

Statement of the Monetary Policy Committee

10 February 2016

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 5.75%.

Year-2015 GDP growth is estimated to have been weaker than was projected in the Bank's November forecast, or 4.1% instead of 4.6%. The outlook is for broadly similar GDP growth this year, or 4.2%. This is 1 percentage point stronger growth than was forecast in November. The difference is due to the prospect of stronger private consumption growth than was projected then, as the outlook is for larger pay increases, more rapid growth in employment, and lower inflation.

The margin of spare capacity is estimated to have disappeared last year, and the outlook is for a widening positive output gap. Pay rises well in excess of the inflation target and productivity growth exacerbate inflationary pressures, which are offset by developments in global energy and commodity prices and the exchange rate of the króna. Inflation has been lower than was forecast in November and appears set to remain so into 2017. Deflation in global goods markets could come to a halt, however, and eventually turn around in the coming term. According to international forecasts, this is expected to happen later in 2016. For this reason, among others, inflation is assumed to rise above 3% by end-2016 and reach 4% a year later. The extent and timing of these developments are uncertain, however.

Global price developments and a stronger króna have provided the scope to raise interest rates more slowly than was previously considered necessary. However, this does not change the fact that, according to the Bank's forecast, a tighter monetary stance will probably be needed in the coming term, in view of growing domestic inflationary pressures. How much and how quickly the monetary stance must be tightened will depend on future developments.