

Economic and monetary chronicle

December 2004

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.

January 2005

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 2005

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 long-term 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+ long-term 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 2005

On March 7, Moody's Investors Service upgraded the long-term deposit and senior debt ratings of Landsbanki Islands 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.