Statement of the Monetary Policy Committee 2 February 2011

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to lower the Bank's interest rates by 0.25 percentage points. The deposit rate (current account rate) is lowered to 3.25%, the maximum bid rate for 28-day certificates of deposit (CDs) to 4.0%, the seven-day collateralised lending rate to 4.25% and the overnight lending rate to 5.25%.

Inflation continued to subside in December and January. The CPI rose 1.8% year-on-year in January, or 1.6% excluding consumption tax effects, significantly below the inflation target of 2½%. One-off factors added to the seasonal drop in January. Favourable exchange rate developments over the past year, declining inflation expectations, and the slack in the economy continue to contribute to low and stable inflation.

According to the forecast published in *Monetary Bulletin* today, economic recovery will be somewhat stronger this year than was forecast in November. Output is forecast to grow by 2.8% in 2011 and by just over 3% in 2012 and 2013. Inflation has been slightly lower than was implied in the November forecast, due mainly to a one-off change in public services charges; however, according to the Bank's forecast, it is expected to remain somewhat below the target until close to the end of the forecast period.

While economic fundamentals and the capital controls continue to support the króna, the exchange rate has depreciated by 4½% in trade-weighted terms since the MPC's December meeting. It is too early to determine to what degree this development has been driven by temporary factors. Moreover, the Central Bank's sizeable purchases of foreign exchange in December 2010, with the aim of reducing the banks' foreign exchange imbalances and bolstering the Bank's non-borrowed reserves, may have had some short-term effect.

With the prospect that inflation will remain near target and with interest rates at a historically low level, the direction of future policy moves becomes more uncertain. In addition, the prospect of removing the capital controls creates uncertainty about short-term room for manoeuvre. The MPC stands ready to adjust the monetary stance as required to achieve its interim objective of exchange rate stability and ensure that inflation is close to target over the medium term.