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Address

by Lára V. Júlíusdóttir, Chairman of the Supervisory Board, at the Annual Meeting of the Central Bank of Iceland, 25 March 2010

Madame Prime Minister, honourable Ministers, honourable Governor, honourable Ambassadors, Ladies and Gentlemen:

On behalf of the Supervisory Board, I welcome you all to this 49th Annual Meeting of the Central Bank of Iceland, and I declare the meeting convened.

At a meeting of the Supervisory Board earlier today, the Minister of Economic Affairs ratified the Central Bank's annual accounts for the year 2009 with his signature. The Annual Report for 2009 was issued today and will be available at the end of the meeting.

2009, no less than 2008, was a year of dramatic change and turbulent activity for the Central Bank of Iceland.

An act of law amending the Act on the Central Bank of Iceland, no. 36/2001, was passed on 26 February 2009. The amendment replaced the three-member Board of Governors with a single Governor and a single Deputy Governor. At the beginning of 2009, the Board of Governors of the Central Bank of Iceland comprised Chairman Davíð Oddsson, Eiríkur Guðnason, and Ingimundur Friðriksson. Ingimundur resigned from the Bank on 9 February 2009, and Davíð Oddsson and Eiríkur Guðnason left the Bank's employ upon the passage of the amended Central Bank Act on 26 February. Thereafter, the Prime Minister appointed Svein Harald Øygard from Norway to act as interim Governor and Arnór Sighvatsson, the Bank's Chief Economist, to act as interim Deputy Governor until both positions had been duly advertised. Már Guðmundsson was then hired as Governor of the Central Bank for a term of five years, effective 20 August 2009; and Arnór Sighvatsson as Deputy Governor for a term of four years, effective 1 July 2009.

The amended Central Bank Act also entailed changes in procedure relating to the Bank's interest rate decisions. The Act established the Monetary Policy Committee, whose statutory role is to take decisions on the application of the Bank's monetary policy instruments. Originally appointed to the Committee were three members from within the Bank – former Governor Svein Harald Øygard, Deputy Governor Arnór Sighvatsson, and Chief Economist Þórarinn G. Pétursson – and two external members – Anne Sibert, Professor of Economics at Birkbeck College of the University of London; and Gylfi Zoëga, Professor of Economics at the University of Iceland. Már

Guðmundsson then took a seat on the Committee when he assumed the Governorship and Svein Harald left the Bank in August.

The Central Bank is responsible for a wide range of activities that have lain dormant for a long time as a direct result of the collapse of Iceland's banks in the fall of 2008. In the fall of 2009, it was decided to strengthen the activities of the Capital Controls Surveillance Unit, which is now an independent unit answering directly to the Governor. The Unit's main functions in 2009 were to conduct general monitoring of the capital controls, investigate violations of the Foreign Exchange Act and the rules set pursuant to it, and process requests for exemptions to the controls. The Capital Controls Surveillance Unit was operated within the Bank for a number of years, but its activities were discontinued when its last employee left the Bank at the end of 1999.

As a result of the banking crisis, large claims against domestic financial undertakings, which were backed by collateral of various types, reverted to the Central Bank. Some of these claims were transferred to the Treasury, and the Central Bank advised the Government on their treatment. Most of the year 2009 was spent in preparing declarations of claim against the estates of the financial institutions, but now the actual asset management phase has begun. At the end of the year, it was decided to transfer these assets to a separate subsidiary of the Central Bank, a holding company called Central Bank of Iceland Asset Management ehf. (ESÍ). At the same time, another subsidiary, Sölvhóll ehf., was established. Sölvhóll is an operating company whose sole purpose is to maximise the value of the assets in the holding company and divest them when market conditions allow, subject to the approval of the board of the holding company. At the end of 2009, the book value of ESÍ's assets was 491 b.kr.

As is well known, the reconstruction of the financial system was underway throughout 2009 and is now nearing completion. The Central Bank of Iceland has played an active role in that process. It is also worth noting that the Central Bank is still carrying out a portion of cross-border payment intermediation, but has systematic plans to discontinue those activities.

The Central Bank has worked closely with the International Monetary Fund during the year, in connection with the economic programme implemented by the Fund and the Icelandic Government. For example, a total of 12 IMF missions came to Iceland last year. The Bank's co-operation with the Fund's experts has been very successful, and it has been most beneficial for the Bank to be able to consult the IMF in various areas.

2009 was also a year of change in the Central Bank of Iceland Supervisory Board, and on two occasions a new Supervisory Board

was elected. Vice-Chairman Jón Sigurðsson resigned from the Board on 26 January, followed by Valgerður Bjarnadóttir on 19 February. The new Supervisory Board of the Central Bank of Iceland was elected by the Parliament of Iceland on 16 March. Its members were Lára V. Júlíusdóttir, August Einarsson, Friðrik Már Baldursson, Katrín Olga Jóhannesdóttir, Jónas Hallgrímsson, Ragnar Árnason, and Ragnar Arnalds.

A new election was held on 11 August, whereupon Lára V. Júlíusdóttir, August Einarsson, Hildur Traustadóttir, Katrín Olga Jóhannesdóttir, Magnús Árni Skúlason, Ragnar Árnason, and Ragnar Arnalds were elected to sit on the Board. Magnús Árni Skúlason resigned from the Supervisory Board on 12 September, and Daníel Gros was elected to replace him on 15 October. On 15 December, Björn Herbert Guðbjörnsson was elected to replace Ágúst Einarsson, who resigned from the Board.

Let us now turn to the Bank's Annual Accounts for 2009, which are consolidated accounts because of Central Bank of Iceland Asset Management and Sölvhóll, the subsidiaries established during the year.

According to the profit and loss account, the Bank's profit for the year totalled 500 m.kr. In 2008, however, the Bank recorded an operating loss of nearly 184 m.kr. before the transfer from the Treasury, which restored the Bank's equity. The transfer amounted to 175 m.kr., and after adjusting for that amount, the Bank's final operating loss was 8.6 b.kr.

Developments in the exchange rate of the króna affect the Bank's operations because of its foreign assets, which generally exceed its foreign liabilities. These effects were unusually strong in 2008, when the Bank recorded exchange rate gains of nearly 44 b.kr. due to the depreciation of the króna. In 2009, the króna weakened only slightly, or by about 7% from the beginning to the end of the year, and the exchange gain for the year was 3 b.kr. Excluding exchange rate differences, the Bank recorded an operating loss of 2.5 b.kr. for the year.

Net interest income declined by just over 4 b.kr., due largely to the reduction in net interest income on the foreign exchange reserves, as foreign interest on bank deposits and securities has declined between years. Other operating revenues rose by just over 1 b.kr. due to the revaluation of gold. Operating expenses fell year-on-year, primarily due to unusually high expenses in 2008 for consultancy relating to the banking collapse. Wage costs rose by 9.7% during the year, owing partly to increased staffing.

The Bank's total assets declined slightly during the year but still amount to nearly 1,200 b.kr., as they did at year-end 2008.

At year-end 2009, the Bank's foreign assets were 41% of total assets, while they were 47% of total assets at year-end 2008.

Foreign assets in the foreign exchange reserves rose by 56 b.kr. during the year. The real increase in the reserves was financed with borrowed funds, including a 20.8 b.kr. loan from the International Monetary Fund and a 54.8 b.kr. loan from the Nordic countries. Foreign liabilities declined by 38 b.kr., however, due mainly to the repayment of outstanding swap agreements with the central banks of Denmark, Sweden, and Norway, in the amount of 100 million euros from each bank. The Bank's foreign liabilities were 241 b.kr. at year-end 2008 and now total 204 b.kr.

The fall of the commercial banks put Central Bank loans secured with shares in the failed banks in a state of disarray. The Bank had loaned money against collateral that proved unsound in spite of having been deemed secure when the loans were extended. An agreement was reached whereby the Treasury purchased a large portion of the Bank's collateral loan portfolio when the banking crisis struck. Collateral loans with a nominal value of 345 b.kr. were purchased from the Bank at year-end 2008 for 270 b.kr., which was paid with an indexed, interest-bearing bond. In 2009, interest and indexation in the amount of roughly 36 b.kr. were entered as income.

At year-end 2009, it was decided that the Central Bank should repurchase the assets in question, plus the outstanding claims that had been established due to securities loans granted by Treasury Relending, and then sold to a separate subsidiary of the Central Bank – Central Bank of Iceland Asset Management ehf. The Bank paid 134 b.kr. for the purchase; therefore, the debt instrument stands at 161 b.kr. at year-end.

Finally, the Treasury's deposit balance with the Central Bank rose from 403 b.kr. at year-end 2008 to 446 b.kr. at the end of 2009. The primary cause of the difference is the Treasury's foreign exchange accounts with the Bank, which increased by 46.8 b.kr. This increase is attributable to new borrowing from the Nordic central banks at year-end 2009.

The Bank's equity totalled 82.8 b.kr. at year-end 2008, as opposed to 82.3 b.kr. at the end of the prior year, with the difference due to the profit for the year.

Honoured guests:

2009 was an eventful and demanding year for the Central Bank of Iceland. The Bank's activities have been marked by the need to solve the problems stemming from the collapse of the banking system. Although the path has been a rocky one, progress has been steady. A number of problems remain to be solved, but it appears as though the Bank's operations will return to normal in the near future. On behalf of the Supervisory Board, I would like to take this opportunity to thank the Central Bank's employees for a job well done in 2009. They have made a supreme effort throughout this difficult time, and they have often worked day and night under the extraordinary circumstances that affect us all.

I would also like to thank the Supervisory Board for successful collaboration during the year.

Now I would like to ask Central Bank Governor Már Guðmundsson to address the meeting.