Statement of the Monetary Policy Committee 20 May 2020

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to lower the Bank's interest rates by 0.75 percentage points. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 1%.

The Committee has also decided to stop offering one-month term deposits. This entails that the Bank's key rate will be more effective and the Bank's policy rate signal clearer. Other things being equal, this measure should increase liquidity in circulation and further strengthen monetary policy transmission.

According to the Bank's new macroeconomic forecast, published in the May issue of *Monetary Bulletin*, the outlook is for an 8% contraction in GDP in 2020. The predominant factor underlying this forecast is a more than 80% decline in tourist visits to Iceland. The outlook is for a steep rise in unemployment, which appears set to reach 12% in Q3 and measure just under 9% for the year as a whole. According to the Bank's forecast, economic activity will gradually normalise starting in H2/2020. GDP growth is forecast at nearly 5% in 2021. Uncertainty is unusually pronounced, however, and economic developments will depend on the path the pandemic takes and the progress made in unwinding the associated public health measures.

Inflation measured 2.2% in April and has been below the Bank's inflation target since December 2019. The króna has depreciated since the pandemic reached Iceland, but this is offset by a steep decline in oil prices, as well as a decline in food and commodity prices. Furthermore, inflation expectations are broadly unchanged, and they appear to be firmly anchored to the target. According to the Bank's forecast, inflation will rise marginally in coming months due to exchange rate pass-through from the depreciation of the króna. The increased slack in the economy will weigh heavier as 2020 progresses, however, and the outlook is for inflation to measure below 2% in the latter half of the forecast horizon.

More firmly anchored inflation expectations provide monetary policy the scope to respond decisively to the deteriorating economic outlook. Lower interest rates, together with other actions taken by the Bank, will support the economic recovery and contribute to a more rapid recovery than would otherwise occur. Fiscal policy measures have pulled in the same direction.

The MPC will continue to monitor economic developments and will use the tools at its disposal to support the domestic economy and ensure that the more accommodative monetary stance is transmitted normally to households and businesses.