

Domestic foreign exchange market and foreign exchange reserves 2014

At the beginning of each calendar year, the Central Bank publishes a foreign exchange market summary of developments in the market and changes in the foreign exchange reserves during the previous year. The foreign exchange market was more stable in 2014 than in the years preceding. The króna appreciated by just under 2% over the year, as opposed to 11% in 2013; turnover rose markedly, and substantial foreign currency inflows prompted the Central Bank to purchase more currency in the interbank market than it had previously done. Central Bank transactions accounted for about 43% of total market turnover, up from 12% in 2013, and total turnover increased by more than 60% year-on-year. The Bank's foreign exchange reserves increased by 42.5 b.kr. during the year, to an end-2014 total of 530 b.kr. At the end of 2014, the foreign exchange reserves net of the Central Bank and central government's foreign-denominated debt were positive by 53 b.kr.

The foreign exchange market in 2014

The króna held relatively stable in 2014. The exchange rate was lowest in January and highest in December. The spread between the highest and lowest exchange rates was 4.4%, as opposed to 12% in 2013. The Central Bank continued to follow the strategy of increased foreign exchange market intervention as set forth by the Monetary Policy Committee in May 2013.¹ The objective of the intervention strategy is to mitigate short-term exchange rate volatility and expand the Bank's non-borrowed reserves inasmuch as conditions allow. Exchange rate volatility diminished significantly after the strategy was announced. The volatility of the trade-weighted index (measured in terms of the standard deviation of daily changes) measured 0.21% in 2014, down from 0.39% in 2013.

The Bank's foreign exchange market transactions reduced exchange rate volatility and strengthening of the króna during the year. The Bank's net foreign exchange purchases totalled 721 euros, the equivalent of just over 111 b.kr.² Nonetheless, the exchange rate rose

¹ Monetary Policy Committee announcement of 15 May 2013.

² At the exchange rate of each transaction.

by nearly 2% in trade-weighted terms over the course of the year. The appreciation occurred entirely in the first half of the year, whereas the foreign currency purchases were concentrated in the latter half. The Bank's purchases equalled just over 5.6% of estimated year-2014 GDP, the largest amount ever purchased by the Central Bank in a single year.

Foreign exchange market turnover rose by over 60% between 2013 and 2014, from just under 166 b.kr. to 266 b.kr. The Bank's trades accounted for 43% of total turnover in 2014, as opposed to 12% in 2013.

In addition to its intervention strategy, the Bank resumed its regular programme of purchasing foreign currency from market makers³ during the year. The programme had been suspended since year-end 2012, and its reinstatement was announced on 11 June. It was decided that the Bank should purchase 3 million euros from market makers at a predetermined time each week. In response to conditions in the market during the ensuing weeks, the Bank announced on 11 July that it would double the amount of the purchases. Thereafter, it bought 3 million euros twice a week, for a weekly total of 6 million euros. The Bank's regular foreign currency purchases totalled 159 million euros, or 24.5 b.kr., during the year. These regular purchases amounted to over 20% of its total foreign currency purchases, reducing the need for the Bank to intervene in the market.

The foreign exchange reserves in 2014

The Bank's foreign exchange reserves increased by 360 million euros, or 42.5 b.kr., during the year, to an end-2014 total of 3,437 million euros, or 530 b.kr.

The main transactions increasing the foreign exchange reserves during the year were the Bank's net purchases in the domestic interbank market in the amount of 721 million euros, or 111 b.kr., and the Treasury's eurobond issue in the amount of 750 million euros, or 116 b.kr., which expanded the reserves by a total of 1,471 million euros, or 227 b.kr.

The main transactions that reduced the reserves were the accelerated repayments of loans taken in connection with the authorities' Stand-By Arrangement with the International Monetary Fund (IMF) in 2008. The acceleration of the Treasury and Central Bank's payments of the bilateral loans from the Nordic countries totalled 735 million euros, or 113 b.kr.), and the Bank's prepayment of the loans from the IMF totalled 328 million euros, or 50.5 b.kr. In all, the payments on these loans amounted to 1,063 million euros, or 164 b.kr.

At the end of 2014, the foreign exchange reserves net of the Central Bank and central government's foreign-denominated debt were positive by 344 million euros, or 53 b.kr. At the end of 2013, the reserves net of these debts were negative in the amount of 177 million

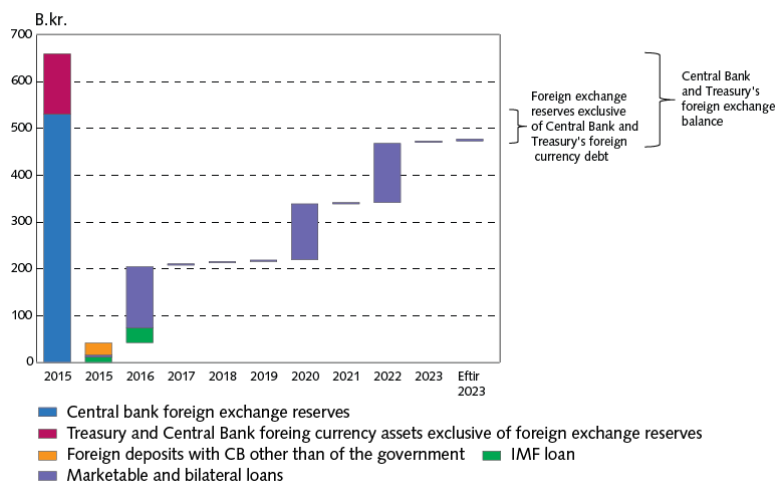
³ There are three market makers in the domestic interbank market for foreign currency: Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf.

euros, or 28 b.kr. The balance has therefore improved by 525 million euros, or 81 b.kr., during the intervening year, owing to the Bank's purchases of foreign currency in the domestic foreign exchange market. Significant progress has thus been made in building up the part of the foreign exchange reserves not financed with foreign-denominated debt; i.e., its "non-borrowed" reserves. The Bank and Treasury's end-2014 foreign exchange balance – that is, the difference between total foreign-denominated assets and total foreign-denominated liabilities – totalled 1,178 million euros, or 182 b.kr. This is approximately 551 million euros, or 85 b.kr. more than at the end of 2013.

At year-end 2014, the Central Bank's foreign exchange reserves totalled 28% of GDP and 30% of broad money holdings (M3), and they covered seven months' worth of goods and services imports.⁴

	2009	2010	2011	2012	2013	2014
<i>Domestic foreign exchange market over the year:</i>						
Exchange rate (-depreciation/+appreciation), %	-7.0	11.9	-4.3	-6.6	10.8	1.7
Exchange rate volatility, %	0.8	0.3	0.2	0.3	0.4	0.2
FX market turnover, b.kr.	62,427	45,212	89,864	167,115	165,873	266,423
- FX market turnover, Central Bank, %	23.9	66.3	14.0	13.8	11.6	42.9
FX market purchases, Central Bank b.kr.	0	29,980	12,612	20,109	10,088	112,764
FX market sales, Central Bank, b.kr.	14,937	0	0	3,012	9,068	1,396
Net purchases, Central Bank, b.kr.	-14,937	29,980	12,612	17,097	1,020	111,368
Net forward purchases, Central Bank, b.kr.	0	47,900	0	0	-6,000	0
<i>End of the year position, foreign exchanges reserves:</i>						
Foreign exchange reserves, in US dollars, m. USD	3,883	5,798	8,535	4,182	4,228	4,178
Foreign exchange reserves, in krónur, m.kr.	484,900	667,000	1,047,300	539,800	487,439	530,200
Foreign exchange reserves, as % of GDP, %	32.4	43.4	64.3	33.0	29.0	28.3
Foreign exchange reserves, equivalent months of imports	14	17	26	13	11	7

Repayment profile of Central Bank and Treasury foreign exchange debt (position 31 December 2014)



⁴ It should be noted that, from 2014 onwards, these figures include imports of both goods and services, whereas they previously included only goods imports. This explains why the 2014 figure is lower than the 2013 figure even though the reserves are larger.