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.