

Statement of the Monetary Policy Committee 4 May 2022

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to raise the Bank's interest rates by 1 percentage point. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 3.75%.

The economic outlook has deteriorated relative to the Bank's February forecast, owing to the adverse impact of Russia's invasion of Ukraine. On the other hand, there are signs of strong domestic economic activity. The slack in the economy appears to have disappeared, and the labour market is tightening. GDP growth is forecast at 4.6% this year, followed by a growth rate of just under 3% in 2023 and 2024.

Inflation measured 7.2% in April, and the outlook has deteriorated markedly. As before, house prices and other domestic cost items are strong drivers of inflation, and global oil and commodity prices have risen sharply as well. Price increases are therefore broad-based, as can be seen in the rapid rise in underlying inflation, which currently measures just over 5%. Furthermore, inflation expectations have risen by all measures. According to the Bank's forecast, the outlook is for inflation to rise above 8% in Q3/2022, some 2.8 percentage points above the February forecast. It is assumed that the combination of interest rate hikes and tighter borrower-based measures will slow down house price inflation and domestic demand.

The MPC considers it likely that the monetary stance will have to be tightened even further in coming months so as to ensure that inflation eases back to target within an acceptable time frame. Decisions taken at the corporate level, the labour market, and in public sector finances will be a major determinant of how high interest rates must rise.