

Box 1 The development of organised financial markets

Securities market: Iceland Stock Exchange established in 1985. In 1986 the Central Bank became the first market maker on the ISE. T-bills were listed on the ISE in 1987 with the Central Bank as their market maker. Housing bonds were listed in 1989, with Landsbréf Securities as market maker under an agreement with the then State Housing Fund. The first equities were listed in 1990. The Central Bank ceased market making for treasury bonds in 1996, when several market participants took over its role. In summer 2000 the Debt Management Agency and Housing Financing Fund invited tenders for market making for treasury bonds, housing bonds and housing fund bonds. The Treasury Debt Management Agency also invited tenders to act as main market maker for T-bills in October 2000, when the Central Bank plans to give up this function.

Foreign exchange market: A foreign exchange market was instituted in May 1993, operating under rules set by the Central Bank. The obligation of holders of foreign exchange permit holders to surrender currency was abolished at the same time. Initial market participants were the three commercial banks, Icebank (savings banks) and the Central Bank. The exchange rate of the króna was fixed at daily meetings at the Central Bank, with unrestricted interbank trading outside meetings. The forex market was restructured in spring 1997, when the participants, then numbering five besides the Central Bank,

became market makers. An information system was introduced for quoting and transmitting two-way quotes for the USD, on which the Central Bank bases the official reference rate that it records between 10.45 and 11 every weekday morning. The number of participants in the forex market has dropped this year to five including the Central Bank.

Króna market: An interbank market for short-term deposits and lending between credit institutions. The market was set up in June 1998. It operates on the basis of rules set by the Central Bank in cooperation with market players. However, the Central Bank's role is solely to organise the market along similar lines to the stock exchange's organisation of the securities market. There are currently 7 market participants, i.e. the four commercial banks, two savings banks and Kaupthing investment bank. Trading takes place with maturities ranging from one day, one week, one month, 3 months, 6 months to 12 months. Market participants make live, indicative two-way quotes for all maturities within the course of the day in an on-line information system based on Reuters. Minimum bid amounts are defined and a maximum interest rate spread of 0.25 percentage points is set for lending with a duration longer than one month. Trading takes place through deposits in current accounts with the Central Bank, which settles trades in accordance with directives from market participants.