Statement of the Monetary Policy Committee 11 May 2016

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to keep the Bank's interest rates unchanged. The Bank's key interest rate – the rate on seven-day term deposits – will therefore remain 5.75%.

According to Statistics Iceland estimates, GDP growth measured 4% in 2015, well in line with the Central Bank's February forecast. The outlook is for even stronger GDP growth this year, or 4.5%, according to the forecast published in *Monetary Bulletin* today. This is slightly more than was forecast in February. The outlook for 2017 has also been revised upwards, with GDP growth now projected at 4% instead of the 3.4% forecast in February. In the domestic labour market, growth can be seen in rapid job creation, a rising participation rate, and declining unemployment. Long-term unemployment has nearly disappeared, and firms are having more difficulty filling available positions than they have for quite a long time.

In spite of large pay increases and a widening positive output gap, inflation has remained below target for over two years. In April, inflation measured 1.6%, about the same as a year ago. As before, this reflects the offsetting effects of domestic inflationary pressures versus the appreciation of the króna and unusually low global inflation. Other things being equal, the outlook is for inflation to remain below target well into this year but then rise when import prices stop falling. According to the Central Bank forecast, inflation will measure 3% in Q4/2016 and 4½% in the second half of 2017, but then begin to ease back to target in response to monetary tightening. This is somewhat higher inflation than was forecast in February, as the outlook is now for stronger growth in economic activity than was assumed then.

Global price developments and a stronger króna have provided the scope to raise interest rates more slowly than was previously considered necessary. By the same token, there are signs that monetary policy has anchored inflation expectations more securely than before and contributed to a more moderate rise in inflation than could have been expected in the wake of large pay increases. However, this does not change the fact that, according to the Bank's forecast, a tighter monetary stance will probably be needed in the coming term, in view of growing domestic inflationary pressures. How much and how quickly the monetary stance must be tightened will depend on future developments.