MONETARY POLICY COMMITTEE REPORT TO PARLIAMENT

2019 • 1

Monetary Policy Committee Report to Parliament

9 August 2019

The Act on the Central Bank of Iceland stipulates that the Monetary Policy Committee (MPC) of the Central Bank of Iceland shall submit to Parliament (Alþingi) a report on its activities twice a year and that the contents of the report shall be discussed in the Parliamentary committee of the Speaker's choosing.

The Act requires that the MPC meet at least eight times each year. Since the last report was sent to Parliament, the Committee has held four regular meetings, most recently on 26 June 2019. The following report discusses the work of the Committee between January and June 2019.

Monetary policy formulation

According to the Act on the Central Bank of Iceland, the principal objective of monetary policy is to promote price stability. This objective is further described in the joint declaration issued by the Bank and the Icelandic Government on 27 March 2001 as an inflation target of 2½%, based on the consumer price index. By law, the MPC takes decisions on the application of the Bank's monetary policy instruments; furthermore, the MPC's decisions shall be based on a thorough and careful assessment of developments and prospects for the economy as published in the Bank's *Monetary Bulletin*. The MPC's statements and minutes, enclosed with this report, contain the arguments for the Committee's decisions in the first half of 2019.

Developments from January to June 2019

The MPC kept the Bank's interest rates unchanged at its meetings in February and March but decided in May to lower the Bank's key rate (the rate on seven-day term deposits) by 0.5 percentage points, to 4%.[1] Until then, the Bank's interest rates had been unchanged since November 2018. Then, at the June meeting, the Committee decided to lower interest rates by an additional 0.25 percentage points, bringing the Bank's key rate to 3.75% by the end of June.

At the beginning of March, the special reserve requirement (SRR) on inflows of foreign currency was lowered to 0%, concurrent with the passage of a bill of legislation releasing the remaining stock

1. The key rate is the interest rate that is the most important determinant of short-term market rates and therefore the best measure of the monetary stance. At present, this is the seven-day term deposit rate.

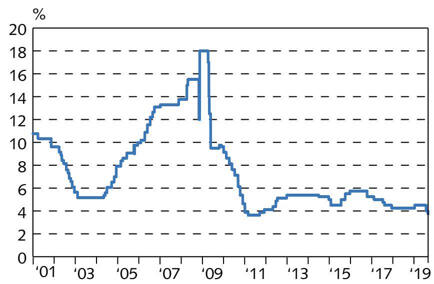
Table 1. Central Bank of Iceland interest rate decisions in H1/2019 (%)

Date	*Current accounts*	*Seven-day term deposits*	*Collateral-ised loans*	*Over-night loans*
26 June	3.50	3.75	4.50	5.50
22 May	3.75	4.00	4.75	5.75
20 March	4.25	4.50	5.25	6.25
6 February	4.25	4.50	5.25	6.25

Chart 1

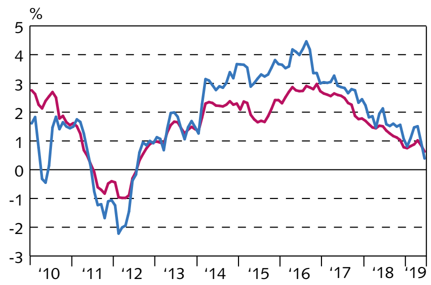
Central Bank of Iceland key interest rate[1]

Daily data 3 January 2001 - 28 June 2019



1. The Central Bank's key interest rate is defined as follows: the 7-day collateralised lending rate (until 31 March 2009), the rate on deposit institutions' current accounts with the Central Bank (1 April 2009 - 30 September 2009), the average of the current account rate and the rate on 28-day certificates of deposit (1 October 2009 - 20 May 2014), and the rate on 7-day term deposits (from 21 May 2014 onwards).
Source: Central Bank of Iceland.

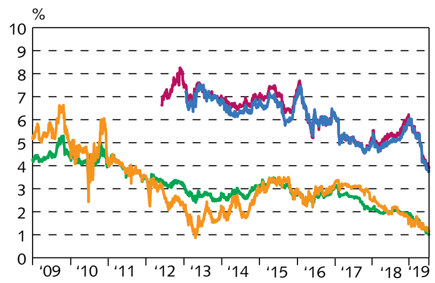
Chart 2
Real Central Bank of Iceland interest rates[1]
January 2010 - June 2019



Real Central Bank of Iceland interest rate in terms of twelve-month inflation
Real Central Bank of Iceland interest rate in terms of various measures of inflation and inflation expectations[2]

1. From 2010 to May 2014, the nominal policy rate was the average of the current account rate and the maximum rate on 28-day CDs. From May 2014, the policy rate has been the seven-day term deposit rate.
2. Until January 2012, according to twelve-month inflation, one-year business inflation expectations, one-year household inflation expectations, the one-year breakeven inflation rate, and the Central Bank forecast of twelve-month inflation four quarters ahead. From February 2012 onwards, according to the above criteria, plus one-year market inflation expectations based on a quarterly Central Bank survey.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Chart 3
Bond yields
Daily data 2 January 2009 - 28 June 2019

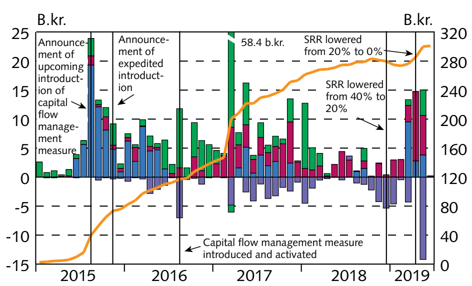


Nominal Treasury bond maturing in:
2022 2031

HFF bond maturing in:
2024 2044

Source: Central Bank of Iceland.

Chart 4
Capital flows due to registered new investments
January 2015 - June 2019



Capital inflows into government bonds (left)
Capital inflows into listed shares (left)
Other capital inflows (left)[1]
Capital outflows (left)
Cumalative net capital flows (right)

1. Other inflows in March 2017 derive almost entirely from non-residents' acquisition of a holding in a domestic commercial bank.
Source: Central Bank of Iceland.

of offshore krónur.[2] The SRR had been lowered to 20% in November 2018, but the goal had always been to lower it to zero when conditions warranted it, and to keep it inactive whenever possible. The interest rate differential had narrowed in the recent term. In addition, the króna had depreciated and, in the MPC's opinion, was likely to be below its equilibrium value. There had also been a turnaround in capital flows to and from Iceland in Q4/2018, when net capital flows from new investment were negative for the first time. The probability of large-scale inflows leading to an overshooting of the exchange rate and severe disturbances in monetary policy transmission had therefore receded.

The monetary stance in terms of the Central Bank's real rate tightened slightly between end-2018 and May 2019, when it eased again following the reduction in the Bank's interest rates. In terms of the average of various measures of inflation and one-year inflation expectations, the Bank's real rate was 0.5% at the end of June, as opposed to 0.7% at the end of December 2018. The Bank's real rate in terms of twelve-month inflation fell by 0.3 percentage points over the same period, to 0.4% at the end of June.

Nominal Treasury bond yields began falling in late 2018 and continued to do so in H1/2019. Interest rates on ten-year bonds were about 3.9% at the end of June, around 1.6 percentage points less than at the end of 2018. Long-term interest rates are at their lowest since nominal rates were liberalised in the 1980s. Indexed long-term interest rates have fallen as well and are now at a historical low. Yields on the longest indexed Treasury bonds were about 1% at the end of June, about 0.6 percentage points lower than in December 2018.

Capital inflows for new investment totalled roughly 50 b.kr. in H1/2019, just over 20 b.kr. more than over the same period in 2018. Outflows of capital previously imported for new investment totalled roughly 24 b.kr. New investment in the domestic bond market increased after the SRR was lowered to 0% in March but is still relatively limited. Inflows into listed equities, which were not subject to the SRR, increased between H2/2018 and H1/2019, and capital outflows grew over the same period.

The króna remained relatively stable in H1/2019, after depreciating last autumn. The tumble in the autumn began with news about airline WOW Air's financing difficulties, followed by increased pessimism about the economic outlook and growing concerns about the results of the forthcoming wage agreements. The króna hardly moved after WOW Air finally collapsed in late March, however, and it appears that the impact of the company's insolvency had already been priced into the exchange rate. The reduction of the SRR and the signing of wage agreements also supported the currency. To date, foreign exchange market outflows following Parliamentary approval of the release of the remaining offshore króna assets in early March have been smaller than expected, and offset to a degree by inflows

2. In June 2016, the Bank introduced a capital flow management measure, a special reserve requirement (SRR) entailing that 40% of new inflows of foreign currency for investment in high-yielding deposits and electronically registered bonds and bills issued in krónur must be held in a non-remunerated account with the Central Bank for one year.

for new investment. At the end of June, the króna was about 6½% weaker than at year-end 2018.

In line with the Central Bank's declared objective of intervening to mitigate excess short-term exchange rate volatility, the Bank traded in the interbank foreign exchange market ten times in H1/2019. Some of this activity was related to outflows of offshore krónur, as the MPC is of the view that the resolution of such a legacy problem that is unrelated to current underlying economic conditions should not be allowed to lower the exchange rate of the króna. The Bank sold foreign currency for approximately 12 b.kr. during the period, and its activity accounted for 11% of total foreign exchange market turnover.

Inflation eased in Q1/2019, after having risen rapidly towards the end of 2018, reaching 3.7% in December. It measured 3.3% in June. Rising petrol and private services prices were the main drivers of inflation in the first half of the year. Twelve-month inflation excluding housing has risen since end-2018, however, measuring 3% in June, and the difference between inflation including and excluding housing has narrowed significantly since June 2018. Underlying inflation in terms of the median of various measures was 3.3% in June and has developed broadly in line with measured inflation.

The contribution of housing to inflation continued to decline. The twelve-month rise in house prices nationwide measured 4.2% in June, as opposed to 6.9% at the end of 2018. Following a rise in imported goods prices in H2/2018, the exchange rate pass-through from the depreciation of the króna to import prices weakened in Q1/2019. As yet, firms appear not to have passed the entire depreciation through to prices, which probably reflects more competition, weaker growth in domestic demand, lower trading partner inflation, and reduced inflation expectations.

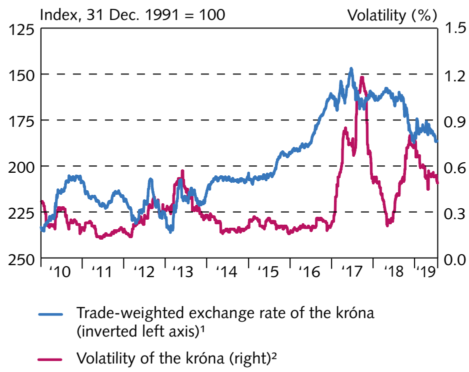
Inflation averaged 3.4% in Q2/2019, in line with the baseline forecast published in *Monetary Bulletin* on 22 May. According to the forecast, inflation is expected to decline as the year progresses and align with the target in mid-2020.

Inflation expectations rose over the course of 2018, and the MPC considered this increase, together with the fact that expectations were above target by all measures, to give cause for concern. However, inflation expectations have fallen by most measures since the last MPC report was sent to Parliament in January 2019. According to recent surveys, market agents and corporate executives expect inflation to measure 3% in one year's time. Households' one-year inflation expectations are 4% and have been unchanged since November 2018. Long-term inflation expectations have fallen by all measures in H1/2019. Market agents' long-term expectations according to surveys and bond pricing are virtually at target, whereas corporate and household expectations are above it. Market agents expect inflation to average 2.8% in the next five years and 2.7% in the next ten years, while households and corporate executives expect inflation to average 3-3.5% in the next five years. At the end of June 2019, the five- and ten-year breakeven inflation rate measured 2.8%, just over 1 percentage point lower than at the end of December 2018.

Chart 5

Exchange rate and volatility of the króna

Daily data 4 January 2010 - 28 June 2019

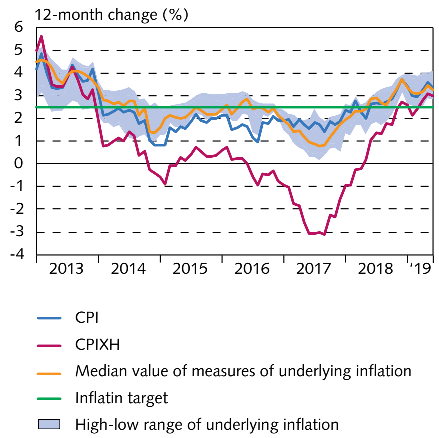


1. Price of foreign currency in terms of the króna. Inverted axis shows a stronger króna as a rise. 2. Volatility is measured by the standard deviation of daily changes in the past 3 months.
Source: Central Bank of Iceland.

Chart 6

Headline and underlying inflation[1]

January 2013 - June 2019

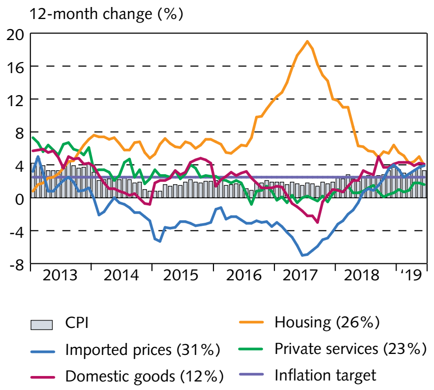


1. Underlying inflation measured using a core index (which excludes the effects of indirect taxes, volatile food items, petrol, public services, and real mortgage interest expense) and statistical measures (weighted median, trimmed mean, a dynamic factor model, and a common component of the CPI).
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 7

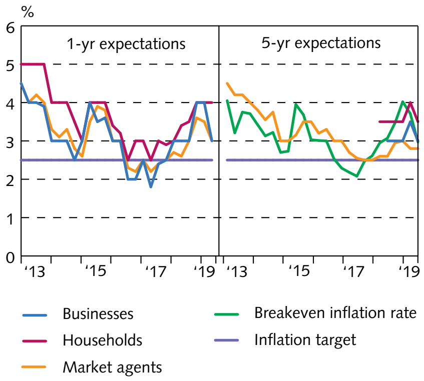
Imported and domestic inflation[1]

January 2013 - June 2019



1. Imported inflation is estimated using imported food and beverages and the price of new motor vehicles and spare parts, petrol, and other imported goods. The figures in parentheses show the current weight of these items in the CPI.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 8
Inflation expectations
Q1/2013 - Q2/2019



Sources: Gallup, Central Bank of Iceland.

In the MPC's opinion, the outlook is for an economic contraction this year; therefore, the inflation outlook has changed markedly in a short period of time. At the May meeting, when the MPC decided to lower interest rates, it emerged in the discussion that monetary policy has considerable scope to respond to the contraction, particularly if inflation and inflation expectations remain close to the target, as is currently envisioned.

In the Committee's view, near-term monetary policy decisions will depend on the interaction between developments in economic activity, on the one hand, and inflation and inflation expectations, on the other.

Accompanying documents

The following documents are enclosed with this report:

1. Monetary Policy Committee statements from January to June 2019.
2. Minutes of Monetary Policy Committee meetings from January to June 2019.
3. Central Bank Chief Economist's presentation on wage agreements, monetary policy, and the domestic economy, delivered at the State Conciliation and Mediation Office on 17 January 2019 (in Icelandic).
4. Press release on the amendment to the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions and the Foreign Exchange Act (release of offshore krónur and special reserve requirement on capital inflows), 4 March 2019.
5. Press release on new Rules on Special Reserve Requirements for New Foreign Currency Inflows and Rules on the Treatment of Króna-Denominated Assets Subject to Special Restrictions, 5 March 2019.
6. Press release on amendments to the Rules on Foreign Exchange – Removal of restrictions on cross-border movement of capital pursuant to reduction in special reserve ratio, 2 April 2019.
7. Press release on amendments to the Rules on securities eligible as collateral for Central Bank facilities, 27 May 2019.
8. Governor's speech on Government debt management, delivered at a conference in Harpa, 5 June 2019.
9. Governor's speech on economic developments during the last ten years, delivered at the Reykjavík Rotary Club, 26 June 2019 (in Icelandic).
10. Joint declaration by the Government and the Central Bank on inflation targeting, March 2001.

On behalf of the Central Bank of Iceland Monetary Policy Committee,

Már Guðmundsson

Governor of the Central Bank of Iceland
and Chair of the Monetary Policy Committee

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No. 4/2019
6 February 2019

Statement of the Monetary Policy Committee
6 February 2019

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 4.5%.

According to the Bank's new macroeconomic forecast, published in the February *Monetary Bulletin*, GDP growth will slow markedly this year, to 1.8%. This is about 1 percentage point less than the Bank projected in November, and if this forecast materialises, it will be Iceland's weakest output growth since 2012. The slowdown in growth is due in particular to a contraction in tourism. Therefore, the outlook is for the positive output gap to narrow faster than previously assumed.

Inflation rose over the course of 2018, measuring 3.7% in December. Weighing heaviest was the rise in import prices, a result of the depreciation of the króna in the autumn. Although inflation eased to 3.4% in January and the króna has appreciated since the MPC's December meeting, the outlook is for inflation to pick up this year and remain above the target until H2/2020.

Market agents' inflation expectations and the breakeven inflation rate in the bond market have fallen since the December meeting. The monetary stance as measured by the Central Bank's real rate has therefore tightened again.

The near-term monetary stance will depend on the interaction between a narrower output gap, wage-setting decisions, and developments in inflation and inflation expectations.

The MPC reiterates that it has both the will and the tools necessary to keep inflation and inflation expectations at target over the long term. This could call for a tighter monetary stance in coming months. Other decisions, particularly those relating to the labour market and fiscal policy, will be important in determining whether that will be the case and will affect the sacrifice cost in terms of lower employment.

No. 7/2019
20 March 2019

Statement of the Monetary Policy Committee
20 March 2019

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 4.5%.

According to the newly published national accounts, GDP growth slowed between H1 and H2/2018. It measured 4.6% for the year as a whole, whereas the Bank had projected a growth rate of 4.3% in its February forecast. Recent indicators of economic activity and the labour market suggest that demand pressures in the economy continue to subside.

Inflation measured 3% in February, down from 3.7% in December 2018. The main factors in the decline are the reduced effect of the rise in import prices stemming from the depreciation of the króna last autumn, and a weaker contribution of housing to inflation. The króna has appreciated by just under 3% since the MPC's February meeting. Inflation is still likely to rise somewhat over most of the year, however, although actual developments will depend on the results of the ongoing wage negotiations.

Households' and businesses' long-term inflation expectations have risen, but the breakeven inflation rate in the bond market has fallen. Long-term inflation expectations are still above target by all measures. Short-term inflation expectations are broadly unchanged since the MPC's last meeting, and the monetary stance in terms of the Bank's real rate is therefore unchanged between meetings.

The near-term monetary stance will depend on the interaction between a narrower output gap, wage-setting decisions, and developments in inflation and inflation expectations.

The MPC reiterates that it has both the will and the tools necessary to keep inflation and inflation expectations at target over the long term. This could call for a tighter monetary stance in coming months. Other decisions, particularly those relating to the labour market and fiscal policy, will be important in determining whether that will be the case and will affect the sacrifice cost in terms of lower employment.

No. 10/2019
22 May 2019

Statement of the Monetary Policy Committee
22 May 2019

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to lower 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 4%.

According to the Bank's new macroeconomic forecast, published in the May issue of *Monetary Bulletin*, the GDP growth outlook has changed markedly since the Bank's last forecast. Output is now forecast to contract by 0.4% this year instead of rising by 1.8%, as was forecast in February. This deterioration in the outlook is due primarily to a contraction in tourism and reduced marine product exports because of the capelin catch failure. As a result, the positive output gap will close and a slack emerge in the near future.

Inflation measured 3.1% in Q1/2019 but rose to 3.3% in April. Underlying inflation has developed in broadly the same manner, and the difference between measures of inflation including and excluding housing is at its smallest since autumn 2013. The króna has held relatively stable in 2019 to date, and the inflationary effects of the autumn 2018 depreciation have thus far been smaller than anticipated. The deterioration in the economic outlook has caused the inflation outlook to change markedly in a short period of time, and the Bank's forecast assumes that inflation will peak at 3.4% in mid-2019 and then ease back to the target by mid-2020.

Although the recently finalised private sector wage agreements provide for sizeable pay increases, the outcome was better in line with the inflation target than was widely expected. Inflation expectations have therefore moderated again after having risen markedly over the course of 2018. Market agents' long-term inflation expectations have now eased back below 3%.

Although the economic contraction will be challenging for households and businesses, the economy is much more resilient than before. Furthermore, monetary policy has considerable scope to respond to the contraction, particularly if inflation and inflation expectations remain close to the target, as is currently envisioned. Moreover, the Government's proposed fiscal measures in connection with wage settlements will pull in the same direction.

Near-term monetary policy decisions will depend on the interaction between developments in economic activity, on the one hand, and inflation and inflation expectations, on the other.

No. 14/2019
26 June 2019

Statement of the Monetary Policy Committee
26 June 2019

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 Bank's key interest rate – the rate on seven-day term deposits – will therefore be 3.75%.

The most recent data on economic developments do not change the assessment of the economic outlook as presented to the Committee at its last meeting. GDP growth in Q1/2019 was in line with the Bank's May forecast; furthermore, a contraction in the domestic economy is still anticipated and is expected to show more clearly in coming months. However, stronger private consumption in Q1 and leading indicators could imply that domestic demand has been more resilient than previously assumed. On the other hand, the outlook is for the contraction in tourism to be deeper than previously expected.

As yet, inflation has been in line with the Bank's last forecast. According to that forecast, inflation has peaked and will ease back to target as the year progresses. Further depreciation of the króna could change these prospects, however. Inflation expectations have fallen since the MPC's last meeting, and the monetary stance has therefore tightened again.

Although the economic contraction will be challenging for households and businesses, the economy is much more resilient than before. Furthermore, monetary policy has considerable scope to respond to the contraction, particularly if inflation and inflation expectations remain close to the target, as is currently envisioned. The proposed fiscal easing will pull in the same direction.

Near-term monetary policy decisions will depend on the interaction between developments in economic activity, on the one hand, and inflation and inflation expectations, on the other.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

February 2019 (82nd meeting)

Published 20 February 2019

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each interest rate decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC meeting held on 4 and 5 February 2019, during which the Committee discussed economic and financial market developments, the interest rate decision of 6 February, and the communication of that decision.

I Economic and monetary developments

Before turning to the interest rate decision, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the 12 December 2018 interest rate decision, as published in the updated forecast in *Monetary Bulletin* 2019/1 on 6 February.

Financial markets

Since the December meeting, the króna appreciated by 1.8% in trade-weighted terms. Over this same period it appreciated by 2.3% against the euro and 2.7% against the US dollar, but depreciated by 0.5% against the pound sterling. Between meetings, the Bank sold foreign currency for approximately 33 million euros (4.5 b.kr.) and bought currency for just under 3 million euros (0.4 b.kr.), for a net sale of about 30 million euros (4.1 b.kr.). The Central Bank's transactions accounted for about 13% of total turnover in the foreign exchange market.

In terms of the Central Bank's real rate, the monetary stance had tightened marginally since the MPC's December meeting, based on the average of various measures of inflation and one-year inflation expectations. By this measure, the Bank's real rate was 0.9%, or 0.1 percentage points higher than after the December meeting. In terms of twelve-month inflation, it was 1.1% and had fallen by 0.1 percentage points between meetings.

Interest rates in the interbank market for krónur were virtually unchanged between meetings, and turnover in the market totalled 2 b.kr. during the period.

Yields on long-term nominal Treasury bonds had fallen by 0.4 percentage points since the December meeting, and yields on long-term indexed Treasury and Housing Financing Fund (HFF) bonds had declined by 0.1 percentage points. Average fixed non-indexed lending rates on pension fund loans and mortgage loans were unchanged from the December meeting, while variable non-indexed rates on pension fund loans had risen by 0.6 percentage points. Over the same period, the average rate on indexed fixed-rate mortgage loans and indexed variable-rate pension fund loans had fallen slightly.

In terms of three-month interbank rates, the interest rate differential versus the euro area was virtually unchanged between meetings, at 5.2 percentage points, but the spread versus the US had risen slightly, to 2.2 percentage points. The long-term interest rate differential versus Germany had fallen by 0.3 percentage points between meetings, to 5.1 percentage points, and the spread versus the US had narrowed by 0.2 percentage points, to 2.5 percentage points.

Measures of the risk premium on the Treasury's foreign obligations had fallen marginally since the MPC's December meeting. The CDS spread on the Treasury's five-year US dollar obligations was just over 0.5%, while the spread between the Treasury's eurobonds and comparable bonds issued by Germany was 0.6-0.7 percentage points.

Financial institutions' analysts had projected that the Bank's interest rates would be held unchanged, citing, among other things, the prospect of weaker economic activity in the coming term, the fact that the Bank's real rate was broadly unchanged since the MPC's last meeting, and the decline in inflation expectations.

According to the Central Bank's quarterly survey, carried out in January, most market agents expected the Bank's key rate to be held unchanged at 4.5% in Q1/2019. On the other hand, they expected a 0.25 percentage point rate hike in Q2. Furthermore, they expect the key rate to be 4.75% in one year but 4.5% again in two years. In the survey, 24% of respondents considered the monetary stance too loose at present, which is a smaller share than in the last survey. About 57% of respondents considered the monetary stance appropriate, as compared with 48% in the last survey. The share who considered the monetary stance too tight measured 19%, up from 12% in the October survey.

Annual growth in M3 measured just under 7½% in December, after adjusting for deposits held by the failed financial institutions. This is slightly below the growth rate in the months beforehand. As before, growth in M3 stemmed primarily from increased household deposits, although the commercial sector's share in the growth rate has increased as well. After adjusting for the impact of the Government's debt relief measures, the stock of credit system loans to resident borrowers had grown in nominal terms by 9½% in December. At constant exchange rates, the stock of foreign-denominated loans grew by just over 8%. Over the same period, household lending grew by 8% year-on-year and corporate lending by just over 11%, whereas the growth rate adjusted for exchange rate movements was about 8%.

The Nasdaq OMXI8 index had risen by 4.6% between meetings. Turnover in the Main Market totalled 492 b.kr. in 2018, some 22% less than in 2017.

Global economy and external trade

According to the forecast published by the International Monetary Fund (IMF) in January, the global GDP growth outlook has deteriorated still further since the Fund's October forecast. The IMF estimates global GDP growth at 3.5% in 2019 and 3.6% in 2020, or 0.1-0.2 percentage points below its October forecast. GDP growth in advanced economies is expected to be weaker this year, owing mainly to a bleaker outlook for the euro area. However, the GDP growth outlook is unchanged for the US and the UK, although the outlook for the UK is highly uncertain because of the significant uncertainty about how Britain's exit from the EU will play out. The IMF also forecasts weaker year-2019 output growth in emerging and developing countries than it did in October. The Fund continues to consider the uncertainty in the output growth forecast to be concentrated on the downside because of the risk that global trade disputes will escalate further. For advanced economies, the IMF projects even slower growth in world trade in 2019 and 2020 than it did in October. The outlook for emerging and developing countries has changed much less, however. Among advanced economies, inflation is forecast at 1.7% in 2019, some 0.2 percentage points below the Fund's October forecast. The outlook for 2020 is unchanged, however.

According to preliminary figures from Statistics Iceland, Iceland's goods trade deficit totalled 11 b.kr. in December and about 191 b.kr. (at constant exchange rates) in 2018 as a whole. The deficit was therefore 7.5 b.kr. smaller than in 2017. Goods export values rose by just over 10% year-on-year in 2018, while import values rose by just over 7%. Export growth in 2018 is due primarily to an increase in exports of marine products and industrial goods, whereas the rise in import values is due mainly to an increase in the value of fuels and lubricants, as well as commodities and operational inputs.

Between MPC meetings, the listed global price of aluminium fell by nearly 3% and was just over 14% below the price seen at the same time last year. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products were up 4.8% year-on-year in 2018. The global price of oil had risen by just over 3% between MPC meetings, to 62 US dollars per barrel as of early February. By the time of the February meeting, however, oil prices were some 9% lower than they were a year earlier and just over one-fourth below their early October 2018 peak.

In terms of relative consumer prices, the real exchange rate rose by 0.6% month-on-month in January but fell by 8.3% year-on-year. In January, it was about 10% above its 25-year average but 14.4% below its June 2017 peak. By this same measure, it fell 2.9% year-on-year in 2018. The decline is due primarily to a 3.8% nominal depreciation of the króna, but in addition, inflation in Iceland was about 0.7 percentage points above the average among Iceland's trading partners.

The domestic real economy and inflation

According to the Statistics Iceland labour force survey (LFS), total hours worked increased by 2.5% year-on-year in Q4/2018. Job creation measured 2.3% year-on-year, and the average work week grew slightly longer. Growth in the number of employed persons according to pay-as-you-earn (PAYE) data has continued to ease, after measuring 2.3% year-on-year in Q3/2018. The labour participation rate was nearly 1 percentage point lower in Q4/2018 than in the same quarter of 2017, and the employment rate fell by 0.5 percentage points over the same period. In 2018 as a whole, both ratios were about 1 percentage point lower than they were in 2017.

Seasonally adjusted unemployment measured 2.8% in Q4/2018, slightly more than in the previous quarter but 0.4 percentage points less than in the same quarter of 2017. In 2018, it measured 2.7%, or 0.1 percentage points lower than in the previous year. Registered unemployment rose by 0.5 percentage points year-on-year in Q4/2018, however, and by 0.2 percentage points for the year as a whole. Foreign nationals accounted for about ⅔ of the increase. Because the LFS response ratio among foreign nationals working in Iceland has been on the decline, it could be that the survey fails to capture the turnaround observed in registered unemployment.

Net migration of foreign nationals aged 20-59 was positive by 0.4% of the population in Q4/2018. For the year as a whole, however, the foreign labour force grew by 3.1% of the population, the second-largest calendar-year increase ever measured. Active employees working for temporary employment agencies and foreign services companies accounted for about 0.8-0.9% of the labour force in the first eleven months of 2018, but only 0.7% in December.

The wage index was virtually unchanged month-on-month in December but had risen by 6% year-on-year, and real wages were 2.2% higher during the month than at the same time in 2017. The wage index rose by 6.5% between annual averages in 2018, and real wages grew by 3.7%.

Key indicators of developments in private consumption in Q4/2018 suggest a slowdown in household demand. Growth in payment card turnover slowed markedly, and new motor vehicle registrations declined in number. The Gallup Consumer Confidence Index rose in January, for the second month in a row, to 93.7 points. Nevertheless, this was well below the January 2018 measurement.

Statistics Iceland's nationwide house price index, published in January, rose by 0.3% month-on-month after adjusting for seasonality, and by 6% year-on-year. The capital area house price index, calculated by Registers Iceland, rose by 0.3% month-on-month in December when adjusted for seasonality, and by 5.9% year-on-year. The twelve-month rise in house prices has gained pace since October, when it measured about 4%. The number of purchase agreements registered nationwide rose by 4.8% year-on-year in 2018, and the average time-to-sale for flats in greater Reykjavík was 1.6 months in December, as opposed to 2.4 months a year earlier.

The consumer price index (CPI) rose by 0.74% month-on-month in December 2018, raising twelve-month inflation to 3.7%. Inflation fell again in January, however, when the CPI declined by 0.41% month-on-month, to 3.4%, or 0.1 percentage points more than at the time of the MPC's last meeting. The CPI excluding the housing component had risen by 2.6% year-on-year in January. The difference between inflation including and excluding housing is at its narrowest since autumn 2013. Underlying inflation measured 3.4% in January, according to the median of various measures, as did headline inflation, and had risen by 1.4 percentage points between years.

Winter sales weighed heavily on the January measurement, together with a drop in new motor vehicle prices, offset by a seasonal increase in public services prices. International airfares fell by 6% between months and were down 5.7% between years. The twelve-month decline has slowed from its average of 12% in H2/2018.

According to the Central Bank survey carried out in January, market agents' short-term inflation expectations fell marginally between surveys, to 3.5% one year ahead and 3% two years ahead. Market agents' long-term inflation expectations also fell, to an average of 2.8%

over the next five and ten years, a 0.2-point decline from the previous survey but a corresponding increase from the survey a year earlier. The breakeven inflation rate in the bond market has also fallen recently. Just before the MPC meeting, the five- and ten-year breakeven rate was 3.5%, after having fallen by approximately 0.4 percentage points since the December meeting; however, it was 0.3-0.5 percentage points higher than it was a year earlier.

Summary from *Monetary Bulletin* 2019/1

According to the forecast published in *Monetary Bulletin* on 6 February 2019, the outlook is for inflation to be higher in 2019 and 2020 than was forecast in November. Inflation has risen somewhat in the recent term, measuring 3.4% in January, as opposed to 2.4% a year earlier. Underlying inflation has risen similarly. Long-term inflation expectations have fallen since November, however, although they remain above the inflation target. The outlook is for inflation to keep rising to a peak of 3.8% in Q3/2019 and remain at or above 3% through mid-2020 before falling back to the target again towards the end of that year. The poorer inflation outlook is due primarily to a lower exchange rate than was assumed in November, albeit offset by a narrower output gap and lower oil prices.

External conditions have developed less favourably than was projected in the Bank's last forecast, and the outlook is for weaker global GDP growth than was assumed at that time. Terms of trade deteriorated more in 2018 than was assumed in November, even though the steep rise in oil prices early in the year reversed towards the year-end. The króna started to appreciate again at the end of 2018 after a sharp depreciation last autumn, but that appreciation reversed for the most part early in 2019.

GDP growth for 2018 is estimated at 4.3%. The outlook is for a significant slowdown in 2019, to only 1.8%, Iceland's weakest output growth rate since 2012 and a steep decline from the November forecast. There are signs that growth in tourism has slowed markedly and that services exports will contract this year, for the first time since 2008. Weaker export growth and the prospect of somewhat slower growth in domestic demand therefore pull in the same direction. As in November, GDP growth for the next two years is expected to be close to 2¾% per year.

The assumptions in the forecast concerning near-term wage developments have changed little since November. However, the revision of the GDP growth outlook entails the prospect of somewhat weaker productivity growth, and therefore a larger rise in unit labour costs this year than was forecast in November. The increase is projected at just under 6%, about the same as in 2018, but is expected to align with the inflation target by the end of the forecast horizon.

Job growth has slowed, and firms' recruitment plans indicate that job numbers may fall in H1/2019. There are therefore signs of reduced strain on domestic resources, and the output gap is now expected to have more or less closed in late 2020, earlier than previously forecast.

II The interest rate decision

The Governor discussed the status of the recent bill of legislation on the release of the last of the offshore króna assets that were locked in by the capital controls in the aftermath of the financial crisis. MPC members also discussed the Bank's foreign exchange market intervention strategy. As the Bank stated in its report on responses to some of the proposals from the task force on the monetary policy framework, it intends to establish a working group whose task will be to submit recommendations to the MPC on the intervention policy and information disclosure about its implementation. In this context, members discussed the Bank's intervention in previous months and the objectives of the intervention policy.

The Committee also discussed the special reserve requirement (SRR) on capital inflows and whether conditions for lowering the SRR, or setting it at zero, would develop once the offshore krónur were released in accordance with the pending bill of legislation. These conditions reflected, among other things, the narrowing of the interest rate differential and the recent decline in the exchange rate, which Committee members considered likely to be below its equilibrium value. There had also been a turnaround in capital flows to and from Iceland in Q4/2018, when net capital flows from new investment were negative for the first time. Furthermore, it had always been the goal to lower the SRR to zero once conditions warranted it, and to keep it inactive whenever possible. The SRR would then be a third line of defence, to supplement conventional economic policy and micro- and macroprudential tools, as had always been the objective. On the other hand, it was necessary to be able to activate it at short notice in order to support monetary and macroprudential policies in response to elevated risk of excess carry trade-related capital inflows. During the discussion, the concerns emerged that unrestricted capital inflows could lead to excessive inflows, which could once again weaken monetary policy transmission along the interest rate channel. The risk was then that the transmission mechanism would shift to the less predictable exchange rate channel, which could also give rise to macroeconomic and financial imbalances. It was pointed out that the domestic foreign exchange market was small and it would not take much to affect the transmission mechanism significantly. MPC members agreed, however, that it was not advisable that the exchange rate channel should be inactive, as it was an important part of the transmission mechanism, without which monetary policy would be less effective. It was also pointed out that it would be possible to activate the capital flow management measure at short notice if conditions changed rapidly. Committee members agreed that conditions had now developed so as to permit the next steps in lowering the SRR.

MPC members also discussed general reserve requirements. At the December meeting, they had noted that conditions for an increase might be developing, given the recent increase in credit growth. The MPC noted that credit growth had certainly gained pace but that the credit stock relative to GDP had remained broadly unchanged since 2016. Members agreed that credit growth was not excessive. Furthermore, the Financial Supervisory Authority had recently decided to increase the countercyclical capital buffer on financial institutions' domestic exposures, in line with the recommendation of the Financial Stability Council in December 2018. To some extent, this could reduce credit growth relative to the level that would otherwise have occurred. As a result, it was not considered necessary to increase general reserve requirements, although developments would continue to be monitored closely.

The MPC discussed the monetary stance in view of the most recent information on the economy and the marginal rise in the Bank's real rate between meetings. Members also discussed whether the stance was appropriate in light of the inflation outlook, as the Committee had decided in December to keep the Bank's key rate unchanged, partly because of indications that demand pressures in the economy were continuing to ease, the depreciation of the króna had slowed down, and the increase in inflation expectations since the last meeting was limited primarily to short-term expectations.

In this context, the MPC took account of the Bank's updated macroeconomic forecast, published in *Monetary Bulletin* on 6 February, which indicated that GDP growth would slow markedly this year, to 1.8%. Members noted that this was about 1 percentage point less than the Bank projected in November, and if the forecast materialised, it would be Iceland's weakest output growth since 2012. Members agreed that the slowdown in growth was due in particular to a contraction in tourism and that the outlook was for the positive output gap to narrow faster than previously assumed.

The MPC discussed developments in inflation, which rose over the course of 2018, measuring 3.7% in December. Members noted that weighing heaviest was the rise in import prices, a result of the depreciation of the króna in the autumn. Although inflation had eased to 3.4% in January and the króna had appreciated since the MPC's December meeting, Committee members noted that the outlook was for inflation to pick up this year and remain above the target until H2/2020. On the other hand, they noted that market agents' inflation expectations and the breakeven inflation rate in the bond market had declined since the December meeting. The monetary stance as measured by the Central Bank's real rate had therefore tightened again.

The Committee discussed the possibility of keeping interest rates unchanged or raising them by 0.25 percentage points. The main argument in favour of keeping rates unchanged was the outlook for the output gap to narrow more rapidly than previously projected. It was pointed out that most high-frequency indicators and sentiment surveys also suggested that GDP growth would be weaker in 2019 than previously assumed. Members also noted that if workers went on strike, it could cause the domestic economy to cool quickly. This would have a strong negative impact on tourism, for instance. It emerged in the discussion that it was positive that long-term inflation expectations had fallen since the December meeting and the monetary stance had therefore tightened slightly.

The main arguments in favour of raising interest rates, however, were that inflation was somewhat above the target and the inflation outlook had deteriorated. It was pointed out that even though long-term inflation expectations had fallen, the fact that expectations were above target by all measures gave cause for concern. Although increased inflation in previous months was due in part to exchange rate pass-through from the depreciation of the króna, there was the risk of second-round effects. A lack of response could affect the anchor for inflation expectations and the credibility of monetary policy. During the discussion, it emerged that there was the risk that wage settlements would be inconsistent with the inflation target, but also that Government measures in connection with wage settlements might not be fully funded, resulting in a weakening of the fiscal stance. The situation was therefore that the MPC needed to weigh together the impact of weaker GDP growth and higher inflation but, as always, under conditions of uncertainty about the estimate of the output gap.

In view of the discussion, the Governor proposed that the Bank's interest rates be held unchanged. The Bank's key rate (the seven-day term deposit rate) would remain 4.5%, the current account rate 4.25%, the seven-day collateralised lending rate 5.25%, and the overnight lending rate 6.25%. All Committee members voted in favour of the proposal.

In the Committee's view, the near-term monetary stance would depend on the interaction between a narrower output gap, wage-setting decisions, and developments in inflation and inflation expectations.

The MPC reiterated that it had both the will and the tools necessary to keep inflation and inflation expectations at target over the long term, and members agreed that this could call for a tighter monetary stance in coming months. Other decisions, particularly those relating to the labour market and fiscal policy, would be important in determining whether that would be the case and would affect the sacrifice cost in terms of lower employment.

The following Committee members were in attendance:

Már Gudmundsson, Governor and Chairman of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor

Thórarinn G. Pétursson, Chief Economist

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

In addition, a number of Bank staff members attended part of the meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 20 March 2019.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

March 2019 (83rd meeting)

Published 3 April 2019

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each interest rate decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC meeting held on 18 and 19 March 2019, during which the Committee discussed economic and financial market developments, the 20 March interest rate decision, and the communication of that decision.

I Economic and monetary developments

Before turning to the interest rate decision, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the 6 February 2019 interest rate decision.

Financial markets

Since the February meeting, the króna had appreciated by 2.9% in trade-weighted terms. Over this same period it appreciated by 3.2% against the euro, 2.7% against the US dollar, and 0.6% against the pound sterling. Between meetings, the Central Bank sold foreign currency for just under 18 million euros (2.5 b.kr.). The Central Bank's transactions accounted for about 9% of total turnover in the foreign exchange market.

Based on the average of various measures of inflation and one-year inflation expectations, the monetary stance in terms of the Central Bank's real rate was unchanged since the MPC's February meeting. By this measure, the Bank's real rate was 0.9%. In terms of twelve-month inflation, it was 1.5% and had risen by 0.4 percentage points between meetings.

Interest rates in the interbank market for krónur were virtually unchanged between meetings, and turnover in the market totalled 17 b.kr. during the period.

Yields on long-term nominal Treasury bonds had fallen by 0.4 percentage points since the February meeting, and yields on indexed Treasury and Housing Financing Fund (HFF) bonds had declined by 0.2-0.4 percentage points. The average rate on non-indexed mortgage loans and pension fund loans was virtually unchanged since the February meeting. Over the same period, the average rate on indexed fixed-rate mortgage loans and indexed variable-rate pension fund loans had fallen slightly.

In terms of three-month interbank rates, the interest rate differential had increased slightly between meetings, to 5.3 percentage points versus the euro area and 2.4 percentage points versus the US. The long-term interest rate differential versus Germany had fallen by 0.3 percentage points between meetings, to 4.7 percentage points, and the spread versus the US had narrowed by 0.3 percentage points, to 2.2 percentage points.

Measures of risk premia on the Treasury's foreign obligations had diverged since the MPC's February meeting. The CDS spread on the Treasury's five-year US dollar obligations widened to just under 0.8%, while the spread between the Treasury's eurobonds and comparable bonds issued by Germany narrowed slightly, to 0.5-0.6 percentage points.

Financial institutions' analysts had projected that the MPC would hold interest rates unchanged, citing, among other things, the prospect of weaker economic activity in the coming term, the fact that the Bank's real rate was broadly unchanged since the MPC's last meetings, and the improvement in the inflation outlook.

Annual growth in M3 measured just over 7½% in January, after adjusting for deposits held by the failed financial institutions. This is slightly below the growth rate in autumn 2018. As before, growth in M3 stemmed primarily from increased household deposits, although the commercial sector's share in the growth rate has increased as well. After adjusting for the impact of the Government's debt relief measures, the stock of credit system loans to resident borrowers had grown in nominal terms by about 10½% year-on-year in January. The stock grew by just over 9%, however, if the stock of foreign-denominated loans is calculated at constant exchange rates. Over the same period, household lending grew by about 8½% year-on-year and corporate lending by nearly 13%, whereas the growth rate adjusted for exchange rate movements was about 10%.

The Nasdaq OMXI8 index had risen by 11.7% between meetings. Turnover in the Main Market totalled 85 b.kr. in the first two months of 2019, some 22% less than in the same period in 2018.

Global economy and external trade

According to preliminary figures from Statistics Iceland, Iceland's goods trade deficit totalled 15.3 b.kr. in February, which is virtually unchanged from the same period in 2018 (at constant exchange rates). In the first two months of 2019, however, the deficit was only 8.2 b.kr., as opposed to a deficit of 18.4 b.kr. over the same period in 2018. Export values were virtually unchanged year-on-year in the first two months of 2019, while import values contracted by 8.3%. The downturn in imports is due to reduced imports of transport equipment, as well as fuels and lubricants.

Between MPC meetings, the listed global price of aluminium rose by just over 1% but was around 8% below the price seen at the same time last year. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products were up 5.5% year-on-year in January. Global oil prices rose by more than 9% between meetings, to just over 67 US dollars per barrel just before the March meeting, or nearly 4% higher than the price a year earlier. It was still about one-fourth below its early October 2018 peak, however.

The real exchange rate in terms of relative consumer prices rose by 0.8% month-on-month in February, when it was 11.4% above its 25-year average but 13.2% below its June 2017 peak. In the first two months of 2019, it was down by 8% compared with the same period in 2018, as the nominal exchange rate of the króna was 9.6% lower and inflation in Iceland was 1.8 percentage points above the trading partner average.

The domestic real economy and inflation

According to preliminary figures published by Statistics Iceland in March, GDP growth measured 4% in Q4/2018 and domestic demand grew by 4.1% year-on-year during the quarter. Exports declined by 5.9% between years, owing to an 11.4% contraction in services exports. At the same time, imports contracted by 6%, but the contribution of net trade to GDP growth was negative by 0.1 percentage points. GDP growth measured 4.6% for the year as a whole, as domestic demand grew by 4.1% and the contribution from net trade was positive by 0.7 percentage points. Export growth measured 1.6% in 2018, while total imports were flat between years because of the contraction in goods imports. Year-2018 GDP growth was 0.3 percentage points stronger than had been forecast in the February *Monetary Bulletin*, mainly because the contribution from net trade was 0.3 percentage points more positive than had been projected. Growth in domestic demand was broadly in line with the forecast, however.

The current account balance was positive by 0.3 b.kr. in Q4/2018. This is a smaller surplus than in Q4/2017, when it measured 6.7 b.kr. The contraction in the surplus is due to a smaller surplus on services trade. On the other hand, the goods trade deficit was smaller and the surplus on primary and secondary income was larger. In 2018 as a whole, the current account balance was positive by 81.5 b.kr., or 2.9% of GDP, whereas the surplus in 2017 measured 3.6% of GDP, the smallest in six years. The surplus on services trade contracted between years, but on the other hand, the deficits on goods trade and on primary and secondary income were smaller.

Key indicators of developments in private consumption in Q1 suggest that growth continued to ease during the quarter and that it will be weaker this year than it was for most of 2018. The Gallup Consumer Confidence Index measured 90.3 in February. After a steep decline in H2/2018, the index inched upwards in early 2019, although it is still lower than it was a year ago.

According to the results of Gallup’s spring survey, conducted in February among Iceland’s 400 largest firms, respondents’ assessment of the current economic situation was neither positive nor negative, and therefore weaker than in the surveys taken this winter and a year ago. However, executives were more upbeat about the outlook six months ahead than they were in the winter survey, albeit more pessimistic than in the spring 2018 survey. About 42% of respondents considered the current situation neither good nor poor, and about 32% considered it poor. About 60% of executives were of the view that economic conditions would deteriorate in the next six months, and a third expected conditions to be neither better nor worse. About 7.5% of respondents expected conditions to improve in the next six months. The share of pessimistic executives has therefore declined since the winter, when just over ⅔ were of the view that conditions would worsen, but it has increased markedly since the spring 2018 survey, when 30% were of that opinion. Executives’ expectations about domestic demand improved slightly from the winter survey but were more downbeat than they were a year ago.

The most marked improvement in expectations about domestic demand between the winter and spring surveys was among executives in manufacturing and miscellaneous specialised services. Attitudes towards foreign demand are broadly unchanged since May 2018, with about half of executives expecting it to remain unchanged in the next six months.

According to the spring survey, just over 36% of firms expected their profit margins to remain broadly unchanged between 2018 and 2019, whereas the share that expected their margins to narrow increased by 2 percentage points relative to the autumn survey. Chief among the latter group were executives in transport, transit, and tourism; construction; and retail and wholesale trade. Furthermore, respondents in all sectors except industry and manufacturing were somewhat more negative about the operational outlook than in the autumn survey.

According to the seasonally adjusted results of the spring survey, 14% of firms were planning to recruit, while 23% were planning to downsize. The balance of opinion was therefore negative by 9 percentage points, whereas in the winter survey it was negative by nearly 19 percentage points. This is a marked turnaround from the spring 2018 survey, however, when the balance of opinion was positive by 16 percentage points. Pessimism was most pronounced in transport, transit, and tourism where the balance of opinion was negative by 25 percentage points, while the outlook was for only a slight increase in staffing in construction, utilities, and miscellaneous specialised services.

After adjusting for seasonality, 12% of firms considered themselves short-staffed. This was about 6 percentage points less than in the winter survey and 21 percentage points less than in the spring 2018 survey. About 30% of executives in construction and utilities considered themselves understaffed, as opposed to only 5% of fishing companies. In other sectors, the ratio lay in the 7-22% range.

About 38% of executives reported that they would have difficulty responding to unexpected demand, after adjusting for seasonality. This was slightly less than in the winter survey but 14 percentage points less than in the spring 2018 survey. The problem was most pronounced in the fishing industry, where nearly three of every five executives were pessimistic about being able to respond to unexpected demand, while it was least pronounced in retail and wholesale trade, where just over one of every five were of that opinion.

The wage index rose by 0.3% month-on-month in January and by 5.8% year-on-year, and real wages were 2.3% higher during the month than at the same time in 2018. According to preliminary figures from Statistics Iceland, the wage share (wages and related expenses relative to gross factor income) was 64.3% in 2018, which is 0.5 percentage points higher than in 2017 and 3.8 percentage points above the twenty-year average. Previous figures were also revised, mostly for 2017, but on the whole, developments in the past two years were in line with the forecast in the February *Monetary Bulletin*.

Statistics Iceland's nationwide house price index, published in February, rose 0.3% month-on-month when adjusted for seasonality and by 5.6% year-on-year. The capital area house price index, calculated by Registers Iceland, rose by 0.2% month-on-month in January, adjusted for seasonality, and by about 5.2% year-on-year. The twelve-month rise in real estate prices has therefore held steady at about 5% since April 2018. The number of purchase agreements registered nationwide declined by 9.4% year-on-year in January, while the number of purchase agreements for new construction rose by 2.6% over the same period.

The consumer price index (CPI) rose by 0.19% month-on-month in February. Twelve-month inflation measured 3% and had fallen by 0.4 percentage points since the MPC's last meeting. The CPI excluding the housing component had risen by 2.1% year-on-year in February. In terms of the median of various measures, underlying inflation was 3.1% in February, about 1 percentage point higher than in the same month of 2018.

In February, end-of-sale effects on furniture and housewares prices were the main driver of the rise in the CPI. International airfares fell for the second month in a row and were nearly 12% lower than at the same time in 2018. Imported food prices and new motor vehicle prices also fell between months.

According to Gallup's spring surveys of household and corporate inflation expectations, respondents expected inflation to measure 4% one year ahead; this was unchanged from the winter surveys but 1 percentage point higher than in the spring 2018 surveys. Expectations concerning average inflation over the next five years rose by 0.5 percentage points between surveys, however, to 3.5-4%. The five- and ten-year breakeven inflation rate in the bond market was 3.4% just before the MPC meeting, after falling slightly since the February meeting. The ten-year breakeven rate has averaged 3.7% in Q1 to date, which is 0.4 percentage points lower than in Q4/2018.

II The interest rate decision

The Governor updated the Committee on developments in the domestic foreign exchange market following the passage of the bill of legislation releasing the last of the offshore króna assets and the decision taken simultaneously to lower the special reserve requirement (SRR) on capital inflows to 0%. Outflows through the foreign exchange market had been less than expected, and inflows for new investment in the bond market had offset them. In addition, there had been some inflows into the equity market, and pension funds' outflows had eased. The Central Bank had only intervened once in the market, selling foreign currency, since the bill of legislation passed, and the króna had appreciated between MPC meetings.

The Deputy Governor explained the highlights of the bill of legislation on the Central Bank, which had been in the Government's consultation portal since 7 March, together with a bill of legislation amending various acts of law due to the merger of the Central Bank and the Financial Supervisory Authority.

Members discussed the monetary stance in view of the most recent information on the economy and the fact that the Bank's real rate had remained unchanged between meetings. They discussed whether the stance was appropriate in view of the inflation outlook, as they had decided at the February meeting to keep the Bank's key rate unchanged, partly because the outlook was for demand pressures in the economy to subside faster than previously expected and the monetary stance had tightened again.

Committee members discussed the newly published preliminary national accounts figures, which indicated that GDP growth had eased between H1 and H2/2018. It measured 4.6% for the year as a whole, whereas the Bank had projected a growth rate of 4.3% in its February forecast. MPC members noted that growth in goods and services imports was negligible in 2018, alongside robust growth in domestic demand. Recent indicators of economic activity and the labour market suggested that demand pressures in the economy had continued to subside. Committee members discussed the uncertainty in the tourism industry because of difficulties in airline operations. It was noted that the ongoing strikes could lead to more rapid cooling in the economy and that the outlook for goods exports had deteriorated because of the poor capelin season.

The Committee discussed developments in inflation, which measured 3% in February, down from 3.7% in December 2018. They noted that the main factors in the decline were the reduced effect of the rise in import prices stemming from the depreciation of the króna in autumn 2018, and a weaker contribution of housing to inflation. It was pointed out that in view of the operational difficulties faced by domestic airlines, airfares could rise and the inflation outlook could therefore deteriorate. Members also noted that the króna had appreciated by just under 3% since the MPC's February meeting. Inflation was still likely to rise somewhat over most of the year, however, although actual developments would depend on the results of the ongoing wage negotiations.

The MPC discussed the possible causes of the situation that had developed in the labour market and the extent to which it stemmed from significant capacity pressures. It emerged in the discussion that the likely cause was the interaction of several factors: strong growth in tourism, a sector with lower productivity than other sectors; increased labour demand; dissatisfaction with income distribution in society; and new priorities among labour union leaders. It was also pointed out that the tight housing market — resulting from steep price increases and a shortage of supply — had made a strong impact, as had probably household debt relief measures. MPC members discussed possible responses in the event that wage settlements caused a deterioration in the inflation outlook. If negotiated pay rises were out of line with the inflation target, and to the extent that they could be traced to strong labour demand and a persistent output gap, it would be unavoidable to tighten the monetary stance, all else being equal.

Members noted that households' and businesses' long-term inflation expectations had risen while the breakeven inflation rate in the bond market had fallen, and that long-term inflation expectations were above the target by all measures. As the MPC had pointed out previously, the steep rise in inflation expectations in H2/2018 probably stemmed in part from the rise in the risk premium and not solely from expectations of higher inflation. The recent decline in the breakeven inflation rate could also be attributed in part to a reduction in the risk premium. MPC members also noted that short-term inflation expectations were broadly unchanged since the MPC's last meeting, and the monetary stance in terms of the Bank's real rate was therefore unchanged between meetings.

In view of the discussion, the Governor proposed that the Bank's interest rates be held unchanged. The Bank's key rate (the seven-day term deposit rate) would remain 4.5%, the current account rate 4.25%, the seven-day collateralised lending rate 5.25%, and the overnight lending rate 6.25%. All Committee members voted in favour of the proposal.

In the Committee's view, the near-term monetary stance would depend on the interaction between a narrower output gap, wage-setting decisions, and developments in inflation and inflation expectations.

The MPC reiterated that it had both the will and the tools necessary to keep inflation and inflation expectations at target over the long term, and members agreed that a tighter monetary stance could be called for in coming months. Other decisions, particularly those relating to the labour market and fiscal policy, would be important in determining whether that would be the case and would affect the sacrifice cost in terms of lower employment.

The following Committee members were in attendance:

Már Gudmundsson, Governor and Chairman of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor

Thórarinn G. Pétursson, Chief Economist

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

In addition, a number of Bank staff members attended part of the meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 22 May 2019.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

May 2019 (84th meeting)

Published 5 June 2019

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each interest rate decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC meeting held on 20 and 21 May 2019, during which the Committee discussed economic and financial market developments, the interest rate decision of 22 May, and the communication of that decision.

I Economic and monetary developments

Before turning to the interest rate decision, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the 20 March 2019 interest rate decision, as published in the new forecast and analysis of uncertainties in *Monetary Bulletin* 2019/2 on 22 May.

Financial markets

Since the March meeting, the króna had depreciated by 3.5% in trade-weighted terms. Over this same period it fell 3.7% against the euro, 5.5% against the US dollar, and 1.1% against the pound sterling. Between meetings, the Central Bank sold foreign currency for 15 million euros (2.1 b.kr.). The Central Bank's transactions accounted for just over 5% of total turnover in the foreign exchange market.

Based on the average of various measures of inflation and one-year inflation expectations, the monetary stance in terms of the Central Bank's real rate was broadly unchanged since the MPC's March meeting. By this measure, the Bank's real rate was 1%. In terms of twelve-month inflation, it was 1.2% and had fallen by 0.3 percentage points between meetings.

Interest rates in the interbank market for krónur had fallen slightly between meetings, and turnover in the market totalled 34 b.kr. during the period.

Yields on long-term nominal Treasury bonds had fallen by 0.6 percentage points since the March meeting, and yields on long-term indexed Treasury and Housing Financing Fund (HFF) bonds had declined by 0.3 percentage points. Average interest rates on non-indexed mortgage loans and pension fund loans had fallen slightly since the March meeting. Over the same period, the average rate on indexed fixed-rate mortgage loans and indexed variable-rate pension fund loans had also fallen slightly.

In terms of three-month interbank rates, the interest rate differential versus the euro area had narrowed slightly between meetings, to 5.2 percentage points, whereas the spread versus the US was broadly unchanged, at 2.4 percentage points. The long-term interest rate differential versus Germany had fallen by 0.5 percentage points between meetings, to 4.3 percentage points, and the spread versus the US had narrowed by 0.5 percentage points, to 1.8 percentage points.

Measures of the risk premium on the Treasury's foreign obligations were largely unchanged since the MPC's March meeting. The CDS spread on the Treasury's five-year US dollar obligations was virtually unchanged at just under 0.8%, while the spread between the Treasury's eurobonds and comparable bonds issued by Germany widened slightly, to 0.5-0.7 percentage points.

Financial institutions' analysts all expected a rate cut of either 0.25 or 0.5 percentage points, citing the improved inflation outlook stemming in part from the prospect of a rapid unwinding of demand pressures in 2019, the finalisation of wage agreements more consistent with the Bank's inflation target than had been expected, and the recent stability of the króna.

According to the Central Bank's quarterly market expectations survey, conducted in early May, respondents expected the Bank's key rate to be lowered by 0.5 percentage points in Q2/2019, to 4%, followed by another rate cut of 0.25 percentage points in the first half of 2020. They also expected the key rate to be 3.75% in one and two years' time. This is a major change from the January survey, when market agents expected a rate increase this year. In the most recent survey, no respondents considered the monetary stance too loose at present, whereas in the previous survey, 24% were of that opinion. About 24% of respondents considered the monetary stance appropriate, as compared with 57% in the last survey. The share that considered the monetary stance too tight or far too tight was 76%, up from 19% in the January survey.

Annual growth in M3 measured 8% in Q1/2019, after adjusting for deposits held by the failed financial institutions. This is slightly below the growth rate in late 2018. As before, growth in M3 stemmed primarily from increased household deposits, although the commercial sector's share in the growth rate has also continued to increase. After adjusting for the effects of the Government's debt relief measures, the stock of credit system loans to domestic borrowers grew in nominal terms by 10% year-on-year in Q1/2019. Over the same period, household lending grew by about 8½% year-on-year and corporate lending by around 12%, whereas the growth rate adjusted for exchange rate movements was about 9½%.

The Nasdaq OMXI8 index had risen by 12% between meetings. Turnover in the Main Market totalled 213 b.kr. in the first four months of 2019, almost 14% more than over the same period in 2018.

Global economy and external trade

According to the forecast published by the International Monetary Fund (IMF) in April, the global GDP growth outlook has deteriorated still further since the Fund's previous forecasts. Global GDP growth is forecast at 3.3% in 2019, some 0.2 percentage points below the Fund's January forecast and 0.4 percentage points below its October forecast. The weaker growth rate is due largely to a poorer outlook for advanced economies, especially in the eurozone, and also for some developing and emerging countries. Output growth among Iceland's main trading partners is projected at 1.7%, or 0.3 percentage points below the October forecast. The IMF projects that global output growth will pick up next year to 3.6%, which is 0.1 percentage points below the October forecast. The Fund continues to consider the uncertainty in the output growth forecast to be concentrated on the downside, particularly because of the risk that global trade disputes will escalate further. World trade is forecast to increase by 3.4% this year instead of the previously projected 4%. Inflation among Iceland's trading partners is forecast at 1.6% this year, as opposed to 1.9% in the October forecast.

Iceland's external goods trade generated a surplus of just under 1 b.kr. for Q1/2019 at constant exchange rates, as opposed to a deficit of 33.4 b.kr. over the same period in 2018. The turnaround between years is due primarily to increased exports of aircraft, as well as of ships. In addition, aircraft imports contracted year-on-year. Excluding ships and aircraft, the goods account showed a deficit of nearly 22 b.kr. in Q1, as opposed to a 25 b.kr. deficit at constant exchange rates in Q1/2018. This year's smaller deficit is due to a contraction in import values, particularly to include fuels and lubricants and passenger cars. Furthermore, exports excluding ships and aircraft contracted marginally, owing largely to a reduction in industrial goods exports — aluminium in particular — caused by a temporary cut in production at a domestic aluminium smelter.

Between MPC meetings, the listed global price of aluminium fell by about 7.4% and was 22.5% below the price seen at the same time last year. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products were up 6.8% year-on-year in Q1/2019. The global price of oil had risen by nearly 7% between MPC meetings, to 72 US dollars per barrel just before the May meeting. Despite an increase of over a third year-to-date, oil prices were down almost 9% between years and were more than 16% below the early October peak.

The real exchange rate in terms of relative consumer prices fell by 0.3% month-on-month in April, when it was 10% above its twenty-five year average but 14% below its June 2017 peak. In the first four months of 2019, it was down by 9.4% compared with the same period in 2018, as the nominal exchange rate of the króna was 10.5% lower and inflation in Iceland was 1.3 percentage points above the trading partner average.

The domestic real economy and inflation

According to the Statistics Iceland labour force survey (LFS), growth in total hours worked measured 1.8% in Q1/2019, which was 0.7 percentage points lower than in Q4/2018 and nearly 1 percentage point below the average of the last six years. The increase was due to a 2.6% rise in the number of employed persons, although it was offset by a shortening of the average work week by nearly 1%. The labour participation rate and the employment rate were broadly unchanged year-on-year in Q1. Data from the pay-as-you-earn (PAYE) register show clearer signs of a slowdown in job growth. According to PAYE records, year-on-year growth in employee numbers has slowed almost uninterrupted since mid-2017, a trend that appears to have continued in Q1/2019.

Seasonally adjusted unemployment measured 3% in Q1, up 0.4 percentage points from the previous quarter and up slightly from the same quarter in 2018. At the same time, the seasonally adjusted registered unemployment rate was 2.8%, after rising slightly between quarters and by 0.7 percentage points since Q1/2018. It rose to 3.5% in April, when the impact of WOW Air's insolvency took hold.

Net migration figures for Q1/2019 show that Iceland's foreign work force continues to grow, but at a slower pace than in the past year. The population increased by 1.8% year-on-year in Q1/2019 due to positive net migration of foreign nationals, as compared with a growth rate of 2.5% in Q1/2018. In addition, employees of temporary employment agencies and foreign services firms declined in number between years in the first four months of 2019, as did the number of new temporary work permits issued.

The general wage index rose by 0.5% between quarters in Q1, and by 5.7% year-on-year, and real wages were 2.5% higher in Q1 than in the same quarter of 2018.

Key indicators of developments in private consumption in Q1 suggest that the growth rate had eased since H2/2018. New motor vehicle registrations declined in number, and growth in payment card turnover subsided during the quarter. At the beginning of Q2/2019, the indicators available suggest a continuation of the pattern set in Q1.

The Gallup Consumer Confidence Index measured 96.9 points in April, an increase of just over 5 points between months but a decline of 19½ points between years. There were several changes in components of the index, with expectations six months ahead improving noticeably while the assessment of the current situation deteriorated.

Statistics Iceland's nationwide house price index, published in late April, declined 0.1% month-on-month when adjusted for seasonality, but rose 4.6% year-on-year. The capital area house price index, calculated by Registers Iceland, rose by 0.1% month-on-month in March when adjusted for seasonality, and by 4.3% year-on-year. The twelve-month rise in real estate prices has therefore held steady at about 5% since April 2018. The number of purchase agreements registered nationwide fell by 1.4% year-on-year in the first three months of 2019, while the number of contracts for new construction declined by 16.9% over the same period.

The consumer price index (CPI) rose by 0.52% month-on-month in March, and twelve-month inflation measured 2.9%. Inflation picked up to 3.3% in April, however, when the CPI rose 0.37% month-on-month. Twelve-month inflation had therefore risen by 0.3 percentage points since the MPC's March meeting. The CPI excluding housing had risen by 2.8% since April 2018, whereas twelve-month HICP inflation measured 3.2%. Underlying inflation picked up slightly between meetings, measuring 3.2% in April, according to the median of various measures.

The April measurement was affected mainly by rising airfares and petrol prices. The increase in airfares was larger than usual for this time of year, owing partly to the collapse of WOW Air, although prices generally rise around the Easter holidays. The pass-through from the depreciation of the króna to import prices has tapered off in the recent past, and the price of imported goods in the CPI has risen by 3.3% in the past twelve months.

According to the Central Bank survey carried out in early May, market agents' short-term inflation expectations fell between surveys, to 3% one year ahead and 2.8% two years ahead. Respondents also expected inflation to average 2.8% over the next five years and 2.7% over the next ten years. Five-year expectations were unchanged between surveys, but ten-year expectations fell marginally. Survey participants' long-term inflation expectations were broadly unchanged from a year earlier. The breakeven inflation rate in the bond market has also fallen in recent months. The ten-year breakeven rate was slightly less than 3% just before the MPC meeting, after falling by 0.4 percentage points since the March meeting. It was also 0.4 percentage points lower than it was a year earlier.

According to the forecast published in *Monetary Bulletin* on 22 May 2019, the inflation outlook has improved since the Bank's February forecast. Inflation rose following the depreciation of the króna last autumn, peaking at 3.7% in December. It fell to 3.1% in Q1/2019 but rose again in April, to 3.3%. Inflation expectations have fallen as well, after rising in 2018. Inflation is expected to pick up slightly until mid-year, albeit less than was assumed in February. It is expected to align with the target in mid-2020 and then dip temporarily below it late in the year. The changed inflation outlook is due primarily to the sharp turnaround in the economy, which is offset in part by a larger rise in unit labour costs and import prices.

The króna has been relatively stable in 2019 to date, after depreciating last autumn. It is expected to hold more or less steady at the current level throughout the forecast horizon, and if the forecast materialises, the trade-weighted average exchange rate will be just over 2% lower in 2020 and 2021 than was forecast in February. The prospect of a weaker króna reflects, among other things, the deterioration of the growth outlook and the expectation of lower domestic interest rates than before, as can be seen in both the market expectations survey and forward interest rates.

In Iceland's main trading partner countries, GDP growth averaged 2.1% in 2018 and the outlook for 2019 has worsened since the February *Monetary Bulletin*. Trading partners' GDP growth is now expected to average 1.7% this year, as opposed to 1.9% in the February forecast and 2.2% in the November 2018 forecast.

After a virtually uninterrupted improvement beginning in mid-2014, terms of trade started to deteriorate in mid-2017. They deteriorated by 3.9% in 2018, owing mainly to rising prices of oil and alumina, although this was offset somewhat by a robust rise in key exported goods prices. As in February, terms of trade are projected to improve by an average of ½% per year in 2019 through 2021, owing to a continued rise in exported goods prices and a decline in oil and alumina prices. If the forecast materialises, terms of trade will be 1½% weaker by the end of the forecast horizon than was projected in February.

The outlook is for a sharp turnaround in exports in 2019 as compared with the previous two years. This is due mainly to the strong contraction in tourism exports, as it was clear early this year that tourist arrivals would be fewer in 2019 than in 2018. Now, with WOW Air's collapse, tourist arrivals are expected to be 10½% fewer in 2019 than in 2018, and services exports are therefore projected to contract by nearly 9%.The outlook for goods exports has deteriorated as well, owing largely to the failure of the capelin catch and the generally poorer outlook for marine product exports. Therefore, the outlook is for combined goods and services exports to contract by nearly 4% in 2019 instead of remaining broadly flat year-on-year, as in the February forecast. Tourist numbers are expected to increase again next year, and total exports are forecast to grow by an average of 2½% year-on-year in 2020 and 2021, mainly as a result of a rebound in services exports.

Output growth is estimated to have slowed in Q1/2019, and GDP is expected to contract by just over 1% year-on-year in Q2. This is a marked change from the February forecast, owing to the external shocks recently hitting the economy, which are described above. For the year as a whole, GDP is expected to shrink by 0.4%, the first contraction in Iceland since 2010. This is also a significant change from the 1.8% growth assumed in the February forecast. The downward revision of the output growth forecast is driven mainly by the poorer outlook for tourism, although reduced marine product exports owing to this year's capelin catch failure weigh heavily as well. Added to this is the impact of slower growth among trading partners, plus a revision of public expenditure growth since February. The baseline forecast assumes that the economic contraction will be relatively brief and that GDP growth will rebound to 2½% in 2020. Even so, this is below the growth rate forecast in February.

The outlook is for total hours worked to decline well into the year but remain virtually flat between annual averages, whereas the February forecast assumed an increase of 1.4%. Thus the outlook is for a noticeable rise in unemployment in Q2. Unemployment is projected to average 3.9% this year, 0.8 percentage points above the February forecast. According to the forecast, it will subside again in 2020 and 2021 but remain well above the February forecast, and above the level considered consistent with price stability.

The year-2019 pay hikes provided for in the new wage agreements are broadly in line with the February forecast, but the wage rises for the two years following are somewhat larger. The outlook is also for weaker productivity growth than was projected in February and thus a larger increase in unit labour costs, which are now forecast to rise by 7% this year and 4%, on average, in 2020 and 2021.

Because of Statistics Iceland's revision of historical GDP growth figures, the output gap is now estimated to have been larger in the past two years than previous figures indicated. This year's abrupt turnaround in economic activity means, however, that the output gap will close much more quickly than previously projected. It is now assumed that an output slack will develop by the end of this year and then close again by the end of 2020.

The Bank's baseline forecast reflects the assessment of the most likely economic developments during the forecast horizon. It is based on forecasts and assumptions concerning domestic economic policy, developments in the external environment of the Icelandic economy, and assessments of the effectiveness of individual markets and how monetary policy is transmitted to the real economy. All of these factors are subject to uncertainty. Changes in key assumptions could lead to developments different from those provided for in the baseline forecast.

Inflation could turn out higher than in the baseline forecast even though uncertainty about the inflation outlook has receded with the approval of private sector wage agreements. Uncertainty has not disappeared entirely, as public sector wage settlements are still outstanding and could affect private sector agreements. Furthermore, there is always uncertainty about wage drift and about how far up the pay scale the generous pay rises for the lowest-paid workers will spread. The exchange rate of the króna is another important uncertainty. It is not impossible, for example, that some of the H2/2018 depreciation has yet to pass through to domestic inflation. In addition, the exchange rate assumptions in the baseline forecast could prove overly optimistic; e.g., if the shocks to the tourism industry prove long-lasting or if terms of trade deteriorate further. Demand pressures in the economy could also turn out more persistent than is currently assumed. By the same token, inflation could turn out higher than is forecast if inflation expectations start to rise again.

Nor can the possibility be excluded that inflation will turn out lower than is assumed in the baseline forecast. The króna could appreciate again, for instance, if external conditions improve. The global economic outlook could prove overly optimistic, and exports and GDP growth could therefore turn out weaker than is currently forecast. Productivity growth could prove stronger than is forecast, and the output slack that appears to be opening up could be underestimated.

II The interest rate decision

The MPC discussed the proposed amendments to the Rules on Central Bank Facilities for Financial Undertakings, which would add covered bonds (bonds secured by individuals' mortgage loans) to the list of securities eligible as collateral. The proposal was discussed and then approved by the Committee.

MPC members discussed the monetary stance in view of the most recent information on the economy and the fact that the Bank's real rate was broadly unchanged since the March meeting. Members discussed whether the monetary stance was appropriate in view of the inflation outlook, as they had decided in March to keep the Bank's interest rates unchanged, partly because of uncertainty about wage agreements. The Committee had also met twice in April to discuss the most recent economic developments, including the outcome of wage settlements and the changes in the tourism industry.

Members discussed economic developments and prospects, taking into account the Bank's new macroeconomic forecast, published in *Monetary Bulletin* on 22 May, which stated that the GDP growth outlook had changed markedly since the Bank's last forecast. According to the forecast, the outlook is for a contraction of 0.4% this year, as opposed to 1.8% growth according to the February forecast. Members agreed that this deterioration in the outlook was due primarily to a contraction in tourism and reduced marine product exports because of the capelin catch failure. They were of the view that as a result, the positive output gap would close and a slack emerge in the near future; that is, if it had not already done so. It emerged in the discussion that in the short run, there was a risk that economic activity would contract more than was assumed in the baseline forecast. It was also pointed out that it was uncertain whether the contraction would be short-lived and a recovery would begin as soon as 2020. On the other hand, it was pointed out that underlying economic activity could also be underestimated.

The MPC discussed developments in inflation, which measured 3.1% in Q1/2019 and rose to 3.3% in April. Members noted that underlying inflation had developed in broadly the same manner, and the difference between inflation including and excluding housing was at its smallest since autumn 2013. It came to light in the discussion that the króna had held relatively stable in 2019 to date, and the inflationary effects of the autumn 2018 depreciation had thus far been smaller than anticipated. It was pointed out that the Central Bank had intervened very little in the foreign exchange market in the recent past and that the real exchange rate was close to its estimated equilibrium value. Committee members agreed that the deterioration in the economic outlook had caused the inflation outlook to change markedly in a short period of time, and they noted that the Bank's forecast assumed that inflation would peak at 3.4% in mid-2019 and then ease back to the target by mid-2020.

The MPC emphasised that although the recently finalised private sector wage agreements provided for sizeable pay increases, the outcome was better in line with the inflation target than had widely been expected. It emerged in the discussion that uncertainty about the inflation outlook had subsided thereafter. Inflation expectations had therefore moderated again after having risen markedly over the course of 2018. Members considered it very positive that long-term inflation expectations in the market had fallen below 3%.

They noted that the economic contraction would be challenging for households and businesses but emphasised that the economy was much more resilient than before. In this context, they noted that underlying economic fundamentals and conditions were entirely different now than, for example, during the economic crisis a decade ago. The MPC emphasised that monetary policy had considerable scope to respond to the contraction, particularly if inflation and inflation expectations remained close to the target, as is currently envisioned. It emerged in the discussion that because of this ample scope, monetary policy could be applied to mitigate the downturn ahead. Moreover, members considered it positive that the Government's proposed fiscal measures in connection with wage settlements would pull in the same direction.

All members agreed that it was necessary to lower the Bank's key rate now, and they discussed whether it should be lowered by 0.25 percentage points or 0.5 percentage points. The main argument discussed at the meeting in favour of the smaller step, a 0.25-point rate cut, was that inflation was still above target and would probably continue to rise in coming months. Furthermore, inflation expectations were still above target. Moreover, the outlook was for a sizeable rise in unit labour costs in coming years, and public sector wage settlements were still outstanding. The main argument in favour of the larger step, a rate cut of 0.5 percentage points, was the abrupt deterioration of the economic outlook as a result of the recent negative shocks. In addition, the economic outlook was highly uncertain, and the possibility of a deeper and longer contraction than in the Bank's forecast could not be ruled out. Also, the inflation outlook had improved, and long-term inflation expectations had fallen and were closing in on the target, giving the MPC greater scope to respond with a larger rate cut than would otherwise have been possible.

In view of the discussion, the Governor proposed that the Bank's interest rates be lowered by 0.5 percentage points. The Bank's key rate (the seven-day term deposit rate) would be 4.0%, the current account rate 3.75%, the seven-day collateralised lending rate 4.75%, and the overnight lending rate 5.75%. All Committee members voted in favour of the proposal.

In the Committee's view, near-term monetary policy decisions would depend on the interaction between developments in economic activity, on the one hand, and inflation and inflation expectations, on the other.

The following Committee members were in attendance:

Már Gudmundsson, Governor and Chairman of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor

Thórarinn G. Pétursson, Chief Economist

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

In addition, a number of Bank staff members attended part of the meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 26 June 2019.

The Monetary Policy Committee of the Central Bank of Iceland

Minutes of the Monetary Policy Committee meeting

June 2019 (85th meeting)

Published 10 July 2019

The Act on the Central Bank of Iceland stipulates that it is the role of the Monetary Policy Committee (MPC) to set Central Bank interest rates and apply other monetary policy instruments. Furthermore, the Act states that "[m]inutes of meetings of the Monetary Policy Committee shall be made public, and an account given of the Committee's decisions and the premises upon which they are based." In accordance with the Act, the MPC has decided to publish the minutes of its meetings two weeks after each interest rate decision. The votes of individual Committee members are also included in the minutes.

The following are the minutes of the MPC meeting held on 24 and 25 June 2019, during which the Committee discussed economic and financial market developments, the interest rate decision of 26 June, and the communication of that decision.

I Economic and monetary developments

Before turning to the interest rate decision, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the 22 May 2019 interest rate decision.

Financial markets

Since the May meeting, the króna had depreciated by 2.3% in trade-weighted terms. Over this same period it fell 2.6% against the euro, 0.5% against the US dollar, and 1% against the pound sterling. Between meetings, the Bank sold foreign currency for 21 million euros (3 b.kr.), in part to prevent outflows of offshore krónur from lowering the exchange rate. The Central Bank's transactions accounted for just under 18% of total turnover in the foreign exchange market.

In terms of the Central Bank's real rate, the monetary stance had tightened slightly since just after the Committee's May interest rate decision. In terms of the average of various measures of inflation and inflation expectations, the Bank's real rate had risen by 0.1 percentage points between meetings, to 0.7%. In terms of twelve-month inflation, it was 0.4% and had fallen by 0.3 percentage points between meetings.

Interest rates in the interbank market for krónur declined in line with the Central Bank's 0.5-point rate cut in May, but turnover totalled about 21 b.kr. during the period.

Yields on long-term nominal Treasury bonds had fallen by 0.3 percentage points since the May meeting, and yields on long-term indexed Treasury and Housing Financing Fund (HFF) bonds had declined by 0.1 percentage points. Average interest rates on fixed- and variable-rate mortgages had fallen in a similar manner, apart from average indexed rates on pension fund loans, which were broadly unchanged.

In terms of three-month interbank rates, the interest rate differential versus the euro area had narrowed by 0.3 percentage points between meetings, to 4.9 percentage points. The corresponding spread versus the US had narrowed by 0.2 percentage points, to 2.2 percentage points. The long-term interest rate differential versus Germany was broadly unchanged between meetings, at 4.2 percentage points, whereas the spread versus the US had widened by 0.1 percentage points, to 1.9 percentage points.

Measures of the risk premium on the Treasury's foreign obligations were largely unchanged since the MPC's May meeting. The CDS spread on the Treasury's five-year US dollar obligations was virtually unchanged at just over 0.7%, while the spread between the Treasury's eurobonds and comparable bonds issued by Germany narrowed slightly, to 0.5-0.6 percentage points.

Financial institutions' analysts expected a rate cut of 0.25 percentage points, citing the decline in corporate inflation expectations and the breakeven inflation rate in the market, as well as the deterioration in the economic outlook since the last interest rate decision. Even though the króna had weakened recently and inflation was above target, analysts expected the MPC to lower interest rates further so as to soften the imminent economic contraction.

Annual growth in M3 measured just under 9% in May, after adjusting for deposits held by the failed financial institutions. This was broadly similar to the growth rate in the two months beforehand. As before, the increase is due largely to growth in household deposits. After adjusting for the effects of the Government's debt relief measures, the stock of credit system loans to domestic borrowers grew in nominal terms by 8½% year-on-year in May 2019. Over the same period, household lending grew by 7½% year-on-year and corporate lending by 9½%, whereas the growth rate adjusted for exchange rate movements was about 6%.

The Nasdaq OMXI8 index had fallen by 2.3% between meetings. Turnover in the main market totalled around 281 b.kr. during the first five months of the year, 23% more than over the same period in 2018.

Global economy and external trade

According to the Organisation for Economic Co-operation and Development's (OECD) May forecast, global GDP growth will be weaker in both 2019 and 2020 than in the OECD's November forecast. It is forecast to measure 3.2% this year and 3.4% next year, which is 0.1-0.3 percentage points below the November forecast. Weaker GDP growth is forecast for nearly all countries worldwide, and particularly for the euro area. The outlook for growth in world trade has deteriorated as well. Growth for this year is projected at just over 2%, the weakest in the post-crisis period. The OECD continues to consider the uncertainty in the output growth forecast to be concentrated on the downside, partly because of the risk that global trade disputes will escalate further and prove more protracted than is currently expected. For Iceland's main trading partners, the OECD forecasts 1.8% GDP growth in both 2019 and 2020, which is 0.1-0.3 percentage points below its November forecast. Trading partner inflation is projected at 1.5% this year and 1.8% next year, some 0.3-0.6 percentage points below the November forecast.

Iceland's external goods trade generated a deficit of just over 15 b.kr. for the first four months of the year (at constant exchange rates), as opposed to a deficit of nearly 52 b.kr. over the same period in 2018. The smaller deficit this year is due for the most part to increased exports of aircraft early in 2019. In addition, aircraft imports contracted year-on-year. Excluding ships and aircraft, the goods account showed a deficit of nearly 37 b.kr. in the first four months of 2019, as opposed to a 38½ b.kr. deficit at constant exchange rates over the same period in 2018. Import values excluding ships and aircraft contracted by 2% year-on-year, particularly imports of passenger cars and fuels and lubricants. Furthermore, exports contracted by 1.7%, especially aluminium exports.

Between MPC meetings, the listed global price of aluminium rose by 0.6% but was 18% below the price seen at the same time last year. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products were up 6.3% year-on-year in the first four months of 2019. The global price of oil had risen by nearly 10% between MPC meetings, to 65 US dollars per barrel just before the June meeting. This is 13% below the price seen at the same time in 2018.

The real exchange rate in terms of relative consumer prices fell by 1.6% month-on-month in May, when it was 8.5% above its twenty-five year average but 15.4% below its June 2017 peak. In the first five months of 2019, it was down by 9.5% compared with the same period in 2018, as the nominal exchange rate of the króna was 10.7% lower and inflation in Iceland was 1.4 percentage points above the trading partner average.

The domestic real economy and inflation

According to preliminary figures published by Statistics Iceland in May, GDP growth measured 1.7% for the first quarter of the year. Domestic demand contracted by 2.8% between years, whereas the contribution of net trade to output growth was positive by 4.4 percentage points. Private and public consumption grew by 2.8% year-on-year, while investment shrank 9.4% and total consumption and investment were unchanged between years. The contribution from inventory changes was negative during the quarter, however, causing the contraction in domestic demand. Q1/2019 GDP growth was 0.1 percentage points stronger than had been forecast in the May *Monetary Bulletin*. Consumption and investment were somewhat stronger than forecast, while inventory changes were weaker. As a result, domestic demand as a whole developed in line with the Bank's forecast. Export growth was weaker than projected, but on the other hand, imports contracted more strongly and the contribution from net trade was in line with the forecast.

The current account balance was positive by just over 35 b.kr. in Q1/2019, as opposed to a surplus of 6.7 b.kr. at the same time in 2018. The larger surplus now is due for the most part to a turnaround in goods trade, owing in particular to increased exports of ships and aircraft, although there was also a contraction in aircraft imports. The balance on primary income was also more positive this year than in 2018, although the surplus on services trade was smaller. Excluding ships and aircraft, the current account showed a surplus of 13.2 b.kr. in Q1/2019, as opposed to a 14.1 b.kr. surplus in the same quarter of 2018.

Key indicators of developments in private consumption in Q2 are rather more robust than in Q1, which could suggest that private consumption growth will firm up between quarters. The Gallup Consumer Confidence Index measured 96 points in May, slightly lower than in the previous month, but on the whole it has been on the rise in recent months, after a steep drop in H2/2018.

According to the approved amendments to the Parliamentary resolutions on the 2018-2022 fiscal strategy and the 2020-2024 fiscal plan, the fiscal outcome will deteriorate markedly, by nearly 1% of GDP each year. One of the reasons for this is the sharp downturn in economic activity this year, which erodes the economic outlook relative to the Government's previous estimates. As a result, the output gap — changes in which greatly affect the fiscal outcome, particularly on the revenues side — will narrow more rapidly. In addition, a number of special measures that have been resolved upon will tend to weaken the fiscal performance, especially measures in connection with the recent wage settlements. Preliminary fiscal performance figures from Statistics Iceland show nearly 8% year-on-year expenditure growth in Q1, while regular revenues grew by just over 2%.

According to the results of Gallup's summer survey, conducted in May among Iceland's 400 largest firms, respondents' assessment of the current economic situation was more positive than in the spring survey but less positive than in the summer 2018 survey. Executives' expectations over the next six months are somewhat more positive, however, than in either the spring survey or the survey taken in summer 2018. About 56% of respondents consider the current situation neither good nor poor, and about 23% consider it good. Just under 41% of executives are of the view that economic conditions will deteriorate in the next six months, and 46% expect conditions to be neither better nor worse. About 14% of executives expect the situation to improve in six months' time, somewhat more than in the last survey. Executives are more optimistic about developments in domestic demand in the next six months than they were in the spring survey, particularly those in retail and wholesale trade and construction.

According to the seasonally adjusted results of the summer survey, about one-fourth of firms are planning to reduce staffing levels in the next six months. The share of firms planning to downsize exceeds the share planning to recruit staff by 12 percentage points, which suggests a downturn in labour demand since the spring survey. The balance of opinion is 16 percentage points below its long-term average. The only sector with the prospect of job growth is specialised services, where the balance of opinion is positive by 11 percentage points, whereas the outlook is for reduced staffing in all other sectors, where the balance of opinion is negative by 16-26 percentage points. Executives in construction and utilities, as well as in retail and wholesale trade, are considerably more pessimistic than in the spring survey, whereas pessimism has retreated among executives in transport, transit, and tourism and in miscellaneous specialised services.

After adjusting for seasonality, 11% of executives considered themselves short-staffed, about the same as in the spring survey but 14 percentage points fewer than in the summer 2018 survey. The shortage was greatest in miscellaneous specialised services and in construction and utilities, where nearly one in five respondents considered themselves understaffed. On the other hand, there was only a negligible shortage in retail and wholesale trade and none in financial and insurance firms and fishing companies. Staffing shortages were below their long-term averages in all sectors.

About 40% of executives reported that they would have difficulty responding to unexpected demand, after adjusting for seasonality. This ratio was broadly unchanged since the spring survey, and very close to its long-term average. Nearly three of five executives in specialised services reported that they would have difficulty responding to unexpected demand, as were about a fifth of executives in retail and wholesale trade.

The wage index rose by 0.5% month-on-month in May and by 5.1% year-on-year. Real wages were 1.4% higher than at the same time in 2018.

Statistics Iceland’s nationwide house price index, published in late May, was virtually unchanged month-on-month when adjusted for seasonality, but rose 5.4% year-on-year. The capital area house price index, calculated by Registers Iceland, fell by 0.1% month-on-month in May when adjusted for seasonality, but rose by 3.9% year-on-year. The number of purchase agreements registered nationwide fell by 10% year-on-year in the first five months of 2019, while the number of contracts for new construction declined by 23% over the same period.

The consumer price index CPI rose by 0.21% month-on-month in May. Twelve-month inflation measured 3.6% and had risen by 0.3 percentage points between MPC meetings. The CPI excluding the housing component had risen by 3.1% year-on-year in May. Underlying inflation also picked up between meetings, measuring 3.4% in May, according to the median of various measures. The reduction in airfares had the strongest impact on the CPI in May, affecting the index about the same as in May of the previous two years. Increased petrol and food prices also made some impact.

According to Gallup’s summer survey, household inflation expectations one year ahead measured 4%, which was unchanged from the spring survey but 0.6 percentage points more than in the summer 2018 survey. Corporate inflation expectations one year ahead fell from the previous survey, however, to 3%, the same as in the summer 2018 survey. Households’ and businesses’ long-term inflation expectations fell by 0.5 percentage points between surveys, to 3-3.5%. The five- and ten-year breakeven inflation rate in the bond market was 2.7-2.9% just before the MPC meeting, after falling by approximately 0.2 percentage points since the May meeting. The ten-year breakeven rate has averaged 2.8% in Q2 to date, which is 0.5 percentage points lower than in Q2/2018.

II The interest rate decision

The MPC discussed monetary policy instruments and Central Bank transactions, as a working group within the Bank has been examining whether monetary policy instruments should be reviewed from the standpoint of efficacy and economy. The Committee also discussed financial institutions’ liquidity position and the Bank’s foreign exchange market intervention policy. Foreign exchange intervention has been limited in recent months, and some of the transactions have been undertaken in response to outflows of offshore krónur.

MPC members discussed the monetary stance in view of the most recent information on the economy and the fact that the Bank’s real rate had risen by 0.1 percentage points since the May meeting. They discussed whether the monetary stance was appropriate in view of the inflation outlook, as they had decided in May to lower the Bank’s interest rates, partly because of the imminent turning point in the economy, the improved inflation outlook, and the decline in long-term inflation expectations. Furthermore, uncertainty about the inflation outlook had abated with the approval of private sector wage agreements.

Members discussed the newly published preliminary national accounts figures but agreed that the most recent data on economic developments did not change the assessment of the economic outlook as presented to the Committee at its last meeting. They noted that GDP growth in Q1/2019 was in line with the Central Bank's May forecast. Furthermore, stronger private consumption in Q1 and leading indicators for Q2 could imply that domestic demand had been more resilient than previously assumed. On the other hand, it emerged that total turnover on foreign credit cards had contracted year-on-year in April and May in foreign currency terms, although turnover per tourist had increased somewhat. This, together with recent data and forecasts concerning tourist numbers, indicated that the contraction in tourism could turn out more pronounced than had been forecast in May. The MPC agreed that, as regards the short-term outlook, stronger-than-expected domestic demand growth partially offset the stronger impact of the negative economic shocks recently hitting the economy. In the Committee's assessment, however, this did not change the outlook for a contraction in the domestic economy that is expected to show more clearly in coming months.

MPC members discussed developments in inflation, which had been in line with the Bank's last forecast. According to that forecast, inflation had peaked and would ease back to target as the year progressed. It emerged in the discussion, however, that further depreciation of the króna could change these prospects. Inflation expectations had also fallen since the Committee's last meeting, whereas long-term expectations as measured by the breakeven inflation rate in the bond market appeared to have been inching upwards again in recent weeks.

In the Committee's view, although the economic contraction will be challenging for households and businesses, the economy was much more resilient than before. The MPC emphasised that monetary policy had considerable scope to respond to the contraction, particularly if inflation and inflation expectations remained close to the target, as is currently envisioned. In addition, members agreed that the proposed fiscal easing would pull in the same direction.

The Committee discussed awaiting further developments and keeping interest rates unchanged versus lowering them by 0.25 percentage points. The main arguments in favour of an unchanged policy rate were that inflation and inflation expectations were still above target and the breakeven inflation rate in the bond market appeared to have begun rising again. Furthermore, the króna had weakened in the recent term and public sector wage agreements were still pending. Moreover, the underlying resilience of domestic demand had been greater than previously assumed. As a result, it could be appropriate to wait for clearer signs of disinflation and falling inflation expectations before lowering interest rates further.

The main argument in favour of a rate cut was that while economic developments had been broadly in line with expectations, there were signs that the economic contraction could turn out deeper and longer than had been forecast in May. Inflation expectations had fallen between MPC meetings and the monetary stance had therefore tightened again. It was also pointed out that the outlook was still for inflation to ease back towards the target in 2019. Consequently, it was appropriate to loosen the monetary stance further, in response to the economic contraction.

In view of the discussion, the Governor proposed that the Bank's interest rates be lowered by 0.25 percentage points. The Bank's key rate (the seven-day term deposit rate) would be 3.75%, the current account rate 3.5%, the seven-day collateralised lending rate 4.5%, and the overnight lending rate 5.5%. Már Gudmundsson, Rannveig Sigurdardóttir, Gylfi Zoëga, and Katrín Ólafsdóttir voted in favour of the proposal. Thórarinn G. Pétursson voted against the Governor's proposal, preferring to keep rates unchanged.

In the Committee’s view, near-term monetary policy decisions would depend on the interaction between developments in economic activity, on the one hand, and inflation and inflation expectations, on the other.

The following Committee members were in attendance:

Már Gudmundsson, Governor and Chairman of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor

Thórarinn G. Pétursson, Chief Economist

Gylfi Zoëga, Professor, external member

Katrín Ólafsdóttir, Assistant Professor, external member

In addition, a number of Bank staff members attended part of the meeting.

Karen Áslaug Vignisdóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 28 August 2019.

SEÐLABANKI ÍSLANDS

Kjarasamningar, peningastefnan og þjóðarbúskapurinn

Ríkissáttasemjari
17. janúar 2019

Þórarinn G. Pétursson
Aðalhagfræðingur Seðlabanka Íslands

Þær skoðanir sem hér koma fram þurfa ekki að endurspegla skoðanir Seðlabanka Íslands eða annarra nefndarmanna peningastefnunefndar

Tölum aðeins um hin efnahagslegu þyngdarlögmál

Hækkun raunlauna ræðst til lengri tíma af framleiðnivexti

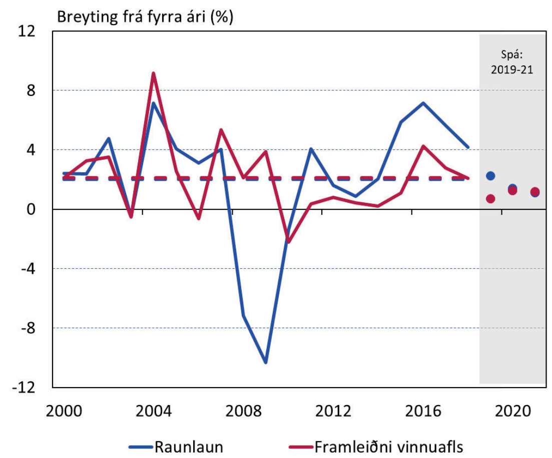
Hið efnahagslega samhengi

- Raunlaun hækka í takt við framleiðnivöxt til lengdar þótt frávik geti orðið á einstaka árum
- T.d. mikil lækkun raunlauna eftir fjármálakreppuna …
- … og mikil hækkun raunlauna 2015-17

Horfur

- Spáð hægari framleiðnivexti á næstu árum sem mun líklega endurspeglast í hægari hækkun raunlauna

Raunlaun og framleiðni[1]



1. Laun mæld með launakostnaði samkvæmt framleiðsluuppgjöri þjóðhagsreikninga. Áætlun Seðlabankans fyrir 2017-2018. Raunlaun eru nafnlaun staðvirt með vísitölu neysluverðs. Framleiðni vinnuafls mæld sem hlutfall landsframleiðslu og heildarvinnustunda samkvæmt Vinnumarkaðskönnun Hagstofunnar. Brotalínur sýna meðaltöl 2000-2017. Punktar sýna spá *Peningamála* 2018/4 fyrir 2019-2021.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Hækkun launakostnaðar á framleidda einingu og verðlags fylgjast að til lengri tíma

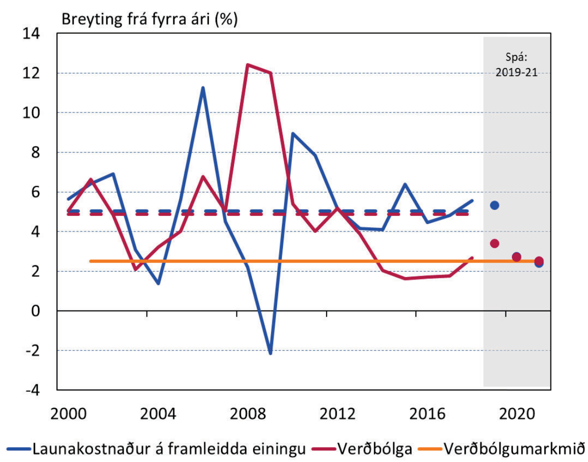
Hið efnahagslega samhengi

- Til lengdar hækkar verðlag í takt við hækkun launakostnaðar á framleidda einingu
  - Um 5% meðalhækkun 2000-17 – tvöfalt meiri en verðbólgumarkmiðið
- En oft tímabundin frávik eins og strax eftir fjármálakreppuna …
- … og mikil hækkun launakostnaðar síðustu ár á sama tíma og verðbólga hefur verið lítil

Horfur

- Spáð að launakostnaður og verðbólga verði í samræmi við verðbólgumarkmið

Launakostnaður og verðbólga[1]



1. Launakostnaður á framleidda einingu er skilgreindur sem hlutfall launakostnaðar og framleiðni vinnuafls. Brotalínur sýna meðaltöl 2000-2017. Punktar sýna spá *Peningamála* 2018/4 fyrir 2019-2021.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Sveiflur í viðskiptakjörum geta haft áhrif á samband launa og annarra þjóðhagsstærða til skemmri tíma

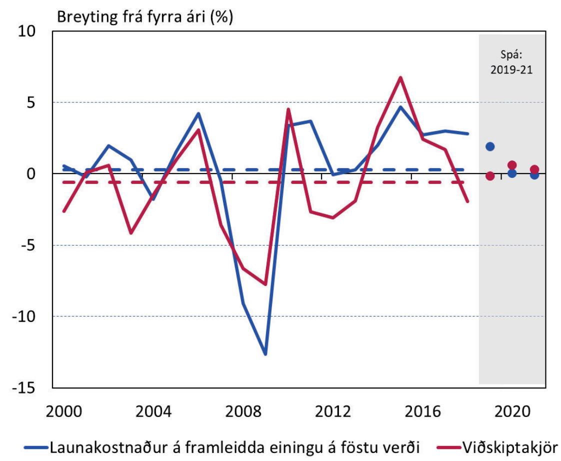
Hið efnahagslega samhengi

- Mikil viðskiptakjararýrnun á þátt í að skýra mikla lækkun launakostnaðar strax í kjölfar fjármálakreppunnar
- Mikill viðskiptakjarabati á þátt í að skýra hækkun launakostnaðar undanfarin ár og af hverju hækkunin kom ekki fram í aukinni verðbólgu

Horfur

- Ekki horfur á viðlíka viðskiptakjarabata á næstu árum og undanfarin ár

Launakostnaður og viðskiptakjör[1]



1. Launakostnaður á framleidda einingu er skilgreindur sem hlutfall launakostnaðar og framleiðni vinnuafls. Launakostnaður á framleidda einingu á föstu verði er fengin með því að staðvirða launakostnað með vísitölu neysluverðs. Viðskiptakjör eru hlutfallslegt verð út- og innflutnings vöru og þjónustu. Brotalínur sýna meðaltöl 2000-2017. Punktar sýna spá *Peningamála* 2018/4 fyrir 2019-2021.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Til skemmri tíma ákvarðast launaþróun einnig af stöðu hagsveiflunnar

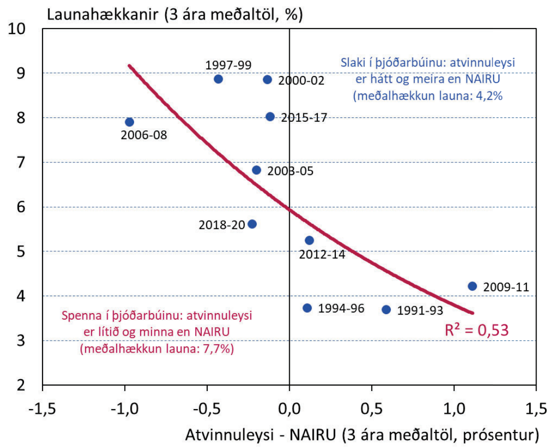
Hið efnahagslega samhengi

- Að öðru jöfnu hækka laun hraðar í efnahagsuppsveiflu þegar atvinnuleysi er lítið
  - Samningsstaða launþega styrkist og fyrirtæki keppa um vinnuaflið með því að bjóða upp laun
- Þarf þó ekki að fara saman ef minnkun atvinnuleysis endurspeglar lækkun kerfislægs atvinnuleysis (þ.e. svokallaðs NAIRU)

Horfur

- Horfur á að atvinnuleysi aukist smám saman og spenna á vinnumarkaði hverfi sem að öðru óbreyttu ætti að hægja á hækkun launa

Launahækkanir og spenna á vinnumarkaði[1]



1. Atvinnuleysi er samkvæmt Vinnumarkaðskönnun Hagstofunnar. Jafnvægisatvinnuleysi (NAIRU) er metið af Seðlabankanum. Punktar sýna pör launahækkana og frávika atvinnuleysis frá NAIRU (3 ára meðaltöl). Spá *Peningamála* 2018/4 fyrir 2019-2020.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Áhrif launahækkana ráðast einnig af viðbrögðum peningastefnunnar

Fjórar ólíkar sviðsmyndir af áhrifum launahækkana á þjóðarbúið

Sviðsmyndir sem byggja á stílfærðu dæmi um launahækkanir

- Laun hækka samtals um 32% 2019-21 (um 10½% á ári að meðaltali) eða um liðlega tvöfalt meira en gert er ráð fyrir í *Peningamálum* 2018/4
- Frá 2022 hækka laun eins og í grunnspá *Peningamála* 2018/4

Mikilvægt að hafa í huga

- Ekki mat á komandi kjarasamningum eða mögulegu „hækkunarsvigrúmi“ – kostnaðarmat frá aðilum vinnumarkaðar liggur ekki fyrir
- Ekki mat á áhrifum launahækkana fyrir einstaka stéttir eða starfshópa
- Engin önnur hagstjórnarviðbrögð en peningastefnu og engir aðrir búhnykkir/skellir sem geta dregið úr eða magnað áhrif
- Ekki gert ráð fyrir annarrar umferðar áhrifum verðbólgu á laun á því 5 ára tímabili sem er sýnt né að launahækkanir grafi undan kjölfestu verðbólguvæntinga til lengdar

Hvernig hafa launabreytingar áhrif á verðbólgu?

Verðbólga í dag = *a* × (liðin verðbólga) + *b* × (vænt framtíðarverðbólga)

+ *c* × (framleiðsluspenna) + *d* × (hækkun innflutningsverðlags)

Hvernig hafa launabreytingar áhrif á verðbólgu?
Áhrif á tekjur og eftirspurn

Verðbólga í dag = *a* × (liðin verðbólga) + *b* × (vænt framtíðarverðbólga)

+ *c* × (framleiðsluspenna) + *d* × (hækkun innflutningsverðlags)

Hækkun launa eykur verðbólgu með því að hækka ráðstöfunartekjur og auka eftirspurn

Hvernig hafa launabreytingar áhrif á verðbólgu?
Áhrif á gengi krónunnar

Verðbólga í dag = a × (liðin verðbólga) + b × (vænt framtíðarverðbólga)

+ c × (framleiðsluspenna) + d × (hækkun innflutningsverðlags)

Hækkun launa eykur verðbólgu með því að auka þrýsting til lækkunar á gengi ISK

Hvernig hafa launabreytingar áhrif á verðbólgu?
Áhrif á verðbólguvæntingar

Hækkun launa eykur verðbólgu ef hún veikir kjölfestu verðbólguvæntinga

Verðbólga í dag = a × (liðin verðbólga) + b × (vænt framtíðarverðbólga)

+ c × (framleiðsluspenna) + d × (hækkun innflutningsverðlags)

Hvernig hafa launabreytingar áhrif á verðbólgu?
Í raunveruleikanum koma áhrifin í gegnum alla þessa þætti

Hækkun launa eykur verðbólgu ef hún veikir kjölfestu verðbólguvæntinga

Verðbólga í dag = *a* × (liðin verðbólga) + *b* × (vænt framtíðarverðbólga)

Hækkun launa eykur verðbólgu með því að auka þrýsting til lækkunar á gengi ISK

+ *c* × (framleiðsluspenna) + *d* × (hækkun innflutningsverðlags)

Hækkun launa eykur verðbólgu með því að hækka ráðstöfunartekjur og auka eftirspurn

Þótt vaxta- og launagreiðslur séu kostnaður fyrirtækja eru áhrif þeirra á verðbólgu gjörólík

Hækkun vaxta dregur úr verðbólgu ef hún styrkir kjölfestu verðbólguvæntinga

Verðbólga í dag = *a* × (liðin verðbólga) + *b* × (vænt framtíðarverðbólga)

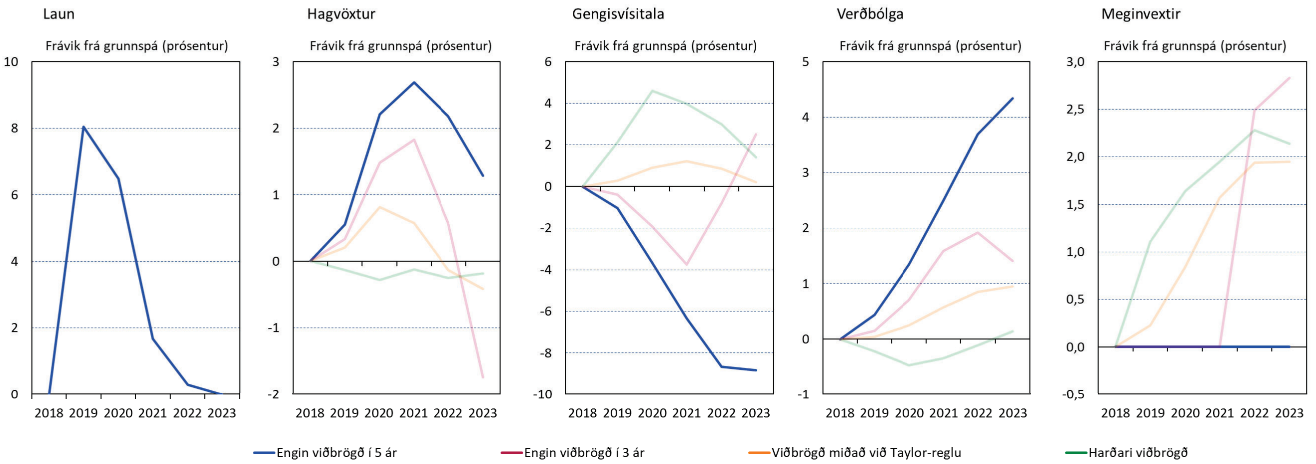
Hækkun vaxta dregur úr verðbólgu með því að hækka gengi ISK

+ *c* × (framleiðsluspenna) + *d* × (hækkun innflutningsverðlags)

Hækkun vaxta dregur úr verðbólgu með því að draga úr ráðstöfunartekjum og hægja á eftirspurn

Áhrif launahækkana á þjóðarbúið ef peningastefnan bregst ekki við í 5 ár

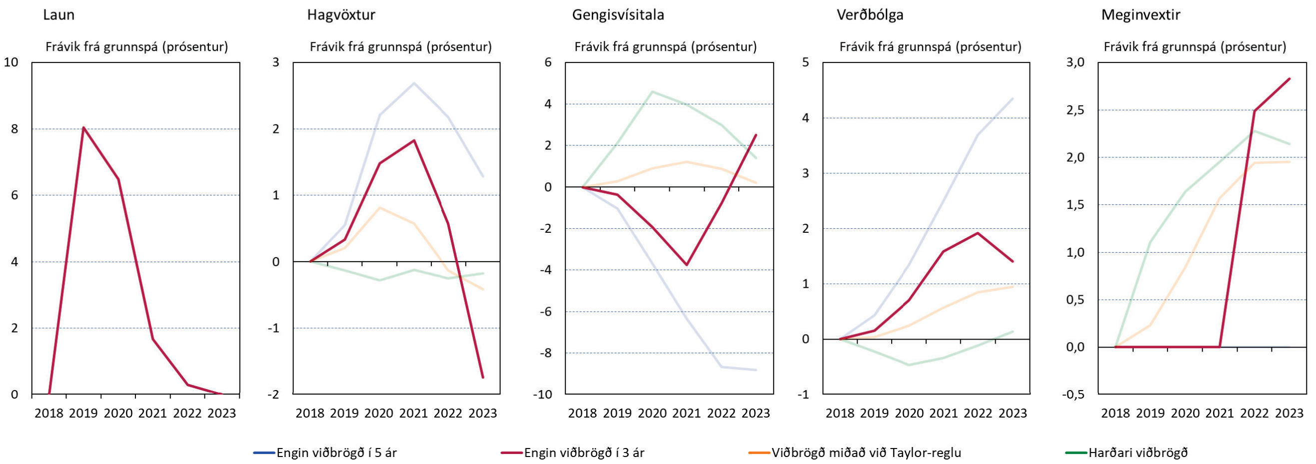
Fráviksdæmi: Áhrif launahækkana miðað við mismunandi viðbrögð peningastefnu



Heimild: Seðlabanki Íslands.

Áhrif launahækkana á þjóðarbúið ef peningastefnan bregst ekki við í 3 ár

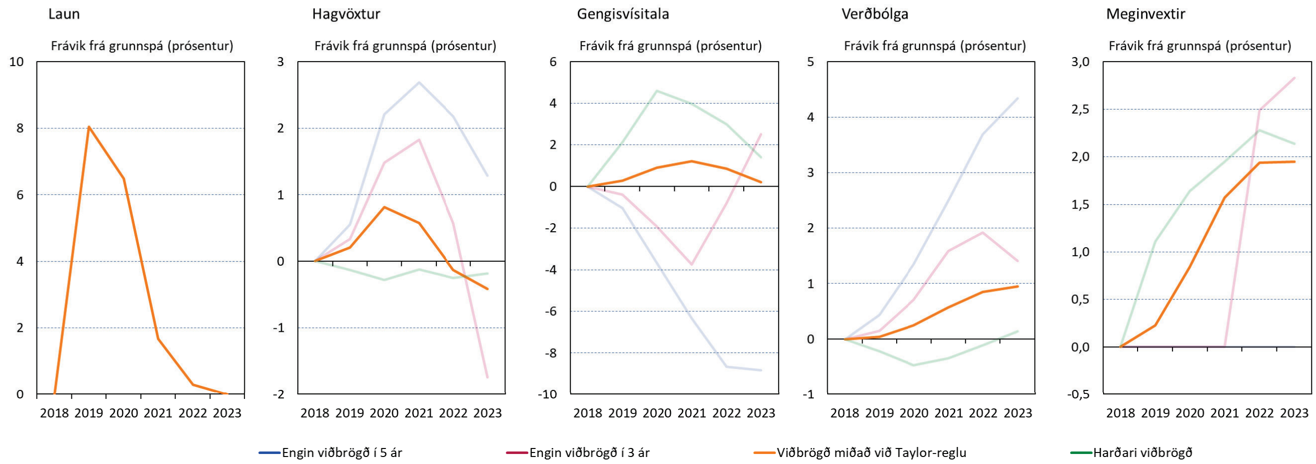
Fráviksdæmi: Áhrif launahækkana miðað við mismunandi viðbrögð peningastefnu



Heimild: Seðlabanki Íslands.

Áhrif launahækkana á þjóðarbúið ef peningastefnan bregst við í takt við hefðbundna peningastefnureglu

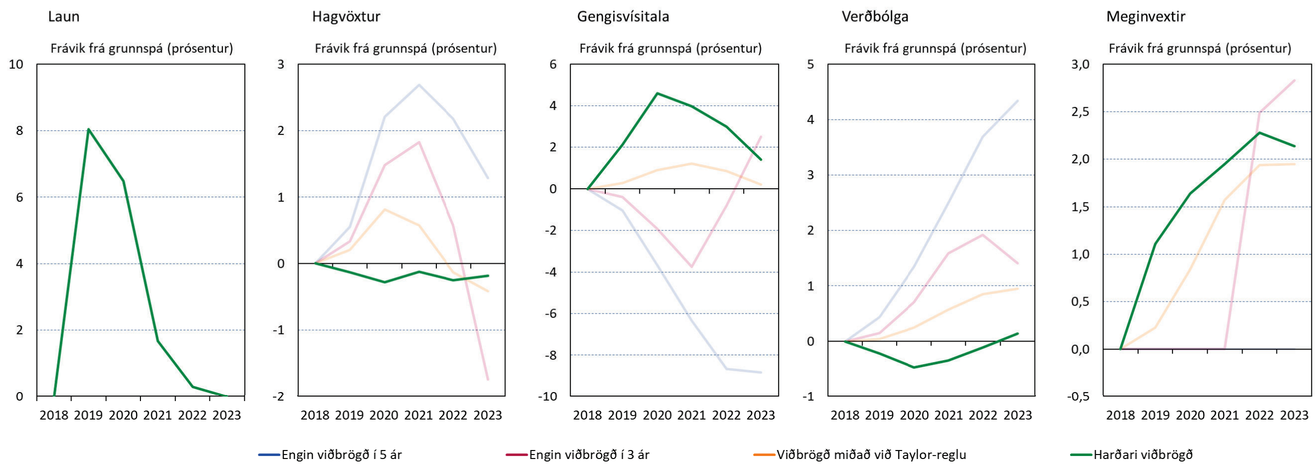
Fráviksdæmi: Áhrif launahækkana miðað við mismunandi viðbrögð peningastefnu



Heimild: Seðlabanki Íslands.

Áhrif launahækkana á þjóðarbúið ef peningastefnan bregst enn harðar við

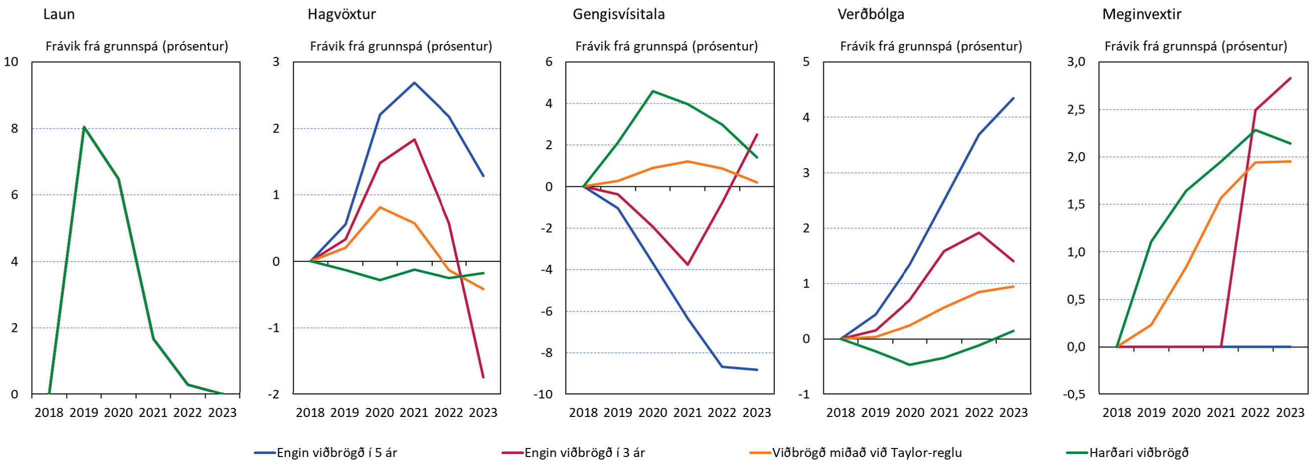
Fráviksdæmi: Áhrif launahækkana miðað við mismunandi viðbrögð peningastefnu



Heimild: Seðlabanki Íslands.

Viðbrögð peningastefnunnar við launahækkunum skipta því sköpum fyrir áhrif þeirra á þjóðarbúið

Fráviksdæmi: Áhrif launahækkana miðað við mismunandi viðbrögð peningastefnu

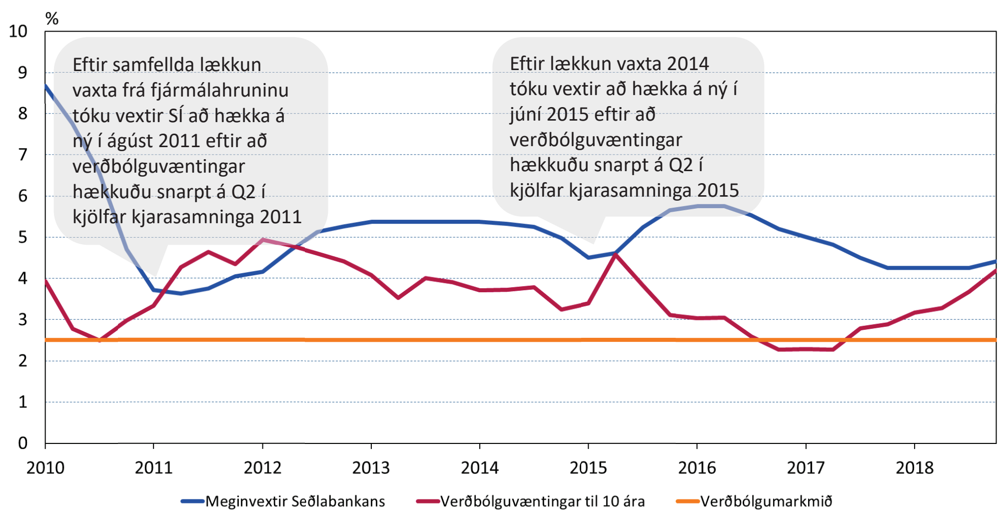


Heimild: Seðlabanki Íslands.

Viðbrögð peningastefnunnar við síðustu tveimur kjarasamningum

Meginvextir Seðlabankans og langtímaverðbólguvæntingar[1]

1. ársfj. 2010 - 4. ársfj. 2018



1. Verðbólguvæntingar metnar með verðbólguálagi á skuldabréfamarkaði.
Heimild: Seðlabanki Íslands.

Removal of capital controls on holders of offshore krónur and reduction of special reserve requirement on capital inflows

Act no. 14/2019, which amends the Foreign Exchange Act, no. 87/1992, and the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions, no. 37/2016, was published in the *Law and Ministerial Gazette (Stjórnartíðindi)* on 4 March 2019; cf. the notice on the *Law and Ministerial Gazette* website. The amendments entailed in the Act were announced in a press release posted on the Central Bank website on 7 December 2018, when the bill of legislation was introduced. The Act will enter into force tomorrow, 5 March 2019.

Amendments to Rules
Because of amendments to the Foreign Exchange Act and the Act on Special Reserve Requirements for New Foreign Currency Inflows, the Central Bank plans to set new Rules on Special Reserve Requirements for New Foreign Currency Inflows and Rules on the Treatment of Króna-Denominated Assets Subject to Special Restrictions. The Rules include new provisions and necessary amendments due to the aforementioned amending legislation. The new Rules on Special Reserve Requirements for New Foreign Currency Inflows will also lower the special reserve ratio (SRR) provided for the previous rules from 20% to 0%. It is assumed that, pending Ministerial approval, the rules will be issued tomorrow, 5 March 2019, and will take effect the day after, 6 March 2019.

Reduction of special reserve ratio from 20% to 0%
The planned reduction in the special reserve ratio marks a turning point in the application of the SRR, which was imposed on capital inflows into the bond market and high-yielding deposits in June 2016. The objective of the SRR is to temper and affect the composition of foreign capital inflows into the domestic bond market and high-yielding deposits, and to strengthen the monetary policy transmission mechanism. The SRR was lowered from 40% to 20% in early November 2018. Conditions have now developed that permit lowering the SRR to 0%, because the likelihood of substantial inflows leading to an overshooting of the exchange rate and to severe disturbances in the monetary policy transmission mechanism has subsided significantly, at least for the present. Capital flows to and from Iceland are now better balanced than they were at the time the SRR was introduced. In the recent past, there have been outflows of new foreign investments in bonds.

It should be noted that because of the above-specified amendments, funds that have been tied up in special reserve accounts will be available for withdrawal or other disposition, in the same manner as when the SRR was reduced from 40% to 20% in November. It should also be noted that if the SRR is increased in the future, the newly passed legislation states unequivocally that the special reserve amount shall remain unchanged throughout the holding period. The new arrangements for the SRR will enable the parties involved to release their funds through market transactions, however.

Legacy issues relating to the capital controls

With the above-mentioned amendments to the Foreign Exchange Act and the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions, a separate offshore market for krónur no longer exists and the vast majority of the capital controls introduced in November 2008 have been lifted. The restrictions that remain have the primary objective of ensuring that the SRR achieves its purpose, including restrictions on derivatives trading for non-hedging purposes. Those restrictions will be examined in connection with a comprehensive review of the Foreign Exchange Act. At the same time, it will be necessary to examine the permanent arrangements for the SRR.

Further information can be obtained from Már Guðmundsson, Governor of the Central Bank of Iceland, at tel: +354 569-9600.

Press release no. 6/2019
4 March, 2019

New Rules published on special reserve requirements and treatment of króna-denominated assets

Rules no. 223/2019, on Special Reserve Requirements for New Foreign Currency Inflows, and Rules no. 224/2019, on the Treatment of Króna-Denominated Assets Subject to Special Restrictions, have been published in the Law and Ministerial Gazette (Stjórnartíðindi); cf. the notice on the Law and Ministerial Gazette website (5 march 2019). The amendments entailed in the Rules were announced in a press release posted on the Central Bank website on 4 March 2019.

The Rules will take effect tomorrow, 6 March 2019.

The new Rules on Special Reserve Requirements for New Foreign Currency Inflows will also lower the special reserve ratio (SRR) provided for the previous rules from 20% to 0%, effective 6 March 2019.

Amended Rules on Foreign Exchange — Removal of restrictions on cross-border movement of capital pursuant to reduction in special reserve ratio

Rules amending the Rules on Foreign Exchange, no. 200/2017, were published on the Central Bank of Iceland's website today, with the aim to lift restrictions on specific transactions related to recent amendments to the special reserve requirement. The amending Rules were also published in the Law and Ministerial Gazette (Stjórnartíðindi) today and will take effect tomorrow, 3 April 2019. The Rules can be viewed here: In Icelandic - Reglur um breytingu á reglum nr. 200/2017 um gjaldeyrismál, með síðari breytingum.

With Rules no. 200/2017, which took effect on 14 March 2017, most restrictions on foreign exchange transactions and cross-border movement of domestic and foreign currency were lifted. Since then, households and businesses have been largely unaffected by the restrictions laid down in the Foreign Exchange Act, including restrictions on foreign exchange transactions, foreign investment, hedging, and lending; furthermore, the requirement that residents repatriate foreign currency was lifted. Restrictions on specified transactions have remained in place, however, with the aim of reducing the likelihood of carry trade in connection with investments not subject to the special reserve requirement on new inflows of foreign currency (also referred to as the capital flow management tool) pursuant to the Rules on Special Reserve Requirements for New Foreign Currency Inflows. These restrictions are as follows:

- Exportation of securities issued in domestic currency that are comparable to those subject to the special reserve requirement, if investments in them have not been subject to the special reserve base pursuant to the Rules on Special Reserve Requirements for New Foreign Currency Inflows.
- Cross-border movement of domestic currency in relation to specified measures other than those that create a special reserve base, when payment is made directly or indirectly by withdrawal from an account owned by a foreign financial institution (Vostro account). The term specified measures refers to investment options comparable to those subject to the special reserve requirement.
- Loans in domestic or foreign currency, granted by resident entities to non-residents, and repayments of loans between these parties that are allocated to investment options comparable to those that are subject to the special reserve requirement.

With the new Rules on Special Reserve Requirements for New Foreign Currency Inflows, no. 223/2019, which took effect on 6 March 2019, the special reserve ratio was lowered to 0%. Therefore, the premises now exist to lift the aforementioned restrictions, whose objective was to ensure the functionality of the special reserve requirement.

Restrictions on the following will remain in effect, however: i) Cross-border transfers of domestic currency due to transactions with offshore króna assets that are subject to special restrictions pursuant to the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions, no. 37/2016. ii) Foreign exchange transactions carried out between residents and non-residents without the intermediation of a financial institution, if domestic currency is a constituent of the transaction. iii) Derivatives transactions involving domestic currency against foreign currency and undertaken for purposes other than hedging against risk or hedging in connection with foreign issuance of króna-denominated bonds (glacier bonds).

Amended Rules on securities eligible as collateral for Central Bank facilities

The Central Bank has issued rules amending the Rules on Central Bank of Iceland Facilities for Financial Undertakings, no. 553/2009, with the aim, among other things, of expanding the range of assets that financial institutions may provide as collateral for Central Bank facilities. In the main, this entails amending Article 11 of Rules no. 553/2009, on financial collateral arrangements in connection with Central Bank facilities, to include covered bonds as eligible collateral.

Covered bonds will therefore be eligible as collateral for Central Bank facilities upon satisfaction of specified conditions. Covered bonds are asset-backed securities that in this instance are secured by individuals' króna-denominated mortgages. Issuance of covered bonds in Iceland is subject to Act no. 11/2008 and Rules set by the Financial Supervisory Authority. The Act contains provisions on monitoring of covered bonds and on maintenance of the value of underlying assets.

The Central Bank requires that the bonds be subject to market making and that at least 5 b.kr. market value have been sold from outstanding bond series. It should be noted that Nordic central banks and others accept covered bonds as collateral for facilities.

The Central Bank of Iceland has not granted loans to its counterparties in regular market transactions in recent years. Nevertheless, the Bank considers it necessary to make known what types of collateral it deems eligible if such lending should resume. In the past decade, securities eligible as collateral for Central Bank facilities have primarily included term deposits and securities issued or guaranteed by the Treasury. Treasury issuance has contracted in recent years, and large series such as Housing Financing Fund bonds are held mainly by investment funds. The three large commercial banks have issued covered bonds in the past several years, and the outstanding stock in the market is currently valued at about 400 b.kr.

According to another amendment to the Rules, equity contribution pledges and contributed capital are no longer eligible as collateral for Central Bank facilities.

No. 11/2019
27 May 2019

SEÐLABANKI ÍSLANDS

Post-Crisis Recovery, Resilience Building and Policy Reforms in Iceland

Government Borrowers Forum 2019

Már Guðmundsson, Governor

Harpa, 5 June 2019

The autumn of 2008

- Iceland's three internationally active banks failed in the first week of October 2008 (almost 10 times GDP and 90% of the banking sector)
- Combined, this was the 3rd biggest corporate failure in the history of mankind
- At that point, Iceland was already in a currency crisis and on its way into recession after an unsustainable boom during 2005-2007
- Icelandic private sector was heavily indebted and there were big currency mismatches in domestic balance sheets
- Net international investment position was -130% of GDP
- Many expected a very deep recession and even that the sovereign might default on its obligations

Two separate but interrelated stories

- Iceland’s boom-bust cycle and problems with macroeconomic management in small, open, and financially integrated economies.
- The rise and fall of three cross-border banks operating on the basis of EU legislation (the European “passport”).

The immediate policy response

- Failing banks placed in resolution regimes and domestic banks carved out (1.7 times GDP)
- Focus on keeping payment intermediation working – deposit preference introduced
- IMF programme (USD 5.1 with bilateral loans) and three key goals: exchange rate stability, fiscal sustainability, and financial sector reconstruction
- Comphrehensive capital controls were a key element in the programme:
  - Stabilise the exchange rate
  - Space to clean up balance sheets
  - Space for domestic economic policies

Where are we now?

Where are we now?

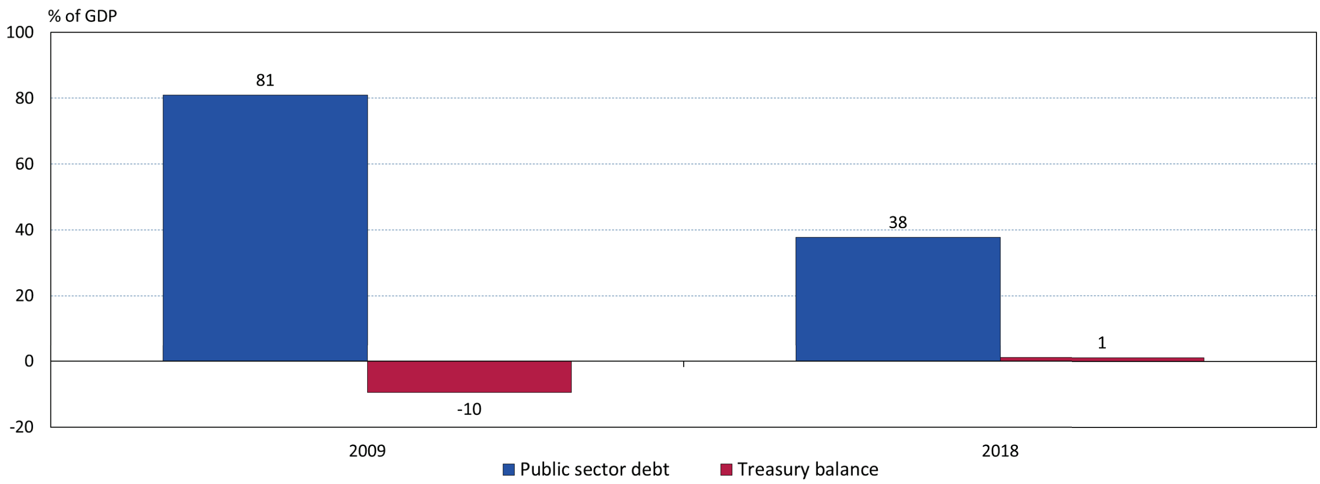
- National income per capita 12% higher in 2018 than in 2007; we rank higher relative to other countries than before the crisis
- Above full employment for the past three years
- Inflation close to target for about five years
- Fiscal position strong
- Private sector debt has fallen steeply and is low in historical context

Where are we now? 2

- External assets exceed external liabilities by 21% of GDP
- Strong, domestic-oriented banking system
- The capital controls have been lifted without derailing economic and financial stability, without tapping the Central Bank's FX reserves excessively, and without discernible legal repercussions from the measures taken to lift the controls
- Overall we have built strong resilience and can face temporary setbacks

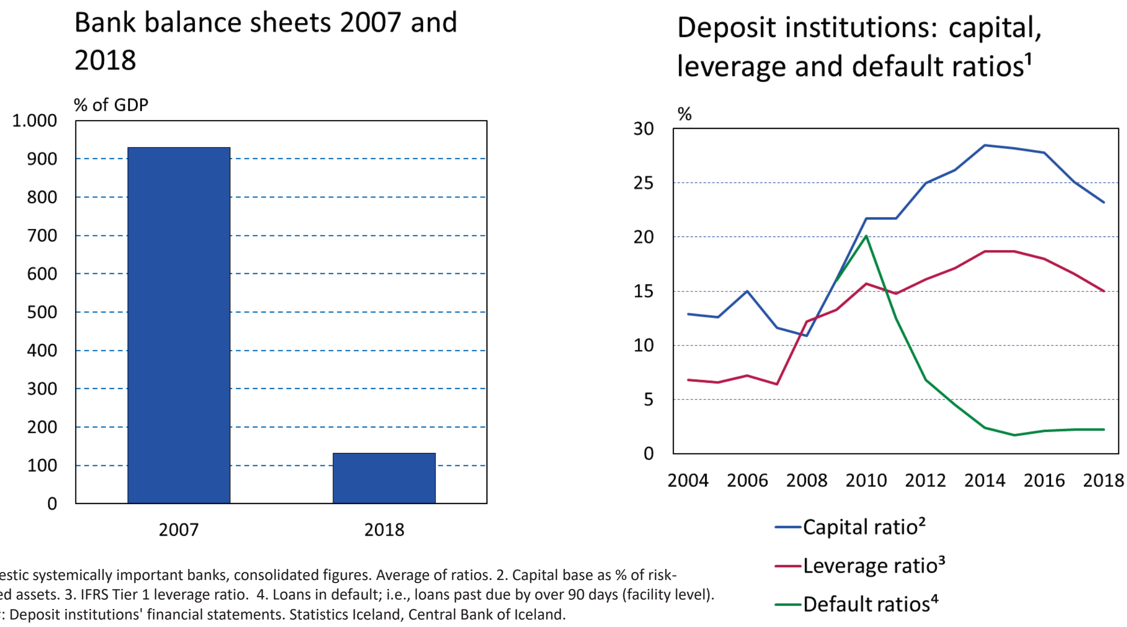
Big improvement public sector finances

Treasury balance and public sector debt position 2009 and 2018



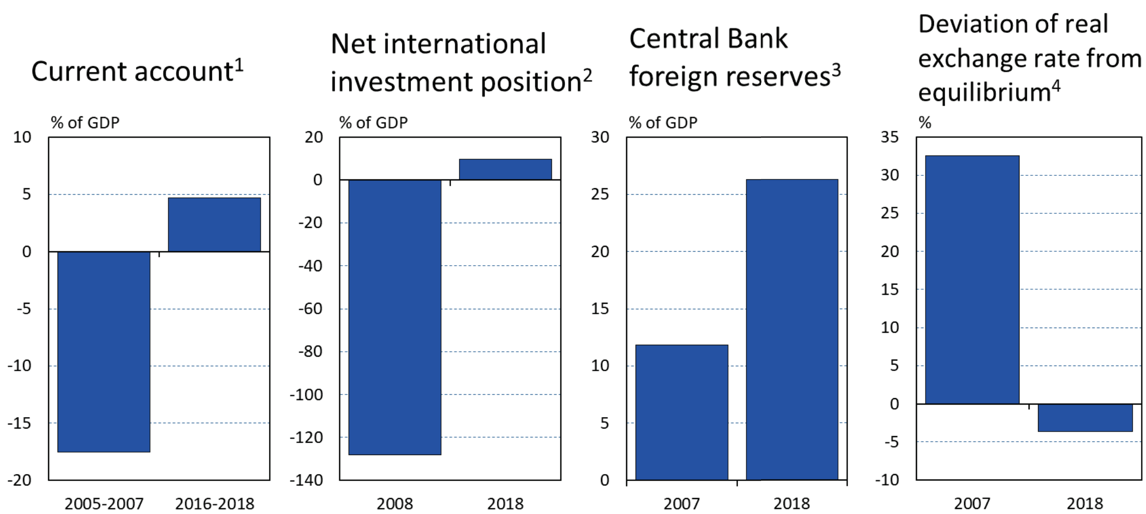
Sources: Ministry of Finance and Economic Affairs, Statistics Iceland, Central Bank of Iceland.

Banking system now focuses mainly on domestic households and businesses and is much more resilient than before



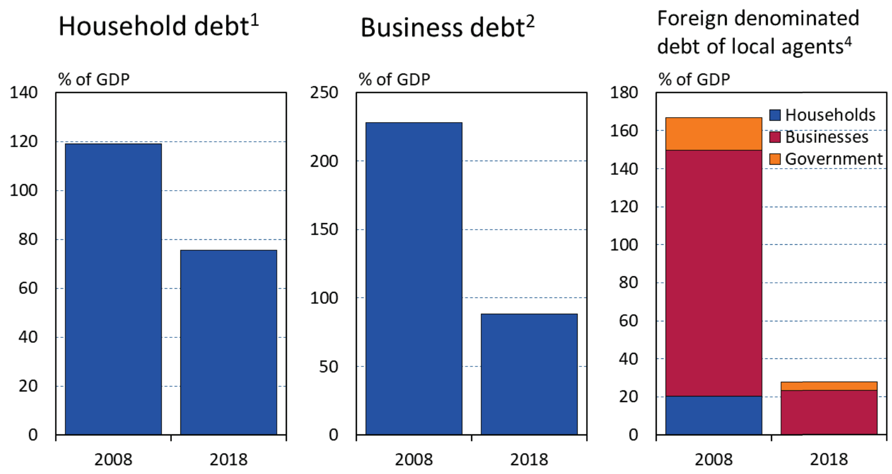
1. Domestic systemically important banks, consolidated figures. Average of ratios. 2. Capital base as % of risk-weighted assets. 3. IFRS Tier 1 leverage ratio. 4. Loans in default; i.e., loans past due by over 90 days (facility level).
Sources: Deposit institutions' financial statements. Statistics Iceland, Central Bank of Iceland.

A major change in the external position



1. Current account as % of GDP. 2. Net foreign position as % of GDP. 3. Foreign reserves as % of GDP. 4. Deviation of the real exchange rate from the estimated equilibrium real exchange rate.
Sources: Statistics Iceland, Central Bank of Iceland.

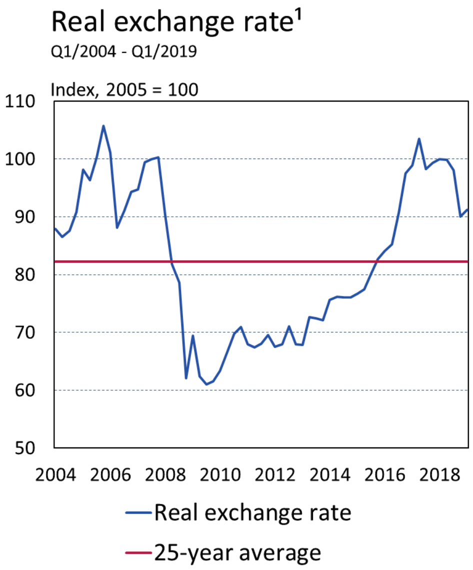
Sharp drop in private sector debt and foreign currency-denominated debt

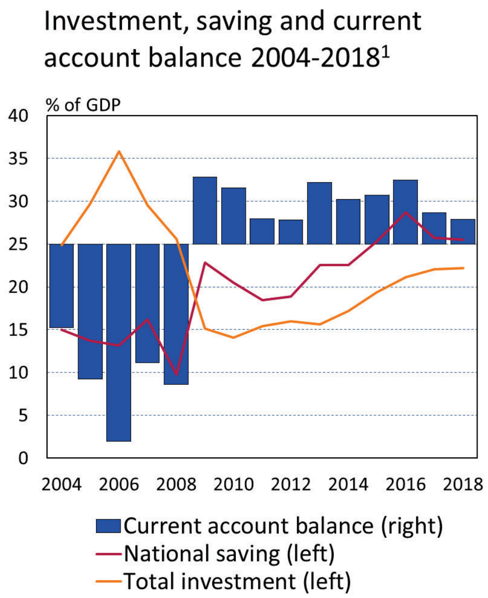


1. Total debt of households as % of GDP. 2. Total debt of businesses (debt and issued bonds) as % of GDP. Businesses excluding financial services firms (including holding companies). 3. Gross public debt as % of GDP. 4. Foreign denominated debt or debt linked to foreign currencies as % of GDP. Businesses excluding financial services firms (including holding companies). Figures for 2008 are September figures for households and businesses but August figures for the government.
Sources: Statistics Iceland, Central Bank of Iceland.

How did we get here?

Real depreciation and upward shift in savings propensity created a dramatic turnaround in the current account

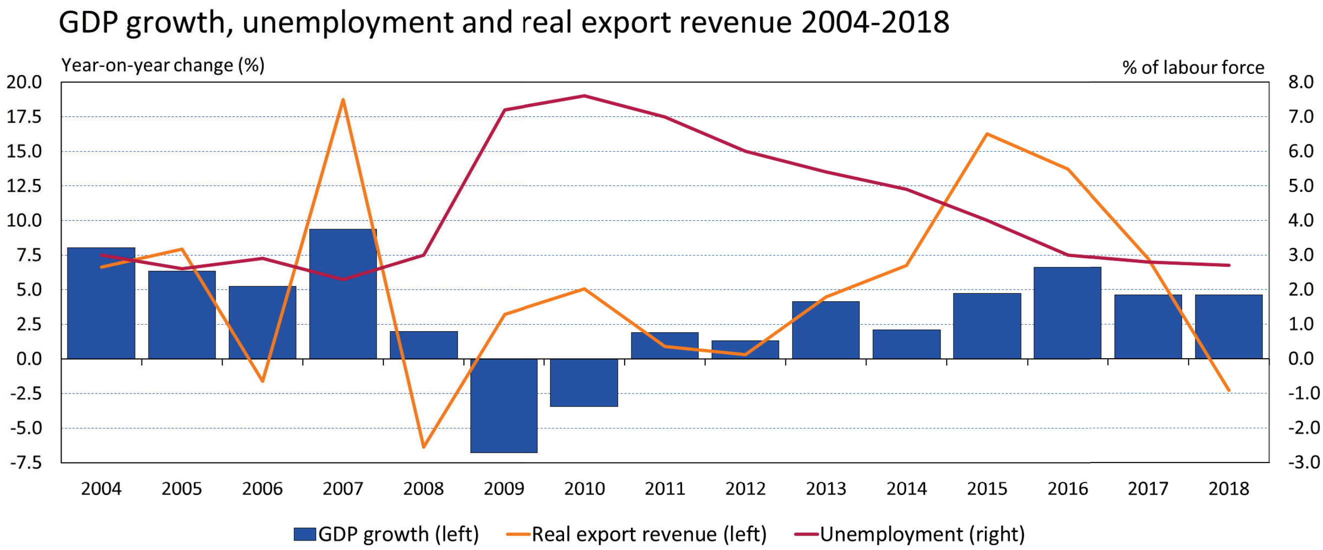




1. Current account balance and national saving based on estimated underlying current account balance in 2008-2015.

Sources: Statistics Iceland, Central Bank of Iceland.

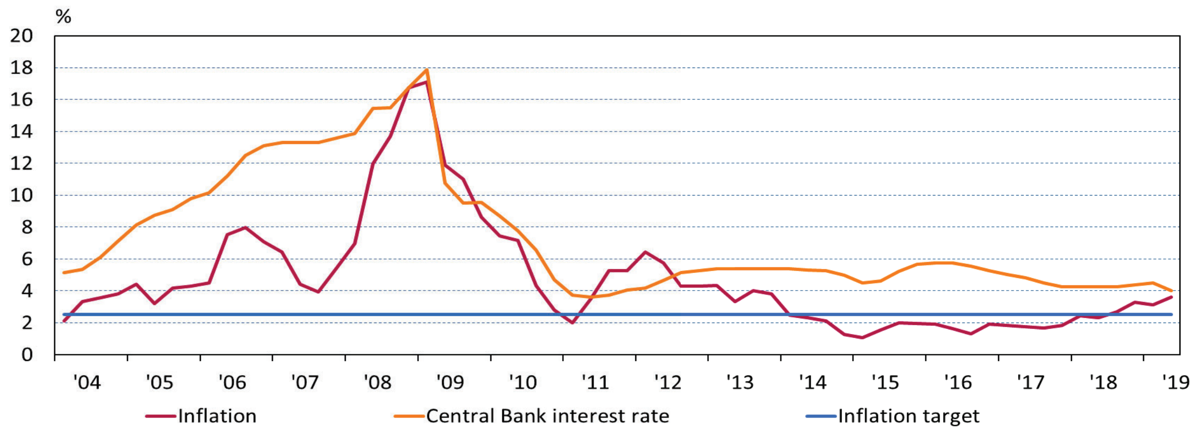
Deep post-crisis contraction but full recovery with strong growth in export sectors



Sources: Statistics Iceland, Central Bank of Iceland.

Inflation peaked in 2009 but declined steadily after the exchange rate stabilised. Monetary policy succeeded in keeping inflation close to target in recent years.

Inflation and policy rate Q1/2004-Q1/2019 and latest



Sources: Statistics Iceland, Central Bank of Iceland.

What explains the success?

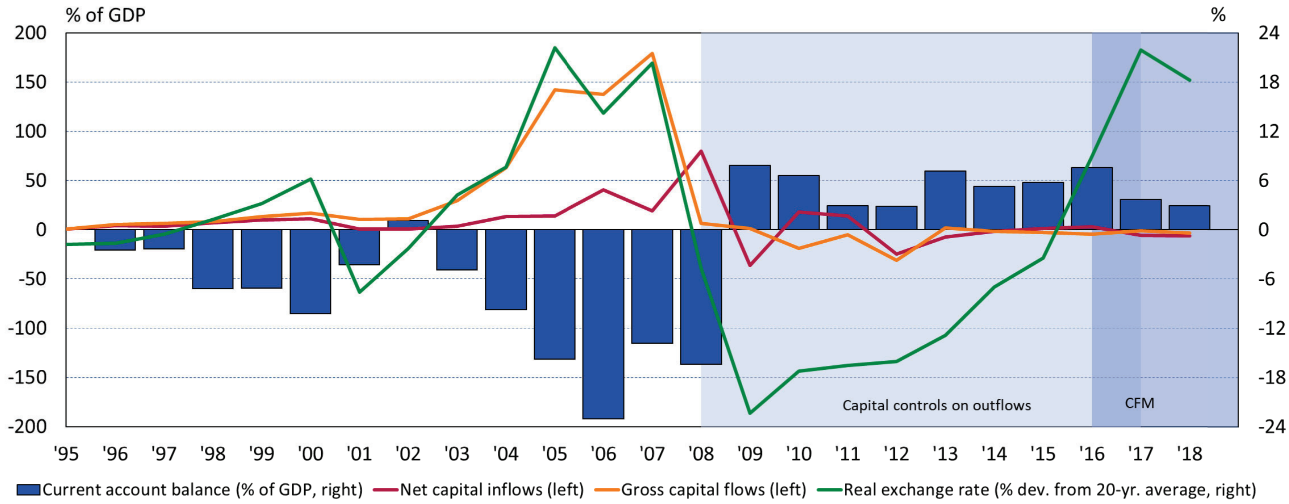
What explains the success?

- The nature of the shocks:
  - Bank losses shared across borders
  - Downsizing of unsustainable sectors and unwinding of imbalances
- The policy response:
  - Dealing with failed banks
  - Programme with the IMF
  - Solution to the balance of payments crisis and lifting capital controls
  - Policy reforms and good MP and FP compared to the past
- Real economic integration with trading partners – cross-border labour mobility
- Luck:
  - Growth of tourism
  - Big improvements in the terms of trade 2015-2017

Preserving stability in small, open and financially integrated economies (SOFIES)

The capital flow problem in Iceland

Capital flows, current account balance, and real exchange rate 1995-2018[1]



1. Capital flows excluding change in reserves. Gross capital flows is the average of gross capital inflows and outflows. Current account excluding the effect of failed financial institutions 2008-2015 and the pharmaceuticals company Actavis 2009-2012 on primary income. Also adjusted for the failed financial institutions' financial intermediation services indirectly measured (FISIM). Real exchange rate relative consumer prices (20-year average, 1998-2017).
Sources: Statistics Iceland, Central Bank of Iceland.

Policy reforms in Iceland related to the SOFIE problem

- More active use of FX interventions – managed float instead of free float
- Tighter regulation of FX-risk:
  - LCR and NSFR in FX for banks
  - CB given powers to restrict FX lending to unhedged borrowers
- Macropru framework (FSC) and development and activation of “orthodox” macropru tools (e.g. countercyclical capital buffers and LTV)
- Capital flow management (CFM): special non-renumerated reserve requirement on capital inflows into the bond market and high yielding deposits. Originally (June 2016) 40% for a year – has now been taken to zero.

Some of the key lessons learned

Some lessons

- It is not save to let the whole banking system go under but banks can be to big to save. Preserve access to deposits and save the payment system
- Capital controls can be helpful under certain conditions
- The exchange rate can both be a shock amplifier and a shock absorber. There are policies that can help in this regard
- It is becoming more difficult to preserve monetary and financial stability in SOFIES
- It requires sound regulation and supervision of FX risk and more policy tools: FX intervention, macropru and sometime CFM

SEÐLABANKI ÍSLANDS

Tíu árum seinna: hvar stöndum við?

Rótarýklúbbur Reykjavíkur 26. júní 2019

Már Guðmundsson
Seðlabankastjóri

Staðan fyrir 10 árum

- Í miðjum mesta efnahagssamdrætti frá fyrri heimstyrjöldinni
- Landsframleiðsla dróst saman um 13% og náði botni á fyrsta ársfjórðungi 2010
- Atvinnuleysi var á uppleið og náði hámarki yfir 8% á fjórða ársfjórðungi 2010
- Verðbólga var 19% í janúar 2009 – 12% um mitt ár
- Stýrivextir 18% í janúar 2009 – 12% um mitt ár
- 10% halli á ríki og sveitarfélögum 2009
- Erlendar skuldir umfram eignir þjóðarbúsins 130%

Staðan fyrir 10 árum - 2

- Gjaldeyrisforðinn var allur fenginn að láni erlendis
- Við vorum að forminu til með altæk fjármagnshöft en þau voru ekki að virka eins og stefnt var að
- Aflandskrónur 40% og vandinn í búunum óþekktur
- Öll þrjú meginmarkmið áætlunar með AGS voru í óvissu eða uppnámi (gengisstöðugleiki, sjálfbær ríkisfjármál og endurreisn fjármálakerfisins

Hvar erum við nú?

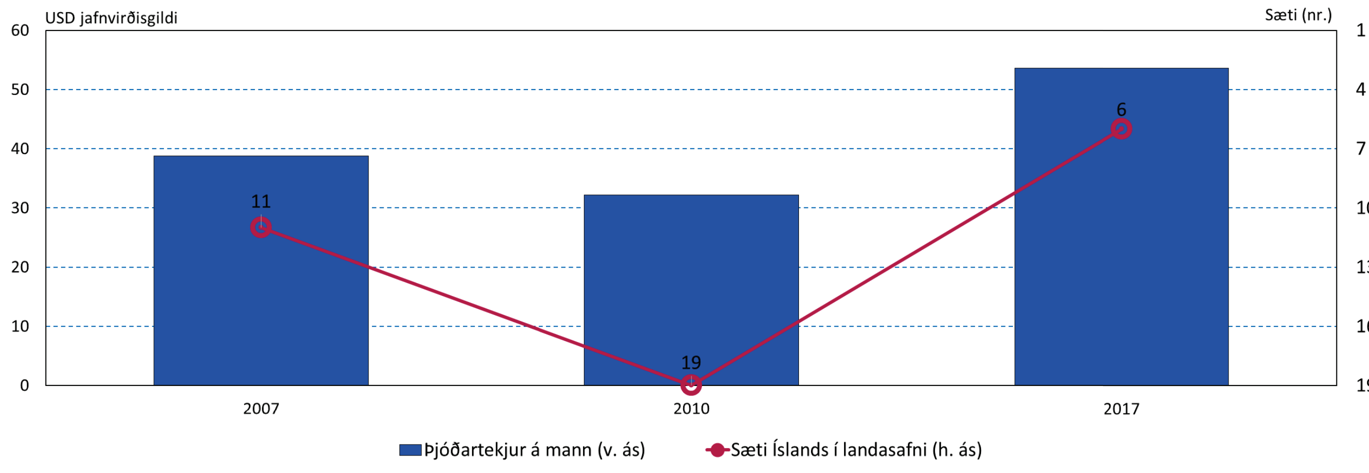
- Þjóðartekjur á mann 2018 12% hærri en árið 2007 og við stöndum framar meðal þjóða en fyrir kreppu
- Kaupmáttur launa 24% hærri
- Full atvinna og gott betur þrjú sl. ár
- Verðbólga var nálægt markmiði í um fimm ár – nú 3,3%
- Hið opinbera stendur sterkt
- Skuldir einkageirans hafa stórminnkað og eru litlar í sögulegu samhengi
- Vextir lágir í sögulegu samhengi: meginvextir Seðlabankans 3,75% og vextir 10 ára óverðtryggðra ríkisskuldabréfa undir 4%

Hvar erum við nú? 2

- Gjaldeyrisforði sem nemur um fjórðungi af landsframleiðslu er nær allur fjármagnaður innanlands
- Þjóðin á eignir umfram skuldir erlendis sem nema 21% af landsframleiðslu
- Sterkt heimamiðað bankakerfi
- Fjármagnshöftin hafa verið losuð án efnahagslegs og fjármálalegs stöðugleika, án þess að nýta um of gjaldeyrisforða Seðlabankans og án teljandi lagalegra eftirmála vegna þeirra aðgerða sem gripið var til í því skyni að losa höftin

Ísland stendur nú enn framar á meðal þjóða þegar kemur að þjóðartekjum á mann en það gerði fyrir fjármálakreppu

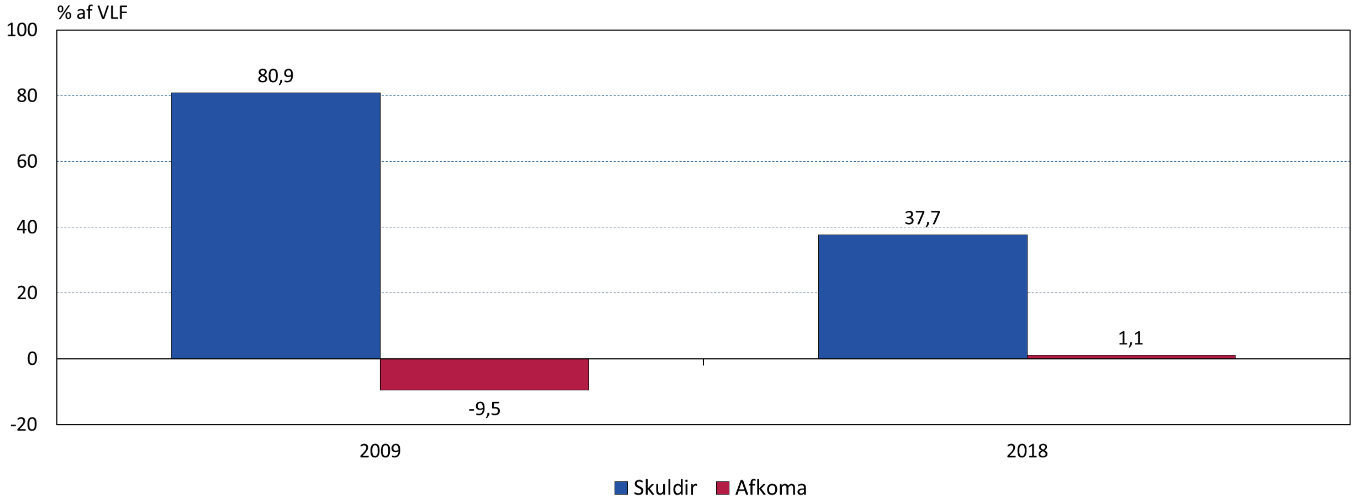
Þjóðartekjur á mann 2007, 2010 og 2017



Heimildir: Thomson Reuters, Hagstofa Íslands, Seðlabanki Íslands.

Staða hins opinbera var þröng í kjölfar fjármálakreppunnar en hefur stórbatnað

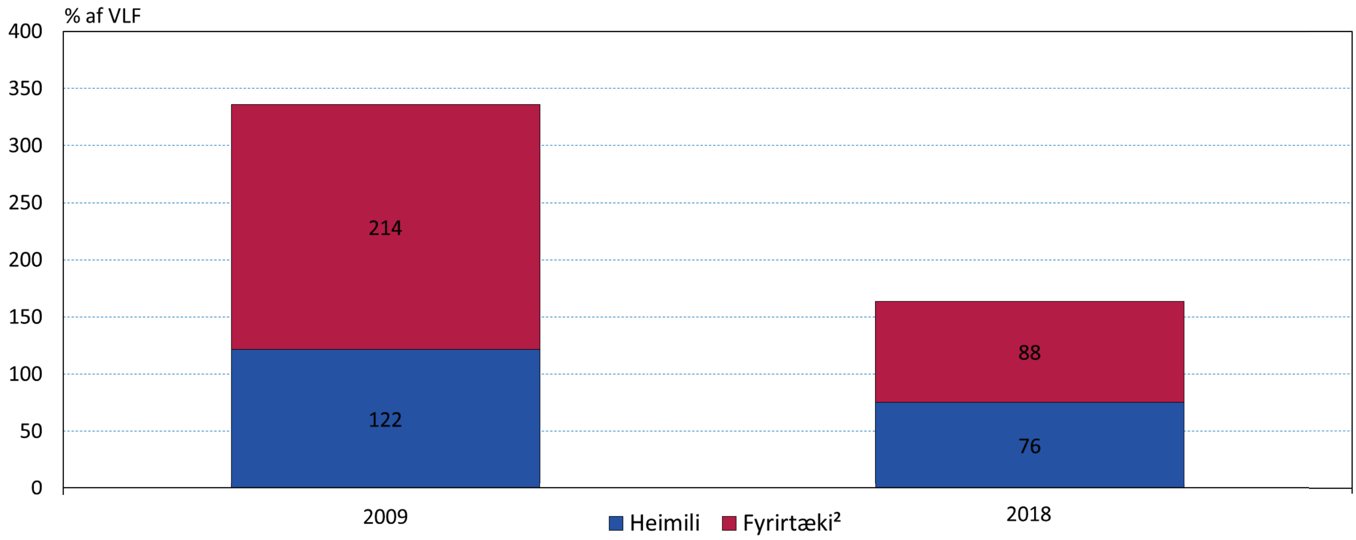
Afkoma og skuldir hins opinbera 2009 og 2018



Heimildir: Fjármála- og efnahagsráðuneytið, Hagstofa Íslands, Lánamál ríkisins, Seðlabanki Íslands.

Skuldir einkageirans eru litlar í sögulegu samhengi

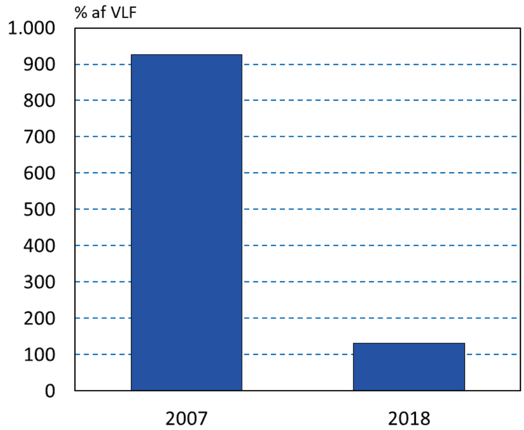
Skuldir heimila, fyrirtækja og hins opinbera 2009 og 2018[1]



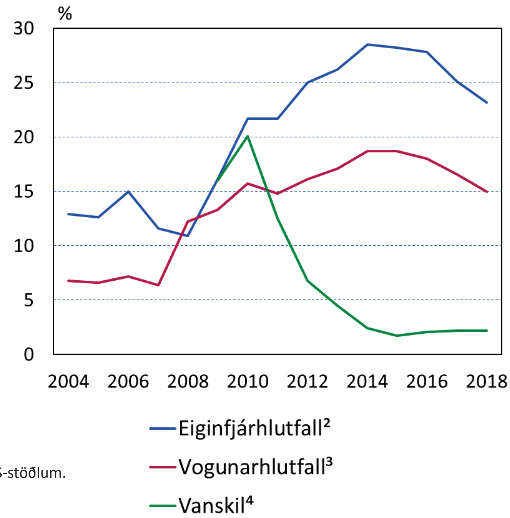
1. Skuldir við fjármálafyrirtæki og útgefin markaðsskuldabréf. 2. Án fjármálafyrirtækja (þar með talið eignarhaldsfélaga).
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Bankakerfið þjónustar nú fyrst og fremst innlend heimili og fyrirtæki og er viðnámsþróttur þess mun meiri nú en áður var

Eignir innlánsstofnana 2007 og 2018



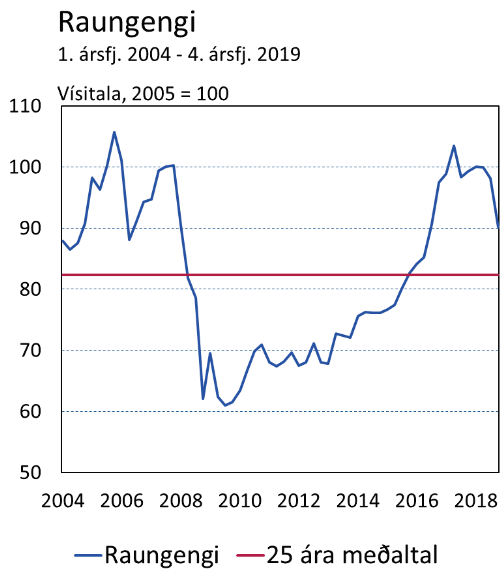
Innlánsstofnanir: eiginfjár- og vogunarhlutföll og vanskil[1]

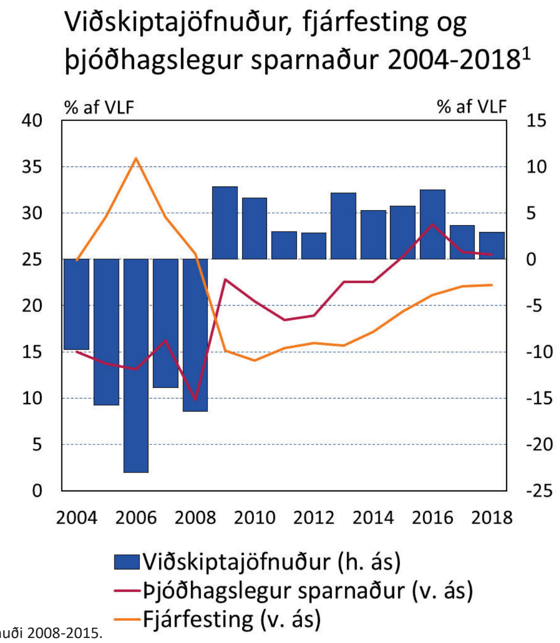


1. Samstæður kerfislega mikilvægra banka. 2. Eiginfjárgrunnur sem hlutfall af áhættugrunni. 3. Skv. IFRS-stöðlum.
4. Útlán sem ekki hefur verið greitt af í 90 daga eða lengur (lánaaðferð).
Heimildir: Ársreikningar innlánsstofnana, Hagstofa Íslands og Seðlabanki Íslands.

Hvernig komumst við þetta?

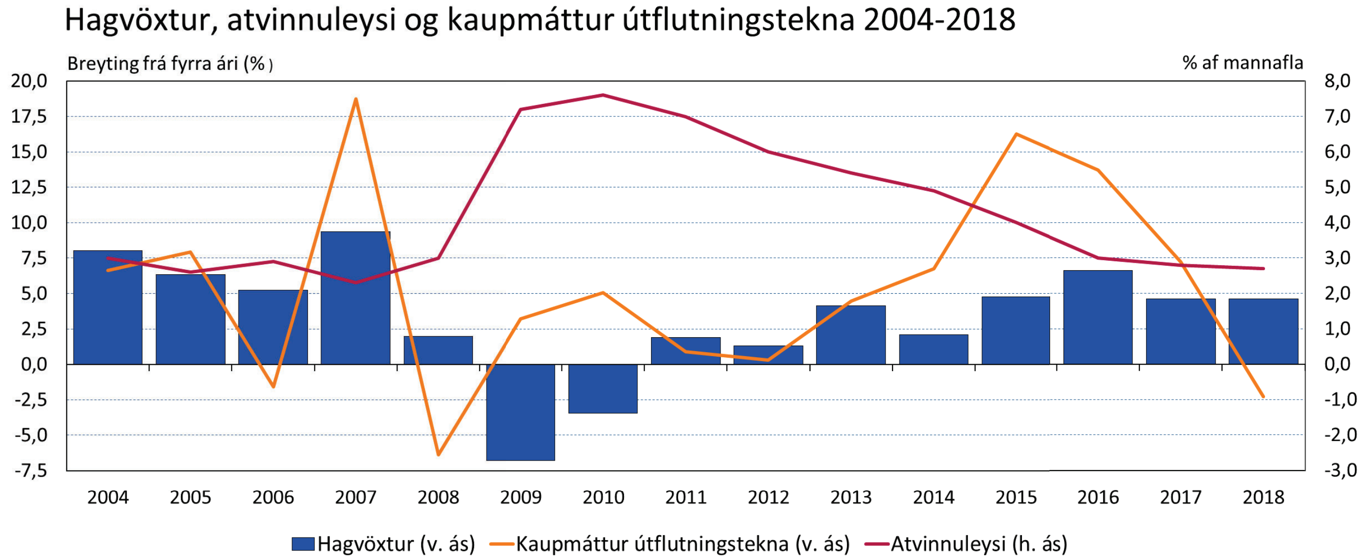
Lækkun raungengis og aukinn þjóðhagslegur sparnaður leiddu til viðsnúnings á viðskiptajöfnuði





1. Tölur um viðskiptajöfnuð og þjóðhagslegan sparnað byggjast á mati á undirliggjandi viðskiptajöfnuði 2008-2015.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands

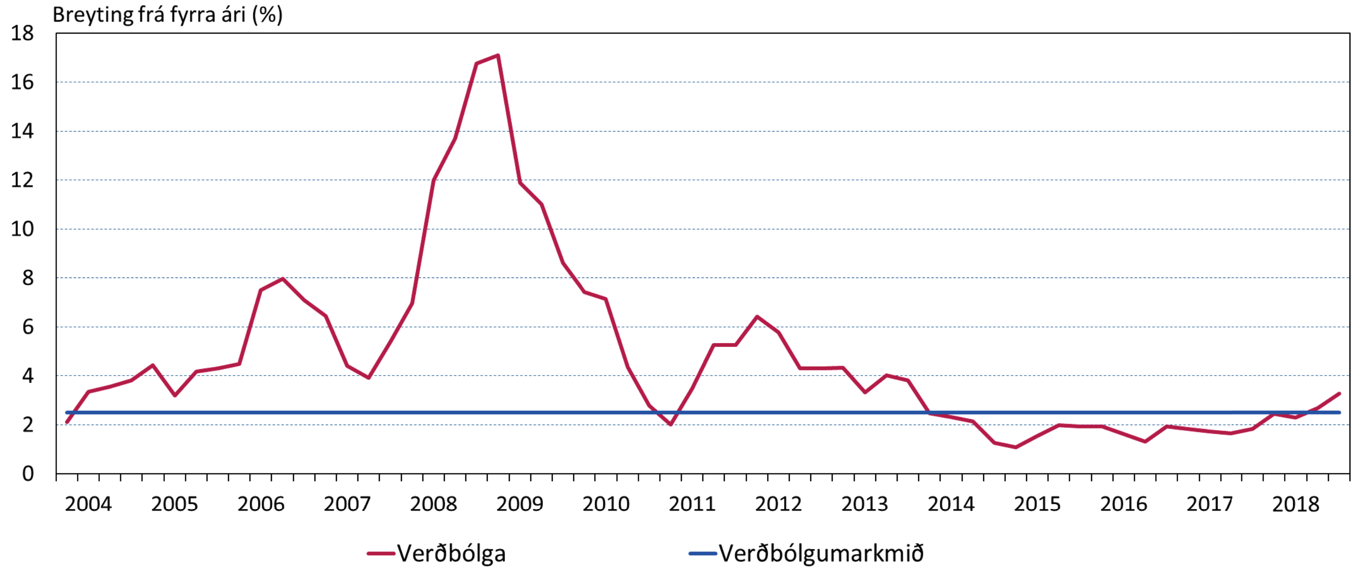
Djúp efnahagslægð í kjölfar fjármálakreppu en fullur bati með vexti útflutningsgreina



Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Verðbólga náði hámarki 2009 í kjölfar gengisfalls en minnkaði samfellt þar til hún fór í markmið undir lok árs 2010

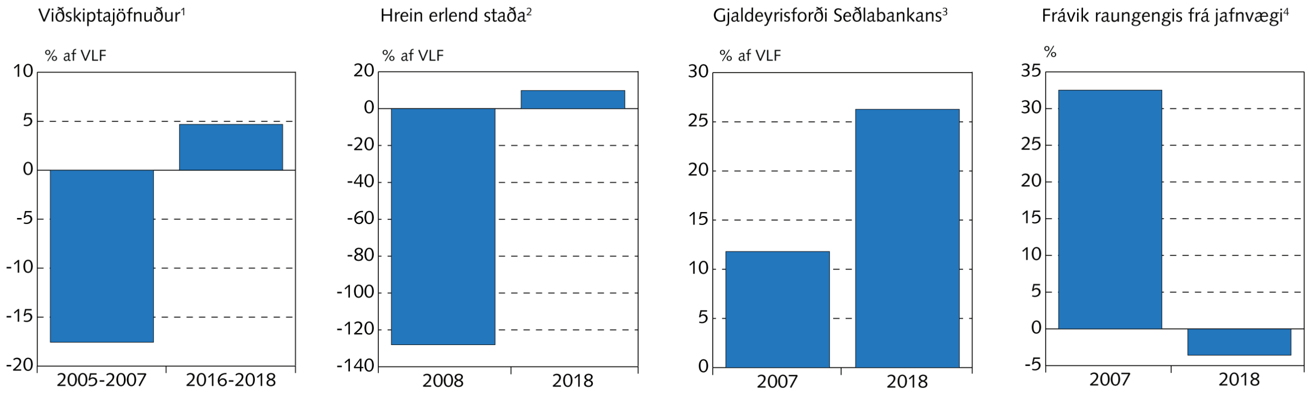
Verðbólga 1. ársfj. 2004 - 4. ársfj. 2018



Heimild: Hagstofa Íslands.

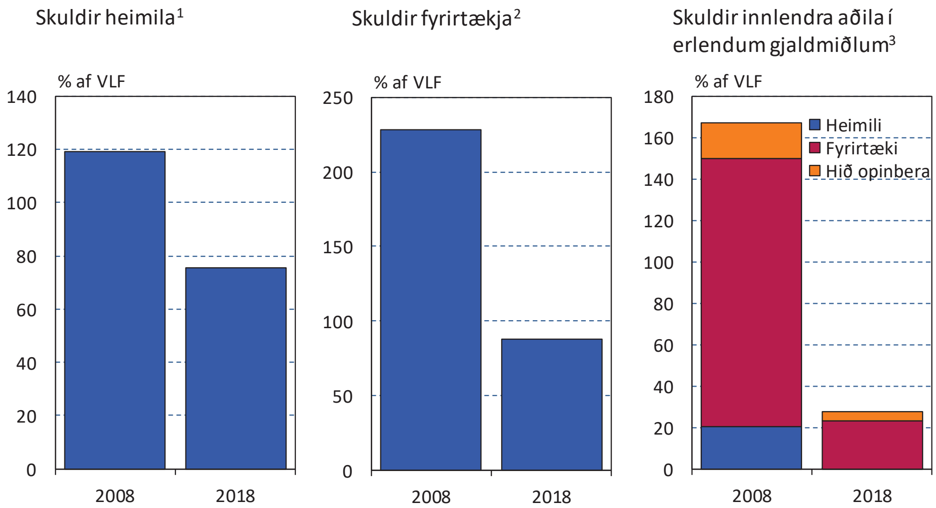
Mikill viðnámsþróttur til að takast á við erfiðari tíma

Algjör umsnúningur í ytri stöðu þjóðarbúsins



1. Viðskiptajöfnuður sem % af VLF. 2. Hrein erlend staða þjóðarbúsins sem % af VLF. 3. Gjaldeyrisforði sem % af VLF. 4. Frávik raungengis frá metnu jafnvægisraungengi.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Mikil lækkun skulda einkageirans og skulda í erlendri mynt



1. Heildarskuldir heimila sem % af VLF. 2. Heildarskuldir fyrirtækja (skuldir og útgefin markaðsskuldabréf) sem % af VLF. Fyrirtæki án fjármálafyrirtækja (þ.m.t. eignarhaldsfélaga). 3. Skuldir í erlendum gjaldmiðlum eða tengdar erlendum gjaldmiðlum sem % af VLF. Atvinnufyrirtæki án fjármálafyrirtækja (þ.m.t. eignarhaldsfélaga). Tölur fyrir 2008 eru fyrir september hjá heimilum og fyrirtækjum en fyrir ágúst hjá hinu opinbera.
Heimildir: Hagstofa Íslands, Seðlabanki Íslands.

Svigrúm hagstjórnar

- Peningastefna: verðbólguvæntingar nálægt markmiði og gengi nálægt jafnvægisgengi => ekki þarf að nota vexti til að hamla gengislækkun og hægt að milda samdrátt
- Ríkisfjármál: afgangur og skuldalækkun undanfarinna ára skapa svigrúm
- => hagstjórn nær kennslubókinni

Hvað skýrir þennan árangur?

1. Eðli áfallanna: ofþandar greinar og misvægi í þjóðarbúskapnum – aðlögun var óhjákvæmileg – tjónið af falli bankanna dreifðist víða um lönd
2. Aðgerðir þegar bankarnir féllu – neyðarlögin
3. Efnahagsáætlunin með AGS og hagstjórn í framhaldinu
4. Hvernig til tókst með losun fjármagnshafta
5. Samþætting þjóðarbúsins við viðskiptalönd (t.d. hreyfanlegt vinnuafl) – EES
6. Heppni

SEÐLABANKI ÍSLANDS

Tíu árum seinna: hvar stöndum við?

March 27, 2001

Declaration on inflation target and a change in the exchange rate policy

(From March 27, 2001 – as amended by agreement between between the Prime Minister of Iceland and the Board of Governors of the Central Bank of Iceland on November 11, 2005, cf. Press release no. 35/2005)

On March 27, 2001 the Prime Minister and the Governors of the Central Bank of Iceland signed a declaration on changes in the framework of monetary policy in Iceland. The declaration is as follows:

The Government of Iceland and the Central Bank of Iceland have decided the following changes in the framework of monetary policy in Iceland, effective March 28, 2001:

(1) The main target of monetary policy will be price stability as defined below. The Central Bank shall also promote financial stability and the main objectives of the economic policy of the Government as long as it does not deem it inconsistent with the Bank's main objective of price stability.

(2) Rather than basing monetary policy on keeping the exchange rate within a fluctuation band, the Central Bank will aim at keeping inflation within defined limits as specified below.

(3) The change described above implies that the fluctuation limits for the króna are abolished. Nevertheless, the exchange rate will continue to be an important indicator in the conduct of monetary policy.

(4) The Government grants full authority to the Central Bank to use its instruments in order to attain the inflation target.

(5) Later this week, the Government will submit to Parliament a bill on a new Central Bank Act which, once enacted, will legally confirm the decisions described above on making price stability the main objective of monetary policy and on the independence of the Central Bank to use its instruments.

(6) The inflation target of the Central Bank will be based on 12-month changes in the consumer price index as calculated by Statistics Iceland. Statistics Iceland will also be asked to calculate one or more indices which may be used to assess the underlying rate of inflation, as will be further agreed between the Central Bank and Statistics Iceland. The Central Bank will take note of such indices in its assessment of inflation and in the implementation of monetary policy.

(7) The Central Bank will aim at an annual inflation rate of about 2½ per cent.

(8) If inflation deviates by more than 1½ percentage point from the target, the Central Bank shall bring it inside that range as quickly as possible. In such circumstances, the Bank will be obliged to submit a report to the Government explaining the reasons for the deviations from the target, how the Bank intends to react and how long it will take to reach the inflation target again in the Bank's assessment. The report of the Bank shall be made public.

(9) The Central Bank shall aim at attaining the inflation target of 2½ percent not later than by the end of 2003. In the year 2001, the upper Declaration on inflation target and a change in the exchange rate policy limit for inflation shall be 3½ percentage points above the inflation target but 2 percentage points above it in the year 2002. The lower limit for inflation will always be 1½ percentage point below the inflation target. Should inflation move outside the target range in 2001 and 2002, the Bank shall respond as set out in item 8 above.

(10) Despite the elimination of the fluctuation limits for the króna, the Central Bank will intervene in the foreign exchange market if it deems such action necessary in order to promote the inflation objective described above or if it thinks that exchange rate fluctuations might undermine financial stability.

(11) The Central Bank shall publish inflation forecasts, projecting inflation at least two years into the future. Forecasts shall be published in the Bank's Monetary Bulletin. This shall also contain the Bank's assessment of the main uncertainties pertaining to the inflation forecast. The Bank shall also publish its assessment of the current economic situation and outlook.

[Amended text by agreement between the Prime Minister of Iceland and the Board of Governors of the Central Bank of Iceland on November 11, 2005]

(12) The Central Bank shall in its publications explain how successful it is in implementing the inflation target policy. The Governors will also report to the Minister, the Government and committees of the Parliament on the policy of the Bank and its assessment of current economic trends and prospects.