

The economic situation – successes and challenges for monetary policy

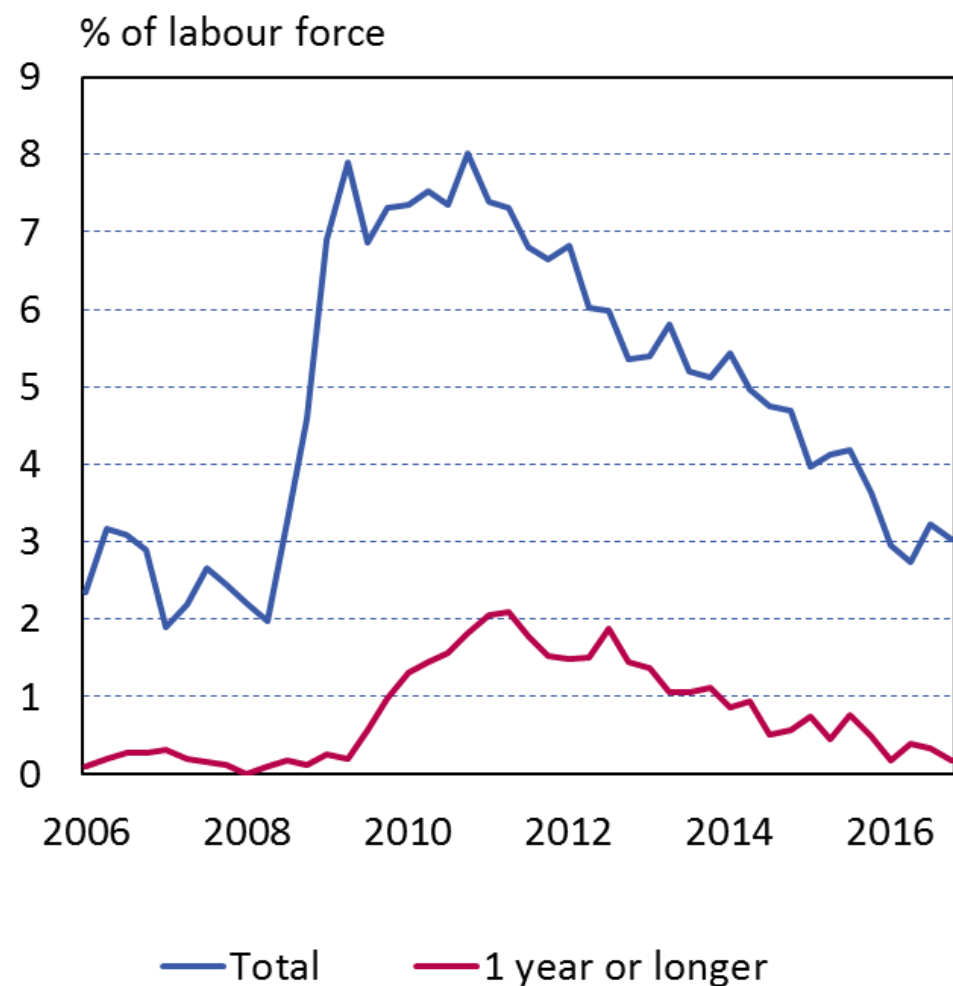


Meeting of the Macroeconomic Council

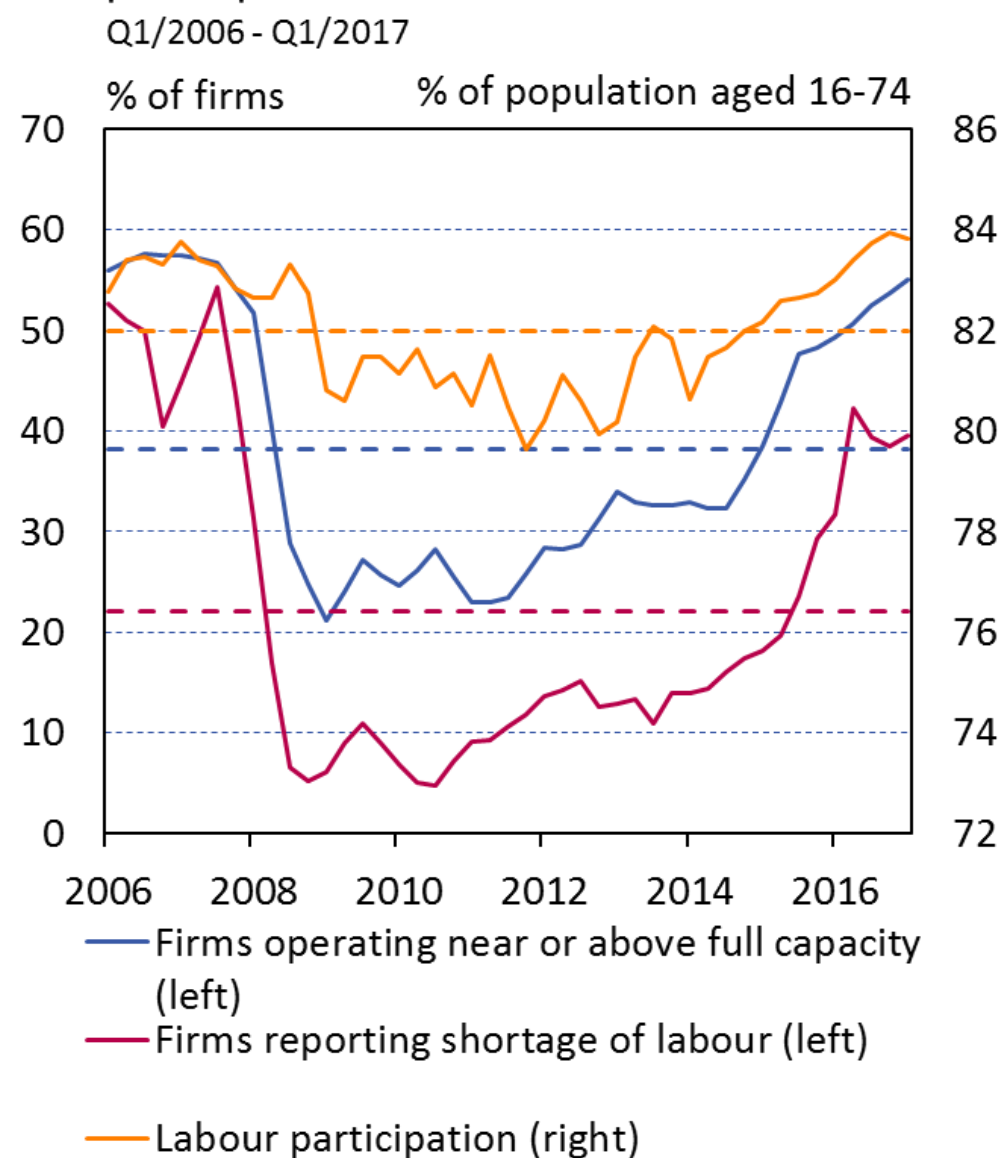
6 April 2017

Domestic resources under strain, but mitigated by labour importation

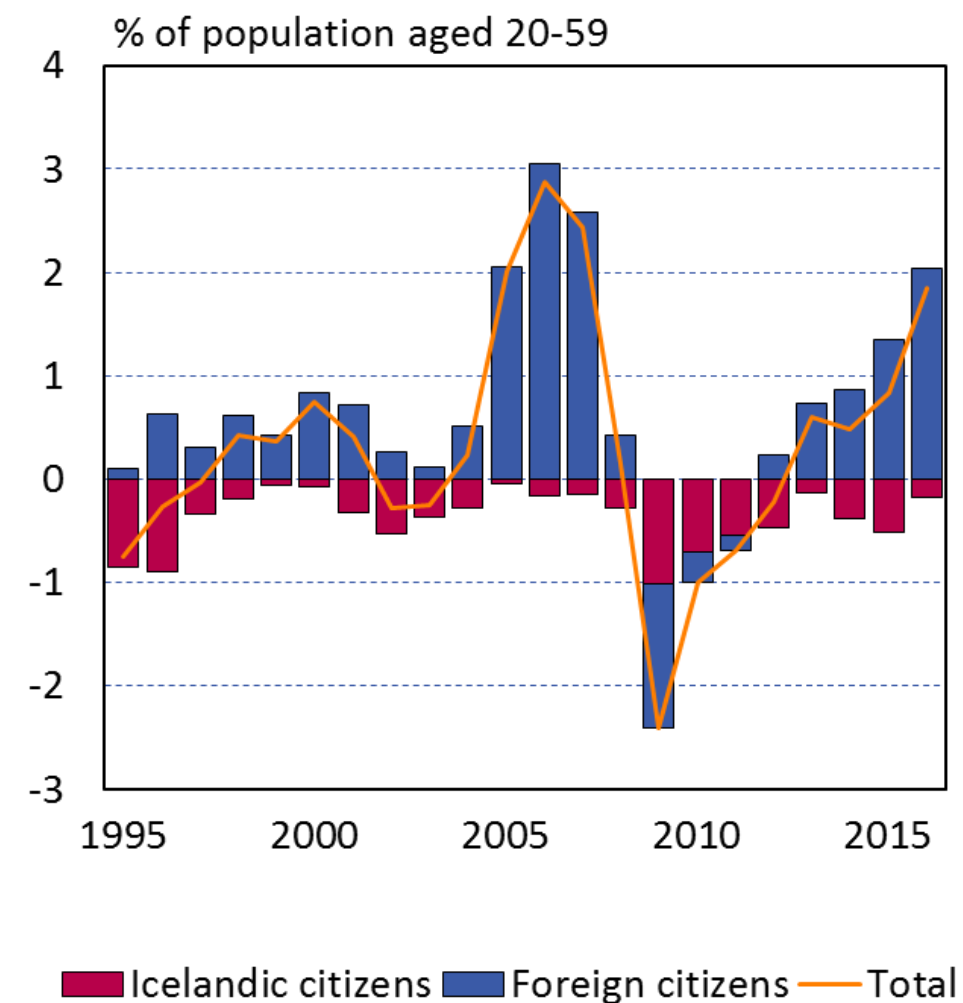
Unemployment 2006-2016¹



Capacity utilisation and labour participation²



Net immigration 1995-2016³

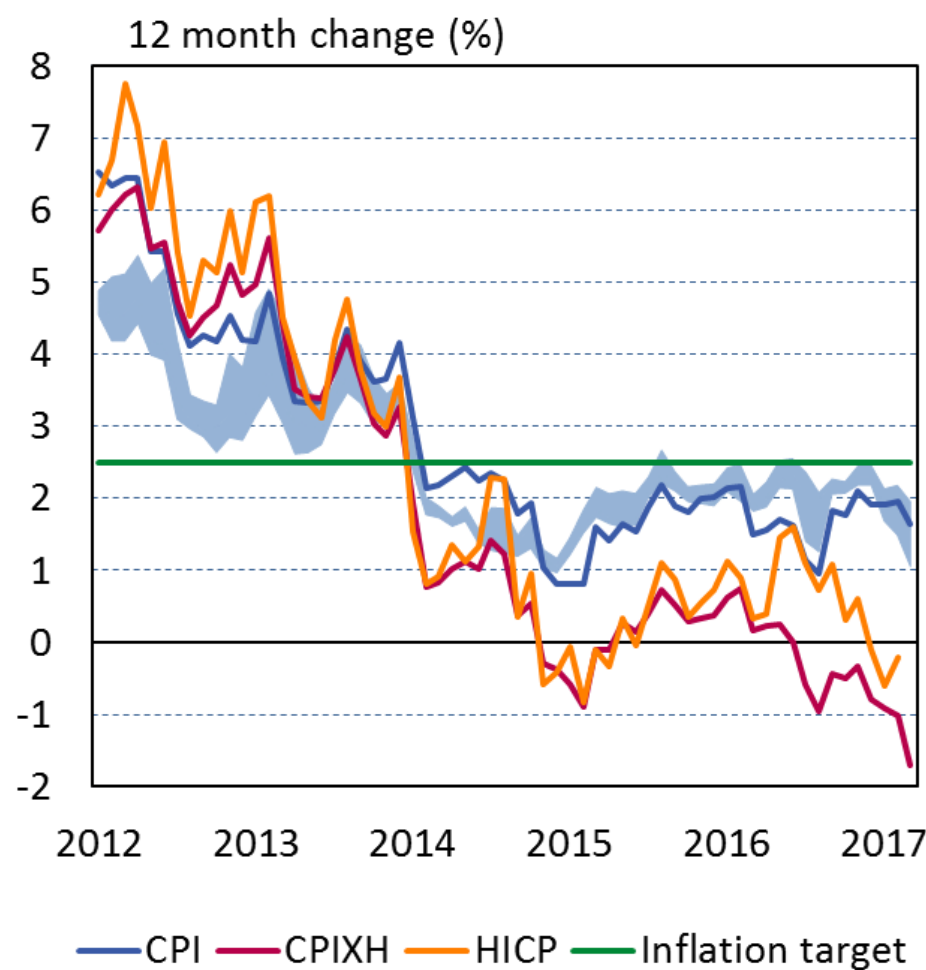


1. Seasonally adjusted figures for Q1/2006-Q4/2016. 2. Measures of factor utilisation from Gallup survey among Iceland's 400 largest firms; labour participation rate according to Statistics Iceland labour force survey. Seasonally adjusted figures for Q1/2006-Q4/2016. Broken lines show average ratios for the period. 3. Migration of persons aged 20-59.

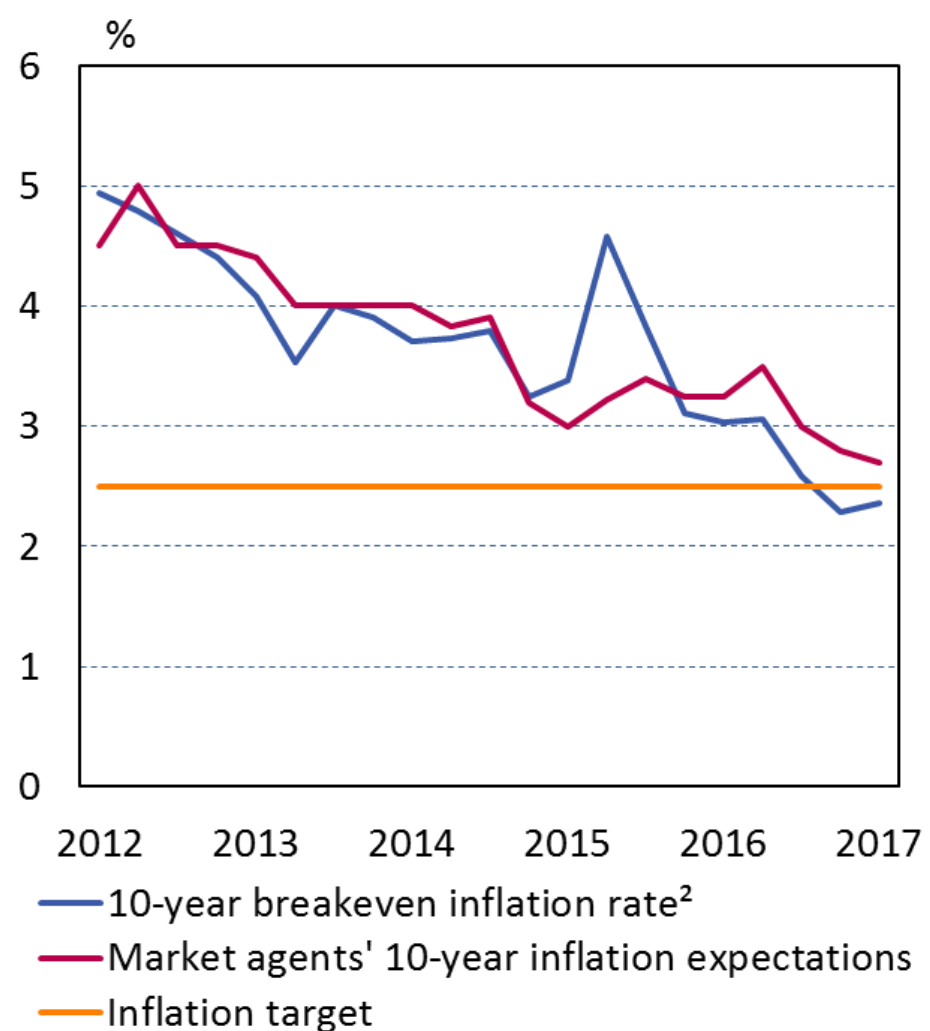
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Price stability and firmer anchor for inflation expectations

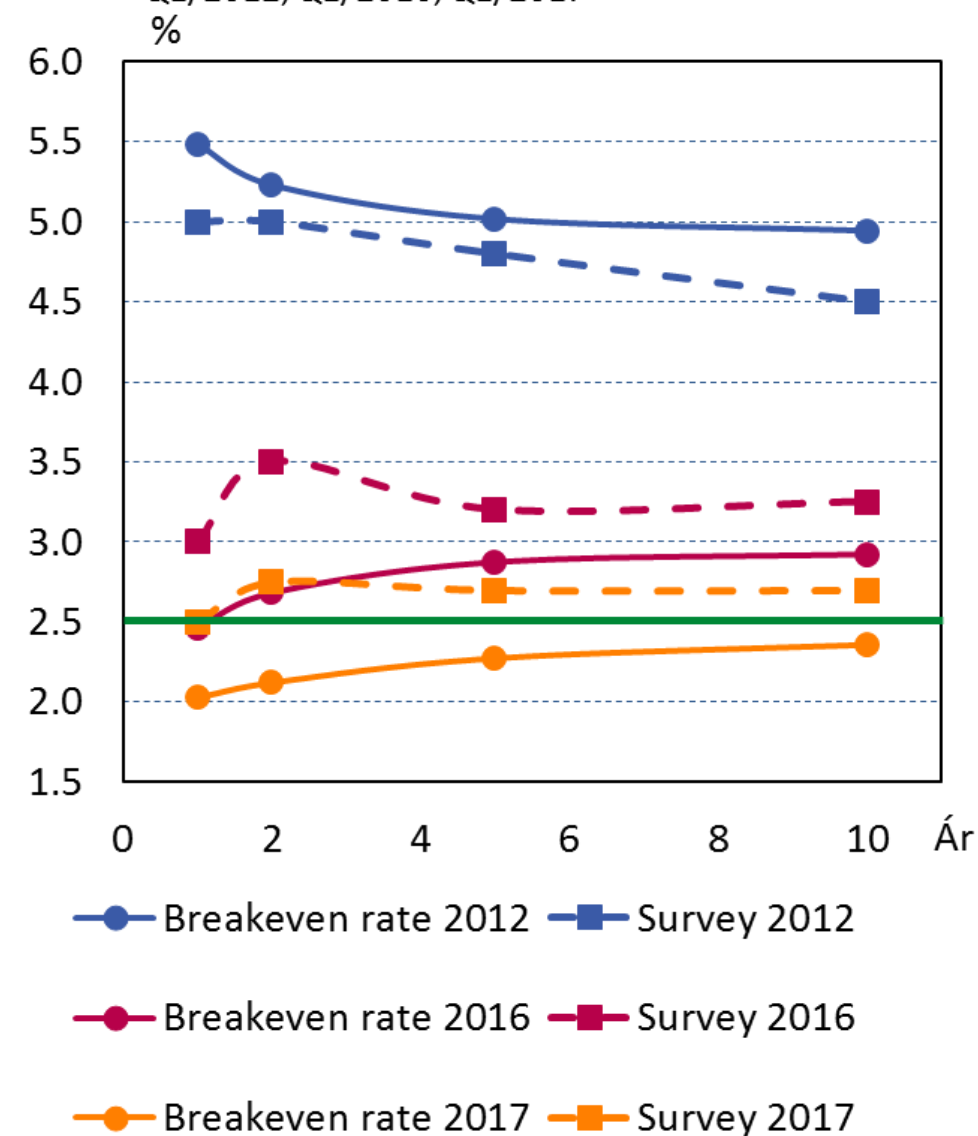
Headline and underlying inflation¹
January 2012 - April 2017



Long-term inflation expectations²
Q1/2012 - Q2/2017



One- to ten-year inflation expectations³
Q1/2012, Q1/2016, Q1/2017

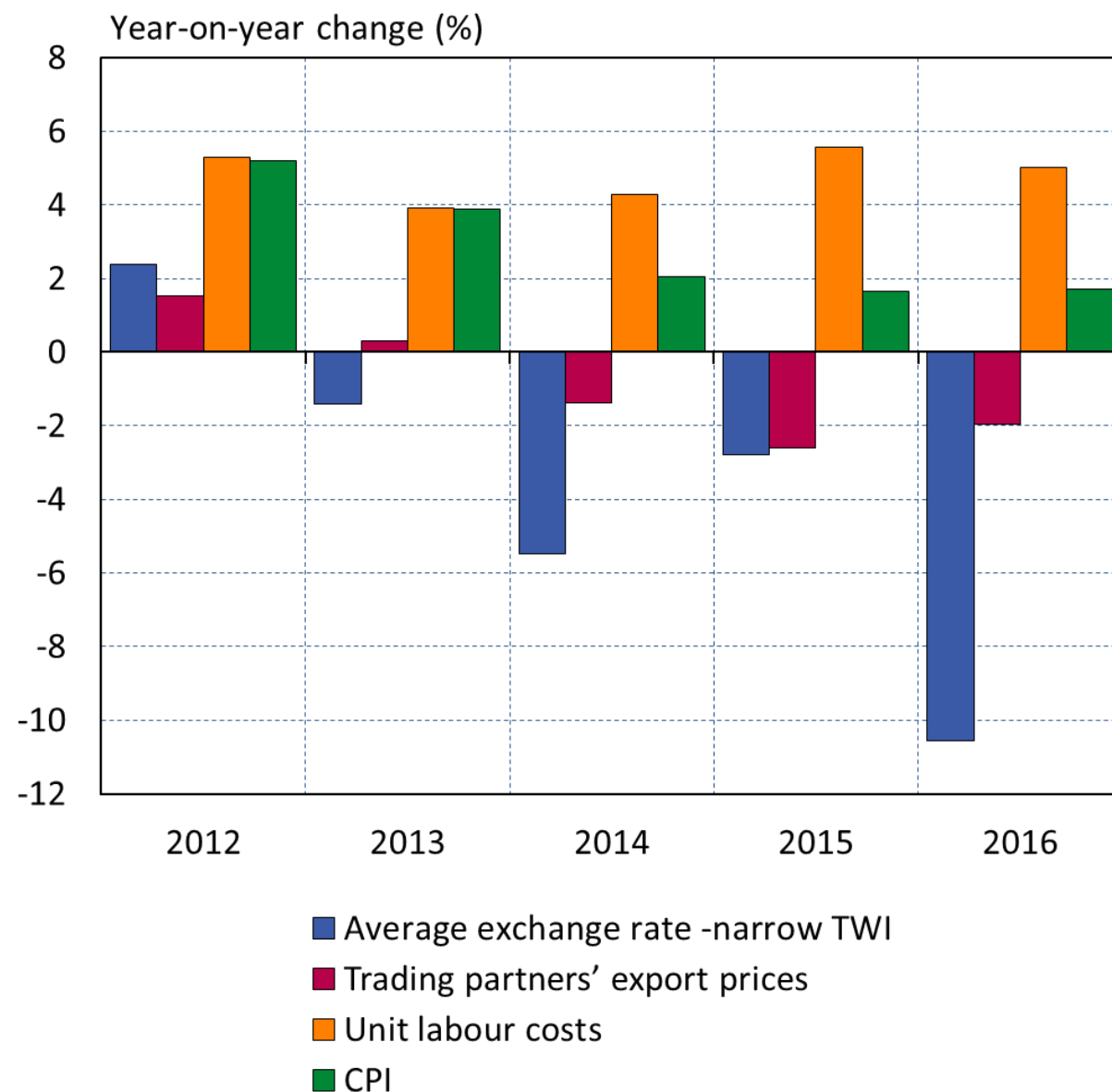


1. The shaded area shows the interquartile range of the estimate of underlying inflation measured using core indices that ignore the effects of tax changes, volatile food items, petrol, public services, and imputed rent, and using statistical measures such as the weighted median, trimmed mean, and dynamic factor model. 2. The Q1/2017 figure is the average for the quarter to date. 3. Inflation years 1, 2, 5, and 10 years ahead, based on the breakeven inflation rate in the bond market (quarterly averages) and survey of market agents.

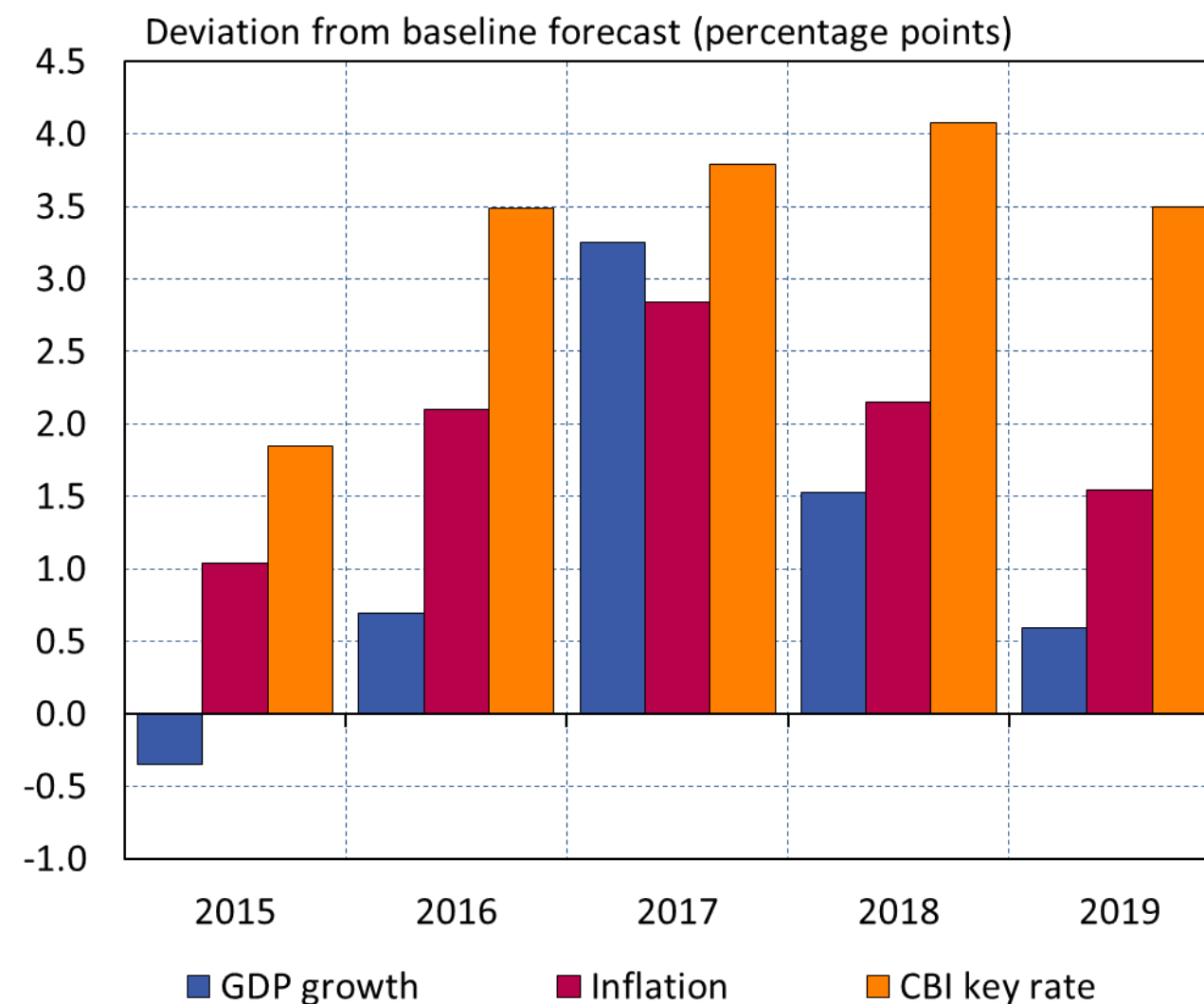
Sources: Statistics Iceland, Central Bank of Iceland.

ISK appreciation part of economic adjustment and has offset domestic inflationary pressures

Inflation and domestic and external factors 2012-2016¹



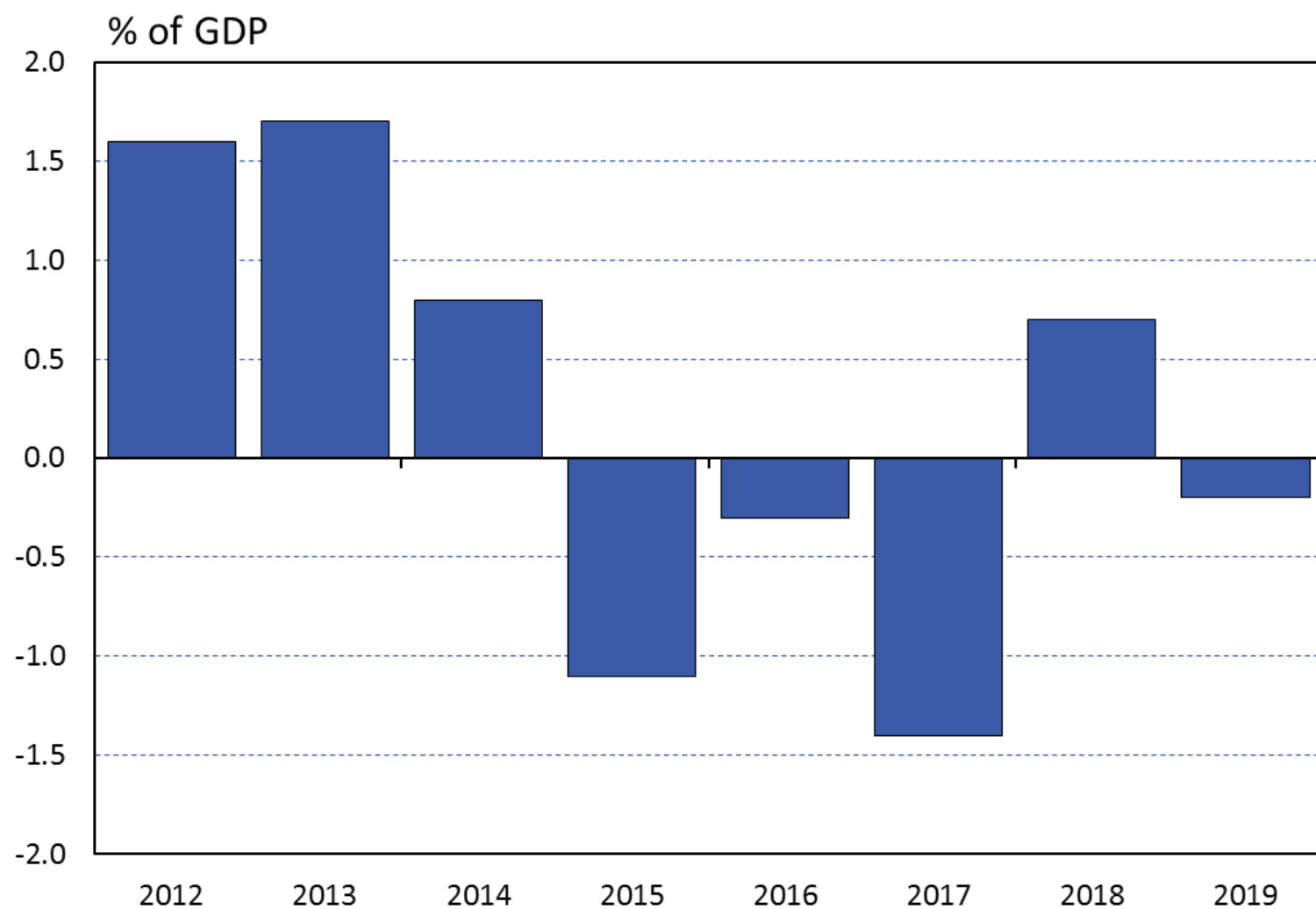
GDP growth, inflation and CBI interest rate at unchanged exchange rate from 2014¹



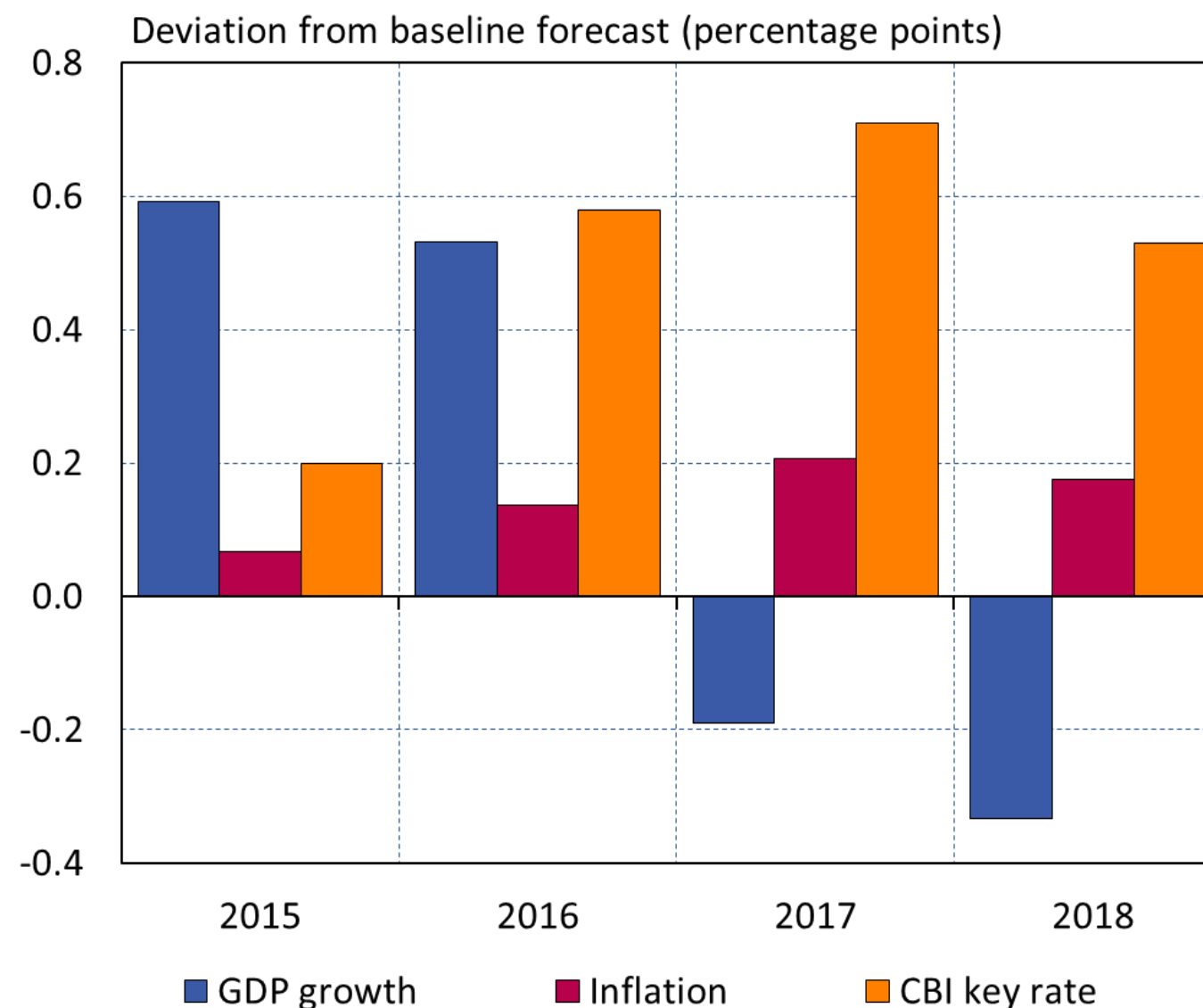
1. A rise in the trade-weighted exchange rate index (TWI) represents a decline in the exchange rate of the króna versus the average of other currencies. Unit labour costs are the ratio of wage costs to labour productivity. 2. A comparison of the baseline forecast in MB 2017/1 and a simulation using the Bank's macroeconomic model, assuming that the TWI remains unchanged at 207 points from 2014 through the end of the forecast horizon. Sources: Statistics Iceland, Central Bank of Iceland.

Fiscal easing ... calls for a tighter monetary stance than otherwise

Change in central government cyclically



Effects of fiscal easing in 2015-16 on GDP growth, inflation and CBI interest rate¹



1. The primary balance is adjusted for one-off revenues and expenditures (such as stability contributions and accelerated payments on indexed mortgage loans). This is an updated estimate of the change in the cyclically adjusted primary Treasury balance from MB 2016/4. Account has been taken of a new assessment of the output gap during the period, in accordance with MB 2017/1, and the part of the transport strategy that is in excess of the 2017 fiscal budget and the fiscal plan has been omitted. 2. Estimated fiscal easing in 2015-2016 is about 2½% of GDP, based on a simulation using the Bank's macroeconomic model (for further discussion, see MB 2016/2).

Sources: Ministry of Finance and Economic Affairs, Central Bank of Iceland.

Foreign exchange market flows 2016

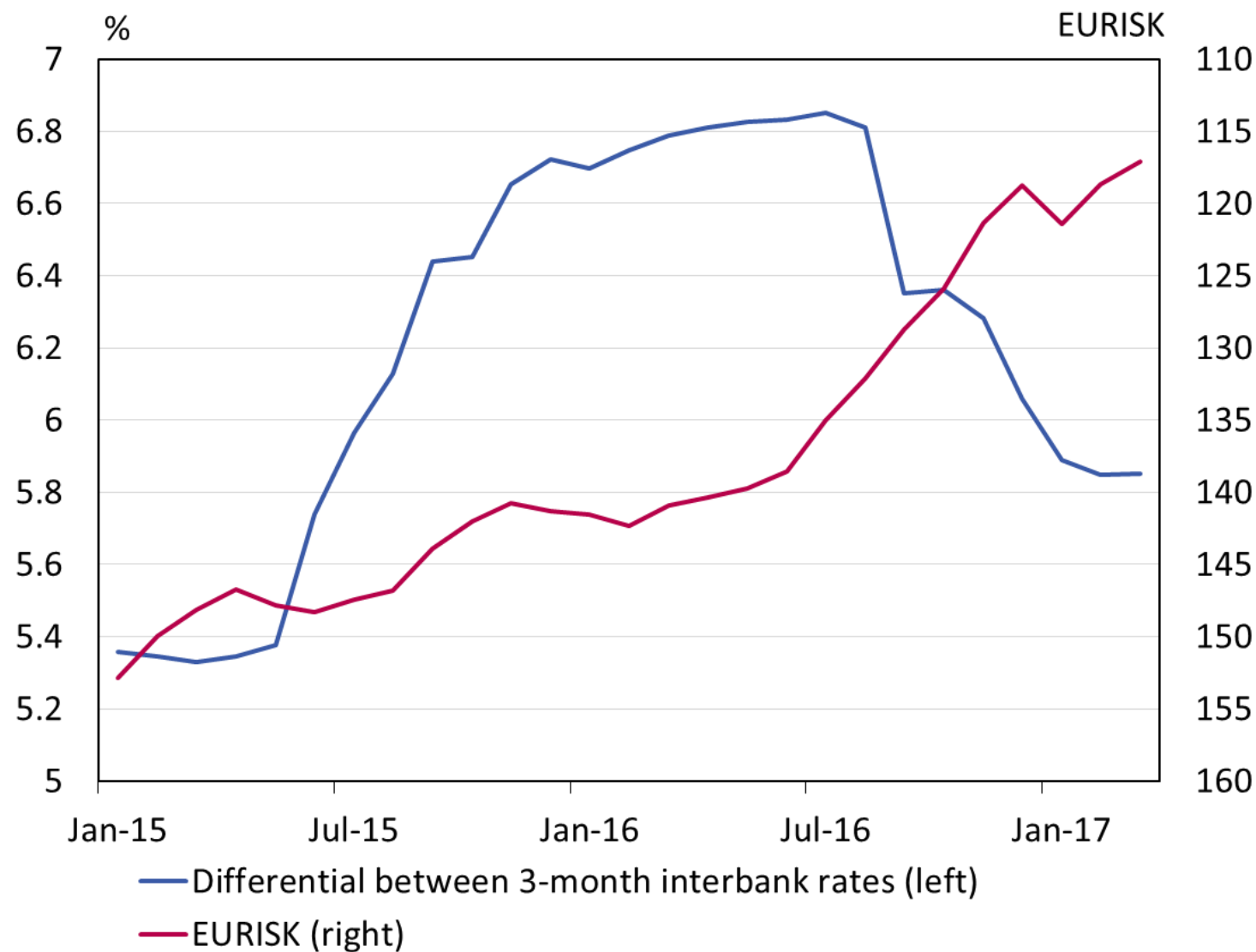
Estimated foreign currency flows in 2016	b.kr.
Estimated FX flows due to current account	195
Domestic systemically important banks (D-SIB)	205
— <i>new FX loans to residents</i>	71
— <i>reduction in FX deposits¹</i>	53
— <i>reduction of long position</i>	52
— <i>forward sale</i>	29
New investment	79
New foreign loans used in Iceland, excl. D-SIB	15
Changes in accounts payable and receivable	10
Miscellaneous one-off items	59
Central Bank of Iceland	-386
Pension funds and third-pillar pension custodians	-68
Foreign loan repayments	-60
Difference between purchases and sales	49

1. Excluding the holding companies of the failed banks.

Interest rate differential with abroad, ISK exchange rate, and Central Bank FX purchases

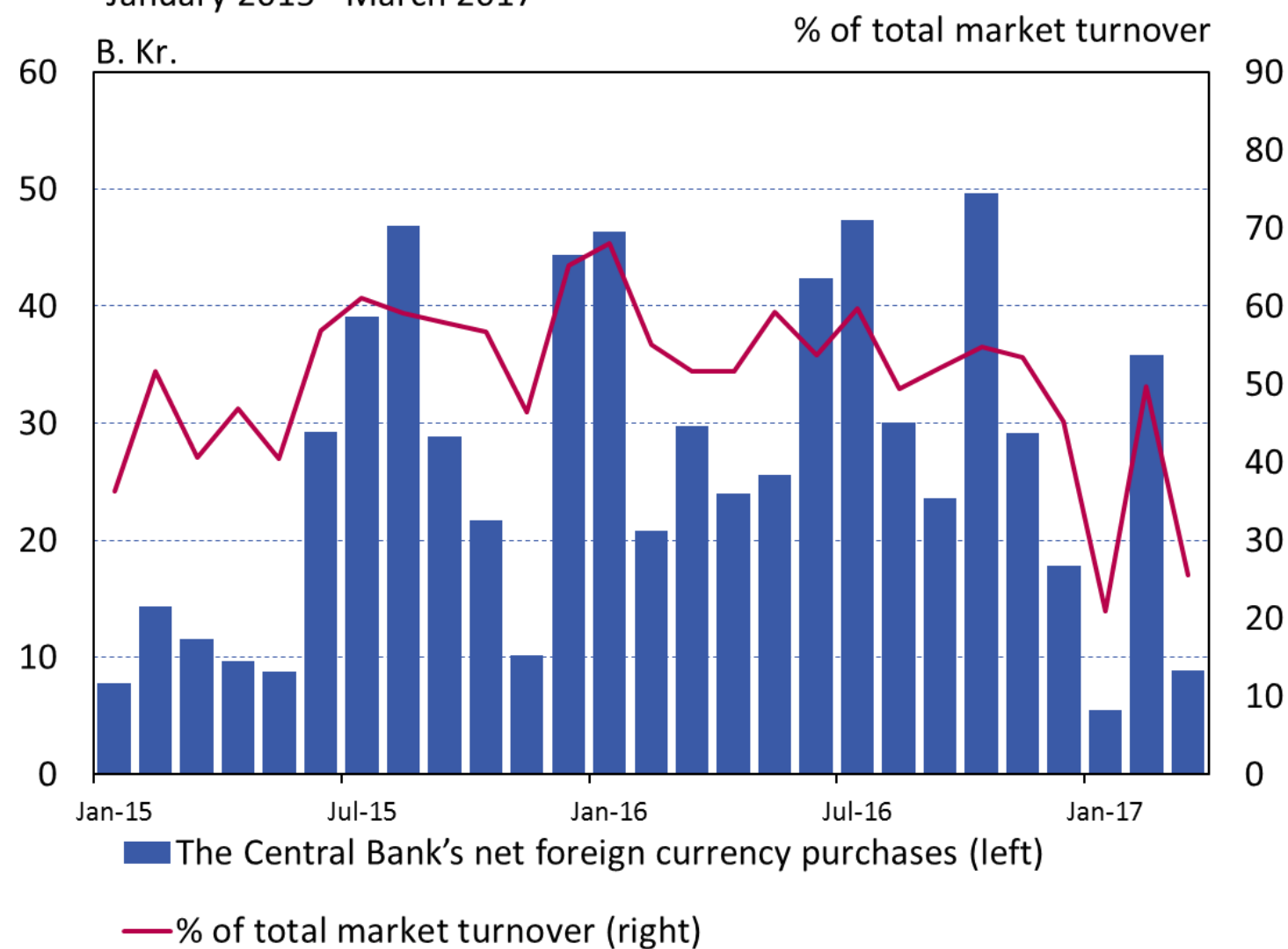
Interest rate differential with abroad¹

January 2015 - March 2017



The Central Bank's foreign exchange market intervention policy

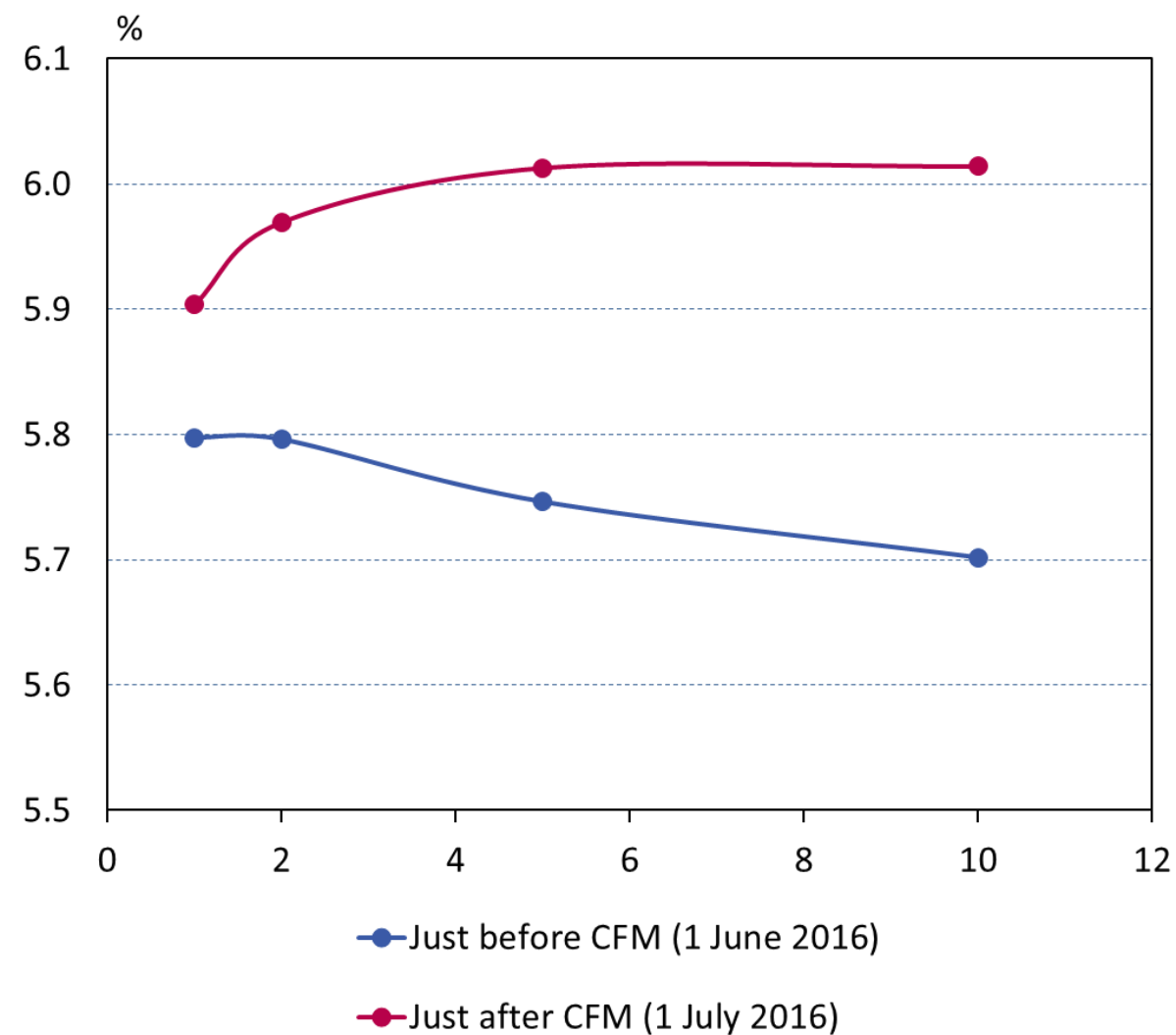
January 2015 - March 2017



1. Differential between 3-mo interbank rates in Iceland and the eurozone. Monthly averages.
Sources: Macrobond, Central Bank of Iceland.

Capital flow management measure and monetary policy transmission

Nominal Treasury bond yield curve



Nominal Treasury bond yield curve

