passing lower interest rates on to customers, as rate cuts had the effect of narrowing the banks' interest rate spreads still further. The viewpoint was expressed that if the króna should depreciate considerably more, it could weaken demand and activity levels in those sectors of the economy that are currently performing relatively well, and as a result, could cause labour market unrest. One Committee member therefore considered it appropriate that the Bank respond if significant pressure should reoccur in the foreign exchange market following the interest rate cut.

In view of the discussion, the Governor proposed that the Bank's interest rates be lowered by 0.75 percentage points. The Bank's key rate (the seven-day term deposit rate) would be 1%, the current account rate 0.75%, the seven-day collateralised lending rate 1.75%, and the overnight lending rate 2.75%. All Committee members voted in favour of the proposal.

The Committee also discussed the one-month term deposits offered by the Bank. They noted that when it was originally decided to offer these deposits, the aim had been to mop up excess liquidity and support the MPC's monetary tightening measures. The policy measure was supposed to remain in effect temporarily, while there was excess liquidity in the system, and to be used to sterilise a portion of the liquidity resulting from the Bank's large-scale foreign currency purchases at that time. Now, however, circumstances were different, and the monetary stance was being eased. As a result, the measure was no longer appropriate, although the possibility of it being reintroduced later could not be excluded. Ceasing to offer these deposits would entail even further monetary easing. It emerged that this would make the Bank's key rate more effective and its policy rate signal clearer, as well as supporting other measures taken by the Bank. In view of the discussion, the Governor proposed that the Bank stop offering one-month term deposits. All members voted in favour of the Governor's proposal, and the Committee agreed that, other things being equal, this measure should increase liquidity in circulation and further strengthen monetary policy transmission.

In the Committee's view, more firmly anchored inflation expectations provided monetary policy the scope to respond decisively to the deteriorating economic outlook. Furthermore, Committee members were of the opinion that lower interest rates, together with other actions taken by the Bank, would support the economic recovery and contribute to a more rapid recovery than would otherwise occur. In addition, fiscal policy measures had pulled in the same direction.

The MPC reiterated at the meeting that it would continue to monitor economic developments and would use the tools at its disposal to support the domestic economy and ensure that the more accommodative monetary stance was transmitted normally to households and businesses.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gunnar Jakobsson, Deputy Governor for Financial Stability

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

Chief Economist Thórarinn G. Pétursson was present for the entire meeting. In addition, a number of Bank staff members attended part of the meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next scheduled Statement of the Monetary Policy Committee will be published on Wednesday 26 August 2020.

11 March 2020

Minimum reserve requirements: their role and changes made to them

Minimum reserve requirements — i.e., the requirement that banks hold liquid assets amounting to a given proportion of their liabilities — have long been among central banks' policy instruments. Their role has changed as circumstances have changed (for instance, in the wake of the financial crisis), as new policy instruments have been introduced (including macroprudential tools), and as general understanding of the efficacy of monetary policy has grown. In most economies, reserve requirements now serve primarily to support monetary policy. This memorandum discusses the role of reserve requirements, their function at the Central Bank of Iceland, and the ways in which they serve that function today. This is followed by a discussion of the changes that have now been made to reserve requirements.

I The overall role of reserve requirements

Although reserve requirements play a multi-faceted role, their main function falls into three categories.[1] First, reserve requirements can play a role in liquidity management and can facilitate more effective monetary policy transmission; second, they can serve as a prudential tool in guaranteeing that banks hold a specified proportion of safe liquid assets; and third, they can be applied in support of monetary policy.

Prudential role

Liquidity can dry up when there are runs on banks and when capital flows out of the country — two occurrences that often coincide in small open economies. Reserve requirements play a role in ensuring that banks hold a certain amount of liquid assets in accounts with the central bank — assets that they can tap under such circumstances. It is likely that the less flexibility commercial banks have in satisfying their reserve requirements, the more effective this prudential role will be. For instance, if it is possible to satisfy reserve requirements on an

[1]For further information, see IMF *Working Paper* 11/36, "Central Bank Balances and Reserve Requirements", by Simon Gray.

average basis over a given reserve maintenance period, a commercial bank or savings bank could conceivably meet their requirements early in the period, only to have no funds left in their central bank account when this prudential role is put to the test. If required reserves are held in a locked account with the central bank, however, the funds will be available when needed and when the central bank deems it appropriate to grant exemptions from the requirements.

Active monetary policy role

Minimum reserve requirements can perform the same type of monetary policy function as central bank interest rates do. Increasing reserve requirements would mop up liquidity, for instance, and increase the marginal cost of capital, thereby pushing market interest rates upwards. Applying the central bank's key interest rate is a more transparent and efficient way to affect market rates in modern financial markets, however. For example, it is unclear how much reserve requirements must be increased in order to bring about a specified change in market interest rates. Furthermore, if reserve requirements are interest-free or bear interest rates considerably below market rates, they can have an unforeseeable and undesirable impact on banks' interest rate spreads. As a result, the use of reserve requirements as a primary monetary policy instrument has widely been discontinued, and the tendency now is to use them instead as a support tool.

Liquidity management and more efficient monetary policy transmission

Reserve requirements can be useful in managing liquidity on central banks' balance sheets and can contribute to more effective transmission of monetary policy. Allowing financial institutions to satisfy liquidity requirements on an average basis within the reserve maintenance period gives them greater flexibility in liquidity management and enables them to respond to unexpected fluctuations in market liquidity. In this case, reserve requirements function as a sort of buffer that banks can either tap or loan to other banks in the interbank market if forecasts of liquidity flows do not materialise. By smoothing out interbank market flows, average reserve requirements can mitigate volatility in short-term interest rates, thereby contributing to more effective monetary policy formulation by better ensuring the achievement of the monetary stance intended by central banks and monetary policy committees at any given time. This is particularly true under conditions when it is difficult for central banks and commercial banks to forecast flows in their balance sheets. In the absence of reserve requirements, central banks could therefore need to intervene more often in the money market in order to keep interest rates at the desired level. Average reserve requirements can also enhance interbank market efficacy in view of increased flexibility in commercial banks' liquidity management.

Moreover, they create constant demand for central bank money and can make demand more predictable; for instance, if banks are required to hold larger reserves than they would otherwise choose. In addition, reserve requirements can be applied so as to boost demand for central bank money when the central bank is a net lender vis-à-vis commercial banks. It can be important, particularly in a system that is on the cusp of a glut or shortage of liquidity, to mitigate fluctuations in interbank rates.

Other functions of reserve requirements

If there is a glut of liquidity, reserve requirements can be used to reduce central banks' interest expense; for instance, by lowering interest rates on reserve balances or having them bear no interest at all. With interest-free reserve requirements, central banks can reduce the amount of liquidity in circulation at little expense. Interest-free reserve requirements affect banks' competitive position vis-à-vis other financial institutions, however, and give them an incentive to change the composition of their balance sheet in order to circumvent the requirements.

II Central Bank of Iceland minimum reserve requirements

The Central Bank of Iceland currently imposes minimum reserve requirements on commercial banks and savings banks.[2] The requirements are calculated as a proportion of the reserve base, which is defined in Central Bank Rules no. 585/2018, and they apply to funding for maturities of two years or less, with a few exceptions. Before the changes that have now been introduced, minimum reserve requirements fell into two categories: a fixed reserve requirement (1%) and an average maintenance requirement (1%). The average requirement has been held in the financial institution's general reserve account (its current account with the Central Bank), whose average balance over each reserve maintenance period must equal or exceed the specified reserve amount. The fixed reserve requirement is fulfilled by deposit of the reserve amount to a separate fixed reserve account with the Central Bank, which is locked during each reserve maintenance period. The Central Bank Monetary Policy Committee (MPC) determines the reserve ratio and its composition. The MPC also sets the interest rate on the reserve amount for both average maintenance (before this change it was 2.5%, or 0.25 percentage points below the Bank's key rate) and the fixed reserve requirement (now 0% and continues to be). Before the change, the combined reserve requirements of institutions subject to such requirements equalled about 40 b.kr., including a fixed requirement of 20 b.kr. and an average maintenance amount of 20 b.kr. per day in each maintenance period.

The role of the average reserve maintenance requirement imposed by the Central Bank

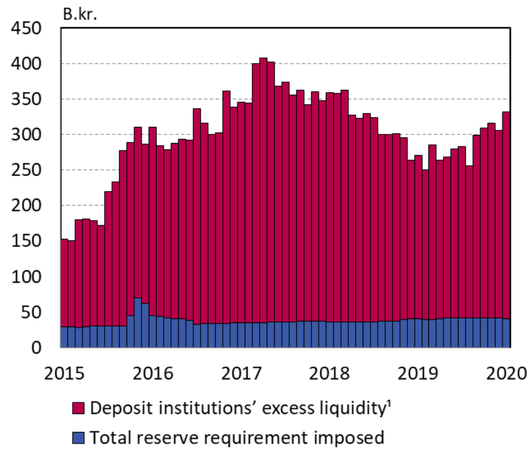
The average reserve requirement, imposed by the Central Bank more than two decades ago, is based on a model from the European Central Bank (ECB). As is the case for the ECB, the role of the reserve requirement in Iceland has been primarily to support monetary policy as regards liquidity management and to promote more effective monetary policy transmission. The objective in applying reserve requirements has been mainly to mitigate short-term volatility in the interbank market and to better ensure the achievement of the monetary stance intended by the Bank and the MPC at any given time. By creating constant demand for central bank money while giving financial institutions the opportunity to satisfy their reserve requirements on an average basis, the requirements function as a buffer, allowing commercial banks to respond to fluctuations in their liquidity. The average reserve requirement was also applied temporarily as a precautionary measure in connection with the settlement of the failed banks' estates.

[2] Institutions subject to minimum reserve requirements are Central Bank counterparties. From 20 March 2020 onwards, these are defined as commercial banks and savings banks, whereas before that date, credit institutions (and investment banks) were included as well.

The role of the average reserve requirement has diminished markedly as circumstances have changed. Commercial banks have had abundant excess liquidity in their Central Bank accounts or in term deposit accounts in recent years, and this has enabled them to respond to unexpected fluctuations in liquidity (Chart 1). Furthermore, it appears to be easier to forecast flows on the Central Bank balance sheet now than it was previously. This has greatly reduced interest rate volatility in the interbank market (Chart 2).

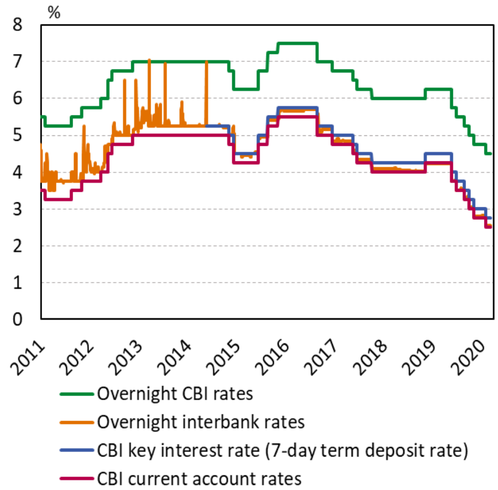
Liquidity management in the financial system has in recent years been shaped by the Central Bank's rules on liquidity coverage ratio (LCR) rather than by minimum reserve requirements. The rules have had a major impact on deposit balances with the Central Bank and have supported much stronger demand for central bank money than the minimum reserve requirements did, particularly because króna-denominated high-quality liquid assets as defined in the LCR rules are in short supply.[3] Minimum reserve requirements affect liquidity ratios, however (see below).

Chart 1
Reserve requirement and deposit institutions' excess liquidity[1]
January 2015 - January 2020



1. Deposit institutions' deposit balances in excess of imposed reserve requirements. Seven-day and one-month term deposits are included.
Sources: Central Bank of Iceland.

Chart 2
Central Bank key interest rate and money market interest rate
1 January 2011 - 6 March 2020



Source: Central Bank of Iceland.

The role of fixed reserve requirements

The fixed non-interest-bearing reserve requirement was imposed in June 2018. The main objective of this was to reduce the cost borne by the Central Bank of implementing monetary policy while the international reserves were large and the exchange rate differential with abroad was wide. The change was not intended to affect the monetary stance. The Central Bank's international reserves confer significant macroeconomic benefits that are enjoyed widely, particularly by the commercial banks, whereas the cost of the reserves was borne

[3] In order to satisfy their average reserve requirements, institutions subject to such requirements must hold an average daily balance of 20 b.kr. in their current accounts with the Bank, but liquid assets in payment systems and in term deposits with the Central Bank amount to 300 b.kr. According to the LCR rules, the commercial banks' combined liquidity requirements in Icelandic krónur amount to nearly 300 b.kr. The banks are permitted to satisfy a portion of this requirement with foreign assets, but they must hold króna-denominated liquid assets amounting to at least half of that amount, owing to the requirement that they satisfy at least a 50% liquidity ratio in Icelandic krónur.

largely by the Central Bank, owing to the wide interest rate differential. Non-interest-bearing fixed reserve requirements shift a portion of the cost of the safety net subsidised by the Central Bank (with its international reserves, for instance) to the entities that operate in the shelter of that safety net; i.e., Central Bank customers. The overall impact of reserve requirements on the banks' income was also relatively limited.

Supervision and rules on capital ratios and liquidity requirements, deposit guarantees, access to Central Bank facilities, and large international reserves have weakened the prudential role of reserve requirements in the event of a potential bank run or large-scale capital outflows from Iceland. However, fixed reserve requirements can also function as a reserve fund in order to support the payment system if access to collateral should be blocked for some reason.

III Interactions between reserve requirements and Central Bank liquidity rules

Credit institutions have had to adhere to liquidity rules (LCR) issued by the Central Bank for a long time. In 2013, the Bank amended its rules to conform to the LCR rules issued by the Basel Committee on Banking Supervision that same year. These rules were amended in 2017 and again at the end of 2019, when a separate minimum was specified for liquidity ratios in Icelandic krónur. The Central Bank's LCR rules were first adopted in November 2013 but were amended in 2017 and again at the end of 2019. The aim of the rules is to mitigate credit institutions' liquidity risk by ensuring that they have enough liquid assets to fulfil their obligations under stressed conditions. The rules are part of the joint regulatory framework of the European Union, and the Central Bank has limited latitude to amend them in Iceland. With the advent of the LCR, the prudential role of minimum reserve requirements has diminished markedly. On the other hand, the reserve requirements affect banks' liquidity ratio (LCR), as the reserve amount is excluded from the calculation of the LCR. Changes in minimum reserve requirements therefore affect the ratio; i.e., all else being equal, a decrease in reserve requirements leads to a rise in the LCR, thereby increasing banks' scope to grant new loans.

IV The impact of the changes in reserve requirements

Both the prudential role and the liquidity management role of reserve requirements have weakened in importance in recent years, in light of changed conditions and the introduction of new macroprudential tools. Conditions have developed that allow for a reduction in reserve requirements without significant sacrifice cost. The MPC has decided to lower deposit institutions' average reserve requirement from 1% to 0%. The changes will take effect on 21 March 2020, the beginning of the next reserve maintenance period.

The fixed reserve requirement will remain unchanged at 1%. The Central Bank has decided that reserves held in fixed reserve accounts could be used in stress periods in the case that the Bank deems liquidity support necessary. Fixed reserve requirements will therefore be included as liquidity buffer according to liquidity rules. The reduction in the average reserve requirement and changes in the treatment of the fixed reserve requirement in liquidity rules will ease the banks' liquidity position and give them greater scope to respond to changed conditions in the domestic economy.

The reduction in average reserve requirements will increase LCRs and, other things being equal, will give the banks scope to increase the weight of other assets in their asset portfolios or to pay out liquid assets. Prior to this change, the combined reserve requirement totalled 40 b.kr. With the reduction of the average reserve maintenance requirement from 1% to 0%, deposit institutions' liquidity in excess of liquidity requirements will increase by approximately 20 b.kr., and their LCR will rise by as much as 8 percentage points. The Central Bank's decision on the treatment of the fixed reserve requirement under stressed conditions increases the banks' LCR by a similar amount. As a result, the combined rise in the LCR amounts to 10-15 percentage points, and the banks' liquidity will improve by a total of 40 b.kr.

It is not considered appropriate to revoke the Bank's authorisation to impose average reserve maintenance requirements, as circumstances could change and the role of the average requirement could become more important once again, including its role in supporting monetary policy conduct.

As before, reserve amounts due to fixed reserve requirements will be held in separate reserve accounts with the Central Bank. The only difference is that these balances will now be considered part of credit institutions' liquidity buffers according to liquidity rules, and will therefore continue to play a role in reducing the cost borne by the Central Bank of conducting monetary policy, in addition to playing a prudential role in the event of threats to payment system functioning.

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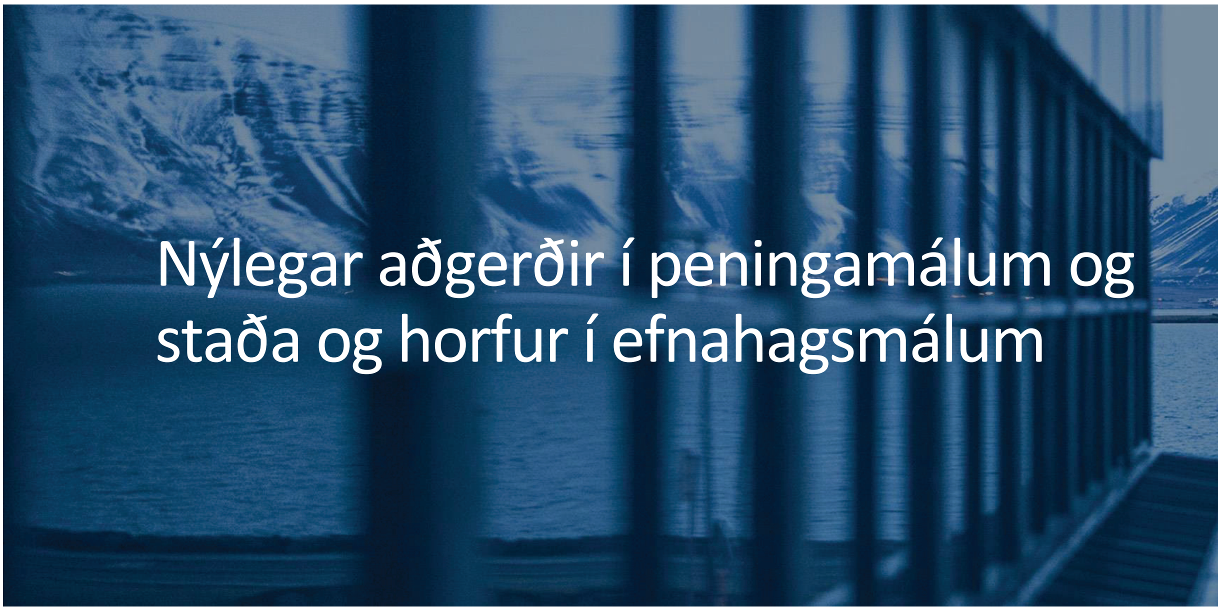


Kynningarfundur

25. mars 2020

Sviðsmyndir af efnahagslegum áhrifum COVID-19 farsóttarinnar

Yfirlit yfir efnahagsskelli í sviðsmyndum

Alþjóðahorfur

- Breytt alþjóðleg efnahagsumsvif byggjast á tveimur sviðsmyndum með mismikla útbreiðslu faraldurs
- Nýjustu upplýsingar um alþjóðlegt eigna-, olíu- og hrávöruverð
- Tvær sviðsmyndir af þróun útflutningsverðs álafurða

Ferðaþjónusta

- Tvær sviðsmyndir af skelli í ferðaþjónustu:
  - Mildari (37% fækkun ferðamanna og 14% samdráttur heildarútflutnings milli ára)
  - Dekkri (55% fækkun ferðamanna og 21% samdráttur heildarútflutnings milli ára)
- Þjónustuinnflutningur dregst saman með áþekkum hætti

Fjármálaleg skilyrði

- Aukin óvissa leiðir til 1 prósentu hækkunar vaxtaálags á fyrirtækjalán

Yfirlit yfir efnahagsskelli í sviðsmyndum

Vinnumarkaður

- Sérstök áhrif tímabundinnar lokunar fyrirtækja á atvinnuleysi og meðalvinnutíma (endurspeglar boðaðar aðgerðir stjórnvalda og skiptast svipað og í fjármálakreppu)
- Hægir á fjölgun fólks á vinnualdri, m.a. vegna minni innflutnings á erlendu vinnuafli vegna landamæralokunar (tvær sviðsmyndir af því hversu mikil áhrifin eru)
- Atvinnuþátttaka minnkar: vinnutap vegna veikinda og fjarveru (sóttkví, skólalokanir, umönnun)

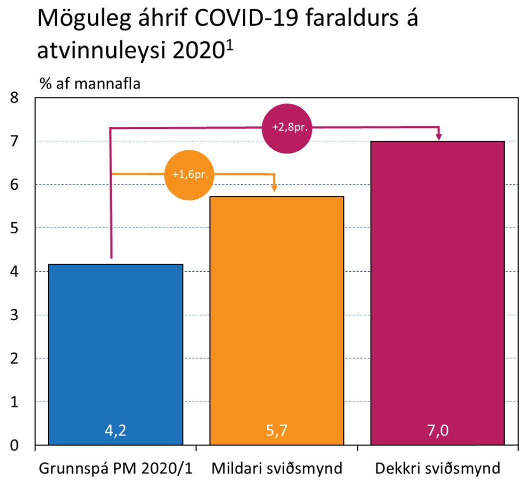
Tímabundin áhrif einangrunar og samkomubanns

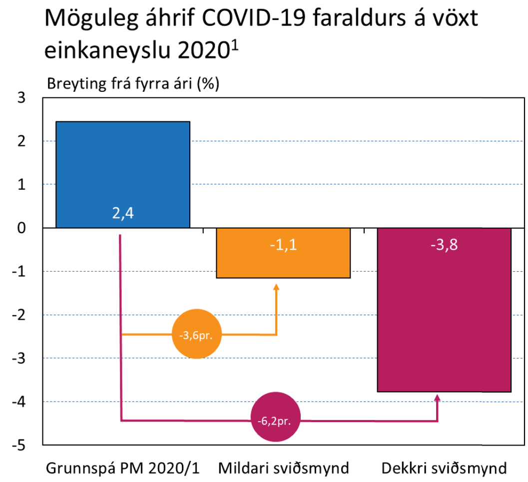
- Sérstök áhrif á einkaneyslu vegna sóttkvíar, sjálfseinangrunar og samkomubanns

Útflutningur sjávarafurða

- Vandamál með afhendingu og dreifingu og minni eftirspurn vegna lokunar veitingastaða erlendis

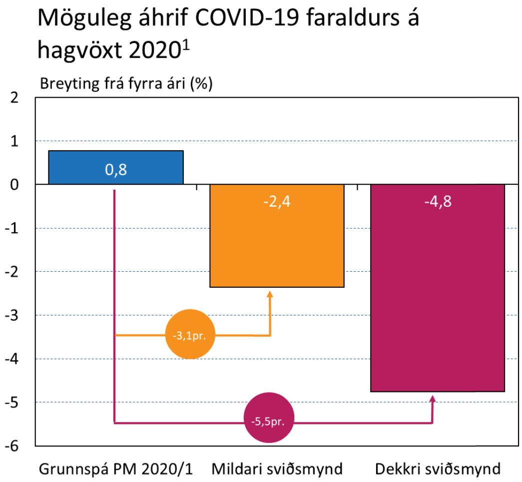
Horfur á að atvinnuleysi aukist töluvert og einkaneysla gæti dregist verulega saman

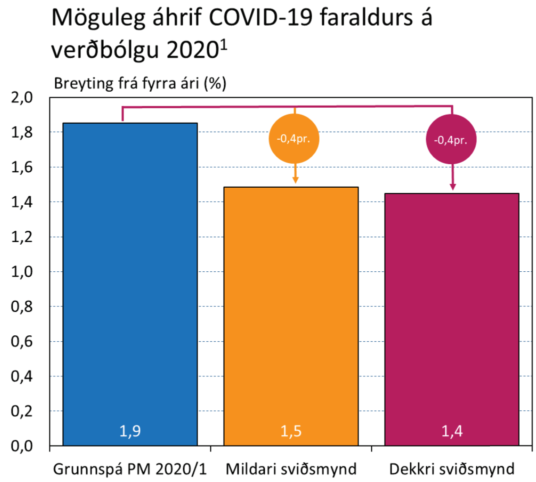




1. Samanburður á efnahagshorfum árið 2020 samkvæmt grunnspá PM 2020/1 og tveimur sviðsmyndum með misalvarlegum áhrifum COVID-19 faraldursins.
Heimild: Seðlabanki Íslands.

Hagvaxtarhorfur versna verulega og horfur á minni verðbólgu þótt gengi krónunnar lækki





1. Samanburður á efnahagshorfum árið 2020 samkvæmt grunnspá PM 2020/1 og tveimur sviðsmyndum með misalvarlegum áhrifum COVID-19 faraldursins.
Heimild: Seðlabanki Íslands.

25. mars 2020

Sviðsmyndir af mögulegum áhrifum COVID-19 á efnahagshorfur árið 2020

COVID-19 faraldurinn hefur valdið miklum búsifjum í heimsbúskapnum. Farsóttin og aðgerðir stjórnvalda til að hemja hana hafa sett framleiðslukeðjur um allan heim í uppnám og dregið úr framleiðslugetu og framboði vöru og þjónustu. Farsóttin hefur einnig aukið mjög á óvissu og ótta og hefur, ásamt aðgerðum stjórnvalda til að hemja smitleiðir, dregið verulega úr eftirspurn eftir vöru og þjónustu. Þá hefur fyrirsjáanlegur efnahagssamdráttur í ár og óvissa um framhaldið valdið usla á fjármálamörkuðum um allan heim sem hefur leitt til mikillar lækkunar eignaverðs og hækkunar áhættuálags á fjölda fjárskuldbindinga. Aðgengi heimila og fyrirtækja að lánsfé er því bæði orðið dýrara og erfiðara en áður sem hefur magnað efnahagslegan skaða farsóttarinnar enn frekar.

Þar sem óvissa um stöðu mála er veruleg og aðstæður nánast án fordæma er erfitt að spá fyrir um líklegustu þróun efnahagsmála. Þó er hægt að gera mismunandi sviðsmyndir þar sem reynt er að leggja mat á mögulega framvindu miðað við ákveðnar forsendur sem virðast sennilegar miðað við stöðuna í dag en rétt er að hafa í huga að þessar forsendur, t.d. varðandi þróun farsóttarinnar breytast stöðugt.

Þótt ekki standi til að birta nýja þjóðhags- og verðbólguspá Seðlabankans fyrr en í *Peningamálum* 2020/2 hinn 20. maí nk. telur bankinn rétt að birta nú tvær af þeim sviðsmyndum sem helst hafa verið til skoðunar innan bankans að undanförnu. Við þróun þessara sviðsmynda hefur verið stuðst við þjóðhagslíkan Seðlabankans, QMM. Mat á þróun alþjóðlegra efnahagsmála byggist m.a. á tveimur nýlegum sviðsmyndum OECD á hagvexti í heiminum miðað við ólíkar forsendur um það hversu útbreidd farsóttin verður. Þá er tekið tillit til nýjustu þróunar alþjóðlegs eigna-, olíu- og hrávöruverðs. Sviðsmyndirnar gera jafnframt ráð fyrir mismiklum samdrætti í ferðaþjónustu. Mildari sviðsmyndin gerir ráð fyrir að ferðamönnum fækki um ríflega þriðjung frá árinu 2019, sem samsvarar um 14% samdrætti útflutnings vöru og þjónustu milli ára, en sú dekkri að ferðamönnum fækki um ríflega 50% milli ára, sem samsvarar ríflega fimmtungs samdrætti útflutnings vöru og þjónustu. Sviðsmyndirnar gera einnig ráð fyrir mismikilli lækkun á verði álafurða og að hnökrar verði í afhendingu sjávarafurða á útflutningsmörkuðum.

Sviðsmyndirnar gera einnig ráð fyrir því að aukin óvissa um efnahagshorfur verði til þess að vaxtaálag á fyrirtækjalán hækki um 1 prósentu sem vegur á móti nýlegum vaxtalækkunum Seðlabankans. Þá er gert ráð fyrir að heimilin haldi að sér höndum með útgjaldaákvarðanir og það, ásamt áhrifum sóttkvía, sjálfseinangrunar, samkomubanns og veikindaforfalla, valdi verulegum samdrætti í einkaneyslu – sérstaklega á öðrum fjórðungi þessa árs.

Tímabundin lokun fyrirtækja af völdum farsóttarinnar kemur þar að auki fram í auknu atvinnuleysi, þótt nýlegar aðgerðir stjórnvalda geri það að verkum að aðlögun á vinnumarkaði komi að nokkru leyti einnig fram í fækkun vinnustunda. Þá fjölgar fólki á vinnualdri hægar, ekki síst þar sem gert er ráð fyrir að stórlega dragi úr innflutningi erlends vinnuafls um tíma í ár. Þá er gert ráð fyrir tímabundnu framleiðslutapi vegna veikindaforfalla og fjarveru vegna sóttkvía og skertrar starfsemi skóla sem einnig hefur afleidd áhrif á getu annarra til að stunda vinnu. Þessi vinnumarkaðsáhrif eru mismikil í þessum tveimur sviðsmyndum.

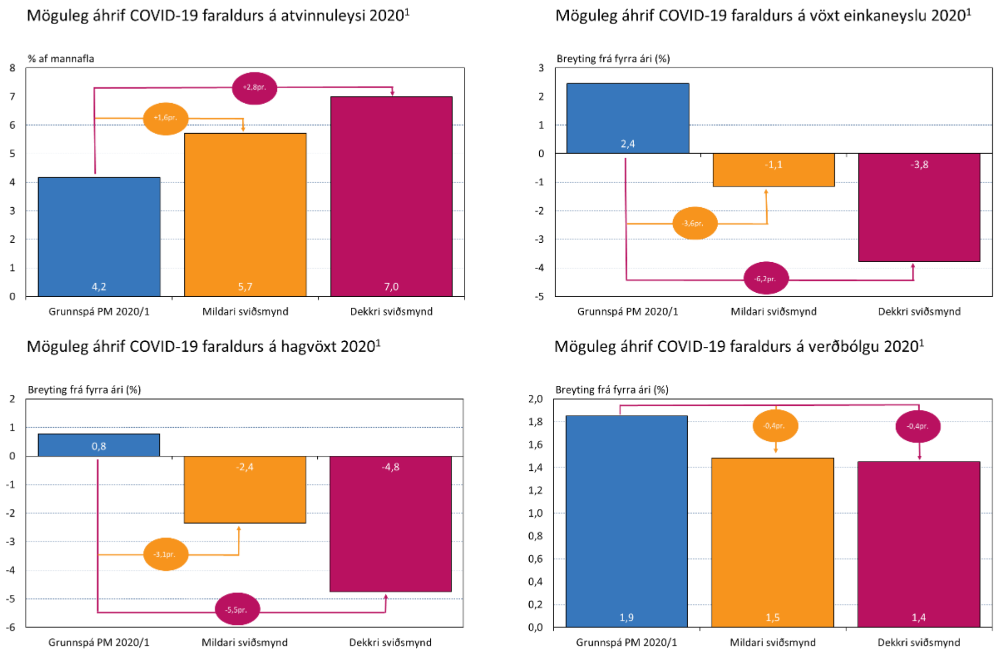
Meðfylgjandi myndir sýna þróun atvinnuleysis, einkaneyslu, hagvaxtar og verðbólgu í ár miðað við þessar tvær sviðsmyndir. Eins og fyrsta myndin sýnir er allt útlit fyrir að atvinnuleysi verði töluvert meira en febrúarspá *Peningamála* hafði gert ráð fyrir. Þar var spáð liðlega 4% atvinnuleysi að meðaltali í ár en vegna farsóttarinnar gæti það orðið um 5½-7% – eða um 1½-3 prósentum meira en spáð var í febrúar.

Horfur um vöxt einkaneyslu hafa einnig breyst mikið. Í febrúar var spáð 2,4% vexti einkaneyslu milli ára en vegna farsóttarinnar gæti hún dregist saman um 1-4% sem samsvarar viðsnúningi upp á um 3½-6 prósentur frá febrúarspánni.

Þriðja myndin sýnir breytinguna á hagvaxtarhorfum ársins. Í febrúar spáði bankinn tæplega 1% hagvexti í ár en miðað við þessar tvær sviðsmyndir gæti orðið um 2½-5% samdráttur – sem samsvarar viðsnúningi í hagvexti upp á um 3-5½ prósentur frá febrúarspánni. Báðar sviðsmyndirnar gera hins vegar ráð fyrir ágætum hagvexti á næsta ári.

Að lokum sýnir fjórða myndin að verðbólguhorfur ársins breytast tiltölulega lítið þrátt fyrir mikið umrót í efnahagsmálum. Þar vegast á nokkrir kraftar. Áföll í útflutningsgreinum og innlendur samdráttur gera það að verkum að gengi krónunnar er nokkru lægra í þessum sviðsmyndum en gert var ráð fyrir í febrúarspá bankans. Á móti vega mikil lækkun alþjóðlegs hrávöru- og olíuverðs og minni alþjóðleg verðbólga. Þá bætast við áhrif mikils viðsnúnings í innlendri efnahagsþróun sem veldur því að töluverður slaki myndast í þjóðarbúinu með auknu atvinnuleysi og minnkandi notkun framleiðsluþátta sem m.a. birtist í minni hækkunum launa en gert var ráð fyrir í febrúar.

Rétt er að ítreka enn og aftur að mikil óvissa er um stöðu og horfur í efnahagsmálum. Seðlabankinn mun áfram vinna að því að greina þessar horfur og endurmeta sviðsmyndir sínar og mögulega birta þær telji bankinn ástæðu til. Næsta þjóðhags- og verðbólguspá bankans verður síðan birt í *Peningamálum* 20. maí nk.



1. Samanburður á efnahagshorfum árið 2020 samkvæmt grunnspá PM 2020/1 og tveimur sviðsmyndum með misalvarlegum áhrifum COVID-19 faraldursins.
Heimild: Seðlabanki Íslands.

Central Bank to reduce one-month term deposit supply

The Central Bank has decided to reduce significantly its offerings of one-month term deposits. The next auction will be held on 1 April 2020. This decision has been made because of the radical changes that have occurred in domestic market conditions in a short period of time. It is foreseen that Treasury expenditure will increase in coming weeks and months, as will Treasury bond issuance. The Bank will continue to offer seven-day term deposits on a weekly basis. The Bank will also continue to ensure that term deposits can be used as payment system collateral.

Press release no. 10/2020
27 March 2020

Rules on Central Bank Facilities for Financial Undertakings amended

The Central Bank has decided to offer its counterparties special temporary credit facilities in the form of collateralised loans. The first auction will be held on 22 April 2020. The collateralised lending facilities are part of the Bank's response to the unprecedented situation currently prevailing and are intended as a means of offering financial institutions increased access to liquidity on a temporary basis, against collateral deemed eligible by the Bank.

In line with its 8 April 2020 press release, the Central Bank has amended its Rules on Central Bank of Iceland Facilities for Financial Undertakings, no. 1200/2019. The amended Rules have been published in the Law and Ministerial Gazette (Stjórnartíðindi). Furthermore, the list of instruments deemed eligible as collateral for Central Bank facilities has been updated to accord with the amendments. The updated list can be found here.

Press release no. 12/2020
17 April 2020

Agreement on guarantee of credit institutions' supplemental loans to businesses

The Ministry of Finance and Economic Affairs and the Central Bank of Iceland have signed an agreement laying down terms and conditions for Treasury guarantees of credit institutions' supplemental lending to businesses in response to the COVID-19 pandemic.

Because of the pandemic, many companies are facing temporary but severe declines in revenues, as well as liquidity problems. In view of this, Parliament authorised the Minister of Finance and Economic Affairs to grant Treasury guarantees covering a portion of supplemental loans provided to companies by credit institutions, subject to specified conditions. The Minister was authorised to negotiate an agreement with the Central Bank concerning the implementation of the guarantee scheme.

The aim of the scheme is to support companies that are severely affected by the spread of COVID-19 and the Government measures taken in response to it. The guarantees are an element in maintaining the highest employment level and the most diverse economy possible.

Each credit institution can access to a specific portion of the total guarantee amount. The supplemental loans must be granted before the end of 2020, and the maximum term is 18 months from the date of issuance. The guarantee on any individual supplemental loan will be capped at 70%. The amount loaned to any individual entity is subject to a maximum of two times the entity's year-2019 wage costs. Furthermore, the company's wage costs must constitute at least 25% of its total operating expenses for 2019. Moreover, the maximum amount of any single guaranteed loan is 1.2 b.kr.

The design of the scheme should be finalised shortly, after further refinements between the Central Bank and the credit institutions. When this is complete, credit institutions will be able to begin granting Treasury-guaranteed loans.

Press release no. 13/2020
17 April 2020

See here: An agreement between the Ministry of Finance and Economic Affairs and the Central Bank of Iceland laying down terms and conditions for Treasury guarantees of credit institutions' supplemental lending to businesses in response to the COVID-19 pandemic (In Icelandic).

Announcement on Central Bank of Iceland purchases of Treasury bonds

At the beginning of May 2020, the Central Bank of Iceland will begin buying Treasury bonds in the secondary market, in accordance with the 23 March 2020 statement by the Monetary Policy Committee. The objective of the purchases is to ensure monetary policy transmission across the yield curve, so that the more accommodative monetary stance is transmitted normally to households and businesses. In this context, particular consideration is given to the market effects that the foreseeable increase in Treasury bond supply will have on monetary policy transmission.

The aim will be to keep the scale of the purchases consistent with normal market functioning. The Central Bank reserves full right to adjust amounts, frequency, and execution of the purchases so as to ensure the efficacy of the measures.

According to the above-mentioned Monetary Policy Committee decision, the Bank may purchase Treasury bonds for up to 150 b.kr. The Bank will announce in advance the maximum amount it intends to buy each quarter. The total amount to be purchased by the Bank in Q2/2020 may range up to 20 b.kr. market value.*

The purchases will focus on all nominal benchmark issues denominated in Icelandic krónur and maturing in 2021, 2022, 2025, 2028, and 2031, and any new nominal benchmark issues that may be added.

The Central Bank will purchase the bonds either by submitting bids to the Nasdaq Iceland trading system or by auction. The purchases will begin with submittal of bids to the Nasdaq Iceland trading system.

Any auctions that are held will be announced with one day's advance notice. The announcement will specify the series and the estimated maximum amount to be purchased. Information on the general terms and conditions for auctions that may be held in connection with the Central Bank's purchase of Treasury bonds in the secondary market can be found here.

Further information can be obtained from Sturla Pálsson, Director of the Markets Department of the Central Bank, at tel +354 569-9600.

**The sale price or market value refers to the clean price plus accrued indexation; i.e., with indexation but without accrued interest.*

Press release no. 14/2020
21 April 2020

Central Bank and credit institutions sign agreements on bridge loans

The Central Bank of Iceland has been entrusted with executing Treasury guarantees under a special agreement with the Ministry of Finance and Economic Affairs. To that end, the Bank has signed agreements with Íslandsbanki, Landsbankinn, Arion Bank, and Kvika on guarantees of supplemental bridge loans to businesses. The loans are intended for companies – primarily small and medium-sized enterprises – that are facing temporary operational difficulties as a result of the COVID-19 pandemic.

The Treasury will guarantee up to 70% of the loans, which companies can receive upon satisfying specified requirements, including refraining from paying dividends or buying their own shares during the term of the guarantee. The total amount of Treasury guarantees under this programme could range up to 50 b.kr.

Ásgeir Jónsson, Governor:
"Finalising these agreements on bridge loans is an important milestone. Distressed companies now have a way to access operating capital in the wake of the COVID-19 pandemic. The banks now have all they need to begin acting on the basis of the agreements, with the aim of supporting businesses through the most difficult period. This should put some wind in our sails in the coming term."

Press release no. 15/2020
12 May 2020

SEÐLABANKI ÍSLANDS

Efnahagshorfur

Kynningarfundur fyrir Samiðn
4. júní 2020

Rannveig Sigurðardóttir
Varaseðlabankastjóri peningastefnu

Peningamál í hnotskurn

COVID-19 veldur usla í heims-búskapnum

Sóttvarnar-aðgerðir hafa mikil efna-hagsleg áhrif

Gríðarlegt högg fyrir fluggeirann og ferða-þjónustu hér á landi

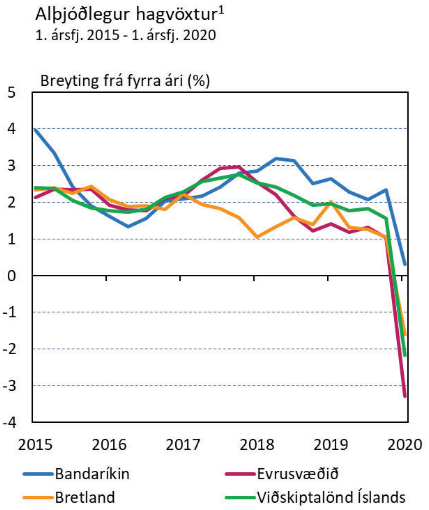
Spáð mesta efnahags-samdrætti á einu ári í heila öld

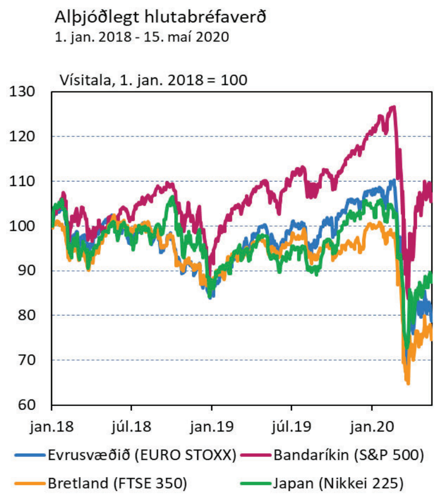
Mikil fækkun starfa og vinnustunda og atvinnuleysi í sögulegar hæðir

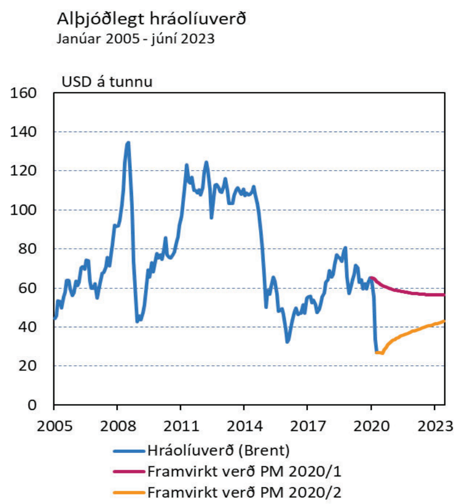
Verðbólga hefur haldist við og undir markmiði og spáð að svo verði áfram

Heimsfaraldur veldur efnahagslegum hamförum

- Aðgerðir til að hemja COVID-19-farsóttin hafa valdið miklum usla í heimsbúskapnum
- Miklar verðlækkanir, umrót og markaðstruflanir: hlutabréfaverð féll um ríflega þriðjung og flökt í hlutabréfaverði jókst
- Mikil lækkun olíuverðs sem olía á eldinn: lækkaði mikið en hefur heldur hækkað á ný



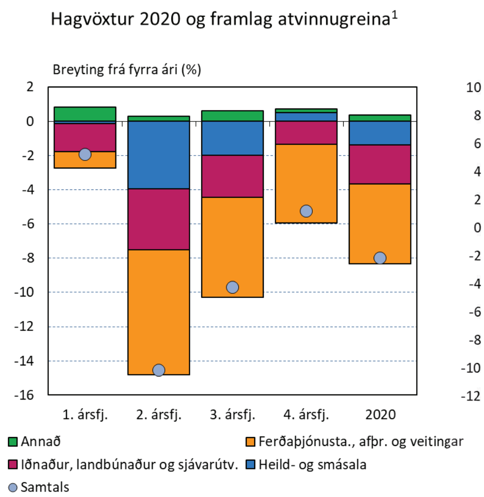


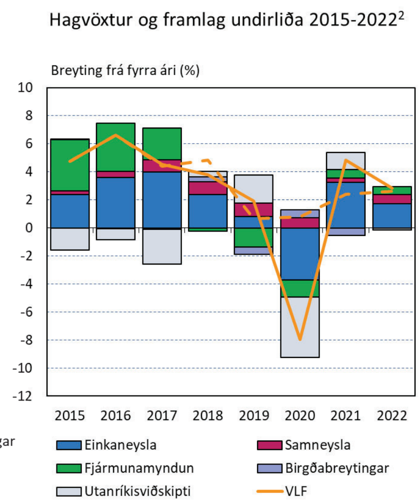


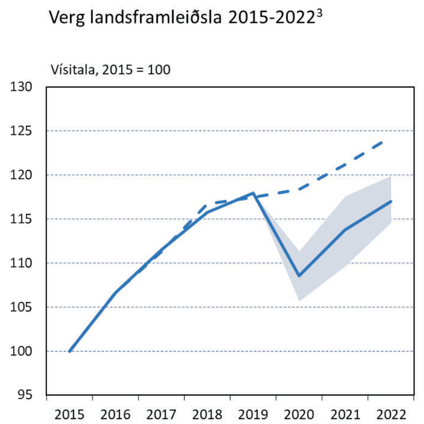
1. Grunnspá Seðlabankans 1. ársfj. 2020 fyrir helstu viðskiptalönd.
Heimildir: FRED-gagnagrunnur Seðlabanka Bandaríkjanna í St. Louis, Refinitiv Datastream, Seðlabanki Íslands.

Spáð er 8% samdrætti landsframleiðslu í ár …

- Spáð 8% samdrætti á árinu öllu en hátt í 5% hagvexti 2021 (endurspeglar mikinn slaka og að efnahagsumsvif vaxa frá lágu stigi)
- Þar vegur þungt að talið er að liðlega 80% færri ferðamenn komi til landsins í ár en í fyrra og áhrif þess á útflutta þjónustu en samdráttur einkaneyslu vegur einnig þungt
- Gangi spáin eftir yrði landsframleiðslan í lok spátímans u.þ.b. 6% undir því sem spáð var í febrúar





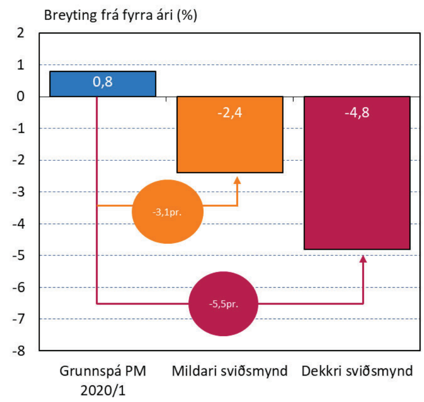


1. Framlag atvinnugreina reiknað út frá vægi atvinnugreina í vergum þáttatekjum árið 2019. 2. Grunnspá Seðlabankans 2020-2022. Brotalína sýnir spá frá PM 2020/1. 3. Grunnspá Seðlabankans 2020-2022. Skyggða svæðið sýnir mögulegt bil landsframleiðslunnar miðað við mismunandi fráviksdæmi í rammagrein 1. Brotalína sýnir spá frá PM 2020/1.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

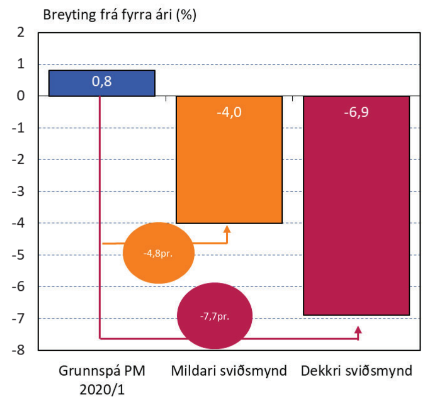
… en óvissa um áhrif faraldursins er mikil

- 25. mars birti bankinn fyrstu sviðsmyndir af mögulegum áhrifum COVID-19 á hagvöxt þá var gert ráð fyrir 2,4-4,8% samdrætti
- 22. apríl birti bankinn sviðsmyndir frá fundi peningastefnunefndar 2. apríl þá var gert ráð fyrir 4-7% samdrætti
- Í nýjustu spá bankans er gert ráð fyrir 8% samdrætti en fráviksdæmi gera ráð fyrir 6-10% samdrætti,
  - Svartsýnna dæmi: Sóttvarnaraðgerðir vari fram eftir ári og óvissa aukist enn frekar
  - Bjartsýnna dæmi: Kröftugri viðsnúningur, farsóttin hjaðni hraðar og bati í ferðaþjónustu kröftugri

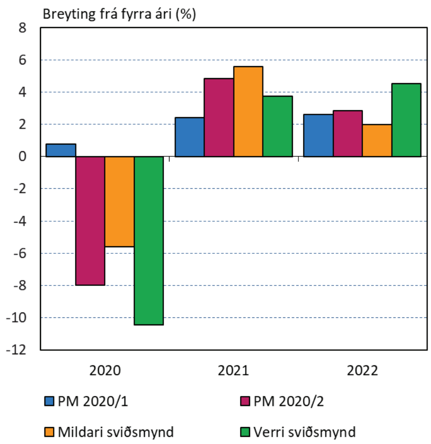
Möguleg áhrif COVID-19 faraldurs á hagvöxt 2020 sviðsmynd 25. mars



Möguleg áhrif COVID-19 faraldurs á hagvöxt 2020 sviðsmynd 2. apríl



Mismunandi spár um hagvöxt 2020-2022[1]

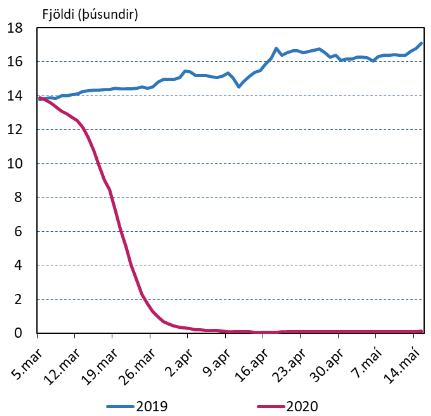


1. Samanburður á grunnspá PM 2020/1 og PM 2020/2 fyrir árin 2020-2022 ásamt tveimur fráviksdæmum sem gera ráð fyrir misdjúpum efnahagssamdrætti og mishröðum bata.
Heimildir: Seðlabanki Íslands.

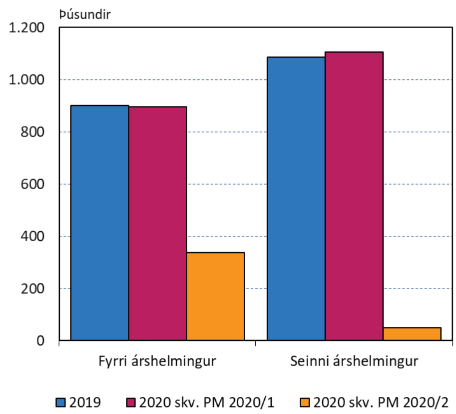
Algert hrun í innlendri ferðaþjónustu …

- Heimsfaraldurinn hefur haft gríðarleg áhrif á ferðaþjónustu og flugsamgöngur um allan heim …
- … ekki síst hér á landi: komum ferðamanna til landsins fækkaði hratt í mars og snemma í apríl stöðvuðust þær nánast alveg
- Horfur á að ferðamenn verði einungis um 400 þús. á árinu öllu (svipaður fjöldi og 2005 og 81% fækkun milli ára)
- Efnahagsleg áhrif eru veruleg fyrir lönd eins og Ísland þar sem ferðaþjónusta vegur þungt í innlendum þjóðarbúskap

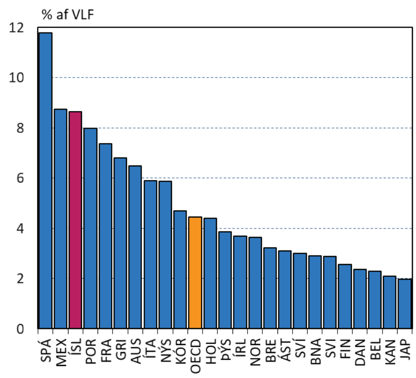
Daglegur farþegafjöldi um Keflavíkurflugvöll[1]



Forsendur um fjölda ferðamanna til landsins árið 2020[2]



Vægi ferðaþjónustu í VLF í ýmsum OECD-ríkjum[3]

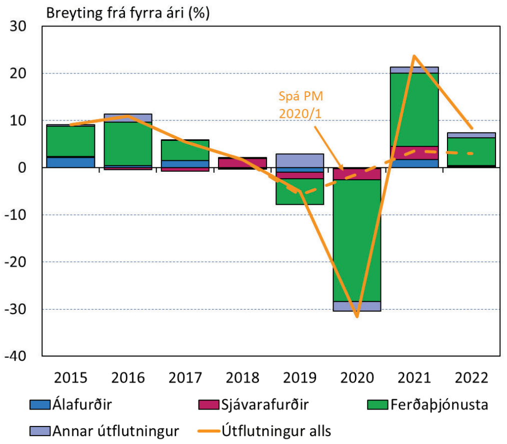


1. Sjö daga hreyfanlegt meðaltal. Fjöldatölur fyrir árið 2019 eru án farþega WOW Air. Dagsetningum gagna fyrir árið 2019 hefur verið hagrætt þannig að sömu vikudagar séu bornir saman (fimmtudagurinn 5. mars 2020 er því t.d. borinn saman við fimmtudaginn 7. mars 2019). 2. Spá PM 2020/2 um fjölda ferðamanna sem fer um Keflavíkurflugvöll og samanburður við spá PM 2020/1 og árið 2019. 3. Vægi ferðaþjónustu í VLF árið 2018 eða nýjasta ár með tiltækum gögnum.
Heimildir: Isavia, OECD, Hagstofa Íslands, Seðlabanki Íslands.

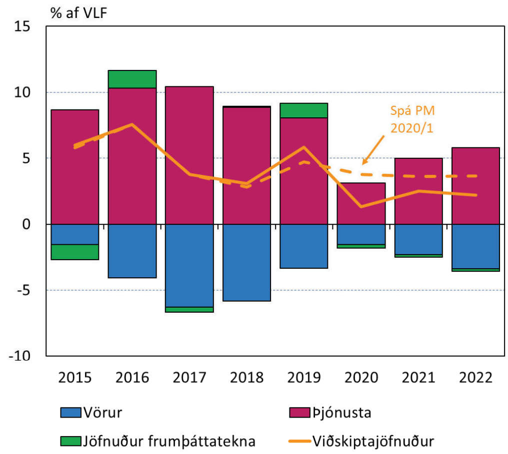
… og mesti samdráttur útflutnings frá upphafi

- Þjónustuútflutningur dregst saman um næstum 53% í ár og við bætist 12% samdráttur í útflutningi sjávarafurða (mesti samdráttur í næstum 4 áratugi): útflutningur í heild dregst saman um 32% (mesti samdráttur frá upphafi þjóðhagsreikninga)
- Viðskiptaafgangur minnkar um 4,5% af VLF frá 2019 – halli á vöruviðskiptum minnkar en afgangur á þjónustu minnkar enn meira

Útflutningur og framlag undirliða 2015-2022[1]



Viðskiptajöfnuður 2015-2022[2]

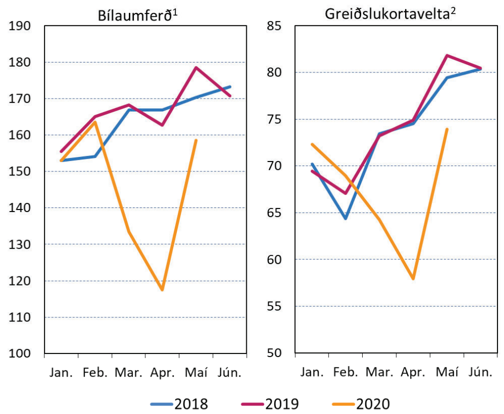


1. Vegna keðjutengingar getur verið að summa undirliðanna sé ekki jöfn heildarútflutningi. Álútflutningur skv. skilgreiningu þjóðhagsreikninga. Ferðaþjónusta er samtala á „ferðalögum“ og „farþegaflutningum með flugi“. Grunnspá Seðlabankans 2020-2022. Brotalína sýnir spá frá PM 2020/1. 2. Jöfnuður rekstrarframlaga talin með frumþáttajöfnuði. Grunnspá Seðlabankans 2020-2022. Brotalína sýnir spá frá PM 2020/1.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

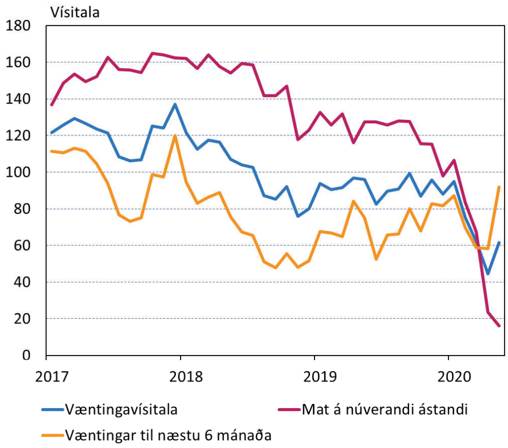
Innlend umsvif minnka mikið, svartsýni eykst …

- Framan af Q1 virtist einkaneysla vaxa svipað og í fyrra en snörp umskipti urðu í mars þegar sóttvarnaraðgerðir tóku gildi
- Vísbendingar um mikinn samdrátt í útgjöldum heimila og aukna svartsýni þeirra í mars og apríl …
- … en nýjustu tölur benda til viðsnúnings í maí – þótt umsvif á Q2 séu líklega 15-20% undir því sem þau voru á Q2/2019

Vísbendingar um efnahagsumsvif á fyrri hluta ársins



Viðhorf heimila til stöðu efnahagsmála[3]
Janúar 2017 - maí 2020

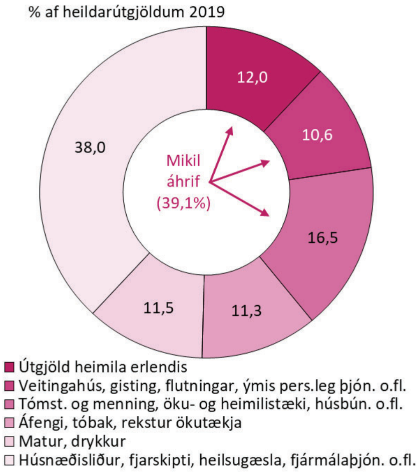


1. Dagleg umferð um Hafnarfjarðarveg sunnan Kópavogslækjar, Reykjanesbraut við Dalveg í Kópavogi og Vesturlandsveg ofan Ártúnsbrekku (þúsund bifreiða). Maítalan sýnir umferð fyrri hluta mánaðar. 2. Debet- og kreditkort útgefin af innlendum aðilum. Velta innanlands raunvirt með vísitölu neysluverðs án húsnæðis. Velta erlendis raunvirt með innflutningsveginni meðalgengisvísitölu (ma.kr.). Veltan í maí er áætluð út frá daglegri greiðslukortaveltu innanlands fyrir fyrstu tíu daga mánaðarins og erlendri veltu fyrri mánaðar. 3. Væntingavísitala Gallup er byggð á viðhorfi almennings til efnahags- og atvinnuástandsins.
Heimildir: Gallup, Hagstofa Íslands, Vegagerðin, Seðlabanki Íslands.

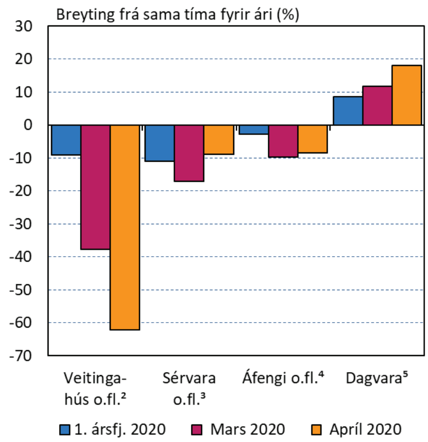
… og útlit fyrir mikinn samdrátt einkaneyslu

- Um 40% neysluútgjalda verða fyrir töluverðum beinum áhrifum lokunaraðgerða – sést skýrt í ríflega 60% árssamdrætti kaupa á veitingaþjónustu og gistingu og um 10% samdrætti á kaupum á sérvöru – bein áhrif á hinn hluta útgjalda hins vegar takmörkuð
- Talið að einkaneysla dragist saman um tæplega 20% á Q2 (svipaður samdráttur og í fjármálakreppunni) og 7,3% á árinu öllu

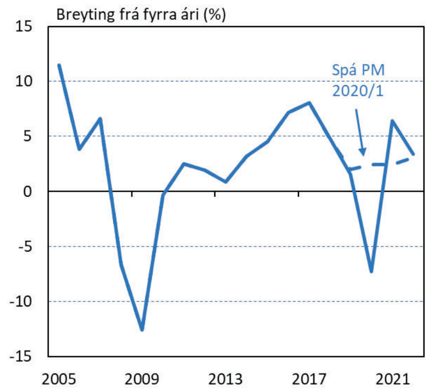
Skipting einkaneyslu eftir líklegu umfangi beinna áhrifa COVID-19 á neysluútgjöld[1]



Greiðslukortavelta eftir helstu útgjaldaflokkum



Einkaneysla 2005-2022[6]

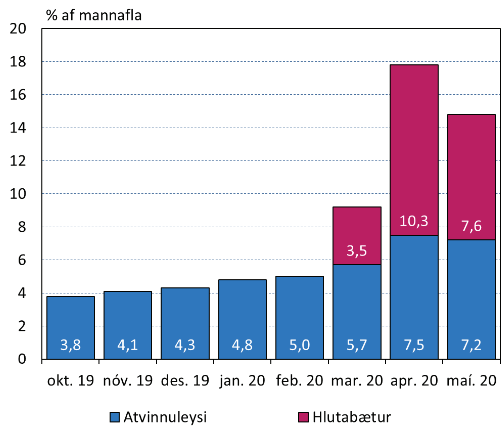


1. Leiðrétt fyrir útgjöldum erlendra ferðamanna í undirliðum einkaneyslu sem byggir á bráðabirgðamati Hagstofu Íslands á skiptingu útgjalda erlendra manna á Íslandi 2019. Dekkri litir endurspegla meiri bein áhrif. 2. Veitingahús, gisting, flutningar, pakkaferðir, tollfrjáls verslun, menning og afþreying, snyrting og ýmis persónuleg þjónusta. 3. Raf- og heimilistæki, húsbúnaður, fatnaður, önnur sérvara og ýmis sérhæfð þjónusta. 4. Áfengi og rekstur ökutækja. 5. Dagvöruverslun og stórmarkaðir. 6. Grunnspá Seðlabankans 2020-2022. Brotalína sýnir spá frá PM 2020/1.
Heimildir: Hagstofa Íslands, Rannsóknarsetur verslunarinnar, Seðlabanki Íslands.

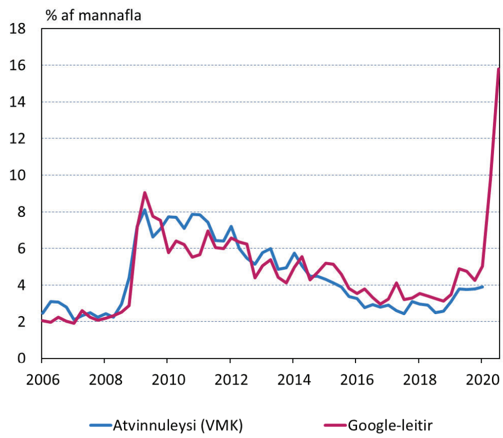
Störfum fækkar og atvinnuleysi eykst hratt

- Störfum fækkaði á Q1 en áhrif faraldurs mun gæta af fullum þunga á Q2 þegar störfum fækkar mikið og vinnutími styttist
- Skráð atvinnuleysi hefur aukist gríðarlega: var 5% í febrúar en var komið í 7,5% í apríl (17,8% ef fólk á hlutabótum er tekið með)
- Atvinnuleysi skv. VMK var 3,9% á Q1 og tíðni netleita með Google bendir til mikillar aukningar á Q2 og enn frekar á Q3

Skráð atvinnuleysi[1]
Október 2019 - maí 2020



Atvinnuleysi og Google-leitir[2]
1. ársfj. 2006 - 3. ársfj. 2020

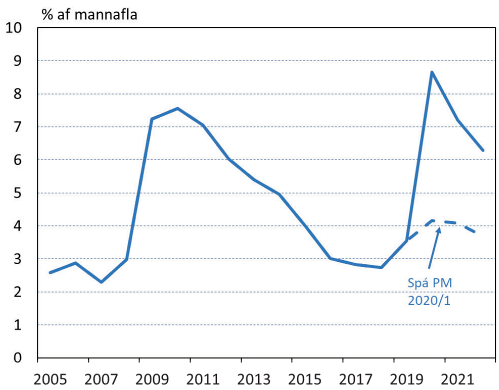


1. Gildi fyrir maí er spá Vinnumálastofnunar. 2. Google-leitir byggjast á hlutfallslegum vinsældum orðanna "atvinnuleysisbætur" eða "Vinnumálastofnun" í leitarvél Google og sýnir 2. ársfj. 2020 gögn fyrir það sem liðið er af fjórðungnum. Röðin er tafin um einn ársfjórðung og gefið sama meðaltal og staðalfrávik og atvinnuleysi. Atvinnuleysi er árstíðarleiðrétt.
Heimildir: Google Trends, Hagstofa Íslands, Vinnumálastofnun, Seðlabanki Íslands.

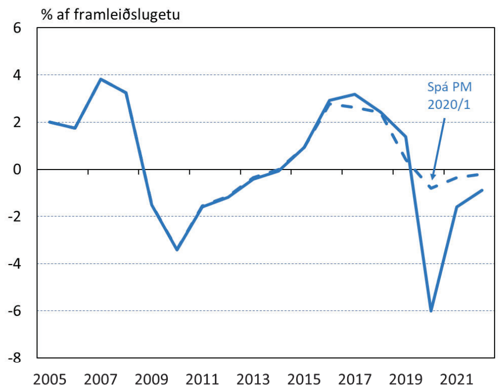
Horfur á sögulega miklu atvinnuleysi og slaka

- Spáð að atvinnuleysi aukist enn frekar er líður á árið og fari í um 12% á Q3 en verði tæplega 9% á árinu öllu – ríflega tvöfalt meira en í fyrra og um 1 pr. meira en það var 2010 og það mesta sem hefur mælst frá upphafi
- Talið að 1½% framleiðsluspenna í fyrra snúist í 6% slaka í ár (tæplega tvöfalt meiri en 2010) – en mikil óvissa um mat

Atvinnuleysi 2005-2022[1]



Framleiðsluspenna 2005-2022[1]

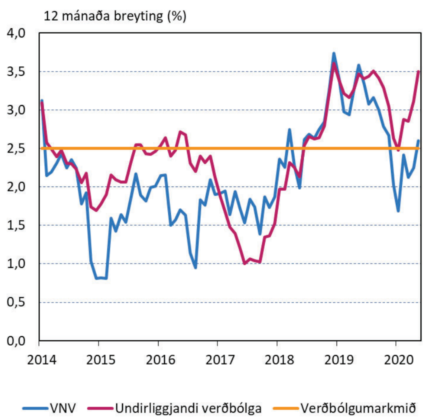


1. Grunnspá Seðlabankans 2020-2022. Brotalína sýnir spá frá PM 2020/1.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Verðbólga haldist við markmið þrátt fyrir gengislækkun

- Verðbólga mældist 2,1% á Q1 og 2,6% í maí – hefur verið um eða undir markmiði síðan í desember sl. og 2,4% að meðaltali undanfarin liðlega 7 ár … undirliggjandi verðbólga mælist hins vegar meiri og var komin í 3,5% í maí
- Gengi ISK tók að lækka þegar faraldur brast á: hafði lækkað um 12% í byrjun maí en byrjaði þá að hækka á ný og er nú um 7% lægra en í lok febrúar, í spánni er gert ráð fyrir að gengi ISK haldist svipað út spátímann og raungengið verði svipað seinni hluta 2015

Mæld og undirliggjandi verðbólga[1]
Janúar 2014 - maí 2020



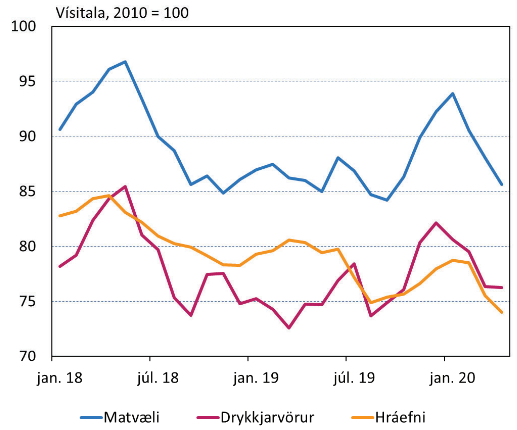
Gengi krónunnar[2]
2. janúar 2017 - 3. júní 2020

1. Undirliggjandi verðbólga er meðaltal verðbólgu m.v. kjarnavísitölu (þar sem áhrif óbeinna skatta, sveiflukenndra matvöruliða, bensíns, opinberrar þjónustu og raunvaxtakostnaðar húsnæðislána eru undanskilin) og tölfræðilega mælikvarða (vegið miðgildi, klippt meðaltal, kvikt þáttalíkan og sameiginlegur þáttur VNV). 2. Verð erlendra gjaldmiðla í krónum (viðskiptavog þröng).
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

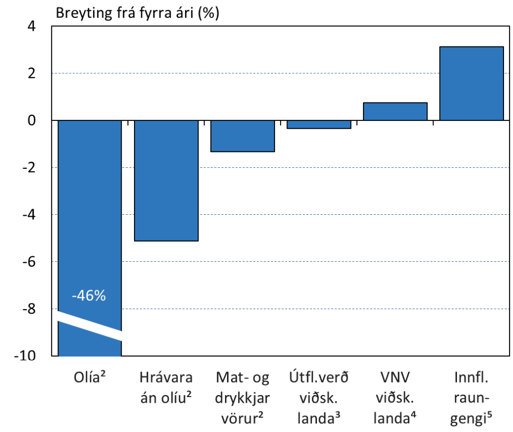
Alþjóðlegar verðlækkanir vega á móti gengislækkun…

- Alþjóðlegt matvæla- og hráefnaverð var tekið að hækka í lok síðasta árs en hefur lækkað um 5-7% frá áramótum
- Horfur á að olíuverði verði 46% lægra í ár en í fyrra, verð annarrar hrávöru 5% lægra og verð mat- og drykkjarvöru 1,3% lægra
- Verðbólga í viðskiptalöndum verður lítil, útflutningsverð þeirra lækkar milli ára og innfluttur verðbólguþrýstingur því hóflegur

Alþjóðlegt hrávöruverð[1]
Janúar 2018 - apríl 2020



Vísbendingar um alþjóðlegar verðbreytingar árið 2020

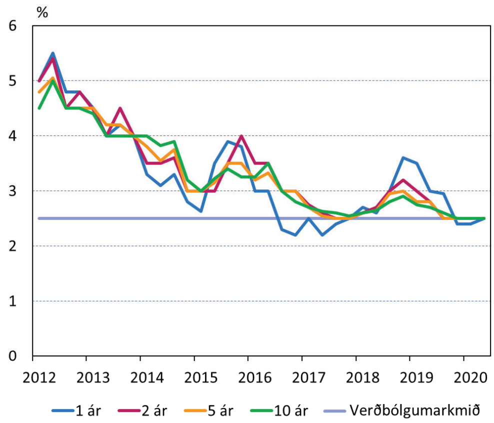


1. Matvæli eru ýmsar tegundir matarolíu, ýmsar mjöl- og korntegundir, kjöt og ávextir. Drykkjarvörur eru kakó, kaffi og te. Hráefni er timbur, baðmull, gúmmí og tóbak. 2. Spáð ársbreyting á verði olíu, hrá-, mat- og drykkjarvöru í USD. 3. Spáð ársbreyting útflutningsverðs út frá viðskiptavegnu meðaltali. 4. Spáð verðbólga í viðskiptalöndum út frá viðskiptavegnu meðaltali. 5. Spáð ársbreyting innflutningsraungengis (hlutfallslegs verðs innflutnings og innlendrar framleiðslu).
Heimildir: Alþjóðabankinn, Seðlabanki Íslands.

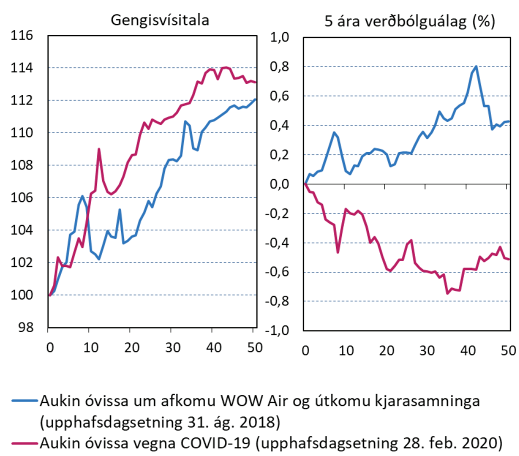
... og það að verðbólguvæntingar hafa ekki hækkað

- Verðbólguvæntingar markaðsaðila hafa ekki hækkað og hafa haldist í markmiði um nokkurn tíma …
- … og verðbólguálag á skuldabréfamarkaði hefur lækkað frá því að gengi krónunnar tók að lækka í lok febrúar …
- … ólíkt því sem gerðist eftir gengislækkun haustið 2018 sem varð í kjölfar aukinnar óvissu um kjaraviðræður og framtíð WOW Air

Verðbólguvæntingar[1]
1. ársfj. 2012 - 2. ársfj. 2020



Gengi krónunnar og verðbólguvæntingar haustið 2018 og vorið 2020[2]

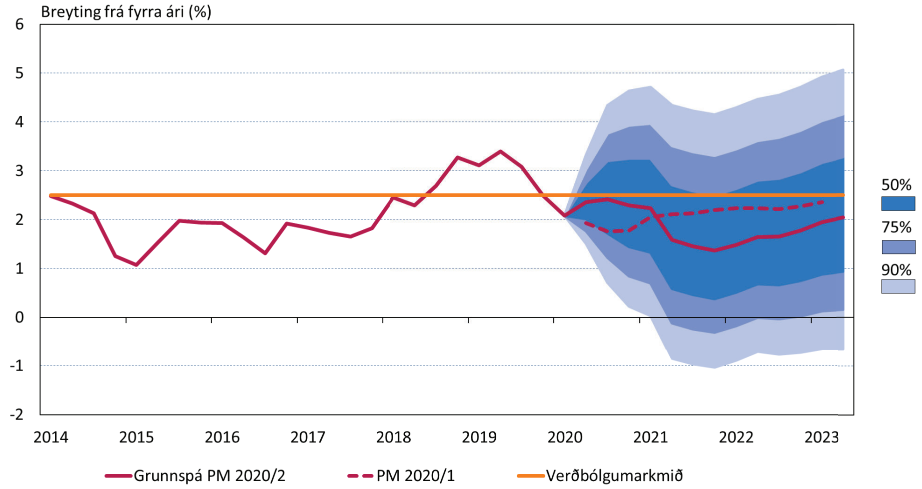


1. Verðbólguvæntingar markaðsaðila út frá könnun Seðlabankans sem framkvæmd var dagana 4.-6. maí 2020. 2. Samanburður á 50 daga þróun gengis krónunnar og verðbólguálags á skuldabréfamarkaði í kjölfar tveggja tímabila aukinnar óvissu. Upphafsdagsetning = 100 fyrir gengi krónunnar og = 0 fyrir verðbólguálag.
Heimild: Seðlabanki Íslands.

Horfur á hóflegri verðbólgu en óvissa mikil

- Þróun verðbólgu á næstunni mun litast af mótverkandi kröftum: áhrif lækkunar á ISK annars vegar og mikillar lækkunar olíuverðs, alþjóðlegrar verðlækkunar mat- og hrávöru og verulegs slaka sem hefur myndast í þjóðarbúinu hins vegar
- Spáð að verðbólga verði við markmið á næstunni en hjaðni í um 1½% um mitt næsta ár og taki síðan að þokast upp í markmið

Verðbólguspá og óvissumat
1. ársfj. 2014 - 2. ársfj. 2023

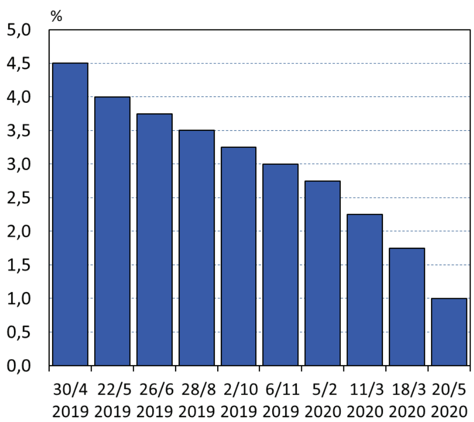


Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

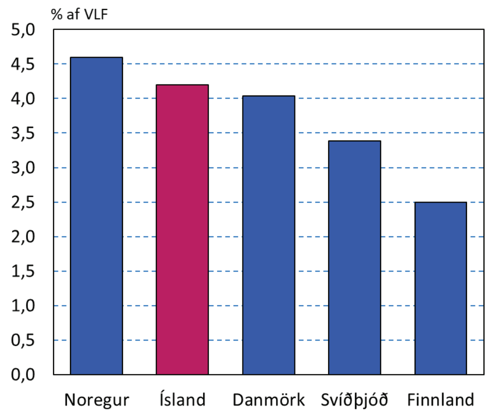
Efnahagsaðgerðir vegna COVID-19- heimsfaraldursins

- Vextir Seðlabankans lækkaðir um 1,75 prósentur frá því faraldurinn hófst
- Lausafé í umferð aukið: bindiskylda, sveiflujöfnunarauki
- Kaup á ríkisskuldabréfum á eftirmarkaði
- Aðgerðir í ríkisfjármálum

Meginvextir Seðlabanka Íslands[1]
Apríl 2019 - maí 2020



Alþjóðlegur samanburður á umfangi aðgerða á sviði fjármálastefnu[2]

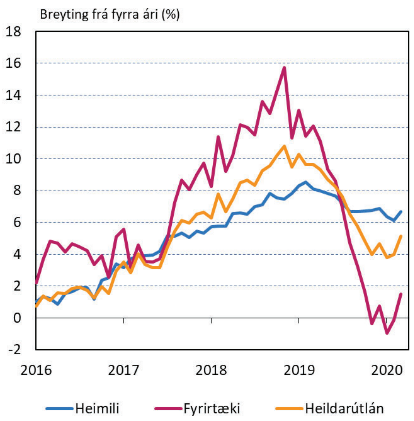


1. Meginvextir Seðlabankans eru vextir á 7 daga bundnum innlánum. 2. Aðeins er tekið tillit til þeirra aðgerða sem hafa bein áhrif á rekstrar-reikning ríkissjóða viðkomandi landa.
Heimildir: Alþjóðagjaldeyrissjóðurinn, Stjórnarráð Ísland, Seðlabanki Íslands.

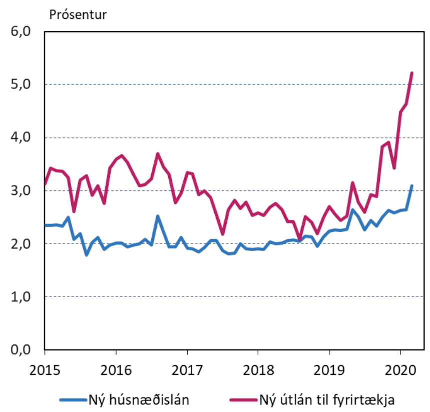
Þróun útlána og miðlun peningastefnunnar

- Vöxtur útlána til heimila hefur enn haldist tiltölulega stöðugur en hratt hefur dregið úr vexti útlána til fyrirtækja
- Vextir útlána til heimila hafa lækkað samhliða vaxtalækkunum Seðlabankans en vaxtaálag á nýjum útlánum til fyrirtækja hefur hækkað talsvert

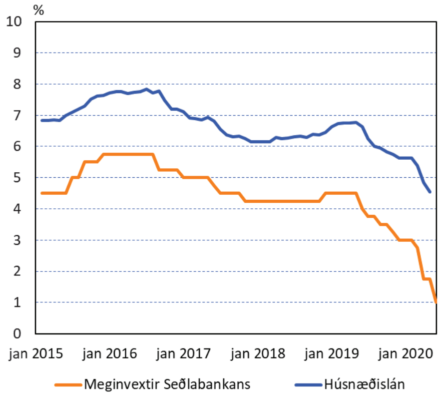
Útlán lánakerfis[1]
Janúar 2016 - mars 2020



Vaxtaálag á útlánum[2]
Janúar 2015 - mars 2020

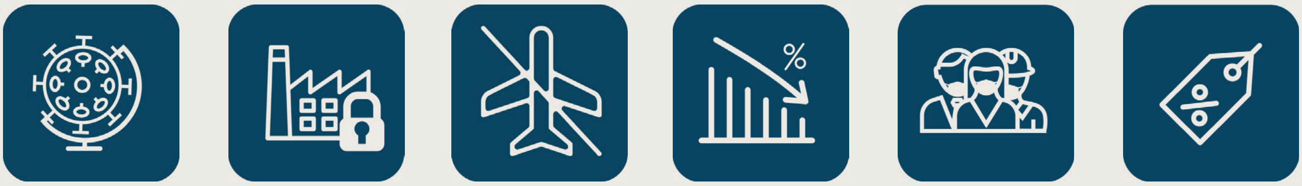


Meginvextir og vextir óverðtryggðra útlána til heimila[3]
Janúar 2015 - maí 2020



1. Leiðrétt fyrir endurflokkun og skuldalækkunaraðgerðum stjórnvalda. Án útlána til innlánsstofnana, fallinna fjármálafyrirtækja og hins opinbera. Fyrirtæki eru atvinnufyrirtæki og félagasamtök sem þjóna heimilum. 2. Mismunur á vegnum meðalvöxtum á óverðtryggðum útlánum stóru viðskiptabankanna þriggja og meginvöxtum Seðlabankans. Nýjustu tölur eru bráðabirgðatölur. 3. Vegnir meðalvextir óverðtryggðra útlána stóru viðskiptabankanna þriggja miðað við fjárhæð útlána.
Heimild: Seðlabanki Íslands.

Peningamál í hnotskurn



COVID-19 veldur usla í heims-búskapnum	Sóttvarnar-aðgerðir hafa mikil efna-hagsleg áhrif	Gríðarlegt högg fyrir fluggeirann og ferða-þjónustu hér á landi	Spáð mesta efnahags-samdrætti á einu ári í heila öld	Mikil fækkun starfa og vinnustunda og atvinnuleysi í sögulegar hæðir	Verðbólga hefur haldist undir markmiði og spáð að svo verði áfram

Ritið í heild
Kynning aðalhagfræðings
Power Point myndir
Myndagögn
Tíst
Skýringarmyndband bankastjóra

Statement by the Central Bank of Iceland on extension of the hiatus in pension funds' foreign currency purchases

After consultations with the Central Bank of Iceland, the pension funds suspended their foreign currency purchases beginning on 17 March 2020, in response to the severe contraction in export revenues caused by the COVID-19 pandemic and the downward pressure it could potentially exert on the exchange rate of the króna. It is clear that this hiatus has played an important role in maintaining macroeconomic stability during the shockwave that has struck the domestic economy in recent months. It has now been decided to extend the hiatus by another three months, or until 17 September 2020. With this, the pension funds have once again demonstrated their commitment to supporting stability in the foreign exchange market.

In the past few years, Iceland has been transformed from a capital-importing country with a sustained current account deficit to a capital exporter with a sizeable current account surplus. This turnaround stems in large part from the savings that are accumulated in the pension system over time, laying entirely new foundations for the maintenance of macroeconomic stability in recent years. This has certainly been of benefit to Iceland in the past few months.

It should be noted in particular that the pension funds' foreign investments are very important in the long run, both for pension fund members and for the nation as a whole. They diversify the pension funds' risk and prevent pension benefit payments from having an adverse impact on the economy in the future. Furthermore, the pension funds' foreign investments are necessary in order to maintain balance of payments equilibrium alongside a current account surplus, export-driven output growth, and job creation.

The Central Bank appreciates the social responsibility the pension funds are demonstrating during the ongoing crisis. The cooperative relationship between the Bank and the pension funds has attracted attention abroad and has been mentioned explicitly in statements from international credit rating agencies.

This cooperative relationship is dynamic in nature, in that it will be possible to respond quickly if conditions in the foreign exchange market change in a way that enables the pension funds to resume foreign investment and the associated foreign currency purchases.

Ásgeir Jónsson, Governor

Press release no. 19/2020
15 June 2020

Announcement concerning Central Bank purchases of Treasury bonds

At the beginning of May 2020, the Central Bank of Iceland began buying Treasury bonds in the secondary market, in accordance with the 23 March 2020 statement by the Monetary Policy Committee. The objective of the purchases is to ensure monetary policy transmission throughout the yield curve, so that the more accommodative monetary stance is transmitted normally to households and businesses. In this context, particular consideration is given to the market effects that the foreseeable increase in Treasury bond supply will have on monetary policy transmission.

The aim is to keep the scale of the purchases consistent with normal market functioning. The Bank will set amounts, frequency, and execution of the purchases so as to ensure the efficacy of the measures.

According to the above-mentioned Monetary Policy Committee decision, the Bank may purchase Treasury bonds for up to 150 b.kr. The Bank announces in advance the maximum amount it intends to buy each quarter. For Q2, it was announced that the Bank's total purchases could range up to 20 b.kr. market value.* The Bank's total purchases for the period came to 892.3 m.kr. market value, as follows: RB21, 203.5 m.kr.; and RB22, 688.8 m.kr.

For Q3/2020, the Bank's purchases could total as much as 20 b.kr. market value, and they could extend to all nominal benchmark Treasury bonds issued in Icelandic krónur and maturing in 2021, 2022, 2025, 2028, and 2031, as well as new nominal benchmark issues that may be added on.

The Central Bank will purchase the bonds by submitting bids to the Nasdaq Iceland trading system. It is also possible that the Bank will announce purchases by auction.

Any auctions that are held will be announced with one day's advance notice. The announcement will specify the series and the estimated maximum amount to be purchased. Information on the general terms and conditions for auctions that may be held in connection with the Central Bank's purchase of Treasury bonds in the secondary market can be found here.

Further information can be obtained from Sturla Pálsson, Director of the Markets Department of the Central Bank, at tel +354 569-9600.

** The sale price or market value refers to the clean price plus accrued indexation; i.e., with indexation but without accrued interest.*

No. 24/2020
30 June 2020

Box 2

Macroeconomic policy measures in response to the COVID-19 pandemic

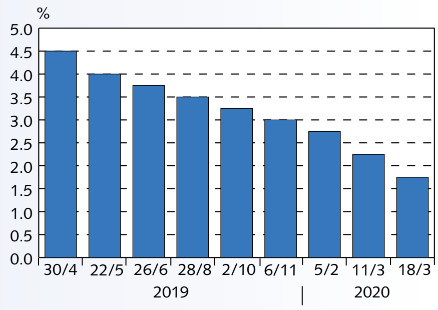
The COVID-19 pandemic and government measures to curb the spread of the disease have caused the global economic outlook to change radically in a short period of time (see Box 1). Many companies have scaled down operations significantly, and both domestic and foreign demand have all but collapsed. In addition, domestic and international financial markets have been highly volatile. The economic contraction has been unusually sharp and sudden, but a rebound is expected to begin in H2. The chief task of macroeconomic policy is to mitigate the economic impact of the pandemic to the extent possible and support households and businesses through the most difficult period. The aim of such mitigation is to minimise the probability of permanent damage to households and businesses, thereby maximising the strength of the economic recovery once the pandemic recedes.

Monetary policy measures

Since the pandemic struck, the Central Bank of Iceland has taken a wide range of actions to ease the monetary stance and boost financial system liquidity, in order to shore up demand, support increased access to credit, and preserve financial system stability. In this way, the Bank attempts to achieve its set objectives; i.e., to ease the economic contraction so that inflation can be held at target and financial stability can be ensured.

Central Bank cuts interest rates by 1 percentage point
The Central Bank Monetary Policy Committee (MPC) lowered the Bank's key interest rate by 0.5 percentage points at two consecutive meetings, on 11 March and again on 18 March, bringing the key rate to 1.75% (Chart 1). Even before these reductions, the key rate was at its lowest ever. The objective of the rate cuts was to ease the monetary stance in response to the worsening economic outlook, which stemmed from the spread of the virus and the negative economic impact of public health measures taken in Iceland and abroad to curb the spread of the disease.

Chart 1
Central Bank of Iceland key interest rate[1]
April 2019 - May 2020



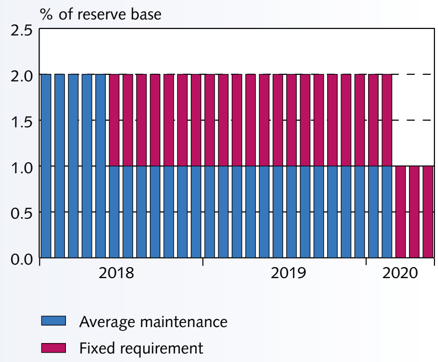
1. The Central Bank's key interest rate is the rate on seven-day term deposits.
Source: Central Bank of Iceland.

Liquidity boost
In order to stimulate demand even further, the Bank adopted wide-ranging measures aimed at easing financial institutions' access to liquidity, thereby facilitating lending to households and businesses.

On 11 March, the MPC announced changes to minimum reserve requirements; i.e., the amount deposit institutions must hold with the Central Bank as liquid assets. Minimum reserve requirements fall into two categories: average reserve maintenance and a fixed reserve requirement. The average reserve maintenance requirement – the requirement that deposit institutions hold in reserve a specified percentage of their liquid assets, on average, over any given reserve maintenance period – was lowered from 1% of short-term funding to 0% (Chart 2). Although the fixed reserve requirement – the portion of liquid assets that deposit institutions must hold in reserve at all times – remained unchanged, its treatment under the Rules on Liquidity Coverage Ratio (LCR) was changed. With this, credit institutions' LCR increased, even though the fixed reserve requirement was unchanged. As a result of these changes in reserve requirements, deposit institutions' liquidity position was strengthened by approximately 40 b.kr.

On 18 March, the Bank's Financial Stability Committee (FSC) announced that financial institutions' capital requirements would be eased so as to bolster their lending capacity and their ability to restructure distressed households' and businesses' debt. The counter-

Chart 2
Minimum reserve requirements[1]
1 January 2018 - 15 May 2020



1. A financial institution's minimum reserve requirement is a percentage of its reserve base, which includes deposits and its own bond issues with a maturity of up to two years.
Source: Central Bank of Iceland.

Chart 3

10-year Government-guaranteed bond yields[1]

1 January 2018 - 15 May 2020

1. Based on the zero-coupon yield curve, estimated with the Nelson-Siegel method, using money market interest rates and Government-guaranteed bonds.
Source: Central Bank of Iceland.

cyclical capital buffer – the special capital buffer that had been built up in recent years so as to bolster financial institutions' resilience – was lowered from 2% to 0% and will remain there for at least two years. All else being equal, this measures should give credit institutions additional scope to expand their loan portfolios by 12.5%, or 350 b.kr.

On 27 March, the Central Bank announced that it would tighten financial institutions' access to one-month term deposits with the Bank. These deposits have been one of financial institutions' main avenues for investing króna-densminated liquid assets and complying with liquidity requirements, as Treasury bonds have been in short supply. The commercial banks have held a large share of their liquid assets in these accounts, and interest rates on them have been somewhat above the Central Bank's key rate. Reducing the supply of term deposits in this manner forces the banks to find other uses for this excess liquidity; i.e., hold it in current accounts or seven-day term deposits or, alternatively, to use it to buy Treasury bonds or increase other assets, such as loans.

On 8 April, in order to ensure that deposit institutions have access to adequate liquidity, the FSC and the MPC introduced a special temporary collateralised lending facility and an expanded list of eligible collateral. This measure was designed primarily to guarantee smaller deposit institutions sufficient access to liquidity while the pandemic is ongoing.

Secondary market purchases of Treasury bonds

On 23 March, the MPC announced that the Bank would begin buying Treasury bonds in the secondary market. The purpose was to ensure even further that the more accommodative monetary stance would be transmitted normally to households and businesses. It was announced that the Bank will purchase bonds for up to 150 b.kr., or about 5% of GDP. Further details on the purchases were announced on 22 April, and in early May the Bank began buying Treasury bonds. The Bank announced that it will purchase bonds for up to 20 b.kr. in Q2.

This measure is particularly important under the current circumstances, where it is foreseen that the Treasury will need to borrow significant amounts via Treasury bond issuance in order to finance pandemic response measures. Because of this, there was a risk that the increased Treasury bond supply would push market rates upwards, thereby disrupting the transmission of the more accommodative monetary stance to the long end of the yield curve. The impact of these Central Bank measures could be seen immediately after the MPC's 23 March announcement, with long-term interest rates falling by 0.37 percentage points (Chart 3).

Other Central Bank measures

The Central Bank had announced previously that, effective 1 April 2020, deposit institutions would be the only institutions authorised to hold deposits with the Central Bank. This forced the deposits of other financial institutions and Government institutions into the financial system, thereby strengthening deposit institutions' liquidity and supporting monetary policy transmission.

The Bank has also intervened in the foreign exchange market in recent months in order to mitigate excess exchange rate volatility. Furthermore, the Bank has urged the pension funds to reduce the amount of foreign currency they purchase to finance foreign investments until the economic situation normalises. Moreover, the Central Bank has obtained access to the US Federal Reserve's temporary repurchase agreement facility, which grants the Bank access to US dollar liquidity against collateral in US Treasury securities from the Bank's international reserves. Finally, the Bank has instructed the boards of financial institutions to refrain from using their improved liquidity position and reduced capital requirements to pay dividends.

Fiscal policy measures

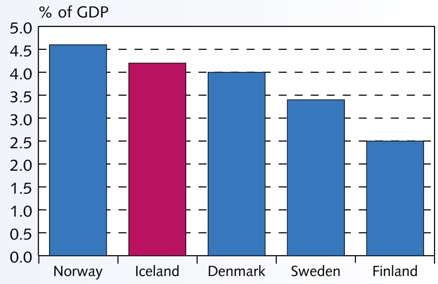
The main objectives of the Government's fiscal policy measures have been, on the one hand, to mitigate the shock suffered by those households and businesses that are most vulnerable to the impact of the pandemic and, on the other hand, to protect jobs and companies during the pandemic and support a strong economic recovery when it recedes.

Policy measures and their scope
In March and April, the Government introduced over twenty measures aimed at softening the economic blow from the pandemic. The scope of these measures is estimated at nearly 352 b.kr., or around 11.9% of year-2019 GDP. The measures that directly affect the fiscal budget amount to 4.2% of GDP, which is similar to the measures announced in Norway and Denmark (Chart 4).

From an economic perspective, the measures centre mainly on two areas: reducing distressed households' and businesses' income losses and supporting economic activity during a steep contraction in private sector demand. Also introduced were special measures aimed at improving the position of students and protecting individuals with delicate health or difficult social circumstances (Table 1).

Chart 4

Pandemic response – international comparison of fiscal measures[1]



1. Only those measures that directly affect the national treasury's profit and loss account are included.
Sources: Government of Iceland, International Monetary Fund, Central Bank of Iceland.

Table 1 Fiscal policy measures in response to COVID-19

Measure	*Scope (b.kr.)*
Government-guaranteed bridge loans to businesses[1]	70.0
Support loans[1]	40.0
Deferral of tax payments[1]	75.0
Corporate income tax netting[1]	13.0
Closure subsidies[3]	2.5
Expedited reduction of bank tax[2]	11.0
Deferral of payments of import levies and cancellation of customs processing fees[1, 2]	13.6
Part-time employment option[3]	38.0
Wage payments during termination notice period[3]	25.0
Wage payments in quarantine[3]	1.0
Supplemental child benefit[3]	3.0
Additional authorisation for third-pillar pension withdrawal[4]	10.0
Special tourism-centred measures[2, 3]	4.6
Special support for media, local governments, and front-line workers[3]	4.7
Innovation and R&D[2, 3]	5.2
Student jobs initiative and artists' stipends[3]	2.5
Measures for students and vulnerable groups[3]	4.7
Increased VAT reimbursement for property construction and maintenance[2]	8.0
Special investment initiative[3]	20.0

1. Affects firms' balance sheets and cash flow statements. 2. Entails reduced Treasury revenues 3. Entails increased Treasury expenditures 4. Increases households' cash balances for consumption spending.

Sources: Government of Iceland, Central Bank of Iceland.

Firms helped to withstand temporary revenue losses
One of the broadest aspects of the Government assistance lies in measures to support companies through a period of substantially reduced revenues stemming from the pandemic and the actions taken

in an attempt to hinder the spread of the disease. The Treasury will guarantee up to 70% of bridge loans to companies deemed viable. The amount of the Treasury guarantee is up to 50 b.kr., and the impact of the measures on firms' balance sheets and cash flow is estimated at 70 b.kr.

As a further measure to counteract smaller companies' liquidity problems, the State will also grant support loans of up to 40 m.kr. per company, for a minimum term of thirty months. The first 10 m.kr. will be guaranteed in full by the State, as will 85% of the loan amount over and above that. Loans of up to 10 m.kr. will bear interest equivalent to the Central Bank key rate, but for loans beyond that, the lender is allowed to charge a moderate credit risk premium. An estimated 40 b.kr. will be loaned in this manner, and both support loans and bridge loans will be processed through the commercial banks.

Firms experiencing operational difficulties will also be authorised to defer up to three payments of pay-as-you-earn tax (PAYE) and payroll tax until 2021. This measure will improve companies' liquidity by an estimated 75 b.kr. Another measure designed to improve companies' liquidity by a further 13 b.kr. is a new authorisation to carry year-2020 operating losses back to offset 2019 profits, thereby lowering their income tax payments.

Businesses that were forced to close for public health reasons will be eligible for closure subsidies of up to 2.4 m.kr. per company, to compensate for a portion of lost revenue and help them to cover fixed costs during the closure period. The scope of these closure subsidies is estimated at 2.5 b.kr.

In addition, a reduction of 11 b.kr. in the tax on financial institutions has been expedited, customs processing fees are cancelled through year-end 2020, and payment due dates for import levies have been deferred by four months. The Treasury will relinquish a total of 13.6 b.kr. in revenues because of these changes in fees and levies.

Mitigating households' income losses

The Government will also guarantee that workers receive income in spite of a temporary reduction in working hours. First, the Treasury will pay income-linked unemployment benefits proportional to the reduction in employment percentage if the employer must scale down operations because of pandemic response measures. Through 30 June 2020, workers must be employed at least 25% to qualify for the measure, and from 1 July through 31 August they must be employed at least 50%. The measure is set to expire on 1 September. For those covered by this measure, the sum of labour income and unemployment benefits may not exceed 90% of the worker's average total monthly wages, and may never exceed 700,000 kr. per month. For jobs that pay 400,000 kr. per month or less for a 100% position, full monthly wages are guaranteed. Although an assessment has yet to be finalised, the cost of this measure is expected to total about 38 b.kr.

Second, firms will be given the opportunity to apply for Government support to cover a portion of wage costs during employees' termination notice period. This support will take the form of a payment not to exceed 633,000 kr. per month for up to three months. It is limited to those companies that have suffered at least a 75% loss in revenue and envision continued revenue losses at least through end-2020. It is estimated that up to one-fourth of companies have suffered such losses. The Government support will be capped at 85%, and the measure is available from 1 May through 30 September 2020. The estimated cost to the Treasury for this measure is 25 b.kr. Third, the Treasury will reimburse employers for wages paid to workers in quarantine and will pay self-employed individuals 80% of their 2019 income, up to 633,000 kr. per month. The estimated cost to the Treasury for this measure is 1 b.kr.

Incentives for increased economic activity

The Government measures also include other incentives to support economic activities and mitigate the adverse impact of the pandemic on the domestic economy. Families with children will be paid a special supplemental child benefit, at an estimated total cost of 3 b.kr. Furthermore, the authorisation for early withdrawal of third-pillar pension savings has been expanded, and the Government's estimates assume that the scope of this measure will be 10 b.kr., some 4 b.kr. of which will revert to the Government in the form of income tax. These measures increase households' cash balances for consumption spending.

Special support for tourism

In order to provide special support to domestic tourism operators, the bed-night tax has been cancelled through end-2021, and payment due dates for the first three months of the year have been deferred until February 2022. The Treasury also plans to allocate 1.5 b.kr. to the issuance of special gift certificates to all adults in Iceland, which can be used to pay for domestic tourism, and another 1.5 b.kr. will be allocated to a dedicated marketing campaign advertising Iceland as a tourist destination. The total scope of these special tourism support measures is estimated at 4.6 b.kr.

Other support measures

It has been decided to provide special support to privately operated news media companies totalling up to 350 m.kr., in partial compensation for revenue losses. There are also plans to support the municipalities that have suffered most from the pandemic response measures, the Suðurnes peninsula in particular. In addition, investment by local governments will be supported with an expansion of the "Back to Work" initiative, and the Real Estate Fund of the Local Authorities' Equalisation Fund will be authorised to grant subsidies to municipalities. Healthcare employees and others fighting COVID-19 on the front lines will receive special wage bonuses totalling 1 b.kr. These measures together total 4.7 b.kr. Incentives for research and development (R&D) will also be strengthened and financing for innovation expanded. The estimated cost to the Treasury for this measure is 5.2 b.kr.

Other measures will be taken to address various groups' special needs due to the pandemic and its repercussions. The Government will offer up to 3,000 new summer jobs for students. It has also been decided to increase the number of artists receiving Government stipends by up to 40%. The estimated cost to the Treasury for this measure is 2.5 b.kr. Funding is also being allocated to new measures intended to strengthen job-seekers' skills. Moreover, funding will be dedicated to new social and mental health measures to protect vulnerable groups. The estimated cost to the Treasury for these measures is 4.7 b.kr.

Increase in investment funding and incentives

The "Back to Work" initiative will be expanded so that value-added tax (VAT) on labour for property construction, maintenance, and renovation will be reimbursed at a rate of 100%, up from the previous 60%. VAT on labour for car repairs will be reimbursed as well. With this programme, which will remain in effect through the year-end, the Treasury will relinquish about 8 b.kr. in revenues.

Finally, the Government has decided to expedite large-scale investment projects and increase total planned public investment by 20 b.kr. relative to the previous plan. Chief among these projects are investments in construction of traffic structures and other infrastructure. In addition, Government-owned companies will expedite investments totalling roughly 10 b.kr.

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 Bankshall 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.