

Statement of the Monetary Policy Committee 26 August 2020

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 1%.

According to the Central Bank's new macroeconomic forecast, published in the *August Monetary Bulletin*, the outlook is for a 7% contraction in GDP this year and roughly 10% unemployment by the year-end. Although the outlook for H2 is somewhat poorer than was forecast in May, the contraction for the year as a whole is expected to be smaller than was projected then. This is due mainly to the more robust private consumption seen this spring and summer. Uncertainty is unusually pronounced, however, and economic developments will depend on the path the pandemic takes.

Inflation measured 2.5% in Q2 but had risen to 3% by July, driven largely by a more than 12% depreciation of the króna since the pandemic reached Iceland. Medium- and long-term inflation expectations are broadly unchanged, however, and appear to remain anchored to the Bank's inflation target. According to the Bank's forecast, inflation is expected to average about 3% over the remainder of 2020. However, because of the significant slack in the economy and low global inflation, it will taper off in 2021 and is projected to average 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 actions taken by the Bank this spring, have supported domestic demand. The impact of these measures has yet to emerge in full, however, and they will continue to support the economy and facilitate a more rapid recovery than would otherwise occur.

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.