

### Box 3 Special foreign exchange trades by the Central Bank of Iceland in 2001 and the pre-announced program to buy back foreign currency in 2002-2003

From the summer 2000, when the Central Bank re-entered the foreign exchange market, and until October 2001, most of its transactions with market makers were direct interventions in order to influence the exchange rate of the króna.

On several occasions the Bank has made special trades with market makers. In December 2001 the Bank sold 10 million US dollars to one market maker and 38½ million US dollars to another a few days later. Simultaneous with the latter trade, the Central Bank made a corresponding currency swap with the market maker, split into four equal parts with a term of one, two, three and four months, whereby the Bank bought dollars and sold them forward. This is the only occasion on which the Bank has formally sterilised its interventions in the foreign exchange market. At the end of August 2002 the Bank sold foreign currency forward for the equivalent of 3 b.kr., for three different maturities in four different currencies. These two trades are the only times that the Central Bank has used forward contracts in its transactions.

In September 2002 the Central Bank began buying foreign currency with the aim of strengthening its net foreign position. Earlier the same year, the Bank had announced in *Monetary Bulletin* that it would buy foreign currency when it considered that circumstances permitted it to do so. The Central Bank contacted foreign exchange market makers before a final decision

was made about the most suitable arrangement for the purchases. A press release was issued on August 27, 2002, stating that the Central Bank intended to purchase the equivalent of up to 20 b.kr. before the end of 2003. The Bank purchases 1½ million US dollars each time on Mondays and Wednesdays, with the possibility of buying on Fridays as well. It also reserves the right to trade with market makers on their initiative for higher amounts, provided that the króna has strengthened from the day before. The Bank may also cancel this program if it considers that market conditions have deteriorated. Purchases are made before the market opens, between 9:00 and 9:15 in the morning, when the Bank receives bids from market participants and accepts the most favourable one. The Bank's first regular purchase under this program was on September 2 and by the end of 2002 it had bought 52½ million US dollars, or the equivalent of 4½ b.kr.

These regular purchases represent the Central Bank's first transactions outside the foreign exchange market's business hours, and also the first time that it has announced in advance the format in which it plans to trade. It should be reiterated that the Bank's aim is not to try to influence the exchange rate of the króna through these purchases, and they are not part of monetary policy measures. Above all they are designed to improve the bank's net foreign position, which deteriorated considerably in 2001.