



Annual Report 2008

ANNUAL REPORT 2008

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- 0 Less than half of the unit used.
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I Objectives and policy

The main objective of monetary policy is price stability. The Act on the Central Bank of Iceland (no. 36/2001, cf. also the amendments contained in Act no. 5/2009) stipulates that the Bank's primary objective is to promote stable price levels. By agreement with the Prime Minister, the Bank is authorised to declare a numerical inflation target. In the joint declaration by the Government of Iceland and the Central Bank of Iceland on March 27, 2001, an inflation target was set for the Bank; that is, a rate of inflation, measured as the twelve-month increase in the CPI, of as close to 2½% as possible.¹ Furthermore, the Act states that the Central Bank shall promote the implementation of the economic policy of the government as long as it does not regard this policy to be inconsistent with its main objective of price stability. The Bank shall also undertake such tasks as are consistent with its role as a central bank, such as maintaining external reserves and promoting an efficient and secure financial system, including payment systems domestically and with foreign countries. In other words, the Bank shall address tasks concerning financial stability. The Act furthermore clarifies provisions on accountability, transparency of monetary policy, and the Bank's activities in general.

Monetary policy

Monetary policy implementation is based on the Central Bank's inflation forecast, made over a horizon of three years. The forecast is published in the Bank's *Monetary Bulletin*, which was issued three times in 2008. The Bank also publishes its own macroeconomic forecast and an in-depth analysis of economic and monetary developments and prospects, in addition to presenting its inflation forecast.

In accordance with the provisions of the Central Bank Act, the Board of Governors has laid down internal rules on the preparation, arguments for, and presentation of its monetary policy decisions.² At the beginning of 2006, the Bank adopted a formal calendar for its interest rate decisions. In 2008, there were six scheduled interest rate decision dates, three of which coincided with the publication of *Monetary Bulletin*. The Board of Governors reserves the right to change the policy rate between scheduled decision dates if necessary. Three extra interest rate decision dates were added in 2008 – one in March and two in October – bringing the total to nine for the year.

The Bank's main instrument is its policy interest rate; that is, the rate of interest on the liquidity facilities that it provides to credit undertakings through collateral loans. Auctions of collateral loans with a maturity of one week are held on a weekly basis.

The Central Bank sets a minimum reserve requirement for credit undertakings; the requirement is equivalent to 2% of specified liabilities with a maturity of two years or less.

1. The declaration was published in *Monetary Bulletin* 2001/2 and on the Bank's website. Minor changes were made to it in November 2005.

2. Published on the Central Bank website.

Financial stability

The Central Bank seeks to have a constant, clear overview of the position of credit institutions and financial markets and publishes regular analyses of factors pertaining to financial stability. These published analyses contain in-depth discussions of the macroeconomic and operational indicators of financial stability. Until 2004, the Bank published its financial stability analysis twice a year in *Monetary Bulletin*. In 2005 it launched *Financial Stability* as a separate report appearing once a year.

As authorised by law, the Central Bank has set rules on minimum liquidity of credit undertakings and on their foreign exchange balance. In 2006, the Board of Governors announced a decision defining the Central Bank's financial stability functions.³

In special circumstances, when the Central Bank deems it necessary in order to preserve confidence in the domestic financial system, it is authorised by law to issue guarantees to credit institutions experiencing liquidity difficulties, or to grant them loans other than those classified as regular facilities. In addition, the Central Bank promotes an efficient and secure financial system by developing Icelandic payment and settlement systems in line with internationally recognised standards. The Central Bank cooperates on financial stability issues with the Financial Supervisory Authority (FME) on the basis of a cooperation agreement made with reference to legislation on the Central Bank and on official supervision of financial operations.⁴ In 2006, a Memorandum of Understanding was also signed by the Office of the Prime Minister, Ministry of Finance, Ministry of Commerce,⁵ Financial Supervisory Authority, and Central Bank of Iceland, on consultation concerning financial stability and contingency plans.⁶

Other functions

By law, the Central Bank has the sole right to issue banknotes and coin. It maintains and invests Iceland's foreign reserves. The Bank cooperates and conducts business with international institutions in its field of activities, including serving as a financial agent with the International Monetary Fund on behalf of the State.

Accountability and transparency

No less than four times a year, the Central Bank is obliged by law to give a public account of its monetary policy; this account must also include monetary, exchange rate and foreign exchange developments, and the Bank's measures in these areas. The Central Bank is also required to issue an annual report in which it explains its activities in detail.⁷ The Central Bank strives to explain its activities to the fullest possible extent. This includes the assumptions underlying its

3. The decision is published on the Central Bank website. See also the discussion in Chapter IV.

4. The agreement is published on the websites of both institutions.

5. Now called the Ministry of Business Affairs.

6. The Memorandum of Understanding is published on the Central Bank website. For further discussion, see Chapter IV.

7. A list of Central Bank of Iceland publications in 2008 can be found in the appendix.

monetary policy decisions, its assessment of financial stability, and many other aspects of its activities. Transparency and accountability are also ensured with defined tolerance limits for the inflation target. This entails that, if inflation deviates by more than 1½ percentage points from the target, the Central Bank is obliged to submit a report to the Government explaining the reasons for the deviations from the target, how the Bank intends to react, and how long, in the Bank's estimation, it will take to reach the inflation target again. This report must be made public.

Over the course of 2008, the difficulties in Iceland's financial system and overall economy escalated, due to internal and external developments. The Central Bank prepared a contingency plan in case of financial crisis, both in work groups within and outside the Bank and with the assistance of foreign experts.

The króna depreciated sharply in the first quarter of the year, and in September it fell again, both before and after the failure of the three commercial banks.

The first to fall was Glitnir Bank hf., which became insolvent in early October, as a result of liquidity difficulties. Thus began the sequence of events that ended with the insolvency of Glitnir hf., Landsbanki Íslands hf., and Kaupthing hf. and the Financial Supervisory Authority's takeover of all three banks' operations.

The collapse of the banks more or less closed off their international activities, with the result that cross-border payment intermediation was transferred to the Central Bank and carried out primarily by the Bank for the remainder of the year. Payment systems and domestic payment intermediation were under strain but maintained full functionality, while cross-border payment intermediation was subject to difficulties because of actions taken by foreign authorities and banks.

In late November, the Icelandic Government and the International Monetary Fund (IMF) concluded an agreement aimed at restoring economic stability to Iceland. The objectives of the IMF programme were threefold: establishing exchange rate stability, achieving fiscal consolidation from 2010 onwards, and restructuring the banking system. The collaboration between Iceland and the IMF entailed a two-year loan facility in the amount of 2.1 billion US dollars. The loan, which is subject to quarterly review, is intended to support the economic programme for the restoration of economic stability, and is to be supplemented by 3 billion dollars in loans from other countries.

Because of the extraordinary circumstances that have developed, exchange rate stability is a key factor in the monetary policy devised jointly by the Icelandic Authorities and the IMF. A stable currency is the precondition for the establishment of price stability and the protection of indebted Icelandic households and businesses. In this way, exchange-rate-centred monetary policy also promotes overall financial stability.

During the year, the Central Bank took steps towards fortifying its foreign exchange reserves. The Bank engaged in discussions concerning currency swap agreements and direct borrowing with central banks, governmental authorities, and financial institutions in Europe and the United States. In May, currency swap agreements were concluded with three Nordic central banks.

Box I-1

The economic crisis: impact on Central Bank policy and operations

II Monetary policy and economic developments

At the beginning of the year, inflation was considerably above the Central Bank's inflation target, measuring 5.8%. Continuing labour market tension and escalating turmoil in the global financial markets signalled that the episode of relative exchange rate stability dating back to 2007 was coming to an end. Difficulties on the capital and currency markets mounted as the year progressed. Three major factors contributed to the currency problem. First, the current account deficit remained very large, necessitating capital inflows from abroad. In addition, Iceland's gigantic banking system had growing difficulty obtaining wholesale credit, which was critical for funding the current account deficit. Moreover, the stock of outstanding króna-denominated securities owned by non-residents, including the so-called Glacier bonds issued abroad, had become enormous. There was mounting unease among investors who had difficulty rolling over their króna positions. Rising risk premia on Icelandic financial institutions and strong domestic demand for foreign currency rendered the FX swap market virtually non-functional in March. The króna fell sharply against foreign currencies, and inflation soared in response. The Central Bank adopted various measures aimed at supporting the króna and containing inflation: it raised the policy rate, issued certificates of deposit to stimulate foreign exchange inflow into the market, and concluded currency swap agreements with other Nordic central banks.

The global financial crisis made its imprint on the markets

Interbank market turnover was quite limited in 2008, and price formation ineffective. The interest rate differential between FX-swap implied Icelandic rates and European interbank rates narrowed sharply, weakening the foundation of currency swap trading. The effect on the exchange rate of the króna was profound.¹ The króna market more or less dried up in the second quarter of the year. Interbank trading picked up again temporarily as the summer progressed, but after the banks failed, the króna market dried up again and remained virtually non-functional for the balance of the year. Unrest in the interbank market was not limited to Iceland, but the impact here was much stronger than in most other countries. As was the case elsewhere, heightened counterparty risk was the main reason for dwindling money market activity during the liquidity crunch. Banks were reluctant to lend to one another without collateral, yet at the same time, both banks and other financial companies were making every effort to safeguard and bolster their liquidity.

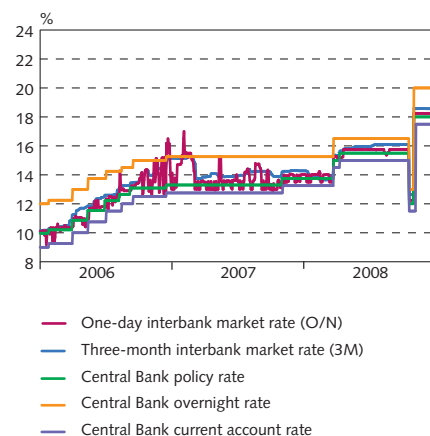
The króna depreciated before and after the banks collapsed

Following the failure of Iceland's largest banks in October, the primary channels for monetary policy transmission became largely

1. The high premia that the banks were required to pay on foreign base interest rates virtually cancelled out the interest rate differential that they had been able to offer on currency swap agreements, and no longer reflected the difference between interbank rates in krónur and foreign currencies. Furthermore, foreign investors were hesitant to hedge their positions through the money market because of increased counterparty risk.

Chart II-1
Interest rates in the interbank market and Central Bank policy rate

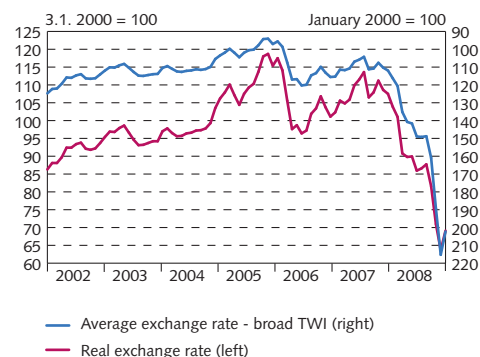
Daily data January 3, 2006 - December 31, 2008



Source: Central Bank of Iceland.

Chart II-2
Nominal and real effective exchange rate of the króna 2002-2008

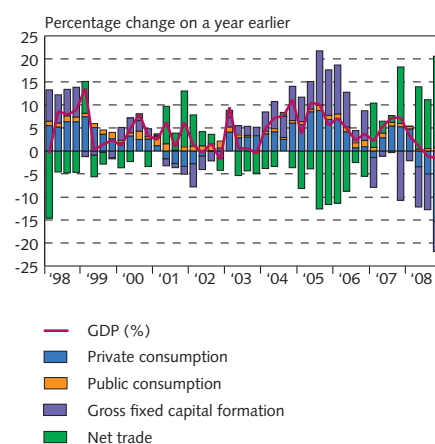
Monthly averages



Source: Central Bank of Iceland.

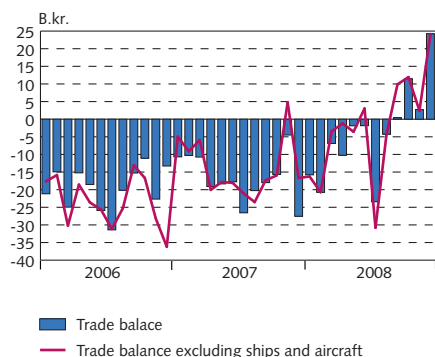
Chart II-3
Contributions to GDP growth 1998-2008

Quarterly data



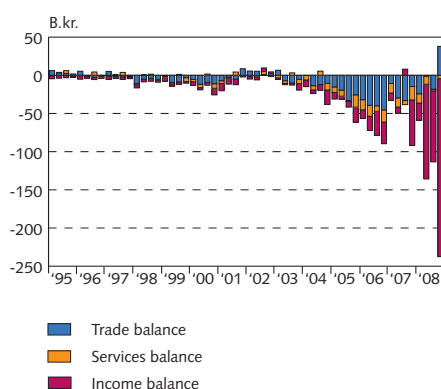
Source: Statistics Iceland.

Chart II-4
Trade balance 2006-2008
At fixed exchange rate



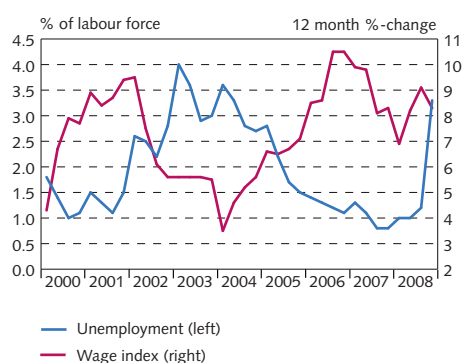
Sources: Statistics Iceland, Central Bank of Iceland.

Chart II-5
Components of current account 1995-2008
Net current transfer is included in factor income



Sources: Statistics Iceland, Central Bank of Iceland.

Chart II-6
Unemployment and wage index
Q1/2000 - Q4/2008



Sources: Directorate of Labour, Statistics Iceland.

non-functional. Cross-border payment intermediation was seriously affected, and the exchange rate of the króna plummeted. In order to prevent shortages of essential goods, it became necessary to instruct the banks to prioritise foreign exchange transactions in accordance with the October 10 statement from the Board of Governors of the Central Bank. In order to facilitate trade, the Central Bank conducted limited currency transactions with the banks at an exchange rate that implied considerable excess demand for foreign currency. As a result, an informal offshore foreign exchange market developed alongside the official market, with an exchange rate considerably below the official listing. This situation continued until the beginning of December, when the interbank foreign exchange market commenced operation again, which occurred as the foreign exchange restrictions on general transactions were lifted and replaced with capital account controls. The capital controls are to be lifted in stages.

By December, the exchange rate of the króna was over 42% lower than the previous January. As a result, the real exchange rate fell to a record low in 2008 and was far below long-term equilibrium levels. In November, at its lowest point, the real exchange rate was more than 34% below the average since 1980. Inflation soared after the banking and currency crisis struck, driven by cost hikes fuelled by the weaker króna. By year-end, inflation had reached 18%.

Correction underway before the banking collapse

Indicators imply that the economic contraction had already begun by the time the banks failed. In Q3/2008, GDP contracted by 0.8%. Private consumption growth remained brisk in the first months of 2008 but abruptly turned negative in the second quarter. The depreciation of the króna, declining purchasing power, limited access to credit, growing debt service, and falling asset prices contributed to the deterioration. The downturn in residential and general business investment gained momentum as well. The banking and currency crisis at the beginning of the fall sharpened the impact of all these factors on the Icelandic economy.

External trade tempers GDP contraction

Declining imports and strong exports offset the contraction in GDP, however. Exports grew rapidly with increased production capacity at the Fjarðaál aluminium smelter, rising by one-fifth year-on-year. The contraction in imports accelerated as the year progressed, in line with the decline in domestic demand. The trade deficit reversed and a surplus developed in the third quarter; however, the current account deficit widened year-on-year, as the income account deficit grew due to negative returns on residents' outward foreign direct investment and losses on equity holdings.

Rapid turnaround on the labour market

Businesses responded sharply to the financial crisis, although signs of a change in the labour market climate had begun to emerge before the fall of the banks. Unemployment hit 4.8% by December, after having held steady at around 1% since year-end 2006. In another sign

of growing labour market slack, the wage index fell for the first time since the compilation of statistics began. At the same time, mounting inflation eroded real wages as the year progressed. By Q4, the year-on-year contraction in real wages measured 7.5%, the sharpest such contraction since 1990.

Inflation driven by ISK depreciation

Inflation mounted steadily throughout 2008, topping 18% in December and averaging 12.4% for the year, its highest level since the early 1990s. The surge in inflation is attributable largely to the depreciation of the króna but was offset somewhat by the drop in global commodity prices and a rapidly cooling real estate market in the latter half of the year.

Real policy rate near zero at year-end

The primary task of monetary policy in the early part of the year was to ensure that economic adjustment could take place without causing a lasting inflation problem. The policy rate was raised by 1.25 percentage points in March and by another 0.5 percentage points in April, bringing it to 15.5%, in a bid to contain the falling exchange rate and control inflation and inflation expectations. As a response to the currency crisis, the Board of Governors of the Central Bank lowered the policy rate to 12% but raised it to 18% soon thereafter, in connection with the economic stabilisation plan prepared by the Government and the International Monetary Fund. In spite of a high nominal rate, the real policy rate at year-end was close to zero in terms of past inflation, and quite low in terms of business and household inflation expectations.

Monetary policy aims to support the króna and reduce exchange rate volatility

Following the collapse of the banking system, the main emphasis of monetary policy was to promote exchange rate stability and a stronger króna, as a stable exchange rate is a precondition for rapid disinflation. In order to achieve this objective, the Central Bank has intervened moderately in the foreign exchange market and significantly limited the banking system's access to its collateralised loan facilities. The temporary capital account restrictions serve the same purpose. Because the authorities plan to lift the capital controls over the next two years, interest rate decisions must provide owners of króna-denominated bonds and deposits and with sufficient incentive to continue owning them when the restrictions are removed.

The Central Bank grants liquidity facilities to financial undertakings in accordance with the provisions of rules pertaining thereto. At year-end, such facilities were subject to the provisions of the Rules on Central Bank Facilities for Financial Undertakings, no. 808, dated August 22, 2008. Financial institutions have the option of requesting overnight loans or seven-day loans (referred to as collateral loans) against collateral that the Central Bank deems eligible. Seven-day loans are granted on Wednesdays. In 2008 such lending increased steadily, and the Central Bank became the financial undertakings'

Chart II-7
Components of CPI inflation
Contribution to inflation 2004-2008

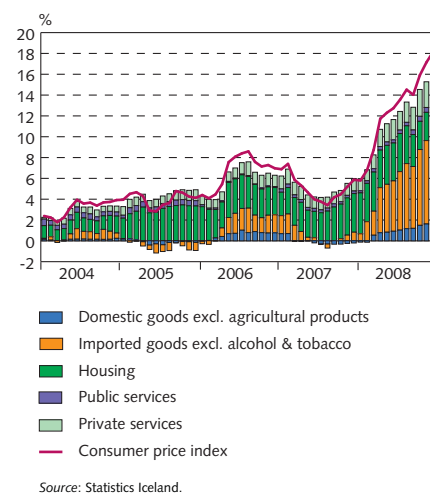
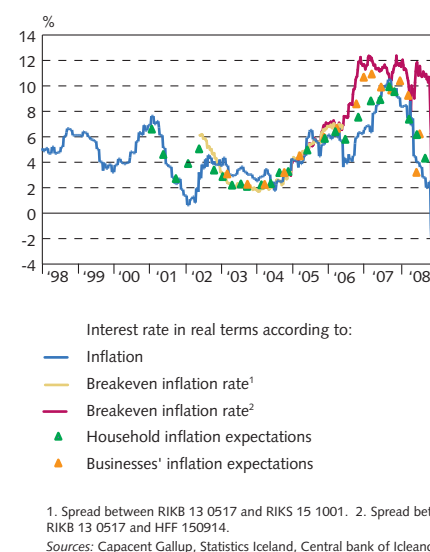


Chart II-8
Central Bank policy interest rate in real terms
Weekly data January 7, 1998 - December 30, 2008



Box II-1

Developments in collateral loans and balance upon the banks' collapse

main source of liquidity. This was due primarily to limited interbank market trading, lack of trust among market participants, and the Central Bank's issuance of certificates of deposit, beginning with a 75 b.kr. issue in March. At year-end 2007, the balance of collateral loans stood at 302 b.kr., its highest point until that time. Collateral loans peaked on October 1, 2008, just before the collapse of the banks, when the Central Bank loaned 520 b.kr. to financial institutions.

At the time the banks failed, nearly 42% of the collateral for Central Bank collateral loan facilities took the form of Treasury-guaranteed securities or asset-backed securities. Some 58% of the underlying collateral consisted of bonds issued by Glitnir, Kaupthing, and Landsbanki. After the collapse of the banking system, the outstanding balance of collateral loans declined because of the fall of the large commercial banks. At year-end, the Treasury took over the Central Bank's claims against the financial institutions that had used unsecured bank bonds to obtain Central Bank liquidity facilities. The Central Bank's outstanding collateral loans totalled 292 b.kr. at the end of 2008.

Table II-1. Outstanding Central Bank collateral loan facilities

<i>Balance on October 1, 2008</i>	<i>B.kr.</i>
Unsecured bonds *	303,365
Covered bonds	140,960
Treasuries and HFF bonds	54,981
Asset-backed securities	13,577
CBI certificates of deposit	7,524
Total	520,407

* Unsecured bonds are bonds issued by the old banks - Glitnir, Landsbanki, and Kaupthing. the bonds are not backed by a particular portfolio.

As of October 6, 2008, financial undertakings owed the Central Bank 53 b.kr. in overnight loans, and 56% of the underlying collateral was in unsecured bonds issued by the commercial banks.

Box II-2

Amendments to the Rules on Central Bank Facilities for Financial Undertakings in 2008

The Rules on Central Bank of Iceland Facilities for Financial Undertakings were amended in January 2008. The review of the Rules took account of comparable rules set by other central banks, including the European Central Bank and the central banks in the other Nordic countries. The amendments made in 2008 to the Rules on Central Bank of Iceland Facilities for Financial Undertakings aimed at allowing financial undertakings to use a greater variety of secured instruments as collateral for collateral loans and overnight loans from the Central Bank. The principal changes from the version of the Rules that took effect in mid-2007 were as follows:

- Bonds issued in US dollars, pounds sterling, or euros were deemed eligible as collateral. Foreign-denominated bonds could not exceed 50% of the total value of collateral.
- Covered bonds issued in Icelandic krónur and backed by housing bond portfolios were deemed eligible as collateral. Financial undertakings were permitted to use their own covered bonds.

Minor amendments were made in April, and in August the Rules were amended once again. The chief amendments made in August were as follows:

- Asset-backed securities were accepted as collateral for overnight loans and seven-day collateral loans. It was not specified what assets must lie behind securities offered as collateral; instead, each was examined individually to determine its eligibility. The securities could be denominated in Icelandic krónur, US dollars, euros, or pounds sterling.
- Covered bonds were not limited to securities backed by housing bond portfolios; other assets were considered as well.
- Foreign-denominated securities could constitute up to 70% of the total collateral value.
- Limitations were set on the amount of unsecured bonds issued by domestic financial institutions a financial undertaking could submit as collateral. The underlying market value of the assets in unsecured bonds issued by domestic financial companies could range up to 50%. This requirement was to be fulfilled in stages: 90% as of September 1, 80% as of October 1, and so on, until January 1, 2009, when the 50% limit was to be reached.

III The financial system

Financial companies

In performing its mandatory role of promoting an efficient and safe financial system, including payment systems domestically and with foreign countries, the Central Bank of Iceland focuses on assessing the risk of illiquidity among financial companies and the risk of problems in payment and securities settlement systems that could be systemically important. It also promotes the efficiency and positive development of the financial system. In its work, the Central Bank has taken into account international agreements and other standards for best practice, as well as considering the work of other central banks in this field. The Central Bank cooperates closely with the Financial Supervisory Authority (FME) on financial stability tasks, on the basis of an agreement between the two institutions.¹ In view of the increasing prevalence of Nordic banks with cross-border establishments, the central banks of the five Nordic countries have signed a Memorandum of Understanding (MoU) on financial crisis management.

In broad terms, financial stability hinges upon the stability of the key institutions and markets that make up the financial system. This requires (1) that the key institutions in the financial system be stable – that is, that there be a high degree of confidence that they can continue to meet their contractual obligations without interruption or outside assistance; and (2) that the key markets be stable, so that participants can transact in them confidently, at prices that reflect fundamental market forces and do not vary substantially over short periods in the absence of changes in fundamentals.

The global financial crisis

The financial crisis currently sweeping the globe traces its origins to the summer of 2007, when the US housing bubble burst and the weaknesses and extravagance embedded in the sub-prime mortgage market came to the fore. Defaults on sub-prime mortgages increased steadily, and in the summer of 2007 the leading credit rating agencies lowered their ratings of financial instruments containing sub-prime loans. Banks on both sides of the Atlantic sustained losses as a result. The financial system's problems were not limited to a glut of sub-prime lending, however. Abundant liquidity, historically low interest rates, and substantial flow of capital to the US and other countries had stimulated growing risk appetite, rising indebtedness, and the development of complex and non-transparent structured securities.

The unrest in the financial markets mounted throughout 2008. Real estate prices continued to fall, undermining GDP growth in the US and elsewhere. This compounded the uncertainty about financial institutions' ability to withstand a challenging economic climate.

1. The new banks are New Glitnir hf., New Kaupthing Bank hf., and NBI hf.

Investors and creditors lost confidence in certain financial companies, which made it difficult for those companies to finance their activities. Among the hardest hit were US government-backed mortgage lenders Fannie Mae (Federal National Mortgage Association, FNMA) and Freddie Mac (Federal Home Loan Mortgage Corporation, FHLMC), the investment bank Lehman Brothers, and American International Group (AIG), the largest insurer in the US. But the financial crisis was not limited to financial institutions in the United States. Banks and financial companies all over Europe experienced serious problems as well. In the UK, for example, the government took over mortgage lender Northern Rock and acted as an intermediary in Lloyds TSB's emergency takeover of HBOS; and Bradford & Bingley, one of Britain's largest mortgage lenders, was nationalised when market conditions proved insurmountably difficult. Germany's second-largest lender, Hypo Real Estate, was granted a government loan to avert bankruptcy. Belgium's largest bank, Fortis, was saved from difficulties when the Belgian government acquired a 49% stake in the Belgian part of the bank, the Dutch government acquired a similar holding in the Dutch part, and the Luxembourgian authorities granted a loan to Fortis in Luxembourg. A number of other financial companies across Europe also experienced difficulties, including firms in Denmark, France, and Ireland.

The Central Bank's Financial Stability report

At the beginning of May 2008, the Central Bank published its 2008 *Financial Stability* report, which included a detailed analysis of the status and outlook for the financial system. The report pointed out vulnerabilities but also identified elements that tended to strengthen the system. The Central Bank's analysis, which bore the title, "Current conditions test the banks' resilience," stated that the system was considered broadly sound but that contingency measures were needed. The chief risk factors were a vulnerable foreign exchange market and limited access to capital, which represented a short-term risk. For the longer term, vulnerabilities centred rather on the effects of higher cost of capital and the risk of erosion of asset quality. *Financial Stability* 2008 reported that the banks' capital ratios were satisfactory, their performance strong from broad-based operations, and their assets diversified. Their liquidity was deemed satisfactory, but it would be put to the test in 2008. And the result of that test was that the banks' resilience proved insufficient.

The report included a detailed analysis of the quality of the banks' loan portfolios. Although the conclusion was that the banks were well prepared to face rising default and loan losses at that time, particular attention was drawn to the fact that the previous year had seen increases in the ratio of large exposures to capital and in the proportion of holding companies among borrowers. The report emphasised that there was good reason to scrutinise this development closely. The Central Bank had pointed this out in earlier reports as well. For the near term, the banks' most critical task was to guarantee access to foreign credit and reduce their borrowing requirement. The confidence of investors and depositors was also vital to their success. It was deemed

unlikely that conditions in the international markets would improve to any dramatic extent in the near future, and when they did, investors would undoubtedly demonstrate more caution and conservatism than they had previously. In addition to this, the report shed light on the banks' enormous re-financing needs in the next few years.

Turning point in domestic financial operations

As is well known, the US investment bank Lehman Brothers became insolvent in mid-September 2008. The US authorities decided not to rescue Lehman, and the ensuing failure of the bank profoundly affected financial stability all over the globe. The unrest that had characterised the global financial markets since the summer of 2007 escalated sharply, and trust between financial institutions vanished. As a result, liquidity sources dried up, with unforeseen consequences for Iceland's commercial banks. The liquidity shortage experienced by Glitnir in the fall of 2008 set off a chain reaction, and by early October the three largest commercial banks had become insolvent (a more detailed description of this sequence of events can be found in the Economic and Monetary Chronicle in the Appendices of this report). On the basis of the newly passed emergency legislation, Act no. 125/2008, the Financial Supervisory Authority intervened in the operations of the banks and appointed resolution committees, which assumed all of the authorisations previously held by the banks' boards of directors. Thereafter, new banks were established for domestic assets and liabilities, and domestic banking activities continued within these new banks. By year-end, the old commercial banks had been granted moratoria on payment. Because the new banks' operations are limited to domestic activities, their assets are far less than they were before the old banks failed. In mid-November 2008, the total assets of the new banks amounted to 2,886 b.kr., some 74% less than those of the parent companies of the old banks in August 2008.²

Payment and settlement systems

Payment intermediation and payment systems are the part of the economic infrastructure involving the transmission of capital from payer to recipient. Icelandic payment intermediation extends to all individuals, employment sectors, and public entities, and it can occur across borders and currency zones. Payment intermediation takes place through centralised payment systems, with the assistance of the financial institutions that are members of the systems. In Iceland, three key systems are classified as systemically important for the Icelandic economy: the Central Bank of Iceland's real-time gross settlement (RTGS) system, the netting system operated by Fjölgreidslumidlun hf. (FGM), and the securities settlement system operated by the Icelandic Securities Depository (ISD). Systemic oversight and supervision are carried out at the Central Bank, which sets requirements concerning security and efficiency and ensures that payment and settlement systems meet domestic and international standards. The Financial

2. The new banks' total assets according to preliminary figures from FME on the banks' initial balance sheets, dated November 14, 2008.

Supervisory Authority ensures that individual participants in payment systems – that is, banks and savings banks – meet set requirements. The Icelandic Banks' Data Centre (RB) provides software services and oversees hosting. Furthermore, the Central Bank acts as an intermediary for final settlement between financial institutions, as well as handling RTGS system operations and overseeing the activities of all of the above-mentioned systems.

The Central Bank requires that Icelandic payment and settlement systems be able to withstand comparison with systems in other countries. Payment systems are expected to fulfil the Bank for International Settlements' (BIS) 10 Core Principles for Systemically Important Payment Systems, and the securities settlement system is expected to comply with the CPSS/IOSCO recommendations for securities settlement systems. Furthermore, it is emphasised that Icelandic payment intermediation and payment systems meet the requirements set forth in European Union directives on payment intermediation, as well as complying with the Icelandic regulatory framework. The Central Bank attempts to keep abreast of developments in these fields, both in Iceland and abroad.

RTGS system

The RTGS system settles payment orders in amounts of 10 m.kr. or more (in the interbank market). It is operated from 9:00 to 17:00 on regular banking days. In addition to conventional payment orders in amounts of 10 m.kr. or more, the RTGS system handles final settlement for the netting and securities settlement systems.

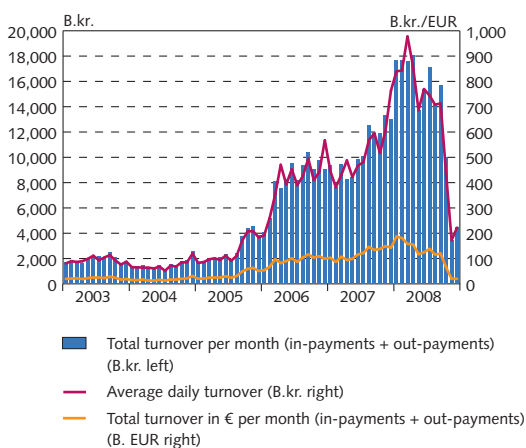
The chart shows monthly turnover in the RTGS system from 2002 to the end of 2008. Monthly turnover (both deposits and withdrawals) declined from 12,987 b.kr. in December 2007 to 4,444 b.kr. in December 2008, a year-on-year drop of 65%. Daily average turnover per month, calculated in the same manner, fell correspondingly over the same period, from just under 764 b.kr. to 222 b.kr. Average turnover in 2008 (deposits and withdrawals) totalled nearly 13,748 b.kr. per month and roughly 663 b.kr. per day, up from an average of 10,475 b.kr. per month in 2007.

After remaining unchanged for years, the number of RTGS system participants increased in 2008, when four Icelandic financial institutions applied for and were granted membership, bringing the total number of participants to 10, including the Central Bank. At year-end 2008, RTGS system participants other than the Central Bank were as follows: New Glitnir Bank, NBI, New Kaupthing Bank, Reykjavík Savings Bank (SPRON), Sparisjóðabankinn – Icebank, Byr Savings Bank, Saga Capital, Straumur-Burðarás, and MP Bank. Thus participation in Icelandic payment intermediation underwent a number of changes during the year, as New Glitnir, NBI, and New Kaupthing Bank took over from their predecessors, and Byr, Saga Capital, Straumur-Burðarás, and MP Bank became members of the system.

User fees for the RTGS system were reviewed in December 2008, and it was decided to keep the tariff unchanged for 2009.

Participants are allocated an authorised intraday overdraft limit on their RTGS system accounts; however, they must submit full collateral

Chart III-1
RTGS system turnover



Source: Central Bank of Iceland.

for their overdraft limits. RTGS system collateral totalled 19.3 b.kr. at year-end 2008. The Central Bank publishes a summary of available collateral and its appraised value. The value of payment system collateral declined after the banks failed in the fall of 2008. In order to gain the necessary flexibility to respond to this problem, the Central Bank issued an amendment to Article 16 of its Rules no. 312/2007, which specifies the securities that are eligible as collateral for RTGS system overdrafts. The amendment afforded the Bank the margin to respond to difficulties by authorising the Board of Governors to accept other RTGS system collateral than that previously specified, thereby maintaining payment intermediation functionality.

The Central Bank Rules on the Real-Time Gross Settlement System were reviewed at year-end 2008. The new Rules, issued early in 2009, can be found on the Bank's website (www.sedlabanki.is).

Netting system

The netting system is owned and supervised by Fjölgreidslumidlun (FGM). It is hosted and maintained by the Icelandic Banks' Data Centre (RB), as the RTGS and netting systems are based on the same computer system. Although the Central Bank has participated actively in developing and supervising the netting system, day-to-day operations and service to participants have been transferred increasingly to FGM.

Turnover in the FGM netting system totalled just over 2,917 b.kr. in 2008, up from 2,776 b.kr. the year before. Year-on-year increases in netting system turnover amounted to 5% between 2007 and 2008, and 11% between 2006 and 2007. A record was set in October 2008, when monthly turnover reached 300 b.kr. for the first time.

At year-end 2008, the following financial undertakings were FGM netting system participants: Byr Savings Bank, Sparisjóðabankinn – Icebank, MP Bank, New Glitnir Bank, New Kaupthing Bank, the Central Bank of Iceland, and Reykjavík Savings Bank (SPRON). New members in 2008 were MP Bank and Byr.

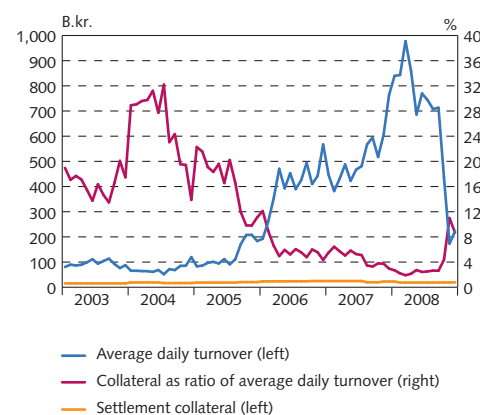
The netting system is based on netting accounts in which participants generate a credit or debit balance with one another until final settlement takes place through the Central Bank of Iceland's RTGS system. In order to guarantee smooth settlement, even though a given participant may be faced with liquidity or capital adequacy problems, collateral is submitted for the maximum debit balance that each participant may establish vis-à-vis other participants in the system. Netting system collateral totalled 5.2 b.kr. at year-end 2008.

The netting system tariff was reviewed in May 2008 and a three-tiered transaction fee system implemented, with fees ranging from 2.50 kr. to 2.80 kr. per transaction, depending on volume. After the new tariff took effect, the average transaction fee was 2.70 kr., as opposed to a fixed charge of 2.65 kr. prior to the change. Further information on the netting system and its tariff can be found on the FGM website (www.fgm.is).

Settlement of netted balances between participants takes place in the RTGS system at 08:30 and 17:00 on regular banking days.

The netting system is subject to the provisions of Central Bank Rules no. 313/2007. The Rules were reviewed in late 2008 and re-

Chart III-2
Average daily turnover in the RTGS system and settlement collateral 2003-2008



Source: Central Bank of Iceland.

sued at the beginning of 2009. Further information can be found on the Central Bank website (www.sedlabanki.is).

Securities settlement system

The Icelandic securities settlement system is operated on the basis of a cooperation agreement concluded by the Central Bank, ISD, and the NASDAQ OMX Nordic Exchange. It includes all institutional arrangements for trade confirmation, determination of rights and obligations, clearance and settlement of securities trades, and custody of securities.

Equity transactions are settled according to a T+3 cycle; that is, settlement and delivery take place three days following the purchase or sale. Bond trades are settled according to a T+1 cycle, with settlement and delivery occurring on the morning of the banking day immediately following the trade. The final settlement of the above transactions takes place in the RTGS system once a day, at 8:00 on banking days.

The agreement between the Central Bank and ISD concerning securities settlement arrangements and new rules of procedure for settlement was reviewed in late 2008. It is planned to move securities settlement back by four hours so that it will take place within the RTGS system's hours of operation, with the aim of giving investors greater scope to acquire securities on the day of settlement. A new agreement, new rules of procedure, and securities settlement during the business day are to be implemented in the first quarter of 2009.

Improvements to system security are always being sought. Changes have been made in order to support delivery versus payment (DvP). The first phase was completed in the spring of 2008, and it is assumed that the changes will be fully implemented in early 2009, parallel to the changes planned for the settlement structure.

The system was expanded with the aim of enabling it to support settlement in euros. It was planned that the Bank of Finland would facilitate final settlement in euros, with implementation scheduled for the fall of 2008, but the project was postponed. An appraisal of the securities settlement system was also postponed in the fall of 2008 owing to the financial crisis.

Total volume in the securities settlement system rose by 82% from 2006 to 2007, and by 95% between 2007 and 2008. Total volume for 2008 amounted to 4,501 b.kr., or an average of 375 b.kr. per month. Volume was highest during the first half of the year but contracted sharply in the last three months, totalling 253 b.kr. in October, 74.6 b.kr. in November, and 144 b.kr. in December. The number of transactions fell by 14% between 2007 and 2008, however. Transactions in the securities settlement numbered some 108,000 in 2008; 125,000 in 2007, and 122,000 in 2006. These figures do not include off-exchange transactions that were not routed through the ISD system.

Payment instruments

Cash in circulation

At the end of 2008, notes and coin in circulation outside the Central Bank amounted to 24.4 b.kr., up from 15.7 b.kr. year-on-year. This

substantial (55.4%) increase is largely attributable to the financial crisis, which struck in the fall of 2008. Demand for banknotes and coin grew substantially afterward, peaking in October with nearly 29 b.kr. in circulation.

Cheques and payment cards

Cheque and debit card turnover declined between 2007 and 2008, while credit card turnover rose 10% year-on-year, totalling nearly 311 b.kr. in 2008, as opposed to 282 b.kr. in 2007. Debit card turnover, however, contracted by 5.4% year-on-year to 410 b.kr., down from 433 b.kr. in 2007. Nonetheless, October saw a 9.4 b.kr. month-on-month surge in debit card use, attributable largely to increased turnover at bank cashiers' desks, where the average withdrawal per transaction appears to have been higher than in the average month. The year's contraction in debit card turnover would presumably have been even sharper, or about 8%, without the spike in October.

Cheque transaction volume has declined steadily. Thus it dropped from 162 b.kr. in 2007 to 126 b.kr. in 2008, a decrease of 22.3% between years.

According to the Central Bank's records from December 2008, active cards in the country included 251 thousand debit cards and 237 thousand credit cards. This is a slight reduction from December 2007.

Responses to the financial crisis

Payment systems and domestic payment intermediation withstood the strain stemming from the crisis that began when the banks collapsed in early October 2008. Over the past few years, the Central Bank of Iceland has collaborated with the owners and operators of the various payment systems – Fjölgreiðslumidlun, the Icelandic Securities Depository, and the Icelandic Banks' Data Centre – on measures to reinforce the infrastructure of payment intermediation and payment systems. Collateral, locks, and other security measures incorporated into the systems over the past several years enabled them to remain fully operative in spite of the enormous strain accompanying the October crisis. These measures minimised counterparty and settlement risk in the systems, thereby ensuring their operability in the face of serious difficulties. They proved very successful, as were the emergency measures adopted in the wake of the banks' failure.

Although domestic payment intermediation continued to function smoothly, the same cannot be said of cross-border payment intermediation, which seized up when the three commercial banks became insolvent. The only remaining cross-border payment intermediation activities were those handled by the Central Bank itself and those carried out by Sparisjóðabankinn (Icebank) for the savings bank system. The Central Bank immediately took over payment intermediation for the new commercial banks, but it took time to solve many of the problems that arose.

When the banks failed in the beginning of October, their foreign bank accounts were closed, as were their means of intermediating payment to and from Iceland. Substantial uncertainty ensued and

distrust of Iceland escalated sharply, making foreign banks reluctant to send payments to Iceland for fear that they would be frozen en route. The Freezing Order imposed by the British authorities on the basis of the Anti-Terrorism, Crime and Security Act of 2001 did nothing to improve matters; indeed, it rendered the situation much more grave than necessary, not least because the original Freezing Order included not only Landsbanki but also mentioned the Treasury, the Financial Supervisory Authority, and the Central Bank of Iceland. Even though the UK authorities later specified that the assets of Icelandic entities other than Landsbanki were not affected by the Freezing Order, the direct and indirect damage resulting from this action by the UK authorities was enormous. The impact was not limited to British banks, nor was it restricted to payment intermediation in pounds sterling. A large number of European banks outside the UK refused to fulfil and execute legitimate payment orders, irrespective of currency or origin of payment. Numerous innocent Icelandic companies and individuals were thus turned into defaulters, with the concomitant cost and damage to their reputation.

IV Various Central Bank activities

Foreign reserves

The Act on the Central Bank of Iceland stipulates that one of the Bank's functions is to maintain Iceland's foreign reserves. Accordingly, the Board of Governors sets rules on management of the reserves, and the rules are approved by the Supervisory Board. Foreign reserves comprise the Central Bank's holdings of foreign securities, deposits in foreign banks and money market funds, gold, Special Drawing Rights (SDRs), and the reserve position at the International Monetary Fund (IMF). SDRs refer to the Bank's position in its SDR account at the IMF.

The Board of Governors sets rules for the investment of the reserves. Funds may be deposited in international financial institutions and invested in money market funds and listed securities issued by entities in member countries of the Organisation for Economic Co-operation and Development (OECD). Issuers can be sovereigns, local governments, state enterprises, international organisations and financial institutions. A minimum rating of A+/A1/A1 from recognised rating agencies (Moody's/S&P/Fitch) is required for long-term securities. Short-term securities require minimum ratings of A-1/P-1/F-1, respectively, from the same agencies. The same demands are made towards deposit-taking institutions. Under the rules set by the Board of Governors, the bulk of the reserves are invested in securities with a lifetime of more than one year, but a share of the reserves must be held in sight accounts. The average duration of securities and deposits in foreign reserves may not exceed five years. The Bank's gold reserves amounted to just over 63.8 thousand ounces at the end of 2008. The gold is held in the Bank of England and may be loaned against gold or US dollar interest rates.

The Central Bank has made agreements for short-term credit facilities with foreign banks and can use these agreements to strengthen the foreign reserves when necessary. At year-end 2008, the Bank's committed credit lines with the Bank for International Settlements (BIS) amounted to 100 million US dollars (approximately 12.1 b.kr.), after having been augmented by 25 million dollars during the year. The Bank also had access to currency swap agreements with the central banks of Denmark, Norway, and Sweden, each in an amount corresponding to 500 million euros. Moreover, the Bank has access to repurchase agreements with foreign entities, under which foreign securities are used as collateral for liquidity facilities.

The Bank's foreign reserves increased by roughly 266.6 b.kr. in 2008 and amounted to 429.4 b.kr. at year-end, due to the substantial depreciation of the króna and borrowing by the Central Bank to strengthen the reserves. A portion of the reserves was used in the latter half of the year for the Central Bank's foreign exchange auctions, as well as other FX transactions that became necessary when the three banks that had constituted the foreign exchange market were granted moratoria on payment. At that point, nearly all of Iceland's

Table IV-1. Returns on investment of Central Bank foreign reserves

	2004	2005	2006	2007	2008
<i>US dollar</i>					
Interest income (%)	3.74	3.84	4.06	4.34	3.17
Price gain/loss (%)	-1.99	-2.35	0.01	2.74	4.21
Total return on securities (%)	1.75	1.49	4.07	7.08	7.38
Average maturity at year-end	2.64	2.33	2.09	2.40	2.12
MSCI 1-3-year index (%) ¹	0.91	1.66	3.95	7.34	6.70
Average maturity at year-end	1.65	1.69	1.70	1.66	1.77
MSCI 3-5 year index (%) ¹	2.12	0.86	3.50	9.83	12.21
Average maturity at year-end	3.66	3.52	3.52	3.62	3.84
Time deposits (%)	1.37	3.16	4.93	5.09	1.97
LIBOR (annual average) (%)	1.34	3.20	4.96	5.10	2.27
<i>Euro (EUR)²</i>					
Interest income (%)	3.59	3.33	3.67	4.27	4.37
Price gain/loss (%)	1.75	-0.46	-2.55	-1.84	1.59
Total return on securities (%)	5.34	2.87	1.12	2.42	5.96
Average maturity at year-end	3.31	2.80	3.52	2.96	2.50
MSCI 1-3-year index (%) ¹	3.21	2.16	1.80	3.83	6.94
Average maturity at year-end	1.61	1.73	1.81	1.70	1.78
MSCI 3-5 year index (%) ¹	5.62	2.91	0.62	3.37	8.76
Average maturity at year-end	3.47	3.50	3.56	3.56	3.61
Time deposits (%)	2.02	2.08	2.82	3.86	4.08
LIBOR (annual average) (%)	2.05	2.09	2.83	3.87	3.87
<i>Pound (GBP)</i>					
Interest income (%)	5.58	5.50	5.01	5.51	4.51
Price gain/loss (%)	0.09	0.15	-2.86	0.68	4.41
Total return on securities (%)	5.67	5.65	2.15	6.18	8.92
Average maturity at year-end	3.31	2.95	2.22	2.23	2.07
MSCI 1-3-year index (%) ¹	4.66	4.90	3.07	7.48	9.18
Average maturity at year-end	2.05	1.51	1.79	1.75	1.92
MSCI 3-5 year index (%) ¹	5.15	5.62	1.48	7.54	11.80
Average maturity at year-end	3.53	3.36	3.38	3.42	3.36
Time deposits (%)	4.31	4.66	4.70	5.58	4.71
LIBOR (annual average) (%)	4.37	4.67	4.66	5.58	4.74

1. For the year 2007 and 2008 returns according to indices reflect the Bloomberg/EFFAS Government Bond Index, which is comparable to the MSCI.

2. Euro reserves 1 and 2 are weighted together.

foreign currency flows were routed through the Central Bank's foreign bank accounts. In addition, a Treasury bond issue amounting to 150 m. euro was paid up at maturity during the year. The combined total of foreign reserves, committed credit lines, and access to swap agreements amounted to 606.9 b.kr. at year-end. At that time, a committed credit line from BIS was in use, and the Central Bank had exercised a portion of the swap agreements with the Nordic central banks. Since 2006, three facilities have been put in place in order to strengthen the foreign reserves. In 2006 the Treasury issued a Eurobond amounting to 1 billion euros under the European Medium-Term Note (EMTN) Program. In the latter half of 2008, two facilities were put in place: a syndicated loan for 300 million euros and a Stand-By Arrangement from the International Monetary Fund (IMF) for 560 million SDRs.¹

1. SDRs are composed of US dollars (44%), euros (34%), pounds sterling (11%), and yen (11%).

The currency composition of the net foreign balance is adjusted with the aim of minimising risk. The Central Bank's net foreign balance is its foreign-denominated assets net of foreign-denominated liabilities. Currency composition of the Central Bank's foreign reserves is regularly reviewed and confirmed in the Board of Governors' rules of procedure. According to the Board of Governors' rules of procedure, the weight of currencies in the foreign reserves for the year 2008 was as follows: US dollars 35%, euros 45%, pounds sterling 15%, and yen 5%.

Return on investment of reserves by currency

2008 was an extraordinarily difficult year in the financial markets. Share price indices all over the globe fell by dozens of percentage points. Investor risk aversion rose sharply, and prices dropped on financial products without guarantees from the world's most stable governments. House prices plunged on both sides of the Atlantic. Treasuries and central banks in Europe and the United States poured money into the capital markets in an attempt to stimulate the global economy, and the largest central banks quickly reduced their policy interest rates while relaxing the eligibility requirements for collateral for loan agreements with the banking system. At this writing, the policy interest rates in the US and the euro area are at an all-time low, and the Bank of England's bank rate is at its lowest point since the 17th century. Several of the world's best-known financial institutions became insolvent during the year, while others were nationalised and still others have received emergency loans from governments and central banks in order to avert bankruptcy.

Table IV-1 shows the return on investment of the individual currencies comprising the foreign reserves over the past five years. The MSCI Sovereign Bond Index is used as a benchmark in measuring investment performance of bond portfolios during the period 2004-2006, while the Bloomberg/EFFAS Government bond index is used for 2007 and 2008, as the MSCI Sovereign Bond Index is no longer updated and has been supplanted by the EFFAS index. Indices have been examined for government bonds with a maturity of 1-3 years, as well as those with a maturity of 3-5 years. The average duration of the Central Bank's portfolios lies between these figures but was closer to the one- to three-year indices in 2008. Returns on tied short-term investments are compared with LIBOR rates in the respective currency; deposits are generally very short-term investments. From mid-2008 onwards, the Central Bank greatly increased its emphasis on security in the investment of its liquid assets and directed its transactions in greater measure towards the central banks in Europe and the US instead of using the interbank market, owing to the extreme turbulence in the global financial markets and the collapse of the domestic banking system in the

Table IV-2. Comparison between portfolio returns and Lehman benchmark indices

	Returns 2008
US dollar	7.38%
Lehman Brothers benchmark	7.62%
<i>Difference</i>	-0.241%
Euro 1*	5.62%
Treasury issue Dec. 1, 2006	-25.49%
<i>Difference</i>	31.111%
Euro 2*	7.19%
Lehman Brothers benchmark	7.16%
<i>Difference</i>	0.031%
Sterling	8.92%
Lehman Brothers benchmark	8.86%
<i>Difference</i>	0.063%

* The euro reserves are divided into two parts. Euro 1 indicates the reserves that offset the obligations related to the December 1, 2006 issue. Euro 2 represents the euro reserves that are compared with the Lehman Brothers benchmark.

Table IV-3. Treasury long-term foreign debt maturing during the year retired

	Annual (millions)		Date of issue	Maturity date	Payment date
	Currency	ISK			
<i>Loan/bond maturing</i>					
Loan	150 EUR	18,360	12.05.2003	12.05.2008	12.05.2008

fall. After the banks failed, cross-border payment intermediation was routed through the Central Bank, which required that the Central Bank greatly enhance its liquidity position.

Until 2005 the Central Bank used only the MSCI Sovereign Bond Index as a benchmark for the yields of securities in the foreign reserves. In Decision no. 1019/2004, the Board of Governors approved an investment policy that assumes that the Central Bank's

Box IV-1

Currency swap agreements and attempts to reinforce the foreign exchange reserves

In March 2008, the Central Bank of Iceland sought to conclude currency swap agreements with other central banks. The Central Bank sought negotiations with the Bank of England, the European Central Bank, the Bank for International Settlements in Basel, and the US Federal Reserve Bank, as well as the central banks in Sweden, Denmark, and Norway. During the course of these discussions, it was requested that the Central Bank solicit a statement from the International Monetary Fund concerning the Icelandic economy and the state of the Icelandic financial system. Specialists from the Fund came to Iceland in April for that purpose and acquainted themselves with the state of economic and financial affairs. The IMF was of the opinion that currency swap agreements would have the desired effect and would facilitate the Bank's endeavours to seek credit on the global markets on behalf of the Treasury. In its discussions with other central banks, the Central Bank of Iceland also emphasised that currency swap agreements would serve the interests not only of Iceland but also of other parties because of Icelandic financial companies' extensive international connections.

Ultimately, the central banks of the largest nations decided not to conclude agreements with the Central Bank of Iceland. Their principal grounds for refusal was the size of the Icelandic banking system and their conviction that swap agreements would not serve the intended purpose. Discussions continued with the three Nordic central banks, and these resulted in the agreements announced in mid-May. Discussions with leaders at the US Federal Reserve Bank continued. In late September, the Fed concluded currency swap agreements with three Nordic central banks and the Reserve Bank of Australia. The fact that the Central Bank of Iceland was not a party to such an agreement was cause for comment. When those agreements were announced, the Central Bank of Iceland contacted the Federal Reserve and requested a comparable agreement. At that point in time, the Federal Reserve declared that it was not prepared to conclude such an agreement with the Central Bank of Iceland at that time but did not rule out a swap agreement at some later date. At the beginning of October, the Central Bank contacted the Federal Reserve Bank once again and requested a currency swap agreement. In the end, the Fed's conclusion was the same as before: the Icelandic financial system was too large relative to the economy for such an agreement to have any genuine effect.

The currency swap agreements with the three Nordic central banks made a positive impact on the market. In May, Parliament authorised the Bank to borrow up to 500 billion krónur for the purpose of expanding its foreign reserves. As a result, a decision was made to go to the global bond market. Three international banks were engaged to lead the endeavour. Presentations were held among investors across Europe. At the unequivocal recommendation of the three leading banks, it was decided not to go to the market at that time. In July, the Central Bank began expanding its foreign reserves with the issue of short-term bills on the European market. In the fall, a syndicated loan agreement was concluded with several European banks.

securities portfolio will contain not only foreign government bonds but also bonds issued by municipalities, multinational organisations, government agencies, and financial institutions; therefore, the MSCI/EFFAS indices are hardly useful as benchmarks for the yield and risk of the securities in the Bank's foreign reserves. The investment bank Lehman Brothers was then engaged to design indices for the Central Bank's bond funds in accordance with Decision no. 1019. Barclays has now taken over these operations from Lehman Brothers. Table IV-2 gives a comparison between the bond portfolio yield and the Lehman/Barclays indices. The bond portfolios outperformed the benchmarks in euros and sterling, while in US dollars, the yield on the benchmarks was better than that for the portfolio. This is due to the fact that, in comparison with the benchmark, the US dollar bond portfolio was underweighted in government bonds, which appreciated significantly during the year.

Government debt management

Domestic

Changes were made in the management of the Icelandic government's debt in 2007, when the Minister of Finance and the Central Bank agreed that the Bank would take over the issuance of the Treasury's domestic marketable securities, as well as other tasks previously carried out by the National Debt Management Agency (NDMA). With this change, which took effect on October 1, 2007, the NDMA discontinued operation, and domestic debt management was added to foreign debt management, which has long been the responsibility of the Central Bank.

A newly concluded agreement with the Minister of Finance assigned the Central Bank the task of administering and overseeing auctions, buybacks, and redemption of government securities, as well as agreements with primary dealers and the administration of securities loans to primary dealers. The Bank also handles regular information disclosure on government debt affairs to the market and the Ministry of Finance and maintains the website www.bonds.is. The aim of merging domestic and foreign debt management affairs was to gain a better overview and achieve more efficient management of matters related to debt, foreign currency, and liquidity. A further objective with the agreement was to streamline operations and make more efficient use of personnel.

According to the agreement, the Central Bank has also taken over the NDMA's projects related to government guarantees and relending. The Bank handles the administration of government guarantees and assesses the Treasury's risk due to such guarantees. It also submits statements to the Ministry concerning government guarantees, handles the processing of guarantees, and collects the pertinent fees. The Bank also issues bonds for relending.

The agreement provides for the division of tasks and the ultimate decision-making authority of the Ministry of Finance with respect to debt affairs. The aim is to prevent potential conflicts of interest in the event that the Central Bank's monetary policy does not conform to the Treasury's policy on debt management.

Foreign

By agreement with the Minister of Finance, the Central Bank is assigned the implementation of Treasury foreign borrowing and other tasks specified in the Act on the National Debt Management Agency, no. 43/1990. Under this agreement, the Central Bank implements the Minister of Finance's decisions on foreign borrowing, interest rate swaps and currency swaps outside Iceland, and management of short-term borrowing facilities, along with management of other foreign loans taken by the Treasury. The agreement also assigns the Central Bank a consultative role on borrowing and debt management policies and on relations with international rating agencies. Furthermore, the Bank supervises the credit terms of entities that enjoy Treasury guarantees and intend to borrow in the international market. The Bank oversees the Treasury's foreign loan accounts and provides related services. In managing the Treasury's foreign borrowing, the Central Bank aims to secure the reputation of the Republic of Iceland in international markets and procure foreign credit on the best available terms.

The credit market in 2008

In the crisis that struck the global financial market in 2008, the credit markets froze. One after another, financial companies reported poor operating results and even bankruptcy, and trust among market participants evaporated. As a result, credit lines were closed off in bond and money markets alike.

It is well known that Iceland's banks were swept into the middle of the maelstrom, and the three largest did not survive. It is clear that the Treasury will incur a significant amount of debt because of the failure of the banks. Between October, when the banks fell, and the end of the year, the Central Bank's long-term debt increased by 155.5 b.kr. at the year-end 2008 exchange rate. The amount of the obligations falling on the Treasury as a result of the banks' insolvency has not yet been confirmed.

Foreign borrowing

Long-term credit is procured with issues under the European Medium-Term Note (EMTN) Program. Short-term credit is issued through two commercial paper programmes: the Euro-Commercial Paper Program (ECPP) and the United States Commercial Paper Program (US-CPP). The Treasury also has a multi-currency revolving credit facility amounting to 250 million US dollars.

EMTN Program

The EMTN program was first signed in 2001. It was most recently renewed in the summer of 2008, and the ceiling now amounts to 5 billion euros.

ECPP and US-CPP

The agreement on the issuance of commercial paper in Europe - the European Commercial Paper Program (ECPP) - has been in effect since 1985 and was last renewed in May 2008. The agreement authorises the issuance of commercial paper up to a ceiling of 1 billion US dollars, or the equivalent in other currencies. Under the program, commercial

paper is issued through four dealers – Citibank, SEB, Deutsche Bank, and Barclays – at current market terms. In July and August, securities were issued on the European market for a total of 487.3 million euros. A total of 10 transactions were made on the European market, with maturities ranging from one to three months. The agreement establishing the United States Commercial Paper Program (US-CPP) was signed in 2001. The total outstanding balance in the US market may not exceed 1 billion US dollars. Dealers are Citibank and J.P. Morgan of New York. The ECPP and the US-CPP are linked so that the combined total amount of the two issues may not exceed 1 billion US dollars. Three transactions made in totalling 130 million US dollars were the US market in July and August. Maturities ranged from one to three months.

Repayment and borrowings

In recent years, the Central Bank has purchased currency on the domestic foreign exchange market in order to pay interest on the Treasury's foreign debt. Because of the upheaval in the foreign exchange market and the depreciation of the króna early in the year, it was decided that the Bank would not purchase currency on the domestic foreign exchange market.

One Eurobond in the amount of 150 million euros matured during the year. The bond matured in May and was repaid in full. Interest payments on foreign loans totalled 10.6 b.kr. during the year.

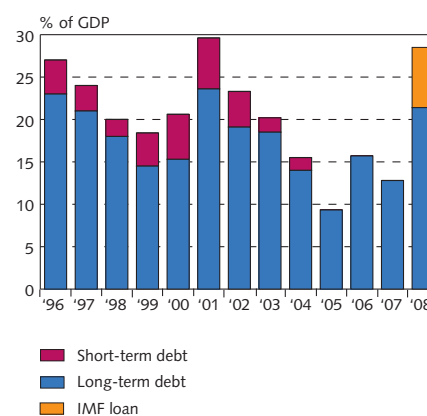
In the autumn, two facilities were put in place in order to strengthen the Central Bank's foreign exchange reserves. One was a syndicated loan in the amount of 300 million euros, and the other was the first portion of the Stand-By Arrangement from the International Monetary Fund, which totals 560 million SDRs. The IMF loan appears in the accounts of the Central Bank and not those of the Treasury.

Debt management and risk analysis

In its debt management activity, the Treasury attempts to spread repayments as equally as possible over the coming years. Management of the Treasury's foreign debt also involves distributing the loan portfolio with regard to maturity and currency composition.

Seven forward currency agreements were made during the year, with the aim of keeping the currency composition of the loan portfolio within the boundaries set for the Bank. No agreements were in effect at the end of the year. The Treasury's foreign liabilities totalled 317.2 b.kr. at year-end 2008, in addition to the debt to the IMF in the Central Bank accounts, which amounted to 104.8 b.kr. at the end of the year. The weighted average maturity of foreign long-term borrowing was 2.25 years and the average duration 1.8 years.

Chart IV-1
Treasury foreign debt and IMF loan



1. GDP for 2008 according to Central Bank forecast.
Sources: Statistics Iceland, Central Bank of Iceland.

Table IV-4. Sovereign credit ratings at end of 2008

	Foreign currency		Domestic currency			Most recent
	Long-term	Short-term	Long-term	Short-term	Outlook	
Moody's	Baa1	P-2	Baa1	P-2	Negative	Dec. 2008
Standard & Poor's	BBB-	A-3	BBB+	A-2	Negative	Nov. 2008
Fitch Ratings	BBB-	F3	A-		Negative	Oct. 2008
R&I Rating of Japan	BBB-				Rating monitor	Oct. 2008

Sovereign credit rating of the Republic of Iceland

Rating agencies are an important determinant of credit terms in global financial markets. The best-known rating agencies are Moody's Investors Service and Standard & Poor's from the US and Fitch Ratings of Europe. Ratings help to provide an indication of the terms a borrower will enjoy. In recent years, the Republic of Iceland has enjoyed confidence as a borrower in international markets, and all main markets have been open to the Treasury because of its strong ratings and prompt repayment of debt. Since the failure of the banks in October, however, the Republic of Iceland's sovereign credit rating has deteriorated markedly.

Moody's rating is now Baa1 for long-term foreign and domestic obligations, A2 for country ceiling, and P-2 for short-term obligations. The outlook on all of the ratings is negative. The sovereign credit rating has been lowered by seven notches in a single year, with the downward trend beginning at the end of May. At the beginning of the year, the sovereign credit rating was Aaa, the highest issued by Moody's. The primary reason for the downgrade was Moody's opinion that the sovereign's financial strength has diminished due to the banking crisis and the status of the króna.

Fitch Ratings downgraded the Republic of Iceland's sovereign credit rating by five notches during the year. The sovereign credit rating is BBB- for long-term foreign-currency obligations and F3 for short-term foreign-currency obligations. The local-currency rating is A-, and the outlook on all of the ratings is negative. The rating from Fitch remains in the investment-grade category. The rationale for the downgrade was the sharp contraction faced by Iceland as a result of the banking collapse. A further consideration was the uncertainty surrounding the ultimate cost to the Treasury as a result of the banking crisis.

Standard & Poor's downgraded the Republic of Iceland's sovereign credit rating by five notches during the year. The Republic's rating is BBB- for long-term foreign-currency obligations and A-3 for short-term foreign currency obligations, while its local-currency ratings are BBB+ and A- for long- and short-term obligations respectively. The rating remains in the investment-grade category. The outlook is negative. In the rationale for its decision, Standard & Poor's cited the sovereign's substantially higher public sector debt burden as compared with the agency's projections at the beginning of the banking crisis, in addition to the expected 10% contraction in GDP during 2009.

R&I Rating of Japan downgraded the Republic of Iceland's sovereign credit rating by nine notches in the wake of the banking crisis. The rating for long-term foreign-currency obligations is now BBB-, and the outlook is negative.

International cooperation

The Central Bank of Iceland has extensive responsibilities and obligations in the field of international finance. The Bank cooperates closely with other central banks and international economic and monetary organisations.

Nordic central banks' MoU on financial crisis management

At a meeting in Stykkishólmur, Iceland, in June 2003, the Governors of the central banks of Denmark, Finland, Iceland, Norway and Swe-

den signed a Memorandum of Understanding (MoU) on financial crisis management. The MoU has been published in its entirety on the websites of all the signatory banks. Nordic central banks cooperate closely on financial stability tasks and contingencies for meeting challenges to the financial system, especially illiquidity.

The International Monetary Fund

The Central Bank represents Iceland at the International Monetary Fund. Davíð Oddsson, Chairman of the Board of Governors of the Central Bank, represented Iceland on the IMF Board of Governors. Bolli Þór Bollason, Secretary General at the Prime Minister's Office, was Iceland's alternate on the IMF Board. Iceland cooperates with the Nordic and Baltic countries through a Constituency at the IMF, and they jointly elect an Executive Director as one of the Fund's 24 Executive Board members. The Nordic-Baltic Constituency's representative to the Fund's International Monetary and Financial Committee (IMFC) was Swedish Minister of Finance Anders Borg. Per Jansson, State Secretary to the Swedish Minister of Finance, acted as chair of the Nordic-Baltic Monetary and Financial Committee (NBMFC), whose role is to coordinate and manage cooperation within the Constituency. Olli-Pekka Lehmuusaari of the General Secretariat of the Bank of Finland was the chair of the NBMFC Alternates, which addresses various common Constituency issues and reports to the NBMFC. In 2007, the Constituency's permanent representative on the IMF Executive Board in Washington was Jens Henriksson from Sweden, and Jón Þ. Sigurgeirsson served as his alternate until April, when he was succeeded by Jarle Bergo from Norway.

Both the Spring meeting and the Annual Meeting of the International Monetary and Financial Committee were held at the IMF headquarters in Washington, DC. In connection with the meetings, the Central Bank of Iceland published on its website the Nordic and Baltic Constituency Office's reports on the main activities of the Fund and its Executive Board. Nordic-Baltic speeches presented to the IMFC and the IMF Annual Meeting were also published.

After Iceland's commercial banks failed in October, the Icelandic authorities formally requested collaboration with the International Monetary Fund (IMF). An agreement was concluded on the basis of an economic plan featuring three main objectives: to stabilise the foreign exchange market, to formulate a fiscal policy aimed at establishing a sustainable level of debt, and to restructure the banking system in a transparent manner consistent with internationally recognised practice. The plan was prepared over a two-year horizon.

The Letter of Intent stipulating the collaboration between the Government and the IMF was signed on November 3, and the Stand-By Arrangement for Iceland was approved by the Executive Board of the IMF on November 19. According to the plan, Iceland will receive a loan of 2.1 billion US dollars in stages. The plan also assumes supplementary loans of up to 3 billion US dollars from Denmark, Finland, Norway, Sweden, Russia, and Poland. In addition, the Faroese Government has loaned Iceland approximately 50 million dollars. The loan from the IMF will be repaid over the period from 2012 to 2015.

Box IV-2

The economic plan drafted by the Government and the IMF

At the request of the Icelandic authorities, a delegation visited Iceland in the beginning of April. The main purpose of this visit was to assess economic status and prospects in the light of current affairs. This visit was an aspect in the process of the Nordic swap arrangements that were signed in mid-May.

Two missions from the IMF visited Iceland in mid-June 2008, one to conduct a regularly scheduled Article IV Consultation and the other specifically to discuss financial stability. The concluding statements of the two missions were published on the websites of both the Central Bank and the IMF following the IMF Executive Board's discussions of Iceland in mid-September 2008.

At the beginning of October, another mission from the IMF visited Iceland in order to assess the position of the economy and the financial system. The mission's objective changed during that time, however, and the Government of Iceland formally requested collaboration with the IMF in order to restore economic stability in Iceland. On November 3, a Letter of Intent was signed by the Icelandic authorities and the IMF, outlining the collaboration planned between the two. The Letter of Intent was renewed on November 15, and the Stand-By Arrangement for Iceland was approved by the Executive Board of the IMF on November 19.

In mid-December, a group from the IMF visited Iceland in order to assess the status and progress of the economic plan drafted by the Government in collaboration with the Fund.

The Bank for International Settlements (BIS)

The Central Bank is a shareholder in the Bank for International Settlements (BIS) in Basel. BIS is an important forum for consultation among central banks as well as being an information and research centre in economics, especially in the monetary field. BIS also addresses financial stability and monitors the operations and financial soundness of financial institutions. Central Bank representatives participate in a number of BIS meetings.

Other central banks

The Nordic central banks engage in extensive cooperation in a number of areas. The governors of the Nordic central banks hold an annual meeting to discuss monetary issues, financial stability, and other relevant topics of joint interest. Their experts in various fields cooperate and share information on issues including reserve management, market operations, legal matters, economic research, general monetary matters, financial stability, administration, human resources, information disclosure, etc. The Central Bank of Iceland also cooperates with various other central banks, including the European Central Bank. The Chairman of the Board of Governors meets regularly with the President of the ECB. Other Central Bank representatives have met with ECB experts to discuss payment systems and various aspects of monetary policy formulation and implementation.

The Organisation for Economic Cooperation and Development (OECD)

Central Bank representatives participate on a regular basis in the work of various OECD committees and groups, including the Economic Pol-

icy Committee, Working Party 1, the Committee on Financial Markets, and an expert committee on government debt management. OECD experts visit Iceland regularly to discuss economic developments with the authorities. Similar discussions are held with all the member countries. Following the visits, the OECD publishes its assessment of economic conditions. An OECD mission visited Iceland in the first half of 2006 and subsequently published its Country Survey in August.

Other financial institutions and rating agencies

The Central Bank is engaged in business relations with a number of financial institutions in connection with the management of the foreign exchange reserves, the Treasury's foreign borrowing, and other tasks. It also handles regular communication with international credit rating agencies.

Agreement with the Ministry of Finance on current accounts and interest rates

The Central Bank Act, which was passed by Parliament in May 2001, removed Treasury access to credit with the Central Bank. Under an agreement between the Ministry of Finance and the Central Bank on current accounts and interest rates, which was renewed most recently in 2005, the rate of interest paid on average deposits is the same for the Treasury's current accounts and those held by credit institutions, as of the beginning of 2006.

Internal rules on the preparation of, arguments for, and presentation of monetary policy decisions

Article 24 of the Central Bank Act, no. 36/2001, states that "the Board of Governors lays down internal rules to be approved by the Supervisory Board on the preparation of, arguments for, and presentation of its monetary policy decisions." These rules have been applied since they were formally adopted in the beginning of 2002. The main principles underlying the rules concern utilisation of information and expertise, professionalism, transparency, and the documentation of arguments behind monetary policy decisions. Their provisions cover the production of inflation forecasts, procedures for evaluating economic and monetary developments and outlook and appraising monetary policy, and the Board of Governors' decision-making process and the announcement of such decisions. The rules were reviewed in 2006 and are published on the Central Bank website.

Financial stability functions

The Central Bank's financial stability functions were defined more closely with a 2006 decision by the Board of Governors, which explains the main principles underlying the Central Bank's operations, with reference to the legal foundation on which the Bank's activities are based. The decision specifies how the Central Bank of Iceland performs these functions with respect to framework and oversight, collection and communication of data, research, analysis and communication, cooperation, and contingencies. It also provides for inter-departmental cooperation, divides financial stability tasks among Bank departments, and specifies the arrangements for regular in-house

meetings on financial stability. The decision is published on the Central Bank website.

Cooperation with the Financial Supervisory Authority

The Central Bank Act and the Act on Official Supervision of Financial Activities state that the Central Bank and the Financial Supervisory Authority (FME) shall conclude a special agreement further stipulating the cooperation between them. A cooperation agreement was first made in 1999 and renewed most recently in 2006. The agreement is published on the websites of both institutions. The Central Bank Act states that the Bank shall grant the FME all the information that it holds and may be utilised for the latter's activities. These institutions regularly exchange statistics and other information, and the Board of Governors of the Central Bank and the Director of the FME hold regular consultative meetings. The Central Bank and the FME have conducted joint contingency exercises, first in 2004 and again in early 2006. In 2007 the Central Bank, FME, and Ministry of Finance participated in a Nordic contingency exercise together with their sister institutions in the Nordic and Baltic countries.

Central Bank participation on the boards of institutions and companies

The Central Bank has an equity interest in the Icelandic Banks' Data Centre (RB). According to a collaboration agreement concluded in 1994, the Bank contributed one-fifth of RB's initial capital. In 2008 Tryggvi Pálsson, Director of the Bank's Financial Stability Department, represented the Central Bank on the RB board. Alternate board member was Ingvar A. Sigfússon, Director of Operations. The Bank's representative on the RB auditing committee was Chief Auditor Stefán Svavarsson.

The Financial Supervisory Authority is governed by a three-person board appointed by the Minister of Business Affairs. One member is nominated by the Central Bank from its own staff. Governor Ingimundur Friðriksson represented the Bank on the FME board until October 2008, when he was replaced by Stefán Svavarsson, Chief Auditor. Sigríður Logadóttir, Chief Attorney, served as alternate.

The Central Bank owns an 8% equity interest in Fjölgreiðslumiðlun hf. (FGM). Guðmundur Kr. Tómasson, Deputy Director of the Financial Stability Department, was the Bank's representative on the board of FGM during 2008. Employees of the Central Bank are members of the Bank Employees' Pension Fund. In 2008, the Bank's representative on the board of the Fund was Ingvar A. Sigfússon, Director of Operations. Alternate board member was Hrönn Helgadóttir, Supervisor in the Statistics and IT Department.

Risk analysis and risk management

Broadly speaking, the Central Bank's risk may be divided into four areas: management risk, reputational risk, financial risk, and operational risk. Management risk involves decisions in connection with monetary policy implementation and the Bank's other mandatory responsibilities. Although difficult to define precisely, it is determined

by factors including management competence, working procedures, and internal controls. Reputational risk concerns the Central Bank's credibility and may be crucial for the Bank itself and even the financial system as a whole. Financial risk mainly lies in credit risk, interest rate risk, liquidity risk, and exchange rate risk, in connection with the maintenance of foreign reserves and monetary policy implementation. In effect are internal rules on the maintenance and investment of foreign reserves. These rules are reviewed by the Board of Governors at regular intervals and confirmed by the Supervisory Board. Rules address investment strategy, investment options, eligibility, duration of securities, and the share of liquid assets in foreign reserves. Operational risk is divided into several subcategories. These include employee risk, accounting risk, technical risk, and the general operational risk posed to the Central Bank's activities.

Efforts are made to minimise risk in the work and responsibilities of all the Bank's departments, by such means as internal rules, work procedures, job descriptions, and internal audit.

Data collection

The Central Bank collects information on a regular basis about the domestic credit market, balance of payments, and external position of the economy. Most institutions and companies operating in the domestic credit market report monthly on balance sheet items. They are also obliged to provide the Central Bank with information about interest rate changes as soon as such changes are made. The balance of payments and external position are calculated on a quarterly basis. These data form the basis for the Bank's assessment of important aspects of monetary developments and for regular dissemination of statistical information, both in the Bank's publications and on the Statistics pages of its website. The Statistics pages provide links to relevant resources and are published simultaneously in English.

In cooperation with the Ministry of Finance, the Central Bank operates a FAME time-series database management system that houses a range of databases with hundreds of thousands of time series, including data from corporate accounts with restricted access. Similar systems are used by most of the largest central banks and many international institutions. The Central Bank of Iceland has subscribed to the IMF's Special Data Dissemination Standard (SDDS) since 1996 and publishes an advance release calendar on its website in accordance with the standard.

Publications and information

Strict requirements are made of central banks to explain clearly their monetary policy objectives and implementation and other activities. In Iceland, the Central Bank is obliged by law to publish reports on its monetary policy; its monetary, exchange rate and foreign exchange developments; and its measures in these areas. The forum it uses is *Peningamál*, which is published simultaneously in English translation as *Monetary Bulletin*. This publication has also presented research findings by Bank employees who are connected with monetary policy, financial stability, and the Bank's general activities. Three editions of *Monetary Bulletin* were published in 2008.

Also published during the year was the Central Bank's *Financial Stability* report, which discusses the position of the Icelandic financial system and financial stability in a macroeconomic context. *Financial Stability* is published once a year.

In its *Annual Report*, the Bank outlines various aspects of its operations. The Chairman of the Board of Governors gives an account of the Bank's policy at its annual meeting. *Hagvísar*, which is issued eleven times a year, is published simultaneously in English under the title *Economic Indicators*. In addition, regular statistical data appear in Icelandic and English on the Statistics pages of the Central Bank's website.

In its English-language *Working Papers* series, the Central Bank publishes economic research conducted within the Bank and outside it. *Economy of Iceland*, which has been published for many years and now appears annually, contains information on Iceland's system of government and its economic structure and developments. Central Bank publications in 2008 are listed in the appendix to the present *Annual Report*.

The Central Bank publishes regular announcements of decisions by the Board of Governors and various other aspects of its activities. Other news is posted on the Bank's website without the issue of an official press release.

Electronic versions of the Bank's publications are available on its website. Press releases, news, statistics, and various information on the Bank's activities can also be found on the website in Icelandic and English, as can information on the contents of the Bank's various seminars and presentations, which are described further in the following section. The Bank also makes a point of promoting its activities to the public; for example, by arranging visits by students and other groups.

Research

A wide range of research is conducted within the Central Bank in connection with its functions. Most is centred in the Economics and Financial Stability Departments, but other departments are active in research as well. Furthermore, the Central Bank occasionally commissions or backs outside research.

To pursue forward-looking monetary policy, a central bank needs models for assessing the economic outlook, especially inflation. A substantial share of research at the Central Bank of Iceland is devoted to this task. A quarterly macroeconomic model (QMM), which has been under design for some years, was introduced in the beginning of 2006 and has substantially enhanced the Bank's forecasting and analysis. It is being further developed and updated on an ongoing basis, with particular emphasis on incorporating forward-looking expectations into the model. Analysis of the model's long-term properties is also well underway. Also in progress is the development of a new DSGE model, which is more suitable for economic policy simulations and will be used alongside QMM.

Other extensive projects in 2008 included an assessment of the yield curve for domestic interest rates, preparation of a simulation

model of the Icelandic financial system, an assessment of expected and unexpected loan losses among the commercial banks, a study of systemic risk in the interbank market, and the development of stress tests for the domestic financial system. Furthermore, a number of smaller research projects are ongoing, including design of short-term forecasting models for key subcomponents of the CPI, an estimation of a multivariate time series model for forecasting developments in government revenues and expenditures, an estimation of the impact of foreign labour on the Icelandic economy, a study of automatic fiscal stabilisers, design of indicators for the housing market and residential investment, and an assessment of the informational value of preliminary national accounts estimates.

Work also commenced on a number of new research projects during the year. Among these are studies of businesses' pricing decisions and exchange rate pass-through, the role of money supply in the formulation of monetary policy, the characteristics of Icelandic economic cycles, the impact of Glacier bonds on monetary policy, the financial accelerator effect, domestic equilibrium interest rates and the use of the Taylor rule in determining monetary policy, the interplay of exchange rate movements and monetary policy regimes, and the interplay of the size and development level of economies and their success in controlling inflation.

Moreover, a number of studies of topics related to the financial crisis and its causes and effects have been undertaken, including an appraisal of the assets and liabilities of domestic households and of the overall economy, and a comprehensive study of the debt position of domestic households, carried out in cooperation with Iceland's principal credit institutions.

In order to create a framework for the Bank's research activities and communicate its findings to professionals and the general public alike, regular presentations are organised, at which researchers inside and outside the Bank report their findings and discuss them with other Bank employees and researchers. Central Bank staff also presented their research findings at seminars outside the Bank, both in Iceland and abroad. They also attended local and international conferences to present their own findings and hear those of other researchers, and lectured at public, specialist and academic venues.

The Central Bank underlines the importance of publishing research by its experts in internationally recognised academic journals. A number of such papers were published during the year.

National Festival Fund

The National Festival Fund operated for its 31st year in 2008. Its founding capital was the proceeds from the Central Bank's commemorative coin issue for the National Festival of 1974, and its revenue base has been the Bank's proceeds from other commemorative coins since then. The board of the Fund comprises five members, three appointed by Parliament and one by the Central Bank. The fifth board member, who serves as chairman, is appointed by the Prime Minister. The board was appointed for a four-year term in 2006. The chairman was Margrét Bóasdóttir, and the Central Bank's representa-

tive was Governor Eiríkur Guðnason. The secretary of the Fund board was Central Bank attorney Sigfús Gauti Þórðarson. The board of the Fund decided to allocate 30.4 m.kr. to 56 applicants for the year 2009, with a special award ceremony held at the Reykjavík Culture House on December 1, 2008. The National Festival Fund's capital amounted to just over 90 m.kr. at the end of the year. It is intended that the Fund's entire capital be allocated no later than in 2010, for the year 2011.

Central Bank premises - library and archive

The Central Bank's premises at Kalkofnsvegur in Reykjavík also housed the Icelandic Banks' Data Centre (RB) at the end of 2008. Most of the Central Bank library and archive is housed at Einholt 4 in Reykjavík. In 2006 the joint Central Bank and National Museum numismatic collection was moved from Einholt 4 to exhibition space on the ground floor of Kalkofnsvegur. A library of periodicals and journals is also located on the Bank's premises at Kalkofnsvegur. The Central Bank's extensive library on the Icelandic economy and industry has been incorporated into the National and University Library of Iceland's computerised card catalogue.

V Accounts and organisation

Central Bank accounting principles

According to Article 32 of the Act on the Central Bank of Iceland, no. 36/2001, the preparation of the Bank's annual accounts "shall be in accordance with the law and with recognised accounting principles. The Prime Minister shall lay down further rules on the accounting principles and preparation of the annual accounts." The current rules were set in 2005. The financial statements for 2008 are based on the same principles as in 2007; however, minor changes have been made in the presentation of individual items. These changes are explained in the notes to the Annual Accounts, which appear in this *Annual Report*.

Operating results and balance sheet

According to its profit and loss account, the Central Bank of Iceland recorded a net loss of 8,625 m.kr. in 2008, compared with a loss of 1,224 m.kr. in the previous year. The table illustrates the changes in the principal items of the Bank's profit and loss account.

As the table shows, the net loss increased by 7,401 m.kr. year-on-year. Net interest income increased by 13,664 m.kr., primarily because the balance sheet stocks upon which interest is calculated more than doubled between year-end 2007 and year-end 2008. The Bank's assets totalled 1,187 b.kr. at year-end 2008, as opposed to 477 b.kr. at the end of 2007. Other operating income rose by 3,222 m.kr., mainly because securities in the Bank's foreign exchange reserves appreciated due to declining market interest rates. The rise in securities values amounted to 3,863 m.kr. The Bank discontinued the practice of appraising liabilities for the funding of the foreign exchange reserves at market value because of the impact of the global liquidity crisis on Iceland's credit ratings. Had that practice been continued, 11.3 b.kr. would have been entered as income due to a drop in the value of the Treasury securities issued to fund the expansion of the foreign exchange reserves at year-end 2006. The Bank's operating expenses rose considerably, due in large part to consultancy costs incurred in connection with the collapse of the banking system in the fall. The year-on-year increase in consultancy expenses amounted to 1,143 m.kr. Wage costs rose by 27%, or 250 m.kr., to a total of 1,171 m.kr. for the year, due to an increase in staffing, a surge in the number of hours worked during the latter half of the year, and a rise in estimated pension obligations. The fall of the commercial banks put Central Bank loans secured with securities issued by the failed banks in a state of uncertainty. An agreement was reached whereby the Treasury purchased a large portion of the Bank's collateral loan portfolio when the banking crisis struck. Collateral loans with a nominal value of 345 b.kr. were purchased from the Bank for 270 b.kr., which will be paid with an indexed, interest-bearing bond. The book value of the Bank's loss therefore totalled 75 b.kr., which was charged in the profit and loss account. There will be no transfer to the Treasury for 2008, as the Bank recorded an operating loss of 52,606 m.kr. before taking into account exchange rate gains. For the prior year, the Bank recorded an operating profit of 7,012 m.kr. One-third of that amount,

Table V-1. Principal items of the Bank's profit and loss account

Figures in millions of kr.	2008	2007	Changes
Net loss	(8,625)	(1,224)	(7,401)
<i>Main changes:</i>			
Net interest income	19,711	6,047	13,664
Other income	5,753	2,531	3,222
Operating expenses	(3,069)	(1,565)	(1,504)
Collateral loans written off	(75,000)	0	(75,000)
Transfer to Treasury	0	(2,338)	2,338
Exchange rate gain	43,980	(5,899)	49,879
Net loss of the year	(8,625)	(1,224)	(7,401)

Table V-2. Main items of the Balance Sheet

(Figures in billions of kr.)	2008	2007	Change
Equity	82	91	(9)
<i>Main changes:</i>			
<i>Assets:</i>			
Foreign assets in reserves	429	164	265
Loans to banks and other financial institutions	483	308	175
Central Government	270	0	270
Other equities	5	5	0
<i>Liabilities:</i>			
Foreign liabilities	(242)	(2)	(240)
Notes and coin	(24)	(16)	(8)
Deposits of banks and other financial institutions	(401)	(154)	(247)
Central government deposits	(403)	(211)	(192)
Other liabilities	(35)	(3)	(32)
Equity	82	91	(9)

or 2,337 m.kr., was paid to the Treasury, in accordance with the provisions of the Central Bank Act. Finally, the recorded exchange rate differential changed dramatically year-on-year, from a loss of 5,899 m.kr. in 2007 to a 43,980 m.kr. gain in 2008. The turnaround is due primarily to the depreciation of the króna and the fact that the Bank's foreign-denominated assets exceeded its foreign-denominated liabilities for the most part of the year. The gain had more or less vanished, however, by the end of the year.

The Bank's balance sheet has undergone substantial change since 2007. The Bank's assets totalled 1,187 b.kr. at year-end 2008, as opposed to 477 b.kr. the year before. The Bank's liabilities have increased correspondingly, rising to 1,105 b.kr. at year-end 2008 from 386 b.kr. at the end of 2007. The accompanying table illustrates the changes in the balance sheet.

Foreign assets in the foreign exchange reserves rose by 265 b.kr. during the year. The real increase in the reserves was financed with borrowed funds, including a 105 b.kr. loan from the International Monetary Fund and a 45 b.kr. loan from the Treasury. The remainder of the increase stems mainly from exchange rate movements. Other foreign liabilities, in the form of a short-term loan from BIS and the Nordic central banks, rose by 134 b.kr. There was also a notable increase in lending to banks and financial institutions, which rose by 520 b.kr. year-on-year. The increase is illustrated in the accompanying table, which shows that lending to these parties rose by 175 b.kr., while the 270 b.kr. increase in the balance vis-à-vis the Treasury stems from the same source. Furthermore, 75 b.kr. was written off due to insufficient collateral following the collapse of the banks. Offsetting the increase in domestic assets is the 439 b.kr. increase in the deposits of the banks, financial institutions, and Treasury, which includes the previously mentioned 45 b.kr. loan to strengthen the foreign reserves. Finally, banknotes in circulation increased by 8 b.kr. during the year, and other liabilities rose by 32 b.kr., due to domestic payment intermediation balances for securities transactions.

At year-end 2008, the Bank's foreign assets and liabilities constituted some 47% of total assets and liabilities, respectively. At the end of 2007, the Bank's foreign assets amounted to 35% of total assets, while foreign liabilities were 24% of total liabilities.

The Central Bank's accounts are presented later in this report, together with detailed explanatory notes for individual items.

Supervisory Board

The Central Bank Act, no. 36/2001, stipulates that there shall be seven members of the Supervisory Board, which is to be elected following the parliamentary elections. The last election of the Supervisory Board took place in June 2007. The Supervisory Board selects a chairman and deputy chairman from among its members. Members of the Supervisory Board at year-end 2008 were Halldór Blöndal (Chairman), Jón Sigurðsson (Deputy Chairman), Erna Gísladóttir, Hannes Hólmsteinn Gissurarson, Jónas Hallgrímsson, Ragnar Arnalds and Valgerður Bjarnadóttir. Sigríður Ingibjörg Ingadóttir resigned from the Supervisory Board towards the end of the year. The Supervisory Board held 14 meetings in the course of 2008.

Board of Governors

The Board of Governors of the Central Bank of Iceland comprised Davíð Oddsson (Chairman), Eiríkur Guðnason, and Ingimundur Friðriksson.

Central Bank organisation

The Bank's activities take place in six main departments, plus the Internal Audit Department. The Governors' Office is separate from the Bank's main departments. It provides general office and administrative service to the Governors, oversees public relations and information disclosure for the Bank, and supervises the publication of the Bank's Annual Report and website. The Governors' Office also handles the Bank's regular relations with foreign financial institutions, international credit rating agencies, and the International Monetary Fund. The Legal Services staff prepare a wide range of contractual agreements for the Bank, as well as preparing legal documents and debt instruments and participating in the preparation of laws, regulations, and legal opinions. The Library and Collection Department is a part of the Governors' Office. It carries out library operations, as well as overseeing the Central Bank and National Museum numismatic collection.

The International and Market Operations Department oversees domestic money markets and currency markets, as well as transactions with domestic financial institutions. It also manages the Bank's foreign reserves and oversees government debt affairs, as well as Treasury guarantees and relending.

The Accounting Department keeps the Central Bank's main accounts, as well as those of the Greenland Fund and the Depositors' and Investors' Guarantee Fund, which are under the Bank's custodianship. The Department also handles accounting relative to Treasury bond redemption and the Government's foreign borrowing. Furthermore, it administers the Bank's SWIFT system, as well as overseeing payments for the Bank, the Treasury, and State enterprises.

The Financial Stability Department's activities centre on the stability and effectiveness of financial institutions and markets. The Department's operations are divided into three units related to financial stability: Financial Systems, Payment Systems, and Contingency. The Cashier's Unit also belongs to the Financial Stability Department. *Financial Systems* carries out analysis of financial institutions and the structure of the financial system. *Payment Systems* oversees the most important payment and settlement systems. *Contingency* handles the development and preparation of stress tests and contingency-related projects. The *Cashier's Unit* carries out the issuance and handling of notes and coin. The Financial Stability Department publishes an annual report entitled *Financial Stability*.

The Economics Department carries out economic and monetary research, prepares macroeconomic and inflation forecasts, participates in formulating policy in currency and monetary matters, and analyses developments in domestic and foreign economic and monetary matters – for example, the macroeconomic elements of financial stability. The Department also oversees or participates in the issuance of various Bank publications, including *Hagvísar/Economic Indicators*, *Peningamál/Monetary Bulletin*, *Working Papers*, *Financial Stability*, and

Table V-3. Employees

	No.	Man-years
Governors' Office	13	12.1
International and Market Operations Department	15	15.0
Accounting Department	12	12.0
Financial Stability Department	15	15.0
Economics Department	16	16.0
Operations Department	31	24.0
Statistics and Information	20	19.5
Internal Auditing Department	2	2.0
Total	124	115.6

Economy of Iceland. The Department comprises two units: the Analysis and Publications Unit and the Research and Forecasting Unit.

The Operations Department has the largest staff among the Bank's departments. It handles security, procurement, budgeting, expenditure control, and the operation and administration of the Bank's real estate and equipment. The Department also handles human resources and payroll affairs, as well as a variety of in-house services. Operations is also responsible for the Bank's archives. Since 2001 telephone reception has been handled by a company in Raufarhöfn.

The Statistics and IT Department handles the compilation, entry, and processing of statistical data that the Central Bank compiles for its work. It also operates the Bank's computer systems and databases. The Department comprises four units: Information Technology, operation and maintenance of the Bank's FAME database, data compilation and entry, and data processing and communication.

The Chief Auditor is hired by the Supervisory Board and not by the Board of Governors. The Internal Auditing Department carries out internal auditing and monitoring of the Bank's operations in a broad sense, as well as administering the funds under the Bank's management.

Human resources

Considerable changes took place in Central Bank staffing during 2008. Seven employees left the Bank or retired, and 17 new staff members were hired, four of them for short-term projects. The number of summer employees was similar to previous years. One employee took a leave of absence to work at the Nordic-Baltic Office of the IMF. Ólöf E. Jónsdóttir retired after over 36 years of service, most recently in the Accounting Department.

In addition to other recruitment, a number of staff members were hired on a temporary basis to work on projects related to the banking crisis. At year-end, seven of these temporary staff members were still working on these projects, five in the Accounting Department and two in the International and Market Operations Department. The Bank also borrowed a number of expert staff members from the commercial banks to work on tasks specifically related to the banks' collapse and payment intermediation.

The International and Market Operations Department, Governors' Office, and IT and Statistics Departments expanded their staff by three, while the Financial Stability Department staff grew by one and the Operations Department staff decreased by three.

At year-end 2008, the Bank's staff totalled 124 – 66 males and 58 females – nine more than at year-end 2007. The number of full-time equivalent positions was 115.6. Five employees were in part-time posts equivalent to 3.6 positions, and the Icelandic Banks' Data Centre was responsible for seven of the 14 positions in the joint cafeteria, security, and maintenance and janitorial services it shares with the Central Bank. Average man-years were 111, the same as in 2007.

Wage agreements

Most Central Bank employees are members of the Federation of Bank Employees and are paid salaries according to its wage agreements.

The current wage agreement expires at year-end 2010. It provides for a pay rise of 14,000 kr. to all employees effective January 1, 2010, subject to a minimum pay increase of 2.5%.

Equal opportunities policy

The Board of Governors first confirmed the Bank's equal opportunities strategy in 1996. An equal opportunities committee has been active since that time. The equal opportunities strategy has been reviewed regularly, most recently in 2007. The Bank's equal opportunities policy was confirmed at that time.

Central Bank of Iceland December 31, 2008

Supervisory Board

Principal members

Halldór Blöndal, Chairman
 Jón Sigurðsson, Deputy Chairman
 Erna Gísladóttir
 Ragnar Arnalds
 Hannes Hólmsteinn Gissurarson
 Jónas Hallgrímsson
 Valgerður Bjarnadóttir

Alternates

Halla Tómasdóttir
 Birgir Þór Runólfsson
 Tryggvi Friðjónsson
 Sigríður Finsen
 Guðný Hrund Karlsdóttir
 Ingibjörg Ingvadóttir
 Guðmundur Jónsson

Board of Governors

Davíð Oddsson, Chairman
 Eiríkur Guðnason
 Ingimundur Friðriksson

Principal Officers

Accounting Department:	Erla Árnadóttir, Chief Accountant
Auditing Department:	Stefán Svavarsson, Chief Auditor
Economics Department:	Arnór Sighvatsson, Chief Economist
Governors' Office:	Jón Þ. Sigurgeirsson, Director
Financial Stability Dep.:	Tryggvi Pálsson, Director
International and Market Operations Department:	Sigurður Sturla Pálsson, Director
Legal Services:	Sigríður Logadóttir, Chief Attorney
Operations Department:	Ingvar A. Sigfússon, Director
Statistics and IT Dep.:	Tómas Örn Kristinsson, Director

Employees

SECRETARIAT

Governors' Office

Ágústa Johnson
Ellen Hrefna Haraldsdóttir
Jón Þ. Sigurgeirsson
Stefán Jóhann Stefánsson

Legal Services

Kjartan Ólafsson
Sigfús Gauti Þórðarson
Sigríður Logadóttir

Library and Collection

Anton Holt
Guðbjörg Þórarinsdóttir
Magný Gyða Ellertsdóttir
Sigurborg Ólafsdóttir
Sigurbór Sigurðsson
Valborg Stefánsdóttir

INTERNATIONAL AND MARKET

OPERATIONS DEPARTMENT

Bergur Barðason
Björgvin Sighvatsson
Daníel Svavarsson
Gerður Ísberg
Guðrún Sóley Gunnarsdóttir
Hafsteinn Hafsteinsson
Halldór Sveinn Kristinsson
Hallgrímur Ólafsson
Helga Rún Helgadóttir
Jóna Guðrún Ísaksdóttir
Lilja D. Alfreðsdóttir
Oddgeir Gunnarsson
Sigurður G. Thoroddsen
Sigurður Sturla Pálsson
Viðar Rúnar Geirsson

ACCOUNTING DEPARTMENT

Alf H. Pedersen
Anna S. Árnadóttir
Arndís Leifsdóttir
Árni Þórðarson
Erla Árnadóttir
Guðrún E. Herbertsdóttir
Halldóra Konráðsdóttir
Ísólfrur Sigurðsson
Jónína Guðbjartsdóttir
Kristín Hannesdóttir
Oddný Lára Eiríksdóttir
Oddrún Jónasdóttir

INTERNAL AUDITING DEPARTMENT

Guðmundur Björnsson
Stefán Svavarsson

FINANCIAL STABILITY DEPARTMENT

Bryndís Ásbjarnardóttir
Elín Kristjana Sighvattdóttir
Guðmundur Kr. Tómasson
Guðrún Ögmundsdóttir
Jónas Þórðarson
Perla Ösp Ásgeirsdóttir
Sylvía Kristín Ólafsdóttir
Tryggvi Pálsson

Cashier's Unit

Auður Gísladóttir
Ingveldur S. Kristjánssdóttir
Jóhanna Pétursdóttir
Kolbrún Jóhannsdóttir
Kristján Guðmundsson
Sigríður Ketilsdóttir
Stefán Arnarson

ECONOMICS DEPARTMENT

Arnór Sighvatsson
Ásgeir Daníelsson
Guðrún Yrsa Richter
Gunnar Gunnarsson
Helga Guðmundsdóttir
Karen Á. Vignisdóttir
Magnús Fjalar Guðmundsson
Markús Möller
Martin Seneca
Ólafur Örn Klemensson
Rannveig S. Sigurðardóttir
Regína Bjarnadóttir
Rósa Björk Sveinsdóttir
Svava Jóhanna Haraldsdóttir
Þorvarður Tjörvi Ólafsson
Þórarinn G. Pétursson

OPERATIONS DEPARTMENT

Birna K. Jónsdóttir
Hólfríður M. Ingibergsdóttir
Ingvar A. Sigfússon
Kristjón Kolbeins
Þórður Gautason

Maintenance and Janitorial Services

Bogey R. Hreiðarsdóttir
Guðný Harpa Hallgrímsdóttir
Hildur Hrönn Hreiðarsdóttir
Káritas Ísaksdóttir
Kristinn Unnarsson
Marteinn Jóhannesson
Olga A. Björnsdóttir
Ólafía Egilsdóttir
Ragnheiður E. Rúnarsdóttir
Rita Sigurðardóttir
Sigurlaug Jósepsdóttir
Sólveig Kristinsdóttir
Stefanía Hrönn Guðnadóttir

Cafeteria

Bergþóra Óskarsdóttir
Guðlaug Erla Ingólfssdóttir
Halla Kristín Björnsdóttir
Sigríður Laufey Guðmundsdóttir
Sigurborg Jónsson

Design and Printing

Sigríður María Jónsdóttir
Sigurborg Steingrimsdóttir
Sveinn A. Blöndal

Secretaries

Hrafnhildur Georgsdóttir
Klara Jóhannsdóttir
Þórey Þórarinsdóttir

Archives

Eva Sóley Sigurðardóttir
Guðrún Sigmarsdóttir
Hilmar Gunnþór Garðarsson
Sveinbjörg Rut Helgadóttir

Transport

Garðar Halldórsson
Karl G. Smith

Security

Guðleifur Svanbergsson
Hannes Ólafsson
Hólmgeir H. Hákonarson
Jóhann Gunnar Friðjónsson
Sigurður Sigurðsson
Sveinbjörn Kristjánsson
Þorsteinn Þorvaldsson

STATISTICS AND IT DEPARTMENT

Anna Karen Arnarsdóttir
Arnar Freyr Guðmundsson
Bryndís Pétursdóttir
Einar Örn Ólafsson
Eva Hjördís Bjarnadóttir
Fjóra Agnarsdóttir
Guðmundur Harðarson
Gylfi Vilberg Árnason
Hrönn Helgadóttir
Jakob Gunnarsson
Karl Jóhann Magnússon
Lárus Jóhannesson
Lilja Anna Gunnarsdóttir
Margrét Sigríður Guðjónsdóttir
Mark Townley
Pétur Örn Sigurðsson
Ríkarður B. Ríkarðsson
Tómas Örn Kristinsson
Tryggvi Eyvindsson
Örn Jónasson



ANNUAL ACCOUNTS 2008

Confirmation by the Supervisory Board and Board of Governors

The Supervisory Board and the Board of Governors of the Central Bank of Iceland hereby confirm the Annual Accounts for the year 2008.

Reykjavík, March 30, 2009

Supervisory Board

Lára V. Júlíusdóttir
Chairman

Ágúst Einarsson
Jónas Hallgrímsson
Ragnar Arnalds

Friðrik Már Baldursson
Katrín Olga Jóhannesdóttir
Birgir Þór Runólfsson

Governors

Svein Harald Øygard
Governor

Arnór Sighvatsson
Deputy Governor

Auditor's Report

We have audited the Annual Accounts for the Central Bank of Iceland for the year 2008. These Annual Accounts comprise a report from the Supervisory Board and the Governors, Profit and Loss Account, Balance Sheet, Statement of Cash Flows, information on important accounting policies, and other explanatory notes.

Management's responsibility for the Annual Accounts

Management is responsible for the preparation and fair presentation of these Annual Accounts in accordance with the Annual Accounts Act. This responsibility includes designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of annual accounts that are free of material misstatement; selecting and applying appropriate accounting principles; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to render an opinion on the Annual Accounts based on our audit. We carried out our audit in accordance with generally accepted auditing standards and the provisions of the Act on the National Audit Bureau. Those standards and provisions require that we follow a code of conduct and that we plan and perform the audit so as to obtain reasonable assurance that the annual accounts are free of material misstatement.

The audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatement in the accounts. The audit also includes evaluating the appropriateness of the accounting principles used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

It is our opinion that the Annual Accounts give a true and fair view of the results of operations of the Central Bank of Iceland for the year 2008, the financial position as at December 31, 2008, and cash flows for the year then ended, in accordance with the Annual Accounts Act.

National Audit Bureau, March 30, 2009

Sveinn Arason
Auditor General

Confirmation by the Prime Minister

With reference to the statements of the auditor, the Supervisory Board and Board of Governors, the Annual Accounts are hereby ratified.

Reykjavík, March 31, 2009

Jóhanna Sigurðardóttir
Prime Minister

Profit and Loss Account for 2008

	Notes	2008	2007
Interest income			
On domestic loans		71,002,316	25,346,076
On foreign deposits and securities		12,833,835	5,935,188
		<u>83,836,151</u>	<u>31,281,264</u>
Interest expense			
On domestic deposits		55,640,308	21,778,592
On foreign liabilities		8,484,573	3,455,811
		<u>64,124,881</u>	<u>25,234,403</u>
Net interest income	14	19,711,270	6,046,861
Other income (expenditure)			
Income from services		388,333	232,651
Expenditure on services		(187,747)	(107,654)
Notes retired		–	118,220
Share investment income		93,330	320,290
Valuation changes on foreign securities and debt	1,9	3,863,404	1,161,156
Price increase on gold		162,560	797,228
Exchange rate gain on foreign currency transactions		1,432,571	9,260
		<u>5,752,451</u>	<u>2,531,151</u>
Net operating income		25,463,721	8,578,012
Other expenses			
Salaries and payroll expenses	10,16	1,171,122	921,195
Other operating expenses	16	1,692,413	413,095
Expenses relating to new notes and coins		115,517	143,355
Depreciation	4	90,520	87,710
		<u>3,069,572</u>	<u>1,565,355</u>
Collateral loans written off	20	75,000,000	–
		<u>78,069,572</u>	<u>1,565,355</u>
Profit (loss) before transfer to Treasury		<u>(52,605,851)</u>	<u>7,012,657</u>
Transfer to Treasury	9	–	2,337,552
Profit (loss) before exchange rate gain (loss)		<u>(52,605,851)</u>	<u>4,675,105</u>
Exchange rate gain (loss), net	15	43,980,457	(5,898,662)
Net profit (loss) for the year	12	<u>(8,625,394)</u>	<u>(1,223,557)</u>

Balance Sheet at December 31, 2008

ASSETS

	Notes	2008	2007
Foreign assets			
Cash balances with other banks		207,256,518	19,348,284
Gold	3	6,652,894	3,305,189
Debt securities	3,6	211,855,297	138,322,338
Reserve tranche with the IMF	5	3,515,293	1,822,996
Assets not included in foreign reserves	2	210,651	786,675
Foreign assets		<u>429,490,653</u>	<u>163,585,482</u>
Domestic assets			
<i>Deposit money banks</i>			
Collateral loans	7	110,334,271	258,164,548
Collateral loans/overnight loans past due	20	231,024,172	–
Foreign loans	20	110,942,609	–
Other claims in foreign currency		14,238,789	–
		<u>466,539,841</u>	<u>258,164,548</u>
<i>Other financial institutions</i>			
Listed securities		2,757,323	1,446,568
Collateral loans		13,665,591	44,553,548
Other loans		–	4,101,698
		<u>16,422,914</u>	<u>50,101,814</u>
<i>Central government</i>			
Bond issued	20	270,005,388	–
<i>Other</i>			
Miscellaneous accounts		117,386	55,070
Securities		61,759	75,859
		<u>179,145</u>	<u>130,929</u>
<i>Fixed assets</i>			
Property and equipment	4	4,821,724	4,875,730
Domestic assets	1	<u>757,969,012</u>	<u>313,273,021</u>
Total assets		<u><u>1,187,459,665</u></u>	<u><u>476,858,503</u></u>
Assets off balance sheet	13		

All amounts in thousand kr.

Balance Sheet at December 31, 2008

LIABILITIES AND EQUITY

	Notes	2008	2007
Foreign liabilities			
Foreign demand deposits and repurchase agreements	3,6	58,029,541	99,541
Loans from Nordic central banks		76,373,187	–
SDR allocation with the IMF	5	3,058,311	1,612,593
IMF stand-by facility	5	104,521,027	–
		<u>241,982,066</u>	<u>1,712,134</u>
Domestic liabilities			
Notes and coin		24,436,438	15,735,426
<i>Deposit money banks</i>			
Sight deposits, including required deposits	7	90,617,889	152,111,529
Certificates of deposit		167,600,343	–
Foreign currency deposits		111,771,235	–
Other claims in foreign currency		16,519,266	–
		<u>386,508,733</u>	<u>152,111,529</u>
<i>Other financial institutions</i>			
Sight deposits, including required deposits	7	4,415,226	1,425,239
Certificates of deposits		9,826,958	–
		<u>14,242,184</u>	<u>1,425,239</u>
<i>Central government</i>			
Government deposits		168,722,997	93,970,973
Time deposits		16,482,643	26,814,835
Foreign currency deposits		2,376,001	864,722
Foreign long-term debt	9	169,404,066	88,990,036
Loan from Treasury	9	45,365,912	–
Government institutions, deposits		894,607	536,006
		<u>403,246,226</u>	<u>211,176,572</u>
<i>Other liabilities</i>			
Unpaid transfer to Treasury		–	2,337,552
Miscellaneous		34,318,954	1,036,091
Pension obligation	8	347,218	320,719
		<u>34,666,172</u>	<u>3,694,362</u>
		<u>863,099,753</u>	<u>384,143,128</u>
Equity			
Contributed capital	12	57,501,000	57,501,000
Revaluation account		4,990,681	4,990,681
Other reserves		19,886,165	28,511,560
		<u>82,377,846</u>	<u>91,003,241</u>
Liabilities and equity		<u>1,187,459,665</u>	<u>476,858,503</u>
Liabilities off balance sheet	13		

All amounts in thousand kr.

Statement of Cash Flows 2008

OPERATING ACTIVITIES:	Notes	2008	2007
Net profit (net loss) for the year		(8,625,394)	(1,223,557)
<i>Operating items not involving cash:</i>			
Depreciation		90,520	87,710
Exchange rate differences on assets and liabilities	15	(16,539,609)	4,321,437
Exchange rate differences on cash position	15	(27,440,848)	1,577,225
Valuation change, long-term debt	9	–	(1,801,665)
Various valuation changes, assets and liabilities		(3,757,613)	(1,263,634)
Collateral loan written off	20	75,000,000	–
<i>Change in operating assets and liabilities, net</i>		<u>(4,647,597)</u>	<u>2,837,936</u>
From operating activities		<u>14,079,457</u>	<u>4,535,452</u>
INVESTING ACTIVITIES:			
Collateral loans and overnight loans granted		(393,209,629)	(159,883,123)
Loans to domestic banks in foreign currency		(100,178,849)	–
Purchase price of property and equipment		(37,068)	(100,617)
Share investment sold		633,921	–
Listed domestic securities bought		(1,702,110)	–
Securities, amortisation		197,293	234,209
Investment in bonds in foreign reserves		(59,902,623)	(47,419,630)
Bonds in foreign reserves sold		116,842,323	22,910,830
Total investing activities		<u>(437,356,742)</u>	<u>(184,258,331)</u>
FINANCING ACTIVITIES:			
Notes and coins in circulation, increase		8,701,012	1,341,145
Stand-by facility from IMF	5	115,743,131	–
Loans from Nordic central banks		67,742,000	–
Other loans	6	91,548,418	–
Certificates of deposit, increase (decrease)		176,448,336	(1,777,253)
Time deposit, (decrease)		(10,100,000)	(6,100,000)
Increase in contributed capital		–	44,000,000
Foreign currency deposits, increase (decrease)		84,124,384	(2,595,000)
Increase (decrease) in demand deposits, money banks		(58,503,653)	112,791,756
Increase in demand deposits, other		32,930,418	–
Increase in demand deposits, central government		75,110,625	11,338,297
Total financing activities		<u>583,744,671</u>	<u>158,998,945</u>
CHANGE IN CASH POSITION:			
Foreign cash balance, increase (decrease)		160,467,386	(20,723,934)
Exchange rate differences on cash position		27,440,848	(1,577,225)
Foreign cash balance at beginning of year		19,348,284	41,649,443
Foreign cash balance at end of year		<u>207,256,518</u>	<u>19,348,284</u>

All amounts in thousand kr.

Notes to the Annual Accounts for 2008

1. The Annual Accounts have been prepared in accordance with the Annual Accounts Act, no. 3/2006; the provisions of the Act on Financial Undertakings, no. 161/2002; and the Rules on Central Bank Accounting and Annual Accounts, no. 1088/2005.
 - Assets and liabilities denominated in foreign currencies are translated into Icelandic krónur (kr.) using the buying exchange rate at the end of 2008. Income and expenses in foreign currencies are converted using the exchange rate on the date of transaction. Exchange rate gains/losses are posted to the Profit and Loss Account.
 - Assets and liabilities linked to price indices are shown in the Balance Sheet with accrued indexation at year-end, stated in terms of the relevant index figures for January 2009 reflecting price levels at year-end 2008. Indexation is entered in the Profit and Loss Account under Interest income/on domestic loans.
 - Debt securities in foreign reserves are recorded at market value, and valuation changes are entered in the Profit and Loss Account. The valuation changes reflect the difference between market value and book value based on amortised cost, with unamortised discounts and premiums recorded based on a straight-line basis, which approximates effective interest cost.
 - Income is entered when earned, whether or not it has been collected. Likewise, expenses are entered when incurred, whether or not they have been paid. Changes in the valuation of debt securities are also entered in the Profit and Loss account regardless of whether they are realised or unrealised.
 - In preparing the Statement of Cash Flows, the conventional classification of activities is used and the cash position refers to foreign bank balances.
 - Share investments are stated at cost because the shares owned by the Bank are not listed.
 - The cost of printing notes and minting coins is expensed as incurred.
 - Fixed assets at the end of 2005 were revalued to fair value, with subsequent depreciation based on that fair value. Fixed assets purchased in 2006 and later are recorded at cost less accumulated depreciation, with annual depreciation based on cost less the expected salvage value.
2. The Bank's holding in the Bank for International Settlements (BIS) is entered at cost price. At the end of 2008, the Bank held 1,070 shares at a nominal value of 5,000 SDR per share. This holding is entered under the item Foreign Assets/Assets not included in foreign reserves. The book value at year-end 2008 amounted to 184.5 m.kr., and the nominal value was 248.8 m.kr. (1.3 m. SDR).

Summary of accounting policies

Shareholdings

The Bank has paid 25% of the nominal value of each share, or 1,250 SDR; thus the remainder, or 75%, is unpaid, and the Bank is obliged to pay the outstanding shares if they are called. Based on the financial statements for BIS at the end of March 2008, the Bank's interest in the book value of equity amounts to 4,7 b.kr.

The item Other/Miscellaneous accounts includes the Bank's 8% equity in Fjölgreiðslumiðlun hf., a netting service provider. The book value of this holding is 1.2 m.kr., which is also the nominal value. During the year, the Bank sold its share in OMX for 633 m.kr.

Foreign assets and gold

3. The Bank's foreign assets amounted to 429.5 b.kr. at the end of 2008 but were 163.6 b.kr. at the end of the previous year. The figure includes the Central Bank's gold reserves, which amounted to 63,785.1 troy ounces. The gold is valued at its end-2008 market value of 865 dollars, or 104,302 kr., per troy ounce. At the end of 2008, the Bank's gold reserves therefore amounted to 6.6 b.kr.

Return on bonds and bank balances in foreign reserves during the year were as follows, by currency:

	<i>Bonds</i>	<i>Bank balances</i>
US dollars	7.38%	1.97%
Euros	5.96%	4.08%
Pounds sterling	8.92%	4.71%

Bond investment at the end of 2008 is specified as follows, and the book value is at market value:

		<i>Un-amortized premium, Amortized net cost</i>			<i>Un-realized valuation chg.</i>	
<i>(amounts in thous. of foreign currency)</i>		<i>Par value</i>	<i>Un-amortized premium, net</i>	<i>Amortized cost</i>	<i>Market value</i>	<i>Un-realized valuation chg.</i>
Euro bonds	EUR	1,010,500	7,459	1,017,959	1,028,464	10,505
Dollar bonds	USD	194,060	2,691	196,751	202,129	5,378
Sterling bonds	GBP	49,109	(1,000)	48,109	50,575	2,466

The Central Bank has entered into a securities lending program with JPMorgan Chase Bank, which lends out securities in the Bank's possession. At year-end 2008, no loaned securities were outstanding, but during the year the fee received from lending amounted to USD 585,000.

Bonds used as collateral for repurchase agreements are valued at 50 b. kr., as per note 6.

Fixed assets

4. Fixed assets were revalued at year-end 2005. Property and equipment acquired after that date are recorded at historical cost less accumulated depreciation, which takes into account the expected salvage value at the end of useful life.

Fixed assets at the end of 2008 are specified as follows (in m.kr.):

	<i>Land</i>	<i>Real estate</i>	<i>Equip./ furnish.</i>	<i>Collec- tions</i>	<i>Total</i>
<i>Assets</i>					
Balance 1/1 2008	24.0	4,666.3	223.7	239.7	5,153.7
Purchased in 2008			34.5	5.4	39.9
Sold in 2008			(3.9)		(3.9)
	<u>24.0</u>	<u>4,666.3</u>	<u>254.3</u>	<u>245.1</u>	<u>5,189.7</u>
<i>Accumulated depreciation</i>					
Balance at 1/1 2008		146.3	131.7		278.0
Depreciation in 2008		49.9	40.6		90.5
Accum. depr. on assets sold in 2008			(0.5)		(0.5)
	<u>0.0</u>	<u>196.2</u>	<u>171.8</u>	<u>0.0</u>	<u>368.0</u>
Book value at year-end 2008	<u>24.0</u>	<u>4,470.1</u>	<u>82.5</u>	<u>245.1</u>	<u>4,821.7</u>
Depreciation ratio	0%	1.25-3%	10-33%	0%	
Land Registry valuation 2008	0.5	4,441.8			4,442.3
Insurance valuation 2008		5,507.6	350.0	260.0	6,117.6

5. Iceland's quota with the International Monetary Fund (IMF) amounted to 117.6 m. SDR at the end of 2008. One-quarter of the quota was originally paid with a gold contribution and the remainder in Icelandic currency. The Bank's reserve tranche position with the IMF was 18.6 m. SDR, which is the difference between the quota and the IMF's total currency holdings from the Bank (see table). The Bank's borrowing in the form of the SDR allocation from the IMF amounted to 16.4 m. SDR. The Bank received the first payment on the Stand-by facility with the IMF.

International Monetary Fund

<i>Assets:</i>	<i>Figures are in millions</i>	
	<i>SDR</i>	<i>ISK</i>
Central Bank of Iceland's quota	117.6	21,876.0
Total currency holdings	(99.0)	(18,418.2)
Reserve tranche position	18.6	3,457.8
Accrued interest on tranche	0.0	4.5
SDR deposit with IMF	0.3	52.9
	<u>18.9</u>	<u>3,515.2</u>
<i>Liabilities:</i>		
	<i>SDR</i>	<i>ISK</i>
SDR allocation with IMF	16.4	3,052.4
Currency holdings, No. 2 account	0.0	0.1
Accrued interest on allocation	0.0	5.8
Stand-by facility	560.0	104,171.2
Accrued interest on stand-by facility	1.9	349.8
	<u>578.3</u>	<u>107,579.4</u>

The stand-by facility, 560 m. SDR, is the first payment on a loan from the IMF. The down payment on the loan was received on November 19, and the average interest cost for the period to year-end 2008 is approximately 3%, excluding lending fees amounting

to 3.1 m. SDR. The remainder of the loan, according to the loan agreement with the IMF, will be paid in eight equal instalments over the next two years, with each payment amounting to 105 m. SDR, for a total of 840 m. SDR. The total amount of the loan, 1.4 b. SDR, will be repaid over a period of four years, beginning in 2012.

Foreign debt

6. The Bank has entered into swap agreements with the central banks of Denmark, Norway and Sweden. The agreement is for 500 m. euros from each of the banks, or a total of 1,500 m. euros. At the end of 2008, the Bank had drawn on this facility in the amount of 150 m. euros from each of the banks, for a total of 450 m. euros. The swap contracts are renewed on a monthly basis, and the interest paid is approximately 3%.

At the end of 2008, the Bank had entered into repurchase agreements with BIS, and the outstanding loans amounted to 46 b.kr. at the end of the year, with collateral, in the form of bond investments, valued at 50 b.kr. Additionally, the Bank has a line of credit with BIS in the amount of 12 b.kr. (70 m. euros) at the end of 2008.

Financial institutions

7. Credit institutions that are participants in the Central Bank's Real-Time Gross Settlement (RTGS) system pledge collateral for payment in the system. Collateral is in the form of securities. The amount corresponds to the intraday overdraft for participants to meet fluctuations on their RTGS accounts.

At the end of 2008, market value of collateral securities in the RTGS system amounted to 19.1 b.kr.

Credit institutions pledge collateral to the custody of the Central Bank for their collateral loans in accordance with Rules no. 997/2004.

The net position of financial institutions towards the bank increased by 196.1 b.kr. during the year, as compared with an increase of 51.5 b.kr. for the previous year; the increase is specified as follows:

<i>Increase in net position:</i>	<i>B.kr.</i>	<i>B.kr.</i>
Collateral loans and claim on central gov. for same at end of 2008.....	825.2	
Collateral loans written off	(75.0)	
Net position as per balance sheet.....	750.2	
Deposits at the end of 2008.....	(400.7)	349.5
Collateral loans at the end of 2008	306.9	
Deposits at the end of 2008.....	(153.5)	153.4
Net position		<u>196.1</u>

Pension obligation

8. According to actuarial valuations, the Bank's total pension obligations towards former Governors of the Bank and their spouses, as well as towards the directors of the National Economics Institute,

for which the Bank was responsible for half the costs, amounted to 347.2 m.kr. at the end of 2008. Payments during the year towards this obligation, amounting to 45.3 m.kr., reduce previously recorded debt. The increase in the pension obligation, after taking into account payments for the year, amounted to 71.8 m.kr., which was expensed.

9. The Central Bank's transfer to the Treasury, according to Article 34 of the Central Bank Act, no. 36/2001, is equal to two-thirds of its net profit (excluding exchange rate loss or gain) in the year, provided that its equity (excluding revaluation of fixed assets) exceeds 2.25% of the outstanding lending and domestic securities stock of the credit system at the end of the year, but otherwise one-third. The Bank's equity was below this limit at the end of 2008. Therefore, a transfer would have been based on one-third of profit except that the Bank incurred a loss in 2008; thus there will be no transfer to the central government for 2008.

The Bank borrowed funds from the central government to increase foreign reserves at the end of 2006. The Treasury sold bonds on foreign markets and lent the proceeds to the Bank in the amount of 1 b. euros. The nominal interest rate is 3.75%, but the bonds sold at the effective rate of 3.88%. Due to the special circumstances on the financial market, a change in accounting policy was called for, and the debt is now recorded at amortised cost; previously, the bond debt was shown at market value with valuation changes credited to the income statement. The net valuation change for 2008, which would have been credited to the income statement with unchanged accounting policy, amounted to 11.4 b.kr. The maturity date of the bond is December 1, 2011.

The Bank also borrowed from the central government in late 2008 for the purpose of increasing its reserves. The government took a loan from Bayerische Landesbank in the amount of 300 m. euros. The loan was received at the end of September, with interest to be paid semiannually, in March and September. The due date is in September 2011. The funds lent to the Bank will be denominated in krónur, and the equivalent amount in kr. is 43.5 b.kr. Interest on the loan will be equal to the interest paid on deposits at deposit money banks, currently 17.5%. Borrowing costs were borne by the Treasury. The book value of the debt at the end of 2008 was 45.3 b.kr., including accrued interest.

Deposits of the central government with the Bank amounted to 403 b.kr. at the end of 2008, as compared with 211 b.kr. at the end of 2007, for an increase of 192 b.kr. The increase is explained by exchange rate difference and valuation changes in the amount of 83 b.kr., new loans to the Bank in the amount of 44 b.kr., and increase in deposits for the remaining 65 b.kr.

10. Total remuneration and fees to the Board of Governors and Supervisory Board amounted to 79.7 m.kr. in 2008. Governors are not

Central government

Emoluments of the Supervisory Board and Board of Governors

remunerated for sitting on boards and committees that are established jointly by the financial market institutions and companies, or to which the Central Bank appoints representatives by law. Total emoluments of the Board of Governors and Supervisory Board in 2008 were as follows:

<i>Board of Governors</i>		<i>M.kr.</i>
Davíð Oddsson		25.3
Eiríkur Guðnason		19.8
Ingimundur Friðriksson		19.7
<i>Supervisory Board</i>		
Halldór Blöndal		3.4
Other members, including alternates (12)		11.5
		<u>79.7</u>

Auditor's fee

11. The fee paid by the Central Bank to the National Audit Office for auditing the accounts and other audit services for 2008 amounted to 1.6 m.kr.

Equity and net profit

12. Over the past five years, the Bank's equity has developed as follows (in m.kr.):

<i>Equity</i>	2008	2007	2006	2005	2004
Equity at beginning of year (excl. revaluation)	86,012	43,236	31,379	34,198	40,217
Capital contribution		44,000			
Net profit before transfer and exch. differences	(52,606)	7,013	48	(186)	487
Transfer to Treasury		(2,338)	(16)		
Exchange rate differences, gain (loss)	43,980	(5,899)	11,825	(2,633)	(6,506)
Equity at end of year (excl. revaluation)	77,386	86,012	43,236	31,379	34,198
Revaluation of fixed assets	4,991	4,991	4,991		
Equity at year-end	<u>82,377</u>	<u>91,003</u>	<u>48,227</u>	<u>31,379</u>	<u>34,198</u>
<i>Position at year-end in b.kr.</i>					
Total assets	1,187.4	476.8	321.8	162.3	106.6
Equity - excluding revaluation reserves	77.4	86.0	43.2	31.4	34.2
Domestic lending and securities	7,705.1	5,576.8	4,298.2	3,234.8	2,658.1
Equity/total assets	6.5%	18.0%	13.4%	19.3%	32.1%
Equity/domestic lending and securities	1.0%	1.5%	1.0%	1.0%	1.3%

Guarantees and off-balance sheet commitments

13. The Bank is obligated on call to pay a subscription to a share issue of the BIS. The Bank has paid 25% of the subscription and the remaining 75% can be called; the obligation involved amounts 746 m.kr.

The Central Bank's equity interest in the Icelandic Banks' Data Centre (RB) is not reflected in the accounts. In formal terms, this is a joint operation under the auspices of all banks and savings banks in Iceland, in accordance with an agreement to that effect. The partnership agreement states that the Central Bank's contribution was one-fifth of the Banks' Data Centre's initial capital. The book value of owners' equity in the Banks' Data Centre was 1.5 b.kr. at the end of 2008.

At the end of 2008, the Central Bank had access to committed credit facilities with foreign financial institutions in the amount of 100 m. US dollars, which was equivalent to 12 b.kr. The Bank had used this facility with a credit line of 70 m. euros, which is included in foreign debt.

14. Net interest income amounted to 19.7 b.kr. in 2008, as compared with 6 b.kr. in the previous year. The main explanation for the increase is higher net interest from monetary policy instruments, which rose by 31 b.kr. This increase was offset in part by an increase in interest expense on the central government's deposits and deposits of money banks in the amount of 18 b.kr. Net interest income is specified as follows (in thous.kr.):

	2008	2007
<i>Net interest income on monetary policy instruments:</i>		
Interest income on collateral loans.....	71,002,316	25,170,987
Interest expense on required deposits with credit institutions	(5,998,252)	(5,459,201)
Interest expense on certificates of deposit....	(13,992,949)	0
	<u>51,011,115</u>	<u>19,711,786</u>
<i>Net interest income on foreign reserves:</i>		
Interest income on foreign bank balances....	1,650,294	644,594
Interest income on foreign debt securities....	9,925,373	5,290,594
Interest expense on central government's financing loan.....	(6,856,944)	(3,013,878)
	<u>4,718,723</u>	<u>2,921,310</u>
<i>Other interest income (expense):</i>		
Interest expense on central government's deposits:		
Time deposits	(3,263,727)	(3,980,385)
Demand deposits	(21,487,274)	(10,322,960)
	<u>(24,751,001)</u>	<u>(14,303,345)</u>
Interest income on other assets	1,258,167	175,088
Other interest expense to credit institutions..	(9,056,194)	(2,016,047)
Interest expense on foreign debt and deposits	(3,469,540)	(441,932)
	<u>(36,018,568)</u>	<u>(16,586,236)</u>
Net interest income	<u>19,711,270</u>	<u>6,046,860</u>

15. The net exchange rate gain amounted to 43.9 b.kr. in 2008, as compared with a net exchange rate loss of 5.9 b.kr. in 2007. The exchange rate differences (loss)/gain are calculated on the following foreign assets and liabilities (in thous.kr.):

Net interest income

Exchange rate differences

	2008	2007
Gold	3,187,420	(404,157)
IMF accounts, net	11,786,879	(21,854)
Foreign bank balances	27,440,849	(1,577,224)
Foreign securities	124,975,203	(7,393,857)
Foreign short-term debt	(9,846,996)	(9,149)
Domestic deposits/debt denominated in foreign currencies	(113,562,898)	3,507,580
Net exchange rate differences	<u>43,980,457</u>	<u>(5,898,661)</u>

Salaries and payroll costs

16. Salaries and payroll costs are specified as follows (in thous.kr.):

	2008	2007
Salaries	918,418	761,395
Payroll costs	180,921	152,855
Pension expense, retired Governors	71,782	6,945
	<u>1,171,121</u>	<u>921,195</u>

Operating expenses other than salaries and related expenses amounted to 1.9 b.kr. for 2008, as compared with 0.6 b.kr. in the previous year. The increase, 1.3 b.kr., is explained primarily by consulting work relating to the financial crisis in the banking sector; expenses relating to consultancy increased by 1.1 b.kr. from the prior year.

Risk management

17. The Central Bank of Iceland is a public institution entrusted by law to carry out specific duties that relate primarily to monetary policy decisions and the management of foreign reserves. The risk in the Bank's operations is therefore of a different character than that in commercial banking operations, even though the same terms are used. The risks the Bank faces are primarily of the following types: interest rate risk, foreign currency risk, credit risk, and liquidity risk. These risks are explained briefly in the following notes. In addition, the Bank's operational risk is the risk of human error and failure of internal processes and systems. Operational risk is managed on a daily basis by the Bank's personnel, and every care is taken to implement internal controls and procedures to minimise the risk of errors and other failures.

Interest rate risk

18. Interest rate risk is the risk of loss due to changes in interest rates. It is the Bank's investment policy, with respect to foreign debt securities, to invest only in liquid securities issued by highly rated parties. The return on these securities is also considered when investments are made. The Bank has not been an active trader thus far; rather, it has adhered largely to the policy of investing in debt securities and holding them to maturity. The portfolio is under constant supervision, however, and the securities are sold if there is the slightest evidence of possible default or decrease in value due to credit risk. The Bank does not use derivatives to manage its interest rate risk on its investments in foreign securities, bank deposits or liabilities, and the same applies to domestic assets and liabilities. The return on domestic assets in the form of collateral loans is depend-

ent on the effective discount rate at any given time; interest on the deposits of commercial banks, as well as the central government, is determined based on such discount rates.

The Bank's net interest is dependent on two things. On the one hand, it is based on the difference between interest rates on assets and liabilities, and on the other hand, it is based on the average amount invested in assets and the corresponding liabilities. The assets and liabilities are specified as follows, with the related actual interest and the related calculated average interest rates for the year 2008:

<i>B.kr. or %</i>	<i>Year-end</i>	<i>Year-end</i>	<i>Avg. position</i>	<i>Interest recorded</i>	<i>Calculated avg. interest</i>
	<i>2007</i>	<i>2008</i>			
<i>Assets</i>					
Bank balances.....	19.3	207.3	113.3	1.60	1.4%
Gold.....	3.3	6.6	5.0	0.01	0.2%
Debt securities.....	138.3	211.9	175.1	9.82	5.6%
Reserve position with the IMF.....	1.8	3.5	2.7	0.05	1.9%
Foreign assets excl. from reserves.....	0.8	0.2	0.5	0.00	0.0%
Collateral loans and overnight loans.....	306.9	465.9	386.4	72.26	18.7%
Listed securities.....	1.4	2.8	2.1	0.10	4.8%
Other securities.....	0.1	14.4	7.3	0.00	0.0%
Central government	0.0	270.0	135.0	0.00	0.0%
	<u>471.9</u>	<u>1,182.6</u>	<u>827.3</u>	<u>83.84</u>	<u>10.1%</u>
Other assets	4.9	4.8	4.9		
	<u>476.8</u>	<u>1,187.4</u>	<u>832.1</u>		
<i>Liabilities</i>					
Foreign deposits and repurchase agreements ..	0.1	134.4	67.3	1.68	2.5%
Loan from IMF and SDR allocation.....	1.6	107.6	54.6	1.05	1.9%
Notes and coins.....	15.7	24.4	20.1	0.00	0.0%
Commercial bank deposits	153.5	95.0	124.3	15.07	12.1%
Commercial bank foreign deposits.....	0.0	111.8	55.9	0.00	0.0%
Certificates of deposit	0.0	177.4	88.7	13.96	15.7%
Central governm. deposits	94.5	169.6	132.1	21.55	16.3%
Central government, time deposits	26.8	16.5	21.7	3.20	14.8%
Central government, foreign deposits	0.9	2.4	1.7	0.73	44.2%
Central government, relent funds.....	89.0	214.8	151.9	6.86	4.5%
Pension obligations.....	0.3	0.3	0.3	0.00	0.0%
Other debt.....	3.4	50.8	27.1	0.00	0.0%
	<u>385.8</u>	<u>1,105.0</u>	<u>745.4</u>	<u>64.10</u>	<u>8.6%</u>
Equity	91.0	82.4	86.7		
	<u>476.8</u>	<u>1,187.4</u>	<u>832.1</u>		

Note: The average position for central government foreign deposits as calculated above is not representative of the actual average position.

Foreign currency risk

19. The foreign currency risk is the risk of loss due to changes in exchange rates. The Bank has not used derivative instruments to manage its foreign currency risk. The currency ratios of the assets in reserves are dependent on the ratios in foreign trade for the economy as a whole, and in that connection, the euro is dominant. The Bank's assets and liabilities denominated in foreign currencies can be specified as follows at the end of 2008 (all figures are in millions of krónur):

Analysis of foreign currency financial assets and liabilities

Assets:	Euro	US dollar	UK pound	Special dr. rights	Japanese yen	Nordic krona	Other curr.	Total
Bank balances	71,112	89,083	26,224		3,934	14,255	2,649	207,257
Gold		6,652						6,652
Debt sec.	178,012	24,789	9,054					211,855
Res. position								
IMF				3,515				3,515
Domestic loans	118,294		2,975		2,939		1,186	125,394
	<u>367,418</u>	<u>120,524</u>	<u>38,253</u>	<u>3,515</u>	<u>6,873</u>	<u>14,255</u>	<u>3,835</u>	<u>554,673</u>
<i>Liabilities:</i>								
Foreign deposits	124,232	5,686	4,405			69	11	134,403
Loan from IMF				107,579				107,579
Foreign curr. dep.	44,788	28,748	21,380			14,169	5,062	114,147
Loan- res. investm.	169,404							169,404
	<u>338,424</u>	<u>34,434</u>	<u>25,785</u>	<u>107,579</u>	<u>0</u>	<u>14,238</u>	<u>5,073</u>	<u>525,533</u>
Difference	<u>28,994</u>	<u>86,090</u>	<u>12,468</u>	<u>(104,064)</u>	<u>6,873</u>	<u>17</u>	<u>(1,238)</u>	<u>29,140</u>
The Bank's domestic assets in excess of domestic liabilities								<u>53,237</u>
Equity at year-end 2008								<u>82,377</u>

Credit risk

20. Credit risk is the risk that asset claims will be lost due to deteriorating financial condition of debtors and debtors' inability to repay their debt to the Bank. The Bank has not experienced such losses as yet. Due to the commercial banks' liquidity problems, which led to solvency problems, the Central Bank will incur losses due to decreasing value of collateral that has proven to be inadequate even though it was deemed to be of good quality at the time of lending. In view of this situation, the central government has bought collateral loans with a book value of 345 billion krónur and paid with a five-year indexed bond in the amount of 270 b.kr. bearing 2.5% interest. Of the total amount, collateral loans in the amount of 51 billion krónur were considered of good quality, but for the remainder, collection is uncertain; therefore, the Bank had to write off 75 billion krónur. Collateral loans and overnight loans to the commercial banks now under administration, but with sound collateral, amount to 231 billion krónur, including accrued interest.

In addition, the Bank has lent the equivalent of 110 billion krónur in foreign currency to the commercial banks. The collateral for these are loans is regarded of good quality and includes all the outstanding shares of the Danish bank FIH. For this reason, no bad debt allowance is made for these loans due to credit risk. Two tables relating to the Bank's credit risk follow:

*Concentration of credit exposure:
(Figures in millions of krónur)*

<i>Origin of claims:</i>	<i>Fin. assets at year-end 2008</i>	<i>Ratio</i>
Iceland	752,985	63.7%
United States of America	112,399	9.5%
Euro countries	250,373	21.2%
United Kingdom	44,335	3.7%
Nordic countries	14,256	1.2%
Supranational financial organisations	3,699	0.3%
Others	4,592	0.4%
Total financial assets	1.182,639	100.0%

*Credit risk of assets in reserves based on credit ranking:
(Figures in millions of krónur)*

	<i>Rating</i>	<i>Year-end 2008</i>	<i>Ratio</i>
Bank balances	AAA	207,257	48.3%
Debt securities, pounds sterling ..	AAA	8,148	1.9%
Debt securities, pounds sterling ..	AA	905	0.2%
Debt securities, US dollars	AAA	22,310	5.2%
Debt securities, US dollars	AA	2,479	0.6%
Debt securities, euros	AAA	122,829	28.6%
Debt securities, euros	AA	46,283	10.8%
Debt securities, euros	A	8,901	2.1%
Other assets in reserves	AAA	10,167	2.4%
Other		211	0.0%
Financial assets in reserves		429,490	100.0%

21. Liquidity risk is the risk of not being able to honour payment obligations as they fall due. This risk also comprises the risk of selling financial assets at a price below their fair value. The following table shows the estimated maturity of assets and liabilities, or due dates. The first column shows assets and liabilities that have no fixed maturity or are expected to be used permanently. The table is shown both in domestic and foreign currencies. All figures are in millions of krónur.

Liquidity risk

Maturity analysis of assets and liabilities

	No fixed maturity	3 months or less	3 to 12 months	1 to 5 years	More than 5 years	Total
<i>Foreign assets</i>						
Bank balances		207,257				207,257
Gold	18	6,634				6,652
Debt securities		211,855				211,855
Reserve position IMF	3,458	57				3,515
Assets exc. from reserve ..	184			27		211
Loans to domestic banks ..		116,707	8,475			125,182
	3,660	342,510	8,475	27	0	554,672
<i>Foreign liabilities</i>						
Short-term debt/deposits ..		248,549				248,549
Loan from IMF	3,058			104,521		107,579
Long-term debt				169,404		169,404
	3,058	248,549	0	273,925	0	525,532
Foreign curr. maturity gap	602	293,961	8,475	(273,898)	0	29,140
<i>Domestic assets</i>						
Collateral loans		124,001				124,001
Loans, past due		231,024				231,024
Listed securities			35	160	2,562	2,757
Other		117	14	48		179
Central government				270,005		270,005
Fixed assets	4,822					4,822
	4,822	355,142	49	270,213	2,562	632,788
<i>Domestic liabilities</i>						
Notes and coin	24,437					24,437
Deposits		111,553				111,553
Certificates of deposits ...			177,427			177,427
Central gov. deposits		168,723				168,723
Central gov. time dep.			16,483	45,366		61,849
Public institutions, dep.		895				895
Various other		34,319				34,319
<i>Pension obligations</i>			45	180	122	347
Equity	82,378					82,378
	106,815	315,490	193,955	45,546	122	661,928
Domestic currency gap	(101,993)	39,652	(193,906)	224,667	2,440	(29,140)
Foreign curr. maturity gap	602	293,961	8,475	(273,898)	0	29,140
Total amounts	(101,391)	333,613	(185,431)	(49,231)	2,440	0

APPENDICES

Press releases in 2008

No.			
1	January 14	The Central Bank of Iceland expands the definition of eligible collateral in regular transactions with the Bank	
2	January 14	Government Debt Management Prospect - Emphases in 2008	
3	January 25	The first working day of the year	
4	January 28	Moody's: Iceland's Aaa ratings at a 'crossroads'	
5	February 14	The Central Bank of Iceland leaves its policy rate unchanged	
6	February 14	<i>Monetary policy statement of the Board of Governors of the Central Bank of Iceland:</i> Policy interest rate unchanged	
7	March 4	Balance of payments in the fourth quarter of 2007 and the external position	
8	March 5	Moody's Assigns Negative Outlook to Iceland's Rating	
9	March 12	Corrections regarding the external position of the Icelandic economy and the capital and financial account for Q4/2007	
10	March 25	<i>Monetary policy statement of the Board of Governors of the Central Bank of Iceland:</i> The Central Bank of Iceland raises its policy rate	
11	March 25	Amendments to Central Bank of Iceland rules	
12	April 9	Moody's issues annual report on Iceland	
13	April 10	The Central Bank of Iceland raises its policy rate	
14	April 17	Iceland Sovereign Ratings Lowered On External Funding Risks; Outlook Negative	
15	May 16	The Central Bank of Iceland concludes swap facility arrangements	
16	May 22	The Central Bank of Iceland leaves its policy rate unchanged	
17	May 22	<i>Monetary policy statement by the Board of Governors of the Central Bank of Iceland:</i> Policy rate left unchanged	
18	June 4	New Rules on Foreign Exchange Balance	
19	June 4	Balance of payments in the first quarter of 2008 and the external position	
20	June 19	Issuance of Treasury notes and Central Bank of Iceland certificates of deposit	
21	July 3	The Central Bank of Iceland leaves its policy rate unchanged	
22	July 4	Concluding Statement by the IMF mission to Iceland 2008	
23	September 4	Balance of payments in the second quarter of 2008 and the external position	
24	September 8	Exchange of certificates of deposit	
25	September 11	The Central Bank of Iceland leaves its policy rate unchanged	
26	September 11	<i>Monetary policy statement by the Board of Governors of the Central Bank of Iceland:</i> Policy rate remains unchanged	
27	September 22	The Executive Board of the International Monetary Fund Concludes 2008 Article IV Consultation with Iceland	
28	September 29	The Government of Iceland provides Glitnir with new equity	
29	September 30	Standard & Poor's Ratings Services lowered its ratings on the Republic of Iceland	
30	October 2	Central Bank of Iceland increases the issue of certificates of deposits	
31	October 7	The Foreign Exchange Reserves of the Central Bank of Iceland bolstered	
32	October 7	Foreign exchange market measures	
33	October 7	Foreign exchange reserves	
34	October 8	Foreign exchange market	
35	October 8	Foreign exchange market	
36	October 14	The Central Bank of Iceland draws on swap facility arrangements	
37	October 15	Board of Governors of the Central Bank of Iceland decides 3.5% policy rate reduction	
38	October 15	Joint press release from the Central Bank of Iceland and the Russian Ministry of Finance	
39	October 21	Central Bank of Iceland collateralised loans	
40	October 28	Central Bank of Iceland raises the policy rate	
41	October 28	Central Bank of Iceland raises the policy rate	

42	November 6	The Central Bank of Iceland leaves its policy rate unchanged
43	November 20	Nordic central banks extend currency swap agreements
44	November 28	New foreign exchange regulation
45	November 28	<i>Monetary policy statement of the Board of Governors of the Central Bank of Iceland: Of vital importance to stabilise the foreign exchange market and strengthen the króna</i>
46	December 3	Interbank foreign exchange market
47	December 5	Balance of payments in the third quarter of 2008 and the external position
48	December 16	Amended Rules on Foreign Exchange
49	December 17	Changes to Central Bank of Iceland interest rates

Publications by the Central Bank of Iceland in 2008

In English:

Annual report 2007

Monetary Bulletin 2008, three issues

Financial Stability 2008

Economic Indicators, eleven issues

The Economy of Iceland 2008

Central Bank of Iceland Working Papers No. 38: The great moderation Icelandic style, by Ásgeir Daniélfsson.

Central Bank of Iceland Working Papers No. 39: Accuracy in forecasting macroeconomic variables in Iceland, by Ásgeir Daniélfsson.

Central Bank of Iceland Working Papers No. 40: How hard can it be? Inflation control around the world, by Þórarinn G. Pétursson.

Central Bank of Iceland Working Papers No. 41: QMM A Quarterly Macroeconomic Model of the Icelandic Economy, by Ásgeir Daniélfsson, Magnús F. Guðmundsson, Svava J. Haraldsdóttir, Þorvarður T. Ólafsson, Ásgerður Ó. Pétursdóttir, Þórarinn G. Pétursson and Rósa Sveinsdóttir.

In Icelandic:

Ársskýrsla 2007

Fjármálastöðugleiki 2008

Peningamál 2008, three issues

Hagvísar Seðlabanka Íslands, eleven issues

All of these publications are also posted on the Central Bank of Iceland website.

Economic and monetary chronicle 2008

January 2008

On January 14, the Government Debt Management Prospect for 2008 was announced. The Prospect described the proposed issue of Treasury notes with a nominal value of 47 b.kr., as well as a new benchmark series of 10- to 11-year Treasury notes. It also announced that the Treasury intended to discontinue the issuance of Treasury bills and retire foreign debt maturing during the year.

On January 17, the Rules on Central Bank of Iceland Facilities for Financial Undertakings were amended. The review of the Rules took account of comparable rules set by other central banks, including the European Central Bank and the central banks in the other Nordic countries. The amendments aimed to allow financial undertakings to use a greater variety of secured instruments as collateral for regular Central Bank facilities. The principal change from earlier versions of the Rules was that bonds issued in US dollars, pounds sterling, or euros were deemed eligible as collateral. Foreign-denominated bonds could not exceed 50% of the total value of collateral, however. Covered bonds issued in Icelandic krónur and backed by housing bond portfolios were also deemed eligible as collateral, and financial institutions were authorised to use their own covered bonds as well.

On January 28, Moody's Investor Service published a special report entitled, "Iceland's Aaa ratings at a crossroads". The report did not announce any changes in the Republic of Iceland's sovereign credit rating.

On January 30, Kaupthing Bank hf. announced that the bank and NIBC had decided to abandon Kaupthing's proposed acquisition of NIBC in view of financial market turbulence. Applications for approval by the pertinent regulatory authorities were withdrawn, and the purchase agreement was invalidated. As a result, the priority offering planned by Kaupthing for the first quarter of 2008 did not materialise.

February 2008

On February 1, the rules concerning the official customs clearance exchange rate were amended so as to base the customs price on the exchange rate registered by the Central Bank on the working day immediately preceding the customs clearance date.

On February 14, the Board of Governors of the Central Bank of Iceland decided to hold the Bank's policy interest rate unchanged at 15.5%.

On February 17, new contractual wage agreements were signed by the national member organisations and the largest unions within the Icelandic Federation of Labour (ASÍ) and the Confederation of Icelandic Employers (SA). The agreements remain in effect until November 30, 2010, and are identical in all fundamental respects. The negotiating parties have estimated that total costs incurred by employers will rise by just under 11% during the term of the settlement, or by an average of 3½% annually. The principal provisions of the new agreement are

threefold: a safety net for wage developments, an increase in the lowest wage rates, and an optional termination clause in 2009. No general wage rise is included until the final year; instead, workers are guaranteed specified wage developments during the first two years. The settlement also provided for the establishment of a Rehabilitation Fund, whose function is to provide various types of assistance and service to employees who are injured or contract long-term illnesses. Further provisions include an increase in vacation days and in days of leave due to children's illnesses. The assumptions underlying the agreement are two. First, real wages in the private sector, according to the Statistics Iceland wage index, must either remain constant or increase between January and December 2008. The other assumption concerns maximum inflation levels. At the beginning of February 2009, the review committee will convene in order to discuss an extension of the agreement based on these underlying assumptions. If the assumptions have held, the agreement will be extended until November 30, 2010; if not, the parties will attempt to reach a consensus on their response to changed circumstances. If they cannot reach such a consensus, the agreement will expire at the end of February 2009.

In connection with the signing of the private sector wage agreements on February 17, the Government decided to raise the tax-free income threshold in excess of price level increases, reduce income-linked cutbacks of child allowances and asset-linked reductions of mortgage interest allowances, lower the corporate income tax rate from 18% to 15% beginning with the income year 2008, raise the unemployment benefit in line with the rise in the lowest wage rates, and contribute one-third to the Rehabilitation Fund beginning in 2009, against matching contributions from employers and pension funds. Other pledges without specific time frames include raising rent subsidy allowances, increasing the number of loans pledged for subsidised residential rental housing, and increasing the amount allocated to continuing education and adult education. The Ministry of Finance estimates that the cost to the Treasury as a result of these measures will total approximately 35 b.kr. over the term of the settlement.

On February 20, the first auction of a new series of Treasury notes, RIKB 19 0226, was held. The maturity date of the notes is in 2019. The objective was therefore to sell notes in the series for a nominal value of 10 b.kr. A total of 76 valid offers totalling 32 b.kr. were received, and offers for 10 b.kr., with a yield of 8.9%, were accepted. Thereafter, primary dealers were offered the opportunity to purchase an additional 10% of the nominal value of the amount sold in the auction, or 1 b.kr., at the same yield. Each primary dealer was entitled to purchase in proportion to the amount purchased in the auction, and an additional 1 b.kr. was sold as a result.

On February 22, the Financial Supervisory Authority approved the merger of the savings banks Sparisjóðurinn í Keflavík, Sparisjóður Vestfirðinga, and Sparisjóður Húnaþings og Stranda. The savings banks have merged under the name Sparisjóðurinn í Keflavík. Sparisjóðurinn í Keflavík assumed all rights and obligations of Sparisjóður Vestfirðinga and Sparisjóður Húnaþings og Stranda as of July 1, 2007.

March 2008

On March 13, the second auction of RIKB 19 0226 was held. Offers were accepted for 2,350 m.kr. nominal value at an average yield of 9.41%.

On March 13, Parliament approved a legislative bill amending the Social Security Act. The amendment abolished the cutbacks in pension benefits due to income earned by a pensioner's spouse, provided for a tax-free threshold for financial income and pension income, and raised the tax-free threshold for pensioners who remain employed, as well as increasing various benefit payments and allowances.

On March 18, Glitnir Bank hf. announced a closed auction of convertible bonds in the amount of 15 b.kr. The bonds are subordinated and convert to Glitnir shares after five years. The issue is classified as Tier I capital.

On March 25, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 1.25 percentage points, to 15%.

On March 25, the Bank announced amendments to its internal rules on collateral loans, reserve requirements, and certificates of deposit, which were drafted with the aim of facilitating financial market activity, especially transactions with Icelandic krónur. It was decided, among other things, to issue transferable certificates of deposit in order to increase the supply of secure short-term instruments on the market.

On March 27, a special auction of Treasury note series RIKB 08 1212 was held, in the nominal amount of 10 b.kr. The auction supplemented the issue announced on January 14 in the Government Debt Management Prospect for 2008. The objective of the sale was to meet the demand for short-term securities bearing a Treasury guarantee. Offers were accepted for 7.2 b.kr. nominal value.

April 2008

On April 7, the Minister of Social Affairs issued a regulation raising rent subsidy allowances effective April 1, as an element in the Government's pledges related to the contractual wage agreements signed on February 17.

On April 10, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 0.5 percentage points, to 15.5%.

On April 17, the third auction of RIKB 19 0226 was held. Offers were accepted for 2.9 b.kr. nominal value at an average yield of 10.64%.

May 2008

On May 13, securities lending facilities to each primary dealer in series RIKB 08 1212 and RIKB 09 0612 were increased from 5 b.kr. to 7 b.kr. nominal value in response to demand for short-term nominal Treasury notes.

On May 15, Parliament passed a law abrogating the taxation of businesses' capital gains on the sale of equity securities and

transferred the administration of tax matters for large corporations to the Regional Tax Director in the Reykjavik district. Previously, it was possible to defer tax payments by reinvesting in other equities within two years.

On May 16, the Central Bank announced the conclusion of bilateral currency swap agreements with the central banks of Norway, Sweden, and Denmark. The agreements are a contingency measure that the Central Bank can utilise at need. Each of the agreements provides access to a maximum of 500 million euros.

On May 22, the Board of Governors of the Central Bank of Iceland decided to hold the Bank's policy interest rate unchanged at 15.5%.

On May 23, new agreements were signed by the Central Bank of Iceland in connection with the issue of Government securities and market making in the secondary market. The objectives of the agreements are to maintain the Treasury's access to loan financing and to enhance price formation in the secondary market for Government securities. The agreements were concluded with seven financial institutions and remain valid for one year.

On May 27, a special auction of short-term Treasury notes was held. The series offered was RIKB 08 1212. Offers were accepted for 15 b.kr. nominal value at an average yield of 12.45%.

On May 28, Parliament approved an amendment to the Act on Electronic Registration of Title to Securities, stipulating that settlement instructions for electronic securities denominated in foreign currencies and held in a domestic securities depository shall take place through the intermediation of a securities depository that fulfils requirements comparable to those set forth in the Act on the Security of Transfer Orders in Payment Systems. The settlement system shall have ready access to the foreign currency in question.

On May 29, the fourth auction of RIKB 19 0226 was held. Offers were accepted for 6.5 b.kr. nominal value at an average yield of 9.55%.

On May 29, Parliament passed an act of law cancelling the stamp fee on a purchaser's first apartment.

On May 30, Parliament approved amendments to the Income Tax Act in accordance with Government pledges related to the signing of the private sector wage settlements in February 2008. The amendments involve raising the personal income tax allowance, raising the income threshold for child subsidy allowances, reducing the income-linkage of child subsidy allowances, raising the asset threshold for mortgage interest allowances, and reducing the corporate income tax rate. In addition, the exchange rate differential for legal entities' operations is distributed over three years.

June 2008

On June 4, the Central Bank of Iceland issued new Rules on Foreign Exchange Balance, which took effect on July 1, superseding the previous Rules no. 318/2006. The principal change is that the maximum mismatch between foreign-denominated assets and

liabilities has been reduced from 30% to 10%. However, financial undertakings can apply for authorisation to maintain a separate positive foreign exchange balance in order to hedge against the effects of adverse exchange rate movements on their capital ratio.

On June 19, the Government approved special measures related to the housing market and the arrangements for Housing Financing Fund (HFF) loans. The ceiling was raised from 18 m.kr. to 20 m.kr., with the maximum loan amount set at 80% of the purchase price of the property rather than the fire insurance value, as it was previously. Furthermore, two new bond series were established for the purpose of financing mortgages granted by financial institutions.

On June 19, the Government announced a supplementary issue of Treasury notes in three series, RIKB 08 1212, RIKB 09 0612, and RIKB 10 0317, which will be issued on the domestic market for a total of 75 b.kr.

On June 19, the Board of Governors of the Central Bank of Iceland decided that its certificates of deposit (SI 08 0924) will be reissued upon the maturity of the CDs issued in March. The current CD issue matures in September 2008. Decisions concerning the issuance of certificates of deposit in 2009 will be made in view of market conditions at that time.

On June 23, the Housing Financing Fund (HFF) decided, following the June 20 auction of HFF housing bonds, to lower the Fund's lending rates by 0.15 percentage points. HFF bonds with a prepayment clause now bear 5.05% interest, and bonds without a prepayment clause bear 5.55% interest.

On June 27, Kaupthing held an auction of covered bonds. The issue is intended to finance the bank's mortgage loans to individuals, and offers were accepted for 4.8 b.kr. nominal value. The weighted average yield in the auction was 5.17%, and the bank's lending rates will be based on that yield plus a premium of 0.9%. The bank's lending rates will therefore fall from 6.4% to 6.05% following of the auction.

July 2008

On July 3, the Board of Governors of the Central Bank of Iceland decided to leave the Bank's policy interest rate unchanged at 15.5%.

August 2008

On August 22, the Rules on Central Bank Facilities for Financial Undertakings were reviewed and amended. The amendments included provisions allowing the use of asset-backed securities as collateral for regular facilities. The securities may be denominated in Icelandic krónur, US dollars, euros, or pounds sterling. Covered bonds were not limited to securities backed by housing bond portfolios; other assets were considered as well. Under the new amendment, foreign-denominated securities could now constitute up to 70% of the total collateral value. Limitations were also set on the amount of unsecured bonds issued by domestic financial institutions a financial undertaking could submit as collateral.

September 2008

On September 11, the Board of Governors of the Central Bank of Iceland decided to leave the Bank's policy interest rate unchanged at 15.5%.

On September 19, the Financial Supervisory Authority approved Byr Savings Bank's application to change the savings bank into a limited liability company.

On September 29, the Office of the Prime Minister announced an agreement between the Government and the largest owners of Glitnir Bank hf., following consultation with the Central Bank of Iceland and the Financial Supervisory Authority, under which the Government would contribute new share capital in the amount of 600 million euros, thereby becoming the owner of a 75% stake in Glitnir.

October 2008

On October 2, the Central Bank granted Kaupthing hf. a loan facility in the amount of 73 million euros. The loan was due and payable on October 16, 2008, and secured with collateral in Kaupthing's asset portfolio.

On October 6, the Central Bank granted Kaupthing hf. a four-day loan facility in the amount of 500 million euros against collateral in the Danish bank FIH.

On October 6, the Financial Supervisory Authority announced its decision to stop trading temporarily with all financial instruments issued by Glitnir Bank hf., Kaupthing Bank hf., Landsbanki Íslands hf., Straumur-Burdarás Investment Bank hf., SPRON hf., and Exista hf., and traded on a regulated securities exchange.

On October 6, Parliament passed the Act on Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, no. 125/2008. According to the Act, special and very unusual circumstances refers to particular financial and/or operational difficulties experienced by a financial undertaking, including the probability that it will not be able to abide by its commitments vis-à-vis its customers or creditors, the likelihood that the premises for revocation of its operating license exist, or the likelihood that the undertaking cannot meet the minimum requirements for own funds, and the measures adopted by the Financial Supervisory Authority are not likely to limit the damage or risk of damage to the financial markets. Under such circumstances, the Financial Supervisory Authority is authorised to adopt special measures.

On October 7, the Financial Supervisory Authority announced its decision to define short sales of shares of specified issuers as behaviour opposed to accepted market practices. From October 7, 2008, through January 16, 2009, it is prohibited to sell short shares in Glitnir Bank hf., Kaupthing Bank hf., Landsbanki Íslands hf., Straumur-Burdarás Investment Bank hf., SPRON hf., and Exista hf., that had been admitted for trading on the regulated securities exchange in Iceland, unless the seller has the securities in his custody at the time of the offer. The prohibition also includes all other financial instruments that have the same purpose and same financial risk as the short sale

of the specified shares, and to other financial instruments whose value is determined by the price of the specified shares.

On October 7, the Financial Supervisory Authority announced that it had intervened in the operations of Landsbanki Íslands hf., based on the authority contained in the Act on Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, no. 125/2008. The Financial Supervisory Authority appointed a resolution committee, which assumed all of the authorisations of the Board of Directors of Landsbanki Íslands hf.

On October 7, the Financial Supervisory Authority announced that it had intervened in the operations of Glitnir Bank hf., based on the authority contained in the Act on Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, no. 125/2008. The Financial Supervisory Authority appointed a resolution committee, which assumed all of the authorisations of the Board of Directors of Glitnir hf.

On October 8, the British Financial Services Authority (FSA) ruled that Kaupthing's British subsidiary, Kaupthing Singer Friedlander Ltd., did not meet minimum liquidity requirements. As a result, the FSA halted further receipt of deposits at KSF and demanded before the UK courts that the bank be subjected to insolvency proceedings. The court granted the request.

On October 8, the British authorities issued a Freezing Order on the basis of the Anti-Terrorism, Crime and Security Act of 2001. The effect of the Order was to freeze all Landsbanki Íslands assets in the United Kingdom. The Government of Iceland and other Icelandic authorities, specifically to include the Central Bank of Iceland and the Financial Supervisory Authority, were among the parties mentioned in the Freezing Order.

On October 9, the Financial Supervisory Authority announced that it had intervened in the operations of Kaupthing Bank hf., based on the authority contained in the Act on Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, no. 125/2008. The Financial Supervisory Authority appointed a resolution committee, which assumed all of the authorisations of the Board of Directors of Kaupthing Bank hf.

On October 9, New Landsbanki Íslands hf. commenced operations after having taken over a part of the operations of Landsbanki Íslands hf.

On October 13, the Financial Supervisory Authority granted MP Investment Bank hf. a commercial banking licence. The commercial banking licence takes effect on October 10, 2008.

On October 14, the Central Bank of Iceland announced that it had drawn a total of 400 million euros on the currency swap agreements with the central banks of Denmark and Norway.

On October 14, the OMX Nordic Exchange Iceland hf. approved Landsbanki Íslands hf.'s request for the delisting of its shares. The bank's shares were removed from trading after the market close on October 14, 2008.

On October 15, the Board of Governors of the Central Bank of Iceland decided to lower the Bank's policy interest rate by 3.5 percentage points, to 12%.

On October 15, the OMX Nordic Exchange Iceland hf. approved Glitnir Bank hf.'s October 14 request for the delisting of its shares. The bank's shares were removed from trading after the market close on October 14, 2008.

On October 15, the Central Bank of Iceland came to an agreement with market makers in the foreign exchange market, as well as with several other financial undertakings, concerning temporary foreign exchange arrangements. Daily auctions of the euro against the króna provide an indication of the exchange rate of the króna vis-à-vis other currencies and ensure a minimum level of cross-border business activity. The exchange rate is determined by supply and demand for foreign currency, which is initially in accordance with the Central Bank guidelines on modifications in currency outflow.

On October 15, New Glitnir Bank hf. commenced operations after having taken over a part of the operations of Glitnir Bank hf.

On October 17, a meeting of Icebank hf. shareholders approved a motion to change the name of the bank to Sparisjódabanki Íslands hf.

On October 22, New Kaupthing Bank hf. commenced operations after having taken over a part of the operations of Kaupthing Bank hf.

On October 24, the Government of Iceland formally requested collaboration with the International Monetary Fund, for the purpose of establishing economic stability in Iceland. Discussions between representatives of Iceland and the IMF concerning the structure of such collaboration had been underway for some time. It was announced that a detailed economic programme had been prepared in consultation with Fund representatives, with the objective of restoring economic stability.

On October 27, the Financial Supervisory Authority announced its opinion that, on October 6, Landsbanki Íslands hf. was unable to remit payment of deposits in specified accounts to customers requesting such payment. Therefore, by law, the Depositors' and Investors' Guarantee Fund was obligated towards the Landsbanki Íslands hf. customers who did not receive payment from their accounts. Comparable obligations developed on October 9 with respect to Kaupthing Bank hf., and on October 3 with respect to Glitnir Bank hf.

On October 28, the Board of Governors of the Central Bank of Iceland decided to raise the Bank's policy interest rate by 6 percentage points, to 18%.

November 2008

On November 6, the Board of Governors of the Central Bank of Iceland decided to leave the Bank's policy interest rate unchanged at 18%.

On November 13, Parliament approved an amendment to the Act on Financial Undertakings, authorising a trustee in bankruptcy for an undertaking undergoing insolvency proceedings or moratorium on

payment to continue to engage in specified activities for which licensing is required if those activities are necessary for the administration of the estate or the protection of creditors' interests. The administrator of such operations shall be exempt from general liability for compensatory damages. Under such conditions, it is prohibited to initiate or continue legal proceedings against the financial undertaking. The provisions on the conferral and the length of moratoria on payment for these financial undertakings were expanded.

On November 13, a temporary amendment to the Acts on Unemployment Insurance and on the Wage Guarantee Fund was passed, with the intention of meeting the needs of wage-earners who must submit to reduced employment percentage at their employer's initiative because of the economic downturn. Furthermore, self-employed individuals were authorised on a temporary basis to take on occasional projects while receiving unemployment benefits.

On November 13, the resolution committee of Kaupthing Bank hf. requested of the OMX Nordic Exchange in Iceland that trading with the company's shares be halted on the Nordic market.

On November 17, Parliament passed an amendment to the Act on Smoothing of Mortgage Loans to Individuals. Payment smoothing allows the borrower to defer payment of a portion of his instalments, but for the long term, it increases costs due to interest and indexation on the deferred amount.

On November 19, the Executive Board of the International Monetary Fund approved a two-year programme to restore economic stability in Iceland. According to the plan, Iceland will receive a facility of 2.1 billion dollars from the IMF, and supplementary facilities totalling some 3 billion dollars from Denmark, Finland, Norway, Sweden, Russia, and Poland. In addition, the Faroese Government offered Icelanders a loan totalling 50 million US dollars.

On November 24, the District Court of Reykjavík granted Kaupthing Bank hf. a moratorium on payment.

On November 24, the District Court of Reykjavík granted Glitnir hf. a moratorium on payment.

On November 25, Glitnir hf. announced that the bank's operations in New York had been sold to former employees of the bank.

On November 26, a regulation was signed, authorising the Housing Financing Fund to take over residential mortgage loans issued by financial institutions. The terms and conditions of the loans remain unchanged after the takeover.

On November 28, Parliament passed an amendment to the Act on Foreign Exchange, authorising temporary restrictions on foreign currency trading due to capital transactions. On the same day, new Central Bank Rules on Foreign Exchange took effect, placing restrictions on movement of capital between Iceland and other countries. The purpose of the Rules is to limit foreign currency outflows. Thereafter, the instructions on temporary modification of foreign currency outflow, issued in October, were revoked.

December 2008

On December 4, the interbank currency market resumed operations. On the same day, the new Central Bank Rules on the Foreign Exchange Market took effect.

On December 5, Parliament approved an amendment to the Act on Housing Affairs. According to the Act, it is now permissible to extend housing loan maturities by up to 30 years in case of financial difficulties, instead of the previous 15 years. Furthermore, the maximum loan period for Housing Financing Fund loans has been lengthened from 55 years to 70 years.

On December 6, the District Court of Reykjavík granted Landsbanki Íslands hf. a moratorium on payment.

On December 8, the Central Bank granted Straumur-Burdarás hf. a loan facility in the amount of 50 million euros, maturing on March 9, 2009, and secured with collateral in all shares in Straumur's Finnish subsidiary, eQ Oyj, the parent company of the Finnish bank eQ Pankki Oy.

On December 11, legislation was passed authorising a 12.5% increase in alcoholic beverage and tobacco taxes, oil and per-kilometre charges, motor vehicle taxes and excise taxes.

On December 12, Parliament passed a law on the investigation of the prelude and causes of the collapse of Iceland's banks in 2008. The purpose of the new Act is to engage a special investigative committee to seek the truth about the prelude and causes of the banks' failure and related events. The committee is also to assess whether there have been errors or neglect in the implementation of regulatory instruments pertaining to financial activities in Iceland and supervision of those activities, and to determine who may be responsible for such errors or neglect.

On December 12, legislation on the office of the special prosecutor entered into force. The Act establishes a position for a special prosecutor, who will investigate suspected criminal conduct before, during and after the events leading to the enactment of the Act on Authorisation for Treasury Disbursements due to Unusual Financial Market Circumstances, etc., and the situation that then developed on the financial market, whether such conduct relates to the activities of financial institutions, other legal entities, or individuals, and to follow the investigation with criminal action as appropriate.

On December 12, the Customs Act was amended so that the entire country is now a single customs jurisdiction.

On December 17, the Board of Governors of the Central Bank of Iceland decided to increase the corridor between the Bank's highest and lowest interest rates. The Bank's policy interest rate was held unchanged.

On December 18, Parliament passed an amendment to the Act on Interest and Price Indexation. The amendment, which pertains to Article 6 of the Act, stipulates that penalty interest will now include a 7% premium on the interest rate for the most common short-term Central Bank loans to credit institutions. Furthermore, the Central

Bank's authority to determine a different non-fulfilment surcharge has been revoked. Penalty interest rates can be expected to decline by 4% as a result of the amendment. Moreover, penalty interest will henceforth be decided on a monthly basis instead of twice a year.

On December 18, a mission from the International Monetary Fund completed a four-day visit to Iceland. The purpose of the mission's visit was to assess the status and outlook for the Icelandic economy. The visit was in relation to the Stand-By Arrangement approved for Iceland by the Executive Board of the Fund on November 19. The mission met with government officials, members of Parliament, and various stakeholders.

On December 18, Parliament passed an amendment to the Annual Accounts Act, authorising companies to apply for permission to prepare their annual accounts for the years 2008 and 2009 in foreign currency.

On December 18, Parliament agreed to utilise the EEA Agreement's adaptation authorisations of 2007 concerning Bulgarian and Rumanian citizens' access to the Icelandic labour market until January 1, 2012.

On December 19, the Landsbanki Íslands resolution committee announced that Kepler Capital Markets had been sold to Kepler management and employees.

On December 22, Parliament passed an amendment to the Pension Fund Act, liberalising the provisions authorising withdrawal of private pension savings, abolishing the maximum age to receive pension income, and expanding pension funds' authorisations to purchase unlisted securities.

On December 22, the supplementary budget for 2008 was approved by Parliament. The budgetary supplement assumes a deficit of 6 b.kr., while the original budget allowed for a 39 b.kr. surplus.

On December 22, the fiscal budget for 2009 was approved by Parliament. Revenues are expected to drop by 19½% at constant price levels relative to the budgetary supplement for 2008, while expenditures are projected to rise by 10½%. Most revenue items decline substantially due to the economic contraction, and the increase in expenditures at constant price levels is primarily due to interest expense. Expenditures exclusive of interest rise by 0–½% in real terms.

On December 29, the Minister of Social Affairs and Social Security issued a regulation raising allowance payments, subsidies, and the tax-free income threshold for the year 2009, with the increase totalling 9.6%. The minimum maintenance stipend for pensioners rose by 20%.

On December 31, the Ministry of Finance announced that the tax rate for income tax and local tax would be 37.2% for 2009, instead of 35.72% in 2008. The personal deduction was increased by 24% and the tax-free income threshold by 19%. The average local tax rate increased from 12.97% to 13.1%, and the income tax rate rose from 22.75% to 24.1%.

Credit ratings – changes 2008

Moody's credit ratings for foreign-currency obligations

	<i>Affirmed</i>	<i>Long-term obligations</i>	<i>Short-term obligations</i>	<i>Financial strength</i>
Republic of Iceland	May 20	Aaa→Aa1		
	Oct. 8	A1	P-1	
	Dec. 4	Baa1	P-2	
HFF	Oct. 8	Aa1→A1		
	Dec. 4	Baa1		
Glitnir	Feb. 28	Aa3→A2	P-1	C→C-
	Sep. 30	Baa2	P-2	D
	Oct. 8	Caa1	Not-Prime	E
Kaupthing	Feb. 28	Aa3→A1	P-1	C→C-
	Oct. 9	Baa3	P-3	D+
Landsbanki	Feb. 28	Aa3→A2	P-1	C→C-
	Oct. 8	Caa1	Not-Prime	E

Fitch Ratings' credit ratings for foreign-currency obligations

	<i>Affirmed</i>	<i>Long-term obligations</i>	<i>Short-term obligations</i>	<i>Individual rating</i>	<i>Support rating</i>
Republic of Iceland	Sept. 30	A+→A-	F1→F2		
	Oct. 9	BBB-	F3		
Glitnir	May 9	A→A-	F1→F2	B/C	2
	Sep. 30	BBB-	F3	F	2
	Oct. 7	B	B	F	4
	Oct. 8	D	D	F	5
	Jan. 8, 2009	The agency affirmed its most recent ratings and announced that it would no longer issue ratings for the bank.			
Kaupthing	May 9	A→A-	F1→F2	B/C	2
	Sep. 30	BBB	F3	C	2
	Oct. 8	CCC	C	E	5
	Jan. 8, 2009	The agency affirmed its most recent ratings and announced that it would no longer issue ratings for the bank.			
Landsbanki	Sep. 30	A→BBB	F1→F3	B/C→C	2
	Oct. 7	B	B	F	4
	Oct. 8	D	D	F	5
	Jan. 8, 2009	The agency affirmed its most recent ratings and announced that it would no longer issue ratings for the bank.			
Straumur-Burdarás Investment Bank	Sep. 30	BBB-→BB+	F3→B	C/D	3
	Oct. 7	BB-	B	D	5
	Nov. 5	B	B	D/E	5

Standard & Poor's credit ratings for foreign-currency obligations

	<i>Affirmed</i>	<i>Long-term obligations</i>	<i>Short-term obligations</i>
Republic of Iceland	Apr. 17	A+→A	A-1→A-2
	Sep. 29	A-	
	Oct. 6	BBB	A-3
	Nov. 24	BBB-	
HFF	Sep. 29	A→A-	
	Oct. 6	BBB	A-1→A-2
	Nov. 24	BBB-	A-3
Glitnir	Apr. 21	A-→BBB+	A-2
	Sep. 29	BBB	A-3
	Oct. 7	CCC	C
	Oct. 9	D	D

R&I credit ratings for foreign-currency obligations

	<i>Affirmed</i>	<i>Long-term obligations</i>
Republic of Iceland	Sep. 30	AA+→AA
	Oct. 7	A+
	Oct. 9	BBB-

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Table 1 Survey

<i>Main economic indicators</i>		1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Gross domestic product	% change year-on-year	4.1	4.3	3.9	0.2	2.4	7.7	7.4	4.5	5.5	0.4
National expenditure	% change year-on-year	4.2	5.9	-2.1	-2.3	5.7	9.9	15.8	9.4	-0.6	-8.7
Exports	% change year-on-year	4.0	4.2	7.4	3.7	1.6	8.5	7.0	-4.9	17.7	7.1
Imports	% change year-on-year	4.4	8.6	-9.1	-2.5	10.7	14.5	29.3	10.4	-1.1	-18.0
Current account balance	% of GDP	-6.8	-10.1	-4.7	1.5	-4.8	-9.8	-16.0	-25.3	-15.4	-21.2
Terms of trade	% change year-on-year	-0.6	-2.4	0.3	0.6	-4.1	-1.3	1.0	3.5	0.3	-7.4
International investment position	% of GDP	67.1	94.0	102.0	89.8	93.3	113.5	152.4	204.2	235.8	425.0
Employment (man-years)	% change year-on-year	2.4	2.2	2.0	0.4	-0.1	1.2	4.1	4.1	3.3	2.1
Unemployment	% of labour force	1.9	1.3	1.4	2.5	3.4	3.1	2.1	1.3	1.0	1.8
<i>General government finances¹</i>											
Treasury fiscal balance	% of GDP	1.4	1.8	-0.5	-1.3	-1.8	1.0	4.5	5.3	4.1	-13.8
Treasury net borrowing requirement	% of GDP	2.2	0.3	-2.8	-1.3	1.6	2.6	8.4	-2.7	-0.2	-27.0
General government revenue	% of GDP	43.1	43.5	41.8	41.6	42.7	44.2	47.5	48.8	50.3	42.3
General government expenditure	% of GDP	41.9	41.8	42.5	44.1	45.5	44.0	42.3	41.8	44.7	56.6
General government fiscal balance	% of GDP	1.1	1.7	-0.7	-2.6	-2.8	0.2	5.2	7.0	4.9	-14.3
General government gross debt	% of GDP	42.3	40.2	44.1	41.8	40.3	33.8	24.9	29.4	28.8	51.0
General government net debt	% of GDP	20.9	20.9	21.5	19.3	20.2	17.2	3.5	-1.1	-1.0	2.7
<i>Prices and wages</i>											
		% change									
Consumer price index	year-on-year	3.4	5.0	6.7	4.8	2.2	3.2	4.0	6.8	5.0	12.4
Wage index	year-on-year	6.8	6.6	8.8	7.2	5.6	4.7	6.8	9.5	9.0	8.1
Real wages (deflated by CPI)	year-on-year	3.3	1.6	2.0	2.3	3.4	1.4	2.6	2.6	3.8	-3.8
<i>Asset prices</i>											
		% change									
Residential housing	Q4-on-Q4	22.2	13.3	3.1	7.5	9.1	23.3	31.0	5.0	15.0	-2.5
Share prices	within year	47.4	-19.3	-11.2	16.7	56.4	58.9	64.7	15.8	-1.4	-94.4
<i>Money supply and credit</i>											
		% change									
M1 ²	within year	19.3	4.4	-2.3	23.8	22.6	30.1	23.5	22.5	94.2	17.2
M3 ²	within year	17.1	11.2	14.9	15.3	17.5	15.0	23.2	19.4	56.5	22.2
Credit system lending and market securities ²	within year	17.3	17.2	19.2	3.2	11.4	19.9	31.1	31.0	22.7	38.2
DMB lending ²	within year	23.0	50.0	12.6	15.0	16.0	42.1	51.5	41.4	30.6	66.8
<i>Exchange rate and real exchange rate</i>											
		% change									
Nominal effective exchange rate	year-on-year	-0.2	0.1	20.1	-3.0	-6.0	-2.0	-10.3	11.7	-2.5	40.7
Icelandic króna vis-à-vis US dollar	year-on-year	-1.8	-8.2	-19.3	6.8	19.2	9.5	11.6	-9.9	9.0	-27.3
Icelandic króna vis-à-vis euro	year-on-year	0.0	6.3	-17.0	1.5	-0.6	-0.5	11.5	-10.9	0.1	-31.3
Real exchange rate: relative prices	year-on-year	2.6	3.9	-12.7	5.1	4.7	2.2	13.5	-6.4	4.2	-21.3
Real exchange rate: relative ULC	year-on-year	4.2	3.4	-13.4	4.2	5.6	-2.9	12.5	-2.2	9.7	-0.5
<i>Central Bank rates</i>											
		average									
Banks' current accounts	% p.a.	3.8	5.9	6.7	5.4	2.9	3.7	7.7	10.9	12.8	14.7
Collateral loans	% p.a.	7.5	9.3	10.0	8.1	5.2	5.1	7.7	9.9	12.5	13.9
Overnight loans	% p.a.	9.3	11.5	12.3	10.6	7.8	8.3	11.0	13.7	15.3	16.8
<i>Yields in the money and bond market (ICEX)</i>											
		average									
ICEX-5Y-I	% p.a.	.	.	.	.	.	.	.	4.6	6.0	4.6
ICEX-3M-NI	% p.a.	.	.	.	.	.	.	.	12.1	13.9	13.1
ICEX-5Y-NI	% p.a.	.	.	.	.	.	.	.	8.5	9.4	10.2
5-year Treasury notes (non-indexed)	% p.a.	8.4	11.1	9.6	7.8	7.6	7.6	7.6	9.3	9.4	11.1
<i>Commercial banks' interest rates</i>											
Non-indexed secured loans	% p.a.	13.6	16.7	18.0	15.4	12.0	12.2	14.8	17.1	19.2	19.4
Indexed securities	% p.a.	8.6	9.5	10.2	10.1	9.1	8.0	7.2	6.9	8.2	9.6
Yield on new standard loans ³	% p.a.	14.2	17.5	.	.	.	.	.	.	.	.
Penalty interest ⁴	% p.a.	17.3	21.9	23.7	21.3	17.3	17.3	20.3	22.5	25.0	25.8
<i>International comparison</i>											
Economic growth in OECD countries	% p.a.	3.1	3.9	1.1	1.5	1.9	3.0	2.5	3.0	2.6	1.1
Inflation in OECD countries	% p.a.	3.7	4.1	3.7	2.9	2.4	2.4	2.6	2.6	2.5	3.6

1. Data for 2008 based on estimates of the Central Bank of Iceland. 2. Latest figures for 2008 are for September, i.e. 12-month changes between September 2007 and 2008, are shown. 3. Cf. Article 10 of Act no. 25/1987. 4. Cf. Article 10 of Act no. 25/1987 and (from July 2001) Art. 10 of Act no. 38/2001.

Sources: Directorate of Labour, Land Registry of Iceland, OECD, OMX Nordic Exchange in Iceland (OMXI), Statistics Iceland, Central Bank of Iceland.

Table 2 Exchange rate indices

	Official exchange rate ¹ Dec. 31, 1991 = 100	Average exchange rate index ² Dec. 31, 1994 = 100			Real exchange rate ³ 2000 = 100			
		Average	Based on import weights	Based on export weights	Based on relative prices		Based on unit labour cost	
					Index	%-change ⁴	Index	%-change ⁴
1998	112.8	96.2	96.7	95.7	93.8	1.8	92.8	2.9
1999	112.6	96.0	96.5	95.6	96.3	2.6	96.8	4.3
2000	112.7	96.1	96.3	95.7	100.0	3.9	100.0	3.3
2001	135.4	115.4	115.1	115.3	87.3	-12.7	86.6	-13.4
2002	131.4	112.0	111.7	112.0	91.7	5.1	90.1	4.1
2003	123.5	105.3	104.8	105.4	96.0	4.7	95.2	5.7
2004	121.0	103.1	102.4	103.5	98.1	2.2	92.5	-2.9
2005	108.6	92.6	91.9	93.0	111.4	13.5	104.1	12.5
2006	121.3	103.4	102.6	104.0	104.2	-6.4	101.7	-2.2
2007	118.3	100.9	99.9	101.5	108.6	4.2	111.6	9.7
2008	166.4	141.9	140.9	142.4	85.5	-21.3	111.0	-0.5

1. The index shows the average exchange rate of foreign currencies against the Icelandic króna for each period. From September 6, 1995, the trade-weighted basket (goods and services) of 16 currencies replaced the former basket of US dollar (18%), ECU (76%) and Japanese yen (6%). 2. The index shows the average exchange rate of foreign currencies against the Icelandic króna for each period. Weights are based on trade in goods and services. 3. Based on quarterly information on prices (consumer prices), wages, employment and output in main trading partner countries. 4. Year-on-year.

Table 3 Sales of Government securities¹

M.kr.	Treasury bonds			Treasury bills, net	Treasury notes, net	Total
	Sales	Redemptions	Net sales			
1988	4,867	3,413	1,454	-219	-	1,235
1989	5,049	4,170	879	5,171	-	6,050
1990	8,275	1,825	6,450	2,166	75	8,691
1991	5,584	4,433	1,151	298	1,158	2,607
1992	3,661	1,495	2,166	4,645	1,244	8,055
1993	8,200	3,706	4,494	742	3,444	8,680
1994	9,447	6,189	3,258	894	-355	3,797
1995	9,252	9,859	-607	830	1,004	1,227
1996	20,051	27,410	-7,359	391	3,772	-3,197
1997	18,454	15,449	3,005	-7,294	2,932	-1,357
1998	8,957	16,855	-7,898	2,912	-6,320	-11,306
1999	2,975	12,302	-9,327	-5,310	-6,231	-20,868
2000	3,531	13,299	-9,768	-3,928	1,015	-12,681
2001	146	5,690	-5,544	6,033	11,285	11,774
2002	0	18,546	-18,546	1	12,790	-5,755
2003	0	9,453	-9,453	8,500	8,202	7,249
2004	2,858	11,100	-8,242	-6,000	13,010	-1,232
2005	0	21,963	-21,963	-500	10,099	-12,364
2006	0	15,173	-15,173	-7,750	21,866	-1,057
2007	0	1,957	-1,957	7,300	5,497	10,840
2008	0	661	-661	60,075	124,461	183,875

1. Sales and redemption of Treasury bonds include accrued interest and indexation, but Treasury bills and Treasury notes, net, are at face value.

Table 4 Notes and coin in circulation by denomination

	2004		2005		2006		2007		2008	
	Thous. kr.	%	Thous. kr.	%	Thous. kr.	%	Thous. kr.	%	Thous. kr.	%
<i>Notes:</i>										
5,000 kr.	6,755,000	67.1	7,932,500	69.3	8,787,500	69.5	9,597,500	70.3	18,000,000	80.8
2,000 kr.	277,000	2.7	279,000	2.4	350,000	2.8	398,000	2.9	617,000	2.8
1,000 kr.	2,113,500	21.0	2,264,000	19.8	2,475,000	19.6	2,669,000	19.5	2,696,500	12.1
500 kr.	810,000	8.0	846,750	7.4	905,000	7.2	989,500	7.2	952,750	4.3
100 kr.	95,600	0.9	95,700	0.8	95,550	0.8	.	.	.	.
50 kr.	11,625	0.1	11,800	0.1	11,825	0.1	.	.	.	.
10 kr.	11,055	0.1	11,055	0.1	11,050	0.1	.	.	.	.
Total	10,073,780	100.0	11,440,805	100.0	12,635,925	100.0	13,654,000	100.0	22,266,250	100.0
<i>Coin:</i>										
100 kr.	799,300	51.3	924,500	52.5	1,006,180	53.6	1,188,600	57.1	1,256,600	57.9
50 kr.	353,440	22.7	388,740	22.1	392,590	20.9	374,890	18.0	373,640	17.2
10 kr.	261,330	16.8	292,130	16.6	314,080	16.8	342,370	16.5	359,520	16.6
5 kr.	72,240	4.6	78,240	4.4	82,480	4.4	89,434	4.3	92,434	4.3
1 kr.	72,218	4.6	77,494	4.4	81,247	4.3	86,132	4.1	87,994	4.1
Total	1,558,528	100.0	1,761,104	100.0	1,876,576	100.0	2,081,426	100.0	2,170,188	100.0

Table 5 Accounts of the Central Bank¹

<i>M.kr. at year-end</i>	2002	2003	2004	2005	2006	2007	2008
Net foreign exchange reserves	20,879	58,150	65,567	67,356	167,975	163,486	295,226
Domestic items, net ²	11,747	-36,448	-27,009	-19,904	-108,423	4,361	219,715
Claims on Treasury and governm. institutions, net	-20,851	-22,185	-17,782	-75,916	-211,002	-211,177	-123,972
Claims on other financial institutions	8,227	4,193	8,993	11,902	28,547	50,102	16,193
Claims on deposit money banks	69,141	24,038	31,771	77,772	119,863	258,165	464,826
Other claims	65	87	84	189	499	131	-
Deposits of other financial institutions	-1,334	-31	-13,681	-145	-131	-1,425	-14,805
Other items, net	-43,500	-42,549	-36,394	-33,706	-46,199	-91,434	-122,527
Base money	32,626	21,700	38,558	47,452	59,518	167,847	410,769
Reserves of deposit money banks	24,960	13,311	29,415	36,952	48,047	155,418	393,330
Required reserves	21,874	3,830	-	-	-	-	-
Certificates of deposits	0	4,501	4,404	2,294	1,777	0	167,266
Other claims	-	-	-	-	-	-	16,519
Cash and liquid reserves	3,087	4,980	25,012	34,658	46,269	155,418	209,545
Notes and coin in circulation	7,666	8,390	9,143	10,500	11,471	12,429	17,438

1. Further breakdown in Table 12. 2. Deposits are marked as negative (-).

Table 6 Summary of the accounts of deposit money banks¹

<i>M.kr. at year-end</i>	2002	2003	2004	2005	2006	2007	2008 ²
<i>Assets:</i>							
Domestic assets, total	997,904	1,181,694	1,606,052	2,445,068	3,314,826	4,921,040	7,419,509
Cash and cash balances with Central Bank	25,288	13,294	29,413	36,906	47,359	163,798	157,185
Receivables on domestic institutions	81,977	59,508	89,757	105,362	196,396	209,168	421,750
Domestic credit	863,986	1,062,053	1,431,579	2,205,912	2,969,617	3,827,402	5,485,507
Lending	694,524	805,376	1,123,510	1,701,808	2,407,176	3,143,584	4,728,420
Redeemed liabilities	548	750	329	468	276	336	821
Overdrafts	154,704	132,608	141,548	171,976	198,986	214,527	251,515
Bills	8,957	6,801	5,051	5,648	4,762	11,248	11,463
Unindexed bonds	64,711	100,953	145,004	201,797	329,420	516,535	630,305
Indexed bonds	206,325	217,821	340,650	658,406	780,351	842,964	973,626
Foreign currency-linked bonds	259,278	346,444	490,928	659,988	1,077,672	1,516,756	2,855,024
Foreign currency-linked overdrafts	...	...	...	3,526	15,710	41,219	110,735
Provisions	...	...	...	...	...	...	-105,068
Leasing contracts	139	16,442	18,739	18,909	28,380	38,126	57,823
Dept instruments	118,991	166,669	195,604	256,788	275,620	393,098	480,707
Treasury bills	7,066	14,849	2,440	5,248	2,770	3,401	0
Equities	43,266	58,717	91,287	223,158	255,670	252,593	218,556
Derivatives	...	...	...	...	...	266,126	776,467
Share in associates	16,217	8,655	11,159	28,892	21,125	23,352	16,155
Share in affiliated undertakings	10,436	38,184	44,143	67,996	80,329	131,774	180,476
Other assets	...	...	...	...	...	299,420	381,968
Foreign assets, total	129,002	307,662	633,492	1,488,256	3,031,477	4,778,010	7,474,954
Foreign credit and equities	59,239	132,762	237,430	723,831	1,284,133	2,867,835	4,519,969
Foreign lending	46,296	113,267	190,455	500,953	817,046	1,996,874	3,445,996
Marketable bonds and bills	2,248	3,098	4,554	71,165	227,456	576,504	598,929
Equities	10,695	16,397	42,421	151,713	239,631	294,457	475,044
Foreign receivables	...	...	...	...	...	788,952	1,082,526
Derivatives	...	...	...	...	...	134,180	467,365
Share in associates	0	208	315	1,168	1,714	76,560	121,030
Share in affiliated undertakings	5,740	24,244	118,088	205,190	329,305	617,378	817,206
Other assets	64,023	150,448	277,659	558,067	1,416,326	293,106	466,858
Assets, total	1,126,906	1,489,356	2,239,544	3,933,324	6,346,303	9,699,049	14,894,463
<i>Liabilities:</i>							
Domestic liabilities, total	606,412	640,189	785,108	1,137,043	1,545,990	2,552,513	3,512,863
Central Bank facilities	69,311	24,062	31,822	77,766	120,388	281,360	455,987
Deposits of residents, total	387,562	455,923	524,686	647,001	774,714	1,217,856	1,413,411
Current accounts	...	99,197	130,811	161,435	184,425	351,059	400,298
Current accounts in foreign currency	...	...	...	850	15,651	47,310	26,951
Money market rate accounts	...	...	...	...	...	173,076	235,989
Sight deposits	...	48,916	56,358	66,296	80,031	111,144	157,521
Indexed deposits	...	136,634	145,352	145,513	148,061	114,572	170,848
Holiday pay accounts	...	...	...	...	...	6,809	4,678
Supplementary pension deposits	...	14,829	20,188	28,448	31,713	36,850	50,488
Other time deposits	...	123,719	126,210	179,540	243,310	250,592	247,299
Foreign currency accounts	...	32,629	45,768	64,920	71,523	126,444	119,339
Deposits from credit institutions	...	...	...	...	...	110,570	58,673
Bond issue	72,800	76,372	95,689	146,243	252,498	409,489	515,960
Subordinated loans	24,457	24,304	25,080	30,392	30,668	39,991	72,640
Direct borrowing	19,656	36,446	72,359	130,997	188,684	234,257	459,242
Derivatives	...	...	...	...	...	51,154	214,417
Other liabilities ³	32,626	23,081	35,471	104,644	179,038	207,835	322,534
Foreign liabilities, total	440,015	737,097	1,212,415	2,391,125	4,234,096	6,224,485	10,317,329
Deposits from foreign credit institutions	...	...	...	...	...	388,858	1,129,039
Dep. from foreign parties, other than credit instit.	...	18,839	14,501	52,069	364,595	1,297,271	1,709,870

Table 6 Summary of the accounts of deposit money banks (cont.)¹

<i>M.kr. at year-end</i>	2002	2003	2004	2005	2006	2007	2008 ²
Derivatives	...	...	...	...	...	125,841	347,325
Bond issue	196,611	478,829	896,934	1,842,123	2,814,959	2,496,270	3,769,446
Subordinated loans	11,749	20,641	71,980	151,125	360,588	418,388	677,541
Direct borrowing	231,655	218,788	229,000	345,808	693,954	1,493,533	2,659,221
Other foreign liabilities	...	...	...	...	...	4,325	24,887
Total equity and minority interest	80,479	112,070	242,021	405,156	566,217	922,051	1,064,259
Total liabilities and equity	1,126,906	1,489,356	2,239,544	3,933,324	6,346,303	9,699,049	14,894,451

1. Lending was reclassified among sectors with the introduction of the ÍSAT 95 standard in September 2003. Kaupþing was licensed to operate as a commercial bank in January 2002 and was thereby reclassified from an investment bank, then merged with Búnaðarbanki in May 2003. Glitnir leasing company merged with Íslandsbanki in May 2003. 2. Preliminary numbers. 3. Other liabilities are shown net from 2002 to 2006.

Note: See Central Bank of Iceland Statistics pages, www.sedlabanki.is.

Table 7 Summary of the accounts of the banking system¹

<i>M.kr. at year-end</i>	2002	2003	2004	2005	2006	2007	2008 ²
Foreign assets, total	166,380	365,936	699,201	1,555,761	3,199,547	4,941,595	7,849,960
Foreign credit and equities	83,332	164,457	276,488	766,533	1,405,600	3,006,157	4,769,464
Other foreign assets	83,049	201,479	422,713	789,228	1,793,948	1,935,438	3,080,496
Foreign liabilities, total	458,316	738,956	1,214,118	2,392,759	4,235,969	6,226,198	10,350,342
Foreign bond issue	196,611	478,829	896,934	1,842,123	2,814,959	2,496,270	3,769,446
Other foreign liabilities	261,705	260,127	317,184	550,636	1,421,010	3,729,928	6,580,897
Domestic assets, total	1,077,153	1,210,727	1,646,933	2,539,857	3,468,598	5,234,312	7,921,473
Domestic credit	943,064	1,091,000	1,472,376	2,295,586	3,118,026	4,135,668	5,982,460
Treasury and Government institutions	28,576	22,504	45,911	18,380	24,855	26,531	449
Municipalities	19,129	13,675	13,420	10,600	11,828	11,980	16,529
Non-bank financial companies	89,709	159,478	195,754	212,173	281,719	501,354	429,182
Companies	486,906	632,710	851,174	872,519	1,137,030	1,422,583	2,118,243
Households	194,435	187,886	305,840	544,418	707,531	834,596	1,032,026
Holding companies	...	...	...	443,509	719,829	995,256	1,702,795
Other	124,308	74,746	60,277	193,986	235,233	343,368	788,305
Provisions	...	...	...	...	...	...	-105,068
Derivatives	...	...	...	...	...	266,126	776,467
Share in associates	16,217	8,655	11,159	28,892	21,125	23,352	16,155
Share in affiliated undertakings	10,436	38,184	44,143	67,996	80,329	131,774	180,476
Other domestic assets	107,436	72,888	119,254	147,383	249,118	677,392	965,916
Broad money and bonds (M4)	468,028	540,687	629,521	803,746	1,037,629	1,636,809	1,941,952
Domestic bond issue	72,800	76,372	95,689	146,243	252,498	407,172	515,960
Broad money (M3)	395,228	464,315	533,832	657,503	785,131	1,229,637	1,425,993
Time deposits	235,482	275,184	291,753	353,501	423,084	580,385	709,302
Money and sight deposits (M2)	159,746	189,131	242,079	304,002	362,047	649,253	716,691
Sight deposit	71,990	81,545	102,125	131,216	150,498	238,533	276,860
Money supply (M1)	87,755	107,586	139,953	172,786	211,549	410,720	439,831
Demand deposits	...	99,197	130,811	162,286	200,077	398,282	427,249
Notes and coin in circulation	7,666	8,389	9,142	10,500	11,472	12,438	12,582
Other domestic borrowing	19,656	36,446	72,359	130,997	199,480	4,148	117,937

1. Lending was reclassified among sectors with the introduction of the ÍSAT 95 standard in September 2003. The formation of the summary has changed from former annual report items are no longer shown net and derivatives are now taken into the accounts. 2. Preliminary numbers.

Table 8 Liquidity and reserve ratios in %¹

<i>Effective as of:</i>	<i>Reserve requirement ratio</i>	<i>Effective as of:</i>	<i>Reserve requirement ratio</i>
June 1, 1979	28.0	January 1, 1992	7.0
April 17, 1985	18.0	November 1, 1992	6.0
March 1, 1987	13.0	December 1, 1992	5.0
August 1, 1988	12.0	November 1, 1993	4.0 (2.5) ²
March 1, 1989	11.0	May 21, 1998	4.0 (1.5) ²
May 1, 1990	10.0	March 21, 2003	3.0 (1.0) ²
June 1, 1990	7.0	December 21, 2003	2.0 (0.0) ³
October 31, 1991	6.0		

1. Percentage of bank total deposits as of June 1, 1979, of domestic disposable funds as of March 1, 1989, and of all disposable funds as of May 21, 1988. 2. Figure in parentheses refers to the reserve ratio for bond issues and time deposits. 3. Figure in parentheses refers to the reserve ratio for deposits and bond issues with an original maturity of more than two years, and securities eligible as collateral for transactions with the Central Bank.

Table 9 Main interest rates announced pursuant to Article 10, Paragraph 2 and Temporary Provision III of the Act on Interest and Price Indexation, no. 38/2001

	<i>General interest rates, rates on damage claims and penalty interest, in % per annum</i>		
	<i>General interest on non-indexed loans</i>	<i>General interest on indexed loans</i>	<i>Interest on damage claims</i>
January 1, 2008	16.5	6.30	11.0
February 1	16.5	6.30	11.0
March 1	16.5	6.30	11.0
April 1	16.5	6.30	11.0
May 1	18.5	6.30	12.3
June 1	18.5	6.30	12.3
July 1	18.5	6.30	12.3
August 1	18.5	6.05	12.3
September 1	18.5	6.05	12.3
October 1	18.5	6.05	12.3
November 1	15.0	5.90	10.0
December 1	21.0	5.90	14.0
Average 2007	16.0	5.20	10.7
Average 2008	17.8	6.20	11.8

Table 10 Selected annual nominal yields of deposit money banks and penalty rates in % per annum

	<i>Non-indexed loans¹</i>		<i>New (long) indexed securities²</i>		<i>Penalty rates</i>		<i>Credit terms index, 12-month change³</i>
	<i>Nominal</i>	<i>Real</i>	<i>Nominal</i>	<i>Real</i>	<i>Nominal</i>	<i>Real</i>	
1995	11.9	10.1	10.5	8.7	14.6	12.8	1.6
1996	12.8	10.5	11.1	8.9	15.8	13.5	2.1
1997	13.3	11.1	11.2	9.0	16.3	14.0	2.0
1998	13.2	11.8	10.1	8.8	16.5	15.1	1.3
1999	14.1	8.0	14.7	8.6	17.3	11.1	5.6
2000	17.4	12.7	14.1	9.5	22.0	17.2	4.2
2001	18.8	9.4	19.7	10.2	23.7	13.9	8.6
2002	16.0	13.7	12.3	10.1	21.3	18.9	2.0
2003	12.4	9.4	12.0	9.1	17.3	14.2	2.7
2004	12.6	8.3	10.5	6.3	17.3	12.9	3.9
2005	15.3	10.7	10.3	5.9	20.3	15.5	4.2
2006	18.6	10.9	13.4	6.1	22.5	14.6	6.9
2007	20.2	13.5	12.9	6.6	25.0	18.0	5.9
2008	22.0	4.8	24.7	7.1	25.8	8.1	16.4

1. Weighted average of DMBs' interest rates. Based on two due dates per year. 2. Weighted average of DMBs' interest rates. 3. January to January.

Table 11 Selected Central Bank interest rates

	<i>Bank's current accounts</i>	<i>Non-indexed certificates of deposit, 90-day</i>	<i>Required deposits, normal terms</i>	<i>O/N loans discount rates</i>	<i>Yield on collateral loan auctions</i>	<i>Collateral loans (nominal rate)</i>	<i>Yield on certificates of deposit, 7-day</i>
March 28, 2001	6.70	10.70	9.50	12.40	10.90	.	.
November 11	6.70	9.60	8.70	12.00	10.10	.	.
April 1, 2002	6.20	9.10	8.20	12.00	9.60	.	.
May 1	5.90	8.80	7.90	11.70	9.30	.	.
May 21	5.70	8.30	7.40	11.20	8.80	.	.
June 21	5.70	8.00	7.10	10.90	8.50	.	.
August 1	5.40	7.40	6.70	10.30	7.90	.	.
September 1	5.10	7.10	6.40	10.00	7.60	.	.
September 21	4.60	6.60	5.90	9.50	7.10	.	.
October 21	4.30	6.30	5.60	9.20	6.80	.	.
November 11	3.80	5.80	5.10	8.70	6.30	.	.
December 17	3.30	5.30	4.60	8.20	5.80	.	.
February 28, 2003	2.80	4.80	4.10	7.70	5.30	.	.
May 11, 2004	3.00	5.00	4.30	7.90	5.50	.	.
June 8	3.25	5.25	4.50	8.00	5.75	.	.
July 6	3.75	5.75	5.00	8.25	6.25	.	.
September 21	4.25	6.25	5.50	8.75	6.75	.	.
November 1	5.00	6.75	6.00	9.25	7.25	.	.
December 10	6.25	7.75	7.25	10.25	8.25	.	.
February 21, 2005	6.75	8.25	7.75	10.75	8.75	.	.
March 29	7.25	8.50	8.00	10.75	9.00	.	.
June 7	8.00	9.35	8.75	11.00	9.50	.	9.35
October 4	8.75	10.10	9.50	11.75	10.25	.	10.10
December 11	9.00	10.35	9.75	12.00	10.50	.	10.35
February 1, 2006	9.25	10.25	10.00	12.25	10.75	.	10.60
April 1	10.00	11.00	10.75	13.00	11.50	.	11.35
May 21	10.75	11.75	11.50	13.75	12.25	.	12.10
June 11	11.50	-	12.00	14.25	13.00	.	12.85
August 21	12.00	-	12.25	14.50	13.50	.	13.35
September 21	12.50	-	12.75	15.00	14.00	.	13.85
December 21	12.75	-	13.00	15.25	14.25	.	14.10
June 20, 2007	12.75	-	13.00	15.25	14.25	.	14.10
June 21	12.75	-	13.00	15.25	-	13.30	13.20
November 1	13.25	-	13.25	15.25	-	13.75	13.65
March 25, 2008	14.50	-	14.50	16.50	-	15.00	14.75
April 10	15.00	-	15.00	16.50	-	15.50	15.25
October 15	11.50	-	11.50	14.00	-	12.00	11.75
October 28	17.50	-	17.50	20.00	-	18.00	17.75
December 18	15.00	-	15.00	22.00	-	18.00	15.25
<i>Time-weighted average</i>							
1998	3.00	7.00	5.50	8.50	7.30	.	.
1999	3.80	7.80	6.60	9.30	8.30	.	.
2000	5.90	9.90	8.70	11.40	10.40	.	.
2001	6.70	10.60	9.40	12.30	10.90	.	.
2002	5.50	7.80	7.00	10.70	8.40	.	.
2003	2.80	4.80	4.10	7.70	5.30	.	.
2004	3.65	5.59	4.88	8.28	6.09	.	.
2005	7.69	8.85	8.50	11.02	9.35	.	9.70
2006	11.00	10.63	11.52	13.77	12.50	.	12.35
2007	12.83	-	13.04	15.25	14.25	.	14.10
2008	14.80	-	14.80	16.82	-	15.40	15.08

Table 12 Balance Sheet of the Central Bank of Iceland

M.kr.	End of year					
	2002	2003	2004	2005	2006	2007
Assets:	116,627	87,307	106,590	162,294	321,842	476,859
<i>Foreign assets</i>	<i>37,378</i>	<i>58,274</i>	<i>65,709</i>	<i>67,506</i>	<i>168,070</i>	<i>163,585</i>
Foreign accounts	9,509	22,740	23,171	21,049	41,650	19,338
Gold	1,727	1,873	1,707	2,074	2,934	3,305
Foreign bonds and Treasury bills	24,093	31,695	39,058	42,702	121,467	139,109
IMF reserve position and SDRs	2,050	1,966	1,773	1,681	2,019	1,834
<i>Domestic assets</i>	<i>79,248</i>	<i>29,033</i>	<i>40,881</i>	<i>94,789</i>	<i>153,772</i>	<i>313,273</i>
<i>Deposit money banks</i>	<i>69,141</i>	<i>24,038</i>	<i>31,771</i>	<i>77,772</i>	<i>119,863</i>	<i>258,165</i>
Securities	105	-	-	-	-	-
Repurchase agreements	69,035	24,038	31,771	77,772	119,863	258,165
Short-term loans	-	-	-	-	-	-
Foreign-currency receivables	-	-	-	-	-	-
<i>Other financial institutions</i>	<i>8,227</i>	<i>4,193</i>	<i>8,993</i>	<i>11,902</i>	<i>28,547</i>	<i>50,102</i>
Listed securities	3,445	3,223	3,232	1,832	1,473	1,447
Repurchase agreements	4,782	969	5,762	10,070	27,074	44,554
Short-term loans	-	-	-	-	-	4,102
Securities	-	-	-	-	-	-
<i>Central government</i>	<i>1,816</i>	<i>715</i>	<i>32</i>	<i>-</i>	<i>-</i>	<i>-</i>
Listed securities	1,816	715	32	-	-	-
Other assets	-	-	-	-	-	-
<i>Other sectors</i>	<i>65</i>	<i>87</i>	<i>84</i>	<i>189</i>	<i>499</i>	<i>131</i>
<i>Real estate and other assets</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>4,926</i>	<i>4,864</i>	<i>4,876</i>
Real estate	-	-	-	4,527	4,479	4,520
Other assets	-	-	-	399	385	356
Liabilities and Capital:	116,627	87,307	106,590	162,294	321,842	476,859
<i>Foreign liabilities</i>	<i>18,301</i>	<i>1,858</i>	<i>1,703</i>	<i>1,634</i>	<i>1,873</i>	<i>1,712</i>
Short-term	16,499	124	142	150	95	100
Long-term	-	-	-	-	-	-
IMF SDR allocation	1,802	1,735	1,561	1,484	1,779	1,613
<i>Domestic liabilities</i>	<i>59,499</i>	<i>45,231</i>	<i>70,689</i>	<i>124,291</i>	<i>271,633</i>	<i>384,143</i>
<i>Notes and coin</i>	<i>9,590</i>	<i>10,583</i>	<i>11,632</i>	<i>13,202</i>	<i>14,513</i>	<i>15,735</i>
<i>Deposit money banks</i>	<i>23,037</i>	<i>11,117</i>	<i>26,926</i>	<i>34,250</i>	<i>45,006</i>	<i>152,112</i>
Sight deposits	1,163	2,786	22,519	31,956	43,228	152,112
Required reserves	21,874	3,830	-	-	-	-
Certificates of deposit	-	4,501	4,404	2,294	1,777	-
Forward contracts	-	-	-	-	-	-
Foreign currency accounts	-	-	-	-	-	-
Insurance accounts	-	-	3	-	-	-
<i>Investment credit funds</i>	<i>1,334</i>	<i>31</i>	<i>13,681</i>	<i>145</i>	<i>131</i>	<i>1,425</i>
Sight deposits	75	31	13,681	145	131	1,425
Required reserves	1,259	-	-	-	-	-
Certificates of deposit	-	-	-	-	-	-
<i>Central government</i>	<i>22,667</i>	<i>22,901</i>	<i>17,815</i>	<i>75,916</i>	<i>211,036</i>	<i>211,177</i>
Treasury current account	8,771	9,689	16,257	33,573	80,110	93,971
Government institutions	1,977	1,208	519	371	605	536
Foreign exchange deposits	399	487	1,039	9,113	97,235	89,855
Tied deposits	11,520	11,517	-	32,859	33,085	26,815
<i>Other liabilities</i>	<i>2,872</i>	<i>599</i>	<i>636</i>	<i>778</i>	<i>948</i>	<i>3,694</i>
Capital	38,827	40,217	34,198	36,370	48,336	91,003

<i>End of month 2008</i>											
<i>Jan.</i>	<i>Feb.</i>	<i>Mar.</i>	<i>Apr.</i>	<i>May</i>	<i>Jun.</i>	<i>Jul.</i>	<i>Aug.</i>	<i>Sep.</i>	<i>Oct.</i>	<i>Nov.</i>	<i>Dec.</i>
392,020	465,407	575,080	644,534	591,210	590,803	665,525	744,585	876,982	1,197,599	1,322,824	1,187,460
175,570	183,012	220,235	206,988	190,290	203,225	227,236	307,913	375,006	410,112	506,876	429,491
22,620	22,720	26,008	30,313	15,179	17,247	42,736	90,379	116,652	162,093	266,269	207,257
3,828	4,064	4,563	4,141	4,212	4,702	4,644	4,405	5,709	5,596	7,352	6,653
147,182	154,253	187,310	170,275	168,647	178,860	177,460	210,707	249,705	239,070	229,264	212,065
1,940	1,974	2,354	2,258	2,253	2,415	2,396	2,422	2,939	3,353	3,991	3,515
216,450	282,395	354,845	437,546	400,919	387,579	438,289	436,672	501,976	787,487	815,949	757,969
187,592	244,072	334,225	417,006	362,728	339,805	396,943	394,707	454,973	733,633	759,585	466,540
-	-	-	-	-	-	-	-	-	343,800	343,800	231,024
187,592	241,378	313,618	417,006	362,728	329,801	394,694	394,707	454,527	263,308	32,329	72,352
-	2,693	20,607	-	-	10,005	2,249	-	446	35,189	274,863	37,982
-	-	-	-	-	-	-	-	-	91,336	108,593	125,181
23,875	33,337	15,609	15,540	33,207	42,765	36,336	36,945	41,980	48,672	51,333	16,422
1,440	1,438	1,467	1,422	1,446	1,472	1,460	1,475	1,494	1,263	1,259	2,757
21,749	31,899	14,142	13,517	29,661	40,619	33,751	34,171	39,021	45,264	49,763	13,666
-	-	-	600	2,100	675	1,125	1,300	1,465	2,145	311	-
685	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	270,005
-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	270,005
108	111	135	125	108	132	134	144	147	306	154	179
4,876	4,876	4,876	4,876	4,876	4,876	4,876	4,876	4,876	4,876	4,876	4,822
4,520	4,520	4,520	4,520	4,520	4,520	4,520	4,520	4,520	4,520	4,520	4,494
356	356	356	356	356	356	356	356	356	356	356	328
392,020	465,407	575,080	644,534	591,210	590,803	665,525	744,585	876,982	1,197,599	1,322,824	1,187,460
1,933	1,972	2,359	2,254	2,251	2,418	3,387	2,277	33,013	165,321	285,531	241,982
228	233	285	265	264	288	1,273	137	30,418	162,378	163,924	134,403
-	-	-	-	-	-	-	-	-	-	118,132	104,521
1,706	1,739	2,073	1,989	1,988	2,130	2,114	2,140	2,596	2,944	3,474	3,058
293,321	362,968	457,680	531,836	478,886	474,399	542,199	621,185	704,706	883,181	883,957	863,100
14,630	14,676	14,982	15,158	15,522	15,920	16,625	16,181	16,045	28,950	26,398	24,436
38,350	87,222	148,867	209,552	157,305	128,575	170,504	209,404	227,150	310,168	381,751	386,509
38,350	87,222	148,566	142,620	84,962	57,011	99,440	91,050	150,446	90,917	98,019	90,618
-	-	-	-	-	-	-	-	-	-	-	-
-	-	301	66,932	72,344	71,563	71,063	72,229	76,704	154,400	172,800	167,600
-	-	-	-	-	-	-	-	-	-	-	16,519
-	-	-	-	-	-	-	46,125	-	64,851	110,933	111,771
-	-	-	-	-	-	-	-	-	-	-	-
715	554	4,863	22,588	22,479	19,450	17,666	25,112	13,918	39,831	38,993	14,242
715	554	452	883	552	3,045	258	185	4,186	6,769	7,101	4,415
-	-	-	-	-	-	-	-	-	32,282	-	-
-	-	4,411	21,705	21,926	16,405	17,408	24,927	9,732	780	31,892	9,827
236,604	256,753	283,232	280,027	282,264	308,506	335,720	368,640	444,905	443,533	408,401	403,246
114,114	130,150	133,715	135,985	137,930	153,966	171,537	169,331	179,812	179,859	163,320	168,723
618	837	1,310	1,590	1,144	812	1,141	730	774	892	900	895
95,659	99,262	121,386	116,217	116,604	126,804	147,028	182,351	247,884	96,550	2,361	217,146
26,212	26,504	26,822	26,236	26,586	26,925	16,014	16,227	16,434	166,233	241,820	16,483
3,022	3,763	5,737	4,511	1,316	1,948	1,685	1,848	2,687	60,699	28,414	34,666
96,765	100,467	115,041	110,443	110,072	113,986	119,939	121,123	139,262	149,096	153,336	82,378

