

SEÐLABANKI ÍSLANDS

Monetary Policy Challenges The labour market – the missing link?

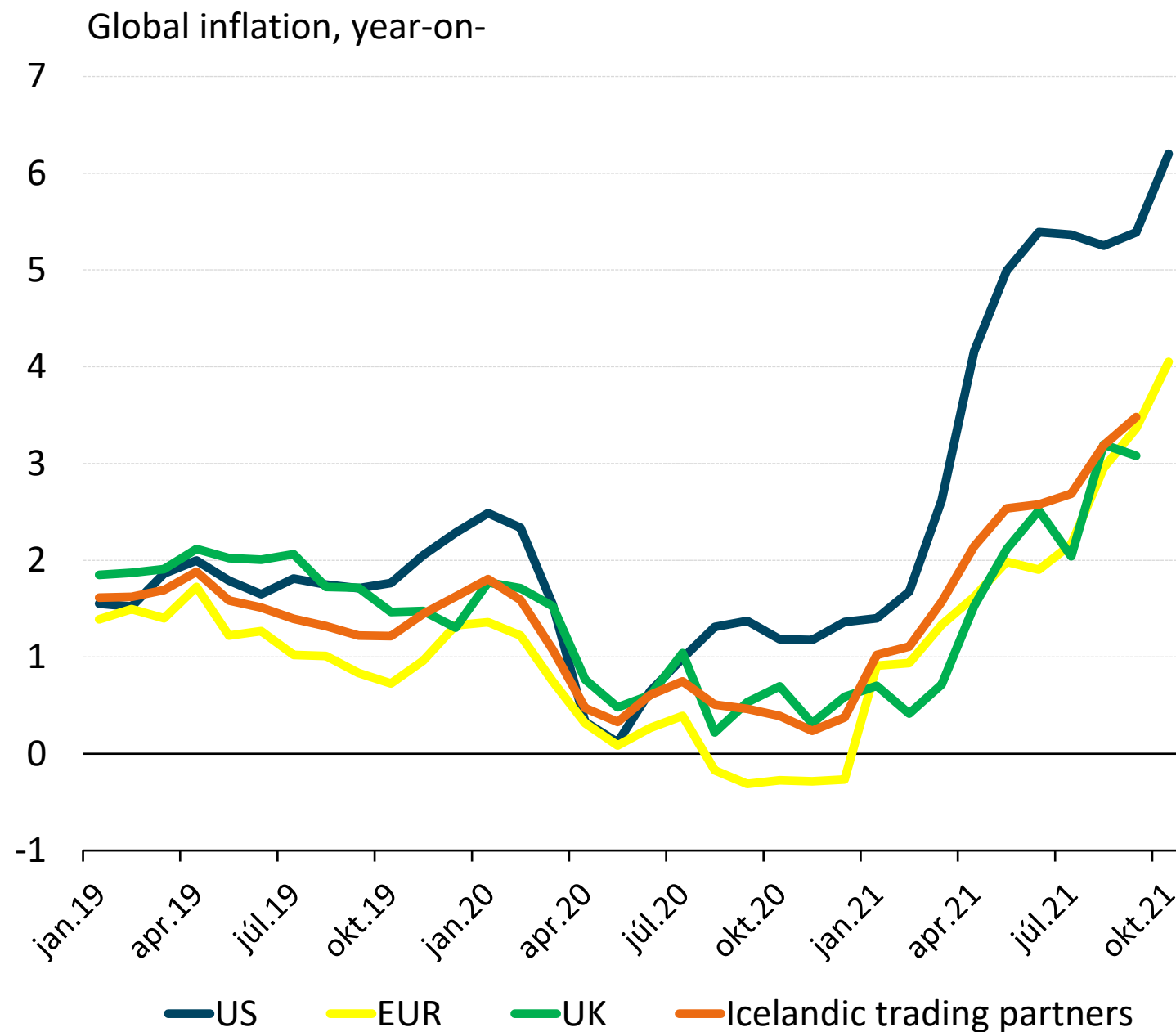
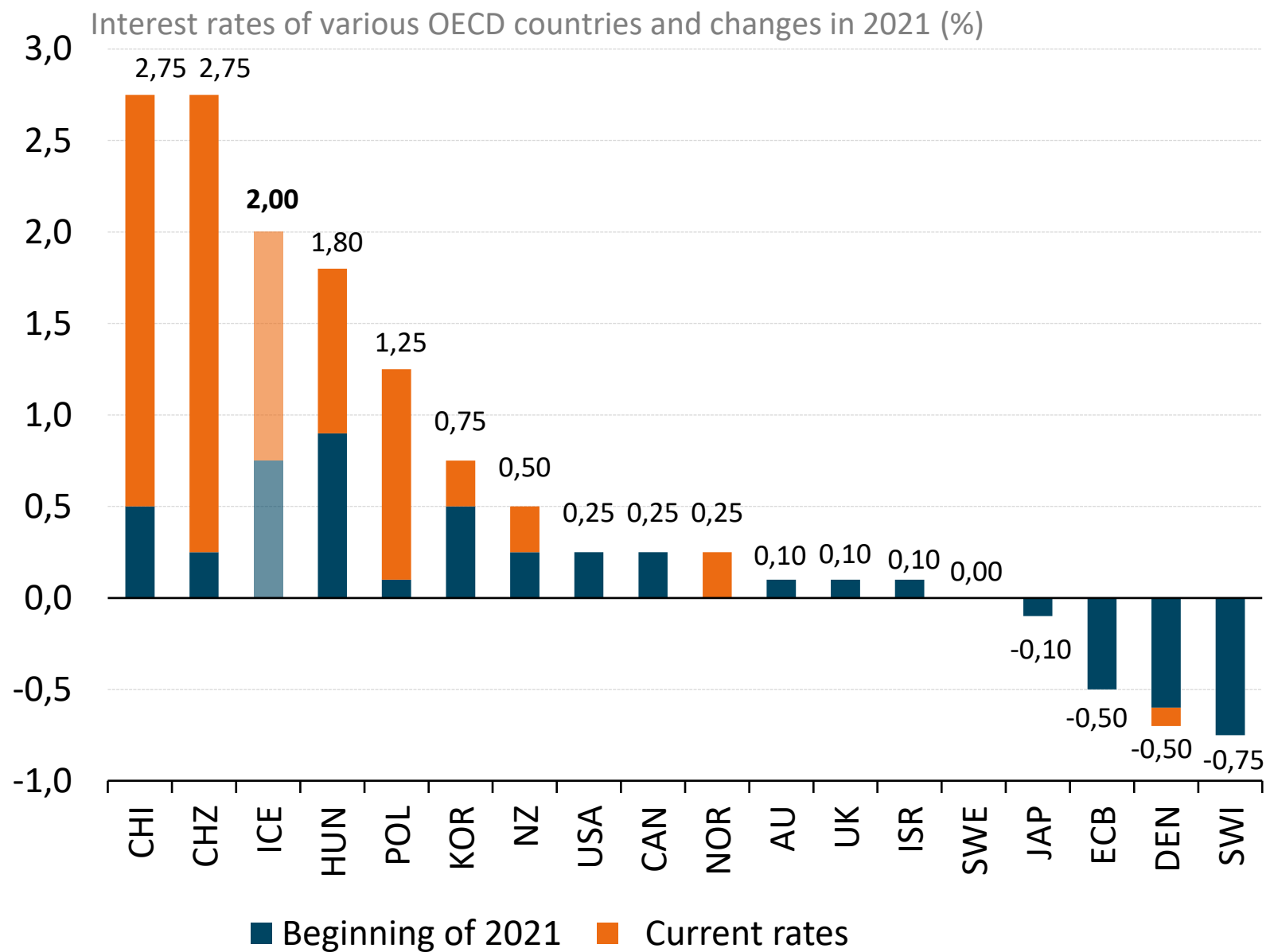
Presentation to a meeting of the Chamber of Commerce



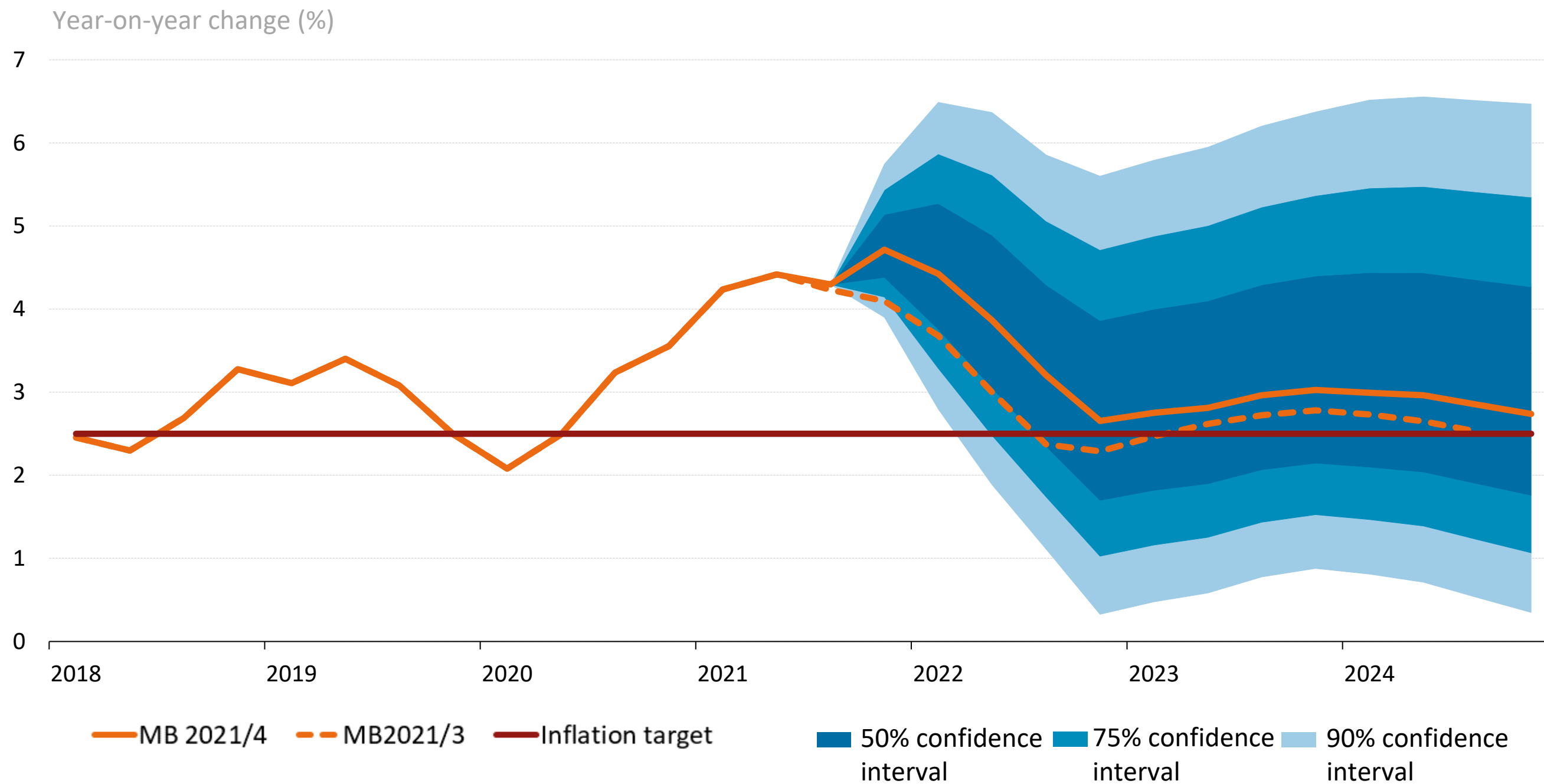
Ásgeir Jónsson
Governor

18 November 2021

Inflation is now a global problem



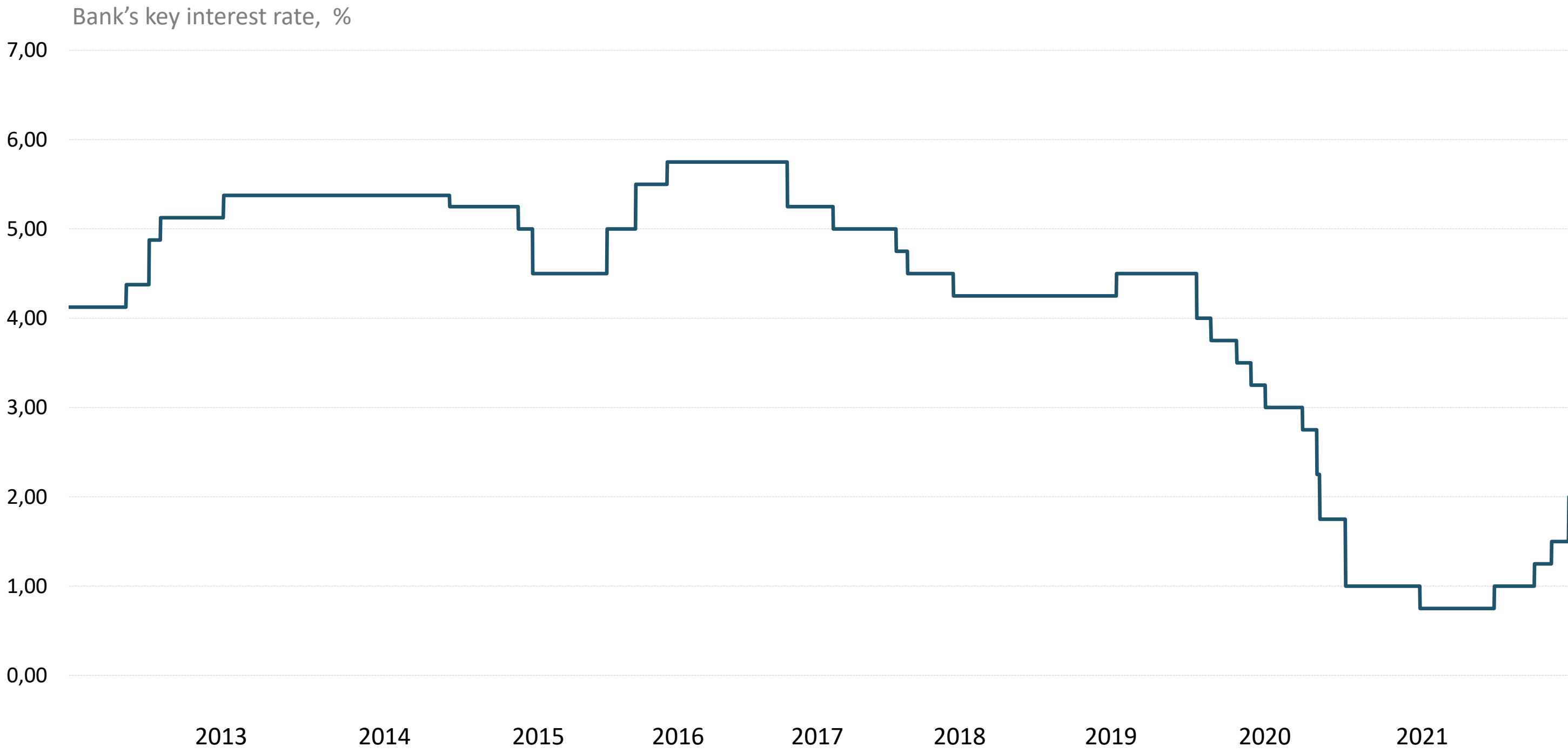
Worse inflation outlook



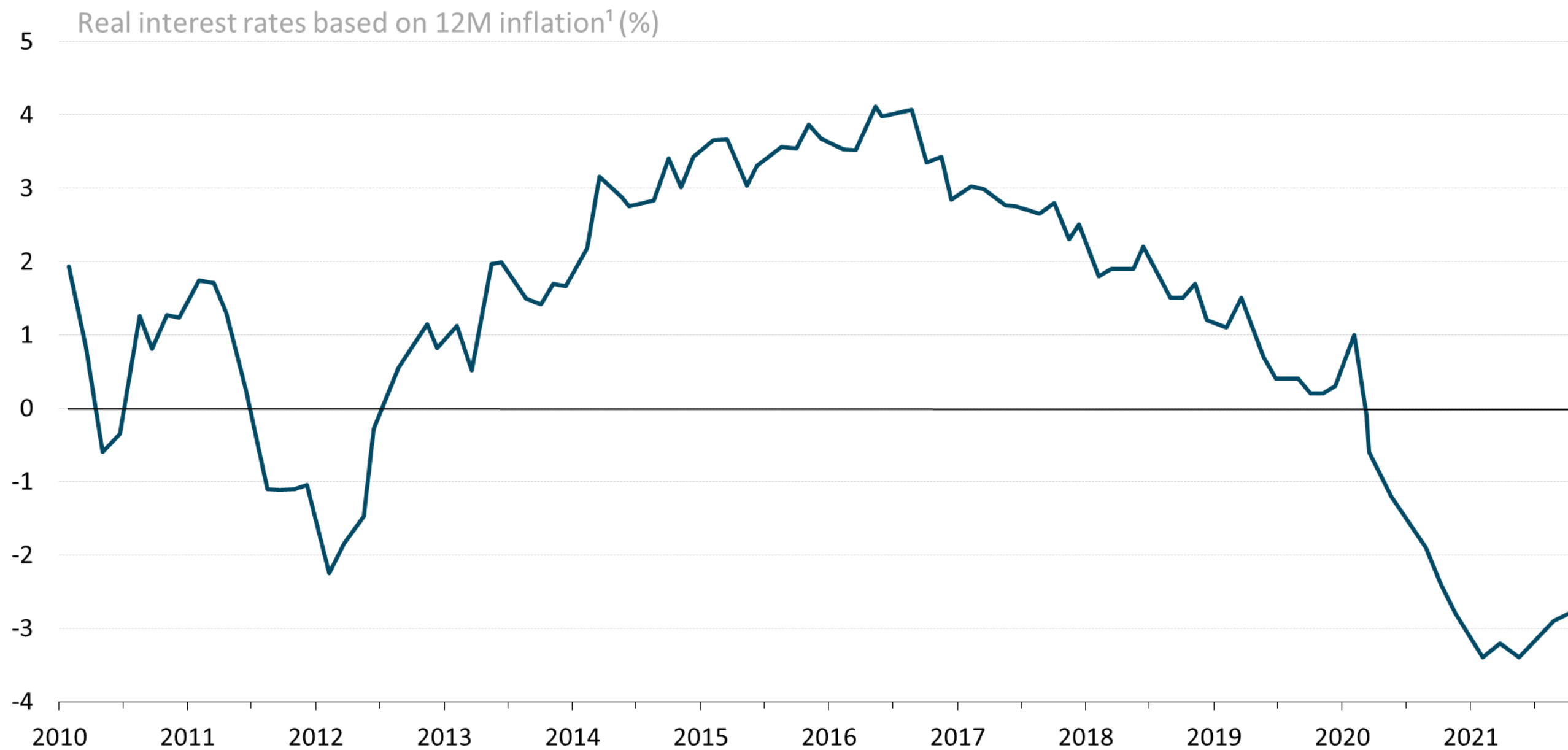
Interest rates and inflation back in the driver's seat

- Strong shift of global demand from services to goods and real estate, which has pushed commodity prices upwards and created goods shortages.
- Emphasis on shortening supply chains and moving production closer to the home market has boosted labour demand in the industrial countries.
- Central banks worldwide are tightening their monetary stance and applying macroprudential tools.
- The Central Bank of Iceland's actions are consistent with those of foreign central banks; we are merely a little ahead of them.
- We can now raise rates to counter domestic inflationary pressures without significantly widening the interest rate differential with abroad.

The Bank's key rate is now 2% – it was 4.5% when the Living Standards Wage Agreements were made in 2019



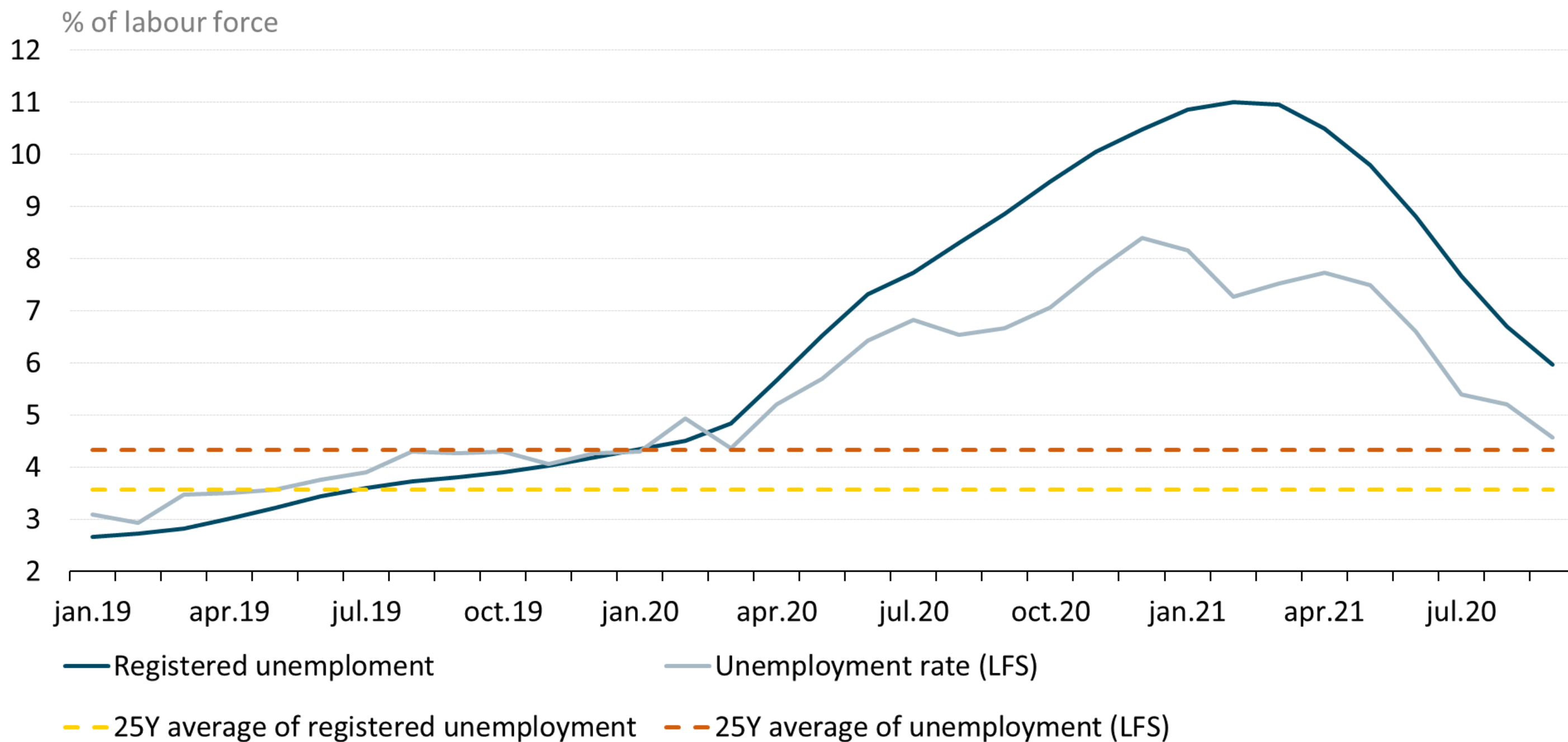
Lower real interest rate have stimulated the economy



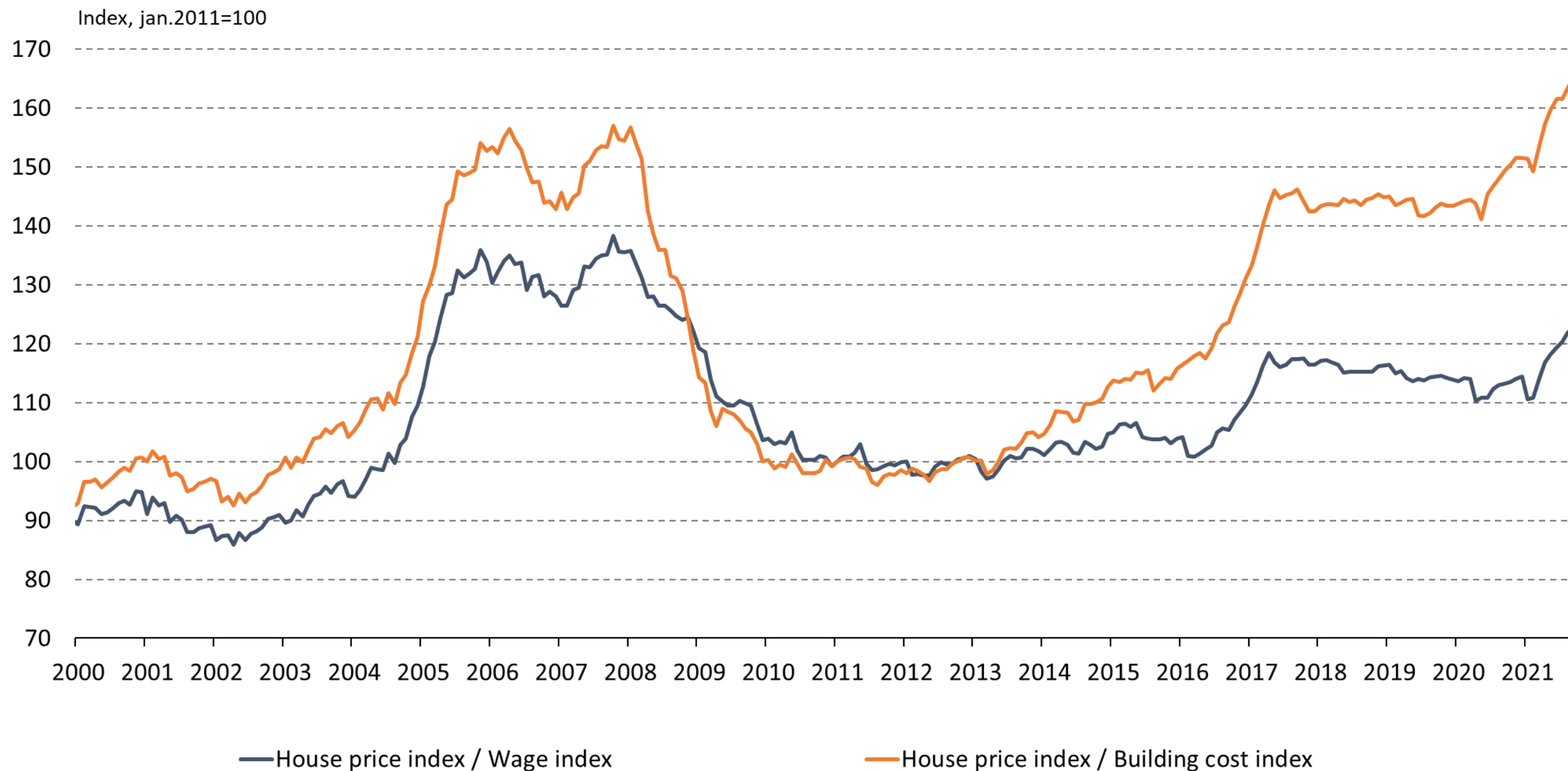
1. Real rate 27 Jan 2010 – 17 Nov 2021. For the period through 21 May 2014, the Bank's key rate is based on the average of deposit rates and the maximum rate on 28-day certificates of deposit. From then onwards, the key rate is the rate on seven-day term deposits.

Sources: Statistics Iceland, Central Bank of Iceland.

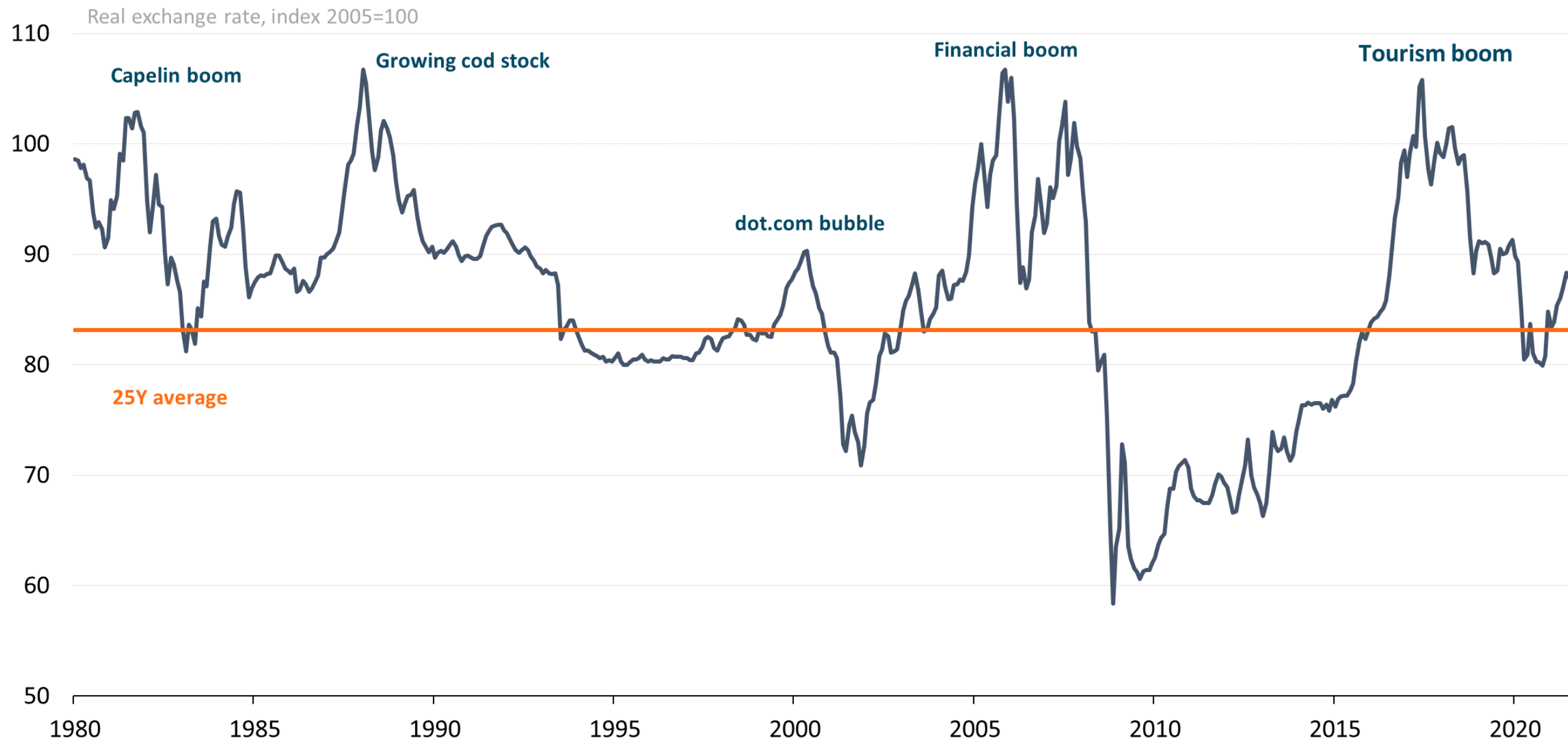
Unemployment has fallen rapidly



House prices have deviated from fundamentals



The real exchange rate is close to its long-term average

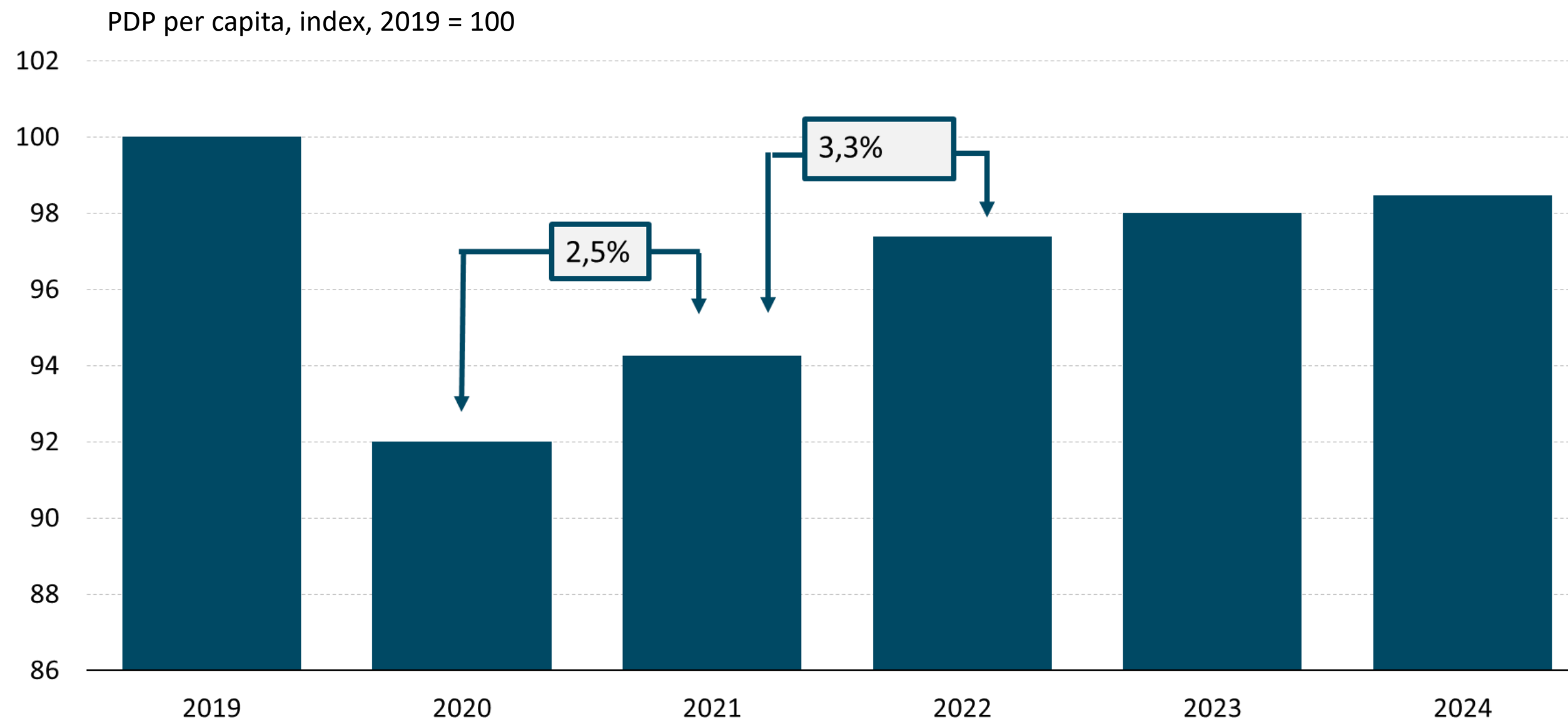


Inflationary has limited fuel

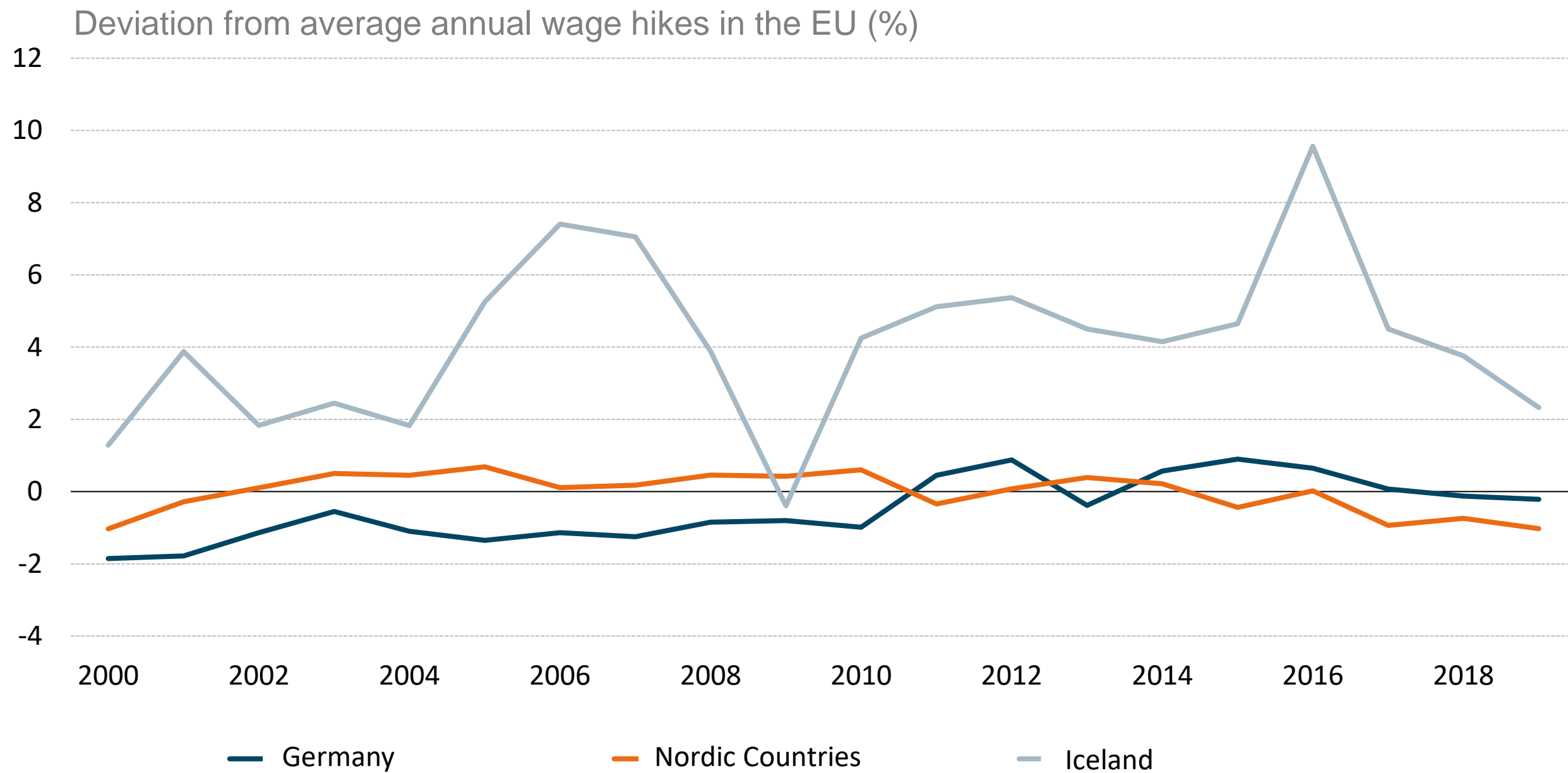
- Property prices are close to their peak.
- There are limits to how much commodity prices can rise – a fall in demand from China could push them downwards.
- The real exchange rate is at an appropriate level – no need for a shift.
- Icelandic inflation is in line with foreign inflation and will not cause the real exchange rate to rise.
- The real risk factor for inflation at present is domestic cost pressures, especially pressures from the labour market.

Wages to rise in 2021-2022 due to GDP growth bonus

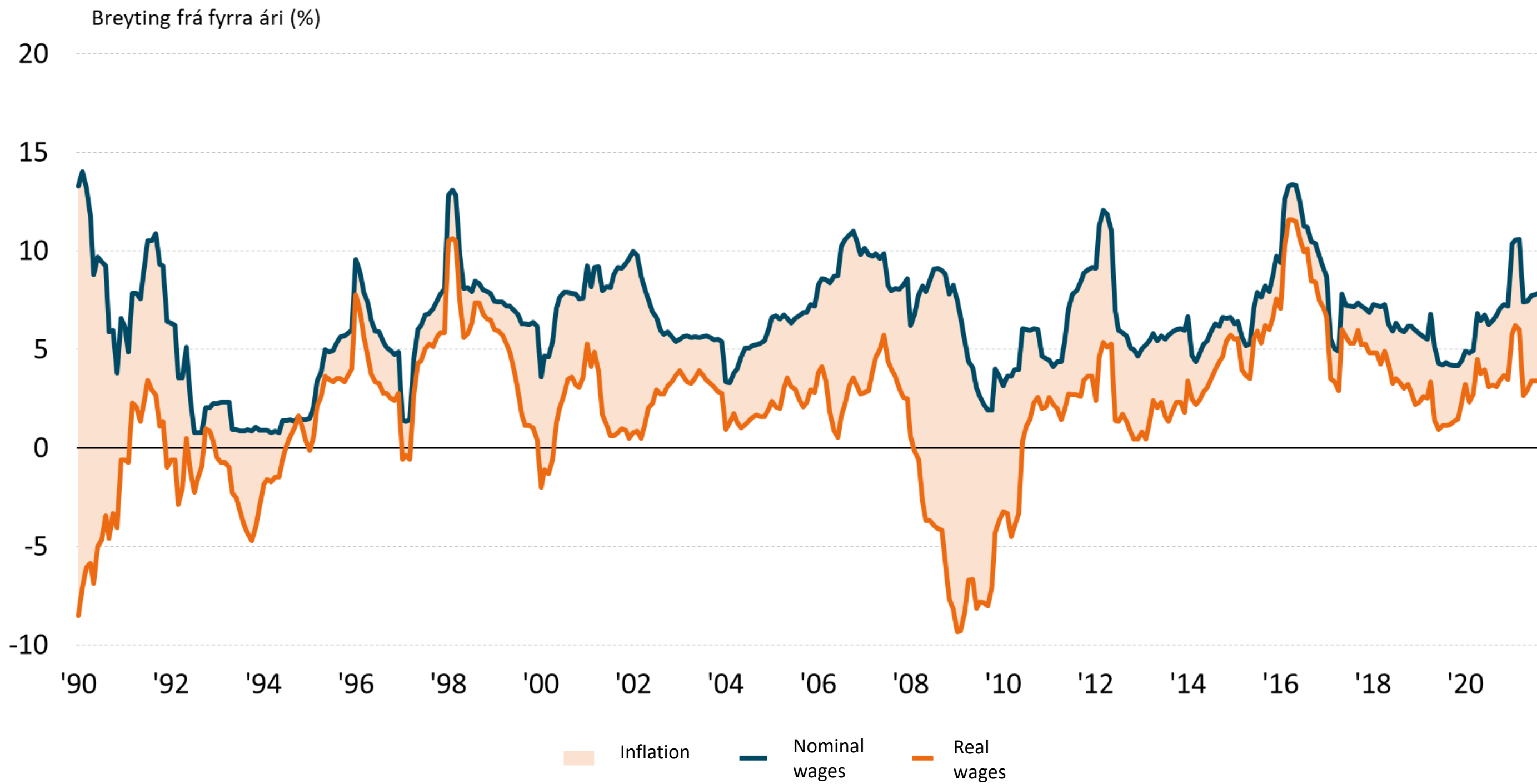
Paid out due to GDP growth in 2021 and 2022, even though GDP per capita will be lower than in 2019



Icelanders seek nominal wage increases



Nominal wage hikes do not necessarily deliver higher real wages



Living standards rather than nominal wage increases

The Icelandic people need:

- Low inflation
- Favourable interest rates
- A stable foreign exchange market
- A stable housing market
- A stable financial market

The Central Bank has both the determination and the capacity to ensure these public goods, but everyone must play for the same team.



Thank you