

Statement of the Monetary Policy Committee

7 November 2018

The Monetary Policy Committee (MPC) of the Central Bank of Iceland has decided to raise 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 4.5%.

GDP growth in 2017 and H1/2018 was stronger than previously estimated. Even though growth is expected to slow down in H2, it is forecast at 4.4% for 2018 as a whole, according to the November *Monetary Bulletin*. This is nearly 1 percentage point more than the Bank forecast in August. GDP growth is projected to ease in the coming term and the positive output gap is expected to close.

Inflation measured 2.8% in October. The difference between measures of inflation including and excluding housing is close to its smallest in over four years. The year-on-year rise in house prices continues to ease, but this is offset by a sizeable increase in import prices in the recent term. This partly reflects the rise in global oil prices, although the króna has also depreciated since August.

The outlook is for inflation to continue rising and be somewhat above the target next year. In addition, inflation expectations have risen recently and are now above target by all measures. The inflation outlook has therefore deteriorated, but on the other hand, the outlook is for growth in economic activity to ease faster than previously expected.

Higher inflation and inflation expectations in recent months have lowered the Central Bank's real rate more than is desirable in view of current economic developments and prospects. As a result, it is necessary to raise the Bank's key rate now.

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 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.