

Economic and monetary chronicle

March 2006

On March 28, Standard & Poor's Rating Services announced its first credit rating for an Icelandic bank, Glitnir Bank (formerly Íslandsbanki). The ratings were long-term A- and short-term A-2, with a stable outlook.

On March 30, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.75 percentage points to 11.5%. Other Central Bank interest rates were also raised by 0.75 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of April 4 and other rates as of April 1.

On March 31, Kaupthing Bank issued € 500 million (43.5 b.kr.) of króna-denominated structured covered bonds. Issued to finance the bank's residential housing loans in Iceland, the bonds were assigned an Aaa credit rating by Moody's Investors Service.

April 2006

On April 4, Moody's Investor Service published a Special Comment on the Icelandic economy which found that Iceland is not experiencing undue risk to solvency or liquidity as result of recent volatility in the nation's business and financial cycles. The report is published on the Moody's website.

On April 4, Moody's Investor Service affirmed the deposit and debt ratings of Landsbanki Islands at A2 long-term and P-1 short-term. At the same time, the rating agency altered the outlook to negative from stable for Landsbanki's financial strength rating, which is currently C.

On April 4, Moody's Investor Service affirmed the deposit and debt ratings of Kaupthing Bank at A1 long-term and P-1 short term. At the same time, the rating agency put the bank's financial strength rating C+ on review for possible downgrade.

On April 4, Moody's Investor Service affirmed the deposit and debt ratings of Glitnir Bank at A1 long-term and P-1 short-term. At the same time, the rating agency altered Glitnir Bank's outlook to negative from stable for the bank's financial strength rating.

On April 24, Moody's Investors Service affirmed its ratings on the Republic of Iceland at Aaa for long-term obligations and P-1 for short-term obligations, both in foreign and domestic currency, with a stable outlook.

On May 1, changes to the Central Bank's Rules on liquidity entered into force. One objective of the review was to preclude intragroup transactions aimed at sidestepping the Bank's liquidity rules.

On May 1, changes to the Central Bank's Rules on foreign exchange balance entered into force. Two main changes were made: uniform exposures for individual currencies were introduced and financial institutions were allowed to maintain a separate positive foreign balance

outside their total foreign balance as a hedge against the effect of exchange rate movements on their capital adequacy ratios.

May 2006

On May 4, the Central Bank of Iceland published its *Financial Stability* report for 2006.

On May 4, the Ministry of Finance and National Debt Management Agency (NDMA) announced a new benchmark series of Treasury securities. The Minister of Finance assigned the NDMA to introduce regular issues of two-year Treasury notes and three-month Treasury bills in order to support economic policy decisions and improve interest rate formation in the bond market.

On May 8-15, an IMF mission visited Iceland for consultations with representatives of the authorities and the private sector. The mission's concluding statement was published on the websites of the Central Bank of Iceland and IMF on May 15.

On May 12, Kaupthing Bank issued subordinated bonds in the amount of 1,250 million US dollars (88.5 b.kr.). The issue is classified as Tier 2 capital.

On May 18, the Governors of the Central Bank of Iceland announced that the Bank would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.75 percentage points to 12.25%. Other Central Bank interest rates were also raised by 0.75 percentage points. Interest rates on one-week certificates of deposit and the repo rate were raised as of May 23 and other rates as of May 21.

On May 24, Glitnir Bank announced that it had acquired all the shares in the Swedish finance group Fischer Partners Fondkommission AB. The acquisition price was 3.7 b.kr.

On May 26, the NDMA signed an agreement in connection with Treasury securities issues and secondary market making. New rules on facilities for primary market makers entered into force on May 30. Primary market makers for Treasury securities – Glitnir Bank, Kaupthing Bank, Landsbanki, MP Fjárfestingarbanki investment bank and Straumur-Burðarás Fjárfestingabanki investment bank – have exclusive access to NDMA's securities lending facilities. The agreement covers all Government securities, replacing the previous two.

On May 30, the NDMA auctioned a new series of three-month Treasury bills, RIKV 06 0901, maturing on September 1, 2006.

June 2006

On June 5, Standard & Poor's Ratings Services revised its outlook on the Republic of Iceland to negative from stable on the increasing likelihood of a hard landing for the country's economy. At the same time, Standard & Poor's affirmed its long-term AA- foreign and AA+ local, and its short-term A-1+ foreign and local currency sovereign credit ratings on the republic.

On June 12, Glitnir Bank issued subordinated bonds in the amount of 500 million US dollars (37 b.kr.). The issue is classified as Tier 2 capital.

On June 14, the NDMA issued a new series of two-year Treasury notes, RIKB 08 0613, maturing on June 13, 2008.

On June 22, the Federation of Labour (ASÍ) and Confederation of Employers (SA) signed a two-part agreement on a review of wage settlements. A joint ASÍ-SA review committee agreed on a wage development safety net which guarantees all employees covered by its settlements a minimum wage rise of 5.5% over the preceding year. SA and ASÍ, along with the latter's national associations, also agreed on a 15,000 kr. increment to all monthly wages as of July 1 inclusive.

On June 22, the Government of Iceland announced the following seven-point measures to facilitate the agreement on a wage review between ASÍ and SA: 1) The personal income tax credit (personal allowance) will be increased by 8.3% over and above the previously decided 2.25% increase and will be indexed to the CPI. 2) Legislation on mortgage interest allowance will be reviewed if rising housing prices erode these tax credits substantially. 3) Child allowances will apply to children up to the age of 18 instead of the present 16. 4) The personal income tax rate will be reduced by 1% in 2007 instead of the announced 2% cut. 5) Contributions to adult education and job training will be increased. 6) The Government will initiate cooperation with the social partners on foreign labour issues and the underground economy. 7) Basic monthly unemployment benefit will be increased by 15,000 kr. as of July 1. The ceiling for income-related unemployment benefit will also increase from 180,000 kr. to 185,000 kr.

On June 27, in continuation of the social partners' agreement, the Government agreed on: 1) a temporary reduction in the Housing Financing Fund's maximum loan-to-value ratio from 90% to 80% of house sale price and a reduction from 18 m.kr to 17 m.kr. in the maximum mortgage amount; 2) a temporary postponement of tenders and new public works investment by the central government; 3) initiation of talks with local authorities on comparable postponements on their part.

