Statement of the Monetary Policy Committee 29 August 2018

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 4.25%.

According to the Bank's new macroeconomic forecast, published in the August *Monetary Bulletin*, GDP growth will measure 3.6% this year, as it did in 2017. This is slightly stronger than the Bank had forecast in May. The improved outlook stems primarily from a more favourable contribution from net trade, which outweighs weaker growth in domestic demand. GDP growth is still expected to ease, with weaker export growth and a less rapid increase in domestic demand. Developments in house prices and indicators from the labour market point in the same direction.

Inflation measured 2.3% in Q2/2018 but had increased to 2.7% by July. Inflation excluding housing has risen as well, and the difference between measures of inflation including and excluding housing has narrowed considerably. The year-on-year rise in house prices continues to ease, but the opposing effects of the previous appreciation of the króna have diminished and petrol prices have risen. This trend will probably continue in the near term. The króna has depreciated slightly since the last MPC meeting, but the foreign exchange market has remained well balanced.

Indicators imply that long-term inflation expectations have risen somewhat above the target. The MPC reiterates that it has both the will and the tools necessary to keep inflation at target over the long term. If inflation expectations continue to rise and remain persistently at a level above the target, it will call for a tighter monetary stance. Other decisions, particularly those relating to the labour market and fiscal policy, will then affect the sacrifice cost in terms of lower employment.

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.