

Statement of the Monetary Policy Committee 5 February 2020

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 2.75%.

Leading indicators suggest that GDP growth was stronger in 2019 than previously assumed, while the outlook for 2020 and 2021 has deteriorated, according to the Bank's new macroeconomic forecast, published in the February *Monetary Bulletin*. According to the new forecast, GDP growth will measure only 0.8% this year, compared to 1.6% in the November forecast. The poorer outlook is due primarily to headwinds facing the export sector and tighter financing conditions for domestic firms.

Inflation declined rapidly over the course of 2019 and aligned with the target in Q4. It continued to fall in January, measuring 1.7%, the lowest observed inflation rate since autumn 2017. Underlying inflation has also fallen and is now at target, as are most measures of inflation expectations. According to the Bank's new forecast, inflation will be lower than was projected in November and below the target for most of the forecast horizon.

The monetary stance as measured in terms of the Bank's real rate has therefore tightened somewhat since the MPC's last meeting. The rise in corporate credit spreads has tightened the monetary stance even further.

Because inflation expectations are more firmly anchored to the target than before, monetary policy has had the scope to respond to the deteriorating economic outlook. The task of monetary policy is to secure medium-term price stability, but also to use the scope that it has to support a normal level of capacity utilisation.

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.