

Economic and monetary chronicle

November 2008

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 billion 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 Reykjavik granted Kaupthing Bank hf. a moratorium on payment.

On November 24, the District Court of Reykjavik 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 2008

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 Reykjavik 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%.

January 2009

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 2009

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 Govern-

ment 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 2009

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.