

Economic and monetary chronicle 2004

January

On January 1, general welfare benefits rose by 3%. On January 2, FME (the Financial Supervisory Authority) approved an application by investment bank Straumur fjárfestingarbanki hf. to be licensed as a credit undertaking under the provisions of article 4, paragraph 1, point 3 of Act No. 161/2002 on Financial Undertakings. Straumur fjárfestingarbanki hf. applied for membership of Iceland Stock Exchange. From the beginning of 2004, the Central Bank of Iceland will purchase 5 million US dollars weekly in the interbank FX market, instead of the weekly purchase of 12.5 million US dollars which had been made since May 2003. The aim of the Central Bank's currency purchases is to strengthen its foreign reserves.

On January 15, the Ministry of Finance published its macroeconomic forecast.

February

On February 4, and again on February 19, the Ministry of Fisheries raised the quota for the capelin fishery by 80 thousand tonnes and 240 thousand tonnes respectively. This brought the total allowable catch of capelin up to 875 thousand tonnes, of which 737 thousand tonnes are earmarked for the Icelandic fleet under international agreements.

On February 5, Act No. 4/2004 was passed amending the Act on Financial Undertakings. One consequence of the amendment was that proposed plans to convert SPRON into a limited liability company were withdrawn and KB banki hf.'s previously announced acquisition of SPRON did not go ahead.

On February 24, KB banki hf. acquired 19,385,994 shares in Singer and Friedlander Group Plc. of the UK, corresponding to 10.00% of its issued share capital. The acquisition brought KB banki hf.'s holding in the UK bank up to 37,866,694 shares (19.53%). KB banki hf. announced that it had no current intention to make a bid for Singer and Friedlander Group Plc.

March

On March 7, two major blue-collar unions, Starfsgreinasambandið (SGS) and Flóabandalagið (comprising SGS member unions in southwest Iceland) agreed on wage settlements with the Confederation of Employers (Samtök atvinnulífsins). If approved by union members, the settlements will be in effect until December 31, 2007.

On March 7, the Federation of Special and General Workers (SGS) and its southwest Iceland branch agreed on wage settlements with the Confederation of Employers (SA). The settlements will be in effect until December 31, 2007. The total cost to employers over the term of the settlement is estimated at 15.1%, or 3.6% on average per year. New pay scales will take effect incorporating various bonus payments and supplements into basic pay rates in 2004 and 2006. In connection with the pay scale changes, more flexible working hours were agreed upon in specific industries or workplaces. The employers' mandatory pension fund contribution will also increase from 6% to 8% over the term of the agreement.

Underlying assumptions of the wage settlements are that prices develop in line with the Central Bank's inflation target and that other labour market settlements entail broadly the same wage increases. A committee appointed by the Federation of Labour (ASÍ) and SA will meet twice (in 2005 and 2006) to review whether the assumptions have held. In connection with the settlements, the government made a commitment to back a 0.45% reduction in national insurance contributions in 2007, to lower the cost impact for employers. Unemployment benefit will go up by 3.6% more than the lowest basic wages over the period and the government will ensure that contributions will continue to be made into a fund for job training until the settlements expire. This measure will cost the Treasury 2½ b.kr.

On March 12, Íslandsbanki hf. reduced its nominal registered share capital by 500 m.kr., to 10 b.kr.

On March 12, Landsbanki Íslands hf. increased its nominal share capital by 600 m.kr., to 8.1 b.kr. Share price in the transaction was 7.6 króna per share, raising the bank's total equity by 4,560 m.kr. Based on figures for the end of 2003 and including the share capital increase, Landsbanki's total equity is nearly 27 b.kr. The new share capital boosted its CAD equity ratio to above 11%, of which more than 8% was Tier 1.

On March 17, the National Debt Management Agency issued a new series of non-indexed Treasury notes, RIKB 10 0317, with a maturity date of March 17, 2010. The notes bear interest which is paid annually at the end of each interest period. The annual interest rate is 7.00%. On the final due date, March 17, 2010, the last payment of interest due will be made, together with payment of the principal amount of the notes.

On March 17, Íslandsbanki hf. announced that it had sold a 75% holding in the UK private bank R. Raphael & Sons plc. After the sale, the bank owns a 25% share in Raphael & Sons, which thereby ceases to be reported as a subsidiary in its accounts. The buyer was Lenlyn Holdings plc. Íslandsbanki hf. announced that the sale price of R. Raphael & Sons plc. was consistent with the book value in its accounts and would therefore have a negligible impact on its operations and balance sheet.

April

On April 5, it was announced that the Ministry of Finance had requested the National Debt Management Agency to increase the volume of government bonds in the series RIKS 15 1001 by a nominal value of 3,434,428,436 kr. The additional issue was made in connection with pension fund obligations that the Treasury and City of Reykjavík have operated jointly.

On April 5, the Treasury and City of Reykjavík signed an agreement on pension fund commitments of employees with institutions that they operate jointly. The Treasury will pay the City 2.9 b.kr., and it is planned to produce an annual statement of the division between Treasury and City commitments as they are incurred. Since the Treasury had already made allowance for these commitments, they did not require a special transfer in the State Accounts for the year.

On April 5, Icelandic government debt securities became eligible for settlement and custody in Clearstream Banking of Luxembourg. Eligible securities are benchmark housing bonds, housing authority bonds, Treasury notes and indexed Treasury bonds.

On April 8, the Federation of Special and General Workers (SGS) signed a new wage settlement with the state for its member unions. In effect until March 31, 2008, the settlement raises wage costs by 20.4% over its term, or 4.7% per year on average. These rises are higher than in the private sector settlements made by national unions within the Icelandic Federation of Labour (ASÍ), because the pension fund contribution paid by the state will be increased from 6% to 11.5%, in line with terms for other civil servants. On April 10, the government bond series RIKS 04 0410 was redeemed for 5 b.kr.

On April 11, Decode Genetics declined a 20 b.kr. Treasury guarantee that parliament had authorised the Minister of Finance to grant. Consequently, the government withdrew its application for an opinion on the guarantee from the EFTA Surveillance Authority, where it had been under scrutiny.

The majority of national unions within ASÍ completed their wage settlements with SA in the second half of April. The Union of Icelandic Electrical Workers (RSÍ) signed up on April 15, followed by the Commercial Federation of Iceland (LÍV) and the Commercial Workers' Union in Reykjavík (VR) on April 21, the Icelandic Federation of Food and Restaurant Workers (Matvís) on April 24 and the Federation of Skilled Construction and Industrial Workers (Samiðn) on April 29. All settlements are in effect until December 31, 2007 and entail broadly the same increases in wage costs as the settlement between SGS and SA, although they differ in certain details.

May

On May 4, Straumur Fjárfestingarbanki hf., an investment bank, was licensed as a securities broker.

On May 6, the Central Bank of Iceland announced that it had decided to raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.2 percentage points to 5.5% as of May 11. The Bank's other interest rates were also raised by 0.2 percentage points on May 11.

On May 11, the National Debt Management Agency signed agreements with market makers concerning issues of Treasury bonds. From June 1, 2004 six banks have been designated principal market makers: commercial banks Íslandsbanki hf, KB banki hf and Landsbanki Íslands hf; investment bank MP Fjárfestingarbanki, the savings banks' clearing house Sparisjóðabanki Íslands, and savings bank Sparisjóður Reykjavíkur og nágrennis.

On May 13, the Housing Financing Fund announced it had commissioned Deutsche Bank AG of London to act as advisor and lead manager for the restructuring of its benchmark housing bonds.

On May 19, the Central Bank of Iceland announced changes to its Rules on Transactions with the Central Bank by Credit Institutions Subject to Minimum Reserve Requirements. Under the new Rules, maturities of the Bank's regular market instruments, i.e. repurchase agreements and certificates of deposit, are shortened from 14 days to 7 days, effective as of June 1, 2004.

On May 19, Fitch Ratings affirmed its credit ratings on the Republic of Iceland, awarding AA- for longterm obligations in foreign currency, AAA for domestic obligations and F1+ for short-term foreign debt. The outlook on the ratings was stable.

June

On June 1, the Central Bank of Iceland announced that it had decided to raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.25 percentage points to 5.75% as of June 8. The Bank's other interest rates were raised on June 11.

On June 7, Moody's Investors Service affirmed its ratings on the Republic of Iceland at Aaa for longterm obligations in foreign and domestic currency and P-1 for short-term obligations in foreign and domestic currency, with a stable outlook.

On June 7, KB banki hf. announced that it had established a London-based asset management business, New Bond Street Asset Management LLP (NBS). NBS will focus on generating a portfolio of floating-rate credit investments for KB banki hf. and managing funds from third parties. Funds under management are expected to reach up to 2 billion euros in the first two years, KB banki hf. announced.

On June 14, KB banki hf. announced that it had acquired the Danish bank FIH A/S from Swedbank. FIH provides medium- and long-term financing to the full spectrum of Danish corporations. The acquisition will double the size of KB banki hf.'s balance sheet. It was conditional upon approval by financial supervisory authorities in both Denmark and Iceland. Acquisition price was 1.0 billion euros, equivalent to just over 84 b.kr.

On June 14, the Housing Financing Fund was awarded ratings from Moody's Investors Service and Standard & Poor's that are matched to the Republic of Iceland's domestic government bond issuance, reflecting the HFF's close links to the Republic of Iceland and its status as a government agency.

On June 18, Stockholm Stock Exchange announced that KB banki hf. was among 13 new companies in Economic and monetary chronicle its Attract 40 index. Based on highest turnover rate, the index will be reviewed at the end of 2004.

On June 18, KB banki hf. announced that it had finalised a subordinated bonds issue totalling 450 m. euros, or approximately 40 b.kr., to finance the acquisition of the Danish bank FIH. Of the total issue, 150 m. euros constitute Tier I capital and the remained Tier II capital.

On June 18, the Iceland Stock Exchange (ICEX) Board of Directors approved Deutsche Bank AG London as an ICEX member.

July

On July 1, changes to the Housing Financing Fund, which had been approved by parliament on May 28, went into effect. Issuance of housing bonds and housing authority bonds was discontinued and a new bond series was issued: HFF bonds in an annuity format, payable twice a year, with maturities of 20, 30 or 40 years. The main change was that loans are now disbursed in cash, not with housing bonds. Owners of the main housing bond and housing authority bond series were invited to swap them for HFF bonds, and exchanges were made for a total of 338 b.kr.

On July 1, the interest rate on HFF mortgages was lowered by 0.3 percentage points, to 4.8%. HFF rates were reduced by a further 0.3 percentage points to 4.5% on August 1, and by 0.15 percentage points to 4.35% on September 1. The sharp reduction was the result of a decrease in market yields on HFF bonds.

On July 5, a meeting of shareholders in KB banki hf. agreed to increase its share capital through the issue of 110,137,128 shares with pre-emptive rights. At a price per share of 360 kr., the total value of the issue was 39,649,366,080 kr. The KB banki hf. shareholders' meeting also authorised the Board of Directors to increase its share capital through a subscription of 110,000,000 new shares without preemptive rights.

On July 5, the Central Bank of Iceland announced that it had decided to raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.5 percentage points to 6.25% as of July 6. The Bank's other interest rates were raised on July 11.

On July 14, a new currency basket was announced by the Central Bank following the annual revision on the basis of Iceland's foreign trade in goods and services the preceding year. The new basket took effect on July 16.

August

On August 9, 110,137,128 new shares in KB banki hf., to a nominal value of 1,101,371,280 kr., were listed on the ICEX Main List. The total number of listed shares in the bank thereby increased to 550,685,640, to a nominal value of 5,506,856,400 kr.

On August 12, Íslandsbanki hf. made an offer to acquire all the outstanding share capital of Kredittbanken AS of Norway, at a price of NOK 7.25 per share. The offer price is equivalent to just over 3.5 b.kr. for all shares in the bank. The Board of Directors of Kredittbanken recommended to its shareholders to accept the offer, which is conditional upon acceptance by holders of 90% of all issued and outstanding share capital in Kredittbanken and approval by the relevant authorities in Iceland and Norway.

On August 23, KB banki hf. announced plans to offer inflation-indexed mortgage loans with a maturity of 40 years and carrying a fixed interest rate of 4.4%, subject to certain conditions. Subsequently, the other commercial banks and some savings banks and pension funds began offering loans on similar terms. Towards the end of the month the interest rate on mortgage loans was lowered to 4.2%, following an HFF bonds auction.

On August 30, Fitch Ratings affirmed Íslandsbanki hf.'s ratings at A for long-term obligations and F1 for short-term obligations. The outlook was also announced as stable.

September

On September 17, the Central Bank of Iceland announced that it would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 0.5 percentage points to 6.75% as of September 21. The Bank's other interest rates were also raised by 0.5 percentage points on September 21.

On September 27, Íslandsbanki hf. increased its share capital by a nominal amount of 200 m.kr. After the increase, total listed nominal share capital in the bank on the ICEX Main List amounted to 10.2 b.kr. Average price per share was 10.80 kr.

On September 29, KB banki hf. announced that its acquisition of the Danish bank FIH A/S had been fully cleared by the Danish and Icelandic financial supervisory authorities, cf. its announcement from June 14. The announce-

ment said that the acquisition was largely financed with a subordinated bond issue and pre-emptive rights issue of new share capital.

On September 30, the nominal share capital in Straumur Fjárfestingarbanki hf. investment bank was raised to 5.4 b.kr. Part of the new share issue was used to acquire a 14.41% share in Íslandsbanki hf. from Burðarás hf. investment holding company (which sold 5.33%), Landsbanki Íslands hf. (4.67%) and Landsbanki Luxembourg (4.42%).

On September 30, H.F. Verðbréf securities house set up a market for trading primary guarantee capital in Sparisjóður Reykjavíkur og nágrennis savings bank (SPRON).

October

On October 1, the budget proposal bill for 2005 was presented to parliament. It assumed a surplus of 11.2 b.kr. The bill also presented the government's medium- term fiscal programme for 2005 to 2008.

On October 6, the state Housing Financing Fund (HFF) raised its maximum loan amount for both new and secondary market housing to 11.5 m.kr. At the same time, the maximum combined amount of ordinary mortgage loans and secondary mortgages was set at 13 m.kr.

On October 15, new shares in KB banki hf. to a nominal value of 1.1 b.kr. were listed on ICEX. After the increase, the total nominal value of listed shares in the bank on the ICEX Main List amounted to 6,606,856,400 kr. Total sale price of the new shares was 52.8 b.kr.

On October 15, HFF increased its loan-to-value ratio from 85% of the fire insurance value of a property, to a maximum of 100%.

On October 18, it was announced that Íslandsbanki hf.'s takeover of Kredittbanken was completed. The takeover bid was accepted by 99.4% of shareholders. From October 20 to 25, IMF staff visited Iceland for discussions on the economy with officials from the Central Bank, government and private sector. The IMF staff's concluding statement was published on the Central Bank's website on October 29.

On October 29, the Central Bank of Iceland announced that it would raise its policy interest rate on repo transactions with credit institutions by 0.5 percentage points to 7.25% as of November 2. The interest rate on credit institutions' current accounts with the Bank was raised by 0.75 percentage points on November 1.

November

On November 3, Moody's Investors Service announced the upgrading of KB banki hf.'s credit rating. The bank's long-term deposit and senior debt ratings were upgraded from A2 to A1. The subordinated debt rating was upgraded to A2 from A3 and its C+ financial strength rating was affirmed. The short-term rating of P-1 was also affirmed, which is the highest rating given.

On November 5, Íslandsbanki hf. announced plans to offer mortgage loans with a loan-to-value ratio of up to 100% market value. With a maturity of up to 40 years, the loans would be subject to certain conditions. Other commercial banks and some savings banks followed suit and announced plans to offer similar mortgage terms.

On November 13, parliament approved a law on the pay conditions of primary school teachers and principals, ending a teachers' strike which had lasted since September 20. The law provided that, if contracting parties had not signed a wage agreement before November 20, 2004, the Supreme Court would appoint a three-man tribunal to decide, before February 28, 2005, the pay and terms of members of the Association of Teachers in Primary and Lower Secondary Schools and the Association of Headmasters with the local authorities that negotiate with them through the joint municipal wage committee. A new agreement was signed on November 17 and the result of a ballot on it was scheduled to be announced on December 6.

On November 16, Moody's Investors Service affirmed Íslandsbanki hf.'s A1 rating on long-term deposit and senior debt and P-1 rating for short-term obligations. The bank's financial strength rating of B- was placed on review.

On November 16, Reykjavík City Council approved an increase in the municipal tax rate from 12.7% to the maximum authorised rate of 13.03%. Real estate tax was also raised from 0.320% to 0.345%. The increases will generate an estimated 0.9 b.kr. in extra annual revenue for the city.

On November 22, new shares in Íslandsbanki hf. to a nominal value of 1 b.kr. were listed on ICEX. After the increase, the total nominal value of listed shares in the bank on the ICEX Main List amounted to 11.2 b.kr. Total sale price of the new shares was 10.65 b.kr.

On November 26, Fitch Ratings affirmed Íslandsbanki's long-term rating of A, short-term rating of F1, individual rating of C and support rating of 2. The outlook was stable.

On November 26, Fitch Ratings affirmed Landsbanki hf.'s long-term rating of A, short-term rating of F1, individual rating of C and support rating of 2. The outlook was stable.

December

On December 2, the Central Bank of Iceland announced that it would raise its policy interest rate (i.e. its repo rate in transactions with credit institutions) by 1 percentage point to 8.25% as of December 7. The Bank's other interest rates were also raised as of December 11: on overnight loans by 1 percentage point and on credit institutions' current accounts and reserve accounts with the Bank by 1½ percentage points.

On December 2, the Central Bank announced in Monetary Bulletin 2004/4 that at the end of the year it would discontinue its purchases of foreign currency specifically aimed at strengthening its foreign reserves. The Bank will continue to purchase foreign currency in order to provide the Treasury with currency to service its foreign debt.

On December 2, the supplementary budget for 2004 was approved by parliament. Revenue and expenditure estimates for the year were raised by 9 b.kr., with parliament increasing expenditures by 3 b.kr. and revenues by just over 1 b.kr. from the original targets in the supplementary budget bill.

On December 2, parliament authorised the Housing Financing Fund to offer a general loan-to-value ratio of 90% on its mortgages, up to a ceiling of 14.9 m.kr.

On December 4, the fiscal budget for 2005 was passed by parliament. Estimated revenues were 306 b.kr. and expenditures 296 b.kr., leaving a surplus of 10 b.kr. Parliament increased expenditures by 2 b.kr. and revenues by just under 1 b.kr. from the original targets in the budget bill. Compared with the fiscal budget and supplementary budget for 2004, estimated revenues will increase by 5% in nominal terms and 1% in real terms. Estimated expenditures will increase by 5% in nominal terms but remain virtually unchanged in real terms. The largest increase in outlays was to education, by 1.7 b.kr. in real terms.

On December 10, parliament passed legislation enacting extensive reforms to income tax and net wealth tax. The Treasury's private income tax will be reduced by one percentage point at the beginning of 2005, a further percentage point at the beginning of 2006 and two percentage points in 2007, leaving it at 21.75% of the tax base. Net wealth tax for private individuals and legal entities was abolished, so that in 2006 it will not be levied on net wealth at the end of 2005. Child allowance will be raised in two similar steps in 2006 and 2007. The draft bill estimates that total child allowance outlays will be 2.4 b.kr. higher in 2007 than in 2005.

On December 21, Kaupthing Sofi Oyj, the Finnish subsidiary of KB banki hf., was licensed as a bank by the Finnish FSA and will be renamed Kaupthing Bank Oyj. KB banki hf. and its subsidiaries now have banking licences in five countries.