

# Economic and monetary chronicle 2003

## January

On January 3 the Minister of Commerce and Minister of Finance, on behalf of the treasury, signed an agreement with Samson eignarhaldsfélag ehf. holding company on the latter's acquisition of the treasury's 45.8% shareholding in Landsbanki Íslands hf.

On January 6, Iceland Stock Exchange revoked the membership of Fjárvernd-Verðbréf hf. securities house, effective from January 7, 2003. The reason was persistent defaults on payment of membership fees.

On January 16 the Minister of Commerce and Minister of Finance signed an agreement on behalf of the treasury with Egla hf., Vátryggingafélag Íslands hf., Samvinnulífeyrissjóðurinn and Eignarhaldsfélagið Samvinnutryggingar on the investor group's acquisition of the treasury's 45.8% shareholding in Búnaðarbanki Íslands hf. Egla is a limited company owned by Hauck & Aufhäuser Privatbankiers KGaA of Germany, Ker hf. and Vátryggingafélag Íslands hf.

## February

On February 4, the Financial Supervisory Authority (FME) confirmed that Samson eignarhaldsfélag ehf. was suitable to control a qualifying holding in Landsbanki Íslands hf.

On February 4, Moody's Investors Service affirmed its A3/P2/C credit rating for Landsbanki Íslands hf.

On February 6, the Central Bank began purchasing 1.5 million US dollars in the domestic interbank market on a daily basis, instead of the previous three times a week.

On February 7, it was announced that Kaupþing banki hf. had acquired the London-based financial company BMY Corporate Finance Limited, which it renamed Kaupthing Limited. The company is authorised by the UK Financial Supervisory Authority to conduct corporate finance activities.

On February 10, the Central Bank announced a 50 bp cut in its interest rates, effective from February 11 and 18. After the cut, the Central Bank policy rate was 5.3%.

On February 12, it was announced that the UK Financial Supervisory Authority (FSA) had approved the change of control of Heritable Bank Limited which is a result of Samson Holding ehf.'s acquisition of a 45.8% share in Landsbanki Íslands hf. The FSA thereby approved Samson Holding ehf.'s acquisition of Landsbanki Íslands hf. as regards Landsbanki's operations in the UK.

On February 25, the Government privatised its remaining 2.5% of the total share capital of Landsbanki Íslands hf. Following the sale, the Treasury no longer holds any stake in Landsbanki.

On February 28, the Central Bank announced a change in the required reserves of credit institutions. As of March 21 the required reserve ratios, i.e. as a proportion of total tied deposits, were reduced to 1% and 3% from 1.5% and 4% respectively. As of April 1, credit institutions' scope for using required reserves as collateral security for payment system settlements will be limited to half of the negotiated collateral amount. The aim behind this restriction is to ensure that credit institutions have scope on their required reserve accounts to meet swings in their liquidity positions.

## March

On March 7, the Government privatised its remaining 9.11% of the total share capital of Búnaðarbanki Íslands hf. Following the sale, the Treasury no longer holds any stake in Búnaðarbanki.

On March 18, the FME confirmed that Egla hf., Eignarhaldsfélagið Samvinnutryggingar hf., Samvinnulífeyrissjóðurinn and Vátryggingafélag Íslands hf. were suitable to control a qualifying holding in Búnaðarbanki Íslands hf.

On March 27, the boards of directors of Kaupþing banki hf. and Búnaðarbanki Íslands hf. announced their decision to commence formal talks on cooperation or a merger between the banks.

On March 31, Fitch affirmed its credit rating of AA for the Republic of Iceland for long-term obligations in foreign currency, AAA for domestic obligations and F1+ for short-term foreign debt. The outlook on the long-term ratings was changed from negative to stable. The main reasons for the upgrade are the strength of the Icelandic economy and the swift adjustment towards macroeconomic balance. Fitch said the main constraint on Iceland's ratings was its relatively high debt burden.

#### **April**

On April 8, Moody's Investors Service announced that it had upgraded its credit ratings for Íslandsbanki hf. The long-term deposit and debt ratings were upgraded from A2 to A1, the subordinated debt rating from A3 to A2 and the financial strength rating from C+ to B-. The P-1 short-term rating was confirmed.

On April 10, Moody's Investors Service announced that it had upgraded its short-term credit rating for Búnaðarbanki Íslands hf. from P-2 to P-1. The long term deposit and debt rating was affirmed at A3 and the financial strength rating at C.

On April 10, Moody's Investors Service announced that it had upgraded its short-term credit rating for Landsbanki Íslands hf. from P-2 to P-1. The longterm rating was affirmed at A3.

On April 14, it was announced that the Boards of Directors of Búnaðarbanki Íslands hf. and Kaupþing banki hf. had agreed to propose to their respective shareholders' meetings that the companies be merged. The proposed name of the merged bank is Kaupþing Búnaðarbanki hf.

On April 28, Búnaðarbanki Íslands hf. announced an agreement on the sale of its operation in Luxembourg to Landsbanki Íslands hf. The agreement is conditional on the merger between Búnaðarbanki Íslands hf. and Kaupþing banki hf. being realised no later than June 1, 2003.

#### **May**

On May 8, Íslandsbanki hf. notified the Financial Supervisory Authority (FME) of its intention to open a branch in Luxembourg.

On May 22, it was announced that Búnaðarbanki Íslands hf. and Landsbanki Íslands hf. had signed a final agreement on the transfer of ownership of Bunadarbanki International S.A., Luxembourg.

On May 26, preparation for the formal merger between Búnaðarbanki Íslands hf. and Kaupþing banki hf. was completed after it was approved by shareholders in the two banks. The following day the FME approved the merger, with reference to the appropriate act of law.

#### **June**

On June 11, the Governors of the central banks of Denmark, Finland, Iceland, Norway and Sweden signed a Memorandum of Understanding on financial crisis management. The MoU is applicable when a severe problem occurs in a bank which is domiciled in a Nordic country and has cross-border establishments in other Nordic countries.

On June 19, Standard & Poor's affirmed all its ratings for the Republic of Iceland, at AA+/A-1+ for local currency and A+/A-1+ for foreign currency. Its outlook for the Republic of Iceland is steady.

#### **July**

On July 4, a new currency basket was announced following the annual revision on the basis of Iceland's foreign trade in goods and services the preceding year. The new basket and changes from the previous year are shown below.

## New currency basket 2003 (%)

Based on foreign trade in 2002

<i>Region</i>	<i>Currency</i>	<i>Exports</i>	<i>Imports</i>	<i>Average</i>	<i>Change from prev. basket</i>
USA	USD	22.17	27.29	24.73	-0.10
Britain	GBP	14.10	10.59	12.35	-0.43
Canada	CAD	1.33	0.84	1.09	-0.14
Denmark	DKK	7.56	8.93	8.24	0.08
Norway	NOK	6.04	6.78	6.41	-0.37
Sweden	SEK	1.71	5.12	3.42	-0.06
Switzerland	CHF	1.51	0.91	1.21	-0.80
Euro zone	EUR	42.38	35.76	39.07	1.99
Japan	JPY	3.20	3.78	3.48	-0.17
North America		23.50	28.13	25.82	-0.24
Europe		73.30	68.09	70.70	0.41
European Union		65.75	60.40	63.08	1.58
Japan		3.20	3.78	3.48	-0.17
Total		100.00	100.00	100.00	0.00

On July 16, Iceland Stock Exchange announced a new method for selecting companies into the ICEX- 15 Index. On March 10, 2004 it will announce the first ICEX-15 based on the new method. The index with that composition will be in effect from April 1, 2004 to June 30, 2004. The principal changes from the current method are:

- Introduction of a maximum spread requirement
- free-float adjustment for market capitalisation of companies
- ICEX-15 constituents are required to publish news concurrently in Icelandic and English

The purpose of these changes is to promote liquidity of equities.

### August

On August 26, Fjárfestingarfélagið Straumur hf. investment company announced an agreement to acquire a 34.72% holding in Framtak Fjárfestingarbanki hf. investment bank, further to its previous holding of 57.08%.

On August 28, it was announced that the Board of Directors of Landsbanki Íslands hf. had confirmed the issue of shares for a nominal value of 344,518,275 kr. in connection with the bank's purchase of a stake in Fjárfestingarfélagið Straumur hf. investment company. At the same time the Board of Landsbanki announced a decision to increase its nominal share capital by a further 309,778,103 kr. Landsbanki's nominal share capital following these changes is 7,500,000,000 kr.

### September

On September 9, Kaupping Búnaðarbanki hf. announced its acquisition of Tyren Holding AS, a Norwegian asset management company specialising in alternative asset management. After this acquisition, Kaupping Búnaðarbanki operates in all five Nordic countries.

On September 18, it was announced that Íslandsbanki hf. had negotiated the acquisition of a 33% shareholding in Sjóvá-Almennar tryggingar hf. insurance company. Íslandsbanki also requested authorisation from the Financial Supervisory Authority (FME) to own a qualifying holding in the company, as provided for in Act No. 60/1994.

### October

On October 3, a shareholders' meeting of Íslandsbanki hf. authorised its board of directors to increase the company's share capital by a nominal value of up to 1,500,000,000 kr. with a new subscription issue. Part of this authorisation was exercised on October 6 when the bank's share capital was raised by a nominal 500 m.kr., from 9 b.kr. to 9.5 b.kr. Authorisation by the shareholders' meeting to raise share capital by up to an additional 1 b.kr. remains in effect.

On October 7, Landsbanki Íslands hf. made an agreement to increase its shareholding in Landsafl hf. property leasing and management company from 25.5% to 74.5%.

On October 10, the Treasury bond RIKB 03 1010 matured. The estimated settlement amount was 11 b.kr.

On October 15, Landsbanki Íslands hf. acquired a further 25.5% in Landsafl hf., bringing its total shareholding to 100%.

On October 16, the Swedish investment company Havsfrun AB announced that it had approved the sale of its shareholding in Finnish investment company Norvestia Oyj to Kaupping Búnaðarbanki hf. The condition set for the acquisition to be able to go ahead was thereby fulfilled.

On October 20, it was announced that Fjárfestingarfélagið Straumur hf. had acquired a 99.3% shareholding in Framtak fjárfestingarbanki hf.

On October 20, Fjárfestingarfélagið Straumur hf. announced that it had applied to the FME for a licence to operate as an investment bank in accordance with Article 4, paragraph 3, item 1 of Act No. 161/2002 on Financial Undertakings.

On October 20, it was announced that Fjárfestingarfélagið Straumur hf. and Brú fjárfestingar hf. had signed an agreement on a merger between these two investment companies, effective retroactively from July 1, 2003.

On October 20, the Central Bank of Iceland announced changes to the payment amount limits and operating times of its RTGS system. The Board of Governors issued new Rules on Activities of Netting Systems and Rules on the Central Bank of Iceland Real-Time Gross Settlement System which replace Rules No. 951 from December 29, 2000, on Access to Settlement Accounts in the Central Bank of Iceland, and enter into force on November 1, 2003.

The following change was made to the RTGS payment amount limits: The minimum amount of a payment handled in the Central Bank's RTGS system will be lowered from 25 m.kr to 10 m.kr. Payment orders amounting to 10 m.kr. or more will therefore be handled in the RTGS system. Payment orders for amounts up to 10 m.kr. will be handled in the netting system. However, all payment orders in connection with settlements in a netting system and securities settlement system are handled in the RTGS system irrespective of their amount.

The following change was made to the RTGS operating times: The regular operating time of the RTGS system, which has been from 08.45 to 18.00 on regular banking days, will be shortened and be from 09.00 to 17.00 on regular banking days. From 08.45 to 09.00 the system will be open for payment orders in connection with the settlement of securities transactions. The system will also be open from 17.00 to 17.30 for banks to settle payments among themselves.

On October 27, FME (the Financial Supervisory Authority) licensed securities company MP verðbréf hf. as a credit institution under the provisions of article 4, paragraph 1, point 3 of Act No. 161/2002, on Financial Undertakings. Following its licensing, the securities company was renamed MP fjárfestingarbanki hf. (investment bank).

On October 31, Norðurál aluminium company signed a memorandum of understanding with Suðurnes Regional Heating (Hitaveita Suðurnesja) and Reykjavík Energy (OR), on the supply of power to its proposed 90 thousand t.p.y. smelter expansion.

## November

On November 6 the Central Bank of Iceland published its quarterly Peningamál (Monetary Bulletin) containing a macroeconomic and inflation forecast, along with reports on financial markets and Central Bank measures and on financial stability.

On November 12, Íslandsbanki made a further acquisition of shares in Sjóvá-Almennar tryggingar hf. which increased its holding to more than 99%. In connection with the acquisition, Íslandsbanki hf. increased its share capital in stages. By November 10 the bank's board of directors had exercised in full the authorisation granted by a shareholders' meeting to increase its share capital by 1.5 b.kr. nominal.

On November 21, Nordea Bank Danmark A/S was licensed as a bond trader in the Iceland Stock Exchange (ICEX) trading system.

On November 27, parliament passed a bill increasing heavy duty vehicle tax and commodity tax on petrol by 8%, effective from the end of the year.

On November 27, the Ministry of Commerce announced that the final price of recently privatised Landsbanki Íslands hf. would be 700 m.kr. lower than originally provided for.

## December

On December 2, the Board of Governors of the Central Bank of Iceland announced that the Bank had adopted new Rules on Minimum Reserve Requirements of Financial Undertakings (credit institutions) which are licensed to operate under Article 4, points 1, 2 and 3 of Act No. 161/2002 on Financial Undertakings. The new Rules completed changes announced by the Central Bank that had begun to be implemented in March. This second phase aimed to adjust the reserve base and the reserve ratios to the practices of the European Central Bank. The new Rules entered into force on December 21.

On December 2, the supplementary budget for 2003 was approved. Revenue estimates were raised by 6.4 b.kr., largely on account of corporate income tax, value-added tax and capital gains tax on dividends. Expenditure authorisations were raised by 12.6 b.kr.

On December 3, Íslandsbanki hf. acquired the entire shareholding held by investment company Fjárfestingarfélagið Straumur hf. in Framtak fjárfestingarbanki hf. investment bank (formerly Eignarhaldsfélag Alþýðubankans hf. and Próunarfélag Íslands hf.) Framtak fjárfestingarbanki hf. was merged into Íslandsbanki hf., effective from January 1, 2004. Alongside the sale, Fjárfestingarfélagið Straumur hf. undertook to acquire Framtak fjárfestingarbanki hf.'s venture capital portfolio.

On December 5, a law was passed whereby employers will no longer be allowed to allocate a part of their national insurance contribution towards matching premiums paid by employees to voluntary pension savings schemes (equivalent to 10% of the employee's voluntary premium, to a maximum of 0.4% of the national insurance contribution base).

On December 12, an amendment to the Income Tax and Wealth Tax Act was passed, extending for two years the tax surcharge on high incomes which would have expired at the end of 2003. The tax surcharge on high incomes will be reduced in phases to 4% on top of the basic income tax rate for the tax year 2004 and 2% for 2005. Under rules determining interest payment rebates for homeowners, maximum interest payments qualifying for rebates were lowered from 7% of mortgage debt to 5.5% for rebates due in 2005. For 2004, rebates will be 90% of what they would have been under the old rules. Amounts and references for the main benefit categories were increased by 2.5% between 2003 and 2004.

On December 12, the act granting tax concessions to international trading companies was repealed, effective from January 1, 2008. New international trading companies will not be licensed after March 1, 2004.

On December 15, parliament passed a law approving new pension rights for the President of Iceland, cabinet ministers, members of parliament and Supreme Court judges.

On December 15, Moody's Investors Service announced the upgrading of Kaupping Búnaðarbanki hf.'s credit rating. The bank's long-term deposit and debt ratings were upgraded from A3 to A2, the subordinated debt rating from Baa1 to A3 and the financial strength rating from C to C+. The short-term rating was confirmed at P-1, which is the highest rating given. All these ratings continued to have a positive outlook. According to Moody's "the upgrading of these ratings reflects the successful merger ... [which] resulted in the creation of a welldiversified and dominant player with healthy financial fundamentals on the Icelandic financial market", and its "excellent performance" since then.

On December 16, Standard & Poor's upgraded its foreign currency outlook on the Republic of Iceland to positive from stable. It also affirmed the sovereign ratings, including A+/A-1+ for foreign currency and AA+/A-1+ for local currency.

On December 18, an agreement was signed between Norðurál aluminium company, Landsvirkjun (the national power company), Reykjavík Energy and Suðurnes Regional Heating on the supply of power to Norðurál's proposed smelter expansion.

On December 19, the Ministry of Finance announced that the personal income tax rate for 2004 would remain unchanged from 2003, at 25.75%. Local government authorities have announced an average municipal tax rate of 12.83% in 2004, compared with 12.80% in 2003. The income tax rate for 2004 will therefore be 38.58%. Local authorities may set their municipal tax rate in the range 11.24% to 13.03%. Of 104 local authorities, 67 intend to levy the maximum municipal rate, and 5 the minimum rate.

On December 21, officials of Kaupþing Búnaðarbanki hf. and the board of directors of Sparisjóður Reykjavíkur og nágrennis (SPRON, the Reykjavík and Environs Savings Bank) signed a declaration that work was in progress to convert SPRON into an independently operating subsidiary of Kaupþing Búnaðarbanki hf. It was proposed to convert SPRON into a limited liability company – which would require the consent of holders of primary guarantee capital in the savings bank, who then would swap their shares in exchange for shares in Kaupþing Búnaðarbanki hf. The bank was reported to plan to continue operating the savings bank as an independent entity.

On December 21 the SPRON board unanimously agreed to propose to holders of primary capital that the savings bank should be converted into a limited liability company. If agreed, a trust, SPRONSjóðurinn ses., would retain an 81% holding in SPRON hf.

On December 22, the Central Bank of Iceland announced its decision to auction 14-day certificates of deposit to credit institutions which are subject to minimum reserve requirements, on December 30. The issue was aimed at reducing liquidity in circulation and thereby its expansionary effect. The Central Bank also announced it would hold further auctions of certificates of deposit as the circumstances warrant.

On December 29, holding company Samson eignarhaldsfélag ehf. remitted its final payment for the acquisition of the Treasury's holding in Landsbanki Íslands hf. Payment was for 12.5% of issued share capital in the bank, with a nominal value of 856 m.kr., and made in US dollars. At the same time, the investor group acquiring Búnaðarbanki Íslands hf. settled its payment for an 8.33% holding (37 million shares) owned by the Treasury in the merged KB banki hf. After these transactions, the commercial banks had been fully privatised.

On December 31, the Minister of Social Affairs announced that maximum loans from the Housing Financing Fund (HFF) would be raised from 9 m.kr. to 9.7 m.kr. for new housing, and from 8 m.kr. to 9.2 m.kr. for secondary market housing, effective from January 2, 2004. It is also planned to change the HFF's bond issues into monetary loans on July 1, 2004. The loans will be financed by auctions of underlying "HFF bonds". At the turn of the year 2003/2004, Kaupþing Búnaðarbanki hf. was renamed KB banki hf. All the bank's branches and activities in Iceland will bear the new name, while its international activities will continue under the Kaupthing brand.