Statement of the Monetary Policy Committee 8 February 2023

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to raise the Bank's interest rates by 0.5 percentage points. The Bank's key interest rate – the rate on seven-day term deposits – will therefore be 6.5%.

Headline inflation gained pace in January, reaching 9.9%, while underlying inflation remained flat at 7%. Although the housing market has begun to cool and global inflation has eased slightly, inflationary pressures are still pronounced and price increases widespread.

The inflation outlook has worsened since the MPC's last meeting, and although inflation has most likely peaked, bringing it back to target will take longer than previously anticipated. The deterioration in the outlook stems in particular from the recently finalised private sector wage agreements, which entail considerably larger pay rises than previously assumed. Furthermore, the króna has depreciated, and the outlook is for a larger positive output gap during the forecast horizon. Added to this is the prospect of a more accommodative fiscal stance than was provided for in the Bank's November forecast, even though the fiscal deficit will narrow this year. Long-term inflation expectations are still well above target, and the Bank's real rate has declined since the MPC's last meeting.

According to the Bank's new macroeconomic forecast, year-2022 GDP growth measured 7.1%, far above the November forecast and, if the forecast materialises, the strongest GDP growth rate since 2007. GDP growth is set to weaken in 2023 but the labour market is expected to remain tight, however.

The MPC considers it likely that the monetary stance will have to be tightened even further in coming term so as to ensure that inflation eases back to target within an acceptable time frame.