

Periodical Part

Monetary Policy Committee report to Parliament / Sedlabanki Islands. 2024

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2024 | 1

REPORT

MONETARY POLICY COMMITTEE REPORT TO PARLIAMENT



REPORT

MONETARY POLICY COMMITTEE REPORT
TO PARLIAMENT 2024/1

Accompanying documents

This report is accompanied by the following documents

Statement of the Monetary Policy Committee, 7 February 2024	11
Statement of the Monetary Policy Committee, 20 March 2024	12
Monetary Policy Committee Statement on changes to credit institutions' minimum reserve requirements, 4 April 2024	13
Statement of the Monetary Policy Committee, 8 May 2024	14
Minutes of the Monetary Policy Committee's February 2024 meeting	15
Minutes of the Monetary Policy Committee's March 2024 meeting	22
Minutes of the Monetary Policy Committee's May 2024 meeting	28
Enn af verðbólgu og vöxtum [en: More on inflation and interest rates] (in Icelandic) Article by Herdís Steingrimsdóttir, external member of the Monetary Policy Committee, published in Vísbending on 12 April 2024	36
Peningastefnan [en: Monetary Policy] (in Icelandic) Article by Ásgerður Ósk Pétursdóttir, external member of the Monetary Policy Committee, published in Vísbending on 28 June 2024	38
Joint declaration by the Government and the Central Bank of Iceland on inflation targeting, March 2001	40

Monetary Policy Committee report to Parliament

28 June 2024

The Act on the Central Bank of Iceland, which entered into force on 1 January 2020, stipulates that the Bank's Monetary Policy Committee (MPC) shall submit to Parliament (Alþingi) a report on its activities twice a year and that the contents of the report shall be discussed in the Parliamentary committee of the Speaker's choosing.

The Act requires that the Monetary Policy Committee meet at least six times each year. Since the last report was sent to Parliament, the Committee has held three regular meetings, the last of them on 8 May 2024, and one extraordinary meeting. The following report discusses the work of the Committee between January and June 2024.

Monetary policy formulation

According to the Act on the Central Bank of Iceland, the principal objective of monetary policy is to promote price stability. This objective is further described in the joint declaration issued by the Bank and the Icelandic Government on 27 March 2001 as an inflation target of 2½%, based on the consumer price index. By law, the MPC takes decisions on the application of the Bank's monetary policy instruments; furthermore, the MPC's decisions shall be based on a thorough and careful assessment of developments and prospects for the economy, including the assessment published in the Bank's *Monetary Bulletin*. The MPC's statements and minutes, enclosed with this report, contain the arguments for the Committee's decisions in the first half of 2024.

Developments from January to June 2024

The Monetary Policy Committee decided to keep the Bank's interest rates unchanged at 9.25% at its rate-setting meeting in February. The Committee considered it clear that the impact of monetary policy was coming more decisively to the fore, as real interest rates had

Table 1. Central Bank of Iceland interest rate decisions H1/2024 (%)

Date.	Current accounts	Seven-day term deposits ¹	Collateralised loans	Overnight loans
7 Feb	9.0	9.25	10.0	11.0
20 Mar	9.0	9.25	10.0	11.0
8 May	9.0	9.25	10.0	11.0

1. Central Bank key interest rate.

Chart 1

Central Bank of Iceland key interest rate¹
3 January 2001 - 28 June 2024



1. The Central Bank's key interest rate is defined as follows: the 7-day collateralised lending rate (until 31 March 2009), the rate on deposit institutions' current accounts with the Central Bank (1 April 2009 - 30 September 2009), the average of the current account rate and the rate on 28-day certificates of deposit (1 October 2009 - 20 May 2014), and the rate on 7-day term deposits (from 21 May 2014 onwards).

Source: Central Bank of Iceland.

risen and both measured and underlying inflation had declined. Indicators implied that growth in economic activity was subsiding faster than previously expected and that the positive output gap was narrowing. The MPC was concerned, however, that long-term inflation expectations remained high and were still above target, and that the labour market remained tight. Furthermore, there was uncertainty about the results of the ongoing wage negotiations and about possible fiscal measures relating to the wage negotiations and the seismic unrest in the Reykjanes area.

At its meeting in March, the Committee decided again to hold rates unchanged. Headline and underlying inflation had fallen marginally, although both were still well above the Central Bank's target. Inflation expectations also remained above target, which could indicate that inflation would continue to be persistent. Furthermore, Statistics Iceland's revised national accounts showed that GDP growth had been considerably stronger in recent years than was indicated by earlier figures. The positive output gap in the domestic economy therefore appeared to be larger than previously estimated. The MPC was of the opinion that uncertainty had subsided after the signing of private sector wage agreements, although the demand pressures in the economy could lead to more wage drift than would otherwise occur. Furthermore, fiscal measures could increase demand and inflationary pressures.

At an extraordinary meeting in April, the MPC decided to increase credit institutions' fixed reserve requirements from 2% to 3% of the reserve base. The decision was part of the Bank's comprehensive review of its key counterparties' interest rate terms, with the aim of distributing the cost of monetary policy conduct more evenly while ensuring sustainable financing of Iceland's international reserves, thereby supporting monetary policy credibility. The Committee was of the opinion that in the longer term, higher reserve requirements would provide a more solid foundation for monetary policy conduct, thereby enhancing the credibility and efficacy of monetary policy.

According to the Bank's new macroeconomic forecast, issued in May, the positive output gap was larger than previously estimated and the outlook was therefore for inflation to ease more slowly than had been assumed earlier. Inflation expectations had declined by some measures but remained above target. The effects of the recent wage agreements and fiscal measures on demand had not yet come fully to the fore. Although the labour market had eased, demand pressures remained,

which could give rise to wage drift, with the associated impact on inflation. The MPC considered it more likely than before that the monetary stance was sufficient to bring inflation back to target within an acceptable time frame; however, the Committee thought it important to begin lowering interest rates at a credible point in time because of the potential impact on expectations. As a result, the Committee had decided to keep interest rates unchanged, leaving the Bank's key interest rate steady at 9.25% at the end of June, where it has been since August 2023.¹

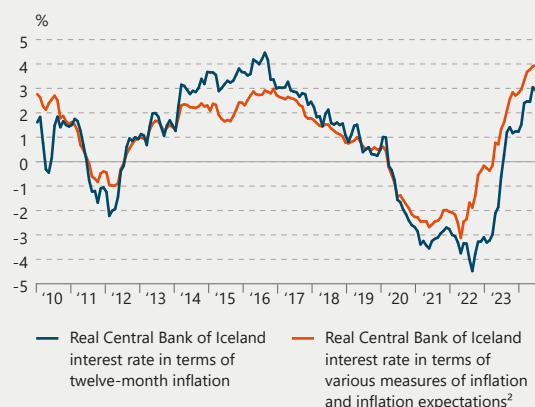
The monetary stance as measured in terms of the Central Bank's real rate continued to tighten in H1/2024. In terms of the average of various measures of inflation and one-year inflation expectations, the Bank's real rate was 4% at mid-year, about 1.1 percentage points higher than at the end of 2023, when the last report was sent to Parliament, and 2.7 percentage points higher than in mid-2023. The Bank's real rate in terms of twelve-month inflation rose by 1.8 percentage points in the first half of the year, to 3.3% at the end of June. Because the Bank's nominal interest rates have not been increased in 2024, the rise in the real rate during the year reflects the decline in inflation and short-term inflation expectations.

Long-term Treasury bond yields began falling in autumn 2023, with the emergence of increased optimism about a rapid drop in inflation. Expectations have changed this year, however, as inflation has proven more persistent than previously assumed and investors expect a slower decline in interest rates than they did at the turn of the year. The yield on ten-year nominal Treasury bonds therefore started rising in March. It measured 6.7% at the end of June and has increased by 0.2 percentage points in 2024 to date. The yield on ten-year indexed Treasury bonds has fallen by 0.2 percentage points in H1/2024, to 2.6% at mid-year.

Year-on-year growth in M3 ranged between 8% and 13% from December until May, about the same pace as in H2/2023. Increased household deposits have been the main driver of growth, as household saving has risen, private consumption has lost pace, and wages are up. In recent months, however, corporate deposits have increased despite rising operating expenses, perhaps owing in part to growth in corporate lending.

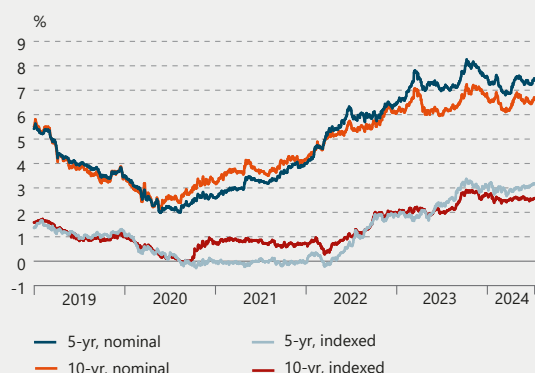
1. The key rate is the interest rate that is the most important determinant of short-term market rates and therefore the best measure of the monetary stance. At present, this is the interest rate on seven-day term deposits with the Central Bank.

Chart 2
Real Central Bank of Iceland interest rates¹
January 2010 - June 2024



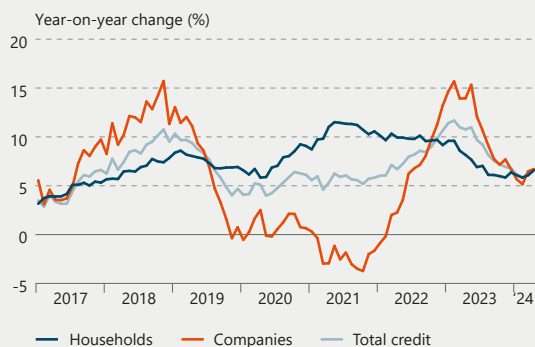
1. From 2010 to May 2014, the nominal policy rate was the average of the current account rate and the maximum rate on 28-day CDs. From May 2014, the policy rate has been the seven-day term deposit rate.
2. Until January 2012, according to twelve-month inflation, one-year business inflation expectations, one-year household inflation expectations, the one-year break-even inflation rate, and the Central Bank forecast of twelve-month inflation four quarters ahead. From February 2012 onwards, according to the above criteria, plus one-year market inflation expectations based on a quarterly Central Bank survey.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Chart 3
Government-guaranteed bond yields¹
2 January 2019 - 28 June 2024



1. Based on the zero-coupon yield curve, estimated with the Nelson-Siegel method, using money market interest rates and government-guaranteed bonds.
Source: Central Bank of Iceland.

Chart 4
Credit system lending¹
January 2017 - April 2024



1. Credit stock adjusted for reclassification and effect of Government debt relief measures. Excluding loans to deposit institutions, failed financial institutions and the Treasury. Companies include non-financial companies and non-profit institutions serving households.
Source: Central Bank of Iceland.

Year-on-year growth in credit system lending to households slowed markedly throughout 2023, to 6% by January 2024. It has held broadly unchanged in 2024 to date, although net new lending began to pick up in mid-2023, alongside an increase in real estate market turnover. The Government's purchase of homes in Grindavík through its real estate company Þórkatla probably offsets growth, as loans are either paid off or taken over by the company. Thus far in 2024, the majority of new loans to households have been indexed, and early retirement of non-indexed loans has continued. Both variable rates on non-indexed mortgages and interest rates on household deposits have held broadly unchanged since the last policy rate hike in August 2023. Fixed interest rates on non-indexed mortgages have fallen slightly in 2024, however, while rates on indexed mortgages have continued to rise.

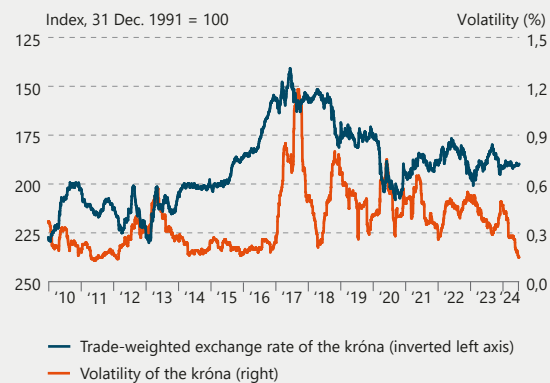
Year-on-year growth in credit system lending to businesses declined swiftly in 2023 and measured 5½% at the beginning of 2024. Growth in lending to businesses has accelerated since then, as net new corporate lending began to increase in autumn 2023, and most new loans have been inflation-indexed. Interest rates on corporate loans have been broadly unchanged since August 2023, but corporate deposit interest rates have fallen marginally.

Inflows of capital for new investment totalled 37.5 b.kr. in the first five months of 2024 and were due largely to purchases of Treasury bonds. Outflows of capital previously imported for new investment totalled 14.2 b.kr. over the same period, due mostly to sales of listed shares and Treasury bonds. Net inflows relating to new investment therefore totalled 23.3 b.kr. in the first five months of 2024, as compared with 12.8 b.kr. in H2/2023.

The króna weakened following the surge in seismic activity on the Reykjanes peninsula last November, but then rebounded quickly. The exchange rate has held relatively stable thus far in 2024. In H1/2024, it rose by about 0.8% in trade-weighted terms. The Central Bank intervened in the foreign exchange market in February, buying foreign currency for 9.2 b.kr. in response to strong foreign inflows into the domestic bond market. It was the first time since May 2022 that the Bank had bought foreign currency, with the transaction amounting to 8½% of market turnover in H1/2024.

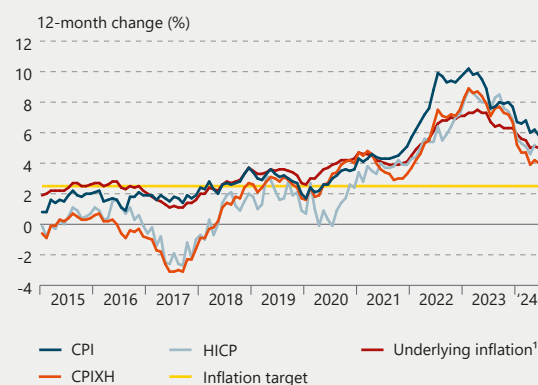
Inflation continued to ease in H1/2024, measuring 5.8% in June, down from 7.7% in December 2023, when the MPC submitted its last report to Parliament. In Q2/2024, it averaged 6%, as was assumed in the Bank's May forecast. Inflation excluding housing measured 4%

Chart 5
Exchange rate and volatility of the króna¹
4 January 2010 - 28 June 2024



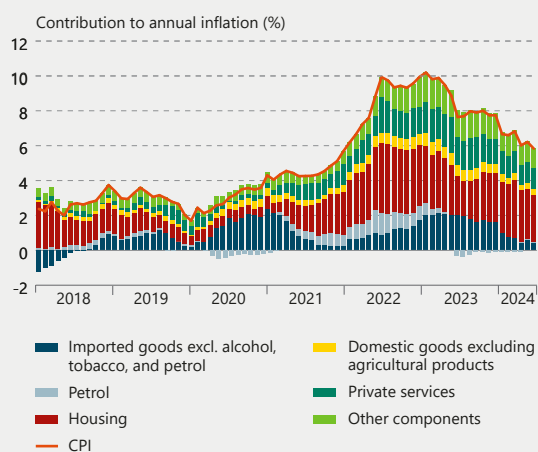
1. Price of foreign currency in terms of the króna. Inverted axis shows a stronger króna as a rise. Volatility is measured by the standard deviation of daily changes in the past 3 months.
Source: Central Bank of Iceland.

Chart 6
Various measures of inflation
January 2015 - June 2024



1. Underlying inflation shows the average of five different measures.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart 7
Components of CPI inflation
January 2018 - December 2024



Sources: Statistics Iceland, Central Bank of Iceland.

in June. It has also fallen in recent months, after having measured 6.7% in December 2023. Statistics Iceland has changed its methodology for calculating imputed rent in the CPI, and the first measurement based on the new method was published this June. From now on, owner-occupied housing costs will be calculated using the rental equivalence method instead of the previously used simple user cost method. According to the average of various measures, underlying inflation measured 5% in June, as compared with 6.3% in December 2023.²

The contribution of the housing component to headline inflation increased early in 2024, alongside growing housing market activity, but has tapered off again recently. The housing component now accounts for just under 2.7 percentage points of twelve-month inflation. In June, imputed rent pushed the CPI upwards by 0.15 percentage points according to the new calculation method, and was up by 12.3% year-on-year.

The rise in domestic goods prices has lost pace in tandem with the slowdown in economic activity in H1/2024. As of June, domestic goods prices had risen by 5.1% in the previous twelve months, owing largely to higher prices of domestic food products. The rise in private services prices has lost momentum as well. Prices had increased year-on-year by 5.3% in June, slightly less than at the end of 2023. Price hikes are still spread across a range of services subcomponents, however; for instance, the price of restaurant services, insurance, and maintenance has increased somewhat since last year. Imported inflation has also fallen in H1/2024. The year-on-year rise in imported food prices is still sizeable, at 4.7% in June. Other imported goods prices have risen much less, however. On the whole, imported goods prices have risen by 1.7% in the past twelve months.

According to the forecast in the May 2024 *Monetary Bulletin*, the long- and short-term inflation outlook was poorer than previously assumed. This was due to a weaker initial position and a larger and more persistent output gap, offset by the prospect of smaller wage cost increases. The forecast assumed that inflation would measure 5.8% in Q3/2024, just over a percentage point more than in the Bank's February forecast. It was forecast to fall to 3.5% by the end of 2025 and reach the target in H2/2026, conditional upon the interest rate path in the forecast.

2. The estimate of underlying inflation in June is based on the average of four measures instead of the previous five, as Statistics Iceland has discontinued publication of Core Index 3 following its adoption of the new imputed rent calculation method.

Chart 8
Goods and services prices
January 2019 - June 2024

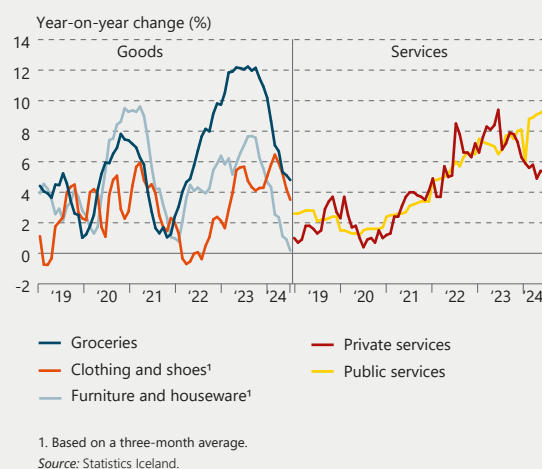


Chart 9
Two- and five-year inflation expectations¹
Q1/2018 - Q2/2024

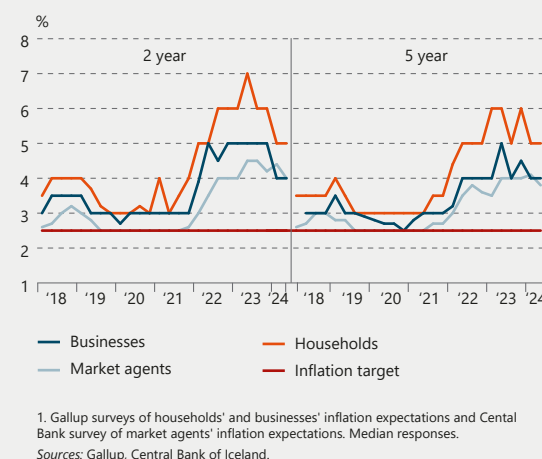
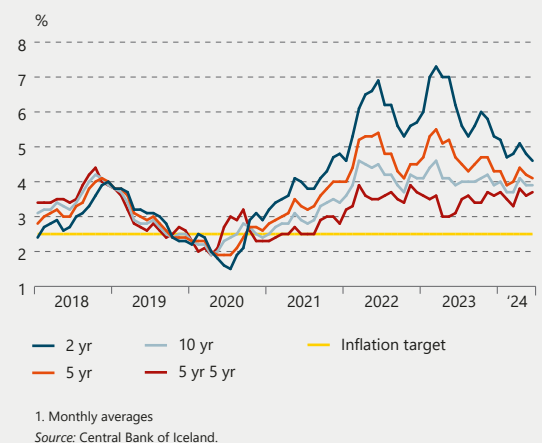


Chart 10
Breakeven inflation rate¹
January 2018 - June 2024



Short-term inflation expectations have fallen since the last report to Parliament, but they are still well above target. According to a survey conducted in May, market agents' two-year inflation expectations have fallen to 4%. According to Gallup's summer surveys, households' and businesses' two-year inflation expectations have also fallen since the last report was sent to Parliament. Households expect inflation to measure 5% in two years' time, while corporate executives project it at 4%.

Long-term inflation expectations have developed similarly and, by most measures, have fallen slightly since December. According to the May survey, market agents expected inflation to average 3.8% over the next five years and 3.5% over the next ten. Their five-year expectations had fallen since December, while their ten-year expectations were unchanged. In the summer survey, households expected inflation to average 5% over the next five years, which represented a decline since December, whereas corporate executives projected it at 4%. The breakeven inflation rate in the bond market rose marginally in H1/2024, however: the five-year breakeven rate five years ahead was about 3.9% at the end of June, compared to just over 3.4% at the end of 2023.

At the MPC's May meeting, it emerged that the impact of last year's policy rate hikes were still coming clearly to the fore in the economy. Growth in domestic demand had subsided, as the monetary stance was tight and the outlook was for a continued slowdown in GDP growth this year. Inflation had continued to ease, and inflation expectations had declined by some measures, although they remained above target.

The Committee was concerned, however, that the outlook was for inflation to fall more slowly than previously expected and that inflation expectations were still high. Furthermore, domestic demand remained relatively strong, there was still considerable strain on capacity, and indicators of a slowdown in the labour market were not unequivocal. Moreover, recent wage rises and fiscal measures could support demand, and the risk existed that companies would pass higher wage costs through to prices to some extent while demand pressures still remained. The Committee was of the opinion that the monetary stance was probably sufficient and that it was fairly likely that the stance would grow tighter in coming months, even if interest rates were held unchanged. On the other hand, indications that inflationary pressures were subsiding to a sufficient degree had not yet come clearly enough to the fore. For this reason, it would be riskier to lower interest rates too soon than to hold them unchanged for the present. Future policy decisions

would be determined by developments in economic activity, inflation, and inflation expectations in the coming term, as it was important to maintain an appropriate policy stance.

On behalf of the Central Bank of Iceland Monetary Policy Committee,

Ásgeir Jónsson

Governor of the Central Bank of Iceland
and Chair of the Monetary Policy Committee

Statement of the Monetary Policy Committee

7 February 2024

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 9.25%.

The effects of monetary policy are coming ever more clearly to the fore. The real rate has risen and inflation has fallen since the MPC's November meeting. Underlying inflation has eased as well. Indicators suggest that economic activity is subsiding faster than previously expected. According to the Central Bank's new forecast, the positive output gap is narrowing and will give way to a slack towards the end of the year. The inflation outlook has therefore improved.

Nevertheless, long-term inflation expectations are virtually unchanged and remain above target. Although labour market tightness has eased somewhat, pressures remain. As a consequence, inflation could remain persistent. Furthermore, there is uncertainty about the results of the ongoing wage negotiations and about possible fiscal measures relating to the wage negotiations and the seismic unrest in the Reykjanes area.

As before, near-term monetary policy formulation will be determined by developments in economic activity, inflation, and inflation expectations.

Statement of the Monetary Policy Committee

20 March 2024

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 9.25%.

Inflation eased slightly in February, to 6.6%. Underlying inflation has also eased but, like headline inflation, is well above the inflation target. Inflation expectations are also above target, which could indicate that inflation will remain persistent.

Statistics Iceland's recently revised national accounts show that GDP growth was stronger in recent years than was indicated by earlier figures. The positive output gap therefore appears to be larger than previously estimated. Economic activity continues to ease, however, as the monetary stance is tight.

Uncertainty has receded with the signing of private sector wage agreements. However, demand pressures in the economy could lead to more wage drift than would otherwise occur. Furthermore, fiscal measures could increase demand and inflationary pressures.

As before, near-term monetary policy formulation will be determined by developments in economic activity, inflation, and inflation expectations.

Monetary Policy Committee Statement on changes to credit institutions' minimum reserve requirements

4 April 2024

The Monetary Policy Committee (MPC) of the Central Bank of Iceland decided at an extraordinary meeting on 2 April 2024 to increase credit institutions' fixed reserve requirement from 2% to 3% of the reserve base. The change will take effect at the beginning of the next reserve maintenance period, on 21 April.

One of the main premises for conducting independent and credible monetary policy is that the Central Bank must have sizeable international reserves. One of the roles of the reserves is to mitigate volatility in Iceland's balance of payments, with reference to the Bank's monetary and exchange rate policies. Furthermore, abundant reserves reduce the likelihood that movement of capital to and from Iceland will compromise financial stability. Moreover, the international reserves function as a reserve fund that can be tapped in the event of large and unexpected shocks that disrupt foreign currency generation. There are costs associated with such protection, however, and they increase as the interest rate differential with abroad widens. The costs are borne largely by the Central Bank, whereas other domestic stakeholders benefit from more favourable interest rate terms in foreign credit markets.

The decision to increase the minimum reserve requirement is part of the Central Bank's comprehensive review of the interest rates the Bank offers its main counterparties. The increase aims to distribute more evenly the cost of conducting independent monetary policy and to ensure sustainable financing of Iceland's international reserves.

Raising reserve requirements can affect the monetary stance, but given deposit institutions' ample liquidity position with the Central Bank, the short-term effects of the change should be limited. In the longer term, however, it will provide a more solid foundation for monetary policy conduct, thereby enhancing the Central Bank's credibility and promoting more effective monetary policy.

Statement of the Monetary Policy Committee

8 May 2024

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 9.25%.

Inflation has continued to ease and measured 6% in April. Inflation excluding housing has fallen more rapidly, and underlying inflation is down to 5%. Inflation expectations have declined by some measures but remain above target.

Growth in domestic demand has subsided, as the monetary stance is tight and the outlook is for a slowdown in GDP growth this year. The positive output gap is larger than previously estimated, however, and inflation is therefore projected to fall more slowly, according to the Bank's new forecast.

The effects of the recent wage agreements and fiscal measures on demand have not yet come fully to the fore. Although the labour market has eased, demand pressures remain, which could give rise to wage drift, with the associated impact on inflation.

The MPC is of the view that there is an increased probability that the current monetary stance is sufficient to bring inflation back to target within an acceptable time frame. As before, monetary policy formulation will be determined by developments in economic activity, inflation, and inflation expectations.



MINUTES

MONETARY POLICY COMMITTEE



2024

FEBRUARY
119th meeting
Published 21 Feb 2024

Minutes of the Monetary Policy Committee meeting

February 2024 (119th meeting)

Published 21 February 2024

The Act on the Central Bank of Iceland states that decisions on the application of the Bank's monetary policy instruments shall be taken by the Monetary Policy Committee (MPC). It also states that the minutes of MPC meetings shall be made public and an account given of the Committee's decisions and the premises on which they are based. On the basis of this statutory authority, the MPC publishes the minutes of each meeting two weeks after the announcement of each decision. The minutes also include information on individual members' votes.

The following are the minutes of the MPC meeting held on 5 and 6 February 2024, during which the Committee discussed economic and financial market developments, decisions on the application of the Bank's monetary policy instruments, and the communication of those decisions on 7 February.

I Economic and monetary developments

Before discussing monetary policy decisions, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the Committee's previous meeting, on 22 November 2023, as published in the updated forecast in *Monetary Bulletin* 2024/1 on 7 February.

The Committee was given a presentation by Statistics Iceland on proposed changes in the methodology used to calculate the housing component of the consumer price index. Statistics Iceland estimates that the change will be implemented in spring 2024.

Financial markets

Since the November meeting, the króna had appreciated by 2.2% in trade-weighted terms. The Central Bank conducted no transactions in the market during the period.

In terms of the Central Bank's real rate, the monetary stance had tightened since the November meeting. In terms of the average of various measures of inflation and one-year inflation expectations, the Bank's real rate was 3.3%, or 0.6 percentage points higher than just after the announcement of the November interest rate decision. In terms of twelve-month inflation, it was 2.4% and had risen by 1.1 percentage points over the same period.

Interest rates on unsecured overnight deposits (the Icelandic króna overnight rate, or IKON) and rates in the interbank market for krónur were virtually unchanged between meetings, and turnover in the market totalled 10 b.kr. during the period. Yields on long-term nominal Treasury bonds had fallen by as much as 0.6 percentage points since the November meeting, while yields on long-term indexed Treasury bonds had held broadly unchanged. The average interest rate on inflation-indexed mortgages rose between meetings, whereas non-indexed mortgage rates were broadly unchanged.

In terms of three-month interbank rates, the short-term interest rate differential was unchanged between meetings, at 5.9 percentage points versus the euro area and 4.3 percentage points versus the US. The long-

term interest rate spread narrowed by 0.4 percentage points between meetings, however, to 4.5 percentage points versus Germany and 2.7 percentage points versus the US. The CDS spread on the Treasury's five-year obligations in US dollars was 0.6% and had narrowed between MPC meetings. The spread between the Treasury's euro-denominated issues and German government bonds narrowed by 0.1 percentage points at the same time, to 1.1-1.2 percentage points.

According to the Bank's quarterly survey of market agents' expectations, carried out in January, respondents were of the view that the Bank's key rate had peaked at 9.25% and would start to fall in Q2/2024. They expected the key rate to measure 7.75% in one year and 5.75% in two years. This is a lower interest rate than they expected in the November survey. Survey participants' responses on the monetary stance changed somewhat between surveys. The share of respondents who considered the current monetary stance appropriate was 42%, down from 60% in the November survey. The share who considered the current monetary stance too tight rose to 42% from the previous 27%. Roughly 15% of respondents considered the monetary stance too loose.

Financial institutions' analysts had projected that the MPC would hold interest rates unchanged, on the grounds that inflation and inflationary pressures had eased and private consumption had contracted, even though house prices had begun to rise again and inflation and inflation expectations were still above target. Furthermore, there was considerable uncertainty about both the forthcoming wage agreements and the Government's actions in response to the seismic activity in Grindavík.

Annual growth in M3 measured 8½% in December. Households' share in growth increased during the year, whereas businesses' share declined. Annual growth in credit system lending to households measured 6.4% in December, after increasing month-on-month. Net new lending to households had begun to pick up in mid-2023. Year-on-year growth in credit system lending to companies had lost pace, measuring 6.7% in December after averaging 14% in H1/2023.

The Nasdaq OMXI15 index had risen by 23.5% between meetings. Turnover in the Main Market totalled 121 b.kr. in January, about 50% more than for the same period in 2023.

Global economy and external trade

According to the International Monetary Fund's (IMF) January forecast, global GDP growth is projected to measure 3.1% in 2024, or 0.2 percentage points above the Fund's October 2023 forecast. The upward revision is due mainly to stronger-than-expected GDP growth in the US and several large emerging market economies. Nevertheless, this is well below the twenty-year average, as central bank interest rates have been raised steeply, fiscal consolidation has been stepped up because of increased indebtedness in recent years, and underlying productivity growth has been limited. The IMF assumes that global output growth will be broadly unchanged in 2025, at 3.2%. Inflation has fallen faster than expected in most countries around the world, however, concurrent with the unwinding of the supply chain bottlenecks of recent years and the tightening of monetary policy. The Fund forecasts that global inflation will subside to 5.8% in 2024 and fall to an average of 4.4% in 2025. In advanced economies, inflation is projected at 2.6% in 2024 and 2% in 2025, which is below the October forecast.

According to preliminary figures from Statistics Iceland, the deficit on goods trade measured 91.9 b.kr. in Q4/2023 and 326.2 b.kr. in 2023 as a whole, as compared with a deficit of 213.4 b.kr. at constant exchange rates in 2022 as a whole. Export values contracted by 11% year-on-year at constant exchange rates, with the value of most categories of exports declining between years. Lower prices for aluminium products and ferrosilicon, together with a downturn in exports of marine products, particularly capelin products, weighed heaviest in the contraction, but were offset by higher values of pharmaceuticals and medical products. At the same time, the value of imports contracted by ½% year-on-year at constant exchange rates, whereas import values excluding ships and aircraft were more or less flat. This is due to an increase in the value of investment goods, consumer goods, and transport equipment, which was offset by a decrease in the value

of fuels and commodities and operational inputs. The year-on-year decline in imported goods values is attributable mainly to a contraction in import volumes, as most categories of imports rose in price between years.

Global aluminium prices fell marginally after the MPC's November meeting, to just under 2,200 US dollars per tonne by the time of the February meeting. This is 12% lower than in February 2023. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products fell by 3% quarter-on-quarter in Q4/2023 but were an average of 3% higher in 2023 as a whole than in the year beforehand. The global price of Brent crude fell by just under 5% between MPC meetings, to 79 US dollars per barrel by the time of the February meeting. This is 3% lower than in February 2023. Other commodity prices had also fallen since the November meeting.

The real exchange rate in terms of relative consumer prices rose by 0.2% month-on-month in January, when it was 9.1% above its 25-year average but broadly the same as in December 2019. It rose by 0.8% year-on-year in 2023, as the nominal exchange rate fell by 2.6%, while inflation in Iceland was 3.6 percentage points above the trading partner average.

Domestic economy and inflation

Indicators of developments in private consumption suggest that it contracted by about the same in Q4 as in Q3, when it shrank by 1.7% year-on-year. Preliminary payment card turnover figures indicate declining household demand, and the end-2023 drop in the Gallup Consumer Confidence Index suggests increased pessimism. Household spending is therefore estimated to have contracted even further in Q4/2023.

In December, the National Budget for 2024 was approved by Parliament with a deficit amounting to 1.1% of GDP. This is only a slight change from the original budget proposal, but the Treasury performance is highly uncertain because of measures relating to the seismic activity in the Reykjanes area and the possibility of fiscal measures related to the ongoing wage negotiations.

According to the results of Gallup's winter survey, conducted in December among Iceland's 400 largest firms, respondents' assessment of the current economic situation was slightly more negative than in the autumn survey. Their expectations six months ahead were also more negative than in the autumn. About 37% of executives – somewhat more than in the autumn – expect economic conditions to deteriorate over the next six months, while 46% expect them to be unchanged. In general, though, executives were relatively optimistic about both domestic and foreign demand, but their assessment was broadly unchanged since the autumn. Executives in finance and insurance, miscellaneous specialised services, and industry and manufacturing were the most optimistic.

According to the seasonally adjusted survey results, job numbers will continue to rise in the coming term. The share of firms planning to recruit net of those planning to downsize was therefore slightly above its historical average during the quarter. Furthermore, one-third of executives consider themselves short-staffed, and just over half say their firms are working at full capacity. Both ratios declined in the winter survey but are still high in historical terms.

According to the Statistics Iceland labour force survey (LFS), total hours worked increased by 4.5% year-on-year in Q4/2023. Job creation measured 3.7% year-on-year, and the average work week grew longer by 0.7%. Figures from the pay-as-you-earn (PAYE) register suggest weaker job creation than is indicated by the LFS, as the number of employed persons rose by 3.1% year-on-year in Q4.

Seasonally adjusted LFS figures for Q4/2023 show that growth in the working-age population continued to lose pace, albeit offset by a higher labour participation rate. The employment rate rose as well, and unemployment was therefore relatively stable between quarters, measuring 3.5%. Seasonally adjusted registered unemployment also measured 3.5% in December. Registered unemployment has increased somewhat and was 0.4 percentage points higher in December 2023 than at mid-year.

In Q4, the general wage index rose by 1.3% between quarters and by 9.4% year-on-year. At the same time, real wages in terms of the index were 1.4% higher than in Q4/2022.

Statistics Iceland's nationwide house price index, published at the end of January, rose by 0.8% month-on-month after adjusting for seasonality, and by 4.7% year-on-year. The capital area house price index, calculated by the Housing and Construction Authority, rose by 1% month-on-month in December when adjusted for seasonality, and by 4.5% year-on-year. The number of purchase agreements registered nationwide fell by 12.5% year-on-year in 2023, while the number of contracts for new construction increased by 12.4% over the same period. The average time-to-sale for homes in greater Reykjavík was 4.4 months in December, up from 2.9 months in December 2022, as the number of homes on the market has increased somewhat in the past twelve months.

Inflation averaged 8.8% in 2023, as compared with 8.3% in 2022. The CPI declined by 0.16% month-on-month in January, and twelve-month inflation therefore fell sharply, from 7.7% to 6.7%. Inflation excluding housing declined as well, to 5.2%. Underlying inflation measured 5.8% according to the average of various measures, its lowest since May 2022.

In January, increased owner-occupied housing costs and higher electricity and heating costs had the largest upward effect on the CPI, while winter sales were the strongest downward-pushing factor. This year's sales were somewhat deeper than the average of the past few years. The cost of owner-occupied housing has increased by 12.7% in the past twelve months, driven to a large degree by the rise in real mortgage interest expense. Food prices also rose in January, mainly because of the agricultural product pricing committee's decision to raise the price of dairy products. Furthermore, public services prices rose due to various price list increases. Airfares fell in January and were nearly 11% lower than in the same month of 2023.

According to the Bank's market expectations survey, market agents' one-year inflation expectations declined marginally, and they now expect inflation to measure 5.3% one year ahead. Their longer-term expectations rose, however, and survey respondents now expect inflation to measure 4.4% in two years' time and 4.1%, on average, over the next five years. Corporate executives and households are more pessimistic, however, and expect inflation to fall more slowly. Executives expect it to average 4.5% over the next five years, whereas households expect it to average 6% over the same period. The breakeven inflation rate in the bond market fell between MPC meetings, however, and the five-year breakeven rate five years ahead was 3.6% at the beginning of February.

According to the forecast published in *Monetary Bulletin* on 8 February, the inflation outlook has improved since November and overall inflationary pressures have subsided. Headline inflation is expected to continue falling, to 6.3% in Q1/2024 and 5% in Q2, which is 0.7 percentage points below the November forecast. The outlook for the next two years has also improved somewhat. Inflation is expected to average 3.3% in 2025 and align with the target in H2/2026, conditional upon the interest rate path in the baseline forecast. This is somewhat earlier than was forecast in November. The improved outlook reflects, among other things, the fact that domestic demand has fallen more rapidly than was forecast in November, and a negative output gap is expected to open up at the end of this year. Global inflation has also fallen faster than was projected in November. On the other hand, the outlook is for wage costs to rise more during the forecast horizon, and some inflationary pressures still remain in the housing market.

GDP growth among key trading partner countries continued to soften over the course of 2023. Since November, the GDP growth outlook has deteriorated somewhat for most trading partners apart from the US, where growth has exceeded expectations. Global inflation has kept easing, as has underlying inflation, albeit more slowly. The war in the Middle East could impede the decline in global inflation, partly because of the recent rise in shipping costs.

In Iceland, GDP growth measured 4.2% for the first three quarters of 2023, in line with the Bank's November forecast. The growth rate slowed markedly as Q3 advanced, measuring 1.1% for the quarter, somewhat less

than was forecast in November. Domestic demand appears to have subsided more rapidly than was expected then, however, which is the main reason for the downward revision of the year-2024 GDP growth forecast. Despite indications that domestic demand had continued to ease in Q4/2023, favourable external trade is estimated to have pushed GDP growth marginally higher again during the quarter. For 2023 as a whole it is projected at 3.6%, which is broadly in line with the November forecast. In 2024, GDP growth is projected to soften further and measure 1.9%, well below the November forecast of 2.6%. On the whole, though, prospects for 2025 and 2026 are in line with the November forecast.

The global economic situation remains uncertain, not least because of the wars in Ukraine and the Middle East. In Iceland as well, uncertainty has mounted in the wake of the volcanic eruption on the Reykjanes peninsula. Actions taken by the Government in response to the situation could cause the economic outlook to differ from that provided for in the baseline forecast, but it is difficult to assess the impact of such measures before their scope and execution have been determined. The results of the ongoing wage negotiations and the possibility of related fiscal measures could also cause the economic and inflation outlook to change relative to the baseline forecast. Another source of concern is still-high inflation expectations, which could make bringing inflation to target more difficult than is assumed in the baseline scenario.

II Decisions on the Bank's monetary policy instruments

The MPC discussed the monetary stance in view of economic developments and the fact that the Bank's real rate had risen since the November meeting. Members discussed whether the monetary stance was appropriate in view of the inflation outlook, as the Committee had decided at its November meeting to hold interest rates unchanged. At that time, the poorer inflation outlook suggested that it could prove necessary to tighten the monetary stance still further, but in view of the economic uncertainty relating to the seismic activity on the Reykjanes peninsula, the Committee decided to wait and see.

Members considered it favourable that the effects of monetary policy were coming ever more clearly to the fore. They noted that the real rate had risen and inflation had fallen since the MPC's November meeting. Underlying inflation had eased as well. Indicators suggested also that economic activity had subsided faster than previously expected. It also emerged that according to the Central Bank's new forecast, the positive output gap was narrowing and would give way to a slack towards the end of the year. The inflation outlook had improved as a result.

Nevertheless, MPC members were concerned that long-term inflation expectations were virtually unchanged and remained above target. They also noted that although labour market tightness had eased somewhat, pressures remained. As a consequence, inflation could remain persistent. The Committee observed as well that there was uncertainty about the results of the ongoing wage negotiations and about possible fiscal measures relating to both the wage negotiations and the seismic unrest in the Reykjanes area.

Members discussed that inflation remained high and that the inflation outlook had primarily improved for 2024, while the longer-term outlook had improved only marginally. They observed that because the labour market was still quite tight, unit labour costs could rise more than they would otherwise. Moreover, it emerged that there was significant uncertainty about both the results of wage agreements and the forthcoming fiscal measures, as well as their impact on economic activity and inflationary pressures. Furthermore, the way in which these measures were financed would be important in the context of the fiscal stance. Although domestic economic activity had eased, there was still the risk that firms would to some extent pass cost increases through to prices following the wage settlements. Housing market activity appeared to be picking up again, and house prices had risen in the recent term. In addition, long-term inflation expectations had held broadly unchanged, even though growth in domestic demand had lost pace and the inflation outlook had improved. Inflation expectations were less firmly anchored to the target, which could affect developments in inflation. It was important to bring inflation expectations down in order to ensure that inflation would realign with the target. It emerged that in view of the high level of uncertainty, it was not a

given that the monetary tightening phase was at an end, and because demand pressures still remained in the economy, it would be better to keep interest rates high for longer than to lower them too soon.

Committee members agreed as well that the impact of the tighter monetary stance was coming rapidly to the fore, as private consumption and investment had begun to contract, which was also reflected in a contraction in imports. As a result, domestic demand had begun to lose momentum, and more rapidly than expected. It also emerged that tourism activity could turn out weaker than expected, both because of the volcanic activity on the Reykjanes peninsula and because of global economic uncertainty. It was pointed out that as a result, there was the risk that the real rate would rise more than necessary at a time of rapidly declining growth in economic activity, as the Bank's real rate was considerably higher than that in trading partner countries.

On the other hand, it emerged that although a turning point was probably close at hand, there was still a need for a high real rate in the economy. It was therefore important to await clearer signs that disinflation was on a solid footing and to proceed carefully in easing the monetary stance, as there was still considerable uncertainty about many key economic variables.

In view of the discussion, the Governor proposed that the Bank's interest rates be held unchanged. The Bank's key rate (the seven-day term deposit rate) would be 9.25%, the current account rate 9%, the seven-day collateralised lending rate 10%, and the overnight lending rate 11%.

Ásgeir Jónsson, Rannveig Sigurdardóttir, Herdís Steingrimsdóttir, and Ásgerdur Ósk Pétursdóttir voted in favour of the proposal. Gunnar Jakobsson voted against the proposal and wanted to lower rates by 0.25 percentage points. He was of the opinion that the most recent data showed that the monetary stance had been sufficient in the recent past, as economic activity had subsided steadily. Furthermore, recent developments in the economy, the inflation outlook, and the real rate suggested that the time had come to lower the policy rate. He pointed out that the Bank's real rate was at its highest since 2012 and that all indicators implied that it would rise considerably more in coming months. It was therefore appropriate to begin easing the monetary stance, but in small increments, given the existing uncertainty.

The Committee was of the opinion that as before, near-term monetary policy formulation would be determined by developments in economic activity, inflation, and inflation expectations.

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gunnar Jakobsson, Deputy Governor for Financial Stability

Herdís Steingrimsdóttir, Associate Professor, external member

Ásgerdur Ósk Pétursdóttir, Assistant Professor, external member

Thórarinn G. Pétursson, Chief Economist of the Central Bank, was present for the entire meeting. In addition, several Bank staff members attended part of the meeting.

Karen Á. Vignisdóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 20 March 2024.



MINUTES

MONETARY POLICY COMMITTEE



2024

MARCH
120th meeting
Published 3 April 2024

Minutes of the Monetary Policy Committee meeting

March 2024 (120th meeting)

Published: 3 April 2024

The Act on the Central Bank of Iceland states that decisions on the application of the Bank's monetary policy instruments shall be taken by the Monetary Policy Committee (MPC). It also states that the minutes of MPC meetings shall be made public and an account given of the Committee's decisions and the premises on which they are based. On the basis of this statutory authority, the MPC publishes the minutes of each meeting two weeks after the announcement of each decision. The minutes also include information on individual members' votes.

The following are the minutes of the MPC meeting held on 18-19 March 2024, during which the Committee discussed economic and financial market developments, decisions on the application of the Bank's monetary policy instruments, and the communication of those decisions on 20 March.

I Economic and monetary developments

Before turning to monetary policy decisions, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the Committee's last meeting, on 7 February 2024.

The Committee was given a presentation by the Ministry of Finance and Economic Affairs on the Government's actions related to the wage agreements and in response to the seismic activity in Grindavík.

Financial markets

Since the February meeting, the króna had depreciated by 0.1% in trade-weighted terms. Between meetings, the Bank bought foreign currency for 62 million euros (9.2 b.kr.). The Bank's transactions during the period accounted for 22.5% of total turnover in the foreign exchange market.

In terms of the Central Bank's real rate, the monetary stance had tightened since the February meeting. In terms of the average of various measures of inflation and one-year inflation expectations, the Bank's real rate was 3.8%, or 0.5 percentage points higher than just after the announcement of the February interest rate decision. In terms of twelve-month inflation, it was 2.5% and had risen by 0.1 percentage points over the same period.

Interest rates on unsecured overnight deposits (the Icelandic króna overnight rate, or IKON) and rates in the interbank market for krónur were virtually unchanged between meetings, but turnover in the market totalled 3 b.kr. during the period. Yields on long-term nominal Treasury bonds had fallen by as much as 0.2 percentage points since the February meeting, but yields on long-term indexed Treasury bonds were virtually unchanged over the same period. The average interest rate on inflation-indexed mortgages rose marginally between meetings, whereas non-indexed mortgage rates were broadly unchanged.

In terms of three-month interbank rates, the short-term interest rate differential had narrowed by 0.1 percentage points versus the US, to 4.2 percentage points, whereas it was unchanged at 5.9 percentage points

versus the euro area. The long-term interest rate spread narrowed by 0.3 percentage points between meetings, to 4.2 percentage points versus Germany and 2.4 percentage points versus the US. The CDS spread on the Treasury's five-year obligations in US dollars was 0.5% and had narrowed between MPC meetings. The spread between the Treasury's euro-denominated issues and German government bonds narrowed by 0.2 percentage points at the same time, to 0.9-1.1 percentage points.

Most analysts from financial institutions projected that the MPC would hold the policy rate unchanged, although some also forecast a rate cut of 0.25 percentage points. Analysts noted that inflation and inflation expectations were still above target and that underlying inflationary pressures were strong. Furthermore, wage agreements were still pending for large worker groups and the labour market remained tight. On the other hand, inflation had subsided somewhat, there were indications that the economy was continuing to cool, and the results of recently concluded wage agreements appeared favourable.

Annual growth in M3 measured just over 8% in January. Household deposits accounted for the majority of the increase, although businesses' share in growth had been on the rise in the previous three months. Year-on-year growth in credit system lending measured 6.1% in January and has continued to lose pace. Lending to households also grew by 6.1% between years in January, while lending to businesses grew 5.6%.

The Nasdaq OMXI15 index had fallen by 6.6% between meetings. Turnover in the Main Market totalled 236 b.kr. in the first two months of 2024, some 39% more than over the same period in 2023.

Global economy and external trade

According to the Organisation for Economic Cooperation and Development's (OECD) forecast from early February, global GDP growth is projected to ease from 3.1% in 2023 to 2.9% this year. This is 0.2 percentage points above the OECD's November forecast. The increase is due mainly to a more promising outlook for the US, where year-2024 GDP growth is now projected at 2.1%, or 0.6 percentage points more than in the last forecast. The outlook for the eurozone has worsened, however. As before, global GDP growth is expected to measure 3% in 2025. The OECD forecasts that inflation will rise marginally in the G20 countries, to an average of 6.6%. However, this is due mainly to Argentina, where inflation is projected at 251%, and Turkey, where it is forecast at nearly 50%. Excluding these two countries, the outlook for the G20 has improved since November, with inflation forecast to average 2.6% in 2024. In particular, prospects have improved for the US, Canada, India, and the eurozone, according to the OECD. Inflation in OECD countries is still expected to taper off to around 2.4% in 2025.

According to preliminary figures from Statistics Iceland, the deficit on goods trade measured 30 b.kr. in the first two months of 2024, as compared with a deficit of 23 b.kr. at constant exchange rates over the same period in 2023. Exported goods values increased by 5.6% year-on-year at constant exchange rates. The export value of marine products and aquaculture products increased, whereas there was a decline in the value of manufactured goods, particularly aluminium and ferrosilicon. At the same time, import values grew by 9%, with all key subcategories increasing year-on-year.

Global aluminium prices rose marginally after the MPC's February meeting, to about 2,200 US dollars per tonne by time of the March meeting. This was similar to the March 2023 price. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products rose by 0.5% month-on-month in January but had fallen by 2.3% year-on-year. The global price of Brent crude fell by 11% between MPC meetings, to 87 US dollars per barrel by the time of the March meeting. This is about 18% higher than in March 2023. On the other hand, other commodity prices had fallen somewhat since the February meeting.

The real exchange rate in terms of relative consumer prices rose by 2% month-on-month in February. At that time it was 11% above its 25-year average and 2% higher than in December 2019. In the first two months of 2024, it had risen by 7.6% year-on-year, as the nominal exchange rate of the króna was 3.4% higher and inflation in Iceland was 4.2 percentage points above the trading partner average.

Domestic economy and inflation

According to preliminary figures published by Statistics Iceland at the end of February, GDP growth measured 0.6% in Q4/2023, somewhat below the forecast in the February *Monetary Bulletin*. For 2023 as a whole, GDP growth measured 4.1%, as compared with the February forecast of 3.6%. The majority of 2023 output growth was attributable to a 2.9 percentage point contribution from net trade, which in turn was due to growth in tourism and a contraction in imports. Both private and public consumption increased as well, while investment shrank between years. Previous figures were revised, and growth in domestic demand proved stronger in the first three quarters of 2023 than previously estimated. For the year as a whole, domestic demand growth measured 1.2%, as compared with the February forecast of 0.8%. Furthermore, GDP growth figures for 2020-2022 were revised sharply upwards, and year-2022 growth proved to be 8.9%, or 1.7 percentage points higher than the previous estimate. This increase is due to much stronger growth in investment, particularly business investment, and the revision is based on corporate asset register data available at the end of 2023, which show more investment in structures and rental vehicles than previously estimated.

Indicators of developments in private consumption in Q1/2024 are somewhat ambiguous. Payment card turnover grew year-on-year in the first two months of 2024, after contracting in the recent past, although the increase is due mainly to growth in card turnover abroad. According to the Gallup Consumer Confidence Index, households had grown less pessimistic during the quarter and the index had risen since the turn of the year. New motor vehicle registrations contracted again, however, after an uptick in late 2023.

According to the results of Gallup's spring survey, conducted in February and March among Iceland's 400 largest firms, respondents' attitudes towards the current economic situation were somewhat more positive than in the winter survey. Their expectations six months ahead were also more positive, as 31% of executives expected the economic situation to improve in six months' time, a somewhat larger share than in the winter. About 47% expected the economic situation to be unchanged over the next six months. Executives were also somewhat more upbeat about domestic and foreign demand than in the winter survey, especially those in miscellaneous specialised services and in the transport, transit, and tourism sector.

Prospects for firms' operating performance in 2024 deteriorated marginally relative to the autumn survey, with 28% of executives expecting weaker profits than in 2023 and 22% expecting this year's profits to be stronger. Some 29% of firms saw their profit margins increase in the previous six months, while 27% of firms' margins contracted. Just over half of firms assumed that their margins would remain unchanged in the coming six months, and another one-fourth expected them to contract. Expectations concerning investment during the year were unchanged from the autumn survey, and as in that survey, executives in transport, transit, and tourism were most optimistic about increased investment.

The seasonally adjusted results of Gallup's spring survey show that firms have scaled up their recruitment plans since the previous survey. The balance of opinion on staffing plans (i.e., firms planning to recruit as compared with those planning redundancies) was positive by 17 percentage points, whereas it had been positive by 9 percentage points in the winter survey. As a result, it was still 9 percentage points above its historical average. About 37% of executives considered themselves short-staffed, which is marginally higher than in the previous survey. The share of companies operating at close to full capacity rose between surveys as well, to 53%. Both shares were still more than 12 percentage points above their historical averages.

The general wage index rose by 0.5% month-on-month in January and by 7% year-on-year, and real wages were 0.4% higher during the month than at the same time in 2023.

Statistics Iceland's nationwide house price index, published at the end of February, rose by 0.6% month-on-month in February, after adjusting for seasonality, and by 5.4% year-on-year. The capital area house price index, calculated by the Housing and Construction Authority, rose by 0.9% month-on-month in January when adjusted for seasonality, and by 5.4% year-on-year. The number of purchase agreements registered nationwide rose by 24.6% year-on-year in the first two months of 2024, while the number of contracts for new construction increased by 80% over the same period. The average time-to-sale for properties in greater

Reykjavík was 3.5 months in February, slightly longer than the 3.1-month average from February 2023, but the number of homes for sale has fallen somewhat since November 2023.

The CPI rose by 1.33% month-on-month in February, and twelve-month inflation eased to 6.6%. Inflation excluding housing declined as well, to 4.7%. The difference between inflation including and excluding housing has grown recently and is at its largest since year-end 2022. Underlying inflation fell month-on-month as well, to 5.6% according to the average of various measures.

As is customary at this time of year, end-of-sale effects were discernible in February, and the price of clothing, footwear, furniture, and housewares rose. In the case of clothing and footwear prices, end-of-sale effects were stronger in February than in the same month of 2023. Public services prices rose 2.5% between months, owing mainly to a 17% hike in waste collection fees. The overall seasonal increase in public services prices at the beginning of 2024 was considerably larger than the average of the past few years.

Households' and businesses' two-year inflation expectations declined, according to Gallup's spring survey. Corporate executives expect inflation to measure 4% in two years' time, while households expect it to measure 5%. Furthermore, households' and businesses' long-term inflation expectations fell between surveys: corporate executives now expect inflation to average 4% over the next five years, while households expect it to average 5% over the same period. The breakeven inflation rate in the bond market had fallen slightly since the Committee's February meeting, and the five-year breakeven rate five years ahead was just under 3.5% in mid-March.

II Decisions on the Bank's monetary policy instruments

The MPC discussed the monetary stance in view of economic developments and the fact that the Bank's real rate had continued to rise since the February meeting. Members discussed whether the monetary stance was appropriate in view of the inflation outlook, as the Committee had decided at its February meeting to hold interest rates unchanged. At that time, inflation had eased somewhat, but long-term inflation expectations were broadly unchanged. Although labour market tightness had eased somewhat, pressures remained.

Committee members discussed the marginal decline in inflation, to 6.6% in February. Underlying inflation had eased as well but, like headline inflation, was well above the target. Inflation expectations were also above target, which could indicate that inflation would remain persistent.

The MPC observed that Statistics Iceland's recently revised national accounts showed that GDP growth had been stronger in recent years than was indicated by earlier figures. All else being equal, the revised figures suggested the presence of a larger positive output gap, although potential output was probably greater as well, as revisions of historical investment data weighed heavily in the updated GDP growth figures. The Committee was therefore concerned that demand pressures in the economy appeared to be stronger than previously estimated, although members agreed that economic activity was continuing to ease, as the monetary stance was tight.

The MPC noted that uncertainty had receded with the signing of private sector wage agreements. However, demand pressures in the economy could lead to more wage drift than would otherwise occur. Furthermore, fiscal measures could increase demand and inflationary pressures.

The Committee discussed the fact that inflation and inflation expectations were still high. Although growth in domestic demand had slowed in the recent term, indicators implied that it remained strong. It emerged that firms had scaled their hiring plans upwards again, the share of firms reporting staffing shortages was still high, and the strain on production factors was significant. The labour market therefore remained tight and unemployment low. Furthermore, housing market activity was still strong, and house prices had risen in

the recent term. It was also pointed out that there was a reasonable probability that 2023 GDP growth had been underestimated in the most recent data, as previous figures had been revised substantially. As a result, it was important to interpret the most recent data with caution. It also emerged in the discussion that even though the recent signing of long-term wage agreements was a positive development, there was some risk that firms would pass a large share of the wage hikes through to prices, as had happened at the beginning of 2023. Moreover, it was not yet clear how fiscal measures would be financed, what impact they would have on demand, and whether the fiscal stance would ease. It was pointed out that a high real rate was still needed to ensure that inflation would not remain persistent for a protracted period of time. The risk that the monetary stance was too loose to bring inflation back to target within an acceptable time frame was still greater than the risk that it was too tight. Unambiguous indications that inflation was clearly on the decline would have to emerge in order to make it possible to lower interest rates, and it was important to begin the monetary easing phase at a credible point in time.

It emerged in the discussion that growth in private consumption and economic activity had lost pace quickly in the recent past, as real interest rates had risen markedly. It was also noted that the revision of GDP growth figures for prior years could indicate that economic activity had slowed much more sharply in the recent term than would otherwise be the case, as the change was from a higher level. Uncertainty had receded between meetings, and recent surveys indicated that inflation expectations had inched downwards. It emerged that it was also important to consider the long-term impact of tight monetary policy.

In view of the discussion, the Governor proposed that the Bank's interest rates be held unchanged. The Bank's key rate (the seven-day term deposit rate) would be 9.25%, the current account rate 9%, the seven-day collateralised lending rate 10%, and the overnight lending rate 11%.

Ásgeir Jónsson, Rannveig Sigurdardóttir, Herdís Steingrímisdóttir, and Ásgerdur Ósk Pétursdóttir voted in favour of the proposal. Gunnar Jakobsson voted against the proposal and wanted to lower rates by 0.25 percentage points. He considered the situation similar in most respects to that prevailing at the previous meeting but was of the view that uncertainty had diminished because of the signing of benchmark-setting private sector wage agreements. Furthermore, the real rate had continued to rise rapidly, and households' and businesses' situation had tightened. In addition, the effects of previous interest rate hikes had yet to emerge. In view of the current situation and the data available to the Committee, it was appropriate to begin lowering the policy rate incrementally.

The Committee was of the opinion that as before, near-term monetary policy formulation would be determined by developments in economic activity, inflation, and inflation expectations.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Gunnar Jakobsson, Deputy Governor for Financial Stability

Herdís Steingrímisdóttir, Associate Professor, external member

Ásgerdur Ósk Pétursdóttir, Assistant Professor, external member

Thórarinn G. Pétursson, Chief Economist of the Central Bank, was present for the entire meeting. In addition, several Bank staff members attended part of the meeting.

Karen Á. Vignisdóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 8 May 2024.



MINUTES

MONETARY POLICY COMMITTEE



2024

MAY
122nd meeting
Published 22 May 2024

Minutes of the Monetary Policy Committee meeting

May 2024 (122nd meeting)

Published: 22 May 2024

The Act on the Central Bank of Iceland states that decisions on the application of the Bank's monetary policy instruments shall be taken by the Monetary Policy Committee (MPC). It also states that the minutes of MPC meetings shall be made public and an account given of the Committee's decisions and the premises on which they are based. On the basis of this statutory authority, the MPC publishes the minutes of each meeting two weeks after the announcement of each decision. The minutes also include information on individual members' votes.

The following are the minutes of the MPC meeting held on 6-7 May 2024, during which the Committee discussed economic and financial market developments, decisions on the application of the Bank's monetary policy instruments, and the communication of those decisions on 8 May.

I Economic and monetary developments

Before discussing monetary policy decisions, members discussed the domestic financial markets, financial stability, the outlook for the global economy and Iceland's international trade, the domestic economy, and inflation, with emphasis on information that has emerged since the Committee's last meeting, on 20 March 2024, as published in the new forecast and analysis of uncertainties in *Monetary Bulletin* 2024/2 on 8 May.

Financial markets

Since the March meeting, the króna had depreciated by 0.8% in trade-weighted terms. The Central Bank conducted no transactions in the market during the period.

In terms of the Central Bank's real rate, the monetary stance had tightened slightly since the MPC's March meeting. In terms of the average of various measures of inflation and one-year inflation expectations, the Bank's real rate was 3.9%, or 0.1 percentage points higher than just after the announcement of the March interest rate decision. In terms of twelve-month inflation, it was 3.1% and had risen by 0.6 percentage points over the same period.

Interest rates on unsecured overnight deposits (the Icelandic króna overnight rate, or IKON) declined marginally between MPC meetings. Interest rates in the interbank market for krónur also fell slightly between meetings, and turnover in the interbank market totalled 10 b.kr. during the period. Yields on long-term nominal Treasury bonds had risen by as much as 0.6 percentage points since the March meeting, and yields on long-term indexed Treasury bonds had risen by 0.1 percentage points. The average interest rate on inflation-indexed mortgages rose marginally between meetings, whereas fixed rates on non-indexed mortgages declined.

In terms of three-month interbank rates, the short-term interest rate differential had narrowed between meetings by 0.1 percentage points versus the US, to 4.1 percentage points, whereas it was unchanged at 5.9 percentage points versus the euro area. The long-term interest rate spread widened between meetings, however. It rose by 0.4 percentage points versus the US, to 2.8 percentage points, and by 0.6 percentage points versus Germany, to 4.8 percentage points. The CDS spread on the Treasury's five-year obligations in

US dollars was 0.4% and had narrowed slightly between MPC meetings. The spread between the Treasury's euro-denominated issues and German government bonds narrowed by 0.1 percentage points at the same time, to 0.8-0.9 percentage points.

According to the Bank's quarterly survey of market agents' expectations, carried out in April, respondents were of the view that the Bank's key interest rate had peaked at 9.25%. They expected the key rate to be lowered in Q3/2024, which is later than according to the January survey. Market agents also expected the key rate to fall more slowly than in the last survey: they expected it to be 7.75% in one year and 6% in two years. The share of respondents who considered the monetary stance too tight continued to rise between surveys, from 42% in January to 62% in this survey. On the other hand, the share who considered the monetary stance appropriate declined from 42% in the January survey to 34% in this one, and the share who considered it too loose declined from 15% in January to 3% in this survey.

Financial institutions' analysts had projected that the MPC would hold interest rates unchanged in May, on the grounds that inflation and inflation expectations were still well above target, the outlook was for inflation not to fall significantly in coming months, and there was still a positive output gap. On the other hand, inflation and underlying inflation had fallen, and indicators continued to suggest that economic activity had subsided.

Annual growth in M3 measured 10% in March, and as before, household deposits accounted for the majority of the increase. Annual growth in credit system lending grew marginally between months, to 6.3% in March, but has lost pace considerably in the past year. Lending to households grew by 6.1% between years in March, while lending to businesses grew 6.5%.

The Nasdaq OMXI15 index had fallen by 3.8% between meetings. Turnover in the Main Market totalled 376 b.kr. in the first four months of 2024, some 20% more than over the same period in 2023.

Global economy and external trade

According to the International Monetary Fund's (IMF) mid-April forecast, global GDP growth is projected to be unchanged at 3.2% in 2024. This is 0.1 percentage points above the Fund's January forecast but below the twenty-year average. For 2025, the growth rate is also expected to measure 3.2%. The 2024 output growth outlook has improved especially for the US, owing to stronger-than-expected growth in late 2023. In the euro area, however, growth in 2024 and 2025 is expected to be slightly weaker than previously forecast. The Fund forecasts that global inflation will subside from 6.8% in 2023 to 5.9% in 2024 and 4.5% in 2025. Furthermore, inflation is projected to fall to central bank targets sooner in advanced economies than in emerging and developing economies.

The IMF forecast aligns well with the May forecast from the Organisation for Economic Co-operation and Development (OECD). According to the OECD forecast, global output growth will measure 3.1% in 2024 and 3.2% in 2025. This is 0.2 percentage points above the OECD's February forecast. To a large extent, the upward revision is due to an improved outlook for the US, although prospects for GDP growth have also improved for China and India since the OECD's February forecast. In the Organisation's opinion, inflation in the G20 countries will average 5.9% this year and 3.6% in 2025. It is expected to be back to target in most countries by the end of 2025.

According to preliminary figures from Statistics Iceland, the deficit on goods trade measured 57 b.kr. in Q1/2024, as compared with a deficit of 44 b.kr. at constant exchange rates over the same period in 2023. Export values shrank by 6.7% year-on-year at constant exchange rates, with a contraction in the export value of manufactured goods and marine products, owing in particular to the capelin catch failure. Aquaculture product values increased, however. At the same time, import values shrank by about 1%, due mainly to an increase in the value of investment goods and consumer goods, which was offset by a decrease in the value of commodities and operational inputs, transport equipment, and fuel.

Global aluminium prices rose by nearly 14% after the MPC's March meeting, to just over 2,500 US dollars per tonne by time of the May meeting. This is also about 9% higher than in May 2023. Preliminary figures from Statistics Iceland indicate that foreign currency prices of marine products were down 2.3% year-on-year in Q1/2024. The global price of Brent crude fell by just under 5% between MPC meetings, to 83 US dollars per barrel by the time of the May meeting. Nevertheless, this is roughly 8% higher than at the beginning of 2024 and in early May 2023. Other commodity prices had risen since the March meeting, however.

The real exchange rate in terms of relative consumer prices rose by 1% month-on-month in April, when it was 10% above its 25-year average and 0.6% higher than in December 2019. In the first four months of 2024, it had risen by 5.4% year-on-year, as the nominal exchange rate of the króna was 1.7% higher and inflation in Iceland was 3.7 percentage points above the trading partner average.

Domestic economy and inflation

According to Statistics Iceland's labour market survey (LFS), total hours worked grew by 4.1% year-on-year in the three months to February. Of that amount, the number of employed persons grew by 3.7%, and the average work week grew longer by 0.4%. Therefore, job creation remains strong according to the LFS, although it is weaker than in 2023. Clearer signs of slower job growth can be seen in the number of persons on the pay-as-you-earn (PAYE) register. By that measure, year-on-year job growth started to decline more rapidly in mid-2023, to 2.7% by Q1/2024.

The seasonally adjusted labour participation rate has held close to 80.5% since end-2022. The employment rate was also relatively stable early in the period but has eased since late 2023. As a result, unemployment has inched upwards, measuring 3.9% in the three months to February. A broader definition of unemployment, which includes groups that are close to being considered unemployed, indicates that labour market tightness has eased somewhat more quickly in the recent past. However, seasonally adjusted registered unemployment remained virtually unchanged at 3.4% from October 2023 through March 2024.

New population data from Statistics Iceland show that population growth slowed more in 2023 than previously thought. In Q4, the population increased 2.3% year-on-year, and the annual growth rate was flat between quarters. In comparison, previous figures had indicated 3% population growth in Q3/2023.

The general wage index rose by 1.6% between quarters in Q1, and by 7.4% between years, while real wages rose 0.2% quarter-on-quarter and 0.6% year-on-year.

The revision of historical national accounts figures indicates that the saving rate was somewhat higher in recent years than previously estimated, which enables households to maintain a higher spending level despite bleaker income prospects. Year-on-year growth in private consumption slowed over the course of 2023, turning negative by 2.3% in Q4. Indicators of developments in private consumption in Q1/2024 are somewhat ambiguous, however. Icelanders' payment card turnover in the domestic market contracted between years, while their card use abroad increased. Total payment card turnover therefore grew year-on-year, and the Gallup Consumer Confidence Index indicates that household sentiment has improved as well. On the other hand, new motor vehicle registrations declined somewhat, perhaps due partly to changes in tax concessions for electric car purchases. Private consumption is estimated to have contracted by 1.6% year-on-year in Q1.

Statistics Iceland's nationwide house price index, published at the end of April, rose by 0.5% month-on-month in April, after adjusting for seasonality, and by 6.4% year-on-year. The nationwide house price index compiled by the Housing and Construction Authority (HMS) rose by 0.8% between months and 5.2% between years in March. The HMS index of capital area house prices increased by 4.8%, and the index for regional Iceland, also compiled by the HMS, rose by 6.8%. The number of purchase agreements registered nationwide rose by 26.4% year-on-year in the first three months of 2024, while the number of contracts for new construction increased by 73.4% over the same period. The increase in turnover is probably due in part to purchases made by Grindavík residents. The average time-to-sale for homes in greater Reykjavík was 3.5

months in March. It has grown shorter in recent months but remains slightly longer than in March 2023, when it measured 3.4 months. The number of homes for sale has fallen by just under 400 from its November 2023 peak.

The CPI rose by 0.55% month-on-month in April, and twelve-month inflation measured 6%. It fell somewhat relative to March, but fairly strong base effects were in evidence. Inflation excluding housing declined as well, to 3.9%. The difference between inflation including and excluding housing therefore continued to grow. Underlying inflation also eased between months, to 5% according to the average of various measures.

The main drivers of the April rise in the CPI were owner-occupied housing costs and higher airfares. Airfares continued to be affected by the Easter holidays, whereas fares have been an average of 9% lower year-to-date than over the same period in 2023. The twelve-month rise in domestic goods and services has eased gradually, but imported inflation has subsided more rapidly. Grocery prices were 5.3% higher in April than in the same month of 2023.

According to the Central Bank's market expectations survey, respondents' two-year inflation expectations have fallen since the previous survey and now measure 4%. Their long-term inflation expectations also fell between surveys. They expect inflation to average 3.8% in the next five years and 3.5% in the next ten years. The breakeven inflation rate in the bond market rose after the MPC's March meeting but has fallen again. The ten-year breakeven rate was just under 3.5% at the beginning of May, broadly unchanged from the time of the Committee's last meeting. The five-year breakeven rate five years ahead has developed similarly, measuring 3½% at the beginning of May.

According to the forecast published in *Monetary Bulletin* on 8 May, inflation is expected to be higher over most of the forecast horizon than was projected in February. The bleaker outlook is due largely to a poorer initial position, as inflation was higher in Q1 than was forecast in February. In addition, the outlook is for stronger housing market activity in the coming term, owing partly to home purchases by Grindavík residents, and moreover, the positive output gap looks set to be larger and more persistent than previously estimated. This is offset by the prospect of slower wage growth. Inflation is projected at 6% in Q2 but is forecast to fall to 5.8% in Q3, which is just over 1 percentage point above the February forecast. It is forecast to fall to 3.5% by the end of 2025 and reach the target in H2/2026, conditional upon the interest rate path in the forecast.

The GDP growth outlook for Iceland's main trading partners is broadly unchanged since February. In the US, growth continues to exceed expectations, but growth remains weak in large parts of Europe. GDP growth in trading partner countries is projected to average 1.2% this year and then inch up to just above 1½% in the two years thereafter. Trading partner inflation tumbled in 2023 but has fallen more slowly in 2024. As in February, it is forecast to measure 2.5% in 2024 and ease to 2% by late 2025.

In Iceland, GDP growth measured 4.1% in 2023, on the heels of 8.9% growth in 2022, the country's strongest output growth rate in over half a century. This is considerably stronger growth than previous estimates from Statistics Iceland had suggested. Statistics Iceland's revision of GDP growth figures for the first three quarters of 2023 is also the main reason growth for the year exceeded the Bank's February forecast. Economic activity began to subside as 2023 advanced, however, and GDP is estimated to have contracted in Q1/2024. The contraction appears to have been larger than was forecast in February, and the outlook for the year as a whole has worsened. Year-2024 GDP growth is now projected at 1.1%, as compared with the February forecast of 1.9%. The deviation is due primarily to a bleaker outlook for domestic demand growth. As in the previous forecast, GDP growth is expected to gain pace in 2025. It is projected to average 2½% over the next two years.

Unemployment has inched upwards since mid-2023, and job growth has slowed. A positive output gap remains, however, and is estimated to be larger than previously thought because of Statistics Iceland's revisions of historical data. It is now estimated to have been 3.8% of capacity in 2023, well above the February

forecast of 2.3%. As before, however, the output gap is expected to narrow over the forecast horizon and a small slack to open up in 2025, a year later than previously projected.

The global economic situation remains uncertain, not least because of the wars in Ukraine and the Middle East. In Iceland as well, uncertainty has mounted in the wake of the volcanic eruption on the Reykjanes peninsula. On the other hand, uncertainty about wage developments has subsided with the signing of private sector wage agreements. The risk remains, though, that weakly anchored inflation expectations will cause inflation to be more persistent than is currently assumed. On top of this is uncertainty about how the change in the calculation of the housing component of the CPI, which Statistics Iceland has announced, will affect near-term measured inflation.

II Decisions on the Bank's monetary policy instruments

At an extraordinary meeting in April 2024, the MPC decided to increase credit institutions' fixed reserve requirements from 2% to 3% of the reserve base. At that meeting, the Committee reviewed the Central Bank's capital position and capital target and discussed various ways to strengthen the Bank's performance. As was noted in the MPC statement published on 4 April, the decision is part of the Bank's comprehensive review of its key counterparties' interest rate terms, with the aim of distributing the cost of monetary policy conduct more evenly while ensuring sustainable financing of Iceland's international reserves, thereby supporting monetary policy credibility. The Committee was of the opinion that in the longer term, higher reserve requirements would provide a more solid foundation for monetary policy conduct, thereby enhancing the credibility and efficacy of monetary policy and contributing to lower inflation expectations. The primary purpose of the decision was not to affect the short-term monetary stance. On the other hand, the possibility that it would have some impact on the policy stance could not be excluded, although in view of deposit institutions' ample liquidity position with the Central Bank, the short-term effects of the change should be limited. Furthermore, an analysis of the potential impact of higher reserve requirements on economic activity and inflation showed that such impact would be negligible. In the long run, greater credibility should enhance efficacy and improve the transmission of monetary policy. All MPC members in attendance at the extraordinary meeting – Ásgeir Jónsson, Rannveig Sigurdardóttir, Ásgerdur Ósk Pétursdóttir, and Herdís Steingrimsdóttir – supported the decision.

At its May meeting, the MPC discussed the monetary stance in view of economic developments and the increase in the Bank's real rate since the March meeting. Members discussed whether the monetary stance was appropriate in view of the inflation outlook, as the Committee had decided at its March meeting to hold interest rates unchanged. At that time, inflation had fallen marginally between meetings, but the positive output gap appeared to be larger than previously estimated.

Committee members noted that inflation had continued to ease, measuring 6% in April. Inflation excluding housing had fallen more rapidly, and underlying inflation was down to 5%. Inflation expectations had declined by some measures but remained above target.

In their discussion, MPC members noted that growth in domestic demand had subsided, as the monetary stance was tight and the outlook was for a slowdown in GDP growth this year. Members were concerned that the output gap was larger than previously estimated, however, and that inflation was therefore projected to fall more slowly, according to the Bank's new forecast.

They observed that the effects of the recent wage agreements and fiscal measures on demand had not yet come fully to the fore. Although the labour market had eased, demand pressures remained, which could give rise to wage drift, with the associated impact on inflation.

The MPC discussed whether to hold interest rates unchanged or to lower them. Members agreed that the outlook was for inflation to fall more slowly than previously expected and that inflation expectations remained too high. Although the monetary stance was tight and economic activity had subsided, domestic demand was still relatively strong. Furthermore, there was still considerable strain on capacity, and indicators of a slowdown in the labour market were not unequivocal. It was pointed out that the economic situation had actually not changed significantly since the MPC's March meeting. Recent wage rises and fiscal measures could also support demand, and the risk existed that companies would pass higher wage costs through to prices to some extent while demand pressures still remained.

The Committee was of the opinion that the monetary stance was probably sufficient and that it was fairly likely that the stance would grow tighter in coming months, even if interest rates were held unchanged. It emerged in the discussion that this was acceptable, given that domestic economic activity was still strong overall, not least because revised figures indicated that the output gap was wider than previously estimated and would take longer to close. In this context, it was also important that the household saving rate had proven higher than previously thought, which could cause private consumption to pick up sooner; therefore, the monetary stance would have to be tighter than would otherwise be needed, given how persistent inflation had been.

In the Committee's opinion, recent developments in the housing market had been affected to a degree by the seismic activity on the Reykjanes peninsula. It was appropriate at present to look past these effects to a large extent, as developments in house prices differed from developments in other economic variables, and the situation partly reflected a change in relative prices. On the other hand, it was not possible to ignore them entirely, partly because both house prices and the number of first-time buyers had started to rise before the earthquakes and eruptions began. It was still unclear whether overall demand for housing had eased, and in addition, the rise in house prices could have a ripple effect and stimulate domestic demand, not least because inflation expectations were high.

The MPC observed that on the other hand, activity in the tourism industry had begun to ease, which would affect the housing market. Furthermore, the impact of recent cost increases on the price level had receded. The rise in goods prices had lost pace, and global commodity prices had fallen year-on-year, which probably had yet to come more clearly to the fore in Iceland. Also, mortgage interest rate reviews were in the offing for a large number of households, which could support the monetary stance.

In the Committee's opinion, it was clear that the past year's interest rate hikes continued to affect economic activity. On the other hand, indications that inflationary pressures were subsiding to a sufficient degree had not yet come clearly enough to the fore. Of particular concern was the fact that inflation expectations remained significantly above target. For this reason, it would be riskier to lower interest rates too soon than to hold them unchanged for the present. It was also important to begin lowering interest rates at a credible point in time, as even a relatively small reduction in the Bank's key rate could have a strong impact on expectations, as it would signal the start of a monetary easing phase. Future policy decisions would be determined by developments in inflation and inflation expectations in the coming term, as it was important to maintain an appropriate policy stance.

In view of the discussion, the Governor proposed that the Bank's interest rates be held unchanged. The Bank's key rate (the seven-day term deposit rate) would be 9.25%, the current account rate 9%, the seven-day collateralised lending rate 10%, and the overnight lending rate 11%.

Ásgeir Jónsson, Rannveig Sigurdardóttir, Herdís Steingrímisdóttir, and Ásgerdur Ósk Pétursdóttir voted in favour of the proposal. Arnór Sighvatsson voted against the proposal and wanted to lower rates by 0.25 percentage points. In his opinion, the risk existed that the monetary stance would become too tight in the near future. Given that the rise in the housing component of the CPI originated to an extent in supply shocks

that would have only a transitory impact on the index, it would be appropriate to look past the recent increase in that component for the most part. The underlying real rate was therefore higher than generally assumed and could continue to rise over the summer months. For this reason, he expected housing market activity to taper off earlier than was generally thought, which would show in more rapid disinflation.

The MPC was of the view that there was an increased probability that the current monetary stance was sufficient to bring inflation back to target within an acceptable time frame. As before, monetary policy formulation would be determined by developments in economic activity, inflation, and inflation expectations.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Monetary Policy Committee

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy

Arnór Sighvatsson, Deputy Governor for Financial Stability

Herdís Steingrímsdóttir, Associate Professor, external member

Ásgerdur Ósk Pétursdóttir, Assistant Professor, external member

Thórarinn G. Pétursson, Chief Economist of the Central Bank, was present for the entire meeting. In addition, several Bank staff members attended part of the meeting.

Karen Á. Vignisdóttir wrote the minutes.

The next Statement of the Monetary Policy Committee will be published on Wednesday 21 August 2024.



Mynd: Seðlabanki Íslands

Enn af verðbólgu og vöxtum

Herdís Steingrímisdóttir

dósent í hagfræði við Viðskipta-
háskólann í Kaupmannahöfn og
lektor við félagsráðgjafardeild HÍ



Á fundi sínum í mars 2024 ákvað peningastefnunefnd að halda stýrivöxtum í 9,25% og hafa vextir þá verið óbreyttir síðan í ágúst 2023. Á þeim tíma hefur dregið úr verðbólgu og taumhald peningastefnunnar því aukist þrátt fyrir óbreytt vaxtastig. Líkt og kemur fram í fundargerð frá fundi peningastefnunar í mars vildi einn nefndarmaður lækka vexti um 0,25 punkta en aðrir nefndarmenn greiddu atkvæðu með tillögu seðlabankastjóra um óbreytta vexti. Á fundinum var meðal annars rætt að spennan í þjóðarþúinu virtist vera umfram það sem áður var talið þó áfram hægði á vexti efnahagsumsvifa.

Baksýnispegillinn

Þó ákvarðanir peningastefnunar byggja einkum á samtímagögnum og spám um þróun og framtíðarhorfur efnahagsumsvifa, verðbólgu og verðbólguvæntinga, getur engu að síður verið lærdómsríkt að horfa í baksýnispegilinn.

Við upphaf Covid-faraldursins í mars 2020 var verðbólga hér á landi 2,1% og stýrivextir Seðlabanka Íslands 2,75%. Farsóttinni fylgdi gríðarleg óvissa um efnahagshorfur en ljóst þótti að ferðatakmörkanir, samkomubönn og tilskipanir um einangrun myndu draga verulega úr innlendra eftirspurn. Í því ljósi var ákveðið að slaka á taumhaldi peningastefnunnar og lækka vexti. Á sama tíma og vextir voru lækkaðir var gripið til ýmissa aðgerða í opinberum fjármálum til að styðja við heimili og fyrirtæki. Vextir Seðlabankans

voru lækkaðir í nokkrum skrefum og náðu lágmarki í 0,75% í nóvember 2020. Þeir voru svo óbreyttir fram í maí 2021, þegar peningastefnunefnd hóf að hækka vexti á ný.

Þegar horft er til baka má velta því fyrir sér hvort efnahagslegar aðgerðir vegna Covid hafi gengið of langt – eða hvort að of seint hafi verið brugðist við þegar eftirspurn tók við sér og verðbólga tók að aukast. Seðlabankar flestra vestrænna landa höfðu það í forgangi að styðja við þjóðarþúinn á þessum óvenjulegu tímum og tóku meðvitaða áhættu á tímabundinni aukningu verðbólgu. Takmarkanir vegna farsóttarinnar gerðu það að verkum að eftirspurnaráhrif þessara aðgerða virtust lítil framan af – en þegar helstu takmörkunum var aflétt reyndist vera töluverð uppsöfnuð eftirspurn í hagkerfinu sem var

þá skyndilega leyst úr læðingi. Framleiðslu-
hnókrar í kjölfar faraldursins, til að mynda
vegna vandamála í framleiðslukeðjum
og flutningum á milli landa, gerðu það
að verkum að teygni var lítil á framboðs-
hliðinni. Þá gerði árás Rússlands á Úkraínu
það að verkum að aðföng svo sem jarðgas
og áburður hækkuðu töluvert í verði. Við
þessar aðstæður jókst verðbólga hratt hér
á landi sem og í okkar helstu viðskipta-
löndum. Þó aukning verðbólgu hafi að
einhverju leyti verið fyrirséð þá má segja
að það hafi komið flestum í opna skjöldu
hversu hátt verðbólgan fór og hversu þrálát
hún hefur verið.

Hér og þar

Verðbólga á Íslandi hefur verið yfir verð-
bólguþröngun frá því um mitt ár 2020.
Hún náði hámarki í 10,2% í febrúar 2023
en hefur síðan þá lækkað niður í 6,8%.
Árshækkun samræmdu vísitölunnar náði
einnig hámarki í febrúar 2023 og var þá
8,8% en er nú 5,3%. Próun verðbólgu á
Íslandi og í helstu viðskiptalöndum hefur
að mörgu leyti verið áþekk síðustu ár, en
þó virðist verðbólgan hér hafa náð hámarki
eilitíð síðar en annars staðar auk þess sem
það hefur gengið hægar að draga úr henni
hér á landi. Á Evrusvæðinu fór verðbólga
(þ.e. hækkun samræmdu vísitölunnar) upp
í 10,6% í október 2022 en er hún nú komin
niður í 2,6%. Í Bretlandi náði verðbólga
einnig hámarki í október 2022 í 11,1% en
er nú 3,4%. Í Bandaríkjunum var verðbólga
mest um 9% í júní 2022 en ári síðar var
verðbólga þar komin niður í um 3% - þar
sem hún er enn. Að baki hárrar verðbólgu
þessara landa liggja sambærilegar ástæður;
farsóttin, afleiðingar hennar og viðbrögð og
aðgerðir hins opinbera. Þó er einnig ýmis-
legt sem skilur löndin að og getur gert það
að verkum að mögulega reynist miserfitt að
ná verðbólgu niður.

Orkuverð

Þrátt fyrir svipaða verðbólguþróun var
samsetning verðbólgunnar ólík á milli
landa. Í Evrópu útskýrði hækkun orku- og
matvælavæðs um tvo þriðju verðbólgunnar,
en einungis um þriðjung í Bandaríkjunum.
Á Íslandi hefur alþjóðlegt orkuverð haft lítil
bein áhrif á verðbólguþróun. Aftur á móti
hefur undirliggjandi verðbólguþrýstingur
verið meiri og kjarnaverðbólga (þ.e.
verðbólga þegar horft er fram hjá orku- og
matvælavæð) verið hærri. Eftir að orkuverð
tók að lækka á ný hefur dregið nokkuð hratt
úr verðbólgu á evrusvæðinu en það sama er
ekki uppi á teningnum hér. Samsetning verð-
bólgunnar hér á landi gerir það að verkum að
hætt er við að hún verði þrálátari og því þurfi
hærra raunvaxtastig til að ná henni niður.

Væntingar

Markmið Seðlabanka Íslands er að verð-
bólga sé að jafnaði í kringum 2,5%. Traust
kjölfesta væntinga felur í sér að almenningur
og fyrirtæki hafi trú á því að víki verð-
bólga frá markmiði þá takist Seðlabanka
að ná verðbólgu aftur í markmið innan

”

Hætta er á að við þessar aðstæður fleyti fyrirtæki umsömdum launahækkunum að miklu leyti út í verðlag

ásættanlegs tíma. Hafi verðbólguvæntingar
trausta kjölfestu ættu skammtímasveiflur
í verðbólgu að hafa lítil sem engin áhrif
á væntingar til meðallangs og lengri
tíma. Traust kjölfesta verðbólguvæntinga
styður við peningastefnuna og má til að
mynda ætla að lækkan langtmaverðbólgu-
væntinga hafi spilað mikilvægt hlutverk
í hjöðnun verðbólgu hér á landi á síðasta
áratug.¹ Langvarandi frávik verðbólgu frá
markmiði eykur hins vegar hættuna á að
kjölfestan veikist og bendir ýmislegt til
að áhrif óvæntrar verðbólgu á verðbólgu-
væntingar hafi aukist á ný síðustu ár.² Við
slíkar aðstæður getur peningastefnan þurft
að bregðast harðar við en ella.

Eins og gefur að skilja er kjölfestan
traustari á stærri gjaldmiðlasvæðum þar
sem verðbólga hefur að meðaltali verið í og
við markmið til lengri tíma. Langtmaverð-
bólguvæntingar á evrusvæðinu hækkuðu
í kjölfar hærri verðbólgu síðustu ár en
væntingar til fimm ára fóru þó ekki yfir
2,2% og verðbólguvæntingar til tveggja ára
fóru hæst í 2,4% (skv. Survey of Profes-
sional Forecasters, ECB). Í Bandaríkjun-
um sýnir könnun á væntingum neytenda
(Survey of Consumer Expectations) að
verðbólguvæntingar til fimm ára hafa verið
í kringum 3,0% síðan mælingar hófust í
janúar 2022. Í Bandaríkjunum fóru fimm
ára verðbólguvæntingar, reiknaðar út frá
álagi á skuldabréfamarkaði, hæst í 2,5%.
Á Íslandi hafa áhrif verðbólgu á væntingar
verið meiri. Verðbólguvæntingar fyrirtækja
til fimm ára náðu hámarki í 5% og eru enn
um 4% og væntingar heimila til fimm ára
náðu hámarki í 6% og eru nú um 5%. Fimm
ára verðbólguálagi á skuldabréfamarkaði fór
í ríflega 5% á síðasta ári og er nú í kringum
4% og 5/5-ára álagið hefur nú verið yfir 3% í
rúmlega tvö ár.

Hagvöxtur og innlend eftirspurn

Hagvöxtur á Íslandi var 4,1% í fyrra og
8,9% árið 2022. Í viðskiptalöndum okkar
hefur hagvöxtur hins vegar almennt verið
mjög lítill og jafnvel neikvæður. Raunlaun
og einkaneysla hafa auk þess hækkað um-
talsvert meira hér á landi. Greiðslukorta-
velta jókst á milli ára fyrstu tvo mánuði
ársins og væntingavísitala Gallup sýnir að
það hefur dregið þó nokkuð úr svartýni
heimila. Vorkönnun Gallup sýnir að viðhorf
fyrirtækja eru einnig jákvæðari og jukust
ráðningaráform þeirra á milli kannana. Um



37% aðspurðra stjórnenda telja vera skort á
starfsfólki og 53% stjórnenda telja fyrirtæki
sitt starfa nálægt hámarksframleiðslugetu.
Þessi hlutföll hafa hækkað lítillega frá
síðustu könnun – og eru bæði hlutföll um
12 prósentustigum yfir sögulegu meðaltali.
Áraun á framleiðsluþætti er því enn nokk-
ur. Hætta er á að við þessar aðstæður fleyti
fyrirtæki umsömdum launahækkunum að
miklu leyti út í verðlag.

Peningastefnan

Verðbólga er enn töluverð og hefur nú
verið yfir verðbólguþröngun í lengri tíma.
Hækkunar á vísitölu neysliverðs síðustu
mánuði benda til þess að enn sé töluverður
verðbólguþrýstingur til staðar. Jafnframt
eru verðbólguvæntingar enn háar. Dregið
hefur úr vexti innlendarar eftirspurnar en
enn eru þó vísbendingar um undirliggjandi
þrýsting í hagkerfinu. Við síðustu ákvörðun
var það því mat meiri hluta nefndarinnar
að enn væri þörf á háum raunvöxtum í hag-
kerfinu til að tryggja að verðbólgan verði
ekki þrálát til lengri tíma. Háir stýrivextir
eru íþyngjandi fyrir fyrirtæki og heimili en
hætta er á að til lengri tíma væri kostnaður
vegna þrálátar verðbólgu enn meiri. Skýr-
ar vísbendingar um minni eftirspurn þurfa
því að vera til staðar til að hægt sé að lækka
vexti. Við mat á næstu skrefum mun pen-
ingastefnufnd sem fyrr horfa til gagna
og fylgjast grannt með þróun og horfum
efnahagssumvifa og verðbólguþrýstings í
þjóðarþúinu. ☞

Fyrirvari

Höfundur er ytri nefndarmaður í peningastefnufnd Seðlabanka
Íslands. Þær skoðanir og ályktanir sem koma fram í þessari grein
þurfa ekki að endurspegla viðhorf annarra nefndarmanna.

Tilvísanir

1. Þórarinn G. Pétursson (2022). Long-term inflation expectations
and inflation dynamics. *International Journal of Finance and
Economics*, 27, 158-174.

2. Sjá Rammagrein 2 í Peningamállum 4/2022

Peningastefnan

Ásgerður Ósk Pétursdóttir

lektor í hagfræði

við Háskólann í Bath



Peningastefnunefnd ákvað á fundi sínum í maí 2024 að halda stýrivöxtum óbreyttum í 9,25%. Sem fyrr ræddi nefndin hvort taumhald peningstefnunnar væri hæfilegt með tilliti til verðbólguhorfa. Verðbólga hafði hjaðnað á milli fundarinnar og mældist ársverðbólga 6%, verðbólga án húsnæðis 3,9% og undirliggjandi verðbólga miðað við meðaltal ólíkra mælikvarða 5%. Þrátt fyrir hjöðnun var verðbólga því vel yfir 2,5% markmiði Seðlabankans og taumhald peningstefnunnar hafði ekki aukist mikið á milli fundarinnar. Raunvextir bankans miðað við meðaltal mismunandi mælikvarða verðbólgu og verðbólguvæntinga höfðu hækkað úr 3,8% í 3,9%. Það sem dró helst úr hækkun raunvaxta á þennan mælikvarða var aukid verðbólguálag á fjármálamarkaði til eins árs, en einnig ný verðbólguþá Seðlabankans þar sem nú er spáð hægari hjöðnun verðbólgu vegna meiri spennu í þjóðarþúskapnum en áður var talið.

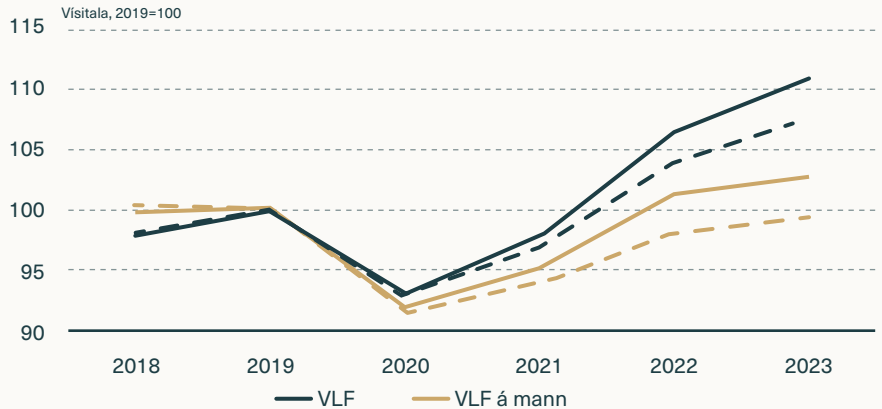
Hagtölur og þjóðhagsspár

Þann 29. febrúar sl. birti Hagstofa Íslands endurmat á þjóðhagsreikningum fyrir árin 2020-2022 og fyrstu þrjá ársfjórðunga ársins 2023. Endurskoðunin fól í sér óvenju mikla uppfærslu á hagvaxtartölum. Samkvæmt endurmetnum tölum var samdráttur árið 2020 ekki jafn mikill og vöxtur landsframleiðslu og þjóðarútgjalda var kraftmeiri árin 2021 og 2022 og í byrjun árs 2023 en fyrri tölur gáfu til kynna. T.a.m. mælist hagvöxtur árið 2022 nú 8,9% en eldri mæling hljóðaði upp á 7,2%. Sambærileg breyting varð á vexti þjóðarútgjalda það ár úr 6,6% upp í 8,2%. Það var því mun meiri kraftur í innlendra eftirspurn en áður var talið.

Mynd 1 sýnir þróun landsframleiðslu árin 2018-2023. Heila línan sýnir þróunina miðað við uppfærðar tölur Hagstofunnar en brotalínan miðað við eldri tölur. Á myndinni sést að landsframleiðsla árið 2023 var komin tæplega 11% yfir það sem hún var fyrir heimsfaraldurinn sem er rúmum 2,9% meira en eldri tölur gáfu til kynna. Þar sem mannfjöldatölur voru endurskoðaðar niður á við þá er enn meiri munur á landsframleiðslu á mann. Eftir endurmat á tölum sést að sú landsframleiðsla á mann sem tapaðist í heimsfaraldurinn hafði endurheimst að fullu árið 2022, þremur árum fyrr en áður hafði verið áætlað.

Uppfærslan á landsframleiðslu á árunna 2021 og 2022 var að mestu tilkomin vegna endurmetinna talna um fjármunamyndun, þá sérstaklega vegna sterkari atvinnu-vegafjárfestingar en fyrri tölur höfðu gefið

Mynd 1 Landsframleiðsla 2018-2023 samkvæmt nýjum og eldri tölum*



*Myndin sýnir VLF og VLF á mann miðað við nýjar (heil lína) og eldri (brott lína) tölur Hagstofunnar (spá PM 2024/1 fyrir árið 2023). Heimildir: Hagstofa Íslands, Seðlabanki Íslands

”

... hefði hið opinbera getað stutt við verðbólguþá miðað við því að draga úr innlendra eftirspurn í stað þess að ýta undir hana ...

til kynna. Þó að meiri fjármunamyndun auki framleiðslugetu hagkerfisins, þá leiddi þessi uppfærsla í ljós að framleiðsluspennna í hagkerfinu var mun meiri en áður var talið eins og sést í nýjustu spá Seðlabankans og á mynd 2.

Þetta endurmat á hagtölum og þeirri spennu sem hefur verið til staðar í þjóðarþúinu setur hagþróun, taumhald peningastefnunnar og verðbólguhorfur í nýtt ljós. Það getur að hluta til útskýrt nýja spá um hægari hjöðnun verðbólgu sem nefnd var hér að ofan og því hvers vegna verðbólga hefur verið þrálátari en fyrri spár hafa gefið til kynna. Þó að peningastefnan og verðbólguþá séu framsýnar, þá skiptir upphafsstaðan máli. Þegar mikið misræmi er á milli gagna og raunverulegra aðstæðna í hagkerfinu byggja spár og ákvarðanir á röngum grunni.

Gögn skiptu óvenju miklu máli við peningastefnuákvæðanir frá byrjun heimsfaraldursins. Þær aðstæður sem sköpuðust og takmarkanir sem settar voru á efnahags-umsvif til að stemma stigu við covid-farsóttinni voru fordæmalausar í nútíma hagkerfi. Bæði reyndist erfitt að sjá fyrir um þróun og endalok heimsfaraldursins en einnig var mikil óvissa um hvernig hagkerfi myndu bregðast við þegar takmörkunum yrði aflétt. Því var einstaklega erfitt að spá

fyrir um framtíðarhorfur. Eins og sést á myndum 2 og 3 voru spár Seðlabankans um hagvöxt og framleiðsluspennu ítrekað uppfærðar og meiri spennu var í þjóðarþúinu frá árinu 2022 en þær gáfu upphaflega til kynna¹.

Af ofangreindu má því sjá að meiri innlendu verðbólguþrýstingur var til staðar en gert var ráð fyrir þegar vaxtaákvæðanir voru teknar.

Taumhald peningastefnunnar

Horft er til visbendinga um þróun og horfur efnahagssumsvifa og verðbólguþrýstings í þjóðarþúinu þegar peningastefnuákvæðanir eru teknar. Hins vegar hefur fortíðin einnig haft áhrif á undanförunum fundum. Þar sem fyrri ákvæðanir voru teknar miðað við misvísandi gögn og forsendur, og taumhaldið of laust miðað við raunverulegar aðstæður, var peningastefnan komin á eftir kúrfunni. Verðbólga verður þrálátari og bregðast þarf við meiri spennu með þéttara aðhaldi en ella, þ.e. raunstýrivextir þurfa að vera meira og lengur yfir jafnvægisraunvöxtum.

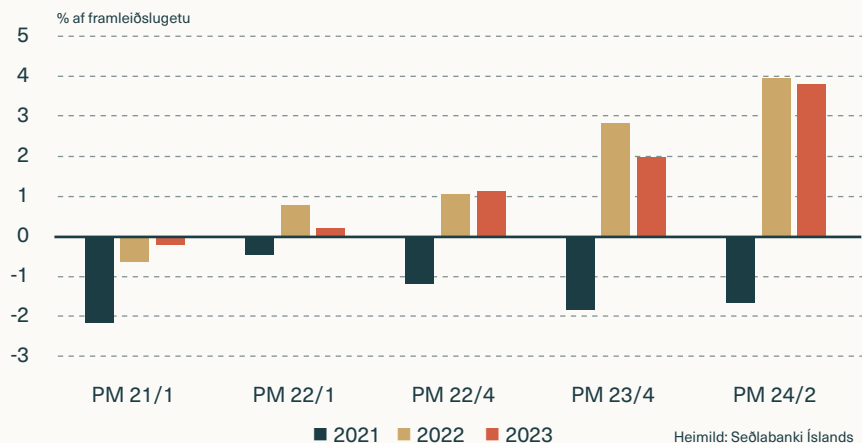
Við sjáum þó að peningastefnan, með vexti sem sitt aðal stýritæki, er að miðlast vel og áhrif hennar hafa komið æ skýrar fram. Eftir að raunstýrivextir urðu jákvæðir hefur hægt á efnahagssumsvifum og verðbólga byrjað að hjaðna í átt að markmiði.

Miðað við horfur á maí fundi peningastefnunefndar var núverandi aðhald metið nægjanlegt til að ná verðbólgu niður í markmið innan ásettans tíma. Það getur þýtt að aðlagða þurfi nafnstýrivexti til að viðhalda aðhaldsstiginu. Nauðsynlegt taumhald er sífellt endurmetið miðað við efnahags- og verðbólguhorfur hvers tíma.

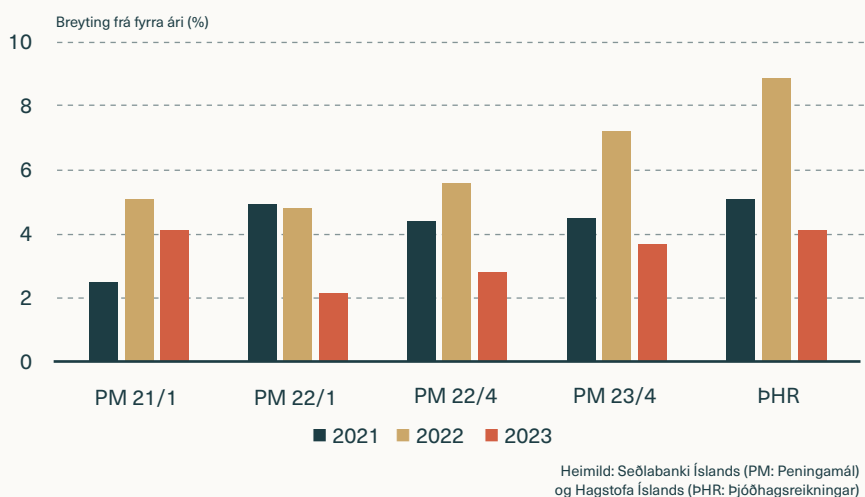
Sjálfstæð peningastefna

Ábyrgð Seðlabanka (e. accountability) varð viðtekið hugtak í kjölfar útbreiddrar innleiðingar verðbólguþá miðaðs þar sem auðvelt er nú að meta hvort markmiðið

Mynd 2 Framleiðsluspenna



Mynd 3 Hagvöxtur



hafi náðst. Eðlilegt er að umræða skapist um ákvarðanir og árangur peningastefnunnar. Seðlabankar taka einnig þátt í þeirri umræðu, m.a. með útgáfu Peningamála, blaðamannafundum, greinagerðum og fundum með nefndum Alþingis.

Nú þegar verðbólga hefur verið yfir markmiði í mörgum löndum til lengri tíma hefur umræðan um ábyrgð, ástæður þrálátrar verðbólgu og peningastefnuviðbrögð orðið háværari. Að skilja og ræða ákvarðanir og draga til ábyrgðar er hins vegar annað en að reyna að hafa áhrif á sjálfstæði Seðlabanka með fyrirmælum um hvernig peningastefnunefndir eigi að beita sínum stýritækjum. Seðlabankar þurfa að beita því taumhaldi sem stuðlar að langtíma verðstöðugleika. Til skemmri tíma litið getur það leitt til óvinsælla ákvarðana. Rannsóknir og gögn sýna þó að sjálfstæð peningastefna leiðir til betri árangurs og minni verðbólgu til lengri tíma litið.

Seðlabanki Ísland er ekki undanskilinn umræðu og þrýstingi þegar kemur að vaxta-ákvörðunum. Áhugavert er þó að háværasta gagnrýnin um núverandi vaxtastig virðast koma frá aðilum vinnumarkaðarins og hinu opinbera sem eiga þó sinn þátt í þeim verðbólguþrýstingi sem skapaðist og því vaxta-

stigi sem er til staðar í dag. Launahækkarnir í kjölfar heimsfaraldursins samrýmdust ekki verðbólguþrýstingnum og voru umtalsvert meiri en í okkar samanburðarlöndum. Þegar litið er til hins opinbera er æskilegt að sjálfvirk sveiflujöfnun dempi hagsveifluna. Í þeirri uppsveiflu sem varð í kjölfar heimsfaraldursins hefði hið opinbera getað stutt við verðbólguþrýstingnum með því að draga úr innlendri eftirspurn í stað þess að ýta undir hana eins og raunin varð. Jákvætt er þó að svo virðist sem aðgerðir vinnumarkaðarins og hins opinbera séu nú farnar að samrýmast betur verðbólguþrýstingnum. Það átti sinn þátt í því að núverandi taumhald var metið hæfilegt á seinasta fundi peningastefnunefndar.

Peningastefnunefnd mun nú sem endranær fylgjast grannt með þróun og horfum efnahagssumsvifa og verðbólguþrýstings í þjóðarþróun og halda áfram að taka sjálfstæðar ákvarðanir um beitingu stjórntækja sem samrýmast verðbólguþrýstingnum. ☺

Fyrirvari:

Höfundur er ytri nefndarmaður í peningastefnunefnd Seðlabanka Íslands. Þær skoðanir og ályktanir sem koma fram í þessari grein þurfa ekki að endurspegla viðhorf annarra nefndarmanna.

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Tilvísanir

1. Í Rammagrein 6 í Peningamálaum 2023/4 er farið ítarlega yfir hvers vegna efnahagssumsvifum og verðbólgu var vanspáð hér á landi.



March 27, 2001

Declaration on inflation target and a change in the exchange rate policy

(From March 27, 2001 – as amended by agreement between between the Prime Minister of Iceland and the Board of Governors of the Central Bank of Iceland on November 11, 2005, cf. Press release no. 35/2005)

On March 27, 2001 the Prime Minister and the Governors of the Central Bank of Iceland signed a declaration on changes in the framework of monetary policy in Iceland. The declaration is as follows:

The Government of Iceland and the Central Bank of Iceland have decided the following changes in the framework of monetary policy in Iceland, effective March 28, 2001:

- (1) The main target of monetary policy will be price stability as defined below. The Central Bank shall also promote financial stability and the main objectives of the economic policy of the Government as long as it does not deem it inconsistent with the Bank's main objective of price stability.
- (2) Rather than basing monetary policy on keeping the exchange rate within a fluctuation band, the Central Bank will aim at keeping inflation within defined limits as specified below.
- (3) The change described above implies that the fluctuation limits for the króna are abolished. Nevertheless, the exchange rate will continue to be an important indicator in the conduct of monetary policy.
- (4) The Government grants full authority to the Central Bank to use its instruments in order to attain the inflation target.
- (5) Later this week, the Government will submit to Parliament a bill on a new Central Bank Act which, once enacted, will legally confirm the decisions described above on making price stability the main objective of monetary policy and on the independence of the Central Bank to use its instruments.
- (6) The inflation target of the Central Bank will be based on 12-month changes in the consumer price index as calculated by Statistics Iceland. Statistics Iceland will also be asked to calculate one or more indices which may be used to assess the underlying rate of inflation, as will be further agreed between the Central Bank and Statistics Iceland. The Central Bank will take note of such indices in its assessment of inflation and in the implementation of monetary policy.

- (7) The Central Bank will aim at an annual inflation rate of about 2½ per cent.
- (8) If inflation deviates by more than 1½ percentage point from the target, the Central Bank shall bring it inside that range as quickly as possible. In such circumstances, the Bank will be obliged to submit a report to the Government explaining the reasons for the deviations from the target, how the Bank intends to react and how long it will take to reach the inflation target again in the Bank's assessment. The report of the Bank shall be made public.
- (9) The Central Bank shall aim at attaining the inflation target of 2½ percent not later than by the end of 2003. In the year 2001, the upper Declaration on inflation target and a change in the exchange rate policy limit for inflation shall be 3½ percentage points above the inflation target but 2 percentage points above it in the year 2002. The lower limit for inflation will always be 1½ percentage point below the inflation target. Should inflation move outside the target range in 2001 and 2002, the Bank shall respond as set out in item 8 above.
- (10) Despite the elimination of the fluctuation limits for the króna, the Central Bank will intervene in the foreign exchange market if it deems such action necessary in order to promote the inflation objective described above or if it thinks that exchange rate fluctuations might undermine financial stability.
- (11) The Central Bank shall publish inflation forecasts, projecting inflation at least two years into the future. Forecasts shall be published in the Bank's Monetary Bulletin. This shall also contain the Bank's assessment of the main uncertainties pertaining to the inflation forecast. The Bank shall also publish its assessment of the current economic situation and outlook.

[Amended text by agreement between the Prime Minister of Iceland and the Board of Governors of the Central Bank of Iceland on November 11, 2005]

- (12) The Central Bank shall in its publications explain how successful it is in implementing the inflation target policy. The Governors will also report to the Minister, the Government and committees of the Parliament on the policy of the Bank and its assessment of current economic trends and prospects.