

# Economic and monetary chronicle 1999

## January

In accordance with legislation adopted by the Icelandic Parliament in June 1998, a new supervisory agency, the Financial Supervisory Authority, was formally established and commenced operations at the beginning of 1999. The new authority takes over the supervisory functions formerly performed by the Central Bank of Iceland and the Insurance Supervisory Authority.

The Housing Financing Fund sold housing bonds for 2.4 billion kr. from two classes, BN20-0101 and BN38-0101.

The US credit rating firm Moody's gave the Icelandic Investment Bank a credit rating of A3/P2 and D for financial strength.

On January 15, the Central Bank presented an inflation forecast projecting a 1.9 percent average increase in consumer prices between 1998 and 1998 and an increase of 2.2 percent in the course of 1999. Prices were projected to rise by 0.6 percent during the first quarter.

On January 28, the IMF published the concluding statement of the Article IV mission to Iceland. The IMF forecast a GDP growth of 5.6% in 1999 and 4.4% in 2000, and an inflation rate of 3.5% and 3.2% in 1999 and 2000 respectively

## February

On February 23, the Central Bank raised its interest rates by 0.4 percentage points and introduced a minimum liquidity requirement on credit institutions. The minimum liquidity requirement is primarily a prudential measure. Nevertheless, in the early months in which it is in effect it could restrain the capacity of credit institutions to grant new credit. It will also have the effect of reducing the reliance of credit institutions on short-term foreign credit. The regulations became effective on March 21.

## April

The Housing Financing Fund sold housing bonds for 2.2 billion kr. from two classes, BN20-0101 and BN38-0101.

On April 21, the Central Bank presented an inflation forecast of a 2.4 percent average increase in consumer prices between 1998 and 1999 and an increase of 2.8 percent in the course of 1999. Prices were projected to rise by 1.0 percent during the second quarter, or 4.2% on an annual basis.

## June

On June 21, the Central Bank raised its interest rates by 0.5 percentage points.

On June 25, the currency basket of the exchange rate index was changed following an annual review of the basket, taking into account changes in the composition of external trade in 1998.

The US credit rating firm Moody's gave the Agricultural Bank Ltd a credit rating of A3/P2 and D for financial strength.

## July

On July 22, the Central Bank presented an inflation forecast of a 3.0 percent average increase in consumer prices between 1998 and 1998 and an increase of 4.0 percent in the course of 1999. Prices were projected to rise by 1.0 percent during the third quarter, or 5.2% on an annual basis.

## September

The Housing Financing Fund sold housing bonds for 2.0 billion kr. from two classes, BN20-0101 and BN38-0101.

On September 15, The treasury announced, at the request of the Minister of Finance, its intention of redeeming government securities and reducing the outstanding government benchmark securities.

### **October**

On October 25, the Central Bank presented an inflation forecast of a 3.3 percent average increase in consumer prices between 1998 and 1999 and an increase of 4.6 percent in the course of 1999. Prices were projected to rise by 1.0 percent during the fourth quarter, or 4.1% on an annual basis.

The Treasury sold its 51% holding in FBA (The Icelandic Investment Bank) for 9.7 billion krónur.

On October 25, the Central Bank began publishing statistics on the Icelandic economy on its website [www.sedlabanki.is](http://www.sedlabanki.is). Statistics mainly relate to areas directly under the Bank's field of activities and are upgraded weekly. Chronology of financial markets February 1999 - February 2000.

### **November**

The first issue of the Central Bank's Monetary Bulletin was published on November 24. This quarterly publication contains coverage of economic and monetary issues and financial market developments, in addition to articles and statistics.

### **December**

The treasury sold 15% of its holdings in Landsbanki and Búnadarbanki. Shares in the banks were sold both by subscription and bid. The sales value was just under 6 billion krónur.

The US credit rating firms Moody's Investor Service and Standard & Poor's confirmed their credit ratings for the Republic of Iceland. Ratings are Aa3 and A+ for long-term liabilities and P-1/A-1+ for short-term liabilities denominated in foreign currency. For liabilities in Icelandic krónur the Republic received the top rating, Aaa from Moody's and AA+ from Standard & Poor's.

On December 8 the Althingi (parliament) passed Act no. 90/1999 on the Security of Payment Orders in Payment Systems. The Act covers the payment systems operated in Iceland.

On December 21 parliament passed Act no. 96/1999 amending the Central Bank Act no. 36/1986, with later amendments. The amendment extended the definition of liquidity specified in Art. 8 of the Act. New rules on liquidity of credit institutions which have required deposits went into effect on December 31. Based on different principles from earlier rules, these involve a comprehensive assessment of their liquid assets and liquid liabilities (see box on p. 18).

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## January

New rules on indexation of savings, credit, etc. went into effect on January 1. The permissible difference between credit institutions' indexed assets and liabilities was extended from 20% to 30% of equity. Scheduled provisions in the Central Bank's rules from June 1995, changing authorization for indexation of savings and lending, were not implemented. The minimum term for indexation to apply will remain 3 years for deposits and 5 years for loans.

On January 1, an amendment to the Central Bank Act no. 36/1986 entered into effect, transferring responsibility for the Bank from the Minister of Commerce to the Prime Minister.

On January 1, Greidslumidlun hf. (Visa Iceland) was granted a permit to operate as a credit institution.

On January 12, the Central Bank raised its interest rates by 0.8 percentage points.

On January 24, the Central Bank presented an inflation forecast of a 5% average increase in consumer prices between 1999 and 2000 and an increase of 3.8% in the course of 2000. Prices were projected to rise by 0.9% during the first quarter, or 3.7% on an annual basis.

## February

New rules on the interbank market for krónur went into effect on February 1. The main change was that market participants undertake to make offers for specified sums with a maturity of 9 and 12 months. The Central Bank will calculate and publish REIBOR and REIBID 9- and 12-month rates.

New rules on Central Bank transactions with credit institutions which have required deposits went into effect on February 1. The main changes involved the formal incorporation of provisions concerning correction of transaction errors, and switching of the Central Bank's deadline for announcing forthcoming weekly repo auctions from Friday after closing to the Monday morning. A new bond category was announced, SLST023/2, which may be used in transactions with the Central Bank.

On February 3 the international credit rating firm Fitch IBCA gave the Republic of Iceland a credit rating of AA- for long-term liabilities in foreign currencies. The Republic was given the rating F1+ for short-term foreign liabilities and AAA for its domestic liabilities, which is the highest rating given by the firm.

On February 11, the Central Bank raised its interest rates by 0.3 percentage points and announced that it had extended the exchange rate bands from  $\pm 6\%$  to  $\pm 9\%$ .

## March

On March 21 new rules took effect on interbank transactions in domestic currency. The main change involved setting a maximum interest rate margin between deposits and lending in participants' bids for one month or more. The maximum margin is 25 points. No maximum margin is stipulated for transactions of a shorter term.

On March 30 the Minister of Commerce granted FBA a licence to operate as a commercial bank in accordance with Art. 4 of the Commercial Banks and Savings Banks Act no. 113/1996.

## April

On April 10 Íslandsbanki and FBA signed a memorandum of intent to propose to their respective shareholders' meetings that the two companies should be merged to create a new company under the name Íslandsbanki-FBA hf.

## May

The Central Bank presented an inflation forecast of a 5.5% average increase in consumer prices between 1999 and 2000 and an increase of 5.0% in the course of 2000. Prices were projected to rise by 1.4% during the first quarter, or 5.7% on an annual basis.

In the middle of May two of the declared market makers for treasury instruments on the Iceland Stock Exchange announced, with one month's notice, that they intended to cease market making.

## June

On June 2, Íslandsbanki-FBA formally commenced operations.

The US credit rating firm Moody's Investors Service gave Íslandsbanki-FBA a credit rating of A2 for long-term obligations, Prime-1 for short-term obligations and C for financial strength.

On June 7, following a tender, the Debt Management Agency signed an agreement with Kaupthing, Búnadarbanki Íslands, Íslandsbanki-FBA and Icebank. From the date of signature these banks are authorized to title themselves approved market makers for treasury bonds. The agreement defines the market makers' obligations regarding presentation of bids on ISE and the maximum spread between buying and selling yields. The Debt Management Agency will pay the market makers a turnover commission for market making. The agreement stipulates four benchmark treasury bond classes, three of them indexed and one unindexed. At the same time, the Debt Management Agency undertook to improve its dissemination of information.

On June 19, the Central Bank raised its interest rates by 0.5 percentage points.

The Housing Financing Fund made an agreement with Landsbanki Íslands and Búnadarbanki Íslands on market making for housing bonds and housing mortgage bonds. From the date of signature these banks are authorized to title themselves approved market makers for housing bonds and housing fund bonds. The Housing Financing Fund selected its market makers in the same way as the Debt Management Agency and its agreement is comparable in all respects. At the same time, the Housing Financing Fund announced that henceforth it would seek to notify the market on a regular basis about information which may have an impact on bond price formation.

On June 30, the Minister of Commerce approved the merger between Samvinnfund and Fjárvangur Securities into Frjalsi Investment bank, which is a credit institution in accordance with Act no. 123/1996.

## July

On July 6, Icebank notified the Central Bank of its decision, effective one month later, to withdraw from participation in the interbank foreign exchange market.

On July 13, the interbank foreign exchange market was closed between 10:00 and 12:00 hrs, on the decision of market makers. The decision was made because of heavy trading in the foreign exchange market and a sharp weakening of the króna that morning. The króna fell somewhat in June and July in several speculative attacks.

On July 18 trading began on Nasdaq in DeCode Genetics' shares.

On July 18 an announcement was made of Landsbankis' purchase of a majority of shares in British investment bank The Heritable and General Investment Bank Ltd. (HGI).

On July 20, the currency basket was revised on the basis of Iceland's foreign trade in goods and services in 1999. The table below shows the new basket and the change from the former basket.

### *New currency basket 2000 (%)*

*Based on foreign trade in 1999*

<i>Country</i>	<i>Currency</i>	<i>Exports</i>	<i>Imports</i>	<i>Average</i>	<i>Change from prev. basket</i>
USA	USD	25.57	24.95	25.26	0.57
Britain	GBP	15.14	13.58	14.36	1.36
Canada	CAD	1.83	1.02	1.42	0.09
Denmark	DKK	8.41	9.37	8.89	0.52
Norway	NOK	6.85	8.37	7.61	0.26

<i>Country</i>	<i>Currency</i>	<i>Exports</i>	<i>Imports</i>	<i>Average</i>	<i>Change from prev. basket</i>
Sweden	SEK	2.58	5.57	4.07	0.35
Switzerland	CHF	3.16	1.06	2.11	-0.39
Euro zone	EUR	32.21	30.64	31.43	-2.92
Japan	JPY	4.25	5.44	4.85	0.16
North America		27.40	25.97	26.68	0.66
Europe		68.35	68.59	68.47	-0.82
European Union		58.34	59.16	58.75	-0.69
Japan		4.25	5.44	4.85	0.16
Total		100.00	100.00	100.00	0.00

### **August**

On August 8, Icebank withdrew from participation as a market maker in the interbank foreign exchange market.

### **September**

On September 4, the Danish Internet bank Basisbank began operations. Íslandsbanki-FBA owns a onequarter share in Basisbank.

On September 11, the number of market makers for housing bonds and housing fund bonds increased from two to five when Íslandsbanki-FBA, Kaupthing Investment Bank and Icebank began participation. Prior market makers were Búnadarbanki and Landsbanki.

On September 29, Búnadarbanki announced that it has applied to the banking authorities in Luxembourg for a permit to operate a bank there.

### **October**

On October 2, the draft treasury budget for 2001 was presented to parliament, assuming a surplus of 30 billion kr.

On October 13, the government of Iceland instructed the boards of directors of Búnadarbanki and Landsbanki to initiate discussions on merging these banks, and announced that a prior ruling would be sought from the Competition Council.

On October 20, revised rules on the interbank foreign exchange market went into effect. Two main changes were made from the earlier rules. A provision authorising market makers to agree on temporary suspension of trading was withdrawn, and the minimum binding amount for trading was raised from USD 1 million to USD 1½ million.

On October 26, Kaupthing hf. was listed on Iceland Stock Exchange.

On October 27, Íslandsbanki-FBA launched a 250 million floating rate note issue, the largest eurobond issue ever made by an Icelandic financial institution.

### **November**

On November 1, the Central Bank raised its interest rates by 0.8 percentage points. After the rise, prepaid interest on Central Bank intraday lending is 12.4% and interest on repurchase agreements with deposit institutions is 11.4%.

On November 7, Bonus Dollar Stores, a subsidiary of Baugur hf., announced it had signed an agreement with Institutional Equity of Dallas which would act as lead manager for the listing of Bonus Dollar Stores on Nasdaq Small Caps in connection with its IPO. The company aims for listing in February 2001.

On November 10, the Minister of Finance announced that, instead of amortising the 15 billion kr. of its foreign debt which matures in 2001, the treasury would roll over the debt with new foreign borrowing.

On November 14, Íslandsbanki-FBA, Landsbanki and Icebank signed an agreement to act as primary dealers in T-bills in the secondary market. The agreement aims to secure T-bill issues and boost secondary market price formation. Primary dealer auctions will take place at intervals of two months.

### **December**

On December 4, Íslandsbanki-FBA announced plans to purchase a 56.2% shareholding in Rietumu Banka of Latvia. The Íslandsbanki-FBA board approved the terms of the acquisition subject to due diligence and approval by the Central Bank of Latvia.

On December 18, the Competition Board ruled that the proposed merger of Búnadarbanki Íslands and Landsbanki Íslands would contravene the Competition Act.

On December 22, the Central Bank of Latvia approved Rietumu Banka's purchase of a 100% holding in another Latvian Bank, Saules Banka. The merger has created one of the largest corporate and private banking entities in the Baltic. Trading on Iceland Stock Exchange reached a record volume on 29 December at 12.5 b.kr.

On December 31, Kaupthing and its clients signed a declaration of intent with Olíufélagid oil company, Samvinnulífeyrissjóður pension fund, Traustfang investment company and Vátryggingarfélag Íslands insurance company, together with Isoport A.S., whereby Kaupthing undertook to purchase at least 2/3 of total share capital in Frjálsi Investment Bank from the above parties. The declaration of intention was signed subject to approval by the sellers' boards and due diligence.

# Economic and monetary chronicle 2001

## January

On January 10, Búnadarbanki Íslands announced that it had been notified by the Financial Supervisory Authority on January 5 of the need for a further investigation into trading by the bank and its equity fund with shares in Pharmaco hf. over the period from June 7, 1999 to March 2000. In the FSA's opinion, Búnadarbanki and its equity fund were in possession of confidential information during the said period.

On January 24 the Central Bank traded in the interbank foreign exchange market following a dive in the króna index after the market opened at 9:15. The Central Bank sold US dollars for 2.06 b.kr., which served to restore calm to the market.

On January 26, the Central Bank signed an agreement with the German bank DePfa Europe on a USD 250 million credit facility, to increase its scope for taking measures in the foreign exchange market.

## February

The US credit rating agency Moody's Investor Service affirmed its credit rating for the Republic of Iceland in a news release on February 7. In its new report on Iceland, Moody's considered Iceland's credit rating stable, reflecting substantially improved public sector debt levels and the government's firm economic policies which have laid the foundation for robust growth and stability. Comprehensive structural reforms undertaken over the past decade have "involved budget consolidation, financial and product market deregulation, enhanced diversification of the productive and export base, and increased monetary stability. When combined with the refinement of fisheries management and a more liberal attitude toward foreign investment, the favorable macroeconomic environment facilitated a burst of growth and a dramatic improvement in living standards," Moody's reported. However, it warned that "this rapid growth has engendered serious imbalances that could imperil Iceland's hard-won economic stability going forward."

The National Debt Management Agency announced results of an issue of RIKB 07 0209, a new nonindexed, zero coupon bullet note maturing on February 9, 2007.

On February 13, it was announced that the marketing division of Frjálsi Investment Bank would be discontinued, following the acquisition of a majority holding in it by a group led by Kaupthing hf.

## March

On March 16, the National Debt Management Agency held its last auction under the agreement on a new system of authorised dealers for T-bills treasury bills and market makers for them.

From March 23 to 27, the Central Bank of Iceland repeatedly needed to sell US dollars for domestic currency with the aim of defending the fluctuation band of the króna. In all, it sold dollars for 6.8 b.kr. The main cause of the unease was uncertainty about the outcome of the Central Bank's annual meeting which had been announced for March 27.

On March 27, the Central Bank and the Prime Minister of Iceland signed a declaration on a reform of the monetary policy framework which went into effect on March 28. Instead of its intermediate objective of maintaining the exchange rate within a fluctuation band, the Central Bank will henceforth target monetary policy towards an inflation rate as close as possible to 2½%, with specified tolerance limits. The government of Iceland grants the Central Bank of Iceland full independence to apply its instruments in order to achieve its inflation target.

At the same time as the announcement of the reform in monetary policy, the Central Bank announced that it had lowered the interest rate on its repo agreements with credit institutions by 0.5 percentage points.

## April

On April 17, the treasury took a 250 million euro credit facility managed by Dresdner Bank.

On April 26, Frjálsi Investment Bank was de-listed from Iceland Stock Exchange. After a takeover bid, Kaupthing hf. and an investor group that it led had acquired 98.64% of total capital stock in Frjálsi Investment Bank, which thereby no longer fulfilled conditions for listing on ICEX.

## May

On May 4, the Central Bank published its first inflation forecast after the introduction of inflation targeting. The Bank forecast that inflation in the second half of this year could reach 6% and would measure 5.7% over the year. This was based on assumptions of an unchanged exchange rate from April 26 to the end of the forecast period, and no alterations to existing wage agreements.

On May 4, Fitch announced its credit ratings for Landsbanki of A for long-term debt and F1 for shortterm debt. F1 is the best rating issued by the agency. Apart from the Republic of Iceland, no Icelandic borrower has achieved a higher credit rating.

On May 21, the Debt Management Agency, on behalf of the Minister of Finance, accepted bids from Landsbanki, Búnadarbanki, Icebank and Kaupthing, which represented the lowest requested commission on market making for five government bond classes. The Debt Management Agency pays each market maker a turnover commission of 0.1% of the amount of its trading in each category, based on monthly turnover on Iceland Stock Exchange. A ceiling of 140 m.kr. p.a. is set for the total commission to be shared out among market makers.

## June

On June 8, Iceland Stock Exchange announced a change in the composition of its ICEX-15 index for the period July 1, 2001 to January 1, 2002. Three new companies were added to the index: Kaupthing, Olíufélagid and SÍF, in place of Grandi, Thormódur rammi-Sæberg and Opin kerfi.

On June 13, shares in Islandssimi were listed on the ICEX main list. Listed capital stock was 587,995,000 kr.

On June 20, the Housing Financing Fund announced its decision to relaunch sales of housing fund bonds from categories 1 and 2 in 1996. Auctions are planned on June 27, September 1, October 1, November 1 and December 1. A sufficient quantity of bonds in these categories is expected to be offered for sale this year to meet the part of the Fund's borrowing requirement that cannot be realised with housing bond issues.

On June 21, the Central Bank intervened in foreign exchange market trading for the first time since inflation targeting was adopted. The exchange rate index had risen rapidly (i.e. the króna depreciated) on the previous day, and continued to do so when the market opened. After the Central Bank sold US dollars for 2.5 b.kr., the index fell again and the market calmed.

On June 22, the Ministry of Finance announced the treasury's decision to borrow 25 b.kr. abroad in order to boost the Central Bank's foreign position. It is planned to allocate part of this sum as a contribution to the Central Bank's capital, which is to be strengthened under the new Central Bank Act. On June 26, the Minister of Commerce announced the start of preparations for privatisation of at least one-third of shares in Landsbanki through sale to a major investor. The sale is planned to take place before the end of 2001. A condition for the sale is that it will increase competition in Icelandic financial markets and enhance the bank's competitiveness.

## July

On July 1, changes were made in the domestic interbank market in line with an agreement made by the Governors of the Central Bank and foreign exchange market makers in the second half of June. Búnadarbanki, Íslandsbanki, Kaupthing and Landsbanki will act as market makers. For a trial period until the end of this year, the Central Bank will pay market makers a specified commission for performing their functions, while they undertake clear obligations in return.



On July 1, a new Interest Rates and Indexation Act no. 38/2001 entered effect, replacing Act no. 25/1987. The many changes introduced include new provisions on penalty interest rates and on the Central Bank's obligation to publish interest rates.

On July 6 a new currency basket took effect. The basket is reviewed annually on the basis of the composition of foreign trade and services during the previous year. The accompanying table shows the new basket and the change from the one it replaces.

#### New currency basket 2001 (%)

Based on foreign trade in 2000

<i>Country</i>	<i>Currency</i>	<i>Exports</i>	<i>Imports</i>	<i>Average</i>	<i>Change from prev. basket</i>
USA	USD	26.13	27.86	26.99	1.73
Britain	GBP	14.92	14.61	14.77	0.40
Canada	CAD	1.76	0.96	1.36	-0.07
Denmark	DKK	8.29	9.07	8.68	-0.21
Norway	NOK	5.94	6.21	6.08	-1.53
Sweden	SEK	2.49	6.40	4.44	0.37
Switzerland	CHF	2.40	0.90	1.65	-0.46
Euro zone	EUR	33.78	29.54	31.66	0.23
Japan	JPY	4.29	4.45	4.37	-0.47
North America		27.89	28.82	28.35	1.66
Europe		67.82	66.73	67.28	-1.19
European Union		59.48	59.62	59.55	0.80
Japan		4.29	4.45	4.37	-0.47
Total		100.00	100.00	100.00	0.00

On July 16, new ICEX rules went into effect concerning publication of interim statements of listed companies. From Q3 inclusive, companies listed on ICEX are obliged to publish their interim statements on a quarterly basis.

#### August

On August 27, the Minister of Social Affairs announced a new fire insurance reference for housing bond loans. Loan ceilings had previously been 65% or 70% of the purchase price of housing or its fire insurance value, whichever was lower and depending upon whether a first housing purchase was involved. Under the new ministerial decision, from September 1, 2001 the reference will be 65% or 70% of purchase price, but never higher than 85% of fire insurance value.

#### September

On September 24 the deadline expired for prospective major shareholders to apply for selection during the privatisation of Iceland Telecom (Landssími Íslands hf.). In all 17 investors announced an interest in acquiring a major shareholding in the company.

On September 26, it was announced that the boards of Búnadarbanki and Lýsing hf. leasing company had approved for their part the merger of Lýsing into Búnadarbanki. Proposals to this effect were announced for approval by shareholders' meetings scheduled for November 10, 2001. The Central Bank announced that the treasury had finalised a foreign loan facility aimed at strengthening the Bank's foreign position, cf. the Ministry of Finance announcement to this effect in June.

#### October

On October 4, the government announced its decision to promote extensive reforms to private and corporate taxation. Firstly, major changes will be made to tax rates and tax reference limits for both private individuals and businesses. Secondly, inflationary accounting principles will be abandoned, having become a rarity in the accounting

principles and tax systems of other countries. Thirdly, tax treatment of the conversion of self-employed businesses to limited liability form will be brought into line with harmonised rules on conversion of other types of businesses. Fourthly, various other changes will be made regarding the interpretation and implementation of tax law.

On October 22, the US credit rating agency Standard & Poor's affirmed an unchanged credit rating for the Republic of Iceland at A+ for long-term liabilities. The outlook was lowered from steady to negative.

On October 29, the deadline expired for non-binding bids for 25% of share capital in Iceland Telecom. This was phase two in the privatisation process which aims to find a major strategic investor that will strengthen Iceland Telecom, enhance its value and boost the Icelandic telecommunications market.

### **November**

On November 8, the Central Bank announced an 0.8 percentage point cut in its interest rates. After the cut, the Central Bank policy rate is 10.1%.

On November 10, a shareholders' meeting of Búnadarbanki Íslands hf. approved a proposal for the bank's merger with Lýsing hf. leasing company. It was assumed that Lýsing would be totally merged with the bank through a takeover of its assets and liabilities.

On November 20, Bakkavör Group hf. announced its acquisition of the British food producer Katsouris Fresh Foods Ltd. This is the largest corporate acquisition in Icelandic business history and makes Bakkavör Group hf. one of the largest corporations in Iceland.

### **December**

On December 12, the boards of directors of Búnadarbanki Íslands hf. and Gilding ehf. investment company announced their approval of a merger between these companies, whereby Gilding would be merged into Búnadarbanki.

On December 15, the minimum amount for payment orders in the Central Bank's RTGS system was lowered from 100 m.kr. to 25 m.kr.

# Economic and monetary chronicle 2002

## January

On January 9 it was announced that Kaupthing hf. had signed a letter of intent to acquire the Swedish securities firm Aragon Holding AB. The transaction has expected to be closed at the end of January, on completion of the due diligence process.

On January 11 a commercial banking licence was issued to Kaupthing. A Kaupthing shareholders' meeting on December 28, 2001 passed a resolution changing the name of the company as a prerequisite for the licence. It was also agreed to add the word "bank" to the title of the company. Henceforth, its name is Kaupthing bank hf. and it will operate in conformity with current legislation on commercial banks and savings banks.

On January 20, changes were announced in the service hours of the RTGS system operated by the Central Bank. The RTGS system will operate from 8.45 to 18.00 hrs. and the minimum payment order amount will be 25 m.kr.

The supplementary budget for 2001, passed by parliament in December, included authorisation for the treasury to make a contribution to the Central Bank's equity capital amounting to 9 b.kr. during 2001. The contribution was paid at the end of the year. The budget for 2002, also passed in December, included authorisation to make a further 4.5 b.kr. equity capital contribution to the Bank in 2002.

## February

On February 11, the Central Bank of Iceland signed an agreement for a credit facility with Union Bank of Norway to the amount 200 million USD, which corresponded to just under 21 b.kr. at that time. Effective for five years, the agreement with Union Bank of Norway is on favourable terms for the Central Bank and is additional to similar credit facility agreements arranged with several other financial institutions.

On February 15, Fitch announced its credit rating of AA- for the Republic of Iceland for obligations in foreign currency. It also affirmed the local currency ratings of AAA for long-term debt and F1+ for shortterm debt. The outlook on the long-term ratings was changed to negative from stable.

## March

On March 5, the Central Bank announced plans to change the rules as to which securities qualify as collateral for repo transactions (See box on p. 31)

On March 8, the Board of Governors of the Central Bank set formal rules for the interbank market for currency swaps. The rules went into force on March 15, 2002.

On March 13, the government announced its decision to halt the process which had been under way for some time aimed at selling a substantial share in Iceland Telecom to an anchor investor. Sale of the state's shareholding in the company will be resumed as soon as financial market conditions allow.

On March 26, the Central Bank announced that it had lowered the interest rate on its repo agreements with credit institutions, and on credit institutions' deposits with the Bank, by 50 bp., effective from April 1.

## April

On April 1, the treasury bond RS02-0401, to the total amount 10 b.kr., matured. Liquidity increased in the wake of the maturity and interbank market interest rates decreased significantly.

On April 1, the agreement on payment of commission to market makers in the forex market was extended for three months.

On April 16, Moody's Investors Service announced that the narrowing of macro imbalances had helped to sustain the stable outlook on Iceland's Aa3 foreign currency ceilings and Aaa rating for issuing government bonds in local

currency. The main reasons stated were the advanced economy, high and level national income per capita and stable political situation. The structural reforms of the past decade have diversified the economy and led to robust growth, price stability and a significant reduction in public sector debt, Moody's said.

On April 30, the Central Bank announced that it had lowered its policy rate and other interest rates by 30 bp, effective from May 1.

### May

On May 8, it was announced that the Minister of Finance had assigned the Debt Management Agency with the issue of new category of non-indexed treasury bonds. With a lifetime of 11 years and maturing in May 2013, this will be the longest non-indexed category in the Icelandic financial market so far.

On May 21, the Central Bank lowered the interest rate on its repo agreements with credit institutions and on its O/N rate, both by 50 bp. Interest rates on credit institutions' deposits with the Bank were lowered by 20 bp at the same time.

On May 28, the government of Iceland announced a public offering of shares in Landsbanki Íslands hf. It was planned to sell 20% of total capital stock in the bank in this phase, reducing the state's holding from just over 68% to just over 48%. The sale took place in June and the plans were fully realised.

### June

On June 18, the Central Bank lowered the interest rate on its repo agreements with credit institutions by 30 bp to 8.5%, effective from June 25. Its other interest rates were also lowered by 30 bp, effective from the same time, except for those on credit institutions' deposits with the Bank which remained unchanged.

New currency basket 2002 (%)

Based on foreign trade in 2001

<i>Region</i>	<i>Currency</i>	<i>Exports</i>	<i>Imports</i>	<i>Average</i>	<i>Change from prev. basket</i>
USA	USD	22.76	26.89	24.83	-2.16
Britain	GBP	14.60	10.97	12.78	-1.99
Canada	CAD	1.50	0.96	1.23	-0.13
Denmark	DKK	7.78	8.54	8.16	-0.52
Norway	NOK	6.75	6.82	6.78	0.70
Sweden	SEK	1.80	5.16	3.48	-0.96
Switzerland	CHF	2.74	1.28	2.01	0.36
Euro zone	EUR	38.73	35.43	37.08	5.42
Japan	JPY	3.34	3.95	3.65	-0.72
North America		24.26	27.86	26.06	-2.29
Europe		72.40	68.19	70.30	3.02
European Union		62.91	60.10	61.50	1.95
Japan		3.34	3.95	3.65	-0.73
Total		100.00	100.00	100.00	0.00

On July 10, the Executive Committee on Privatisation, on behalf of the Minister of Commerce, requested notification from parties interested in acquiring a shareholding of at least 25% in Landsbanki and Búnadarbanki. A domestic or foreign investor was sought with the aim of strengthening the bank and boosting competition in the Icelandic financial market. It was stated that a 25% share would be sold in only one of the two banks if an acceptable price were fetched and talks led to a sale. The aim was then to sell the shareholding in the other bank later this year.

On July 19, it was announced that the Housing Financing Fund and Debt Management Agency had signed an agreement on the implementation of the Fund's agreement with market makers for housing bonds and housing authority bonds in the secondary market for the period July 1, 2002 to June 30, 2003. The Agency began formal supervision of this arrangement on Monday, 22 July.

## July

On July 5, a new currency basket was announced following the annual revision on the basis of Iceland's foreign trade in goods and services in the preceding year. The new basket and changes from the previous year are shown in the table below.

## August

On August 30, the Central Bank announced a 30 bp cut in its interest rates, effective from September 1. After the cut, the Central Bank policy rate was 7.6%.

## September

On September 10, the Ministerial Committee on Privatisation announced its decision to begin talks with Samson eignarhaldsfélag ehf. holding company on the acquisition of a substantial shareholding in Landsbanki Íslands hf. At the same time it was decided to launch preparations for the sale of a substantial shareholding in Búnaðarbanki Íslands hf.

On September 18, the Central Bank announced a 50 bp cut in its interest rates, effective from September 21. After the cut, the Central Bank policy rate is 7.1%.

On September 30, SPRON acquired Kaupthing Bank hf.'s entire holding in Frjálsi fjárfestingarbankinn hf. investment bank.

## October

On October 15, the Central Bank announced a 30 bp cut in its interest rates, effective from October 21. After the cut, the Central Bank policy rate was 6.8%.

On October 21, it was announced that the Executive Committee on Privatisation and Samson eignarhaldsfélag ehf. had reached an agreement on the latter's acquisition of a 45.8% holding in Landsbanki Íslands hf. After this transaction, the state's holding in Landsbanki will be 2.5%. Following the agreement it was decided to continue the sales process for the state's holding in Búnaðarbanki. Two groups of investors were selected for further talks.

On October 22, Moody's Investors Service upgraded its foreign currency country ceiling for Iceland for bonds and bank deposits to its highest rating, Aaa, up from Aa3.

## November

On November 5, the Ministerial Committee on Privatisation announced its decision to begin talks with an investor group comprising Eignarhaldsfélagid Andvaka holding company, Eignarhaldsfélagid Samvinnutryggingar holding company, Vátryggingafélag Íslands hf. insurance company, Kaupfélag Skagfirdinga svf. cooperative, Ker hf. holding company and Samvinnulífeyrissjóðurinn pension fund, together with one or more foreign financial institutions, on their acquisition of a substantial shareholding in Búnadarbanki Íslands hf. This decision was based on preconditions set by the Executive Committee on Privatisation and an evaluation by the British bank HSBC of documents submitted by the two parties with which the committee had held talks.

On November 6 the Central Bank announced a 50 bp cut in its interest rates, effective from November 11. After the cut, the Central Bank policy rate was 6.3%.

On November 12, Statistics Iceland began publication of two core indices to measure the underlying inflation trend. Under the joint declaration by the Government of Iceland and the Central Bank of Iceland from March 27, 2001 on an inflation target and a change in the exchange rate policy, Statistics Iceland was asked to calculate one or more indices which may be used to assess the underlying rate of inflation as further agreed by the Central Bank and Statistics Iceland. Core Indices 1 and 2 are the outcome of that work. Both use the same base as the Consumer Price Index, but the former excludes prices of vegetables, fruit, agricultural products and petrol, and the latter prices of public services as well.

On November 18, the US credit rating agency Standard & Poor's changed its outlook for the Republic of Iceland from negative to steady. It also affirmed both its ratings for the Republic of Iceland, at AA+/A-1+ for local currency and A+/A-1+ for foreign currency. The main reasons for the upgraded outlook were Iceland's improved external position, the successful privatisation of state-owned banks and ongoing good bank profitability at the end of a strong credit expansion phase.

**December**

On December 10 the Swedish financial supervision authority announced that it had approved Kaupthing Bank's takeover of JP Nordiska bank of Stockholm. Kaupthing Bank's takeover of JP Nordiska was thereby completed.

On December 12 the Central Bank announced a 50 bp cut in its interest rates, effective from December 17. After the cut, the Central Bank policy rate was 5.8%.

# Economic and monetary chronicle 2003

## January

On January 3 the Minister of Commerce and Minister of Finance, on behalf of the treasury, signed an agreement with Samson eignarhaldsfélag ehf. holding company on the latter's acquisition of the treasury's 45.8% shareholding in Landsbanki Íslands hf.

On January 6, Iceland Stock Exchange revoked the membership of Fjárvernd-Verðbréf hf. securities house, effective from January 7, 2003. The reason was persistent defaults on payment of membership fees.

On January 16 the Minister of Commerce and Minister of Finance signed an agreement on behalf of the treasury with Egla hf., Vátryggingafélag Íslands hf., Samvinnulífeyrissjóðurinn and Eignarhaldsfélagid Samvinnutryggingar on the investor group's acquisition of the treasury's 45.8% shareholding in Búnaðarbanki Íslands hf. Egla is a limited company owned by Hauck & Aufhäuser Privatbankiers KGaA of Germany, Ker hf. and Vátryggingafélag Íslands hf.

## February

On February 4, the Financial Supervisory Authority (FME) confirmed that Samson eignarhaldsfélag ehf. was suitable to control a qualifying holding in Landsbanki Íslands hf.

On February 4, Moody's Investors Service affirmed its A3/P2/C credit rating for Landsbanki Íslands hf.

On February 6, the Central Bank began purchasing 1.5 million US dollars in the domestic interbank market on a daily basis, instead of the previous three times a week.

On February 7, it was announced that Kaupþing banki hf. had acquired the London-based financial company BMY Corporate Finance Limited, which it renamed Kaupthing Limited. The company is authorised by the UK Financial Supervisory Authority to conduct corporate finance activities.

On February 10, the Central Bank announced a 50 bp cut in its interest rates, effective from February 11 and 18. After the cut, the Central Bank policy rate was 5.3%.

On February 12, it was announced that the UK Financial Supervisory Authority (FSA) had approved the change of control of Heritable Bank Limited which is a result of Samson Holding ehf.'s acquisition of a 45.8% share in Landsbanki Íslands hf. The FSA thereby approved Samson Holding ehf.'s acquisition of Landsbanki Íslands hf. as regards Landsbanki's operations in the UK.

On February 25, the Government privatised its remaining 2.5% of the total share capital of Landsbanki Íslands hf. Following the sale, the Treasury no longer holds any stake in Landsbanki.

On February 28, the Central Bank announced a change in the required reserves of credit institutions. As of March 21 the required reserve ratios, i.e. as a proportion of total tied deposits, were reduced to 1% and 3% from 1.5% and 4% respectively. As of April 1, credit institutions' scope for using required reserves as collateral security for payment system settlements will be limited to half of the negotiated collateral amount. The aim behind this restriction is to ensure that credit institutions have scope on their required reserve accounts to meet swings in their liquidity positions.

## March

On March 7, the Government privatised its remaining 9.11% of the total share capital of Búnaðarbanki Íslands hf. Following the sale, the Treasury no longer holds any stake in Búnaðarbanki.

On March 18, the FME confirmed that Egla hf., Eignarhaldsfélagið Samvinnutryggingar hf., Samvinnulífeyrissjóðurinn and Vátryggingafélag Íslands hf. were suitable to control a qualifying holding in Búnaðarbanki Íslands hf.

On March 27, the boards of directors of Kaupþing banki hf. and Búnaðarbanki Íslands hf. announced their decision to commence formal talks on cooperation or a merger between the banks.

On March 31, Fitch affirmed its credit rating of AA for the Republic of Iceland for long-term obligations in foreign currency, AAA for domestic obligations and F1+ for short-term foreign debt. The outlook on the long-term ratings was changed from negative to stable. The main reasons for the upgrade are the strength of the Icelandic economy and the swift adjustment towards macroeconomic balance. Fitch said the main constraint on Iceland's ratings was its relatively high debt burden.

#### **April**

On April 8, Moody's Investors Service announced that it had upgraded its credit ratings for Íslandsbanki hf. The long-term deposit and debt ratings were upgraded from A2 to A1, the subordinated debt rating from A3 to A2 and the financial strength rating from C+ to B-. The P-1 short-term rating was confirmed.

On April 10, Moody's Investors Service announced that it had upgraded its short-term credit rating for Búnaðarbanki Íslands hf. from P-2 to P-1. The long term deposit and debt rating was affirmed at A3 and the financial strength rating at C.

On April 10, Moody's Investors Service announced that it had upgraded its short-term credit rating for Landsbanki Íslands hf. from P-2 to P-1. The longterm rating was affirmed at A3.

On April 14, it was announced that the Boards of Directors of Búnaðarbanki Íslands hf. and Kaupþing banki hf. had agreed to propose to their respective shareholders' meetings that the companies be merged. The proposed name of the merged bank is Kaupþing Búnaðarbanki hf.

On April 28, Búnaðarbanki Íslands hf. announced an agreement on the sale of its operation in Luxembourg to Landsbanki Íslands hf. The agreement is conditional on the merger between Búnaðarbanki Íslands hf. and Kaupþing banki hf. being realised no later than June 1, 2003.

#### **May**

On May 8, Íslandsbanki hf. notified the Financial Supervisory Authority (FME) of its intention to open a branch in Luxembourg.

On May 22, it was announced that Búnaðarbanki Íslands hf. and Landsbanki Íslands hf. had signed a final agreement on the transfer of ownership of Bunadarbanki International S.A., Luxembourg.

On May 26, preparation for the formal merger between Búnaðarbanki Íslands hf. and Kaupþing banki hf. was completed after it was approved by shareholders in the two banks. The following day the FME approved the merger, with reference to the appropriate act of law.

#### **June**

On June 11, the Governors of the central banks of Denmark, Finland, Iceland, Norway and Sweden signed a Memorandum of Understanding on financial crisis management. The MoU is applicable when a severe problem occurs in a bank which is domiciled in a Nordic country and has cross-border establishments in other Nordic countries.

On June 19, Standard & Poor's affirmed all its ratings for the Republic of Iceland, at AA+/A-1+ for local currency and A+/A-1+ for foreign currency. Its outlook for the Republic of Iceland is steady.

#### **July**

On July 4, a new currency basket was announced following the annual revision on the basis of Iceland's foreign trade in goods and services the preceding year. The new basket and changes from the previous year are shown below.



## New currency basket 2003 (%)

Based on foreign trade in 2002

<i>Region</i>	<i>Currency</i>	<i>Exports</i>	<i>Imports</i>	<i>Average</i>	<i>Change from prev. basket</i>
USA	USD	22.17	27.29	24.73	-0.10
Britain	GBP	14.10	10.59	12.35	-0.43
Canada	CAD	1.33	0.84	1.09	-0.14
Denmark	DKK	7.56	8.93	8.24	0.08
Norway	NOK	6.04	6.78	6.41	-0.37
Sweden	SEK	1.71	5.12	3.42	-0.06
Switzerland	CHF	1.51	0.91	1.21	-0.80
Euro zone	EUR	42.38	35.76	39.07	1.99
Japan	JPY	3.20	3.78	3.48	-0.17
North America		23.50	28.13	25.82	-0.24
Europe		73.30	68.09	70.70	0.41
European Union		65.75	60.40	63.08	1.58
Japan		3.20	3.78	3.48	-0.17
Total		100.00	100.00	100.00	0.00

On July 16, Iceland Stock Exchange announced a new method for selecting companies into the ICEX- 15 Index. On March 10, 2004 it will announce the first ICEX-15 based on the new method. The index with that composition will be in effect from April 1, 2004 to June 30, 2004. The principal changes from the current method are:

- Introduction of a maximum spread requirement
- free-float adjustment for market capitalisation of companies
- ICEX-15 constituents are required to publish news concurrently in Icelandic and English

The purpose of these changes is to promote liquidity of equities.

### August

On August 26, Fjárfestingarfélagið Straumur hf. investment company announced an agreement to acquire a 34.72% holding in Framtak Fjárfestingarbanki hf. investment bank, further to its previous holding of 57.08%.

On August 28, it was announced that the Board of Directors of Landsbanki Íslands hf. had confirmed the issue of shares for a nominal value of 344,518,275 kr. in connection with the bank's purchase of a stake in Fjárfestingarfélagið Straumur hf. investment company. At the same time the Board of Landsbanki announced a decision to increase its nominal share capital by a further 309,778,103 kr. Landsbanki's nominal share capital following these changes is 7,500,000,000 kr.

### September

On September 9, Kaupping Búnaðarbanki hf. announced its acquisition of Tyren Holding AS, a Norwegian asset management company specialising in alternative asset management. After this acquisition, Kaupping Búnaðarbanki operates in all five Nordic countries.

On September 18, it was announced that Íslandsbanki hf. had negotiated the acquisition of a 33% shareholding in Sjóvá-Almennar tryggingar hf. insurance company. Íslandsbanki also requested authorisation from the Financial Supervisory Authority (FME) to own a qualifying holding in the company, as provided for in Act No. 60/1994.

### October

On October 3, a shareholders' meeting of Íslandsbanki hf. authorised its board of directors to increase the company's share capital by a nominal value of up to 1,500,000,000 kr. with a new subscription issue. Part of this authorisation was exercised on October 6 when the bank's share capital was raised by a nominal 500 m.kr., from 9 b.kr. to 9.5 b.kr. Authorisation by the shareholders' meeting to raise share capital by up to an additional 1 b.kr. remains in effect.

On October 7, Landsbanki Íslands hf. made an agreement to increase its shareholding in Landsafl hf. property leasing and management company from 25.5% to 74.5%.

On October 10, the Treasury bond RIKB 03 1010 matured. The estimated settlement amount was 11 b.kr.

On October 15, Landsbanki Íslands hf. acquired a further 25.5% in Landsafl hf., bringing its total shareholding to 100%.

On October 16, the Swedish investment company Havsfrun AB announced that it had approved the sale of its shareholding in Finnish investment company Norvestia Oyj to Kaupping Búnaðarbanki hf. The condition set for the acquisition to be able to go ahead was thereby fulfilled.

On October 20, it was announced that Fjárfestingarfélagið Straumur hf. had acquired a 99.3% shareholding in Framtak fjárfestingarbanki hf.

On October 20, Fjárfestingarfélagið Straumur hf. announced that it had applied to the FME for a licence to operate as an investment bank in accordance with Article 4, paragraph 3, item 1 of Act No. 161/2002 on Financial Undertakings.

On October 20, it was announced that Fjárfestingarfélagið Straumur hf. and Brú fjárfestingar hf. had signed an agreement on a merger between these two investment companies, effective retroactively from July 1, 2003.

On October 20, the Central Bank of Iceland announced changes to the payment amount limits and operating times of its RTGS system. The Board of Governors issued new Rules on Activities of Netting Systems and Rules on the Central Bank of Iceland Real-Time Gross Settlement System which replace Rules No. 951 from December 29, 2000, on Access to Settlement Accounts in the Central Bank of Iceland, and enter into force on November 1, 2003.

The following change was made to the RTGS payment amount limits: The minimum amount of a payment handled in the Central Bank's RTGS system will be lowered from 25 m.kr to 10 m.kr. Payment orders amounting to 10 m.kr. or more will therefore be handled in the RTGS system. Payment orders for amounts up to 10 m.kr. will be handled in the netting system. However, all payment orders in connection with settlements in a netting system and securities settlement system are handled in the RTGS system irrespective of their amount.

The following change was made to the RTGS operating times: The regular operating time of the RTGS system, which has been from 08.45 to 18.00 on regular banking days, will be shortened and be from 09.00 to 17.00 on regular banking days. From 08.45 to 09.00 the system will be open for payment orders in connection with the settlement of securities transactions. The system will also be open from 17.00 to 17.30 for banks to settle payments among themselves.

On October 27, FME (the Financial Supervisory Authority) licensed securities company MP verðbréf hf. as a credit institution under the provisions of article 4, paragraph 1, point 3 of Act No. 161/2002, on Financial Undertakings. Following its licensing, the securities company was renamed MP fjárfestingarbanki hf. (investment bank).

On October 31, Norðurál aluminium company signed a memorandum of understanding with Suðurnes Regional Heating (Hitaveita Suðurnesja) and Reykjavík Energy (OR), on the supply of power to its proposed 90 thousand t.p.y. smelter expansion.

## November

On November 6 the Central Bank of Iceland published its quarterly Peningamál (Monetary Bulletin) containing a macroeconomic and inflation forecast, along with reports on financial markets and Central Bank measures and on financial stability.

On November 12, Íslandsbanki made a further acquisition of shares in Sjóvá-Almennar tryggingar hf. which increased its holding to more than 99%. In connection with the acquisition, Íslandsbanki hf. increased its share capital in stages. By November 10 the bank's board of directors had exercised in full the authorisation granted by a shareholders' meeting to increase its share capital by 1.5 b.kr. nominal.

On November 21, Nordea Bank Danmark A/S was licensed as a bond trader in the Iceland Stock Exchange (ICEX) trading system.

On November 27, parliament passed a bill increasing heavy duty vehicle tax and commodity tax on petrol by 8%, effective from the end of the year.

On November 27, the Ministry of Commerce announced that the final price of recently privatised Landsbanki Íslands hf. would be 700 m.kr. lower than originally provided for.

## December

On December 2, the Board of Governors of the Central Bank of Iceland announced that the Bank had adopted new Rules on Minimum Reserve Requirements of Financial Undertakings (credit institutions) which are licensed to operate under Article 4, points 1, 2 and 3 of Act No. 161/2002 on Financial Undertakings. The new Rules completed changes announced by the Central Bank that had begun to be implemented in March. This second phase aimed to adjust the reserve base and the reserve ratios to the practices of the European Central Bank. The new Rules entered into force on December 21.

On December 2, the supplementary budget for 2003 was approved. Revenue estimates were raised by 6.4 b.kr., largely on account of corporate income tax, value-added tax and capital gains tax on dividends. Expenditure authorisations were raised by 12.6 b.kr.

On December 3, Íslandsbanki hf. acquired the entire shareholding held by investment company Fjárfestingarfélagið Straumur hf. in Framtak fjárfestingarbanki hf. investment bank (formerly Eignarhaldsfélag Alþýðubankans hf. and Próunarfélag Íslands hf.) Framtak fjárfestingarbanki hf. was merged into Íslandsbanki hf., effective from January 1, 2004. Alongside the sale, Fjárfestingarfélagið Straumur hf. undertook to acquire Framtak fjárfestingarbanki hf.'s venture capital portfolio.

On December 5, a law was passed whereby employers will no longer be allowed to allocate a part of their national insurance contribution towards matching premiums paid by employees to voluntary pension savings schemes (equivalent to 10% of the employee's voluntary premium, to a maximum of 0.4% of the national insurance contribution base).

On December 12, an amendment to the Income Tax and Wealth Tax Act was passed, extending for two years the tax surcharge on high incomes which would have expired at the end of 2003. The tax surcharge on high incomes will be reduced in phases to 4% on top of the basic income tax rate for the tax year 2004 and 2% for 2005. Under rules determining interest payment rebates for homeowners, maximum interest payments qualifying for rebates were lowered from 7% of mortgage debt to 5.5% for rebates due in 2005. For 2004, rebates will be 90% of what they would have been under the old rules. Amounts and references for the main benefit categories were increased by 2.5% between 2003 and 2004.

On December 12, the act granting tax concessions to international trading companies was repealed, effective from January 1, 2008. New international trading companies will not be licensed after March 1, 2004.

On December 15, parliament passed a law approving new pension rights for the President of Iceland, cabinet ministers, members of parliament and Supreme Court judges.

On December 15, Moody's Investors Service announced the upgrading of Kaupping Búnaðarbanki hf.'s credit rating. The bank's long-term deposit and debt ratings were upgraded from A3 to A2, the subordinated debt rating from Baa1 to A3 and the financial strength rating from C to C+. The short-term rating was confirmed at P-1, which is the highest rating given. All these ratings continued to have a positive outlook. According to Moody's "the upgrading of these ratings reflects the successful merger ... [which] resulted in the creation of a welldiversified and dominant player with healthy financial fundamentals on the Icelandic financial market", and its "excellent performance" since then.

On December 16, Standard & Poor's upgraded its foreign currency outlook on the Republic of Iceland to positive from stable. It also affirmed the sovereign ratings, including A+/A-1+ for foreign currency and AA+/A-1+ for local currency.

On December 18, an agreement was signed between Norðurál aluminium company, Landsvirkjun (the national power company), Reykjavík Energy and Suðurnes Regional Heating on the supply of power to Norðurál's proposed smelter expansion.

On December 19, the Ministry of Finance announced that the personal income tax rate for 2004 would remain unchanged from 2003, at 25.75%. Local government authorities have announced an average municipal tax rate of 12.83% in 2004, compared with 12.80% in 2003. The income tax rate for 2004 will therefore be 38.58%. Local authorities may set their municipal tax rate in the range 11.24% to 13.03%. Of 104 local authorities, 67 intend to levy the maximum municipal rate, and 5 the minimum rate.

On December 21, officials of Kaupþing Búnaðarbanki hf. and the board of directors of Sparisjóður Reykjavíkur og nágrennis (SPRON, the Reykjavík and Environs Savings Bank) signed a declaration that work was in progress to convert SPRON into an independently operating subsidiary of Kaupþing Búnaðarbanki hf. It was proposed to convert SPRON into a limited liability company – which would require the consent of holders of primary guarantee capital in the savings bank, who then would swap their shares in exchange for shares in Kaupþing Búnaðarbanki hf. The bank was reported to plan to continue operating the savings bank as an independent entity.

On December 21 the SPRON board unanimously agreed to propose to holders of primary capital that the savings bank should be converted into a limited liability company. If agreed, a trust, SPRONSjóðurinn ses., would retain an 81% holding in SPRON hf.

On December 22, the Central Bank of Iceland announced its decision to auction 14-day certificates of deposit to credit institutions which are subject to minimum reserve requirements, on December 30. The issue was aimed at reducing liquidity in circulation and thereby its expansionary effect. The Central Bank also announced it would hold further auctions of certificates of deposit as the circumstances warrant.

On December 29, holding company Samson eignarhaldsfélag ehf. remitted its final payment for the acquisition of the Treasury's holding in Landsbanki Íslands hf. Payment was for 12.5% of issued share capital in the bank, with a nominal value of 856 m.kr., and made in US dollars. At the same time, the investor group acquiring Búnaðarbanki Íslands hf. settled its payment for an 8.33% holding (37 million shares) owned by the Treasury in the merged KB banki hf. After these transactions, the commercial banks had been fully privatised.

On December 31, the Minister of Social Affairs announced that maximum loans from the Housing Financing Fund (HFF) would be raised from 9 m.kr. to 9.7 m.kr. for new housing, and from 8 m.kr. to 9.2 m.kr. for secondary market housing, effective from January 2, 2004. It is also planned to change the HFF's bond issues into monetary loans on July 1, 2004. The loans will be financed by auctions of underlying "HFF bonds". At the turn of the year 2003/2004, Kaupþing Búnaðarbanki hf. was renamed KB banki hf. All the bank's branches and activities in Iceland will bear the new name, while its international activities will continue under the Kaupthing brand.

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## January

On January 1, general welfare benefits rose by 3%. On January 2, FME (the Financial Supervisory Authority) approved an application by investment bank Straumur fjárfestingarbanki hf. to be licensed as a credit undertaking under the provisions of article 4, paragraph 1, point 3 of Act No. 161/2002 on Financial Undertakings. Straumur fjárfestingarbanki hf. applied for membership of Iceland Stock Exchange. From the beginning of 2004, the Central Bank of Iceland will purchase 5 million US dollars weekly in the interbank FX market, instead of the weekly purchase of 12.5 million US dollars which had been made since May 2003. The aim of the Central Bank's currency purchases is to strengthen its foreign reserves.

On January 15, the Ministry of Finance published its macroeconomic forecast.

## February

On February 4, and again on February 19, the Ministry of Fisheries raised the quota for the capelin fishery by 80 thousand tonnes and 240 thousand tonnes respectively. This brought the total allowable catch of capelin up to 875 thousand tonnes, of which 737 thousand tonnes are earmarked for the Icelandic fleet under international agreements.

On February 5, Act No. 4/2004 was passed amending the Act on Financial Undertakings. One consequence of the amendment was that proposed plans to convert SPRON into a limited liability company were withdrawn and KB banki hf.'s previously announced acquisition of SPRON did not go ahead.

On February 24, KB banki hf. acquired 19,385,994 shares in Singer and Friedlander Group Plc. of the UK, corresponding to 10.00% of its issued share capital. The acquisition brought KB banki hf.'s holding in the UK bank up to 37,866,694 shares (19.53%). KB banki hf. announced that it had no current intention to make a bid for Singer and Friedlander Group Plc.

## March

On March 7, two major blue-collar unions, Starfsgreinasambandið (SGS) and Flóabandalagið (comprising SGS member unions in southwest Iceland) agreed on wage settlements with the Confederation of Employers (Samtök atvinnulífsins). If approved by union members, the settlements will be in effect until December 31, 2007.

On March 7, the Federation of Special and General Workers (SGS) and its southwest Iceland branch agreed on wage settlements with the Confederation of Employers (SA). The settlements will be in effect until December 31, 2007. The total cost to employers over the term of the settlement is estimated at 15.1%, or 3.6% on average per year. New pay scales will take effect incorporating various bonus payments and supplements into basic pay rates in 2004 and 2006. In connection with the pay scale changes, more flexible working hours were agreed upon in specific industries or workplaces. The employers' mandatory pension fund contribution will also increase from 6% to 8% over the term of the agreement.

Underlying assumptions of the wage settlements are that prices develop in line with the Central Bank's inflation target and that other labour market settlements entail broadly the same wage increases. A committee appointed by the Federation of Labour (ASÍ) and SA will meet twice (in 2005 and 2006) to review whether the assumptions have held. In connection with the settlements, the government made a commitment to back a 0.45% reduction in national insurance contributions in 2007, to lower the cost impact for employers. Unemployment benefit will go up by 3.6% more than the lowest basic wages over the period and the government will ensure that contributions will continue to be made into a fund for job training until the settlements expire. This measure will cost the Treasury 2½ b.kr.

On March 12, Íslandsbanki hf. reduced its nominal registered share capital by 500 m.kr., to 10 b.kr.

On March 12, Landsbanki Íslands hf. increased its nominal share capital by 600 m.kr., to 8.1 b.kr. Share price in the transaction was 7.6 króna per share, raising the bank's total equity by 4,560 m.kr. Based on figures for the end of 2003 and including the share capital increase, Landsbanki's total equity is nearly 27 b.kr. The new share capital boosted its CAD equity ratio to above 11%, of which more than 8% was Tier 1.

On March 17, the National Debt Management Agency issued a new series of non-indexed Treasury notes, RIKB 10 0317, with a maturity date of March 17, 2010. The notes bear interest which is paid annually at the end of each interest period. The annual interest rate is 7.00%. On the final due date, March 17, 2010, the last payment of interest due will be made, together with payment of the principal amount of the notes.

On March 17, Íslandsbanki hf. announced that it had sold a 75% holding in the UK private bank R. Raphael & Sons plc. After the sale, the bank owns a 25% share in Raphael & Sons, which thereby ceases to be reported as a subsidiary in its accounts. The buyer was Lenlyn Holdings plc. Íslandsbanki hf. announced that the sale price of R. Raphael & Sons plc. was consistent with the book value in its accounts and would therefore have a negligible impact on its operations and balance sheet.

## April

On April 5, it was announced that the Ministry of Finance had requested the National Debt Management Agency to increase the volume of government bonds in the series RIKS 15 1001 by a nominal value of 3,434,428,436 kr. The additional issue was made in connection with pension fund obligations that the Treasury and City of Reykjavík have operated jointly.

On April 5, the Treasury and City of Reykjavík signed an agreement on pension fund commitments of employees with institutions that they operate jointly. The Treasury will pay the City 2.9 b.kr., and it is planned to produce an annual statement of the division between Treasury and City commitments as they are incurred. Since the Treasury had already made allowance for these commitments, they did not require a special transfer in the State Accounts for the year.

On April 5, Icelandic government debt securities became eligible for settlement and custody in Clearstream Banking of Luxembourg. Eligible securities are benchmark housing bonds, housing authority bonds, Treasury notes and indexed Treasury bonds.

On April 8, the Federation of Special and General Workers (SGS) signed a new wage settlement with the state for its member unions. In effect until March 31, 2008, the settlement raises wage costs by 20.4% over its term, or 4.7% per year on average. These rises are higher than in the private sector settlements made by national unions within the Icelandic Federation of Labour (ASÍ), because the pension fund contribution paid by the state will be increased from 6% to 11.5%, in line with terms for other civil servants. On April 10, the government bond series RIKS 04 0410 was redeemed for 5 b.kr.

On April 11, Decode Genetics declined a 20 b.kr. Treasury guarantee that parliament had authorised the Minister of Finance to grant. Consequently, the government withdrew its application for an opinion on the guarantee from the EFTA Surveillance Authority, where it had been under scrutiny.

The majority of national unions within ASÍ completed their wage settlements with SA in the second half of April. The Union of Icelandic Electrical Workers (RSÍ) signed up on April 15, followed by the Commercial Federation of Iceland (LÍV) and the Commercial Workers' Union in Reykjavík (VR) on April 21, the Icelandic Federation of Food and Restaurant Workers (Matvís) on April 24 and the Federation of Skilled Construction and Industrial Workers (Samiðn) on April 29. All settlements are in effect until December 31, 2007 and entail broadly the same increases in wage costs as the settlement between SGS and SA, although they differ in certain details.

## May

On May 4, Straumur Fjárfestingarbanki hf., an investment bank, was licensed as a securities broker.



On May 6, the Central Bank of Iceland announced that it had decided to raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.2 percentage points to 5.5% as of May 11. The Bank's other interest rates were also raised by 0.2 percentage points on May 11.

On May 11, the National Debt Management Agency signed agreements with market makers concerning issues of Treasury bonds. From June 1, 2004 six banks have been designated principal market makers: commercial banks Íslandsbanki hf, KB banki hf and Landsbanki Íslands hf; investment bank MP Fjárfestingarbanki, the savings banks' clearing house Sparisjóðabanki Íslands, and savings bank Sparisjóður Reykjavíkur og nágrennis.

On May 13, the Housing Financing Fund announced it had commissioned Deutsche Bank AG of London to act as advisor and lead manager for the restructuring of its benchmark housing bonds.

On May 19, the Central Bank of Iceland announced changes to its Rules on Transactions with the Central Bank by Credit Institutions Subject to Minimum Reserve Requirements. Under the new Rules, maturities of the Bank's regular market instruments, i.e. repurchase agreements and certificates of deposit, are shortened from 14 days to 7 days, effective as of June 1, 2004.

On May 19, Fitch Ratings affirmed its credit ratings on the Republic of Iceland, awarding AA- for longterm obligations in foreign currency, AAA for domestic obligations and F1+ for short-term foreign debt. The outlook on the ratings was stable.

## June

On June 1, the Central Bank of Iceland announced that it had decided to raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.25 percentage points to 5.75% as of June 8. The Bank's other interest rates were raised on June 11.

On June 7, Moody's Investors Service affirmed its ratings on the Republic of Iceland at Aaa for longterm obligations in foreign and domestic currency and P-1 for short-term obligations in foreign and domestic currency, with a stable outlook.

On June 7, KB banki hf. announced that it had established a London-based asset management business, New Bond Street Asset Management LLP (NBS). NBS will focus on generating a portfolio of floating-rate credit investments for KB banki hf. and managing funds from third parties. Funds under management are expected to reach up to 2 billion euros in the first two years, KB banki hf. announced.

On June 14, KB banki hf. announced that it had acquired the Danish bank FIH A/S from Swedbank. FIH provides medium- and long-term financing to the full spectrum of Danish corporations. The acquisition will double the size of KB banki hf.'s balance sheet. It was conditional upon approval by financial supervisory authorities in both Denmark and Iceland. Acquisition price was 1.0 billion euros, equivalent to just over 84 b.kr.

On June 14, the Housing Financing Fund was awarded ratings from Moody's Investors Service and Standard & Poor's that are matched to the Republic of Iceland's domestic government bond issuance, reflecting the HFF's close links to the Republic of Iceland and its status as a government agency.

On June 18, Stockholm Stock Exchange announced that KB banki hf. was among 13 new companies in Economic and monetary chronicle its Attract 40 index. Based on highest turnover rate, the index will be reviewed at the end of 2004.

On June 18, KB banki hf. announced that it had finalised a subordinated bonds issue totalling 450 m. euros, or approximately 40 b.kr., to finance the acquisition of the Danish bank FIH. Of the total issue, 150 m. euros constitute Tier I capital and the remained Tier II capital.

On June 18, the Iceland Stock Exchange (ICEX) Board of Directors approved Deutsche Bank AG London as an ICEX member.

## July

On July 1, changes to the Housing Financing Fund, which had been approved by parliament on May 28, went into effect. Issuance of housing bonds and housing authority bonds was discontinued and a new bond series was issued: HFF bonds in an annuity format, payable twice a year, with maturities of 20, 30 or 40 years. The main change was that loans are now disbursed in cash, not with housing bonds. Owners of the main housing bond and housing authority bond series were invited to swap them for HFF bonds, and exchanges were made for a total of 338 b.kr.

On July 1, the interest rate on HFF mortgages was lowered by 0.3 percentage points, to 4.8%. HFF rates were reduced by a further 0.3 percentage points to 4.5% on August 1, and by 0.15 percentage points to 4.35% on September 1. The sharp reduction was the result of a decrease in market yields on HFF bonds.

On July 5, a meeting of shareholders in KB banki hf. agreed to increase its share capital through the issue of 110,137,128 shares with pre-emptive rights. At a price per share of 360 kr., the total value of the issue was 39,649,366,080 kr. The KB banki hf. shareholders' meeting also authorised the Board of Directors to increase its share capital through a subscription of 110,000,000 new shares without preemptive rights.

On July 5, the Central Bank of Iceland announced that it had decided to raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.5 percentage points to 6.25% as of July 6. The Bank's other interest rates were raised on July 11.

On July 14, a new currency basket was announced by the Central Bank following the annual revision on the basis of Iceland's foreign trade in goods and services the preceding year. The new basket took effect on July 16.

## August

On August 9, 110,137,128 new shares in KB banki hf., to a nominal value of 1,101,371,280 kr., were listed on the ICEX Main List. The total number of listed shares in the bank thereby increased to 550,685,640, to a nominal value of 5,506,856,400 kr.

On August 12, Íslandsbanki hf. made an offer to acquire all the outstanding share capital of Kredittbanken AS of Norway, at a price of NOK 7.25 per share. The offer price is equivalent to just over 3.5 b.kr. for all shares in the bank. The Board of Directors of Kredittbanken recommended to its shareholders to accept the offer, which is conditional upon acceptance by holders of 90% of all issued and outstanding share capital in Kredittbanken and approval by the relevant authorities in Iceland and Norway.

On August 23, KB banki hf. announced plans to offer inflation-indexed mortgage loans with a maturity of 40 years and carrying a fixed interest rate of 4.4%, subject to certain conditions. Subsequently, the other commercial banks and some savings banks and pension funds began offering loans on similar terms. Towards the end of the month the interest rate on mortgage loans was lowered to 4.2%, following an HFF bonds auction.

On August 30, Fitch Ratings affirmed Íslandsbanki hf.'s ratings at A for long-term obligations and F1 for short-term obligations. The outlook was also announced as stable.

## September

On September 17, the Central Bank of Iceland announced that it would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.5 percentage points to 6.75% as of September 21. The Bank's other interest rates were also raised by 0.5 percentage points on September 21.

On September 27, Íslandsbanki hf. increased its share capital by a nominal amount of 200 m.kr. After the increase, total listed nominal share capital in the bank on the ICEX Main List amounted to 10.2 b.kr. Average price per share was 10.80 kr.

On September 29, KB banki hf. announced that its acquisition of the Danish bank FIH A/S had been fully cleared by the Danish and Icelandic financial supervisory authorities, cf. its announcement from June 14. The announce-



ment said that the acquisition was largely financed with a subordinated bond issue and pre-emptive rights issue of new share capital.

On September 30, the nominal share capital in Straumur Fjárfestingarbanki hf. investment bank was raised to 5.4 b.kr. Part of the new share issue was used to acquire a 14.41% share in Íslandsbanki hf. from Burðarás hf. investment holding company (which sold 5.33%), Landsbanki Íslands hf. (4.67%) and Landsbanki Luxembourg (4.42%).

On September 30, H.F. Verðbréf securities house set up a market for trading primary guarantee capital in Sparisjóður Reykjavíkur og nágrennis savings bank (SPRON).

### **October**

On October 1, the budget proposal bill for 2005 was presented to parliament. It assumed a surplus of 11.2 b.kr. The bill also presented the government's medium- term fiscal programme for 2005 to 2008.

On October 6, the state Housing Financing Fund (HFF) raised its maximum loan amount for both new and secondary market housing to 11.5 m.kr. At the same time, the maximum combined amount of ordinary mortgage loans and secondary mortgages was set at 13 m.kr.

On October 15, new shares in KB banki hf. to a nominal value of 1.1 b.kr. were listed on ICEX. After the increase, the total nominal value of listed shares in the bank on the ICEX Main List amounted to 6,606,856,400 kr. Total sale price of the new shares was 52.8 b.kr.

On October 15, HFF increased its loan-to-value ratio from 85% of the fire insurance value of a property, to a maximum of 100%.

On October 18, it was announced that Íslandsbanki hf.'s takeover of Kredittbanken was completed. The takeover bid was accepted by 99.4% of shareholders. From October 20 to 25, IMF staff visited Iceland for discussions on the economy with officials from the Central Bank, government and private sector. The IMF staff's concluding statement was published on the Central Bank's website on October 29.

On October 29, the Central Bank of Iceland announced that it would raise its policy interest rate on repo transactions with credit institutions by 0.5 percentage points to 7.25% as of November 2. The interest rate on credit institutions' current accounts with the Bank was raised by 0.75 percentage points on November 1.

### **November**

On November 3, Moody's Investors Service announced the upgrading of KB banki hf.'s credit rating. The bank's long-term deposit and senior debt ratings were upgraded from A2 to A1. The subordinated debt rating was upgraded to A2 from A3 and its C+ financial strength rating was affirmed. The short-term rating of P-1 was also affirmed, which is the highest rating given.

On November 5, Íslandsbanki hf. announced plans to offer mortgage loans with a loan-to-value ratio of up to 100% market value. With a maturity of up to 40 years, the loans would be subject to certain conditions. Other commercial banks and some savings banks followed suit and announced plans to offer similar mortgage terms.

On November 13, parliament approved a law on the pay conditions of primary school teachers and principals, ending a teachers' strike which had lasted since September 20. The law provided that, if contracting parties had not signed a wage agreement before November 20, 2004, the Supreme Court would appoint a three-man tribunal to decide, before February 28, 2005, the pay and terms of members of the Association of Teachers in Primary and Lower Secondary Schools and the Association of Headmasters with the local authorities that negotiate with them through the joint municipal wage committee. A new agreement was signed on November 17 and the result of a ballot on it was scheduled to be announced on December 6.

On November 16, Moody's Investors Service affirmed Íslandsbanki hf.'s A1 rating on long-term deposit and senior debt and P-1 rating for short-term obligations. The bank's financial strength rating of B- was placed on review.

On November 16, Reykjavík City Council approved an increase in the municipal tax rate from 12.7% to the maximum authorised rate of 13.03%. Real estate tax was also raised from 0.320% to 0.345%. The increases will generate an estimated 0.9 b.kr. in extra annual revenue for the city.

On November 22, new shares in Íslandsbanki hf. to a nominal value of 1 b.kr. were listed on ICEX. After the increase, the total nominal value of listed shares in the bank on the ICEX Main List amounted to 11.2 b.kr. Total sale price of the new shares was 10.65 b.kr.

On November 26, Fitch Ratings affirmed Íslandsbanki's long-term rating of A, short-term rating of F1, individual rating of C and support rating of 2. The outlook was stable.

On November 26, Fitch Ratings affirmed Landsbanki hf.'s long-term rating of A, short-term rating of F1, individual rating of C and support rating of 2. The outlook was stable.

### **December**

On December 2, the Central Bank of Iceland announced that it would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 1 percentage point to 8.25% as of December 7. The Bank's other interest rates were also raised as of December 11: on overnight loans by 1 percentage point and on credit institutions' current accounts and reserve accounts with the Bank by 1½ percentage points.

On December 2, the Central Bank announced in Monetary Bulletin 2004/4 that at the end of the year it would discontinue its purchases of foreign currency specifically aimed at strengthening its foreign reserves. The Bank will continue to purchase foreign currency in order to provide the Treasury with currency to service its foreign debt.

On December 2, the supplementary budget for 2004 was approved by parliament. Revenue and expenditure estimates for the year were raised by 9 b.kr., with parliament increasing expenditures by 3 b.kr. and revenues by just over 1 b.kr. from the original targets in the supplementary budget bill.

On December 2, parliament authorised the Housing Financing Fund to offer a general loan-to-value ratio of 90% on its mortgages, up to a ceiling of 14.9 m.kr.

On December 4, the fiscal budget for 2005 was passed by parliament. Estimated revenues were 306 b.kr. and expenditures 296 b.kr., leaving a surplus of 10 b.kr. Parliament increased expenditures by 2 b.kr. and revenues by just under 1 b.kr. from the original targets in the budget bill. Compared with the fiscal budget and supplementary budget for 2004, estimated revenues will increase by 5% in nominal terms and 1% in real terms. Estimated expenditures will increase by 5% in nominal terms but remain virtually unchanged in real terms. The largest increase in outlays was to education, by 1.7 b.kr. in real terms.

On December 10, parliament passed legislation enacting extensive reforms to income tax and net wealth tax. The Treasury's private income tax will be reduced by one percentage point at the beginning of 2005, a further percentage point at the beginning of 2006 and two percentage points in 2007, leaving it at 21.75% of the tax base. Net wealth tax for private individuals and legal entities was abolished, so that in 2006 it will not be levied on net wealth at the end of 2005. Child allowance will be raised in two similar steps in 2006 and 2007. The draft bill estimates that total child allowance outlays will be 2.4 b.kr. higher in 2007 than in 2005.

On December 21, Kaupthing Sofi Oyj, the Finnish subsidiary of KB banki hf., was licensed as a bank by the Finnish FSA and will be renamed Kaupthing Bank Oyj. KB banki hf. and its subsidiaries now have banking licences in five countries.

# Economic and monetary chronicle 2005

## January

On January 1, the average municipal income tax rate in the PAYE system went up from 12.83% to 12.98%. The main factor at work was the decision by local authorities in Reykjavík and neighbouring Kópavogur to levy the maximum municipal income tax rate of 13.03%. However, the total PAYE income tax rate went down by 0.85%, from 38.58% to 37.73%, due to the recently approved cut in state personal income tax.

On January 13, Íslandsbanki hf. increased its share capital by a nominal value of 1.8 b.kr. Originally, a pre-emptive rights issue of 1,500 million shares of 1 kr. each was made, but a further 300 million were offered to meet excess demand. The price of the new capital was 10.65 kr. per share and the market value of the offering just over 19 b.kr. Total nominal share capital in Íslandsbanki hf. after the increase is 13 b.kr.

On January 20, Landsbanki Íslands hf. announced its decision to establish a branch in the UK.

## February

On February 3, Moody's Investors Service affirmed Landsbanki Islands' A3 long-term and P-1 short-term debt and deposit ratings and its C financial strength rating. The outlook on all ratings remained positive.

On February 10, Standard & Poor's Ratings Services raised its longterm foreign currency sovereign credit rating on the Republic of Iceland to AA- from A+, and affirmed the AA+ long-term local currency and A-1+ short-term foreign and local currency ratings. The outlook was stable. The state Housing Financing Fund's (HFF) rating was upgraded correspondingly, but S&P placed the HFF's AA+ longterm local currency credit rating on CreditWatch with negative implications, following recent changes in the Icelandic mortgage market, which had reduced the HFF's market share. S&P removed the AA+ long-term currency issuer credit rating on the HFF from CreditWatch on February 16 and changed the outlook on the local currency rating to negative.

On February 17, Íslandsbanki hf. received a banking licence from the Ministry of Finance in Luxembourg. The new bank is planned to commence operations in spring 2005 and aims to expand the activities of Íslandsbanki's current branch in Luxembourg.

On February 18, the Board of Governors of the Central Bank submitted a report to the Government of Iceland after inflation moved beyond the tolerance limits in February. At the same time, the Board of Governors announced its decision to raise the Central Bank's policy rate (repo rate) by half a percentage point to 8.75% as of February 22. The Central Bank's other interest rates were also hiked by half a percentage point as of February 21.

## March

On March 7, Moody's Investors Service upgraded the long-term deposit and senior debt ratings of Landsbanki Íslands hf. to A2 from A3. The outlook on these ratings is stable. At the same time, Moody's affirmed with a stable outlook its financial strength rating of C (outlook changed to stable from positive) and the P-1 short-term deposit and debt ratings.

On March 15, Íslandsbanki hf. increased its share capital by a nominal value of just over 134 m.kr. Shareholders were given the option of receiving part of their dividends in the form of these new shares at the price of 10.65 kr. per share. After the increase, Íslandsbanki's listed nominal share capital amounts to 13,134 m.kr.

On March 16, Landsbanki Íslands hf. announced its completion of a €350m (28 b.kr.) subordinated bond issue under its EMTN programme. It consisted of two tranches: €150m of Tier I capital and €200m of Tier II capital.

On March 18, Straumur Fjárfestingarbanki hf. investment bank announced an issue of subordinated bonds in the amount of 5 b.kr. This was Straumur's first subordinated debt issue and was classified as Tier II capital.

On March 22, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.25 percentage points to 9% as of March 29. Other interest rates were also raised as of April 1: on credit institutions' current accounts in the Bank by 0.5 percentage points and on their reserve accounts by 0.25 percentage points.

On March 31, Straumur Fjárfestingarbanki hf. investment bank increased its share capital by a nominal value of 700 m.kr. After the increase, Straumur's listed nominal share capital on Iceland Stock Exchange (ICEX) was 6.1 b.kr. Sale price of the new shares was 7 b.kr.

#### **April**

On April 1, Bolig- og Næringsbanken ASA (BNbank) of Norway became part of the Íslandsbanki hf. consolidated accounts after all conditions for Íslandsbanki's acquisition of it had been fulfilled. Íslandsbanki originally bid for all the shares in BNbank on November 15, 2004. The offering price was NOK 3.3 b. (35 b.kr.) and the final condition for the acquisition was fulfilled on March 15.

On April 13, Íslandsbanki hf. announced that its subsidiary SB Luxembourg S.A. had formally started operations and lending activities of Íslandsbanki's branch in Luxembourg would be transferred to it.

On April 18, Landsbanki Íslands hf. increased its share capital by a nominal value of 800 m.kr. After the increase, Landsbanki's listed nominal share capital on ICEX was 8.9 b.kr. Sale price of the new shares was 11.4 b.kr.

On April 19, Íslandsbanki hf. sold 66.6% of shares in its insurance subsidiary Sjóvá to Páttur eignarhaldsfélag ehf. holding company for 17.5 b.kr. Sjóvá thereby ceased to be part of the Íslandsbanki consolidated accounts. After the sale, Íslandsbanki holds 33.4% of shares in Sjóvá.

#### **May**

On May 2, it was announced that the Central Bank would purchase foreign currency in the domestic interbank market on behalf of the Treasury, in connection with a discretionary prepayment of Treasury foreign debt. The purchase was made in tranches of 20 m. US dollars each, on May 12, 17, 19, 23 and 25.

On May 10, Moody's Investors Service affirmed Kaupthing Bank's A1 long-term and P-1 short-term debt and deposit ratings, and its C+ financial strength rating.

On May 10, Moody's Investors Service downgraded the financial strength rating of Íslandsbanki hf. to C+. Moody's affirmed Íslandsbanki's A1 long-term and P-1 short-term debt and deposit ratings, with a stable outlook.

#### **June**

On June 3, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.5 percentage points to 9.5% as of June 7. For one-week certificates of deposit, the rate of interest was set at 0.15 percentage points below the repo rate and ceilings were abolished in weekly auctions. Other Central Bank interest rates were also raised as of June 11: on credit institutions' current accounts in the Central Bank by 0.75 percentage points and on overnight loans by 0.25 percentage points.

On June 15, Íslandsbanki hf. announced an issue of subordinated capital bonds in the amount €150 million (12 b.kr.). The bonds will be accounted for as Own Funds Part A (Tier I) under rules on additional own funds items for financial undertakings.

#### **July**

On July 12, the Central Bank announced a new currency basket following the annual revision on the basis of Iceland's foreign trade in goods and services the preceding year. The new basket took effect the same day.

On July 19, Moody's Investors Service affirmed its ratings on the Republic of Iceland at Aaa for long-term obligations and P-1 for short-term obligations, both in foreign and domestic currency, with a stable outlook.

## New currency basket 2005 (%)

Based on foreign trade in 2004

<i>Region</i>	<i>Currency</i>	<i>Export basket</i>	<i>Import basket</i>	<i>Currency basket</i>	<i>Change on previous basket</i>
USA	USD	22.03	24.02	23.03	1.19
UK	GBP	14.66	9.55	12.10	0.21
Canada	CAD	1.27	0.94	1.10	0.04
Denmark	DKK	7.67	8.59	8.13	-0.28
Norway	NOK	5.02	7.05	6.04	0.13
Sweden	SEK	2.11	5.64	3.87	0.19
Switzerland	CHF	1.50	0.92	1.21	-0.18
Euro area	EUR	42.67	39.60	41.14	-1.23
Japan	JPY	3.07	3.69	3.38	-0.07
North America		23.30	24.96	24.13	1.23
Europe		73.63	71.35	72.49	-1.16
EU		67.11	63.38	65.24	-1.11
Japan		3.07	3.69	3.38	-0.07
Total		100.00	100.00	100.00	0.00

On July 11, Kaupthing Bank announced that all the conditions set for Kaupthing Holdings UK's offer for the acquisition and control of Singer & Friedlander Group Plc had been fulfilled. It is subsequently intended to delist Singer & Friedlander shares from London Stock Exchange. The offer price was 316 pence per share, which is equivalent to 547 million pounds (64.6 b.kr.) for all issued share capital in Singer & Friedlander. The board of Singer & Friedlander recommended shareholders to accept the offer. Before this acquisition, Kaupthing Bank held a 19.5% share in Singer & Friedlander.

**August**

On August 3, Fitch Ratings, the international rating agency, affirmed the ratings of Landsbanki Íslands hf. at long-term A, short-term F1, individual C and support 2. The outlook remains stable.

On August 4, Fitch Ratings affirmed the Republic of Iceland's longterm foreign and local currency ratings at AA- and AAA respectively with a stable outlook. The short-term foreign currency rating was affirmed at F1+.

On August 5, the Treasury's 98.8% shareholding in Landssími Íslands (Iceland Telecom) was sold to Skipti ehf., an investor group comprising Exista ehf. (45%), Kaupthing Bank (30%), Lífeyrissjóður verslunarmanna (the Pension Fund of Commerce, 8.25%), Gildilífeyrissjóður pension fund (8.25%), Sameinaði lífeyrissjóðurinn pension fund (2.25%), Samvinnulífeyrissjóðurinn pension fund (2.25%), MP fjárfestingarbanki investment bank (2%) and Imis ehf. (2%). The acquisition price of 66.7 b.kr. was based on the Central Bank of Iceland's official exchange rate on July 27, 2005. It was spread between three currencies: 34,505,550,000 kr., €310,000,000 and 125,000,000 US dollars. The new owners are obliged to fulfil conditions set by the Treasury in its terms of sale. These include that no single entity or associated or related entities shall acquire a shareholding of more than 45% in Iceland Telecom until its listing on the Iceland Stock Exchange (ICEX) Main List, and that a minimum of 30% of total share capital shall be offered for sale to the public and investors no later than the end of 2007. Before that time, the company shall be listed on the ICEX Main List. After this privatisation, the state has completely withdrawn from competitive operation in the telecommunications market.

On August 12, Moody's Investor Service affirmed the ratings of Landsbanki Íslands hf. at A2 for long-term deposits, P-1 for shortterm liabilities and C for financial strength. The outlook was stable.

On August 17, Lánasjóður sveitarfélaga (Municipality Credit Iceland) was licensed to operate as a credit undertaking by the Financial Supervisory Authority (FME).

## September

On September 6, the Treasury received a payment of 66.7 b.kr. from Skipti ehf. for its shareholding in Iceland Telecom. The 32.2 b.kr. portion paid in foreign currency will be used to prepay external debt of the Treasury. Most of the remainder of the privatisation proceeds will be deposited in the Central Bank of Iceland and will be available over the period 2007-2010. The part of the payment rendered in Icelandic currency has been earmarked (at adjusted prices) as follows: 2007-2010: 15 b.kr. to roadbuilding; 2008-2012: 18 b.kr. towards the development of a high-technology hospital, 3 b.kr. to the purchase of a patrol vessel and aircraft for the Icelandic Coast Guard; 2.5 b.kr. towards promoting business innovation; 2.5 b.kr. to a telecommunications fund; 1 b.kr. to infrastructure investment for the mentally handicapped; and 1 b.kr. for new premises for an Institute of Icelandic Studies.

On September 8, the Central Bank announced that it will increase its regular currency purchases in the domestic interbank market on behalf of the Treasury. In light of the improved liquidity position of the Treasury, the Minister of Finance has decided to retire more of the government's foreign debt than had previously been planned. From September 12, the Bank will purchase 10 million US dollars a week in addition to the 2.5 million dollars that it has purchased weekly so far this year.

On September 15, Straumur Fjárfestingarbanki investment bank was renamed Straumur – Burðarás Fjárfestingabanki.

On September 29, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.75 percentage points to 10.25%. Other Central Bank interest rates were also raised by 0.75 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of October 4 and other rates as of October 1.

On September 30, Burðarás investment company was divided up and its separate parts were merged into Straumur – Burðarás Fjárfestingabanki and Landsbanki respectively, on completion of all the conditions for merger which had been laid down in an agreement from August 1. Burðarás was thereby removed from the register of companies.

## October

On October 1, the draft budget for 2006 was presented to Parliament. It assumed a budget surplus of 14 b.kr. The bill also presented the Government's medium-term fiscal programme for 2006-2010.

On October 3, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Iceland. The IMF Staff Report on the current economic outlook and prospects was compiled after Iceland received a regular staff visit in June. Four Selected Issues Papers were also completed on Simple Efficient Policy Rules and Inflation Control in Iceland; Some Illustrative Simulations of the Potential Impact of Income Tax Cuts in Iceland; Mortgage Market Developments in Iceland and the Role of the Housing Financing Fund; and Corporate Leverage: How Different is Iceland?

On October 14, the Staff Report was published on the IMF and Central Bank of Iceland websites. On October 3, the share capital of Landsbanki was increased by the nominal amount of 2,120 m.kr. The additional shares were delivered to Burðarás's shareholders as partial payment for their shares in that company. After the announcement, Landsbanki's nominal registered share capital amounted to 11,020,677,803 kr.

On October 3, the share capital of Straumur – Burðarás Fjárfestingabanki was increased by the nominal amount of 4,575 m.kr. The additional shares were delivered to Burðarás's shareholders as partial payment for their shares in that company. After the announcement, Straumur – Burðarás Fjárfestingabanki's nominal registered share capital amounted to 10,675,747,810 kr.

On October 3, the share capital of Straumur – Burðarás Fjárfestingabanki was reduced by the nominal amount of 316 m.kr. The reduction of shares was carried out in accordance with the agreement on the acquisition of shares in Burðarás Fjárfestingarbanki whereby shares owned by Burðarás in Straumur at the time of merger would be cancelled and the share capital of Straumur reduced accordingly. After the announcement, Straumur – Burðarás Fjárfestingabanki's nominal registered share capital amounted to 10,359,144,971 kr.



On October 31, the share capital of Kaupthing Bank was increased by 3,867,413 shares. The objective of the increase was to fulfil the terms of employee stock option agreements. The total nominal share capital of Kaupthing Bank after the increase was, 645,530,530 kr.

On October 31, Standard & Poor's Ratings Services affirmed its AA long-term foreign currency and AA+ long-term local currency sovereign credit rating on the Republic of Iceland. At the same time, the A-1+ short-term foreign and local currency ratings on Iceland were affirmed. The outlook is stable.

### November

On November 14, Landsbanki announced that all conditions had been satisfied for its acquisition of Kepler Equities SA and the transaction had been completed. Kepler Equities thereby became part of the Landsbanki group. Landsbanki acquired 82% of the total shares of Kepler Equities for 76.1 million pounds sterling (5.8 b.kr.) and will acquire the remaining shares over a five-year period.

On November 15, the joint committee of the Icelandic Federation of Labour (ASÍ) and Confederation of Employers (SA) reviewing the wage agreement between their members concluded that the price assumptions underlying the current wage agreements had not held. The wage section of the agreements was renegotiated. A one-off payment of 26,000 kr. was agreed for December 2005. This is equivalent to an additional wage rise of roughly 0.65% over the 13 months from that time. If wage settlements are not revoked in the second review in November 2006, wages will go up at the beginning of 2007 by 0.65% on top of the 2.25% originally negotiated in 2004. The social partners also agreed on principles for revising unemployment insurance. The Government of Iceland issued a declaration (see below) that it will sponsor legislation on changes agreed by the social partners and finance the measures with payments from the Unemployment Insurance Fund. Under the ASÍ/SA agreement, unemployment benefit will be earnings-related with a ceiling of 180,000 kr. Earnings-related benefit will be paid from the tenth weekday of unemployment, for no longer than three months over a three-year period. Entitlement to benefit will be renewed over a period of twenty-four months. Basic unemployment insurance benefit will be 96,000 kr. when the new law enters into force in 2006, instead of 93,821 kr., and be revised in step with wage changes at the beginning of 2007.

On November 15, the Government of Iceland issued a declaration on its measures to facilitate the wage review agreement between ASÍ and SA. The Government presented a four-point package: First, a contribution of 100 m.kr. to vocational training and retraining of unskilled workers. Second, measures to facilitate a more even distribution of the disability pension burden between pension funds covered by the agreements between ASÍ and SA with a contribution equivalent to 0.25% of the national insurance base, to be implemented over the period 2007-2009. Based on current forecasts for unemployment insurance revenues, this measure would cost the Treasury 1.5 b.kr. Third, the Government will sponsor legislation on temporary employment agencies for approval by Parliament before the Christmas 2005 recess. Fourth, the Government pledged to sponsor legislation on changes to the payment of unemployment benefits in line with the ASÍ/SA agreement, financing the measures with payments from the Unemployment Insurance Fund.

On November 18, the Government decided to grant old-age pensioners and recipients of disability benefits the same one-off payment that was negotiated when the social partners extended current wage settlements. This measure will cost the Treasury an estimated 700 m.kr.

On November 22, Fitch Ratings upgraded Íslandsbanki's individual rating to B/C from C and affirmed the other ratings at long-term A, short-term F1 and support 2. The rating outlook is stable.

On November 22, Fitch Ratings assigned Kaupthing Bank ratings of long-term of A, short-term F1, individual B/C and support 2. The rating outlook is stable.

On November 29, the supplementary budget for 2005 was passed by Parliament with a surplus of 91 b.kr., of which 64 b.kr. was accounted for by the privatisation of Iceland Telecom. Estimated regular revenues were 10.7% higher than the budget figures, and regular expenditures 3.5% higher.

On November 29, Fitch Ratings upgraded the individual rating of Landsbanki Íslands to B/C from C, and affirmed its other ratings at long-term A, short-term F1 and support 2. The rating outlook is stable.

### **December**

On December 2, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.25 percentage points to 10.5%. Other Central Bank interest rates were also raised by 0.25 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of December 6 and other rates as of December 11.

On December 2, the formal interest rate decision dates for 2006 were announced in Monetary Bulletin, under a new arrangement described in a Central Bank press release from November 11. As of 2006, Monetary Bulletin will be published three times a year instead of quarterly. Besides the publication dates for Monetary Bulletin, interest rate decisions will be announced on three other fixed dates, together with detailed explanations for them. Thus there will be six interest rate decision dates in 2006: the publication dates of Monetary Bulletin on March 30, July 6 and November 2, and announcements with press releases on January 26, May 18 and September 14.

On December 2, the Central Bank announced in Monetary Bulletin its plans to make weekly purchases of 5 million US dollars in 2006 to meet Treasury requirements and strengthen the foreign reserves. The Bank purchased 2.5 m. US dollars five times a week until the end of 2005 and reduced this to 2.5 m. US dollars twice a week in 2006. Under a new arrangement until the end of 2006, the Central Bank will purchase currency before the interbank market opens on Monday and Wednesday mornings.

On December 7, the budget for 2006 was passed by Parliament with a 20 b.kr. surplus. Regular revenues of the Treasury are expected to decrease by 5.1% in real terms and regular real expenditures by 3.8%.

On December 21, Landsbanki Íslands announced that all conditions for its acquisition of Merrion Capital Group Limited had been met and the transaction was complete. Landsbanki will acquire an initial 50% shareholding in Merrion and the remaining 50% over the next three years. Merrion was initially valued at 4 b.kr. but the subsequent acquisition price will be based on future profits generated by it.



# Economic and monetary chronicle 2006

## January

On January 1, the second phase of the income tax cuts approved by Parliament in autumn 2004 went into effect. The personal income tax rate was lowered from 24.75% to 23.75%. The personal allowance was raised by 2.5% and the average municipal income tax rate was lowered marginally from 12.98% to 12.97%. Thus the total personal income tax PAYE rate will be 36.72% in 2006, compared with 37.73% in 2005.

On January 1, net wealth tax on private persons and legal entities was also abolished, i.e. it will not be levied on assets held at the end of 2005. The surcharge on highest incomes was also abolished at the end of the year; it will be levied this summer in the final settlement of taxes on income earned in 2005, but will not be levied on income in 2006.

On January 20, Fitch Ratings assigned Straumur-Burðar ás Fjárfestingabanki investment bank ratings of long-term BBB-, short-term F3, individual C/D and support 3. The rating outlook was stable.

On January 26, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.25 percentage points to 10.75%. Other Central Bank interest rates were also raised by 0.25 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of January 31 and other rates as of February 1.

## February

On February 21, Fitch Ratings affirmed the Republic of Iceland's issuer default ratings for long-term foreign and local currency at AA- and AAA respectively. The country ceiling was also affirmed at AA and the short-term foreign currency rating at F1+. The outlook was revised from stable to negative.

On February 24, the Central Bank of Iceland's revised internal Rules on the preparation, rationale and presentation of monetary policy decisions were formally ratified. The Rules were set with reference to the provisions of paragraph 3, Article 24 of Act No. 36/2001 on the Central Bank of Iceland. They have now been revised in light of experience and also the fact that as of 2006, the Board of Governors of the Central Bank of Iceland announces its interest rate decisions on fixed, preannounced days.

## March

On March 16, Standard & Poor's Ratings Services affirmed its AA long-term foreign currency and AA+ long-term local currency sovereign credit ratings on the Republic of Iceland. At the same time, the A-1+ short-term foreign and local currency ratings on Iceland were affirmed. The outlook remains stable.

On March 28, Standard & Poor's Rating Services announced its first credit rating for an Icelandic bank, Glitnir Bank (formerly Íslandsbanki). The ratings were long-term A- and short-term A-2, with a stable outlook.

On March 30, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.75 percentage points to 11.5%. Other Central Bank interest rates were also raised by 0.75 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of April 4 and other rates as of April 1.

On March 31, Kaupthing Bank issued € 500 million (43.5 b.kr.) of króna-denominated structured covered bonds. Issued to finance the bank's residential housing loans in Iceland, the bonds were assigned an Aaa credit rating by Moody's Investors Service.

## April

On April 4, Moody's Investor Service published a Special Comment on the Icelandic economy which found that Iceland is not experiencing undue risk to solvency or liquidity as result of recent volatility in the nation's business and financial cycles. The report is published on the Moody's website.

On April 4, Moody's Investor Service affirmed the deposit and debt ratings of Landsbanki Islands at A2 long-term and P-1 short-term. At the same time, the rating agency altered the outlook to negative from stable for Landsbanki's financial strength rating, which is currently C.

On April 4, Moody's Investor Service affirmed the deposit and debt ratings of Kaupthing Bank at A1 long-term and P-1 short term. At the same time, the rating agency put the bank's financial strength rating C+ on review for possible downgrade.

On April 4, Moody's Investor Service affirmed the deposit and debt ratings of Glitnir Bank at A1 long-term and P-1 short-term. At the same time, the rating agency altered Glitnir Bank's outlook to negative from stable for the bank's financial strength rating.

On April 24, Moody's Investors Service affirmed its ratings on the Republic of Iceland at Aaa for long-term obligations and P-1 for shortterm obligations, both in foreign and domestic currency, with a stable outlook.

## May

On May 1, changes to the Central Bank's Rules on liquidity entered into force. One objective of the review was to preclude intragroup transactions aimed at sidestepping the Bank's liquidity rules.

On May 1, changes to the Central Bank's Rules on foreign exchange balance entered into force. Two main changes were made: uniform exposures for individual currencies were introduced and financial institutions were allowed to maintain a separate positive foreign balance outside their total foreign balance as a hedge against the effect of exchange rate movements on their capital adequacy ratios.

On May 4, the Central Bank of Iceland published its Financial Stability report for 2006.

On May 4, the Ministry of Finance and National Debt Management Agency (NDMA) announced a new benchmark series of Treasury securities. The Minister of Finance assigned the NDMA to introduce regular issues of two-year Treasury notes and three-month Treasury bills in order to support economic policy decisions and improve interest rate formation in the bond market.

On May 8-15, an IMF mission visited Iceland for consultations with representatives of the authorities and the private sector. The mission's concluding statement was published on the websites of the Central Bank of Iceland and IMF on May 15.

On May 12, Kaupthing Bank issued subordinated bonds in the amount of 1,250 million US dollars (88.5 b.kr.). The issue is classified as Tier 2 capital.

On May 18, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.75 percentage points to 12.25%. Other Central Bank interest rates were also raised by 0.75 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of May 23 and other rates as of May 21.

On May 24, Glitnir Bank announced that it had acquired all the shares in the Swedish finance group Fischer Partners Fondkommission AB. The acquisition price was 3.7 b.kr.

On May 26, the NDMA signed an agreement in connection with Treasury securities issues and secondary market making. New rules on facilities for primary market makers entered into force on May 30. Primary market makers for Treasury securities – Glitnir Bank, Kaupthing Bank, Landsbanki, MP Fjárfestingarbanki investment bank and Straumur-Burðarás Fjárfestingabanki investment bank – have exclusive access to NDMA's securities lending facilities. The agreement covers all Government securities, replacing the previous two. On May 30, the NDMA auctioned a new series of three-month Treasury bills, RIKV 06 0901, maturing on September 1, 2006.

## June

On June 5, Standard & Poor's Ratings Services revised its outlook on the Republic of Iceland to negative from stable on the increasing likelihood of a hard landing for the country's economy. At the same time, Standard & Poor's affirmed its long-term AA- foreign and AA+ local, and its short-term A-1+ foreign and local currency sovereign credit ratings on the republic.

On June 12, Glitnir Bank issued subordinated bonds in the amount of 500 million US dollars (37 b.kr.). The issue is classified as Tier 2 capital.

On June 14, the NDMA issued a new series of two-year Treasury notes, RIKB 08 0613, maturing on June 13, 2008.

On June 22, the Federation of Labour (ASÍ) and Confederation of Employers (SA) signed a two-part agreement on a review of wage settlements. A joint ASÍ-SA review committee agreed on a wage development safety net which guarantees all employees covered by its settlements a minimum wage rise of 5.5% over the preceding year. SA and ASÍ, along with the latter's national associations, also agreed on a 15,000 kr. increment to all monthly wages as of July 1 inclusive.

On June 22, the Government of Iceland announced the following seven-point measures to facilitate the agreement on a wage review between ASÍ and SA: 1) The personal income tax credit (personal allowance) will be increased by 8.3% over and above the previously decided 2.25% increase and will be indexed to the CPI. 2) Legislation on mortgage interest allowance will be reviewed if rising housing prices erode these tax credits substantially. 3) Child allowances will apply to children up to the age of 18 instead of the present 16. 4) The personal income tax rate will be reduced by 1% in 2007 instead of the announced 2% cut. 5) Contributions to adult education and job training will be increased. 6) The Government will initiate cooperation with the social partners on foreign labour issues and the underground economy. 7) Basic monthly unemployment benefit will be increased by 15,000 kr. as of July 1. The ceiling for income-related unemployment benefit will also increase from 180,000 kr. to 185,000 kr.

On June 27, in continuation of the social partners' agreement, the Government agreed on: 1) a temporary reduction in the Housing Financing Fund's maximum loan-to-value ratio from 90% to 80% of house sale price and a reduction from 18 m.kr to 17 m.kr. in the maximum mortgage amount; 2) a temporary postponement of tenders and new public works investment by the central government; 3) initiation of talks with local authorities on comparable postponements on their part.

## July

On July 1, the Housing Financing Fund's loan-to-value ratio was temporarily lowered from 90% to 80% and the maximum mortgage amount from 18 m.kr. to 17 m.kr. as part of the government's restraint package.

On July 4, Glitnir Bank announced that all conditions for its acquisition of the Swedish brokerage firm Fischer Partners Fondkommission AB had been met and the transaction was complete. The acquisition price was 3.7 b.kr.

On July 6, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.75 percentage points to 13%. Interest rates on overnight loans and required reserves were raised by 0.5 percentage points and other Central Bank interest rates by 0.75 percentage points. All raises were made as of July 11. The Board of Governors also decided to assess the need for further monetary restraint in the middle of August and announce a decision on interest rates on August 16.

On July 17, Standard & Poor's Ratings Services lowered its long-term local currency issuer credit rating on the Icelandic Housing Financing Fund (HFF) to AA- from AA+. The rating was removed from Credit-Watch. At the same time, the AA- long-term foreign currency and the A-1+ short-term foreign and local currency ratings on HFF were affirmed. The foreign currency outlook is negative but the local currency outlook is stable.

## August

On August 16, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.5 percentage points to 13.5%. Interest rates on

overnight loans and required reserves were raised by 0.25 percentage points and other Central Bank interest rates by 0.5 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of August 22 and other rates as of August 21.

### September

On September 12, Moody's Investors Service downgraded the Bank Financial Strength Rating of Kaupthing Bank from C+ to C. At the same time it affirmed Kaupthing's A1/Prime-1 deposit ratings. The outlook on all ratings is stable.

On September 12, Glitnir Bank announced the issue of subordinated bonds in the amount of 250 million US dollars (18 b.kr.). The issue is classified as Tier 1 capital.

On September 14, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.5 percentage points to 14%. Other Central Bank interest rates were also raised by 0.5 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of September 19 and other rates as of September 21.

On September 25, Landsbanki announced that all conditions for its acquisition of Guernsey-based bank Cheshire Guernsey Limited had been met and the transaction was complete. The bank was included in the Landsbanki Group consolidated accounts as of the end of Q3/2006 and its name will subsequently be changed to Landsbanki Guernsey Limited.

### November

On November 1, an agreement was signed confirming the Treasury's acquisition of the shares held in Landsvirkjun (the national power company) by the City of Reykjavík and Town of Akureyri, conditional upon the approval of their councils.

On November 9, Fitch Ratings affirmed Iceland's foreign and local currency issuer default ratings of AA-/AAA. The outlook remained negative. On November 24, Parliament approved a government bill raising mortgage interest relief, in keeping with a commitment made during the public sector wage review in June 2006.

On November 27, Kaupthing Bank issued new shares of nominal value 660 m.kr. in an offering to international institutional investors. On December 1, Kaupthing Bank made a further issue, after exercising overallotment option, of nominal value 99 m.kr. These new issues raised the total nominal value of the bank's listed shares to 7,404,530,530 kr.

In November, the Republic of Iceland completed a five-year €1 billion Eurobond issue in international bond markets. The entire proceeds from the issue were used to strengthen the foreign reserves of the Central Bank of Iceland.

### December

On December 1, market makers in the FX market began trading in euros instead of US dollars. Their minimum indicative bid is set at € 3 million. Market makers continue to quote prices in US dollars.

On December 1, OMX AB shares were listed on Iceland Stock Exchange (ICEX) Main List. The listing of OMX was the first secondary listing on ICEX. OMX shares are primary-listed on Stockholm Stock Exchange.

On December 4, the state budget for 2007 was passed by Parliament. The surplus excluding irregular items is estimated at 9 b.kr., with total revenues amounting to 376 b.kr. and total expenditures 367 b.kr.

On December 4, the supplementary budget for 2006 was passed by Parliament. Additional revenues amounted to 44 b.kr. and additional expenditures to 20 b.kr., and additional borrowing of 87 b.kr. was authorised in order to strengthen the Central Bank of Iceland's foreign reserves.

On December 8, Parliament agreed to convert Municipality Credit Iceland into a statutory limited liability company.

On December 8, the Government agreed to raise unemployment benefit by 2.9% on January 1, 2007, instead of the previously announced increase of 2.25%.

On December 8, the Financial Supervisory Authority (FME) approved the merger of two savings banks, Sparisjóður vélstjóra and Sparisjóður Hafnarfjarðar.

On December 9, Parliament passed a government-sponsored bill raising the minimum pension fund contribution from 10% of wages to 12% and authorising funds no longer backed by employer guarantees to amend their articles of association accordingly.

On December 9, Parliament amended the Income Tax Act to lower the personal income tax rate by 1 percentage point at the beginning of 2007, instead of the previously announced 2 percentage points, while increasing the personal tax-free threshold by 14%. The personal tax credit was also indexed to the CPI and child allowance extended to the age of 18.

On December 9, Parliament agreed to extend the temporary cut in fuel tax and mileage tax on heavy-duty vehicles from 2004 until the end of 2007.

On December 9, Parliament agreed to cut VAT and excise on food, catering, compact discs and other categories from 14% or 24.5% to 7%, and to abolish commodity taxes on domestic and imported food excluding confectionery.

On December 9, Parliament agreed to cut the payroll tax by 0.45 percentage points, and 0.25% of the payroll tax base will be paid annually to pension funds in proportion to their disability benefit commitments, phased in at 0.15% in 2007 and 0.20% in 2008.

On December 19, Straumur-Burðarás investment bank announced its decision to prepare its accounts and annual financial statements in euros effective from January 1, 2007. At its annual meeting in March 2007, shareholders in Straumur-Burðarás approved an amendment to the company's articles authorising the board to determine the issue of company share capital in euros instead of Icelandic krónur.

On December 21, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its collateral loan rate in transactions with credit institutions) by 0.25 percentage points to 14.25%. Other Central Bank interest rates were also raised by 0.25 percentage points. Interest rates on one-week certificates of deposit and the collateral loan rate were raised as of December 27 and other rates as of December 21.

On December 22, Standard & Poor's Ratings Services lowered its foreign currency sovereign credit ratings on the Republic of Iceland to A+ long-term and A-1 short-term, from AA- and A-1+, respectively. At the same time, the long-term local currency rating on Iceland was lowered to AA from AA+, and the short-term local currency rating was affirmed at A-1+. The outlook was changed from negative to stable.

# Economic and monetary chronicle 2007

## February

On February 6, Moody's Investors Service downgraded the financial strength rating of Glitnir from C+ to C, and affirmed the bank's A1/P-1 credit rating.

On February 20, the Central Bank of Iceland made króna-denominated bonds issued outside Iceland eligible as collateral for its loan facilities. Conditions include a minimum issue of 20 b.kr.

On February 23, Moody's Investor Service upgraded the credit ratings of Kaupthing Bank, Glitnir and Landsbanki due to changes in its joint default analysis (JDA) methodology. Long-term credit ratings were upgraded to Aaa, from A1 for Glitnir and Kaupthing Bank and from A2 for Landsbanki. Ratings for short-term obligations in local and foreign currencies and for financial strength were affirmed at P-1 and C, respectively. Shortly after the upgrade, Moody's announced that it would review its methodology and issue new ratings in April 2007.

## March

On March 1, the Housing Financing Fund raised its loan-to-value ratio from 80% to 90% and its maximum mortgage amount from 17 m.kr. to 18 m.kr.

On March 2, Landsbanki announced the sale of all its shares in Landsafl real estate investment company. The sale positively impacted Landsbanki's equity by approximately 3.5 b.kr.

On March 15, 2007 Fitch Ratings downgraded Iceland's foreign and local currency issuer default ratings to A+ and AA+ from AA- and AAA respectively. The outlook on both ratings was stable. The short-term foreign currency rating was also downgraded to F1 from F1+ and the country ceiling was lowered to AA- from AA.

On March 16, Parliament amended the Act on the Affairs of the Elderly whereby taxpayers paying only personal capital income tax now pay the same rate of contribution to the Senior Citizens' Building Fund as payers of personal income tax on wages.

On March 17, Parliament passed a government bill exempting companies from income tax on their gains on trading in equities that they have held for more than one year.

On March 16, Glitnir announced that it had completed the acquisition of 68.1% of shares in FIM Group Corporation of Finland. Glitnir planned to launch a tender offer for the remaining shares in FIM Group in early April. In all, Glitnir will pay 30 b.kr. to acquire FIM Group.

On March 29, the Board of Governors of the Central Bank of Iceland announced its decision to leave the Bank's policy rate unchanged.

## April

On April 10, Moody's Investor Service downgraded its credit ratings for Glitnir, Kaupthing Bank and Landsbanki following a review of its new Joint Default Analysis (JDA) rating methodology. The banks' longterm local currency ratings were lowered from Aaa to Aa3. Their ratings for short-term debt and financial strength remained unchanged at P-1 and C respectively.

On April 20, the Financial Supervisory Authority (FME) granted Saga Capital a licence to operate as an investment bank.

## May

On May 3, the Treasury sold its 15.2% shareholding in Hitaveita Suðurnesja (Suðurnes Regional Heating) to the privately owned Geysir Green Energy for 7.6 b.kr.



On May 16, the Board of Governors of the Central Bank of Iceland announced its decision to leave the Bank's policy rate unchanged.

On May 16, Glitnir completed its public tender offer for all issued and outstanding shares and option rights in FIM Group Corporation of Finland. Afterwards, Glitnir's total holding in FIM was 98.28%. FIM was included in Glitnir's consolidated statements as of April 1, 2007.

On May 22, Straumur-Burðarás investment bank announced its acquisition of a majority shareholding in the Finnish bank eQ Corporation and an offer for the outstanding shares and option rights in it. The combined value of the acquisitions and offer is €260 million.

From May 31 to June 11, an IMF mission visited Iceland for consultations with representatives of the authorities and the private sector. The mission's concluding statement was published on the websites of the IMF and Central Bank of Iceland on June 11.

## June

On June 6, Rating and Investment Information (R&I), a Japan-based rating agency, assigned an A+ credit rating to Kaupthing Bank, the agency's first rating for an Icelandic bank. The rating outlook is stable.

On June 6, R&I Rating of Japan announced its first rating for the Republic of Iceland, assigning it a foreign currency issuer rating of AA+. The outlook was stable. The rating was announced in connection with a formal request by Kaupthing Bank for a rating from the agency. R&I Ratings also decided to assign a rating to the Republic of Iceland, although this had not been requested by the authorities.

On June 13, parliament elected a new Supervisory Board for the Central Bank of Iceland, pursuant to Article 26 of the Central Bank Act no. 36 from May 22, 2001. At its first meeting, the Supervisory Board elected Halldór Blöndal as Chairman and Jón Sigurðsson as Deputy Chairman.

On June 13, parliament passed amendments to the Social Security Act and Act on the Affairs of the Elderly whereby basic pension payments from the Social Insurance Administration are no longer means-tested against earnings from employment of pensioners aged 70 and older. The reform is expected to cost the Treasury 6-700 m.kr. annually.

On June 21, new rules on Central Bank of Iceland facilities for financial undertakings entered into force. The amendments were largely of a technical nature but the Bank drew attention to two specific aspects of the changes. It was decided to rename the Central Bank's lending facility for financial companies to which the policy rate applies. This facility was known as repos but is now termed collateral loans, because strictly speaking it did not involve repurchase agreements. The second change relates to the numerical presentation of the policy interest rate. Until now, the Central Bank has announced its policy rate in terms of the annual rate of return and not the nominal interest rate. It was decided that all Central Bank interest rates will in future be stated and announced as nominal rates.

On June 26, Kaupthing Bank announced the issue of subordinated bonds in the amount of EUR 250 million or approximately 21 b.kr. The bonds are classified as Tier 1 capital.

## July

On July 5, the Board of Governors of the Central Bank of Iceland announced its decision to leave the Bank's policy interest rate unchanged.

On July 5, the Financial Supervisory Authority (FME) approved the merger of VBS Investment Bank Inc. and Fjárfestingarfélag sparisjóðanna (FSP) under the name VBS Investment Bank Inc.

On July 6, the government announced a one-third cut in the cod quota allocation for the coming fishing year and plans for offsetting policy actions. The actions are primarily designed to moderate the initial impact of the income reduction associated with a cut in the cod catch, to support the fishing communities and to bolster marine research. The government's offsetting policy actions call for approximately 6.5 b.kr. to be spent over the next three years on

new projects designed to support economic activity in the country, strengthen education, and provide alternative options for individuals who will suffer loss of income. In addition, expenditure of more than 4 b.kr. will be disbursed on an expedited basis for previously planned projects in the transportation and communications sector. Work on the projects involved is scheduled to be undertaken in 2008-2010.

On July 30, the National Debt Management Agency solicited tenders for Treasury Bills RIKV 07 1101. Bids were requested for the issue and the total amount was estimated to be in the 2,500-5,000 m.kr. range. The nominal value of all bids received was 8,500 m.kr. Bids were accepted for a nominal amount of 5,000 m.kr. at an average yield of 13.82%. The highest yield of bids accepted was 13.90% and the lowest was 13.58%.

On July 31, the Board of Directors of Landsbanki Íslands exercised its authorization to raise the share capital of Landsbanki Íslands by a nominal amount of 172,076,284 kr. in accordance with a resolution approved by its Annual General Meeting, held on February 9, 2007. The new shares will be used as payment for 90% of the total price payable for the takeover of the UK broker and investment bank Bridgewater Group plc. New shares in Landsbanki were issued on August 8 and registered in the OMX Nordic Stock Exchange Iceland on August 9. Bridgewater became part of the consolidated accounts of Landsbanki as of August 10, 2007. The operations of Bridgewater and Teather & Greenwood will be merged under the name of Landsbanki Securities UK.

### **August**

On August 15, Kaupthing Bank announced the signing of a purchase agreement for all the shares of the Dutch bank NIBC Holding BV for approximately EUR 3 billion or 270 b.kr. Kaupthing will pay the seller part of the purchase price with an issue of 110 million new shares, worth a total of EUR 1,360 million. EUR 1,625 million is to be paid in cash from disposable funds from a subordinated bond issue and the proceeds of 40 million new shares to be offered to pre-emptive right shareholders.

On August 29, the FME granted Straumur-Burdaras Investment Bank an operating licence as a commercial bank.

On August 30, the National Debt Management Agency solicited tenders for Treasury Bills RIKV 07 1203. Bids were requested for the issue and the total amount was estimated to be in the 2,500-5,000 m.kr. range. The nominal value of all bids received was 7,900 m.kr. Bids were accepted for a nominal amount of 4,450 m.kr. at an average yield of 14.13%. The highest yield of bids accepted was 14.31% and the lowest was 13.95%.

### **September**

On September 3, the Board of Directors of Straumur-Burdaras Investment Bank, acting under the company's resolution and the decision of a meeting of shareholders held on March 8, 2007, decided to record the Bank's share capital in euros instead of Icelandic krónas. Straumur's share capital will be EUR 109,493,129 instead of ISK 10,359,144,971. The conversion will not change shareholders' ownership proportions within the company and, as such, will not affect the value of each individual's holdings.

On September 4, it was announced that the Minister of Finance had decided to entrust the Central Bank of Iceland with the issue of government's domestic market securities, which had previously been handled by the National Debt Management Agency. This places the supervision of all Treasury's loan operations within a single agency.

On September 6, the Board of Governors of the Central Bank of Iceland announced its decision to leave the Bank's policy interest rate unchanged.

On September 19, tenders were solicited for the issue of 2-year Treasury Bills RIKB 09 0612. The nominal value of all bids received was 8,000 m.kr. and bids were accepted in the amount of 4,300 m.kr. The average required rate of return was 13.46%. In the non-competitive average price part of the tender conducted over the next two days, 430 m.kr. were on offer, all of which was taken up by Primary Dealers. At the end of September the outstanding amount under the issue was 15,505 m.kr. Under the program for the year 2007, it was planned to issue Treasury Bills in the nominal amount of 25 b.kr., and that target was achieved with this tender.



On September 20, the FME authorized the conversion of Sparisjóður Reykjavíkur og nágrennis (SPRON) to a limited liability company. SPRON is considered a limited liability company as of April 1, 2007. Shares of SPRON were accepted for trading on the main market of the OMX Nordic Stock Exchange Iceland on Tuesday, October 23. The number of SPRON shares issued is 5,004,000,000 and the nominal value of each share is one króna.

On September 27, the National Debt Management Agency solicited tenders for Treasury Bills RIKV 08 0103. Bids were requested for the issue and the total amount was estimated to be in the 2,500-5,000 m.kr. range. The nominal value of all bids received was 8,250 m.kr. Bids were accepted for a nominal amount of 3,550 m.kr. at an average yield of 14.06%. The highest yield of bids accepted was 14.12% and the lowest was 13.95%.

### **October**

On October 1, the operations of the National Debt Management Agency were transferred to the Central Bank of Iceland. The unit's name is "Lánamál ríkisins" in Icelandic and Government Debt Management in English.

On October 11, Kaupthing Bank announced the issue of subordinated bonds in the amount of 400 million US dollars or approximately 24 b.kr. The bonds are classified as Tier 1 capital.

On October 12, Landsbanki Íslands issued subordinated bonds in the amount of 400 million US dollars or approximately 24 b.kr. The bonds are classified as Tier 1 capital.

### **November**

On November 1, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 0.45 percentage points to 13.75%.

On November 20, rating agency Standard & Poor's announced that it had changed the outlook for the Republic of Iceland's sovereign credit rating from stable to negative. The agency affirmed its foreign currency sovereign credit ratings of A+ for long-term obligations and A-1 for short-term obligations. The local currency sovereign ratings are AA for long-term obligations and A-1+ for short-term obligations.

### **December**

On December 6, the supplementary budget for 2007 was approved by Parliament. Estimated tax revenues increased by 20% from the original budget, and estimated fiscal performance improved from 9 b.kr. to 83 b.kr.

On December 12, the Norwegian Ministry of Finance approved the merger of Glitnir Bank ASA and BNbank. The merged entity has also been authorised to acquire all shares in Glitnir Factoring ASA and Glitnir Securities ASA, as well as a 70% share in Glitnir Property Holding AS, with the subsidiary Glitnir Property Group AS.

On December 13, the fiscal budget for 2008 was approved by Parliament, with revenues amounting to 473 b.kr., expenditures amounting to 434 b.kr., and a surplus of 39 b.kr. The increase in revenues over and above the 2007 budget was estimated at 0.3% and the increase in expenditures at 11½%. On the same day, Parliament approved a temporary reduction in oil charges, from 45 kr./l. to 41 kr./l., and an indefinite extension of the temporary reduction in the fee schedule for special per-kilometre fees for diesel vehicles.

# Economic and monetary chronicle 2008

## January

On January 14, the Government Debt Management Prospect for 2008 was announced. The Prospect described the proposed issue of Treasury notes with a nominal value of 47 b.kr., as well as a new benchmark series of 11-year Treasury notes. It also announced that the Treasury intended to discontinue the issuance of Treasury bills and pay up foreign debt maturing during the year.

On January 28, Moody's Investors Service issued a special comment on Iceland entitled, "Iceland's Aaa ratings are at a crossroads". The report did not announce any change in ratings on the Republic of Iceland.

On January 30, Kaupthing Bank announced that the bank and NIBC had decided to abandon Kaupthing's proposed acquisition of NIBC in view of financial market turbulence. Applications for approval by the pertinent regulatory authorities were withdrawn, and the purchase agreement was invalidated. As a result, the priority offering planned by Kaupthing for the first quarter of 2008 did not materialise.

On January 31, international rating agency Fitch Ratings affirmed Kaupthing Bank's credit rating and revised its outlook from negative to stable. The outlook for the rating had been negative since December 6. Kau

## February

On February 1, the rules concerning the official customs clearance exchange rate were amended so as to base the customs price on the exchange rate registered by the Central Bank on the working day immediately preceding the customs clearance date.

On February 17, new wage settlements were signed by the national member organisations and the largest unions within the Icelandic Federation of Labour (ASÍ) and the Confederation of Icelandic Employers (SA). The wage settlements remain in effect until November 30, 2010, and are identical in their fundamentals. The negotiating parties have estimated that total costs incurred by employers will rise by just under 11% during the term of the settlement, or by an average of 3½% annually. There are three main pillars in the settlements: a "safety net" for wage developments, an increase in the lowest wage rates, and a review clause in 2009. No general wage rise is included until the final year; instead, workers are guaranteed specified wage developments during the first two years. The settlement also provided for the establishment of a Worker Rehabilitation Fund, whose function is to provide assistance and services to employees who are injured or have long-term illnesses. Further provisions include an increase in vacation days and in days of leave due to children's illnesses. The assumptions underlying the settlements are two. First, real wages in the private sector, according to the Statistics Iceland wage index, must not drop between January and December 2008. The other assumption concerns maximum inflation levels. At the beginning of February 2009, the review committee will meet in order to discuss an extension of the agreement based on the underlying assumptions. If they have held, the agreement will be extended until November 30, 2010; if not, the parties will attempt to reach a consensus on their response to the changes. If they cannot reach a consensus, the agreement will expire at the end of February 2009. In connection with the signing of the private sector wage settlements on February 17, the Government pledged to raise the tax-free income threshold in excess of price levels, reduce income-linked cutbacks of child allowances and asset-linked reductions of mortgage interest allowances, lower the corporate income tax rate from 18% to 15% beginning with the income year 2008, raise unemployment benefits in line with the rise in the lowest wage rates, and contribute one-third to the Rehabilitation Fund beginning in 2009, against matching contributions from employers and pension funds. Other pledges include raising rent subsidy allowances, increasing the number of loans pledged for subsidised residential rental housing, and increasing the amount allocated to continuing education and adult education. The Ministry of Finance estimates that the cost to the Treasury as a result of these measures will total approximately 35 b.kr. over the term of the settlement.

On February 20, an auction of a new series of Treasury notes, RIKB 19 0226, was held. The maturity date of the T-notes is in 2019. The objective was to sell notes in the series for a nominal value of 10 b.kr. A total of 76 valid offers totalling 32 b.kr. were received, and offers for 10 b.kr., with a yield of 8.9%, were accepted. Thereafter,

primary dealers were offered the opportunity to purchase an additional 10% of the nominal value of the amount sold in the auction, or 1 b.kr., at the same yield. Each primary dealer was entitled to purchase in proportion to the amount purchased in the auction, and an additional 1 b.kr. was sold as a result.

On February 22, the Financial Supervisory Authority approved the merger of the savings banks Sparisjóðurinn í Kefl avík, Sparisjóður Vestfirðinga, and Sparisjóður Húnaþings og Stranda. The savings banks have merged under the name Sparisjóðurinn í Keflavík. Sparisjóðurinn í Keflavík assumed all rights and obligations of Sparisjóður Vestfirðinga and Sparisjóður Húnaþings og Stranda as of July 1, 2007.

On February 28, international credit rating agency Moody's Investor Service announced a downgrade of Kaupthing Bank, Landsbanki Íslands, and Glitnir Bank. The banks' credit ratings for long-term obligations in local and foreign currencies were downgraded from Aa3 to A1 for Kaupthing and from Aa3 to A2 for Glitnir and Landsbanki, and all three banks' financial strength ratings were lowered from C to C. The ratings for short-term obligations in local and foreign currencies remain unchanged at P-1. The outlook on all of the ratings is stable.

### March

On March 5, Moody's Investor Service announced that it had changed its outlook for the Republic of Iceland's Aaa Government bond ratings and the country ceiling on foreign currency bank deposits from stable to negative. The outlook remains stable for the Aaa/P-1 long- and short-term country ceilings for bonds and notes, as well as for the Aaa local currency bank deposit ceiling.

On March 13, the second auction of RIKB 19 0226 was held. Offers were accepted for 2,350 m.kr. nominal value at an average yield of 9.41%.

On March 13, Parliament approved a legislative bill amending the Social Security Act. The amendment abolished the cutbacks in pension benefits due to income earned by a pensioner's spouse, provided for a tax-free threshold for financial income and pension income, and raised the tax-free threshold for pensioners who remain employed, as well as increasing various benefit payments and allowances.

On March 18, Glitnir Bank announced a closed auction of convertible bonds in the amount of 15 b.kr. The bonds are subordinated and convert to Glitnir shares after five years. The issue is classified as Tier I capital.

On March 20, Standard & Poor's announced that it had placed Glitnir Bank hf. on credit watch with negative implications. The bank's ratings for long- and short-term obligations are now A- and A-2, respectively.

On March 25, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 1.25 percentage points to 15%. Also announced were amendments to internal Central Bank rules that were drafted with the aim of facilitating financial market activity, especially transactions with Icelandic krónur.

On March 27, a special auction of Treasury note series RIKB 08 1212 was held in the nominal amount of 10 b.kr. The auction supplemented the issue announced on January 14 in the Government Debt Management Prospect for 2008. The objective of the sale was to meet the demand for short-term securities bearing a Treasury guarantee. Offers were accepted for 7.2 b.kr. nominal value.

### April

On April 1, Fitch Ratings announced that it had revised the outlook for the Republic of Iceland's long-term foreign and local currency issuer default ratings from stable to negative. The long-term foreign and local currency issuer default ratings were affirmed at A+ and AA+, respectively, and the F1 rating for short-term obligations and the country ceiling of AA- were likewise affirmed.

On April 1, Fitch Ratings announced that it had placed Glitnir Bank, Kaupthing Bank and Landsbanki Íslands ratings for long- and short-term obligations and financial strength on ratings watch negative.

On April 1, Standard & Poor's announced that it had placed the Republic of Iceland's long-term ratings on credit watch with negative implications.

On April 7, the Minister of Social Affairs issued a regulation raising rent subsidy allowances effective April 1, as an element in the Government's pledges related to the contractual wage agreements signed on February 17. On April 10, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 0.5 percentage points, to 15.5%.

On April 17, the third auction of RIKB 19 0226 was held. Offers were accepted for 2.9 b.kr. nominal value at an average yield of 10.64%.

On April 17, Standard

& Poor's Rating Services lowered its foreign and local-currency sovereign credit ratings on the Republic of Iceland to A and AA-, from A+ and AA, respectively. The ratings for short-term local-currency obligations (A-1+) and short-term foreign currency obligations (A-1) were affirmed. The outlook for the long-term sovereign ratings remains negative.

On April 21, Standard & Poor's lowered the long-term credit rating for Glitnir from A- to BBB+. The rating for short-term obligations was affirmed at A-2. The outlook for long-term obligations is negative.

## May

On May 9, Fitch Ratings lowered its credit ratings for Kaupthing and Glitnir. The banks' ratings for long- and short-term obligations were lowered from A to A-, and from F1 to F2, respectively. The banks' individual ratings of B/C and their support ratings of 2 were unchanged. The outlook for long-term obligations is negative.

On May 13, securities lending facilities to each primary dealer in series RIKB 08 1212 and RIKB 09 0612 were increased from 5 b.kr. to 7 b.kr. nominal value in response to demand for short-term nominal Treasury notes.

On May 15, Parliament passed a law abrogating the taxation of businesses' capital gains on the sale of equity securities and transferred the administration of tax matters for large corporations to the Regional Tax Director in the Reykjavík district. Previously, it was possible to defer the payment of taxes by reinvesting in other equities within two years.

On May 16, the Central Bank announced the conclusion of bilateral currency swap agreements with the central banks of Norway, Sweden, and Denmark. The agreements are a contingency measure, and the Central Bank can draw on them at need. Each of the agreements provides access to a maximum of 500 million euros.

On May 20, Moody's Investor Service lowered the Republic of Iceland's sovereign credit rating by one notch, from Aaa to Aa1. The country ceiling for bank deposits in foreign currency was also down-graded from Aaa to Aa1. The outlook for the sovereign credit ratings was changed from negative to stable.

On May 22, the Board of Governors of the Central Bank of Iceland decided to hold the Bank's policy interest rate unchanged at 15.5%.

On May 23, new agreements were signed by the Central Bank of Iceland in connection with the issue of Government securities and market making in the secondary market. The objectives of the agreements are to maintain the Treasury's access to loan financing and to enhance price formation in the secondary market for Government securities. The agreements were concluded with seven financial institutions and remain valid for one year.

On May 27, a special auction of short-term Treasury notes was held. The series offered was RIKB 08 1212. Offers were accepted for 15 b.kr. nominal value at an average yield of 12.45%.

On May 28, Parliament approved an amendment to the Act on Electronic Registration of Title to Securities, stipulating that settlement instructions for electronic securities denominated in foreign currencies and held in a domestic securities depository shall take place through the intermediation of a securities depository that fulfills requirements comparable to those set forth in the Act on the Security of Transfer Orders in Payment Systems. The settlement system shall have ready access to the foreign currency in question.

On May 29, the fourth auction of RIKB 19 0226 was held. Offers were accepted for 6.5 b.kr. nominal value at an average yield of 9.55%.

On May 29, Parliament passed an act of law abolishing the stamp fee on a purchaser's first apartment.

On May 30, Parliament approved amendments to the Income Tax Act in accordance with Government pledges related to the signing of the private sector wage settlements in February 2008. The amendments involve raising the personal tax credit, raising the income threshold for child subsidy allowances, reducing the income-linkage of child benefits, raising the asset threshold for mortgage interest allowances, and reducing the corporate income tax rate. In addition, the exchange rate differential for legal entities' operations can be distributed over three years.

## June

On June 4, the Central Bank of Iceland issued new Rules on Foreign Exchange Balance, which took effect on July 1, superseding the previous Rules no. 318/2006. The principal change is that the maximum mismatch between foreign-denominated assets and liabilities has been reduced from 30% to 10%. However, financial undertakings can apply for authorization to maintain a separate positive foreign exchange balance in order to hedge against the effects of adverse exchange rate movements on their equity ratio.

On June 19, the Government approved special measures related to the housing market and the arrangements for Housing Financing Fund (HFF) loans. The ceiling was raised from 18 m.kr. to 20 m.kr., with the maximum loan amount set at 80% of the purchase price of the property instead of the fire insurance value, as it was previously. Furthermore, two new bond series were established for the purpose of financing mortgages granted by financial institutions.

On June 19, the Government announced a supplementary issue of Treasury notes in series, RIKB 08 1212, RIKB 09 0612, and RIKB 10 0317, which will be issued on the domestic market for a total of 75 b.kr.

On June 19, the Board of Governors of the Central Bank of Iceland decided that its certificates of deposit (SI 08 0924) will be reissued upon the maturity of the CDs issued in March. The current CD issue matures in September 2008. Decisions concerning the issuance of certificates of deposit next year will be made in view of market conditions at that time.

On June 23, the Housing Financing Fund (HFF) decided, following the June 20 auction of HFF housing bonds, to lower the Fund's lending rates by 0.15 percentage points. HFF bonds with a prepayment clause now bear 5.05% interest, and bonds without a prepayment clause bear 5.55% interest.

On June 27, Kaupthing held an auction of covered bonds. The issue is intended to finance the bank's mortgage loans to individuals, and offers were accepted for 4.8 b.kr. nominal value. The weighted average yield in the auction was 5.17%, and the bank's lending rates will be based on that yield plus a premium of 0.9%. The bank's lending rates will therefore fall from 6.4% to 6.05% following of the auction.

## July

On July 3, the Board of Governors of the Central Bank of Iceland decided to leave the Bank's policy interest rate unchanged at 15.5%.

## September

On September 11, the Board of Governors of the Central Bank of Iceland decided to leave the Bank's policy interest rate unchanged at 15.5%.

On September 19, the Financial Supervisory Authority approved Byr Savings Bank's application to change the savings bank into a limited liability company.

On September 29, the Office of the Prime Minister announced an agreement between the Government and the largest owners of Glitnir Bank hf., following consultation with the Central Bank of Iceland and the Financial Supervisory Authority, under which the Government would contribute new share capital in the amount of 600 million euros, thereby becoming the owner of a 75% stake in Glitnir.

## October

On October 6, the Financial Supervisory Authority announced its decision to stop trading temporarily with all financial instruments issued by Glitnir Bank hf., Kaupthing Bank hf., Landsbanki Íslands hf., Straumur-Burdarás Investment Bank hf., SPRON hf., and Exista hf., and traded on a regulated securities exchange.

On October 6, Parliament passed the Act on Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, no. 125/2008. According to the Act, special and very unusual circumstances refers to particular financial and/or operational difficulties experienced by a financial undertaking, including the probability that it will not be able to honour its commitments vis-à-vis its customers or creditors, the likelihood that the premises for revocation of its operating license exist, or the likelihood that the undertaking cannot meet the minimum requirements for equity, and the measures adopted by the Financial Supervisory Authority are not likely to limit the damage or risk of damage to the financial markets. Under such circumstances, the Financial Supervisory Authority is authorised to adopt special measures.

On October 7, the Financial Supervisory Authority announced its decision to define short sales of shares of specified issuers as behaviour opposed to accepted market practices. From October 7, 2008, through January 16, 2009, it is prohibited to sell short shares in Glitnir Bank hf., Kaupthing Bank hf., Landsbanki Íslands hf., Straumur-Burdarás Investment Bank hf., SPRON hf., and Exista hf., that had been admitted for trading on the regulated securities exchange in Iceland, unless the seller has the securities in his custody at the time of the offer. The prohibition also includes all other financial instruments that have the same purpose and same economic exposure as the short sale of the specified shares, and to other financial instruments whose value is determined by the price of the specified shares.

On October 7, the Financial Supervisory Authority announced that it had intervened in the operations of Landsbanki Íslands hf., based on the authority contained in the Act on Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, no. 125/2008. The Financial Supervisory Authority appointed a resolution committee, which assumed all of the authorisations of the Board of Directors of Landsbanki.

On October 7, the Financial Supervisory Authority announced that it had intervened in the operations of Glitnir Bank hf., based on the authority contained in the Act on Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, no. 125/2008. The Financial Supervisory Authority appointed a resolution committee, which assumed all of the authorisations of the Board of Directors of Glitnir.

On October 9, the Financial Supervisory Authority announced that it had intervened in the operations of Kaupthing Bank hf., based on the authority contained in the Act on Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, no. 125/2008. The Financial Supervisory Authority appointed a resolution committee, which assumed all of the authorisations of the Board of Directors of Kaupthing.

On October 9, New Landsbanki Íslands hf. commenced operations after having taken over a part of the operations of Landsbanki Íslands hf.

On October 13, the Financial Supervisory Authority granted MP Investment Bank hf. a commercial banking licence. The commercial banking licence took effect on October 10, 2008.

On October 14, the Central Bank of Iceland announced that it had drawn a total of 400 million euros on the currency swap agreements with the central banks of Denmark and Norway.

On October 14, the OMX Nordic Exchange Iceland hf. approved Landsbanki Íslands hf.'s request for the delisting of its shares. The bank's shares were removed from trading after the market closed on October 14, 2008.

On October 15, the Board of Governors of the Central Bank of Iceland decided to lower the Bank's policy interest rate by 3.5 percentage points, to 12%.

On October 15, the OMX Nordic Exchange Iceland hf. approved Glitnir Bank hf.'s October 14 request for the delisting of its shares. The bank's shares were removed from trading after the market closed on October 14, 2008.



On October 15, the Central Bank of Iceland came to an agreement with market makers in the foreign exchange market, as well as with several other financial undertakings, concerning temporary foreign exchange arrangements. Daily auctions of the euro against the króna provide an indication of the exchange rate of the króna vis-à-vis other currencies and ensures a minimum level of cross-border business activity. The exchange rate is determined by supply and demand for foreign currency, which is initially in accordance with the Central Bank's guidelines on modifications in currency outflow.

On October 15, New Glitnir Bank hf. commenced operations after having taken over a part of the operations of Glitnir Bank hf.

On October 17, a meeting of Icebank hf. shareholders approved a motion to change the name of the bank to Sparisjóðabanki Íslands hf.

On October 22, New Kaupthing Bank hf. commenced operations after having taken over a part of the operations of Kaupthing Bank hf.

On October 27, the Financial Supervisory Authority announced its opinion that, on October 6, Landsbanki Íslands hf. was unable to remit payment of deposits in specified accounts to customers requesting such payment. Therefore, by law, the Depositors' and Investors' Guarantee Fund was obligated towards the Landsbanki Íslands hf. customers who did not receive payment from their accounts. Comparable obligations developed on October 9 with respect to Kaupthing Bank hf., and on October 3 with respect to Glitnir Bank hf.

On October 28, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 6 percentage points, to 18%.

### Credit ratings – changes July-October 2008

Moody's credit ratings for foreign-currency obligations

	<i>Affirmed</i>	<i>Long-term obligations</i>	<i>Short-term obligations</i>	<i>Financial strength</i>
Republic of Iceland	Oct. 8	Aa1→A1	P-1	
Housing Financing Fund	Oct. 8	Aa1→A1		
Glitnir	Sept. 30 Oct. 8	A2→Baa2 Caa1	P-1→P-2 Not-Prime	C-→D E
Kaupthing	Oct. 9	A1→Baa3	P-1→P-3	C-→D+
Landsbanki	Oct. 8	A2→Caa1	P-1→Not-Prime	C-→E

Fitch Ratings' credit ratings for foreign-currency obligations

	<i>Affirmed</i>	<i>Long-term obligations</i>	<i>Short-term obligations</i>	<i>Individual rating</i>	<i>Support rating</i>
Republic of Iceland	Sept. 30 Oct. 9	A+→A- BBB-	F1→F2 F3		
Glitnir	Sept. 30 Oct. 7 Oct. 8	A-→BBB- B D	F2→F3 B D	B/C→F F F	2 4 5
Kaupthing	Sept. 30 Oct. 8	A-→BBB CCC	F2→F3 C	B/C→C E	2 5
Landsbanki	Sept. 30 Oct. 7 Oct. 8	A→BBB B D	F1→F3 B D	B/C→C F F	 4 5
Straumur-Burdaras Investment Bank	Sept. 30 Oct. 9	BBB-→BB+ BB-	F3→B B	C/D D	3 5



## Credit ratings – changes July-October 2008

## Standard &amp; Poor's credit ratings for foreign-currency obligations

	<i>Affirmed</i>	<i>Long-term obligations</i>	<i>Short-term obligations</i>	<i>Financial strength</i>
Republic of Iceland	Sept. 29	A→A-	A-1→A-2	
	Oct. 6	BBB	A-3	
Housing Financing Fund	Sept. 29	A→A-	A-1→A-2	
	Oct. 6	BBB	A-3	
Glitnir	Sept. 29	BBB+→BBB	A-3	A-2→A-3
	Oct. 7	CCC	C	
	9. okt.	D	D	

## R&amp;I's credit rating for foreign-currency obligations

	<i>Affirmed</i>	<i>Long-term obligations</i>
Republic of Iceland	Sept. 30	AA+→AA
	Oct. 7	A+
	Oct. 9	BBB-

**November**

On November 5, Fitch Ratings announced that it had lowered Straumur- Burdaras Investment Bank's rating for long-term obligations from BB- to B. The individual rating was downgraded from D to D/E. The ratings for short-term obligations were affirmed at B, and the support rating at 5. The outlook for Straumur's credit ratings was negative.

On November 6, the Board of Governors of the Central Bank of

Iceland decided to leave the Bank's policy interest rate unchanged at 18%.

On November 13, Parliament approved an amendment to the Act on Financial Undertakings, authorising a trustee in bankruptcy for an undertaking undergoing insolvency proceedings or moratorium on payment to continue specified activities for which licensing is required if those activities are necessary for the administration of the estate or the protection of creditors' interests. The administrator of such operations shall be exempt from general liability for compensatory damages. Under such conditions, it is prohibited to initiate or continue legal proceedings against the financial undertaking. The provisions on the conferral and the length of moratoria on payment for these financial undertakings were expanded.

On November 13, a temporary amendment to the Acts on Unemployment Insurance and on the Wage Guarantee Fund was passed, with the intention of meeting the needs of wage-earners who must reduce their employment percentage at their employer's initiative because of the economic contraction. Furthermore, self-employed individuals were authorised, on a temporary basis, to take on occasional projects while receiving unemployment benefits.

On November 13, the resolution committee of Kaupthing Bank hf. requested of the OMX Nordic Exchange in Iceland that trading with the company's shares be halted on the Nordic market.

On November 17, Parliament passed an amendment to the Act on Smoothing of Mortgage Loans to Individuals. Payment smoothing allows the borrower to defer payment of a portion of his instalments, but for the long term, it increases costs due to interest and indexation on the deferred amount.

On November 19, the Executive Board of the International Monetary Fund approved a two-year Stand-By Arrangement for Iceland to support the country's programme to restore economic stability. According to the plan, Iceland will receive a loan of USD 2.1 billion from the IMF, and supplementary loans totalling some USD 3 bil-

lion from Denmark, Finland, Norway, Sweden, Russia, and Poland. In addition, the Faroese Government offered Icelanders a loan of approximately USD 50 million.

On November 24, the District Court of Reykjavík granted Kaupthing Bank hf. a moratorium on payment.

On November 24, the District Court of Reykjavík granted Glitnir hf. a moratorium on payment.

On November 24, Standard & Poor's lowered the Republic of Iceland's sovereign credit rating by one notch, from BBB to BBB-, due to mounting public sector debt. Iceland's transfer and convertibility assessment was lowered from A- to BBB- because of restrictions placed on the capital account and certain current account transactions in October. The outlook remained negative.

On November 25, Glitnir hf. announced that the bank's operations in New York had been sold to former employees of the bank.

On November 26, a regulation was signed, authorising the Housing Financing Fund to take over residential mortgage loans issued by financial institutions. The terms and conditions of the loans remain unchanged after the takeover.

On November 28, Parliament passed an amendment to the Act on Foreign Exchange, authorising temporary restrictions on foreign currency trading due to capital transactions. On the same day, new Central Bank Rules on Foreign Exchange took effect, placing restrictions on movement of capital between Iceland and other countries. The purpose of the Rules is to limit foreign currency outflows. Thereafter, the instructions on temporary modification of foreign currency outflow, issued in October, were revoked.

## **December**

On December 4, the interbank currency market resumed operation. On the same day, the new Central Bank Rules on the Foreign Exchange Market took effect.

On December 4, Moody's Investors Service lowered the Republic of Iceland's foreign and local currency ratings by four notches, from A1 to Baa1. The rating for short-term obligations was downgraded by one notch, from P-1 to P-2. The outlook remained negative. At the same time, the agency reported that, with this downgrade, it had completed its review for possible downgrade announced on October 8.

On December 5, Parliament authorised the Government to conclude agreements on financial assistance from the International Monetary Fund (IMF).

On December 5, Parliament approved an amendment to the Act on Housing Affairs. According to the Act, it is now permissible to extend housing loan maturities by up to 30 years in case of financial difficulties, instead of the previous 15 years. Furthermore, the maximum loan period for Housing Financing Fund loans has been lengthened from 55 years to 70 years.

On December 6, the District Court of Reykjavík granted Landsbanki Íslands hf. a moratorium on payment.

On December 11, legislation was passed authorising a 12.5% increase in alcoholic beverage and tobacco taxes, oil and per-kilometre charges, motor vehicle taxes, and excise taxes.

On December 12, Parliament passed a law on the investigation of the prelude and causes of the collapse of Iceland's banks in 2008. Under the new Act, a special investigative committee is to seek the truth

about the prelude and causes of the banks' failure and related events. The committee is also to assess whether there have been errors or neglect in the implementation of regulatory instruments pertaining to financial activities in Iceland and supervision of those activities, and to determine who may be responsible for such errors or neglect.

On December 12, legislation on the office of the special prosecutor entered into force. The Act establishes the office of special prosecutor, whose task is to investigate suspected criminal conduct before, during and after the

events leading to the enactment of the Act on Authorisation for Treasury Disbursements due to Unusual Financial Market Circumstances, etc., and the situation that then developed on the financial market, whether such conduct relates to the activities of financial institutions, other legal entities, or individuals, and to follow the investigation with criminal action as appropriate.

On December 12, the Customs Act was amended so as to define the entire country as a single customs jurisdiction.

On December 17, the Board of Governors of the Central Bank of Iceland decided to increase the corridor between the Bank's highest and lowest interest rates. The Bank's policy interest rate was held unchanged.

On December 18, Parliament passed an amendment to the Act on Interest and Price Indexation. The amendment, which pertains to Article 6 of the Act, stipulates that penalty interest will now include a 7% premium on the interest rate on the most common short-term Central Bank loans to credit institutions. Furthermore, the Central Bank's authority to determine a different non-fulfilment surcharge has been revoked. Penalty interest rates can be expected to decline by 4% as a result of the amendment. Moreover, penalty interest will henceforth be decided on a monthly basis instead of twice a year.

On December 18, Parliament passed an amendment to the Annual Accounts Act, authorising companies to apply for permission to prepare their annual accounts for the years 2008 and 2009 in foreign currency.

On December 18, Parliament agreed to utilise the EEA Agreement's adaptation authorisations of 2007 concerning Bulgarian and Rumanian citizens' access to the Icelandic labour market until January 1, 2012.

On December 18, a mission from the IMF concluded a four-day visit to Iceland. The purpose of the mission's visit was to assess the status and outlook for the Icelandic economy. The visit was in connection with the Stand-By Arrangement approved for Iceland by the Executive Board of the Fund on November 19. The mission met with Government officials, members of Parliament, and various other stakeholders.

On December 19, the Landsbanki Íslands resolution committee announced that Kepler Capital Markets had been sold to Kepler management and employees.

On December 20, Parliament passed legislation on fiscal measures. The individual tax rate was raised from 22.75% to 24.1% and the maximum local tax rate from 13.03% to 13.28%. Parish fees, sea

man's credits, maximum childbirth leave, child subsidy allowances, and payments under agricultural products agreements were reduced from previous amounts, and the Government's costs for pension insurance and residence for the elderly were cut by increasing the weight of investment income in the calculation of benefits and the individual's participation in these expenses.

On December 22, Parliament passed an amendment to the Pension Fund Act, liberalising the provisions authorising withdrawal of private pension savings, abolishing the maximum age to receive pension income, and expanding pension funds' authorisations to purchase unlisted securities.

On December 22, the supplementary budget for 2008 was approved by Parliament. The budgetary supplement assumes a deficit of 6 b.kr., while the original budget allowed for a 39 b.kr. surplus.

On December 22, the fiscal budget for 2009 was approved by Parliament. Revenues are expected to drop by 19.5% at constant price levels relative to the budgetary supplement for 2008, while expenditures are projected to rise by 10.5%. Most revenue items decline substantially due to the economic contraction, and the increase in expenditures at constant price levels is primarily due to interest expense. Expenditures exclusive of interest rise by 0 – 0.5% in real terms.

On December 29, the Minister of Social Affairs and Social Security issued a regulation raising allowance payments, subsidies, and the tax-free income threshold for the year 2009, with the increase totalling 9.6%. The minimum maintenance stipend for pensioners rose by 20%.

On December 31, the Ministry of Finance announced that the tax rate for income tax and local tax combined would be 37.2% for 2009, instead of 35.72% in 2008. The personal deduction was increased by 24% and the tax-free income threshold by 19%. The average local tax rate increased from 12.97% to 13.1%, and the income tax rate rose from 22.75% to 24.1%.

# Economic and monetary chronicle 2009

## January

On January 1, the Iceland Civil Aviation Administration operations at Keflavík Airport and Leifur Eiríksson International Airport were merged into a State-owned corporation called Keflavik Airport Ltd.

On January 2, the listing of the exchange rate index was discontinued. The old index, which bore the abbreviation GVT, was replaced with an index based on a narrow trade basket (TWI), which was recalculated so that its January 2 value equalled that of the GVT index.

On January 6, the Government announced that it would thoroughly investigate the possibility of seeking legal remedy before the European Human Rights Court because of the UK authorities' application of the Anti-Terrorism, Crime and Security Act of 2001 against Landsbanki in late 2008. The Government also reiterated that it would support legal action by the Kaupthing resolution committee because of the British Financial Services Authority's conduct against Kaupthing subsidiary Singer & Friedlander on October 8, 2008. It will also support possible legal action taken by the Landsbanki resolution committee against the British authorities.

On January 8, Fitch Ratings announced that it had affirmed its ratings for Kaupthing Bank hf., Landsbanki Íslands hf., and Glitnir hf. (the old Icelandic banks). The ratings for short- and long-term obligations were affirmed at D, the support rating was 5, and the individual rating was F. The agency also announced that it would no longer assign credit ratings for the banks.

On January 23, Moody's Investors Service released its annual sovereign credit report on the Republic of Iceland. The report stated that Moody's still considered Iceland an investment-grade country despite the current financial and economic crisis and the challenges it faces. However, the negative outlook for the Baa1 rating was maintained because "the economic outlook remains uncertain and could quickly change."

On January 26, the coalition government between the Independence Party and the Social Democratic Alliance was dissolved. A coalition between the Social Democratic Alliance and the Leftist Green Party assumed control on February 1, under the leadership of Prime Minister Jóhanna Sigurðardóttir.

On January 28, the Ministry of Finance published a statement of Treasury assets and liabilities. It is assumed that the Treasury's total liabilities will rise by just over 400 b.kr. in 2009. In addition, the Treasury will guarantee the debt due to Icesave/Edge and the loans from the IMF and others to the Central Bank of Iceland, in the amount of almost 1,300 b.kr. The Treasury's debt is estimated to approach 1,100 b.kr. by year-end 2009. According to the National Budget for 2009, the Treasury deficit for the year will be 150 b.kr.

On January 29, the Board of Governors of the Central Bank of Iceland decided to hold the Bank's policy interest rate unchanged at 18%.

## February

On February 3, the Minister of Health cancelled the consultation fee charged by hospitals and health care institutions. The previous regulation, set on December 29, 2008, was revoked.

On February 9, Moody's Investors Service announced that it had lowered (old) Kaupthing Bank hf.'s credit rating for long-term obligations from Caa1 to C. The bank's short-term obligations are still rated as "Not Prime" and the financial strength rating is E.

On February 11, Moody's Investors Service announced that it had lowered (old) Glitnir Bank hf.'s credit rating for long-term obligations from Caa1 to C. The bank's short-term obligations are still rated as "Not Prime" and the financial strength rating is E.

On February 12, the International Monetary Fund published a report entitled, "Iceland-SBA-Review Under the Emergency Financing Mechanism", about the progress of the economic programme drafted by the Fund and the Government of Iceland. The report was a part of the Stand-By Arrangement granted by the IMF to the Icelandic Government on November 19, 2008, and was written following the visit to Iceland by the IMF mission on December 15-19, 2008.

On February 19, the District Court of Reykjavík extended Kaupthing and Glitnir's moratoria on payment until November 13, 2009.

On February 25, the Icelandic Federation of Labour (ASÍ) and the Confederation of Icelandic Employers (SA) agreed to postpone the implementation of the negotiated wage increases that were to take effect on March 1, and to postpone their review of contractual wage settlements for up to four months. Despite the postponement of general wage hikes, the agreement contained a provision stipulating that minimum wages should rise to 157,000 kr. and that several other provisions should take effect, including lengthened vacation time.

On February 26, Parliament passed legislation amending the Act on the Central Bank of Iceland. The new Act provides for one Governor and one Deputy Governor within the Central Bank instead of a Board of Governors. The Governor and Deputy Governor are to be appointed following advertisement of the positions; applicants must have completed a master's degree in economics or a related field and must possess extensive experience and knowledge of monetary issues. Decisions on the application of the Bank's monetary policy instruments will henceforth be made by a Monetary Policy Committee, but in other respects, the Bank's direction shall be in the hands of the Governor. In this context, the Bank's monetary policy instruments include decisions on interest rates, specified transactions with credit institutions, determination of reserve requirements, and currency market transactions intended to influence the exchange rate of the króna. Upon the entry into force of the amendment, the Board of Governors was abolished, as were the positions of the three governors then constituting the Board.

On February 27, the Prime Minister appointed Svein Harald Øygard and Arnór Sighvatsson to temporary positions as Central Bank Governor and Deputy Governor, respectively, in accordance with the amended Central Bank Act. They will remain in office until the Prime Minister has made permanent appointments on the basis of an advertisement pursuant to the provisions of the Act.

### **March**

On March 3, the District Court of Reykjavík extended Landsbanki Íslands hf.'s moratorium on payment until November 26, 2009.

On March 3, the Governor of the Central Bank decided that Thórarinn G. Pétursson, Acting Chief Economist of the Central Bank, should take a seat on the Monetary Policy Committee. Other members include Central Bank Governor Svein Harald Øygard, who also chairs the Committee, and Deputy Governor Arnór Sighvatsson. That same day, the Prime Minister appointed two external representatives, Dr. Gylfi Zoëga and Dr. Anne Sibert, to the Monetary Policy Committee.

On March 5, Parliament agreed to repeal an act of law from 2003 concerning retirement income for the president of Iceland, governmental ministers, members of Parliament, and Supreme Court judges. Their terms of remuneration in retirement will henceforth be on a par with those of other civil servants.

On March 6, Parliament passed legislation providing for 100% reimbursement of value-added tax on on-site labour for construction work done on residential property. The increased reimbursement percentage applies to the period March 1, 2009 to July 1, 2010.

On March 9, the Financial Supervisory Authority announced that it had intervened in the operations of Straumur-Burdaras Investment Bank hf. on the basis of the provisions of Article 100(a) of the Act on Financial Undertakings, no. 161/2002. The Financial Supervisory Authority appointed a resolution committee, which assumed all of the authorisations of Straumur's Board of Directors.

On March 9, Fitch Ratings announced that it had lowered Straumur- Burdaras Investment Bank's rating for long-term obligations from B to D. The agency has stopped issuing ratings for Straumur.

On March 10, Moody's Investors Service announced that it had lowered (old) Landsbanki Íslands hf.'s credit rating for long-term obligations from Caa1 to C. The bank's short-term obligations are still rated as "Not Prime" and the financial strength rating is E. Moody's also announced that it had stopped issuing ratings for the bank.

On March 10, Parliament authorised owners of private pension savings to withdraw up to 1 m.kr. over a nine-month period. The authorisation covers applications submitted between March 1, 2009, and October 1, 2010.

On March 13, the International Monetary Fund mission completed a fifteen-day visit to Iceland. The visit, whose purpose was to review the economic programme prepared by the Fund and the Icelandic Government, was conducted in connection with the USD 2.1 billion Stand- By Arrangement approved for Iceland by the Executive Board of the Fund on November 19. The mission met with Government officials, members of Parliament, and representatives of the private sector and labour organisations.

On March 17, Parliament passed an amendment to the Act on Securities Transactions. The amendment reduced the threshold for mandatory takeover bids from 40% to 33% but provided for exemptions under which, in certain instances, a holding may exceed the threshold without creating a takeover requirement.

On March 17, Parliament passed a statutory amendment authorising the Financial Supervisory Authority to publish the results of its investigations except in exceptional circumstances.

On March 19, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's policy interest rate by 1.0 percentage point, to 17%.

On March 19, the District Court of Reykjavík granted Straumur-Burdaras Investment Bank hf. a moratorium on payment.

On March 21, the Financial Supervisory Authority announced that it had intervened in the operations of Reykjavík Savings Bank hf (SPRON) on the basis of the provisions of Article 100(a) of the Act on Financial Undertakings, no. 161/2002. The Financial Supervisory Authority appointed a resolution committee, which assumed all of the authorisations of SPRON's Board of Directors.

On March 21, the Financial Supervisory Authority announced that it had intervened in the operations of Sparisjóðabanki Íslands hf. on the basis of the provisions of Article 100(a) of the Act on Financial Undertakings, no. 161/2002.

On March 23, the District Court of Reykjavík granted Sparisjóðabanki Íslands hf. a moratorium on payment.

On March 26, a Government loan facility was announced. The facility was arranged with VBS Investment Bank and Saga Capital because of the debts that the Treasury took over from the Central Bank. The banks will receive indexed seven-year loans at 2% interest. The loan is subject to various security-related terms and conditions.

On March 27, the Financial Supervisory Authority announced that it appointed a resolution committee for Sparisjóðabanki Íslands hf. on the basis of the provisions of Article 100(a) of the Act on Financial Undertakings, no. 161/2002. The resolution committee assumed all of the authorisations previously held by the bank's Board of Directors.

On March 30, the report prepared by Finnish banking expert Kaarlo Jännäri was made public. The report centred on the regulatory framework and supervision of banking operations and contained various comments and suggestions for improvements. The Government then appointed a work group to examine the recommendations in the report.

On March 30, Parliament approved amendments to the Act on Bankruptcy, etc., which centre on payment mitigation measures designed to support individuals in severe financial distress. According to the amended Act, an individual may seek composition of creditors for the purpose of payment mitigation if he can demonstrate that he



cannot fulfil his financial commitments and will be unable to do so for the foreseeable future. Under debt mitigation, it is possible to stipulate full cancellation of contractual claims; proportional reduction of such claims; deferral of payment; payment with a share in the instalment amount, either in a single payment or at given intervals during a further specified period of time; change in the form of payment; or the last four of these simultaneously.

On March 30, Parliament passed legislation on guarantors, which includes provisions on required disclosure of information to prospective guarantors and exempts a guarantor's real property from settlement if a claim should fall on him.

On March 31, Parliament agreed to tighten foreign exchange restrictions with amendments to the Customs Act and the Foreign Exchange Act. A new temporary provision added to the Foreign Exchange Act stipulates that exports of goods and services shall take place in foreign currency. The amendment to the Customs Act requires that the transaction price on exportation reports be listed in foreign currency and that it be based on the currency appearing on the exporter's sales invoice, but not Icelandic krónur.

#### April

On April 3, the Financial Supervisory Authority announced that it had intervened in the operations of SPM Savings Bank, at the savings bank's request, on the basis of the authority contained in Article 00(a) of the Act on Financial Undertakings, no. 161/2002. The savings bank's assets and liabilities were allocated in accordance with a purchase agreement with New Kaupthing hf. and an agreement with the savings bank's largest creditors.

On April 8, the Monetary Policy Committee of the Central Bank decided to lower the collateral loan rate by 1.5 percentage points to 15.5%. Other Central Bank interest rates were also lowered by the same amount.

On April 8, an agreement was announced between the Ministry of Business Affairs and credit institutions that grant foreign-denominated loans, extending the payment smoothing option for indexed loans to cover foreign-denominated loans as well.

On April 15, Parliament passed Act no. 46/2009 amending the Income Tax Act. The main provisions of the amendment are as follows:

i) parties with interest income in Iceland shall be required to pay tax on that income; ii) cancelled debt in accordance with composition of creditors agreements providing for debt mitigation is not considered income; iii) provisions are to be adopted for the taxation of residents that own companies domiciled in low-tax countries.

On April 15, Parliament passed Act no. 44/2009, which amends the provisions in the Act on Financial Undertakings pertaining to the delivery of a financial undertaking to an interim Board of Directors and the requirements for and commencement of winding-up proceedings.

On April 15, Parliament passed Act no. 45/2009, which provides for increases in household mortgage interest allowances. The increase in 2009 was estimated to total 2 b.kr.

On April 15, Parliament passed Act no. 50/2009 on temporary payment mitigation of residential mortgage loans, which can be offered to debtors for up to five years.

On April 17, Parliament passed Act no. 51/2009, which authorises the Minister of Industry to negotiate with prospective owners concerning the construction of an aluminium smelter at Helguvík. Among other provisions, the Act stipulates that the activities of the smelter shall be exempt from future amendments to the principal provisions of the Income Tax Act that may be onerous.

On April 18, agreements between the Minister of Agriculture and the Farmers' Association of Iceland were announced. The agreements set forth provisions for agricultural subsidies over the next few years. According to the agreements, payments will rise by 2% in both 2010 and 2011, and they will also rise by half of the accumulated non-fulfilment of the original agreements, up to a maximum total amount of 5%. In 2012, payments will rise to the amount specified in current agricultural subsidy agreements, subject to a maximum of 5%.

On April 22, the Financial Supervisory Authority announced that Deloitte LLP had completed its valuation of the assets transferred from the old banks in order to form the balance sheets of New Kaupthing Bank, NBI, and Íslandsbanki. Concurrent with this, the consulting firm Oliver Wyman completed its appraisal of the valuation.

On April 24, the Competition Authority announced that commercial banks, savings banks, pension funds, and the Housing Financing Fund were authorised to take co-ordinated action to assist individual mortgage holders in financial distress. Without such authorisation, concerted action of this type could have been in violation of the Competition Act.

On April 27, the District Court of West Iceland granted SPM Savings bank a moratorium on payment.

## May

On May 7, the Monetary Policy Committee of the Central Bank decided to lower the collateral loan rate by 2.5 percentage points to 13.0%. Overnight lending rates were also lowered by 2.5 percentage points, and other Central Bank rates were reduced by 3 percentage points.

On May 10, the coalition government of the Social Democratic Alliance and the Left-Green Movement assumed power.

On May 12, the District Court of Reykjavík appointed a winding-up committee for Straumur-Burðarás Investment Bank hf.

On May 22, the District Court of Reykjavík appointed a winding-up committee for Sparisjóðabanki Íslands hf.

On May 28, Parliament passed Act no. 60/2009, raising alcoholic beverage and tobacco taxes, oil charges, and motor vehicle taxes, while lowering per-kilometre charges. The change was intended to generate some 4.4 b.kr. annually for the Treasury.

## June

On June 4, the Monetary Policy Committee of the Central Bank decided to lower the collateral loan rate by 1 percentage point to 12.0%. The overnight lending rate was also lowered by 1 percentage point.

On June 5, agreements between the governments of Iceland and the Netherlands, on the one hand, and Iceland and the United Kingdom, on the other, were signed. The agreements provide for the liability of the Icelandic Depositors' and Investors' Guarantee Fund for deposits in Landsbanki branches in the two countries, as well as for a Government guarantee of the Fund's financing. The agreements were signed by Iceland subject to parliamentary approval of the Government guarantee.

On June 24, the District Court of Reykjavík approved a request to appoint winding-up committees for SPRON hf. and Frjálsi Investment Bank hf.

On June 26, the Prime Minister appointed Már Guðmundsson as Governor of the Central Bank, effective August 20, and Arnór Sighvatsson as Deputy Governor, effective July 1.

On June 29, Parliament passed Act no. 70/2009, which sets forth various fiscal measures. The measures include the following:

- i) raising the payroll tax by 1.56% of the tax base and raising the contribution to the Wage Guarantee Fund by 0.1% of wages;
- ii) levying a separate 8% tax on individual income in excess of 700,000 kr. per month, irrespective of the spouse's income;
- iii) raising the tax on financial income from 10% to 15% on such income in excess of 42,000 kr. per month and accelerating the collection of the tax,
- iv) tightening income-linking and reducing the tax-free threshold in the social security system,
- v) reducing childbirth leave benefits,

- vi) limiting Government payments to victims and restricting entitlement to indigent party status,
- vii) revoking payments to the University of Iceland in the amount of parish fees for persons outside organised religious groups.

Estimated revenues from tax code amendments amounted to 17 b.kr. on a full-year basis, and 8.6 b.kr. in 2009, excluding the Treasury's payroll tax payments to itself. The reduction in expenditure was estimated at 4.5 b.kr. on a full-year basis, and 2.2 b.kr. in 2009.

## July

On July 1, an agreement was signed between Iceland, on the one hand, and Norway, Denmark, Finland, and Sweden, on the other, concerning a loan of 1775 million euros from the four Nordic countries to Iceland.

On July 1, revised Rules on Central Bank of Iceland Facilities for Financial Undertakings, no. 553 of June 26, 2009, took effect. The new Rules provided for two major changes. On the one hand, eligibility rules concerning collateral for Central Bank facilities were tightened. The main securities eligible as collateral for Central Bank of Iceland facilities are now Housing Financing Fund bonds, Treasury notes, and Treasury bills. The new Rules also contain provisions that expand and clarify the Central Bank's authorisation to manage market liquidity.

On July 2, the Monetary Policy Committee decided to hold the collateral loan rate unchanged at 12.0%.

On July 3, the Financial Supervisory Authority appointed a threemember interim Board of Directors for SPM Savings Bank on the basis of Article 100(a) of the Act on Financial Undertakings, no. 161/2002, as amended by Act no. 44/2009.

On July 10, the Minister of Fisheries announced the decision on fishing quotas for the principal non-pelagic species in the 2009-2010 fishing year. The quota permitted catches amounting to 150,000 tonnes of cod, 50,000 tonnes of perch, 63,000 of haddock, and 50,000 tonnes of pollock. The total allowable catch for haddock was reduced by 30,000 tonnes between years, and the cod quota by 12,500 tonnes.

On July 10, Parliament passed Act no. 75/2009, which provides for the establishment of a State-owned limited liability company to support the restructuring of viable non-financial firms.

On July 10, Parliament passed Act no. 73/2009, amending the Foreign Exchange Act. The amendments expand the Financial Supervisory Authority's investigative authority and include penalty provisions for unauthorised intermediation in foreign exchange transactions.

On July 10, Parliament passed Act no. 76/2009, amending the Act on Financial Undertakings. The new amendment makes extensive changes in the legal environment of savings banks. It clarifies provisions on their operational form, revokes their authorisation to convert to limited liability companies, simplifies and tightens the rules on dividend payments, and adds rules on changes to guarantee capital.

On July 16, Parliament authorised the Government to apply for European Union membership. That same day, the Prime Minister, on behalf of the Government, sent the European Union an application for membership for Iceland.

On July 20, the Ministry of Finance announced that agreements had been reached with the resolution committees of the three commercial banks – Glitnir, Kaupthing, and Landsbanki – concerning capitalisation and settlement of assets. The agreement entailed offering the resolution committees of Glitnir and Kaupthing the possibility of acquiring a majority holding in Íslandsbanki and New Kaupthing. In the case of Landsbanki, the agreement centred on the arrangements for continuing negotiations. All of the agreements were subject to the final decision of the resolution committees, which was to be taken following consultation with creditors. They were also subject to the approval of the Financial Supervisory Authority, which must determine whether the actions taken are in compliance with funding requirements, the banks' strength, and the position of the owners at any given time.

## August

On August 5, the Central Bank announced its strategy for the phased removal of the capital controls. The first phase entails the liberalisation of capital inflows and investment. The liberalisation strategy ensures that assets thus flowing into the country can be expatriated again, provided that they are registered with the Central Bank. In later phases, restrictions on capital outflows will be lifted, first on long-term obligations and then on short-term assets.

On August 11, Parliament elected a new Central Bank Supervisory Board following a proportional election, in accordance with Article 26 of the Act on the Central Bank of Iceland, no. 36 of May 22, 2001. Elected Board members are Lára V. Júlíusdóttir, Ragnar Arnalds, Ágúst Einarsson, Hildur Traustadóttir, Ragnar Árnason, Magnús Árni Skúlason, and Katrín Olga Jóhannesdóttir. The following were elected as alternates: Margrét Kristmannsdóttir, Anna Ólafsdóttir Björnsson, Björn Herbert Guðbjörnsson, Guðrún Ágústa Guðmundsdóttir, Birgir Þór Runólfsson, Ingibjörg Ingadóttir, and Friðrik Már Baldursson. At the first meeting of the new Supervisory Board, Lára Júlíusdóttir was elected Chairman and Ragnar Arnalds was elected Vice-Chairman. Daniel Gros was elected to replace Magnús Árni Skúlason on October 15, 2009.

On August 11, Parliament passed the Act on the Iceland State Banking Agency, no. 88/2009, which provides for a Government institution whose role is to administer the State's holdings in financial institutions.

On August 13, the Monetary Policy Committee decided to hold the collateral loan rate unchanged at 12.0%.

On August 14, the Ministry of Finance announced that Government funding for Íslandsbanki and New Kaupthing was assured. The funding was approved at shareholders' meetings and was in line with proposals that had been announced on July 20. The banks' equity was contributed in the form of Treasury bonds and corresponded to a capital adequacy ratio of approximately 12%.

On August 28, Parliament passed Act no. 98/2009, which amends a number of laws due to the transfer of tasks within the Government of Iceland. Among other changes, all tasks related to economic policy, including the administration of Statistics Iceland and the Central Bank of Iceland, were transferred from the Prime Minister's Office and the Ministry of Finance to the Ministry of Economic Affairs. Consumer affairs and property registration were transferred to the Ministry of Justice and Human Rights, and ownership of the State-owned farmsteads and publicly owned companies previously administered elsewhere was transferred to the Ministry of Finance.

On August 28, Parliament passed Act no. 96/2009, authorising the Minister of Finance to guarantee the Depositors' and Investors' Guarantee Fund's obligations for the Landsbanki Icesave accounts in the Netherlands and the UK. The authorisation was subject to a number of reservations, mainly that the so-called Brussels guidelines, from November 14, 2008, on the consideration of Iceland's extraordinary circumstances should apply to the agreements, that State assets should enjoy immunity according to international law, and that annual payments to the UK and the Netherlands should not exceed 4% and 2%, respectively, of accumulated GDP growth since 2008.

## September

On September 3, Fitch Ratings published its sovereign credit ratings for the Republic of Iceland. The ratings were unchanged since October 2008: A- for domestic obligations, BBB- for foreign long-term obligations, and F3 for foreign short-term obligations. The outlook remains negative. The domestic rating is higher than the foreign rating because the domestic bond market is considered relatively strong.

On September 4, the Ministry of Finance announced that the Icelandic Government and the Kaupthing resolution committee had signed a settlement agreement pertaining to assets transferred from Kaupthing to New Kaupthing in October 2008. The settlement agreement is in accordance with the agreement announced on July 20, 2009. As was announced on August 14, the Treasury contributed capital to New Kaupthing in the form of Treasury bonds amounting to 72 b.kr., which corresponds to a capital adequacy ratio of approximately 12%. Like the agreement announced on July 20, the agreement authorises the Kaupthing resolution committee, upon consulting with creditors, to acquire an 87% stake in New Kaupthing. This would reduce the Icelandic Government's stake to 13%, and a large portion of its capital contribution would be reversed. If creditors do not exercise this option, the Icelandic

Government will remain the owner of the bank; however, the creditors will retain an option to purchase up to 90% of share capital in the bank between 2011 and 2015, at terms that guarantee the State a suitable return on its investment in the bank.

On September 13, the Ministry of Finance announced that the Icelandic Government and the Glitnir resolution committee had signed a settlement agreement pertaining to assets transferred from Glitnir to Íslandsbanki in October 2008. The settlement agreement is in accordance with the agreement announced on July 20, 2009. As was announced on August 14, the Treasury contributed capital to Íslandsbanki in the form of Treasury bonds amounting to 65 b.kr., which corresponds to a capital adequacy ratio of approximately 12%. The agreement authorises the Glitnir resolution committee, upon consultation with creditors, to acquire 95% of share capital in Íslandsbanki. The Icelandic Government's stake would then be 5%, and a large portion of its capital contribution would be reversed; however, the Government would continue to support the bank with its holding and with a 25 b.kr. subordinated loan. If creditors choose not to exercise this option, the Icelandic Government will remain the owner of the bank. The payment for transferred assets will then be remitted with a bond issued by Íslandsbanki. Furthermore, the creditors will be granted the option of purchasing up to 90% of share capital in the bank between 2011 and 2015, at terms that guarantee the State a suitable return on its investment in the bank.

On September 24, the Monetary Policy Committee decided to keep the collateral loan rate and the interest rate on financial institutions' current accounts unchanged at 12% and 9.5%, respectively. Overnight lending rates were lowered by 1.5 percentage points to 14.5%. The Committee also decided that the Bank should auction 28-day certificates of deposit with a minimum bid rate of 9.5% and a maximum of 10%. The first auction was held on September 30.

## October

On 1 October, the District Court of West Iceland authorised SPM Savings Bank to seek composition of creditors agreements.

On 1 October, the Financial Supervisory Authority granted Íslandsbanki hf. and SAT Holding Company hf. permission to own a qualifying holding in SA tryggingar hf. SA tryggingar hf. has two shareholders: Íslandsbanki hf., with 9.3% of share capital, and SAT Holding Company hf., with the equivalent of 90.7% of share capital. SAT Holding Company hf. is wholly owned by Glitnir Bank hf. SA tryggingar took over the insurance operations of Sjóva Almennar on 21 September.

On 4 October, an agreement was signed concerning a loan taken by Treasury in Poland, in the amount of 630 million Polish zlotys, or about 200 million US dollars. The loan term is 12 years, with no instalments paid in the first five years. It will be paid up during the period 2015-22. The interest rate is 2% over and above comparable Polish Government bonds.

On 12 October, the Icelandic government, the Landsbanki Islands hf. resolution committee, and Landsbankinn (NBI hf.) signed an agreement on the settlement of assets and liabilities of the old Landsbanki.

On 15 October, the Ministry of Finance, Íslandsbanki, and the Glitnir resolution committee announced that the resolution committee, on behalf of creditors, had decided to exercise the option set forth in the agreement with the Icelandic Government and acquire a 95% stake in Íslandsbanki.

On 18 October, the round of Icesave negotiations that began after 28 August 2009, when Parliament passed the bill providing a conditional State guarantee for the obligations of the Depositors' and Investors' Guarantee Fund, was concluded.

On 22 October, the Icelandic Government submitted to the European Commission its answers to a 2,600-item questionnaire connected with Iceland's application for EU membership.

On 27 October, the Iceland State Banking Agency (ISBA) assumed ownership of the three commercial banks. Contractual agreements will still be finalised under the auspices of the Minister of Finance. The ISBA operates pur-

suant to Act no. 88/2009. Its role is to administer the State's holdings in financial companies. The ISBA shall have completed its work no later than five years after its establishment.

On 28 October, the Executive Board of the International Monetary Fund (IMF) approved the First Review of Iceland's macroeconomic

programme, thereby authorising the disbursement of the next tranche of the IMF loan to Iceland, in the amount of 167.5 million US dollars (21 b.kr.). Thereafter, the Icelandic Government was able to draw on supplementary credit lines from the Nordic countries, in the amount of 300 million euros. At the request of the Icelandic Government and due to delays in the implementation of the programme, it was also agreed to extend the IMF Stand-by Arrangement by six months, or until 31 May 2011. Disbursements will be adjusted to reflect this change.

On 28 October, the Icelandic Federation of Labour and the Confederation of Icelandic Employers decided not to activate the termination clause in private sector wage agreements. As a result, the wage agreements remain in effect until end-November 2010, with agreed wage changes taking effect on 1 November 2009 and 1 June 2010.

On 31 October, the Minister of Social Affairs signed an agreement with Iceland's major credit institutions, providing for automatic payment smoothing and an extension of indexed mortgage loans by a maximum of three years. An act of law to this effect had been passed by Parliament on 23 October. In addition, it was agreed that these measures would also be available, at the debtor's request, for foreigndenominated mortgages, as well as indexed or foreign-denominated motor vehicle loans that are not in arrears. The reference date was set at January 2008 for indexed loans and 2 May 2008 for foreigndenominated loans. If the loan concerned was taken after these dates, however, the date of the loan shall be the reference date.

On 31 October, the Central Bank of Iceland announced the first phase in the removal of the capital controls. Capital inflows for new investments and subsequent outflows stemming from those investments were authorised. As such, investors are authorised, without restrictions, to convert into foreign currency the sales proceeds from assets in which they invest after 1 November 2009. In addition, a number of technical changes were made to the capital controls in order to reduce circumvention and facilitate implementation.

## **November**

On 5 November, the Central Bank of Iceland Monetary Policy Committee decided to reduce interest rates on deposit institutions' current accounts by 0.5 percentage points, to 9.0%. The maximum amount in weekly auctions of 28-day certificates of deposits was raised from 25 b.kr. to 30 b.kr., with a minimum bid rate of 9.5% and a maximum of 10.25%. This represented a 0.25 percentage point increase in the maximum rate. Interest on seven-day collateral loans was reduced from 12.0% to 11.0%, and overnight lending rates were cut from 14.5% to 13.0%

On 6 November, Parliament passed amendments to the Act on Forced Sale, no. 90/1991, deferring the decision on final sale of residential property until after 28 February 2010, at the debtor's request and upon fulfilment of the requirements set forth in the Act.

On 11 November, Moody's Investors Service lowered the Republic of Iceland's credit ratings for long-term obligations in foreign and domestic currency from Baa1 to Baa3, and for short term obligations from P-2 to P-3. The outlook for all ratings was changed from negative to stable.

## **December**

On 1 December, the Kaupthing resolution committee, upon consultation with creditors and considering the advice of experts, decided that Kaupthing, and therefore the creditors, would acquire 87% of share capital in Arion Bank. The State will retain ownership of 13% of share capital. In capitalising the bank, the State pledged to contribute 72 b.kr. in equity. According to the agreement, the Kaupthing resolution committee will contribute 66 b.kr. instead of the State.

On 4 December, the EFTA Surveillance Authority (ESA) handed down an interim decision on a complaint about the Emergency Act, no. 125/2008, filed by a group of general creditors against the old banks. The interim conclusion



was that the provisions of the Act, particularly those concerning the priority assigned to deposits and the Icelandic Government's actions based on the Act, were in compliance with the EEA Agreement and other legal requirements. The ESA pointed out that no other measures had been available in order to prevent a total collapse of the Icelandic economy.

On 10 December, the Central Bank of Iceland Monetary Policy Committee decided to reduce interest rates on deposit institutions' current accounts by 0.5 percentage points, to 8.5%. The Bank will continue to auction 28-day CDs, although the maximum bid rate will be 9.75% instead of 10.25%. Interest on seven-day collateral loans was reduced from 11.0% to 10.0%, and overnight lending rates were cut from 12.5% to 11.5%.

On 1–4 December, a mission from the International Monetary Fund (IMF) visited Iceland. The mission was led by Mark Flanagan.

On 15 December, the supplementary budget for 2009 was approved by Parliament. Treasury revenues increase by 14.8 b.kr. over and above the National Budget, primarily due to interest income and despite the fact that revenues from the proposed sale of embassy assets are reduced by 5 b.kr. Treasury expenditures rise by 13 b.kr., primarily due to unemployment benefits, mortgage interest allowances, and agricultural subsidies, while expenditures for pension benefits and investment expenses decline.

On 15 December, the Minister of Social Affairs adjusted the guideline amounts for municipal financial assistance upwards by 8.63%, effective 1 January 2010. The change was proportional to the rise in consumer prices, as is stipulated in the agreement between the Ministry and the Association of Local Authorities.

On 16 December, it was announced that the resolution committee and creditors of Landsbanki had decided to acquire 19% of share capital in the new bank, NBI. The Icelandic Government contributes 81% of share capital in Landsbanki, or 122 b.kr. of a total of 150 b.kr. The

new bank will issue a 260 b.kr. foreign-denominated 10-year bond to creditors. This is the minimum valuation of appropriated assets in excess of liabilities. If the recovery is greater, the bank will issue further bonds in exchange for creditors' shares.

On 16 December, Parliament passed Act no. 116/2009, thereby agreeing to act on comments by the EFTA Surveillance Authority (ESA) pertaining to points regarding the implementation of EU Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, via Act no. 64/2006, and concerning, among other things, the reliability of information and the scope of legislation on measures to combat money laundering and terrorist financing.

On 17 December, Parliament agreed, with Act no. 126/2009, to implement EU Directive 2007/36/EC of 11 July 2007, on the exercise of certain rights of shareholders in listed companies, and the Act on Private Limited Companies. The principal amendment is that the minimum advance notice for calling shareholders' meetings in companies that are listed on regulated securities markets has been lengthened from one week to three. Further changes focus, among other things, on increasing the rights and influence of shareholders and ensuring non-discrimination among shareholders, whether domestic or foreign, as regards participation in shareholders' meetings and voting in the companies concerned.

On 18 December, Parliament passed Act no. 120/2009, which entailed changes to various types of social security benefits, particularly with the aim of strengthening the Treasury's operating performance.

On 18 December, Parliament passed Act no. 134/2009, amending legislation on unemployment benefits. The Directorate of Labour's penalties and follow-up measures were strengthened, and the authorisation to pay benefits for curtailed employment percentages was extended to end-June 2010, although a ceiling was set on such payments. Also addressed was student membership to the general benefits system, and students' rights to apply for benefits after leaving school were enhanced.



On 19 December, Parliament agreed, with Act no. 125/2009, to extend the deadline, set forth in the Act on Financial Undertakings, for initiating cancellation proceedings due to legal instruments of financial institutions in winding-up proceedings from six months to 24 months. The change was made to ensure equitable treatment of creditors in view of the scope of activities of many financial institutions, including those in winding-up proceedings.

On 19 December, Parliament passed Act no. 129/2009, which provides for an environmental and natural resource tax to be levied on fossil fuels, on the one hand, and electricity and hot water, on the other.

On 21 December, Parliament passed Act no. 128/2009 on the generation of State revenues. The main elements of that Act are: i) The standard personal income tax deduction was increased by 4.7% to 530,466 kr. per year and the reference to consumer prices was discontinued. ii) The lowest income tax rate remains unchanged at 24.1%; therefore, the tax-free threshold is raised by the same percentage, to 1,485,000 kr. per year. Income between 2.4 m.kr. and 7.8 m.kr. per year bears 27% income tax, and income over 7.8 m.kr. is taxed at 33%. The tax withholding percentage is based on monthly income. iii) Joint taxation of cohabiting couples was discontinued, except that, if one party earns more than 7.8 m.kr. per year and the other less than that amount, up to half of the income exceeding 7.8 m.kr. may be transferred to the lower-income party. However, the receiving party may not have more than 2.7 m.kr. in the 27% tax bracket. The tax brackets follow the wage index. iv) The tax on individuals' financial income was increased from 15% to 18%; however, 30% of rental income on residential housing and individuals' interest income is exempted, up to 100,000 kr. per year. v) The income tax on legal entities was raised from 15% to 18%. vi) Seamen's credits remain unchanged in 2010 and then are phased out in stages until they are discontinued as of 1 January 2014. vii) The payroll tax rises by 1.6% of the tax base, to 8.65%.

On 21 December, Parliament passed Act no. 137/2009, which provides support for innovation companies. Companies approved by Rannis can deduct 15% of their research and development costs, up to a maximum of 50 m.kr., from their taxable income each operational year. The maximum is set as 75 m.kr. if services are purchased from another approved company. Individuals may deduct the purchase of stock in approved companies from their taxable income, up to a maximum of 300,000 kr. per year.

On 21 December, Parliament passed Act no. 130/2009, providing for various tax measures. The main changes are: i) The oil charge and the gasoline charge increase by 2.50 kr. and 1.65 kr. per litre, respectively. ii) Motor vehicle taxes, alcoholic beverage taxes, and tobacco taxes increase by 10%. iii) The higher value-added tax rate rises from 24.5% to 25.5%. iv) Various fees for permits and services were increased. v) The authorisation to withdraw fund from private pension savings was extended until 1 April 2011, and the maximum withdrawal was raised from 1 m.kr. to 2.5 m.kr.

On 21 December, the first tranche of the loan from the Nordic countries was disbursed to Iceland in connection with the macroeconomic programme of the Icelandic Government and the International Monetary Fund (IMF). The amount disbursed was 300 million euros. The accumulated loan facility authorisation is now 444 million euros. Because there is no further need for borrowed funds at present, 144 million euros will be carried forward to the next period; that is, until after the Second Review of the IMF programme.

On 22 December, the National Budget for 2010 was approved by Parliament. Revenues are estimated at 462 b.kr. and rise by 11% compared to estimated revenues for 2009; expenditures are estimated at 561 b.kr. and declined by 3% compared to 2009 estimates; and the balance on income will be negative by 99 b.kr.

On 22 December, Parliament passed Act no. 138/2009, authorising the Minister of Finance to confirm agreements with the resolution committees of Kaupthing, Glitnir, and Landsbanki concerning their takeover of shares in Arion Bank, Islandsbanki, and NBI.

On 23 December, Fitch Ratings affirmed the Republic of Iceland's sovereign credit rating and removed it from credit watch status. The long-term ratings in foreign and domestic currency are BBB- and A-, respectively. The rating for short-term obligations in foreign currency is F3, and the country ceiling is BBB-. The outlook remains negative.

On 29 December, Parliament agreed, with Act no. 146/2009, to amend legislation on the investigation of the background and causes of the fall of the Icelandic banks in 2008 and related events. The amendments are primarily aimed at preparing for the presentation of the Parliamentary Special Investigative Commission report on the banks' collapse and to clarify what will happen afterwards. In this context, the Commission's deadline for submittal of the report was set at end-January 2010, instructions on parliamentary treatment of the report were added, a provision on storage of and access to the massive electronic databases compiled during the Commission's work was added, and the individuals who worked on the investigation are guaranteed certain immunity from possible legal action arising from their work on the investigation.

On 30 December, Parliament passed Act no. 1/2010 (Icesave), authorising the Minister of Finance to guarantee loans extended to the Depositors' and Investors' Guarantee Fund (DIGF) by the British and Dutch governments, in order to cover payments to depositors of Landsbanki Islands hf.

On 31 December, Standard & Poor's affirmed the Republic of Iceland's sovereign credit rating and changed the outlook from negative to stable following the passage of the Icesave bill. The rating is BBB- for long-term obligations in foreign currency, and BBB+ for long-term obligations in domestic currency. The ratings for short-term obligations in foreign and domestic currency are A-3 and A-2, respectively.

# Economic and monetary chronicle 2010

## January

On 5 January, the president of Iceland refused to sign an act of law amending the Minister of Finance's authorisation to grant a Treasury guarantee of loans taken by the Depositors' and Investors' Guarantee Fund (DIGF) due to Icesave deposit accounts. In so doing, the president referred the matter to a national referendum. Three days later, Parliament passed an act of law stipulating that the referendum should take place as soon as possible, and no later than 6 March.

On 5 January, rating agency Standard and Poor's announced an unchanged rating for the Republic of Iceland, citing the risk of isolation in credit markets and heavy pressure from abroad to resolve the Icesave dispute.

On 5 January, rating agency Fitch Ratings announced a downgrade of Iceland's sovereign credit ratings for domestic and foreign currency obligations. Iceland's long-term foreign and domestic currency ratings are now BB+ and BBB+, and the short-term foreign currency rating is B. The country ceiling was lowered from BBB- to BB+.

On 6 January, rating agency Moody's announced that it was keeping Iceland's sovereign rating unchanged for the present, in spite of the president's veto of the Icesave guarantee legislation. The agency considered it likely that domestic political instability and external pressure to resolve the Icesave dispute would result, both of which could have a negative effect on Iceland's credit rating.

On 7 January, the Financial Supervisory Authority (FME) granted ISB Holding ehf. permission to own a qualifying holding in Íslandsbanki on behalf of Glitnir Bank hf. The permission was granted following a 13 September 2009 agreement between Glitnir and the Icelandic Ministry of Finance, authorising Glitnir to acquire a 95% holding in Íslandsbanki upon fulfilment of specified conditions.

On 8 January, Japanese rating agency R&I Rating announced that Iceland's sovereign credit rating would remain on the Rating Monitor with a view to possible downgrade. The agency affirmed its previous rating of BBB-.

On 11 January, the Financial Supervisory Authority (FME) authorised Kaupskil ehf. to own qualifying holding in Arion Bank hf. (Arion) on behalf of Kaupthing Bank hf. (Kaupthing). The permission was granted following a 3 September 2009 agreement between Kaupthing and the Icelandic Ministry of Finance, authorising Kaupthing to acquire an 87% holding in Arion upon fulfilment of specified conditions.

On 22 January, the Financial Supervisory Authority (FME) authorised Landskil ehf. to own a qualifying holding in NBI hf. on behalf of Landsbanki Íslands hf. The permission was granted following a contractual agreement with Landsbanki Íslands hf. and the Icelandic Ministry of Finance, dated 15 December 2009, stipulating,

inter alia, that Landsbanki Íslands hf. was authorised to acquire an 18.7% holding in NBI hf., upon fulfilling specified conditions.

On 27 January, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 8.0%; maximum rates on 28-day certificates of deposit (CDs), to 9.25%; seven-day collateral loans, to 9.5%; and overnight loans, to 11.0%.

On 29 January, the Minister of Fisheries authorised a 130,000 tonne capelin quota for the winter fishing season. A quota of 97,100 tonnes was allocated to Icelandic fishing vessels.

## February

On 1 February, rating agency Standard and Poor's announced an unchanged rating for the Republic of Iceland but indicated that the rating would remain on CreditWatch negative due to uncertainty about external financing, capital account liberalisation, and the status of the Icesave dispute.

On 8 February, the Minister of Transport, Communications, and Local Government appointed a financial supervisory board for the municipality of Álftanes, upon the recommendation of the surveillance committee for municipal finances.

On 17 February, it was announced that the Financial Supervisory Authority had established a three-member advisory committee to assess the eligibility of board members in supervised financial companies.

On 24 February, the European Commission issued an opinion on Iceland's application for EU membership. Its conclusion was that Iceland met all of the conditions required of an EU applicant, and it was recommended that membership negotiations with Iceland begin.

On 25 February, Parliament passed an amendment to the Act on Forced Sale (Case no. 389 at the 138th Legislative Session), so that until 1 August 2010, a debtor can, upon filing an application, have the forced sale of his or her own residence deferred for up to three months. The amendment took effect the same day. Previously, the Act contained a provision deferring forced sale of residential housing through 28 February. On 26 February, rating agency Moody's expressed its concerns about the downward pressure that the stalemate in the Icesave dispute placed on Iceland's Baa3 credit rating. No changes in the credit rating were announced.

### March

On 4 March, Parliament passed amendments to the Act on Public Limited Companies (Case no. 71 at the 138th Legislative Session). The amendment restricts the role of the Chairman of the Board, thereby eliminating the position of Acting Chairman of the Board. Explicit provisions on gender equality in the boards of companies were also passed into law.

On 4 March, the Financial Supervisory Authority confirmed joint financial institution rules on corporate financial restructuring. This was done with Act no. 107/2009 on measures to assist individuals, households, and businesses due to extraordinary circumstances in the financial market.

On 5 March, the Financial Supervisory Authority announced the conclusion of information exchange agreements with the Financial Services Commission of the British Virgin Islands and the Alberta Securities Commission in Canada.

On 6 March, a national referendum was held on the authorisation to issue a Treasury guarantee for loans related to the Icesave accounts. The authorisation to grant the guarantee was rejected with 98% of valid votes. Hence the previous act of law authorising the guarantee with reservations, Act no. 96/2009, regained its validity.

On 10 March, the Financial Supervisory Authority granted Arev Securities hf. expanded authorisation to operate as a securities company. The company's operating licence was reissued to take account of this.

On 17 March, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 7.5%; maximum rates on 28-day certificates of deposit (CDs), to 8.75%; seven-day collateral loans, to 9.0%; and overnight loans, to 10.5%.

On 22 March, Parliament passed an act of law prohibiting the air mechanics' strike that had begun at midnight the previous night (Case no. 483 at the 138th Legislative Session). The term of the wage agreement that expired on 31 October 2009 was extended through the end of November 2010.

On 23 March, the committee for foreign investment ruled that there was no occasion to make formal comment on Magma Energy Sweden AB's investment in HS Orka hf. The committee's ruling is considered final.

On 25 March, Parliament passed an amendment to the Income Tax Act (Case no. 386 at the 138th Legislative Session), which authorises the Director of Internal Revenue to demand that the assets of parties suspected of major violations of tax reporting rules be frozen, if it is considered that there is a significant risk of large-scale default in tax payments.

On 29 March, the Financial Supervisory Authority granted Arctica Finance hf. a licence to operate as a securities undertaking in accordance with the Act on Financial Undertakings. Concurrent with this, Arctica Holding Company ehf. received an authorisation to own and administer a stake of over 50% in Arctica Finance.

On 30 March, rating agency Standard & Poor's affirmed the Republic of Iceland's sovereign credit ratings for long- and short-term obligations in foreign currency at BBB-/A-3. The ratings for long- and short-term obligations in domestic currency were downgraded from

BBB+/A-2 to BBB/A-3. The ratings were removed from CreditWatch status, where they have been with negative implications since 5 January 2010. The outlook remains negative.

#### **April**

On 12 April, the Parliamentary Special Investigation Commission (SIC) report on the background and causes of the collapse of the Icelandic banks in 2008 was published, both in printed form and on the website of the Parliament of Iceland.

On 13 April, the Financial Supervisory Authority granted Alfa Securities hf. a licence to operate as a securities undertaking pursuant to Article 4, Paragraph 1, Subparagraph 5 of the Act on Financial Undertakings, no. 161/2002.

On 14 April, the volcanic glacier Eyjafjallajökull erupted, after a smaller eruption on Fimmvorduhals, north of the glacier, had been underway since 20 March. The Eyjafjallajökull eruption caused severe disturbances in air traffic in Iceland and across Europe and dramatically reduced the number of visitors to Iceland well into the summer. The eruption had largely subsided by mid-May.

On 16 April the Executive Committee of the International Monetary Fund (IMF) approved the second review of Iceland's economic programme. At the request of the Icelandic Government, the Fund agreed to extend Iceland's Stand-By Arrangement by three months, until end-

August 2011, due to delays in programme reviews. Upon approval by the Executive Board, the third tranche of the IMF loan facility, SDR 105 million, became available. This tranche of the facility is equivalent to 160 million US dollars, or about 20 b.kr. Also released were loan facilities from the Nordic countries and Poland, in the amount of 85 b.kr.

In April 22, the Financial Supervisory Authority (FME) took over the operations of Byr Savings Bank and Keflavik Savings Bank upon requests by the two banks' boards of directors, following unsuccessful negotiations with creditors. In the FME's decision on the disposal of the savings banks' assets and liabilities, it is stated that Byr's assets and deposits had been transferred to a new commercial bank, Byr hf., and that Keflavik Savings Bank's assets and liabilities had been transferred to a new savings bank, SpKef Savings Bank. Both institutions are wholly owned by the State.

On 23 April, Parliament passed Act no. 31/2010 amending the Act on Bankruptcy, etc. no. 21/1991. According to the amended Act, the deadline for cancellation of measures entered into by a bankrupt shall be four years prior to the reference date, so as to ensure that it will be possible to conclude matters emerging in the wake of the banks' collapse without running the risk that interests will not be protected due to workload and time constraints.

On 23 April, Moody's changed its outlook for the Republic of Iceland's sovereign debt from negative to stable. Iceland's rating remained Baa3 for domestic and foreign long-term obligations and P-3 for short-term obligations. The change was attributable to the Treasury's improved liquidity position following the second review of the economic programme of the Government and the IMF.

On 23 April, the Financial Supervisory Authority authorised KEA svf. to own a qualifying holding in Sparisjodur Hofdhverfinga.

On 30 April, the Central Bank of Iceland amended its Rules on Foreign Exchange. The amendments clarified the Rules, reduced the maximum amount of foreign currency that can be purchased for travel, and changed specified exemptions so as to remove all doubt about the legality of offshore transactions

## May

On 5 May, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 7.0%; maximum rates on 28-day certificates of deposit (CDs), to 8.25%; seven-day collateralised loans, to 8.5%; and overnight loans, to 10.0%.

On 19 May, the Central Bank of Iceland, the Banque centrale du Luxembourg (BCL), and the liquidator of Landsbanki Luxembourg entered into an agreement concerning the Bank's purchase of 98% of outstanding Avens B.V. bonds. The bonds were owned by Landsbanki and pledged to BCL as collateral for a liquidity facility provided in 2008. The Bank was granted full control of the assets of Avens, the largest single owner of krona-denominated assets outside Iceland, with about 120 b.kr., or one-fourth, of all non-residents' krona-denominated holdings at the time the transaction was concluded.

On 26 May, the EFTA Surveillance Authority (ESA) sent a letter of formal notice stating that, in its opinion, the Icelandic authorities were obliged to set up a deposit insurance scheme guaranteeing deposits in the amount stipulated by Directive no. EC 94/19/EC on Deposit- Guarantee Schemes, or roughly ISK 20,000 euros.

On 28 May, the Central Bank of Iceland, on behalf of the Treasury, negotiated the purchase of just over 2% of issued Avens B.V. eurobonds. With this transaction, the Treasury became the owner of all of the company's issued euro-denominated bonds, as it had previously finalised the purchase of 98% of outstanding bonds with an agreement concluded in Luxembourg on 19 May.

On 30 May, the Treasury sold 26 pension funds Housing Financing Fund bonds with a nominal value of 90 b.kr., which the Treasury had acquired upon the banks' collapse and through purchases from the Banque centrale du Luxembourg. The pension funds bought the bonds at a yield of 7.2%, financing the purchase by selling foreign assets. The sale reduced the Government's net foreign-denominated debt, which had grown due to the funding of the above-mentioned agreement concluded in Luxembourg. It also expanded the Central Bank's foreign exchange reserves by about 82 b.kr.

## June

On 1 June, Parliament passed Act no. 49/2010 amending the Act on Stamp Fees, no. 36/1978, and the Act on Treasury (Additional Revenue) Act, no. 88/1991. The amendments authorise a temporary

exemption from stamp fees upon refinancing of motor vehicle loans and expand the exemptions from payment of registration fees for refinancing of individuals' mortgages and motor vehicle loans.

On 9 June, the People's Bank of China and the Central Bank of Iceland signed a bilateral currency swap agreement. The amount of the agreement is 66 b.kr., or 3.5 billion Chinese yuan. The agreement remains valid for three years and may be extended subject to the approval of both parties.

On 9 June, the FME's application for International Organization of Securities Commissions (IOSCO) membership was approved. The membership allows the FME to exchange information on securities transactions with most other nations, within the framework of existing legislation.

On 10 June, Parliament passed Act no. 60/2010 amending the Act on Bankruptcy, etc., with the aim of improving the legal position of debtors. Among other provisions, the amended Act allows the debtor to continue living in his or her residential property for a period of time during bankruptcy proceedings or after forced sale. According to other new provisions, if a property is sold via forced sale at a normal market price, the difference is calculated to the benefit of the debtor.

On 10 June, Parliament passed Act no. 70/2010 amending the Act on Unemployment Insurance, no. 54/2006, and the Act on Rent Subsidy Allowances, no. 138/1997. The amendments extend the right to proportional benefits against part-time employment until year-end 2010; furthermore, income from third-pillar pension funds does not curtail unemployment benefits (retroactive to 1 March 2009), and the implementation of the Act shall take account



of international obligations. According to the amendments to the Act on Rent Subsidy Allowances, income from third-pillar pension funds does not reduce benefits.

On 10 June, a new Act on Insurance Activities, no. 56/2010, entered into force, supplanting the previous Act on Insurance Activities, no. 60/1994. The Act applies to direct insurance in the areas of liability insurance and personal insurance, as well as any type of reinsurance. Supervision of such insurance remains in the hands of the Financial Supervisory Authority.

On 11 June, Parliament passed the Mortgage Rights Act, no. 67/2010, authorising financial undertakings to grant mortgage rights in connection with the Financial Supervisory Authority's disposal of assets and liabilities due to extraordinary circumstances in the financial markets. The Act was passed in order to facilitate settlement between the old and new banks.

On 12 June, Parliament passed Act no. 75/2010, amending the Act on Financial Undertakings. The amendments tighten rules and increase surveillance in a number of ways: the Financial Supervisory Authority is granted increased powers, financial institutions are required to hold a special register of large borrowers, the conditions upon which a financial institution may own its own shares are narrowed and clarified, financial institutions are prohibited from granting loans against

collateral in their own shares or guarantee capital shares, conditions for loans to specific related parties are tightened, and rules on large exposures are tightened, as are rules on incentive programmes, bonus schemes, and termination agreements.

On 14 June, Parliament passed Act no. 78/2010 amending the Foreign Exchange Act, no. 87/1992, and the Customs Act, no. 88/2005. The amendments assign the Central Bank of Iceland sole jurisdiction over investigations and fines in connection with surveillance of the Foreign Exchange Act and the Rules on Foreign Exchange.

On 15 June, Parliament passed Act no. 95/2010 amending the Act on Execution, no. 90/1989, and the Act on Bankruptcy, etc., no. 21/1991. The amendments entail, among other things, making composition of creditors a more effective measure for debtors, as well as expanding the conditions for enforcement of unsuccessful distraint and bankruptcy proceedings.

On 15 June, Parliament passed the Act on Concessions for New Investment in Iceland, no. 99/2010. The aim of the Act is to stimulate and promote investment in business operations in Iceland by specifying, in a transparent manner in the law, what authorisation the State and municipal governments have to grant defined concessions to investment projects, so as to depart from the previous arrangement of concluding separate investment contracts for individual projects on the basis of special legislation approved by Parliament.

On 16 June, Parliament passed Act no. 92/2010 amending the Income Tax Act, no. 90/2003, with regard to concessions for renovation and maintenance of real estate. In levying income tax in 2011 and 2012, it is permissible to deduct 50% of the amount paid for labour (net of value-added tax) carried out in 2010 and 2011, up to a maximum of 200,000 kr. for individuals and 300,000 kr. for couples and jointly taxed parties, for maintenance of residential and vacation property for personal use.

On 16 June, the Supreme Court of Iceland handed down judgments in two exchange rate linkage cases focusing on the legality of exchange rate-linked motor vehicle loans. The Supreme Court concluded that the agreements in question were indeed loan agreements and not motor vehicle agreements, and that the loan in question was a loan in Icelandic kronur and not a loan in foreign currency. Furthermore, the Court concluded that linking the principal of the loan to foreign currency exchange rates was in contravention of the Act on Interest and Price Indexation. The judgments set precedent for the interpretation of exchange rate-linked motor vehicle loan agreements; however, they did not answer the question of how to apply interest to those agreements.

On 22 June, the Republic of Iceland redeemed eurobonds maturing in 2011 and 2012, following a public auction. The nominal value of the purchase was 160 million euros for the first bond and 32 million euros for the latter. It was



also decided to draw on the bilateral loan facility negotiated with Denmark, Finland, Norway, Poland, and Sweden, in connection with the economic programme of the Icelandic Government and the International Monetary Fund. The total amount,

639 million euros, was added to the Central Bank of Iceland foreign exchange reserves.

On 23 June, the Monetary Policy Committee of the Central Bank decided to lower the collateralised lending rate by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 6.5%; maximum rates on 28-day certificates of deposit (CDs), to 7.75%; seven-day collateralised loans, to 8.0%; and overnight loans, to 9.5%.

On 24 June, Parliament passed the Act on the Debtors' Ombudsman, no. 100/2010, establishing the separate office of the Debtors' Ombudsman, whose task is to assist individuals, free of charge, in gaining an overview of their financial status and seeking solutions to financial problems. The Debtors' Ombudsman's role is to act as an intermediary in interactions and contractual agreements with creditors, and to implement debt mitigation. It also receives communications from debtors, protects their interests, and takes action if debtors' rights are encroached upon. Furthermore, it provides comprehensive advice and instruction on household finance.

On 24 June, Parliament passed the Act on Debt Mitigation for Individuals, no. 101/2010. The objective of the Act is to enable individuals in severe financial difficulties to restructure their finances and establish balance between their debt and their capacity to pay, so that the debtor can realistically fulfil his obligations for the foreseeable future.

On 24 June, Parliament passed Act no. 102/2010 amending the Act on Temporary Mitigation of Residential Mortgage Payments, no. 0/2009, establishing as permanent the measures set forth in the original Act.

On 24 June, Parliament passed the Act on Temporary Measures for Individuals with Two Residential Properties, no. 103/2010. According to the Act, an individual who pays mortgages on two properties because of purchasing a property for residential use can request that one of the properties be transferred to the holder of collateral. The Act remains in force from 1 August 2010 until year-end 2011.

On 24 June, Parliament passed Act no. 104/2010, temporarily amending the Income Tax Act, no. 90/2003, as regards taxation of cancelled debt for corporations, self-employed persons, and individuals, with consideration of the extraordinary circumstances currently reigning. According to the Act, it will temporarily be permissible, upon fulfilment of specific conditions, to report only a specified percentage of the cancelled debt as taxable income.

On 30 June, the Central Bank of Iceland and the Financial Supervisory Authority issued guidelines based on the Supreme Court of Iceland judgments on exchange rate-linked loans. This was done because of the uncertainty that developed concerning the scope and terms of the agreements falling under the judgments. This uncertainty was considered to undermine stability in the financial markets and the financial system as a whole. The guidelines instructed financial institutions to calculate loans based on interest rates determined by the Central Bank

of Iceland, with reference to the lowest interest rate on new indexed or nominal loans instead of the foreign interest rate reference.

## July

On 6 July, the Prime Minister, Minister of Finance, Minister of Economic Affairs, Governor of the Central Bank, and Director of the Financial Supervisory Authority signed an agreement on the appointment of a Financial Stability Committee. The agreement and the work of the committee are based on the 2006 agreement on financial stability and contingency, between the pertinent ministries and institutions. The members of the committee represent the Ministry of Economic Affairs, Prime Minister's Office, Ministry of Finance, Financial Supervisory Authority, and Central Bank of Iceland. The representative of the Ministry of Economic Affairs steers the committee's activities.

On 7 July, the Government announced a campaign to increase employment. Reimbursements of value-added tax due to labour carried out on residential and vacation property were raised from 60% to 100%. A deduction from

the income tax base of up to 200,000 kr. for individuals and 300,000 kr. for couples is granted for maintenance of residential real estate.

On 7 July, the Parliamentary Ombudsman sent the Central Bank of Iceland and the Financial Supervisory Authority identical queries concerning the 30 June guidelines issued in the wake of the Supreme Court judgments on exchange rate-linked loan agreements. The queries presented detailed questions in several numbered items, and the deadline for response was 16 July. After having received a one-week extension of the deadline, the Central Bank of Iceland responded on 23 July, as did the Financial Supervisory Authority.

On 12 July, the International Monetary Fund report on changes to the Icelandic tax system was published. The report was prepared for the Ministry of Finance, which sought guidelines on possible improvements with reference to output growth and efficiency, as well as the need to meet an increased need for revenue amounting to 1-2% of GDP over the medium term. The report proposes ways to increase revenues. The proposals are based in large part on bringing in revenues through individual income tax and value-added tax but also mention increases in corporate income tax, financial income tax, and fuel taxes.

On 13 July, the Financial Supervisory Authority appointed an interim board of directors for Avant hf. at the company's request, on the basis of Article 100(a) of the Act on Financial Undertakings, no. 161/2002; cf. Article 4 of Act no. 44/2009.

On 16 July, the total allowable catch (TAC) for the fishing year beginning on 1 September 2010 was announced. The permissible cod quota was raised by 10,000 tonnes, in line with recommendations, while the TAC for haddock and saithe was reduced, although less than was recommended. Restrictions on ocean shrimp fishing were removed.

On 30 July, Moody's changed its outlook for Iceland's sovereign credit rating on foreign and domestic obligations from stable to negative.

The change was made following the Supreme Court judgments on non-binding exchange rate linkage clauses in motor vehicle loan agreements.

## August

On 16 August, the Financial Supervisory Authority approved the Central Bank of Iceland Holding Company ehf.'s (ESI) application for permission to own a qualifying holding in the insurance company Sjóva- Almennar hf. (SA tryggingar). The Central Bank of Iceland Holding Company is wholly owned by the Central Bank of Iceland. Other SA tryggingar shareholders are Islandsbanki hf., with 9.3% of share capital, and SAT Holding Company hf., with the equivalent of 17.67% of share capital.

On 17 August, a cross-border collaboration agreement between the Nordic and Baltic countries took effect. The aim of the agreement is to ensure financial stability and coordinated response to financial shocks affecting more than one country. The agreement is not legally binding but allows for enhanced cooperation and coordinated response, including improved information disclosure between institutions.

On 18 August, the Monetary Policy Committee of the Central Bank decided to lower the collateral loan rate by 1 percentage point. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 5.5%; maximum rates on 28-day certificates of deposit (CDs), to 6.75%; seven-day collateralised loans, to 7.0%; and overnight loans, to 8.5%.

On 31 August, the Central Bank began purchasing foreign currency from market makers in the interbank foreign exchange market. The aim of the purchase is to expand the Bank's non-borrowed reserves. The Central Bank decided to buy 500 thousand euros from each market maker on Tuesday of each week.

On 31 August, the Financial Supervisory Authority revoked the operating licences of SPRON Securities and the operating company Rekstrarfelag SPRON hf. In both instances, the companies themselves had relinquished their licences.

## September

On 14 September, the Financial Supervisory Authority sent a circular to credit institutions on the treatment of operational, private, and financing leases. The circular included the following instructions to credit institutions: "Until a final ruling has been rendered on whether operational, private, and financing leases fall within the scope of Chapter VI of the Act on Interest and Price Indexation and whether such agreements contain non-binding exchange rate linkage clauses, such contracts shall be treated in the same manner as the discussed lease-purchase agreements from the credit institutions in question. In other words, they shall be treated in accordance with the 30 June 2010 guidelines issued by the Financial Supervisory Authority and the Central Bank of Iceland."

On 16 September, the Supreme Court of Iceland handed down a judgment in a case in which the treatment of the balance of an exchange rate-linked motor vehicle loan falling under the scope of the 16 June judgment was in dispute. The Supreme Court concluded that, in calculating the balance due, the interest rate specified in the contract should not prevail, as the premises for that interest rate no longer applied once exchange rate linkage had been deemed unlawful. Instead, the interest on the loan should be based on the lowest non-indexed interest rate published by the Central Bank of Iceland. The judgment set precedent for the treatment of other exchange rate-linked motor vehicle loan agreements.

On 17 September, a report by a special committee appointed by the Prime Minister was published. The committee expressed the opinion that there were no obvious legal flaws in the agreement concerning Magma Energy Sweden's purchase of shares in HS Orka. Other possible legal interpretation of the connection between the buyer and the parent company could lead to another conclusion, however.

On 19 September, the Central Bank sold a 99.89% stake in Danish bank FIH, which the Central Bank accepted as collateral for a lastresort loan granted to Kaupthing Bank in October 2008, in the amount of 500 million euros. The sale price was 5 billion Danish kroner (approximately 103 b.kr., or 670 million euros). The purchase is linked to the performance of FIH until 2014.

On 20 September, Moody's Investors Service issued an opinion on the Supreme Court's 16 September decision on exchange rate-linked loans. The agency was of the opinion that the judgment reduced uncertainty but did not affect Iceland's sovereign credit rating.

On 20 September, the Financial Supervisory Authority granted ALM Fjarmalaradgjof hf. a licence to operate as a securities undertaking pursuant to Article 4, Paragraph 1, Subparagraph 5 of the Act on Financial Undertakings, no. 161/2002.

On 21 September, the Financial Supervisory Authority authorised Annex ehf. to own a qualifying holding of up to 50% in ARM Securities hf., cf. Chapter VI of the Act on Financial Undertakings, no. 161/2002.

On 22 September, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.75 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 4.75%; maximum rates on 28-day certificates of deposit (CDs), to 6.0%; seven-day collateralised loans, to 6.25%; and overnight loans, to 7.75%.

On 23 September, the Financial Supervisory Authority granted Virðing hf. increased authorisation to operate as a securities company. The company's operating licence was reissued to take account of this.

On 29 September, the Executive Committee of the International Monetary Fund (IMF) approved the third review of Iceland's economic programme. The programme is subject to seven reviews in all. Upon approval by the Executive Board, the fourth tranche of the IMF loan

facility, SDR 105 million, became available. This tranche of the facility is equivalent to 162 million US dollars, or just under 19 b.kr. It is expected that, with the approval of the review, bilateral loan financing from the Nordic countries (444 million euros) and Poland (210 million zlotys, or 71 million US dollars) will also become available.

## October

On 5 October, the report of the monitoring committee on measures to assist individuals, households, and businesses due to extraordinary circumstances in the financial market was presented to the Government and the opposition party leaders. The aim of the Act on Problem Debt Restructuring is to expedite the reconstruction of the Icelandic economy and establish equilibrium in private sector debt. The committee assessed the financial institutions' work on private sector debt mitigation and made suggestions for improvements in its report.

On 14 October, Parliament passed Act no. 128/2010 amending the Act on Debt Mitigation for Individuals, no. 101/2010, due to the extremely heavy workload at the newly established Office of the Debtors' Ombudsman. The amendments were intended to ease debtors' position by granting applicants a deferral of payment upon submittal of the application for debt mitigation and not upon approval.

On 14 October, the Ministry of Finance, the Byr Savings Bank winding-up committee, and the Byr hf. board of directors signed an agreement on the settlement and ownership of Byr hf. with the takeover of the savings bank by the Byr winding-up committee. The State's holding in Byr hf. will be 5.2%. Byr Savings Bank's stake, 94.8%, will be in the custody and oversight of the Ministry of Finance until the winding-up committee requests it, probably within two years. With this action, Byr hf. is fully capitalised and meets the capital adequacy and liquidity requirements of the Financial Supervisory Authority and the Central Bank of Iceland. The Treasury grants Byr hf. a subordinated loan of up to 5 b.kr. at market rates for a period of 10 years, which Byr hf. is expected to pay in full in five years' time. Byr Savings Bank's claim against Byr hf. will be converted to share capital.

On 15 October, the Financial Supervisory Authority authorised Arion Bank hf. to own a qualifying holding in Valitor hf. Arion Bank hf. requested permission to increase its qualifying holding in Valitor hf. indirectly, through its holding in Valitor Holding hf., cf. Article 40 of the Act on Financial Undertakings. The Financial Supervisory Authority considers Arion Bank eligible to own and administer the holding, partly because of Valitor's sound and reliable operations. On 12 October, the Financial Supervisory Authority authorised Arion Bank to own a stake of over 50% in Valitor.

On 15 October, the Ministry of Fisheries authorised a 15,000-tonne quota for Icelandic summer spawning herring, for the fishing year 2010/2011.

On 15 October, the committee on foreign investment submitted its third report on the legality of Magma Energy Sweden's investment in the subsidiaries of HS Orka. The committee expressed the opinion that there was no further reason to comment on the acquisition, citing two previous opinions wherein the majority of the committee considered Magma's purchase of HS Orka in compliance with the law.

On 18 October, the Financial Supervisory Authority announced that, on 1 October, it had recalled ALMC hf.'s (previously Straumur-Burdaras Investment Bank) commercial banking licence, as the company was dissolved pursuant to Chapter XII of the Act on Financial Undertakings, no. 161/2002; cf. Article 9, Paragraph 1, Subparagraph 6 of the same Act.

On 20 October, Parliament passed Act no. 129/2010 amending the Act on Forced Sale, no. 90/1991. Because the Office of the Debtors' Ombudsman had only recently commenced operation and because of the time required to resolve pending cases, the Act on Forced Sale was amended, and the respondent's deadline for requesting that the Commissioner postpone the continuation of a forced sale be deferred for three months was extended until 31 March 2011.

On 21 October, it was decided at a meeting of coastal nations that the total catch of the Norwegian spring spawning herring stock should be 988,000 tonnes in 2011. The total blue whiting catch was set at 44,000 tonnes. Iceland's share of the quotas is 143,000 tonnes of herring and 6,500 tonnes of blue whiting.

## November

On 1 November, the Central Bank announced that the review of the Rules on Foreign Exchange, no. 370/2010, was complete. The Bank considered it unnecessary to amend the Rules; therefore, they remained in effect unchanged.

On 3 November, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.75 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 4.0%; the maximum rate on 28-day certificates of deposit (CDs), to 5.25%; seven-day collateralised loans, to 5.5%; and overnight loans, to 7.0%.

On 3 November, Már Guðmundsson issued a statement explaining the policy framework and plans for the removal of the capital controls. In the statement, the Governor reviewed the status of the controls and described the conditions that must be in place in order for liberalisation to take place.

On 3 November, the Ministry of Fisheries increased the maximum quota for Icelandic summer spawning herring from 15,000 tonnes to 40,000 tonnes.

On 14 November, a two-week visit to Iceland by an IMF mission under the leadership of Julie Kozack was completed. The mission discussed the fourth review of the IMF-supported economic programme with the Icelandic authorities. Meetings were held with the authorities, members of Parliament, academics, private sector representatives, and labour market representatives.

On 16 November, Parliament passed Act no. 132/2010 amending the Act on Financial Undertakings, no. 161/2002, as regards provisions concerning winding-up proceedings and bankruptcy proceedings for the failed commercial banks. The amendment was made following comments by the resolution committees and winding-up committees of the failed banks as a result of judgments handed down by an appeals court in France on 4 November 2010. It can be concluded from the judgment that there could be some legal uncertainty pertaining to the origination of financial institutions' winding-up proceedings according to general rules. Because significant interests were at stake, it was considered necessary to eliminate all doubt about the involvement of the courts in winding-up proceedings and to ensure that there was no doubt about whether the formal requirements set forth in Directive 2001/24/EC on reorganisation and winding up of credit institutions were fulfilled.

On 19 November, the Ministry of Fisheries issued a capelin quota of 200,000 tonnes for the winter fishing season dating from 23 November 2010 – 30 April 2011.

On 25 November, the Supreme Court of Iceland handed down Decision no. 274/2010 concerning the Act on Guarantors, no. 32/2009. In the case, payment was demanded of two guarantors for a debt of which the District Court had relieved a debtor with a composition of creditors agreement involving debt mitigation. The Supreme Court upheld the District Court decision, which was that the creditor's right against the guarantors of the debt was protected by Article 72 of the Constitution and that those rights could not be curtailed without compensation by means of retroactive legislation. The provisions of the Act on Guarantors were therefore in contravention of the Constitution.

On 30 November, Parliament passed Act no. 135/2010 amending the Act on Debt Mitigation for Individuals, no. 101/2010, and other Acts, with the aim of rectifying various flaws in the Act on Debt Mitigation, clarifying provisions and ensuring the effectiveness of debt mitigation, and co-ordinating the implementation of the debt mitigation measure.

## **December**

On 1 December, the Enterprise Investment Fund announced that the Competition Authority's examination and due diligence analysis of the Fund's purchase of the holding company Vestia from Landsbanki was complete. The valuation changed somewhat during the process, and Landsbanki retains more of the company's assets than was assumed at the time of the purchase on 20 August. As a result, the purchase price is 15.5 b.kr. instead of the 19.5 b.kr. assumed in August.

On 3 December, the Government announced an agreement with credit institutions and pension funds concerning measures to assist distressed households. Distressed borrowers with over-leveraged assets are offered the opportunity to reduce their outstanding debt to 110% of the value of the asset concerned. The original debt service burden must be at least 20% of the income tax base plus investment income. Collateralised debt could be reduced by as



much as 4 m.kr. for individuals and 7 m.kr. for couples or single parents. A much more detailed appraisal of assets and capacity to pay must be carried out if a larger write-down is needed, up to a maximum of 15 m.kr. for individuals and 30 m.kr. for couples and single parents. Changes were also made to problem debt restructuring measures so that they would benefit a larger number of households. Over 2 b.kr. would be allocated to the maintenance of a special increase in mortgage interest allowances that was implemented in 2009-2010. A new temporary measure would then be created to pay down interest expense due to residential housing. Lenders will also attempt to reach all households that are in arrears and offer them satisfactory solutions before 1 May 2011. In connection with the agreement on debt problems, the Government declared that it would reduce the linkage between pension benefits and social security benefits and that the tax-free threshold for pensioners would be raised in stages during the period 2013-2015.

On 7 December, the supplementary budget for 2010 was approved by Parliament. Estimated revenues for 2010 rise by 16 b.kr., due primarily to stronger asset sales, while estimated expenditures decline by 0.9 b.kr., because a 24 b.kr. increase stemming from appropriated bank debt offsets a 24 b.kr. reduction in interest expense.

On 8 December, the Monetary Policy Committee of the Central Bank of Iceland decided to narrow the Bank's interest rate corridor by 1 percentage point. Interest on deposit institutions' current accounts was reduced by 0.5 percentage points, to 3.5%. The maximum rate on 28-day CDs and the interest on seven-day collateralised loans were reduced by 1.0 percentage point each, to 4.25% and 4.5%, respectively. The overnight lending rate was lowered by 1.5 percentage points, to 5.5%. According to the MPC statement, the objective of the changes was to reduce volatility in short-term rates and move the overnight lending rate closer to the centre of the corridor.

On 9 December, the Icelandic negotiating committee in the Icesave dispute announced the results of discussions with the British and Dutch negotiating committees and presented a draft of a new agreement. The draft provides for an average interest rate of 2.64% until 2016 instead of the 5.5% in the previous agreement. It also provides for flexible repayment time if the outstanding balance in 2016 is higher than expected. In addition, annual payments are subject to a maximum of 1.3% of GDP, or 5% of Government revenues, whichever is lower. On 15 December, the Government presented a bill of legislation authorising the approval of the agreement.

On 15 December, Parliament passed Act no. 141/2010 amending the Act on Securities Transactions, which expands the exemptions from the takeover requirement when a company is listed on the market or lists financial instruments on the market.

On 15 December, the Ministry of Economic Affairs, Icelandic Federation of Trade, Ministry of Finance, Confederation of Icelandic Employers, Icelandic Financial Services Association, and Iceland Chamber of Commerce signed an agreement concerning a plan to expedite the settlement of small and medium-sized companies' debt with financial institutions. The agreement covers companies whose continued operation is most likely, in the opinion of the financial institution concerned, to protect the interests of creditors, employees, and owners. The objective is that companies' total indebtedness following financial restructuring not exceed their restated asset value or operational value, whichever is higher, plus the value of other collateral backing the debt of the company in question. Monthly goals will be set for the number of processed offers for the period January to May 2011. The State will facilitate the agreement by lengthening the payment deadlines for public levies and increasing authorisations to cancel public claims that are considered unlikely to be collected. The agreement was announced under the title "the Straight Path."

On 16 December, the National Budget for 2011 was approved by Parliament. Revenues are estimated at 473 b.kr., expenditures at 510 b.kr., and the deficit at 37 b.kr. The surplus before interest income and expense is estimated at 15 b.kr. Revenues are estimated to decline by 1% from the increased 2010 National Budget due to lower sales revenues and the transfer of revenue bases to municipalities. Tax revenues are estimated to rise by 3%, even though the transfer of revenues for the affairs of the disabled to municipalities will cause a 2.4% reduction. Expenditures are projected to decrease by 9%, including 1.6% due to the transfer of the affairs of the disabled.

On 16 December, the EFTA Surveillance Authority (ESA) confirmed its previously issued preliminary conclusion that the provisions of Act no. 125/2008, the so-called Emergency Act, were in compliance with the EEA Agreement and

fulfilled other legal requirements. This included both the provisions assigning higher priority to deposits than to general claims and the actions taken by the Icelandic authorities on the basis of the Act. ESA was of the opinion that the actions to which the authorities resorted were the only options that could have averted the complete collapse of the Icelandic economy.

On 16 December, the Financial Supervisory Authority announced that it had granted T Plús hf. in Akureyri a licence to operate as a securities undertaking in accordance with Article 4 of the Act on Financial Undertakings, no. 161/2002.

On 17 December, Parliament decided that it would have an impartial and independent investigation carried out of the operations of the Housing Financing Fund during the period 2004-2010.

On 17 December, Parliament passed Act no. 142/2010 amending the Act on Bankruptcy, Etc., which aimed at enabling individuals who have undergone bankruptcy proceedings but are still responsible for debt not paid during the proceedings to stabilise their finances. The changes entailed shortening the expiry deadline for those claims, or for the portion not paid during bankruptcy proceedings, so that the expiry date of all claims in the estate will be the same – two years – irrespective of the type of claim.

On 17 December, Parliament passed Act no. 144/2010 amending the Act on the Establishment of the Partnership Orkuveita Reykjavíkur, which limits the owners' liability in the wake of the EFTA Surveillance Authority's decision that unlimited owner liability is not consistent with the EEA Agreement provisions on state aid.

On 17 December, Parliament passed Act no. 152/2010, which stipulates that the municipalities of Iceland shall assume professional and financial responsibility for the provision of services for the disabled, and that this responsibility shall be transferred from the State to the municipalities as of 1 January 2011, in return for increased local tax revenues.

On 17 December, the Minister of Fisheries allocated a 147,000-tonne mackerel quota to Icelandic fishing vessels for 2011, a 17,000-tonne increase from the prior year.

On 18 December, Parliament passed Act no. 150/2010, which provided for a 40% year-on-year increase in supervisory fees paid to the Financial Supervisory Authority by financial institutions.

On 18 December, Parliament passed Act no. 151/2010 amending the Act on Interest and Price Indexation; the Act on Measures to Assist Individuals, Households, and Businesses due to Extraordinary Circumstances in the Financial Markets; and the Act on the Debtors' Ombudsman. The amendments were intended to reduce the uncertainty that developed in the wake of the Supreme Court judgments on exchange rate-linked loans, as regards the legality of contractual agreements covering a wide range of short- and long-term financing. The objectives were to ensure, to the extent possible, that comparable cases would receive comparable treatment, and to ensure legal security in the settlement of loan agreements with non-binding exchange rate linkage clauses.

On 18 December, Parliament passed Act no. 153/2010, amending legislation on unemployment benefits. For those who lost their jobs after end-April 2008, the period of entitlement to benefits was lengthened from three years to four, and the authorisation to pay benefits commensurate with reduced employment was extended by six months, until 30 June 2011. Benefits are only paid if the reduction in employment is at least 30% of a full-time position, as opposed to the previous 20%.

On 18 December, Parliament passed Act no. 155/2010, imposing a special tax on financial institutions in the amount of 0.041% of a base equal to total liabilities.

On 18 December, Parliament passed Act no. 156/2010, which changes the structure of the excise tax on imported motor vehicles, the motor vehicle tax, and the oil charge, so that levies rise with increased CO<sub>2</sub> emissions.

On 18 December, Parliament passed Act no. 163/2010 amending the Value-Added Tax Act, so as to enable monitoring and follow-up by the tax authorities, to clarify provisions on tax deductions for exported electronic services,



including data centre services, and to discontinue rebates for indoor heating while extending authorisations for special rebates due to distance coaches and construction work done on residential housing until year-end 2011.

On 18 December, Parliament passed Act no. 164/2010, which sets forth various fiscal measures. The main features of the Act are i) the investment tax is increased from 18% to 20%; ii) the corporate income tax is raised from 18% to 20%; iii) the wealth tax is raised from 1.25% to 1.5%, and tax-free threshold is reduced by 16.7%; iv) the inheritance tax is raised from 5% to 10%; v) the tobacco tax is raised by 7%, and a special, limited tobacco levy is imposed at the duty-free store upon arrival in Iceland; vi) the carbon tax is increased by 50% by raising the reference from 50% to 75% of the price of emissions allocations at EU auctions; vii) the overall authorisation to withdraw third-pillar pension savings before 1 April 2011 is raised from 2.5 m.kr. to 5 m.kr. per person. These changes are expected to generate a total of 11 b.kr. in tax revenues for the Treasury in 2011.

On 18 December, Parliament passed Act no. 165/2010, amending various pieces of tax legislation. Chief among them were i) the transfer of local tax revenues to municipalities due to the transfer of the affairs of the disabled; ii) the authorisation for companies to distribute the tax base due to cancelled debt over the years 2010-2014 and to pay the outstanding balance over five years; iii) the expansion of authorisations to defer or cancel businesses' tax debt; iv) the cancellation of the equity securities discount on individuals' income tax, in view of comments from EFTA, and increased authorisations for tax deductions for innovation companies; v) amendments to the statutory framework for tax investigations, so as to expedite case handling.

On 22 December, Parliament passed Act no. 141/2010 amending the Act on Securities Transactions, no. 108/2007, as regards mandatory takeover bids due to control of a company upon its listing on a stock exchange. The amendment was made because of comments indicating that the previous provisions could harm the securities market and could pose a serious risk that companies would remove their shares from trading in Iceland.

On 22 December, the Ministry of Finance published the tax brackets for withholding tax in 2011. The average local tax rate will be 14.41%, 66 of a total of 76 municipalities will levy the maximum local tax, and two municipalities will levy the minimum tax. The withholding percentages for income tax and local tax will be in three brackets: 37.31%, 40.21% and 46.21%. The monthly income thresholds for the three brackets will be 209,400 kr. for the first bracket; 471,150 kr. for the second bracket, and 680,550 kr. for the third bracket. The personal deduction will be unchanged at 44,205 kr. per month, and the tax-free income threshold will be 123,417 kr., after wage earners' mandatory 4% pension fund contribution. Municipalities' minimum and maximum local tax rates will rise by 1.20% due to the transfer of the affairs of the disabled to the local authorities, and the national tax percentages will decline accordingly, in each tax bracket. The tax-free income threshold and the thresholds between tax brackets will increase proportional to the twelve-month rise in the wage index, now about 4.7%.

On 30 December, the Central Bank of Iceland announced that it had concluded contractual agreements concerning the debt of five savings banks that did not meet minimum capital adequacy requirements in the wake of the banking collapse. The savings banks in question are: Sparisjóður Bolungarvíkur, Sparisjóður Norðfjarðar, Sparisjóður Svarfdæla, Sparisjóður Vestmannaeyja, and Sparisjóður Þórshafnar og nágrennis. In addition, Sparisjóður Suður-Þingeyinga and Sparisjóður Höfðhverfinga have paid their debts to the Central Bank. During the restructuring process, the Central Bank acquired a large part of the savings banks' guarantee capital. The guarantee capital shares have been transferred to Icelandic State Financial Investments, which administers the holding on behalf of the State.

Near the end of the year, the Central Bank purchased foreign currency for 24.6 b.kr. (160 million euros), as well as negotiating forward contracts amounting to 47.9 b.kr. (312 million euros). These transactions will expand the Central Bank's foreign exchange reserves by about 72.5 b.kr. (472 million euros) during the term of the agreement. These transactions were undertaken so as to correct imbalances between foreign assets and liabilities on the balance sheets of various financial institutions. In addition, they promote increased financial system stability and bolster the Central Bank's non-borrowed foreign exchange reserves.

# Economic and monetary chronicle 2011

## January 2011

On 1 January, the asset and income thresholds according to the rules on State-subsidised residential housing were raised by 2.46%. The asset limit for rent subsidy allowances was raised by the same percentage. The increases accord with the rise in consumer prices from the beginning of 2010 to the beginning of 2011.

On 4 January, the Minister of Welfare instructed the municipalities to increase financial assistance to individuals to equal the amount of unemployment benefits.

On 5 January, an agreement between the Government and the Icelandic Pension Funds' Association was announced. The agreement stipulates as follows: i) general increases in pension payments within the year 2011 will not reduce State payments through income linkage; ii) during the same period, the pension funds will not use income linkage to reduce payments, even though disability assessments are denied; iii) the tax-free threshold for pensioners will increase in three stages over the period 2013-2015, in accordance with the increase in the tax-free threshold for disability benefits.

On 6 January, the Central Bank and the Financial Supervisory Authority announced the conclusion of a new co-operation agreement. The aim of the agreement is to promote a sound, effective, and safe financial system in Iceland, including payment and settlement systems. Among other new provisions, senior management and relevant experts from both institutions are to meet regularly, at least twice a year, so as to assess systemic risk in the financial system, including macroeconomic risk factors, risks in financial institutions' operations, the interplay of risk factors, the status of payment systems, the need for amendment of regulatory instruments, and improvements in contingency exercises.

On 7 January, the Government agreed to extend the incentive programme called "Back to Work," which was established in collaboration with the Icelandic Federation of Labour, the Confederation of Icelandic Employers, the Federation of Icelandic Industries, and others. The authorisation for reimbursement of value-added tax on labour costs for work done on residential housing will be extended until year-end 2011 and will remain in effect for the same length of time as the authorised income tax deduction.

On 10 January, the Executive Committee of the International Monetary Fund (IMF) approved the fourth review of Iceland's economic programme. The approval by the Executive Board released the fifth tranche of the IMF loan facility, in the amount of SDR 105 million (just under 19 b.kr.). Iceland is also authorised to draw further funds on the loan facilities from the Nordic countries and Poland.

On 28 January, the Financial Supervisory Authority decided that the holding company Eignarhaldsfélag NBI ehf. is eligible to own qualifying holdings large enough that Landsvaki hf. and SP-Fjármögnun hf. will be considered its subsidiaries.

On 28 January, it was announced that the Competition Authority had approved the Central Bank's sale of its stake in the Icelandic Banks' Data Centre, concurrent with its takeover of Fjölgreiðslumiðlun hf., which will henceforth be called Greiðsluveitan. Before this change was implemented, Fjölgreiðslumiðlun operated the netting system and the joint payment channel for payment card transactions. Henceforth, it will also operate the RTGS system, the SWIFT-Alliance system for cross-border payments, the collections system for electronic claims and remittance slips (payables pool), and the system that handles the posting of electronic documents to online banking accounts (the check-free system). In its approval of the change, the Competition Authority makes reference to its ruling on the card companies' violation in 2008 and sets requirements for Greiðsluveitan's conduct in the market.

On 31 January, the Financial Supervisory Authority concluded that NBI hf. was eligible to own and administer up to a 33% qualifying holding in Borgun hf.

On 31 January, the Central Bank announced a minor change in the announcement of decisions by the Monetary Policy Committee. Beginning with the Committee's 2 February decision, the MPC statement announcing and explaining the decision would be published at 9:00 on the interest rate decision date instead of 11:00, as had previously been done. The change was made primarily to allow market agents to assess the Committee's decision before markets open. This arrangement allows members of the media, financial analysts, and other interested parties to acquaint themselves with the MPC statement prior to the press conference.

### **February 2011**

On 2 February, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.25 percentage points. The current account rate was reduced to 3.25%, the maximum rate on 28-day certificates of deposit (CDs) to 4.0%, the seven-day collateralised lending rate to 4.25%, and the overnight lending rate to 5.25%.

On 2 February, Parliament passed Act no. 9/2011, amending the Act on Responsible Utilisation of Fish Stocks. The amendment authorises the Minister of Fisheries to impose per diem fines in order to enforce submittal of catch reports.

On 2 February, the Minister of Finance publicised the Government's debt management strategy for 2011-2014 and its plans for borrowing. The plans aim to reduce total Treasury debt from 83% of GDP at end-2010 to 70% of GDP at end-2014, and to reduce net debt from 43% of GDP to 35% of GDP over the same period. Annual repayments on domestic Treasury bonds shall be less than 6% of GDP, balances on the Treasury's current accounts shall equal at least 80 b.kr. at all times, and Treasury debt shall be 60-80% domestic and non-indexed, 20-40% indexed, and 0-20% foreign.

On 3 February, Parliament passed Act no. 12/2011, which increased the number of judges in the judicial system. Three new Supreme Court judges and five new District Court judges will be appointed because of the strain on the judicial system in the wake of the financial crisis.

On 7 February, the Minister of Welfare presented a report on consumption criteria for Icelandic households, prepared by a group of experts. Three types of consumption criteria were presented: i) typical criteria, which represent modest consumption; that is, the median expenses of Icelandic households; ii) short-term criteria based on the same assumptions, but assuming a temporary reduction in consumption and postponement of expenditure items; and iii) basic criteria, which indicate the minimum a household needs to support itself.

On 16 February, Parliament passed the so-called Icesave Act, no. 13/2011, which authorises the Government to guarantee repayment by the Depositors' and Investors' Guarantee Fund to the British and Dutch governments for the compensation paid for Icesave deposits.

On 18 February, the Ministry of Agriculture and Fisheries announced that the capelin quota for the year had been increased to 390,000 tonnes. The original quota was 200,000 tonnes.

On 20 February, the President of Iceland refused to sign Act no. 13/2011, the so-called Icesave Act, which confirmed the agreements providing for a State guarantee of the Depositors' and Investors' Guarantee Fund repayment to the British and Dutch governments. In so doing, the President referred the matter to the electorate for a national referendum, which was subsequently scheduled for 9 April.

On 23 February, the Financial Supervisory Authority revoked the operating licenses of the old financial institutions Byr Savings Bank, Frjálsi Investment Bank hf., and Reykjavík Savings Bank (SPRON) hf., in the wake of a ruling winding up these institutions pursuant to Chapter XII of the Act on Financial Undertakings, no. 161/2002.

On 23 February, rating agency Moody's Investors Service issued a special opinion on the results of the Icesave referendum. The opinion stated that if the Icesave agreements were approved in the referendum, the outlook for Iceland's sovereign credit rating would probably be changed from negative to stable. On the other hand, if the agreements were rejected in the referendum, the rating would probably be downgraded to non-investment grade.

On 23 February, Parliament passed Act no. 14/2011 in order to reinforce the Competition Act, no. 44/2005. Provisions include authorising the Competition Authority to take action against conditions or conduct that prevents, restricts, or is detrimental to competition and is contrary to the public interest. The Competition Authority is now authorised to initiate legal proceedings before the courts in order to revoke rulings by the Competition Appeals Committee.

On 25 February, the Financial Supervisory Authority concluded that the holding company Eignarhaldsfélag NBI ehf. was eligible to own a large enough qualifying holding in Rose Invest hf., a UCITS management company, that Rose Invest would be considered a subsidiary of the holding company.

### **March 2011**

On 1 March, Parliament passed amendments to the Electricity Act. Among other changes, the amended Act expands the requirements for connecting to distribution systems. It also stipulates that Landsnet shall be directly owned by the State and/or the municipalities beginning on 1 January 2015. Furthermore, price lists shall be structured so that they can support average operating expenses plus a profit equivalent to taxes and cost of capital. The Act also requires a licence to operate a market for energy distribution.

On 3 March, Parliament approved amendments to the Act on Landsvirkjun, no. 42/1983, so as to comply with ESA guidelines and to ensure that State guarantees for Landsvirkjun are in compliance with the EEA Agreement provisions on State aid. According to the amendment, the State guarantee is not unlimited; that is, the Act on Bankruptcy, Etc., no. 21/1991, can apply to the company, the amendment covers only credit obligations, and a suitable guarantee fee must be paid for the State guarantee.

On 3 March, Parliament passed an amendment to the Act on State Guarantees, no. 121/1997. According to the amendment, instead of the general State guarantee fee (0.25%) pursuant to Article 6, Paragraph 2 of the Act, Landsvirkjun and others specified in Article 6, Paragraph 1 of the Act on State Guarantees shall pay a guarantee fee that fully corresponds to the concession enjoyed by the company on the basis of the State guarantee, in the form of credit terms more beneficial than those generally available in the market without such a guarantee. With Act no. 144/2010 amending the Act on the Establishment of the Partnership Orkuveita Reykjavíkur, no. 139/2001, with subsequent amendments, Parliament approved the same type of changes as regards owner liability for Orkuveita Reykjavíkur's credit obligations.

On 5 March, the Minister of Finance concluded an agreement with Landsbanki Íslands concerning the latter's takeover of SpKef Savings Bank. This was done in consultation with Icelandic State Financial Investments and with the approval of the Financial Supervisory Authority. On 5 February, SpKef's capital was assessed as negative in the amount of 11 b.kr. In all, the savings bank was deemed in need of 19.4 b.kr. in order to fulfil the FME's minimum capital adequacy requirements. The savings bank had been in liquidity difficulties as well. The agreement with Landsbanki limits the Treasury's expense in relation to deposit insurance. The additional economic capital was estimated at 8.2 b.kr.

On 16 March, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

On 16 March, Parliament authorised the Government to confirm various decisions of the EEA Committee on amendments to the following annexes to the EEA Agreement: Annex IX (on financial reporting standards, Parliamentary Document 1056; and electronic payment intermediation, Parliamentary Document 1057); Annex XIII (on maritime insurance, Parliamentary Document 1058); Annex XIX (on consumer protection, Parliamentary Document 1055); Annex XX (on environmental affairs, Parliamentary Document 1054); and Annex XXII (on company law, Parliamentary Document 1060).

On 16 March, Parliament passed Act no. 24/2011, amending the Act on Withholding of Public Levies, the Value-Added Tax Act, and the Act on Withholding of Investment Tax. Provisions were added to all of these Acts, authorising freezing of assets if the risk is considered to exist that the taxable party could avoid payment of public levies by transferring assets to another party. A comparable provision was added to the Income Tax Act in 2010.

On 17 March, an agreement was reached among major fishing nations apart from Russia, concerning fishing of the ocean perch stock around the Reykjanes peninsula. The agreement was reached after many years of discussions. The objective is that fishing will be carried out as advised and that Iceland's share will be 31%.

On 22 March, the Prime Minister issued a code of conduct for Government ministers. The code includes provisions on connections and conflicts of interest, finances and wage payments, conduct and demeanour, interactions between ministers and ministerial employees, and disclosure of information to the public.

On 22 March, Parliament authorised the Government to confirm two decisions of the EEA Committee on amendments to Annex XX to the EEA Agreement (on environmental issues, Parliamentary Documents 1090 and 1091).

On 25 March, it was announced that the Financial Supervisory Authority's advisory committee on board member eligibility had evaluated 47 insurance and financial company board members, including eight board members from holding companies. The conclusion was that the expertise, understanding, and attitudes of the board members as regards the main topics related to their sphere of activity were adequate in 35 instances and inadequate in 12 instances.

On 25 March, the Central Bank of Iceland published its capital account liberalisation strategy report. The report discusses the experience gained from the Central Bank's previous strategy and the conditions that must be met in order for it to be possible to lift the controls. In addition, two main phases of the strategy are described, as are smaller increments in the first phase. The report concludes that the conditions required to begin careful removal of some controls already exist, while major steps cannot be taken until the Treasury has demonstrated, through borrowing, that it is able to refinance its foreign loans.

On 28 March, Parliament agreed to add a temporary provision to the Housing Affairs Act, no. 44/1998, authorising the Housing Financing Fund (HFF), upon fulfilment of specified conditions, to write individual mortgage loans down to 110% of the value of the underlying residential property. The amendment is in accordance with the 3 December 2010 agreement between the Government, on the one hand, and credit institutions and pension funds, on the other. The cost of the HFF write-down is estimated at 21.8 b.kr.

#### **April 2011**

On 8 April, the Financial Supervisory Authority revoked the operating licences of Askar Capital hf., Sparisjóðabanki Íslands hf. – Icebank, and VBS Investment Bank hf.

On 9 April, a national referendum was held concerning Act no. 13/2011, which authorised the Minister of Finance to guarantee the Depositors' and Investors' Guarantee Fund's reimbursement of costs incurred by the UK and Dutch governments for minimum deposit insurance in British and Dutch branches of Landsbanki and to pay the outstanding balance, with interest, of those obligations. The President of Iceland had referred the matter for referendum on

20 February. Voter turnout was 75%, and the authorisation was rejected with 59.77% of valid votes. 40.23% voted in favour of the authorisation.

On 11 April, the Financial Supervisory Authority approved the transfer of a specified operational unit of EA Investment Company hf. (previously MP Bank hf.) to MP Bank hf. (previously nb.is-Savings Bank hf.) and granted the new bank a commercial banking licence. At the same time, the company's savings bank licence was revoked. In addition, the Financial Supervisory Authority concluded that Titan Investment Company ehf. was eligible to own a qualifying holding of up to 20% in the new MP Bank hf.

On 13 April, rating agency Standard & Poor's placed the Republic of Iceland on CreditWatch negative status.

On 15 April, the Central Bank of Iceland, on behalf of the Treasury, offered to purchase, at par, foreign-denominated Treasury bonds maturing in 2011 and 2012. The offer extended to two bond series in the original amount of 1,250 million euros. The measure was an element in Treasury liquidity and debt management, as well as the management of the Bank's foreign exchange reserves. The offer remained in effect until 5 May 2011.

On 20 April, the Competition Authority imposed per diem fines on the Central Bank of Iceland in order to force the delivery of information on lending by individual banks and savings banks, which the Central Bank considered confidential. The fines would amount to 1.5 m.kr. per day until the documents were submitted. The fines were recalled after the credit institutions concerned authorised the Central Bank to deliver the requested information.

On 20 April, rating agency Moody's Investors Service affirmed the Republic of Iceland's Baa3 ratings for long-term obligations in local and foreign currency in the wake of the rejection of the Icesave agreement in the 9 April referendum. The outlook on the ratings was negative. The agency had previously indicated that rejection of the agreement would probably lead to a rating downgrade. In its press release of 21 April, Moody's attributed the unchanged rating to the positive outlook for payments from the Landsbanki estate, Iceland's performance under the IMF-led economic programme, and support from the Nordic countries in the wake of the referendum.

On 20 April, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

### **May 2011**

On 2 May, the Icelandic authorities delivered to the EFTA Surveillance Authority a letter from the Minister of Economic Affairs, rejecting the assertion that Iceland had violated the EU Directive on deposit guarantees and demanding that the case be dismissed. It was pointed out that the Landsbanki estate would cover the vast majority of the deposit claims, payouts were scheduled to begin in the near future, and the actions taken by the British and Dutch authorities had delayed settlement.

On 5 May, contractual wage agreements were signed by the national member organisations and the largest unions within the Icelandic Federation of Labour (ASÍ) and the Confederation of Icelandic Employers (SA). The main provisions of the agreements are: A general percentage increase in wages above a specified monthly wage threshold, a rise of a specific sum in wage scales below that threshold, an increase in minimum wages, and a bonus due to delays in contract negotiation. Similar agreements were then concluded in both private and public sectors. The agreements remain in effect until 31 January 2014 if the premises hold. They would have expired on 1 February 2012 if various contract-related pledges had not been formalised before 22 June 2011. The premises that must be met upon review of the agreements in 2012 are that real wages must have risen between December 2010 and December 2011, price levels must have remained stable, and the króna must have appreciated markedly between the effective date of the agreement and year-end 2011. Upon the latter review, in 2013, real wages must have risen between December 2011 and December 2012, twelve-month inflation must be below 2.5% in December 2012, and the trade-weighted



exchange rate index must be below 190 at that time. According to the agreements, wages above 282,353 kr. per month will rise by 4.25% on 1 June 2011; wages above 314,286 kr. will rise by 3.5% on 1 February 2012; and wages above 338,462 kr. will rise by 3.25% on 1 February 2013. Wage scales below these thresholds rise by 12,000 kr. on 1 June 2011 and by 11,000 on 1 February 2012 and 2013. The minimum pay for full-time employment shall be at least 204,000 kr. per month by the end of the contract period, an increase of 23.6%. Employers' costs rise very little due to the increase in minimum pay, as few workers are employed on those terms. One-time payments due to contract delays amount to 75,000 kr.: 50,000 kr. paid upon approval of the contract and 25,000 kr. in connection with vacation and December bonuses in 2011. The gross increase in expense incurred by employers affected by the contract will be about 13% over the lifetime of the agreement, or an average of 4.3% per year. Employers' net costs will increase less, however, as the payroll tax will decline in line with falling inflation, according to a Government announcement.

At the time the agreements were signed, the Government stated that the personal deduction would be indexed, benefits from the general and unemployment insurance funds would rise in line with wages, income linkage of child benefits and mortgage interest allowances reviewed, and the payroll tax reduced in line with declining expenditures related to unemployment. Other pledges included easing the corporate tax environment, improving corporate governance practises, and strengthening employees' position in the event of bankruptcy. The parties to the agreement declared that it was their objective to increase the investment ratio to 20% or more by the end of the contract period. This corresponds to an investment level of at least 350 b.kr. per year. A campaign to help unemployed people back to school was promised, with 2 b.kr. to be shifted from unemployment benefits to educational measures. The Government pledged to work towards the harmonisation of pension rights without curtailing public sector employees' accrued rights, with the aim of presenting the matter before Parliament before the end of the legislative session. Finally, it pledged to show stakeholders proposals for amendments to the Fisheries Management Act before presenting them to Parliament.

On 6 May, the Central Bank announced the approval of plans to purchase, at par, foreign Treasury bonds in the amount of 346 million euros (57 b.kr.). The bonds mature in 2011 and 2012. The transaction was carried out following a tender among investors in Treasury bonds, which was announced on 15 April. The tender centred on two bond series in the combined total amount of 1,250 million euros (204 b.kr.) nominal value. Prior to the purchase, approximately 800 million euros (130 b.kr.) were outstanding.

On 16 May, Fitch Ratings changed the outlook on Iceland's sovereign credit rating from negative to stable.

On 17 May, rating agency Standard & Poor's affirmed Iceland's sovereign credit rating for obligations in foreign currency. The rating for long-term obligations in domestic currency was downgraded to BBB-.

On 23 May, the Central Bank offered to purchase Icelandic krónur against cash payment in foreign currency. The auction was an element in the removal of restrictions on movement of capital as set forth in the Central Bank's capital account liberalisation strategy, published on 25 March 2011. The Bank offered to purchase 15 b.kr. in return for payment in euros. The objective of these initial measures in Phase I of the capital account liberalisation strategy was to enable investors to sell their króna assets in an orderly manner if they so chose.

## June 2011

On 3 June, the Executive Board of the International Monetary Fund (IMF) approved the fifth review of Iceland's economic programme. It was also decided at that time to merge the two last reviews. The approval by the Executive Board released the sixth tranche of the IMF loan facility, in the amount of SDR 140 million (just under 26 b.kr.).

On 7 June, an auction was held of Icelandic krónur in return for payment in foreign currency. The auction was announced on 23 May. All accepted bids in the auction were based on the exchange rate at which they were submitted. Bids were submitted for 61.13 b.kr., and bids amounting to 13.4 b.kr. were accepted. The average accepted price was 218.89 kr. per euro, and the minimum price of accepted offers was 215.00 kr. per euro.



On 9 June, the Treasury concluded agreements for a bond issue in the amount of 1 billion US dollars, or 114 b.kr. The bonds bear fixed interest and are issued for five years at a yield of 4.993%. The terms are equivalent to a 3.20% premium on interbank market rates. Investors were keenly interested, with demand totalling 2 billion dollars.

On 10 June, Parliament passed Act no. 64/2011 Amending the Act on Greenhouse Gas Emissions, no. 65/2007. The amendment incorporates the European Union's system for emissions allocations into Icelandic law.

On 10 June, Parliament passed Act no. 78/2011, amending the Act on Financial Undertakings, no. 161/2002. The amendments strengthen creditors' and winding-up committees' right to dispose of assets, as well as strengthening creditors' rights in other countries vis-à-vis cancellation, setting eligibility requirements for participation in winding-up committees, confirming the Financial Supervisory Authority's right to supervise winding-up committees and resolution committees, and requiring winding-up committees and resolution committees to notify creditors of all major actions.

On 10 June, Parliament approved Resolution no. 42/139 providing for the appointment of a committee to investigate the collapse of the savings banks.

On 11 June, Parliament passed Act no. 70/2011, amending the Fisheries Management Act. The Act expands authorisations for inshore fishing and allocates supplemental quotas for several species versus payment. The deduction due to regional catch quotas and inshore fishing is to be applied in part to all catch quotas rather than to quotas for the species in question, and inshore fishing requirements for multi-vessel fisheries are tightened. The regional quota is increased, the fishing fee is raised from 9.5% to 13% of the calculated margin, and 15% of it reverts to the municipalities.

On 11 June, Parliament passed Act no. 73/2011, legalising points made in the Government's statement concerning the wage settlements in May.

On 11 June, Parliament passed Act no. 81/2011, extending the Central Bank of Iceland's temporary authorisation to restrict or stop specified types of capital movements and related foreign exchange transactions until 30 September 2011.

On 14 June, the Financial Supervisory Authority announced that it had approved the merger of Avant hf. and SP fjármögnun hf. with Landsbanki hf. under the name of Landsbanki.

On 15 June, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

On 16 June, the Central Bank of Iceland offered to purchase euros against payment in Treasury bonds. The auction was held in connection with the capital account liberalisation strategy. The aim was to recoup the foreign currency that the Central Bank of Iceland used to purchase offshore krónur in the previous auction and sell krónur to buyers prepared to hold them for at least five years. The Central Bank offered to purchase 64 million euros against payment in Treasury series RIKS 30 0701.

On 23 June, Registers Iceland announced the revision of the property valuation to be used to levy property taxes in 2012. The total nationwide property valuation rose by 6.8%, to 4,400 b.kr. The total valuation of residential housing rose by 9%.

On 24 June, the Financial Supervisory Authority announced that it had revoked SpKef's operating licence due to a ruling on the winding-up of the savings bank.

On 28 June, the foreign currency auction announced on 16 June took place. Bids totalling 71.8 million euros were submitted, and bids amounting to 61.74 million euros were accepted. The auction was structured with a single-price format, so that all accepted offers were made available to primary dealers at the same price, which was set at 210.00 kr. per euro. Purchasers receive indexed Treasury bonds in the RIKS 30 0701 series as payment for the foreign currency.

### July 2011

On 4 July, the Financial Supervisory Authority announced that its board had approved rules on financial institutions' bonus payment systems, as was stipulated in the amendments to the Act on Financial Undertakings. The annual bonus may not exceed 25% of the annual salary without the bonus, and payment of a portion of the bonus must be deferred for at least 3 years. Payment of non-performance-linked bonuses is prohibited.

On 5 July, the Minister of Fisheries announced quota allocations for the 2011/2012 fishing year. The cod quota was increased by 17,000 tonnes, the haddock quota was reduced by 5,000 tonnes, and the perch quota was increased by 12,000 tonnes. Overall, quotas were increased by 32,500 tonnes in the species for which quotas were issued.

On 6 July, the Central Bank offered to purchase Icelandic krónur against cash payment in foreign currency. The auction was an element in the liberalisation of restrictions on movement of capital. The Bank offered to purchase 15 b.kr. in return for payment in euros.

On 12 July, the Central Bank announced the results of the auction of foreign currency against payment in Icelandic krónur, which was announced on 6 July. Bids were submitted for 52.2 b.kr., and bids amounting to 14.9 b.kr. were accepted. The average accepted price was 216.33 kr. per euro, and the minimum price of accepted offers was 215.00 kr. per euro. Offers above the minimum price were accepted in full, and those equal to the auction price were accepted pro rata, at a percentage of 44.0%.

On 13 July, an agreement between Byr and Íslandsbanki was announced, according to which Íslandsbanki would contribute new share capital to Byr and purchase the Byr shares held by the Byr winding-up committee and the Ministry of Finance. The two firms would then merge under the name of Íslandsbanki, subject to the approval of the Competition Authority and the FME.

On 14 July, the Parliamentary Ombudsman notified the Central Bank of Iceland that the Icelandic Homes' Coalition (HH) considered the Bank's Rules on Indexation of Savings and Loans, no. 492/2001, to lack statutory authority. According to Article 13 of the Act on Interest and Price Indexation, no. 38/2001, indexation should be applied to loan payments, not to principal, as the Rules stipulated. Consequently, HH considered the financial institutions' collection of indexed claims unauthorised. In its response of 30 August, the Central Bank pointed out that the Rules were set on the basis of instructions in the Act and that, in practise, payments were always the same, irrespective of whether the wording of the Act or the Rules was followed. Therefore, there could be no violation of the rule of legality.

On 15 July, the Minister of Fisheries issued a regulation based on the newly passed legislation and raised the fishing fee for cod equivalents by 6.44 kr., to 9.46 kr. The Treasury's estimated revenues from the fee rise from 2.7 b.kr. to 4.5 b.kr. per year. The increase is due both to increased fishing quotas and an increase in the fishing fee.

On 21 July, the Financial Supervisory Authority announced that it had revoked the operating licences of Glitnir Bank hf. and Kaupthing Bank hf.

On 26 July, the national accounts for 2010 were published. Treasury expenditures in excess of revenues totalled 123 b.kr., as opposed to 139 b.kr. in 2009. Revenues net of interest rose by 13½% due to an increase in tax revenues. Expenditures rose by 4% year-on-year and were 7½% over budget. Excluding interest, pension obligations, lost claims, and other expenditures related to the economic crisis of 2008, expenditures declined by 3% in nominal terms and almost 8% in real terms; therefore, the budget held by that measure.

On 28 July, it was announced that the Central Bank of Iceland Holding Company ehf. had finalised the sale of a 52.4% share in the insurance firm Sjóvá-Almennar hf., in accordance with a purchase agreement dated 18 January 2011. The purchaser is SF1 slhf., a firm operating under the oversight of Stefmir hf. The transaction has been approved by the Competition Authority and the Financial Supervisory Authority.

### **August 2011**

On 2 August, the Central Bank of Iceland offered to purchase up to 72 million euros against payment in Treasury bonds. The auction was an element in the removal of restrictions on movement of capital as set forth in the Central Bank's capital account liberalisation strategy, published on 25 March 2011. The aim was to recoup the foreign currency that the Central Bank of Iceland used to purchase krónur in the previous auction and sell krónur to buyers prepared to hold them for at least five years.

On 4 August, it was announced that the EFTA Court had ruled that the Icelandic authorities were prohibited from requiring that employees sent temporarily to Iceland should enjoy the rights enjoyed by Icelanders in the Icelandic labour market if they exceed the rights set forth in the EU directive on minimum protection for such employees.

On 16 August, the Central Bank of Iceland publicised the results of the foreign currency auction of 72 million euros, announced on 2 August. Bids were submitted for a total of 3.4 million euros, and all offers were accepted in full. The auction was structured with a single-price format, so that all accepted offers were made available to primary dealers at the same price, which was set at 210.00 kr. per euro. Purchasers received indexed Treasury bonds as payment for the foreign currency.

On 17 August, the Monetary Policy Committee of the Central Bank of Iceland decided to raise the Bank's interest rates by 0.25 percentage points. Interest rates were raised to the following amounts: interest on deposit institutions' current accounts, to 3.5%; the maximum rate on 28-day certificates of deposit (CDs), to 4.25%; seven-day collateralised loans, to 4.5%; and overnight loans, to 5.5%.

On 26 August, the Executive Board of the International Monetary Fund (IMF) approved the sixth and last review of Iceland's economic programme. The approval by the Executive Board released the last tranche of the IMF loan facility, in the amount of SDR 280 million (51 b.kr.). The total loan facility from the Fund amounts to SDR 1.4 billion, or 257 b.kr. In addition, the Nordic countries and Poland loaned Iceland about 150 b.kr. in connection with the IMF programme and authorised borrowings in the amount of 160 b.kr.

On 31 August, it was announced that MP Bank had negotiated the purchase of Saga Investment Bank's corporate finance department.

On 31 August, the Financial Supervisory Authority granted Straumur IB hf. a licence to operate as a credit institution according to the Act on Financial Undertakings.

### **September 2011**

On 1 September, Arion Bank introduced non-indexed 25- or 40-year mortgage loans. The loans bear 6.45% interest up to a loan-to-value ratio of 60%, with fixed interest for the first five years. Supplemental loans up to an LTV of 80% bear 7.55% interest. Interest will be reviewed after five years in line with market interest rates. Customers can then continue, change the form of their loan, or retire the debt without a prepayment penalty. Other banking institutions followed soon thereafter, offering similar non-indexed loans.

On 2 September, Parliament passed Act no. 103/2011, amending the Unemployment Insurance Act and the Act on the Legal Status of Employees upon Transfer of Ownership of an Undertaking. The act extends until year-end 2011 a temporary provision which lengthens the payment period for income-linked benefits in proportion to the entitlement for 100% job loss against utilised benefits. In addition, parties that assume control of an undertaking are

required to take on obligations vis-à-vis employees according to existing contracts. The changes were related to the Government's involvement in the wage settlements in May.

On 8 September, the Minister of Fisheries announced an initial capelin quota of 181,000 tonnes for the coming fishing season.

On 16 September, Parliament passed Act no. 119/2011, amending the Act on Financial Undertakings, no. 161/2002, with subsequent amendments (equity, large exposures, securitisation, etc.). The primary purposes of the Act were to incorporate into Icelandic law the provisions of Directive no. 2009/111/EC and to make minor amendments to other provisions of the Act, such as Article 52, Paragraph 4, concerning eligibility for participation in the board of directors of a financial undertaking.

On 17 September, Parliament passed the Payment Services Act, no. 120/2011, which incorporates into Icelandic law the European Payment Services Directive, no. 2007/64/EC and sets comprehensive legislation on payment services. The aim of the Directive is to create a comprehensive, harmonised, modern regulatory framework for payment services within the European Economic Area. The Act contains, among other things, detailed provisions on the rights and responsibilities of users and providers of payment services.

On 17 September, Parliament passed Act no. 122/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. The amendment tightened the eligibility requirements for managing directors and board members and expanded the authorisation for third-pillar pension savings withdrawals.

On 17 September, Parliament passed Act no. 123/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. The pension funds are authorised to own and operate residential housing, establish companies for the operation of residential housing, or negotiate with private entities for the provision of such services.

On 17 September, Parliament passed Act no. 127/2011 Amending the Foreign Exchange Act, the Customs Act, and the Central Bank Act, and enshrined in law the Rules on Foreign Exchange set by the Central Bank. It is assumed that the capital controls will remain in effect until year-end 2013. The validity period of related provisions in the Customs Act and the Central Bank Act was extended for the same period.

On 17 September, Parliament passed the Act on Mutual Funds, Investment Funds, and Institutional Investment Funds, no. 128/2011. Investment funds are thereby included in older legislation that now covers all funds for collective investment. In addition, the Act implements the provisions of Directive 2007/16/EC, amending the Directive on undertakings for collective investment in transferable securities (UCITS). Other principal amendments include narrowing the authorisations for investment, tightening the requirements for operation of funds, and expanding the requirements for disclosure of information to customers.

On 17 September, Parliament passed Act no. 134/2011, amending the Housing Act, no. 44/1998, with subsequent amendments. The Act authorises the Housing Financing Fund to offer nominal mortgage loans, whereas previous provisions stipulated that HFF bonds should be indexed to the consumer price index. The amendment also stipulates that interest on indexed HFF bonds shall be fixed for the entire duration of the loan, while interest on nominal HFF bonds may be variable.

On 17 September, Parliament passed the Local Government Act, no. 138/2011. The main new provisions concerning municipal finances are that budgets and annual financial statements must be submitted earlier and that deviations from budgets require an annex to the budget. The combined expenditures of municipalities and their institutions may not exceed regular revenues for each three years, and combined debt and obligations may not exceed 150% of regular revenues. Municipalities are given a 10-year grace period to adapt to the provisions of the Act.

On 21 September, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.5%, the maximum rate on 28-day certificates of deposit (CDs) was 4.25%, the seven-day collateralised lending rate was 4.5%, and the overnight lending rate was 5.5%.

On 26 September, the Financial Supervisory Authority ruled that Íslandsbanki hf. was eligible to own a large enough qualifying holding in Byr hf. for Byr to be considered its subsidiary.

On 28 September, the Financial Supervisory Authority announced that it had revoked the collections permit held by SPRON Factoring hf. and the operating licence of Vextir hf. – verðbréfamiðlun, as well as a portion of the operating licence of old Landsbanki, as a ruling had been handed down on the winding-up of the bank.

### **October 2011**

On 4 October, the Financial Supervisory Authority announced that it had granted Íslandsbanki hf. a licence to issue covered bonds. On 5 December, Arion Bank hf. received the same type of licence.

On 11 October, an agreement was reached at a meeting of coastal nations concerning blue whiting fishing in 2012. The total allowable catch will be 391,000 tonnes, a considerable increase year-on-year, and the Icelandic quota will be 63,477 tonnes.

On 14 October, the relevant coastal nations concluded an agreement on fishing from the Norwegian summer-spawning herring stock in 2012. The total allowable catch will be 833,000 tonnes, and the Icelandic quota will be 123,000 tonnes.

On 20 October, Parliament passed Act no. 146/2011. This Act amends Chapter XII of the Act on Financial Undertakings, no. 161/2002, so as to legalise a special venue provision concerning rescission cases involving Icelandic financial institutions undergoing winding-up proceedings, and to extend the deadline for initiation of rescission cases involving financial institutions.

On 20 October, the Financial Supervisory Authority announced that it had revoked Saga Investment Bank hf.'s licence to operate as a credit institution effective 3 October, as the company did not meet the statutory capital requirements.

On 28 October, the Supreme Court handed down judgments in 11 cases that had been appealed at the district court level. The cases centred on whether specified claims against the old banks should be considered deposits and whether they should be considered priority claims with reference to the Emergency Act, no. 125/2008. The priority of deposit claims was deemed to stand. On that occasion, the Prime Minister's Office published a statement to the effect that the provisions of the Emergency Act giving priority to deposit claims against the old banks were deemed valid by the Court.

### **November 2011**

On 1 November, it was announced that MP Bank had purchased Júpiter rekstrarfélag hf. Júpiter specialises in asset management. It operates four mutual funds and one institutional investment fund.

On 2 November, the Monetary Policy Committee of the Central Bank of Iceland decided to raise the Bank's interest rates by 0.25 percentage points. Interest rates were raised to the following amounts: interest on deposit institutions' current accounts, to 3.75%; the maximum rate on 28-day certificates of deposit (CDs), to 4.5%; seven-day collateralised loans, to 4.75%; and overnight loans, to 5.75%.

On 7 November, the Ministry of Fisheries announced the Minister's decision to raise the total allowable catch of Icelandic summer-spawning herring by 40,000 tonnes for the 2011/2012 fishing year.

On 10 November, the boards of Auður Capital hf. and Tindar verðbréf hf. agreed to merge the two firms' operations under the name Auður Capital. Tindar verðbréf had been licensed by the Financial Supervisory Authority to operate as a securities undertaking and to offer its customers securities brokerage and corporate finance services, whereas Auður Capital had not offered securities brokerage services prior to the merge.

On 11 November, the Minister of Finance signed an agreement with the municipality of Reykjanesbaer concerning the State's purchase of land and energy resources owned by Reykjanesbaer, subject to Parliamentary approval. The acquisition was authorised in the budgetary supplement on 17 November.

On 15 and 16 November, rating agency Moody's Investors Service published a statement on Iceland's sovereign credit rating. The ratings were kept unchanged at Baa3 for long-term obligations and P-3 for short-term obligations.

On 17 November, the supplementary budget for 2011 was approved by Parliament. Estimated revenues rose by 8 b.kr. and expenditure authorisations by 17.4 b.kr., due primarily to transfers and increased expenses for Government operations, whereas interest expense declined due to falling interest rates. The budget supplement also authorised the sale of the Government's holding in Byr hf.

On 18 November, the Central Bank of Iceland announced a new step in capital account liberalisation under the title "Investment Programme." The Investment Programme is an element in the Bank's capital account liberalisation strategy of 25 March 2011. It authorises investors interested in investing in Iceland with foreign currency to purchase Icelandic krónur for a portion of their foreign currency via Central Bank auctions. The investor concerned must purchase at least the same amount of krónur through a conventional transaction with a financial institution, and the investment is subject to a long-term commitment period.

On 23 November, rating agency Standard & Poor's affirmed Iceland's sovereign credit rating of BBB-/A-3 for long- and short-term obligations in foreign and local currency. The outlook on the rating was changed from negative to stable.

On 25 November, it was announced that the Government had sold its holding in Byr hf. to Íslandsbanki with the consent of the Financial Supervisory Authority, the Competition Authority, and the EFTA Surveillance Authority. The purchase price was 740 m.kr. for an 11.8% stake.

## **December 2011**

On 7 December, the National Budget for 2012 was approved by Parliament. Total revenues according to the 2012 budget are estimated at 523 b.kr., an increase of 9% over the 2011 budget supplement; total expenditures are estimated at 544 b.kr., an increase of 3%; and the deficit is estimated at 35 b.kr., as opposed to 57 b.kr. according to the 2011 budget supplement.

On 7 December, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.75%, the maximum rate on 28-day certificates of deposit (CDs) was 4.5%, the seven-day collateralised lending rate was 4.75%, and the overnight lending rate was 5.75%.

On 14 December, the EFTA Court confirmed that capital controls like those in effect in Iceland are in compliance with the EEA Agreement. The ruling was a guideline opinion requested by the District Court of Reykjavík in connection with a case then under consideration by the Court.

On 14 December, the EFTA Surveillance Authority announced that it had been decided to refer the so-called Icesave case concerning Iceland's alleged violation of the EU Deposit Insurance Directive to the EFTA Court.

On 17 December, Parliament passed Act no. 156/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. New provisions include these: a) extending by one year the pension funds' authorisa-



tion to maintain a difference of up to 15% between asset items and future pension obligations without amendment to the Articles of Association; b) requiring pension funds to pay into a vocational re-education fund; c) imposing a tax of 0.0814% on pension fund assets for supplemental housing benefits in 2011-2012; and d) postponing the implementation of a prohibition on simultaneous participation in numerous pension fund boards.

On 17 December, Parliament passed Act no. 164/2011, which sets forth various fiscal measures. It was decided, among other things, to reduce the payroll tax by 0.91% of the tax base beginning in 2012, to raise the share of the childbirth benefits fund from 1.08% to 1.28% of the base payroll tax, and raise payments to the guarantee fund by 0.05% of the same base. The personal income tax deduction was increased by 5.2%, the threshold between tax brackets #1 and #2 was increased by 15%, and the threshold between tax brackets #2 and #3 was increased by 8.4%. The national tax percentage did not change, but the average local tax rate and the tax withholding percentage rose by 0.03% of the tax base. Parish fees rose by 0.5%, the wealth tax levy was extended by two years, and the deduction from the tax base for premiums to acquire supplemental pension rights was reduced from 4% to 2% of income for the period 2012-2014. In addition, the fuel tax, the alcoholic beverage tax, and the carbon tax were increased. The imposition of a special tax on financial institutions was extended through 2013, as were various other tax provisions related to financial shocks.

On 17 December, Parliament passed the Financial Administration Tax Act, no. 165/2011. The Act provides for a tax on financial institutions and entities engaged in insurance operations. The tax base for the tax will be these entities' total wage and salary payments, and the tax rate was set at 5.45%. The Act is an element in special revenue generation measures in the 2012 National Budget, and revenues deriving from the new tax are estimated at 2.25 b.kr. in 2012. Concurrent with this, a special 6% income tax was levied on these companies' profits in excess of 1 b.kr.

On 17 December, Parliament passed Act no. 175/2011, amending the Act on Landsvirkjun, no. 42/1983, the Act on the Establishment of the Partnership Orkuveita Reykjavíkur, no. 139/2001, the Electricity Act, no. 65/2003, and Act no. 19/2011, amending the Electricity Act, no. 65/2003, with subsequent amendments. The amendment to the Act on Landsvirkjun is intended to eliminate all uncertainty about which financial obligations shall enjoy owner guarantees. A comparable amendment was made to the Act on the Establishment of the Partnership Orkuveita Reykjavíkur. In addition, Article 8 of the Electricity Act was amended so that, instead of stipulating that firms engaged in electricity transmission shall be directly owned by the Icelandic Government and/or Icelandic municipalities, they shall be majority-owned by them and/or firms owned by them.

On 17 December, Parliament passed Act no. 178/2011, amending various laws concerning social security. Among other provisions, social security benefits were increased by 3.5% starting in 2012, and the benefit period for those becoming unemployed after the end of February 2008 was extended by one year, until end-2012.

On 17 December, Parliament extended by one year the main provisions of Act no. 107/2009 on measures to assist individuals, households, and businesses due to extraordinary circumstances in the financial market. These provisions are now valid until year-end 2012.

On 21 December, the Ministry of Finance announced the key figures for tax withholding in 2012. The average local tax rate will be 14.44%, an increase of 0.03% year-on-year. Tax withholding percentages increase by this amount (0.03%), to 37.34% for income up to 230,000 kr. per month; 40.24% for income between 230,000 and 704,000 kr. per month; and 46.24% on income above 704,000 kr. per month. The tax-free threshold will be 130,000 kr. per month, an increase of 5.2%; the lower threshold for tax bracket #2 rises by 9.8% to 230,000 kr.; and the lower threshold for tax bracket #3 rises by 3.5% to 704,000 kr.

On 31 December, the temporary provision in the Act on Unemployment Insurance authorising payment of partial benefits against reduced employment expired. A corresponding provision for self-employed individuals expired at the same time.



# Economic and monetary chronicle 2012

## January 2012

On 3 January, it was announced that the Republic of Iceland and the Central Bank of Iceland had decided to draw the full amount of the Nordic loan facilities. The loans concerned were negotiated in connection with the Government-IMF Stand-By Arrangement programme that concluded in 2011. The decision to draw on the loans was made in view of the situation in the global credit markets. In all, the Nordic loan facilities totalled 1,775 million euros (just under 300 b.kr. at the current exchange rate) and were to expire at the end of the year. The amount of the loan was 140 b.kr.

On 9 January, the Financial Supervisory Authority announced that it had imposed per diem fines on Stapi Pension Fund in the amount of 200,000 kr. per day due to shortcomings in the Authority's access to the fund's financial information.

On 10 January, the Financial Supervisory Authority approved the merger of Tindar verðbréf hf. and Auður Capital hf. under the name of the latter, on the basis of the Act on Financial Undertakings.

On 12 January, the Central Bank of Iceland offered to purchase euros in exchange for Icelandic krónur for long-term investment in the Icelandic economy, or in exchange for payment in Treasury bond series RIKS 30 0701. The Central Bank offered to purchase up to a maximum of 100 million euros in the two auctions combined. The objective of the measures was to sell Icelandic krónur for foreign currency to parties that have decided to invest in the Icelandic economy or in Icelandic Treasury bonds for at least five years. The deadline for submittal of bids was 15 February 2012.

On 20 January, the negotiating committees of the member organisations of the Icelandic Federation of Labour (ASÍ) and the Confederation of Icelandic Employers (SA) announced that the review committee had decided not to terminate the wage agreement signed on 5 May 2011, even though the commitment given by the Government in its statement at the time of the settlement had not been fulfilled. In the parties' opinion, other conditions considered during the review of the wage settlement had been met: that purchasing power must have grown in 2011, that prices must have been stable, and that the króna must have appreciated markedly.

On 23 January, it was announced that the board of directors of the Central Bank of Iceland Holding Company ehf. (ESI) had decided to drop claims against holders of guarantee capital in Sparisjóður Svarfdæla. The claims in question were loans granted by Saga Investment Bank to over 100 parties at the end of 2007 in connection with an increase in Sparisjóður Svarfdæla guarantee capital.

On 25 January, the Financial Supervisory Authority ruled that Íslensk verðbréf hf. was eligible to own a qualifying holding of up to 50% in T Plús hf., in accordance with the Act on Financial Undertakings.

On 26 January, Parliament passed Act no. 5/2012, authorising the Government to approve an increase in Iceland's International Monetary Fund (IMF) quota and confirm amendments to the IMF Articles of Agreement on Iceland's behalf. The Act authorises the Government to negotiate an increase in Iceland's IMF quota from SDR 117.6 million to SDR 321.8 million. The Central Bank of Iceland is to contribute the funds needed for the quota increase. The Government is also authorised, on behalf of Iceland, to approve the amendments to the IMF Articles of Agreement that concern the arrangements for the Executive Board and were approved by the Board of Governors of the Fund on 15 December 2010.

On 26 January, the Supreme Court ruled that the Icelandic Government was not liable to compensate the losses of those who owned shares in Landsbanki money market funds at the time the banks collapsed in 2008.

## February 2012

On 1 February, Parliament passed Act no. 8/2012 Amending the Act on Public Limited Companies and the Act on Private Limited Companies (simplification of merger and division rules, etc.). The Act primarily incorporates into Icelandic law EU Directive 2009/109/EC, which amends four directives in the field of company law. The main purpose

of the Directive is to reduce the administrative burden in limited liability companies, which are subject to a variety of information requirements. Those obligations are reduced under certain conditions as regards preparation and publication of documents and reports. The authorisation to utilise companies' websites, among other things, is expanded.

On 8 February, the Central Bank of Iceland Monetary Policy Committee decided to keep the Bank's interest rates unchanged. The overnight lending rate therefore remained 5.75%, the seven-day collateralised lending rate was 4.75%, the maximum rate on 28-day certificates of deposit (CDs) was 4.5%, and the current account rate was 3.75%.

On 9 February, the Central Bank announced that the swap rate for the Bank's foreign currency purchases in connection with the sale of RIKS 30 0701 Treasury bonds would be based on the auction price and the fixed price of the Treasury bond, which was 115.675833 kr. per bond unit including accrued interest and indexation (dirty price), assuming settlement on 17 February 2012 (yield 2.50%). The formula is as follows: Swap rate = auction price/(bond price/100).

On 9 February, the Financial Supervisory Authority approved the transfer of Saga Capital hf. Corporate Finance to MP Bank hf.

On 10 February, the Ministry of Finance announced that it had finalised an agreement with the Icelandic Pension Funds Association concerning the pension funds' share in the financing of special interest rebates as stipulated in the 3 December 2010 memorandum of understanding concluded by the Government, the financial institutions, and the pension funds.

On 15 February, an auction took place in connection with the removal of restrictions on movement of capital as set forth in the Central Bank's capital account liberalisation strategy, published on 25 March 2011. In all, 77 bids totalling 173.6 million euros were submitted, and bids in the amount of 141.3 million euros were accepted. All approved bids were accepted at the same price, which was set at 240 kr. per euro. Investors selling foreign currency according to the Treasury bond option received indexed RIKS 30 0701 bonds as payment. Bonds sold in the series had a total nominal value of 17.1 b.kr. As payment for foreign currency sold, investors participating in the Investment Programme received Icelandic krónur for long-term investment in the Icelandic economy. Euros purchased in the auction totalled the equivalent of 14.2 b.kr.

On 15 February, the Supreme Court ruled that Frjálsi Investment Bank was prohibited from demanding increased interest, pursuant to Article 4 of the Act on Interest and Price Indexation, for interest periods that concluded prior to the date of the judgment in the same parties' case concerning the illegality of exchange rate-linked loans in Icelandic krónur (14 February 2011), subject to the existence of a receipt for full payment according to the loan agreement. Following the Court decision, the Competition Authority authorised financial institutions to work together to resolve the matter and recalculate comparable loans.

On 16 February, the Financial Supervisory Authority published a statement to the effect that the Supreme Court judgment of 15 February 2012 on recalculation of exchange rate-linked loans did not jeopardise financial stability.

On 17 February, international credit rating agency Fitch Ratings upgraded the Republic of Iceland's credit rating for long-term obligations in foreign currency from BB+ to BBB-. The rating for short-term obligations in foreign currency was also raised, from B to F3. The outlook remained stable.

### **March 2012**

On 2 March, a mission from the International Monetary Fund (IMF) concluded its visit to Iceland. The mission's assessment was that the outlook was for a good economic recovery. For the medium term, the source of output growth would shift from domestic demand (investment in particular) to foreign demand (with increased exports). In spite of this, however, the mission was of the opinion that a number of hurdles of domestic and foreign origin remain.

On 5 March, the Minister of Economic Affairs appointed Dr. Katrín Ólafsdóttir to a position on the Central Bank of Iceland Monetary Policy Committee. Katrín replaced Anne Sibert on the Committee.

On 5 March, the District Court of Reykjavík handed down a decision in the case Saga Capital hf. vs. Financial Supervisory Authority. Saga Capital filed suit in an attempt to have the Court nullify the Financial Supervisory Authority's decision to revoke the company's licence to operate as a credit undertaking. The Court ruled in favour of the Financial Supervisory Authority; therefore, the Authority's decision stands unchanged.

On 6 March, the Central Bank of Iceland sold 12 million euros in the interbank foreign exchange market. There had been unusually large foreign exchange outflows in previous weeks, a situation that the Bank considered temporary. Exemptions from the Foreign Exchange Act granted by the Bank had entailed substantial purchases of foreign currency in the market. The sale was carried out in accordance with the Central Bank's policy of intervening in the foreign exchange market when necessary in order to mitigate exchange rate volatility.

On 7 March, the Ministry of Finance published preliminary figures on Treasury finances for 2011. According to these figures, collected revenues totalled 468 b.kr., an increase of 1½% year-on-year in nominal terms. Expenditures excluding final accounting items totalled 526 b.kr., a decrease of 1%. Expenditures net of revenues totalled 57 b.kr. by that measure, as opposed to 69 b.kr. in 2010.

On 13 March, Parliament passed Act no. 17/2012 amending the Foreign Exchange Act, no. 87/1992, with subsequent amendments. The Act entered into force the same day, implementing the following amendments: First, it rescinded the exemption for payments from a bankruptcy estate and payments of contractual claims in accordance with composition of creditors agreements (cf. Act no. 21/1991) in domestic currency when payment is disbursed from the payer's account with a financial institution in Iceland. The purpose of the amendments was to provide the Central Bank of Iceland with a prudential tool to prevent disbursements from domestic bankruptcy estates from disrupting the balance of payments or undermining the capital account liberalisation strategy. Second, the Act amended Article 13(j) of the Foreign Exchange Act. According to the amendment, it is no longer permissible to purchase foreign currency for the value of indexation on bond principal; furthermore, it is prohibited to purchase foreign currency for instalments of bond principal. Third, the amendment rescinded the exemption from the statutory prohibition against cross-border movement of foreign currency, which was previously enjoyed by the resolution committees and winding-up committees of the old banks.

On 13 March, the Competition Appeals Committee confirmed the Competition Authority's decision to authorise the merger of Íslandsbanki and Byr Savings Bank, with respect to the provisions of the Competition Act pertaining to firms in distress.

On 14 March, the Central Bank offered to purchase euros in exchange for Icelandic krónur for long-term investment in the Icelandic economy, or in exchange for payment in Treasury bond series RIKS 33 0321. The Bank also advertised for bids on the sale of Icelandic krónur for cash payment in foreign currency. The three auctions were an element in the removal of restrictions on movement of capital as set forth in the Bank's capital account liberalisation strategy of 25 March 2011, and in the Bank's Terms of foreign exchange transactions according to the Investment Programme for capital account liberalisation, dated 18 November 2011, with subsequent amendments. The deadline for submittal of bids was 28 March 2012.

On 15 March, it was announced that the Treasury of Iceland and the Central Bank of Iceland had partially prepaid loans from the International Monetary Fund (IMF) and the Nordic countries. The prepayments totalled SDR 289 million (55.6 b.kr.) to the IMF and 366 million euros (60.5 b.kr.) to the Nordic countries, and are about 20% of the loans taken from these parties. The transaction was an element in paying down short-term debt and reducing the expense associated with maintenance of the Central Bank's foreign exchange reserves.

On 19 March, the Financial Supervisory Authority approved the merger of Alfa verðbréf hf. and MP Bank hf. under the name of the latter, on the basis of the Act on Financial Undertakings.

On 21 March, the Monetary Policy Committee of the Central Bank of Iceland decided to raise the Bank's interest rates by 0.25 percentage points. The overnight lending rate was raised to 6.0%, the seven-day collateralised lending rate to 5.0%, the maximum rate on 28-day certificates of deposit (CDs) to 4.75%, and the current account rate to 4.0%.

On 22 March, the Financial Supervisory Authority approved the transfer of the operation of 10 mutual funds, three investment funds, and eight institutional investment funds from Landsvaki hf. to Landsbréf hf., effective 31 March.

On 28 March, the Central Bank of Iceland held auctions for the purchase of euros against payment in Icelandic krónur and for the purchase of Icelandic krónur against payment in foreign currency. In the euro purchase auction, 79 bids totalling 92.9 million euros were submitted, and bids in the amount of 22.5 million euros were accepted. All approved bids were accepted at the same price, which was set at 239 kr. per euro. Investors selling foreign currency according to the Treasury bond option received indexed RIKS 33 0321 bonds as payment. Bonds sold in the series had a total nominal value of 416.7 m.kr. As payment for foreign currency sold, investors participating in the Investment Programme received Icelandic krónur for long-term investment in the Icelandic economy. In the króna purchase auction, the Bank purchased euros for a total of 4.9 b.kr., with the minimum price set at 235 kr. per euro.

On 30 March, the Financial Supervisory Authority approved the merger of Íslandsbanki hf. and Kreditkort hf. Íslandsbanki hf. will take over all rights and responsibilities of Kreditkort hf., and the two companies will be merged under the name Íslandsbanki hf.