

Progress of the Plan for Removal of Capital Controls

This report is published by the Minister of Finance and Economic Affairs as provided for in Paragraph 2 of the Temporary Provision I in Act No. 87/1992 on Foreign Exchange, which reads as follows:

The Minister shall make public a report on the progress of plans to remove restrictions on cross-border capital movements and foreign currency trading at six-month intervals until such restrictions are finally removed. The report referred to in the first sentence shall be published for the first time within six months of the entry into force of this act.

Former reports are available at the website of the Ministry of Finance and Economic Affairs¹.

The special reserve ratio decreases

Rules amending Rules no. 490/2016 on Special Reserve Requirements for New Foreign Currency Inflows (SRR) were published on 2 November 2018 and took effect immediately. The amending Rules entail that the special reserve ratio is decreased from 40% to 20%. Other provisions, such as on the special reserve base, the holding period and interest rates on capital flow accounts remain unchanged. The amendment is made possible as several advanced economies have been normalizing their monetary policy while the Icelandic policy rate has been coming down and is low by historical standards. As a result, the interest rate differential has narrowed which, in turn, reduces the incentive for carry trading.

Remaining restrictions on capital flows

Although capital controls have largely been lifted, full liberalisation of the capital account has still not taken place. Remaining restrictions on capital movements and foreign exchange transactions are mainly twofold:

1. Offshore króna assets, which remain subject to special restrictions according to Act no. 37/2016. Remaining offshore króna assets amount to 88 b.kr., i.e. 3.2% of GDP. The assets amounted to 40% of GDP when capital controls were introduced in 2008.
2. Restrictions that are necessary in order for the Central Bank's SRR, sometimes referred to as the capital flow management measure (CFM), to achieve its objective, including restrictions on derivatives trading for purposes other than hedging.

The liberalisation of offshore króna assets, which require legislative amendments, is being prepared. Furthermore, amendments concerning the permanent arrangement of the SRR are being prepared in the Ministry of Finance and Economic Affairs and the Central Bank of Iceland, in relation to amendments to Act no. 36/2001, on the Central Bank of Iceland, introduced on October 11 this year. Lastly, a holistic revision of Act no. 87/1992, on Foreign Exchange, is also being prepared.

As mentioned above, remaining offshore króna assets amount to 87 b.kr. Table 1 shows their breakdown by asset classes. In comparison, the current account surplus from 2017Q3 to 2018Q2 is 73 b.kr. and the Central Bank's foreign exchange reserves amount to approximately

¹ <https://www.government.is/topics/economic-affairs-and-public-finances/progress-of-plans-to-remove-capital-controls/>

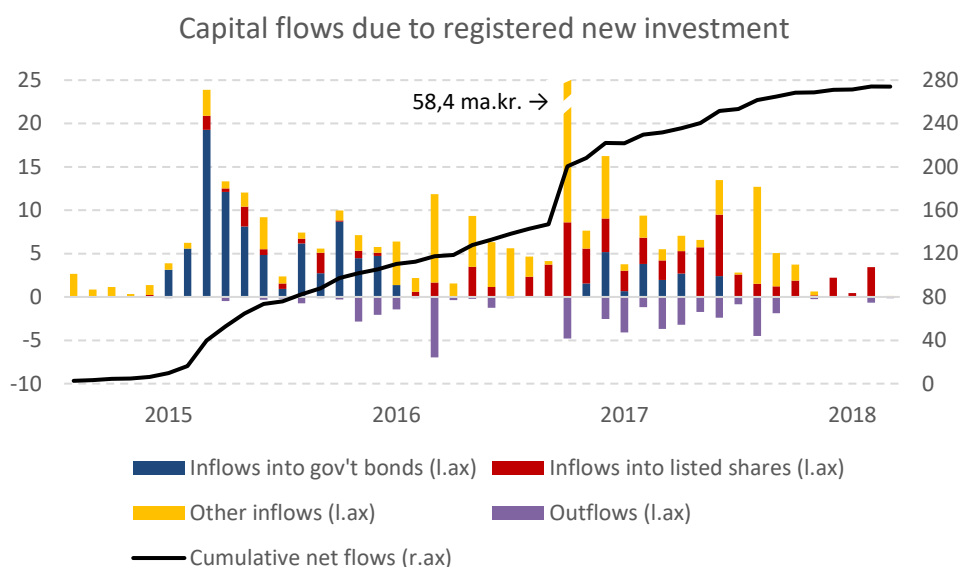
700 b.kr.

Offshore króna assets	Market value (b.kr.)
Treasury bonds and bills and other bonds with gov't guarantee	39,9
Deposits and Central Bank CDs	35,8
Other securities and unit shares	12,0
Total amount	87,7

The table shows the amount of offshore krona assets on 30 September 2018

Reduced turnover in the foreign exchange market

Net capital inflows for new investment by non-residents have eased this year. Inflows into government bonds have been minimal and inflows into equities listed on the Nasdaq Iceland exchange, which are not subject to the SRR, have significantly decreased. Net capital inflows for new investment until the end of August amounted to 21 b.kr, down from 93 b.kr. for the same period last year.



Other inflows in March 2017 derive almost entirely from non-residents' acquisition of a holding in a domestic commercial bank

The turnover in the foreign exchange market has also decreased compared to last year. Total turnover from January to September this year amounts to 120 b.kr., which is less turnover than in the first quarter of the two previous years. The Central Bank bought substantial amounts of foreign currency in 2016 and in the beginning of 2017 in relation to the build up of the bank's foreign exchange reserves. However, even without the bank's interventions, the turnover in the foreign exchange market is still relatively low this year compared to previous years. The Central Bank intervened in the foreign exchange market in September for the first time this year, buying krónur corresponding to 1.2 b.kr. on one business day. The bank bought krónur corresponding to the same amount on one business day in October. The interventions were in line with the bank's Monetary Policy Committee statement of 17 May 2017, which stated that the Central Bank would intervene in the foreign exchange market to reduce fluctuations if it deemed it necessary.