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June 2, 2021

**Statement by Mr. Dresse and Mr. Tsur on Iceland
(Preliminary)
Executive Board Meeting
June 4, 2021**

*We thank staff for their insightful report and Mr Sigurgeirsson for his informative Buff statement. We commend the authorities for their strong policy response to the crisis and particularly the measures they have taken to limit the spread of COVID-19. The COVID-19 crisis has illustrated, like the 2009 financial crisis, the importance of policies that encourage a diverse economy. **The recovery phase of the current crisis provides an opportunity to invest in a green, digital, and inclusive economy to promote diversity and reduce the vulnerability of the economy to shocks.** We agree with staff's analysis and the main messages of the report, and would like to offer the following comments on the way forward:*

We encourage the authorities to increase the flexibility of the labor market while equipping the labor force with tools to adjust to possible shifts in the structure of the economy. We are glad that Iceland stands out with limited health consequences of COVID-19, but the sectorial structure of the economy, and especially the dependency on tourism, contributes to the slow pace of the recovery. While the response of the authorities to the crisis has been strong and timely, the deep economic crisis and especially the high unemployment call for short- and long-term policies to mitigate scarring.

The CBI's positive policy rate and the government's accumulated buffers allow to tailor an appropriate policy response for the recovery stage. We agree with staff that monetary policy should now be kept on hold, however if the recovery is slower than expected, the CBI could consider more stimulus, contingent on the capacity to contain inflationary pressure. This will free up resources to the government for more investment in longer term goals. At the same time, the government should keep working on transparent and credible medium-term deficit planning to safeguard a sustainable path of debt and to help the CBI in maintaining inflation expectations within the target.

We encourage the authorities to promote structural reforms allowing for optimal sectoral composition based on market dynamics rather than the government's discretion. We commend the authorities on their ongoing efforts to implement structural reforms, particularly supporting

innovation, enhancing human capital, and optimizing the regulatory framework. Equal opportunities to compete on labor, capital and financial resources can advance the diversity that the Icelandic economy needs to absorb external shocks more softly than in the two recent global crises. Greening the economy and adjusting the financial regulation to mitigate potential systemic climate risks should be a prominent segment of this structural agenda. Finally, we support staff's call to ensure that the transformation of the financial oversight architecture is fully operational and provides the needed powers and resources.