

Katrín Jakobsdóttir, Prime Minister, Speech delivered at Central Bank Annual Meeting, 5 April 2018

Honoured guests:

I.

Although I am addressing you for the first time as Prime Minister, I remember well the Annual Meetings I attended as Minister of Science, Education, and Culture during the difficult post-crisis years. Those meetings were serious affairs, as could be expected, but I also remember the palpable relief in the room when the Prime Minister, Chair of the Supervisory Board, and Governor had finished speaking and it was announced that the time for refreshments had come. Because when all is said and done, man is man's delight, as the ancient saying goes. Having the opportunity to discuss national affairs in a group of good people is important. We have yet to see how long I keep you from today's refreshments, but I do have it in mind to give you some food for thought and discussion.

It must be considered a time of unrest when four prime ministers have held office in the space of two years. After the banks fell, Iceland was faced with two main tasks: to resurrect the economy and re-establish trust and confidence. The first one has been resolved successfully — better than expected, perhaps — but the same cannot be said of the second. The general public's confidence in politics and societal institutions is still much less than it was a decade ago. This is a serious matter for our democracy and one of the tasks facing politics as a whole: to respond to this situation by learning from experience, considering international benchmarks on interests and ethics, and improving communications between the authorities and the media.

The Government coalition agreement discusses ways to achieve social, economic, and political stability that will ensure that the rank and file of our citizens have a good standard of living for the future. The overall context is this. To ensure favourable conditions, we must consider the interactions of the main pillars of our economy: monetary policy, fiscal policy, and the labour market. These interactions can be demonstrated with simple examples:

- The success of monetary policy depends in large part on how successful fiscal policy is.
- Credible monetary policy makes it easier for Government authorities to formulate and act on plans concerning revenues and expenditures.
- It is important to ensure that the public sector and the labour market communicate effectively during wage negotiations.
- In order for inflation expectations to remain stable, it is vital that centralised wage agreements take account of economic developments and prospects.
- If the social partners do not have faith in the effectiveness of monetary and fiscal policy, increased labour market unrest will probably result.

Everything points in the same direction: We must all take responsibility and work towards establishing this sensitive balance.

II

Let us consider the labour market, for instance. The labour market is not considered an external, immutable aspect of economic policy. It is a human creation on which we can have influence. It is an important link in this complex chain of monetary policy, fiscal policy, and employment terms policy, which is ultimately a major determinant of how we fare economically and what standards of living our people enjoy, and in what distribution.

The current situation in the labour market is based on a long-standing tug-of-war and lack of communication, particularly between the most recent Governments and the labour movement. Trust has been lacking. Politicians, employers, and labour union leaders must be able to have honest discussions but must also know their limits. Politicians are elected not to negotiate private sector employment terms but to create a framework and to distribute public goods to the people. The opposite applies to labour market leaders.

I remember when, at a meeting a few years ago, a Nordic labour market scholar described to politicians and parties in the labour market the constant framework for employment terms that the Nordic countries apart from Iceland had experienced in recent decades. When he was asked how to prevent a game of leap-frog between various occupational groups in the market, he had no answer. He didn't understand the question. He was entirely unaccustomed to seeing individual groups jump on the bandwagon, one after another, making demands that seem normal and enjoyed public support when viewed in isolation but distort the fragile balance between the pillars of economic policy lead to a poorer outcome for all.

On the other hand, it is understandable that there should be unrest among labour union members — who constitute a majority of voters — concerning, for instance, social welfare and housing systems that do not meet the stringent expectations of today. Labour unions are, and should be, effective democratic agents that address the question of what policies will generate maximum well-being for their members. It is positive and healthy that there should be debate on which course to take, and it is important to consider how we can guarantee the best consensus in our society; for instance, how we bring about the balance needed to establish that consensus. How wide should the pay gap be? Where does inequality come from? From the pay gap, or from differences in wealth, as has been identified as the actual root of inequality in most other economies? And how can inequality best be addressed? Is it the Government's private affair — through the social welfare and tax systems — or should employers and the labour movement participate as well?

This is why I emphasise strongly that the employee movement participate in communicating with the authorities. The demands of wage-earners are based on improvements in the social welfare system — the province of politics — as much as on higher wages. The Government has expressed its willingness to discuss changes in personal income tax, payroll tax, and

employment-linked rights with the social partners. We want to listen and heed what the social partners say, and then work together to find the best solutions.

III.

Honoured guests.

It is natural that there should be tension about dividing the pie when the pie has grown larger. And the tourism boom is one of the main reasons it for that growth. The composition of our export revenues has changed radically as a result, as has the structure of the economy. Tourism-related services exports now dwarf goods exports from the two sectors that have long been the mainstay of the economy: fishing and heavy industry. The fishing industry, which historically has been Iceland's largest export revenue generator, only accounted for 16% of export revenues last year. Tourism has overtaken it. This is a dramatic change.

The tourism boom came at the best possible time for the economy, and it is a major contributor to Iceland's recent economic success. But we must consider the crowding-out effect of tourism on other sectors, as we had to do when fishing was the dominant force in the economy. Production of marine products is constrained by the need for sustainable utilisation of fish stocks, and over time, tourism exports will be similarly constrained by the need for sustainable utilisation of tourist destinations and the country's wilderness areas.

IV

Yesterday the Government introduced its five-year fiscal plan, which is based on the fiscal strategy approved by Parliament last month. The newly approved fiscal strategy reflects the strong position of public finances. But at the same time, we face certain challenges: GDP growth has eased more quickly than official forecasts provided for, and it is appropriate that the State use its resources to create resilience in the economy. According to the fiscal plan, the overall government balance, including publicly owned companies, will be positive by 3% each year of the five-year horizon. Account is taken of conditions in the domestic economy. For example, the Treasury Part A outcome is best when there is a sizeable positive output gap, and then it declines, owing to the need to improve social infrastructure. It is also very positive that local governments participate more than before in the new public finances process and have, as a group, pledged to achieve a positive outcome of 0.2% of GDP. At the same time, there are plans for significant reduction of public debt during the period.

A proposal for a Parliamentary resolution on the fiscal plan is presented on the basis of the new fiscal strategy. It reflects the Government's focus as expressed in its policy statement. Also expressed is the intention to allow society as a whole to reap the benefits of the ongoing GDP growth phase and strengthen social stability and living standards for the future.

The fiscal plan is based on using the scope that has been created with deleveraging and reduced interest payments to build up infrastructure — transport infrastructure in particular — and increase allocations to healthcare, social welfare, housing, insurance, education and culture, environmental affairs, and public security and criminal justice. In addition, it is planned to lower income tax and payroll tax, while environment taxes and levies on tourists will be increased. Even though GDP growth is tapering off, it is still robust; however, reduced growth creates the opportunity for the Government to redress the balance with contributions to public investment and operations.

The fiscal plan is intended to give the broad outlines based on current assumptions. It will never be perfect any more than anything else created by human hands, nor does it answer all questions, as major tasks lie ahead — tasks such as discussions with the social partners on tax system reform, discussions with disability pensioners on how best to use the scope available to improve their standard of living, and so on. And we do not know how external conditions will develop. There is considerable geopolitical tension at present. We are very dependent on international cycles and markets. We do not know what price we will get for our products. It is therefore far from guaranteed that economic conditions will be favourable for the entire five-year horizon of the fiscal plan.

V

The third pillar I mentioned earlier is monetary policy. I trust that the Governor will take advantage of the opportunity to discuss it in some depth today. My involvement in it, and that of politics in general, centres on the monetary policy framework.

The committee that has been reviewing the monetary policy framework has been working for about a year. According to the Government's policy statement, the committee will conclude its work, and necessary changes will be made thereafter. The committee's work will be made public in early June.

The aim of the review is to find the monetary and currency policy framework that, in the long run, will be most conducive to economic and financial stability. The review is based on the assumption that the króna will remain Iceland's currency in the near future. The objective is that movement of capital to and from the country will be as unrestricted as possible, and in line with Iceland's international obligations.

Now is a good time to undertake this work and to consider how we can improve. Our inflation target dates from the beginning of the century, and given the turbulence of the past decade, there has been little time to give deep consideration to long-term monetary policy.

But we should remember that there is no magic formula that mitigates volatility and maintains stability. Options that pose a solution to part of the problem create new challenges and threats in other areas.

I intend to examine the committee's findings thoroughly this summer, and I look forward to fruitful discussions of monetary policy based on those findings. I also intend to work on amending the Central Bank Act and plan to present a bill of legislation on it in the autumn.

In closing, I would like to thank the Central Bank Supervisory Board, the Governor, the Deputy Governor, and other Central Bank employees for a job well done. The Bank has often been at the centre of controversy, and opinions on its work are many and varied. This shows just how important and complex monetary policy conduct is. It is difficult to conclude otherwise than that the Central Bank has played an important role our current strength: GDP growth has remained robust without careening into overdrive, inflation is moderate, the external position of the economy is excellent, and the current account has been in surplus for several years. In general, economic conditions are very positive, although there are numerous risks as well.

Thank you.