



Speech

by Gylfi Magnússon, Chair of the Central Bank of Iceland Supervisory Board, at the 58th Annual Meeting of the Central Bank, 28 March 2019.

Speaker of Parliament; Prime Minister; other ministers, bank directors; foreign ambassadors; and other honoured guests! I welcome you to the 58th Annual Meeting of the Central Bank of Iceland and hereby call the meeting to order.

As has been stated at previous Central Bank annual meetings, the Supervisory Board monitors the Bank's compliance with the statutory provisions applying to its activities. In addition, the Board confirms various decisions and rules set by the Governor.

At the beginning of 2018, Thórunn Guðmundsdóttir was Chairman of the Board. Other members were Sveinn Agnarsson, Björn Valur Gíslason, Sigurdur Kári Kristjánsson,

Thór Saari, Frosti Sigurjónsson, and Audur Hermannsdóttir. A new Supervisory Board was elected on 18 April 2018. Those elected to serve on the Board were Gylfi Magnússon (elected chair at the first meeting of the new Board), Thórunn Guðmundsdóttir, Bolli Héðinsson, Una María Óskarsdóttir, Sigurdur Kári Kristjánsson, Jacqueline Clare Mallett, and Frosti Sigurjónsson. The Supervisory Board held 15 meetings during the year.

As is described in the *Annual Report*, which is available here today, the Central Bank is responsible for a number of regular projects, in connection with its objectives, and various special projects.

As before, the main focus of the Central Bank's activities was on monetary policy and financial stability. The shift towards unrestricted movement of capital was a major endeavour requiring increased oversight and preparation of contingency policy under new conditions. Other major projects include the review of the monetary policy framework and instruments; administration of large international reserves and related work on securing the Bank's operating performance; work on maintaining secure, effective, and efficient payment intermediation; and renewal of financial market infrastructure. Furthermore, projects relating to the expected merger of the Central Bank and the Financial Supervisory Authority required some work, a part of which was the reorganisation of the Bank's information technology services. Additional projects include work on the Bank's equal pay policy and equal pay certification, achieved at the year-end, and a special project involving the preparation and

publication on the Bank's website of an economic chronicle and historical time series from the time Iceland achieved sovereignty.

Work continued during the year on a massive project involving the renewal of the Bank's interbank netting and real-time gross settlement systems. Moreover, an analysis of domestic retail payment intermediation from the standpoint of preparedness and financial stability was underway, with reference to the forthcoming changes in arrangements for and settlement of payment card transactions.

By law, the principal objective of the Central Bank of Iceland is to promote price stability. The Central Bank of Iceland shall also promote financial stability. Inflation was close to the Bank's 2.5% inflation target at the beginning of the year but then began to increase. It averaged 2.7% in 2018 and, by the end of the year, had risen to 3.7%, which is still below the 4% threshold requiring the submittal of an explanatory report to the Government.

The Monetary Policy Committee (MPC) held the Bank's key interest rate unchanged for most of the year and then raised it by 0.25 percentage points in November. The MPC also decided to change the arrangements for credit institutions' minimum reserve requirements so as to reduce the cost to the Bank, although without intending to affect the monetary stance. This is discussed further in Chapter II of the Bank's *Annual Report*, which is available here today.

Uncertainty about the economy began to mount in 2018 in spite of robust GDP growth, and risk in the financial system increased, although it was still considered moderate. The increase in risk was deemed to stem mainly from tourism and the real estate market. The banks' profitability declined, credit growth was considerable, and even though customers' debt increased, credit risk subsided as their equity position improved. The stress test carried out on the large commercial banks during the year indicated that the banks would be able to withstand a significant shock that could stem from a sharp contraction in exports and tourism-generated revenues, plus higher cost of capital for the banks. The position of the large commercial banks was sound at the year-end: their capital ratios were high and their liquidity position well above the regulatory minimum. This is explored more fully in Chapter III of the *Annual Report*.

One of the Central Bank's main tasks is to maintain Iceland's international reserves, which have been quite large in recent years. In 2018 the reserves grew by nearly 50 billion krónur, to 736 billion krónur

at the end of the year. The increase in the reserves in krónur terms was due mostly to exchange rate movements.

The Central Bank communicates and conducts transactions with international institutions in its field, including the International Monetary Fund, the Bank for International Settlements, and the Organisation for Economic Co-operation and Development, as well as foreign central banks and financial supervisory bodies.

In accordance with an agreement made with the Ministry of Finance and Economic Affairs, the Central Bank of Iceland oversees Treasury foreign borrowing and conducts domestic auctions, buybacks, and Treasury bond redemptions. It also executes primary dealer agreements and oversees securities lending to primary dealers. The Bank handles risk management and debt management for the Government's debt portfolio, as well as undertaking tasks involving Government guarantees and other related work. Furthermore, the Bank has carried out tasks relating to communications with international credit rating agencies on behalf of the Government, but this function has now been transferred to the Ministry of Finance and Economic Affairs.

As has been mentioned, the Central Bank carries out capital controls surveillance; i.e., the implementation of the Foreign Exchange Act, no. 87/1992 and the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions, also called the Offshore Króna Act. The work required in this area has contracted sharply, as the capital controls have been all but fully lifted, although work on guidelines, supervision, and investigations must still be undertaken. Last year and in early 2019, the Supervisory Board prepared a report on the activities of the Capital Controls Surveillance Unit, which was submitted to the Prime Minister and has been made public.

The Central Bank of Iceland Holding Company ehf., which was established to administer the Central Bank's claims against the estates of domestic financial institutions, shrank substantially last year. Its balance sheet amounted to 4.4 b.kr. at year-end 2018, and its activities were wound up just a few weeks ago.

According to the Central Bank's profit and loss account, the Bank recorded a profit of just over 35 b.kr. in 2018, as opposed to a loss of nearly 23 b.kr. in 2017. This improvement in operating performance is due in particular to large international reserves and a positive exchange rate differential, as can be seen in the Annual Accounts, available here today. Net interest expense was just over 13 b.kr.

Wages and related expenses increased by 2.8% between years, after having contracted by 3% in the previous year. The Bank's total operating expense increased by 2.2% in 2018. The Bank's assets totalled 754 b.kr. at the end of the year, some 98% of them foreign. Equity increased from 22 b.kr. to 58 b.kr., and the year-end capital ratio was 7.7%, as opposed to 2.9% at year-end 2017. There is no profit available for disposition, as transfers to the value adjustment reserve exceed unrealised gains.

At the end of 2018, the Bank employed 181 members of staff, four fewer than in 2017. The gender ratio remained relatively even, with 92 men and 89 women employed by the Bank at the year-end. Among departmental directors there were six men and six women just before the end of the year, but that ratio changed to seven women and five men in early 2019.

Although the Central Bank of Iceland's basic functions have not changed radically since its establishment in 1961 — i.e., to promote price stability and secure the foundations and efficacy of the financial system — the execution of tasks and the organisation of the Bank have changed at somewhat regular intervals, such as with statutory amendments in 1986, 2001, 2009, and 2013 in connection with interest rate liberalisation, inflation targeting, establishment of the Monetary Policy Committee, and increased emphasis on financial stability.

And now, a major change in the tasks and organisation of the Central Bank lies ahead, with the Government's plan to merge the Bank and the Financial Supervisory Authority. As a result, the staff and management of the Bank will probably be every bit as busy in coming years as they have been in the recent past. The need for a sound framework and efficient operations will remain. In this work, it is important that the Bank have the tools and equipment it needs to carry out the transactions and communications required of central banks in modern society. If the Bank is to achieve its set objectives, the most important of these tools is a team of competent and qualified employees. The Bank must also have the financial strength to perform its legally mandated functions.

I would like to take this opportunity to thank Central Bank staff members for satisfying collaboration in 2018. I want to thank my fellow Supervisory Board members and the Governor, the two Deputy Governors who served during the year, the Supervisory Board secretary, and the Internal Auditor for fruitful cooperation. In particular, though, I would like to thank Governor Már Gudmundsson for our work together during the year. Már assumed leadership of the Bank under unprecedented conditions and has been at the helm for a decade. He will leave the Bank later this year; therefore, this is his last Annual Meeting as Governor. In a moment Már will speak, giving us a backward glance

and a glimpse of the near future, but first let us hear Prime Minister Katrín Jakobsdóttir.