



ICELAND CHAMBER
OF COMMERCE

The Icelandic Economic Situation - Status Report -

During the past year, the Icelandic economy has gone through dramatic changes due to the collapse of its financial sector. Despite these substantial difficulties, general economic activity is still well functional and many Icelandic businesses remain strong and prosperous. Due to inadequate external information flow, a lot of misconceptions have developed concerning the chain of events in the recent scenario and the current status of the Icelandic economy. This status report is meant to give further insight into those issues.

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The current economic turmoil in Iceland is part of a complex global financial crisis and is by no means an isolated event. Governments around the world have introduced emergency measures to protect their financial system and rescue their banks, as they suffer from a severe liquidity shortage. Thus far, Iceland has been hit particularly hard by this unprecedented financial storm due to the large size of the banking sector in comparison to the overall economy. The Icelandic Government, both past and present, has taken measures and is working hard to resolve the situation. Iceland has been cooperating with its Nordic and European partners and is actively cooperating with the IMF on measures toward further stabilization of the Icelandic economy.

I. WHAT HAPPENED?

A globalized economy, and an active participant in the EU's common market through the EEA, Iceland is among the first nations to be seriously hit by the global financial crisis. The situation has hit Icelandic households hard and many have lost a sizeable portion of their savings. Inflation is still in double-digit numbers but rapidly cooling, unemployment is around 7% and is on the rise and the currency, the Icelandic Krona (ISK), has fallen significantly, but has now stabilized, i.a. due to measures in the financial exchange markets.

The large size of the banking sector in comparison to Iceland's overall economy is undoubtedly a driving factor behind the current economic turmoil. However, it should be underlined that the Icelandic banks operated under Icelandic and European banking laws and the strictest of international regulatory standards. Nevertheless, as the liquidity crisis deepened, Iceland's three largest banks, Glitnir, Landsbanki and Kaupthing, whose balance sheets are several times larger than the total output of the Icelandic economy (around 10 times GDP), were no longer able to re-finance their operations.

As a response to these circumstances, the Icelandic Parliament (Althingi) passed a new law, allowing the Financial Supervisory Authority (FSA) to take over the operations of the banks. On the basis of this new law, all three banks are now being restructured and the domestic operations are being separated and re-capitalized. More information on the new banks is provided in [chapter VII e](#)) and in [appendix 2](#).

II. WHAT WAS DONE?

Progress in ensuring continued functioning of the Icelandic financial system was achieved at quite an early stage. The Icelandic government prioritized the tasks facing the economy based on their importance for the general public. The first task was to secure the functioning of the domestic banking, payment and settlement systems. The stock market had been re-opened even though the operations were obviously limited considering that the financial companies were the majority share of the total market capitalization of the stock exchange, see further information in [chapter VII h](#)).

Furthermore, Iceland was working closely and constructively with other countries to address problems that have arisen in connection with the government takeover of Iceland's three largest commercial banks. The government of Iceland had clearly stated that it intended to honor its legal commitments and seek close cooperation with other countries' authorities.

In order to prevent a potential shortage of foreign currency, the Central Bank of Iceland implemented temporary restrictions on foreign exchange transactions with the Icelandic krona. These restrictions resulted in some problems with payments and settlements of international transfers between Iceland and other countries. However, no restrictions on currency transactions relating to the import and export of goods and services were introduced, see further information in [chapter VII c](#)) and [appendix 3](#).

III. INTERNATIONAL MONETARY FUND (IMF)

The Icelandic government reached an agreement with the International Monetary Fund (IMF), on 24th of October 2008, on a comprehensive stabilization program, which includes a \$2.1 billion loan from the IMF. The agreement has been approved by the IMF's executive board. There are three main objectives of the IMF program:

1. To contain the negative impact of the crisis on the economy by restoring confidence and stabilizing the exchange rate in the near-term.
2. To promote a viable domestic banking sector and safeguard international financial relations by implementing a sound banking system strategy that is nondiscriminatory and collaborative.
3. To safeguard medium-term fiscal viability by limiting the socialization of losses in the collapsed banks and implementing an ambitious multi-year fiscal consolidation program.

Significant progress was made towards attaining these goals as is confirmed in the IMF's first progress report, which was issued in the first week of February. According to the IMF's assessment, there should be room to gradually remove currency restrictions and lower the Central bank's policy rate in the near future. A statement from the IMF Mission can be found [here](#) and further information on the Economic Program can be found [here](#).

Second payment from the IMF has been halted due to uncertainty regarding fiscal policy, see [chapter VII b](#)) for further information on the delay and the current status of the second payment.

According to the IMF's economic forecast for Iceland, the Icelandic economy is expected to adjust further in the near term under the program. Given the high leverage in the economy and significant dependence of the private sector on foreign currency and inflation-indexed debt, the economy is expected to enter into a serious recession in 2009-10. The anticipated large import compression will, however, lead to a rapid swing of the current account into surplus, providing significant support to the exchange rate going forward. Once confidence is restored and balance sheets readjusted, domestic demand—both investment and consumption—is projected to rebound strongly in 2011. Long-term growth prospects are favorable, in line with Iceland's very strong fundamentals, not least its highly educated labor force, favorable investment climate and rich natural resource endowment.

IV. WHAT HAPPENED TO ICELANDIC BANKS ABROAD?

The Icelandic banks' operations abroad were inevitably affected by the restructuring of the Icelandic banking system. Some of the banks continued to operate abroad as before, like Glitnir in Norway and Kaupthing in Luxemburg, most under new names and owners. Others, Landsbankin's operations in the UK, were shut down and their assets will be used to reimburse deposits and other outstanding liabilities – with the backup of the Deposit Guarantee Funds in the respective country according to EU/EEA regulations.

The deposits of foreign customers in Icelandic banks within the EEA are generally guaranteed according to EU rules. Depending on whether the bank is operated as a subsidiary or a branch, different deposit-guarantee schemes may come into play if assets do not cover commitments. Any foreign subsidiary of an Icelandic bank is fully covered by the deposit-guarantee scheme in the country it operates. All branches of Icelandic banks are covered by the Icelandic Depositor's and Investor's Guarantee Fund, which operates according to the EU-directive relating to these issues. According to the directive, the amount covered is €20,887 for each depositor in each financial institution. These are the basic rules that apply throughout the EU and the EEA, of which Iceland is a part

One of the provisions approved in the new Emergency Bank Act, is that deposits are to be considered a priority claim on the bank's estates. This was done in order to secure the interests of depositors in the foreign branches. Ideally, a bank's assets will be worth enough to cover all or most outstanding deposits.

In several countries, the Government has stepped in and offered further support to their banks, including Icelandic owned subsidiaries. In Sweden and Norway, for example, measures have been taken by the Government to ensure the ongoing operation of banks. This is the best way to safeguard assets and investments, which might otherwise be sold prematurely or liquidated at a price well below true value.

However, the assets of Landsbanki in the UK were frozen via provisions in the Anti Terrorism, Crime and Security Act from 2001. This has been forcefully opposed through diplomatic channels with British authorities, as this clearly had a very damaging effect on the Icelandic banking sector and put Icelandic companies in Britain in a difficult situation. Iceland has also taken the issue up for discussion within NATO and Icelandic authorities have considered legal action. This is also one of the main factors leading to disruptions in Iceland's international payments and settlements system.

Further information about the old banks can be found [here](#) (for Kaupthing Bank), [here](#) (for Landsbanki) and [here](#) (for Glitnir Bank). The Minister of Economic Affairs has also recently published his view on the task ahead concerning the financial system reconstruction. This overview can be found [here](#).

V. FOREIGN EXCHANGE MARKETS

On November 28th, the Icelandic Parliament approved an amendment of Act no. 87/1992 on Foreign Exchange. The Act gave the Central Bank temporary authorization to set rules limiting international capital movements, with the aim of restricting the outflow of foreign currency, for instance, by imposing obligations to repatriate

foreign currency. The amended Act makes it clear that all transactions connected to import and export of goods and services are - and will continue to be - unrestricted. It includes a temporary clause which will be in effect for two years and authorises the Central Bank to impose rules that prohibit foreign exchange related to capital account transactions. The purpose is to prevent excessive short term volatility in the ISK and is in line with the conditions of the IMF Stand-by Arrangement.

On April 4th the Parliament approved amendments to the Act on Foreign currency. The ISK exchange rate had been sliding steadily, and there were strong indications that the objective of building up strong foreign currency reserves through mandatory currency repatriation might be in jeopardy. This was attributed primarily to the fact that exporters were not obliged to receive payment for their products in foreign currency.

The amendment was intended to plug this loophole in the legislation. It adds a temporary provision to the Act on Foreign Currency, stipulating that exports of goods and services must be concluded in foreign currency. Following the amendment to the Customs Act, the price of exports recorded on export declarations must be in foreign currency and the enforcement of these provisions will be monitored

Further Q&A concerning foreign exchange matters can be found [here](#).

VI. POLITICAL ENVIRONMENT: NEW GOVERNMENT

Due to strong social pressure and extraordinary circumstances, former Prime Minister Mr. Geir H. Haarde made an announcement in late January that national elections were to be held in May 2009. The coalition Government of the right-wing Independence Party and the Social Democratic Alliance came to an end a few days later.

A week later, a new Government of the Social Democratic Alliance and the Left-Green Movement was formed. According to its official announcement its goal was to assure an effective administration to carry out urgent measures, particularly for the benefit of households and businesses, for rebuilding the banking system, in the field of administrative reform and to carry out measures in favor of increased democracy.

The economic policy of the Government was based on the program already established by the authorities and the IMF. The Government announced it would conduct a prudent fiscal policy according to which the fundamentals of the welfare system would be protected. The two parties agreed on holding early elections, set for 25th of April 2009. The Progressive Party defended the Government in the event of motions of no-confidence.

Following the outcome of the national elections, the Social Democrats and Left-Greens now hold a majority of seats in the Parliament, 34 MP's against the oppositions 29 MP's. The parties decided to continue their coalition partnership and have formed a new Government. According to its announcement the central aim of the Government is to rebalance the state budget by 2013 while at the same time implementing an ambitious plan of job creation and innovation to restore Iceland's position among the most energetic and competitive states in the world by 2020.

A press release with further information on the agenda for the first 100 days of the new Government as well as the co-operation statement by the new Government can be found [here](#).

There have also been made some amendments to the Act on the Central Bank of Iceland, which are outlined in [appendix 4](#)

VII. FROM SPRING TO AUTUMN '09

Significant progress has been made over the last five months, both in terms of the financial sector and the Government's program with the IMF.

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a) Icesave Negotiations: Concluded

The Government proposed for a legislation before the Parliament, in its summer session, authorizing a state guarantee for the loans granted by the Governments of the United Kingdom and the Netherlands to the Depositors' and Investors' Guarantee Fund of Iceland. The legislation was passed on 8th of August, after 10 weeks of debate, with certain preconditions. The preconditions are aimed at ensuring debt sustainability and allowing Iceland to restore its financial system and its economy while at the same time honoring Iceland's international obligations. The proposal for preconditions can be found [here](#).

In light of the pre-conditions the Icelandic Government had to re-negotiate with the Governments of the United Kingdom and the Netherlands. The re-negotiations process was concluded on 18th of October with the Governments of the United Kingdom and the Netherlands accepting the principal points of the conditions set by the Parliament, with some deviations. A presentation of the outcome of the re-negotiations can be found [here](#).

On 22nd of October the Icelandic Government proposed for a second legislation before the Parliament on the state guarantee to amend the first legislation in line with the outcome of the re-negotiations. A press release from the Ministry of Finance on the matter can be found [here](#).

Discussions about the proposed legislation are still in the first phase of three in the Parliament. Since the opposition's MP's have demonstrated heavy resistance towards the proposed legislation it is projected that the debate will at least take several weeks.

The conclusion of the Icesave negotiations is seen by many as a vital step in the restoration of Iceland's economy. The reason being mainly its' role in the IMF program but also since it has impeded the resolution of many other important matters regarding households and the business community. Both the Ministry of Economic Affairs and the Central Bank have issued statements on possible effects of further delays in concluding the matter, see [here](#). (The statements are only available in Icelandic).

b) The IMF Program: Back on Track

The proposed 1st review of the Economic Recovery Program, which was scheduled to be concluded in May/June, has been substantially delayed because of the Parliamentary debates over the before-mentioned legislation on the state guarantee and subsequent re-negotiations with the Governments of the United Kingdom and the Netherlands.

Since the conclusion of the re-negotiations the IMF has announced that all the major policy work that was needed to complete the 1st review has been done, see [here](#). On 28th of October IMF's Executive Board approved the review, giving Iceland access to \$167,4 million from the IMF and also to \$675 million from the Nordic countries and Poland, see [here](#). The Governments statement regarding the approval and the Letter of Intent can be found [here](#).

c) The Capital Restrictions: Up for Review 1st of November

The Central Bank's Monetary Policy Committee (MPC) has not seen reasons to lift the capital restrictions which were set to prevent excessive short term volatility in the ISK. This is, amongst other things, due to the delay in receiving approval from IMF on the 1st review of the Economic Recovery Program, according to the Monetary Policy Committee (see [here](#)).

Surveillance on the foreign exchange rules has in fact been tightened, the Capital Controls Surveillance Unit within the Bank has been reorganized and fortified and the Central Bank's information gathering has been improved. More information on this can be found [here](#).

However, according to the Capital Account Liberalization Strategy, from 5th of August, inflow of capital should be liberalized on 1st of November allowing for foreign direct investments into Iceland. Liberalizing outflows will be initiated gradually at the Central Bank's discretion. More on the strategy [here](#). IMF's approval of the 1st review should facilitate liberalization of capital inflow.

d) Policy Interest Rates: At 12% Since June

The MPC has kept the monetary policy stance unchanged (collateral loan and deposit rates at 12% and 9.5%) for almost four months now. The main reasons for this standstill have been the before mentioned delay of the 1st Review of the IMF Program but also delays regarding the re-capitalization and restoration of the banking sector. The Government's commitment to a sustainable medium-term fiscal plan has also played a part, which according to the MPC has been inadequate. See the [minutes](#) of the last MPC meeting from 24th of September for further information.

As was mentioned above significant progress has been made in these matters over the last 30 days or so. There have also been other signs of improvement, e.g. lesser need for foreign exchange intervention by the Central Bank due to the ISK being broadly stable, the trade surplus has turned out somewhat larger than expected (from a ISK 43 billion deficit to a ISK 48 billion surplus in 13 months), the business sector's accumulation of foreign exchange deposits at domestic banks has stopped, export prices have firmed and CDS spreads suggest that the risk premium on ISK-denominated assets appear to have continued to decline.

Because of these multiple conversions, along with IMF's approval of the 1st review, many anticipate that the MPC will lower the policy interest rates on the 5th of November.

Information on Iceland's CDS spread can be found [here](#). The Central Bank of Iceland's report Financial Stability 2009 can be found [here](#).

e) The Banks: Almost on Their "New" Feet

Since the FSA took over the operations of the banks in October 2008 they have been appointed Special Resolution Committees and new banks have been established around the old banks domestic operations, in accordance with the FSA's decision on the disposal of assets and liabilities between the old and new banks. The Government also appointed boards to govern the new state owned banks.

The decision of the FSA on the disposal of assets and liabilities can be found [here](#). Information about the resolution committees can be found [here](#) and various FAQ can be found [here](#).

In April Deloitte delivered its valuation of the assets that were moved from the old banks to the new banks and Oliver Wyman also issued its independent assessment report, see [here](#). The Government also engaged with the corporate advisory firm Hawkpoint to negotiate with creditors of the old banks the appropriate compensation for assets transferred and also to advice on the capitalization and the imbalance issues.

On 20th of July the Government, the boards of the new banks and the resolution committees of the three old banks announced that an agreement had been made on the initial capitalization of the new banks and

the basis for the compensation payable to the creditors of the old banks for the transfer of assets into the new banks. The announcement can be found [here](#). According to the agreements each bank will be prudently capitalized with a core Tier 1 ratio of approximately 12%. In respect of the new banks, Islandsbanki (former Glitnir) and New Kaupthing, the agreement included an option for the old banks to subscribe for majority equity interests in the new banks.

On 15th of October the Resolution Committee of Glitnir, on behalf of its creditors, decided to utilize that option and acquired 95% of the share capital in Islandsbanki, see [here](#). The Resolution Committee of Old Kaupthing, on behalf of its creditors, has a deadline until 31st of October to acquire control of New Kaupthing by capitalizing the bank directly, see [here](#). The cost of capitalizing the new banks is expected to reduce because of this from around ISK 270 billion to approximately ISK 200 billion. These levels of capital commitment are significantly lower than the estimated commitment of ISK 385 billion at the time of the original transfer in October 2008, leading to lower fiscal cost and impact on gross state debt than previously envisaged.

With regards to Landsbanki, the agreement stipulates that the Government will provide the majority of the equity capital for new Landsbanki. The new bank will furthermore issue a ISK 260 billion ten year bond to compensate the creditors of the old Landsbanki. More information can be found [here](#). The Government will hold majority equity interests in Landsbanki.

The Government has furthermore set up a Banking Agency (The Icelandic State Banking Agency-ISBA) which is intended to control the state's holding in financial undertakings in compliance with currently applicable law, good administrative and business practices, and the state's current ownership strategy, and provide them with funding on behalf of the state based on budget allocations. See more on ISBA [here](#). Further information on the ownership policy can be found [here](#).

ISBA is set up in accordance with an expert report from the Coordination Committee led by Mr. Mats Josefsson, see [here](#) for further information. The Committee had the overall responsibility of developing, implementing and communicating a comprehensive strategy for bank restructuring. Another expert report, by Mr. Kaarlo Jännäri, on Banking Regulation and Supervision in Iceland was published in March, see [here](#).

f) The European Union: Application in Process

The Parliament voted on 16th of July in favor of applying for membership in the European Union (EU), with some proposals from the Parliament's Foreign Affairs Committee, see [here](#).

Iceland's application was submitted to the Swedish Government, which holds the EU presidency, on 17th July and on 27th of July the Foreign Ministers of the EU invited the Commission to formulate an opinion on Iceland's application, see [here](#). A copy of the application can be found [here](#). The Commission questionnaire was formally presented to the Icelandic Prime Minister Ms. Jóhanna Sigurðardóttir by Mr. Olli Rehn, the European Commissioner for Enlargement on 8th of September and the answers were submitted on 22th of October. See the questionnaire [here](#) and the answers [here](#).

If the Commission renders its opinion before the EU Council meeting in December Iceland might be granted a candidate status which is a precondition for the opening of accession negotiations.

g) The State Treasury: Hit Hard by the Turmoil

The aftermaths of the financial crisis has hit the State Treasury and municipalities significantly, both in terms of revenue and expenditure:

- » **Net Government (and Central Bank) debt** has increased as a direct result of the failure of the banks by around 13% of GDP. Most of this figure reflects funds advanced to the banks by the CBI and, to a much lesser extent, the Treasury. In addition, the Government will incur debt to meet minimum EU deposit guarantee requirements on Landsbanki's Icesave accounts in the United Kingdom and the Netherlands. Assuming a 75% recovery ratio, (the Resolution Committee is expecting 90% recovery) the CBI estimates

that the present value of the cost to the Icelandic Government of meeting this obligation is ISK 240 billion (17% of estimated GDP in 2009).

- » **Treasury revenues** contracted significantly towards the end of 2008 with most of the tax bases shrinking with increased bankruptcies in the private sector, especially company and capital taxes. Due to reduced private consumption revenues from VAT and excises taxes have also contracted.
- » **Treasury cyclical expenditures** have increased with the sharp increase in unemployment which has put the unemployment benefit scheme under considerable pressure. The revenue balance amounted to 13% of GDP that year. In 2009, the deficit is estimated to reach 17.2% of GDP.

The Government took various measures over its summer session to dampen the hit and it has also put forth legislation on the national budget for the year 2010 with further measures.

- » Personal income tax rates were increased by 1.35% and a temporary 8% surcharge was introduced on high incomes.
- » Various excise taxes, e.g. on alcohol, gasoline and cars, have been increased (some twice) along with increased VAT on certain products.
- » Various benefits were decreased, such as maternity leave benefits, and income thresholds for others were lowered.
- » The payroll tax, paid by Icelandic companies, was increased to a level that is expected to balance the unemployment fund's accounts.
- » Government expenditure measures of restriction around 1.5% for the Ministries and their institution were introduced in June.
- » The national budget for 2010 entails increased taxes, e.g. new energy, environmental and resource taxes, increased capital and income taxes, as well as changes to commodity taxes and a possible expansion of the VAT base and reclassification of VAT levels.
- » The national budget also entails expenditure measures of restriction around 10% in the Government's administration, 7% in educational matters and 5% in welfare matters. Public investments will be reduced and further decreases in benefits, such as child support benefits, have been introduced.

The 2010 budget is based on the premises set out in, and aimed at achieving the objectives of, the report on Government plans for fiscal balance in 2009-2013 which is based on the IMF Economic Recovery Program.

The Budget Highlights for 2010 from the Ministry of Finance can be found [here](#) and the Treasury finances for January-August 2009 can be found [here](#). The new macroeconomic forecast from the Ministry of Finance can be found [here](#) and the forecast for 2009-2014 can be found [here](#).

h) The NasdaqOMX Iceland: Slowly Picking up Pace

Before the financial crisis hit Iceland seriously, market cap on the equity market amounted to around 120% of GDP. This number has now been brought down to around 20% of GDP after the collapse of the three biggest banks, Glitnir, Landsbanki and Kaupthing. After trading was suspended for three trading days in the second week of October the OMX Iceland 15 index closed at 678.4, which corresponds to a plunge of about 77% compared with 3,004.6 closing on October 8th, 2008. This reflects the fact that the value of the three big banks, which form 73.2% of the value of the OMX Iceland 15, had been set to zero.

On 2nd of January 2009 the OMX Iceland 15 index was replaced with a new index, the OMXI6. The new index comprises of 6 companies instead of 15, which have the most trading volume of the listed companies and which are mostly industry based. The index combination will be revised 1st of January and 1st of July each year.

Despite the heavy blow the NasdaqOMX Iceland Stock Exchange is on a good recovering phase. The OMXI6 index has risen by nearly 25% in the last 6 months and trading volume of bonds has already transcended its yearly record of ISK 21 billion. More information on the NasdaqOMX Iceland Stock Exchange can be found [here](#).

i) The Stability Pact: Unsolved Matters

Near the end of June the Government, both central and local, and the Confederation of Employers and the Confederation of Employees signed an agreement, The Stability Pact. The Pact's aim is to secure broad social consensus for adjustment measures necessary to ensure economic recovery. Its aim is also to "create conditions for increased investment by both domestic and foreign parties, stronger growth, boosting employment and laying the foundation for improved living standards in the future."

The Pact stipulates e.g. that collective wage agreements shall remain valid until the end of November 2010; that the balance in the national budget shall be attained with a suitable mix of cuts in expenditure and higher taxes; that the Government shall pave the way for major investment projects and seek co-operation with Icelandic pension funds to finance infrastructure projects and that restructuring of the banks shall be concluded by 1st November.

The Confederations of Employers and Employees have been pressing against the Government, in the last 2-3 weeks, to act in accordance with the Pact. Despite the conflicts between the social partners and the Government the Confederations of Employers has decided not to terminate the collective wage agreements.

Further information on the Stability Pact can be found [here](#).

VIII. ICELAND'S FUTURE IS BRIGHT

Despite the current economic setbacks, Iceland's future is bright. Iceland is a dynamic, technology-driven society with a young and well educated workforce. The country is endowed with abundant natural resources, which include rich fishing grounds, vast renewable energy sources (of which only a third has been harnessed), a plentiful supply of clean water and a natural environment and culture that draw an increasing number of tourists to the country each year.

Other major strengths of the economy include diverse export industries, a flexible labor market, a strong fiscal position, an efficient pension system and an excellent education system.

Armed with these strengths, Iceland's future is bright and prosperous.

Appendix 1: Timeline of the Icelandic Financial Crisis

September 29	Government announces takeover of 75% share in Glitnir and EUR 600 m equity injection. S&P downgrades Glitnir to BBB; Sovereign to A-.
September 30	Fitch downgrades sovereign to A-; Landsbanki to BBB;Kauþthing to BBB;Glitnir to BBB. Moody's downgrades sovereign to Aa1;Landsbanki to A2;Kauþthing to A1;Glitnir to Baa2.
October 4-5	Government evaluates crisis in an attempt to save banking sector.
October 6	Emergency law is introduced and passed by parliament; government guarantees all domestic deposits. Icelandic FSA seizes control of Landsbanki under terms of emergency law. S&P downgrades sovereign to BBB.
October 7	Assets of Landsbanki seized by UK authorities;Landsbanki Luxembourg goes into administration. FSA seizes control of Glitnir under terms of emergency law. Central Bank extends EUR 500 m loan to Kauþthing; announces intentions to negotiate EUR 4 bn loan with Russian Government. Central Bank announces exchange rate peg and starts by selling EUR 6 m. at ISKEUR 131. Fitch downgrades sovereign to BBB-;Landsbanki to B;Glitnir to B. S&P downgrades Glitnir to CCC.
October 8	Central Bank announces intention to maintain currency peg; later announces that peg is not sustainable and has been abandoned. Swedish Central Bank extends SEK 5 bn loan to Kauþthing Sweden. British authorities put Kauþthing Edge and Kauþthing Singer & Friedlander into administration. British PM threatens to sue Icelandic Government to claim guarantee for Icesave deposits. Icelandic PM states that sale of Landsbanki assets will be used to refund Icesave depositors. Fitch downgrades sovereign to BBB-;Landsbanki to D;Kauþthing to CCC;Glitnir to D. Moody's downgrades sovereign to A1 and puts on review for further downgrade;Kauþthing to Baa3;Glitnir to Caa2. Board of Kauþthing requests FSA to assume control of bank.
October 9	New Landsbanki starts operations. Dutch finance minister threatens to sue Icelandic Government over Icesave deposit guarantee; British PM reiterates threats. Fitch downgrades Kauþthing to CC Moody's downgrades Kauþthing to Caa2. S&P downgrades Glitnir to D.
October 10	Dutch delegation arrives in Reykjavik; initiates talks with treasury department about Icesave Central Bank announces limits on currency outflow; low amounts for travel and import restricted to necessities, companies must apply for currency to the CB.
October 11	British delegation initiates talks with treasury department about Icesave deposits. Accord signed with Dutch Government on loan to guarantee a refund of Icesave deposits. Outlines of an accord with British Government on loan to guarantee refund of Icesave deposits.
October 14	Central Bank delegation starts talks in Moscow with Russian Finance Ministry on loan to Iceland. Central Bank draws on swap facility arrangements with Denmark and Norway, each by EUR 200 m. Moody's confirms sovereign credit rating issued on October 8 (A1).
October 15	Central Bank lowers policy rate by 350 bp to 12%. Central Bank introduces auction system to meet demand for foreign currency, resulting in an allocation of EUR 25m. at a ISKEUR rate of 150. Fitch issues credit update for sovereign debt holding rating steady at BBB- on negative watch. Iceland and Russia agree to continue discussions on a possible loan. New Glitnir starts operations.
October 16	Central Bank announces that it guarantees that all payments will reach ultimate beneficiaries' accounts with local banks in an attempt to revitalize payment system.

October 22	New Kaupthing starts operations. Norwegian delegation arrives in Iceland to gather information about the the situation.
October 24	Government announces an agreement ad referendum with an IMF mission of USD 2 bn stand-by-facility programme. Government formally requests assistance from the Nordic countries, the ECB and the FED. Delegation from the US Treasury Department arrives in Reykjavik.
October 27	High-level Nordic committee established to present proposals for Nordic assistance to Iceland in cooperation with the IMF.
October 28	Central Bank raises policy rate by 600 bp to 18%. Faroe Islands pledge DKK 300 million loan for Iceland.
November 19	The Icelandic Government enters into a program with the IMF which approves a two-year SDR 1.4 billion (about US\$2.1 billion) Stand-By Arrangement to support the country's program to restore confidence and stabilize the economy.
November 28	New foreign exchange regulation is implemented

Appendix 2: More on the new Bank Act

As previously mentioned the Icelandic parliament passed on October 6th a new law, allowing the Financial Supervisory Authority (FSA) to take over the operations of the banks in unusual and extraordinary circumstances in order to limit damage or the risk of damage in the financial markets.

These unusual and extraordinary circumstances are stipulated further in art. 1 ph. 2. This list of circumstances is however not exhaustive; the FSA can thus, in other circumstances, apply its authority given by the law as long as the board of the FSA approves. The Central bank, which monitors liquidity status of financial institutions, appoints one member to the FSA board. The Central bank therefore has first hand information about the status of financial institutions and probable FSA actions in that regard.

The FSA has, on basis of this new law, taken over Iceland's three biggest banks and the procedure has been as follows:

1. The boards were dismissed.
2. Special Resolution Committees were appointed to take over board activities and management.
3. New companies were founded around the old banks domestic operations.
4. The FSA decides on disposal of assets and liabilities of the old banks to the new companies.
5. The Government, the Resolution Committees and the new banks came to an agreement on capitalization of the new banks and compensation to creditors of the old banks.
6. The Resolution Committee of Glitnir, on behalf of its creditors, decided to acquire 95% of the new bank, Islandsbanki.
7. The Resolution Committee of Kaupthing, on behalf of its creditors, has a deadline until 31st October to decide on acquisition of the new bank, New Kaupthing.
8. NBI bank, built on the domestic operations of Landsbankinn, will be owned by the Government.

Appendix 3: Q&A about Foreign Exchange Matters

The Central Bank of Iceland has published questions and answers about the recent changes in the Foreign Exchange Act of 1992 and the Bank's new Rules on Foreign Exchange, see [here](#).

The Capital Account Liberalization Strategy, from 5th of August, is available [here](#).

Appendix 4: The New Act on the Central Bank

Act no. 5/2009 amending the Act on the Central Bank of Iceland, no. 36/2001, was passed by Parliament in late February. The new Act provides for one Governor and one Deputy Governor within the Central Bank instead of a Board of Governors. Decisions on applying the Central Bank's monetary policy instruments will henceforth be taken by a Monetary Policy Committee. In other respects, the Bank's direction will be in the hands of the Governor.

According to the new law, the Board of Governors of the Central Bank of Iceland has been abolished, together with the positions of the three Governors who sat on the Board, including the position of Chairman of the Board of Governors.

Pursuant to the new law, the Prime Minister appointed Mr. Svein Harald Øygard to act as interim Governor and Mr. Arnór Sighvatsson, the Bank's Chief Economist, to act as interim Deputy Governor. Information on Svein Harald Øygard can be found [here](#). The interim Governor and Deputy Governor held these positions until appointments were made by the Prime Minister on the basis of advertisements, in accordance with the provisions of the Act.

On 26th of June the Prime Minister appointed Mr. Már Guðmundsson as the new Governor of the Central Bank, for a term of five years, and Mr. Arnór Sighvatsson as Deputy Governor, for a term of four years. The Governor appointed on 15th of September Mr. Þórarinn G. Pétursson as the Chief Economist of the Central Bank. Information about the Central Bank's new Governors' and new Chief Economist can be found [here](#) and [here](#).

Appendix 5: The IMF Loan Package

On November 19th the IMF approved Iceland's request for a two year stand-by arrangement. Iceland will receive USD 2.1 billion from the IMF. Additional loans of up to USD 3 billion have been secured from Denmark, Finland, Norway, Sweden, and Poland. These loans are based on Iceland's agreement with IMF. The Faroe Islands have announced that they would lend Iceland USD 50 million.

The loans main purpose is to buttress Iceland's liquid foreign exchange reserves, and by doing so increasing the economy's credibility and its capabilities to address potential capital outflow, and protect the ISK, ones the currency restrictions are lifted. The loans will up to some extent also be used by the Government to pay loans maturing in the near future.

a) The IMF Loan

On 19th of November the Executive Board of the IMF approved a two-year SDR 1.4 billion (about USD 2.1 billion) Stand-By Arrangement for Iceland.

The approval made SDR 560 million (about USD 827 million) immediately available and the remainder is available in eight equal installments of SDR 105 million (about USD 155 million), subject to quarterly reviews. Iceland has already drawn the initial USD 827 million and is now able to draw the first of eight installments as the 1st Review of the IMF Economic Program has been approved by IMF's Executive Board.

Further information on the IMF loan can be found [here](#), [here](#) and [here](#). Further information on the IMF program can be found [here](#).

b) The Nordic Loans

In July 2009 the Nordic countries agreed to loan Iceland in total of EUR 1.775 billion, which is equivalent to USD 2.5 billion or ISK 317 billion. The loan agreements with Denmark, Finland, and Sweden are between the Icelandic Government and the governments concerned, while the agreement with Norway is between the two countries' central banks. The loans will be disbursed in four equal tranches tied to the IMF's reviews of the Icelandic economic program.

The loans will be disbursed in Euros with an overall maturity of 12 years, with installment payments of principal deferred for the first five years during which time interest will be paid quarterly. At the end of the five-year period, the principal amount will be repaid in equal quarterly installments for the remainder of the loan period. The loans will bear variable (floating) interest based on three-month EURIBOR rates, plus a 2.75% premium.

Further information on the Nordic loans can be found [here](#).

c) The Polish Loan

In October 2009 The Republic of Poland agreed to lend Iceland PLN 630 million, the approximate equivalent of USD 200 million. The loan's overall maturity of 12 years, with a grace period of five years. The loan will be disbursed in three equal tranches tied to the second, third and fourth reviews of Iceland's IMF program, with the payment of each tranche conditional on the approval of the respective review.

The loan will be denominated and disbursed in Polish z³oty (PLN). The net cost to the borrower will consist only of an interest margin to be paid simultaneously with interest payments on the Polish Treasury Bonds issued by the Polish Treasury. This interest margin will be 2% per annum until 31 December 2015 and 1.3% per annum thereafter. The loan will be repaid in four installments coinciding with the maturity dates of the selected Polish Treasury Bonds, in October 2015, 2017 and 2019, and in September 2022.

Further information on the Polish loan can be found [here](#).

d) The Faroe Islands' Loan

A loan agreement was signed between the Government of the Faroe Islands and Iceland in March 2009. Under the agreement, the Government of the Faroe Islands will lend the Republic of Iceland DKK 300 million. The loan was the first bilateral loan of this type extended to Iceland, and it is not based upon the IMF economic program.

Further information on the Faroe Islands' loan can be found [here](#).

e) The Russian Loan

The Russian Government indicated in November 2008 its willingness to lend up to 500 million dollars. The loan agreement negotiations have come to a halt.

Appendix 6: Macroeconomic Forecasts

For further information on macroeconomic forecasts, please review:

- » Central Bank of Iceland, **Monetary Bulletin**, November 2008.
- » OECD **Economic Outlook**, November 2008.
- » OECD **Economic Survey**, September 2009.
- » Ministry of Finance updated **macroeconomic forecast** for 2009.
- » Ministry of Finance **macroeconomic forecast** for 2009-2014.

For information on the IMF stabilization program and the progress being made, please refer to the **IMF's website**.

Appendix 7: Further Information

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