

Featured statistics

Icelandic pension funds' foreign portfolio investment returns in 2006

Each year the Central Bank of Iceland surveys the return on pension funds' foreign securities portfolios. The pension funds were asked about the market value of foreign portfolio securities at the beginning and end of 2006. They were also asked about new portfolio investment and sales of foreign securities during the year, as well as dividend and interest payments received. In the survey for 2005, the sample was the 18 largest pension funds, which owned 92% of total pension fund foreign portfolios. The 2006 sample comprised 11 large pension funds, which owned 83% of total pension fund foreign portfolios.

Returns on pension funds' foreign securities portfolios remain high

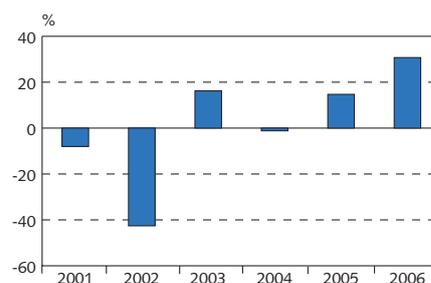
Total return on securities is measured as the increase in their market value plus dividend and interest earnings. In balance of payments statistics, only net return is regarded as earnings on foreign portfolio investments. Changes in the market value of the securities and movements in the exchange rate of the króna are left out. The survey findings are used to estimate returns on Icelandic residents' foreign portfolios in the balance of payments and to identify increases in market value relative to international equity indices.

In estimating returns on Icelandic residents' foreign portfolios, the most natural approach is to measure returns on the largest pension funds, which account for the largest share of foreign securities portfolios of all pension funds in Iceland. These pension funds are usually parties to the major part of transactions in foreign securities each year. Returns on the 11 largest pension funds' foreign portfolio investments in 2006 amounted to 30.7%, a considerably higher figure than for 2005, when it was about 14.7% (see Chart 1) by the 18 largest pension funds. The highest return was on mutual fund units, at 31.3%. Of this figure, 0.16 percentage points was explained by dividend payments and 31.1 percentage points by increases in market value and exchange rate movements. Returns on equity portfolios also ran high, at 30.8%, of which 30.1 percentage points was due to increased market value and exchange rate changes. The average return on bonds was 20%, of which 16.8 percentage points were due to increased market value and exchange rate changes and 2.9 percentage points were explained by interest income.

The main purpose of the survey on returns on the largest pension funds' portfolio securities is to measure dividend payments. It is noteworthy how low the dividend payments are: for the 11 large pension funds in the survey, they were in the range of 0-1.6% in 2006. The explanation is that corporations and mutual funds rarely pay high dividends to investors, who stand to gain through possible increases in the market value of their securities holdings. Corporations that pay dividends base their calculations on the stocks' nominal value, which is a low percentage of their market value.

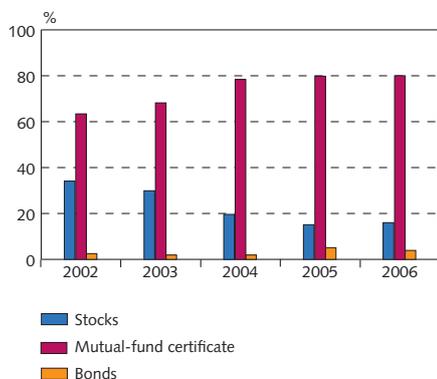
On the other hand, the pension funds claim a return of 10-20% on their foreign securities. In their calculations the majority of the re-

Chart 1
Average return on foreign portfolios
of the pension funds
In Icelandic krónas



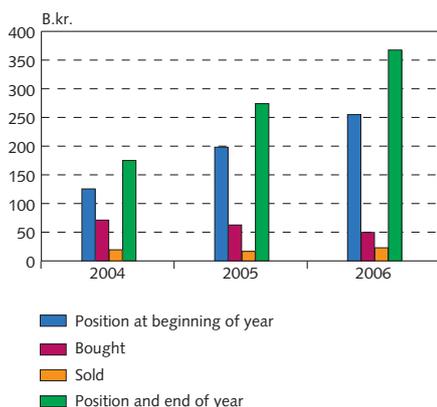
Source: Central Bank of Iceland.

Chart 2
Breakdown of the pension funds' portfolios
At end of year



Source: Central Bank of Iceland.

Chart 3
Main pension funds' trading
in foreign securities markets



Source: Central Bank of Iceland.

turn is due to higher market value, measured in krónas, rather than in dividend payments.

The composition of holdings of foreign securities showed little change

The amount in corporate equities, mutual fund units, and bonds did not change much between years (see Chart 2). Corporate equities and mutual fund units rose slightly, but the amount in bonds declined. The amounts held in mutual fund units are high, which is normal, as the risk associated with investments in mutual fund units of foreign securities is low compared to that accompanying purchases of foreign corporate equities.

Good returns in foreign currency and even better in krónas

The rise in international equity yielded satisfactory returns for investors in 2006. The MSCI index went up 14.6% year-on-year in dollar terms, S&P500 index rose by 13.6%, and the FTSE-100 index by 10.7%. Sizeable gains were also recorded on the CAC-40 index in France (17.5%) and Japan's Nikkei index (6.9%). The exchange rate index of the króna went up by 23.2% in 2006, thus, the exchange rate of the króna depreciated with respect to foreign currencies by 18.8% over the year. Accordingly, the return on foreign securities was good when measured in foreign currency and even better when measured in króna. The króna depreciated by 21% against the euro, by 22.8% against sterling, by 12.1% against the dollar, and by 11% against the yen. These exchange rate movements increased the return on holdings of foreign securities measured in krónas and added to the increase in the market value of the securities.

Pension funds' foreign portfolios increased in 2006

Foreign portfolio holdings of pension funds amounted to 29.6% of the net assets of the funds at the end of 2006. During 2006, the foreign portfolio holdings of pension funds increased by 144.1 b.kr. It is interesting to compare this figure with the results of the survey of the 11 large pension funds. The position at the beginning of the year was about 254.9 b.kr. Purchases during the year were 49.6 b.kr., sales amounted to 22.9 b.kr., and the position at the end of 2006 was 367.6 b.kr. Accordingly, net purchases during the year were about 26.7 b.kr. while the increase in the market value of the securities was 86 b.kr. (see Chart 3).

Conclusion

Returns on the 11 large pension funds' foreign portfolio investments in 2006 were much higher than in the previous year despite low dividend payments. The increase in the market value of the foreign securities ensured a high return for the pension funds.

The composition of the holdings of foreign securities by the pension funds was similar year-on-year. As noted before, holdings of foreign securities in the form of mutual fund units were by far the largest part of the holdings of foreign securities by the pension funds, representing about 80% of the total at the end of 2006. The return on foreign securities measured in foreign currency was good in 2006, and even better when measured in Icelandic krónas.