

# Economic and monetary chronicle 2001

## January

On January 10, Búnadarbanki Íslands announced that it had been notified by the Financial Supervisory Authority on January 5 of the need for a further investigation into trading by the bank and its equity fund with shares in Pharmaco hf. over the period from June 7, 1999 to March 2000. In the FSA's opinion, Búnadarbanki and its equity fund were in possession of confidential information during the said period.

On January 24 the Central Bank traded in the interbank foreign exchange market following a dive in the króna index after the market opened at 9:15. The Central Bank sold US dollars for 2.06 b.kr., which served to restore calm to the market.

On January 26, the Central Bank signed an agreement with the German bank DePfa Europe on a USD 250 million credit facility, to increase its scope for taking measures in the foreign exchange market.

## February

The US credit rating agency Moody's Investor Service affirmed its credit rating for the Republic of Iceland in a news release on February 7. In its new report on Iceland, Moody's considered Iceland's credit rating stable, reflecting substantially improved public sector debt levels and the government's firm economic policies which have laid the foundation for robust growth and stability. Comprehensive structural reforms undertaken over the past decade have "involved budget consolidation, financial and product market deregulation, enhanced diversification of the productive and export base, and increased monetary stability. When combined with the refinement of fisheries management and a more liberal attitude toward foreign investment, the favorable macroeconomic environment facilitated a burst of growth and a dramatic improvement in living standards," Moody's reported. However, it warned that "this rapid growth has engendered serious imbalances that could imperil Iceland's hard-won economic stability going forward."

The National Debt Management Agency announced results of an issue of RIKB 07 0209, a new nonindexed, zero coupon bullet note maturing on February 9, 2007.

On February 13, it was announced that the marketing division of Frjálsi Investment Bank would be discontinued, following the acquisition of a majority holding in it by a group led by Kaupthing hf.

## March

On March 16, the National Debt Management Agency held its last auction under the agreement on a new system of authorised dealers for T-bills treasury bills and market makers for them.

From March 23 to 27, the Central Bank of Iceland repeatedly needed to sell US dollars for domestic currency with the aim of defending the fluctuation band of the króna. In all, it sold dollars for 6.8 b.kr. The main cause of the unease was uncertainty about the outcome of the Central Bank's annual meeting which had been announced for March 27.

On March 27, the Central Bank and the Prime Minister of Iceland signed a declaration on a reform of the monetary policy framework which went into effect on March 28. Instead of its intermediate objective of maintaining the exchange rate within a fluctuation band, the Central Bank will henceforth target monetary policy towards an inflation rate as close as possible to 2½%, with specified tolerance limits. The government of Iceland grants the Central Bank of Iceland full independence to apply its instruments in order to achieve its inflation target.

At the same time as the announcement of the reform in monetary policy, the Central Bank announced that it had lowered the interest rate on its repo agreements with credit institutions by 0.5 percentage points.

## April

On April 17, the treasury took a 250 million euro credit facility managed by Dresdner Bank.

On April 26, Frjálsi Investment Bank was de-listed from Iceland Stock Exchange. After a takeover bid, Kaupthing hf. and an investor group that it led had acquired 98.64% of total capital stock in Frjálsi Investment Bank, which thereby no longer fulfilled conditions for listing on ICEX.

## May

On May 4, the Central Bank published its first inflation forecast after the introduction of inflation targeting. The Bank forecast that inflation in the second half of this year could reach 6% and would measure 5.7% over the year. This was based on assumptions of an unchanged exchange rate from April 26 to the end of the forecast period, and no alterations to existing wage agreements.

On May 4, Fitch announced its credit ratings for Landsbanki of A for long-term debt and F1 for shortterm debt. F1 is the best rating issued by the agency. Apart from the Republic of Iceland, no Icelandic borrower has achieved a higher credit rating.

On May 21, the Debt Management Agency, on behalf of the Minister of Finance, accepted bids from Landsbanki, Búnadarbanki, Icebank and Kaupthing, which represented the lowest requested commission on market making for five government bond classes. The Debt Management Agency pays each market maker a turnover commission of 0.1% of the amount of its trading in each category, based on monthly turnover on Iceland Stock Exchange. A ceiling of 140 m.kr. p.a. is set for the total commission to be shared out among market makers.

## June

On June 8, Iceland Stock Exchange announced a change in the composition of its ICEX-15 index for the period July 1, 2001 to January 1, 2002. Three new companies were added to the index: Kaupthing, Olíufélagid and SÍF, in place of Grandi, Thormódur rammi-Sæberg and Opin kerfi.

On June 13, shares in Islandssimi were listed on the ICEX main list. Listed capital stock was 587,995,000 kr.

On June 20, the Housing Financing Fund announced its decision to relaunch sales of housing fund bonds from categories 1 and 2 in 1996. Auctions are planned on June 27, September 1, October 1, November 1 and December 1. A sufficient quantity of bonds in these categories is expected to be offered for sale this year to meet the part of the Fund's borrowing requirement that cannot be realised with housing bond issues.

On June 21, the Central Bank intervened in foreign exchange market trading for the first time since inflation targeting was adopted. The exchange rate index had risen rapidly (i.e. the króna depreciated) on the previous day, and continued to do so when the market opened. After the Central Bank sold US dollars for 2.5 b.kr., the index fell again and the market calmed.

On June 22, the Ministry of Finance announced the treasury's decision to borrow 25 b.kr. abroad in order to boost the Central Bank's foreign position. It is planned to allocate part of this sum as a contribution to the Central Bank's capital, which is to be strengthened under the new Central Bank Act. On June 26, the Minister of Commerce announced the start of preparations for privatisation of at least one-third of shares in Landsbanki through sale to a major investor. The sale is planned to take place before the end of 2001. A condition for the sale is that it will increase competition in Icelandic financial markets and enhance the bank's competitiveness.

## July

On July 1, changes were made in the domestic interbank market in line with an agreement made by the Governors of the Central Bank and foreign exchange market makers in the second half of June. Búnadarbanki, Íslandsbanki, Kaupthing and Landsbanki will act as market makers. For a trial period until the end of this year, the Central Bank will pay market makers a specified commission for performing their functions, while they undertake clear obligations in return.

On July 1, a new Interest Rates and Indexation Act no. 38/2001 entered effect, replacing Act no. 25/1987. The many changes introduced include new provisions on penalty interest rates and on the Central Bank's obligation to publish interest rates.

On July 6 a new currency basket took effect. The basket is reviewed annually on the basis of the composition of foreign trade and services during the previous year. The accompanying table shows the new basket and the change from the one it replaces.

#### New currency basket 2001 (%)

Based on foreign trade in 2000

<i>Country</i>	<i>Currency</i>	<i>Exports</i>	<i>Imports</i>	<i>Average</i>	<i>Change from prev. basket</i>
USA	USD	26.13	27.86	26.99	1.73
Britain	GBP	14.92	14.61	14.77	0.40
Canada	CAD	1.76	0.96	1.36	-0.07
Denmark	DKK	8.29	9.07	8.68	-0.21
Norway	NOK	5.94	6.21	6.08	-1.53
Sweden	SEK	2.49	6.40	4.44	0.37
Switzerland	CHF	2.40	0.90	1.65	-0.46
Euro zone	EUR	33.78	29.54	31.66	0.23
Japan	JPY	4.29	4.45	4.37	-0.47
North America		27.89	28.82	28.35	1.66
Europe		67.82	66.73	67.28	-1.19
European Union		59.48	59.62	59.55	0.80
Japan		4.29	4.45	4.37	-0.47
Total		100.00	100.00	100.00	0.00

On July 16, new ICEX rules went into effect concerning publication of interim statements of listed companies. From Q3 inclusive, companies listed on ICEX are obliged to publish their interim statements on a quarterly basis.

#### August

On August 27, the Minister of Social Affairs announced a new fire insurance reference for housing bond loans. Loan ceilings had previously been 65% or 70% of the purchase price of housing or its fire insurance value, whichever was lower and depending upon whether a first housing purchase was involved. Under the new ministerial decision, from September 1, 2001 the reference will be 65% or 70% of purchase price, but never higher than 85% of fire insurance value.

#### September

On September 24 the deadline expired for prospective major shareholders to apply for selection during the privatisation of Iceland Telecom (Landssími Íslands hf.). In all 17 investors announced an interest in acquiring a major shareholding in the company.

On September 26, it was announced that the boards of Búnadarbanki and Lýsing hf. leasing company had approved for their part the merger of Lýsing into Búnadarbanki. Proposals to this effect were announced for approval by shareholders' meetings scheduled for November 10, 2001. The Central Bank announced that the treasury had finalised a foreign loan facility aimed at strengthening the Bank's foreign position, cf. the Ministry of Finance announcement to this effect in June.

#### October

On October 4, the government announced its decision to promote extensive reforms to private and corporate taxation. Firstly, major changes will be made to tax rates and tax reference limits for both private individuals and businesses. Secondly, inflationary accounting principles will be abandoned, having become a rarity in the accounting

principles and tax systems of other countries. Thirdly, tax treatment of the conversion of self-employed businesses to limited liability form will be brought into line with harmonised rules on conversion of other types of businesses. Fourthly, various other changes will be made regarding the interpretation and implementation of tax law.

On October 22, the US credit rating agency Standard & Poor's affirmed an unchanged credit rating for the Republic of Iceland at A+ for long-term liabilities. The outlook was lowered from steady to negative.

On October 29, the deadline expired for non-binding bids for 25% of share capital in Iceland Telecom. This was phase two in the privatisation process which aims to find a major strategic investor that will strengthen Iceland Telecom, enhance its value and boost the Icelandic telecommunications market.

### **November**

On November 8, the Central Bank announced an 0.8 percentage point cut in its interest rates. After the cut, the Central Bank policy rate is 10.1%.

On November 10, a shareholders' meeting of Búnadarbanki Íslands hf. approved a proposal for the bank's merger with Lýsing hf. leasing company. It was assumed that Lýsing would be totally merged with the bank through a takeover of its assets and liabilities.

On November 20, Bakkavör Group hf. announced its acquisition of the British food producer Katsouris Fresh Foods Ltd. This is the largest corporate acquisition in Icelandic business history and makes Bakkavör Group hf. one of the largest corporations in Iceland.

### **December**

On December 12, the boards of directors of Búnadarbanki Íslands hf. and Gilding ehf. investment company announced their approval of a merger between these companies, whereby Gilding would be merged into Búnadarbanki.

On December 15, the minimum amount for payment orders in the Central Bank's RTGS system was lowered from 100 m.kr. to 25 m.kr.