



18 September 2018

## The Governor's introductory comments at an open meeting of the Parliamentary Economic Affairs and Trade Committee on the work of the Monetary Policy Committee

It is now seven months since representatives of the Monetary Policy Committee (MPC) last attended a meeting of the Parliamentary Economic Affairs and Trade Committee.

Economic developments have been broadly in line with what was expected when we were here in February. The positive output gap has continued to narrow but remains sizeable. According to the Central Bank's August forecast, GDP growth will be slightly stronger this year than was projected in February, but slightly weaker next year. The difference is small, however. The forecast for next year's output gap is similar to the February forecast, and the output gap will not close until 2020. As always, the outlook is uncertain, and unexpected positive or negative shocks could change the situation.

The króna is now about 3.7% weaker than it was when we met in February, and exchange rate volatility has increased in the past few weeks, at least partly because of uncertain prospects for the tourism industry. Inflation has remained very close to the target, however, although there are signs that long-term inflation expectations have risen somewhat above it.

The Central Bank's nominal interest rates have been unchanged in 2018 to date, but the monetary stance has eased. The monetary stance is measured in terms of the Bank's real rate, using the Bank's key interest rate and the average of several measures of inflation and inflation expectations. At the beginning of the year, the real rate was 1.7%, but it is now around 1.3%. As regards other monetary policy instruments, a change was made to minimum reserve requirements on 4 June, and the Bank intervened in the foreign exchange market once, on 11 September. The aim of the change to reserve requirements was to reduce the cost incurred by the Central Bank in connection with monetary policy implementation but without affecting the monetary stance. This goal appears to have been met. The intervention entailed the sale of foreign currency for 9 million euros (just over a billion krónur) in order to halt

and unwind a spiral that had materialised in the market. This was successful as well.

In its August statement, the MPC reiterated that it has both the will and the tools necessary to keep inflation at target over the longer term. If inflation expectations continue to rise and become anchored at a level above the target, it will call for a tighter monetary stance. Other decisions, particularly those relating to the labour market and fiscal policy, will affect the sacrifice cost in terms of lower employment.

The MPC statement also emphasised that the near-term monetary stance will depend on interactions between a narrower output gap, wage-setting decisions, and developments in inflation and inflation expectations.