The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

March 2020 (91st meeting)

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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.